Quarterly Assessment of Financial System

No. 30, Q I/2020

Summary

Developments in the macroeconomic environment have been favorable during 2019, thus supporting the sustainability of Kosovo's financial system. According to the estimates of Kosovo Agency of Statistics, real GDP growth rate reached 4.2 percent in 2019, which basically was supported by the recovery of net exports. Due to the lack of the official data for Q1 2020, thus being relied on other more frequent published indicators, the economic growth during this quarter is estimated to have been weaker compared to other previous quarters of 2019, hence reflecting the impact of containment measures due to the efforts to contain the COVID-19 virus. For the whole year of 2020, the CBK forecasts a decline of economic activity of 5.9 percent. The second quarter is expected to mark the sharpest decline of the economic activity, and these implications are expected to be transmitted to some extent also in Q3. A modest recovery is expected to be marked only in Q4 2020.

On quarterly basis, assets of financial system declined by EUR 78.1 million, mainly reflecting the decline of assets of pension sector and banking sector assets. The reduction of assets of these two sectors, especially the pension sector, is attributed mainly to the new situation created this year by facing the health and economic crisis which reached its peak at the time of announcing the pandemics. The banking sector, although with limited effect as the closure of the economy began only in the last two weeks of March 2020, was characterized by a decrease in deposits held in the banking sector during Q1 2020 compared to the same period of the previous year. The higher increase of income (mainly from interest on loans), compared to the slower growth of expenditures (primarily from non-interest and operating expenses), had an impact on the sector to realize net profits with a value of EUR 21.7 million. Financial soundness indicators of the sector continued to stand at optimal values. Banking sector continued to be characterized with a high credit portfolio quality, with a low level of nonperforming loans, and satisfactory coverage with loan loss provisions. The solvency and liquidity indicators, despite of marking a decline, continued to remain above the minimum level recommended by the regulation.

While the country's economy has been hit by the pandemic situation and containment measures taken to prevent the potential spread of COVID-19 virus in Q2 2020, pension sector as the most exposed sector to foreign markets was characterized by a decline of assets also in Q1 2020.

Negative fluctuations in global financial markets as a consequence of the uncertainties caused by the pandemics was reflected in a negative return from investments in this quarter. A factor which had a positive impact on assets of the sector were the new contributions of the pension sector, which marked an increase during this quarter.

Insurance sector during the first quarter of 2020 was characterized with an activity expansion, albeit at a lower level. The level of written premiums was higher compared to the same quarter of the previous year, influenced mainly by the increase in prices of compulsory insurance premiums of vehicles at the end of the last year. The insurance sector recorded a profit increase in this quarter, mainly as a result of the decline of claims incurred and the reduction of other operating expenses, which may have been affected by the undertaken containment measures on COVID-19 in the last two weeks of Q1 2020.

Microfinance sector was characterized with a slower increase of its activity in Q1 2020, as a consequence of the slower increase of lending, especially for households. The banking sector activity was affected by increased uncertainties caused by pandemics and containment measures taken by institutions in order to prevent the spread of the virus, despite that measures were taken only in the last two weeks of this quarter. The sector realized a satisfactory level of net profits in this quarter, while the level of loans with problems at the end of the period (March 2020) has marked an increase compared to the previous period (March 2019), and also in the previous quarter (December 2019), albeit remaining at quite low levels and well provisioned.

In the securities market, the amount of the debt issued by the Kosovo's Government reached the value of EUR 55 million, which is significantly lower than in Q1 2019. As a consequence of the delay of the establishment of the institutions in the beginning of 2020, the demand from the Government was lower, while the bid of the main participants of the securities market exceeded the ask.

PUBLISHER: ©Central Bank of the Republic of Kosovo, Economic Analysis and Financial Stability Department.
Address: Garibaldi 33, Prishtinë 10000, Tel: ++381 38 222 055, Fax: ++381 38 243 763 E-mail: economic.analysis@bqk-kos.org
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Macroeconomic Developments[1]

According to the estimates of Kosovo Agency of Statistics (KAS), real GDP growth rate marked an annual increase of 4.2 percent in 2019, which basically was supported by the recovery of net exports. The highest increase was marked by financial and insurance activities (12.2 percent), followed by extracting and processing industry (5.9 percent), trade (5.7 percent), and construction (5.6 percent). Due to the lack of official KAS data for GDP for the period of Q1 2020, being relied on other more frequently published indicators, the CBK has estimated that the growth of the economic economic activity has slowed down the increasing pace, reflecting the containment measures on COVID-19 in the last weeks of the quarter. These estimates are based on the slowdown increase of the domestic demand and the slight increase of of the deficit of net exports. For the whole year of 2020, the CBK forecasts a decline of economic activity of 5.9 percent. A higher decline of economic activity is expected to be marked in Q2, while the negative effects are expected to be marked in Q3 as well, with a modest recovery which would have been reached in Q4 2020.

Consumer price index in Q1 2020 marked a slowdown increase of 1.1 percent, mainly as a result of the slowdown increase of food prices. Core inflation, excluding food, energy, alcoholic beverages and tobacco, marked an increase of only 0.4 percent or 0.7 percentage points lower compared to the general inflation.

Fiscal sector, in Q1 2020, was characterized with an increase of revenues by 2.2 percent and a decline of budgetary expenditures of 2.3 percent. Consequently, Kosovo's budget recorded a primary budget deficit of EUR 23.5 million (a deficit of EUR 6.1 million marked in Q1 2019). Public debt, in Q1 2020, reached EUR 1.2 billion, which is for 6.8 percent higher compared to Q1 2019. As a percentage to GDP, public debt reached 16.5 percent from 16.3 percent as it was in Q1 2019.

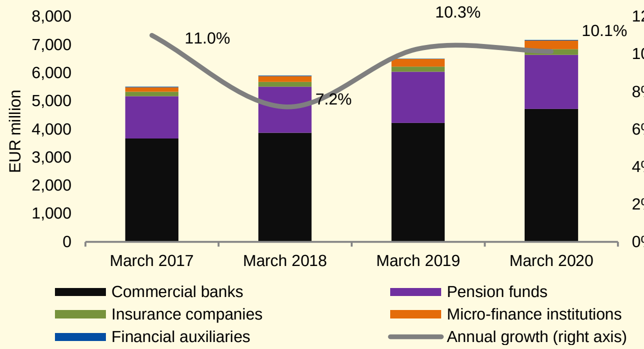
In Q1 2020, the external sector was characterized with an increase of the deficit of the current account of 2.6 percent. The increase of the deficit of the current account is attributable to the decline of the positive balance of services and primary income and the slight increase of goods, while the secondary income marked an increase. Within the balance of payments, remittances and Foreign Direct Investments marked an annual increase of 1.3 percent and 60.5 percent, respectively.

[1] For more information on macroeconomic developments, please refer to: Quarterly Assessment of Macroeconomic Developments (Q1 2020) published on the CBK website.

Financial System

Financial system assets of Kosovo marked a slowdown increase of activity, albeit the increase continues to be of a double digit. The value of total assets, until March 2020, amounted to EUR 7.17 billion (figure 1).

Figure 1. Assets value of financial system in Kosovo

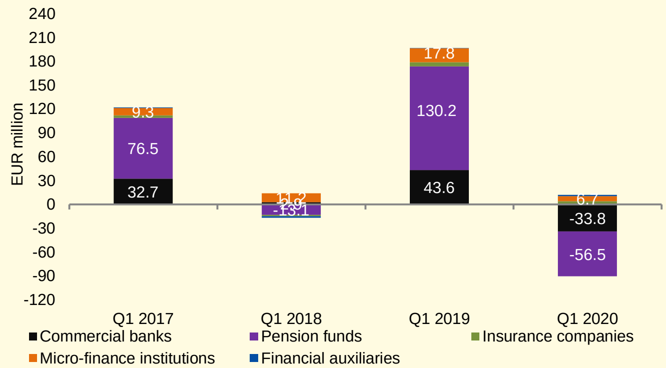


Note: The data are as at end of the noted quarter

Source: CBK (2020)

On quarter basis, financial system assets contracted by EUR 78.1 million, primarily being affected by the value of the pension sector assets (EUR -56.5 million) and the banking sector (EUR -33.8 million) (figure 2).

Figure 2. Assets of financial system constituent sectors in the respective quarters



Source: CBK (2020)

The contraction of assets, especially for the pension sector, is associated with the spread of COVID-19 pandemic, consequently resulting in a considerable loss from investments in foreign markets. Also, in the banking sector, albeit with limited effect, due to the closure of the economy which began only in the last two weeks of March 2020, deposits held at the banking sector reduced in Q1 2020 compared to the previous period.

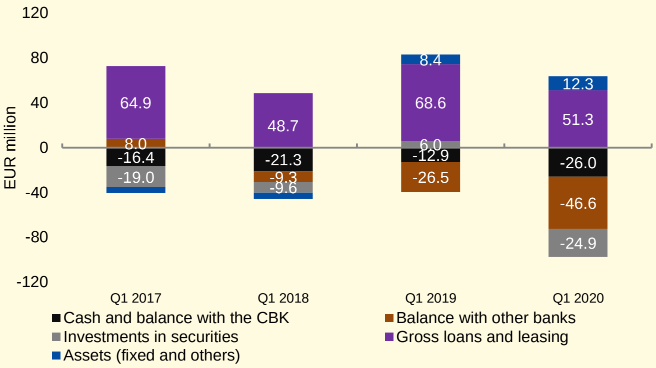
Banking Sector

Within the assets of the banking sector, loans were characterized by slower growth during this quarter, while investment in securities marked a decline. Also deposits, as the main source of financing the banking activity, were characterized with a decline in this quarter against the previous period. During Q1 2020, banking sector continued to be sustainable, to have high quality of credit portfolio, and to be well capitalized and liquid.

Assets

The value of total assets of the banking sector at the end of Q1 2020, reached EUR 4.72 billion, representing an annual growth of 11.7 percent. Whereas, on quarterly basis, banking sector assets contracted by EUR 33.8 million, in Q1 2020. The category of the balance sheet with commercial banks marked the most significant decrease of EUR 46.6 million in this quarter, mainly due to the withdrawal of funds deposited at other banks, both in the country and abroad. With a decline was characterized also the category of cash and balance with the CBK (for EUR 26.0 million), which mainly reflects the level of collecting the deposits in this quarter. In Q1 2020, a decline was marked also by investments in securities (for EUR 24.9 million), primarily as a consequence of the lower ask from the Kosovo's Treasury to issue debt, and the investments in foreign markets in securities were characterized with a decline during this period, as well. Whereas, the lending activity, which has the highest weight within the assets of the sector (65.3 percent), marked an increase in Q1 2020 (figure 3).

Figure 3. Banking sector assets structure in the respective quarters



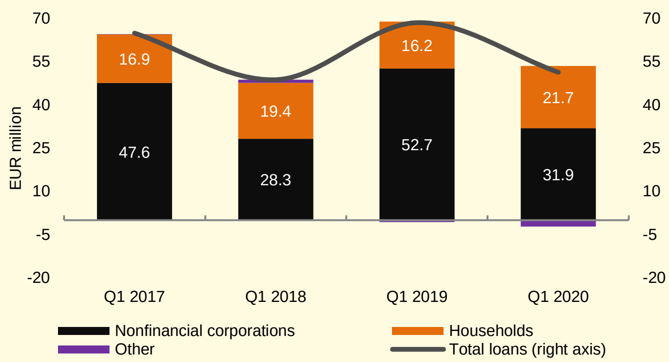
Source: CBK (2020)

Loans

The value of total loans at the end of Q1 2020, reached EUR 3.08 billion, representing an annual increase of 9.2 percent. For the first time in the recent four years, the lending activity was characterized with slowdown of dynamics of increase from a double digit into a single digit increase. Loans to nonfinancial corporations, which comprise 63.2 percent of total loans, marked a slowdown increase of 8.4 percent (12.0 percent in the previous period). Meanwhile, loans to households marked the same increase of 10.7 percent as in the previous period.

Only in Q1 2020, total loans marked an increase of EUR 51.3 million, against the increase of EUR 68.6 million in Q1 2019. Loans to nonfinancial corporations marked a slower increase (for EUR 31.9 million), mainly as a consequence of the slowdown, namely decline of lending to certain economic sectors.

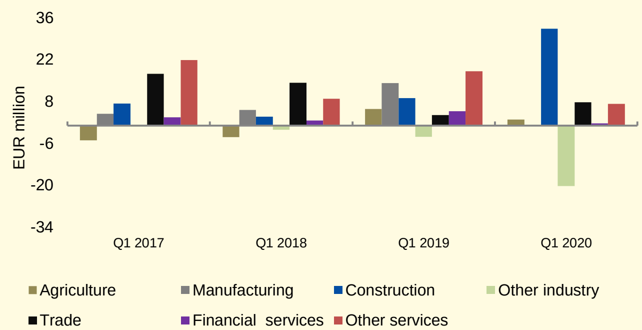
Figure 4. Quarter change of loans and main categories of loans, of the specific quarters



Source: CBK (2020)

While, loans to households increased by EUR 21.7 million on quarterly basis, representing a higher value compared to the previous period mainly as a result of the increase of consumer credit (figure 4).

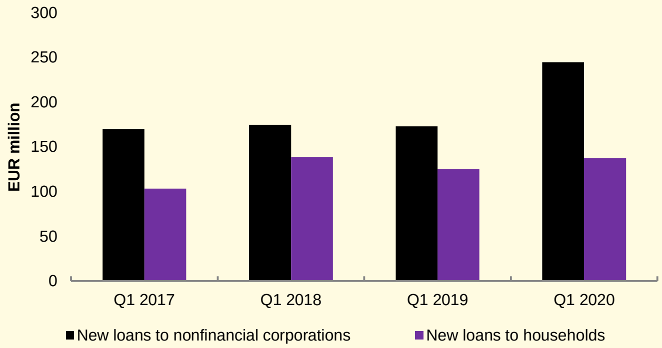
Figure 5. Loans structure by economic activity



Source: CBK (2020)

By economic activity, on quarterly basis, lending to construction sector and trade marked an increase compared to the previous period (figure 5). Conversely, lending to agriculture sector slowed down during this quarter. Similarly, also the increasing rate of lending to the sector of other services (hotels and other services) results to have been slowed down. In the reporting period, lending to other sectors of industry declined significantly (by EUR 20.2 million), mainly as a result of of the decline of lending to the mining sector, and to a lesser extent to the energy sector (figure 5).

Figure 6. New loans to nonfinancial corporations and households, in Q1



Source: CBK (2020)

Total new loans reached a value of EUR 382.4 million, in Q1 2020. New loans were characterized with an annual increase of 28.4 percent, compared to the annual decline of 5.0 percent marked in Q1 2019. The highest contribution to this increase was marked by new loans to nonfinancial corporations, which marked an increase of 41.6 percent. Their value reached EUR 244.9 million in Q1 2020 (figure 6), of which EUR 184.3 million designated to investments, while EUR 55.5 million for non-investments purposes. On the sectoral aspect, new loans to agriculture marked an increase of EUR 1.0 million compared to Q1 2019, reaching the value of EUR 3.4 million only in Q1 2020. Whereas, the highest growth was marked by new loans to services sector, which expanded at a rate of EUR 37.3 million compared to Q1 2019, reaching the value of EUR 139.8 million. Similarly, new loans to the sector of industry marked an increase of EUR 28.1 million compared to Q1 2019, reaching the value of EUR 76.6 million at the end of Q1 2020.

With a significant increase were characterized also new loans to households. The value of total new loans was for EUR 12.5 million higher against Q1 2019, reaching the value of EUR 137.5 million in Q1 2020. Of which, new consumer credit increased by EUR 12.1 million compared to Q1 2019, reaching the value of EUR 101.6 million at the end of Q1 2020. New mortgage loans increased by EUR 1.3 million compared to Q1 2019, reaching the value of EUR 26.6 million at the end of Q1 2020.

Box 1. Summary of bank lending survey results for Q1 2020

The pandemic situation announced in March 2020 and containment measures taken in the country and in the external economy have impacted the overall financial system, and especially the banking sector.

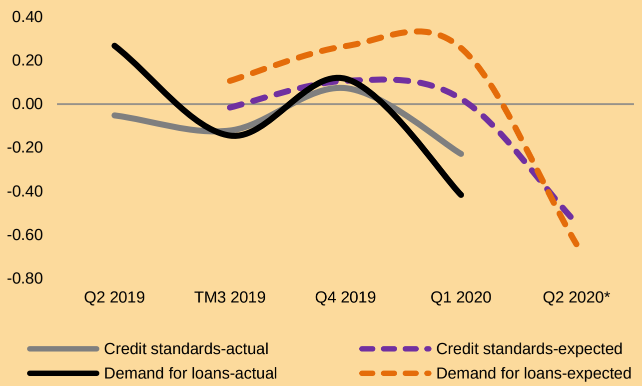
The uncertainties created from this situation and the lack of data make it difficult to forecast the trend of the economic activity and lending developments during this year. In order to be informed on the lending dynamics of Q1 2020 and the expectations of banks on these dynamics during the second quarter, in this box are revealed the bank lending survey results conducted in March 2020. This survey provides detailed information on the risk perception of banks and their willingness to lend, and, the behavior of households and enterprises against lending dynamics.[2]

Results of the survey with commercial banks in the country suggest that increased uncertainties and containment measures taken in mid-March 2020 have

[2] For detailed information on the methodology and results of the Bank Lending Survey, please refer to the CBK website.

had an immediate and significant effect on the overall lending dynamics of the first quarter. Consequently, credit supply conditions of banks, in Q1, results to be tightened, and the demand for loans marked a decline. For the second quarter, banks have stated that they expect a more tightening supply and a more significant decline of lending demand.

Figure 1. Changes in supply and demand for loans



Source: CBK (2020)

Within the credit supply, banks have reported to have tightened to some extent the standards applied in assessing enterprise applications for loans, for SMEs and large enterprises as well. Tightening of the lending standards was attributable to the containment measures taken by the Government of Kosovo to contain the Covid-19 virus, a factor that has increased the perceived risk of banks (complete disruption in some business activities, namely a contraction of the activity of most of the registered businesses in the country). The increased uncertainty due to Covid-19 pandemic has been negatively affected also by other factors such as the deteriorating market outlook and the domestic banking market in particular, then potentially declining credit portfolio quality, increasing the negative impact of international factors such as the perspective of the global market and the quality of the credit portfolio, as well as the increased uncertainties about the stability of financing by deposits in the domestic market. For the second quarter of 2020, banks' expectations consist of further tightening of credit standards for both categories of enterprises, expectations that are primarily attributed to the expected decline in economic activity with isolation as a precautionary measure against the spread of COVID-19, as well as uncertainties about the dynamics that the pandemic situation will follow in the coming months. By banks, this tightening is expected to be more concentrated on long-term loans.

Terms and conditions applied by banks in granting loans to enterprises were eased, albeit at a lower extent. The support by KCGF and the competition pressure by other banks had an impact on easing the credit terms and conditions to some extent. Meanwhile, for the second quarter of 2020, banks have stated that they expect tightening to some extent of the terms and conditions for new loans, mainly through reducing the size of loans and reducing maturity for new loans. Factors which are expected to have an impact on terms and conditions in Q2 2020 are the same with those that are expected to contribute in tightening the credit standards.

During the first quarter, the demand of enterprises for bank loans results to have declined. The negative index that resulted after the indexation of the banks' responses regarding the demand for loans is highly attributable to both SMEs and large enterprises. Banks have stated that the demand was characterized with a decline for financing the fixed investments and for debt restructuring. In Q2 2020, banks expect further decline of demand for loans from enterprises, a decline which is expected to be attributed to the decline of demand for financing fixed investments. This reflects the immediate need for liquidity from enterprises and their uncertainties relating to potential impact of the pandemic on the decline of the activity and as a consequence of the demand for financing fixed investments.

The dynamic of the credit activity for household loans during the reporting period, based on the survey, were negatively affected by the demand for loans, while the credit supply side remained unchanged for this segment. Credit standards applied for households, based on the survey, result to have remained not impacted by the situation created by the pandemic in the first quarter of 2020. However, the banks' expectations for Q2 2020 provide indications of a significant tightening of credit standards for the household sector, in particular for housing loans, as a result of increased uncertainties about future prospects and the long maturity of these loans. Banks expect tightening of credit standards also for consumer credit, albeit at lower level compared to housing loans. These expectations were based on the increase of banks' sensitivity to risk as a result of pandemics.

Terms and conditions for new loans to households were eased to some extent, mainly through offering 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, and the favorable perspective of the banking market in the country and the good perspective of the real estate, result to have been key factors in easing the terms and conditions of lending to households in the first quarter of 2020. For the second quarter of 2020, banks expect a tightening to some extent of terms and condition for loans, especially for housing loans. Terms and conditions for new loans to households are expected to be adversely affected by the increased risk perceived by banks, deterioration of credit portfolio quality in the country and abroad, and to a lesser extent, unsatisfactory liquidity position. All the aforementioned factors reflect the impact of the pandemic on the economic activity of Kosovo and abroad.

Although containment measures on Covid-19 have been taken only in the last two weeks of this quarter, the demand for loans from households results to have been affected to some extent. In this quarter, banks reported a decline in demand for loans from households, a more significant decline in housing loans against the demand for consumer credit. Banks reported that the decline in demand for loans from households has been attributed to declining demand for consumer financing, the decline of demand for debt restructuring and to a lesser extent, from the unsatisfactory perspective of the real estate market. In the second quarter of 2020, banks expect a sharp decline in loans demand from households, with a more pronounced decline in demand for housing loans, while consumer credit demand is expected to decline to a lower level. The results of the survey suggest that banks' expectations for loans demand dynamics are largely based on unfavorable prospects in the real estate market, declining customer confidence in their solvency, and declining demand for consumer financing.

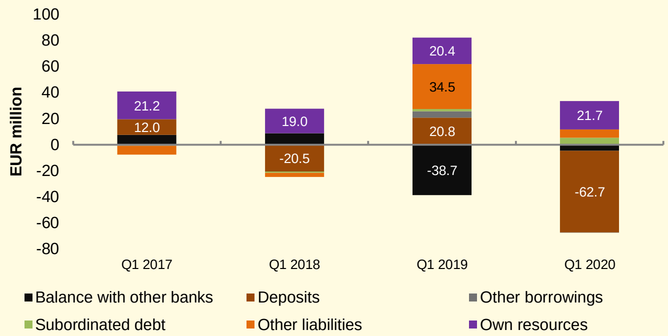
Credit risk resulted to have been increased. Banks reported an increase of nonperforming loans to some extent compared to total loans in the first quarter of 2020, an indicator that is expected to worsen further in the second quarter of 2020.

Banks reported a slight decline of total financing in the reporting period, being affected by the withdrawal of enterprise deposits, implying a covering of liquidity shortages, due to the lack of the generation of revenues. Households, on the contrary, continued to support financing of the banking activities. Over the next quarter, banks expect further decline in access to financing. Financing through household deposits is expected to decrease compared to Q1 2020, and financing from enterprise deposits is expected to continue to decline. Unlike the first quarter of 2020, in the next quarter two of the surveyed banks expect a support in financing the activity from international financial institutions, while, as a result of the global nature of Covid-19 pandemics, banks generally do not expect changes in being financed from parent banks.

Liabilities and Own Resources

The structure of liabilities and own resources is mainly comprised by deposits (81.4 percent), whose stock, at the end of March 2020 reached EUR 3.85 billion and marked an annual growth of 13.6 percent. Whereas, on quarterly basis, during Q1 2020, total deposits declined by EUR 62.7 million (figure 7). Conversely, the category of own resources increased by EUR 21.7 million in Q1 2020 (EUR 20.4 million in Q1 2019), as a consequence of the profit realized during the first quarter of 2020. At the end of the March 2020, the stock of total own resources reached the value of EUR 541.8 million, marking an annual increase of 4.6 percent.

Figure 7. Structure of liabilities and own resources



Source: CBK (2020)

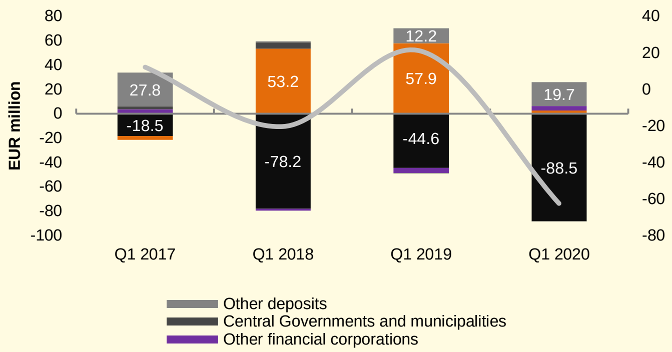
Within the category of other liabilities, subordinated debt increased by EUR 5.5 million (EUR 1.8 million in Q1 2019), while savings from commercial banks reduced by EUR 4.7 million (EUR -38.7 million in Q1 2019).

Deposits

The stock of deposits marked an annual increase of 13.6 percent in March 2020, representing the highest annual increase in the last ten years. However, on quarterly basis, total deposits marked a decline. In Q1 2020, total deposits declined by EUR 62.7 million, against the increase of EUR 20.8 million marked in Q1 2019. Household deposits increased by EUR 2.4 million in Q1 2020, reaching the value of EUR 2.60 billion at the end of the period (March 2020) (figure 8). Whereas, nonfinancial corporation deposits declined by EUR 88.5 million in Q1 2020, reaching the value of EUR 659.1 million at the end of the mentioned period (March 2020). According to categories, transferable deposits marked a significant decline of EUR 67.1 million (EUR -6.6 million in Q1 2020) on quarterly basis, whose stock reached the value of EUR 2.31 billion at the end of the period (March 2020) (figure 9).

Whereas, also time deposits and saving deposits expanded during this quarter, albeit compared to the same period of the previous year these deposits were at lower levels. The value of time deposits on quarterly basis expanded by EUR 3.5 million, while saving deposits increased by EUR 1.0 million (EUR 16.6 million and EUR 10.9 million, respectively, in the same period). Transferable deposits continued to have the highest share to total deposits of the sector (60.2 percent), followed by time deposits (26.7 percent) and saving deposits (13.1 percent).

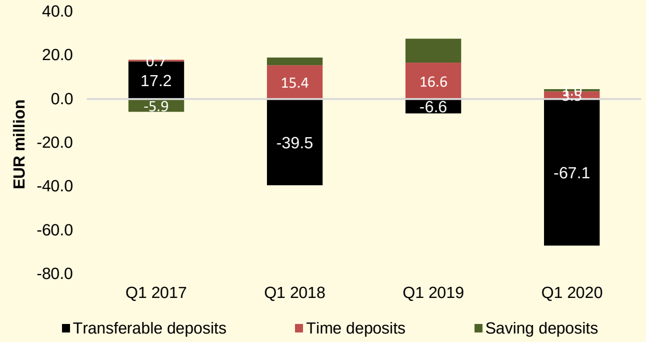
Figure 8. Total deposits value and main categories, in Q1



Source: CBK (2020)

New deposits, in Q1 2020, increased by EUR 109.9 million, of which EUR 36.2 million belonged to nonfinancial corporations, while 73.8 million were comprised of household deposits. Interest rates on new deposits in this quarter were the same as the ones marked in Q1 2019, and this may have had an impact on new deposits collected in this quarter to be for EUR 6.1 million lower than in Q1 2019.

Figure 9. Deposits structure during the reporting periods

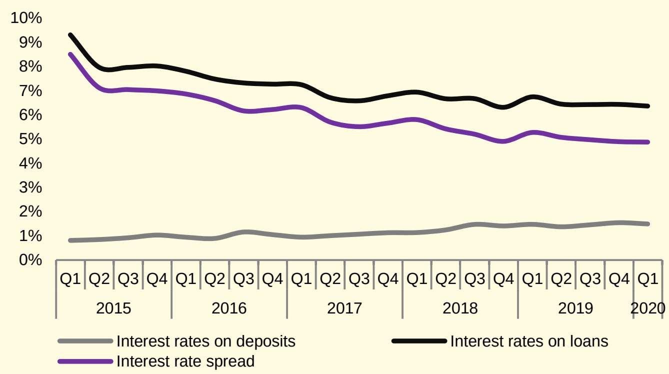


Source: CBK (2020)

Interest Rates[3]

The average interest rate on loans in Q1 2020 was 6.4 percent, or 0.4 percentage points lower against the same period of the previous year. Whereas, interest rates on deposits remained at the same level as in the previous periods, standing at 1.5 percent in Q1 2020. Consequently, the interest rate spread of loans and deposits narrowed down to 4.9 percentage points (figure 10).

Figure 10. Interest rate on loans and deposits



Source: CBK (2020)

[3] The calculation of interest rates: quarter average of interest rates on loans and deposits. In the text it is referred as "the interest rates".

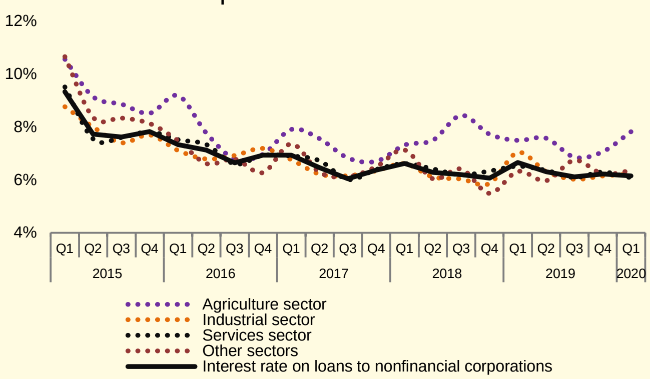
Interest rates on loans

The average interest rate on loans in Q1 2020, for nonfinancial corporations was 6.1 percent, or 0.5 percentage points lower against the previous year (figure 11).

As regards to categories of loans, the interest rates on investment loans was lower (6.1 percent) compared to interest rate on non-investment loans (6.3 percent). Alongside with the same period as in the previous year, it was observed a more emphasized decline of interest rates of investment loans (for 0.6 percentage points) compared to the decline for non-investment loans (for 0.2 percentage points).

In sectoral term, the interest rate on agricultural loans marked an increase of 0.8 percentage points, reaching an average of 6.2 percent.

Figure 11. Interest rates on loans to nonfinancial corporations

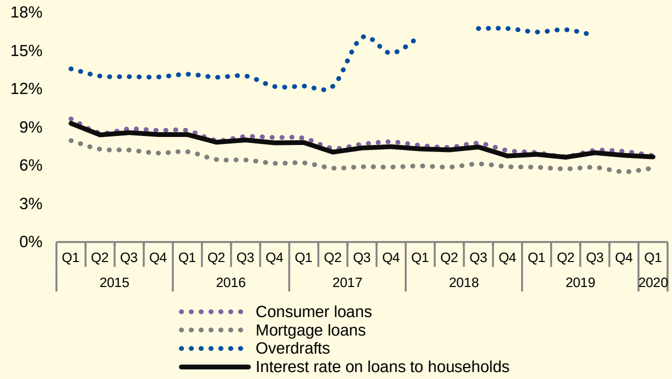


Source: CBK (2020)

Interest rate on loans to industry marked a decline of 0.8 percentage points, reaching an average rate of 6.2 percent. Meanwhile, a more favorable interest rate on loans was marked by services sector, of 6.1 percent (figure 11).

Concerning loans to household, the interest rate stood at 6.7 percent, representing a lower level compared to Q1 2019. A higher interest rate was on consumer credit (6.8 percent), which compared to the previous period this rate was lower for 0.2 percentage points.

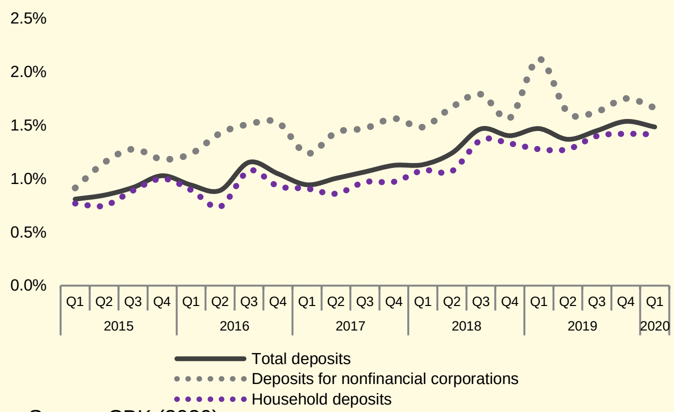
Figure 12. Interest rates on loans to households



Source: CBK (2020)

In addition, interest rate on mortgage loans marked a decline in this quarter (from 5.9 percent in Q1 2019, to 5.8 percent in Q1 2020) (figure 12).

Figure 13. Interest Rates on Deposits



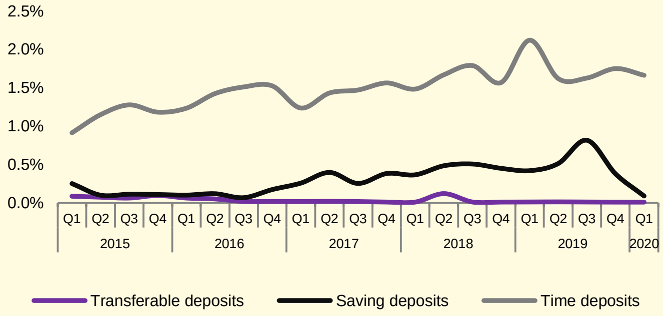
Source: CBK (2020)

Interest rates on deposits

The average interest rate on deposits stood at the same level compared to the previous period. During Q1 2020 ,the average interest rate on deposits was 1.5 percent (figure 13).

Interest rate on nonfinancial corporations deposits continued to be higher, compared to interest rate on household deposits, also in this quarter.

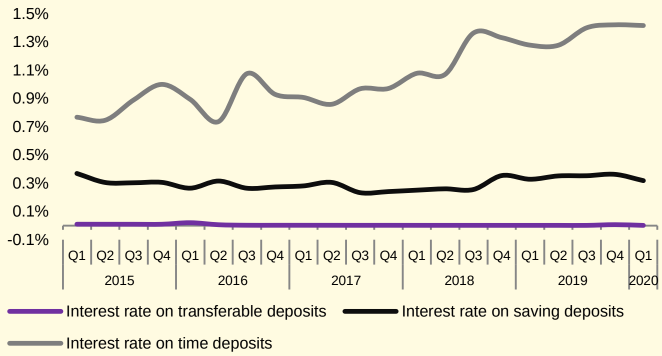
Figure 14. Interest rate on deposits of nonfinancial corporations, by categories



Source: CBK (2020)

Compared to Q1 2019, the interest rate on nonfinancial corporation deposits marked a decline of 0.5 percentage points, dropping at the level of 1.7 percent in the first quarter of 2020. This decline came as a result of the reduction of the interest rate on time deposits. (figure 14).

Figure 15. Interest rates on household deposits, by categories



Source: CBK (2020)

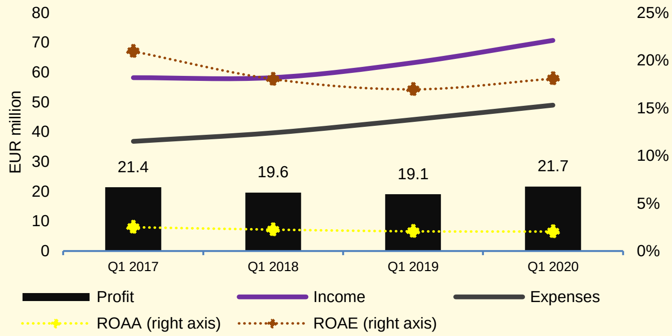
Interest rates on household deposits marked an annual increase of 0.1 percentage points compared to Q1 2019, reaching the rate of 1.4 percent (figure 15). This came as a result of the rate increase of time deposits of 0.1 percentage points. Interest rate on saving deposits remained at the same level of 0.3 percent.

Performance of the Banking Sector

The first quarter of 2020 marked the highest profit realized compared to the first quarters of the previous years. The sector realized a profit with a value of EUR 21.7 million, which is for EUR 2.6 million higher compared to Q1 2019 (figure 16). This profit increase marked in Q1 2020 was a result of the higher increase of income (for EUR 7.5 million) compared to the increase of expenditures (for EUR 4.9 million). Within income, interest income reached a value of EUR 54.5 million (for EUR 6.3 million higher compared to Q1 2019), which mainly is comprised of interest income from loans. Interest income reached a value of EUR 16.2 million (for EUR 2.2 million higher compared to Q1 2019), which mainly is comprised of income from fees and commissions.

The same as income, also expenditures of the banking sector marked an increase, albeit to a slower pace. The largest category, the one of general and administrative expenditures reached the value of EUR 27.0 million (for EUR 1.5 million higher compared to Q1 2019). The category of non-interest expenditures, in Q1 2020, reached the value of EUR 13.5 million (for EUR 2.5 million higher compared to the previous period), mainly as a consequence of the higher share for expenditures on loan loss provisions. Whereas, the category of interest expenditures reached the value of EUR 5.8 million (for EUR 0.9 million higher compared to previous period).

Figure 16. Profit and profitability indicators of the banking sector



Source: CBK (2020)

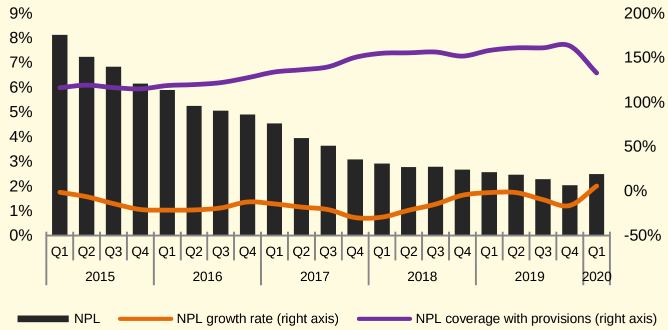
In Q1 2020, expenditures to income ratio was at the rate of 69.3 percent, or 0.5 percentage points lower compared to the same period of the previous year. This decline came as a result of the higher income growth along with the lower increase of expenditures. This ratio indicates that the banking sector spends EUR 1 for EUR 0.693 earned (figure 16).

Financial Soundness Indicators

The indicators of credit portfolio quality, in Q1 2020, stood at a satisfactory level, with low level of nonperforming loans (NPL) and an adequate coverage of loans with provisions. The value of nonperforming loans, after a decline of five consecutive years, in March 2020 marked an increase of 5.8 percent. However, the level of NPL at the end of March 2020 stood at 2.5 percent (2.6 percent at the end of March 2019) (figure 17). This level of NPL represents the lowest level by now, and is well covered with loan loss provisions.

The coverage of nonperforming loans with loan loss provisions, at the end of December 2020, was for 25.3 percentage points lower compared to the level marked at the end of the same quarter of the previous year, reaching the level of 133.0 percent.

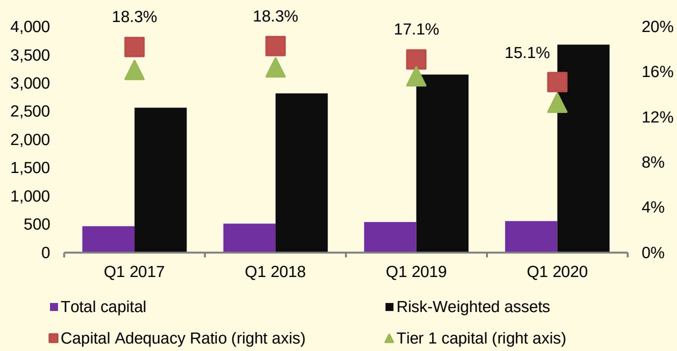
Figure 17. Indicators of credit portfolio quality



Note: The data are as at end of the noted quarter
Source: CBK (2020)

The banking sector continues to be well capitalized and sustainable, in Q1 2020. During this period, the Capital Adequacy Ratio was at the level of 15.1 percent, representing a lower level for 2.0 percentage points than in the same period of the previous year (figure 18).

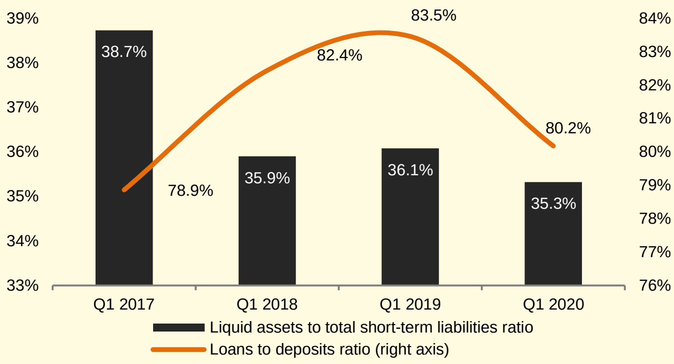
Figure 18. Solvency indicator



Note: The data are as at end of the noted quarter
Source: CBK (2020)

Although standing at lower level, this indicator remained at satisfactory level and above the minimum required regulatory capital. The higher level of lending activity had an impact on the increase of risk weighted assets, which marked an annual increase of 16.9 percent. Conversely, the regulatory capital marked an annual increase of only 3.2 percent, as a result of the spread of the dividend during the previous year.

Figure 19. Liquidity indicators



Note: The data are as at end of the noted quarter
Source: CBK (2020)

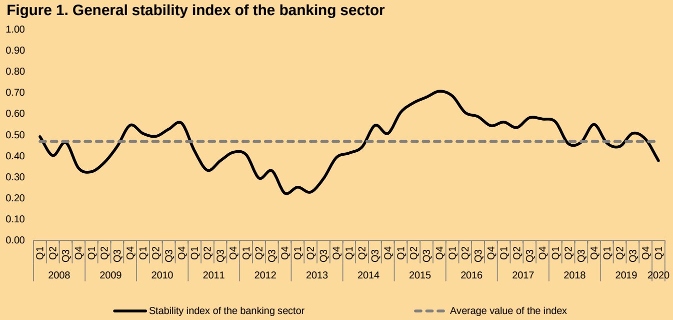
As regards to the liquidity of the banking sector, the liquid assets to short-term liabilities ratio marked a slight decline of 0.8 percentage points compared to Q1 2019, standing at the level of 35.3 percent. The slight decline of this indicator, came as a result of the slowdown increase of liquid assets (cash, the balance with the CBK and the balance with other banks) compared to the higher increase of short-term liabilities (mainly non-time deposits). Loans to deposits ratio stood at the level of 80.2 percent, which is approximate to the recommended level of 80.0 percent.

Box 2. Stability index of the banking sector

Banking sector, until the outbreak of Covid-19 pandemic, operated in an environment with low risk level. The outbreak of Covid-19 pandemic and the containment measures, have had an impact on the increase of risks to which the banking sector is exposed. In this box will be elaborated the effect of Covid-19 pandemic on the indicators with high frequency of the banking sector, summarized in the Stability Index of the Banking Sector. Since the available data include only the last two weeks of March, this analysis does not fully provide the effects of the pandemics since the closure of the economy until its opening (in the beginning of June).

The stability index of the banking sector is constructed in order to measure and assess the domestic measures of the banking sector which reflect the stability of the sector. The index has been constructed on the base financial indicators of the banking sector, taking the values ranging from 0 to 1, where the higher values represent a risk in decline and vice versa[4]. The index has been calculated on quarterly basis in order to assess the increase or the decline of the risk sensitivity through this index.

Figure 1. General stability index of the banking sector

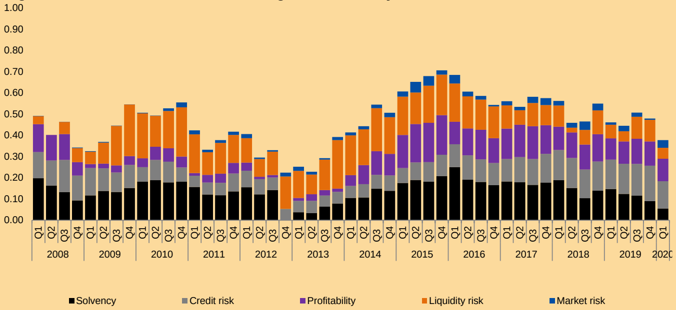


Source: CBK (2020)

Based on the general aggregated index of the sector's stability, banking sector has marked a year-on-year increase of the risk sensitivity (decline of the index) in Q1 2020. The overall value of the index is at the lowest level (0.38) for the first time since Q2 2013 (figure 1).

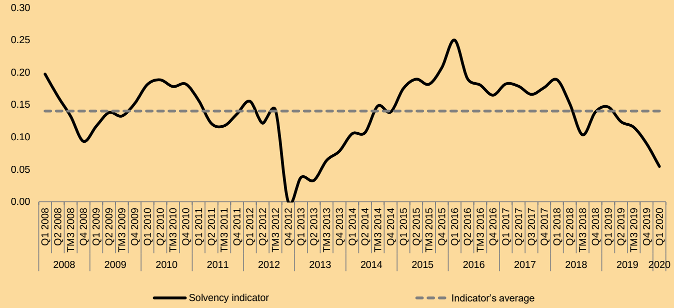
[4] For further details on the methodology of the construction of the stability index of the banking sector, please refer to the Financial Stability Report no. 9.

Figure 2. Constituent criteria of banking sector stability index



Source: CBK (2020)

Figure 3. Solvency indicator



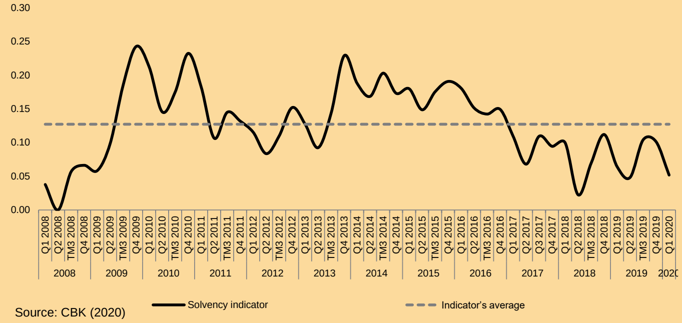
Source: CBK (2020)

Compared to the same quarter of the previous year, a decline of the index (read: an increase of risk sensitivity) was marked by: solvency indicator, credit and liquidity risk. Whereas, an increase of the index (read: a decline of risk sensitivity) was marked by profitability and risk indicators of the market (which has no significant weight) (figure 2). However, there should be noted that changes in the indicators of the index in this period do not result to have been affected by developments of Covid-19 pandemics, but by other dynamics elaborated below. Expectations suggest that effects of Covid-19 pandemics will reflect i the coming periods.

The increase of sensitivity to solvency at the end of Q1 2020 compared to the statement marked in Q1 2019, is attributable to the decline of capitalization level. The decline of the capitalization level was affected by the accelerated increase of risk bearing assets compared to the slower decline of the regulatory capital. A more accelerated increase of risk weighted assets was impacted by the accelerated increase of lending in the recent years. While, the slowdown increase of the capital came as a result of the dividends spread in 2019.

The increase of sensitivity to liquidity risk, in Q1 2020, compared to the level marked in the same period of the previous year, came as a result of the slower growth of liquid assets compared to the higher growth of short-term liabilities. Assets held at the CBK, by commercial banks marked a slower growth compared to March last year, reflecting the statement of the total liquid assets. The balance with the CBK continuously exceeded the minimum level as required by the regulation, hence commercial banks have channeled part of their assets into lending activity. On the other hand, the most significant increase in short-term liabilities (up to one year) came as a result of the significant expansion of deposits during 2019, mainly from households and non-financial corporations.

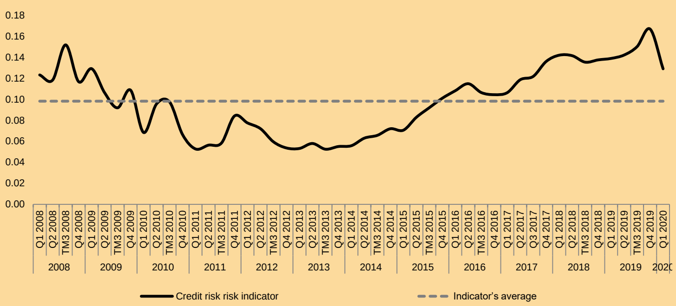
Figure 4. Liquidity indicator



Source: CBK (2020)

The increase of the sensitivity to credit risk came as a result of the increase in the value of nonperforming loans compared to the previous period, which was offset by the higher growth of the credit stock. The downward trend in the value of nonperforming loans was discontinued for the first time in Q1 2020, since Q4 2014 when they began to decline. The level of NPL is expected to increase, as currently it is at a quite low level, as this will be influenced by Covid-19 pandemic in Kosovo's economy. This is as a consequence of the decline of households' income, businesses income and other economic activities. The increase of the sensitivity to credit risk was also influenced by the increase in the level of large credit exposures to Tier 1 capital.

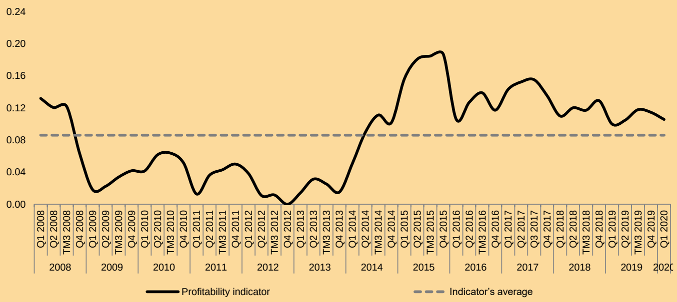
Figure 5. Credit risk indicator



Source: CBK (2020)

On the other hand, the decrease of the sensitivity to profitability risk, came as a result of the higher level of income (mainly interest income), along with the slower growth of expenditures (mainly from non-interest and operating expenditures). However, the effects of the pandemic and the easing measures taken by banks to enable customers (individuals and businesses) to defer credit installments by 3 months will have a negative impact on banks' profits, as revenues are expected to decline in the second quarter of the year, and this will be reflected in the performance indicators of the banking sector.

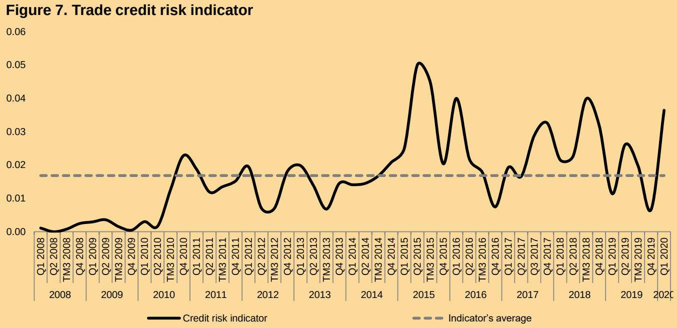
Figure 6. Profitability indicator



Source: CBK (2020)

The indicator that measures market risk sensitivity has the lowest weight in the overall financial stability index as only 4.0 percent of assets and 3.5 percent of liabilities are in foreign currency. Also, the level of loans and deposits in foreign currency is at a quite low level. As a consequence, movements of this indicator have quite low impact in the aggregated index of the financial stability. This indicator, measured by the opened position in foreign currency to Tier 1 capital, at the end March 2020 marked a decline (1.1 percent in March 2020 from 3.2 percent a year earlier).

Figure 7. Trade credit risk indicator



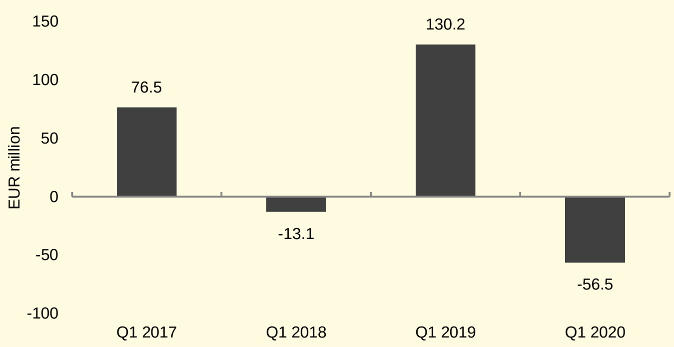
Source: CBK (2020)

Pension Sector

Increased uncertainties by announcing the pandemic situation of Covid-19 affected the dynamics on global financial markets. As a consequence, the pension sector was characterized with a negative return on investments and a decline of assets. Meanwhile, new contributions marked an increase.

Pension sector as the second sector by importance of weight in the financial sector, comprises 26.8 percent of total assets of the financial system in the country. Total assets of the pension sector marked an annual increase of 5.5 percent and their value reached EUR 1.92 billion in Q1 2020. On a quarterly basis, only during Q1 2020, assets of the pension sector decreased by EUR 56.5 million, mainly as a result of investment losses due to the losses in global financial markets which were reflected in sector's investments abroad (figure 20).

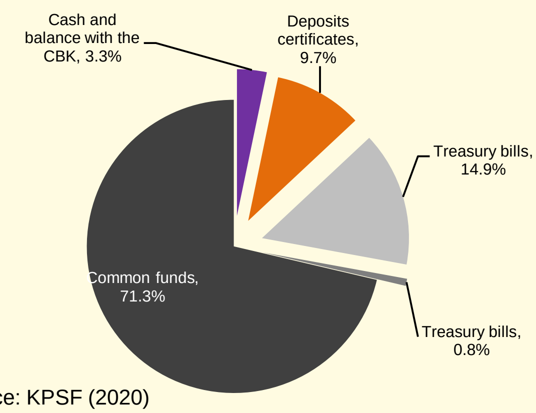
Figure 20. Assets of the pension sector, quarterly changes



Source: CBK (2020)

Assets of the pension sector consist of 99.6 percent which belong to Kosovo Pension Saving Trust (KPST) and 0.4 percent of assets of Slovenian-Kosovo Pension Fund (SKPF). KPST assets structure is mainly comprised of assets invested abroad allocated in common investment funds (71.3 percent) and invested in Kosovo's Government Securities (15.7 percent), deposits certificates in the banking sector (9.7 percent) (figure 21).

Figure 21. Structure of KPST assets, Q1 2020

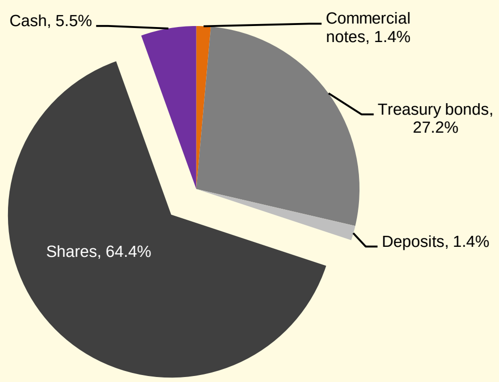


Source: KPSF (2020)

During this quarter, KPST assets contracted by EUR 55.5 million, mainly as a result of the decline of investments abroad whose value dropped at EUR 115.9 million compared to the previous quarter (EUR growth 199.0 million in Q1 2019). The impact of the decline of investments abroad was mitigated by investments within the country, which increased by EUR 60.4 million, mainly from cash held at the CBK. An increase of investments, albeit at marginal level, was marked by deposits held at commercial banks and investments in Government Securities.

Assets structure of SKPF is mainly comprised of shares invested abroad (64.4 percent), bonds of foreign governments and of Kosovo's government (27.2 percent) and other assets in the form of cash and deposits (figure 22). Total assets of SKPF, in Q1 2020, contracted by EUR 1.0 million mainly as a result of the decline of the investments abroad in share, securities and cash. In addition, also investments in the form of deposits in commercial banks operating in Kosovo and in Government securities shrank on quarter basis.

Figure 22. Structure of SKPF assets, Q1 2020



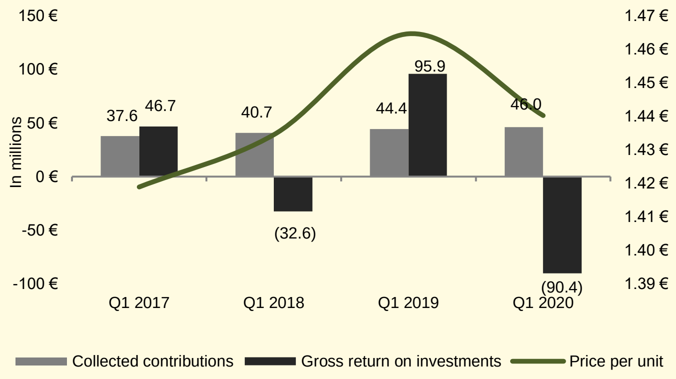
Source: SKPF (2020)

During Q1 2020, SKPF marked not a good investments performance, realizing gross loss from investments with a value of EUR 910.0 thousands (EUR 573.5 thousands in Q1 2019). Moreover, SKPF registered new collections in Q1 2020, which amounted to EUR 130.0 thousands (EUR 153.0 thousands in Q4 2019).

In this quarter, contributions collected by KPST increased by EUR 46.0 million, representing an increase of 3.7 percent, compared to the same period of the previous year. Conversely, KPST marked gross loss return on investments with a value of EUR 90.4 million (figure 23). This decline came as a result of the decline in the global financial markets which started in February 2020 influenced by uncertainties caused by Covid-19 pandemic. In the containment measures on Covid-19 taken by states, the economic activity ceased, which caused significant uncertainties about the economic situation globally which was reflected in the historical decline of the main indices in foreign markets, where a large part of KPST investment is invested. KPST stated that in order to maintain investments from these fluctuations, has reduced investments in instruments with higher risk, as shares and has oriented them in instruments with higher security in cash market. Also, KPST has increased investments in the country. Driven by news of stimulus packages for the recovery of economies and optimistic findings on the vaccine against Covid-19, financial markets recorded strong growth during May 2020, albeit this growth is not expected to be stable and financial markets may face a further negative trend in the remainder of the year as a result of ongoing uncertainties and fears of a second wave of potential spread.

Regarding the pension sector in general, gross negative return on investments was EUR 91.3 million, while the contributions collected were EUR 46.2 million, of which 99.7 percent belong to KPST. Also the declining trend of unit price reflected the uncertainty and losses in financial markets all over the world.

Figure 23. Return on investments and KPST performance



Source: KPSF (2020)

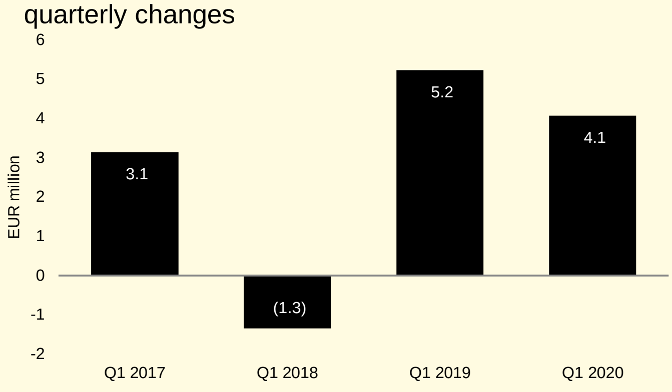
Insurance Sector

Insurance sector during the first quarter of 2020 was characterized with an activity expansion, albeit at a lower level. The level of written

premiums was higher compared to the same quarter of the previous year, influenced by the increase in prices of compulsory insurance premiums of vehicles at the end of the last year. The insurance sector recorded a profit increase this quarter, mainly as a result of the decline of claims incurred and the reduction of other operating expenses, which may have been affected by the undertaken containment measures on COVID-19 in the last two weeks of Q1 2020.

Assets of the insurance sector, in March 2020, marked an annual increase of 10.8 percent, thus reaching EUR 200.6 million. The highest contribution to the growth of sector's assets was given by the category of deposits held at the banking sector, investments in securities, cash and deposits held at the banking sector and at the CBK. While, on quarterly basis, assets of the insurance sector increased by EUR 4.1 million in Q1 2020 (figure 24).

Figure 24. Assets of the insurance sector, quarterly changes



Source: CBK (2020)

Similarly to the growth trend of assets, also the overall capitalization level of the sector was characterized with an increase. Only during this quarter, the total capital marked an increase of EUR 4.7 million, thus reaching the value of EUR 52.1 million as at end of period (March 2020). This capital increase came as a result of the paid additional shareholders capital. While, the high level of losses accumulated from the previous years has had a negative impact on the further increase of the capital of insurance sector.

Regarding liabilities, they were characterized with a slight decline during this quarter (a decline of EUR 0.7 million in Q1 2020), while their value reached EUR 148.4 million at the end of March 2020.

The value of gross written premiums of insurance companies, in Q1 2020, amounted to EUR 22.3 million, representing an annual increase of 2.1 percent(figure 25). "Non-life" premiums account for 96.0 percent of total written premium, whereas "life" premiums comprise 4.0 percent. In Q1 2020, the insurance sector collected "non-life" premiums with a value of EUR 21.4 million, while "life" insurance premiums with a value of EUR 895.4 thousands.

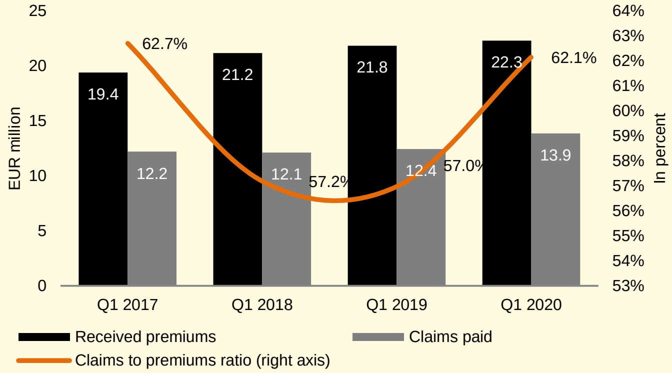
Similarly to the level of the written premiums, also claims paid by the insurance sector (including also the Kosovo Insurance Bureau), during this quarter marked an increase, reaching the value of EUR 13.9 million (figure 25). Compared to Q1 2019, the value of claims paid was higher for EUR 1.4 million, as a consequence of the increase of claims paid by insurance companies, as the level of claims paid by KIB marked a decline. As a consequence of the higher increase of claims paid compared to the received premiums, during this quarter the ratio of claims to premiums increased by 5.2 percentage points compared to the same period of the previous year, reaching 62.1 percent.

Performance of the Insurance Sector

In Q1 2020, insurance sector performed with a net profit of EUR 2.1 million (EUR 143.5 thousands in Q1 2019). The profit realized in this quarter was a result of the increase of the premiums earned on one side, and the decline of the value of claims incurred and other operating expenses of the sector.

Regarding the liquidity of the insurance sector, until March 2020, one of the liquidity indicator, cash and its other equivalents to technical reserves ratio shows that liquidity stood at the level of 97.8 percent, representing a higher level of 4.4 percentage points compared to the previous period. Moreover, the other indicator of cash and its equivalent to total liabilities shows a growth of 1.7 percentage points of the level of the sector's liquidity, thus reaching at 84.6 percent. This growth was a result of the slower annual increase of cash and its equivalent (11.2 percent) compared to liabilities (8.9 percent).

Figure 25. Written premiums and claims paid



Source: CBK (2020)

Microfinance Sector

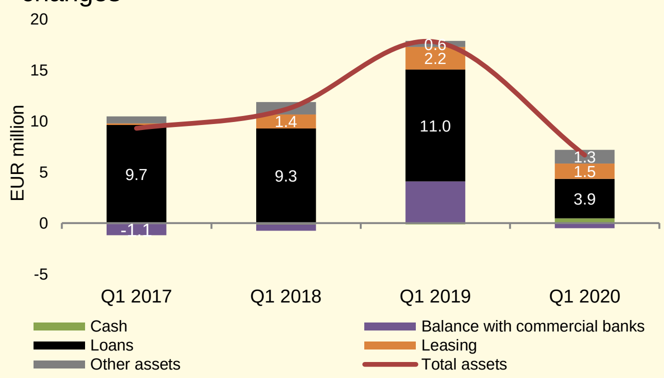
Microfinance sector has marked an increase of its assets in Q1 2020, mainly being impacted by the increase of lending activity. Moreover, the sector was characterized with a satisfactory performance and a good quality of credit portfolio.

Assets

Total assets of microfinance sector continued with an increasing trend, marking an annual increase of 16.9 percent, in March 2020, reaching the value of EUR 314.4 at the end of the period. On quarterly basis, assets increased by EUR 6.7 million, whereas compared to Q1 2019, this value was lower for EUR 11.1 million. The increase of assets mainly was a result of the increase of lending activity (EUR 3.9 million on quarter basis) and the increase of leasing (EUR 1.5 million on quarter basis) (figure 26).

Conversely, the category of cash marked a slight increase of EUR 0.5 million, while the balance with commercial banks had a decline of EUR 0.5 million on quarterly basis.

Figure 26. Assets of the microfinance sector, quarterly changes



Source: CBK (2020)

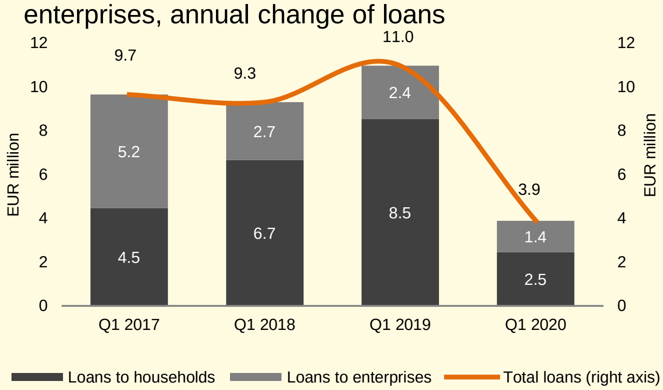
Loans

The stock of total loans, in Q1 2020, expanded by EUR 3.9 million on quarterly basis, a value which is lower for EUR 7.1 million compared to Q1 2019. However, on annual basis, total loans marked an increase of 15.7 percent by the end of March 2020, reaching the value of EUR 225.5 million. A higher increase during this period was marked by loans to households with 17.0 percent, reaching the value of EUR 152.1 million at the end of the period.

Only in Q1 2020, loans to households marked an increase of EUR 2.5 million(figure 27).

Moreover, also loans to nonfinancial corporations marked an annual increase in March 2020, albeit at a lower rate compared to loans to households. The stock of these loans reached EUR 73.4 million, representing an annual increase of 13.1 percent. On quarterly basis, during Q1 2020, loans to nonfinancial corporations marked an increase of EUR 1.4 million (figure 27).

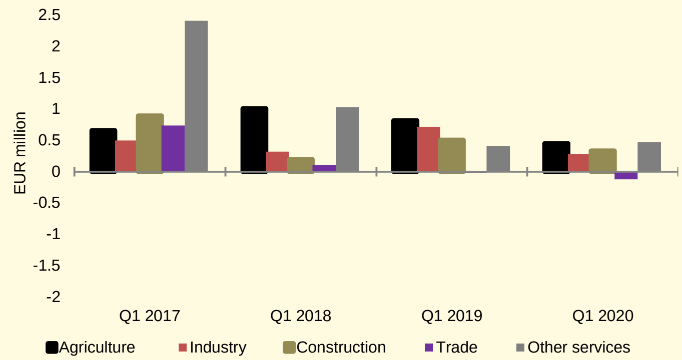
Figure 27. The value of loans to households and to enterprises, annual change of loans



Source: CBK (2020)

Based on sectoral basis, the value of loans granted to other services sector marked the highest increase for this period, reaching EUR 0.5 million on quarterly basis (figure 28). Loans to agriculture sector expanded by EUR 0.4 million, while loans to industry and construction increased by EUR 0.3 million. While, loans to trade sector contracted by 0.1 million in Q1 2020.

Figure 28. Value of loans to nonfinancial corporations, by economic sectors, quarterly change

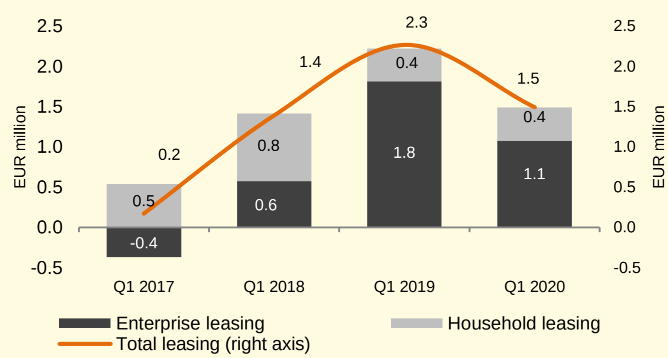


Source: CBK (2020)

Leasing

The activity of leasing of the microfinance sector marked an increase during Q1 2020 with a value of EUR 1.5 millions, reaching the value of EUR 54.2 million at the end of the period. This increase was mainly a result of leasing to nonfinancial corporations, the value of which increased by EUR 1.1 million during this quarter, reaching the value of EUR 29.2 million at the end of the period (figure 29).

Figure 29. Value of microfinance sector leasing



Source: CBK (2020)

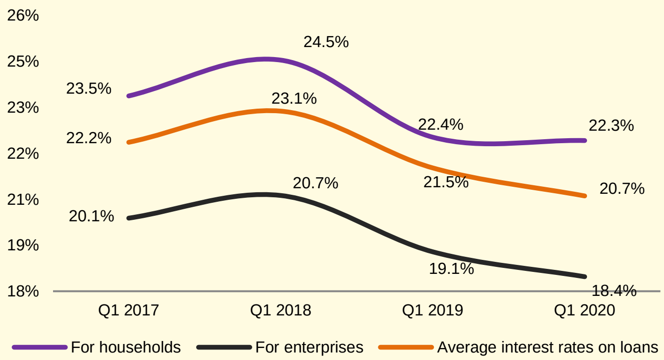
Similarly, also the leasing to households increased by EUR 0.4 million in Q1 2020, reaching the total value of EUR 25.0 million at the end of the mentioned period.

Interest Rates

During the first quarter of 2020, the average interest rate on loans was 20.7 percent, representing a lower rate for 0.8 percentage points compared to the same period of the previous year (figure 30).

The average interest rate on loans to households marked a marginal decline of 0.1 percent compared to Q1 2019, falling to 22.3 percent(figure 30). Regarding the categories of loans, interest rates on consumer loans to households marked a decline compared to Q1 2019 with 0.1 percentage points, dropping to 22.1 percent in Q1 2020.

Figure 30. Average interest rate on microfinance sector loans

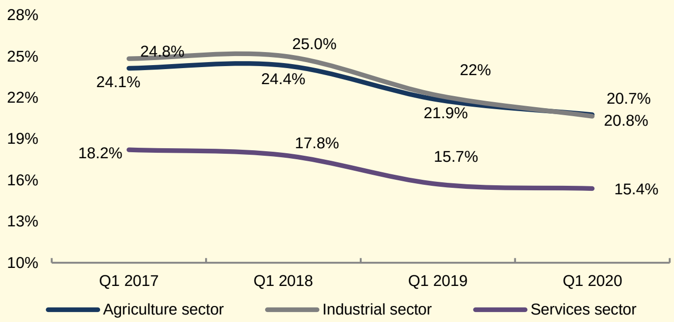


Source: CBK (2020)

Whereas, the average interest rate on mortgage loans marked in Q1 2020 compared to the previous period, was characterized with an increase of 0.4 percentage points, reaching 21.9 percent.

Similar to households, also interest rate on loans to nonfinancial corporations marked a slight decline. In Q1 2020, the average interest rate on loans to nonfinancial corporations stood at 18.4 percent. In sectoral terms, the lowest interest rate on loans remained in the services sector with 15.4 percent, while the average rate for the industrial sector had the highest decline of 1.5 percentage points, dropping to 21.7, where as a result the average rate remained the highest in the agricultural sector with 21.8 percent (figure 31).

Figure 31. Average interest rate on loans to enterprises, by economic sectors



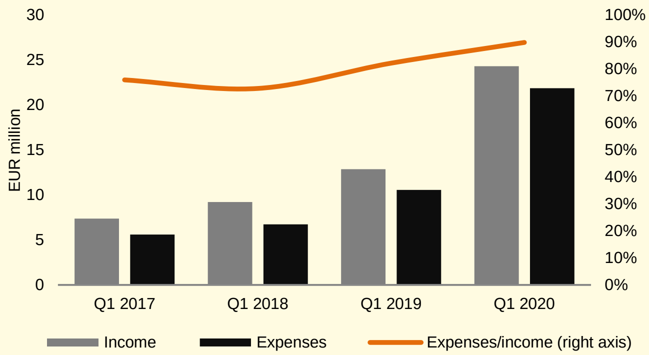
Source: CBK (2020)

Performance of the Microfinance Sector

Microfinance sector was characterized with a satisfactory financial performance also in the end of 2020. Only during this quarter, the income of the sector reached EUR 24.3 million at the end of the period. This increase was mainly driven by the significant increase of interest income, EUR 23.0 million compared to the same period of the previous year, which was EUR 10.3 million (figure 32).

Furthermore, during this quarter, also expenditures of the sector were characterized with an increase. In Q1 2020, total expenditures of the sector reached the value of EUR 21.9 million (EUR 10.6 million in Q1 2019). The increase of expenditures was mainly a result of the increase of administrative and personnel expenses, loan loss provisions, and as a result of interest expenses.

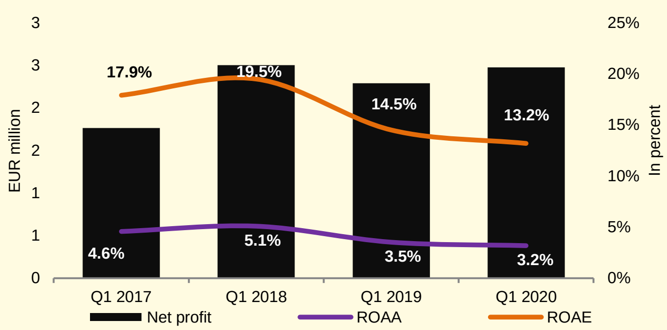
Figure 32. Microfinance sector income and expenses



Source: CBK (2020)

Consequently, expenditures to income ratio was at the rate of 89.8 percent, or 7.7 percentage points higher compared to the same period of the previous year. This increase is a result of the higher increase of expenditures compared to income. Consequently, the net profit during this quarter marked an increase of EUR 0.2 million compared to Q1 2019, reaching the value of EUR 2.5 million (figure 33).

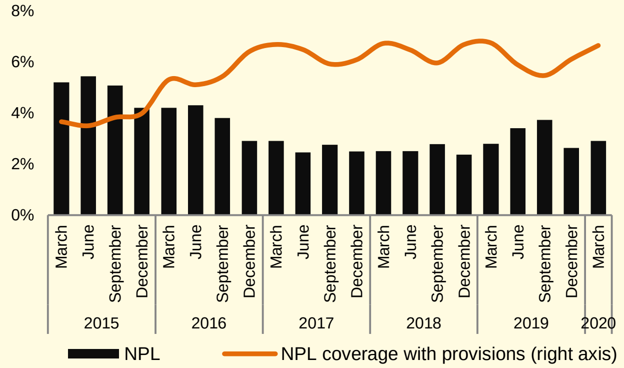
Figure 33. Profitability indicators of microfinance sector



*Profit was annualized for the respective quarter
Source: CBK (2020)

Despite the good financial performance, two profitability indicators, Return on Average Assets (ROAA) and Return on Average Equity (ROAE), marked a slight decline by 0.3 percentage points and 1.3 percentage points, respectively, compared to Q1 2019 (figure 33).

Figure 34. Indicators of credit portfolio quality



Source: CBK (2020)

Regarding the indicators of credit portfolio quality in microfinance institutions, nonperforming loans continued to stand at low levels and were characterized with good coverage of provisions. Until the end of the period, nonperforming loans stood at 2.9[5] percent, representing a slightly higher level compared to the same period of the previous year (2.8 percent in Q1 2019). Moreover, the NPL coverage with provisions was 207.7 percent, until the end of Q1 2020 (figure 34).

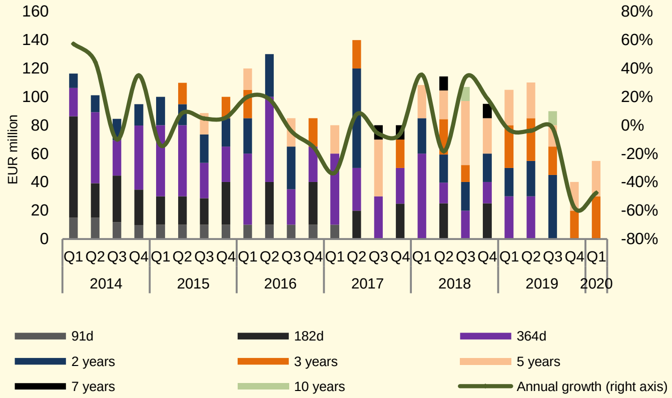
Securities Market

In Q1 2020, Kosovo's Government issued a debt with a quite lower value compared to the previous period, mainly due to the delay of establishment of institutions in the beginning of 2020.

[5] In this calculation were not included two financial institutions (MI/NBFI) whose licenses have been revoked and liquidation procedures have begun.

The debt issued by Kosovo's Government marked an annual decline of 47.6 percent in Q1 2020 (figure 35).

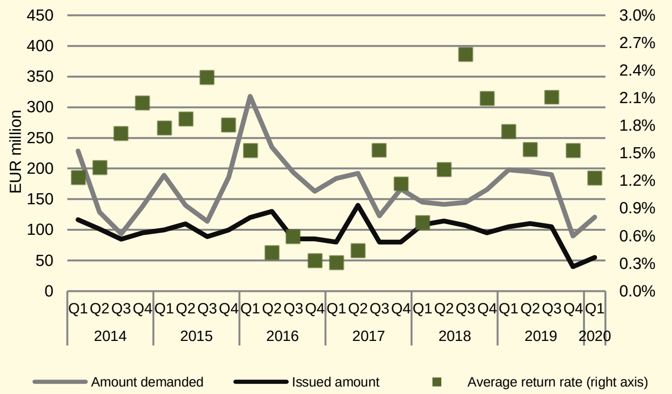
Figure 35. Value of issued debt, annual growth



Source: Ministry of Finance (2020)

The amount of the issued debt during this period amounted to EUR 55 million, despite the fact that the demand was higher for EUR 120.9 million. The average interest rate on securities was 1.2 percent in Q1 2020, representing a lower rate for 0.5 percentage points than in Q1 2019 (figure 36).

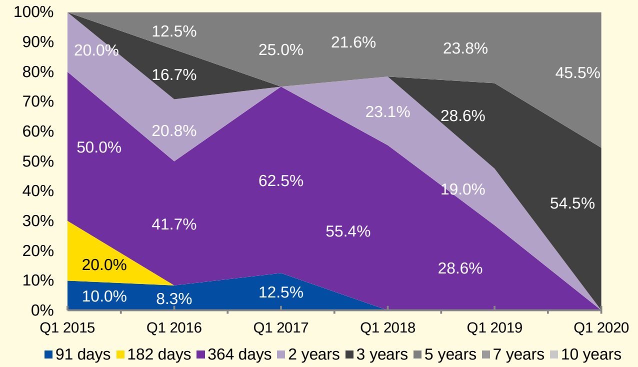
Figure 36. Bid to cover ratio



Source: Ministry of Finance (2020)

During Q1 2020, the securities structure of the Government was dominated by government bonds, of which lead those with a maturity of 3 years and 5 years (figure 37).

Figure 37. Government securities structure, in percent



Source: Ministry of Finance (2020)

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Macroeconomic selected indicators

Description	Q1 2019	Q1 2020
Real sector 1/		
Gross Domestic Product (GDP) (in millions of EUR)*	6,726.1	7,079.6
Consumer prices (annual average)	3.2%	1.1%
Consumer prices (end of period)	3.2%	0.8%
Fiscal Sector* 2/		
Budget Revenues (in millions of EUR)	388.5	397.3
Budget Expenditures (in millions of EUR)	382.5	373.7
Primary balance (in millions of EUR)	6.1	23.5
Financial sector (in millions of EUR) 3/		
Assets of financial corporations	6,513.1	7,174.0
of which : Banks	4,229.1	4,721.9
Loans	2,824.1	3,083.3
Deposits	3,383.7	3,845.4
Interest Rate s on Loans, end of period	6.7%	6.3%
Interest Rate s on Loans, end of period	1.5%	1.3%
Interest rate gap	5.2%	5.0%
External sector*,(in millions of EUR) 3/		
Balance of payments		
Current and capital account	-86.5	-82.7
of which: remittances	184.9	187.3
Financial account	-23.9	-86.3
Foreign Direct Investmentsin Kosovo	69.8	112.0
Portfolio investments, net	71.1	-17.4
Other investments, net	-152.2	54.1
International Investment Position (PNI), net*	-409.4	-401.6
Assets	4,766.2	5,162.7
Liabilities	5,175.6	5,564.3
External debt, total*	2,035.7	2,179.4
Private external debt	1,537.3	1,680.4
Public external debt	498.4	499.0

Source:
1/ KAS (2020);
2/ MF (2020);
3/ CBK (2020).

*Data on GDP, IIP and external debt are as of December 2019.