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

Bank Lending Survey

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Bank Lending Survey and Inflation Expectations

Number 14

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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 for the fourth quarter of 2022, and banks expectations for credit dynamics in the first quarter of 2023.

In addition to the standard questions, this survey has been supplemented with three additional questions to address the impact of inflationary pressures in clients' behavior, consequently reflection on the increase of risks and expectations on materialization of credit risk. In one of the questions, banks elaborated the direct impact of inflation on the financing cost of the banking sector. Also, one of the questions breaks down credit supply and demand by economic sectors.

Results Summary[2]

The high rate of inflation that characterized the economy of Kosovo throughout the year 2022 has influenced the weakening of the purchasing power of agents in the market - translated into the weakening of the general demand in the country. These dynamics were reflected also in the behavior of banks, through the review of the credit policies against the demand for financing.

Annual growth of total loans stock continued with an accelerated pace until the fourth quarter of 2022. However, new loans compared to the same quarter of the previous year marked a decline, whereas they were the same compared to the previous quarter. This dynamic reflects a more cautious approach of consumers in undertaking additional debts. Credit activity was influenced to a greater extent by credit demand, since credit supply had no significant changes during this quarter. While in contrast to the current quarter, for Q1 2023, banks expect that the demand for loans will mark a marginal decline, while the credit offer will be characterized mainly with marginal positive movements.

According to the banks, the dynamics of lending to enterprises during this quarter was largely influenced by the increased credit demand from SMEs, while the credit supply remained mainly unchanged. Within the credit supply, banks have reported unchanged credit standards applied in assessing enterprise loan applications in the fourth quarter of 2022 (table 1). In the context of expectations for economic slowdown, the risks related to the not so good global market outlook, had the main negative contribution to credit standards. Whereas, the factors that had a positive impact to the credit standards were the good position of the sector's liquidity, competition pressures between banks, and support from the KCGF. Also, the approval rate of loans to enterprises turns out not to have undergone any significant changes during this quarter for both segments of enterprises. For the first quarter of 2023, banks are expected to apply marginal changes to credit standards, mainly positive changes for SMEs and negative for large enterprises (chart 1). Good liquidity position, KCGF support and competition pressure are factors that are expected to positively contribute to credit

[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.

standards, while uncertainties in the perspective of the local and global market are expected to contribute negatively. The approval rate of loans is expected to mark a marginal decline during the next quarter, primarily for large enterprises.

Terms and conditions applied by banks in the process of loans issuance to enterprises were characterized with marginal movements for both segments of enterprises. More specifically, there was applied a marginal ease in collateral requirements, as a result of the support given by the KCGF and competition pressure. In the following quarter, banks are expected to apply changes in terms and conditions for SMEs, by increasing interest rates on loans and also easing the collateral requirements. Positive changes in terms and conditions of loans to enterprises are expected to be inclined by KCGF support and competition pressures, while negative changes are expected to be driven from poor perspective of the global and local markets, as well as expectations for deteriorating of loan portfolio quality.

During the fourth quarter of 2022, there was marked an increase of demand for bank loans by enterprises, representing a significant higher level compared to the previous quarter. However, the demand for loans from enterprises turned out to have been lower compared to the banks' expectations for Q4 2022, expressed in the previous survey (Q3 2022). The generated index of the demand for loans from SMEs was impacted by the replies given by five banks which stated an increase of the demand. Meanwhile, the demand for loans to large enterprises was characterized with a marginal increase. This increase of demand, according to the banks' statements, was primarily driven by the increase in demand for financing the inventory and working capital. The generated index of banks' expectations on loans demand during the following quarter, show a marginal movement. This result was impacted by the replies of five banks, where two of them expect a decline in demand whereas three other banks expect an increase to some extent of the demand for loans. At the same time, banks expect a marginal deterioration of quality of applications received for loans, especially from SMEs.

The stock of loans to households marked an annual accelerated increase, in December 2022. This dynamic was mainly supported by credit demand, as the supply side of loans was characterized by marginal changes. 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 for both types of loans to households, stated by a bank with systemic importance, that was supported by the reduction of risk through the required collateral, mainly as a result of agreements with construction companies. In the first quarter of 2023, banks do not expect significant movements in credit standards for both types of loans to households (table 1).

Terms and conditions for new loans to households generally tightened to some extent. The generated results mainly reflect tightenings to a same level for both types of loans. Specifically, banks applied tightenings through the increase of interest rate. Whereas, a marginal ease was applied by declining the collateral requirements. The main factor in increasing the interest rate was the poor perspective of global markets, which for most banks means increasing the EURIBOR rate, a rate applied for loans with variable interest rate. For the first quarter of 2023, banks in general expect marginal tightenings in terms and conditions for loans to households. The tightenings of terms and conditions is expected to be, to some extent, higher for consumer credit. 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 Q4 2022, and to ease to a low level by declining the collateral requirements. Also, consumer loans are expected to marginally tighten the maturity size of approved loans, a response stated by a single bank but with systemic importance.

The demand for loans from households in general marked an increase during the fourth quarter of 2022. Broken down by the types of loans to households, it turns out that the demand for loans marked an approximate increase for both types of loans. More specifically, five banks, of which three with systemic importance, reported an increase of demand for both types of loans. The need to finance consumption and the perspective of the real estate market were the factors that contributed positively, while the decrease in confidence of clients about the capacity to repay loans was a factor that contributed negatively to the demand for loans. In the first quarter of 2023, banks do not expect a significant oscillations in the demand for loans from households. Banks generally expect negative marginal movements in the demand for loans, precisely these movements reflect the expectations for a marginal decline in the demand for loans for houses purchase (table 1). The survey results suggest that banks expect that the decline of consumers' confidence on the solvency will have an impact, to some extent, to the decline of the demand for loans during the following quarter. At the same time, banks expect a deterioration of the applications quality received for loans, mainly for house purchase.

Table 1. Banks assessment on credit supply and demand

	Supply (Credit standards)		Demand	
	Q4 2022	Q1 2023 (expectations)	Q4 2022	Q1 2023 (expectations)
Enterprises	→	↘	↑	→
SMEs	→	↗	↑	→
Large enterprises	→	↘	↗	→
Households	↗	→	↗	↘
Housing loans	↗	→	↗	↘
Consumer credit	↗	→	↑	→

↑ Easing of credit standards/Increase in demand for loans (positive index over 0.20)
↗ Easing of credit standards/Increase in demand for loans (positive index below 0.20)
→ Mainly unchanged (positive index /negative up to 0.05)
↘ Tightening of credit standards/Decrease in demand for loans (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 and a more conservative assessment of new applications for loans by banks helped to improve or maintain loan repayment performance. Consequently, banks reported an improvement of the loans quality portfolio, as the response index also in this quarter stood as negative, albeit at lower levels compared to the previous quarter. This improvement was higher for households segment than for the enterprises segment. 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 enterprises at a higher level compared to households. Six banks, out of which four with systemic importance, expect an increase in enterprise nonperforming loans, against five banks, also four of them with systemic importance, which expect the same for nonperforming loans to household.

Banks reported a significant increase of access to financing during the fourth quarter of 2022, exceeding the level of the previous quarter (Q3 2022). The aggregated result of the banks' replies was affected by the responses of eight banks which stated an increase in financing, where two of the banks with systemic importance stated a considerable increase of financing. Household deposits marked a higher increase, being followed by enterprise deposits. Financing from parent banks did not contribute to the growth of financing, as it has not resulted to have a significant movement. Whereas, financing from international financial institutions marked a marginal decline. By maturity, short-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, albeit to a significantly lower level compared to the actual quarter. Financing through the household deposits is expected to lead the increase of banking sector financing, followed by financing from the money markets. 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 to withdraw deposits from the banking 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.

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

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

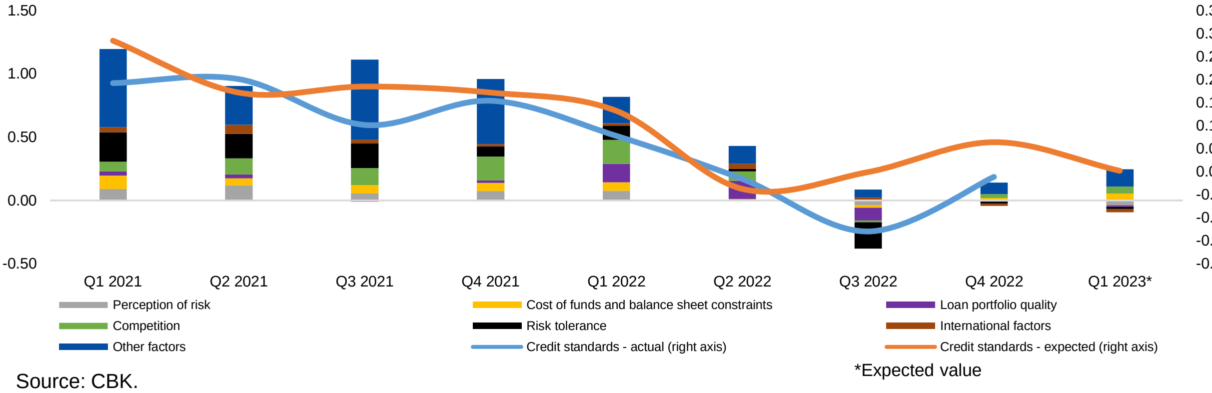
Developments in credit standards, credit terms and conditions, and in the demand for loans

Loans to enterprises

Credit standards

During the fourth quarter of 2022, the result on credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises in general represent no significant movements. Whereas in the previous survey (Q3 2022), banks had stated that they expect mainly eased credit standards, albeit at low levels (chart 1).

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



Source: CBK.

*Expected value

Within loans to enterprises, banks stated unchanged credit standards for both categories. This implies that tightened credit standards to some extent stated by banks (Q3 2022) continue to still remain. The main factor which had a negative impact on credit standards was the not so good perspective in the global markets, albeit it resulted with a negative marginal index of 0.07. Whereas, the factors that had, to some extent, a positive impact, thus providing security to the banking sector, were the competition pressures between banks, and support from the KCGF.

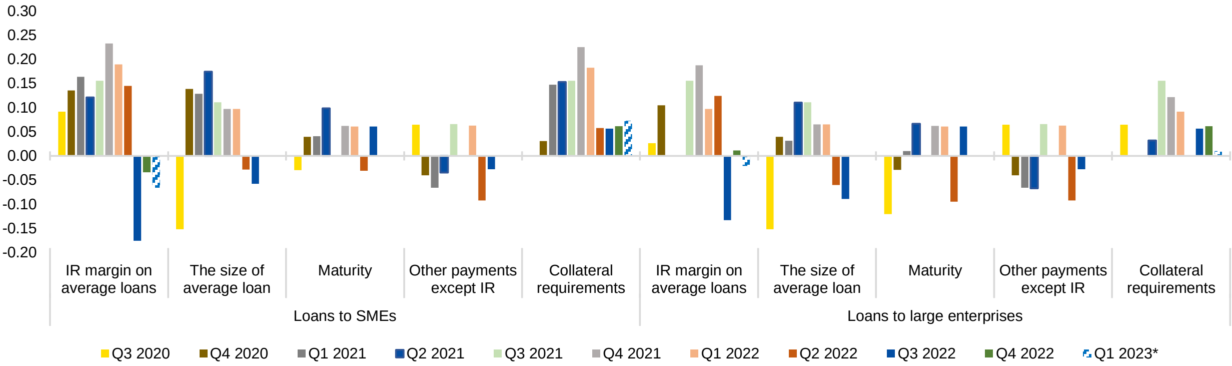
Also, the approval rate of loans to enterprises turns out not to have undergone any significant changes during this quarter for both segments of enterprises.

Overall credit standards are expected to mark marginal changes in the following quarter. More specifically, an ease is expected to be marked in credit standards for SMEs, being impacted by expectations of one bank with systemic importance, whereas a tightening is expected for large enterprises as well, having an impact from the reply of one bank with systemic importance. Good liquidity position, the support from KCGF and the pressure from competition represent the factors which are expected to contribute positively in credit standards. Meanwhile, uncertainties in the domestic and global markets outlook are expected to negatively contribute to the credit standards. The approval rate of loans is expected to mark a marginal decline during the next quarter, primarily for large enterprises.

Terms and conditions

In the third quarter 2022, terms and conditions applied by banks in issuing loans to enterprises (the specific terms and conditions of a contract for loans), were characterized with marginal movements for both categories of enterprises (chart 2). Specifically, for two categories of enterprises a marginal ease was applied for the collateral requirements with a positive index of 0.06. This result was impacted by a reply of a single bank which is with a high weight and systemic importance, as a result of the support of KCGF. The pressure from competition among the banks has also had a positive impact on applied terms and conditions.

Chart 2. Changes of terms and conditions applied to enterprises



Source: CBK.

*Expected value

During the following quarter, applied terms and conditions by banks are expected to have marginal movements. In this context, these changes are expected to be applied for SMEs. Precisely, on the one hand, an increase in the interest rate for loans is expected, as the replies from three banks were stated, one of which is with systemic importance, while on the other hand, an ease for the collateral requirements was applied as stated in the replies given by two banks, one of which is with systemic importance. These expectations were negatively influenced by the not so good outlook in the domestic and global markets, and the expectations for the deterioration of loans portfolio quality. Meanwhile, the support from KCGF and the competitive pressure among the banks had a positive impact on the expectations of banks on terms and conditions during the following quarter.

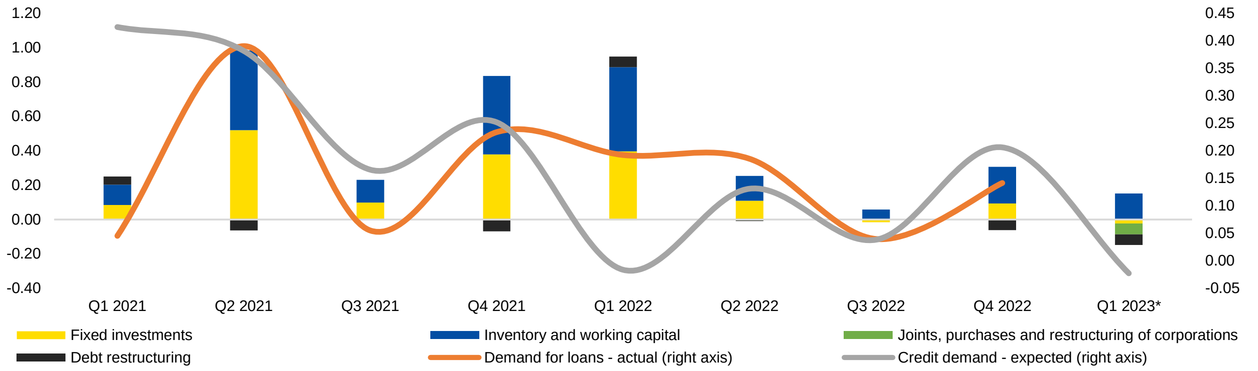
Demand for loans

During the fourth quarter of 2022, **the demand for loans from enterprises** marked an increase, representing a significant higher level compared to Q3 2022. However, the demand for loans turned out to have been lower compared to the banks' expectations for Q4 2022, expressed in the previous survey (Q3 2022) (chart 3). The demand for loans from SMEs marked a positive index of 0.22, whereas the demand for loans from large enterprises generated a positive index of 0.06. The generated index of the demand for loans from SMEs was impacted by the replies given by five banks, of which two with high weight and systemic importance.

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 index of 0.21, while the demand for financing fixed investments had a low index of 0.09. 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. The quality of the applications submitted by enterprises did not mark significant changes, in Q4 2022.

According to the survey, during Q4 2022 the nonperforming loans to total loans ratio of enterprises decreased, resulting with a negative index of 0.09, albeit this result is lower compared to the result of the previous survey where the replies given by banks generated a negative index of 0.11 of this ratio. This result was impacted by the replies of seven banks, where three of the banks (two with systemic importance) stated a decline of nonperforming loans, while two other banks (one with systemic importance), stated an increase 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. These expectations were impacted by the replies of five banks, where two of them expect a decline in demand, whereas three other banks expect an increase to some extent of the demand for loans. Consequently, these replies neutralized each other and resulted with a marginal index. The demand for loans is expected to finance investments in the working capital and inventory. At the same time, banks expect a marginal deterioration of quality of applications received for loans, especially from SMEs.

During the following quarter banks expect nonperforming loans to total loans ratio for enterprises to change direction and be shifted to a high positive index of 0.32, 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. Six banks, where four of them with systemic importance, stated expectations for increase of nonperforming loans of enterprises.

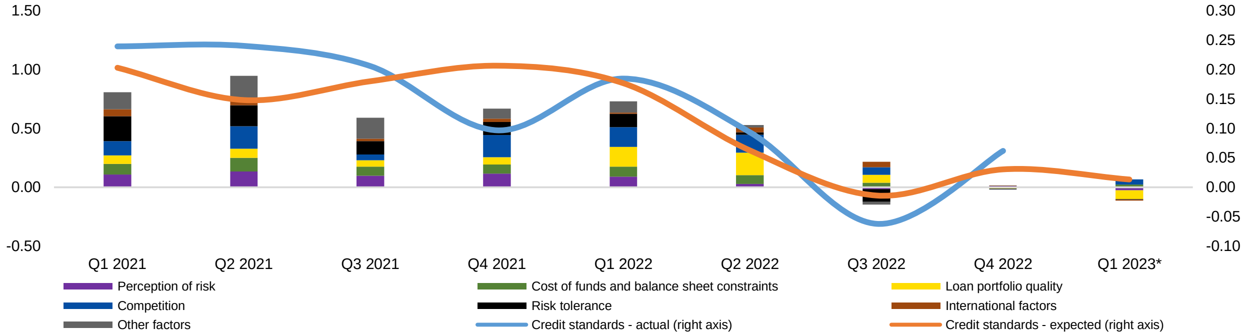
Loans to households

Credit standards

Credit standards applied for households, during the fourth quarter of 2022, generally were characterized with marginal positive movements. The result was the same for both types of loans to households, namely positive index of 0.06. The result reflects the replies of one bank with systemic importance which eased, to some extent, credit standards for two types of loans. Expectations for the fourth quarter of 2022, as stated by banks in the previous survey, resulted to be of an approximate level (chart 4). The factor that resulted in a positive contribution to the credit standards was the reduction of the risk from the required collateral with a positive index of 0.06, this factor was stated by a bank with a systemic importance in the banking sector, and which was mainly based on the bank's agreements with construction companies.

Banks stated marginal changes also in the approval rate of loans to households, namely for housing loans with a positive index of 0.07, while consumer credit marked a positive index of 0.05.

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



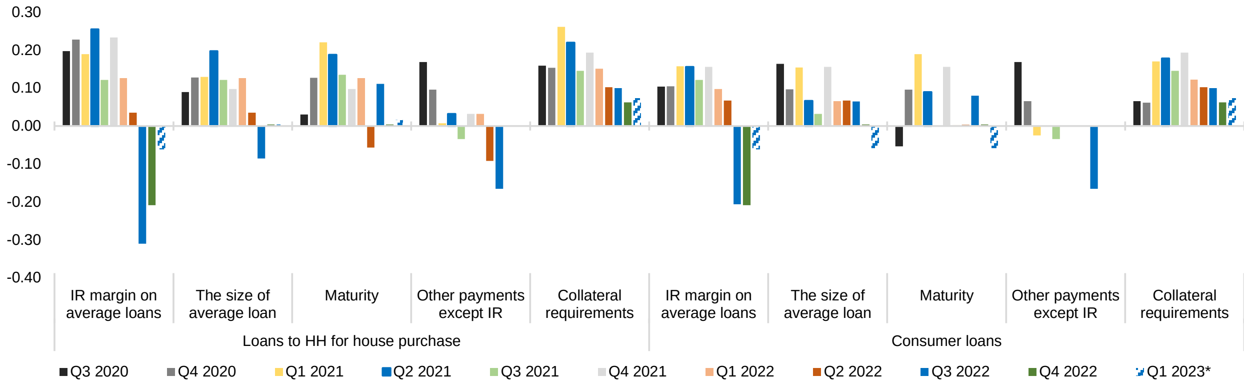
Source: CBK. *Expected value

In the first quarter of 2023, banks do not expect important movements in credit standards for both types of loans to households. However, some of the factors generated negative indices, which imply expectations for a negative impact on credit standards, which are the not so good outlook of the domestic market in general and the banking market in particular, the deterioration of the quality of loans portfolio and the not so good outlook of the parent banks. Whereas, expectations for a positive impact on credit standards, were supported by banks through the favorable access to financing within the country and the pressure from competition. Banks expect marginal decline of loans approval level for households. More specifically, it is expected a decline of loans approval rate for housing loans with a marginal negative index of 0.06.

Terms and conditions

Terms and conditions for new loans to households generally tightened to some extent. The generated results mainly reflect tightenings to a same level for both types of loans. At the same time, banks applied higher interest rates (negative index of 0.21), while marginally eased collateral requirements (positive index of 0.06). The main factor in increasing the interest rate was the not so good global markets outlook, which for the majority of banks means increasing the EURIBOR rate, a rate which applies for loans with variable interest rate (chart 5).

Chart 5. Changes of terms and conditions applied to households



Source: CBK. *Expected value

For the first quarter of 2023, banks in general expect marginal tightenings in terms and conditions for loans to households. The tightenings of terms and conditions is expected to be, to some extent, higher for consumer credit. 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 Q4 2022, while it is expected to slightly ease the collateral requirements. Furthermore, for consumer credit also the length of maturity will marginally tighten for approved loans, a response stated by a single bank with systemic importance. After indexing the replies of the banks, it turns out that mainly the not so good outlook in the global and domestic market to affect the expectations of the banks for terms and conditions during the following quarter.

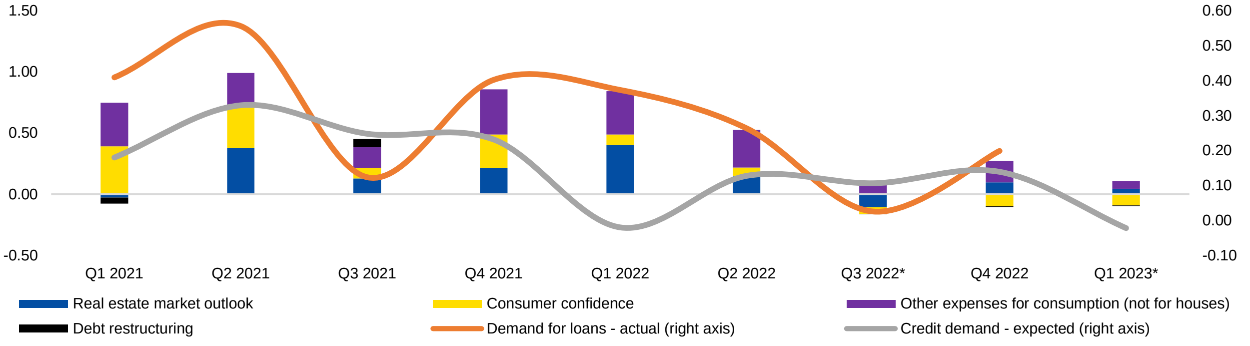
Demand for loans

After generating the results for the credit demand in this quarter, it turns out that the credit demand for households in general has marked a marginal increase. if the credit demand is broken down by types of loans to households, it turns out that the demand for consumer credit marked an increase with a positive index of 0.22, whereas the demand for housing loans marked a growth with a negative index of 0.18. More specifically, five banks, of which three with systemic importance, reported an increase of demand for both types of loans. However, one bank with systemic importance stated a decline of demand for loans for house purchase. If the current results of loans demand are compared with the expectations of banks stated in the previous survey for the same period, the actual level of the increase of the demand for both types of loans is higher.

The factors which positively affected the dynamics of the demand for loans were the need to finance consumer spending (a positive index of 0.17), and at a low level, also the real estate market outlook had a positive impact (positive index of 0.10). Meanwhile, the decline of the clients' confidence for solvency had a negative impact on the demand for loans, albeit at low level (negative index of 0.10). The quality of applications submitted by households for housing loans during this quarter turns out to have remained the same for both types of loans.

As regards to the loans portfolio quality for households, banks stated an improvement with a negative index of 0.17, thus reflecting the replies of three banks for a decline of nonperforming loans to total loans ratio and one bank which stated an increase of this ratio.

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



Source: CBK.

*Expected value

In the first quarter of 2023, banks expect marginal negative movements in the demand for loans from households. More specifically, banks expect a marginal decline of demand for housing loans with negative index of 0.06. Expectations for this dynamic, were affected by replies of three banks (two of them with systemic importance) which expect a decline of demand for these loans, and three other banks (one with systemic importance) which expect an increase of demand for the same ones. The survey results suggest that banks expect that the decline of consumers' confidence on the solvency will have an impact, to some extent, to the decline of the demand for loans during the following quarter. Whereas, the impact of the factors which positively impacted the demand for loans was marginal. Banks stated that they expect a deterioration, albeit at low levels, of the applications quality received for loans, mainly for house purchase loans.

During Q1 2023, 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 actual quarter. More precisely, banks' expectations on nonperforming loans ratio resulted in a high positive index of 0.30, stated by five banks, where four of them are banks with high weight in lending and with systemic importance.

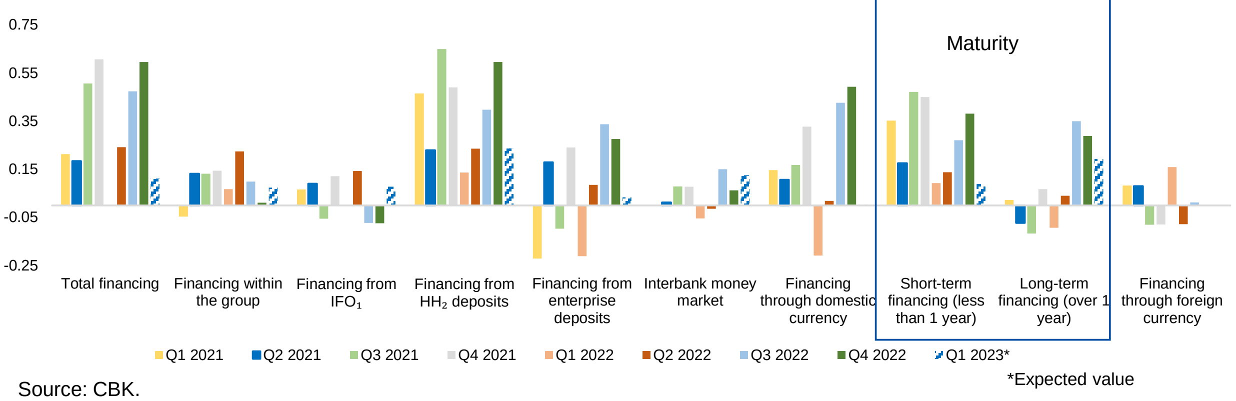
Financing

Banks reported a significant increase of access to financing during the fourth 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 two of the banks with systemic importance stated a considerable increase of financing. Whereas, only one of the banks, stated a decline, to some extent, of financing.

Based on the aggregated result of the replies, during this quarter, total financing marked a higher increase compared to the previous quarter, namely positive index of 0.6 (positive index of 0.47, in Q3 2022). Household deposits generated a positive index of 0.60 (positive index of 0.40 marked in Q3 2022). This result was affected by the replies of nine banks out of total ten participating banks in the survey, where two of them stated a considerable increase of household deposits. While, financing from enterprise deposits compared to the previous quarter was lower, with a positive index of 0.28 (positive index of 0.34, in Q3 2022), reflecting the replies of eight participating banks, six banks stated an increase (two of the banks with systemic importance stated a considerable increase), while two other banks stated a decrease in financing from this category (one of the banks with systemic importance). Financing from parent banks did not contribute to the growth of financing, as it has not resulted to have a significant movement. 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, financing with short-term maturity dominated in this quarter. More specifically, short-term deposits generated a positive index of 0.38, while long-term deposits generated a positive index of 0.29.

For the next quarter, banks in general expect an increase in access to financing to a significantly lower level compared to the actual quarter with a positive index of 0.11. Financing through household deposits is expected to lead the increase in financing of the banking sector with a positive index of 0.24, followed by financing from money market with a positive index of 0.12 (as stated by two banks with systemic importance). As regards the maturity of financing, banks expect that deposits with long-term maturity will dominate the increase in financing with a positive index of 0.19, while financing with short-term maturity is expected to increase with a positive index of 0.09 (chart 7).

Chart 7. Changes in financing the banking sector



Source: CBK.

Results of focused questions

The questionnaire of the survey for the fourth quarter of 2022, has been supplemented with three additional questions aimed at addressing the impact of inflationary pressures in the clients' behavior, consequently reflection and expectations for materializing the credit risk. In these questions, banks elaborated the direct impact of inflation on the financing cost of the banking sector. Also, 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 year 2021. Since the increase in prices negatively affects the purchasing power of consumers, it is important to understand their behavior to manage this situation, as well as the perception of the banking sector on the customers solvency, and consequently the expectations for the possible materialization of credit risk.

In this aspect, banking sector has noticed an increase of consumer spending from the clients, which was translated into an increase of the demand for loans, especially for consumer credit, to cover any possible short-term liquidity gaps. Clients have also cut non-essential spending to cope with the effects of prices increase. Considering banks assessments, the most affected segments result to be households, especially those with low income, and micro enterprises. Within enterprises, banks evaluated that all the sectors have been affected, however they emphasize the construction sector. Nevertheless, the good financial performance, and consequently also the good solvency of the clients, banks attribute to the additional cost of prices supply/raw materials to the final consumer. Moreover, since the previous year banks have applied a more vigilant observation of the clients financial performance, especially those belonging to the sectors more affected, and are more conservative in the process of assessment of the solvency capacity, especially towards the households.

Another aspect covered by supplemented questions was the impact of price increases on customers solvency, which implies an increase of the credit risk. Banks' sentiment from the replies which were received indicates that banks expect a rise in credit risk, expected to be materialized in the first quarter of 2023 and further deteriorate in the second half of the year. However, banks assess that as a potential mitigating factor in materialization of the credit risk, is the additional income level received from remittances which are expected to inflow into the country, especially during Q3 2023.

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 securing financing, mainly through the increase of interest rates on deposits, which is translated into an increase in the cost of bank financing. In addition, the continuous increase of the interest rates by the ECB, as well as by other monetary authorities, also affected the cost of financing from parent banks and international financial institutions. In this respect, the majority of banks stated an increase in financing costs, thus signaling uncertainties 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. Whereas, only two of the banks stated that their financing has not changed.

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 of 2022, credit standards mainly remained unchanged compared to the previous quarter. A marginal positive result was marked only for trade sector and residential real estate with a positive index of 0.06, which is a reply given by a single bank. Construction sector, had a tightened offer from two banks with lower weight in the banking sector, whose replies were neutralized by a reply given from a bank with systemic importance, stating that it eased credit standards for this sector. Whereas, terms and conditions were tightened to a greater extent for some sectors, and especially for the real estate sector with a negative index of 0.17, and for the construction sector with a negative index of 0.12. The demand for loans marked an increase from this economic sectors. The sector with the most increased demand for financing was the one of construction with a positive index of 0.17, an increase stated from five banks. Whereas, the second sector by increase of the demand was the trade sector with a positive index of 0.13, an increase stated from four banks.

Based on the generated results, during Q1 2023, 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 tighten to a greater extent for the construction sector (negative index of 0.22), whereas for other sectors is not expected a significant change of terms and conditions. At the same period, the demand for loans is expected to mark a decline from the construction sector (negative index of 0.15) and an increase of a low level for the services sector (positive index of 0.11).

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 actual quarter, the questionnaire addresses also the overall expectations of the banks for the second quarter of 2023 and for the whole year of 2023 in general. The survey serves also as a tool to identify specific factors which potentially may affect bank expectations for the specified level of inflation.

Methodology

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

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

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

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

Results Summary

Based on the survey conducted in January 2023, banks have estimated a lower level of inflation in the first quarter of 2023 compared to the previous quarter, and expect an even lower level of inflation, in the second quarter of 2023. For 2023 , banks expect that the level of inflation rate will reach 6.4% from 11.6%, as it was in 2022.

Data published by the Kosovo Agency of Statistics for January 2023 suggest that the annual average inflation rate was around 12.1%. For the first and second quarter of 2023 , banks expect that the average inflation rate would range between 7.8% and 5.9%. Most banks (7 of them) expect inflation to be above 5% in the second quarter, whereas the remainder of the banks expect inflation to be below this level.

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

Banks	Q1 2023	Q2 2023	2023
1	6.8%	6.6%	6.7%
2	11.5%	10.0%	9.5%
3	2.9%	2.9%	7.8%
4	5.5%	5.3%	4.7%
5	12.1%	5.0%	5.0%
6	10.0%	5.8%	5.8%
7	9.0%	7.0%	6.5%
8	8.6%	4.1%	5.7%
9	3.1%	2.7%	2.8%
10	9.1%	9.3%	9.3%
Average	***7.8%***	***5.9%***	***6.4%***

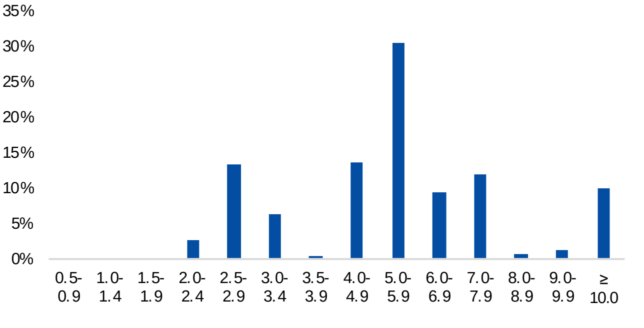
Source: Commercial banks and CBK calculations.

As depicted in chart 8, the reported spreads of probability show that there is a relatively high certainty relating the following result of inflation, hence the spread of probability of the banks is concentrated in the expected inflation.

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

- ✓ The war in Ukraine is the main reason for the increase in prices because Russia and Ukraine are important suppliers of raw materials, but it is expected that these prices will stabilize a little and there will be no enormous increase as in the previous year;
- ✓ As a factor that may have influenced the slowdown in price increase, banks have mentioned the increase in interest rates by the Federal Reserve in the USA, which was then followed by other banks such as the European Central Bank, the Bank of England, etc.;

Chart 8. Probability of inflation for Q2 2023 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.

- ✓ 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 are estimated to have been the main determinate factors of inflation in the country.

Taking into account the dynamics with which the prices are being characterized in the country, it is thought that the expectations of the banks are realistic.

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