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

Bank Lending Survey

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CENTRALNA BANKA REPUBLIKE KOSOVA

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Bank Lending Survey and Inflation Expectations

Number 11

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Economic Analysis and Financial Stability Department

Garibaldi 33, Prishtina 10000

Tel: ++383 38 222 055

Fax: ++383 38 243 763

Website www.bqk-kos.org

E-mail economic.analysis@bqk-kos.org

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Bank Lending Survey

Introduction[1]

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 analyzes 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 first quarter of 2022, and banks expectations for credit dynamics in the second quarter of 2022.

In addition to the standard questions, this survey was supplemented with three additional questions in an effort to address the impact of inflationary pressures that were evident especially in the second half of 2021, on lending dynamics, as well as the potential impact on borrowers' repayment performance. Also, in the additional questions, the supply and credit demand are broken down by economic sectors.

Results Summary[2]

The year 2021 marked a strong economic recovery as a result of the improvement of the pandemic situation, in the euro area and in the region, including Kosovo as well. Lending and financing of the banking sector marked a considerable increase in the second half of 2021. This pace continued also in the first quarter of 2022, albeit the beginning of the war Russia-Ukraine resulted in an additional uncertainty and a surge of prices in the world. These dynamics were reflected on banks expectations for the remainder of 2022.

Annual growth of total loans stock continued with an accelerated pace during the first quarter of 2022. At the same time, also new loans compared to the same quarter of the previous year marked a significant annual increase, while compared to the previous quarter, marked a decrease, which may have been influenced by the seasonality of this quarter. These lending dynamics were largely influenced by credit demand, which increased twice more than the credit supply eased. Similar to the current quarter, banks for Q2 2022 expect the lending activity of the sector to be supported to some extent by demand for loans, as the credit supply side is expected to not change significantly.

According to banks, the dynamics of lending to enterprises during this quarter was positively affected to a larger extent by increased credit demand, while credit supply side eased, albeit at lower level. Within credit supply, banks have reported to have eased, to some extent, the credit standards applied in assessing enterprise credit applications of enterprises during the first quarter of 2022. Credit standards were eased primarily for SMEs, while did not mark significant changes for large enterprises (table 1). The changes in credit standards were positively influenced mainly by the increase in competition pressures in the banking market and the improvement of the outlook in the banking market in the country. At the same time, banks increased also the approval level of loans to enterprises, at an approximate level for both categories.

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[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.

For the second quarter of 2022, banks are not expected to have significant changes in the overall credit standards. More specifically, after indexing the replies, a marginally positive index resulted for SMEs, while a low negative index for large enterprises, which means tightening to a certain extent (chart 1). The perspective in the international markets was the factor that negatively affected the credit standards, while the increased competition pressures in the banking sector, the good quality of the credit portfolio, as well as the support from KCGF gave a positive contribution.

Terms and conditions applied by banks in granting loans to enterprises were eased, albeit at a lower level. Eased terms and conditions were mainly applied to both categories of enterprises, especially for SMEs, through the decrease of interest rates and lower collateral requirements. The factors that influenced the easing of terms and conditions were the increase of competition pressures within the banking sector, the favorable access to financing and the support of SMEs by the KCGF. In the second quarter of 2022, banks expect easing of terms and conditions for both categories of enterprises, albeit at a lower level than in the first quarter of 2022. Eased terms and conditions are expected to be similar with those applied in the current quarter. The ease applied in terms and conditions for enterprises are expected to be driven by the favorable approach to financing of the parent banks, as well as at a lower level by the pressures of competition in the banking market, the good quality of the credit portfolio, as well as the support offered to SMEs by the KCGF.

During the first quarter of 2021, **the enterprises demand for loans** resulted to have been increased, albeit at lower level compared to the previous quarter. Credit demand turned out to have been underestimated in banks' expectations for Q1 2022 expressed in the previous survey (Q4 2021). SMEs credit demand increased at a higher level compared to the demand of large enterprises. This increase in demand, according to bank statements, was mainly driven by the increase in demand for financing inventories and working capital and for financing fixed investments. Expectations for increased uncertainty as a result of the continuous increase in the level of prices in the country and abroad have also affected the expectations of the banks, which declared that they expect a low increase in the demand for loans during the next quarter from both categories of enterprises (table 1).

New loans to households were characterized with a considerable increase during the first quarter of 2022, compared to the same period of the previous year, and compared to the previous quarter. Similar to lending to enterprises, credit demand was the main incentive of lending activity dynamics for households during the reporting period, while credit supply had a weaker impact in this aspect. Credit standards in the current quarter, in general, turn out to be the same to the expectations of banks expressed in the previous survey. Credit standards were eased to a higher level for consumer credit than for housing loans. The ease were mainly influenced by the increased pressure of competition among banks, the good perspective of the banking market in the country, the favorable liquidity position of the banks, as well as the good quality of the credit portfolio. In the first quarter of 2022, banks expect an ease, to some extent, in credit standards for households. Credit standards are expected to ease mainly for consumer credit, while no significant changes are expected for housing loans (table 1). The determining factors of the credit standards applied by banks for households during the next quarter are expected to be the increase in competition pressures and the favorable access to financing of the parent banks.

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, based on the level of the generated index. Almost all the terms and conditions conveyed in the survey were eased, except for other payments other than interest, which remained unchanged. The key factors that eased terms and conditions of lending to households, during the first quarter of 2022, were the increased competitive pressure, the good outlook in the domestic market in the country, and the favorable access in financing of the sector. For the second quarter of 2022, banks expect marginal movement in terms and conditions for loans to households. The ease of terms and conditions is expected to be higher for consumer credit. Mainly, terms and conditions for housing loans are expected to be eased by the decrease of the interest rate, the increase of the approved amount, and lower collateral requirements. The increase in competition pressures in the banking market, as well as the favorable approach to financing of the parent banks are expected to be the driving factors for the easing of terms and conditions applied by banks during Q2 2022.

In line with the dynamics in household lending during the first quarter of 2022, the demand for loans marked a significant increase during this quarter, at a similar level compared to the previous quarter. Banks reported similar increases in demand for both consumer credit and housing loans. More specifically, six out of total ten participating banks in the survey, have stated an increase in the overall demand for loans. This increase was positively influenced by two of the factors listed in the survey, precisely by the improvement of the perspective in the real estate market and the need for consumer financing. In the second quarter of 2022, banks expect minor changes in the demand for loans from households, mainly for consumer credit. The survey results suggest that banks expect the improved outlook in the real estate market to affect to some extent the credit demand over the next quarter.

Table 1. Banks assessment on changes of credit supply and demand

	Supply (Credit standards)		Demand	
	Q1 2022	Q2 2022 (expectations)	Q1 2022	Q2 2022 (expectations)
Enterprises	↗	➡	⬆	↗
SMEs	↗	➡	⬆	↗
Large enterprises	➡	↘	↗	↗
Households	⬆	↗	⬆	↗
Housing loans	↗	➡	⬆	↗
Consumer credit	⬆	↗	⬆	↗

⬆ Easing of credit standards/Increase in demand for loans (positive index over 0.20)
↗ Easing of credit standards/Increase in demand for loans (positive index below 0.20)
➡ Mainly unchanged (positive index /negative up to 0.05)
↘ Tightening of credit standards/Decrease in demand for loans (positive index over 0.20)
⬇ Tightening of credit standards/Decrease in demand for loans (positive index over 0.20)

Source: CBK.

Economic recovery as a result of positive global developments and increased income from abroad to the country during 2021, as well as the vigilant monitoring of customers performance helped to improve loan repayment performance. Consequently, banks reported an improvement of the loans portfolio, as the responses index in this quarter stood to negative, albeit at lower level compared to the previous quarter, implying a decline of nonperforming loans to total loans ratio. A same improvement of loans portfolio quality was marked for enterprises and households as well. Whereas, for the next quarter the generated index is expected to change direction and go negative, reflecting the expectations of the banks for the deterioration of the quality of the credit portfolio. These expectations were influenced by the dynamics of the price increase in the country, along with the decline of the customers' power purchase.

Unlike the considerable increase marked in the previous quarter (Q4 2021), in this quarter total financing remained unchanged, based on the aggregated result of replies. The aggregated result of the banks' replies was influenced by the replies of the three banks which declared a decrease in financing, despite the fact that six other banks declared an increase in financing to some extent. Two out of three banks in question are with systemic importance and have high weight in the banking sector, and one of them stated a considerable decline of financing during that period. Financing from the household deposits gave a contribution to the growth, while financing from enterprises contributed to a decline. Financing from international financial institutions and parent banks did not mark a significant change. By maturity, short-term deposits were the main financing source during this quarter. For the next quarter, banks generally expect growth in access to financing, at a significantly higher level than in the current quarter. Financing through the household deposits and with short-term maturity is expected to lead the increase of financing of the banking sector. Also, it is expected that financing from parent banks and international financial institutions to continue to have positive contribution in financing the sector.

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 of the banking sector to financing, on quarterly basis. Questions on bank lending are focused on two main categories: (i) loans to enterprises, and (ii) loans to households. Moreover, loans to enterprises are sub-categorized in to 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, the approval rate of loans, 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 the 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-month period, additional questions may refer to changes occurred during a longer period of time. The survey conveys ten out of eleven 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 scales: (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 replies 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 replies 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 defined for answers when banks declare tightening/lowering to some extent (a value of -0.5). Similarly, the replies 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

[3] The bank that was not included in the survey is Komercialna Banka which has limited lending activity.

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.

Furthermore, 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.

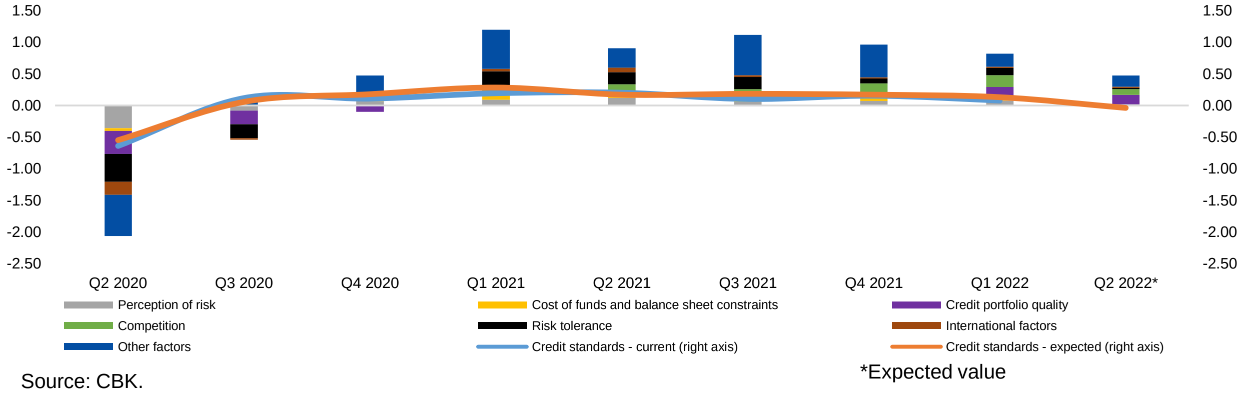
Developments in credit standards, credit terms and conditions, and in credit demand

Loans to enterprises

Credit standards

During the first quarter of 2022, the result for credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises in general represent an ease which is of a lower level compared to the previous quarter with a positive index of 0.18 from 0.22 as it was in the previous survey. In the previous survey (Q4 2021), banks had stated that they expect an ease of credit standards to an approximate level as in the current one (chart 1).

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



Source: CBK.

*Expected value

Within loans to enterprises, banks reported a positive index of 0.18 for changes in credit standards for SMEs, and marginal changes with a low positive index of 0.09 for large enterprises. More specifically, this result was influenced by the replies of three participating banks which stated an ease to some extent of credit standards for SMEs, while three other banks stated a tightening to some extent of standards for large enterprises against one bank which stated ease for the same credit standards.

The main role in easing the credit standards applied by banks in Q1 2022, turns out to have had the increase of the competition pressure in the banking market with a positive index of 0.39 (responses from four banks, of which two of the banks attributed considerable contribution), and the improvement of the market outlook of the banking sector in the country with a positive index of 0.18 (a factor stated by four banks). The loan approval rate for enterprises increased at an approximate level for both categories of enterprises during this quarter, although at a lower level compared to the previous quarter. This result was influenced by the replies of four participating banks (of which one bank with systemic importance) stating an increase in the loan approval rate for SMEs, while three of the banks stated the same for large enterprises (of which one bank with systemic importance).

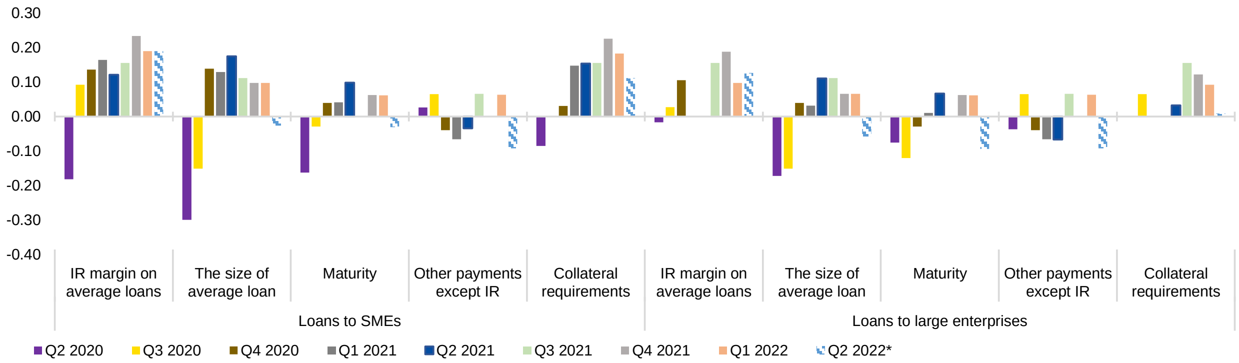
Banks are not expected to have significant changes in the overall credit standards during Q2 2022. More specifically, after indexing the replies, a marginally positive index resulted for SMEs, while a low negative index of 0.12, implying a tightening for large enterprises (chart 1). The perspective in the international markets was the factor that negatively affected the credit standards, while positive contribution was given by the competition pressure, the good quality of the credit portfolio, as well as the support from the KCGF.

Conversely, approval rate of loans to enterprises, in general, is not expected to have significant change over the next quarter. Whereas, if the categories of enterprises are taken into account, it is expected a decrease in the loans approval rate for large enterprises with a negative index of 0.11.

Terms and conditions

In Q1 2022, 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). The banking sector applied higher level of ease on terms and conditions for new loans to SMEs compared to large enterprises. Namely, for both categories of enterprises there was marked an ease to some extent in the applied interest rate (positive index of 0.19 for SMEs and 0.10 for large enterprises) and in the collateral requirement (with a positive index of 0.18 and 0.09 for large enterprises).

Chart 2. Changes of terms and conditions applied to enterprises



Source: CBK.

*Expected value

The factor with the main contribution to the ease of terms and conditions in this quarter was the increase of competitive pressures within the banking sector, with a positive index of 0.26. Also, a positive contribution was given by the favorable access in financing and the support by the KCGF, with a positive index of 0.16 and 0.15, respectively.

Banks are expected to apply eased terms and conditions during Q2 2022, but at low levels. In this context, similar to the current quarter, banks stated that they expect higher ease for SMEs compared to large enterprises, through offering a more favorable price for loans (positive index 0.19 for SMEs and 0.13 for large enterprises), while lower requirements for collateral are expected only for SMEs, albeit with a low positive index of 0.11. The ease applied in terms conditions for enterprises are expected to be driven by the approach to financing of the parent banks, as well as at a lower level by the pressures of competition in the banking market, the good quality of the credit portfolio, as well as the support offered to SMEs by the KCGF.

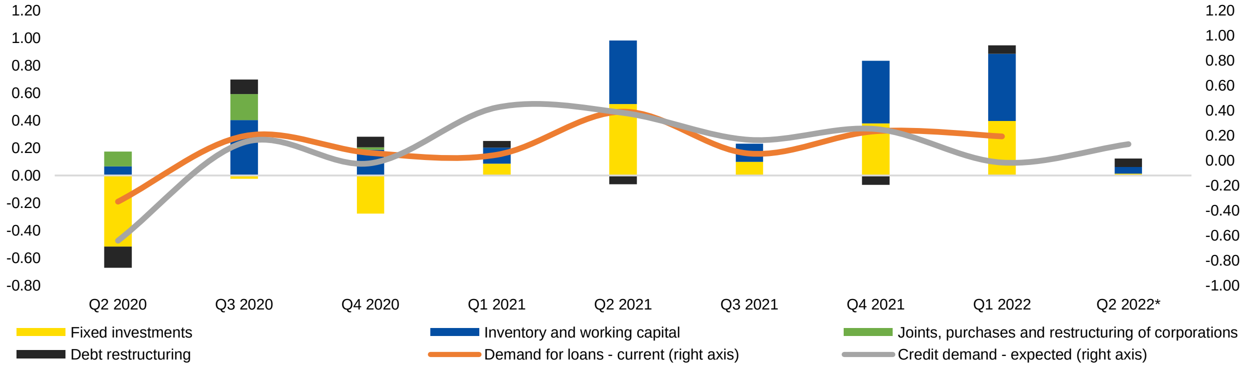
Demand for loans

During the first quarter of 2022, the enterprises demand for loans results to have been increased, albeit at lower level compared to Q4 2021. Credit demand turned out to have been underestimated in banks' expectations for Q1 2022 expressed in the previous survey (Q4 2021) (chart 3). More specifically, the demand for loans from SMEs increased with a positive index of 0.28, whereas the demand from large enterprises generated a low positive index of 0.11. The index generated for credit demand was influenced by the replies of six banks which stated an increase in demand, where three of them stated a significant increase.

According to the survey, the change in demand for loans from enterprises was mainly affected by the demand for financing inventories and working capital, and financing fixed investments with a high positive index of 0.49 and 0.40, respectively. The result of the contributing factors to the credit demand was determined by the replies of seven banks, which stated a positive impact of the demand for financing inventories and working capital and six banks for financing fixed investments. The quality of the received enterprise applications was improved to some extent, during Q1 2022, mainly for applications for loans from SMEs with a positive index of 0.14.

According to the survey, during Q1 2022 the nonperforming loans of enterprises to total loans ratio is decreasing with a negative index of 0.11, however in the last survey the banks' replies generated a higher negative index of 0.31 of this ratio. This result was influenced by the replies of six banks, where three of them stated a decrease in nonperforming loans, while the other three banks stated an increase of nonperforming loans.

Chart 3. Changes in demand for loans from enterprises and contributing factors



Source: CBK.

*Expected value

Banks expect an increase of a low level in the demand for loans from enterprises during the next quarter. These expectations were impacted by the replies of six banks, which stated that they expect an increase in the demand for loans, to some extent. However, one bank with systemic importance and with the high weight of lending in the banking sector, stated that it expects a decline of credit demand, to some extent. Consequently, these replies resulted with a positive index, albeit of a low level if compared to the actual demand for loans, namely resulted with a positive index of 0.14 for Q2 2022. At the same time, banks expect improvement, albeit of a low level, of the loan applications quality submitted by the SMEs.

During the next quarter, banks expect that the ratio of nonperforming loans to total loans to enterprises will change direction and move to a positive index, reflecting the banks' expectations for the deterioration of the quality of the credit portfolio. These expectations were influenced by the dynamics of the price increase in the country, along with the decline of the customers' power purchase.

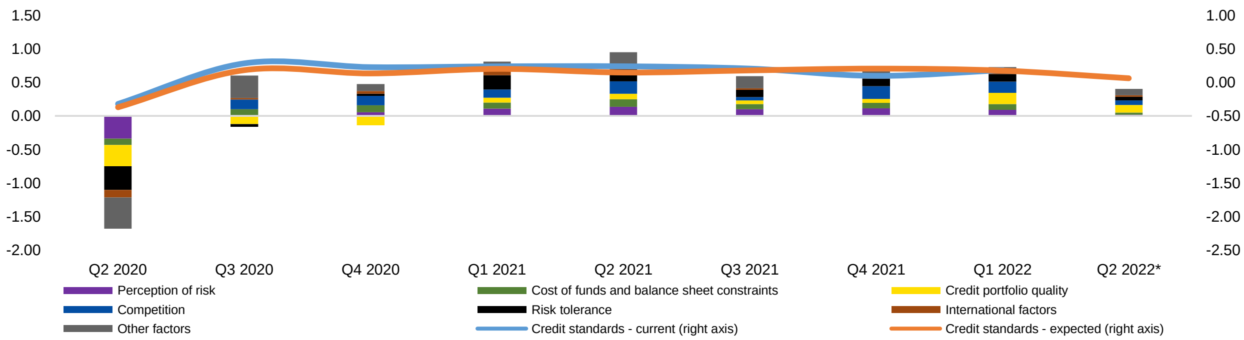
Loans to households

Credit standards

Credit standards applied to households during the fourth quarter of 2022 generally eased, although the easing mainly affected credit standards for consumer credit with a positive index of 0.25, while credit standards for housing loans had a lower level of ease with a positive index of 0.12. The result mainly reflects the responses of four banks, where three of them are of systemic importance. Expectations for the first quarter of 2022 stated by banks in the previous survey, resulted to be correct (chart 4). Banks stated that they have significantly increased the loans approval rate for households, to a higher extent for consumer credit with a positive index of 0.33, than for housing loans which marked a positive index of 0.25.

Factors that contributed positively to the easing of credit standards were the increase of competitive pressures with a positive index of 0.34, the good outlook of the domestic banking market, favorable liquidity position with a positive index of 0.18, and the good quality of credit portfolio with a positive index of 0.17.

Chart 4. Changes in credit standards applied for households and contributing factors



Source: CBK.

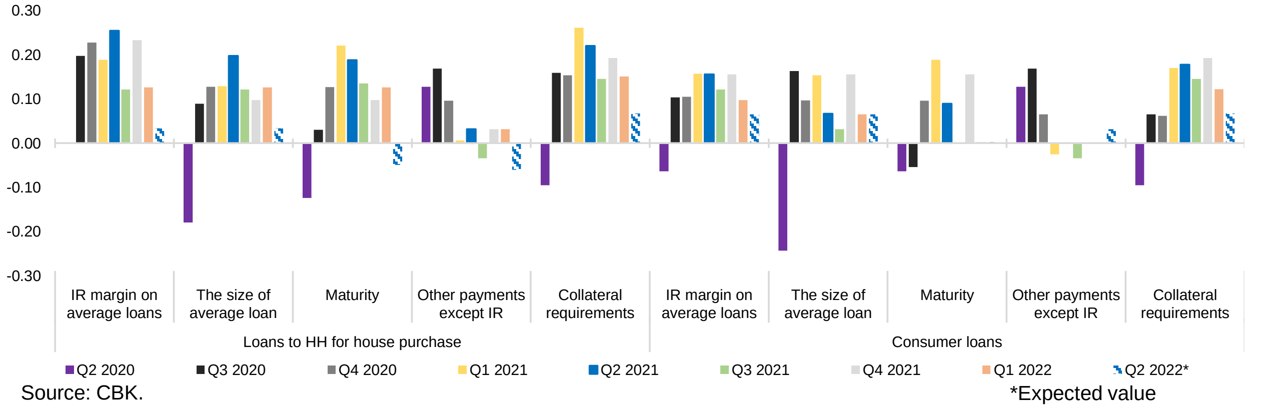
*Expected value

In the second quarter of 2022, banks expect an ease in credit standards, to some extent, for consumer credit with a positive index of 0.15. Meanwhile, housing loans are not expected to mark significant changes. Credit standards are expected to be positively affected by the increase of competitive pressures and the favorable access in financing of parent banks. At the same time, banks expect an increase of loans approval rate, albeit at a lower level compared to the actual values marked in Q1 2022. More precisely, the results of the replies generated a positive index of 0.27 for housing loans, and 0.10 for consumer credit.

Terms and conditions

Terms and conditions generally eased for new loans to households in the first quarter of 2022. The ease of terms and conditions was higher for housing loans compared to consumer credit, based on the level of the generated index. Almost all the terms and conditions conveyed in the survey were eased, except for other payments other than interest, which remained unchanged. Specifically, as regards to housing loans, banks applied reduced collateral requirements (positive index of 0.15), lower interest rate, increased amount of approved loans and extended loans maturity (positive index of 0.13). While for consumer credit, banks applied an ease at a lower level, mainly in collateral requirements (positive index of 0.12), and interest rate (positive index of 0.10) (chart 5).

Chart 5. Changes of terms and conditions applied to households



Source: CBK. *Expected value

The main factors that contributed to the easing of the terms and conditions applied are mainly the increased competitive pressure, the good outlook of domestic banking market, and the favorable access in financing of the banking sector.

For the second quarter of 2022, banks expect marginal movements in terms and conditions for loans to households. The ease of terms and conditions is expected to be higher for consumer credit. Mainly, terms and conditions for consumer credit are expected to be eased by the decrease of the interest rate, the increase of the approved amount, and lower collateral requirements with a low positive index of 0.07. The increase in competition pressures in the banking market, as well as the favorable approach to financing of the parent banks are expected to be the driving factors for the easing of terms and conditions applied by banks during Q2 2022.

Demand for loans

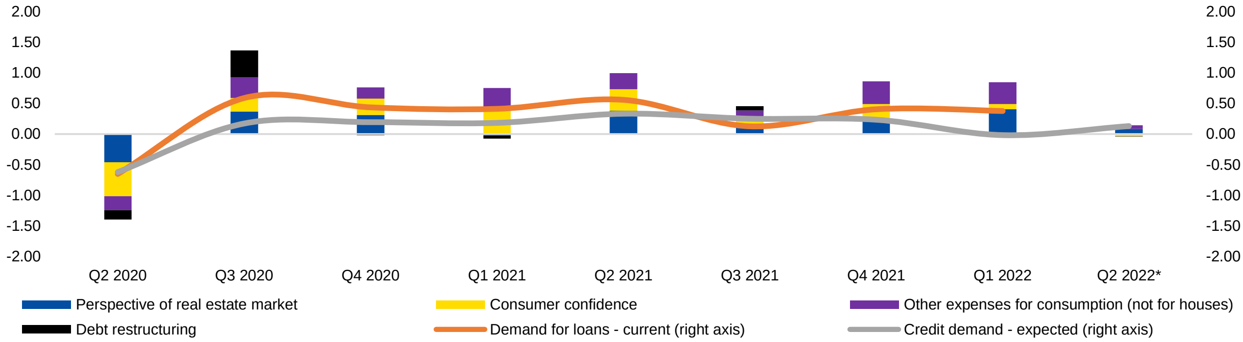
Banks in this quarter reported an increase in demand from households, which is approximate compared to the increase of the demand, marked in the previous quarter (Q4 2021). Six out of a total of ten banks participating in the survey, stated a growth in the demand for loans in general, which after indexing the replies resulted in a positive index of 0.50. Banks have reported a similar increase of demand for consumer credit, as well as for housing loans, with a positive index of 0.38 and 0.37, respectively. If the current result of loans demand are compared with the expectations of banks stated in the previous survey for the same period, the current level of the increase in demand is significantly higher, being affected by the actual value of the demand for both categories which are higher than the expectations stated by banks (chart 6).

This increase was positively influenced by two of the factors listed in the survey, namely by improvement of the real estate market outlook and the need to finance consumption with a positive index of 0.40 and 0.35, respectively. The quality of loan applications submitted by households during this quarter improved marginally for both types of loans, namely with a positive index of 0.07 for housing loan applications and a positive index of 0.10 for consumer credit applications.

Regarding the loans portfolio quality for households, banks stated improvement, reflecting the replies of four banks (two of them with systemic importance) for a decline in nonperforming loans to total loans ratio for households, which resulted in a negative index of 0.16.

In the second quarter of 2022, banks expect small changes in demand for loans from households, mainly for consumer credit. Expectations for an increase of demand for loans were impacted by the replies of six banks (three of them with systemic importance). However, one bank with systemic importance and with the high weight of lending in the sector, stated that it expects a decline of credit demand, which had an impact in the decline of the aggregated result of loans demand. The survey results suggest that banks expect the improved outlook in the real estate market to affect, to some extent, the credit demand over the next quarter. Banks have stated that they do not expect significant changes in the received applications quality of loans to households.

Chart 6. Changes in demand for loans from households and contributing factors



Source: CBK.

*Expected value

Unlike the actual quarter, banks expect the credit portfolio quality of households to change direction resulting in a positive index, albeit of marginal level, during the second quarter of 2022.

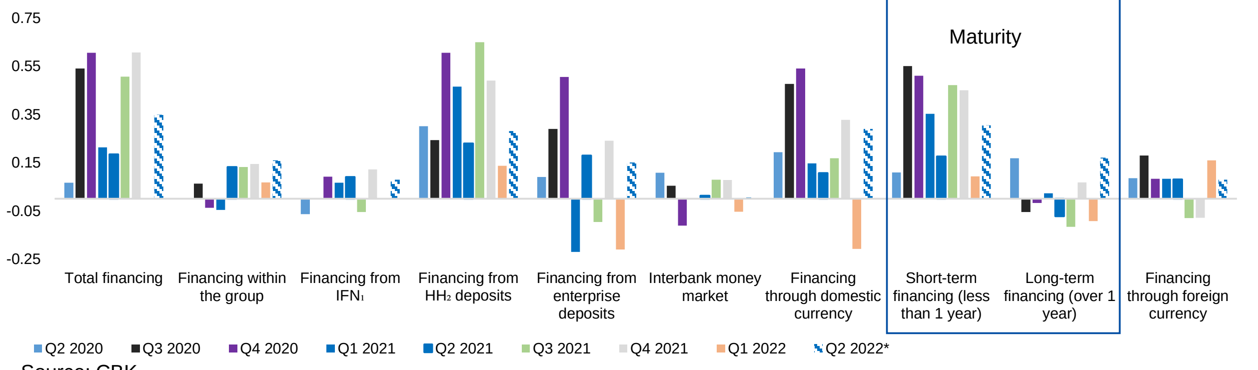
Financing

Banks did not report changes of access to financing during the first quarter of 2022. The aggregated result of the banks' replies was influenced by the replies of the three banks which declared a decrease in financing, despite the fact that six other banks stated an increase in financing to some extent. Two out of three banks in question are with systemic importance and have high weight in the banking sector, and one of them stated a considerable decline of financing during that period. Financing through the household deposits contributed to the increase, while financing through enterprise deposits contributed to the decline.

Unlike the considerable increase marked in the previous quarter, in this quarter the total financing remained unchanged, based on the aggregated result of replies. However, household deposits generated a low positive index of 0.14 (positive index of 0.49 marked in Q4 2021). This result was impacted by the replies of six banks out of total ten participating banks of the survey, where four banks stated an increase of financing and two of them stated a decline. While, financing from enterprise deposits recorded a decrease at a higher level with a negative index of 0.21 (positive index of 0.24 in Q4 2021), also reflecting the replies of six participating banks, three with an increase and three with a decrease in financing from this category. Financing from international financial institutions and parent banks did not mark a significant change(chart 7). By maturity, short-term deposits were the main financing source during this quarter.

For the next quarter, banks generally expect a growth in access to financing, at a significantly higher level than in the current quarter. Financing through household deposits is expected to lead the increase in financing of the banking sector with a positive index of 0.28, while financing from corporate deposits is expected to have lower movements with a positive index of 0.15. Also, banks expect an increase of financing from parent banks with a positive index of 0.16. As regards to maturity of financing, banks stated that they expect the increase in financing to be dominated by short-term deposits with a positive index of 0.30 (chart 7).

Chart 7. Changes in financing the banking sector



Source: CBK.

*Expected value

Results of focused questions

The survey questionnaire for the first quarter of 2021 was completed with three additional questions, in an attempt to address the impact of inflationary pressures that were evident especially in the second half of the year, on lending dynamics. Also, one of the questions breaks down credit supply and demand by economic sectors.

With the easing of restrictive measures in the country and abroad during 2021, economic activity had a strong recovery supported by an increase in domestic demand. However, both domestically and globally, this significant recovery with the beginning of the Russia-Ukraine war, was translated into an overall price increase. Given that price increases negatively affect the consumers' purchasing power, it is important to understand the behavior of the banking sector in doing business in these dynamics, and the sector's perception of the customers' solvency.

Banks stated that as a consequence of price increase in the country, during the first quarter, there have been no changes in the credit supply side, whereas the credit demand was characterized with an increase to a small extent. However, regarding the credit supply side, almost all the banks did not exclude the possibility of adjusting the credit standards and conditions offered for loans during the coming 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. Moreover, one of the banks stated that it has already changed the bank policies on the debt to income ratio for the clients with lower income. On the other hand, the demand for loans 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 increase in demand to continue, albeit its increasing trend is followed by uncertainties. Also, from the replies of the banks, there is more uncertainty regarding the demand for loans from households, based on pending changes, where some banks expect an increased demand for consumer credit, and at the same time there are banks that expect a postponement of the loans demand until a period of price stabilization is present in the market.

Another aspect covered by additional questions was the impact of price increases on customers' solvency. Banks' sentiment from the responses received shows that banks believe in the absorption capacity of their customers, in the short-term period, expectations which were based on the reviewing process of loan applications. However, the majority of the banks stated that they expect that during the following quarters of 2022, given the continuing inflationary pressures in the country and abroad, to negatively affect the customers' solvency, and consequently the loan portfolio quality of the banks.

The disaggregated replies of banks for enterprises, classified by sectors, indicate the direction of financing the economy and dynamics in certain sectors. During the first quarter, based on the easing of credit standards, the manufacturing sector, services and trade, present the sectors with the most favorable offer. The replies of three banks, of which two with systemic importance and with a high weight to the total lending of the sector, reflected easing of credit standards for this sector, which resulted in a positive index of 0.18. At the same time, also terms and conditions were eased at higher level for lending to the same sectors. However, terms and conditions for the manufacturing sector were eased to a higher extent with a positive index of 0.31. Whereas, for the trade and services sectors, the replies of banks resulted with an index of 0.19 and 0.16, respectively. The demand for loans marked an increase for all of the sectors. The sectors with the highest demand for financing were trade and services ones with a positive index of 0.46 and 0.31, respectively. Also, the construction sector (positive index of 0.27), and the one of residential real estate and manufacturing (positive index of 0.26) were characterized with an increased demand during Q1 2022.

For Q2 2022, banks expect to offer an ease of credit standards mainly for the manufacturing and trade sectors. Meanwhile, it is expected that the credit standards will not change significantly, even a tightening of the credit standards is expected for the construction sector with a negative index of 0.18 and for the residential real estate sector with a low negative index of 0.10. In the same period, credit demand is expected to mark a low increase, where according to bank expectations the increase of credit demand from the majority of the sectors was translated into marginal indices. The demand for financing the services and trade sectors is expected to mark an increase, however this expectation from banks' replies was characterized by a positive marginal index of 0.10.

Inflation Expectations

In order to enhance the analytical capacities and based on the best regional practices and beyond, the CBK surveys the financial institutions in the country, based on the hypothesis that financial 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, besides the statements of the banks relating their estimates on the level of inflation for the actual quarter, the questionnaire addresses also the overall expectations of the banks for the third quarter of 2022 and for the whole year of 2022, in general. 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, they 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, then also 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 current 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.

Estimates which are performed by commercial banks are of 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 actual quarter and the expectations for the following quarter and the current year in general. 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.

Results Summary

Based on the survey conducted in April 2022, banks have estimated a little lower level of inflation in the second quarter of 2022 compared to the previous quarters, and expect an even lower level in the third quarter of 2022. Dynamics that have characterized the price fluctuations during the reporting period were reflected in expectations of commercial banks: 0.8 percent in Q2 2022 and 7.1 percent in Q3 2022, from 8.2 percent as it was in Q1 2022 (table 2). For 2022 banks expect that the level of inflation rate will reach 6.5% from 3.4% as it was in 2021.

Data published by the Kosovo Agency of Statistics (KAS), for the first quarter of 2022, suggest that the average annual inflation rate was around 8.2%. Most of the banks (7 of them) expect inflation to be above 8%, while the remainder of the banks (3 of them) expect inflation to be in the range of 2 to 5%.

Table 2. Inflation expectations of banks, annual change in per cent

Banks	Q2 2022	Q3 2022	2022
1	3.6%	3.6%	3.6%
2	12.5%	10.0%	6.5%
3	4.2%	5.3%	7.0%
4	9.3%	5.3%	6.8%
5	10.0%	10.0%	10.0%
6	9.3%	8.6%	8.0%
7	9.0%	8.0%	7.0%
8	8.9%	7.3%	5.8%
9	10.0%	10.0%	7.0%
10	2.8%	3.1%	3.1%
Average	**8.0%**	**7.1%**	**6.5%**

Source: Commercial banks and CBK calculations.

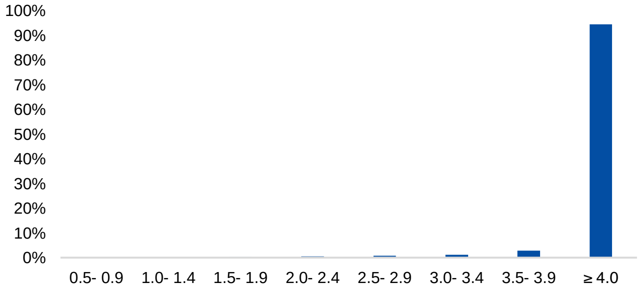
As depicted in chart 8, the reported spreads of probability show that there is a relatively high certainty relating the following result of inflation, hence the spread of probability of the banks is concentrated in the expected inflation.

In their qualitative comments, the banks have mentioned the possible internal and external factors that have influenced the increase in the inflation rate:

- ✓ Temporary factors attributed to the growth of economic activity, are the easing of the pandemic measures, the decrease in the number of people infected with the virus and the vaccination of the population. Therefore, a more optimistic view regarding the pandemics has had an impact on the increase of the economic activity and consequently of the level of inflation. Conversely, the limitations in the offer as a result of the barriers created in supply chains coming from Covid-19 pandemic, where many companies are finding it difficult to find raw materials to produce their products, has had an effect on the price increase, as well. Moreover, the increase in the cost of transport has led to an increase in prices, especially of oil, fuels, construction materials, etc.

- ✓ Russian invasion of Ukraine and supply disruptions. For the global economy, Russia and Ukraine are important suppliers of raw materials such as energy, metals and agricultural products, and the war has called into question the supply of these resources and accelerated prices increase. There are concerns that a further increase in the price of these inputs could be translated into higher operating costs of production, which are translated into higher prices and higher inflationary expectations;

Chart 8. Probability of inflation for Q2 2022 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.

- ✓ The increase in prices of oil products but also of other categories is reflected in the overall increase in prices. Price developments in international markets as well as low manufacturing in Kosovo and the high dependence of the country's economy on imports has had an impact on the increase of prices;

Expectations of the banks for Q2 2022 are in line with the higher trend of inflation while for the whole year of 2022 compared to 2021, taking into account the dynamics with which are being characterized prices in the country, it is thought that banks expectations are low.

Street Garibaldi, no.33, 10000 Prishtina,
Republic of Kosovo
Tel: +383 38 222 055; Fax: +383 38 243 763
Web: www.bqk-kos.org