



BANKA QENDRORE E REPUBLIKËS SË KOSOVËS  
CENTRALNA BANKA REPUBLIKE KOSOVA  
CENTRAL BANK OF THE REPUBLIC OF KOSOVO

# Financial Stability Report

Number 1

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CENTRALNA BANKA REPUBLIKE KOSOVA  
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# Financial Stability Report

## Number 1

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**ABBREVIATIONS:**

ATM	Automated Teller Machines
BEEPS	Business Environment and Enterprise Performance Survey
CAR	Capital Adequacy Ratio
CBK	Central Bank of the Republic of Kosovo
CED	Contract Enforcement Days
CEE	Central and Eastern Europe
CIS	Commonwealth of Independent States
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
GDP	Gross Domestic Product
HHI	Herfindahl-Hirschman Index
IMF	International Monetary Fund
INM	Interest Net Margine
FDI	Foreign Direct Investments
KPST	Kosovo Pension Saving Fund
MEF	Ministry of Economy and Finance
MFI	Micro-Finance Institutions
MTA	Money Transfer Agencies
NFA	Net Foreign Assets
NLIS	New Legal Indicators Survey
NPISH	Non-Profitable Institutions Serving Households
NPL	Non-performing Loans
POS	Point of Sales
pp	Percentage Points
PTK	Post and Telecommunication of Kosovo
ODC	Other Depository Corporations
OECD	Organization for Economic Cooperation and Development
RI	Raiffeisen International
RLI	Rule of Law Index
ROAA	Return on Average Assets
ROAE	Return on Average Equity
ROE	Return on Equity
RWA	Risk Weighted Assets
SDR	Special Drawing Rights
SEE	South-Eastern Europe
SOK	Statistical Office of Kosovo
TPL	Third Party Liabilities
VAT	Value Added Tax

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## 1. Foreword

The Central Bank of the Republic of Kosovo is pleased to present to the public the first edition of the Financial Stability Report. This publication, which is enriched in its content and improved in quality, is a continuity of the Financial Sector Bulletin that has been published on yearly basis since 2005. The Financial Stability Report aims at informing the public, professionals, and decision-making authorities on the financial sector developments, with particular focus on the banking sector, by identifying fragilities and risks threatening the stability of this sector. Based on the Law on the Central Bank of the Republic of Kosovo, the primary objective of this institution is to ensure financial sector stability. Since financial crises have high economic and social costs, financial stability represents an important objective for policy-makers. Consequently, the publication of Financial Stability Report represents a continuity of engagements of the Central Bank contributing to the stability of this sector. By informing the public on the state of the financial sector, the Central Bank aims at increasing the transparency and eliciting the professional debate on the developments and challenges of the domestic financial sector.

Considering the degree of integration of the global finances, this edition of Financial Stability Report initially concentrates on main international macroeconomic and financial sector developments, in order to identify potential external risks to the financial sector of Kosovo. Developments in the real, external and fiscal sectors are jointly determined with developments in the financial sector and represent an important determinant of the performance of this sector. Thus, the report continues with an analysis of macroeconomic developments in the domestic economy. The report then presents an overview of the general characteristics of Kosovo's financial sector. A special focus is given to the banking sector, so it continues with a more detailed analysis of the latest developments with regard to the activity and the performance of this sector.

In order to provide a clearer view of sustainability and potential risks facing the banking sector, this report also addresses banking sector risks, including liquidity risk, credit risk and solvency risk. Also, the methodology and results of the stress-test for Kosovo's banking sector are presented, thus providing an assessment on the ability of Kosovo's banking sector to absorb potential shocks. Part of the report is dedicated to main developments in other sectors of Kosovo's financial system and interrelation with the banking sector.

Financial sector stability, apart from the ability to absorb shocks, also means an efficient functioning of markets, institutions and infrastructure supporting the financial system for an efficient allocation of resources. Therefore, this edition of the Financial Stability Report also presents four special topics that elaborate specific segments of the banking sector and interactions with other factors in the economy. The first topic addresses issues related to economic growth and financial stability in SEE countries. Second analysis decomposes the cost of intermediation in Kosovo's banking sector and compares it with several countries in the region, thus providing a general idea on the factors that determine loan interest rates. The third topic addresses issues related to the enforcement of creditor rights in Kosovo and is based on the results obtained from a survey with commercial banks in Kosovo. The last analysis presented in this report deals with the issue of access to finance in Kosovo, based on data from Business Environment and Enterprise Performance Survey (BEEPS).

Gani Gërguri

Acting Governor



## 2. Executive Summary

The global economy during the last two years experienced one of the most severe crises in its history, which started with the turbulences in the financial sector, leading to a general economic crisis. Many developed countries entered into recession and financial sector difficulties occurred almost in every country. The effects of the crisis were reflected also in Kosovo, but the impact may be considered to have been moderate. Within the financial sector, Kosovo Pension Savings Trust (KPST) represents the most hardly hit sector, which recorded a substantial decline in the value of its investments in international financial markets during this period. Also, the performance of foreign banking groups that have subsidiaries in Kosovo was affected negatively, but it was not reflected in the banks operating in Kosovo. The global crisis was reflected in Kosovo also through the external sector, where it was observed a decline of exports, remittances and foreign direct investments (FDI). However, in the first half of 2010, the global economy performed better compared to 2009, as a result of expansionary monetary and fiscal policies taken in many countries. As a result, most of developed countries are expected to record positive growth rates in 2010 and financial markets have started to recover. Improvements in the global economy were reflected also in the economy of Kosovo during this period. In this context, the performance of KPST investments improved and it is observed a recovery of exports, remittances and FDI. These improvements reduce the risks of potential shocks to the Kosovo's economy arising from the external sector.

The recent developments in Kosovo's economy to some extent followed international developments, which is typical for a small-open economy. In 2009 remittances, exports and foreign direct investments declined, with negative implications for the private sector consumption and investments. These developments increased the uncertainty of banks towards the domestic economy, which was reflected in a slower credit growth. However, the increase of public expenditures during this period to some extent compensated the negative impact of the contraction in private sector consumption and investments. As a result, Kosovo's economy in 2009 recorded a positive growth rate of 2.9 percent according to the Statistical Office of Kosovo; nevertheless, this growth rate was lower compared to the growth rate of year 2008. In 2010, Kosovo's economy is expected to record a real GDP growth of 4.6 percent (IMF program document), which mainly relies on the increase of private sector consumption and investments. Kosovo's economy continues to be characterized with low inflation and budget deficit rates, while high current account deficit and high unemployment continue to represent a challenge. Overall, the economy of Kosovo during 2010 is expected to have a better performance, which has positive implications for the stability of the financial sector. In this regard, it increases the capacity of borrowers to service their loans, thus contributing to the decrease of credit risk for the banking sector. This is expected to have a positive impact on the lending activity of the banking sector, thus contributing to the further increase of consumption, investment and overall economic activity.

Kosovo's financial system continues to be dominated by the banking sector, whose assets represent 77.5 percent of total financial system assets. Total assets of the banking sector recorded a lower growth rate in the first half of 2010, which led to a slight decline in the share of these assets to total financial sector assets. On the other hand, the share of pension fund assets marked an increase, reflecting the better performance of KPST investments abroad during this period. The market structure of Kosovo's financial system varies in different sectors. While the insurance and microfinance institutions have a moderate degree of market concentration, banking market remains highly concentrated. Nevertheless, the degree of market concentration in the banking sector is continuously decreasing as a result of the continuous expansion of the activity of smaller banks, which are increasing the competitive pressures in the market.

Kosovo's banking sector continues to be dominated by foreign-owned banks both in terms of the number of banks and in terms of market share. Among eight commercial banks operating in Kosovo, six are foreign-owned and represent around 90 percent of total banking sector assets. Banking sector has continuously expanded its network, thus facilitating the access of public to banking services. However, the slowdown of intermediation activity induced banks to cut their operating expenditures, which led to a decrease of banking expenditures for the expansion of banking network and also reduction in the number of employees in this sector.

During the first half of 2010, Kosovo's banking sector assets marked a yearly growth rate of 15.1 percent reaching at euro 2.2 billion. Regarding the composition of banking sector assets, it is observed a considerable increase of securities abroad, while the share of loans to total assets marked a decline. Nevertheless, loans continue to represent the main component of Kosovo's banking sector assets. Banking sector continued to tighten lending terms. As a result, in June 2010, it was recorded an annual credit growth rate of 9.7 percent (17.5 percent in June 2009). Nevertheless, signals for a better performance of the economy during 2010 have influenced positively the lending activity of the banking sector, taking into account that the growth rate recorded in the first half of 2010 was higher compared to the growth rate that was recorded in the second half of 2009. The structure of banking sector loans continues to be dominated by loans issued to enterprises, while loans issued to households remain at a lower level, though increasing during this period. The low share of households loans may partly be explained by the high level of unemployment prevailing in Kosovo that reduces the proportion of population that qualify for bank loans. Regarding the structure of loans issued to enterprises, it mainly comprises of loans issued to the trade sector, which mirrors the high reliance of Kosovo's economy on the trade sector.

The main source of funding for the banking sector activity is deposits, representing 79 percent of total banking sector liabilities. Deposits were a stable source of funding for the banking sector even at the peak of the crisis in global markets, which is mainly attributed to the fact the majority of deposits are collected in the domestic economy. As such, Kosovo's banking sector had not been dependent on funds from international markets to finance its operations. In June 2010, deposits in the banking sector amounted at euro 1.8 billion, representing an annual growth of 15.8 percent.

The credit tightening by Kosovo's banking sector, accompanied with the decline in interest rates in the European interbank market, in end 2009, resulted in a substantial decline of banking sector profit. The annual growth rate of interest income continued to decrease also during the first half of 2010. However, banks took measures to reduce their expenditures, especially general and administrative expenses. As a result, Kosovo's banking sector recorded a net profit of euro 17.1 million in June 2010, which is an increase of 65.4 percent compared to the same period of the previous year. The measures taken by banks improved some efficiency indicators for the banking sector, such as the cost to income ratio, total assets per employee, etc.

The slowdown of credit growth and the cautious behaviour of banks in managing the liquidity risk led to a further improvement of the liquidity position of the banking sector during the first half of 2010. In this context, the loan-to-deposit ratio in June 2010 was 80.2 percent, which is in compliance with the Central Bank recommendations. Furthermore, the share of liquid assets to total banking sector assets in June 2010 increased at 34.5 percent, from 29.4 percent in June 2009. The satisfactory position of banking sector liquidity is shown also by the stress-test results, which suggest that banks are quite well prepared to withstand the assumed liquidity shock that was considered under a hypothetical scenario in this exercise.

The reflection of the global crisis in Kosovo's economy was negatively affected in the quality of banking sector loan portfolio. In June 2010, non-performing loans represented 4.5 percent of total loans, compared to 3.9 percent in June 2009. The highest growth of non-performing loans was observed within loans issued to enterprises, which also represent the

largest share of total non-performing loans. Despite the increase, non-performing loans continue to be well covered by provisions for loan losses, which cover over 130 percent of total non-performing loans. Kosovo's banking sector also has a high level of capitalization, which reduces the solvency risk from the deviation of loan portfolio quality or other developments, such as decline of interest rates. In June 2010, capital adequacy ratio stood at 18.7 percent, while the minimum required ratio by the Central Bank is 12 percent. The ability of the banking sector to remain solvent against increasing non-performing loans, declining interest rates and depreciation of the euro currency was assessed through the stress-test exercise, where results suggest a relatively high level of banking sector resilience against the shocks assumed in a hypothetical scenario.

This issue of Financial Stability Report presents some thematic analyses, which address issues that are related to the efficiency and stability of the banking sector. First of all, it is presented an analysis which addresses financial stability and growth in SEE countries, concluding that these countries are characterized by stable financial sectors, but emphasizing the potential for higher economic growth, which can be achieved mainly by advancing the institutional framework. The report also contains an analysis on the decomposition of intermediation cost, where it was found that operational costs and risk costs represent the largest contributors to the intermediation cost in Kosovo, unlike other countries in the region, where funding costs represent the largest component of intermediation cost. To assess the enforcement of creditor rights in Kosovo, CBK conducted a survey with four largest commercial banks. The results from the survey suggest that Kosovo compares well with other transition economies with respect to the enforcement of creditor rights, but the enforcement process still suffers from inefficiencies that prolong the enforcement of contracts. In the end, the report presents an analysis that deals with the access of enterprises to finance in Kosovo, based on data from the Business Environment and Enterprise Performance Survey. The data from this survey suggest that access to finance in Kosovo does not appear to be a substantial obstacle to business development compared to other barriers, but on the other hand, Kosovo appears to be the country with the lowest level of access of enterprises to finance.

### 3. Macroeconomic and Financial Developments in the Global Economy

The financial crisis which was triggered by the collapse of real estate markets in the U.S. had great influence in the world economy. Many countries entered into recession and in some countries economic growth slowed down significantly. As a result of the financial crisis, governments of many countries were forced to increase public spending to boost economic activity and central banks introduced monetary expansion. These measures had a substantial impact in alleviating the impact of the crisis, by off-setting the decline of the private sector activity with increased public sector involvement in the economy.

Monetary policy was expansionary, and in many countries interest rates declined to record levels. In addition, central banks were forced to inject huge amounts of funds into the financial system aiming at improving the liquidity position of the system. During this period many central banks used instruments which were not used before. In this context we can distinguish ECB, which for the first time since it started functioning purchased bonds in the financial markets. As a result of these interventions, the balance sheet of the central banks grew considerable, creating potential risks for speculative asset growth.

Regarding fiscal measures, government interventions were decisive in preventing the crisis, but many countries faced deteriorating public finances. As a result of these interventions, the global budget deficit rose to 9 percent of GDP. According to IMF projections, in 2014, the share of debt to world GDP will exceed the level of 100 percent, which is for 35pp higher compared to the pre-crisis level.

According to IMF projections, the global economy during 2010 will increase by 4.25 percent (Table 1). This forecast is for 1pp higher compared to the IMF's projections at end 2009. The increase of the forecasted growth rate is a result of several economic developments during 2010, which led to more optimistic expectations for the performance of the economy during this year. The improvement of financial markets during 2010 exceeded the forecasts. Lending activity is stabilising and household income and consumption are reviving. Positive developments were noticed also with regard to the industrial production and the global trade.

Although the world economy is expected to mark positive growth rates, this growth will be unbalanced. Developed countries will continue to face slower economic growth characterized by high budget and trade deficits. According to IMF, economic growth in 2010 in developed countries is expected to be 2.3 percent. Among developed countries the highest growth is expected to be recorded in the U.S. (3.1 percent). Japan and the Eurozone countries are expected to record an economic growth of 1.9 percent and 1 percent, respectively.



Table 1. The world GDP growth rate, in percent

Description	2009	2010	2011
World GDP	-0.6	4.25	4.3
Developed countries	-3.2	2.3	2.4
USA	-2.4	3.1	2.6
Eurozone	-4.1	1.0	1.5
Japan	-5.2	1.9	2
United Kingdom	-4.9	1.3	2.5
Developing countries	2.4	6.3	6.5
Russia	-7.9	4.0	3.3
China	8.7	10.0	9.9
India	5.7	8.8	8.4

Source: IMF (2010a)

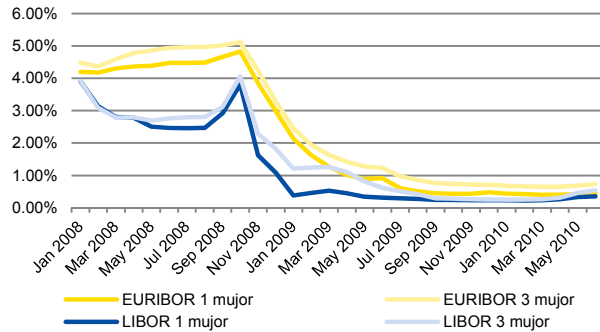
Developing countries, particularly China and India, will continue to record high growth rates, largely driven by exports, partly as a result of undervalued currencies. For 2010, IMF projections suggest an average growth rate of 6.3 percent for developing countries. The highest growth rate is expected to be recorded in China (10.0 percent), followed by India (8.8 percent). In these countries, apart from the revival of the world trade, another important factor contributing to economic growth was the increase in domestic demand.

Large public expenditures that took place during the crisis led to the increase of budget deficit. According to IMF, the debt-to-GDP ratio for G7 countries reached its peak in the last 60 years. This high level of public debt also affects the flexibility of these governments to react in case of further deterioration in the economy. Fiscal problems during this period were prevalent in the eurozone countries. The problem of fiscal deficit was more acute in Greece, and it was forced to request financial support from the IMF and other eurozone countries. As a result of the deteriorating fiscal position, the EU countries were determined to establish a mechanism for European Financial Stability. In order for this mechanism to work, the IMF and the EU countries committed an amount of euro 750 billion. These funds would be used to overcome potential fiscal crises.

Most developed economies are operating below potential output, which has led to low rates of inflation and low inflation expectations in the near future. Furthermore, in some developed countries the decline of economic activity has resulted in deflation. In June 2010, the annual inflation rate in the U.S. was 1.1 percent, which is lower compared to the rate of 2 percent recorded in 2009. According to EUROSTAT statistics, the annual inflation rate in eurozone in June 2010 was 1.4 percent. Regarding interest rates, most central banks in developed economies did not change interest rates, including FED and the ECB, where base rates remained at 0.25 percent and 1 percent, respectively.

The improvements in the real sector of the economy were also reflected in the performance of the global financial system. During 2010, most of financial markets (stock markets, money markets) recorded an improvement in the performance. This resulted in the return of investors' confidence and decline in the volatility of financial markets, which was quite evident in the previous periods. The actions taken to support the liquidity position of the financial system and credit growth as had a positive influence on the increase of activity in money and equity markets. These developments contributed to the slowdown and alleviation of the impact of the crisis.

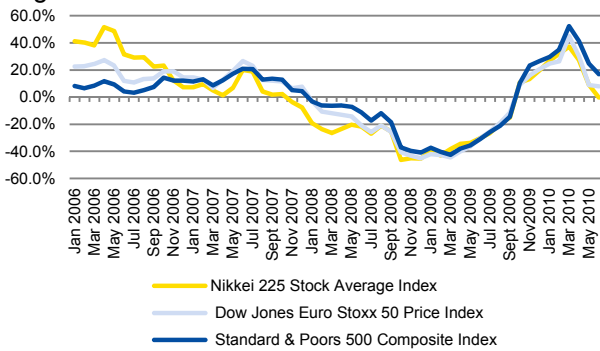
Figure 1. EURIBOR and LIBOR interest rates



Source: Datastream

Nevertheless, risks remain present; therefore, it is needed a continuous awareness by governments and central banks to prevent the decline of economic activity and the return of uncertainty in financial markets. Given the high level of public debt in many developed countries, especially in the eurozone, the scope for potential actions is very limited. The increase of public debt led to a deterioration of sovereign ratings for countries facing fiscal difficulties, which was reflected in higher premiums for government bonds. However fiscal difficulties can have spill over effect on the banking system. First, considering that commercial banks invest considerable funds in government bonds, the default of a government to service its liabilities would cause considerable losses for banks. Second, the country rating has a substantial impact also for the cost of financing for the private sector. The deterioration of country rating increases the cost of external financing for commercial banks and may have negative implications for the stability of the entire banking sector.

Figure 2. Annual change of indices of the three largest stock markets



Source: Datastream

One of the countries that are experiencing such a scenario is Greece, where the weak fiscal position contributed to the downgrading of sovereign rating which in turn will increase the cost of financing for public and private sector. While economic activity is increasing, lending is lower than in the pre-crisis period deteriorated in many developed countries. Asean economies are an exception, where lending has increased continuously. In some countries, such as China, the regulatory authorities have taken measures to slowdown the credit growth in order to avoid potential asset bubble.

Rapid economic growth of developing countries was a key contributor to the increase of capital flows and the return of investors' confidence in these countries. Despite the high capital inflows, the currencies of developing countries and especially of China continue to be undervalued.

During 2009, lending activity in developed countries declined, while in early 2010 first signs of recovery showed up. During this period, increased activity is noticed also with regard to the bond markets. This development is attributed to the fact that credit growth by banks is still insufficient to meet financing needs of enterprises, which are then directed to bond markets. This trend is more pronounced especially in the U.S., where bonds are widely used as a source of finance. In the eurozone countries, bonds represent a less important source of finance with banking loans having a much wider use.

Improvements in the performance of the global economy during 2010 led to a decline of banking sector losses in many countries. According to IMF projections, potential losses for year 2010 declined from USD 2.8 trillion to USD 2.3 trillion. Whereas, realized losses during the first half of 2010 were USD 1.5 trillion (Table 2; for the performance of banking groups operating in Kosovo see Box 1).

### Box 1. The performance of foreign banking groups operating in Kosovo<sup>1</sup>

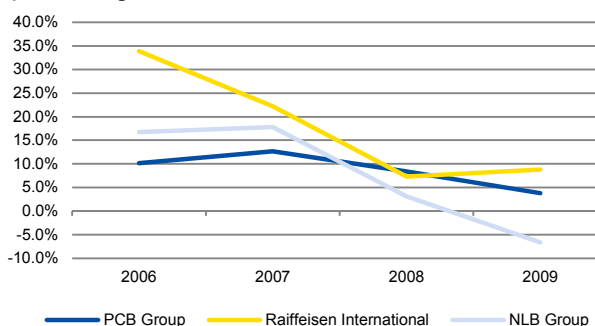
During 2009, the global economy continued to face the consequences of the financial crisis. In 2009, financial systems of countries where the foreign banking groups that have subsidiaries in Kosovo are based were characterized with slower growth, difficulties in securing financing and deterioration of loan portfolio quality. During this period, all banks shifted the focus from the expansion of the banking operations towards the management of the crisis. Performance indicators for 2009 marked a decline for all banking groups included in this analysis. The largest contributors to the decline of performance were higher costs for provisions for loan losses that are attributed to the deterioration of quality in their loan portfolios.

During the first half of 2010, the increase in global economic activity resulted in the improvement of the banking sector performance in general.

The financial crisis necessitated banks to be more conservative in managing their assets. In this period, banks were focused on improving loan portfolio quality and therefore tighter criteria were applied regarding the expansion of lending activity. However, the performance of banking groups operating in Kosovo, in the first half of 2010 was different between groups. While Raiffeisen International recorded higher profits than in 2009, Procredit Group and NLB Group recorded losses.

#### Procredit Group (Germany)

Figure 3. Return on equity for the banking groups in percentage

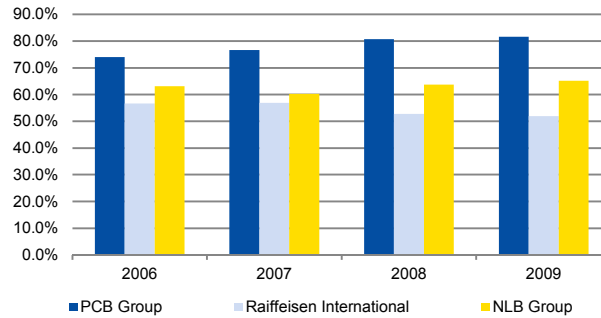


Source: Annual reports of the banking groups

<sup>1</sup> Banking groups included in the analysis are: Procredit Group, Raiffeisen International and NLB Group.

The interest income for Procredit Group (PCB Group) in year 2009 recorded a decline of 5.8 percent compared to 2008. The decline of this category of income is mainly attributed to narrowing of the interest margin<sup>2</sup> to 7.9 percent, which is a decrease of 2.2pp compared to 2008. Income from other banking services<sup>3</sup> recorded an increase of 3.8 percent compared to 2008. As a result of the overall decline in income in 2009, PCB Group took measures to reduce costs. Although there was rationalization of expenditures, cost to income ratio increased by 1 pp, reaching at 81.7 percent, which mainly reflects the increase of provisions for loan losses that amounted at euro 111.7 million in 2009 from euro 98.2 million in 2008. Net profit in 2009 declined to euro 11.5 million from euro 30.0 million in 2008, while Return on Equity (ROE) before tax decreased to 3.8 percent (8.4 percent in 2008). This decrease was due to increased expenditures for provisions and the decline of operating income.

Figure 4. Cost to income ratio for the banking groups, in percentage



Source: Datastream

The performance of PCB Group continued to decline also during the first half of 2010.

Net interest income recorded a decline of 2.1 percent, whereas income from banking services increased by 5.9 percent. During this period, operating expenditures decreased by 2.7 percent, but were still higher than the operating income. As a result, in the first half of 2010, PCB Group reported losses amounting at euro 5.1 million, against the profit of euro 2.7 million that was recorded in the first half of 2009. A negative impact on the profit had also the increased expenditures for provisions from euro 111.6 million in June 2009 to euro 125.1 million in June 2010. In June 2010, CAR of PCB Group was 16.2 percent, which shows a satisfactory level of capitalization. In June 2010, Procredit Kosovo constituted 5.5 percent of total assets of the Procredit Group.

### Raiffeisen International (Austria)

In 2009, Raiffeisen International (RI) recorded a positive profit despite difficult conditions as a result of the financial crisis. Net interest income in 2009 declined by 9 percent compared to 2008. The decrease of income is attributed to the reduction of the intermediation activity and above all to the reduction of the interest margin by 0.26 pp, declining at 3.73 percent. Also, the income from banking services declined by 18 percent compared to 2008. The decline of income was associated with the reduction of general expenditures. RI took measures to reduce costs, which recorded a decline of 14 percent compared to 2008. These measures led to the decrease of expenditure to income ratio at 52.5 percent, which is by 1.5pp lower compared to 2008. The crisis caused a deterioration of the loan portfolio quality, which led to an increase by 123 percent in provisions for loan losses, that reached the amount of euro 1.738 billion. This development significantly influenced the reduction of net profit, which in 2009 was euro 287 million or 73.4 percent lower compared to 2008. Weaker performance influenced the decline of ROE before tax to 5.7 percent (22.0 percent in 2008).

In the first half of 2010, net interest income declined by 4 percent, as a result of increased financing cost, whereas expenditures for provisions declined by 42 percent as a result of improved customer rating and restructuring of loans. Cost to income ratio stood at 57.6 percent in June 2010 or 6 pp higher than in the previous year. The first half of 2010 was characterized with a doubling of net profit

<sup>2</sup>

Interest margin represents the difference between interest rates on lending and borrowing.

<sup>3</sup>

Income from banking services consists of fees and commissions from transfers and other banking services.

to euro 171 million compared to the first half of 2009. The growth of net profit had a positive impact on ROE before tax that increased to 8.6 percent from 4.9 percent in June 2009. The capital adequacy ratio for RI in June 2011 was 11 percent. In June 2010, Raiffeisen Kosovo constituted 0.85 percent of total assets of Raiffeisen International.

#### NLB Group (Slovenia)

At the end of 2009, net interest income for the NLB Group decreased by 11 percent compared to 2008. Also, income from banking services recorded a decline of 5.0 percent. The higher financing cost in financial markets was reflected in the reduction of the interest margin to 2.3 percent, which is a decline of 0.3pp compared to 2008. The reduction of interest margin had significant impact on the reduction of income. Consequently, NLB Group took measures to reduce overall costs, which resulted in a decline of around 1 percent compared to 2008. However, unfavourable results in 2009 led to the increase of the cost-to-income ratio at 65.2 percent, which is for 1.5 pp higher compared to 2008. Expenditures for provisions amounted at euro 315.5 million, representing an increase of 49 percent compared to the previous year. NLB Group ended year 2009 with losses amounting at euro 85.9 million, marking a considerable decrease of performance compared to 2008 when net profit was euro 22.8 million. Pre-tax ROE in 2009 declined to -6.6 percent from 3.1 percent in 2009.

During the first half of 2010, NLB Group continued to face difficulties resulting from the financial crisis. During this period, net interest income increased by 10.2 percent, whereas the income from banking services declined by 21 percent. The cost-to-income ratio, in June 2010, stood at 63.5 percent, which is for 1.3 pp lower than in the same period of 2009. Expenditures for provisions reached at euro 159.1 million from euro 114.8 million in June 2009. In the first half of 2010, NLB Group recorded after-tax losses amounting at euro 34.6 million compared to losses of euro 5.6 million in the first half of 2009. The pre-tax ROE during this period was -6.6 percent, compared to 1.1 percent in 2009. The capital adequacy ratio for NLB Group in June 2010 was 10.6 percent or 0.1 percent lower compared to the same period of 2009. In June 2010, NLB Prishtina represented 1.58 percent of total assets of the NLB Group.

The reduction of losses implies decline of banks' needs for additional capital, representing a positive development for many countries, taking into account the amount of funds that are used in the form of capital injection.

**Table 2. Total reported losses and additional capital for banks, in USD billion**

Description	Total reported losses	Total increased capital	Tier 1 capital / RWA in %
USA	680	329	11.3
Eurozone	415	256	9.1
United Kingdom	355	222	11.5

Source: IMF (2010b)

Improvement of economic activity has also affected the credit portfolio in many developed countries. In the eurozone, economic growth contributed to the reduction of non-performing loans in the banking sector. Improvements in the quality of loan portfolio are also reported in the U.K., especially in the categories of private and commercial real estate. Whereas, high unemployment rate in the U.S. is causing further growth of NPL, especially within loans issued to the real estate sector. Capital Adequacy Ratio has also improved, since the peak of the crisis in late 2008. According to IMF data, banks in the US have increased the

Capital Adequacy Ratio at 11.3 percent, which is an increase of 1.5pp. In the eurozone, this indicator increased by 1.1pp, reaching at 9.1 percent, while in the U.K. grew from 10.2 percent to 11.5 percent. The increased rate of capitalization has mainly resulted from the injection of capital by investors and positive profits. In order to assess the resilience of the banking sector, a considerable number of banks in US and Europe were subject to the stress-test, where the results suggested that majority of banks were capable of withstanding a new wave of the crisis, without needing additional capital.

## 2.1. Economic Developments in SEE

Economic activity in the SEE countries in the first half of 2010 has shown moderate recovery. Economic recovery was mainly a result of increased exports from these countries due to the increase of the global demand during this period. Conversely, low domestic demand in the SEE countries is reflected in unemployment growth and credit tightening. While most SEE countries have been characterized with positive economic developments during 2010, Croatia and Montenegro reported continued economic contraction. According to IMF latest projections, apart from Croatia and Montenegro, all SEE countries will record positive growth rates. The highest growth rate is expected to be in Kosovo (4.6 percent), followed by Albania (2.6 percent), Serbia (1.5 percent) and Macedonia (1.2 percent), while Bosnia and Herzegovina is expected to have modest growth of 0.5 percent.

The improved performance of exports and the decline in imports during 2010 led to a further reduction of the current account deficit in SEE countries. The 2010 IMF projections report the lowest current account deficit in Croatia (3.8 percent), followed by Macedonia (3.9 percent) and Bosnia and Herzegovina (5.5 percent). The current account deficit is expected to remain higher in Kosovo (18.5 percent), Montenegro (17.0 percent), Serbia (9.6 percent) and Albania (9.2 percent).

All SEE countries ended the year 2009 with a negative budget balance, which persisted also in the second half of 2010. IMF projections suggest that countries with the highest budget deficit in 2010 will be Montenegro (7.1 percent of GDP), Bosnia and Herzegovina and Bulgaria (4.9 percent of GDP, respectively). In some countries like Serbia, Croatia and Kosovo, the budget deficit to GDP ratio in 2010 is expected to be higher than in the previous year, standing at 4.8 percent for Serbia, 4.7 percent for Croatia, and 3.4 percent of GDP for Kosovo. Macedonia represents the country with the lowest expected budget deficit in the region (2.5 percent of GDP in 2010). In order to overcome potential problems associated with the budget deficits, in February 2010, Bosnia and Herzegovina, Serbia, and Romania entered into arrangements with the IMF to obtain financial support from this institution.

The economic downturn in 2009 had considerable impact on the unemployment growth in the SEE countries. The increase of unemployment rate in these countries has continued also during the first half of 2010. The SEE countries continue to be characterized with high unemployment rate, with the highest rate prevailing in Kosovo (around 45 percent), followed by Bosnia and Herzegovina (about 43.1 percent) and Macedonia (about 32.1 percent).

Regarding the exchange rate between the currencies of the SEE countries and the euro, in June 2010, the Albanian lek appreciated against the euro by 1.8 percent, reaching 136.07



ALL/EUR, while the Serbian dinar depreciated against the euro by 4.2 percent, reaching 104.70 RSD/EUR. Croatian Kuna (7.21 HKR/EUR) and Macedonian denar (61.52 MKD/EUR) during this period were more stable against the euro.

Increasing prices in the eurozone were also reflected in the price level in SEE, where inflation rates in the majority of these countries were higher than in the previous quarter. Serbia and Albania during this quarter marked the highest rate of annual inflation (4.3 and 4.2 percent, respectively), while Macedonia and Montenegro marked the lowest annual inflation rate in this period (0.5 and 0.8 percent, respectively).

While in 2009, the banking sector of some of the SEE countries was mainly characterized by credit tightening and deposit withdrawals, the first half of 2010 indicated an increase of confidence in the banking sector. Although at a modest pace, loan and deposit rates marked an increase in some of the region countries, suggesting continuous improvement in the banking sector performance during this period. Countries with the highest credit growth in June 2010 were Serbia (26.2 percent), Kosovo (9.7 percent) and Albania (8.5 percent), while negative credit growth rates were recorded in Montenegro (11.4 percent) and Bosnia and Herzegovina (2.0 percent). With regard to deposits, in Q2 2010, Serbia led with the highest growth rate in the region (22.5 percent), followed by Kosovo (15.8 percent), Albania (14.8 percent) and Macedonia (14.4 percent).

In Q2 2010, the banking sectors of SEE countries were profitable, with the exception of Macedonia and Bosnia and Herzegovina which were characterized by losses. Compared with Q1 2010, the quality of loans in Q2 2010 deteriorated in almost all countries of SEE. Montenegro had the highest rate of non-performing loans from 16.8 percent (14.6 percent in Q1 2010), followed by Albania with 12.0 percent (11.5 percent in Q1 2010), Serbia 12.0 percent (10.6 percent Q1 2010) and Bosnia and Herzegovina 8.7 percent (7.1 percent in Q1 2010). Kosovo remains the country with the lowest rate of non-performing loans in the region with 4.5 percent in Q2 2010 (4.6 percent in Q1 2010).

#### 4. Macroeconomic Developments in Kosovo

Despite the global economic crisis, Kosovo's economy was characterized with a stable macroeconomic environment. Even though at a moderate rate, Kosovo's economy experienced positive growth rates during 2009. Continuous growth of financial intermediation as well as remittances represented an important source of finance for private consumption and investments, despite the negative impact of the recent crisis. Euroisation minimized the exchange rate risk and brought price stability to the economy. Limited discretion of fiscal policy as a result of euroisation, and lack of law on public debt until 2009, as a result of Kosovo's unresolved political status, resulted in a tight fiscal policy. As a result of these developments and policies, Kosovo's budget registered surpluses and low levels of deficits. However, the low level of domestic production and, consequently, import-based economy resulted in continuous high current account deficit. The high unemployment rate remains one of the main challenges for the economy and it necessitates higher economic growth rates in order to generate jobs and absorb the high growth rate of labor force.

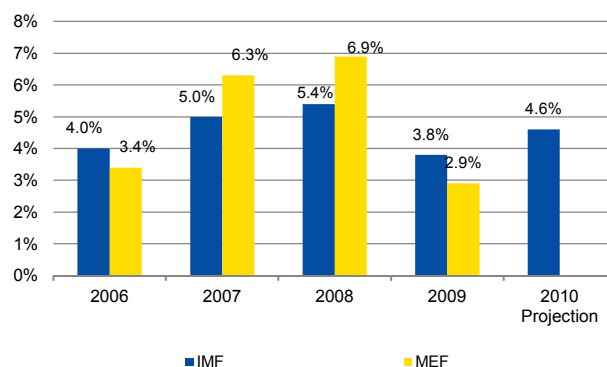
As a small-open economy, Kosovo was affected by the global crisis during 2008-2009. The impact was transmitted mainly from the external sector through remittances and foreign direct investments (FDI), which decreased during 2009 by 5.5 and 23.3 percent, respectively. In spite of the low base, also the decline of exports had a negative impact on the economic activity in Kosovo. These developments increased the overall uncertainty on the performance of the real sector of the economy, which led to a credit tightening by banks. This was considered as a precautionary measure for the quality of the credit portfolio of banks as a result of weaker performance of the real sector. Consequently, the slowdown of credit growth extended the negative impact of lower remittances and FDI on the consumption and investment levels. However, the impact of the crisis to some extent was offset by the fiscal policy. The contribution of the fiscal policy in mitigating the effects of the crisis is attributed to the increase of public spending, which is considered as the main driver of the economic growth in 2009. Moreover, the decrease of corporate taxes stimulated investments. The decrease of the income tax might have mitigated the negative effects of the crisis with regard to the consumption; on the other hand, the increase of the VAT rate might have offset to some extent the effect of income tax reduction by putting upwards pressure on prices.

According to the data from the Statistical Office of Kosovo (SOK), consumption during 2009 decreased in nominal terms, however, as a result of deflation, in real terms consumption increased compared to the previous year. Also, investments in real terms recorded a higher growth rate. Public spending increased in both, nominal and real terms. Therefore, the economy of Kosovo during 2009 according to SOK data recorded a positive growth rate of 2.9 percent, while IMF estimated a growth rate of 3.8 percent (Figure 5).

The economic recovery in developed countries during the first half of 2010 was reflected also in Kosovo's economy. In this context, remittances and FDI increased in the first half of 2010, while exports doubled compared to the same period of the previous year. This improved the perceptions of banks for the business environment in Kosovo, thus contributing to a slight recovery of lending growth rates. Also, the continuous growth of public spending represents an important contributor to the improved economic activity. Therefore, the real GDP growth in 2010 is projected to reach at 4.6 percent according to IMF projections and 4.8 percent according to the projections of the Ministry of Economy and Finance (IMF, 2010; MEF 2010).

Prices during the first half of 2010 can be considered as stable. Consumer Price Index (CPI) in June 2010 recorded an annual growth rate of 2.2 percent (Figure 6). As for the annual average, a deflation rate of 0.4 percent was recorded in June 2010. Food and transport prices represent the main contributor to overall increase of prices during the first half of 2010. The large impact of import prices and the lack of monetary policy instruments due to the euroization have limited to a large extent the options of Kosovo's authorities to influence price developments in the country. Therefore, prices in Kosovo's economy are

Figure 5. Real GDP growth



Source: IMF (2010c), SOK (2010a)



largely determined by price movements in the international markets. For instance, import prices until June 2010 recorded an annual increase of 3.8 percent, largely influencing the price level in Kosovo. Producer prices during the first half of 2010 remained stable compared to the previous year (0.2 percent increase in June 2010 compared to June 2009).

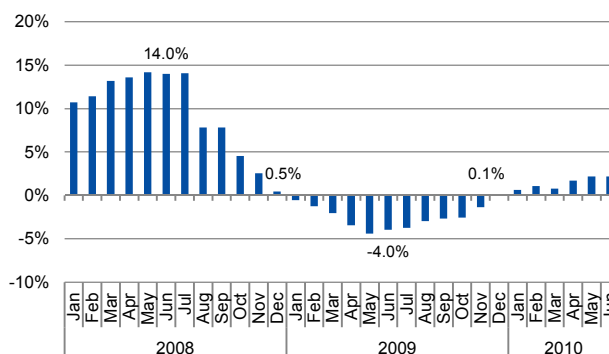
The high unemployment rate continues to be one of the main challenges for the Kosovo's economy. According to the Labor Market Survey conducted by the Statistical Office of Kosovo (SOK), the unemployment rate in Kosovo stood at 45 percent in 2009. Unlike many countries of the region and the EU, where the global crisis led to increased unemployment rate, the unemployment rate in Kosovo has not been negatively affected by the crisis, but decreased by around 2 percentage points. However, Kosovo remains the country with the highest unemployment rate in the region (Figure 7).

Fiscal policy in the postwar period in Kosovo may be considered as conservative and mainly characterized by budget surpluses or low deficits. This approach to fiscal policy to some extent reflects the limitations of government to finance budget deficits due to the lack of instruments (e.g. lack of law on public debt until 2009). Consequently, the only sources for financing the budget deficit were the previously accumulated surpluses and donor support to the Kosovo budgeted from the international community.

Similar to other countries, public spending had a significant role in mitigating the effects of the global crisis in Kosovo. However, unlike many countries where the country's budget was used for direct assistance to financial institutions or other sectors of the economy through various forms of transfers, the increased public spending in Kosovo stimulated the overall level of consumption and investment in the economy through increased government investments, especially in infrastructure.

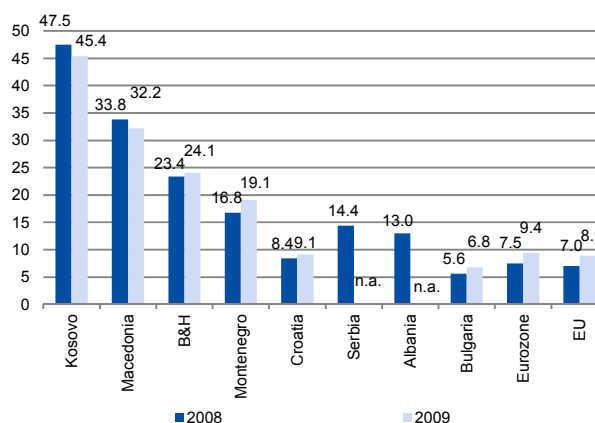
In 2009, Kosovo's budget recorded a deficit equivalent to 2.2 percent of GDP, which resulted from the higher growth rate of expenditures. Budget expenditures in 2009 recorded a growth rate of 29.7 percent, while budget revenues, increased by 21.7 percent. As a result of the import-based economy, the main source of budget revenues in Kosovo consist of border

Figure 6. Consumer Price Index, annual change



Source: SOK

Figure 7. Unemployment Kosovo, region and Europe, in percent



Source: SOK (2010b)

taxes (55.3 percent of total revenues). The high dependency of the budget revenues on a single source has increased the sensitivity of Kosovo's budget to external sector shocks. In this context, the decline of imports during 2009 resulted in a slowdown of revenues from border taxes, which had a significant impact on the overall level of budget revenues. On the other hand, the increase of the VAT rate from 15 to 16 percent in 2009 had a positive impact on budget revenues. However, budget revenues during 2009 increased as a result of the dividend transfer from the PTK to the Kosovo's Government budget.

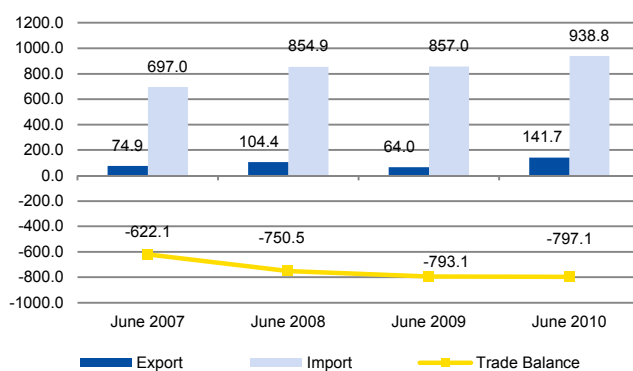
During the first half of 2010, Kosovo's Budget was characterized with a surplus of euro 67.3 million. During this period, revenues recorded a higher growth rate compared to expenditures. While revenues recorded an annual growth of 27 percent compared to the same period of the last year, budget expenditures increased by 8.4 percent, representing a lower growth rate compared to the annual growth of 18.1 percent in the first half 2009. According to the revised budget, year 2010 is expected to record a deficit of 3.7 percent of GDP. In general, Kosovo's public finances may be considered to have been sustainable during the post-war period and, as such, have not represented a potential risk for the financial stability in the country. In addition, the exposure of Kosovo's financial sector to the Government is limited, since financial institutions operating in Kosovo do not have claims on the Government, but only liabilities consisting of government deposits in financial institutions (mainly CBK).

The approval of the law on public debt and Kosovo's membership in the International Monetary Fund (IMF) and World Bank (WB) represents important developments for public finances and the economic development of Kosovo. In June 2010, the IMF for the first time approved the 'stand-by' arrangement for Kosovo amounting at euro 108.9 million (SDR 92.9 million), which represents 157 percent of the total quota for Kosovo in the IMF. This arrangement has been approved for a period of 18 months. Initially, Kosovo could withdraw euro 22.1 million, while the withdrawal of the other instalments is subject to the quarterly reviews. At the same time, the approval of the financial program with the IMF has created the possibility of using the donations pledged by the European Commission and the World Bank. However, during the second quarter, Kosovo's Parliament did not ratify the loan allowed by the World Bank, amounting at USD 20 million, which was aimed at modernizing the public administration.

The transmission of the global economic crisis to the Kosovo's economy was mostly channelled through the external sector, namely through the decline of exports, remittances and foreign direct

investments, which represent important sources of finance for the economy. The crisis affected also Kosovo's imports, which recorded a slight decrease for the first time in the postwar period. The main contributor to the decline of imports in Kosovo was the decrease of prices in international markets during 2009. Kosovo's economy continues to record a high level of trade deficit (44.5 percent of GDP in 2009), which reflects the low level of domestic

Figure 8. Trade Balance, in millions of euro



Source: CBK

production in Kosovo and the high dependence on imports. As a result of improvements in the external sector during the first half of 2010, positive developments were noticed in the economy of Kosovo as well. During this period, remittances increased by 1.4 percent and amounted at euro 225.8 million until June 2010 (euro 222.8 until June 2009), while FDI increased by 13.0 percent amounting at euro 125.1 million (euro 117.7 million until June 2009). Also, imports grew by 9.5 percent, amounting at euro 938.7 million, suggesting that domestic demand during this period increased compared to the same period of the last year. The most significant impact is observed in the volume of exports, which until June 2010 amounted at euro 141.7 million, representing an annual growth rate of 121.6 percent (Figure 8). The increase of exports is largely attributed to the export of base metals, representing 64.5 percent of total exports. Exports of base metals mostly consist of nickel (76 percent of base metal exports). High concentration of Kosovo's exports on only few products increases the sensitivity of the exports performance against external shocks, as it happened during 2009 when the export of base metals decreased by nearly 30 percent. Such developments, despite the low base of exports, might increase the vulnerability of the overall performance of the economy.

## 5. The Financial Sector in Kosovo

### 5.1. General Characteristics

In June 2010, financial sector assets amounted at euro 2.9 billion, recording an annual growth rate of 17.5 percent that is similar to the annual growth rate recorded in the previous year (18.4 per cent in June 2009), despite the lower growth rate of banking sector assets, which represent the largest share of total financial sector assets. The annual increase of insurance companies' assets by 35.8 percent and pension funds' assets by 20.1 percent, respectively, contributed significantly to the growth of financial sector assets in the first half of 2010.

**Table 3. Number of financial institutions**

Description	June 2007	June 2008	June 2009	June 2010
Commercial banks	7	8	8	8
Insurance companies	10	12	11	11
Pension funds	2	2	2	2
Financial auxiliaries	30	29	28	29
Microfinance institutions	16	16	19	17

Source: CBK

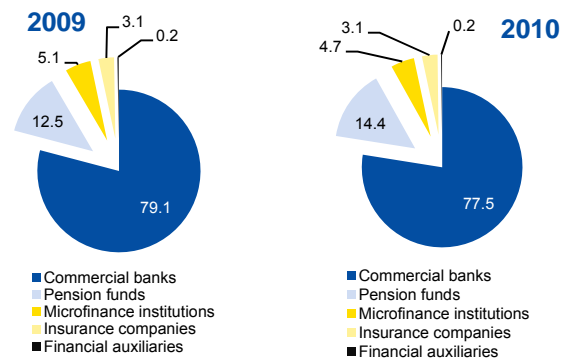
The number of financial institutions operating in Kosovo in June 2010 was 68, which is similar to June 2009, when the financial system consisted of 67 financial institutions. During this period, the Central Bank revoked the license of two microfinance institutions, while a new institution that acts as a financial auxiliary entered the market (Table 3). Banking sector continues to represent the largest sector within Kosovo's financial sector, although its share to total financial sector assets recorded a slight decrease (Figure 9). In June 2010, banking sector assets amounted euro 2.2 billion, representing an annual increase of 15.1 percent. However, since banking sector assets are mainly dominated by

loans, the slowdown of the credit growth led to a lower share of banking sector assets to total financial sector assets. In June 2010, the share of banking sector assets to total financial sector assets decreased to 77.5 percent, from 79.1 percent in June 2009 (Figure 9). In the same period, also microfinance institutions reported a slowdown of credit growth, which was reflected in a slight decline of their share to total financial sector assets. On the other hand, positive rates of return on KPST investments during the first half of 2010 contributed to the increase of pension fund assets, which increased their share to total financial sector assets to 14.4 percent in June 2010 (12.5 percent in June 2009).

The market structure in Kosovo's financial system is different in different sectors (Figure 10). While the insurance sector and microfinance institutions have a moderate degree of market concentration, the banking market continues to be characterized by a high degree of concentration. The Herfindahl-Hirschman Index (HHI) for the insurance market, in June 2010, stood at 1061 points, while for the microfinance institutions sector it stood at 1643 points. Regarding the banking sector, the HHI in June 2010 stood at 2371 points. However, the degree of concentration in this sector has followed a steady decline since 2008. In June 2010, the HHI for the banking market was for 252 points lower compared to the previous year. The decline in the degree of concentration has mainly resulted from a more pronounced slowdown of credit growth in the large banks, while small banks recorded higher rates of credit growth. The decrease of the degree of concentration in the banking market is also shown by the decline of the market share of three largest banks from 82.8 percent in June 2009 to 78.9 percent in June 2010.

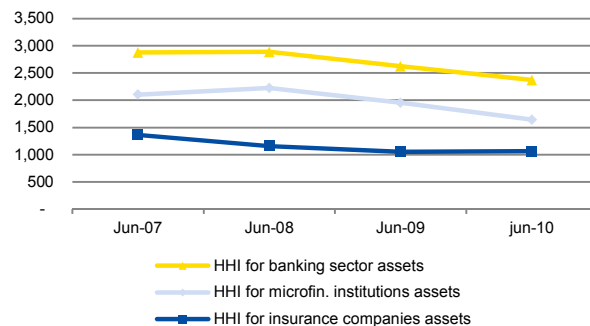
Kosovo's financial sector (including CBK) continues to invest a substantial portion of assets in the external sector. In June 2010, Net Foreign Assets (NFA) of Kosovo's financial sector amounted at euro 1.74 billion (43.4 percent of GDP), which represents an annual increase of 8.6 percent. Financial sector claims on the external sector recorded an annual growth of 17.3 percent in June 2010, reaching at euro 2.1 billion. In terms of sector, the structure of claims on the external sector is dominated by the claims of CBK that in June 2010 composed 57 percent of total claims, followed by the claims of commercial banks (26.0 percent) and pension funds 16.7 percent (Figure 11). Regarding the instruments, financial

Figure 9. The structure of financial sector assets, by sector



Source CBK (2010)

Figure 10. HHI for financial sector in Kosovo



Source: CBK (2010)

sector claims on the external sector mainly consist of deposits (45.8 percent), followed by securities (27.1 percent of total claims) and loans (12 percent of total claims).

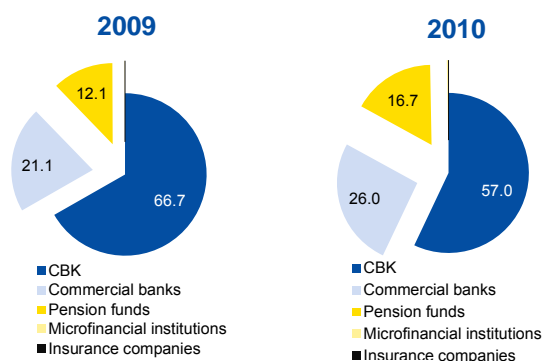
In June 2010, financial sector liabilities to the external sector amounted at euro 349.3 million (euro 178.6 million in June 2009). The increase of liabilities to the external sector in is mainly attributed to the membership of the Republic of Kosovo in the IMF (IMF account and SDR allocations) in year 2009.<sup>4</sup> The structure of financial sector liabilities to the external sector primarily consists of the banking sector liabilities to financial institutions abroad (40.8 percent of total liabilities). Regarding the structure of banking sector liabilities to the external sector, loans that these institutions have received from financial institutions operating abroad represent the largest category (44.4 percent of total), followed by non-residents' deposits at commercial banks operating in Kosovo (21.7 percent).

Kosovo's financial sector has no claims on the government, while liabilities to this sector, which mainly consist of government deposits at the CBK, reached at euro 940.7 million in June 2010 (euro 900.6 million in June 2009). Government deposits at the CBK (including Kosovo Privatization Agency deposits) in the reporting period decreased to euro 802.6 million (euro 899.1 million in June 2009), reflecting the increase of government expenditures during this period. Since October 2009, it is observed an increase in the banking sector liabilities to the government, mainly due to the transfer of PTK dividend to the government. In order to avoid a potential liquidity shock to the banking sector, the amount that was transferred to the government continued to be held as deposits in commercial banks. Financial sector claims to the real sector continued to be dominated by loans issued by commercial banks. Claims to the real sector amounted at euro 1.5 billion, an annual growth of 10 percent. Liabilities to the real sector are mainly composed of deposits in commercial banks.

## 5.2. The banking sector exposure to other financial institutions

The banking sector continues to have a low level of exposure to other sectors that operate within the financial system of Kosovo, while the interbank market is virtually inexistent. Other financial institutions' deposits in commercial banks operating in Kosovo represent only 4.8 percent of total banking sector deposits. These deposits mainly consist of the deposits of insurance companies held at commercial banks. Also, the credit exposure of the banking sector to other financial institutions remains at a very low level, with only 0.3 percent of total banking sector loans. Majority of these loans are issued to microfinance institutions (68.6 percent), followed by insurance companies, (29.2 percent).

Figure 11. The structure of financial sector investments, by sector



Source: CBK (2010)

<sup>4</sup> According to statistical standards, the value of SDR and the IMF quota are registered on gross basis, on the asset and liability side.

The low level of linkage among financial institutions is also observed in terms of the ownership structure of these institutions. Based on the shareholders' structure of financial institutions operating in Kosovo, only three cases were identified where individuals had shares both in commercial banks and insurance companies.

The low level of interdependence between financial institutions operating in Kosovo implies a low level of potential systemic risk in the financial sector. In other words, financial difficulties in one sector are not likely to have a substantial impact on other sectors. However, given the good performance and stability that financial institutions that operate in Kosovo have demonstrated, an increased interaction between them would contribute to a more rapid expansion of their activity, without posing substantial increase of risk for the stability of the financial sector.

## 6. Banking Sector

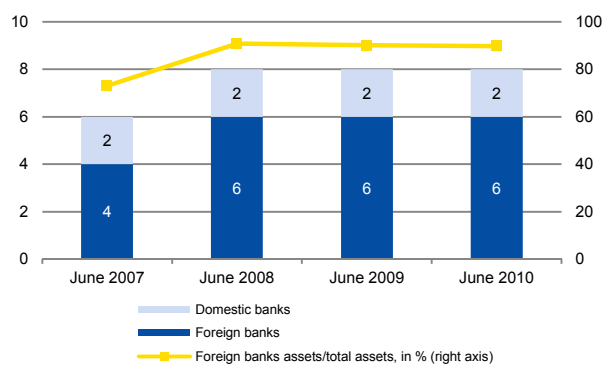
### 6.1. General characteristics of the banking sector

The structure of the banking sector with regard to the number and the ownership of banks in June 2010 was similar to the same period of the previous year. In this period, Kosovo's banking sector consisted of eight commercial banks, of which six were foreign-owned and two domestically-owned (Figure 12). The dominance of foreign-owned banks in the banking sector is expressed also by the large share of the assets of these banks to total banking sector assets. In June 2010, foreign-owned bank assets represented 89.8 percent of total banking sector assets, while domestically-owned banks accounted for the remaining 10.2 percent.

Commercial banks continued to expand their infrastructure, thus creating conditions for easier access of clients to banking services. However, the slowdown of intermediation activity that began in 2009 and

continued during 2010 had a negative impact on banking sector income. As a consequence, banks were pushed to take measures for reducing their expenditures, causing a slowdown of banking sector network expansion (Table 2). In June 2010, Kosovo's banking sector had 296 branches and sub-branches, which shows an expansion by only 7 units since June 2009. A slower trend of expansion was observed also with regard to the number of Automated Teller Machines (ATM) and Points of Sale (POS) installed during this period. Despite the recent slowdown, Kosovo appears to compare well with other region countries with regard to the scope of banking sector infrastructure. The number of bank branches per 1000km<sup>2</sup> in Kosovo stands at 26.8, while the average for the region is 23.8. Similarly, the number of ATM per 1000km<sup>2</sup> in Kosovo is equivalent to the average for the region, which in 2009 was 38. Among measures taken by commercial banks to reduce expenditures

Figure 12. Number of banks and ownership structure



Source: CBK (2010)



was also the reduction of the number of employees in this sector. The number of banking sector employees in June 2010 was 3727, compared to 3827 in June 2010.

**Table 4. Banking sector network**

Description	June 2007	June 2008	June 2009	June 2010
Number of branches and sub-branches	227	279	289	296
Number of employees	2,855	3,762	3,827	3,727
Number of ATM	0	1,061	1325	1329
Number of POS	0	2,837	4,612	5,493
Number of e-banking accounts	0	11,242	17,496	48,188

Source: CBK 2010

Among other services, banks continued to mark a rapid increase of e-banking accounts, which in June 2010 reached at 48188 from 17496 in June 2009. These services represent important factors for the enhancement of banking sector efficiency and also facilitate the access of clients to banking services.

In 2010, the payment system in Kosovo's banking sector marked an increase in the number as well as in the volume of total transactions, reflecting a sustained confidence and efficiency of the banking sector in Kosovo. The total number of transactions reached 1.87 million in June 2010, an increase of 3.0 percent compared with the same period in 2009. Amounting at euro 1.94 billion in June 2010, the value of total banking transactions marked an annual increase of 18.9 percent.

## 6.2. Banking sector balance sheet

### 6.2.1 Assets

Banking sector continued to expand the activity also during the first half of 2010 with assets reaching at euro 2.2 billion in June 2010 (55.1 percent of GDP), representing an increase of 15.1 percent. The main contributing categories to the overall increase of banking sector assets were loans and securities (Figure 13). The activity of commercial banks operating in Kosovo is dominated by the intermediation activity within the country, while the exposure to the external sector accounted for 24.5 percent of total assets in June 2010. Compared to June 2009, banking sector assets invested abroad increased their share to total assets by 5pp. These assets are mainly deposited in commercial banks and a smaller part is invested in securities.

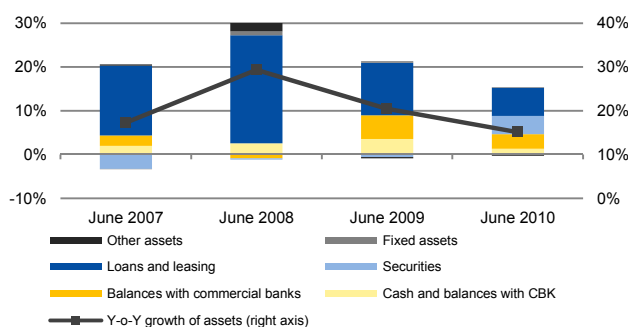
Table 5. The structure of banking sector assets

Description	June 2007		June 2008		June 2009		June 2010	
	In millions of euro	In percent	In millions of euro	In percent	In millions of euro	In percent	In millions of euro	In percent
Cash and balances with CBK	152.8	12.4	184.5	11.5	241.9	12.6	268.1	12.1
Balances with commercial banks	211.1	17.1	200.4	12.5	286.7	14.9	351.6	15.8
Securities	46.6	3.8	43.4	2.7	34.1	1.8	114.0	5.1
Loan and leasing	784.4	63.4	1089.7	68.1	1280.9	66.5	1404.6	63.3
Fixed assets	23.1	1.9	33.4	2.1	40.1	2.1	42.6	1.9
Other assets	18.6	1.5	48.2	3.0	43.5	2.3	37.8	1.7
<b>Total</b>	<b>1236.6</b>	<b>100%</b>	<b>1599.6</b>	<b>100%</b>	<b>1927.1</b>	<b>100%</b>	<b>2218.8</b>	<b>100%</b>

Source: CBK (2010)

The activity of Kosovo's banking sector continues to be concentrated in lending to the domestic economy, with loans accounting for 63.3 percent of total banking sector assets in June 2010 (Table 5). However, compared to the previous year, banks marked a slowdown of lending to the domestic economy, while increased the investments abroad, such as in securities. As a consequence, the share of loans to total assets in June 2010 was lower by 3.2 pp compared to June 2009, while a larger share of banking sector assets allocated to investments in securities (3.4 pp). As a result, securities became the second largest contributors to the growth rate of total banking sector assets (Figure 13).

Figure 13. The contribution in asset growth by category



Source: CBK (2010)

Following the decline that started in year 2008, in the first half of 2010 investments in securities picked up again, reaching an amount of euro 114 million (euro 34.1 million in June 2009). The decline of investments in securities in the previous period is mainly attributed to the rapid expansion of banking sector loans during that period, which provided a higher rate of return to the banks due to the high interest rates prevailing in the market. In addition, financial market turbulences during 2008 and 2009 increased the reluctance of banks to invest in securities abroad. However, the slowdown of credit growth during the first half of 2010, together with improved conditions in the international financial markets during 2010, led to a sharp increase in investments in securities during this period. These developments suggest that banks shifted a part of their resources from lending to the domestic economy towards investments in securities in the external sector. The structure of bank investments in securities consists primarily of investments in government bonds, financial corporations and non-financial corporations.

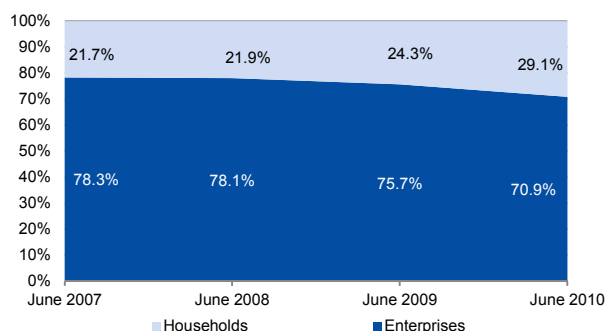
### 6.2.1.1 Loans

The decline of income from abroad and possible implications on economic growth raised uncertainty over the capability of borrowers to repay their debts. This resulted in slowdown of credit growth, while the funding sources of commercial banks (mainly deposits)



continued to grow at a similar trend with previous periods. In June 2010, loans issued by Kosovo's banking sector reached at euro 1.4 billion, recording an annual growth rate of 9.6 percent, while in June 2009 the annual growth rate of loans was 17.5 percent. Credit tightening by the banking sector mostly affected loans to enterprises, which increased at a very low rate compared to previous periods. In the first half of 2010, loans issued to enterprises recorded an annual growth rate of only 2.3 percent, compared to the growth rates of 13.9 percent and 38.5 percent in 2009 and 2008, respectively. On the other hand, the growth rate of loans issued to households seems not to have been affected. Loans issued to households in June 2010 recorded an annual growth rate of 31.4 percent (30.4 percent in June 2009). Consequently, the share of loans to enterprises to total loans decreased at 70.9 percent (75.7 percent in June 2009), while loans to households increased their share at 29.1 percent (Figure 14).

Figure 14. Structure of loans by sector

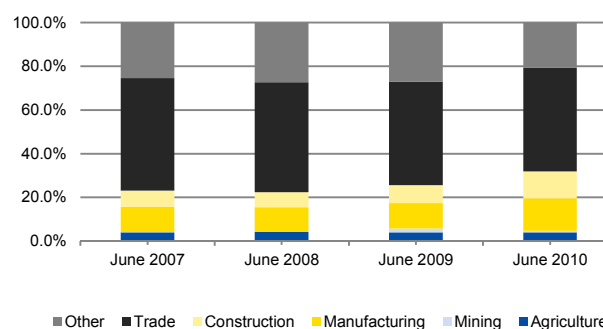


Source: CBK (2010)

Reluctance of banks to expand lending to enterprises reflects banks' uncertainty about the performance of this sector, which is characterized by a higher level of sensitivity to domestic and global economic developments. On the other hand, lending to households is perceived as less risky primarily because household revenues are considered to be more stable since a large proportion are employed by the public sector.

The improvements in the performance of global economy during 2010 had a positive impact on the Kosovo's economy as well. Banks' perceptions on the economic environment in the country improved, which was expressed through a higher rate of credit growth during this period compared to the end of 2009. The growth rate of 9.6 percent in June 2010 is slightly higher than the growth rate of 8.9 percent in December 2009, showing a slight recovery of the credit growth.

Figure 15. Structure of loans by industry, in percent



Source: CBK (2010)

Moreover, the new loans issued during the first half of 2010 marked an annual increase of 5.6 percent, compared to the amount of loans issued during the first half of 2009. The increase in the amount of new loans issued during this period is primarily attributed to the increase of household loans, while credit tightening for enterprises remains present. The credit tightening for loans to enterprises might largely restrict investment potentials in the country, with negative consequences for the overall performance of the economy.

The structure of loans extended to enterprises continues to be dominated by loans extended to the services sector, which represent 67.1 percent of total loans to enterprises. Within

services, the majority of loans are issued to the trade sector (51 percent of total loans to enterprises), which reflects the high reliance of the Kosovo's economy on this sector (Figure 15). The largest increase during the first half of 2010 was noticed in loans issued to the manufacturing sector and the construction industry, which grew by 33.6 and 59.7 percent, respectively. As a consequence, the share of loans to the manufacturing sector reached at 14.7 percent of total loans to enterprises (11.8 percent in June 2009); while loans to the construction industry accounted for 11.2 percent in June 2010 (8.1 percent in June 2009).

Loans issued to the agriculture sector continue to represent only a small part of total loans issued to enterprises. In June 2010, loans issued to the agriculture sector amounted at euro 39.9 million, representing only for 4 percent of total loans. The low share of loans extended to the agriculture sector to some extent might be attributed to high interest rates on agriculture loans, which may discourage farmers to apply for loans. In addition, some of the specifics that characterize the agricultural sector, such as the uncertainty over property rights and the small number farms organized as businesses with appropriate bookkeeping, may increase the credit risk for this category of loans, resulting in higher interest rates and more stringent lending criteria.

Longer maturity loans have continued to increase their share to total loans. Loans with maturity of over two years represented 71.8 percent of total loans in June 2010, which indicates a continuous increase of these loans over the past years (67.2 percent of total loans in 2009 and 65.6 percent of total loans in 2008, respectively). The share of loans with maturity of up to two years followed a decreasing trend on the other hand, representing 28.2 percent of total loans in June 2010 (32.8 percent of total loans in 2009 and 34.4 percent of total loans in 2008, respectively).

### 6.2.2. Liabilities

Banking sector activity continues to be financed mainly from domestic sources of financing, which has contributed to a lower sensitivity of Kosovo's banking sector towards the changing conditions in the external financial markets during the crisis. Deposits collected within the country continue to be the main source of finance for banks, representing 79.0 percent of total banking sector liabilities (Table 6). Another important source of finance for commercial banks in Kosovo have been own resources, representing 10.1 percent of total banking sector liabilities. In June 2010, own resources recorded an annual growth of 10.3 percent, which mainly resulted from the increase of shareholder capital, which comprises around 73.3 percent of total own resources.

Description	June 2007		June 2008		June 2009		June 2010	
	In millions of euro	In percent	In millions of euro	In percent	In millions of euro	In percent	In millions of euro	In percent
Balances from other banks	25.0	2.0	32.6	2.0	41.8	2.2	48.5	2.2
Deposits	981.6	79.4	1264.4	79.0	1513.0	78.5	1751.7	79.0
Other debt	3.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	94.3	7.6	112.4	7.0	152.1	7.9	168.7	7.6
Subordinated debt	7.0	0.6	7.0	0.4	16.9	0.9	24.4	1.1
Own resources	125.6	10.2	183.2	11.5	203.3	10.5	224.3	10.1
Total liabilities	1236.7	100%	1599.6	100.0%	1927.1	100%	2217.6	100%

Table 6. Structure of banking sector liabilities

Source: CBK (2010)

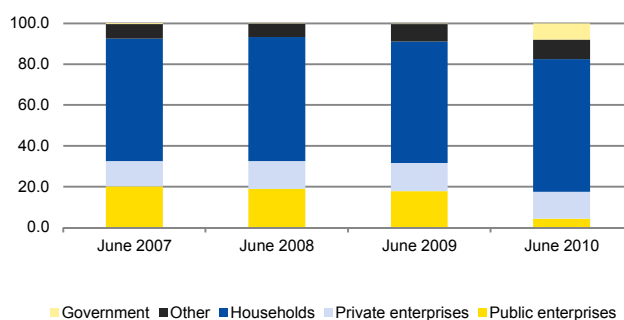
Despite that the structure of liabilities of Kosovo's banking sector is mainly dominated by domestic funding, a tendency of increasing the use of external funding has been observed recently. This will broaden the sources of finance for banks, contributing to the increase of their capacity to further expand the lending activity. In June 2010, the banking sector liabilities to the external sector in the form of subordinated debt reached at euro 24.4 million from euro 16.9 million in June 2009. Despite an annual increase of 44.3 percent, the share of the subordinated debt to total liabilities continues to be low at only 1.1 percent.

### 6.2.2.1 Deposits

In June 2010, deposits amounted at euro 1.8 billion, which represents an annual growth of 15.8 percent. Although the annual growth rate of deposits in this period was lower than in 2009 by 3.9pp, deposits were less sensitive to the crisis mainly because the Kosovo's banking sector is mainly dominated by deposits collected within the domestic economy.

The increase of total banking sector deposits was mainly driven by the increase of deposits collected from households, which in June 2010 amounted at euro 1.13 billion, contributing with 15.6pp to the total deposit growth. Reaching a value of euro 306.2 million, enterprise deposits recorded an annual decline of 36.1 percent in June 2010. The decline in enterprise deposits is mainly attributed to the fall of the deposits of public enterprises from euro 270.4 million in June 2009 to euro 75.7 million in June 2010. The sharp decline of deposits of public enterprises, and at the same time the substantial increase of government deposits (from euro 1.5 million in June 2009 to euro 138.1 million in June 2010) is mainly due to the transfer of Post and Telecom of Kosovo (PTK) dividend amounting euro 200 million to the government in October 2009. On the other hand, the value of deposits of private enterprises increased by 10.5 percent in June 2010, amounting at euro 230.5 million.

Figure 16. Structure of deposits by sector, in percent



Source: CBK (2010)

The structure of deposits at the banking sector remained similar to previous periods, with household deposits representing the main source of deposits for the banking sector (65 percent of total), followed by deposits of enterprises that represent 17.5 percent of total (Figure 16). Government and other financial institutions' deposits are represented with 7.9 and 5.0 percent, respectively.

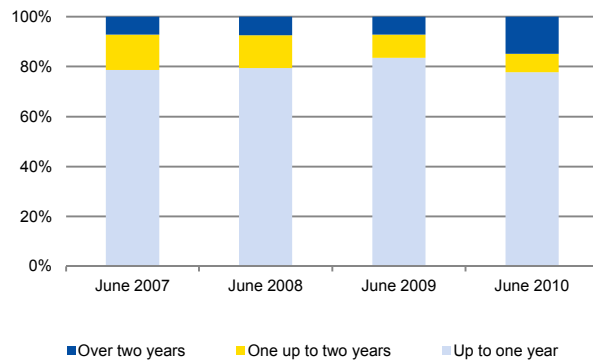
The deposits of non-residents in the Kosovo's banking sector in June 2010 represented 4.3 percent of total deposits (3.6 percent in June 2009), indicating an upward trend of these deposits in the recent years. Favourable interest rates on deposits and the increased public confidence on Kosovo's banking sector are among the main factors that have contributed to the growth of non-residents' deposits. Risks deriving from potential exchange rate

fluctuations for deposits in the Kosovo's banking sector are minimal, given that 94.4 percent of deposits in this sector are held in euro.

In terms of the maturity, the structure of deposits has remained similar compared to the previous periods. Time deposits compose 52.7 percent of total deposits, followed by transferable deposits representing 30 percent of total deposits. The remainder belongs to saving deposits, which in June 2010 represented 17.3 percent of total deposits.

Regarding time deposits, 39.5 percent are deposits with maturity of up to one year, 7.6 percent with maturity of over two years, and the remaining are deposits with maturity of one to two years (Figure 17). The continuous increase of deposits with longer maturities will contribute to a sounder and longer-term lending, considering that banking sector assets in Kosovo are mainly financed by deposits.

Figure 17. Structure of time deposits



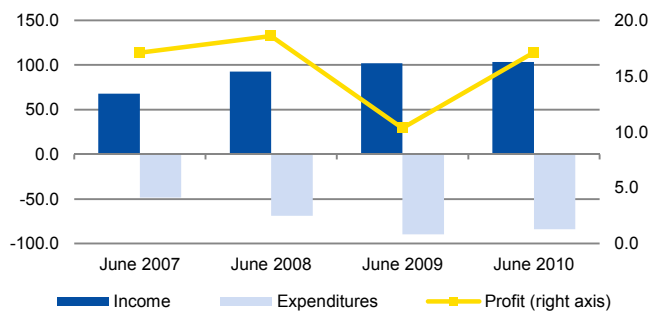
Source: CBK (2010)

### 6.3. Banking sector performance

After a period of declining profits, in June 2010, Kosovo's banking sector attained a net profit of euro 19.4 million, which represents an annual growth of 56.8 percent (Figure 18). The increase of the profit mainly resulted from the reduction of expenditures, which reflects the measures taken by commercial banks to safeguard their efficiency, considering the slowdown in the financial intermediation activity. Whereas, revenues continued to grow at lower rate compared to previous periods.

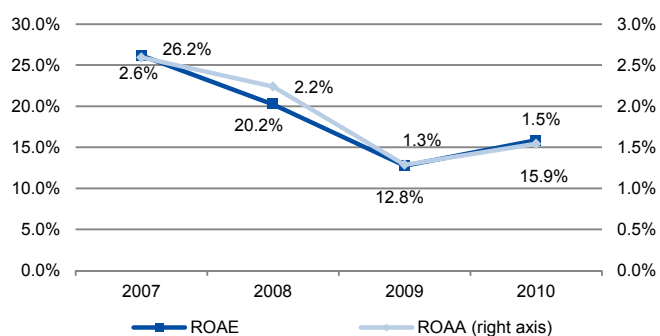
After two years of declining trend in profitability, the annual increase of net profit in June 2010 led to an increase of the profitability indicators, such as the Return on Average Asset (ROAA) and the

Figure 18. Balance of income and operational expenditures, in millions of euro



Source: CBK (2010)

Figure 19. Profitability Indicators, in percent



Source: CBK (2010)

Return on Average Equity (ROAE) (Figure 15). The increase in ROAA and ROAE was mainly a result of the increase in the profits of the three largest banks in the economy.

**Box 1. Decomposition of factors contributing to the change of ROAE**

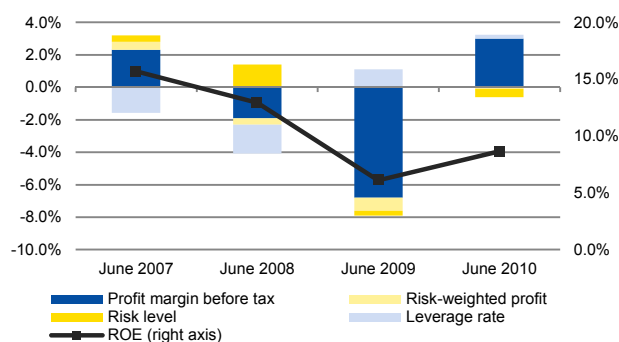
Return on Average Equity (ROAE) represents an important indicator that measures the profitability of the banking sector. After three years of continuous decline, in June 2010 it was noticed an increase of this indicator compared to previous year. The factors that have affected the change in ROAE can mainly be decomposed through the following formula, which presents ROAE as a product of four different factors.

$$ROAE = \left( \frac{\text{Profit Before Tax}}{\text{Operational Profit}} \right) \times \left( \frac{\text{Operational Profit}}{\text{Risk Weighted Assets}} \right) \times \left( \frac{\text{Risk weighted Assets}}{\text{Total Assets}} \right) \times \left( \frac{\text{Total Assets}}{\text{Total Equity}} \right)$$

Profit Margin
Risk Adjusted Profit
Risk level
Leverage

The increase of the ROAE is driven by higher profit margin before tax implying that the banking sector income is increasing faster than expenditures. Therefore, the increase of profit due to the higher profit margin is considered to have positive implications for the resilience of the banking sector. The banking sector resilience is affected positively also when the increase of ROAE results from the higher level of risk adjusted profit, which implies that banking profit is increasing at a higher rate compared to the increase of risk-weighted assets. On the other hand, the increase of ROAE as a result of a higher risk level has negative implications for the banking sector sustainability, indicating that the composition of banking sector assets is changing in favour of assets that bear higher risk levels. Banking sector resilience may be negatively affected also if its profitability increases as a result of higher leverage rate, which implies that banking sector assets are increasing at a higher rate compared to the increase of capital, meaning that less capital in proportion to total assets will be available as a cushion against potential losses.

Figure 20. Factors contributing to the change of ROAE



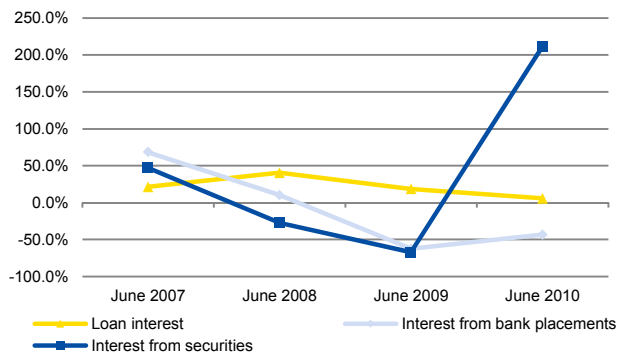
Source: CBK (2010)

Figure 20 presents the main contributors to the change of ROAE for the Kosovo's banking sector. The increase of ROAE in June 2010 appears to have resulted mainly from the increase of profit margin, thus reflecting the decrease of banking expenditures during this period. Profit margin was the most important determinant for the profitability of Kosovo's banking sector also in year 2009, when ROAE recorded a decline. Another factor that contributed to the increase of ROAE in June 2010 was the increase of leverage, indicating that assets have increased faster than the capital. On the other hand, the risk factor had a negative impact on the profitability of the banking sector. This reflects the lower growth rate of risk-weighted assets due to the lower growth rate of loans that represent the main component of risk-weighted assets. The lower rate of credit growth has had a negative impact on the profitability of the sector, but is considered to have decreased the level of risk taken by banks.

The slowdown in the growth trend of banking sector income, which started since the beginning of 2009, continued throughout the first half of 2010. Until June 2010, banking sector revenues reached at euro 103.2 million, recording an annual growth of 1.2 percent (June 2008: 36.5 percent; June 2009: 10.0 percent). The lower growth rate in income was mainly a consequence of the slowdown of credit growth, which caused a slowdown of interest income from loans that represents the main source of income for the banking sector. The slowdown in the growth trend of total income was also caused by the decline in the income from interest on bank placements abroad (Figure 21). Despite the increase in the volume of placements with banks abroad, the decline of interest rates in the European interbank market, following the reduction of key interest rate by the ECB, led to a decline of interest income from these placements. Banking sector income during the first half of 2010 was negatively affected also by other income, which recorded an annual decline of 80 percent in June 2010 (Figure 22). On the other hand, an upward trend was evident in the banking sector investments in securities during 2010, which had a positive impact in the overall level of income.

The structure of the banking sector revenues continues to be dominated by the interest income from loans, which in June 2010 represented 79.3 percent of total banking sector revenues (Figure 23). The structure of banking sector revenues reflects the structure of its balance sheet, where loans represent the majority of assets. However, the high dependence of banking sector revenues on a single source of income implies that the sector is more sensitive to developments in a certain market segment. This was evident in the previous two years, when the slowdown of lending activity led to a significant slowdown in the growth trend of banking revenues. Other important

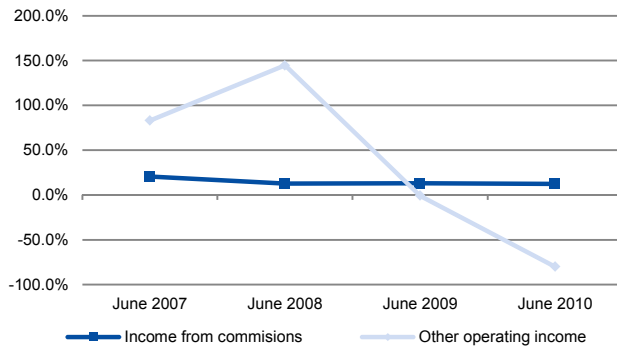
Figure 21. The trend of interest income, in percent



Source: CBK (2010)

The slowdown in the growth trend of total income was also caused by the decline in the income from interest on bank placements abroad (Figure 21). Despite the increase in the volume of placements with banks abroad, the decline of interest rates in the European interbank market, following the reduction of key interest rate by the ECB, led to a decline of interest income from these placements. Banking sector income during the first half of 2010 was negatively affected also by other income, which recorded an annual decline of 80 percent in June 2010 (Figure 22). On the other hand, an upward trend was evident in the banking sector investments in securities during 2010, which had a positive impact in the overall level of income.

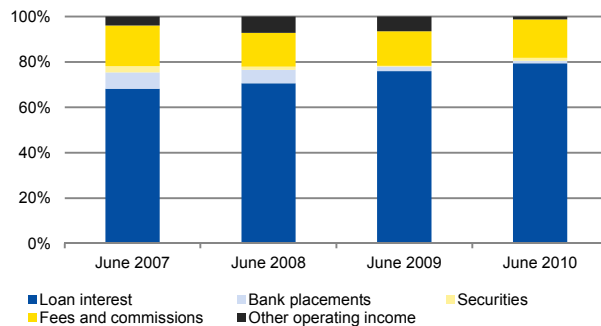
Figure 22. The trend of non-interest income, in percent



Source: CBK (2010)

On the other hand, an upward trend was evident in the banking sector investments in securities during 2010, which had a positive impact in the overall level of income.

Figure 23. Structure of banking sector income, in percent



Source: CBK (2010)



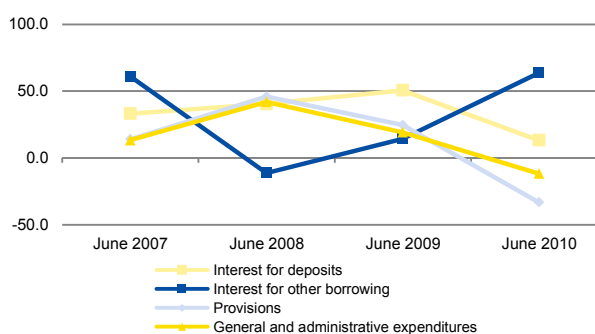
sources of income for the banking sector also consist of fees and commissions on banking services, which in the first half of the year generated 16.8 percent of total banking sector revenues.

Since the beginning of the functioning of Kosovo's banking system, the first half of 2010 represents the first period when banking sector expenditures recorded a decline (Figure 24). In June 2010, banking sector expenditures reached at euro 83.8 million, marking an annual decline of 6.5 percent. The reduction of banking sector expenditures mainly relied on the reduction of operating expenses in order to maintain the efficiency of the sector. In this context, general and administrative expenses of the banking sector in June 2010 recorded an annual decline of 11.6 percent. Among these expenditures, a more pronounced reduction was observed in other non-interest expenses which decreased by 50 percent, while personnel expenditures rose by just 0.6 per cent (20.4 percent in June 2009). Within non-interest expenses, the highest decline was noticed in the provisions for loan losses, which in June 2010 recorded an annual decline of 33.2 percent. The reduction of these costs has occurred despite the fact that the share of non-performing loans to total loans in June 2010 was higher than in June 2009. This is because the growth of non-performing loans has mainly taken place during the second half of 2009 and the provisions for new non-performing loans were allocated during that period. On the other hand, interest expenditures recorded a higher level,

which is mainly attributed to interest expenditures on deposits that recorded an annual increase of 13.3 percent. Increased interest expenditures on deposits resulted mainly from the increase in the value of deposits during this period, while interest rates on deposits recorded a slight decline.

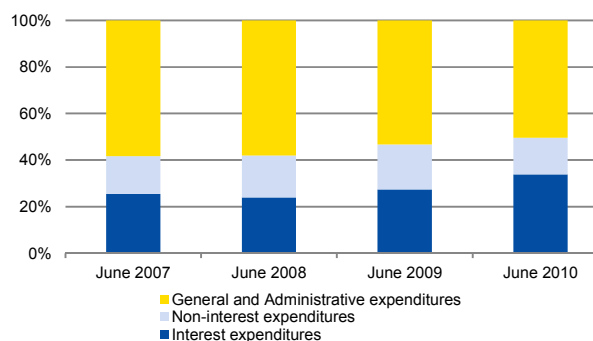
The structure of banking sector expenditures during the first half of 2010 remained similar to previous periods. General and administrative expenditures continue to represent the largest category, with a share of 50.3 percent in June 2009). The second largest category of banking sector expenditures are interest expenses, the share of which rose to 33.9 percent of total revenues in June 2010 from 27.4 percent in June 2009

Figure 24. The trend of banking sector expenditures, in percent



Source: CBK (2010)

Figure 25. Structure of banking sector expenditures, in percent

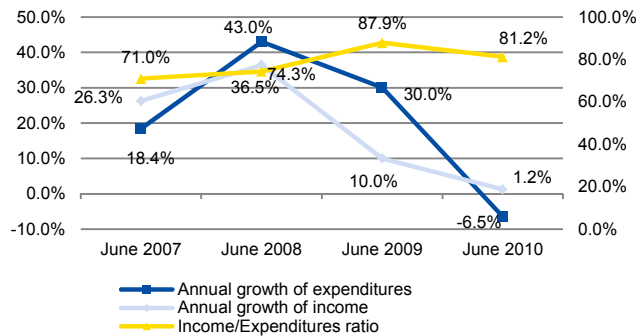


Source: CBK (2010)

(Figure 25). The share of non-interest expenses decreased to 15.8 percent of total expenditures in June 2010 from 19.3 percent in June 2009.

Measures taken by the banking sector to cut expenditures improved the efficiency of this sector. In this context, the expenditures-to-income ratio in June 2010 decreased to 81.2 percent, from 87.9 percent in June 2009 (Figure 26). Moreover, the cut in the number of employees in the banking sector led to an increase in the average amount of banking sector assets per employee. In June 2010, the average amount of banking sector assets per employee reached at euro 638 thousand, from euro 504 thousand in June 2009. The efficiency of the banking sector appears to have improved also in terms of the average number of loans issued by an employee (Table 7).

Figure 26. Income and expenditures growth trend, in percent



Source: CBK (2010)

Table 7. Banking sector efficiency indicators, in thousands of euro, unless otherwise indicated

Description	June 2007	June 2008	June 2009	June 2010
Assets/No. of employees	446.3	467.6	503.6	637.9
Profit/No. of employees	7.1	6.9	3.2	5.4
Number of loans/No. of employees	45.4	68	66.6	75.8
Net Interest Margin (in percent)	3.9	4.1	3.4	3.0

Source: CBK (2010)

However, the lower growth rate in revenues compared to the growth rate of banking sector total assets can be interpreted as a decrease of efficiency. The income-to-total assets ratio in June 2010 declined to 4.6 percent, from 5.3 percent in June 2009, suggesting that banking sector has been less effective in generating revenues from the use of assets.

Higher growth rate of interest expenditures compared to the growth rate of revenues led to the decrease of Net Interest Margin (NIM), which represents the difference between interest income and interest expenditures as a share of total banking sector assets. The NIM declined to 3.0 percent in June 2010 from 3.5 percent in June 2009 (Table 7). The decrease of NIM reflects the higher growth rate of deposits compared to the growth rate of loans, while interest rates were broadly stable.

#### 6.4. Interest rates

The average interest rate on loans (12-month moving average) has followed a stable trend, standing at 14.3 percent in June 2010, compared to 14.4 percent in June 2009 (Figure 27).



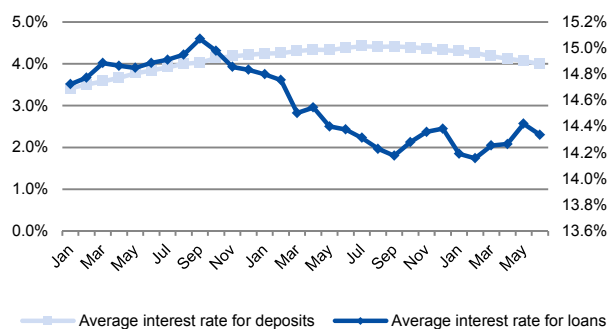
Loans to enterprises continue to bear higher interest rates compared to loans issued to households. One of the reasons that may have affected the banks' conservative approach towards enterprises is their higher sensitivity to shocks in the economy, as well as the higher risk profile of business projects. In June 2010, the average interest rate on loans to enterprises was 16.7 percent, while the average for household loans was 12.2 percent. Among loans to enterprises, higher interest rates are observed in loans for investment purposes.

After a period of continuous increase, interest rates on deposits recorded a slight decline compared to the same period of the previous year. The average interest rate on deposits (12-month moving average) in June 2010 was 4.0 percent compared to 4.4 percent in June 2009. The decline of deposit rates may be a result of the slowdown of lending activity by the banking sector, which reduced the demand for deposits. Interest rates on enterprise deposits tend to be higher in Kosovo's banking sector, mainly

because these deposits represent a larger amount of total deposits. In June 2010, the average interest rate on enterprise deposits stood at 5.27 percent, which is offered for deposits amounting over euro 250 thousand and with a maturity of 6 to 12 months. Regarding household deposits, the highest interest rate during the same period reached at 5.22 percent for deposits with maturity of over two years.

The interest rate spread in the Kosovo's banking sector has followed a downward trend, mainly due to the decline on loan interest rates, but also due to the increase of deposit rates. Interest rates in Kosovo are determined by a number of factors. Interest rates, especially on loans, depend heavily on factors that are under the control of commercial banks as well as by factors beyond their control. The impact of the Central Bank through monetary policy instruments is very limited due to the euroisation of the economy, which has eliminated the traditional instruments of central banks to influence interest rates. An increase of banking sector efficiency would contribute to the reduction of banking sector costs and, thus contributing to the reduction of lending rates. Moreover, the environment in which the banking sector operates has a significant impact on loan interest rates since it usually dictates the level of risk perceived by banks. The improvement of the overall business environment in the country is an essential factor for reducing the credit risk, which represents one of the main factors for the determination of the loan interest rates. In this regard, increasing the efficiency of the judicial system will facilitate the execution of collateral, thus affecting banks efficiency and reducing the credit risk. Also, an improvement of financial reporting by businesses will have a positive impact in increasing the confidence of banks towards the business, thereby reducing the costs of monitoring. Another important factor to reduce credit risk is the promotion of corporate governance at businesses, including an increase of planning capacities.

Figure 27. '12-month' moving average interest rates



Source: CBK (2010)

## 6.4. Banking sector risks

### 6.4.1 Liquidity risk

Deposits continue to represent the main source of finance for Kosovo's banking system, representing 79 percent of total banking sector liabilities. Other financing sources consist of own resources and subordinated debt, which represent 10 percent and 1.1 percent of total liabilities, respectively. The banks that are operating in Kosovo are financed mainly from the domestic sources and therefore do not depend much on the external funding.

Consequently, liquidity shortages in the international financial markets during the crisis did not have a significant impact on the banking sector of Kosovo.

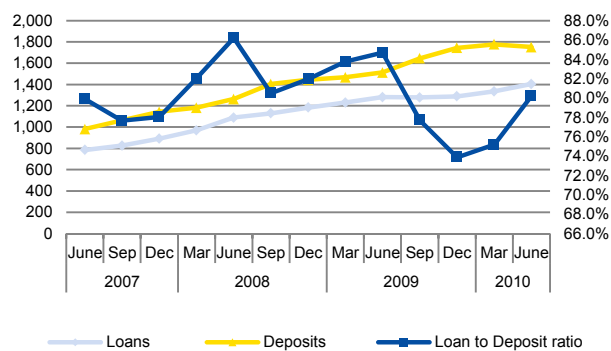
The banking sector of Kosovo was consistently characterized with satisfactory level of liquidity. All the banks have reported improvement in their liquidity position, which represents a positive development for the resilience of the banking system. The growth rate of deposits was

higher compared to the growth rate of loans, resulting in a lower loan-to-deposit ratio. In June 2010, loan-to-deposit ratio stood at 80.2 percent, whereas in June 2009 this ratio was 84.7 percent (Figure 28). The actual loan-to-deposit ratio is in line with Central Bank recommendations, which suggest that commercial banks operating in Kosovo in general should maintain a loan-to-deposit ratio of around 80 percent. This ratio reduces the need for banks to borrow short-term funds for liquidity support, which generally are characterized with higher costs.

The slowdown of credit growth was also reflected in the share of liquid assets to total assets of the banking sector. In June 2010, the share of liquid assets to total assets stood at 34.4 percent, which represents an increase of 5pp compared to the same period of 2009. The current ratio of liquid assets to total assets indicates a satisfactory liquidity position of the banking sector. In June 2010, the ratio between liquid assets and short-term liabilities stood at 67 percent,

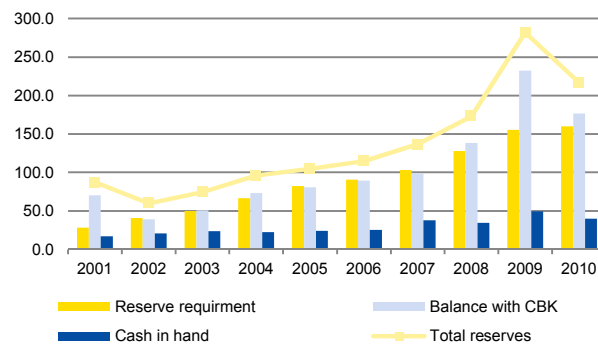
compared to 64 percent in June 2009. This indicator explains the ability of the banking sector to cover short-term liabilities with liquid assets. The improvement of this indicator was due to the higher growth rate of liquid assets, which recorded an annual growth rate of 35.4 percent, compared to the growth rate of 29.2 percent for short-term liabilities.

Figure 28. Banking sector loans and deposits



Source: CBK (2010)

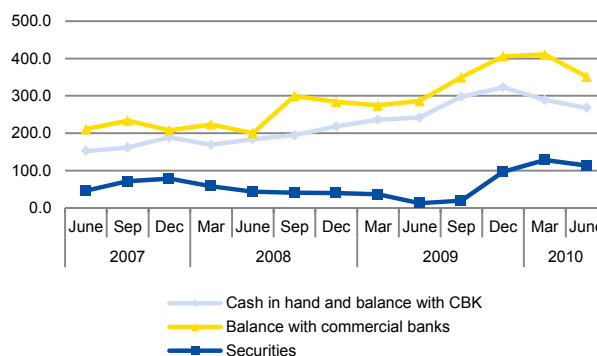
Figure 29. Banking sector reserves, in millions of euro



Source : CBK (2010)

The growth of liquid assets largely reflects the slowdown of lending activity by the banking sector, which implies that part of funds that could be used to lend to the economy, now are being invested in assets such as securities and placements with commercial banks abroad that are considered to be highly liquid compared to loans. Another factor that might have influenced the decision of banks to increase liquidity was the anticipation of withdrawal of PTK deposits from the banking sector. Since October 2009, a substantial part of these deposits were transferred from PTK accounts to the accounts of Kosovo's Government in commercial banks. The possibility of immediate withdrawal of these deposits posed a potential risk for the liquidity of some banks. As a result, banks showed a cautious behaviour, allocating additional funds as reserves at the CBK. At the end of 2009, commercial bank reserves at the CBK exceeded the required reserve by euro 126.2 million (Figure 29). In June 2010, balances with CBK were euro 216.9 million or 57 million more than the required reserves under the current banking regulations.

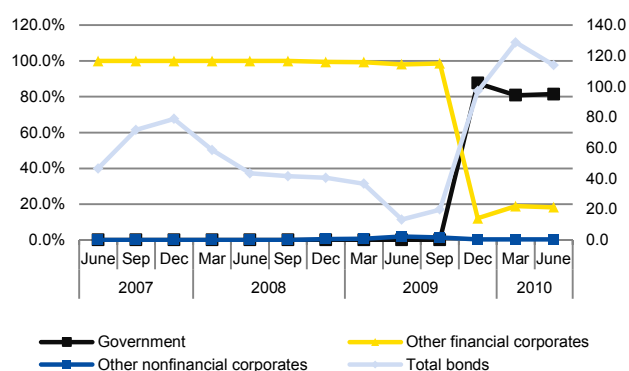
Figure 30. Liquid assets, in millions of euro



Source: CBK (2010)

The structure of liquid assets of the banking sector consists of cash and balances with the CBK, balances with commercial banks and investments in securities (Figure 30). During the period June 2009-June 2010, the category 'cash and balances with CBK' did not change significantly. Whereas, a significant change in the structure of liquid assets was the shift of funds from the category of 'balances with commercial banks' towards 'investments in securities'. Assets in the category 'balances with commercial banks' increased from euro 200 million in June 2009 to euro 351 million in June 2010, an increase of 22 percent. In the absence of the interbank market in Kosovo, assets in the category 'balances with commercial banks' are invested as placements with banks abroad. Nevertheless, the increase was more pronounced for the banking sector assets invested in securities. In June 2010, investments in securities reached at euro 114 million compared to euro 13.3 million in June 2009. One of the main determining factors for the increase of the banking sector investments in securities are more optimistic expectations regarding the performance of financial markets. This development is reasonable considering the fact that international financial markets were characterized by recovery and were less volatile during this period. However it should be emphasized that the increase in the amount of funds invested abroad limits the amount of funds available for lending to the domestic economy.

Figure 31. The structure of securities



Source: CBK (2010)

The structure of investments in securities is primarily focused on three main categories, consisting of investments in government bonds, financial corporations' bonds and non-financial corporations' bonds. Figure 31 shows that there was a large shift from investments in financial corporations' bonds to government bonds from the third quarter of 2009. While in June 2009, 98.1 percent of commercial banks' investments in securities consisted of financial corporations' bonds, in June 2010, 81.5 percent of securities consisted of government bonds. The share of financial corporations' bonds to total bank investments in securities, in June 2010, was only 18.2 percent. Meanwhile, banks' investments in non-financial corporations' bonds represent only 0.3 percent of total investments in securities. The shift of investments from financial corporations' to government bonds might be attributed to the increase of premiums in the bonds of some foreign governments in the recent period.

Maturity mismatch between assets and liabilities represents another important aspect of liquidity risk. A more pronounced maturity mismatch is noticed in the maturity bucket of 'more than 1 year', where the assets of this maturity considerably exceed the liabilities (Figure 32). The maturity mismatch between assets and liabilities mostly reflects the differences between the maturity of loans and deposits, given that they constitute the majority of assets and liabilities, respectively. In June 2010, 53 percent of loans had maturity of 'more than 1 year', while 98.4 percent of deposits had maturity of 'less than 1 year'.

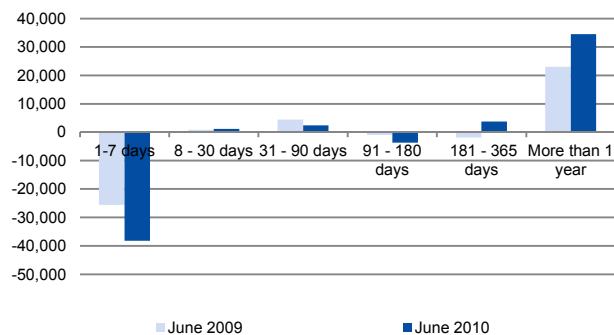
Banking sector activity should be focused more on attracting liabilities with longer maturity, which will narrow the liquidity gap, and hence decrease the liquidity risk. Furthermore, the increase of funds with longer maturity ensures a more sustainable growth of long-term lending.

### Credit risk

Despite the better performance of the economy in the first half of 2010, Kosovo's banking sector continued to apply more stringent lending criteria. This reflects the conservative approach applied by banks in managing their credit risk as a consequence of the global crisis. Despite the positive economic growth rate that was registered in Kosovo in 2009, and projections for even higher growth in 2010, the effects of global crisis were present also in the economy of Kosovo, causing a slower growth rate. This may have had an impact on the debt servicing capacity of the borrowers, resulting in a deterioration of the quality of loan portfolio at the banking sector.

The structure of loans based on quality classification changed marginally, with a slight shift from the category of standard loans (which represent loans without problems) towards

Figure 32. Liquidity Gap, difference between total assets and liabilities based on maturity



Source: CBK (2010)

categories of loans that have lower quality.<sup>5</sup> In June 2010, substandard loans increased their share to total loans by 0.8pp, compared to the same period of last year; whereas, loans classified as watch and standard recoded a slight decline as a share to total loans (Figure 33).

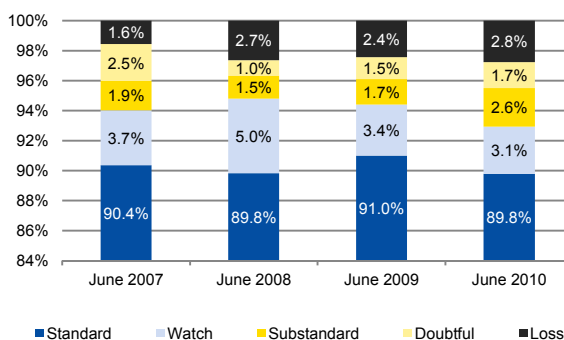
The category of classified loans has increased the share to total loans at 10.2 percent in June 2010 from 9 percent in June 2009, suggesting a slight deterioration in the quality of loan portfolio. Also, the category of loans with problems has increased its share from 5.6 in June 2009 to 7.1 percent of total loans in June 2010.

Regarding loan quality, Non-performing Loans (NPL) represent the most important category. In June 2010, share of NPL in the overall loan portfolio of Kosovo’s banking sector was 4.5 percent, which indicates an increase of 0.6pp compared to the same period of the previous year (Figure 34). During the period 2008-2010, the average annual growth rate of NPL was 26.8 percent, while average credit growth was 22 percent. The continuation of this trend would imply a further deterioration of the quality of loan portfolio; therefore, banks should ensure that further expansion of lending activity should be based on prudent lending policies. In June 2010, four of the banks operating in Kosovo reported improvement in the quality of their loan portfolio, while three of the banks reported increase in the share of NPL in their loan portfolios.

The structure of NPL is mainly dominated by loans classified as loss, which in June 2010 represented 62 percent of total NPL, while the rest consists of loans classified as doubtful (Figure 35). During this period, the category of doubtful loans increased by 30.8 percent (euro 5.6 million), while loss loans increased for 22.5 percent (euro 7.7 million) compared to the previous year.

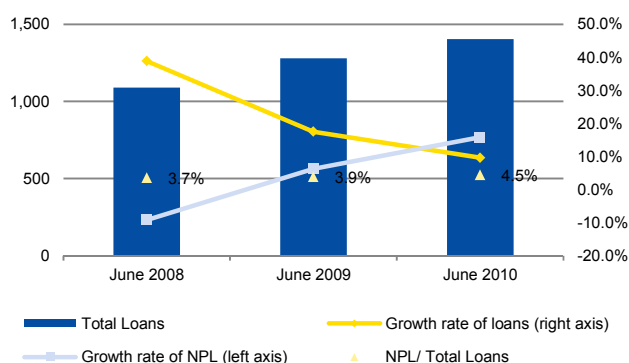
Deterioration of the quality was noticed both in loans issued to households and loans issued to enterprises. However, the deterioration of the quality is more pronounced in loans issued to enterprises, which could be one of the factors that led banks to significantly tighten lending to this sector. In June 2010, 5 percent of total loans issued to enterprises ended up as non-performing loans, representing an annual increase of 1.3pp compared to

Figure 33. Structure of loans according to their classification



Source: CBK (2010)

Figure 34. Total loans and NPL



Source: CBK (2010)

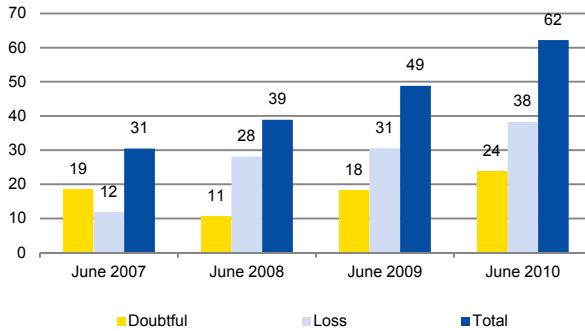
<sup>5</sup> According to CBK regulations, loans are classified as: standard, watch, substandard, doubtful and loss. Classified loans include: watch, substandard, doubtful and loss. Loans with problems include: substandard, doubtful and loss. Nonperforming loans include: doubtful and loss.

the same period of last year (Figure 36). Whereas from total loans issued to households, only 1.2 percent of the loans turned non-performing (1 percent in June 2009). Based on the structure of NPL, loans to enterprises appear to be more problematic in terms of repayment.

The increase of NPL was evident in all the sectors of the economy. Though, the quality deterioration was more pronounced in loans issued to construction and manufacturing sectors. NPL as a proportion of the total loans issued for the construction sector rose from 1.5 percent in June 2009 to 4 percent in June 2010 (Figure 37). At the same time, NPL for the manufacturing sector increased from 7.5 percent to 9.7 percent. The decline in the quality of loans for these sectors may be related to the developments in the global economy as a consequence of the crisis. In this context, increase in NPL for construction sector loans to some extent can be attributed to the lower turnover in the property market of Kosovo, which to an extent might be attributed to the decline of purchases by Kosovo immigrants. Also, the reduction of demand for Kosovo's exports might have adversely affected the ability of the manufacturing industry to repay the loans, thus affecting the growth of NPL in this sector. The manufacturing sector represents the most problematic sector in Kosovo's economy in terms of loan repayment. A high level of NPL is recorded also in loans issued to the mining and energy sector. Nevertheless, the exposure of the banking sector to these sectors is very low. In June 2010, total loans issued to mining and energy sector constituted only around 2 percent of total banking sector loans.

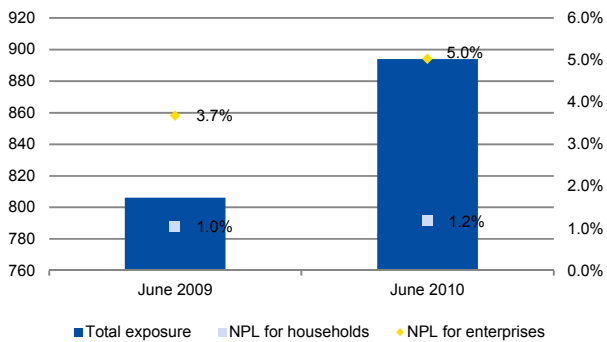
The definition of NPL, besides delays in the repayment of loans also takes into account other factors related to borrower's financial performance. The increase of NPL may reflect

Figure 35. Structure of non-performing loans, in millions of euro



Source: CBK (2010)

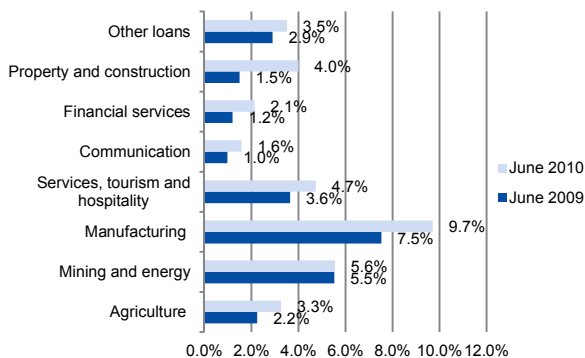
Figure 36. NPL by sector



Source: CBK (2010)

the decline of purchases by Kosovo immigrants. Also, the reduction of demand for Kosovo's exports might have adversely affected the ability of the manufacturing industry to repay the loans, thus affecting the growth of NPL in this sector.

Figure 37. NPL by industry



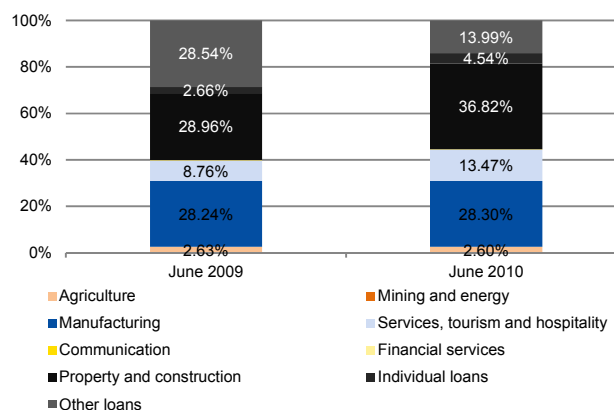
Source: CBK (2010)



the perceptions of banks and the regulator on the increase of uncertainty in the real sector of the economy as a consequence of the crisis, thus affecting the classification of credit risk.

Taking into account only the aspect of delays in loan repayment, it is noticed that the share of loans in arrears to total loans declined to 3.5 percent, from 3.7 percent in June 2009. The structure of loans that have been in arrears for over 90 days is dominated by loans issued to the construction sector that represent 36 percent of total loans in arrears for over 90 days, followed loans issued to the manufacturing sector that are represented with 28.3 percent (Figure 38). This shows that loans issued to the manufacturing sector represent a significant portion of both loans in arrears and NPL, what may affect banks' and regulator's perceptions on the potential default of loans issued to this sector as well as the interest rates for these loans.

Figure 38. Structure of loan in arrears over 90 days by industry

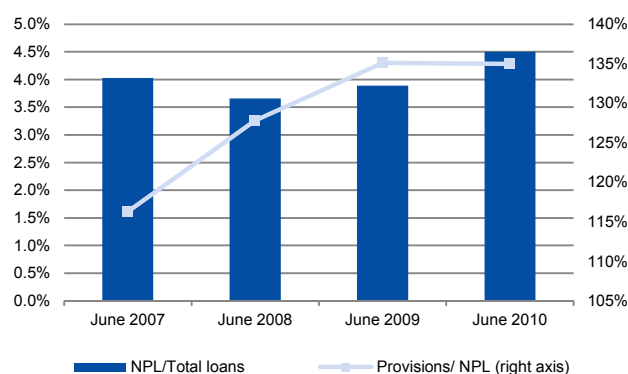


Source: CBK (2010)

Loans issued to households appear to have better quality also in terms of the number of days in arrears. In June 2010, only around 4.5 percent of total loans in arrears for over 90 days consisted of loans issued to households. The household sector is considered by banks to be less risky, which is also reflected in the lower interest rates charged on household loans, compared to those for enterprises.

Although the amount of NPL has increased in the past years, Kosovo's banking sector has continuously maintained a high coverage level of NPL with provisions for loan losses. In June 2010, provisions covered 135 percent of the total amount of NPL, whereas the average for the past four years was 129 percent (Figure 39). The total amount of provisions in June 2010 amounted at euro 75 million or euro 22.8 million higher compared to the previous year.

Figure 39. NPL and provisions



Source: CBK (2010)

### Concentration of credit risk

The analysis of the concentration of credit risk enables the identification of potential vulnerabilities for the banking sector, arising from large credit exposures, which threaten the stability of the banking sector in case of default. The increase of large exposures increases the credit risk, because the system becomes more sensitive to the performance of

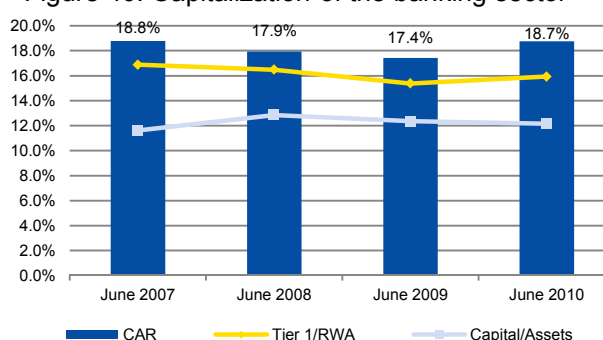
a certain number of loans, which have larger weight in the total loan portfolio. In this context, the increase of the concentration of credit risk represents a higher sensitivity of the banking system to the performance of a particular industry or a certain group of borrowers.

According to the CBK rules, loans that exceed 10 percent of Tier 1 capital are classified as large exposures. In June 2010, the amount of loans that were classified as large exposures increased to 88.4 million euro (euro 83.6 million in June 2009), while the number of large exposures increased to 45 from 20 in June 2009. However, the ratio between total large exposures and Tier 1 capital declined to 39.9 percent, from 41.4 percent in June 2009, which can be interpreted as a reduction of credit risk.

### 6.4.3. Solvency Risk

Capital Adequacy Ratio (CAR) for the Kosovo's banking system rose to 18.7 percent in June 2010 compared to 17.4 percent in the same period last year (Figure 40).<sup>6</sup> This ratio is satisfactory considering that significantly exceeds the minimum regulatory level of 12 percent required by the Central Bank. The increase of CAR was mainly due to the faster increase of capital compared to the increase of Risk-Weighted Assets (RWA). While the annual growth of capital was 12.8 percent, RWA

Figure 40. Capitalization of the banking sector



Source: CBK (2010)

recorded an increase of only 4.8 percent. The slowdown in RWA growth rate reflects the slowdown of growth rate for loans, which represent the main component of the RWA.

Table 8. Distribution of assets by CAR level

Description	Number of banks			Market share		
	12-15 %	15-18%	> 18 %	12-15 %	15-18%	> 18 %
2007	1	1	4	40.0%	35.5%	24.5%
2008	1	1	6	38.9%	35.6%	25.5%
2009	0	6	2	0.0%	84.6%	15.4%
2010	3	1	4	13.9%	14.7%	71.4%

Source: CBK (2010)

While in June 2009 most of the banking sector assets were managed by banks with CAR of 15 – 18 percent, in June 2010 around 71 percent of total assets were managed by banks with CAR of over 18 percent (Table 8). The high level of CAR in commercial banks that

<sup>6</sup> Based on CBK rules, all banks shall maintain a minimum total capital to RWA ratio of 12 percent and a Tier I capital to RWA ratio of 8 %.



operate in Kosovo shows the high level of capitalization, which increases the ability of the sector to withstand potential shocks.

## Capital

In June 2010, the capital of banking sector reached the value of euro 259.3 million, representing an annual increase of 12.8 percent compared to same period of last year. As can be observed from Figure 41, during past three years the capital of banking sector increased continuously, but its growth rate followed a declining trend.

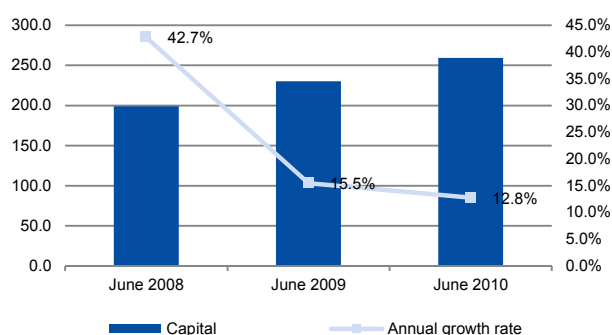
Regulatory capital in the banking sector of Kosovo is mainly financed through shareholders capital and retained profit of the banks. In addition, in recent years banks started to use other ways of financing from abroad, such as subordinated debt, which is part of Tier 2 capital. It may be noted that banks still do not use hybrid financial instruments, which can bear higher level of risk.

The proportion of shareholders capital to total capital reflects the quality of regulatory capital. The higher the participation of shareholders capital to total regulatory capital, the better the quality of capital. Quality of capital, besides having significant importance for the banking sector ability to withstand potential shocks, it also represents a very important factor in credit ranking of the banks, thus representing better opportunity and lower costs of external financing for commercial banks. In June 2010, the share of shareholders capital to total regulatory capital recorded a slight decline, standing at 85 percent (88 percent in June 2009). The decline occurred due to the increase in the share of Tier II capital to total capital from 12 percent in June 2009 to 15 percent in June 2010. The increase of Tier II capital mainly resulted from the increase of subordinated debt.

## Tier 1 capital

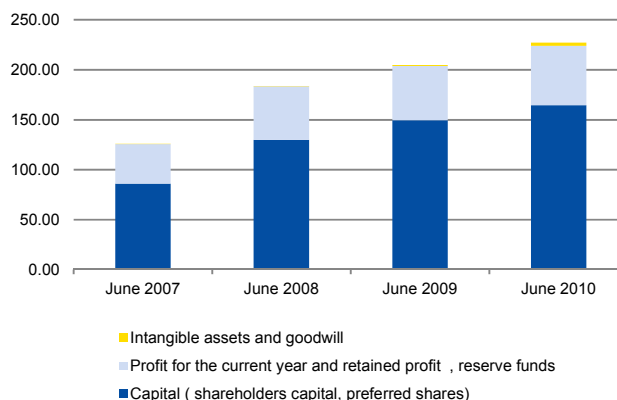
In June 2010, Tier I capital amounted at euro 220.5 million, which represents an annual increase of 8.6 percent. The structure of Tier 1 capital continues to be dominated by shareholders capital that represents 73 percent of total, while the second largest component is retained profit that represents 26 percent of Tier I capital (Figure 42). Intangible assets and goodwill increased their share from 0.4 percent in 2009 to 1.0

Figure 41. Total capital of the banking sector



Source: CBK (2010)

Figure 42. Structure of Tier 1 capital, in millions of euro



Source: CBK (2010)

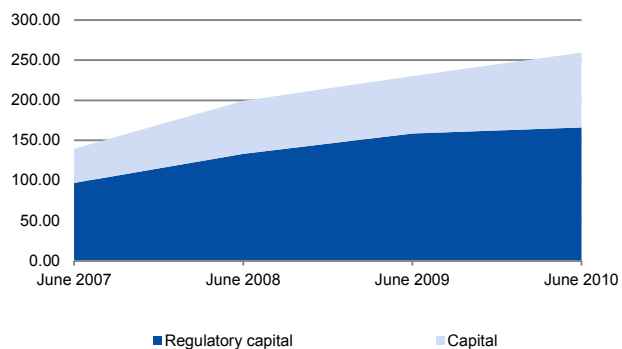
percent in June 2010.

In June 2010, shareholders capital amounted at euro 164.4 million or 10 percent higher compared to June 2009. Whereas the profit for the current period and reserve funds increased to euro 59.4 million in June 2010 from euro 54.4 million in June 2009. Intangible assets and goodwill, which are deducted from Tier I capital according to CBK rules, increased to euro 3.28 million in June 2010, from euro 820 thousands in June 2009.

### Regulatory capital

Kosovo's banking sector has continuously maintained a capital level well beyond the required capital by the Central Bank. In June 2010, the required regulatory capital was euro 166.1 million, while the total regulatory capital held by the banking sector was euro 259.3 million, with an excessive capital amounting at euro 93.3 million (Figure 43). The excessive capital held by banks comprises around 56.1 percent of the required regulatory capital, which is an increase of 10.9pp compared to June 2009 (Figure 40).

Figure 43. Total capital and regulatory capital



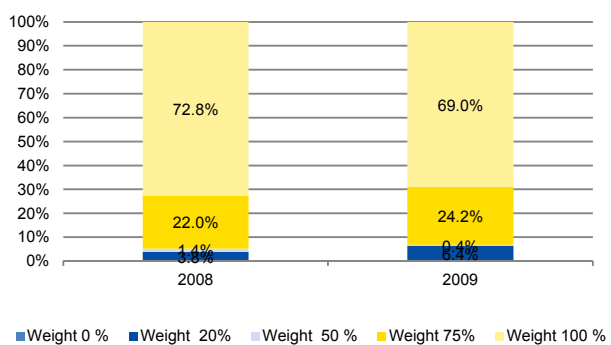
Source: CBK (2010)

### Risk-weighted assets

The RWA of Kosovo banking sector reached euro 1.38 billion in June 2010. However, the share of assets with 100 percent risk weight in June 2010 declined to 69 percent of total RWA, compared to 72.8 percent in June 2009 (Figure 44). The decline in the share of this category of RWA is mainly a result of the slowdown in the growth rate of loans, which represent the main component of assets with 100 percent risk weight.

The category of assets with 75 percent risk weight recorded an annual increase of 14.4 percent, reaching a value of euro 334.9 million in June 2010. This category consists of loans secured by first mortgage on real estate with less than 30 days past due. The category of assets with 50 percent<sup>7</sup> risk weight experienced the most

Figure 44. Structure of RWA by risk weight



Source: CBK (2010)

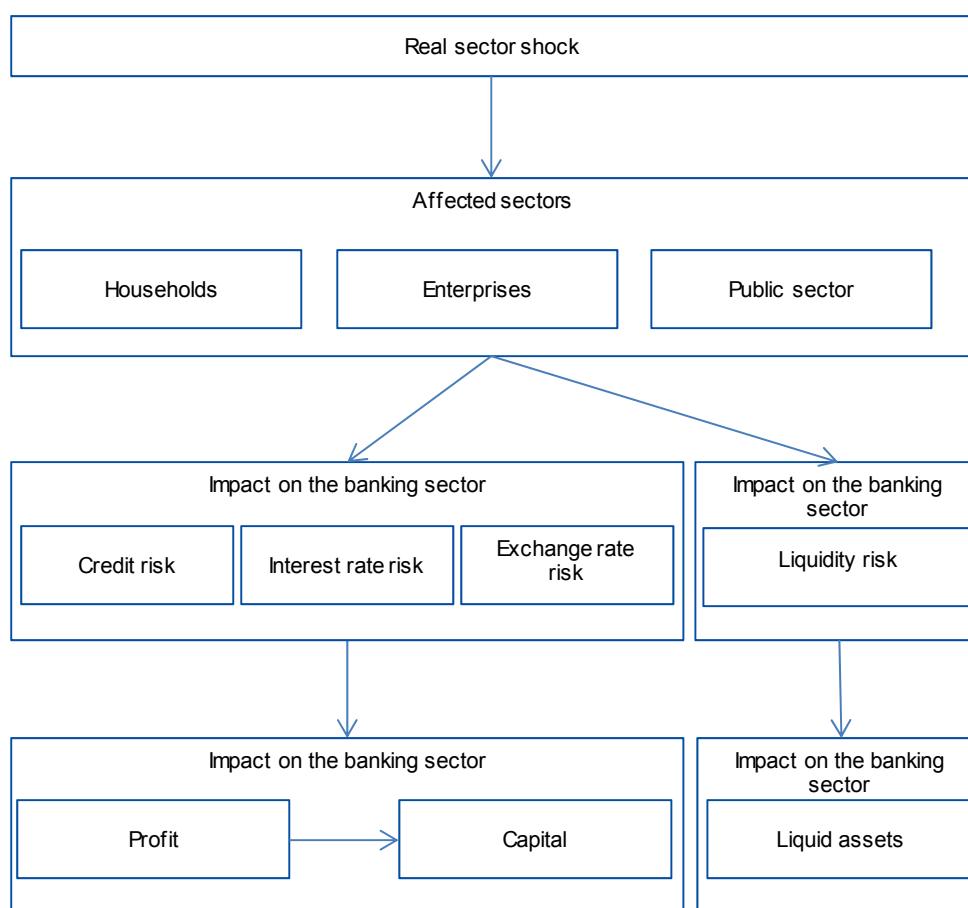
<sup>7</sup> This category consists of claims with maturity of 1 year or less at banks operating in countries of the OECD. These claims are not classified or are classified by Standard & Poor's with B or lower or Moody's with P-3 or lower.

pronounced decline compared to the previous year. In June 2010, the value of these RWA was euro 5.7 million or 69 percent lower than in June 2009.

## 6.5. Stress-Test Analysis

Stress-test analysis provides information on the stability of the banking system under the assumptions of negative shocks to the sector. Stress-test represents a very important instrument for risk management at individual banks, which is also used by central banks to assess risks at the level of the system. The main objective of the stress-test is to explain the vulnerability of the banking system to the fluctuations of different risk factors. Stress-test can be applied both on the asset and liability side of the bank portfolio.

Figure 45. Simplified presentation of the stress-test methodology



In this context, with the stress-test analysis the sensitivity of banks against various risks can be assessed: such as credit risk (potential losses from the increase of non-performing loans); liquidity risk (the possibility of withdrawal of large amounts of deposits); interest rate risk (potential losses from changes in interest rates); and exchange rate risk (potential losses from changes in exchange rates). Figure 45 presents the channels through which a

shock to the economy could affect the performance and stability of the banking sector. For example, a negative shock in the real sector would negatively affect the performance of enterprises with a negative impact on debt servicing capacities. Consequently, non-performing loans in the banking sector would increase, profits will decline, provisions for loan losses will increase and, consequently, capital will be lower. The reduction of the capital has negative implications for the sustainability of the banking sector because it weakens the capacity of banks to absorb potential shocks. Therefore, the stress-test analysis presents an important tool to link macroeconomic developments with the performance of the banking system, thus enabling the assessment of the vulnerability of the banking system against various macroeconomic shocks.

The Central Bank of the Republic of Kosovo (CBK) applies the stress-test analysis to assess potential risks for individual banks and for the overall banking system. The stress-test applied by the CBK is largely based on the analysis of the banks' vulnerability against changes in risk factors, such as credit risk, liquidity risk and interest rate risk. Some progress is being made in better linking the risk factors of banking system with macroeconomic developments in the country. The assumed shocks for the banking system are mainly based on historical trends and expert judgement. This analysis takes into account the state of the banking system at a given point of time. A progress is being made towards incorporating dynamics in order to create a better platform for anticipating shocks.

The stress-test analysis for this edition of Financial Stability Report is conducted with June 2010 data. This analysis tested the vulnerability of Kosovo's banking system against credit risk combined with the interest rate and exchange rate risk. The vulnerability of the banking sector with regard to liquidity risk was also tested.

### **6.5.1 Joint determination of the credit risk, interest rate and exchange rate risk**

#### ***Methodology***

This analysis is based on the scenario that the economic crisis in the European Union will continue to be reflected in the Kosovo's economy through reduction of remittances and exports from Kosovo, thus discouraging the aggregate demand in the country. Consequently, it is supposed that economic growth will be adversely affected, expanding the output gap and affecting negatively the quality of credit portfolio.

In this scenario is taken into account the average rate of economic growth in Kosovo of 4 percent in the last five years and it is assumed a slump of 1.2 percent for 2010, which would have raised the output gap for 5.2 percent. To assess the impact of output gap in the quality of loan portfolio, namely in non-performing loans (NPL), elasticity coefficients for several countries in Central and Eastern Europe are used (IMF, 2009). Consequently, considering a coefficient of 0.8 for the elasticity of NPL against output gap, the share of NPL to total banking sector loans would increase by 4.2pp, which represents almost a doubling of the current level of NPL. Credit risk is combined with the interest rate and exchange rate risk, where it is assumed a decline of interest rates and a devaluation of euro against other currencies as a result of developments in some eurozone countries such as Greece. . Consequently, in addition to the increase of the share of NPL to total loans, in this scenario

it is also considered the depreciation of the euro against the U.S. dollar by 20 percent<sup>8</sup> and the reduction of interest rates by 2.0 pp. The increase of NPL leads to an increase of provisions; the depreciation of euro affects the the loss/profit from net open positions; and the reduction of interest rates affects the loss/profit in net interest income by considering the maturity gap between loans and deposits. Apart from the abovementioned assumptions/shocks, the expected profit as a potential for loss absorption from these shocks is also taken into account. In this context, it is assumed that revenues from 'commissions and similar' and other non-interest revenues in 2010 would be equivalent to 60 percent of the level realized in 2009 (because it is assumed that there is no increase of loans), while other components of the income statement are assumed to be of similar level to those in 2009.

- The assumed increase of NPL is expressed through the migration of loans from performing categories (standard, watch, substandard) towards non-performing categories (doubtful and loss). NPL growth was proportionally distributed in the two non-performing categories, taking into account the initial distribution of NPL in these categories. NPL growth is reflected in the level of provisions based on the CBK regulations for loan provisioning. The assumption for the NPL growth is applied also to off-balance sheet items, including unused commitments, guarantees and letters of credit.
- Despite the fact that in the scenario it is considered the depreciation of the euro against the U.S. dollar in order to assess the exchange rate risk, it must be emphasized that the impact of this risk in the balance sheet of Kosovo's banking system remains negligible. Net open positions in foreign currencies at the end of June 2010 were equivalent to only 11 percent of Tier 1 capital. Lending in foreign currency virtually is nonexistent, which minimizes the exchange rate risk.
- The assumption on the interest rate risk implies a reduction of interest rates by 2pp (for assets and for liabilities on the balance sheet). The reduction of interest rates may affect Net Interest Margin (NIM), taking into account the maturity of loans and deposits. However, the majority of loans and deposits in the banking system in Kosovo have fixed interest rate, which makes the banking system less sensitive to short term interest rate fluctuations.
- Sustainability of the banking sector in this analysis is assessed in terms of the impact of increasing NPL, euro depreciation and interest rate decline on the level of the banking sector regulatory capital, risk-weighted assets and, consequently, Capital Adequacy Ratio (CAR).

## Results

The stress-test results based on the scenario explained above suggest that banking sector would be sustainable even in the case of this hypothetical scenario. Under the assumption that this scenario would occur, only one of the banks operating in Kosovo would have a CAR below 12 percent, which is the minimum required level by the Central Bank, while the

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<sup>8</sup> This assumption is based on historical data for the volatility of euro – US dollar exchange rate.

amount that would be required for the potential recapitalization of this bank is only euro 1.7 million or 0.04 percent of GDP (Table 9).

**Table 9. Summary results of the Stress-Test: Credit Risk**

Description	Number of banks 1/			CAR			NPL ratio			Recapitalization 2/	
	CAR <0	CAR 0-8%	CAR 8-12%	Lowest level	Highest level	System level	Lowest level	Highest level	System level	In thousands euro	As % of GDP
Baseline (before shocks)	0	0	0	13.2	20.7	18.8	0.8	8.4	4.5		
Results of macroscenarios 3/											
2010	0	0	1	10.3	22.9	19.4	4.2	12.5	8.7	1,734.0	0.04
2011	0	2	2	3.6	21.2	16.2	8.7	17.0	13.1	13,156.1	0.29

**Notes:**

1/ From eight banks considered in the stress test analysis, number of banks that fall below the minimum regulatory requirement.

2/ Total recapitalization required to maintain CAR of banks at 12 percent. GDP figures are IMF projections (IMF, 2010c).

3/ Increase in NPL ratio, euro depreciation and decline in interest rates.

Under these circumstances, the share of NPL to total loans of the banking system would increase at 8.7 percent; while regarding individual banks, the lowest share of NPL would be 4.2 percent and the highest would be 12.5 percent. In case that the same scenario applies for 2011, it appears that the impact in the banking sector would be stronger.

As initial situation for 2011, it is taken the end of 2010 after having applied the shocks from the above scenario, The number of banks with CAR lower than 12 percent, under this scenario, would be four, while the capital required to restore the CAR of these banks to 12 percent would amount at euro 13.1 million or 0.3 percent of GDP.

The relatively low share of NPL to total loans (4.5 percent), the adequate coverage of NPL with provisions for loan losses (135 percent) and the high level of capital adequacy ratio (18.7 percent) make Kosovo's banking system to be quite resilient to potential shocks in the quality of loan portfolio. Also, the dominance of loans and deposits with fixed interest rates make Kosovo's banking sector less sensitive against potential interest rate fluctuations. The sector also appears to have a very low sensitivity against exchange rate fluctuations, since the majority of loans and deposits are in euro. In general, stress-test results, based on the combined scenario of credit risk, interest rate and exchange rate risk, suggest that Kosovo's banking sector is resilient even under the assumption of the occurrence of the scenario presented above, which is based on hypothetical and very conservative assumptions.

## 6.5.2 Liquidity risk

### Methodology

Liquidity risk is addressed in this analysis by assessing the ability of banks operating in Kosovo to withstand a more significant withdrawal of deposits for a period of five days, not taking into account the possibility of banks's access to external financing. Stress-test of liquidity risk is based on a very conservative scenario, assuming withdrawal of deposits at the rate of 10 percent of total deposits on a daily basis, over a period of five consecutive

days. The scenario is also built on the assumption that during this period, the possibility of converting liquid assets into cash will be 80 percent, while the possibility of converting illiquid assets would be 1 percent within a day. In this scenario it is assumed that banks have full access to their reserves, but it was not considered the possibility of banks to have access to external sources.

The assessment of the banking sector sustainability against liquidity risk, based on the above scenario, is done by assessing the adequacy of banks' liquid assets to meet the deposit withdrawal.

## Results

Under the assumption that the abovementioned scenario is likely to happen, in the first day of deposit withdrawal none of the banks operating in the country would need additional liquid assets to meet deposit withdrawals, while in the second day one bank would need additional liquid assets, amounting at only euro 1.6 million (Table 10). After the fifth day, five banks would need additional liquid assets worth euro 42 million (1 percent of GDP), while the loan-to-deposit ratio (assuming that the value of loans remains constant) for the whole system would reach 134.7 percent. Under such a scenario, where during five consecutive days 10 percent of deposits would be withdrawn daily, the total amount of deposits withdrawn in the end of the five-day period would be 41 percent of total deposits in the banking system.

**Table 10. Summary results of the Stress-Test: Liquidity Risk**

Description	Number of banks 1/	Additional liquid assets needed (in thousands of euros)
After first day	0	0
After second day	1	1,621
After third day	1	4,312
After fourth day	4	14,232
After fifth day	5	41,969

Note:

1/ Number of banks that would need additional liquid assets.

The banking sector stress-test against liquidity risk was based on a hypothetical scenario, with quite conservative assumptions, which meant very high rates of deposit withdrawals and exclusion of the possibility of banks to have access to other funding, except their liquid assets. Stress-test results suggest that the banking sector of Kosovo would show a strong liquidity position, even under the assumption of the occurrence of this hypothetical scenario. The amount of additional liquid assets that would be needed by banks under such a scenario, at the end of the five-day period, results to be relatively low. Relatively high ability of the banking sector to withstand the liquidity shocks is attributed to the relatively high level of liquid assets maintained by the banks.



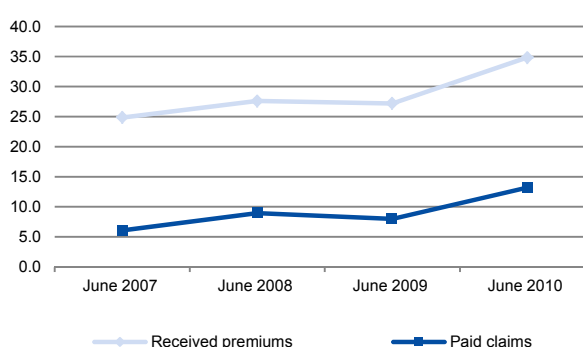


## 7. Other Financial Institutions

### 7.1. Insurance companies

The sector of insurance companies in Kosovo in the first half of 2010 continued to expand its activity. Until June 2010, the value of the assets of insurance companies reached at euro 90 million, representing an annual growth of 20.1 percent. Assets of insurance companies operating in Kosovo mainly consist of deposits in commercial banks, which represent 65.2 percent of total assets. In June 2010, the number of insurance companies operating in Kosovo was 11. Regarding the ownership structure, eight companies are foreign-owned, whereas the other three are domestically-owned. Regarding the composition of assets by ownership structure, 79.9 percent of total assets of the insurance industry are foreign-owned, while 20.1 percent of total assets are domestic.

Figure 46. Received premiums and paid claims, in millions of euro



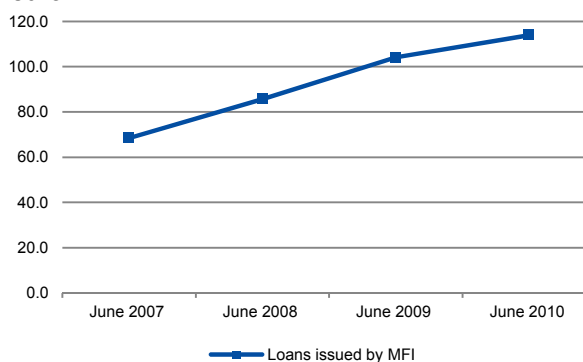
Source: CBK (2010)

Until June 2010, the number of policies sold by insurance companies was 241 thousand, representing an annual growth of 8 percent. The amount of premiums received by insurance companies until June 2010 reached at euro 34.8 million, marking an annual growth rate of 5.4 percent (Figure 46). The main activity of insurance companies operating in Kosovo continues to be Third Party Liability insurance (TPL). The amount of premiums from TPL policies in June 2010 represented 61.2 percent of total premiums received by insurance companies. Whereas the amount of claims paid until June 2010 doubled compared to the same period of last year, reaching the value of euro 13.2 million. The largest part of claims paid by insurance companies consists of claims paid on TPL policies (74 percent of total claims paid). The ratio between premiums received and claims paid until June 2010 increased to 38 percent, compared to 24.2 percent in June 2009.

### 7.2. Microfinance Institutions

The number of microfinance institutions (MFI) operating in Kosovo in June 2010 was 17. The MFI activity continues to be concentrated on lending to small businesses and households. The average amount of one loan issued by MFI is around 1,852 euro. The number of loans issued by these institutions until June 2010 reached at 61,498, which represents an annual growth of 15.2 percent. Regarding the value of loans

Figure 47. Loans issued by MFI, in millions of euro



Source: CBK (2010)

issued by microfinance institutions, it is noticed a slowdown in the growth rate. Until June 2010, the value of MFI loans amounted at euro 113.9 million, which represents an annual growth of 9.4 percent, compared to the annual growth rate of 21.5 percent registered in June 2009 (Figure 43). Consequently, the share of loans issued by MFI to total loans issued by Kosovo's financial sector declined to 7.5 percent in June 2010, from 8.9 percent in June 2009.

### 7.3. Pension funds

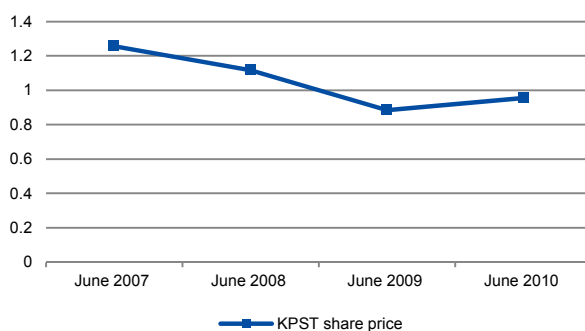
In the first quarter of 2010, the performance of Kosovo Pension Savings Trust (KPST) was positive, given the positive returns on investments. However, in line with the decline of the performance of international financial markets, also the performance of KPST investments started to have a slight decline.<sup>9</sup> These developments led to a decrease of the share price from 1.00 euro in the first quarter to 0.95 euro in the second quarter. However, the share price of 0.95 euro, which was recorded in June 2010, was higher compared with same period of last year when the share price was 0.88 euro (Figure 48).

The value of KPST assets in June 2010 reached at euro 407.6 million, recording an annual growth of 35.5 percent. KPST investments continue to be concentrated in shares and other forms of capital, which shows the high sensitivity of the overall KPST investments against the fluctuations of share prices in international markets.

For this reason, due to the turbulences in international financial markets as a result of the financial

crisis, in the first half of 2009, KPST reduced its investments in shares and other equity in the international markets and increased its deposits at the CBK in order to avoid potential risks. As a result, in June 2010, 23.7 percent of KPST assets were kept as deposits in the CBK (2.6 percent in June 2008), while shares and other equity represented 43.5 percent of total assets (59.5 percent in June 2008). The recovery of international financial markets during the first half of 2010 led to an increase of KPST investments in shares and other equity, which in June 2010, represented 61.2 percent of total KPST assets, while the share of deposits at the CBK declined to 8.5 percent of total KPST assets. The rest of the KPST assets were invested in bonds (23.4 percent) and commercial banks (6.2 percent).

Figure 48. Share price of KPST, in euro



Source: KPST (2010)

<sup>9</sup> International financial markets during the second quarter of 2010 were characterized with negative performance, due to debt problems in Greece, the devaluation of euro, the flow of oil in the Mexico Gulf, reforms in financial and other markets, etc.

## **Special Topics**



## 8. Financial Sector Stability and Economic Growth in SEE Countries

Boštjan Jazbec and Albulenë Kastrati

### 8.1 Introduction

Recent financial crisis which outcome is still unresolved and poses many problems to the future development of the world financial markets also affected less developed economies in the region. As many economies which were formerly known as transition economies have more or less successfully either joined the European Union or are intensively involved in the accession processes, their response to the world financial crisis depended primarily on the extent of the reforms they have been able to introduce during the last twenty years of the transition processes. Today it is rather uncommon to talk about those countries as transition economies, instead it is common to address those countries as new EU country members or less developed economies of the EU region. Following the footsteps of the most successful transition economies in terms of their economic development and proximity to the EURO adoption, the less developed economies of the EU region are able to leap over early stages of the transition process which one was able to observe almost twenty years ago.

However, it seems that factors which were important twenty years ago in determining the success of the transition process lost its importance as it has become obvious that macroeconomic stabilization and financial liberalization are not enough to maintain higher growth rates in less developed EU countries which were previously known as transition economies of the Central and South-Eastern Europe.

The South-Eastern European countries (SEE)<sup>10</sup> represents the late comers to the processes of accession to the European Union (EU). The region was plagued by political and war conflicts which mainly determined the pace of structural reforms in their economies. Being geographically landlocked also contributed to their lack of faster economic revival and higher economic growth. The only EU country in the region is Greece except for Bulgaria which joined the EU in 2007. However, it is Greece which in recent years was the most problematic EU member countries in terms of economic stability and financial fragility. The aim of the paper is to examine the growth potential of the SEE countries also with regards to the effects of the financial crisis in the EU. It will be shown that financial crisis in the EU and particularly in Greece did affect the financial systems in the SEE countries. However, one can not solely attribute slow economic revival and lower than expected growth rates in the region to the macroeconomic developments and fragile financial systems in those countries. On contrary, it will be shown that most countries have been successful in implementing needed reforms and opened up their financial sectors. For those reasons, these economies are ready to experience the economic revival by norms of macroeconomic framework and development of their financial system. It will be claimed that this does not happen because these economies lack the institutional setting which would support the investment demand needed to generate economic growth.

The second chapter of paper discusses the transition process of the last twenty years. Looking back from the distance it is obvious that macroeconomic stabilization and financial liberalization are not sufficient determinants of economic growth in less developed

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<sup>10</sup> Albania, Macedonia, Bulgaria, Kosovo, Serbia, and Montenegro.

economies. Third chapter presents the macroeconomic developments in the region pointing out the similarities of their developments despite different monetary and exchange rate regimes that countries implemented to stabilize their economies. Financial sector development in the region is presented in chapter four. It is shown that financial crisis did affect the SEE countries although they still experience relative abundance of financial sources to support the economic growth. Potential sources of economic catch-up of the region are presented in chapter five. Chapter six concludes.

## 8.2 What have we learned in the last twenty years of transition?

At the time the transition began, there was little experience with the processes of economic transformation. Guidance and western expertise were drawn on general principles and experiences from structural reforms in developing countries. The Latin American countries served as a starting point in designing the programs of macroeconomic stabilization although starting points in those countries were substantially different from the emerging problems in transition economies. However, the facts on distinguishable characteristics of transition economies were mainly learned while the transformation had already begun and well before the evidence could be gathered.

What economists knew *a priori* about restructuring and transformation was that the inflation stabilization was necessary for the resumption of growth. However, the striking problem at the beginning of transition was the enormous fall in output ranging from 30 to 50 % accompanied by a high inflationary environment. Although the transition encompasses a wide horizon of institutional and political changes, macroeconomic stabilization and restructuring of the ill-designed economies, it was the inflation and output performance in the first days of transition that occupied economists across the world. An extension of the problem and lack of experience of economic transformation from centrally planned to market-oriented economies generated surprise on a great scale. All advice and help to design the reforms had to be drawn on general economic principles or - somehow to a lesser extent - lessons from structural reforms in developing countries.

While countries started the transition with different sets of starting positions either regarding political environment or unfavourable macroeconomic conditions, they all have experienced the common challenge of transforming their economies from a centrally planned system to a market-oriented framework. This has transformed a rather different assessment of structural changes across the region to a uniform process of transition that has taken place during the last decade. Experiences with the transition process were different from country to country in the region, however, all tried to focus on the most pending problem in their economies, namely, how to curb the inflation rates which were mitigating the success of all other reforms.

Although the Central and Eastern European countries have adopted different exchange rate regimes, they have all experienced real appreciation as well as large inflows of capital in a relatively short time span. Although capital inflows were not the most important issue at the beginning of the transition, the relevance of the presence of foreign capital in transition economies have become substantial just after the first shock of political and economic transformation had slowly started to die out. Those economies that were fast in restructuring and privatization of state and social entities were among the first to enjoy the positive effects of fresh foreign capital. It is true that surge in foreign capital inflows was associated with new problems in terms of pressures on external competitiveness;

however, it seems that negative effects of capital inflows were mainly offset by early growth recovery. In contrast, those economies that were slow in adopting reform measures and mainly attracted foreign capital into the government debt instruments to finance their increasing budget deficits have suffered from balance of payments and financial crises.

The choice of fundamental macroeconomic policy in the design of a stabilization program was even more pronounced in transition economies with special reflection on the importance of fiscal policy. Fiscal policy in transition economies does not only entail the control over the budget deficit, but also involves the issue of reducing the role of the government in the economy. However, to tackle inflationary pressure was not the only area of action needed to bring transition economies on the right track of transformation and restructuring toward market economies. The need for action in transition economies was widely recognized in six areas (Fisher, Sahay, and Vegh, 1996):

- macroeconomic stabilization;
- price liberalization;
- trade liberalization and current account convertibility;
- enterprise reform (especially privatization);
- creation of a safety net; and
- development of the institutional and legal framework for a market economy, including the creation of a market-based financial system.

There were few authors<sup>11</sup> in the 90's especially emphasized the importance of building the institutional arrangements, since there is danger of informal institutionalization that fills the systemic vacuum. One cannot separate one area of action from the others. However, sound macroeconomic stabilization was necessary for the success of all other reforms, since it forced some state enterprises to contract as a consequence of the implementation of hard-budget constraints and pushed people into a new private sector. In some respects, economic reforms in transition economies can be compared to reforms introduced in Latin American countries (Bruno, 1992). However, the extent of institutional reforms required in transition economies was much greater and demanded the change of fundamental characteristics of the institutional legacy of the centrally-planned regime.

### 8.3 Macroeconomic Developments in South-Eastern Europe

After twenty years of political turmoil and uncertain economic developments economies of the South Eastern Europe<sup>12</sup> are struggling with reaching their growth potential. Being geographically far from EU common market if one does take into account that trade flows with Greece and Bulgaria which are EU member countries are relatively modest, the SEE countries are mostly left on their own in the process of reinvigorating their economic development. As it will be shown the thrust of the problem lies in the lack of appropriate development of the market institutions which mitigates the effects of initial positive macroeconomic stabilization and microeconomic liberalization.

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<sup>11</sup> Wyplosz (1999) and Kolodko (1999).

<sup>12</sup> Bulgaria, Macedonia, Kosovo, Serbia, Albania, and Montenegro.

All six SEE countries are small and open economies which have introduced different monetary and exchange rate policies in the order to achieve macroeconomic stabilization. Bulgaria opted for currency board while Macedonia introduced tightly managed floating exchange rate regime similar to the one Slovenia introduced in the 90's. Albania and Serbia are the followers of the inflation targeting which implicitly presupposes free floating of the domestic currency. Nonetheless, one can observe rather systematic central bank intervention in both countries respectively. The tiniest of the SEE countries, Montenegro and Kosovo chose unilateral adoption of EURO due to their unfavourable conditions at the time of declaring their independent political and sovereign states.

Despite differences in official monetary regimes in the SEE countries, all of them have experienced similar price developments in the last ten years. The most volatile price development was observed in Serbia although all countries were able to curb their inflation rates below 5 %s which qualifies their macroeconomic environment as relatively stable. It is rather instructive to say that despite differences in monetary regimes all countries in the region have faces very similar if not almost identical price developments in their economies. Confusion about the most appropriate monetary or exchange rate regime which was so legitimate twenty years ago has lost its strength during the course of transition in other more developed transition economies. It seems that the choice of the monetary or exchange rate regime was rather arbitrary and prone to particular circumstances at the time of the transitional process in those economies. Trade openness and substantial presence of foreign owned institutions in the financial sector limits the operational scope of different monetary or exchange rate regimes and reduce them to follow the autonomous flows of trade and capital into and out of these economies. Corner solutions in design of the monetary or exchange rate policies are therefore adjusted to the point that one can hardly differentiate among different regimes proving the tendency of the central bank to be rather discretionary in conduct of monetary policy (Reinhart and Calvo, 2002).

**Table 11. The structure of exports and imports in selected countries, in percent**

Kosovo	Macedonia	Albania	Bulgaria	Serbia	Montenegro
<i>Mostly exports:</i>	<i>Mostly exports:</i>	<i>Mostly exports:</i>	<i>Mostly exports:</i>	<i>Mostly exports:</i>	<i>Mostly exports:</i>
Base metals (50%)	Iron&Steel (26%)	Textiles (35%)	Non-ferrous metals (37%)	Manufactured goods (33%)	Aluminium (41%)
Mineral products (15%)	Clothing (20%)	Minerals (30%)	Clothing (36%)	Food (16%)	Iron and steel (13%)
Vegetables (6%)	Food&Beverages (14%)	Construction mat. & Metals (19%)	Energy resources (5%)	Machinery (15%)	Beverages, alcohol, vinegar (6%)
<i>Mostly imports:</i>	<i>Mostly imports:</i>	<i>Mostly imports:</i>	<i>Mostly imports:</i>	<i>Mostly imports:</i>	<i>Mostly imports:</i>
Mineral products (17%)	Machinery&Trasports equip. (24%)	Machinery (20%)	Machines&Tools (43%)	Machinery (25%)	Machines&Mech.Equipments (12%)
Machinery (14%)	Mineral fuels (16%)	Food&Beverages (18%)	Food (32%)	Manufactured goods (20%)	Mineral fuels (8%)
Food&Beverages (13%)	Food (11%)	Construction mat.&Metals (15%)	Textiles (27%)	Mineral fuels (18%)	Iron and steel products(5%)

Source: Central banks of the respective countries

The cases of Montenegro and Kosovo strengthen that argument even further by deliberately surrendering the option of quasi-independent monetary policy and opting to unilateral adoption of EURO. Without their own monetary policies price developments in those countries are closely mimicking inflation rates in their neighbouring countries.

As it will be shown below in each country presentation, some SEE countries even experienced deflation in last few years. Substantial part in explaining the price



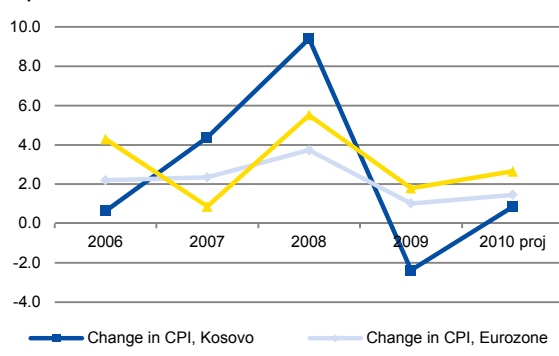
developments in the SEE countries is played by the price of their imported good. Most countries are importing food, final products and machinery which sectors were greatly hit by the recent financial crisis. The structure of imports in SEE countries also corresponds to the general level of their development as these economies are still mainly specialized in low value added sectors of their economies, while they are importing everything else. Looking at the exports in these economies, one can observe that mostly base materials and mineral products are exported with exception of Serbia where manufactured goods dominate, and Albania which has specialized in export of textiles. Relatively low value-added exports and imports of high-value products also contribute substantially to chronic current account deficits in these countries. Although recent price development of imports contributed to bring down inflation rates in these economies, developments in the balance of payments are less favourable in the medium and long run.

To further strengthen an argument that SEE countries exhibit similar developments in real and financial sectors short presentation of each individual country is presented as it follows.

### 11.3.1 Kosovo

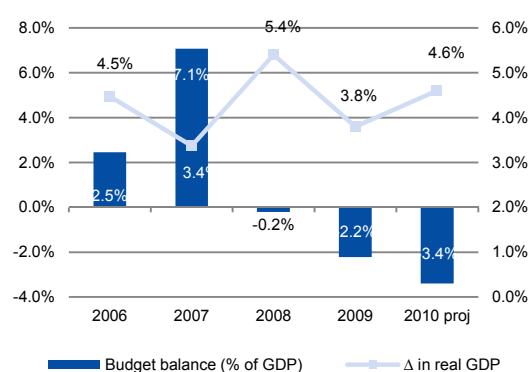
Kosovo does not issue a currency of its own, since it has unilaterally adopted EURO as its legal tender in 2002. Consequently, CBK is not a member of the European System of the

Figure 49. Inflation, average consumer prices



Source: WEO April 2010, IMF

Figure 50. Real growth and budget



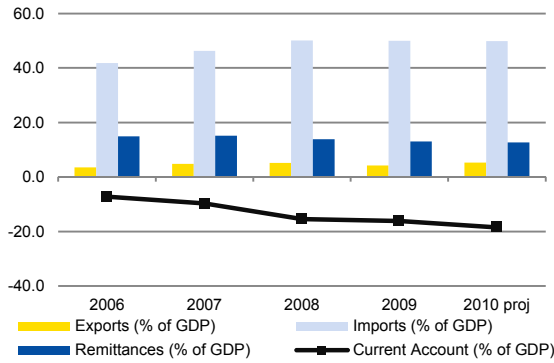
Source:

Central Banks or EURO zone and does not conduct its own monetary policy and is not a lender of last resort.

The economic growth was mainly generated by the increase of private consumption and public investment, largely financed by banking sector loans, remittances, foreign assistance, and considerable increase of budget expenditures. In course of the adoption of the EURO, foreign trade became easier and Kosovo has achieved great progress in terms of maintaining the inflation close to EURO area levels being mainly an import base economy, inflation closely reflects the imports price developments. On the other side, the export base is low but with positive trends. Around 74 % of the trade of Kosovo is realized with EU and CEFTA countries. From EU countries, Kosovo mostly exports in Italy (around 30 %) and

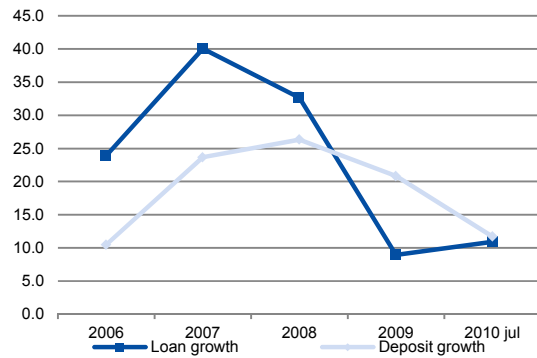
Germany (around 4 %), while imports from Germany (around 13 %) and Greece (around 5 %). Remittances to Kosovo comprise around 14 % of GDP. Around 64 % of remittance inflows come from Europe countries that use EURO, from which Germany has the largest share.

Figure 51. Current account, in percent of GDP



Source: CBK

Figure 52. Deposit and loan growth in Kosovo, in percent



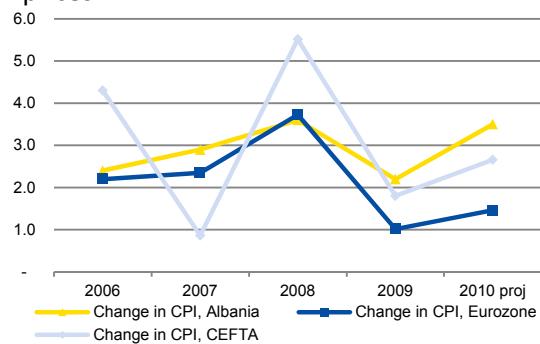
Source: CBK

Financial sector in Kosovo is almost fully euroized (around 96 % of deposits and loans), therefore it is not exposed to the exchange rate risk or the need to guarantee the central bank liabilities. Hence, besides central bank’s monitoring and risk assessment of the banking sector, most of the burden of safeguarding the financial stability falls on the fiscal authorities.

### 11.3.2 Albania

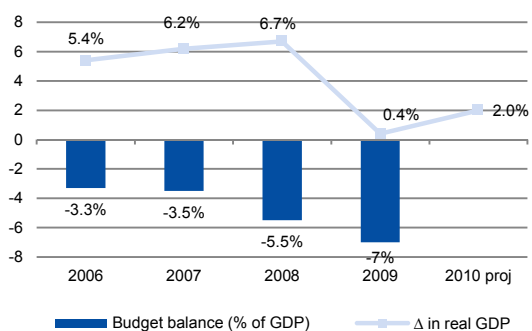
Albania uses a flexible exchange rate regime combined with an inflation targeting policy. Monetary policy in Albania has served well in absorbing the external shocks of financial crisis and proved to be an asset in the current uncertain environment, while keeping real growth at positive levels (Figure 54).

Figure 53. Inflation, average consumer prices



Source: WEO April 2010, IMF

Figure 54. Real growth and budget balance

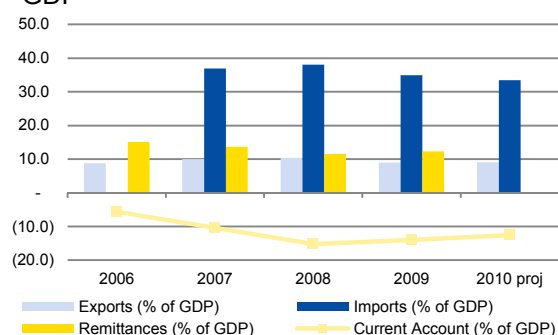


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Euroization in Albania is mainly favoured through FDI inflows, trade, remittances and credit lines. Albania is one of the region countries highly exposed to Greece and Italy through significant trade, remittances and financial sector.

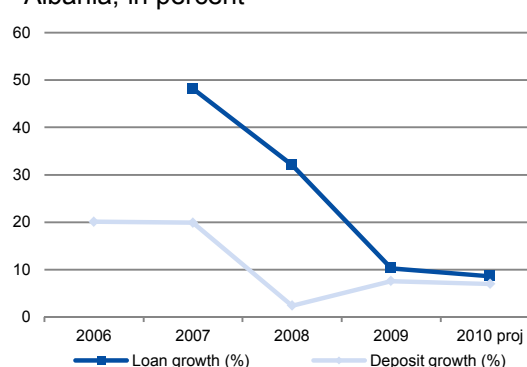
Main trading partners in Albania are EU countries (around 67 %), of which the highest share is realized through Greece and Italy. Exports in Albania have a low base. Recently, the decline in demand in Greece and Italy triggered a decline in Albanian exports, as well in imports. However, trade in Albania is mainly import based. Moreover, due to the rising unemployment in Greece in and Italy, where the largest share of the Albanian emigrants are concentrated, Albania has recorded a sharp decline in remittances during 2008 and 2009. Another strong link between Albania and Greece is through banking sector.

Figura 55. Current account, in percent of GDP



Source: INSTAT and WEO April 2010, IMF

Figure 56. Deposit and loan growth in Albania, in percent



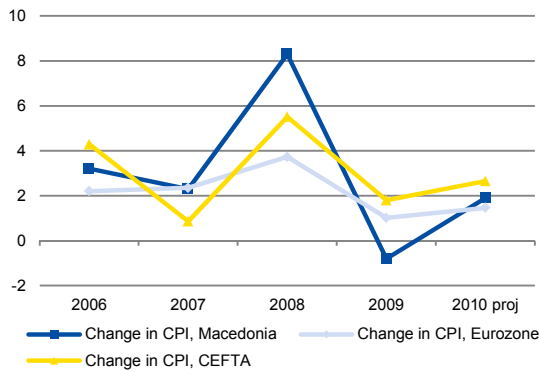
Source: BoA (2010) and country report, IMF (2010)

Greek bank subsidiaries and branches account for one quarter of the banking system and have the lowest capital and liquidity buffers in the system. Greek banks in Albania have witnessed a deposit withdrawal during recent economic problems in Greece. However, following the IMF and EU program with Greece, Greek banks in Albania are recording deposit growth.

### 8.3.3 Macedonia

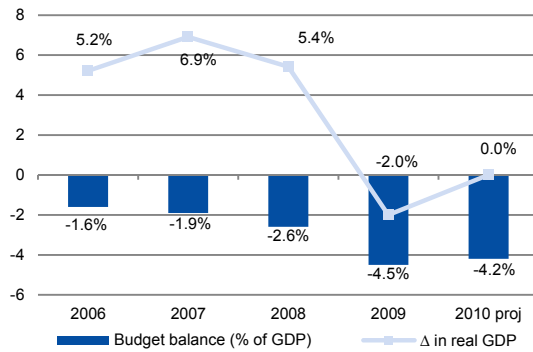
Macedonian denar is quasi-pegged to EURO with a purpose of keeping the price stability. With tight measures of the National Bank of the Republic Macedonia (NBRM) that took in 2009 (raising the liquidity and reserve requirements from banks), Macedonia is one of the countries with most tightened monetary policy in the region. The measures of the NBRM were taken to maintain the peg with EURO and protect the availability of foreign reserves. These measures appeared to be feasible implementing from banking sector with a relatively small impact on growth.

Figure 57. Inflation, average consumer prices



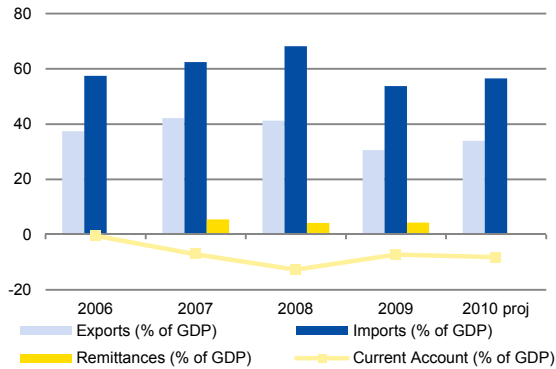
Source: WEO April 2010, IMF

Figure 58. Real growth and budget balance, in percent



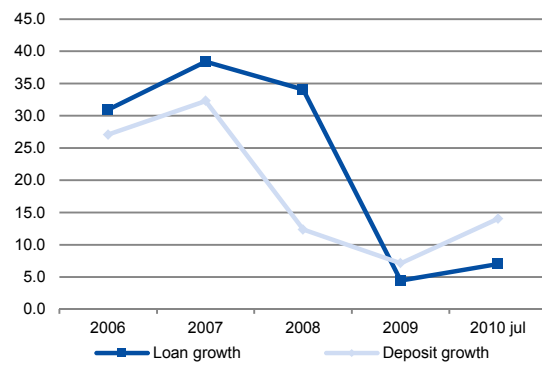
Source: WEO April 2010, IMF

Figure 59. Current account, in percent of GDP



Source: NBRM (2010) and WEO April 2010, IMF

Figure 60. Deposit and loan growth, in percent



Source: NBRM (2010)

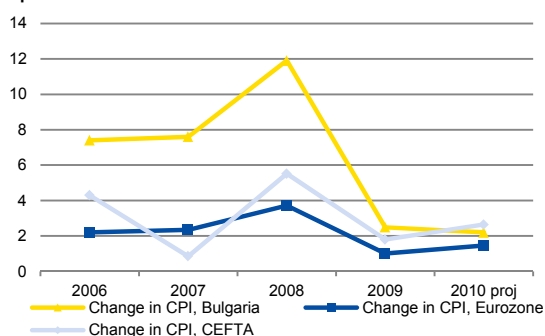
Macedonia experiences relatively high current account deficit. Recently, potential adverse effects may have come from trade with EU countries, since only Germany, Greece, Bulgaria and Italy comprise 45 % of exports and 31 % of imports. In the first part of 2010 Macedonia has recorded a fall in exports to Greece, while imports have been increasing. Recent Greek crisis may be a possible negative effect in the trade deficit of Macedonia with Greece. In addition, Macedonia has the smallest share of remittances to GDP (around 5 %), however with a stable trend.

Macedonia has a small banking system with limited reliance on external financing or investments. One of the biggest banks in Macedonia (Stopanska Banka) is a subsidiary of a Greek bank Nevertheless, banking sector in Macedonia, appear to be stable and good positioned. Around 30 % of the banking sector is euroized. In 2009 and in the beginning of 2010 the government issued bonds with high interest rates and low risk, which created more favourable conditions for banks to invest in bonds rather than crediting the economy.

### 8.3.4 Bulgaria

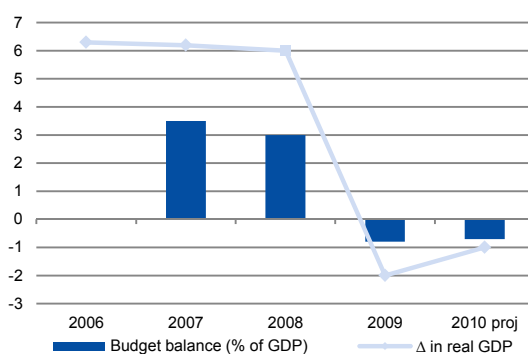
Bulgaria has a currency board with EURO, with a final goal of EURO area membership. The currency board has served Bulgaria in anchoring inflation and keeping fiscal deficit at moderate levels. High inflation during 2006-2008 was a consequence of the high capital inflows, which raised the credit growth and has boosted domestic demand.

Figure 61. Inflation, average consumer prices



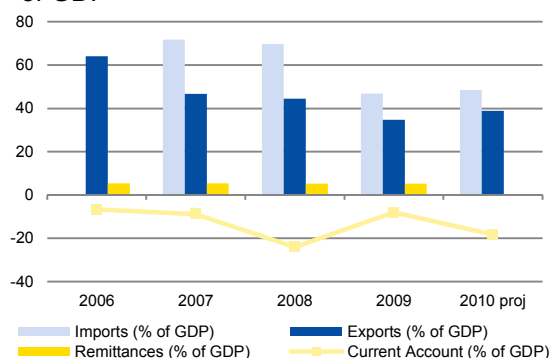
Source: WEO April 2010, IMF

Figure 62. Real growth and budget balance, in percent



Source: WEO April 2010, IMF

Figura 63. Current account, in percent of GDP



Source: BNB (2010); WEO April 2010, IMF and World Bank

This was manifested with higher prices and wages (however lowest in EU). Nevertheless, with a start of the global crisis, Bulgaria was hit by a sharp decline in capital inflows, which in effect impacted domestic demand and the budget revenues. In return, Bulgaria's economy fell 5 % after years of economic boom. The effects of the crisis in Bulgaria mainly felt in 2009, where the recession of the trading partners hit exports and the decline in domestic demand decelerated imports.

Main trading partners of Bulgaria are EU countries (62 % of exports and 53 % of

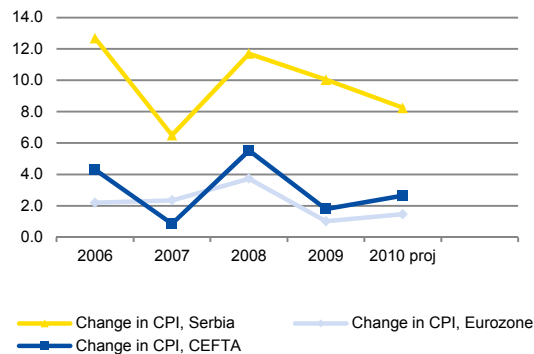
imports). Within EU, Greece is a country geographically and economically linked with Bulgaria. Bulgaria exports around 9 % and imports around 5 % in Greece.

In 2009, loans issued in euro comprised 57.9 %, while deposits were 58.7 % of the total. Greece banks' assets pertain around 16 % of the total assets of the banking sector. However, existing capital buffers of the banking sector in Bulgaria are pretty sufficient to absorb counter cyclical increase in NPLs and provisions. Moreover, Bulgarian National Bank (BNB) has advised banks to fully retain their profit in Bulgaria.

### 8.3.5 Serbia

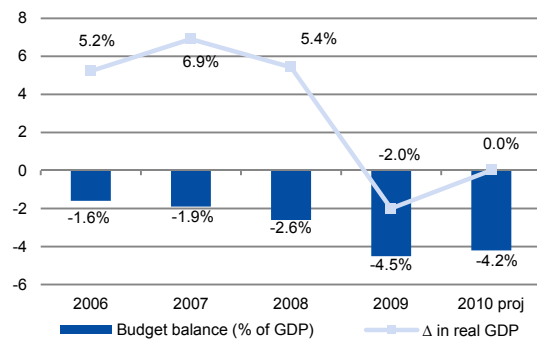
Serbia pursues the managed floating exchange rate regime. This enables the intervention of the National Bank of Republic of Serbia (NBRB) of keeping price stability and the foreign reserves at adequate level. Serbia uses interest rates as its main monetary policy tool.

Figure 64. Inflation, average consumer prices



Source: WEO April 2010, IMF

Figure 65. Real growth and budget balance, in percent



Source: WEO April 2010, IMF

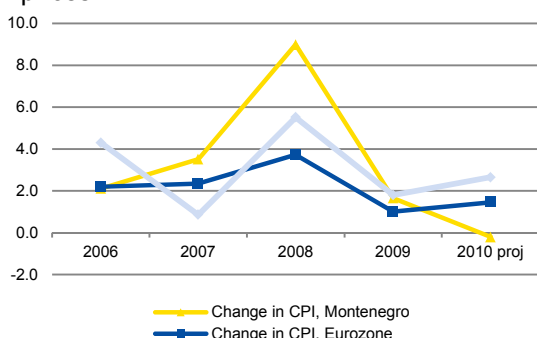
Average inflation during 2000's was the highest in the region. Generally, Serbia has inherited lack of trust in dinar due to hiperinflation during '90s, which in effect has usually caused high inflationary expectations. Moreover, gaining dinar confidence was hardly possible considering the expansionary monetary policies of the NBRB in order to finance high current account deficit and buy foreign reserves. Entering in the IMF financial program in 2009 helped Serbia in stabilizing inflation considerably.

Serbia trades with EU countries (54 % of exports and 55 % of imports) rather than CEFTA countries (31% of exports and 8% of imports). Prior to global crisis, similar to Bulgaria, Serbia has enjoyed fast economic growth. In late 2008 global crisis hit Serbia through a trade shrink, a sudden decline of the capital inflows and household deposit withdrawal. Banking sector in Serbia is highly euroized, also because of the favouring of the EURO to local currency. There are four Greek bank subsidiaries in Serbia, which account for around 14 % of total assets.

### 8.3.6 Montenegro

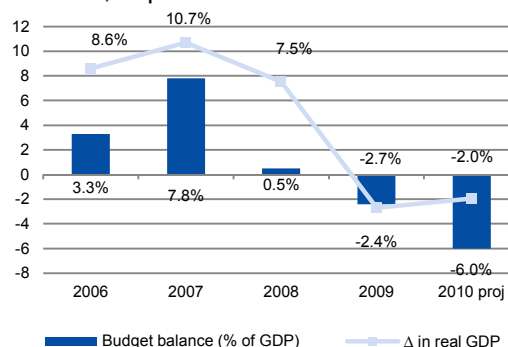
Prior to introduction of the EURO, Montenegro has highly used Deutsche Mark (DM) in private and banking sector. With the introduction of the EURO, the Government has decided using EURO as its legal tender. The average inflation during 2000s appears to be higher than the inflation of the region, up to 2009, even though following the same pattern of movement. Similar to other countries in the region, Montenegro is considerably linked with EU countries through trade and capital flows. More than 50 % of the Montenegro exports are addressed to EU, mostly Greece (22 %) and Italy (12 %). On the other side, 41 % of imports come from Serbia, while 31 % from EU countries.

Figure 66. Inflation, average consumer prices



Source: WEO April 2010, IMF

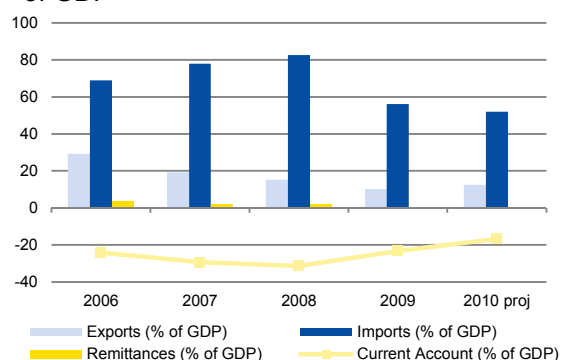
Figure 67. Real growth and budget balance, in percent



Source: WEO April 2010, IMF

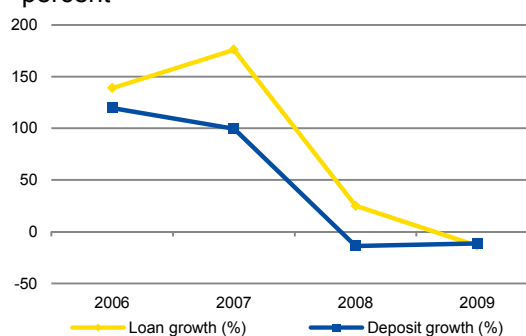
The decline in exports during 2010 was also subject to adverse external circumstances (including recent developments in Greece), since Greece is one of the biggest importers of Montenegro.

Figure 68. Current account, in percent of GDP



Burimi: Country Report, IMF (2010)

Figure 69. Deposit and loan growth, in percent



Source: Country Report, IMF (2010)

Soon after its independence, Montenegro has experienced large inflows of FDI which have contributed to a robust growth of the economy. Moreover, soon after its independence the levels of the credit growth to domestic sector were very high. However, during financial crisis, the economy was hit severely.

The current account deficit and private sector debt rose, while the loan quality deteriorated and deposit withdrawals took place. In effect, these developments contracted the economy from positive to negative growth. Euroization was useful in anchoring expectations; however Montenegro lacked the tools to control massive credit growth or FDI inflows. Moreover, expansionary monetary policy in the EURO area was not appropriate facing macroeconomic problems for Montenegro. Fiscal policies, as the only tool left to control money supply and banking sector were already loose. Therefore, considering the impact of the shocks, Montenegro economy weakened more than other countries in the region.



## 8.4 Developments in Financial Sector

Despite different monetary and exchange rate regimes across the region, countries resemble similar developments in their financial sectors. The financial crisis which originated in the USA and was later spread to EU did not affect countries in the region directly. The financial sectors in these countries were mainly affected by declining sources of financing through diminished foreign direct investments and cut in remittances. Consequently, the loan growth was substantially decreased which led to slowing domestic demand and lower economic growth. Interest rates remained on relatively high levels averaging around 14 % for loans and around 5 % for deposits.

The economic growth decline in the SEE countries has been associated with the rise of unemployment and considerable decline of the international trade and capital inflows. Starting from low levels of economic development, the declines in the economic growth are likely to be greater in the SEE countries than in the advanced economies where the crisis actually originated. By 2010, the economic recovery is being expected to have sluggish positive movement of the real economic activity in the advanced economies, while the economic recovery in the SEE countries is still uncertain and at most gradual. As to the financial sector, the SEE economies have been less affected by the financial contagion from the world financial crisis because their banking activities are mainly based on traditional banking models with literally no exposure to toxic assets. Nonetheless, the loan growth in all SEE countries has been decreased as banks started to reduce their loans by introducing new lending policies, and thus, increasing their lending rates. Partly as a reaction to a rise of non-performing loans (Kosovo, Albania, and Montenegro) while others (Serbia and Macedonia) rose lending rates to protect their currencies from substantial depreciation. Although an increase in lending rates contributed to slowdown of domestic demand, it will be claimed later that higher interest rates are not dominating factor in determining developments in aggregate demand in these countries.

Although all SEE countries aspire to enter the EU, except of Bulgaria which is already in the EU, these countries are already linked to the EU through the ownership of their banking sectors as shown in Table 12.

**Table 12. The structure of ownership of the banking sector, in percent**

Description	Kosovo	Macedonia	Albania	Bulgaria	Serbia	Montenegro
Foreign ownership	91.5%	93.1%	93.6%	83.9%	75.3%	84.5%
Domestic ownership	8.5%	6.9%	6.4%	16.1%	24.7%	15.5%

Source: EBRD Transition Report 2009 and central banks of the respective countries.

The only EU country in the region – except Bulgaria – is Greece which is also the country which is the most problematic in terms of its macroeconomic stability. In four of the SEE countries: Albania, Macedonia, Serbia, and Bulgaria, the Greek banks are present, which might be point of concern in terms of financial stability in these economies. One obvious consequence of the financial crisis in these financial sectors was an increase of deposit interest rates confirming the hypothesis that banks aggressively started to look for sources from domestic households. The effect of financial and economic turmoil in Greece was the most pronounced in Bulgaria where the presence of Greek banks is the highest in the

region. Contrary to other countries in the region, also lending interest rates increased in Bulgaria jointly with significant increase in deposit interest rates. This development was not observed in other SEE countries where only deposit interest rates increased in order to strengthen domestic sources of financing. Because of an increase of domestic sources of financing together with restrictive lending policies due to economic uncertainties, banking sectors in the SEE countries turned out to be net exporter of capital. This is primarily true for Kosovo and Albania where banks have been experiencing excess liquidity problems in recent years. That might come as surprise as these are also countries which are the least developed in the region. This fact points out the important conclusion stating that it is not necessarily the development of the financial sector which mitigate the growth potential in these countries, and that one should look at other factors determining the growth in the SEE countries.

The SEE countries have been affected by the global, but not in a way of financial contagion. Nonetheless, it represented turmoil which took place due to a lack of demand in most EU trading partners and declining global commodity prices. The financial markets in the SEE countries have experienced indirect negative impact through the decline of the foreign direct investments, transfers from remittances, and restricted bank's lending to the private real sectors. Therefore, the decline of the economic growth is likely to be greater in the SEE countries than in the advanced economies where the crisis really originated. However, one should not overlook other factors determining the growth revival in the SEE countries as explained below.

## 8.5 Growth Potentials in the SEE Countries

As it was shown, the SEE countries have established macroeconomic stability and pursued financial market liberalization as suggested by early reformers in Central and East European countries. They all chose the monetary and exchange rate regimes which suited their policy makers the best. They have all opened up the financial sectors to foreigners with intention to be more integrated into financial markets and primarily because those sectors almost did not exist before. Most countries have extensively started to export to EU markets although the structure of their exports still reflects relatively low level of economic development. As claimed before, the exports structure of these economies contributed substantially to less preferable economic development in recent years as raw material prices helped to bring down inflation rates in the SEE countries, but negatively affected current accounts.

Also, dependency on EU exports demand negatively affected growth dynamics in the region. Table 13 presents intra-regional trade flows which are relatively weak and request further explanation. Namely, although landlocked the countries in region trade among each other relatively little. With similar exports structure they do not find their trade patterns as complements but rather compete with each other on primarily EU markets. Regional cooperation is further mitigated by pending political problems which prevent these economies to fully exploit their growth potentials.

Table 13. Trade matrix of the selected countries as a share to total, unless otherwise indicated

Matrix of the countries	Kosovo	Macedonia	Albania	Bulgaria	Serbia	Montenegro
<b>Kosovo</b>	Exports=4.6% of GDP Imports=47.6% of GDP	Exp (KS→MKD)=9.6% Imp(KS→MKD)=15%	Exp (KS→AL)=13.5% Imp(KS→Mac)=3.2%	Exp (KS→Blg)=2% Imp(KS→Blg)=2%	Exp (KS→SR)=1.6% Imp(KS→SR)=11.1%	Exp (KS→MNG)=1.5% Imp(KS→MNG)=0.6%
<b>Macedonia</b>	Exp (MKD→KS)=7.5% Imp(MKD→KS)=0.2%	Exports=37.1% of GDP Imports=59.7% of GDP	Exp (MKD→AL)=2.9% Imp(MKD→AL)=0.5%	Exp (MKD→BLG)=8.8% Imp(MKD→BLG)=4.8%	Exp (MKD→SR)=18% Imp(MKD→SR)=7.8%	Exp (MKD→MNG)=1% Imp(MKD→MNG)=0.03%
<b>Albania</b>	Exp (AL→KS)=6.7% Imp(AL→KS)=0.6%	Exp (AL→MKD)=2.8% Imp(KS→MKD)=2.0%	Exports=9.5% of GDP Imports=35.8% of GDP	Exp (AL→Blg)=0.7% Imp(AL→Blg)=1.4%	Exp (AL→SR)=3.0% Imp(KS→SR)=3.5%	Exp (AL→MNG)=3.4% Imp(KS→MNG)=0.3%
<b>Bulgaria</b>	Exp (BLG→KS)=n/a Imp(BLG→KS)=n/a	Exp (BLG→MKD)=2.1% Imp(BLG→MKD)=3.2%	Exp (BLG→AL)=0.5% Imp(BLG→AL)=0.05%	Exports=45.8% of GDP Imports=59.2% of GDP	Exp (BLG→SR)=2.1% Imp(BLG→SR)=3.2%	Exp (BLG→MNG)=2.1% Imp(BLG→MNG)=3.2%
<b>Serbia</b>	Exp (SR→KS)=3.5% Imp(SR→KS)=0.03%	Exp (SR→MKD)=4.6% Imp(SR→MKD)=2.2%	Exp (SR→AL)=1.4% Imp(SR→AL)=0.1%	Exp (SR→BLG)=2.5% Imp(SR→BLG)=2.1%	Exports=20.9% of GDP Imports=40.2% of GDP	Exp (SR→MNG)=4.6% Imp(SR→MNG)=2.2%
<b>Montenegro</b>	Exp (MNG→KS)=7.4% Imp(KS→KS)=0.1%	Exp (MNG→MKD)=0.5% Imp(KS→MKD)=1.4%	Exp (MNG→AL)=0.5% Imp(KS→AL)=1.4%	Exp (MNG→BLG)=2.8% Imp(KS→BLG)=0.0%	Exp (MNG→BLG)=24.9% Imp(KS→BLG)=41.2%	Exports=17.3% of GDP Imports=67.6% of GDP

Source: Created by the author based on the IMF World Economic Outlook Database (April 2010), World Bank Data, Central Banks of Respective Countries.

However, it is the lack of institutional development in the region that one may blame for missing stronger economic growth revival. Although one could claim that the SEE countries have been successful in establishing macroeconomic stability and proceeded prudently with microeconomic liberalization processes and privatization of state owned sectors of their economies, it is important to acknowledge that the SEE countries have not been successful in development of the institutional market economy framework which is needed to support further economic growth. By institutional market economy framework one understands the establishment of property rights, protection of the Rule of Law, and especially the capacity to enforce the existing contracts in the economy.

Table 12 presents the ranking of the SEE countries according to the World Bank Doing Business 2010 study which provide tentative answers to the question why the SEE countries lack the power to grow faster.

Namely, private investors in the region are not protected by the institutional settings in these countries which prevent them from increasing their exposure to the region. This is even more important at the times when world financial markets are more cautious in supporting new investments in relatively riskier environments.

Table 14. Doing Business in the SEE Countries, 2010

	Ease of doing business rank	Starting business	Construction permits	Employing workers	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Closing business
Macedonia	5	2	14	9	14	11	3	1	9	19	22
Bulgaria	10	12	11	8	12	1	7	12	17	21	11
Montenegro	15	18	19	6	24	11	6	19	8	26	5
Albania	18	11	22	16	17	4	2	18	11	22	27
Serbia	19	15	23	14	21	1	15	17	13	23	21
Kosovo	22	27	24	4	16	11	27	6	19	27	2

Source: World Bank, Doing Business 2010

For the time being, the SEE countries exhibit relative macroeconomic stability despite unfavourable developments in the current account and fiscal balances. Most of the financial sector is foreign owned which helps to maintain the financial stability in those economies, although temporary effects of the financial crisis are observed. However, the economic revival of these economies is substantially dependent on development of market institutions aimed to protect the rule of law and efficiency of market based institutions and processes known in developed economies. Table 14 provides an evidence that the SEE countries are ranked the worst in terms of enforcing contracts among 27 countries in Eastern Europe and Central Asia. While most of them rank higher in other categories according to the World Bank study, it is the legal framework of doing business that seems to be temporarily detrimental in experiencing higher investment demand in the region.

## 8.6. Conclusions

According to the general understanding of the transition process, the SEE countries should exhibit higher economic growth rates. They have all brought down inflation rates and imposed macroeconomic stability. The financial sectors in the region operate according to international standards and practices. Moreover, the health of the financial sector is temporarily better than in other Central and Eastern European countries and it does not seem to deteriorate despite financial sector difficulties in home countries where the mother banks come from. Although interest rates are high in the region, the reasons for higher interest rate stem from higher risks perceived by the financial sector. Those risks are mainly associated with weak legal protection of banks and other financial institutions in law enforcement of existing business contracts.

For those reasons one could conclude that the SEE countries seem to lack the institutional support to generate higher economic growth. Although most of those economies exhibit positive growth rates which are mainly generated by public investment, it is important to acknowledge that higher growth rates can only be achieved by higher private and foreign direct investment. For that to happen, the SEE countries should develop credible institutional and legal framework which would protect those investors willing to invest in the region, both private domestic and international investors, respectively. What seemed to be taken for granted in other transition economies might take longer time to develop in the

SEE countries. However, one cannot expect those countries to benefit from relatively stable financial sectors unless the institutional and legal environment is developed.

## 9. Decomposition of Financial Intermediation Costs: A Comparative Analysis

Valentin Toçi, Arben Mustafa and Astrit Panxha

### 9.1. Introduction

The interest rate spread in the Kosovo's banking sector has shown some declining trend. High interest rate spread mainly reflects high lending and low deposit rates. This can have implications in discouraging investments and savings thus harming economic growth.

Lending rates are determined by many factors, such as bank size, market power, liquidity, economies of scale and operating costs. Also, funding costs, regulatory costs (e.g., taxation and reserve requirements), rule of law, overall institutional setting, and macroeconomic environment represent important determinants of lending rates. In addition, a very important component of interest rates consists of risk perceived by banks, which can derive, among others, from institutional failures in general and the legal ones in particular i.e., difficulties in repossessing collateral.

This study draws on and is an updated version of earlier paper by Morina and Toçi (2007). The main focus is to explain the trend in interest rate spread in Kosovo. It also compares the structure of income statement and earning margins of Kosovo's banking sector with four countries in the region. Then the study focuses on the cost structure of the banking sector in Kosovo related to lending to the domestic economy only by decomposing funding, operational, risk and regulatory costs. The results indicate that one of the most important components contributing to the high level of lending rates and the spread are operational costs and risk costs expressed by the level of provisioning.

### 9.2. Interest rate spread and earning margins

One of the commonly used measures of the banking sector efficiency is interest rate spread, i.e., the difference between the interest rate that banks charge for loans and interest rate paid to savers. Lower spreads can be interpreted as an indication of the intermediation efficiency of the banking sector, although this may not necessarily always be the case. For instance, low *ex post* spread may reflect excessive risk-taking and high loan defaults. On the other hand, high spreads could imply excessive transfer to banks, inefficiency in intermediation in the local market, lack of competition, excessive risk by borrowers, institutional failures, etc. According to Valverde *et al.* (2004), high spreads will decrease savings and investment. Barjas *et al.* (1999) found evidence that commercial banks with greater market power and high reserve requirement set by the regulatory body will increase interest rate spreads. Also, weak institutions will increase interest rate spreads (Demirguc-Kunt *et al.*, 2003). Regarding macroeconomic variables, there is an extensive literature that found evidence that high inflation, large fiscal deficit and increase in broad money ( $M_2$ ) can increase interest spreads (Crowley, 2007; Demirguc-Kunt and Huizinga, 1998).

Higher efficiency, as broadly recognized in the literature of banking, comes at cost for stability (a so-called efficiency-stability trade-off). Higher spreads may contribute to the stability of the sector by ensuring profitability, increasing the franchise value of the sector

presumably contributing to the decrease in excessive risk-taking on banks' side; while the opposite is true on the borrowers' side. For example, higher lending rates may induce borrowers to undertake riskier projects. It may also have detrimental effects in the demand for credit where high interest rates, coupled with high collateral requirements, are reflected in making fewer projects qualify for bank loans. Hence, many profitable ventures may not be undertaken. To some extent, this is in line with the findings in the previous study where results from BEEPS show that Kosovo is ranked low in terms of access to finance compared to countries in the region.

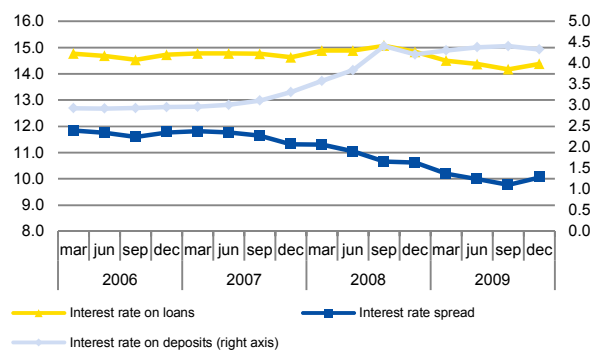
The Central Bank of the Republic of Kosovo (CBK), starting from June 2004, publishes effective deposit and lending interest rates charged by commercial banks in Kosovo. Figure 70 shows the weighted average of lending and deposit rates (12-month moving average) for the period 2005–2009.

On average for 2004-2009 the lending rates stood at 14.75% while the deposit rates at around 3.49%, making up the spread of 11.26

percentage points (pp).<sup>13</sup> The interest rates, as appear on the statistics, are *ex ante* measures of the intermediation spread. These, for example, are contractual rates charged on loans and paid in deposits, and they intend to measure market conditions at one point in time. How much interest is paid after the contract is not reflected in the data, e.g., bad loans do not pay interest rate. Therefore it is important to compute and decompose the *ex-post* lending rate, which reflects the true value of intermediation cost and enables the breakdown of factors that compose the intermediation cost, including overhead expenditures, regulatory costs, risk costs, etc.

One approach for decomposing intermediation costs is the method used by Hansen and Rocha (1986) using income statement data expressed in terms of ratios to total assets. This method is utilized for countries in the region Albania, Croatia, Macedonia and Serbia. In Table 15 the decomposition of the accounting data is presented and items 1 and 2 represent interest received from earning assets and interest paid on interest bearing liabilities divided by total assets. The difference between the two represents interest margin. Other income net represents net non-interest income such as income/expenditures from fees and commissions, income/expenditures in dealing securities, foreign exchange, etc., excluding operating costs and provisions. The sum of interest margin and other income gives the gross margin of banks in their operations. By subtracting operational costs (item 6) such as staff costs, administrative costs, fixed asset costs and similar, from the gross margin the net margin is obtained (item 7). Subtracting provisions (item 8) from the net margin we end up with profitability indicators of the banking sector in respective countries.

Figure 70. Interest rates in the banking sector, 2006-2009



Source: CBK (2010)

<sup>13</sup> Until 2008, administrative expenditure paid by the client were not included in the loan interest rate. This administrative cost was 1.5 pp of total interest rate charged for the loan. However, since 2008, in compliance with international statistical standards, administrative costs are included as part of the loan interest rate. If these expenditures were included prior to 2008, interest rates would be much higher for that period and also the decline would be sharper in the recent years.

Table 15. Structure of banking sector income statement and profit margins

(in thousands of national currencies and as % of total assets)

Description	Kosovo				Macedonia	Croatia	Albania	Serbia
	2006	2007	2008	2009	2009	2009	2009	2009
1. Interest Received	89	118	156	163	19,131	22,830	154,831	168,920
	<b>7.65</b>	<b>8.21</b>	<b>8.61</b>	<b>7.41</b>	<b>7.12</b>	<b>6.03</b>	<b>4.53</b>	<b>7.23</b>
2. Interest Paid	20	26	38	52	8,436	13,279	78,804	68,390
	<b>1.71</b>	<b>1.81</b>	<b>2.11</b>	<b>2.37</b>	<b>3.14</b>	<b>3.51</b>	<b>2.31</b>	<b>2.93</b>
3. Interest Margin (1-2)	69	92	118	111	10,695	9,551	76,027	100,530
	<b>5.93</b>	<b>6.40</b>	<b>6.50</b>	<b>5.04</b>	<b>3.98</b>	<b>2.52</b>	<b>2.22</b>	<b>4.30</b>
4. Other Income (net)	26	39.0	38.2	38	3,423	13,436	23,280	31,590
	<b>2.26</b>	<b>2.72</b>	<b>2.11</b>	<b>1.70</b>	<b>1.27</b>	<b>3.55</b>	<b>0.68</b>	<b>1.35</b>
5. Gross Margin (3+4)	95	131	156	149	14,118	22,987	99,307	132,120
	<b>8.19</b>	<b>9.12</b>	<b>8.61</b>	<b>6.74</b>	<b>5.26</b>	<b>6.08</b>	<b>2.91</b>	<b>5.66</b>
6. Operating Costs	61	69.7	86.0	87	10,278	7,564	52,859	104,420
	<b>5.23</b>	<b>4.86</b>	<b>4.76</b>	<b>3.95</b>	<b>3.83</b>	<b>2.00</b>	<b>1.55</b>	<b>4.47</b>
7. Net Margin (5-6)	34	61	70	62	3,840	15,423	46,448	27,700
					<b>1.43</b>	<b>4.08</b>	<b>1.36</b>	<b>1.19</b>
8. Provisions	14	18	17	26	5,254	3,515	31,525	138,362
	<b>1.18</b>	<b>1.24</b>	<b>0.94</b>	<b>1.16</b>	<b>1.96</b>	<b>0.93</b>	<b>0.92</b>	<b>5.92</b>
9. Profits Before Tax	27	41	48	29	1,725	4,216	7,503	20,030
	<b>2.29</b>	<b>2.88</b>	<b>2.63</b>	<b>1.31</b>	<b>0.64</b>	<b>1.11</b>	<b>0.22</b>	<b>0.86</b>
10. Profits After Tax	20	33	36	25	1,676	3,278	5,489	20,030
	<b>1.74</b>	<b>2.33</b>	<b>2.01</b>	<b>1.15</b>	<b>0.62</b>	<b>0.87</b>	<b>0.16</b>	<b>0.86</b>
A. Total assets	1,161	1,435	1,808	2,204	268,543	378,371	3,417,473	2,336,046
B. Loans	637	892	1,183	1,289	178,195	252,428	1,596,615	1,989,552
C. Loans/ total assets	<b>54.82</b>	<b>62.17</b>	<b>65.45</b>	<b>58.48</b>	<b>66.36</b>	<b>66.71</b>	<b>46.72</b>	<b>85.17</b>

Source: Central banks of respective countries and own calculations.

As can be observed from Table 15 interest margin is the highest in Kosovo (around 1pp higher compared to Macedonia and Serbia, and over 2.5pp higher compared to Albania and Croatia). This difference is mainly driven by higher interest received. Interest margin in the Kosovo's banking sector has maintained an increasing trend from 2005 until 2008, mainly due to the increase in loans to domestic economy as proportion of total assets, which are characterized with higher interest rates. On the other hand, for the period 2005-2008, loan interest rates have declined modestly, while interest rates on deposits followed an upward trend. In 2009, however, interest margin decreased and this development can be attributed to the slowdown of credit growth and higher funding costs.

Also in terms of gross margin Kosovo is ahead compared to the countries in the region, mainly due to the higher level of other income in the banking sector. This category includes income generated from fees and commissions, trading profit and other operating income. Operational costs and provisions add substantial proportion to the intermediation cost. These indicators for Kosovo are substantially higher compared to Albania and Croatia, comparable to Macedonia, but lower compared to Serbia. This reflects cost inefficiencies, risk perception of banks/regulators in the loan portfolio, which to some extent may explain the high interest rates.



This approach generalizes the intermediation costs related to overall banking operations. For example, interest received when relating to total assets does not make the distinction between assets invested in low-risk low-return investments such as placements in banks abroad, government bonds and, on the other hand, assets invested in high-risk high-return loans in the domestic market. However, the approximation is not unrealistic provided similarities in the ratio of loans to domestic economy to total assets for countries in the region ranging from 58.48% in Kosovo to 66.24% average for the countries in the region included in this analysis (see Table 2). Also provisions relate to total banking operations and not explicitly to banks' lending activity in the domestic market. Considering this, the next section aims at decomposing the intermediation costs related to lending to domestic economy for the banking sector of Kosovo and other countries in the region.

### 9.3. Decomposing intermediation spread

The decomposition of the *ex post* intermediation costs is made into the *funding*, *operational*, *risk* and *regulatory* costs. This approach uses balance sheet and income statement information and under the set of assumptions approximates the intermediation cost related to domestic economy only. The analysis follows the basic accounting identity

$$II + NII = IE + C + Pv + Tax + P$$

where interest income (*II*) plus noninterest income (*NII*) equals interest expenses (*IE*), operating costs (*C*), provisions for loan losses (*Pv*), taxes paid (*Tax*) and profit (*P*). However, this framework does not take into account behavioral effects of macroeconomic factors, institutional factors nor the bank and market-specific factors such as economies of scale, market power, etc., which may be reflected in the cost/revenue components.

Regarding the institutional failures which to a great extent contribute to the credit risk, based on a survey with banks in Kosovo, a study on the enforcement of creditor rights has been conducted recently, where Kosovo appears to compare well with other countries in the region and wider. Similar results are presented also by the World Bank's Doing Business (2011), where Kosovo compares well with other countries with regard to the days needed for the enforcement of a contract and with regard to the protection of creditor rights by law. Nevertheless, the survey results suggest that institutional inefficiency still represents an obstacle, causing delays in the execution of collateral, which may increase banking sector expenditures and credit risk, which are then reflected in the lending rate. As a matter of the macroeconomic factors, due to the use of euro, Kosovo is characterized with stable inflationary environment although external imbalances, low economic activity and high unemployment rate may increase the general risk perception.

#### 9.3.1 Ex-post lending rate

Costs that incur to borrowers are the interest rate they pay for the loans they get, plus fees and commissions. For example, *ex ante* interest rate does not reflect those loans that do not

pay interest, have fallen in arrears, etc. To deal with this issue the ratio between the interest income from loans derived from monthly income statements (flow data) and gross loans derived from monthly balance sheet (stock data) is calculated and the monthly flow data are annualized and the ratio averaged over one year (to smooth the effect of the problem when relating flow and stock data). In addition, banks in Kosovo charge 1-2% fee on each disbursed loan (processing/disbursement fee). To capture this and other possible fees e.g., penalty for late loan re-payment, the ratio between the income from fees and commissions (flow variable) and gross loans (stock variable) is calculated. To separate the income from fees and commissions related to lending activity in the domestic economy only, the fee and commission item is multiplied with factor  $A$ .  $A$  represents for each period the share of lending to domestic economy in the total balance sheet. It is assumed that the banking sector activity devoted only to lending to domestic economy is captured by this factor.<sup>14</sup>

### 9.3.2 Ex-post cost decomposition

The cost structure of banking sector is decomposed by calculating four components: funding costs, operational costs, risk costs and regulatory costs. Deposits represent the most important source of finance for the banking sector lending activity. *Funding costs* or the 'actual' deposit rate is derived by calculating the ratio of interest expenditures on deposits and other borrowings to total outstanding debt to clients ( $D$ ). Again, the former being a flow variable and the latter a stock variable, monthly flow data are annualized and the ratio averaged over one year.

*Operational costs* such as personnel costs, occupancy costs and other non interest costs may be shifted to customers through higher interest rates. These costs are attributable to entire banking activities. For the period 2004-2009 the largest proportion of operational costs consisted of personnel costs (40 percent) and occupancy costs (40 percent). To separate the operational costs related to lending to domestic economy only, we multiply the costs with factor  $A$ . Relating this to gross loans ( $L$ ) may give the operational costs devoted to lending to domestic economy. This percentage is additional contributing factor to the intermediation costs related to lending activity of commercial banks.

Provisions represent the risk that bankers perceive or assess in their portfolio and are additional wedge to the intermediation costs. The *risk costs* is derived from the balance sheet data by dividing provisions for loan losses with gross loans to domestic economy on a monthly basis for each year in the period 2004-2009. In addition, based on actual data around 95% of provisioning is attached to loans to domestic economy.

The *regulatory costs* cover taxation and mandatory reserves required by the central bank. Basically the same calculation logic is used for taxation, by relating provisioning for taxes (multiplied with factor  $A$ ) with gross loans. Taxation and reserve requirement costs are expected to be less important. After the 'actual' lending rate and all the cost components are calculated, the difference between the two reflects the *residual* ( $e$ ). This is composed of other banking operations income and errors that result from assumptions made and combining the flow data from income statement and stock data from balance sheet.

The basic accounting identity is transformed in this form:

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<sup>14</sup> Another possible assumption for factor  $A$  may be interest income from loans to total income. However, the results do not change significantly.

$$\frac{II}{L} + \frac{NII}{L} * A = \frac{IE}{D} + \frac{C}{L} * A + \frac{Pv}{L} * 0.95 + \frac{Tax}{L} * A + \frac{IE}{L} * A * 0.1 + \frac{P}{L} * A + \varepsilon$$

### 9.3.3 Results

As Table 16 indicates, the *ex post* lending rate of 12.59% and fees and commissions adding to the borrowing cost 1.99pp make the *ex post* lending rate in the Kosovo's banking sector at 14.58% for year 2009. The *ex post* lending rate in the banking sector appears to be higher compared to other countries in the region with an average at 11.14%.

During 2009, , the most important contributing factors to the lending rate in Kosovo were operating costs followed by the risk costs proxied by provisioning for loan losses. Operating costs explain about 4.48pp of total costs incurred by banking sector, followed by risk costs which add an additional 5.08pp. Funding costs and regulatory costs add additional 3.80pp, while bank profits explain 1.28pp. The structure of *ex post* costs in the Kosovo's banking sector differs from banking sectors of other countries in the region. Unlike Kosovo, where risk costs and operational costs explain the largest share of *ex post* costs, the largest item of *ex post* cost in the banking sectors of region countries appear to be funding costs. In Macedonia, operational costs represent the second largest category of *ex post* costs, whereas in other countries risk costs represent the second largest category, leaving operational costs in the third place. The dominance of risk costs and operational costs in the overall structure of *ex post* costs in the Kosovo's banking sector reflect the higher level of risk that is perceived by banks in Kosovo as well as the lower efficiency of banks. Furthermore banks profit also plays an important role in explaining the *ex post* costs for the banking sector of Kosovo and it is much higher compared to the average of the countries in the region.

Table 16. Decomposition of intermediation cost

Description	Kosovo				Macedonia	Albania	Croatia	Serbia	Average fore region countries
	2006	2007	2008	2009	2009	2009	2009	2009	
<b>Ex-post lending rate</b>	<b>15.66</b>	<b>16.30</b>	<b>15.52</b>	<b>14.58</b>	<b>11.90</b>	<b>12.19</b>	<b>10.18</b>	<b>10.29</b>	<b>11.14</b>
Lending rate	13.32	13.30	13.09	12.59	10.74	9.70	9.04	8.49	9.49
Fees and commissions	2.35	3.00	2.43	1.99	1.16	2.49	1.14	1.80	1.65
<b>Ex post Costs</b>	<b>12.93</b>	<b>13.25</b>	<b>13.50</b>	<b>13.37</b>	<b>8.85</b>	<b>7.85</b>	<b>11.92</b>	<b>12.87</b>	<b>10.37</b>
Funding costs	2.30	2.52	2.93	3.36	4.10	2.93	5.17	6.17	4.59
Operational costs	5.64	5.37	5.28	4.48	3.99	2.00	1.89	0.42	2.07
Risk costs	4.22	4.54	4.37	5.08	0.38	2.55	4.30	6.26	3.37
Regulatory costs	0.77	0.81	0.92	0.45	0.39	0.36	0.57	0.01	0.33
o/w taxes	0.59	0.61	0.69	0.18	0.02	0.08	0.23	0.00	0.08
o/w reserves	0.19	0.20	0.23	0.27	0.36	0.29	0.33	0.01	0.25
<i>Memorandum items</i>									
<b>Residual</b>	<b>2.74</b>	<b>3.05</b>	<b>2.02</b>	<b>1.21</b>	<b>3.04</b>	<b>4.34</b>	<b>-1.74</b>	<b>-2.57</b>	<b>0.77</b>
o/w Profit	1.88	2.60	2.26	1.28	0.72	0.21	0.82	0.22	0.49

Source: Central banks of respective countries and own calculations.

Operational costs as the most important component of the intermediation cost have shown a declining tendency since 2005. In 2009, operational costs explained 4.48pp of total *ex post* costs, compared to 6.13pp in 2005. The higher level of operational costs in the first years of the operation of Kosovo's banking sector might be attributed to the need for expanding banking sector network. This expansion led to a higher level of expenditure that was needed to open and functionalize branches and other infrastructure. In 2009, it may be considered that the banking sector has vastly completed the expansion of its network and the banking services are available around the country. In addition, in the first years of operation, banks incurred additional costs on staff training and other expenses, taking into consideration that at that time the market could not provide experienced staff for this industry. According to a study conducted by the World Bank (2010), wages for the financial sector in Kosovo are highest compared to other sector of economy. This is measured through the wage difference between the financial sector and low-skill sectors (construction, catering and retail trade). The wage differential between financial sector and other sectors in Kosovo is the also highest compared to countries in the region. For example, compared to Macedonia, the wage differential is for 50 percent higher, whereas compared to Croatia it is for 100 percent higher. This sheds some light on cost inefficiencies in Kosovo's banking sector.<sup>15</sup>

Unlike previous years, when operational costs represented the largest component of banking sector *ex post* costs, in 2009, risk costs were the largest component accounting for 5.08pp of total costs. Risk costs have shown an increasing trend in the last five years, mostly due to credit growth and higher risk-taking that took place during this period. The larger contribution of risk costs to the total costs in year 2009 presumably reflects the deterioration of real sector conditions during this period as a consequence of global crisis. This resulted in the increase of non-performing loans from 3.3 percent in 2008 to 4.3 percent in 2009. Funding costs represent another category that has continuously increased its contribution to the overall *ex post* costs. The increase of funding costs primarily reflects the increase of deposit interest rates especially during 2008 and 2009. This period has been characterized with new entries in the Kosovo's banking sector, which intensified the competition among banks in attracting deposits. In addition, high rates of credit growth during this period necessitated the attraction of larger amounts of deposits in order to finance the credit growth. These developments had a positive impact on deposit interest rates, increasing the cost of finance for the banking sector.

## 9.4 Conclusions

The interest rate spread in the banking sector of Kosovo is considered to be high compared to the countries in the region. High interest rate spread in Kosovo primarily reflects high lending rates. On the other hand, deposit rates show an increasing trend, thus modestly narrowing the interest rate spread. This study found that lending rates in Kosovo are mainly explained by operational and risk costs. In the cost structure of banks in Kosovo, operating costs are predominantly the most important category. Costs in the adoption of technological advances for upgrading banking products and services, a shift towards the segments of small business sector which are more costly led to higher operational costs. Also start-up costs or cost of acquiring domestic banks, and costs in further building human

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<sup>15</sup> See also Toçi (2009) for relative inefficiencies in intermediation in the Kosovo banking sector.

capital which was generally lacking in the Kosovo also had an impact on higher operational cost. Risk costs, proxied by the level of provisions, also play an important role in determining lending rates in Kosovo. This is particular because of young and cost inefficiencies in the short-run and the risk perception of bankers and/or the regulator entailing lending shortfalls and high provisioning. Unlike Kosovo, in other countries of the region, funding costs appear to have a significant impact in explaining lending rates.

The large share of operational costs in the overall structure of banking sector costs in Kosovo indicates cost inefficiencies in this sector. This necessitates the undertaking of measures by banks to improve the cost efficiency in order to have a decline of lending interest rates. The increase of competition in the banking sector can also have a substantial impact on the enhancement of banking sector efficiency. In addition, the evidence found in this study poses the need for improvements in the risk assessments techniques by banks operating in Kosovo, bearing in mind that risk costs have resulted to be one of the main components of the intermediation. In this regard, improvements in the sharing of information such as credit registry, and accounting disclosure and transparency by firms is crucial in reducing risk costs. Additionally, the improvement in the system of notice together with improvement of courts' efficiency to process default cases can also give a substantial contribution to the reduction of credit risk and, hence, to the decline of lending rates in the banking sector of Kosovo.

## 10. Enforcement of Creditor Rights in Kosovo: Empirical Study

Valentin Toçi and Arben Mustafa

### 10.1. Introduction

After the war in 1999, Kosovo started to build institutions needed for the functioning of a market economy. Kosovo marked substantial progress in creating conditions for the functioning of the financial market and protection of creditor rights, putting in place the financial sector regulatory framework, bankruptcy, mortgage and pledge laws as well as pledge and credit registers. Kosovo appears to stand better than the average of transition economies when it comes to the protection of creditor rights as they appear in the books of law. An assessment of creditor rights was made by the World Bank's 'Doing Business' (2011), which rated the protection of creditors in some key aspects of bankruptcy and pledge laws – covering three aspects of bankruptcy laws and seven aspects of collateral laws. The scoring of the Creditor Rights Index ranges from 0 to 10 (the higher the score, the better the protection of creditor rights). The Creditor Rights Index for Kosovo stood at 8, which is higher than the average of 7 for other transition economies. Regarding the SEE countries, only Albania attained a higher score than Kosovo. In terms of enforcement, however, there is no conclusive evidence on how laws work in practice as different studies provide different assessments (e.g., World Bank, 2004; Zahler, 2004; BCI, 2005). Some point to the weak 'rule of law', while others highlight the strong protection of creditor rights – better than the average transition economy and even some high-income countries.

This study provides an up-to-date assessment of enforcement of creditor rights in Kosovo. Initially, the analysis shows assessments by some international agencies for the enforcement of creditor rights. These indicators, however, may not fully explain the law enforcement specifically in the context of the banking sector. The limitations are either because they may fail to fully capture the context of the lender-borrower relationship or are multidimensional. Therefore, this study aims at investigating the legal environment surrounding Kosovo's banking sector, particularly aspects of the enforcement process related to the lender-borrower relationship. The analysis relies on primary data collected from a survey with banks in Kosovo, aiming at assessing how the pledge law works in practice.

### 10.2. Enforcement of Creditor Rights

The World Bank (2004) evaluated the 'laws in action' in Kosovo and pointed out many deficiencies in court procedures. Aspects such as the unpredictability of the judgment, the length of the process, and the complexity and lack of clarity in procedures are considered as constraints in enforcing creditor rights which may encourage a culture of non-payment on the borrowers' side. This suggests the poor development of the legal system related to the enforcement of contracts. In addition, based on interviews with bankers in Kosovo, Zahler (2004) claims that courts and judges tend to favour borrowers *vis a vis* the lenders in disputes. The author also points to the poor functioning of legal institutions governing financial transactions.

Doing Business (2011) provides a picture on the enforcement of law in Kosovo by considering the number of days it takes to enforce a simple debt contract. As shown in Table 17, Kosovo compares well with other transition economies when it comes to enforcing contracts. It outperforms most of SEE countries and, on average, even OECD countries. It takes 420 days to enforce a simple debt contract in Kosovo, while the SEE average is 506 days, the CEE average 547 days, the CIS average 301 days and the OECD average 518 days. The average number of days for the enforcement of a contract in Kosovo in 2010 substantially increased compared to year 2005 (Table 17). This can be attributed to the credit growth during this period while the number of cases sent to courts continuously increased.

The enforcement of contracts in Kosovo, however, may be impeded by the high cost of contract enforcement, which is higher than in all transition economies and OECD countries. According to Doing Business (2011), the cost of enforcing a contract in Kosovo, on average, accounts for 61 percent of the debt, while the average for SEE countries is 34 percent, for CEE countries 28 percent, for CIS countries 24 percent and for OECD countries 20 percent.

**Table 17. Contract Enforcement Days, Cost of Enforcement and Rule of Law Index**

	Contract Enforcement Days		Cost (% of debt)		Rule of Law Index	
	2005	2010	2005	2010	2005	2009
Kosovo	153	420	...	61	-0.9	-0.5
Albania	390	390	39	39	-0.8	-0.5
Bosnia and Herzegovina	330	595	38	40	-0.6	-0.4
Bulgaria	440	564	24	24	-0.1	-0.1
Croatia	415	561	14	14	0.2	0.2
Macedonia	335	370	33	33	-0.3	-0.2
Romania	509	512	20	29	-0.1	0.1
Serbia	1028	635	33	29	-0.9	-0.4
SEE (average)	450	506	29	34	-0.4	-0.2
CEE (average)	442	547	24	28	0.6	0.4
CIS (average)	331	301	24	24	-0.9	-0.8
OECD (average)	280	518	20	20	1.6	1.3

Source: World Bank, Doing Business (2011)

However, World Bank's 'Governance Indicators' paint a less favourable picture for law enforcement in Kosovo compared to the World Bank's 'Doing Business', which is mainly attributed to methodological changes.<sup>16</sup> The Rule of Law Index, which is measured based on various aspects of the quality of institutions, reflects, among others, civil liberties, the freedom of press, political rights, crime, infrastructure, enforceability of government and private contracts, speediness and fairness of judicial process. It ranges from -2.5 to 2.5 and a higher score corresponds to better law enforcement. The Rule of Law Index suggests that

<sup>16</sup> 'Governance Indicators' measure different aspects of the quality of institutions, such as political stability, government effectiveness, regulatory quality, control of corruption and rule of law.



Kosovo lags behind the average of SEE countries with respect to the law enforcement (Table 17). In 2009, the Rule of Law Index for Kosovo was ranked at -0.5 which is lower compared to the average of SEE, CEE and OECD countries, but higher than the average of CIS countries. Based on this methodology, the law enforcement in Kosovo in year 2009 improved compared to 2005 when it stood at -0.9.

### 10.3. The lender-borrower litigation process: an empirical study

The previous section treated the enforcement of creditor rights in Kosovo, based on Contract Enforcement Days (CED) and the Rule of Law Index (RLI). However, these indicators have their drawbacks either because they may fail to fully capture the context of lender-borrower relationship (i.e. Contract Enforcement Days) or are multidimensional (i.e. Rule of Law Index). In this context, CED is constructed by specifying the time it takes for courts to handle two types of cases: the eviction of residential tenant for non-payment of rent and the collection of a cheque returned for non-payment. As such, the time needed for the enforcement of a contract in these cases may not necessarily explain the lender-borrower relationship. Regarding the RLI, although it embodies some characteristics related to the efficiency of contract enforcement such as the enforceability of private contracts, the fairness of judicial system and the speediness of judicial process, it contains diverse other dimensions such as organized crime, violent crime and costs of crime, civil liberties, the freedom of press, political rights, infrastructure, etc. Even though these measures may be good proxies for law enforcement in a particular country, they are a mixture of indicators and reflect the general institutional setting. As such, the RLI does not explicitly deal with law enforcement in the lender-borrower relationship.

The need to concentrate on laws in practice in transition economies, explicitly with regard to the lender-borrower relationship, led the EBRD to embark on a New Legal Indicator Survey (hereinafter NLIS2003) aimed at helping credit providers assess the potential advantages of taking security, highlighting strengths and weaknesses of the legal framework for collateral and giving a basis for objective comparison. By trying to capture commercial reality, the key concern of the survey was how effectively the process of enforcement of movable collateral works in practice.

As described in EBRD (2003), for the law enforcement survey a case study methodology was adopted and an imaginary case was presented to commercial lawyers in transition economies. They were asked to evaluate how the bank can enforce their rights in a case of borrower default. The evaluation had three dimensions: (i) how much of the loan the creditor can recover; (ii) how fast the creditor can recover the loan; and (iii) how simple is the recovery procedure (amount, time and simplicity). In addition, 12 additional questions concerning the process of enforcement were asked to highlight the influence of third parties in this process. For example, within the process factors if the debtor can obstruct the process then that would have implications for the amount, time and simplicity dimensions in the enforcement process. The scope factors of enforcement would show how the responses might be affected if some circumstances would change. For example, to what extent the enforcement would be affected if the debtor files for bankruptcy, or how the enforcement would be affected if immovables are pledged as collateral.

In order to provide a more up-to-date picture on the enforcement of creditor rights with regard to the lender-borrower relationship in Kosovo, the Central Bank of the Republic of Kosovo conducted a survey with banks operating in Kosovo in 2010, based on the NLIS



2003. In the survey undertaken for this research, the original NLIS 2003 questions were retained in order to generate comparable results with other transition economies.

The EBRD approach of assessing the enforcement process focuses on the final stage of the litigation, i.e. how the collateral disputes are handled by courts. However, as Hendley (2001) points out, only a small proportion of disputes ever end up in court because either they are settled or the potential costs of proceeding outweigh the potential benefits. The litigation process can be thought as comprising several stages. For example, Cooter and Rubinfeld (1989) in their analysis of law recognize four stages of legal disputes: harm, assertion of legal claim, bargaining and trial. Therefore, the questionnaire was extended to explore other steps of the litigation process not analyzed by the EBRD. It takes into account the issue of voluntary compliance on the borrower's side, the bargaining phase of dispute resolution, a clearer distinction between methods of enforcement (self-help and court involvement) and the existence of a market for collateral.

The survey was conducted with four banks composing around 80 percent of total banking sector assets. The survey was conducted by interviewing banks' legal experts, loan officers and risk managers. Regarding the scores, when answers were given in a range (e.g. it takes two to six months to enforce the claim), the average figure is recorded. Subsequently, the answers by all the respondents are averaged to produce a single score.

#### 10.4. Results

In this section the results of the survey regarding the enforcement of collateral laws in Kosovo are presented and then compared with those of other transition economies. Regarding the 'how much' question (amount), which reflects the likely return on the realisation of the assets pledged as collateral, Kosovo scores 5.5 out of 10; that is, lenders may expect to recover around 55 percent of the loan in default with the pledged collateral (Table 18). Compared to the results obtained from the same survey in 2005, actual figures show a slight deterioration with regard the amount of loan recovered. Regarding the 'how fast' question (time), which relates to the time needed for completion of the enforcement procedure, Kosovo scores 8 out of 10; that is, lenders may expect to recover the pledged collateral within six months.<sup>17</sup> In terms of the time needed for the recovery of the loan, the situation appears to be similar to five years ago. For 'simplicity' of the entire enforcement process, the score was 5 (of three possible answers: 1, 5 and 10). The reason that 'simplicity' was not scored 10 (the best ranking) was because of the responses related to the functioning of courts: the presence of inexperienced judges to deal with cases, the lack of specialised courts, small number of judges, etc. The overall score of the NLIS 2003 for Kosovo is 18.5 (5.5 for the amount, 8 for time and 5 for simplicity), which is for 0.5pp lower compared to year 2005.

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<sup>17</sup> A zero score implies that the process is likely to take 24 months or more, and the maximum score 10 when the process is likely to take one month.

Table 18. Enforcement of collateral laws in Kosovo (NLIS 2003)

NLIS 2003	2005	2010
Amount (% of loan recovery)	6 (60%)	5.5 (56.25%)
Time (taken in the recovery process)	8 (6 months)	8 (6.25 months)
Simplicity	5	5
<b>Process Factors</b>		
Debtor obstruction	1.67	1.75
Preferential creditors	1	1
Creditor control	1.67	1
Practical experience	1	1.25
Corruption	2.17	1.75
Institutions	2.17	2
<b>Scope factors</b>		
Scope for collateral	2	1
Insolvency process	na	na
Insolvency ranking	1	1
Inventory	1.17	1.5
Immoveables	2.5	2.25
Receiveables	2.5	2.75

Notes: Amount represents the percentage of the loan that lenders may expect to recover and ranges from 0 to 10 with higher scores corresponding to higher amounts of recovery; Time represents the time needed expressed in months that lenders may expect to recover a loan and ranges from 0 to 10 with higher scores corresponding to faster recovery; Simplicity represents how simple is the recovery process and takes value of 1, 5 and 10 when the process involves major, moderate and minor complexities. Process and scope factors take value of 1, 2 and 3 when the particular factor represents a minor, moderate and major problem in the enforcement process, respectively.

In terms of the factors that affect the enforcement process, the major problems were 'immovables' and 'receivables'.<sup>18</sup> The score was 2.25 for immovables and 2.75 for receiveables, which mean that the enforcement process including immovables and receiveables as collateral becomes more complex for recovering claims. Compared to year 2005, it is noticed a slight improvement with regard to the execution of immoveable collateral, while the opposite is true for receiveables. The next highest scores were assigned to factors 'institutions' (2), 'corruption' (1.75) and 'debtor obstruction' (1.75). The score 2 for institutions suggests that the operation of institutions creates problems for the banks, mainly due to insufficient number of judges that slowdown the resolution of defaulted cases. Compared to year 2005, the inefficiency of institutions appears to be a larger impediment for banks that can be attributed to the expansion of credit portfolio of the banking sector. That would imply a larger number of cases going to courts, while the number of judges appears to be insufficient. The main complaints of respondents were that courts lack the expertise and resources to do their job. Therefore, the enforcement process would be facilitated if specific commercial courts or specialized judges were to deal with commercial disputes.<sup>19</sup> Corruption of court officials appears to be a moderate problem and compared to 2005 the score for corruption recorded a slight decline, which means that there

<sup>18</sup> The scoring for factors takes values of 1, 2 and 3, and the higher the score the more problematic the factor is.

<sup>19</sup> According to Stanfield, et al. (2004), commercial cases have lower priority compared to criminal and other cases in Kosovo. In addition, the number of court judges in Prishtina in 1989 (when it had 120,000 inhabitants) was 35, while in 2004 the number of judges was 26 (with an estimated 0.5 million inhabitants).

is a lower perception about the presence of corruption in courts. 'Debtor obstruction' (1.75), which relates to the possibilities which exist for the debtor to prevent, slowdown or otherwise obstruct the enforcement proceedings, seems to be a moderate impediment to the enforcement process. Compared to year 2005, debtor obstruction seems to be more of a problem, mainly because debtors are increasingly causing process delays through filing unsubstantiated complaints or by influencing the process in other ways. In terms of scope of collateral, broad categories of assets can serve as collateral and the replacement of collateral or the inclusion of new collateral is possible, so the scope of collateral was scored at 1.

Score (1) was attained also for 'preferential creditors', 'credit control', and 'insolvency ranking'. For example, there are no preferential creditors that may have priority over bank claims. This is also the case with the provisions of the bankruptcy law that give priority to secured creditors (insolvency ranking). Then the practical experience with the cases seems extensive and inventory quite effective as collateral. The insolvency process was not scored due to lack of experience with bankruptcy proceedings.

Overall, the situation regarding the enforcement of creditor rights in Kosovo, in 2010, may be considered to be in a similar level with year 2005. This is in line with the view that institutions in general change slowly over time (Clague *et al.*, 1997). Taking into account the fact that the situation with regard to the enforcement of creditor rights in Kosovo in 2010 was at a similar level with year 2005, and also the fact that in general institutions are considered to change slowly over time, we compare the survey results obtained for Kosovo in 2010 with the results obtained from the EBRD's survey for other transition economies in year 2003 despite the time distance between the two surveys (Table 19). Regarding the overall score for NLIS 2003, Kosovo's score of 18.5 suggests that Kosovo, on average, outperforms SEE and CIS countries, while lagging behind the CEE countries. Considering the countries in the region, Bulgaria, Croatia and Macedonia are ahead. Regarding the process and scope factors, Kosovo scores 1.57, which outperforms the CIS average (2.18), the SEE average (1.94) and also the CEE average (1.68). For the process and scope factors, lower scores indicate better rating.

**Table 19. Enforcement of collateral laws in Kosovo, SEE, CEE and CIS**

	Amount, Time and Simplicity	Process and Scope Factors
Kosovo (2010)	18.5	1.57
Albania	18	1.92
Bosnia and Herzegovina	4	2.58
Bulgaria	23	1.83
Croatia	22	1.83
Macedonia	21	1.58
Romania	18	1.67
Serbia and Montenegro	19	2.17
SEE (average)	17.9	1.94
CEE (average)	24.3	1.68
CIS (average)	13.2	2.18

Source: EBRD (2003) and own survey for Kosovo

Notes: Amount, Time and Simplicity ranges from 0 to 30 and a higher score corresponds to better enforcement; Process and Scope factors take value of 1, 2 and 3 when the particular factor represents a minor, moderate and major problem in the enforcement process, respectively.

## 10.5. Voluntary compliance, bargaining, self-help and the market for collateral

In the context of the bank-client relationship, the process of dispute resolution can be thought of as a game with sequential solutions between the lender and the defaulting borrower. Each step influences the expectation of recovery on the lenders' side. First, the dispute can be solved by voluntary compliance, i.e. without the involvement of formal institutions. It may be that most cases are resolved in this manner because the threat of legal action by banks against a borrower in default may be sufficient. In this phase, a part of the debt will be recovered and it will take some time for the recovery to take place. The evolution of voluntary compliance may be linked to various possibilities. Agents may know *ex ante* that the law and institutions that support that law are in place. Or, they may have no knowledge of the law and simply abide contracts based on trust. Alternatively, agents may be reluctant to deal with the state's formal institutions, care about their reputation and/or calculate costs/benefits of defaulting. On the other hand banks may prefer not to use courts because they consider them to be slow and thus opt using other means. Hay, *et al.* (1996) point out that the legal system may not be used to resolve disputes because bad courts raise the cost of using legal system; court fees may be prohibitively high; judges may be corrupt, uninformed and incompetent; courts may be unpredictable and so it may take years to get a dispute resolved by which time the value of the damages that may be collected falls to zero in real terms.

It seems that motives for voluntary compliance of the law are diverse. If institutions make the threat of enforcement credible, then voluntary compliance may outweigh compulsory enforcement and reduce transaction costs. Cross (2002) notes that to the extent that the agents believe that the legal system works, the costs of enforcing rules are reduced enormously by the simple fact that the individuals will not disobey the rules or violate property rights, a standard assumption in legal theory. Thus looking at only the formal part of dispute resolution is only one part of the story. Formal and informal resolution should not be seen as substitutes, rather they complement each other, specifically when formal resolutions are efficient, informal ones should be more pronounced. The issue of voluntary compliance is not explored by the EBRD since the methodology was designed exclusively to explore how legal institutions work.

Second, the bargaining phase can be thought of as another step before the dispute comes to formal resolution. Again some amount will be recovered and it will take some time before the recovery is made. The weakest party in the bargaining phase reveals the functioning of institutions, or at least the perception of how institutions function. If lenders are the weakest in this phase, i.e. ready to make concessions, then this may signal poor performance of institutions in the dispute resolution. Again, this issue has not been explored by EBRD. Third, when it comes to enforcement then two possibilities exist: (i) self-help, i.e. the lender repossesses the collateral by court order but not involving court officials (or police), or (ii) court involvement. If a majority of disputes are solved with self-help, again that reflects not so much on the effectiveness of the law explicitly. Instead, it may signal the credibility of institutions which would have important policy implications. Specifically, enforcement by the state would be necessary in only a few cases, especially in small societies, to make the threat credible and thus can be quite effective by involving low costs.

As mentioned before, the present research extends the EBRD survey to capture other stages and elements prior to legal enforcement such as voluntary compliance, bargaining, self-help and the market for collateral. The survey results reveal that around 60 percent of defaulted loans never reach the court stage and are resolved by voluntary compliance, after the 'threat' is made. In these cases the recovery is around 50 percent of the amount. From the threats used by banks, respondents considered 'the bank will confiscate the collateral' as the most effective, followed by 'the bank will involve the court'. In the third place were reputation considerations such as 'the bank will not extend credit in the future', 'the bank will force the guarantor to pay the debt', etc. This may give an impression of the credibility of institutions in the country or at least in the lender-borrower relationship. The enforcement of creditor rights is largely dependent also on the extent to which creditors pursue their claims actively by demanding legal services. Better law enforcement occurs when the legal staff work extensively on contractual matters and when enterprise personnel possess larger amounts of legal human capital (Hendley, *et al.* 2001). For the case of Kosovo, KCBS (2005) points out that one bank aggressively enforces its legal repossession and the right to sell the collateral with the help of its own legal staff who work closely with judges, sometimes 'showing them how', and is quite successful.

When 'threats' fail, the bargaining phase follows, though it is rarely practiced (less than 20 percent of cases). If bargaining takes place between the lenders and the defaulting borrower, they are not likely to give significant concessions. For example, they may extend the period of repayment but not other terms. Again, recovery in these cases is high (around 70 percent of the amount). This may show the better bargaining position of the banks and, again, the credibility of institutions. After the bargaining phase, there are two possibilities: self-help or court involvement. In terms of self-help, i.e. banks confiscating the collateral by court order but without the involvement of court officials and/or police, the results suggest that on average 3 percent of cases are solved in this way, around 20 percent of the amount is recovered and within two months. When it comes to the existence of a market for collateral, the picture is somewhat different. Banks' responses suggest that, on average, banks achieve to sell only around 30 percent of the pledged assets and the recovery is around 50 percent of the amount of loan and within a period of 3.5 months.

## 10.6. Conclusions

Kosovo started to build its institutions only after the war in 1999. Since then Kosovo has marked substantial progress in establishing and functionalizing the institutions needed for the operation of a market economy, including the provision of conditions that ensure the functioning of the financial market and the protection of creditor rights. Based on the law in books, Kosovo has made significant progress with regard to the protection of creditor rights – outperforming other transition economies and some developed countries. However, the picture is not very clear when considering the enforcement of creditor rights. Based on the Contract Enforcement Days indicator, Kosovo stands better than other transition economies and even some OECD countries. On the other hand, World Bank's Rule of Law Index presents less favourable picture for Kosovo, suggesting that it lags behind other countries concerning law enforcement. However, these indicators have their drawbacks and, as such, may not fully capture the enforcement of creditor rights specifically with regard to the lender-borrower relationship.

Based on the EBRD methodology (NLIS 2003), a survey with four banks operating in Kosovo was conducted aiming at providing an up-to-date assessment on the enforcement of creditor rights in the lender-borrower relationship in Kosovo. The survey results suggest that, compared to year 2005, the overall picture for the enforcement of creditor rights in Kosovo is broadly the same. Among the most important factors affecting the enforcement process, according to banks' responses, are the inefficiency of courts, corruption and debtor obstruction. Regarding the inefficiency of courts, the main complaints of respondents were that courts lack the expertise and resources to do their job. Therefore, the enforcement process would be facilitated if specific commercial courts or specialized judges were to deal with commercial disputes. The inefficiency of courts is reported to cause delays in the process of contract enforcement and, to some extent, may have induced the culture of non-payment by borrowers, which can be expressed through the increasing debtor obstruction in the enforcement process. However, the results indicate that Kosovo compares well with countries in the region and other transition economies with respect to the enforcement of creditor rights. The survey was also extended to cover other stages prior to legal enforcement such as voluntary compliance, bargaining, self-help and the market for collateral. Results show that a substantial part of default cases never reach the court for dispute resolution but is solved by voluntary compliance, thus emphasizing the role of the credibility of institutions in the enforcement process.

## 11. Access to Finance in Kosovo: Results from BEEPS 2009

Valentin Toçi, Zana Gjocaj and Arben Mustafa

### 11.1. Introduction

This analysis addresses the problem of firms' access to bank finance in Kosovo and countries in the SEE region. The analysis relies primarily on data obtained from BEEPS (Business Environment and Enterprise Performance Survey), which is a joint project of the World Bank and European Bank for Reconstruction and Development (EBRD), designed to collect information on the impact of business environment in the operations of firms through detailed surveys. These surveys were conducted in almost all transition economies in 1999, 2002, 2005, 2007 and 2009. Apart from information regarding the obstacles that firms face, the four cycles of BEEPS also provide information on firm characteristics and performance indicators such as sales level, profits, sources of funds that firms use to finance their investments, etc.

BEEPS is becoming an important tool for increasing the awareness of policy-makers about the obstacles firms face and to assist them in establishing policies that will improve the business environment in which firms operate. The financing obstacles that firms face may be induced by governments (for instance, when creditor rights are not well protected due to failures in the judiciary system), as well as by different market features such as imperfect markets, which will hamper businesses and make their access to finance expensive.

Easier access to external financing has proven to encourage firm growth and subsequently improve the overall economic performance. Therefore, the implementation of BEEPS in Kosovo enabled the policy-makers to identify the main impediments to the business operation and growth in the domestic economy, with particular emphasis on obstacles that businesses face when accessing bank finance.

BEEPS surveys conducted in Kosovo included 270 firms, of which 70 percent were declared as small firms. Over 50 percent of surveyed companies in Kosovo have stated that they have been operating in the market for a period of 6-10 years, while 20 percent of respondents declared 16-20 years. All of the surveyed firms were of domestic ownership. Regarding sectoral distribution, 38 percent of firms were declared as manufacturing firms, 6.3 per cent as trade firms and 38.5 percent declared that offer other services. Considering the structure of the Kosovo's economy, which is mainly dominated by trade firms, BEEPS might not be considered a representative sample for the economy of Kosovo.

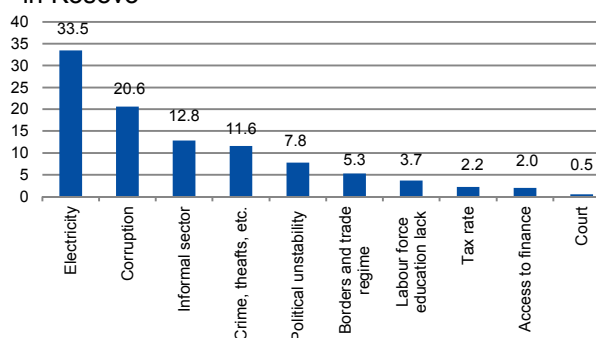
### 11.2. Main obstacles for businesses in Kosovo

According to BEEPS, among ten main obstacles that firms assessed as most problematic were ranked the lack of electricity, the presence of corruption, informal economy, etc., (Figure 71). In 2009, about 33.5 percent of firms surveyed ranked lack of electricity as the main obstacle to their daily operations and growth, reflecting the ongoing problems with electricity supply in the country. Also, the presence of corruption (20.6 percent) and the informal economy (12.8 percent) were assessed as major obstacles to doing business in Kosovo.



Unlike in many countries of the region, access to finance in Kosovo was not considered a major obstacle to the firm's surveyed; only 2 percent of firms reported access to finance as the main obstacle to their business development. However, it should be noted that access to finance was not considered a major obstacle mainly because other areas, such as infrastructure and other problems related to the overall economic environment, were considered more problematic.

Figure 71. Ten main obstacles for doing business in Kosovo



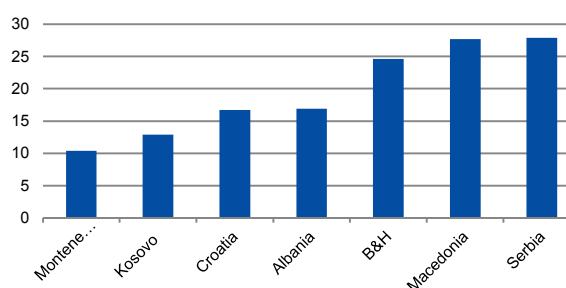
Burimi: [www.enterprisesurvey.org](http://www.enterprisesurvey.org)

In the region, the participation of firms that identified access to finance as the main obstacle to their business is significantly higher than in Kosovo. In Macedonia, 26.9 percent of firms surveyed declared access to finance as the main obstacle to their business, followed by Romania and Slovenia (19.9 percent and 19.2 percent, respectively). Apart from Kosovo, Albania and Bosnia and Herzegovina also reported a low participation of firms that ranked access to finance as the main obstacle to their business (Figure 74). A common feature of almost all SEE countries was the relatively high participation of firms that considered the presence of informal sector of the economy, corruption and political instability as the main impediments for their business growth and development.

### 11.3. Access to finance

Access to finance in Kosovo and the SEE countries improved over the years, however it continues to be considered lower compared to developed countries. Although according to BEEPS results, the participation of firms that reported access to finance as the main obstacle to developing their business was quite low, the proportion of firms that responded positively to the question of whether access to finance is an obstacle to their business development was higher. Of total firms surveyed in Kosovo, 12.9 percent reported that access to finance was an obstacle to the development of their business activity (Figure 72).

Figure 72. Percentage of firms which identify access to finance as an obstacle for doing business in Kosovo



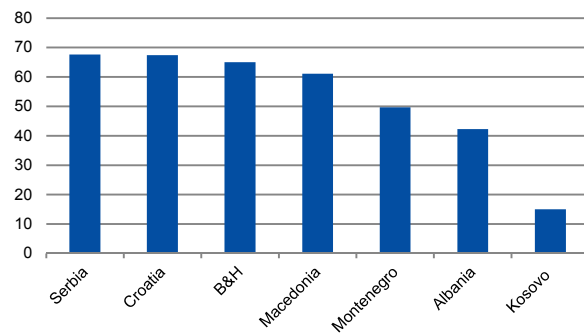
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However, this percentage is lower compared with the SEE countries' average of 20.7 percent. Among countries in the region, Serbia (27.9 percent) and Macedonia (27.7 percent) had the highest share of firms that reported access to finance as an obstacle to doing business.



Findings from BEEPS indicate that firms in Kosovo in 2009 did not perceive access to finance as an impediment to their business operation and growth. Adversely, the indicators that point to the level of access to finance in Kosovo result lower compared with other countries in the region. Among the firms surveyed in Kosovo, only 15 percent have declared to have received loans from financial institutions, while the average for other countries in the region for this indicator was 58.8 percent (Figure 73). This indicates that firms in Kosovo rely more on internal funds, while bank financing remains at low levels in 2009 as well.

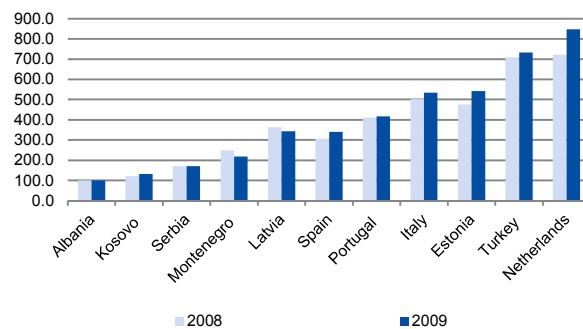
Figure 73. The percentage of firms receiving loans from financial institutions



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The low level of funding from financial institutions in Kosovo was also reflected in the 'Financial Access Survey' of the IMF. According to this survey, the number of borrowers in commercial banks in 1000 adult residents in Kosovo was only about 100 (Figure 74). In region, Serbia and Montenegro had the highest number of borrowers in 1000 adult inhabitants (about 171.6 and 217.8 borrowers per 1000 inhabitants). Most of the countries in the region had no available data for this indicator. With about 132.2 borrowers per 1000 adult residents, Kosovo has the lowest number of borrowers from commercial banks, leaving behind only Albania with 99.6.

Figure 74. The number of borrowers from commercial banks in 1000 adults



Source: Financial access survey, IMF

That firms in Kosovo face higher financing constrained relative to countries in the region is also reflected through the low rate of private sector lending as a share to GDP indicator. In 2009, private sector lending rate as a share to GDP in Kosovo was around 32.9 percent, while the regional average for this indicator in the same period was around 52.7 percent. Montenegro reported the highest private sector lending rate (77.7 percent of GDP) followed by Croatia (66.5 percent of GDP). Apart from Kosovo, Albania reported the lowest rate of private sector lending (36.6 per cent of GDP).

The literature on access to finance suggests that regardless of size or ownership, firms tend to turn to external funds only after the internal funds have been used completely. This is due to a number of reasons, including monitoring and transaction costs for obtaining bank loans such as the applications costs, screening costs, bankruptcy costs, etc. (Hashi and Toçi, 2010). However, using internal funds rather than bank financing has been considered to adversely affect business growth and development, regardless of firm size (Chavis et al. 2010). This, to some extent, may be because when a firm is funded by a bank, the bank's

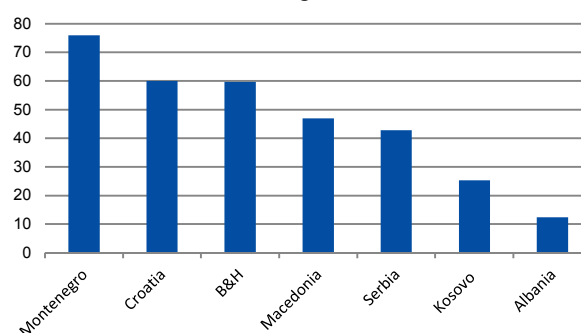
role consists also in monitoring the spending of borrowed funds as well as monitoring the management and the overall performance of the firm, thereby contributing to the efficiency of the firm.

Small firms are considered to rely more on internal financing rather than bank financing, therefore are more financially constrained when accessing bank finance. Small firms are considered to carry higher credit risk level mainly due to lack of information about the company's previous activities and credit history, which increases the financial institutions uncertainty to finance them. Consistent with the theory, BEEPS results suggest that small firms in Kosovo and the region countries resulted more financially constrained compared to large firms. Moreover, it should be noted that in Kosovo, about 70 percent of firms surveyed by BEEPS were small firms (an average of 43.8 percent of firms were declared as small in the region countries). This may explain to some extent the rather low rate of bank financing in 2009 in Kosovo as well as in the region.

Furthermore, of total firms surveyed, small firms in Kosovo declared of using less bank credit and borrowings from financial institutions (12.0 per cent) compared to medium or large firms (25.6 and 30.1 per cent, respectively). In the region, an average of about 52.9 per cent of firms classified as small firms declared of using bank financing in 2009, while the average use of bank financing for medium and large firms was higher (67.7 percent and 71.9 percent, respectively). Large firms have easier access to bank financing mainly due to the longer credit history because the presence of information facilitates and enables better selection of borrowers. Easier access to external financing enables large firms to further enhance their activity.

Small firms face more severe financing constraints not only because of a limited credit supply and the banks tendency to reject loans to them, but also because of the firms' limited demand for bank financing. Small firms tend to apply less for bank loans compared to medium or large firms because transaction costs for the application process can be very high or the value of the collateral they possess is low and does not meet the required standards. This indicates that small firms in most cases do not apply for bank loans because they assess that the cost for borrowing is higher than they will be to afford.

Figure 75. The percentage of enterprises which have used bank financing for investments



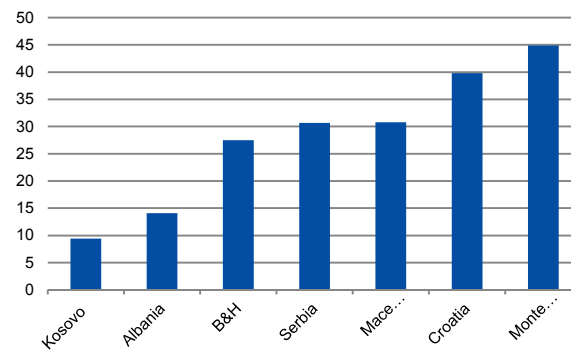
Burimi: [www.enterprisesurvey.org](http://www.enterprisesurvey.org)

Firms in Kosovo are not only more financially constrained compared to firms in other countries of the region. They differ from firms in the SEE countries also in terms of the purpose for which loans are used by firms. In Kosovo, only 25.3 percent of firms have stated that they use bank financing for investment, while the regional average for this indicator is 49.6 percent (Figure 75). Survey data also indicate that only 9.4 percent of firms in Kosovo finance their investments through bank financing (the regional average was 28.2 per cent), while the rest of investments are financed through other financing sources such as own funds, borrowing from family, etc. (Figure 76).

A constrained access to bank financing in Kosovo is related to many factors. The global financial crisis of recent years has led to credit tightening worldwide, which was also expressed in the financial market in Kosovo. Banks have tightened lending, especially for firms, presenting a constraint in access to finance for firms. Moreover, firms in the country face many obstacles when deciding to approach bank financing. If we consider the value of collateral needed to obtain a loan, we will notice that the ratio of the loan coverage with collateral in Kosovo is very high and exceeds the average of the region. According to the survey data, the coverage ratio of credit with collateral in Kosovo stood at an average of 236.1 percent, while the average for the region was 126.6 percent (Figure 77). This makes it more difficult for firms to access bank financing and discourages them to apply for bank loans. Regarding firm size, the smaller the firm is, the higher the ratio of loan coverage by collateral appeared to be, which adversely affects the small firms opportunities to access bank finance. The high rate of collateral needed for obtaining bank loans in Kosovo can relate to the need for higher efficiency of the judicial system, which would contribute to a facilitation of the execution of collateral for loans that have failed. The high coverage ratio of credit with collateral in Kosovo, to some extent, can also be attributed to the structure

of the firms surveyed, where small firms dominated. The constrained access to bank finance in Kosovo can also be attributed to interest rates, which are considered to be higher than elsewhere in the region. The average interest rate on loans of about 14 percent in Kosovo exceeds the average interest rate of 7.9 percent in the region. High interest rates may discourage firms to apply for funding in financial institutions in Kosovo, which negatively affects the activity and growth of their business. Moreover, in addition to the above mentioned factor, access to finance in Kosovo also depends on investment projects that

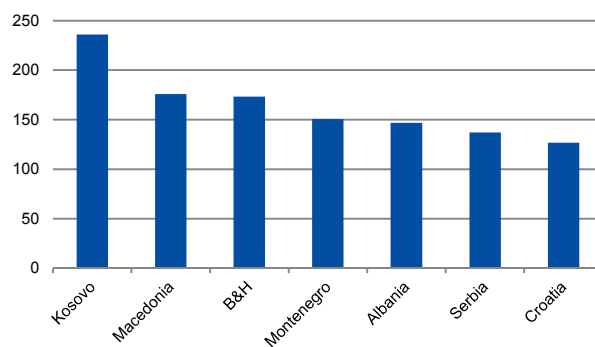
Figure 76. Percentage of investments covered by bank financing



Source: [www.enterprisesurvey.org](http://www.enterprisesurvey.org)

of the firms surveyed, where small firms dominated. The constrained access to bank finance in Kosovo can also be attributed to interest rates, which are considered to be higher than elsewhere in the region. The average interest rate on loans of about 14 percent in Kosovo exceeds the average interest rate of 7.9 percent in the region. High interest rates may discourage firms to apply for funding in financial institutions in Kosovo, which negatively affects the activity and growth of their business. Moreover, in addition to the above mentioned factor, access to finance in Kosovo also depends on investment projects that

Figure 77. Collateral-to-loan ratio, in percent



Source: [www.enterprisesurvey.org](http://www.enterprisesurvey.org)

firms have in their disposal. One of the factors that may influence the lower level of access to finance for firms in Kosovo may have been the lack of investment projects, which means that the current level of access to finance may be sufficient for the actual firms' financing demands.

#### 11.4. Conclusions

This analysis is based on data from BEEPS, which was first implemented in Kosovo in 2009. Results from this survey enable the identification of the obstacles faced by firms in Kosovo, and compare them with obstacles for firms in other countries of the region. Based on survey results, it can be concluded that firms in Kosovo considered the lack of electricity as well as the presence of corruption and informal economy as the most problematic obstacles to their business operation and growth. Unlike other regional countries, the participation of firms that reported access to finance as the main obstacle to their activities in Kosovo is quite low. However, we should note that access to finance was not considered a major obstacle for businesses in Kosovo mainly because other areas such as electricity, the presence of corruption and the informal economy, were considered more problematic than the constrained access to finance.

On the other hand, access to finance for firms in Kosovo appears to be more constrained compared with other countries in the region. This to some extent is attributed to the structure of firms operating in Kosovo, which consists mainly of small firms, that also reflects the structure of companies involved in the survey. Small firms are considered to be more constrained in terms of their ability to access bank financing mainly due to factors related to the limited information on their past performance as well as the higher rate of loan coverage by collateral for these firms.

At the same time, the percentage of firms that use bank financing for investments and the percentage of funding covered by the investment banking in Kosovo is lower compared with countries in the region. This may reflect not only problems on the demand but also supply-side constraints. High interest rates for loans in Kosovo and the high level of collateral needed discourages the demand of borrowers to access bank financing. However, higher constraints to access bank financing in Kosovo compared with countries in the region may also reflect lack of investment ideas and projects by the firms, which directly affects their demand for access to bank financing.



## **Statistical Appendix**



Table 1. Main Macroeconomic Indicators

Description	2006	2007	2008	2009
<b>Real Sector</b>				
Nominal GDP (in millions of euro) 1/	3,182	3,411	3,849	3,868
Real GDP 1/	4.0%	4.0%	5.4%	4.0%
GDP per capita (in euro) 1/	1,515	1,605	1,784	1,766
Nominal GDP (in millions of euro) 2/	3,120	3,394	3,851	3,912
Prices (annual average) 2/	0.6%	4.4%	9.4%	-2.4%
Prices (annual change) 2/	1.1%	10.5%	0.5%	0.1%
<b>Financial Sector (in millions of euro)</b>				
Financial corporations assets	2,159.0	2,941.9	3,370.3	4,005.0
of which: Other dep. corporations	1,161.2	1,435.0	1,808.2	2,204.1
Other depository corporations loans	636.6	892.1	1,183.4	1,289.0
Other depository corporations deposits	924.3	1,143.1	1,444.1	1,744.9
<b>External Sector (in millions of euro)</b>				
Current account	-226.1	-354.1	-628.7	-673.5
of which: goods import	-1,295.6	-1,545.2	-1,885.7	-1,850.6
of which: remittances (received)	467.1	515.6	535.4	505.6
Capital and financial account	-14.9	91.3	462.8	535.7
of which: foreign direct investments (received)	289.2	431.0	341.5	273.6

1/ IMF (2008, 2010);

2/ SOK (2010);

3/ MEF.



Table 2. Financial Stability Indicators

Banking system	Core set	2007	2008	2009	June 2010
<b>Capital adequacy</b>	Regulatory capital to risk-weighted assets	17.5	16.5	18.1	18.7
	Regulatory Tier I capital to risk-weighted assets	16.2	15.3	15.2	15.9
	Nonperforming loans net of provisions to capital	2.8	2.3	2.9	3.6
<b>Assets quality</b>	Nonperforming loans to total gross loans	4.1	2.8	4.3	4.5
	Sectoral distribution of loans to total loans				
	<i>Other financial corporations</i>	0.0	0.1	0.2	0.3
	<i>Public nonfinancial corporations</i>	0.02	0.01	0.02	0.45
	<i>Other nonfinancial corporations</i>	77.5	76.2	73.1	70.1
	<i>Households</i>	22.5	23.7	26.7	29.2
	<i>Total</i>	100.0	100.0	100.0	100.0
<b>Earnings and profitability</b>	Return on assets (ROA)	3.2	3.0	1.5	1.7 *
	Return on equity (ROE)	32.6	27.3	15.0	18 *
	Interest margin to gross income	69.9	75.0	74.4	75.0
	Noninterest expenses to gross income	68.2	68.7	80.2	74.1
<b>Liquidity</b>	Liquid assets (core) to total assets (liquid assets ratio)	26.5	26.8	34.6	29.2
	Liquid assets (broad) to total assets (liquid assets ratio)	26.6	28.0	37.3	32.1
	Liquid assets (core) to short-term liabilities	32.9	33.4	43.6	36.9
	Liquid assets (broad) to short-term liabilities	33.0	35.0	47.0	40.5
<b>Sensitivity to market risk</b>	Pozicionet neto të hapura në valutë të huaj ndaj kapitalit		13.1	12.4	11.3
	<b>Encouraged set</b>				
	Capital to assets	11.2	11.2	9.8	10.7
	Large exposures to capital	38.3	56.5	64.6	62.8
	Personnel expenses to noninterest expenses	35.8	36.2	39.4	34.9
	Spread between reference lending and deposit rates	10.1	9.4	10.1	10.3
	Customer deposits to total (noninterbank) loans	124.0	117.1	129.8	121.9
	Foreign-currency-denominated liabilities to total liabilities	3.9	4.7	5.4	4.8

\* ROA and ROE data for June 2010 are annualized

Table 3. Balance Sheets of Commercial Banks, in millions of euro

<b>Procredit Bank</b>			
<b>Assets</b>	<b>Amount</b>	<b>Liabilities</b>	<b>Amount</b>
Cash and balances with CBK	90,221	Balance from other banks	1,712
Balance with commercial banks	61,295	Deposits	597,372
Securities	53,096	Other borrowings	
Loans	498,259	Other liabilities	45,666
Fixed assets	17,788	Subordinated debt	24,448
Other assets	17,463	Own resources	68,924
<b>TOTAL ASSETS</b>	<b>738,121</b>	<b>TOTAL LIABILITIES</b>	<b>738,121</b>

<b>Raiffeisen Bank</b>			
<b>Assets</b>	<b>Amount</b>	<b>Liabilities</b>	<b>Amount</b>
Cash and balances with CBK	77,821	Balance from other banks	33,439
Balance with commercial banks	172,820	Deposits	521,973
Securities	40,642	Other borrowings	...
Loans	378,853	Other liabilities	50,948
Fixed assets	8,451	Subordinated debt	...
Other assets	6,659	Own resources	78,887
<b>TOTAL ASSETS</b>	<b>685,247</b>	<b>TOTAL LIABILITIES</b>	<b>685,247</b>

<b>Banka për Biznes</b>			
<b>Assets</b>	<b>Amount</b>	<b>Liabilities</b>	<b>Amount</b>
Cash and balances with CBK	12,964	Balance from other banks	90
Balance with commercial banks	8,090	Deposits	74,716
Securities	...	Other borrowings	...
Loans	64,210	Other liabilities	4,003
Fixed assets	2,010	Subordinated debt	
Other assets	730	Own resources	9,195
<b>TOTAL ASSETS</b>	<b>88,004</b>	<b>TOTAL LIABILITIES</b>	<b>88,004</b>

## Banka Ekonomike

Assets	Amount	Liabilities	Amount
Cash and balances with CBK	10,358	Balance from other banks	3,231
Balance with commercial banks	15,307	Deposits	87,924
Securities	-	Other borrowings	...
Loans	78,643	Other liabilities	3,958
Fixed assets	1,431	Subordinated debt	...
Other assets	1,767	Own resources	12,393
<b>TOTAL ASSETS</b>	<b>107,506</b>	<b>TOTAL LIABILITIES</b>	<b>107,506</b>

## Banka Kombëtare Tregtare

Assets	Amount	Liabilities	Amount
Cash and balances with CBK	5,515	Balance from other banks	...
Balance with commercial banks	1	Deposits	43,362
Securities	8,184	Other borrowings	...
Loans	51,101	Other liabilities	18,145
Fixed assets	2,335	Subordinated debt	...
Other assets	591	Own resources	6,220
<b>TOTAL ASSETS</b>	<b>67,726</b>	<b>TOTAL LIABILITIES</b>	<b>67,726</b>

## NLB Prishtina

Assets	Amount	Liabilities	Amount
Cash and balances with CBK	31,982	Balance from other banks	9,333
Balance with commercial banks	68,163	Deposits	260,013
Securities	12,100	Other borrowings	...
Loans	206,560	Other liabilities	27,048
Fixed assets	4,971	Subordinated debt	...
Other assets	3,217	Other liabilities	30,599
<b>TOTAL ASSETS</b>	<b>326,993</b>	<b>TOTAL LIABILITIES</b>	<b>326,993</b>

## TEB Bank

Assets	Amount	Liabilities	Amount
Cash and balances with CBK	30,000	Balance from other banks	...
Balance with commercial banks	6,268	Deposits	124,261
Securities	...	Other borrowings	...
Loans	<b>100,093</b>	Other liabilities	3,681
Fixed assets	4,070	Subordinated debt	...
Other assets	<b>480</b>	Own resources	12,968
<b>TOTAL ASSETS</b>	<b>140,911</b>	<b>TOTAL LIABILITIES</b>	<b>140,910</b>

## Komerzijalna Banka

Assets	Amount	Liabilities	Amount
Cash and balances with CBK	9,064	Balance from other banks	...
Balance with commercial banks	19,607	Deposits	26,819
Securities	...	Other borrowings	...
Loans	3,230	Other liabilities	679
Fixed assets	...	Subordinated debt	...
Other assets	<b>683</b>	Own resources	5,086
<b>TOTAL ASSETS</b>	<b>32,584</b>	<b>TOTAL LIABILITIES</b>	<b>32,584</b>

Table 4.1. FC survey – net foreign assets and domestic claims

(Cumulative data, end of period, in millions of euro)

Description	Net foreign assets							Domestic claims									
	Claims on non residents		of which:					Less: liabilities to nonresidents	Net claims on central government				Claims on other sectors		of which:		
	Monetary gold and SDR holdings	Deposits	Securities other than shares	IMF Quota	Shares and other equities	Claims on central government	Less: Liabilities to central government		Deposits	Loans	of which:						
								Other non financial corporations			Households						
2004 December	722.8	772.0	—	384.0	236.7	—	83.3	49.2	202.5	-216.8	—	216.8	216.8	419.3	413.5	329.8	83.7
2005 Dhtjetor	827.3	890.9	—	422.6	242.4	—	145.3	63.6	348.9	-225.7	—	225.7	225.7	574.6	565.6	439.6	126.0
September	1,136.3	1,209.0	—	635.5	327.4	—	149.6	72.7	194.2	-497.8	—	497.8	497.8	692.0	676.1	532.0	144.0
2006 Dhtjetor	1,173.6	1,245.7	—	660.0	341.3	—	170.8	72.1	231.7	-475.0	—	475.0	475.0	706.6	694.3	548.2	146.1
March	1,331.4	1,420.0	—	761.2	411.5	—	139.9	88.6	144.3	-617.4	—	617.4	617.4	761.6	749.2	598.2	150.9
June	1,400.3	1,481.1	—	846.0	371.9	—	155.3	80.9	160.4	-704.9	—	704.9	704.9	865.4	852.8	682.8	169.9
September	1,590.9	1,670.9	—	989.9	395.8	—	170.0	80.0	60.5	-850.2	—	850.2	850.2	910.7	895.6	709.0	186.5
2007 Dhtjetor	1,622.4	1,704.6	—	955.0	408.9	—	175.4	82.3	124.5	-853.3	—	853.3	853.3	977.8	965.9	765.1	200.6
March	1,621.8	1,720.7	—	996.0	384.8	—	173.5	98.9	140.8	-919.6	—	919.6	919.6	1,060.5	1,045.6	834.7	210.7
June	1,638.9	1,749.5	—	1,054.2	369.6	—	173.7	110.6	226.4	-963.0	—	963.0	963.0	1,189.4	1,175.4	936.6	238.6
September	1,761.0	1,892.4	—	1,244.9	361.3	—	159.3	131.5	238.8	-998.3	—	998.3	998.3	1,237.1	1,223.6	961.0	262.4
2008 December	1,593.1	1,726.7	—	795.1	661.6	—	128.2	133.6	419.6	-871.8	—	871.8	871.8	1,291.5	1,276.8	995.7	281.0
March	1,605.4	1,758.1	—	658.4	838.4	—	115.8	152.7	446.7	-898.4	—	898.4	898.4	1,345.1	1,327.6	1,038.1	289.4
June	1,610.7	1,789.3	—	654.7	862.5	—	132.1	178.6	501.2	-900.6	—	900.6	900.6	1,401.8	1,384.0	1,072.7	311.2
September	1,740.1	2,009.2	—	768.0	895.1	—	138.3	269.1	535.3	-871.9	—	871.9	871.9	1,407.2	1,387.8	1,055.6	329.7
2009 December	1,700.5	2,036.2	60.3	910.1	724.3	64.3	144.3	335.7	573.7	-846.3	—	846.3	846.3	1,420.0	1,398.4	1,052.3	343.5
March	1,769.7	2,116.8	62.4	1,003.7	635.3	66.5	211.5	347.1	589.3	-878.3	—	878.3	878.3	1,467.6	1,446.1	1,056.3	382.8
2010 June	1,748.8	2,098.1	67.0	961.2	568.5	71.4	252.3	349.3	600.9	-940.7	—	940.7	940.7	1,541.6	1,518.6	1,103.1	409.1

Table 4.2 FC survey – Liabilities

(Cumulative data, end of period, in millions of euro)

Description	Deposits									Loans	Insurance technical reserves			Shares and other equity	Other items (net)
	Transferable deposits	of which:			Other deposits	of which:			Net equity of households in pension funds		Pre payment of premiums and reserves				
		Public non financial corporations	Other non financial corporations	Households		Public non financial corporations	Other non financial corporations	Households							
2004 December	670.7	273.7	34.6	81.3	145.5	396.9	149.3	24.4	222.5	2.3	106.5	88.7	17.9	145.1	0.7
2005 Dhjetor	830.6	315.0	67.6	76.8	155.5	515.6	181.3	33.7	298.9	3.0	174.5	152.4	22.1	165.8	2.2
September	849.6	312.5	54.6	95.0	149.8	537.1	162.3	31.0	341.2	3.2	224.5	199.8	24.7	200.5	52.6
2006 Dhjetor	886.4	300.5	34.8	96.4	156.2	586.0	193.3	27.6	359.5	3.4	251.4	223.9	27.5	209.3	54.7
March	935.0	316.1	45.5	85.8	169.7	618.8	200.7	23.8	394.2	...	267.8	241.1	26.6	216.2	56.7
June	970.5	355.9	73.6	87.1	180.9	614.6	176.0	27.2	408.3	...	291.2	263.9	27.3	238.4	60.6
September	1026.2	339.4	41.8	103.4	180.6	686.9	191.9	43.8	449.1	...	304.6	274.9	29.7	254.8	65.8
2007 Dhjetor	1110.9	386.1	49.6	133.5	187.5	724.8	188.4	43.8	489.3	...	316.1	286.2	29.9	273.8	46.0
March	1142.3	367.1	62.7	117.3	174.9	775.2	190.8	45.9	536.2	...	306.9	276.5	30.4	279.2	34.3
June	1209.6	387.9	57.6	127.3	189.9	821.7	198.3	44.5	576.1	...	323.2	291.8	31.4	298.1	34.4
September	1335.3	475.0	115.9	148.6	195.7	860.2	148.6	53.3	655.8	...	312.8	280.7	32.1	303.7	48.0
2008 December	1351.9	390.9	15.4	176.0	186.2	961.0	250.1	51.4	656.7	...	288.6	256.3	32.3	311.1	61.1
March	1378.6	378.0	19.6	134.3	215.3	1000.6	249.7	69.4	678.9	...	292.3	261.1	31.2	318.1	63.1
June	1393.2	381.9	25.4	136.4	211.2	1011.3	245.4	72.2	690.7	...	337.7	303.6	34.1	328.3	52.6
September	1512.3	435.4	39.9	157.6	225.7	1076.9	256.8	75.7	742.3	...	385.3	350.0	35.4	324.4	53.5
2009 December	1444.3	483.2	50.1	184.0	237.7	961.0	73.9	82.9	801.9	...	422.3	380.8	41.5	326.1	79.3
March	1474.3	457.8	51.4	145.2	251.6	1016.5	91.4	75.6	849.5	...	454.5	412.6	41.9	340.1	90.2
2010 June	1454.8	477.8	44.8	153.8	270.2	977.0	31.3	76.7	869.0	...	456.2	412.5	43.8	351.0	87.6

Table 5.1. ODC balance sheet – assets

(Cumulative data, end of period, in millions of euro)

Description	Total assets													
	Cash and balances with CBK		Balances with commercial banks			Securities	Gross loans and lease financing of which: in Euro	of which in euro:				Gross loans in non euro currency	Fixed assets	Other assets
			In euro currency	In non euro currencies				Other financial corporations	Public non financial corporations	Other non financial corporations	House holds			
2000 December	103.1	25.4	71.4	71.4	.	—	3.3	—	—	3.3	—	—	0.4	2.6
2001 December	519.8	265.1	212.8	212.8	.	7.5	25.9	—	—	25.9	—	—	4.5	3.9
2002 December	473.7	81.3	292.7	292.7	.	...	86.5	—	—	80.8	5.7	—	9.5	3.7
2003 December	589.2	106.2	106.2	106.2	.	119.6	232.8	—	0.2	193.5	39.0	—	12.3	12.2
2004 December	816.5	116.5	186.0	169.2	16.8	112.3	373.7	—	...	289.9	83.7	—	15.9	12.2
2005 December	984.4	131.7	221.9	201.0	21.0	82.9	513.9	—	...	387.9	126.0	—	16.9	17.0
2006 December	1,161.2	141.1	243.3	218.8	24.5	99.4	636.6	—	...	490.5	146.1	—	23.0	17.9
2007 December	1,435.0	189.0	208.1	173.4	34.7	78.9	892.1	—	0.2	691.3	200.6	—	27.2	39.7
May	1,559.3	170.8	214.9	168.5	46.4	43.4	1,052.8	—	0.2	823.6	229.0	—	32.1	45.2
June	1,599.6	184.5	200.4	150.3	50.1	43.4	1,089.7	—	0.2	850.9	238.6	—	33.4	48.2
July	1,657.0	195.9	232.4	180.9	51.5	34.8	1,114.0	—	0.2	863.0	250.8	—	33.8	46.1
August	1,718.9	192.8	283.3	229.5	53.9	39.9	1,124.2	—	0.2	868.0	256.0	—	34.2	44.5
September	1,749.4	195.2	299.9	244.3	55.5	41.5	1,130.2	0.6	0.2	867.1	262.4	—	35.0	47.7
October	1,761.1	211.2	267.7	205.8	61.8	42.3	1,160.8	0.6	0.2	890.3	269.8	—	35.6	43.5
November	1,748.9	196.5	247.7	187.6	60.2	41.8	1,187.9	0.6	0.2	911.0	276.1	—	35.8	39.3
2008 December	1,808.2	218.2	283.9	236.3	47.6	40.5	1,183.4	0.6	0.1	901.7	281.0	—	39.0	43.1
January	1,793.6	205.1	280.6	224.4	56.2	40.7	1,188.6	1.1	0.1	905.5	281.8	—	38.8	39.7
February	1,825.4	218.9	277.9	225.1	52.8	40.9	1,211.2	1.1	0.1	926.0	284.0	—	39.0	37.5
March	1,863.1	236.6	274.7	219.0	55.6	38.5	1,229.8	1.0	0.1	939.3	289.4	—	39.3	44.3
April	1,858.8	237.8	263.0	206.2	56.8	36.2	1,238.9	1.0	0.1	943.1	294.7	—	38.9	44.0
May	1,909.9	249.3	269.1	209.2	59.9	38.1	1,267.9	1.7	0.1	964.7	301.4	—	39.4	45.9
June	1,927.1	241.9	286.7	213.9	72.7	34.1	1,280.9	1.0	0.1	968.5	311.2	—	40.1	43.5
July	1,959.5	242.3	318.4	243.1	75.3	36.9	1,274.1	1.0	0.1	956.3	316.7	—	40.5	47.4
August	2,024.1	282.3	349.5	278.2	71.3	40.8	1,264.6	1.5	0.1	939.4	323.6	—	40.3	46.6
September	2,066.3	297.6	350.0	276.0	73.9	40.4	1,279.0	2.2	2.2	946.8	329.7	—	40.5	58.9
October	2,066.9	273.0	341.5	275.1	66.5	73.8	1,291.5	2.4	2.4	955.0	333.8	—	42.5	44.5
November	2,087.0	246.4	370.2	305.8	64.5	84.1	1,298.6	2.3	2.3	962.6	333.4	—	41.7	46.0
2009 December	2,204.1	322.7	405.6	326.7	78.8	97.0	1,289.0	2.3	2.3	942.9	343.5	—	43.1	46.7
January	2,206.1	305.8	435.1	358.7	76.4	99.3	1,292.7	2.2	0.3	946.9	343.4	1.5	42.9	30.4
February	2,228.3	309.8	430.3	358.8	71.4	118.3	1,297.5	1.9	7.5	912.7	373.9	1.5	42.6	29.8
March	2,240.1	289.1	410.5	338.0	72.5	128.7	1,336.2	2.4	6.8	942.5	382.8	1.6	42.4	33.2
April	2,203.7	259.0	381.9	312.6	69.3	123.9	1,359.9	4.2	6.9	955.9	390.9	2.0	42.6	36.4
May	2,208.1	258.3	372.8	306.8	66.1	122.5	1,380.8	4.1	6.3	969.8	397.7	2.8	42.5	31.2
2010 June	2,218.8	268.1	351.6	282.6	69.0	114.0	1,404.6	4.0	6.3	982.2	409.1	3.1	42.6	37.8

Table 5.2. ODC balance sheet – liabilities

(Cumulative data, end of period, in millions of euro)

Description	Total liabilities														Write-downs, provisions	Other liabilities	Subordinated debt	Own resources	of which: Share capital
	Balances from other banks	Deposits					Other deposits:	Saving deposits	Other borrowings (incl. non neg. CD)										
		Transferable deposits	Other non financial corp.	House holds	Overseas	Public non financial corp.				Other non financial corp.	Households								
2000 December	103.1	93.0	93.0	93.0	...	...	...	...	...	...	...	2.9	...	1.1	...	6.2	4.6		
2001 December	519.8	492.3	365.4	133.9	219.2	126.8	...	...	313	93.9	...	5.0	...	2.0	...	20.4	18.4		
2002 December	473.7	427.2	295.9	159.7	121.7	131.3	...	...	23.9	104.4	...	5.4	...	6.6	1.3	33.2	30.8		
2003 December	589.2	18	54.0	290.5	139.0	134.4	223.5	...	...	87.1	133.5	...	8.9	...	17.5	2.0	45.0	44.1	
2004 December	816.5	14.3	694.5	281.0	81.3	145.5	413.5	...	149.3	24.4	222.5	...	14	...	27.9	9.3	69.1	57.7	
2005 December	984.4	23.0	836.7	296.6	76.8	155.5	540.1	0.0	181.3	33.7	298.9	...	6.4	...	37.3	7.0	74.0	62.4	
2006 December	1161.2	30.3	924.3	308.9	96.4	156.2	615.4	1.0	193.3	27.6	359.5	...	4.2	...	92.1	7.0	103.3	78.4	
2007 December	1435.0	25.8	1413.1	380.7	133.5	175.5	762.4	2.4	188.4	43.8	489.3	...	2.7	...	103.7	7.0	152.7	114.9	
May	1559.3	27.1	1235.9	363.6	128.1	184.0	872.2	12.4	220.6	39.7	562.5	...	...	...	109.8	7.0	179.5	129.9	
June	1599.6	32.6	1264.4	395.7	127.3	189.9	868.7	...	198.3	44.5	576.1	...	...	...	112.4	7.0	183.2	129.9	
July	1657.0	33.6	1316.6	405.9	149.0	193.8	910.7	...	214.0	49.9	594.9	...	...	...	114.9	7.0	185.0	129.9	
August	1718.9	31.4	1372.3	406.2	142.9	194.4	966.1	...	223.9	59.5	634.2	...	...	...	119.1	7.0	189.0	129.9	
September	1749.4	32.2	1404.1	483.7	148.6	195.7	920.4	...	148.6	53.3	656.8	...	...	...	120.4	7.0	185.7	131.9	
October	1761.1	31.2	1414.6	412.5	141.9	200.3	1002.1	...	233.1	48.5	657.3	...	...	...	121.7	7.0	186.6	131.9	
November	1748.9	31.5	1386.9	372.8	137.8	174.5	1014.1	...	255.7	48.0	653.4	...	...	...	133.3	7.0	190.2	131.9	
2008 December	1808.2	34.9	1444.1	429.8	176.0	186.2	1014.2	...	250.1	51.4	656.7	...	...	...	129.8	7.0	192.5	145.9	
January	1793.6	38.9	1421.7	390.0	144.9	180.8	1031.8	...	244.0	51.4	681.6	...	...	...	134.9	7.0	191.0	145.9	
February	1825.4	42.0	1444.4	390.3	128.2	195.4	1054.1	...	244.1	69.0	685.1	...	...	...	140.0	7.0	192.0	145.9	
March	1863.1	52.2	1468.5	414.7	134.3	215.3	1053.7	...	249.6	69.4	678.9	...	...	...	141.7	7.0	193.8	145.9	
April	1858.8	46.2	1465.7	398.1	125.0	204.0	1067.5	...	231.8	78.7	681.2	...	...	...	140.4	7.0	199.5	148.4	
May	1909.9	51.8	1500.8	472.0	132.2	210.0	1028.9	...	195.8	78.7	683.2	...	...	...	147.8	7.0	202.4	149.4	
June	1927.1	41.8	1513.0	417.4	136.4	211.2	1095.5	...	245.3	72.2	690.7	...	...	...	152.1	16.9	203.3	149.4	
July	1959.5	41.1	1552.9	443.6	144.9	225.2	1109.3	...	247.9	66.3	703.7	...	...	...	147.7	16.9	201.0	149.4	
August	2024.1	40.8	1616.9	477.5	158.7	230.0	1139.4	...	250.5	72.9	731.8	...	...	...	154.8	16.9	194.5	159.4	
September	2066.3	50.5	1646.2	485.8	157.6	225.7	1160.4	...	256.8	75.7	742.3	...	...	...	148.9	24.4	196.3	159.4	
October	2066.9	45.0	1640.1	521.8	162.6	222.9	1118.3	180.1	16.5	80.1	755.3	...	...	...	161.9	24.4	195.4	159.4	
November	2087.0	44.3	1648.3	544.8	156.7	221.9	1133.5	175.0	21.8	80.7	770.9	...	...	...	166.8	24.4	203.1	159.4	
2009 December	2204.1	58.5	1744.9	577.8	184.0	237.7	1229.5	163.9	73.9	82.9	801.9	...	...	...	171.7	24.4	204.6	159.4	
January	2206.1	59.1	1754.1	482.7	156.9	224.7	1271.4	151.7	151.7	84.5	832.9	...	...	...	159.0	24.4	209.4	160.4	
February	2228.3	55.9	1775.6	513.6	150.0	244.9	992.4	151.7	151.7	70.4	590.5	269.5	...	1.1	159.5	24.4	211.8	160.4	
March	2240.1	55.3	1777.2	512.0	145.2	251.6	992.3	151.7	151.7	65.7	592.3	272.9	...	1.1	166.4	24.4	215.6	162.4	
April	2203.7	52.9	1746.4	496.1	137.5	258.1	967.6	112.9	98.3	71.6	594.1	282.8	...	1.1	163.6	24.4	215.3	162.4	
May	2208.1	51.2	1749.5	536.4	149.4	264.2	914.9	136.5	29.0	68.7	591.0	298.2	...	1.1	163.9	24.4	218.0	163.4	
2010 June	2218.8	48.6	1751.7	525.9	153.8	270.2	923.0	137.5	31.0	67.4	594.3	302.0	...	1.1	168.7	24.4	224.3	164.4	



Table 6.1. ODC deposits – euro deposits

(Cumulative data, end of period, in millions of euro)

Description	Total deposits in euro														
	Government	Financial corporations						Non financial corporations			Other domestic sectors		Nonresidents		
		Other depository corporations	Other financial intermediaries	Insurance companies	Pension funds	Financial auxiliaries	Public nonfinancial corporations	Other nonfinancial corporations	Households	NPISH					
2000 December	93.0	--	--	--	--	.	--	93.0	--	93.0	--	--	--	--	
2001 December	492.3	--	--	--	--	.	--	165.2	--	165.2	313.1	313.1	--	13.9	
2002 December	427.2	--	--	--	--	.	--	183.6	--	183.6	226.1	226.1	--	17.5	
2003 December	515.8	--	1.8	1.8	--	--	.	--	226.1	--	226.1	267.9	267.9	--	20.0
2004 December	674.9	1.3	25.6	3.7	3.5	16.5	.	2.9	275.3	173.5	10.18	360.3	350.7	9.6	12.3
2005 December	815.3	2.9	35.4	8.1	5.8	18.8	.	2.8	319.0	211.3	107.7	440.7	428.7	12.0	17.3
2006 December	890.4	7.0	28.1	0.1	2.4	24.7	0.4	0.5	337.8	217.4	120.5	499.2	486.1	13.1	18.2
2007 December	1092.0	4.1	39.1	3.1	5.6	28.3	0.4	1.7	386.2	215.5	170.7	647.0	631.9	15.2	15.6
May	1169.8	14.7	36.4	0.5	2.9	30.0	2.4	0.5	396.7	238.8	157.9	703.5	691.9	11.6	18.6
June	1195.3	3.2	49.9	...	1.8	26.6	21.2	0.4	401.6	238.5	163.1	719.1	708.4	10.7	21.4
July	1242.9	1.3	53.7	...	3.0	31.2	19.1	0.4	433.9	243.1	190.8	734.7	725.1	9.6	19.3
August	1295.4	0.8	54.6	...	2.4	32.6	19.2	0.4	445.8	252.4	193.4	773.0	762.8	10.2	21.1
September	1322.8	2.0	52.0	1.0	2.6	28.7	19.2	0.5	440.7	248.5	192.2	793.2	780.9	12.3	34.9
October	1320.6	2.8	52.0	...	4.1	28.5	18.8	0.5	443.1	262.8	180.4	790.6	776.2	14.4	31.9
November	1299.1	1.3	54.7	1.2	5.7	27.9	19.5	0.4	444.1	272.1	172.0	766.7	755.2	11.4	32.4
2008 December	1366.9	1.4	62.9	5.0	6.5	31.5	19.4	0.4	479.7	263.8	215.9	785.0	774.5	10.5	37.9
January	1345.1	3.0	62.0	8.7	4.4	29.1	19.2	0.6	446.8	261.4	185.5	800.4	790.1	10.3	32.9
February	1369.9	1.6	61.3	8.3	4.0	28.9	19.5	0.6	451.1	262.3	188.8	818.7	808.5	10.2	37.3
March	1391.9	3.6	59.3	6.3	4.2	28.7	19.4	0.7	461.3	267.5	193.8	834.1	823.6	10.5	33.6
April	1384.1	1.2	65.0	6.8	5.2	32.9	19.5	0.6	446.8	252.5	194.3	821.0	808.4	12.5	50.1
May	1421.3	2.3	66.3	4.1	5.9	34.0	21.7	0.6	459.3	258.6	200.7	835.4	822.1	13.3	58.0
June	1427.2	1.5	67.7	4.4	5.2	35.8	21.5	0.7	468.0	270.1	197.9	836.0	824.8	11.3	54.0
July	1459.5	0.9	68.8	3.5	6.3	36.7	21.2	1.1	473.2	273.1	200.0	858.1	845.7	12.4	58.6
August	1523.7	1.5	73.3	3.4	6.2	41.3	21.3	1.1	504.0	285.2	218.8	9.9	893.5	13.3	51.4
September	1549.5	3.2	75.7	3.1	6.0	44.2	21.5	0.9	516.1	296.5	219.5	898.2	884.5	13.7	56.4
October	1543.1	180.8	75.2	2.7	6.3	42.9	22.4	0.8	330.4	102.2	228.3	908.6	895.0	13.6	48.0
November	1549.8	174.4	73.0	2.6	5.5	41.7	21.8	1.4	332.0	108.8	223.2	920.3	908.7	11.6	50.1
2009 December	1640.1	165.0	78.2	6.1	5.9	43.1	22.6	0.4	371.5	121.6	249.9	962.2	948.8	13.4	63.2
January	1650.9	152.3	79.1	7.2	5.0	43.9	21.8	1.1	361.0	136.8	224.2	982.9	968.7	14.2	75.7
February	1667.4	152.1	76.4	4.3	5.3	43.7	22.4	0.7	355.6	136.8	218.8	1005.2	995.0	10.1	78.1
March	1670.4	152.3	77.9	4.1	5.5	45.1	22.5	0.7	347.7	140.8	206.9	1022.0	1012.0	10.0	70.4
April	1640.0	113.7	77.3	3.4	5.6	45.0	22.5	0.7	348.4	142.0	206.3	1037.3	1028.5	8.7	63.4
May	1665.5	138.6	94.8	6.1	7.5	49.8	30.5	0.9	289.5	78.6	210.9	1061.9	1052.3	9.6	80.7
2010 June	1653.6	138.2	88.2	4.0	5.4	45.6	32.5	0.8	291.0	73.3	217.7	1066.3	1057.1	9.2	69.8

Table 6.2. ODC deposits – non-euro deposits

(Cumulative data, end of period, in millions of euro)

Description	Non-euro deposits															
	Financial corporations					Nonfinancial corporations				Other domestic sectors						Non residents
	Total	CBK	Other depository corporations	Other financial intermediaries	Insurance companies	Total	Public nonfinancial corporations	Other nonfinancial corporations	Households			NPISH				
									Transferable deposits	Saving account	Other deposits					
2004 December	23.4	1.1	—	...	...	1.1	4.4	0.5	4.0	17.5	17.3	8.7	—	8.7	0.1	
2005 December	29.4	...	—	...	...	...	2.8	—	2.8	26.0	25.7	10.8	—	14.9	0.3	0.5
2006 December	34.3	...	—	...	...	...	3.7	0.3	3.5	29.8	29.6	12.4	—	17.2	0.2	0.5
2007 December	53.3	0.5	—	...	0.1	0.4	8.1	1.5	6.6	44.3	44.2	16.2	—	28.0	0.1	0.4
May	66.6	0.9	—	...	...	0.8	10.4	0.5	10.0	54.9	54.7	16.7	—	37.9	0.2	0.4
June	69.0	0.8	—	...	...	0.8	9.8	0.5	9.4	57.8	57.6	17.7	—	39.9	0.2	0.5
July	73.4	0.8	—	...	...	0.8	8.1	0.1	8.1	63.6	63.4	22.6	—	40.8	0.2	0.8
August	76.7	0.9	—	...	...	0.9	9.1	0.1	9.0	65.9	65.5	19.8	—	45.7	0.4	0.8
September	82.0	0.9	—	...	...	0.9	9.8	0.1	9.7	70.6	70.3	19.9	—	50.4	0.3	0.7
October	93.7	1.0	—	...	...	1.0	10.2	0.1	10.1	81.3	81.0	26.9	—	54.1	0.3	1.2
November	88.7	1.0	—	...	...	1.0	14.1	0.3	13.8	72.8	72.5	21.0	—	51.4	0.4	0.7
2008 December	81.9	0.9	—	...	...	0.9	11.6	0.1	11.5	68.4	68.2	22.9	—	45.2	0.3	1.0
January	85.7	1.6	—	0.6	...	1.0	10.9	0.1	10.8	72.2	72.0	22.2	—	49.7	0.2	0.9
February	83.1	1.7	—	0.6	...	1.0	8.5	0.1	8.4	71.9	71.8	21.9	—	49.9	0.1	1.0
March	83.1	1.5	—	0.5	...	1.0	10.0	0.1	9.9	70.6	70.3	21.3	—	49.0	0.3	0.9
April	88.8	1.6	—	0.6	...	1.0	9.4	0.1	9.4	76.8	76.5	26.9	—	49.6	0.3	1.0
May	83.9	1.5	—	0.6	...	0.9	10.3	0.1	10.2	71.1	70.9	22.5	—	48.4	0.2	1.0
June	90.7	1.7	—	0.7	...	0.9	11.1	0.3	10.7	77.1	76.9	25.9	—	51.0	0.2	0.9
July	97.5	1.9	—	1.0	...	0.9	11.7	0.6	11.2	83.1	82.9	30.8	—	52.1	0.2	0.8
August	97.3	2.0	—	1.1	...	0.9	12.9	0.1	12.9	81.6	81.3	27.2	—	54.1	0.2	0.9
September	100.5	1.9	—	1.0	...	0.9	13.9	0.1	13.8	83.5	83.3	28.3	—	55.0	0.2	1.3
October	100.9	2.1	—	1.2	...	0.9	14.5	0.1	14.4	83.3	83.1	26.0	—	57.1	0.2	1.0
November	101.9	1.8	—	1.0	...	0.9	14.7	0.5	14.2	84.3	84.1	27.1	—	57.1	0.2	1.1
2009 December	112.1	2.1	—	1.2	...	0.9	18.3	1.3	17.0	91.1	90.9	29.7	—	61.1	0.2	0.7
January	111.4	2.3	—	1.4	...	0.9	18.5	1.3	17.2	89.6	89.0	26.3	—	62.7	0.6	1.0
February	110.9	2.4	—	1.4	...	1.0	15.8	0.7	15.1	92.5	89.8	27.3	25.3	37.2	0.2	0.3
March	109.2	2.3	—	1.4	...	1.0	15.5	1.5	14.0	91.0	88.2	26.9	24.5	36.7	0.3	0.4
April	108.7	2.0	—	1.3	...	0.7	14.8	2.3	12.5	89.2	88.9	28.5	24.0	36.4	0.3	2.8
May	99.8	2.0	—	1.8	...	...	16.4	2.1	14.3	78.5	78.1	26.0	20.8	31.3	0.4	2.8
2010 June	101.2	1.7	—	1.5	...	0.2	15.2	2.4	12.8	81.8	81.2	27.7	21.9	31.6	0.7	2.5

Table 7.1. Euro Deposits at ODC by original maturity - nonfinancial corporations

(Cumulative data, end of period, in millions of euro)

Description	Non financial corporations																								
	Public nonfinancial corporations									Other nonfinancial corporations															
	Transf- erable depos- its	Saving accou- nt	Other depos- its	of which:					Transf- erable depos- its	Saving accou- nt	Other depos- its	of which:													
Up to 1 month				Over 1 month and up to 3 month	Over 3 month s and up to 6	Over 6 month s and up to 1 year	Over 1 year and up to 2 years	Over 2 years				Up to 1 month	Over 1 month and up to 3 month	Over 3 month s and up to 6	Over 6 month s and up to 1 year	Over 1 year and up to 2 years	Over 2 years								
2000 December	93.0	—	—	—	—	—	—	—	—	—	93.0	93.0	—	—	—	—	—	—	—	—	—	—	—	—	—
2001 December	165.2	—	—	—	—	—	—	—	—	—	31.3	165.2	133.9	—	—	—	—	—	—	—	—	—	—	—	—
2002 December	183.6	—	—	—	—	—	—	—	—	—	23.9	183.6	159.7	—	—	—	—	—	—	—	—	—	—	—	—
2003 December	226.1	—	—	—	—	—	—	—	—	—	87.1	226.1	139.0	—	—	—	—	—	—	—	—	—	—	—	—
2004 December	275.3	173.5	24.2	—	149.3	34.0	0.0	115.3	—	—	—	101.8	78.2	—	—	—	—	—	—	—	—	—	—	0.2	2.1
2005 December	319.0	211.3	29.9	—	181.3	23.9	12.8	119.5	—	—	25.3	—	107.7	74.4	—	—	—	—	—	—	—	—	—	5.1	0.7
2006 December	337.8	217.4	24.0	24.0	193.3	19.9	19.4	114.3	—	—	39.7	—	120.5	93.6	—	—	—	—	—	—	—	—	—	1.7	3.0
2007 December	386.2	215.5	27.1	—	188.4	105.6	21.4	44.8	—	—	16.7	—	170.7	128.4	—	—	—	—	—	—	—	—	—	3.7	2.0
May	396.7	238.8	18.2	—	220.6	102.5	26.7	80.1	—	—	11.3	—	157.9	121.3	—	—	—	—	—	—	—	—	—	1.9	6.5
June	401.6	238.5	41.0	—	198.3	90.7	22.3	74.0	—	—	11.3	—	163.1	120.3	—	—	—	—	—	—	—	—	—	2.3	7.1
July	433.9	243.1	29.1	—	214.0	104.4	29.0	69.9	—	—	10.7	—	190.8	142.5	—	—	—	—	—	—	—	—	—	2.2	7.3
August	445.8	252.4	28.6	—	223.9	118.8	38.2	63.7	—	—	3.1	—	193.4	135.5	—	—	—	—	—	—	—	—	—	4.0	7.2
September	440.7	248.5	99.9	—	148.6	39.2	38.9	65.3	—	—	5.3	—	192.2	141.5	—	—	—	—	—	—	—	—	—	1.5	7.3
October	443.1	262.8	29.7	—	233.1	36.9	49.3	141.6	—	—	5.3	—	180.4	134.0	—	—	—	—	—	—	—	—	—	2.0	6.7
November	444.1	272.1	16.4	—	255.7	38.7	45.5	166.2	—	—	5.3	—	172.0	126.1	—	—	—	—	—	—	—	—	—	2.0	6.8
2008 December	479.7	263.8	13.7	—	250.1	21.8	47.2	175.8	—	—	5.3	—	215.9	170.2	—	—	—	—	—	—	—	—	—	2.0	7.0
January	446.8	261.4	17.3	—	244.0	24.2	25.7	188.9	—	—	5.3	—	185.5	140.2	—	—	—	—	—	—	—	—	—	2.0	7.0
February	451.1	262.3	18.2	—	244.1	26.8	21.8	190.3	—	—	5.3	—	188.8	125.0	—	—	—	—	—	—	—	—	—	2.3	8.3
March	461.3	267.5	17.8	—	249.6	19.5	25.7	199.2	—	—	5.3	—	193.8	130.0	—	—	—	—	—	—	—	—	—	2.1	9.3
April	446.8	252.5	20.6	—	231.8	27.5	27.6	171.5	—	—	5.3	—	194.3	121.2	—	—	—	—	—	—	—	—	—	2.4	9.2
May	459.3	258.6	62.8	—	195.8	11.3	29.5	149.7	—	—	5.3	—	200.7	127.1	—	—	—	—	—	—	—	—	—	5.1	10.1
June	468.0	270.1	24.8	—	245.3	36.8	23.7	172.8	—	—	12.0	—	197.9	130.8	—	—	—	—	—	—	—	—	—	5.2	10.0
July	473.2	273.1	25.3	—	247.9	0.6	34.2	201.0	—	—	12.0	—	200.0	138.8	—	—	—	—	—	—	—	—	—	4.8	10.0
August	504.0	285.2	34.7	—	250.5	0.7	30.1	204.2	—	—	15.5	—	218.8	153.0	—	—	—	—	—	—	—	—	—	5.2	9.9
September	516.1	296.5	39.8	—	256.8	4.6	2.5	234.2	—	—	15.5	—	219.5	151.3	—	—	—	—	—	—	—	—	—	5.9	10.0
October	330.4	102.2	85.7	—	16.5	0.9	4.0	1.3	—	—	10.3	—	228.3	155.9	—	—	—	—	—	—	—	—	—	5.2	11.5
November	332.0	108.8	87.0	—	21.8	1.7	4.0	5.8	—	—	10.3	—	223.2	149.1	—	—	—	—	—	—	—	—	—	5.7	10.9
2009 December	371.5	121.6	47.6	—	73.9	0.7	10.7	52.3	—	—	10.3	—	249.9	178.0	—	—	—	—	—	—	—	—	—	5.3	10.9
January	361.0	136.8	48.5	—	88.3	0.3	10.2	54.9	—	—	10.3	12.6	224.2	150.5	—	—	—	—	—	—	—	—	—	8.9	7.3
February	355.6	136.8	47.6	0.6	88.6	0.6	14.7	5.3	45.0	10.3	12.6	218.8	144.2	8.3	66.3	22.5	8.5	8.6	11.8	6.3	8.7	—	—	—	
March	347.7	140.8	49.4	0.3	91.1	3.0	4.5	16.2	44.5	10.3	12.6	206.9	137.7	7.5	61.8	18.8	7.1	9.2	11.1	6.7	8.9	—	—	—	
April	348.4	142.0	43.4	0.3	98.3	4.5	3.0	15.2	52.4	10.3	12.9	206.3	130.2	8.2	67.9	22.3	6.2	11.3	13.5	6.7	8.0	—	—	—	
May	289.5	78.6	45.2	0.3	33.2	0.3	0.0	10.2	9.7	0.0	13.0	210.9	135.2	8.7	66.9	24.7	6.4	7.4	11.1	9.3	8.0	—	—	—	
2010 June	291.0	73.3	42.0	0.3	31.0	0.0	0.0	10.6	6.7	1.0	12.6	217.7	144.5	7.7	65.4	26.8	5.8	3.4	15.1	6.1	8.3	—	—	—	



Table 7.3. ODC loans – by maturity

(Cumulative data, end of period, in millions of euro)

Description	Total													
	Financial corporations	of which:			Nonfinancial corporations of which:	Public nonfinancial corporations	Other nonfinancial corporations			Other domestic corporations	Households			
		Other financial intermediaries	Insurance companies	Public nonfinancial corporations			Up to 1 year	Over 1 year and up to 2 years	Over 2 years		Up to 1 year	Over 1 year and up to 2 years	Over 2 years	
2000 December	3.3	—	—	—	3.3	—	3.3	3.3	—	—	—	—	—	—
2001 December	25.9	—	—	—	25.9	—	25.9	24.6	1.3	—	—	—	—	—
2002 December	86.5	—	—	—	80.8	—	80.8	67.3	13.5	—	5.7	5.7	14	4.3
2003 December	232.8	—	—	—	193.7	0.2	193.5	124.7	68.7	0.2	39.0	39.0	114	16.0
2004 December	373.7	—	—	—	289.9	—	289.9	111.5	111.3	67.2	83.7	83.7	15.9	15.2
2005 December	513.9	—	—	—	387.9	—	387.9	117.9	125.2	144.7	126.0	126.0	19.5	21.0
2006 December	636.6	—	—	—	490.5	—	490.5	128.7	127.7	234.1	146.1	146.1	19.7	24.7
2007 December	892.1	—	—	—	691.5	0.2	691.3	174.0	122.6	394.6	200.6	200.6	24.0	29.6
May	1052.8	—	—	—	823.8	0.2	823.6	192.8	127.7	503.1	229.0	229.0	16.4	26.2
June	1089.7	—	—	—	851.1	0.2	850.9	203.7	126.7	520.5	238.6	238.6	16.3	28.4
July	1114.0	—	—	—	863.2	0.2	863.0	201.9	125.2	535.9	250.8	250.8	17.1	30.5
August	1124.2	—	—	—	868.2	0.2	868.0	200.4	122.2	545.4	256.0	256.0	17.4	30.6
September	1130.2	0.6	—	0.6	867.2	0.2	867.1	192.9	119.4	554.7	262.4	262.4	17.4	31.1
October	1160.8	0.6	—	0.6	890.5	0.2	890.3	190.8	129.7	569.8	269.8	269.8	17.9	31.5
November	1187.9	0.6	—	0.6	911.2	0.2	911.0	207.1	130.7	573.2	276.1	276.1	19.9	32.0
2008 December	1183.4	0.6	—	0.6	901.8	0.1	901.7	191.0	132.3	578.4	281.0	281.0	20.9	30.9
January	1188.6	1.1	—	1.1	905.7	0.1	905.5	200.1	129.9	575.5	281.8	281.8	22.1	30.4
February	1211.2	1.1	—	1.1	926.1	0.1	925.9	223.3	120.2	582.4	284.0	284.0	22.7	28.8
March	1229.8	1.0	—	1.0	939.4	0.1	939.3	230.2	118.2	590.9	289.4	289.4	23.6	30.5
April	1238.9	1.0	—	1.0	943.2	0.1	943.1	233.9	118.0	591.2	294.7	294.7	24.5	29.8
May	1268.0	1.7	—	1.7	964.8	0.1	964.7	246.5	117.3	600.8	301.4	301.4	25.4	29.7
June	1280.9	1.0	0.2	0.8	968.7	0.1	968.5	238.9	123.9	605.8	311.2	311.2	26.4	30.8
July	1274.1	1.0	0.2	0.8	956.4	0.1	956.3	238.2	119.7	598.4	316.7	316.7	26.0	29.2
August	1264.6	1.5	0.2	1.2	939.5	0.1	939.4	227.7	112.0	599.7	323.6	323.6	25.4	31.1
September	1279.0	2.2	0.2	1.2	947.2	0.3	946.8	235.5	110.6	600.8	329.7	329.7	27.7	31.7
October	1291.5	2.4	1.2	1.1	955.3	0.3	955.0	236.8	108.0	610.3	333.8	333.8	26.8	32.0
November	1298.6	2.3	1.2	1.1	962.9	0.3	962.6	242.7	107.1	612.8	333.4	333.4	28.5	29.0
2009 December	1289.0	2.3	1.2	1.1	943.2	0.3	942.9	215.7	113.0	614.2	343.5	343.5	27.0	32.1
January	1287.7	2.2	1.2	1.0	942.2	0.3	941.9	219.9	111.8	610.2	343.4	343.4	27.7	31.4
February	1295.0	1.9	1.2	0.8	918.9	7.5	911.5	231.9	70.7	608.9	374.1	373.9	15.9	27.7
March	1333.6	2.4	1.2	1.2	948.1	6.8	941.3	250.5	69.1	621.8	383.0	382.8	20.6	28.0
April	1359.9	4.2	2.9	1.2	961.5	6.9	954.7	257.0	69.6	628.1	391.1	390.9	21.7	27.4
May	1380.8	4.1	2.8	1.2	974.9	6.3	968.6	255.9	69.5	639.0	396.6	397.7	22.6	27.4
2010 June	1404.6	4.1	2.7	1.2	987.3	6.3	980.6	268.8	68.5	643.6	409.1	409.1	23.3	27.4

Table 7.4. ODC loans – main economic sectors

(Cumulative data, end of period, in millions of euro)

Description	Total									
	Agriculture			Industry, energy and construction			Services			
		Up to 1 year	Over 1 year		Up to 1 year	Over 1 year		Up to 1 year	Over 1 year	
2000 December	3.3	—	—	—	0.8	0.8	...	2.5	2.5	...
2001 December	25.9	...	...	—	3.8	3.8	...	22.2	22.2	...
2002 December	86.5	1.5	1.5	—	13.6	13.6	...	71.4	71.4	...
2003 December	232.8	4.7	3.9	0.8	22.2	12.6	9.7	205.8	119.7	86.1
2004 December	289.9	7.9	3.9	4.1	47.8	22.5	25.3	234.2	89.5	144.8
2005 December	387.9	12.5	4.1	8.4	74.2	24.5	49.7	301.1	92.4	208.8
2006 December	490.5	16.4	3.4	13.0	97.7	28.0	69.7	376.4	120.6	255.8
2007 December	691.5	29.0	4.1	24.9	144.5	32.8	111.7	518.0	149.5	368.5
May	823.8	34.8	5.6	29.2	168.9	49.9	119.0	620.2	153.1	467.1
June	851.1	35.9	5.5	30.4	169.0	48.7	120.3	646.2	162.1	484.1
July	863.2	36.7	...	31.1	172.8	48.6	124.2	653.7	161.7	492.0
August	868.2	37.3	5.5	31.8	178.8	52.3	126.4	652.1	159.0	493.1
September	867.8	37.6	5.4	32.2	167.0	41.3	125.7	663.1	160.5	502.0
October	891.1	37.7	4.2	33.5	162.9	30.2	132.7	690.4	122.5	567.4
November	911.8	37.5	4.2	33.3	163.4	30.6	132.8	710.8	137.5	572.8
2008 December	902.4	37.4	4.1	33.3	160.2	28.9	131.2	704.8	126.4	578.4
January	906.8	37.4	4.1	33.3	162.4	29.6	132.8	707.0	129.6	577.4
February	927.2	42.9	4.5	38.4	175.3	32.2	143.1	709.0	149.1	559.9
March	940.4	44.2	4.9	39.3	193.9	38.3	155.6	702.4	143.6	558.8
April	944.2	39.0	4.7	34.3	192.4	39.4	152.9	712.8	147.1	565.7
May	966.5	38.6	4.6	34.0	223.7	65.8	157.9	704.2	131.7	572.5
June	969.7	38.9	4.6	34.3	222.9	65.1	157.8	707.9	125.3	582.6
July	957.4	41.6	4.3	37.3	225.3	66.8	158.5	690.5	123.8	566.7
August	941.0	40.9	4.1	36.8	223.2	66.5	156.7	677.0	117.1	559.9
September	949.3	40.4	4.2	36.2	220.5	64.1	156.3	688.4	123.2	565.2
October	957.7	40.2	4.1	36.0	227.7	66.2	161.5	689.8	120.5	569.3
November	965.2	39.7	3.9	35.8	230.0	64.7	165.3	695.5	125.5	569.9
2009 December	945.5	38.2	3.8	34.4	236.7	54.8	181.9	670.5	113.2	557.3
January	944.3	38.1	3.9	34.1	238.9	57.2	181.7	667.4	113.9	553.5
February	922.4	38.2	3.7	34.5	253.4	79.4	174.0	630.8	157.0	473.9
March	952.2	38.9	3.9	35.0	262.6	81.2	181.4	650.7	166.6	484.1
April	967.8	39.7	4.1	35.6	265.7	82.6	183.0	662.4	172.2	490.2
May	973.4	39.7	4.0	35.7	252.4	80.1	172.2	642.3	164.1	478.2
2010 June	1,019.9	40.1	4.1	36.0	295.3	97.0	198.2	684.6	184.1	500.5

Table 8.1. ODC effective interest rates – deposit rates

(New contracts)

Description	Deposit rates	Nonfinancial corporations									Households						
		Transferable deposits	Other deposits						Saving deposits	Transferable deposits	Other deposits				Saving deposits		
			Less than 250.000 euro				More than 250.000 euro				Up to 1 month	Over 1 month and up to 3 months	Over 6 months and up to 1 year	Over 1 year and up to 2 years		Over 2 years	
			Up to 1 month	Over 1 month and up to 3 months	Over 6 months and up to 1 year	Over 2 years	Up to 1 month	Over 1 month and up to 3 months									Over 6 months and up to 1 year
2004 December	2.8	0.1	1.8	2.3	3.0	*	3.3	*	*	2.0	...	1.7	2.1	2.9	3.8	*	1.6
2005 December	3.1	0.3	2.1	2.4	3.4	*	2.9	*	3.5	1.7	...	1.8	2.2	3.3	3.9	4.0	1.7
2006 December	3.1	0.4	2.1	2.9	4.3	*	3.1	*	3.8	1.5	...	1.9	2.3	3.4	4.2	4.5	1.7
2007 December	4.0	0.5	2.7	2.9	4.4	*	4.3	4.1	*	2.4	...	2.6	2.7	3.6	4.7	5.3	2.3
May	4.0	0.4	2.7	3.5	4.2	*	4.3	*	*	2.9	...	2.7	3.0	4.1	4.4	4.8	2.4
June	4.0	0.6	2.7	3.3	4.1	*	4.1	*	5.2	2.7	...	2.8	3.3	3.9	4.6	5.3	2.4
July	4.2	0.6	3.1	3.3	4.9	*	4.2	4.9	5.4	2.8	...	2.9	3.3	4.2	4.6	4.7	2.6
August	4.3	*	3.0	4.2	4.6	*	*	5.1	*	2.2	0.1	3.0	3.3	4.2	4.8	5.4	2.6
September	4.0	0.7	3.0	3.7	4.2	5.2	3.8	*	5.1	2.6	0.1	3.0	3.5	4.4	4.8	5.7	2.5
October	5.0	0.6	2.8	3.0	4.5	*	4.0	5.3	5.9	2.6	0.1	3.1	3.5	4.4	5.2	5.5	2.6
November	4.5	0.9	2.8	4.5	4.3	*	4.2	5.2	5.6	2.5	0.1	3.1	4.1	4.3	4.9	5.0	2.6
2008 December	4.4	0.5	3.1	4.0	5.3	*	3.6	4.9	5.7	2.9	0.1	3.2	4.6	4.5	5.0	3.9	2.7
January	4.5	0.7	2.9	4.1	4.8	*	3.8	4.3	5.4	2.9	0.1	3.2	4.5	4.7	5.1	5.7	2.7
February	4.3	0.7	3.0	3.9	5.3	5.5	*	4.3	5.4	2.8	0.1	3.1	3.3	4.5	5.1	5.5	2.4
March	4.5	0.9	2.9	3.9	5.4	*	*	*	5.9	3.1	0.1	3.1	3.5	4.4	4.9	5.8	2.7
April	4.3	0.7	2.9	3.2	5.2	*	4.5	4.5	5.6	3.1	0.2	3.5	3.4	4.4	4.3	5.5	2.6
May	4.0	*	2.9	3.8	5.1	*	3.4	*	5.4	3.1	0.1	3.5	3.4	4.4	4.9	5.2	2.7
June	4.7	0.7	3.1	3.7	4.7	*	*	*	6.1	3.0	0.2	3.4	3.6	4.4	4.9	5.3	2.6
July	4.6	0.8	3.1	3.9	4.9	*	3.5	*	5.9	3.1	0.2	3.2	3.8	4.4	3.9	4.6	2.7
August	4.1	0.9	3.3	4.2	5.0	*	3.6	*	*	3.0	0.3	3.3	3.5	4.5	4.6	5.4	2.7
September	4.0	0.9	3.0	3.7	4.4	*	*	*	6.1	2.6	0.3	3.3	3.4	4.3	4.9	5.4	2.5
October	4.8	0.8	3.0	3.1	5.4	*	3.7	4.5	5.2	2.8	0.3	3.2	3.3	4.4	4.9	5.3	2.5
November	4.2	*	3.3	3.6	4.6	5.8	4.4	*	5.1	2.6	0.5	3.0	3.1	4.5	5.6	5.4	2.5
2009 December	4.0	0.7	3.4	3.4	5.0	*	3.9	4.9	5.2	2.6	0.3	3.1	3.3	4.4	5.0	5.5	2.5
January	4.1	*	3.2	3.0	5.2	*	3.6	*	5.9	2.6	0.3	3.1	3.4	4.4	5.0	5.6	2.5
February	3.8	*	3.1	3.0	4.9	4.6	3.8	*	*	2.2	0.2	2.9	2.9	4.5	4.6	5.5	2.2
March	3.6	0.9	3.1	3.0	4.6	5.8	3.1	*	*	2.6	0.1	2.8	3.0	4.2	4.3	4.9	2.3
April	3.5	0.9	2.9	2.6	4.7	5.2	*	4.8	*	2.2	0.1	2.7	2.8	4.1	4.6	5.7	2.2
May	3.4	1.1	2.6	2.9	4.5	*	2.5	*	5.3	2.5	0.4	2.7	2.7	4.2	4.3	5.2	2.3
2010 June	3.7	0.9	2.6	3.1	5.3	*	*	*	5.1	2.4	0.3	2.6	3.0	4.4	4.6	5.2	2.2

Table 8.2. ODC effective interest rate – loan interest rate

Description	Interest rates		Non-financial corporations						Households							
			Investments Business Loans		Other non-investment business loans		Overdrafts	Credit lines	Cash cover loans	Overdrafts	Cash cover loans	Other loans	Consumer loans	Mortgage loans		
			Up to 1 year	Over 1 up to 5 years	Up to 1 year	Over 1 up to 5 years								Up to 5 years	Over 5 up to 10 years	Over 10 years
2004 December	15.7	15.16	14.47	15.04	15.32	15.06	*	...	*	...	*	12.53	*	*	*	
2005 December	14.5	17.34	13.29	15.18	14.38	15.11	*	...	*	...	*	11.51	*	*	*	
2006 December	14.7	*	14.50	13.60	15.18	15.72	*	...	*	...	*	12.36	*	13.36	*	
2007 December	14.1	*	13.76	*	14.64	15.09	*	...	*	...	*	13.72	12.92	12.36	*	
Prill	14.6	*	15.57	13.36	14.90	13.81	*	...	18.94	...	...	14.16	12.73	11.36	*	
May	14.5	26.22	13.99	17.96	15.51	13.48	*	...	19.81	...	...	13.78	12.95	10.82	*	
June	15.3	*	15.11	19.24	15.76	13.66	*	...	18.11	...	...	14.30	*	11.24	*	
July	15.4	*	13.72	18.46	15.49	14.48	*	...	20.36	...	...	14.12	11.18	11.93	*	
August	14.8	*	14.78	14.08	15.94	14.75	*	...	20.53	...	...	14.10	11.22	10.57	7.91	
September	15.5	23.53	17.05	17.74	15.15	15.07	*	...	20.26	...	...	13.94	12.01	10.30	10.49	
October	13.0	13.89	13.68	17.60	15.36	14.14	*	...	17.09	...	...	13.53	11.91	11.53	9.87	
November	13.2	*	15.79	14.46	15.73	13.26	*	...	18.68	...	...	13.78	11.16	11.25	10.93	
2008 December	13.8	*	13.92	14.20	13.45	15.03	*	...	19.48	...	...	13.50	9.81	10.82	8.13	
January	15.7	20.95	15.06	14.57	16.73	13.28	*	...	18.94	...	...	13.96	10.70	12.03	*	
February	15.0	17.26	14.63	15.44	15.02	12.62	*	...	*	...	...	13.01	10.50	9.42	*	
March	13.1	15.06	15.09	17.13	15.77	12.47	*	...	18.22	...	...	13.26	10.79	11.59	12.60	
April	15.2	*	15.65	*	15.90	12.52	*	...	*	...	...	13.10	13.10	10.36	*	
May	12.7	18.74	13.65	*	15.91	12.49	*	...	17.08	...	...	13.32	10.04	9.94	9.76	
June	15.0	20.39	14.41	10.32	16.99	12.09	*	...	16.26	...	...	13.27	10.91	9.91	9.05	
July	14.7	16.44	15.76	14.22	16.57	12.54	*	...	*	...	...	12.49	11.86	10.76	9.99	
August	13.8	*	13.13	12.44	15.52	12.43	*	...	17.71	...	...	12.78	9.94	*	9.22	
September	14.9	12.29	15.25	16.11	15.62	12.36	*	...	17.48	...	...	12.99	9.85	10.79	*	
October	14.2	11.31	13.98	12.96	15.50	12.66	*	...	17.96	...	...	13.04	11.10	9.74	10.23	
November	14.1	*	14.22	13.76	16.40	12.24	*	...	17.89	...	...	12.88	10.87	11.25	9.20	
2009 December	14.1	14.24	14.34	*	13.99	12.76	*	...	17.83	...	...	13.31	*	10.67	*	
January	13.4	19.96	14.76	15.67	15.47	12.66	*	...	18.65	...	...	13.36	11.38	11.41	*	
February	14.6	18.00	14.57	17.37	16.82	11.82	14.94	6.72	21.04	5.84	5.17	14.02	14.76	12.25	11.10	
March	14.3	14.17	14.06	19.04	16.88	12.86	14.30	6.22	21.06	7.29	5.35	13.16	13.11	11.99	10.50	
April	15.3	19.14	15.47	19.53	17.19	12.72	13.62	6.69	22.12	6.66	5.54	13.42	14.54	12.37	10.96	
May	14.6	17.30	13.83	18.93	15.97	12.87	14.46	7.20	23.26	6.91	5.35	13.80	16.98	12.30	10.67	
2010 June	14.0	19.66	14.90	15.55	16.68	12.55	13.58	6.77	22.04	7.18	5.39	13.69	*	12.16	10.72	



Table 9.1. ODC income statement – income and expenditures

Description	Net Income	Income						Expenditures								
		Interest income	of which:		Non-Interest income	of which:		Interest expenditures			Non-Interest expenditures	of which:		General and administrative expenses		
			Loans	Securities		Fees and commissions	Deposits	Borrowings	Other	Provisions for loan and other assets losses						
2000 December	3.9	7.1	1.8	...	...	5.3	5.3	3.3	0.2	0.2	...	...	0.2	0.2	2.9	
2001 December	6.5	16.6	7.2	2.1	...	9.4	9.2	10.1	1.3	0.8	0.5	...	0.6	0.6	8.2	
2002 December	3.5	31.9	17.8	9.4	0.2	14.0	13.2	28.4	3.5	3.1	0.4	...	3.3	3.3	21.6	
2003 December	7.8	48.7	30.7	23.8	0.8	18.0	16.8	40.9	5.3	4.8	0.5	...	7.7	7.7	27.9	
2004 December	14.6	73.4	54.0	48.1	3.4	19.4	17.5	58.9	10.0	9.2	0.7	...	11.1	11.1	37.8	
2005 December	16.3	94.3	74.6	68.0	2.7	19.7	17.4	78.0	15.4	13.9	1.5	...	13.4	13.4	49.2	
2006 December	25.5	114.0	88.8	79.4	2.8	25.2	22.5	88.5	19.9	17.5	2.4	...	13.7	13.7	54.8	
2007 December	41.7	157.3	117.9	103.0	3.6	39.5	23.8	115.6	26.0	23.2	2.8	...	19.9	17.8	69.7	
May	19.3	74.7	59.5	53.3	12	15.2	11.1	55.4	13.5	12.4	1.0	...	10.1	9.4	31.8	
June	23.7	92.7	72.4	65.1	14	20.3	13.7	69.0	16.5	15.2	1.3	...	12.4	11.4	40.0	
July	27.5	109.9	85.7	77.4	16	24.2	17.1	82.4	19.8	18.2	1.6	...	16.3	14.1	46.3	
August	32.8	126.3	99.2	89.5	17	27.1	19.4	93.5	23.2	21.4	1.8	0.1	17.0	14.3	53.3	
September	38.3	142.3	113.1	102.0	19	29.2	22.0	104.0	26.6	24.5	2.0	0.1	17.5	14.3	59.9	
October	41.5	161.1	127.5	114.6	2.0	33.6	24.8	119.5	30.2	27.9	2.2	0.1	20.0	16.3	69.2	
November	45.8	177.0	141.3	127.0	2.1	35.6	27.3	131.2	33.9	31.3	1.9	0.7	20.7	16.6	76.5	
2008 December	49.0	195.0	155.7	140.4	2.3	39.3	30.2	146.0	38.1	35.1	2.1	0.8	21.9	17.0	86.0	
January	2.6	17.1	13.7	12.8	0.1	3.5	2.4	14.5	4.0	3.8	0.2	...	3.3	2.9	7.3	
February	3.9	32.8	26.1	24.7	0.2	6.8	4.8	29.0	7.9	7.4	0.5	...	5.3	4.3	15.8	
March	5.9	50.1	39.7	37.9	0.3	10.5	7.3	44.3	12.1	11.3	0.7	0.1	7.4	5.9	24.8	
April	8.2	67.3	52.8	50.8	0.4	14.5	10.0	59.1	16.1	15.0	1.0	0.1	10.3	8.3	32.6	
May	11.4	84.7	66.4	64.2	0.4	18.2	12.7	73.3	20.3	18.9	1.2	0.2	13.0	10.4	40.0	
June	12.4	102.0	79.9	77.3	0.5	21.7	15.4	89.6	24.6	22.9	1.5	0.2	17.3	14.2	47.7	
July	16.6	120.2	94.4	90.9	0.5	24.9	18.3	103.6	29.3	27.2	1.9	0.2	19.1	15.4	55.2	
August	19.4	137.9	108.2	104.2	0.6	28.2	21.3	118.5	34.1	31.6	2.2	0.3	22.1	17.8	62.3	
September	21.4	156.0	122.1	117.5	0.7	33.9	24.0	134.6	38.8	36.1	2.4	0.3	25.9	21.0	69.9	
October	20.4	172.3	134.6	130.7	0.9	37.7	26.6	151.9	43.0	39.7	2.8	0.5	31.3	25.7	77.6	
November	27.6	190.5	148.8	144.7	1.0	41.6	29.3	162.8	47.6	43.8	3.2	0.5	29.7	23.4	85.6	
2009 December	29.6	201.5	163.2	158.6	1.2	38.2	32.5	171.8	52.2	48.0	3.6	0.6	32.6	25.7	87.0	
January	2.8	16.9	14.2	13.8	0.2	2.7	2.6	14.1	5.0	4.6	0.4	0.0	2.4	1.9	6.7	
February	5.9	33.3	27.7	26.4	0.4	5.6	5.3	27.4	9.7	8.7	0.8	0.1	4.1	3.1	13.6	
March	8.0	51.3	42.0	40.3	0.7	9.3	8.5	43.2	14.7	13.3	1.3	0.1	7.5	5.8	21.0	
April	11.0	68.3	55.7	53.9	1.0	12.6	11.5	57.3	19.5	17.6	1.7	0.2	9.8	7.4	28.1	
May	13.8	85.8	69.7	67.4	1.2	16.2	14.7	72.0	24.2	21.9	2.1	0.2	12.6	9.6	35.3	
2010 June	19.4	103.2	84.5	81.8	1.4	18.7	17.3	83.8	28.4	25.9	2.5	0.1	13.2	9.5	42.2	

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