

## Summary

Worsening of the health crisis as a result of the third wave of Covid-19 virus spread, and the restrictive measures taken in the euro area countries resulted in a contraction of economic activity of -5.0%, in Q4 2020. With an economic crisis is being faced also the Western Balkan region. In Q3 2020, an economic decline of -8.5% is estimated in this region, while the IMF forecast for 2020 suggests a decline in the economic activity of an average of -6.9%.

Based on KAS estimates, real GDP marked a decline of -5.6% by September 2020. With a decline were characterized also investments and net exports, whereas consumption was estimated to have marked an increase. In Q4 2020, the indications suggest a lower decline compared to the previous quarters. These estimates are based on the increase in exports of goods and services in the reporting period, in public consumption, the increase of remittances, etc. Conversely, public investments, the turnover of businesses and new investment loans were characterized with a considerable decline.

Price dynamics in the country were accompanied by a decline in consumer prices of -0.1% in Q4 2020, mainly due to the decline in prices of transport, footwear and clothing, recreation, home furnishing, etc. The slowdown increase of prices was marked also by the prices of food and non-alcoholic beverages, thus making the core deflation reach 0.8%.

Mitigating the negative effects of the Covid-19 pandemic on economic developments has improved the performance of budget revenues compared to previous quarters. In Q4 2020, budget revenues marked a decline of -0.6% (-13.5% in Q3 2020), while budget

expenditures marked an increase of 8.6%. Consequently, Kosovo's budget recorded a primary budget deficit of EUR 280.5 million. Public debt reached EUR 1.5 billion, which is for 23.9% higher compared to Q4 2019. As a percentage to GDP, public debt reached 21.8%, from 17.5% as it was in Q4 2019.

Assets of financial system increased by EUR 236.8 million in Q4 2020 being impacted by increase of the banking sector and insurance sector assets. The increase of assets of the banking sector mainly reflects the increase in deposits, which can be attributed, to some extent, to the withdrawal of 10% from the pension system. The insurance sector marked an increase of assets, being characterized with a higher written premiums and a decline of claims paid. Whereas, the contraction of the pension sector assets mainly was attributed to the withdrawal of 10% of pension savings at the end of 2020. Also the microfinance sector has marked a contraction of assets, albeit continued to have good quality of credit portfolio.

The external sector was characterized with a decline of the current account deficit of 56.8% in Q4 2020. The positive balance of services as well as primary and secondary income have increased significantly, while the goods deficit has improved. The trade deficit of goods was EUR 836.2 million or 2.0% lower compared to Q4 2019, a dynamic that was mainly attributed to the significant increase of exports, despite the increase of imports. Within the balance of payments, a considerable increase was marked by remittances and FDI, in Q4 2020 (26.3% and 82.2%, respectively).

## CONTENTS

Summary .....	i
<b>Euro area and Western Balkans .....</b>	<b>4</b>
<b>Kosovo's Economy .....</b>	<b>6</b>
<b>Real Sector .....</b>	<b>6</b>
<b>Prices .....</b>	<b>6</b>
<b>Fiscal Sector .....</b>	<b>7</b>
<b>Financial Sector .....</b>	<b>8</b>
<b>External Sector .....</b>	<b>9</b>

## GRAPHDS AND TABLES

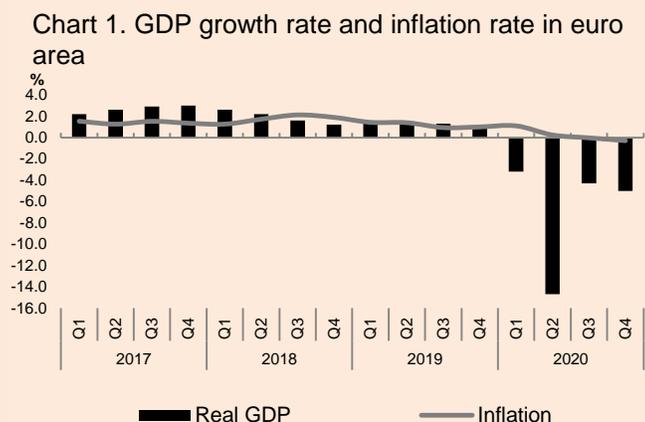
Chart 1. GDP growth rate and inflation rate in euro area .....	04
Chart 2. Real GDP growth rate and main contributors .....	06
Chart 3. General inflation and base inflation .....	06
Chart 4. Current account deficit and its components .....	09
Chart 5. Export and import of goods .....	10
Chart 6. Structure of exports by category .....	10
Chart 7. Structure of imports by category .....	10
Chart 8. Remittances .....	11
Chart 9. Structure o foreign direct investments .....	11
Table 1. Real GDP growth rate in the Western Balkans .....	05
Table 2. Annual Inflation rate in the Western Balkans .....	05
Table 3. Contribution of specific categories to overall inflation .....	07
Table 4. Macroeconomic selected indicators .....	13

## **ABBREVIATIONS**

KAS	Kosovo Agency of Statistics
GDP	Gross Domestic Product
CBK	Central Bank of the Republic of Kosovo
ECB	Central European Bank
EUR	Euro currency
IMF	International Monetary Fund
CPI	Consumer Price Index
FDI	Foreign Direct Investments
IPI	Import Price Index
MF	Ministry of Finance of the Republic of Kosovo
WEO	World Economic Outlook

## Euro area and Western Balkans

Worsening of the health crisis with the new wave of Covid-19 spread caused the euro area countries to take restrictive measures of movements and activities again, which resulted in a contraction of economic activity of -5.0% in Q4 2020 (chart 1).



Source: Eurostat (2021)

Among the main euro area countries, Germany and France reported a decline in economic activity of -3.9% and -5.0%, respectively, while Italy and Spain marked an even higher decline of economic activity of -6.6% and -9.1%, respectively. For 2021, the ECB forecasts a recovery in economic activity and a GDP growth of 3.9%, based on the assumption of lifting restrictive measures and increasing the confidence as a result of the assumption of mass vaccination within the year.

The decline of the economic activity was translated in weak dynamics also in the level of euro area prices, mainly as a consequence of the decline of energy prices and the decline of prices of industrial production. The average rate of Harmonized Consumer Price Index, in Q4 2020, was -0.3% (1.0% in Q4 2019). In response to

the declining prices and to create favorable financing conditions for economic recovery, in December 2020, the Governing Council of the ECB decided to increase the amount to EUR 1,850 billion under the Pandemic Emergency Purchase Program (PEPP) and facilitate conditions for long-term refinancing. Moreover, the ECB Governing Council has decided to keep unchanged the interest rate on main refinancing operations (0.0%), the interest rate on credit and deposits facilities (0.25% and -0.50%, respectively).

Conversely, credit and depository activity in euro area continued to increase, by which were characterized enterprises and households as well. Loans to enterprises marked an increase of 6.4% in Q4 2020, while loans to households expanded by 3.5%. With a high increase were characterized also deposits of the banking system, where enterprise deposits marked an increase of 20.7%, while household deposits increased by 8.7%.

Also the Western Balkan countries were hit by Covid-19 pandemic, thus being faced with a deep recession. According to national data, the highest economic decline was recorded in Q2 2020 (with an average of -12.2%), while in Q3 2020<sup>1</sup> economic activity in the Western Balkans was characterized by an average decline of -8.5%. The highest economic decline was recorded in Montenegro, a country highly dependent on tourism, which is also the sector mostly affected by the pandemic crisis. Also, Kosovo marked a considerable decline of economic activity, mainly due to the decline of diaspora visits with restrictions on movements in the main euro area countries where the diaspora is more

<sup>1</sup> The data for Q4 2020, for the majority of countries, have not been published yet.

concentrated. Serbia is the country which was less affected by the pandemic (table 1).

**Table 1. Real GDP growth rate in W. Balkans**

Description	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3
Serbia	2.6	2.9	4.9	6.3	5.2	-6.3	-1.4
Montenegro	3.2	3.6	5.2	3.7	2.6	-20.3	-26.9
Kosovo	4.2	4.1	4.4	3.9	1.3	-9.3	-7.3
North Macedonia	1.4	4.3	3.6	3.3	0.9	-14.9	-3.3
Albania	2.3	2.3	4.2	0.0	-2.3	-10.2	-3.5

Source: National Statistics Offices of the respective countries

Challenges that accompanied the pandemic crisis and uncertainties about the progress of mass vaccination have led the IMF to forecast a decline in economic activity by an average of -6.9% in 2020. IMF projections for 2021 suggest an economic activity recovery with an average growth of GDP of 5.6%.

Weak inflationary pressures were also reported in the Western Balkan countries, as a result of the decline of the domestic demand and the decrease of oil prices. The average inflation rate in Q4 2020 was 0.9%. In Kosovo and Montenegro was recorded a deflation, while in other countries of the region the inflation rate was higher (table 2).

**Table 2. Annual inflation rate in W. Balkans**

Description	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4
Kosovo	3.2	3.3	2.6	1.7	1.1	0.2	-0.4	-0.1
Montenegro	0.4	0.5	-0.1	1.1	0.5	-1.1	-1.4	-1.3
North Macedonia	1.2	1.2	0.6	0.0	0.6	0.5	1.5	2.2
Serbia	2.4	2.3	1.3	1.4	1.7	1.0	1.9	1.6
Albania	2.0	1.5	1.5	1.6	1.9	2.4	2.2	2.2

Source: National Statistics Offices of the respective countries

In terms of developments in the banking sector, Western Balkan countries recorded an increase of 6.5% in lending activity, which is a lower growth rate compared to 7.3% marked in Q4 2019. The countries with the highest growth rates were Serbia and Kosovo (10.8% and 7.1%, respectively), followed by Albania (6.6%), North Macedonia (4.7%) and Montenegro (3.2%). Deposits marked an average increase of 7.8%,

representing a higher rate compared to the increase of 7.4% recorded in Q4 2019. The highest increased rate of deposits was marked in Serbia and Kosovo (16.4%, and 11.5%, respectively), followed by Albania (8.3%), and North Macedonia (5.9%), while Montenegro reported a decline of the growth rate of deposits (-3.0%).

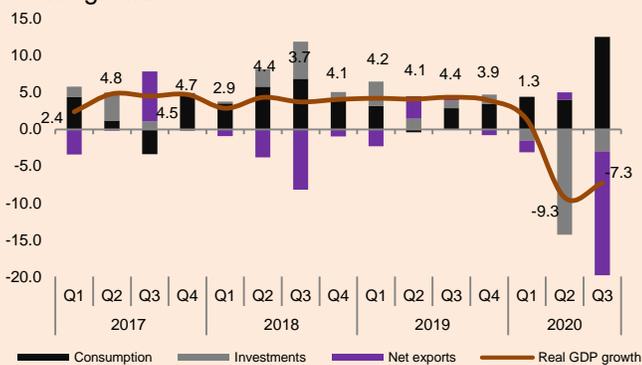
During Q4 2020, EUR depreciated against the Swiss franc (1.7%) while appreciated against other currencies: 46.5% against the Turkish lira, 7.7% against the US dollar, 5.0% against the British pound, 1.6% against the Croatian kuna, 0.9% against the Albanian lek, etc.

## Kosovo's Economy

### Real Sector

To manage the Covid-19 pandemic, the same as other governments, Kosovo Government has taken restrictive measures in terms of movements, travel, public and non-public activities, service activities in some of the enterprises, etc. Restrictive measures taken have resulted in an average decline in economic activity of -5.6% in the first nine months of 2020. Within the GDP, components of net investments and exports decreased by -6.5 and -6.4 percentage points, respectively. Conversely, the economic activity was supported by the positive contribution of consumption with 7.4 percentage points (chart 2).

Chart 2. Real GDP growth rate and main contributors to the growth



Source: KAS and CBK calculations (2021)

According to KAS, the highest decline was recorded in the hotels and restaurants sector (-30.7%), transport and storage (-30.2%), construction (-28.6%), administrative and support activities (-12.4%), trade (-8.9%), etc. On the other hand, a higher growth was recorded in the health sector and social work (12.7%), electricity and gas supply (12.2%), processing industry

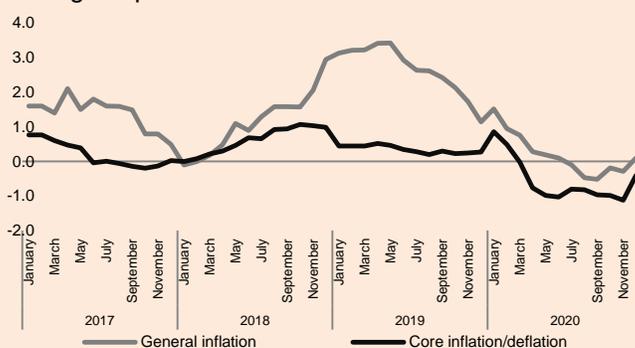
(12.0%), information and communication (10.5%), extractive industry (4.4%), etc.

The CBK estimates suggest that in Q4 2020 there was a slower decline in economic activity of -3.8%, compared to the decline recorded in the previous two quarters of the year. These estimates are based on the increase of exports of goods and services in the reporting period, the increase of public consumption, and the increase of remittances. Conversely, public investments, the turnover of businesses and new investment loans were characterized with a considerable decline.

### Prices

Consumer Price Index marked a slowdown increase of 0.2% in 2020 (an increase of 2.7% in 2019). As of July, KAS reported a decline of prices, while the average of deflation was 0.1%, in Q4 2020 (chart 3).

Chart 3. General inflation and base inflation, annual change in percent



Source: KAS and CBK calculations (2021)

A decline of prices, in Q4 2020, was marked in prices of transport, footwear and clothing, recreation, and in prices of furnishing. Conversely, an increase was marked in prices of communication means, health services, hotel services, etc. The prices of food and non-

alcoholic beverages were also characterized by a slower rise, however, due to the large weight in the basket of Kosovar consumers, they contributed positively by 0.65 percentage points to the overall price level (table 3).

**Table 3. Contribution of specific categories to overall inflation in Q4 2020**

Description	Weight 2020	Deflation rate	Contribution
<i>Total</i>	<i>100.0%</i>	<i>-0.1</i>	<i>-0.13</i>
Food and non-alc. beverages	40.1%	1.6	0.65
Alcoholic beverages and tobacco	5.7%	0.4	0.03
Footwear and clothing	4.1%	-2.1	-0.08
Energy	7.7%	0.5	0.04
Furnishing	7.6%	-0.4	-0.03
Health	2.1%	4.4	0.09
Transport	15.7%	-7.3	-1.16
Communication	3.8%	5.2	0.18
Recreation	4.4%	-0.4	-0.02
Education	1.0%	0.5	0.00
Hotels	3.2%	1.6	0.05
Goods and other services	4.5%	2.0	0.12

Source: KAS and CBK calculations

As shown in the table, the Kosovar's consumer basket is characterized with a very high share of products with seasonal price fluctuations (food, energy, alcoholic beverages and tobacco), where the exclusion of these components results in a higher core deflation compared to the overall deflation (chart 3). Core deflation stood at 0.8%, which resulted to be higher for 0.7 percentage points than the overall deflation.

Due to the high dependence of Kosovo's economy on import, the dynamic of Kosovar consumer basket is mainly determined by import price fluctuations, which in Q3 2020 marked an average decline rate of -2.3% (an increase of 2.2% in Q3 2019). Besides import prices, also producer prices were characterized with a decline of -0.8%, albeit this rate was lower compared to import prices.

## Fiscal Sector

Budget revenues,<sup>2</sup> until December 2020, reached a net value of EUR 1.7 billion, representing an annual decrease of 8.8%, while budget expenditures<sup>3</sup> marked an annual increase of 6.5% and reached a value of EUR 2.2 billion. Only in Q4 2020, budget revenues amounted to EUR 505.9 million, representing an annual decline of 0.6% compared to Q4 2019, while budget expenditures increased by 8.6% and reached the value of EUR 786.4 million. Consequently, Kosovo's budget recorded a primary budget deficit of EUR 280.5 million during this quarter.

Mitigation, to some extent, of the negative effects on the country's economy in Q4 2020 turns out to have affected a slight increase in direct tax revenues of 0.4%. Personal income tax, as the main category of direct tax revenues, increased by 2.9%, while corporate income tax decreased by -6.4%. The negative impact of the pandemic on domestic demand and imports of goods was reflected in a decrease of -3.3% in indirect tax revenues, a category that dominates budget revenues by about 73%. In Q4 2020, indirect tax revenues amounted to EUR 368.1 million, where VAT and excise as the two main categories of this category decreased by -1.4% and -3.1%, respectively.

Measures taken by the Government to mitigate the negative economic and social effects of the Covid-19 pandemic health crisis resulted in increased budget expenditures. The main category which contributed to the increase of budget expenditures, during Q4 2020, was the one of subsidies and transfers, which reached the value of EUR 322.0 million, representing an

<sup>2</sup> Within budget revenues are not included financing income.

<sup>3</sup> Within budget revenues are not included financing payments.

increase of 77.3%, compared to Q4 2019. With a growth of 7.4% were characterized also expenses on salaries, which reached the value of EUR 170.4 million. Government expenditures on goods and services (including municipal utilities) marked an increase of 5.2%, reaching a value of EUR 118.0 million. Conversely, capital expenditures marked a decline of -35.3% and reached the value of EUR 176.0 million.

Public debt, in Q4 2020, reached EUR 1.5 billion, which is for 23.9% higher than the public debt marked in the Q4 2019. As a percentage to GDP, public debt reached 21.8%, from 17.5% as it was in Q4 2019. The increase of public debt is attributed to the growth of domestic debt of 21.5% (which reached EUR 961.9 million), and the increase of external debt of 28.6% (which reached to EUR 525.8 million). The share of public external debt to total public debt increased at 35.3% from 34.0% as it was in Q4 2019. The threshold of public debt in Kosovo is set by law at 40% of GDP, and consequently the level of 21.8% ranks Kosovo in the position of the country with the lowest level of public debt compared to the region countries. Nevertheless, this low level of public debt may quickly surge in the future as a result of the negative impact of Covid-19 pandemic in Kosovo's economy and due to the Government's plans to finance the budget deficit through the public debt.

### **Financial Sector**<sup>4</sup>

On quarterly basis, assets of financial system increased by EUR 236.8 million, mainly reflecting the increase of the banking sector and insurance sector assets. The significant growth of assets of the banking

sector in this quarter mainly reflects the deposits activity, as a result of the transfer of funds from the pension sector (10%) to the citizens' accounts and the increase in the level of deposits from nonfinancial corporations.

Within the assets of the banking sector, cash and balance with the CBK marked the highest growth, followed by lending activity, and investments in securities. Whereas, within liabilities, deposits as the main source of financing the banking activity, marked the most notable increase in this quarter. With an increase were characterized also the category of own resources (from the retained and realized profit). Regarding the soundness of the banking sector, also during Q4 2020, the sector maintained high level of the capital, of liquidity indicators and high credit portfolio quality.

The pension sector was characterized with a contraction of assets in Q4 2020, mainly as a result of the withdrawal of 10% of pension savings at the end of the year, a dynamic which was neutralized to some extent from the collected contributions and positive return on investments.

Also the insurance sector was characterized by an increase in activity during Q4 2020, mainly reflected through the increase of assets, the higher level of written premiums and the decrease of the level of claims paid compared to Q4 2019.

The microfinance sector has marked a contraction of activity in Q4 2020 compared to the previous year, a dynamic that largely reflects the revocation of the

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<sup>4</sup> For more information on financial sector, please refer to: Quarterly Assessment of Financial System (Q4 2020) published at the CBK website.

licenses of two non-bank microfinance / financial institutions during the previous year, whose assets are gradually being deducted from the total balance sheet of the sector. Moreover, the overall decline of the microfinance sector activity was affected by the negative effect of the Covid-19 pandemic.

During the fourth quarter of 2020, Kosovo's Government issued debt with a significant higher value compared to the same quarter of the previous year. The level increase of the sovereign debt issued reflects the needs of Kosovo's Government to finance its activity through this instrument.

### External Sector

External sector of the economy was the main channel through which was transmitted the economic and social crises driven by the Covid-19 pandemic in Kosovo. Current account deficit in 2020 marked an increase of 7.5% reaching an amount of EUR 429.4 million. As a percentage to GDP, current account deficit it was estimated to have reached -6.4% from -5.6% as it was in 2019. If we analyze Q4 as isolated, we notice more positive trends compared to the rest of the year, a performance that turns out to be translated into a decrease of the current account deficit by 56.8% compared to Q4 2019. Within the balance of payments, the positive balance of services as well as primary and secondary income have increased significantly, while the goods deficit has improved (chart 4).

The increase of export of goods and the considerable decrease of import as a result of the decline of the economic activity has had an impact on the trade

deficit of goods<sup>5</sup> which marked a value of EUR 2.8 billion, corresponding to a decline of -9.4%. Only in Q4 2020, trade deficit of goods was EUR 836.2 million or 2.0% lower compared to Q4 2019.

Chart 4. Current account deficit and its components, EUR million

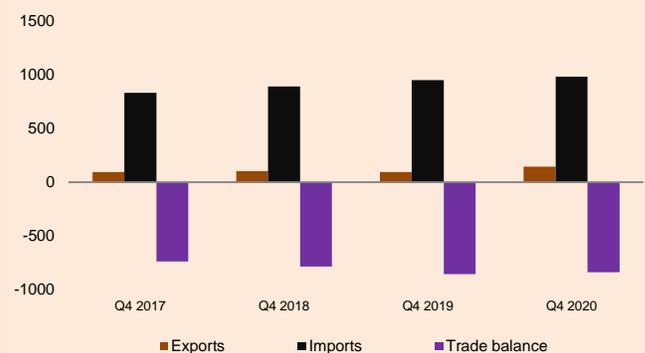


Source: CBK (2021)

This deficit decline of goods is mainly attributable to the considerable increase of export, despite the increase of import of goods.

The value of export of goods, in Q4 2020, was EUR 143.2 million, representing an annual increase of 51.2% (chart 5).

Chart 5. Export and import of goods, EUR million



Source: KAS (2021)

<sup>5</sup>The source of data for import and export of goods in Kosovo is Kosovo Agency of Statistics.

The increase of export of goods was more notable in metals and vegetables, while with a decline were characterized leather and articles thereof, fats and edible oils, etc. (chart 6).

Chart 6. Structure of exports by category, in percent



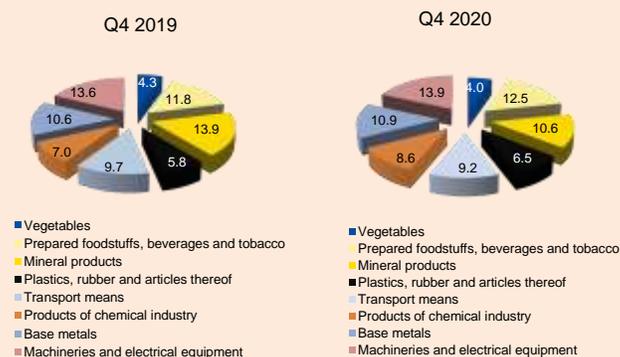
Source: KAS (2021)

The value of goods imported reached EUR 979.4 million in Q4 2020, representing an annual increase of 3.3%. The increase of import was mainly impacted by the higher level of import of chemical industry products. With an increase were characterized also the import of prepared foodstuff, beverages and tobacco and the import of plastic and rubber. Conversely, the import of mineral products, of transport means, and import of vegetables, etc. were characterized with a decline (chart 7).

Within the balance of payments, trade of services was the component that suffered the sharpest decline as a direct consequence of the restrictive measures taken to manage the health crises. The balance in trade of services in 2020, marked a value of EUR 430.2 million or 53.5% lower compared to 2019. This decline of export of services is one of the main external channels of crisis transmission, as export of services has a high share to GDP and consist mainly of the expenses of diaspora

during their stay in Kosovo. Unlike developments of the previous quarters, in Q4 2020, the balance of services increased for 47.4%. The value of export of services increased by 9.0%, amounting to EUR 287.0 million.

Chart 7. Structure of imports by category, in percent



Source: KAS (2021)

The increase of diaspora visits to Kosovo for the end-year feasts has influenced the export of travel services to reach the value of EUR 183.1 million in Q4 2020, corresponding with an annual increase of 2.3%. With an increase were characterized also other services, such as: export of pension and insurance services, construction services, transport services, etc. Conversely, the import of services has continued its downward trend also in Q4 2020, where the value of services imported amounted to EUR 153.0 million, or for 11.3% less compared to Q4 2019. The highest decline was marked in the import of computer services (-43.5%), travel services (-24.0%), and transport services (-12.1%).

The primary income account increased by 11.7% in Q4 2020, mainly as a result of the increase of investment income, while the income from employees compensation decreased. The balance of secondary income marked an increase of 21.8%, which is mainly attributable to the higher level of remittances. Remittances received in Kosovo, which at the same time represent the largest category within the

secondary income account, marked the value of EUR 283.1 million in Q4 2020, representing an annual increase of 26.3% (chart 8).

Graph 8. Remittances, EUR million

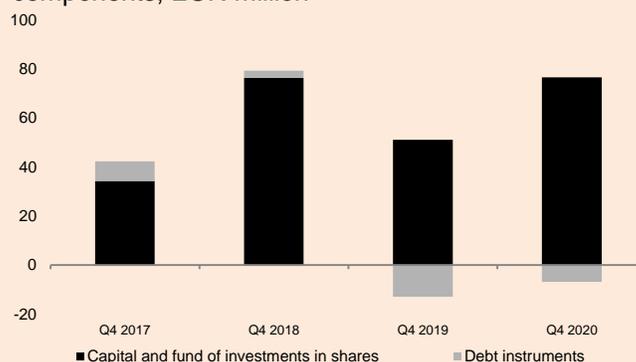


Source: CBK (2021)

The increase of remittances was continuously of double digit during the whole year of 2020, except in the months of March and April 2020 when it had been marked a decline. In terms of transferring channels, the vast majority of remittances (61.5%) came through money transferring agencies, which marked an increase of 54.4% in Q4 2020. Remittances received through banks marked an increase of 29.1%, while remittances which came through “informal channels” marked a decline of 13.6%. Remittances received in Kosovo mainly come from Germany and Switzerland, which represent the countries with a share of 42.9% and 20.0%, respectively, of total remittances. A considerable amount of remittances was received also from the U.S.A (6.7% of total remittances).

Foreign Direct Investments (FDI), in Q4 2020, reached the value of EUR 69.6 million, representing an increase of 82.2%. Within the structure of FDI, investments in capital and fund of investments in shares marked an increase of 49.6%, while in debt instruments the decline was lower for 46.7% compared to Q4 2019 (chart 9).

Graph 9. Structure of foreign direct investments by components, EUR million



Source: CBK (2021)

The increase of FDI mainly was recorded in the sector of financial activities and in real estate, sectors which at the same time have the highest share to the structure of FDI. The increase of FDI in real estate in Q4 2020 was attributable to some extent to the increase of the diaspora visits in this period, while the increase of FDI in the sector of financial activities mainly reflects not distributing the dividend in this period.

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CBK (2021): Quarterly Assessment of Macroeconomic Developments No. 33 Q4 2020, Central Bank of the Republic of Kosovo

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## Macroeconomic selected indicators

Description	December 2019	December 2020
Real sector 1/		
Gross Domestic Product (GDP) (in millions of EUR)*	5,212.7	4,902.3
Consumer prices (annual average)	2.7%	0.2%
Consumer prices (end of period)	1.1%	0.1%
Fiscal Sector 2/		
Budget Revenues (in millions of EUR)	1,888.2	1,721.2
Budget Expenditures (in millions of EUR)	2,070.0	2,205.2
Primary balance (in millions of EUR)	-181.8	-484.1
Financial sector (in millions of EUR) 3/		
Assets of financial corporations	7,259.9	7,907.8
of which : Banks	4,760.5	5,353.1
Loans	3,031.9	3,246.4
Deposits	3,908.1	4,358.8
<i>Interest Rates on Loans, end of period</i>	6.42%	6.01%
<i>Interest Rates on Loans, end of period</i>	1.60%	1.52%
Interest rate gap	4.8%	4.5%
External sector,(in millions of EUR) 3/		
Balance of payments		
Current accounts	-399.5	-429.4
of which: remittances	851.7	980.1
Financial account	-163.0	-502.2
Foreign Direct Investments in Kosovo	254.6	321.7
Portfolio investments, net	59.0	-81.6
Other investments, net	-128.8	-195.3
International Investment Position (PNI), net*	-304.6	-773.6
Assets	5,185.2	5,198.6
Liabilities	5,489.8	5,972.2
External debt, total*	2,160.9	2,381.1
Private external debt	1,662.1	1,883.7
Public external debt	498.8	497.4

Source:

1/ KAS (2020).

2/ MF (2020).

3/ CBK (2020).

\*Data on IIP and external debt are as of September 2020.

