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

Bank Lending Survey

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

Bank Lending Survey and Inflation Expectations

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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 highlights the credit behavior for the second quarter of 2023, and the banks' expectations for the lending dynamics for the third quarter of 2023.

In addition to the standard questions, this survey has been completed with three additional questions in an attempt to identify possible risks in the banking sector in general, as well as the impact of credit risk on credit supply, in particular. Also, one of the questions breaks down by economic sectors credit supply and demand for enterprises.

Results Summary[2]

The annual increase in the stock of total loans continued to grow until the second quarter of 2023, but at a slower pace compared to the same period of the previous year. In the same period, new loans showed almost the same growth trend as in the previous quarter, and also compared to the same period of the previous year. This dynamic may reflect a more careful approach of consumers in undertaking additional debts, in an environment of the increase of life cost, and at the same time, a more careful approach and monitoring the banks in lending. Credit activity was influenced to a larger extent by loan demand, since credit supply had minor changes during this quarter. For the next quarter, banks expect that the driver of credit activity will be the demand for consumer credit, while the credit supply is not expected to change, and also the demand for loans from enterprises is expected to remain unchanged.

According to the banks, the dynamics of lending to enterprises during this quarter were affected by increased loan demand from enterprises, while credit supply was characterized by marginal negative movements. Within the enterprise segments, banks stated marginally tightened credit standards for large enterprises, while for SMEs there was no significant movement in credit standards (table 1). In the context of the factors that influenced these developments, the increase in the EURIBOR rate and the poor outlook in the local banking market and in the parent banks had the main negative contribution to the credit standards. Meanwhile, the support given by the KCGF had a positive impact, to some extent, in credit standards. At the same, the approval rate of loans to enterprises results with an increase for both categories of enterprises, albeit at a lower level compared to the previous quarter. For the third quarter of 2023, there is not expected a change in credit standards by banks (chart 1). The support from the KCGF is expected to positively contribute to the credit standards, whereas the increase of the EURIBOR rate is expected to contribute negatively on the credit standards. The approval rate of loans is not expected to have significant changes over the next quarter.

[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 increase of EURIBOR rate and the unfavorable outlook in the global markets. On the other side, the support given by the KCGF and the low perceived risk in the real estate market, marked a positive impact in applied terms and conditions. In the next quarter, banks are expected to further tighten terms and conditions for both categories of enterprises. More precisely, it is expected a higher increase of interest rate for both categories of enterprises, in the current quarter. Conversely, it is expected an ease for collateral requirements, mainly for SMEs. The increase in the EURIBOR rate is expected to negatively affect terms and conditions for enterprises, while the positive changes in them are expected to be driven by the support from KCGF, higher risk tolerance and competition pressure among the banks.

During the second quarter of 2023, in general, there was marked an increase of demand for bank loans at a lower level compared to the previous quarter. The SMEs demand for loans was higher compared to the demand from large enterprises. The demand for loans from enterprises turned out to have been higher compared to the banks' expectations for Q2 2023, expressed in the previous survey (Q1 2023). The generated index of the demand for loans from enterprises was impacted by the replies given by six 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 to a lower level for financing fixed investments. The generated index of banks' expectations on loan demand during the following quarter, does not show significant movements of loan demand from enterprises. Furthermore, the demand to finance fixed investments is expected to mark a decline during Q3 2023, and the demand to finance inventories and working capital is expected to remain unchanged.

The credit activity dynamic of households was mainly supported by loan demand, since the latter was eased to a lesser extent. Credit standards in the current quarter, in general, turn out to be characterized with more significant movements than the expectations of banks expressed in the previous survey. Credit standards were eased to some extent for housing loans, whereas they changed marginally for consumer credit. The increased competitive pressure among the banks was the factor with the highest impact on easing the credit standards for households. Meanwhile, banks stated an increase, to some extent, of the approval rate of loans to households, especially for consumer credit. In the first quarter of 2023, banks do not expect changes in credit standards for any types of loans to households (table 1). 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. 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 an approximate level for both types of loans, through the increase 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 increase of the EURIBOR rate, a rate applied for loans with variable interest rate. Conversely, the competitive pressure was the only factor which positively affected terms and conditions applied for loans to households. For the third quarter of 2023, banks in general expect a tightening in terms and conditions for loans to households. The tightening of terms and conditions is expected to have an impact on housing loans. Primarily, terms and conditions are expected to tighten through the increase of interest rate, at a significantly higher level compared to the current quarter, while, collateral requirements are expected to ease to some extent. After indexing the replies of the banks, it turns out that mainly the increase of the EURIBOR rate is expected have an impact on banks' expectations for terms and conditions during the following quarter. Meanwhile, banks based their expectations for ease on the increased pressure of competition among banks.

The loan demand for loans from households in general marked an increase during the second 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 third quarter of 2023, banks expect an increase in demand for loans from households at a lesser extent compared to the current level (table 1). The demand for loans, in general, is expected to be driven mainly by the demand for consumer credit. The survey results suggest that this increase of the demand will be mainly driven by the need to cover consumer spending . At the same time, banks expect an improvement in the quality of applications received for consumer credit.

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

	Supply (Credit standards)		Demand	
	Q2 2023	Q3 2023 (expected)	Q2 2023	Q3 2023 (expected)
Enterprises	↘	→	↑	→
SMEs	→	→	↑	→
Large enterprises	↘	→	↑	→
Households	↗	→	↑	↗
Housing loans	↑	→	↑	→
Consumer credit	→	→	↑	↑

↑ Easing of credit standards/Increase in demand for loans (positive index over 0.20)
↗ Easing of credit standards/Increase in demand for loans (positive index below 0.20)
→ Mainly unchanged (positive index/negative up to 0.05)
↘ Tightening of credit standards/Decrease in demand for loans (negative index below 0.20)
↓ Tightening of credit standards/Decrease in demand for loans (negative index over 0.20)

Source: CBK.

Prudent monitoring of clients' financial performance and a more conservative assessment of new applications for loans by banks helped to 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 low 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. Four banks, out of which two with systemic importance, expect an increase in enterprise nonperforming loans, against three banks, also two of them with systemic importance, which expect the same dynamic for household nonperforming loans.

Banks reported an increase of access to financing during the second quarter of 2023. The aggregate score of the banks' replies was based on the replies of seven banks (four of them systemically important banks) which stated an increase in financing, while two other banks stated a decrease to some extent in financing (one of the banks was systemically important). Household deposits were characterized with higher increase, albeit compared to the previous quarter the increase was almost half of that lower. Financing from parent banks and from enterprise deposits were characterized with a limited contribution to the increase of financing, since they resulted with a marginal positive index. Another category which contributed to financing the sector was the financing from interbank money market.

As regards to the maturity, in this quarter an approximate increase was marked by both maturities. 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 financing the banking sector, followed by financing from enterprise deposits and financing from international financial institutions. As regards to the maturity of financing, banks expect the increase of financing to be approximate for both maturities.

Box 1. Methodology

The questionnaire of the Bank Lending Survey

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 twelve banks operating in Kosovo. Consequently, the participating banks represent the general banking market and ensure a proper statistical representation, taking into account that they represent 98% of total assets of the banking sector, and 99.8% of total lending of the banking sector.

Survey participants are asked to indicate, in a qualitative manner, the strength of any tightening or easing or the strength of any decrease or increase, reporting changes using the following five-point scale: (i) tightened / decreased considerably, (ii) tightened / decreased somewhat , (iii) basically no change, (iv) eased / increased somewhat or (v) eased / increased considerably.

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 values of indices are ranged from -1 to 1, where the positive values of the index represent ease, increase or positive contribution, whereas negative values represent tightening, decline or negative contribution.

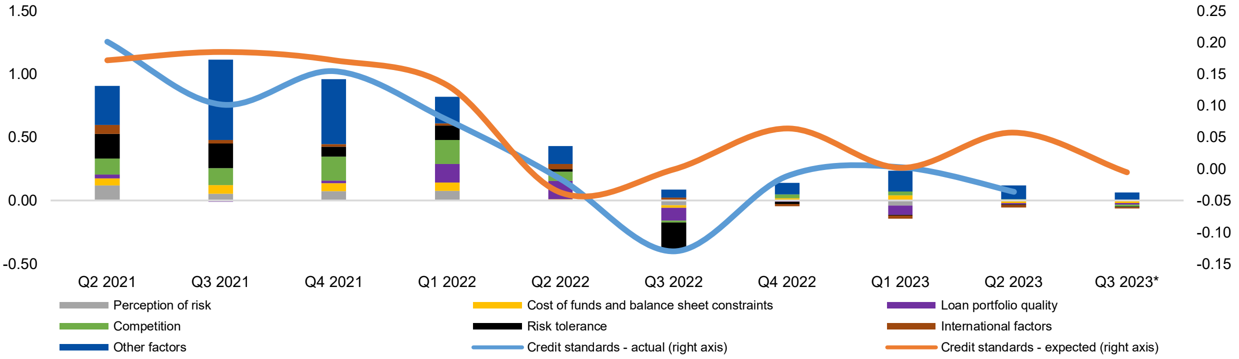
Developments in credit standards, credit terms and conditions, and in the demand for loans

Loans to enterprises

Credit standards

During the second quarter of 2023, the result on credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises, in general represent marginal tightening of credit standards. Expectations of banks expressed in the previous survey (Q1 2023), result to have overestimated the changes in credit standards for enterprises for Q2 2023 (chart 1).

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



Source: CBK.

*Expected value

Within the enterprise segments, banks stated marginally tightened credit standards for large enterprises with a negative index of 0.07, while for SMEs there was no significant movement in credit standards. The main factors that had negative impacts on credit standards were the increase of EURIBOR rate and poor perspective in the local banking market and in the parent banks with a marginal negative index 0.10 and 0.07, respectively. Whereas, the factor which to some extent had positive impact on credit standards, and giving security to the banking sector, was the support offered by the KCGF with a positive index of 0.21.

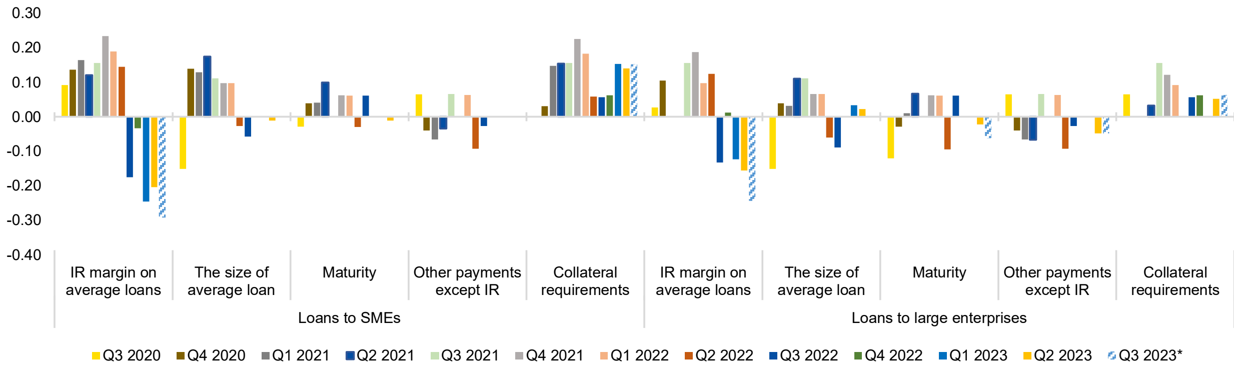
At the same, the approval rate of loans to enterprises results with an increase for both categories of enterprises, albeit at a lower level compared to the previous quarter. More precisely, the results generated a positive index of 0.14 for SMEs and 0.11 for large enterprises.

Overall credit standards are expected to remain unchanged in the following quarter. More specifically, nine out of ten participating banks in the survey stated that they do not expect changes in credit standards. The support from the KCGF is expected to positively contribute to the credit standards, whereas the increase of the EURIBOR rate is expected to contribute negatively on the credit standards. Also, the approval rate of loans is not expected to have significant changes over the next quarter.

Terms and conditions

In the second 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 0.20 for SMEs and negative index of 0.16 for large enterprises). This result was impacted by the replies of three banks, of which, one with systemic importance in the sector. Whereas, low ease was marked for collateral requirements for SMEs with a positive index of 0.14, as stated by two banks with systemic importance. Applied terms and conditions were negatively affected by the increase of EURIBOR rate and unfavorable outlook in the global markets. On the other side, the support given by the KCGF and the low perceived risk in the real estate market, 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, applied terms and conditions by banks are expected to further get tightened. More precisely, there is expected a higher increase of interest rate for both categories of enterprises, as stated by four banks, two of them with systemic importance in the sector, where their replies generated a negative index of 0.29 for SMEs and a negative index of 0.24 for large enterprises. Conversely, it is expected an ease for collateral requirements, mainly for SMEs, as stated by two banks with systemic importance. These expectations were negatively affected by the increase rate of EURIBOR with a negative index of 0.26. Meanwhile, the support from the KCGF, the higher tolerance towards the risk and the competitive pressure among the banks had a positive impact on the expectations of banks on terms and conditions during the following quarter.

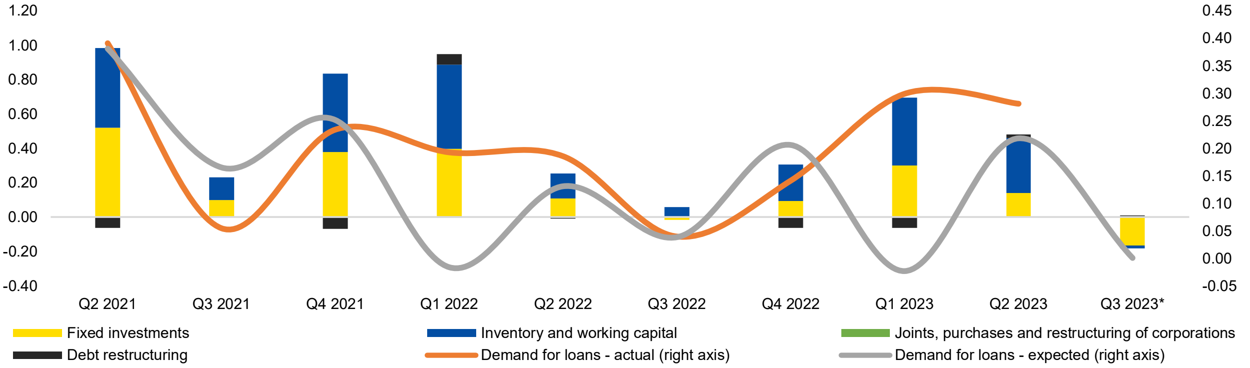
Demand for loans

During the second quarter of 2023, **the enterprises demand for loans** marked an increase at a lower level compared to Q1 2023. More precisely, the replies generated a positive index of 0.31, as expressed by six banks out of ten participating banks in the survey. Also, the demand for loans turned out to have been higher compared to the banks' expectations for Q2 2023, expressed in the previous survey (Q1 2023) (chart 3). According to the categories of enterprises, the responses to the demand for loans generated a positive index of 0.32 for SMEs and a positive index of 0.24 for large enterprises.

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 0.32, and at a lower level for financing fixed investments with a positive index of 0.14. The result of the contributing factors to the loan demand was determined by the replies of seven banks, which stated a growth of the demand for financing inventories and working capital and of five 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 Q2 2023.

According to the survey, during Q2 2023, the nonperforming loans to total loans ratio of enterprises decreased, resulting with a negative index of 0.12, which turns out to be a lower index compared to the outcome of the previous survey, where the replies given by banks generated a negative index of 0.15 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 ratio.

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



Source: CBK. *Expected value

In general, banks do not expect significant oscillations in the demand for loans from enterprises during the next quarter. This outcome was impacted by the replies of seven banks, where three of the banks (two with systemic importance) stated an overall decline of demand for loans, while four other banks (one with systemic importance), stated an increase of the demand for loans from enterprises. Consequently, these replies neutralized each other and resulted with a marginal index. The demand to finance fixed investments is expected to mark a decline during Q3 2023, and the demand to finance inventories and working capital is expected to remain unchanged. Meanwhile, the quality of the received applications for loans is not expected to undergo significant changes.

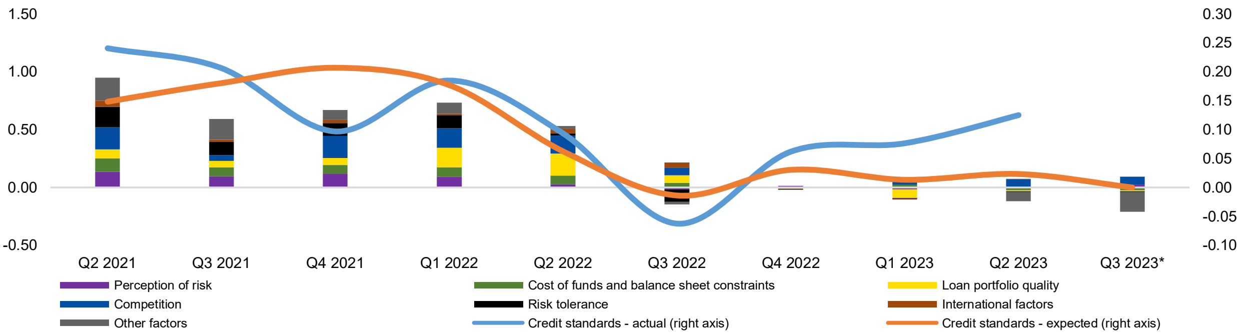
During the following quarter, banks expect nonperforming loans to total loans ratio for enterprises to change direction and be shifted to a positive index of 0.13, thus reflecting banks' expectations on the deterioration of credit portfolio quality. These expectations were mainly impacted by the dynamics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

Loans to households

Credit standards

Credit standards applied to households, during the second quarter of 2023, generally eased. This ease was mainly applied for housing loans with a positive index of 0.20, based on the replies of three banks, where two of them are with systemic importance. Conversely, the ease on consumer credit resulted with a marginal positive index of 0.05, which corresponds with the replies of two banks, one of them with systemic importance.

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



Source: CBK. *Expected value

Expectations for the current quarter, stated by banks in the previous survey (Q1 2023), resulted to be lower than the actual values (chart 4). The increased competitive pressure among the banks was the factor with the highest impact on easing the credit standards for households.

Banks stated an increase of approval rate of loans to households, namely for housing loans with a positive index of 0.10, while consumer credit, marked a positive index of 0.22.

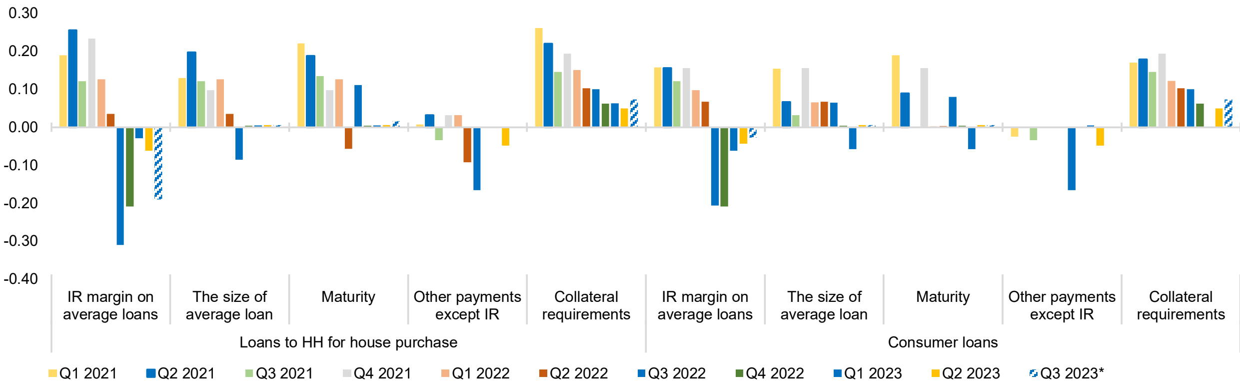
In the third quarter of 2023, banks do not expect changes in credit standards for any types of loans to households. Factors that are expected to positively impact credit standards are the increased pressure of competition among banks and the perception of lower risk in collateral. Banks expect an increase 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 low positive index of 0.09 and for consumer credit with a positive index of 0.16.

Terms and conditions

Terms and conditions for new loans to households, generally were characterized with marginal negative movements in the second quarter of 2023. The generated results mainly reflect tightenings to an approximate level for both types of loans. Specifically, banks applied higher interest rates (negative index of 0.06), a result which was influenced by the replies of three banks which increased interest rates for housing loans and two other banks that declined the same ones. Meanwhile, only one bank applied higher interest rates for consumer credit which resulted in a marginal negative index of 0.04. At the same time, for both types of loans the collateral requirements were marginally eased (positive index of 0.05). The main factor in increasing the interest rate was the increase of the EURIBOR rate, a rate primarily for loans with variable interest rate (chart 5). The competitive pressure was the only factor which positively affected terms and conditions applied for loans to households.

For the third quarter of 2023, banks in general expect a tightening in terms and conditions for loans to households. The tightening of terms and conditions is expected to have an impact on housing loans. Mainly, terms and conditions are expected to be tightened through the increase of the interest rate to a significantly higher level compared to the current quarter, with a negative index of 0.19, a reply stated by three banks, where two of them with systemic importance. At the same time, the collateral requirements are expected to ease at a low level for both types of loans. After indexing the replies of the banks, it turns out that mainly the increase of the EURIBOR rate (negative index of 0.24) is expected to have an impact on banks' expectations for terms and conditions during the following quarter. Meanwhile, banks based their expectations for ease on the increased pressure of competition among banks.

Chart 5. Changes of terms and conditions applied to households



Source: CBK.

*Expected value

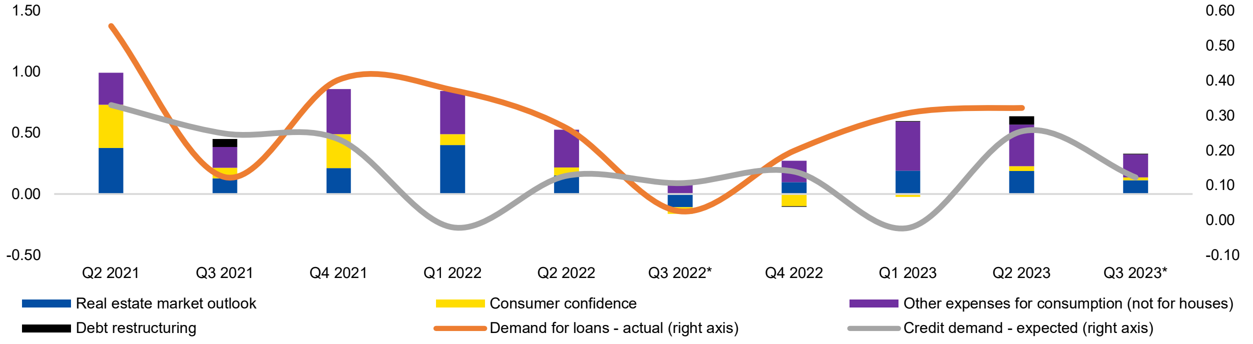
Demand for loans

After generating the results for the loan demand in this quarter, it turns out that the loan demand from households in general has marked an approximate increase compared to the previous quarter. If the loan demand is broken down by types of loans to households, it turns out that the demand for consumer credit marked an increase with a positive index of 0.35, 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 results of the actual demand for loans are compared with the expectations of banks stated in the previous survey for the same period, the actual level of the increase of the demand is higher(chart 6).

The factors which positively affected the dynamics of the demand for loans were the need to finance consumer spending (a positive index of 0.34), and at a lower level, also the real estate market outlook had a positive impact (positive index of 0.19). The quality of applications submitted by the households, generally decreased with a marginal negative index, influenced by the reply of one systemically important bank which stated a decrease in the quality of applications received, against two other banks with a lower weight which stated an increase in the quality of the same ones.

Banks stated a deterioration in the quality of the credit portfolio for households, based on a positive index of 0.13, reflecting the responses of three banks, of which one bank with systemic importance, which stated an increase in the nonperforming loans ratio.

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



Source: CBK.

*Expected value

In the third quarter of 2023, the demand for loans from households is expected to be driven mainly by consumer credit. More specifically, banks expect an increase in demand for consumer credit with a positive index of 0.21 and for housing loans with a positive index of 0.04. The expectations for this dynamic, were impacted by replies of five banks (two of them with systemic importance) which expect an increase for consumer credit. The survey results suggest that mainly the need to cover consumer spending will drive this increase of the demand. At the same time, banks expect an improvement in the quality of applications received for consumer credit, albeit at a low level with a positive index of 0.12.

During Q3 2023, banks expect that the loan portfolio quality of households will be characterized by a further deterioration, based on the positive value of the index. More precisely, banks' expectations on nonperforming loans ratio resulted in a positive index of 0.17, stated by four banks, where two of them are banks with high weight in lending and with systemic importance.

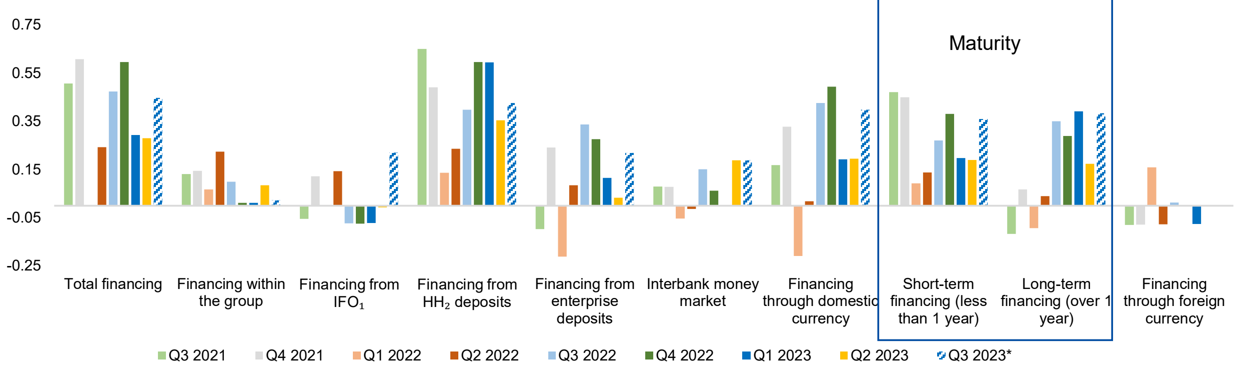
Financing

Banks reported an increase of access to financing during the second quarter of 2023. The aggregate score of the banks' replies was based on the replies of seven banks (four of them systemically important banks) which stated an increase in financing, while two other banks stated a decrease in financing (one of the banks with systemic importance).

Based on the aggregated result of the replies, during this quarter, total financing marked an approximate increase compared to the previous quarter, namely positive index of 0.28 (positive index of 0.29, in Q1 2023). On the other hand, household deposits generated a positive index of 0.35, representing almost a half lower level compared to the previous quarter (positive index of 0.60). This result was affected by the replies of six participating banks in the survey, where four of them are with systemic importance, and further, one of these banks stated a considerable increase of household deposits. While, financing from enterprise deposits had a limited contribution to the increase of financing since it generated a marginal positive index (positive index of 0.03), reflecting the replies of six participating banks, two banks with systemic importance stated a decline, while four other banks (two of them with systemic importance) stated a growth in financing from this category. Another category which contributed to financing the sector was the financing from interbank money market, stated by two banks with systemic importance, where one of them stated a considerable increase from this source. Financing from parent banks contributed marginally in the increase of financing with a positive index of 0.09, as stated by two banks, where one of them turns out to be with systemic importance (chart 7). As regards to the maturity of financing, in this quarter an approximate increase was marked by both maturities. More specifically, long-term deposits generated a positive index of 0.17, while short-term deposits generated a positive index of 0.19.

For the next quarter, banks in general expect an increase in total access to financing, to some extent of a larger level, compared to the current quarter, with a positive index of 0.45. Financing through household deposits is expected to lead the increase in financing of the banking sector with a positive index of 0.43, followed by financing from enterprise deposits and financing from international financial institutions (stated by three banks with systemic importance) with a positive index of 0.22. As regards to the maturity of financing, banks expect the increase of financing to be approximate for both maturities. More specifically, there is expected an increase in short-term financing with a positive index of 0.36 and a long-term financing with a positive index of 0.38 (chart 7).

Chart 7. Changes in financing the banking sector



Source: CBK.

*Expected value

Results of focused questions

In addition to the standard questions, the questionnaire of the survey for the second quarter of 2023 has been supplemented with three additional questions in an attempt to identify possible risks in the banking sector in general, as well as the impact of credit risk on credit supply, in particular. Also, one of the questions breaks down credit supply and demand by economic sectors.

Driven by the consequences of the war in Ukraine on the dynamics of prices of energy and other basic products, from last year onwards during 2023, a number of factors influenced the assessments and expectations for the growing risks to the banking sector in the country and on the global level. In this context, to understand in more detail the assessments and expectations of the banks in the country, the survey also included a question on the most possible risks of the sector during the second quarter, and further the expectations of the banks for the second half of 2023. Although, during the second quarter there was no materialization of risks, banks were more cautious in monitoring liquidity risk and interest rate risk, which were affected by the increase in uncertainty in securing financing and by the oscillations of interest rates as a result of inflation. In order to manage these dynamics, banks offered higher interest rates on deposits and follow-up packages to attract deposits, and started applying variable interest rates on loans, which primarily are interlinked with EURIBOR rate. For the remainder of 2023, banks identified as increasing risks the credit risk, liquidity risk and profitability risk. The factors on which these expectations were based are mainly the high level of prices in the country/the increase in the cost of living, the weakened economic activity, exposure to the sectors most affected by the increase in prices (especially the construction sector), the increase in the cost of bank financing, the lack of labor force in the local market and the risk of young people emigrating after visa liberalization, as well as, the political developments in the country.

The survey questionnaire for Q2 2023 includes an additional question on the impact of banks' nonperforming 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. Generated results showed that the NPL ratio did not affect credit standards nor terms and conditions applied for enterprises and households. At the same time, banks referred to the increased perception on risks, costs for clearing the balance sheet[3] and the cost of capital position 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 and banks' risk tolerance remained 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 second quarter of 2023, credit standards did not have significant changes. A marginal negative result, which implies a tightening of credit standards was marked for the manufacturing and construction sector with a negative index of 0.06, while for other sectors credit standards have not changed. Terms and conditions were tightened to a larger extent for almost all of the sectors, and especially for the construction sector with a negative index of 0.14, and for the residential real estate sector with a negative index of 0.12. Tightening of terms and conditions were marked also for other economic sectors, albeit at marginal levels. These tightening mainly represent a raise of interest rate. Conversely, the demand for loans marked an increase from all economic sectors. The sector with the most increased demand for financing was the one of construction with a positive index of 0.28, an increase stated from six banks. Whereas, the second sector by increase of the demand was the residential real estate sector with a positive index of 0.20, an increase stated by three banks.

Based on the generated results, during the following quarter banks are not expected to apply changes in the credit supply for none of the economic sectors. Terms and conditions are expected to tighten at a larger extent compared to the current quarter for all economic sectors. Sectors with the highest negative index were the one of construction (negative index of 0.24), services sector (negative index of

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

0.17) and real estate sector (negative index of 0.14). At the same period, the demand for loans is expected to mark a marginal movement. More specifically, it is expected a decline in demand from the construction and manufacturing sector (negative index of 0.09), while it is expected a marginal increase in demand from the trade and services sector (positive index of 0.05 and 0.04, respectively).

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, the 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 third 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 July 2023, banks have estimated a lower level of inflation in the second quarter of 2023 compared to the previous quarter, and expect an even lower level of inflation, in the third quarter of 2023. For 2023 , banks expect that the level of inflation rate will reach 4.8% from 11.6%, as it was in 2022.

The data published by the Kosovo Agency of Statistics, for the second quarter of 2023, suggest that the annual average inflation rate was around 4.2%, while for the third quarter of 2023 banks expect that the average inflation rate would be 4.5%. Most of the banks expect inflation to be above 4% 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

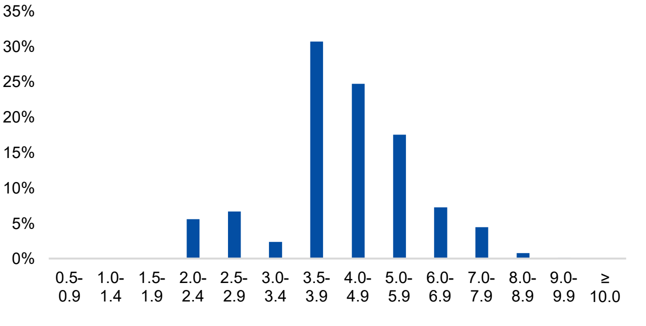
Banks	Q2 2023	Q3 2023	2023
1	6.9%	6.9%	6.8%
2	6.0%	4.0%	3.0%
3	4.2%	4.2%	5.2%
4	4.2%	3.8%	5.4%
5	5.5%	5.6%	5.6%
6	4.2%	2.5%	3.4%
7	2.9%	4.0%	4.9%
8	7.5%	3.2%	2.2%
9	7.5%	5.5%	5.7%
10	5.8%	5.4%	5.7%
Average	***5.5%***	***4.5%***	***4.8%***

Source: Commercial banks and CBK calculations.

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

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

Chart 8. Probability of inflation for Q3 2023 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.

- ✓ As a factor that may have influenced the slowdown rise of inflation, banks have mentioned the increase in interest rates by the Federal Reserve in the USA, the European Central Bank, the Bank of England, etc. The drop in prices in the international markets as well as the slowdown in the growth of the global economy may have influenced the slowing down the rise of inflation, given the high dependence of Kosovo's economy on the import of goods, etc.

- ✓ Whereas, as factors which contributed to inflation to remain still high, banks have mentioned the war in Ukraine and the fact that Russia and Ukraine are important suppliers of raw materials. Another factor is the decision taken by Energy Regulatory Office to increase the energy tariffs by 15%, which is going to have an impact also in the following months, especially during the winter period.

As a conclusion, banks expect to have a slowdown increase of inflation during the year of 2023 and taking into account the dynamics with which are being characterized prices in the country, it is thought that these expectations are realistic. However, the expectations of the slowdown increase of inflation may be negatively affected by the increase of oil prices during the recent months, as a result of the cut in production undertaken by OPEC, the violation of the agreement by Russia on export of wheat and unfavorable climatic conditions, which resulted with a lower harvest output of wheat.

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