

## **Governor Mehmeti's interview for "Monitor" magazine**

How do you assess the progress of the banking sector in Kosovo during 2021 and during the first part of this year?

**Governor Mehmeti:** Kosovo has managed to build a sound financial system, which not only proved to be able to withstand a very unfavorable economic environment during 2020, but also to take a very important role in supporting the economy to face the crisis with consequences as small as possible. Despite the increased risks as a result of the economic difficulties that businesses have inherited from the pandemic period, the banking sector has continued to increase lending and maintain the level of sustainability. Until December 2021, the value of new loans issued by the banking sector was over 1.8 billion euros, while the total value of active loans in the banking sector until December 2021 was 3.7 billion euros. In total, the assets of the banking sector have continued the growth trend during 2021, reaching the value of 5.95 billion euros in December or an annual increase of 15.5%. The banking sector continues to enjoy high public trust and this trust is also expressed in the continuous growth of deposits. In December last year, the total value of deposits was around 4.90 billion euros or an increase of 12.4% compared to 2020. The growth of deposits is mainly dictated by household deposits in amount of 3.36 billion euros, followed by non-financial corporations worth 987.1 million euros and other financial corporations worth 196.8 million euros. The average interest rate on loans in December 2021 was 5.8 percent, which is lower compared to the rate of 6.0 percent recorded in December 2020. Financial health indicators for the banking sector continued to show a high level of stability in all aspects. It is worth highlighting the good quality of the credit portfolio with a rate of non-performing loans of only 2.4 percent in December 2021, while in the same period of the previous year (2020), the rate of non-performing loans was 3.0%.

What would you highlight as the most important developments for banks operating in Kosovo?

**Governor Mehmeti:** The financial system continued the positive growth trend, but at a significantly slower pace compared to the previous period. The dynamics in the financial system during the first quarter of 2022 were mainly determined by the slowdown in the growth of deposits, while lending marked a marked increase. At the end of March 2022, the assets of the financial system reached the value of 8.80 billion euros, which represents an annual increase of 9.1 percent (12.4 percent a year ago). In general, the banking sector continues to operate in an environment with low levels of non-performing loans, optimal liquidity and is well capitalized. During this period, the banking sector recorded a significant increase in lending, supported by the increase in demand for loans, financed through deposits. The growth of banking sector assets slowed down, after three years of accelerated growth, mainly reflecting the performance of deposit collections. In March 2022, the total assets of the banking sector reached the value of 5.82 billion euros, which represents an annual increase of 6.9 percent. The structure of assets continues to remain similar to previous years, where loans have the largest weight within assets (67.5 percent), followed by cash (12.2 percent), securities (10.5 percent) and assets held in other commercial banks (6.7 percent) that are mainly abroad.

What is the current and expected impact of high inflation and the increase in interest rates on the activity of the banking sector in Kosovo?

**Governor Mehmeti:** The Central Bank of the Republic of Kosovo is closely following all economic developments in Europe and is in full coordination with the European Central Bank and the central banks of EU member states and beyond. Based on the Bank Lending Survey, the banks declared that as a result of the increase in prices in the country, during the first quarter, there was no change in the credit supply, while the credit demand increased to a small extent. However, as far as the credit supply is concerned, almost all banks did not rule out the possibility of adjusting the credit standards and terms offered for loans during the following quarters, if the price increase continues. The conditions that can be affected by the increase in prices are the increase in the interest rate, as well as the reduction of the financing of the most affected sectors. In addition, one of the banks stated that they have already changed the bank's policies on the debt-to-income ratio for customers with lower incomes. On the other hand, the demand for credit increased during this quarter, especially from enterprises for the purchase or prepayment of working capital in order to reserve the price. Similarly, banks expect the growth in demand to continue, however the pace of its growth is accompanied by uncertainty. Also, from the answers of the banks, more uncertainty is observed regarding the demand for loans from households, based on expected changes, where a part of the banks expect an increased demand for consumer loans, and at the same time there are banks that expect a postponement of the loan demand until a period of price stabilization in the market.

Most of the banks in Kosovo have already increased the interest rates for loans. How do you see this movement? Was it necessary for this to happen, and what impact will it have on the citizens?

**Governor Mehmeti:** The Central Bank of the Republic of Kosovo does not have monetary policy powers, therefore interest rates are determined by global dynamics in interest rates, as well as by many other factors in the domestic market. For existing loans, most of which have fixed rates, the cost/interest/installment does not change; meanwhile, for loans with variable interest rates, the interest rate may change, depending on the change in the reference rate, mainly Euribor.

What will be the main challenges for banks, and more broadly for the banking sector in Kosovo for the remainder of 2022 and beyond?

**Governor Mehmeti:** Both throughout the world and in Kosovo, the last few years have been quite challenging and characterized by high uncertainty, for the financial system and for the country's economy. As a result of the adequate regulatory framework as well as high supervisory standards, the pandemic situation found the banking system in Kosovo with high levels of capital and liquidity as well as very good quality of assets. Also, the prudent measures undertaken by the CBK in cooperation with the financial institutions operating in Kosovo have been shown to be very effective in maintaining financial stability and minimizing the consequences for the country's economy in general. As a result of these measures, the banking sector managed to maintain a high degree of resilience against the impact of the crisis and cope very well with the challenges and implications of the pandemic, and play a very important role in the recovery of the economy through continuous lending and the provision of facilitating measures for borrowers. The war in Ukraine, which is first of all a human tragedy, has brought economic consequences all over the world where we are now facing a slowdown in economic growth and an increase in inflation, a situation quite different from the pandemic. The banking sector is now in a very strong position, given the high levels of capital, liquidity, very good asset quality, to face

this shock. Credit risk remains the main risk in the banking sector, therefore the quality of assets in the banking sector must be carefully managed. Our priority remains that the banks continue to maintain a high degree of sustainability, therefore credit risk continues to be the focus of the CBK in 2022, especially focusing on the assessment of credit risk management practices, the adequacy of provisions for loan losses and management of overdue loans.

Is the banking market in Kosovo safe and how much security does Kosovo offer for banks that are currently operating?

**Governor Mehmeti:** The banking sector in Kosovo continues to be very stable and safe. This is reflected through indicators of financial health such as high levels of capital, liquidity, stable profitability and very good quality of assets. The banking sector also enjoys a high public trust which is reflected in the continuous growth of deposits, with an annual growth of 11.8%. Also, the adequate regulatory framework established by CBK, similar to that of the European Union as well as the Basel standards, enable genuine stability and competition in the banking sector.

How do you consider competition between banks in Kosovo, is there pure competition?

**Governor Mehmeti:** CBK estimates that there is genuine competition among banks in Kosovo. This is proven by the presence of a total of 11 banks. Also, soon it is expected that a bank with local capital will join the banking sector in Kosovo, which will further contribute to the competitiveness of the banking sector.

Is it expected that any new bank will join the Kosovo market this year?

**Governor Mehmeti:** The banking sector continues to be an incentive, therefore with Decision NO. 26 - 10/2022 of the Executive Board of the Central Bank of the Republic of Kosovo, the entity "Pribank" has been preliminarily approved for licensing as a bank. The subject "Pribank" is obliged to fulfill the requirements set forth in Article 8, paragraphs 5 and 6, of Law No. 04/L-093 for Banks, Microfinance Institutions and Non-Banking Financial Institutions and the Regulation on Licensing of Banks and Branches of Foreign Banks, before applying for a final license