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

Bank Lending Survey

Number 7

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CENTRALNA BANKA REPUBLIKE KOSOVA

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Bank Lending Survey and Inflation Expectations

Number 7

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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 2021, and banks expectations for credit dynamics in the second quarter of 2021.

Besides the standard questions, in this survey were added some other additional questions. One of the questions aims to create a perception on the repayment capacity of loans by economic entities affected by the Covid-19 pandemic. Also, through these questions it is aimed to disaggregate the supply and demand for loans by economic sectors. At the same time, it provides an overview of the orientation of funds ensured through loans from enterprises.

Results Summary[2]

Credit supply has eased and the demand for loans has increased to some extent during the first quarter of 2021. Furthermore, the commencement of vaccination in the country, expectations for easing of restrictive measures and consequently the return to normal economic activity in Kosovo dictated the expectations of banks, optimistic expectations that consist of easing credit supply and increasing demand for loans during the second quarter 2021.

According to banks, the dynamics in lending by enterprises during the first quarter of 2021, were positively affected to a larger extent by credit supply, while the demand for loans had a low growth. **Also, bank expectations for the following quarter result to be more optimistic.** Within the credit supply, banks have reported to have eased to some extent the standards applied in assessing enterprise loans applications during the first quarter of 2021. Credit standards were eased at a higher level for SMEs compared to large enterprises (table 1). Changes in credit standards were positively affected mainly by KCGF loan support, increased risk tolerance, and favorable access to sector financing.

For the second quarter of 2021, expectations of banks account mainly of the further ease of credit standards. Credit supply to some extent is expected to be more favorable for SMEs than for large enterprises. Banks expectations are based on the expectations for the domestic economic recovery, as a result of the ease of restrictive measures and the vaccination of the population in the country. Four of the participating banks, among which three with systemic importance, expect that the support of KCGF for SMEs will have an impact on easing of the standards. Also, a positive contribution is expected from the increase of competitive pressures, and the increase of the risk tolerance.

Terms and conditions applied by banks in issuing loans to enterprises **were eased at a low level.** Eased terms and conditions were applied mainly for SMEs through the decline of interest rate,

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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.

the decrease of collateral requirements, and the increase of loans amount. Factors that influenced the easing of terms and conditions to some extent, were the support of SMEs by the KCGF, the increase of risk tolerance, as well as the stable financing of the sector by the internal sources. Whereas, the increase of credit risk continued to be a factor with negative contribution on terms and conditions offered by banks, albeit with a low negative index. While, for the second quarter of 2021, banks expect an ease of terms and conditions for SMEs, although at a lower level compared to the first quarter of 2021. The ease is expected mainly to be applied on the increase of loans amount.

During the first quarter of 2021, **the enterprises demand for bank loans** results to have been increased, albeit at lower level compared to the previous quarter. The increase resulted to be at a lower level than banks' expectations for Q1 2021, expressed in the previous survey. Positive index which resulted after the indexation of the banks' replies regarding the demand for loans, is mainly attributable to SMEs demand, while the demand for loans from large enterprises resulted with a marginal negative index. Demand for loans from enterprises, according to bank statements, was driven mainly by the increase in demand for financing of inventories and working capital. While, the demand for financing fixed investments unlike the four previous surveys, had positive index, albeit at low level. Expectations for easing of restrictive measures to prevent the spread of Covid-19 virus, and consequently also for an increased economic activity in the country, banks reflected in their forecasts for a demand for loans during Q2 2021. Consequently, the demand is expected to increase significantly from both segments of enterprises, especially from SMEs (table 1). Potential factors that may affect the increase of demand for loans from enterprises are expected to be the need to finance inventories and working capital, as well as the need to finance fixed investments, a factor that indicates an optimism of banks towards normalization of the economic activity in the country.

The credit activity dynamics for households during the reporting period were positively affected by credit supply conditions and demand for loans. New loans for this economic segment increased significantly compared to the same period of the previous year. Credit standards applied for households result to have been eased at a higher level than the expectations of banks for the same period stated in the previous survey. Despite the prospects for recovery of the economic activity, banks expect the easing of credit standard for households to be at a lower level during the following quarter compared to this quarter (table 1).

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. Terms and conditions were eased mainly through the decline of collateral requirements, maturity lengthening, and at lower level through the decline of interest rates and the increase of approved loans average amount. The key factors that influenced the easing of terms and conditions for households, during the first quarter of 2021, were the higher risk tolerance, the satisfactory liquidity position of the sector, as well as the stable financing of the sector in the country and of the parent banks abroad. For the second quarter of 2021, banks stated that they expect an ease, to some extent, in terms and conditions for loans to households. The easing of terms and conditions is expected to be higher for consumer credit than for housing loans, mainly through declining the interest rate, increasing the loan amount, and to a lower level through the decline of collateral requirements. Favorable access to financing of banks in the country and those abroad, and the satisfactory liquidity position are expected to be the incentive factors of easing terms and conditions applied by banks during Q2 2021.

The ease of containment measures of Covid-19 to some extent, vaccination commencement in the country and consequently the prospects for normalization to some extent of the economic activity were reflected in a significant increase in demand for loans from households, in the first quarter of 2021 (table 1). Banks have reported an approximate increase in demand for housing loans and consumer credit as well. More specifically, seven out of total nine participating banks in the survey, have stated an increase in the overall demand for loans. Banks reported that this increase was positively influenced by two of the factors listed in the survey, namely the increase in consumer confidence and the need to finance consumer spending. In the second quarter of 2021, banks expect an increase in demand for loans to households, albeit significantly at lower level compared to the current quarter. The survey results suggest that banks attributed these expectations to increased demand for financing other expenditures, increased consumer confidence and a good outlook on the real estate market.

Table 1. Banks assessment on credit supply and demand

	Supply (Credit standards)		Demand	
	Q1 2021	Q2 2021 (expectations)	Q1 2021	Q2 2021 (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.

Due to the regulatory easing measures taken by the CBK, such as the moratorium or postponement of loan installments payment in the period March - June 2020 and the continuation of restructuring throughout 2020 and 2021, credit risk remained at low levels. However, banks stated that the sector's sensitivity to this risk is expected to emerge in the coming quarters, mainly due to uncertainties about the financial performance of domestic entities affected by the Covid-19 pandemic. During Q1 2021, for the quality of the loan portfolio for both enterprises and households, the replies of banks in the survey generated a low positive index, while for the next quarter they expect an increase of this index, especially for enterprises.

Unlike the previous survey, results of the survey for the stated period show that financing of the banks increased at lower level compared to the previous quarter. Financing of the banks was positively impacted by households short-term deposits. Financing from enterprise deposits marked a decline, whereas other sources of financing were not characterized with significant changes. During the following quarter, banks expect an increase of access to financing, albeit at a lower level compared to Q1 2021. Similarly, financing through household short-term deposits is expected to be the main contributor to financing the sector. At the same time, banks expect a support in being financed also by international financial institutions and parent banks, albeit at low 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 banks lending are focused on two main categories: (i) loans to enterprises, and (ii) loans to households. Moreover, loans to enterprises are sub-categorized in 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 currency in which they were granted.

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

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

Generation of the bank lending survey results

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

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

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

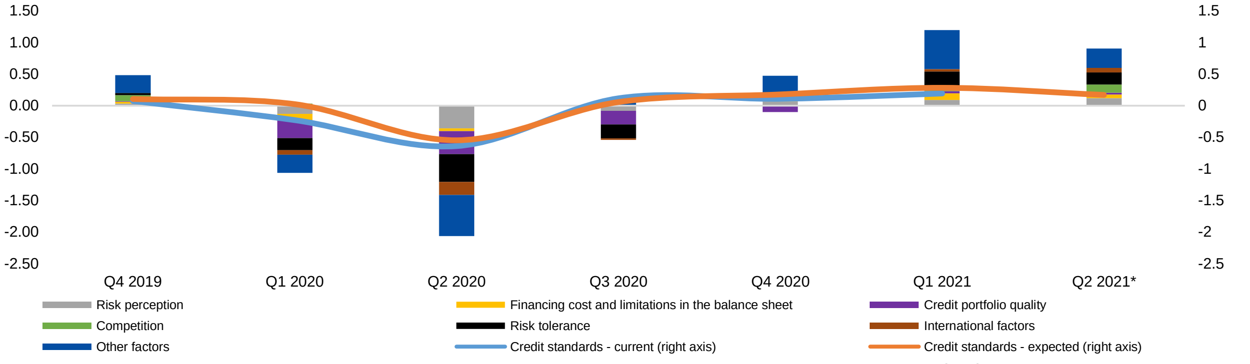
Developments in credit standards, credit terms and conditions, and in loans demand

Loans to enterprises

Credit standards

During the first quarter of 2021, credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises marked a higher ease in general with a positive index of 0.28 compared to the index of 0.09 marked in Q4 2020. Whereas in the previous survey (Q4 2020), 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 0.28 for changes in credit standards for SMEs, and a positive lower index of 0.11 for large enterprises. Specifically, this result was impacted by the replies of five participating banks which stated an ease to some extent of credit standards for SMEs, whereas the number of banks that stated the same for large enterprises was smaller.

The main role in easing the credit standards applied by banks in Q1 2021, results to have been the support for enterprises in lending by KCGF with a positive index of 0.48 (replied five banks), increasing the sector's risk tolerance with a positive index of 0.23, as well as favorable access to finance with a positive index of 0.21. In line with the eased supply side, the approval rate of loans to enterprises marked a significant increase in this period, especially for SMEs.

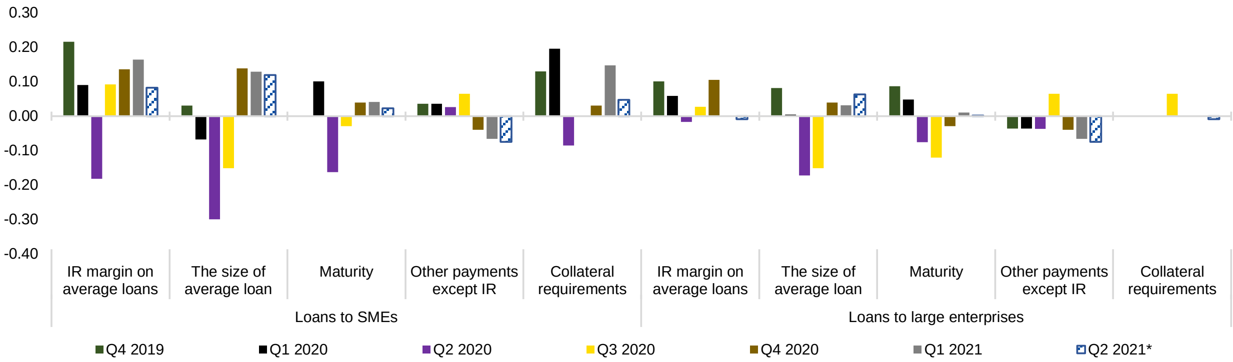
Banks are expected to ease credit standards during Q2 2021, based on expectations for economic recovery in the country, after the beginning of the vaccination of population and the improved pandemic situation to some extent. Four out of nine participating banks, among which three with systemic importance, expect that the support of KCGF for SMEs will continue to have an impact on easing the standards. Also, a positive contribution is expected from the increase of competitive pressures, and the increase of the risk tolerance. Two of the banks with systemic importance also stated that they expects a positive contribution, in credit standards from the favorable access in being financed by the parent banks. Specifically, the easing of credit standards is expected to be at a lower level than in the current quarter, where after the indexation of replies it was resulted in a positive index for SMEs of 0.21, and a positive index of 0.13 for large enterprises.

In line with expectations for credit standards, the approval rate of loans to enterprises is expected to mark an approximate level as in the current quarter, namely for SMEs with a positive index of 0.23, while for large enterprises with a positive index of 0.14.

Terms and conditions

In Q1 2021, 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 ease of terms and conditions was applied mainly for SMEs, while for large enterprises the change was marginal. Specifically, for SMEs the ease was marked for the interest rate and collateral requirements, with an index of 0.16 and 0.15, respectively, while the size of the amount of approved loans resulted in a lower positive index of 0.13.

Chart 2. Changes of terms and conditions applied to enterprises



Source: CBK. *Expected value

The factor with the main contribution and positive high index in easing terms and conditions was the support offered by KCGF for SMEs. At a lower level, also the increase of the sector's tolerance to risk contributed positively, as well as the favorable access of the sector to financing from the internal market (deposits). The increase of credit risk continued to be a factor with negative contribution on terms and conditions offered by banks, albeit with a low negative index.

Banks are expected to apply eased terms and conditions during Q2 2021, but at low levels. In this context, banks stated that they expect easing of terms and conditions mainly for SMEs, through increasing the size of the loan amount (positive index of 0.12). Banks are not expected to offer a significant change in terms and conditions for large enterprises. The factor with a positive contribution to credit terms and conditions for new loans with an index of 0.34, is expected to be marked by the support of KCGF for SMEs. Also, the increase of competitive pressures and the increase of risk tolerance are other factors that according to banks are expected to influence the easing of terms and conditions during Q2 2021.

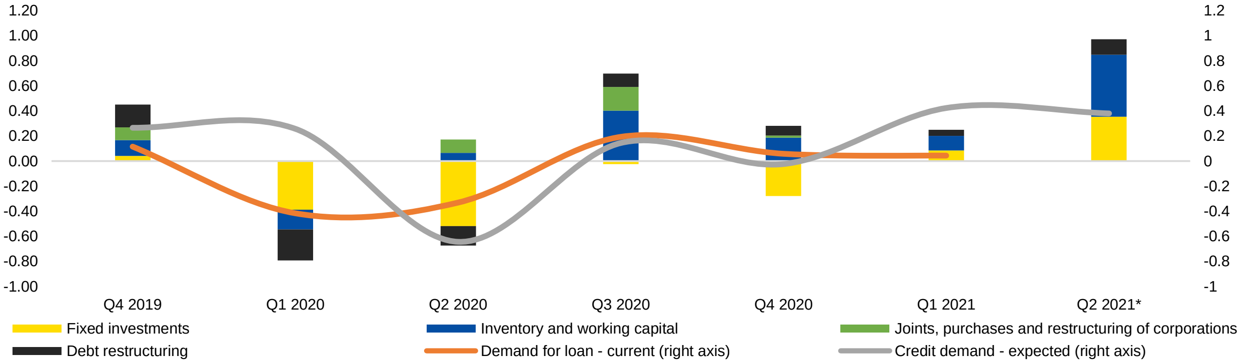
Demand for loans

During the first quarter of 2021, **the enterprises demand for loans** results to have been increased, albeit at lower level compared to Q4 2020. Also, the increase in demand for loans resulted to be at a lower level than banks' expectations for Q1 2021 expressed in the previous survey (Q4 2020) (chart 3). More specifically, the demand for loans from SMEs increased with a positive index of 0.13, whereas the demand from large enterprises were marginal. The index generated for the demand for loans by large enterprises was affected by the replies of two systemically important banks which declared a decrease in demand, whereas five of the banks declared an increase demand, to some extent. The return of the economic activity to the most affected sectors of enterprises, as a result of the easing of containment measures against Covid-19 and the need for liquidity, influenced the demand for loans from enterprises to mark an increase.

According to the survey, the increase in demand for loans from SMEs was mainly influenced by the increase in demand for financing of inventories and working capital (positive index of 0.12). Meanwhile, the demand for financing fixed investments contributed positively to the demand for loans, albeit with a low index of 0.09, influenced by the replies for a decline of demand from one systemic bank and two other banks with lower weight, despite the fact that three banks with systemic importance declared an increase to some extent in the demand for this type of loans. The quality of the received applications was improved to some extent, during Q1 2021, mainly for applications for loans from large enterprises with a positive index of 0.17.

According to the survey, during Q1 2021, nonperforming loans of enterprises to total loans ratio generated a marginal positive index of 0.09.

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



Source: CBK. *Expected value

Expectations for easing restrictive measures to prevent the spread of Covid-19 virus, and consequently also for an increased economic activity in the country, banks reflected in their forecasts for their demand for loans during Q2 2021. Consequently, the demand is expected to increase significantly from both segments of enterprises, especially from SMEs with a positive index of 0.46. Factors with a positive contribution to loans demand are expected to be the need for financing inventories and working capital with an index of 0.50, as well as to a lesser extent the need to finance fixed investments with an index of 0.36. At the same time, banks expect an improvement to some extent of the enterprise applications quality for loans from enterprises. Therefore, expectations for the applications quality in Q2 2021 are approximate, with an index of 0.25 for SMEs and a positive index of 0.17 for large enterprises.

During the following quarter, banks expect the nonperforming loans ratio to worsen, with a positive index of 0.22.

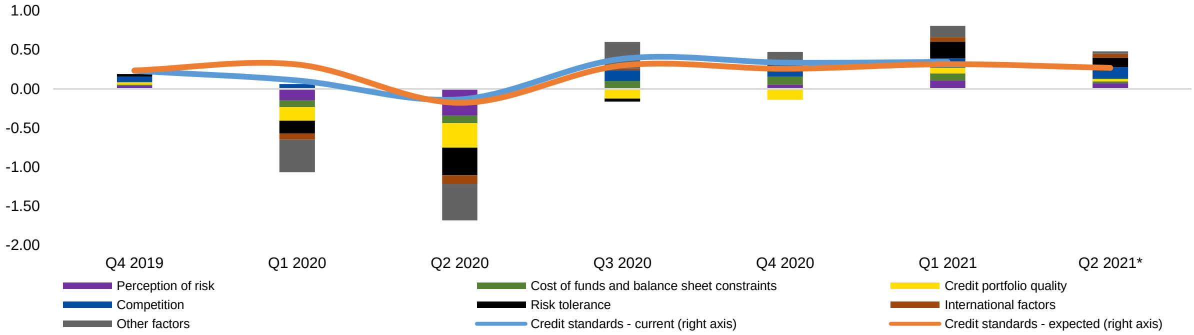
Loans to households

Credit standards

Credit standards applied to households during the first quarter of 2021 generally eased, generating a positive index of 0.21 for housing loans and a positive index of 0.27 for consumer credit. The expectations for the first quarter stated by banks in the previous survey, suggested an ease of applied credit standards, albeit at lower level (chart 4). At the same time, banks stated that they have significantly increased the loans approval rate for households, and namely to a higher extent for consumer credit with a positive index of 0.40 than for housing loans which marked a positive index of 0.28.

Factors that contributed positively to the easing of credit standards were the good domestic market outlook (positive index of 0.27), increased competitive pressures (positive index of 0.24), as well as the good perspective of the banking sector in the country and increased risk tolerance (both factors with a positive index of 0.21).

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



Source: CBK.

*Expected value

In the second quarter of 2021, banks expect eased credit standards for households to some extent, albeit with a lower positive index compared to this quarter. Credit standards are expected to ease to a higher level for consumer credit than for housing loans, with a positive index of 0.18 and 0.12, respectively. Credit standards are expected to be positively affected by the increase of competitive pressures, and the favorable access to financing of parent banks (stated by two banks with systemic importance). At the same time, banks expect an increase up to the stage of loans approval, but at a lower level compared to the current values marked in Q1 2021. The level of approval of loans is expected to increase to an approximate extent for consumer credit and for housing loans, with a positive index of 0.25 and 0.24, respectively.

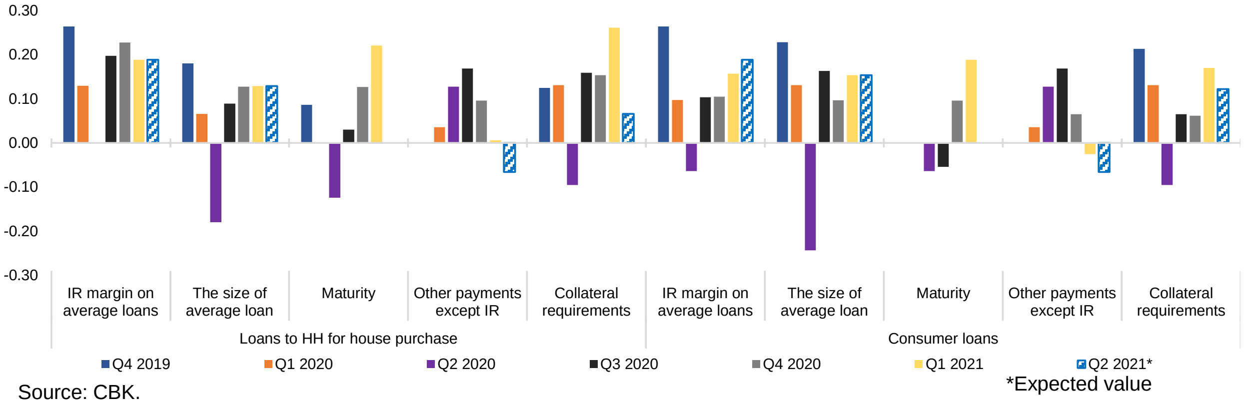
Terms and conditions

Terms and conditions generally eased for new loans to households in the first quarter of 2021. The ease of terms and conditions was higher for housing loans compared to consumer credit. Mainly, terms and conditions were eased through the reduction of the required collateral (positive index of 0.26 for housing loans and 0.17 for consumer credit), lengthening of maturity (positive index of 0.22 for housing loans and 0.19 for consumer credit) as well as the decline of interest rate (positive index of 0.19 for housing loans and 0.16 for consumer credit). In addition to these terms and conditions for consumer credit, banks also increased the average amount of the approved loans with a positive index of 0.15 (chart 5).

The key factors that influenced the easing of terms and conditions were the higher risk tolerance, the satisfactory liquidity position of the sector, as well as the stable financing of the sector in the country and of the parent banks abroad.

For the second quarter of 2021, banks stated that they expect an ease, to some extent, in terms and conditions for loans to households. The ease of terms and conditions is expected to be higher for consumer credit than for housing loans. Mainly, terms and conditions for consumer credit are expected to be eased through the decline of the interest rate with a positive index of 0.19, the increase of the loans amount with a positive index of 0.15, and at a lower level with a positive index of 0.12 is expected to be marked by the reduction of collateral requirements. Meanwhile, for housing loans, terms and conditions that are expected to ease through the decrease of interest rate and the increase of the loans size with a positive index of 0.19 and 0.15, respectively.

Chart 5. Changes of terms and conditions applied to Households



Source: CBK.

Favorable access to financing of banks in the country and those abroad, and the satisfactory liquidity position are expected to be the incentive factors of easing terms and conditions applied by banks during Q2 2021.

Demand for loans

The ease of containment measures of Covid-19 to some extent, vaccination commencement in the country and consequently the prospects for normalization to some extent of the economic activity were reflected in a significant increase in demand for loans from households, in the first quarter of 2021. Banks have reported an approximate increase in demand for housing loans and consumer credit as well. Seven out of a total of nine banks participating in the survey stated an increase in demand for loans in general (three of the banks stated a considerable increase), which after indexing the replies resulted in a positive index of 0.46. The demand for housing loans was characterized with a positive index of 0.40, while for consumer credit the index was 0.42. If we compare the current results of loans demand 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 consumer credit which is many times higher than the banks' statement (chart 6).

This increase was positively influenced by two of the factors listed in the survey, namely the increase of the consumer confidence and the need to finance consumption expenditures with a positive index of 0.39 and 0.36, respectively. The quality of the received applications for loans was not characterized with significant changes for both categories of loans.

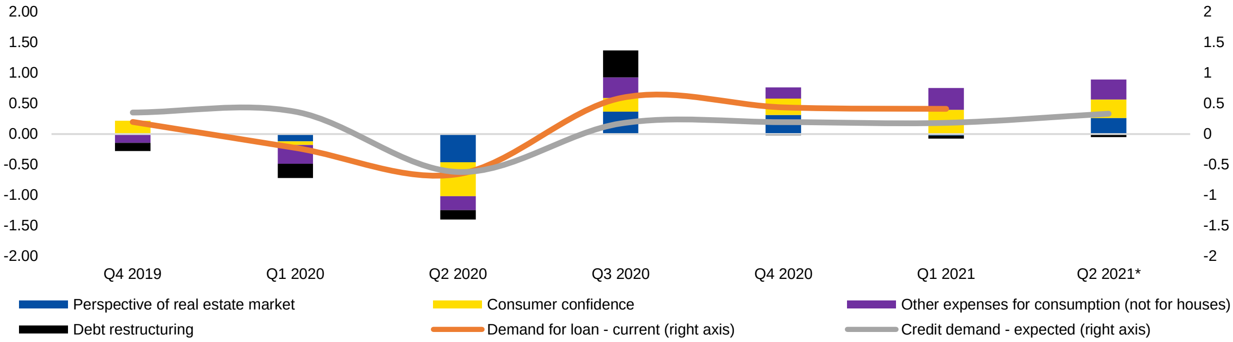
As regards to loans portfolio quality of households, banks stated a marginal movement of it. Changes in portfolio quality reflected the replies for an increase of nonperforming loans to total loans ratio for households, which resulted in a positive index of 0.9. These changes were stated by three participating banks, where two of them are with systemic importance.

In the second quarter of 2021, banks expect an increase in demand for loans to households to some extent , albeit at a lower level than the increase in the current quarter. Banks stated that they expect an increase in demand for housing loans with a positive index of 0.36, while the demand for consumer credit would mark a positive index of 0.30. The survey results suggest that banks attributed these expectations to increased demand for financing other expenditures, increased consumer confidence and a good outlook on the real estate market.

Unlike the current quarter (Q1 2021), banks expect loans portfolio quality of household to deteriorate to some extent during the second quarter of 2021 with a positive index of 0.13. Based on the banks' replies, it is implied that the dynamics in credit risk are expected to be affected to a larger extent by the enterprise segment than households.

At the same time, banks stated that they expect an improvement to some extent of loans quality applications from households, especially for housing loans with a positive index of 0.22.

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



Source: CBK.

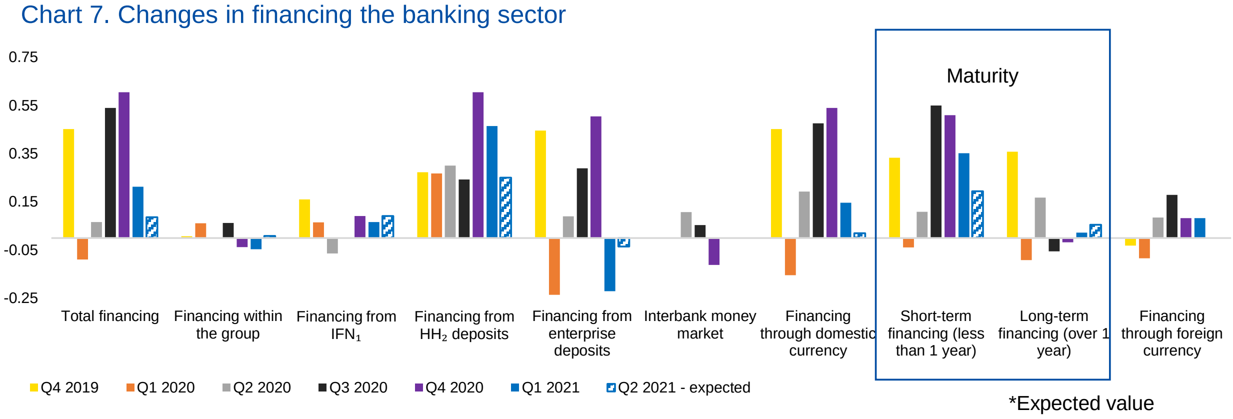
*Expected value

Financing

Banks reported an increase of access to financing during the first quarter of 2021. Taking into account the traditional model of the banking sector in Kosovo, the financing continued to be dominated by household deposits.

Unlike the previous survey, results show that financing of the banks was increased at a lower level, where household deposits dominated with an index of 0.47 (0.61 in Q4 2020). At the same enterprise deposits contributed negatively to the financing of the banking sector with an index of 0.22, while other sources of financing did not change significantly (chart 7). By maturity, short-term deposits were the main financing source during this quarter with a high positive index of 0.35.

Chart 7. Changes in financing the banking sector



*Expected value

Source: CBK.

For the following quarter, banks expect the increase of access to financing to continue, albeit at low level. Financing through household deposits is expected to be the only source of financing with a higher positive index of 0.25. In the second quarter of 2021, two banks with systemic importance expect a support in financing the banking activity also from international financial institutions. By maturity, in the following quarter it is expected to continue a higher growth of short-term financing with a positive index of 0.19, while long-term financing is expected to remain unchanged (chart 7).

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

The survey questionnaire for the first quarter of 2021 was added three additional questions. One of the questions aims to create a perception on the repayment capacity of loans by economic entities affected by the Covid-19 pandemic. Also, through these questions it is intended to disaggregate the supply and demand for loans by economic sectors. At the same time, it provides an overview of the orientation of funds ensured through loans from enterprises.

According to banks, the debt repayment capacity of customers, not counting the easing measures taken by the CBK (moratorium or loan restructuring due to the Covid-19 pandemic) during the first quarter of 2021 has largely remained stable, despite the expectations of banks for the deterioration of the repayment trend. Moreover, some banks stressed a positive direction towards the improvement of fulfilling the obligations. Such statements of the banks were based on the low demand for loan restructuring through the latest regulatory easing measures undertaken by the CBK as a result of improving the financial performance of the economic entities. Nevertheless, two of the banks stated a deterioration and an emerge of challenges in fulfilling the obligations. For the next quarter, according to the banks, the trend of debt repayment by customers is expected to remain stable, however, this trend is accompanied by uncertainties related to the pandemic and consequently restrictions on economic activity in the coming period, with diaspora visits which depend on the restrictive measures applied by other countries, as well as on the trend of vaccination of the population in the country.

The disaggregated banks' replies for enterprises classified by sectors, indicate the direction of financing the economy and dynamics in other sectors. The trade sector represents the sector with the most favorable offer according to the replies of the banks, where six of the participating banks stated for easing of credit standards for this sector with a positive index of 0.30. Furthermore, also for loans to services sector and manufacturing were applied eased standards, namely with a positive index of 0.20 and 0.19, respectively. Similarly, the terms and conditions were eased to some extent also for the manufacturing sector (positive index of 0.22), trade sector (positive index of 0.21) and construction sector (positive index of 0.20). In terms of the demand for loans, the sector with the highest growth during Q1 2021 was the manufacturing sector, while other sectors did not have significant changes. For Q2 2021, banks expect an ease of credit standards mainly for the manufacturing and trade sectors. Similarly, also for the trade sector terms and conditions are expected to be eased to a larger extent, services and manufacturing sectors, while a lower level of ease is expected for the construction sector. At the same time, the demand for loans is expected to increase from all the sectors, with a higher level from the trade sector, being followed by services and manufacturing sectors.

When asked about the purposes of the demand for loans to enterprises, banks stated that enterprises oriented these funds mainly towards meeting acute liquidity needs and as a safeguard for liquidity or liquidity reserves. However, the generated indices from the banks' replies have low levels, where this level was reported by four participating banks. For the next quarter, banks expect that enterprises will use the funds from loans mainly to finance fixed investments and replace existing loans, while at a lower level the funds are expected to be used to cover acute liquidity needs and maintain liquidity reserves.

Inflation expectation rate

In order to enhance the analytical capacities and based on the best regional practices and beyond, CBK has continued with the survey of 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 previous quarter, the questionnaire addresses also the overall expectations of the banks for the second quarter of 2021 and for the whole year of 2021 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, 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 and in the future it is expected to cover a wider range including also other economic agents.

Estimates which deal with commercial banks belong to quantitative forms associated also with the spread of the profitability. Inflation expectations are estimated for different time frameworks, where initially are performed the estimates on the previous quarter and the expectations for the 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

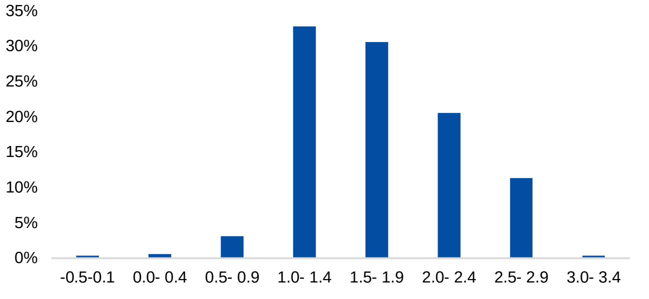
Based on the survey conducted in April 2021, banks have estimated a higher level of inflation in the first quarter of 2021 compared to previous quarters and expect an even higher increase in the second quarter of 2021, from 1.3% as it was the estimation for the previous quarter to 1.7% (table 1). For 2021 banks expect that the level of inflation rate will reach 0.9% from 0.2% as it was in 2020. The survey realized conveys also the potential effects that banks expect after they have faced with the new situation caused by Covid-19 pandemic.

Table 1. Inflation expectations of banks, annual change in per cent

Banks	Q1 2021	Q2 2021	2021
1	1.2%	1.9%	2.2%
2	1.2%	1.4%	1.6%
3	1.2%	2.7%	2.8%
4	0.6%	1.4%	1.7%
5	1.2%	1.6%	1.4%
6	1.1%	1.2%	1.1%
7	1.2%	1.6%	1.9%
8	2.7%	2.4%	2.4%
9	1.4%	1.6%	1.7%
Average	***1.3%***	***1.7%***	***1.9%***

Source: Commercial banks and CBK calculations.

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



Source: Commercial banks and CBK calculations.

Data published by the Kosovo Agency of Statistics (KAS) until March 2021, suggest that the average annual inflation rate was around 0.6%. Therefore, expectations of banks showed that the level of inflation was higher compared to the current data. For the second quarter, almost all the banks expect that the inflation will range from 1% to 2%, except two of the banks which expect that the inflation rate will be higher than 2%. As depicted in chart 8, the reported spreads of probability show that there is a relatively low uncertainty relating the following result of inflation, hence the spread of probability of the banks is concentrated in the expected inflation.

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

- ✓ For the year of 2021, banks have stated that the situation is more optimistic regarding the pandemics and expect an increase of the economic activity and consequently of the level of inflation.
- ✓ Price developments in international markets;
- ✓ Low manufacturing in Kosovo and the dependence on imports. Besides this, the barriers created in the chain of supply as a result of pandemic, have had an impact on the increase of transport cost and consequently in an increase of prices;

Expectations of the banks for 2021 are in line with the higher trend of inflation compared to the previous year and taking into account the inflation of the recent months, it is considered that banks expectations are realistic.

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