



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

Bank Lending Survey

Number 8

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CENTRALNA BANKA REPUBLIKE KOSOVA
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Bank Lending Survey and Inflation Expectations

Number 8

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CONTENTS

Bank Lending Survey -----	4
Introduction-----	4
Results Summary-----	4
Box 1. Methodology-----	7
Developments in credit standards, credit terms and conditions, and in loans demand-----	8
Loans to enterprises-----	8
Credit standards-----	8
Terms and conditions-----	9
Demand for loans-----	9
Loans to households-----	10
Credit standards-----	10
Terms and conditions-----	11
Demand for loans-----	12
Financing-----	13
Results of focused questions: The impact of Covid-19 in the banking sector-----	14
Inflation Expectations -----	15
Methodology-----	15
Results Summary-----	15

Bank Lending Survey

Introduction¹

In order to increase the analytical capabilities on a good assessment of lending dynamic activities in Kosovo and expectations on the price level, the Central Bank of the Republic of Kosovo (CBK) has designed and conducted a survey with commercial banks which operate in the banking sector of Kosovo. The report which analyzes the results of this survey will be published on quarterly basis at the website of the CBK, aiming at providing a more comprehensive survey about the risk perception of the banks, the willingness of the banks to lend, and the behavior of the households and enterprises in relation to credit activities dynamics. This report records the credit behavior for the second quarter of 2021, and banks expectations on lending dynamics in the third quarter of 2021.

Besides the standard questions, in this survey were added some other additional questions. These questions aim to reflect the impact of the pandemic on the growth of credit risk during 2021, as well as the impact on the dynamics of loans supply and demand by economic sectors.

Results Summary²

The recovery of economic activity in the country as a result of easing the Covid-19 containment measures, expectations for increased visits from the diaspora compared to previous years and the expansion of priority groups for vaccination against Covid-19 in the country resulted that the second quarter of 2021 to be characterized by a significant increase in lending activity by the banking sector. Annual growth of total loans stock exceeded the annual growth of lending prior to the pandemic. Also, new loans marked a considerable increase compared to the same quarter of the previous year, and against to the previous quarter. These lending dynamics were significantly affected by the demand for loans, which marked a higher increase against the easing of loans supply conditions. Furthermore, the above-mentioned developments dictated the more optimistic expectations of banks in terms of easing loans supply and increasing demand for loans during the third quarter of 2021.

According to banks, the dynamics of lending to enterprises during this quarter was positively affected to a larger extent by loans demand, while loans supply side had a lower easing. Within the loans supply, banks have reported to have eased to some extent the standards applied in assessing enterprise loans applications during the second quarter of 2021. Credit standards were eased at a higher level for SMEs compared to large enterprises (table 1). The changes in credit standards were positively affected mainly by the support of loans from KCGF, the easing of restrictive measures for the spread of Covid-19 virus, as well as the increased competitive pressure in the banking sector.

For the third quarter of 2021, expectations of banks account mainly of an approximate ease of credit standards as in the actual quarter. Similarly, loans supply is expected to be more favorable for SMEs against large enterprises. Five of the participating banks, among which three with systemic importance, expect that the support of KCGF for SMEs will have an impact on easing the credit standards. Also, the easing of restrictive measures against the Covid-19 virus, the increase of competition pressures, the satisfactory liquidity position, as well as the increase of risk tolerance are expected to have a positive contribution.

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 eased, albeit at a lower level. Eased terms and conditions were applied mainly for SMEs through the increase of loans amount, the decrease of collateral requirements, and the decline of interest rate at a lower level. Factors that influenced the easing of terms and conditions for SMEs were the support of KCGF, the improved outlook in the local market, the easing of restrictive measures against Covid-19, as well as the increase of competitive pressures in the banking sector. While, for the third quarter of 2021, banks expect an ease of terms and conditions for SMEs, although at a lower level compared to the second quarter of 2021. The ease is expected to be applied mainly through the decline of collateral requirements and the increase of the loans amount. Similar to the actual quarter, the support by the KCGF is expected to have the key role in the ease for this segment.

During the second quarter of 2021, **the enterprises demand for bank loans** results to have been increased significantly compared to the previous quarter. This increase resulted to be at an approximate level as banks' expectations for Q2 2021, expressed in the previous survey. Positive index which resulted after the indexation of the banks' replies regarding the demand for loans, is mainly attributable to SMEs demand, while the demand for loans from large enterprises resulted to be at a lower positive index. The banks attributed the demand for loans from enterprises mainly to the increase in demand for fixed investments financing and the financing of inventories and working capital. The demand for financing fixed investments in this quarter was characterized by a significant increase in contrast to the previous five surveys, where in four of them there was a negative index, and in the previous quarter there was a positive index but at a marginal level. Despite expectations for increased economic activity in the country, uncertainties about the dynamics of the potential spread of new variants of the Covid-19 virus over the next quarter, may have affected banks' expectations for lower demand for loans over the next quarter, compared to the current quarter from both categories of enterprises (table 1). Potential factors that may affect the increase of demand for loans from enterprises are expected to be the need to finance inventories and working capital, as well as the need to finance fixed investments.

New loans to households were characterized with a considerable increase during the second quarter of 2021 compared to the previous quarter, and also compared to the same period of the previous year. Similar to lending to enterprises, the demand for loans was the main incentive of lending activity dynamics for households during the reporting period. Despite the low actual level of ease, credit standards applied for households result to have been eased at a higher level than the expectations of banks for the same period stated in the previous survey. Despite the prospects for recovery of the economic activity, banks expect the easing of credit standard for households during the following quarter to ease at a lower level compared to this quarter, especially for consumer credit (table 1). The ease of Covid-19 containment measures and the increase of competitive pressure are expected to be the main determining factors of credit standards applied by banks for households.

Terms and conditions for new loans to households eased to some extent. The ease of terms and conditions was higher for housing loans compared to consumer credit. Terms and conditions were eased primarily through the decline of interest rate, the decline of collateral requirements, and lengthening of loans maturity. The key factors that eased terms and conditions of lending to households, during the second quarter of 2021, were the increased competitive pressure, the good outlook in the local market in general and the banking market in particular, as well as the easing of restrictive measures against Covid-19. For the third quarter of 2021, banks stated that they expect an ease, to some extent, in terms and conditions for loans to households. The easing of terms and conditions is expected to be higher for housing loans, mainly through declining the interest rate, lowering the collateral requirements, and lengthening of loans maturity. Easing of Covid-19 containment measures, favorable outlook of the banking market, and the satisfactory liquidity position are expected to be the incentive factors of easing terms and conditions applied by banks during Q3 2021.

The significant increase in loans demand from household segment during the second quarter of 2021 can be attributed, to some extent, to the impact that had the easing of Covid-19 containment measures during this quarter, the expectations for expansion of priority vaccination groups in the country and higher number of diaspora visits (table 1). Banks have reported a higher increase of demand for housing loans compared to consumer credit. More specifically, eight out of total nine participating banks in the survey, have stated an increase in the overall demand for loans. Banks reported that this increase was positively influenced by almost all the factors listed in the survey, namely the favorable real estate outlook, increase in consumer confidence and the need to finance consumer spending. In the second quarter of 2021, banks expect an increase in demand for loans to households, albeit almost at a half level compared to the actual quarter. Survey results suggest that banks expect the same factors which had an impact in the demand for loans in this quarter to contribute also in the following quarter, albeit at lower intensity.

Table 1. Banks assessment on credit supply and demand

	Supply (Credit standards)		Demand	
	Q2 2021	Q3 2021 (expectations)	Q2 2021	Q3 2021 (expectations)
Enterprises	↑	↔	↑	↔
SMEs	↑	↑	↑	↔
Large enterprises	↔	↔	↑	↔
Households	↔	↔	↑	↑
Housing loans	↑	↑	↑	↑
Consumer credit	↑	↔	↑	↔
<ul style="list-style-type: none"> ↑ 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.

Due to the regulatory easing measures taken by the CBK, such as the moratorium or postponement of loan installments payment in the period March - June 2020 and the continuation of restructuring throughout 2020 and 2021, it was enabled for credit risk to remain at low levels. However, banks in the last survey stated that they expect the sector's sensitivity to this risk to emerge during the following quarters of 2021. For the second quarter, banks announced an improvement in portfolio quality, where their responses resulted in a negative index which means a decrease in NPLs to total loans ratio for both enterprises and households. At the same time, banks do not expect this indicator to have significant changes over the next quarter, resulting in a positive but marginal index.

Unlike the previous survey, results of the survey for the stated period show that financing of the banks increased at lower level compared to the previous quarter. Banks' financing in this quarter was dominated by increase of household short-term deposits. Financing from enterprise deposits and also from parent banks marked an increase, albeit at lower level. Over the next quarter, banks do not expect significant changes in access to financing. Financing through household deposits is expected to remain unchanged, while financing from corporate deposits is expected to contribute negatively to bank financing.

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 banks 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 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 nine out of ten 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 determined 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.

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

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

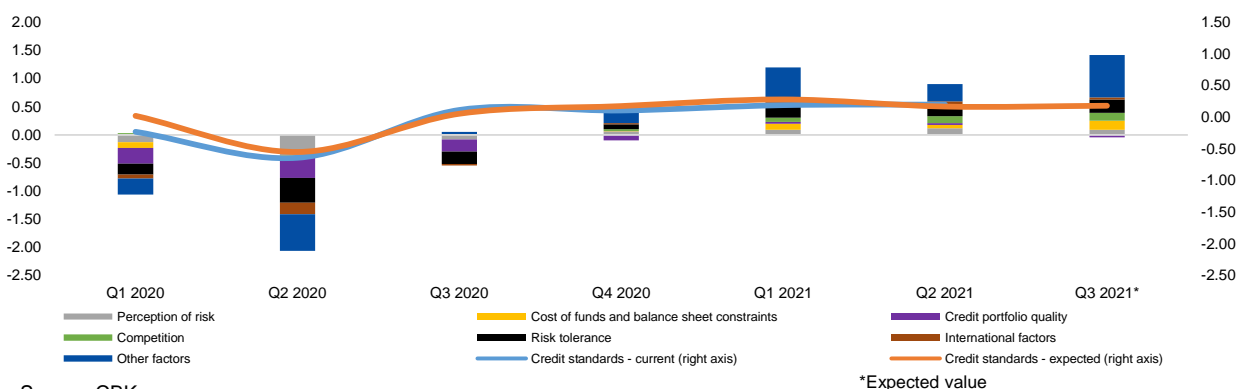
Developments in credit standards, credit terms and conditions, and in loans demand

Loans to enterprises

Credit standards

During the first quarter of 2021, credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises in general represent same ease as in the previous quarter with a positive index of 0.28. In the previous survey (Q1 2021), banks had stated that they expect an ease of credit standards to an approximate level as in the current one (chart 1).

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



Within loans to enterprises, banks reported a positive index of 0.28 for changes in credit standards for SMEs, and a lower positive index of 0.12 for large enterprises. Specifically, this result was impacted by the replies of five participating banks which stated an ease to some extent of credit standards for SMEs, whereas only one bank stated the same for large enterprises.

The main role in easing the credit standards applied by banks in Q2 2021, results to have been the support for enterprises in lending by KCGF with a positive index of 0.52 (replied five banks), an ease of Covid-19 containment measures with a positive index of 0.32, as well as the increase of competitive pressures in the banking market with a positive index of 0.31. In line with the eased supply side, the approval rate of loans to enterprises marked an increase in this period, especially for SMEs (positive index of 0.31).

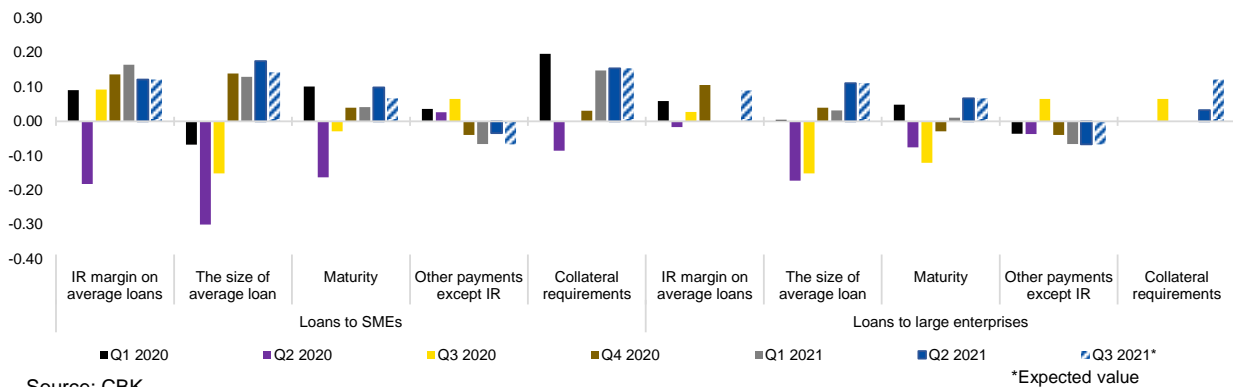
Banks are expected to ease credit standards to some extent during Q3 2021, based on expectations for economic recovery in the country, as a consequence of the beginning of vaccination of population and the improved pandemic situation. Four out of nine participating banks, among which three with systemic importance, expect that the support of KCGF for SMEs will continue to have the main contribution in easing the credit standards. Also, a positive contribution is expected to have the easing of restrictive measures against Covid-19, the increase of competitive pressures, the satisfactory liquidity position, as well as the increase of risk tolerance. Specifically, the easing of credit standards is expected to be at an approximate level as in the current quarter, where after the indexation of replies it was resulted in a positive index for SMEs of 0.25, and a positive index of 0.12 for large enterprises.

While, approval rate of loans to enterprises is not expected to have significant changes for enterprise categories.

Terms and conditions

In Q2 2021, the overall terms and conditions applied by banks in issuing loans to enterprises (the specific terms and conditions of a contract for loans) were eased, albeit to a low level (chart 2). The ease of terms and conditions was applied mainly for SMEs, while for large enterprises the change was marginal. Specifically, for SMEs, the ease was marked for the size amount of loans approved and collateral requirements, with an index of 0.17 and 0.15, respectively, while the interest rate resulted with a lower positive index of 0.12.

Chart 2. Changes of terms and conditions applied to enterprises



The factor with the main contribution and positive high index in easing terms and conditions was the support offered by KCGF for SMEs with a positive index of 0.56. Also, with a positive index contributed the good outlook of the domestic market perceived by banks, the ease of Covid-19 containment measures, and the increase of competitive pressures.

Banks are expected to apply eased terms and conditions during Q3 2021, but at low levels. In this context, banks stated that they expect easing of terms and conditions mainly for SMEs, through the decrease of collateral requirements (positive index of 0.15) and the increase of the size of loans amount (positive index of 0.14). Banks are not expected to offer a significant change in terms and conditions for large enterprises. The factor with a positive contribution to credit terms and conditions for new loans with an index of 0.48 is expected to be marked by the support of KCGF for SMEs. Also, the ease of restrictive measures against the spread of Covid-19 virus and the increase of competitive pressures are other factors, that according to banks are expected to influence the easing of terms and conditions during Q3 2021.

Demand for loans

During the second quarter of 2021, **the enterprises demand for loans** marked a significant higher increase compared to Q1 2021. Also, the increase in demand for loans resulted to be at an approximate level with banks' expectations for Q2 2021 expressed in the previous survey (Q1 2021) (chart 3). More specifically, the demand for loans from SMEs increased with a positive index of 0.55, whereas the demand from large enterprises generated a lower positive index of 0.23. The index generated for loans demand was influenced by the replies of seven banks which stated an increase in demand, and moreover, a bank of systemic importance and a large share in lending of the banking sector declared a significant increase in demand for loans. The return of the economic activity of the most affected sectors of enterprises, as a result of the easing of containment measures against Covid-19 and the need for investments, influenced the demand for loans from enterprises to mark an increase.

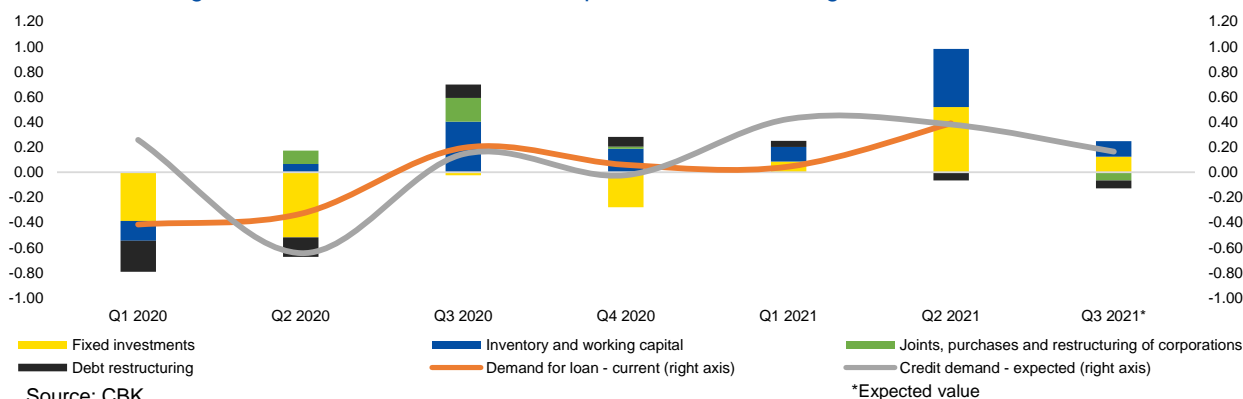
According to the survey, the increase in demand for loans from SMEs was mainly influenced by the increase in demand for financing the fixed investments, and financing of inventories and working capital with a positive index of 0.52 and 0.46, respectively. The outcome of the demand for fixed

investments financing was determined by the replies of seven out of the nine participating banks which stated an increase in this factor. The increase in demand for fixed investments suggests the recovery of economic entities, which after a year of representing the demand for acute liquidity, started with the demand for financing capital investments, which means further expansion of business activities.

The quality of the received applications was improved to some extent, during Q2 2021, mainly for applications for loans from SMEs with a positive index of 0.15.

According to the survey, during Q2 2021, the nonperforming loans to total loans ratio of enterprises generated a negative index of 0.17, for the first time since Q1 2020, representing an improvement in the quality of loans portfolio.

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



Despite expectations for increased economic activity in the country, uncertainty about the greater spread of new variants of the Covid-19 virus over the next quarter, may have prompted banks to expect lower demand than in the current quarter. Consequently, the demand is expected to increase significantly from both segments of enterprises compared to Q2 2021, especially from SMEs with a low positive index of 0.17. Factors with a positive contribution to loans demand are expected to be the need for financing inventories and working capital, and fixed investments with a low positive index of 0.12 for both types of loans. At the same time, banks do not expect a significant change on the quality of the enterprise applications for loans.

During the following quarter, banks expect the nonperforming loans ratio for enterprises to switch back into a positive index, albeit at a marginal level of 0.08.

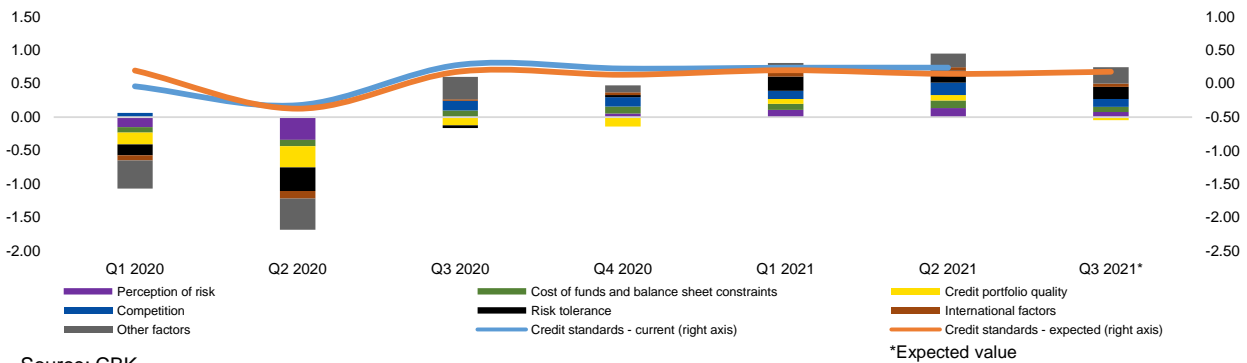
Loans to households

Credit standards

Credit standards applied to households during the second quarter of 2021 generally eased, generating a positive index of 0.25 for housing loans and a positive index of 0.24 for consumer credit. The expectations for the second quarter stated by banks in the previous survey, suggested an ease of applied credit standards, albeit at a lower level (chart 4). At the same time, banks stated that they significantly increased the approval rate of loans to households, to a higher extent for housing loans with a positive index of 0.59 against the consumer credit with a positive index of 0.44.

Factors that contributed positively to the easing of credit standards were the increase of competitive pressures (positive index of 0.39), good outlook of the local market (positive index of 0.29), as well as the satisfactory liquidity position of the banking sector in the country (a positive index of 0.24).

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



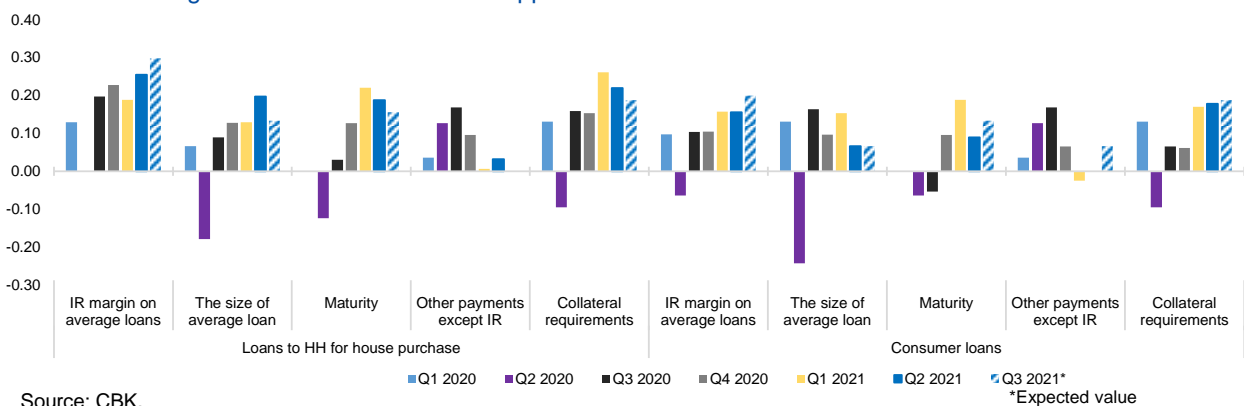
Source: CBK.

In the third quarter of 2021, banks expect eased credit standards for households to some extent, albeit with a lower positive index compared to this quarter. Credit standards are expected to ease to a higher level for housing loans compared to consumer credit, with a positive index of 0.21 and 0.15, respectively. Credit standards are expected to be positively affected by the increase of competitive pressures and the ease of containment measures of Covid-19. At the same time, banks expect an increase of loans approval rate, but at a lower level compared to the actual values marked in Q1 2021. The level of the approval rate of loans is expected to mark a higher level for housing loans compared to consumer credit, with a positive index of 0.31 and 0.10, respectively.

Terms and conditions

Terms and conditions generally eased for new loans to households in the second quarter of 2021. The ease of terms and conditions was higher for housing loans compared to consumer credit. Almost all the terms and conditions for housing loans conveyed in the survey were eased, except for other payments other than interest, which remained unchanged. Specifically, banks applied lower interest rates (positive index of 0.25), reduced collateral requirements (positive index of 0.22), increased the amount of approved loans (positive index of 0.20), and lengthened loan maturity (positive index of 0.19). While for consumer credit, banks applied an ease at a lower level, mainly in collateral requirements (positive index of 0.18) and interest rate (positive index of 0.16) (chart 5).

Chart 5. Changes of terms and conditions applied to households



Source: CBK.

The main factors that contributed to the easing of the conditions and rules applied are mainly the increased competitive pressure, the good local market outlook in general and the banking market in particular, as

well as the satisfactory liquidity position of the sector. Also, these easing of terms and conditions were affected by the ease of Covid-19 containment measures.

For the third quarter of 2021, banks stated that they expect an ease, to some extent, in terms and conditions for loans to households. The same as in the current quarter, the ease of terms and conditions is expected to be higher for housing loans compared to consumer credit. Mainly, terms and conditions for housing loans are expected to be eased through the decline of the interest rate with a positive index of 0.30, the decline of the collateral requirements with a positive index of 0.19, and lengthening of maturity with a lower positive index of 0.16.

Meanwhile, concerning consumer credit, terms and conditions are expected to ease through the decrease of interest rate and the reduction of collateral requirements with a positive index of 0.20 and 0.19, respectively. Easing of Covid-19 containment measures, favorable outlook of the banking market, and the satisfactory liquidity position are expected to be the incentive factors of easing terms and conditions applied by banks during Q3 2021.

Demand for loans

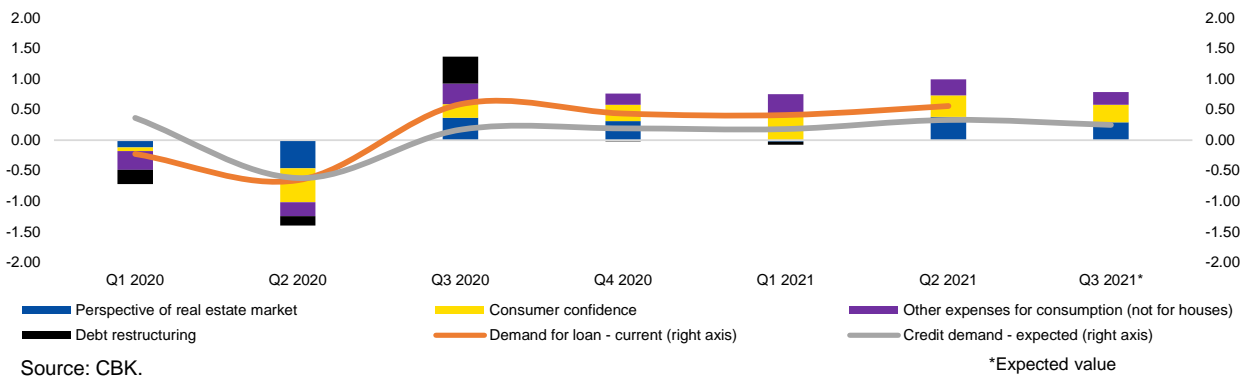
The ease of containment measures of Covid-19 to some extent, expectations for expansion of priority groups for vaccination in the country and the high number of visits from the diaspora which suggest a normalization, to some extent, of the economic activity, were reflected to a significant increase in demand for loans from households, in the second quarter of 2021. Banks have reported a higher increase of demand for housing loans compared to consumer credit. Eight out of a total of nine banks participating in the survey stated an increase in demand for loans in general (three of the banks stated a considerable increase), which after indexing the replies resulted in a positive index of 0.63. The demand for housing loans was characterized with a positive index of 0.63, while for consumer credit the index was 0.48. If we compare the current results of loans demand with the expectations of banks stated in the previous survey for the same period, the current level of the increase in demand is significantly higher, being affected by the actual value of the demand for both categories which are many times higher than the banks' statement (chart 6).

This increase was positively influenced by three of the factors listed in the survey, namely by the improvement of the real estate outlook, the increase of the consumer confidence and the need to finance consumption with a positive index of 0.38, 0.35 and 0.26, respectively. The quality of loan applications received from households during this quarter significantly improved for both types of loans, and especially for housing loans (positive index of 0.40).

As regards to loans portfolio quality of households, banks stated an improvement of loans portfolio quality. Changes in portfolio quality reflected the replies for a decline of nonperforming loans to total loans ratio for households, which resulted in a positive index of 0.21 for the first time since Q1 2020. These changes were stated by four participating banks, where two of them are with systemic importance.

In the third quarter of 2021, banks expect an increase in demand for loans to households to some extent, albeit at a lower level than the growth in the current quarter. Banks stated that they expect an increase in demand for housing loans with a positive index of 0.35, while the demand for consumer credit would mark a low positive index of 0.14. Results of the survey suggest that banks have attributed these expectations to the good outlook of the real estate market, the increase of the consumer confidence, and to the increase of the demand for financing other expenses.

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



Unlike the current quarter (Q2 2021), banks expect loans portfolio quality of household to remain unchanged the third quarter of 2021.

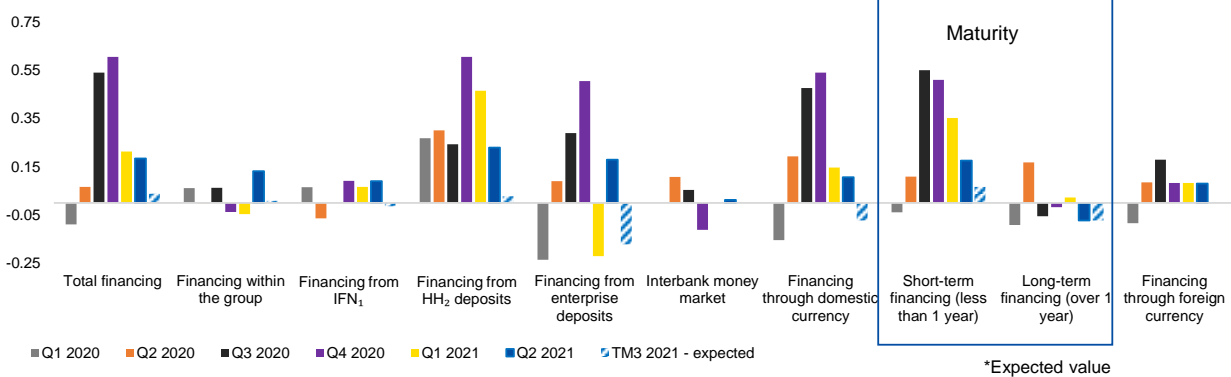
At the same time, banks stated that they expect an improvement to some extent of loans quality applications from households, especially for housing loans with a positive index of 0.25.

Financing

Banks reported an increase of access to financing during the second quarter of 2021. Taking into account the traditional model of the banking sector in Kosovo, the financing continued to be dominated by household deposits.

Unlike the previous survey, results show that financing of the banks was increased at a lower level, where household deposits dominated with an index of 0.23 (0.47 in Q1 2021). Enterprise deposits and financing from parent banks also contributed positively to the financing of the banking sector, but with a low positive index of 0.18 and 0.13, respectively (chart 7). By maturity, short-term deposits were the main financing source during this quarter with positive index of 0.18.

Chart 7. Changes in financing the banking sector



Over the next quarter, banks do not expect significant changes in access to financing. Financing through household deposits is expected to remain unchanged, while financing from corporate deposits is expected to contribute negatively to bank financing with a negative index of 0.17. Banks have not stated an expectation for an important movement, either, regarding the maturity of financing during the following quarter (chart 7).

Results of focused questions: The impact of Covid-19 in the banking sector

The survey questionnaire for the second quarter of 2021 was supplemented with two additional questions, which sought to address expectations about the dynamics in the dimension of credit risk during 2021 and the impact of the pandemic crisis on the dynamics of credit supply and demand by economic sectors.

In the question on banks' expectations for the transition of restructured loans to nonperforming loans (NPL), banks have shown uncertainties that still follow the dynamics around the materialization of the impact of the pandemic on credit risk in the short term future. Consequently, banks' expectations are divided between those which do not expect restructured loans to be shifted into nonperforming loans by the end of 2021, and banks that have provided a probability forecast for this to happen. More specifically, five participating banks stated that they do not expect that loans restructured as a result of Covid-19 to be shifted into nonperforming loans, based on the continuous monitoring and the stable performance of loan repayments by these clients. Nevertheless, four other banks stated that from 3% up to 6% of the structured loans, as a consequence of Covid-19, will be shifted into nonperforming loans. One of the systemically important banks has stated that it expects this percentage to reach the level of 15% to 20% of restructured loans, emphasizing that the highest risk for this dynamic comes from the segment of small enterprises.

The disaggregated replies for enterprises classified by sectors, indicate the direction of financing the economy and dynamics in certain sectors. During the second quarter, based on the easing of credit standards, the construction sector offers the most favorable offer according to the banks. The replies of two systemically important banks and with a high weight to the total lending of the sector stated significant easing of credit standards for this sector, which resulted in a positive index of 0.30. Furthermore, also for loans to manufacturing and residential real estate were applied eased standards, namely with a positive index of 0.21 for both of the sectors. Terms and conditions were eased to some extent mainly for the lending to the sector of residential real estate (positive index of 0.33), manufacturing sector (positive index of 0.29) and for the sector of commercial real estate (positive index of 0.27). In contrast to the previous survey where the dynamics in lending to the trade sector were driven to a large extent by the eased credit supply conditions, in this quarter this sector was mainly affected by the demand for loans with a high positive index of 0.52. Besides the industry sector, all the economic sectors increased the demand for loans during the second quarter. A high demand for loans was marked also by the manufacturing sector (positive index 0.53), followed by the construction sector (positive index 0.44) and services sector (positive index 0.42).

For Q3 2021, banks expect an ease of credit standards mainly for the manufacturing and services sectors. Similarly, also terms and conditions are expected to ease at large extent for the manufacturing sector and real estate sector (residential real estate), whereas at a lower level an ease is expected also for the trade and services sectors. At the same time, the demand for loans is expected to mark an increase by all the sectors, especially by manufacturing, trade and residential real estate sectors.

Inflation Expectations

In order to enhance the analytical capacities and based on the best regional practices and beyond, CBK has continued with the survey of 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 third quarter of 2021 and for the whole year of 2021 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, 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 deal with commercial banks belong to quantitative forms associated also with the spread of the profitability. Inflation expectations are estimated for different time frameworks, where initially are performed the estimates on the previous quarter and the expectations for the following quarter and the current year in general. The summarizing of inflation through the surveys is followed by a systemic process, elaboration and aggregation in order to find the average of inflation expectations from the commercial banks.

Results Summary

Based on the survey conducted in June 2021, banks have estimated a higher level of inflation in the second quarter of 2021 compared to the previous quarters, and expect an even higher increase in the third quarter of 2021. Dynamics that have characterized the price fluctuations during the reporting period were reflected in inflationary expectations of commercial banks: 1.9% in Q3 2021 from 1.6% as they had estimated for the previous quarter (table 2). For 2021 banks expect that the level of inflation rate will reach 1.9% , from 0.2% as it was estimated to have been in 2020. The survey realized conveys also the potential effects that banks expect after they have faced with the new situation caused by Covid-19 pandemic.

Data published by the Kosovo Agency of Statistics (KAS) for the second quarter of 2021 suggest that the average annual inflation rate was around 2.1%. Therefore, estimates of banks for the level of inflation rate was lower compared to the actual data. For the third quarter, banks expect the average inflation rate to be 1.9%. Five banks expect the inflation rate to be 2%, while four other banks expect the inflation rate to range between 1% to 2%.

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

Banks	Q2 2021	Q3 2021	2021
1	2.7%	2.3%	1.7%
2	1.2%	1.9%	2.2%
3	1.2%	2.4%	2.5%
4	0.6%	2.0%	1.7%
5	2.4%	2.2%	1.9%
6	1.1%	1.0%	1.1%
7	1.2%	1.7%	1.9%
8	2.7%	2.4%	2.5%
9	1.4%	1.6%	1.7%
Average	1.6%	1.9%	1.9%

Source: Commercial banks and CBK calculations.

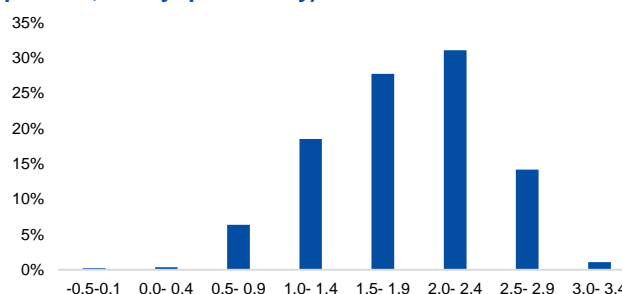
As depicted in chart 8, the reported spreads of probability show that there is a relatively low uncertainty relating the following result of inflation, hence the spread of probability of the banks is concentrated in the expected inflation.

In their qualitative comments, banks have cited some of the possible factors which had an impact on the level of inflation:

- ✓ A more optimistic view regarding the pandemics - expect an increase of the economic activity and consequently of the level of inflation;
- ✓ Barriers created in the supply chains as a result of the Covid-19 pandemic as well as the increase in the prices of oil products, dynamics that are reflected in the increase of transport costs and consequently in the increase of prices;
- ✓ Price developments in international markets;
- ✓ Low manufacturing in Kosovo and the dependence on imports (imported inflation).

Banks expectations for 2021 are in compliance with the higher trend of inflation compared to 2020, however, remain lower as expectations when taken into account the dynamics with which prices are being characterized in the country.

Chart 8. Probability of inflation for Q3 2021 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.



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