

Summary

Financial system was characterized with strengthening of the performance in all its constituent sectors in 2017. Banking sector and pension sector continued to give the main contribution to total assets growth of the system. Banking sector was characterized with an increase of its credit activity and a satisfactory level of indicators which measure the health of the sector. In the fourth quarter of 2017, assets of the banking sector expanded for EUR 66.1 million, mainly as a result of the increase of credit activity which was supported by credit supply conditions offered by banks. The economic sectors which were credited more in this period were trade and construction, while within households consumer loans marked a higher increase.

Lending increase continued sustainably to be financed by deposits collected within the country's economy, which in the fourth quarter of 2017 increased by EUR 45.6 million.

In the fourth quarter of 2017, interest rates on loans continued to be characterized with a declining trend, while interest rates on deposits marked a slight annual increase. Interest rate on loans, in the fourth quarter of 2017, stood at 6.8 percent, while interest rate on deposits reached 1.1 percent.

Banking sector was characterized with a satisfactory financial performance in the fourth quarter of 2017, realizing a net profit of EUR 16.2 million. In this period, the banking sector marked an increase of the income generated, which primarily reflect the increase of non-interest income. Total expenses during this period marked an increase mainly coming from a rise of general and administrative expenses.

Banking sector marked an improvement of the key financial health indicators. At the end of 2017, nonperforming loans stood at the rate of 3.1 percent while their coverage with loan-loss provisions was 150.5 percent.

The Capital Adequacy Ratio of the banking sector reached 18.0 percent (the level required by the CBK is 12.0 percent), and a satisfactory liquidity level of 38.2 percent (the level required by the CBK is 25.0 percent).

With an increase of the activity and improved performance were characterized also other segments of the financial system.

The pension sector recorded an increase of assets which was reflected also in an increase of the assets weight of the financial system. In the fourth quarter, this sector was characterized with a positive growth trend of new contributions and a considerable return on gross investments.

Pension sector significantly improved also the performance activity during this quarter which was characterized with a financial positive result. More specifically, the factors which had an impact on the insurance sector improvement were represented by increase of net premiums income, the decline of claims occurred and the efficient management of expenses of the sector.

Microfinance sector continued to increase its activity, hence, also the fourth quarter was characterized with a significant increase of assets as a result of the considerable increase of loans of the sector. At the same time, the dynamic of this sector and the considerable increase of income enabled marking a double profit in the fourth quarter of 2017.

Securities market was characterized with a higher issuance of Kosovo's Government securities, an average increase of the maturity, a higher demand to invest in securities, and a higher overall average rate compared to the same period of the previous year.

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

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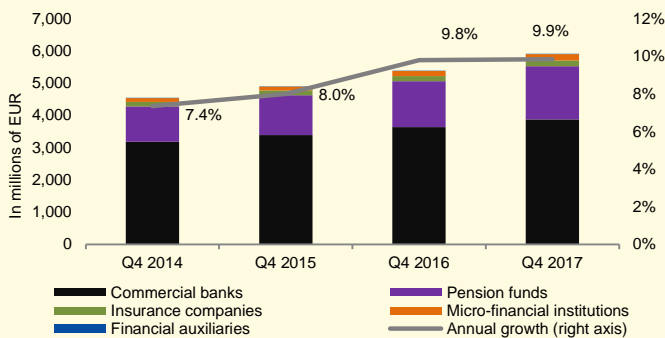
ABBREVIATIONS

CAR	Capital Adequacy Ratio
CBK	Central Bank of the Republic of Kosovo
CHF	Swiss Franc
EUR	Euro currency
FDI	Foreign Direct Investments
GBP	British Pound
GDP	Gross Domestic Product
IMF	International Monetary Fund
KAS	Kosovo Agency of Statistics
MF	Ministry of Finance of the Republic of Kosovo
NPL	Nonperforming loans
REER	Real Effective Exchange Rate
ROAA	Return on Average Assets
ROAE	Return on Average Equity
RWA	Risk-Weighted assets
SEE	Southeastern Europe
USD	American Dollar
WEO	World Economic Outlook

Financial System

The expansion of assets of financial system continued to be a result of the increase of the banking and pension sectors. Other sectors continued to have low contribution in expanding assets of the financial system.

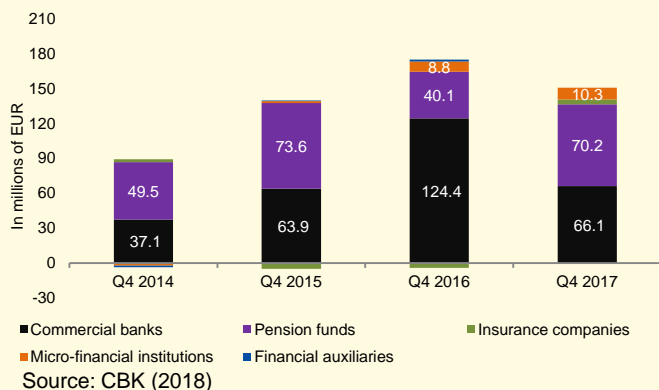
Figure 1. Assets value of Kosovo's financial system



Note: The data are as at end of the noted quarter
Source: CBK (2018)

At the end of the fourth quarter of 2017, the value of total assets of the Kosovo's financial system reached EUR 5.92 billion, corresponding to an annual increase of 9.9 percent (figure 1).

Figure 2. Quarterly change of assets of financial system constituent sectors



Source: CBK (2018)

Figure 2 depicts that *the banking and pension sectors* continued to have the main contribution to assets

increase of the constituent sectors of financial system on quarter basis.

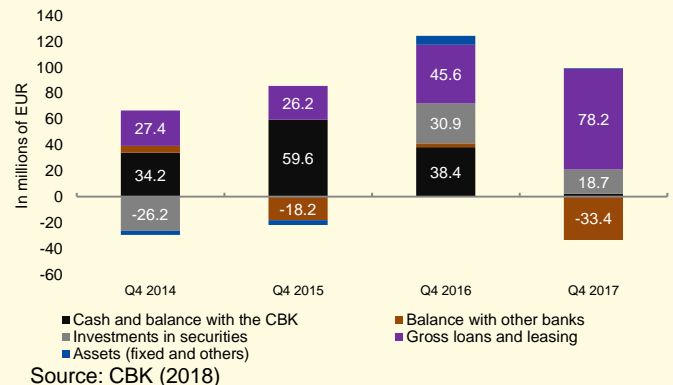
Banking Sector

Banking sector continued to be characterized with an accelerated increase of its credit activity, good financial performance and a satisfactory level of indicators which measure the health of the sector.

Assets

Assets of the banking sector, in the fourth quarter of 2017, increased by EUR 66.1 million, thus reaching a value of EUR 3.88 billion. The main contribution to assets increase of the banking sector, for the second consecutive year continued to be marked by credit activity. Investments in securities were ranked as the second contributor by importance to assets growth of the sector, in the fourth quarter of 2017.

Figure 3. Quarterly change of assets structure of the banking sector



Source: CBK (2018)

Whereas, the balance with commercial banks was the only category which marked a decline in this quarter (figure 3), mainly being impacted by negative rates on

deposits, applied by banks operating abroad (around 96.2 percent of this category was invested in banks abroad).

In the fourth quarter of 2017, securities stock increased by EUR 18.7 million (an increase of EUR 30.9 million, in the fourth quarter of 2016) and reached EUR 486.7 million. The slowdown increase of investments in securities reflects the general slowdown trend of assets of the banking sector, in the fourth quarter of 2017, compared to the correspondent period of 2016. Moreover, the slowdown increase of investments in securities is attributed also to the concentration of banks' investments on credit activity, as a more profitable instrument. Low rates of return from securities may have had an impact on shifting banks' investments from securities towards credit activity. In addition, the liquidity of the banking sector is at a satisfactory level, which may have influenced banks to invest more in crediting.

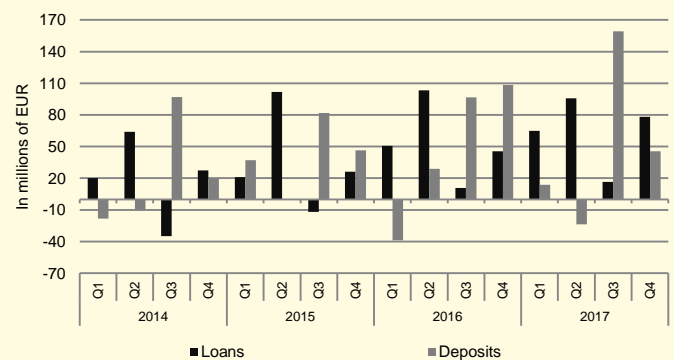
Cash and balance with the CBK marked a considerable slowdown at EUR 2.2 million in the fourth quarter of 2017 (from the increase of EUR 38.4 million marked in the fourth quarter of 2016), reaching the value of EUR 499.3 million. The slowdown increase of this category mainly is attributable to developments in the category of the balance with the CBK, namely deposits of the banking sector, which during the current quarter, marked a significant annual slowdown increase. Applying of negative interest rates (of -0.40 percent) on banks reserves which exceed the obligatory level of 10.0 percent, as at end of the second quarter of 2016 may

have had an impact on the level of reserves held at the CBK.

Loans

Loans issued by the banking sector marked an accelerated increase during the whole year of 2017, including the fourth quarter of 2017. The banking sector issued loans to domestic economy with an amount of EUR 78.2 million in the fourth quarter of 2017, representing significantly higher value than EUR 45.6 million marked in the fourth quarter of 2016, reaching the amount of EUR 2.49 billion (figure 4). An impact to the increase of active loans was marked by new loans issued to enterprises (which increased by EUR 65.9 million on annual basis, in the fourth quarter of 2017, and reached the value of EUR 218.3 million) and new loans to households as well (which increased by EUR 46.0 in the fourth quarter of 2017, reaching the value of EUR 143.9 million.

Figure 4. Quarterly change of loans and deposits of the banking sector

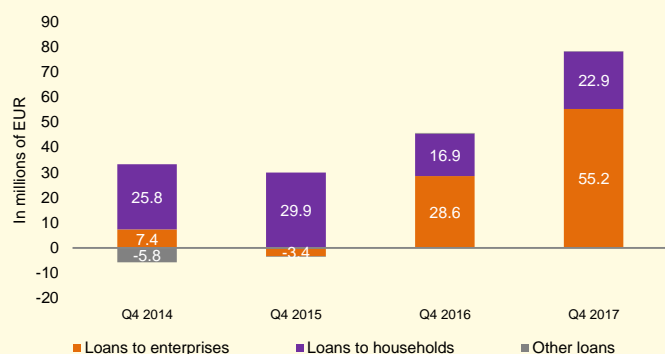


Source: CBK (2018)

Developments in the stock of active loans and new loans, among others, were impacted by eased supply side applied by banks through improving credit terms and conditions for both economic categories.

Loans to enterprises, in the fourth quarter of 2017, increased by 55.2 million, reaching a value of EUR 1.58 billion (figure 5).

Figure 5. Quarterly change of credit structure of the banking sector



Source: CBK (2018)

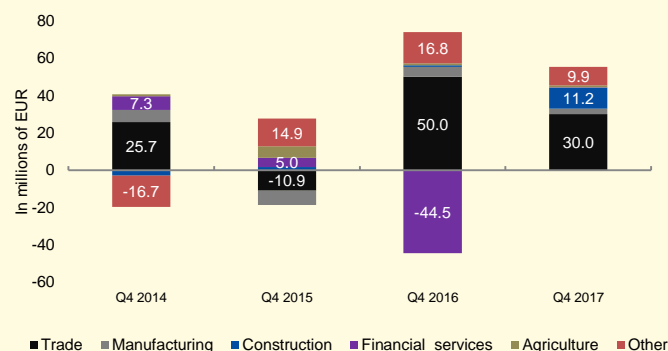
Within *loans to enterprises*, sectors of trade and construction marked the highest annual increase in the fourth quarter of 2017. Loans to *trade sector*, which dominate the structure of total loans to *enterprises*, were characterized with a slower annual increase of EUR 30.0 million in the reporting period (an increase of 50.0 million in the fourth quarter of 2016) reaching the value of EUR 785.8 million. Conversely, lending to *construction sector* accelerated its increase, where in the fourth quarter of 2017 loans intended for this sector increased by 11.2 million amounting to EUR 136.4 million.

During this period, loans to *agriculture sector*, *manufacturing* and *other services* marked an increase, albeit standing considerably at lower levels compared to the same period of the previous year.

Loans to Households, in the fourth quarter of 2017, increased by 22.9 million, reaching a value of EUR 897.6 million. This increase, among others, reflects the trend of *new loans* granted by banks during this

period. More specifically, *new loans* designated for *consumption*, during this period, marked an increase of EUR 106.0 million, or EUR 38.0 million more than the value in the fourth quarter of 2016.

Figure 6. Quarterly change of credit structure by economic activity



Source: CBK (2018)

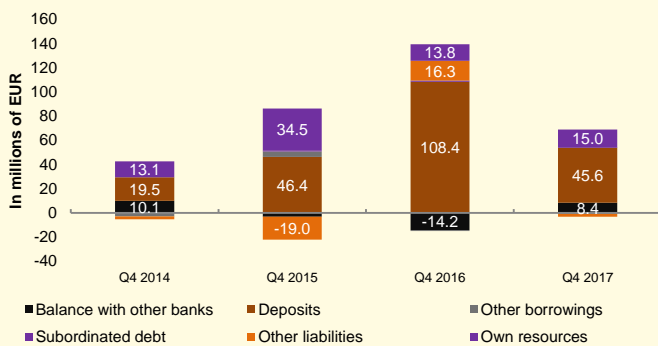
Meanwhile, new mortgage loans marked an increase of EUR 24.5 million during this quarter, which comparing to the same period of the previous year, shows an increase of EUR 5.6 million. The value of loans granted for the purpose of consumption, in the last quarter of 2017 amounted to EUR 369.5 million, whereas new mortgage loans reached the value of EUR 91.2 million.

Liabilities and Own Resources

The structure of liabilities and own resources of the banking sector is dominated by *deposits*, which in the fourth quarter of 2017 were characterized with a slowdown increase compared to the trend marked in the fourth quarter of 2016. The second most important category, namely own resources, primarily as a result of the realized profit increase, marked a growth of EUR 1.2 million compared to the fourth quarter of 2016 amounting to EUR 15.0 million. The other categories have not marked significant changes

within the structure of total liabilities and own resources in the fourth quarter of 2017 (figure 7).

Figure 7. Quarterly change of liabilities structure and own resources



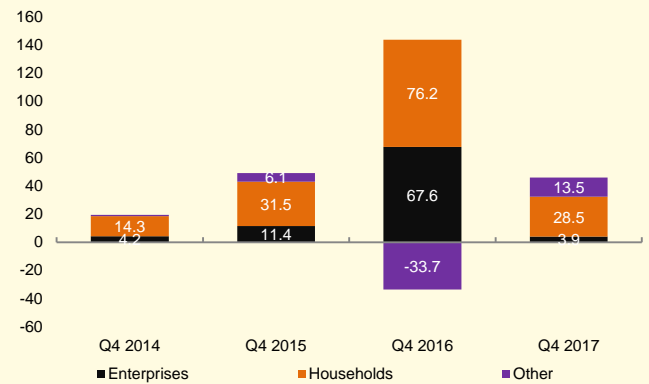
Source: CBK (2018)

Deposits

Deposits in the Kosovo's banking sector increased by EUR 45.6 million, in the fourth quarter of 2017, thus reaching the total amount of EUR 3.09 billion, compared to the growth of EUR 108.4 million marked in the previous year. The slower increase within deposits mainly reflects the developments in enterprise deposits, which decreased by EUR 63.7 million dropping to EUR 3.9 million in the fourth quarter of 2017. Also, household deposits decreased by EUR 47.8 million compared to the fourth quarter of 2016, dropping to EUR 28.5 million in the fourth quarter of 2017 (figure 8).

These developments within enterprise deposits, and more specifically within household deposits, among others reflects low interest rates on deposits applied by banks.

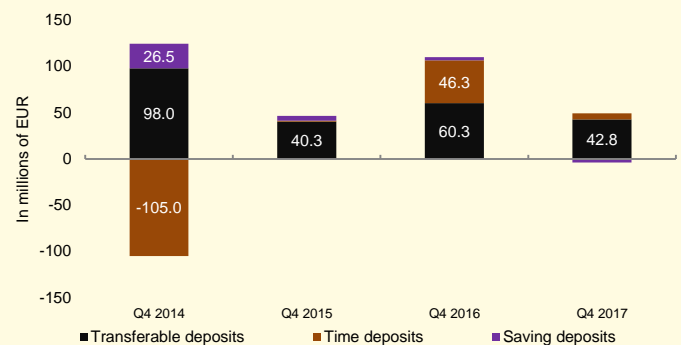
Figure 8. Structure of deposits, in percent



Source: CBK (2018)

Deposits by categories, namely transferable deposits increased by EUR 42.8 million, in the fourth quarter of 2017, compared to the increase of EUR 60.3 million marked in the fourth quarter of 2016.

Figure 9. Quarterly change of deposits structure



Source: CBK (2018)

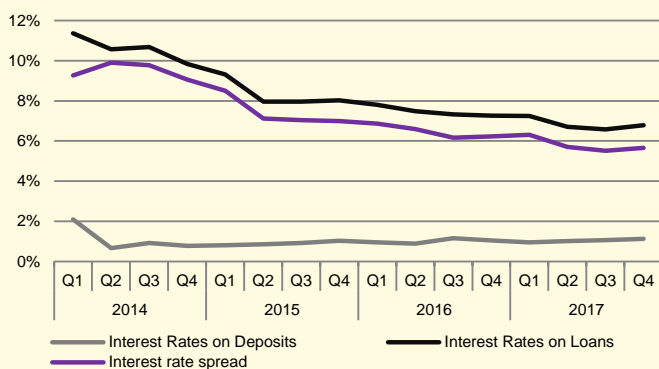
Time deposits, which are more sensitive to interest rates, taking into account low interest rates applied by banks, contracted by EUR 39.7 million compared to the fourth quarter of 2016, standing at the value of EUR 6.6 million in the fourth quarter of 2017. Meanwhile, saving deposits, which comprise the category with the lower weight within total deposits, was the only category that marked a decline in the

fourth quarter of 2017, decreasing by EUR 3.7 million during this quarter (figure 9).

Interest Rates¹

In the fourth quarter of 2017, interest rates on loans continued to be characterized with a declining trend, while interest rates on deposits marked a slight annual increase. The interest rate spread of loans and deposits continued to narrow, dropping down to 5.7 percentage points (6.2 percentage points in the fourth quarter of 2016).

Figure 10. Interest rate on loans and deposits



Source: CBK (2018)

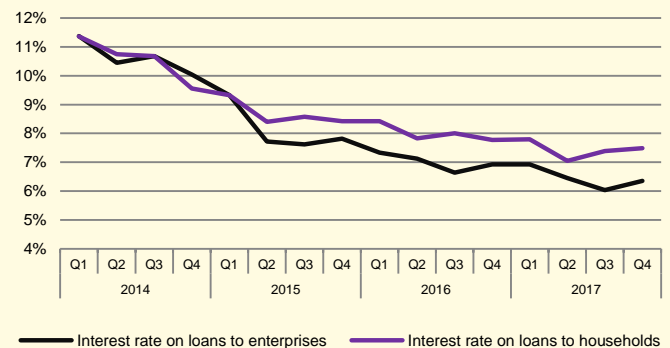
Interest rates on loans, in the fourth quarter of 2017, was decreased to 6.8 percent, while the average interest rate on deposits marked a slight increase reaching 1.1 percent compared to the fourth quarter of 2016 (figure 10).

Interest Rates on Loans

The interest rate on loans to enterprises decreased to 6.4 percent from 6.9 percent as it was in the fourth quarter of 2016 (figure 11).

All the categories of interest rates on loans to enterprises, in the fourth quarter of 2017, were characterized with an annual decline. The highest decline (0.7 percentage points) were marked in loans intended for investments, declining to 6.5 percent. In the reporting period, interest rates on loans intended for non-investment purposes had an interest rate of 6.2 percent. Other categories of interest rates applied to enterprises, such as overdrafts and credit lines had the same interest rates as in the previous year. Interest rates on loans with favorable conditions, namely cash over loans and other similar assets, continued to have quite low interest rates (2.5 percent in the fourth quarter of 2017).

Figure 11. Interest rate on loans to enterprises and to households



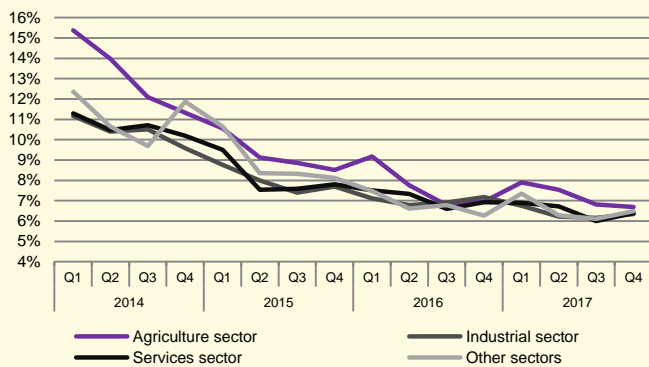
Source: CBK (2018)

Interest rates on loans to all economic sectors continued to mark a decline, albeit with slower pace compared to 2014 and 2015. In the fourth quarter of 2017, the lowest interest rate was marked by loans to industry sector, as a result of a more significant decrease of interest rates in 2017. Interest rates on loans to agriculture sector continue to be higher, albeit, if the recent years are observed it is noted a significant decline until the fourth quarter of 2017.

¹ The calculation of interest rates: quarter average of interest rates on loans and deposits. In the text it is referred as "the interest rates".

Interest rate on loans to industry sector, services and other sectors were significantly more favorable compared to loans to agriculture sector. The beginning of the implementation of KCGF², and guaranteeing loans to this sector may have encouraged banks to decline the interest rates on loans to agriculture businesses (figure 12).

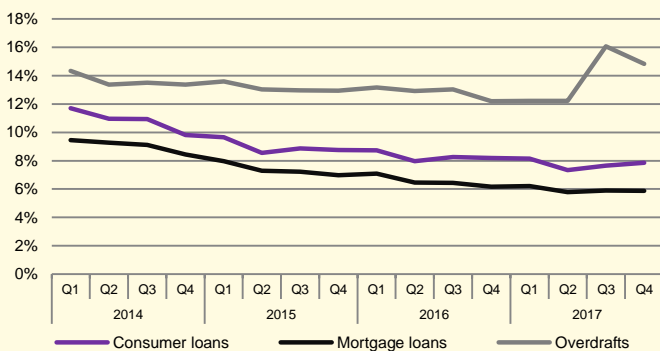
Figure 12. Interest rate on loans, by economic sectors



Source: CBK (2018)

Interest rates on loans to households followed the overall trend of interest rates applied by banks.

Figure 13. Average interest rate on loans to households, by purpose



Source: CBK (2018)

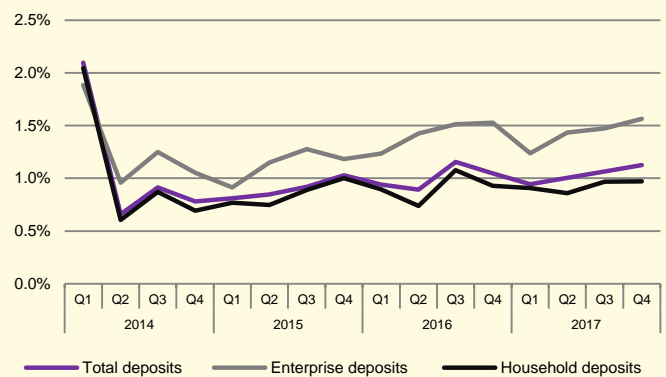
Interest rates applied to mortgage loans, continued to be more favorable due to their coverage with real estate. In the fourth quarter of 2017, interest rate

applied to consumer loans stood at 5.9 percent, representing a decline of 0.3 percentage points compared to the fourth quarter of 2016. Interest rates applied to consumer loans are significantly higher with an average of 7.8 percent, albeit, were characterized with an annual decline of 0.3 percent. Banks continued to have low interest rates on loans to households and enterprises, whereas high interest rates on the category of overdrafts. This category had an interest rate of 14.8 percent in the fourth quarter of 2017, marking an annual increase of 2.6 percentage points (figure 13).

Interest Rates on Deposits

Interest rates on deposits, despite the slight increase marked in the last year, continued to stand at low levels compared to periods before 2014 (figure 14).

Figure 14. Interest rates on deposits



Source: CBK (2018)

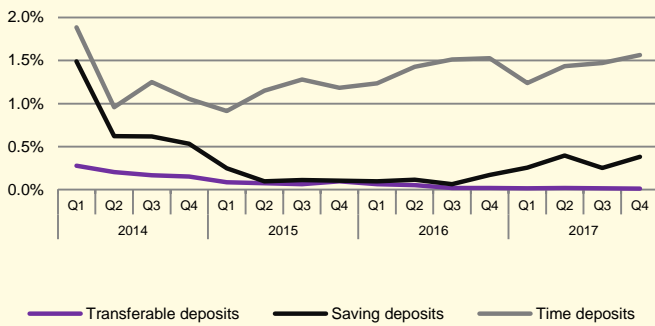
Interest rates on enterprise deposits continued to be more favorable compared to rates offered to households.

Interest rates on enterprise deposits stood at 1.6 percent in the fourth quarter of 2017, being characterized with an increase of 0.1 percentage points compared to the fourth quarter of the previous

² Kosovo Credit Guarantee Fund

year. More specifically, an increase was marked by interest rates on saving deposits (0.4 percent in the fourth quarter of 2017 from 0.2 percent in the fourth quarter of 2016). Interest rates on enterprise time deposits marked a slight increase while transferable deposits remained at similar levels as in the same period of the previous year (figure 15).

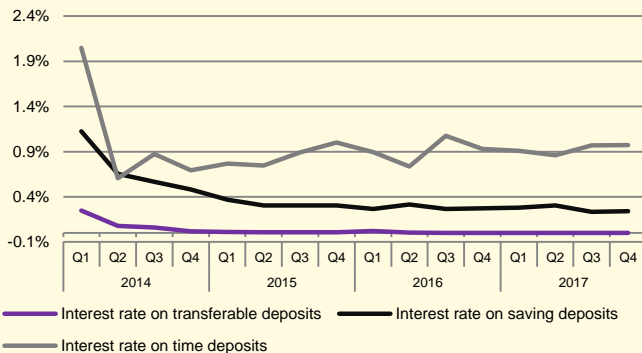
Figure 15. Interest rates on enterprise deposits, by categories



Source: CBK (2018)

Interest rates on household deposits continued to remain at quite low levels (1.0 percent in the fourth quarter of 2017) compared to the same period of 2014 (around 3.5 percent).

Figure 16. Interest rates on household deposits, by categories



Source: CBK (2018)

Rates applied to household deposits, in each quarter of 2017, are approximately the same as in the previous years' quarters (figure 16).

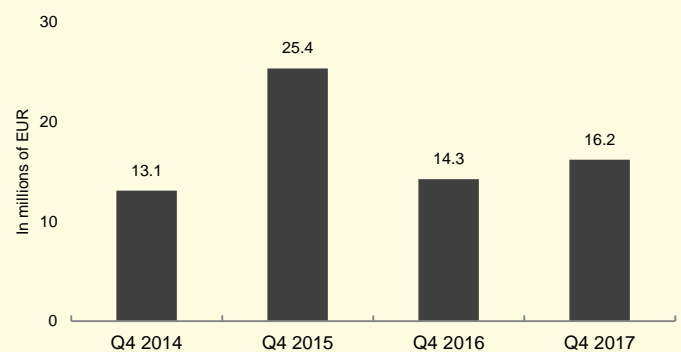
Therefore, interest rates on transferable deposits (0.002 percent), saving deposits (0.2 percent) and time deposits (1.0 percent) in the fourth quarter of 2017 are the same with the rates applied in the fourth quarter of 2016, and almost unchanged in the last three years.

Performance of the Banking Sector

Financial performance of the banking sector, in the fourth quarter 2017, was ranked as the second most efficient period since the beginning of the operation of Kosovo's banking sector. This good financial performance, compared to the fourth quarter of 2016, was a result of the higher income realized and the significant slowdown of expenditures.

The profit realized in the fourth quarter of 2017 reached EUR 16.2 million, which is for EUR 1.9 million more compared to the same quarter of the previous year (figure 17).

Figure 17. Net profit of the banking sector, in millions of EUR



Source: CBK (2018)

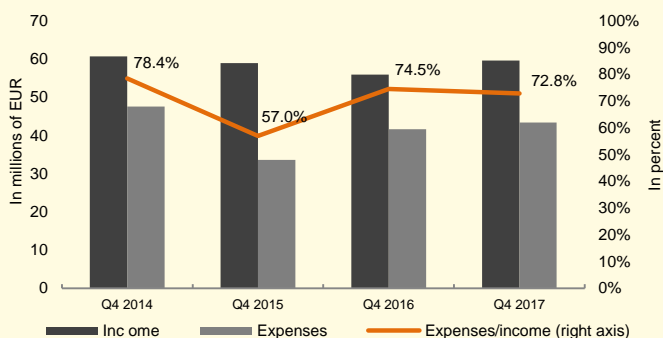
During the period of the fourth quarter of 2013 to the fourth quarter of 2016, banking sector income had marked a continuous decline, albeit, for the first time in the last five years, this declining trend was interrupted. Hence, in the fourth quarter of 2017, the income value reached EUR 59.6 million, representing an increase of EUR 3.7 million compared to the same period of the previous year (figure 18). The increase of income, during this period, is attributable to the increase of non-interest income, namely the increase of fees and commissions and the income from other operations. Interest income, which represent 75.2 percent of total income, after four consecutive years of declining trend, have marked an increase for the first year, which may have been impacted by the accelerated credit growth, despite the continuous decline of interest rates on loans.

Total value of expenditures of the banking sector, in the fourth quarter of 2017, reached EUR 43.4 million, representing an increase of 1.8 million compared to the last quarter of the previous year (figure 18).

increased by EUR 1.3 million in this quarter compared to the corresponding quarter of 2016. Non-interest expenses, was the category which marked the highest annual decline in the fourth quarter of 2017, as a result of the lower amount dedicated for loan loss provisions. This category decreased by EUR 4.5 million compared to the fourth quarter of 2016, falling to EUR 3.1 million. This decline is primarily a result of the improvement of credit portfolio quality and lower amount dedicated for loan loss provisions. Interest expenses, in the fourth quarter of 2017, were at the same level as in the corresponding period of the previous year. This came as a result of interest rates on deposits, which have not marked any significant changes compared to the previous period.

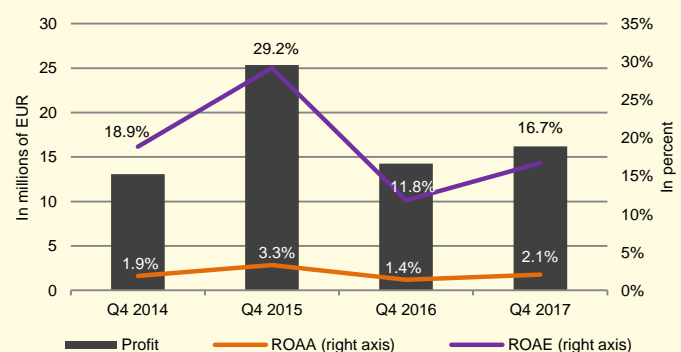
Cost to income ratio of the banking sector marked an improvement, declining at 72.8 percent in the fourth quarter of 2017 from 74.5 percent as it was in the previous quarter. This came as a result of income increase and a more efficient management of expenses by commercial banks operating in Kosovo (figure 18).

Figure 18. Income and expenses of the banking sector



Source: CBK (2018)

Figure 19. Profitability indicators of the banking sector



Note: ROAA and ROAE calculation for the appropriate quarter was annualized
Source: CBK (2018)

The main contributors to the growth of total expenses were general and administrative expenses, which

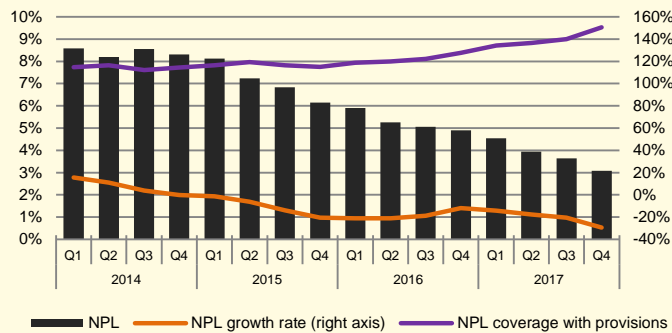
The more efficient financial performance of the banking sector in this quarter compared to the fourth

quarter of 2016, resulted in an improvement of two profitability indicators, namely Return on Average Assets (ROAA) and Return on Average Equity (ROAE). ROAA improved at 2.1 percent, while ROAE improved at 16.7, in the fourth quarter of 2017 (figure 19).

Financial Soundness Indicators

Banking sector continued to be characterized with a consistent decline of nonperforming loans in the recent years and an improvement of the coverage with loan loss provisions. The level of nonperforming loans, at the end of the fourth quarter of 2017, stood at 3.1 percent, representing a decline of 1.8 percentage points compared to the same period of the previous year (figure 20).

Figure 20. Indicators of loan portfolio quality and NPL growth rate



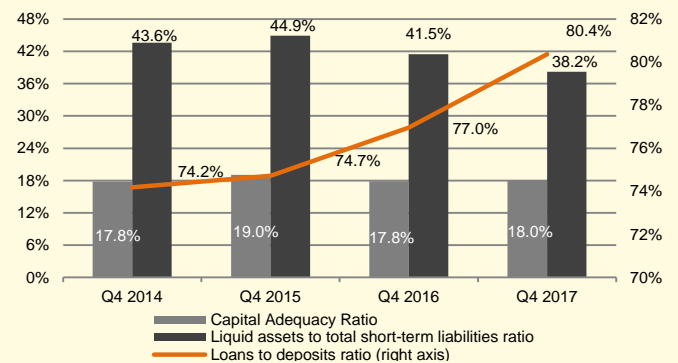
Note: The data are as at end of the noted quarter
Source: CBK (2018)

The coverage level of loans with loan loss provisions improved further by covering 50 percent more than required by the regulation, mainly as a result of the significant decline of the value of nonperforming loans until the fourth quarter of 2017.

Capital Adequacy Ratio has marked a slight improvement at the end of the fourth quarter of 2017,

compared to the same period of the previous year. This indicator was for 0.2 percentage points higher compared to the same period of the previous year. This was a result of the higher annual growth of the capital compared to the slower increase of risk weighted assets.

Figure 21. Liquidity and solvency Indicators



Note: The data are as at end of the noted quarter
Source: CBK (2018)

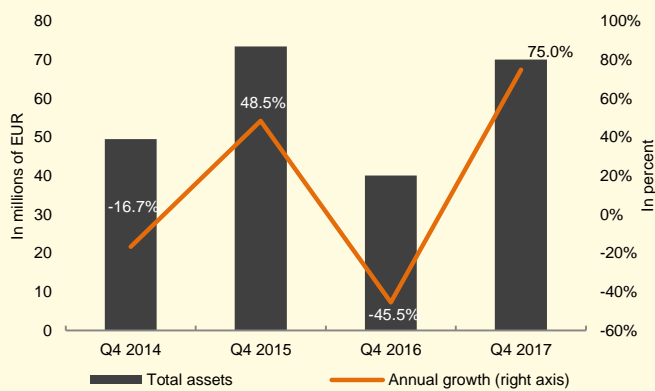
The key liquidity indicator, being presented by the liquid assets ratio to total short-term liabilities, marked a decline at the end of the fourth quarter of 2017 compared to the corresponding period of 2016. This decline was impacted by developments in banking credit activities, namely the increase of loans (a shrink of disposable liquid assets) and the shift of deposits in the category of transferable deposits (the increase of short-term liabilities) (figure 21).

Pension Sector

Positive trend of new contributions and gross returns of asset investments from pension funds have had an impact on the growth of this sector along the years.

Pension sector continued to be the second sector by the share of assets to financial system with 27.9 percent to total assets.

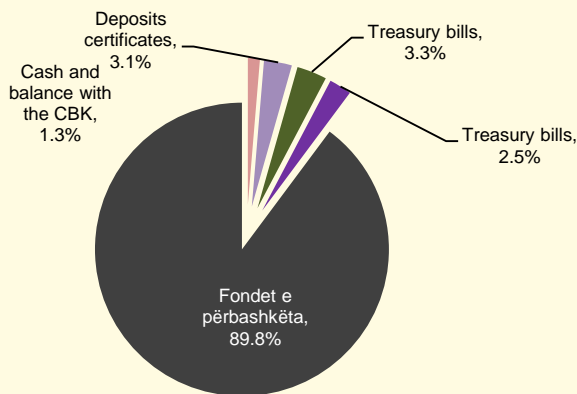
Figure 22. Assets of the pension sector



Source: CBK (2018)

Assets managed by this sector continued to grow also in the fourth quarter of 2017. Assets of pension funds increased by EUR 30.1 million compared to the fourth quarter of 2016 (figure 22).

Figure 23. Structure of KPSF assets (Q4 2017)



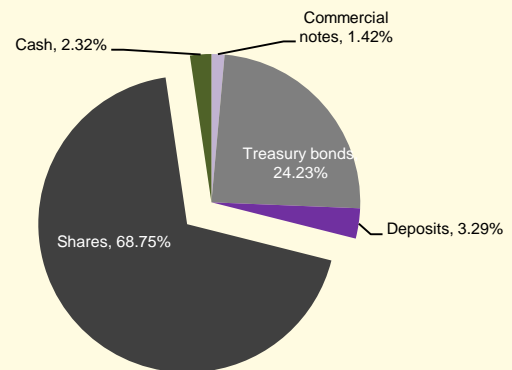
Source: KPSF (2018)

This increase was impacted by the higher investments abroad, which represents the component with the highest share of assets of the funds. More specifically, KPSF which comprises 99.5 percent of total assets of pension funds, marked an increase of 20.8 percent of

investments in Kosovo's Government securities, while the investment in common investment funds abroad increased by 13.4 percent.

Pension funds operating in Kosovo have a different assets investment strategy. KPSF follows a cautious strategy of investment, thus ensuring a diversification of the risk in common investment funds which are managed by assets management enterprises. Conversely, SKPF invested its assets mainly in shares abroad, followed by asset investments in securities in Kosovo and abroad, as well (figure 23 and 24).

Figure 24. Structure of SKPF assets (Q4 2017)



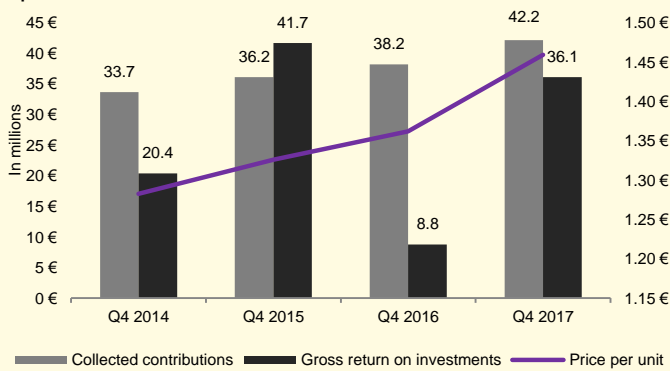
Source: SKPF (2018)

The expansion of assets was impacted by new collections, which in the fourth quarter of 2017 rose by EUR 4.0 million compared to the same quarter of the previous year, reaching EUR 42.2 million. Out of these collected contributions, 99 percent belong to KPSF, while the remainder is comprised of SKPF contributions. The increase of contributions mainly was impacted by the higher number of new contributors in this quarter compared to the same quarter of the previous year. In addition, the value of new collections may have been affected to some extent

also by the salary rise of public sector employees³, as the dominant sector in the labor market.

In this quarter KPSF managed to realize an investment return of EUR 36.1 million, representing a significant improvement with a gross return of 8.8 million of the fourth quarter of the previous year (figure 25). Meanwhile, SKPF marked a slowdown of gross returns from investments declining at EUR 179.2 thousands from EUR 257.7 thousands as it was in the fourth quarter of 2016.

Figure 25. Return on investments and KPSF performance



Source: KPSF (2018)

Financial markets in USA were characterized with positive fluctuations as a result of the fiscal facilities and the increase of GDP beyond projections. Government bonds market in euro area, during the fourth quarter, was characterized with a decline of interest rates. This development was impacted by the ECB decision to continue with the quantity easing program also in 2018 albeit with lower value, despite that the euro area suffered a more accelerated economic increase in the recent decade. However, positive developments in the USA and the investment strategy had an impact on the more efficient

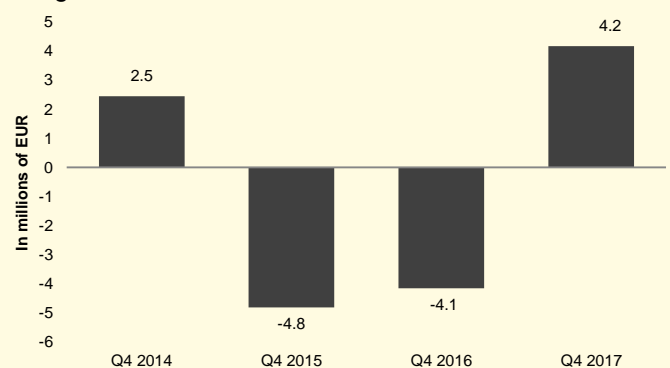
performance of pension sector, ensuring an increase of investment return value.

Insurance Sector

The increase of premiums net income, the decline of claims occurred and the more efficient management of expenses resulted in an improvement of the insurance sector statement, being characterized with a financial positive result.

Insurance sector was characterized with positive developments in the fourth quarter of 2017, marking an increase of assets, hence generating profits after a five-year period of financial losses.

Figure 26. Assets of insurance sector



Source: CBK (2018)

Assets of the insurance sector were influenced mainly by the increase of liquid assets, namely by increase of cash at commercial banks, which at the same time comprise the category with the highest share to total assets of the sector. During the fourth quarter of 2017, assets reached EUR 4.2 million, representing an annual increase of EUR 8.3 million compared to the fourth quarter of 2016 (figure 26).

³ KAS, Quarterly Bulletin, Q4 2017.

The trend movement of the whole sector is in line with “non-life” insurance developments, which comprises the majority of the sector’s total assets with 87.7 percent. Assets of this segment marked an annual increase of EUR 6.0 million in the fourth quarter of 2017 compared to the fourth quarter of 2016, whereas “life” insurance increased by 2.3 million. In addition, the fourth quarter marked the highest annual increase of total assets in 2017.

The value of written premiums of insurance companies, in the fourth quarter of 2017, reached EUR 20.8 million, representing an annual increase of 9.7 percent. Premiums of “non-life” insurance account for 97.1 percent of total written premiums structure. The realized value of written premiums from non-life insurance amounted to EUR 20.2 million in the fourth quarter of 2017 (an annual increase of 10.4 percent), while the value of written premiums from “life” insurance was characterized with an annual decline of 8.4 percent falling to EUR 641.4 million.

until the fourth quarter of 2016), representing a significant annual increase of 19.4 percent.

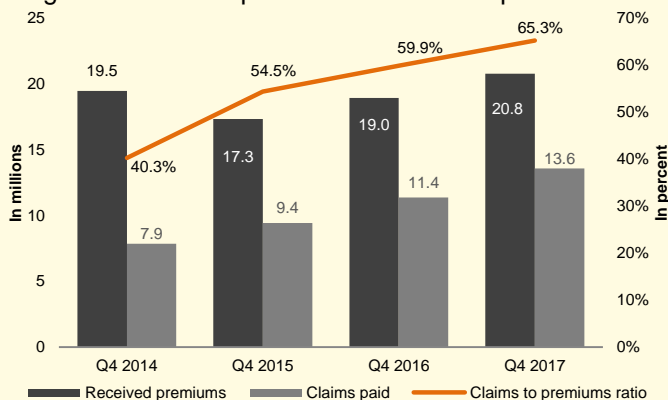
The written premiums of the sector which is dedicated to the payments processed for claims occurred was expanded in this quarter due to the higher increase of claims paid during this period alongside with the lower increase of written premiums. This ratio increased by 5.3 percentage points compared to the same period of the previous year, reaching 65.3 percent (figure 27).

Performance of the Insurance Sector

Insurance sector during the fourth quarter of the year was characterized with a positive performance and improvement of profitability indicators unlike in the previous year.

Net income from the premiums of the insurance sector, in the fourth quarter of 2017, marked an annual increase of 4.4 percent, while at the same time, expenses of the insurance sector and claims occurred were characterized with a significant annual decline of 14.7 and 74.0 percent, respectively. As a consequence of income increase against the significant decline of expenses and claims occurred, insurance sector in the fourth quarter of 2017 recorded a profit of EUR 3.7 million, against the loss of EUR 13.9 million in the same period of the previous year. The expenses decline of the sector in the reporting period may be attributed to some extent to measures undertaken by the CBK in the beginning of 2017, namely entering into force of the Regulation on the sale of compulsory motor liability insurance and the management of the expenses of insurers.

Figure 27. Written premiums and claims paid



Source: CBK (2018)

Claims paid by insurance sector and Kosovo Insurance Bureau (KIB), reached EUR 13.6 million until the fourth quarter of 2017 (EUR 11.4 million

The positive financial result was impacted also by the increase of claims paid processed by some non-life insurance companies and the amendment of the secondary legislation of the CBK in line with the legislative requirements within the Regulation of Compensation Fund. These measurements had an impact on decreasing technical reserves, thus narrowing expenses and increasing the profit.

Alongside with the positive developments and improvement of the sector's statement, liquidity position improved also during 2017. This improvement was impacted by the increase of cash and its equivalents (8.3 percent), and the decline of technical reserves (6.0 percent) which resulted in an increased ratio to 104.6 percent from 90.7 percent as it was in the fourth quarter of 2016. Other liquidity indicators marked an improvement as well, being impacted by the decline of total liabilities, thus reaching 91.6 percent of the ratio between cash and its equivalents to total liabilities from 83.1 percent as it was in the fourth quarter of 2016.

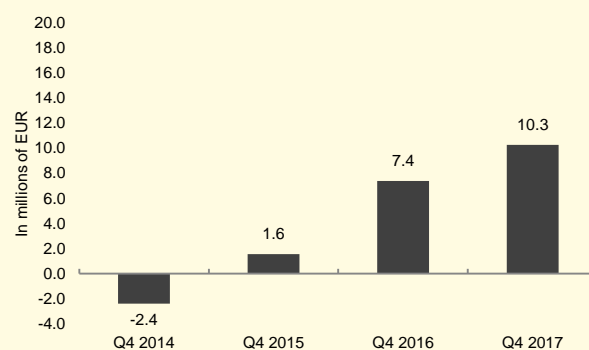
Microfinance Sector

Assets increase, primarily being impacted by the considerable increase of the sector's loans, and the increase of income resulted on the continuous growth of this sector.

Assets

Microfinance sector marked the highest increase among other sectors of the financial system during the fourth quarter of 2017. However, the share of this sector to total assets of the financial system remains low with around 3 percent.

Figure 28. Assets of the microfinance sector



Source: CBK (2018)

During the fourth quarter of 2017, the total value of assets of the microfinance sector reached EUR 10.3 million, marking a significant increase of 38.9 percent compared to the same quarter of the previous year (figure 28).

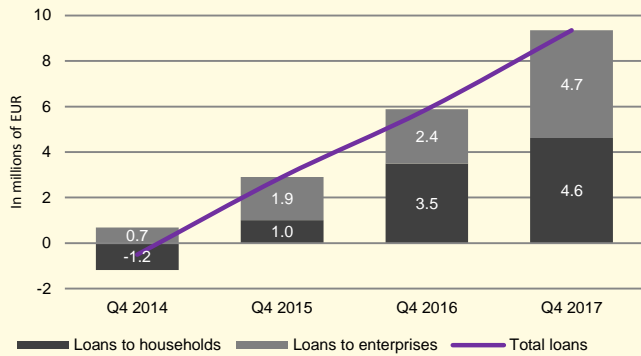
The expansion of microfinance sector mainly is attributed to the increase of credit activity, which primarily was financed by borrowings from external sector (67.2 percent of total assets).

Loans

The value of total loans issued by the microfinance institutions until the fourth quarter of 2017 reached EUR 9.4 million, representing an annual increase of 3.5 million (figure 29).

Households, which have a share of 64.1 percent to total loans of the sector, increased by EUR 1.1 million compared to the fourth quarter of 2016. Meanwhile loans to enterprises, which comprise 35.9 percent of total loans of the sector, marked an increase of EUR 2.3 million.

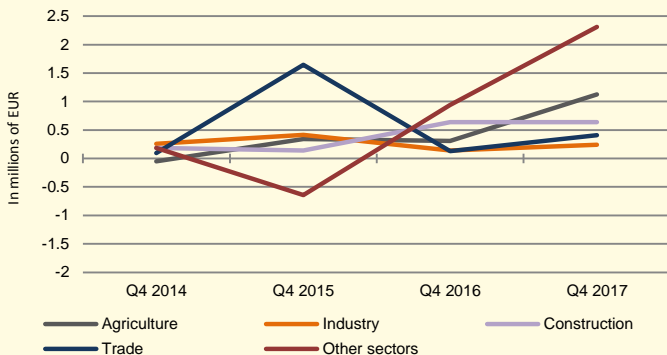
Figure 29. Value of loans to households and to enterprises, annual growth of loans



Source: CBK (2018)

As regards to lending to economic sectors, in the last three quarters of the year, it is worth noting, that for the third consecutive year, almost all economic sectors were characterized with an increase. The sectors with the highest increase were “other sectors”, being followed by agriculture sector (figure 30).

Figure 30. Value of loans to enterprises, by economic sectors



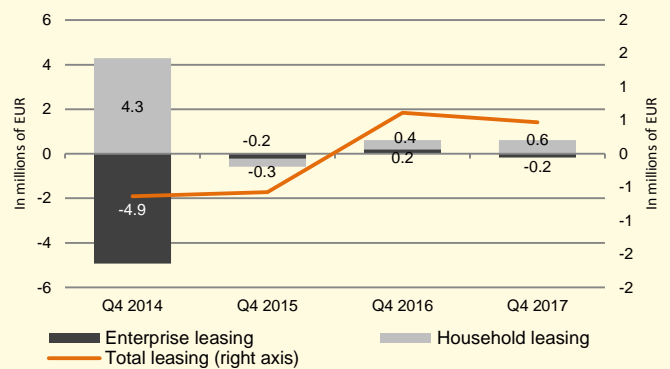
Source: CBK (2018)

Leasing

Leasing, during the fourth quarter of 2017, decreased to EUR 0.5 million, representing a decline of EUR 0.1 million compared to the same quarter of the previous year (figure 31).

The decline of leasing for equipment had an impact on the slight value decline of total leasing, while the category of “other leasing” (leasing to enterprises and households) and mortgage leasing (leasing to households) contributed in softening their decline.

Figure 31. Value of microfinance sector leasing

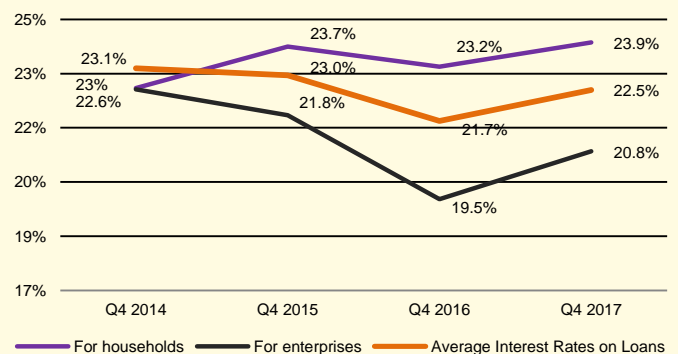


Source: CBK (2018)

Interest Rates

Average interest rates on loans changed direction unlike in the previous year, thus marking an increase in both categories and almost in all economic sectors, an increase which may be a reflection of operating expenses of microfinance institutions.

Figure 32. Average interest rate on microfinance sector loans

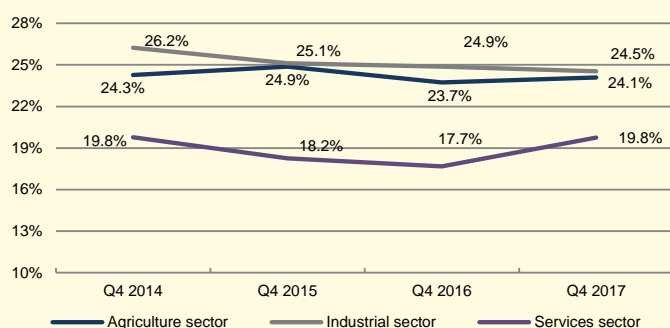


Source: CBK (2018)

During this quarter, the average interest rate increased to 22.5 percent, from 21.7 percent as it was in the fourth quarter of 2016.

Interest rate on loans to households marked a slight increase of 0.7 percentage points, whereas interest rate on loans to enterprises was characterized with an increase of 1.3 percentage points (figure 32). Within loans to households the average interest rate on consumer loans decreased by 0.2 percentage points, while the average interest rate on mortgage loans increased by 1.8 percentage points.

Figure 33. Average interest rate on loans, by economic sectors



Source: CBK (2018)

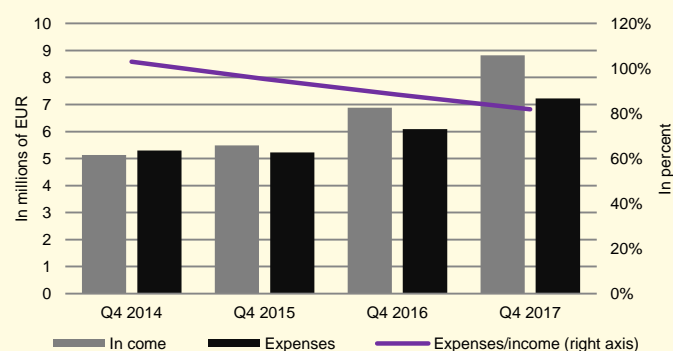
Within loans to enterprises, services sector results to have the lowest interest rate; however this sector marked a significant increase of 2.1 percent compared to the same period of the previous year. While, industry sector, continued to have the highest interest rate on loans despite the decline of 0.3 percentage points (figure 33).

Performance of the Microfinance Sector

The dynamic of the microfinance sector enabled the positive financial performance to continue also in the

fourth quarter of 2017. This sector doubled its profit to EUR 1.6 million compared to the profit of EUR 0.8 million marked in the fourth quarter of 2016 (figure 34).

Figure 34. Microfinance sector income and expenses



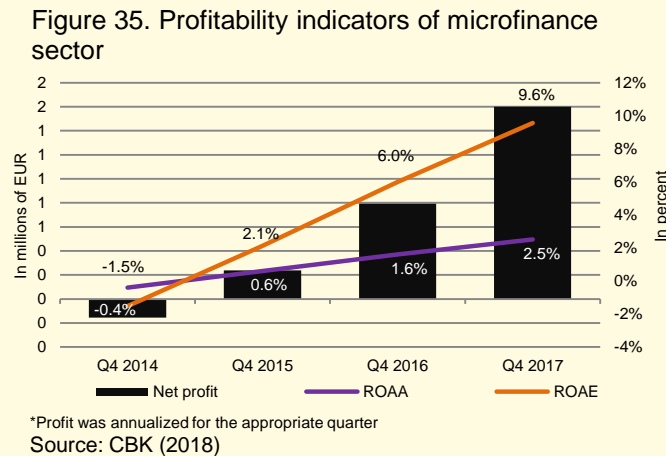
Source: CBK (2018)

The profit increase is mainly attributed to the significant income increase of EUR 8.8 million, namely the increase of interest income of EUR 7.6 million, which comprise around 85 percent of total income. Also, an impact on the increase, but with a lower contribution, was marked by non-interest income which marked an increase of EUR 1.2 million.

The increase of interest income was a result of credit activity increase by microfinance institutions in the last three years, and as well a result of the increase of interest rates applied on loans. Meanwhile, the increase of non-interest income is attributed to other operating income. Total sector's expenses marked an annual increase of EUR 7.2 million, of which the highest increase was marked by non-interest expenses and more specifically by personnel and administrative expenses.

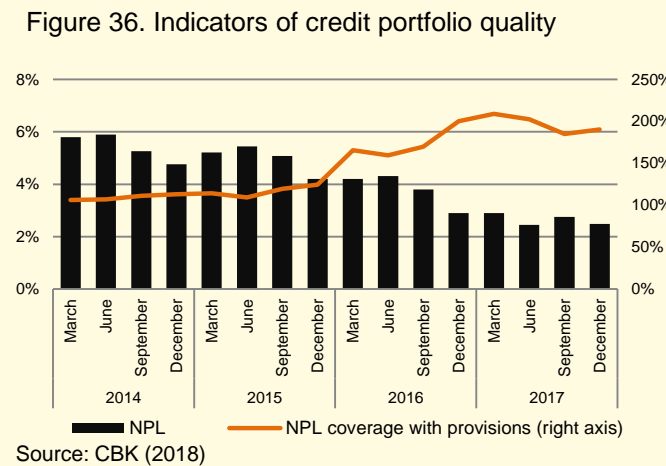
As a result of the positive financial performance during the fourth quarter of 2017, profitability

indicators calculated for the whole year marked a significant improvement (figure 35).



Microfinance institutions continued to be characterized with low level of nonperforming loans and good coverage with loan loss provisions.

The level of nonperforming loans to total loans ratio of the sector, until December 2017, marked a decline of 0.4 percentage points against the previous year, dropping to 2.5 percent (figure 36).

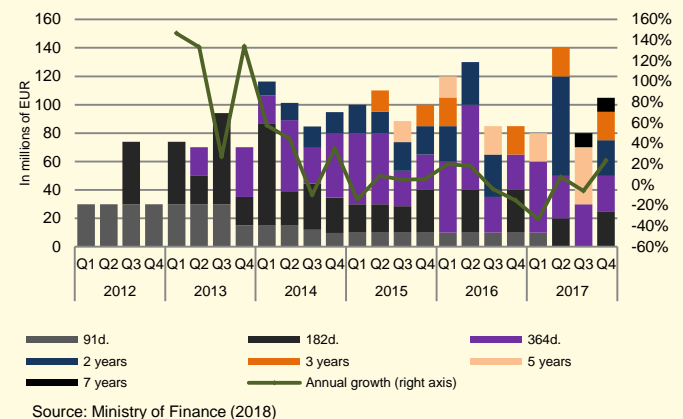


Whereas, the coverage level of nonperforming loans with loan loss provisions, in December 2017, stood at 190.3 percent compared to the level of 200.2 percent in December 2016.

Securities Market

In the fourth quarter of 2017, Treasury Department of the Ministry of Finance of Kosovo's Government realized 5 auctions, issuing government bonds and government bills with a total value of EUR 104.95 million (figure 37).

Figure 37. Value of issued debt, annual growth

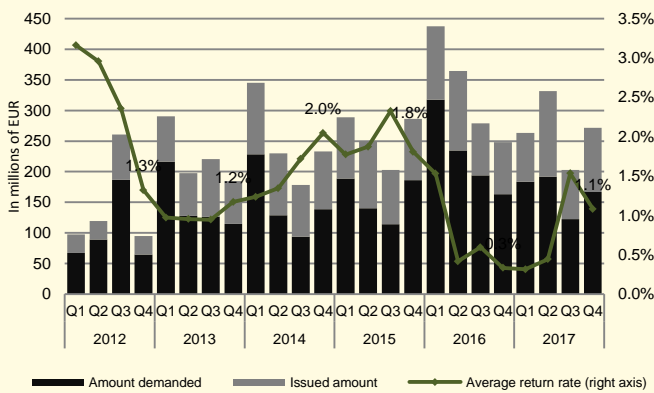


The value issued in this quarter was higher for 23.5 percent compared to the same quarter of the previous year and for 31.2 percent higher than in the previous quarter of this year. Compared to the same period of the previous year, the number of auctions and the amount received from issuing treasury bills in these auctions marked a decline, while the number and amount received from issuing treasury bonds marked an increase (table 2).

The beginning of issuing government bonds with a maturity of 7 years had an impact on the

interest rate on these securities to be higher and the average maturity of securities portfolio to be longer (figure 38).

Figure 38. Bid to cover ratio



Source: Ministry of Finance (2018)

Average interest rate on treasury bills, issued in the fourth quarter of 2017, was 0.3 percent (0.2 percent in the fourth quarter of 2016), while government bonds in this quarter were issued with an average interest rate of 1.6 percent compared with 0.8 percent as it was in the same period of the previous year.

Table 2. Number and amount of securities issued by Kosovo's Government

Period	Treasury bills		Treasury bonds	
	Number realized	Received amount	Number realized	Received amount
Q4 2012	3	30.00	-	-
Q4 2013	5	70.20	-	-
Q4 2014	4	79.85	1	15.00
Q4 2015	3	65.00	2	35.00
Q4 2016	3	65.00	1	20.00
Q4 2017	2	49.95	3	55.00

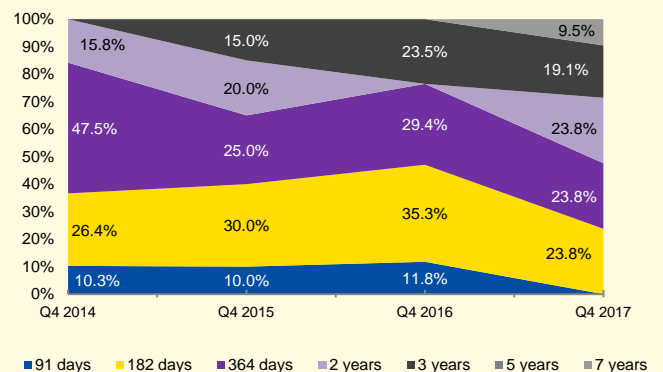
Source: Ministry of Finance (2018)

In the fourth quarter of the previous year the average maturity of securities issued was approximately 1.2 years, whereas in the fourth quarter of this year the average of maturity was 2.7 years.

The structure of securities by maturity was categorized with treasury bills with a maturity of 182

days, 364 days and government bonds with a maturity of 2 years, with the same share of 23.8 percent. Whereas, government bonds with a maturity of 7 years, which for the first time were issued in August of this year, had a share of 9.5 percent of total amount issued in the fourth quarter of 2017 (figure 39).

Figure 39. Structure of Government securities, in percent



Source: Ministry of Finance

Bid amount of participants was for 1.6 times higher than the amount issued in auctions of the Ministry of Finance (1.9 times higher in the fourth quarter of 2016). Despite the lower level of bid-to-cover ratio, in this quarter the demand to invest in securities was for 2.2 percent higher (figure 39). Consequently, the higher demand and the issuance of instruments with longer maturity resulted that the overall average interest rate to be higher than in the corresponding quarter of the previous year (figure 39). Securities of the Kosovo's Government represent attractive instruments of investments considering that they bear no risk. Therefore banks in this case based on the regulation in force on capital adequacy, are not required to hold capital reserves for this category of assets which are considered as zero risk of weighted assets.

Suggested citation for this publication:

CBK (2018): Quarterly Economic Assessment of the Financial System No. 21, Q4 2017, Central Bank of the Republic of Kosovo, Prishtinë

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Macroeconomic selected indicators

Description	2016	2017
Real sector 1/		
Gross Domestic Product (GDP) (in millions of EUR)	6,070.1	6,282.2
Consumer prices (annual average)	0.3%	1.5%
Consumer prices (end of period)	1.3%	0.5%
Fiscal Sector 2/		
Budget Revenues (in millions of EUR)	1,596.5	1,681.5
Budget Expenditures (in millions of EUR)	1,657.6	1,740.5
Primary balance (in millions of EUR)	-61.1	-59.0
Financial sector (in millions of EUR) 3/		
Assets of financial corporations	5,386.9	5,917.1
of which : Banks	3,637.1	3,877.5
Loans	2,230.0	2,485.3
Deposits	2,897.8	3,092.5
Interest Rates on Loans, end of period	7.2%	6.8%
Interest Rates on Loans, end of period	1.2%	1.3%
Interest rate gap	6.0%	5.5%
External sector,(in millions of EUR) 3/		
Balance of payments		
Current and capital account	-467.2	-425.1
of which: remittances	691.0	759.2
Financial account	-199.1	-330.0
Foreign Direct Investmentsin Kosovo	220.0	287.8
Portfolio investments, net	343.6	14.7
Other investments, net	-264.0	-164.7
International Investment Position (PNI), net	-81.0	-120.1
Assets	4,547.7	4,824.4
Liabilities	4,628.7	4,944.4
External debt, total	2,015.1	2,091.6
Private external debt	1,570.5	1,598.3
Public external debt	444.6	493.3

Source:

1/ KAS (2017).

2/ MF (2017).

3/ CBK (2017).

