

Dear Charmian of the Committee, Mr. Abdixhiku

Dear Members of the Committee,

Based on the requirements of the Law on the Central Bank, I am pleased to present in front of you the 2017 Annual Report of the Central Bank of the Republic of Kosovo. The Annual Report was prepared pursuant to the provisions of the Law on the Central Bank of the Republic of Kosovo in the first months of 2017. In accordance with the Article 35 of the CBK Law, the Central Bank Board approved the report on 31 May 2018 and in accordance with Article 59 of the Law on the CBK, it has been submitted to the Assembly of the Republic of Kosovo during June 2018.

During 2017, the Central Bank of the Republic of Kosovo (the CBK) successfully fulfilled its legal objectives, ensuring a sustainable financial system and contributing to the support of development and stability of the country's economy. During this year, the CBK continued to advance all of its functions within its scope. A special attention was paid to services for public authorities, financial institutions and the public in general.

In addition, let me present to you a summary of the CBK 2017 Annual Report, including economic developments in Kosovo and the external sector, financial system of Kosovo, as well as developments in the scope of the CBK functions.

The Euro Area economy continued to record positive growth rate while the inflation continues to be below the ECB's target, despite showing signs of approximation to the target of 2 percent. The annual growth rate of GDP for 2017 is estimated to be 2.4 percent, mainly driven by private consumption and investments, as well as the improvement of net export position as the result of global economic recovery. Based on the ECB projections, the Eurozone economy will continue to recover in 2018 as well. The favorable performance of Eurozone economy positively reflected to the economies of the **Western Balkan** countries, manifested by the improvement of the net export position and Foreign Direct Investments, which significantly contributed to the ongoing growth of these economies. The recovery of economic activity, as well as rising prices in international markets have increased the inflationary pressures in the region, which were reflected by the rise of the average annual inflation rate at about 1.9 percent from 0.3 percent of a year earlier.

Kosovo's economy continued to grow in 2017 as well. According to preliminary estimates of Kosovo Agency of Statistics, Kosovo's economy, in 2017, recorded an annual growth of about 3.7 percent. This growth of economic activity was generated mainly by investment growth of 10.7 percent, while the consumption has marked a decline of 1.6 percent.

The high reliance of Kosovo's economy in the import of goods and the low level of export continue to be among the main challenges of the country's economy. Despite the accelerated growth of exports by 22.1 percent, as compared to the growth of imports by 9.2 percent, the trade deficit continues to be high. In 2017, trade deficit value was 2.7 billion euros or 41.5 percent of GDP.

The high trade deficit in account of goods continues to be the main contributor to **current and capital account deficit**, which in 2017 amounted to euro 425.1 million (6.6 percent of GDP). However, the contribution of the trade deficit to the current and capital account deficit continues to be significantly neutralized by **remittances**. In 2017, remittances received in Kosovo, amounted to euro 759.2 million, representing an annual growth of 9.9 percent. In addition to remittances, which have consistently proved to be a sustainable source of consumption finance in Kosovo, Kosovo's diaspora contribution to the country's economy is also expressed through the expenses they make during their stay in Kosovo as well as foreign direct investments.

In 2017, **Foreign Direct Investment (FDI)** in Kosovo amounted to euro 287.8 million, compared to euro 220.0 million in 2016, recording a significant increase. The FDI structure in Kosovo continues to be dominated by investments in real estate sector, representing 65 percent of total FDIs in 2017.

The Republic of Kosovo continues to enjoy a satisfactory fiscal position, characterized by a low level of **budget deficit and public debt**.

The development of the **securities market in Kosovo** over recent years has increased the financing opportunities through the debt for the Government of Kosovo and at the same time has increased the investment alternatives in the domestic market for financial institutions operating in Kosovo.

The **trend of prices** in Kosovo is mainly in line with the price movements in international markets. The price recovery in the international markets was also reflected in Kosovo, where the country's economy recorded an inflation rate of 1.5 percent in 2017, compared to the previous year that was characterized by low inflation rate of 0.3 percent.

The **financial system activity** has also expanded during 2017. The financial system is growing at a steady pace, representing one of the most important components of development and stability of the country's economy.

The **banking sector's** lending activity has continued to be characterized by an accelerated growth rate as the result of improved lending conditions by banks and increased demand for enterprises and households loans. In 2017, the value of **total loans** reached euro 2.5 billion, representing an annual increase to 11.5 per cent. Lending to all economic sectors marked an increase during 2017. The sectors that marked most significant increase were the construction, agriculture and production sectors (26.1 per cent, 13.4 per cent and 9.3 per cent respectively). Structure of loans remained similar to previous years, with trade sector loans amounting to 50.4 percent of total loans to enterprises.

The structure of banking sector loans largely reflects the structure of enterprises operating in Kosovo, with high participation of commercial enterprises. A greater diversification of the loans structure to less credited sectors of the economy with potential to accelerate economic development would be very beneficial to the Kosovo economy. Significant decline in loan interest rates by banks during last two years represents a very important development for facilitating access to finance for these sectors as well. The Kosovo Credit Guarantee Fund is also playing a significant role, the use of which has marked a growing trend, with over 30 million euros at the end of 2017.

In addition to the accelerated pace of lending, Kosovo's economy in 2017 also benefited from further improvement of lending conditions by banks. **Loan interest rates**, which for a long time have been considered as one of the main obstacles for business development, continued to decline in 2017, down to the average level of other countries in the region. By the end of 2017, the average loan interest rate was 6.8 percent, compared with the 7.2 percent rate in the previous year.

Decline of the interest rate on loans reflects, among others, increase of competition and banks' efficiency as well as ongoing improvement of the overall business environment, which will enable further improvement of the financing conditions in the country's economy. Reduce of the

financing cost on loans was also influenced by the interest rate on deposits, which in 2017 was 1.3 percent.

Accelerated lending growth associated with interest rates decline, shows that Kosovo has made significant progress in facilitating access to finance, which is one of the most important prerequisites for greater economic growth.

The increase of **deposits**, mainly collected within the country, continues to serve as a main source of financing for banking sector activity. In 2017, the total value of deposits in the banking sector amounted to euro 3.1 billion, representing an annual growth of 6.8 percent. This constancy of deposits shows a high public confidence in the Kosovo banking sector, built based on the sustainability that has characterized this sector since the beginning.

During 2017, the banking sector's **financial health indicators** improved further, thus reinforcing the sound fundamentals of this sector.

The **non-performing loans** to total loans ratio, this year decreased to 3.1 percent compared to the rate of 4.9 percent in 2016. Kosovo continues to have a significantly better credit portfolio than other countries in the region, where the average rate of non-performing loans in 2017 was about 8.5 percent. This qualitative loan portfolio has reduced the risks to the banking sector and has led to faster growth and favorable lending conditions.

The banking sector continues to have a **strong liquidity position**, which means that banks are able to meet their liabilities. Liquidity indicator stands at 37.9 percent, which is well above the regulatory minimum of 25 percent.

The banking sector continues to be **well capitalized**, with the Capital Adequacy Indicator at the rate of 18.1 percent, which is significantly higher than the required regulatory minimum of 12 percent. The high level of capitalization shows that banks have invested heavily their own capital, for absorbing possible negative shocks without risking investors' assets.

Satisfactory performance recorded other sectors of Kosovo's financial system as well. **Pension system** marked positive performance as the result of the growth realized by pension contributions and increase in the return on investment. The total value of assets of the pension sector amounted to euro 1.65 billion, a significant increase of assets by 16.0 percent.

Regarding the **insurance sector**, the value of total written premiums in 2017 marked an annual growth of 3.9 percent, while in the same period, the total claims paid by insurance companies and the Kosovo Insurance Bureau marked an annual growth of 17.8 percent. The insurance sector recorded positive performance this year, unlike the previous years when characterized by losses. Improved performance reflects regulatory and supervisory measures undertaken by the CBK and improvement of management practices in the insurance companies.

The microfinance and non-bank financial sector continued to serve as an important source of funding, especially for small enterprises and households. In 2017, the total value of this sector's loans amounted to euro 143.9 million, corresponding to a significant annual growth of 32.1 percent. The average interest rate on microfinance sector loans was 22.6 percent in December 2017.

The CBK forecasts for 2018 suggest that the real economic growth rate is expected to fluctuate at an interval of 4.2 to 4.4 percent. A significant contribution to the growth of investments is expected by the banking sector's lending growth. Investments in 2018 are expected to reach a real growth of 10.1 percent, based on projections for significant public investment growth (25.8 percent) and private investment (5.0 percent).

In addition, let me disclose a summary of the CBK's main activities during 2017

As a **financial regulator**, the CBK, during 2017, has continued to work towards advancement of secondary legislation and the harmonization of this legislation with the EU directives and international standards, thus creating a regulatory framework that promotes a sound financial system development. In this context, it is worth mentioning the activities related to the alignment of the banking supervision regulatory framework with the Basel framework and the regulatory framework for the supervision of insurers, Solvency I.

In order to ensure a comprehensive and transparent financial **licensing** process, the CBK, during 2017 reviewed the licensing and registration policies, procedures and practices for all types of financial institutions in order to provide a dynamic, efficient and structured financial licensing and registration framework. As the result, the number of financial institutions licensed by the CBK in 2017 has increased, thus contributing to increase of competition in the financial market.

The CBK has continued to supervise all financial institutions operating in Kosovo to make sure they operate in accordance with applicable laws and regulatory framework.

The CBK has continued to provide the relevant banking services to state institutions, financial institutions and the general public as well as qualitative and quantitative cash supply.

We continued to provide efficient financial infrastructure, ensuring an efficient, secure and stable interbank payment system. The continuous increase in the value of transactions through this system, besides reflecting the growth of economic activity, also shows the importance of this system for increasing formalities in the domestic economy by replacing cash payments.

Asset management that is under the responsibility of the CBK has continued the investment in financial instruments that fall in the category of safe, liquid instruments and with superior credit rating.

In providing regular information for public and decision-making authorities, the CBK has continued to **compile and publish various analytical materials** that reflect economic developments in the country. The CBK's **statistical function** has advanced harmonization of statistics with international standards.

Special attention has been paid to the advancement of the CBK's internal functions, ensuring a **good corporate governance**, by building sustainable internal control systems.

As presented in the financial statements included in the Annual Report, the CBK's financial performance continues to be satisfactory, being characterized by a positive balance sheet.

Regarding external cooperation, I would like to emphasize the CBK activities related to financial education aimed at enhancing the knowledge of the public about the financial system. At international level, we have successfully positioned the CBK, by providing representation and membership in the International Organization of Pensions Supervision (IOPS). This year, the CBK signed a cooperation agreement with EBA (European Banking Authority) and for the first time

was invited to participate in regular meetings of this institution alongside the supervisory authorities of the countries of the region (Western Balkans).

In conclusion of my discussion, I would like to thank you for your attention and to assure you that the CBK remains committed to pursue the objectives arising from the Law on Central Bank, strictly implementing its functions in the service of stability and economic development of the country.