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

Bank Lending Survey in Kosovo

Number 17

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CENTRALNA BANKA REPUBLIKE KOSOVA

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Bank Lending Survey in Kosovo and Inflation Expectations

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Bank Lending Survey In Kosovo (BLSK)

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 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 records the credit behavior in the third quarter of 2023, and banks expectations for credit dynamics in the fourth quarter of 2023.

In addition to the standard questions, this survey has been supplemented with three additional questions in an attempt to identify possible risks in the banking sector in general, as well as the breakdown of credit supply and demand for enterprises by economic sectors.

Results Summary[2]

The annual increase in the stock of total loans continued to grow until the third quarter of 2023, but at a slower pace compared to the same period of the previous year. New loans marked a lower increase compared to the same quarter of the previous year, while compared to the previous quarter, they marked a significant decline. This dynamic may reflect a more careful approach of consumers in undertaking additional debts, in an environment of the increase of cost of living, and at the same time, a more cautious approach and monitoring of the banks in lending activity. Dynamics in credit activity were influenced to a larger extent by loans demand for consumer credit, since credit supply had minor changes during this quarter. For the next quarter, banks expect the credit demand to be the driver of credit activity, while credit supply is expected to have positive marginal changes.

According to banks, the dynamics of lending to enterprises during this quarter were positively affected to a low extent by slightly eased credit supply, while credit demand was characterized by marginal decline. Within the enterprise segments, banks stated marginally tightened credit standards for large enterprises, while for SMEs there was marked a marginal ease (table 1). In the context of the factors that influenced these developments, the increase in the EURIBOR rate and the poor outlook in the global markets resulted to have been the main negative contributors to credit standards. Meanwhile, the support given by the KCGF and the favorable liquidity position had a positive impact, to some extent, in credit standards. At the same time, the approval rate of loans to enterprises generally results with positive marginal movements, primarily for SMEs. For the fourth quarter of 2023, marginal movements in credit standards are generally expected by banks, precisely a marginal ease is expected for SMEs (chart 1). The support given by the KCGF is expected to positively contribute to credit standards. While banks' expectations of the effects of the Euribor rate on credit standards appear to have remained unchanged (usually rising interest rates affect credit demand), sector expectations of the impact of Euribor on lending terms and conditions suggest weakening of this effect compared to the previous quarter. The approval rate of loans is expected to mark an increase to some extent, primarily for loans to SMEs.

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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 BLSK questionnaire, and time series of the bank lending survey results, are available on the CBK website, on the link of the Bank Lending Survey in Kosovo.

Terms and conditions applied by banks in granting loans to enterprises were tightened for both segments of enterprises. More specifically, there was applied a tightening of the applied interest rate and other charges besides interest. Conversely a low easing was marked for collateral requirements for SMEs. Applied terms and conditions were negatively affected by the increase of EURIBOR rate and the unfavorable outlook in the global markets. On the other side, the support given by the KCGF and the increased competitive pressure among the banks, affected positively the terms and conditions for enterprises. In the coming quarter, banks are expected to mark marginal positive movements. More precisely, a marginal decrease in the interest rate on loans is expected for both categories of enterprises, also an easing in the demand for collateral is expected, mainly for SMEs. These positive changes are expected to be driven by the support given from KCGF and increased competitive pressure among banks, while the poor outlook in global markets negatively affected banks' expectations on terms and conditions for the next quarter.

During the third quarter of 2023, in general there was marked a marginal decline of demand for bank loans by enterprises, representing a considerable change compared to the dynamics of the previous quarter. More specifically, the demand for loans from SMEs marked a decline, albeit of a low level. Also the demand for loans from enterprises turned out to have been lower compared to the banks' expectations for Q3 2023, expressed in the previous survey (Q2 2023). The generated index of the demand for loans from enterprises in general was impacted by the replies given by five banks, of which two with systemic importance, which stated a decline of the demand. This decrease of demand, according to the banks' statements, was primarily driven by the decline in demand for financing the fixed investments. The index generated for banks' expectations on credit demand during the next quarter, shows an increase in credit demand for two categories of enterprises. The banks attributed these expectations mainly to the increase in the demand for financing inventories and working capital.

The stock of loans to households until the third quarter of 2023, recorded a same annual growth compared to the previous year. At the same time, new loans marked a significant increase compared to the same quarter of the previous year, whereas compared to the previous quarter, there was marked a decline of new loans. This lending activity dynamic to households was mainly supported by credit demand, since the credit supply was eased to low extent. Credit standards in the current quarter, in general, turn out to be characterized with more significant movements than the expectations of banks expressed in the previous survey. Credit standards were eased to some extent for housing loans, whereas they changed marginally for consumer credit. The favorable liquidity position was the factor with the most significant impact on the easing of credit standards for households. Meanwhile, banks stated an increase, to some extent, of the approval rate of loans to households. In the fourth quarter of 2023, banks expect marginal positive changes in credit standards of the same level for both types of loans to households (table 1). The factor which is expected to positively affect the credit standards is the favorable liquidity position of banks. Also, there is expected an approximate increase of the approval rate for both types of loans to households.

In general, terms and conditions tightened for new loans to households during the third quarter of 2023. The generated results mainly reflect tightening to higher level for house purchase loans, through an increase of interest rate. The main factor in increasing the interest rate was the increase of the EURIBOR rate, a rate applied for loans with variable interest rate. On the other hand, the banks' favorable liquidity position of banks was the factor with a higher positive impact on terms and conditions applied for loans to households. For the fourth quarter of 2023, banks in general expect significant movements in terms and conditions for loans to households, including changes in interest rates. More precisely, only two banks with low weight in the banking sector are expected to apply higher interest rates for both types of loans. Unlike the actual quarter and the previous one, the expectations for the negative contribution of the increase in the EURIBOR rate were significantly reduced, while the interest rates are expected to be positively affected by stabilizing in the current trend from the increased pressure of competition among banks and favorable liquidity position in the banking sector.

The demand for loans from households in general marked an increase during the third quarter of 2023. It turns out that the demand for loans showed higher growth for consumer credit than for house purchase loans. More precisely, five banks, of which three with systemic importance, reported an increase in demand for loans for house purchase, while six banks, of which four with systemic importance, stated an increase in consumer credit. The need for financing consumption expenditures was the only factor that contributed positively, while the factor with a negative impact on credit demand was the decline in consumer confidence. In the fourth quarter of 2023, banks expect an increase in demand for loans from households at an approximate level compared to the current one (table 1). The demand for loans, in general, is expected to be driven mainly by the demand for consumer credit. The survey results suggest that the need to cover consumer spending is mainly expected to drive this increase of the demand.

Table 1. Banks assessment on credit supply and demand

	Supply (Credit standards)		Demand	
	Q3 2023	Q4 2023 (expectations)	Q3 2023	Q4 2023 (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 (negative index below 0.20)
↓ Tightening of credit standards/Decrease in demand for loans (negative index over 0.20)

Source: CBK.

Prudent monitoring of clients' financial performance and a more conservative assessment of new applications for loans by banks helped to maintain the satisfactory level of loan repayment performance. However, banks stated a deterioration of a low level of loan portfolio quality for enterprises and households as well. For the following quarter, the generated index is expected to be positive and higher for both segments, reflecting banks' expectations for a further deterioration of loans portfolio quality. These expectations were mainly impacted by the dynamics of prices increase in the country, along with the decline of clients' purchasing power. Three banks, where two of them with systemic importance, expect an increase of enterprise nonperforming loans ratio, and at the same time, there is expected a same dynamic for households as well.

Banks reported a significant increase of access to financing during the third quarter of 2023. The aggregated result of the banks' replies was affected by the responses of nine banks (of which five with systemic importance) that stated an increase in financing. Household deposits were characterized with higher increase, where compared to the previous quarter the increase was almost twice as high. Unlike the previous quarter, financing from enterprise deposits was characterized with a considerable contribution to the increase of financing. Meanwhile, financing from parent banks and from international financial institutions had a marginal contribution to financing. In this quarter, both types of maturities marked an approximate increase. During the next quarter, banks in general expect an increase in access to financing to almost a same level as in the current quarter. Financing through the household deposits is expected to lead the increase of banking sector financing, followed by financing from enterprise deposits. As regards to the maturity of financing, banks expect the increase of financing to be approximate for both maturities.

Box 1. Methodology

The questionnaire of the Bank Lending Survey in Kosovo

The BLSK questionnaire is based on the standardized questionnaires used by Central Banks in the euro area and beyond. However, the BLSK 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 BLSK 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 BLSK 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 twelve banks operating in Kosovo. 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.

The bank lending survey generated results

Quantifying of the answers received from individual banks and their aggregation to present the changes on the level of the sector is achieved by generating the appropriate 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 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 bank 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 values 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.

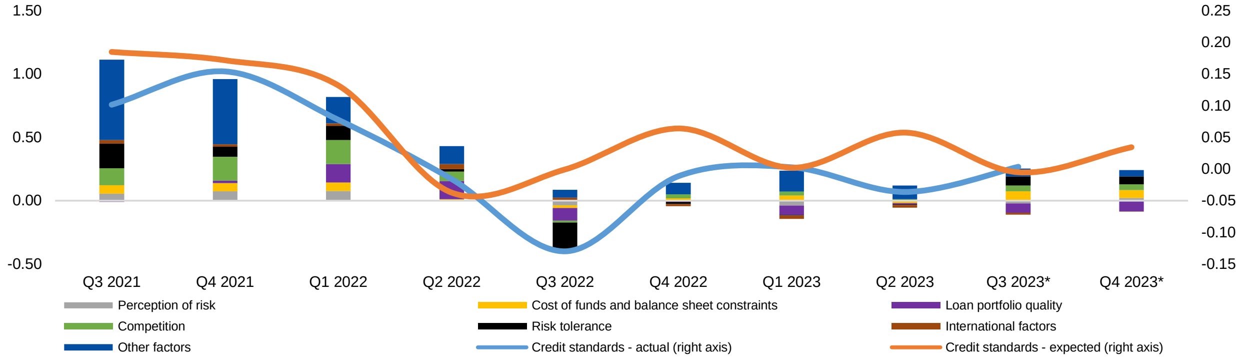
Developments in credit standards, credit terms and conditions, and in the demand for loans

Loans to enterprises

Credit standards

During the third quarter of 2023, the result on credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises in general represent no significant movements. Expectations of banks expressed in the previous survey (Q2 2023), result to have been approximate with the changes in credit standards for enterprises for Q3 2023 (chart 1).

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



Source: CBK.
*Expected value

Within the enterprise segments, banks stated marginally tightened credit standards for large enterprises with a negative index of 0.07, while for SMEs there was marked a marginal ease with a positive index of 0.08. The main factors that had negative impacts on credit standards were the increase of EURIBOR rate and poor perspective in the global market with a negative index of 0.14 and 0.17, respectively. While, the factors which to some extent had positive impact on credit standards, providing security to the banking sector, were the support offered by the KCGF and the favorable liquidity position with a positive index of 0.20 and 0.13, respectively.

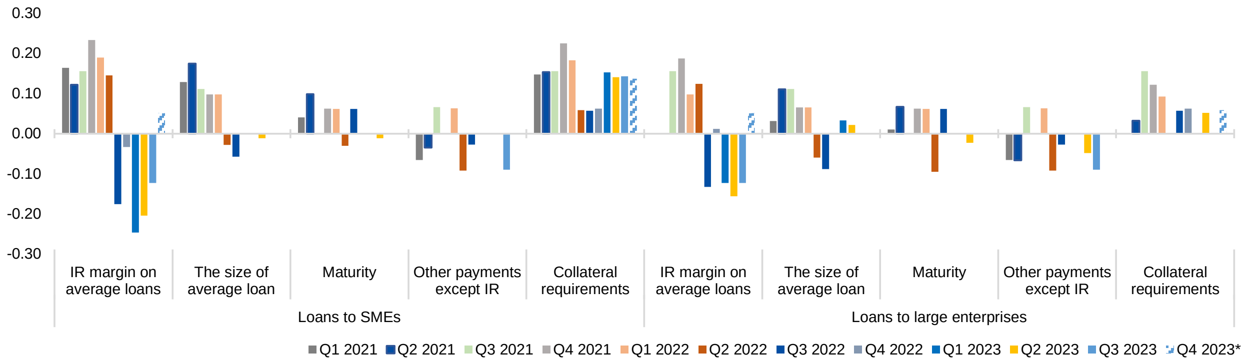
At the same time, the approval rate of loans to enterprises generally results with positive marginal movements, primarily for SMEs. More precisely, the results generated marginal positive index of 0.05 for SMEs while there was no change for large enterprises.

Overall credit standards are expected to mark marginal oscillations in the following quarter. More specifically, eight out of ten participating banks in the survey stated that they do not expect changes in credit standards. The support from the KCGF is expected to positively contribute to the credit standards, whereas the increase of the EURIBOR rate is expected to contribute negatively on the credit standards. Whereas, the approval rate of loans is expected to mark an increase to some extent, primarily for loans to SMEs.

Terms and conditions

In the third quarter of 2023, overall terms and conditions applied by banks in issuing loans to enterprises (the specific terms and conditions of a contract for loans), were tightened to some extent for both categories of enterprises (chart 2). Specifically, for both categories of enterprises, a tightening was applied to applied interest rate and to additional changes besides interest with a negative index of 0.12 and 0.09, respectively. This result was impacted by the replies of three banks, of which, one with systemic importance in the sector. Whereas, an ease to some extent was marked for collateral requirements for SMEs with a positive index of 0.14, as stated by two banks with systemic importance. Applied terms and conditions were negatively affected by the increase of EURIBOR rate and unfavorable outlook in the global markets. On the other side, the support given by the KCGF and the competitive pressure among the banks, affected positively the applied terms and conditions.

Chart 2. Changes of terms and conditions applied to enterprises



Source: CBK.

*Expected value

During the following quarter, applied terms and conditions by banks are expected to have marginal positive movements. More specifically, it is expected a marginal decrease of interest rate for both categories of enterprises with a positive marginal index of 0.05, a dynamic which has been impacted by a response of one bank with systemic importance. Also, it is expected an ease for collateral requirements for SMEs with a positive index of 0.14 as stated by two banks with systemic importance. These positive changes are expected to be driven by the support from KCGF and increased competitive pressure among banks, while the poor outlook in the global markets negatively affected banks' expectations on terms and conditions during the next quarter.

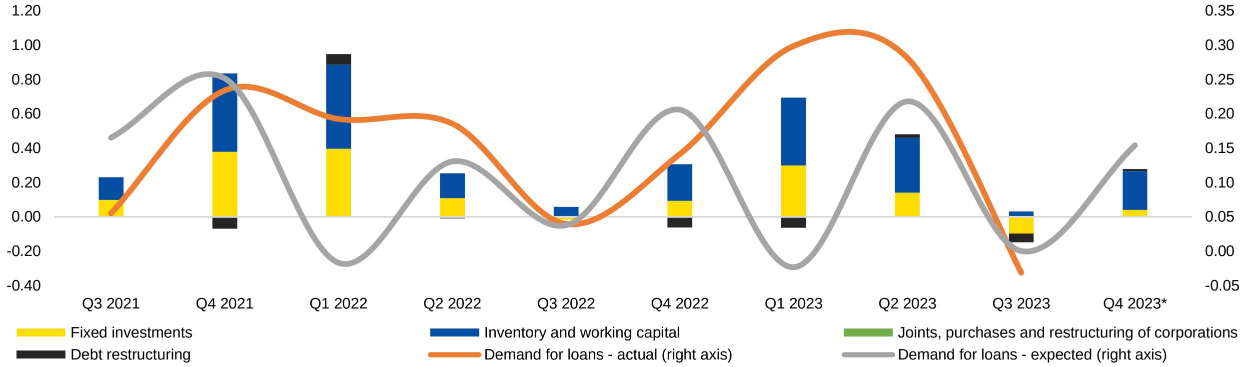
Demand for loans

During the third quarter of 2023, there was marked a marginal decline of demand for loans by enterprises, representing a considerable distinction compared to the dynamics of the previous quarter. More precisely, the responses generated a negative index of 0.06 expressed by five of the total ten participating banks in the survey, of which two banks with systemic importance stated a decrease in loan demand, while three banks with smaller weight stated an increase of the demand for loans. This decline was affected by loans demand from SMEs, with a negative index of 0.09. Also, the demand for loans turned out to have been lower compared to the banks' expectations for Q3 2023, expressed in the previous survey (Q2 2023) (chart 3).

According to the results of the survey, changes in the demand for loans from enterprises were mainly driven by the decline of demand for financing fixed investments with a negative index of 0.10. The result of factors contributing to credit demand was influenced by the responses of three systemically important banks, of which two banks stated a decrease in the demand for financing fixed investments and one bank stated a decrease in the demand for financing inventories and working capital. The quality of the applications submitted by enterprises did not mark significant changes, in Q3 2023.

According to the survey, during Q3 2023, the nonperforming loans to total loans ratio of enterprises increased, resulting with a positive index of 0.10, which turns out to have changed direction compared to the outcome of the previous survey, where the replies given by banks generated a negative index of 0.12 of this ratio. This outcome was impacted by the replies of six banks, where four of the banks (two with systemic importance) stated a growth of nonperforming loans, while two other banks (one with systemic importance), stated a decline of nonperforming loans ratio.

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



Source: CBK. *Expected value

Unlike the current quarter, banks expect an increase of loans demand from enterprises during the following quarter. This result was impacted by replies of five banks (one of them with systemic importance) which expect an increase for loans demand in general. A higher demand to some extent is expected to be marked by large enterprises. The banks attributed these expectations mainly to the increase in the demand for financing inventories and working capital. The quality of received applications is expected to mark marginal negative changes for SMEs and marginal positive changes for large enterprises.

During the following quarter, banks expect nonperforming loans to total loans ratio for enterprises to further increase with a positive index of 0.13, thus reflecting banks' expectations on the deterioration of credit portfolio quality. These expectations were mainly impacted by the dynamics of prices increase in the country, along with the decline of clients' purchasing power. Three banks, where two of them with systemic importance, expect an increase of enterprise nonperforming loans ratio, whereas one bank expects a decline of this ratio.

Loans to households

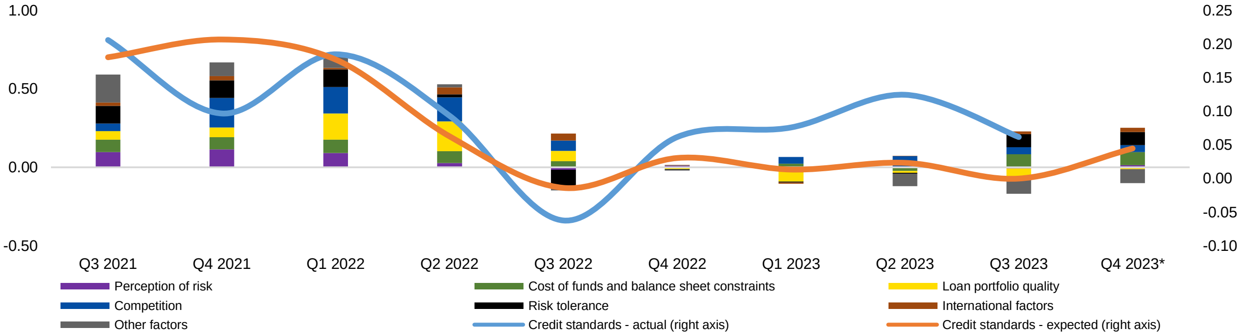
Credit standards

Credit standards applied for households, during the third quarter of 2023, generally were characterized with marginal positive movements. This ease was mainly applied for housing loans with a positive index of 0.09, based on the response of one bank with systemic importance. Expectations for the current quarter, stated by banks in the previous survey (Q2 2023), resulted to be lower than the actual values (chart 4). The favorable liquidity position was the factor with the most significant impact on the easing of credit standards for households.

Banks stated an increase of approval rate of loans to households, namely for housing loans with a positive index of 0.18, while consumer credit, marked a positive index of 0.15.

In the fourth quarter of 2023, banks expect marginal positive changes in credit standards of the same level for both types of loans to households. The factor which is expected to positively affect the credit standards is the favorable liquidity position of banks.

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



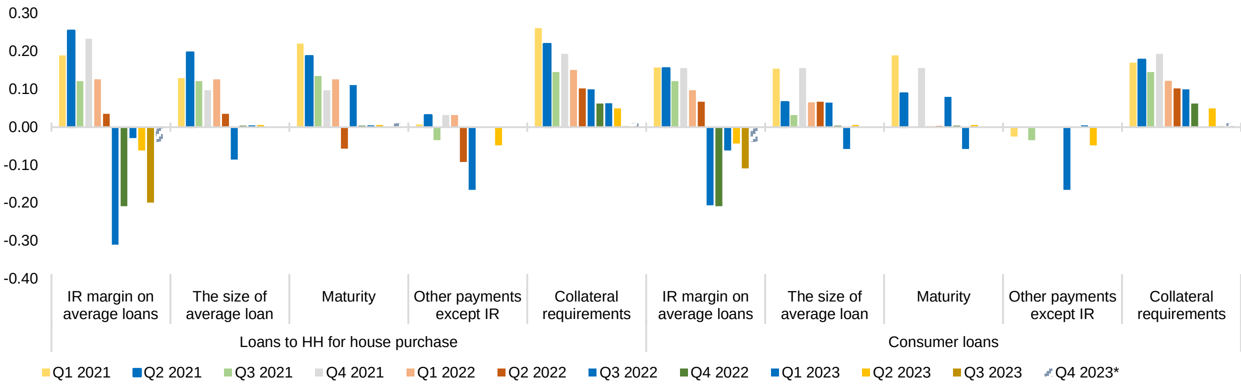
Source: CBK. *Expected value

Banks expect an increase in the level of loans approval for households. More specifically, banks stated that they expect an increase of the demand for housing loans with a positive index of 0.18 and for consumer credit with a positive index of 0.20.

Terms and conditions

Terms and conditions for new loans to households, generally were characterized with negative movements in the third quarter of 2023. The generated results mainly reflect tightenings to higher level for housing loans compared to consumer credit. More accurately, banks applied higher interest rates for housing loans with a negative index of 0.20, a result which has been impacted by the replies of three banks (two of them with systemic importance) which increased their interest rates of housing loans. Whereas, for consumer loans, the interest rate was increased by two banks (one of them with systemic importance), generating a negative index of 0.11. The main factor in increasing the interest rate was the increase of the EURIBOR rate, a rate primarily applied for loans with variable interest rate (chart 5). The banks' favorable liquidity position of banks was the factor with the highest positive impact on terms and conditions applied for loans to households.

Chart 5. Changes of terms and conditions applied to households



Source: CBK. *Expected value

For the fourth quarter of 2023, banks in general do not expect significant movements in terms and conditions for loans to households. Tightening of terms and conditions is expected to be applied through an increase in the interest rate for both types of loans to households only from two banks with a smaller weight in the banking sector, which consequently generated a negative marginal index of 0.04. Unlike the current quarter and the previous one, the expectations for the negative contribution of the increase in the EURIBOR rate were significantly reduced, while the interest rates are expected to be positively affected by the increased competitive pressure among banks and favorable liquidity position in the banking sector.

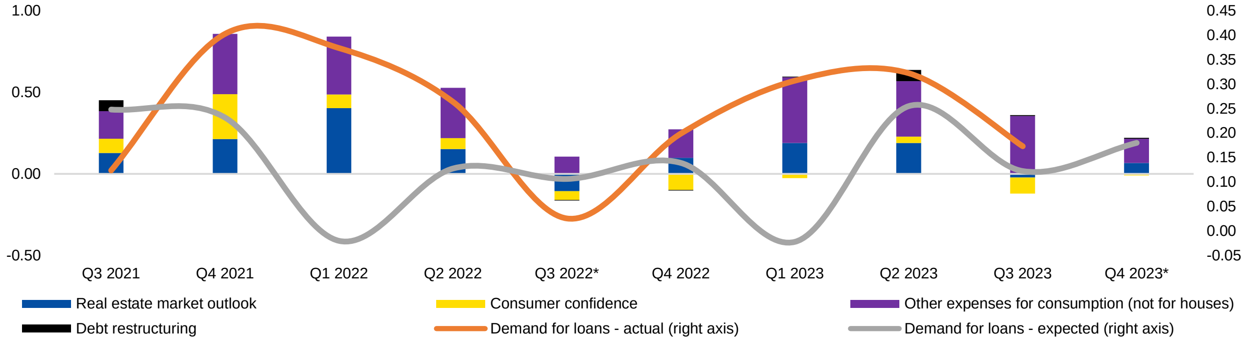
Demand for loans

After generating the results for the credit demand in this quarter, it turns out that the credit demand from households in general has marked an increase, albeit of a lower rate compared to the previous quarter. If the loan demand is broken down by types of loans to households, it turns out that the demand for consumer credit marked an increase with a positive index of 0.20, whereas the demand for housing loans marked a growth with a positive index of 0.14. More precisely, five banks, of which three with systemic importance, reported an increase in demand for loans for house purchase, while two other banks, (of which one with systemic importance) stated a decrease in demand for the same ones. For consumer credit, six banks, of which four with systemic importance, stated an increase in demand and two other banks (of which one with systemic importance) stated a decrease in demand for the same ones. If the results of the actual demand for loans are compared with the expectations of banks stated in the previous survey for the same period, the actual level of the increase of the demand is higher(chart 6).

The factor which positively affected the dynamics of the demand for loans was the need to finance consumer spending (a positive index of 0.36), while a factor with a negative impact on the demand for loans was the decline of consumer confidence (negative index of 0.10). At the same time, the quality of applications received by households decreased with a marginally negative index for housing loans, while the quality of applications for consumer credit increased marginally.

Banks stated a deterioration in the quality of the credit portfolio for households, based on the positive index of 0.09, although it is at a lower level compared to the previous quarter. Dynamics influenced by the responses of three banks, two of them with systemic importance, which stated an increase in the nonperforming loans ratio.

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



Source: CBK.

*Expected value

In the third quarter of 2023, the demand for loans from households is expected to have an approximate increase as in the actual quarter. More specifically, banks expect an increase in demand for consumer credit with a positive index of 0.23 and for housing loans with a positive index of 0.13. Expectations for this dynamic, were affected by replies of four banks (two of them with systemic importance) which expect an increase in demand for housing loans and six banks (two of them with systemic importance) which expect an increase in the demand for consumer credit. The survey results suggest that mainly the need to cover consumer spending is expected to drive this increase of the demand and to a lower level the good outlook in real estate market. Banks do not expect a significant change regarding the quality of applications for loans.

During Q4 2023, banks expect that the loan portfolio quality of households will be characterized by a further deterioration, based on the positive value of the index. More precisely, banks' expectations on nonperforming loans ratio resulted in a positive index of 0.16, stated by four banks, where two of them are banks with high weight in lending and with systemic importance.

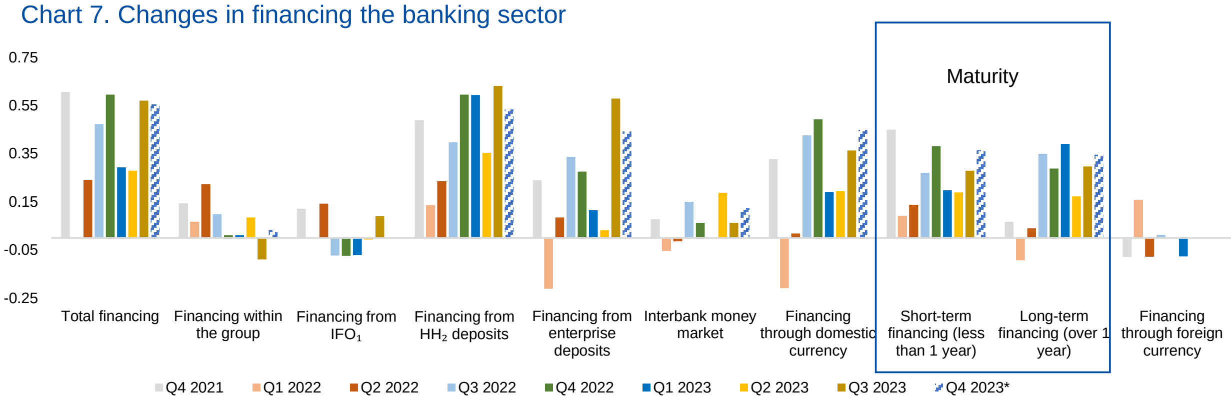
Financing

Banks reported a significant increase of access to financing during the third quarter of 2023. The aggregated result of the banks' replies was affected by the responses of nine banks (of which five with systemic importance) that stated an increase in financing.

Based on the aggregated result of the replies, during this quarter, total financing marked a double high increase compared to the previous quarter, namely positive index of 0.57 (positive index of 0.28, in Q2 2023). Also, household deposits generated a positive index of 0.63, representing almost a double higher index compared to the previous quarter (positive index of 0.35). This result was affected by the replies of nine participating banks in the survey, where four of them are with systemic importance, and further, one of these banks stated a considerable increase of household deposits. Unlike the previous quarter, financing from corporate deposits also had a significant contribution to the increase in financing as it generated a positive index of 0.58 (positive index of 0.03, in Q2 2023), reflecting the responses of eight participating banks, of which five of them are banks with systemic importance, and further, one of these banks stated a significant increase in enterprise deposits. Financing from parent banks and from international financial institutions had a marginal contribution to financing with a negative index of 0.09 and a positive index of 0.09, respectively, as stated from one bank with systemic importance (chart 7). As regards to the maturity of financing, in this quarter an approximate increase was marked by both maturities. More specifically, long-term deposits generated a positive index of 0.30, while short-term deposits generated a positive index of 0.28.

For the following quarter, in general, banks expect an increase to total access to financing approximately at a same level as in the current quarter with a positive index of 0.56, stated by nine participating banks in the survey. Financing through household deposits is expected to lead to the increase in financing of the banking sector with a positive index of 0.53, followed by financing from company deposits with a positive index of 0.44, stated by eight banks that expect an increase in these sources of financing and one bank with a less weight expects a decrease in funding from the same sources. As regards to the maturity of financing, banks expect the increase of financing to be approximate for both maturities. More specifically, there is expected an increase in short-term financing with a positive index of 0.36 and a long-term financing with a positive index of 0.35 (chart 7).

Chart 7. Changes in financing the banking sector



Source: CBK.

*Expected value

Results of focused questions

The questionnaire of the survey, for the third quarter of 2023, has been supplemented with four additional questions in an attempt to identify possible risks in the banking sector in general, as well as to break down the credit supply and demand by economic sectors.

Driven by domestic price dynamics, and by continues geopolitical pressures, a number of factors influenced the assessments and expectations for the growing risks to the banking sector in the country and on the global level. In this context, to understand in more details the assessments and expectations of the banks in the country, the survey also included questions on the most possible risks of the sector during the third quarter, and further the expectations of the banks for the following six-month period.

During the third quarter, there was no materialization of risks, however, some of the banks described the bank's risk profile as average and under observation. Thus, banks showed increased cautiousness in monitoring credit risk, liquidity risk and interest rate risk, which were affected by the increase in uncertainty in securing financing, by the movement of interest rates, and by the impact of prices on customers' repayment capabilities. For the next six months, the banks identified some of the factors that are expected to affect the risks in general and to which the banks are paying special attention. These factors include political developments in the country and geopolitical developments at the global level, the potential lack of labor in the domestic market (especially in certain economic sectors, such as construction and services) or the potential risk of young people emigrating after visa liberalization, expectations for weakened economic activity, the potential increase and the high level of the EURIBOR rate, as well as the continuation of the high level of prices in the country (high cost of living).

The survey questionnaire for Q3 2023 includes additional questions on bank's risk perception and expectations on liquidity risk. The generated results showed that half of the surveyed banks rated the risk from the liquidity position as low risk, based on the liquidity indicators which were above the required minimum regulatory, and also due to the regular control of the relevant indicators. These banks have high weight and stable financing sources in th sector. The survey suggests that the sector has taken measures to manage and reduce the possible effects of liquidity risk through increasing deposit rates, campaigns with favorable conditions of attracting deposits, as well as more cautious lending activity. Further, during the next six months, the banks predict that the liquidity risk will be stable, but under close observation, as it is expected to be affected by the developments in the international markets and the intensified competition of the banking sector in attracting deposits. In case of the increase of the exposure to this risk, banks find as a supportive mechanism financing/aid receiving from parent banks, and the liquidity Reserve Plan, as possible options, albeit there are no such expectations.

Referring to the sensitivity of the balance sheet to the increase in interest rates, in general, the banks described it as an average risk. Specifically, the banks with the largest weight in the banking sector assessed it as not high or limited risk, while the banks with smaller weight expressed a higher sensitivity of the balance sheet items to changes in interest rates. Some of the banks based this assessment by referring to the sensitivity scenarios to the interest rate change of +/- 200 pp in the bank's book positions according to the "Regulation for the Management of Interest Rate Risk in the Bank's Book", and the share of variable rates in their loans portfolio. Banks with a lower weight in the banking sector express higher sensitivity on the liabilities side, due to their more unfavorable position in terms of providing more stable financing. Also, the banks emphasized the negative impact of this risk in their profitability. As a measure to manage this risk, a considerable number of banks consider applying variable interest rates.

The disaggregated replies of banks for enterprises, classified by sectors, indicate the direction of financing the economy and dynamics in certain sectors. During the third quarter of 2023, credit standards marked marginal changes in some of the economic sectors. The sector of construction was characterized with marginal negative results with a negative index of 0.08, implying a tightening of credit standards. Conversely, a positive marginal result, implying a tightening of credit standards, was marked for the services and trade sectors with a positive index of 0.08, whereas for other sectors credit standards have not changed. Terms and conditions were tightened to a larger extent for all of the sectors, and especially for the construction sector with a negative index of 0.20, and for the real estate sector (residential and commercial sectors) with a negative index of 0.12. Tightening of terms and conditions were marked also for other economic sectors, albeit at marginal levels. These tightening mainly reflect a rise of interest rates on loans. Conversely, the demand for loans marked an increase, to some extent, from two economic sectors. The sector with the most increased demand for financing was the one of construction with a positive index of 0.14, an increase stated by five banks. At the same time, the second sector by increase of the demand was the residential real estate sector with a positive index of 0.09, an increase stated by four banks. On the other hand, banks stated a decrease, to some extent, of loans demand from trade sector, generating a negative index of 0.14.

Based on the generated results, during the following quarter banks are expected to apply minor changes in the credit supply for certain economic sectors. Terms and conditions are expected to ease for all economic sectors unlike the actual quarter, where the sectors with the highest positive indices are expected to be manufacturing sector (positive index 0.15) and trade sector (positive index of 0.12). At the same period, the demand for loans is expected to mark positive movements. Specifically, demand growth is expected from the services and construction sector (positive index 0.18 and 0.14, respectively), and also it is expected an increase of demand from the residential real estate sector with a positive index of 0.11.

Inflation Expectations

In order to enhance analytical capacities and based on the advanced regional and more comprehensive experiences, the CBK surveys financial institutions in the country. This happens based on the hypothesis that financial institutions carry the best practices from parent banks and have the appropriate expertise to project inflation dynamics. Since the third quarter of 2019, BLSK has been enriched with supplementary questions, which address commercial banks expectations on price developments in the country. This helps complement our publications in terms of analysis, 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 fourth quarter of 2023 and for the whole year of 2023 in general. The survey serves also as a tool to identify specific factors, which potentially may affect bank expectations for the specified level of inflation.

Methodology

Inflation expectations have at least two important roles. First, they offer summarized quantitative series for inflation rate in the future, and secondly, they may be used to assess the confidence of the objective of inflation set by the central banks.

The importance of inflation expectations is higher for the countries which have adopted the strategy of targeting the inflation. For these countries, inflation expectations, among others, serve also as an indicator of the public confidence towards central banks. If it is believed that the central bank will act in order to achieve the objective, then, also the expectations of the economic agents on the inflation rate would be closer to the objective.

Inflation expectations are important also for banks which do not have monetary policy, given that they serve as an important input in defining the prices and salaries, and in the process of modeling and forecasting. Moreover, inflation expectations have an impact on the aggregate demand, which later affect the inflation trend.

Unlike the current inflation which is measured in a direct way, inflation expectations are assessed with indirect methods. Among the mostly used is the survey of economic agents: consumers, businesses, commercial banks, etc. The Central Bank of the Republic of Kosovo, for the first time began with the assessment of inflation expectations in the third quarter of 2019, initially with commercial banks.

Estimates which are performed by commercial banks are of quantitative forms associated also with the spread of the profitability. Inflation expectations are estimated for different time frameworks, where initially are performed the estimates on the actual quarter and the expectations for the following quarter and the current year in general. The summarizing of inflation through the surveys is followed by a systemic process, elaboration and aggregation in order to find the average of inflation expectations from the commercial banks.

Results Summary

Based on the survey realized in October 2023, banks have estimated a lower level of inflation in the third quarter of 2023 compared to the previous quarter. They expect a slightly higher inflation level for the fourth quarter of 2023. For 2023, banks expect that the level of inflation rate will drop to 4.7%, representing a significant slowdown of the rate of 11.6%, as it was in 2022.

The data published by the Kosovo Agency of Statistics, for the third quarter of 2023, suggest that the annual average inflation rate was around 3.2%, while for the fourth quarter of 2023 , banks expect that the average inflation rate would be 4.2%. Most of the banks expect inflation to be above 4% in the fourth quarter, whereas the remainder of the banks expect inflation to be below this level.

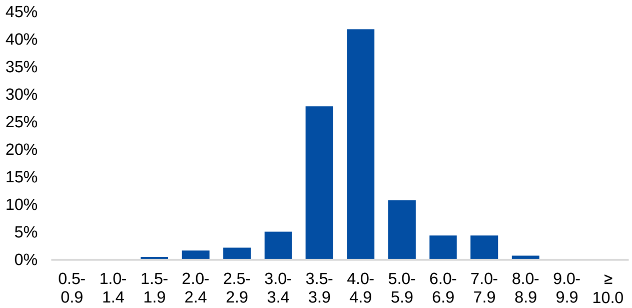
Table 2. Inflation expectations of banks, annual change in per cent

Banks	Q3 2023	Q4 2023	2023
1	5.5%	5.7%	5.6%
2	3.3%	2.5%	2.5%
3	4.2%	4.2%	5.2%
4	4.2%	3.6%	5.3%
5	4.2%	5.0%	5.0%
6	3.2%	4.3%	5.2%
7	4.2%	4.6%	4.9%
8	4.2%	3.8%	3.8%
9	3.3%	3.7%	3.8%
10	4.3%	5.0%	5.4%
Average	***4.1%***	***4.2%***	***4.7%***

Source: Commercial banks and CBK calculations.

Chart 8 depicts the spread of reported probability, shown by a relatively high certainty concerning the result of the expected inflation. This is because the spread of banks' probability is concentrated in the expected inflation.

Chart 8. Probability of inflation for Q4 2023 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.

In their qualitative comments, banks have mentioned several key factors that have affected and are expected to affect the rate of inflation, including interest rate increases by the US Federal Reserve, the European Central Bank, and the Bank of England. The drop in prices in the international markets as well as the slowdown in the growth of the global economy, may have influenced the slowing down of the rise of inflation, given the high dependence of Kosovo's economy on the import of goods, etc.

In addition, other factors that have influenced inflation to remain high include the war in Ukraine, with significant influence from Russia and Ukraine as they represent the supplying countries of raw materials, and also the war in Gaza. Internal pressures for salary increases, together with pressures from the performance of energy prices after the decision of the Energy Regulatory Office to increase tariffs by 15%, are expected to have an impact in the coming months as well, especially during the period of winter.

As a conclusion, banks expect to have a slowdown increase of inflation during the year of 2023. However, the expectations for the slowdown may be negatively affected by global developments and the uncertainty surrounding them, as well as unfavorable weather conditions, which resulted in lower yields of agricultural crops.

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