

Summary

- **The outlook for the euro area economy** continues to be affected by geopolitical developments related to the war in Ukraine, while growing risks have worsened the outlook for economic growth in the mid term aspect. The high increase in energy and food prices was reflected in the increase in prices in general, a dynamic that prompted the European Central Bank (ECB) to stop the net asset purchase program and tighten the monetary policy. **Economic activity in the Western Balkan countries (WB)** during Q2 2022 was mainly supported by the increase in domestic demand and exports, while in relation to global developments, it faced high inflationary pressures. In the medium term, projections about the economic outlook in the region remain pessimistic, suggesting a slowdown in economic growth.
- **The real growth of the Gross Domestic Product (GDP) in Kosovo** turns out to have slowed down in Q2 2022, mainly as a result of the increase in general inflationary pressures in the country that negatively affected domestic demand. The continuous intensification of inflationary pressures was reflected in the spread of inflation in other sectors of the economy, which was reflected in the rise of the Producer Price Index (PPI) and the cost of construction, as well as a significant rise of core inflation. In the following quarter, the support of the diaspora as well as the increase in loans and public transfers are estimated to have influenced a slight improvement in economic activity, while the increased risks as a result of ongoing inflation and the energy crisis are estimated to have neutralized this growth to some extent. **The budget of Kosovo** has recorded a primary budget surplus of EUR 58.4 million in Q2 2022, as a result of the higher growth of budget revenues compared to expenditures, while the public debt has declined to 20.8% of GDP. **The current account** turns out to have deepened the deficit to 15.2% of GDP, mainly as a result of the increase in the trade deficit of goods that is mainly attributed to the increase in prices in international markets, while the balance of services marked a positive trend. In this quarter, received remittances result to have marked a growth at a slower pace, dynamics that can be attributed to a certain extent to the increased uncertainties during this period in the countries from where these inflows come, as well as the potential impact of the fiscal measures in the form of subsidies for the most sensitive social groups.
- **The financial system** has been characterized by stability and without any materialized risk during Q2 2022, despite concerns about the economic slowdown, inflationary pressures and increased uncertainties in international markets.
 - **The banking sector** has managed to ensure a high level of capitalization and liquidity, as well as to maintain a low level of nonperforming loans along the years, which has been translated into an absorbing capacity of the sector. Meanwhile the direct exposure of the **banking sector** in the country to the war in Ukraine is quite limited, the risks from unfavorable geopolitical, macroeconomic and financial developments have been transmitted mainly indirectly through the pressure on the price level. The high rate of inflation is estimated to have influenced the potential reduction of disposable income in the economy, a factor that can potentially put at risk the capacity of the borrowers solvency (increase of potential credit risk) and discouraging savings (liquidity risk). In Q2 2022, lending activity was the main positive contributor to the increase in assets of the financial system, while investments in securities and deposits held in other banks, mainly abroad, marked a decline. The increased uncertainty from the increase in prices in the country and globally, a development that coincided with the slowdown in the growth of deposits in this quarter, pushed the banking sector to offer more favorable conditions for securing financing.
 - **The pension sector** recorded a slowdown in growth compared to the previous year, a development that can be attributed to the unfavorable circumstances created by the beginning of the war and the inflationary pressures that further destabilized the international financial markets. While the value of collected contributions increased in both pension funds, the return on investments suffered a decrease in value in the reporting period.
 - **The insurance sector** has maintained the level of activity growth of the previous year, favored by the higher level of collected premiums and the slower growth of claims paid. Moreover, the sector has operated with a profit, thus reducing the further losses accumulated along the years.
 - Also **the microfinance sector** was characterized with an accelerated increase of assets, mainly being attributable to the increase of lending activity. Financial soundness indicators show as well a stability of the sector in general, while the financial result turns out to be the highest since the consolidation of the sector. In the following periods, the dynamics of the increase in interest rates in the international markets are expected to be reflected in the increase in financing costs for the microfinance sector.

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Euro area and Western Balkans

The euro area economy marked a real growth rate of 4.3% during Q2 2022, according to Eurostat, a growth that was mainly supported by the easing of supply constraints that were reflected in manufacturing activity, while the output of services increased as pandemic-related restrictions were lifted, which mainly affected tourism. As a result, the ECB's projection for 2022 was revised to 3.1% in September's projections, from 2.8% as it was in June. However, the war in Ukraine and its consequences resulting in increased inflationary pressures, the still evident obstacles in supply chains as well as the tightening of financing conditions, are expected to be reflected in the overall economic activity in the euro area in the second half of 2022. In the short term, the intensification of inflationary pressures is expected to have a negative impact on purchasing power and the increase in uncertainty will reduce the confidence of consumers and businesses, potentially affecting the contraction of overall demand. Growing risks have worsened the outlook for economic growth in the medium term, with the ECB's projection for economic growth in the euro area for 2023 and 2024 being revised down from the 2.1% as it was forecasted, in June, for both years, to 0.9% and 1.9% for 2023 and 2024, respectively.

The inflation rate in the euro area followed an upward trend, reaching 8.03 percent during Q2 2022, influenced by the strengthened domestic demand, the war in Ukraine and ongoing disruptions in global supply chains. The main drivers of inflation during Q2 2022 continued to be the increased prices of energy and food, with a contribution of 3.9 percentage points and 1.6 percentage points, respectively. An increase was also noted in core inflation, which reached 3.7% (from 2.7% in Q1 2022) and confirms the spread of inflationary pressures in other sectors as well. Moreover, the inflation during Q2 2022 was influenced also by the depreciation of euro currency. Consumers' expectations for inflation in the euro area according to the consumer survey conducted in August show an inflation of 6.9% over the next 12 months, and 4.7% in the next three years. Meanwhile, the ECB projections for 2022 suggest that the average rate of inflation in the euro area is expected to be 8.1%, which is an upward revision from the 6.8% that was forecasted in June. Regarding monetary policy interventions and the expected transmission channel, the ECB forecasts that inflation is expected to normalize to around 2% during 2024.

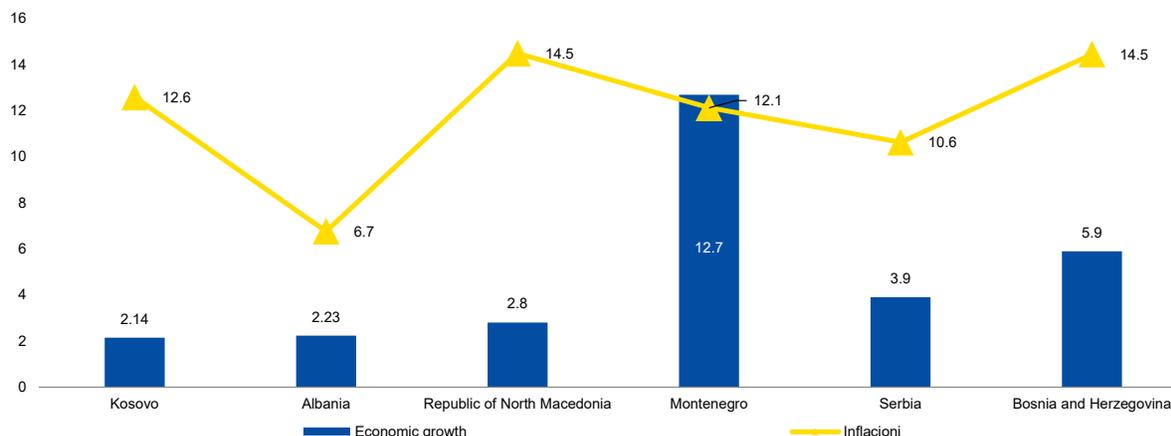
The outlook for the euro area economy continues to be accompanied by increased risks in geopolitical developments such as fluctuations in energy prices and ensuring a supply, the deterioration of manufacturing capacity, the decline of consumer confidence, and the contraction of economic activity at the global level. Inflation-related risks have intensified recently, and include continued high energy and food prices, consumer pessimism about inflation returning within the targeted level, the growth of salaries beyond expectations, and others.

In order to combat inflation and maintain the level of consumer expectations about inflation, the ECB took several steps towards normalizing monetary policy, initially stopping the asset purchase program but continuing the full reinvestment of principal payments from securities to ease liquidity conditions, as well as increasing the ECB's three main interest rates by 50 basis points, in July. Further, in September, the ECB raised increased rates by 75 basis points, indicating that further interest rate increases are likely to happen, depending on price dynamics.

The countries of the Western Balkans recorded an increase in economic activity of 4.95% during Q2 2022, influenced by the increase in consumption driven by domestic demand as well as supportive fiscal policies. The highest economic growth rate was recorded in Montenegro with 12.7%, while the lowest was marked in Kosovo with 2.14% and Albania with 2.23%. The performance of the hotel sector during the first half of 2022 has had a positive impact on exceeding forecasts for economic growth, influencing the IMF projection for the region to be revised to 3.4% in October from 3.1% as it was in April. However, the energy

crisis and its effect on rising prices and declining purchasing power have caused the outlook for economic growth in the medium term to deteriorate, with the IMF's projections for economic growth for 2023 and 2024 being revised down by 0.8 percentage points and 0.3 percentage points, respectively.

Chart 1. Economic growth and inflation in Western Balkans



Source: Respective statistical offices.

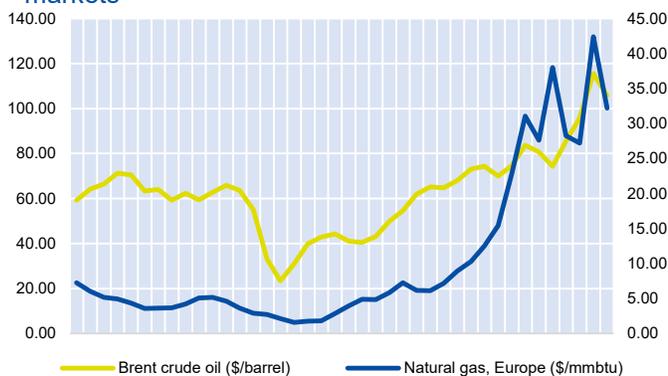
The increase in the prices of imported goods and the strengthening of domestic demand translated into increased inflationary pressures also in the Western Balkans, where the consumer price index recorded an annual increase of 11.9% during Q2 2022. Similar to the developments in the euro area, inflation in the Western Balkans was driven by the increase in food and energy prices, while the highest inflation rate was recorded in North Macedonia and Bosnia and Herzegovina with 14.5% in both cases, while the lowest was recorded in Albania with 6.8%.

During Q2 2022, the euro currency has appreciated against the Turkish lira by 66.1%, it has remained almost unchanged against the Macedonian denar, the Croatian kuna, and the Serbian dinar, while it has depreciated against the US dollar by 11.6%, the Swiss franc by 6.5%, the Albanian lek by 2.1%, and the British pound by 1.7%.

Main commodity prices in international markets

The prices of basic goods in international markets suffered high fluctuations as a result of geopolitical dynamics in 2022, especially the prices of energy and food that make up most of the exports of Russia and Ukraine. According to the World Bank, energy prices continued to fluctuate, with the average price of Brent crude oil reaching \$112.7 per barrel during Q2 2022, representing an increase of 13.9% compared to the previous quarter and 64.3% compared to Q2 2021. Natural gas in Europe averaged \$31.6/mmbtu, reflecting a decline of 3.0% compared to the previous quarter, while more than tripled against the same period of the previous year. The high prices of natural gas come as a result of the reduction in the amount of supply from the Russian Federation, as a response to the sanctions imposed by the European Union (EU). In May, the EU

Chart 2. Oil and natural gas prices in international markets

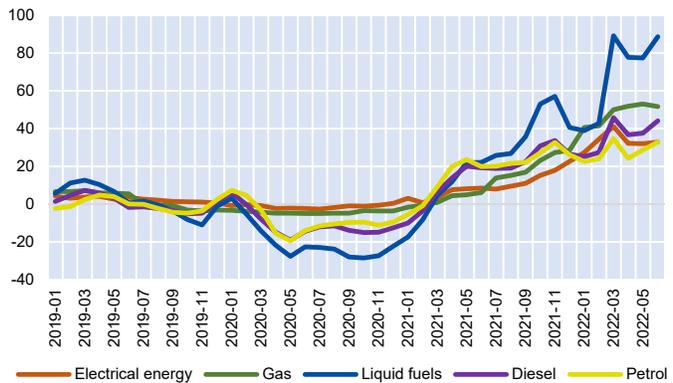


Source: World Bank

adopted the REPowerEU plan through which it aims to reduce energy imports from the Russian Federation, and at the same time, increase the security of energy supply, prioritizing the green transition. To reduce dependence on Russian energy imports, the EU has imposed an embargo on the import of Russian coal (effective as of August 2022) and aims to reduce imports of Russian natural gas by around 70% during 2022, replacing it with liquefied natural gas (LNG) imported from other countries and raising own capacities for LNG processing.

Large fluctuations in oil and natural gas prices in the international market have caused energy prices in the euro area to increase by about 38%, during Q2 2022. This increase in prices has been passed on to consumers, being reflected in the increase in the price of fuels (diesel, petroleum, and other heating oils), gas, and electricity. According to Eurostat, the highest price increase during Q2 2022 compared to the same quarter of the previous year was recorded in the gas category of 52.1%, followed by oil with an increase of 39.4%, petroleum with 28.5%, and electricity which marked an increase of 32.3%. The obvious dependence of the euro area economy on energy imports from Russia and high demand have caused inflationary pressures to spread to other sectors during Q2 2022, with the services sector and that of non-energy industrial goods recording price increases of 3.4% and 4.1%, respectively.

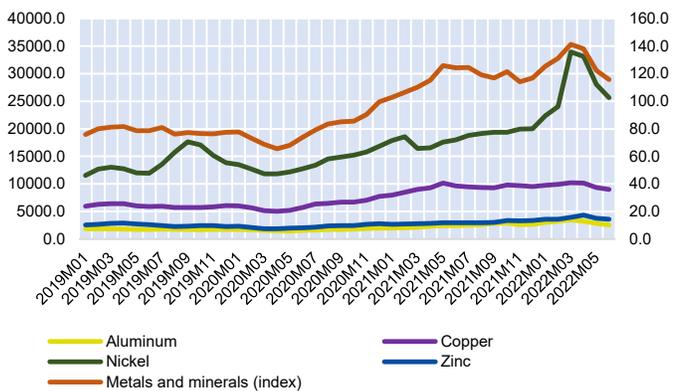
Chart 3. Energy prices, in euro area



Source: Eurostat.

Prices of metals and minerals decreased by 5.4% compared to the previous quarter, while they increased by 3.0% compared to Q2 2021. As a result of the war in Ukraine and the sanctions imposed on Russia, which produces 6% of the amount of nickel globally, the price of this metal has increased by 8.2% compared to the previous quarter, and 66.8% compared to Q2 2021. Also, the war directly affected the reduction of Russia's production capacity in terms of aluminum, as a result of the interruption of production at the factory of Rusal in southern Ukraine, but also as a result of the imposition of sanctions by Australia regarding aluminum exports to Russia. These developments were reflected in prices of aluminum, which marked an annual growth of 20.0%, while compared to Q1 2021 marked a decline of 11.4%. The decline in metal prices during Q2 2022 on a monthly basis comes as a result of movement restrictions in China related to the Covid-19 pandemic, which led to a decrease in demand for metals, but also as a result of pessimism regarding the global trend of the economic activity taken into account the recent developments in the increase of interest rates.

Chart 4. Oil prices in international markets



Source: World Bank.

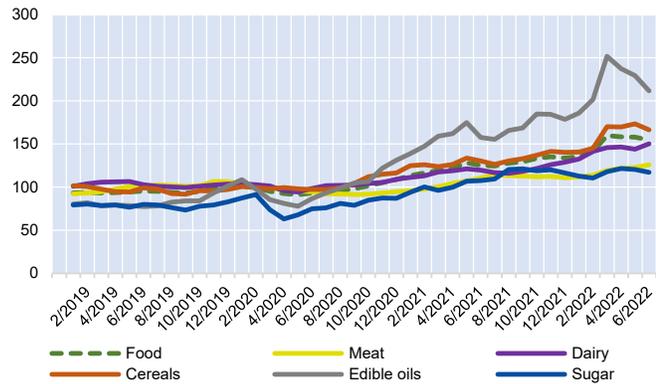
On the other hand, more significant fluctuations during Q2 2022 were recorded in the prices of artificial fertilizer, whose index increased by 11.0% compared to Q1 2022, while it more than doubled compared to the same period of the previous year. Prices of fertilizer follow the upward trend of natural gas prices, considering the intensive use of this resource in the production of artificial fertilizer. In addition, Russia and

China have at various times banned fertilizer exports to ensure domestic demand is met, so developing countries that depend on fertilizer imports remain exposed to potential decisions to reduce their supply in the future, which would directly affect the reduction of agricultural production.

Also, the food price index according to FAO marked a growth of 7.9% compared to the previous quarter. Despite positive signals for the monthly decline in food prices in June against May, the food price index during Q2 2022 was for 25.5% higher compared to the same quarter of

the previous year. In the coming months, the downside risk could be the potential increase in exports from Ukraine through the Black Sea port, as well as the increase in agricultural production with the improvement of climatic conditions during the summer season - factors that would contribute to the decline in food prices.

Chart 5. Food price index



Source: FAO.

Kosovo's Economy

Real sector

Double-digit real GDP growth rate marked in 2021 was accompanied by unprecedented growth in macroeconomic risks in 2022. Inflationary pressures throughout the year of 2022 were accompanied by an increase in the value of imports and a potential decrease in disposable income in the country, factors that are estimated to have determined the deepening of the deficit in net exports and the slowdown of the overall demand in the country. Only in Q2 2022, the economic activity growth was slowed down at 2.1%. Domestic demand contributed negatively to real GDP growth by 4.3 percentage points, while net exports contributed positively by 6.4 percentage points. The CBK forecasts a slowed down real economic growth rate of 2.9% for the euro area, in 2022 (chart 6).

Private consumption, which recorded a slow down growth of 3.2% (a growth of 10.3 marked in Q2 2021), in addition to the increase in prices, was also affected by the drop in new consumer credit of 13.4% in Q2 2022, as well as the slowdown in the growth of inflows of remittances which recorded an increase of only 0.8%. Public consumption marked a decline of 2.8%, which may be attributed to the decline of expenses on salaries of 1.7%. The other component of domestic demand, which is comprised by investments, marked a decline of 16.8%, in Q2 2022. Two of the financing sources, such as new investment loans (3.6%) and government investments (27.8%), were also characterized by a decrease. External trade turns out to have recovered from the decline marked in the previous quarter, with the increase in the export of goods and services by 13.6% and 49.8%, respectively, while the import of goods and services has increased by 1.0%, and 23.8%, respectively, in real terms. Consequently, the deficit of net exports was lower for 16.3%, in Q2 2022.

On a sectoral basis, the sectors that recorded a decrease in added value in GDP, generated during Q2 2022, were the construction sector (-18.0%) and the electricity supply sector (-5.7%). The decrease in added value in the construction sector, can be attributed to the increase in input prices and this has influenced the postponement of investment projects in this sector. The sectors that recorded a lower increase in added value compared to the same period of the previous year were the sector of hotels and restaurants, transport and storage, trade, processing industry, etc. The slowdown of economic activity in these sectors is also presented in the short-term statistics of services, where it was marked a significant slowdown of activity, dynamics mainly influenced by the increase in prices. The average of the net sales volume index in the service sector has recorded a slow down growth of 36.0% in Q2 2022, which can mainly be attributed to the dynamics in the transport and storage sector as well as in the travel agency sector. The average industrial production index has recorded an increase of only 0.6% (an increase of 32.8% in Q2 2021), where the processing industry sector and the water supply sector have recorded a slight increase, while the extractive industry sector and the electricity supply sector were almost the same compared to the same period of the previous year. Also the trade sector, as one of the main sectors, has recorded an increase in added value with 12.7% in Q2 2022, which is a lower increase compared to the increase of 18.2% marked in Q2 2021. However, due to the increase in prices, the average turnover index in retail trade increased by 19.3%, while in Q2 2021 it increased by 14.5%.

Chart 6. Real GDP growth rate and main contributors to the growth



Source: KAS and CBK calculations.

As a result of the slowdown in economic activity, the entrepreneurial initiative also turns out to have slowed down. In Q2 2022, 2,835 new enterprises were registered or 0.8% more (an increase of 38.4% marked in Q2 2021), whereas 460 enterprises were closed or 20.7% more than in Q2 2021. The sectors with the highest decrease in the number of registered enterprises were the sectors of trade, hotels, manufacturing, etc., meanwhile there were also other sectors which marked an increase in the number of registered enterprises, as the sectors of information and communication, construction, etc.

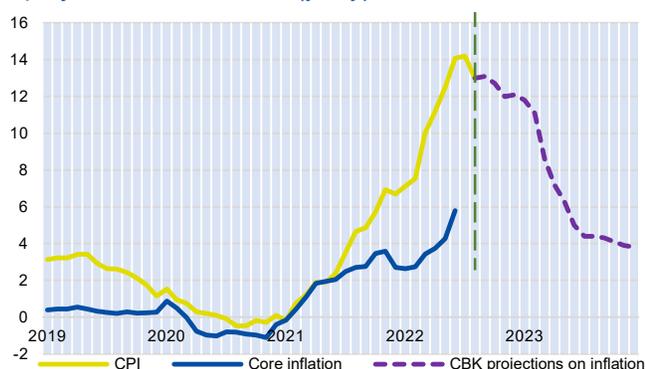
Regarding Q3 2022, the recent disposable income suggest that there was marked a slight improvement of the economic activity compared to the previous quarter, as a result of the support given by diaspora (inflows in the form of remittances and the visits of diaspora during the third quarter), the increase of loans and public transfers, while the increased risks as a consequence of the continued inflation and the crises with energy are estimated to have neutralized this increase to some extent. **For the whole year of 2022, the CBK projections suggest that the economic activity will record a growth of around 2.9%.** The slowdown increase of the economic activity is expected to be mainly a consequence of inflationary pressures widely, which are expected to have an impact on the contraction of the domestic demand. The war in Ukraine has increased the risks to the economic outlook, and the impact of this crisis is further reflected on increases in energy, oil and food prices, on the level of the global economy and domestically as well, with negative effects on consumer confidence and purchasing power in the second half of 2022. The higher consumption of energy during winter months, which will not be able to be covered by domestic production in Kosovo, is expected to result in a further increase of import due to the increase of energy costs in international markets, while also the inflows from diaspora may be negatively affected due to the increase of energy prices, gas and food in EU countries. The risks to main financing sources of consumption in the country would be associated with a decline of households capacity to spend and save as a consequence of the impact on the disposable income, with potential effects in the overall financial stability.

Prices

In the second quarter of 2022, inflation in Kosovo reached the highest levels since mid-2008, driven mainly by the extraordinary increase of energy and food prices. The consumer price index during Q2 2022 reached 12.6%, with the highest inflation rate recorded during the month of June of 14.1%. As a result of the intensification of inflationary pressures during Q2 2022, inflation in Kosovo has begun to spread to other sectors, especially in services, which results at the transfer of increased costs by producers to consumers.

Rising costs and ongoing disruptions in food and energy commodity supply chains have made these components of the overall index to mark the highest growth, with an increase of food and non-alcoholic beverage category of 16.6%, and prices of electricity, gas, and other fuels that recorded an increase of 17.1%. Within the food category, high increases were marked in oil and fat prices of 53.1%, bread and cereals of 26.3%, and milk, cheese, and eggs with an increase of 22.2%. The spread of inflationary pressures in other sectors is observed in the increase in core inflation, which marked an increase of 4.6% (2.9% in Q1 2022) as a result of the increase in the prices of transport (23.9%), restaurants and hotels (10.1%), and furnishing (6.3 percent) (chart 7). Prices in these sectors, in addition to the transfer of costs to

Chart 7. Headline inflation, core inflation, and CBK projections on inflation (y-o-y)

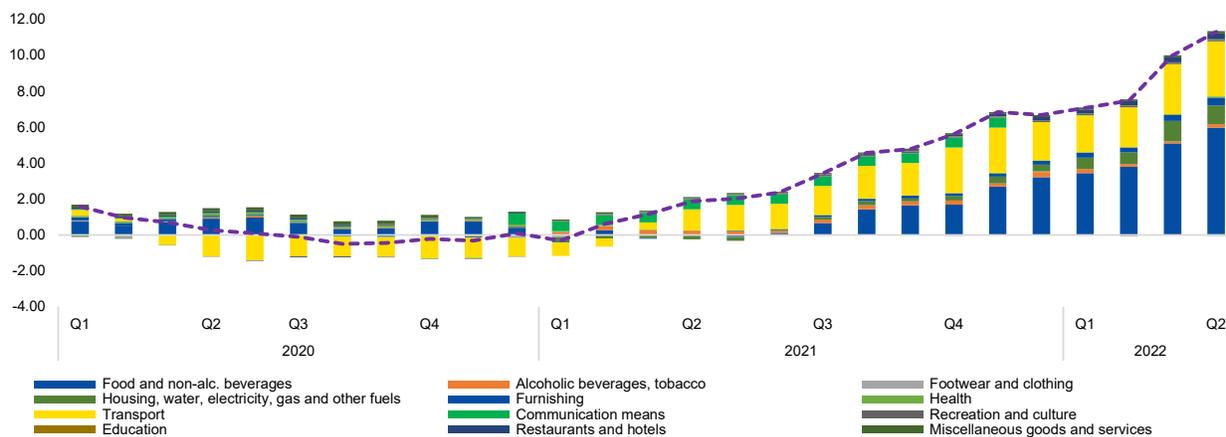


Source: KAS and CBK calculations.

consumers, were also affected by the return of economic activity as a result of the easing of restrictions from the pandemic, compared to the same period of the previous year.

Considering the position of Kosovo's economy as a net importer of energy and food, the large price fluctuations of these categories and their significant weight in the consumer basket, make the contribution of these categories to the headline inflation higher than of other components. Thus, the contribution of food and non-alcoholic beverages and transport to the headline inflation during this period was 6.6 percentage points and 3.8 percentage points, respectively, that of housing, water, electricity, gas, and other fuels was 0.9 percentage points, while the contribution of furnishing was almost 0.5 percentage points. (chart 8).

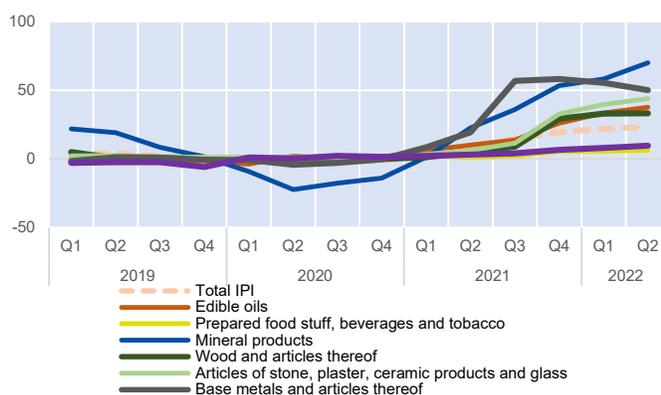
Chart 8. Contribution of specific categories to headline inflation



Source: KAS and CBK calculations.

Based on the developments in international markets and Kosovo's dependence on the import of goods, the import price index resulted in relatively high growth, reaching 23.3% (chart 9). A significant increase was observed in the prices of mineral products with an annual growth of 70.0%, and base metals and their articles with an inflation of 50.0%. The import prices of prepared food items, beverages and tobacco increased by 6.3%, those of edible oils increased by 37.7%, while the import prices of wood and its articles increased by 33.1%. which shows that most of the inflation during this period is imported.

Chart 9. Imports Price Index (% , y-o-y)



Source: KAS and CBK calculations.

Since **part of the imports are used as raw materials or intermediate goods in the domestic production, the increase in import prices was also reflected in the domestic production price index, which resulted in an annual increase of 10.0%, during Q2 2022.** According to the economic activity with the largest weight in this index, the production of electricity, gas, steam, and air conditioning supply marked a price increase of 15.6%, the processing of food products marked a price increase of 16.0%, the production of wood and its products recorded an inflation of 13.2%, while metal production increased by 13.1%.

The construction cost index that is reflected in real estate prices shows an annual increase in construction costs of 19.8% during Q2 2022, driven mainly by the rise in import prices as well as those

of local production. Taking into account the increase in energy prices, the highest increase was recorded in the transport category of 35.5% and energy of 15.6%, while construction materials with the highest representation in construction costs (about 70% of the total) recorded an increase of 22% compared to the same quarter of the previous year.

According to the CBK projections, the average inflation rate for 2022 is expected to be 11.6%, while it is expected to fall to 6.2% during 2023 (chart 10). According to the developments so far and if there are no additional obstacles in supply chains and the dynamics of global trade and prices in international markets, inflation in Kosovo is expected to reach 13.5% during Q3 2022, and to drop to 12.3% during Q4 2022. Banks' expectations for inflation also show an upward trend throughout the year of 2022, albeit it remains below the level projected by the CBK and below the current level of inflation so far.

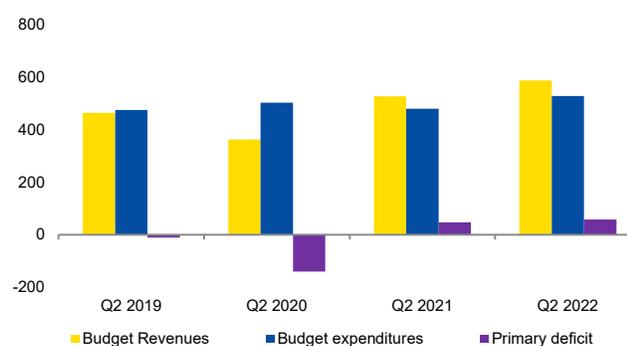
In order to mitigate the impact of inflation on the economy, the government has taken several measures, including the setting of ceiling prices for derivatives (diesel, petroleum, and gas) from June, as well as the approval of the package to deal with inflation in the amount of EUR 150 million, which is expected to subsidize electricity bills according to criteria that stimulate energy savings, private sector wage increases, as well as one-time increases in social and pension schemes and one-time financial support for various categories.

Fiscal Sector

The higher budget revenues, as a result of the economic recovery marked in the previous year but also the increase in prices during this year, accompanied by a low level of capital expenditures, have influenced the budget balance to be positive during the first half of 2022 (6.6% of GDP in Q1 and 2.9% in Q2 2022).

Budget revenues, during Q2 2022, reached a net value of EUR 587.6 million (an increase of 11.4%), while budget expenditures reached a value of EUR 529.2 million (an increase of 10.1%). Consequently, Kosovo's budget recorded a primary budget balance of EUR 58.4 million during this quarter (chart 10).

Chart 10. Budget income and expenditures, EUR million



Source: KAS and CBK calculations.

Economic activity accompanied by price increases has influenced direct taxes to reach the value of EUR 115.6 million in Q2 2022 or 17.7% more compared to Q2 2021. As a result of this increase, the share of direct taxes in total budget revenues has also increased from 18.6% in Q2 2021 to 19.7% in Q2 2022. Corporate income tax marked an increase of 33.6%, while personal income tax, which represent the main category of direct tax revenues, marked a growth of 10.5%. The increase in prices has influenced the increase in the value of the import of goods and this has influenced the increase in indirect tax revenues of 11.0%. In Q2 2022, indirect tax revenues reached EUR 439.7 million and constitute 74.8% of total budget revenues. VAT and customs marked an increase of 17.0% and 9.4%, respectively, while the excise registered a decrease of 1.3%.

In terms of expenditures, the main category that contributed to the increase in budget expenditures were current expenditures, which in Q2 2022 were EUR 477.9 million or 16.7% more compared to Q2 2021. Within current expenditures, subsidies and transfers marked an increase of 40.8%, reaching the value of EUR 235.9 million. Government expenditures on goods and services (including municipal utilities) marked an increase of 3.6%, reaching the value of EUR 77.4 million, meanwhile expenses on salaries declined by 1.7% and reached

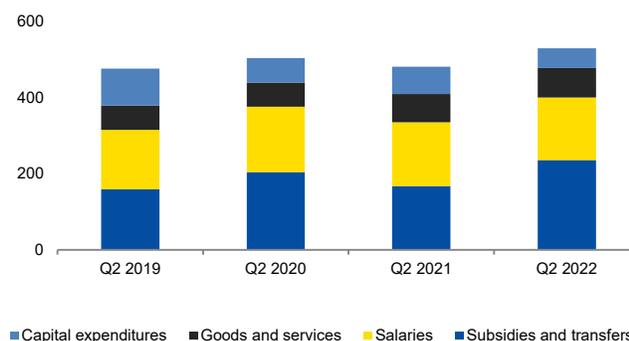
the value of EUR 164.6 million. Capital expenditures, in Q2 2022, reached the value of EUR 51.3 million or 27.8% lower compared to Q2 2021. During this quarter, capital expenditures accounted for only 9.7% of total budget expenditures (14.8% in Q2 2021) (chart 11).

Debt to GDP ratio was 20.8% in Q2 2022, compared to 23.2% as it was in Q2 2021. This decrease was a result of the improvement of the government's budget balance and the increase in nominal GDP (real growth plus inflation), which reduces the debt to GDP ratio. This level of public debt is far from the threshold provided by law of 40% of GDP as well as far from the average of the countries of the region of about 60% of GDP. However, in absolute terms the public debt has reached EUR 1.72 billion in Q2 2022, which is 5.1% higher compared to Q2 2021. The increase of public debt is attributed to the growth of domestic public debt of 7.2% (which reached EUR 1.14 billion), and the increase of external public debt of 1.2% (which reached EUR 578.7 million).

External Sector

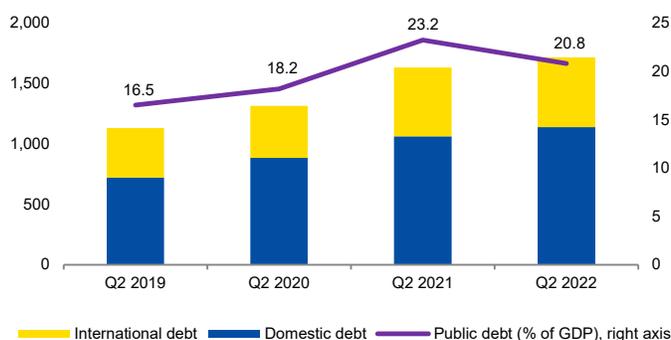
The current account in Q2 2022 recorded a deficit in the amount of EUR 320.66 million, which consists of an annual increase of 3.9%. The increase in the deficit of the current account was mainly attributed to the high increase in the import of goods, which to some extent was influenced by the increase in the prices of goods in the international markets. On the other hand, the balance of the services component and secondary revenues, which marked a significant increase in Q2 2022, had a positive effect on the current account.

Chart 11. Structure of budget expenditures, EUR million



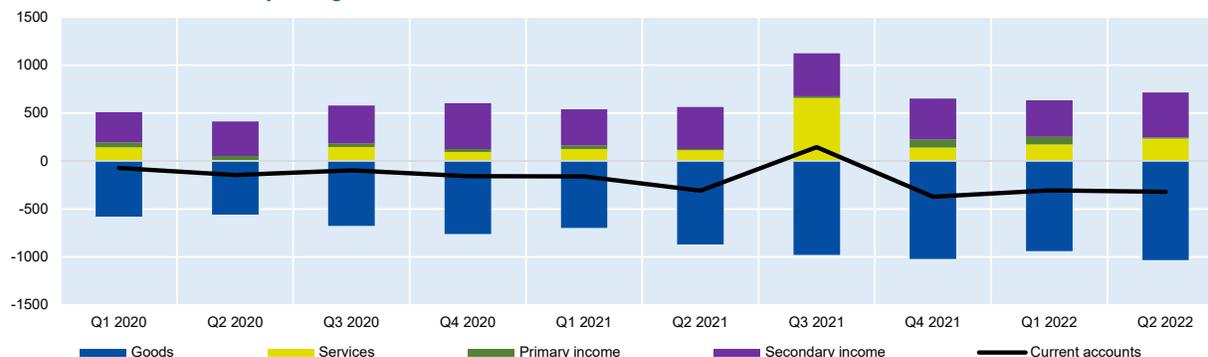
Source: KAS and CBK calculations.

Chart 12. Public debt, EUR million



Source: MFLT.

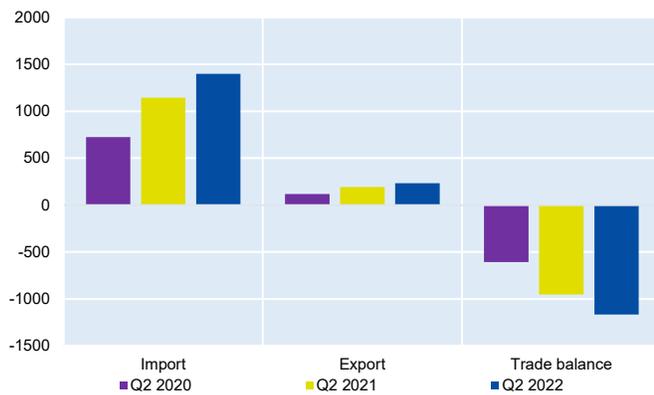
Chart 13. Contribution by categories, in current account



Source: CBK.

Based on the official data published by KAS, the trade balance of goods in Kosovo, in Q2 2022, turned out to have a trade deficit of EUR 1.17 billion, which corresponds to an annual increase of 22.6%. The main reason for the increase in the trade deficit is related to the significant increase in the import of goods. The export of goods in Kosovo during Q2 2022 was about EUR 231 million, while the import reached the value of EUR 1.39 billion. Export of goods manages to cover 16.6% of imported goods or standing 1 to 6 with the proportion of the trade balance. While the deficit in the current account constitutes a structural problem in the country’s economy, the continuous increase in the import of consumer and intermediate goods signals the increased sensitivity of the country’s economy to future dynamics in international markets.

Chart 14. Trade balance of goods

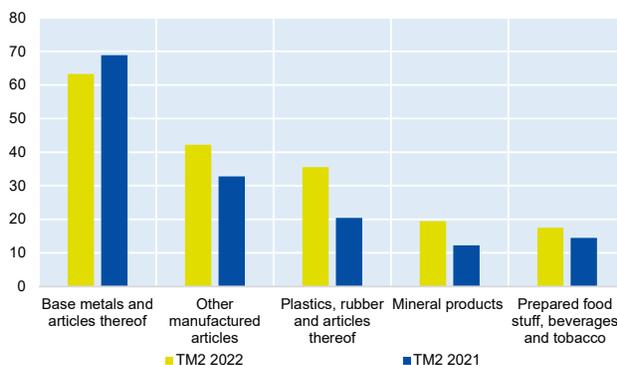


Source: KAS.

The export of goods, in Q2 2022, recorded an annual increase of 20.76%, an increase that is mainly attributed to the increase in prices in international markets and, to a lesser degree, to the increase in the amount exported. While concerning to the countries of the region, Kosovo has continued to export mainly base metals and their articles, to EU countries, were exported mainly plastic materials, mineral products, and articles from base metals. Meanwhile, the increase in exports to the American market mainly consists of mattresses. Inflationary dynamics have been reflected in Kosovo’s external trade mainly through the increase in the value of exports in categories such as plastic items, mineral products, and food items.

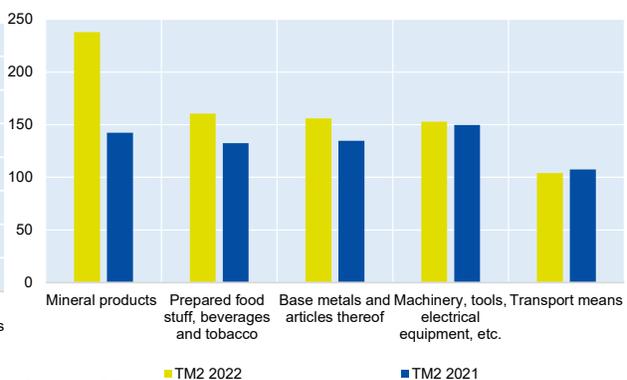
The increase in imports that characterized Kosovo’s economy during 2022 in general, and during Q2 2022, is mainly attributed to price dynamics, while estimates suggest a slowdown in overall demand in the country. The value of imports into the country reached EUR 1.39 billion in Q2 2022, and suggests an increase of 22.3%. While the structure of trade partners and main import categories remained unchanged, Kosovo mainly imported mineral products and metals from the countries of the region, while food products and metals from the EU countries. Whereas from countries like China, mainly machinery, electrical equipment, and plastic items were imported. While the prices mainly affected the imports of goods for consumption and intermediate goods as a result of the increase in prices that are related mainly to the category of food and energy, the countries from which these categories were imported remained unchanged.

Chart 15. Export, by main categories



Source: CBK.

Chart 16. Import, by groups of goods

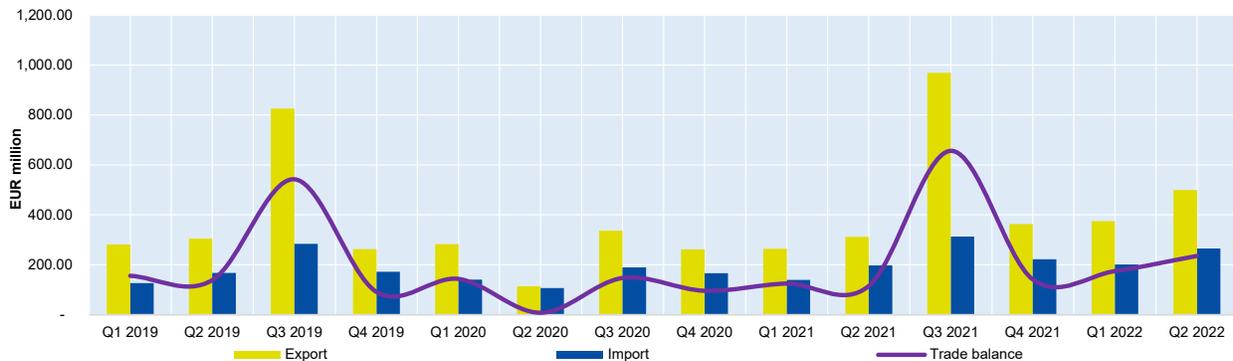


Source: CBK.

Unlike from the trade balance, services marked a positive balance in Q2 2022. The export of services reached the value of EUR 499.6 million in Q2 2022, marking an annual increase of around 60.55%. The export of services

marked a significant increase as a result of the increase in the export of services in the travel category, a category that reached the value of around EUR 346.33 million. In Q2 2022, revenues from the travel services category had a share of 16.4% in the total GDP generated in the country. A high annual increase of EUR 33.2 million was also recorded in the export of computer and telecommunication services, a category that reached EUR 52.1 million, in Q2 2021. The import of services during Q2 2022 has increased, where the import value of all services has reached EUR 264.66 million, an annual increase of 34.3% compared to Q2 2021. A higher increase was also marked in the import of transport and travel services, which is also related to the increase in costs as a result of the increase in the prices of the main goods.

Chart 17. Balance of services



Source: CBK.

The balance of the primary income account marked a decrease of 7.2% compared to the same quarter of the previous year, a decrease that was mainly attributed to the dividend return from direct investments in the amount of EUR 66.5 million or EUR 12.6 million more than in Q2 2021. An increase of 10.6% was also marked in compensation of employees, the balance of which reached EUR 72.2 million (chart 17).

Remittances constitute one of the main financing sources of consumption in the country, a source that in June 2022, reached 14.9% of the total GDP generated in the country. The value of remittances received in Q2 2022 reached EUR 314.11 million, an annual increase of 0.82% with the same period of the previous year. The slower growth of remittances during this quarter compared to the same quarter of the previous year can be attributed to a certain extent to the increased uncertainties during this period in the countries from where these inflows come, as well as the potential impact of the fiscal measures undertaken in the form of subsidies for the most vulnerable social groups. The structure of remittances received has remained unchanged, in terms of the sending countries (Germany and Switzerland lead with about 56.8% of the total remittances received), as well as in terms of the channels through which they were received.

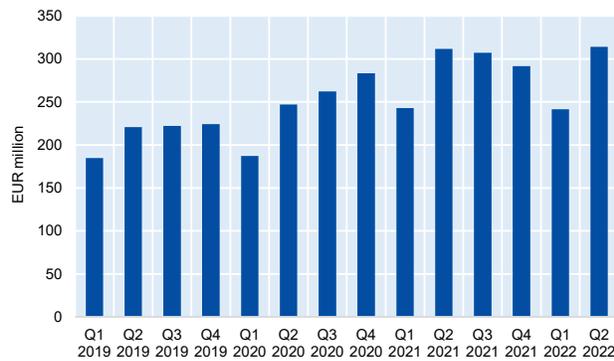
Chart 18. Balance of primary income



Source: CBK.

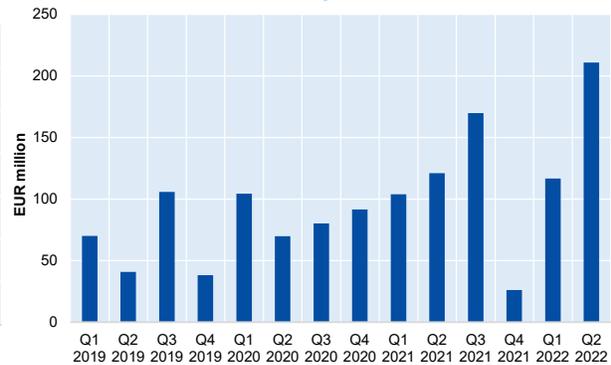
Foreign Direct Investments, in Q2 2022, reached the value of EUR 210.78 million or 74.16% more compared to Q2 2021. The most significant increase was observed in the capital and investment fund in shares of about EUR 129.12 million, or an increase of 57.62% compared to Q2 2021. While debt instruments recorded an increase of EUR 36.7 million or EUR 21.4 million more than in Q2 2021. The structure of FDI remained unchanged, mainly concentrated in the real estate sector (56.92% of total FDI in Q2 2022) and the financial sector. This increase in FDI in real estate sector can be attributed, among others, to the increase in the prices of inputs for the cost of construction, which recorded an annual increase of 19.8% during Q2 2022. The performance of companies in other sectors was good, where the balance of the reinvested profit was 89.0% higher compared to Q2 2021.

Chart 19. Remittances



Source: CBK.

Chart 20. Balance of foreign direct investments



Source: CBK.

Financial system

The financial system was characterized by stability and without materialized risks, despite concerns about the slowdown economic growth, the increase in inflation and the fluctuations in the prices of goods in the international markets.

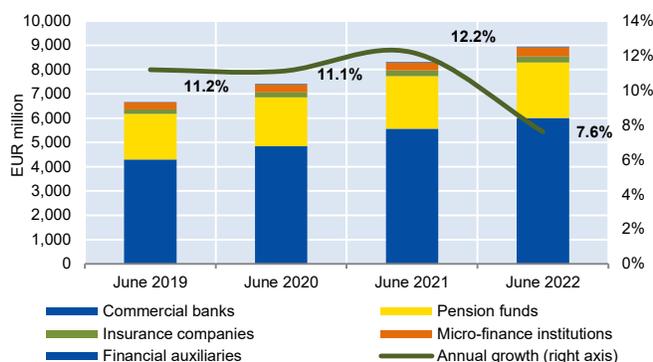
Since the end of 2021, inflationary pressures have inhibited the rapid post-pandemic economic recovery, increasing the uncertainties and sensitivity of the financial system as well. The liquidity risk and the credit risk of the banking sector are increasing and the perspective for their materialization is being strongly influenced by the unfavorable dynamics created in the market as a result of the war and the growing inflationary pressures. The financial system in the country expanded by EUR 633.2 million reaching EUR 8.94 billion, which coincides with slower annual growth of 7.6% compared to 12.2%, marked in the previous year. The slower growth of the total assets of the financial system (chart 21), came mainly as a result of the developments in the banking sector, due to the slowdown in the growth of deposits, and the pension sector as a consequence of the decline in the investments value.

The banking sector represents about 67.2% of the total assets of the financial system, giving the main contribution to the expansion of the total assets of the financial system, although at a slower level compared to the previous period (chart 22). While the microfinance sector, insurance and financial intermediaries, due to their lower weight, had a more limited impact on the overall structure of the system's assets.

1. Banking Sector

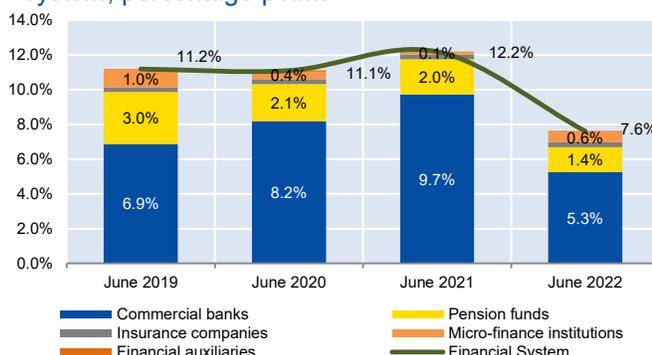
The direct exposure of the **banking sector** in the country to the war in Ukraine is quite limited, however the risks from unfavorable geopolitical developments, macroeconomic and financial developments have been transmitted mainly indirectly through the impact of inflationary pressure. Inflationary pressures are estimated to have affected the decline of disposable income in the economy, which has been translated into a potential decrease in borrowers' solvency (increased credit risk) and weakening of saving capacity (increased liquidity risk). The banking sector historically had optimal levels of capitalization,

Chart 21. Assets value of Kosovo's financial system



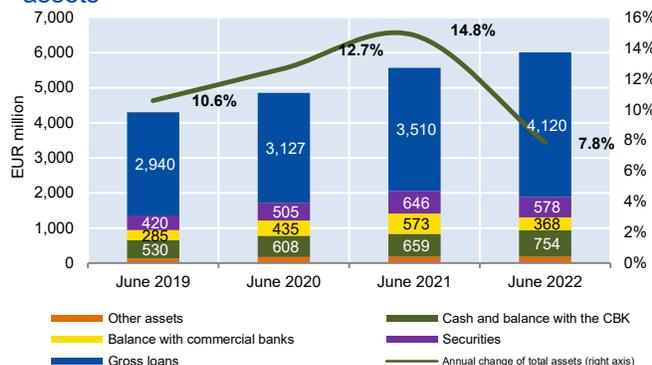
Source: CBK.

Chart 22. Contribution to assets growth of financial system, percentage points



Source: CBK.

Chart 23. Balance sheet of the banking sector - assets



Source: CBK.

liquidity and low levels of nonperforming loans, being proactive in applying prudent lending practices and maintaining adequate capital and liquidity reserves to withstand increased risks.

Assets

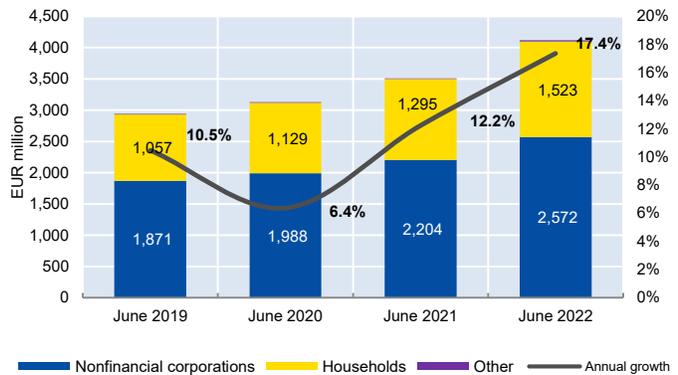
Banking sector marked a slowdown increase of activity for the first time in four recent years, as a consequence of the slowdown increase of deposits. Lending activity was the main positive contributor to the increase in assets, while investments in securities and deposits held in other banks, mainly abroad, marked a decline. Investments in securities declined for 10.4% against the annual growth of 27.7% marked in June 2021, thus dropping at the value of EUR 578.2 million from EUR 645.6 million, as it was in the previous year. The decline in investments in securities resulted from reduced investments in the domestic government securities market, which marked a decline of 9.8%, and to a lesser extent from the reduction in foreign government investments in securities, which declined by 0.5%. The category of balance with other banks decreased by 35.8% in June 2022, compared to the increase of 31.7% marked in the previous year, as a result of the reduction of assets held as transferable deposits abroad.

Lending

Lending activity marked a significant increase for the second year in a row, exceeding pre-pandemic levels. Expectations for further price increases appear to have encouraged the purchase of real estate and the increase in stocks by businesses, thus increasing the demand for loans from both segments – households and businesses.

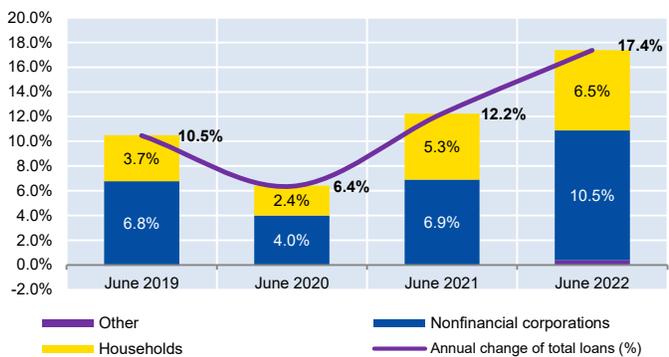
Until June 2022, active loans reached the value of EUR 4.12 billion, representing an annual increase of around 17.4% (chart 24). While lending growth was high for both segments, lending to non-financial corporations had a more significant contribution to the growth (graph 25). Given that the private sector had good credit performance even during the pandemic crisis, banks created the capacity and comfort to increase lending to households and businesses. New loans increased significantly by 18.5% until June, highlighting new investment loans for nonfinancial corporations of 35.6% as well as new mortgage loans for households of 16.3% (chart 26).

Chart 24. Stock of total loans, annual change



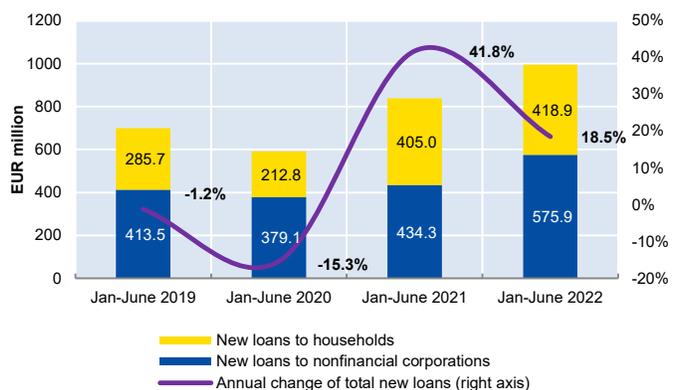
Source: CBK.

Chart 25. Contribution to the growth of total loans, in percentage points



Source: CBK.

Chart 26. New loans, annual change



Source: CBK.

In terms of loans for nonfinancial corporations, lending to the trade sector was at the highest levels over the years, followed by the manufacturing sector, which has gradually expanded in the recent years, as well as the construction sector. Lending to the agricultural sector, despite the support from the Kosovo Credit Guarantee Fund (FKGK), continues to have a rather low weight. Until June 2022, lending to the manufacturing sector had the highest contribution to the growth of total loans to nonfinancial corporations segment (chart 27), marking the most accelerated annual growth of 45.6% (37.2% in the previous year), or for EUR 158.8 million. Likewise, lending to the trade and construction sectors recorded an increase of EUR 108.0 million (an increase of 10.7%) and EUR 62.8 million (an increase of 21.5%), representing a slower increase compared to the previous year (13.4% and 36.1%, respectively) (chart 28).

Chart 27. Contribution to the growth of total lending to nonfinancial corporations, by economic activity

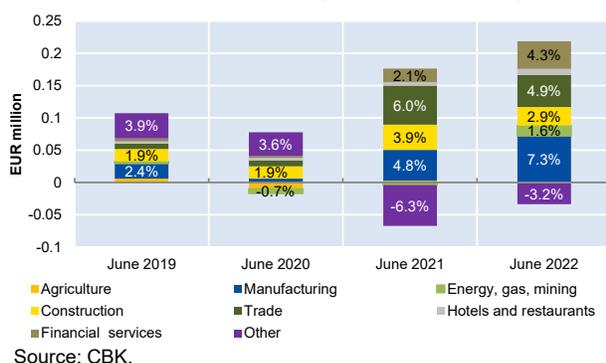
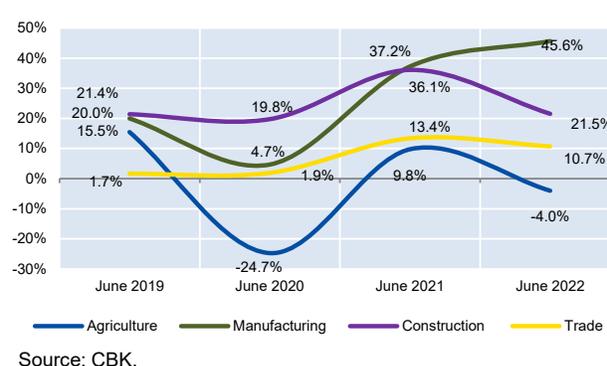


Chart 28. Annual change on loans to nonfinancial corporations, by economic activity

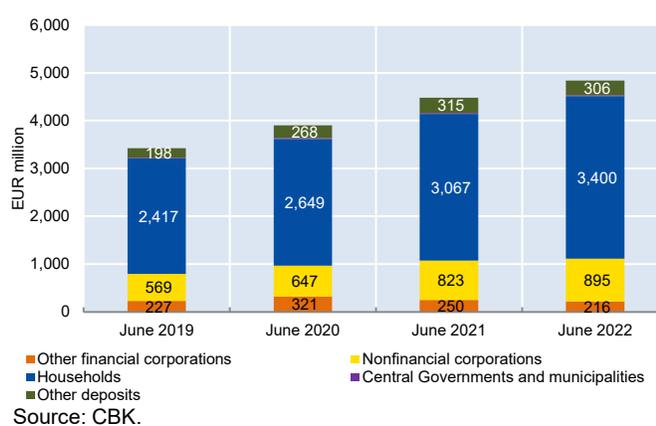


Based on the turnover data of enterprises, the sectors with the highest turnover were the processing industry, trade and construction sectors. The expansion of the activity in these sectors has consequently influenced the increase in the demand for loans to support the increased activity.

1.1. Liabilities and Own Resources

Financing of the banking sector activities continued to rely on customer's deposits and own capital, namely retained earnings and realized earnings during the current year. Both of these items comprise 92.0% of liabilities and equity, where 80.5% is comprised only of deposits. However, the increased uncertainties as a result of inflationary pressures and the slowdown of economic activity were reflected in consumers behavior through the reduction of deposits, which pushed the banking sector to offer more favorable conditions for securing the financing and to start increasing the interest rate on deposits.

Chart 29. Stock of total deposits



1.1.1 Deposits

The value of total stock of deposits at the end of June 2022, reached EUR 4.83 billion, representing an annual slowdown increase of 8.0% (an increase of 14.7% marked in June 2021).

The slowdown increase of total deposits mainly reflects the performance of household deposits since they have the highest weight in total deposits (chart 30), a dynamic which may have been influenced by the higher

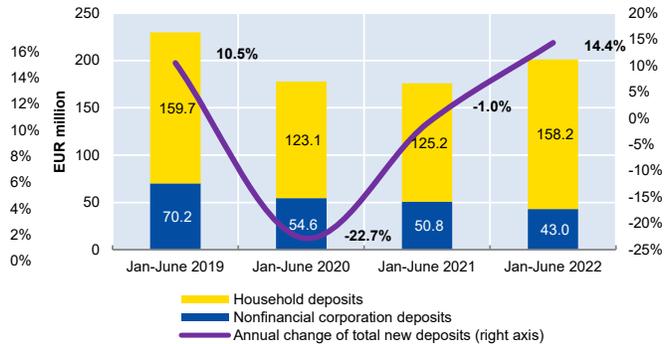
spending during this year and by the decline in the level of remittances compared to the previous year - when it is considered the correlation between the performance of household deposits and remittances received.

Chart 30. Contribution to annual growth of total deposits, percentage points



Source: CBK.

Chart 31. New deposits, annual change



Source: CBK.

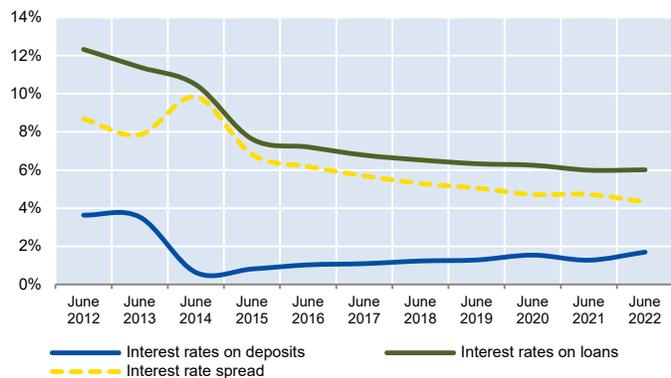
Total household deposits at the end of June 2022, reached the value of EUR 3.40 billion, representing an annual increase of 10.8% (an increase of 15.8% marked in the previous year). Regarding the level of new deposits collected by households, which includes only time deposits, during the period of January-June 2022 they reached the value of EUR 158.2 million, representing an annual increase of 26.4% (1.7% marked in the previous year) (chart 31). The increase in interest rates on deposits for this category (from 1.1% in the previous year to 1.5% in June 2022) may have had a major impact on the growth of new deposits.

The stock of nonfinancial corporation deposits reached EUR 894.9 million at the end of June 2022, representing an annual increase of 8.7% (an annual growth of 27.2%, in June 2021). New collected deposits from this segment, during January-June, marked an annual decline of 15.3%, reaching the value of EUR 43.0 million. The slowdown in the growth of NFC deposits is estimated to have been influenced by the investment of funds in working capital, with the aim of reserving current prices, taking into account the expectations for further price increases.

1.2. Interest rates

The dynamics of interest rates on loans and deposits, in 2022, were influenced by developments at the global level, where most central banks applied tight monetary policy in response to the continuous increase in prices. More precisely, the increase in interest rates applied by the banking sector was influenced and is expected to be further influenced, to some extent, by external factors such as the increase in

Chart 32. Interest rate on loans and deposits



Source: CBK.

basic interest rates by the ECB, as well as by local factors such as campaigns to withdraw deposits, especially by banks with domestic capital and branches of foreign banks.

Moreover, as a measure to manage the growing risk from inflation, almost all banks have increased, or in the case of some of the banks have started to increase the application of variable interest rates, which are mainly based on the EURIBOR rate.

Interest rates on loans, which in recent years had marked a gradual decline, in 2022 interrupted the downward trend, and in the second quarter of 2022 a marginal increase was observed, which is expected to gradually accelerate during the following periods. Such expectations are also relied on the Bank Lending Survey results. At the same time, interest rates on deposits, which also decreased in recent years, began to rise in 2022, and in particular in the second quarter of 2022.

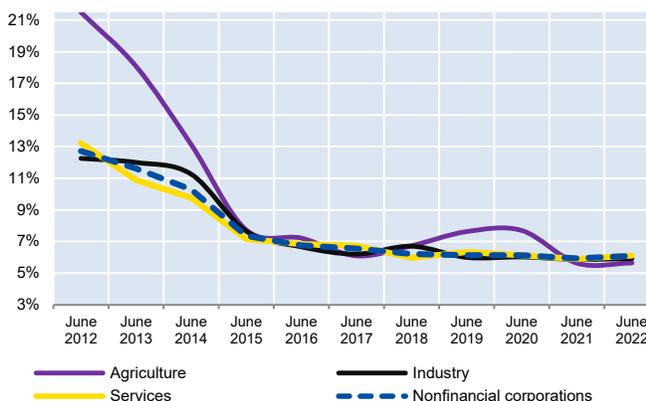
In June 2022, the interest rate on loans was 6.0%, while interest rate on deposits stood at 1.7%, narrowing the interest rate spread of loans and deposits at 4.3 percentage points (chart 32).

1.2.1 Interest rates on loans

In June 2022, the average interest rate on loans to nonfinancial corporations was 6.1%, or for 0.2 percentage points higher compared to the same period of the previous year. More favorable interest rates on loans were provided for the agriculture segment, which historically had higher interest rates due to higher risks (sensitive to climate changes). However, the continuous support, through the guarantee of loans from the KCGF, has influenced that the interest rates on loans for this sector are leveled with those for the industry and services sector (chart 33).

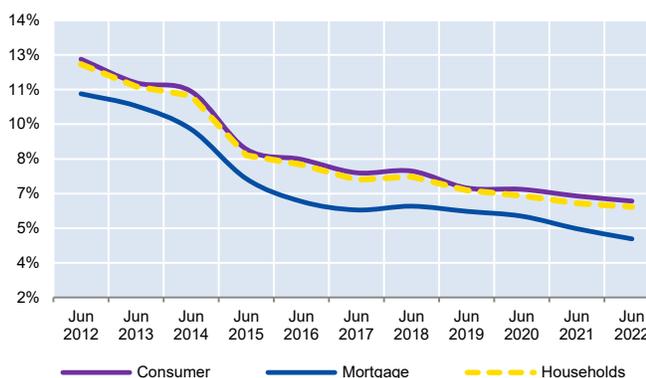
In June 2022, the average interest rate on loans to households stood at 5.9%, representing a decline of 0.2 percentage points compared to the previous year. Interest rates on mortgage loans are more favorable due to their lower risk, as they are covered by collateral (mortgage). Whereas, consumer credit continue to have higher interest rates despite of marking marginal decline compared to the same period of the previous year (chart 34).

Chart 33. Interest rate on loans to nonfinancial corporations



Source: CBK.

Chart 34. Interest rate on loans to households



Source: CBK.

1.2.2 Interest rates on deposits

Interest rates on deposits interrupted their declining trend of the recent years and were characterized with an increase. The average interest rate on nonfinancial corporation deposits increased by 0.3 percentage points, reaching 2.1%, while for households there was marked an increase of 0.4 percentage points, reaching 1.5% (chart 35).

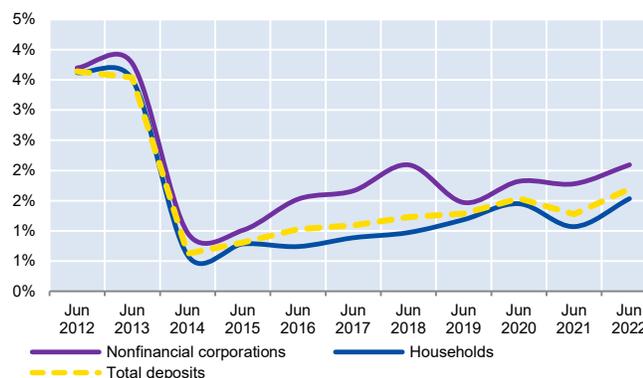
Performance of the Banking Sector

Banking sector realized a profit with a value of EUR 67.5 million in the first half of 2022, representing the highest value registered in the first semiannual period, since the foundation of the banking sector. This financial result is attributable to the higher income increase, being supported by the accelerated growth of lending, and at the same time, the lower increase of expenditures (chart 36).

Total income reached the value of EUR 168.9 million, representing an annual increase of 11.6% (an increase of 11.1% marked in the previous year). Interest income, which represents 71.2% of total income, gave the main contribution to the growth of income. In the context of interest income, the collection of interest on loans had the main contribution to this increase, a category which was influenced by the significant increase in lending. In contrast to the previous periods, interest income from assets held in other banks was characterized by a significant increase, which may have been influenced by the increase in interest rates on deposits. Meanwhile, the category of non-interest income recorded a slower growth compared to the previous year, of 13.3% (23.9% in June 2021), and reached the value of EUR 42.1 million, mainly as a result of collections from fees and commissions.

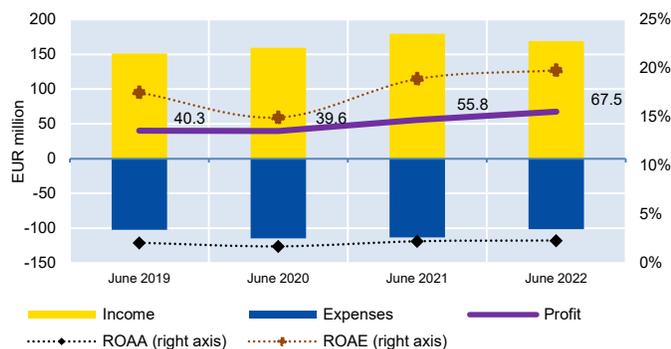
Unlike the previous year, the total expenses of the banking sector increased by 6.1% until June 2022 (a decrease of 1.1% in June 2021) and reached the value of EUR 101.4 million. The contribution to this difference was marked by the increase in general and administrative expenses of 8.6%, which mainly reflects the increase in personnel expenses for 11.9%. This increase suggests an increase in the salaries of employees in the banking sector, which may be a correction for the increase in prices in the country. On the other hand, the category of

Chart 35. Interest rates on deposits



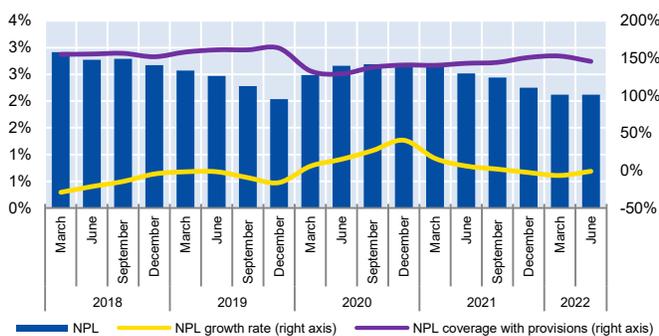
Source: CBK.

Chart 36. Profit and profitability indicators of the banking sector



Source: CBK.

Chart 37. Nonperforming loans and loan loss provisions



Source: CBK.

non-interest expenses marked a significant decrease compared to the previous year, mainly due to the reduction of expenses for loan loss provisions.

Financial Soundness Indicators

Over the years, the banking sector has managed to ensure a high level of capitalization and liquidity, as well as to maintain a low level of nonperforming loans. The satisfactory state of these indicators gives priority to the sector in absorbing shocks from uncertainties caused by crises such as the Covid-19 pandemic and further macroeconomic risks as a result of price increases and economic slowdown activity.

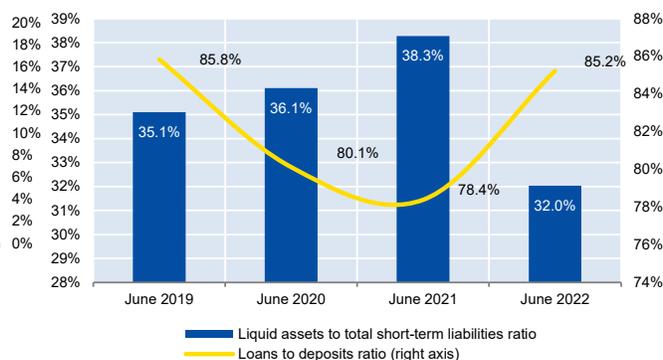
The credit quality has improved compared to the previous year's quality. Whereas, compared to the same period of the previous year, the level of capitalization and the position of liquidity decreased, however, the level of both indicators remained significantly above the regulatory minimums.

Chart 38. Solvency indicator



Source: CBK.

Chart 39. Liquidity indicators



Source: CBK.

The level of nonperforming loans, in June 2022, stood at 2.1%, and the coverage with provisions from potential loan losses at 145.7% (chart 27). The capital adequacy indicator decreased to the level of 15.1% from 17.3% as it was in June 2021, which is a result of the distribution of dividends by banks (chart 38).

As regards to the liquidity position, liquid assets to short-term liabilities ratio stood at 32.0%, in June 2022 (chart 29). The decrease in the level of liquidity compared to previous year's level is a result of the reduction of liquid assets as a result of the lower investment in securities and the reduction of deposits in banks and other financial institutions, orienting these assets towards lending. At the same time, short-term liabilities increased, thus reflecting an increase of deposits during this period.

Pension sector

The pension sector recorded a slowdown in growth compared to the previous year, mainly as a result of the dynamics marked in international markets.

With the second highest share to total assets of the financial system (of 25.5%), assets of pension funds marked a further increase of 5.5% (an increase of 7.5% marked in the same period of the previous year). The value of pension funds assets reached EUR 2.28 billion, of which 99.6% are represented by Kosovo Pension Saving Trust (KPST), whereas the remainder belongs to Slovenian-Kosovo Pension Fund (SKPF) (chart 40).

Investments from KPST are mainly focused on the external market, in joint funds worth EUR 1.6 billion (or 70.6% of investments), and the rest of the investments are diversified in securities of the Government of Kosovo in the value of EUR 574.4 million or 25.3% of total investments and certificates of deposit in the banking sector

in the amount of EUR 54.9 million (2.4% of total investments). The investment portfolio structure of SKPF is the same as KPST's structure. The majority of SKPF's assets are invested in the external sector, mainly in shares (68.3% of investments), and of marginal value in securities. Meanwhile, investments within the country are mainly focused on Kosovo's Government securities (16.0% of investments).

While the value of collected contributions increased in both pension funds, the return on investments suffered a decrease in value, influenced by fluctuations in the financial markets. Unfavorable circumstances created by the beginning of the war in Ukraine and rising inflationary pressures caused destabilization of the markets, thus affecting the performance of pension funds to be much weaker in this quarter.

The value of contributions collected by SKPF during the period of January-June 2022 reached EUR 294.9 thousand, which represents an annual increase of 19.0%, influenced by the increase in the number of contributors. Meanwhile, gross return on investments stood at negative value of EUR 801.6 thousands.

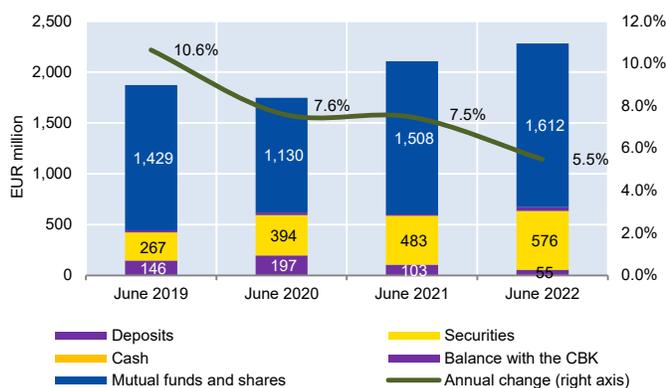
The value of the contributions collected by the KPST until June 2022 reached EUR 116.2 million, marking an annual increase of 11.8%. While KPST investments suffered a decline in value, with a negative return of EUR 161.6 million (chart 41). KPST, also in the past, faced such destabilizing situations of markets (as the financial crises of 2008) and had totally recovered those losses. The investment policy of the funds requires diversification of investments and aims for a positive return in the long term, while simultaneously maintaining a so-called "conservative" portfolio whose assets are required to be invested in the shorter term and with a safe positive return - such as investments in securities of Kosovo.

Insurance sector

The insurance sector has maintained the level of activity growth of the previous year, favored by the higher level of collected premiums and the slower growth of claims paid. Moreover, the sector has operated with a profit, thus reducing the further losses accumulated along the years.

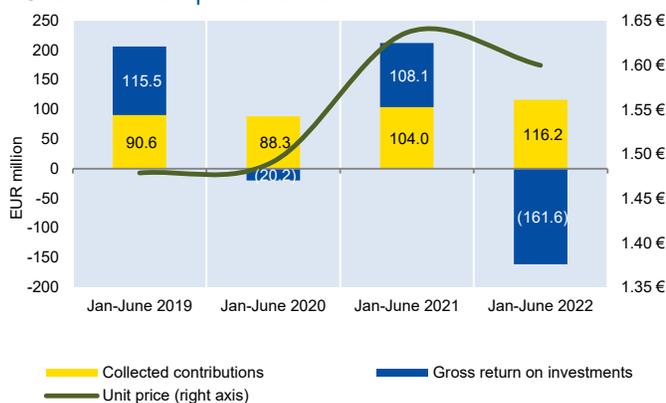
Insurance sector represents 2.8% of the financial system in the country and continued with a positive growth trend in the recent years (chart 42). The highest

Chart 40. Assets of the pension sector



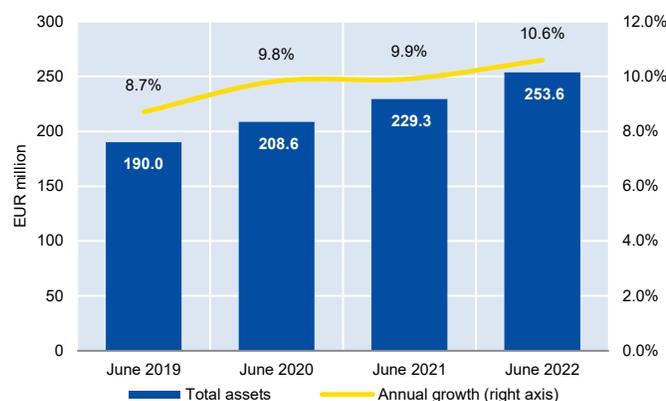
Source: CBK.

Chart 41. KPST performance



Source: KPST.

Chart 42. Assets of insurance sector



Source: CBK.

contribution to the increase of assets was marked by Kosovo's Government securities with an annual increase of 27.7% (an increase of EUR 9.7 million), to EUR 44.9 million, followed by deposits held at commercial banks with an annual increase of 5.7% (an increase of EUR 6.0 million), and reached the value of EUR 110.8 million. Due to the increase of written premiums, technical reserves marked an increase of 9.8% (for EUR 14.5 million) at EUR 162.7 million thus affecting the increase of total liabilities.

The value of written premiums reached EUR 61.4 million until June 2022, representing an annual increase of 13.1% against 19.5% as it was in the previous year. A more significant increase that was marked in the previous year was more a result of the low base of written premiums during the pandemic in 2020. The increase in written premiums until June 2022 mainly reflects the increase in written premiums of the third-party liability.

On the other hand, the value of claims paid by insurance companies and the Kosovo Insurance Bureau in the first half of 2022 reached the value of EUR 30.9 million, which represents an annual increase of 5.5% (35.4% in the previous year, as a result of the low base from a pandemic year 2020) (chart 43). The value of the claims paid by KIB decreased by 11.8%, while the claims paid by insurance companies marked an annual increase of 9.3%. The insurance sector in the first half of 2022 recorded a profit in the amount of EUR 2.5 million¹ (EUR 1.5 million² in the same period of the previous year). The higher profit realized during this period compared to that of the previous year was favored by the increase in the level of written premiums against the decrease in operating expenses.

Microfinance sector

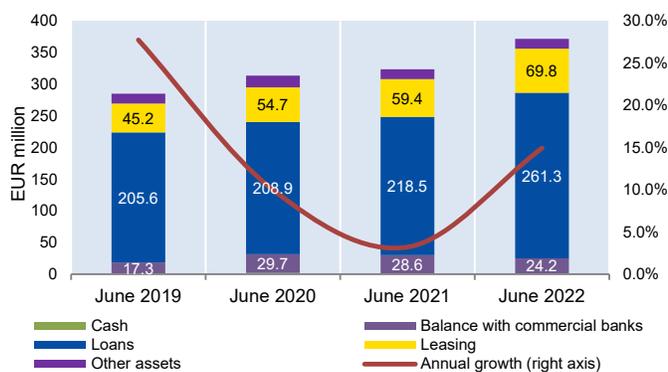
Microfinance sector marked an accelerated increase of assets in the first half of 2022, mainly influenced by the increase of lending activity. The financial result turned out to be the highest since the consolidation of the sector in the respective period, namely the increase of income was five times higher compared to the increase of expenses. The support of the lending activity was financed by borrowings from the external sector(credit lines). Financial soundness indicators also show an overall stability of the sector. However, based on the continued increase in prices, the microfinance sector is expected to face increased funding costs due to the increase in base interest rates as part of the monetary policies applied by a large number of foreign countries in terms of facing inflation. Due to the already high interest rates of this sector, there remains limited space for transferring the increased

Chart 43. Written premiums and claims paid



Source: CBK.

Chart 44. Assets of the microfinance sector



Source: CBK.

¹ Excluding net profit/loss of the insurance companies Insig&Kosova e Re (retained after revoking the license)

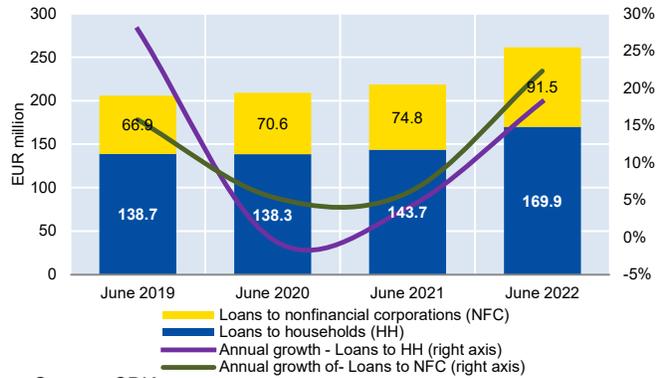
² Excluding profit/loss of the insurance companies Insig&Kosova (retained after revoking the license)

cost to customers. Therefore, expecting weaker economic activity, despite of being followed by many uncertainties, there may be expected a decline of the financing demand by this sector.

Assets

Assets of the microfinance sector recorded accelerated annual growth of 14.9% in June 2022, reaching the value of EUR 372.0 million at the end of the period (chart 44). The dynamics of assets was contributed by the increase of lending, supported by loans (credit lines), which recorded an annual increase of 13.3%, reaching the value of EUR 235.0 million at the end of June 2022. Also, the increase of the level of capital contributed to the increase of the activity of the sector, mainly through the profit retained over the years and the profit realized until June 2022.

Chart 45. Value of loans to households and to nonfinancial corporations



Loans

The lending activity of the microfinance sector marked an accelerated growth, approaching the level of lending growth that had been marked in the pre-pandemic period.

Chart 46. Value of loans to nonfinancial corporations, by economic sectors

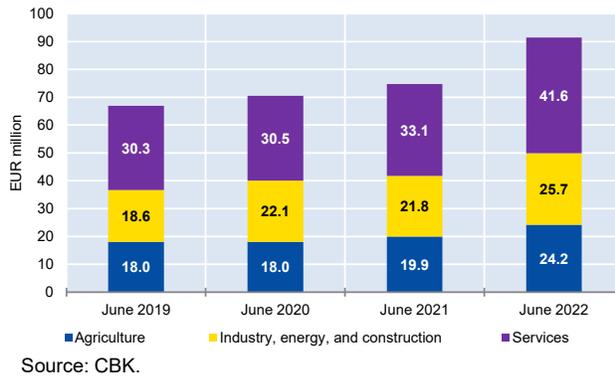
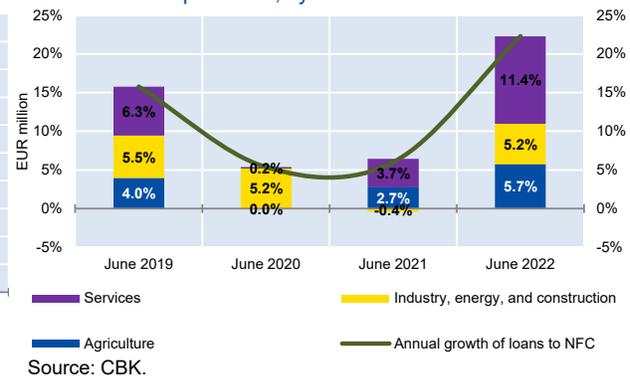
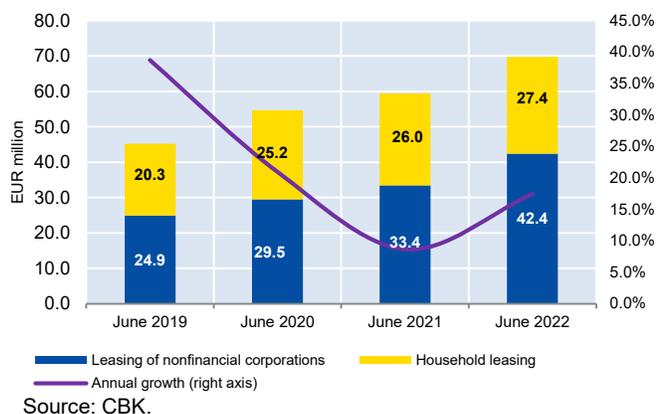


Chart 47. Contribution to the growth of lending to nonfinancial corporations, by economic sectors



Total loans issued by the microfinance sector marked an accelerated growth of 19.6% in June 2022, while their stock reached the value of EUR 261.3 million. Lending of the sector increased for both economic segments, namely for nonfinancial corporations and households. More specifically, lending to households expanded at a rate of 18.2% (an increase of 3.9% marked in June 2021), reaching the value of EUR 169.9 million at the end of June 2022 (chart 45). Loans stock to nonfinancial corporations marked a value of EUR 91.5 million, representing an annual increase of 22.3% (an increase of 6.0% in June 2021). In terms of loans to nonfinancial corporations, lending to the services sector was characterized by the highest increase, followed by agriculture and industry, energy and construction (charts 46 and 47).

Chart 48. Value of microfinance sector leasing



Leasing

The value of leasing, at the end of June 2022, reached EUR 69.8 million, representing an annual increase of 17.5%, significantly higher than in the previous year (chart 48). The highest contribution to this growth was given by the segment of nonfinancial corporations, which expanded by EUR 8.9 million, reaching EUR 42.4 million at the end of June 2022. Whereas, leasing to households increased by EUR 1.4 million and their stock reached EUR 27.4 million, at the end of June 2022.

Interest Rates

The average interest rate on loans issued by this sector, in June 2022, was 18.9%, which is for 0.5 percentage points lower than in the same period of the previous year (chart 49).

Interest rates on loans to households marked an annual decline of 0.3 percentage points, falling at 21.5%. By loan categories, the average interest rate on consumer credit declined by 0.9 percentage points, reaching 21.7%. Meanwhile, mortgage loans continue to have the lowest interest rates, at an average of 18.1% in June 2022, marking an annual decline of 0.4 percentage points.

Also, the average interest rate on loans to nonfinancial corporations decreased by 1.8 percentage points, dropping at 15.0%. On sectoral terms, a more favorable interest rate was marked by loans to services sector, followed by loans to industry sector. Loans to agriculture sector, during this period, were characterized with the highest interest rates (chart 50).

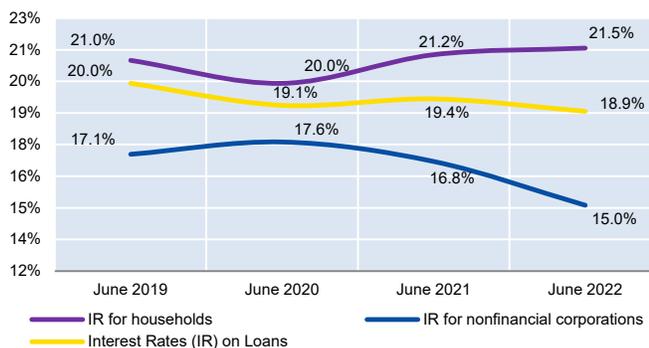
Performance of the microfinance sector

Microfinance sector marked the record highest profit value in the first half of 2022 against the same period, since the beginning of its operation.

Net profit of the sector was EUR 8.8 million, which is for EUR 3.7 million more compared to the same period of the previous year (chart 51).

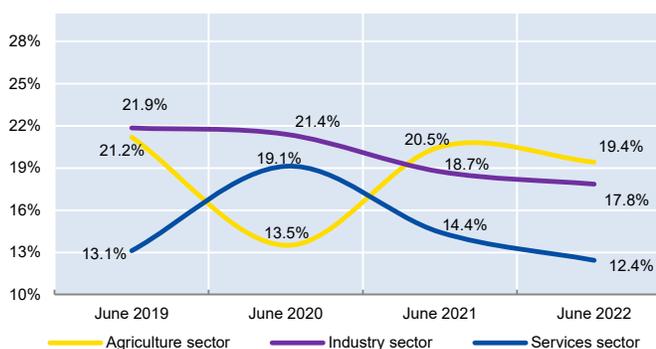
The income of the sector marked the value of EUR 27.4 million June 2022, representing an annual increase of 20.4%. This increase was attributable to the increase of interest income on loans and leasing. During this period, with an increase were characterized also non-interest income.

Chart 49. Average interest rate on microfinance sector loans



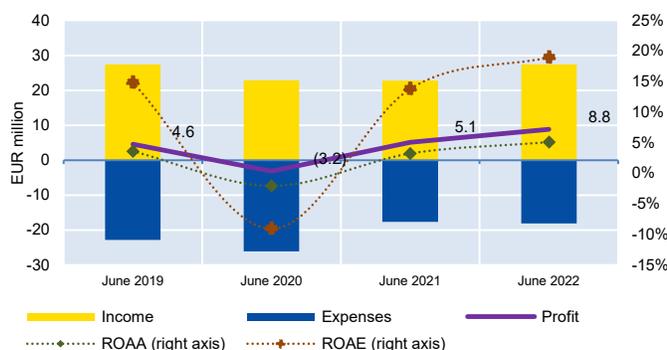
Source: CBK.

Chart 50. Average interest rate on loans to enterprises, by economic sectors



Source: CBK.

Chart 51. Profit and profitability indicators of the microfinance sector



Source: CBK.

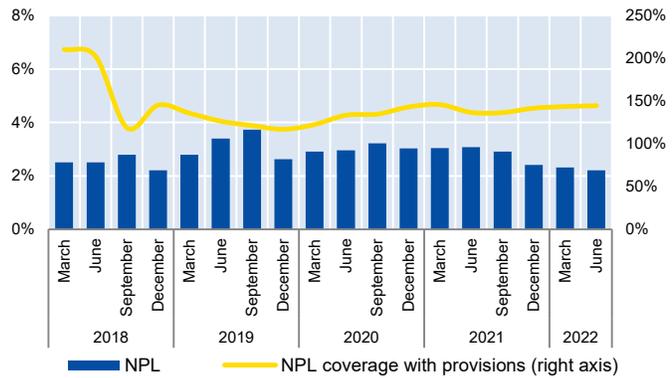
Expenditures of the sector marked an annual increase of 4.8%, reaching the value of EUR 18.1 million, at the end of June 2022. Expenditures increase reflects the trend of non-interest expenses, namely those of administrative and personnel expenses.

As a consequence of the recovery of the sector’s performance, expenses to income ratio marked a significant recovery, declining for 9.8 percentage points, compared to the same period of the previous year, standing at the level of 69.0%.

The financial performance of the sector was reflected also on two other profitability indicators, return on average assets (ROAA) and return on average equity (ROAE), which increased by 5.1% and 18.9%, from 3.2% and 13.8%, respectively, in June 2021.

Regarding the indicators of loans portfolio quality, nonperforming loans continued to stand at low levels and were characterized with high coverage with provisions. More precisely, in June 2022, nonperforming loans declined at 2.2% from 3.1%, as they were in June 2021. While, the coverage of NPL with loan loss provisions reached 144.5% from 136.6% as it was in June of the previous year (chart 52).

Chart 52. Indicators of credit portfolio quality



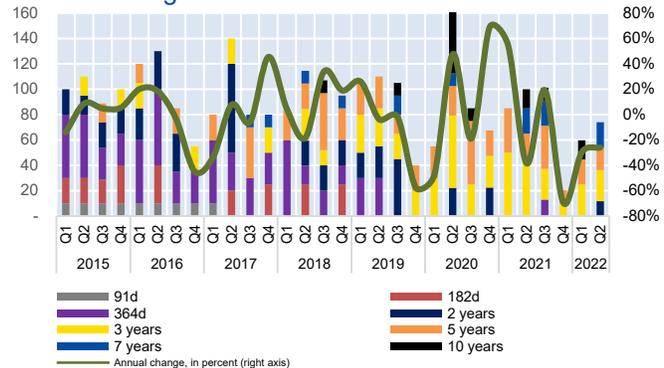
Source: CBK.

Kosovo’s Government securities market

Issuance of government securities until June 2022 was at a lower level compared to the previous year, while the demand to invest in these securities continued to exceed the supply side of the government.

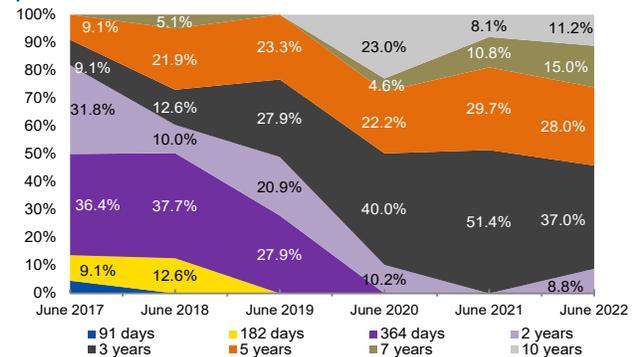
During the first half of 2022, the Government of Kosovo issued debt in the amount of EUR 133.8 million, for 27.7% less than in the previous year (chart 43). Meanwhile, the demand to invest, in the absence of investment alternatives for asset diversification, has continuously exceeded the supply, albeit this ratio was lower than in the previous year. The demand for securities of the Kosovo’s Government was 1.28 times higher than the amount offered by the Government, while in the previous year it was 1.79 times higher. The decline of demand to supply ratio reflects the decrease in demand by 51.3% compared to the previous year as well as the offer from the Government or the announced amount which was lower by 16.2%. Pension funds, as the main investors in government securities, have increased their share in total government debt from 45.0% in June 2021, to 50.0%, while commercial banks have reduced their share in

Chart 53. Amount and maturity of issued debt, annual change



Source: Ministry of Finance Labor and Transfers.

Chart 54. Government securities structure, in percent



Source: Ministry of Finance Labor and Transfers.

debt to 24.0% from 31.0% in June 2021. Banks may have reduced the demand for securities in the period when lending was at a relatively higher level. The average interest rate on securities during the period of January-June 2022 was 2.6%, marking an increase of 0.5 percentage points compared to the same period of the previous year. The increase in the interest rate reflects, among other things, the narrowing of the demand/supply ratio, as well as the global tendency to increase interest rates in financial instruments.

During the first half of 2022, the Government of Kosovo issued debt in the amount of EUR 133.8 million, which is for 27.7% less than in the previous year (chart 43). The structure of Kosovo's Government securities over the years has undergone gradual changes towards the issuance of securities with longer maturities. The securities structure is dominated by government bonds, with a maturity of '3 years' followed by securities with a maturity of "5 years" and "7 years" (chart 54).

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