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

Bank Lending Survey

Number 5

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Bank Lending Survey and Inflation Expectations

Number 5

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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 in the third quarter of 2020, and banks expectations for credit dynamics in the fourth quarter of 2020.

In addition to the standard questions, in this survey were added certain other questions about the impact of the pandemic and the induced health and economic crises on the credit supply of the banking sector in the country, the main risk perceived by banks, and the impact of weighting schemes on managing the pandemic crisis.

Results Summary

Credit supply has eased and the demand for loans has increased to some extent during the third quarter of 2020. Banks attributed these dynamics, to some extent, to the easing of restrictive measures taken by the government in the country and governments in countries where the Kosovar diaspora is more concentrated, factors that reflected in the overall increased demand in the country. While uncertainties about the pandemic situation and, consequently, the economic and social crisis remained high, banks' expectations, mainly relying on improving prospects in the context of vaccine invention and non-tightening of measures taken by the government, suggest improved lending supply side. The demand for loans is expected to remain unchanged in the fourth quarter of 2020.

Although the growth rate of credit stock to enterprises slowed down until the third quarter of 2020, new loans during the third quarter compared to the same period last year increased significantly, positively affected by the credit supply, as well as from the demand for loans. Also, bank expectations for the following quarter result to be more optimistic. Within the credit supply, banks have reported to have eased to some extent the standards applied in assessing enterprise loans applications during the third quarter of 2020. Credit standards mainly eased for SMEs, while for large enterprises it was marked a marginal ease. The most favorable offer of banks for enterprise lending was mainly attributed to the easing of restrictive measures taken by the Government of Kosovo to prevent the spread of Covid-19 virus, a factor that is estimated to have affected the recovery, to some extent, of the overall demand in the country. Factors which positively impacted on the supply side were marked by the support for loans from KCGF and the favorable access on bank financing. Despite the easing of credit standards, the decline of the sector's tolerance to risk, the increase of credit risk in the country and abroad, as well as to a lesser extent the risk perceived by the required collateral were listed by banks as factors that negatively affected the credit supply.

For the fourth quarter of 2020, banks stated to have expected further ease in credit standards, with a more favorable offer for SMEs. Banks' expectations are based on more positive prospects for the recovery of economic activity in the country as a result of easing the restrictive measures taken to manage the pandemic crisis, as well as the support of the KCGF. Positive contribution is expected to

[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.

be marked by the stable access of the banking sector in being financed by the domestic market, namely from deposits. Regarding the maturity, banks are expected to offer eased credit standards especially for long-term loans.

Terms and conditions applied by banks in issuing loans to enterprises tightened to some extent during this period, primarily through the reduced size of loans and shortening the maturity. The factors that determined the tightening of credit terms and conditions were the increase of the perceived risk through the risk from the required collateral, as well as the increase in risk sensitivity - to a lower level. On the other hand, the factors that contributed to the marginal ease of credit terms and conditions applied were mainly the favorable access to financing in the domestic and foreign markets through the parent banks, the ease of containment measures for Covid-19 and the support for enterprises in lending by KCGF. For the fourth quarter of 2020, banks are expected to have a more favorable credit supply-side for enterprises, based on the answers for terms and conditions for new loans. Namely, banks stated to expect an increase of the loans size for both categories of enterprises.

During the third quarter, the demand of enterprises for bank loans turned out to have increased significantly compared to the previous quarter, exceeding the expectations stated in the previous survey. The increased demand for loans results to have been mainly driven by SMEs segment. In the context of the demand for loans from enterprises, banks stated an increase in the demand for financing inventories and working capital, an increase to some extent in the demands for financing the acquisitions / mergers and restructuring of enterprises, as well as the demand for debt restructuring. In Q4 2020, banks expected that with the potential emergence of the second wave of infections in the country, Covid-19 containment measures may be restored, albeit not at the level of measures applied in the second quarter of 2020. Consequently, banks stated that they do not expect significant changes in the demand for loans from enterprises. A positive factor in the credit demand is expected to be the need to finance inventories and working capital, while the demand for debt restructuring is expected to negatively affect the credit demand from enterprises, given that the deadline for applying for debt restructuring as a result of Covid-19 ended in Q3 2020.

Activity dynamics on lending to households during the reporting period were positively affected by credit supply conditions and credit demand as well, where new loans increased significantly compared to the same period of the previous year. Credit standards applied to households, based on the survey, have eased taking into account that Covid-19 containment measures were eased during this quarter. Although the country's institutions have taken easing measures to manage the pandemic crisis, the possibility of restoring to some extent the restrictive measures during the following quarter resulted in banks exceptions on easing credit standards, albeit at a lower level compared to this quarter.

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 mainly eased through the decline of interest rate, the decrease of other charges other than the interest, and the decline of collateral requirements. Banks have also increased the amount of consumer credit. The key factors that eased credit terms and conditions for households during the third quarter of 2020 were mainly the increase of competitive pressures, stable financing of the sector from internal sources, easing of restrictive measures of the Covid-19, as well as good prospects in the real estate market. For the fourth quarter of 2020, banks stated that they expect terms and conditions to ease for loans to households. The ease of terms and conditions is expected to be higher for housing loans compared to consumer credit. These expectations were based on the good perspective of the real estate market, favorable access of parent banks to financing, increasing competitive pressures, stable financing of the sector, as well as the better perspective of the parent banks.

The easing of restrictive measures to prevent the spread of the Covid-19 virus, remittances and visits of the diaspora in the country, as well as the recovery to some extent of the economic activity were reflected in a significant increase of demand for loans from households in the third quarter of 2020. In this quarter, banks reported a similar increase of the demand for loans to households for both categories. Eight out of total nine participating banks in the survey stated an increase of the overall demand for loans. Banks reported that this increase was positively impacted by all the factors listed in the survey, however the factor with the highest impact was the need for debt restructuring, followed by the favorable real estate market outlook. In the fourth quarter of 2020, banks expect an increase of demand for both categories of loans to households, albeit significantly at lower level compared to the current quarter. Survey results suggest that banks attributed these expectations to the favorable real estate market perspective, and to a lower extent to the increase of the demand for debt restructuring.

Uncertainties about economic prospects during 2020, as a result of the health crisis and limited business activities resulted in increased credit risk and expectations for further growth in the coming year. Despite easing the restrictive measures and restoring economic activity of economic entities, as well as easing measures taken by the CBK to support them in overcoming the crisis, banks announced an increase of non-performing loans to total loans ratio in the third quarter of 2020. Based on the expectations stated by banks, this indicator is expected to worsen further in the following quarter despite of supportive programs on economic recovery in the country.

Survey results show that banks financing, during the third quarter of 2020, was positively affected by household and enterprise deposits, while other financing sources have not undergone significant changes. Unlike the previous survey, results show that financing of the banks was affected more significantly by enterprise deposits than by household deposits. During the next quarter, banks expect further increase in access to financing. Financing through enterprise deposits is expected to increase at a higher level compared to household deposits. At the same time, two banks with systemic importance expect also a support in financing the banking activity from international financial institutions.

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 in banking sector's financing. 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 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, 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 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. 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 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.

The questionnaire, and time series of the BLS results, are available on the CBK website, in the link of the Bank Lending Survey.

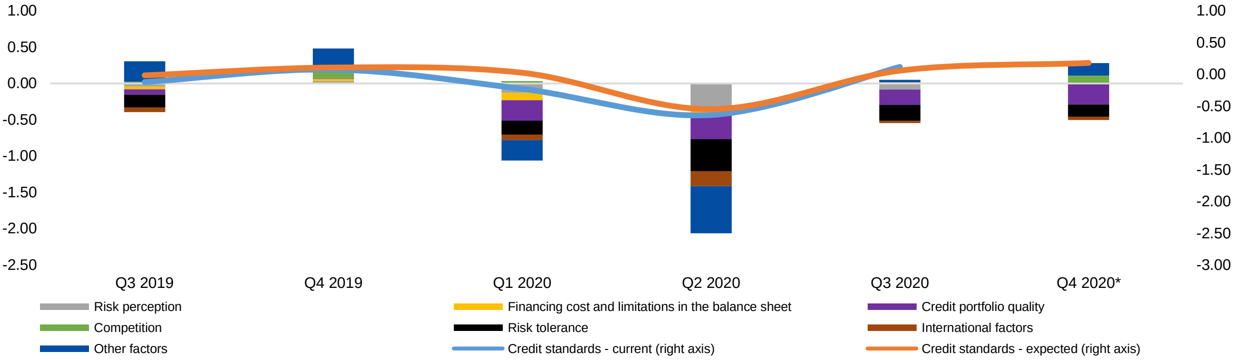
Developments in credit standards, credit terms and conditions, and in loans demand

Loans to enterprises

Credit standards

During the third quarter of 2020, credit standards (banks' internal guidelines or loans approval criteria) applied to enterprises eased in general, albeit with a low positive index of 0.08 (negative index of 0.64 in Q2 2020). In the previous survey (Q2 2020), banks had stated approximate expectations for credit standards for Q3 2020 (chart 1).

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



Source: CBK.

*Expected value

Within enterprise loans, banks reported a positive index of 0.14 for changes in credit standards for SMEs, and a positive marginal index of 0.09 for large enterprises. This ease was affected by the replies of two systemically important banks, which eased credit standards to some extent for both categories of enterprises.

The main role in easing the credit standards applied by banks in Q3 2020 result to have had the support from KCGF, and favorable access to bank financing. Despite the easing of credit standards, banks stated also some other factors which had a negative impact on credit standards such as the decline of the sector's tolerance to the risk, the increase of credit risk in the country and abroad, and to a lesser extent the increased risk from the required collateral. In line with the eased supply side, the approval rate of loans to enterprises marked a significant increase in this period, especially for SMEs.

Banks are expected to further ease credit standards during Q4 2020, being relied on the expectations for the beginning of the economic recovery in the country. Banks, namely six out of the participating banks, expect that the support of KCGF will have an impact on easing the standards. Also, positive contribution is expected to be marked by the access of the banking sector in being financed by the domestic market, namely from deposits. One of the banks with systemic importance stated that it expects a positive contribution, to some extent, in credit standards from the increase of competitive pressures.

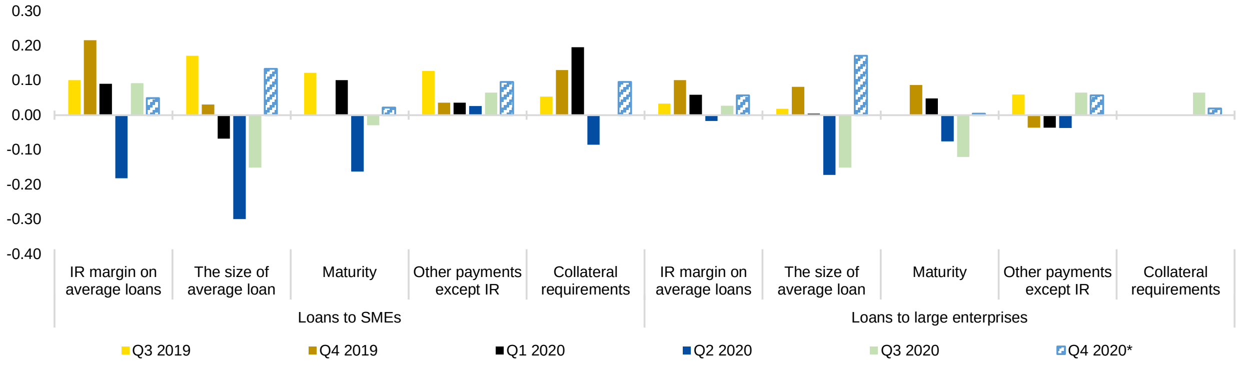
More specifically, banks with higher share to total lending of the sector stated that they expect credit standards to remain unchanged, while other banks expect ease to some extent (in general a positive index, albeit at low level of 0.16). A more significant ease is expected for SMEs compared to large enterprises. At the same time, concerning the maturity banks are expected to offer eased credit standards for two maturity terms, albeit for long-term loans the ease will be of at a higher level (positive index of 0.11).

In line with expectations for credit standards, the approval rate of loans to enterprises is expected to mark an increase to some extent, namely for SMEs with a positive index of 0.19, while for large enterprises with a negative index of 0.10.

Terms and conditions

In Q3 2020, the overall terms and conditions applied by banks in issuing loans to enterprises (the specific terms and conditions of a contract for loans) tightened to some extent (chart 2). More specifically, for SMEs, it was marked a tightening to some extent in the size of approved loans (negative index of 0.15). Conversely, interest rates were the only segment to have marked an ease, albeit at low level (positive index of 0.09). Terms and conditions for loans to large enterprises tightened as well with the same level, by reducing to some extent the size of loans (negative index of 0.15), and shortening the maturity (negative index of 0.12).

Chart 2. Changes of terms and conditions applied to enterprises



Source: CBK. *Expected value

Factors that had an impact on tightening terms and conditions were the increase of perceived risk which is interlinked with the required collateral (stated by one bank), and the increase of risk sensitivity. On the other hand, the factors that contributed to the marginal ease of credit terms and conditions applied were mainly the favorable access to financing in the domestic and foreign markets through the parent banks, the ease of containment measures for Covid-19 and the support for enterprises in lending by KCGF.

Relying on the positive prospects regarding the beginning of the process of recovery of economic activity in the country, for Q4 2020, banks expect ease of terms and conditions of lending to some extent. Banks are expected to apply eased credit supply side for enterprises, based on terms and conditions offered. In this context, banks stated to expect an increase of the loans size for both categories of enterprises. Banks marginally exempted SMEs from other charges other than interest rates and collateral requirements (low positive index of 0.10 for both of the segments). The factor with a positive contribution to credit terms and conditions for new loans and with an index of 0.21 during Q4 2020, is expected to be the support of KCGF for SMEs. Also, the favorable access in financing, the increase of competition pressure and the favorable access of parent banks in financing were presented by other factors which are expected to have an impact on the ease of terms and conditions during the following quarter.

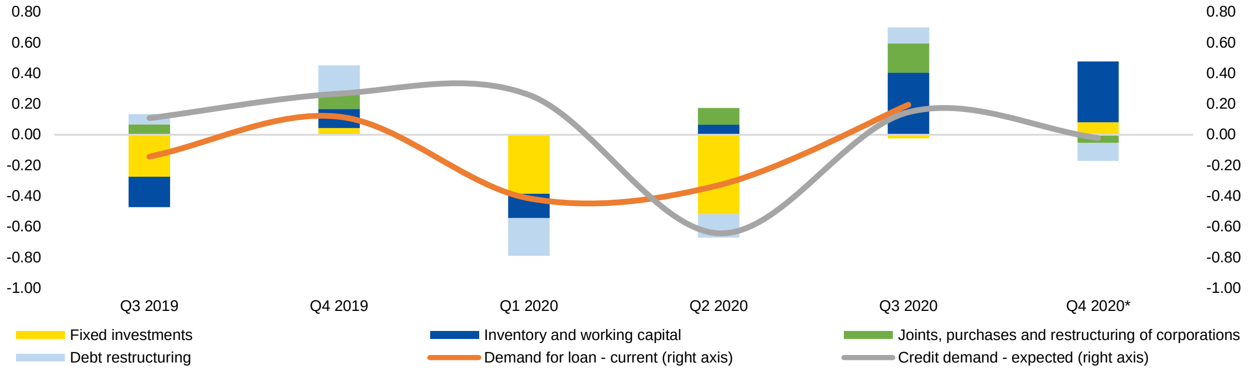
Demand for loans

During the third quarter of 2020, the demand for loans from enterprises marked a significant growth compared to Q2 2020, which resulted to be at a higher level than banks' expectations stated in the previous survey (Q2 2020) (chart 3). More specifically, the demand for loans from SMEs increased with a positive index of 0.32, whereas the demand from large enterprises with a marginal positive index of 0.07. The increase in the demand for loans during this period was attributed to the reactivation of some economic activities of the most affected sectors of enterprises, as a result of the easing of measures taken to prevent the spread of Covid-19, and increased liquidity needs.

According to the survey, the increase of the demand for loans from enterprises was largely affected by the significant increase of the demand for financing the inventory and working capital (positive index of 0.40) and to some extent by the increase of the demand for acquisitions / mergers of enterprises and the demand of debt restructuring (positive index of 0.19 and 0.11, respectively). At the same time, the quality of received applications remained almost unchanged, with marginal positive changes for both categories of enterprises.

According to the survey, the ratio of nonperforming loans of enterprises continued to be characterized with a positive index of 0.14 (an approximated level as in the previous survey with a positive index of 0.10), implying an increase to some extent of nonperforming loans of enterprises.

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



Source: CBK. *Expected value

Over the next quarter, banks do not expect a significant change in the demand for loans from enterprises, relying on expectations to restore the restrictive measures to prevent the spread of Covid-19 virus with the potential emergence of a second wave of infections in the country. These expectations were reflected in the projections of banks for changes in the demand for loans in Q4 2020. Consequently, the demand is expected to mainly not have significant changes for both categories of enterprises. Despite the banks' expectations for unchanged demand, they listed factors which had an impact on the demand for loans. A positive factor in the demand for loans is expected to be the need to finance inventories and working capital, while the demand for debt restructuring is expected to negatively affect the demand for loans from enterprises, given that the deadline for applying for debt restructuring as a result of Covid-19 ended in Q3 2020. Also, banks expect the nonperforming loans ratio to worsen further in Q4 2020, with a positive index of 0.25.

Despite the limitation to some extent of the economic activity during Q4 2020, banks expect improvements to some extent of the loans applications quality of enterprises. Therefore, expectations for Q4 are similar, with a low positive index of 0.13 for SMEs and a positive index of 0.10 for large enterprises.

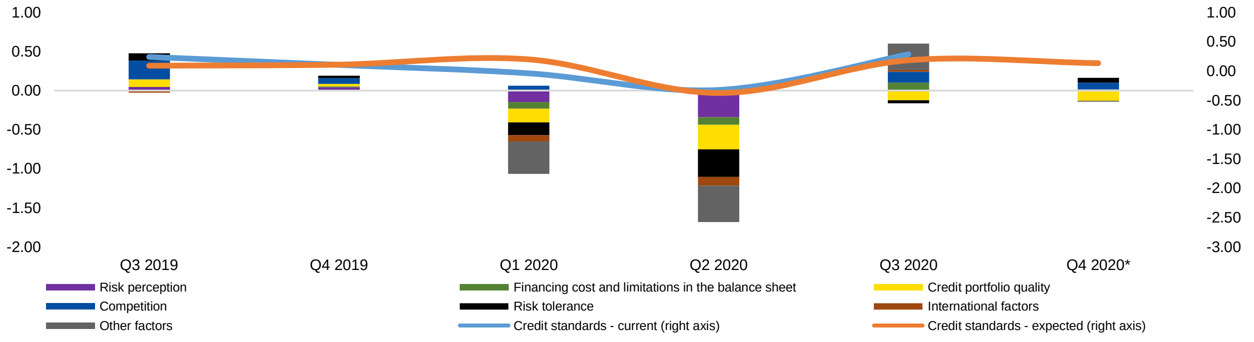
Loans to households

Credit standards

Credit standards applied to households during the third quarter of 2020 generally eased compared to the previous quarter with a positive index of 0.21 for housing loans and a positive index of 0.36 for consumer credit. Also, the expectations for the third quarter stated by banks in the previous survey suggested an ease of applied credit standards, albeit at lower level (chart 4). At the same time, banks stated that they had reduced the loan approval rate for households to a higher extent for consumer credit (negative index of 0.57) than for housing loans (negative index of 0.46).

Measures taken by the Government of Kosovo to suspend or reduce activities in certain economic sectors in order to prevent the spread of pandemic eased significantly during the third quarter, which contributed positively in the change of credit standards applied to households with a positive index of 0.34. Other factors which contributed positively were the increase of competition pressure, favorable access in financing (deposits of domestic market), and to a lesser extent, the good perspective of the parent banks.

Chart 4. Changes of credit standards applied for households and factors which contributed



Source: CBK.

*Expected value

In the fourth quarter of 2020, mainly based on the supporting measures taken by the institutions of the country, and at the same time the possibility of restoring measures to prevent the spread of Covid-19 as a result of the second wave of infections, banks expect eased credit standards for households, albeit with a lower positive index of 0.18. Credit standards are expected to ease to a higher level for consumer credit than for housing loans, with a positive index of 0.15 and 0.12, respectively. Credit standards are expected to be affected positively by the increase of competition pressures, and the improvement, to some extent, of the market outlook in the country and abroad. Despite not reflected in the general expectations for credit standards, banks have stated that to some extent the deterioration of the quality of the loan portfolio both domestically and abroad, as well as the risk of required collateral are expected to contribute negatively to credit standards during Q4 2020. At the same time, banks expect an increase, to some extent, of the approval level of loans, which is significantly lower compared to the current values marked in Q3 2020. The level of approval of loans is expected to ease to a higher extent for consumer credit than for housing loans, with a positive index of 0.18 and 0.15, respectively.

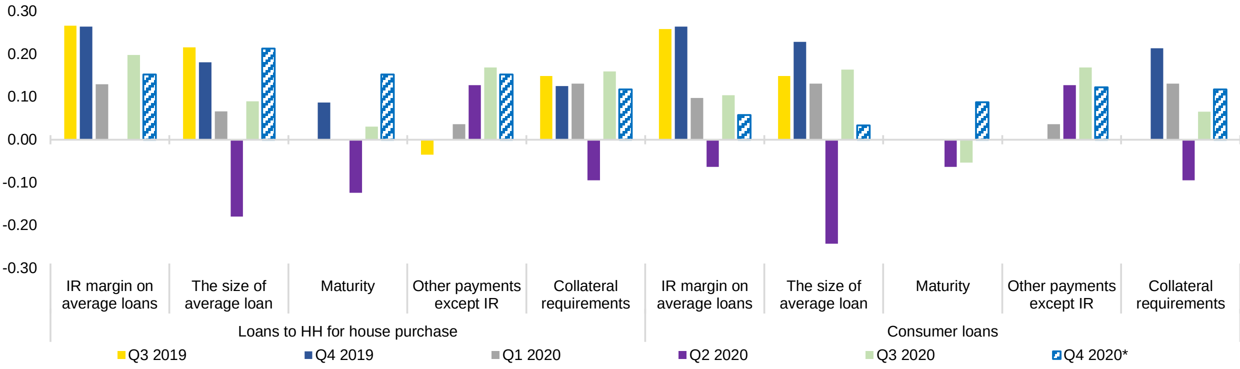
Terms and conditions

Terms and conditions for new loans to households generally eased in the third quarter of 2020, albeit at a lower level. The ease of terms and conditions was higher for housing loans compared to consumer credit. Mainly, terms and conditions were eased through the reduction of the interest rate (positive index of 0.20 for housing loans and 0.10 for consumer credit), reduction of other charges other than interest (positive index of 0.17 for both types of loans), as well as the reduction of the required collateral (low positive index of 0.16 for housing loans and 0.07 for consumer credit). Also, banks increased the amount of loan with a positive index of 0.16 (chart 5).

The factors that eased credit terms and conditions applied were mainly the increase of competition pressures, stable financing of the sector from internal sources, easing of restrictive measures of the Covid-19, as well as the good perspective in the real estate market.

For the fourth quarter of 2020, banks stated that they expect an ease in terms and conditions for loans to households. The ease of terms and conditions is expected to be higher for housing loans compared to consumer credit. In general, all terms and conditions for housing loans are expected to ease to some extent.

Chart 5. Changes of terms and conditions applied to households



*Expected value

Source: CBK.

Expectations for the increase of the amount of loans were marked with a positive index of 0.21, followed by the decline of the interest rate and other charges and maturity extension with a positive index of 0.15. Meanwhile, for consumer credit, terms and conditions that are expected to ease are the reduction of other charges other than interest and the decline of the required collateral with a low positive index of 0.12. These expectations were based on the good perspective of the real estate market, favorable access of parent banks to financing, increasing competition pressures, stable financing of the sector, as well as the better perspective of the parent banks.

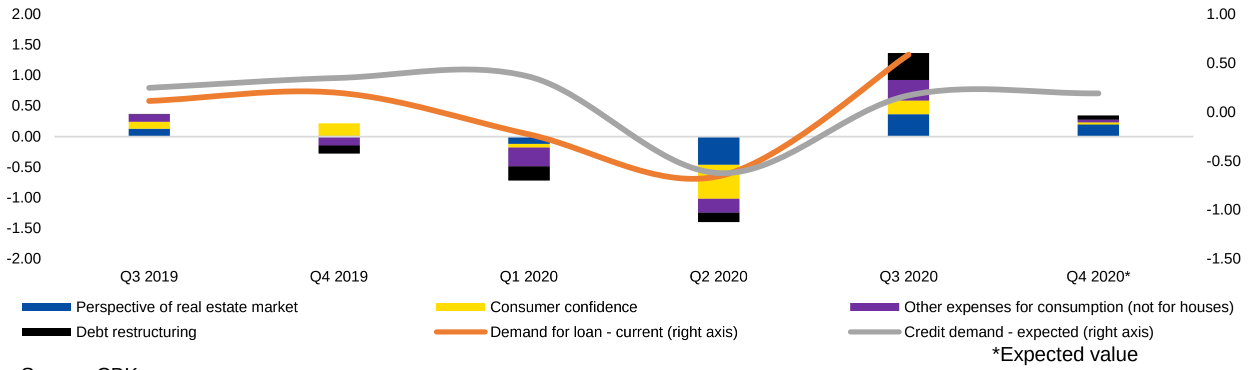
Demand for loans

The easing of restrictive measures to prevent the spread of the Covid-19 virus, remittances and visits of the diaspora in the country, as well as the recovery to some extent of the economic activity were reflected in a significant increase of demand for loans from households in the third quarter of 2020. Banks reported a similar increase of the demand for loans to households for both categories. Eight out of total nine participating banks in the survey stated an increase of the overall demand for loans, with a positive index of 0.69. The demand for housing loans was characterized with a positive index of 0.58, while for consumer credit the index was 0.59. If we compare the current results of loans demand with the expectations of banks stated in the previous survey for the same period, the level of the increase of the demand is many times higher, while the demand for housing loans the expectations remained unchanged (chart 6).

This increase was positively influenced by all the factors listed in the survey, but the factor with the highest impact was the need for debt restructuring with a positive index of 0.44, followed by the favorable perspective of the real estate market and the need for financing consumption with a positive index of 0.37 and 0.34, respectively. Banks have also stated that on a lower level, the increase of the demand for loans contributed the increase of the clients' confidence (positive index of 0.22). The quality of the received applications for loans has not suffered significant changes, being characterized with a positive index, albeit standing at a marginal level of 0.07 for both types of household loans.

Banks stated a deterioration of the loans portfolio quality, albeit at a lower level compared to the previous survey results. Changes of loans portfolio quality were based on the responses on the nonperforming loans to total loans ratio for households with a positive index of 0.21 against the positive index of 0.34 as stated by banks in the previous survey (Q2 2020).

Chart 6. Changes of demand for loans from households and factors which contributed



Source: CBK.

In the fourth quarter of 2020, banks expect an increase of demand to some extent for both categories of loans to households, albeit significantly at lower level compared to the current quarter. Banks stated that they expect an increase of the demand for housing loans with a positive index of 0.20 and a demand for consumer credit with a positive index of 0.18. Survey results suggest that banks attributed these expectations to the favorable real estate market outlook, and to a lower extent, an increase of the demand for debt restructuring.

Banks expect an increase of credit risk in the fourth quarter of 2020, based on expectations for an increase in the ratio of nonperforming loans to total loans to households with a positive index of 0.26.

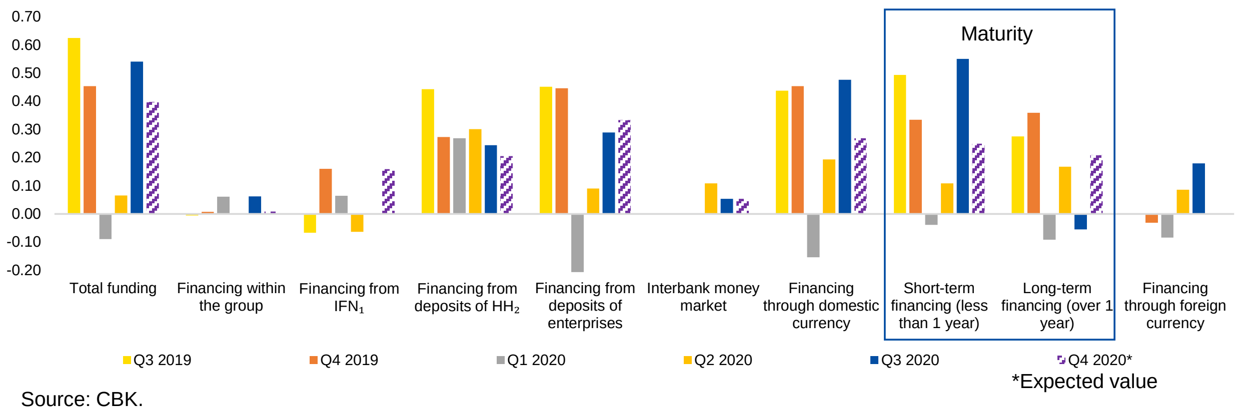
At the same time, banks stated that they expect an improvement to a low extent of loans quality applications from households, especially for housing loans with a positive index of 0.13.

Financing

Banks reported an increase of access to financing during the third quarter of 2020. Taking into account the traditional model of the banking sector in Kosovo, the financing continued to be dominated by household and enterprise deposits.

Unlike the previous survey, results show that financing of the banks was affected more significantly by enterprise deposits with an index of 0.29. Also, household deposits contributed to financing the banking sector with an index of 0.24. Other financing sources have not mark significant changes (chart 7). Two of the banks surveyed stated an increase of financing, to some extent, from the parent bank, albeit due to the low weight, the index for this component resulted to be of marginal level. By maturity, short-term deposits were the main financing source during this quarter, with a high index of 0.55.

Chart 7. Changes in financing the banking sector



Source: CBK.

For the next quarter, banks expect further increase in access to financing. Financing through household deposits is expected to increase to a higher level compared to household deposits, with a positive index of 0.33 and 0.21, respectively. In the fourth quarter, two banks with systemic importance expect a support in financing the banking activity also from international financial institutions. Meanwhile, one bank with low weight in lending of the sector stated that it expects a support in being financed by the parent bank. By maturity, in the next quarter is expected to continue a higher growth of short-term financing along with the long-term financing, namely positive index of 0.25 and 0.21, respectively (chart 7).

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

The survey questionnaire for the third quarter of 2020 was compiled with four additional questions, in order to assess the impact of the crisis caused by the Covid-19 pandemic on the overall credit supply and the demand for loans. The questions also address the banks' perception of the risks posed by the crisis caused by the Covid-19 pandemic, increasing dynamics of lending, as well as the effectiveness of measures taken by the country's institutions in addressing the increased risks in this period.

As regards to the increasing risks for the banking sector during this period, banks stated that the credit risk continued to remain the main one which is being increased, especially during the following year. Banks emphasized the positive impact of the measures taken to postpone loans installments. However, banks further stated that the impact of these measures will eventually fade and that the loan portfolio is expected to deteriorate in the coming year of 2021, mainly relying on indications of weakening solvency of the banking clients due to the dynamics in the general macroeconomic environment.

In the additional question on the impact of the Economic Recovery Package on the lending supply side, banks stated that they do not expect significant impact or effectiveness from the Economic Recovery Package, due to delays in approval by the Assembly of Kosovo, and consequently delays in implementation of this package upon approval. Banks also stated that the package as such is not sufficient in addressing the problems faced by the private sector, and expressed doubts about the proper implementation of this package as a result of political processes in the coming period (new elections / new government). Consequently, this measure is not expected to have an impact on the increase of the credit supply conditions.

While, one of the systemic banks emphasized that among the effective measures that positively affected the credit offer were the measures taken by the CBK such as deferring the payment of loans installments, and that within the Recovery Package, welcome the increase of credit guarantee coverage up to 80% from KCGF and subsidies on the interest rate and fees. Based on the lending dynamics during 2020, banks were asked for a projection of the lending increase until the end of the respective year. The banks response to this question was that they expect an increase in lending, albeit at a lower level compared the previous years standing at around 7% for 2020.

Regarding the question on banks' expectations of restructured loans to be shifted to nonperforming loans, banks emphasized that they generally do not expect restructured loans to be turned into nonperforming loans in 2020. However, they added that the effect of the economic crisis on the quality of the loans portfolio is expected to appear after the first quarter of 2021, when the restructuring measure expires for almost half of the restructured loans and borrowers begin to pay regular loan installments. One of the banks with systemic importance, which consequently has a high weight of the sector, has stated that it expects around 20% of restructured loans to be shifted into the category of nonperforming loans. Moreover, banks stated that also along the process of restructuring there was applied a revaluation of the risk and was allocated a provision regarding the clients' risk.

Expectations of Inflation

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 conducted in October 2020, besides the statements of the banks relating their estimates on the level of inflation for the third quarter of 2020, the questionnaire addresses also the overall expectations of the banks for the fourth quarter and for the whole year of 2020. 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, 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 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 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, enterprises, 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 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 time horizons, initially expectations of inflations for the whole current year, accompanied also with the assessments for the previous quarter and the expectations for the coming quarter. 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

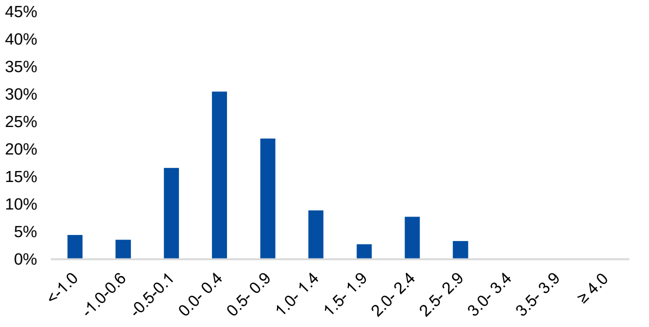
Based on the survey conducted in October 2020, banks have estimated a lower level of inflation compared to the previous year. For the fourth quarter of 2020, banks expect a slight increase of inflation rate compared to the previous quarter. Banks have estimated that inflation will be 0.7% in 2020, compared to 2.7% as it was in 2019. For Q4 2020, banks expect an average inflation rate of 0.5%, from 0.2% that had been estimated for the previous quarter (table 1). The survey realized in July conveys also the potential effects that banks expect after they have faced with the unprecedented situation caused by Covid-19 pandemic.

Table 1. Inflation expectations of banks, annual change in percent

Banks	2020	Q3 2020	Q4 2020
1	0.8%	0.3%	0.1%
2	0.5%	-0.5%	0.4%
3	0.2%	-0.1%	0.3%
4	-0.6%	-0.4%	-0.6%
5	0.7%	-0.5%	-0.1%
6	0.5%	0.5%	0.5%
7	2.3%	2.1%	2.2%
8	1.3%	0.5%	1.0%
9	0.3%	-0.4%	0.3%
Average	***0.7%***	***0.2%***	***0.5%***

Source: Commercial banks and CBK calculations.

Chart 8. Probability of inflation for Q4 2020 (axis-x: inflation expectations, annual change in percent; axis-y: probability)



Source: Commercial banks and CBK calculations.

The data published by the Kosovo Agency of Statistics (KAS) until December 2020, suggest that the inflation rate was 0.2%, while only for Q3 2020 the current data for this quarter suggest that it was marked a deflation of 0.4%. Therefore, expectations of banks showed that the level of inflation would have been higher compared to the actual data. Most of the banks surveyed expect that inflation will range from 0 to 1%; two of the banks expect that inflation will be above 1%; and two other banks expect that there will be a deflation in the fourth quarter of 2020. 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:

- ✓ Due to the increase in the number of cases with corona virus infection worldwide during the last quarter of 2020, most of the banks have stated that there will be a decline in economic activity and consequently weakened demand will not put pressure on the growth of consumer prices. Conversely, certain banks have stated that due to the broken chain of supply, prices may rise;
- ✓ Energy prices are projected to remain low for a longer period of time;
- ✓ Low manufacturing in Kosovo and the dependence on imports;
- ✓ Price developments in international markets.

Expectations of banks for 2020 are in line with the lower inflation trend compared to the previous year. However, taking into account the deflation marked in the recent months, banks expectations have resulted to be high to some extent.

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