

Summary

Economic activity in euro area has continued with accelerated growth also in Q2 2017. Inflation rate in euro area marked an increase, mainly being impacted by eased monetary policy in euro area and the increase of energy, services and food prices.

The ease of financing conditions, as a result of the expansionary policies and non-convention measures taken by the ECB and the improvement of domestic demand have supported the economic activity in euro area. The strengthened demand in euro area was positively reflected in economic developments of Western Balkan countries, which were characterized with an increase of exports, investments and consumption.

The growth of the economic activity in Kosovo, in the first half of 2017, was supported by the strengthened domestic demand, namely by the increase of consumption and investments and also by the increase of goods and services. According to KAS estimates, Kosovo's economy was characterized with a real GDP growth rate of 3.9 percent in Q1 2017, while preliminary estimates of the CBK suggest a higher increase of GDP for Q2 2017. During the first half of 2017, consumer price index in Kosovo was characterized with an average increase of inflation rate of 1.7 percent.

Fiscal sector was characterized with an increase of budget revenues and expenditures of 4.1 and 6.9 percent, respectively. Consequently, Kosovo's budget recorded a primary budget balance of EUR 2.8 million, compared to the budget balance of EUR 21.6 million in the same period of 2016.

Current and capital account deficit was lower for 3.9 percent compared to the same period of the previous year. This improvement of the current and capital account is mainly attributed to a more significant increase of exports of goods and services (11.6 percent) compared to the increase of imports of goods and services (5.2 percent).

Besides goods and services, also primary and secondary income account was characterized with an increase (22.1 and 4.6 percent, respectively).

Within financial account, foreign direct investments during the first half of 2017 have marked an increase of 64.2 percent compared to the same period of 2016.

Until Q2 2017, the banking sector was characterized with an accelerated increase of lending activity (10.0 percent), mainly as a result of eased conditions of lending by banks and the increase of credit demand. Lending increase consistently continued to be financed by deposits collected within the country's economy, which during this period marked an annual increase of 7.2 percent.

The average interest rate on loans, in June 2017, decreased to 6.8 percent, while the average interest rate on deposits increased slightly to 1.1 percent.

The NPL rate continued to follow a decreasing trend, falling to 3.9 percent until June 2017, while also other financial soundness indicators continued to have satisfactory levels.

With an activity increase were characterized also other segments of financial system, as pension sector, insurance sector and microfinance sector. As regards the performance, pension sector realized significantly higher return on investments compared to the same period of the previous year. Also, microfinance and insurance sectors were characterized with an increase of profit in June 2017 compared to the same period of the previous year.

Euro area and Western Balkans

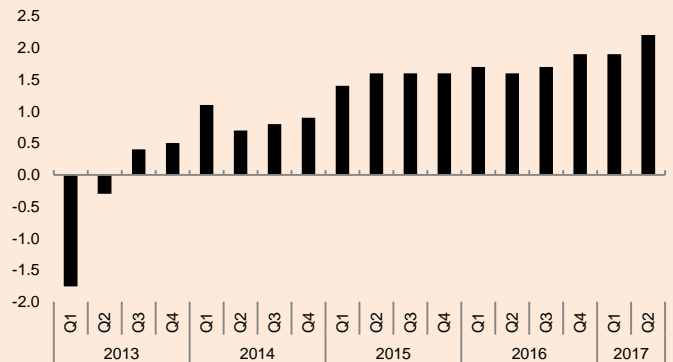
During Q2 2017, euro area was characterized with an accelerated dynamic of the economic activity. Further strengthening of domestic demand in euro area, and the increase of consumer and business confidence after elections in Holland, Austria and France, were reflected positively in the economic activity of euro area. Moreover, expansionary policies and non-conventional measures taken by the ECB within the quantitative easing program, financial conditions were significantly eased in euro area, thus supporting the expansion of the economic activity. Compared to the same period of the previous year, in Q2 2017, euro area economy increased by of 2.2 percent. Whereas, compared to the previous quarter, euro area was characterized with a GDP increase of 0.6 percent. The increased added value of GDP, in particular being supported by manufacturing sectors, especially in Germany and France, was positively reflected to the overall increase of GDP in euro area. In 2017, the ECB has forecasted a real GDP growth rate of 1.9 percent, mainly being supported by strengthening of euro area exports and eased monetary policy. The economic growth, in Q2 2017, remained concentrated in central euro area economies as in Germany (2.1 percent), France (1.8 percent), Holland (3.8 percent), Italy (1.5 percent) and Spain (3.1 percent).

In June 2017, inflation rate reached 1.3 percent, unlike in the same period of the previous year when it was 0.1 percent.

Eased monetary policy and price increase of main categories such as energy, services and food were

reflected in an increase of inflation rate in the reporting period.

Figure 1. Annual real GDP growth rate in euro area



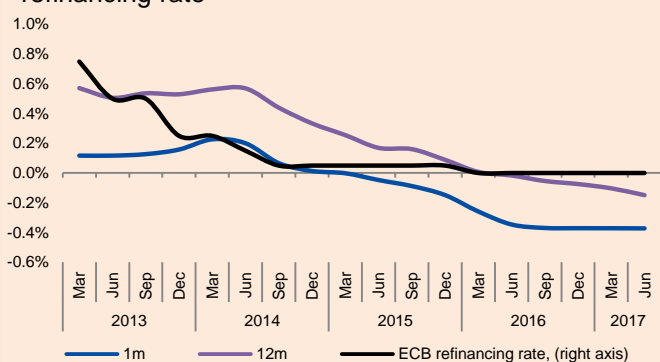
Source: Eurostat (2017)

For 2017, based on the ECB forecasts, inflation rate in euro area is expected to be 1.5 percent. The launch of comprehensive stimulus program since March 2016 was reflected in a decline of 1-month interest rates of interbank Euribor lending. Also, in Q2 2017, 12-month interest rate of interbank lending in euro area was characterized with a decline. The ECB continued to keep the interest rate on main refinancing operations at zero percent (figure 2).

During the second quarter of 2017, lending activity in euro area continued to recover, thus being characterized with an annual increase of 1.9 percent. The expansion of lending activity was mainly supported by the increase of demand, which resulted from the improvement of conditions of lending and the acceleration of the economic activity. During this period, households were characterized with a more accelerated increase of 2.4 percent, while loans to enterprises increased annually by 0.8 percent.

During this period, the increase of disposable income in euro area may have had an impact on the increase of resident deposits in the banking sector of euro area. Enterprise deposits marked a higher increase during this period (8.0 percent), followed by household deposits (5.0 percent).

Figure 2. EURIBOR interbank lending and ECB refinancing rate



Source: Euribor (2017) and ECB (2017)

Performance of the economic activity in the Western Balkans, during Q2 2017, continued to mark an improvement. The increased demand in the euro area, as the main trading partner for the Western Balkan countries, was translated in position improvement of net exports of the region. The export growth, along with the increase of foreign investments and domestic consumption, represented important contributors to the average increase of GDP of 3.3 percent in the Western Balkans, in Q2 2017 (table1).

The same as in the euro area, the price increase in international markets was reflected in an increase of inflation rate in Western Balkans. By June 2017, Serbia was characterized with the highest inflation rate of 3.4 percent, followed by Montenegro with a rate of 2.5 percent, while Macedonia was

characterized with the lowest inflation rate of 0.9 percent.

Table 1. Annual real GDP growth rate

Description	2013	2014	2015	2016	2017
Bosnia and Herzegovina	2.4	1.1	3.2	3.0	3.0
Kosovo	3.4	1.2	4.1	3.4	3.7*
Montenegro	3.5	1.8	3.2	5.1	3.3
Macedonia	2.9	3.5	3.7	2.2	3.2
Serbia	2.6	-1.8	0.7	2.5	3.0
Albania	1.0	1.8	2.8	3.4	3.7

*Preliminary forecast of the CBK.

Source: WEO (2017) and CBK estimation

Regarding the developments of the banking sector, region countries were characterized with an increase of the lending activity of 3.9 percent in the second quarter of 2017. Kosovo had marked the highest increase of 10.0 percent, followed by Montenegro with 9.3 percent, while Albania reported a decline of 0.1 percent. Region countries reported an increase also in deposits, where Montenegro marked the highest increase until June 2017 (10.9 percent), followed by Macedonia (7.6 percent), while the lowest increase was marked by Albania (3.7 percent).

Until June 2017, EUR depreciated against currencies as Albanian lek (2.3 percent), Swiss franc (1.8 percent), Croatian kuna (1.5 percent), Serbian dinar (0.1 percent), and US dollar (3.0 percent). While against British pound EUR marked an appreciation of 10.5 percent.

Kosovo's Economy

Real sector

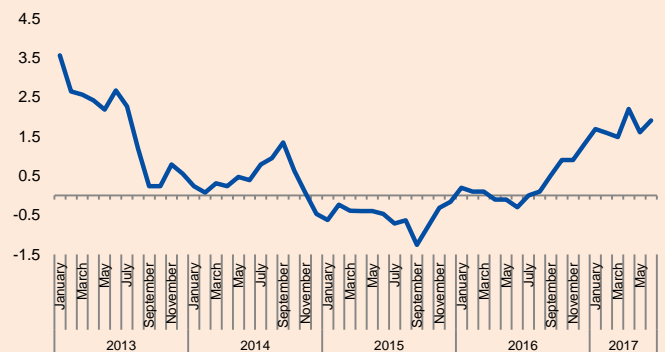
Kosovo's economy, based on KAS estimates, has marked an increase of GDP with 3.9 percent, in Q1 2017. This increase of GDP was generated by investments increase of 13.7 percent and the increase of consumption of 1.6 percent. During this period, net exports are considered to have been characterized with a considerable deepening of the deficit with 3.3 percent in real terms. Concerning manufacturing approach, the increase was mainly estimated to have been generated by construction (an increase of 16.5 percent), trade (7.1 percent), financial activities (12.0 percent), real estate business (5.8 percent), and mining and processing industry (21.9 and 5.3 percent, respectively). While, a real decline is estimated to have been marked by agriculture (4.0 percent), and public administration (3.9 percent).

CBK forecasts for 2017 suggest an economic growth rate of 3.7 percent of Kosovo's economy. This increase is expected to be generated by domestic demand, while net exports are foreseen to have lower negative contribution to the GDP growth compared to the previous year. Consumption as the main component of domestic demand, is expected to mark a real increase of 2.1 percent, while investments are forecasted to mark a real increase of 6.8 percent. Net exports of goods and services in 2017 are expected to have a lower negative contribution to GDP compared to previous year; an assumption that relies mainly on forecasts on metal prices increase which are expected to have an impact on the increase of the value of total exports.

Prices

In the first half of 2017, the price level in Kosovo was characterized with an increase. CPI marked an average increase of 1.7 percent (figure 3).

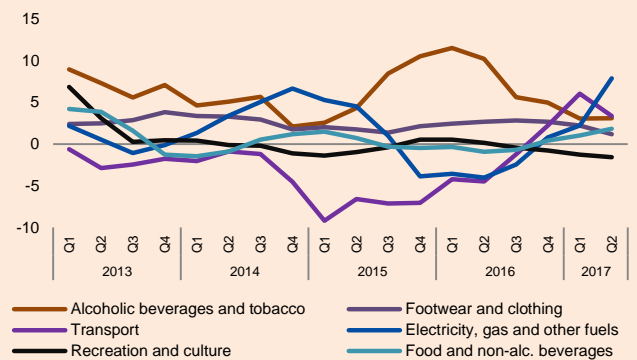
Figure 3. Inflation rate, annual change in percent



Source: KAS (2017)

Regarding the CPI components, with an increase were characterized prices of electricity, gas and other fuels (4.9 percent), transport (4.7 percent), followed by prices of alcoholic beverages and tobacco (3.1 percent), footwear and clothing (1.7 percent).

Figure 4. Price movements by main components, annual change in percent



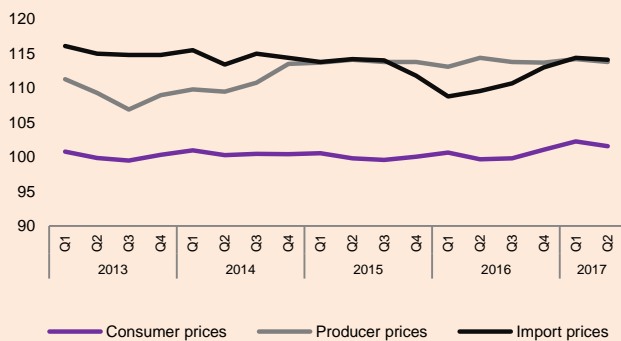
Source: KAS (2017)

With an increase of 1.2 percent were characterized also food prices, which represent around 33.9 percent of the Kosovar consumer basket.

Conversely, a price decline was marked by recreation and culture (1.4 percent) and communication means (0.8 percent) (figure 4).

Import price index, in Q2 2017, marked an increase of 4.1 percent (figure 5).

Figure 5. Consumer, producer and import price indices

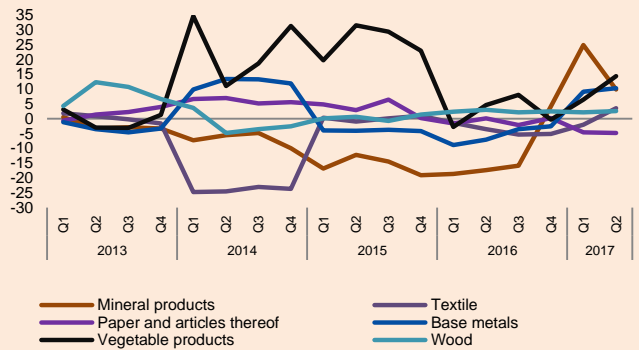


Source: KAS (2017)

Prices of vegetable products, mineral products and base metals, which represent the main category of import price index, marked the highest increase (14.5 and 10.0 percent, respectively), while prices of paper and articles thereof marked the highest price decline (4.8 percent) (figure 6).

Producer price index was characterized with a decline of 0.5 percent. During this period, with an increase of prices were characterized the extraction of metal ore, electrical energy, furniture, etc.

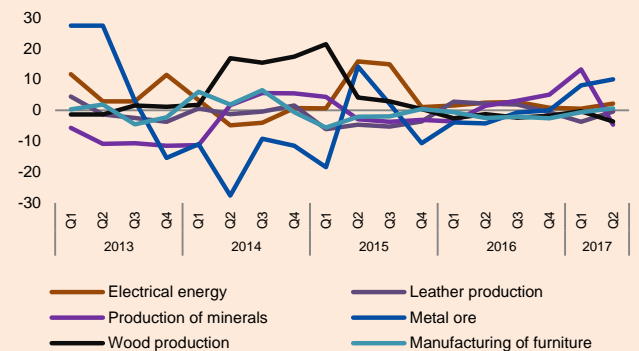
Figure 6. Price movements of import prices, annual change in percent



Source: KAS (2017)

Whereas, with a price decline were characterized mainly metal production, manufacturing of wood, manufacturing of leather etc. (figure 7).

Figure 7. Producer price movements, annual change in percent

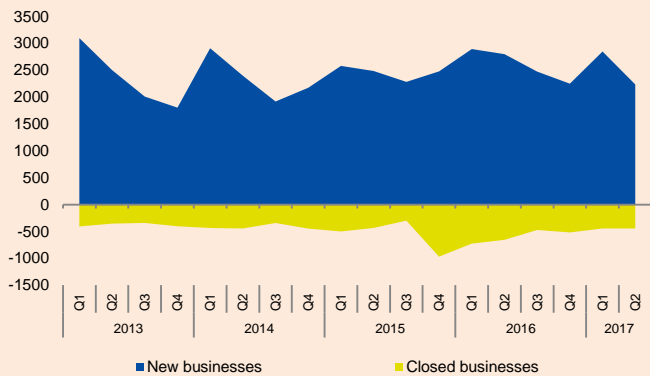


Source: KAS (2017)

Business registry

Regarding the business registry, in June 2017 it was marked a lower number of registered enterprises and lower number of closed enterprises as well. The number of new registered enterprises was 5,087 or 610 enterprises fewer than in the same period of 2016, while were closed 890 enterprises or 494 fewer enterprises (figure 8).

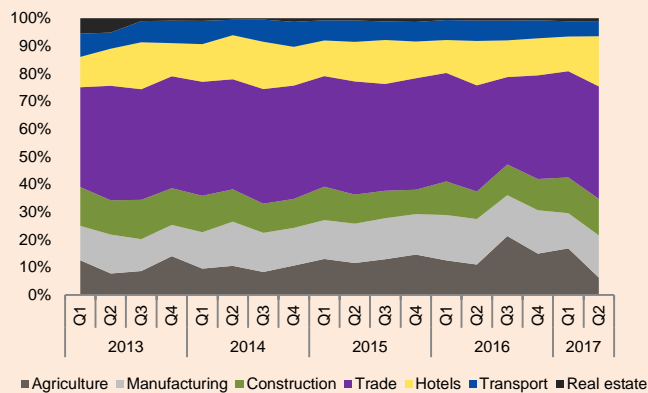
Figure 8. Business registry, non-commulative



Source: KAS (2017)

The largest number of new registered enterprises continued to be concentrated in trade sector with 1,422 new enterprises, followed by hotels sector with 539 enterprises, manufacturing sector with 499 enterprises, etc. (figure 9).

Figure 9. Structure of new enterprises



Source: KAS (2017)

Compared to the first half of 2016, in most of the sectors it was marked a lower number of registered enterprises. Manufacturing sector was characterized with the highest decline of new enterprise, being registered 178 enterprises fewer, followed by financial trade sector which was characterized with 177 fewer registered enterprises. The sectors which marked the largest number of registered enterprises were the

sector of professional activities and construction sector (24 and 15 enterprises more, respectively).

Fiscal Sector

Budget revenues¹ in June 2017 reached a net value of EUR 753.9 million, representing an annual increase around 4.1 percent. At the same time, budget expenditures² reached a value of EUR 751.1 million, representing an annual increase of around 6.9 percent. Consequently, Kosovo's budget recorded a primary budget balance of EUR 2.8 million compared to the budget balance of EUR 21.6 million in the same period of 2016.

Regarding the type of taxes, it was observed a higher increase of non-direct tax revenues which reached a value of EUR 573.6 million (an increase of 5.1 percent), followed by direct tax revenues which reached a value of EUR 119.0 million (an increase of 3.9 percent). Non-tax revenues marked even higher increase of budget revenues with 9.5 percent, which reached a value of EUR 90.9 million.

Regarding expenditures, almost all categories were characterized with increase. Government expenditures on wages and salaries marked an increase of 0.6 percent and reached a value of EUR 274.2 million. Goods and services (including also the municipal utilities) marked a growth of 8.2 percent and reached a value of EUR 94.9 million. Subsidies and transfers marked an increase of 9.0 percent, reaching the value of EUR 230.9 million. The highest

¹ Within the primary income were not included the revenues from borrowings, income from privatization, receipts of donor defined grants and receipts from deposits in trust.

² Within budget expenditures were not included debt payments, membership payments at International Financial Organizations (IFO), returns from deposit funds, and the return of loans from public enterprises which is treated as a reduction of expenditures.

increase was marked by capital investments which reached the value of EUR 159.3 million representing an increase of 18.7 percent compared to the same period of the previous year.

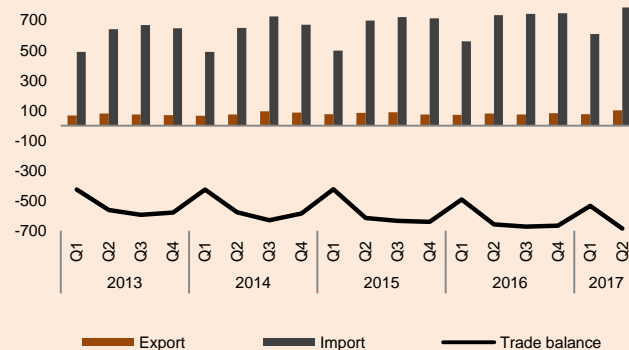
Public debt reached EUR 947.5 million in June 2017, marking an increase of 15.3 percent compared to the same period of the previous year. As a percentage to GDP, public debt reached around 15.5 percent from 13.8 percent. This increase in public debt is attributable to external debt increase of 15.5 percent (its value reached EUR 443.0 million) and the increase of domestic debt with 15.1 percent (EUR 504.5 million).

External Sector

Until June 2017, the current and capital account deficit reached a value of EUR 372.4 million, compared with the deficit of EUR 387.4 million as it was in the same period of the previous year. This deficit of current and capital account is mainly attributable to the deficit of goods account. Conversely, positive balances of services, primary and secondary income accounts were characterized with an increase.

The deficit in trade of goods was characterized with an annual increase of 6.2 percent until June 2017. Export of goods reached the value of EUR 179.3 million, corresponding with an annual increase of 17.7 percent (figure 10).³

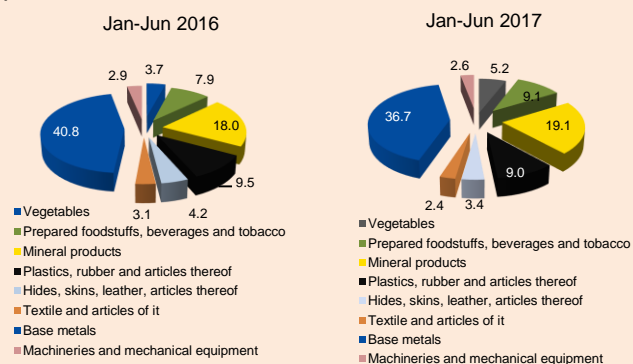
Figure 10. Export and import of goods, in millions of EUR



Source: KAS (2017)

The increase of the value of export of goods during this period is mainly attributed to the increase of export of mineral products, base metals, prepared foodstuff, beverages, vegetables, etc. Conversely, with a decline were characterized export of textile and articles of it and leather and its products (figure 11).

Figure 11. Structure of exports by category, in percent



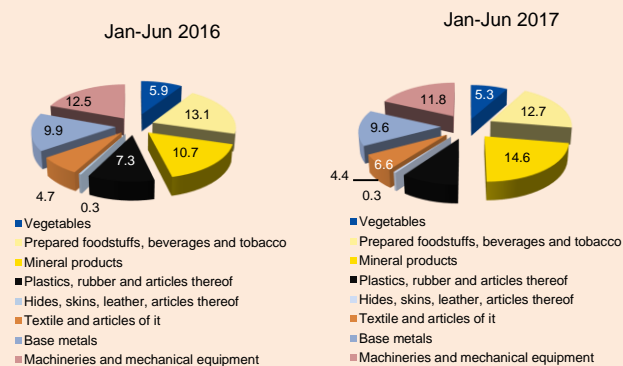
Source: KAS (2017)

The value of total goods imported reached EUR 1.4 billion until June 2017, representing an annual increase of 7.6 percent. The growth of import was mainly a result of the increase of mineral products, which accounts for import of oil and its derivatives, whose prices had marked an increase in international markets. With an increase were characterized also the

³ The source of data for import and export of goods in Kosovo is Kosovo Agency of Statistics.

import of transport means, machinery, prepared foodstuffs, beverages, etc. Conversely, the import of plastics, articles of stone, ceramic products, glass, etc. marked a decline (figure 12). In June 2017, the coverage rate of imports with exports stood at 12.8 percent (11.7 percent in June 2016).

Figure 12. Structure of imports by category, in percent



Source: KAS (2017)

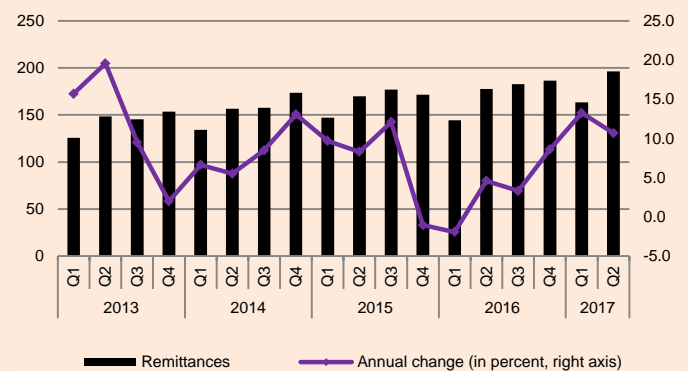
The balance in trade of services marked a value of EUR 165.1 million until June 2017, representing an increase of 37.3 percent compared to the same period of the year 2016. The value of total exported services marked an annual increase of 8.0 percent, reaching EUR 350.7 million, while the value of imported services marked a decline of 9.3 percent and reached a value of EUR 185.6 million.

Within export of services, travel services were characterized with an increase, while construction services marked a decline. Regarding import of services, travel services and transport services marked a decline whereas computer services marked an increase.

Primary income account was characterized with an increase of 22.1 percent. The balance of income from

the compensation of employees⁴ marked an increase of 11.2 percent, while the balance of income from investments shrank for 1.1 percent. At the same time, the balance of secondary income marked an increase of 4.6 percent, which is attributable to the higher level of remittances. Remittances received in Kosovo, which at the same time represent the largest category within the secondary income account, reached the value of EUR 359.9 million, representing an annual increase of 11.8 percent (figure 13).

Figure 13. Remittances, in millions of EUR



Source: CBK (2017)

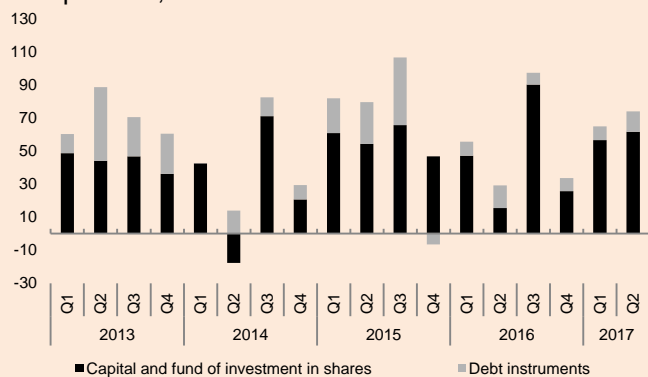
Remittances received in Kosovo mainly come from Germany and Switzerland, which represent the countries with a share of 39.2 percent and 22.6 percent, respectively, of total remittances received. A considerable amount of remittances was received from USA, namely 7.3 percent of total remittances received in Kosovo.

Foreign Direct Investments (FDI) received in Kosovo reached the value of EUR 139.2 million, until June 2017, representing an increase of 64.2 percent compared to the same period of the previous year.

⁴ Compensation of employees includes wages, salaries and other benefits received by resident workers from abroad. In this context, are included seasonal employees or other short-term contracted employees (less than one year) and custom employees whose interest economic center is in their economy.

Within the structure of FDI, with an increase were characterized capital and fund of investments in shares while investment in debt instruments marked a decline (figure 14).

Figure 14. Structure of foreign direct investments by components, in millions of EUR



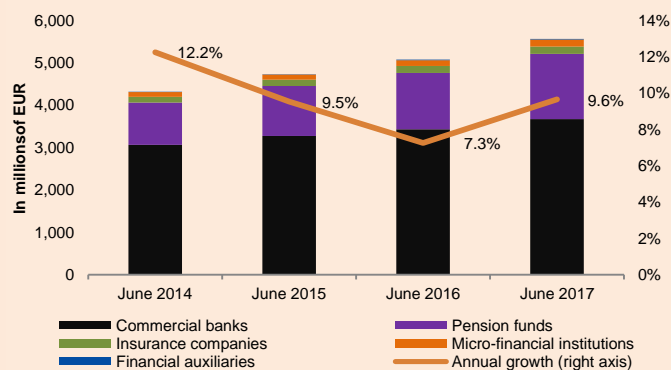
Source: CBK (2017)

The capital and investments fund in shares, which comprises around 85.0 percent of total FDI, reached the value of EUR 118.3 million marking an increase of 88.3 percent. FDI in the form of debt instruments reached a value of EUR 20.9 million, representing a decline of 4.8 percent. The highest increase of FDI was marked in financial services and in construction (EUR 32.5 and EUR 13.9 million more compared to the same period of the previous year), while trade sector was characterized with an annual decline of 1.0 percent.

Financial System

The total value of assets of Kosovo's financial system reached EUR 5.56 billion in June 2017, representing an annual increase of 9.6 percent (figure 15).

Figure 15. Assets value of Kosovo's financial system



Source: CBK (2017)

The increase of the banking sector and pension funds gave the main contribution to the expansion of financial system assets, while the impact of other institutions was quite low.

Banking Sector

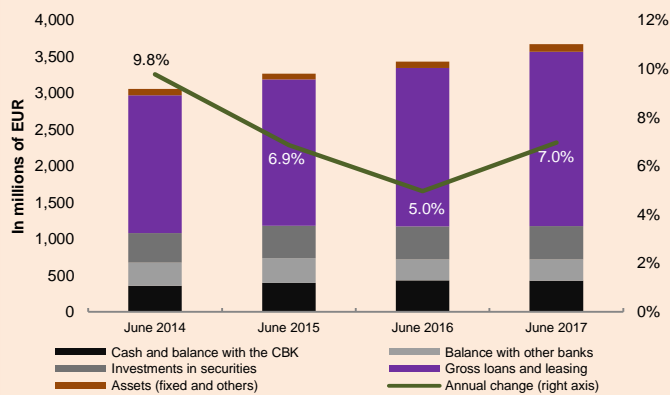
Assets

In June 2017, assets of the banking sector marked an annual increase of 7.0 percent, thus reaching EUR 3.67 billion (figure 16). The increase of the banking sector assets continues to be supported mainly by the increase of lending activity.

The expansion of lending activity of the banking sector continued to rely on deposits trend, whose increase represents the major source of financing lending activity.

In June 2017, securities stock of the banking sector marked a slowdown increase at 1.4 percent, from 2.1 percent in the previous year.

Figure 16. Assets structure of the banking sector



Source: CBK (2017)

The slowdown increase of this category is mainly attributed to the decline of investments in external sector. In June 2017, investments in securities of foreign governments were characterized with an annual decline of 7.1 percent (an increase of 10.1 percent in June 2016). In the same period, investments in Kosovo’s Government securities increased annually by 11.7 percent (a decline of 6.2 percent in June 2016). The slowdown of investments increase in securities may be attributable to some extent to the change of investment strategy of banks, taking into account the decline of average interest rate on securities of Kosovo’s Government and lower interest rates in foreign markets. Conversely, the continuous improvement of credit portfolio and higher returns from investments in loans, has had an impact on banks to shift their investments toward lending also in the second quarter of 2017, which continued to follow an accelerated increasing trend.

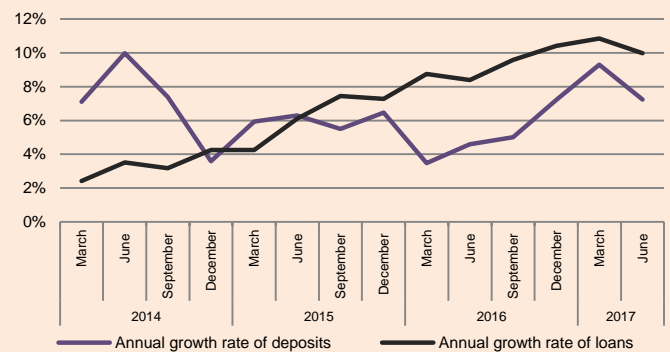
Cash and balance with the CBK marked an annual decline of 1.5 percent compared to the increase of 9.0 percent marked in the previous year. Setting negative interest rates on bank reserves which exceed the obligatory level of 10 percent, and 13

the shift of assets in credit portfolio, may have had an impact on the decline of this category.

Loans

Loans of the banking sector continued to follow a positive trend for the fourth consecutive year, marking an annual increase of 10.0 percent in June 2017 (figure 17). The value of total loans reached EUR 2.39 billion in the reporting period mainly due to eased lending offer.

Figure 17. Growth trend of loans and deposits, in percent



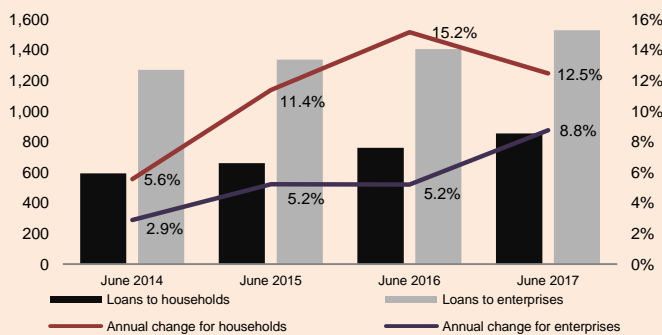
Source: CBK (2017)

The stock of loans to households continued to be the category with the highest increasing rate in the six recent years. In June 2017, this category marked an annual increase of 12.5 percent (figure 18). While, new loans granted to households were characterized with a slowdown increase. These loans marked an annual increase of 2.3 percent in the first six months of 2017 (18.7 percent in the same period of the previous year). The slowdown increase of new loans to households was primarily impacted by decline of portfolio of new consumer loans.

Loans to enterprises accelerated their annual increase in the reporting period (figure 18). New

issued loans to enterprises marked a significant increase during this period (29.5 percent) compared to the annual decline with which were characterized in the previous year (17.4 percent). The significant increase of new loans to enterprises was mainly a result of increase of new investment and non-investment loans, mainly designated to industry and services sectors.

Figure 18. Loans to enterprises and loans to households



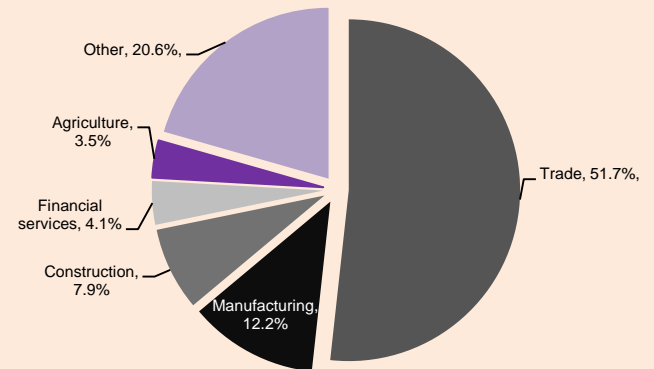
Source: CBK (2017)

The structure of loans to enterprises by economic activity continued to remain dominated by loans intended to the trade sector. Compared to the previous period, loans to other services sector increased their share for 2.7 percentage points, while loans designated to financial services shrank by 3.1 percentage points. (figure 19).

An annual increase of lending was especially marked by construction, manufacturing and trade sectors, which all together account for 71.8 percent of total loans to enterprises.

While, with a decline were characterized the sector of financial services, energy and agriculture, which comprise 9.0 percent of total lending to industry.

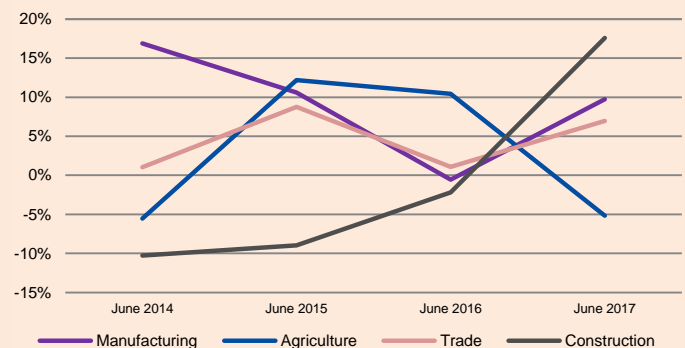
Figure 19. Loans by economic sectors, in percent (June 2017)



Source: CBK (2017)

In June 2017, lending to all important economic sectors marked an increase (figure 20).

Figure 20. Annual growth of loans by economic sectors



Source: CBK (2017)

New loans to enterprises which in the previous year were characterized with a decline, in the first half of 2017 marked a significant increase. The main contribution to the increase of new loans to enterprises were marked by non-investment loans (46.0 percent), followed by investment loans (15.3 percent). By economic sectors, new loans to industry and services sectors marked a significant annual increase of 46.1 and 21.4 percent, respectively, by June 2017. Whereas, new loans to agriculture sector

continued their declining trend for second consecutive year.

The increase of the banking sector activity in the first half of 2017 was supported by expansion of credit portfolio as a result of the improvement of credit offer. Regarding the structure of the economic sectors, it continued to remain the same as in the previous periods. Significant annual increase of lending was marked by construction, manufacturing and trade sector.

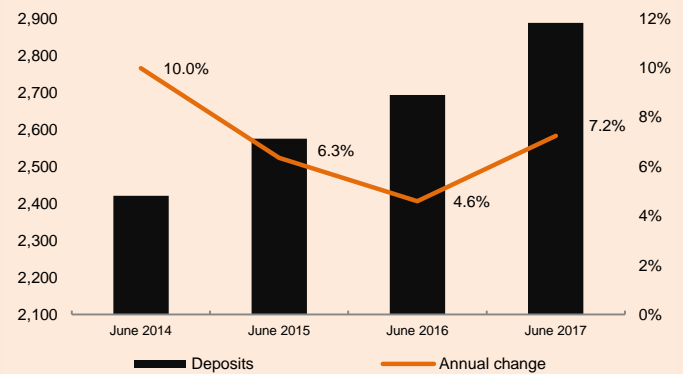
Liabilities and Own Resources

Structure of banking sector liabilities is dominated by deposits, which comprise 78.7 percent of total liabilities and own resources. Deposits continue to be the main source of financing the banking sector activities. The category of own resources of the banking sector was characterized with an annual increase of 13.4 percent, mainly as a result of the increased profit value and of retained earnings of EUR 45.6 million and EUR 129.6 million, respectively (EUR 37.7 million and EUR 88.2 million, in June 2016).

Deposits

Deposits at the banking sector of Kosovo marked an annual increase of 7.2 percent, representing an accelerated pace compared to the previous period (4.6 percent in June 2016). The value of total deposits, in June 2017, reached EUR 2.89 billion (figure 21).

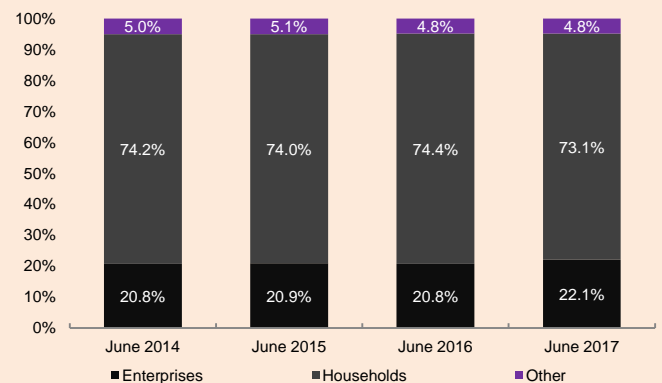
Figure 21. Deposits, in millions of EUR



Source: CBK (2017)

The level of deposits of the banking sector reflects the trend of household deposits, which dominate the structure of total deposits and the reporting period marked an annual growth of 5.4 percent (figure 22).

Figure 22. Structure of deposits, in percent



Source: CBK (2017)

At the first half of the year, enterprise deposits marked an accelerated annual increase of 14.1 percent, which may have been impacted by the increase of the average interest rate of enterprise deposits. By categories of deposits, transferable deposits continued to increase their share to the structure of total deposits, but with a subdued pace compared to the same period of the previous year.

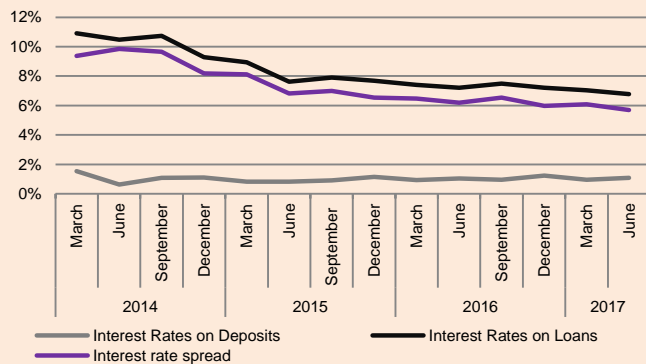
Conversely, saving and time deposits declined their share, which to some extent may be attributable to low interest rates of deposits.

After two years of slowdown increase, deposits of the banking sector, in June 2017, accelerated their growth pace. Transferable deposits continued to dominate the deposits structure, while time and saving deposits shrank their share to total deposits.

Interest Rates

The interest rate spread between loans and deposits narrowed to 5.7 percent compared to the same period of the previous year (6.2 percent in June 2016).

Figure 23. Average interest rate on loans and deposits



Source: CBK (2017)

The average interest rate on loans, in June 2017, decreased to 6.8 percent, while the average interest rate on deposits increased slightly to 1.1 percent (figure 23).

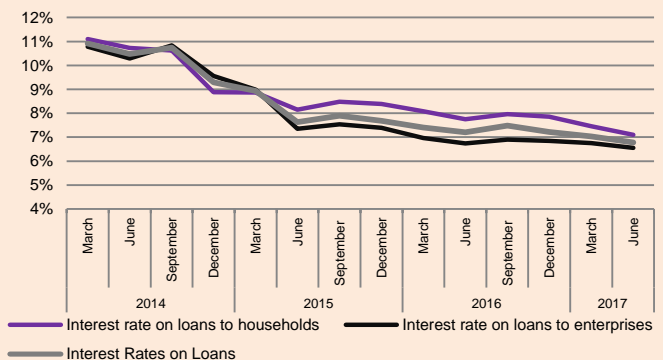
Interest Rates on Loans

The average interest rate on loans to enterprises, in June 2017, stood at 6.6 percent

from 6.7 percent as it was in June 2016 (figure 24).

Within this category, interest rates on non-investment loans continued their declining trend, whereas interest rates on investment loans increased slightly. Also other categories of interest rates as “overdrafts”, “credit lines” and those with “favorable conditions”, during this period were characterized with a slight decline compared to the previous period.

Figure 24. Average interest rate on loans to households and enterprises

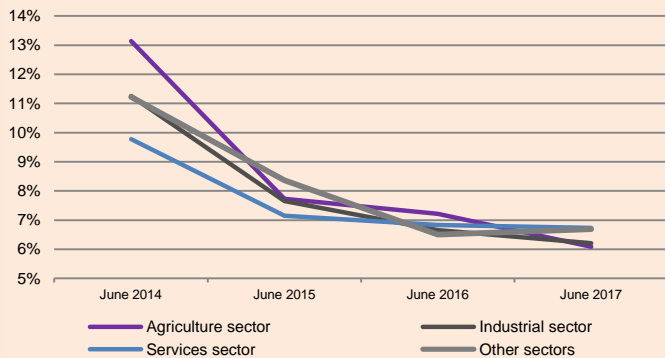


Source: CBK (2017)

Interest rates on all economic sectors, besides “other sectors”, marked a decline. Interest rate on agriculture sector marked a more significant decline, unlike the industry and services sector which had marked a slight decline (figure 25).

Interest rates on loans to households continued their declining trend dropping at 7.1 percent (7.8 percent in June 2016).

Figure 25. Average interest rate on loans, by economic sectors



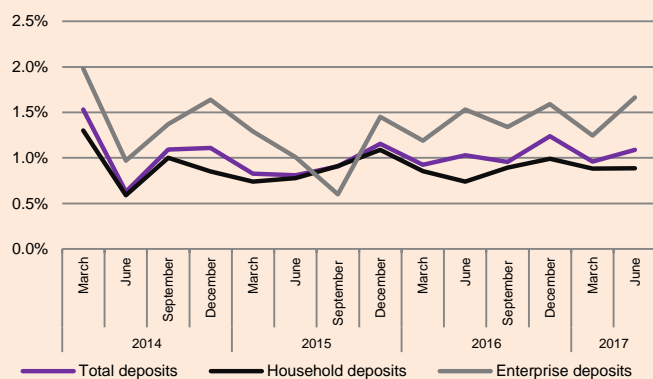
Source: CBK (2017)

Within loans to households, the average interest rate on consumer and mortgage loans continued to follow a declining trend, while loans with favorable conditions marked an increase.

Interest Rates on Deposits

The average interest rate on total deposits marked a slight increase compared to the same period of the previous year (figure 26).

Figure 26. Average interest rate on deposits

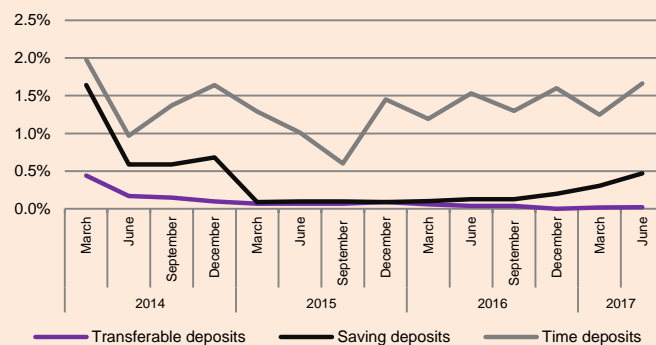


Source: CBK (2017)

Interest rate on enterprise deposits increased to 1.7 percent from 1.5 percent as it was in the same period of the previous year. More specifically, an increase was marked on interest rates

of saving and time deposits of enterprises with 0.3 and 0.1 percent, respectively (figure 27).

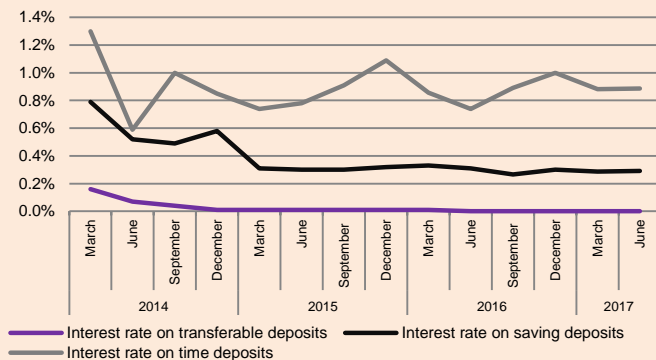
Figure 27. Average interest rates on enterprise deposits, by category



Source: CBK (2017)

Also, the average interest rate on household deposits marked an increase of 0.1 percentage points compared to the previous year.

Figure 28. Average interest rate on household deposits, by categories



Source: CBK (2017)

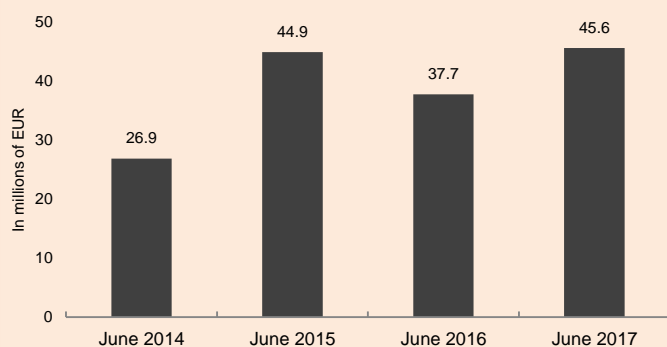
Average interest rates of transferable and saving deposits marked a slight decline, while the average interest rate on time deposits marked a slight increase (figure 28).

Performance of the Banking Sector

The profit of the banking sector marked a significant increase compared to the previous year, as a result of the increase of income and the decline of expenses of the sector.

The profit value realized until June 2017 was EUR 45.6 million, representing an annual increase of 20.8 percent (figure 29).

Figure 29. Net profit of the banking sector, in millions of EUR

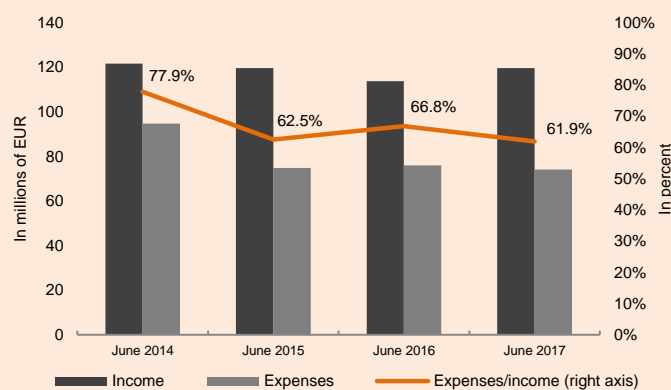


Source: CBK (2017)

Banking sector income interrupted their declining trend by which were characterized during the four recent years (figure 30). Until June 2017, the value of income reached EUR 119.7 million, thus marking an annual increase of 5.2 percent. The increase of income is mainly attributable to the increase of non-interest income, namely the increase of fees and commissions and other operations income. Whereas, interest income marked a slight decline, especially the interest income from loans, as a result of the decline of the average interest rates on loans.

The value of total expenses of the banking sector reached EUR 74.1 million, representing an annual decline of 2.5 percent (figure 30).

Figure 30. Income and expenses of the banking sector



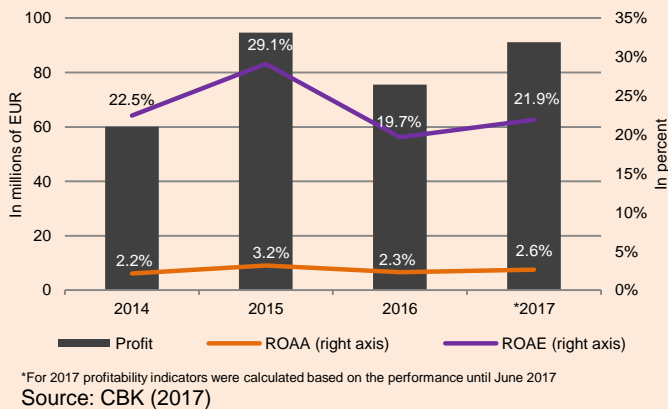
Source: CBK (2017)

The decline of total loans was a result of the decline of non-interest expenses, and to some extent of interest expenses. Within the category of non-interest expenses, the decline was due to the shrinkage of loan loss provisions. The decline of the category of interest expenses was a result of the decline of interest expenses of customers deposits.

Expenses to income ratio of the sector marked an improvement, dropping to 61.9 percent, mainly as a consequence of the improvement of banks performance in collecting income and due to a better management expenses (figure 30).

Return on Average Assets (ROAA) and Return on Average Equity (ROAE) marked a slight decline compared to the same period of 2016. The increase of these two indicators was mainly attributed to the annualized profit (figure 31).

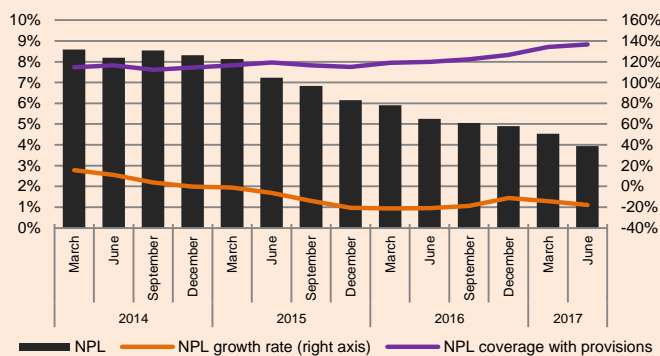
Figure 31. Profitability indicators of the banking sector



Financial Soundness Indicators

Until June 2017 the banking sector recorded a decline of nonperforming loans, and an improvement of their coverage with provisions. The level of nonperforming loans declined to 3.9 percent, representing a low rate compared to Western Balkans and euro area (figure 32).

Figure 32. Indicators of credit portfolio quality and NPL growth rate



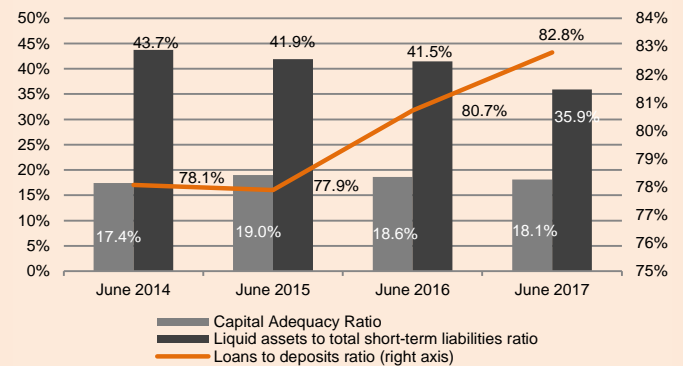
Source: CBK (2017)

Moreover, the level of the coverage of nonperforming loans with loan loss provisions increased at 136.6 percent.

Banking sector continued to have high level of capitalization, where the Capital Adequacy

Ratio stood at 18.1 percent in June 2017. The key liquidity indicator, being presented by the liquid assets ratio to total short-term liabilities, marked a decline compared to previous year.

Figure 33. Liquidity and solvency indicators



Source: CBK (2017)

This development was affected in one hand by the increase of short-term liabilities, which reflects the higher share of transferable deposits to total deposits, and the decline of liquid assets, as a consequence of shifting liquid assets to long-term assets. However, the banking sector continued to be characterized with a satisfactory level of liquidity (figure 33).

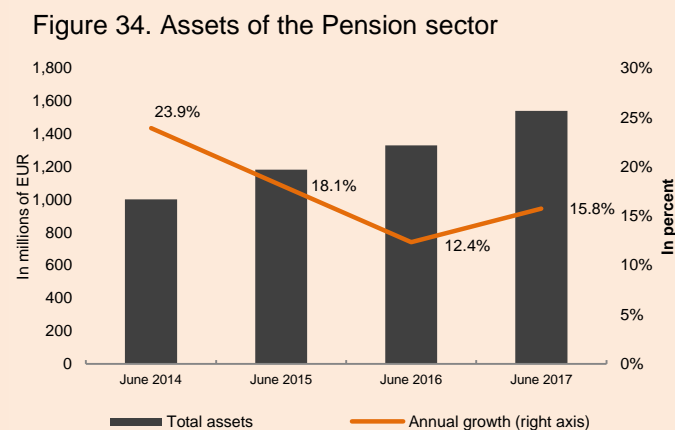
Until June 2017, the banking sector marked a significant increase of the profit as a result of the increase of income and decrease of expenses. NPL rate is quite low and the level of loan loss provisions is very high. Moreover, the banking sector continues to have high level of capitalization and satisfactory position level of liquidity.

Pension Sector

Until June 2017, pension sector marked an accelerated annual increase of assets with 15.8 percent. The total value of assets of pension sector

reached EUR 1.54 billion, representing the second largest sector within the financial system with 27.7 percent of total assets (figure 34). The increase of assets of pension sector may be attributed to the increase of new contributions and investments return during this period.

The value of new collections reached EUR 77.2 million, compared to the value of EUR 74.3 million in June 2016. The value of new collections of Kosovo Pension Saving Fund (KPSF) reached EUR 77.0 million, while the new collections of Slovenian-Kosovo Pension Fund (SKPF) amounted to EUR 244.3 thousands.



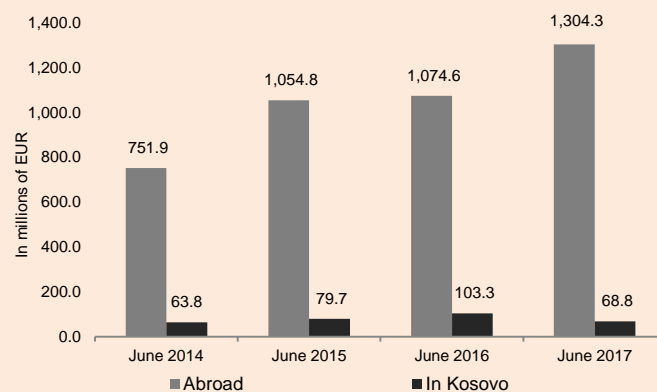
Source: CBK (2017)

Pension sector significantly increased the value of investments return reaching EUR 56.5 million, unlike the amount of investments return of EUR 33.6 million marked in the same period of the previous year. KPSF realized positive investments return of EUR 56.3 million, while SKPF investments return reached EUR 227.8 thousands. The improvement of the economic development indicators and profit realized by corporations in EU, USA, United Kingdom and Japan

had an impact on main indices which contribute to a significant increase of KPSF return investments. Moreover, also the reduction of political risk in EU gave its contribution to positive return on investments.

KPSF, which comprises 99.5 percent of total assets of the pension sector, changed its investment strategy compared to the previous year, by increasing investments abroad along with the decline of investments in Kosovo's Government Securities.

Figure 35. KPSF investments, in millions of EUR



Source: KPSF (2017)

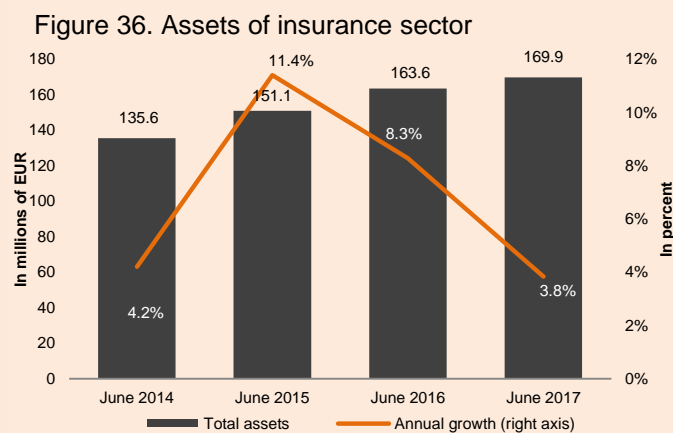
Investments abroad of the fund reached the value of EUR 1.3 billion (EUR 1.1 billion in June 2016), unlike investments in Kosovo's Government securities which declined to EUR 68.8 million (EUR 103.3 million in June 2016) (figure 35).

Pension sector until June 2017 marked an accelerated annual increase of assets. The positive investments return and the increase of new contributions were two key indicators which affected this increase. The sector oriented its investments in common investment funds abroad, resulting in a decline of investments in Kosovo's Government securities.

Insurance Sector

Insurance sector which comprises around 3.0 percent of total financial system assets, in June 2017 marked a slowdown annual increase of 3.8 percent (figure 36). One of the main contributors to assets growth of the insurance sector was the increase of cash held at commercial banks, which comprises the highest share in the structure of assets of insurance companies.

Non-life insurances, which represent the largest part of the sector with 90.0 percent of total assets, marked an annual growth of 3.3 percent. While the remainder of the sector being presented by “life” insurances increased annually by 8.4 percent.



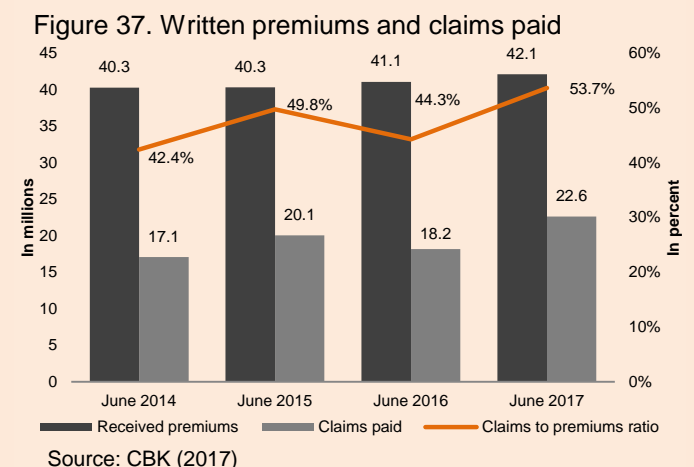
Source: CBK (2017)

Until June 2017, the value of written premiums of insurance companies reached the value of EUR 42.1 million, representing an annual increase of 2.5 percent. The structure of written premiums is led by non-life insurance, which account for 96.9 percent of total written premiums. The realized value of written premiums from non-life insurance reached EUR 40.8 million, in June 2017, marking an annual increase of 2.7 percent. Whereas,

the value of written premiums of life insurance reached the value of EUR 1.3 million, marking an annual decline of 2.9 percent.

Claims paid by the insurance sector, which account for claims of insurance companies and Kosovo Insurance Bureau (KIB) reached EUR 22.6 million in June 2017 (EUR 18.2 million in June 2016), representing a significant annual increase of 24.4 percent.

The lower increase of received premiums during this period along with the higher increase of claims paid, had an impact on the increase of total claims paid to written premiums ratio, implying a higher burden for insurance companies, given that more than half of the income realized from premiums is designated to payments for incurred damages (figure 37).



Source: CBK (2017)

Performance of the Insurance Sector

Until June 2017 the insurance sector was characterized with positive performance unlike the same period of the previous year.

Net income of the insurance sector, in June 2017, reached a value of EUR 37.1 million, whereas expenses declined at EUR 20.9 million. The decline of expenses was reflected in an increase of the profit marked by the insurance sector which reached EUR 2.0 million until June 2017, compared to the loss of EUR 11.5 million marked in the same period of the previous year.⁵ The profit increase is mainly attributed to the increase marked within “non-life” insurance (a profit of EUR 1.9 million), while the positive financial performance of “life” insurance reached EUR 158.8 thousands.

The annual increase of cash and its equivalents of 6.6 percent, compared to the higher increase of 10.7 percent of technical reserves of insurance sector, reflected on the deterioration of the liquidity level of the sector. The cash and cash equivalents to reserves ratio decreased at 94.2 percent in June 2017 (97.8 percent in June 2016), while cash and its equivalents to total liabilities ratio declined at 85.2 percent (86.3 percent in June 2016).

Insurance sector in June 2017 was characterized with an increase of assets. Financial performance of this sector was improved, reflecting in an increase of net income and profit, and a decline of expenses.

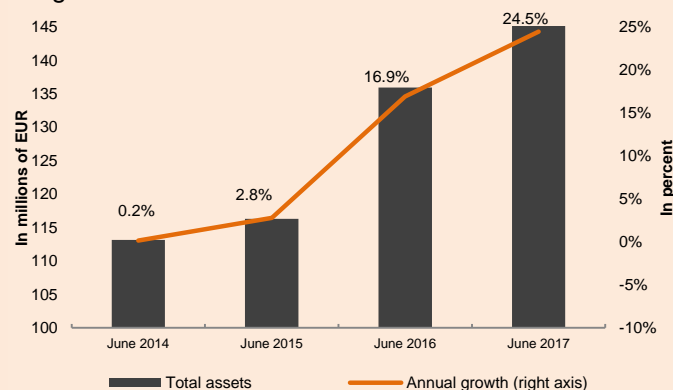
Microfinance Sector

Assets

Until the second quarter of 2017, assets of microfinance sector reached EUR 169.2 million, marking a significant annual increase of 24.5 percent (figure 38).

⁵ Based on data which were not audited.

Figure 38. Assets of the microfinance sector



Source: CBK (2017)

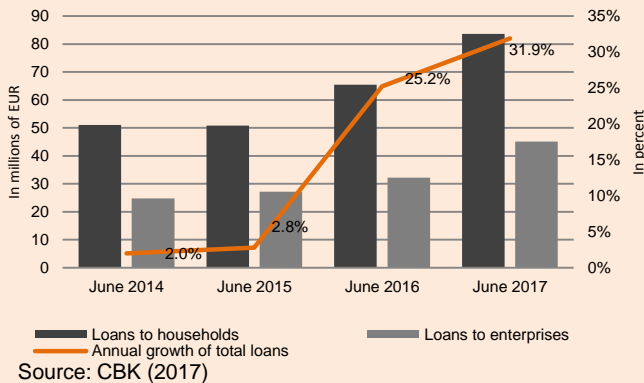
The main contributor to assets growth of the sector was the increase of gross loans, which mainly were financed by borrowings from the external sector, and which dominate the general structure of assets of the microfinance sector (76.1 percent).

Loans

Lending activity of microfinance sector during the first half of 2017 was characterized with an accelerated increase of the value of loans with 31.9 percent (figure 39).

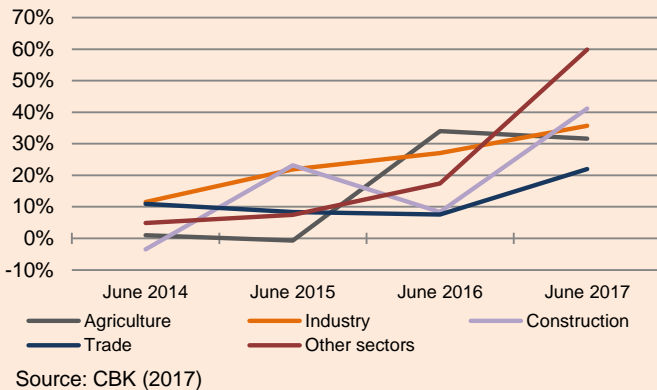
Households, which have a share of 64.9 percent to total loans of the sector, were characterized with an annual increase of 27.8 percent. Also, loans to enterprises which comprise 35.1 percent of total loans of the sector, marked an annual increase of 40.2 percent.

Figure 39. The value of loans to households and loans to enterprises, annual growth of loans



As regards to stock of loans to economic sectors, the category of “other sectors” marked the highest annual increase, followed by construction and industry (figure 40).

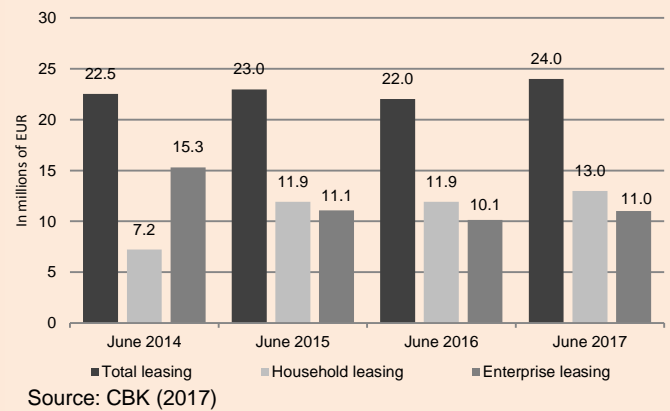
Figure 40. Growth rate of loans to enterprises, by economic sectors



Leasing

Until June 2017, leasing marked an annual increase of 8.9 percent, compared to the decline of 4.1 percent marked in the previous year (figure 41).

Figure 41. Microfinance sector leasing

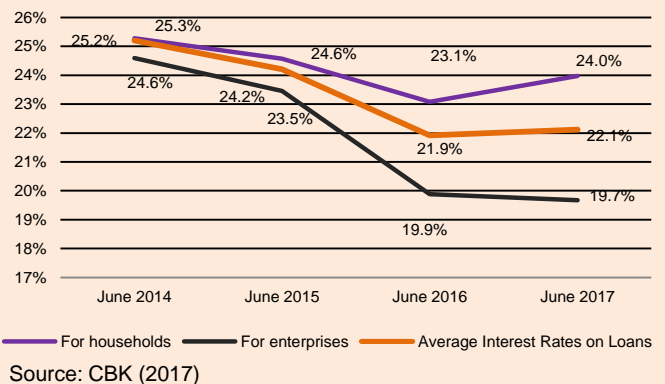


To the increase of leasing the contribution was given by “other leasing” and mortgage leasing, which marked an annual increase of 22.6 and 4.4 percent, respectively.

Interest Rates

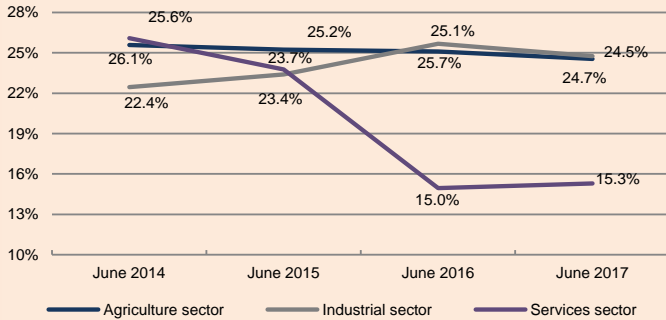
The average interest rate on microfinance sector loans, in June 2017, increased slightly to 22.1 percent.

Figure 42. Average interest rate on microfinance sector loans



Interest rate on loans to households increased by 0.9 percentage points, while the interest rate on loans to enterprises was characterized with a decline of 0.2 percent (figure 42).

Figure 43. Average interest rate on loans, by economic sectors



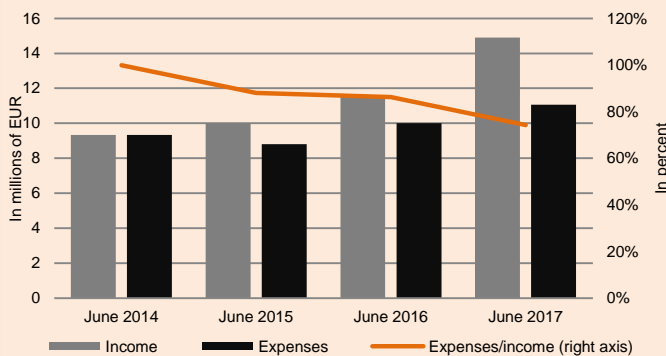
Source: CBK (2017)

Within loans to enterprises, services sector results to have the lowest interest rate on loans. While, industry sector, despite the decline, continued to have the highest interest rate on loans (figure 43).

Performance of the Microfinance Sector

Microfinance sector realized a profit of EUR 3.9 million by June 2017, compared to the profit of EUR 1.6 million realized in the same period of the previous year.

Figure 44. Microfinance sector income and expenses



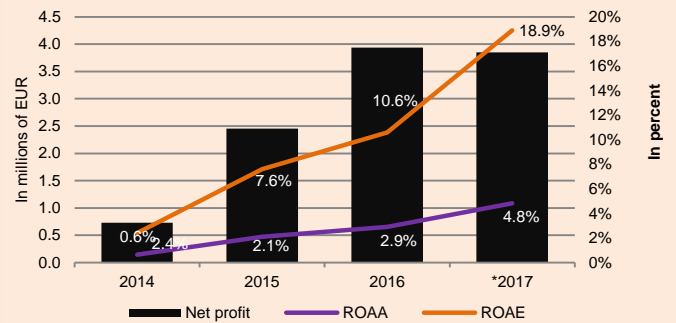
Source: CBK (2017)

The highest increase of income (mainly the increase of interest income) alongside with the lower increase of

expenses had an impact on the higher profit realized in this period (figure 44).

As a result of the positive financial performance during the first quarter of 2017, profitability indicators marked an improvement (figure 45).

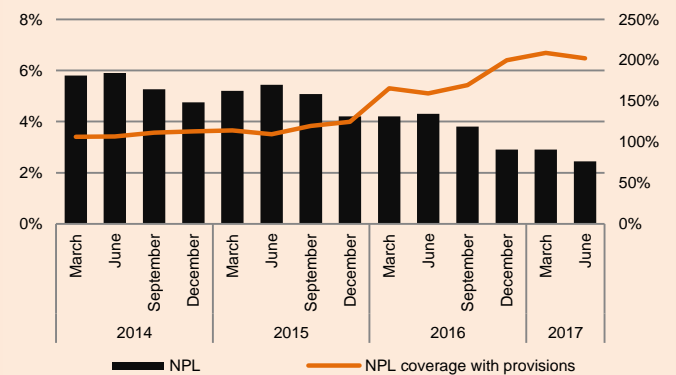
Figure 45. Profitability indicators of microfinance sector



*For 2017 the profit was annualized based on the performance until June 2017
Source: CBK (2017)

The level of nonperforming loans to total loans ratio of the sector, in June 2017, marked a decline of 1.9 percentage points against the previous year, dropping to 2.5 percent, showing the lowest level in recent years (figure 46).

Figure 46. Indicators of credit portfolio quality



Source: CBK (2017)

Moreover, the coverage level of nonperforming loans with loan loss provisions increased significantly to 202.6 percent, mainly impacted by the decline of nonperforming loans value (figure 46).

Microfinance sector was characterized with an accelerated increase of assets in the first half of 2017. Total loans continued to mark an increase, while the average interest rate changed the direction of declining trend and increased slightly. The sector marked a significant profit increase, while also the quality of credit portfolio improved significantly.

Securities Market

According to the calendar published by the Ministry of Finance, until June 2017 the number of auctions of Kosovo’s Government securities reached 10. The announced amount in auctions reached EUR 220.0 million.

Compared to the same period of the previous year, the issued number and value of treasury bills declined, whereas the value and number of issued treasury bonds increased. Whereas, until June 2017, the number and the value of issued treasury bills and of treasury bonds was the same for both of them (table 2).

Table 2. The number and value of securities issued by Kosovo’s Government

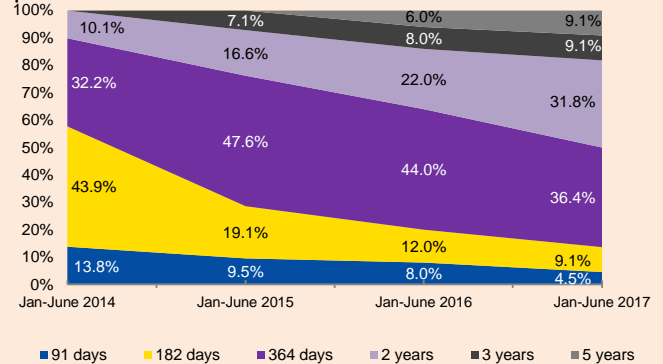
Period	Number of treasury bills	Announced amount of treasury bills	Number of bonds	Announced value of treasury bonds
Jan-June 2014	9	200.0	2	22.0
Jan-June 2015	8	160.0	3	55.0
Jan-June 2016	7	160.0	4	90.0
Jan-June 2017	5	110.0	5	110.0

Source: MF (2017)

As regards to maturity, the structure of securities of Kosovo’s Government shows a shifting trend from securities with short-term maturity (364

days) to securities with long-term maturity (2 years).

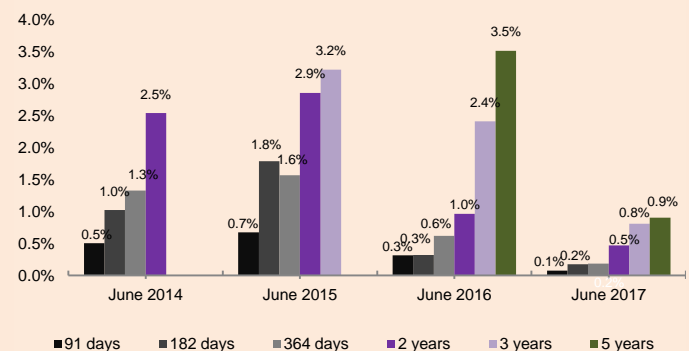
Figure 47. Structure of Government securities, in percent



Source: CBK (2017)

The main category in the structure of securities continued to remain treasury bills category with a maturity of 364 days, being followed by treasury bonds with a maturity of two years, which was the category with the highest increase until June 2017 (figure 47).

Figure 48. Interest rates on Government securities by maturity, in percent



Source: CBK (2017)

The bidding amount of participants exceeded the amount announced by the Ministry of Finance for 1.71 times (2.21 in June 2016). In the first half of 2017, it was observed a decline of the offer and at the same time a decline of Kosovo’s Government issued securities.