



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

Annual Report 2012

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LIST OF ABBREVIATIONS

NFA	Net Foreign Assets
PAK	Privatisation Agency of Kosovo
KAS	Kosovo Agency of Statistics
ATK	Kosovo Tax Administration
ATM	Automated Teller Machine
MTA	Money Transfer Agencies
WB	World Bank
EU	European Union
BEC	Broad Economic Categories
BEEP	Business Environment Enhancement Project
EBRD	European Bank for Reconstruction and Development
BIC	Business Identifier Code
BIS	Bank for International Settlements
KIB	Kosovo Insurance Bureau
BKT	Banka Kombëtare Tregtare
BPB	Banka për Biznes
CBK	Central Bank of the Republic of Kosovo
CAR	Capital Adequacy Ratio
CEFTA	Central European Free Trade Agreement
CPI	Consumer Price Index
DJI	Dow Jones Industrial Average
DLE	Department of Labour and Employment
DSFAE	Department of Financial Stability and Economic Analyses
SDR	Special Drawing Rights
ECB	European Central Bank
EFSE	European Fund for Southeastern Europe
SEE	Southeastern Europe
EULEX	European Union Rule of Law Mission in Kosovo
EUROSTAT	General Directorate of European Statistics
IMF	International Monetary Fund
SKPF	Slovenian-Kosovo Pension Fund
GBR	Great Britain Pound
HHI	Herfindahl-Hirschman Index
IAIS	International Association for Insurance Supervisors
FDI	Foreign Direct Investments
IMF	Microfinance Institutions
IPI	Import Price Index

KEK	Kosovo Energy Corporation
NPC	National Payment Council
KMB	Komercijalna Banka
ODC	Other Depositing Corporations
MF	Ministry of Finance
MLSW	Ministry of Labour and Social Welfare
MTPL	Motor Third Party Liability Insurance
NLB	Nova Ljubljanska Banka
NPL	Non-Performing Loans
NPHSO	Non-profitable Household Service Organizations
GDP	Gross Domestic Product
PCB	Procredit Bank
IIP	International Investment Position
POS	Point of Sale
pp	Percentage Point
PPI	Producer Price Index
PPP	Purchasing Power Parity
PTK	Post and Telecommunication of Kosovo
RBK	Raiffeisen Bank of Kosovo
REER	Real Effective Exchange Rate
CRK	Credit Registry of Kosovo
ROAA	Return on Average Assets
ROAE	Return on Average Equity
RTGS	Real Time Gross Settlement
RWA	Risk Weighted Assets
SEKN	Interbank Electronic Clearing System
SEPA	Single Euro Payment Area
SFR	Swiss Franc
ARS	Accountancy Registry System
SWIFT	Society for Worldwide International Financial Telecommunication
TEB	Türk Ekonomi Bankasi
KPST	Kosovo Pension Savings Trust
TPL	Third Party Liability
TVSH	Value Added Tax
UNMIK	United Nations Mission in Kosovo
USAID	United States Agency for International Development
USD	United States Dollar
VPN	Virtual Encryption and Network Technology

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Cover letter of Chairman of the Central Bank Board

Dear readers,

The past year was characterized by a general stable movement in global level. Gross Domestic Product, although recording a lower growth, it was characterized by a positive growth of 3.2 percent. Positive developments have particularly been noticed in the USA economy, which in 2012 recorded a growth of 2.2 percent compared to 1.8 percent that was in 2011. Euro area recorded a decline of 0.6 percent, while in spite of a lower annual growth, the developing countries recorded a considerable growth of 4.7 percent in 2012. Central and Eastern Europe had a slower but positive growth of 1.6 percent in 2012, which is significantly lower than the previous year which was 5.2 percent. Inflation during 2012 had a declining tendency in general and in global level it was 5.5 percent compared to 6.4 percent as it was in 2011. Almost all major economies recorded a lower decline compared to the previous year. Stabilizing inflation developments have also been recorded in euro area and in the majority of the European Union countries. Negative developments were in particular noticed with respect to employment, as one of the key macroeconomic parameters. Unemployment in 2012 recorded a growth in global level in general and in European countries in particular, with exception of Germany which had a lower decline compared to the previous year.

In Southeastern Europe, as a result of impact of global general economic developments in the previous years, the Gross Domestic Product recorded a decline of 0.2 percent. All countries recorded a decline of economic activity, or they had a lower level compared to the previous year. General developments of prices had a declining tendency, with exception of Serbia, Montenegro and Croatia. Inflation rate in these countries had basically a declining trend although it remained at the level of the previous year. Unemployment in all these countries remains a serious problem.

In 2012, the general economic developments in Kosovo had a positive tendency. The Gross Domestic Product, despite of having a slight decline compared to the previous year, remained at the highest level in Southeastern Europe. General developments of prices were stable, while inflation recorded a decline compared to the previous year and it was only 2.5 percent compared to the previous year that was 7.3 percent. The number of unemployed people in Kosovo shows a decline of the jobseekers.

Financial system in Kosovo is stable, where banks in general continued with their positive business trends as well as increasing the number of products and services provided. Although loans and deposits have relatively recorded a decline, they continued to be higher than in the previous year. Also, the loans quality had stable developments. Insurance companies continued to increase their types of products as well as the quality of services provided.

The role of the Central Bank in maintaining the financial system in Kosovo during the last year was unchallengeable, especially in its regulatory and supervising role. With purpose of a better functioning of the financial system, the Central Bank Board approved a large number of new regulations or amended the existing ones during the last year. Also, the Central Bank through the supervision sector exercised its function to ensure a stable, efficient and sustainable financial system. Developments in financial markets have constantly been followed up and decisions on asset investment policies have been rendered accordingly, which unfortunately have not been convenient as a result of general developments, but they have kept the interest and risk management balanced. The Central Bank continued developing different forms of professional

capacity building of staff as well as recruiting new staff. It has also increased the level of internal supervision relating to the bank's internal function activities, as well as supervision through internal audit function and the Audit Committee's activity. Statistical surveys and reports have also been produced and published, which are important to follow up the general economic developments in the country and worldwide. One of them is the annual report for 2012, which represents not only a summary of the activities of the Central Bank of the Republic of Kosovo, but also a summary of the economic and financial developments in Kosovo and wider.



Chairman of the Central Bank Board

Prof. Dr. Sejdi Rexhepi

Cover Letter of the Governor

The domestic economy continued with a positive growth rate, which was supported by financial and fiscal stability as well as improvement in the trade balance of goods and services, especially in the last quarter of 2012. Real growth of domestic economy for 2012 is estimated to have been 2.9 percent, which was predominantly generated by public investments, private and public consumption.

Financial stability was characterized by an enviable soundness and expansion of the financial sector activity. Despite challenges faced by the region, we have achieved to be the only country in the region which has licensed a new bank with foreign capital in 2012. Banks as the most important part of financial system continued extending their crediting activity making sure that the adequate quality of credit portfolio is maintained, while non-performing loans recorded a modest growth during 2012. Deposits and loans continued to mark a growth rate, while the banking system capital adequacy consistently maintained its high level in spite of new regulations which have increased the requirements for capital adequacy. Also the other parts of financial sector continued with a growth trend. Insurance industry recorded a growth of total assets and an increase of claims paid. Also, pension fund recorded a growth of assets and a better return from their investments, while the microfinance institutions recorded a decrease of their activity.

The year 2012 was characterized by important activities related to financial stability and CBK's responsibilities. CBK has jointly implemented with the IMF and the World Bank the Financial Sector Assessment Program. Recommendations from this program have been included in the CBK Strategic Plan 2013 – 2015, as revised and approved at the end of the last year. Following the adoption of Law on Banks, Microfinance Institutions and Non-bank Financial Institutions, numerous regulations have been adopted, thus further advancing the prudential conduct of financial institutions. In this context, CBK has undertaken a wide range of administrative and prudential administrative measures against financial institutions, including measures such as detection and prevention of exercising any unlicensed financial activities.

CBK pursued advancing its cooperation with local and international institutions. Memoranda of Understanding have been signed with Kosovo Customs and with Kosovo Police, then with the Agency for Supervision of Capital Financing of Pension Insurance of the Republic of Macedonia, Agency for Insurance Supervision of Slovenia and with the Bank of Albania. At the same time, CBK promoted its local and international presence in public by actively participating in important events of international financial institutions and by organizing events of international character in Kosovo. In particular, we have to underline the initiative undertaken in cooperation with the international partners regarding access to SWIFT, organization of an international conference on competition and banking risk, publication for the first time of statistics on the international investment position and external debt of the Republic of Kosovo, commencement of the Government Securities market, fulfilment of all commitments under the IMF Program, implementation of the Project on Diagnostic Assessment of Consumer Protection and Financial Education and implemented the new version of Credit Registry supported by the USAID.

Taking into account the current economic developments in the region and in a wider area, CBK remains focused on undertaking necessary actions in order to ensure the financial stability in Kosovo.



Governor

Bedri Hamza

Central Bank Board, Executive Board and Audit Committee

Activities of the Central Bank Board

Activities of the Central Bank Board were oriented towards successful implementation of powers and duties determined under the Law on Central Bank of the Republic of Kosovo. The Board has continuously held meetings whereby it was informed and discussed the overall developments of the financial system in Kosovo and in a wider area, thus holding more than 14 formal meetings and taking decisions thereof.

The Board has approved within its timeframe the annual budget of the Central Bank and conducted continuous supervision of its execution. The Board also reviewed and approved the periodic and final CBK financial statements and reports.

The Board reviewed and approved the Internal Audit Annual Plan and it also reviewed and approved the periodic and final report of the Audit Committee.

The Board reviewed and approved the supplementation of regulations in financial system area according to requests and proposals made by the Executive Board. Also, as a result of adoption of Law on Banks and Microfinance Institutions as well as the general economic and financial developments, the Board adopted numerous regulations presented below.

- Regulation on Bank Capital Adequacy;
- Regulation on Credit Risk Exposures;
- Regulation on Bank Minimum Reserves;
- Regulation on Credit Registry;
- Regulation on Registry of Bank Account Holders;
- Regulation on Reporting Standards and Supervision of Kosovo Insurance Bureau;
- Regulation on International Payments;
- Regulation on Maintenance, Financing and Use of Compensation Fund;
- Regulation on General Terms of Motor Liability Insurance Policy;
- Regulation on Implementation of Bonus-Malus System;
- Regulation on Licensing of Foreign Banks and Branches;
- Regulation on Opening Representative Office Inside and Outside of the Republic of Kosovo;
- Regulation on Opening and Closing Inside and Outside of the Republic of Kosovo of Bank Branches and Subsidiaries;
- Regulation on Merger and Acquisitions of Banks;
- Regulation on Publication of Information by Banks;
- Regulation on External Audit of Banks;
- Regulation on Reporting of Banks to CBK;
- Regulation on Credit Risk Management;
- Regulation on Consolidated Supervision of Banking Groups;
- Regulation on Internal Controls and Internal Audit

- Regulation on Limits of Holding of Real Estate and Movable Property;
- Regulation on Foreign Currency Activity Risk;
- Regulation on Deposits Equivalent to Capital for Branches of Foreign Banks;
- Regulation on Directors and Senior Managers of Banks;
- Regulation on Large Exposures;
- Supplementation of Regulation on Large Exposures;
- Regulation on Liquidity Risk Management;
- Regulation on Operational Risk Management;
- Regulation on Bank Capital Adequacy;
- Regulation on Changes in Capital Accounts of Banks;
- Regulation on Loans of Related Persons;
- Regulation on Effective Interest Rate and Disclosure Requirements;
- Regulation on Procedures for Processing Damage Compensation Claims Deriving from Compulsory Motor Liability Insurance.

The Central Bank has also approved:

- Internal Audit Annual Plan for 2012;
- Committee and the Head of CBK Audit Committee Annual Report for 2011;
- CBK annual financial report for 2011;
- CBK budget for 2013;
- CBK reports and periodical reports of CBK's financial statements.

With purpose of implementing the powers established under law, CBK has carried out on timely basis all duties related to:

- Implementation of the process for nominations and appointments within the powers set forth under the Law on CBK;
- Review of all Executive Board and Governor's reports and recommendations with purpose of satisfaction of financial stability; and
- Other issues falling under the authority of the Central Bank Board.

The Board has also discharged other duties in compliance with Law on Central Bank of the Republic of Kosovo and the other applicable laws.

As of 31 December 2012, the Board of Central Bank of the Republic of Kosovo was composed of the following members:

Sejdi Rexhepi, Chairman of the Central Bank Board (non-executive member);

Gani Gërguri, Governor and member of the Central Bank Board (executive member);

Mejdi Bektashi, non-executive member of the Central Bank Board;

Fatmir Plakiqi, non-executive member of the Central Bank Board (Director of MoF Treasury);

A position for a non-executive member of the Central Bank Board is vacant as of 20 November 2012.

Pursuant to Law No. 03/L-209 on Central Bank of the Republic of Kosovo, namely Article 34 item 3, the Executive Board is composed of the Governor (Chairman of the Executive Board) and Deputy Governors.

Powers and duties of the Executive Board as set forth under Article 36 of Law No. 03/L-209 on Central Bank of the Republic of Kosovo

During 2012, the Executive Board of the Republic of Kosovo held 31 meetings.

As of 31 December 2012, the Executive Board was composed of Gani Gërguri (Governor/Chairman of the Executive Board, Nexhat Kryeziu (Deputy Governor for Supervision of Financial Institutions) and Lulzim Ismajli (Deputy Governor for Banking Operations).

Flamur Mrasori (Head of Governor's Cabinet) was the Secretary of the Executive Board.

Audit Committee

The Audit Committee is operating within the framework of transparent governance in the CBK organizational structure pursuant to Article 62 of Law No. 03/L-209 on Law on Central Bank of the Republic of Kosovo and the Audit Committee status. The Audit Committee objectives are to assist the CBK Governing Board in implementing its duties in relation to the internal audit activity, internal controls, business ethics and transparent governance as well as the CBK's financial report.

The Audit Committee is appointed by the Central Bank Board and is composed of three members (two non-executive members selected among the Central Bank Board members and one member-external expert from the accountancy and audit area).

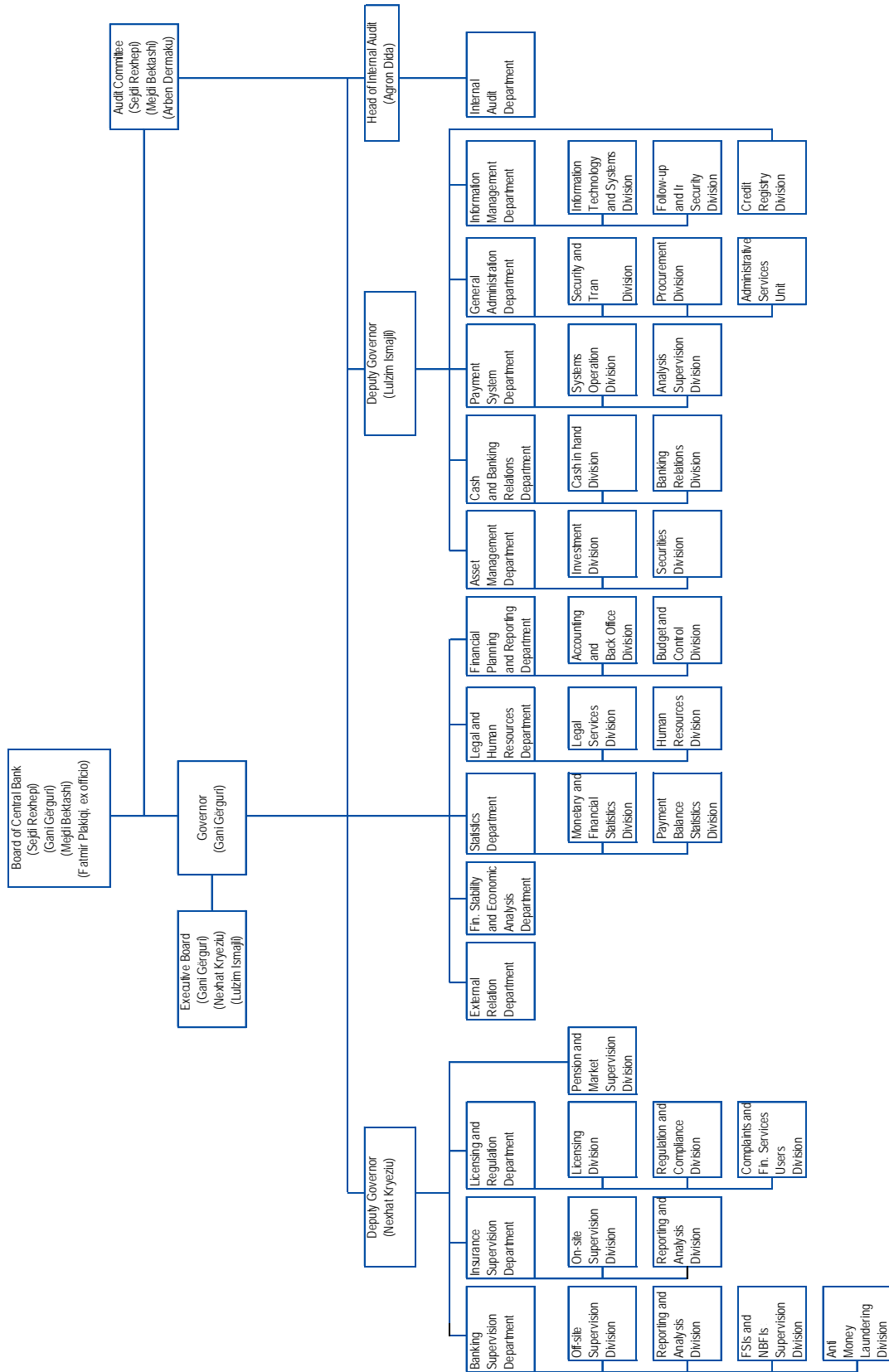
As of 31 December 2012, the Audit Committee was composed of the following members:

Sejdi Rexhepi, Chairman of the Central Bank Board (Gazmend Luboteni until 20 November 2012)

Mejdi Bektashi, member of the Central Bank Board;

Arben Dermaku, external member.

CBK Organizational Structure as of 31 December 2012



1. Executive Summary

The economic activity at the global level during 2012 had positive but limited developments as a result of slow developments in the Eurozone. During 2012, the USA economy was characterized by a positive performance and a higher growth than in 2011. On the other hand, the euro area economy during this period faced a recession of 0.6 percent as a consequence of weakening of internal consumption and investments, tightening of fiscal policies and growing unemployment. Consequently, the economic growth at the global level during 2012 was 3.2 percent, which growth was mainly driven by developing countries and the USA. These developments were also reflected in the SEE countries, impacting on the contraction of internal demand as well as the decline of exports. In addition, the region during 2012 faced a substantial decline of Foreign Direct Investments (FDI), and also a decrease of remittances. As a result of these developments and also of an increased caution of banks in crediting, the economic activity in SEE recorded a decline of 0.2 percent.

In spite of unfavourable developments in the region and elsewhere, the Kosovo's economy recorded a positive growth rate during 2012 as well. Real DGP growth is estimated to have reached 2.9 percent during 2012, which at the same time represents the highest growth in the region. The increase of both private and public consumption is considered to have been the major source of economic growth in the country. On the other hand, the investment component faced different developments compared to the previous years, as FDI underwent negative developments. However, these developments within FDI were neutralized by the growth of public investments. Regarding the Kosovo's external position, the constant trade deficit in goods and services is continuously having a negative impact on the economic growth, yet improvements during 2012 within the negative trade balance impacted on making this effect become lower than in the previous years. These developments during 2012 were followed by a lower inflation rate which reached 2.5 percent compared to 7.3 percent in 2011.

Financial sector in Kosovo was characterised by a recuperation of growth trend in 2012. The value of total financial sector assets in the country reached euro 3.8 billion in 2012, which represents an annual growth rate of 9.7 percent (9.2 percent in 2011). A more sustainable growth of financial sector in 2012 came as a consequence of recuperation of the growing trend of almost all its sectors, other than the banking system assets which continued with a slower growing trend. The fastest growth in 2012 was recorded by the pension fund assets, increasing their contribution to the growth of total financial sector assets to 4.4pp. While the banking system structure in context of ownership remained unchanged from the last year, a new bank joined the banking sector in Kosovo in 2012, increasing the number of commercial banks to nine (9). The banking sector loans reached the value of euro 1.76 billion, which represents an annual growth of 3.8 percent (16.4 percent in 2011). The slowdown of crediting growth trend during 2012 was driven by reduction of the demand for loans, and also by tightening the criteria and standards applied in crediting process by banks in the country both for enterprises and households. Also, in 2012, the value of total deposits reached euro 2.2 billion, which shows an annual growth of 8.3 percent (8.6 percent in 2011). The slowdown of deposits growth was mainly driven by decrease of deposits of public non-finance corporation in this period. Kosovo's banking system continues to be well capitalized in spite of a slight decline of the Capital Adequacy Ratio. In 2012, this ratio decreased to 17.9 percent, from 18.8 percent as it was in 2011. Also, during 2012, the ratio between non-performing loans and total loans reached the level of 7.5 percent (5.8 percent in 2011). The liquidity rate in banking system continued to have a satisfactory level. Loans to deposit ratio in 2012 reached 77.4 percent, while banks reserves continued to exceed the minimum level required by the Central Bank.

Regarding the insurance market, in 2012, the number and the structure of insurance companies remained unchanged from the last year. The number of insurance companies remained thirteen (13), where ten (10) of them continued to provide non-life insurance products, while three (3) others provide also life insurance products. In 2012, the value of gross written premiums was characterized by a growth of 3.3 percent, where non-life insurance products continue having the largest share in written premiums. Law on Supervision of Pension Funds was adopted in March 2012, which entered into force on 30 March 2012. The Law on Supervision of Pension Funds defines and regulates the basic pension, individual savings pensions and voluntary individual supplementary pensions. Kosovo Pension Savings Trust (KPST) was characterized by a positive performance in 2012. From the assets invested in external markets, the pension fund realized a positive return of 7.2 percent or euro 53.7 million.

Similar to the previous year, in 2012 the CBK realized successfully the supply of banknotes and coins to ensure execution of transactions in cash in the economy. Interbank payments system recorded a growth in 2012 both in volume and value of payments, reflecting a decrease of payments in cash, thus increasing the credibility in banking system. In 2012, around 4.3 million transactions have been executed through IECS, with a total value of euro 5.7 billion. Within the payments system, it is worth mentioning the automation of IESC interfaces with the Central Securities System (DEPO/x) as well as the implementation and functionality of the Registry of Bank Account Holders for the first time in Kosovo. Also, some of the planned developing projects within the Strategy for Development of National Payments System continued to be implemented. The CBK realizes the investment of assets pursuant to the Law on CBK and the CBK investment policy. In 2012, the CBK realized positive returns from investments. While the first part of the year was characterized by higher returns from investments, the measures undertaken by the European Central Bank (ECB) made returns realized by investments in euro currency market to be lower in the second half of the year. The first auction on the issue of securities was held in the beginning of 2012, which also marked the commencement of functioning of primary market for the issue of Government Securities of the Republic of Kosovo.

2. External Economic Environment

The annual economic growth at the global level is estimated to have reached the rate of 3.2 percent, while in 2011 it recorded an annual growth of 4.0 percent (Table 1). This slowdown was more significant in European countries, where the decline of internal demand and the uncertainty caused by developments in fiscal sector during 2012 had an impact on the decline of consumption and investments. Developing countries also faced a slowdown of economic growth, as the increase of internal demand was contracted by rather tighter monetary policies.

According to the IMF estimations, during 2012, the USA extended its economic activity by a real GDP growth of 2.2 percent compared to the growth of 1.8 percent recorded in 2011. Investments had the largest contribution to the GDP growth of the USA, recording a growth rate of 6.2 percent. On the other hand, the euro area economy in 2012 recorded a decline of 0.6 percent compared to a growth of 1.4 percent in 2011. However, unlike the USA, the major cause of recession in euro area was the decline of private consumption and investments, which recorded an annual decline of 1.1 and 3.1 percent, respectively. Almost all euro area countries recorded a decline or a lower economic growth rate compared to 2011. The economic contraction in euro area countries is expected to induce consequences to the fiscal and financial sector in the following periods, which would deteriorate the overcoming of public debt crisis, which is reflected on the decline of credibility rate in markets as well as influenced on the increase of financing cost and growth of non-performing loans in financial institutions.

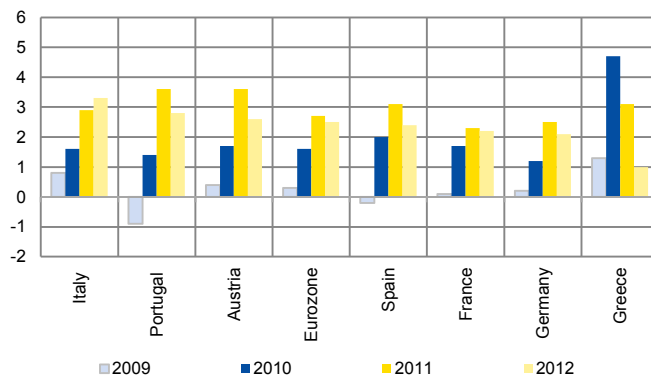
Table 1. Key macroeconomic indicators

Description	GDP		Inflation		Current account (% of GDP)	
	2011	2012	2011	2012	2011	2012
World economy	4.0	3.2	6.4	5.5	0.6	0.5
USA	1.8	2.2	3.1	2.1	-3.1	-3.0
Eurozone	1.4	-0.6	2.7	2.5	0.6	1.8
Developing countries	4.1	4.7	7.5	6.4	1.9	1.4
Central and Eastern Europe	5.2	1.6	5.3	5.8	-6.3	-4.3

Source: IMF (2013)

Recent financial global crisis was reflected in constant increase of public debt in developed countries. In this context, a poorer performance of the real sector impacted on further increase of uncertainty of participants in the market in relation to the sustainability of fiscal policies and public debts. Consequently, at the end of 2012, the public debt rate in euro area reached 93.6 percent of GDP (in 2011 it was 88.0 percent of GDP). Almost all euro area countries deepened the public debt level during 2012, especially countries having a high public debt level. Furthermore, the public debt in euro area deepened although the budget deficit recorded a decline of 3.3 percent of GDP (in 2011 it was 4.1 percent of GDP). Despite the

Figure 1. Inflation in eurozone and in some eurozone selected countries



Source: Eurostat (2013)

decline of budget deficit, the lack of economic growth makes the maintenance of debt sustainability in euro area quite challengeable.

World economy is characterized by a decline of inflation rate during 2012. The IMF estimated the average inflation rate at the global level to be 5.5 percent (6.4 percent in 2011). The decline of oil price and consequently the decline of food and energy prices were the key contributors to the decline of inflationary pressures both in developed countries and in developing countries. Inflation in developed countries during 2012 was 2.3 percent (3.9 percent in 2011), while inflation in developing countries was 6.4 percent (7.5 percent in 2011). According to the current data, the average inflation rate in the USA during 2012 declined to 2.1 percent (3.1 percent in 2011), while in euro area it declined to 2.5 percent (2.7 percent in 2011). Due to the debt crisis which caused a decline of the overall demand, a more significant decline of inflation rate is observed in Greece, Spain and Portugal (Figure 2).

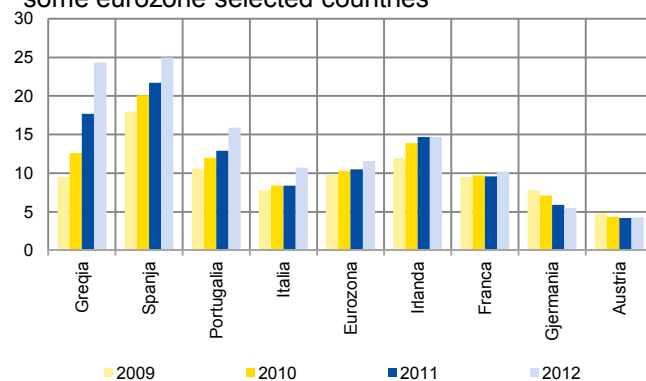
Concerning unemployment, the current data indicate a decrease of its rate in majority of powerful world economies. In the USA, the unemployment rate decreased to 8.1 percent in 2012 (8.9 percent in 2011), 4.3 percent in Japan (4.6 percent in 2011), 4.1 percent in China (4.1 percent in 2011) and 6.0 in Russia (6.5 percent in 2011). On the other hand, the unemployment rate in euro area countries continued to grow as a result of slowdown of economic activity in 2012, recording a decrease from 10.5 percent in 2011 to 11.6 percent in 2012.

Greece, Spain and Portugal, in addition to heading the list of unemployment rate, they also represent the countries where unemployment recorded the highest increased rates during 2012 compared to 2011 (Figure 2). On the other hand, countries like Germany and Austria, in addition to having the lowest unemployment rate, are among the countries that managed to further decrease the unemployment during 2012.

The slowdown of export growth at the global level during 2012 had an impact on deterioration of current account. The volume of export of goods and services for developed countries and developing ones recorded a growth of only 2.1 and 3.6 percent, respectively, compared to 5.6 and 6.6 percent respectively, recorded in 2011. The growth of export of goods and services recorded a more significant slowdown in euro area countries (from 6.1 percent that was in 2011 to 1.4 percent in 2012) and the USA (from 7.4 percent in 2011 to 4.2

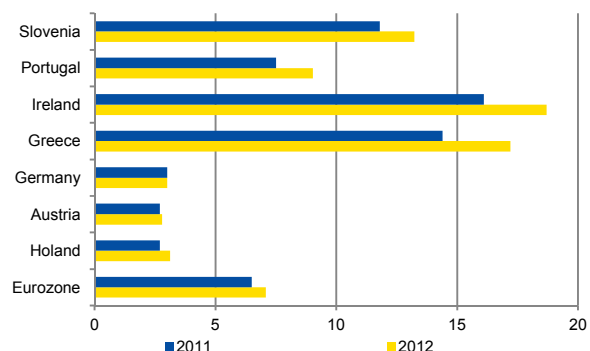
percent in 2012), whereas the average growth rate of exports in all other countries of the world recorded a slight decline (from 8.0 percent in 2011 to 7.8 percent in 2012). Nevertheless, euro area increased the current account surplus rate from 0.6 percent in 2011 to 1.8 percent of GDP in 2012, the USA recorded the same current account deficit rate as in the previous year marking the

Figure 2. Unemployment in eurozone and in some eurozone selected countries



Source: Eurostat (2013)

Figure 3. NPL rate in eurozone and in some eurozone selected countries

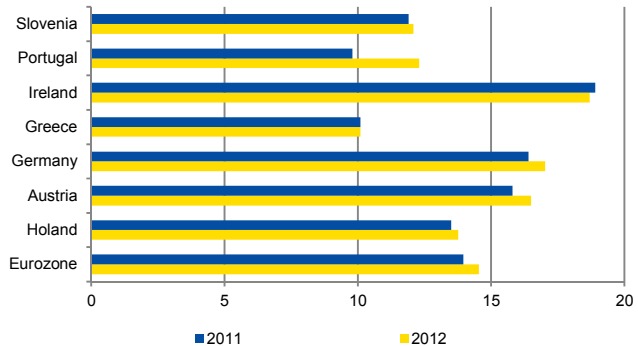


Source: IMF (2013)

rate of 3.1 percent of GDP, while the current account surplus in developing countries decreased from 1.9 percent in 2011 to 1.4 percent of GDP in 2012.

Crediting in majority of developed countries continues to stand at low levels, especially in countries which are facing the debt crisis. This is because the debt crisis has increased the banks' uncertainty to issue loans. Banks in most European countries recorded a deterioration of credit portfolio quality (Figure 3). On the other hand, in most euro area countries, banks reported an improvement of capital adequacy ratio (Figure 4). However, in countries where the debt crisis is more significant, despite of an improvement recorded in capital adequacy level, they are still facing difficulties considering that they invested large assets on Government bonds and household loans.

Figure 4. Capital Adequacy Ratio in eurozone and in some eurozone selected countries



Source: IMF (2013)

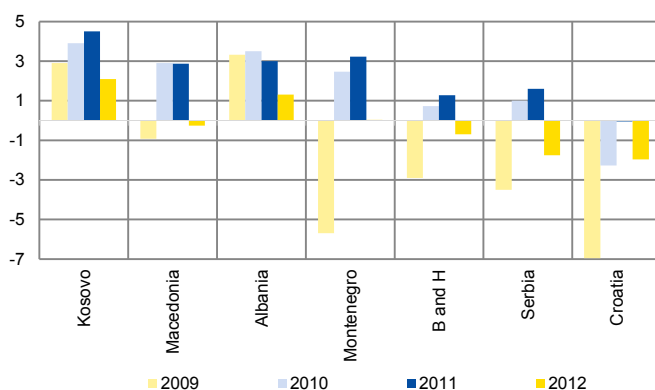
Key ECB interest rate changed several times during 2011, while in 2012 it was changed only once. In July 2012, the Central European Bank (ECB) decided to decrease the key interest rate by 0.25 pp to 0.75 percent.

Concerning the exchange rate, euro depreciated against the majority of main currencies during 2012. A rather significant depreciation at the end of 2012 was recorded against the British Pound by 3.75 percent then against Swiss Franc by 1.50 percent and the US Dollar by 0.45 percent. Euro depreciation was mainly driven by uncertainty due to the increase of the risk from fiscal difficulties faced by some of the euro area countries.

2.1. Southeastern Europe

During 2012, the Southeastern European (SEE) countries were characterized by a decline of economic activity, mainly driven by the decline of the overall demand. According to the IMF estimation, the real GDP of SEE countries was characterized by a decline of 0.2 percent compared to a growth of 2.3 percent recorded in 2011. Croatia recorded the highest level of economic decline compared to the other countries (2.0 percent), followed by Serbia (1.8 percent), Bosnia and Herzegovina (0.7 percent), Macedonia (0.3 percent), while

Figure 5. Real GDP growth rate in SEE



Source: IMF (2013)

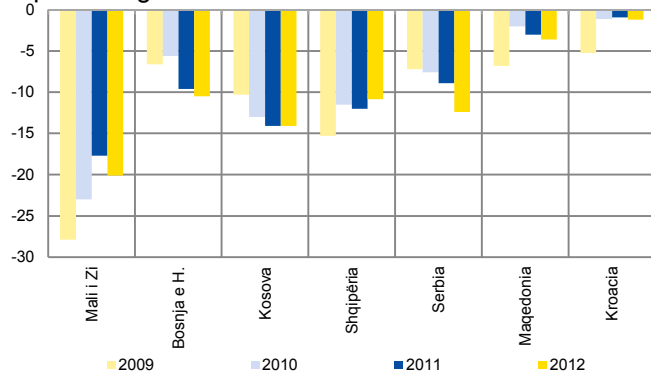
the rest of the countries in SEE are estimated to have had a positive growth although at significantly lower levels than in 2011 (Figure 5). This decline of economic activity is attributed to the fact that the regional countries continue to be sensitive towards developments in euro area economy in terms of trade, foreign direct investments (FDI) and remittances.

The decline of economic activity in the regional countries has also impacted on deterioration of the labour market situation. Recent estimations by the European Commission show an average

unemployment rate of 26.7 percent (0.7pp higher than in 2011) in SEE. However, Bosnia and Herzegovina and Kosovo continued to lead with the highest unemployment rate.

The average of current account deficit rate in SEE countries in 2012 was 10.4 percent (0.9 percent higher than in 2011). All SEE countries were characterized by deepening the current account deficit with exception of Albania which decreased the current account deficit and Kosovo which had almost the same level as in 2011 (Figure 6). Montenegro, Kosovo and Serbia reported the highest current account deficit rates, whereas Croatia and Montenegro continue to be the countries with the lowest current account deficit rates. According to the IMF estimations for 2012, almost in all SEE countries, exports recorded a significantly lower growth rate than in 2011, while imports are forecasted to have recorded a decline. The growth of exports of goods and services was 0.2 percent compared to the growth of 9.5 percent recorded in 2011, while the decline of imports was 1.7 percent, while in 2011 imports recorded a growth of 5.9 percent. The current account deficit in regional countries also deteriorated as a consequence of the decrease of current transfers in majority of regional countries. On the other hand, FDI balance deteriorated as well, which represents a very important component for the current account deficit funding. The average of net FDI rate to GDP was 5.4 percent, compared to 6.1 as it was in 2011. Concerning individual countries, Serbia, Macedonia, Kosovo and Montenegro recorded a decline of the ratio between FDI and GDP (2.4, 2.1, 1.8 and 0.9pp, respectively), while Bosnia and Herzegovina and Croatia recorded a growth (with an average of 0.7pp).

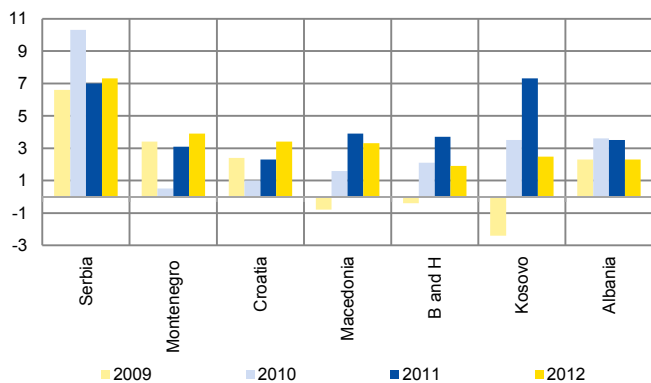
Figure 6. Current account deficit in SEE as percentage to GDP



Source: European Commission (2013)

The decline of the economic activity made some governments of regional countries increase their expenditures and stimulate the general demand in their economies, which was reflected in deterioration of their budget balance. Compared to 2011, Serbia, Macedonia and Kosovo were characterized by a faster growth of expenditures compared to the budget income, which had an impact on deepening of their budget deficit. The highest budget deficit rate was recorded by Serbia (6.7 percent of GDP), followed by Croatia (4.4 percent of GDP), Montenegro (4.0 percent of GDP), while Kosovo, Albania, and Bosnia and Herzegovina recorded a budget deficit at lower level compared to the other countries (1.9 percent of GDP on the average). Consequently, during 2012, the average public debt in SEE deepened by reaching 45.1 percent of GDP compared to the rate of 39.4 percent of GDP recorded in 2011. Albania and Serbia reported the highest public debt rate of 63.8 percent and 63.1 percent of GDP, respectively, while Kosovo continues to have the lowest public debt rate in the region with only 6.0 percent of GDP in 2012.

Figure 7. Annual average inflation rate in SEE



Source: European Commission (2013)

Consequently, during 2012, the average public debt in SEE deepened by reaching 45.1 percent of GDP compared to the rate of 39.4 percent of GDP recorded in 2011. Albania and Serbia reported the highest public debt rate of 63.8 percent and 63.1 percent of GDP, respectively, while Kosovo continues to have the lowest public debt rate in the region with only 6.0 percent of GDP in 2012.

During 2012, the majority of SEE countries faced with a decline of inflationary pressures which were mainly a reflection of the decline of demand as well as the decline of oil and food prices at the global level. The average inflation rate in 2012 was 3.5 percent compared to the average rate of 4.4 percent recorded in 2011. Serbia, Montenegro, Croatia and Macedonia reported the highest inflation rates, while Kosovo, Albania and Bosnia and Herzegovina reported the lowest inflation rates (Figure 7).

Regarding the exchange rate between euro and the other SEE currencies, in December 2012 compared to December 2011, euro reached the highest appreciation against Serbian Dinar with 8.5 percent (113.5 RSD/EUR), then against the Albanian Lek with 1.1 percent (139.7 ALL/EUR), Macedonian Denar with 1.0 percent (61.5 MKD/EUR), and Croatian Kuna with 0.3 percent (7.5 HRK/EUR).

Loans and deposits were characterized by a slower growth compared to 2011. Data for 2012 show that, with exception of Montenegro and Croatia, where crediting recorded a decline, all SEE countries recorded a crediting growth rate, but in the majority of them the growth rate was lower than in 2011. According to the European Commission data, the highest crediting growth rate was recorded in Serbia (16.0 percent), whereas Montenegro reported the highest decline of crediting (4.3 percent).

Table 2. Annual growth of loans and deposits

Description	Albania		B and H		Croatia		Macedonia		Montenegro		Serbia		Kosovo	
	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012
Loans	11.7	7.0	5.6	4.9	6.5	-0.3	8.1	7.0	-11.1	-4.3	7.4	16.0	16.4	3.8
Deposits	14.5	9.1	2.6	2.5	7.3	7.1	10.9	6.8	1.5	4.2	9.2	13.0	8.6	8.3

Note: December is missing for 2012; therefore it is presented the average rate of the other months.

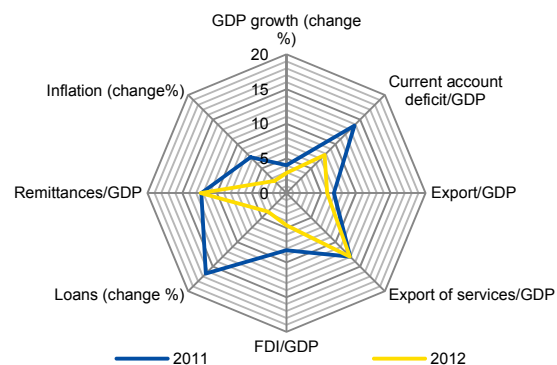
Source: European Commission, Q4 2012; CBK data for Kosovo.

Concerning deposits, all SEE countries recorded a positive growth rate. Albania and Montenegro reported a rather significant slowdown of growth compared to 2011, while Serbia and Montenegro reported an acceleration of growth (Table 2). Banking systems in SEE were characterized by a deterioration of credit portfolio quality during this period. In 2012, Albania, Croatia and Bosnia and Herzegovina reported the highest rates of non-performing loans in the region with 21.2, 13.2, 12.6 percent, while Kosovo continues to have the lowest rate of non-performing loans with only 7.5 percent.

3. Kosovo's Economy

Kosovo's economy in 2012 recorded a positive growth rate. However, the overall economic activity in the country was challenged by developments in the regional and European markets. During 2012, there was a significant fluctuation of some important funding resources in the country, especially of foreign direct investments. Exports of goods were also characterized by negative developments, but the growth of exports of services neutralized the impact of total exports. In addition to external sector channels of economy which

Figure 8. Macroeconomic map



Source: CBK (2013)

are being affected by developments in the global economy, the economy in the country continued to show a solid performance taking into account that the country's financial system continued with financial intermediation marking positive growth rates in loans and deposits. Despite deteriorations in some sectors of economy, financial sector and banking system in particular had a positive performance and is estimated to have supported the overall economic activity. On the other hand, remittances, as one of the key components of funding consumption in the country, continued with a positive growing trend, and yet with higher rates than in the last four years. Public sector also is having positive role in the stability of the country's economy both in terms of income and budget expenditures as well. Besides investments, public sector during 2012 assisted through subsidies in accelerating the development trend in agriculture sector, as an increase of the number of new enterprises was recorded in this sector.

Prices in Kosovo during this year were characterized by stability, recording an average inflation rate of 2.5 percent. Developments regarding the consumer basket content during this year were considered to have been positive, as the share of food products recorded a decline, which is a reflection of improvement of the overall standard in the country.

However, the high level of unemployment remains a constant challenge in Kosovo, whereas the current economic growth rate is insufficient to absorb the constant growth of labour force in the country. Nevertheless, the relatively high level of remittances is contributing in softening this burden of the country's economy.

3.1. Real Sector

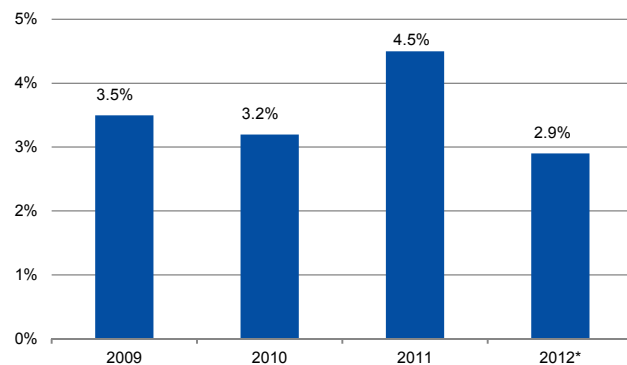
3.1. Gross Domestic Product¹

Gross Domestic Product (GDP) during 2012 is estimated to have reached the value of euro 5.02 billion (a real growth of 2.9 percent). The growth during 2012 was slowed down as a result of developments in euro area and in the region. Private and public consumption is considered to have been the key promoter to the economic growth during 2012, while the impact of investments was more limited as a result of the decline of foreign direct investments (FDI). This decline of FDI was neutralised by the growth of public

investments, while the negative impact of net export of goods and services on the real economic growth is softened due to the improvement of this component compared to the previous year.

Consumption in Kosovo's economy, in addition to the banking system loans, is also supported by remittances which reached euro 605.6 million, representing a growth of 3.6 percent. The increase of the government expenditures for wages and salaries by more than 5 percent was also a supporter of consumption. Besides wages, the consumption of government goods and services has also positively contributed to the overall consumption, as it increased to over 6 percent.

Figure 9. Real GDP growth



Source: *KAS (2012) and CBK estimates

¹The source of data on GDP come from Kosovo Agency of Statistics and the International Monetary Fund, World Economic Outlook, October 2012.

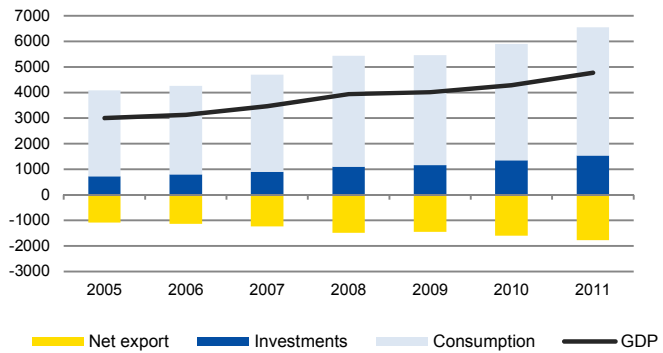
Regarding investments, their motion during 2012 was rather different from previous years, as the decline of FDI and the decline of new loans neutralized the impact of public investments growth. The contributor within the investments was the public sector, investments of which during 2012 reached euro 550 million, which compared to the previous year marked an increase of over 4 percent. Trade balance continues to have a negative impact on GDP as a result of constant deficit within the goods trade. However, the goods and services trade balance during 2012, in spite of being negative, had a lower level compared to the previous year by euro 66.7 million or narrowing the deficit by 3.7 percent. A contribution to narrowing the trade balance, besides the decline of imports by 1 percent, was also given by the growth of exports of services by 3.7 percent. Regarding GDP by economic activity, the data are available only for the period of 2006-2011. However, taking into consideration the economic structure in Kosovo, no substantial changes in structure is expected, with exception of agriculture which is expected to have improvements. The GDP structure during the period 2006-2011 is presented in figure 11.

GDP per capita in Kosovo during 2012 reached the level of over euro 2,750 compared to euro 2,650 as it was in 2011. The GDP growth per capita in nominal terms was lower compared to the previous years, yet the GDP growth estimated by the Purchasing Power Parity (PPP) was higher, as it reached over euro 7,400. Consequently, in context of purchasing power, the GDP per capita stands at the same level with Bosnia and Herzegovina and Albania, while it continues to be lower compared to Macedonia, Montenegro and Serbia.²

3.1.2 Prices

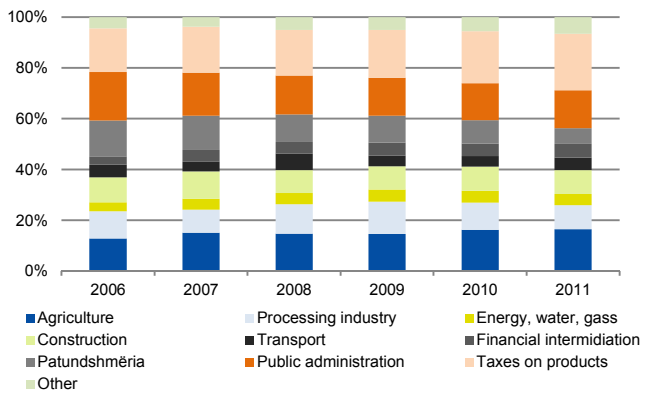
Based on the Consumer Price Index (CPI), inflation in Kosovo recorded an average rate of 2.5 percent in 2012. Inflationary pressures during 2012 were lower compared to the previous year, whereas it was the second half of the year that was

Figure 10. Contribution of main components in GDP



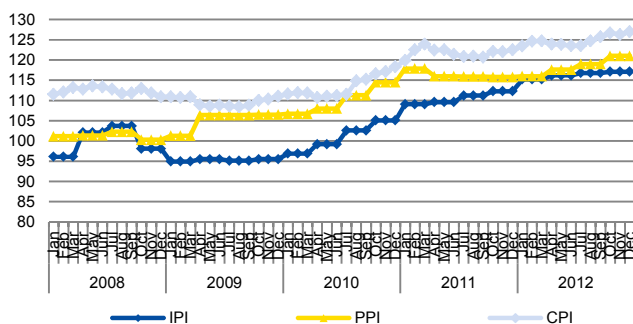
Source: KAS (2013)

Figure 11. GDP by economic activity



Source: KAS (2013)

Figure 12. Consumer, Import and Producer price Index



Source: KAS (2013)

² Source of data is IMF, with CBK additional calculations.

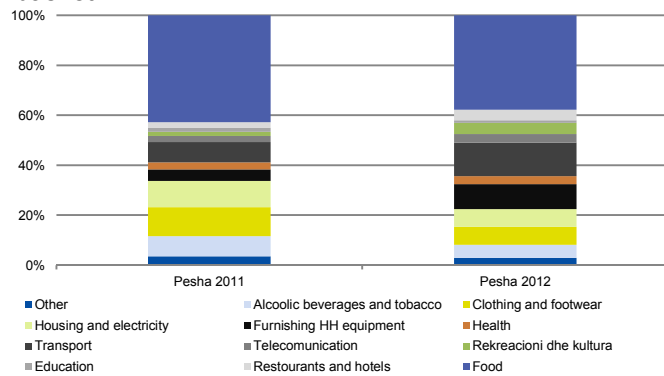
characterized by more significant pressures. Constantly, imported products are those impacting on the level of prices in Kosovo, including the producer price. Food products in Kosovo are considered as a key factor to inflation level. This is because of the large weight of this category in consumer basket. However, the general trends within this category are positive in the country, as this category is gradually decreasing its share in consumer basket. During 2012, the weight of food category recorded a decline to 37.8 percent compared to 42.7 percent as it was in the previous year. Also, the category of products was characterized by stability during 2012, as prices of food products increased by only 0.7 percent. A rather significant increase of prices during 2012 was recorded by the category of alcoholic products and tobacco as well as housing services, energy, water, gas, etc. However, both these categories had a limited impact on the annual average inflation rate in the country taking into account that the weight of these categories in total consumer basket recorded a decline from 8 percent and 10.4 percent, respectively, to 5.1 percent and 7.1 percent, respectively. The other reflecting categories on the increase of prices are transport with 3.7 percent of growth of prices as well as the increase of weight on consumer basket from 8.1 to 13.3 percent, recreation and culture with 4.6 percent of price growth as well as the growth of the share in the basket from 1.7 to 4.4 percent and furniture which from 4.6 percent of the basket in 2011 increased to 10.0 percent, whereas the increase of these prices was 2.4 percent.

As presented in figure 12, prices in Kosovo have similar inclinations with import prices. This is because the biggest influence on domestic prices is exactly coming from imported goods as a result of high dependency of the country's economy on import of goods. In 2012, the average annual growth rate of Import Price Index (IPI) was over 5 percent but the impact this year was more limited on CPI due to the decline of weight of food products. The impact of Producer Price Index ((PPI) on consumer prices remains lower compared to import prices. The increase of producer prices during this period was 1.7 percent which represents a relatively similar level with the overall inflation level in the country.

3.1.3 Labour Market

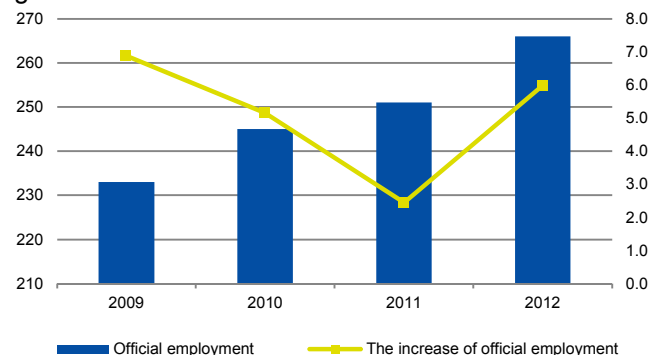
One of the main constant challenges in Kosovo remains the high unemployment rate, which is considered as the major burden on the domestic economy. Another factor which has an impact in softening the negative effects from unemployment rate in the country is considered to be the relatively high level of remittances. Taking into consideration the constant growth of labour force in the country, which results from the young structure of population, the current economic growth rate is considered to have low absorbing capacities for labour force.

Figure 13. CPI components contribution to consumer basket



Source: KAS (2013)

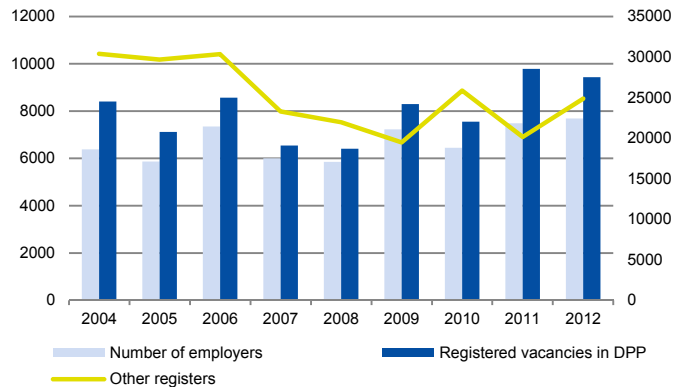
Figure 14. Formal employment and employment growth rate



Source: KAS (2013)

According to the results of the Labour Force Survey published by KAS, the unemployment rate in Kosovo, in the first half of 2012, was 35.1 percent. According to the results of this survey, the unemployment rate is more significant in rural areas (40.1 percent) compared to urban areas (28.5 percent), and then unemployment is higher among women (44.4 percent) than among men (32.0 percent). A concerning characteristic is the high level of unemployment among the youth aged 15-24 years old (60.2 percent). The data on jobseekers registered during 2012 show that during 2012 there were around 260 thousand registered jobseekers. However, during 2012, the number of new jobseekers registered with MLSW was 24,879. Out of that number of MLSW intermediated in employing 7,692 jobseekers, which is a higher number than the previous year. As presented in figure 15, there were 9,434 vacancies presented in MLSW during 2012. The ratio between the vacancies and employments reported by MLSW during this year was 81.5 percent (76.5 percent in the previous year).

Figure 15. Employment intermediation by MLSW



Source: MLSW (2013)

3.2. Fiscal Sector³

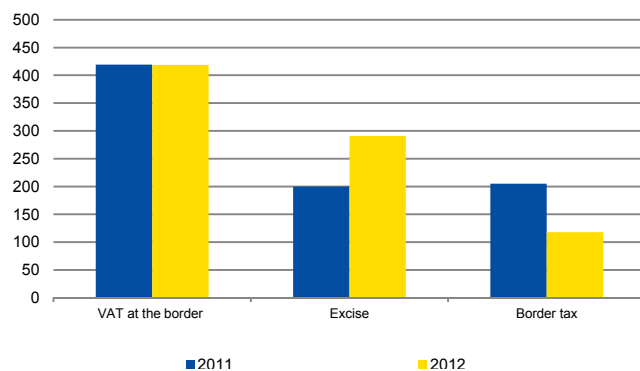
Kosovo's budget in 2012 was closed by a surplus of euro 71.49 million compared to the last year deficit of euro 84.48 million. While all regional countries closed the reporting period with a budget deficit (3.4 percent of GDP on the average), Kosovo was the only country in the region having a positive budget balance of 1.5 percent of GDP. The growth of the budget balance in 2012 was mainly a result of the growth of income from borrowings. Concerning the progress of income and expenditures by projection, the budget income was implemented up to 99.6 percent of budget projection, while budget expenditures were implemented up to 94.7 percent of originally projected ones.

3.2.1 Budget revenues

Budget revenues without including donor grants and trust funds, in 2012 reached the value of euro 1,537.95 million recording an annual growth of 18 percent. As a consequence of the GDP growth, the share of the budget revenues to GDP decreased to 30.6 percent, compared to the share of 37 percent recorded in the previous year.

Revenues collected from border taxes represent the category with the highest share within the budget revenues (57.6 percent). However, the share of border tax revenues decreased to 8.5pp as a consequence of the growth of other categories or establishment of new categories within the budget revenues. The value of border revenues in

Figure 16. Main sources of border revenues, in millions of euro

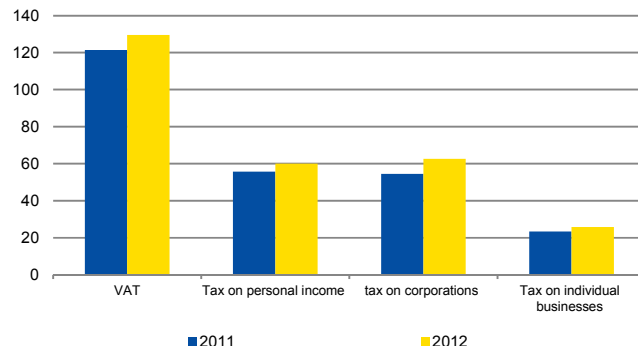


Source: Ministry of Finance (2013)

³ The data on fiscal sector are not audited and are presented as published on the website of the Ministry of Finance in June 2013.

2012 reached euro 844.86 million and recorded an annual growth of 2.1 percent (a growth of 18.1 percent in 2011). The slowdown of the border revenues growth rate in 2012 was mainly driven by the decline of imports (nominally of 1.0 percent), as well as the decline of prices among some of the most important categories, such as basic metals and mineral products. The main category within the border revenues is the border VAT, with a share of 49.6 percent (Figure 16). The border VAT revenues in 2012 decreased to 0.1 percent and reached the value of euro 418.93 million, which may also be attributed to the decline of imports. The second largest category within border revenues continues to be represented by excise, which comprises 34.5 percent of total border revenues.

Figure 17. Main sources of domestic tax revenues, in millions of euro



Source: Ministry of Finance (2013)

This share was consistent with the share of the previous year. However, the value of excise revenues recorded a considerable growth of 45.6 percent, reaching the value of euro 291.3 million. On the other hand, the custom tax revenues recorded a considerable decline of 42.8 percent and reached euro 117.72 million. The remaining part of border tax revenues is comprised by the category of banner income, internal excise, fine revenues, etc., which altogether reached euro 16.9 million and had a share of 2 percent in total budget revenues.

Revenues from domestic taxes increased from euro 261.13 million in 2011 to euro 283.91 million by the end of 2012. This is because the key categories of revenues from domestic taxes were characterised by a growth. The same as border VAT, the VAT collected inside the country represents the main category within the local taxes, with a share of 45.6 percent. VAT revenues reached the value of euro 129.58 million, recording a growth of 6.7 percent (Figure 17). Corporate tax revenues represent the second largest category within local taxes (22.1 percent), which generated euro 62.68 million (an annual growth of 14.9 percent). At the same time, corporate tax revenues have mostly contributed to the growth of total revenues from domestic taxes, with 14.9 pp. Another category with the same share were also the revenues from personal income taxes, which generated euro 60.1 million. Revenues from this category recorded annual growth rate of 8 percent.

Another growing category within the domestic taxes are the revenues from individual businesses, which recorded a growth of 9.1 percent, reaching euro 25.93 million. The other part of revenues from domestic taxes, which is mainly derived from collection of income from KTA fines, interest tax, leasehold dividend, licences for gambling etc., represent a relatively small share, which does not exceed 2 percent or euro 6 million of total revenues from domestic taxes.

It is worth mentioning that pursuant to the approval of the Law on Public Debt in the end of 2009 and later the establishment of infrastructure by the CBK, securities started to be issued for the first time by the Government of the Republic of Kosovo in January 2011. Consequently, out of total auctions on securities implemented during 2012, the internal Government debt reached euro 73.3 million. On the other hand, the external public debt, which mostly includes the loans from the World Bank and the International Monetary Fund, amounted to euro 93.68 million. Consequently, the share of the total public debt (domestic and foreign debt) to GDP in 2012 reached 9.5 percent, which represents a comparatively lower share than the average rate of the region (around 40 percent of GDP).

Part of non-tax budget revenues are also own source revenues, which are generated both by the central and municipal level. In 2012, euro 44.83 million non-tax revenues were generated from the central level or 25.2 percent less than in 2011. The central level revenues are mostly generated from the category of revenues from licenses, participations of ministries and other institutions, inspections etc. On the other hand, own source revenues from the municipal level reached 6.9 percent compared to 2011 reaching the value of euro 59.44 million. These revenues are generated from the municipal activity and mainly from fines.

Regarding one-off revenues, respectively the transfer of PTK dividend, in 2012, euro 45 million were transferred to Kosovo budget compared to euro 60 million in the previous year. In 2012, euro 28.93 million were also generated through PAK one-off funding. Also, euro 4 million were realized for the first time in Kosovo budget through the return of borrowing from public enterprise.

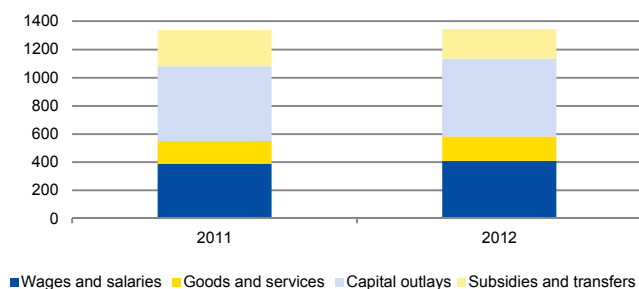
3.2.2 Budget Expenditures

Budget expenditures, without including grants defined by donors as trust funds, in 2012, reached the value of euro 1.46 billion, or 22.2 percent of GDP (29.5 percent of GDP in 2011). Government expenditures in 2012 recorded an annual growth of 5.7 percent, which is a slower growth rate compared to the growth of 9.1 percent in 2011. The deceleration of the growth of the total budget expenditures was mainly driven by the increase of wages and salaries during this period. The government expenditures dedicated for consumption were 11.5 percent of GDP, while the government expenditures for capital outlays were 11 percent of GDP.⁴

Similarly to the previous years, capital outlays in 2012 continued absorbing the largest share of the budget expenditures, with a share of 37.8 percent (38.3 percent in 2011). Capital outlays in 2012 reached the value of euro 550.24 million representing an annual growth of 4.2 percent (Figure 18). At the same time, capital outlays represent one of the categories with the largest contribution to the growth of total budget expenditures with 1.6pp. The major part of capital outlays (61 percent) was designated for infrastructure

investments, which are primarily oriented on investments on the Morinë-Merdarë highway that started to be constructed in April 2010. The second largest category was wages and salaries, with a share of 27.9 percent in total budget expenditures. Wages and salaries in 2012 reached the value of euro 409.24 million, where euro 407.71 million have been allocated by the general budget, while euro 1.54 million came from donor designated funds. Wages and salaries in 2012 recorded a growth of 5.9 përqind, compared to the growth of 26.6 percent in 2011.⁵ Subsidies and transfers continue to represent the third largest category, with a share of 19.1 percent. In 2012, euro 280.2 million transfers and subsidies were allocated and it was the category with the highest annual growth rate of 9.3 percent. As usually, basic pension absorb the major part of subsidies and transfers (39.9 percent), while categories like subsidies to public enterprises and payment to war invalids had a relatively low share of 18.6 percent and 11 percent, respectively.

Figure 18. Structure of main categories of budget expenditures, in millions of euro



Source: Ministry of Finance (2013)

⁴ Consumer expenditures include wages and salaries and goods and services, while capital outlays include investments.

⁵ Wages and salaries in 2011 recorded a rather considerable growth as a consequence of a decision on the increase of public sector wages.

Basic pensions and payments to war invalids increased by 19.7 percent and 5.5 percent, respectively, while subsidies to public enterprises decreased by 13.7 percent.

One of the categories with a relatively low share in total budget expenditures were goods and services expenditures, with a share of 11.8 percent. Goods and services, in 2012, reached the value of euro 169.36 million and recorded an annual growth of 8.2 percent. The increase of supply expenditures and contracting expenditures has mainly impacted on the increase of this category of budget expenditures. The remainder of budget expenditures is comprised of the following categories: payments of government debt (principal, interest and fees) with euro 21.42 million, utilities expenditures with euro 21.56 million and the loan granted to KEK with an amount of euro 15 million.

3.3. Financial Sector

3.3.1 General Characteristics

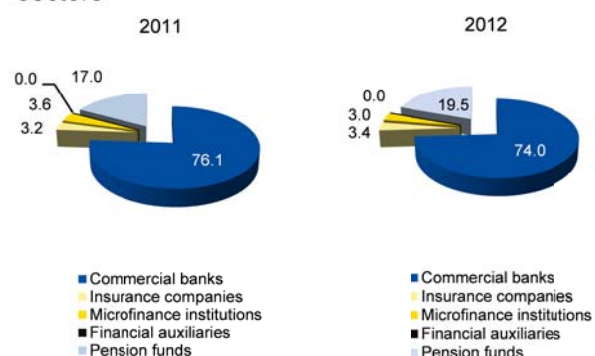
During 2012, the financial sector in Kosovo was characterized by recuperation of growth trend compared to the previous year. The growth of financial sector sustainability in 2012 was mainly driven by recuperation of the growing trend of assets of insurance sector and pension funds, while the banking system assets continued with a slower growing trend. The value of total assets of financial sector in the country reached euro 3.8 billion in 2012, which represents an annual growth of 9.7 percent (in 2011 this growth was 9.2 percent). Banking system, as a key component of Kosovo's financial sector, reported an annual growth of assets of 6.8 percent in 2012 compared to the annual growth of 7.9 percent in 2011, which is mainly driven by the slowdown of crediting growth.

The value of asset of microfinance institutions decreased to euro 115.8 million in 2012, from euro 127.1 million that was in 2011, resulting mainly from the slowdown of lending activity of these institutions due to making funding conditions difficult by external markets. On the other hand, it were the insurance companies and pension fund sectors that recuperated their growing trend in 2012 compared to the previous year, thus increasing their contribution to the total assets of financial sector.

The value of assets of insurance companies reached euro 130.8 million in 2012, an annual growth of 16.3 percent (15.6 percent in 2011). Also, assets of pension funds amounted to euro 745 million in 2012, an annual growth of 25.6 percent (20.2 percent in 2011).

The financial sector in the country basically provides traditional financial services. Commercial banks, which are mainly funded by collection of deposits inside the country, as their primary activity continue crediting the domestic economy. The insurance industry generates the written premiums mainly through the Third Party Liability (TPL) insurance, and the microfinance institutions through lending as a primary activity financed by funds borrowed from financial institutions operating outside Kosovo.

Figure 19. Structure of financial system assets, by sectors



Source: CBK (2013)

Regarding the structure of financial sector assets in Kosovo, commercial banks continued to be the major participants, managing 74.0 percent of total assets of the sector. During this period, it was noticed that the share of pension funds and insurance companies recorded a growth of 19.5 percent, respectively 3.4 percent (17.0 percent and 3.2 percent, respectively, in 2011). The same as in the previous year, microfinance institutions and financial auxiliaries were characterized by a decrease of their share (Figure 19).

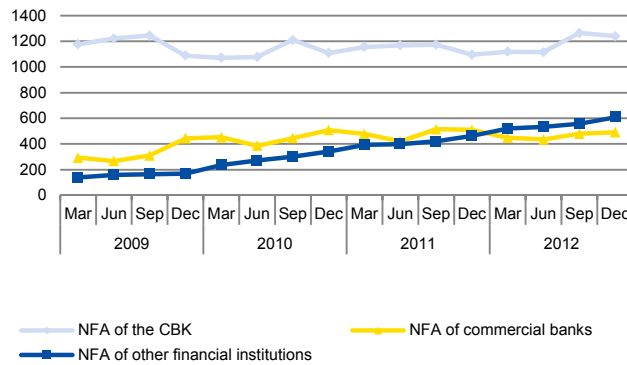
In 2012, the number of commercial banks operating in Kosovo increased to nine (9), whereas the number of insurance companies remained unchanged from the last year, which was thirteen (13). Including also 18 microfinance institutions, 38 financial auxiliaries and 2 pension funds, the financial sector in the country listed a total of 80 financial institutions.

A considerable part of assets of Kosovo financial sector continues to be invested on external markets. The value of Net Foreign Assets (NFA)⁶ in 2012 reached euro 2.34 billion, representing an annual growth of 13.0 percent (5.6 percent in 2011). In 2012, net foreign assets of the CBK, which have a share of 53 percent of total NFA, reached the value of euro 1.2 billion. On the other hand, NFA of commercial banks and other financial institutions, which have a share of 21 percent and 26 percent, respectively, in total NFA, reached the value of euro 490.8 and 607.6 million, respectively, (Figure 20).

Acceleration of the NFA growth trend during 2012 was mainly a result of a higher growth rate of claims of the financial institutions operating in Kosovo to the external sector. Reaching the value of euro 2.77 billion in 2012, claims to the external sector recorded an annual growth of 13.4 percent compared to an annual growth of only 2.4 percent in 2011. The majority of claims to the external sector remain invested on deposits (45 percent), other shares and equities (24.0 percent) and securities (17.5 percent). During 2012, it was noticed a growth of the share of investments in securities and a growth of investments in other shares and equities, while investments in deposits decreased their share (Figure 21).

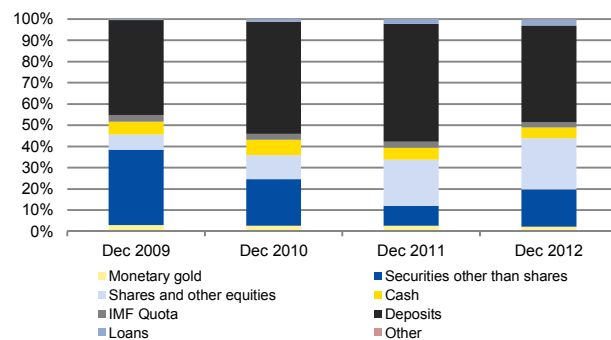
In 2012, the financial sector claims to the external sector were shifted from investments in deposits (45.5 percent in 2012 and 55.6 percent in 2011) to investments in securities (17.5 percent in 2012 and 9.4 percent in 2011). Commercial banks also shifted a small part of their investments in deposits to investments in securities. Investments in securities comprised 20.8 percent of total assets invested abroad from commercial banks operating in Kosovo (11.1 percent in 2011), while

Figure 20. Net foreign assets by institutions, in millions of euro



Source: CBK (2013)

Figure 21. Structure of claims to external sector, in percent



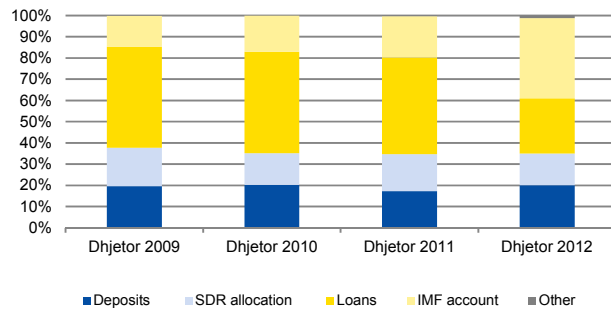
Source: CBK (2013)

⁶In this context, financial sector includes Central Bank of the Republic of Kosovo and all financial institutions operating in Kosovo.

investments in deposits continue to represent the largest part with a share of 53.9 percent (65.7 percent 2011).

In 2012, the financial sector liabilities to the external sector reached the value of euro 436.3 million, which represents an annual growth of 15.4 percent compared to the previous year. Non-resident deposits in banks operating in Kosovo recoded an annual growth of 34.1 percent in 2012, thus contributing to the growth of total liabilities of financial sector to the external sector by 5.9pp. However, loans that financial institutions operating in Kosovo received from financial institutions operating abroad recorded an annual decline of 34.1 percent and contributed negatively to total liabilities to the external sector by 15.5pp. In 2012, the IMF quota reached euro 165.3 million (73.7 million euro in 2011), contributing positively to the growth of financial sector liabilities to the external sector by 24.2pp and increasing the share to total liabilities to 37.9 percent (19.5 percent in 2011) (Figure 22).

Figure 22. Structure of liabilities to external sector, in percent



Source: CBK (2013)

In 2012, net claims against the internal sector reached the value of euro 1.1 million, which represents a growth of 9.6 percent compared to the same period of the previous year (28.8 percent in 2011). A slower growth of net claims against the internal sector was mainly driven by the growth of government deposits of 5 percent in this period, as well as a slowdown of the growth of claims against the private sector by around 3.4 (12.2 percent in 2011).

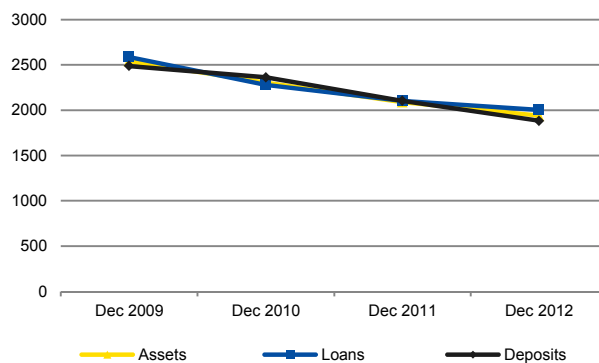
3.3.2 Banking System

In 2012, a new bank joined Kosovo banking system, thus increasing the number of commercial banks to nine (9). The structure of banks by ownership remained unchanged: 7 banks of foreign ownership and 2 banks of domestic ownership. Foreign banks have a share of 89.5 percent in total asset of the country's banking system.

Banking market continues to be characterized by a relatively high concentration rate, although this rate indicated a declining tendency in recent years.

Constant growth of the activity of small banks participating in banking system in the country made the share of assets of three large banks to be 69.3 percent in 2012, which represents a decline compared to the last year when these three banks managed 73.3 percent of total assets. This decline of concentration in banking market is also noticed through Herfindahl-Hirschman Index (HHI), which presents the market concentration rate. In the last four years, HHI on banking market in the country recorded a decline of the banking concentration of the total assets, loans and deposits (Figure 23). According to HHI for assets, the banking market was

Figure 23. HHI for assets, loans and deposits



Source: CBK (2013)

characterized by a concentration rate of 1,939 points in 2012, which represents a decline of concentration rate by 150 HHI points compared to 2011.

Banking infrastructure remained unchanged from the previous year in terms of expansion. The number of branches and sub-branches of commercial banks reached 310 in 2012, which represents a similar level to the previous year. Also, in 2012, commercial banks had a total of 3,727 employees, compared to the previous year when the banking system had 3,728 employees.

Table 3. Electronic payments, in millions of euro

Description	2009	2010	2011	2012
Number of branches and sub-branches	295	311	310	310
Number of employees	3,459	3610	3728	3727
ATM withdrawals	582	640	790	873
POS payments	68	94	142	178
E-banking payments	607.3	782.4	1,191.8	1,499.1

Source: CBK (2013)

On the other hand, it was continued with the expansion of the network of Point of Sales (POS) terminals, Automated Teller Machines (ATM) and the number of e-banking accounts (Table 1). The use of POS terminals was higher in 2012, amounting to euro 178 million compared to the total amount of euro 142 million in the previous year. Client's withdrawals through ATM was also characterized by a growth, which in 2012 reached the amount of euro 873 million (euro 790 million in 2011). Also, the value of e-banking electronic payments recorded the amount of euro 1.5 billion, which represents a growth compared to the previous year when these payments had the value of euro 1.2 billion. The growth of electronic payments proves a constant decrease of payments in cash.

3.3.2.1 Banking System Balance Sheet

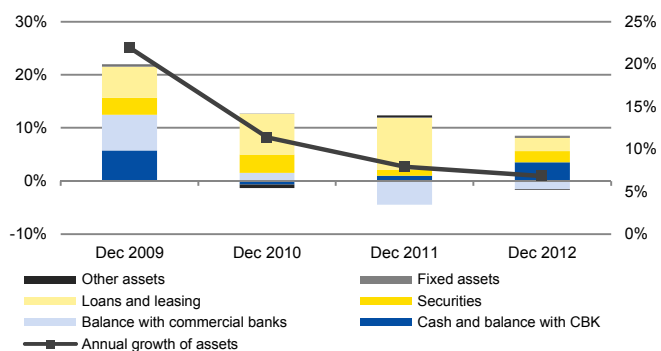
i. Assets

Banking system assets were characterized by a slower growth trend in December 2012. Total assets of commercial banks reached the value of euro 2.83 billion in 2012, which represents an annual growth of 6.8 percent (7.9 percent in 2011). As a GDP share, the banking system asset in the country had a share of 56.3 percent to GDP in 2012.

The growth of assets during this period was mainly realized through lending and investments in securities, and despite

the contribution given by loans it was significantly lower compared to the previous years. In 2012, the growth of loans and investments in securities contributed by 2.5 percent and 2.1pp, respectively, to the growth of total assets of the banking system (9.8 and 1.2pp, respectively, in 2011). The largest contribution to the growth of assets in 2012 was given by cash and balance with CBK, namely the commercial banks reserves in CBK and other accounts, which contributed by around 3.1pp to the growth of total assets of the banking system. On the other hand, the growth of asset in this period restrained the balance with other banks, contributing negatively by

Figure 24. Contribution to the growth of the banking system assets by categories, in percent

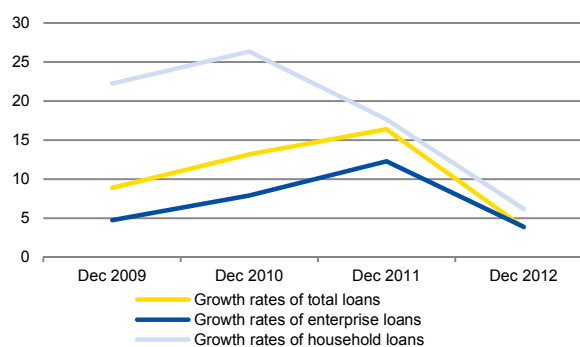


Source: CBK (2013)

around 1.6pp in 2012. Balance with commercial banks had a negative contribution to the growth of total assets of the banking system in this period, mainly because of the orientation of banks operating in the country towards investments in securities and lending, in addition to placements in banks outside Kosovo, (Figure 24).

The main banking activity continues to be focused on crediting the economy, although the loan growth trend during 2012 appears to be slow. Structure of the banking system assets in 2012 continues to be dominated by loans, which represent 62.3 percent of total assets of commercial banks (Table 4). In 2012, loans reached the value of euro 1.76 billion (euro 1.69 billion in 2011). While in 2011, crediting of the economy was characterized by an acceleration trend compared to 2010; the data for 2012 show a significant slowdown of growth. The annual growth rate of banking system loans in 2012 was 3.8 percent compared to the growth of 13.2 and 16.4 percent, respectively, in 2010 and 2011 (Figure 25).

Figure 25. Growth rates of loans by sectors, in percent



Source: CBK (2013)

The slowdown of crediting growth during 2012 was a consequence of the decrease of demand for loans, as well as tightening the criteria and standards applied in crediting process by banks in the country both to enterprises and households. While the decrease of demand for loans was present mainly among the enterprises, tightening of standards and criteria by banks to issue loans was applied to both enterprises and households

Demand for loans by enterprises is estimated to have declined as a consequence of tightening of standards and criteria by banks. According to the results of questionnaire conducted by CBK with banks operating in the banking market in the country, banks stated that besides specific problems faced by sectors where enterprises operate and the impact of these specifications as a consequence on the performance of loan payment, the key factor that impacted on tightening the crediting criteria and standards was the negative perception of the overall economic environment in the country.

Table 4. Structure of the banking system assets

Description	December 2009		December 2010		December 2011		December 2012	
	In millions of euro	Share in percent	In millions of euro	Share in percent	In millions of euro	Share in percent	In millions of euro	Share in percent
Cash and balance with CBK	322.2	14.6	307.5	12.5	331.5	12.5	425.7	15.0
Balance with commercial banks	405.6	18.4	439.0	17.9	329.5	12.4	287.9	10.2
Securities	97.0	4.4	173.4	7.1	202.0	7.6	256.6	9.1
Loans and leasing	1289.0	58.5	1458.7	59.4	1698.1	64.1	1,763.4	62.3
Fixed assets	43.1	2.0	44.0	1.8	47.4	1.8	57.7	2.1
Other assets	47.7	2.1	32.3	1.3	41.3	1.6	38.1	1.4
Total	2,204.6	100.0	2,455.0	100.0	2,649.7	100.0	2,829.3	100.0

Source: CBK (2013)

Similar to the previous year, slower investment trends of commercial banks in markets abroad were evidenced during 2012. The balance of commercial banks in Kosovo with banks abroad decreased by 12.6 percent in 2012, reaching euro 287.9 million. On the other hand, commercial banks increased investments in securities in external market in 2012. Reaching the value of euro 256.6 million, investments in securities recorded an annual growth of 27 percent in 2012 (16.4 percent in 2011). Commercial banks in the country oriented a larger part of their assets towards investments in securities during 2012 (9.1 percent of total assets in 2012 compared to 7.6 percent of assets in 2011), mainly due to the slowdown of crediting the economy in the same period.

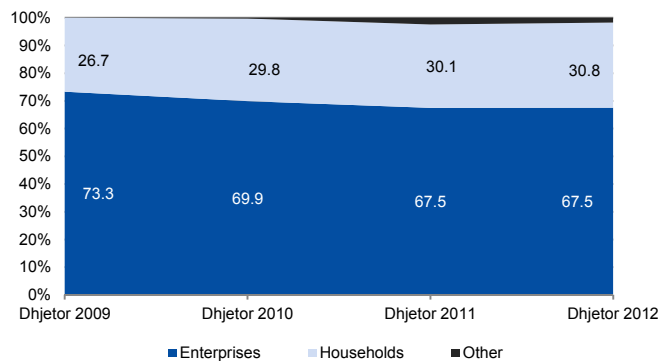
ii. Structure of Loans

Slowdown of crediting the economy by commercial banks during 2012 was reflected both in loans to households and loans to enterprises. Loans to households recorded an annual growth of 6.2 percent in 2012, compared to an annual growth of 17.7 percent in the previous year. Similarly, loans to enterprises were characterized by a slowdown of growth from 12.3 percent in 2011 to 3.9 percent in 2012.

Slowdown of crediting from banking system weighted more on non-financial enterprises, which shows a decrease of their contribution in total loans to 2.0pp in 2012 from 8.8pp that they contributed in the previous year. The contribution of household loans to the growth of total loans of banking system decreased to 1.9pp for the same period, compared to the contribution of 5.3pp in 2011. These developments were not also reflected in the structure of total loans, where it is noticed a slight growth of the share of household loans, while the share of loans to enterprises remained at the same level as in the previous year (Figure 26). The share of household loans in total loans issued by commercial banks in the country reached 30.8 percent in 2012, compared to the share of 30.1 percent in the previous year.

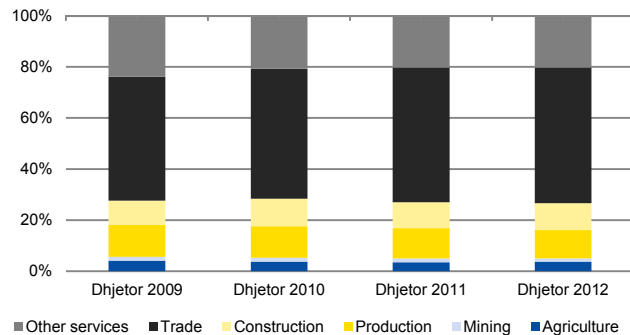
Concerning the banking system loans to enterprises, the structure according to their economic activity remained unchanged from the previous years. Services sectors continue dominating

Figure 26. Structure of loans, in percent



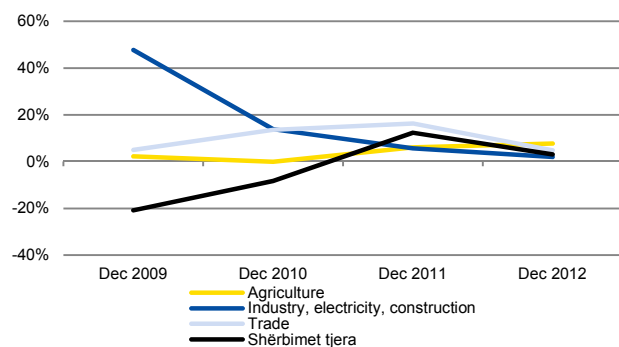
Source: CBK (2013)

Figure 27. Structure of loans by economic activity, in percent



Source: CBK (2013)

Figure 28. Growth trends of loans by economic sectors, in percent



Source: CBK (2013)

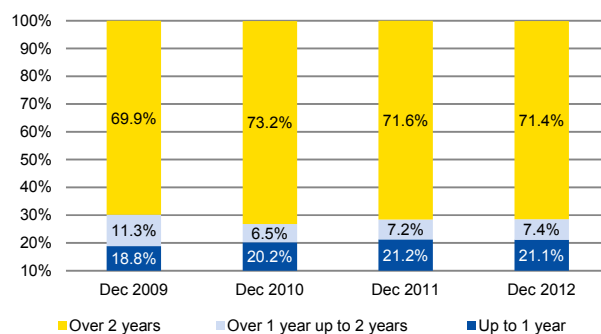
the structure of loans to enterprises, with 72.0 percent in 2012 (71.7 percent in 2011). Within the services sector, loans to trade enterprises continue to have the highest share in total loans of banking system. In 2012, trade loans represented 53.2 percent of total loans of the banking system (52.7 percent in 2011). Loans to mines, manufacturing and construction, which are characterized as loans to industry sector, represented 24.2 percent of total loans in 2012 (Figure 27). Agriculture loans continue to have a lower share of 3.7 percent in 2012 (3.5 percent in 2011). Estimated as a sector with a higher uncertainty, banks apply higher rates to agriculture loans, thus discouraging the borrowers to apply for loans, as this increases furtherly their financing cost.

The growth trend of loans by economic sectors reflects a slowdown of crediting to all sectors, other than agriculture loans which were characterized by an acceleration of growth trend. In 2012, loans to agriculture sector recorded a growth of 7.7 percent, compared to the growth of 6.1 percent in the previous year (Figure 28). Conversely, loans belonging to industry sector, energetic and construction sector suffered a slowdown of growth with 2.0 percent in 2012, compared to an annual growth of 5.7 percent in the previous year. Also, loans to trade sector recorded an annual growth of 4.8 percent in 2012, which is a slowdown compared to the annual growth of 16.3 percent in the previous year. Loans classified within other services also indicated a slowdown of growth in the reporting period with 3.1 percent (12.4 percent in 2011).

The structure of loans by maturity continue to be dominated by loans with a longer maturity (over two years), which in 2012 comprised 71.4 percent of total loans. Loans with maturity up to one year also had a considerable share of 21.1 percent in 2012. However, regarding their share in total loans of banking system, both these two categories recorded a slowdown of growth in 2012 compared to the previous year, where loans with maturity over two years and loans with maturity up to one year had a share of 71.6 and 21.2, respectively. Conversely, loans with maturity over one year up to two years increased their share in total loans to 7.4 percent in 2012 from 7.2 percent in 2011 (Figure 29).

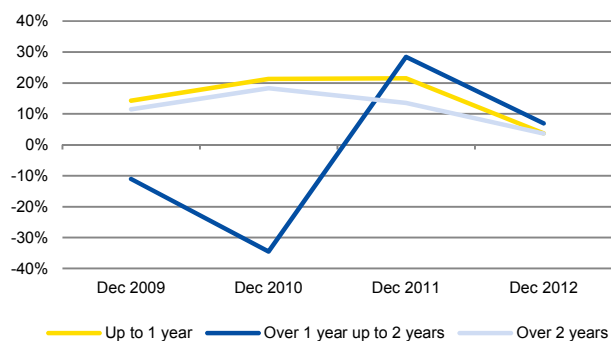
Regarding the annual growth of loans by maturity, the hesitation of banks to extend crediting during 2012 was reflected throughout the allocation of loans by maturity. Compared to the previous years, in 2012 it was evidenced a slowdown of growth with maturity up to one year to 3.7 percent (21.5 percent in 2011) and loans with maturity over one year up to two years 6.9 percent (28.4 percent in 2011). On the other hand, loans classified as loans with longer maturity

Figure 29. Structure of loans by maturity, in percent



Source: CBK (2013)

Figure 30. Growth trend of loans by maturity, in percent



Source: CBK (2013)

where characterized by a slowdown of growth since 2010. In 2012, loans with maturity over two years slowed down their annual growth to 3.6 percent (13.6 percent in 2011) (Figure 30).

iii. Liabilities

The structure of the banking system liabilities continued to be dominated by deposits, which at the same time represent the main funding resource for commercial banks in Kosovo. In 2012, the banking system deposits had a share of 80.6 percent, which is an annual growth compared to their share of 79.4 percent in 2011, (Table 5).

The value of total deposits of banking system in the country in 2012 reached euro 2.3 billion, which shows an annual growth of 8.3 percent compared to an annual growth of 8.6 percent in the previous year (Figure 31). The slowdown of deposit growth was mainly driven by the decrease of public non-financial corporate deposits in this period.

Table 5. Structure of the banking system liabilities

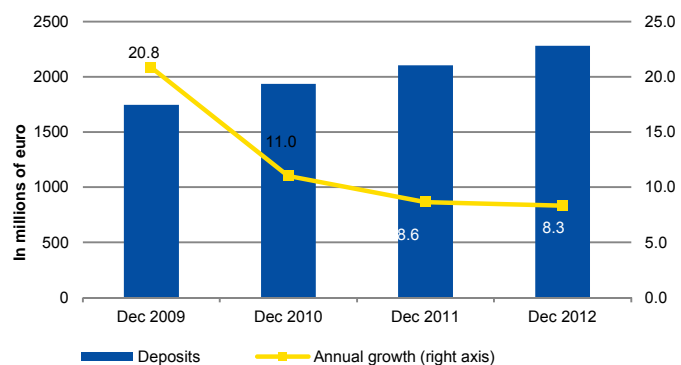
Description	December 2009		December 2010		December 2011		December 2012	
	In millions of euro	Share in percent	In millions of euro	Share in percent	In millions of euro	Share in percent	In millions of euro	Share in percent
Balance with other banks	58.5	2.7	94.0	3.8	40.0	1.5	6.0	0.2
Deposits	1,744.8	79.2	1,936.9	78.9	2,104.0	79.4	2,279.1	80.6
Other borrowings	0.0	0.0	0.1	0.0	30.4	1.1	18.9	0.7
Other liabilities	171.3	7.8	160.0	6.5	190.1	7.2	223.6	7.8
Subordinated debt	24.4	1.1	33.5	1.4	31.0	1.2	31.0	1.1
Own resources	205.6	9.3	230.5	9.4	254.3	9.6	270.7	9.6
Total liabilities	2,204.6	100.0	2,455.0	100.0	2,649.7	100.0	2,829.3	100.0

Source: CBK (2013)

Also, own assets keep having a considerable share in the structure of liabilities of commercial banks in the country, which in 2012 remained unchanged from the previous year at 9.6 percent of total liabilities. Own assets reached the value of euro 270.7 million in 2012, and recorded an annual growth of 6.5 percent. As an external funding resource to commercial banks in Kosovo, the balance with other banks shows a decline in 2012. The balance with other banks abroad recoded the value of euro

6 million, which represents a significant decrease of this item compared to the value of euro 40 million in 2011. On the other hand, the subordinated debt recorded the value of euro 31 millions, a similar value to the previous year. Compared to the previous year, commercial banks in the country decreased the use of other borrowings, which are basically credit lines from the international institutions. These borrowings by banks reached the value of euro 18.9 million in 2012, a decrease compared to the value of euro 30.4 million in 2011. As indicated, commercial banks in the country in 2012 faced a decline, respectively a slowdown of all traditional funding resources, which was reflected in a slowdown of growth of total liabilities of banking system to 6.8 percent (7.9 percent 2011).

Figure 31. Deposits growth trend, in percent



Source: CBK (2013)

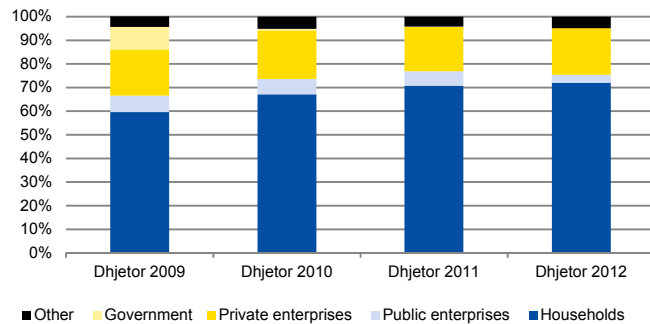
iv. Structure of Deposits

Similarly to the previous years, the structure of banking system deposits in Kosovo banking sector continues to be generated mainly from households, whose deposits comprised 72 percent of total deposits in 2012. Compared to 2011, household deposits increased their share in total deposits by 1.1pp, despite of their lower growth rate they had in 2012. Household deposits reached the value of euro 1.6 billion and recorded an annual growth of 10 percent in 2012, compared to a growth of 14.7 percent in 2011.

As to division of sectors, enterprise deposits reached the value of euro 528 million, which is an annual growth of 0.8 percent. In 2012, the structure of enterprise deposits continued to be dominated by deposits of private enterprises with 85.7 percent of the total enterprise deposits. Compared to the previous year, where deposits of private enterprises recorded an annual decline of 1.1 percent, in 2012, these deposits recorded an annual growth of 14.4 percent. Deposits of the public enterprises reached the value of euro 75.6 millions, a decrease of 41.2 percent compared to 2011. Deposits of the public enterprises also decreased their share compared to the last year from 24.5 percent of total enterprise deposits in 2011 to 14.3 percent in 2012 (Figure 32). Government deposits further decreased in 2012 to euro 0.7 million from euro 2.7 million in 2011, decreasing their share in non-resident deposits increased their share in total deposits of the banking system to 3.8 percent in 2012. In 2012, the total value of non-resident deposits reached euro 86.9 million compared to euro 64.2 million in 2011.

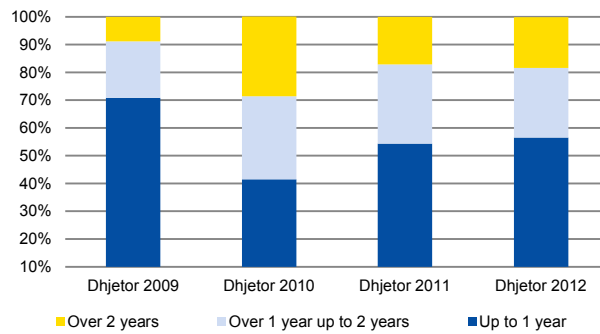
Kosovo banking system maintained the similar maturity of deposits structure as in the previous year. With a share of 51.4 percent in the total deposits of banking system, time deposits continued to dominate the structure of deposits. The remaining part of deposits consist of transferable deposits and savings deposits, which by the end of 2011 had a share of 33.0 percent, and 15.6, respectively, of total deposits.

Figure 32. Structure of deposits by sectors, in percent



Source: CBK (2013)

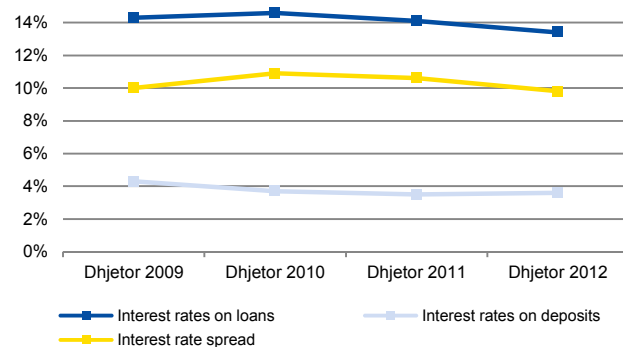
Figure 33. Structure of deposits by maturity, in percent



Source: CBK (2013)

total deposits by 0.1pp during this period. Conversely,

Figure 34. Annual average interest rates, in percent



Source: CBK (2013)

Source: CBK (2013)

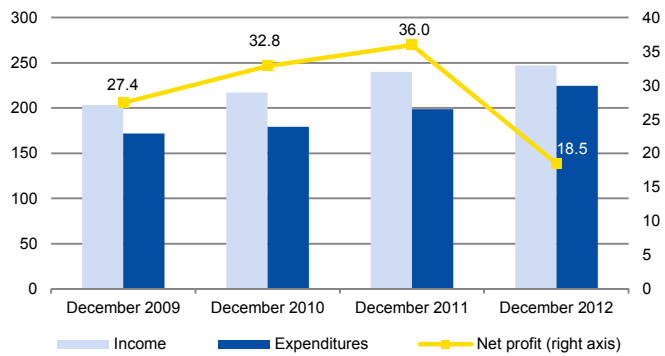
According to maturity, the structure of time deposits remained dominated by deposits with shorter maturity. With a share of 56.5 percent in total banking system deposits in 2012, deposits with maturity up to one year increased their share by 2.1pp (Figure 33). Deposits with maturity over one year up to two years represented 25.1 percent of total deposit, which is a decrease of their share compared to the previous year when these deposits represented 28.5 percent. The decrease of share of deposits with maturity over one year up to two years was mainly driven by retiming a part of household deposits under this maturity into deposits with maturity over six months up to one year. The remainder of banking system deposits consists of deposits with maturity over two years, which in 2012 had a share of 18.3 percent (17.1 percent in 2011). In 2012, deposits with maturity up to one year were characterized by an annual growth of 14.5 percent, while deposits with maturity over two years were characterized by an annual growth of 18 percent. Deposits with maturity over one year up to two years, which were characterized by an annual decline of 2.7 percent in 2012, were an exception. In general, it is noticed a growth of deposits with longer maturity, which among the others reflected a constant enhancement of public trust on Kosovo banking system. To some extent the approval of the law and functioning of the scheme for deposits insurance might have had its contribution to this.

3.3.2.2 Interest Rates

In 2012, the loan interest rates were characterised by a decline, while the deposit interest rates recorded a growth. The average loan interest rate in 2012 decreased to 13.4 percent, compared to 14.1 percent that was in 2011. Consequently, the interest rate spread decreased to 9.8pp in 2012 from 10.6pp as it was in 2011 (Figure 36).

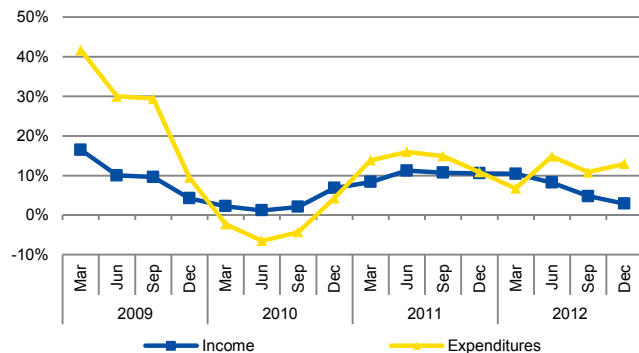
Concerning deposits, the average interest rate on household deposits was higher compared to the average interest rate on enterprise deposits in 2012. The highest average interest rate on household deposits in 2012 was 5.23 percent for deposits with

Figure 35. Balance of income and expenditures, in millions of euro



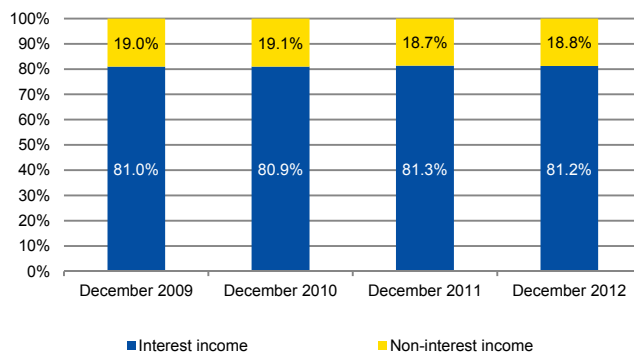
Source: CBK (2013)

Figure 36. Annual growth of income and expenditures



Source: CBK (2013)

Figure 37. Income structure, in percent



Source: CBK (2013)

maturity over two years. On the other hand, the highest interest rate on enterprise deposits in 2012 was 5.09 percent for deposits with a value of euro 250 thousand and with maturity of over two years.

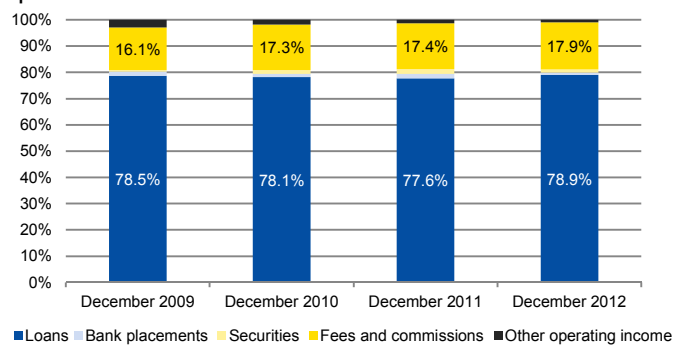
The average interest rates on loans to enterprise indicated a decline in 2012 compared to 2011 for all sectors. Investment loans had an average interest rate of 12.9 percent, compared to the average rate of 14.2 percent in 2011. The other business loans also indicated a decrease of the average interest rate to 14.6 percent in 2012, compared to the average interest rate of 15.6 percent in 2011. Also, the average interest rates on overdrafting and credit lines was characterized by a slight decline to 11.0 percent and 12.1 percent, respectively, in 2012, compared to 12.1 and 13.2 percent, respectively, in the previous year. Concerning the average interest rates on household loans, in 2012, it was noticed a slight decline of 0.2 percent both in consumer loans and in mortgage loans.

3.3.2.3 Banking system performance

Kosovo banking system profit in 2012 decreased to euro 18.5⁷ million, recording an annual decline of 48.8 percent (Figure 38). Three out of eight total banks and bank branches that operated in Kosovo during 2012 recorded a negative performance. The decline of banking system profit came as a consequence of slowdown of annual growth of the overall income, which increased only by 2.9 percent (10.5 percent in 2011). On the other hand, expenditures recorded a rather significant growth of 13.0 percent (10.9 percent in 2011), thus contributing in decreasing the net profit up to around 50 percent (Figure 39).

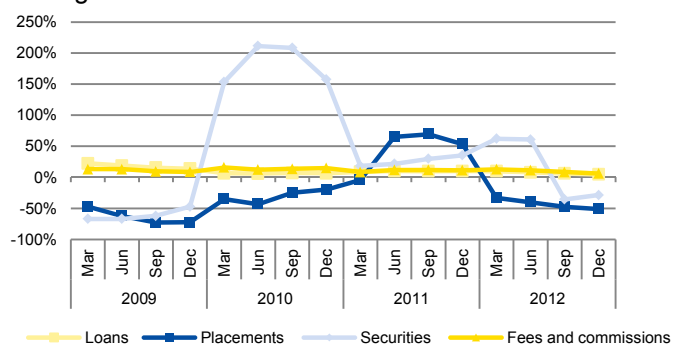
Key factors which impacted on the decrease of income growth rate are the low credit activity growth and the slight decline of the interest rates on loans. This is due to the fact that the interest income (namely the income from loan interest) dominated the structure of the banking system income (Figure 39). By the end of 2012, the value of interest income reached euro 200.5 million, recording an annual growth of only 2.7 percent (11 percent in 2011). On the other hand, non-interest income, which amounted at euro 46.6 million, indicated a lower volatility. The annual growth of non-interest income was 3.5 percent (8.6 percent in 2011), making the share of the latter in the structure of total income record a slight growth at the

Figure 38. Structure of income by categories, in percent



Source: CBK (2013)

Figure 39. Annual growth rate of income by categories



Source: CBK (2013)

⁷ Including the performance of a branch of Turkish bank Ish Bankasi, which started its operation in December 2012, increasing the number of banks and bank branches operating in Kosovo.

level of 18.8 percent (Figure 37). However, the interest income are those that significantly continue to dominate the structure of banking system income in Kosovo, which at the same time makes the system income very much exposed to changes in volume, structure and quality of interest generating assets as well as changes in interest rates.

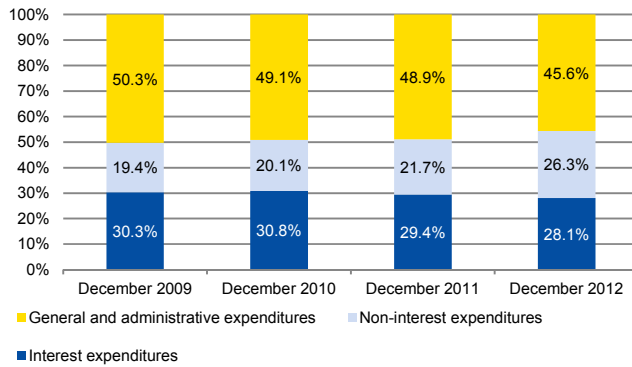
Income from placement of banks operating in Kosovo to banks abroad, as well as income from investments in securities recorded a negative growth compared to 2011, decreasing their share in the income structure (Figure 38), and consequently contributing to a slowdown of growth to total revenues (Figure 39). Interest income from placements abroad decreased up to around 50 percent as a consequence of the decrease of placements volume with banks abroad (a decline of 13 percent compared to the previous year), and as a consequence of the decline of interest rates on these placements, which corresponds with a decrease of basic interest rate from the ECB in December 2011 and in July 2012.

Income from securities decreased to 29 percent against a growth of 27 percent of investments volume in this category. This deteriorated performance caused by investments in securities mainly reflects the decrease of premiums in European financial markets during the second half of 2012, as well as the possibility of imposing a rather conservative investment policy by banks. Non-interest income basically is comprised by fee and commission income, which in 2012 recorded an annual growth of 5.9 percent (11.1 percent in 2011).

Despite a slowdown of growth, fee and commission income continued with a slightly growing trend of their share in the structure of total income, which suggests a constant expansion of the variety of services provided by banks and a growth of utilization rate of these services.

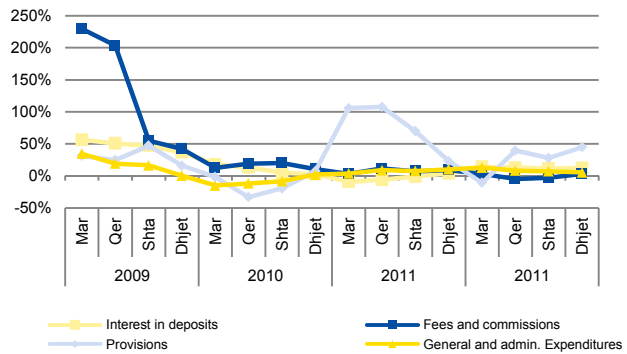
Banking system expenditures during 2012 reached the value of euro 224.6 million compared to euro 198.8 million in 2011. The structure of expenditures continues to be dominated by general and administrative expenses, followed by interest and non-interest expenses (Figure 40). The dominating category of expenses, general and administrative expenses, recorded a slowdown of growth from 10.3 percent in 2011 to 5.4 percent in 2012. The slowdown of expenses of this category was significantly driven by the slowdown of growth of personal expenses, which dominate the structure of these expenses, and which increased by 3.9 percent compared to 7.7 percent in 2011. However, the other two categories of expenses, interest expenses and non-interest expenses incurred an acceleration of their growth, impacting on a slight acceleration of

Figure 40. Structure of expenditures, in percent



Source: CBK (2013)

Figure 41. Annual growth rate of expenditures by categories, in percent



Source: CBK (2013)

growth of total expenses compared to 2011 (Figure 41). A rather significant growth was recorded by provision income, which consist a dominating portion of non-interest expenses.

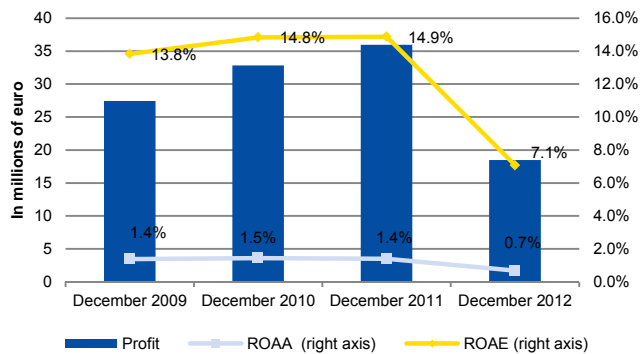
Their value by the end of 2012 reached euro 50.3 million, which represents an annual growth of 44.8 percent (22.9% in 2011). These expenses mainly include provisions allocated to cover prospected loan losses, which were allocated as a result of deterioration of loan portfolio and growth of non-performing loans in banking sector. Interest expenses also accelerated the growth to 8 percent from 5.9 percent in the previous year. Deposit interest expenses, as the main component of expenses of this category with a share of 91 percent, recorded a growth of 12.3 percent compared to 3.9 percent in 2011. This growth is mainly attributed to the growth of the deposit interest rate, as the growth rate of the volume of deposits remains roughly the same with the previous year.

3.3.2.3.1 Banking System Profitability and Efficiency

The key profitability indicators recorded a decline as a result of profit decline. Return on Average Equity decreased to 7.1 percent compared to 14.9 percent in 2011 (Figure 42). Return on Average Assets also recorded a decline to 0.7 from 1.4 percent in the previous year. However, the decline of these profitability indicators does not present any risk to the banking system capital adequacy which remains at satisfactory level.

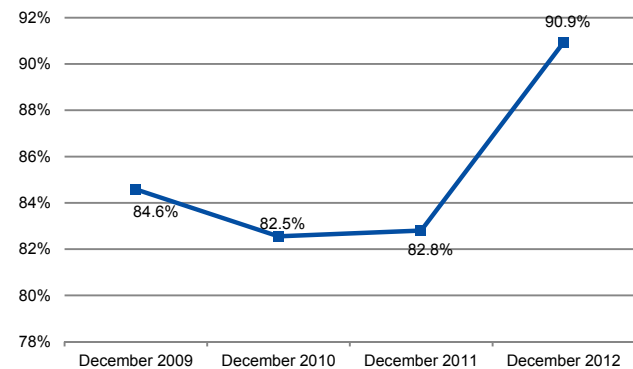
The efficiency ratios also recorded a decline. The general efficiency ratio, which shows the system capacity to cover general expenses during a period by total income generated at the same period, is deteriorated. Faster growth of expenses compared to income made the ratio between expenses and income increase to 90.9 percent in 2012, which represents a growth of 8.1pp compared to the previous year (Figure 43). Another efficiency ratio, the operating expenses against total income, has also recorded deterioration, yet at a lower rate of 1.0pp (Figure 44). This suggests that deterioration of the general efficiency ratio is not driven by

Figure 42. Profitability indicators



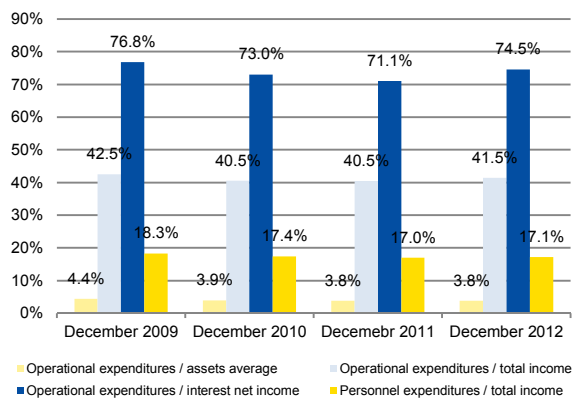
Source: CBK (2013)

Figure 43. Expenditures-to-income ratio, in percent



Source: CBK (2013)

Figure 44. Efficiency indicators



Source: CBK (2013)

the decline of efficiency in the management of operating expenses, but it was mainly driven by deterioration of the efficiency in management of activities related to other expenses, such as the credit risk management which caused the growth of provision expenses.

The net interest margin, which is another important performance and efficiency ratio of bank investments, recorded a decline (Figure 45). Net interest income recorded a slight growth, yet the volume of assets average which generate interest recorded a rather significant growth, impacting on the decrease of net interest margin, or the return from investments in these assets by 0.25pp.

3.3.2.4 Banking System Risks

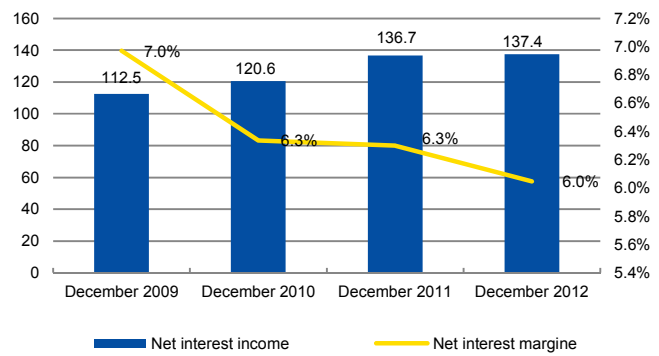
i. Liquidity Risk

All system liquidity ratios were maintained at satisfactory levels and in compliance with the CBK recommendations. The satisfactory liquidity situation is also confirmed by the stress-test analysis, the results of which suggest that even under the severest scenarios of deposit motion, the possible liquidity problems would be endurable by the banking system and isolated within individual banks.

Taking into account the liquidity ratios and the continuity of sustainable growth of banking system deposits, which also reflects a sustainable trust of citizens in this system, the liquidity risk in Kosovo’s banking system continues to be considered low.

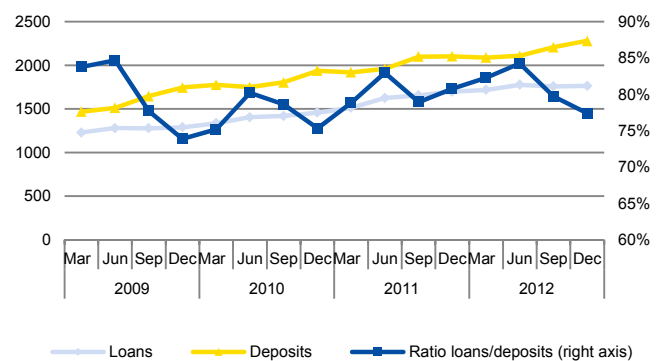
High level of liquid asset and low exposure to liquidity risk is directly linked to the structure of activity of Kosovo banking system, which is considered to be a traditional banking activity based system, with loans and deposits as the key components of the system balance sheet. High dependency on deposits as a funding resource made banks have a stable financing resource and not rely on short-term funds, the supply of which is more volatile and have a higher financing cost, especially at the periods of economic and financial difficulties similar to those the developed countries are going through.

Figure 45. Net interest margin



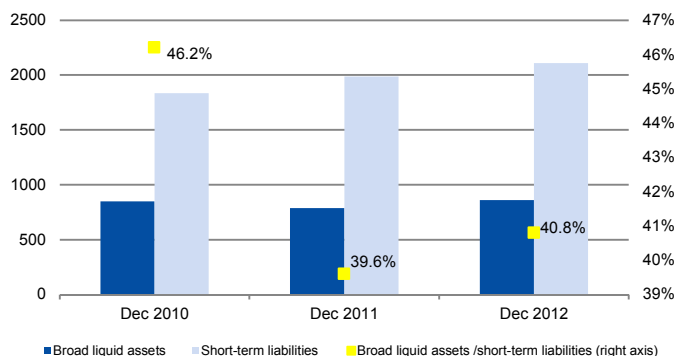
Source: CBK (2013)

Figure 46. Loans and deposits of the banking sector, in millions of euro



Source: CBK (2013)

Figure 47. The ratio of broad liquid assets /short-term liabilities



Source: CBK (2013)

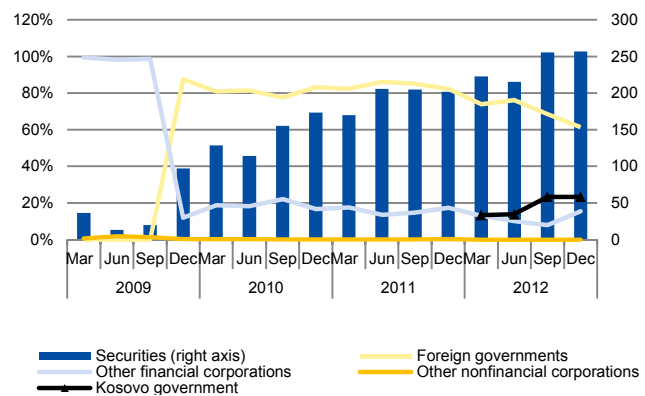
The fact that the banking deposits comprise 80.6 of total liabilities also indicates the high dependency of banks on local funds (79.4 percent in 2011). The advantage of dependency on deposits lies with the fact that these funds represent a stable resource and have recorded a positive growth for several years now, and they have a relatively low cost, compared to other funds, such as funding from abroad.

One of the most important indicator of the banking system liquidity is loan/deposit ratio, which shows the banks' capacity to cover loans by deposits. This ratio in 2012 decreased to 77.4 percent, compared to 80.7 percent in the last year (Figure 46). Decrease of this ratio reflects a lower growth of loans in 2012, compared to the growth of deposits, which did not change much compared to the last year. As it can be seen in Figure 46, the loan/deposit ratio is usually affected by seasonal factors. For instance, in the first quarters, this ratio records a slight increase and reaches the highest point usually in the second quarter. The fourth quarter is usually characterized by a decline of loan/deposit ratio. Consequently, the decrease of loan/deposit ratio also reflects partially the seasonal impact in this period.

Another important ratio of banking system liquidity is also the ratio between liquid assets and total assets. According to the International Monetary Fund definition, liquid assets are divided into core liquid assets and broad liquid assets.⁸ In December 2012, the share of core liquid assets was 25.3 percent, compared to 26.6 percent in December 2011. The decline of core liquid assets during this period was driven by the decrease of up to around 50 percent of banks' investments in placements with other banks abroad. In the meantime, during 2012, banks in Kosovo oriented around euro 5 million to investments in tradable assets and they increased to around euro 72 million (more than 60 percent) investments in securities, which investments were characterized by a higher risk and also by a higher return. Consequently, the share of broad liquid assets to total assets of the banking system increased to 32.6 percent compared to 31.3 percent in December 2011. Certainly, the liquidity rate of both core assets and broad assets suggest that the liquidity level in Kosovo banking system stands at a satisfactory position, although banks have to be more careful in diversification of investment portfolio, especially those of higher risk.

Another important ratio to the liquidity rate is also the ratio between assets and short-term liabilities, which assesses the banks' capacity in meeting short maturity liabilities, such as requests for withdrawal of deposits or payment of

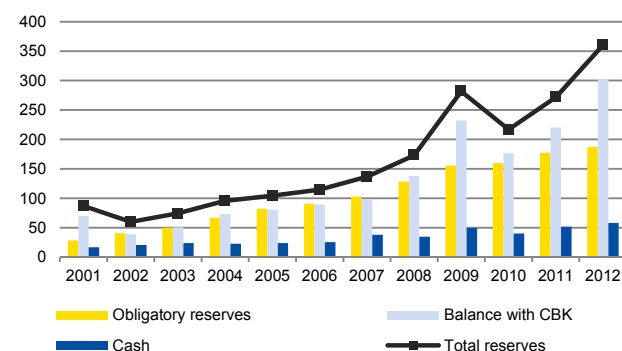
Figure 48. Structure of securities, in percent



Source: CBK (2013)

and they increased to around euro 72 million (more than 60 percent) investments in securities,

Figure 49. Banking sector reserves, in millions of euro



Source: CBK (2013)

⁸ Core liquid assets include cash and balance of banks with the CBK, current accounts with other banks and placements with other banks with maturity up to 90 days. Broad liquid assets include the core liquid assets and tradable assets and securities with maturity up to 90 days.

short-term debt. In December 2012, the ratio between core liquid assets and short-term liabilities stood at 31.7 percent which represents a decline of 2pp. The second part of 2012 was certainly characterized by a growing trend of this ratio. At the same reporting period, the ratio between broad liquid asset and short-term liabilities increased to 40.8 percent, compared to 39.6 percent in December 2011, which represents a higher ratio than the ratio established for banks, which has to be 25 percent of short-term liabilities (Figure 47).⁹ Core liquid assets against short-term liabilities, in the first half of 2012, recorded a declining trend from 29.4 percent in March to 28.3 percent in June 2012, while the second part of the year was characterized by a growth of this indicator to 30.3 percent in September and 31.7 percent in December 2012. Consequently, the ratio in the first part of the year impacted on the decrease of the share of core liquid assets in short-term liabilities, compared to the share of the last year. Despite the decline of core liquid assets against short-term liabilities, this ratio, together with the ratio of broad assets are considered to stand at satisfactory levels, suggesting that banks in Kosovo have a capacity to face the possible liquidity risk.

High concentration of deposits also serves as a liquidity risk ratio, especially to the category of deposits that can be withdrawn at any time (transferable deposits). The main part of deposits continues to be concentrated in large banks, but the share of transferable deposits to total deposits has certainly recorded a declining trend during the recent years which shows an improvement of liquidity management by banks (33 percent 2012, 33.2 percent 2011, 34.6 percent 2010). Within the transferable deposits of households and nonfinancial corporations, banks reported a concentration growth in 12.8 percent, respectively 23.8 percent. It is worth mentioning that the participation of 20 largest depositories in banking system was around 16.2 percent of total deposits, which shows a lower concentration of Kosovo citizens' deposits compared to some of the regional countries (for instance Macedonia).

The structure of banks' investments abroad is concentrated on products characterised by a relatively low non-return risk rate, such as investments in government bonds, financial corporations and nonfinancial corporations. At the same time, the diversification of investment portfolio by selected countries, such as France, Germany, United States, Netherlands etc., also indicated the orientation of banks' investments in the markets with higher security.

Assets invested in foreign markets during 2012 maintained the structure to three previous years (initiated in the end of 2009), where the majority of them was invested in Government bonds and less in financial corporations (Figure 48). In December 2012, the majority of 61.3 percent of investments was invested in bonds issued by foreign government. Investments in bonds and financial corporations usually have a relatively low percentage of total investments in securities (0.5 percent on the average, yet, during 2012 banks hesitated to invest in these securities and their share in total portfolio of investments in securities abroad was therefore almost zero.

As from the beginning of 2012, securities of Government of the Republic of Kosovo started to be issued for the first time, whereby it was possible to use the excessive liquidity for investment in a new product, respectively in treasury bills.¹⁰ In December 2012, investments in securities of Government of the Republic of Kosovo recorded 23.3 percent of total securities, which shows a relatively high interest of banks to invest in treasury bills inside the country, during a relatively short period of time (Figure 49).

The structure of investments in securities so far indicates a rather more conservative and prudential approach by commercial banks in the country. Certainly, lower risk investments or

⁹ According to new Regulation on Liquidity Management, which entered into force on 3 December 2012, banks have to keep at all times liquid assets against short-term liabilities: a) in Euro currency and foreign currencies at a level of 20 percent, b) total currencies at a minimum level of 25 percent.

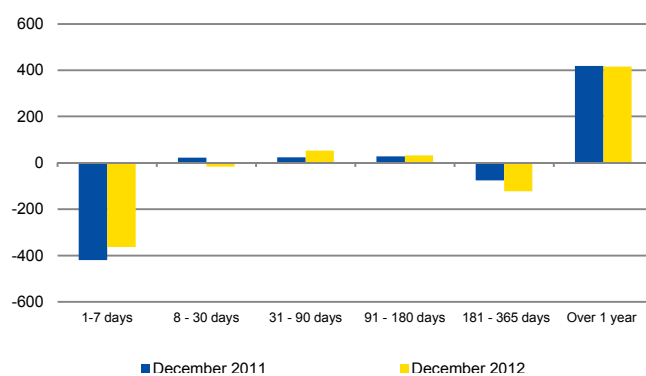
¹⁰ For more details, see Box 1, Monthly Statistical Bulletin No. 127, <http://www.bqk-kos.org/repository/docs/2012/BMS%20nr%20127%20shqip.pdf>

almost free risk ones, such as government securities also imply a lower return on investment, which is currently characterizing Kosovo banking system.

The fact that Kosovo banking system has a low exposure to liquidity risk is also confirmed by the rate of mandatory reserves, which are constantly maintained by banks in Kosovo at a higher level than the minimum level required by the regulatory (Figure 50). In December 2012, the total value of banking system liquidity reserves with CBK was euro 360.3 million, or 48 percent higher than the required reserve (banking system mandatory reserve in December 2012 was euro 187.1 million). The remainder of additional reserves helps in decreasing the banking system liquidity risk, and also implies an opportune cost of non-utilization of these assets in investments, taking into account that besides the mandatory reserve, the remainder is not reimbursed by return from interest.

The gap liquidity analysis is another way of liquidity risk assessment, which assesses the liquidity risk of assets with fixed maturity to settle liabilities within the same maturity timeframe. The difference between the value of assets with definite maturity and the value of liabilities with the same maturity gives the gap or the inconsistency of maturity. Positive value results in figure 50 show that the liquidity gap is positive, whereby the value of assets with a fixed maturity is higher than liabilities with the same maturity, which implies that these liabilities can remain solvent on time. Conversely, the negative gap shows that the value of assets with fixed maturity is lower than liabilities of that maturity.¹¹ Taking into consideration that the largest part of banking system assets comprises of loans, while liabilities are comprised of deposits, then the liquidity gap reflects the maturity distinction between loans and deposits. As shown in figure 50, period with shorter maturity are usually characterized by a negative liquidity gap, as liabilities exceed the assets and money outflows from banks are higher (usually non-time deposits). With the increase of maturity, the liquidity inconsistency moves into a positive gap, as the value of assets with longer maturity exceeds the loans issued (for instance with maturity over 1 year).

Figure 50. Liquidity gap, in millions of euro

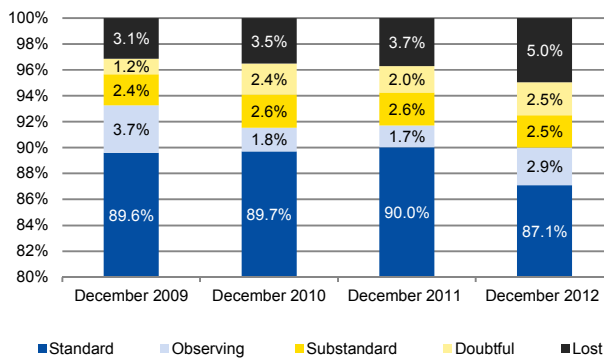


Source: CBK (2013)

ii. Credit Risk

During 2012, poorer performance of the economy in general and of the banking system in particular impacted on the decrease of credit portfolio quality. Taking into account difficulties faced by the Eurozone countries, as well deterioration of credit portfolio in majority of regional countries, it should be underlined that Kosovo banking system credit portfolio in general continues to have a good quality in

Figure 51. Structure of loans by classification



Source: CBK (2013)

¹¹ Maturity of assets and liabilities is divided in the following periods: 1 to 7 days, 8 to 30 days, 31 to 90 days, 91 to 180 days, 181 to 365 days and over 1 year.

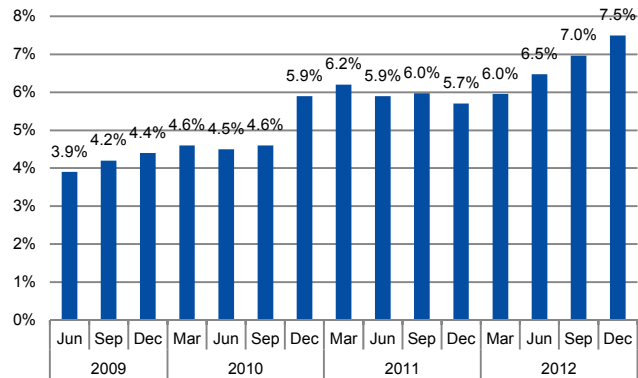
terms of classification of loans. However, it is worth mentioning the fact that during 2012 it was noticed a decline of credit portfolio quality.

Regarding the structure of loan classification based on quality, it is noticed a migration of loans from the category known as standard (which represents loans having no return problems) towards categories characterized by a poorer quality¹² Figure 51 shows that the share of loans falling under standard category recorded a decline of 2.9 pp compared to the previous year and stood at 87.1 percent of total banking system loans. During 2012, the share of classified loans to total loans recorded a growth by standing at 12.9 percent (10.0 percent in 2011). Also the share of loans with problems to total loans, in December 2012, was 10.0 percent (8.3 percent in December 2011).

A rather significant growth was recorded by loans classified as 'loss' and 'doubtful', where these two categories together comprise the non-performing loan portfolio. At the same time, this is the most important category in terms of description of credit portfolio quality. In December 2012, the share of NPL to total credit portfolio of banking system reached 7.5 percent from 5.7 percent in December 2011. Figure 52 shows that the NPL rate recorded a gradual growth throughout 2012. The current NPL level represents the highest level of NPL as from the beginning of banking system functioning in Kosovo.

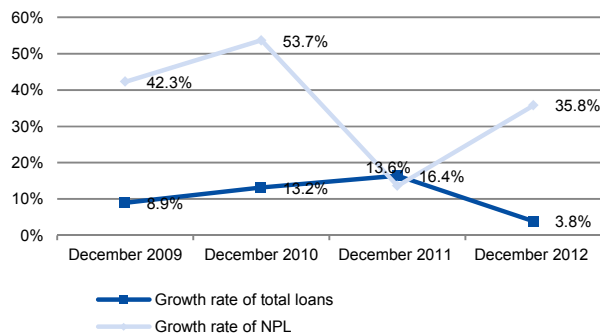
The annual growth of total loans was 3.8 percent, compared to 16.4 percent that was in December 2011 (Figure 53), while the annual NPL growth

Figure 52. NPL to total loans ratio, in percent



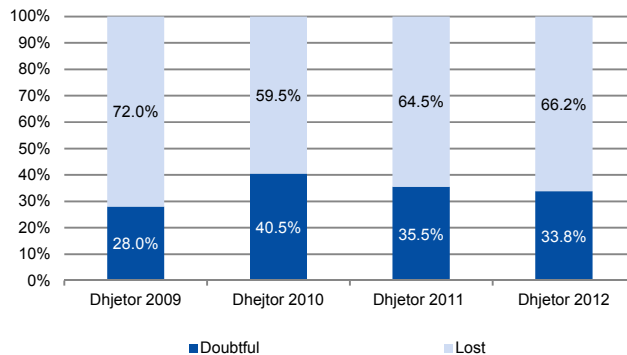
Source: CBK (2013)

Figure 53. Annual growth rate of total loans and NPL



Source: CBK (2013)

Figure 54. Structure of non-performing loans, in percent



Source: CBK (2013)

¹² Based on CBK regulations, loans in Kosovo banking sector are classified in five main categories: standard, observing, substandard, doubtful and loss. Classified loans include the following categories: watch, substandard, doubtful and loss loans. Problematic loans include the following categories: substandard, doubtful and loss loans. Non-performing loans include the following categories: doubtful and loss loans

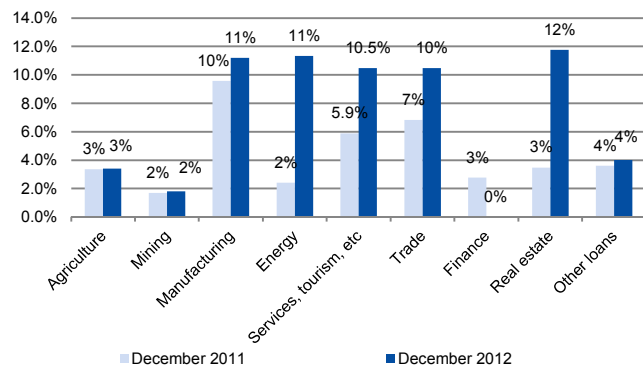
reached 35.8 from 13.6 that was at the end of 2011. The slowdown of the growth of loans in general was directly affected by the growth of NPL nominal level.

Concerning the NPL structure, by the end of 2012 loans classified as ‘loss’ represented 66.2 percent of total loans, while loans classified as ‘doubtful’ stood at 33.8 percent (Figure 54). During the respective period, ‘doubtful’ loans reached euro 44.2 million by recording a growth of 29.3 percent, while ‘loss’ loans increased to 39.4 percent, reaching euro 86.5 million compared to the previous year.

Despite the growth of NPL ratio, Kosovo banking system continues to have a high sustainability level, relying on its high capital adequacy level. However, further deterioration of credit portfolio quality must impact on the increase of capacities for credit risk management by commercial banks in order not to have the banking system performance affected. Also, commercial banks have to continue to further expand crediting in order not to have an impact on the overall economic system performance.

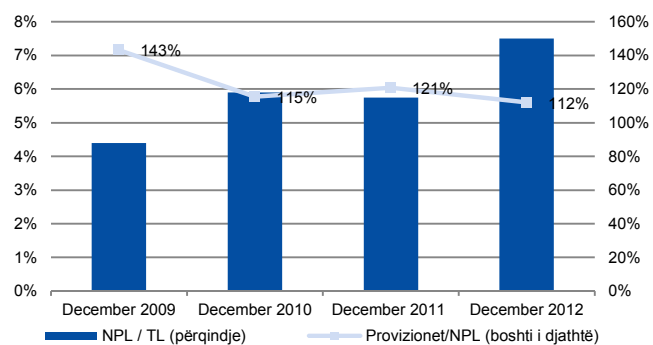
The NPL growth was present almost in all sectors of economy. However, the quality deterioration was more significant to sector loan such as trade, construction, energy and hotel services (Figure 55). Taking into account the high exposure to trade sector, a rather significant deterioration of credit portfolio quality designated to trade, impacted to large extent on the overall banking system performance. During 2012, the NPL share in total loans issued to trade sector increased from 7 percent that was in December 2011 to 10 percent in December 2012. The deterioration of loan quality during this period was recorded on loans issued to hotel sector, where NPL almost doubled by increasing their share to 10.5 percent of total loans designated to this sector, compared to 5.9 in December 2012. The credit portfolio quality also recorded a decline in manufacturing and construction sector which are the two key sectors to sustainable economic development. In this context, the NPL growth among manufacturing sector loans can be attributed to some extent to the decline of demand for domestic products, as well as the decrease of demand for Kosovo exports. Also, the NPL growth in construction sector resulted by the decline of demand for purchase of flats. On the other hand, during 2012, the credit portfolio quality for sectors such as agriculture, mines and other loans remained unchanged compared to the same period of the previous year. However, banks have constantly been more cautious in crediting these sectors by maintaining low credit exposures against these sectors.

Figure 55. NPL by sectors



Source: CBK (2013)

Figure 56. NPL and provisions



Source: CBK (2013)

Kosovo banking system has continuously proven quite conservative in terms of NPL coverage by loan loss provisions. However, in 2012, a higher growth of NPL share to total credit portfolio impacted on the decrease of coverage of loans by provisions. It should also be emphasised that the value of assets allocated for provisions always exceed the overall NPL value. In December 2012, the NPL coverage rate by loan loss provisions was 112 percent, while the average rate for the last four years was 123 percent (Figure 56). The high NPL coverage rate by provisions makes the current NPL level not a threat for the banking system stability.

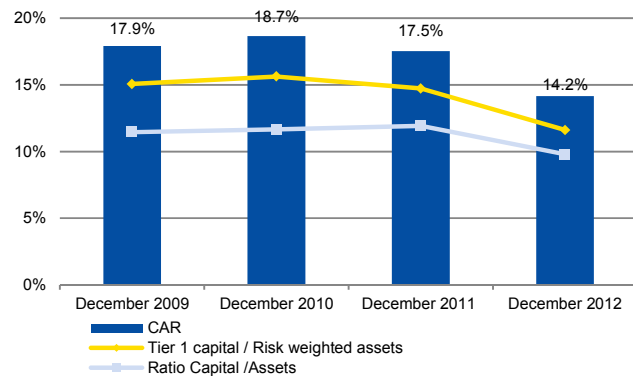
ii. Solvency Risk

Capital Adequacy Ratio

Kosovo banking system is characterized by a high capital adequacy rate, which has constantly exceeded the regulatory minimum requirement. The capital adequacy rate represents an important banking system sustainability ratio, considering the fact that the capital is considered to be the main pillar to cover potential losses in case of any instabilities in the banking system.

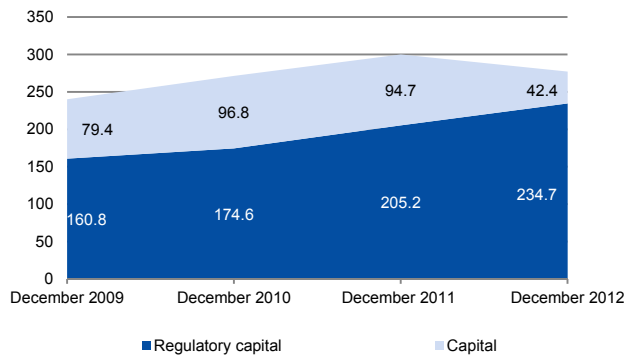
The Capital Adequacy Ratio (CAR)¹³ in Kosovo banking system in December 2012 stood at 14.1 percent, compared to 17.5 percent as it was in the same period of the previous year (Figure 57). Controversially, during the respective period, the ratio between the Tier 1 capital and the Risk Weighted Assets (RWA) stood at 11.6 percent compared to 14.7 percent in December 2011.¹⁴ A lower level of these two ratios is justified by the fact that the capital recorded a negative annual growth of 7.6 percent, while RWA recorded an annual growth rate of 14.0 percent. Changes in the level of capital and RWA to a large extent are related to amendments of Regulation on Bank Capital Adequacy, which started to be implemented in December 2012.¹⁵ Pursuant to this regulation, it has changed the way of calculation of capital and RWA. In case of capital, respectively calculation of Tier 1 capital, two positions have been added, which are deduced from the overall amount of Tier 1 capital. The first position added relates to ‘Investments in equities of other banks or credit institutions’, while the second position relates to ‘Borrowings by bank related persons’. These two positions together impacted on the decrease of the level of Tier 1

Figure 57. Banking system capitalization



Source: CBK (2013)

Figure 58 Total capital and regulatory capital, in millions of euro



Source: CBK (2013)

¹³ According to the CBK Regulation on Capital Adequacy, banks are obliged to maintain the ratio between the capital and the risk weighted assets at a level of at least 12%.

¹⁴ According to the CBK Regulation on Capital Adequacy, banks are obliged to maintain the ratio between the Tier I capital and the risk weighted assets at a level of at least 8%.

¹⁵ Board of the Central Bank of the Republic of Kosovo in its meeting held on 29 November 2012 adopted the Regulation on Capital Adequacy of Banks, which entered into force on 3 December 2012. <http://www.bqk-kos.org/repository/docs/2012/Rregullore%20per%20Adekuatshmerine%20e%20Kapitalit%20te%20Bankave.pdf>

capital to around euro 31.9 million. The methodology on calculation of RWA has also changed, underlining the added position 'Operating risk' which impacted on the growth of the RWA overall amount.

Despite the decrease of capital and the increase of RWA, it should be emphasised that the current capital adequacy (coverage by capital) of banking system in Kosovo, expressed through these indicators, is quite satisfactory, considering that it significantly exceeds the minimum rates of 12 percent as established by the CBK.

Pursuant to the CBK Regulation¹⁶, in December 2012, banks were obliged to maintain a capital rate at a level of euro 234.7 million. However, banks have constantly maintained a higher level of regulatory capital than they were required. In December 2012, the total regulatory capital was euro 177.1 million, which represents a surplus of regulatory capital of euro 42.4 million (Figure 58). Thus, in order to maintain the financial stability and sustainability, the CBK through the new regulation on capital started applying a new prudential measure that has to do with the leverage rate.¹⁷ Pursuant to the new regulation, commercial banks are obliged to maintain a minimum leverage ratio of seven percent (7 percent). In December 2012, the leverage ratio for all banks stood at 9.8 percent, which is quite a satisfactory level compared to the required regulatory minimum.

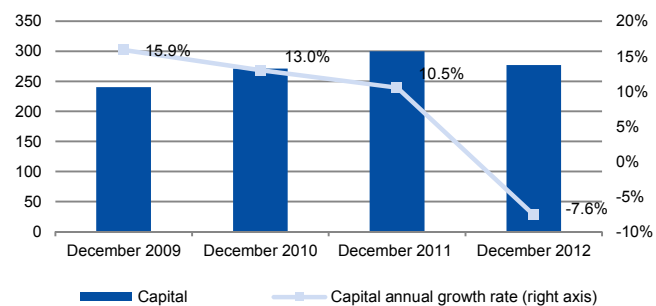
Capital

In December 2012, the banking system capital reached euro 277.1 million, recording an annual growth of 7.6 percent (euro 300.0 million in December 2011). As indicated in figure 59, with exception of 2012 when new regulations on calculation of capital were adopted, the banking capital followed a growing trend, yet the growth rate recorded a constant slowdown. During 2012, the decline of the level of total capital was mainly a result of the decline of profit for the current year, as well as of the portfolio decrease of borrowings of bank related person from the total capital.

Despite the decrease of total capital, it can be stated that Kosovo banking system capital has constantly been characterized by a good quality. A quality indicator of capital sustainability of a bank is the share of equity capital to the total capital and this share in case of Kosovo banking system is 72.2 percent.

The structure of the banking system capital kept dominated by Tier 1 capital which amounted at euro 227.0 million (in December 2011 it was euro 252.0 million). On the other hand Tier 2 capital recorded the value of 50.1 million (euro 48.0 million in December 2011). In December 2012, the share of Tier 1 capital to the total capital recorded a decline of 2.1pp, standing at 81.9 percent compared to the same period of the last year (Figure 60). Controversially, Tier 2 capital increased the share from 16.0 percent that was in 2011 to 18.1 percent in 2012.

Figure 59. Total capital and annual growth rate, in millions of euro



Source: CBK (2013)

¹⁶ According to the CBK Regulation on Capital Adequacy, banks are obliged to maintain the ratio between the capital and assets at a level of at least 12%.

¹⁷ According to the CBK Regulation on Capital Adequacy, the leverage ratio is equal to the total equity/total f assets = CBK Rule on Capital Adequacy.

Tier 1 Capital

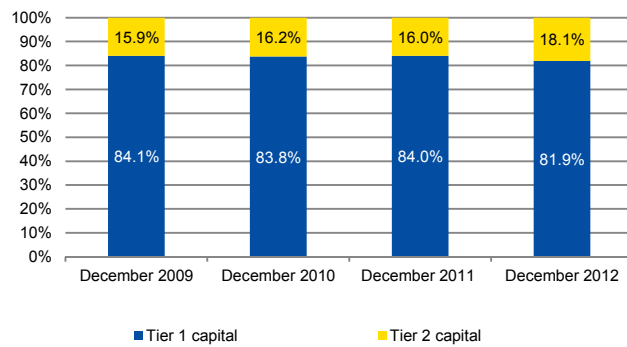
At the end of 2012, the total amount of Tier 1 capital in the banking system was euro 227.0 million compared to euro 252.0 million in the same period of the previous year, which represents an annual decline of 9.9 percent. During the respective period, the equity capital, as the main category of Tier 1 capital recorded an annual growth of 13.3 percent, reaching the value of euro 200.0 million. Also, the retained earnings from the previous years recorded an annual growth of 5.8 percent, reaching euro 44.3 million. On the other hand, the value of current year earnings reached euro 18.7 million, recording an annual decline of 49.1 percent. Categories like intangible assets and value of goodwill, borrowings of bank related persons and investments in equities of other banks or credit institutions are the categories which decreased from the overall value of Tier 1 capital. Intangible assets and goodwill comprised around euro 5 million of total Tier 1 capital, which is higher compared to the previous year (euro 3.82 million in December 2011). Categories added to calculation of capital, borrowings of bank related persons and investments in equities of other banks or credit institutions stood at euro 31.5 million and euro 333 thousand, respectively.

The structure of Tier 1 capital changed compared to the previous years. However, it should be emphasised that the change did not occur as a consequence of change in capital management by banks, but as a result of amendment of regulation on calculation of the capital. Figure 61 shows that the equity capital continues to dominate the overall structure of Tier 1 capital. In December 2012, this category represented 88.1 percent of total Tier 1 capital. On the other hand, the second category in terms of size comprises of retained earnings, which in this period represented 19.5 percent of total Tier 1 capital. The share of current earnings was 8.2 percent. Intangible assets and the goodwill had a share of 2.2 percent to the total Tier 1 capital (1.5 percent in December 2012). On the other hand, borrowings of bank related persons and investments in equities of other banks or credit institutions represented 13.9 percent and 0.1 percent, respectively, of the total Tier 1 capital.

Risk Weighted Assets

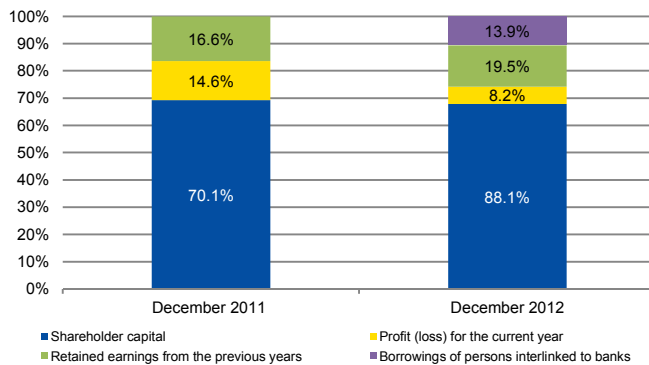
The total value of RWA of the Kosovo banking sector, in December 2012, reached the value of euro 1.95 billion, recording an annual growth rate of 14.0 percent. The RWA growth is largely attributed to the amendment of Regulation on Capital Adequacy. There are two positions that impacted on the change of RWA structure. Firstly, the category of risk weighted assets of 150 percent was added, which impacted on the RWA growth by euro 31.7 million (the share of which

Figure 60. Capital structure of banking system



Source: CBK (2013)

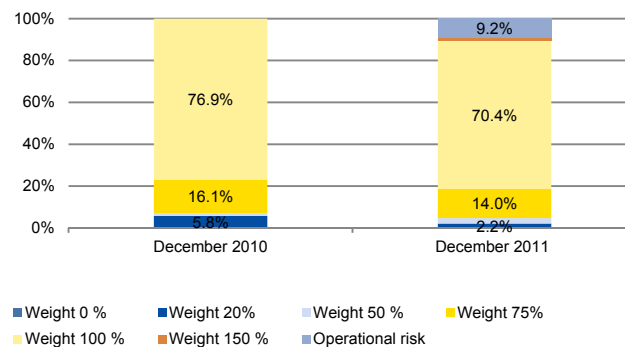
Figure 61. Structure of Tier 1 capital



Source: CBK (2013)

reached 1.6 percent (Figure 62). Secondly, it was added the category of operational¹⁸ risk weighted assets, impacting on the asset growth of euro 180 million (the share of operational risk reached 9.2 percent). The remainder of RWA structure did not suffer any significant changes, where it is worth mentioning that the risk weighted assets of 100 percent continued to have the largest share of 70.4 percent of total. This category is composed of loans¹⁹ and non-balance items which together recorded an annual growth of euro 1.37 billion. The share of risk weighted assets of 75 percent to total RWA decreased to 14.0 percent from 16.1 percent that was at the end of 201. This category is composed of loans guaranteed by the first mortgage on real estate, having a delay in return of less than 30 days as well as construction loans to fund the construction of real estate, where the funded property was sold or rented out, which together reached euro 273.3 million (an annual decline of 1 percent).

Figure 62. RWA structure, by weight risk



Source: CBK (2013)

3.3.2.4.1 Stress-Test Analysis

Along with the analysis of current situation of the banking system exposure against credit risk, liquidity risk and solvency risk, the stress-test analysis represents an additional tool which provides an assessment of the sector sustainability against potential instabilities, both in credit portfolio and liquid assets. Results elaborated below are based on the banking sector data for the month of December 2012. During this analysis, it is tested the Kosovo banking system sustainability against the credit risk, combined with the interest risk rate and the exchange risk rate, and also it is tested the banking system capacity in maintaining the liquidity position under hypothetical assumptions on deposit withdrawals.

Credit Risk

Methodology

The analysis is grounded on a hypothetical scenario that the economic crisis in European Union countries will continue to be reflected on Kosovo's economy through the decrease of remittances and exports, discouraging the overall demand in the country. As a result, this is supposed to affect negatively the economic growth by expanding the producer gap and by negatively affecting the credit portfolio quality. Under this scenario, it is taken into consideration the average economic growth rate in Kosovo of 4 percent in the five last years and it is assumed a rather significant economic decline of 2.0 percent in 2012, which would increase the producer gap by 6.0 percent. Elasticity multipliers from an analysis published by IMF on some Southeastern European countries²⁰ were used to assess the producer gap impact on the credit portfolio quality, respectively on non-performing loans. Consequently, considering the NPL elasticity multiplier against the producer gap of 0.8 percent, the NPL share in total banking sector loans would increase by 4.8pp. Credit risk was composed with interest rate risk and exchange rate risk, where it was assumed a decline of interest rates and depreciation of Euro currency against the

¹⁸The way of calculation of operating risk is presented on Regulation on Bank Capital Adequacy, <http://www.bqk-kos.org/repository/docs/2012/Rregullore%20per%20Adekuatshmerine%20e%20Kapitalit%20te%20Bankave.pdf>

¹⁹ For detailed RWA classification, please refer to Regulation on Bank Capital Adequacy.

²⁰ IMF unpublished note "CESE Bank Loss Projection and Stress Testing Exercise", July 2009.

other currencies as a result of developments in some of the Eurozone countries such as Greece, Spain and Cyprus. Consequently, besides the growth of NPL share to total loans, under this scenario, it is also considered the depreciation of Euro against US Dollar by 20 percent²¹ and the decrease of interest rates by 2.0 pp. The growth of NPL share to total loans affects the growth of provisions, the depreciation of Euro affects the loss/profit reassessment from open net positions, and the decrease of interest rates affects the losses/earnings in net interest income considering the maturity gap of loans and deposits.

Along with the assumptions on the above-mentioned shocks, the expected profit as an absorber of losses from these shocks was taken into account. In this context, it is assumed that after tax net profit in 2013 would be equivalent to the net profit for 2012 (this is because it is assumed that there would be no growth of loans – they remain at the same level), and it should also be underlined that for banks that recorded a net profit after negative tax in 2012, it is supposed that during 2013 the after tax net profit would be zero.

The assumed growth of NPL is expressed through migration of loans from performing loans (standard, watch, sub-standard) towards non-performing loans (doubtful and loss). The NPL growth was proportionally distributed within the category of doubtful loans and loss loans, by taking into account the initial share of these categories to total NPL. The NPL growth reflects the provision level pursuant to the CBK regulation on provisioning of loans by classification. An assumption on NPL growth also applies to non-balance items which include unused commitments, guarantees, available credit notes and commercial credit notes.

In spite of the fact that under the analyzed scenario a consideration was given to depreciation of Euro against the US Dollar to assess the currency exchange rate, it is important to point out that the impact of this banking system balance keeps being quite low. The majority of credit portfolio is in euro, crediting in foreign currency is almost inexistent, thus the currency exchange rate risk remains minor.

The scenario on the interest rate risk implies a decrease of interest rates by 2 pp (both for assets and liabilities in the balance sheet). The decrease of interest rates may affect the Net Interest Margin (NIM), considering the maturity of loans and deposits. Kosovo banking system has a low exposure against this risk, with the majority part of loans and deposits in Kosovo banking system having a fixed interest rate. Therefore, the banking system is much less sensitive against the movements of these interest rates in a short-term period.

The banking sector sustainability under this analysis was assessed in terms of NPL growth, depreciation of Euro currency and decline of interest rates in the level of banking sector regulatory capital, risk weighted assets, and consequently the capital adequacy ratio.

Results

From the available data of CBK, it can be assessed that the current Kosovo's banking system situation regarding bank capital adequacy is favourable, with the capital adequacy ratio at 14.2 percent²². Also, the banking system keeps standing at a relatively good position regarding the level of non-performing loans in relation to total loans (7.5 percent) coverage of potential loan losses by provisions, which cover NPL with 112 percent. As a consequence, it can be stated that the banking system indicates a satisfactory sustainability level against credit risk even under conditions of introduction of hypothetical scenario described above.

²¹ Assumption based on historical data on Euro/US Dollar currency exchange rate movement.

²² CAR decrease is basically related to the amendment of Regulation on Bank Capital Adequacy.

Under the assumption that NPL share in loan sector portfolio would increase to 4.8pp²³, Euro would depreciate against the US Dollar by 20 percent, and the interest rates would decrease by 2.0pp as well as the assumption on earnings, in the banking system level in general, CAR would remain at 13.3 percent, which means over 12 percent as required by the Central Bank of the Republic of Kosovo.

However, although the CAR level for the entire banking system would remain over 12 percent, four banks operating in Kosovo would need an injection of capital of euro 30.8 percent (equivalent to 0.61 percent of GDP). Under these circumstances, the new level of NPL share to total banking system loans would reach 12.3 percent and the highest level would be 15.9 percent. Based on the above-mentioned assumptions on shocks, the growth of NPL share, depreciation of Euro against the US Dollar, decrease of interest rate as well as the assumption on net profit would make the total loss of banking sector reach the value of euro 54.5 million (1.1 percent of GDP). However, not this entire value can be considered as possible loss considering the fact that a large part of this loss would be absorbed by the expected earnings in the respective period.

Liquidity Risk

Methodology

The liquidity risk analysis relies on the scenario on withdrawal of rather considerable value of deposits from banking system and measures the system capacity in facing such a shock. In this analysis, a consideration is given to withdrawal of deposits throughout a five-day period of time, without considering the possibility of banks to have access to external funding. The liquidity risk scenario is based on a quite conservative assumption; withdrawal of deposits by a rate of 10 percent of total deposits on daily basis throughout a five-day period of time. The scenario is also built on assumption that during this period the possibility of conversion of liquid assets into cash would be 80 percent of liquid assets, while the possibility of conversion of non-liquid assets in cash would be only one percent of these assets within a day. It is also assumed that banks have full access to their reserves, while the possibility of bank financing from external financing resources was not taken into consideration.

The banking system sustainability under this analysis is tested in terms of assessment of adequacy of banks' liquid assets to face such withdrawal of deposits.

Results

The existing banking system situation regarding the liquidity level is considered quite favourable. By the end of 2012, core liquid assets and broad liquid assets consisted 25.3 percent, and 32.5 percent, respectively, of the total asset of the banking system.

Table 6. Summary of stress-test results – Liquidity risk

Description	number of banks 1/	Additional liquid needed assets (in thousands of euro)	Ratio loans/deposits(in percent)
After the first day	0	0	85.5
After the second day	0	0	95.0
After the thord day	1	161	105.5
After the fourth day	2	21,690	117.2
After the fifth day	4	73,574	130.3

Note:1/ Number of banks in need of additional liquid assets.

Source: CBK (2013)

²³ The assumed NPL growth rate is established by taking for granted the average economic growth rate in Kosovo in recent years, the assumption on economic decline and NPL elasticity multiplier against producer gap, which is based on an analysis, published by IMF "CESE Bank Loss Projection and Stress Testing Exercise", July 2010.

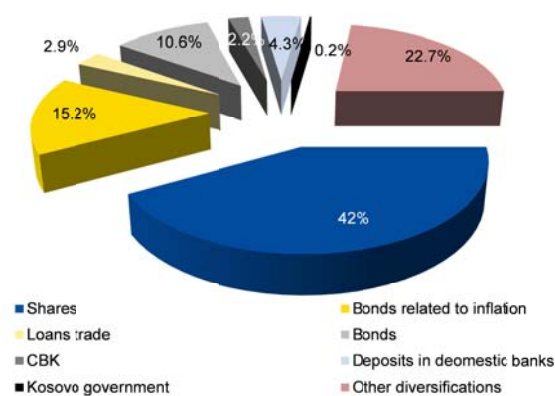
Under the assumption of a scenario on constant withdrawal of deposit for five days, the stress-test results suggest that Kosovo banking system appears to have a satisfactory sustainability level even in case of higher deposit withdrawal rates would be encountered. Under the hypothetical assumption on continuous withdrawal of deposit for five consecutive days with a high assumed rate, the first liquidity problems in banks would be encountered only after the third day, namely in one of the banks. The deposit withdrawal level from each bank is considered to be 10 percent of their total deposits. As indicated in Table 6, after the third day, the majority of additional liquid assets of the affected bank would be only euro 161 thousand (0.003 of GDP). On the other hand, the loan/deposit ratio would reach 85.5 percent (assuming that the level of loans would not continue to increase during this period).

After the fourth day, only two out of eight banks operating in Kosovo would be in need of additional assets with a value of euro 21.6 million (0.43 percent of GDP). After the five-day deposit withdrawal cycle, the number of banks encountering liquidity problems would remain at four, while the value of additional liquid assets would reach euro 73.5 million (1.47 percent of GDP). In this stage, under the assumption that the loan value remains unchanged, the loan/deposit ratio would reach 130.3 percent in the banking system level. Therefore, it can be considered that even if the above-mentioned scenarios would emerge in practice, the banking system would show quite a high sustainability against the liquidity risk.

3.3.3 Pension Funds

Kosovo pension fund system was among the systems with a rather considerable growth within the financial sector, the assets of which in 2012 reached the value of euro 745 million and recorded a growth of 15.9 percent (19.5 percent in 2011). At the same time, Kosovo pension system represents the second largest system within the financial sector, with a share of 19.5 percent (15.3 percent of GDP). The major part of the pension system assets is managed by Kosovo Pension Savings Trust (KPST), while a part of 0.7 percent of pension system total assets belongs to Slovenian-Kosovo Pension Fund (SKPF).

Figure 63. Structure of KPST investments



Source: CBK (2013)

During 2012, the KPST performance was considered as successful given that it was realized an annual positive return from investments in value of euro 54 million. This is because the share price in December 2012 reached euro 1.117 and recorded an annual growth of 8 percent (euro 1.0347 in December 2011). Undoubtedly, the positive return of KPST investments reflects the positive development in the second part of 2012.

The positive return of KPST invested assets during 2012 reflects an improvement of performance of the international stock markets, where majority of KPST assets have been invested. The enhancement of credibility on global financial markets, and consequently of their performance, among the others, was particularly driven by the commitment of EU countries and international financial institutions in saving countries facing public debt problems. However, despite the share price growth, the KPST share value has not returned yet to the levels that were before the global financial crisis. On the other hand, the value of assets under KPST management, in 2012, increased by euro 152 million more, which represents the highest growth since the establishment

of KPST. The growth of assets under KPST management came as a result of the growth of contributions paid during this year.

On the other hand, developments in SKPF in 2012 were consistent with those of the previous year, as managed assets stood at the same level of euro 4.9 million.

As to the structure of KPST, 42 percent of total invested assets were concentrated on stock markets, which are characterized as investments with relatively high risk but also of higher return (Figure 63). The remainder of KPST assets is mainly placed in investments with safe returns. For example, 25.7 percent of KPST investments during 2012 were invested in foreign government bills, and inflation related bills, around 2.9 percent in loan market, while investments in local banks in Kosovo had a share of 4.3 percent. It is worth mentioning that in 2012, KPST invested for the first time euro 14 million (0.2 percent of total invested assets) in securities of the Kosovo’s Government.

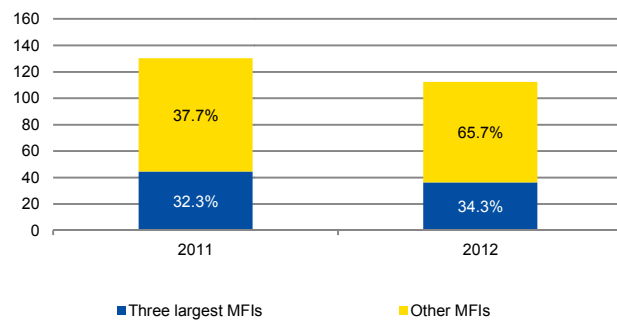
On the other hand, the structure of SKFP assets during 2012 was dominated by investments in bonds and less by investments in deposits, shares and cash.

3.3.4 Insurance Companies

Insurance industry represents one of financial sector systems, which during 2012 was characterized by an expansion. However, this system share to total sector assets is relatively low with only 3.4 percent. Out of total 13 insurance companies operating in Kosovo during 2012, 10 of them provided non-life insurances, while 3 others provided life insurances as well. The ownership structure of insurance companies was similar to that of the previous year, where 10 companies are of foreign ownership and 3 other are of domestic ownership. A similar relation also characterizes the structure of assets by ownership, where 77 percent of assets are managed by foreign companies, while the other part of assets is managed by domestic companies.

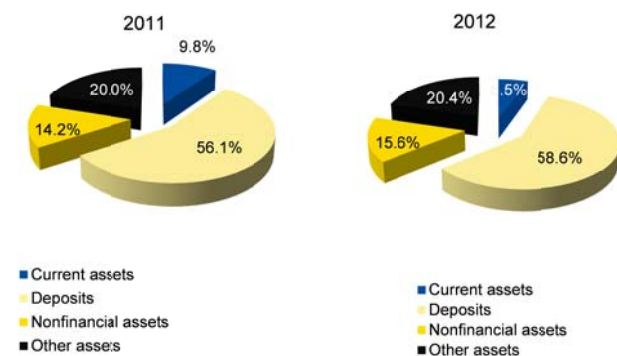
The market of insurance companies was continuously characterized by a low concentration rate in market, compared to banks or microfinance institutions. However, during 2012, the concentration of three largest insurance companies increased to 34.3 percent of total assets (32.3 percent in 2011) (Figure 64). A similar movement in the insurance market is also suggested through Herfiendahl-Hirschman Index (HHI), which shows that the concentration rate in 2012 increased to 937.7 points, compared to 882.3 points in 2011. This is because the three largest insurance companies have significantly increased the value of assets during 2012.

Figure 64. Insurance companies assets, in millions of euro



Source: CBK (2013)

Figure 65. Structure of insurance companies assets



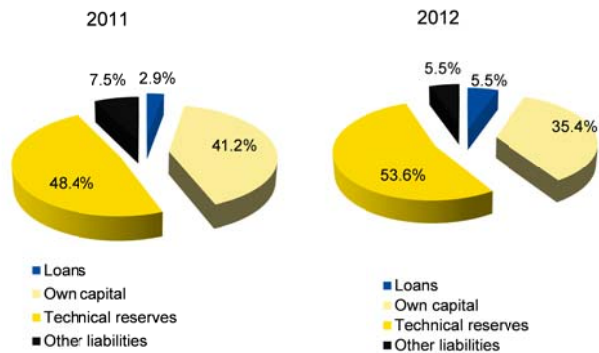
Source: CBK (2013)

Total assets of insurance companies in 2012 reached the value of euro 130.8 million and recorded a growth of 16.3 percent. The structure of assets of insurance companies is dominated by deposits, with a share of 58.6 percent of total assets (56.1 percent in 2011) (Figure 65).

Concerning the liabilities, own capital and technical reserves represent the largest categories, with a share of 35.4 percent, respectively 34.4 of total asset (Figure 66). A smaller but growing category are loans borrowed by insurance companies, which in 2012 doubled their value to euro 7.2 billion and had a share of 5.5 percent loans of insurance companies are basically loans borrowed by local banks.

The ratio between capital and assets, which represents the capital adequacy of insurance companies in 2012, decreased to 35.4 percent compared to 41.2 percent that was in 2011. The decrease of this ratio was driven by the decrease of own capital by 0.4 percent, as well as the growth of value of assets in 2012. On the other hand, the ratio between own capital and technical reserves, which shows the capacity of insurance companies to face potential losses, decreased to 66.1 percent, compared to 85 percent in 2011.²⁴ This ratio decreased to rapid growth of technical reserves (an annual growth of 28 percent).

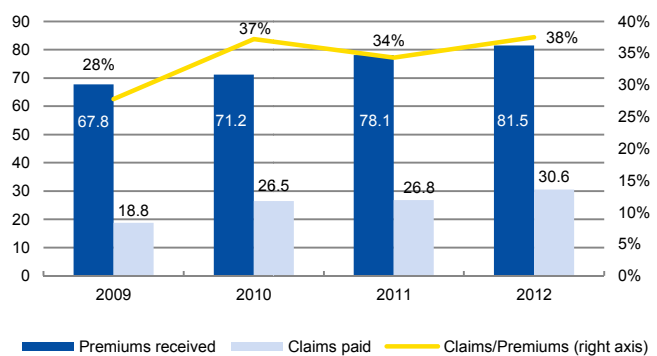
Figure 66. Structure of liabilities of insurance companies



Source: CBK (2013)

Despite the expansion of assets of insurance companies, the insurance industry in 2012 closed the reporting period by net losses of euro 2.3 million. Closing the year by negative profit impacted on deterioration of two performance ratios, respectively the Return on Average Assets (ROAA) and the Return on Average Equity (ROAE). The ROAA ratio by the end of 2012 stood at -1.9 percent, compared to 0.9 percent in 2011, while the ROAE ratio in 2012 was -4.7 perqind, compared to 2.2 percent in the previous year.

Figure 67. Premiums received and claims paid, in millions of euro



Source: CBK (2013)

By the end of 2012, the number of insurance policies sold by insurance companies operating in Kosovo reached 757.2 thousand policies, which represents an annual growth of 25.1 percent compared to the number policies sold a year ago. On the other hand, the value of premiums receive from sold policies in 2012 reached euro 81.5 million euro, recording an annual growth of 4.4 percent (Figure 67). The growth of received premiums was mainly contributed by border policies.

On the other hand, the value of claims paid by insurance companies was characterized by a faster annual growth of 14.1 percent (1.1 percent in 2011). Consequently, the ratio between the

²⁴Technical reserves are needed to ensure permanent fulfilment of liabilities of insurance companies against policyholders until the expiry of insurance agreement.

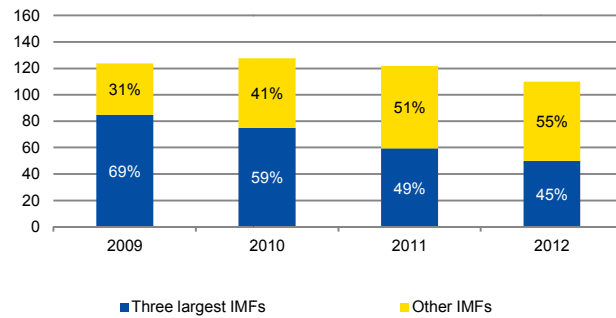
claims paid and premiums received in 2012 increased to 38 percent, compared to 34 percent that was in 2011.

The activity of insurance companies in Kosovo is based on a relatively simple sample, which is concentrated on provision of non-voluntary insurance policies. The majority of non-voluntary insurances is comprised of the Third Party Liability Insurance (TPL), with a share of 54.2 percent in total premiums received (Figure 69). The value of TPL received premiums in 2012 reached euro 44.1 million and decreased by 3.4 percent. An important part of non-voluntary insurance are also the border policies, which represent 18.1 percent of total premiums received. Premiums received from border policies recorded a considerable growth of 52.6 percent, reaching the value of euro 14.7 million.²⁵

A significant part of premiums received is also composed of voluntary policies, the value of which in recent years stood at the same level, with around euro 20 million. Voluntary policies include health insurances, casco insurances and property insurances, etc.

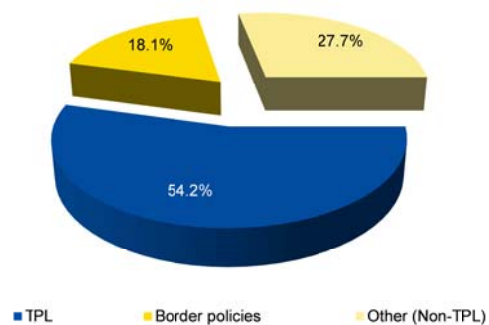
Within the claims paid, also TPL payments dominate with a share of 61.9 percent (Figure 69). In 2012, it was noticed an improvement in the payment of TPL policies, considering the annual growth of 5.2 percent as well as the fact that a year earlier payments for these policies decreased by 6.2 percent. Claims paid for border policies reached the value of euro 1.1 million, which represent a similar level to the previous year. Certainly, payments for these policies have a relatively low share in total claims paid, with 3.7 percent. In 2012, claims paid for voluntary insurances were characterized by a growth of 33.8 percent, increasing their value to euro 10.5 million.

Figure 68. MFI assets, in millions of euro



Source: CBK (2013)

Figure 69. Structure of primiums received of insurance companies



Source: CBK (2013)

3.3.5 Microfinance Institutions and Financial Auxiliaries

A total of 18 microfinance institutions (MFI) and 30 financial auxiliaries operated in microfinance industry in 2012. During 2012, the licensees of two MFIs were revoked: ‘Agro Invest’ and ‘Fund Way Mortgages’, while no new MFIs entered the microfinance market. Concerning the ownership structure, two MFI institutions are founded with domestic capital, one MFI is founded with both local and foreign capital, whereas the remainder is comprised of foreign ownership MFI institutions.

²⁵ The growth of premiums received and claims paid for border policies during 2012 came as a result of the agreement on Integrated Border Management (IBM) between Kosovo and Serbia.

Despite the fact that microfinance was constantly characterized by a high concentration rate, in recent years the concentration trend in market declined successively. The decline of concentration rate in this industry shows an improvement of competitiveness in this industry, firstly because most of small MFIs continued to increase their share in the market, and also as a consequence of the decrease of assets of the three largest MFIs. As indicated in Figure 9, the concentration rate of the three largest MFIs in 2012 declined to 45 percent (49 percent in 2011), while the remainder of 45 percent belongs to other MFIs altogether.

Also, the Herfindahl-Hirschman Index, as a measuring tool of the concentration rate in the market, shows a decline of the concentration rate to 1,138 points, compared to 1,293 points in the previous year.

The infrastructure of microfinance industry was characterized by a slowdown trend. The number of MFI branches started with 119 branches in January and decreased to 111 in December 2012. The number of MFI employees during 2012 was characterized by the same movement, where in January 2012, this industry recorded a total of 934 employees, while in December 2012 the number of employees decreased to 904.

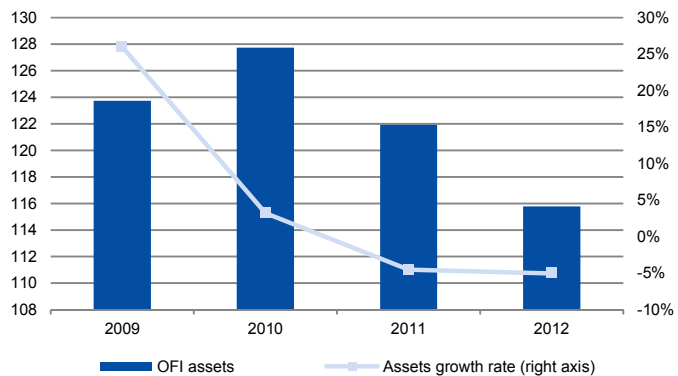
3.3.5.1 Balance Sheet of Microfinance Institutions

Along with the decrease of number of participants in microfinance industry, the value of assets in the last two years has also recorded a decline of 4.6 percent (Figure 70). Otherwise, the value of MFI asset in 2012 was euro 115.8 million (around 2.4 percent of GDP), compared to euro 121.9 million in 2011. Loans contributed mostly to the decrease of MFI assets with 7.7 pp.

Within the MFI assets, loans represent the most important category, with a share of 66.9 percent (71.3 percent in 2011), (Figure 71). However, during the last four years, it is noticed that the share of loans in total MFI assets recorded a decline and this is because MFI developed other products, such as leasing. The share of leasing loans increased by 3.6pp in 2012 or 18 percent in total MFI assets. Despite the fact that leasing loans are provided only by two MFIs in the market, as from 2009 they started to become functional for the first time, as the leasing loans have constantly recorded a growing trend. The value of leasing loans in 2012 reached euro 20.8 million and recorded a growth of 19.1 percent (a growth of 62 in 2011).

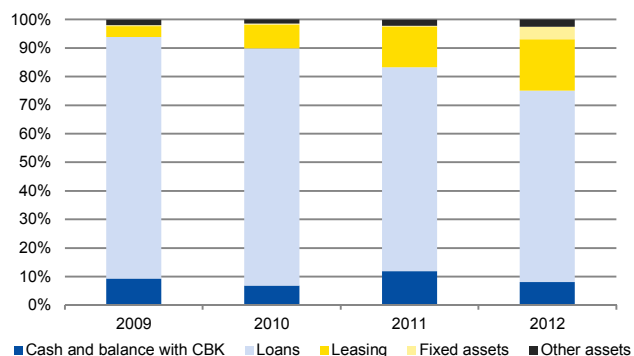
Cash and balance with CBK represents the third most important category within MFI, which decreased its share to 8.1 percent (11.9 percent in 2011). The value of this category also

Figure 70. MFI assets and their annual growth



Source: CBK (2013)

Figure 71. Structure of MFI assets



Source: CBK (2013)

decreased to euro 9.4 million (14.5 million in 2012). Two other categories with a lower share are also fixed assets and other assets, with a share of 4.4 percent, respectively 2.5 percent. Within the MFI assets, investments in securities remain an instrument which is still not developed in microfinance industry.

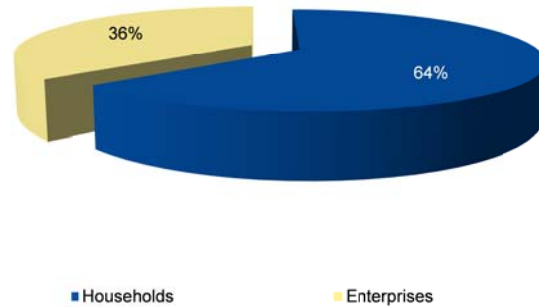
3.3.5.2 Loans of Microfinance Institutions

As indicated in Figure 72, the value of loans issued by MFI recorded a declining trend in recent years. The value of MFI loans in 2012 reached euro 77.5 million and decreased by 10.8 percent (a decline of 18 percent in 2011). At the same time, the number of active loans during 2012 decreased by 8.1 percent, or from 57,536 loans in 2011, they decreased to 52,885 loans in 2012.

One of the reasons for tightening the lending by MFIs comes due to the fact that two MFIs were closed in 2012. On the other hand, the decrease of loans issued by MFIs during 2012 was partially a consequence of difficult financing conditions for these institutions from external markets. This is because MFIs operating in Kosovo have the credit lines from external markets as the key funding resource, because according to applicable legislation, MFIs are not entitled to receive deposits, other than those in form of guarantees for receiving loans. Also, taking into consideration the slowdown of economic growth in the country, also the demand for MFI loans may have declined.

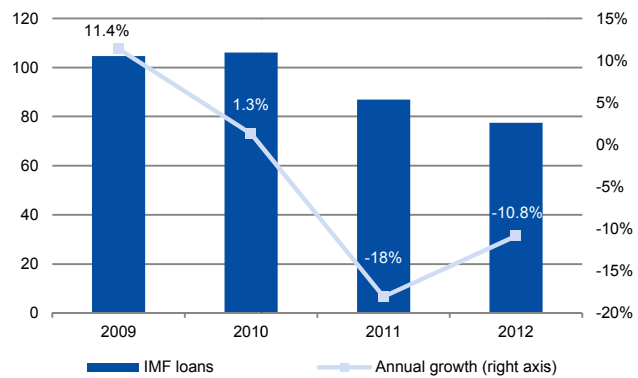
The MFI activity in Kosovo is primarily concentrated in financing the households and small businesses. Unlike commercial banks, where enterprise loans dominate the loan structure, in case of MFI, loans issued to households represent the major part of MFI loans, with a share of 64 percent (Figure 73). One of the reasons of this loan structure lies with the fact that microfinance institutions mainly provide smaller loans in volume, which are designated for household consumer needs. Also, the capacity of smaller loans does not necessarily satisfy the financial needs of enterprises.

Figure 72. Structure of MFI loans, in percent



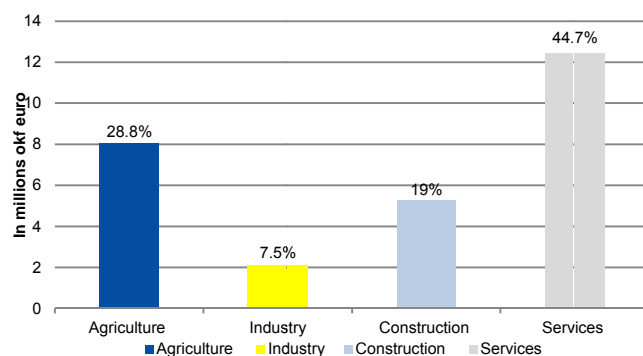
Source: CBK (2013)

Figure 73. Growth trend of MFI loans, in percent



Source: CBK (2013)

Figure 74. Structure of MFI loans by sectors



Source: CBK (2013)

The value of loans designated to enterprises in 2012 reached euro 27.9 million. The majority of these loans in 2012 were issued to services sector (44.7 percent), and namely 17.2 percent only to trade sector. Agriculture sector is more supported by MFIs than by banks, considering that 28.8 percent of total enterprise loans were designated to this sector. A considerable part of enterprise loans is also comprised of construction loans (19percent) and industrial loans (7.5 përqind), (Figure 74). Within the enterprise loans, the maximum value of new loans issued during 2012 was euro 1.2 million, while the maximum value of loans issued to households was euro 1.7 million.

Regarding allocation of the number of total loans issued by MFIs, the minimum value of loans issued during 2012 was euro 100, while the maximum value of loans issued by MFIs was euro 358,267. The average value of a loan issued during 2012 was 1,869.6 euro, compared to euro 1,829.1 in 2011.

Table 7. Distribution of MFI loans at intervals, according to their values and numbers

MFI loans	2012			
	0 ≤ 5,000	5,001 ≤ 10,000	10,001 ≤ 25,000	> 25,000
Value (in millions of euro)	48.8	7.1	4.8	12.1
Number of loans	31,879	905	290	194

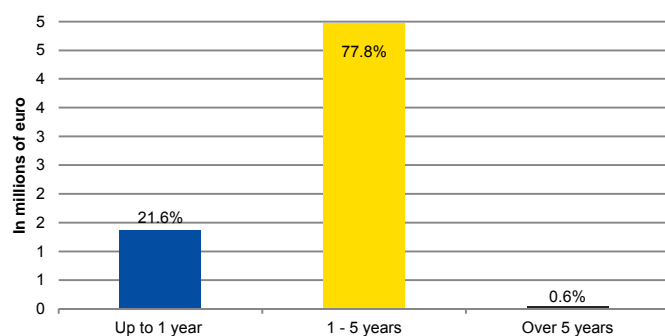
Source: CBK (2013)

In Table 7, loans issued by MFIs in 2012 are divided in 4 intervals: loans of a value of euro 0 – 5,000, loans with a value of 5,001 – 10,000, loans with a value of 10,001 – 25,000 and loans with a value over euro 25,001. As indicated in Table 7, loans with lower values which are allocated at the interval of euro 0 up to 5,000 are frequent loans issued by MFIs. Loans issued at the value up to euro 5,000 have a share of 67.1 percent of total loans issued during 2012. Also, the number of loans issued at this interval dominates the number of total

loans issued by MFIs, which is also confirmed by the intermediation nature of this industry. Within the loan interval of euro 5,001 up to 10,000, total loans with a value of euro 7.1 million were issued, while the number of loans at this interval was 290 loans. The lowest parts of loans issued by MFIs are the high value loans, respectively loans over euro 25,000 euro, of which 194 loans were issued in 2012.

The structure of MFI loans by maturity is mainly dominated by loans with short or medium maturity. Middle-term loans, the maturity of which is from 1 up to 5 years, dominate the structure of loans by maturity, with a share of 77.8 percent (Figure 75). Short-term loans up to one year also comprise a considerable part of loans, with a share of 21.6 percent. On the other hand, loans with maturity over 5 years are rarely issued by MFIs, which in 2012 comprised only 0.6 percent of total loans.

Figure 75. Structure of MFI loans by maturity



Source: CBK (2013)

3.3.5.3 Liabilities of Microfinance Institutions

The major part of liabilities of microfinance institution is comprised of obligations such as payable accounts. Payable accounts in 2012 recorded the value of euro 84.6 million, with a share of 54.6 percent of total liabilities. This category mainly includes deposits of financial sector, enterprises, clients etc., which have a guaranteeing nature and together with the loan maturity are returned to clients, as according to Law on MFIs, these institutions are not entitled to keep deposits of clients.²⁶ An important part of liabilities of microfinance institutions is also the own capital. In three previous years, the MFIs own capital mainly stood at a sustainable level. However, in 2012 the value of own capital reached euro 31.2 million and recorded a decline of 20.2 percent. The decrease of own capital was mainly driven by negative balance between income and expenditures of 2012 of euro 4.5 million. The major part of own capital is comprised of the shareholders capital (57.4 percent).

3.3.5.4 Interest Rates of Microfinance Institutions

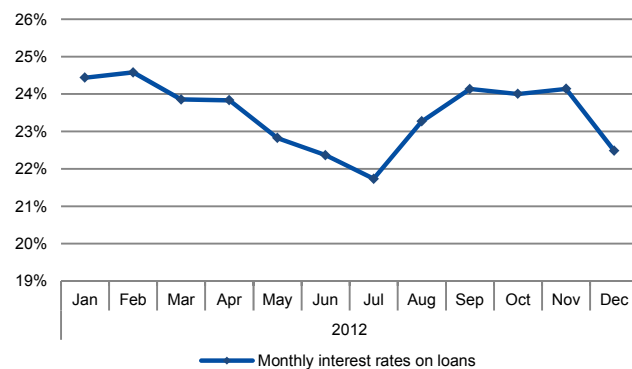
The average interest rates on loans issued by microfinance institutions are mainly characterized by a relatively higher level compared to the average rates on loans issued by banks. One of the factors impacting on higher interest rates on MFI loans relates to the fact that MFIs are not entitled to receive deposits from citizens, and consequently MFIs tend to ensure other financing funds from international financial institutions, capital markets or local banks, which have high lending rates. Also, a considerable part of MFI loans are designated to the economic sectors considered to have high risk, such as the agriculture sector. In addition, the requirements for collateral, guarantees etc., and easier procedures for borrowing in general may justify higher interest loan rates, as coverage for loan with non-return risk.

The average interest rate on MFI loans in 2012 was 23.47 percent. However, if the trend of monthly interest rates is to be followed, it is noticed that the interest rates suffered changes during 2012. For instance, in the period of January-March, the loan interest rates stood at about an unchangeable level. However, from May to July when it was recorded the lowest interest rate of 21.73 percent, a successive decline of interest rates has been observed (Figure 76). One of the reasons for the interest rate decline in this period relates to seasonal factors,

such as the growth of remittances or the growth of household income from other resources than loans, which also could have had an impact on the decrease of demand for MFI loans. The decline of demand for MFI loans in this period can also be confirmed by the number of new loans, which from June to July decreased to 14.5 percent (a decline of 2.6 percent in June compared to May). From August onwards, the interest rates returned again at previous levels.

By maturity, the highest interest rates were recorded by loans with maturity up to 1 year, with an average rate of 24.78 percent for 2012. The highest loan interest rate within loans with short maturity was 29.34 percent while the lowest interest on these loans was 25.88 perqind. The

Figure 76. Interest rates of MFI loans



Source: CBK (2013)

²⁶ Pursuant to Article 91.6 of Law No. 04/L-093 on MFI, microfinance institutions shall not engage in collection of deposits exceeding the amount of 50 percent of its capital surplus or the maximum amount of euro 125,000.

average interest rate on loans from 1 up to 5 years was 23.49 percent, where the highest rate evidenced was 28.57 percent, while the lowest rate evidenced was 24.53 percent.

Based on the purpose of use, the interest rates on household loans during 2012 were relatively higher than the interest rates on enterprise loans. Within the household loans, the highest interest rates were evidenced by consumer loans and then by those for non-investment purposes. The highest interest rate on consumer loans recorded during 2012 was 29.34 percent, while the lowest interest rate was 21.66 percent. The average interest rate on non-investment loans was 25.13 percent. During 2012, the interest rate on household investment loans was characterized by the lowest rates of 24.84 percent on the average. Regarding enterprise loans, non-investment loans were characterized by relatively higher rates, the average of which during 2012 was 21.96 percent. The average interest rate on investment loans was characterized by an average interest rate of 20.8 percent during 2012.

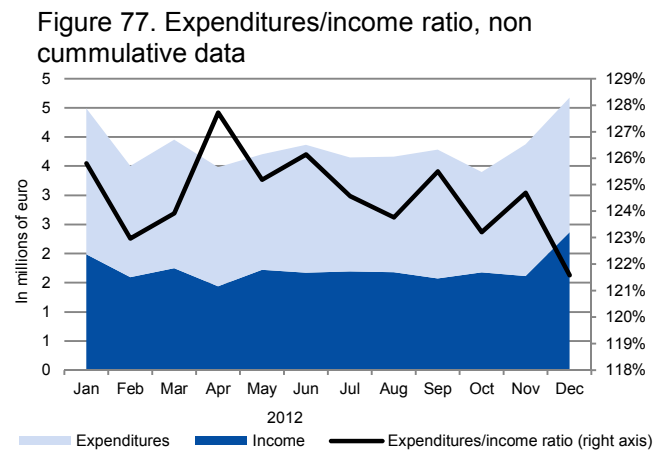
3.3.5.5 Performance of Microfinance Institutions

Microfinance industry in 2012 closed the reporting period by a negative balance between income and expenditures. One of the reasons of negative performance was the growth of non-interest income and the lack of efficiency to manage personnel expenses.

In 2012, microfinance institutions recorded a loss of euro 4.5 million. The MFI income in 2012 recorded the value of euro 20.8 million, while expenditures stood at euro 25.3 million. As indicated in figure 77, the MFIs expenditures during 2012 have constantly stood at higher level than the MFIs income. Consequently, the ratio between MFI expenses and income in the end of 2012 stood at 121.6 percent.

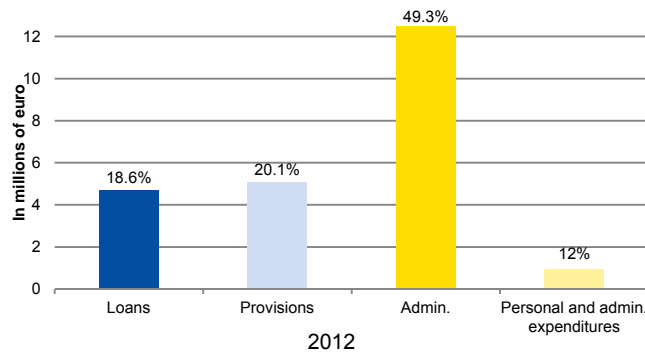
Regarding the structure of MFI income in 2012, this income was dominated by income interest, respectively the loan interest income, which represents the major resources of MFI income (Figure 77). The loan interest income in 2012 had a share of 82.8 percent. The remainder of MFI generated income comprise of non-interest income, where the largest part is comprised of other operating income (12.4 percent of total MFI income). Two other categories with a lower share in MFIs income are the administrative income (4 percent) and services income (0.9 percent).

Unlike the structure of bank income, the structure of MFI expenditures is dominated by non-interest expenditures, respectively administrative expenditures, which have a share of 49.3 percent of total expenditures (Figure 78). The relatively high share of administrative



Source: CBQK (2013)

Figure 78. Structure of expenditures by categories, in percent



Source: CBK (2013)

expenditures may be a consequence of the lack of MFI efficiency compared to commercial banks,

mainly due to the nature of microfinance institutions operating as non-governmental organizations. Within non-interest expenditures, provision expenditures also have a considerable share of 20.1 percent. Considering that microfinance institutions by definition do not represent depository institutions, the interest expenditures comprise a lower part of total expenditures, namely 18.6 percent. The MFI income expenditures mainly include payments of interest on funds borrowed from international financial institutions and capital markets such as EFSE, EBRD, Blueorchard, Credit Swiss, etc.

Table 8. MFI profitability and efficiency indicators

Indicators	ROAA	ROAE	Assets/no. of employees	Profit/no. of employees	Number of loans /no. of employees	NIM
Result in 2012	-3.7%	-14%	128,097.3	4,977.9 euro	44.5	14.5%

Source: CBK (2013)

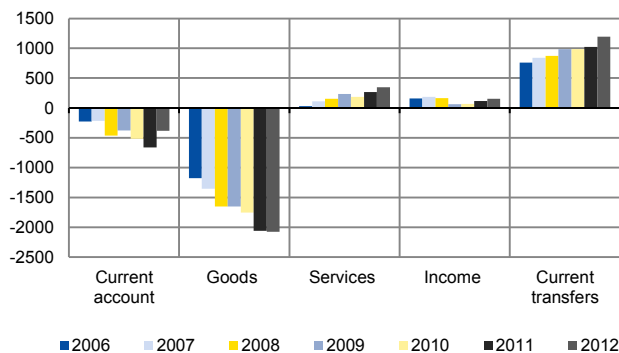
The negative balance between income and expenditures in 2012, together with the decrease of assets and own equities (own capital) also impacted on deterioration of MFI profitability ratios, such as the Return on Average Assets (ROAA) and the Return on Average Equity (ROAE). In 2012, the ROAA ratio recorded a decline by decreasing to -3.7 percent, compared to 0.9 percent that was in 2011 (Table 2). Similarly to ROAA, the return on average equity (ROAE) was negative in 2012, from -14 percent compared to 2.5 percent in 2011. Net Interest Margin (NIM), which expresses the ratio between net interest income and assets generating interest in 2012, was 14.5 percent.²⁷

Both the decrease of assets and the decrease of the number of employees in microfinance institutions impacted on the decline of efficiency in management of assets by employees. The average value of assets managed by an employee in 2012 was euro 128.1 thousand, while a year earlier an employee managed euro 129.6 thousand assets on the average. In 2012, the average number of loans issued by an employee was 44.5 percent, while the profit generated in 2012 per employee was euro 4.9 thousand.

3.4. External Sector

Balance of Payments in Kosovo continues to be characterized by current account deficit and positive position in capital and financial account. Current account deficit (basically led by trade balance deficit) in spite of improvements during 2012 continues to remain at a relatively high level. On the other hand, the funding of this deficit from capital and financial account, despite constant sustainability, during 2012 faced challenges as a result of decline of FDI and trade loans.

Figure 79. Current account balance, in millions of euro



Source: CBK (2013)

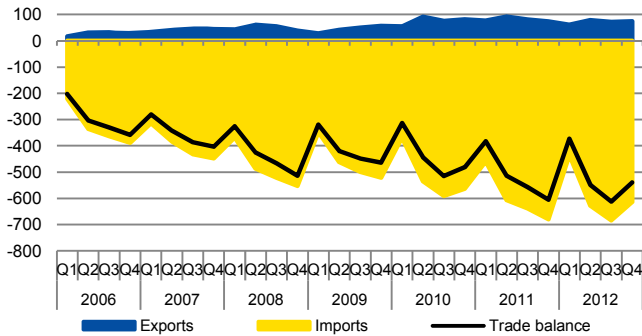
²⁷ NIM ratio differs from the ratio measuring the difference of interest rate spread, as NIM also considers the volume of interest generating assets and the volume of borrowed funds.

3.4.1 Current Account

Current account deficit in Kosovo during 2012 recorded a considerable decline by reaching the level of euro 379.4 million, which level in comparison to 2011 represents a decline of 42.4 percent. As a share to GDP, the current account deficit during 2012 had the lowest level in the recent years reaching 7.7 percent of GDP.

A substantial decline of the current account deficit was mainly affected by imports which in 2012 were lower by 1.0 percent compared to the previous year. Also, the growth of exports of services during 2012 impacted on the decrease of current account deficit. Then, the decrease of current account deficit was also affected by income category and current transfer category. As presented in figure 80, trade deficit is the key contributor to the current account deficit, while the other categories, such as services trade, income account and current transfers are the key factor impacting on narrowing the current account deficit.

Figure 80. Imports, exports and trade balance, non-cummulative

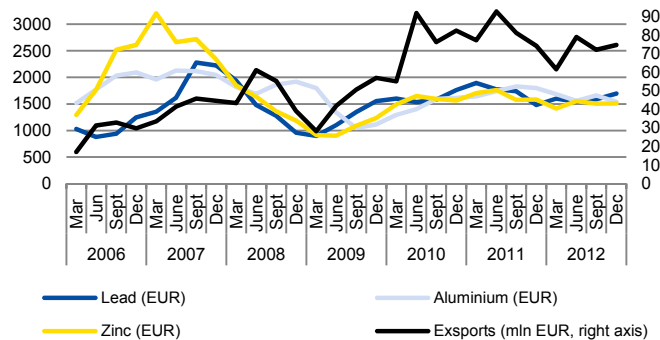


Source: CBK (2013)

3.4.1.1 Goods and services

Trade activity during 2012 recoded a significant slowdown both in exports and imports. The ratio of the trade activity against GDP during 2012 was 53.9 percent compared to 57.1 percent in 2011. The domestic economy is considered to have a lack of competitiveness in goods trade when taking into consideration the high trade deficit level (Figure 81). A relatively low level of production in Kosovo's economy makes it highly dependent on imports, and at the same time, reflections from changes of prices of key imported products are more significant within the local prices.

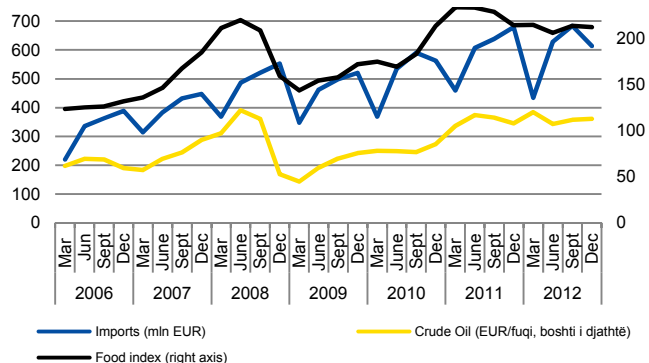
Figure 81. Exports and international metal prices, without seasonal adjustments



Source: CBK (2013) and Bloomberg.

Kosovo's exports during 2012 amounted to euro 286.9 million, which represents a decline of 11.7 percent in nominal terms. In real terms, the decline of exports was higher, thus reaching 13 percent. The decline of exports from Kosovo besides being caused by the overall decline of demand in the region and in the EU countries, it was also affected by the price decrease of key components exported by Kosovo. Over 60 percent of goods exported from

Figure 82. Imports and international prices of crude oil and food, without seasonal adjustments



Source: CBK (2013) and IFS and FAOUN

Kosovo are comprised of products of base metals and changes in metal prices reflect the nominal value of exports. Prices of base metals during 2012 recorded a decline close to the decline of domestic exports. For example, lead, aluminium, zinc and copper were characterized by a decline of prices between 7-9 percent, while nickel had a more significant decline of 20 percent. This ratio is also noticed in figure 81 where the general inclination of exports was similar to prices of base metals in international market. Besides developments within prices, the general forecasts of economic activity in global level are slightly better than in 2012, which are also expected to have positive impacts on Kosovo's exports. As a result, it is expected a recuperation of exports during 2013, with a growth rate of 8 up to 10 percent. Stabilization of prices of key products that Kosovo exports (ex. base metals) is expected to be a key factor which will drive the export growth during 2013.

On the other hand, the value of imports during 2012 reached euro 2.36 billion which represents a decline of 1.0 percent. The decline of exports during this period may have been caused as a result of stabilization and decline of prices of key food products and mineral products, which are mainly comprised of oil derivatives (Figure 82).

Trade in services during 2012 was characterized by a positive balance of euro 346.2 million which compared to the previous year (euro 265 million) represents an annual growth of 30.3 percent.

A key component within trade in services continues to be the travel category which is comprised of sale of services to non-residents. Compared to the previous year, during 2012 the account balance of travel services reached euro 309.3 million which represents an annual growth of 31.3 percent. The balance

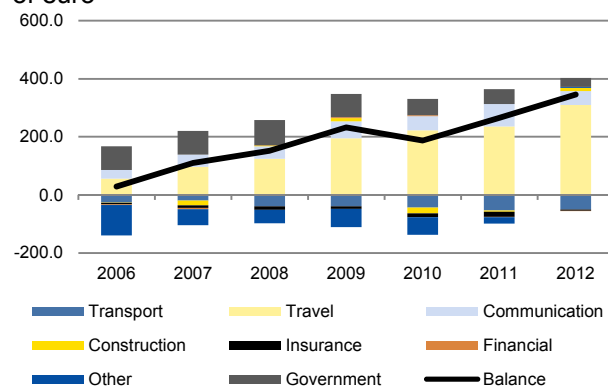
growth of this account was a result of the decline of import of travel services by 28.1 percent and the growth of exports of these services by 13.4 percent.

An important category within services was the trade activity in communication services. The position within communication services during 2012 reached euro 70.3 million export and euro 22.0 million import, resulting in a positive balance of euro 48.3 million. However, compared to the previous year this category recorded a decline of 37.3 percent. Another important category within services was the export of government services and it has to do with services provided to the international presence in Kosovo, such as diplomatic missions and the presence of other international institutions (EULEX and KFOR). The balance of this category was euro 30.9 million. Transport with euro 50.9 euro and security services with euro 4.0 million (Figure 83) continue to have a negative balance within the trade in services.

3.4.1.2 Income and Current Transfers

Income account during 2012 had a positive balance of euro 154.1 million against euro 113.8 million in 2011. The growth of positive balance within this category was a result of the decline of payments within investments. On the other hand, the receipt from compensation of employees was characterized by stability.

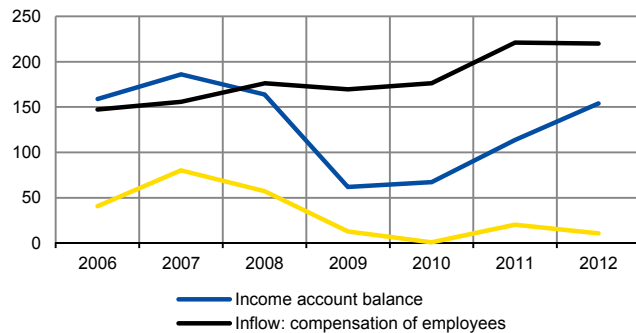
Figure 83. Net export structure of services, in millions of euro



Source: CBK (2013)

The largest category within the income category continues to be the compensation of employees which during 2012 had a balance of euro 219.9 million (euro 221.2 million in 2011). This category mainly is comprised of income of employees abroad, such as seasonal employees and employees in Afghanistan and Iraq. On the other hand, a category with constant negative balance is the investment income category. This category represents the distribution of the dividend from foreign companies which invested in Kosovo. During 2012, this category had a negative balance of euro 60.1 million which compared to the same period of the previous year recorded a decline of 36.2 percent (euro 94.3 million in 2011). The income account during this period was characterized by a positive balance growth of 35.4 percent (Figure 84).

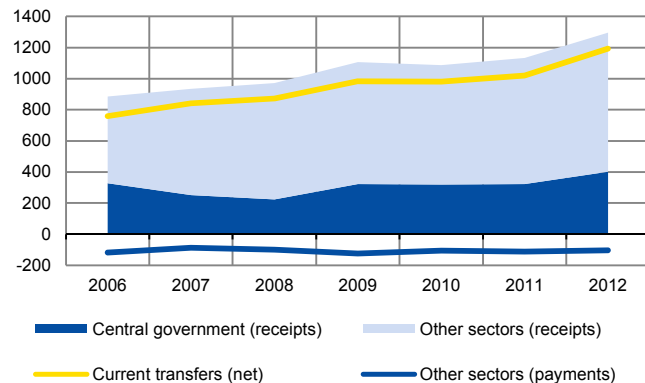
Figure 84. Income account, in millions of euro



Source: CBK (2013)

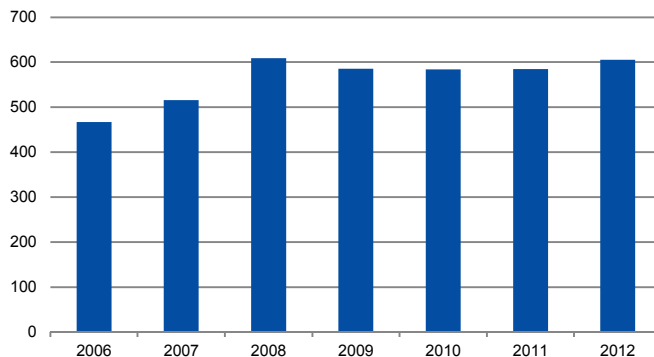
The category with the highest contribution in narrowing the current account deficit is the current transfer account. This category is comprised of both government transfers and private transfers which are dominated by remittances. Current transfer account during 2012 recorded a higher growth compared to the other accounts. The annual growth of current account reached 16.8 percent, resulting in a balance of euro 1.2 billion. Remittances within transfers against central government had the highest annual growth of 24.6 percent, reaching the level of euro 401.6 million. The government current transfers mainly include transfers of donors, EULEX and UNMIK. Another category with higher weight is that of other sectors which mostly contains remittances. Payments by Kosovo's economy within private transfers recorded a decline of 7.4 percent by contributing the overall growth (Figure 86). Remittances continue to be the key component within private sector transfers (67.7 of total transfers of private sector). Income from remittances in 2012 reached euro 605.6 million which compared to 2011 represent a growth of 3.6 percent. As a share to GDP, remittances in 2012 stood at 12.5 percent, representing the same level as in the previous year.

Figure 85. Current transfers, in millions of euro



Source: CBK (2013)

Figure 86. Received remittances, in millions of euro



Source: CBK (2013)

Germany and Switzerland continue to be the main source of remittances for Kosovo, with a share of 34 and 23 percent, respectively, to the total remittances, while the other countries are represented with a lower share: Italy and Austria comprise 7 and 6 percent, respectively, of the total remittances, followed by Belgium with 3 percent, the USA with 4 percent and Sweden with 3 percent. Around 20 percent of remittances are transferred through banking system, while 36 percent are transferred through money transfer agencies. The remainder is transferred through other channels including informal channels as well.

3.4.2 Capital and Financial Account

Capital and financial account continues to be characterized by a positive balance, yet significantly lower compared to previous years (Table 9). In 2012, the balance of this category reached euro 140.1 million which represents a decline of euro 66.6 percent compared to the previous year. Due to the decline of capital investment grants, the capital account balance decreased to euro 13.0 million, compared to euro 42.0 million in 2011.

Within the balance of euro 127.1 million of the financial account, assets recorded a growth of euro 322.3 million and liabilities increased to euro 449.4 million. The key contributors to the financial account positive balance continue to be the foreign direct investments (FDI), followed by other investments, while the constant growth of portfolio investments and reserve assets outside Kosovo economy continue to have a negative impact on the financial account balance.

Table 9. Capital and financial account, in millions of euro

Description	2006	2007	2008	2009	2010	2011	2012
CAPITAL AND FINANCIAL ACCOUNT	-14.9	10.7	298.9	213.3	297.2	419.6	140.1
Capital account	20.8	16.5	10.5	100.3	21.3	42.0	13.0
Financial account	-35.7	-5.8	288.5	113.1	275.9	377.5	127.1
Assets	367.5	508.5	227.8	230.6	402.9	93.9	322.3
Direct investments	5.6	9.7	25.0	10.5	34.7	15.7	15.8
Portfolio investments	65.4	34.5	109.9	124.8	48.6	57.8	185.7
Other investments	218.7	170.0	74.7	190.1	266.2	81.7	-146.4
Reserve assets	77.9	294.3	18.2	-94.8	53.4	-61.2	267.2
Liabilities	331.8	502.7	516.3	343.7	678.7	471.4	449.4
Foreign direct investments	294.8	440.7	366.5	291.4	365.8	394.6	232.0
Portfolio investments	0.0	0.0	0.0	0.5	-0.7	0.8	0.7
Other investments	37.0	61.9	149.8	51.8	313.6	76.0	216.6

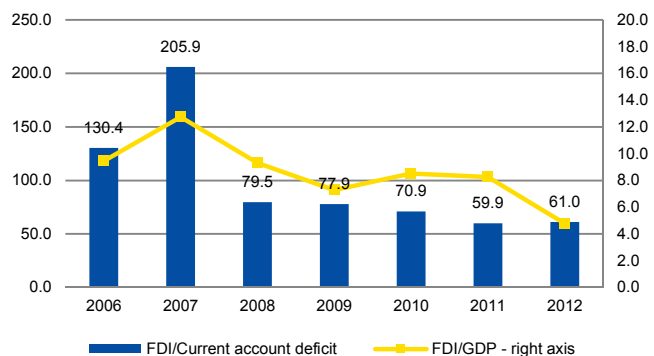
Source: CBK (2013)

3.4.2.1 Foreign Direct Investments

FDI in Kosovo were euro 232.0 million or 41.2 percent lower than in 2011. While Kosovo resident investments in other countries recorded a slight growth 0.8 percent and reached euro 15.8 million, Kosovo resident direct investments are mainly capital investment, which in majority of cases are purchases of real estate.

As presented in figure 87, FDI in Kosovo

Figure 87. FDI as percentage to GDP and current account deficit



Source: CBK (2013)

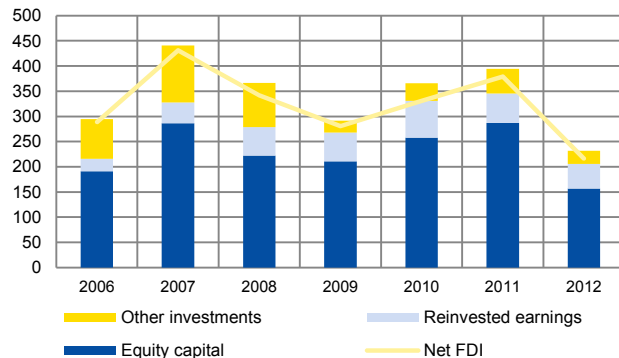
during the period 2008 – 2011 maintained a similar share of 8.3 percent to GDP on average. As a result of global financial crises, during 2009, FDI recorded a more significant decline, while in 2010-2011 the value of these investments started to increase again although with a slow trend. Meanwhile, the trend deteriorated significantly in 2012, reaching the share 5 percent to GDP. This deterioration of trend proves the sensibility that FDI has against developments in the economy of euro area countries, which at the same time represent the main resource of FDI in Kosovo.

FDI sensitivity against euro area developments is illustrated by the fact that the other investments (borrowings between enterprises) recorded a rather significant decline (46.6 percent) compared to shareholders capital (a decline of 45.3) or reinvested earnings (a decline of 16.1).

FDI in Kosovo are basically concentrated on economy sectors, such as real estate with 31.7 percent of total FDI, construction with 20.8 percent, production with 12.1 percent, financial sector with 10.4 percent, followed by transport and telecommunication sector with a share of 7.9 percent to total FDI. As presented in figure 88, 2012 was characterized by changes regarding the FDI structure by sectors. The value of investments in real estate is almost the same as in the previous year, yet due to the decline of investments in construction and manufacturing sector, it is noticed a larger share of this sector to total FDI. Financial sector which in the two previous years is found to have recorded a significant decline in total FDI, in 2012 recorded a slight increase and it is also expected to increase in 2013, as a new bank commenced its operation in Kosovo's banking system.

EU countries continue to represent the key resource of FDI in Kosovo. Unlike last year when the largest part of FDI originated from Great Britain (20.3 percent of total FDI), in 2012 Turkey represents the country where the majority of FDI in Kosovo came from (28.3 percent of total FDI). Investments from this country in 2012 were mainly designated to the transport and telecommunication sector (53.8 percent), financial services (19.6 percent), production (14.2

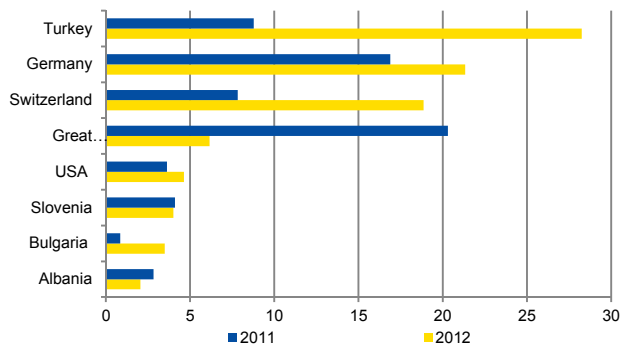
Figure 88. FDI structure by components, in millions of euro



Source: CBK (2013)

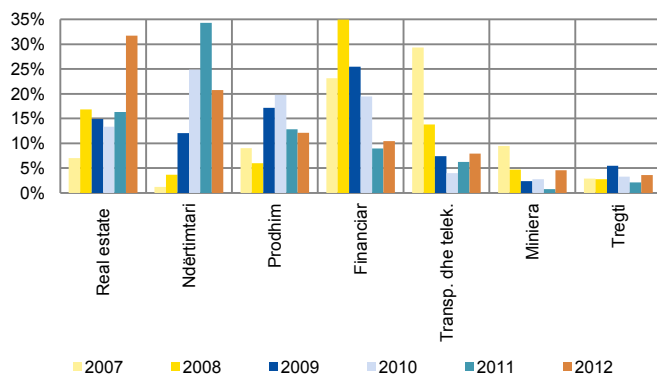
that the other investments (borrowings between

Figure 89. FDI structure by country of origin, in percent



Source: CBK (2013)

Figure 90. FDI by main economic sectors, in percent



Source: CBK (2013)

percent), etc. There was also a significant growth of FDI from Switzerland, which during this period represents the third country in terms of the FDI amount in Kosovo (18.9 percent). Unlike Turkey, FDI from Switzerland during 2012 was mainly concentrated on real estate (66.1 percent) and construction (18.5 percent). From the majority of EU countries, including Germany, there was a decline of FDI, yet due to the fact that the decline of FDI from Great Britain was quite high, some other countries recorded a growth of the share in FDI structure (Figure 90).

3.4.2.2 Portfolio Investments, Other Investments and Reserve Assets

Portfolio investment balance in 2012 was euro -184.9 million (euro -57.0 million in 2011). Portfolio investments abroad in 2012 recorded a significant growth compared to the previous year. This growth was marked due to investment on deposits in securities abroad. The value of portfolio investments abroad reached euro 185.7 million (euro 57.8 million in 2011). Out of this amount, 61.9 percent was invested in equity securities, while the remainder of 38.1 percent was invested in debt securities. This proportion of portfolio investments reflects perceptions by local financial institutions on improvement of general environment in global financial markets since investments in equity securities are considered to have higher risk and consequently the possibility of earnings is higher than in case of investments in debt securities.

Regarding institutions, the largest part of portfolio investments belongs to the Central Bank and commercial banks, while the other part comprises of investments in pension funds in different financial instruments abroad. Liabilities in form of portfolio investments, which mainly comprise reinvested earnings of shareholders of commercial banks who own less than 10 percent of the shares, in 2012 was only euro 0.7 million. This level of liabilities in the form of portfolio investments is because the development of the capital is still at the initial stage.

The category of other investments, as one of the most weighted category within financial account, had a balance of euro 363.0 million (euro -5.7 million in 2011). The positive balance of this category recorded a growth because of the decrease of assets by euro 146.4 million and the increase of liabilities by euro 216.6 euro. The growth of liabilities of residents against non-residents represents the capital inflow in the country, similarly as the decrease of assets results in the capital inflow in the country. Within assets, the category of deposits decreased by euro 179.8 million (withdrawal of deposits placed outside Kosovo's economy during the previous years and their investments in securities). The major part of this amount belongs to the Central Bank, while the other part belongs to commercial banks and other sectors. Non-resident loans recorded a growth of 27.1 percent or euro 31.3 million. The growth of loans was mainly a result of allocation of non-resident loans by commercial banks, while the share of other sectors²⁸ within loans was quite low (only 6.8 percent).

Regarding the liabilities, the key component continues to be the category of trade loans²⁹ which during 2012 reached the value of euro 100.3 euro (an annual growth of 7.7 percent). The growth of trade loans may be an indicator of the lack of local companies' solvency, and also it may serve as a confidence measuring tool of international companies against local ones. The category of deposits, which are basically non-resident deposits with domestic banks, reached euro 97.0 million (euro -1.3 million in 2011). On the other hand, liabilities in form of loans recorded a growth of euro 19.4 million (euro 15.8 million was the value of loans refunded in 2011).

Reserve assets are available-to-drain equities outside a certain economy and controlled by monetary authorities to directly fund the needs of balance of payments through intervention in

²⁸Other sectors include: pension funds, financial auxiliaries, insurance companies, non-governmental organizations, private companies and individuals.

²⁹Trade loans and advances appear at the moment when payment for goods and services are not executed at the same time with the change of ownership of that goods and service. If the payment is executed after the change of ownership, it will be registered as a trade loan, while if it is executed before the change of ownership, it is registered as an advance payment.

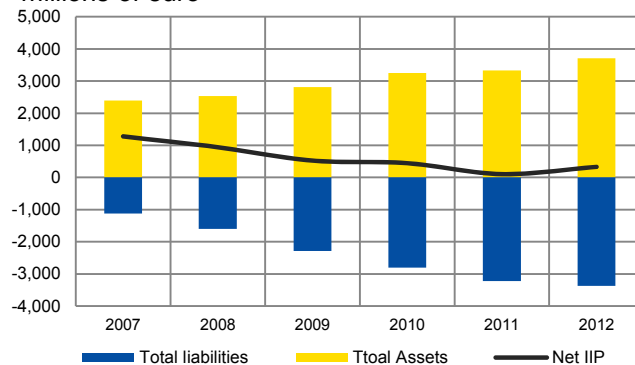
currency exchange markets to influence on the currency exchange rate, and for other purpose (maintaining the trust on money and economy, and serving as a ground for receiving loans abroad). Considering this definition, it can be considered that reserve assets in Kosovo are of great importance in comparison to the majority of other countries, as euro is used as an official currency in Kosovo, which is acceptable in any international transaction. However, reserve assets in 2012 increased to euro 267.2 million. This growth of reserve assets was around 56.7 percent in monetary trade instruments and the other part in deposits.

3.4.3 International Investment Position

Net International Investment Position (IIP)³⁰ at the end of 2011 was positive (euro 330.5 million). IIP positive trend followed a declining trend until 2011, where as a share to GDP reached 2.2 percent, while it started to increase again in 2012 reaching 6.7 percent of GDP. This balance improvement was driven by a higher growth of Kosovo's assets abroad against liabilities that Kosovo has against other countries (11.3 and 4.7 percent, respectively) (Figure 91). In this context, the reserve assets and net portfolio marked the main contribution to the IIP balance improvement, recording a growth of 46.2 and 33.0 percent, respectively, at the end of 2012 compared to the end of 2011. On the other hand, other net investments recorded a decline of 20.5 percent, while the balance of direct investments continued to be negative and recording a further decline of 3.1 percent in 2012.

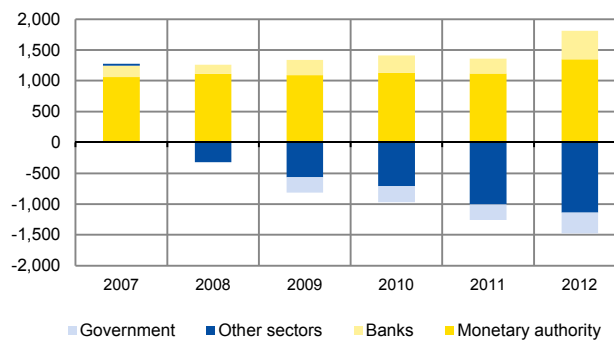
As to institutional sectors, the Central Bank and commercial banks have constantly had credit balance (euro 1.3 billion and 457.5 million, respectively, at the end of 2012), while the other sectors and the Government had a debit balance (euro 1.1 billion and 336.5 million, respectively). The positive balance of the Central Bank and commercial banks recorded a growth of 21.3 and 84.5 percent, respectively, while the other sectors and the Government deepened the negative balance by around 13.7 and 32.7 percent, respectively (Figure 92).

Figure 91. International Investment Position, in millions of euro



Source: CBK (2013)

Figure 92. Net International Investments Position by institutional sectors, in millions of euro



Source: CBK (2013)

³⁰ Net Investment Position presents the balance in the end of a certain period of time of external financial assets and liabilities. Balance in the end of period is a result of transactions deriving from the past, including corrections as a consequence of exchange rate movement to calculate the value of financial assets/liabilities on reporting day or changes in price market.

3.4.3.1 Assets and Liabilities in International Investments Position

The stock value at the end of 2012 reached euro 3.7 billion (an annual growth of 11.3 percent). The growth of assets was mostly contributed by reserve assets which recorded a growth of 46.2 percent and portfolio investments which recorded a growth of 32.7 percent (Figure 93). Portfolio investments, which have a considerable share in the asset stock abroad (26.6 percent) have been mainly invested in debt securities (64.1 percent), while the other share (35.9 percent) in equity securities. Over 90 percent of portfolio investments are concentrated in euro area countries, mainly in Ireland (31.1 percent), Luxembourg (23.5 percent, Belgium 22.2 percent), etc.

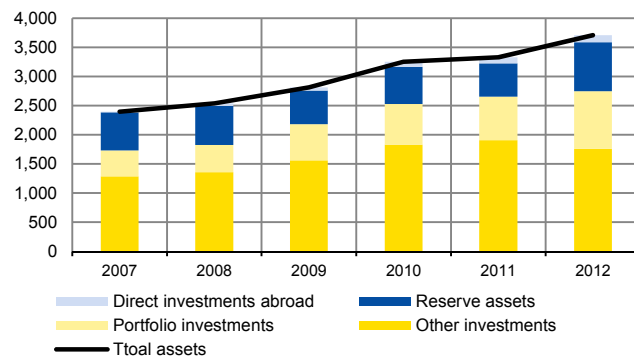
Reserve assets have a share of 22.7 percent to total assets and are mostly held in deposits abroad (71.1 percent) and money market instruments (19.4 percent), while the other part is held in form of Special Drawing Rights (7.5 percent) and Kosovo's reserve in IMF (2.0 percent).

Direct investments of Kosovo residents abroad recorded a growth of 15.5 percent, yet the contribution to asset stock is low as only 3.2 percent of total assets belong to this category. Regarding direct investments, they all are in form of the equity capital and are mainly oriented in the purchases of real estate in the regional countries. Albania represents the country where the majority of direct investments from Kosovo investors (26.3 percent of Kosovo residents abroad) were invested, followed by Germany (10.9 percent), Macedonia (7.5 percent), etc. (Figure 94).

The category of other investments, which represents the main category within Kosovo's assets abroad (47.5 percent of total assets), was the only category recording a growth of 7.7 percent compared to the end of 2011.

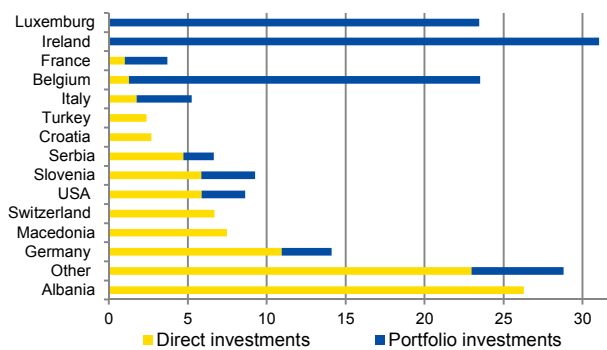
Over 95 of assets within this category are in form of deposits, of which over 50 percent are deposits of other sectors, while the other part consists of deposits of the Central Bank (21.0 percent). Loans comprise 4.6 percent of other investments and in general they belong to

Figure 93. Assets by form of investments, in millions of euro



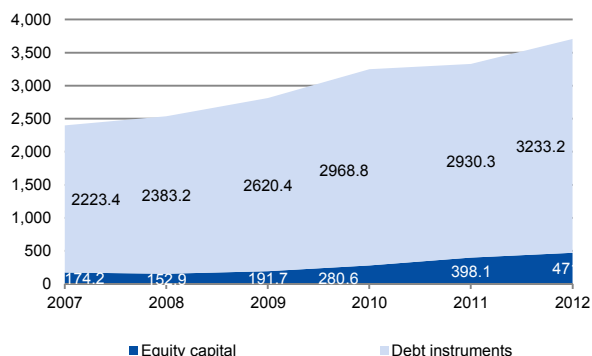
Source: CBK (2013)

Figure 94. Stock of portfolio and direct investments by countries, in percent



Source: CBK (2013)

Figure 95. Assets stock in equity capital and debt instruments, in millions of euro



Source: CBK (2013)

commercial banks. Other investments also include trade loans and other assets which have a low share (0.1 percent each).

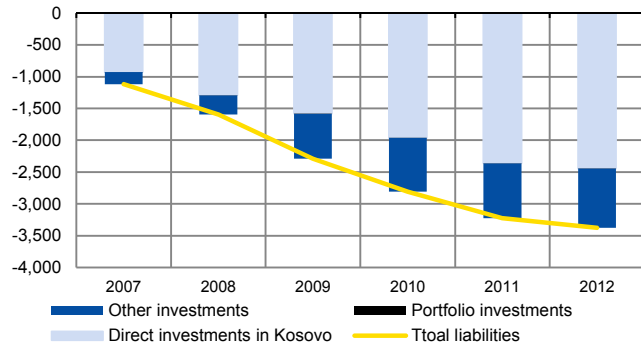
The above mentioned elaboration indicates that certain components participate by more than one item (for example, deposits consist of the largest part of both reserve assets and other investments). Therefore, it is also important to elaborate assets by two main groups, shareholders capital and debt instruments. Kosovo's assets are mainly invested in debt securities (87.3 percent) and shareholders capital (12.7 percent). As presented in figure 95, the shareholders capital although at low level, has constantly increased its share within the total assets. Within shareholders capital, the majority part comprises investments in equity securities (75.0 percent) while the other part (25.0 percent) in direct investments of Kosovo residents abroad. This structure was almost similar at the end of 2011. Assets invested in form of debt instruments are concentrated in the category of other investments (54.5 percent), then in reserve assets (26.0 percent) and debt securities (19.6 percent). This concentration in the category of other investments was more significant at the end of 2011 (65.1 percent). In other words, making a comparison between 2012 and 2011, it is observed that investments shifted from the category of other investments towards reserve assets and securities.

By institutional sectors, the key owners of Kosovo's assets abroad are the other sectors with 45 percent, the Central Bank with 38 percent and commercial banks with 17 percent.

The stock value of liabilities by the end of 2012 reached euro 3.4 billion (4.7 percent higher than in 2011). While the majority of Kosovo's assets are invested in debt securities, liabilities of Kosovo's economy are dominated by FDI (72.5 percent), which represent a favourable structural feature of liabilities (Figure 96). Other investment liabilities have a share of 27.5 percent, while portfolio investment liabilities have a share of only 0.02 percent.

Liabilities can be grouped in two major types: debt liabilities (other investments, portfolio investments and FDI in form of inter-company borrowings), which will be elaborated within the external debt and other non-debt liabilities (FDI in form of shareholders capital and portfolio investment equity securities).

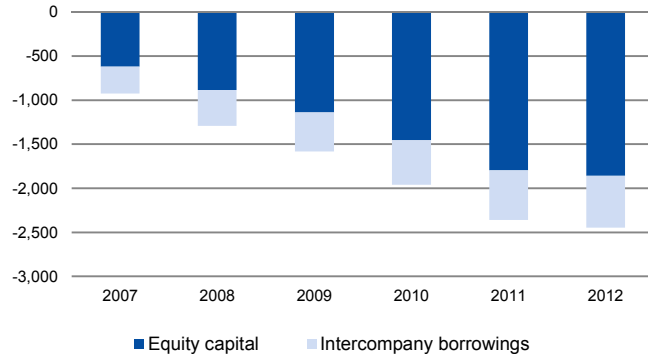
Figure 96. Liabilities to external sector by instruments, in millions of euro



Source: CBK (2013)

This structure was almost similar at the end of 2011. Assets invested

Figure 97. FDI by equity capital and debts, in millions of euro



Source: CBK (2013)

FDI stock as one of the most important sector of liabilities reached the value of euro 2.4 billion. Out of this amount, 75.9 percent are in form of shareholders capital while the other part of (24.1 percent) belongs to FDI in form of loans received by direct investing enterprises in Kosovo form direct investors. Almost a similar structure was also in the previous years (Figure 97). Out of euro 1.9 billion of FDI shareholders capital, Germany leads with 10.1 percent followed by Slovenia and Austria with 5.7 percent, Switzerland, Turkey and United Kingdom had a share of 4 percent each, while Albania has a share of 2.2 percent, followed by other countries with a lower share.

Liabilities within portfolio investment equity securities, which mainly belong to domestic banks, remained at a lower level (euro 0.5 million) due to the development of capital market which is still at its initial stage.

3.4.4.2 External Debt

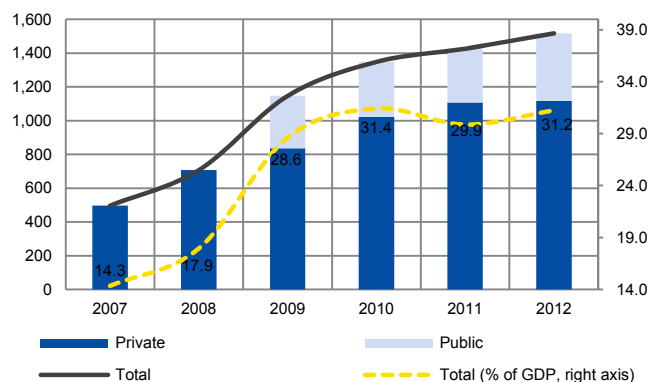
Kosovo gross external debt, which includes private debt and public debt³¹, in 2012 reached euro 1.5 billion which is by 6.4 percent higher than in 2011. Kosovo's economy has the lowest level in the region in terms of debt. As a share to GDP, gross external debt at the end of 2012 reached 31.2 percent from 29.9 percent that was at the end of 2011 (Figure 98). Kosovo favourable position compared to the other regional countries

due to the fact that the public debt has a low share to the total gross external debt (euro 401.4 million or 26.4 percent of the gross external debt). As a share to GDP, public debt at the end of 2012 was only 8.3 percent. On the other hand, private debt, which reached euro 1.1 billion comprises 73.6 percent of gross external debt.

The majority of external debt belongs to the form of intercompany borrowings within FDI (Figure 99). Consequently, foreign companies operating in Kosovo owe to external sector euro 589.7 million or 38.9 percent of total external debt. Direct investors from Slovenia and Turkey have mostly issued loans to their enterprises operating in Kosovo, with 25.6 percent and 13.2 percent, respectively, of intercompany loans, followed by Switzerland and Albania with 3.0 percent and 2.6 percent, respectively etc.

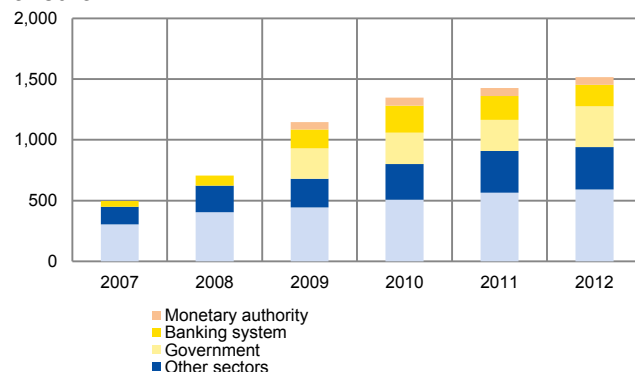
A considerable share within Kosovo total external debt is also recorded by 'other sectors'³² (euro 350.9 million or 23.1 percent of external debt). The debt stock of other sectors is dominated by trade loans (56.9 percent), while the other share comprises other loans (43.1 percent). The majority of debt of other

Figure 98. Gross external debt, in millions of euro



Source: CBK (2013)

Figure 99. Gross external debt by sectors, in millions of euro



Source: CBK (2013)

³¹ Within the public debt it is included the Government and Central Bank, while within the private debt are included inter-company borrowings within FDI, banking system and other sectors.

³² Within other sectors are included: pension funds, financial auxiliaries, insurance companies, non-governmental organizations, private companies and individual.

sectors is a short-term debt (90.5 percent), while the other part is long-term debt (9.5 percent).

Government external debt with a value of euro 336.5 million is mainly an inherited debt which means that it is a long-term debt and consists of 22.2 percent of gross external debt. Government debt is mainly due to the World Bank (66.4 percent), while the other part is due to IMF (33.6 percent). The growth of Government debt of 32.7 percent in 2012 compared to 2011, is mainly attributed to the IMF loan within the Stand-by-Arrangement program.

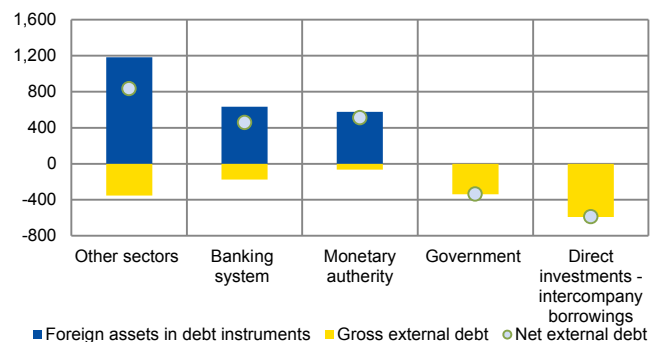
The stock of gross external debt of the banking system at the end of 2012 was euro 176.6 or 11.6 percent of total external debt. The majority of this debt was a short-term one, and the largest part of it was comprised of non-resident deposits with 68.6 percent, followed by loans with 28.6 percent and other liabilities with 2.8 percent. Central Bank has the lowest share to total external debt with (euro 65.0 million or 4.3 percent of total external debt). The Central Bank activities mainly belong to the stock of allocation of Special Drawing Rights (SDR) from IMF.

Kosovo's economy, with its funds invested abroad (privatization assets and KPST assets), is quite active in international financial markets, and

besides the gross external debt, in order to assess the external stability position, it is important to analyse also the net external debt. Kosovo at the end of 2012 had a credit position of euro 875.5 million, i.e. the external sector debt against Kosovo's economy (euro 2.4 billion) is higher than Kosovo's economy debt against the external sector (euro 1.5 billion).

All sectors have a credit position against external sector other than Government and inter-company borrowings (Figure 100). 'Other sectors' have a higher credit position of euro 831.9 million followed by the Central Bank with euro 511.8 million and commercial banks with euro 458.0 million. On the other hand, the credit position of Government and inter-bank borrowings of euro 336.5 and 589.7 million, respectively, is the same to their gross debt as these two sectors have no assets invested abroad.

Figure 100. Net external debt by sectors, in millions of euro



Source: CBK (2013)

4. Supervision of Financial Institutions

4.1. Licensing and Regulatory Framework

4.1.1 Licensing

Criteria and conditions to obtain a licence for exercising banking activities and other financial activities in the Republic of Kosovo are established under Law on CBK (Law No. 03/L-209) and other sub-legal acts adopted by CBK.

Licensing criteria established by law aim at a fair financial market regulated through a process built based on the principle of fairness, honesty and equality. Licensing conditions and criteria are of supervisory character and are not intended to impose barriers against investors whether domestic or foreign ones.

CBK strategy on the licensing area of financial institutions is concentrated on attraction of investors who have a good financial position, meet the ethical and professional criteria necessary for shareholders and management to be fit and proper, are capable to run an approach on prudent exercise of business to protect clients' interests, thus aiding in strengthening the financial sector and enhancing its credibility.

Licensing and Methodology Department is tasked to control completion of legal framework on financial supervision pursuant to the European Directive and the best international practices, as presented under "Core Principles on Effective Banking Supervision" published by the Bank for International Settlement (BIS), as well "Core Principles on Effective Insurance Supervision" published by the International Association of Insurance Supervisors (IAIS). In achieving this mission, the Licensing Department is in charge of receipt, review and recommendation of applications by institutions applying for licensing respectively for registration to operate in Kosovo, such as commercial banks, insurance companies and insurance intermediaries, pension funds and all other non-banking institutions.

Licensing activity of financial supervision during 2012 mainly included:

- Approval of licensing of a foreign bank branch;
- Approval of two (2) requests by banks to change the charter and status;
- Approval of two (2) requests for distribution of dividend;
- Approval of a request by an insurance company to be transferred from branch to independent entity;
- Approval of thirty-seven (37) requests for appointments of administrators, senior managers and internal auditors of banks and microfinance institutions as well as insurance companies;
- Approval of eighty-five (85) requests to open new branches and relocation of branches of banks, insurance companies and other financial institutions in Kosovo;
- Approval of (4) requests to increase the insurance activities and products;
- Approval of sixty-eight (68) requests of agents of insurance companies;
- Approval of registration of an exchange bureau;
- Revocation of registration of two (2) microfinance institutions;

- Rejection of two (2) requests of managing board members of insurance companies and insurance intermediaries;
- Rejection of nine (9) requests of agents of insurance companies.
- Suspension of license of an assessor of claims.

In the approved cases of bank administrators, twenty-one (21) of them are for bank managing board members, one (1) for audit committee member, and eight (8) cases are for general director and deputy director of banks and microfinance institutions, as well as seven (7) for senior managers of banks. On the other hand, regaining insurances, eight (8) of them are for members of governing boards of insurance companies and insurance intermediaries, five (5) case are for general director and deputy director of insurance companies and insurance intermediaries, four (4) cases for internal auditors, sixteen (16) cases are for medium management of insurance companies and insurance intermediaries.

Banks and insurance companies have constantly worked on expanding their activity towards diversification of banking and insurance products and providing more investment opportunities and numerous solutions to their clients. During 2012, only one application was received for establishment of a new bank, yet there has been an interest from foreign investors to apply for banks or bank branches.

In 2012, there have been nine (9) banks with 310 bank branches and sub-branches in banking market, while in insurance market there have been thirteen (13) insurance companies – ten (10) life insurance companies and three (3) non-life insurance companies. During 2012, an application was received for establishment of a new insurance intermediary.

The CBK Executive Board approved during 2012 the final licence of the foreign bank branch, Turkiye Is Bankasi, from Turkey.

Two pension funds kept operating in pension area, the mandatory pension fund – Kosovo Pension Savings Trust (“Trust”) and the individual pension fund – Slovenian-Kosovo Pension Fund.

Table 10. Number of banks, insurance companies and pension funds, 2010-2012

Description	2010	2011	2012
Banks	8	8	9
Insurance companies	12	13	13
Obligatory and individual pension funds	2	2	2

Source: CBK (2013)

Microfinance and Non-banking Financial Institutions. Fourteen (14) microfinance institutions and four (4) non-banking financial institutions dealing with lending activity have been operating in Kosovo by the end of 2012. In accordance with the legal framework requirement, the Executive Board revoked registrations of two microfinance institutions “Agro Invest” (Krusha e Vogel, Prizren) and “Fundway Mortgage” (Prishtina), because they did not commence their operations.

Insurance Intermediaries. Three (3) insurance intermediaries were operating by the end of 2012.

Currency Exchange Bureaus and Money Transfer Agencies. During 2012, the CBK Executive Board approved the additional money transfer for non-banking financial institutions “DMTH L.L.C”, as well as the registration of non-banking financial institution “Capital” (Prishtina) to

perform transfer activity and payment services; and the registration of exchange bureau “Te Bernardi” (Klina). By the end of 2012, there have been thirty-one (31) currency exchange bureaus and five (50) money transfer agencies operating in Kosovo.

Table 11. Number of microfinance institutions, non banking institutions, money transfer agencies and currency exchange bureaus, 2010-2012

Description	2010	2011	2012
Microfinance institutions	13	15	14
Financial non-bank crediting institutions	4	5	4
Money transferring agencies	2	4	5
Exchange bureaus	26	30	31

Source: CBK (2013)

Table 12. Number of insurance intermediaries 2010-2012

Description	2010	2011	2012
Agents/operators	679	744	631
Insurance brokers	3	2	2
Damage adjusters	1	1	1

Source: CBK (2013)

4.1.2 Regulatory Framework

a) Legal Framework

Legal framework on licensing and regulation of financial supervision was reviewed and updated during 2012 to ensure an effective financial supervision in full compliance with the best international practices, EU standards and directives. In the course of significant developments characterizing 2012, it is worthy to mention Law No. 04/L-093 on Banks, Microfinance Institutions and Non-banking Financial Institutions.

Also, in cooperation with the American Treasury Department technical assistance it was continued with the revision and amendment process of the draft law on general insurances. This draft law includes a higher advancement of the legal ground for regulation and supervision of the insurance sector in Kosovo.

As a result of entering into force of Law No. 04/L-018 on Compulsory Motor Liability Insurance in 2011, CBK in cooperation with insurance industry and other relevant stakeholders founded Kosovo Insurance Bureau (KIB) and submitted an application for Kosovo membership in the International Green Card System. Efforts have also been made during 2012 by Kosovo Insurance Industry in finding a representation modality in the International Green Card System.

Banking Supervision Regulations

The purpose of supplementing the relevant regulations on financial supervision is to ensure and establish a well regulated business environment, without imposing undue burdens to the financial services users.

In accordance with the new law on banks, microfinance institutions and non-bank financial institutions, during 2012, it was preceded with amendment and finalization of regulations on banking supervision pursuant to Basel Committee standards and EU directives.

Year 2012 was characterized by finalization of twenty (21) new banking regulations approved by the Executive Board and the CBK Board, as follows:

- Regulation on Licensing of Banks and Branches of Foreign Banks,
- Regulation on Bank Directors and Senior Managers,
- Regulation on Opening Representative Office Inside and Outside of the Republic of Kosovo,
- Regulation on Opening and Closing Inside and Outside of the Republic of Kosovo of Bank Branches and Subsidiaries,
- Regulation on Bank Capital Adequacy,
- Regulation on Capital Equivalency Capital for Branches of Foreign Banks,
- Regulation on Changes in Capital Accounts,
- Regulation on Large Exposures,
- Regulation on Transactions with Related person and Exposures to Employees,
- Regulation on Limits of Holding of Real Estate and Movable Property,
- Regulation on Foreign Currency Activity Risk,
- Regulation on Credit Risk Management,
- Regulation on Liquidity Risk Management,
- Regulation on Operating Risk Management,
- Regulation on Consolidated Supervision of Banking Groups,
- Regulation on Merger and Acquisitions of Banks,
- Regulation on Reporting of Banks to CBK,
- Regulation on Publication of Information by Banks,
- Regulation on External Audit of Banks,
- Regulation on Internal Controls and Internal Audit, and
- Regulation on Effective Interest Rate and Disclosure Requirements.

The relevant commission established to review the regulatory framework and draft new supervising regulations is working on drafting a regulation on microfinance institutions and non-banking financial institutions, as well as to finalize drafting of the law on general insurances and relevant insurance regulations.

Year 2012 will be a year of continuity of consolidation of the legal framework on supervision of banks, MFI, NBF, insurance companies and pension funds in accordance with the new laws and

at the same time of establishment of a regulatory framework reflecting the needs and requirements identified during a thirteen-year period of the existence of banking supervision in Kosovo.

Insurance Supervision Regulations

During 2012, it was preceded with preparation of other sub-legal acts as provided for by Law No. 04/L-018 Compulsory Motor Liability Insurance. The Executive Board and the CBK Board thereafter approved the following regulations;

- Regulation on Implementation of *Bonus-Malus* System,
 - Regulation on General Terms of Motor Liability Insurance Policy,
 - Regulation on Procedures for Processing Damage Compensation Claims,
 - Regulation on Maintenance and Use of Equity of Kosovo Insurance Bureau compensation fund,
 - Regulation on Determination of Reporting and Supervision Standards of Kosovo Insurance Bureau,
- Regulation on Determination of Reporting Standards and Forms of Kosovo Insurance Bureau and Insurance Companies

c) List of financial institutions and number of their branches/sub-branches, end of 2012

Table 13. Commercial banks

Commercial banks		
No.	Name	Affiliates/existing branches
1	ProCredit Bank	68
2	Raiffeisen Bank Kosovo J.S.C.	50
3	NLB Prishtina sh.a	51
4	Banka për Biznes	41
5	Banka Ekonomike	44
6	TEB sh.a	23
7	Banka Kombetare Tregtare – Branch in Kosovo	24
8	Komercijalna Banka – Branch in Mitrovica	8
9	Türkiye İİ bankası - Branch in Prishtina	1
	Total	310

Source: CBK (2013)

Table 14. Insurance companies

Insurance companies		
No.	Name	Affiliates/existing branches
1	Dardania	31
2	Illyria	48
3	Kosova e Re	34
4	Siguria	37
5	Insig	32
6	Sigma	39
7	Sigal	44
8	Croatia Sigurimi	23
9	Sigkos	25
10	Graw e Elsig	38
11	Illyria Life	1
12	Graw e Kosova	1
13	Sigal Life Uniqa Group Austria	1
	Total	354

Source: CBK (2013)

Table 15. Microfinance institutions

Microfinance institutions		
No.	Name	Affiliates/existing branches
1	Finca	21
2	KEP	34
3	KGAMMF-Grameen	4
4	AFK	12
5	Besëlidhja	11
6	KRK	15
7	Mështekna	1
8	Qelim Kosovë	1
9	KosInvest	6
10	Start	2
11	Perspektiva 4	1
12	KAD	1
13	ACP	1
14	Timi Invest	1
15	Total	111

Source: CBK (2013)

Table 16. Non banking financial institutions

Non-banking institutions		
No.	Name	Affiliates/existing branches
1	Crimson Finance Fund	1
2	Lesna	9
3	Raiffeisen Leasing	1
4	Factor Leasing	1
5	Total	12

Source: CBK (2013)

Table 17. Money transfer agencies

Money Transferring Agencies		
No.	Name	Affiliates/existing branches
1	UFP (sub-agents)	175
2	DMTH (sub-agents)	113
3	Vllesa Co	23
4	KLM Enterprise	1
5	Capital	1
	Total	313

Source: CBK (2013)

Table 18. Insurance intermediaries

Insurance intermediators		
No.	Name	Affiliates/existing branches
1	WVP Sh.p.k	1
2	Risk Sh.p.k	1
3	Ansia Sh.p.k	1
	Total	3

Source: CBK (2013)

Table 19. Money exchange bureaus

Exchange offices		
No.	Name	Affiliates/existing branches
1	Euro Cufa	1
2	NBS	1
3	Monedha	1
4	Euro	1
5	Euro Këmbimi	1
6	Euro Eki	1
7	Gipa	1
8	Xeni	1
9	Agimi	1
10	Indriti	1
11	Agoni	1
12	Ximi	1
13	Beni	1
14	Prizreni	1
15	Valuta	1
16	Edona	1
17	Ebani	1
18	Te Gazi	1
19	Hamza	1
20	Veli	1
21	Mena	1
22	Sara	1
23	Kujtimi	1
24	Adis	1
25	Aral	1
26	Ismeti	1
27	Kemi	1
28	Safeti	1
29	Yllka	1
30	Mani	1
31	Bernardi	1
	Total	31

Source: CBK (2013)

4.2. Banking Supervision

4.2.1 Banking Sector – General Developments

During 2012, Kosovo banking sectors continued to grow and maintain the sustainability of integral liquidity, profitability and capital adequacy. The value of total banking sector assets reached at euro 2.641 billion, recording an annual growth of around euro 138.6 million or 5.5 percent, which proves a slower trend compared to the last year when total assets increased to around euro 176.0 or 7.6 percent. At the same time, the credit portfolio indicated a significantly lower growth compared to last year, namely euro 66.1 million or 3.9 percent compared to the growth of euro 240.2 million or 16.7 percent recorded in 201. The asset structure continued to be primarily funded by deposits and was concentrated on lending activity.

The growth dynamics was characterized by a constant system consolidation, respectively an increasing weight of small banks and branches of foreign banks and a slight decreasing weight of large banks. In 2012, Türkiye İş Bankası was licensed by CBK to operate as a foreign bank branch of Türkiye İş Bankası from Turkey, which started its banking operating activity in the end of December 2012.

Small banks (G2)³³ have given a key contribution to the increase of sector assets with around euro 91.5 million or 3.7 percent, followed by branches of foreign banks (G3)³⁴ with around euro 51.9 million or 2.0 percent, while the group of large banks (G1)³⁵ recorded a decline of total assets with around euro 4.8 million or 0.2 percent. Following these changes, the share of small banks (G2) within the banking sector increased to 22.0 percent in 2012 from 19.5 percent that was in 2011. Similarly, the share of branches of foreign banks (G3) increased to 8.7 percent from 7.2, whereas the share of large banks decreased to 69.3 percent from 73.2 percent.

The above-mentioned changes within banking sector serve to trigger the interbank competition by increasing the weight of small banks and branches of foreign banks operating in Kosovo. Constant growth of activity of small banks and branches of foreign banks is reflected in concentration rate declining trend, which is estimated to be relatively high. Three largest banks in Kosovo banking sector manage around 69.3 of total assets of the sector, which last year operated with around 72.3 percent. The supervising activity was also adapted to these changes during the year, increasing the monitoring focus on financial performance examinations and more frequent examinations in group-banks with a faster growth rate and more comprehensive profiling of large banks based also on the financial consolidated sustainability analysis of the group which they belong to.

Assets and Deposits – Developments and Trends

During 2012, the banking sector was characterized by a lower growth rate of total assets with 5.5 percent against 7.6 percent during 2011.

The structure of the banking sector assets compared to the same period of previous year is characterized by the following main developments:

“Cash and balance with CBK” recorded a growth of around euro 87.2 million or 26.3 percent, namely the cash increased by euro 13.1 million or 11.7 percent, while the balance with CBK by euro 74.1 million or 33.7 percent. At the same time, the position “Cash and balance with CBK” is characterized by a higher growth compared to other positions within the total assets of the banking system, increasing its share in total assets to 15.8 percent from 13.1 percent that was last year. This is a result of attendance a rather prudential policy by banks in allocation of new loans, thus strengthening the liquidity positions.

“Claims against banks/placements” recorded a decline of around euro 41 million or 12.6 percent compared to the previous year, which was reflected by a decline of their weight within the total assets from 13.2 percent to 10.9 percent in 2012. The decrease of placements was mainly directed to the growth of bank most liquid position “Cash and balance with CB”. During this year, CBK followed a rather prudent approach regarding the existing limits of banks’ exposures to financial institutions abroad. In this aspect, a regulatory level in credit-risked exposures against the Tier I capital was maintained. This approach was dictated to a considerable extent by the inconsistency of global financial markets and fluctuations in regional markets

³³ Banks with a share in market of <10% of total assets.

³⁴ It includes branches of foreign banks operating in Kosovo.

³⁵ Banks with a share in market of >10% of total assets.

“*Investments in securities*” increased by euro 55.9 million or 27.7 percent, which are characterized by a higher growth rate compared to the previous year, during which these investments increased by euro 28.5 million or 16.4 percent. The tendency to a faster growth of securities was dictated by banks’ strategy to increase investments which bring higher return rate compared to placements with other banks. It is worthy to underline the fact that commercial banks invested around euro 60.0 million in treasury bills of Kosovo Government, which induce a zero risk rate. This new investment opportunity for banks was enabled since treasury bills started to function for the first time in Kosovo in 2012. The share of securities within total assets increased to 9.8 percent from 8.1 percent, while they have good quality given that they are securities of central government of countries with favourable rating, respectively with high solvency.

“(Gross) *Loans and Leasing*” increased by euro 66.1 million or 2.9 percent during 2012 compared to a growth of around euro 240.2 million or 16.7 percent during the previous year. Banking sector kept crediting the country’s economy, with a significantly lower growth trend of loan portfolio compared to last year, which was reflected by the decline of share of loans within total assets from 62.4 percent to 60.4 percent. This resulted from a more prudent approach by banks in allocation of loans, which also affected the general economic development in the country as well as the growth of non-performing loans, which made banks concentrated in qualitative crediting and not only on volume growth. Financial intermediation from banking system, especially from credit activity, is another important component supporting the economic activity in the country. Lending from banking system recorded a higher growth level compared to the previous period. By all means, the sufficient liquidity and good financial position of banks enabled the banks’ capacity to increase the lending level.

In an analysis of total loans by industry, it is noticed that credit activity keeps being oriented towards trade crediting which has the largest weight in total loans and comprises around 35.7 percent in the end of 2012 from 36.2 percent in 2011. Regarding loans issued to individual (individual consumer loans), in December 2012, they comprised 29.1 percent of portfolio or 0.2 point percent higher than in 2011. Loans issued for immovable property also recorded a growth of their share in total banking system loans, the share of which increased to 8.8 percent from 8.1 percent.

On the contrary, a decline of share in total loans was recorded by loans for mines to 0.9 percent from 1.0 percent, production loans to 7.0 percent from 7.1 percent, loans for services, tourism, hotel services to 7.4 percent from 7.5 percent. Agriculture loans, although slightly increasing their share by 0.1 point percent compared to last year, their share keeps being quite low in total loans in the country’s economy with 2.5 percent.

Although the decline of loan quality during 2012 is evident, non-performing loans keep being manageable and covered by satisfactory provisions from loan losses. Changes in categories of credit portfolio quality are herein described.

- “*delayed loans*³⁶ against total loans” increased from 10.3 percent that were in the previous year to 13.0 percent in the current year,
- “*problematic loans*³⁷ against total loans” from 8.5 percent to 10.0 percent, and
- “*non-performing loans*³⁸ against total loans” evidenced a growth from 5.9 percent to 7.5 percent.

³⁶ Delayed loans include loans classified as: watch, substandard, doubtful and loss loans.

³⁷ Problematic loans include loans classified as: substandard, watch and loss loans.

³⁸ Non-performing loans include loans classified as: watch and loss loans.

These developments in loan quality have impacted on the growth of reserve for loan losses compared to last year by euro 32.4 million or 28.3 percent.

Table 20. Loans by industry

Description	2011		2012	
	Thousands of euro	Share (%)	Thousands of euro	Share (%)
Agricultural loans	40,489.3	2.4%	43,508.7	2.5%
Mining	17,227.1	1.0%	16,004.6	0.9%
Production	119,594.9	7.1%	122,020.5	7.0%
Electricity	23,675.3	1.4%	24,712.0	1.4%
Services, tourism, hotels, restaurants	125,239.4	7.5%	128,301.3	7.4%
Communication	2,467.8	0.1%	3,725.4	0.2%
trade	606,972.1	36.2%	622,510.1	35.7%
Financial services (other from claims to banks)	5,065.9	0.3%	17,907.4	1.0%
Real estate-construction of real estates	135,649.5	8.1%	153,278.4	8.8%
Individual loans for households, family and other personal expences (consumer loans)	484,929.9	28.9%	507,583.6	29.1%
Other loans	114,269.9	6.8%	102,083.1	5.9%
Leasing	0.0	0.0%	0.0	0.0%
Total loans and leasings	1,675,581	100%	1,741,635	100%

Source: CBK (2013)

The structure of banking system financing resources compared to the same period of last year evidenced the following major changes:

“*Total Deposits*” recorded an annual growth of euro 170.1 million or 8.1 percent. Non-interest deposits increased by euro 49.2 million or 9.6 percent, while interest deposits increased to euro 120.8 million or 7.6 percent compared to the previous year.

The following changes have been recorded within the structure of interest free deposits: bank deposits decreased to euro 2.0 million or 57.0 percent; individual deposits increased to euro 39.1 million or 13.7 percent, while enterprise deposits decreased to around euro 51.0 million or 21.6 percent.

On the other hand, within the structure of interest deposits the following changes have been recorded: bank deposits decreased to around euro 6.0 million or 71.9 percent, individual deposits increased to around euro 130.9 million or 10.8 percent, while enterprise deposits decreased to euro 4.1 million or 1.1 percent.

Client deposits keep being the most important and sustainable founding resource to Kosovo banking system. In the end of 2012, client deposits in sectors reached at the level of euro 2.269 billion. During this year, these deposits increased, although it is observed a slight decline of their growth trend – namely 8.1 percent compared to 8.7 percent that was a year ago. Client deposits keep maintaining a high weight that their position has within total liabilities and equity of shareholders. In the current year, this share is evidenced around 85.9 percent. Individual deposits consist the largest part of banking system client deposits with around 74.6 percent, comprising also the major share of growth of total deposits.

Regarding concentration in sectors, around 67.7 of client deposits are concentrated in three largest banks of the sector, which figure is by 5.3 percent lower than a year ago, which proves an improvement of deposit concentration ratio in 3 largest banks.

“Shareholders Equity” recorded an annual growth of around euro 11.0 million or 4.3 percent, though the growth rate was slower compared to a year ago during which “Shareholders Equity” evidenced an annual growth of around euro 22.4 million or 9.7 percent. The slower growth of this item was mainly affected by dividend distribution by two sector banks during 2012 and the growth of earnings with a lower rate during 2012 compared to 2011. The dividend distributed amount in banking sector in 2012 had a value of euro 32.0 million, of which euro 15.0 million are returned to equity. Consequently the share of item “Shareholders Equity” in total banking sector assets in the end of 2012 declined to 10.0 percent from 10.1 percent that was in 2011. However, this ratio continues to be evidenced with a relatively significant high rate compared to the CBK regulatory requirement, which requires banks to maintain a minimum leverage³⁹ rate of 7.0 percent.

Regulatory Capital – Adequacy and Trends

Total regulatory capital⁴⁰ in banking sector unlike 2011 was also characterized by a decline trend. The value of total regulatory capital is reported to be around euro 277.1 million, which represents an annual decline in the amount of euro 20.8 million or 7.0 percent. This change of regulatory capital was particularly affected by the implementation of Law on Banks, Microfinance Institutions and Non-banking Institutions (hereinafter: Law on Banks) as well as regulatory banking amendments. In 2011, two banks also distributed dividends from their retained earnings in the amount of euro 32.0 million, of which euro 15.0 million was returned to equity. However, in banking sector it was evident the increase of fresh capital from bank shareholders with around euro 8.5 million during 2012. The importance of this development is an indicator of shareholders’ willingness to support banking activity.

As presented in the table below, the shareholding (paid-in) capital keeps being the most important of shareholders equity, which in 2012 recorded a growth of euro 23.5 million or 13.3 percent. The system net profit recorded a level of euro 18.6 million, which seems to be lower than that of last year by euro 15.9 percent or 46.0 percent.

The banking sector Tier I capital comprises the key component of regulatory capital with a weight of 81.9 percent, which shows a qualitatively good and sustainable capital. However, compared to the same period of the previous year, in the end of 2012 its weight recorded a slight decline of 2.0 point.

³⁹ Leverage ratio is equal to total equity against total assets

⁴⁰ Regulatory capital = Tier I capital + Tier II capital

Table 21. Structure of regulatory capital and development of its components

Description	2011		2012	
	Thousands of euro	Share (%)	Thousands of euro	Share (%)
Capital (shareholders capital, surplus, preferential shares)	176,574	59.3%	200,074	72.2%
Reserve funds	606	0.2%	853	0.3%
profit (loss) of the current year	34,555	11.6%	18,649	6.7%
Retained profit from the previous years	41,933	14.1%	44,366	16.0%
intangible assets and the value of good will	3,821	1.3%	5,059	1.8%
Investments in other banks equity or other crediting institutions	0	0.0%	333	0.1%
Borrowings of people interlinked with banks	0	0.0%	31,584	11.4%
Total of Tier 1 capital	249,848	83.9%	226,967	81.9%
General provisions on loans*	16,520	5.5%	19,063	6.9%
Preferential ordinary shares	0	0.0%	0	0.0%
Time preferential shares	0	0.0%	0	0.0%
Subordinated debt	31,045	10.4%	31,045	11.2%
Other instruments	442	0.1%	0	0.0%
Total Tier 2 capital	48,007	16.1%	50,109	18.1%
Total capital (HII)	297,855	100.0%	277,076	100.0%

* (Standard and Watch) Limited up to 125% of the risked assets

Source: CBK (2013)

Tier II capital, which consists of general loan provisions and subordinated debt, is estimated at a level of euro 50.1 million against euro 48.0 million in the end of 2011, representing around 18.1 percent of regulatory capital. The number of banks having subordinated debt remains two, similar to the end of 2011.

Table 22. Capital adequacy ratio, in percentage

Description	December 2011	March 2012	June 2012	September 2012	December 2012
Total capital/total risk weighted assets	17.5	18.0	17.2	17.7	14.2
Shareholders equity/total assets	10.1	10.6	10.3	10.1	10.0
Problem loans (net) / Tier 1 capital	17.7	17.3	20.5	18.9	19.8

Source: (2013)

The risk-based capital ratio “*Total capital against total risk weighted assets*” as an essential supervision indicator, in 2012 recorded a significant decline compared to 2011, respectively from 17.5 percent to 14.2 percent. The decline of this indicator is mainly affected by the decline of total capital with around euro 20.8 million or 7.0 percent as well as by the growth of total risk weighted assets with around euro 243.9 million or 14.3 percent. Following implementation of Law on Banks and regulatory amendments, the regulatory capital decreased by the amount of loans issued to bank related persons as well as other claims related to risk weighted assets by operating risk. The amount of loans issued to bank related persons in the end of 2012 evidenced a level of euro 31.6 million, while the amount of risk weighted assets by operational risk is around euro 179.5 million. However, risk weighted capital ratio exceeds significantly the minimum regulatory level of 12.0 percent.

The weight of problematic net loan against Tier I capital is estimated to be 19.8 percent from 17.7 percent that was by the end of last year. The growth of this ratio is driven by the decline of

Tier I capital on one hand and the growth of problematic net loans on the other hand. As underlined above, the decline of Tier I capital is a result of application of Law on Banks and banking regulatory amendments.

The ratio “Shareholders equity against total assets” as an indicator of support of assets from shareholders equity recorded a slight declining trend. The decline of this indicator from 10.1 percent to 10.0 percent means that even this year the sector keeps counting more on asset funding from debts. Consequently, the banking sector was characterized by a faster growth trend of total liabilities, respectively a growth of euro 127.7 million or 5.7 percent compared to the shareholders equity growth rate of around euro 11.5 million or 4.5 percent compared to the previous years. However, this indicator keeps being significantly above the required regulatory rate of 7.0 percent. This change mainly resulted from the growth of shareholders equity by a faster trend, respectively a growth of euro 24.9 million or 10.8 percent compared to the growth trend of total liabilities to around euro 163.0 million or 7.8 percent compared to the last year.

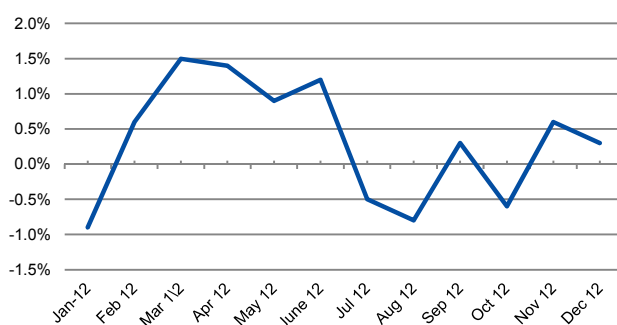
Loan Quality

In 2012, total loans of banking sector recorded a growth of euro 66.1 million or 3.9 percent, which are characterized by a lower growth rate compared to 2011, during which year total loans evidenced a growth of around euro 240.2 million or 16.7 percent. A higher growth of loans is evidenced in the second quarter of 2012 with euro 59.5 million, while the lowest rate results in the first quarter of 2012 with a decline of euro 21.7 million. The loan growth level was primarily impacted by the group of small banks (G2), followed by the group of large banks (G1), with respectively euro 58.4 million (3.5 percent) and euro 8.6 million (0.5 percent), while the group of foreign banks evidenced a slight decline of euro 923 (0.1 percent).

Monthly growth of total loans has been characterized by a fluctuating development since May during 2012. The average monthly growth of loans during 2012 recorded the value of 0.3 percent. The highest monthly growth rate of loans is evidenced in March 2012 of 1.5 percent, followed by April and June with around 1.4 percent respectively 1.2 percent. On the other hand, January 2012 is the month that had the highest decline of loans with a decline of 0.9 percent.

Developments show a growth of banking sector exposure against credit growth. “Problematic loans against total loans” and “Non-performing loans against total loans” recorded a growth of 8.5 percent and 5.9 percent that were in 2011 to 10.0 percent and 7.5 percent in 2012. The decline of loan quality is a result of “Doubtful” loans and “Loss” loans by euro 8.1 million or 22.2 percent and euro 23.6 million or 37.9 percent on one hand, and the growth of total loans by a lower growing trend in 2012 on the other hand. However, reserves for loan losses cover the non-performing loans in a satisfactory level of 112.4 percent. This means that banking sector keeps extending necessary caution to non-performing loans by adequate allocation of reserves for loan losses.

Figure 101. Monthly growth (decrease) rate of loans in 2012



Source: CBK (2013)

Table 23. Loan quality indicators, in percentage

Indicators	December 2011	March 2012	June 2012	September 2012	December 2012
Delayed loans / Total loans	10.3	10.8	11.5	12.1	13.0
Problem loans / Total loans	8.5	8.8	9.5	9.8	10.0
Non-performing loans/Total loans	5.9	5.9	6.5	7.0	7.5
Reserves on loan losses/non-performing loans	115.6	119.6	117.3	115.0	112.4

Source: CBK (2013)

From the loans quality analysis based on credited industries, it is evidenced that no significant change was reported in the end of 2012 compared to the end of 2011. A higher level of non-performing loans keeps being reported within trade loans, the share of which in the total banking system loans increased to 3.7 percent from 3.1 percent that was in the last year. Similarly, non-performing loans issued to individuals (consumer loans) evidenced a growth of 0.7 percent in the end of 2012 from 0.4 percent that was in the end of 2011.

Table 24. Non performing loans by industry, in percentage

Description	2011	2012
	Share (%)	Share (%)
Agricultural loans	0.06	0.09
Mining	0.02	0.02
Production	0.94	0.78
Electricity	0.03	0.16
Services, tourism, hotels, restaurants	0.74	0.77
Communication	0.00	0.01
Trade	3.15	3.75
Financial services (other from claims to banks)	0.01	0.00
Real estate-construction of real estates	0.29	1.03
Individual loans for households, family and other personal expenses (consumer loans)	0.43	0.66
Other loans	0.24	0.23
Leasing	0.00	0.00
Total loans and leasings	5.91	7.50

Source: CBK (2013)

Banking Sector Profitability

Banking sector performance in 2012, from the net profit point of view, is presented by lower growth trends compared to 2011. Net profit earned during 2012 in the value of euro 18.6 million was around by around euro 15.9 million or 46.0 percent lower, where the significant growth of loan loss provisions as result of weakened loan quality was determinant to this result. In the end of 2012, loan loss provisions evidenced a level of euro 49.2 million, which is higher by euro 14.1 million euro or 40.1 percent compared to the end of 2011. The key profitability indicators, respectively the Return On Average Assets (ROAA) and the Return on Average Equity (ROAE) recorded a decline from 1.4 percent to 14.3 percent that was in the previous year to 0.7 percent and 7.2 percent in the current year.

Table 25. Profitability indicators (annualized), in percent

Indicators	December 2011	March 2012	June 2012	September 2012	December 2012
Return on average assets (ROAA)	1.4	1.4	0.9	0.9	0.7
Return on average equity (ROAE)	14.3	13.2	9.0	8.9	7.2
Interest net margine	6.4	6.3	6.4	6.2	6.1
Interest net income/General expenditures	140.7	141.0	142.1	138.2	134.2

Source: CBK (2013)

The analysis of ROAA ratio by group-banks indicates a higher break-even of the group of large banks (G1) against the other two groups (G2 & G3). The ROAA ratio for G1 is estimated around 1.4 percent, recording a decline compared to that of the previous period of 1.8 percent. For bank of G2 and G3, the ROAA is presented at negative levels, respectively minus 0.1 percent (from 0.6 percent) and minus 2.5 percent (from 0.2 percent). Net Interest Margin (NIM)⁴¹ evidenced a slight decline of 0.3 point percent, recording a rate of 6.1 percent. The high level of efficiency ratio⁴² of 134.2 percent indicates a high efficiency in covering general expenses from net interest income. The profitability of banks keeps ensuring a key support to the capital sustainability.

Banking Sector Liquidity

Banking sector in 2012 was characterized by adequate liquidity although the key liquidity ratios reflected a declining tendency compared to 2011. “Liquid assets against total assets” and “Liquid assets against total deposits” are estimated at 30.5 percent and 35.5 percent from the level of 32.3 percent and 38.5 percent that were in the last year. The declining tendency of these ratios was mainly driven by regulatory amendments which entered into force in December 2012. The key funding resources of assets – deposits kept having a growing trend, recording an annual growth of euro 170.1 million or 8.1 percent. In banking activity funding (in balance sheet of liabilities), it is noticed that the fund generating contribution has entirely come from deposit activities.

Table 26. Liquidity indicators, in percentage

Indicators	December 2011	March 2012	June 2012	September 2012	December 2012
Loans/Deposits	79.8	81.3	83.3	78.7	76.7
Liquid assets/total assets	32.3	31.2	29.4	33.7	30.5
Liquid assets/total deposits	38.5	37.1	34.7	39.6	35.5
Liquid assets/Total liabilities	36.2	34.9	32.8	37.5	33.9

Source: CBK (2013)

Deposit growth during 2012 was followed by a significantly lower growth of total loans. This resulted in the decline of loan against deposit ratio, which had a sustainable trend during 2012, recording a rate of 76.7 percent from 78.8 percent that was in 2011. By group-banks, the deposit growth is evidenced in the three groups, respectively with around euro 92.3 million in G2, euro 74.2 million in G3 and euro 3.6 euro in G1. During 2012, all banks have been in full compliance with the CBK regulation which establishes the minimum requirement of bank reserves.

⁴¹NII = Net Interest Income / Profitable Average Assets

⁴²Efficiency Ratio = Net Interest Income/ General Expenses

On-site Examinations

With purpose of fulfilling the legal established objectives, the bank examinations were primarily focused on assessment of banking risks faced by banks, and especially the credit risk.

In spite of engagement of the Banking Supervision Department staff with the working groups in drafting banking regulations as a part to secondary legislation, deriving from Law on Banks, MFI and NFBI in 2012, it was also kept up with implementation of bank examination annual plan.

During 2012, a total of six (6) bank examinations were conducted, of which two (2) full examinations and four (4) focused examinations.

Full examinations intended to assess the general bank situation including internal controls, compliance with CBK rules and regulations, banking practices, assessment of capital, quality of assets, assessment of policies and procedures, management, earnings, liquidity and sensitivity against market risk. Full examinations also included the assessment of adequacy of money laundering prevention activity and assessment of information technology. In specific cases, where from the examination results it was estimated that a memorandum of understanding should be issued to the bank by CBK, implementation of such memorandum of understanding by the bank according to scheduled timeframes was also followed up.

On the other hand, focused examinations intended to follow up the fulfilment of recommendations from examinations conducted by CBK, and in specific cases to follow up the implementation of CBK "Decision" as a result of examination conducted by CBK. Loan issuing and administration process, loan quality trend, adequacy of loan loss provisions, non-balance items and loans to internal person were assessed as well. The resource of origin of clients' deposited funds in bank was also examined.

Microfinance and Non-banking Sector⁴³

Microfinance and non-banking finance credit institutions manifested a declining trend of total assets throughout 2012. The amount of total assets of this sector was over euro 108.9 million, recording an annual growth of euro 13.1 million or 10.8 percent compared to the annual decline level of 2.1 percent in 2011. Decline of total assets mainly refers to continuation of asset decrease in two largest microfinance institutions, which derives from the decrease of their borrowings against relevant creditors.

This sector keeps being characterized by a high concentration rate, where around 55.2 percent of total assets are managed by four institutions. However, in 2012, it is evidenced a decline of concentration rate compared to previous years of 57.7 percent in 2011, respectively 67.4% in 2010.

Assets in this sector are mainly funded by borrowings, which comprise around 66.7 percent and equity of 34.3 percent of total assets. Compared to 2012, liabilities against total assets decreased by 1.9 point percent; respectively the share of equity is increased by the same point percentage. Liabilities during 2012 recorded an annual decline of around euro 11.0 million or 13.3 percent, while the equity despite its growth in relation to total asset from the previous year recorded an annual decline of 2.1 percent, respectively a decline by euro 2.1 million, which decrease was reflected losses of 2012.

The activity of these institutions continues to be concentrated on crediting small businesses and households. Loan portfolio in the end of 2012 is over euro 98.2 million, which represents an

⁴³Including: non-banking institutions the activity of which is crediting – including financial leasing, money transfer agencies, currency exchange bureaus

annual decline of euro 6.4 million or 6.3 percent, yet in the previous year the annual decline was euro 12.4 million or 10.6 point percent. Also, from 2011 to 2012, gross loans decreased their weight within total assets by 4.4 point percent. Net loans in the amount of euro 91.6 million participate in the structure of total assets with 84.1 percent.

Loan Quality

Quality indicators of loan portfolio had a lower deteriorating development compared to the previous year. The ratio of problematic loans against total loans and the ratio of non-performing loans against total loans are reflected at the levels of 7.3 percent and 5.3 percent, while in the end of 2011 it was 4.8 percent, respectively 3.8 percent. Reserves for loan losses against total loans stand at levels of 6.8 percent, which represents an annual growth of 1.4 point percent from 2011. In December 2011, the coverage rate of non-performing loans by reserves for loan losses stood at a level of 128.8 percent from 139.3 percent that was in the last year. However, such level represents a satisfactory coverage level and implies that this sector kept cautiously treating non-performing loans by adequate allocation of reserves for loan losses.

Table 27. Development of loan quality indicators for the period 2011 – 2012, in percent

Indicators	December 2011	March 2011	June 2012	September 2012	December 2012
Problem loans/Total loans	4.8	6.1	7.6	8.5	7.3
Non-performing loans/ Total loans	3.8	4.8	6.4	7.0	5.3
Reserves on loan losses / Non-performing loans	139.3	135.1	119.2	113.7	128.8

Source: CBK (2013)

Microfinance System Profitability

Microfinance and non-banking credit system during 2012 generated net losses in the amount of euro 4,454 thousand, whereas in the end of 2011 the performance of this sector in terms of profit presented modest earnings of euro 704 thousand.

The general expenses in 2012 presented similar levels with those of 2011, which means that the profitability sector mainly consists on the decrease of net interest income and the growth of loan loss provisions, as a result of weakening of loan quality.

The key profitability ratios evidenced a significant improvement compared to 2011. Return on Average Assets (ROAA) and Return on Average Equity (ROAE) recorded negative levels of minus 0.4 percent and minus 11.8 from 0.6 percent respectively 1.8 percent that were in 2011.

Table 28. Development of profitability indicator for the period December 2011 – December 2012, in percent

Indicators	December 2011	March 2011	June 2012	September 2012	December 2012
Return on Average Assets (ROAA)	0.6	-4.4	-4.6	-4.5	-4.0
Return on Average Equity (ROAE)	1.8	-13.8	-13.9	-13.5	-11.8
Net Interest Margine	15.5	12.3	12.9	12.9	13.6
Net interest income / General expenditures	107.3	88.7	88.3	85.5	86.8

Source: CBKK (2013)

Net Interest Margin (NIM)⁴⁴ was historically quite high, yet throughout 2012 it had an average rate of 12.9 percent compared to the average rate of 14.5 percent in the previous year. The low level of efficiency ratio⁴⁵ of 133.8 percent shows the inefficiency in covering general expenses by net interest income.

On-site Examinations

During 2012, three (3) full examinations of microfinance institutions and one focused examination in one of the lending non-banking institutions were conducted, and it was preceded with a follow-up of implementation of supervising recommendations to relevant microfinance and non-banking institutions. In cases of non-transparency or misapplication of relevant requirements, the CBK has undertaken remedial measures against the said institutions.

Prevention of Money Laundering and Terrorist Financing

Pursuant to relevant objectives, the banking supervision during 2012 also focused on raising the awareness of private and public sector on prevention of money laundering and terrorist financing (hereinafter "PML&TF"), improvement of legal infrastructure and reporting structure in relation to PML&TF.

The CBK during 2012 continued to contribute in raising the awareness of private and public sector on PML&TF through different presentations by the professional staff of the Banking Supervision Department during round tables and numerous campaigns in cooperation with the Police of the Republic of Kosovo, Banking Association, the US Treasury Department, Organization for Security and Co-operation in Europe and other stakeholders.

As to the legal infrastructure, the CBK in cooperation with the Ministry of Finance, Financial Intelligence Unit of the Republic of Kosovo, EULEX) and the Technical Assistance of the US Treasury Department played an essential role in identifying the legal gaps relating to the adequacy of Law on Prevention of Money Laundering and Terrorist Financing decreed in 2008. As a result, the law with proposed amendments and supplementations was adopted by the Assembly in the begging of 2012. Pursuant to these amendments and supplementations, the CBK is also in process of redrafting the secondary legislation in PML&TF area.

During the year, the CBK also played an important role in prevention of money laundering and terrorist financing in Kosovo by contributing to implementation of Draft Law against Economic Crime in Kosovo initiated by the European Union and the Council of Europe. The goal of this draft law is strengthening the institutional capacities in cooperation with the Council of Europe in PML&TF area.

Banking supervision conducted during 2012 general periodical examinations in banks, microfinance institutions and non-banking financial institutions, focused on the compliance with the PML&TF legislation. From these examinations, it was evidenced that the above-mentioned institutions have advanced the necessary infrastructure related to PML&TF, such as policies, procedures and systems in identifying, recognizing and reporting the suspicious transactions and in addressing in general this sensitive area both in local and international level.

However, as a result of recent amendments in legal structure all institutions remained subject to constant monitoring by the CBK in the course of regular on-site supervision and off-site monitoring and are in process of harmonization of compliance with the new legal framework.

⁴⁴ NII = Net Interest Income / Profitable Average Assets

⁴⁵ Efficiency Ratio = Net Interest Income/ General Expenses

Compliance with Regulatory Legal Framework – Mandatory Actions

Banking system in general acted in compliance with legal framework and supervising regulatory requirements. However, during on-site examinations of banks, some deficiencies have been observed in relation to governance practices, credit risk management, excess of credit exposure limits, risk weighted capital adequacy and reporting accuracy.

The following inconsistencies with CBK legal and regulatory framework have been evidenced during examinations of banks:

- Board of Directors failed to supervise to required extent the application of the following policies:
 - Credit risk management policy;
 - Operational risk policy, and
 - Risk and interest rate management policy;
 - Credit risk management committee failed to monitor to required extent:
 - Application of loan issuing policies and procedures;
 - Administration of loans and it failed in monitoring the compliance with Regulation 1999/21 and CBK Rule IX;
 - Loan replacing amount, respectively guarantees for participation in tender in fixed amount were weighted by risk factors of 0%, while according to CBK regulation on capital adequacy, it is required that direct loan replacements are weighted by 20%;
 - Excess of borrowers' exposure limits above the limits established under regulation on large exposures;
 - Non-classification of loans in compliance with CBK Rule IX;
 - Depreciation of loan loss provisions under requirement of CBK Rule IX.

As a result of such inconsistencies with legal and regulatory framework being evidenced in some banks, CBK has undertaken the following mandatory measures against some banks and listed the areas requiring attention of the Board of Directors:

- Remedial measures, in form of "Decision";
- Imposing penalties and monetary fines;
- Written warning for lack of discharging relevant functions with accountability by persons in charge:
 - Request for republication of financial statement, based on financial position corrections from CBK examination results;
 - Replacement of current members of Board of Directors by new professional members and in compliance with requirement of Law on Banks, MFI and NBFİ;
 - Paid-in capital growth, in order to supply the risk weight capital at levels required under the CBK regulation on capital adequacy;
 - Execution of frozen loan deposits, which incur delays in payments, as specified by bank policy;
 - Bringing all credit exposures of borrowers to the CBK established regulatory and legal limit;

- Bringing loans of bank related persons to a regulatory level limit of 100% of Tier I capital, as established under CBK Rule XX;
- Bringing the ratio between equity and total asset to a minimum level of 10%;
- Improvement of management information and credit risk management practices;
- Compilation of an improvement plan for earnings, analysing rationalization of other cost expenses charging the financial position;
- Compilation of a plan for the decrease of credit portfolio concentration in large exposures;
- Ensuring the capital adequacy after corrections of exposure against bank related persons;
- Ensuring the capital adequacy by weighting operational risk losses;
- Ensuring compliance with applicable regulatory framework, by eliminating all evidenced breaches;
- Approval by Board of Directors of all bank policies as a sole bank policymaking body;
- Ensuring a sound internal control system;
- Compilation of operational risk policies, adapting them to domestic market specifications;
- Approval of credit strategy and ensuring that an asset quality improvement plan is in place;
- Cover of rescheduled loans to be done in compliance with the credit risk management regulation.

Development of Liquidation Process of the Credit Bank of Prishtina (BKP)

Liquidation process of the Credit Bank of Prishtina also continued during 2012 and by the end of the year a total 54.10% of the amount of deposits, respectively 99.82% of the number of deposit account was reimbursed. The liquidation process was enabled from collections of loans. During 2012, a total of euro 501.856 was collected from loans.

The liquidation process perspective closely relates to the efficiency of collections of loans, secondary collections from collaterals as well as from potential buyers of the remaining loan portfolio

Table 29. Loans – collection trend

Description	No. accounts	Amount	Change in accounts		Change in amount	
			No.	Percent	No.	Percent
Loans 13.03.2006		28,438,587				
Loans on 01.01.2012		22,497,072			5,941,515	20.89
Loans 31.12.2012		21,789,058			6,649,529	23.38
Cashing in 2012		501,856			501,856	1.76

Source: CBK (2013)

Table 30. Deposits – reimbursement trend

Description	No. accounts	Amount	Change in accounts		Change in amount	
			No.	Percent	No.	Percent
Deposits on 13.03.2006	35,529	33,454,222				
Depozitat me 01.01.2012	76	15,649,497	35,453	99.79	17,804,725	53.22
Depozitat me 31.12.2012	65	15,355,734	35,464	99.82	18,098,488	54.1

Source: CBK (2013)

Also during 2012, the liquidation process was affected by the current position of loan quality, payments and very slow execution procedures in courts. Office of Liquidator was constantly operational in undertaking all possible measures and actions, so that during the liquidation process, a considerations is given to the key principle that the liquidation process is followed at all its stages by maximizing the available liquid assets in order to maximize the reimbursement of depositors and all other creditors.

As to future challenges in liquidation process, with purpose of supplying liquid asset through the sale of collaterals after completion of court execution procedures and through loan restructuring (based on the fact that there is no other way out since there is not potential party interested to purchase the bank equity), and with purpose of reimbursing the bank depositors, undertaking the following measures is estimated to be necessary:

- Loan restructuring;
- Completion of executive procedures;
- Finalization of court proceedings against former bank directors and related groups;
- Capital premises: Having the premises available (leasehold compensation which is currently being used by local institutions) and the sale of premises which was estimated by international experts to be over euro 2 million;
- Organization for Security and Cooperation in Europe (OSCE): Finalization of the dispute with OSCE in District Court of Prishtina regarding BKP claim for compensation of the amount of euro 800 thousand for the use of premises by the OSCE.

4.3. Insurance Supervision

Insurance Companies, Ownership Structure

Insurance market during 2012 kept growing, though with a lower trend than in the previous year. The number and structure of insurance companies operating in Kosovo remained unchanged. During this year (2012), the number of insurance companies was thirteen (13), of which ten (10) provided non-life insurance products, while three (3) of them provided life insurance products.

If we take into consideration the structure of insurance companies by ownership during 2012, there has been no change compared to the last year, which means that the number of insurance companies and their ownership structure remained the same with the previous year (2011). Out of total companies operating in insurance market, seven (7) companies were of foreign ownership, two (2) companies of mixed ownership, three (3) of them were of domestic ownership and one (1) company was a subsidiary.

Structure of Premiums Portfolio – Number and Amount

During 2012, the number of contracts undertaken in insurance market increased by 20.2% compared to the previous year (2011). Out of the total number of undertaken contracts that was in 2012, around 99,8% of them consist of non-life insurance products and only 0,2% consists of life insurance.

Table 31. Value of written premiums, 2010-2012

Activity	Years (Millions)			Change in percent	
	2010	2011	2012	2011/2010	2012/2011
Written gross premiums (Non-life)	61,8	67,6	69,8	9,3%	3,2%
Written gross premiums (Life)	0,7	1,0	1,5	47,6%	42,5%
Total	62,5	68,6	71,2	9,7%	3,8%

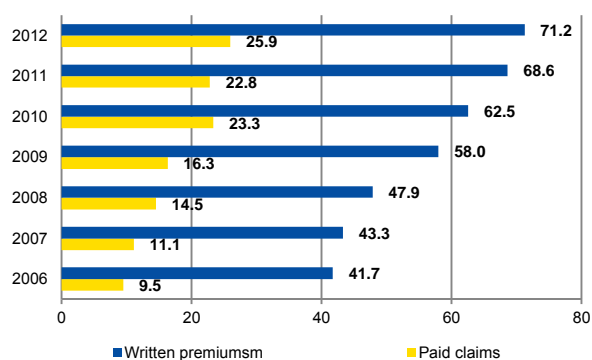
Source: CBK (2013)

The value of gross written premiums was characterized by a growth of around 3.8% compared to a year ago (see Table 1). Gross written premiums for 2012 reached the figure of euro 71.2 million. Out of total gross premiums, around 97.9% of premiums consisted of non-life insurance, while only 2.1% of premiums consisted of life insurance.

Insurance market growth during 2011 was mainly triggered by the growth dynamics of non-life insurances. Non-life market insurance in 2012 reached at euro 69.8 million of 3.2% which is more compared to the previous year (2011). A rather higher significant growth within non-life insurances was recorded by border (Serbia and Montenegro), and for the first time in 2012 all vehicles passing through Kosovo border points were subject of border insurance fees.

Gross written premiums in non-life insurance in 2012 reached at euro 1.5 million, recording an annual growth of around euro 0.5 million compared to the previous year (2011). Non-life insurance growth during 2012 mainly relates to the fact that two new companies joined the market in the end of last year, which impacted on the increase of portfolio of products provided by thee companies.

Figure 102. Written premiums and paid claims



Source: CBK (2013)

Density of Insurances⁴⁶

Year 2012 was characterized by a slight growth of insurance market in Kosovo.

Premium per capita was roughly euro 30.24 on the average compared to euro 37.79 that was in 2011. Out of this amount, euro 338.42 was spent for non-life insurance and only euro 0.82 was spent on life insurance.

During this year, the share of gross written premiums in relation to GDP remains still low as a result of slowdown of written premiums in relation to the previous year and in relation to the GDP growth rate.

⁴⁶Population, December 2012: esk.rks-gov.net

Non-life Insurance Premiums

Gross written premiums from non-life insurance continued with a growth trend during 2012, yet with a slower trend. The number of non-life insurance contracts reached a euro 0.7 million or 20.1% more than the previous year 2011. Out of total number of undertaking contracts, around 84.4% consisted of compulsory insurances, while only 15.6% consisted of voluntary insurances.

Gross written premiums from non-life insurance reached at 8.9 million or 3.2% more than in the previous year 2011

(Figure 103). Out of total value of gross written premiums of non-life insurance, around 72.7% consisted of compulsory insurances, while only 27.3% consisted of voluntary insurances (2011: 70.1% by 29.9%). The growth of share of compulsory insurance against voluntary insurance comes as a result of the growth of border insurance income on one hand and by the decline of the demand for voluntary products on the other hand (see Table 2).

It is worthy to emphasise that among the compulsory insurance in 2012, it is noticed a slight decline of internal third party motor liability insurance⁴⁷ as a result of nonrenewal of contracts by policyholders compared to the previous year. This decline level of internal motor liability insurance premiums and voluntary products significantly impacted on the decline of growth rate of written premiums compared to previous years (Figure 103).

Table 32. Gross written premiums, non-life insurances

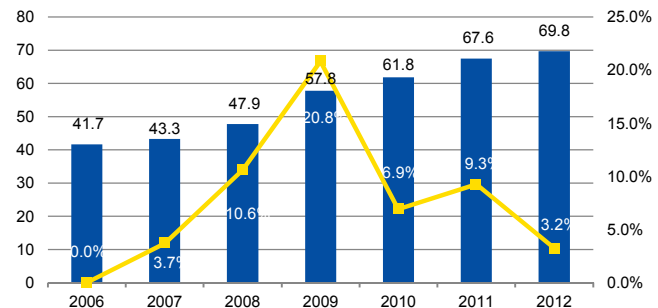
Activity	2011 (mln)	2012 (mln)	Change %	The share 2011	The share 2012
Obligatory insurances	47,4	50,7	7.1%	70,1%	72,7%
Voluntear insurance	20,2	19,0	-5.7%	29,9%	27,3%
Total non life insurance	67,6	69,8	3,2%	100%	100%

Source: CBK (2013)

Compulsory Insurances

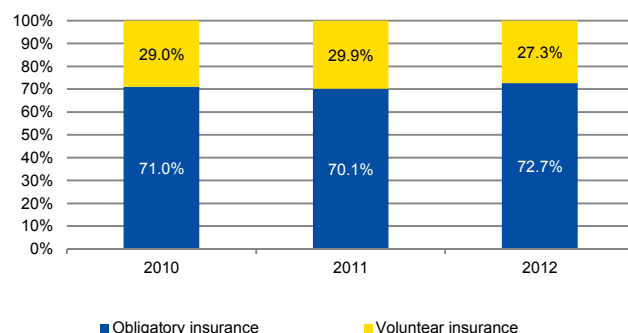
During 2012, compulsory insurances maintained their domination compared to voluntary insurances, generating around 73.3% of income from gross written premiums of insurance market (see Figure 104). This growth of share of compulsory insurances was affected by the growth dynamic of border insurances, which during 2012 recorded the highest growth (see Table 32).

Figure 103. Non-life written premiums



Source: CBK (2013)

Figure 104. Portfolio of non-life insurance



Source: CBK (2013)

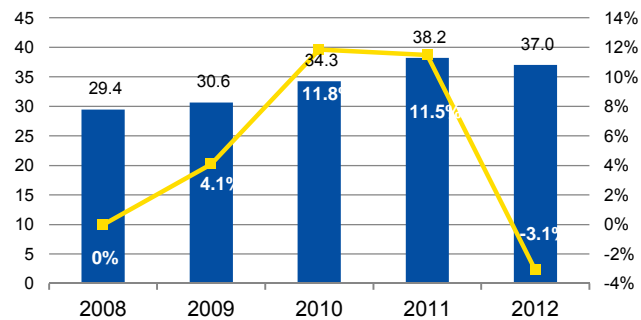
⁴⁷ MTPL: Motor Third Party Liability

Gross written premiums from internal third party motor liability insurance, during 2012, recorded a decline reaching at euro 37.0 million or around 3.1% lower than in the previous year 2011 (see Figure 105). It can be stated that this was the first year where third party motor liability insurances recorded a decline.

In 2012, gross written premiums from TPL+48 insurance were around euro 1.2 million or 1.1% which is more compare to the previous year (see Table 33).

Gross written premiums from border insurances distributed in companies reached the value of euro 12.6 million or 56.4% more compared to the previous year.

Figure 105. Written premiums from internal MTPL



Source: CBK (2013)

Table 33. Compulsory insurances

Description	2011 (mn)	2012 (mn)	Change %	The share 2011	The share 2012
5. TPL	38,2	37,0	3,1%	80,6%	72,9%
6. TPL +	1,1	1,2	1,3%	2,4%	2,3%
7. Border insurance	8,0	12,6	56,4%	17,0%	24,8%
Total	47,4	50,7	7,1%	100,0%	100,0%

Source: CBK (2013)

Voluntary Insurances

During 2012, voluntary insurances reached the value of around euro 19.0 million or 5.7% compared to the previous year (see Table 34). The decline of voluntary insurances compared to the previous year also shows a decline of the share of these products in total portfolio of written premiums during 2012.

Table 34. Voluntary insurances

Description	2011	2012	Change %	The share 2011	The share 2012
Accidents and health	9,9	9,2	-7,1%	49,0%	48,1%
Motor liability	2,8	3,0	4,8%	14,1%	15,6%
Fire & Property damages	3,0	3,7	24,6%	14,6%	19,3%
General responsibility	2,0	1,1	44,2%	10,0%	5,9%
Loans and guarantees	1,5	1,5	0,9%	7,6%	8,1%
Financial losses	1,0	0,5	43,4%	4,7%	2,8%
Total	20,2	19,0	-5,7%	100,0%	100,0%

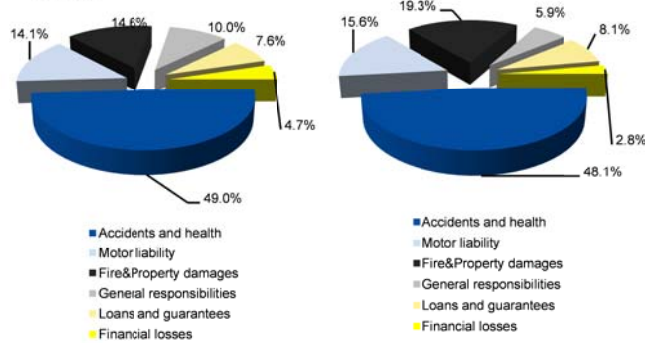
Source: CBK (2013)

⁴⁸ TPL+. From the Memorandum of Understanding with Macedonia.

The decline of voluntary insurance premiums was mainly affected by insurance classes “General liability”, which compared to the previous year recorded a decline of 44.2%, then insurance classes “Financial losses”, recorded a decline of 43.4% and insurance classes “Accident and health” with a decline of around 7.4%.

The growth of insurance classes “Fire and other property damages” can be estimated as good indicator, which compared to the previous year recorded a growth of 24.6%, insurance classes “Motor” increased by 4.8% mainly due to the growth of “Casco” insurance, while insurance classes “Loans and guarantees” remained the same.

Figure 106. Voluntary products, share in % 2011 - 2012



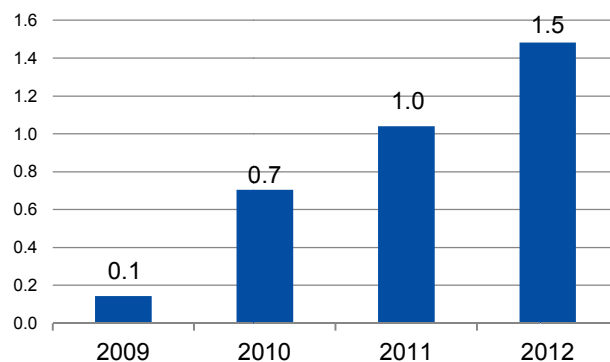
Source: CBK (2013)

Out of total written premiums of voluntary insurances, the highest specific weigh is consisted of the insurance classes “Accident and health” with 48.1%, then insurance classes “Fire and other property damages” with 19.3%, insurances “Motor” with 15.6%, “Loans and guarantees” with 8.1, “General liability” with 5.9% and “Financial losses” with 2.8% (Figure 106).

Life Insurance Premiums

Gross written premiums in life insurance in 2012 compared to last year recorded a growth of 42.5%, reaching their value of euro 1.5 million (Figure 107). Also, a growth was recorded by the number of undertaking contracts with 81% compared to the previous year. The growth of gross written premiums in life sector was mainly impacted the two new companies that joined the market in the end of 2012, increasing the portfolio of products offered to life insurance market.

Figure 107. Written premiums from life insurance 2009-2012



Source: CBK (2013)

Thus, the highest growth in value was recorded by the product “Mixed Life Insurance”, which during 2012 reached at euro 1.1 million, with a share of 76.4% in gross written life premiums. This was followed by the product “Loan Guarantee Insurance” which is closely related to the lending level with a share of 7.1% in gross written life premiums (see Table 5i).

Life insurances still remain low compared to other non-life insurance products. This market recorded a significant increase of the value of gross written life premiums, the share of which is estimated as a low one and in total gross premium they comprise only 2.1% in 2012 (2011: 1.5%).

Table 35. Life insurance, in thousand

Description	2011	2012	Change %	The share 2011	The share 2012
Life mixed insurance	921.6	1,133.2	23.0%	88.6%	76.4%
life insurance in groups	38.2	16.7	-56.2%	3.7%	1.1%
Personal accidents	75.7	86.6	14.4%	7.3%	5.8%
*Endowment	5.0	40.8	716.8%	0.5%	2.8%
Term Life	-	41.8		0.0%	2.8%
Creditors insurance on borrowings	-	105.4		0.0%	7.1%
Other	0.2	58.4	30778.4%	0.0%	3.9%
Total	1,040.7	1,483.0	42.5%	100.0%	100.0%

*Endowment, life insurance contract which pays the undertaking amount in case of death of an insured person and in case of maturity of contract.

Source: CBK (2013)

Claims

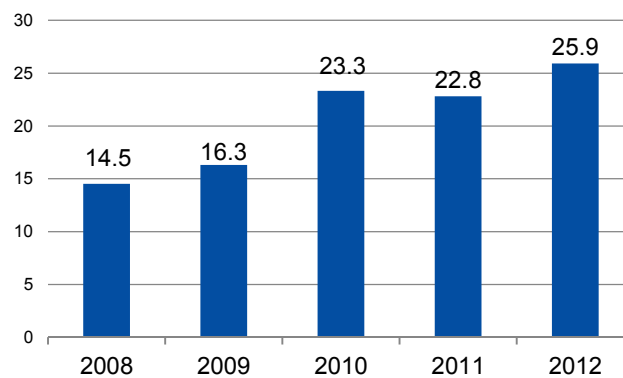
During 2012, insurance companies in Kosovo paid around euro 25.9 million gross claims⁴⁹ or 13.7% more compared to the previous year 2011 (Figure 107 and 108). It is worthy to emphasise that claims paid by KIB⁵⁰ are not included within the claims paid, which in 2012 reached the value of euro 4.8 million or 13.2% more than in the previous year 2011.

The number of claims paid during 2012 was around euro 78.3 thousand or 6.4% more than in the previous year. Out of this number of claims paid, around 75.3 thousand claims were paid by insurance companies and 3.0 thousand by KIB.

The growth of level of claims paid during 2012 was mainly affected by the payment of claims related to voluntary products which reached at euro 10.5 million or 32.6% more compared the last year. Key factors impacting on the growth of level of claims paid within voluntary products were mainly claims of low frequency and high severity, where in 2012 a large portion of them was covered by the reinsurance companies.

It is worthy to mention that within voluntary products during 2012, around 51.6% of claims paid consisted of the insurance "Accident and health", 21.5% consisted of Casco insurance within "Motor" insurances, 23.3% from the insurance "Fire and other property damages" and 3.6% other voluntary insurance.

In addition to claims paid within voluntary insurances, during 2012 a growth was recorded by claims paid within compulsory insurances reaching the amount of euro 15.2 million or 3.4% more than in the previous year. Within the compulsory insurances, the highest share of claims paid consisted of internal third party motor liability insurance with 99.4% while TPL+ had only 0.6%.

Figure 108. Gross paid claims 2008-2012

Source: CBK (2013)

⁴⁹ In gross claims it is also included the portion of reinsurer.

⁵⁰ KIB – Kosovo Insurance Bureau.

During 2012, the value of claims paid from life insurances reached at euro 63,683, while this value in 2011 was euro 30,666 recording a significant growth.

Kosovo Insurance Bureau

Kosovo Insurance Bureau was founded on 07.09.2011 from 10 licensed insurance companies operating in the Republic of Kosovo pursuant to Law No. 04/L-018 on Compulsory Motor Liability Insurance.

Kosovo Insurance Bureau is a professional organization in the capacity of legal entity established for nonprintable purposes. Government of the Republic of Kosovo recognizes the status of National Insurance Bureau with unlimited rights, in capacity of payment bureau and processing bureau, which guarantees the fulfilment of all liabilities under the international green card system.

The bureau is funded by its members and its activity is supervised by the Central Bank of Kosovo. Within Kosovo Insurance Bureau operate the Compensation Fund, Border Insurance, Insurance Information Centre and Green Card.

Table 36. Claims paid

Activity	2010 (mln)	2011 (mln)	*2012 mln euro
KIB	4.5	4.3	4.8
Compensation fund	3.3	3.3	3.5
Border insurance	1.1	1.0	1.4
% Growth/Decline	0%	4%	13%

*Data for 2012 belong to Kosovo Insurance Bureau (KIB), while data for the other two previous years, 2011 and 2010 belong to IAK (Insurance Association of Kosovo).

Source: CBK (2013)

Reinsurance

Based on the CBK legal requirements against the insurance industry, insurance companies are required to transfer risks through reinsurance contracts in the course other activities.

During 2012, insurance companies took over such risks which belong to different business classes, starting from the insurance against accident and health, motor insurance, fire and property damage insurance, insurance of goods in transport, guarantees insurance, insurance of public liabilities and motor third party liability insurance.

During 2012, insurance companies in Kosovo, ceded premiums to reinsurers in value of euro 5.9 million or around 8.5% of gross written premiums.

Over 78.0% of reinsurance contract of insurance companies have a classification from A+ to AA-rated by Standard & Poor's, and only 22.0% have the BBB- classification. Among the key participants in these reinsurance programs we can mention Munich Re, Hannover Re, Swiss Re etc. Reinsurance contracts are in compliance with CBK legal requirements.

CBK exercised constant supervision by monitoring the risk management activity by insurance companies and compliance with risk limits pursuant to CKB laws and regulations. .

Financial Position of the Insurance Companies

Insurance Industry Assets

In 2012, the insurance industry assets reached at euro 122.1 million or 8.2% more than in the previous year (see Table 6). Current accounts continued their domination in comparison to other assets within total assets with 16.4% of total assets. Claims and receivables recorded a slight decline compared to the previous year, and also a growth was recorded by technical assets which are consisted of prepaid settled costs and reinsurance assets. If we make a comparison with the previous year 2011 where current assets comprised 65.8% of fixed assets with 15.8%, then we see that there is no significant change in the structure insurance market assets. Growth of money as asset in one hand is a result of money increase in covering liquidity and deficit, whereas the growth of fixed assets on the other hand is a result of reassessment of invested property conducted during this year by the insurance companies.

Liabilities and Equity

In 2012, the insurance market liabilities reached at euro 76.7 million or 14.8% which is more than in the previous year. Technical assets comprised 50.1% of total liabilities, other liabilities comprised 12.8% while capital and other reserves comprised 37.2%. During 2012, it is noticed a constant growth trend of allocation of funds to technical reserves. As a result, technical reserves recorded a growth by 12.3% while the capital recorded a decline of 1.4%. Within technical reserves, the largest growth was recorded by technical reserves within the Incurred But Not Reported (IBNR) claims to an extent of 32.0%. Reserve for claims recognized but not settled increased to the extent of 20.0% as well as the reserve for claims to the extent of 47.0%, but they represent lower monetary values.

The growth of technical reserves in 2012 in relation to the increase of insurance assuming risks by insurance companies is a result of constant monitoring of allocation of reserves by CBK. This constant monitoring was conducted pursuant to the applicable laws and rules related to calculation of technical provisions, and necessary measures were undertaken accordingly. It is worthy to mention that during this year, the external auditor was required to make an assessment of adequacy of technical provisions.

Economic Performance Indicators

In 2012, the insurance company in Kosovo recorded a decline in financial performance indicators compared to the previous year 2011. Net financial result of insurance market in 2012 recorded a loss in the amount of euro 3.0 million, compared to euro 0.5 million net income in the previous year 2011. Life insurance market kept having a positive financial result with a value of euro 0.3 million, while non-life market recorded a loss in the amount of euro 3.4 million.

This negative result for 2012 was affected to a considerable extent by a combined ratio which this year reached the rate of 115.0%. From this indicator we see that the insurance industry for this year, for each euro 1 collected, spent euro 1.15.

Insurance Industry Profitability

If we take for granted the profitability ratios, the Return on Average Assets (ROAA) and the Return on Average Equity (ROAE), it is seen that the insurance industry in Kosovo during 2012 recorded a significant decline in these ratios compared to the previous year. Return on Average Assets (ROAA) recorded a declining trend from 0.5% that was in 2011 to -2.6% in 2012. A decline

was also reported by the Return on Average Equity (ROAE) from 1.1% that was in 2011 to -6.7% in 2012. These ratios recorded a decline as a result financial loss recorded during 2012.

Solvency Level in Insurance Industry

Solvency means the capacity of a company to cover its long-term liabilities. Solvency differs compared to liquidity which shows only the organization's capacity to cover its short-term liabilities. Solvency in Kosovo insurance industry is regulated by the CBK regulation on "Deposit of assets as guarantee, capital adequacy, financial reporting, management of risk, investments and liquidity", which in Solvency calculation does not recognize as assets: i) 100% of debtors of premiums over 90 days, ii) 100% of advance payments and other intangible assets and iii) 25% of stayed and prepaid expenses. Consequently, when we deduct liabilities from net assets then we obtain the solvency result which has to be over euro 0.6 million for each company, as set forth under the above-mentioned CBK regulation.

Based on the financial reports 2012, total calculated insurance industry solvency was euro 13.7 million recording a decline of 25% compared to the previous year 2011.

Table 37. Calculation of minimum Solvency margin (non-life companies)

Activity	2012	2012
Total Asetet	102.1	110.4
Minus:Unaccepted assets	-12.5	-15.5
=Net Assets	89.6	94.9
Minus:Liabilities except net w ealth	-65.2	-75.2
The level of minimal margine of solvence	6.0	6.0
The level of solvence	18.4	13.7
The position of solvence	Solvent	Solvent

Source: CBK (2013)

The decline of solvency level compared to the previous year comes as a result of the growth of unacceptable assets under the applicable framework on one side and the growth of liabilities on the other hand.

Liquidity Ratios

During 2012, the insurance industry in general resulted in sustainable liquidity ratios, yet with a slight decline compared to the previous year. Cash and its equivalent against the ratio of technical reserves was 123.6% (2011: 136.4%), while against total liabilities it was 105.7% (2011: 111.1%) (see Table 7). Liquidity shrinking for 2012 resulted as a consequence of fast growth trend of the total technical reserves compared to the previous year 2011.

Table 38. Liquidity indicators

Activity	2011	2012
Liquid assets Cash/Technical Provisions	136.4%	134.9%
Liquid Assets Cash/Total liabilities	111.1%	111.2%
Claims/Total Assets	6.8%	6.0%
NPSH/Equity	1.30	1.36
Equity/Liabilities	68.8%	59.1%

Source: CBK (2013)

Role of Insurance Supervision Department (ISD)

The CBK objective role is to protect the policyholders by acting always towards application of CBK laws and regulations, within the scope of which the insurance industry exercises its undertaking activity by reimbursing property claims against its clients.

CBK, through Insurance Supervision Department, plays an important role in building a stable and efficient market, building an adequate environment for shareholders, potential investors as well as development of a fair and free competition.

Accordingly, necessary measures have been undertaken to enforce a constant insurance supervision and create conditions for further development of the insurance industry.

Furthermore, CBK during 2012 was also engaged in adapting the best practices based on the principles of the International Association of Insurance Supervisors (IAIS) as well as the risk-based supervision, thus contributing to the enhancement transparency of operations against the insurance industry and at the same time the enhancement of insurance companies' transparency towards public.

Also, during 2012, CBK kept working on implementation of recommendations given in the World Bank report regarding application of Insurances Core Principle, and an assessment of application of insurance core principles (ICP) by World Bank external experts was conducted in 2011.

Development of Legal Framework

The legal framework is certainly essential for establishment of a sustainable and competitive market. An effective insurance supervision cannot be imagined without a sustainable regulatory framework which is essential for the insurance industry stability and for making it more competitive in the region.

To this end, CBK in close cooperation with the technical assistance provided by the World Bank, USAID, IMF and Technical Assistance from the USA Treasury Department etc, marked an important progress towards the development of a legal framework, namely replacement of UNMIK Regulations by laws of the Republic of Kosovo.

During 2012, joint efforts have been made with local and international stakeholders as well as with Kosovo Insurance Industry in finding a representation modality in the International Green Card System.

As a follow-up in 2013, ISD kept working on drafting the other sublegal acts as provided for under the Law on Compulsory Motor Liability Insurance, which thereafter was forwarded to the Executive Board and to the CBK Board for approval. Consequently, the following regulations have been approved. (i) implementation of Bonus Malus system, (ii) general terms of motor liability insurance policy, (iii) procedures for processing damage compensation claims, (iv) maintenance and use of equity of Kosovo Insurance Bureau compensation fund, (v) determination of reporting and supervision standards of Kosovo Insurance Bureau and (vi) determination of reporting Standards and forms of Kosovo Insurance Bureau and insurance companies.

Ongoing Processes

CBK in cooperation with insurance industry is working on drafting the Law on General Insurances, which law is under review process, respectively its finalization is a step forward in advancing towards the European Directives.

Organizational Structure of Insurance Supervision Department (ISD)

The Insurance Supervision Department is composed of two divisions: a) Reporting and Analysis Division and b) On-site Supervision Division (OSD).

Reporting and Analysis Division (RAD)

Monitoring of insurance companies is done through “Reporting and Analysis Division” (RAD) which systematically and in standardised forms issues regular monthly, quarterly and annual analyses pursuant to the CBK internal regulations, based on IFRS principles and IAIS practices. RAD monitors the insurance industry financial performance on regular monthly, quarterly and annual basis and prepares regular reports to the CBK governing bodies.

The other following indicators are also included within the financial performance:

- Calculation of minimum Solvency margin,
- Calculation of capital and equity,
- Calculation of adequacy of variable capital,
- Calculation of the ratio of claims paid, claims incurred, ratio of expenses and combined ratio etc.

During 2012, RAD kept applying the Early Warning Test. Thus, the IRIS (Insurance Regulatory Information System) system ratios adapted to non-life companies in Kosovo were used in analysing the financial position of insurance industry and the individual assessment of insurance companies. These financial ratios serve to evidence at appropriate time problems that may lead to deterioration of one or some parameters of insurers in this industry.

20 other parameters – other financial industry risk and performance indicators are also included within the financial performance (IRIS).

As a result of constant monitoring, ISD issued three instructions on variable capital default (undertaking risk) as well as one instruction on capital default – Equity. With purpose of maintaining the liquidity, ISD recommended to insurance companies to increase the level of liquid ratio against the other assets. Also, upon ISD recommendation, CBK undertook other necessary actions against insurance companies for having committed different breaches of other applicable CBK laws and regulations.

Based on financial performance indicators, ISD recommended actions against insurance companies, especially against those companies which are exposed to high risk or with purpose to protect clients’ interests.

On-site Supervision Division (OSD)

On-site Supervision Division carries out an important supervision process through which information on exercise of undertaking activity are information on drafted policies and procedures and information on their application by relevant stakeholders are provided. On-site supervision is conducted according to an examination plan on full and focused examinations in insurance companies and insurance intermediaries previously approved by the Management.

On-site supervision is implemented through on-site verification of undertaking activity and other entities dealing with insurance activity. It is an important supervision process because it provides source information on exercise of activity and it discloses information on drafted policies and procedures as well as information on their application by relevant stakeholders.

Examinations conducted during 2012 were basically oriented based on risk assessments in examined entities and also with priority in insurance companies – entities in relation to examination time cycle from previous examination.

Seven full examinations were conducted - (for the entire activity) in six insurance companies, of which three non-life insurance companies and three life companies and one full examination in KIB, which also included the activity of Insurance Association of Kosovo (IAK)/Compulsory Insurance Unit (CIU) up to the establishment of Kosovo Insurance Bureau (KIB). Full examinations have also been conducted in other entities, such as insurance professionals. A total of four examinations were conducted, of which one insurance intermediary, one broker and two claim assessors.

Thirty-two focused examinations were conducted (for a certain area of the activity), which were performed as result of developments in insurance industry owing to constant supervision and monitoring. Such examinations were conducted to follow up compliance with recommendations and measures imposed thereof, examination in the area of claim payment process etc.

Within on-site examinations, wrap-up meetings were held, examination reports were prepared, comments were received by insurance companies – intermediaries and other entities were reviewed and analysed and measures were recommended in compliance with regulatory framework.

The following findings were ascertained during examinations: Lack of clear policies and procedures, lack of authentic internal controls, insufficient exercise of authorities by board, irregularities in handling and settling claims, lack of appropriate fulfilment of policyholders' requirements, delays in settling and paying claims, noncompliance with regulatory framework – (breach of regulatory framework), disregard of supervising authority requirements by company officials, occurrence of awarding rewards, bonuses and donations without coverage (without balanced results in relation to company benefit, occurrences of handing cases with falsified content, in appropriate fulfilment of recommendations.

Regarding the ascertained situation, CBK has undertaken measures pursuant to the regulatory framework.

Such measures include recommendation to remedy issues ascertained thereof, issuing a written warning to the board, management and internal auditor, imposing fines on companies and individuals, removal from company management, license suspension etc.

4.4. Pension Supervision

Kosovo pension system during 2012 did not have any significant changes, although fluctuation of financial markets has a direct impact on pension fund assets invested outside Kosovo. The purpose of Pension Supervision Division is to supervise and regulate pension funds, pension providers, asset managers, investments, and to safeguard the participants' assets.

Law on Pension Fund Supervision was adopted in March 2012, thus Kosovo pension fund operates pursuant to Law No. 04/L-101 which entered into force on 30 March 2012. The law establishes and regulates three (3) pension fund pillars:

- Basic pension provided to all elderly aged over 65, funded by Kosovo Consolidated Budget revenues (know as Pillar I);

Individual savings pension provided by mandatory fully funded contributions by employers and employees for current employees (known as Pillar II) and;

Supplementary individual voluntary pensions, funded by voluntary contributions of individual and employees (known as Pillar III).

Pursuant to Law 03/L-084 on Pensions in Kosovo, the second pillar is funded by mandatory monthly contributions established by law, where the employees contribute by 5 percent of their gross wage and the employers contribute by another 5 percent. Payments are transferred to individual accounts of participants in Kosovo Pension Savings Trust (KPST).

During 2012, full and focused inspections have been conducted Kosovo Pension Savings Trust and one full inspection in Slovenian-Kosovo Pension Fund.

During 2012, the Pension Fund Supervision Division started reviewing and adapting Pension secondary legislation to bring it in compliance with the European Union law and regulatory framework. It is also under preparation the risk-based Off-site Supervision Manual and the necessary regulatory framework.

Kosovo Pension Savings Trust (KPST)

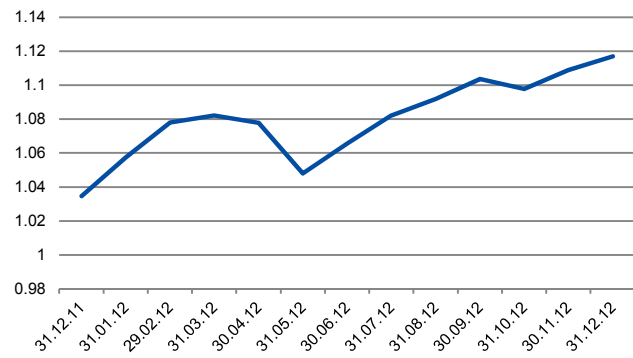
KPST is established to administer and manage the second pillar as long as the pension market is not liberalized. KPST is the sole institutions in charge with management and administration of the second pillar as provided for under the Law 03/L-084 on Pensions.

Kosovo Pension Savings Trust (hereinafter: “KPST”) was established pursuant to UNMIK Regulation No. 2001/35 dated 22 December 2001, as amended by UNMIK Regulation 2005/20, which was then amended by Law on Pension No. 03/L-084 of the Republic of Kosovo as a non-profitable legal entity the sole and exclusive purpose of which is to administer and manage the individual accounts of pension savings, ensuring a prudent investment and protection of pension assets and paying out flows from individual accounts for purchase of annuities for pension savings, as a trustee to manage an act on behalf of contributors and its beneficiaries.

The number of contributors by the end of 31 December 2012 was 418,064 while in 2011 it was 384,574 contributors. During 2012, the amount of asset under the KPST management increased to €151,721,906.50 where €113,038,605.25 are contributions received during 2012. The total

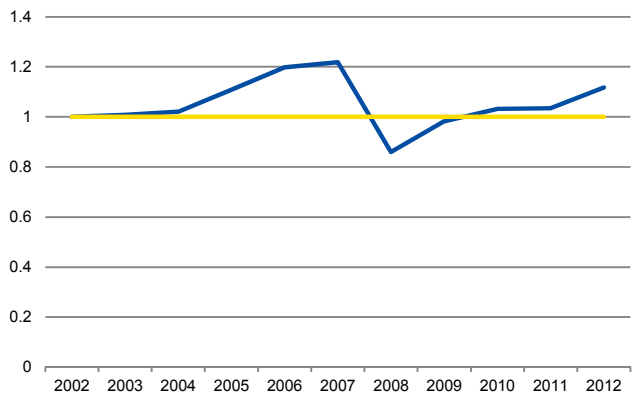
Kosovo Pension Savings Trust (KPST) - funded by

Figure 109. Price unit January-December 2012



Source: KPST (2013)

Figure 110. Price unit during 2002-2012

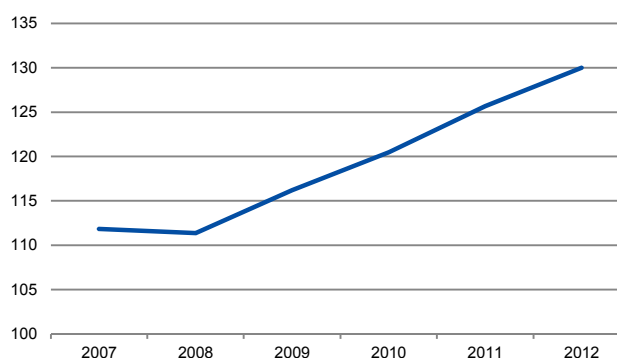


Source: KPST (2013)

value of asset under Kosovo Pension Savings Trust management as of 31 December 2012 was €740,125,122.47 while in 2011 it was €588,403,215.97.

During 2012, KPST invested in foreign markets assets in value of €145,000,000.00, and it had a positive return. Pursuant to Law No. 04/L-101, the Pension Savings Trust invested the value of €13,752,252.00 in Kosovo Government Securities. The Pension Savings Trust during 2012 had a positive return with gross return being at €53,654,123.00 or 7.18%, while in 2011 it had a value of €3,314,530.00 or 0.56%. In the end of 2012, Kosovo Pension Savings Trust unit price was €1.117 while in 2011 it was €1.0346, which represents a growth of unit price by 7.34%.

Figure 111. Unit value of Slovenian-Kosovar Pension Fund 2007-2012



Source: Slovenian-Kosovar Pension Fund (2013)

The table below shows the share of asset managers in investment of pension assets according to asset classes in total KPST assets for 2012.

Table 39. Structure of investments of pension assets as of 31 December 2012

Institutions where Pension Funds are invested	Assets type	Assets	Shares in percent
Vanguard	Equities	272,937,642	36.88
Schroders	Bonds	64,758,425	8.75
European Credit Management	Loans market	22,086,565	2.98
Aquila	Diversified	73,938,085	9.99
AXA GILB	Bonds linked to inflations	115,609,533	15.62
BNY Mellon	Different	83,960,682	11.34
State Street	Shares	33,028,458	4.46
Government securities		13,928,911	1.88
Raiffeisen Bank	Certificates of banking deposits	16,120,085	2.18
NLB Prishtina	Certificates of banking deposits	16,428,599	2.22
CBK	Not invested	27,328,138	3.69
Total		740,125,122	100

Source: CBK (2013)

Slovenian-Kosovo Pension Fund (SKPF) is founded as a shareholding company “Prva Group” from Ljubljana and Corporation “Dukagjini” from Peja on 4 September 2006 pursuant to Law 04/L-101. SKPF is licensed as Supplementary Pension Fund.

On 31 December 2012, the Slovenian-Kosovo Pension Fund assets reached the value of €4,467,722.66€, while this value on 31 December 2011 was €4,079,674.97. The price value on 31 December 2012 was €129.9732 while on 31 December 2011 this value was €125.6594.

The number of contributors for 2012 reached at 3,590 members while in 2011 it was 3,515. Similarly to other financial institutions, the pension system operators both the Trust and the SKPF were subject to “on-site” and “off-site” examinations.

Table 40. Structure of investments of SKPF pension assets as of 31 December 2012

Description	Assets in euro	Percent
Shares	176,283	3.95
Obligations and other fixed securities	3,143,127	70.35
Deposits	962,600	21.55
Cash	101,059	2.26
Other assets	84,654	1.89
Total fund assets	4,467,723	100

Source: SKPT (2013)

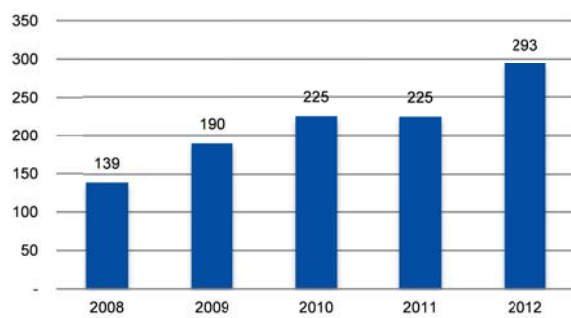
5. Services Provided Authorities, Financial Community and Public

CBK provides the regular services which are to be offered by central banks to the state institutions, financial institutions and public. In general, these services have to do with cash flow, account transactions, managing the financial assets, interbank payment systems, credit registries as well as economic statistics and analyses.

5.1. Operations and Cash Management

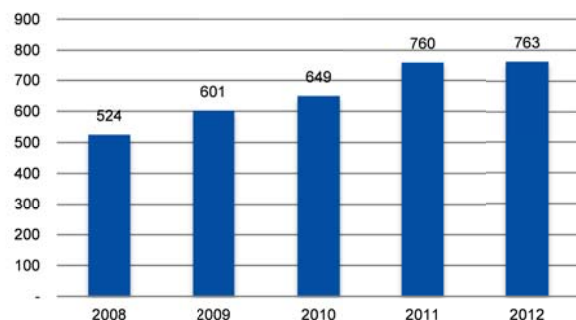
The CBK strategic function and goal to ensure a proper supply of banknotes and coins for execution of cash transactions in the economy during 2012 was successfully performed. Since Euro is a currency that is being officially used in Kosovo, the CBK's responsibilities with respect to operations and cash management are related to Euro in the first place.

Figure 112. Cash supply (value), in millions of euro



Source: CBK (2013)

Figure 113. Cash admission (value), in millions of euro



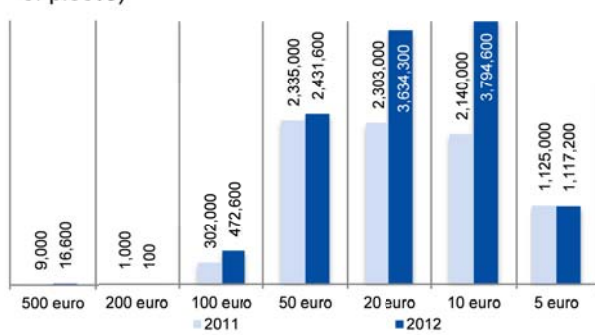
Source: CBK (2013)

In 2012, the overall amount of cash supplied recorded a growth of 30.65 percent compared to 2011. The structure of cash supplied by denominations, which first of all is determined by the banking sector demands, had significant change from 2011 to 2012. As to the euro banknotes, low denominations - 5, 10, 20 and 50 euro kept dominating, while higher denomination volumes of 100, 200 and 500 euro remain evidently lower.

During 2012, low denomination volumes of 20 and 10 euro had considerable growth compare to the last year.

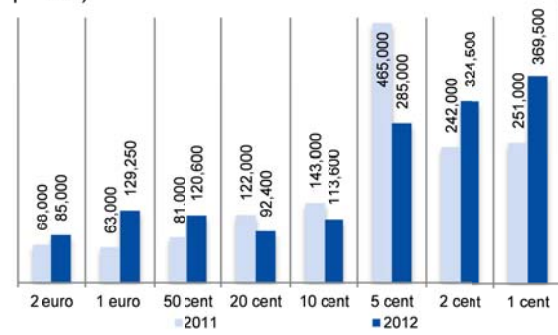
As presented in the figures below, during 2012, CBK supplied commercial banks and other institutions with approximately 11.5 million pieces of euro banknotes (in the amount of over euro 293.4 million) and over 1.52 million pieces of euro coins (in the amount of around euro 0.42 million).

Figure 114. Supply with euro banknotes (number of pieces)



Source: CBK (2013)

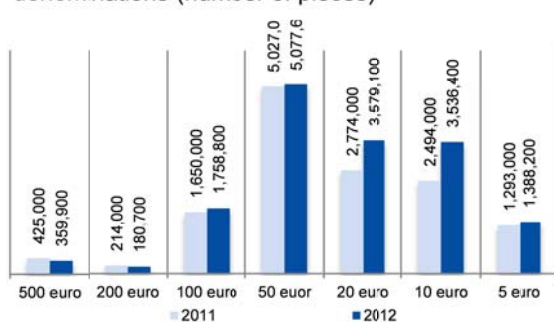
Figure 115. Supply with euro coins (number of pieces)



Source: CBK (2013)

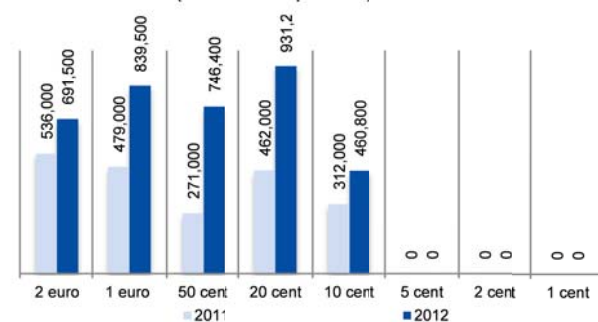
Similar to 2011, the supply of euro coins was mainly dominated by low value coins from 1 eurocent to 5 eurocent. During 2012, the volumes of low value denominations of 2 eurocent and 1 eurocent had a considerable growth compare to the last year while the denomination volume of 5 eurocent recorded a decline.

Figure 116. Euro banknotes received by denominations (number of pieces)



Source: CBK (2013)

Figure 117. Euro coins received by denominations (number of pieces)



Source: CBK (2013)

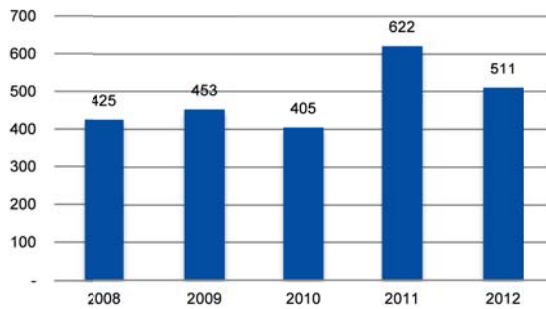
In 2011, the overall value of cash received as deposits recorded a slight growth of 0.33 percent compared to the previous year. CBK received around 15.9 million pieces of euro banknotes (an average of 64,000 pieces of banknotes per day) and around 3.67 million pieces of euro coins (an average of around 14,00 pieces of coins per day) as cash deposits from commercial banks and other institutions. Expressed as value, these deposits have approximately reached the amounts of euro 759.7 million and euro 2.8 million, respectively. The structure of euro banknotes and coins received does not have a great difference compared to previous year.

Likewise previous years, in 2012, the net deposited cash⁵¹ was in a higher amount than the cash supply. In fact, by reaching at nearly euro 469.2 million, the variation of cash deposit was considerably lower compared to the previous year when it was around euro 535.5 million. This decrease was mainly a result of banknotes supply in value of 10 and 20 euro.

⁵¹ Deposits less Withdrawals

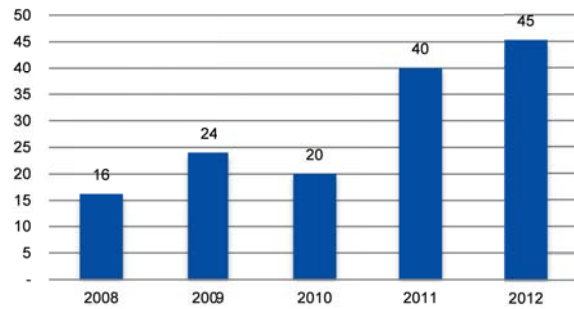
Since CBK keeps only the minimum required level of cash, the overflow was remitted to Eurozone, wherein they are refunded into the interest assets and are also used for execution of international payments and investments. Net remittances of cash abroad in 2012 reached the amount of euro 465.5 million, being lower from the previous year when they were euro 581.9 million. Cash export and import situation during the recent years are depicted in the two following figures. This decrease of net remittances came as consequence of an annually lower position of cash in CBK treasury than in the beginning of the year on one hand and the increase of demand for cash by commercial banks in the other hand.

Figure 118. Export of cash (value), in millions of euro



Source: CBK (2013)

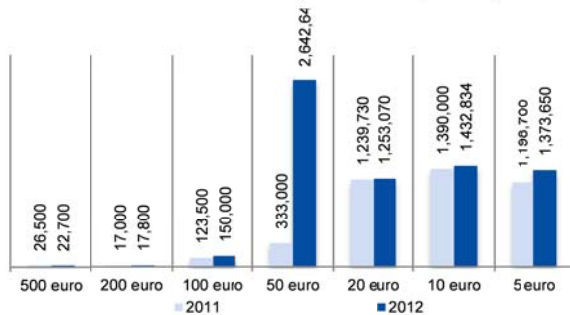
Figure 119. Import of cash (value), in millions of euro



Burimi: BQK (2013)

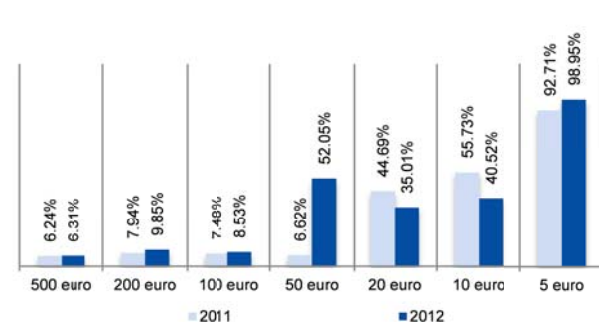
Similarly to previous years, the cash operations kept being executed through modern processing equipment and in compliance with CBK standard rules. All cash received by commercial banks and other institutions are processed (around 15.9 million pieces of euro banknotes and 3.67 million pieces of euro coins) and are classified according to their outdating rate.

Figure 120. Number of outdated banknotes withdrawn from circulation (number of pieces)



Source: CBK (2013)

Figure 121. Proportion of banknotes withdrawn from circulation from the total received ones



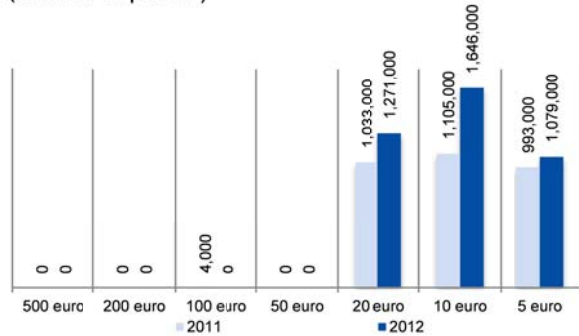
Source: CBK (2013)

During 2012, around 6.9 million euro banknotes (43,3 percent of deposited euro banknotes number) were classified as outdated and were excluded from the circulation by being remitted towards the Eurozone central banks. Such considerable volume of outdated euro banknotes excluded from circulation has evidently contributed to the improvement of the quality of cash in circulation in the Republic of Kosovo. Banknotes that mainly were classified as highly outdated and were excluded from circulation were those of denominations 50, 20, 10 and 5 euro, due to their higher circulation in the economy.

The quality of cash in circulation also improved through supply of brand new banknotes, which were brought by Eurozone. During 2012, CBK supplied the banking sector with around 4 million new euro banknotes (34.85 percent total number of supplied euro banknotes).

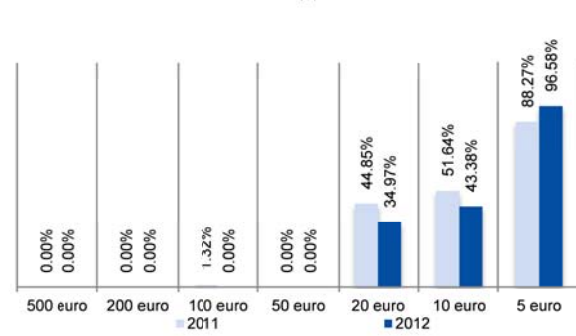
Most of the new banknotes supplied were those of low denominations (20, 10 and 5 euro), and mainly commercial banks were supplied with them aiming at equipping their ATM machines. In addition, all the used euro banknotes that were supplied were of the highest standard quality (proper quality for ATMs).

Figure 122. Supply with new banknotes (number of pieces)



Source: CBK (2013)

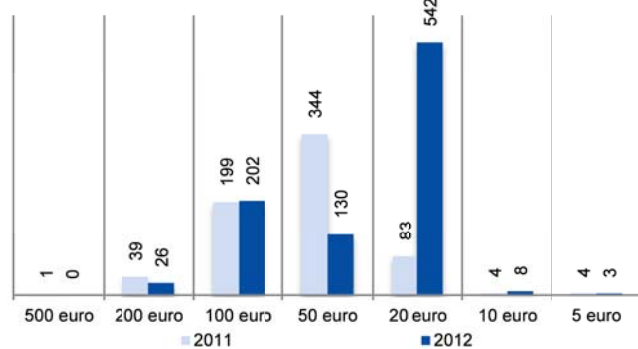
Figure 123. Proportion of new banknotes induced in circulation from the total supplied



Source: CBK (2013)

Regarding measures against the counterfeiting, CBK kept on following up the cases of counterfeit money in 2012. In particular, it proceeded with its cooperation with authorities in charge to advance the reporting of cash suspected as counterfeit and with organizing relevant trainings on counterfeit money designated for the staff of financial institutions operating in cash. It is worthy to mention that regular meetings of Counterfeit Money Analyzing Central Committee⁵² are being held. Furthermore, in 2011, CBK together with the Kosovo Police and the Forensic Laboratory published on its website⁵³ statistics on counterfeit money in the Republic of Kosovo wide. The published materials aim at informing a wider public of counterfeit banknote and coins.

Figure 124. Counterfited euro in Kosovo (number of pieces)



Source: Forensic Agency of Kosovo (2013)

5.2. Account and Transaction Maintenance

CBK provides banking services to the Treasury and other institutions of Government of the Republic of Kosovo, such as Privatization Agency of Kosovo (PAK), and other institutions such as banks and other financial institutions, public entities, foreign banks, central banks, international financial institutions (IMF, WB) and international organizations as specified under Article 9 of Law No. 03/L-209 on CBK.

In 2012, similar to the previous years, these services consisted mainly of account maintenance and execution of transactions, excluding any form of crediting.

During 2012, CBK kept advancing the processes of execution of transactions and allocations of Treasury and PAK. Types of payments and ways of communications have been adapted to their

⁵² The Committee consists of three KP senior representatives and three CBK representatives

⁵³ <http://www.bqk-kos.org/?cid=1,141>

requirements. It is worthy to underline the complete automation of Treasury international transfer orders.

Table 41. Amount of transactions by their main types of payments (in thousands of euro)

Types of transactions	2008	2009	2010	2011	2012
Cash transactions	+385,113	+411,055	+423,658	+535,190	+468,755
Deposits in cash	524,346	601,207	648,911	760,082	762,596
Cash withdrawals	139,233	190,152	225,253	224,892	293,841
Domestic transfers	+78,078	+41,169	+392,587	+462,867	+335,267
Incoming domestic transfers	1,076,145	1,225,527	1,568,021	1,615,232	1,568,574
Outgoing domestic transfers	998,067	1,184,358	1,175,434	1,152,365	1,233,308
International transfers	-364,795	-463,816	-408,689	-558,778	-366,873
Incoming international transfers	203,113	202,755	326,319	266,706	372,967
Outgoing international transfers	567,908	666,571	735,008	825,483	739,840

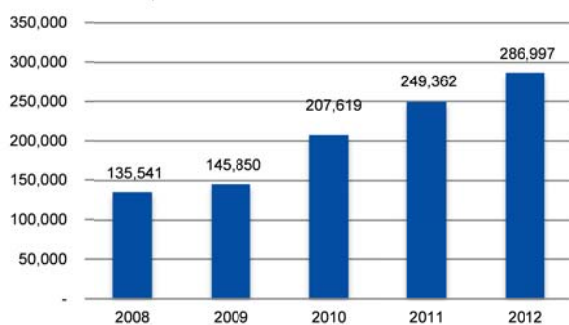
Source: CBK (2013)

In the first part of 2012, all stages planned for the complete automation of Treasury international transfer orders were completed. CBK during 2012 processed electronically the Treasury international transfer orders and most of these transfer orders have been performed and validated at the same date unlike the two-day period that was required before. With purpose of advancing the validation of international transfer orders and in absence of SWIFT – BIC code, CBK during 2012 continued to use the license of BIC-SWIFT codes given by SWIFT company which uses and international payment module for validation of BIC codes of international transfer orders of CBK clients and Treasury in particular.

While the largest part of the CBK cash operations during 2012 is related to commercial banks, the largest part of the CBK domestic payments are executed for and on behalf of commercial banks, the largest part of CBK's domestic payments are executed for and on behalf of Treasury⁵⁴.

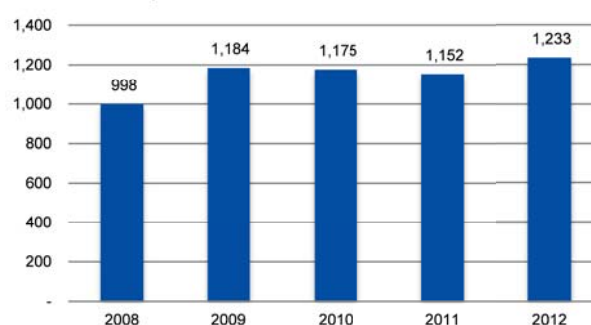
As a direct participant in the Electronic Interbank Clearing System (EICS), CBK has transmitted and received domestic transfer orders for and on behalf of its accountholders. During 2012, through EICS, CBK transmitted on behalf of its clients around 287 thousand outgoing payment orders (a growth of 15.1 percent compared to the previous year), and it received on their behalf around 96.6 thousand incoming payment orders (a growth of 3 compared to the previous year).

Figure 125. Volume of domestic outgoing transactions, number



Source: CBK (2013)

Figure 126. Value of domestic outgoing transactions, in millions of euro

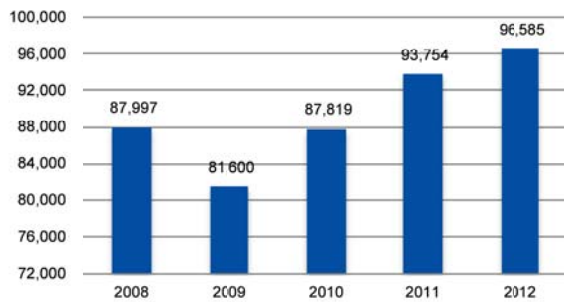


Source: CBK (2013)

⁵⁴ Treasury – Ministry of Economy and Finance

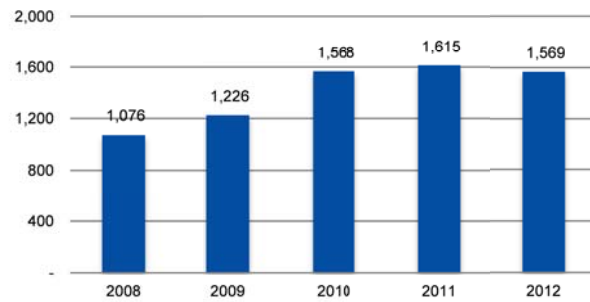
Expressed in value, the outgoing payment orders in 2012 reached at euro 1.23 billion (a growth of 7 percent compared to the previous year) and the incoming payment orders reached around euro 1.57 billion (a growth of 2.9 compared to the previous year). The CBK also remained the largest participant in EICS both in terms of value and volume of transactions.

Figure 127. Volume of domestic incoming transactions, number



Burimi: BQK (2013)

Figure 128. Value of domestic incoming transactions, in millions of euro

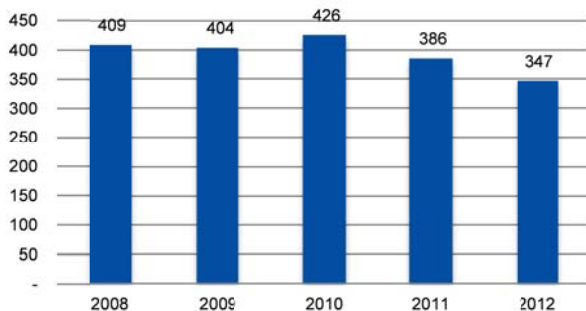


Source: CBK (2013)

When mentioning the domestic payment transactions, it should be emphasized that all commercial banks generate them on their own as participants in EICS, whereas the insurance institutions execute the largest number of their payments through commercial banks. In fact, all the other CBK accountholders make use of payment services provided by the CBK in a limited way, since they all have accounts in commercial banks.

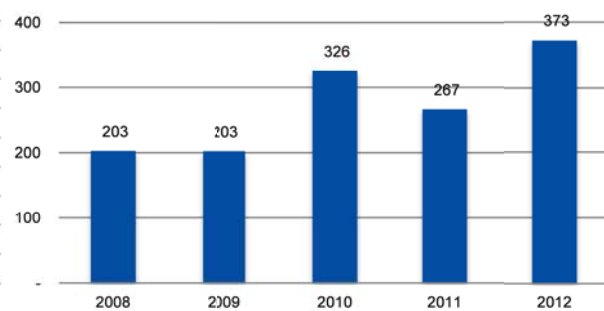
Regarding the international transactions in 2012, the largest number of them was executed by CBK upon the Treasury order. On the other hand, considering their value, the largest part of international transactions executed by CBK relate to the transfer of funds of commercial banks. Annual data on international transactions for the last five years are presented in the following figures.

Figure 129. Volumem of international incoming transactions, number



Source: CBK (2013)

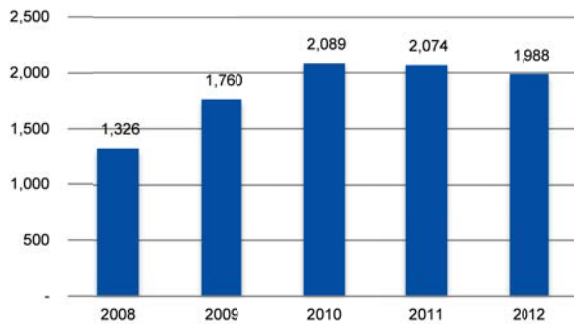
Figure 130. Value of international incoming transactions, in millions of euro



Source: CBK (2013)

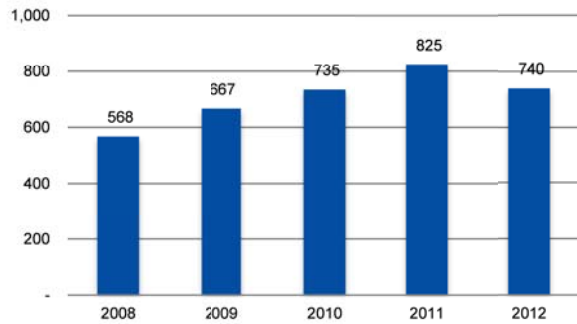
As to the amount of deposits, Kosovo Government institutions along with the deposits of PAK deposits consisted the major part of the overall deposits held in CBK by the end of 2012 (61.07 percent). On 31 December 2012, deposits of Kosovo Government institutions reached the amount of euro 271.7 million, whereas those of PAK reached the amount of euro 549.4 million.

Figure 131. Volume of international outgoing transactions, number



Source: CBK (2013)

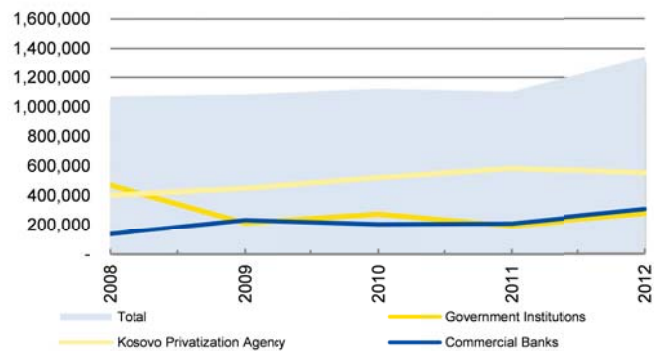
Figure 132. Value of international outgoing transactions, in millions of euro



Source: CBK (2013)

Among the other accountholders, commercial banks and insurance institutions are the most important ones in regard to the level of deposits kept in the CBK accounts. Deposits of commercial banks and of insurance institutions kept in CBK mainly have to do with their regulatory liabilities. They consisted 22.8 percent of total deposits kept in CBK during 2012. On 31 December 2021, deposits of commercial banks and of insurance institutions reached an amount of euro 307.13 million.

Figure 133. Deposit motion of main clients of CBK, in millions of euro



Source: CBK (2013)

The level of deposits of Kosovo Pension Savings Trust (KPST) kept in CBK increased during 2012. They consisted around 2 percent of total deposits kept in CBK during 2012 and they reached at euro 307.12 million.

5.3. Payment System

5.3.1 Electronic Interbank Clearing System Operation

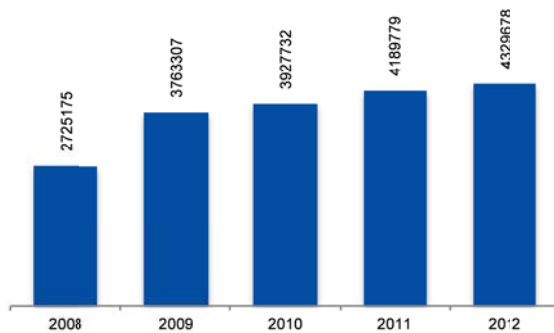
Development of an efficient, safe and sustainable national payment system, as a key pillar of financial infrastructure is one of the CBK's primary functions. Electronic Interbank Clearing System (EICS) operated by the CBK is the only interbank payment system in the country. EICS functions as a hybrid system which enables interbank channelling of a wide range of payment instruments.

During 2012, a growth was marked in volume and value of EICS transactions and a further advancement of the system was carried out.

Among the developments of particular importance was the automation of interfaces of Electronic Interbank Electronic System (EICS) with the Central System of Securities (DEPO/X) for the first time in Kosovo, as well as the beginning of implementation of some of the development projects⁵⁵ planned within the National Payment System Development Strategy.

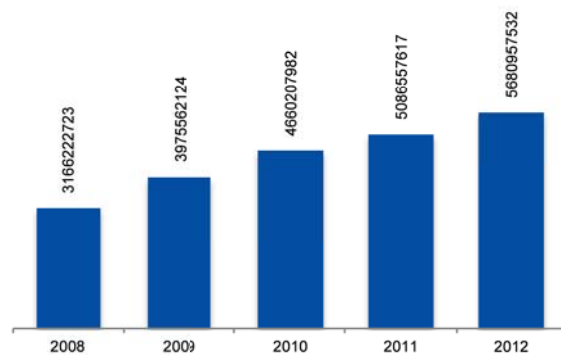
⁵⁵ Provision of web services of interbank electronic services to companies and Government and public institutions (Pillar IV); Project on wages and pensions (Pillar IV); Remittances (Pillar VIII), drafting and publication of the survey on "remittances" focused from the perspective of payment circulation facilitation

Figure 134. IECS transactions number



Source: CBK (2013)

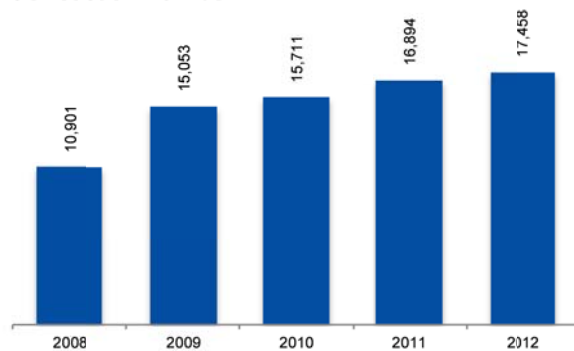
Figure 135. IECS transaction value



Source: CBK (2013)

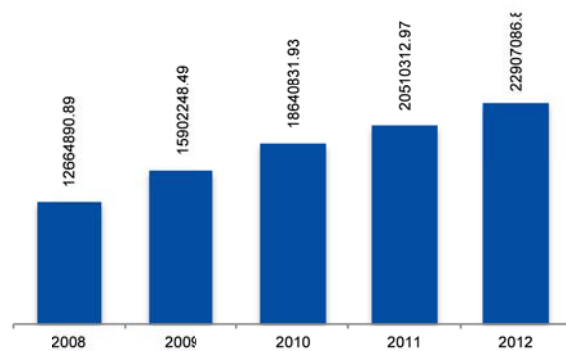
The constant growth of the volume and amount of the EICS transactions reflects the relative payment growth without cash and the enhancement of credibility in the banking system. As in the previous years, in 2012, the annual growth of volume as well as amount of EICS transactions was evident. Around 4.3 million transactions with an overall amount of euro 5.7 billion were channelized through EICS during 2012.

Figure 136. Daily average of IECS transaction number



Source: CBK (2013)

Figure 137. Daily average of IECS transaction value



Source: CBK (2013)

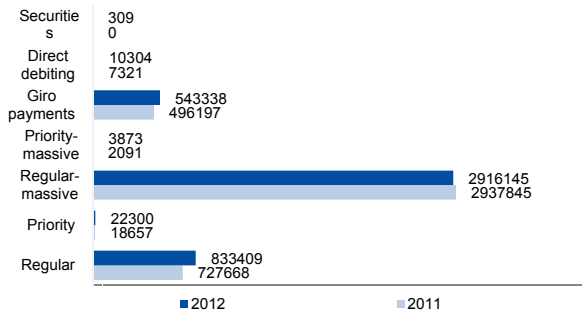
Compared to EICS transactions in the previous year, the transaction volume increased by 3.34 percent while the transaction value increased by 11.69 percent. EICS transaction growth can be seen also from the average daily data. The increase of EICS transactions can be seen from daily data. In 2012, the EICS daily transaction value was around euro 22.9 million, compared to around euro 20.5 million in 2011. Furthermore, in 2012, the EICS daily transaction volume was nearly 17.5 thousand, compared to around 16.9 thousand in 2011. One of the factors that impacted on the growth of the value of EICS transactions was the fiscal transactions from the Post and Telecommunication of Kosovo and the issue of securities by Government of the Republic of Kosovo. On the other hand, the increase of the number of interbank payments during this year was not as significant as in the previous years.

There are some specific types of EICS transactions, such as regular (individual and massive), priority (individual and massive), Kos-Giro, Direct Debit and Securities. Their volume and amount levels for 2011 and 2012 are presented in the figures below.

Regular payments (individual and massive) comprise around 87.6 percent of the volume and around 63.9 percent of the EICS transactions value. They are channelized through the EICS either as individual transactions (one-to-one) or as massive transactions (one-to-many or many-to-one). They are processed through regular clearing sessions and are cleared on net basis.

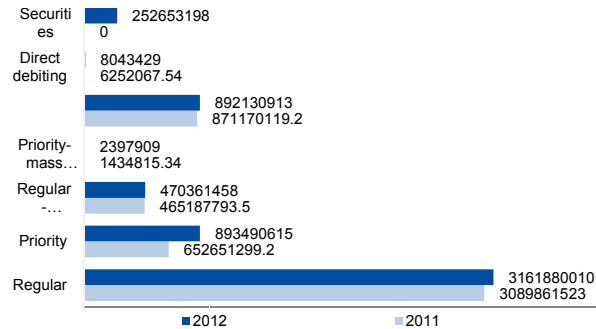
Kos-Giro transactions represent a special type of regular transactions, which are also processed through clearing sessions and are cleared on the net basis. They are channelized through the EICS as massive transactions (many-to-one). While regular individual transactions are meant for payments in general, the massive regular payments are meant for payments and collections of different enterprises and institutions, the Kos-Giro transactions are meant for standardized and automated cashing of the large recipient entities. A growth was recorded during 2011 both in their volume and amount.

Figure 138. Annual transaction volume of IECS, by their types



Source: CBK (2013)

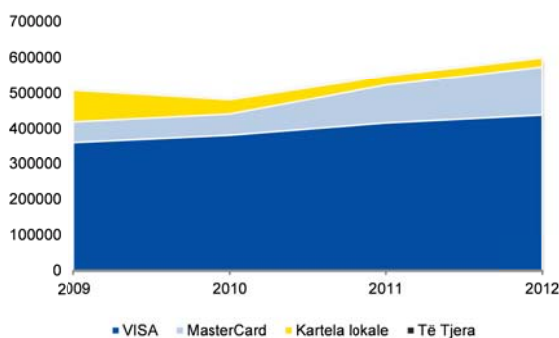
Figure 139. Annual transaction value of IECS, by their types



Source: CBK (2013)

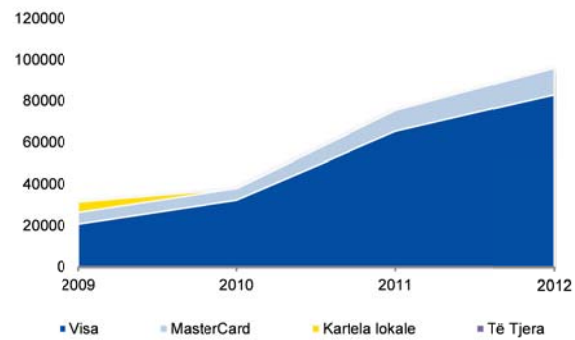
Priority (urgent) transactions are processed and immediately cleared on the gross basis during the working hours. Same as regular transactions, priority transactions can be channelized through EICS either as individual or massive transactions. They still represent a small part of overall EICS transactions. In 2012, in terms of their volume, they represented less than 1 percent of transactions, while in terms of their amount they achieved to represent more than 15.7 of transactions. This type keeps mainly being used for urgent payment transactions and for those of high amounts.

Figure 140. Number of debit accounts, by types



Source: CBK (2013)

Figure 141. Number of credit accounts, by types



Source: CBK (2013)

Direct Debit as a new payment instrument and scheme in Kosovo launched in November 2009 provides an advanced method of periodical automated payment (without cash) from a bank account, which have to do, in the first place, with regular services with regard monthly expenses for electrical energy, water supply, telephony, heating, maintenance, etc. As a new type of EICS transactions this is not still used as much as the other types. As a new type of EICS transactions, it is still not being used to the extent the other types are used, thus during 2012, Direct Debit

represented less than 1 percent of both in volume and amount of EICS transactions. During 2012, three new companies joined the Direct Debit scheme.

A detailed overview of concentration indicators of the share of more active institutions in EICS during 2012 against the total activity in this system is presented below

Table 42. Concentration indicators for IECS initiated/transmitted transactions

IECS System	Vëllimi	Vlera
Three banks	51.15%	67.26%
Five other banks	48.85%	32.74%
Total (absolute value)	4,329,681	5,680,977,737

Source: CBK (2013)

Referring to the overall value of the EICS cleared transactions during 2012, the overall value was €5,680,957,532, where the three first institutions with higher initiated transfers comprise 67.26 percent of the absolute value, while all the other institutions comprise 32.74 percent. As far as the number of initiated transfers is concerned, out of their overall number of 4,329,678, the three first institutions with higher initiated transfers comprise 51.15 percent of the total number, whereas all the other institutions comprise 48.85 percent.

Table 43. Concentration indicators for IECS received/incoming transactions

IECS System	Volume	Value
Three banks	75.71%	69.97%
Five other banks	24.29%	30.03%
Total (absolute value)	4,329,681	5,680,977,737

Source: CB (2013)

Regarding the received transfers, the three institutions with a higher value of received transfers comprise 69.97 of total value, while all the other institutions comprise 30.03 percent.

On the other hand, out of total number of received transfers, the three first institutions comprise 75.71 percent of total number, while all the other institutions comprise 24.29 percent.

5.3.2 General Developments, Payment System Analysis and Supervision

In the course of implementation of the National Payments System Development Strategy, activities have been undertaken almost in all its relevant pillars during 2012, such as: i) legal framework, ii) large amount and urgent payments, iii) low amount payments, iv) governmental transactions, v) securities, vi) monetary market, vii) remittances, viii) supervision of payment system and ix) cooperation and coordination between the payment stakeholders.

With view to initiatives for implementation of the strategy, working groups have been established for all pillars envisaged in the strategy and a wide range of relevant activities have been undertaken. Namely, the terms of reference have been prepared for new payment system (pillar ii, iv and vi) and the draft law on payment system was finalized, it passed the first reading in Kosovo Assembly, it was reviewed by budget and finance commission and is proceeded for adoption. Within the first pillar (legal framework on payment system), the following regulations have been amended and approved: a) Regulation on minimum bank reserves, b) Regulation on registry of accountholders,, and c) Regulation and instruction on international payments.

Within the last pillar (ix), the National Payment Council (NPC) was constituted to support the development and growth of sustainable efficient clearing and settlement systems to settle payments and securities in Kosovo. During this year, a management group for the project on reduction of non-cash payments in Kosovo performed successfully under the auspices of this council. In this area, particular analyses have been conducted regarding the use of electronic instruments in the country and comparisons have been made with the regional countries and other countries as well as analysis have been conducted in relation to non-cash payments – a research into the client and the trader, etc. Simultaneously, in the course of activities of this team, the first contacts have been initiated and maintained with representatives of the companies “MasterCard” and “Visa”, to exchange ideas and cooperation regarding the promotion of the ways of electronic payments, etc.

In the payment system supervision area (Pillar vii), CBK has established and developed the relevant function in line with the international principles and standards, and regular publications have been made on payment instruments analytical indicators in Kosovo.

Also, during 2012, Payment Instruments Reporting Methodology was revised and harmonized, which aim at:

- Collecting and perfecting the periodical data processing as well as the efficient maintenance of the database on the use of payment instruments in Kosovo.
- Monitoring the developments in payment system area in order to assess the risk rate carried by them and to ensure transparency in arraignments related to the payment instruments and services.
- Improving the quality of reports, analyses and publications on payment instruments in accordance with the European Central Bank reports, aiming at publication of the data on Kosovo in a relevant publication in a near future⁵⁶.
- Analyzing the developments in the payment instruments area vis-à-vis Southeastern Europe and Central European countries.⁵⁷

From the data collected and analyzed during 2012, a clear picture was crated on the level of development of national payment system. In general, it is noticed that the infrastructure and payment instruments are developing with a rapid trend.

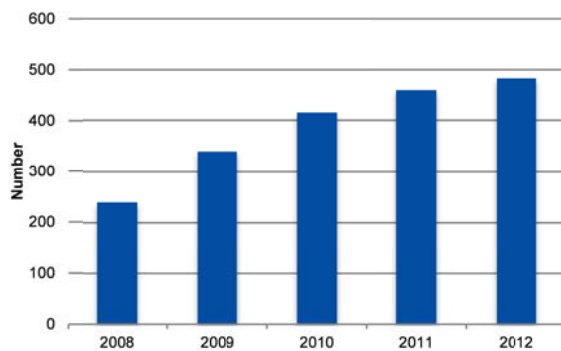
The number of payment function cards has constantly increased. The network of bank terminals in Kosovo is also increasing. In December 2012, 599.851 debit cards and around 95.942 credit cards as well as 13.081 prepaid cards have been reported. These cards could have been used in more than 483 ATM terminals and in more than 8.592 POS terminals distributed throughout Kosovo.

Compared to the previous year, the number of ATM terminals increased by 5 percent and the number of POS terminals increased by 14.04.

⁵⁶ Source: <http://www.bqk-kos.org/?cid=1,59,54>

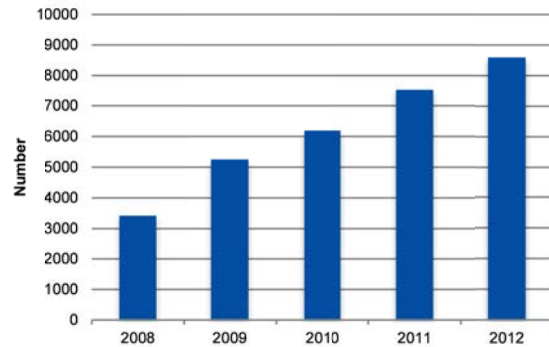
⁵⁷ Source: <http://www.bqk-kos.org/?cid=1,59,55>

Figure 142. Number of ATM terminals



Source: CBK (2013)

Figure 143. Number of POS terminals



Source: CBK (2013)

From the bank reports, it results that the total number of clients' bank accounts by the end of 2012 was around 1.8 million, with a decline of 11.4% compared to the end of 2011. Around 98.4% of them are resident accounts, whereas around 1.6% are non-resident accounts.

Out of the total accounts by the end of 2012, around 97 thousand accounts have "online" access in internet to make payments and check account balance, recording an increase of 41 percent compared to 2011. Regardless a significant growth of this indicator during 2012, the level of use of banks accounts through "e-banking" keeps remaining low. Compared to the other Central and Southeastern Europe countries, Kosovo has much more to do. Regarding the number of terminals in 1 million residents, Kosovo stands among the last regional countries.

Table 44. Number of accounts

Account description	Clients' accounts in total			Accessible through internet		
	2010	2011	2012	2010	2011	2012
Clients' accounts (1+2)	1,857,608	2,059,878	1,824,266	50,274	68,990	97,089
1-residents' accounts (a+b)(%)	98.40%	98.34%	98.40%	94.20%	94.80%	97.00%
a-individual (%)	94.30%	94.36%	93.20%	83.60%	80.00%	78.70%
b-company (%)	5.70%	5.63%	6.80%	16.40%	20.00%	21.30%
2-non-residents accounts (c+d)	1.60%	1.66%	1.60%	5.80%	5.20%	3.00%
c-individual (%)	96.10%	96.60%	96.50%	94.30%	90.80%	94.90%
d-company (%)	3.90%	3.40%	3.50%	5.70%	9.20%	5.10%

Source: CBK, Bank reporting according to "Payment Instruments Reporting Methodology".

However, a positive sign in this direction is the faster trend of infrastructure development which is above the average development of the regional countries. The same situation also stands with bank cards. The number of payment function cards keeps growing.

Table 45. Comparative table of payment instruments and terminals⁵⁸

Description	Inhabitants	Sipërfaqja (km ²)	Density (per km ²)	ATM	per 1 million inhabitants	per 100 km ²	POS	per 1 million inhabitants	per 100 km ²	Credit accounts	per 1 million inhabitants	Debit accounts	per 1 million inhabitants	E-Banking
Kosovo	2.1	10,887	193	460	219	4	7,534	3,588	69	74,873	35,654	548,253	261,073	68,990
Albania	3.19	28,748	111	805	252	3	5,126	1,607	18	37,893	11,879	693,958	217,542	37,138
Czech Republic	10.54	78,865	134	4,082	387	5	77,651	7,367	98	2,858,390	271,194	7,455,017	707,307	-
Turkey	73.73	783,562	94	32,462	440	4	1,976,843	26,812	252	51,360,809	696,607	81,879,926	1,110,537	-
Slovenia	2.05	20,273	101	1,845	900	9	34,167	16,667	169	1,544,161	753,249	2,502,526	1,220,744	701,311
Bulgaria	7.54	110,879	68	5,792	768	5	64,425	8,544	58	978,546	129,781	7,007,157	929,331	-
Hungary	9.74	93,028	105	4,907	504	5	84,678	8,694	91	1,230,544	126,339	7,680,693	788,572	-
Bosnia and Herz	3.77	51,197	74	1,202	319	2	18,589	4,931	36	180,453	47,866	1,480,855	392,800	94,339
Montenegro	0.62	13,812	45	311	502	2	10,131	16,340	73	50,897	82,092	303,630	489,726	27,230
Croatia	4.42	56,594	78	3,975	899	7	100,012	22,627	177	1,983,188	448,685	7,062,580	1,597,869	1,253,171
Macedonia	2.06	25,713	80	876	425	3	33,435	16,231	130	290,638	141,086	1,098,800	533,398	306,981

Source: CBK (2012) and central banks or supervision authorities of relevant countries

5.4. Asset Management

5.4.1 Asset Management and CBK Investment Policy

Pursuant to Law No. 03/L-209 (Article 1, paragraph 1.6), the Central Bank of the Republic of Kosovo (CBK) acts as a fiscal agent of the Government. This form of financial investments enables the return on investments of financial assets, which assets are then collected in Budget of the Republic of Kosovo.

Deposited funds mainly belong to Government institutions; Ministry of Finance, Privatization Agency of Kosovo (PAK) as well as financial institutions (mandatory liquidity reserves).

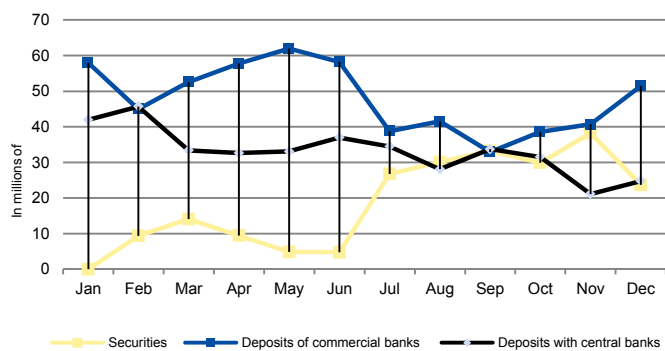
The Investment Policy approved by the Executive Board is implemented by the Asset Management Department. Since a large part of the funds under its management are assets of public institutions, which according to the Investments Policy can be returned at a short period of time, the primary objective under this policy are security, liquidity and return on investments.

5.4.2 Asset Management in 2012

Pursuant to the CBK Investment Policy, throughout 2012, all assets have been invested in financial instruments falling under a safer and more liquid instrument category.

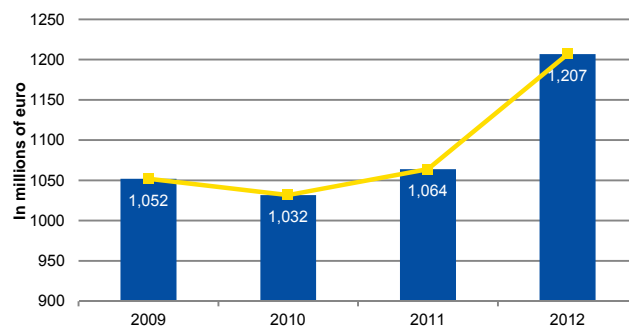
Respectively, there are two financial

Figure 144. Spread ratio of CBK portfolio investments



Source: CBK (2013)

Figure 145a. Total amount of assets in portfolio investments, in millions of euro every end of the year



Source: CBK(2013)

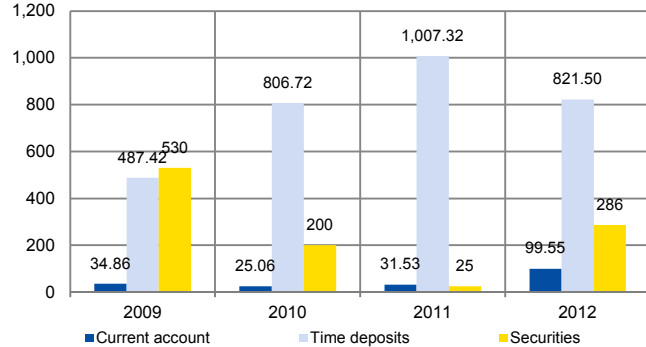
⁵⁸ Data in the table are for 2011, since some regional countries have not yet published their data for 2012.

instrument categories where assets under the CBK portfolio management are invested:

- Held-to-maturity banking deposits with a maturity as established under the CBK Investment Policy in financial institutions having superior ranking/rating, respectively time euro-deposits with commercial and central banks of the most credible European Union and Eurozone countries, and
- Treasury bills of most developed countries in Euro-zone with a maximum maturity up to one year issued in euro.

Figure no. 145a which represents the distribution ratio of CBK portfolio in securities and deposits in central and commercial banks shows that the securities curve recorded a growth of investment percentage in this asset investment category, especially in June when investments in banking deposits became less favourable due to the situation in Eurozone⁵⁹ market. With exception of January 2012, during the other part of this year, the exposure of time deposits in commercial banks recorded an increase against treasury bills of the most developed Eurozone countries.

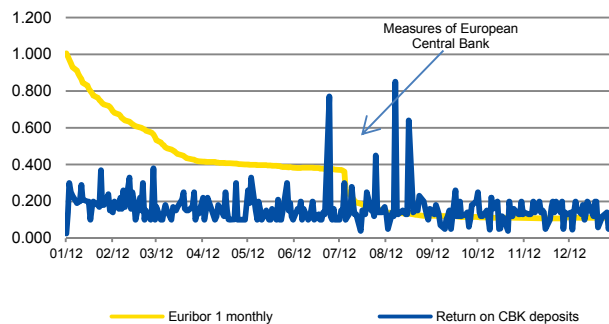
Figure 145b. Spread of portfolio investments, end of the year



Source: CBK(2013)

Year 2012 was characterized as a year of growth of total assets in CBK investment portfolio. Figures 145a and 145b show the growth of CBK invested assets by their position as of 31 December 2009, 2010, 2011 and 2012.

Figure 146a. Movements of the rate in inter-bank market of the eurozone and the movements of deposit rates invested by CBK



Source: CBK (2013)

5.4.2.1 Performance Portfolio for 2012

Impacts from debt crisis in Eurozone associated with European Central Bank (ECB) measures became significantly evident throughout the year in returns to CBK portfolio. In particular, following the decrease of key interest rates by ECB on 11 July 2012, the inter-bank market rates decreased as a consequence of the decrease of deposit rate to 0%. Figure 146a represents the movement from investments in CBK portfolio against Euro interbank market, respectively EURIBOR-in 1-month (Average interbank lending rate for Euro currency).

To have a clear reflection on Eurozone situation regarding return from asset investment, Figure 146b presents two categories at two periods: the returns from investments against return risk change rate expressed as a variation of acquired interest rate.

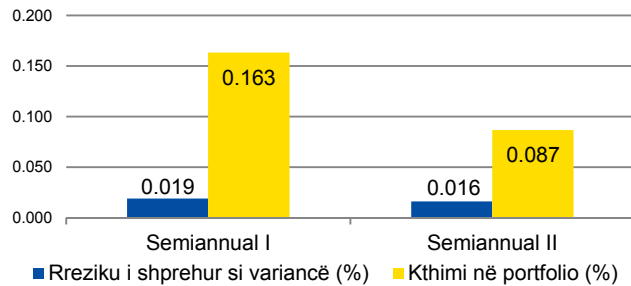
⁵⁹ The highest participation point was reached in November.

Time period of investments: investments in securities, respectively the treasury bills, during 2012 were realized at longer time periods compared to the average time period of deposits, other than September and December. Investment at longer time period in treasury bills was due to the security and the growth of financial asset liquidity since these instruments can be traded.

Consequently, the return rates from securities were higher than time deposit interest rates. The average time period of total deposits is 23.16 days.

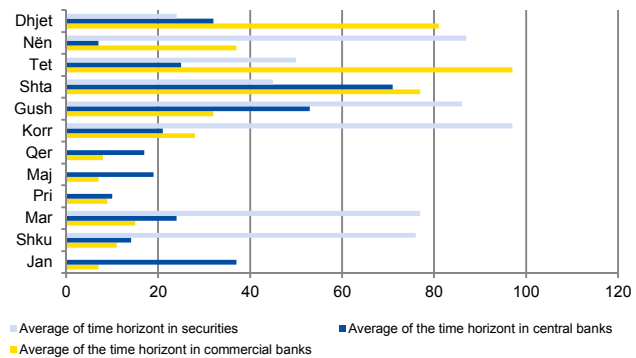
Figure no. 146d presents the CBK portfolio performance throughout six-month periods of 2012 expressed in percentage of return rate from investment and comparison of these rates against the key monetary performance indicators. Each indicator recorded a drastic performing decline in between the two six-month periods, as a consequence of CBK decision to decrease the banking deposit interest rate. It also can be noticed that only the return interest rate from investment in securities managed to stay more stable in the second half of the year, and this was a consequence of purchase of treasury bills for longer time periods and the growth of investment portfolio in this type of financial instrument

Figure 146b. Rate of investing returns in portfolio and the risk for two semiannual periods of 2012



Source: CBK(2013)

Figure 146c. Time horizon average of financial assets investments



Source: CBK (2013)

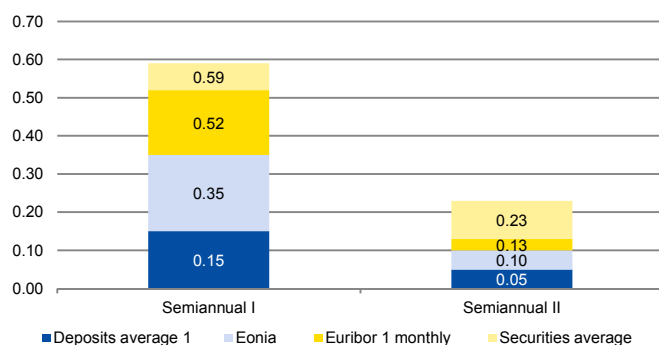
5.4.2 Investment Risk Management

CBK invests in funds of financial institutions in countries having high credit rating based on credit assessment by large internationally recognized agencies, such as Standard & Poor's and Moody's as well as other market risk indicators. Current risks are financial risks, such as credit risk, interest risk, liquidity risk and operational risk.

5.4.2.1 Credit Risk

All investments done in relation to criteria established under the Investment Policy are enclosed at the lowest level P-2/A-2 (Moody's/S&P) for short-term investments.

Figure 146d. Portfolio performance of investments along with monetary indicators, in percent



Source: CBK (2013)

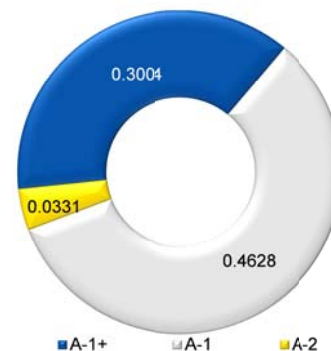
CBK manages the credit risk through investment diversification which is established by quantitative limits for countries and financial institutions. Because of debt crisis in Eurozone, decisions have been rendered on limitation of investments and prevention of investment in banks which haven't been estimated to have a potential in providing security of invested asset.

5.4.2.2 Interest Risk Rate

The relative measurement of the interest rate risk can also be done by comparing the realized interest rate in portfolio with the interest rate of a reference or comparative point. Reference points which the return on investment portfolio are compared with are EONIA (Average one-day interbank lending rate for Euro currency) and EURIBOR 1-month (Average interbank lending rate for Euro currency) and comparing with statistical indicator as a standard deviation of interest rates. Standard deviation in the interest rates for 2012 is 0.139% which means that the average interest rate may vary by +/-0.139%.

The average return rate from CBK portfolio assets is 0.144% and results in a lower return by 5 base points compared to EONIA reference point which for 2012 was 0.20%, and if we take EURIBOR 1-month as a reference point which was 0.326%, this represents a lower return by 18 base points. Figure 147 presents the portfolio distribution of short-term credit ratings (S&P).

Figure 147. Spread of portfolio by short term crediting rank (S&P)



Source: CBK (2013)

5.4.2.3 Liquidity Risk

Investments were mainly done in treasury bills and short-term bank deposits in relation to the CBK Investment Policy, which means that banks maintained the liquidity level for investment portfolio.

Liquidity risk is constantly being monitored during 2012 and there were no cases of fund insufficiency in satisfying payment needs of CBK depositors.

5.4.2.4 Operational Risk

This risk exists in all activities and may result in losses due to mistakes by staff or information technology system in the course of realization of investments. During 2012, there has been no case of introduction of such risk in the course of investment of financial assets.

5.4.3 Securities

5.4.3.3 Securities Market Operations

Pursuant to the Law on Public Debts No. 03/L-175, (Article 2, paragraph 1.1. and 1.2.), and Regulation on Primary and Secondary Market of Government Securities adopted by the Ministry of Finance and the Central Bank of the Republic of Kosovo, CBK acts as an agent of the Ministry of Finance to issue Securities. On 17 January 2012, the first auction was held to issue Securities of Government of the Republic of Kosovo and Treasury bills with maturity of 3 months on behalf of Government of the Republic of Kosovo. This auction recorded the beginning of functioning of primary market for issuing Securities of Government of the Republic of Kosovo. CBK hold during

2012 all auctions pursuant to the Schedule on Issue of Securities of Government of the Republic of Kosovo through electronic platform for Securities Trading. Pursuant to Regulation on Primary and Secondary Market of Government Securities, Section 1, paragraph 1.26 and Section 7, all auctions have to be realized through Commercial Banks operating as Primary Actors.

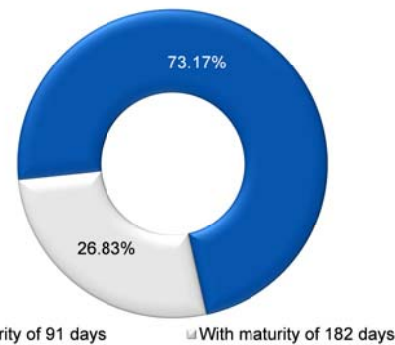
In addition to Primary Actors, participants in the market of Securities of Government of the Republic of Kosovo were also the other non-banking institutions and natural persons, who submitted their bids in auctions through Primary Actors, Pursuant to Regulation on Primary and Secondary Market of Government Securities; bids from participants were competitive and non-competitive. For competitive bids, participants bided the amount and annual return rate, whilst for non-competitive bids, participants bided only the amount and accepted the annual return rate as determined by successful competing bids.

Pursuant to the Schedule on Issue of Securities of Government of the Republic of Kosovo, fourteen auctions were held in 2012.

In twelve of these auctions, Securities with maturity of 91 days in the amount of euro 10 million were issued, while in the other two auctions were issued Securities with maturity of 182 days in the amount of euro 20 million in July 2012 and euro 24 million in September 2012. Figure 148 presents the structure of Government Securities by maturity.

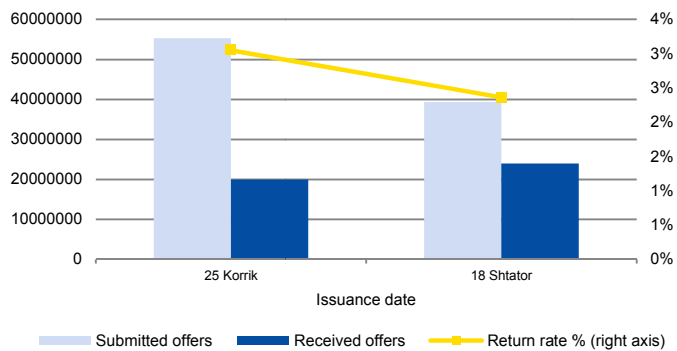
All auctions on Securities of Government of the Republic of Kosovo were successfully conducted and all Primary Actors participated and the amount bided for purchase of Securities has constantly exceeded the MoF issuing amount. As a result, the amount bided for 2012 was euro 407.8 million, being by 2.49 times higher than the amount required by Ministry of Finance (Treasury) of the Republic of Kosovo for auctions on Securities with maturity from 91 to 182 days. The highest demand for auctions on Securities with maturity of 91 days was in June 2012 where for the issued amount of euro 10 million, participants' bid was euro 35.75 million. The lowest demand for auctions on Securities with

Figure 148. Structure of government securities by maturity



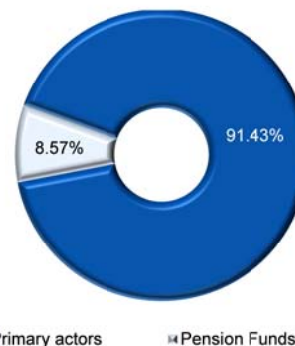
Source: CBK (2013)

Figure 149. Government securities auction with maturity of 182 days



Source: CBK (2013)

Figure 150. Share structure of allocated amounts



Source: CBK (2013)

maturity of 91 days was in October 2012 where for the issued amount of euro 10 million, the participants' bid was euro 14.65 million. Figure 150 present the structure of Government Securities with maturity of 91 days.

The demand for Government Securities with maturity of 182 days was euro 55.35 in July 2012 for issued amount of euro 20 million and euro 39.35 million in 2012.

Figure 149 shows the structure of Government Securities with maturity of 182 days. Participants to auctions, through Primary Actors, were also non-banking institutions, such as Kosovo Pension Savings Trust and Slovenian-Kosovo Pension Fund.

Kosovo Pension Savings Trust participated in the auctions held in July 2012 and September 2012, while Slovenian-Kosovo Pension Funds participated in the auction held in May 2012. Consequently, these two non-banking institutions comprised 8.57% of nominal value allocated to successful participants during 2012.

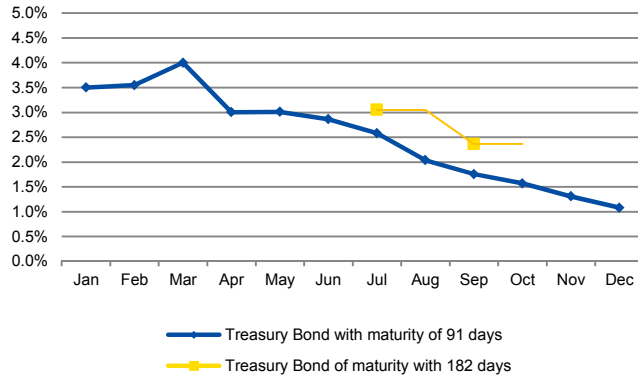
Figure 150 shows the structure of participants by allocated amounts. The annual return rate of Government Securities with maturity of 91 days recorded during 2012 a declining trend, starting with an annual return rate of 3.5% in January 2012 to 1.08% in reached in December 2012, which is a result of the request for participation in the market of securities of Government of the Republic of Kosovo.

The average annual return rate in all Securities auctions with maturity of 91 days was 2.52 percent. Regarding the issue of Securities with maturity of 91 days, the highest annual return rate was in March 2012 auction (4.0 percent), while the lowest annual return rate was in December 2012 auction (1.08 percent). Figure 151 shows the annual return rate movement on Government Securities. On the other hand, regarding the issue of Securities with maturity of 182 days, the annual return rate was 3.05 percent in July 2012 auction and 2.3-percent in September 2012 auction. The annual return rate for all Securities with maturity of 182 days was 2.71 percent.

Commencement of issuing Government Securities through auctions showed an added interest by Primary Actors to purchase them, where in all auctions held in 2012 bids submitted to purchase Government Securities were higher than the amount issued. Figure no. 152 shows all auctions held in 2012.

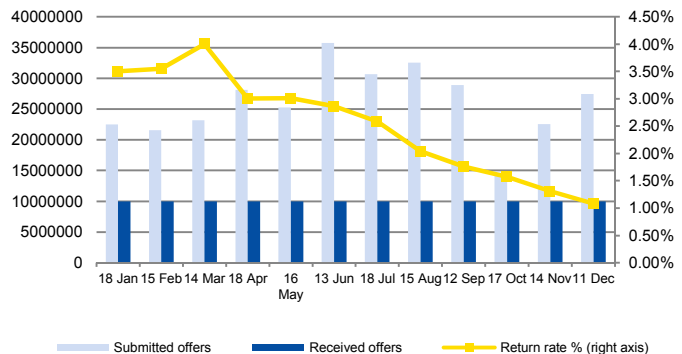
During 2012, CBK has also carried out all preparations needed for development of Secondary Market of Securities of the Republic of Kosovo. Trading in Securities is considered as an important factor to financial and fiscal sector in Kosovo.

Figure 151. Movement of government securities annual rate



Source: CBK (2013)

Figure 152. Government securities auction with maturity of 91 days



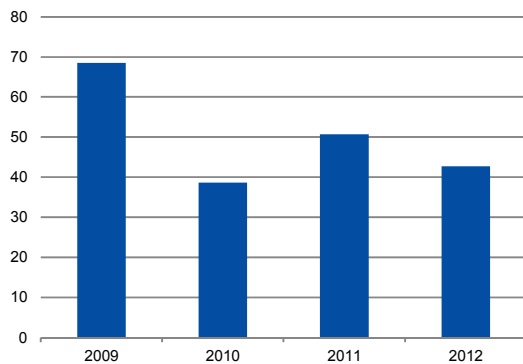
Source: CBK (2013)

This market promotes the efficiency in financial intermediation process and is considered as an important ground for capital market development in the country.

5.5. Credit Registry of Kosovo

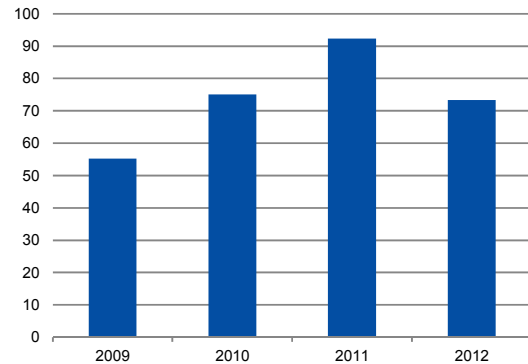
Supplying the lending and borrowing institutions with individual credit information through Credit Registry of Kosovo (CRK) system is an important function of Central Bank of the Republic of Kosovo (CBK).

Figure 153. Number of certificates



Source: CBK (2013)

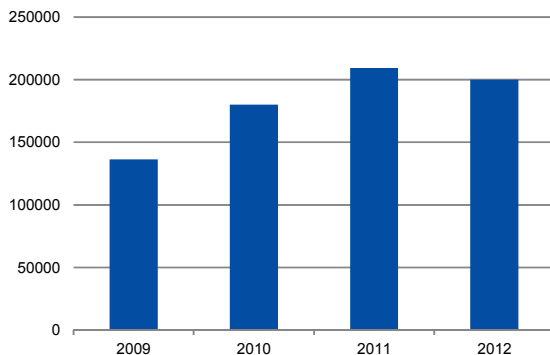
Figure 154. Number of surveys



Source: CBK (2013)

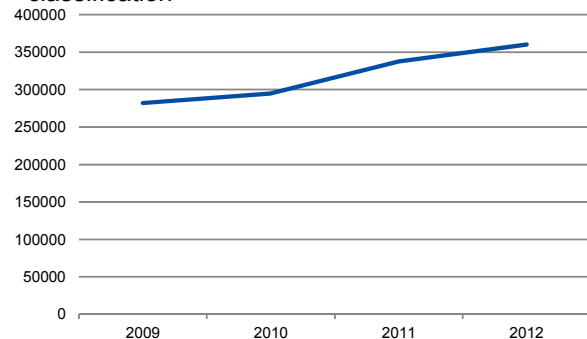
CRK is designed as an internet-based application which can be directly accessed in real time by financial institutions, which are members of CRK system.

Figure 155. Number of new loans



Source: CBK (2013)

Figure 156. Number of loans by standard classification



Source: CBK (2013)

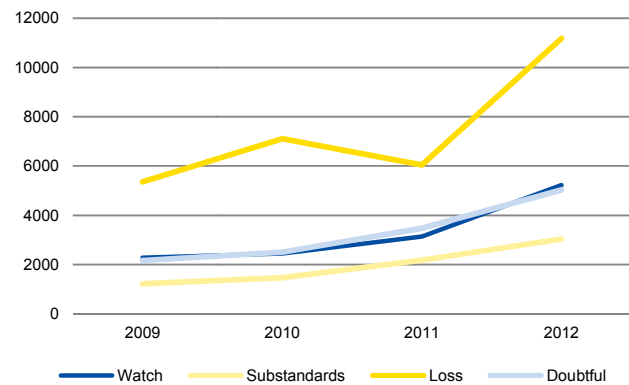
Pursuant to regulation on credit registry, system members are considered all financial institutions, designated by the Central Bank as providers of loans, including all licensed banks and microfinance institutions as well as those non-banking financial institutions and insurance companies licensed to engage in special credit activities. Member institutions duly authorize their officials to be user of CRK system. Currently, there are over 1300 active users in credit registry system, who are supplied with authorizing certificates by credit registry. During 2012, the credit registry generated 427 ne certificates as a consequence of requests submitted by member institutions. The number of certificates for 2009, 2010, 2011 and 2012 is presented in figure 155.

The credit registry system users, who are authorized by lending institutions, access the system in order to search the creditor applicants' liabilities and credit background. According to statistics deriving from the credit registry system, the number of searches during 2012 exceeded the figure of 700,000 searches.

An overview on this activity on annual basis, for 2009, 2010, 2011 and 2012 is resented in Figure 157.

Loans reported by member institutions to CRK system are classified based on Regulation on Credit Risk Management, which are reported to CRK system on monthly basis. All credit products approved and provided by lending institutions to credit applicants are reported to credit registry system.

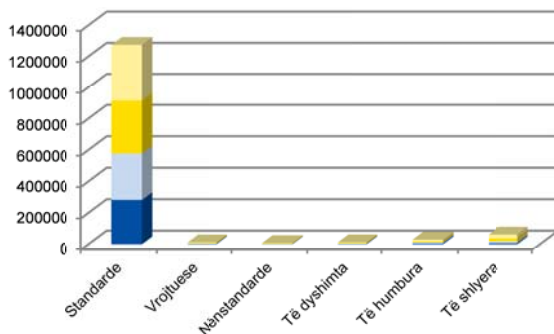
Figure 157. Number of observing loans



Source: CBK (2013)

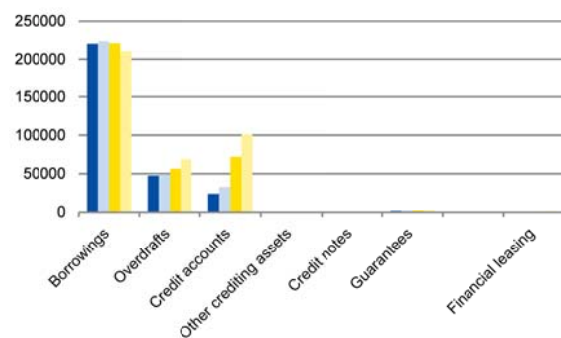
Entities of data provided to Credit Registry of Kosovo are natural and legal persons reported as borrowers. It is important to have all data related to borrowers' loans recorded because this impacts on lending institutions rendering fair decisions.

Figure 158. Number of active loans and classification



Source: CBK (2013)

Figure 159. Crediting products



Source: CBK (2013)

Pursuant to Regulation on Credit Registry and Law on Protection of Personal Data, with purpose of controlling the own information, any borrowers may receive his/her credit report. This is enabled by any banks or even directly from the Central Bank of Kosovo. The following figure presents reports received by borrowers for 2009; 2010; 2011 and 2012.

With the USAID support funded through BEEP three-year project on improvement of business environment in Kosovo, a component is concentrated on credit reporting and information, namely on credit registry. Based on identification of segments needed for advancement, it was worked on advancing the CRK credit registry system regulatory framework.

Thus, the Regulation of Credit Registry and the Instruction on Credit Registry were approved, the technical capacity building of CRK system was successfully implemented and it was developed and implemented the Credit Report.org portal, which enabled all natural and legal persons receive credit reports through internet.

In terms of supporting the human resources through trainings for CRK system member institutions, the Credit Registry Division (CRD) in cooperation with BEEP-USAID project held trainings to certify around 500 CRK system users.

Kosovo Credit Registry Division attended the Financial Fair 2012, organized by Banking Association, whereby it distributed information leaflets in relation to Credit Registry to participating persons and business entities.

With purpose of informing the wider public of Credit Registry and Credit Report, CRD prepared three information leaflets, namely on Credit Registry, Description of Credit Report and Credit Report through Internet. These leaflets are prepared in Albanian, Serbian and English. Their distribution was done throughout Kosovo to clients of financial institutions through the network of branches of Banks, Microfinance and Non-Banking Institutions.

A media campaign in TV, newspapers and portals was prepared with the support of USAID|BEEP to promote loan importance, which reached an audience around 380.000 persons.

In survey area, it is worthy to mention the second survey on Kosovo borrowers' over-indebtedness, initiated and implemented by EFSE in cooperation with Kosovo Credit Registry in nine lending institutions (five banks and four microfinance institutions). 2200 samples (cases-clients) were considered for two levels of loan heights, namely loans amounting from euro 10001 up to euro 25000 and loans amounting from euro 25001 up to euro 50000.

The survey results proved once again the importance and influence the CRK system has on protection of lending institutions as well as protection of borrowers from over-indebtedness.

Also in 2012, the credit registry contributed directly to the data collected by the World Bank (WB) for 2013 report. According to the report published by WB, the "getting credit" area during four years has constantly reflected and improvement, ranked at 23rd position in 2012 and marking the "getting credit" indicator as the most positive indicators among all the other indicators of "Doing Business 2013" report on the Republic of Kosovo.

Following up the developing trends (global and global) in credit reporting area is an integral part of works and activities performed within the Credit Registry Division. As a full member of Credit Reporting European Agency - ACCIS, the professional training and following up the developments in reporting and information credit segment was more effective, more concrete and in line with developments carried out pursuant to the best practices in this area.

5.6. Activity in Economic Analysis and Financial Stability Area

Financial Stability and Economic Analysis Department (FSEAD) kept playing during 2012 an important role in estimating economic developments in the country, with a particular emphasis on financial sector, enabling identification of possible fragilities and recommendation of preventive measures to ensure a financial stability in the country.

During this year, FSEAD kept advancing the quality of its periodical publications, enabling a clear picture of developments in the country' economy. The third edition of Financial Stability Report was published during this period, which besides providing a comprehensive analysis of situation in this sector, it also presented two materials of researching character: "Relation between Banking System Competition and Loan Loss Provisions" and "Identification of Banks having Systemic Importance in Kosovo". A progress was also achieved in drafting the Balance of Payments Report, which presents a detailed analysis of developments in Kosovo balance of payments and, furthermore, it also contains researching analyses treating different aspects of developments in the country's economy. The last edition of this report presented a researching article "Utilization of Producing Capacities in Western Balkans Countries: BEEPS 2009 based

Analysis 2009". Within the other publications, FSEAD continued to publish the quarterly assessment of economy which is an integral part of Monthly Statistical Bulletin, while preparations were done to have this analysis published as a separate material on quarterly basis as from 2013.

Among the other activities, a progress was marked in compilation of banking system "stress-test" in accordance with recommendations from a joint mission of the International Monetary Fund and the World Bank on Financial Stability Assessment Program (FSAP). FSEAD continued with publication of Early Warning Indicators on monthly basis, making progress towards timely identification of possible fragilities in the country's economy and especially in banking system. Also, compilation on regular basis of financial soundness indicators provided a good tool for assessment of banking system sustainability.

During 2012, FSEAD kept conducting the quarterly questionnaire with banks operating in Kosovo, which aims at providing a clearer picture relating to lending activity developments in the country, including developments related to bank standards on approval of loan request, amendment of credit rules and conditions, bank perceptions on change of factors impacting on loan demand. Results from this questionnaire served as important inputs on compilation of analyses related to banking system developments, including the Financial Stability Report.

A particular contribution by FSEAD was the organization of the first CBK international conference of researching character on "Competition against Risk Assumption in Central and Eastern Europe Countries", where in addition to participation of a number of Governors from Central Banks of the Region and wider area, presentation of researching materials were presented by economists from central banks of Kosovo, Austria, Turkey, Bulgaria, Poland, Croatia, Albania and Macedonia. Furthermore, the Deputy Head of Financial Assessment Division within the European Central Bank attended as a keynote speaker in one of researching sessions. During 2012, the FSEAD staff staged presentations of researching materials in other international conferences, including conferences organized by Bank of Albania and National Bank of Austria.

Another quite intensive area in terms of FSEAD activities was the engagement in the process related to European integration of Kosovo, where issues related to banking system developments have basically been covered. FSEAD staff has also been constantly engaged in public communication area, serving to the enhancement of transparency in financial sector developments and in country's economy in general.

5.7. Activities in Statistics Area

The CBK statistical function during 2012 was characterized by an expansion of published statistics range and further advancement in terms of quality and methods of financial and external sector statistics. Among the key achievements are included: publication of statistics on international investment position, external debt, as well as publication of statistics of non-banking institutions. During the last year, the software for external sectors statistics was developed (technically upgraded) as well. In international level, the CBK Statistics Department staff kept providing professional expertises to other countries within the International Monetary Fund.

Commencement of publication of statistics of international investment position (IIP), external debt (ED), coordinated direct investment survey (CDIS) and coordinated portfolio investment survey (CPIS) are considered to be the major statistical achievements in the area of external sector statistics during 2012. As from March 2012, it was preceded with publication of PIN

statistics with the International Monetary Fund (IMF).⁶⁰ In June 2012, Kosovo became part of IMF statistical project called CDIS and CPIS which has to do with publication of data on foreign direct investments and investments in securities.⁶¹

Year 2012 represents a (pilot) period of forwarding to Eurostat statistics of balance of payments (BP), services and foreign direct investments. This was done within the IPA project, the key objective of which is having Kosovo and the other Balkans countries harmonize the statistical methods in compliance with Eurostat requirements (in compliance with methods applied by the European Union countries). CBK is close to fulfilling these requirements and regular reporting to Eurostat is expected to start soon.

Publication of external sector statistics is done in compliance with the international statistical standards, especially those of International Monetary Fund, World Bank, Eurostat and other relevant institutions. As from 2012, the necessary steps are taken to proceed with implementation of new standards on compilation of external sector statistics pursuant to the new IMF Balance of Payments and International Investment Position Manual, 6th Edition - BPM6). Preparations are done to have the full implementation of this standard enforced during 2013, although the European Union countries will start its implementation in 2014.

In terms of coverage growth, and consequently of qualities produced by CBK, the latter entered cooperation agreements with different institutions, especially the agreement with Kosovo Customs and Kosovo Police needs to be specified.

Starting from January 2012, CBK extended the produced statistics range related to financial institutions. Statistical projects which have already been transformed into CBK statistical standards included microfinance institutions, institutions dealing with leasing and money transfer agencies. This refers to the Statistical Report on Microfinance Institutions, Report on Interest Rates of Microfinance Institutions and Report on Money Transfer Agencies. Production of these statistics implies their compilation in compliance with international statistical standards of International Monetary Fund, European Central Bank, Eurostat, etc.

Statistics on microfinance institutions and institutions dealing with leasing include: balance of payments, loans by institutional sectors, loans by industry, leasing, new loans issued, effective interest rates on loans and balance of success. On the other hand, statistics on money transfer agencies include: balance sheet, international transfers by countries, balance of success. Besides developments in banking industry, year 2012 was also characterized by further and constant advancement of quality of banking industry statistics.

With purpose of further advancement towards compilation and technical validation of statistics, during 2012 it was started with the technical upgrade of existing statistical software. This is about the software used for financial sector statistics since 2014 which already includes the data input, compilation, technical validation and issuance of reports on external sector statistics. This will serve as a considerable support and will increase the security in processing numbers considering the increasing volume of produced statistics against limited resources and short-term publication deadlines.

Regular, periodical and timely publication of statistics represents a peculiar feature of CBK Statistics Department. Despite the increase of the range of produced statistics in one hand and the same number of resources on the other hand, it was managed to have statistics published in accordance with deadlines specified in CBK webpage. Time Series and Monthly Statistical Bulletin (where December 2012 edition represents the 136th edition) represent the CBK key

⁶⁰The number of countries reporting on PID data is 133 (October 2012).

⁶¹For more details, see the IMF Press Release regarding CDIS, CPIS and securities:<http://www.imf.org/external/np/sec/pr/2012/pr12219.htm>; <http://elibrary-data.imf.org/NewsItem.aspx?id=111>; <http://www.imf.org/external/np/sec/pr/2012/pr12438.htm>

statistical publications. In addition, statistics produced by the CBK Statistics Department serve as key information to the other CBK publications, namely to Annual Report, Financial Stability Report and Balance of Payments Bulletin.

As from March 2012, CBK started with publication of statistics on *Quarterly External Debt Database* – (QEDS)⁶² opening a new page for the Republic of Kosovo in the World Bank. CBK is a country wide coordinator for General Data Dissemination System (GDDS) in IMF. Consequently, the National Summary Data Page published on IMF webpage which represents information designated to Kosovo. In the light of foregoing, it was continued with dissemination of existing periodical statistics on external financial sector⁶³ to the International Monetary Fund, World Bank, Eurostat and other important institutions.

As from May 2012, CBK is heading the Statistical Council of the Republic of Kosovo. Furthermore, the Director of CBK Statistics Department was appointed as the Head of Statistical Council, which functions pursuant to Law on Official Statistics of the Republic of Kosovo. A particular achievement in this direction is the adoption by Kosovo Assembly of the Official Statistics Program 2013 – 2017 which represents one of the key responsibilities of Statistical Council.

Also during 2012, the CBK staff kept providing professional expertises to central banks of other countries in the world. The Director of Statics Department and the Head of Balance of Payments Statistics Division have successfully performed three international missions, namely in Central Bank of Trinidad and Tobago (March and June 2012, respectively in Central Bank of Botswana (August 2012)).

6. Internal Developments

6.1. Internal Control

Head of Internal Audit

Duties and responsibilities as well as the authorities of the Head of Internal Audit (HIA) are defined and established under the Law on CBK No. 03/L-209 (Article 60 and 61).

Role and Objectives of Internal Audit

The CBK Internal Audit Department prepared the Audit Universe for the three-year period 2012-2014. The Annual Audit Plan was drawn and compiled from the Audit Universe, taking for granted the risk-based methodology, where the highest priority was given to audit universe areas, which when compiling the risk matrix were assessed against a higher risk. Also, the two following principles are taken for granted: maintenance of asset of Central Bank of the Republic of Kosovo and maintenance of reputation of Central Bank of the Republic of Kosovo.

As a ground for preparation of Annual Action Plan of Internal Audit Department were taken the IIA 2010 standards (planning) of the Institute of Internal Auditors, which guides the Internal Audit Department towards drafting a risk-based action plan and establishing priorities of activities to be carried out in line with the institution's objective and purpose. Pursuant to IIA 2020 standard (communication and approval) and the CBK Internal Audit Charter, the Head of

⁶²QEDS – is a database for countries which are members of SDDS and GDDS regarding external debt statistics. Currently, 118 countries from all around the world submit the data on external debt to QEDS database.

⁶³This refers to publications: International Financial Statistics, IMF Balance of Payments Statistical Yearbook, Financial Access Survey, and Global Financial Stability Report.

Internal Audit presented the Internal Audit Action Plan for 2012 to the Audit Committee. The Audit Committee approved the IAD Action Plan for 2012 and this Plan was then approved by the CBK Board.

The Internal Audit Action Plan for 2012 was implemented as originally planned by achieving to fulfil completely the recommendations deriving from the International Monetary Fund Report on Safeguards Assessment of CBK, where processes were monitored and systematic (comprehensive) planned audits were performed.

In addition to planned audits, the Internal Audit Department performed seven ad hoc audits at the request of CBK senior management.

As a follow up on Investment Portfolio in CBK Corresponding Banks, the Internal Audit during 2012 prepared 52 special reports on weekly basis for the period January-December 2012.

Based on Technical Memorandum of Understanding - 2012-13 SBA Arrangement with IMF, item 5, paragraph I of the Procedure "Independent Audit of Reconciliation of Government Account" was updated and the version 2.0 was compiled. The following ten (10) independent audits of stand-off of Government accounts were performed so far: two (2) independent audits for 2010 were performed on quarterly basis, four (4) independent audits were performed for 2011 and four (4) independent audits for 2012.

Pursuant to Law No. 03/l-209 on Central Bank of the Republic of Kosovo, Article 61 "Duties of the Head of Internal Audit", the Head of Internal Audit reported to the Audit Committee on monthly basis. These reports presented the work of internal auditors who have provided their independent and objective opinions in relation to risk management, effective governance and assessment in achieving the institution's objective based on IIA standards (independence and objectivity).

Follow-up on implementation of recommendations pursuant to IIA standard 2500 (progress monitoring), during 2012 was done on quarterly basis where it was prepared a special report on the status of recommendations. These quarterly reports are compiled in the summarized annual report January – December 2012, including all findings, recommendations, management comments and status of recommendations. This year there was a more detailed characterization of the status of recommendations, whereby five categories were defined and this resulted in a smoother and more accurate reporting in the course of follow-up of implementation of recommendations in associated reports.

Parallel to advancements made in Internal Audit Department, the Internal Audit Department during 2012 reviewed the Internal Audit Manual – edition 1.2. The Internal Audit Manual is a very important document and guide to the activity of Internal Audit.

Table 46. Determination of risk-based audit areas for the period 2009-2012

Department	Year			
	2009	2010	2011	2012
Information Technology	4.20%	10.00%	10.30%	21.80%
Assets Management	16.90%	11.00%	16.00%	14.80%
General Administration	18.70%	18.30%	22.20%	12.60%
Accounting	15.60%	9.90%	11.20%	9.60%
Human Resources	9.40%	8.80%	6.10%	7.30%
Financial Supervision		6.40%	5.00%	7.30%
Treasury	16.50%	17.80%	7.30%	6.50%

Source: CBK (2013)

Cooperation between the CBK Internal Audit Department and the Control Department of Bank of Albania also continued during 2012, whereby there has been a visit by CBK IAD to Tirana and a visit by BA Control Department to Prishtina. In addition to the visit, the internal auditors during 2012 had the opportunity to attend trainings in order to further extend their knowledge on internal audit.

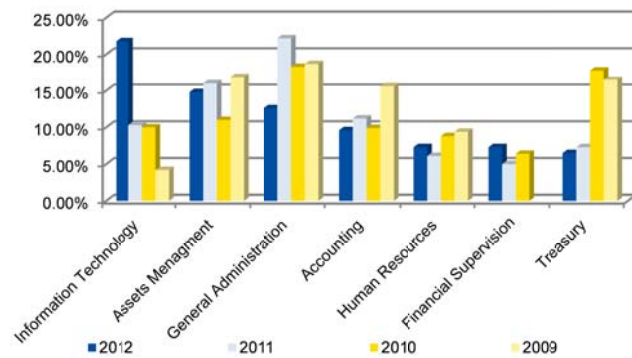
During 2012, preparations were done for implementation of software for the need of Internal Audit, which would assist in enhancing the internal auditors' performance quality in the course of data collection and analysis.

The key objectives of CBK's internal auditors were focussed on auditing the compliance with applicable laws and regulations (objective of legitimacy), auditing the presentation of full financial and managerial information (objective of information) and auditing the efficiency and effectiveness of the use of assets and other resources of Central Bank of the Republic of Kosovo (objective of business).

During 2012, it was prepared the Internal Audit Action Plan for 2013, which is concentrated on advancing the quality against quantity, thus decreasing the number of reports compared to the past year. However, the entire Audit Universe will be included, but in some departments it is planned to have systematic comprehensive audits.

Auditing identified areas by risk rage for the period 2008-2012 are presented in tabular form and in the following chart.

Figure 160. Definition of auditing fields based on the risk for 2009-2012



Source: CBK (2013)

6.2 Human Resources

In December 2012, the number of employees in Central Bank of the Republic of Kosovo was 180, which is by 2.2% higher than in the previous year. CBK is an employer of equal opportunities and correct, impartial, equal and on-discriminatory treatment during employment. Based on selection through external vacancies (15 vacancies), CBK filled in 11 (eleven) positions. On the other hand, there have been 11 internal vacancies, of which 10 positions were filled in.

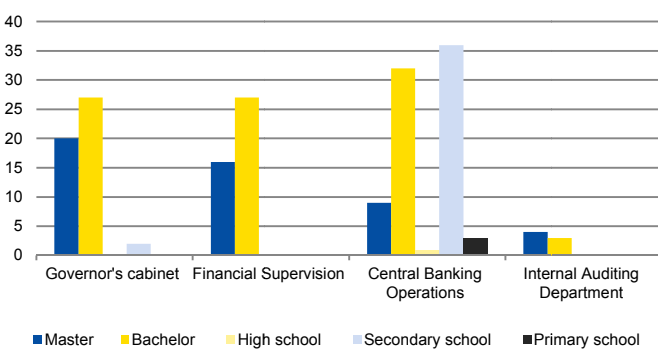
Out of the total number of employees (180), 88 are female and 92 male employees.

Regarding the overall qualification of CBK employees, 50% of them have university degree, 26% post-university degree, 21% secondary school degree, 1% high school degree and 2% with basic education.

Regarding the structure of managerial positions, male employees participate with 55%, while female employees with 45%.

The average age of employees by the end of December 2012 was around 40 years.

Figure 161. Educational structure of the CBK employees



Source: CBK (2013)

Central Bank of the Republic of Kosovo is constantly supporting its employees' education through courses, seminars, workshops, important conferences as well as academic programs relevant to the CBK with purpose of satisfying their performance requirements in line with the highest standards and fulfilment of CBK's objectives.

During 2012, 72 CBK employees participated in professional trainings supported by institutions as indicated below.

The majority of trainings during 2012, respectively 91% are attended by employees of the departments as indicated below

With purpose of fulfilling the CBK objectives and permanent development of Human Resources Division, in the end of 2012, the Human Resources Division was supported by the professional assistance funded by the World Bank.

CBK has also constantly supported students to carry out the practice, enabling them to make an interrelation between theoretical knowledge acquired during the studies and the practical work in independent public institutions.

In 2012, 20 students from universities/colleges both from the country and from abroad finalized an internship program in CBK

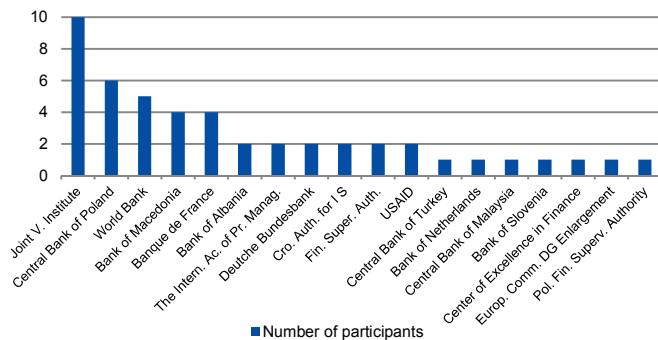
6.3. Legal Activity of Central Bank of the Republic of Kosovo during 2012

With view to achieving objectives and fulfilling relevant task during 2012, the legal activity of Central Bank of the Republic of Kosovo was focused on strengthening and implementing the financial sector legal framework through adoption of new laws and approval of secondary legislation. A significant progress was achieved towards finalization and enforcement of legal and regulatory framework on supervision and regulation of banks, microfinance and non-banking financial institutions, of payment system, pension funds, and deposit insurance, supplementing the legal and regulatory framework with purpose of compliance with new and existing legislation.

Furthermore, during 2012, the CBK legal framework was supplemented with the entry into force of laws covering different financial sectors. Thus, during this year, with purpose of further regulation of financial sector, Kosovo Assembly adopted the following laws: Law on Pension Funds in Kosovo, Law on Banks, Microfinance Institutions and Non-banking Financial Institutions, as well as the Law amending and supplementing the Law on Establishment of a Deposit Insurance System for Microfinance Institutions in Kosovo.

In the course of supplementation of the legal framework, in cooperation with technical assistance of World Bank experts, during this year it was drafted the Draft Law on Payment System, which draft law was forwarded to relevant authorities for adoption. The said draft law aims at establishing a legal framework necessary for a safe and sound functioning of the national payment system and the role and duties of Central Bank of the Republic of Kosovo in relation to licensing, regulation and supervision of payment and settlement systems in the Republic of Kosovo.

Figure 162. Organizers of trainings and the number of participants



Source: CBK (2013)

With purpose of advancing and completing the insurance infrastructure in Kosovo, it is drafted the Draft Law on General Insurances, which is under process of final review in the Central Bank. This draft law aims at advancing the supervision legal framework, regulation and licensing of insurers, reinsurers, insurance intermediaries and other entities as provided for by this law, so that the insurance industry in Kosovo could operate in a safe, sustainable and transparent way towards protection of policyholders' rights and interests. This draft law is drafted in compliance with international basic standards and principles of insurance supervision.

Also, during 2012, the legal activity resulted in amendment of securities regulatory framework, namely the Regulation on Primary and Secondary Market of Government Securities, as well the review of existing legal frameworks relating to consumer protection in cooperation with World Bank experts, with purpose of advancing the legal and regulatory framework, clients' financial education and awareness, strengthening of mechanism for handling appeals and clear rules of financial institutions, as well as strengthening the Central Bank role and mandate within relevant laws and provisions on consumer protection.

In the course of legal activity continuity, during this year there was also no lack of cooperation and technical assistance extended by International Monetary Fund and World Bank.

In general, the legal and regulatory framework of Central Bank of the Republic of Kosovo provides for a perfect ground to ensure financial stability and development of a sound financial system towards implementation of the best international standards and practices in financial area.

Therefore, with view to achieving its objectives and fulfilling its tasks, the Central Bank legal activity is constantly oriented towards the process of implementation of laws and sub-legal acts, warranting a legal, sound and contemporary legal framework duly revised and updated in compliance with standards and criteria required for advancement and stability in the area of regulation, supervision and development of financial system in Kosovo.

6.4. Information Technology

During 2012, the organizational chart of Information Management Department (IMD) was amended and reorganized with purpose of better separation of responsibilities, namely two units were established, Information Technology Unit and Business Continuity and Information Security Unit.

A very important project was also the advancement of e-mail into a rather safe and flexible system which provides for more flexibility and better collaboration between CBK employees.

It is also important to mention the functionality of Securities system to business continuity which is located in another location different from CBK premises.

In the course of further advancement of systems, the basic information system was reorganized into a safer and powerful system.

Another very important project is also the complete redesigning of credit registry, starting with software and the way of communication between participants and system which generates data and which is located at CBK.

In the area of Information Security, IMD during 2012 revised the Information Security Rule, by also approving the Information Security Manual. Thus, a ground was established for further developments regarding the maintenance of information security at appropriate level. Also, in the area of Business Continuity, IMD during 2012 revised the Business Continuity Rule as well as the Business Continuity Plan. A project for functionality of CBK Business Continuity Centre also started to be implemented. During 2012, besides the security of funds, an interest was

announced on the consultant that will prepare the architectonic plan of the building which will serve as CBK Business Continuity Centre.

7. Regional and International Cooperation

7.1. International Agreements, Promotion and Representation

CBK continued its close cooperation with important international institutions, including International Monetary Fund and World Bank with view to strengthening the overall supervising activities in order to respond by flexibility to effects deriving from developments of recent years in global financial markets.

Thus, one of the internationally important events during 2012 worth mentioning is the visit of the Financial Sector Assessment Program (FSAP). FSAP as a joint responsibility of the International Monetary Fund and World Bank aimed at the assessment of the two key components: the financial satiability (financial sector soundness and security, and the financial development (legal framework quality). This program introduced a profound comprehensible analysis of banking sector. Parallel to examination of financial sector stability, this assessment is also focused on developing aspects of this sector considering the individual specifics of our country. During this assessment, the focus was, among the others, laid on the stress-test area and the macro-prudential framework on banking system, prevention of financial instability, security of deposits, access to funding and a technical assessment on insurance system in the country. Results of this assessment will significantly contribute towards further assessment of our country's financial sector.

Mission assessments, suggestions and recommendations were quite valuable and welcomed to CBK, and they have therefore been incorporated into the CBK 2013 – 2015 Strategic Plan, then these actions have become operational through a concrete action plan with purpose of adapting and strengthening the legal framework pursuant to required international standards and in compliance with the country's environment.

A very successful cooperation in the area of supervising information exchange was realized with institutions which CBK concluded cooperation agreements with. Such important cooperation during 2012, was realized between CBK and Financial Supervising Authority (FMA) in Austria on quarterly basis, between CBK and Bank of Slovenia, CBK and Regulatory and Supervising Authority of Turkey (BRSA).

7.2. Technical Assistance

CBK kept benefiting from the technical assistance provided by international financial institutions and different donors both to exiting projects and through new initiatives. During 2012, it was preceded with implementation of the *Technical Assistance to Financial Sector* project funded by the World Band (International Development Agency - IDA). This project aided in advancing the legal frameworks and its approximation to European directives and international standards as well as in internal capacity building for a more effective supervision of banking sector in Kosovo. Also, the *Strengthening of Financial Sector and Market Infrastructure* project funded by the loan agreed between the Government of the Republic of Kosovo and the International Development Agency (IDA) keeps being implemented according to the forecasted dynamics. The particular focus of this project is: (i) funding the cost related to implementation of the CBK Strategy on National Payment System Development and establishment of a system on

Stand-off of Real Time Payment based on the National Payment System Strategy, (ii) Construction of Business Continuity Centre for CBK to ensure the business continuity in case of disasters (from uncontrolled factors) with purpose of recuperation of information technology operations which warrants that the data are updated from all CBK critical systems, and (iii) Provision of funding of initial capital for Deposit Insurance Fund of Kosovo (DIFK) with purpose of collecting a reserve in form initial capital.

CBK considers consumer protection as an essential element for building and maintaining an efficient, competitive and fair financial sector; therefore, with purpose of advancing this function, in November 2012, this was subject to Diagnostic Assessment of Consumer Protection and Financial Education. The assessment was focused on banking system, insurance industry and microfinance institutions. This assessment includes the following areas: 1) laws, regulations and practices, 2) transparency and disclosure of information, 3) appeal and contest resolution mechanisms, 4) consumer awareness and education. Implementation of the action plan resulting from this assessment will aid to a greater advancement of financial sector consumer rights in order to have at their availability clear, full, accurate and comprehensive information on all their roles as users of financial services, including extension of financial education in cooperation with relevant local and international institutions. The above-mentioned projects will contribute to further deepening of effective and efficient inter-institutional cooperation.

8. Financial Statements of CBK



Central Bank of the Republic of Kosovo
Independent Auditors' Report and Financial Statements
as at and for the year ended 31 December 2012

Central Bank of the Republic of Kosovo

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Independent auditors' report

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To the Governing Board of the
Central Bank of the Republic of Kosovo

We have audited the accompanying financial statements of Central Bank of the Republic of Kosovo ("the Bank"), which comprise the statement of financial position as at 31 December 2012, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2012, and of its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards.

Grant Thornton LLC
Grant Thornton LLC

Prishtina, Kosova
10 May 2013

Central Bank of the Republic of Kosovo


Statement of comprehensive income

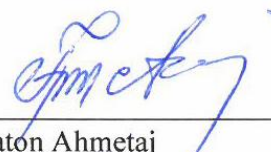
As at 31 December

<i>In thousands of EUR</i>	Note	2012	2011
Assets			
Cash on hand	7	16,761	13,456
Current accounts with non-resident banks	8	99,549	31,513
Treasury bills	9	285,983	24,988
Deposit accounts with non-resident banks	10	821,590	1,009,046
Assets related with IMF	11	245,401	155,687
Property and equipment	12	1,450	1,576
Intangible assets	13	1,425	1,506
Other assets	14	462	446
Total assets		1,472,621	1,238,218
Liabilities			
Due to domestic banks	15	302,147	209,700
Due to IMF related accounts	16	246,890	156,509
Due to governmental institutions	17	821,509	782,178
Due to public and commercial entities	18	49,023	37,059
Other domestic liabilities	19	3,289	3,337
Total liabilities		1,422,858	1,188,783
Capital and reserves			
Statutory fund	20	30,000	30,000
Reserve fund	21	19,435	17,980
Retained Earnings		328	1,455
Total capital and reserves		49,763	49,435
Total liabilities, capital and reserves		1,472,621	1,238,218

The notes from 1 to 32 are an integral part of these financial statements

These financial statements were approved by the management of CBK on 10 May 2013 and signed on its behalf by:


Bedri Hamza
Governor


Faton Ahmetaj
Director of Financial Planning and Reporting

Central Bank of the Republic of Kosovo

Statement of comprehensive income

For the year ended 31 December 2012

<i>In thousands of EUR</i>	Note	2012	2011
Interest income		2,786	10,079
Interest expense		(1,770)	(7,585)
Net interest income	22	1,016	2,494
Fee and commission income		1,914	2,651
Fee and commission expense		(388)	(290)
Net fee and commission income	23	1,526	2,361
Grant revenue	24	55	44
Other operating income	25	1,729	1,620
Foreign exchange net gain/(loss)	28	32	(1,139)
Operating income		4,358	5,380
Personnel expenses	26	(2,566)	(2,249)
Depreciation and amortization	12,13	(482)	(625)
General and administrative expenses	27	(982)	(1,051)
Operating expenses		(4,030)	(3,925)
Profit for the year		328	1,455
Other comprehensive income			
Total comprehensive income for the year		328	1,455

The notes from 1 to 32 are an integral part of these financial statements

Central Bank of the Republic of Kosovo

Statement of changes in equity

As at 31 December

<i>In thousands of euro</i>	Statutory fund	Reserve fund	Retained Earnings	Total
Balance at 1 January 2012	30,000	17,980	1,455	49,435
Transfer to reserve fund	-	1,455	(1,455)	-
Total transactions required by law	-	1,455	(1,455)	-
Profit for the year	-	-	328	328
Other comprehensive income	-	-	-	-
Total comprehensive income for the year	-	-	328	328
Balance at 31 December 2012	30,000	19,435	328	49,763
Balance at 1 January 2011	30,000	14,923	3,057	47,980
Transfer to reserve fund	-	3,057	(3,057)	-
Total transactions required by law	-	3,057	(3,057)	-
Profit for the year	-	-	1,455	1,455
Other comprehensive income	-	-	-	-
Total comprehensive income for the year	-	-	1,455	1,455
Balance at 31 December 2011	30,000	17,980	1,455	49,435

The notes from 1 to 32 are an integral part of these financial statements

Central Bank of the Republic of Kosovo

Statement of cash flows

For the year ended 31 December 2012

<i>In thousands of EUR</i>	Note	2012	2011
Cash flows from operating activities			
Profit for the year		328	1,455
<i>Adjustments for:</i>			
Depreciation	12	300	484
Amortization	13	182	141
Grant revenue	24	(55)	(44)
Gain on sale of equipment		(13)	-
Interest income	22	(2,786)	(10,079)
Interest expense	22	1,770	7,585
		(274)	(458)
Change in treasury bills		(221,043)	104,122
Change in deposit accounts with nonresident banks		(508)	(40,989)
Change in assets with IMF		(89,571)	(1,112)
Change in other assets		(17)	30
Change in due to domestic banks		92,447	6,128
Change in due to IMF related accounts		90,240	2,678
Change in due to governmental institutions		40,683	(17,212)
Change in due to public and commercial entities		11,965	(6,170)
Change in other domestic liabilities		(44)	77
		(76,122)	47,094
Interest received		4,319	9,147
Interest paid		(2,979)	(6,895)
Net cash (used in)/generated from operating activities		(74,782)	49,346
Cash flows from investing activities			
Proceeds from sale of equipment		13	-
Purchase of equipment	12	(174)	(334)
Purchase of intangible assets	13	(101)	(738)
Net cash used in investing activities		(262)	(1,072)
Cash flows from financing activities			
Proceeds from grants		50	634
Net cash generated from financing activities		50	634
Net (decrease)/increase in cash and cash equivalents		(74,994)	48,908
Effect of exchange rate		-	-
Cash and cash equivalents at 1 January		772,213	723,305
Cash and cash equivalents at 31 December	29	697,219	772,213

The notes from 1 to 32 are an integral part of these financial statements

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

1. Reporting entity

The Central Bank of the Republic of Kosovo (hereinafter "CBK" or "the Bank"), the successor to the Central Banking Authority of Kosovo, is an independent juridical entity with full capacity as a legal person under the law applicable in the Republic of Kosovo. CBK is a distinct public entity with the authority to license, supervise and regulate financial institutions in the Republic of Kosovo. The Bank acts in accordance with Law No.03/L-209 "Law on Central Bank of the Republic of Kosovo", hereafter referred to as ("the CBK Law"). As per this law, the principal objectives of CBK are to:

- foster and maintain a stable financial system, including a safe, sound and efficient payment system.
- contribute to achieving and maintaining domestic price stability.
- support the general economic policies of the Government.

As prescribed in the Law, CBK shall act in accordance with the principles of an open market economy with free competition, favoring an efficient allocation of resources.

CBK operates from its premises located in Pristina. The address of the registered office of CBK is as follows:

33 Garibaldi Street

Pristina, Kosovo.

Central Bank Board, Executive Board and Governor

The decision-making bodies of CBK are the Central Bank Board, the Executive Board, and the Governor. As per Article 79, paragraph 2 of the CBK Law, the Central Bank Board comprises of the Governor, the General Director of Treasury and three non-executive members and is charged with the supervision of the implementation of the policies, and the supervision of the administration and the operations of CBK.

As at 31 December 2012, the Central Bank Board of CBK comprised the following members:

- Sejdi Rexhepi – Chairman
- Gani Gerguri – Governor
- Fatmir Plakiqi – Member, Director of Treasury of Ministry of Finance
- Mejdi Bektashi – Member

The Executive Board shall comprise the Governor, who shall be the Chairperson, and two Deputy Governors, and shall be charged with the implementation of the CBK's policies and its operations.

2. Basis of preparation

a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

b) Basis of measurement

The financial statements have been prepared using the measurement bases specified by IFRS for each type of asset, liability, income and expense. The measurement bases are more fully described in the accounting policies in note 3 below.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

2. Basis of preparation (continued)

c) Functional and presentation currency

These financial statements are presented in Euro (“EUR”), which is CBK’s functional currency. Except as indicated, financial information presented in Euro has been rounded to the nearest thousand.

d) Use of estimates and judgments

The preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected. In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are described in note 5.

The accounting policies set out below have been applied consistently to all the periods presented in these financial statements.

3. Significant accounting policies

a) Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between the amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss.

b) Interest

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

3. Significant accounting policies (continued)

b) Interest (continued)

The calculation of the effective interest rate includes all fees and points paid or received transaction costs, and discounts or premiums that are an integral part of the effective interest rate.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Interest income and expense presented in the profit or loss includes interest on financial assets and liabilities at amortised cost on an effective interest rate basis.

c) Fees and commission

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including transaction fees for operating accounts, fund transfers and licensing fees are recognized as the related services are performed.

Other fees and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received.

d) Employee benefits

CBK makes compulsory social security contributions that provide pension benefits for employees upon retirement. These contributions are classified under defined contribution plans based on Kosovo legislation. CBK's contributions are charged to profit or loss as incurred.

CBK makes pension contributions as permitted by the Kosovo law, whereby the State provides pension benefits for employees upon retirement. CBK's contributions to the pension plan are charged to profit or loss as incurred.

e) Taxation and profit allocation

CBK is exempt from income tax according to Law No. 03/L-209 issued on 22 July 2010. See note 4 (f) on how CBK allocates its profit.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

3. Significant accounting policies (continued)

f) Financial assets and liabilities

The Bank classifies its investments into the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity financial assets and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this at every reporting date.

Financial assets at fair value through profit and loss

This category has two sub-categories: financial assets held for trading and those designated at fair value through profit or loss at inception. A financial asset is classified into the “financial assets at fair value through profit or loss category at inception if acquired principally for the purpose of selling in the short term, if it forms part of a portfolio of financial assets in which there is evidence of short term profit-taking, or if so designated by management.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that the Bank intends to sell in the short term or that it has designated as at fair value through profit or loss or available for sale. Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of loans and receivables is established when there is objective evidence that the Bank will not be able to collect all amounts due according to their original terms. The bank has no assets classified in this category.

Held-to-maturity financial assets

Held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and fixed maturities other than those that meet the definition of loans and receivables that the Bank’s management has the positive intention and ability to hold to maturity. These assets are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of debt securities held to maturity is established when there is objective evidence that the Bank will not be able to collect all amounts due according to their original terms.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. The Bank has no assets classified in this category.

i. Recognition

CBK initially recognizes deposits on the date they originate. All other financial assets and liabilities are initially recognized on the trade date at which CBK becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

3. Significant accounting policies (continued)

f) Financial assets and liabilities (continued)

ii. Derecognition

CBK derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by CBK is recognized as a separate asset or liability. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in other comprehensive income is recognized in profit or loss.

CBK derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

iii. Offsetting

Financial assets and liabilities are offset and the net amount is presented in the statement of financial position when, and only when, CBK has a legal right to set off the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions.

iv. Amortized cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

v. Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, CBK measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, CBK establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to CBK, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. CBK calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

3. Significant accounting policies (continued)

f) Financial assets and liabilities (continued)

vi. Identification and measurement of impairment

At each reporting date CBK assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a placement or advance by CBK on terms that CBK would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in CBK, or economic conditions that correlate with defaults in CBK.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest on the impaired asset if applicable, continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

g) Cash and cash equivalents

For the purpose of cash flow statement, cash and cash equivalents include cash balance on hand, demand deposits with banks and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by CBK in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

h) Investment securities

Investment securities, consisting of Treasury Bills, are initially measured at fair value plus incremental direct transaction costs and subsequently accounted for as held-to-maturity investment.

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that CBK has the positive intent and ability to hold to maturity, and which are not designated at fair value through profit or loss. Held-to-maturity investments include treasury bills.

Held-to-maturity investments are carried at amortised cost using the effective interest method. Any sale or reclassification of a significant amount of held-to-maturity investments not close to their maturity would result in the reclassification of all held-to-maturity investments as available-for-sale, and prevent CBK from classifying investment securities as held-to-maturity for the current and the following two financial years.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

3. Significant accounting policies (continued)

i) Property and equipment

i. Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located.

Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

ii. Subsequent costs

The cost of replacing part of an item of property or equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to CBK and its cost can be measured reliably. The costs of the day-to-day servicing of property and equipment are recognised in profit and loss as incurred.

iii. Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment.

The estimated useful lives for the current and comparative periods are as follows:

	2012	2011
Leasehold improvements	20 years	20 years
Equipment	5 years	5 years
Computers	3 years	3 years
Vehicles	5 years	5 years

The other equipment useful life is assessed on case by case basis. Depreciation methods, useful lives and residual values are reassessed at the reporting date.

j) Intangible assets

Software acquired by CBK is stated at cost less accumulated amortisation and accumulated impairment losses.

Subsequent expenditure on software is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of the software, from the date that it is available for use. The estimate useful life of each software is based on assessment of the use of that software without any large need of upgrade, currently from 3 to 10 years.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

3. Significant accounting policies (continued)

k) Impairment of non-financial assets

The carrying amounts of CBK's non-financial assets are reviewed at each reporting date whenever there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses in respect of cash-generating units are allocated to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

l) Financial liabilities

CBK's sources of funding are from international, governmental, public, banking and other financial institutions. Financial liabilities are measured at their amortised cost using the effective interest rate method.

m) Grant revenue

Government grants are recognised initially as deferred income when there is reasonable assurance that they will be received and that CBK will comply with the conditions associated with the grant. Grants that compensate CBK for expenses incurred are recognised in profit or loss on a systematic basis in the same periods in which the expenses are recognised. Grants that compensate CBK for the cost of an asset are recognised in profit or loss on a systematic basis over the useful life of the asset.

n) Donor financed salaries

Certain individuals engaged at CBK are international experts appointed and funded for a short term by international organisations. The funding from these international organisations includes, but it is not limited to, the payment of salaries to these international experts. As this assistance is paid by the international organisations directly to the appointee, the extent of the payments are not known nor are they included in these financial statements.

o) Provisions

A provision is recognised if, as a result of a past event, CBK has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for onerous contracts is recognised when the expected benefits to be derived by CBK from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, CBK recognises any impairment loss on the assets associated with that contract.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

3. Significant accounting policies (continued)

p) Changes in accounting policies and disclosures

(i) Adoption of 'Presentation of Items of Other Comprehensive Income' (Amendments to IAS 1)

The Bank has adopted 'Presentation of Items of Other Comprehensive Income' (Amendments to IAS 1). The Amendments to IAS 1 are effective for annual periods beginning on or after 1 July 2012 and require entities to separate items presented in other comprehensive income (OCI) into those that, in accordance with other IFRSs, will not be reclassified subsequently to profit or loss and those that will be reclassified subsequently to profit or loss when specific conditions are met. The existing option to present items of OCI either before tax or net of tax remains unchanged; however, if the items are presented before tax, then the Amendments to IAS 1 require the tax related to each of the two groups of OCI to be shown separately.

(ii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Bank

At the date of authorisation of these financial statements, certain new standards, amendments and interpretations to existing standards have been published by the IASB but are not yet effective, and have not been adopted early by the Bank (except for the Amendments to IAS 1 noted above).

Management anticipates that all of the relevant pronouncements will be adopted in the Bank's accounting policies for the first period beginning after the effective date of the pronouncement. Information on new standards, amendments and interpretations that are expected to be relevant to the Bank's financial statements is provided below. Certain other new standards and interpretations have been issued but are not expected to have a material impact on the Bank's financial statements.

IFRS 9 Financial Instruments (IFRS 9)

The IASB aims to replace IAS 39 'Financial Instruments: Recognition and Measurement' (IAS 39) in its entirety with IFRS 9. To date, the chapters dealing with recognition, classification, measurement and derecognition of financial assets and liabilities have been issued. These chapters are effective for annual periods beginning on or after 1 January 2015. Chapters dealing with impairment methodology and hedge accounting are still being developed. Further, in November 2011, the IASB tentatively decided to consider making limited modifications to IFRS 9's financial asset classification model to address application issues. The Bank's management have yet to assess the impact of this new standard on the Bank's financial statements. However, Management does not expect to implement IFRS 9 until all of its chapters have been published and they can comprehensively assess the impact of all changes.

Consolidation Standards

A package of new consolidation standards is effective for annual periods beginning or after 1 January 2013. Information on these new standards is presented below. Management has not yet completed its assessment of the impact of these new and revised standards on the Bank's financial statements.

IFRS 10 'Consolidated Financial Statements' (IFRS 10)

IFRS 10 supersedes IAS 27 'Consolidated and Separate Financial Statements' (IAS 27) and SIC 12 'Consolidation – Special Purpose Entities'. IFRS 10 revises the definition of control and provides extensive new guidance on its application. These new requirements have the potential to affect which of the Group's investees are considered to be subsidiaries and therefore change the scope of consolidation.

However, the requirements on consolidation procedures, accounting for changes in non-controlling interests and accounting for loss of control of a subsidiary remain the same.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

3. Significant accounting policies (continued)

p) Changes in accounting policies and disclosures (continued)

(iii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Bank (continued)

IFRS 11 'Joint Arrangements' (IFRS 11)

IFRS 11 supersedes IAS 31 'Interests in Joint Ventures' (IAS 31). It aligns more closely the accounting by the investors with their rights and obligations relating to the joint arrangement. In addition, IAS 31's option of using proportionate consolidation for joint ventures has been eliminated. IFRS 11 now requires the use of the equity accounting method, which is currently used for investments in associates.

IFRS 12 'Disclosure of Interests in Other Entities' (IFRS 12)

IFRS 12 integrates and makes consistent the disclosure requirements for various types of investments, including unconsolidated structured entities. It introduces new disclosure requirements about the risks to which an entity is exposed from its involvement with structured entities.

Transition guidance for IFRS 10, 11, 12

Subsequent to issuing the new standards the IASB made some changes to the transitional provisions in IFRS 10, IFRS 11 and IFRS 12. The guidance confirms that the entity is not required to apply IFRS 10 retrospectively in certain circumstances and clarifies the requirements to present adjusted comparatives. The guidance also makes changes to IFRS 11 and IFRS 12 which provide similar relief from the presentation or adjustment of comparative information for periods prior to the immediately preceding period. Further, it provides additional relief by removing the requirement to present comparatives for the disclosures relating to unconsolidated structured entities for any period before the first annual period for which IFRS 12 is applied. The new guidance is also effective for annual periods on or after 1 January 2013.

Consequential amendments to IAS 27 'Separate Financial Statements' (IAS 27) and IAS 28 'Investments in Associates and Joint Ventures' (IAS 28). IAS 27 now only addresses separate financial statements. IAS 28 brings investments in joint ventures into its scope. However, IAS 28's equity accounting methodology remains unchanged.

IFRS 13 'Fair Value Measurement' (IFRS 13)

IFRS 13 clarifies the definition of fair value and provides related guidance and enhanced disclosures about fair value measurements. It does not affect which items are required to be fair-valued. IFRS 13 applies prospectively for annual periods beginning on or after 1 January 2013.

Management is in the process of reviewing its valuation methodologies for conformity with the new requirements and has yet to complete its assessment of their impact on the Bank's financial statements.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

3. Significant accounting policies (continued)

p) Changes in accounting policies and disclosures (continued)

(iii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Bank (continued)

Amendments to IAS 19 ‘Employee Benefits’ (IAS 19 Amendments)

The IAS 19 Amendments include a number of targeted improvements throughout the Standard. The main changes relate to defined benefit plans.

They:

- eliminate the ‘corridor method’, requiring entities to recognise all actuarial gains and losses arising in the reporting period,
- changes the measurement and presentation of certain components of defined benefit cost,
- enhance the disclosure requirements, including information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in them.

The IAS 19 Amendments are effective for annual periods beginning on or after 1 January 2013 and will apply retrospectively.

Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)

The Amendments to IAS 32 add application guidance to address inconsistencies in applying IAS 32’s criteria for offsetting financial assets and financial liabilities in the following two areas:

- the meaning of ‘currently has a legally enforceable right of set-off’
- that some gross settlement systems may be considered equivalent to net settlement.

The Amendments are effective for annual periods beginning on or after 1 January 2014 and are required to be applied retrospectively. Management does not anticipate a material impact on the Bank’s financial statements from these Amendments.

Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)

Qualitative and quantitative disclosures have been added to IFRS 7 ‘Financial Instruments: Disclosures’ (IFRS 7) relating to gross and net amounts of recognised financial instruments that are (a) set off in the statement of financial position and (b) subject to enforceable master netting arrangements and similar agreements, even if not set off in the statement of financial position. The Amendments are effective for annual reporting periods beginning on or after 1 January 2013 and interim periods within those annual periods. The required disclosures should be provided retrospectively. Management does not anticipate a material impact on the Bank’s financial statements from these Amendments.

Annual Improvements 2009-2011 (the Annual Improvements)

The Annual Improvements 2009-2011 (the Annual Improvements) made several minor amendments to a number of IFRSs. The amendments relevant to the Bank are summarised below:

Clarification of the requirements for opening statement of financial position:

- clarifies that the appropriate date for the opening statement of financial position is the beginning of the preceding period (related notes are no longer required to be presented)
- addresses comparative requirements for the opening statement of financial position when an entity changes accounting policies or makes retrospective restatements or reclassifications, in accordance with IAS 8.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

3. Significant accounting policies (continued)

p) Changes in accounting policies and disclosures (continued)

(iii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Bank (continued)

Clarification of the requirements for comparative information provided beyond minimum requirements:

- clarifies that additional financial statement information need not be presented in the form of a complete set of financial statements for periods beyond the minimum requirements,
- requires that any additional information presented should be presented in accordance with IFRS and the entity should present comparative information in the related notes for that additional information.

Tax effect of distribution to holders of equity instruments:

- addresses a perceived inconsistency between IAS 12 'Income Taxes' (IAS 12) and IAS 32 'Financial Instruments: Presentation' (IAS 32) with regards to recognising the consequences of income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction;
- clarifies that the intention of IAS 32 is to follow the requirements in IAS 12 for accounting for income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction.

Segment information for total assets and liabilities:

- clarifies that the total assets and liabilities for a particular reportable segment are required to be disclosed if, and only if: (i) a measure of total assets or of total liabilities (or both) is regularly provided to the chief operating decision maker; (ii) there has been a material change from those measures disclosed in the last annual financial statements for that reportable segment.

The Annual Improvements noted above are effective for annual periods beginning on or after 1 January 2013. Management does not anticipate a material impact on the Bank's financial statements from these Amendments.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

4. Financial risk management

a) Introduction and overview

CBK has exposure to the following risks from its use of financial instruments:

- Credit risk
- Operational risk
- Liquidity risk
- Market risk

This note presents information about CBK's exposure to each of the above risks, CBK's objectives, policies and processes for measuring and managing risk and CBK's management of capital. Further qualitative and quantitative disclosures are included throughout these financial statements.

Risk management framework

The Central Bank Board has overall responsibility for the establishment and oversight of CBK's risk management framework. CBK management reports regularly through CBK's Executive Board to the Central Bank Board on risk management practices. The Executive Board and Investment Committee have obligations for developing and monitoring CBK risk management policies. These policies are implemented by the respective organisational units.

CBK's risk management policies are established to identify and analyze the risks faced by CBK, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. CBK, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

CBK's Audit Committee is responsible for review and monitoring compliance with CBK's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by CBK. CBK's Audit Committee is assisted in these functions by the Internal Audit Directorate. Internal audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported through the chief Internal Audit to the Audit Committee.

b) Credit risk

Credit risk is the risk of financial loss to CBK if a counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from CBK's investments in debt securities and deposits (in money markets or current account) in other banks.

Management of credit risk

i. Investments and exposure to other banks

CBK limits its exposure to credit risk by investing only in debt securities issued by the governments of EU countries and having deposits with foreign banks whose short term liabilities are rated in one of the two highest categories by internationally recognized credit rating agencies. Given the high credit ratings, management does not expect any counterparty to fail to meet its obligations.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

4. Financial risk management (continued)

Management of credit risk (continued)

ii. Exposure to credit risk

The maximum exposure to credit risk as at 31 December 2012 and 31 December 2011 is presented by the carrying amount of its: current accounts with non-resident banks, treasury bills and money market placements with non-resident banks. For details on the exposures please see Notes 8, 9 and 10.

None of CBK's exposures are past due or impaired. There are no changes in the credit risk management policies from previous years. CBK does not hold any collateral or other credit enhancements against its exposure to credit risk.

c) Liquidity risk

Liquidity risk is the risk that CBK will encounter difficulty in meeting obligations from its financial liabilities.

Management of liquidity risk

CBK's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to CBK's reputation.

Policies to monitor and address liquidity risk are set by the Bank Executive Board. CBK manages its liquidity risk by investing in short term deposits with nonresident banks and holding adequate quantity of cash in its vaults. Liquidity management policies are set to ensure that even under adverse conditions, CBK is in a position to meet its obligations.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by CBK management. Monthly reports covering the liquidity position of CBK are regularly submitted to the Investment Committee members by the Asset Management Department.

Exposure to liquidity risk

Residual contractual maturities of financial liabilities, excluding future interest payments

	Note	Carrying amount	Less than 1 month	1-3 months	3 Months to 1 year	1 year to 5 year
31 December 2012						
<i>Non-derivative liabilities</i>						
Due to domestic banks	15	302,147	302,147	-	-	-
Due to IMF related accounts	16	246,890	133,832	-	-	113,058
Due to governmental institutions	17	821,509	681,502	80,003	60,004	-
Due to public and commercial entities	18	49,023	49,023	-	-	-
Other domestic liabilities	19	2,428	2,428	-	-	-
		1,421,997	1,168,932	80,003	60,004	113,058
31 December 2011						
<i>Non-derivative liabilities</i>						
Due to domestic banks	15	209,700	209,700	-	-	-
Due to IMF related accounts	16	156,509	136,045	-	-	20,464
Due to governmental institutions	17	782,178	355,365	165,171	261,642	-
Due to public and commercial entities	18	37,059	37,059	-	-	-
Other domestic liabilities	19	2,427	2,427	-	-	-
		1,187,873	740,596	165,171	261,642	20,464

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

4. Financial risk management (continued)

c) Liquidity risk (continued)

The previous table shows the undiscounted cash flows of CBK's financial liabilities on the basis of their earliest possible contractual maturity. To manage the liquidity risk arising from financial liabilities, CBK holds liquid assets comprising cash and cash equivalents, current accounts, deposit accounts and treasury bills for which there is an active and liquid market.

Volatility in the global and Kosovo financial markets

The global financial and economic crisis has resulted in, among other things, a lower level of capital market funding, and lower liquidity levels across the banking sector, central bank interest rate cuts to help borrowers, government capital injection, higher interbank saving rates and volatility in stock markets. Further adverse developments resulting from the crisis might result in negative implications on the financial and liquidity position of CBK.

d) Market risks

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect CBK's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

Management of market risks

CBK's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in differing amounts. In the case of floating rate assets and liabilities, there is exposure to basis risk, which is the difference in repricing characteristics of the various floating rate indices.

Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with CBK's operations strategies. CBK's exposure to market risk is related only to non-trading portfolios.

Exposure to interest rate risk non-trading portfolios

One of the principal risks to which non-trading portfolios are exposed is a change in market interest rates causing a reduction in future cash flows for variable-rate financial assets or a decline in the fair values of fixed-rate financial assets. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands. The Investment Committee is the monitoring body for compliance with these limits. A summary of CBK's interest rate gap position on non-trading portfolios is as follows:

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

Exposure to interest rate risk-non-trading portfolios

31 December 2012	N o t e	Carrying amount				
		Carrying amount	Less than 3 months	3-6 months	6-12 months	1-5 years
Current accounts with non-resident banks	8	99,549	99,549	-	-	-
Treasury bills	9	285,983	39,994	145,992	99,997	-
Deposit accounts with non-resident banks	10	821,590	540,922	280,668	-	-
Assets related with IMF	11	193,303	80,245	-	-	113,058
Total		1,400,425	760,710	426,660	99,997	113,058
Due to domestic banks	15	(302,147)	(302,147)	-	-	-
Due to IMF related accounts	16	(194,792)	(81,734)	-	-	(113,058)
Due to governmental institutions	17	(821,509)	(761,505)	(32,652)	(27,352)	-
Due to public and commercial entities	18	(49,023)	(49,023)	-	-	-
Other domestic liabilities	19	(2,428)	(2,428)	-	-	-
Total		(1,369,899)	(1,196,837)	(32,652)	(27,352)	(113,058)
Gap		30,526	(436,127)	394,008	72,645	-

31 December 2011	N o t e	Carrying amount				
		Carrying amount	Less than 3 months	3-6 months	6-12 months	1-5 years
Current accounts with non-resident banks	8	31,513	31,513	-	-	-
Treasury bills	9	24,988	-	24,988	-	-
Deposit accounts with non-resident banks	10	1,009,046	727,474	177,255	104,317	-
Assets related to IMF	11	155,687	135,223	-	-	20,464
Total		1,221,234	894,210	202,243	104,317	20,464
Due to domestic banks	15	(209,700)	(209,700)	-	-	-
Due to IMF related accounts	16	(156,509)	(136,045)	-	-	(20,464)
Due to governmental institutions	17	(782,178)	(520,536)	(221,545)	(40,097)	-
Due to public and commercial entities	18	(37,059)	(37,059)	-	-	-
Other domestic liabilities	19	(2,427)	(2,427)	-	-	-
Total		(1,187,873)	(905,767)	(221,545)	(40,097)	(20,464)
Gap		33,361	(11,557)	(19,302)	64,220	-

Non-interest bearing financial assets and liabilities have not been included in the table above.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

Overall non-trading interest rate risk positions are managed by the Asset Management Department, which uses investment securities and placements with banks to manage the overall position arising from CBK's non-trading activities.

Management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and nonstandard interest rate scenarios. Standard scenarios that are considered on a regular basis include a 100 basis point ("bp") parallel fall or rise in all yield curves. An analysis of the Bank's sensitivity to an increase or decrease in market interest rates (assuming no asymmetrical movement in yield curves and a constant financial position) is as follows:

2012

	100 bp Increase	100 bp Decrease
Estimated Profit (loss) effect	305	(305)

2011

	100 bp Increase	100 bp Decrease
Estimated Profit (loss) effect	376	(376)

Exposure to other market risks/currency risks non-trading portfolios

CBK has an exposure to SDR related to its IMF assets and liabilities, which they monitor on an ongoing basis. CBK's exposure to foreign currency risk is as follows:

2012

	100 bp Increase	100 bp Decrease
Estimated Profit (loss) effect	15	(15)

2011

	100 bp Increase	100 bp Decrease
Estimated Profit (loss) effect	35	(35)

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

31 December 2012	EUR	SDR (EUR equivalent)	Total
Assets			
Cash on hand	16,761	-	16,761
Current accounts with non-resident banks	99,549	-	99,549
Treasury bills	285,983	-	285,983
Deposit accounts with non-resident banks	821,590	-	821,590
Assets with IMF	113,058	132,343	245,401
Other assets	462	-	462
Total	1,337,403	132,343	1,469,746
Liabilities			
Due to domestic banks	302,147	-	302,147
Due to IMF related accounts	165,334	81,556	246,890
Due to governmental institutions	821,509	-	821,509
Due to public and commercial entities	49,023	-	49,023
Other domestic liabilities	3,289	-	3,289
Total	1,341,302	81,556	1,422,858
Net foreign currency position		50,787	

31 December 2011	EUR	SDR (EUR equivalent)	Total
Assets			
Cash on hand	13,456	-	13,456
Current accounts with non-resident banks	31,513	-	31,513
Treasury bills	24,988	-	24,988
Deposit accounts with non-resident banks	1,009,046	-	1,009,046
Assets with IMF	20,464	135,223	155,687
Other assets	446	-	446
Total	1,099,913	135,223	1,235,136
Liabilities			
Due to domestic banks	209,700	-	209,700
Due to IMF related accounts	73,668	82,841	156,509
Due to governmental institutions	782,178	-	782,178
Due to public and commercial entities	37,059	-	37,059
Other domestic liabilities	3,337	-	3,337
Total	1,105,942	82,841	1,188,783
Net foreign currency position		52,382	

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

CBK deals predominantly in EUR, while the foreign currencies CBK deals with are predominantly Special Drawing Rights (“SDRs”). The exchange rates used for translation at 31 December 2012 and 2011 were as follows:

	2012	2011
	EUR	EUR
1 SDR	1.1658	1.1865

SDRs are supplementary foreign exchange reserve assets defined and maintained by the international Monetary Fund (IMF). Although SDRs are not a currency itself, they represent a potential claim on the currencies of IMF member states for which they may be exchanged. SDRs were created in 1969 to alleviate a shortage of preferred foreign exchange reserve assets, namely the US dollar and gold, the value of the SDR is defined by a weighted currency basket of four major currencies, the Euro, the US dollar, the British pound, and the Japanese yen.

(e) Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with CBK’s processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of CBK’s operations and are faced by all of the organization’s units.

CBK’s objective is to manage operational risk so as to balance the avoidance of financial losses and damage to CBK’s reputation with overall cost effectiveness.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to managerial staff within each organizational unit. This responsibility is supported by the development of overall CBK policies and procedures for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced and the adequacy of controls and procedures to address the risks identified;
- requirements for the reporting of operational losses and proposed remedial actions;
- development of contingency plans;
- training and professional development;
- ethical and code of conduct policy; and
- risk mitigation, including insurance, where this is effective.

Compliance with CBK policies and procedures is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with management of the organizational unit to which they relate, with summaries submitted to the Audit Committee and CBK management.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

4. Financial risk management (continued)

(f) Capital management

Law no. 03/L-209 on the Central Bank of the Republic of Kosovo, approved on 22 July 2010 by the Assembly of the Republic of Kosovo, sets the capital requirements of CBK. According to this law, the authorized capital of CBK is EUR 30 million. The capital may be increased by such amounts as may be proposed by CBK and approved by the Government. No reduction of CBK capital shall be permitted at any time.

As per Law no. 03/L-209, the net income or the net loss of CBK is calculated in accordance with International Financial Reporting Standards (IFRS).

From the net income by deducting the total amount unrealized revaluation gains it's derived the earnings available for distribution (under Article 56 of the above mentioned Law)

Net income is allocated in each year to a general reserve account until the aggregate amount of initial capital and general reserves equals five percent (5%) of the Central Bank's monetary liabilities.

50% of the net balance of realized income remaining after fulfilling the 5% criteria mentioned above is required to be transferred to the Ministry of Economy and Finance. The remaining 50% of the realized income is required to be allocated to the general reserve account of CBK.

5. Use of estimates and judgments

Management discusses with the Central Bank Board the development, selection and disclosure of CBK's critical accounting policies and estimates, and the application of these policies and estimates. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

These disclosures supplement the commentary on financial risk management (see note 4).

Key sources of estimation uncertainty

Allowances for credit losses

Assets accounted for at amortised cost are evaluated for impairment on a basis described in accounting policy 3(f)(vi). The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about the counterparty's financial situation and the net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, and an estimate of cash flows considered recoverable is independently approved.

Critical accounting judgments in applying CBK's accounting policies

Critical accounting judgments made in applying CBK's accounting policies include:

Financial asset and liability classification

CBK's accounting policies provide scope for assets and liabilities to be designated on inception into different accounting categories in certain circumstances.

In classifying financial assets as held-to-maturity, CBK has determined that it has both the positive intention and ability to hold the assets until their maturity date as required by accounting policy 3(h).

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

6. Financial assets and liabilities (accounting classifications and fair values)

The table below sets out CBK's classification of each class of financial assets and liabilities, and their fair values.

<i>In thousands of EUR</i>	Note	Loans and receivables	Held-to-maturity	Other amortized cost	Total carrying amount	Fair value
31 December 2012						
Cash on hand	7	16,761	-	-	16,761	16,761
Current accounts with non-resident banks	8	99,549	-	-	99,549	99,549
Treasury bills	9	-	285,983	-	285,983	285,984
Deposit accounts with non-resident banks	10	821,590	-	-	821,590	821,590
Assets related with IMF	11	245,401	-	-	245,401	245,401
		1,183,301	285,983	-	1,469,284	1,469,285
Due to domestic banks	15	-	-	302,147	302,147	302,147
Due to IMF related accounts	16	-	-	246,890	246,890	246,890
Due to governmental institutions	17	-	-	821,509	821,509	821,509
Due to public and commercial entities	18	-	-	49,023	49,023	49,023
Other domestic liabilities	19	-	-	2,428	2,428	2,428
		-	-	1,421,997	1,421,997	1,421,997
31 December 2011						
Cash on hand	7	13,456	-	-	13,456	13,456
Current accounts with non-resident banks	8	31,513	-	-	31,513	31,513
Treasury bills	9	-	24,988	-	24,988	24,990
Deposit accounts with non-resident banks	10	1,009,046	-	-	1,009,046	1,009,046
Assets related with IMF	11	155,687	-	-	155,687	155,687
		1,209,702	24,988	-	1,234,690	1,234,692
Due to domestic banks	15	-	-	209,700	209,700	209,700
Due to IMF related accounts	16	-	-	156,509	156,509	156,509
Due to governmental institutions	17	-	-	782,178	782,178	782,178
Due to public and commercial entities	18	-	-	37,059	37,059	37,059
Other domestic liabilities	19	-	-	2,427	2,427	2,427
		-	-	1,187,873	1,187,873	1,187,873

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

7. Cash on hand

Cash on hand is all denominated in EUR.

8. Current accounts with non-resident banks

These accounts were held at the following banks:

	2012	2011
Deutsche Bundesbank	40,240	30,961
Raiffeisen Zentralbank	650	61
Commerzbank	-	481
Banque De France	1,050	-
Deutsche Bank	17,264	10
Banque centrale du Luxembourg	40,345	-
Total	99,549	31,513

All current accounts have credit ratings of A-1/P-1 as per 2012 rankings of the above banks by Standard & Poor's/Moody's ratings at 31 December 2012.

9. Treasury bills

Treasury bills are debt securities issued by governments of European Union countries. They have maturities up to twelve months and they are held to maturity. All bills are denominated in EUR and have effective interest rates ranging from 0.005% to 2.131% p.a. (2011: 0.35% to 1.20% p.a.)

Treasury bills are issued by governments of European Union countries as follows:

	2012	2011
Italy	39,994	-
Belgium	245,989	24,988
Total	285,983	24,988

CBK invests in treasury bills with a minimum credit rating of A-2u and P-2, as per Standard & Poor's/Moody's ratings.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

10. Deposit accounts with non-resident banks

Deposit accounts with non-resident banks are composed of:

	2012	2011
Time deposits		
Raiffeisen Zentralbank	162,000	129,200
Svenska Handelsbanken	110,004	36,000
ING Bank	85,579	120,664
Deutsche Bundesbank	50,000	80,000
KBC	-	87,334
Rabobank	161,204	132,555
Danske Bank	-	98,534
Banque de France	-	165,755
Banque Centrale du Luxembourg	167,711	157,279
Deutsche Bank	85,000	-
	821,498	1,007,321
Interest accrued on time deposits		
Raiffeisen Zentralbank	5	434
Svenska Handelsbanken	23	185
ING Bank	33	387
Deutsche Bundesbank	-	9
KBC	-	186
Rabobank	-	140
Danske Bank	-	1
Banque de France	-	354
Banque Centrale du Luxembourg	2	29
Deutsche Bank	29	-
	92	1,725
Total	821,590	1,009,046

11. Deposit accounts with non-resident banks

Deposits placed with non-resident banks are denominated in EUR and earn interest at effective interest rates ranging from 0.005% to 0.85% p.a. (2011: 0.05% to 1.68% p.a.) and have original maturities from 1 to 365 days (2011: from 1 to 367 days). All deposits have credit rating A-1/P-1, as per December 2012 ranking by Standard & Poors/Moody's ratings.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

12. Assets related with IMF

	2012	2011
IMF quota	68,784	70,006
SDR Holdings	63,348	65,149
Accrued interest	211	68
IMF	132,343	135,223
Government		
Due from the Government for the use of IMF funds (SBA)	113,058	20,464
Total	245,401	155,687

The assets listed above are related to the admission of Kosovo to the IMF in June 2009. CBK acts as depository and fiscal agent in relation to Kosovo's membership in the IMF. This is in accordance with the Law No. 03/L-209 on the Central Bank of the Republic of Kosovo and Law No. 03-L-152 on Membership of the Republic of Kosovo in the International Monetary Fund and World Bank Group Organizations.

IMF Quota represents a subscription amount determined at the time of admission of Kosovo into IMF and is expressed in SDR (above disclosed on euro equivalent) and its amount is determined based on IMF rules and regulations.

SDR Holdings represents assets approved by the IMF Board of Governors as per allocations of SDRs to IMF's member countries (decisions made on 28 August 2009 and 9 September 2009). SDR holding assets bear annual average interest rates in 2012 ranging from 0.06% to 0.16% p.a. (2011: 0.11% - 0.55% p.a.).

Due from the Government for the use of IMF funds, represents an amount due from the Government as per IMF and Kosovo Stand-by Arrangement signed in July 2010 and 2012, through which the Government of Kosovo obtained from IMF a Stand-By Arrangement in the amount of SDR 109.7 million (EUR: 127.9 million). The interest rate of this arrangement is tied to IMF's market-related interest rate, known as the basic rate of charge, which is itself linked to the SDRs interest rate. The interest rate for the year 2012 fluctuated in quarterly basis annually in average as 1.06% - 1.16%, p.a. (from August 2011 until 31 December 2011 fluctuated from 1.11% to 1.55% p.a.).

Balance drawn from IMF as at 31 December 2011 and three other tranches during 2012, in total amount around SDR 97 million (EUR 113 million) by the Government of Kosovo from the Stand-by Arrangement. CBK acts as depository institution for the Government of Kosovo. To regulate the Stand-By Arrangement with IMF, CBK and the Government of Kosovo entered into an agreement's on July 2010 and April 2012 "on the Procedure for Request, Acceptance, Service and Repurchase of the Funds from the IMF in terms of the Stand -By Arrangement". Based on this arrangement's CBK withdraws the SDRs from IMF, on behalf of the Government, and credit's them to the Government's account.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

12. Property and equipment

Property and equipment is composed as follows:

	Leasehold improvements	Equipment	Computers	Vehicles	Assets in process of capitalization	Total
Cost						
At 1 January 2011	1,279	1,566	846	286	9	3,986
Acquisitions	-	31	119	-	184	334
Disposals	-	(279)	(162)	-	-	(441)
At 31 December 2011	1,279	1,318	803	286	193	3,879
At 1 January 2012	1,279	1,318	803	286	193	3,879
Acquisitions	106	41	27	-	-	174
Transfer (from)/to	165	-	28	-	(193)	-
Disposals	-	-	-	(44)	-	(44)
At 31 December 2012	1,550	1,359	858	242	-	4,010
Depreciation						
At 1 January 2011	256	1,220	664	121	-	2,261
Charge for the year	64	233	133	54	-	484
Disposals	-	(279)	(163)	-	-	(442)
At 31 December 2011	320	1,174	634	175	-	2,303
At 1 January 2012	320	1,174	634	175	-	2,303
Charge for the year	71	66	117	46	-	300
Disposals	-	-	-	(44)	-	(44)
At 31 December 2012	391	1,240	751	177	-	2,559
Carrying amounts						
At 1 January 2011	1,023	346	182	165	9	1,725
At 31 December 2012	959	144	169	111	193	1,576
At 31 December 2012	1,159	119	107	65	-	1,450

There are no assets pledged as collateral as at 31 December 2012 (31 December 2011: nil).

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

13. Intangible assets

Intangible assets are composed as follows:

	Software under development	Software	Total
Cost			
Balance at 1 January 2011	826	1,194	2,020
Acquisitions	620	118	738
Transfer From/To	(800)	800	-
Disposal	-	(177)	(177)
Balance at 31 December 2011	646	1,935	2,581
Balance at 1 January 2012	646	1,935	2,581
Acquisitions	-	101	101
Transfer to Software	(621)	621	-
Disposals	-	-	-
Balance at 31 December 2012	25	2,657	2,682
Amortization			
Balance at 1 January 2011	-	1,111	1,111
Amortization for the year	-	141	141
Disposals	-	(177)	(177)
Balance at 31 December 2011	-	1,075	1,075
Balance at 1 January 2012	-	1,075	1,075
Amortization for the year	-	182	182
Disposals	-	-	-
Balance at 31 December 2011	-	1,257	1,257
Carrying amounts			
Balance at 1 January 2011	826	83	909
Balance at 31 December 2012	646	860	1,506
Balance at 31 December 2012	25	1,400	1,425

14. Other assets

Other assets are composed as follows:

	2012	2011
Accrued fee income	390	371
Accounts receivable and prepayments	72	75
Total	462	446

Accrued fee income represents the estimated license renewal fees and other fees for the fourth quarter from local financial institutions.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

15. Due to domestic banks

Under CBK supervision Banking Rule XVII, commercial banks operating in Kosovo are required to maintain a liquidity reserve amounting to 10% of their qualifying customer deposits. At least half of these reserve balances must be kept in accounts at CBK.

CBK pays interest to commercial banks on the balances held by them at CBK representing up to the minimum required reserve. No interest is paid by CBK to commercial banks on amounts maintained at CBK above the minimum required reserve. The annual interest rate as at 31 December 2012 was 0.00% (31 December 2011: 0.10%).

Due to domestic banks

	2012	2011
ProCredit Bank Kosovë	29,605	29,255
Raiffeisen Bank Kosovë	25,332	28,314
NLB Prishtina	15,613	12,062
Banka Ekonomike e Prishtinës	5,887	5,356
Banka për Biznes	4,188	3,713
Banka Kombëtare Tregtare	8,465	4,674
Banka Ekonomike Turke - TEB	12,052	8,553
Komercijalna Banka – Dega Mitrovicë	1,955	1,774
Total required reserve	103,097	93,701

Additional amount above required reserve

ProCredit Bank Kosovë	65,204	35,547
Raiffeisen Bank Kosovë	11,078	9,775
NLB Prishtina	35,843	8,105
Banka Ekonomike e Prishtinës	18,770	21,220
Banka për Biznes	16,540	25,630
Banka Kombëtare Tregtare	28,092	4,900
Banka Ekonomike Turke	14,617	8,992
Komercijalna Banka – Dega Mitrovicë	1,872	1,816
Turkiye is Bankasi a.s.	6,999	-
Banka Kreditore e Prishtinës	35	14
Total Addition on current account	199,050	115,999
Total	302,147	209,700

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

16. Due to IMF related accounts

	2012	2011
IMF Account No. 1	172	175
IMF Account No. 2	6	5
IMF Security Account	165,156	73,488
IMF SDR Allocation	64,550	65,697
Accrued Interest	211	68
Total due to IMF	230,095	139,433
Due to Government		
IMF - Paid portion of Government quota	16,795	17,076
Total Due to Government	16,795	17,076
Total	246,890	156,509

These positions are related to the admission of Kosovo to the IMF in June 2009.

Accounts No. 1 and No. 2 are IMF accounts with CBK opened according to IMF's rules and regulations.

IMF Security Account represents a promissory notes issued by the Kosovo Government, they have to be paid upon IMF's request. This amount represents a liability of CBK to IMF and is matched by a corresponding claim of CBK to the Government of Kosovo.

IMF paid portion of Government quota represents the amount paid by the Government to the IMF regarding the IMF quota.

SDR Allocation represents allocations of SDRs to IMF's member countries as approved by IMF Board of Governors on 28 August 2009 and 9 September 2009.

SDR Allocations and Paid portion of quota are interest-bearing with annual interest rates for 2012 in quarterly averages ranging from 0.06% - 0.16% p.a. (2011: 0.11% - 0.55% p.a.).

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

17. Due to governmental institutions

Due to governmental institutions includes current accounts from the following:

	2012	2011
Current accounts		
Treasury - Ministry of Finance	73,697	89,326
Privatization Agency of Kosovo	549,403	265,310
Interim administration institutions	407	729
Total current accounts	623,507	355,365
Time Deposits		
Treasury - Ministry of Finance	152,007	105,042
Privatization Agency of Kosovo	-	321,771
Total time deposits	152,007	426,813
Securities		
Treasury - Ministry of Finance	45,995	-
Total Securities	45,995	-
Total	821,509	782,178

The effective annual interest rate for current accounts for the year ended 31 December 2012 is 0.00% (for the year ended 31 December 2011: 0.10% p.a.). For time deposits the effective interest rates for the year 2012 ranged from 0.01% - 0.85% (2011: 0.25% - 1.53% p.a.).

18. Due to public and commercial entities

	2012	2011
Current accounts		
Insurance companies	4,227	6,938
Other public institutions	44,725	30,050
Licensed pension funds	68	68
Other	3	3
	49,023	37,059

The effective interest rate for current accounts as at 31 December 2012 is 0.00% (31 December 2011: 0.10% p.a.).

19. Other domestic liabilities

	2012	2011
Safe custody accounts	2,428	2,427
Deferred grants	590	595
Other deferred income	76	62
Sundry creditors	195	242
Other deferred income and liabilities	-	11
	3,289	3,337

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

19. Other domestic liabilities (continued)

The Safe custody balance represents these types of account and amounts.

Amount of EUR 1,135 represents rents collected by the CBK until 5 January 2004 on behalf of the Kosovo Government for the offices of the former national bank of Kosovo, which were rented out to various entities/individuals. This amount also included interest earned on these rent payments until 31 December 2012.

Included in the safe custody accounts are also certain amount of cash in various currencies and other assets, that CBK inherited upon inception, from the former National Bank of Kosovo and the interest earned over the years.

As of 31 December 2012 in the safe custody accounts are also included EUR 756 thousand related to the current accounts of the Kosova Insurance Company which was liquidated on April 2010.

The movement in deferred grant revenue was as follows:

	Ministry of Finance	World Bank	ECB	Total
Deferred grant revenue at 1 January 2011	5	-	-	5
Grants received during the year	606	11	17	634
Grant recognized as revenue for the year	(16)	(11)	(17)	(44)
Deferred grant revenue at 31 December 2011	595	-	-	595
Deferred grant revenue at 1 January 2012	595	-	-	595
Grants received during the year	12	36	2	50
Grant recognized as revenue for the year	(52)	(1)	(2)	(55)
Deferred grant revenue at 31 December 2012	555	35	-	590

20. Statutory fund

The CBK statutory fund as at 31 December 2012 and 2011 is EUR 30,000 thousand as per Law no. 03/L-209 approved on 22 July 2010.

CBK reports directly to the Assembly of Kosovo. CBK capital is not subject to encumbrances.

21. Reserve fund

The level of the reserve fund is regulated by Law no. 03/L-209 on the Central Bank of the Republic of Kosovo. The profit of each financial year is allocated as described in note 4 (f) in accordance with this law.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

22. Net interest income

Net interest income is composed as follows:

	2012	2011
Interest income		
From money market placements	2,398	8,943
From treasury bills	269	696
From current accounts	119	440
	2,786	10,079
Interest expense		
On current accounts from non-banking entities	255	870
On current accounts from bank entities	73	598
On time deposits	1,442	6,117
	1,770	7,585
Net interest income	1,016	2,494

23. Net fees and commission income

Net fee and commission income is composed as follows:

	2012	2011
Fee income		
From cash deposits	463	372
From foreign incoming transfers	32	68
From foreign outgoing transfers	203	238
From the inter-bank clearing system	321	281
From the credit registry system	135	158
From management of treasury fund	721	1,500
Other fees	39	34
	1,914	2,651
Fee expenses		
For cash transportation	350	259
For correspondent bank transactions	35	31
Penalties charges	3	-
	388	290
Net fee and commission income	1,526	2,361

Income from management of treasury fund is resulted from asset management services provided to the Treasury of the Ministry of Finance by CBK. Those services are in accordance with the CBK law.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

24. Grant revenue

Grant revenue is composed as follows:

	2012	2011
European Central Bank ("ECB")	2	17
World Bank	1	11
Ministry of Economy and Finance	52	16
Total	55	44

25. Other operating income

Other operating income mainly comprises of fees charged to financial institutions in Kosovo as part of issuing or renewing licenses, as well as other statutory fees related to their activities. Other operating income consists of the following:

	2012	2011
Fees charged to insurance companies	1,017	938
Fees charged to commercial banks	599	611
Fees from non-banking financial institutions	62	67
Pension renewal fee	27	-
Other fees	24	4
Total	1,729	1,620

26. Personnel expenses

Personnel expenses are composed as follows:

	2012	2011
Wages and salaries	1,927	1,639
Pension contributions	303	261
Health insurance costs	97	97
Staff training	62	85
Central Bank Board expenses	128	132
Other	49	35
Total	2,566	2,249

The average number of employees at CBK in 2012 was 178 (2011: 167).

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

27. General and administrative expenses

General and administrative expenses are composed as follows:

	2012	2011
Insurance expenses	201	223
Repairs and maintenance	69	53
Software maintenance	178	209
Communication expense (telephone, telex and internet)	57	79
Utilities	84	81
Audit and consulting expense	14	20
Security and guard services	78	79
Travel and transportation	88	95
Vehicle operating expenses	25	22
Stores and stationery	26	32
Representation expenses	72	44
Computer and other consumables expense	41	50
Publication and literature expenses	34	41
Other	15	23
Total	982	1,051

28. Foreign exchange net income profit/(loss)

Foreign exchange net profit of EUR 32 thousand for the year ended 31 December 2012 (2011: loss of 1,139 thousand) represents unrealized foreign exchange profit and losses in relation to foreign exchange differences resulting upon translation of SDR assets and liabilities on the CBK books.

29. Cash and cash equivalents

Cash and cash equivalents are composed as follows:

	Note	2012	2011
Cash on hand	7	16,761	13,456
Current accounts with non-resident banks	8	99,549	31,513
Treasury bills with maturity up to three months		39,994	-
Deposit accounts with non-resident banks with maturity up to three months		540,915	727,244
Total		697,219	772,213

Cash and cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. An investment qualifies as a cash equivalent when it has a short maturity, three months or less from the date of acquisition.

Central Bank of the Republic of Kosovo

Notes to the financial statements

(in thousands of EUR, unless otherwise stated)

30. Commitments and contingencies

Legal

CBK is involved in routine legal proceedings in the ordinary course of business. It is management's opinion that the final outcome of these lawsuits will not have a material effect on CBK's financial statements as at and for the year ended 31 December 2012.

Credit related commitments

As at 31 December 2012, CBK had commitments to place deposits in total amount of EUR 50 million (31 December 2011, CBK had commitments to place deposits in total amount of EUR nil).

Other commitments

Other commitments are composed as follows:

	2012	2011
Equipment contracts	50	-
Services contracts	44	-
Total	94	-

In 2009, Kosovo became member of the World Bank Group organizations - International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA) and the Multilateral Investment Guarantee Agency (MIGA). In relation to this membership, CBK acts as depository. This is in accordance with the Law No. 03/L-209 on the Central Bank of the Republic of Kosovo and Law No. 03-L-152 on Membership of the Republic of Kosovo in the International Monetary Fund and World Bank Group Organizations.

In June 2009, the Government of Kosovo issued promissory notes to make payments concerning membership subscription to the World Bank sub-agencies above mentioned upon their requests and payment instructions. The total balance at 31 December 2012 and 2011 of these promissory notes was EUR 4,007 thousand.

31. Related party transactions

Related parties include Key Management and the Central Bank Board. Their compensations are presented below:

	2012	2011
Compensation to Central Bank Board members	120	130
Compensation to Audit Committee	8	2
Compensation to Key Management Personnel	139	103
Total	267	235

32. Subsequent events

There are no events after the reporting date that would require either adjustments or additional disclosures in the financial statements.

9. Statistical Appendix

1.1. Financial corporation survey – net foreign assets and domestic claims

(Outstanding amounts, end of period, in millions of euro)

Description	Net foreign assets							Domestic claims									
	Claims on non residents	of which:					Less: liabilities to nonresidents	Net claims on central government			Claims on other sectors	of which:					
		Monetary gold and SDR holdings	Deposits	Securities other than shares	IMF Quota	Shares and other equities		Claims on central government	Less: Liabilities to central			Loans	of which:				
									Deposits				Other non financial corporations	Households			
2005 December	827.3	890.9	—	422.6	242.4	—	145.3	63.6	348.9	-225.7	—	225.7	225.7	574.6	565.6	439.6	126.0
2006 December	1,173.6	1,245.7	—	660.0	341.3	—	170.8	72.1	231.7	-475.0	—	475.0	475.0	706.6	694.3	548.2	146.1
2007 December	1,622.4	1,704.6	—	955.0	408.9	—	175.4	82.3	124.5	-853.3	—	853.3	853.3	977.8	965.9	765.1	200.6
2009 December	1,700.5	2,036.2	60.3	910.1	724.5	64.3	144.3	335.7	571.5	-846.3	—	846.3	846.3	1,417.8	1,396.1	1,052.3	343.5
2010 December	1,957.5	2,387.7	64.0	1,257.8	525.2	68.5	269.3	430.2	766.8	-824.8	—	824.8	824.8	1,591.6	1,568.3	1,127.7	434.2
2011 December	2,080.3	2,454.3	65.1	1,369.2	230.0	70.1	533.1	374.0	989.0	-798.4	—	798.4	798.4	1,787.4	1,761.7	1,244.1	514.6
2012 December	2,337.3	2,773.6	63.3	1,260.7	486.0	68.8	666.5	436.3	1,082.4	-764.8	73.7	838.5	838.5	1,847.2	1,819.4	1,271.3	546.3

1.2. Financial corporation survey – liabilities

(Outstanding amounts, end of period, in millions of euro)

Description	Deposits								Loans	Insurance technical reserves			Shares and other equity	Other items (net)	
	Transferable deposits	of which:				Other deposits	of which:			Net equity of households in pension funds	Pre payment of premiums and reserves				
		Public non financial corporations	Other non financial corporations	Households			Public nonfinancial corporations	Other nonfinancial corporations				Households			
2005 December	830.6	315.0	67.6	76.8	155.5	515.6	181.3	33.7	298.9	3.0	174.5	152.4	22.1	165.8	2.2
2006 December	886.4	300.5	34.8	96.4	156.2	586.0	193.3	27.6	359.5	3.4	251.4	223.9	27.5	209.3	54.7
2007 December	1,110.9	386.1	49.6	133.5	187.5	724.8	188.4	43.8	489.3	...	316.1	286.2	29.9	273.8	46.0
2008 December	1,351.9	390.9	15.4	176.0	186.2	961.0	250.1	51.4	656.7	...	288.6	256.3	32.3	311.1	61.1
2009 December	1,444.3	483.2	50.1	184.0	237.7	961.0	73.9	82.9	801.9	...	422.3	380.8	41.5	326.1	79.3
2010 December	1,744.2	621.2	83.8	218.6	303.5	1,123.1	42.8	83.4	995.9	...	540.5	493.7	46.8	361.0	78.6
2011 December	1,940.2	665.1	75.5	208.1	360.9	1,275.1	60.8	79.7	1,129.6	...	647.8	593.3	54.5	395.1	86.2
2012 December	2,094.0	717.5	31.2	257.5	407.2	1,376.5	61.8	78.2	1,232.9	...	814.9	745.1	69.8	399.2	111.5

2.1. Depository corporation survey – net foreign assets and domestic claims

(Outstanding amounts, end of period, in millions of euro)

Description	Net foreign assets							Domestic claims								
	Claims on non residents	of which:					Less: Liabilities to non residents	Net claims on central government	Claims on central gov.	Less: Liabilities to central gov.	Claims on other sectors	of which:				
		Currency	Deposits	Securities other than shares	IMF Quota	Loans						Public financial corporations	Other non financial corporations	Households		
2001 December	583.3	604.8	239.2	358.1	7.5	---	21.5	-44.2	-70.3	---	70.3	26.1	25.9	...	25.9	---
2002 December	649.5	674.1	53.1	621.0	...	---	24.6	-171.8	-258.6	---	258.6	86.8	86.5	...	80.8	5.7
2003 December	695.8	727.0	73.2	533.6	119.6	---	31.2	-12.6	-346.4	---	346.4	233.8	232.8	...	193.5	39.0
2004 December	648.7	687.9	55.3	384.0	236.7	---	39.2	156.9	-216.8	---	216.8	373.8	373.7	...	289.9	83.7
2005 December	695.1	744.5	74.6	422.6	242.4	---	49.3	289.0	-225.7	---	225.7	514.6	513.9	...	387.9	126.0
2006 December	975.4	1,035.6	63.4	660.0	303.1	---	60.2	162.2	-475.0	---	475.0	637.1	636.6	...	490.5	146.1
2007 December	1,377.5	1,426.1	145.3	955.0	308.2	---	48.6	39.1	-853.3	---	853.3	892.4	892.1	0.2	691.3	200.6
2008 December	1,436.1	1,512.0	121.1	794.9	581.8	---	75.9	311.9	-871.8	---	871.8	1,183.8	1,183.4	0.1	901.7	281.0
2009 December	1,531.6	1,782.2	111.4	910.0	626.4	64.3	250.6	442.9	-846.3	---	846.3	1,289.2	1,289.0	0.3	942.9	343.5
2010 December	1,616.2	1,957.1	164.3	1,257.8	372.7	68.5	340.9	632.8	-824.8	---	824.8	1,457.5	1,457.1	6.3	1,010.8	434.2
2011 December	1,603.8	1,900.3	124.9	1,359.3	227.0	70.1	296.6	867.7	-798.4	---	798.4	1,666.1	1,665.6	1.5	1,139.6	514.6
2012 December	1,729.6	2,102.6	141.4	1,260.7	482.8	68.8	373.1	962.9	-778.7	59.9	838.5	1,741.6	1,740.9	1.4	1,172.9	546.3

Table 2.2. Depository corporation survey - liabilities

(Outstanding amounts, end of period, in millions of euro)

Description	Deposits included in broad money										Deposits excluded from broad money ^{1/}	Shares and other equity	Other items net	
	Transferable deposits	of which:					Other deposits	of which:						
		Other financial corporations	Public non financial corporations	Other non financial corporations	Households	Other financial corporations		Public non financial corporations	Other non financial corporations	Households				
2001 December	486.8	361.5	.	7.0	135.3	219.2	125.2	.	.	31.3	93.9	12.9	25.2	14.3
2002 December	413.6	285.3	.	3.5	160.1	121.7	128.3	.	.	23.9	104.4	25.1	43.8	-4.8
2003 December	499.3	278.7	.	5.3	139.0	134.4	220.6	.	.	87.1	133.5	29.2	61.1	-6.4
2004 December	719.5	303.5	29.8	34.6	81.3	145.5	416.0	19.1	149.3	24.4	222.5	---	87.1	-10
2005 December	865.4	345.6	30.5	67.6	76.8	155.5	519.9	24.3	181.3	33.1	279.6	19.9	94.4	4.3
2006 December	912.8	336.4	35.9	34.8	96.4	156.2	576.3	30.5	193.3	24.6	322.4	40.6	128.8	55.4
2007 December	1,126.6	413.7	27.7	49.6	133.5	187.5	712.8	40.3	188.4	41.8	439.0	53.7	186.5	49.8
2008 December	1,393.0	454.6	63.7	15.4	176.0	186.2	938.3	47.6	250.1	44.2	593.8	74.9	233.8	46.4
2009 December	1,548.5	621.4	138.2	50.1	184.0	237.7	927.0	60.7	73.9	71.7	718.5	98.1	249.0	79.0
2010 December	1,747.9	674.3	53.1	83.8	218.6	303.5	1,073.6	85.2	30.2	73.5	884.7	138.2	278.5	84.4
2011 December	1,902.2	705.3	37.8	77.2	208.1	360.9	1,196.9	91.0	49.2	71.7	979.9	175.8	304.3	89.2
2012 December	2,036.7	759.4	41.9	31.2	257.5	407.2	1,277.3	100.4	49.8	70.5	1,053.1	206.2	321.7	127.9

Table 3.1. CBK survey – net foreign assets and domestic claims

(Outstanding amounts, end of period, in millions of euro)

Description	Net foreign assets									Net claims on central government	Claims on other sectors	Liabilities to ODC	
	Claims on non residents						Less: liabilities to non residents						
	Monetary gold and SDR	Currency	Deposits	Securities other than shares	IMF Quota	SDR allocations	IMF Accounts						
2001 December	293.7	296.2	—	150.8	145.4	—	—	2.6	—	—	-70.3	0.2	173.9
2002 December	345.4	345.8	—	17.5	328.3	—	—	0.4	—	—	-258.6	0.3	46.2
2003 December	454.3	454.6	—	26.6	427.4	—	—	0.3	—	—	-346.4	1.0	59.6
2004 December	344.7	349.9	—	12.1	213.2	124.4	—	5.2	—	—	-216.8	0.1	72.9
2005 December	394.4	397.5	—	24.5	213.4	159.5	—	3.1	—	—	-225.7	0.8	82.5
2006 December	641.1	641.2	—	11.1	424.9	203.6	—	0.1	—	—	-472.9	0.5	94.5
2007 December	1,057.6	1,057.6	—	63.8	759.0	229.3	—	...	—	—	-849.4	0.3	113.6
2008 December	1,110.7	1,110.7	—	39.7	529.0	541.3	—	...	...	—	-870.5	0.3	137.2
2009 December	1,088.3	1,198.5	60.3	21.8	522.3	529.7	64.3	110.2	60.3	49.1	-681.5	0.2	233.2
2010 December	1,108.0	1,246.9	64.0	60.2	854.4	199.2	68.5	138.9	64.2	73.0	-813.1	0.5	203.6
2011 December	1,098.8	1,234.6	65.1	13.5	1,059.3	25.0	70.1	135.8	65.7	69.4	-797.2	0.5	209.7
2012 December	1,238.8	1,469.1	63.3	16.8	1,034.1	286.0	68.8	230.3	64.6	165.3	-837.9	0.7	302.1

Table 3.2. CBK survey - liabilities

(Outstanding amounts, end of period, in millions of euro)

Description	Deposits included in broad money							Deposits excluded from broad money			Shares and other equity	of which:		Other items (net)
	Transferable deposits	of which:				Other deposits		Other financial corporations	Local gov.	Funds contributed by owners		Profit/losses of the year		
		Other financial corporations	Local government	Public non financial corporations	Other financial corporations									
2001 December	8.4	8.4	—	—	7.0	—	—	12.9	10.6	2.4	4.7	2.6	1.1	23.6
2002 December	3.9	3.9	—	—	3.5	—	—	25.1	24.6	0.5	10.6	2.6	3.6	1.3
2003 December	5.3	5.3	—	—	5.3	—	—	27.4	25.7	1.7	16.1	2.6	4.5	0.5
2004 December	37.7	32.6	20.7	1.9	9.9	5.1	5.1	—	—	—	18.0	10.0	3.0	-0.6
2005 December	66.6	62.5	23.3	1.6	37.6	4.1	4.1	—	—	—	20.4	10.0	3.0	...
2006 December	49.9	41.9	31.0	0.4	10.5	8.0	8.0	—	—	—	25.5	10.0	6.4	-1.2
2007 December	57.2	46.7	22.4	3.2	21.1	10.6	10.6	—	—	—	33.8	20.0	9.2	3.9
2008 December	63.9	56.7	49.9	5.3	1.5	7.2	7.2	—	—	—	41.4	30.0	7.5	-2.0
2009 December	130.8	130.8	129.7	...	1.1	...	...	—	—	—	44.9	30.0	3.7	-2.0
2010 December	45.6	45.6	43.9	...	0.0	...	...	—	—	—	47.9	30.0	3.0	-1.8
2011 December	39.5	39.5	28.5	...	9.3	...	...	—	—	—	54.3	30.0	5.8	-1.3
2012 December	51.5	51.5	32.4	...	17.4	...	...	—	—	—	50.4	30.0	1.8	-2.4

Table 4.1. Other depository corporation survey – net foreign assets and domestic claims

(Outstanding amounts, end of period, in millions of euro)

Description	Net foreign assets								Claims on CBK	Net claims on central government	Claims on other sectors				
	Claims on non residents	of which:			Less: liabilities to non-residents	of which:		Loans			Public nonfinancial corp.	Other nonfinancial corp.	Households		
		Currency	Deposits	Securities other than shares		Deposits	Loans								
2001 December	289.7	308.6	88.3	212.8	7.5	18.9	13.9	5.0	176.8	—	25.9	25.9	—	25.9	—
2002 December	304.1	328.3	35.6	292.7	...	24.2	17.5	6.7	45.7	—	86.5	86.5	—	80.8	5.7
2003 December	241.5	272.4	46.6	106.2	119.6	31.0	20.0	10.9	59.6	—	232.8	232.8	0.2	193.5	39.0
2004 December	304.0	338.0	43.2	170.8	112.3	34.0	12.7	21.3	73.2	—	373.7	373.7	—	289.9	83.7
2005 December	300.7	346.9	50.1	209.2	82.9	46.2	18.4	27.9	81.6	—	513.9	513.9	—	387.9	126.0
2006 December	334.4	394.5	52.3	235.1	99.4	60.1	21.4	38.7	88.8	(2.1)	636.6	636.6	—	490.5	146.1
2007 December	319.9	368.5	81.5	196.0	78.9	48.6	17.9	30.7	107.5	(3.9)	892.1	892.1	0.2	691.3	200.6
2008 December	325.4	401.3	81.4	265.9	40.5	75.9	42.0	33.7	136.8	(13)	1,183.4	1,183.4	0.1	901.7	281.0
2009 December	443.6	583.9	89.6	387.7	97.0	140.3	65.5	74.5	233.1	(164.9)	1,289.0	1,289.0	0.3	942.9	343.5
2010 December	508.1	710.2	104.1	403.3	173.4	202.1	85.5	116.6	203.4	(116)	1,457.1	1,457.1	6.3	1,010.8	434.3
2011 December	509.2	665.7	111.5	300.0	202.0	156.5	64.8	90.5	220.0	(12)	1,665.6	1,665.6	1.5	1,139.6	516.1
2012 December	490.8	633.6	124.6	226.6	196.8	142.8	87.7	50.2	301.1	59.2	1,740.9	1,740.9	1.4	1,139.6	546.7

Table 4.2. Other depository corporation survey – liabilities

(Outstanding amounts, end of period, in millions of euro)

Description	Deposits included in broad money										Deposits excluded from broad money	of which:		Shares and other equity	Other items (net)	
	Transferable deposits	of which:				Other deposits	of which:					Other nonfinancial corporations	Households			
		Other financial corp.	Public nonfinancial corp.	Other nonfinancial corp.	Households 2/		Other financial corporations	Public nonfinancial corp. 1/	Other nonfinancial corp.	Households 2/						
2001 December	478.4	353.1	.	.	133.9	219.2	125.2	.	.	31.3	93.9	.	.	.	20.4	-6.4
2002 December	409.7	281.4	.	.	159.7	121.7	128.3	.	.	23.9	104.4	.	.	.	33.2	-6.6
2003 December	494.0	273.4	.	.	139.0	134.4	220.6	.	.	87.1	133.5	1.8	1.8	.	45.0	-7.0
2004 December	681.9	270.9	9.0	24.7	81.3	145.5	410.9	14.0	149.3	24.4	222.5	0.0	0.0	0.0	69.1	-0.1
2005 December	798.8	283.0	7.2	30.0	76.8	155.5	515.8	20.2	181.3	33.1	279.6	19.9	0.7	19.3	74.0	3.4
2006 December	862.9	294.5	4.9	24.3	96.4	156.2	568.4	22.5	193.3	24.6	322.4	40.6	3.0	37.1	103.3	50.9
2007 December	1,069.3	367.1	5.3	28.5	133.5	187.5	702.3	29.8	188.4	41.8	439.0	53.7	2.0	50.3	152.7	39.8
2008 December	1,329.0	397.9	13.8	13.8	176.0	186.2	931.1	40.4	250.1	44.2	593.8	74.9	7.3	63.0	192.3	48.1
2009 December	1,417.8	490.6	8.5	48.9	184.0	237.7	927.2	60.8	73.9	71.7	718.5	97.9	11.2	83.5	204.2	81.0
2010 December	1,702.3	628.6	9.2	83.8	218.6	303.5	1,073.6	85.2	30.2	73.5	883.7	138.2	9.9	112.2	230.5	86.1
2011 December	1,862.7	665.9	10.1	67.9	208.1	360.9	1,196.9	91.0	49.2	71.7	979.9	175.8	8.0	149.7	254.3	100.8
2012 December	1,985.3	708.0	9.6	13.8	257.5	407.2	1,277.3	100.4	49.8	70.5	1,053.1	206.2	7.8	179.8	271.4	129.2

Table 5.1. Other depository corporation survey – net foreign assets

(Outstanding amounts, end of period, in millions of euro)

Description	Net foreign assets						Claims on depository corporations						Net claims on central government	Claims on other sectors	Loans	
	Claims on non-residents	of which:		Less: liabilities to non-residents	Loans	CBK	Other depository corporations			Net claims on central government	Claims on other sectors	Loans				
		Securities other than shares	Shares and other equity				Transferable deposit	Other deposits	Transferable deposit							Other deposits
2005 December	132.1	146.4	—	145.3	14.3	14.3	54.8	27.4	23.3	4.1	27.4	7.2	20.2	—	60.0	51.7
2006 December	198.1	210.0	38.3	170.8	119	119	66.9	39.0	31.0	8.0	28.0	4.9	23.0	—	69.5	57.7
2007 December	244.9	278.5	100.7	175.4	33.6	33.6	72.8	32.9	22.4	10.6	39.8	6.2	33.6	—	85.4	73.8
2008 December	157.0	214.7	79.8	128.2	57.7	57.7	113.0	57.1	49.9	7.2	55.9	7.9	48.0	—	108.3	94.0
2009 December	168.6	253.8	97.9	144.3	85.1	85.1	200.0	129.7	129.7	...	70.3	7.4	62.9	—	130.8	109.4
2010 December	341.3	430.5	152.5	269.3	89.2	89.2	142.8	43.9	43.9	...	98.8	8.2	90.6	—	139.7	116.9
2011 December	462.4	544.1	3.1	533.1	81.7	81.7	137.9	27.7	27.7	...	110.4	7.3	103.1	—	128.1	102.5
2012 December	607.6	670.8	3.3	666.5	63.2	63.2	147.7	32.4	32.4	...	115.3	9.5	105.8	13.9	122.2	98.3

Table 5.2. Other depository corporation survey – liabilities, excluding foreign and fiscal sector

(Outstanding amounts, end of period, in millions of euro)

Description	Loans	Insurance technical reserves				Shares and other equity				Other items				
		Net equity of households in life ins.	Net equity for households in pension funds	Prepayment of premiums and reserves	Funds contributed by owners	Retained earnings	General and special reserves	Profit/Loss for the year	Other liabilities	Less: other assets	Plus: consolidation adjustment			
2005 December	3.0	174.5	—	152.4	22.1	71.4	47.7	12.9	6.7	4.0	-2.1	4.4	6.5	—
2006 December	3.4	251.4	—	223.9	27.5	80.5	55.2	15.8	7.9	1.6	-0.7	7.4	8.2	—
2007 December	...	316.1	—	286.2	29.9	87.4	62.1	20.1	1.7	3.5	-0.4	9.6	10.0	—
2008 December	1.0	288.6	—	256.3	32.3	77.4	54.0	12.7	7.4	3.4	11.3	24.2	12.9	—
2009 December	2.9	422.3	...	380.8	41.5	77.0	53.4	19.4	7.2	-3.1	-2.7	13.1	15.8	—
2010 December	2.9	540.5	...	493.7	46.8	82.5	59.7	13.6	7.2	2.0	-2.1	20.9	23.1	—
2011 December	3.3	647.8	...	593.3	54.5	85.4	60.4	13.3	10.8	0.9	-6.3	16.1	22.4	—
2012 December	4.5	806.9	...	745.1	61.8	79.3	60.5	14.6	11.2	-7.0	4.9	28.1	23.2	—

Table 6.1. Euro deposits at other depository corporations – by initial maturity, main sectors

(Outstanding amounts, end of period, in millions of euro)

Description	Total deposits in euro														
	Government	Financial corporations						Non financial corporations		Other domestic sectors			Nonresidents		
		Other depository corporations	Other financial intermediaries	Insurance companies	Pension funds	Financial auxiliaries	Public nonfinancial corporations	Other nonfinancial corporations	Households	NPISH					
2001 December	492.3	—	—	—	—	—	—	—	165.2	—	165.2	313.1	313.1	—	13.9
2002 December	427.2	—	—	—	—	—	—	—	183.6	—	183.6	226.1	226.1	—	17.5
2003 December	515.8	—	1.8	1.8	—	—	—	—	226.1	—	226.1	267.9	267.9	—	20.0
2004 December	674.9	1.3	25.6	3.7	3.5	15.5	—	2.9	275.3	173.5	10.18	360.3	350.7	9.6	12.3
2005 December	815.3	2.9	35.4	8.1	5.8	18.8	—	2.8	319.0	211.3	107.7	440.7	428.7	12.0	17.3
2006 December	890.4	7.0	28.1	0.1	2.4	24.7	0.4	0.5	337.8	217.4	120.5	499.2	486.1	13.1	18.2
2007 December	1,092.0	4.1	39.1	3.1	5.6	28.3	0.4	1.7	386.2	215.5	170.7	647.0	631.9	15.2	15.6
2008 December	1,366.9	1.4	62.9	5.0	6.5	31.5	19.4	0.4	479.7	263.8	215.9	785.0	774.5	10.5	37.9
2009 December	1,640.1	165.0	78.2	6.1	5.9	43.1	22.6	0.4	371.5	121.6	249.9	962.2	948.8	13.4	63.2
2010 December	1,831.1	11.7	105.0	7.3	7.9	47.6	41.6	0.6	414.9	122.3	292.6	1,220.1	1,206.1	14.0	79.4
2011 December	1,980.7	2.7	117.5	9.9	6.8	57.2	43.1	0.5	406.6	128.5	278.1	1,395.6	1,373.4	22.2	60.0
2012 December	2,162.8	0.7	120.0	3.8	6.2	64.3	45.3	0.4	401.7	75.6	326.1	1,558.6	1,535.4	23.2	81.7

Table 6.2. Non-euro deposits at other depository corporations – by initial maturity

(Outstanding amounts, end of period, in millions of euro)

Description	Non-euro deposits															
	Financial corporations	of which:				Nonfinancial corporations	Other domestic sectors		Nonresidents							
		CBK	Other depository corporations	Other financial intermediaries	Insurance companies		Public nonfinancial corporations	Other nonfinancial corporations		Households	NPISH					
		Transferable deposits	Saving account	Other deposits												
2005 December	29.4	...	—	...	...	...	2.8	—	2.8	26.0	25.7	10.8	—	14.9	0.3	0.5
2006 December	34.3	...	—	...	...	...	3.7	0.3	3.5	29.8	29.6	12.4	—	17.2	0.2	0.5
2007 December	53.3	0.5	—	...	0.1	0.4	8.1	1.5	6.6	44.3	44.2	16.2	—	28.0	0.1	0.4
2008 December	81.9	0.9	—	...	...	0.9	11.6	0.1	11.5	68.4	68.2	22.9	—	45.2	0.3	1.0
2009 December	112.1	2.1	—	12	...	0.9	18.3	1.3	17.0	91.1	90.9	29.7	—	61.1	0.2	0.7
2010 December	113.8	3.1	—	2.9	—	—	13.7	4.3	9.4	93.8	93.3	33.1	25.9	34.3	0.5	3.1
2011 December	131.5	0.3	—	0.3	—	—	9.8	0.1	9.7	117.5	117.0	46.5	31.7	38.9	0.4	3.8
2012 December	120.9	1.6	0.0	12	0.2	0.0	9.6	0.0	9.6	104.9	104.7	45.7	27.0	32.0	0.2	4.8

Table 6.3. Other depository corporation loans – by initial maturity

(Outstanding amounts, end of period, in millions of euro)

Description	Total														Loans in Non Euro Currency	
	Financial corporations	of which:			Nonfinancial corporations	of which:			Other domestic corporations	of which:			Households			
		Other financial intermediaries	Insurance companies	Public nonfinancial corporations		Other nonfinancial corporations	Up to 1 year	Over 1 year and up to 2 years		Over 2 years	Up to 1 year	Over 1 year and up to 2 years		Over 2 years		
2001 December	25.9	—	—	—	25.9	—	25.9	24.6	13	—	—	—	—	—	—	—
2002 December	86.5	—	—	—	80.8	—	80.8	67.3	13.5	—	5.7	5.7	14	4.3	—	—
2003 December	232.8	—	—	—	193.7	0.2	193.5	124.7	68.7	0.2	39.0	39.0	114	16.0	11.6	—
2004 December	373.7	—	—	—	289.9	...	289.9	111.5	111.3	67.2	83.7	83.7	15.9	15.2	52.6	—
2005 December	513.9	—	—	—	387.9	...	387.9	117.9	125.2	144.7	126.0	126.0	19.5	21.0	85.4	—
2006 December	636.6	—	—	—	490.5	...	490.5	128.7	127.7	234.1	146.1	146.1	19.7	24.7	101.7	—
2007 December	892.1	—	—	—	691.5	0.2	691.3	174.0	122.6	394.6	200.6	200.6	24.0	29.6	147.1	—
2008 December	1,183.4	0.6	—	0.6	901.8	0.1	901.7	191.0	132.3	578.4	281.0	281.0	20.9	30.9	229.2	—
2009 December	1,289.0	2.3	12	1.1	943.2	0.3	942.9	215.7	113.0	614.2	343.5	343.5	27.0	32.1	284.5	—
2010 December	1,458.7	5.7	2.6	3.0	1,014.5	6.3	1,008.3	259.4	64.3	684.5	434.3	434.2	26.5	30.7	377.0	2.5
2011 December	1,698.1	8.3	6.6	1.7	1,137.6	1.5	1,136.1	307.8	83.4	744.8	512.4	510.9	44.0	38.1	428.8	7.3
2012 December	1,763.4	19.8	16.3	3.5	1,171.2	1.4	1,169.8	313.4	91.7	764.8	543.0	542.6	52.2	37.3	453.0	6.9

Table 6.4. Other depository corporation loans – by industry

(Outstanding amounts, end of period, in millions of euro)

Description	Total									
	Agriculture			Industry, energy and construction				Services		
		Up to 1 year	Over 1 year		Up to 1 year	Over 1 year		Up to 1 year	Over 1 year	
2001 December	25.9	...	...	—	3.8	3.8	...	22.2	22.2	...
2002 December	86.5	1.5	1.5	—	13.6	13.6	...	71.4	71.4	...
2003 December	232.8	4.7	3.9	0.8	22.2	12.6	9.7	205.8	119.7	86.1
2004 December	289.9	7.9	3.9	4.1	47.8	22.5	25.3	234.2	89.5	144.8
2005 December	387.9	12.5	4.1	8.4	74.2	24.5	49.7	301.1	92.4	208.8
2006 December	490.5	16.4	3.4	13.0	97.7	28.0	69.7	376.4	120.6	255.8
2007 December	691.5	29.0	4.1	24.9	144.5	32.8	111.7	518.0	149.5	368.5
2008 December	902.4	37.4	4.1	33.3	160.2	28.9	131.2	704.8	126.4	578.4
2009 December	945.5	38.2	3.8	34.4	236.7	54.8	181.9	670.5	113.2	557.3
2010 December	1,022.8	38.2	1.7	36.5	269.3	77.1	192.2	715.3	188.5	526.8
2011 December	1,149.5	40.5	0.8	39.7	284.7	82.3	202.4	824.4	220.5	603.8
2012 December	1,194.2	43.6	3.0	40.6	290.4	74.1	216.2	860.2	232.3	627.9

Table 6.5. Other depository corporation effective interest rates

(New businesses, unless otherwise indicated)

Description	Deposit rates	Nonfinancial corporations								Households								
		Transferable deposits	Other deposits						Saving deposits	Transferable deposits	Other deposits					Saving deposits		
			Less than 250.000 euro			More than 250.000 euro					Up to 1 month	Over 1 month and up to 3 months	Over 3 months and up to 6 months	Over 6 months and up to 1 year	Over 1 year and up to 2 years		Over 2 years	
			Up to 1 month	Over 1 month and up to 3	Over 6 months and up to 1 year	Over 2 years	Up to 1 month	Over 1 month and up to 3										Over 6 months and up to 1 year
2005 December	3.12	0.26	2.07	2.37	3.40	*	2.90	*	*	1.71	0.04	1.85	2.24	*	3.33	3.87	4.04	1.74
2006 December	3.11	0.39	2.06	2.85	4.32	*	3.11	*	*	1.53	0.03	1.93	2.35	*	3.44	4.16	4.51	1.65
2007 December	4.00	0.48	2.68	2.93	4.35	*	4.27	4.15	*	2.45	0.02	2.55	2.75	*	3.60	4.72	5.27	2.25
2008 December	4.42	0.53	3.09	3.97	5.32	*	3.61	4.92	*	2.85	0.11	3.21	4.60	*	4.45	4.99	3.95	2.74
2009 December	3.98	0.72	3.42	3.42	5.03	*	3.88	4.88	*	2.63	0.34	3.09	3.28	*	4.39	5.00	5.50	2.51
2010 December	3.38	0.63	2.44	3.08	4.96	5.14	*	3.74	*	2.07	0.55	2.58	2.63	3.15	4.49	4.77	5.14	2.21
2011 December	3.71	0.86	0.00	2.91	4.90	5.05	*	3.88	5.25	2.20	0.48	2.49	2.47	2.88	4.21	4.56	5.36	2.06
2012 December	3.74	0.83	*	2.79	*	*	2.67	4.02	4.75	2.15	0.54	2.30	2.46	2.84	4.20	4.52	4.76	2.06

Table 6.6. Other depository corporation effective interest rates - deposit rates

(New businesses, unless otherwise indicated)

Description	Loan rates	Non-financial corporations (loans)								Households							
		Investment business loans			Other business loans (non-investing)		Overdrafts	Credit lines	Loans with favourable conditions		Overdrafts	Loans with favourable conditions		Consumer loans	Mortgage loans		
		Up to 1 year	Over 1 year up to 5 years	Over 5 years	Up to 1 year	Over 1 year up to 5 years			Loans covered by deposits	Other loans		Loans covered by deposits	Other loans		Up to 5 years	Over 5 years up to 10 years	Over 10 years
2005 December	14.47	17.34	13.29	13.29	15.18	14.38	15.11	11.51	...	*	*	...	*	11.51	*	*	*
2006 December	14.70	*	14.50	14.50	13.60	15.18	15.72	12.36	...	*	*	...	*	12.36	*	13.36	*
2007 December	14.06	*	13.76	13.76	*	14.64	15.09	13.72	...	*	*	...	*	13.72	12.92	12.36	*
2008 December	13.79	*	13.92	13.92	14.20	13.45	15.03	13.50	...	*	19.48	...	...	13.50	9.81	10.82	8.13
2009 December	14.09	*	14.34	14.34	*	*	*	...	*	17.83	...	...	13.31	*	10.67	*	
2010 December	14.31	16.13	13.95	*	18.66	14.44	12.65	13.27	7.69	*	22.57	6.55	8.56	14.56	*	11.67	10.26
2011 December	13.69	15.89	13.55	11.68	16.40	13.80	11.78	12.12	6.10	9.88	16.44	6.01	8.58	14.02	14.31	11.99	10.83
2012 December	12.86	15.37	12.03	10.19	15.29	13.66	10.70	11.90	5.92	*	12.46	6.11	7.97	13.06	*	10.78	9.79

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