

Summary

Based on KAS estimates, real GDP marked a decline of 4.6% in the first half of 2020. Investments and net exports were characterized with a decline, whereas consumption has marked an increase. Despite the opening of the economy, it was estimated that the downward trend of economic activity has continued also in Q3 2020. Estimates were supported by the decline of services exports, the decline of capital expenditures of the government, the decline of FDI, etc. An indication of the decline in domestic demand is also the decline of imports of goods, while despite the pandemic crisis, remittances and export of goods have increased.

On quarterly basis, assets of financial system expanded by EUR 258.8 million in Q3 2020, mainly reflecting the increase of the banking sector and pension sector assets. The increase of the banking sector assets was mainly supported by deposits collected in this quarter, while the increase of the pension sector assets was attributed to the contributions collected and the return on investments during this period.

Lending activity was characterized by more pronounced quarterly growth for households against nonfinancial corporations. New loans, during Q3 2020, marked a significant annual increase for both households and enterprises, although a high share of loans issued in this period were reprogrammed loans. Banking sector marked a net profit with a value of EUR 17.6 million in this quarter, which is lower for EUR 7.7 million compared to Q3 2019, mainly as a consequence of the higher increase of expenditures against the slower increase of the sector income. Financial soundness indicators of the sector continued to stand at satisfactory values. Banking sector continued to be characterized with high credit portfolio quality and with optimal coverage of loan loss provisions. The solvency and liquidity indicators continued to remain above

the minimum level as recommended by the regulation (12.0% and 25.0%, respectively).

Pension sector was characterized with an expansion of its activity also in Q3 2020, as a result of the collected contributions and positive return on investments in two recent quarters. Also insurance sector was characterized with an activity increase in Q3 2020, albeit at lower level compared to Q3 2019. The value of collected premiums marked a slight increase during this period. Whereas, the value of claims paid and claims incurred was significantly higher compared to the previous period.

Microfinance sector has marked a significant slowdown increase of its activity in Q3 2020, and a lower financial performance against the previous period. However, the sector continued to have good loans portfolio quality, albeit it changed direction, compared to the trend of the previous periods.

During the third quarter of 2020, Kosovo's Government issued debt with a lower value compared to the previous quarter (Q2 2020) and the level issued in Q3 2019. This dynamic mainly is attributable to the decline of the Kosovo's Government demand to finance its activity through this instrument. Also, the lower demand for issuance of the domestic debt can be attributed to the increase of the level of external borrowings, the value of which, by October 2020, reached EUR 130.7 million, while the total value in the previous year had reached only EUR 42.9 million.

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ABBREVIATIONS

CAR	Capital Adequacy Ratio
CBK	Central Bank of the Republic of Kosovo
CHF	Swiss Franc
EUR	Euro currency
FDI	Foreign Direct Investments
GBP	British Pound
GDP	Gross Domestic Product
IMF	International Monetary Fund
KAS	Kosovo Agency of Statistics
MF	Ministry of Finance of the Republic of Kosovo
NPL	Nonperforming loans
REER	Real Effective Exchange Rate
ROAA	Return on Average Assets
ROAE	Return on Average Equity
RWA	Risk-Weighted assets
SEE	Southeastern Europe
USD	American Dollar
WEO	World Economic Outlook

Macroeconomic Developments¹

Based on KAS estimates, real GDP marked a decline of 4.6% in the first half of 2020. With a decline were characterized investments and net exports, whereas consumption has marked an increase. Despite the opening of the economy, it is estimated that the downward trend of economic activity has continued also in Q3 2020. The estimates were supported by the decline of services exports, the decline of capital expenditures of the government, the decline of FDI, etc. An indication of the decline in domestic demand is also the decline of imports of goods, while despite the pandemic crisis, remittances and export of goods have increased.

Consumer prices marked a decline of 0.4% in Q3 2020, mainly as a consequence of the decline of transport prices, recreation, furnishings, footwear and clothing, energy, etc. The slowdown increase of prices was marked also by the prices of food and non-alcoholic beverages, thus making the core inflation to be lower (-0.9%) compared to the overall inflation.

Fiscal sector, during Q3 2020, was characterized with a decline of budget revenues of 13.5% and an increase of budget expenditures of 11.1%. Consequently, Kosovo's budget recorded a primary budget deficit of EUR 86.4 million. Public debt reached EUR 1.3 billion, which is for 12.2% higher compared to Q3 2019. As a

percentage to GDP, public debt reached 19.9%, from 17.4%, as it was in Q3 2019.

External sector was characterized by a current account deficit of EUR 90.9 million, mainly attributed to the reduction of the positive services balance, which was significantly lower. On the other side, the deficit of goods was lower, while the positive balance of primary and secondary income was higher. Within the balance of payments, remittances marked an annual increase of 18.1%, while Foreign Direct Investments (FDI) marked a decline of 27.0%, during Q3 2020.

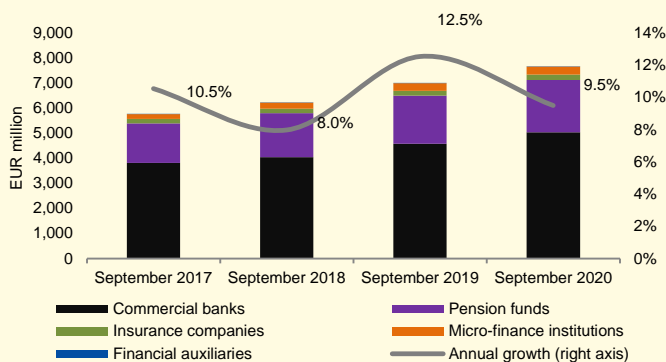
¹ For more information on macroeconomic developments, please refer to: Quarterly Assessment of Macroeconomic Developments (Q3 2020) published at the CBK website.

Financial System

Assets of the financial system at the end of September 2020 reached a value of EUR 7.67 billion, representing an annual increase of 9.5% (graph 1). The slowdown in the growth of financial system assets mainly reflects the performance of lending institutions, which were affected to some extent by the negative effects caused by the COVID-19 pandemic.

The banking sector, despite the slowdown in activity growth, had the highest contribution to the growth with 9.5% of financial system assets. The pension sector, as the second sector by weight, had the second most important contribution in increasing the activity of the system, followed by the microfinance and insurance sectors.

Figure 1. Assets value of Kosovo's financial system



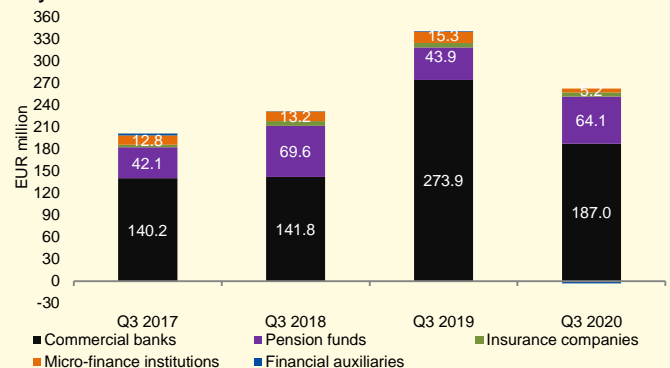
Source: CBK (2020)

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

On quarterly basis, financial system assets expanded by EUR 258.8 million, primarily being affected by assets of the banking sector (EUR +187.0 million) and assets of the pension sector (EUR +64.1 million), and to lower extent from other sectors (EUR +7.7 million) (graph 2).

The slowdown in the growth of the banking sector activity in this quarter is mainly attributed to the performance of deposits, which marked a significantly slower growth compared to the previous period (Q3 2019). Conversely, the increase of the pension sector in this quarter was attributable mainly to collected contributions and return on investments during this period. It is worth noting that this sector fully recovered the losses from investments caused during Q1 2020 (as a result of fluctuations and uncertainties in foreign markets as a result of the spread of COVID-19 pandemic from early 2020).

Figure 2. Quarterly change of assets of financial system constituent sectors



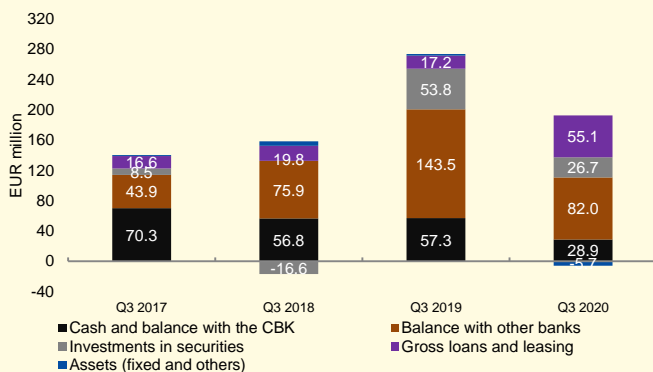
Source: CBK (2020)

Banking Sector

Within the assets of the banking sector, the balance sheet with commercial banks marked the highest growth, followed by lending activity, cash and investments in securities. Deposits, as the main source of financing the banking activity, marked a slow increase in this quarter. Banks' own resources (from retained and realized profit) and loans from other banks (mainly from the external sector) were also characterized by an increase. In general, the banking sector

continued to be well-capitalized, liquid and with high-quality of loan portfolio, despite the increased risks as a result of the economic and social crisis caused by the COVID-19 pandemic.

Figure 3. Banking sector assets structure in the respective quarters



Source: CBK (2020)

Assets

The value of total assets of the banking sector at the end of Q3 2020, reached EUR 5.04 billion, representing an annual growth of 10.0%. On quarterly basis, assets of the insurance sector increased by EUR 187.0 million in Q3 2020. Lending activity of the banking sector (which has the largest share within the assets of the sector, with a share of 63.2%) increased by EUR 55.1 million in this quarter (graph 3). The category of balance sheet with commercial banks, which is mainly comprised of deposits and the like, invested in banks abroad, marked the most significant increase in this quarter, with EUR 82.0 million. Cash held in the treasury and the CBK, increased by EUR 28.9 million in this quarter, while investments in securities increased by only EUR 26.7 million.

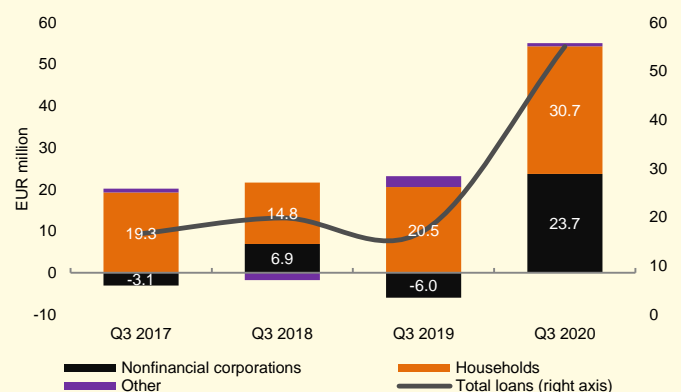
In general, due to the uncertainty caused by the spread of COVID-19 pandemic, despite the increase in lending

activity in Q3, the banking sector has held a significant share of cash and similar assets (at the treasury, at the CBK and at the other banks). Moreover, the stock value of this category, by September 2020, reached the value of EUR 637.1 million, representing the highest historical level of the banking sector in Kosovo.

Loans

The value of total loans at the end of Q3 2020, reached EUR 3.18 billion, representing an annual increase of 7.6% (an increase of 10.3% marked at the end of Q3 2019). For the first time in the recent four years, the lending activity was characterized with slowdown of increasing dynamics from a double digit into a single digit increase. This dynamic of double digit increase of lending has been interrupted as of March 2020, when the first containment measures against COVID-19 pandemic had started. Loans to nonfinancial corporations, which comprise 63.2% of total loans, marked an increase of 7.9% at the end of September 2020 (9.9% in the previous period).

Figure 4. Quarterly changes of loans stock



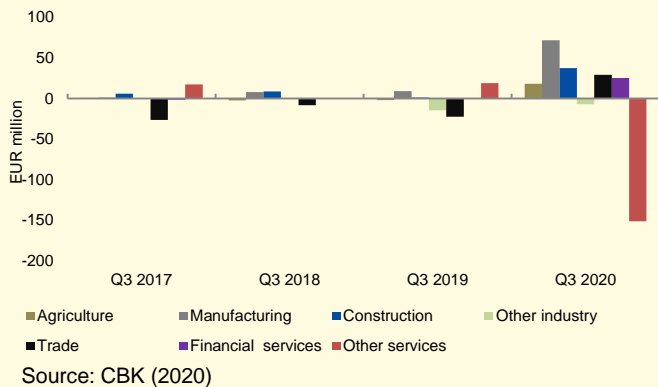
Source: CBK (2020)

Similarly, loans to households marked an annual increase of 7.6% during this period (an annual increase of 10.8% at the end of September 2019).

Only in Q3 2020, total loans marked an increase of EUR 55.1 million, against the increase of EUR 17.2 million in Q3 2019. Loans to households increased by EUR 30.7 million (EUR 20.5 million during Q3 2019), while loans to nonfinancial corporations increased by EUR 23.7 million (EUR -6.0 million during Q3 2019) (graph 4).

In terms of economic activities, on quarterly basis, only lending to other services sector and of energy, gas, etc., marked a decline. Manufacturing sector was characterized with a lending growth in this quarter, followed by the construction, trade, financial services and agriculture sectors. (graph 5).

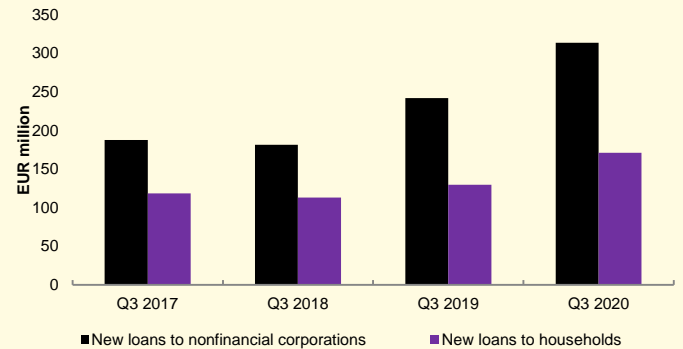
Figure 5. Loans structure by economic activity



New loans, in Q3 2020, reached a value of EUR 484.6 million, representing an annual increase of 30.3% compared to Q3 2019. New loans designated to nonfinancial corporations increased by 29.6%, reaching the value of EUR 313.4 million (graph 6). A significant annual increase was marked by loans with investment purposes with 60.3%, whose value reached EUR 211.1 million. While, new loans with non-investment purposes were characterized with an annual decline of 9.6%, reaching the value of EUR 95.8 million. In sectoral terms, all categories marked an annual

increase compared to Q3 2019, in particular new loans to the sector of agriculture, industry and other services.

Figure 6. New loans to nonfinancial corporations and households, in Q3

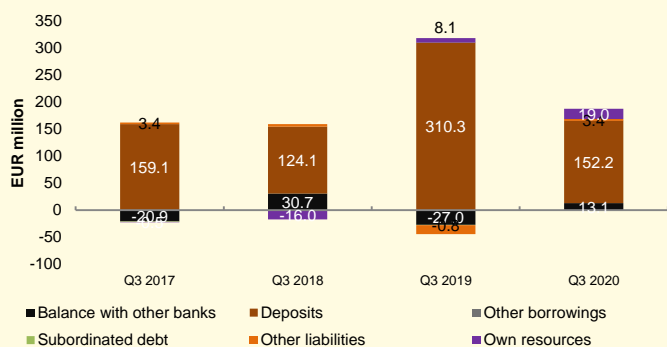


With a growth were characterized also new loans to households. The value of total new loans was for EUR 41.3 million higher against Q3 2019, reaching the value of EUR 171.1 million in Q3 2020. Of which, new consumer credit marked a sharper increase with EUR 37.5 million, reaching the value of EUR 126.2 million, in Q3 2020. New mortgage loans were also characterized by an increase of 23.7%, reaching the value of EUR 34.4 million at the end of Q3 2020. The dynamics identified in the new loans issued during Q3, take into account also the re-programmed loans from the banking sector during this period, as an emergency mitigation measure taken by the CBK to enable the postponement/moratorium of bank customers' debt and mitigation of the COVID-19 pandemic effect to both lending institutions and banking customers. As a consequence, during the period of April-August 2020, at an average, around 40.3% of total stock of loans were comprised of re-programmed loans, whereas their level was only 2.3%, in February 2020.

Liabilities and Own Resources

The structure of liabilities and own resources is mainly comprised by deposits (80.5%), whose stock, at the end of September 2020, reached EUR 4.06 billion and marked an annual growth of 8.6% (16.4% September 2019). Also, on quarterly basis, deposits marked a slower growth for EUR 152.2 million, compared to an increase of EUR 310.3 million in the same period of the previous year (graph 7). The category of own resources increased by EUR 19.0 million in Q3 2020 (EUR 8.1 million in Q3 2019), as a consequence of the profit realized during this quarter. At the end of September 2020, the stock of total equity reached the value of EUR 589.0 million, marking an annual increase of 14.5%.

Figure 7. Structure of liabilities and own resources, quarterly change



Source: CBK (2020)

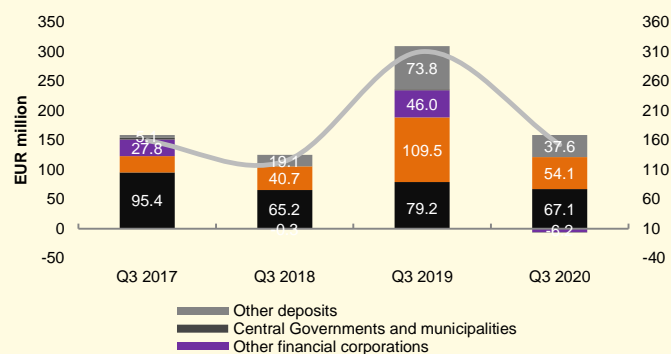
Within the category of other liabilities, subordinated debt declined by EUR 0.7 million (EUR -0.8 million in Q3 2019), while borrowings from commercial banks increased by EUR 13.1 million (EUR -27.0 million in Q3 2019).

Deposits

The stock of total deposits marked an increase of 8.6% in September 2020, representing a half downsize of the increased level compared to the same period of the

previous year (of 16.4%). This significantly slower growth of deposits compared to the previous period was influenced by the largest share of household deposits, followed by those of nonfinancial and financial corporations, which also marked a slowdown in growth.

Figure 8. Total deposits value and main categories, in Q3



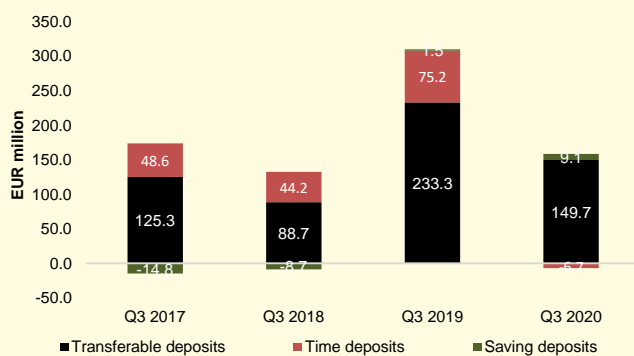
Source: CBK (2020)

During Q3 2020, total deposits marked an increase of EUR 152.2 million, against the increase of EUR 310.3 million in Q3 2019. Household deposits increased by EUR 54.1 million in Q3 2020, reaching the value of EUR 2.70 billion at the end of the period (September 2020) (graph 8). Whereas, nonfinancial corporation deposits increased by EUR 67.1 million in this quarter, reaching the value of EUR 717.3 million at the end of the period (September 2020). According to the categories of deposits, transferable deposits expanded with a value of EUR 149.7 million (EUR +233.3 million in Q3 2019) on quarterly basis, while their stock reached the value of EUR 2.49 billion at the end of the period (September 2020) (graph 9).

Whereas, time deposits during this period shrank by EUR 6.7 million (an expansion of EUR 75.2 million during Q3 2019), reaching the value of EUR 1.04 billion at the end of the period (September 2020). Saving deposits marked an expansion of the value of EUR 9.1

EUR million (+1.5 million in Q3 2019), reaching the value EUR 525.1 million at the end of the period (September 2020). Transferable deposits continued to have the highest share to total deposits of the sector (61.5%), followed by time deposits (25.6%) and saving deposits (12.9%).

Figure 9. Deposits structure by main categories, quarterly change



Source: CBK (2020)

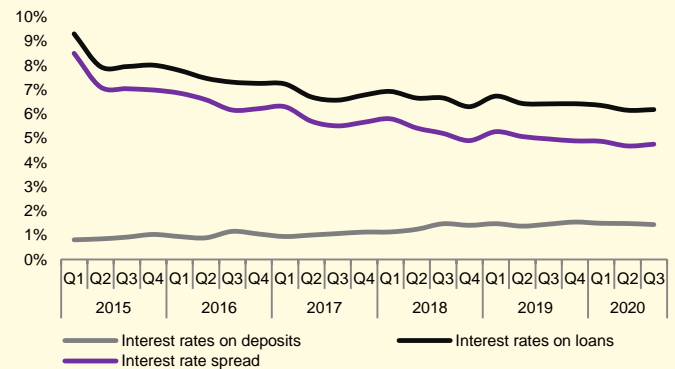
The value of new collected deposits, in Q3 2020, was EUR 150.7 million, of which EUR 41.8 million were deposits collected from nonfinancial corporations, whereas EUR 108.9 million belonged to household deposits. Whereas, compared to Q3 2019, it was observed a sharp decline for both, households (EUR -27.7 million) and for nonfinancial corporations (EUR -22.5 million).

Interest Rates²

The average interest rate on loans was 6.2%, in Q3 2020, or 0.2 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 1.4% in Q3 2020. Consequently,

the interest rate spread of loans and deposits narrowed down to 4.8 percentage points (graph 10).

Figure 10. Interest rate on loans and deposits



Source: CBK (2020)

Interest rates on loans

The average interest rate on loans to nonfinancial corporations stood at 6.0% during Q3 2020, or for 0.1 percentage points lower against the previous year (graph 11).

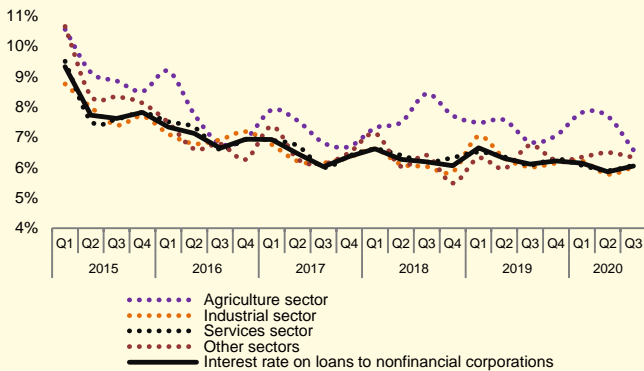
As regards to categories of loans, the interest rates on investment loans was lower (6.0%) compared to interest rate on non-investment loans (6.2%). Alongside with the same period as in the previous year, it was observed a more significant decline of interest rates of non-investment loans (for 0.22 percentage points) compared to the decline for investment loans (for 0.21 percentage points).

In sectoral term, the interest rate on agriculture loans marked an increase of 0.3 percentage points, declining at an average of 6.6%.

The interest rate on industry and services loans remained similar to last year, standing at 6.0% and 6.1%, respectively.

²The calculation of interest rates: quarterly average of interest rates on loans and deposits. In the text it is referred as "the interest rates".

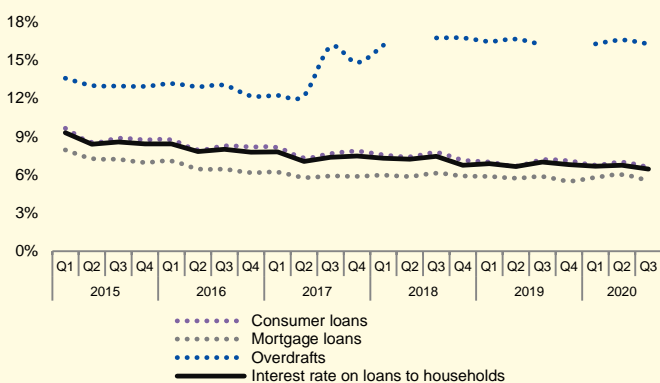
Figure 11. Interest rates on loans to nonfinancial corporations



Source: CBK (2020)

Concerning loans to household, the interest rate stood at 6.4% , representing a decline of 0.6 percentage points compared to Q3 2019. A higher interest rate was marked by consumer credit (6.6%), which marked a decline of 0.6 percentage points compared to Q3 2019. In addition, also interest rate on mortgage loans marked a decline in this quarter (from 5.9% in Q3 2019 to 5.5% in Q3 2020) (graph 12).

Figure 12. Interest rates on loans to households

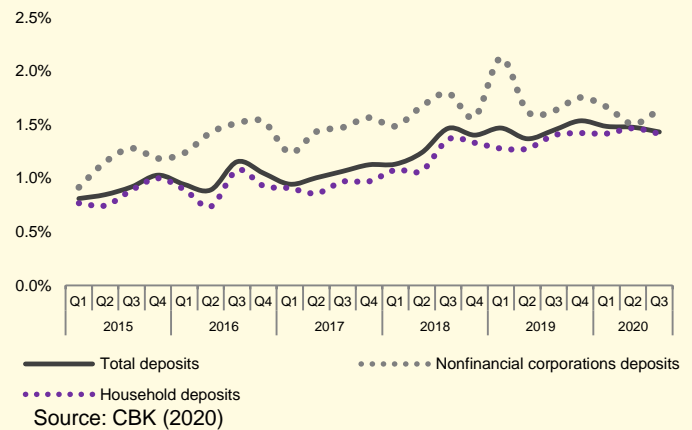


Source: CBK (2020)

Interest rates on deposits

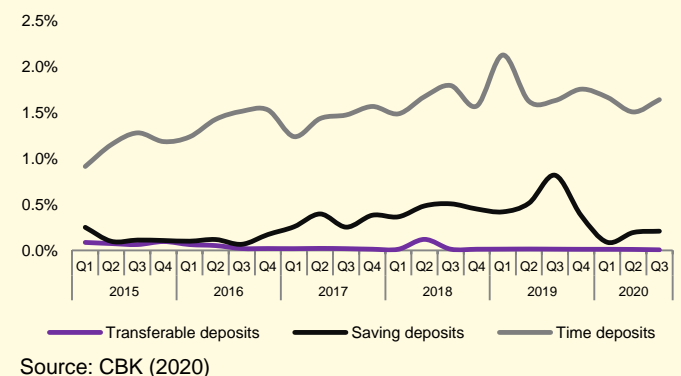
The average interest rates on deposits remained at the same level as in the previous periods, standing at 1.4% (graph 13).

Figure 13. Interest rates on deposits



Interest rates on nonfinancial corporations deposits, during Q3 2020, were more favorable compared to those for households, although the difference between them was marginal.

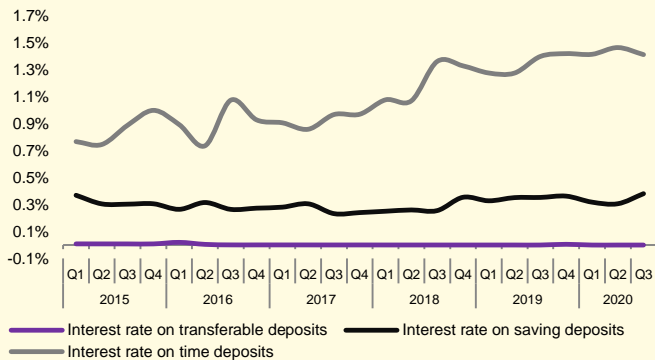
Figure 14. Interest rates on nonfinancial corporation deposits, by categories



Interest rates on nonfinancial corporations deposits was similar to the previous year, standing at 1.6%. (graph 14).

Similarly, also interest rates on household deposits remained the same in this quarter compared to the previous period (Q3 2019). The average interest rate stood at 1.4%, similar to the rate on time deposits, while those on saving deposits stood at 0.4% (graph 15).

Figure 15. Interest rates on household deposits, by categories



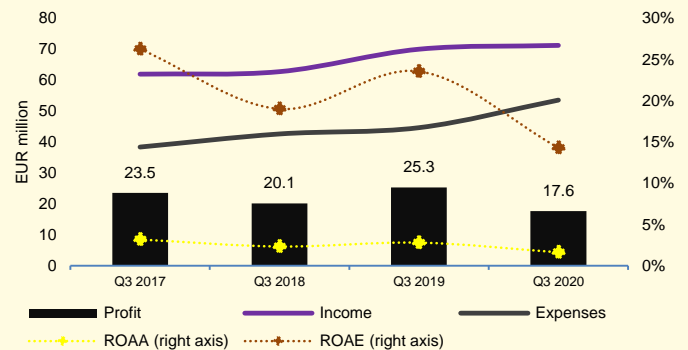
Source: CBK (2020)

Performance of the Banking Sector

The banking sector realized a profit with a value of EUR 17.6 million, in Q3 2020, which is for EUR 7.7 million lower compared to Q3 2019 (graph 16). The lower profit realized in Q3 2020 was mainly a result of the higher expenditures increase (of EUR 8.9 million) compared to the increase of income (of EUR 1.2 million). During this quarter income amounted to EUR 71.2 million, where interest income (mainly interest income on loans) amounted to EUR 54.1 million (annual increase of EUR 2.7 million). Meanwhile, non-interest income which is mainly comprised of fees and commissions, marked a value of EUR 16.8 million, marking an annual decline of EUR 1.8 million. Expenditures of the banking sector marked a value of EUR 53.6 million. The largest category, the one of general and administrative expenses reached the value of EUR 26.4 million (for EUR 0.4 million lower compared to Q3 2019). The category of non-interest expenses, in Q3 2020, reached the value of EUR 19.1 million (for EUR 10.6 million higher compared to the previous period), mainly as a consequence of the higher

share for expenses on loan loss provisions. Whereas, the category of interest expenses reached the value of EUR 6.0 million (for EUR 1.1 million higher compared to previous period).

Figure 16. Profit and profitability indicators of the banking sector



Source: CBK (2020)

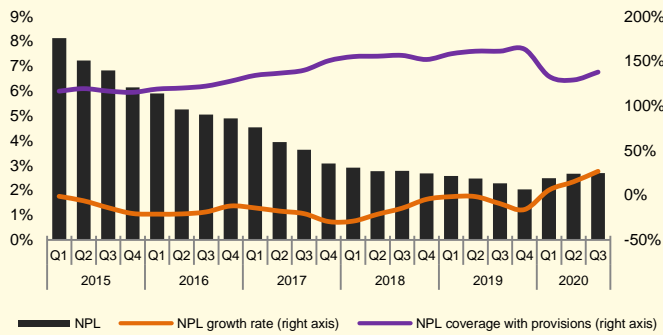
As a consequence of the higher increase of expenditures against the income, in Q3 2020, expenditures-to-income ratio was at the rate of 75.2% , or 11.4 percentage points higher compared to the same period of the previous year. This ratio indicates that the banking sector spends EUR 0.752 for every EUR 1 earned (graph 16).

Financial Soundness Indicators

Financial soundness indicators of the banking sector continued to remain at a satisfactory level also during the third quarter of 2020, despite the increasing risks caused by COVID-19 pandemic. Nonperforming loans, although having marked an increase compared to the previous quarters, their level to total loans continues to be low and they are quite well provisioned against the possible losses that may be caused. The NPL rate to total loans ratio stood at low level of 2.7%, in September 2020 (2.3% at the end of September 2019) (graph 17). Nonperforming loans continued to be well

provisioned, at the level of 137.8% (161.3% at the end of September 2019).

Figure 17. Indicators of loans portfolio quality and NPL growth rate

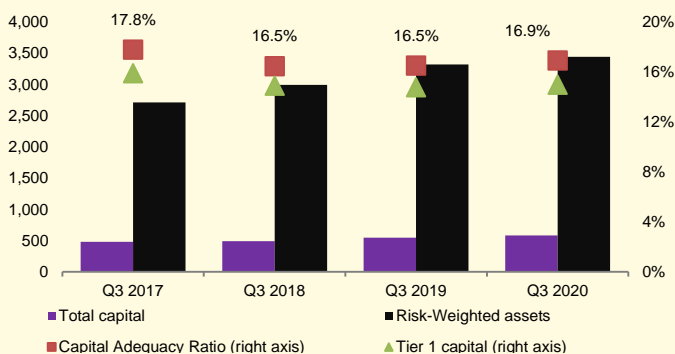


Source: CBK (2020)

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

The banking sector continues to be well capitalized and sustainable. During this period, the Capital Adequacy Ratio was at the level of 16.9%, representing a higher level for 0.4 percentage points than in the same period of the previous year (graph 18). The slight increase of this indicator is attributable to the higher increase of total capital compared to the slower increase of risk weighted assets.

Figure 18. Solvency indicators



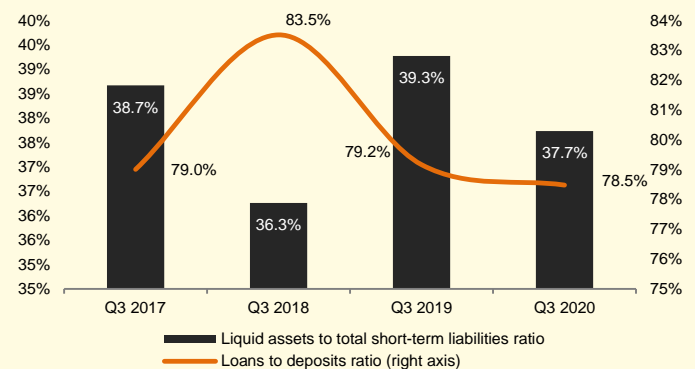
Source: CBK (2020)

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

As regards to the liquidity of the banking sector, the liquid assets to short-term liabilities ratio marked a slight decline of 3.9 percentage points compared to Q3

2019, standing at the level of 37.7%. The slight decline of this indicator was due to the accelerated growth of short-term liabilities (mainly non-time deposits), compared to the slower growth of liquid assets (cash, balance sheet with CBK and balance sheet with other banks). Loans-to-deposits ratio stood at the level of 78.5% at the end of September 2020, which is approximate to the recommended level of 80.0%.

Figure 19. Liquidity indicators



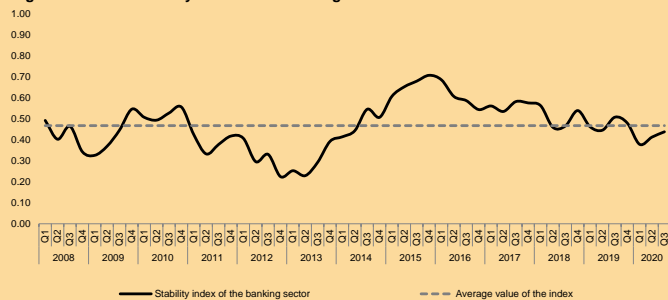
Source: CBK (2020)

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

Box 1. Stability index of the banking sector

Banking sector, until the outbreak of Covid-19 pandemic, operated in an environment with low risk level. The spread of COVID-19 pandemic, as of the second half of March, and the containment measures taken continuously, 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.

Figure 1. General stability index of the banking sector

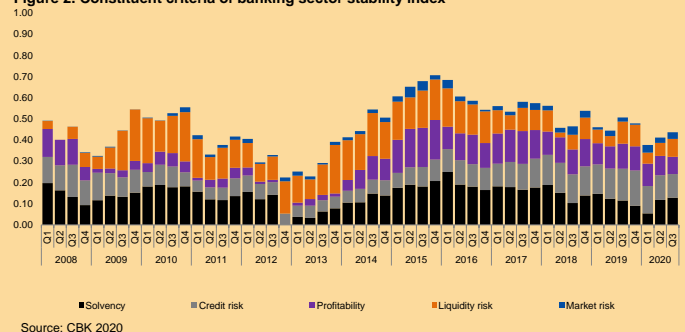


The stability index of the banking sector is constructed to measure and assess the domestic measures of the banking sector which reflect the stability of the banking sector. The index has been constructed on the base of the financial indicators of the banking sector, taking the values ranging from 0 to 1, where the higher values represent a risk in decline and vice versa.³ The index has been calculated on quarterly basis in order to assess the increase or the decline of the risk sensitivity through this index.

Based on the general aggregated index of the sector's stability, banking sector has marked, at an average, an

increase of the risk sensitivity (read a decline of the index) in Q3 2020 compared to Q3 2019. The overall value of the index is at the lowest level (0.44) for the first time since Q3 2013 (graph 1). Also, the value of the index since Q1 2020 is below the historical average, albeit it has recovered significantly during Q3 compared to the level it had during Q2.

Figure 2. Constituent criteria of banking sector stability index



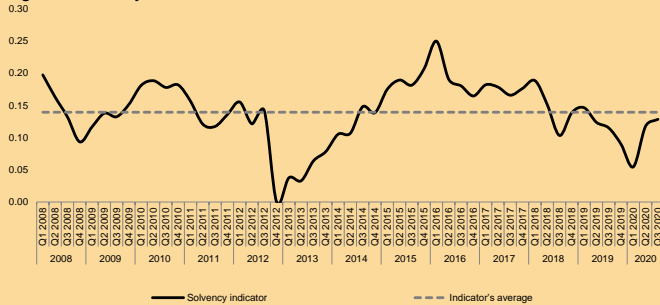
Compared to the same quarter of the previous year, a decline of the index (read: an increase of risk sensitivity) was marked by: credit risk indicator, profitability and liquidity. Whereas, an increase of index (a decline of risk sensitivity) was marked by the risk indicator of solvency. Whereas, the indicator that measures the market risk, which has a very low weight in the general index, marked an increase of the index (decrease of risk sensitivity), but taking into account the low level of assets held in foreign currency, its contribution to the overall stability index is quite small. (graph 2).

The decline of sensitivity to solvency, at the end of Q3 2020, compared to the statement marked in Q3 2019, is attributable to the decline of capitalization level of the sector. The increase in the level of

³ 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.

capitalization has influenced the faster growth of regulatory capital against the slower growth of risk-bearing assets. The increase of the capital level is a result of the retained profit during this period as well as the profit realized until September 2020. Whereas, the slowdown increase of risk-bearing assets is a result of the slowdown in the growth of lending activity since the beginning of the pandemic compared to the performance of recent years (double-digit growth in the previous three years).

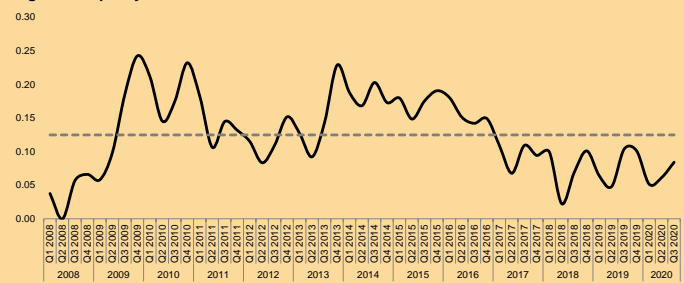
Figure 3. Solvency indicator



Source: CBK 2020

The increase of sensitivity to liquidity risk, in Q3 2020, compared to the level marked in the same period of the previous year, mainly is attributable to the slower increase of liquid assets compared to the higher growth of short-term liabilities. Cash and assets held at the CBK by commercial banks marked a slower growth compared to September of the previous year. Despite this, banks continue to exceed the minimal obligatory level of assets held at the CBK. On the other hand, the more significant increase of short-term liabilities (up to one year) came as a result of the significant increase of transferable deposits compared to the pace increase of time deposits and saving deposits.

Figure 4. Liquidity indicator

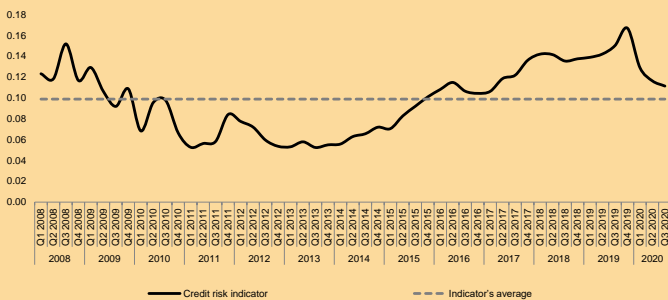


Source: CBK 2020

The increase in credit risk sensitivity came as a result of the increase of nonperforming loans of their level and value, compared to the previous period. The downward trend in the value of nonperforming loans was discontinued for the first time in Q1 2020, since Q4 2014 when they had begun to decline. The level of NPL is expected to increase also in the following period, 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 of the level of large credit exposures to Tier 1 capital compared to the previous period (Q3 2019).

The sensitivity increase of profitability risk can mainly be attributed to the lower level of realized income against the marked increase of expenditures. The income of the sector (mainly interest income) marked a significant slower increase. The easing measures taken by banks

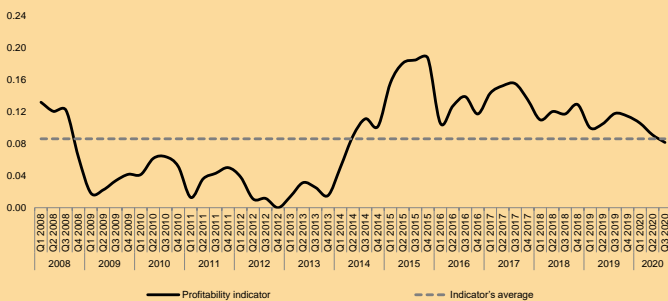
Figure 5. Credit risk indicator



Source: CBK 2020

to enable customers (individuals and businesses) to postpone credit installments have affected the profit realized by banks.

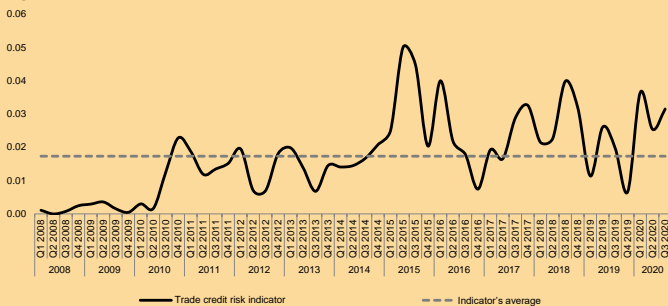
Figure 6. Profitability indicator



Source: CBK 2020

Consequently, the financial performance realized until the end of Q3 2020 has also affected the indicators that measure profitability such as Return on Average Equity (ROAE) and expenditures-to-income ratio indicator.

Figure 7. Trade risk indicator



Source: CBK 2020

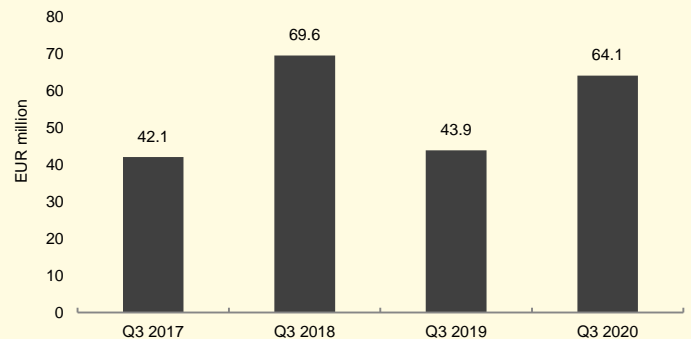
The decline of the market risk sensitivity was mainly attributable to the decline of net position in

foreign currency of the banking sector. This indicator has the lowest weight in the overall financial stability index as only 4.6% of assets and 3.9% of liabilities are in foreign currency. Moreover, 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.

Pension Sector

Pension sector was characterized with an activity expansion being impacted by positive return on investments and contributions collected during this quarter.

Figure 20. Assets of the pension sector, quarterly change

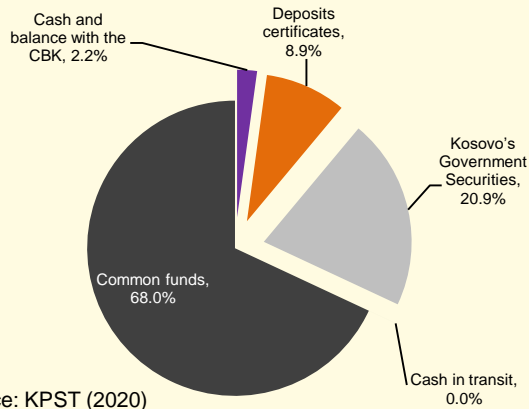


Source: CBK (2020)

Pension sector, as the second sector by importance of weight in the financial sector, comprises 27.1% of total assets of the financial system. Total assets of the pension sector marked an annual increase of 8.5%, reaching a value of EUR 2.08 billion, at the end of September 2020. On quarterly basis, only in Q3 2020, pension sector assets increased by EUR 64.1 million (a growth of EUR 43.9 million in Q3 2020), as a result of

the positive return on investments and collections from the contributors (graph 20).

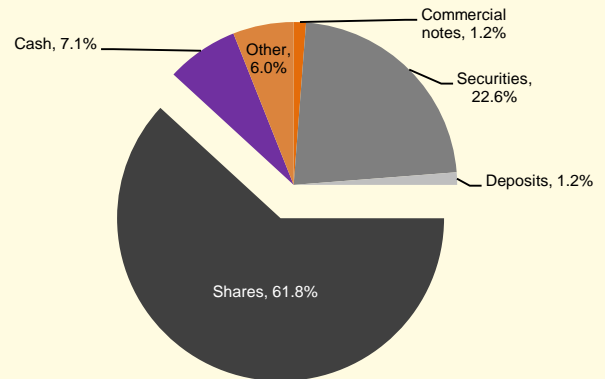
Figure 21. Structure of KPST assets (Q3 2020)



Source: KPST (2020)

Assets of the pension sector consist of 99.6% which belong to Kosovo Pension Saving Trust (KPST) and 0.4% of assets of Slovenian-Kosovo Pension Fund (SKPF). Assets structure of KPST is mainly comprised of assets invested abroad, albeit its weight considerably marked a decline compared to the previous period. Around 68.0% of KPST assets are held abroad, or about EUR 1.41 billion allocated to common investment funds (graph 21). The remainder of assets invested in the domestic economy (32.0%) increased by 6.8 percentage points compared to the same quarter of the previous year. Until the end of September 2020, the value of investments in the country reached EUR 661.5 million. The largest portion of these assets are invested on bonds and treasury bills of Kosovo's Government, which only in Q3 2020 marked an increase of EUR 40.5 million. The category of assets invested in the banking sector shrank by EUR 12.4 million in this quarter. Whereas, cash held at the Central Bank of Kosovo marked an increase of EUR 19.3 million in Q3 2020.

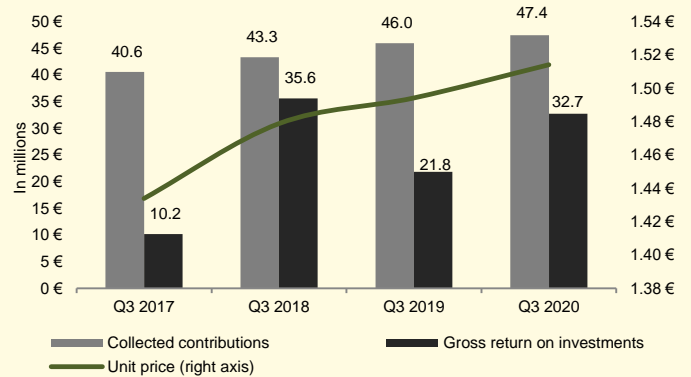
Figure 22. Structure of SKPF assets (Q3 2020)



Source: SKPF (2020)

Assets structure of SKPF is mainly comprised of shares invested abroad (61.8%), treasury bonds of foreign governments and of Kosovo's Government (22.6%) and other assets (graph 22). Total assets of SKPF increased by EUR 123.2 thousands in Q3 2020, of which the majority were investments in the domestic sector.

Figure 23. Return on investments and KPST performance



Source: KPST (2020)

During Q2 and Q3 2020, SKPF marked a significant recovery from losses from investments recorded in Q1 2020 (EUR -910.0 thousands). Only during Q1 2020, SKPF realized a gross profit from investments with a value of EUR 171.9 thousands (EUR 220.4 thousands in Q3 2019). Whereas, the value of new collections of contributors amounted to EUR 133.7 thousands in Q3 2020 (EUR 137.5 thousands in Q3 2019).

In this quarter, contributions collected by KPST increased by EUR 47.4 million, representing an increase of 3.2% , compared to the same period of the previous year. After considerable losses marked by KPST due to investments abroad in Q1 2020 (EUR - 90.4 million), financial markets started to recover, and consequently KPST managed to realize a record profit of EUR 70.3 million in Q2 2020, and EUR 32.7 million in Q3 2020. Until September 2020, KPST marked a net profit from investments with a value of EUR 12.5 million.

Insurance Sector

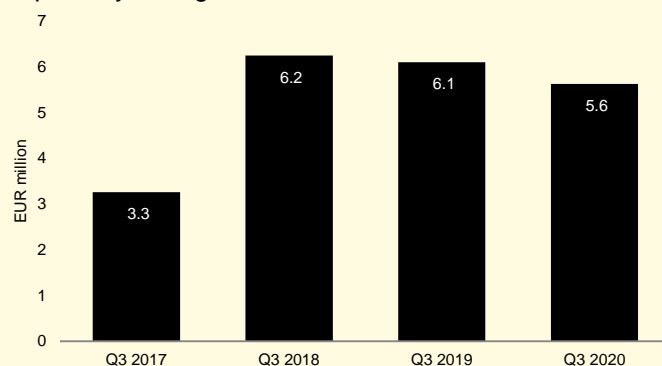
Insurance sector was characterized with an activity increase during the third quarter of 2020, albeit at lower level compared to the same period of the previous year. The value of premiums collected increased slightly during this period while the value of claims paid and claims incurred was significantly higher compared to the previous period. As a consequence, this sector marked positive financial results in Q3 2020, albeit at lower level compared to Q3 2019.

Assets of insurance sector by the end of September 2020, reached EUR 214.3 million, representing an annual growth of 9.3% . The highest contribution to the growth of assets was given by the category of deposits held in the banking sector, followed by investments in securities and other tangible assets. While, on quarterly basis, assets of the insurance sector increased by EUR 5.6 million in Q3 2020 (graph 24). Also, on quarterly basis, the increase was supported mainly by deposits held at commercial banks, followed

by other intangible asset, and of investments in Kosovo's Government securities.

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 0.9 million, thus reaching the value of EUR 57.4 million as at end of period (September 2020). This capital increase came as a result of the increase of the paid shareholders capital and the profit realized in this period. 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.

Figure 24. Assets of the insurance sector, quarterly change



Source: CBK (2020)

Regarding liabilities, they were characterized with an increase during this quarter (EUR +4.7 million), which mainly are technical reserves, while the value of total liabilities reached EUR 156.9 million at the end of September 2020.

The value of gross written premiums of insurance companies, in the third quarter of 2020, amounted to EUR 26.9 million, representing an annual growth of 1.0% (an annual growth of 7.3% in Q3 2019) (graph 25). “Non-life” premiums account for 96.6% of total written premium, whereas “life” premiums comprise 3.4% . The

pronounced slowdown increase of written premiums mainly reflects the effects on COVID-19 on the economy. As a consequence, only during Q3 2020, insurance sector realized sales of policies ('non-life') with a number of 219.9 thousands, whereas in the same period of the previous year the sales stood at 415.1 thousands.

Similarly to the level of the written premiums, also claims paid by the insurance sector (including the Kosovo Insurance Bureau), marked significantly a slower increase during this quarter. Their value, at the end of Q3 2020, reached EUR 13.6 million, representing an annual increase of 4.9% (annual increase of 12.4% during Q3 2019) (graph 25). As a result of the higher increase of claims paid compared to premiums earned, claims-to-premiums ratio deteriorated during Q3 2020, increasing by 1.9 percentage points, to 50.4% in Q3 2020 (graph 25).

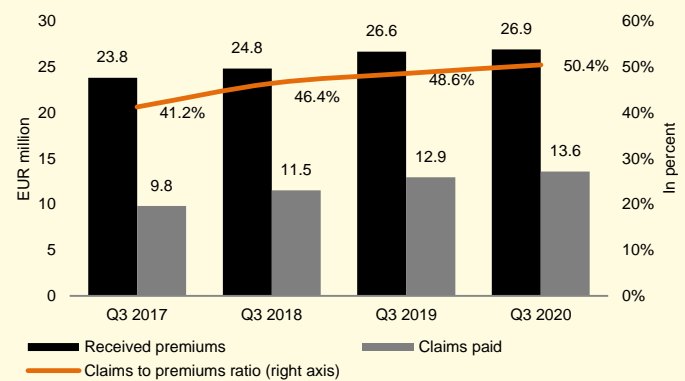
Performance of the Insurance Sector

During Q2 2020, insurance sector performed with a net profit of EUR 172.9 thousands (a profit of EUR 2.0 million in Q3 2019). The low profit realized in this quarter was attributed to the lower increase of written premiums against the higher increase of claims incurred. Meanwhile, operating expenses marked a significant decrease during this period and affected the sector to have a positive financial performance during this period.

As regards to the liquidity level, insurance sector marked a significant improvement compared to the statement recorded until September of the previous year. Cash and its equivalents to technical reserves

ratio shows that liquidity stood at the level of 101.5%, representing a higher level with 5.4 percentage points compared to September 2019. Moreover, the other indicator of cash and its equivalent to total liabilities ratio shows a growth of 2.3 percentage points of the level of the sector compared to the statement marked by September 2019, reaching 86.8% at the end of September 2020.

Figure 25. Written premiums and claims paid



Source: CBK (2020)

Microfinance Sector

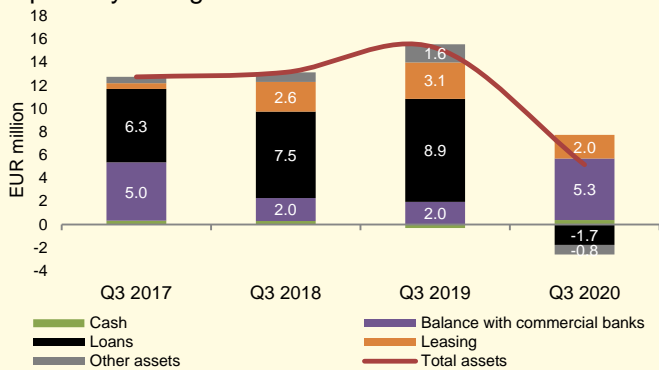
During Q3 2020 microfinance sector has marked a significant slowdown increase of its activity and a lower financial performance against the previous year. The sector continued to have good loans portfolio quality, albeit with a tendency of changing its direction.

Assets

After four years of sector's dynamic growth, in September of this year was marked a pronounced activity slowdown of microfinance institutions and non-bank financial institutions. In September 2020, the total value of assets reached EUR 323.9 million,

representing an annual increase of 7.8% (27.1% in September 2019). On quarterly basis, assets increased by EUR 5.2 million, whereas compared to Q3 2019, this value was lower for EUR 10.1 million.

Figure 26. Assets of the microfinance sector, quarterly change



Source: CBK (2020)

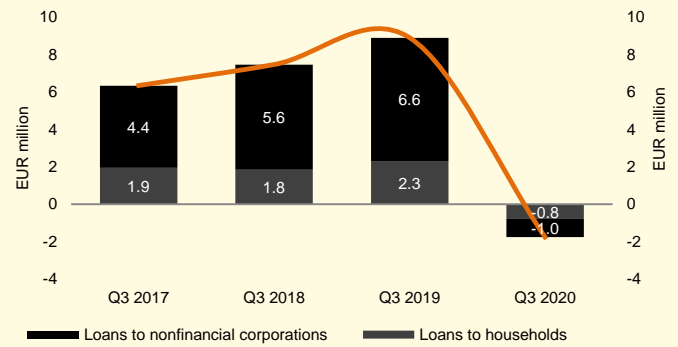
The slower annual growth of sector's assets marked in Q3 2020 was mainly attributable to consequences of COVID-19 pandemic caused to the domestic economy, reflected at lower level on the borrowings issued by external sector. The decline of the level of external sector borrowings was reflected on the decline of lending and a slower increase of leasing activity. As a consequence, during this period, was marked a significant increase of cash category and the one held at commercial banks (graph 26).

Loans

On annual basis, total loans marked an increase of 2.0% by the end of September 2020, while their stock reached the value of EUR 218.8 million. Compared to the previous period, loans marked a pronounced slowdown increase, representing a dynamic which reflected on both categories of nonfinancial corporations and households as well. Lending to

households expanded at a rate of 2.6% (an annual increase of 27.3% until September 2019), reaching the value of EUR 149.1 million at the end of September 2020.

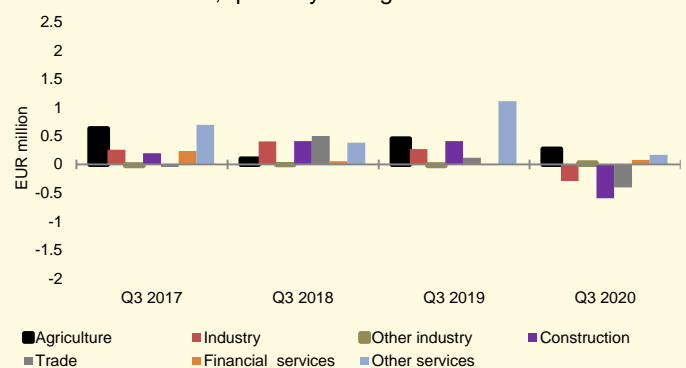
Figure 27. Value of loans to households and nonfinancial corporations, annual change of loans



Source: CBK (2020)

Total loans value, on quarterly basis, decreased by EUR 1.7 million in Q3 2020, compared to the increase of EUR 8.9 million that had been marked in Q3 2019. Only in Q3 2020, loans to households marked a decrease of EUR 1.0 million (graph 27).

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



Source: CBK (2020)

Loans stock to nonfinancial corporations marked a value of EUR 69.8 million at the end of September 2020, representing an annual increase of 0.8% (an annual growth of 16.1% until September 2019). On

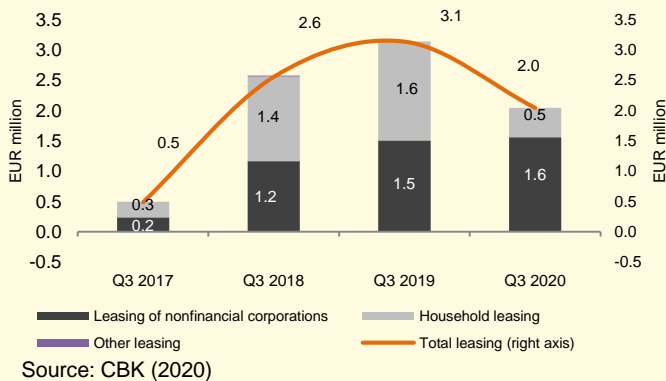
quarterly basis, during Q3 2020, loans to nonfinancial corporations marked a decline of EUR 0.8 million.

On sectoral terms, on quarterly basis, lending to agriculture sector and other services was characterized with an increase, albeit at lower level compared to previous period. Whereas, lending to construction sector, industry and trade was characterized with an annual decline in Q3 2020 (graph 28).

Leasing

In contrast to the developments in lending, microfinance institutions largely maintained the trend of increasing leasing activity during this period.

Figure 29. Value of microfinance sector leasing

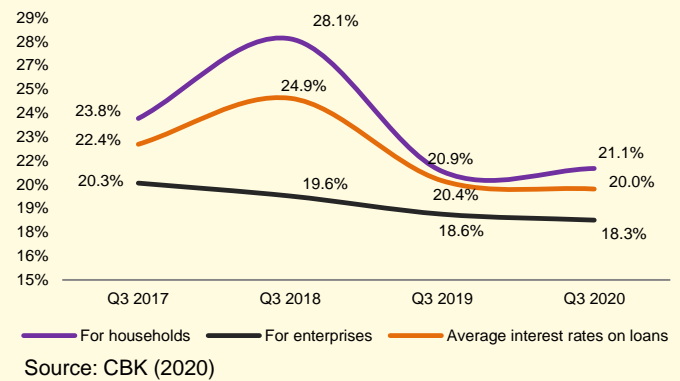


The activity of leasing of the microfinance sector marked an increase with a value EUR 2.0 million during Q3 2020 (EUR 3.1 million in Q3 2019), reaching the value of EUR 56.7 million at the end of the period. This increase mainly reflects the leasing to nonfinancial corporations, the value of which increased by EUR 1.6 million during this quarter, reaching the value of EUR 31.0 million at the end of the period (graph 29). Similarly, also leasing to households increased by EUR 0.5 million in Q3 2020, reaching the total value of EUR 25.7 million at the end of the mentioned period.

Interest Rates

During the third quarter of 2020, the average interest rate on loans was 20.0%, or for 0.4% lower compared to the same period of the previous year (graph 30).

Figure 30. Average interest rate on microfinance sector loans

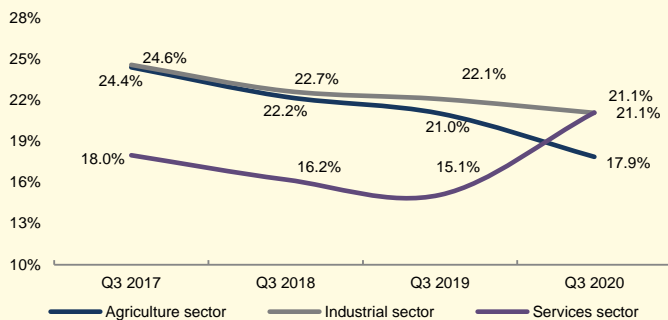


The average interest rate on loans to households marked a marginal increase of 0.2 percentage points, reaching 21.1% during Q3 2020 (graph 30). By loan categories, the average interest rate on mortgage loans decreased by 0.9 percentage points falling at 19.7% in Q3 2020. Whereas, the interest rate on consumer loans increased by 2.0 percentage points compared to the previous period, reaching 22.2%.

Unlike households, the interest rate on loans to nonfinancial corporations edged down slightly. In Q3 2020, interest rates applied to nonfinancial corporations stood at 18.3%, representing a decline of 0.3 percentage points compared to Q3 2019. In sectoral terms, a more favorable interest rate was on loans to agriculture, which decreased by 3.2 percentage points falling at 17.9% during Q3 2020, compared to the previous period. However, the most significant increase was marked by interest rates on loans to services sector, which historically had more favorable

conditions for loans, reaching 21.1% during Q3 2020 (an increase of 6.0 percentage points compared to Q3 2019). While, interest rate on industry sector marked a decline of 1.0 percentage points dropping to 21.1%, in Q3 2020. (graph 31).

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



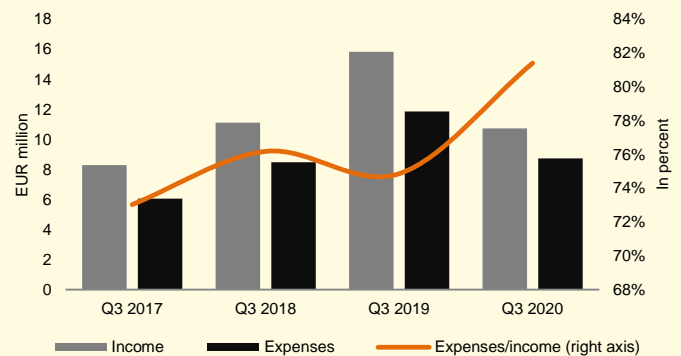
Source: CBK (2020)

Performance of the Microfinance Sector

Microfinance sector during Q3 2020 realized lower profit compared to the previous period due to the more significant decline in income against expenditures. During this quarter, the income of the sector amounted to EUR 10.7 million, representing a decline of EUR 5.1 million compared to the same quarter of the previous year. This decline came as a result of the decrease of interest income of EUR 5.8 million, falling at EUR 9.9 million during Q3 2020 (graph 32). Non-interest income increased by EUR 0.7 million during this quarter, reaching the value of EUR 0.8 million, which primarily reflects the trend of income from services. Expenditures of the sector marked the value of EUR 8.7 million in Q3 2020, representing a value which is lower for EUR 3.1 million compared to the same quarter of the previous year. Expenses decline mainly

reflects the decrease of non-interest expenses (administrative expenses, staff expenses, and loan loss provisions), which declined by EUR 1.9 million, falling at EUR 5.3 million during Q3 2020.

Figure 32. Microfinance sector income and expenses



Source: CBK (2020)

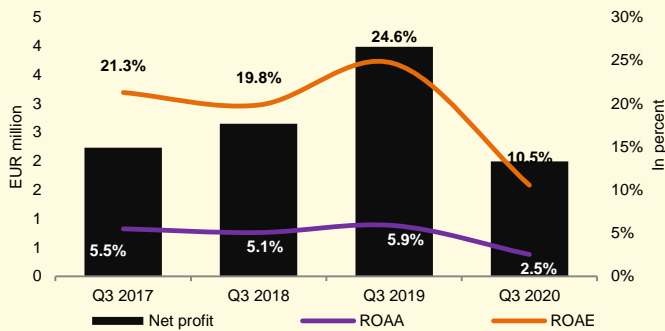
Also, a decline was marked by interest expenses and other operating expenses, albeit at lower levels. Expenses-to-income ratio, as an indicator of the sector performance, marked a growth of 6.6 percentage points compared to the previous period, standing at the level of 81.4%, in Q3 2020. This implies that for every EUR 1 invested, the microfinance sector spends around EUR 0.814. The higher decline of income compared to expenditures was translated in a halved down of net profit during this quarter, falling at EUR 2.0 million (graph 33).

The financial performance of the sector was reflected also on two other profitability indicators, Return on Average Assets (ROAA) and Return on Average Equity (ROAE), which declined by 3.3 percentage points and 14.1 percentage points, respectively, compared to Q3 2019 (figure 33).

Regarding the indicators of loans portfolio quality in microfinance institutions, nonperforming loans

continued to stand at low levels and were characterized with good coverage of provisions.

Figure 33. Profitability indicators of microfinance sector

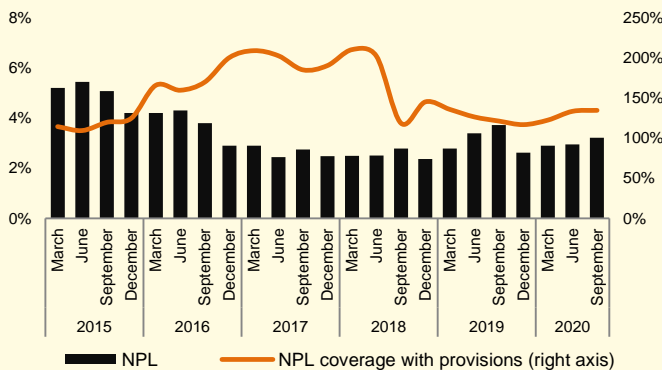


Source: CBK (2020)

*Profit was annualized for the respective quarter

Until the end of the period, nonperforming loans stood at 3.2%, while the NPL coverage with provisions reached 134.6% by the end of Q3 2020 (graph 34).

Figure 34. Indicators of loans portfolio quality



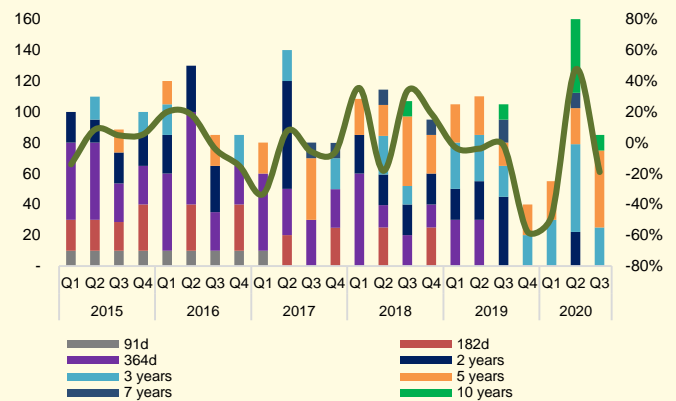
Source: CBK (2020)

Securities Market

During the third quarter of 2020, Kosovo's Government issued debt with a lower value compared to the previous quarter (Q2 2020) and to the same quarter of the previous year. The level decline of the sovereign debt issued reflects the needs of Kosovo's Government to finance its

activity through this instrument. Also, the decline of the demand for issuance of the domestic debt can be attributed to the increase of the level of external borrowings, the value of which, by October 2020, reached EUR 130.7 million, while the total value in the previous year had reached only EUR 42.9 million.

Figure 35. Amount of issued debt, annual increase



Source: Ministry of Finance (2020)

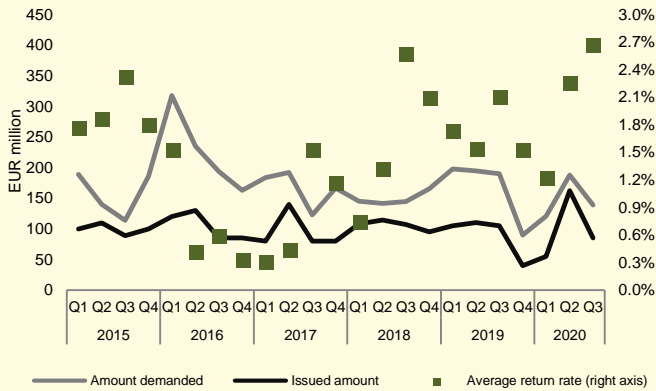
During this quarter successfully were realized all the planned auctions, where the investment demand was significantly higher than the supply side with public debt issuance.

The debt issued by Kosovo's Government marked an annual decline of 19.0% in Q3 2020 compared to Q3 2019, reaching the value of EUR 85.0 million (graph 35). The bid investments amount on securities continued to exceed the Kosovo's Government demand, which was for 1.63 times higher than the demanded amount, albeit compared to the previous year, it stood at lower levels. The average interest rate on securities was 2.7% in Q3 2020, representing a higher rate for 0.6 percentage points compared to Q3 2019 (graph 36).

The increase of interest rate compared to the previous period reflects the trend of securities issuance towards

long-term maturities. During Q3 2020, over 70.0% of securities issued had a maturity of over five years, while in Q3 2019, only 38.1% of securities issued were with a maturity of over five years.

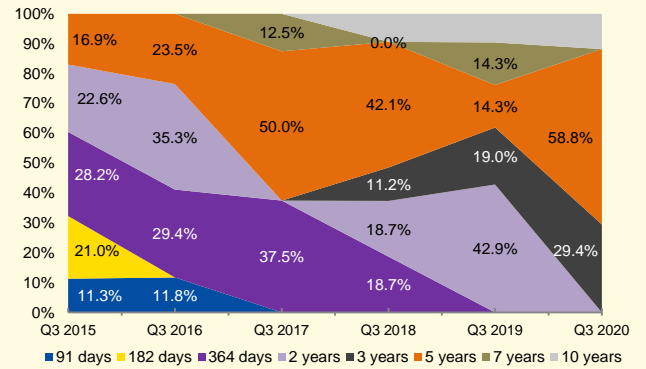
Figure 36. Bid to cover ratio



Source: Ministry of Finance (2020)

The securities structure is dominated by government bonds, with a maturity of 5 years, followed by securities with a 3-year maturity. Compared to the third quarters of previous years, there were no issuance of treasury bills (bills with the longest maturity of up to 364 days) (graph 37).

Figure 37. Government securities structure, in percent



Source: Ministry of Finance (2020)

The banking sector, pension funds and insurance companies continue to be the only financial institutions in the country to invest in the primary market of Kosovo's Government securities.

The suggested citation of this publication:

CBK (2020): Quarterly Assessment of Financial System No. 32 Q3 2020, Central Bank of the Republic of Kosovo, Prishtina

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Macroeconomic selected indicators

Description	September 2019	September 2020
Real sector 1/		
Gross Domestic Product (GDP) (in millions of EUR)*	3,245.3	3,073.9
Consumer prices (annual average)	3.0%	0.3%
Consumer prices (end of period)	2.4%	-0.5%
Fiscal Sector 2/		
Budget Revenues (in millions of EUR)	1,379.3	1,215.2
Budget Expenditures (in millions of EUR)	1,340.3	1,413.1
Primary balance (in millions of EUR)	39.1	-197.9
Financial sector (in millions of EUR) 3/		
Assets of financial corporations	7,006.3	7,671.0
of which : Banks	4,577.2	5,036.0
Loans	2,957.2	3,182.5
Deposits	3,735.6	4,055.4
Interest Rates on Loans, end of period	6.5%	6.4%
Interest Rates on Loans, end of period	1.5%	1.5%
Interest rate gap	5.0%	4.9%
External sector,(in millions of EUR) 3/		
Balance of payments		
Current and capital account	-144.2	-301.8
of which: remittances	627.6	697.0
Financial account	-36.5	-293.0
Foreign Direct Investmentsin Kosovo	216.4	250.6
Portfolio investments, net	-23.6	-35.6
Other investments, net	-143.3	-62.1
International Investment Position (PNI), net*	-462.4	-709.7
Assets	4,912.3	5,076.3
Liabilities	5,374.7	5,786.1
External debt, total*	2,155.0	2,273.0
Private external debt	1,663.2	1,754.4
Public external debt	491.7	518.6

Source:

1/ KAS (2020);

2/ MF (2020);

3/ CBK (2020).

*Data on GDP, IIP and external debt are as of June 2020.

