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

Bank Lending Survey

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CENTRALNA BANKA REPUBLIKE KOSOVA

CENTRAL BANK OF THE REPUBLIC OF KOSOVO

Bank Lending Survey and Inflation Expectations

Number 10

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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 fourth quarter of 2021, and banks expectations for credit dynamics in the first quarter of 2022.

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

Results Summary[2]

As a result of the improvement of the situation with the pandemic, and consequently the easing of restrictive measures in the country and abroad, economic activity had a strong recovery in 2021. Lending and financing of the banking sector marked a significant increase in the second half of 2021, an increase that together with the increase of formal and informal diaspora income, supported the economic recovery in the country. The annual growth of the total credit stock exceeded the level of annual growth of pre-pandemic lending, and the year 2021 closed with the highest annual credit growth in the last ten years. At the same time, new loans compared to the previous quarter and the same quarter of the previous year marked a significant annual increase, both for enterprises and households. These lending dynamics were largely influenced by credit demand, which increased twice more than the credit supply eased. In contrast to the current quarter, banks for Q1 2022 expect the lending activity of the sector to be supported to some extent by credit supply, as the demand for loans is expected to not change significantly.

According to banks, the dynamics of lending to enterprises during this quarter was positively affected to a larger extent by increased credit demand, while credit supply side eased, albeit at lower level. Within credit supply, banks have reported to have eased, to some extent, the credit standards applied in assessing enterprise credit applications of enterprises during the fourth 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 influenced mainly by the support of loans from the KCGF, and the increased competitive pressure in the banking sector. At the same time, banks increased the approval level of loans to enterprises, especially for SMEs.

For the first quarter of 2022, banks' expectations consist of easing credit standards to a level close to that marked in the current quarter. Credit offer based on credit standards to some extent is expected

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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.

to be more favorable for SMEs than for large enterprises. The increase of competitive pressures is expected to have the main positive contribution in easing credit standards in Q1 2022.

Terms and conditions applied by banks in granting loans to enterprises were eased to some extent. Eased terms and conditions were mainly applied to both categories of enterprises through lower interest rates and lower collateral requirements. Factors that influenced the easing of terms and conditions were the support of SMEs by the KCGF and the increase of competitive pressures in the banking sector. In the first quarter of 2022, banks expect easing of terms and conditions for both categories of enterprises, but at a lower level than in the fourth quarter of 2021. Eased terms and conditions are expected to be similar with those applied in the current quarter. The easing of terms and conditions for enterprises is expected to be driven by competitive pressures in the banking market, the good liquidity position of the banking sector, as well as the support of SMEs by the KCGF.

During the fourth quarter of 2021, there was a significant increase in the demand for bank loans by enterprises compared to the previous quarter. The demand for loans from enterprises turns out to be underestimated in banks' expectations for Q4 2021 expressed in the previous survey (Q3 2021), where banks expected a lower increase in the demand for loans. The increased demand for loans came from SMEs, while the demand for loans from large enterprises remained unchanged. This increase in demand, according to bank statements, was mainly driven by the increase in demand for financing inventories and working capital and for financing fixed investments. Expectations for lower economic activity due to seasonality have also affected the expectations of banks which stated that they do not expect significant changes in credit demand over the next quarter from both categories of enterprises, where banks' responses generated a marginal negative index (table 1). The key factor that is expected to positively affect the demand for loans from enterprises is the need to finance fixed investments, albeit with low intensity based on the index generated.

New loans to households were characterized with a considerable increase during the fourth quarter of 2021, compared to the same period of the previous year. 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 close to the expectations of banks expressed in the previous survey. Credit standards were eased to some extent for consumer credit, while for housing loans there were no significant changes. The easing was mainly influenced by the increased competitive pressure between banks, as well as by the improved domestic market outlook. In the first quarter of 2022, banks expect an ease in credit standards for households to some extent. Credit standards are expected to ease to a higher level for consumer credit than for housing loans (table 1). The same factors as in the current quarter are expected to determine the credit standards applied by banks to households also during the next quarter.

Terms and conditions for new loans to households eased to some extent. The level of easing of terms and conditions was approximate for both housing loans and consumer credit. Almost all the terms and conditions conveyed in the survey were eased, except for other payments other than interest, which remained unchanged. The key factors that eased terms and conditions of lending to households, during the third quarter of 2021, were the increased competitive pressure, the good outlook in the domestic market in general and the banking market in particular, as well as the favorable liquidity position of banks. For the first quarter of 2022, banks stated that they expect an ease in terms and conditions for loans to households, albeit at lower level compared to the current quarter. An ease of terms and conditions is expected for both types of loans, albeit for housing loans banks are expected to offer more favorable terms and conditions. Mainly, terms and conditions for housing loans are expected to be eased by lowering the interest rate and increasing the approved amount. The good market outlook in the country, as well as the increase of competitive pressures in the banking market are expected to be the driving factors of the easing of terms and conditions applied by banks during Q1 2022.

In line with the strong recovery of the economic activity, the demand for loans increased significantly during the fourth quarter compared to the previous quarter. Banks have reported a higher increase of demand for consumer credit compared to housing loans demand. More specifically, nine out of total ten participating banks in the survey, have stated an increase in the overall demand for loans. This increase was positively influenced by three of the factors listed in the survey, namely the need for consumer financing, the increase in consumer confidence, as well as the improvement of the outlook in the real estate market. In the first quarter of 2022, banks do not expect a significant change in the demand for loans from households (table 1). The survey results suggest that banks expect the improved outlook in the real estate market and increased consumer confidence to affect credit demand over the next quarter.

Table 1. Banks assessment on the change of credit supply and demand

	Supply (Credit standards)		Demand	
	Q4 2021	Q1 2022 (expectations)	Q4 2021	Q1 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.

Banks' supportive approach to the needs of their customers, vigilant monitoring of customer performance, as well as economic recovery due to positive global developments and increased income received from abroad helped to improve the repayment performance of loans. Consequently, banks reported an improvement of the loans portfolio, as the response index in this quarter shifted to negative from the positive index as it was in the previous quarter, implying a decline of nonperforming loans to total loans ratio. An improvement of loans portfolio quality was marked for enterprises and households as well. In the next quarter, banks generally do not expect a significant change in the value of nonperforming loans.

Despite the significant increase in the previous quarter (Q3 2021), during the fourth quarter, the financing of the banking sector increased significantly. An increase in financing was stated by all participating banks in the survey. Similar to the previous quarter, bank financing was dominated by the significant increase in short-term household deposits. More specifically, seven banks stated an increase of household deposits, where two of them with systemic importance stated a considerable increase. Banks attributed the increase in deposits to reluctance of the economic entities to invest during the period of pandemics, high inflow of remittances, as well as the high level of diaspora visits to the country. Financing from enterprise deposits , from parent banks and also from international financial institutions marked an increase as well, albeit at lower level. Over the next quarter, banks expect a growth of financing to continue through the growth of short-term household deposits, albeit at a lower level compared to the current quarter. Also, it is expected that financing from parent banks and international financial institutions to continue to have positive contribution in financing the sector.

Box 1. Methodology

The questionnaire of the Bank Lending Survey

The BLS questionnaire is based on the standardized questionnaires used by the Central Banks in the euro area and beyond. However, the BLS questionnaire of the CBK has been modified and adopted to its best and comprehensive way to represent lending developments in Kosovo's banking sector.

The BLS questionnaire contains 19 questions, which cover the changes of credit supply, changes in the demand for loans, factors which contribute in these changes and the access of the banking sector to financing, on quarterly basis. Questions on bank lending are focused on two main categories: (i) loans to enterprises, and (ii) loans to households. Moreover, loans to enterprises are sub-categorized in to loans to SMEs and loans to large enterprises, while loans to households are sub-categorized in housing loans and consumer credit. For all the above mentioned categories, changes in loan supply conditions are defined by credit standards applied in the process of loans approval, terms and conditions applied for new loans, the approval rate of loans, and the factors which affect their changes. Meanwhile, the changes in the demand for loans are defined by the demand for loans (the number of applications for loans), the quality of the applications received, and the factors which affect the demand for loans. The questions of the survey primarily are designed to obtain a feedback for changes over the past three months and changes expected in the following three months. Also, questions cover loans in the aspect of their maturity and the currency in which they were granted.

Besides the standard questions, the BLS questionnaire may contain also additional questions on specific issues in order to explain the developments in the banking sector. While standard questions cover a three-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 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.

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

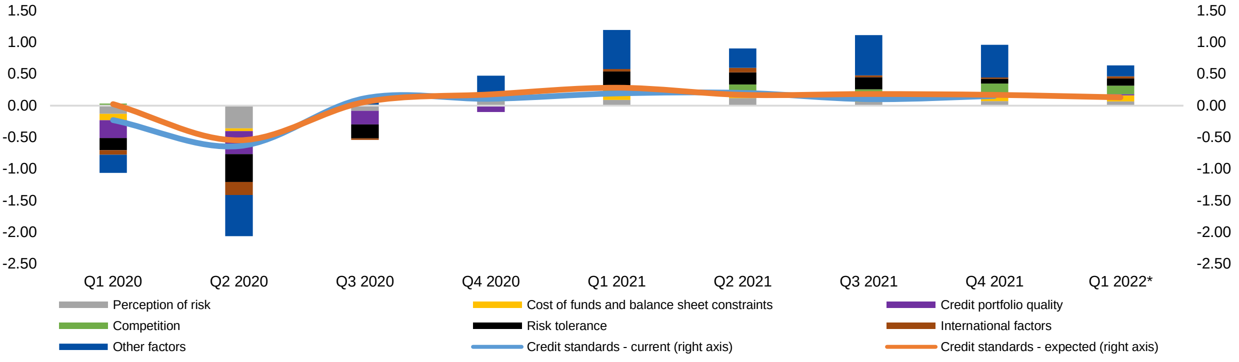
Developments in credit standards, credit terms and conditions, and in loans demand

Loans to enterprises

Credit standards

During the fourth quarter of 2021, credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises in general represent an ease which is of a lower level compared to the previous quarter with a positive index of 0.22 from 0.15 as it was in the previous survey. In the previous survey (Q3 2021), banks had stated that they expect an ease of credit standards to an approximate level as in the current one (chart 1).

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



Source: CBK. *Expected value

Within loans to enterprises, banks reported a positive index of 0.22 for changes in credit standards for SMEs, and marginal changes with a low positive index of 0.09 for large enterprises. More specifically, this result was influenced by the responses of four participating banks which stated an ease to some extent of credit standards for SMEs, while two of the banks stated an ease of standards for large enterprises against the other two banks which stated tightening for the same credit standards.

The main role in easing the credit standards applied by banks in Q4 2021, turns out to have had the support of enterprises in borrowing by the KCGF with a positive index of 0.48 (responses from five banks, of which three of the banks attributed significant contribution), and the increase of competitive pressures in the banking market with a positive index of 0.39 (a factor stated by four banks of which two of the banks attributed a considerable contribution). The approval rate of loans to enterprises during this quarter increased significantly compared to the previous quarter. The approval rate of loans to enterprises increased for both categories of enterprises, albeit this rate was twice higher for SMEs than for large enterprises. This result was influenced by the responses of six participating banks which stated an increase in the loan approval rate for SMEs, while four of the banks stated the same for large enterprises.

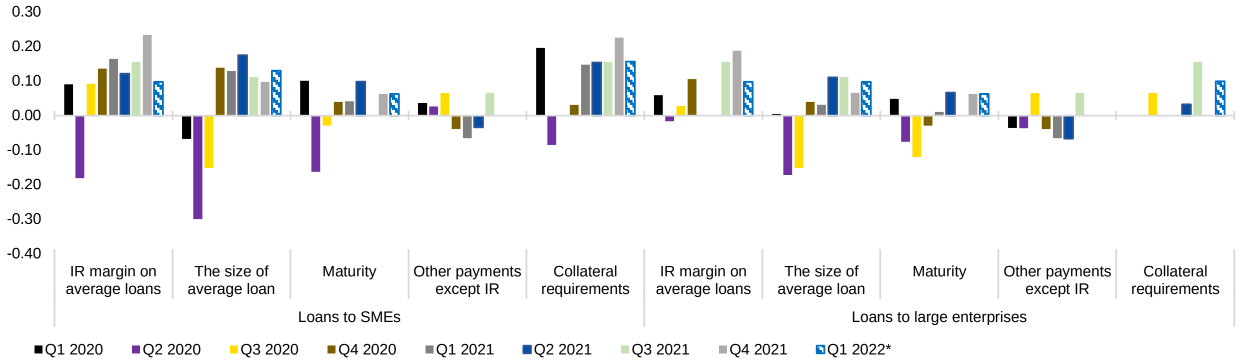
Banks are expected to ease credit standards to some extent during Q1 2022. Five out of ten participating banks in the survey, among which one with systemic importance, expect the increase of competition to have the main contribution in easing the credit standards for enterprises. Also, a positive contribution is expected to be given by the favorable position of the banking sector liquidity. Specifically, the easing of credit standards is expected to be at a lower level than the change in the current quarter, where after the indexation of replies it was resulted in a positive index for SMEs of 0.18, and a positive index of 0.09 for large enterprises.

Conversely, approval rate of loans to enterprises is not expected to have significant change over the next quarter.

Terms and conditions

In Q4 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 banking sector applied the same ease of terms and conditions for new loans to both SMEs and large enterprises. Namely, for both categories of enterprises there was marked an ease to some extent in the applied interest rate (positive index of 0.23 for SMEs and 0.19 for large enterprises) and in the collateral requirement for approved loans (with a positive index of 0.23 and 0.12 for large enterprises).

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 continued to be the support offered by the KCGF for SMEs with a positive index of 0.48. Also, a positive contribution was given by the increase of competitive pressures in the banking sector with a high positive index of 0.40.

Banks are expected to apply eased terms and conditions during Q1 2022, albeit at low levels. In this context, similar to the current quarter, banks stated that they expect similar easing of terms and conditions for both categories of enterprises, by offering a more favorable price for loans (positive index 0.10 for both categories of enterprises), as well as lower collateral requirements (positive index 0.16 for SMEs and 0.10 for large enterprises). The easing of terms and conditions for enterprises is expected to be driven by competitive pressures in the banking market, the good liquidity position of the banking sector, as well as the support of SMEs by the KCGF.

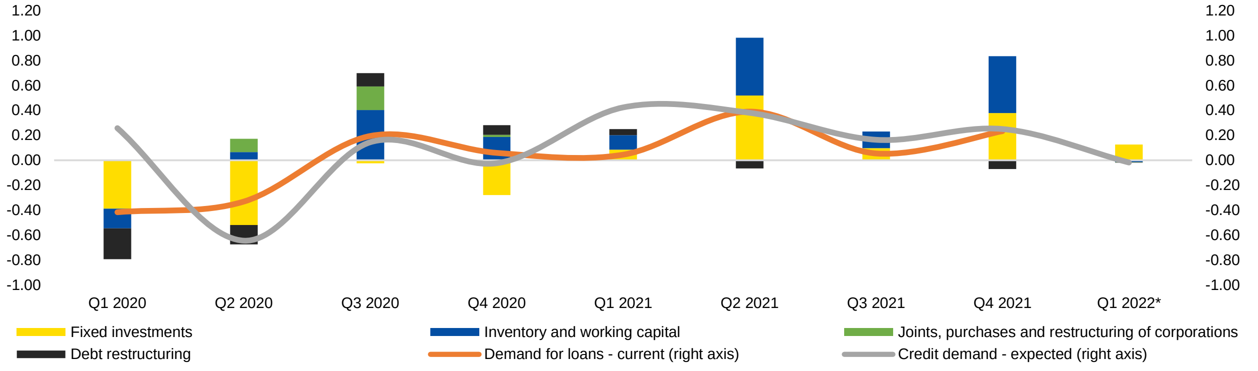
Demand for loans

During the fourth quarter of 2021, **enterprises demand for loans** marked a significant higher increase compared to Q3 2021. Credit demand turned out to have been underestimated in banks' expectations for Q4 2021 expressed in the previous survey (Q3 2021) (chart 3). Specifically, the credit demand from SMEs increased significantly with a positive index of 0.48, while credit demand from large enterprises remained unchanged. The index generated for credit demand was influenced by the responses of eight banks which stated an increase in demand, with three of them stating a significant increase.

According to the survey, the change in demand for loans from enterprises was mainly affected by the demand for financing inventories and working capital, and financing fixed investments with a high positive index of 0.46 and 0.38, respectively. The result of the contributing factors to the credit demand was determined by the responses of nine banks which stated a positive impact of the demand for financing inventories and working capital and seven banks for financing fixed investments. The quality of applications received from enterprises improved to some extent during Q4 2021, namely with a positive index of 0.19 for SME applications and 0.11 for large enterprise applications.

According to the survey, during Q4 2021, enterprise nonperforming loans to total loans ratio generated a negative index of 0.31, in contrast to the previous survey where banks stated a positive index of this ratio, implying an improvement of the loans portfolio quality. This result was impacted by the responses of six banks which stated a decline of nonperforming loans.

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



Source: CBK. *Expected value

Banks do not expect significant changes in the demand for loans from enterprises during the next quarter. However, two banks of systemic importance and high weight in lending of the banking sector, stated that they expect a decrease in credit demand to some extent, while three other banks, one of them systemically important, stated that they expect an increase in demand for loans. Consequently, these responses resulted in a marginal negative index of 0.06. The need for financing fixed investments is expected to be the only driver of demand for loans with a low positive index of 0.13. At the same time, banks do not expect a significant change on the quality of enterprise applications for loans.

At the same time, over the next quarter, banks do not expect a significant change in the nonperforming loans to total loans ratio for enterprises.

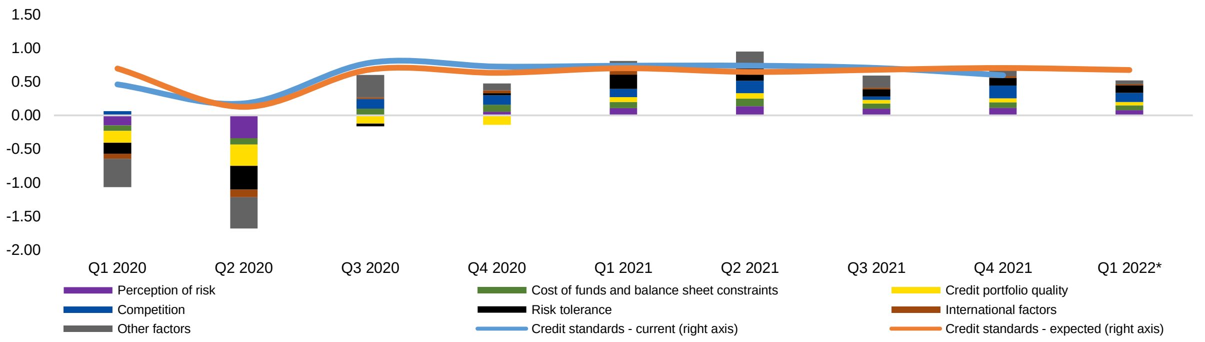
Loans to households

Credit standards

Credit standards applied to households during the fourth quarter of 2021 generally eased, although the easing mainly affected credit standards for consumer credit, while credit standards for housing loans remained largely unchanged. The result mainly reflects the responses of four banks, where three of them are of systemic importance. Expectations for the fourth quarter of 2021 stated by banks in the previous survey resulted to be correct (chart 4). Banks stated that they significantly increased the approval rate of loans to households, where housing loans were characterized with a higher approval rate with a positive index of 0.33 against the consumer credit which marked a positive index of 0.27. The higher approval rate for housing loans against the consumer credit may, among other things, be influenced by existing campaigns / agreements with construction companies which affect the easing of approval criteria, as well as the quality of applications received for this segment against the consumer credit.

Factors that contributed positively to the easing of credit standards were the increase of competitive pressures with a positive index of 0.39, the good outlook of the domestic market in general and the banking market in particular with a positive index of 0.30 and 0.18, respectively.

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



Source: CBK.

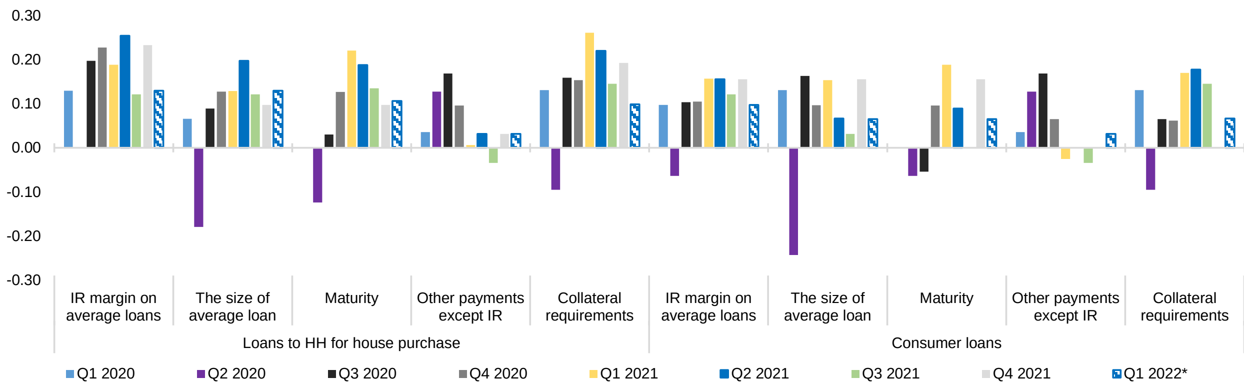
*Expected value

In the first quarter of 2022, banks expect an ease in credit standards for households to some extent. Credit standards are expected to ease to a higher level for consumer credit than for housing loans, with a positive index of 0.23 and 0.12, respectively. Credit standards are expected to be positively affected by the increase of competitive pressures and the good outlook of the banking market in the country. At the same time, banks expect an increase of loans approval rate, albeit at a lower level compared to the actual values marked in Q4 2021. More precisely, the results of the responses generated a positive index of 0.18 for consumer credit and 0.10 for housing loans.

Terms and conditions

Terms and conditions generally eased for new loans to households in the fourth quarter of 2021. The ease of terms and conditions was approximate for housing loans and consumer credit, based on the index level that was generated. Almost all the terms and conditions conveyed in the survey were eased, except for other payments other than interest, which remained unchanged. Specifically, as regards to housing loans, banks applied lower interest rates (positive index of 0.23), reduced collateral requirements (positive index of 0.19), increased the amount of approved loans and extended loans maturity (low positive index of 0.10). While for consumer credit, banks applied an ease at a lower level, mainly in collateral requirements (positive index of 0.19), and in interest rate, amount and maturity (positive index of 0.16) (chart 5).

Chart 5. Changes of terms and conditions applied to households



Source: CBK.

*Expected value

The main factors that contributed to the easing of the terms and conditions applied are mainly the increased competitive pressure, the good local market outlook in general and the banking market in particular, as well as the satisfactory liquidity position of the sector. Also, these easing of terms and conditions were affected by the ease of Covid-19 containment measures.

For the first quarter of 2021, banks expect terms and conditions for loans to households to ease at a lower level compared to the current quarter. The ease of terms and conditions is expected to be higher for housing loans. Mainly, terms and conditions for housing loans are expected to be eased by lowering the interest rate and increasing the approved amount with a positive index of 0.13. Whereas, for consumer credit it is expected an ease in interest rate with a low positive index of 0.10. The good market outlook in the country, as well as the increase of competitive pressures in the banking market are expected to be the driving factors of the easing of terms and conditions applied by banks during Q1 2022.

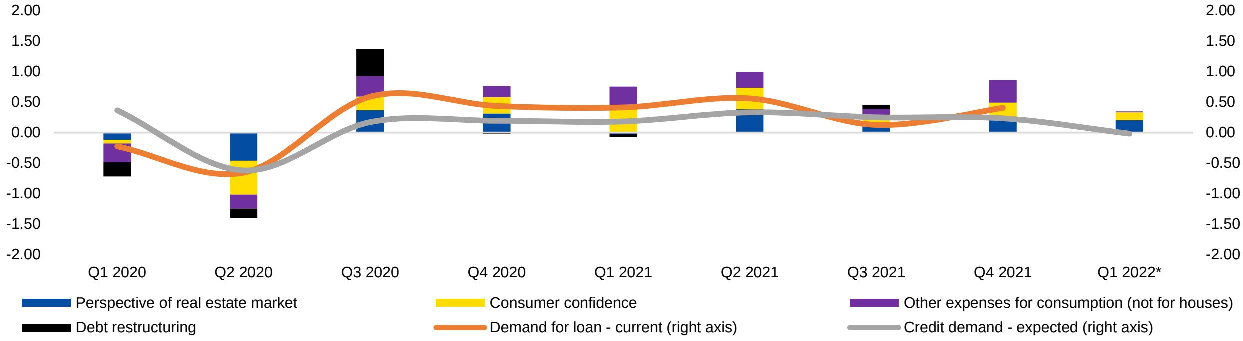
Demand for loans

Banks in this quarter reported a significant increase in demand from households compared to the low growth in demand during the previous quarter (Q3 2021). Seven out of a total of ten banks participating in the survey, stated a growth in the demand for loans in general, which after indexing the responses resulted in a positive index of 0.55. Banks have reported a higher increase of demand for consumer credit compared to the demand for housing loans, with a positive index of 0.47 and 0.33, respectively. If the current result of loans demand are compared with the expectations of banks stated in the previous survey for the same period, the current level of the increase in demand is higher, being affected by the actual value of the demand for both categories which are higher than the expectations stated by the banks (chart 6).

This increase was positively influenced primarily by three of the factors listed in the survey, namely the need for consumer financing, the increase in consumer confidence, as well as the improvement of the outlook in the real estate market, with a positive index of 0.37, 0.28 and 0.21, respectively. The quality of loan applications received by households during this quarter improved for both types of loans at a similar level, with a positive index of 0.23 for housing loan applications and a positive index of 0.22 for consumer credit applications.

Regarding the loans portfolio quality for households, banks stated improvement, reflecting the responses of three banks with systemic importance for a decline in nonperforming loans to total loans ratio for households, which resulted in a negative index of 0.21.

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



Source: CBK.

*Expected value

In the first quarter of 2021, banks do not expect a significant change in the demand for loans from households. However, this result was influenced by the expectations of two systemically important banks and a large share in lending to the sector, which expect a decline in credit demand, offsetting the increase in demand for loans stated by four other banks. Results of the survey suggest that banks have attributed these expectations to outlook of the real estate market, and to the consumers' confidence.

Unlike the current quarter (Q4 2021), banks expect loans portfolio quality of household to remain unchanged in the first quarter of 2022. At the same time, banks stated that they expect an improvement to a low extent of loans quality applications from households, namely for consumer credit with a positive index of 0.11.

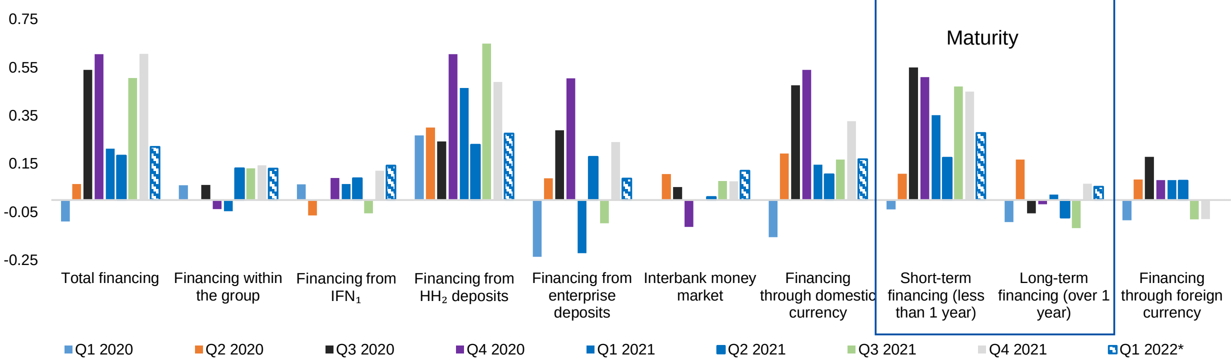
Financing

Banks reported a significant increase of access to financing during the fourth quarter of 2021. Taking into account the traditional model of the banking sector in Kosovo, the financing continued to be dominated by household deposits. All the banks participating in the survey reported an increase in financing during this quarter, one of them (a bank with high weight and of systemic importance) stated a significant increase in financing.

Financing increased significantly also during the previous quarter, however, the growth recorded in this quarter resulted to have been much higher. Total financing generated a high positive index of 0.61, where short-term household deposits dominated with a positive index of 0.49. This result was impacted by the responses of seven banks out of total ten banks which participated in the survey. In contrast to the previous quarter, financing from corporate deposits increased to a significantly higher level of 0.24 (negative index of 0.10 in Q3 2021), also reflecting the responses of the seven participating banks. At the same time, financing from international financial institutions and parent banks contributed positively to the financing of the banking sector, albeit with a low index of 0.12 and 0.14, respectively (chart 7). By maturity, short-term deposits were the main financing source during this quarter with positive index of 0.45.

For the next quarter, banks generally expect growth in access to financing, but at a significant slower pace than in the current quarter. Financing through household deposits is expected to lead the increase in financing of the banking sector with a positive index of 0.28, while financing from corporate deposits is expected to have marginal movements with a positive index of 0.09. Banks also stated that they expect the increase in financing to be dominated by short-term deposits with a positive index of 0.28 (chart 7).

Chart 7. Changes in financing the banking sector



Source: CBK.

*Expected value

Results of focused questions

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

With the easing of containment measures in the country and abroad during 2021, economic activity had a strong recovery in 2021, reflected in high GDP growth on a quarterly basis, especially in the second quarter. This increase was supported by increased domestic demand, Government facilitation measures, CBK measures through moratorium and loan restructuring, as well as high financing from diaspora inflows. However, both domestically and globally, this recovery and other pandemic-related factors were translated into overall price increases. Given that price increases negatively affect the consumers' purchasing power, it is important to understand the behavior of the banking sector in doing business in these dynamics, and the sector's perception of the customers' solvency.

Banks stated that during the fourth quarter there was no change in credit supply and that no significant change in credit demand was observed as a result of increased prices in the country. However, almost all banks noted that the effect of price increases is more likely to be reflected in the behavior of the banking sector during Q1 2022 and Q2 2022. Banks expect the highest change in demand for loans, especially from households. According to banks, households are expected to increase the demand for loans, more precisely for consumer credit with short-term maturity as a result of the decrease of the purchasing power. On the other hand, one of the banks emphasized that it expects customers to postpone their planned investments until a period of stabilization of prices in the market.

Another aspect covered by additional questions was the impact of price increases on customers' solvency. Banks' sentiment from the responses received shows that banks believe in the absorption capacity of their customers, in the short-term period. Banks supported these expectations in their process of reviewing loan applications and ensuring that customers are not over-indebted against their respective income that they have. However, some of the banks stated that they expect that during the first half of 2022, given the continuing inflationary pressures in the country and abroad, to negatively affect the customers' solvency, and consequently the loan portfolio quality of the banks.

The disaggregated replies of banks for enterprises classified by sectors, indicate the direction of financing the economy and dynamics in certain sectors. During the fourth quarter, based on the easing of credit standards, the manufacturing sector presents the sector with the most favorable offer. The replies of four banks, of which two with systemic importance and with a high weight to the total lending of the sector, reflected easing of credit standards for this sector, one of them stated considerable ease, which resulted in a positive index of 0.29. Furthermore, for loans to services and trade sector were applied eased credit standards as well, namely with a positive index of 0.20 and 0.16, respectively. At the same time, also terms and conditions were eased at higher level for lending to manufacturing sector with a positive index of 0.35. Other sectors with eased terms and conditions were the trade sector and services sector, which resulted with a positive index of 0.29 and 0.25, respectively. The demand for loans marked an increase for all of the sectors. The sectors with the highest demand for financing were manufacturing and trade with a positive index of 0.39. Also, the residential real estate and services sectors were characterized with an increased demand during Q4 2021, translated into positive indices of 0.29 and 0.26, respectively.

For Q1 2022, banks expect an ease of credit standards mainly for the manufacturing and trade sectors. Similarly, also for the manufacturing sector, terms and conditions are expected to be eased to a larger extent, while for trade and services sectors terms and conditions are expected to ease at a lower rate. In the same period, credit demand is not expected to change significantly, where according to banks expectations most of the sectors were translated into marginal indices. Demand for financing the real estate sector is expected to mark a decline, however this expectation from banks' responses was characterized by a negative marginal index of 0.10.

Inflation Expectations

In order to enhance the analytical capacities and based on the best regional practices and beyond, the CBK surveys the financial institutions in the country, based on the hypothesis that financial institutions convey the best practices from parent banks and have proper expertise to design inflation dynamics. As a result, since the third quarter of 2019, BLS has been enriched with supplementary questions, which address commercial banks expectations on price developments in the country, thus supporting and supplementing our analysis, in modeling and forecasting.

In the last questionnaire, besides the statements of the banks relating their estimates on the level of inflation for the previous quarter, the questionnaire addresses also the overall expectations of the banks for the first 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 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 January 2022, banks have estimated a higher level of inflation in the fourth quarter of 2021 compared to the previous quarters, and expect an even higher increase, in the first quarter of 2022. Dynamics that have characterized the price fluctuations during the reporting period were reflected in inflationary expectations of commercial banks: 5.1% in Q1 2022 from 5.0% as it had been estimated for the previous quarter (table 2). For 2022 , banks expect that the level of inflation rate will reach 3.8% from 3.4% as it was in 2021. The survey realized conveys also the potential effects that banks expect after they have faced with the new situation caused by Covid-19 pandemic.

Data published by the Kosovo Agency of Statistics (KAS), for the fourth quarter of 2021, suggest that the average annual inflation rate was around 6.4%, which shows an underestimation of banks as regards to the inflation rate. For the first quarter of 2022, banks expect the average inflation rate to be 5.1%. Most banks (6 of them) expect inflation to be above 4 percent, while other banks (4 of them) expect inflation to be in the range of 3 to 4%.

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

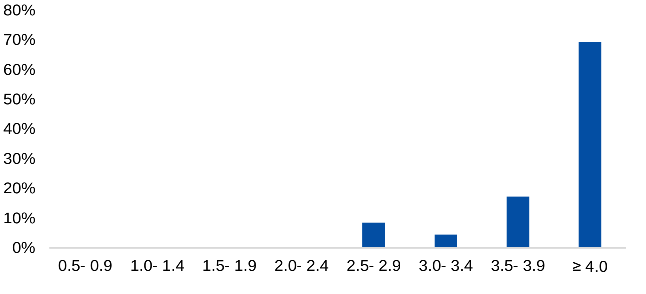
Banks	Q4 2021	Q1 2022	2022
1	3.5%	3.7%	3.5%
2	6.7%	6.5%	4.9%
3	3.4%	3.0%	2.7%
4	6.4%	8.6%	6.8%
5	6.7%	6.5%	3.5%
6	6.4%	5.5%	3.7%
7	3.4%	3.8%	3.5%
8	4.0%	4.0%	4.0%
9	6.7%	6.1%	2.5%
10	2.8%	3.1%	3.1%
Average	***5.0%***	***5.1%***	***3.8%***

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 cited some of the possible factors which may have an impact on the level increase of inflation:

Chart 8. Probability of inflation for Q1 2022 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.

- ✓ Temporary internal and external factors attributed to the growth of economic activity, as a result of the easing of pandemic measures, the decrease in the number of people infected with the virus and the vaccination of the population. A more optimistic view regarding the pandemics has had an impact on the increase of the economic activity and consequently of the level of inflation;
- ✓ There were supply constraints 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. Moreover, the increase in the cost of transport has led to an increase in prices, especially of oil, fuels, construction materials, etc.;
- ✓ The increase in prices of oil products but also of other categories is reflected in the overall increase in prices. Moreover, the increase of energy prices is expected to further influence other price increases. Price developments in international markets as well as low manufacturing in Kosovo and the high dependence of the country's economy on imports has had an impact on the increase of prices.

Expectations of the banks for Q1 2022 are in line with the higher trend of inflation while for the whole year of 2022 compared to 2021, taking into account the dynamics with which are being characterized prices in the country, it is thought that banks expectations are low.

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