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
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Bank Lending Survey and Inflation Expectations

Number 9

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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 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 in the third quarter of 2021, and banks expectations for credit dynamics in the fourth 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 restrictive measures applied in September 2021, and at the same time the expectations for the impact of the operationalization of the easing measures from the Economic Recovery Package on the lending activity of banks. One of the questions aims to elaborate on the factors that contributed to the significant increase in deposit financing. Also, credit supply and demand are broken down by economic sectors.

Results Summary[2]

As a result of the improvement of the pandemic situation based on the small number of cases with Covid-19 and the good progress with the immunization of the population, the restrictive measures were eased. The ease enabled the return of economic activity to a normal stage in the first two months of this quarter, especially through the large number of visits from the diaspora, which consequently influenced the expansion of lending activity by the banking sector during this quarter. Annual growth of total loans stock exceeded the annual growth of lending prior to the pandemic. Whereas, new loans during this quarter, although in high value, were lower compared to the previous quarter. These lending dynamics were influenced to a greater extent by credit supply, which eased to some extent, compared to credit demand, which had marginal changes. Furthermore, the above-mentioned developments in the country's economy also dictated the expectations of banks, affecting the expectations on the ease of credit supply and the increase in credit demand to some extent during the fourth quarter of 2021.

According to banks, lending to enterprises during this quarter was positively affected mainly by credit supply, while credit demand did not change significantly. Within loans supply, banks have reported to have eased, to some extent, the standards applied in assessing enterprise loans applications during the third quarter of 2021. Credit standards were eased at a higher level for SMEs compared to large enterprises (table 1). Changes in credit standards were positively influenced mainly by the support of loans from the KCGF, the increased competitive pressure in the banking sector, as well as the increase in risk tolerance.

For the fourth quarter of 2021, banks' expectations consist of easing to a higher level of credit standards than in the current quarter. Similar to the current quarter, credit supply to some extent is expected to be more favorable for SMEs than for large enterprises. Five of the participating banks,

[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.

among which three with systemic importance, expect that the support of KCGF for SMEs to be the key factor on easing of the credit standards. Also, the increase of competitive pressures from banks is expected to have a positive contribution to the ease.

Terms and conditions applied by banks in granting loans to enterprises were eased, albeit at a lower level. Eased terms and conditions were applied for both categories of enterprises through the lower collateral requirements, and the decline of interest rate, and at lower level the increase of loans amount. Factors that influenced the easing of terms and conditions were the support of SMEs by the KCGF and the increase of competitive pressures in the banking sector. While, for the fourth quarter of 2021, banks expect an ease of terms and conditions for both categories of enterprises, at a marginally higher level compared to the third quarter of 2021. Eased terms and conditions are expected to be similar with those applied in the current quarter. Similar to the current quarter, the increase of competitive pressures in the banking market and the support of the KCGF to enterprises are expected to have the key role to the ease.

During the third quarter of 2021, **the enterprises demand for bank loans** did not mark a significant change compared to the previous quarter. The demand for loans from enterprises turns out to be overestimated in banks' expectations for Q3 2021 expressed in the previous survey (Q2 2021), where banks expected an increase to some extent in the demand for loans from enterprises. There was a positive marginal change in the demand for loans from large enterprises, while the demand from SMEs was unchanged. Demand for loans from enterprises, according to banks' statements, was driven mainly by the increase in demand for fixed investments and financing of inventories and working capital, although both of these factors were characterized by a low positive index. Expectations for increased economic activity in the country may have been affected by the banks' expectations for higher credit demand during the next quarter compared to the current one from both categories of enterprises, especially from SMEs (table 1). Potential factors that are expected to influence the increase in demand for loans from enterprises are the need to finance inventories and working capital and financing fixed investments, with a higher intensity to some extent, compared to the current quarter.

New loans to households were characterized with increase during the third quarter of 2021, compared to the same period of the previous year. Similar to lending to enterprises, credit supply was the main incentive of lending activity dynamics for households during the reporting period, while credit demand had a weaker impact in this aspect. Credit standards in the current quarter, in general, turn out to be similar to the expectations of banks expressed in the previous survey, but if we break it down by purposes of loans (for housing purchase and consumer credit), consequently banks' expectations do not correspond to current values. Credit standards were eased to some extent, especially for consumer credit. The ease were influenced mainly by the improved outlook of the domestic market. Banks also expect that such easing of credit standards to an approximate level as in this quarter to continue for households also during the next quarter, especially for consumer credit (table 1). Increased competitive pressure in the banking sector is expected to be the key determinant 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 mainly through the decline of collateral requirements, extension of loan maturity, and at lower level through the decline of interest rates and the increase of loan amount. The key factors that eased terms and conditions of lending to households, during the third quarter of 2021, were the increased competitive pressure, the good outlook in the domestic market in general and the banking market in particular, as well as the favorable liquidity position of banks. For the fourth quarter of 2021, banks stated that they expect an ease in terms and conditions for loans to households to a higher extent compared to the current quarter. An ease of terms and conditions is expected for both types of loans, albeit for consumer credit banks are expected to offer more favorable terms and conditions. All terms and conditions listed in the survey are expected to be eased besides other payments than interest which is expected to remain unchanged. Increased competitive pressures, the good outlook of the banking market, and the expectation of easing the containment measures of Covid-19 are expected to be the incentive factors of easing terms and conditions applied by banks during Q4 2021.

Despite the eased measures during the longest time of the current quarter and the return of the country's economy to a normal stage, the demand for loans from households marked a significantly lower growth compared to the previous quarter. Banks reported a same increase of demand for both types of housing loans and consumer credit. Exactly, five of the nine banks surveyed reported an overall increase in credit demand while three banks reported a decline in credit demand. Banks reported that this increase was positively impacted by favorable prospects in the real estate market and the need to finance consumer spending. In the fourth quarter, banks expect an increase in demand for loans from households, but at a higher level compared to the current quarter, especially for consumer credit (table 1). 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	
	Q3 2021	Q4 2021 (expectations)	Q3 2021	Q4 2021 (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/negative index 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.

Eased regulatory measures taken by the CBK such as moratorium and loans restructuring enabled the credit risk to remain at low levels. However, the sector's sensitivity to this risk may appear after the maturity of restructured loans - end of 2021. Banks reported a deterioration of the loan portfolio, as the response index in this quarter shifted to positive from the negative as it was in the previous quarter, which means an increase in the nonperforming loans to total loans ratio. This index mainly reflects the responses for enterprises, where four participating banks and three of them of systemic importance declared an increase in this indicator. In the next quarter, a period that corresponds to the maturity of restructuring, banks expect further growth in nonperforming loans, in particular in the household portfolio.

Unlike the previous survey, results of the survey for the stated period show that financing of the banks increased considerably compared to the previous quarter. Banks' financing in this quarter was dominated by the considerable increase of household short-term deposits. More specifically, eight banks stated an increase of household deposits, where two banks with systemic importance stated a considerable increase. Banks attributed the increase in deposits to reluctance to invest from economic entities, high amount of remittances, as well as high level of diaspora visits to the country during this quarter. Whereas, financing from enterprise deposits and also from international financial institutions marked a decline, albeit at lower level. Over the next quarter, banks expect a growth of financing to continue through the growth of short-term household deposits, albeit at a lower level compared to the current quarter. Unlike from this quarter, it is expected that financing through enterprise deposits to contribute positively in financing the sector.

Box 1. Methodology

The questionnaire of the Bank Lending Survey

The BLS questionnaire is based on the standardized questionnaires used by the Central Banks in the euro area and beyond. However, the BLS questionnaire of the CBK has been modified and adopted to its best and comprehensive way to represent lending developments in Kosovo's banking sector.

The BLS questionnaire contains 19 questions, which cover the changes of credit supply, changes in the demand for loans, factors which contribute in these changes and the access of the banking sector to financing, on quarterly basis. Questions on bank lending are focused on two main categories: (i) loans to enterprises, and (ii) loans to households. Moreover, loans to enterprises are sub-categorized in to loans to SMEs and loans to large enterprises, while loans to households are sub-categorized in housing loans and consumer credit. For all the above mentioned categories, changes in loan supply conditions are defined by credit standards applied in the process of loans approval, terms and conditions applied for new loans, the approval rate of loans, and the factors which affect their changes. Meanwhile, the changes in the demand for loans are defined by the demand for loans (the number of applications for loans), the quality of the applications received, and the factors which affect the demand for loans. The questions of the survey primarily are designed to obtain a feedback for changes over the past three months and changes expected in the following three months. Also, questions cover loans in the aspect of their maturity and the currency in which they were granted.

Besides the standard questions, the BLS questionnaire may contain also additional questions on specific issues in order to explain the developments in the banking sector. While standard questions cover a three-months period, additional questions may refer to changes occurred during a longer period of time. The survey conveys 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 defined for answers when banks declare tightening/lowering to some extent (a value of -0.5). Similarly, answers have a value of 1 when there is a considerable ease/increase, while those with ease/increase to some extent are determined with a value of 0.5. Results are also weighed based on the weight that each of the banks has in total lending of the banking sector. Consequently, the weight of each bank based on its share on the credit market is multiplied with the value determined based on the intensity of the given answer, thus obtaining the index in question.

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

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

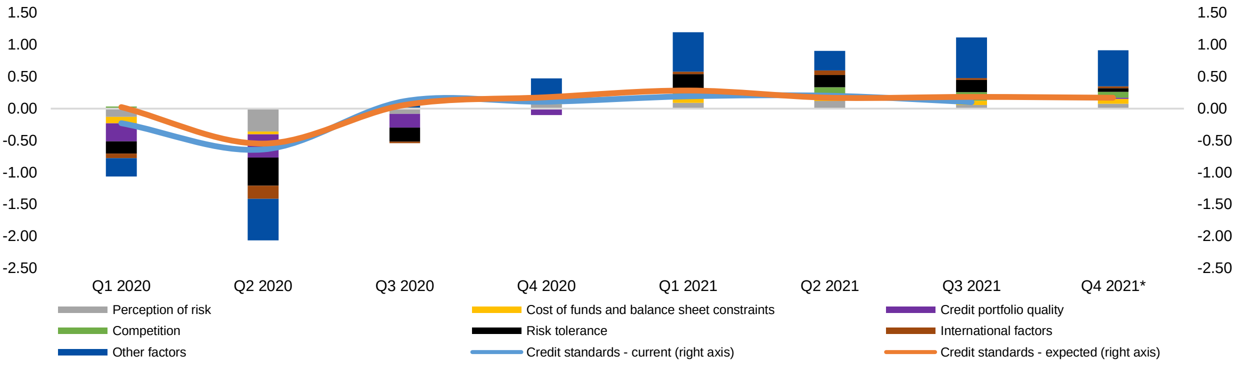
Developments in credit standards, credit terms and conditions, and in loans demand

Loans to enterprises

Credit standards

During the third quarter of 2021, credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises in general represent an ease, albeit of a lower level compared to the previous quarter with a positive index of 0.15 from 0.28 as it was in the previous survey. In the previous survey (Q2 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



*Expected value

Source: CBK.

Within loans to enterprises, banks reported a positive index of 0.15 for changes in credit standards for SMEs, and marginal changes with a positive index lower for 0.06 for large enterprises. Specifically, this result was impacted by the replies of two 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 Q3 2021, turns out to have had the support of enterprises in lending by the KCGF with a positive index of 0.46 (responses from four banks, three of which attributed significant contribution), the increase of competitive pressures in the banking market with a positive index of 0.28 (a factor stated by two banks of systemic importance and with high weight in lending to the sector), as well as with a lower index of 0.19 increase in risk tolerance. Following the indexation of responses, restrictive measures to prevent the spread of Covid-19 virus resulted in a low but positive index of 0.18, an unexpected result considering that during September, due to the significant increase in cases of Covid-19 infections, there were restrictions of movements and economic activities, mainly of the services sector. Based on the performance of the banking sector, it can be suggested that the banks' responses were mostly attributed to the period of July and August, during which the restrictive measures were significantly eased. The loans approval rate for enterprises did not change significantly during this quarter, where positive movement, although marginal for large enterprises, the result was greatly affected by the fact that one of the banks with high weight in lending declared a tightening of approval rate to some extent for SMEs, thus influencing the approval rate for large enterprises to be positive.

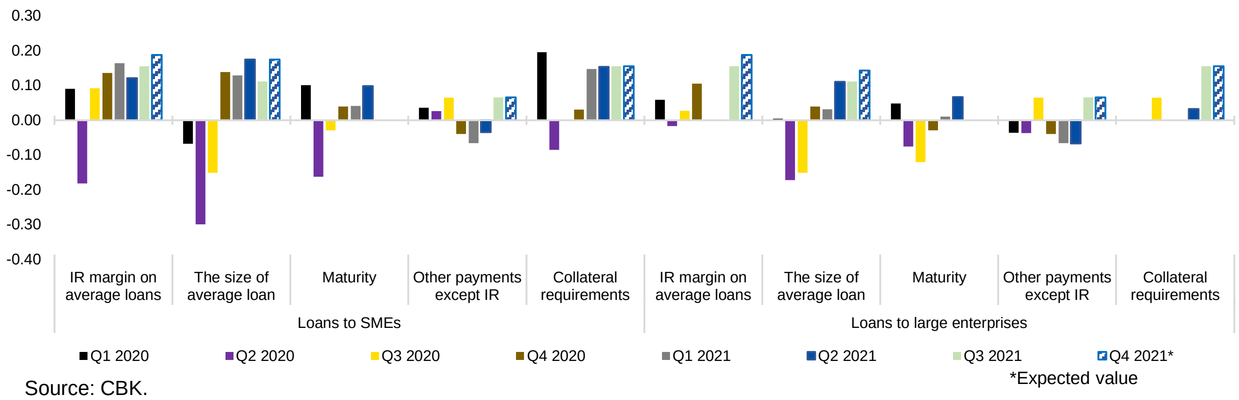
Banks are expected to ease credit standards to some extent during Q4 2021, based on expectations for a return to normal economic activity in the country, as a result of overcoming the latest wave of Covid-19 infections, the high number of vaccinations and the ease of restrictive measures. Five out of nine participating banks in the survey, 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 for enterprises. Also, a positive contribution is expected from the increase of competitive pressure in the banking sector. Specifically, the easing of credit standards is expected to be at a higher level than the change in the current quarter, where after the indexation of replies it was resulted in a positive index for SMEs of 0.26, and a positive index of 0.09 for large enterprises.

At the same time, with the same level as the easing of credit standards, also the loans approval rate for enterprises is expected to increase, mainly for SMEs.

Terms and conditions

In Q3 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 banking sector applied the same ease of terms and conditions for new loans to both SMEs and large enterprises. More specifically, for both categories of enterprises there was an ease to some extent in the applied interest rate and in the collateral requirements for approved loans with a positive index of 0.16. Also, banks offered a more favorable size of loans to enterprises with a positive index of 0.11.

Chart 2. Changes of terms and conditions applied to enterprises



Source: CBK.

The factor with the main contribution and positive high index in easing terms and conditions continued to be a support offered by the KCGF for SMEs with a positive index of 0.41. Also, a positive contribution was given by the increase of competitive pressures in the banking sector with a positive index of 0.29.

Banks are expected to apply eased terms and conditions during Q4 2021, albeit at low levels. In this context, similar to the current quarter, banks stated that they expect similar ease of terms and conditions for both categories of enterprises, by offering a more favorable price for loans (positive index 0.19), increasing the size of the loan amount (positive index 0.17 for SMEs and 0.14 for large enterprises), as well as lower collateral requirements (positive index 0.16). The easing of terms and conditions for enterprises are expected to be stimulated by the competitive pressures in the banking market, the support of SMEs by the KCGF, as well as the expectations for the ease of containment measures of Covid-19, during Q4.

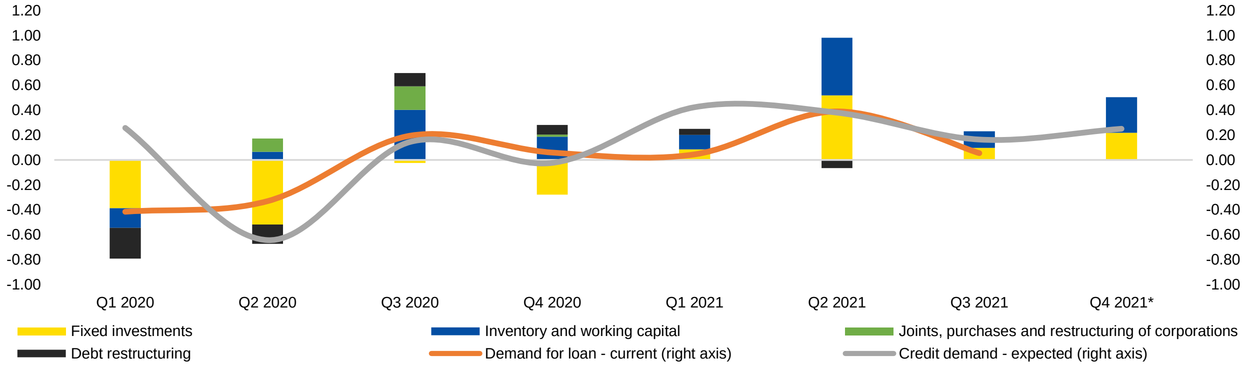
Demand for loans

During the third quarter of 2021, **the enterprises demand for loans** did not mark a significant change compared to Q2 2021. The demand for loans resulted to have been overestimated in banks' expectations for Q3 2021 stated in the previous survey (Q2 2021), where banks expected an increase to some extent in the demand for loans from enterprises(chart 3). More specifically, the demand for loans from SMEs remained unchanged with a positive index of 0.02, whereas the demand from large enterprises resulted with a marginal positive index of 0.09. The index generated for credit demand was influenced by the responses of three banks which stated an increase to some extent in demand, while two banks declared a decrease in demand, one of them a bank of systemic importance and with large share in lending of the banking sector.

According to the survey, the change in demand for loans from enterprises was mainly affected by the demand for financing the fixed investments, financing inventories and working capital, albeit with a positive low index of 0.10 and 0.13, respectively. The result of the contributing factors in the demand for loans was determined by the responses of four banks which stated a positive impact of the two contributing factors, while two banks, one of them with systemic importance, stated a negative impact of the same factors. At the same time, the quality of the applications submitted by enterprises did not mark significant changes in Q3 2021.

According to the survey, during Q3 2021, enterprise nonperforming loans to total loans ratio generated a positive index of 0.14, unlike in the previous survey when banks stated a negative index of this ratio. This result was influenced by the responses of four banks which reported an increase in nonperforming loans, although one of the banks with the high weight in lending reported a decrease in nonperforming loans.

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



Source: CBK. *Expected value

Expectations for increased economic activity in the country, as a result of the improvement of the pandemic situation and the process of vaccination in the country during the following quarter, may have inclined banks to expect a higher demand for loans compared to the current quarter. The demand is expected to increase significantly from both segments of enterprises compared to Q3 2021, especially from SMEs with a positive index of 0.33. 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 positive index of 0.29 and 0.22, respectively. At the same time, banks expect an improvement of loans applications quality from enterprises compared to the current quarter.

During the following quarter, banks expect the nonperforming loans ratio for enterprises to continue to remain with a positive index, albeit lower than in the current quarter, more precisely at the level of 0.11.

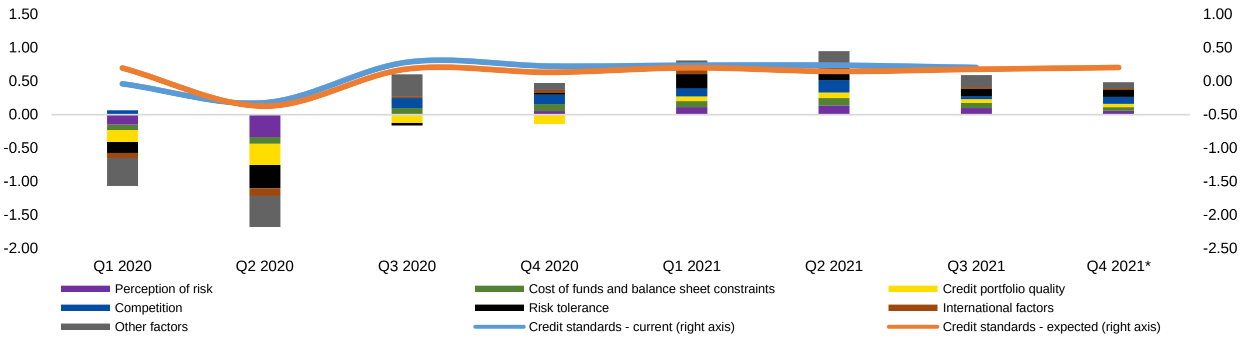
Loans to households

Credit standards

Credit standards applied to households during the third quarter of 2021 generally eased, generating a positive index of 0.18 for housing loans and a positive index of 0.23 for consumer credit. Expectations for the third quarter, stated by banks in the previous survey, also suggested an ease of applied credit standards, but to a greater extent for housing loans than for consumer credit (chart 4). Banks stated that they significantly increased the approval rate of loans to households, where housing loans were characterized with a higher approval rate with a positive index of 0.33 against the consumer credit which marked a positive index of 0.25.

Factors that contributed positively to the ease of credit standards were the good domestic market outlook (positive index of 0.30), the ease of Covid-19 containment measures (positive index of 0.18), and to a lower level the good outlook of parent banks (positive index of 0.15).

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



Source: CBK.

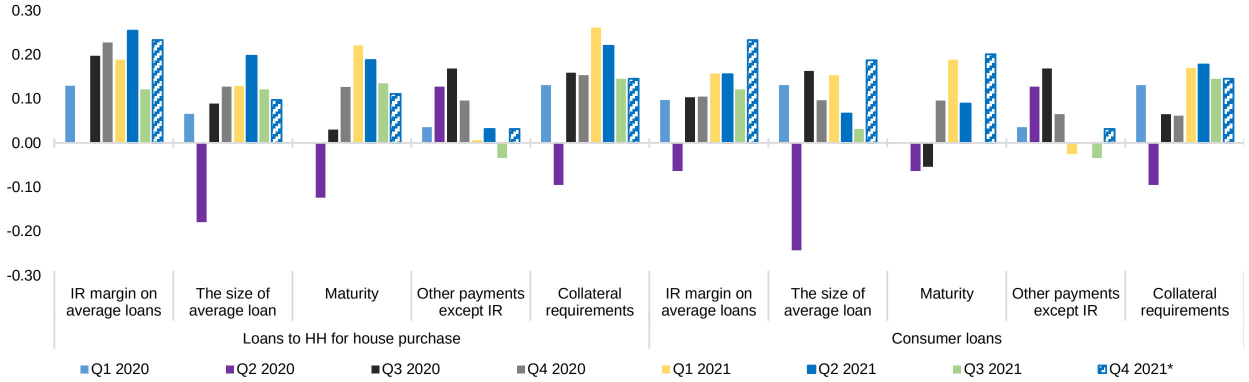
*Expected value

In the fourth quarter of 2021, banks expect an ease in credit standards for households to some extent. Credit standards are expected to ease to a higher level for consumer credit than for housing loans, with a positive index of 0.28 and 0.13, respectively. Credit standards are expected to be positively affected by the increase of competitive pressures. At the same time, banks expect an increase of loans approval rate at an approximate level compared to the current values, marked in Q3 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 0.35 and 0.27, respectively.

Terms and conditions

Terms and conditions generally eased for new loans to households in the third quarter of 2021. The ease of terms and conditions was higher for housing loans compared to consumer credit based on the number of conditions that were eased. 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 0.12), reduced collateral requirements (positive index of 0.15), increased the amount of approved loans (positive index of 0.12), and extension of loan maturity (positive index of 0.14). While for consumer credit, banks applied an ease at the same level, albeit only in two of the conditions, mainly in collateral requirements (positive index of 0.15) and in interest rate (positive index of 0.12) (chart 5).

Chart 5. Changes of terms and conditions applied to households



Source: CBK. *Expected value

The main factors that contributed to the easing of the terms and conditions 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, referring to the months of July and August 2021, as these measure were brought back during September.

For the fourth quarter of 2021, banks expect an ease in terms and conditions for loans to households to a higher extent compared to the current quarter. The ease of terms and conditions is expected to be to some extent higher for consumer credit than for housing loans. Mainly, terms and conditions for housing loans are expected to be eased through the decline of interest rate with a positive index of 0.23, reduction of collateral requirements with a positive index of 0.15, and at a lower level by extension of loan maturity and increase of the approved amount of loans, namely with a positive index of 0.11 and 0.10, respectively. The same conditions are expected to be eased for consumer credit, and moreover the response index was the same for the ease of interest rate and collateral requirements (0.23 and 0.15, respectively). While the difference lies in the extension of loan maturity and the increase in the amount of loans approved with a positive index of 0.20 and 0.19, respectively. Increased competitive pressures, the good outlook of the banking market, and the expectation of easing the containment measures of Covid-19 are expected to be the incentive factors of easing terms and conditions applied by banks during Q4 2021.

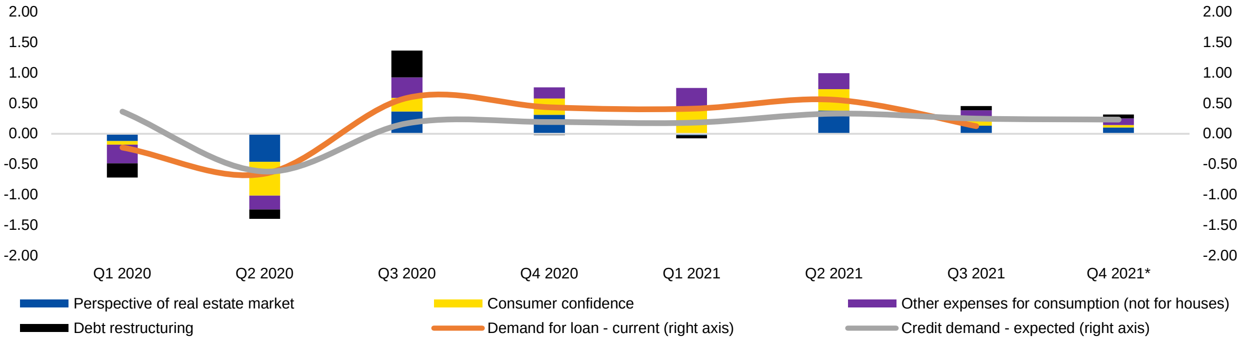
Demand for loans

Compared to the significant increase in demand for loans from households during the previous quarter (Q2 2021), banks, this quarter, reported low growth in demand from households. Five out of a total of nine banks participating in the survey, stated an overall increase in demand for loans, whereas three of the banks stated a decrease of demand for loans, which consequently after indexing the replies resulted in a low positive index of 0.20. Banks have reported a higher increase of demand for housing loans compared to consumer credit, with a positive index of 0.13 and 0.12, respectively. If the current results of loans demand are compared with the expectations of banks stated in the previous survey for the same period, the current level of the increase in demand is lower, being affected by the actual value of the demand for both categories which are lower than the expectations stated by the banks (chart 6).

This increase was positively influenced by two of the factors listed in the survey, namely by the improvement of the real estate market outlook and the need to finance consumption with a positive index of 0.13 and 0.17, respectively. The quality of loan applications received from households during this quarter improved for both types of loans, and especially for housing loans (positive index of 0.20).

As regards to loans portfolio quality of households, banks did not state any significant change of loans portfolio quality. Changes in portfolio quality reflected the responses to the decline in nonperforming loans to total loans ratio of loans to households by two banks and an increase in this ratio by two other banks, which affected an almost unchanged index.

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



Source: CBK.

*Expected value

In the fourth quarter of 2021, banks expect an increase in demand for loans to households to some extent, at a higher 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 0.16, while the demand for consumer credit resulted with a positive index of 0.31. Results of the survey suggest that banks have attributed these expectations to the good outlook of the real estate market, and to the increase of the demand for financing other expenses.

Unlike the current quarter (Q3 2021), banks expect loans portfolio quality of household to deteriorate during the fourth quarter of 2021. These expectations were reflected in a positive index of 0.17.

At the same time, banks stated that they expect an improvement to a low extent of loans quality applications from households, namely for housing loans with a positive index of 0.11.

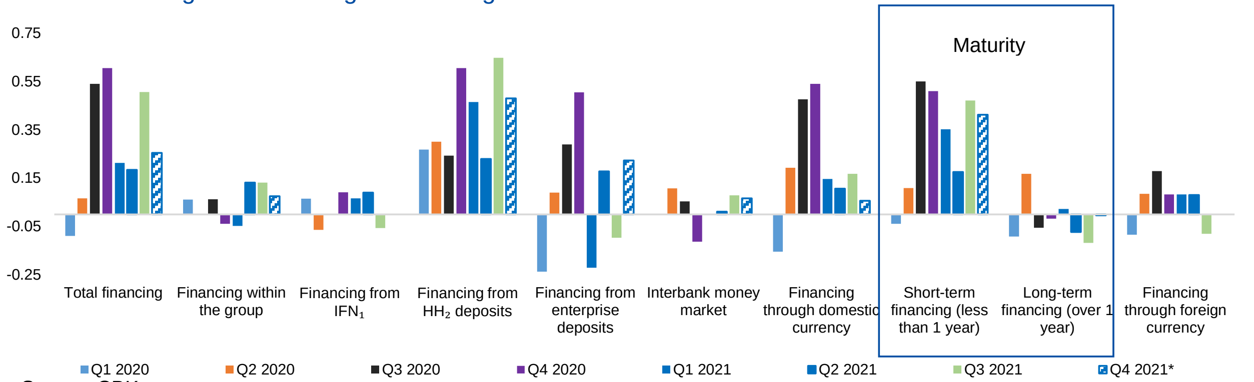
Financing

Banks reported a significant increase of access to financing during the third quarter of 2021. Taking into account the traditional model of the banking sector in Kosovo, the financing continued to be dominated by household deposits. Of the nine banks participating in the survey, eight reported an increase in financing during this quarter, two of them (banks of significant importance and systemic importance in the sector) declared a significant increase in financing.

Unlike the previous survey, results show that financing of the banks marked a significant increase, where household deposits dominated with an index of 0.65 (0.23 in Q2 2021). This result came from eight banks out of total nine banks which participated in the survey. Whereas, financing from corporate deposits and financing from international financial institutions contributed negatively to the financing of the banking sector, albeit with a marginal index of 0.10 and 0.06, respectively (chart 7). By maturity, short-term deposits were the main financing source during this quarter with positive index of 0.47.

For the next quarter, banks generally expect growth to some extent in access to financing, but at a half-slower pace than in the current quarter. Financing through household deposits is expected to lead the increase in financing of the banking sector with a positive index of 0.48, followed by financing from corporate deposits with a positive index of 0.22. Banks also stated that they expect the increase in financing to be dominated by short-term deposits with a positive index of 0.41 (chart 7).

Chart 7. Changes in financing the banking sector



Source: CBK.

*Expected value

Results of focused questions

The survey questionnaire for the third quarter of 2021 was supplemented with four additional questions in order to understand the impact of Covid-19 containment measures and the implementation of easing measures against the effects of Covid-19 on the banking sector's behavior towards lending to economic sectors. Also, credit supply and demand dynamics are explained and broken down by economic sectors. The additional questions also included the question about the factors that stimulated the significant growth of deposits in the banking sector until the third quarter of 2021.

At the end of August and during the most time of September 2021, due to the significant increase in the number of Covid-19 infected people and the overload of the health sector, the government reintroduced restrictive measures to prevent further spread of the virus. These measures mainly had an impact on services sector, namely on gastronomy and hotels. In the additional question on the impact of the return of measures on the lending activity of the banking sector, banks mainly stated that no significant impact was observed, as the impact was limited only to certain sectors. Banks with the highest exposure in the sectors affected by the measures declared a negative impact, albeit at a minimal level. However, most banks noted that if such measures are repeated during Q4, this impact is expected to deepen and the difficulties of the affected sectors would emerge and materialize.

During August 2021, the operationalization of two of the easing measures from the Economic Recovery Package were discussed, namely measure 2.1 for subsidizing investment loans and measure 3.6 for supporting family liquidity (starting as of October 2021). One of the additional questions in the survey relates to banks' expectations about the effect that these measures may have on their lending activity. Five of the participating banks stated that they expect the operationalization of these measures to have a positive impact by encouraging an increase in the number of loan applications and at the same time an increase in lending for investment loans to enterprises and consumer credit to households. However, three banks do not expect a significant change in their lending activity based on these measures. Depending on the lending strategy and the structure of the loans portfolio of the respective banks, different easing measures have different relevance. The banks that expect a positive impact of these measures, four of them expect a higher impact on consumer credit.

During 2021, deposits in the banking sector marked a significant increase, especially those from households. The annual growth of total deposits, until September 2021, was 15.1%, while household deposits increased by 18.3%, where these increases were also confirmed in the question on access to financing (in the section "Financing"). The upcoming question of the survey aimed at elaborating the incentive factors of this increase of deposits. In this regard, banks attributed the significant increase of deposits to the reluctance of economic entities to invest, as a result of increased uncertainties due to the dynamics of the pandemic, high level of remittances which increased by 23.5% for the period of

January-September 2021/2020, as well as the high visits of the diaspora in the country, implying there is an inflow of remittances coming from outside of the banking system. A small number of banks listed among the increasing factors of financing also the benefit of economic facilitation packages (business support packages and the withdrawal of 10% of savings from the KPST).

The disaggregated banks' replies for enterprises classified by sectors, indicate the direction of financing the economy and dynamics in other sectors. During the third quarter, based on the easing of credit standards, the manufacturing sector presents the sector with the most favorable offer. 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, one of them stated considerable ease, which resulted in a positive index of 0.21. Furthermore, also for loans to manufacturing and residential real estate were applied eased credit standards, namely with a positive index of 0.15 for both of the sectors. At the same time, also terms and conditions were eased at higher level for lending to manufacturing sector with a positive index of 0.20. Other sectors with eased terms and conditions were the trade sector and residential real estate sector, which resulted with a positive index of 0.16. In contrast to the previous survey where the dynamics in lending to the trade sector were driven to a large extent by the increased credit demand, in this quarter this sector was mainly affected by easing the credit supply conditions. Higher demand for loans came from enterprises of the trade sector with an index of 0.21, while demand from other sectors was low or unchanged.

For Q4 2021, banks expect an ease of credit standards mainly for the manufacturing and services sectors. Similarly, also for the trade sector, terms and conditions are expected to be eased to a larger extent, services and manufacturing sectors. At the same time, almost all the sectors are expected to mark a demand for loans, besides the sector of construction which is not anticipated to undergo a significant change. The sector with the highest demand for loans is expected to be the trade sector, followed by the services sector.

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 fourth 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 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 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 October 2021, banks have estimated a higher level of inflation in the third quarter of 2021 compared to the previous quarters, and expect an even higher increase, in the fourth quarter of 2021. Dynamics that have characterized the price fluctuations during the reporting period were reflected in inflationary expectations of commercial banks: 3.8% in Q4 2021 from 3.4% as it had been estimated for the previous quarter (table 2). For 2021 banks expect that the level of inflation rate will reach 3.4% from 0.2% as it was 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 third quarter of 2021, suggest that the average annual inflation rate was around 4.4%. Therefore, estimates of banks for the level of inflation rate was lower compared to the actual data. Banks expect the average inflation rate to be 3.8%, in the fourth quarter Four banks expect the inflation rate to reach 4%, two of the banks expect the inflation to range from 3% to 4%, and three other banks expect the inflation rate to be 3%.

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

Banks	Q3 2021	Q4 2021	2021
1	2.1%	2.3%	2.3%
2	4.9%	5.5%	5.5%
3	1.2%	2.4%	2.5%
4	4.4%	5.3%	3.1%
5	4.9%	5.0%	3.5%
6	4.0%	4.0%	3.5%
7	2.6%	3.0%	3.4%
8	3.8%	3.8%	3.8%
9	2.4%	2.9%	3.2%
Average	***3.4%***	***3.8%***	***3.4%***

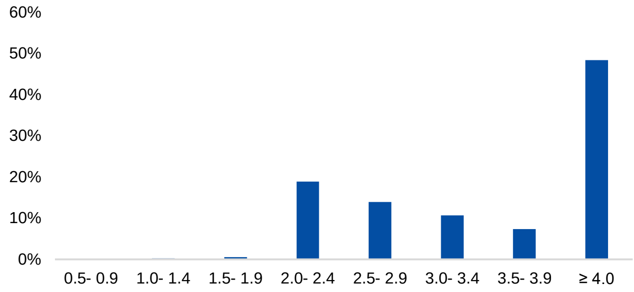
Source: Commercial banks and CBK calculations.

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 show an expectation of an increase of the economic activity and consequently of the level of inflation;
- ✓ Due to the barriers created in the supply chains as a result of the Covid-19 pandemic, many companies are finding it difficult to find raw materials to manufacture their products. Moreover, the cost of shipping has increased and this has led to an enormous increase in prices, especially of oil, fuel, construction materials, etc.
- ✓ Price developments in international markets as well as low manufacturing in Kosovo and the high dependence of the country's economy on imports. The whole year of 2021 has been accompanied by an increase in the prices of oil products but also of other categories, while recently there is an increase in energy prices, dynamics that are reflected in the overall increase in prices.

Chart 8. Probability of inflation for Q4 2021 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.

Expectations of the banks for 2021 are in line with the higher trend of inflation compared to 2020 and taking into account the dynamics with which are being characterized prices in the country, banks expectations are realistic.

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