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

Bank Lending Survey

Number 2

April 2020

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

Bank Lending Survey and Inflation Expectations

Number 2

CONTENTS

Bank Lending Survey

Introduction[1]

In order to increase the analytical capabilities on a good assessment of lending dynamic activities in Kosovo and expectations on the price level, the Central Bank of the Republic of Kosovo (CBK) has designed and conducted a survey with commercial banks which operate in the banking sector of Kosovo. The report which will analyze 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 and 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 fourth quarter of 2019, and banks expectations for credit dynamics in the first quarter of 2020. In addition to the standard questions, the survey also added the question of the impact of the delay of government formation on the behavior of economic agents towards loans demand and supply.

This survey was conducted during January 2020,where, besides in China, the COVID-19 virus disease had not been spread globally yet and become a pandemic. Consequently, the effects of this virus, now announced the outbreak of COVID-19 as pandemic by World Health Organization (WHO), have not reflected on bank expectations for lending dynamics during the first quarter of 2020.
Judged by anecdotal evidence, in the second quarter, the banking sector will be able to face an increase of liquidity risk, credit risk and solvency risk. The uncertainties created and potentially reduced income of households and businesses, in the event of prolongation of measures against the spread of COVID-19, could be reflected in the increased demand for deposit withdrawals and to be translated into limited funds available to be allocated for credit activities. Moreover, insolvency as a result of the challenges that both households and businesses are expected to face will potentially affect the position and capital of the banking sector and, consequently, limit credit activity. In these circumstances, the credit supply conditions of banks would be reduced.
Also, uncertainties created in the continuation of business activities for enterprises (work with reduced staff, declining demand for consumption or interruption of supply routes), and uncertainties in the labor market for households (lack of salary or reduced salaries in cases of not going to work as a result of pandemic), will be potentially reflected in the demand of economic entities for loans.

However, the materialization and extent of banks' difficulties as a result of potential risks depend on the duration of the crisis, the situation in the domestic and foreign sectors, and the measures that relevant institutions will take to support the financial system and the overall country's economy .

Results Summary

The dynamic of credit activity for enterprises during the fourth quarter of 2019, according to the bank lending survey, results to have been negatively affected by the loans supply conditions and loans demand. In line with this development, credit stock for nonfinancial corporations (NFC) increased by EUR 52.0 million in Q4 2019, while during Q3 2019 there were EUR 6.0 million less compared to Q2 2019.

Within the credit supply, banks have reported to have eased to some extent the standards applied in assessing enterprise loans applications, in line with expectations stated in the the previous survey. Within loans to enterprises, credit standards for large enterprises remained mainly unchanged, while for small and medium enterprises (SMEs), credit standards eased to some extent. For the first quarter

---

[1] For more detailed information about the back ground of the CBK bank lending survey, please refer to the publication "Bank Lending Survey and Inflation Expectations" No. 1.

of 2020, banks are expected to keep almost unchanged credit standards for large enterprises and SMEs as well.

Main factors that affected the ease of credit standards, based on banks statements, were the support of enterprises by Kosovo Credit Guarantee Fund (KCGF) and increased pressures of competition among the banks operating in the country. During the same period, one of the largest banks in the banking sector stated that financing from the parent bank had a positive impact on the easing of credit standards.

Terms and conditions applied by banks in granting loans to enterprises were eased at an approximate level compared to the previous quarter. Competitive pressure from other banks and the support from KCGF had an impact on credit terms and conditions to some extent. Banks in the following quarter expect an ease to a lower extent in terms and conditions for new loans compared to this quarter, mainly on interest rates, the size of loans and a more favorable requirements on collateral.

During the fourth quarter, the demand of enterprises for bank loans results to have marked a growth, however in the previous survey, banks had stated expectations for a higher increase of demand from enterprises. The positive index that resulted after the indexation of the banks' responses regarding the demand for loans is attributable to both SMEs and large enterprises. Within loans demand from enterprises, banks have stated that the demand was higher for financing the inventory and the working capital, as well as for debt restructuring. Also, banks have stated an increase of demand for financing the purchase, merger of enterprises or enterprises restructuring. In Q1 2020, the demand for loans is expected to increase significantly for both categories of enterprises, and more specifically for SMEs.

The credit activity dynamics during the reporting period, based on the survey, were positively affected by credit supply and demand of this segment. Credit standards applied in processing the household applications for loans were eased, especially for consumer credit. Banks expectations for Q1 2019 give indications for a continuous higher ease of credit standards for consumer loans, whereas for loans for house purchase are not expected significant changes.

Terms and conditions for new loans to households were eased for both loan categories, especially for consumer credit, primarily through the more favorable interest rates, the increase of the amount of the approved loans and a more favorable demand for collateral. The increase of the competition pressure by the banking sector, the high quality of credit portfolio, and to some lower extent the increased tolerance of the risk along the more favorable perspective of the banking market in the country, result to have been the key factors in easing terms and conditions of lending to households in the fourth quarter of 2019. In the following quarter is expected a further ease of terms and conditions, being positively impacted by the lower perception of the risk by banks, the increase of competition among the banks in the country and the improvement of the credit portfolio quality. Banks are expected to offer similar terms and conditions for consumer credit and housing loans.

Banks reported an increase of demand for loans from households, from both comprising categories. The increase of the demand for loans was higher unlike the demand marked in the previous quarter. Moreover, not the same as the expectations of banks stated in the previous survey, the demand for consumer credit was higher than the demand for housing loans. Based on the survey, the increase of the demand for loans from households is attributable to some extent to the increase of borrowers' confidence on their solvency. In the first quarter of 2020, banks expect a significant increase of the demand for loans, especially for long-term loans for house purchase, mainly being supported by favorable developments in the real estate market and the increase of clients confidence regarding the solvency capabilities.

Banks have declared a satisfactory increase of the total financing in the reporting period, namely a sustainable increase of deposits from both economic entities, especially from enterprises. While,

regarding the maturity, the increase was approximately at the same level for short-term and long-term deposits. During the following quarter, banks expect an increase of financing approach, albeit at a significantly lower level compared to this quarter. Financing through household deposits will further improve, while financing through enterprise deposits is expected to mark a decline compared to the previous quarter. Unlike this quarter, it is expected that long-term financing will dominate the structure of the funds.

Box 1. Methodology

The questionnaire of the Bank Lending Survey

The BLS questionnaire is based on the standardized questionnaires designed 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 in banking sector's funding. 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 loans to SMEs and loans to large enterprises, while loans to households are sub-categorized in loans for house purchase 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, loans approval rate, 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 ad hoc questions on specific issues in order to explain the developments in the banking sector. While standard questions cover a three-months period, ad hoc questions may refer changes occurred during a longer period of time. The survey conveys nine out of ten 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 way 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 in 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 when there is a considerable ease/increase have a value 1, 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. Finally, 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 indexes obtained for each of the bank. The value of indexes 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.

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.

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

Loans to enterprises

Credit standards

Credit standards (internal guides of banks or the criteria for loans approval) applied for enterprises eased to some extent during the fourth quarter of 2019, being translated in a positive index, albeit at low level of 0.14 (negative index of 0.15 in Q3 2019). In the previous survey (Q3 2019), banks had stated their expectations for Q4 2019 were reflected in eased standards to some extent (chart 1).

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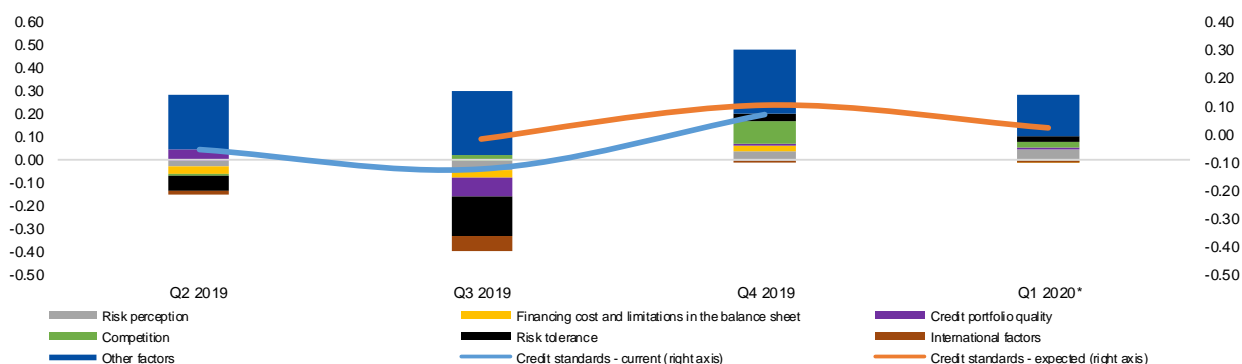
Source: CBK.

Within loans to enterprises, credit standards for large enterprises remained unchanged, while for SMEs credit standards eased to some extent. Four out of five banks with which the survey was conducted have stated an ease to some extent for SMEs which resulted in a positive index of 0.14.

The main role in easing credit standards applied by banks during this period, results to have had the KCGF, while almost all the banks reported a positive impact of the fund in their credit policy, with an index of 0.28. Another factor influencing the easing of credit standards for enterprises was the increase in competition pressure, mainly competition from other banks with an index of 0.18. One of the largest banks in the banking sector stated that financing from the parent bank affected to some extent the ease of its credit policies. Unlike the previous quarter's survey, banks stated that the risk appetite remained unchanged and international factors also did not affect the credit standards applied in the country. Similar to developments in credit standards, the rate of loans approval for SMEs increased to some extent during this quarter, as well as for large enterprises the approval rate of loans increased, albeit remained at marginal levels.

For the first quarter of 2020, banks are expected to keep almost unchanged credit standards for large enterprises and SMEs as well.

Terms and conditions

In the fourth quarter of 2019, the overall terms and conditions applied by banks in issuing loans to enterprises (terms and conditions of a contract specified for a loan) marked an ease at an approximate level as in the previous quarter (chart 2). However, the structure of eased conditions differs from the previous quarter. Specifically, there was a more significant ease marked in interest rates and collateral requirements, where the same as in the previous quarter they were almost unchanged. These changes are more attributable to the terms and conditions for SMEs. Whereas at a lower extent the ease of conditions reflects also the maturity for loans approved for large enterprises.

Chart 2. Changes of terms and conditions applied to enterprises
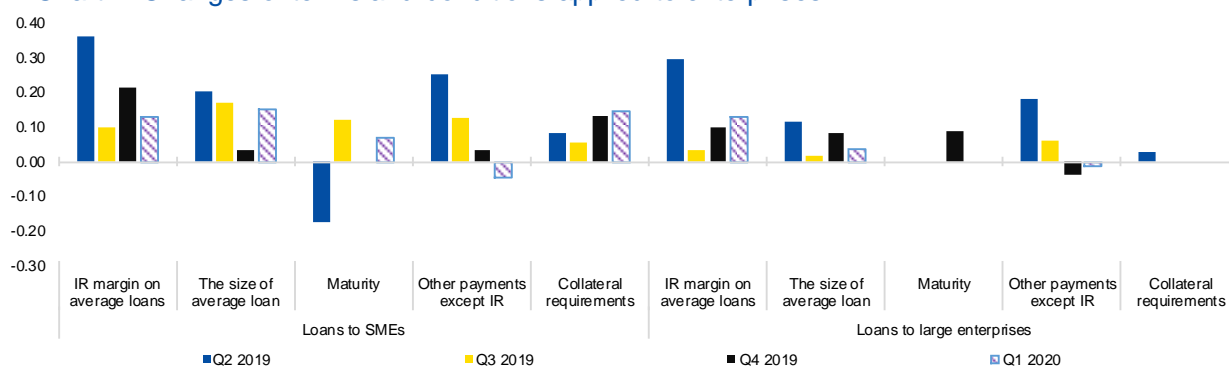
Source: CBK.

Factors that had an impact on easing the terms and conditions were mainly driven by competition pressure from other banks operating in the country with a higher index of 0.37 and the support from KCGF with an index of 0.34. Banks also stated that the quality of the loan portfolio and the favorable outlook of the banking market have contributed to the ease of the terms and conditions applied, albeit to a lesser extent, namely with the index of 0.12 for both factors.

For the first quarter of 2020, banks are expected to have a more relatively similar credit supply-side for enterprises based on terms and conditions offered. In this context, banks stated that they will provide lower interest rates, albeit at lower level compared to this quarter, ease in the size of approved loans and more favorable collateral requirements. The above mentioned ease will support more SMEs.

Regarding the factors which are expected to contribute in terms and conditions during the coming quarter, the support of KCGF is expected to be the main factor in easing terms and conditions for enterprises, followed by the pressure of competition from other banks. Moreover, also competition pressures by non-bank institutions will increase in Q1 2020.

Demand for loans

During the fourth quarter, the overall demand for loans from enterprises marked an increase (a positive index of 0.21) despite that in the previous survey banks had anticipated a more dynamic activity of enterprises with a higher increase of their demand (a positive index of 0.36) (chart 3). The increase of the demand from enterprises was similar for both segments as for SMEs and large enterprises as well.

According to the survey, the increase in demand for loans from enterprises was largely influenced by the demand for debt restructuring, expressed by only two banks which at the same time have a larger weight in the sector with an index of 0.18. Also, enterprises increased their demand to some extent for financing the inventory and working capital, with an index of 0.13. The demand for purchase, restructuring or merger of enterprises was characterized with a low positive index, representing the situation in two banks.

A marginal improvement in the quality of the received applications marked in large enterprises, while the quality of the applications submitted by large enterprises remained almost unchanged. Banks also stated a continuous growing trend of nonperforming loans to total enterprises loans ratio with a high negative index of 0.32.

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

Source: CBK.
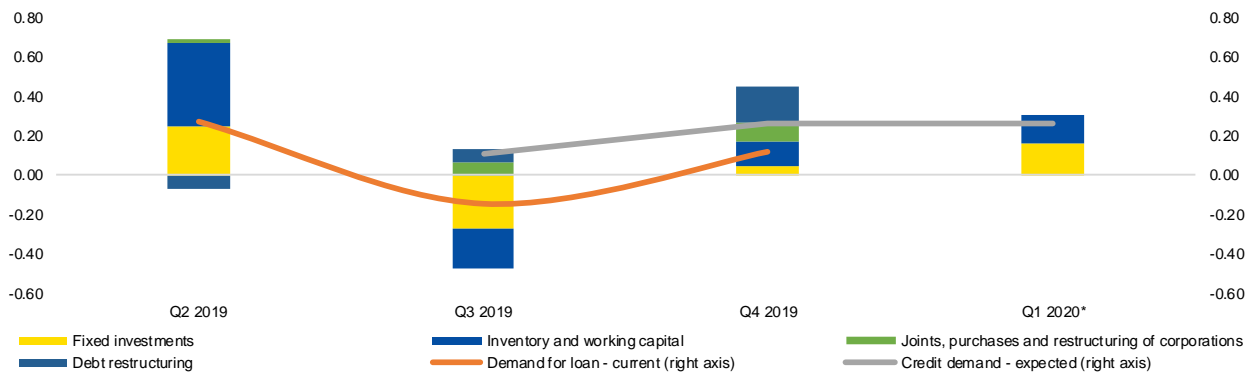
Besides the standard survey questions, this survey also had an additional question for banks, to understand whether, according to them, the delay of the formation of the government had an impact (until the survey was conducted in January 2020) in the behavior of enterprises in terms of financing the investment and if it did, what impact it had on lending dynamics. The majority of banks stated that there were observed no impact in this aspect, and one of the banks emphasized that its delay may also have an impact on the increase of the demand for loans. Significant impact was marked by banks which were more exposed to the segment of enterprise (especially the construction sector with contracts for government projects), where banks stated that enterprises postponed capital investments and were focused on investing in liquid or current assets. Banks have also stated for implications that this issue might have in credit portfolio quality. However, this was not reflected in banks' credit portfolio quality.

In the following quarter, banks expect higher activity of enterprises, reflecting this in their anticipation for changes on demand for loans during Q1 2020. A significant increase of demand for loans is expected to be marked by SMEs and from large enterprises as well. The increased demand for loans is expected to be affected by the need of enterprises to finance fixed investments, inventory and working capital.

Loans to households

Credit standards

Credit standards applied for households during the fourth quarter of 2019 marked an ease which was lower compared to the previous quarter. Despite of banks' statements in the previous survey that to a higher extent there will an ease on loans for house purchase against consumer credit, the results of the survey of Q4 2019 give contrary indications. A more favorable supply side was marked by consumer credit compared to housing loans, with a positive index of 0.13 and 0.08, respectively (chart 4). Banks have also stated to have increased the approval rate of loans to households at the same extent for both loans categories.

Within the segment of households, a factor with a higher impact in easing credit standards was marked by pressure from competition, especially pressure from other banks with an index of 0.16. As a consequence of the increase of the pressure in the market for consumer loans banks have simplified the applying and loans approval procedures, and have come to an agreement with different companies to reach more attractive offers for the clients. Meanwhile, the ease of standards for housing loans was realized mainly through agreements with construction companies, for ensuring the needed collateral

and other easing conditions. A factor with a positive contribution, albeit at low level (index of 0.08) was also the good perspective of the real estate market.

Chart 4. Changes of credit standards applied for Households and contributing factors
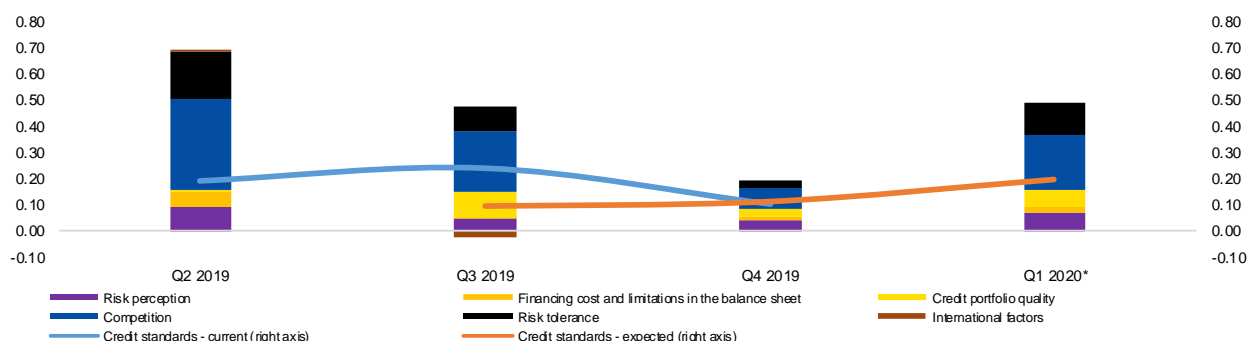
Source: CBK.

In the first quarter of 2020, banks expect an ease in credit standards at higher level compared to the previous quarter. Credit standards are expected to ease mainly for consumer credit. The ease is expected to be driven primarily by high competition pressures of the banking sector, declining perception of risk expressed through declining collateral risk as well as increased tolerance for risk by the banking sector.

Terms and conditions

Terms and conditions for new loans to households in general marked an ease in the fourth quarter of 2019. A significant ease was marked by new consumer credit. Mainly, terms and conditions for consumer credit were eased through the interest rates decline (a positive index of 0.26), the increase of the approved amount (positive index of 0.23) and the decrease of the collateral requirements (a positive index of 0.21).

Chart 5. Changes of terms and conditions applied to Households
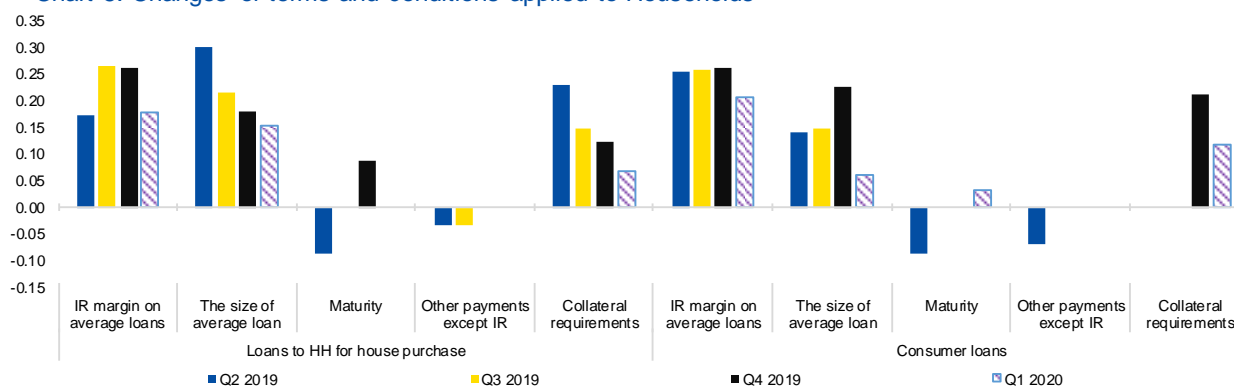
Source: CBK.

Similarly, terms and conditions for housing loans were eased through the more favorable interest rates (a positive index of 0.26), the increase of the approved amount (positive index of 0.18) and to a lesser extent lower collateral requirements (a positive index of 0.13) (chart 5).

Factors that contributed to an easing of terms and conditions applied are mainly increased competition pressure from the banking sector, high quality of credit portfolio, and to a lesser extent a positive impact was given by the increased tolerance for risk alongside with the favorable outlook of the banking market in the country.

For the first quarter of 2020, banks expect a further ease of terms and conditions for loans. Banks are expected to offer similar terms and conditions for consumer credit and for housing loans. Terms and conditions for new loans to households are expected to positively be affected by the lower risk perception by banks, such as satisfactory perception for the banking sector and of the overall market in the country, and to some extent a declining risk of the required collateral. At the same time, a positive significant impact is expected to be driven by the increase of the competition among banks in the country and the improvement of loans portfolio.

Demand for loans

In the fourth quarter of 2019, banks reported for an increase of the demand for loans by the households segment. Unlike the changes for the demand for loans during the third quarter, when it was marked a weaker increase of the demand, this quarter was characterized with a higher increase. The segment with the highest demand was the one for consumer credit with an index of 0.21, whereas the demand for housing loans reached the index of 0.18. The actual situation results to differ from that what banks expected for the same period, reported on the previous survey (chart 6).

Chart 6. Changes of demand for loans from Households and contributing factors
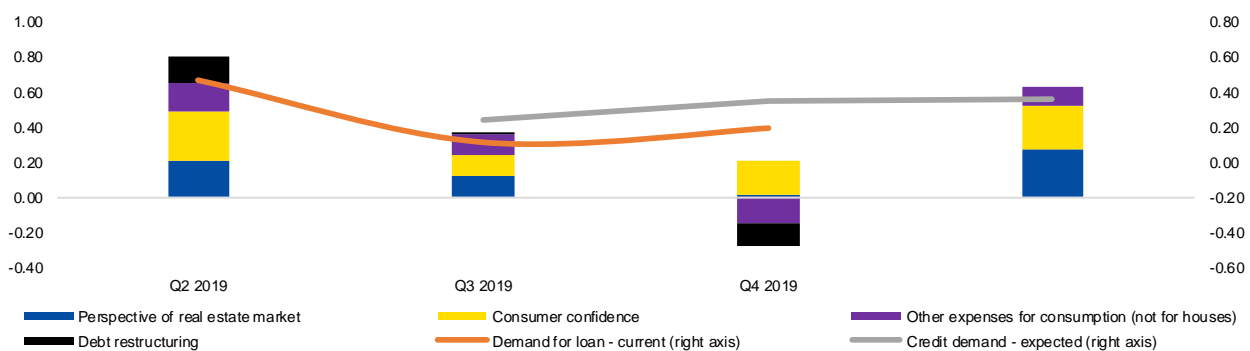
Source: CBK.

This increase to some extent was supported by the increase of borrowers' confidence in their solvency, while financing of consumption and the demand for restructuring the debt during this quarter gave negative contribution to the increase of the demand for loans from households.

Regarding the quality of the received applications, an improvement was marked with the applications for loans for house purchase with a positive index of 0.17, while the quality of applications for consumer loans reached a positive index albeit at lower rate of 0.08. Also banks stated a consistent declining trend of nonperforming loans to total household loans with a negative of 0.37.

In the fourth quarter of this year, banks expect significantly higher increase of the demand for loans, especially for long-term loans for house purchase. An increase is expected to be marked also by consumer loans.
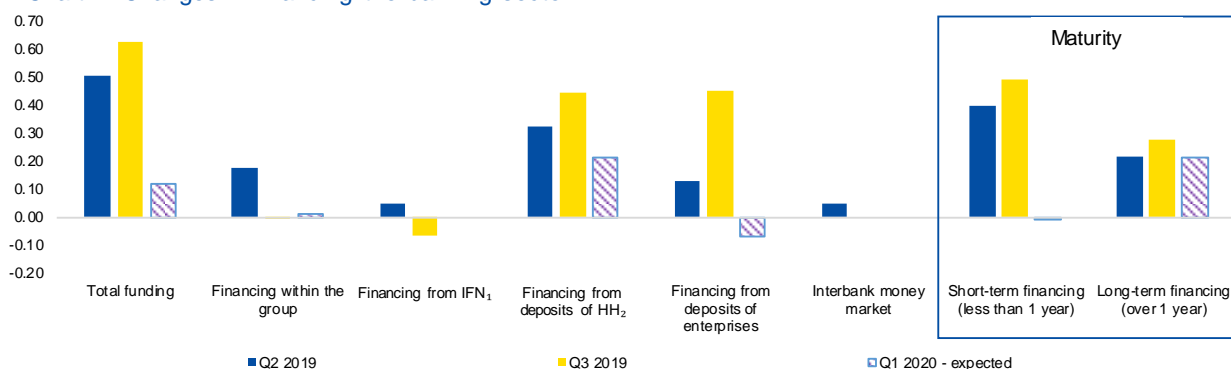
Financing

Banks reported for an improvement of the access in financing of banks in Kosovo during the fourth quarter of 2019. Taking into account the traditional model of the banking sector in Kosovo, the funding continued to be dominated by household and enterprise deposits. The results of this survey which differ from the previous survey, show that financing of the banks increased significantly with a high index of 0.45. Also, household deposits contributed to financing the banking sector with an index of 0.27 (chart 7). Two of the banks stated an increase of being financed by international institutions,

which reached an index of 0.16. By maturity, in this quarter, the index was approximate for short-term and long-term deposits, namely being presented by 0.33 and 0.6, respectively.

For the following quarter, banks expect an increase of access in financing, albeit at a significantly lower intensity. Financing through household deposits will further improve, while financing through enterprise deposits is expected to mark a decline to some extent compared to the previous quarter. Unlike the fourth quarter of 2019, in the following quarter is not expected a support in financing the activity of the banks operating in the country by international financial institutions.

Regarding expectations for financing classified by maturity, banks expect different trend compared to Q4 2019. In the following quarter surveys signal expectations for increase of long-term financing, while short-term financing is expected to remain unchanged (chart 7).

Chart 7. Changes in financing the banking sector

Source: CBK.

Expectations of Inflation

In order to advance 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 conducted in January 2020, besides the statements of the banks relating their estimates on the level of inflation for the fourth quarter of 2019, the questionnaire addresses also the expectations of the banks for 2020. The survey serves also as a tool to identify specific factors which potentially may affect bank expectations for the specified level of inflation.

Taking into account that the survey on banks expectations on inflation is in its initial stage of implementation, the time series available is limited and does not enable comparative analysis at this stage.

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, than 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 objectives, 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 present 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 as of the third quarter of 2019, initially with commercial banks and in the future it is expected to cover a wider range including also other economic agents.

Assessments which deal with commercial banks belong to quantitative forms associated also with the spread of the profitability. Expectations of inflation are assessed for different period of times, initially expectations for the whole current year, being associated with the rest of the quarters of that year and also the expectations of inflation for the following year. 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. The analysis of the inflation expectations is expected to be part of the regular reports of the CBK.

Results Summary

Based on the survey conducted in January 2020, most of the banks expect that inflation will be lower in 2020 compared to the previous year, whereas for the fourth quarter of 2019 banks have estimated a same level of inflation as in the previous quarter. Regarding the inflation, banks expect an inflation

average of 2.1% in 2020, from 2.6% as their expectations were for 2019 (table 1). However, the survey conducted in January does not include the potential effects that banks expect after facing the new unprecedented pandemic situation, effects that will be able to be assessed after conducting the banks survey for the first quarter of 2020.
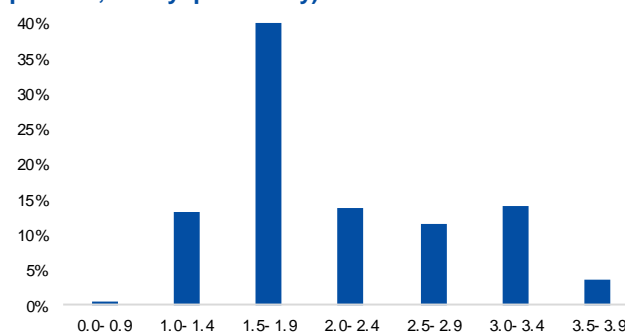
Table 1. Inflation expectations of banks, annual change in percent

Banks	2019	Q4 2019	2020
1	2.7%	2.8%	1.8%
2	2.2%	2.1%	1.8%
3	2.8%	2.3%	1.5%
4	2.0%	2.0%	2.4%
5	2.2%	2.2%	1.7%
6	2.9%	2.9%	1.6%
7	2.8%	3.2%	3.2%
8	2.2%	2.2%	1.3%
9	3.4%	3.4%	3.5%
Average	*2.6%*	*2.6%*	*2.1%*

Source: Commercial banks and CBK calculations.

The data published by the Kosovo Agency of Statistics (KAS) for 2019, suggest that inflation is around 2.7 percent, which is an approximate level with the expectations of the banks. In the survey conducted with the commercial banks for the previous quarter, expectations of the banks were that the level of inflation will be around 2.6 percent in the fourth quarter of 2019. The actual data for this quarter suggest that the level of inflation was 2.0 percent, representing to some extent a lower inflation than the expectations of the banks. Regarding 2020,

Chart 8. Probability of Inflation for 2020 (axis-x: inflation expectations, annual change in percent; axis-y: probability)

Source: Commercial banks and CBK calculations.

banks expect the level of inflation to reach 2.1 percent. Most of the banks (six of them) expect that inflation will range from 1 to 2 percent, while three other banks expect that inflation will be above 2 percent. As depicted in figure 8, the reported spread 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 for the level of inflation:

- ✓ The tariff on imports from Serbia and Bosnia and Herzegovina;
- ✓ Expectations regarding the level of economic activity;
- ✓ Low manufacturing in Kosovo and the dependence on imports;
- ✓ Price developments in international markets;
- ✓ Trade relations between the U.S.A. and China.

Banks' expectations regarding inflation rate dynamics have been accurate for 2019, while for the fourth quarter of 2019 banks' expectations were slightly higher. For 2020, banks' expectations are in line with CBK forecasts, which suggest lower inflation compared to the previous year.