



BANKING AND PAYMENTS AUTHORITY OF KOSOVO  
AUTORITETI BANKAR DHE I PAGESAVE TË KOSOVËS  
BANKARSKI I PLATNI AUTORITET KOSOVA

# 2002 ANNUAL REPORT

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***Honourable Special Representative of the Secretary General of the United Nations***

*It gives me great pleasure to present to you the Banking and Payments Authority of Kosovo 2002 Annual Report. Its publication also coincides with the first full year I have spent in Kosovo. I visited Prishtina briefly in 1999 and nearly three years later I was offered the opportunity to return to Kosovo to head the BPK. I was pleasantly surprised to discover how much had been achieved and how many positive changes had taken place in Kosovo in the three years.*

*Year 2002 was marked by two major events – transition to euro and divestment of the BPK branch network to the local commercial banks.*

*First, I am proud to acknowledge the tremendous effort of all staff of the BPK in ensuring that the euro changeover was accomplished smoothly and on time in Kosovo. Preparations for this transition had started in earnest in early 2001 and required considerable planning and organisation.*

*Secondly, I am in a position to announce that in line with the objective that BPK would cease to be involved in commercial banking activities when the financial sector was sufficiently developed in Kosovo, BPK divested itself of the branch network of six branches and 15 sub-branches as a going concern to the commercial banks in July 2002. This objective was achieved with no job losses. Commercial services, mainly to support CFA and UNMIK functions, were however continued through the BPK's Prishtina Branch.*

*A new organisation structure, developed with assistance of the IMF, was implemented in September 2002 to support the BPK's new responsibilities as banker to and fiscal agent of the anticipated Kosovo Administration, as represented by the Provisional Institutions of Self Government (PISG), in 2003. BPK would then effectively function as the central bank of Kosovo. The new structure assigns day-to-day operational responsibilities to local designate managers and, effective January 1, 2003, role of the International Experts at the BPK would change to that of Advisors who would continue to support and further develop the relevant functional areas.*

*In 2002, training was assigned the highest priority and programmes underway to improve professional and management skills of staff of the BPK were continued. While much progress has been made in this area, much still remains to be done.*

*I am pleased to submit the 2002 Annual Report of the Banking and Payments Authority of Kosovo.*

*Chaiha Kim Rhee  
Managing Director*

*Prishtina, April 2003*

## Executive Summary

Despite the global economic slowdown that began in 2001 and continued into 2002, economies of the Western Balkan region countries continued to grow, although growth rates were lower than in the previous two years. In terms of GDP growth, Kosovo maintained its leading position in the region achieving 7% growth rate in the real GDP in 2002. In spite of this the income level is still one of the lowest in Europe. The per capita GDP in 2002 is estimated to be near \$1,000 and this is continuously below the levels recorded in other post-conflict countries in the region.

The economic growth is still mainly driven by large foreign assistance and remittances from Kosovo Diaspora. In view of the declining donor assistance and the private remittances, which are vulnerable to the global economic climate, there is an urgent need for a comprehensive development strategy to transform Kosovo's aid-dependent economy to one of sustainable growth. The unemployment rate, at an estimated 50%, continues to be one of the highest in the region.

Initial significant increases in prices at two-digit annual rates were followed, in 2001-2002, by a gradual price stabilisation. In July 2002 the prices of consumer goods and services were higher by only 1.4% than those of one year earlier. In December 2002, they were slightly lower than in December 2001. The average consumer price level in 2002 was, however, still 3.6% higher than in 2001. As a result of limited spending capacity and additional revenue from the newly introduced personal taxation, the level of overall consolidated budget surplus (excluding budget grants) rose from euro 41.7 million in 2001 to euro 68.7 million in 2002.

The year 2002 was marked by a Europe-wide transition from the local currencies to the euro. The use of the Deutsche Mark was formalised in Kosovo in 1999 and subsequently a decision was made to replace it with the euro at the same time as the rest of the participating EU countries. Although, the principle of the euro changeover was simple, the scale and technical constraints of the operations dictated the need for involvement of many governmental agencies, KFOR and commercial enterprises. Preparations for the euro changeover started in Kosovo in August 2000. The main objective of BPK and UNMIK was to ensure a smooth and safe changeover to the euro at the lowest cost possible. The euro changeover provided a unique opportunity to reduce the amount of cash in circulation and, by encouraging a move away from the existing cash-based to a non-cash payment system, to further develop the banking system.

The last three years have witnessed a rapid development of the financial sector in Kosovo, especially of the banking sector. This is best illustrated by the increase in the number of banking units from 5 in December 2000 to 112 in December 2002 and the growth in numbers and value of inter-bank operations between 2001 and 2002. The financial sector in Kosovo reached a level of sufficient development in 2002 and BPK was able to divest itself of the branch network by leasing its six branches and 15 sub-branches as a going concern to the commercial banks. BPK ceased, therefore, to conduct commercial banking activities. A new organisation structure of the BPK was implemented in September 2002 to support its new responsibilities as banker to and fiscal agent of the anticipated Kosovo Administration, as represented by the Provisional Institutions of Self Government (PISG). BPK's is undergoing a gradual transition that will effectively lead to it assuming functions and responsibilities of the central bank of Kosovo.

In 2002, training was assigned the highest priority and programmes underway to improve professional and management skills of staff of the BPK were continued. Much progress has been made in this area.

# International Environment

## Global economy

The global economic slowdown that began in 2001 continued into 2002. The weakness of economic recovery stemmed primarily from uncertainties surrounding geopolitical situation, the weak corporate sector, declining equity markets, and soaring oil prices.

After the sharp decline in economic activity in the last quarter of 2001, vigorous global growth was expected to follow. However, the forecast recovery that started in the first quarter of 2002 failed to accelerate and the growth in the OECD countries that reached 0.7% in the first quarter of 2002 fell to 0.4% in the second. First full year estimates put year on year change in GDP in the OECD countries at 1.2% in 2002. The latest leading indicators calculated by the OECD point to continued weak growth in 2003. As in every slowdown, the developing countries, especially those dependent on commodity exports, were hardest hit. At the time when oil prices soared and many commodity prices reached historical lows, private investors reduce their exposure to the emerging economies, especially those that are highly indebted. Countries greatly dependent on high-tech and tourism also suffered equally. It is anticipated that correction in the equity markets, taking into account the time lag in its negative effect on wealth, will further impact the already deteriorating investment spending in 2003.

The policy induced recovery in the US, resulting from the loosening of the monetary policy, led to a recovery in international trade in the first four months of 2002. International trade values had been in decline since the late 2000 and the US led recovery resulted in temporary reversal of this trend. After a strong rise in the start of 2002, monthly trade value declined below the 2001 year-end level again by May 2002.

The 2002 year on year percentage change in GDP is expected at around 1.2% in the US and only 0.9% in the EU. The US economic growth has been primarily a result of government spending and private investment. Import driven expansion and weak exports have resulted in widening of trade deficit. After a long period of low inflation and strong dollar policy, the inflationary pressures reappeared in the US economy. The CPI recorded in October (2%) and November (2.2%) were at the highest levels in just over a year. The PPI in manufacturing sector also increased for the first time in over 12 months despite continued under-utilisation in capacity.

Economic recovery in other regions was uneven. Canada was the best performing economy among G-7 nations, with Australia and New Zealand also growing at rates above the rest of the world. Asia showed strong and accelerating growth rates, with China, Malaysia and Korea particularly benefiting from public sector investment and export growth. Even Japan appeared to be coming out of recession, after years of poor performance. Among the emerging market economies the EU accession countries showed continued growth despite the slowdown elsewhere in the EU. Similarly satisfactory results were achieved in Russia. Latin America suffered an economic setback in 2002. The prolonged economic crisis in Argentina spread to other countries of the region and the banking sector failure caused financial turmoil in Uruguay, Paraguay and Brazil. The compound effect of political instability in Brazil and Venezuela also added to the already existing economic problems. This resulted in an estimated 1% decline in the Latin America's 2002 GDP. Mexico and Chile were the outperforming countries in the region.

## European Union

In the eurozone, the year 2002 set off on a positive note with the successful introduction of euro notes and coins. The euro continues to be a positive factor in economic reform and integration, and provides a base for sustainable growth and stability. The relative stability of European exchange rates against the dollar also suggests that most industrial countries' economies were affected to a similar degree.

Despite financial turbulence in East Asia, Russia and Brazil in the three years between 1998 and 2000, and a negative trade shocks that followed, the euro area experienced rates of economic growth of more than 3% on average during this period. Contrary to the assumption that the euro area, as a large and relatively closed economy, would be resilient to external shocks, strong growth could not be maintained when the external environment was deteriorating. Investment continued to contract and private consumption was weak in the euro area as uncertainty increased, preventing the promising pick-up in international trade to spill over to domestic demand. Domestic demand growth in the area began to slow down in mid-2000, becoming temporarily negative in 2001 and has made a weak contribution to GDP growth in 2002.

The euro-area economy has experienced three similar major cycles over the past three decades, in 1974, 1980 and 1992. Although the current downturn is not qualified as a recession in a technical sense, its severity is comparable to previous downturns. It is also characterised by an unusual feature of the nearly simultaneous slowdown of all components of domestic demand and of world trade. Notwithstanding this, the current overall economic environment looks more positive than in previous cycles. Budgetary deficits are at significantly lower levels (two-year average after the cycle-peak: 1975/76 – 3.7%, 1981/82 - 5.2%, 1993/94 – 5.3% and 2001/02 - 1.9% of GDP) and employment growth in the euro area has been positive with unemployment increasing only marginally (two-year average after the cycle-peak: 1975/76 – 4.1%, 1981/82 – 7.4%, 1993/94 – 10.5% and 2001/02 – 8.1%).

After two years of low growth in the euro area, with real GDP growth of an estimated 0.9% in 2002 after 1.5% in 2001, a third year of weak growth is expected. A specific feature of the current slowdown is that consumer price inflation has not shown signs of abating. HICP (Harmonised Indices of Consumer Prices) inflation has been close to the ECB's 2% upper target limit since spring 2002, while core inflation has remained persistently high at around 2.5%. The surge in oil prices, the continued depreciation of the euro exchange rate and a sudden rise in food prices were the main factors behind the inflation increases in the 2001-2002 period. Excluding these factors, inflation appears to have been almost unaffected by the economic downturn. Core inflation has come down only gradually and its persistence, especially in the services sector, has become a source of concern. Given that services is the single most important component of the euro area HICP basket (with a weight of nearly 40%), its rising inflation trend has put upward pressure on euro area core inflation and has slowed down the reduction in headline inflation. The switchover to the euro, which complicated price comparisons with the past and encouraged some suppliers to raise prices, may have contributed to the temporarily excessively negative perception of inflation. Although the available official data still point to no significant overall impact of the euro change-over on prices so far, the Eurostat estimated impact might be in region of 0.0-0.2%.

The introduction of the euro has, however, eliminated distortions from exchange and interest rate movements among the eurozone member states, with the real short and long term interest rates (two-year average after the cycle-peak: 1975/76 – n/a, 1981/82 – 2.9% and 2.9%, 1993/94 – 3.9% and 4.0%, and 2001/02 – 1.5% and 2.6% respectively) at levels that encourage investment.

## The Western Balkan Countries

The Western Balkan region is composed of relatively small size economies of Albania, Bosnia and Herzegovina (BiH), Croatia, the Federal Republic of Yugoslavia (FRY), the former Yugoslav Republic of Macedonia (FYROM) and Kosovo. The largest economy with a GDP of more than € 22 billion is that of Croatia, while in terms of population, Federal Republic of Yugoslavia (FRY) with 8.6 million people, is the biggest.

While the population of the whole region is almost 25 million people, equivalent to 6.5% of the EU population, its GDP of about € 50 billion stands at approximately 0.6% of the total EU's GDP. The GDP per capita in the region, at around € 1,800, shows significant differences between the countries. Croatia has much higher GDP per capita, at around € 5,100, than any other Western Balkan country.

Following the recovery in 2000, the Western Balkan region continued to grow by 4% in 2001, despite the slowdown of the world economy. Growth rates in countries of the region showed, however, significant differences with Kosovo achieving the highest rate of growth in real GDP of 11%. Albania (+6.5%) and the FRY (+5.5%) also performed well while the economy of FYROM as measured by the GDP contracted by 4.1%.

The effect of the political stabilisation and reform process in the region had positive effect on the economic performance of the countries in the region. The first full year estimates put the year on year real GDP growth at close to 4% in 2002.

	Population*	Real GDP growth		Inflation (end period)	
	million	%		%	
	2001	2001	2002*	2001	2002*
Albania	3.4	6.5	5.0	3.5	3.9
BiH	4.3	2.3	2.5	3.3	2.3
Croatia	4.4	3.8	4.0	2.6	3.0
FRY	8.6	5.5	4.0	39.0	15.0
Kosovo	1.8	11.1	7.0	11.6	3.6
FYROM	2.0	-4.1	0.5	3.7	3.0
<b>Western Balkans</b>	<b>24.5</b>	<b>4.1</b>	<b>3.8</b>	<b>12.0</b>	<b>6.1</b>

\*latest available or European Commission estimates and projections

Source: National sources, IMF and European Commission

In 2001 and 2002, the Western Balkan region continued to grow at a faster pace in comparison to the world economy and inflation has declined steadily. Albania, Bosnia and Herzegovina (BiH), Croatia and the FYROM have over the past four years maintained one-digit inflation rates. At the end of 2001, the average inflation rate for these four countries was equal to 2.9%. Inflation for the region as a whole is estimated to have declined to some 6%, compared to 12% in 2001, reaching a single digit rate for the first time in nearly 15 years. The overall region-wide inflation rate was distorted by the relatively high inflation of 39% at the end of 2001 in the FRY, which nevertheless declined from the 113% level recorded in 2000.

In 2001, only the FRY and Kosovo, which respectively recorded a general government deficit (before grants) of 1.3% of GDP and a surplus of 1.3% excluding capital expenditures, avoided having large fiscal deficits. In the other countries of the region, general government deficits as ratio to GDP averaged more than 6% in the same period. First estimates indicate that countries in the Western Balkan region, with the exception of the FRY, have continued to reduce their fiscal deficits in 2002.

While trade deficits in terms of GDP continue to be high, ranging from almost 12% in the FYROM in 2001 to 50% in Kosovo in 2002, and imports continually outpacing export growth, significant private remittances, positive balances of services, and official transfers contributed to limiting current account deficits.

The EU is, and by and large remains, the main trading partner of the Western Balkan countries. In 2001, the EU share in total trade for the whole region was slightly over 50%, ranging from around 80% in Albania to more than 40% in the FRY. In 2002, based on the available initial data, trade deficits have not improved substantially.

Further improvement of the economic climate in the region, fight against corruption, the completion of the privatisation process, and reform of the public sector are needed to improve the performance of the Western Balkan economies.



# Kosovo Economy

## Gross Domestic Product

The post-conflict Kosovo economy is experiencing high GDP growth, but in spite of this the income level is still one of the lowest in Europe. The per capita GDP in 2002, which is estimated to be near \$1,000, and is significantly below the levels recorded in other post-conflict countries in the region. According to the World Bank's Living Standard Measurement Survey, carried out in the autumn of 2000, Kosovo is facing widespread but not very deep poverty. The unemployment rate, at an estimated 50%, continues to be one of the highest in the region.

### Kosovo: Selected Economic Growth Indicators, million euro

	2000	2001	2002*
<b>Foreign assistance (FA)</b>	<b>1,336</b>	<b>1,290</b>	<b>1,032</b>
PIP (Public Investment Program)	628	551	411
Budget support	102	60	10
Other	606	679	611
<b>Donor related imports</b>	<b>1,268</b>	<b>1,275</b>	<b>1,014</b>
<b>Direct contribution</b>	<b>356</b>	<b>388</b>	<b>337</b>
FA minus donor related imports	68	15	18
Consumption expatriates (plus related foreigners)	111	210	187
Wages of local employees	177	163	132
<b>Net domestic demand</b>	<b>1,057</b>	<b>1,359</b>	<b>1,653</b>
<b>Private consumption</b>	<b>1,411</b>	<b>1,559</b>	<b>1,802</b>
<b>Government consumption</b>	<b>152</b>	<b>187</b>	<b>273</b>
<b>Private investment</b>	<b>337</b>	<b>397</b>	<b>460</b>
<b>Imports</b>	<b>783</b>	<b>775</b>	<b>962</b>
<b>Adjustment factor</b>	<b>-61</b>	<b>-9</b>	<b>81</b>
<b>GDP</b>	<b>1,413</b>	<b>1,747</b>	<b>1,990</b>
GDP deflator	100.0	11.3	118.5
Inflation rate		11.3	6.5
At constant prices			
<b>GDP</b>	<b>1,413</b>	<b>1,570</b>	<b>1,679</b>
<b>Net domestic demand</b>	<b>1,057</b>	<b>1,221</b>	<b>1,394</b>
<b>Net donor generated demand</b>	<b>356</b>	<b>349</b>	<b>285</b>
Real growth (%)			
<b>GDP</b>		11.1	7.0
<b>Net domestic demand</b>		15.5	14.2
<b>Net donor generated demand</b>		-2.1	-18.4
Contribution to GDP growth (%)			
<b>GDP</b>		11.1	7.0
<b>Net domestic demand</b>		11.6	11.1
<b>Net donor generated demand</b>		-0.5	-4.1
<b>GNP (GDP+Net factor income+worker remittances)</b>	<b>2,063</b>	<b>2,434</b>	<b>2,648</b>

Source: IMF staff \*estimates/projections

The recent strong economic growth is still mainly driven by large foreign assistance (about 50% of GDP) and remittances from Kosovo Diaspora (about 30% of GDP). But, since the donors' transfers to Kosovo are declining year-on-year, there is an urgent need for a comprehensive development strategy that will enable a transformation from an aid-dependent economy to one of sustainable growth. In order to achieve this objective, establishment of feasible economic program and much better inter-sectoral cooperation are required from all constituents of the Kosovo economy.

According to the IMF staff estimates<sup>1</sup> and available results for 2002, Kosovo's economic growth slowed to 7.0% as foreign assistance declined and economic activity (especially manufacturing) remained weak. As a consequence Kosovo is facing the decrease in contribution to GDP growth both from net donor generated demand and persistently negligible exports of goods and services.

In 2002 the Gross National Product (GNP)<sup>2</sup> exceeded the actual GDP by euro 658 million, whereas there was a decrease in both consumption and investment share to the GDP. In comparison to the previous year the ratio of total imports to GDP decreased from 117% to 99% at the end of 2002. Apart from the economic recovery driven by the donor-financed reconstruction of buildings and infrastructure, improvement in Kosovo's economy was slow due to delayed privatisation and a static private sector, that is mainly engaged in retail trade and services, and on a limited scale in processing of agricultural goods, manufacturing of machinery parts and production of soft beverages. As a result of lack of progress in the industry, Kosovo continued to rely heavily on both imports and foreign assistance.

## Money and Prices

In comparison to the end of 2000, broad money increased 37.6% at the end of 2002 mainly due to the shift in portfolio (end of 2001) from currency in circulation both into deposits of enterprises and deposits of individuals. This impressive four-fold growth of deposits over the one year period (2001) was driven both by rapid development of the banking system and changeover to the euro. The stable level of deposits during 2002 confirms an improvement in credibility of the banking system.

Despite the significant commercial risks that still exist in Kosovo, bank lending to the private sector shows a positive trend. In 2000 the share of credit to the private sector in total assets of the commercial banks was only 3.8% but in 2001 it increased to 8.3%. In 2002 this share has increased to 25.6%. However, loan activity in general remains constrained – it corresponds to 20% of deposits – reflecting the limited maturity available (mainly below 1 year) at rather high interest rates. In addition, the share of these loans to GDP is still too small, only 4.2% at the end of 2002.

Kosovo continues to find itself in a very unusual position regarding the net domestic credit<sup>3</sup>. Domestic credit in Kosovo is permanently negative (euro 175 million at the end of 2002). This is a direct result of both prudent fiscal policy and the fact that BPK does not issue currency and is not authorised to extend credit. Consequently BPK cannot exercise classical monetary and credit policies. Adoption of the euro was in fact a monetary policy choice.

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<sup>1</sup> The estimates for past years and medium-term projection done by IMF Mission (September 2002) currently are in the process of reviewing by IMF Mission (March 2003). The last Mission found more reliable and analytical data especially regarding the foreign assistance and the level of imports into Kosovo. Therefore, we expect considerable changes in Kosovo's macroeconomic indicators.

<sup>2</sup> Gross National Product (GNP) = GDP + labour income of Kosovars employed in Kosovo by international donors + remittances transferred by Kosovars who are employed abroad.

<sup>3</sup> The sum of net claims on the government (including UNMIK deposit accounts) and claims on the domestic economy

## Kosovo: Monetary Survey, thousands euro

Description	2000	2001	2002
	Dec	Dec	Dec
<b>Net foreign assets</b>	<b>678,101</b>	<b>958,678</b>	<b>1,109,623</b>
Currency in circulation*	536,229	366,578	441,130
BPK	61,697	296,051	345,589
Assets	61,697	296,235	345,773
Liabilities	0	184	184
Commercial banks	80,175	296,050	322,904
Assets	83,099	301,095	328,322
Liabilities	2,924	5,045	5,418
<b>Net domestic assets</b>	<b>-52,612</b>	<b>-109,760</b>	<b>-248,683</b>
Net claims on the government	-8,741	-72,066	-258,917
Claims	0	0	0
Deposits	8,741	72,066	258,917
Net claims on other public sector	-32,378	-10,885	-4,245
Net claims on financial institutions	0	-11,087	-24,619
Loans to the private sector	3,148	25,135	83,976
Other items net	-14,642	-40,857	-44,878
BPK	-4,826	-28,109	-11,586
Commercial banks	-9,816	-12,749	-33,292
<b>Broad money</b>	<b>625,489</b>	<b>848,918</b>	<b>860,940</b>
Currency in circulation*	536,229	366,578	441,130
Private sector's deposits	89,260	482,340	419,810
Current account-enterprises	0	138,441	166,576
Current account-individuals	89,260	205,604	115,161
Terms and saving account-enterprises	0	31,158	25,568
Terms and saving account-individuals	0	107,138	112,505

\*Cash in circulation is estimated on the basis of BPK and commercial banks imports/exports

The most widely used currency in Kosovo is euro (Serbian dinar is still used in some areas in Kosovo). The introduction of the euro has enabled rapid macroeconomic stabilisation after many years of struggle with very high inflation in former Yugoslavia. Initial significant increases in prices at two-digit annual rates were followed, in 2001-2002, by a gradual price stabilisation. In July 2002 the prices of consumer goods and services were higher by only 1.4% than those of a year earlier. In December 2002, however, they were slightly lower than in December 2001.

Overall, the average consumer price level in 2002 was higher by 3.6% than in 2001, although the year-on-year rate in July had dropped to 1.4% and was slightly negative in December 2002. Tax collection in Kosovo was also euro 200 million higher in 2002 or 15% of all goods and services (for consumption and investment) purchased by Kosovo households. During this period, however, the average price level in the euro zone (European Union) increased by 2.3%. The data seems to suggest deflation of labour income and business profits. If this process continues, then one can expect further significant declines in nominal incomes, wages and prices during the next several years.

As shown in the table below, a standard basket of consumption goods purchased by a Kosovar family composed of 6.5 persons, expressed in euro, was 4,017 in 2000, 4,484 in 2001, and 4,643 in 2002. The share of food and tobacco in this basket was 44.2%. In 2002 total amount of money spent by Kosovar families on purchasing consumer goods was 1,263 million. At the same time, about euro 90 million worth of goods and services was sold to internationals residing in Kosovo.

## Price inflation: The cost of households' average consumer basket

	2000	2001	2002	
	Purchases of consumer goods, annual			
	per household			Total
	euro			Mln euro
Total	4,017	4,484	4,643	1,263
Food	1,743	1,964	2,053	558
Non-food	2,275	2,520	2,590	705

Average price in previous year=100

	2000	2001	2002
Total	100.0	111.6	103.6
Food	100.0	112.7	104.5
Non-food	100.0	110.8	102.8

Source: MFE – MEU (Macro Economic Unit)

## Population

The current population of Kosovo (December 2002) is estimated at 1.94 million, which is nearly the same as in 1990. During the last decade, however, a large number of people have emigrated. At the end of 2002, the total number of Kosovars residing abroad was about 660,000, including about 170,000 of whom were reported as actual members of Kosovo-resident households (most of them included in the official Kosovo Civil Register) and 490,000 who are considered permanent residents or citizens of other countries. About 85% of Kosovo Diaspora live in four countries: Germany, Switzerland, Austria, and Serbia.

	Total	Residents		Non-residents	
		Thous.	%	Thous.	%
Total	1,940	1,768	100.0	172	100.0
Rural	1,200	1,080	61.9	120	69.8
of which: Prishtina municipality		49			
Urban	740	688	38.1	52	30.2
of which: Prishtina municipality		175			

Source: MFE – MEU

The average number of Kosovo residents in 2002 is estimated at 1.77 million, about 90% are Albanians and 10% non-Albanians, mostly Serbs. There are more people in Kosovo during the summer and less during winter. The largest number of arrivals (according to border crossing statistics) occurs in June while the largest number of departures occurs in September. This number is augmented by about 50,000 of internationals who are working for diverse donor organisations, KFOR troops, short-term visitors and tourists. A total of 1.82 million persons is, therefore, the estimate on which the main macroeconomic aggregates, such as income, consumption, unemployment, etc. could be made.

About 62% of Kosovo residents live in rural areas. Kosovo has the youngest population in Europe. Half of its population is under 24 years of age; one-third is under 15 years of age; 6% is 65 years and older. The fertility rates, crude birth rates and death rates also remain the lowest in Europe. Nevertheless, the 2002 birth-rate (21 per one thousand of population) is significantly lower than that those twenty years ago (around 32).

## Households and enterprises

Table below presents "official" labour employment in Kosovo in 2000-2002. In 2002, the average number of persons employed in enterprises included in the SOK Business Register was 190,000 while

that in enterprises registered as current taxpayers was 78,000. These figures suggest that the number of employed workers is low and while according to the Business Register it is growing, according to Tax Administration it is declining. In fact, this may be a result of combination of at least three factors: (1) decline in employment, (2) decline in tax payment compliance, and (3) decline in data quality (SOK Business Register lacks solid update procedures). There is not enough information in order to sort out these three possibilities.

#### Labour employment (based on Business Register's and Tax Administration's data)

	Business Register	Tax Administration	Tax to Register Ratio (%)
Budget*			
2000			
2001		61,741	
2002		65,406	
Non-private sector (public enterprises and SOEs)**			
2000	54,153	34,791	64.2
2001	61,023	36,490	59.8
2002	62,471	27,350	43.8
Private sector enterprises**			
2000	78,237	51,187	65.4
2001	112,180	61,808	55.1
2002	130,091	50,530	38.8

Source: MFE – MEU \* End of year, \*\* End of third quarter

#### Employment by economic sector, according to different data sources

	Wage tax payers	Enterprise tax (presumptive tax and VAT)	SOK Business Register	SOK December 2001 labour force survey	LSMS*
	1	2	3	4	5
Thousands of employees					
<b>Total</b>	<b>132.4</b>	<b>77.9</b>	<b>192.4</b>	<b>400.4</b>	
Manufacturing	27.6	24.2	54.1	68.0	
Construction	5.0	5.4	22.5	34.0	
Trade	21.4	34.6	72.8	87.6	
Transportation and communications	4.7	4.4	15.7	20.0	
Finance	3.2	2.7	6.2	5.2	
Personal services and other	4.7	4.0	13.5	17.2	
Budget sector					
Health	13.0			28.8	
Education	28.9			62.0	
Public administration and other	21.9			36.0	
Agriculture	2.0	2.6	7.6	24.8	210.0
Donor sector					
				16.8	

Column 1: Number of income taxpayers, average for the third quarter of 2002.

Column 2: employees paying tax.

\*LSMS – Living Standards Measurement Survey

The available data shown above suggest that the largest employment is in agriculture, manufacturing, trade and education. A cause of concern is the healthcare sector, where employment is declining, wages are the lowest in the budget sphere and continue to decline in both nominal and real terms.

## Consumption

Anecdotal evidence suggests that the incomes and consumption patterns have not changed much, except: (1) a major upgrade in housing and (2) increase in the stock of passenger cars and consumer durables, many of them brought to Kosovo as property of returning repatriates or offered by family members as in-kind remittances.

Households and Enterprises	Daily	Annual (2002)		
Income and expenditure	per capita	Total		
		Cash and non-cash		Cash only
	Euro	Mln euro	%	Mln euro
<b>Income: total, cash*</b>	<b>3.06</b>	<b>1,973</b>	<b>100.0</b>	
Income from labour	1.29	833	42.2	
Budget wages and salaries	0.22	144	7.3	144
Wages from donors employment	0.29	186	9.4	186
Wages in agriculture	0.02	15	0.8	15
Other labour income	0.76	488	24.7	488
Social transfers, including pensions	0.11	70	3.5	
Kosovo budget	0.08	53	2.7	53
Serbia budget	0.03	17	0.9	17
Other income (from business)	0.50	320	16.2	320
Remittances**	1.16	751	38.1	751
<b>Consumption: total</b>	<b>2.58</b>	<b>1,665</b>	<b>84.4</b>	
Total purchases (cash)	1.96	1,263	64.0	
Food and tobacco	0.87	558	28.3	558
Non-food	1.09	705	35.7	705
Self-produced items	0.25	163	8.3	
Food	0.23	148	7.5	
Non-food	0.02	15	0.8	
Housing (imputed)	0.17	110	5.6	
Gifts (including remittances in kind)	0.20	129	6.5	
<b>Residential Housing Investment: total**</b>				
<b>Imputed expenditure (incl. own labour)</b>	<b>0.17</b>	<b>110</b>	<b>5.6</b>	
Paid to contractors	0.03	19	0.9	19
Purchased materials	0.10	63	3.2	63
Own materials	0.12	77	3.9	
Own labour	0.03	21	1.1	
<b>Commercial Investment: total**</b>	<b>0.30</b>	<b>196</b>	<b>9.9</b>	
Fixed capital formation	0.26	170	8.6	170
Change in inventories	0.04	26	1.3	26
<b>Taxes paid (Kosovo general budget revenue)</b>	<b>0.77</b>	<b>494</b>	<b>25.1</b>	494
<b>Pension Fund Contributions</b>	<b>0.00</b>	<b>1</b>	<b>0.1</b>	1
<b>Savings (change on saving bank accounts)</b>	<b>-0.10</b>	<b>-62</b>	<b>-3.1</b>	-62

\* Subsidies from donors not included

\*\* Subsidies from Kosovo General Budget and donors not included

## Financial Intermediation

The last three years have witnessed a rapid development of the financial intermediation in Kosovo, especially of the banking sector. The rapid expansion of banking activities is illustrated by the increase in the number of banking units (commercial banks and their branches) - by almost five times between December 2000 and December 2001 and again, between the latter and December 2002 (see table below). The annual amount of inter-bank operations increased almost ten times between

2001 and 2002. During this time, the ratio of bank operations to assets increased six times, from 0.33 to 1.91.

### Financial intermediation

	2000	2001	2002
Commercial banks, end of year, number of branches	5	24	112
MFIs and non-bank fin. inst., end of year, num. of branches	10	29	40
Assets of commercial banks, end of year, million euro	103	518	471
Of which: interest bearing, %	66.4	39.7	76.8
Liabilities of commercial banks, end of year, million euro	103	519	471
Of which: Deposits	93	492	427
Of which: Legal entities		169	192
Natural persons		313	228
Demand deposits		344	282
Long-term deposits		138	138
Commercial credits, end of year, million euro	6	47	120
Inter-bank operations, number of transactions		5,124	75,763
Inter-bank operations, total amount, million euro		86	841
Annual average amount of assets, million euro		260	439
Turnover ratio: operations to assets		0.33	1.91
Wire transfers (commercial): total turnover, million euro	468	1,141	1,591
Incoming – gross	293	630	854
Outgoing – gross	175	511	737
Incoming – net	117	119	118
Total commercial exports of goods - gross, million euro*	19	23	27
Total commercial imports of goods - gross, million euro	372	660	934
Total commercial imports of goods - net, million euro	353	637	906
Ratio: gross outgoing transfers to gross imports, %	47.1	77.4	78.9

The data also suggest that banks handled the payments for an increasing share of imports. An increasing number of individuals and businesses used banks for diverse financial operations, purchases and sales, cash transfers, etc.

Yet, both the banking system and the non-financial enterprises are still not ready to initiate/support large investment projects in the private sector. During the last three years, there has been little private investment in Kosovo, outside of house (re)construction. About 80% of bank credits are short-term credits that do not support long-term investments. Most of the deposits are demand deposits.

A rapid increase in bank deposits during 2000 and 2001 reflected, among other things, an increase in the savings of the population. In 2002, a noticeable shift occurred. While government account balance at BPK (budget cash surplus) increased by euro 120 million, the sum of population saving account balances in commercial banks declined by 85 million euro. It shrunk from euro 313 million at the end of 2001 to euro 242 million at the end of March 2002, and has stabilised around euro 225 million since. An anticipated decline in donor activities and Diaspora remittances is likely to prevent these savings from growing in 2003 and beyond.

## Foreign Trade and The Balance of Payments

Kosovo's balance of payments can be characterised as highly vulnerable. As in previous years, and also in 2002, the Kosovo's economy continued to rely heavily on foreign assistance, remittances from abroad, and imports. Developments in the balance of payments are tantamount to changes in these three factors.

Remittances from abroad have been relatively stable and, as in the past, they were contributing to the very survival of 80% of Kosovars' families. In 2002, the ratio of workers' remittances to GDP remained almost at the unchanged level of 30% of GDP. The remittances were mainly channelled into personal consumption and renovation of private housing.

### Kosovo: Balance of Payments\*, euro million, unless otherwise indicated

	2000	2001	2002
<b>Trade Balance</b>	<b>-968</b>	<b>-827</b>	<b>-999</b>
Export	148	231	246
Imports	-1,116	-1,058	-1,246
<b>Non-factor services</b>	<b>-935</b>	<b>-992</b>	<b>-730</b>
Receipts	0	0	1
Payments	-935	-992	-731
<b>Factor income</b>	<b>649</b>	<b>688</b>	<b>658</b>
Workers' remittances	472	524	526
Factor income from donor-related employment	177	163	132
<b>Transfers</b>			
<b>Assistance provided by donors</b>	<b>1,336</b>	<b>1,290</b>	<b>1,032</b>
PIP plus designated funds	628	551	411
Humanitarian assistance	36	18	9
Undesignated budget funds	102	60	10
Imputed services provided by donors	570	661	602
<b>Current account balance</b>	<b>83</b>	<b>159</b>	<b>-40</b>
<b>In percent of GDP</b>	<b>5.8</b>	<b>9.1</b>	<b>-2.0</b>
<b>Capital account balance</b>	<b>0</b>	<b>5</b>	<b>10</b>
FDI	0	5	10
Portfolio investment	0	0	0
Loans	0	0	0
<b>Errors and omissions</b>	<b>-83</b>	<b>192</b>	<b>103</b>
Overall balance	0	356	73
<b>Net change in international reserves (- increase)</b>	<b>0</b>	<b>-356</b>	<b>-73</b>
Official reserves	n/a	-234	-39
Net international reserves of banking system	n/a	-122	-35

\*IMF staff estimates (2000/2001) and projections (2002) – prepared by September 2002 Mission

Despite signs of decline, the foreign assistance remained the main driving force of Kosovo's economic growth in 2002. Last year projections, as well as this year preliminary estimates prepared by IMF staff, show that the foreign assistance accounts for roughly half of the Kosovo's GDP. Following a modest overall reduction in foreign assistance, the current account showed a moderate deficit of 2% of GDP in 2002.

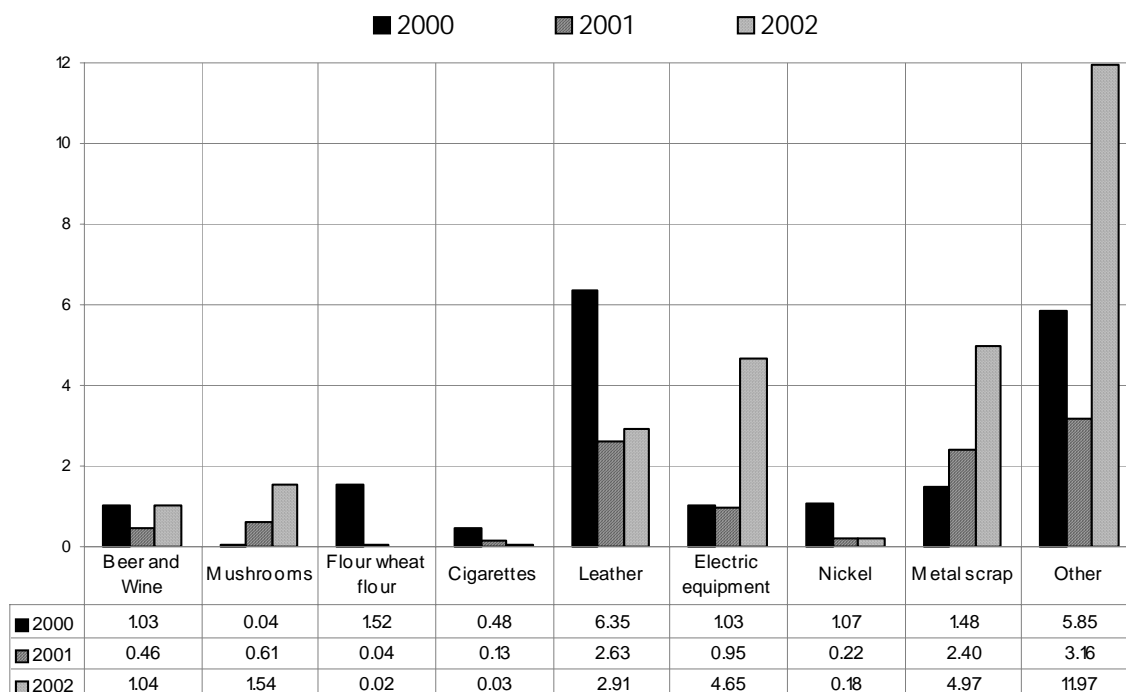
The performance of Kosovo's trade balance is quite alarming. The data for 2002 show that Kosovo economy can cover only one fifth of its imports by exports and that the trade balance deficit accounts for more than half of the GDP. Furthermore, the recent data show that regular exports (excluding the exports related to the expenditure of KFOR and consumption of expatriates), amounting to euro



27.32 million in 2002, can in fact cover only 2.0-2.5% of Kosovo's imports. This is quite exceptional even in the countries of the region. In comparison, Serbia and Montenegro recorded a trade deficit of near 30% of GDP, Albania over 20% and Macedonia under 15% in 2001.

The return of exports to the balance of trade of Kosovo shows that there are some positive signs of basic structural improvements in the economy. Apart from the goods classified as other exports, the highest share in exports, at 35%, had electric equipment together with metal products and scrap. Leather, beer, wine and mushrooms, together at 21% of all exports, came a close second.

### Foreign trade: Exports by selected commodities, euro million

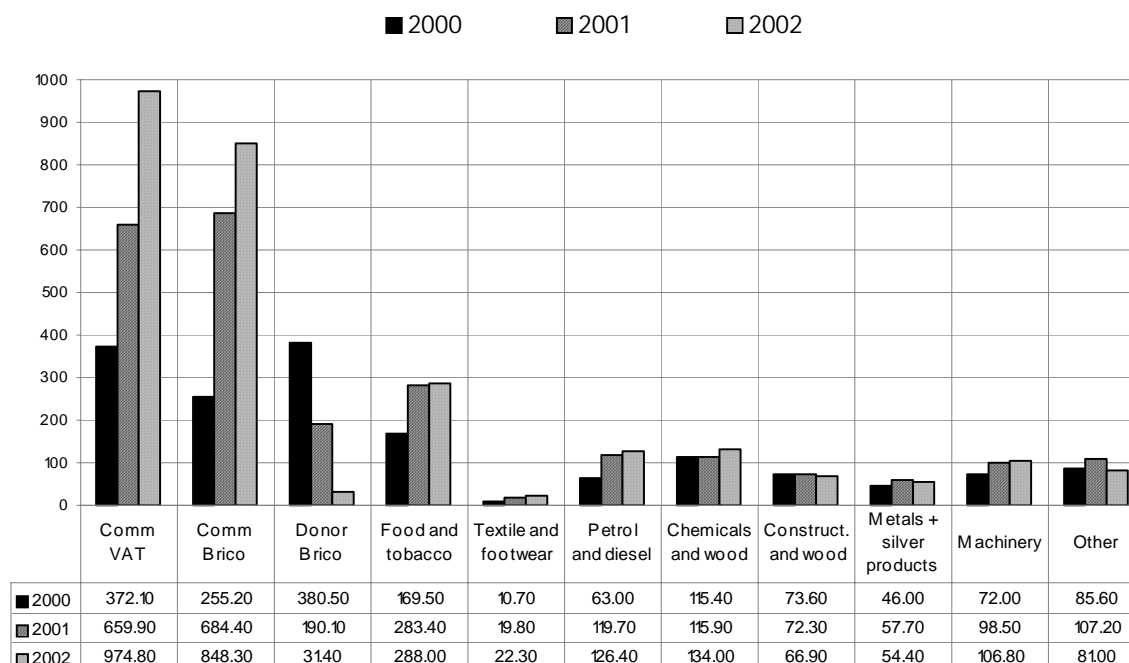


Source: Customs Service of Kosovo and MFE - MEU

Further and more significant improvement in the export performance will be crucial in the coming years. Taking into account the current structure of imported goods it is reasonable to expect gradual substitution of quite considerable range of imported goods with domestically produced goods. While high participation in imports of petrol (13%) and to some extent chemical and wood products (13.7%) is understandable, it is rather disappointing that food and tobacco imports occupy such a predominant place (30%) in the trade balance of an otherwise agricultural economy.

In addition, as further anticipated structural reforms (privatisation, reduction of grey economy, adoption of modern legislation) take place, reasonable incentives for moving the economy toward more efficient use of domestic resources should occur.

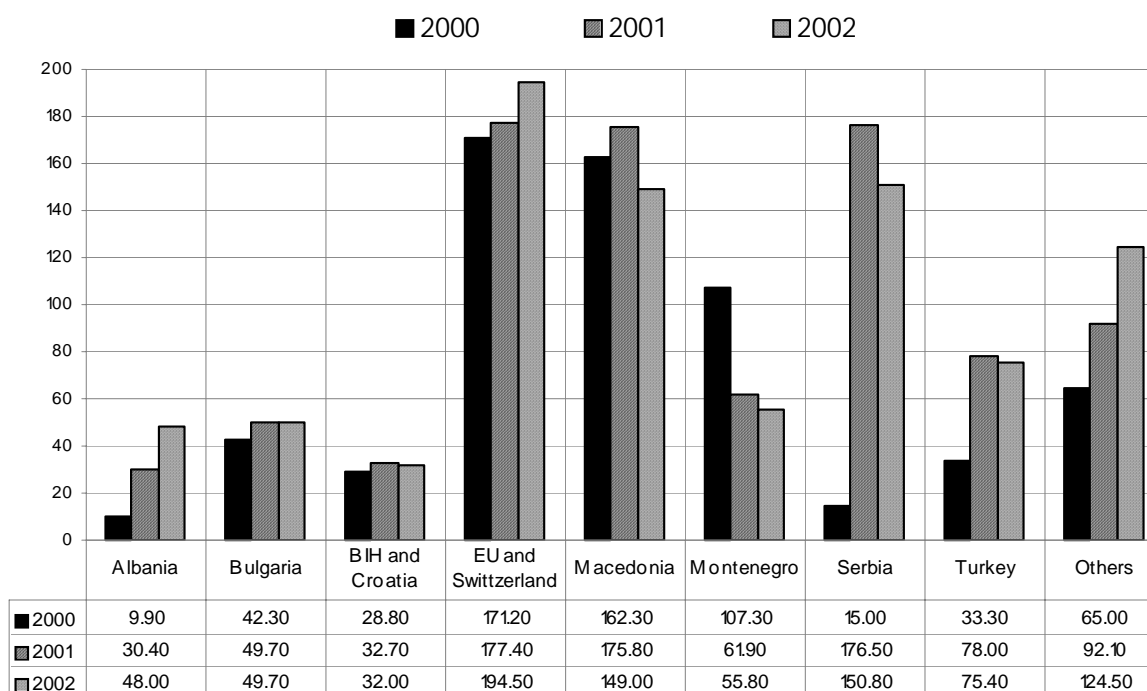
## Foreign trade: Imports by commodity group, euro million



Source: Customs Service of Kosovo and MFE - MEU

Kosovo's main trading partners are the European Union and Macedonia. Trading with Serbia, Turkey, Albania and Bulgaria grew rapidly in the past two years. Slovenia and Croatia are also increasing their presence in Kosovo's market especially after the establishment of their chambers of commerce representative offices in Kosovo.

## Foreign trade: Imports by the place of loading, euro million



Source: Customs Service of Kosovo and MFE - MEU

Data regarding the geographic structure of exports by country of destination are not yet available. The available data of the exports by border points show that just over half of exports that left Kosovo went through the border with Macedonia (Border cross point Hani i Elezit).

The geographic structure of imports seems to be blurred by lack of detailed data on imports by country of origin. In order to benefit as much as possible from the free trade agreement between Macedonia and FRY (only 1% custom duty) which was signed in the pre-conflict period, Macedonian certificates of origin are often issued to cover goods originating from other countries.

## Fiscal Policy

### Kosovo Consolidated Budget

	2000	2001	2002
	<i>euro million</i>		
<b>Revenues</b>	<b>128.5</b>	<b>323.0</b>	<b>497.9</b>
Central government	128.5	308.0	478.0
of which: VAT on imports	63.4	127.2	169.0
Customs	32.3	47.6	67.5
Excises at the boarder	19.5	77.0	125.6
Municipalities own taxes	0.0	15.0	19.9
<b>Expenditures</b>	<b>234.9</b>	<b>281.3</b>	<b>429.2</b>
Current expenditures	234.9	274.6	413.3
Wages	92.3	109.5	130.9
Goods and services	74.4	96.8	148.8
of which: DDG funded	31.1	35.5	26.9
Transfers and subsidies	67.4	74.2	133.6
of which: to State Enterprises <sup>1</sup>	32.2	39.6	76.3
of which for investment	17.0	14.0	46.0
Other	0.8	-5.9	0.0
Capital expenditure	0.0	6.6	15.9
<b>Overall balance</b>	<b>-106.4</b>	<b>41.7</b>	<b>68.7</b>
Financing	106.4	-41.7	-68.7
Budget grants	160.6	83.7	39.0
Donor Designated Grants	40.0	42.6	20.9
Budgetary support	120.6	41.1	18.1
Other (+ withdrawal)	-54.2	-125.5	-107.7
Change in designated fund balances	-8.9	-7.2	6.0
Change in other bank balances	-45.3	-118.3	-113.7
	<i>% of GDP</i>		
<b>Revenues</b>	9.1	18.5	25.0
<b>Expenditures</b>	16.6	16.1	21.6
Current expenditures	16.6	15.7	20.8
Capital expenditure	-	0.4	0.8
<b>Overall balance (before donor grants to budget)</b>	-7.5	2.4	3.5
Budget grants	11.4	4.8	2.0
<b>Overall balance (after donor grants to budget)</b>	3.8	7.2	5.4

Source: MFE - MEU and IMF Mission (March 2003)

Note: <sup>1</sup>In 2002 includes a one-off spending on KEK related to damage caused by lightening in mid-summer.

Due to the prudent fiscal policy, Kosovo's fiscal position remained sustainable with the overall balance in surplus for the second consecutive year in 2002. The level of the overall consolidated budget (excluding budget grants) surplus rose from euro 41.7 million (2.4% of GDP) in 2001 to euro 68.7 million (3.5% of GDP) in 2002.

The new domestic taxes, introduced last April, provided the budget with some additional income – euro 6.4 million, while despite the extension of VAT (July 2001) to cover a larger number of enterprises, the share of domestic VAT in total VAT revenue has remained at a low level.

#### Public sector: the Government

Total expenditure	2000	2001	2002	2003
Kosovo General Budget*	235	283	376	510
UNMIK**	413	449	388	368
PIP/NGOs***	635	541	292	270
KFOR****	5,000	4,000	3,000	2,000
<b>Total public sector</b>	<b>6,282</b>	<b>5,273</b>	<b>4,057</b>	<b>3,148</b>
Households, farms and enterprises*****			2,442	

Source: MFE - MEU

\*Social assistance transfers not included,

\*\*Wages paid to foreigners included only when paid from UNMIK budget,

\*\*\*Subsidies to Kosovo General Budget not included,

\*\*\*\*Rough estimates (no accurate data available),

\*\*\*\*\*Consumption of goods in kind included

The consolidated budget's total revenue (excluding budget grants) increased considerably in 2002. Tax revenue collected at the border constituted the main component of total revenues, accounting for almost 75% in 2002. Although the level of tax revenue increased during this period, rising from 14.3% of GDP in 2001 to 21.8% of GDP in 2002, non-tax revenue increased moderately from 2.3% of GDP in 2001 to 3.7% of GDP in 2002.

The level of consolidated budget's expenditure also showed a marked increase over the year 2002. Current expenditure constituted the main component of total expenditures, accounting for almost 96.3% in 2002. Budget expenditures have, however, been growing at almost the same rate as the revenues.

## **Structure and Operations**

### **Organisation Structure**

BPK is organised into three principal divisions – Financial Supervision, Banking Operations and Financial Operations. Each of these divisions has clearly defined roles that best serve the financial institutions of Kosovo, Provisional Institutions of Self Government (PISG) and UNMIK, and at the same time safeguard interest of the general public.

#### **FINANCIAL SECTOR REGULATION AND SUPERVISION**

Regulation 2001/24 Amending UNMIK Regulation 1999/20 on the Banking and Payments Authority of Kosovo, places the responsibility for licensing, supervision and regulation of financial institutions in Kosovo on the BPK. The division of statutory responsibility for financial sector regulation and supervision is conferred upon three departments:

- Bank Supervision Department,
- Insurance Supervision Department, and
- Pensions Supervision Department.

### **Banking Supervision**

BPK's bank supervision framework is organised into five key components. These are all linked to provide an effective system of bank supervision in which no component operates independently of the others:

- Supervisory philosophy,
- Prudential regulations and rules,
- Policy and procedures, supervisory tools and techniques,
- Supervisory monitoring, and
- Supervisory responses.

### **Supervisory Philosophy**

The BPK's goal is to have a bank supervision and regulatory process that is effective, flexible and promotes a competitive market-based banking system, which meets the Basle Core Principles for Effective Bank Supervision. During 2002, international advisors from USAID continued to assist in the establishment of a bank supervision function that is based on international best practices. The supervisory approach adopted by the BPK is based on a risk-based system. This approach is intended to enable the BPK to appropriately allocate its supervisory resources to those areas of greatest risk, within individual banks and the banking system. Supervision by risk focuses on the ability of management to identify, measure, monitor and control risk.

One of the major objectives of international advisors is to achieve full transfer of bank supervision responsibilities to the Kosovar staff. During first quarter of 2003, a local manager will be appointed as head of the Bank Supervision Department.

## **Prudential Regulations and Rules**

The BPK's objective in the banking regulation field is to have a banking legal framework that is in line with EU directives and international standards. Regulation 1999/21 provides a framework for bank and non-bank financial institution licensing, bank organisation and governance, the issuance of prudential rules and orders, maintenance of financial records and accounts in accordance with International Accounting Standards (IAS), requirements for external audits and on-site inspections, and the application of enforcement actions or penalties to assure compliance with the regulation.

By year-end 2002 twenty-two prudential and supervisory rules had been adopted by the Governing Board, which establish limits, operating guidelines, procedures, and reporting requirements for banks and financial institutions. Important regulatory developments in 2002 included:

- Effective 1 January 2002, the minimum capital for a bank license was increased to euro 2.5 million. Licensed banks were given until December 31, 2002 to meet the new capital requirement.
- On 28 March 2002, the Governing Board adopted rule XXII on Changes in Bank Equity Capital Accounts. The Rule specifies the requirements for the approval of the BPK for changes in a bank's equity capital.
- On 15 December 2002, the Governing Board amended Rule I on Risk-Based Capital. The Rule was amended to apply a 75% risk weight to loans secured by a first lien on residential property.

## **Supervisory Policies and Procedures**

Two bank supervision policy manuals have been developed and implemented, a bank licensing manual and a bank supervision manual, which outline bank licensing and supervision policies and procedures. During 2002, work continued on updating and developing uniform procedures for bank licensing and on-site and off-site examinations to ensure an effective framework for the sound functioning of the banking sector.

The bank-licensing manual includes standardised forms and procedures for licensing of banks and non-bank financial institutions. The bank supervision manual provides for standardised on-site supervision procedures based on a five-scale CAMEL system<sup>4</sup> of assigning banking ratings and allows for higher efficiency and consistency in conducting inspections and examinations.

Further refinements to the BPK's bank supervision unit were made during 2002. Four new supervision manuals were developed including: (1) an Information Technology (IT) Examination Manual; (2) a Bank Supervision Process Handbook; (3) a Policy for Bank Supervision and Enforcement; and (4) a Receivership Manual for bank receivership/liquidation. The new policies and procedures will further formalise the operations of the bank supervision unit to ensure consistency in supervision activities.

## **Supervisory Monitoring Activities**

Supervisory monitoring activities include bank licensing activities, periodic on-site inspections, and continuous off-site surveillance. To carry out its responsibility under Regulation 1999/21 for the licensing and supervision of banks and financial institutions, the Bank Supervision Department is following a supervisory approach of continuous supervision through on-site inspections and off-site monitoring.

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<sup>4</sup> Capital adequacy, Asset quality, Management, Earnings and Liquidity

## **Licensing**

The BPK's strategy in the field of bank licensing is centred on attracting investors who, having a strong financial position, fit and proper shareholders and management, are able to pursue a cautious approach to banking to protect the interest of clients, thus helping to strengthen the banking system and increase its credibility.

The licensing activity of the BPK during 2002 was related to the establishment of banks, opening of bank branches, and changes in banks' ownership structure. No new banks were licensed by the BPK during 2002, with the number of licensed banks remaining at seven. Two bank license applications were processed by the Bank Supervision Department during 2002. One of the applications was granted preliminary approval by the Governing Board, and the other application was rejected on the grounds that it did not meet the requirements for a bank license specified in Regulation 1999/21.

During 2002, the Bank Supervision Department processed 93 branch applications from local banks as they expanded their operating networks throughout Kosovo. At year-end 2002, the banks were operating a total of 118 branch offices compared to only 25 offices at the end of 2001, making banking services more accessible to citizens and enterprises.

With the requirement to increase capital to a minimum of euro 2.5 million by 31 December 2002, a large number of requests from local banks regarding changes in ownership structure were processed during 2002. By year-end 2002, all banks had successfully met the new capital requirement.

A significant event in the development in the banking system during 2002 year was the acquisition of 76% of the shares in American Bank of Kosovo (ABK) by a subsidiary of Vienna-based Raiffeisen Zentralbank Osterreich AG (RZB-Austria), the central institution of the Raiffeisen Banking Group, which is Austria's second largest banking group. Through the majority acquisition of ABK, RZB extended its banking network in the Balkans and plans to introduce new credit products and banking services to retail customers and businesses located in Kosovo. USAID through the Kosovo Business Finance Fund continues as a shareholder in ABK.

## **On-Site Examinations**

The inspection and examination activity undertaken during 2002 was carried out on the basis of an annual inspection plan approved by the Deputy Managing Director for Financial Supervision. BPK inspectors conducted 21 on-site inspections in banks during the year including six full-scope examinations, nine targeted inspections, and six Information Technology inspections. In addition, ten on-site inspections in non-bank credit institutions were conducted during the year.

## **Off-Site Analysis**

An off-site supervision process has been developed. During 2002, the off-site supervision and analysis of banks included the following: (1) ongoing monthly analysis of individual banks based on standardised bank regulatory reports; and (2) an overall analysis of the banking sector to detect systemic risk issues.

## **Supervisory responses/enforcement actions**

Regulation 1999/21 includes provisions for enforcement actions for non-compliance with the regulation or BPK rules, or for unsafe and unsound banking practices. Enforcement actions under the regulation range from written warnings to revocation of the license. During 2002, the BPK imposed a fine on one bank for regulatory violations, and another bank was placed under a Formal Agreement with the BPK due to credit management problems.

## Staffing and Training

The BPK's goal continues to be to develop a well-trained professional staff of bank supervisors who are knowledgeable of modern risk-based bank supervision techniques. A formal training program has been developed for bank supervisors. The training program includes both formal classroom training and on-the-job training. During 2002, seven formal classroom training seminars were provided by an international bank supervision training expert in the following areas: Basic Bank Supervision; Advanced Offsite Analysis; Ethics and Professional Conduct of Supervisors; Advanced Bank Supervision; Money Laundering, Train-the-Trainer; and Examination Management Techniques.

In addition to formal bank supervision seminars, international advisors provided extensive on-the-job training throughout 2002 to the bank supervision staff during on-site inspections and off-site monitoring activities.

## Structure of the Financial System

Type of Financial Institution	Number	Number of Offices
Licensed banks	7	118
Banks with preliminary license approval	1	Not applicable
Micro Finance Institutions	16	29
Exchange Bureaus	3	3
Wire Transfer Operators	2	56

## Development of the Banking Sector

The year 2002 continued to be a year of development for the banks in post-conflict Kosovo. While the number of banks did not change during 2002, most banks were very aggressive in expanding their network of banking offices (branches and sub-branches) throughout Kosovo. At 31 December 2002, aggregate total assets in the banking system were euro 471 million; total loans were euro 86 million, and total deposits were euro 420 million. Total loans outstanding in the banking sector increased by euro 61 million, or 244%, during 2002. At the same time, total deposits in the banking system at year-end 2002 decreased by euro 65 million from year-end 2001, or 13%. The decrease in deposits during 2002 is partly attributed to the withdrawal of deposits in the first half of the year after the sharp increase in bank deposits just prior to the start of the changeover to the euro in January 2002. Deposits in the banking system declined 23% during the first seven months of 2002, but increased 13% from July to December 2002.

## Financial System Loans and Deposits – December 31, 2002

(Thousands euro)

	Loans	Deposits
Banks	86,612	419,436
MFI's and non-banks	33,437	0
Total	120,049	419,436

The ownership structure of the banking sector at 31 December 2002 measured by share capital was 62% foreign capital and 38% domestic capital. There is no state-ownership of banks in Kosovo, however, approximately 5% of share capital in the banking system is held by socially owned enterprises.



Other significant developments in the banking system during 2002 included the introduction of Automated Teller Machines (ATMs) by Micro Enterprise Bank (MEB). At year-end MEB's had a network of 14 ATMs. Also during 2002, two banks (Micro Enterprise Bank and American Bank of Kosovo) had been approved for membership in the SWIFT system of international payments.

### **Non-bank Financial Institutions**

The BPK is responsible for the licensing and supervision of non-bank financial institutions. By year-end 2002, the BPK had registered 16 non-bank financial institutions that are engaging in micro finance and lending to small and medium size enterprises. These institutions are funded by grants from international donors. Both solidarity group guarantees and individual loans for productive purposes with guarantors are used. Non-bank financial institutions are helping to create a stable system that provides financial services for disadvantaged groups and small businesses that lack access to credit. At year-end 2002, outstanding loans for this sector were 33 million euro, up from euro 21 million a year earlier.

Under BPK Rule XVI on the Registration, Licensing and Supervision of Foreign Exchange Bureaus and Money Transfer Services, entities operating as foreign exchange bureaus and/or money transfer services are required to register with the BPK, and must comply with the operating requirements outlined in the rule. By year-end 2002, the BPK had approved applications to establish three foreign exchange bureaus, and two applications from entities to conduct money transfer services.

### **Insurance Supervision**

An insurance company licensing system was introduced through UNMIK Pillar II under Administrative Direction No. 1999/3 whereby five non-life insurance companies were licensed. This licensing program was accomplished during 2000 to undertake sale of compulsory third party liability insurance. During 2001 the decision was made that a modern insurance regulation be prepared and enacted under which all insurance companies would be licensed, regulated and supervised by BPK. The BPK Insurance Program started with four Insurance Companies licensed by Pillar II - one licensed company withdrew from the Kosovo market during 2001.

On 5 October 2001, UNMIK Regulation 2001/25 on Licensing, Supervision and Regulation of Insurance Companies and Insurance Intermediaries was signed and a new regulatory regime, based on European Union principles, was created. Under this regulation, the effective responsibility of supervision and licensing of the four existing non-life insurance companies was transferred from Pillar II to BPK. The existing companies were temporarily allowed to operate under UNMIK Pillar II licences but they and other newly established companies were required to apply to BPK for a new licence to operate.

At 31 December 2001 the four existing insurance companies submitted applications for licence under the new UNMIK Regulation. Based on the BPK's enforcement powers provided under the new insurance regulation a Temporary Administrator was appointed in place of incumbent management of one insurance company. The company was subsequently placed into receivership.

### **Goal of BPK**

BPK's goal is protection of the Kosovo people by establishing and enforcing the regulation and rules under which insurance industry conducts its operations and pays claims.

## **Status of Development**

A functioning insurance regulatory department has been established and a training program developed. Supervision staff consists of nine inspectors and 3 assistant inspectors. The inspectors are receiving on the job training and in-house training programs have been developed to advance their knowledge and understanding of insurance supervision. BPK will complete the goal of 100% local management by appointing a Kosovar as Insurance Regulator in the early 2003. Thirty prudential rules have been drafted and approved by the BPK Governing Board directing legal requirements for the operation of all types of insurance companies, intermediaries, brokers and adjusters, and their financial requirements. Today there are 8 licensed insurance companies and one is operating under a temporary licence. The insurance companies have been gradually expanding their operations and two of them are already operating in the minority areas. BPK is currently processing one life company application and anticipates two more applications.

BPK has sponsored formation of the Insurance Association of Kosovo and the Insurance Institute to further stability of the insurance industry and for education of the Kosovo public and insurance industry. A Guarantee Fund to protect the Kosovo population against uninsured motorists has also been established by the BPK.

## **Premium Written and Claims settlement**

In 2001 the four insurance companies wrote a total of 179,864 policies with euro 31,161,676 in premium and settled claims totalling euro 2,655,560.

In 2002, the eight insurance companies wrote a total of 174,967 policies with euro 27,127,023 in premium and settled 7,766 claims totalling euro 3,389,982.

Guarantee Fund has settled 212 claims totalling euro 155,678.

## **New Classes of Business**

Six additional classes of business have been approved for three companies: Fire, Personal Accident (PA), Construction all Risk (CAR), Physical Damage to vehicles (CASCO), Directors and Officers Liability (D&O) and Professional Liability.

Four additional classes of business have been approved for three companies: Fire, Personal Accident (PA), Construction all Risk (CAR), Physical Damage to vehicles (CASCO).

Two companies still write only Compulsory Third Party Liability

## **International Insurance Memorandums of Understanding**

BPK has entered into two Insurance Memorandums of Understanding that will allow Kosovo Motorists to enter surrounding countries, one of which allows Kosovo Motorists to enter without paying Border Insurance. BPK is also negotiating four further bilateral agreements with other countries to allow cross border travel without paying border insurance. Implementation is expected soon.

## **Investment Policy**

Two Insurance Rules provide for a comprehensive investment policy for insurance companies. BPK has limited and restrictive investments available to insurance companies due to the lack of economic and legal development and structure.

The current investments available to insurance companies are shown below:

Permissible Assets	Limitations	Valuation
Cash in euros on hand	Petty Cash	Fixed Deposit or Market Value (MV)
Cash in other Currency	0	
Deposits:		
BPK	100%	MV
Other Kosovo Commercial Banks	10%	MV
Maximum all Commercial Banks	30%	MV
Foreign Approved Banks	10%	MV
Bonds:		
Government – Kosovo	<i>Note 1</i>	MV
Government – Non-Kosovo	100%	MV
Government – Non-recognised	1%	MV
Corporations – Approved	5%	MV
Equities:		
Securities Exchange – Approved	5%	MV
Securities- Non-recognised	1%	MV
Securities – Banks approved by BPK	5%	MV
Loans:		
Secured – approved by BPK	2.5%	MV
Unsecured	0	
Property:		
Home Office and Branch Offices	5%	MV
Other	0	
Kosovo	0	
European Union Guaranteed Instruments	<i>Note 2</i>	MV
BPK Financial Instruments:		
Fixed Deposit Instruments	100%	MV
Other	<i>Note 3</i>	MV
Kosovo Non-public Sector Investments	0	

*Note 1: This is not an option in the foreseeable future. Note 2: This option is being explored. Note 3: No such instrument currently exists.*

## **Pension Funds Supervision**

UNMIK Regulation No. 2001/35, on Pensions in Kosovo established the Department of Pensions Supervision within the BPK.

The Department is charged with regulatory and supervisory oversight functions over the business activities of Supplementary Employer Pension (Pension Funds) and providers of Supplementary Individual Pensions. These functions also apply to the service providers of pension entities, including the Kosovo Savings Pension Trust, asset managers and custodians of pension assets.

The BPK Department of Pensions Supervision was established and organised on 1 June 2002. Three pensions examiners currently man the Department. The examiners have undergone and continue to receive extensive training on both the legal and regulatory framework of pensions and on skills, techniques and methodologies that are applied in the prudential pensions oversight functions. An international consultant provides technical assistance.

The first initiatives of the Department focused on the establishment and development of local pensions regulatory capacity that will install in Kosovo a pensions supervisory regime to apply prudential rules approximating best international standards. Towards this end, as of the end of December 2002, twenty-four Rules on Pension have been adopted and issued by the BPK as secondary legislation in the implementation of the Pensions Regulation. The Department also licensed Pension Funds that existed before the Pension Regulation entered into force to ensure that the pension benefit payments made and the pension entitlements were contracted within the requirements of the Pensions Regulation.

It is a mission of the Department to amend the existing rules as necessary and to also formulate additional rules that are responsive to the pension system and allow the system to grow within a sound and prudential governance framework.

As at 31 December 2002, the BPK had issued six new Pension Fund licenses for Supplementary Employer Pensions. The new Funds registered a combined participation of 1,706 participants. More enterprises are expected to establish Pension Funds for their employees as supplement to the mandatory individual savings pensions.

The BPK remains committed to building and strengthening a pensions regulatory and supervisory capacity to promote and support the healthy development and growth of pensions under a regime of supervision characterised with transparency and adherence to sound and internationally accepted regulatory standards.

## **Banking Operations**

Banking operations of the BPK are grouped in three major sections: Cash & Vault Management, Banking Services and Interbank Clearing System.

Cash & Vault Management is predominantly concerned with maintenance of adequate stock of euro banknotes and coins for the needs of the local economy. In 2002, the year of euro conversion, this function played a significant role. BPK vault personnel had to deal with exceptional volumes of cash, both Deutsche Marks and euro. It was also their responsibility to minimise the need for cash transportation between the branches and thereby reduce the overall cost of cash operations. Proper planning and maintenance of cash reserves allowed the BPK to increase the amount of funds available for investment in the financial markets.

BPK, through its branch network, provided exchange facilities to the majority of Kosovo population. Until divestment of the branch network to the local commercial banks in July 2002, customer deposits

and withdrawals, tax payments, customs receipts, salary payments of public sector workers, social assistance and pensions payments, and dealings with banks and financial institutions were all conducted by the BPK. Most of these transactions continued to be provided at a much reduced level until the end of the year through the one remaining branch in Prishtina. Banking Services will continue to provide banking services to the Bank's customers, mainly PISG and UNMIK, through the Prishtina office although commercial banking operations will cease to be conducted by the BPK at the end of February 2003.

As the gradual transition to non-cash banking operations was taking place and the number of individuals and companies making payments through the banking system was increasing, the need for cash operation decreased significantly. This allowed BPK to transform its operations to correspond to those of a central bank. The importance of an efficient and modern Interbank Clearing System became even more evident at that time and the further necessary developments and improvements in the interbank clearing system were implemented.

## **Interbank Clearing System**

The Interbank Clearing System (ICS) was established in May 2001 to facilitate domestic payment operations through the banking system. ICS underwent further major technological transformation and as a result a fully electronic inter-bank transfer of payment information has been in operation since April 2002. The success of ICS reflects both the growth and return of confidence in the local banking system.

BPK not only manages and monitors operations but also participates directly in the payment system in which all seven local commercial banks are participants. The new system offers improved means of communication between the banks, real-time adjustment to bank balances maintained at the BPK, significant reduction of payment and settlement related risks and costs, and ability to execute payments quickly and efficiently. Standard numbering of bank accounts based on IBAN was successfully introduced in all banks in Kosovo.

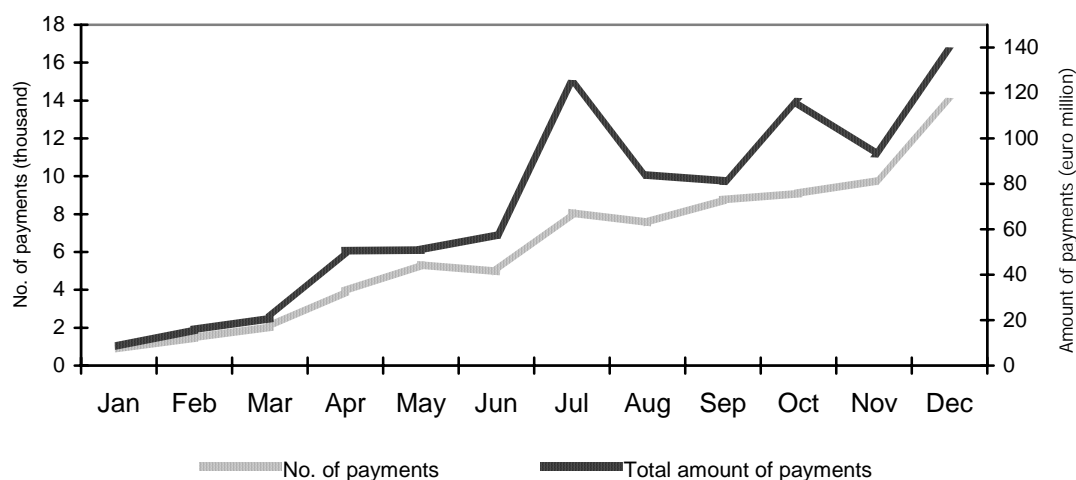
The number and total value of transactions processed by the ICS continued to grow steadily. By December 2002 the daily average number of bank-to-bank payment transactions reached 640 compared with just over 40 transactions per day in January. While the average amount of transfers processed by the ICS remained almost unchanged, the monthly total amount of funds transferred between the banks had gone up from euro 8.6 million to euro 138.1 million in the same period.

Apart from normal (bank-to-bank file-transfer) and priority (small number of individual transfers) payments, ICS operations also involve mass payments. There was a significant increase in this type of transfers as a direct result of wider introduction of salary payments directly through the bank accounts. BPK estimates that there are nearly 200,000 of such individual payments processed monthly.

Fees charged by the ICS, both for membership and transactions, remained unchanged during the course of the year. A new fee structure, to further encourage and allow greater flexibility in payment operations, is being developed with full cooperation of the IPAC and is expected to be introduced in early 2003.

Subject to the BPK Prudential Rule XVII, all banks licensed to operate within Kosovo have to maintain Liquidity Reserve accounts at the BPK. ICS department was responsible for monitoring and administration of these accounts. ICS was also charged with the liaison function between the BPK and the commercial banks in the day-to-day operation of their settlement accounts.

## Monthly number and total amount of ICS payments in 2002



Despite the significant progress achieved in 2002, ICS will undergo further technological and organisational improvements. These will involve development and introduction of a direct payment information link to the largest originators of mass payments, fully automated link with the BPK internal accounting system, and further improvements in collection and publication of statistical data on ICS operations. ICS will continue to encourage commercial banks to extend their communications infrastructure with their branch network to achieve a full real-time settlements capability in the Kosovo banking system. Expanding a number of the already existing dedicated telecommunication links between the BPK and the other ICS participants, security of these lines and possibility of establishing a wireless network will be researched in 2003.

## Foreign Operations

BPK Foreign Asset Management function was refocused and streamlined during 2002 in line with the revised corporate strategy. Its international payments function reduced gradually with transfer out of most of its commercial activities to the local commercial banks. Although foreign payment activities continued to be conducted by the BPK, they were at a reduced level and were offered predominantly to the government and the financial institutions.

The amount of funds under BPK management available for investment, after replacement of Deutsch Mark with euro, grew significantly and BPK developed closer relationships with other central banks of Europe and furthered its recognition. Along with on going relationships with correspondent banks in Germany and Austria, new banking relationships were established and are expected to come into operation in 2003.

BPK was able to improve the return on its investments while observing the general rules of prudence and maintaining adequate liquidity and security of its investments. Risk Management function was developed during 2002 and the newly appointed Risk Manager, together with Internal Audit, would be responsible for evaluation, determining and observance of investment policies and strategies. Segregation of duties between the dealing activities and settlements continued to be strictly observed.

## Highlights of BPK activities

### Transition to euro

The use of the Deutsche Mark was formalised in Kosovo by Regulation 1999/04 and Administrative direction No. 1999/02. Administrative direction No. 2001/24 subsequently paved the way for replacing Deutsche Mark with the euro as the most widely used currency in Kosovo. This also placed the responsibility for the colossal task of the changeover to euro with the BPK management and staff.

Preparations for the euro changeover started in Kosovo in August 2000. The main objective of BPK and UNMIK was to ensure for a smooth and safe changeover to the euro at the lowest cost possible. BPK liaised with IMF, Deutsche Bundesbank, European Central Bank, Commerzbank, Austrian National Bank and Raiffeisen Zentral Bank to achieve the optimal solution for Kosovo. This included technical evaluation and assessment of the needs and preparation of changeover scenarios. Although, the principal of the euro changeover was simple, the scale and technical constraints of the operations dictated the need for involvement of many governmental agencies, KFOR and commercial enterprises.

Due to lack of comprehensive statistical data, precise estimation of the Deutsche Mark currency in circulation in Kosovo was not possible. Based on the available information and sample market analysis, it was estimated that import of euro 500 million was needed to finalise the changeover by 28 February 2002. Frontloading of euro banknotes and coins started in Kosovo at the beginning of December 2001. In order to provide the local commercial banks and to satisfy BPK's own needs nearly euro 100 million was imported to Kosovo before the end of 2001. As part of preparatory works for the changeover, BPK invited, through an international tender, CIT companies to provide the cash for frontloading of euros.

Unlike in the euro zone countries, where all banks enjoyed direct access to the issuing central banks to exchange holdings in national currency into euro free of charge, in Kosovo euro cash had to be shipped from abroad. Additionally, after the exchange, the collected Deutsche Mark banknotes and coins had to be repatriated. This involved substantial transportation, insurance and security costs.

On the 1 January 2002, all balances in DEM held on accounts with the BPK and the local commercial banks in Kosovo were automatically converted into euro free of charge and at the irrevocable conversion rate of DEM 1,95583 for one euro.

During January and February 2002 (the dual circulation period), both euro and DEM banknotes and coins were accepted for payments. At the same time the physical exchange of Deutsche Mark for euro took place on the following conditions:

- amounts up to DEM 1,000 (household amount) were exchanged free of charge,
- amounts up to DEM 10,000 were subject to a fee,
- amounts over DEM 10,000 were accepted only as a bank deposits.

The euro changeover provided a unique opportunity to reduce the amount of cash in circulation and, by encouraging a move away from the existing cash-based to a non-cash payment system, to further develop a modern and efficient banking system. By announcing limits on the amounts of exchange and with strict adherence to the dual circulation period limit, cash holders were encouraged to open accounts and deposit their money with the banks.

The role public information campaign played in the successful changeover cannot be underemphasized. It was developed with the assistance of the European Agency for Reconstruction and UNMIK, and was conducted through the Chamber of Commerce and support of the Euro Info Correspondence Centre. Thanks also to the partnership with the EU Pillar IV Leaflets and press

releases were also dispatched throughout all the territory of Kosovo. Over 300,000 copies of leaflets were printed and distributed in the three official languages – Albanian, Serbian and English.

### **Import & Export of cash in 2002- BPK and Commercial Banks** (including euro frontloading in December 2001)

	<b>Import (euro)</b>	<b>Export (euro)</b>	<b>Repatriation (DEM)</b>
BPK	455,212,500	45,000,000	1,027,268,819
Commercial Banks	142,200,000	61,211,407	151,634,126
<b>Total</b>	<b>597,412,500</b>	<b>106,211,407</b>	<b>1,178,891,095</b>

Frontloading of euro coins and subsequent additional import amounted to nearly euro 7 million. BPK also repatriated DEM coins with a total value of DEM 9.67 million. These tasks required significant logistic planning and organisation as over 100 tons of coins had to be transported.

### **BPK Branch Network**

When the BPK was established in November 1999, there were no other banks operating in Kosovo. It therefore provided banking facilities and services to the UNMIK Administration and all communities in Kosovo. It was envisaged then that when the commercial banking sector was sufficiently developed, all commercial operations of the BPK would transfer to the commercial sector. This objective was achieved in 2002. BPK divested of its branch network of six branches and fifteen sub-branches, and with it a substantial part of its payment operations, to the commercial banks in 2002. The program was completed with signing of the last lease agreement on July 8. With the divestment, employee numbers reduced from 362 in January to 127 at the end of July 2002. As part of the lease agreements incumbent staff transferred to the leasing banks and the branches were, therefore, effectively divested as going concerns and with no job losses. Divestment of branch operations resulted in a 60% reduction of BPK revenue. Lease agreements for the branch properties, for which BPK has the responsibility of maintenance, generate a revenue of euro 175,000. This revenue is, however, not available to the BPK as income as it is deposited in a special trust account until the property rights to these premises is resolved..

### **Human Resources Development**

Apart from its administrative functions within the BPK, Human Resources department is assigned the responsibility of improving the knowledge and skills of the BPK staff. A new position of Training Officer has been created within the department to coordinate the various on-going training programmes and advance the training effort. BPK is still a new organisation and its business and the environment in which it operates are subject to continuous changes. This puts significant demands on the BPK staff who need to keep abreast of the developments and strive to lead the financial sector knowledge league.

Human Resources department has established comprehensive long-term training plans and is also well equipped now to respond quickly to most unexpected needs. In cooperation with managers of all departments, it continually assesses the training needs and professional development of staff with the overall aim of building a high quality organisation that is cost effective and, through provision of tailor-made training at every level of work experience, efficient.

BPK work education programmes start with a structured and supervised on the job training. In house courses are organised for groups of employees in similar positions. For more specialised or



individual training needs, BPK employees attend seminars at other institutions, both within and outside of Kosovo.

Additionally, for new regulations, laws and issues such as pensions and medical insurance, seminars are organised to inform all personnel. Training in management techniques, work ethics and team building is provided to improve competence levels of all local managers.

In the last quarter of 2002, BPK arranged for its entire staff to receive English language tuition and started to financially support employees' relevant part-time and postgraduate studies at Pristina University. BPK Staff have continued to benefit from IMF sponsored training in Vienna and Washington, contacts with similar Ministry of Finance and Economy (MOFE) functions and visits to other central banks of the region. An advisory group has been set-up with the Statistical Office of Kosovo (SOK) to undertake Macro Economic Analysis, improve and stream line statistical data collection and identify and develop joint projects. Staff attended seminars on counterfeit detection at the ECB in Frankfurt and the ACE Program of the Faculty of Economics and Econometrics of the University of Amsterdam. Several BPK employees also attended accounting courses organised by the Kosovo Board of Accounting.

### **Transition of Management Responsibilities**

Effective January 1, 2003, role of the International Experts at the BPK would change to that of Advisors. They would support and further develop the relevant functional areas where work is incomplete or prolonged absences of incumbents are necessary for academic work or external training. All managerial positions would have local designate managers and day-to-day operational responsibilities would substantially reside with them.

After divestment of the Branches, BPK commenced work on redefining its role and, in line with the corporate strategy, the Governing Board approved a revised BPK organisation structure on 29 July 2002. The new structure, more akin to Central Bank operations, identified requirement of 138 positions. It acknowledged the need to invest in staff and their professional development to enable them to keep abreast of the anticipated changes in the financial sector. In arriving at requirements per the revised organisation structure, every effort was made to reassign incumbent staff to the vacant positions with commitment to invest in their professional development. With the help of IMF Consultants a new personnel policy and staff grading, career paths and salary structure were developed and implemented in September 2002.

Staff training and development were assigned the highest priority and where skills gaps were identified, training programs – external, in-house, on-the-job, were developed. BPK has chosen ten young employees from its staff for accelerated training to prepare them for future management appointments and has also introduced an internships program for the most promising students from University of Prishtina to access the best candidates for BPK requirements from a graduating class.

### **Introduction of BPK Supplementary Pension Plan**

On 18 December 2002, the BPK Governing Board approved and adopted a resolution creating the BPK Pension Fund. The BPK pension will supplement other entitlements that an employee would receive on retirement. Thus, when a BPK employee retires at the age of 65, he or she can expect that the modest income stream provided by the monthly life pensions derived from the Basic Pension and the annuity payments on savings that will have been accumulated in the Mandatory Pension Plan will be further enhanced by an amount of monthly pension provided under the BPK Pension Plan.

The BPK Pension Plan enhances the annuity payments from the Mandatory Pensions Scheme. The Plan integrates guaranteed pension benefits with the annuity payments so that no employee of the BPK on retirement shall receive, for life, a monthly pension lesser than 45% of his or her pension base monthly salary. The Pension Plan is non-contributory, meaning that all contributions required to pre-finance the pension entitlement come from the BPK.

The BPK Pension Fund is organised under the independent trust management of the Pension Fund Board of Directors. The five Member Board of Directors represents both the BPK (2) and the Employees/Participants (3). The employee representatives were elected to the Board by the participants of the Fund and the BPK representatives to the Board were appointed by the BPK management.

The BPK Pension Fund and the BPK Pension Plan commenced independent operations effective 1 January 2003.

# BPK Financial Statements for the Year 2002

## General Information in relation to Financial Statements

The Banking and Payments Authority of Kosovo (the "BPK") is a distinct public entity with the authority to license, supervise and regulate financial institutions in the territory of Kosovo. The BPK was established in accordance with the provisions of the United Nations Interim Administration Mission in Kosovo ("UNMIK") regulation no. 1999/20 issued on November 15, 1999 (as amended on October 1, 2001) "On the Banking and Payments Authority of Kosovo". Under this regulation the BPK's principal objectives are to:

- Foster an efficient and safe system for domestic payments, and
- Foster the liquidity, solvency and efficient functioning of a stable market based financial system, including regulating banks, insurance companies and other financial institutions.

The BPK has the following specific powers to:

- Recommend broad policy guidelines to the Special Representative of the Secretary-General of the United Nations in areas under its responsibility, under the guidance of the Deputy Special Representative for Economic Reconstruction and Development;
- Formulate and implement measures for, and supervise and regulate, payments and settlement systems for transactions in domestic and foreign currency in Kosovo;
- Own and operate one or more payments systems;
- Act as banker to the Central Fiscal Authority and to provide financial advice at its request;
- Act as fiscal agent to the Central Fiscal Authority;
- Hold foreign currency deposits of banks, the Central Fiscal Authority and other entities;
- Ensure an adequate supply of bank notes and coins for the settlement of cash transactions;
- Maintain a depository for safe keeping of currency and securities;
- License, supervise and regulate financial institutions;
- Supervise and regulate dealers in foreign exchange, and
- Conduct regular economic and monetary analysis of the Kosovo economy, make public the results, and submit proposals and measures to the United Nations Interim Administration Mission in Kosovo on the basis of such analysis.

The BPK operates from a head office located in Prishtina. During July 2002, as part of a restructuring of the Bank, its former branches were taken over by a local commercial bank through a tender process.

## Governing Board Composition:

The Governing Board determines policies for the operations of the Banking and Payments Authority of Kosovo and supervises their implementation. Under UNMIK regulations, the Board is composed of seven members appointed by the Special Representative of the Secretary-General.

At 31 December 2002 the Governing Board of the Banking and Payments Authority of Kosovo comprised the following members:

Mr. Arji Begu, Chairman of the Governing Board  
Ms. Chaiha Kim Rhee, Managing Director of the BPK  
Mr. David Weatherman, Deputy Managing Director for Financial Sector Supervision  
Mr. Benoit Waelkens, Deputy Managing Director for Financial Operations  
Mr. Andy Bearpark, Deputy Special Representative of the Secretary General  
Dr. Gazmend Luboteni, Deputy Dean of Economic Faculty in Prishtina  
Vacant (1 position)

## Independent Auditor's Report

We have audited the accompanying balance sheets of the Banking and Payments Authority of Kosovo (the "BPK") as at 31 December 2002 and the related statements of income, changes in paid-up capital and reserves and cash flows for the year ended 31 December 2002. These financial statements are the responsibility of the BPK's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the BPK as of 31 December 2001 were audited by another auditor, whose report dated October 4, 2002, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the financial statements present fairly, in all material respects, the financial position of the Banking and Payments Authority of Kosovo as of 31 December 2002 and the results of its operations, changes in paid-up capital and reserves and cash flows for the year ended 31 December 2002 in accordance with International Financial Reporting Standards including International Accounting Standards and interpretations issued by the International Accounting Standards Board.

Without qualifying our opinion, we draw your attention to the fact that at present there is uncertainty in Kosovo surrounding the likely future direction of domestic economic policy, regulatory policy and political developments. We are unable to predict what changes in conditions will take place and what effect these might have on the financial position of the Banking and Payments Authority of Kosovo.

PricewaterhouseCoopers Audit SRL

Bucharest, 21 February 2003

## BPK Balance Sheet as at 31 December 2002

	<i>Note</i>	<u>2002</u> (EUR '000)	<u>2001</u> (EUR '000)
<b>Assets</b>			
Cash on hand		17,474	196,132
Current accounts with non-resident banks	<i>3</i>	65,321	99,379
Deposit accounts with non-resident banks	<i>4</i>	262,696	46,016
Property, plant and equipment, net	<i>5</i>	621	734
Other assets	<i>6</i>	<u>36</u>	<u>677</u>
<b>Total assets</b>		<u>346,148</u>	<u>342,938</u>
<b>Liabilities</b>			
Due to domestic banks	<i>7</i>	46,235	219,193
Due to governmental institutions	<i>8</i>	268,869	79,622
Due to public and commercial entities	<i>9</i>	19,326	14,485
Other domestic liabilities	<i>10</i>	<u>1,782</u>	<u>23,139</u>
<b>Total liabilities</b>		<u>336,212</u>	<u>336,439</u>
<b>Capital and reserves</b>			
Statutory fund	<i>11</i>	2,556	2,556
Reserve fund	<i>12</i>	<u>7,380</u>	<u>3,943</u>
<b>Total capital and reserves</b>		<u>9,936</u>	<u>6,499</u>
<b>Total liabilities and capital and reserves</b>		<u>346,148</u>	<u>342,938</u>

These financial statements and accompanying notes, based on the statutory accounts restated in accordance with International Financial Reporting Standards, were signed and approved on behalf of the Governing Board by:

**Chaiha Kim Rhee**  
Managing Director

**Hysni Rudi**  
Head of Accounting  
Department

**Benoit Waelkens**  
Deputy Managing Director

## BPK Statement of Income for the Year Ended 31 December 2002

	<i>Note</i>	<u>2002</u> (EUR '000)	<u>2001</u> (EUR '000)
Interest income		6,765	2,828
Interest expense		<u>(3,044)</u>	<u>(240)</u>
<b>Net interest income</b>		3,721	2,588
Fee and commission income		3,041	3,392
Fee and commission expense		<u>(184)</u>	<u>(197)</u>
<b>Net fee and commission income</b>		2,857	3,195
<b>Grant revenue</b>	<i>10</i>	2,860	566
<b>Other operating income</b>	<i>13</i>	<u>369</u>	<u>125</u>
<b>Net operating income</b>		9,807	6,474
<b>Other non-operating expenses</b>			
Staff costs	<i>14</i>	929	816
Depreciation		329	215
General and administrative expenses	<i>15</i>	4,775	3,052
Other expenses		<u>337</u>	<u>25</u>
<b>Total other non-operating expenses</b>		<u>6,370</u>	<u>4,108</u>
<b>Net profit for the period</b>		<u>3,437</u>	<u>2,366</u>

These financial statements and accompanying notes, based on the statutory accounts restated in accordance with International Financial Reporting Standards, were signed and approved on behalf of the Governing Board by:

Chaiha Kim Rhee  
Managing Director

Hysni Rudi  
Head of Accounting  
Department

Benoit Waelkens  
Deputy Managing Director

## BPK Cash Flow Statement for the Year Ended 31 December 2002

	<i>Note</i>	<u>2002</u> (EUR '000)	<u>2001</u> (EUR '000)
<b>Cash flows from operating activities</b>			
Net profit for the period		3,437	2,366
<b>Non-cash items in the statement of income</b>			
Depreciation		329	215
Grant revenue	<i>10</i>	(2,860)	(566)
<b>Change in operating assets</b>			
Increase in deposit accounts with foreign banks		(216,680)	(511)
(Increase)/decrease in other domestic assets		641	(270)
<b>Change in operating liabilities</b>			
(Decrease)/increase in due to domestic banks		(172,958)	202,650
Increase in amounts due to governmental institutions		189,247	57,083
Increase/(decrease) in amounts due to public and commercial entities		4,841	(2,842)
(Decrease)/increase in other domestic liabilities		<u>(21,106)</u>	<u>21,254</u>
<b>Net cash from operating activities</b>		<b>(215,109)</b>	<b>279,379</b>
<b>Cash flows from investing activities</b>			
Acquisition of tangible fixed assets		<u>(216)</u>	<u>(447)</u>
<b>Net cash used in investing activities</b>		<b>(216)</b>	<b>(447)</b>
<b>Cash flows from financing activities</b>			
Capital introduced		-	-
Grant funds received		<u>2,609</u>	<u>783</u>
<b>Net cash from financing activities</b>		<b>2,609</b>	<b>783</b>
<b>(Decrease)/increase in cash and cash equivalents during the period</b>		<b>(212,716)</b>	<b>279,715</b>
<b>Cash and cash equivalents at the beginning of the period</b>		<u>295,511</u>	<u>15,796</u>
<b>Cash and equivalents at the end of the period</b>		<u><u>82,795</u></u>	<u><u>295,511</u></u>



**Statement of Changes in Paid-up Capital and Reserves  
for the Year Ended 31 December 2002**

	<u>Capital</u> (EUR '000)	<u>General Reserve</u> (EUR '000)	<u>Retained Earnings</u> (EUR '000)	<u>Total</u> (EUR '000)
<b>Balance as at 31 December 2000</b>	2,556	309	1,268	4,133
Net profit for the year	-	-	2,366	2,366
Transfer to reserve fund	<u>-</u>	<u>3,634</u>	<u>(3,634)</u>	<u>-</u>
<b>Balance as at 31 December 2001</b>	<u>2,556</u>	<u>3,943</u>	<u>-</u>	<u>6,499</u>
Net profit for the year	-	-	3,437	3,437
Transfer to reserve fund	<u>-</u>	<u>3,437</u>	<u>(3,437)</u>	<u>-</u>
<b>Balance as at 31 December 2002</b>	<u>2,556</u>	<u>7,380</u>	<u>-</u>	<u>9,936</u>

## **Notes to the BPK Financial Statements**

### **1. BASIS OF PRESENTATION**

These financial statements of Banking and Payments Authority of Kosovo ("BPK") are prepared, in all material aspects, in accordance with International Financial Reporting Standards ("IFRS") including International Accounting Standards and interpretations issued by the International Accounting Standards Board, except donor financed salaries which are not recorded as expenses and grant revenue in the financial statements of the BPK.

#### **Currency of presentation**

Up until 31 December 2002, the financial statements of the BPK were presented in the official currency of the territory of Kosovo, the German Mark ("DEM") being then the measurement and reporting currency in the territory of Kosovo. In accordance with UNMIK regulation No.1999/4 the Euro ("EUR") was adopted as one of the official currencies in Kosovo from January 1, 2002 and consequently DEM denominated amounts were converted into EUR as at January 1, 2002 using the irrevocable fixed exchange rate of EUR 1 = DEM 1.95583. From January 1, 2002 BPK's books and records are maintained in EUR.

#### **Basis of accounting**

The BPK maintains its accounting records in accordance with the generally accepted accounting practices in the United Nations administered territory of Kosovo and prepares its financial statements in accordance with International Financial Reporting Standards ("IFRS").

The financial statements of the Bank are prepared on the historical cost convention.

#### **Use of estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates.

#### **Reclassification of comparative amounts**

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

## **Notes to the BPK Financial Statements (continued)**

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### **Interest and commissions**

In these financial statements, interest income and expense is recognised on an accrual basis.

Commission income is credited to income when received and commission expense is debited to expense when paid.

#### **Foreign currency translation**

Transactions denominated in foreign currency are translated into EUR at the BPK's official exchange rate on the date of the transaction.

Foreign currency monetary assets and liabilities are retranslated into EUR at the Bank's official exchange rate on the financial statements reporting period end. Unrealised foreign exchange gains/losses are credited/charged to the statement of income.

The applicable official Bank rates (EUR to the foreign currency unit) for the principal currencies as at December 31 were as follows:

	<u>31 December 2002</u>	<u>31 December 2001</u>
United States dollar ("USD")	0.938	1.060
Swiss franc ("CHF")	0.674	0.661
Pound sterling ("GBP")	1.502	-

#### **Cash and cash equivalents**

For the purpose of the cash flow statement, cash and cash equivalents include cash in hand and current accounts with non-resident banks.

#### **Property, plant and equipment**

Property, plant and equipment are stated at historical cost less accumulated depreciation and provision for impairment when necessary.

## **Notes to the BPK Financial Statements (continued)**

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

If the fair value of an item of property, plant and equipment is lower than its carrying amount, due to circumstances not considered to be temporary, the item of property, plant and equipment is written down to its fair value.

Gains and losses on disposal of property, plant and equipment are recognised in the statement of income in the year of disposal.

Depreciation is provided on all property, plant and equipment based on historic cost. The annual charge for depreciation is computed using the straight-line method using rates specified for each depreciable asset based on estimated useful lives. The estimated useful lives applied during the year ended 31 December 2002 and the period ended 31 December 2001 are:

	<b><u>Depreciation rate per annum</u></b>	<b><u>Useful life</u></b>
Vehicles	20%	5 years
Plant, office and other equipment	20%	5 years
Computer equipment	33.3%	3 years

#### **Grant revenue**

Grants received for the purpose of acquiring property, plant and equipment, or granted property, plant and equipment, are recorded as deferred grant income in the balance sheet and released to grant revenue over the same period as the useful life of the item of property, plant and equipment. Grants received to fund the BPK's expenses are credited directly to grant revenue in the statement of income in the period that the related expenditure took place.

#### **Fiduciary activities**

In certain specific instances the Banking and Payments Authority of Kosovo acts as fiscal agent and paying agent of the Central Fiscal Authority (Ministry of Finance and Economy from 1 January 2003). Assets and income arising from these activities are excluded from these financial statements where the Banking and Payments Authority of Kosovo acts in fiduciary capacity such as nominee or agent.

#### **Fair value of financial instruments**

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by a quoted market price.

## Notes to the BPK Financial Statements (continued)

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

The Banking and Payments Authority of Kosovo's short term assets are carried on the financial statements at cost which approximates their fair value because these instruments have short maturity terms and are convertible into cash and are settled without significant transaction costs.

#### **Taxation and profit allocation**

The Bank is exempt from income tax according to the UNMIK regulation 1999/20 issued on November 15, 1999 (as amended on October 1, 2001) "On the Banking and Payments Authority of Kosovo" and is required by law to pay any balance of its net income directly to the Central Fiscal Authority ("CFA") after allocations to replenish the levels of reserve funds directed by the Governing Board.

#### **General reserve**

In accordance with UNMIK regulation 1999/20 (as amended), each year the BPK shall allocate net income to the general reserve account until the capital and general reserve accounts amount to 5% of the aggregate, amount of the credit balances of all accounts maintained on the books of the Bank by account holders shown on the balance sheet of the BPK for the end of each financial year.

### 3. CURRENT ACCOUNTS WITH NON-RESIDENT BANKS

	<u>31 December 2002</u> (EUR '000)	<u>31 December 2001</u> (EUR '000)
Deutsche Bundesbank	65,028	98,848
Raiffeisen Zentralbank Osterreich AG	77	269
Commerzbank AG	150	246
Den Norske Bank	-	5
Dresdner Bank	<u>66</u>	<u>11</u>
Total	<u>65,321</u>	<u>99,379</u>

Current accounts held with foreign banks are mainly denominated in EUR. Current accounts at 31 December 2002 held at Dresdner Bank bear interest at 1.53%, at Raiffeisen Zentralbank Osterreich AG bear interest at 2.01% (31 December 2001: 2.35%) and at Deutsche Bundesbank bear interest at 1.75% (31 December 2001: 2.25%).

Following the EUR conversion the BPK provided a collateral of DEM 193,329 thousand (being its balance with Deutsche Bundesbank) as guarantee for the equivalent amount of EUR 98,848 thousand as part of the frontloading of EUR banknotes and coins distributed from Deutsche Bundesbank on 8 December 2001 and 20 December 2001. The amount guaranteed expired on 2 January 2002 when the EUR banknotes and coins became legal tender.

## Notes to the BPK Financial Statements (continued)

### 4. DEPOSIT ACCOUNTS WITH NON-RESIDENT BANKS

	<u>31 December 2002</u> (EUR '000)	<u>31 December 2001</u> (EUR '000)
Raiffeisen Zentralbank Osterreich AG	104,378	42,949
Commerzbank AG	48,852	2,045
Dresdner Bank	<u>109,466</u>	<u>1,022</u>
Total	<u>262,696</u>	<u>46,016</u>

### 5. PROPERTY, PLANT AND EQUIPMENT

	<u>Plant and other equipment</u> (EUR '000)	<u>Office equipment</u> (EUR '000)	<u>Computer &amp; software equipment</u> (EUR '000)	<u>Vehicles</u> (EUR '000)	<u>Total property plant &amp; equipment</u> (EUR '000)
<b>COST</b>					
Balance at 1 January 2001	380	58	584	44	1,066
Additions	55	20	113	28	216
Disposals	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance at 31 December 2001	435	78	697	72	1,282
<b>ACCUMULATED DEPRECIATION</b>					
Balance at 1 January 2001	59	6	263	4	332
Charge for the period	81	14	220	14	329
Disposals	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance at 31 December 2001	140	20	483	18	661
<b>NET BOOK VALUE</b>					
Balance at 31 December 2002	<u>295</u>	<u>58</u>	<u>214</u>	<u>54</u>	<u>621</u>
Balance at 31 December 2001	<u>321</u>	<u>52</u>	<u>321</u>	<u>40</u>	<u>734</u>

Property, plant and equipment additions as at 31 December 2002 include EUR 216 thousand (31 December 2001: EUR 244 thousand) of property, plant and equipment purchased from the grant funds received from the Central Fiscal Authority, the United States Assistance in Development (USAID), the European Agency for Reconstruction, the European Union and the Government of Norway.

## Notes to the BPK Financial Statements (continued)

### 6. OTHER DOMESTIC ASSETS

	<u>31 December 2002</u> (EUR '000)	<u>31 December 2001</u> (EUR '000)
Receivables from the Central Fiscal Authority (CFA)	-	305
Prepaid expenses	21	84
Bank licensing fees	15	-
Receivables from the European Agency for Reconstruction (EAR)	-	19
Other assets	-	187
Receivable for duplicate payment	-	67
Inventory consumables	<u>-</u>	<u>15</u>
<b>Total</b>	<b><u>36</u></b>	<b><u>677</u></b>

### 7. DUE TO DOMESTIC BANKS

	<u>31 December 2002</u> (EUR '000)	<u>31 December 2001</u> (EUR '000)
Micro Enterprise Bank	13,319	9,508
New Bank of Kosovo	1,893	723
Private Business Bank	1,193	423
American Bank of Kosovo	2,350	-
Economic Bank of Kosovo	584	88
Credit Bank of Kosovo	450	-
Kasabank	<u>518</u>	<u>-</u>
<b>Total required liquidity reserves</b>	<b><u>20,307</u></b>	<b><u>10,742</u></b>
Micro Enterprise Bank	9,368	137,929
New Bank of Kosovo	7,875	33,595
Private Business Bank	2,659	15,236
American Bank of Kosovo	3,832	10,093
Economic Bank of Kosovo	1,095	6,952
Credit Bank of Kosovo	1,099	4,046
Kasabank	<u>-</u>	<u>600</u>
<b>Total current accounts</b>	<b><u>25,928</u></b>	<b><u>208,451</u></b>
<b>Total</b>	<b><u>46,235</u></b>	<b><u>219,193</u></b>

## Notes to the BPK Financial Statements (continued)

### 7 DUE TO DOMESTIC BANKS *(continued)*

Under BPK supervision regulation Rule XVII commercial banks operating in Kosovo are required to maintain liquidity reserves of 10% total customer deposits. At least half of these reserve balances must be kept in accounts at the BPK. Certain commercial banks at 31 December 2001 were not required to maintain such liquidity reserves as their deposit collection activities at that date were still limited.

The reserve balances in excess of 5%, up to 10%, of total customer deposits bear interest of 1.25% as at 31 December 2002 (1.55% at 31 December 2001). Current account deposits are repayable on demand and are non interest bearing.

### 8. DUE TO GOVERNMENTAL INSTITUTIONS

	<u>31 December 2002</u> (EUR '000)	<u>31 December 2001</u> (EUR '000)
UNMIK	365	2,559
CFA treasury, custom and taxes	258,753	69,536
UNMIK public utilities entities	629	5,074
Due to local governments municipalities	494	2,369
Due to other governmental institutions	<u>8,628</u>	<u>84</u>
<b>Total</b>	<u>268,869</u>	<u>79,622</u>

### 9. DUE TO PUBLIC AND COMMERCIAL ENTITIES

	<u>31 December 2002</u> (EUR '000)	<u>31 December 2001</u> (EUR '000)
Insurance Companies	16,069	10,982
Kosovo Energy Corporation (KEK)	2,080	591
Post and Telecommunications enterprise of Kosovo (PTK)	761	1,255
Non-commercial entities (aid agencies and NGOs)	<u>416</u>	<u>1,657</u>
<b>Total</b>	<u>19,326</u>	<u>14,485</u>

Starting July 2002 current accounts bear interest rates that varied between 1.25% and 1.75% during the year. The interest rate applicable to current accounts as at 31 December 2002 was 1.25%.



## Notes to the BPK Financial Statements (continued)

### 10. OTHER DOMESTIC LIABILITIES

	<u>31 December 2002</u> (EUR '000)	<u>31 December 2001</u> (EUR '000)
Due to Government	384	-
Sundry creditors and accruals	340	868
Foreign transfer suspense account (note a)	-	20,857
Deferred grant revenue (note b)	599	850
Due to the former National Bank of Kosovo (note c)	450	446
Other domestic liabilities	<u>9</u>	<u>118</u>
<b>Total</b>	<u><b>1,782</b></u>	<u><b>23,139</b></u>

**Note a:** The amount of EUR 20,857 thousand at 31 December 2002 relates to transfer payments in favour of BPK customers which were cleared to customer accounts by 9 January 2002.

**Note b:**

	<u>CFA</u> (EUR '000)	CFA Grant Euro <u>conversion</u> (EUR '000)	<u>USAID</u> (EUR '000)	<u>European Union</u> (EUR '000)	<u>Government of Norway</u> (EUR '000)	<u>EAR</u> (EUR '000)	<u>Total</u> (EUR '000)
<b>Deferred grant revenue at 31 December 2001</b>	332	204	40	95	65	114	850
Grant funds received in the year	1,419	1,116	55	-	-	19	2,609
Transfer to grant revenue	<u>(1,469)</u>	<u>(1,226)</u>	<u>(35)</u>	<u>(60)</u>	<u>(50)</u>	<u>(20)</u>	<u>(2,860)</u>
<b>Deferred grant revenue at 31 December 2002</b>	<u><b>282</b></u>	<u><b>94</b></u>	<u><b>60</b></u>	<u><b>35</b></u>	<u><b>15</b></u>	<u><b>113</b></u>	<u><b>599</b></u>

**Note c:** The amount due to the former National Bank of Kosovo relates to cash balances in various currencies belonging to that entity which were physically on hand at the inception of the Bank. These balances were converted into DEM on 22 December 2000, physically transferred to Commerzbank AG in Frankfurt and included in the BPK's current account balance at that entity.

## Notes to the BPK Financial Statements (continued)

### 11. STATUTORY FUND

In accordance with UNMIK regulation 1999/20 'On the Banking and Payments Authority of Kosovo' the capital of the BPK totalling DEM 5,000 thousand (EUR 2,556 thousand) was contributed by the Central Fiscal Authority on 31 March 2000.

### 12. RESERVE FUND

The reserve fund was created during the period to 31 December 2000, in accordance with UNMIK regulation 1999/20 and the Governing Board of the Bank's decision. Transfer of EUR 3,437 thousand was made in year 2002.

### 13. OTHER OPERATING INCOME

	<u>Year ended</u> <u>31 December 2002</u> (EUR '000)	<u>Year ended</u> <u>31 December 2001</u> (EUR '000)
Bank licensing fees	346	80
Rental income	16	19
Other	<u>7</u>	<u>26</u>
<b>Total</b>	<u><b>369</b></u>	<u><b>125</b></u>

### 14. STAFF COST

Staff costs consist largely of employee salaries. As at 31 December 2002, the Bank had 132 employees (31 December 2001: 377 employees).

## Notes to the BPK Financial Statements (continued)

### 15. GENERAL AND ADMINISTRATIVE EXPENSES

	<u>Year ended</u> <u>31 December 2002</u> (EUR '000)	<u>Year ended</u> <u>31 December 2001</u> (EUR '000)
Security and cash transportation expenses	3,258	1,675
Euro conversion expense	369	393
Repairs and maintenance	176	188
Audit and consulting expense	157	171
Communication expenses (telephone, telex and internet)	152	82
Utilities	122	128
Travel and transportation	199	183
Vehicle operating expenses	56	36
Stores and stationery	90	69
Software license	49	36
Computer expenses	35	36
Other	<u>112</u>	<u>55</u>
<b>Total</b>	<u><b>4,775</b></u>	<u><b>3,052</b></u>

### 16. RELATED PARTY TRANSACTIONS

Related parties consist of UNMIK and those entities it directly owns or over which it exerts significant influence. Such entities include the Central Fiscal Authority (CFA), the Kosovo Energy Corporation (KEK) and the Post and Telecommunications enterprise of Kosovo (PTK). Significant balances with related parties have been separately disclosed in these financial statements.

### 17. INTEREST RATE RISK

The table below summarises the effective interest rates for monetary financial instruments as of 31 December 2002:

	<u>31 December 2002</u>
Current accounts non-resident banks	2.30%
Term deposits non-resident banks	2.92%
Due to domestic banks	1.25%
Due to governmental institutions	1.25%
Due to public and commercial entities	1.25%
Insurance institutions	2.67%

## **Notes to the BPK Financial Statements (continued)**

### 18. RISK MANAGEMENT

Through its normal operations, the Bank is exposed to a number of risks, the most significant of which are currency, operating, credit, interest rate, and liquidity risks. The structure of the BPK's assets and liabilities is primarily determined by the nature of the Bank's statutory functions, rather than commercial considerations. At the same time the BPK continually manages its exposure to risk, through a variety of risk management techniques. Risk management of the BPK is regulated by its internal instructions, and is closely monitored by the Governing Board of the BPK.

Operating risk is the risk of loss arising from the breakdown of internal controls. The BPK manages this risk through the Internal Audit Department of the Bank, which exercises control over accounting policies and procedures and the effective functioning of the system of internal controls of the BPK.

#### **Interest rate risk**

The BPK is exposed to interest rate price risk in domestic and foreign markets, principally as a result of investing international foreign exchange reserves at fixed interest rates, in amounts and for periods which differ from those of term deposits and other borrowed funds.

#### **Liquidity risk**

Liquidity risk is defined as the risk of loss arising due to the mismatch of the maturities of assets and liabilities. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the BPK and its exposure to changes in interest and exchange rates.

#### **Credit risk**

The BPK takes on exposure to credit risk which is the risk that a counterparty will be unable to pay amounts in full when due. The BPK's maximum exposure to credit risk, excluding the value of collateral, is generally reflected in the carrying value of financial assets. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

*Management of credit risk.* Credit risk on transactions with currency reserves is managed through the approval of transactions and placements of funds, the establishment of limits restricting risk and constant monitoring of positions. Counterparty limits are set based on credit ratings and are subject to regular review.

#### **Currency risk**

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates.

## Notes to the BPK Financial Statements (continued)

### 18 RISK MANAGEMENT *(continued)*

The table below analyses assets and liabilities of the BPK into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date, as of 31 December 2002:

	<u>Up to 1 month</u> (EUR '000)	<u>1 to 3 months</u> (EUR '000)	<u>3 months to 1 year</u> (EUR '000)	<u>1 to 5 years</u> (EUR '000)	<u>Total</u> (EUR '000)
<b>Assets</b>					
Cash on hand	17,474	-	-	-	17,474
Current accounts non- resident banks	65,321	-	-	-	65,321
Deposit accounts with non- resident banks	212,617	48,560	1,519	-	262,696
Property and equipment	-	-	-	621	621
Other assets	<u>36</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>36</u>
<b>Total assets</b>	<u>295,448</u>	<u>48,650</u>	<u>1,519</u>	<u>621</u>	<u>346,148</u>
<b>Liabilities</b>					
Due to domestic banks	46,235	-	-	-	46,235
Due to governmental institutions	268,869	-	-	-	268,869
Due to public and commercial entities	12,698	5,112	1,516	-	19,326
Other liabilities	<u>1,782</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,782</u>
<b>Total liabilities</b>	<u>329,584</u>	<u>5,112</u>	<u>1,516</u>	<u>-</u>	<u>336,212</u>
<b>Net liquidity gap</b>	<u>(34,136)</u>	<u>43,448</u>	<u>3</u>	<u>621</u>	<u>9,936</u>

### 19. COMMITMENTS AND CONTINGENCIES

#### **General claims**

From time to time and in the normal course of business, claims against the BPK are received from its partners. The Management resists such claims and considers that no material losses will be incurred.

#### **Legal proceedings**

As at 31 December 2002, the Banking and Payments Authority of Kosovo was not engaged in any material litigation proceedings.

#### **Credit related commitments**

As at 31 December 2002, there were no outstanding credit related commitments.

## BPK Regulations and Rules

**REGULATION NO. 2001/24** - AMENDING UNMIK REGULATION NO. 1999/20 ON THE BANKING AND PAYMENTS AUTHORITY OF KOSOVO

**REGULATION NO. 1999/21** – ON BANK LICENSING, SUPERVISION AND REGULATION

**REGULATION NO. 2001/25** – ON LICENSING, SUPERVISION AND REGULATION OF INSURANCE COMPANIES AND INSURANCE INTERMEDIARIES

**REGULATION NO. 2001/35** – ON PENSIONS IN KOSOVO

### **Other Relevant Regulations and Administrative Directions**

**ADMINISTRATIVE DIRECTION NO. 2001/24** – AMENDING ADMINISTRATIVE DIRECTION NO. 1999/2 IMPLEMENTING UNMIK REGULATION NO. 1999/4 ON THE CURRENCY PERMITTED TO BE USED IN KOSOVO

## BPK Prudential Rules:

Number	Description
I	<i>On Capital Adequacy</i>
II	<i>On Credit Concentrations</i>
III	<i>On Real Estate and Fixed Assets Holdings Limitations</i>
IV	<i>On Liquid Assets Holdings</i>
V	<i>On Large Exposures</i>
VI	<i>On Licensing of and Restrictions on Branches of Foreign Banks</i>
VII	<i>On Foreign Exchange Activities</i>
VIII	<i>On the Governance of Banks</i>
IX	<i>On Bank Assets Classifications, Provisioning and Non-Accruals</i>
X	<i>On Money Laundering</i>
XI	<i>On Reporting of Banks</i>
XII	<i>On Record Retention</i>
XIII	<i>On Principal Shareholders and Others Who Control Banks</i>
XIV	<i>On Licensing and Supervision of Micro Finance Institutions</i>
XV	<i>On Translated Version of Rules and Orders</i>
XVI	<i>On Licensing and Supervision of Foreign Exchange Offices &amp; Money Transfer Services</i>
XVII	<i>On Minimum Required Liquidity Reserves</i>
XVIII	<i>On Clearing and Operation of Settlement Accounts</i>
XIX	<i>On Kosovo Bank Account Numbering System</i>
XX	<i>On Credit Restrictions</i>
XXI	<i>On Increase in Minimum Capital of Banks</i>
XXII	<i>On Changes in Bank Equity Capital Accounts</i>

## The Insurance Rules of Kosovo:

Number	Description
1	<i>Definition, Interpretation and General Rules of Insurance</i>
2	<i>General Insurance Classes Recognised by the BPK</i>
3	<i>Compulsory Motor Vehicle Third Party Liability Insurance</i>
4	<i>Licensing of Insurance Companies</i>
5	<i>Licensing of Insurance Intermediaries</i>
5 S	<i>Supplementary on Licensing of Other Insurance Intermediaries</i>
5 A	<i>Licensing of Insurance Adjusters/Surveyors</i>
5 B	<i>Licensing of Surplus Lines Brokers</i>
5 C	<i>Licensing of Reinsurance Brokers</i>
6	<i>Financial Requirements of Insurance Intermediaries</i>
7	<i>Accounting Standards and Record-keeping Requirements</i>
8	<i>Required Minimum Capital and Margin of Solvency</i>
9	<i>Part I, Reserve Requirements for General Insurance Companies</i>
9 A	<i>Part II, Reserve Requirement for Life Insurance Companies</i>
10	<i>Limitation on Net Premium Written</i>
11	<i>Limitation of Company's Exposure to a Single Insurable Event</i>
12	<i>Part I, Assets and Liabilities, Liquidity and Matching</i>
12A	<i>Part II, Investment of Assets</i>
13	<i>Valuation of Assets, Methodology</i>
14	<i>Credit Allowed for Reinsurance</i>
15	<i>Changes to the Business Plan</i>
16	<i>Reinsurance</i>
17	<i>Derivative Financial Products</i>
18	<i>Affiliation and Outsourcing Contracts</i>
19	<i>Maintenance of Assets in Kosovo</i>
20	<i>Restrictions on Non-insurance Related Activities</i>
21	<i>Insurance Related Activities</i>
22	<i>Additional Requirements to be included in the Engagement Letter of External Auditors</i>
23	<i>Financial Reporting</i>
24	<i>Corporate Governance</i>
25	<i>Written Investment Policies and Procedures</i>
26	<i>Internal Controls</i>
27	<i>Related Party Transactions</i>
28	<i>Establishment of Arbitration Forum</i>
29	<i>Selling Insurance Via the Internet</i>
30	<i>Determination of Validity and Amount of Claims, Priority of Claims</i>



## BPK Rules on Pensions

Number	Description
1	<i>on Licensing of Supplementary Employer Pension Funds</i>
2	<i>on Licensing of Supplementary Individual Pensions</i>
3	<i>on Transitional Licensing of Supplementary Employer Pension Funds and Supplementary Individual Pensions</i>
4	<i>on Licensing of Assets Manager of Pension Assets</i>
5	<i>on Reports and Other Information Required to be Submitted by the Kosovo Pension Savings Trust</i>
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# Appendices

## Glossary of Terms

<b>BPK</b>	Banking and Payments Authority
<b>CFA</b>	Central Fiscal Authority
<b>CSK</b>	Customs Service of Kosovo
<b>ECB</b>	European Central Bank
<b>FDI</b>	Foreign Direct Investment
<b>FRY</b>	Federal Republic of Yugoslavia
<b>GDP</b>	Gross Domestic Product
<b>GNP</b>	Gross National Product
<b>IAS</b>	International Accounting Standards
<b>ICS</b>	Interbank Clearing System
<b>IMF</b>	International Monetary Fund
<b>IPAC</b>	Interbank Payment Advisory Committee
<b>KCB</b>	Kosovo Consolidated Budget
<b>KTA</b>	Kosovo Trust Agency
<b>LSMS</b>	Living Standards Measurement Survey
<b>MFE</b>	Ministry of Finance and Economy
<b>MFI</b>	Micro Finance Institution
<b>OECD</b>	Organisation for Economic Cooperation and Development
<b>PIP</b>	Public Investment Program
<b>PISG</b>	Provisional Institutions of Self Government
<b>PPI</b>	Producer Price Index
<b>SOE</b>	Socially Owned Enterprise
<b>SOK</b>	Statistical Office of Kosovo
<b>UNMIK</b>	United Nations Interim Administration Mission in Kosovo
<b>USAID</b>	United States Agency for International Development

## Statistical Data

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**Table 1**  
**Monetary Survey**

(‘000 EUR)

Description	2000	2001	2002			
	Q4	Q4	Q1	Q2	Q3	Q4
<b>Net foreign assets</b>	<b>678,101</b>	<b>958,678</b>	<b>900,560</b>	<b>946,435</b>	<b>1,087,793</b>	<b>1,109,623</b>
Currency in circulation <sup>1</sup>	536,229	366,578	385,216	403,854	422,492	441,130
BPK	61,697	296,051	193,113	247,461	344,459	345,589
Assets	61,697	296,235	193,297	247,646	344,643	345,773
Liabilities	0	184	184	184	184	184
Commercial banks	80,175	296,050	322,231	295,120	320,842	322,904
Assets	83,099	301,095	327,335	298,120	325,271	328,322
Liabilities	2,924	5,045	5,104	3,000	4,429	5,418
<b>Net domestic assets</b>	<b>-52,612</b>	<b>-109,760</b>	<b>-129,768</b>	<b>-166,466</b>	<b>-276,557</b>	<b>-248,683</b>
Net claims on the government	-8,741	-72,066	-120,239	-165,417	-270,856	-258,917
Claims	0	0	0	0	0	0
Deposits	8,741	72,066	120,239	165,417	270,856	258,917
Net claims on other public sector	-32,378	-10,885	-16,167	-17,547	-10,009	-4,245
Net claims on financial institutions	0	-11,087	-13,075	-12,946	-15,711	-24,619
Loans to the private sector	3,148	25,135	46,476	57,700	66,231	83,976
Other items net	-14,642	-40,857	-26,764	-28,256	-46,213	-44,878
BPK	-4,826	-28,109	-7,620	-8,301	-10,481	-11,586
Commercial banks	-9,816	-12,749	-19,143	-19,955	-35,732	-33,292
<b>Broad money</b>	<b>625,489</b>	<b>848,918</b>	<b>770,792</b>	<b>779,969</b>	<b>811,236</b>	<b>860,940</b>
Currency in circulation	536,229	366,578	385,216	403,854	422,492	441,130
Private sector's deposits	89,260	482,340	385,576	376,115	388,744	419,810
Current account-enterprises	0	138,441	120,260	132,432	147,860	166,576
Current account-individuals	89,260	205,604	134,626	121,411	115,908	115,161
Terms and saving account-enterprises	0	31,158	22,831	22,435	20,155	25,568
Terms and saving account-individuals	0	107,138	107,859	99,837	104,821	112,505

<sup>1</sup> Based only on cash export and import by BPK and commercial banks

**Figure 1**  
**Monetary Aggregates** (‘000 EUR)

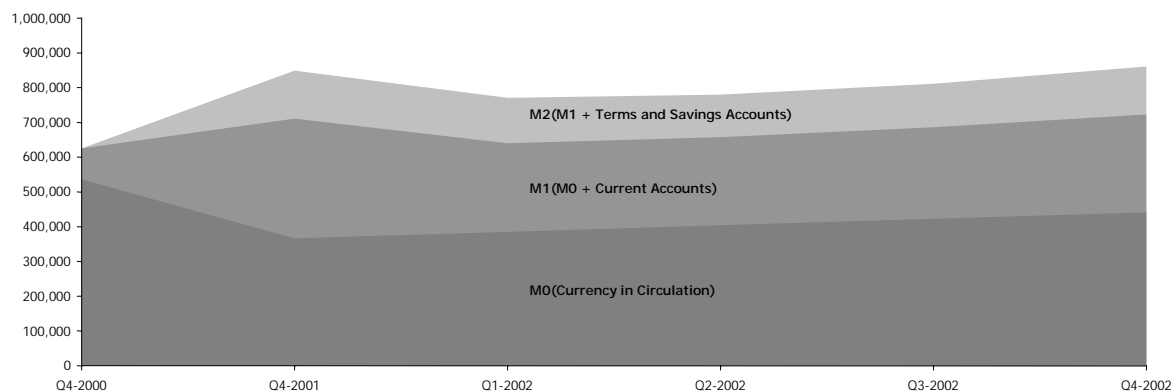


Table 2

## BPK's Survey

('000 EUR)

Description	2000	2001	2002			
	Q4	Q4	Q1	Q2	Q3	Q4
<b>Net foreign assets</b>	<b>597,926</b>	<b>662,628</b>	<b>578,329</b>	<b>651,315</b>	<b>766,951</b>	<b>786,719</b>
Currency in circulation <sup>1</sup>	536,229	366,578	385,216	403,854	422,492	441,130
Assets	61,697	296,235	193,297	247,646	344,643	345,773
Cash	15,828	249,685	47,808	31,098	37,122	17,474
Deposits in foreign banks	45,869	46,550	145,489	216,548	307,521	328,299
Liabilities	0	184	184	184	184	184
Deposits of non-residents		184	184	184	184	184
<b>Net domestic assets</b>	<b>-45,944</b>	<b>-122,147</b>	<b>-157,101</b>	<b>-204,211</b>	<b>-307,056</b>	<b>-299,367</b>
Net claims on the government	-8,741	-72,066	-120,239	-165,417	-270,856	-258,917
Claims	0	0	0	0	0	0
Central government Deposits	8,741	72,066	120,239	165,417	270,856	258,917
Net claims on the rest of the public sector	-32,378	-10,885	-16,167	-17,547	-10,009	-4,245
UNMIK deposit accounts	9,581	2,581	3,753	2,267	1,698	363
Public nonfin. Corporations deposits	22,796	6,959	11,426	14,384	7,879	3,467
Other Nonfinancial deposits	n/a	1,346	988	896	433	415
Net claims on financial institutions	0	-11,087	-13,075	-12,946	-15,711	-24,619
Insurance Companies	n/a	10,562	12,804	12,729	14,151	15,999
Pension Funds	n/a	0	0	0	1,560	8,620
Other financial institutions	n/a	525	271	217	0	0
Other items net	-4,826	-28,109	-7,620	-8,301	-10,481	-11,586
of which: shareholders'equity	4,925	4,727	4,779	4,779	7,130	10,560
<b>Base money</b>	<b>551,982</b>	<b>540,482</b>	<b>421,228</b>	<b>447,104</b>	<b>459,895</b>	<b>487,352</b>
Currency in circulation	536,229	366,578	385,216	403,854	422,492	441,130
Banks deposits	15,753	173,904	36,012	43,250	37,403	46,222

<sup>1</sup> Based only on cash export and import by BPK and commercial banks

Table 3

## Commercial Banks Survey

(000 EUR)

Description	2000	2001	2002			
	Q4	Q4	Q1	Q2	Q3	Q4
<b>Net foreign assets</b>	<b>80,175</b>	<b>296,050</b>	<b>322,231</b>	<b>295,120</b>	<b>320,842</b>	<b>322,904</b>
Assets	83,099	301,095	327,335	298,120	325,271	328,322
Cash	11,671	88,342	41,723	46,963	49,002	35,597
Deposits in foreign banks	65,214	179,514	245,611	222,445	227,366	275,360
Non-interest bearing deposits	6,215	33,239	40,001	28,712	48,903	17,365
Liabilities	2,924	5,045	5,104	3,000	4,429	5,418
<b>Net domestic assets</b>	<b>9,085</b>	<b>186,290</b>	<b>63,345</b>	<b>80,995</b>	<b>67,902</b>	<b>96,906</b>
Claims on the private sector	3,148	25,135	46,476	57,700	66,231	83,976
gross loans	3,148	25,916	47,555	59,048	68,247	86,498
provision	0	781	1,079	1,348	2,016	2,522
Deposits at BPK	15,753	173,904	36,012	43,250	37,403	46,222
Other items net	-9,816	-12,749	-19,143	-19,955	-35,732	-33,292
of which: shareholders' equity	6,152	20,435	24,038	28,240	32,976	33,244
<b>Liabilities to the private sector</b>	<b>89,260</b>	<b>482,340</b>	<b>385,576</b>	<b>376,115</b>	<b>388,744</b>	<b>419,810</b>
Current account-enterprises	0	138,441	120,260	132,432	147,860	166,576
Current account-individuals	89,260	205,604	134,626	121,411	115,908	115,161
Terms and saving account-enterprises	0	31,158	22,831	22,435	20,155	25,568
Terms and saving account-individuals	0	107,138	107,859	99,837	104,821	112,505

**Table 4**

**BPK cash operations-deposits by main accounts,** flow data

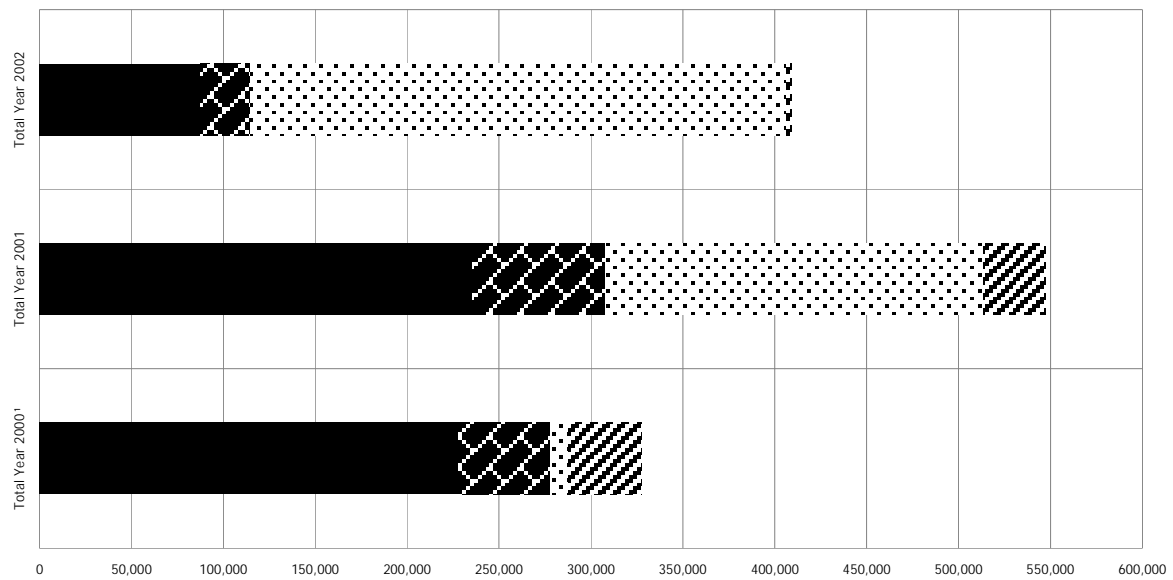
(‘000 EUR)

Period	Government Agencies	Public Utilities	Banks and other fin. Institutions	Insurance Companies	Enterprises	NGO-s	Donor Agencies	Total Deposits
Total Year 2000 <sup>1</sup>	227,810	50,349	9,790	5,468	16,313	10,878	7,149	327,757
Total Year 2001	235,199	72,761	205,642	18,654	6,887	3,281	4,826	547,250
2002 Q1	71,064	8,345	89,664	775	0	331	139	170,318
2002 Q2	8,926	9,595	42,310	606	0	99	4	61,540
2002 Q3	4,808	4,758	92,112	301	0	74	0	102,053
2002 Q4	2,542	4,677	67,570	339	0	104	0	75,232
Total Year 2002	87,340	27,375	291,656	2,021	0	608	143	409,143

Note: This table represents deposits made only by BPK costumers. Thus, the total figure has meaning only when it is compared with the total of withdrawals (table 5) and net transfers (table 6).

**Figure 2**

**Deposits by main accounts,** (‘000 EUR)



<sup>1</sup>Data available since June 2000.

**Table 5**

**BPK cash operations-withdrawals by main accounts,** flow data

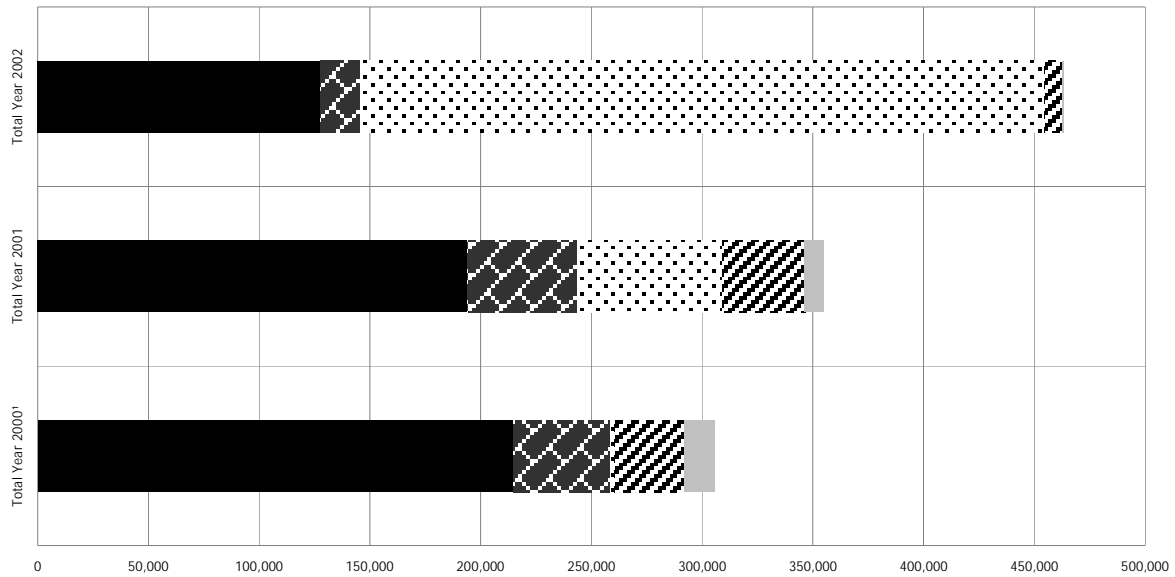
(‘000 EUR)

Period	Government Agencies	Banks and other fin. Institutions	Public Utilities	Donor Agencies	NGO-s	Enterprises	Insurance Companies	Total Withdrawals	
Total Year 2000 <sup>1</sup>	214,924	2,124	43,554	82,756	31,284	12,238	1,408	<b>388,288</b>	
Total Year 2001	193,832	65,351	49,883	150,047	37,299	5,170	3,504	<b>505,086</b>	
2002	Q1	61,759	114,807	7,767	19,346	1,718	0	264	<b>205,661</b>
	Q2	25,137	81,607	4,005	6,844	1,480	0	438	<b>119,511</b>
	Q3	21,614	46,888	2,669	0	3,219	0	0	<b>74,390</b>
	Q4	19,378	65,714	3,258	0	1,468	0	0	<b>89,818</b>
Total Year 2002	127,888	309,016	17,699	26,190	7,885	0	702	<b>489,380</b>	

Note: This table represents withdrawals made only by BPK costumers. The total sum has meaning only if it is compared with the total of deposits (table 4) and the net transfers (table 6).

**Figure 3**

**Withdrawals by main accounts,** (‘000 EUR)



<sup>1</sup>Data available since June 2000.



**Table 6**

**BPK non-cash operations: net transfers by main accounts**

(‘000 EUR)

Period		Government Agencies	Public Utilities	Banks and Other Fin. Institutions	Insurance Companies	Enterprises	NGO-s	Donor Agencies	Net Transfers <sup>1</sup>
2002	Q1	133,931	10,904	61,468	12,294	0	3,076	0	221,673
	Q2	65,891	-1,955	46,505	-244	0	1,285	0	111,483
	Q3	123,239	-8,593	-51,263	1,121	0	682	0	65,185
	Q4	10,624	-5,830	6,982	1,510	0	1,348	0	14,634
Total Year 2002		333,686	-5,474	63,692	14,681	0	6,391	0	412,975

Note: <sup>1</sup>Incoming less outgoing transactions through main accounts at the BPK.

**Figure 4**

**BPK non-cash operations - net transfers by main accounts, (‘000 EUR)**

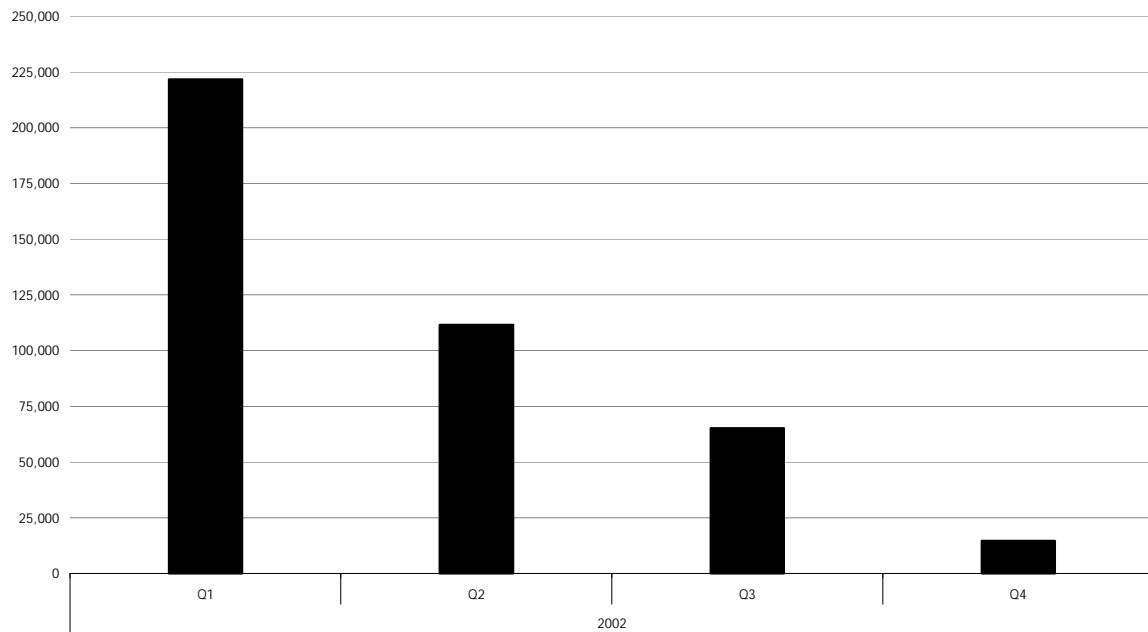


Table 7

BPK cash vaults, stock data

('000' EUR)

Period	TOTAL	Euro	DEM & Other Currencies <sup>1</sup>
<u>2000</u>			
Nov	15,385	0	15,385
Dec	15,828	0	15,828
<u>2001</u>			
Jan	29,267	0	29,267
Feb	19,595	0	19,595
Mar	25,883	0	25,883
Apr	21,207	0	21,207
May	29,914	0	29,914
Jun	26,139	0	26,139
Jul	35,431	0	35,431
Aug	39,801	0	39,801
Sep	47,451	0	47,451
Oct	21,885	0	21,885
Nov	23,184	0	23,184
Dec <sup>2</sup>	249,685	0	249,685
<u>2002</u>			
Jan <sup>2</sup>	193,689	76,159	117,530
Feb <sup>2</sup>	115,094	49,584	65,545
Mar	47,808	41,474	6,334
Apr	49,670	44,519	5,151
May	41,060	35,907	5,152
Jun	31,098	25,945	5,153
Jul	33,493	33,282	211
Aug	30,832	30,628	205
Sep	37,122	36,916	206
Oct	36,360	36,158	201
Nov	35,930	35,728	202
Dec	17,474	17,288	186

<sup>1</sup>DEM available in the BPK vaults up to June 2002, <sup>2</sup> Euro conversion effect

Figure 5

BPK vault cash flow, ('000 EUR)

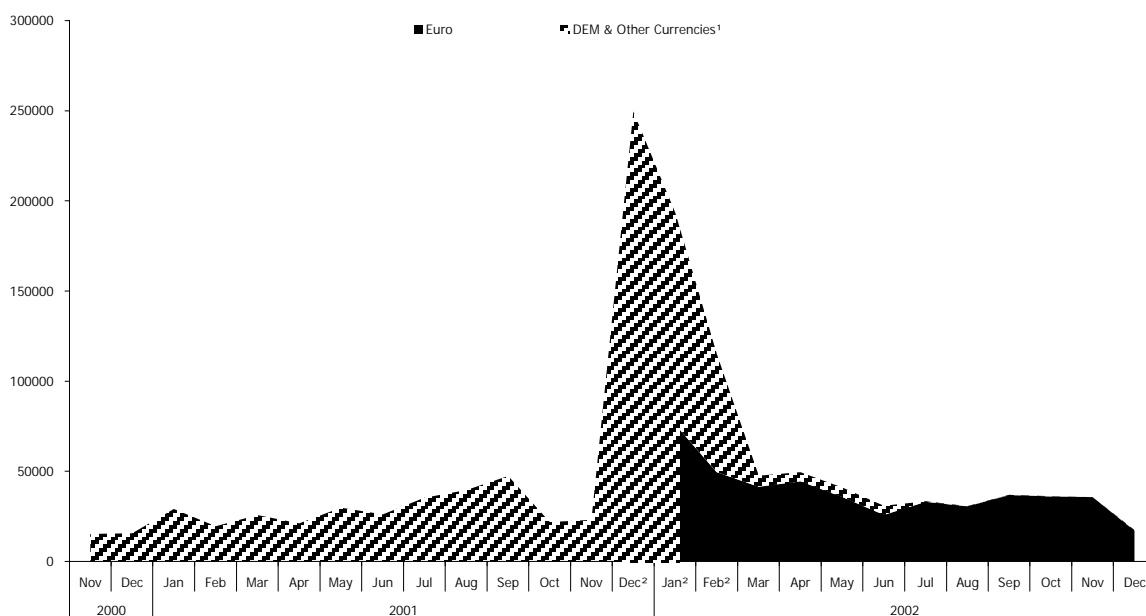


Table 8

## Balance sheet of commercial banks

('000 EUR)

DESCRIPTION	2000	2001	2002			
	Q4	Q4	Q1	Q2	Q3	Q4
<b>ASSETS</b>						
Cash	11,671	88,342	41,723	46,963	49,002	35,597
Balance with BPK	13,700	176,793	35,929	45,048	37,454	45,740
Bearing current account with other Banks	6,215	33,239	40,001	28,712	48,903	17,365
Loans to financial institutions(placement)	65,214	179,514	245,611	222,445	227,366	275,360
Securities	0	7,498	7,498	7,599	103	0
Gross loans to non-financial institutions	3,148	25,916	47,555	59,048	68,247	86,498
Less: Provisions for loan losses	0	781	1,079	1,348	2,016	2,522
Net loans	3,148	25,135	46,476	57,700	66,231	83,976
Property and equipment, net of depreciation	441	4,544	5,568	7,096	8,369	9,498
Interest receivable and other assets	2,576	3,920	2,247	4,797	3,667	3,657
<b>Total</b>	<b>102,964</b>	<b>518,985</b>	<b>425,053</b>	<b>420,360</b>	<b>441,095</b>	<b>471,193</b>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>						
Customer deposits	89,260	482,340	385,576	376,115	388,744	419,810
Current account-enterprises	0	138,441	120,260	132,432	147,860	166,576
Current account-individuals	89,260	205,604	134,626	121,411	115,908	115,161
Terms and saving account-enterprises	0	31,158	22,831	22,435	20,155	25,568
Terms and saving account-individuals	0	107,138	107,859	99,837	104,821	112,505
Borrowings	2,924	5,045	5,104	3,000	4,429	5,418
Ineterest payable and other liabilities	8,371	11,165	10,333	10,960	12,901	11,430
Subordinated debts	0	0	2	2,045	2,045	1,291
Shareholder's equity	6,152	20,435	24,038	28,240	32,976	33,244
<b>Total</b>	<b>102,964</b>	<b>518,985</b>	<b>425,053</b>	<b>420,360</b>	<b>441,095</b>	<b>471,193</b>
<b>OFF BALANCE SHEET COMMITMENTS</b>						
1. Direct credit substitutes(guaranties and standby letters of credit )	184	1,961	4,562	7,997	9,091	9,289
2. Transaction related contingencies	0	0	55	0	0	0
3. Loan commitments	5,778	0	0	239	726	52
4. Interest and foreign exchange rate related items including swaps,options and futures	0	0	0	0	0	0
<b>Total</b>	<b>5,962</b>	<b>1,961</b>	<b>4,617</b>	<b>8,236</b>	<b>9,817</b>	<b>9,341</b>

Figure 6

Cash, net loans and customer deposits at the commercial banks, ('000 EUR)

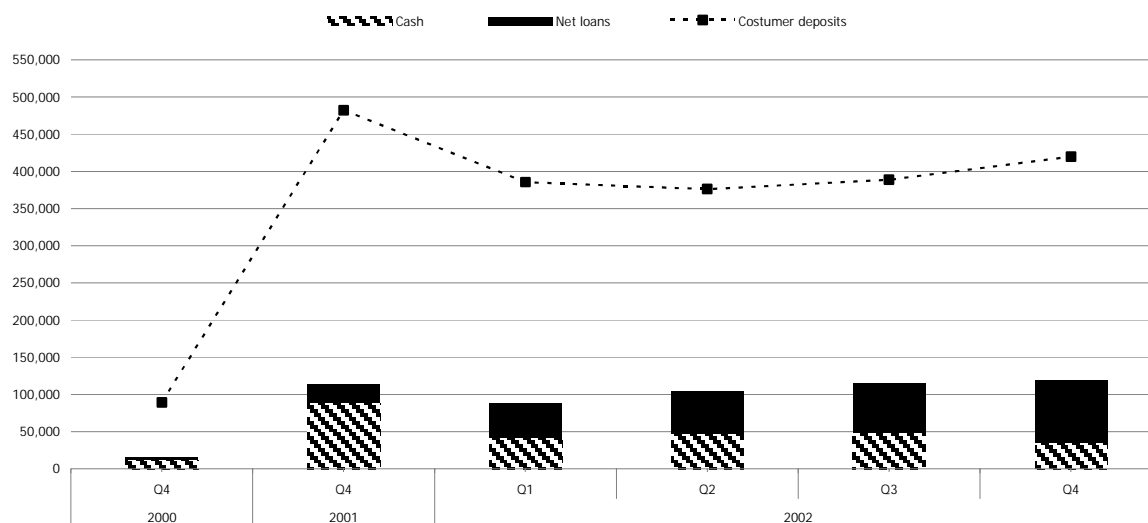


Table 9

## Income statement of commercial banks

('000 EUR)

Description	2000	2001	2002			
	Q4	Q4	Q1	Q2	Q3	Q4
<b>Income</b>						
<b>Interest income</b>	<b>1,829</b>	<b>7,179</b>	<b>2,965</b>	<b>7,194</b>	<b>12,225</b>	<b>17,818</b>
Loans	0	2,150	1,314	3,404	6,174	9,373
Placement with banks	0	5,029	1,598	3,675	5,801	8,257
Securities	0	0	53	115	250	188
<b>Non-interest income</b>	<b>5,274</b>	<b>9,402</b>	<b>3,804</b>	<b>6,888</b>	<b>9,893</b>	<b>14,034</b>
Fees and commissions	5,274	9,212	3,424	6,099	9,252	13,194
Other operating income	0	190	380	789	641	840
<b>Total income</b>	<b>7,104</b>	<b>16,581</b>	<b>6,769</b>	<b>14,082</b>	<b>22,118</b>	<b>31,852</b>
<b>Expenditures</b>						
<b>Interest expenditures<sup>1</sup></b>	<b>207</b>	<b>1,312</b>	<b>1,010</b>	<b>1,879</b>	<b>2,756</b>	<b>3,470</b>
Deposits	207	855	719	1,707	2,488	3,102
Borrowings	0	458	291	172	268	368
<b>Non-interest expenditures</b>	<b>338</b>	<b>1,507</b>	<b>629</b>	<b>1,738</b>	<b>3,491</b>	<b>5,792</b>
Provision for losses on loans (placement)	166	616	181	763	1,883	3,282
Depreciation on fixed assets	172	891	448	975	1,608	2,510
<b>General and administrative expenses</b>	<b>2,707</b>	<b>7,271</b>	<b>3,755</b>	<b>7,668</b>	<b>12,695</b>	<b>19,130</b>
<b>Total expenditures</b>	<b>3,252</b>	<b>10,090</b>	<b>5,394</b>	<b>11,285</b>	<b>18,942</b>	<b>28,392</b>
<b>Net income</b>						
<b>Net operating income</b>	<b>3,852</b>	<b>6,491</b>	<b>1,375</b>	<b>2,797</b>	<b>3,176</b>	<b>3,460</b>
Net gains/losses from dealing securities	0	0	0	0	0	0
Net gains/losses from dealing in foreign exchange	577	699	229	348	459	509
Net gains losses from foreign currency revaluations	33	-19	8	-58	44	53
<b>Net income from banking activities before taxes</b>	<b>4,462</b>	<b>7,172</b>	<b>1,612</b>	<b>3,087</b>	<b>3,679</b>	<b>4,022</b>
Provision from taxes	610	456	137	431	919	1,306
<b>Net profit / loss for period</b>	<b>3,852</b>	<b>6,716</b>	<b>1,475</b>	<b>2,656</b>	<b>2,760</b>	<b>2,716</b>
Less: dividends	2,300	5,260	-1	0	0	2,118
<b>Retained profit for period</b>	<b>1,552</b>	<b>1,457</b>	<b>1,476</b>	<b>2,656</b>	<b>2,760</b>	<b>598</b>

Figure 7

## Commercial banks income and expenditure, ('000 EUR)

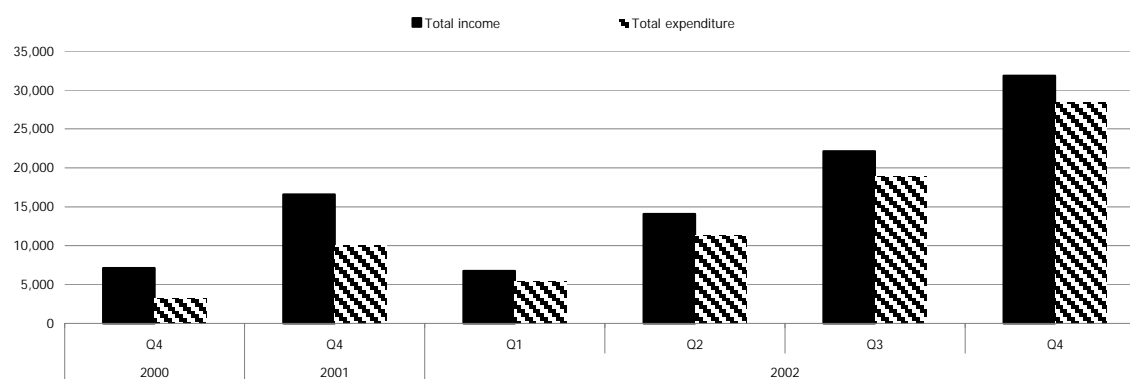


Table 10

## Commercial banks deposits

('000 EUR)

DESCRIPTION	2000	2001	2002			
	Q4	Q4	Q1	Q2	Q3	Q4
<b>Residents</b>						
Individuals	22,792	297,146	234,383	216,297	209,982	222,669
Time deposits	0	93,471	96,165	89,123	91,543	104,359
Sight deposits	0	203,676	138,218	127,174	118,439	118,310
Legal entities	55,990	157,814	132,156	143,548	161,972	179,607
Time deposits	0	31,318	23,423	22,116	25,879	23,921
Sight deposits	0	126,496	108,733	121,432	136,093	155,686
Banks	0	0	0	0	0	0
Time deposits	0	0	0	0	0	0
Sight deposits	0	0	0	0	0	0
<b>Total</b>	<b>78,782</b>	<b>454,960</b>	<b>366,539</b>	<b>359,845</b>	<b>371,954</b>	<b>402,276</b>
<b>Nonresidents</b>						
Individuals	1,742	4,844	5,680	5,035	4,706	5,401
Time deposits	0	1,549	1,656	1,540	1,617	1,977
Sight deposits	0	3,296	4,024	3,495	3,089	3,124
Legal entities	7,973	9,039	11,048	12,501	13,294	12,433
Time deposits	13	28	118	28	28	1,028
Sight deposits	7,975	9,011	10,930	12,473	13,266	11,405
Banks	0	0	0	0	0	0
Time deposits	0	0	0	0	0	0
Sight deposits	0	0	0	0	0	0
<b>Total</b>	<b>9,715</b>	<b>13,884</b>	<b>16,728</b>	<b>17,536</b>	<b>18,000</b>	<b>17,534</b>
<b>Total (Residents + Nonresidents)<sup>1</sup></b>	<b>88,496</b>	<b>468,844</b>	<b>383,267</b>	<b>377,381</b>	<b>389,954</b>	<b>419,810</b>

Note: <sup>1</sup> Data in this table are not consistent with the data from the balance sheet of commercial banks due to the amount of deposits in process excluded/included in total deposits.

Figure 8

## Commercial banks deposits , ('000 EUR)

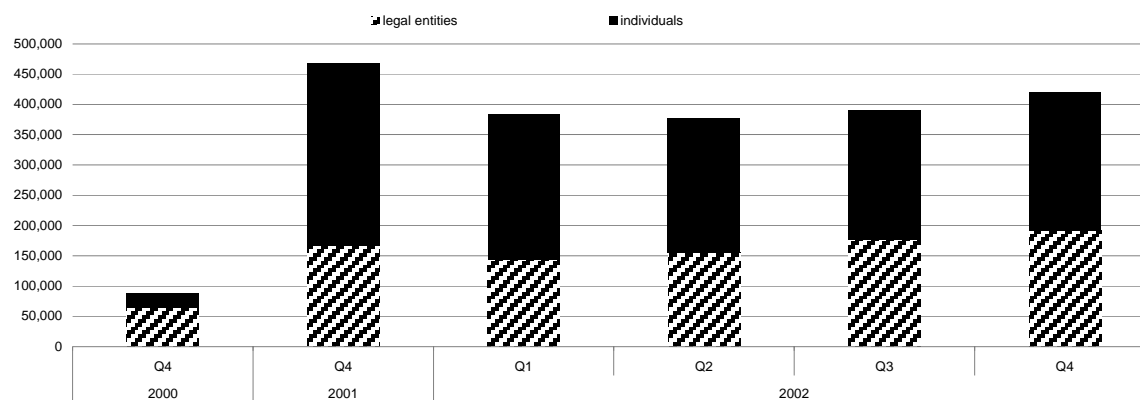


Table 11

Commercial banks loans

('000 EUR)

DESCRIPTION	2000	2001	2002			
	Q4	Q4	Q1	Q2	Q3	Q4
Individuals	n/a	n/a	n/a	n/a	n/a	5,692
Enterprises	3,313	25,191	48,411	58,972	68,039	80,806
<b>By Ownership</b>						
Private	3,313	24,191	45,857	57,234	66,370	79,469
Social-Owned	0	1,000	2,554	1,723	1,658	1,283
Public	0	0	0	15	11	54
<b>By economic activity</b>						
Trade	2,187	13,940	23,207	27,782	35,916	47,912
Industry	561	3,122	8,437	11,509	12,596	13,129
Services	565	3,988	8,877	12,393	13,747	13,287
Agriculture	0	10	393	602	1,416	1,478
Other	0	4,131	7,497	6,686	4,364	5,000
<b>Total loans</b>	<b>3,313</b>	<b>25,191</b>	<b>48,411</b>	<b>58,972</b>	<b>68,039</b>	<b>86,498</b>

Note: n/a = not available

Figure 9

Commercial banks loans, ('000 EUR)

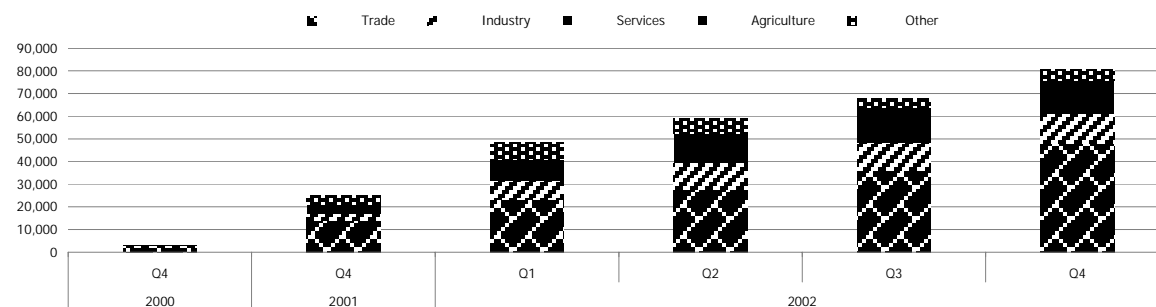
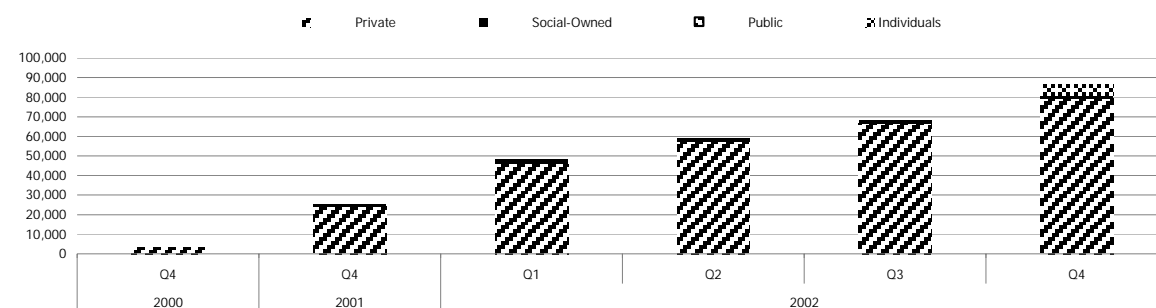


Figure 10

Loans to individuals and to enterprises by ownership, ('000 EUR)

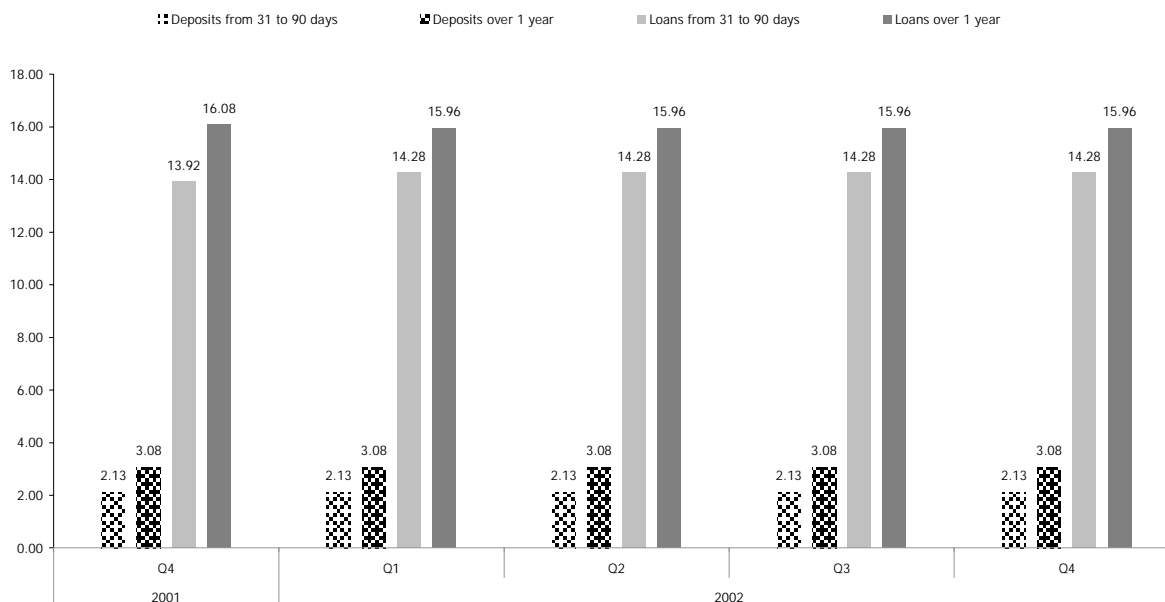


**Table 12**  
**Commercial banks nominal interest rates (in %)<sup>1</sup>**

Categories	2001	2002			
	Q4	Q1	Q2	Q3	Q4
<b>LOANS</b> monthly					
Loans up to 30 days	1.12	1.15	1.15	1.15	1.15
Loans from 31 to 90 days	1.16	1.19	1.19	1.19	1.19
Loans from 91 to 180 days	1.24	1.25	1.25	1.25	1.25
Loans from 181 days to 1 year	1.30	1.30	1.30	1.30	1.30
Loans over 1 year	1.34	1.33	1.33	1.33	1.33
<b>DEPOSITS</b> annual					
Deposits up to 30 days	1.83	1.83	1.83	1.83	1.83
Deposits from 31 to 90 days	2.13	2.13	2.13	2.13	2.13
Deposits from 91 to 180 days	2.38	2.38	2.38	2.38	2.38
Deposits from 181 days to 1 year	2.68	2.68	2.68	2.68	2.68
Deposits over 1 year	3.08	3.08	3.08	3.08	3.08

<sup>1</sup>MEB not included because of its different classification of interest rates (according to the amounts and type of loans)

**Figure 11**  
**Interest rates on loans and deposits (in % per annum)**



**Table 13**

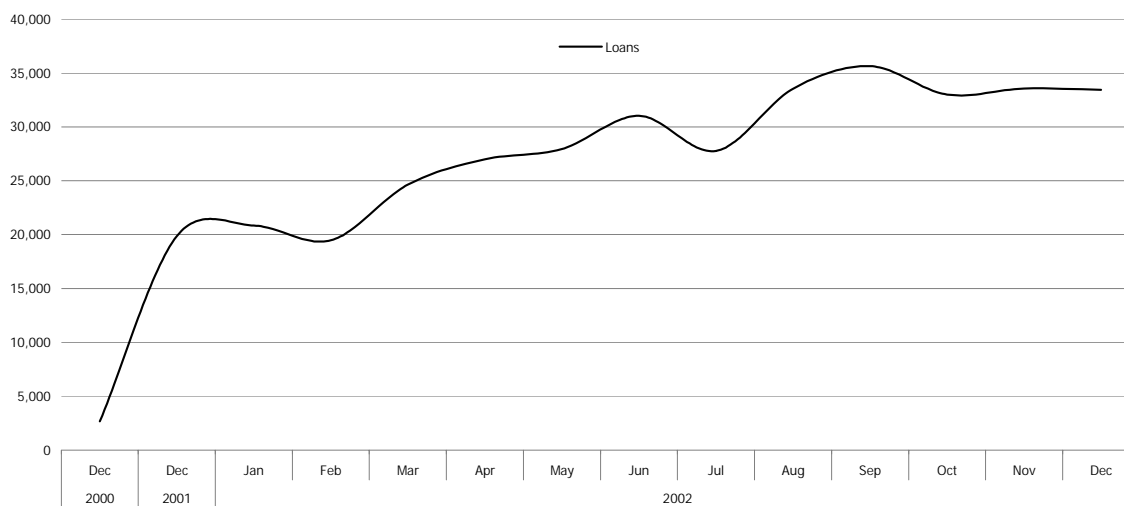
**MFI's loan activity, stock data**

(‘000 EUR)

Period	Finca	Icu	Icmc	Gram Men	Mci	Cord-Aid	Bese-Lidhja	Adie	Deg	Abu	Drc	Kosiv-Est	Mesh-Tekna	Ce.L.I.M	Iom	Start	Total
Dec-00	560	0	1,282	234	0	111	373	101	0	0	0	0	0	0	0	0	2,661
Dec-01	2,169	6,217	3,638	957	854	143	729	1,069	0	3,624	152	84	163	71	0	0	19,870
Jan-02	2,302	6,254	3,543	1,032	777	143	798	1,063	0	4,457	133	92	200	52	0	0	20,846
Feb-02	2,553	6,357	3,616	1,064	793	139	859	1,036	2,596	0	148	93	174	38	0	0	19,466
Mar-02	2,620	6,311	4,088	1,054	809	137	945	1,081	2,596	4,457	148	122	226	52	0	0	24,646
Apr-02	2,703	6,200	4,008	1,114	788	137	1,041	1,140	2,596	6,665	108	144	287	66	0	0	26,997
May-02	3,447	6,082	4,585	1,276	760	137	1,065	1,082	2,596	6,230	132	144	325	81	0	0	27,942
Jun-02	4,111	5,977	4,944	1,368	765	136	1,015	1,291	2,596	6,640	111	203	337	119	0	0	31,034
Jul-02	1,034	5,881	4,802	1,419	770	136	1,098	1,363	2,596	7,711	168	349	320	128	0	0	27,775
Aug-02	5,913	5,784	4,678	1,533	802	136	1,141	1,423	2,596	8,603	200	217	306	124	16	62	33,534
Sep-02	6,575	5,634	4,898	1,702	845	136	1,160	1,582	2,596	9,382	336	272	281	115	35	96	35,645
Oct-02	3,102	5,501	5,094	1,964	891	133	1,198	1,771	2,596	9,340	436	369	262	117	122	116	33,012
Nov-02	3,198	5,411	5,122	2,288	900	133	1,389	1,922	2,596	9,089	401	459	228	116	170	136	33,558
Dec-02	3,349	5,277	4,788	2,389	900	138	1,426	1,922	2,596	9,220	348	400	207	121	215	141	33,437

**Figure 12**

**MFI's loan activity, (‘000 EUR)**





**Table 14**

**MFI's number of loans**

Period	FINCA	ICU	ICMC	GRAM MEN	MCI	CORD- AID	BESE- LIDHJA	ADIE	DEG	ABU	DRC	KOSINV- EST	MESH- TEKNA	Ce.L.I.M	IOM	START	TOTAL
Dec-00	520	0	925	488	0	12	668	109	0								2,722
Dec-01	1,569	50	4,452	2,345	173	18	910	1,597	0	7	124	73	103	76	0	0	11,497
Jan-02	1,576	52	4,468	2,496	172	18	912	1,530	0	7	124	86	132	76	0	0	11,649
Feb-02	1,625	54	4,604	2,549	186	18	909	1,633	3	0	140	101	142	76	0	0	12,040
Mar-02	1,666	54	4,826	2,632	203	18	965	1,754	3	7	140	126	174	79	0	0	12,647
Apr-02	1,717	54	4,826	2,783	216	18	1,009	1,835	3	18	140	156	204	82	0	0	13,061
May-02	1,825	54	5,207	3,055	232	18	1,051	1,652	3	18	164	156	240	88	0	0	13,763
Jun-02	1,826	54	5,334	3,321	229	18	967	1,707	3	22	162	238	272	112	0	0	14,319
Jul-02	1,813	54	5,425	3,550	236	18	1,026	1,820	3	22	200	259	282	118	0	0	14,826
Aug-02	1,820	54	5,284	3,726	241	18	1,106	1,942	3	21	222	257	299	118	4	66	15,181
Sep-02	1,777	54	5,462	3,957	248	18	1,150	2,123	3	21	251	281	301	126	9	120	15,901
Oct-02	1,777	54	5,556	4,276	247	18	1,198	1,916	3	20	320	316	310	143	28	152	16,334
Nov-02	1,792	56	5,549	4,551	254	18	1,198	1,916	3	20	320	316	310	143	28	152	16,626
Dec-02	1,795	56	4,921	4,650	254	18	1,284	2,035	3	21	317	396	258	146	62	215	16,431

**Figure 13**

**MFI's number of loans**

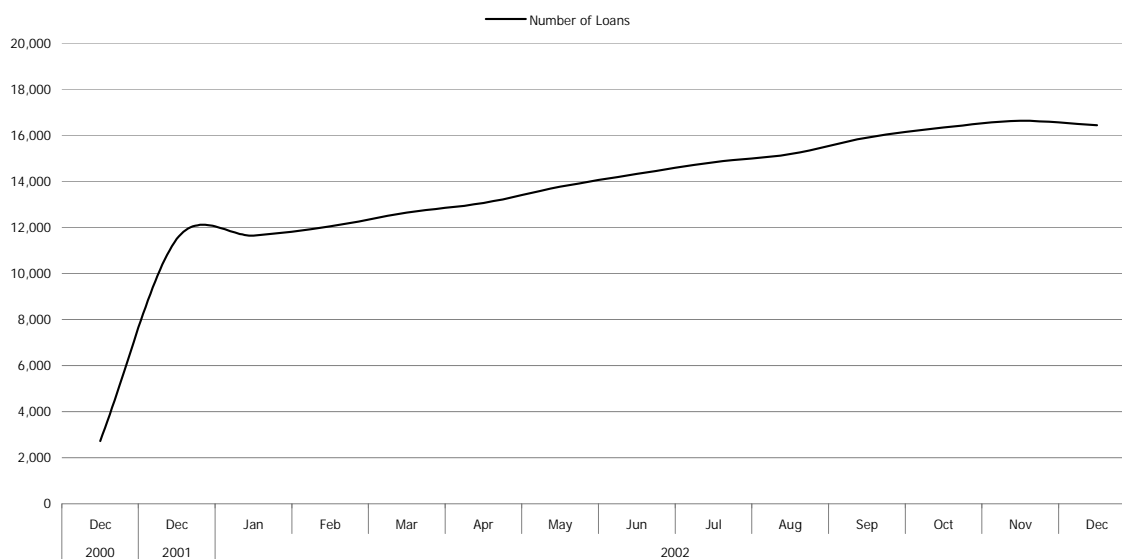


Table 15

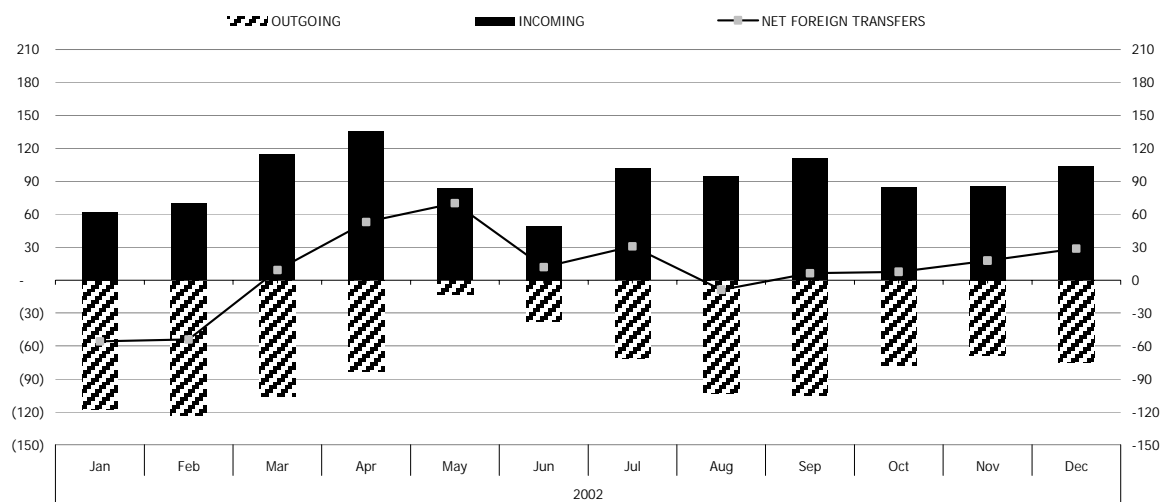
## Foreign transfers

('000 EUR)

Period	OUTGOING				INCOMING			
	BPK	Commercial Banks	Wire transfers Agencies	Total	BPK	Commercial Banks	Wire transfers Agencies	Total
2000	8,553	173,463	1,746	183,762	117,213	286,096	6,370	409,679
2001	77,295	500,522	10,094	587,911	226,980	588,229	41,841	857,050
2002								
Jan	86,857	29,670	1,296	117,823	13,525	43,305	5,109	61,939
Feb	86,741	35,204	1,455	123,400	12,591	50,727	5,989	69,307
Mar	1,270	102,300	1,690	105,260	19,523	89,106	5,689	114,318
Apr	1,092	80,309	1,132	82,533	32,094	91,109	12,284	135,487
May	904	12,088	200	13,192	31,649	42,600	8,945	83,194
Jun	1,146	34,859	1,205	37,210	26,321	15,075	7,611	49,007
Jul	1,416	68,432	1,225	71,073	31,864	61,715	8,106	101,685
Aug	28,275	73,881	1,184	103,340	13,344	71,927	9,226	94,497
Sep	5,195	98,176	1,378	104,749	14,185	86,236	10,406	110,827
Oct	12,237	63,374	1,367	76,978	10,922	61,844	11,681	84,447
Nov	16,156	50,866	1,140	68,162	20,321	54,619	10,917	85,857
Dec	429	73,256	1,214	74,899	13,367	79,669	10,508	103,544

Figure 14

Foreign transfers , ('000 EUR)



**Table 16**

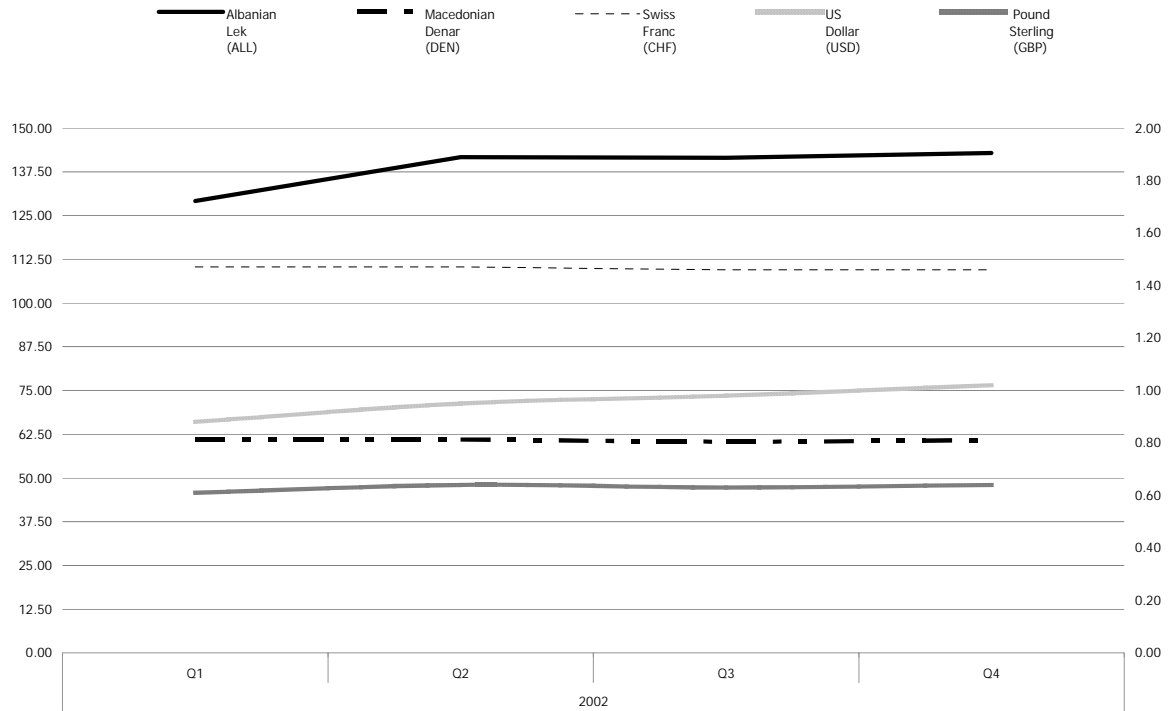
**Euro exchange rate against selected currencies, average for period**

Period	Albanian Lek (ALL)	Macedonian Denar (DEN)	Slovenian Tolar (SIT)	Swiss Franc (CHF)	Turkish Lira (TRL) (millions)	US Dollar (USD)	Pound Sterling (GBP)	Yugoslavian Dinar (YUN)
	1	2	3	4	5	6	7	8
<b>2000</b>	133.72	60.72	207.44	1.56	0.58	0.92	0.62	10.74
<b>2001</b>	130.60	60.91	219.03	1.51	1.11	0.90	0.62	42.12
<b>2002</b>								
Q1	129.20	60.95	228.68	1.47	1.22	0.88	0.61	52.37
Q2	141.66	60.95	229.76	1.47	1.48	0.95	0.64	59.35
Q3	141.46	60.37	231.09	1.46	1.64	0.98	0.63	60.29
Q4	142.85	60.80	237.18	1.46	1.65	1.02	0.64	61.89

Source: [www.oanda.com/convert/fxhistory](http://www.oanda.com/convert/fxhistory)

**Figure 15**

**Euro exchange rate against selected currencies, average for period**



Left-hand side (ALL, DEN), Right-hand side (CHF, USD, GBP)