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

Bank Lending Survey

Number 15

JUNE 2023

BANKA QENDRORE E REPUBLIKËS SË KOSOVËS

CENTRALNA BANKA REPUBLIKE KOSOVA

CENTRAL BANK OF THE REPUBLIC OF KOSOVO

Bank Lending Survey and Inflation Expectations

Number 15

PUBLISHER

© Central Bank of the Republic of Kosovo

Economic Analysis and Financial Stability Department

33 Garibaldi, Prishtina 10000

Tel: ++383 38 222 055

Fax: ++383 38 243 763

Website www.bqk-kos.org

E-mail economic.analysis@bqk-kos.org

Contents

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

In addition to the standard questions, this survey has been supplemented with four additional questions in an attempt to address the impact of inflationary pressures on the behavior of the clients, and of the banking sector, at the same time. In these inquiries, the banks elaborated the indirect impact of inflation on the financing costs of the banking sector, and the impact of the credit risk on the credit offer. Also, one of the questions breaks down credit supply and demand by economic sectors.

Results Summary[2]

Annual growth of total loans stock continued with an accelerated pace until the first quarter of 2023. However, new loans compared to the same quarter of the previous year marked a decline, although they were the same compared to the previous quarter. This dynamic may reflect a more careful approach of consumers in undertaking additional debts and, at the same time, a more careful approach and monitoring the banks in lending. Credit activity was influenced to a greater extent by credit demand, since credit supply had positive marginal changes during this quarter. Similar dynamics to the current quarter are also expected for Q2 2023, where the demand is expected to be the driver of the credit activity.

According to the banks, the dynamics of lending to enterprises during this quarter were positively affected to a larger extent by increased credit demand, while credit supply did not go under significant changes. Within the enterprise segments, banks stated a marginally eased credit standards for SMEs and marginally tightened for large enterprises (table 1). In the context of the factors that influenced these developments, the risks related to the poor outlook in the global and local markets, as well as the quality of the credit portfolio had the main negative contribution to the credit standards. On the other hand, the factors that had a positive impact on the credit standards were the good liquidity position of the sector and the support from the KCGF. At the same time, the approval rate of loans to enterprises turns out to have undergone a significant increase compared to the previous quarter, and especially for SMEs, as stated by five banks, three of them with systemic importance. For the second quarter of 2023, banks are expected to apply an ease, to some extent, in credit standards, mainly positive changes for SMEs (chart 1). The support from the KCGF and the competition pressure are the factors expected to positively contribute to credit standards. Conversely, the uncertainties in the perspective of the local and global market, as well as the risk from the deterioration of the credit portfolio are expected to contribute negatively to credit standards. The approval rate of loans is expected to mark a low increase over the next quarter, primarily for SMEs.

---

[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.

Terms and conditions applied by banks in granting loans to enterprises were tightened for both segments of enterprises. More specifically, there was applied a tightening of the interest rate. While, a low easing was marked for collateral requirements for SMEs. Applied terms and conditions were negatively affected by the unfavorable outlook in the global markets and in the parent banks, and also by the unfavorable conditions for securing financing from abroad, which mainly means the increase in the Euribor rate. In the following quarter, banks are expected to apply minor changes in terms and conditions, mainly for SMEs. Precisely, on the one hand, an ease is expected for the collateral requirements, while on the other hand, a small increase in the interest rate for loans is expected to be marked. Positive changes in terms and conditions of loans to enterprises are expected to be inclined by the KCGF support, a lower perceived risk from collateral and increased competition pressures, while negative changes are expected to be driven from poor perspective of the global and local markets, uncertainties related to securing financing, as well as expectations for deteriorating of loan portfolio quality.

During the first quarter of 2023, there was marked an increase of demand for bank loans from both segments of enterprises of a significantly higher level compared to the previous quarter. The demand for loans from enterprises turned out to have been significantly higher compared to the banks' expectations for Q1 2023, expressed in the previous survey (Q4 2022). The generated index of the demand for loans from enterprises was impacted by the replies given by eight banks which stated an increase of the demand. This increase in demand, according to bank statements, was mainly driven by the increase in demand for financing inventories and working capital and for financing fixed investments. The index generated for banks' expectations on credit demand during the next quarter shows an increase in credit demand, albeit at a lower level than in the current quarter. More specifically, the increasing loan demand from SMEs is expected to be approximately the same as of the current level. The demand for loans is expected to finance fixed investments and investments in the working capital and inventory.

The stock of loans to households marked an annual accelerated increase, until March 2023. Compared to the same quarter of the previous year, new loans marked a decline, while the quarterly increase was higher. 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 characterized with a more significant movements than the expectations of banks expressed in the previous survey. Credit standards were eased marginally for both types of loans to households. Factors that resulted in a positive contribution to credit standards were favorable access to financing and increased competitive pressure. Meanwhile, banks stated an increase, to some extent, of the approval rate of loans to households, for both types of loans. In the second quarter of 2023, banks expect positive marginal movements in credit standards for consumer loans, whereas they do not expect changes in loans for house purchase. Factors that are expected to positively influence credit standards are the increased pressure of competition among banks and the perception of lower risk in collateral (table 1). Also, there is expected an increase of the approval rate for loans, and especially for consumer credit.

The overall terms and conditions for new loans to households were marginally tightened. The generated results mainly reflect tightening to higher level for consumer credit, through a raise of interest rate. On the other hand, the collateral requirements were marginally eased for both types of loans. The main factor in increasing the interest rate was the poor perspective of global markets, which for most banks means raising the Euribor rate, a rate applied for loans with variable interest rate. For the second quarter of 2023, banks in general expect marginal tightening in terms and conditions for loans to households. The tightening 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, at an approximate level as the values marked in Q1 2023, while, collateral requirements are expected to ease to some extent. Moreover, the maturity of consumer credit is expected to be shortened and the size of loans approved to be cut.

The demand for loans from households in general marked an increase during the first quarter of 2023. Results suggest that the demand for loans marked an approximate increase for both types of loans. More precisely, five banks, of which three with systemic importance, reported an increase in demand for loans for house purchase, while six banks, of which three with systemic importance, stated an increase in consumer credit. The need to finance consumption and the perspective of the real estate market outlook were the factors that gave a positive contribution. In the second quarter of 2023, banks expect an increase in demand for loans from households at a lower extent compared to the current level (table 1). The survey results suggest that mainly the need to cover consumer spending will drive this increase of the demand. Banks stated that they expect a deterioration of the received applications quality for housing loans and an improvement of the applications for consumer credit, albeit at a marginal level.

Table 1. Banks assessment on credit supply and demand

	Supply (Credit standards)		Demand	
	Q1 2023	Q2 2023 (expectations)	Q1 2023	Q2 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. However, banks stated an improvement in the loan portfolio quality only for enterprises, while the overall index of replies for households resulted positive, albeit at a marginal level. For the following quarter, the generated index is expected to be positive and significantly higher for both segments, reflecting banks' expectations for a deterioration of loans portfolio quality. These expectations were mainly impacted by the dynamics of prices increase in the country, along with the decline of clients' purchasing power. Five banks, of which three with systemic importance, expect an increase in enterprise nonperforming loans, against four banks, also four of them with systemic importance, which expect the same for household nonperforming loans.

Banks reported an increase of access to financing during the first quarter of 2023. The aggregated result of the banks' replies was affected by the responses of five banks which stated an increase in financing, where one of the banks with systemic importance stated a considerable increase of financing. On the other hand, two of the participating banks in the survey stated a decline, to some extent, 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, 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 total access to financing to a higher level, to some extent, compared to the current quarter. Financing through the household deposits is expected to lead the increase of banking sector financing, followed by financing from enterprise deposits. Regarding the maturity of financing, banks expect, during following quarter, financing to be dominated by short-term 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 bank, based on its share on the credit market, is multiplied with the value determined based on the intensity of the given answer, thus obtaining the index in question.

Furthermore, the aggregation of the index on the sector's level is performed through the sum of the indices obtained for each of the bank. The value of indices are ranged from -1 to 1, where the positive values of the index

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

represent ease, increase or positive contribution, whereas negative values represent tightening, decline or negative contribution.

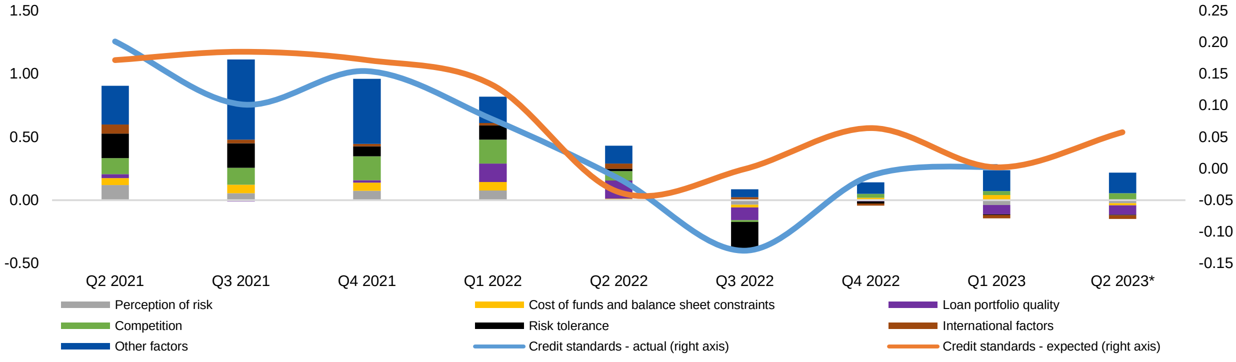
Developments in credit standards, credit terms and conditions, and in the demand for loans

Loans to enterprises

Credit standards

During the first quarter of 2023, the result on credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises in general represent no significant movements. Expectations of banks expressed in the previous survey (Q4 2022), turn out to be in line with the current results for Q1 2023 (chart 1).

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



Source: CBK. *Expected value

Within the enterprise segments, banks stated a marginally eased credit standards for SMEs with a positive index of 0.08, and marginally tightened credit standards for large enterprises with a negative index of 0.07. The main factors that negatively affected the credit standards were the poor outlook on the global and local markets, and the deterioration of the loans portfolio quality with a marginal negative index of 0.07. Whereas, the factors that had, to some extent, a positive impact, thus providing security to the banking sector, were the good liquidity position of the sector and support from KCGF with positive indices of 0.11 and 0.16, respectively.

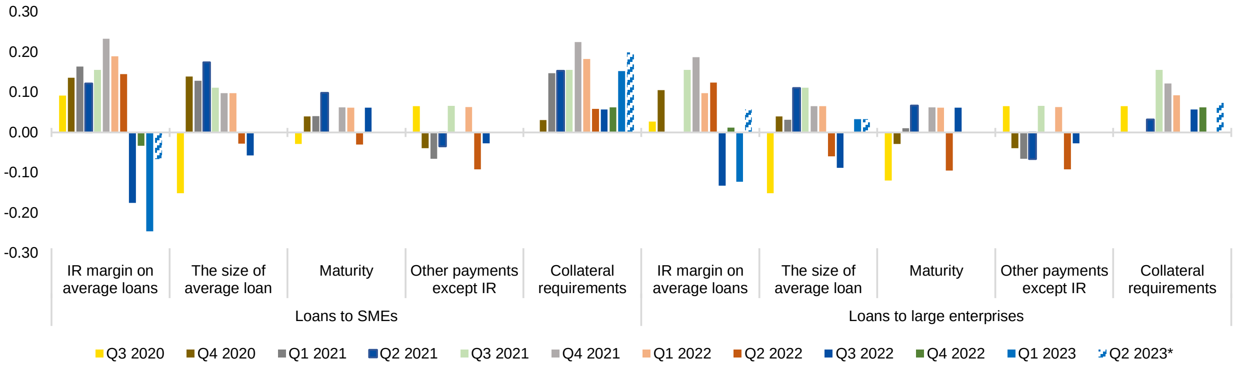
At the same time, the approval rate of loans to enterprises results to have undergone a significant increase compared to the previous quarter, with a positive index of 0.29 as stated by five banks, of which three with systemic importance. Higher approval rate was marked for SMEs.

Overall credit standards are expected to mark an ease, to some extent, in the following quarter. More specifically, an ease is expected to be marked in credit standards for SMEs, being impacted by the expectations of two banks, of which one with systemic importance. The support from the KCGF and the competition pressure are the factors expected to positively contribute to credit standards. Meanwhile, the uncertainties in the perspective of the local and global market, as well as in the risk from the deterioration of the loans portfolio are expected to contribute negatively to credit standards. The approval rate of loans is expected to mark a low increase over the next quarter, primarily for SMEs.

Terms and conditions

In the first quarter of 2023, overall terms and conditions applied by banks in issuing loans to enterprises (the specific terms and conditions of a contract for loans), were tightened to some extent for both categories of enterprises (chart 2). Specifically, for both categories of enterprises, tightening was applied to the interest rate (negative index of 0.25 for SMEs and negative index of 0.12 for large enterprises). This result was impacted by the replies of four banks, of which two with systemic importance in the sector. Whereas, low ease was marked for collateral requirements for SMEs with a positive index of 0.15 as stated by two banks with systemic importance. Applied terms and conditions were negatively affected by the unfavorable outlook in the global markets and in the parent banks, and also by the unfavorable conditions for securing financing from abroad. Also the increasing credit risk had a negative impact on terms and conditions in this quarter. On the other side, the support given by the KCGF, the competition pressure and the good liquidity position marked a positive impact in applied terms and conditions.

Chart 2. Changes of terms and conditions applied to enterprises



Source: CBK. *Expected value

During the following quarter, terms and conditions applied by banks are expected to have marginal movements. In this context, these changes are expected to have an impact, to a higher extent, for SMEs. Precisely, on the one hand, it is expected an ease on the collateral requirements, as emphasized by the replies of three banks, two of them with systemic importance, while on the other hand, replies of banks also stated that there will be a small increase of interest rate, where one of the banks is with systemic importance. These expectations were negatively influenced by the not so good outlook in the domestic and global markets, uncertainties in providing financing, and the expectations for the deterioration of loans portfolio quality. Meanwhile, the support from the KCGF, lower perceived risk from collateral, and the competitive pressure among the banks had a positive impact on the expectations of banks on terms and conditions during the following quarter.

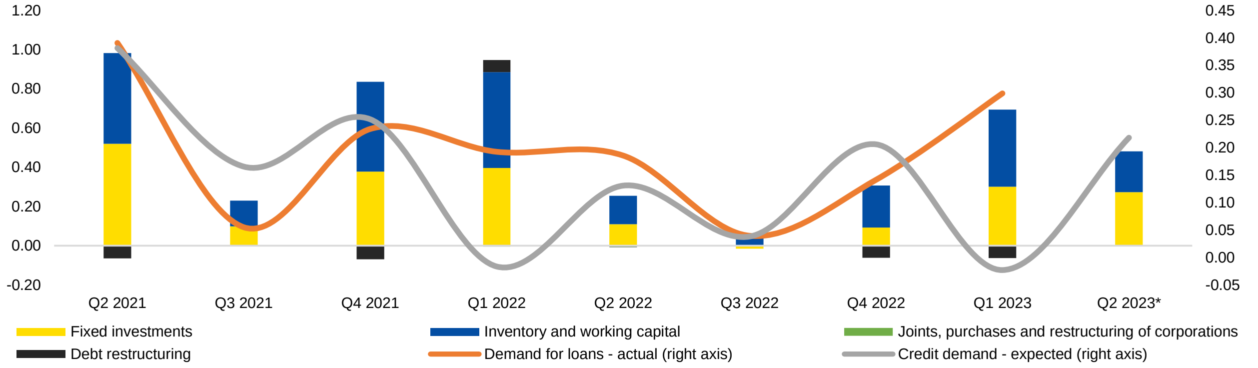
Demand for loans

During the first quarter of 2023, the demand for loans from enterprises marked an increase, at a significantly higher level compared to Q4 2022, with a positive index of 0.46 as stated by eight banks out of total ten participating banks in the survey. Also, the demand for loans turned out to have been significantly higher compared to the banks' expectations for Q1 2023, expressed in the previous survey (Q4 2022) (chart 3). The demand for loans, from both categories of enterprises, had a positive index of 0.30.

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 0.39, and for financing fixed investments with a positive index of 0.30. The result of the contributing factors to the credit demand was determined by the replies of eight banks which stated a growth of the demand for financing inventories and working capital and of seven 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 Q1 2023.

According to the survey, during Q1 2023, the nonperforming loans to total loans ratio of enterprises decreased, resulting with a negative index of 0.15, which results in a higher index compared to the outcome of the previous survey, where the replies given by banks generated a negative index of 0.09 of this ratio. This outcome was impacted by the replies of seven banks, where four of the banks (two with systemic importance) stated a decline of nonperforming loans, while three 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 expect an overall increase of demand for loans from enterprises during the following quarter, albeit at a lower level than in the current quarter. Specifically, the increase in the demand for loans from SMEs is expected to be close to the current level, while the demand from large enterprises is expected to be halved down, which also affects the overall level of demand expected for Q2 2023. The demand for loans is expected to finance fixed investments and investments in the working capital and inventory. Meanwhile, the quality of the received applications for loans is not expected to undergo significant changes.

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 0.25, thus reflecting banks' expectations on the deterioration of credit portfolio quality. These expectations were mainly impacted by the dynamics of prices increase in the country, along with the decline of clients' purchasing power. Five banks, where three of them with systemic importance, expect an increase of nonperforming loans of enterprises.

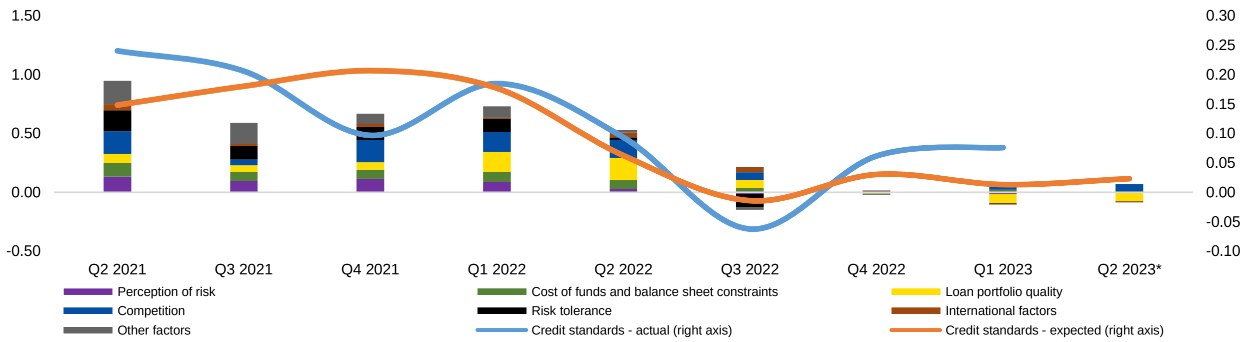
Loans to households

Credit standards

Credit standards applied for households, during the first quarter of 2023, generally were characterized with marginal positive movements. The result was approximate for both types of loans to households, namely a positive index of 0.06 for housing loans and 0.09 for consumer credit. The result reflects the response of two systemically important banks which eased the credit standards to some extent for both types of loans and another systemically important bank which tightened them. Expectations for the current quarter, stated by banks in the previous survey (Q4 2022), resulted to be lower than the current values (chart 4). Factors that resulted in a positive contribution to credit standards were the favorable access to financing and increased competitive pressure, with a positive index of 0.09 and 0.08, respectively.

Banks stated an increase of approval rate of loans to households, namely for housing loans with a positive index of 0.19, while consumer credit, marked a positive index of 0.15.

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



Source: CBK.

*Expected value

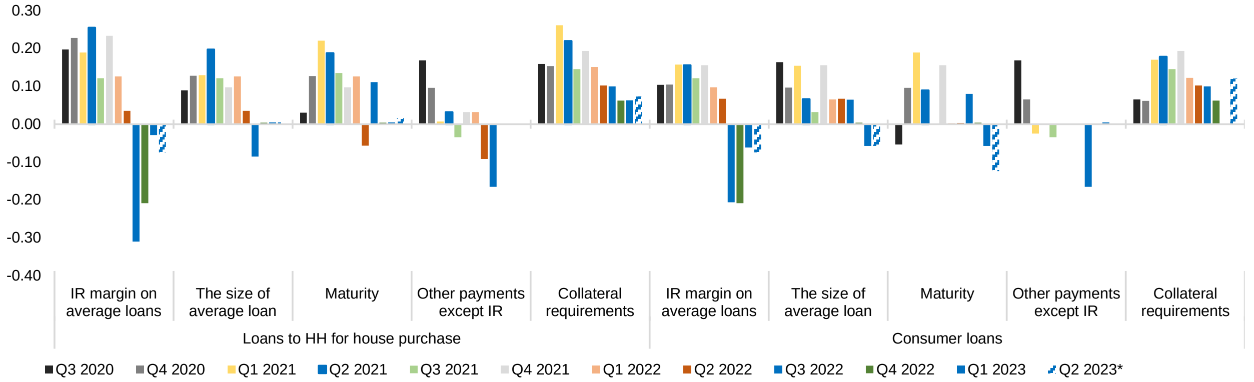
In the second quarter of 2023, banks expect positive marginal movements in credit standards for consumer credit, whereas they do not expect changes in loans for house purchase. Factors that are expected to positively impact credit standards are the increased pressure of competition among banks and the perception of lower risk in collateral. Banks expect an increase in the level of loans approval for households. More specifically, banks stated that they expect an increase of the demand for housing loans with a positive index of 0.11 and for consumer credit with a positive index of 0.18.

Terms and conditions

Terms and conditions for new loans to households, generally were characterized with marginal negative movements in the first quarter of 2023. The generated results mainly reflect tightenings to a higher level for consumer credit. Specifically, banks applied higher interest rates (negative index of 0.06), a result which was influenced by the responses of three banks that increased interest rates for consumer credit and two other banks that eased them. While, for both types of loans the collateral requirements were marginally eased (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 presents an increase of the Euribor rate, a rate which applies for loans with variable interest rate (chart 5).

For the second quarter of 2023, banks in general expect marginal tightening of terms and conditions for loans to households. The tightening of terms and conditions is expected to be higher for consumer credit. Primarily, terms and conditions for both categories are expected to tighten through the increase of interest rate, at an approximate level of the values marked in Q1 2023, while, collateral requirements are expected to ease to some extent. Moreover, the maturity of consumer credit is expected to be shortened and the size of loans approved to be cut. After indexing the replies of the banks, it turns out that mainly the not so good outlook in the domestic market in general and more specifically in the banking sector to affect the expectations of the banks for terms and conditions during the following quarter. Meanwhile, banks based their expectations for ease on the increased pressure of competition among banks and the lower perceived risk in collateral.

Chart 5. Changes of terms and conditions applied to households



Source: CBK. *Expected value

Demand for loans

After generating the results for the credit demand in this quarter, it turns out that the credit demand from households in general has marked a higher increase compared to the previous quarter. 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 0.32, whereas the demand for housing loans marked a growth with a positive index of 0.30. More precisely, five banks, of which three with systemic importance, reported an increase in demand for loans for house purchase, while six banks, of which three with systemic importance, stated an increase in consumer credit. If the current results of the demand for loans are compared with the expectations of banks stated in the previous survey for the same period, the actual level of the increase of the demand is significantly higher(chart 6).

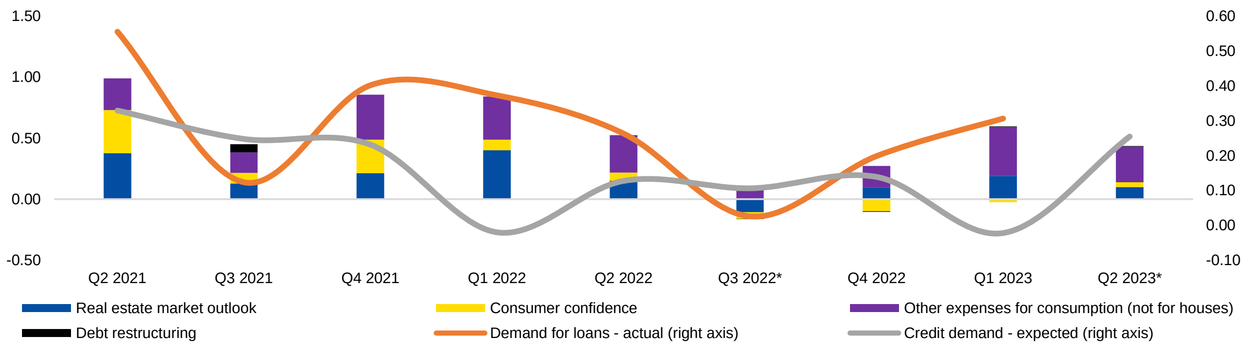
The factors which positively affected the dynamics of the demand for loans were the need to finance consumer spending (a positive index of 0.40), and at a lower level, also the real estate market outlook had a positive impact (positive index of 0.19). Meanwhile, the decline of the clients' confidence 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 the households generally decreased with a low negative index, influenced by the responses of two systemically important banks which declared a decrease in the quality of applications received, compared to two other banks with a lower weight which declared an increase in the quality of the loan applications.

Banks stated a deterioration in the quality of the credit portfolio for households, based on a marginal positive index of 0.06, reflecting the responses of five banks, of which three banks (two with systemic importance) stated an increase in the nonperforming loans ratio and two other banks, also of systemic importance, stated a decline in this ratio.

In the first quarter of 2023, banks in general expect an increase in demand for loans from households. More specifically, banks expect an increase in demand for consumer credit with a positive index of 0.28 for housing loans with a positive index of 0.23. Expectations for this dynamic, were affected by replies of six banks (two of them with systemic importance) which expect an increase in demand for consumer credit and five banks (two of them with systemic importance) which expect an increase in demand for housing loans. The survey results suggest that mainly the need to cover consumer spending will drive this increase of the demand. Hence, banks expect a deterioration of the received applications quality for housing loans and an improvement of the applications quality for consumer credit, albeit at a marginal level.

During Q2 2023, banks expect that the loan portfolio quality of households will be characterized by a further deterioration, based on the deepening of the value of the negative index compared to the current quarter. More precisely, banks' expectations on nonperforming loans ratio resulted in a positive index of 0.24, stated by four banks, where three of them are banks with high weight in lending and with systemic importance.

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



Source: CBK.

*Expected value

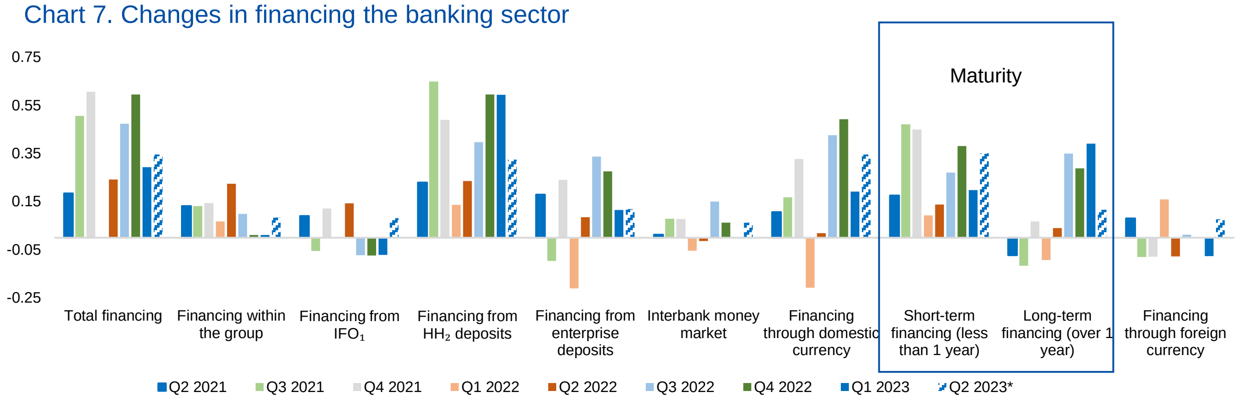
Financing

Banks reported an increase of access to financing during the first quarter of 2023. The aggregated result of the banks' replies was affected by the responses of five banks which stated an increase in financing, where one of the banks with systemic importance stated a considerable increase of financing. Whereas, two 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 lower increase compared to the previous quarter, namely positive index of 0.29 (positive index of 0.60, in Q4 2022), which is a result affected by the decline of financing as stated by two banks. On the other hand, household deposits generated a positive index of 0.60, the same as in the previous quarter. This result was affected by the replies of six banks out of total ten participating banks in the survey, where five of them are of systemic importance, and further two of these banks stated a considerable increase of household deposits. While, financing from enterprise deposits compared to the previous quarter was lower, with a positive index of 0.12 (positive index of 0.28 in Q4 2022), reflecting the replies of seven participating banks, four banks (two of them with systemic importance) stated an increase, while three other banks (two of them with systemic importance) stated a decrease in financing from this category. 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, in this quarter dominated the financing with long-term maturity. More specifically, long-term deposits generated a positive index of 0.39, while short-term deposits generated a positive index of 0.20.

For the next quarter, banks in general expect an increase in total access to financing, to some extent higher, compared to the current quarter with a positive index of 0.35. Financing through household deposits is expected to lead the increase in financing of the banking sector with a positive index of 0.32, followed by financing from corporate deposits with a positive index of 0.12. As regards the maturity of financing, banks expect that deposits with short-term maturity will dominate the increase in financing with a positive index of 0.35, while financing with long-term maturity is expected to increase with a positive index of 0.12 (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 first quarter of 2023, has been supplemented with four additional questions in an attempt to address the impact of inflationary pressures in the clients' behavior and in the banking sector, at the same time. In these inquiries, the banks elaborated the indirect impact of inflation on the financing costs of the banking sector, and the impact of the credit risk on the credit offer. Also, one of the questions breaks down the credit dynamic of supply and demand by economic sectors.

The high inflation rate is estimated to have negatively impacted the purchasing power of the consumers, with potential effects in the consumers' capacity, of spending and saving of all the participants in the market. Therefore, in order to monitor and analyze macroeconomic risks and potential consequences in the behavior of lending institutions, the questionnaire has been completed with additional questions, both to understand the behavior of customers and the perception of the banking sector on increased risks.

The banking sector assessed that, in order to cover short-term liquidity shortages, bank customers increased their demand for loans, especially for consumer credit. Also, the questionnaire suggests that customers have limited non-essential spending in the reporting period, as a way to cope with the effects of price increases. 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 and the sectors interconnected with it, and also the trade sector. Despite the expectations for a higher level of deterioration of repayment capacity, only two of the banks emphasized that they have observed a trend of deterioration of payments.

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. Being under this pressure, 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. Such a dynamic is expected to be translated into an increase of financing cost of the banks. The tightening of the monetary policy by the ECB, through the increase in interest rates, is expected to affect the increase in the financing cost of the banking sector. 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 survey questionnaire for Q1 2023 includes an additional question on the impact of banks' non-performing loans (NPL) ratio on their lending policies and the factors through which the NPL ratio contributed to changes in lending policies. Banks were asked about the impact on loans to enterprises and loans to households. The generated results showed a small impact of the NPL ratio on credit standards, precisely negative impact was mainly on loans to large enterprises and consumer credit with a negative index of 0.07. Similarly, the same impact of NPL resulted in terms and conditions applied by banks. At the same time, banks referred to the costs for clearing the balance sheet,[4] the increased perception of risks and the cost of capital as a factor that contributed negatively to the impact of the NPL ratio on lending by banks. For the next quarter, banks do not expect significant changes to occur in lending policies driven by the NPL ratio, however the increase in perceived risk remains as the factor with the highest negative contribution to the impact of the NPL ratio in lending by banks.

The disaggregated replies of banks for enterprises classified by sectors, indicate the direction of financing the economy and dynamics in certain sectors. During the first quarter of 2023, credit standards mainly had minor changes against the previous quarter. There was a positive marginal result for the service sector with a positive index of 0.10, followed by the manufacturing and real estate sectors with a positive index of 0.09. Construction sector, had a tightened offer from the banking sector, the replies of which generated negative index of 0.07. Whereas, terms and conditions were tightened to a greater extent for almost all of the sectors, and especially for the construction sector with a negative index of 0.27, and for the manufacturing and services sector with a negative index of 0.19. These tightening mainly represent a raise of interest rate. The demand for loans marked an increase of all economic sectors, besides the construction sector. The sector with the highest demand increase for financing was the trade sector with a high positive index of 0.55, an increase stated by eight banks. Whereas, the second sector by increase of the demand was the manufacturing sector with a positive index of 0.23, an increase stated by four banks.

Based on the generated results, during Q2 2023, banks are expected to apply a marginally tightened offer for the construction sector, while a more affordable offer, albeit at a low level, is expected for the services and manufacturing sector. Terms and conditions are expected to tighten at a low level for the construction sector (negative index of 0.09), while for the real estate sector it is expected an ease at a low level (positive index of 0.09). At the same period, the demand for loans is expected to mark an increase from the construction and trade sector (positive index of 0.26), followed by the sector of services and residential real estate with a positive index of 0.19 and 0.18, respectively.

[4] Among other things, it includes costs due to the need for additional provisions and/or write offs that exceed the previous stock of provisions.

Inflation Expectations

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

In the last questionnaire, besides the statements of the banks relating their estimates on the level of inflation for the previous quarter, the questionnaire addresses also the overall expectations of the banks for the 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 April 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 the year of 2023, banks expect the level of inflation to reach 5.4%.

Data published by the Kosovo Agency of Statistics for the first quarter of 2023 suggest that the annual average inflation rate was around 10.1%. For the second quarter of 2023 , banks expect that the average inflation rate would be 5.9%. Most of the 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.

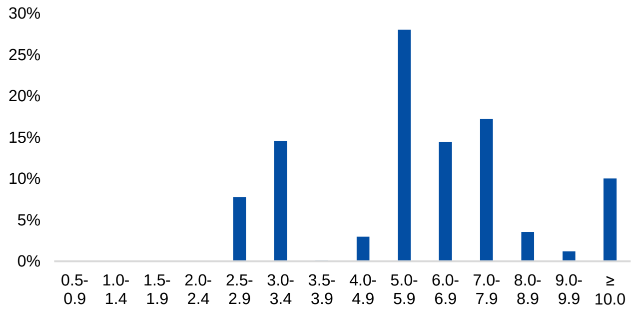
Table 2. Inflation expectations of banks, annual change in per cent

Banks	Q1 2023	Q2 2023	2023
1	6.9%	6.9%	6.8%
2	8.0%	5.8%	2.8%
3	3.4%	3.4%	3.9%
4	9.2%	7.2%	6.3%
5	7.6%	5.0%	5.0%
6	10.2%	5.8%	5.8%
7	9.0%	7.0%	6.5%
8	7.5%	3.2%	2.2%
9	7.5%	5.5%	5.7%
10	9.1%	9.1%	9.1%
Average	***7.8%***	***5.9%***	***5.4%***

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.

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.

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

- ✓ The war in Ukraine remains 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.;
- ✓ 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.

As a conclusion, banks expect to have a slowdown increase of inflation during the year of 2023. While also the CBK expectations suggest a decline in the inflation level, geopolitical tensions, dynamics in the global demand with the tightening of monetary policies and the stabilization of core inflation remain obvious risks that may undermine these expectations.

BQK

Street Garibaldi, no.33, 10000 Prishtina,
Republic of Kosovo
Tel: +383 38 222 055; Fax: +383 38 243 763
Web: www.bqk-kos.org