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

Bank Lending Survey

Number 13

DECEMBER 2022

BANKA QENDRORE E REPUBLIKËS SË KOSOVËS
CENTRALNA BANKA REPUBLIKE KOSOVA
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Bank Lending Survey and Inflation Expectations

Number 13

PUBLISHER

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

In addition to the standard questions, this survey has been supplemented with six additional questions in an attempt to address the impact of inflationary pressures on lending dynamics and policies. Also, the banks elaborated on the indirect impact of inflation on the financing costs of the banking sector and the impact on credit risk. Furthermore, in these questions, the expectations of the banks on the energy crisis and the possible measures for the management of this risk were elaborated. Furthermore, one of the questions breaks down credit supply and demand by economic sectors.

Results Summary[2]

Inflationary pressures in the country and on the global level continued to determine the behavior of the main agents in the market. Increased risks to consumers' purchasing power result to have affected credit supply, while the shrinking value of disposable income appears to have dampened credit demand in the third quarter of 2022.

Annual growth of total loans stock continued with an accelerated pace until the the third quarter of 2022. Compared to the same quarter of the previous year, new loans also recorded an accelerated growth, while compared to the previous quarter, they recorded a decrease. These lending dynamics were largely influenced by credit demand, as credit supply tightened to some extent. While in contrast to the current quarter, for Q4 2022, banks expect that the demand for loans will increase, while the credit offer will remain mostly unchanged.

According to the banks, the dynamics of lending to enterprises during this quarter was largely influenced by the increased credit demand from large enterprises, while the credit supply was tightened at a low level. Within the credit supply, banks have reported that tightened credit standards were applied in assessing enterprise loan applications during the third quarter of 2022. Banks' responses resulted in a low negative index for changes in credit standards for both categories of enterprises (table 1). In the context of expectations for economic slowdown, the risks related to the poor market outlook in the country, as well as the decrease in risk tolerance had the main negative contribution to the credit standards. Meanwhile, the only factor with a positive impact on credit standards was the favorable access to financing of parent banks. At the same time, banks slightly decreased the approval rate of loans to enterprises, primarily for SMEs. For the fourth quarter of 2022, banks are expected to apply marginally positive changes in credit standards, mainly for SMEs (chart 1). The support from the KCGF and the competition pressure were the factors which had an

[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.

impact on these movements of credit standards. At the same time, the approval rate of loans to SMEs is expected to have mark an increase over the next quarter.

Terms and conditions applied by banks in granting loans to enterprises were tightened to some extent. Tightened terms and conditions were applied for both segments of enterprises, mainly through the decline of interest rates, while for large enterprises there was applied a limit of the approved loans amount. Meanwhile, an ease, albeit at a low level, was applied to collateral requirements and maturity of loans for both categories of enterprises. The factors that influenced the tightening of terms and conditions were the uncertain outlook of the local market and low tolerance for risk, while the favorable access to financing of the parent bank and the support from KCGF constitute the factors contributing to the easing of terms and conditions. In the following quarter, banks are expected to apply eased terms and conditions, albeit to a low level, for both categories of enterprises. Eased terms and conditions are expected to be applied for interest rates and to a lower level for the approved amount and collateral requirements for loans. The changes in terms and conditions of the enterprises are expected to be driven by the support from KCGF, the favorable access to internal financing (deposits), as well as by the good quality of the credit portfolio.

During the third quarter of 2022, there was marked a marginal increase of demand for bank loans by enterprises, albeit at lower level compared to the previous quarter. The demand for loans from enterprises turned out to have been approximate with banks' expectations for Q3 2022, expressed in the previous survey (Q2 2022). The index generated for the demand for loans from SMEs was influenced by the responses of two banks with a large weight and systemic importance which declared a decrease in demand to an extent, and by the response of five banks, one of them with systemic importance, which declared increased demand. This increase of demand, according to the banks' statements, was primarily driven by the increase in demand for financing the inventory and working capital. Banks expect significantly higher demand for loans in the following quarter, mainly for SMEs. An increase in demand is expected for financing the inventory and working capital, and for fixed investments as well.

The stock of loans to households recorded a significant annual increase in September 2022, but new loans to households during the third quarter of 2022 marked a decline compared to the previous quarter, whereas there was marked an increase 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 was tightened. 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 tightened mainly for house purchase loans, while for consumer credit they remained almost unchanged. These tightening were mainly impacted by the weak domestic market outlook, low risk tolerance, and to lower level the weak real estate market outlook. In the fourth quarter of 2022, banks do not expect important movement in credit standards for households. More precisely, there is expected a marginal ease of credit standards for consumer credit (table 1).

Terms and conditions generally tightened for new loans to households. The generated results mainly reflect tightening to higher level for housing loans compared to consumer credit. More specifically, banks applied tightening in terms and conditions for loans through the increase of interest rate and charges other than interest. Whereas, an ease to a lower level was applied by declining the collateral requirements. The main factors that negatively affected the terms and conditions for households were the unfavorable outlook of the market in the country in general, and of the real estate market in particular. The price increase in the country and the decrease of clients' confidence, were the factors that negatively contributed to this dynamic. Favorable access to financing of the parent banks contributed to the ease of terms and conditions applied by banks, during Q3 2022. For the fourth quarter of 2022, banks in general expect a minor changes in terms and conditions for loans to households. The tightening of terms and conditions is expected to be approximate for both categories of loans. Primarily, terms and conditions for both categories are expected to tighten through the increase of interest rate, albeit at a lower level than the values marked in Q3 2022, and to ease by declining the collateral requirements.

The demand for loans from households in general marked a marginal increase during the third quarter of 2022. However, if we break down the credit demand according to the types of loans to households, it turns out that the demand for consumer credit increased to a some extent, while the demand for housing loans marked a decrease. These dynamics for the demand for loans were reflected also in the factors which contributed to its direction. More specifically, the need to finance consumption was the factor that positively contributed, while the deterioration of the real estate outlook market was the factor that gave a negative contribution to the demand for loans. In the fourth quarter of 2022, banks expect an increase in demand for loans to households, at an approximate level for both types of loans. The survey results suggest that banks expect that the perspective of the real estate market and the need to finance consumer spending, to affect the demand for loans to some extent, during the next quarter.

Table 1. Banks assessment on credit supply and demand

	Supply (Credit standards)		Demand	
	Q3 2022	Q4 2022 (expectations)	Q3 2022	Q4 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.

Prudent monitoring of clients' financial performance helped to improve or maintain loan repayment performance. Consequently, banks reported an improvement of the loan portfolio quality, as the response index also in this quarter stood as negative and even at higher levels compared to the previous quarter, implying a decline of nonperforming loans to total loans ratio. This improvement was higher for households than for enterprises. Whereas, for the following quarter the generated index is expected to change direction and be shifted towards a positive level, reflecting banks' expectations for a deterioration of loan portfolio quality. These expectations were mainly impacted by the dynamics of prices increase in the country, along with the decline of clients' purchasing power. More precisely, banks expect a deterioration of loan portfolio quality for households at a higher level compared to enterprises.

Banks reported a significant increase of access to financing during the third quarter of 2022, exceeding the level of the previous quarter (Q2 2022). The aggregated result of the banks' responses was affected by the responses of eight banks which stated an increase in financing, and by one systemically important bank which stated a decrease to some extent in access to financing. Financing from almost all financing sources marked an increase. Household deposits marked a higher increase, being followed by enterprise deposits. Financing from parent banks also contributed to the increase in financing, although at a lower level compared to the previous quarter, as stated by only two banks. By maturity, long term deposits presented a financing source which marked the highest increase during this quarter. During the next quarter, banks in general expect an increase in access to financing to a lower level compared to the current quarter. Financing through the household deposits is expected to lead the increase of banking sector financing, followed by financing from international financial institutions. Regarding the maturity of financing, banks expect that also during this quarter deposits with long-term maturity will dominate the increase in financing. There was observed an incentive dynamic from favorable offers applied by banks to withdraw deposits.

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

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

bank based on its share on the credit market is multiplied with the value determined based on the intensity of the given answer, thus obtaining the index in question.

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

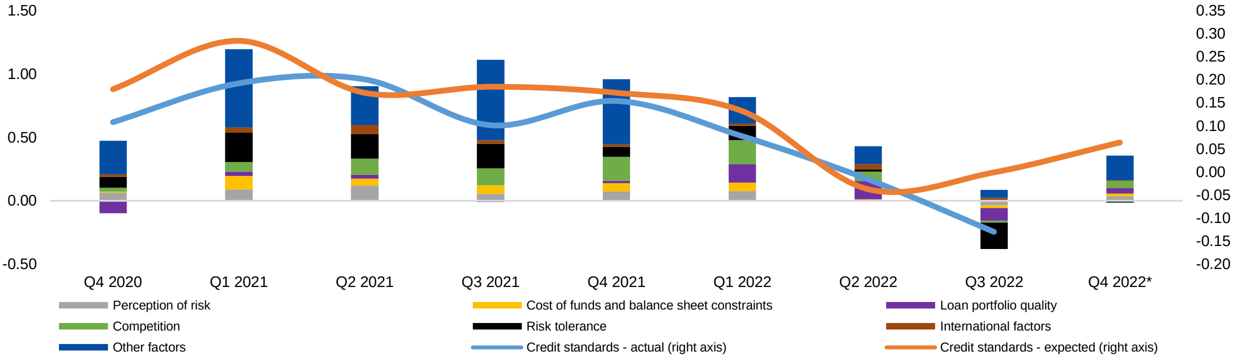
Developments in credit standards, credit terms and conditions, and in the demand for loans

Loans to enterprises

Credit standards

During the third quarter of 2022, the result on credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises in general represent tightened credit standards to some extent. Whereas in the previous survey (Q2 2022), banks had stated that they expect mainly unchanged credit standards (chart 1).

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



Source: CBK.

*Expected value

Within enterprise loans, banks reported a negative index of 0.14 for changes in credit standards for SMEs and a negative index of 0.12 for large enterprises. More precisely, the result for SMEs was impacted by the replies of three participating banks, two of them with systemic importance, which stated tightening to some extent of credit standards for large enterprises. Also, for large enterprises two banks stated a tightening to some extent. The main factors that negatively affected credit standards were the decrease in risk tolerance and the increased risk in the domestic market outlook with a negative index of 0.21 and 0.14, respectively, reflecting the impact of rising prices in the country. Whereas, the only factor with an index to a higher extent that had a positive impact, providing security to the banking sector, was the favorable access to financing of parent banks with a positive index of 0.14.

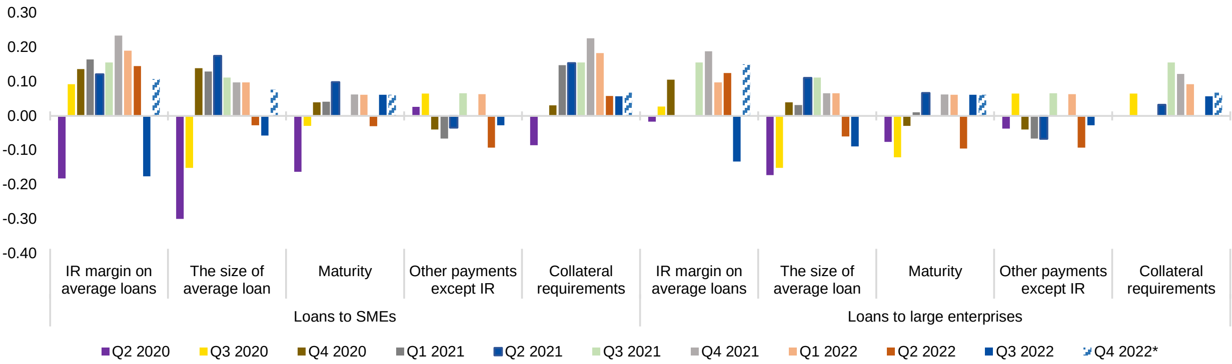
The approval rate of loans to enterprises resulted to have been marginally tightened. Precisely, this result reflects the replies of two banks with a large weight and systemic importance, which neutralized the replies of three other banks that declared an increase to some extent in the loan approval rate. The approval rate of loans to SMEs was impacted by the replies of six participating banks (two of them systemically important banks) which stated a decrease, while four of the banks stated an increase in the approval rate (of which one with systemic importance). Meanwhile, the approval rate of loans to large enterprises did not mark important movements in this quarter.

Overall credit standards are expected to mark marginal positive changes in the following quarter. More specifically, an ease is expected to be marked in credit standards for SMEs, being impacted by two banks with systemic importance. The support from the KCGF and the competition pressure were the factors which positively affected credit standards. At the same time, the approval rate of loans is expected to mark an increase over the next quarter, primarily for SMEs.

Terms and conditions

In the third quarter 2022, the overall terms and conditions applied by banks in issuing loans to enterprises (the specific terms and conditions of a contract for loans) were tightened, albeit to a low level (chart 2). The banking sector applied an approximate tightening of terms and conditions for new loans to both SMEs and large enterprises. Namely, for both categories of enterprises there was marked a tightening to some extent in the applied interest rate (a negative index of 0.18 for SMEs and 0.13 for large enterprises), while for large enterprises was applied also a limit in the approved loans amount (a negative index of 0.09). An ease, to a low level, was applied to collateral requirements and maturity of loans for both categories of enterprises.

Chart 2. Changes of terms and conditions applied to enterprises



Source: CBK.

The factors with the main contribution to the tightening of terms and conditions in this quarter were the uncertainty of the local market outlook and the low risk tolerance with a negative index of 0.13 and 0.20, respectively. Meanwhile, a positive contribution was given by the favorable access to financing of the parent bank and the support from the KCGF with a positive index of 0.15 and 0.16, respectively.

Banks are expected to apply eased terms and conditions during the following quarter, albeit at low levels. In this context, banks stated that they expect an approximate ease for SMEs and large enterprises as well. Three banks, two of them with systemic importance and a high weight in lending, expect a decline in interest rates for loans to some extent, while the third bank stated that it expects an increase of interest rate for SMEs, which generated a low positive index of 0.11 for SMEs and 0.15 for large enterprises. Lower requirements for collateral are expected for both categories of enterprises with a positive marginal index of 0.07, while the amount approved for new loans is expected to increase only for SMEs. These expectations of banks were based on the support given by the KCGF, the favorable internal financing (deposits), and the good loan portfolio quality.

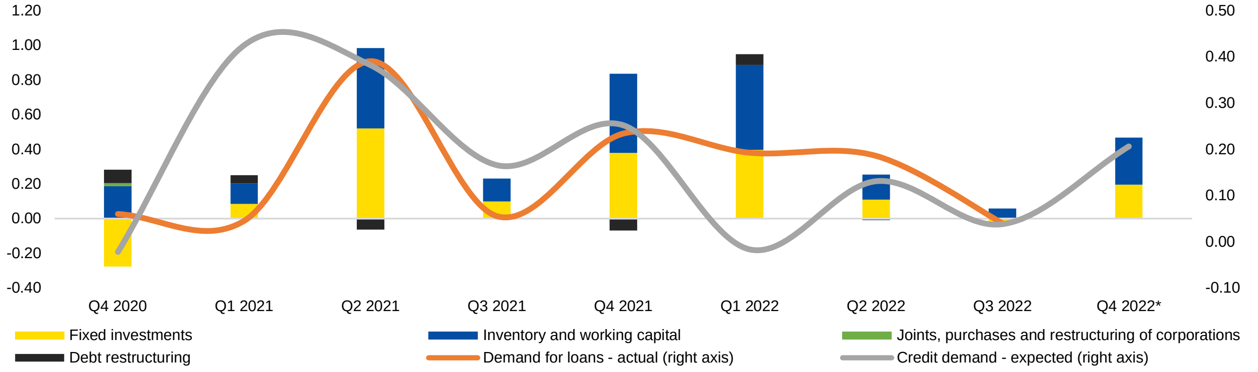
Demand for loans

During the third quarter of 2022, **the enterprises demand for loans** results to have been increased marginally, representing a lower level compared to Q2 2022. The demand for loans turned out to have been approximate with banks' expectations for Q3 2022, expressed in the previous survey (Q2 2022) (chart 3). The demand for loans from SMEs marked a marginal negative index of 0.04, whereas the demand for loans from large enterprises generated a positive index of 0.12. The index generated for the demand for loans from SMEs was influenced by the responses of two banks with a large weight and systemic importance which declared a decrease in demand to an extent, and by the response of five banks, one of them with systemic importance, which declared increased demand.

According to the results of the survey, changes in the demand for loans from enterprises were mainly driven by the demand for financing inventories and working capital with a positive marginal index of 0.06, while the demand for financing fixed investments remained largely unchanged. The result of the contributing factors to the credit demand was determined by the replies of five banks which stated a growth of the demand for financing inventories and working capital and of four banks which stated an increase of demand for financing fixed investments. However, two banks with high weight in lending stated that for two above mentioned factors there was to some extent a lower demand, which resulted with marginal indices. The quality of the applications submitted by enterprises did not mark significant changes, in Q3 2022.

According to the survey, during Q3 2022 the nonperforming loans to total loans ratio of enterprises is decreasing with a low negative index of 0.11, however, this result represents an improvement compared to the result of the previous survey where banks' replies generated a marginal negative index of 0.04 of this ratio. This result was impacted by the replies of seven banks, where three of the banks with systemic importance stated a decrease in nonperforming loans, while four other banks, one of them with systemic importance, stated an increase.

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



Source: CBK.

*Expected value

Banks expect a significant increase of the demand for loans from enterprises during the next quarter. These expectations were impacted by the replies of seven banks, where five of them are with systemic importance, expect an increase to some extent of the demand for loans. Consequently, these replies resulted in a higher positive index, if it is compared to the actual demand for loans, namely it resulted with a positive index of 0.32 for Q4 2022. The increase of the demand for loans is expected to finance investments in the working capital and inventory, and fixed investments as well. At the same time, banks do not expect a significant change regarding the quality of enterprise applications for loans.

During the following quarter banks expect nonperforming loans to total loans ratio for enterprises to change direction and be shifted to a positive index of 0.11, thus reflecting banks' expectations on the deterioration of loan portfolio quality. These expectations were mainly impacted by the dynamics of prices increase in the country, along with the decline of clients' purchasing power. Three banks, of which two systemically important banks, stated expectations for an increase of nonperforming loans of enterprises, while one bank which is of systemic importance stated expectations on the decline of NPL.

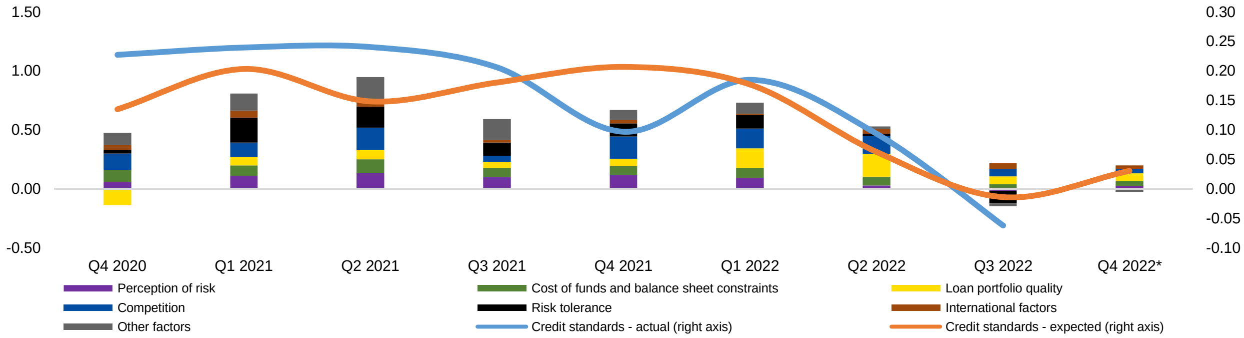
Loans to households

Credit standards

Credit standards applied to households generally tightened, during the third quarter of 2022. The tightening of credit standards was primarily applied for housing loans with a negative index of 0.14, while credit standards for consumer credit remained almost unchanged. The result mainly reflects the replies of two banks with systemic importance which tightened credit standards, and of two other banks with systemic importance, as well, eased credit standards. Expectations for the third quarter of 2022 as stated by banks in the previous survey, resulted to be of an approximate level with the actual values (chart 4). Factors that contributed negatively to credit standards were the poor outlook of the local market with a negative index of 0.13, low risk tolerance with a negative index of 0.11, as well as the poor outlook of the real estate market with a low negative index of 0.09.

Banks stated that they have increased the approval rate of loans for households, only for consumer credit, with a low positive index of 0.10, while the approval rate of housing loans resulted in a marginal negative index of 0.06.

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



Source: CBK. *Expected value

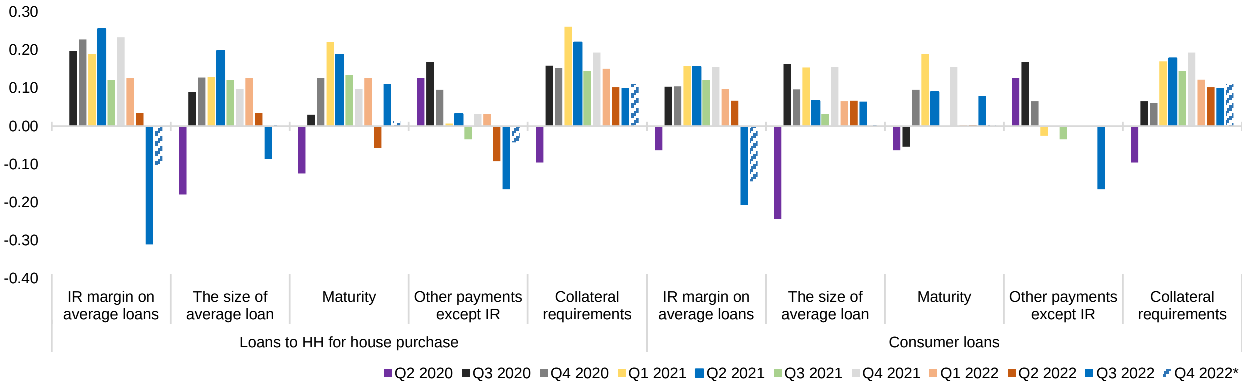
In the fourth quarter of 2022, banks do not expect important movement in credit standards. More precisely, there is expected a marginal ease of credit standards for consumer credit. In line with these expectations, also the listed factors in the survey generated marginal indices Whereas, banks expect a lower increase in the approval rate of loans for consumer credit. More precisely, it is expected a same increase of approval rate of loans for both categories of loans with a positive index of 0.09.

Terms and conditions

Terms and conditions for new loans to households generally tightened to some extent. The generated results mainly reflect tightenings to higher level for housing loans compared to consumer credit. Precisely, for housing loans, banks applied higher interest rates (negative index of 0.31) and higher charges other than interest (negative index of 0.17), while eased the maturity and collateral requirements (positive index of 0.11 and 0.10, respectively). For consumer credit, banks applied higher interest rates (negative index of 0.21) and higher charges other than interest (negative index of 0.17), while eased collateral requirements (positive index of 0.10) (chart 5).

According to the banks, the main factors that negatively affected the terms and conditions for households were the unfavorable outlook of the market in the country in general, and of the real estate market in particular. The price increase in the country and the decrease of clients' confidence, were the factors that negatively contributed to this dynamic. Favorable access to financing of the parent banks contributed to the ease of terms and conditions applied by banks, during Q3 2022.

Chart 5. Changes of terms and conditions applied to households



Source: CBK. *Expected value

For the fourth quarter of 2022, banks in general expect a tightening in terms and conditions for loans to households. The tightening of terms and conditions is expected to be approximate for both categories of loans. Primarily, terms and conditions for both categories are expected to tighten through the increase of interest rate, albeit at a lower level than the values marked in Q3 2022, while it expected to slightly ease the collateral requirements. After indexing the answers of the banks, it results that mainly the factors listed in the survey are not expected to change during the next quarter, except for the increased pressure of competition, which is expected to have a positive contribution to the terms and conditions for households.

Demand for loans

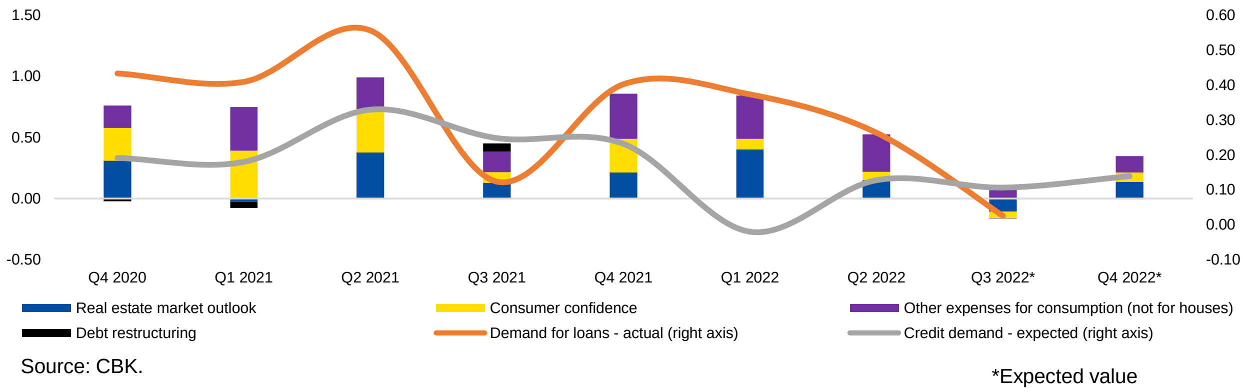
After generating the results for the credit demand in this quarter, it turns out that the credit demand in general has marked a marginal increase. However, if we break down the credit demand according to the types of loans to households, it turns out that the demand for consumer credit marked an increase with a positive index of 0.20, while the demand for housing loans marked a decrease with a negative index of 0.14. More specifically, five banks, of which two with systemic importance reported an increase of demand for consumer credit. Whereas, three banks, of which two with systemic importance, stated a decline of demand for housing loans against two banks, of which one with systemic importance, which stated an increase for the same ones. If the current result of the demand for loans are compared with the expectations of banks stated in the previous survey for the same period, the current level of the increase in demand is lower, being affected by the actual value of the demand for housing loans which was not expected by the banks (chart 6).

These dynamics for the demand for loans were reflected also in the factors which contributed to its direction. More specifically, the need to finance consumer spending was the factor that positively contributed (positive index of 0.11), while the deterioration of the real estate outlook market was the factor that gave a negative contribution (negative index of 0.11) The quality of applications submitted by the households for housing loans during this quarter turns out to have deteriorated with a negative marginal index of 0.08, while the quality of applications for consumer credit remained largely unchanged.

As regards to the loans portfolio quality for households, banks stated an improvement with a negative index of 0.25, thus reflecting the replies of four banks with systemic importance for a decline of nonperforming loans to total loans ratio and two other banks which stated an increase of this ratio.

In the fourth quarter of 2022, banks expect an increase in demand for loans to households, for both types of loans at an approximate level. Expectations for an increase of the demand for loans in general were affected by the replies of six banks (two of them with systemic importance), which resulted with a positive index of 0.23. The survey results suggest that banks expect the need to finance consumer spending and the real estate market outlook to to affect to some extent the demand for loans during the next quarter. Banks stated that they expect an improvement, albeit at low level of applications received for loans, mainly for consumer credit.

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



Source: CBK.

Regarding the quality of loan portfolio in Q4 2022, banks expect that the loan portfolio quality of households will be characterized by a deterioration, based on the change of the index direction from negative to positive compared to the current quarter. More precisely, the banks' expectations for the nonperforming loans to total loans ratio resulted in a positive index of 0.18, stated by five banks (two of them with systemic importance) expecting an increase in this ratio, whereas one systemically important bank expects a decrease of it.

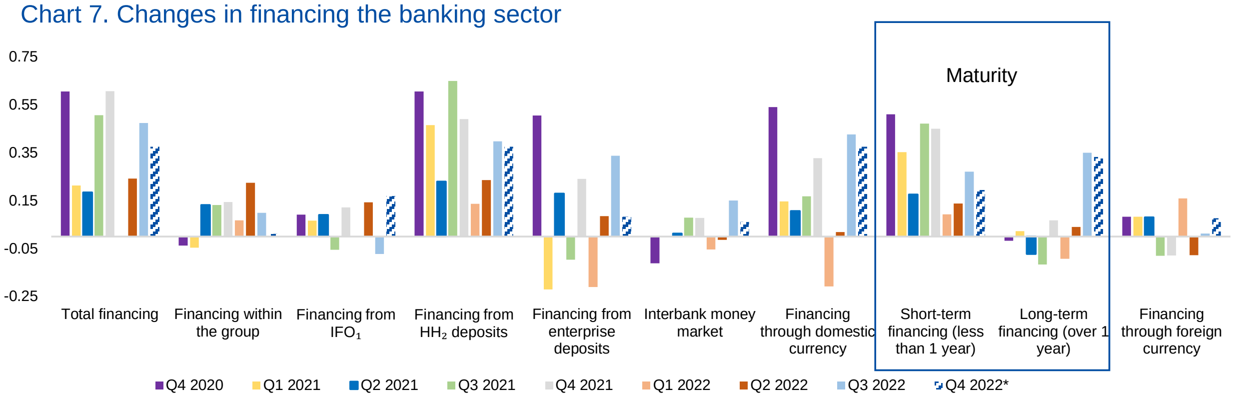
Financing

Banks reported a significant increase of access to financing during the third quarter of 2022. The aggregated result of the banks' replies was affected by the responses of eight banks which stated an increase in financing, where one of the banks with systemic importance stated a considerable increase of financing. Whereas, one of the banks, with systemic importance as well, stated a decline to some extent of financing. All the financing sources of the banking sector contributed to the growth.

Based on the aggregated result of the replies, during this quarter total financing marked an almost double increase compared to the previous quarter. Household deposits generated a positive index of 0.40 (positive index of 0.24 marked in Q2 2022). This result was impacted by the responses of nine out of a total of ten banks participating in the survey, where eight banks stated an increase in household deposits and one stated a decrease to some extent. While, financing from enterprise deposits compared to the previous quarter increased significantly with a positive index of 0.34 (positive index of 0.08 in Q2 2022), reflecting the replies of eight participating banks, seven banks stated an increase (one bank with systemic importance stated a significant increase), while one bank stated a decrease in financing from this category. Financing from parent banks also contributed to the increase in financing, although at a lower level compared to the previous quarter, as stated by only two banks, namely with a positive index of 0.10 and 0.24 as it was in Q2 2022. Whereas, financing from international financial institutions marked a marginal decline, as stated by only one bank with systemic importance with a negative index of 0.07 (chart 7). Unlike in the previous quarter, in this quarter dominated the financing with long-term maturity. More specifically, long-term deposits generated a positive index of 0.35, while short-term deposits generated a positive index of 0.27.

For the next quarter, banks in general expect an increase in access to financing to a lower level compared to the current quarter with a positive index of 0.38. Financing through household deposits is expected to lead the increase in financing of the banking sector with a positive index of 0.38, followed by financing from international financial institutions with a positive index of 0.17. As regards the maturity of financing, banks expect that also during this quarter deposits with long-term maturity will dominate the increase in financing with a positive index of 0.33, while financing with short-term maturity is expected to increase with a positive index of 0.19 (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 2022, has been supplemented with six additional questions in an attempt to address the impact of inflationary pressures on lending dynamics and policies. Also, the banks elaborated on the indirect impact of inflation on the financing costs of the banking sector and the impact on credit risk. Furthermore, in these questions, the expectations of the banks on the energy crisis and the possible measures for the management of this risk were elaborated. Furthermore, one of the questions breaks down credit supply and demand by economic sectors.

On the global and domestic level prices have been increased since the second half of the previous year. Since the increase in prices negatively affects the purchasing power of consumers, it is important to understand the behavior of the banking sector to manage the increased risk, as well as the perception of the banking sector on the customers solvency, thus the expectations for the possible materialization of credit risk.

In this aspect, the banking sector has already started to take measures for managing the increasing risk which comes from the prices increase. A considerable number of banks stated that they have applied a more vigilant observation of the clients financial performance and are more conservative in the process of assessment of the solvency capacity, especially towards the households. Also, banks have increased the interest rates on loans, and more over one of that banks applies changes in the structure of interest rates on loans based on the client status, implying a shortage of the period with fixed rate against lengthening of the period with a variable interest rate. Among other measures undertaken, there is a more conservative distribution of provisions, such as provisioning which targets certain segments of customers with lower salaries, further reduction of the debt-to-income ratio for customers with a certain level of income, the increase of acceptable income criteria for credit approval, as well as diversification of the credit portfolio to reduce exposure in the most affected sectors. When asked about the sectors mostly affected, banks stated that all the sectors were affected by the increase of prices. Nevertheless, they also stated that the construction sector, manufacturing and transport sector were the ones more vulnerable against the price increases. The household sector, was also mentioned as one of the sectors mostly affected.

The majority of the banks stated that the inflation impact did not reflect on the dynamic for loans demand up to this quarter. In line with this, lending dynamics supported the expectations of banks, which were not based on the price increase, but on the usual dynamics of the economic seasonality. However, relying the banks replies, more uncertainty can be observed regarding the expectations of the demand for loans, where some banks expect an increased demand for loans, and at the same time there are banks that expect a postponement of the demand for loans until a period of price stabilization is in the market. Moreover, given the impact of price increases on clients income, and consequently on the deposits level, a number of banks shifted their focus from expanding lending activity to providing financing through deposits. A development was also observed by the increase in interest rates on deposits and campaigns specially adapted for the withdrawal of deposits.

Another aspect covered by supplemented questions was the impact of price increases on customers solvency, and consequently the increase of credit risk. Banks' sentiment from the replies which were received indicates that banks expect a rise in credit risk, amplified by the expected energy crisis, to start to be materialized in the first quarter of 2023 and further deteriorate in the second half of the year.

The continuous increase in prices in the market affects the reduction of available income, which is reflected in the limitation of funds held in the banking sector. Consequently, in order to secure financing from deposits, banks have started and are expected to continue with favorable offers for withdrawing deposits, mainly through the increase of interest rates on deposits, which is translated into an increase in the cost of bank financing. In addition, the increase of the interest rates by the ECB, as well as by other monetary authorities, also affected the cost of financing, increasing the costs of financing from parent banks and international financial institutions. In this respect, the majority of banks stated an increase in financing costs, thus signaling a fluctuation in their financial performance, since the increased costs cannot be fully transmitted to clients due to competitive pressures and clients sensitivity to high interest rates. It is worth noting a bank statement according to which its cost increased by 30%. Whereas, only two of the banks stated that their financing has not changed.

Expectations of an energy crisis, caused by the uncertainty of electricity supply and rising energy prices, are already reflected in the banks' replies. Banks have stated that all of the sectors are expected to be affected, taking into account the implication of this input to all of the sectors. However, they noted that the manufacturing sector, construction, supply with electricity, and households are the sectors mostly sensitive. As a preventive measure, banks identified the most vulnerable clients and offered them support based on their needs, mainly through possible restructuring, financing of alternative energy sources and short-term liquidity provision. Moreover, they will also monitor closely and take decisions on new financing, especially for the affected sectors, in a more conservative way.

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 2022 credit standards for all the economic sectors were tightened. Based on the tightening of credit standards, construction and real estate sectors account for sectors with the least favorable offer. The replies of five banks for the construction sector (two banks with systemic importance, one of them stated significant tightening) and three banks for the real estate sector, of which two banks with systemic importance and with a high weight in the total lending of the sector, reflected the tightening of credit standards for these sectors, resulting in a negative index of 0.37 and 0.15, respectively. At the same time, terms and conditions were tightened for all economic sectors, especially for the construction sector with a negative index of 0.29, and for the manufacturing sector, services and commercial real estate sectors with a negative index of 0.19. The demand for loans marked a decline from the economic sectors and a low increase from two other sectors. The sectors with reduced demand for financing were the manufacturing sector with a negative index of 0.15, followed by the construction and services sector with a low negative index of 0.06 and 0.07, respectively. While, the real estate sector resulted with a low positive index of 0.10, influenced by the replies of two systemic banks, one of them with a large weight in the sector stated a significant increase in demand, thus neutralizing the responses of the other two banks also with systemic importance which stated a decrease in demand to some extent for this sector.

Based on the generated results, during Q4 2022, banks are expected to apply an offer to a tight extent for the construction sector, while a more affordable offer, albeit at a marginal level, is expected for the services, trade and manufacturing sectors. Terms and conditions are expected to be eased mainly for the manufacturing and services sector, while at the marginal level there are expected to be restrictions for the construction sector. At the same period, the demand for loans is expected to mark an increase for all of the sectors. Specifically, the demand for financing from the sectors of trade (positive index of 0.28), services and manufacturing (positive index of 0.21) is expected to have the highest growth in Q4 2022.

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, in addition to the statements of the banks regarding the estimates they have for the level of inflation in the current quarter, the questionnaire also addresses the expectations of the banks for the year 2022 in general as well as for the first quarter of 2023. The survey serves also as a tool to identify specific factors which potentially may affect bank expectations for the specified level of inflation.

Methodology

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

The importance of inflation expectations is higher for the countries which have adopted the strategy of targeting the inflation. For these countries, inflation expectations, among others, serve also as an indicator of the public confidence towards central banks. If it is believed that the central bank will act in order to achieve the objective, then also the expectations of the economic agents on the inflation rate would be closer to the objective. Inflation expectations are important also for banks which do not have monetary policy, given that they serve as an important input in defining the prices and salaries, and in the process of modeling and forecasting. Moreover, inflation expectations have an impact on the aggregate demand, which later affect the inflation trend.

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

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

Results Summary

Based on the survey conducted in October 2022, banks have estimated a higher level of inflation in the fourth quarter of 2022 compared to the previous quarter, and expect an even higher increase, in the first quarter of 2023. For 2022 , banks expect that the level of inflation rate will reach 11.0% from 3.4% as it was in 2021.

Data published by the Kosovo Agency of Statistics for the third quarter of 2022 suggest that the annual average inflation rate was around 13.3%. For the fourth quarter of 2022 , banks expect that the average inflation rate would be 11.3%. Most banks (8 of them) expect inflation to be above 10%, while other banks (2 of them) expect inflation to be below this level.

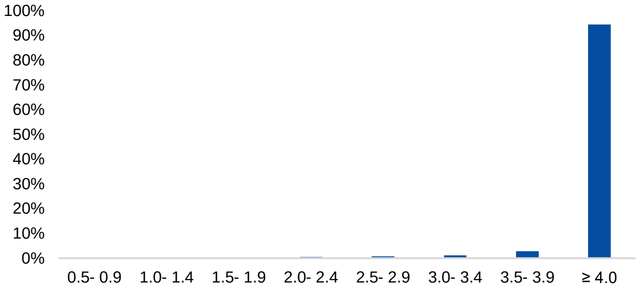
Table 2. Inflation expectations of banks, annual change in per cent

Banks	Q4 2022	Q1 2023	2022
1	10.0%	8.0%	10.0%
2	14.5%	13.2%	14.0%
3	4.2%	5.3%	7.0%
4	12.1%	5.5%	11.6%
5	13.0%	5.0%	13.0%
6	11.0%	10.2%	11.2%
7	12.0%	13.0%	12.0%
8	11.1%	7.6%	11.4%
9	12.7%	11.0%	7.0%
10	12.0%	13.0%	13.0%
Average	***11.3%***	***9.2%***	***11.0%***

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.

Chart 8. Probability of inflation for Q4 2022 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.

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

- ✓ The war in Ukraine is the main reason of the price increase. For the global economy, Russia and Ukraine are important suppliers of raw materials such as energy, metals and agricultural products, and the war has called into question the supply of these resources and accelerated prices increase. Due to the uncertainty of geopolitical risks, commodity prices may rise further and this may translate into higher operating costs of manufacturing, which translate into higher prices and higher inflationary expectations;

- ✓ The increase in prices of oil products but also of other categories is reflected in the overall increase in prices. The decision of the OPEC countries to cut the production of fuels by 2%, as well as the expectations for an increase in energy prices as a result of winter consumption may have an impact on further increases in inflation;
- ✓ The price developments in the international markets, as well as, the high dependence of the country's economy on imports as a result of low manufacturing capacities have influenced the increase in prices;
- ✓ Limitations on supply as a result of barriers created in supply chains coming from Covid-19 pandemic, where many companies are finding it difficult to find raw materials to produce their products, has also had an impact on the increase of prices. Moreover, the increase in the cost of sea transport has led to an increase in prices, especially of oil, fuels, construction materials, etc.

Taking into account the dynamics with which the prices are being characterized in the country, where in recent months a slower increase in prices has been observed, it is thought that the expectations of the banks are realistic.

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