



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

Bank Lending Survey

Number 6

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Bank Lending Survey and Inflation Expectations

Number 6

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Bank Lending Survey

Introduction¹

In order to increase the analytical capabilities on a good assessment of lending dynamic activities in Kosovo and expectations on the price level, the Central Bank of the Republic of Kosovo (CBK) has designed and conducted a survey with commercial banks which operate in the banking sector of Kosovo. The report which will analyze the results of this survey will be published on quarterly basis at the website of the CBK, aiming at providing a more comprehensive survey about the risk perception of the banks, the willingness of the banks to lend, and the behavior of the households and enterprises in relation to credit activities dynamics. This report records the credit behavior for the fourth quarter of 2020, and banks expectations for credit dynamics in the first quarter of 2021.

In addition to the standard questions, in this survey were added certain other questions about the impact of the pandemic and health crisis on the credit supply of the banking sector in the country, the main risk perceived by banks, and the impact of weighting schemes on managing the pandemic crisis.

Results Summary²

Credit supply has eased and the demand for loans has increased to some extent during the fourth quarter of 2020. These developments are attributable to some extent to the containment measures of Covid-19, the visit and financial aid from the diaspora. Easing measures taken by country's institutions to mitigate the impact of the pandemic on the economy, the invention of the vaccine against the virus and the beginning of the vaccination in the region and beyond had an impact on the banks' expectations, affecting the credit supply conditions and the increase of the credit demand during this quarter of 2021.

New loans to enterprises during the fourth quarter were characterized with a slight increase compared to the same period of the previous year, being impacted positively by credit supply side and loans demand. Also, bank expectations for the following quarter result to be more optimistic. Within the credit supply, banks have reported to have eased to some extent the standards applied in assessing enterprise loans applications during the fourth quarter of 2020, albeit with a low positive index. Credit standards were eased at an approximate level for both segments (SMEs and large enterprises). Credit supply conditions were positively affected by the increase of the optimism because of the ease of restrictive measures against the spread of Covid-19 virus and the invention of the vaccine, the support by Kosovo Credit Guarantee Fund (KCGF), the improvement of the perspective of global markets, the easing measures of the Government and regulatory ease taken by the CBK such as loans restructuring. Despite of the banks statements on easing credit standards, banks have listed also other factors which had a negative impact on the credit standards, albeit at low level, which is the increase of credit risk in the country and abroad.

For the first quarter of 2021, expectations of banks account mainly of the further ease of credit standards. Credit supply to some extent is expected to be more favorable for SMEs than for large enterprises. Banks expectations are based on the expectations for economic recovery in the country, as a result of the ease of restrictive measures along with the ease of the measures taken by the authorities in the country in order to manage the effects of the pandemic crises. Six of the

¹ For more detailed information about the background of the CBK bank lending survey, please refer to the publication "Bank Lending Survey and Inflation Expectations" No. 1.

² The BLS questionnaire, and time series of the bank lending survey results, are available on the CBK website, on the link of the Bank Lending Survey.

participating banks, expect that the support of KCGF will have an impact on easing of the standards. Also, a positive contribution is expected from the good perspective of the banking market in the country, the increase of risk tolerance, as well as to a lower level from the increase of competitive pressures and changes in regulatory easing. At the same time, in terms of maturity, banks are expected to offer eased credit standards, where for long-term loans the ease is expected to be at a higher level.

Terms and conditions applied by banks in granting loans to enterprises **were eased at a lower level.** Eased terms and conditions were applied for both segments of enterprises, mainly through the decline of interest rates, while for SMEs there was an ease also in increasing the loans amount. Factors that influenced the easing of terms and conditions to some extent, were the support of SMEs by KCGF, the decrease of perceived risk based on the improvement of the market outlook in the country in general and banking perspective in particular, as well as the increase of pressure competition and the ease of measures taken to prevent the spread of Covid-19. Whereas, the increase of credit risk continued to be a factor with negative contribution on terms and conditions offered by banks. Meanwhile, for the first quarter of 2021, banks expect easing of terms and conditions for both segments of enterprises, while more significant ease is expected for SMEs. The ease is expected to be applied mainly through declining interest rates, lower collateral requirements, as well as to a lower extent through the increase of the loans amount and the lengthening of the loans maturity.

During the fourth quarter of 2020, **the enterprises demand for bank loans** results to have been increased, albeit at lower level compared to the previous quarter. This increase has exceeded banks expectations stated in the previous survey. Positive index which resulted after the indexation of the answers of the banks regarding the demand for loans, is mainly attributable to SMEs demand, while the demand for loans from large enterprises resulted with a marginal negative index. Demand for loans from enterprises, according to bank statements, was driven mainly by the increase in demand for financing of inventories and working capital, while the demand for financing the fixed investments contributed negatively to the demand for loans. Expectations for easing of restrictive measures to prevent the spread of Covid-19 virus, vaccine invention, as well as expectations for the realization of deferred investments from 2020, banks reflected in their forecasts for increased demand for loans during Q1 2021. Consequently, the demand is expected to increase significantly from both segments of enterprises, especially from SMEs. Potential factors that may affect the increase of demand for loans from enterprises are expected to be the need to finance inventories and working capital, as well as to a lesser extent the need to finance fixed investments, a factor that since the first quarter of 2020 has contributed negatively to loans demand.

The credit activity dynamics for households during the reporting period were positively affected by credit supply conditions and demand for loans. New loans for this economic segment increased significantly compared to the same period of the previous year. Credit standards applied to households **have been eased**, given that containment measures against COVID-19 were eased during this period, and also supported by the increase of the diaspora's visit during this quarter.

Despite the prospects for recovery of the economic activity, banks expect the easing of credit standards for households to be at a lower level compared to this quarter.

Terms and conditions for new loans to households eased to some extent. The ease of terms and conditions was higher for housing loans compared to consumer credit. The ease is expected to be applied mainly through declining interest rates, lower collateral requirements, as well as to a lower extent through the increase of the loans amount and lengthening of maturity. The key factors that eased credit terms and conditions for households during the fourth quarter of 2020 were mainly the increase of competitive pressures, liquidity position and stable financing of the sector from internal sources, as well

as the improvement of the outlook in the domestic market. For the first quarter of 2021, banks stated that they expect an ease, to some extent, in terms and conditions for loans to households. The ease of terms and conditions is expected to be higher for housing loans compared to consumer credit.

The containment measures of Covid-19 which were eased to some extent, remittances and visits of the diaspora in the country, as well as the return to some extent of the economic activity were reflected in a significant increase of demand for loans from households, in the fourth quarter of 2020. Banks have reported a higher increase of demand for housing loans compared to consumer credit. More specifically, seven out of total nine participating banks in the survey, have stated an increase of the overall demand for loans. Banks reported that this increase was positively impacted by almost all the factors listed in the survey, however the factor with the highest impact was the favorable perspective of the real estate, followed by the increase of the clients confidence and the need for financing other expenses. In the first quarter of 2021, banks expect an increase of demand for loans to households, albeit significantly at lower level compared to the current quarter. Results of the survey suggest that banks have attributed these expectations to the clients confidence, and to the need of financing other expenses.

Table 1. Banks assessment on credit supply and demand

	Supply (Credit standards)		Demand	
	Q4 2020	Q1 2021 (expectations)	Q4 2020	Q1 2021 (expectations)
Enterprises	↗	↑	↗	↑
SMEs	↗	↑	↗	↑
Large enterprises	↗	↑	↘	↑
Households	↑	↗	↑	↑
Housing loans	↑	↗	↑	↑
Consumer credit	↑	↑	↑	↗

↑	Ease if credit standards (cs) (positive index over 0.20)
↑	Increase of demand for loans (positive index over 0.20)
↗	Ease of cs / increase of demand (positive index below 0.20)
→	No changes applied (positive index/ negative up to 0.05)
↓	Tightening of credit standards (negative index over 0.20)
↓	Decline of demand for loans (negative index over 0.20)
↘	Tightening of cs / decline of demand (negative index below 0.20)

Source: CBK.

Uncertainties about economic prospects during 2020, as a result of the health crisis and limited business activities resulted in increased credit risk expectations in 2021, by the realization of the measures taken from the CBK in order to manage the effects of the pandemic. Despite easing the restrictive measures and restoring economic activity of economic entities, as well as easing measures taken by the CBK to support them in overcoming the crisis, banks announced an increase of non-performing loans to total loans ratio for households in the fourth quarter of 2020. Based on the expectations stated by banks, this indicator is expected to worsen further in the following quarter mainly for loans to enterprises. **Survey results show that banks financing, during the fourth quarter of 2020, was positively affected by household and enterprise deposits, while other financing sources have not had significant impact.** Unlike the previous survey, survey results for the stated period show that financing of the banks increased significantly, with a dominated contribution given by household deposits. During the following quarter, banks expect an increase of financing approach, albeit at a lower level compared to Q4 2020. Financing by household deposits is expected to be higher compared to enterprise deposits. At the same time, banks expect a support in being financed by international financial institutions and parent banks.

Box 1. Methodology

The questionnaire of the Bank Lending Survey

The BLS questionnaire is based on the standardized questionnaires used by the Central Banks in the euro area and beyond. However, the BLS questionnaire of the CBK has been modified and adopted to its best and comprehensive way to represent lending developments in Kosovo's banking sector.

The BLS questionnaire contains 19 questions, which cover the changes of credit supply, changes in the demand for loans, factors which contribute in these changes and the access in the banking sector's financing, on quarterly basis. Questions on banks lending are focused on two main categories: (i) loans to enterprises, and (ii) loans to households. Moreover, loans to enterprises are sub-categorized in loans to SMEs and loans to large enterprises, while loans to households are sub-categorized in housing loans and consumer credit. For all the above mentioned categories, changes in loan supply conditions are defined by credit standards applied in the process of loans approval, terms and conditions applied for new loans, loans approval rate, and the factors which affect their changes. Meanwhile, the changes in the demand for loans are defined by the demand for loans (the number of applications for loans), the quality of the applications received, and the factors which affect the demand for loans. The questions of the survey primarily are designed to obtain a feedback for changes over the past three months and changes expected in the following three months. Also, questions cover loans in the aspect of their maturity and currency in which they were granted.

Besides the standard questions, the BLS questionnaire may contain also additional questions on specific issues in order to explain the developments in the banking sector. While standard questions cover a three-months period, additional questions may refer to changes occurred during a longer period of time. The survey conveys nine out of ten banks operating in Kosovo.³ Consequently, the participating banks represent the general banking market and ensure a proper statistical representation, taking into account that they represent 98% of total assets of the banking sector, and 99.8% of total lending of the banking sector.

Survey participants are asked to indicate in a qualitative manner the strength of any tightening or easing or the strength of any decrease or increase, reporting changes using the following five-point scale: (i) tightened/decreased considerably, (ii) tightened/decreased somewhat, (iii) basically no change, (iv) eased/increased somewhat or (v) eased/increased considerably.

Generation of the bank lending survey results

Quantifying of the answers received from individual banks and their aggregation to present the changes on the level of the sector is achieved through a generation of an index. This index is generated for each category and sub-category of each of the questions, thus giving a quantifying unit for the answers received on the level of the sector. Initially, the answers are determined by a value based on the strength of the changes, namely answers where banks stated a considerable tightening/lowering are determined with a value - 1 a double value in size than the one determined for answers when banks declare tightening/lowering to some extent (a value of -0.5). Similarly, answers have a value of 1 when there is a considerable ease/increase, while those with ease/increase to some extent are determined with a value of 0.5. Results are also weighed based on the weight that each of the banks has in total lending of the banking sector. Consequently, the weight of each bank based on its share on the credit market is multiplied with the value determined based on the intensity of the given answer, thus obtaining the index in question.

Further more, the aggregation of the index on the sector's level is performed through the sum of the indices obtained for each of the bank. The value of indices are ranged from -1 to 1, where the positive values of the index represent ease, increase or positive contribution, whereas negative values represent tightening, decline or negative contribution.

³ The bank that was not included in the survey is Komercijalna Banka which has a very low level of loans in the form of a credit line and not to the private sector, therefore it was not considered to be included in the survey.

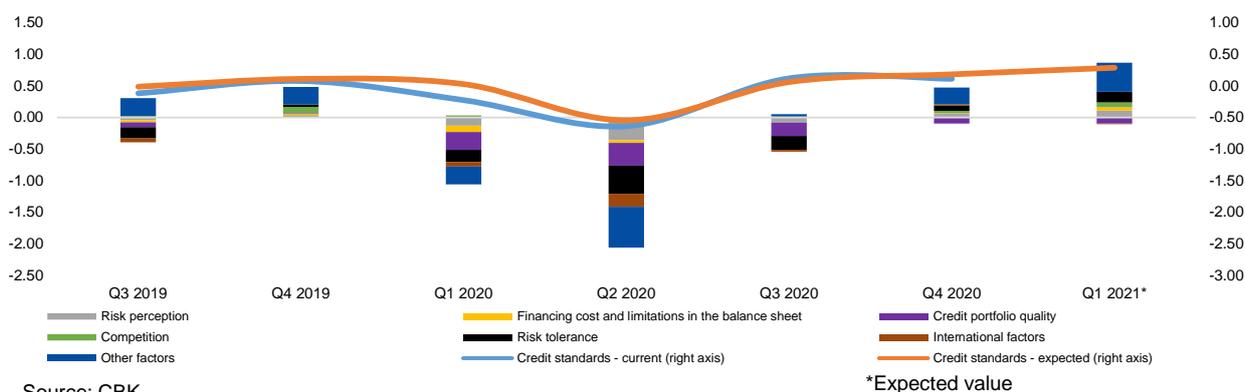
Developments in credit standards, credit terms and conditions, and in loans demand

Loans to enterprises

Credit standards

During the fourth quarter of 2020, credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises in general although with a low positive index of 0.09 represent an approximate ease with a positive index of 0.08 marked in Q3 2020. Whereas in the previous survey (Q3 2020), banks had stated that they expect an ease of credit standards to a higher level in Q4 2020 (chart 1).

Chart 1. Changes of credit standards applied for enterprises and factors which contributed



Within enterprise loans, banks reported a positive index of 0.12 for changes in credit standards for SMEs, and a positive lower index of 0.10 for large enterprises. This ease was influenced by answers of a systemically important bank and another bank with lower weight which eased the credit standards for both categories of enterprises.

The main role in easing the credit standards applied by banks in Q4 2020, results to have had the KCGF support to enterprises in borrowing, improving the outlook in global markets, as well as regulatory easing to manage the effects of the pandemic, such as restructuring loans due to the Covid-19 pandemic. Despite of the banks statements on easing credit standards, banks have listed also other factors which had a negative impact, albeit at lower level, on the credit standards, such as the increase of credit risk in the country and abroad. In line with the eased supply side, the approval rate of loans to enterprises marked a significant increase in this period, especially for SMEs.

Banks are expected to further ease credit standards during Q1 2021, being relied on the expectations for the beginning of the economic recovery in the country, in correlation with the ease of the containment measures taken to manage the pandemic crises. Six out of the nine participating banks, expect that the support of KCGF for SMEs will have an impact on easing of the standards. Also, a positive contribution is expected from the good perspective of the banking market in the country, the increase of risk tolerance, as well as to a lower level from the increase of competitive pressures and changes in regulation as easing measures taken to manage the crises. One of the banks with systemic importance also stated that it expects a positive contribution, to some extent, in credit standards from the favorable access in being financed by the parent bank.

Specifically, five banks, two of them of systemic importance, stated that they expect eased credit standards for SMEs, while for large enterprises this expectation was stated by four banks. Consequently, after indexing the answers, there was a higher positive index for SMEs of 0.34, while, for large enterprises a positive index resulted to be of 0.23. At the same time, concerning the maturity

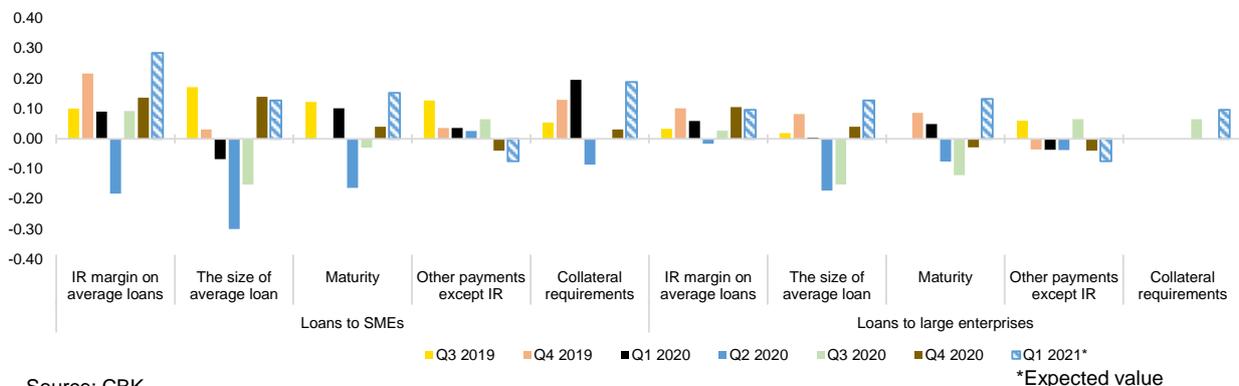
banks are expected to offer eased credit standards for maturity terms, albeit for long-term loans the ease will be of a higher level (positive index of 0.32).

In line with expectations for credit standards, the approval rate of loans to enterprises is expected to mark a significant increase, namely for SMEs with a positive index of 0.54, while for large enterprises with a positive index of 0.33.

Terms and conditions

In Q4 2020, the overall terms and conditions applied by banks in issuing loans to enterprises (the specific terms and conditions of a contract for loans) were eased, albeit to a lower level (chart 2). More specifically, for SMEs, it was marked an ease to some extent in the interest rate and the size of approved loans, which resulted with a positive index of 0.14, for both conditions. Terms and conditions for loans to large enterprises were eased, as well, at a same level through the decline of interest rate (with a positive index of 0.11).

Chart 2. Changes of terms and conditions applied to enterprises



Source: CBK.

Factors that influenced to some extent the easing of terms and conditions were the support of SMEs by KCGF, as well as the reduction of perceived risk through improving the market outlook in the country. At a lower level, positively contributed also, the increase of competitive pressures, the good outlook of the banking market and the easing of the measures taken to prevent the spread of Covid-19. At the same time, according to the statements of banks, the deterioration of the quality of the loan portfolio quality both in the country and abroad was a factor that contributed negatively to the terms and conditions applied by banks during Q4 2020.

As a result of the expectations for the recovery of the economy in the country, during Q1 2021, banks are expected to apply eased credit offer mainly for enterprises, based on the offered terms and conditions. In this context, banks stated that they expect an ease of terms and conditions for both categories of enterprises, but the ease is expected to be of a higher extent for SMEs. Banks are expected to decline the interest rates for SMEs (positive index of 0.28), decrease collateral requirements (positive index of 0.19), as well as at a lower level to mark an increase of loans size and lengthen the maturity (positive index of 0.13 and 0.15, respectively). For large enterprises, banks are mainly expected to offer higher and longer maturities to some extent (positive index of 0.13 for both segments). The factor with a positive contribution to credit terms and conditions for new loans with an index of 0.36, during Q1 2021, is expected to be marked by the support of KCGF for SMEs. Also, the increase of competitive pressures and regulatory easing to manage the effects of the pandemic are other factors that according to banks are expected to influence the easing of terms and conditions during Q1 2021.

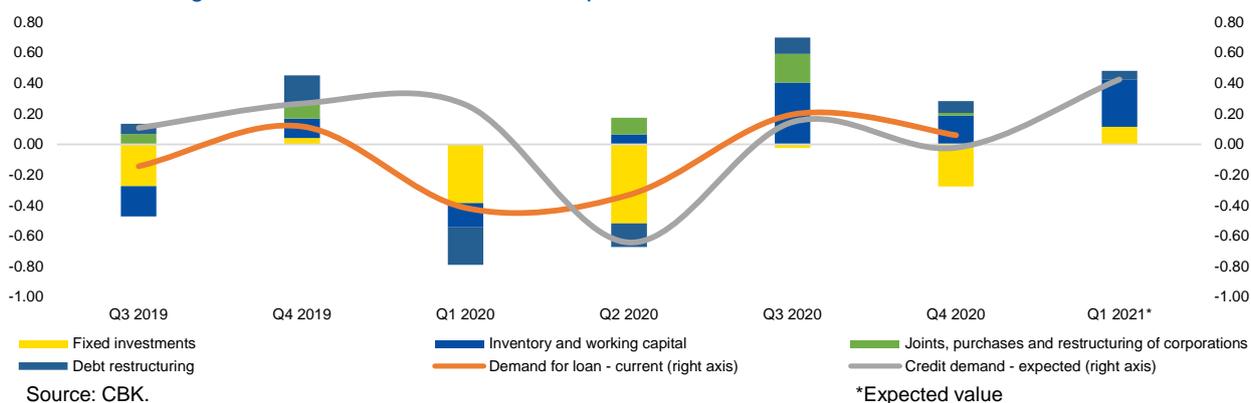
Demand for loans

During the fourth quarter of 2020, **the enterprises demand for loans** results to have been increased, albeit at lower level compared to Q3 2020. However, the increase in demand for loans resulted to be at a higher level than banks' expectations for Q4 2020 expressed in the previous survey (Q3 2020) (chart 3). More specifically, the demand for loans from SMEs increased with a positive index of 0.19, whereas the demand from large enterprises had a negative index of 0.07. The index generated for the demand for loans by large enterprises was affected by the answers of two systemically important banks which declared a decrease in demand, where one of them declared a significant decrease in demand, whereas four of the banks declared an increase in demand from this segment, to some extent. The return of the economic activity to the most affected sectors of enterprises, as a result of the easing of containment measures against Covid-19 and the need for liquidity, influenced the demand for loans from enterprises to mark an increase.

According to the survey, the increase in demand for loans from SMEs was mainly influenced by the increase in demand for financing of inventories and working capital (positive index of 0.19). Meanwhile, the demand for financing the fixed investments contributed negatively to the demand for loans with a negative index of 0.28, which can be attributed to the decline of demand from the category of large enterprises. The quality of the received applications was improved to some extent, during Q4 2020, for both categories of enterprises, especially loan applications from SMEs with an index of 0.22.

According to the survey, during Q4 2020 nonperforming loans of enterprises to total loans ratio mainly remained unchanged.

Chart 3. Changes of demand for loans from enterprises and factors which contributed



Expectations for easing of restrictive measures to prevent the spread of Covid-19 virus, and consequently also for an increased economic activity in the country, banks reflected in their forecasts for their demand for loans during Q1 2021. Consequently, the demand is expected to increase significantly from both segments of enterprises, especially from SMEs. Factors with a positive contribution to loans demand are expected to be the need for financing inventories and working capital, as well as to a lesser extent the need for financing fixed investments. At the same time, banks expect an improvement to some extent of the enterprise applications quality for loans from enterprises. Therefore, expectations for the applications quality in Q1 2021 are approximate, with a low positive index of 0.10 for SMEs and a positive index of 0.17 for large enterprises.

Also, banks expect the nonperforming loans ratio to worsen in Q1 2021, with a positive index of 0.16.

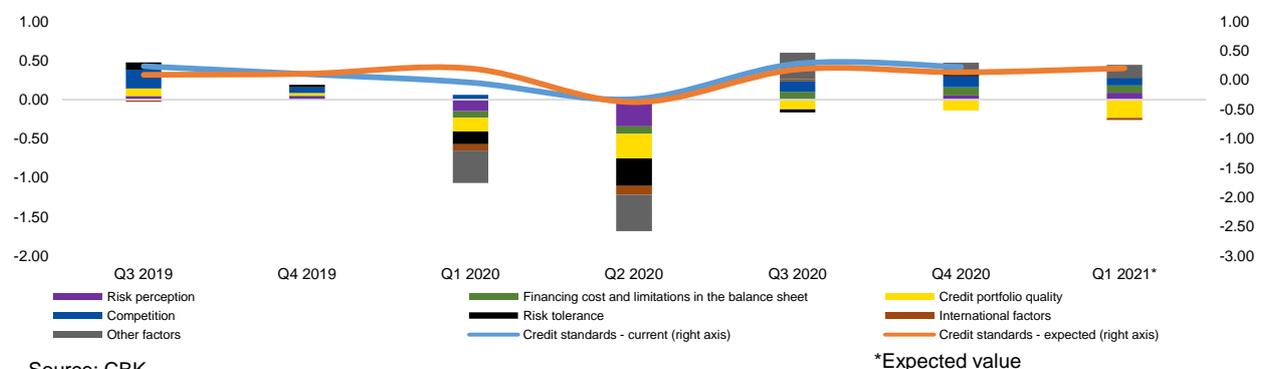
Loans to households

Credit standards

Credit standards applied to households during the fourth quarter of 2020, generally eased compared to the previous quarter with a positive index of 0.21 for housing loans and a positive index of 0.24 for consumer credit. The expectations for the fourth quarter stated by banks in the previous survey suggested an ease of applied credit standards, albeit at lower level (chart 4). At the same time, banks stated that they had reduced the loans approval rate for households, and namely to a higher extent for consumer credit with a positive index of 0.26 than for housing loans with a positive index of 0.22.

Factors that contributed positively to the easing of credit standards were the increase of competitive pressures with a positive index of 0.37, followed by a satisfactory liquidity position, favorable access to financing through deposits in the domestic market, as well as the good outlook of domestic banks and their access to finance with a positive index of 0.20.

Chart 4. Changes of credit standards applied for Households and factors which contributed



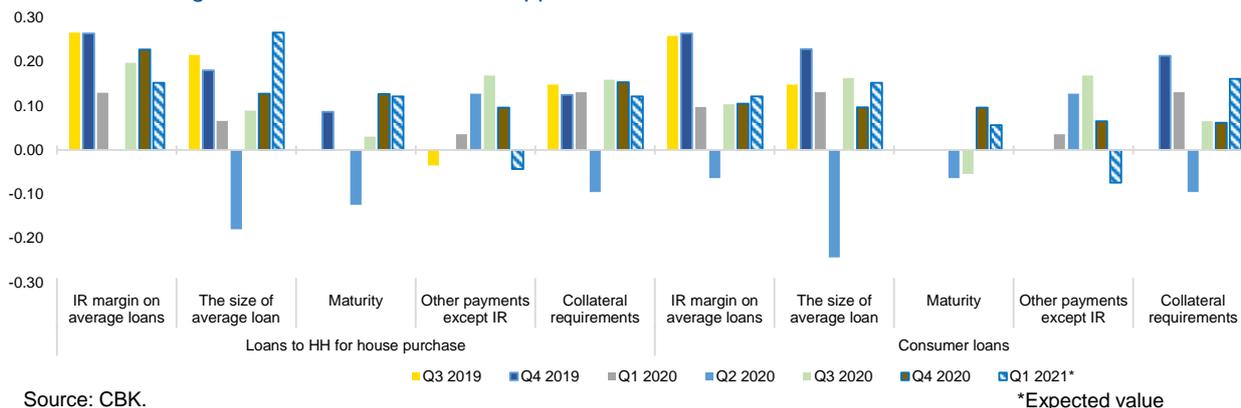
Source: CBK.

In the first quarter of 2021, banks expect eased credit standards for households, albeit with a lower positive index. Credit standards are expected to ease to a higher level for consumer credit than for housing loans, with a positive index of 0.22 and 0.18, respectively. Credit standards are expected to be positively affected by the improvement, to some extent, of the market outlook in the country, the increase of competitive pressures, as well as the easing of measures taken by the Government of Kosovo to suspend or reduce activity in certain economic sectors in order to prevent the spread of the pandemic. Despite of not reflecting in the general expectations for credit standards, banks have stated that to some extent the deterioration of the quality of the loan portfolio in the country, are expected to contribute negatively to credit standards during Q1 2021. At the same time, banks expect an increase up to the stage of loans approval, but at a lower level compared to the current values marked in Q4 2020. The level of approval of loans is expected to ease to a higher extent for consumer credit than for housing loans, with a positive index of 0.26 and 0.22, respectively.

Terms and conditions

Terms and conditions for loans to households generally eased in the fourth quarter of 2020, albeit at low level. The ease of terms and conditions was higher for housing loans compared to consumer credit. Mainly, terms and conditions were tightened by declining the interest rate (positive index of 0.23 for housing loans and 0.11 for consumer credit), increasing the size and lengthen the maturity of loans (low positive index of 0.13 and 0.10 for consumer credit). In addition to these terms and conditions for housing loans, banks also reduced the collateral requirements by a positive index of 0.15 (chart 5).

Chart 5. Changes of terms and conditions applied to households



The factors that contributed in easing credit terms and conditions applied were mainly the increase of competitive pressures, liquidity position and stable financing of the sector from internal sources, as well as the improvement of the outlook in the domestic market.

For the first quarter of 2021, banks stated that they expect an ease, to some extent, in terms and conditions for loans to households. The ease of terms and conditions is expected to be higher for housing loans compared to consumer credit. In general, all terms and conditions for housing loans, besides other interest charges, are expected to ease to some extent. Expectations for the increase of the loan amount have a positive index of 0.27, followed by the decline of the interest rate with a positive index of 0.15, as well as at a lower level with a positive index of 0.12 the expectations are for lengthening of maturity and decrease of collateral requirements. Meanwhile, for consumer credit, terms and conditions that are expected to ease are the decline of collateral requirements and the increase of loans size with a positive index of 0.16 and 0.15, respectively. Whereas, the decline of interest rate is expected to be marked by a low change with a positive index of 0.12.

Demand for loans

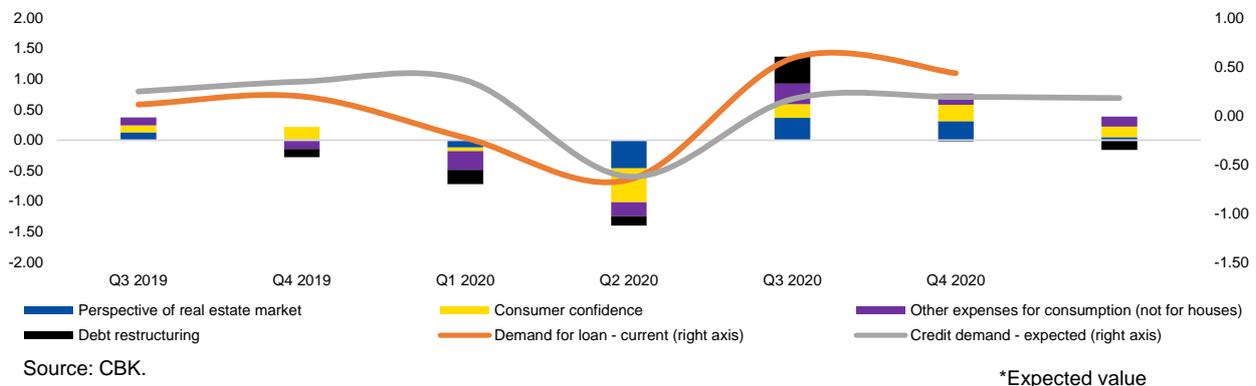
The easing of Covid-19 containment measures, remittances and visits of the diaspora in the country, as well as the reactivation to some extent of the economic activity were reflected in an increase of demand for loans from households in the fourth quarter of 2020. Banks have reported a higher increase of demand for housing loans compared to consumer credit. Seven out of a total of nine banks participating in the survey stated a growth in the demand for loans in general, which after indexing the answers resulted in a positive index of 0.50. The demand for housing loans was characterized with a positive index of 0.50, while for consumer credit the index was 0.36. If the current results of loans demand are compared with the expectations of banks stated in the previous survey for the same period, the actual level of the increase of the demand is significantly higher. Moreover, the current value of demand for housing loans is almost twice as high as the expectations stated by banks (chart 6).

This increase was positively influenced by all the factors listed in the survey, but the factor with the highest impact was the favorable outlook of the real estate market with a positive index of 0.31, followed by the increase of the clients' confidence and the need for financing consumption with a positive index of 0.27 and 0.18, respectively. The quality of the applications was improved to some extent for both categories of loans. More specifically, the applications quality for housing loans was characterized with a positive index of 0.28 whereas for consumer credit improved with a marginal positive index of 0.10.

Banks stated a deterioration of the loans portfolio quality, albeit at a lower level compared to the previous survey results. Changes of loans portfolio quality were based on the responses on the

nonperforming loans to total loans ratio for households with a positive index of 0.11 against the positive index of 0.21 as stated by banks in the previous survey (Q3 2020).

Chart 6. Changes of demand for loans from Households and factors which contributed



In the first quarter of 2021, banks expect an increase of demand for loans to households to some extent, albeit significantly at lower level compared to the current quarter. Banks stated that they expect an increase of the demand for housing loans with a positive index of 0.32, while the demand for consumer credit is expected not to have significant changes. Results of the survey suggest that banks have attributed these expectations to the increase of clients confidence, and to the increase of the demand for financing other expenses.

Banks expect household loans portfolio quality to remain unchanged in the first quarter of 2021. Consequently, based on the answers of the banks, this implies that dynamics in the credit risk are expected to be affected by the segment of enterprises.

At the same time, banks stated that they expect an improvement to a low extent of loans quality applications from households, especially for housing loans with a positive index of 0.28.

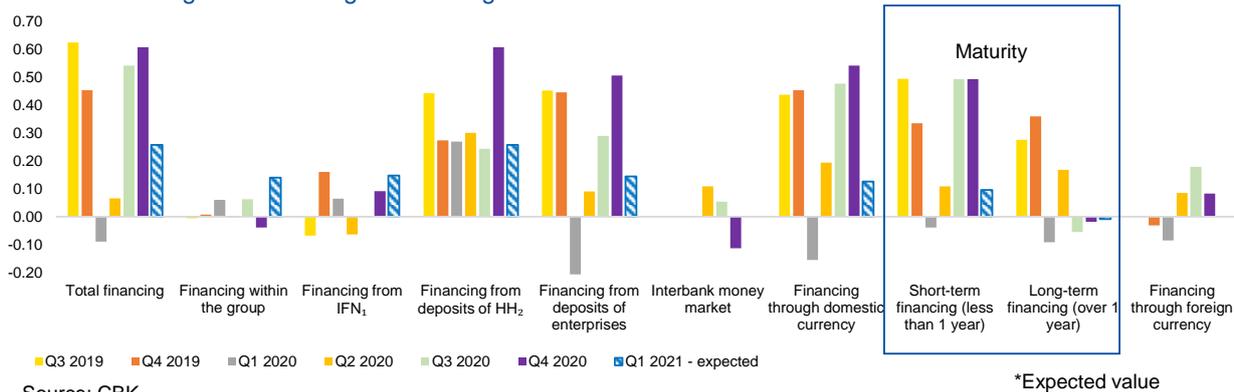
Financing

Banks reported a significant increase of access to financing during the fourth quarter of 2020. Taking into account the traditional model of the banking sector in Kosovo, the financing continued to be dominated by household and enterprise deposits.

Unlike the previous survey, results show that financing of the banks was increased at a significant higher level, where household deposits dominated with an index of 0.61. At the same time, enterprise deposits contributed to the financing of the banking sector with an index of 0.51, while other sources of financing did not change significantly (chart 7). Two banks with systemic importance stated an increase of financing to some extent from international financial institutions. However, due to the decline in financing from these institutions of another bank, this component resulted in a positive marginalized index. By maturity, short-term deposits were the main financing source during this quarter with a high positive index of 0.51.

For the following quarter, banks expect the increase of access in financing to continue, albeit at a lower level compared to Q4 2020. Financing through household deposits is expected to increase to a higher level compared to enterprise deposits, with a positive index of 0.26 and 0.14, respectively. In the first quarter, two banks with systemic importance expect a support in financing the banking activity also from international financial institutions. Meanwhile, two banks, one of them of general systemic importance and one bank with a low share in total bank lending, stated that they expect support in financing from the parent bank. By maturity, in the following quarter it is expected to continue a higher growth of short-term financing with a positive index of 0.10, while long-term financing is expected to remain unchanged (chart 7).

Chart 7. Changes in financing the banking sector



Source: CBK.

Results of focused questions: The impact of Covid-19 on the banking sector

The survey questionnaire for the fourth quarter of 2020 was compiled with four additional questions, in order to assess the impact of the crisis caused by the Covid-19 pandemic on the overall credit supply and demand for loans. The questions also address the banks’ perception of the risks posed by the crisis caused by Covid-19 pandemic, increasing dynamics of lending, as well as the effectiveness of measures taken by the country’s institutions during this period in order to mitigate the crisis effects caused by the pandemic.

The question of the risks which are being increased, to which the banking sector is directly exposed, was part also of this survey. Similar to previous surveys, banks stated that credit risk continues to be the main growing risk, where it is expected that this risk could potentially materialize during 2021. Banks emphasized that the non-materialization of credit risk, so far, is attributed to the regulatory easing measures taken, such as the moratorium or postponement of loan installments in March - June and the continuation of restructuring throughout 2020. Therefore, banks expect that with the completion of these measures will be felt the effects of increased pandemic risk, mainly through the decline in solvency of customers employed in the sectors most affected by the pandemic crisis such as hotels, gastronomy, transport, as well as construction and agriculture.

In the additional question on the impact of the Economic Recovery Package on credit supply, banks stated that the impact of the package was not reflected in their credit standards during Q4 2020. However, banks stated that the impact of the Package on the domestic economy and on the customers’ confidence for their debt repayment capacity is expected to be observed during the first quarter of 2021, which is consequently supported by the increase of the coverage of guaranteed loans by KCGF up to 80%, as an effective part of the package, will affect the implementation of more eased credit standards. The effect is expected to reflect especially on the sectors more affected by the pandemic crisis. While allowing the withdrawal of 10% of personal savings from the Kosovo Pension Saving Trust, according to bank statements has improved the quality of the loan portfolio to some extent, as during the period of allowing the withdrawal of savings has increased the performance of customers credit obligations to the banks. Also, this has had an impact on the ease of credit standards for households, albeit at a low level. Banks expect that the effects of these measures will be observed during the upcoming quarter. When asked about the forecast for lending dynamics for 2021, based on lending performance during 2020 and developments with the pandemic situation, banks generally stated that they expect higher lending growth compared to 2020, but at a lower level compared to the previous years. According to banks forecasts, credit growth rate for 2021 is expected to range from 6.0% to 10.0%. Individual banks forecasts were asymmetric, where two of the banks had a forecast of a lending growth of 20%. Banks’ forecasts for credit growth were based on factors such as the execution of deferred investments from 2020, the easing of containment measures against the spread of the virus, the growth of economic activity in the country, the invention and application program of the anti-Covid vaccine, the positive effects of the Economic Recovery Package and other mitigation measures applied by the country’s institutions. While the digitalization of services, especially during this period, is expected to expand the opportunities of the banking sector to remain profitable in the coming years.

Expectations of Inflation

In order to enhance the analytical capacities and based on the best regional practices and beyond, the Central Bank of the Republic of Kosovo has continued with the survey of depositing financial institutions in the country, based on the hypothesis that these institutions convey the best practices from parent banks and have proper expertise to design inflation dynamics. As a result, since the third quarter of 2019, BLS has been enriched with supplementary questions, which address commercial banks expectations on price developments in the country, thus supporting and supplementing our analysis, in modeling and forecasting.

In the last questionnaire conducted in October 2020, besides the statements of the banks relating their estimates on the level of inflation for the third quarter of 2020, the questionnaire addresses also the overall expectations of the banks for the fourth quarter in particular and for the whole year of 2020. The survey serves also as a tool to identify specific factors which potentially may affect bank expectations for the specified level of inflation.

Methodology

Inflation expectations have at least two important roles. First, they offer summarized quantitative series for inflation rate in the future, and secondly, may be used to assess the confidence of the objective of inflation set by the central banks.

The importance of inflation expectations is higher for the countries which have adopted the strategy of targeting the inflation. For these countries, inflation expectations, among others, serve also as an indicator of the public confidence towards central banks. If it is believed that the central bank will act in order to achieve the objective, than the expectations of the economic agents on the inflation rate would be closer to the objective. Inflation expectations are important also for banks which do not have monetary policy, given that they serve as an important input in defining the prices and salaries, and in the process of modeling and forecasting. Moreover, inflation expectations have an impact on the aggregate demand, which later affect the inflation trend.

Unlike the present inflation which is measured in a direct way, inflation expectations are assessed with indirect methods. Among the mostly used is the survey of economic agents: consumers, businesses, commercial banks, etc. The Central Bank of the Republic of Kosovo, for the first time began with the assessment of inflation expectations in the third quarter of 2019, initially with commercial banks and in the future it is expected to cover a wider range including also other economic agents.

Estimates which deal with commercial banks belong to quantitative forms associated also with the spread of the profitability. Inflation expectations are estimated for different time frameworks, where initially are performed the estimates on the previous quarter and the expectations for the current year and the following quarter. The summarizing of inflation through the surveys is followed by a systemic process, elaboration and aggregation in order to find the average of inflation expectations from the commercial banks. The analysis of the inflation expectations is expected to be part of the regular reports of the CBK.

Results Summary

Based on the survey conducted in January 2021, banks have estimated a lower inflation rate in the fourth quarter of 2020 compared to the previous quarters, while for the first quarter of 2021, banks have stated that they expect an increase of the inflation rate from 0.2% in Q4 to 0.5%. For 2021, banks expect that the inflation rate will reach 0.9%, from 0.2% as it was in 2020 (table 1). The survey

realized conveys also the potential effects that banks expect after they have faced with the unprecedented situation caused by Covid-19 pandemic.

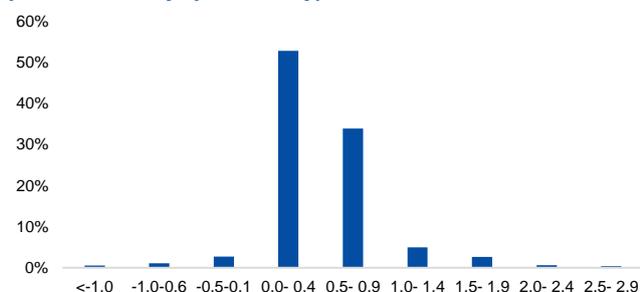
Table 1. Inflation expectations of banks, annual change in percent

Banks	Q4 2020	Q1 2021	2021
1	0.4%	0.6%	1.1%
2	0.1%	0.9%	1.2%
3	-0.3%	0.1%	0.3%
4	-0.1%	0.3%	0.7%
5	0.2%	0.3%	1.2%
6	-0.2%	0.3%	-0.2%
7	0.2%	0.5%	1.5%
8	1.1%	1.1%	1.1%
9	0.2%	0.4%	0.7%
Average	0.2%	0.5%	0.9%

Source: Commercial banks and CBK calculations.

Data published by the Kosovo Agency of Statistics (KAS) suggest that the average inflation rate in the first three months of the year was about 0.6%, while in Q4 2020, there was marked a deflation of 0.1%, suggesting well based expectations of banks for the period. Almost all the banks expect that the inflation will be below the level of 1%, except one of the banks which expects that the inflation rate will be higher than 1%, in the first quarter of 2021. As depicted in chart 8, the reported spreads of probability show that there is a relatively low uncertainty relating the following result of inflation, hence the spread of probability of the banks is concentrated in the expected inflation.

Chart 8. Probability of inflation for Q4 2020 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.

In their qualitative comments, banks have cited some of the possible factors which had an impact on the level of inflation:

- ✓ The increase of the cases with Covid-19 infections will be translated in a decline of the economic activity and consequently, in a weakened demand in the country, thus having an impact on the weakened inflationary pressures. Counter-effect on this dynamic can cause the disruption in the supply chain, potentially affecting the increase of prices (especially food prices);
- ✓ Energy prices are projected to remain low for a longer period of time;
- ✓ Determining factors for the dynamics of prices in the country remain also the low level of manufacturing and the high dependence on imports - consequently the price developments in international markets;
- ✓ Unlike in 2020, banks have stated to be more optimistic against the pandemic in 2021, and expect an increase of the economic activity and consequently an increase of inflation.



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