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

Bank Lending Survey

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BANKA QENDRORE E REPUBLIKËS SË KOSOVËS

CENTRALNA BANKA REPUBLIKE KOSOVA

CENTRAL BANK OF THE REPUBLIC OF KOSOVO

Bank Lending Survey and Inflation Expectations

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Contents

Bank Lending Survey

Introduction[1]

In order to increase analytical capacities for a better assessment of credit dynamics in Kosovo and expectations for price level developments, the Central Bank of the Republic of Kosovo (CBK) has designed and conducted a survey with commercial banks operating in the banking market in Kosovo. The report that will analyze the results of this survey will be published on a quarterly basis on the CBK website, in order to provide a broader overview of banks' risk perception and banks' willingness to lend, as well as, the behavior of households and enterprises against the dynamics in lending, as a consequence. This report highlights the credit behavior for the second quarter of 2022, and the banks' expectations for the lending dynamics for the third quarter of 2022.

In addition to the standard questions, this survey has been supplemented with five additional questions in an attempt to address the impact of inflationary pressures (obvious since the second half of 2021) on lending dynamics, as well as the potential impact on borrowers' repayment performance. Also, the banks elaborated on the indirect impact of inflation on the liquidity position and the possible increase in financing costs of the banking sector. Furthermore, in the additional questions, the supply and credit demand are broken down by economic sectors.

Results Summary[2]

After the improvement of the situation with the pandemic in the previous year, the economy marked a strong recovery, also supported by the increase in lending from the banking sector as well as the significant increase in financing. The high growth of aggregate demand on the global level throughout 2021, and the start of the Russia-Ukraine war in the first quarter of 2022 resulted in increased uncertainty and an acceleration of price growth globally. These dynamics and the consequences that the monetary, financial and fiscal measures are expected to produce, have been reflected in the performance of banks' expectations for credit supply and demand for the remainder of 2022.

Annual growth of total loans stock continued with an accelerated pace in the first half of 2022. Meanwhile, new loans were characterized with annual and quarterly decline. Dynamics marked in lending were largely influenced by credit demand, which was many times higher than the ease of credit supply. Expectations for Q3 2022 suggest that credit demand and credit supply remain mainly unchanged, suggesting a more moderate credit growth in the remainder of 2022.

According to banks, the dynamics of lending to enterprises during this quarter were positively affected to a larger extent by increased credit demand, while credit supply did not go under significant changes. Within the credit supply, banks have reported unchanged credit standards applied in assessing enterprise loan applications during the second quarter of 2022. Banks' responses resulted in a marginal negative index for changes in credit standards for large enterprises, while there was no significant change for SMEs (table 1). Changes in credit standards were negatively affected from the perspective of international markets, referring to the impact of global price increases, while the factors that positively affected the banking sector were the favorable access to financing from the parent banks, the good perspective of the parent banks, the growth of competition pressures, the good quality of the credit portfolio, as well as the support from Kosovo Credit Guarantee Fund (KCGF). At the

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[1] For more detailed information about the purpose and the publications of the bank lending survey in the CBK, please refer to "Bank Lending Survey" 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.

same time, banks increased the approval level of loans to enterprises, primarily for SMEs. For the third quarter of 2022, banks mainly do not expect to have significant changes in credit standards (chart 1). The international markets outlook was the factor that impacted negatively in credit standards, while positive contribution was given by the KCGF.

Terms and conditions applied by banks in issuing loans to enterprises were eased marginally. Eased terms and conditions were applied for both categories of enterprises, especially for SMEs, by reducing the interest rate. While, although at a low level, tightening was applied to charges other than interest for both categories, and at the same time, the maturity and approved amount of new loans were negatively affected for large enterprises. The factors that influenced the easing of terms and conditions were the increase in competition pressures within the banking sector, the favorable access to financing of the parent bank and the support from the KCGF. At the same time, the global markets outlook and the liquidity position of the sector contributed negatively to the applied terms and conditions. In the third quarter of 2022, banks are expected to apply tightened terms and conditions, albeit to a low level, for both categories of enterprises. Tightened terms and conditions are expected to be applied for interest rates and to a lower level for the approved amount of loans. Changes in terms and conditions for enterprises are expected to be driven by the uncertainties in the liquidity position of the banks. However, a factor with a positive contribution was the favorable access in financing of the parent banks, and the support given by the KCGF.

During the second quarter of 2022, there was marked an increase of demand for bank loans by enterprises, albeit at lower level compared to the previous quarter. The demand for loans from enterprises turned out to have been underestimated in banks' expectations for Q2 2022 expressed in the previous survey (Q1 2022). The demand for loans was approximate for both categories of 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 at a lower level. Expectations for increased uncertainties 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 marginal increase in the demand for loans, mainly from SMEs (table 1).

The stock of loans to households recorded a significant annual increase in June 2022, but new loans to households during the second quarter of 2022 marked a decline compared to the same period of the previous year, as well as 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 eased to a higher level for consumer credit, while for housing loans they remained almost unchanged (table 1). These easing conditions were mainly impacted by the increased competition pressure among the banks, favorable access of parent banks to financing, and the good loans portfolio quality. In the third quarter of 2022, banks expect tightened credit standards at a low level for loans to households. Credit standards are expected to tighten for housing loans, whereas a marginal ease is expected for consumer credit (table 1). The key factor with a negative contribution to the credit standards applied by banks for households during the next quarter is expected to be the unfavorable perspective in the real estate market, while the increase in competition pressures and the favorable access to financing of the parent banks are expected to have a positive contribution.

Terms and conditions generally eased for new loans to households. The generated results mainly reflect an ease for consumer credit, whereas a tightening for certain conditions for housing loans. More precisely, as regards to consumer credit, banks applied lower demand for collateral requirements, lower interest rate and increased the amount of approved loans. Meanwhile, banks applied tightening of terms and conditions for housing loans mainly in charges other than interest and for maturity, whereas collateral requirements were eased. The key factors that influenced the easing of lending terms and conditions for households were the good loans portfolio quality, the increased pressure of competition, as well as the favorable access to financing of the parent banks. While, the global markets unfavorable outlook contributed negatively to terms and conditions applied by banks, in Q2 2022. For the third quarter of 2022, banks in general expect a tightening in terms and conditions for loans to households, similarly for both categories of loans. A tightening is expected for interest rates and charges other than interest, while it is expected an ease of a low level for collateral requirements and loans maturity. The outlook of real estate market in the country, clients confidence as well as the unfavorable perspective in the global markets are expected to be the driving factors of the tightening of terms and conditions applied by banks during Q3 2022. Meanwhile, for easing, driving factors are expected to be the favorable access to financing of the parent banks, and their good perspective.

In line with dynamics of lending to households during the second quarter of 2022, the demand for loans marked an increase, albeit half in size compared to the previous quarter's demand. Banks have reported a higher increase of demand for consumer credit against the housing loans demand. According to the banks' statements, this increase was positively influenced by two of the factors listed in the survey, namely the need for consumer financing, as well as the improvement of the outlook in the real estate market. In the third quarter of 2022, banks expect an increase in demand for loans to households, only for consumer credit. The survey results suggest that banks expect the need to finance consumer spending, to some extent, to affect the demand for loans during the next quarter.

Table 1. Banks assessment on credit supply and demand

	Supply (Credit standards)		Demand	
	Q2 2022	Q3 2022 (expectations)	Q2 2022	Q3 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.

The increase in economic activity as a result of positive global developments and the high level of income from abroad, as well as the prudent monitoring of the financial performance of clients helped to improve or maintain the performance of re-payment of loans. Consequently, banks reported an improvement of the loan portfolio, as the response index also in this quarter stood as negative, albeit at lower levels compared to the previous quarter, implying a decline of nonperforming loans to total loans ratio. However, this improvement is mainly for enterprises, while NPL ratio of households was characterized with a positive marginal index. Whereas, for the following quarter the generated index is expected to change direction and be shifted towards a positive level, reflecting banks' expectations for a deterioration of loan portfolio quality. These expectations were mainly impacted by the dynamics of prices increase in the country, along with the decline of clients' purchasing power.

Unlike the unchanged approach of financing in the previous quarter (Q1 2022), in this quarter, total financing marked an increase to some extent, based on the aggregated result of the responses. The aggregated result of the banks' responses was affected by the responses of seven banks which stated an increase in financing, and by one systemically important bank which stated a decrease to some extent in access to financing. Financing from almost all financing sources marked an increase. Household deposits marked the highest increase, while financing from enterprises was characterized with a marginal increase. A more specific change that should be noted is the financing increase from the parent banks, a category which resulted in the highest positive index since the beginning of this survey. Financing from financial international institutions also marked an increase, albeit at low level. By maturity, short-term deposits were the main financing source during this quarter. During the next quarter, banks in general expect an increase in access to financing to a higher level compared to the current quarter. Financing through enterprise deposits and with short-term maturity is expected to lead the increase in financing of the banking sector. This development is based on expectations for higher turnover of enterprises during this quarter. Whereas, financing from enterprise deposits and from parent banks is expected also to mark an increase, albeit at lower level.

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-months 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 scale: (i) tightened / decreased considerably, (ii) tightened / decreased somewhat , (iii) basically no change, (iv) eased / increased somewhat or (v) eased / increased considerably.

Generation of the bank lending survey results

Quantifying of the answers received from individual banks and their aggregation to present the changes on the level of the sector is achieved through a generation of an index. This index is generated for each category and sub-category of each of the questions, thus giving a quantifying unit for the answers received on the level of the sector. Initially, the answers are determined by a value based on the strength of the changes, namely answers where banks stated a considerable tightening/lowering are determined with a value - 1 a double value in size

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

than the one defined for answers when banks declare tightening/lowering to some extent (a value of -0.5). Similarly, answers have a value of 1 when there is a considerable ease/increase, while those with ease/increase to some extent are determined with a value of 0.5. Results are also weighed based on the weight that each of the banks has in total lending of the banking sector. Consequently, the weight of each bank based on its share on the credit market is multiplied with the value determined based on the intensity of the given answer, thus obtaining the index in question.

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.

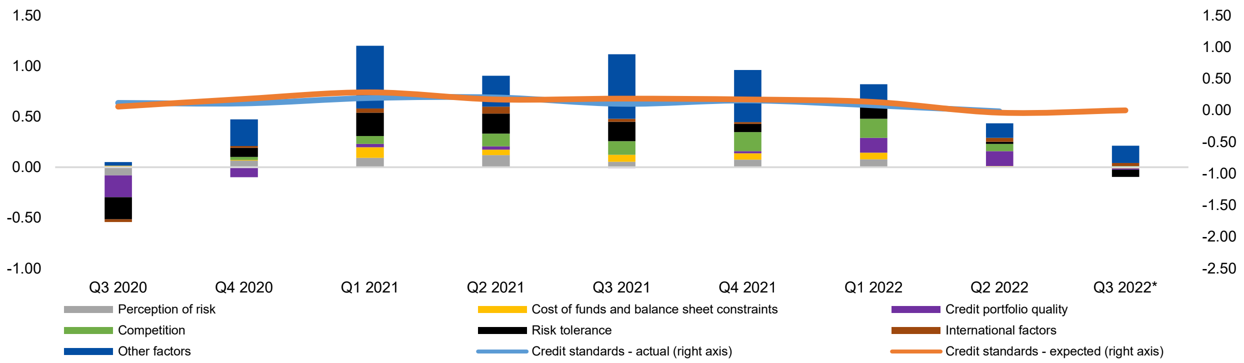
Developments in credit standards, credit terms and conditions, and in the demand for loans

Loans to enterprises

Credit standards

During the first quarter of 2022, the result on credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises in general represent unchanged credit standards. In the previous survey (Q1 2022), banks had stated that they expect unchanged credit standards to an approximate level as in the current results (chart 1).

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



Source: CBK.

*Expected value

Within loans to enterprises, banks stated marginal negative index of 0.07 on changes of credit standards for large enterprises, while for SMEs there were no changes marked. More precisely, this result was influenced by the responses of two participating banks, one of them systemically important, which stated tightening of credit standards for large enterprises to some extent, while the same banks also stated tightening of credit standards to some extent for SMEs against the three smaller banks that stated an ease for the same ones.

The main factor that negatively affected credit standards was the international markets outlook with a negative index of 0.16, referring to the impact of global price increases. Whereas, the factors that had a positive impact by providing security to the banking sector were the favorable access to funding of the parent banks (positive index of 0.21), the good perspective of the parent banks (positive index of 0.17), increased competition pressures (positive index of 0.16), the good quality of the loan portfolio, as well as the support of SMEs by KCGF with a positive index of 0.15. The approval rate of loans to enterprises during this quarter increased mainly for SMEs at a higher level compared to the previous quarter. This result was influenced by the responses of six participating banks (of which three of them with systemic importance) which stated an increase in the loan approval rate for SMEs, while four of the banks stated the same for large enterprises (of which one of them with systemic importance). The decrease in the approval rate stated by one of the banks with a large weight and systemic importance in the sector affected the low positive index for both SMEs and large enterprises.

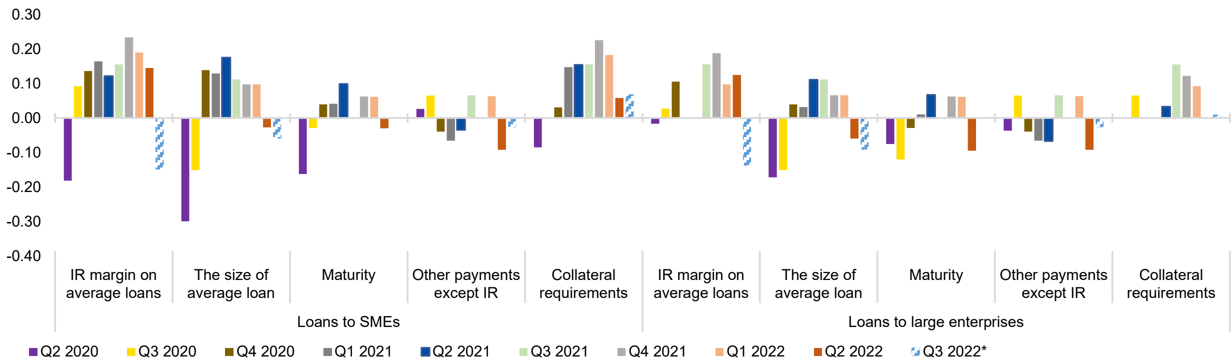
In general banks are not expected to have significant changes in credit standards during Q3 2022. More specifically, the indexing of responses did not reflect changes in credit standards for both SMEs and large enterprises. The international markets outlook was the factor that impacted negatively the credit standards, while positive contribution was given by the KCGF. At the same time, approval rate of loans to enterprises is not expected to have significant change over the next quarter. Whereas, if the categories of enterprises are specified, it is expected that there will be a decrease in the loan approval rate for large enterprises with a negative marginal index of 0.08.

Terms and conditions

In Q2 2022, the overall terms and conditions applied by banks in issuing loans to enterprises (terms and conditions of a contract specified for loans) marked a marginal ease (chart 2). The banking sector applied higher ease of terms and conditions for new loans to SMEs than for loans 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 0.15 for SMEs and 0.12 for large enterprises) and in the collateral requirement for SMEs with a positive index of 0.06. Meanwhile, tightening although at a low level was applied to charges other than interest for both categories, and at the same time, the maturity and approved amount of new loans were negatively affected for large enterprises.

The factor with the main contribution to easing terms and conditions in this quarter was the increase of competition pressure within the banking sector with a positive index of 0.26. Also, a positive contribution was given by the favorable access to financing of the parent bank and the support from the KCGF with a positive index of 0.15 and 0.12, respectively. Whereas, the perspective in the global markets and the liquidity position of the sector contributed negatively to the terms and conditions, specifically influenced by the responses of two banks, and one of them being a systemic bank with a high weight in lending.

Chart 2. Changes of terms and conditions applied to enterprises



Source: CBK.

*Expected value

Banks are expected to apply tightened terms and conditions during Q3 2022, albeit at low levels. In this context, banks stated that they expect an approximate tightening for SMEs and large enterprises as well. Three banks, two of them with systemic importance and a high weight in lending, expect an increase in interest rates for loans to some extent, while one bank also with systemic importance stated that it expects interest rates to decrease, which generated a low negative index of 0.15 for SMEs and 0.14 for large enterprises. Whereas, lower collateral requirements are expected for SMEs, albeit with a marginal positive index of 0.07. The approved amount for new loans will also be one of the conditions that banks expect to tighten during Q3 2022. The factor with the highest negative index turned out to be the liquidity position of the banks, which contributed to the expectations for the tightening of terms and conditions for Q3 2022. At the same time, banks expect support and evaluate as a positive factor the favorable access in financing from parent banks, and the support from the KCGF.

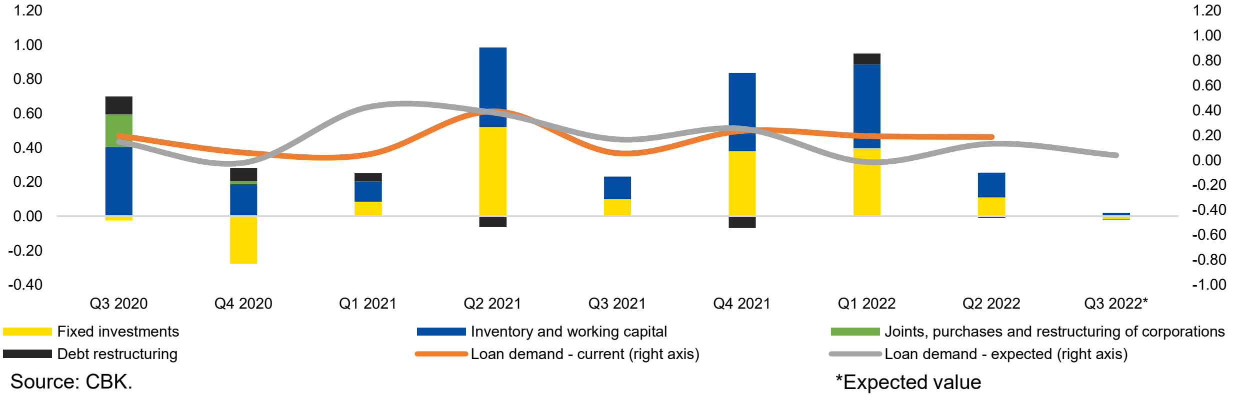
Demand for loans

During the second quarter of 2022, **the enterprises demand for loans** results to have been increased, albeit at lower level compared to Q1 2022. Credit demand turned out to have been underestimated in banks' expectations for Q2 2022, expressed in the previous survey (Q1 2022) (chart 3). More specifically, the demand for loans from SMEs marked an increase with a positive index of 0.19, whereas the demand for loans from large enterprises generated a positive index of 0.18. The index generated for loan demand was influenced by the replies of seven banks which stated an increase in demand to some extent, and moreover, a bank of systemic importance and a large weight in lending of the banking sector stated a considerable decline in demand for loans.

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 low positive index of 0.14 and 0.11, respectively. The result of the contributing factors to the credit demand was determined by the responses of six banks which stated a growth of the demand for financing inventories and working capital and for financing fixed investments. However, one bank with systemic importance stated that for the two above mentioned factors there was a considerable decline in demand, which resulted with a low positive index. The quality of the applications submitted by enterprises did not mark significant changes, in Q2 2022.

According to the survey, during Q2 2022 the nonperforming loans to total loans ratio of enterprises is decreasing with a marginal negative index of 0.04, however, in the previous survey, banks' responses generated a higher negative index of 0.11 of this ratio. This result was influenced by the responses of five banks, where two systemically important banks stated a decrease in nonperforming loans, while the other three banks, one of them with systemic importance, stated an increase.

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



Source: CBK. *Expected value

Banks expect a marginal increase of the demand for loans from enterprises during the next quarter. These expectations were influenced by responses of six banks, where five of them with a lower weight expect an increase of demand to some extent. However, one bank with systemic importance and high weight in lending of the banking sector, stated that it expects a decline of demand for loans to some extent. Consequently, these responses resulted in a positive index, albeit at low levels compared to the current demand for loans, namely it resulted with a positive index of 0.06 for Q3 2022. At the same time, banks do not expect a significant change regarding the quality of enterprise applications for loans.

During the following quarter banks expect nonperforming loans to total loans ratio for enterprises to change direction and be shifted to a positive index of 0.17, thus reflecting banks' expectations on the deterioration of loan portfolio quality. These expectations were mainly impacted by the dynamics of prices increase in the country, along with the decline of clients' purchasing power. Five banks, of which three systemically important banks, stated expectations for an increase of nonperforming loans of enterprises, whereas one bank which is of systemic importance stated expectations on the decline of NPL.

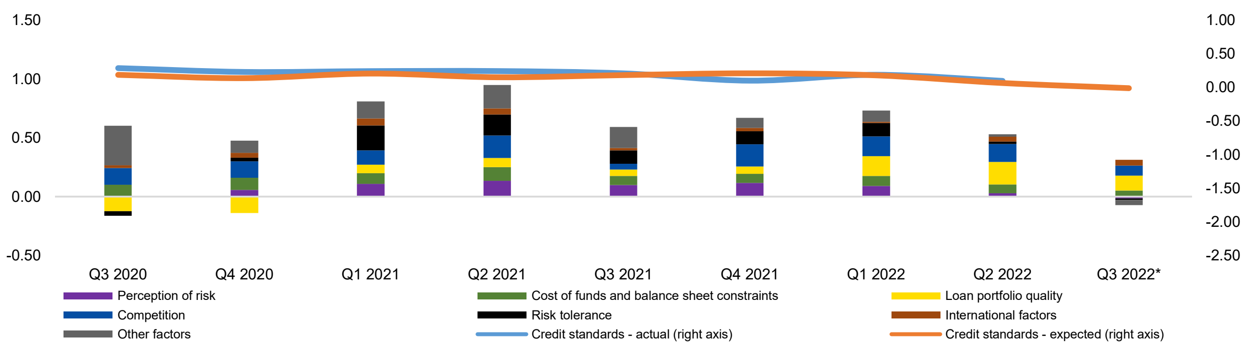
Loans to households

Credit standards

Credit standards applied to households during the second quarter of 2022 generally eased, although the easing mainly affected credit standards for consumer credit with a positive index of 0.15, while credit standards for housing loans remained almost unchanged. The result mainly reflects the responses of three banks, where two of them are of systemic importance. Expectations for the second quarter of 2022 as stated by banks in the previous survey, resulted to be correct (chart 4). Banks stated that they had reduced the loans approval rate for households, and namely to a higher extent for consumer credit with a positive index of 0.28 than for housing loans which marked a positive index of 0.12.

Factors that contributed positively to the easing of credit standards were the increase of competitive pressures with a positive index of 0.31, favorable access to financing of the parent banks with a positive index of 0.28, as well as the satisfactory liquidity position of the banking sector with a positive index of 0.19.

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



Source: CBK.

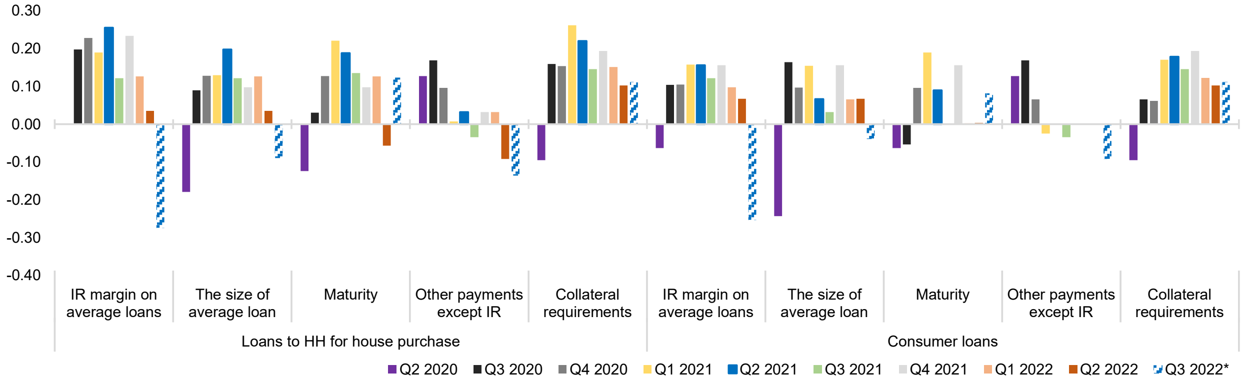
*Expected value

During the third quarter of 2022, banks expect tightened credit standards although at low level, especially for housing loans with a positive index 0.09. Meanwhile, credit standards for consumer credit were marginally eased with a positive index of 0.06. Credit standards are expected to be negatively affected by unfavorable prospects in the real estate market, while factors that are expected to positively affect them are the increase in competition pressures and the favorable approach to financing by parent banks. At the same time, banks expect an increase in the level of approved loans for consumer credit at an approximate level as marked in the previous quarter. Meanwhile, it is expected a decline of approval rate of housing loans at a low level. More precisely, the results of the responses generated a positive index of 0.09 for consumer credit and a negative index of 0.08 for housing loans.

Terms and conditions

Terms and conditions for new loans to households generally eased, albeit at low level. The generated results mainly reflect an ease for consumer credit, whereas a tightening for certain conditions for housing loans. More precisely, as regards to consumer credit, banks applied lower demand for collateral requirements (positive index of 0.10), lower interest rate and increased the amount of approved loans (positive index of 0.07). Meanwhile, banks applied tightening of terms and conditions for housing loans mainly in charges other than interest and for loans maturity (negative index of 0.09 and 0.06, respectively), whereas collateral requirements were eased (positive index of 0.10) (chart 5).

Chart 5. Changes of terms and conditions applied to households



Source: CBK. *Expected value

The key factors that influenced the easing of applied lending terms and conditions are primarily the good quality of loan portfolio, the increased pressure of competition, as well as the favorable access to financing of the parent banks. While, the global markets unfavorable outlook contributed negatively to terms and conditions applied by banks, in Q2 2022.

For the third quarter of 2022, banks in general expect a tightening in terms and conditions for loans to households. The tightening of terms and conditions is expected to be approximate for both categories of loans. Mainly, terms and conditions for consumer credit are expected to be tightened through an increase in the interest rate and an increase in charges other than interest, while a low level of ease is expected in collateral requirements and loans maturity. The same terms and conditions are expected to be tightened for housing loans, as well as the approved amount is expected to be limited to a certain extent, and similarly there is expected an ease for the maturity of loans and collateral requirements. The outlook of real estate market in the country, clients confidence as well as the unfavorable perspective in the global markets expected to be the driving factors of the tightening of terms and conditions applied by banks during Q3 2022. Meanwhile, driving factors for easing terms and conditions are expected to be the favorable access to financing of the parent banks, and their good perspective.

Demand for loans

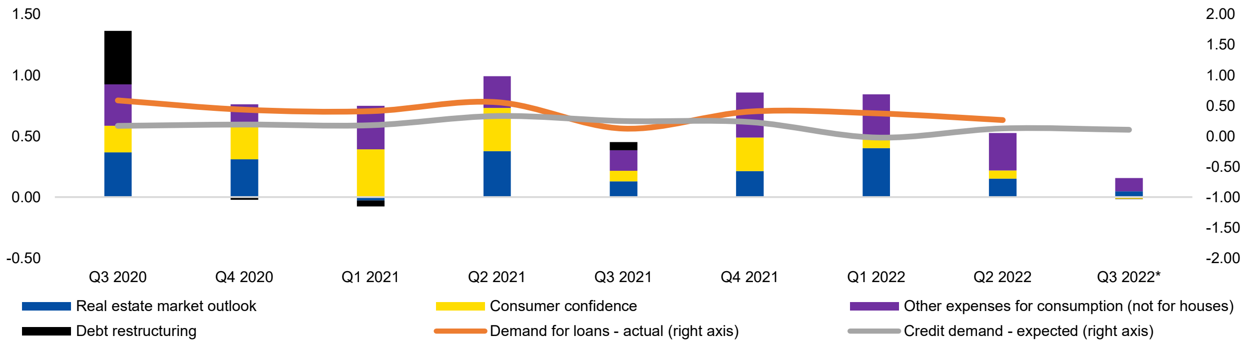
Banks in this quarter reported an increase in demand from households, which is generally half a size compared to the increase in demand during the previous quarter (Q1 2022). Six out of a total of ten banks participating in the survey, stated a growth in demand for loans in general, which after indexing the responses resulted in a positive index of 0.26 (a positive index of 0.50 in Q1 2022).. Banks have reported a significantly higher increase of demand for consumer credit compared to the demand for housing loans, with a positive index of 0.37 and 0.15, respectively. If the current result of the demand for loans 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 higher, being affected by the actual value of the demand for both categories of loans which is higher than the expectations stated by the banks (chart 6).

This increase was positively influenced primarily by two of the factors listed in the survey, namely the need for consumer financing, and at a lower level from the improvement of the real estate market outlook , with a positive index of 0.31 and 0.15, respectively. The quality of loan applications submitted by households during this quarter improved for both types of loans at a low level, namely with a positive index of 0.13 for housing loans and a positive index of 0.10 for consumer credit.

As for the quality of loan portfolio for households, banks stated a marginal deterioration, reflecting the responses of five banks (one of them systemically important) for an increase in the ratio of nonperforming loans and two banks (one of them systemically important) which stated a decrease in this ratio, resulting in a positive index of 0.06.

In the third quarter of 2022, banks expect an increase in demand for loans to households, only for consumer credit. Expectations for an increase of the demand for loans in general were affected by the responses of seven banks (three of them with systemic importance). However, a bank with systemic importance and a large weight in lending, stated that it expects a decrease in the demand for loans, which affected the reduction of the aggregated result of loans demand to 0.20. The survey results suggest that banks expect the need to finance consumer spending, to some extent, to affect the demand for loans during the next quarter. Banks stated that they do not expect significant changes in the quality of the applications for loans submitted by the households.

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



Source: CBK.

*Expected value

Regarding the quality of loan portfolio in Q3 2022, banks expect that the loan portfolio quality of households will be characterized by a further deterioration, based on the increase of the positive index compared to the current quarter. More precisely, the banks' expectations for the nonperforming loans to total loans ratio resulted in a positive index of 0.17, stated by five banks (two of them with systemic importance) expecting an increase in this ratio, whereas one systemically important bank expects a decrease of it.

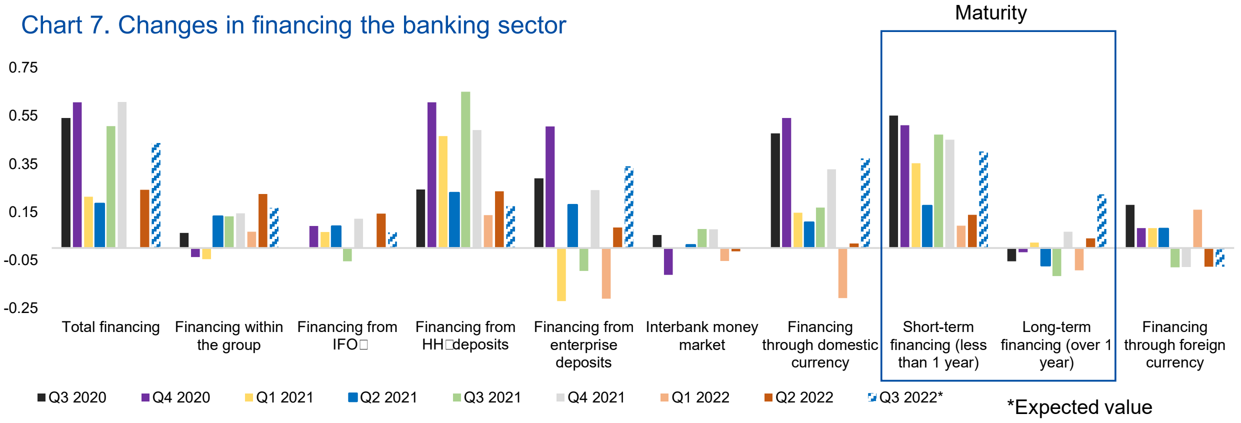
Financing

Banks reported an increase of access to financing during the second quarter of 2022. The aggregated result of the banks' responses was affected by the responses of seven banks which stated an increase in financing, and by one systemically important bank which stated a decrease to some extent in access to financing. All the financing sources of the banking sector contributed to the growth.

Unlike the unchanged approach of financing during the previous quarter, in this quarter total financing marked an increase, based on the aggregated result of the responses. Household deposits generated a positive index of 0.24 (positive index of 0.14 marked in Q1 2022). This result was influenced by the responses of seven out of a total of ten banks participating in the survey, where six banks stated an increase in financing and one stated a decrease to some extent. Whereas, financing from enterprise deposits compared to the previous quarter changed direction and marked a marginal increase with a positive index of 0.08 (negative index of 0.21 in Q1 2022), also reflecting the responses of eight participating banks, six with an increase and two with a decrease in financing from this category. A significant change that should be noted is the notable financing increase from the parent banks, a category which resulted with a positive index of 0.22 representing the highest level since the beginning of this survey. Four out of a total of ten banks stated an increase in access to financing from their parent banks, three of them with systemic importance and a large weight in the banking sector. Also, financing from international financial institutions marked an increase, albeit at a lower level with a positive index of 0.14 (chart 7).. By maturity, short-term deposits were the main financing source during this quarter.

For the next quarter, banks in general expect an increase in access to financing to a higher level compared to the current quarter. Financing through household deposits is expected to lead the increase in financing of the banking sector with a positive index of 0.34, while financing from enterprise deposits is expected to have lower movement with a positive index of 0.17. Regarding the maturity of financing, banks stated that they expect the increase in financing to be dominated by short-term deposits with a positive index of 0.40. In comparison to the previous year, banks expect also a higher increase of long-term financing with a positive index of 0.22 (chart 7).

Chart 7. Changes in financing the banking sector



Source: CBK.

Results of focused questions

The survey questionnaire for the second quarter of 2022 was supplemented with five additional questions, in an attempt to address the impact of inflationary pressures that were evident since the second half of the previous year, on lending dynamics. Also, the banks elaborated the indirect impact of inflation on the liquidity position and the possible increase in financing costs of the banking sector. Furthermore, one of the questions breaks down credit supply and demand by economic sectors.

During 2021, economic activity had a strong recovery supported by an increase in domestic demand after the improvement of the pandemic situation. However, both domestically and globally, this recovery was translated into overall price growth, further amplified by the start of the Russia-Ukraine war in February 2022. 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.

A significant number of the banks stated that as a result of the increase in prices in the country, during the second quarter, there was mostly no change in the credit supply, while the demand for loans increased. However, regarding the credit supply, in conditions of continuous price increase, almost all banks emphasized that they expect to change and adapt the credit standards and the conditions offered for loans during the following quarters. Conditions anticipated by the banks may change to manage the impact of rising prices account for the increase in the interest rate on both loans and deposits, an increase in the level of application of variable rates based on the Euribor rate, a review of policy for lending, as well as reducing the debt-to-income ratio for customers with a certain level of income. Conversely, the majority of banks stated that there was additional demand for loans during this quarter. The requests for financing that were emphasized by the banks were the investments or prepayments of working capital in order to reserve the price, as well as investments in real estate market. Similarly, banks expect the demand to continue, albeit its increasing pace is followed by uncertainties. From the responses of the banks, more uncertainty can be observed regarding the demand for loans from households, based on the expected changes, where some banks expect increased demand for consumer credit, and at the same time there are banks that expect a postponement of the demand for loans until a period of price stabilization is in the market. Also, it is expected a decline in the demand for mortgage loans in the coming period as a consequence of additional uncertainties.

Another aspect covered by supplemented questions was the impact of price increases on customers' solvency. The sentiment of the banks from the responses received shows that the banks believe in the absorption capacity of their clients, in the short term, expectations which were based on their process of reviewing loan applications and increased monitoring during this period. However, the majority of 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 also the loan portfolio quality of the banks.

On the one hand, the continuous increase in prices in the market affects the reduction of available income, which is reflected in the limitation of funds held in the banking sector. At the same time, on the other hand, in order to secure financing from deposits, banks have started and are expected to continue increasing interest rates on deposits, which is translated into an increase in the cost of financing for banks. Moreover, the increase of interest rate from the ECB is also expected to affect the financing cost. The banks stated that they do not see this dynamic as an important risk for their liquidity position, based on the high reserves they already hold and the support from the parent banks for liquidity. However, this puts the local banks in a more sensitive position, for which the main tool for securing deposits remains the increase in interest rates on deposits. All the banks surveyed stated for an increase of financing cost in this quarter and have the same expectations for the following periods, whose length of time is accompanied with uncertainties. Also, the increase in financing costs becomes a burden in terms of limiting the capacities for issuing loans, and consequently also for the financial performance of the sector. However, reserves from the considerable profits from the previous years are expected to offer enough absorbing capacities for the banking sector in the short-term period.

The disaggregated replies of banks for enterprises classified by sectors, indicate the direction of financing the economy and dynamics in certain sectors. During the second quarter of 2022, based on the tightening of credit standards, construction and residential real estate sectors account for sectors with the least favorable offer. The responses of three banks for the construction sector and two banks for the real estate sector, one of them with a systemic importance and a high weight in the total lending of the sector, reflected the tightening of credit standards for these sectors, resulting in a negative index of 0.15 and 0.10, respectively. The sectors with the most favorable offer, albeit with a low positive index were the manufacturing and services sectors. At the same time, terms and conditions were tightened mainly for the construction sector with a negative index of 0.14, while they were eased to a higher extent for lending to the manufacturing sector with a positive index of 0.18. Also, for the trade sector, the responses of banks resulted in a marginal positive index of 0.09. The demand for loans marked a low increase for all of the sectors, besides the real estate sector. The sectors with the highest demand for financing were trade and services sector with a positive index of 0.17 and 0.09, respectively. The sector of construction resulted with a marginal positive index of 0.08, albeit five banks, of which two with systemic importance stated an increase in demand to some extent for this sector. However, this result was affected by the response of one bank with systemic importance and high weight in lending which stated a considerable decline of the demand for the same sector.

Based on the generated results during Q3 2022, banks are expected to apply a tightened offer to some extent for almost all the sectors. Similarly, also the demand for loans is expected to decline from almost all the economic sectors. Specifically, banks are expected to tighten credit standards to a higher extent for the construction sector and to a lesser extent for the real estate sector (residential and commercial). At the same time, terms and conditions are expected to be tightened for all sectors, but to a higher extent for the construction and real estate sectors. In the same period, the demand for loans is expected to mark a decline, where according to banks' expectations the decline of the demand for loans from the majority of the sectors were translated into marginal indices. The demand for financing the construction sector and commercial real estate sector is expected to mark a decline, to a higher extent, however this expectation from banks' responses was characterized by a marginal negative index of 0.12 and 0.09, respectively.

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 current quarter, the questionnaire addresses also the overall expectations of the banks for the fourth 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 current 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 August 2022, banks have estimated a lower level of inflation in the third quarter of 2022 compared to the previous quarters, and expect an even lower level in the fourth quarter of 2022. For 2022 banks expect that the level of inflation rate will reach 9.7% from 3.4% as it was in 2021.

Data published by the Kosovo Agency of Statistics for the second quarter of 2022 suggest that the annual average inflation rate was around 12.6%. For the third quarter of 2022 banks expect that the average inflation rate would be 10.3%. Most banks (8 of them) expect inflation to be above 8% while other banks (2 of them) expect inflation to be below this level.

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

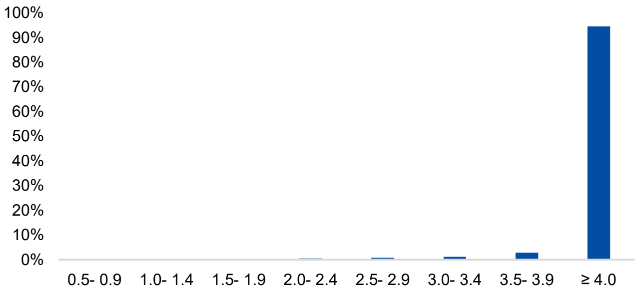
Banks	Q3 2022	Q4 2022	2022
1	10.0%	8.0%	10.0%
2	14.5%	13.2%	12.5%
3	4.2%	5.3%	7.0%
4	11.0%	9.0%	10.2%
5	14.0%	14.0%	12.0%
6	11.8%	9.5%	10.4%
7	9.0%	8.0%	8.0%
8	6.5%	6.5%	7.0%
9	10.0%	10.0%	7.0%
10	12.0%	13.0%	13.0%
Average	***10.3%***	***9.7%***	***9.7%***

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, banks have mentioned possible internal and external factors, which had an impact on the rise of inflation rate:

Chart 8. Probability of inflation for Q3 2022 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.

- ✓ The Russian invasion of Ukraine and supply disruption. 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.

Due to the uncertainty of geopolitical risks, commodity prices may rise further and this may translate into higher operating costs of manufacturing, which translate into higher prices and higher inflationary expectations;

- ✓ 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;
- ✓ Limitations on supply as a result of 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 also had an impact on the increase of prices. Moreover, the increase in the cost of sea transport has led to an increase in prices, especially of oil, fuels, construction materials, etc.

Expectations of the banks for Q3 2022 and for the whole year of 2022, taking into account the dynamics with which are being characterized prices in the country, it is thought that banks expectations are low.

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