

Summary

- In the last quarter of 2022, the economy of the euro area has recorded a slowed growth of 0.1%, mainly influenced by the weakening of domestic demand as a result of the decline in real household income and the increase in the cost of production. Unlike in the previous quarter, energy prices were characterized by a decrease as a result of the decline in demand for natural gas, good climatic conditions, but also the measures taken by the government to promote gas and energy saving. Despite the dynamics in energy prices, the inflation rate in the euro area continued to be high even at the end of the year, prompting the ECB to raise the key interest rate again. The ECB's latest projections suggest slow economic growth in 2023, influenced by high prices and tightening of monetary policy. Also the Western Balkans, which has the euro area as an important trading partner, has been influenced by the general macroeconomic dynamics in the euro area and international financial markets.
- **The real Gross Domestic Product (GDP) growth in Kosovo, in Q4 2022, was higher compared to the previous quarter.** Private consumption, the export of goods and services as well as the decrease in the import of goods contributed positively to the real economic growth, while the decrease in investments and the increase in import of services had a negative impact. Based on the quarterly data, the preliminary estimates of the KAS suggest that the Kosovo economy has recorded a slow growth of 3.5% in 2022, while for 2023 the CBK forecasts suggest a real economic growth of 3.9%. The increase in the economic activity during this year is expected to be generated by domestic demand as well as net export.
- **The budget of Kosovo has recorded a budget deficit in Q4 2022,** as a result of the higher growth of budget expenditures compared to income, meanwhile public debt has declined to 20.7% of GDP.
- **Prices in the country** continued to increase compared to the same period of the previous year. While the inflation rate continued with double-digit growth throughout the year, compared to the previous quarter, inflationary pressures in the country eased in Q4 2022, mainly as a result of the positive dynamics in prices in international markets, mild climatic conditions and the resulting impact on reducing energy consumption electricity, the slowdown of domestic demand and the deterioration of the outlook for global economic activity. Price increase continued to be driven by food and energy prices, which comprise the largest part of the consumers' basket in the country. Although the inflation rate marked a slowdown pace compared to the previous quarter, core inflation followed an upward trend, giving indications that it may have not reached its peak yet. The import, production, and construction cost indices also eased compared to the previous quarter, albeit compared to the previous quarter of the previous year, they still remained high, with the exception of the production price index, which resulted in a significant slowdown also in annual terms.
- **Kosovo's budget has recorded a positive primary budget balance,** as a result of the higher growth of budget revenues compared to expenditures, meanwhile public debt has declined to 20.7% of GDP.
- **Current account recorded a negative balance of EU 412.0 million in Q4 2022, a dynamic which mainly was determined by developments in trade balance of goods.** The balance of goods deepened the trade deficit, mainly influenced by the increase in prices in international markets, while also the balance of primary income recorded a negative balance. On the other hand, the balance of services and secondary income influenced the contraction of the negative balance of the current account. Within the current account, one of the most important financing sources of consumption, remittances, recorded a slow growth of 9.1%, reaching EUR 318.3 million or 12.9 percent of GDP.
- **The financial system** has been characterized by stability and without any materialized risk during Q4 2022, despite concerns about the economic slowdown, inflationary pressures and increased uncertainties in international markets.
 - **The banking sector** has managed to maintain a high level of capitalization and liquidity, as well as to maintain a low level of nonperforming loans, which has been translated into an absorbing capacity of the sector over the years. Meanwhile the high rate of inflation is estimated to have influenced the potential reduction of disposable income in the economy, a factor that can potentially put at risk the capacity of the borrowers solvency (increase of potential credit risk) and discouraging savings (liquidity risk). In the fourth quarter of 2022, the nonperforming loans value started to increase, against two years when it had marked a declining trend. In Q4 2022, lending activity was the main positive contributor to the increase in assets of the financial system, while investments in securities marked a slowdown increase. The increased uncertainty from the increase in prices in the country and globally and the reaction of monetary policies with the increase in basic interest rates in combating inflation, were developments that coincided with the increase in financing risk and, consequently, with the increase in loan interest rates and with relatively higher intensity of the increase in interest rates on deposits.
 - **The pension sector** recorded a slowdown in growth and a decline of investments return compared to the previous year, mainly as a result of the unfavorable dynamics marked in international financial markets. While the cumulative return for the entire year was negative, the change began to occur in the fourth quarter, during which a good performance was realized, characterized by an increase in the value of investments.
 - Insurance sector was characterized with an approximate level of assets increase as in the previous year, being favored by the high level of collected premiums. However, the increase of claims incurred and operational expenses, resulted in a slower financial performance compared to the previous year.

Also **the microfinance sector** was characterized with an accelerated increase of assets, mainly being attributable to the increase of lending activity. Financial soundness indicators show as well a stability of the sector in general, while the financial result turns out to be the highest since the consolidation of the sector. In the following periods, the dynamics of the increase in interest rates in the international markets are expected to be reflected in the increase in financing costs for the microfinance sector.

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Euro area and Western Balkans

The euro area economy marked a growth of 0.1% in real terms in the last quarter of 2022, according to Eurostat, a slower but positive increase given expectations for a possible recession. The slower economic growth in the euro area in Q4 2022 was mainly influenced by the decline in real household income and the increase in the cost of production – which were translated into a slowdown in consumer spending and overall economic activity. The largest economy in the euro area, Germany, has recorded a decrease in economic activity of 0.4% as a result of the decrease in the investment component and the slowdown in exports due to the decrease in external demand. Expectations for a recession in the final months of the year faded, mainly as a result of better weather conditions and higher temperatures that followed during the winter, as well as incentive measures from governments to save gas and electricity. Slower economic growth in Europe was also affected by reduced activity in China, which represents an important trading partner, whose economy is under severe COVID-19 restrictions. **ECB projections for economic growth in the euro area were revised in March against December projections, to 1.0% for 2023 and 1.6% for 2024.**

The inflation rate in Q4 2022 has continued the growth trend, reaching 9.9% (9.6% in Q3 2022), mainly influenced by the increase in energy and food prices. In December 2022, for the fourth time within the second half of the year when the direction of monetary policy changed after 11 years, the ECB increased the base interest rate by 0.5 basis points, reaching the level of 2.5%. Moreover, the increase in interest rates will continue in 2023, according to the ECB, until prices normalize and inflation is curbed. The inflation rate for 2022 was 8.4%, while ECB projections suggest a drop in inflation to 5.3% in 2023 and 2.9% in 2024.

Dynamics in energy and gas prices and consumption remain an important factor in determining developments throughout 2023 as well, while Q4 2022 was characterized by a decline in demand, influenced by the mild winter, stimulating policies to save energy and gas by governments and the slowdown of industrial activity. However, replenishing gas inventories for the coming months is seen as challenging, especially as China's economy reopens in 2023, and is expected to boost demand for liquefied natural gas (LNG) imports. Moreover, the continuation of geopolitical uncertainties, price dynamics in international markets and the consequences in the general global activity remain a factor with potential influence on the real GDP growth in the euro area throughout 2023.

Western Balkans

Until September 2022, real GDP from the countries of the Western Balkans has recorded a slight increase of 2.7%, influenced by the slowdown economic growth in the euro area and the increase in prices in international markets. High energy and food prices increased inflationary pressures in all countries of the region, reducing purchasing power and consumer spending and slowing down the overall demand. **IMF projections suggest that the countries of the Western Balkans are expected to record an economic growth of 3.4% in 2022 and 2.6% in 2023.**

The average inflation rate in Q4 2022 in the countries of the region turns out to have been 14.5%, with the highest rate recorded in North Macedonia of 18.7% and in Montenegro of 17.2%, while Albania recorded the lowest rate of inflation with 7.9%. In an effort to combat rising inflation, Central Banks in the countries of the region have increased the base interest rate in Q4 2022. In November 2022, Albania increased the base rate by 0.5 percentage points reaching 2.75 percent, followed by North Macedonia which also increased the base rate by 0.5 percentage points thus reaching 4.75%, and Serbia increased the base rate by 0.5 percentage points reaching 5.0%.

In Q4 2022, the foreign exchange market of the EUR against the currencies of trading partners was estimated to be 1.6% against the British pound, 5.1% against the Turkish lira and 1.3% against the US dollar. The value of EUR remained almost the same against Albanian lek, Serbian dinar, and Macedonian denar.

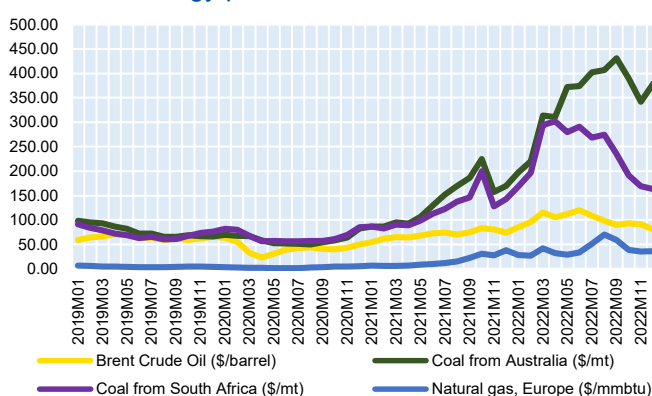
Main commodity prices in international markets

Inflationary pressures on commodity prices in international markets eased in Q4 2022, mainly as a result of the worsening outlook for global economic activity and the easing of supply chain bottlenecks. However, the prices of different commodities followed different trajectories, depending on the mitigating impact of the decline in demand for certain commodities and the dynamics on the supply side.

Brent crude oil prices according to the World Bank averaged \$88.4 per barrel in Q4 2022, representing an annual increase of 11.0% (\$79.6 per barrel in Q4 2021) (chart 1). However, compared to the previous quarter, oil prices declined by 10.9% (\$99.2 per barrel in Q3 2022). In monthly terms, an increase in oil prices was recorded in October, after the decision of the OPEC+ countries to reduce the amount of oil production by 2 million barrels per day as of November. Whereas, in November and December, oil prices followed a downward trend influenced by the slowdown in global economic growth, the continuation of restrictions related to the containment of the pandemic in China, as well as the use of strategic oil reserves in many countries that affected the decline in oil demand. Risks which follow the outlook of oil prices from the downside direction include the risk of a global recession that would affect further the decline in demand, while upside risks are mainly related to disruptions and potential reductions in supply.

Natural gas prices in Europe that peaked in August 2022 as a result of the reduction in the amount of natural gas supplies from Russia and the massive purchase of liquefied natural gas (LNG) by the EU to replenish stocks before winter, were eased significantly in Q4 2022, marking a decline of 38.7% to \$36.9/mmbtu from \$60.2/mmbtu in Q3 2022. The decline in natural gas prices in Q4 2022 was supported by natural gas supplies from Norway and LNG from the US, which helped fill reserves to 90% of capacity, reducing concerns about potential natural gas supply problems. In addition, prices were also affected by lower natural gas demand

Chart 1. Energy prices in international markets



Source: World Bank.

due to lower usage of electricity from households for heating as a result of higher energy prices and mild weather conditions during Q4 2022, as well as the shutdown of several factories in Europe which used energy for intensive manufacturing process. Moreover, the policies undertaken by the EU to reduce the consumption of natural gas and diversify the energy sources with a focus on renewable sources also had an impact on the drop in natural gas prices. Despite the recent easing, natural gas prices in Q4 2022 were higher than those of the previous year, marking an annual increase of 14.6% compared to the same quarter of the previous year.

Similarly, an ease was also evident in prices of coal in Q4 2022, with Australian and South African coal prices which marked a decline of 10.4% and 32.8%, respectively, compared to the previous quarter. Prices of coal in international markets rose during Q3 2022, as a result of the increase in the use of coal for electricity generation following the increase in natural gas prices. This influenced the increase in domestic coal production in many countries to reduce import dependence, thereby increasing supply which was consequently reflected in the decline in coal prices. However, compared to the same quarter of the previous year, coal prices were also higher in Q4 2022, with annual increases of 101.4% in Australian coal prices and 11.3% in South African coal prices.

The dynamics in the price of natural gas in Europe were also reflected in the prices of artificial fertilizers in Q4 2022, considering the intensive use of energy in the production of artificial fertilizers. Artificial fertilizers DAP, TSP, and urea recorded an average annual price decrease of 10.3% compared to the previous quarter, influenced by lower demand as a result of price increases and by the continued import of Russian artificial fertilizers into the EU, which is an exception to the EU sanctions established in order to maintain security of supply. On the other hand, the prices of potassium chloride continued to remain high as a result of the embargo imposed by the EU on Belarus, which stopped the latter from exporting to the EU and using the territory of the EU for the transport of goods.

Inflationary pressures on food prices also eased in Q4 2022, with the World Bank's food index which declined by 0.2% in nominal terms compared to Q3 2022, as a result of increased supply of edible oils, the agreement between Ukraine and Russia for allowing the export of Ukrainian grain stocks, as well as the worsening of outlook for global economic activity that affected aggregate demand. In many countries, despite easing in Q4 2022, food prices continued to deteriorate as a result of currency depreciation. However, at the global level, the food price index in Q4 2022 stood at 8.8% higher compared to the same quarter of 2021, as a result of the increase in the price of cereals due to the decrease in production, while an annual decrease was evident in the prices of edible oils. The outlook for food prices continues to be undermined by a combination of risks such as potential increases in input prices, disruptions in supply chains, trade policies, a worsening outlook of the global economic activity, climate conditions, and others.

The base metal price index recorded an annual decline of 13.8% in Q4 2022, compared to the same period of the previous year as a result of the slowdown growth of the global economy and the restrictive measures to contain the pandemic in China. Compared to the previous quarter, metal prices showed an upward trend, increasing by 2.1% in Q4 2022. Although metal prices fell in October due to a worsening outlook of the global economic activity, they increased in November and December following the easing of pandemic restrictions in China and easing financing policies in the construction and real estate sectors.

Kosovo's Economy

Economic growth

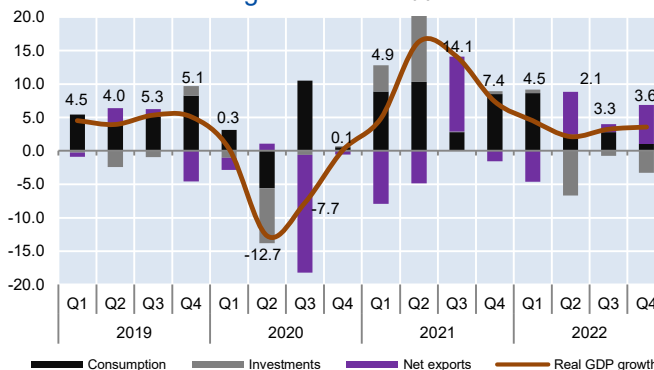
Economic activity in Kosovo, according to Kosovo Agency of Statistics (KAS) estimates, marked a real growth of 3.6% in Q4 2022. Domestic demand contributed negatively to real GDP growth by 2.3 percentage points, while net exports contributed positively by 5.8 percentage points and compared to the previous quarter, it represents a significant acceleration (chart 2).

Consumption contributed by 1.0 percentage points to real GDP growth, which compared to previous quarters is a lower contribution. The slowdown in the growth of consumption has been influenced by the slowdown in the growth of the main sources of financing such as employees' compensation, remittances, the decrease in new consumer credit, the decrease in public consumption, as well as the decrease in the purchasing power of consumers due to the increase in prices. Investments contributed negatively by 3.3 percentage points to the real GDP, mainly as a result of the decline in new investment loans, as well as the slowdown of economic activity in the construction sector. Regarding the foreign trade, net exports contributed positively by 5.8 percentage points to real GDP growth, with the export of goods and services recording a real increase of 9.5% and imports recording a decrease of 5.0%.

The increase in economic activity in Q4 2022 was mainly supported by the growth in the processing industry sector (12.5%), financial and insurance activities (11.5%), scientific, professional and technical activities (9.8 percent), etc. Also, the trade sector, as one of the main sectors, has recorded an increase in added value with 6.9% in Q4 2022, which is a lower increase compared to the increase of 19.7% marked in Q4 2021. However, due to the increase in prices, the average turnover index in the trade sector has increased by 38.1%. On the other hand, the highest decrease in added value was recorded in the construction sector (11.8%). The decline of the economic activity in this sector is largely attributed to the increase in construction costs of 16.6% in Q4 2022, which has influenced the postponement of investment projects in this sector.

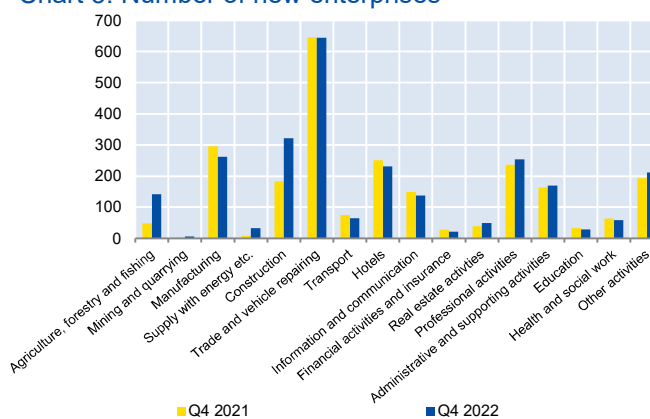
Economic activity was also reflected in the number of registered enterprises, which reached 2,636 enterprises in Q4 2022, namely 9.1% more compared to Q4 2021. The largest number of registered enterprises was observed in trade sector, construction, manufacturing, professional activities, hotels, etc. Whereas, the sectors that registered more enterprises compared to the same period of 2021 were construction, agriculture, electricity supply, professional activities, etc. (chart 3). On the other hand, during Q4 2022, 457 enterprises were closed or 38.9% more compared to Q4 2021.

Chart 2. Real GDP growth rate and main contributors to the growth



Source: KAS and CBK calculations.

Chart 3. Number of new enterprises



Source: KAS.

KAS preliminary estimates suggest that Kosovo's economy has recorded a slowdown growth of 3.5% in 2022 and these dynamics are expected to continue in 2023. **CBK forecasts suggest an economic growth rate of 3.9%.** The increase in economic activity during this year is expected to be generated by domestic demand as well as net export. Consumption, as the main component of domestic demand, is expected to record a real growth of 2.3%, while the nominal growth is expected to be 7.9%. The factors that are expected to affect the increase in consumption, among others, are the increase in remittances, employees' compensation, the increase in consumer credit and the increase in public consumption. Investments in 2023 are projected to record a real increase of 3.6% (7.3% decrease in 2022). An important contribution to the increase in investments is expected to be bank lending as well as the increase in public investments. Net exports are expected to reduce the trade deficit by 1.6% in real terms, as a result of the increase in the export of goods and services by 14.5%.

Prices

Annual inflation rate reached 12.1% in Q4 2022, against 6.4% as it was in the same quarter of the previous year. Whereas, the annual increase in the inflation rate in Q4 compared to the previous quarter turns out to have slowed down (13.3% in Q3 2022), which can be attributed to the slowdown in domestic demand after the burden of inflation on purchasing power, climate conditions and policies undertaken to save energy that affected the decrease in electricity consumption compared to Q4 2021, as well as the positive dynamics that affected the decrease in energy prices and the slowdown in food prices in international markets. Considering the significant weight of food commodities and energy in the consumer basket in Kosovo (46.7%), food and fuel prices in international markets remained the main drivers of inflation in Q4 2022, being transmitted to local prices through imports.

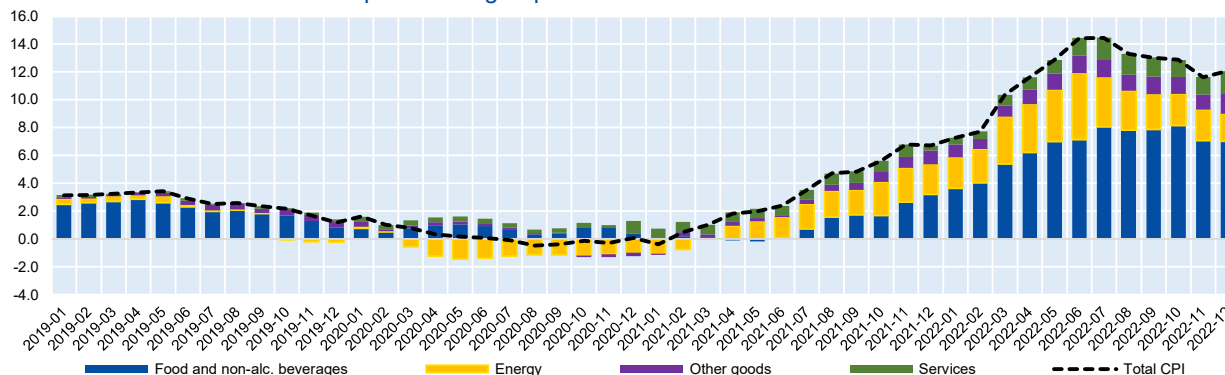
Although there was a slowdown in the prices of food commodities that recorded an annual increase of 18.7% in Q4 2022 compared to 19.5% in the previous quarter, they continued to remain high compared to food inflation, compared to the same period of the previous year, which was 6.3%. Within the food categories, the highest annual growth was observed in prices of oils and fats of 36.0%, milk, cheese and eggs (26.5%), bread and cereals (24.2%), meat (21.4%), and others. In general, with the exception of fruit, all food commodities in the consumer basket recorded an average annual price increase higher than 7.0%.

Prices of electricity and other fuels within the housing category recorded an average annual increase of 18.4% in Q4 2022, which is a significant acceleration compared to Q4 2021 when this category resulted in an inflation of 5.9%. While the data from KAS about the consumption of electricity, show a decrease in electricity consumption of 7.6% compared to Q4 2021 as a result of mild climatic conditions and the decrease in consumption by households for heating, the increase in prices in this category compared to Q4 2021 mainly is attributed to the increase in the wholesale price of electricity in foreign markets in Q4 2022. In addition to climatic conditions, an impact on the decline of the energy consumption in Q4 2022 was given by the policies undertaken by the Government, such as subsidizing electricity bills for households with consumption below 800 kWh, subsidizing the purchase of more efficient heating equipment for households, reducing of electricity consumption for public lighting and use in public institutions, and others. Whereas, compared to Q3 2022, in Q4 there was an increase in electricity consumption as a result of the drop in temperatures and the increase in the use of electricity for heating, which resulted in an increase in the price for households with consumption over 800kWh due to the exceeding of the block fee. Consequently, as a result of the increase of the wholesale electricity prices in foreign markets and the increase in consumption during Q4 2022, the electricity index in Q4 2022 recorded an average increase of 6.1% compared to the previous quarter. An increase in prices was also evident in the prices of solid fuels, which recorded an annual increase of 46.4%, while compared to the previous quarter, they recorded an increase of 9.0%.

Transportation prices recorded an annual growth of 10.9% in Q4 2022, with the personal transportation equipment usage category recording the highest price growth of 15.6%, which then was translated into

transportation services price growth of 14.3%. Whereas, on a quarterly basis, transport prices recorded a slowdown growth of 7.3 percentage points, from the rate of 18.2% in Q3 2022, mainly as a result of the drop in fuel prices in international markets.

Chart 4. Contribution of the respected subgroups in CPI

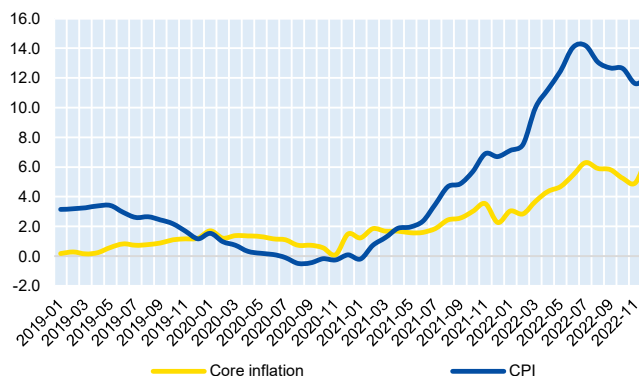


Source: KAS and CBK calculations.

The contribution of food to the average inflation rate was 6.9 percentage points, with the highest contribution recorded by the increase in the prices of bread and cereals of 2.2 percentage points, meat of 2.0 percentage points, and milk, cheese and eggs of 1.5 percentage points. Whereas, as for the category of transport, which includes most of the fuel, the contribution of transport to the total headline inflation in Q4 2022 was 1.7 percentage points, which was mainly generated by the subcategory of the use of equipment for personal transport with a contribution of 1.2 percentage points (chart 4).

The easing of prices in international markets was also reflected in the prices of other goods (goods excluding food and energy) and services, with the contribution of goods remaining the same as in the previous quarter (1.2 percentage points), although with an upward trend from December, and with the contribution of services which decreased by 0.1 percentage points (from 1.5 percentage points in Q3 2022) and which also showed an upward trend as a result of the acceleration of the prices of transport services, in December 2022.

Chart 5. Core and headline inflation of consumption

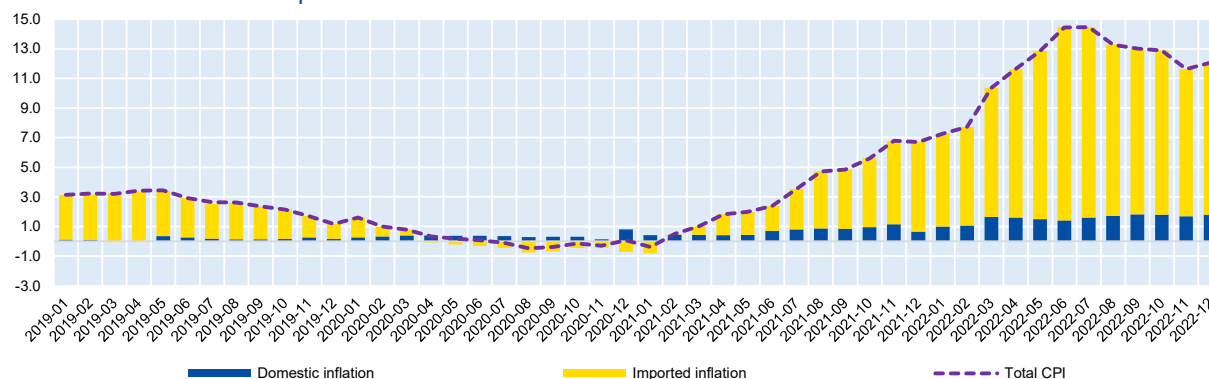


Source: KAS and CBK calculations.

Core inflation in Q4 2022 marked an annual increase of 5.7%, which compared to the previous quarter, represents a slowdown of 0.3 percentage points (chart 5). However, the obvious rise in core inflation, in December, gives indications that core inflation may not have reached its peak yet, with fluctuations mainly attributed to prices of services, especially transport, and prices of other goods (excluding food and non-alcoholic beverages, alcoholic beverages and tobacco, and energy).

The dependence of Kosovo’s economy on the import of food commodities and energy, as well as the high degree of their share to the consumption basket, influence that the rate of inflation in Kosovo is largely determined by the prices of imported goods. In Q4 2022, 10.4 percentage points of inflation in Kosovo was imported, while 1.7 percentage points was generated by internal inflationary pressures (chart 6). As a result of the easing of prices of basic goods in international markets, imported inflation in Q4 2022 shows a slowdown pace compared to the previous quarter, which was consequently also reflected in the containment of domestic inflation.

Chart 6. Domestic and imported inflation



Source: KAS and CBK calculations.

Fluctuations in the prices of basic goods in international markets, reflected in Kosovo through the increase in the prices of imported goods, are summarized through the import price index (IPI), which in Q4 2022 marked an increase of 13.1% compared to Q4 2021. In relation to the previous quarter, IPI recorded an increase of 0.9%, as a result of the acceleration of the prices of i) paper and articles thereof, ii) wood and wood articles, iii) plant products, and others. On the other hand, there was a slowdown in the prices of i) mineral products, ii) plastic, rubber and articles thereof, iii) basic metals and articles thereof, iv) edible oils.

The PPI resulted in a notable slowdown to 0.6% in Q4 2022 compared to the same quarter of the previous year. Whereas, compared to the previous quarter, the PPI resulted in a decrease of 13.7% mainly as a result of the decrease of 42.8% in the prices of the production of electricity, steam and air conditioning supply, the decrease of 1.4% in the prices of the production of non-metallic mineral products, and the decrease of 0.2% in the prices of processing food products, these categories which make up more than half of the weight within this index.

The Construction Cost Index (CCI) recorded an annual increase of 16.7% in Q4 2022, driven by the increase in the prices of construction materials which comprise 60.4% of CCI and which recorded an annual increase of 17.6%, transportation (40.4% annual increase), machinery (17.7%), and others. Whereas, the acceleration of this index was partially neutralized by the drop in energy prices in Q4 2022 (-15.2%) compared to the same quarter of the previous year. In relation to the previous quarter, a decrease of CCI of 0.6% was observed, mainly as a result of the decrease in the prices of construction materials of 0.3% and energy of 42.8%.

Regarding the perspective of inflation in Kosovo, the CBK forecasts that inflation in 2023 will slow down to 5.4%. Factors expected to contribute to these dynamics include the ongoing easing of supply chain constraints, the downward trend in inflation in the euro area, the transmission of financing conditions tightening to domestic demand, and others. However, risks related to inflation continue to be on the upside direction and mainly consist of the risks of new disruptions in supply chains as a result of the war in Ukraine, the potential increase in prices of energy, base metals, and other commodities from the reopening of China's economy, shifting consumer expectations for inflation, pressures for rise in wages, and more.

As for the banks' expectations for annual inflation in Kosovo for 2022, these have increased to 11.0% in Q4 2022 from expectations for annual inflation of 9.7% in Q3 2022. Meanwhile, expectations for inflation in the next quarter rose to 11.3% from 10.3% in Q3 2022.

Although banks' expectations on inflation have followed an upward trend, they remain below the actual values of headline inflation.

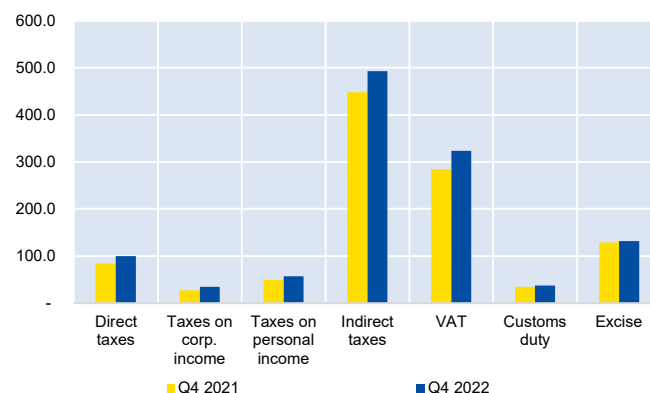
Fiscal Sector

Budget revenues¹, in Q4 2022, reached a net value of EUR 640.9 million, representing an annual increase of 11.9%. The increase in budget revenues was mainly a result of the high rate of inflation, which primarily affected indirect taxes, as the main category of budget revenues, as well as the efforts undertaken to formalize the economy, through the formalization of employment as well as the increase of controls and inspections in the field. **Also, the budget expenditures² increased by 18.9% and reached the value of EUR 942.7 million, driven mainly by the realization of expenditures in the form of subsidies and transfers within the framework of measures to deal with the increase of inflation.** Consequently, Kosovo's budget recorded a primary budget deficit of EUR 301.8 million.

Within budget revenues, all the categories have marked an increase.

With a higher increasing rate were characterized direct tax revenues, which reached a value of EUR 100.0 million or 18.9% more compared with Q4 2021. Within this category, corporate income tax marked an annual increase of 25.8%, while personal income tax, which represent the main category of direct tax revenues, marked an annual growth of 15.2%. Indirect tax revenues marked an increase of 10.1% and reached the value of EUR 492.8 million. Within indirect taxes, VAT income marked an increase of 14.3% being significantly affected by increase of prices. While,

Chart 7. Tax income structure



Source: MFLT and CBK calculations.

despite the decrease of the imports amount, revenues from customs duty and excise recorded an increase of 7.2% and 1.9%, respectively, as a result of prices increase of imported goods. Non-tax revenues marked an increase of 4.4%, reaching the value of EUR 67.1 million. Within non-tax revenues, the revenues from the central government reached the value of EUR 36.3 million, marking an increase of 6.0%, while the revenues from the local government increased by 8.2%, amounting to EUR 17.2 million (chart 7).

Regarding budget expenditures, current expenditures increased by 14.6%, while capital expenditures increased by 31.9%. Within current expenditures, subsidies and transfers marked an increase of 21.2%, reaching the value of EUR 365.5 million. Government expenditures on goods and services (including municipal utilities) marked an annual increase of 11.5%, reaching the value of EUR 140.9 million, meanwhile government expenses on salaries marked a growth of 5.0% and reached the value of EUR 175.1 million. Capital expenditures marked an increase of 31.9% and reached the value of EUR 261.2 million. During this quarter, capital expenditures accounted for 27.7% of total budget expenditures compared to 25.0% as they were in the same quarter of 2021.

Debt to GDP ratio was 20.7% in Q4 2022, compared to 21.5%, as it was in Q4 2021. This decrease was a result of the improvement of the government's budget balance and the increase in nominal GDP, which reduces the debt to GDP ratio. This level of public debt is far from the threshold provided by law of 40% of GDP as well as far from the average of the countries of the region of about 60% of GDP. However, in absolute terms the public debt has reached EUR 1.75 billion in Q4 2022, which is 4.2% higher compared to Q4 2021. The increase

¹ Within the primary income were not included the revenues from borrowings, income from privatization and donor defined grant receipts.

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of public debt is attributed to the growth of external public debt of 11.2% reaching EUR 641.2 million, and the increase of public domestic debt of 0.5%, reaching EUR 1.1 billion. External debt is comprised of liabilities to International Agency for Development (34%), International Bank for Reconstruction and Developments (16%), International Monetary Fund (8%), etc. Whereas, domestic debt primarily is comprised of Kosovo's Government debt to pension funds (49%), commercial banks (25%), public institutions (19%), etc.

External sector

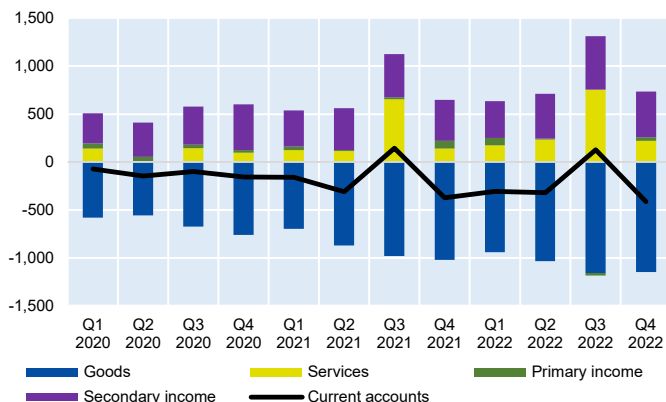
The current account, in Q4 2022, recorded a negative balance of EUR 412.0 million, which corresponds to 16.7% of GDP. Compared to the same period of the previous year, the negative balance of the current account has recorded an annual increase of 11.0% (EUR 371.0 million in Q4 2021) (chart 8). The current account deficit in the last quarter of 2022 continued to be determined mainly by the developments in the trade balance of goods, while the primary income account also recorded a negative balance. Meanwhile, in the same period of time, services and secondary income continued to contribute to the reduction of the negative balance of the current account.

Based on KAS data, the trade balance of goods in Kosovo for Q4 2022 has recorded a trade deficit of EUR 1.16 billion, marking an annual increase of 22.7%. The main reason for the increase in the trade deficit is related to the high

value of the import of goods, a value that mainly reflects the increase in prices in international markets and, consequently, import prices (chart 9). In this quarter, Kosovo's economy imported goods with a value of EUR 1.49 billion, while in the same period, goods that were exported reached a value of EUR 232 million. The exports covered only 15.6% of imports, with a trade ratio of 1:6.3.

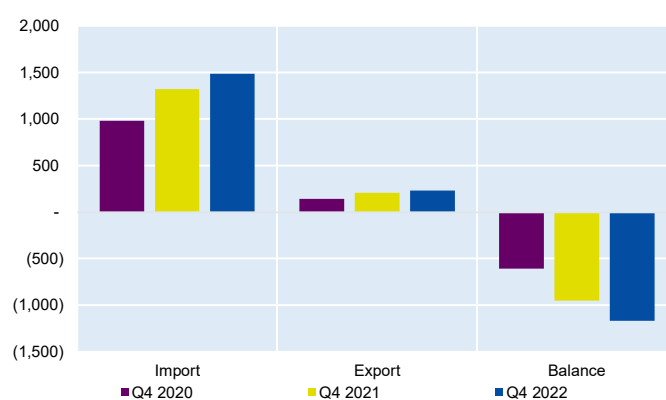
The value of total exports, in Q4 2022, reached EUR 232.4 million, which coincides with an annual increase of 11.5%, an increase that was mainly attributed to prices in international markets, but also to the increase in the quantity exported goods (the quantity of goods marked an increase of 4.1% in Q4 2022) (chart 10). The structure and composition of goods exported remained unchanged. The main partners for the export of goods in Q4 2022 remain the Western Balkans with 36.3% of total exports, and EU countries with 35.4%. Kosovo's economy mainly exported base metal goods, destined mainly to the countries of the region, followed by exports of plastic products, including rubber and minerals, which were mainly exported to EU countries.

Chart 8. Financial account, EUR million



Source: CBK.

Chart 9. Trade balance of goods

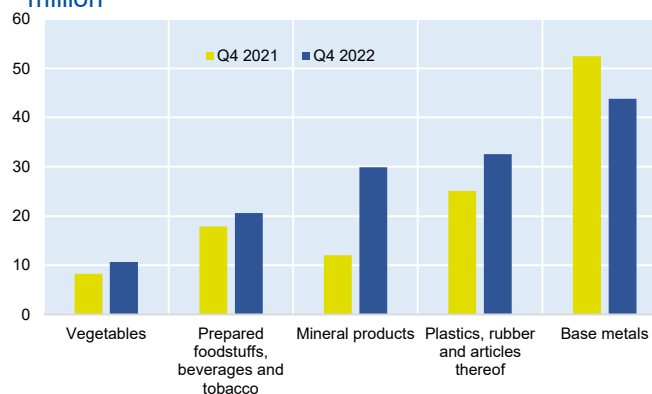


Source: KAS.

Reaching 60.2% of GDP, the value of imported goods reached EUR 1.49 billion in Q4 2022, representing an annual increase of 12.5%. The increase in the import component was mainly attributed to the dynamics of prices in international markets, while the total quantity and weight imported turned out to have decreased by 4.5% and 14.5%, respectively, influenced by the slowdown of the general demand in the country. The structure of imported goods categories remained unchanged, with mineral products, food commodities and machinery including household appliances as the main import categories (chart 11). While the share by the main categories was dominated by the category of intermediate goods of 50.7%, consumer goods 31.0%, while the category of capital goods continues to remain low at 10.1% of the total import. The increase in prices in the international markets, mainly in the category of food and energy, can potentially affect the increase in the value of the import of intermediate and consumer goods. Around 42.1% of goods imported came from European Union countries (EUR 625.5 million), among which, Germany continues to have the main weight with 11.6% of total imports. Kosovo imported from the region countries 17.7% of total imports, or EUR 262.3 million. Meanwhile, the import of goods from Turkey has reached the amount of EUR 262.1 million or 17.6% of the total imports.

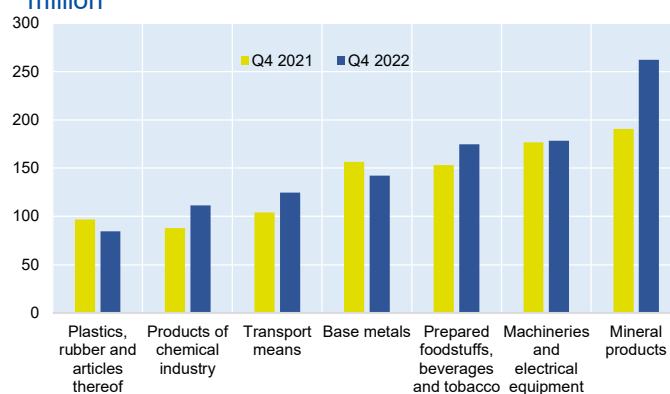
Activity from services have marked a positive balance in Q4 2022, reaching the value of EUR 223.6 million, marking an annual increase of 59.0% (chart 12). The export of services marked a significant increase, mainly due to the increase in services in the travel category, marking an annual increase of 24.6% reaching the value of EUR 278.8 million at the end of the period, which had a share of 11.3% to the total GDP. The dynamics in this category are mainly reflected by the increase in the number of passengers, 44.7% more compared to Q4 2021 (the source of data is Prishtina International Airport). An increase in the export of services results in the category of computer services with a value of EUR 58.2 million or 66.9% annual growth, influenced by the increase in external demand. On the other hand, the increase in the import of services was attributed to the increase in travel and

Chart 10. Main categories of goods export, EUR million



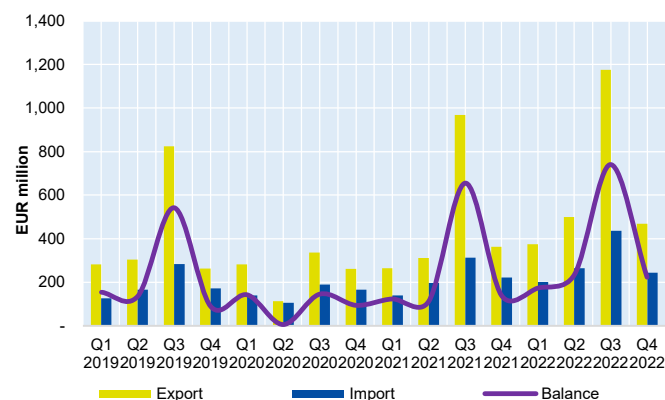
Source: CBK.

Chart 11. Main categories of goods import, EUR million



Source: CBK.

Chart 12. Balance of services



Source: CBK.

reflected by the increase in the number of passengers, 44.7% more compared to Q4 2021 (the source of data is Prishtina International Airport). An increase in the export of services results in the category of computer services with a value of EUR 58.2 million or 66.9% annual growth, influenced by the increase in external demand. On the other hand, the increase in the import of services was attributed to the increase in travel and

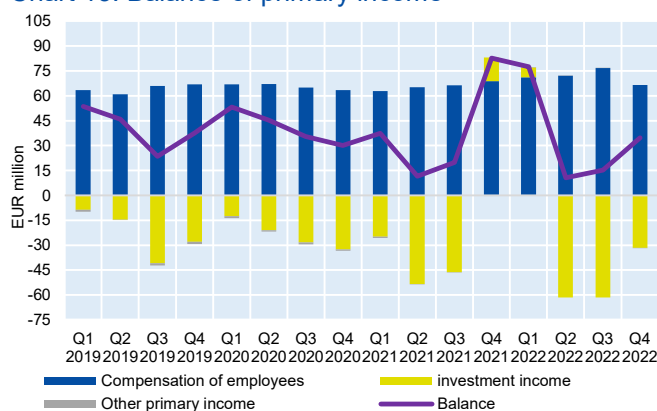
transport components, which comprise 54.9% of the total import, influenced by the increased prices of mineral products in international markets.

The balance of primary income recorded a decrease of 58.0%, reaching the value of EUR 34.7 million (EUR 82.7 million Q4 2021) (chart 13). The decrease in primary income was mainly influenced by the balance of income from investments, as a result of the return of dividends in the amount of EUR 44.9 million from direct investments. Meanwhile, the balance of income from employees' compensation has recorded a slight decrease of 3.4%, influenced by the decrease in income from resident workers abroad.

The value of remittances received in Q4 2022 reached EUR 318.3 million, representing an increase of 9.1% compared to the same period of the previous year (12.9% of GDP) (chart 14). The slow growth of remittances may have been influenced by the high rate of inflation in the countries where the diaspora lives, affecting the contraction of disposable incomes or the decline of real income. The structure by country remains unchanged, with Germany leading (41.2% of remittances sent from), followed by Switzerland (20.2%) and the USA (9.1%). Remittances by formal channels (banks and other institutions) have recorded an increase in the value of EUR 30.9 million, while there has been a slight increase in remittances through non-formal channels. Considering that most of the remittances are from the euro area countries (59.4%), the uncertainties that accompany the general economic dynamics but also without the security from the dominant sector (the construction sector) where the Kosovo diaspora is focused, can be translated into reduction of this important funding source.

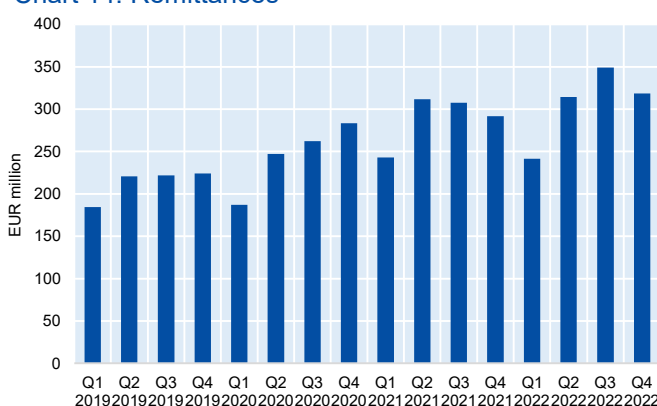
Foreign direct investments, in Q4 2022, show an increase of EUR 137.8 million and have reached the value of EUR 163.9 million (chart 15). The increase of FDI in Kosovo, in 2022, is mainly evident in the real estate and mining sectors (including quarries). The real estate sector covers 78.6% of total FDI or EUR 129.0 million, marking an annual increase of 36.2%. The growth of FDI in the real estate sector is estimated to be mainly influenced by the increase in demand and partially influenced by the increase in the cost of construction (16.7% increase in Q4 2022). FDI invested by residents from Kosovo in other countries has shown high growth in Q4 2022, reaching the value of EUR 62.1 million (EUR 18.5 million in Q4 2021), investments destined to the countries of the region and mainly oriented to the real estate sector.

Chart 13. Balance of primary income



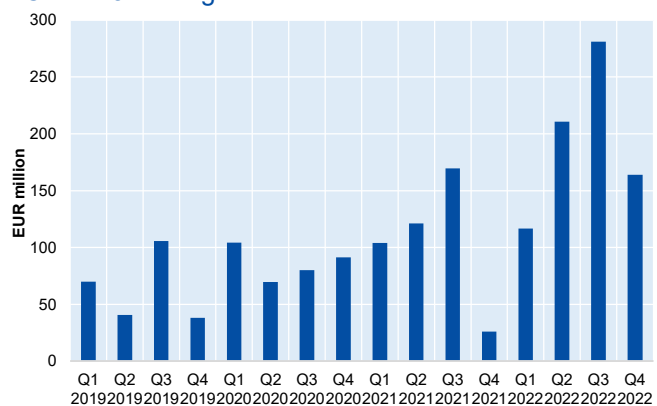
Source: CBK.

Chart 14. Remittances



Source: CBK.

Chart 15. Foreign direct investments



Source: CBK.

Financial system

Financial system was characterized with a significant expansion of its activity, despite the high increase of inflation, concerns about slowdown of the economic activity and the fluctuations of goods prices in the international markets.

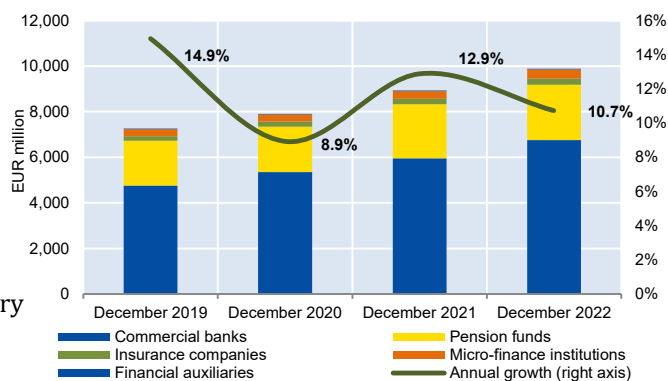
Inflationary pressures have curbed the rapid post-pandemic economic recovery, increasing the uncertainties and sensitivity of the financial system as well. Financial system assets in the country slowed down the annual growth for 2.1 percentage points, and their value reached EUR 9.9 billion. The slowdown of growth trend was developments in the pension sector, whereas assets of other sectors marked an accelerated growth (chart 16).

The banking sector, in December 2022, represented about 68.4% of the total assets of the financial system, giving the main contribution to the expansion of the total assets of the financial system (chart 17). The microfinance sector was characterized by a significant increase in activity, and despite the low share of only 4.1% in the total assets of the system, it was ranked the second in terms of contribution to the total annual growth of assets. The pension sector was characterized by a decrease in the value of investments, which was reflected in a marked slowdown in the growth trend of the assets of this sector and, consequently, in the decrease in the weight/contribution to the growth of the total assets of the financial system (chart 17). While the insurance and financial intermediaries' sector, due to their lower weight, had a more limited impact on the overall structure of the system's assets, despite the accelerated increase marked during this period.

1. Banking Sector

Risks for the banking sector, from unfavorable geopolitical and macroeconomic developments continue to be high, however, in 2022 these risks did not materialize significantly in the activity and performance of the sector. Continuous inflationary pressures are estimated to have affected the decline of disposable income in the economy, which has been translated into a potential decrease in borrowers' solvency (increased credit risk) and weakening of saving capacity (increased liquidity risk). The slowdown of the economic activity, the increase of interest rates to combat inflation and the potential increase of energy tariffs are expected to further contribute to the increase of credit risk for the banking sector.

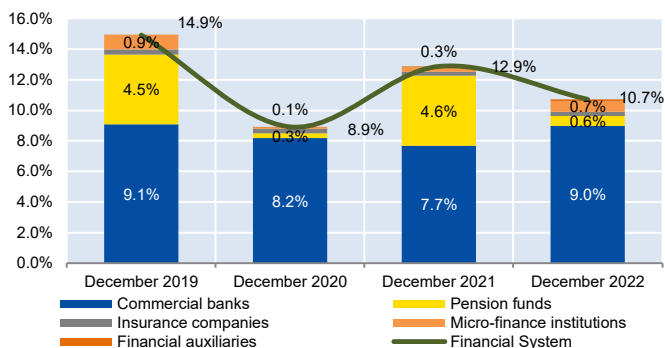
Chart 16. Assets value of Kosovo's financial system



Source: CBK.

impacted by the

Chart 17. Contribution to assets growth of financial system, percentage points



Source: CBK.

Assets

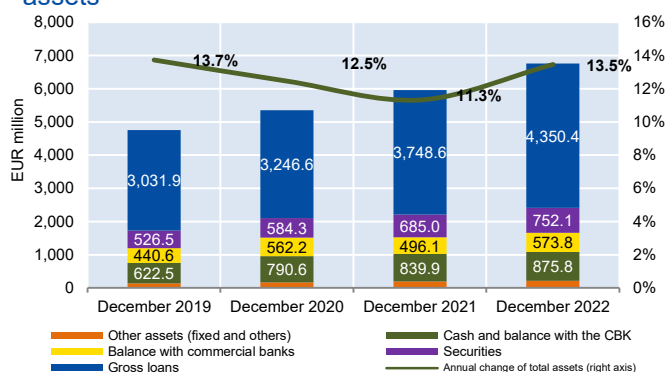
Banking sector assets reached the value of EUR 6.76 billion in 2022, which corresponds with an accelerated annual increase of 13.5% compared to the increase of 11.3% in the previous year (chart 18). The main contribution to the growth was given by lending expansion which is the main activity of the sector. The balance with other banks was the second consecutive component in terms of contribution to the acceleration of assets growth, while other items slowed down the growth rate. Investments in securities slowdown the annual growth to 9.8% from 17.2% as it was in the previous year. Also, cash and balance with the CBK slowed down the annual growth to 4.3% from 6.2% in the previous year.

Lending

Lending activity of the sector marked an annual growth of 16.1%, which corresponds to the highest growth marked in the recent eleven years. However, the last quarter of the year was characterized with a slowdown increasing trend. According to the Bank Lending Survey, lending dynamics in the last quarter of the year were largely influenced by credit demand, since credit supply had no significant changes from the previous quarter. Terms and conditions for loans to households were generally tightened (an increase of interest rates) during the year, but the demand, nevertheless, marked an increase for both categories of loans to household – consumer credit and real estate loans. The need to finance the inventory and working capital from enterprises was reflected by increased demand from enterprises as well, although at a lower level than expected.

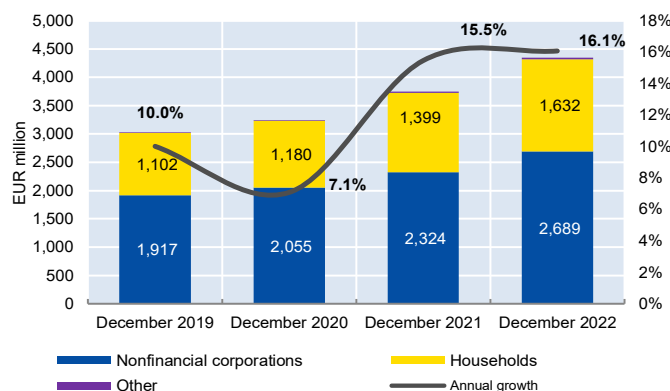
The segment of non-financial corporations recorded an annual increase of loans stock of 15.7%, which coincides with the acceleration of the annual growth trend by 2.6 percentage points (chart 19). Meanwhile, loans to households recorded an annual increase of 16.7%, which compared to the previous year represents a slowdown in growth by 1.9 percentage points. Consequently, the dominant contribution of the non-financial corporations' segment to the total credit growth of the sector increased further (chart 20).

Chart 18. Balance sheet of the banking sector - assets



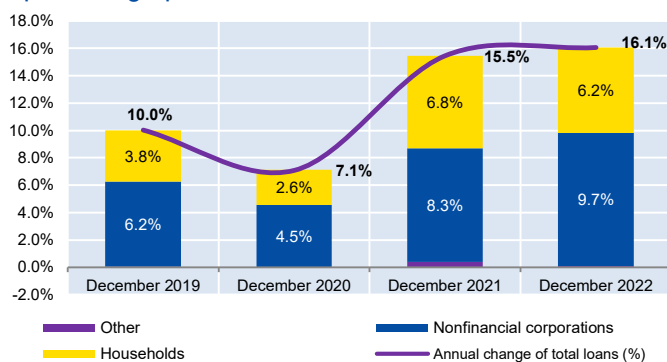
Source: CBK.

Chart 19. Stock of total loans, annual change



Source: CBK.

Chart 20. Contribution to the growth of total loans, in percentage points

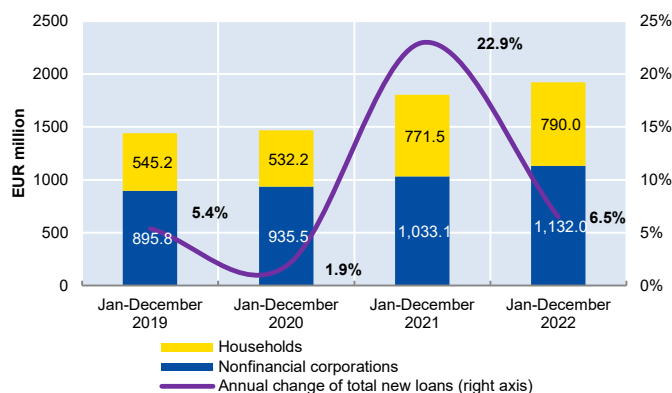


Source: CBK.

New loans, during 2022, marked a slowdown in the growth trend to 6.5% compared to the notable increase of 22.9% in 2021. The slowing trend was influenced by the dynamics of new loans in the fourth quarter, which was characterized by an annual decrease in loans in two segments – nonfinancial corporations and households. Unlike in the previous year, which was characterized with a higher increase of new loans to households, in this year the increase was more significant for nonfinancial corporations (chart 21). Until December 2022, new loans to nonfinancial corporations increased by 9.6%. The growth was slightly higher for investment loans, 9.0%, than for non-investment loans, which grew by 7.8%. New loans to households marked a much slower growth of just 2.4%, compared to 45% growth, marked in 2021. New consumer credit recorded an annual decrease of 6.3% (an increase of 40.3% marked in 2021), mainly influenced by the decline in the fourth quarter of the year. Mortgage loans generally marked a slowdown in the annual growth trend to 13.5% (an increase of 56.5% marked in 2021), despite a more significant growth that was marked in the fourth quarter of the year. The year 2022 was characterized by increased use of credit products such as overdrafts and credit lines, both by nonfinancial corporations and by households.³

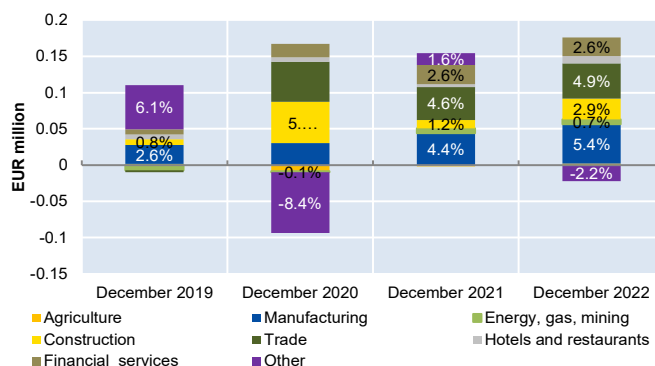
In terms of loans to nonfinancial corporations, lending to the trade sector was at the highest levels over the years, followed by the manufacturing and construction sector, which have gradually expanded in the recent years, thus increasing their share to total loans of the banking sector. Until December 2022, lending to manufacturing sector had the highest contribution to the growth of total loans to nonfinancial corporate segment (chart 22), as a result of the high annual growth of 29.4% (chart 23). Trade sector marked an annual increase of 10.3% and was the second one by contribution to the growth of loans to nonfinancial corporations. The construction sector marked an accelerated increase of 21.1%, despite the challenges that this sector was facing due to the high

Chart 21. New loans, annual change



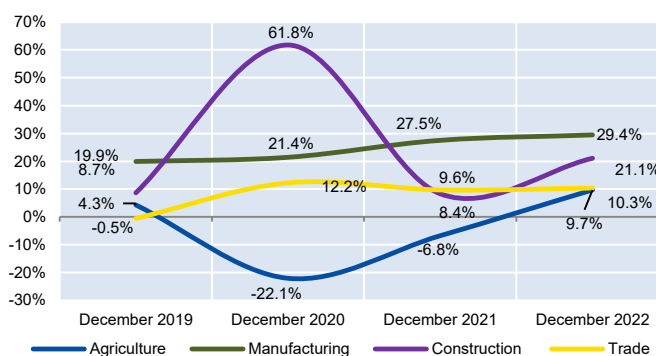
Source: CBK.

Chart 22. Contribution to the growth of total lending to nonfinancial corporations, by economic activity



Source: CBK.

Chart 23. Annual change on loans to nonfinancial corporations, by economic activity



Source: CBK.

³ A note from Statistics Department: Since November 2021 there has been an improvement on the quality of report on overdrafts and credit lines.

increase of inflation - the increase of prices of construction materials. Agriculture sector was characterized with a positive increase in this year by 9.7 %, unlike the notable decline marked in the previous year.

Lending to nonfinancial corporations, namely to manufacturing sector was supported by the Economic Recovery Package, through subsidizing investment loans for manufacturing businesses. The implementation of this measure during this year may have had an impact on accelerating the increase of loans to this sector.

1.1. Liabilities and own resources

Financing of the banking sector activities continued to rely on customer's deposits and own capital, namely retained earnings and realized earnings during the current year.

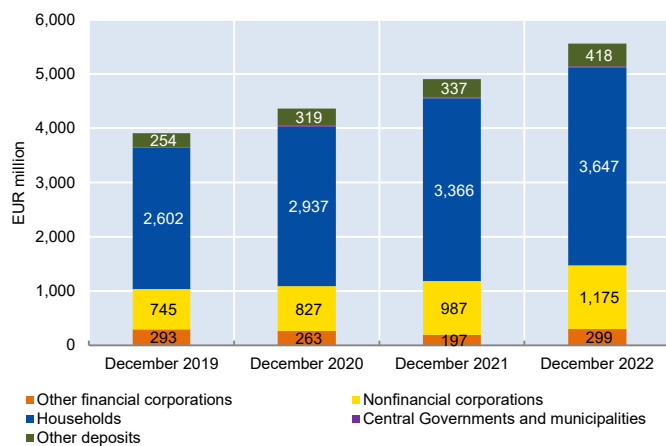
Both of these items comprise 92.5% of liabilities and equity, where 82.1% is comprised only by deposits. Increased uncertainties as a result of inflationary pressures and the slowdown in economic activity were reflected in consumer behavior through the slowdown in the growth of deposits of the two dominant categories in the structure of deposits, households and nonfinancial corporations. This development, along with the new circumstances of higher interest rates at the global level as well as the increased competition in the domestic market, inclined the banking sector to offer more favorable conditions for securing financing by increasing the interest rate on deposits.

1.1.1 Deposits

The value of the stock of deposits, at the end of December 2022, reached EUR 5.6 billion (chart 24), representing an accelerated annual growth of 13.3%, from 12.4 percent in December 2021. Deposits of the two dominant segments in the structure of total deposits - households and nonfinancial corporations - marked a slowdown in growth, but the high growth in deposits of financial corporations, public corporations as well as deposits from non-residents determined the accelerated upward trend of total deposits.

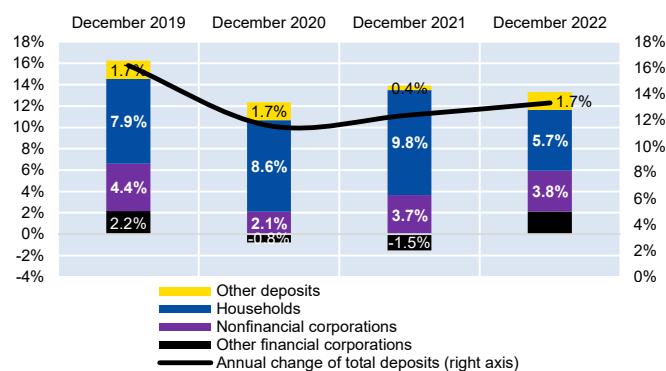
Household deposits recorded a slowdown in annual growth to 8.3% from 14.6% in the previous year, a development that may have been influenced by higher household expenditures this year as a result of prices increase, while income/salaries remained at the

Chart 24. Stock of total deposits



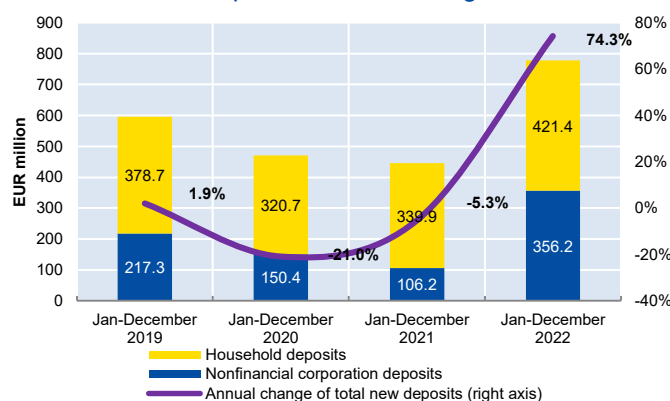
Source: CBK.

Chart 25. Contribution to annual growth of total deposits, percentage points



Source: CBK.

Chart 26. New deposits, annual change



Source: CBK.

same level or increased at a much lower rate. In December 2022, the value of household deposits reached EUR 3.65 billion, and the contribution to the growth of total deposits remained the highest from this category (chart 25). Regarding the level of new deposits collected from households, which include only time deposits, during the year 2022, they reached the value of EUR 421.4 million, representing an annual increase of 10.4%, while in the previous year it was marked an annual decline of 24.0% (chart 26). This increase is mainly attributed to the increase in interest rates on deposits for this category, which were increased by banks in an effort to keep deposits/financing to support the high level of lending in the country, in circumstances of the increase in the cost of financing from abroad.

The stock of nonfinancial corporate deposits, at the end of 2022, reached EUR 1.2 billion, representing annual growth of 19.0% - slightly lower than in 2021, when the growth was 19.3%. New deposits collected during the year from this segment increased to EUR 356.2 million from EUR 106.2 million in 2021. This development is estimated to have been influenced by the increase in interest rates, increased economic activity as well as increased uncertainty about the economic outlook which may have discouraged investments.

1.2. Interest rates

Interest rates on new loans and new deposits have suffered movements towards increases, after declining trends marked in the previous years. The application of tight monetary policies in combating inflation have created an environment with increased interest rates, a situation that has also been followed in the domestic market. The transmission of changes in basic interest rates has been reflected in all segments of the banking and financial market, but at different levels.

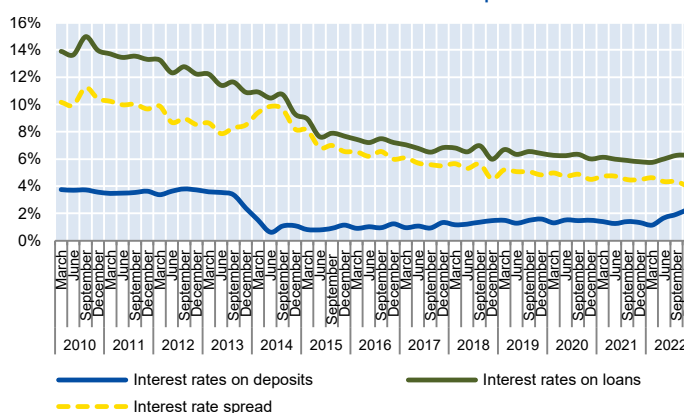
In the banking market, interest rates on new deposits have been affected at a higher level

than interest rates on new loans. In December 2022, the interest rate on loans reached 6.3% from 5.8% in the previous year, and 6.0% as of June 2022, when inflation intensified and discussions on monetary policy intervention began. Also, the average interest rate on deposits increased to 2.4% from 1.3% as it was in the previous year, and 1.9% in September 2022, when concerns over the holding of deposits in the banking sector and consequently the liquidity risk was further highlighted. The margin of interest rate spread of loans and deposits narrowed to 3.9 percentage points from 4.5 percentage points (chart 27).

The dynamics of interest rates influenced by developments at the global level, as well as the increase in liquidity risk and uncertainties about future developments as a result of increased inflationary pressures, in addition to driving the banks in the country to increase interest rates on loans and deposits, at the same time have influenced the change in the structure of loans according to the type of interest rates. While in the previous year and in 2020, loans with variable interest rates, which are mainly determined by the movements of the Euribor rate for the additional margin, accounted for an average of 19.6% of the loans portfolio and 16.5% respectively, where this level has risen to 24.1% this year. Moreover, some of the banks which were applying fixed rates only, this year they have started to apply variable rates as well (chart 27a).

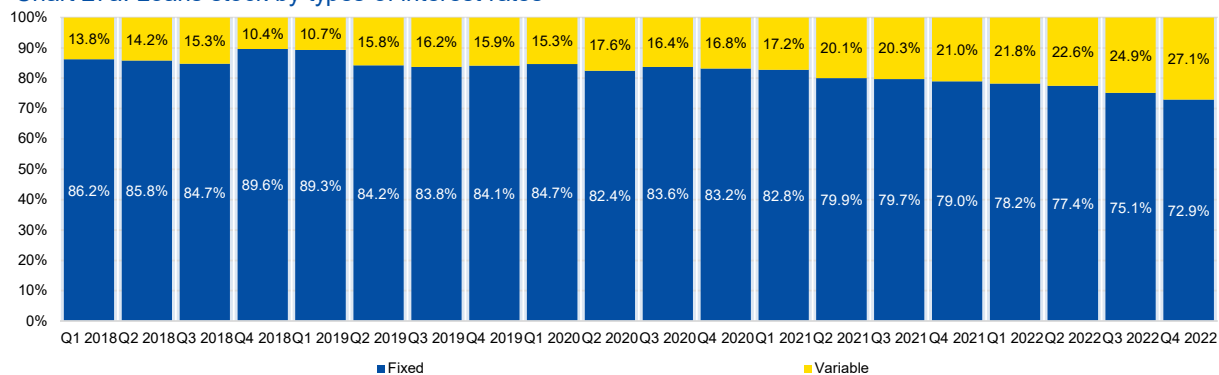
This dynamic shows a prudent approach, which has been adopted by banks to manage the increasing risk of inflation, and developments of the same directions on the global level. According to these expectations this share and the increase of interest rates will continue also in the following periods, relying on banks statements given in the Bank Lending Survey report.

Chart 27. Interest rate on loans and deposits



Source: CBK.

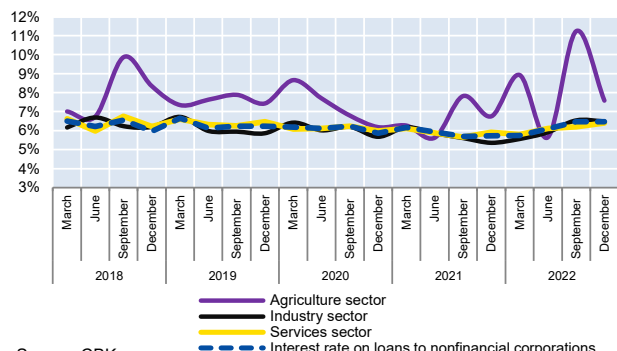
Chart 27a. Loans stock by types of interest rates



Source: CBK.

The average interest rate on loans to nonfinancial corporations, in December 2022, stood at 6.5%, namely 0.76 percentage points higher than in the same period of the previous year, and 0.03 and 0.39 percentage points higher than in September and June 2022, respectively.

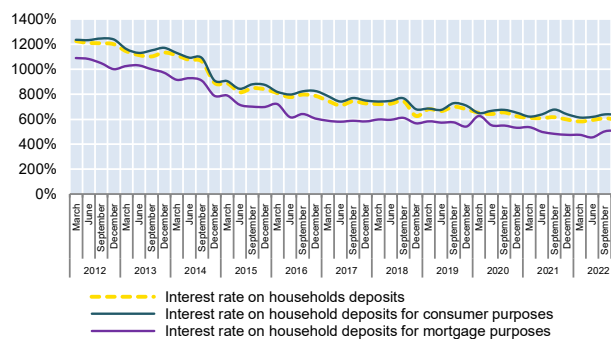
Chart 28. Interest rate on loans to nonfinancial corporations



Source: CBK.

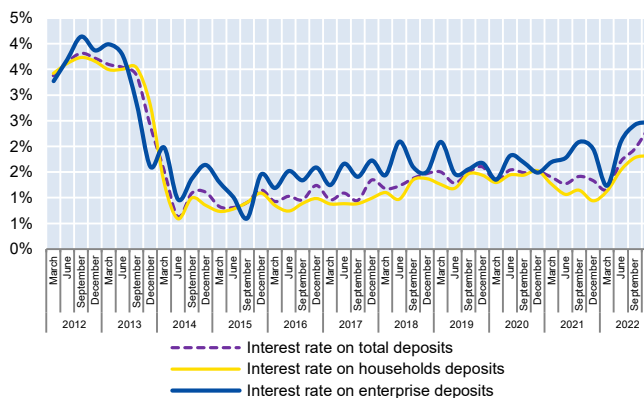
More favorable interest rates on loans were offered for services segment (6.4%), while the highest average interest rate of 7.6% was for agriculture sector due to the higher risk these loans bear (chart 28). **The average interest rate on loans to households** stood at 5.9%, which is almost the same interest rate as in the previous year. The more favorable interest rates have been applied to mortgage loans at an average of 5.1%, since they are considered to have a little lower risk when they are covered by collateral (mortgage). However, consumer credit continues to have the highest interest rate of 6.4% on average (chart 29). Interest rates on deposits started the upward trend from June 2022, reaching an average of 2.4% at the end of the year. The average interest rate on nonfinancial corporation deposits increased by 0.5 percentage points, reaching 2.5%, while for households there was marked an increase of more than 0.9 percentage points, reaching 1.8% (chart 30).

Chart 29. Interest rate on loans to households



Source: CBK.

Chart 30. Interest rates on deposits



Source: CBK.

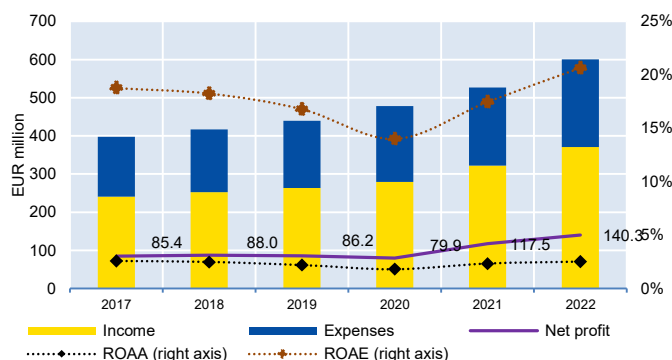
Performance of the banking sector

Banking sector realized an annual profit with a value of EUR 140.3 million in 2022, representing the highest value registered since the foundation of the banking sector. Such a financial result was enabled by the high increase of income compared to the increase of expenditures (chart 31). Also, the fourth quarter turns out to have marked a better financial performance compared to the same quarter of the previous year, but to a lesser extent than in the second and third quarters of this year.

Total income reached the value of EUR 370.4 million, representing an annual increase of 15.0% (an increase of 15.4% marked in the previous year). Interest income, which represent 71.1% of total income, gave the main contribution to the growth of income. In the context of interest income, the collection of interest on loans had the main contribution to this increase, a category which was influenced by the significant increase in lending. In addition, this year, interest income from placements in other banks and from investments in securities have increased significantly compared to the decrease from the previous year. Meanwhile, the category of non-interest income, mainly derived from fees and commissions, recorded a slower growth compared to the previous year, of 8.0% from 31.0% as it was in December 2021, and reached the value of EUR 92.7 million.

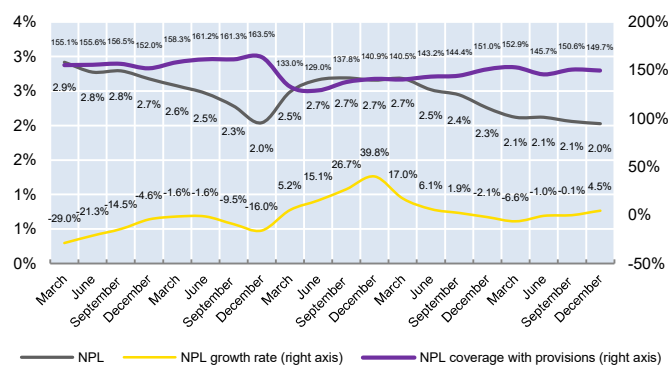
The sector's expenditures were also characterized by a growth, which recorded a higher annual growth compared to the previous year of 12.4% from 2.6%, and reached the value of EUR 230.0 million. The contribution to this difference was given by the increase of 12.1% or EUR 14.6 million of general and administrative expenses, which mainly reflect the increase of personnel expenses of 16.3% (or for EUR 8.4 million). This increase suggests the pressure of inflation in the correction of employees' salaries in the banking sector. Also, the category of non-interest expenses marked an increase compared to the decline that had been marked in the previous year, due to the increase of fees and commissions of loan loss provisions (an increase of 17.1% or EUR 2.5 million).

Chart 31. Profit and profitability indicators of the banking sector



Source: CBK.

Chart 32. Nonperforming loans and loan loss provisions



Source: CBK.

Financial soundness indicators

Over the years, the banking sector has managed to ensure a high level of capitalization and liquidity, as well as to maintain a low level of nonperforming loans. The satisfactory state of these indicators gives priority to the sector in absorbing shocks from uncertainties caused by geopolitical crises, the increase of inflation and economic slowdown activity.

Credit quality marked an improvement starting from the last quarter of 2021 until September of this year, where the value of nonperforming loans had a downward trend of an average of 2.5%. In the last quarter of 2022, the declining trend changed its direction, where the NPL value increased to 4.4%. While the value of nonperforming loans to households has decreased by 3.9%, it was the credit portfolio of enterprises that experienced an annual increase in the NPL value with 6.1% and affected the NPL growth in the last quarter of the year. The increase in the NPL value was more significant in the sectors that have a higher use of energy and were therefore more sensitive to developments in the energy market (the manufacturing sector which recorded an increase in the value of NPL with 11.4%, real estate and construction 7.5%, and trade with 4.5%).⁴

Facing rising energy prices and spending to find energy alternatives under the uncertainties of possible reductions and difficulties in supplies, may have affected the repayment ability of some enterprises.

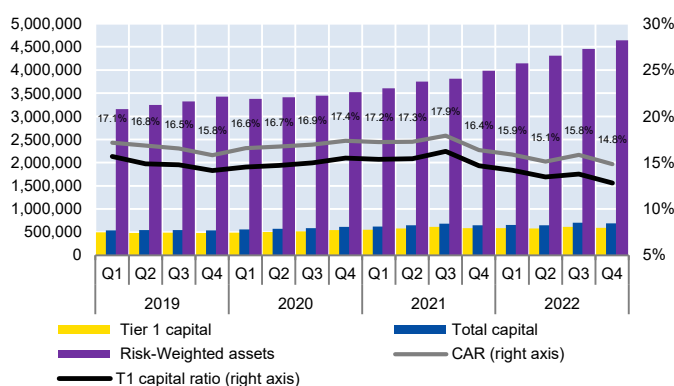
The most significant growth of lending in the reporting period influenced the nonperforming loans to total loans ratio to mark a decrease to 2.0%, from 2.1% in September 2022 and 2.3% in December 2021. Coverage by possible loan loss provisions declined slightly to 149.7%, from 151.0% and 150.6 percent in September 2022, due to higher growth in the value of nonperforming loans than the value of provisions dedicated for coverage of loans (chart 32).

Capital Adequacy Ratio dropped at the level of 14.8% from 16.4% in December 2021, which is a result of the more notable increase of risk weighted assets due to the significant increase of lending. Also, compared to the previous quarter, the capital adequacy ratio was at a lower level, as a result of the reduction of the capital and the increase of risk-weighted assets (chart 33).

Liquid assets to total short-term liabilities ratio, declined to 36.5% from 37.2% (chart 34). The decline of liquidity level compared to the previous year's level is a result of the increase of short-term liabilities of 9.0% compared to the decrease of liquid assets of 7.0%.

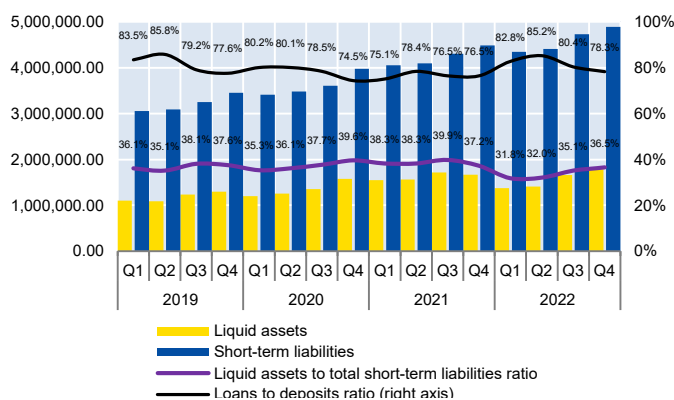
Within the liquid assets, investments in securities of foreign governments recorded the most significant growth, and also deposits and

Chart 33. Solvency indicator



Source: CBK.

Chart 34. Liquidity indicators



Source: CBK.

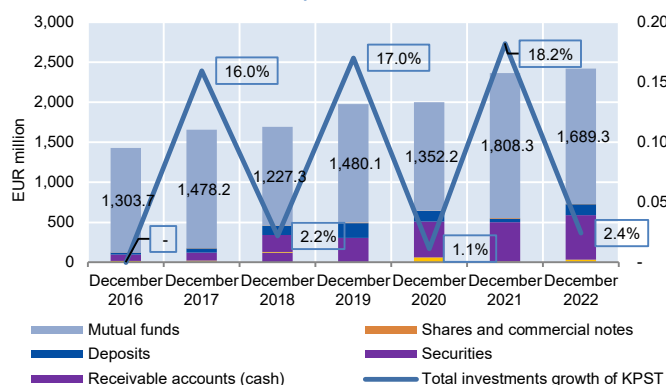
⁴ For more information please refer to the explanations above on lending activities.

placements in foreign banks had a positive impact on the growth of liquid assets. Meanwhile short-term liabilities marked an increase due to the increase of deposits especially during of the last quarter of the year. While compared to the previous quarter, the level of liquidity has increased due to the higher growth of 7.5% of liquid assets compared to the increase of short-term liabilities of 3.4%. Loans to deposits ratio was increased to 78.3% from 76.5% that was in the previous year, which is a result of the high increase of lending during this year. While this level was higher than in the previous quarter, because the growth of deposits was higher reaching the level of 5.6% compared to the growth of lending of 2.8% (from September to December).

Pension sector

The assets of the pension sector recorded a more pronounced slowdown in the growth and a decrease in the value of investments compared to the previous year, which is a consequence of unfavorable macroeconomic developments that have simultaneously affected the turbulences of the financial markets.

Chart 35. Assets of the pension sector

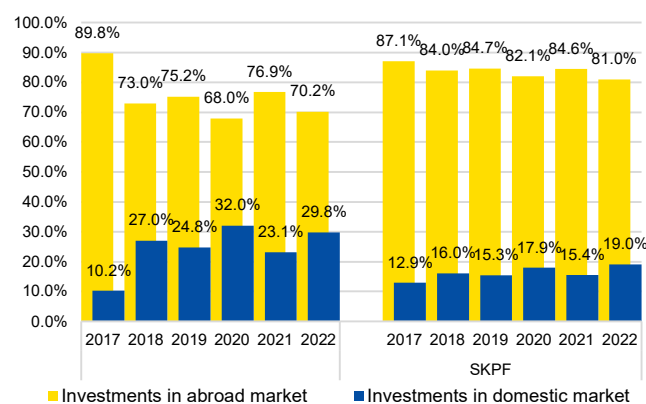


Source: CBK.

With the second highest share to total assets of the financial system, assets of pension funds increased by 2.4%, albeit it presented an increase which was significantly slower than in the previous year when it had reached 18.2%. The value of pension funds' assets reached EUR 2.42 billion, of which 99.6% are represented by Kosovo Pension Saving Trust (KPST), whereas the remainder belongs to Slovenian-Kosovo Pension Fund (SKPF). While the KPST recorded an increase in assets of 2.5%, the assets of the Slovenian-Kosovar Pension Fund (SKPF) recorded a decrease of 9.4%. (chart 35).

Investments from KPST are mainly focused on the external market (70.2% of investment portfolio), joint funds worth with a value of EUR 1.7 billion (or 70.0% of total assets of KPST), and the rest of the investments are diversified in securities of the Kosovo's Government with a value of EUR 553.8 million or 23.0% of total investments and certificates of deposit in the banking sector with an amount of EUR 136.9 million (5.7% of total investments). Also, the structure of SKPF investment portfolio is similar to that of KPST structure, being mainly oriented to the foreign market, in the form of shares that make up 69.1% of the investment portfolio, and marginally in securities with an investment share of 5.4%. Meanwhile, investments within the country are mainly focused on Kosovo's Government securities which account for 15.7% of total investments portfolio.

Chart 35a. Structure of pension funds investments



Source: KPST, SKPF

Both pension funds were characterized by a decrease in the investment portfolio in the external market compared to the increase in investments in the domestic market, being impacted by the negative fluctuations that have affected the financial markets. In this context, for KPST, there was a significant increase in certificates of deposit and balance/cash with the CBK, representing the categories which were decreasing in the previous

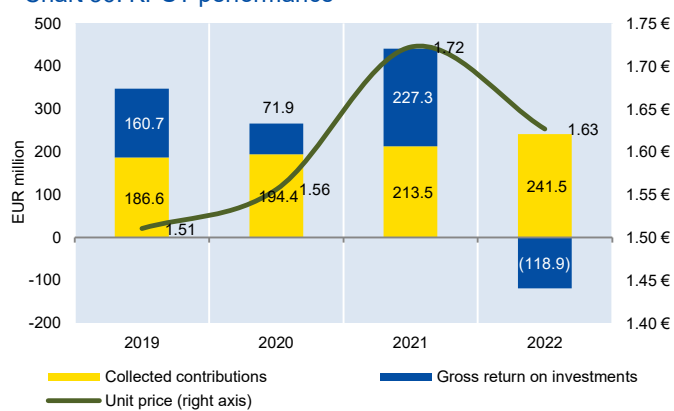
year, while the securities of the Kosovo's Government continued to increase by 12.7% from the increase of 9.0% marked in the previous year (chart 35a).

While the value of collected contributions marked an increase in both pension funds, the performance of pension funds throughout the year was weak compared to the previous year, after the decline in the value of investments until the third quarter of the year when unfavorable geopolitical circumstances and increasing inflationary pressures caused destabilization of the markets and made the investments stand at a difficult situation. However, the change started to happen in the fourth quarter of this year, with the realization of positive investment returns from both pension funds.

The value of contributions collected by SKPF during the whole year of 2022 reached EUR 608.4 thousand, which represents an annual increase of 11.3%, influenced by the increase of the number of contributors. Whereas, the gross return on investments had a negative value of EUR 788.6 thousand in 2022 (a positive return of EUR 1.1 million marked in 2021). However, the fourth quarter of the year had a good performance, characterized by an increase in the value of investments, at the level of EUR 106.7 thousand, unlike the third quarter, where investments had a negative value of EUR 93.7 thousand, and the second quarter, which had an even higher negative return of EUR 505.8 thousand.

The value of collected contributions by KPST, for the year of 2022, marked an annual growth of 13.1%, reaching the value of EUR 241.5 million. Despite the difficult geopolitical situation and pressures on economic activity from tight monetary policies combating inflation, investments of KPST in the fourth quarter managed to return to positive investment value, from the negative returns recorded in the three previous quarters. Consequently, the cumulative value has a negative return of EUR 119.7 million in 2022 (positive return of EUR 228.4 million in 2021). However, the fourth quarter was characterized by an increase in the value of investments at a total level of EUR 51.6 million, in contrast to the negative return marked in the previous quarter of EUR 8.7 million and the second quarter of EUR 101.1 million (chart 36). The investment policy of the funds requires diversification of investments and aims for a positive return in the long term, while simultaneously maintaining a so-called “conservative” portfolio whose assets account for contributors who soon will be retired, which in order to maintain the value of these assets, they are invested in shorter terms and with a safe positive return - such as investments in Kosovo’s Government securities.

Chart 36. KPST performance



Source: KPST.

Insurance sector

The insurance sector recorded an increase in activity for the fourth year in a row; despite unfavorable political, economic and financial developments that prevailed during 2022.

Insurance sector assets represented 2.7% of total financial system assets at the end of 2022. Total assets value reached EUR 267.5 million at the end of the period, representing an annual increase of 11.2%, thus continuing the double-digit growth trend marked in the previous years (chart 37). The expansion of the sector came mainly as a result of the technical reserves increase, which source out from the written premiums, and own capital (shareholders capital and the realized profit). Within assets, the most significant increase was recorded in the category of deposits held at commercial banks, which are mainly in the form of time deposits. The second

category in terms of weight, that of Kosovo's Government Securities, recorded a growth, albeit at a slower pace compared to the previous year's, as a result of the lower level of debt issued by the Kosovo's Government.

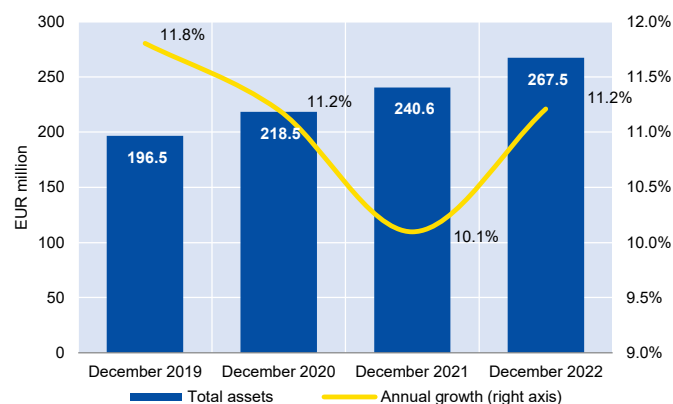
The value of written premiums reached EUR 134.0 million in 2022, representing an annual increase of 14.1%. The increase in written premiums mainly reflects the increase in written premiums of 'accident and health', a category within the framework of voluntary insurance. Meanwhile, the written premiums against compulsory insurance continue to have the largest weight, reaching 58.9% of the total non-life written premiums. The increase in premiums within the "accident and health" insurance (for 29.3%) is a positive signal for the increase in the number of citizens who have health insurance. While the increase in compulsory insurance premiums mainly reflects the category of 'motor third party liabilities - MTPL', which increased by 5.4%.

On the other hand, the value of claims paid by insurance companies and the Kosovo Insurance Bureau in 2022, reached the value of EUR 64.3 million, representing an annual growth of 5.4% (24.4 percent in the previous year)(chart 38). The value of claims paid by KIB decreased by 13.3%, while the claims paid by insurance companies marked an annual increase of 9.1%. The insurance sector, in 2022, recorded a profit in the amount of EUR 3.5 million (EUR 6.3 million marked in the previous year). The decrease in realized profit compared to the previous year mainly reflects the increase in operating expenses, namely the cost of purchasing goods and services (affected by inflationary pressures in 2022), administrative expenses (mainly employees compensation) and claims incurred.

Microfinance sector

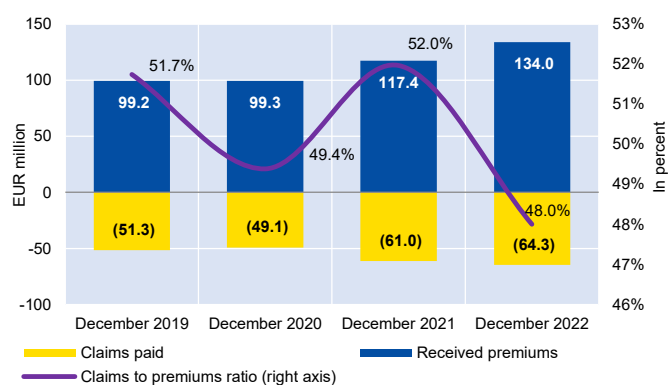
The microfinance sector in 2022 marked an accelerated growth of assets, mainly influenced by the expansion of lending and leasing, which were financed by loans received from the external sector. The financial result exceeded previous year's level, and is the highest since the consolidation of the microfinance sector, influenced by the higher growth of income against expenditures. Financial health indicators are at an optimal level and have improved compared to the previous year; signaling stability in this sector. However, the

Chart 37. Assets of insurance sector



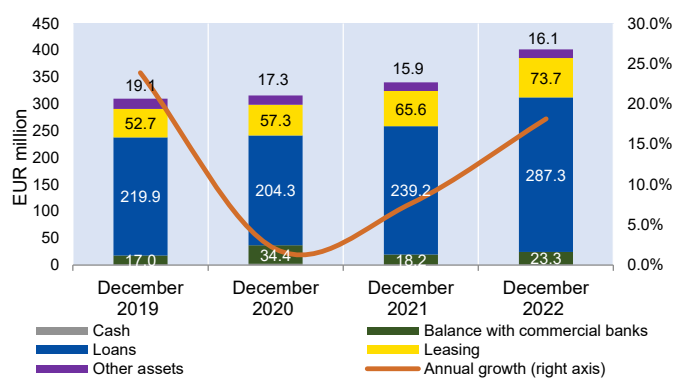
Source: CBK.

Chart 38. Written premiums and claims paid



Source: CBK.

Chart 39. Assets of the microfinance sector



Source: CBK.

microfinance sector is expected to face increased funding costs due to the increase in base interest rates as part of the monetary policies applied by a large number of foreign countries in terms of managing inflation. These dynamics can be reflected in the increase of interest rates for loans, due to the high dependence on financing the activity from external borrowings (61.1% of liabilities and equity).

Assets

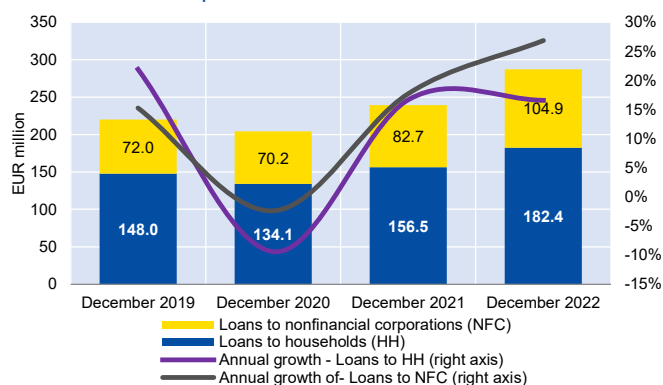
Assets of the microfinance sector recorded an accelerated annual growth of 18.1% in December 2022, reaching the value of EUR 401.7 million at the end of the period (chart 39). The main contribution to this increase was the increase in lending (71.5% of assets) and to a lesser extent the increase in leasing; which were characterized by double-digit growth in the last two years. Lending activity of the sector continued to be supported by borrowings (credit lines) abroad which increased by 21.1%. Also, the contribution to the increase of the sector's activity was given by the increase of the capital level, mainly through the profit retained over the years and the profit realized during 2022, components which increased by 31.9% and 22.2%, respectively.

Loans

The credit activity of the microfinance sector recorded an accelerated growth in 2022 and it reversed the growth trend similar to the years before the outbreak of the pandemic (2015-2019).

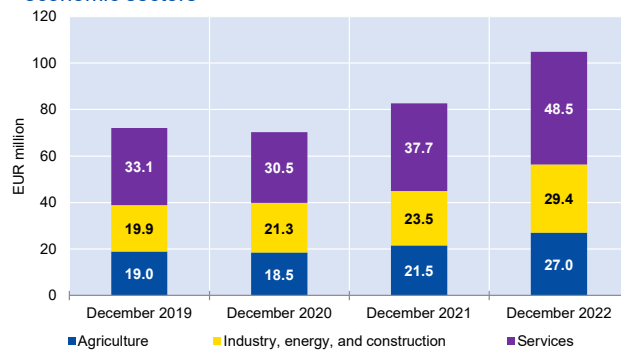
Total loans issued by the microfinance sector marked an accelerated growth of 20.1% in 2022, while their stock reached the value of EUR 287.3 million. Lending of the sector increased for both economic segments, namely for nonfinancial corporations and households.

Chart 40. Value of loans to households and to nonfinancial corporations



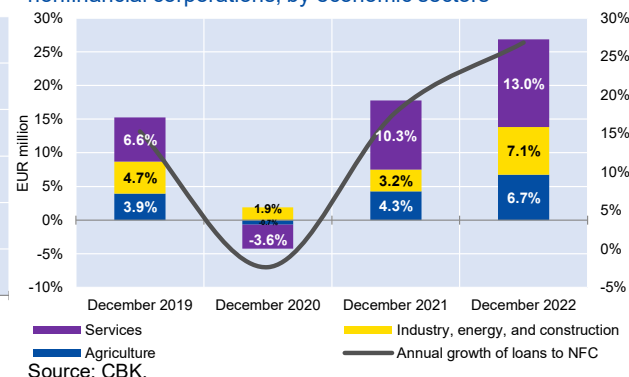
Source: CBK.

Chart 41. Value of loans to nonfinancial corporations, by economic sectors



Source: CBK.

Chart 42. Contribution to the growth of lending to nonfinancial corporations, by economic sectors



Source: CBK.

More specifically, lending to households marked an annual increase of 16.6% (an annual increase of 16.7% marked in 2021), reaching the value of EUR 182.4 million at the end of December 2022 (chart 40). Loans stock to nonfinancial corporations marked a value of EUR 104.9 million, representing an annual increase of 26.9% (an increase of 17.8%, in December 2021).

Lending to nonfinancial corporations by economic sectors has followed a general trend, marking an increase in each of the segments (chart 41). In contrast to the banking sector, the stock of loans to the agriculture segment has the largest weight to total lending to nonfinancial corporations of MFI-s/NBFI-s with 25.8%.

Moreover, this segment had the second highest contribution to the growth of total lending to nonfinancial corporations (chart 42), marking an annual growth of 26.0% in 2022 and reaching the value of EUR 27.0 million. The guarantee offered by the KCGF to cover the risk for loans to the agriculture sector for SMEs, had an impact on the increase of loans to the agriculture segment. The amount of loans approved by the KCGF reached EUR 506.3 million, or 23.9% more than in the previous year. As a result of the guarantees given by the KCGF, MFIs have responded positively to the requests for loans for this sector, which has a higher risk, due to the great dependence on climatic conditions and the risk of nature disasters. With a double-digit growth during this period, the segment of industry, construction and trade were characterized as well, similar to the trend of credit growth marked by the banking sector. Lending to the segment of other services, had the contribution and the highest growth during this period.

Leasing

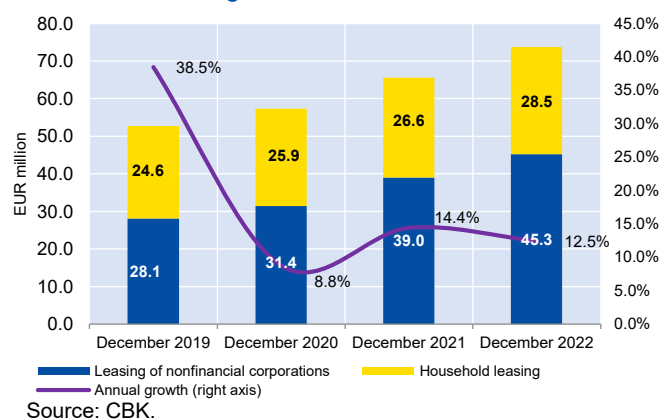
Leasing continue to be the second most important category in terms of weight in the assets structure of the microfinance sector (18.4%). Leasing activity for the second year in a row recorded a double-digit growth, and reached the value of EUR 73.7 million at the end of 2022 (chart 43). Nonfinancial corporations continue to make the main contribution to the increase in leasing, while the contribution of leasing to households was more limited.

Interest Rates

The average interest rate on issued loans by this sector was 18.6% in December 2022, or for 0.8 percentage points lower compared to the same period of the previous year (chart 44). Unlike the banking sector, which has a rate of almost three times lower due to the low cost of financing activities (through deposits), MFIs/NBFIs are mainly financed by loans received from the external sector, which have higher interest rates. The latest developments in the financial sector, namely the increase in the basic interest rates from the central banks, is expected to be reflected in the cost of financing the sector and potentially, it is translated into an increase of interest rate offered by this sector.

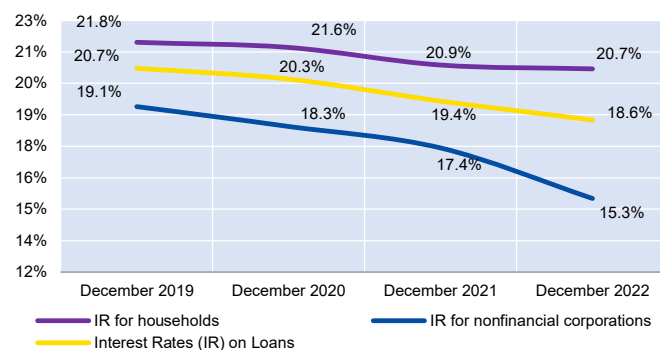
Interest rates on loans to households marked a decline of 0.2 percentage points, dropping to 20.7%. By loan categories, the average interest rate on consumer credit declined by 0.5 percentage points, reaching 22.4%. Meanwhile, mortgage loans continue to have the lowest interest rates, at an average of 17.3% in December 2022, marking an annual decline of 1.3 percentage points.

Chart 43. Leasing value of microfinance sector



Source: CBK.

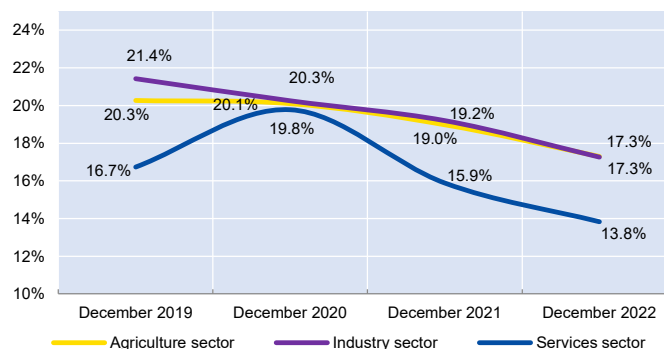
Chart 44. Average interest rate on microfinance sector loans



Source: CBK.

For nonfinancial corporations, average interest rates, on annual basis, decreased for all economic activities, with special emphasis on the services sector (chart 45). The interest rate on loans to the agriculture and industry sectors decreased by 1.7 and 1.9 percentage points, respectively, standing at 17.3% in December 2022. Meanwhile, loans to the services sector had the lowest interest rate, of 13.8%, marking an annual decrease of 2.1 percentage points. The guarantees given by the KCGF had also an impact on the decline of interest rates of loans to agriculture sector.

Chart 45. Average interest rate on loans to enterprises, by economic sectors

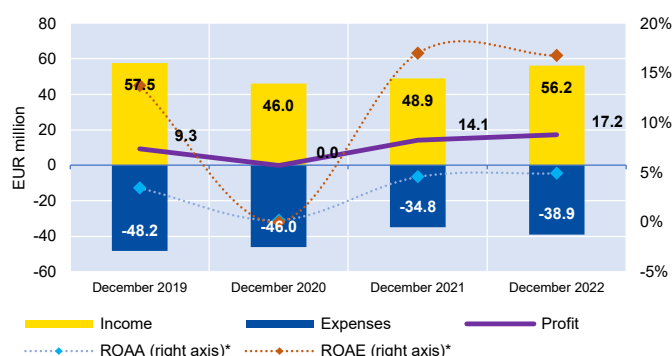


Source: CBK.

Performance of the microfinance sector

The microfinance sector in 2022 managed to record a net profit in the amount of EUR 17.2 million, recording at the same time the highest level of profit realized since the beginning of the operation in the local market (chart 46).

Chart 46. Profit and profitability indicators of the microfinance sector



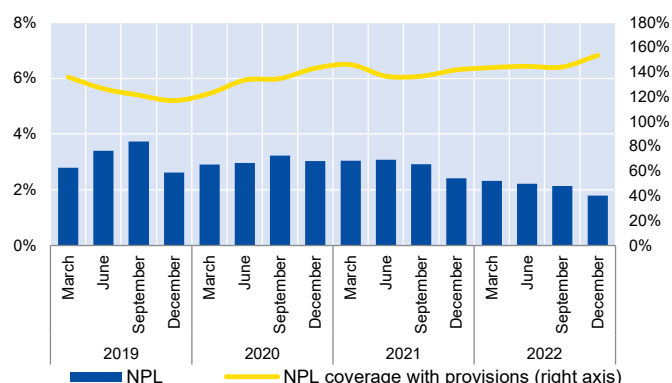
Source: CBK.

*The value of September 2022 is

The most emphasized increase of income (14.9%) compared to the level of the increase of expenses (12.0%) of the sector has influenced that MFI-s/NBFI-s realize a higher profit of EUR 3.1 million compared to the previous year.

Within income, interest income, representing the dominant category of income (89.8%), recorded an annual increase of 15.9% (an increase of 3.0% marked in 2021), as a result of the significant increase in lending, in the last two years. The category of non-interest income in 2022 increased by 7.2%, albeit their contribution to the increase in total income was limited due to the low weight in total income (10.1%).

Chart 47. Indicators of loans portfolio quality



Source: CBK.

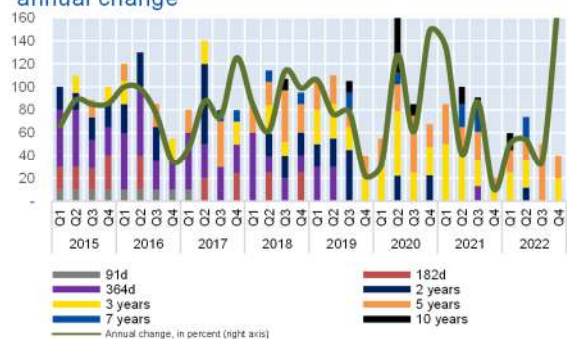
In the context of expenses, in the category of non-interest expenses, the growth recorded was mainly attributed to personnel and administrative expenses. This category marked an annual increase of 18.3% (7.7% in the previous year), which may be attributed to the increase of expenses for employees, and to a lower extent to administrative expenses. Moreover, the increase in the number of personnel as well as the increase of salaries to compensate to some extent the high inflation that has prevailed in most of the year 2022, have contributed to the growth of this subcategory of non-interest expenses. Meanwhile, the category of interest expenses (21.7% of total expenses) recorded an annual increase of 5.6% in 2022 (-37.0% in the previous year), reflecting the

increase in the level of loans from the external sector. The level of nonperforming loans to total loans remains low and it further declined by 0.6 percentage points, dropping to 1.8%. Whereas, the coverage level of nonperforming loans with loan loss provisions, in December 2022, reached 153.2% (141.6% in 2021) (chart 47).

Kosovo’s Government securities market

Issuance of government securities in December 2022 was significantly lower compared to the previous year, while the demand to invest in these securities continued to exceed the supply side of the government. In line with the lengthening of issuance maturities, also the average interest rate was increased, which among others it also reflects the narrowing of the demand/supply gap, as well as the global tendency marked at the end of the year.

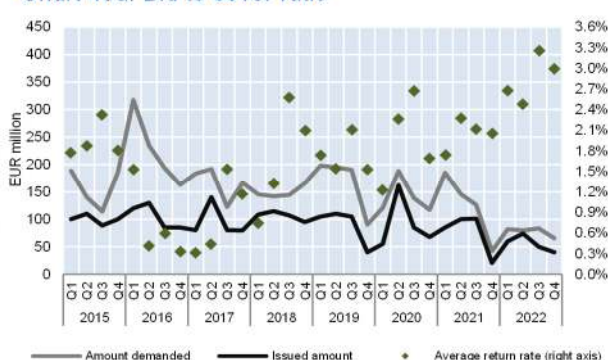
Chart 48. Amount and maturity of issued debt, annual change



Source: Ministry of Finance, Labor and Transfers.

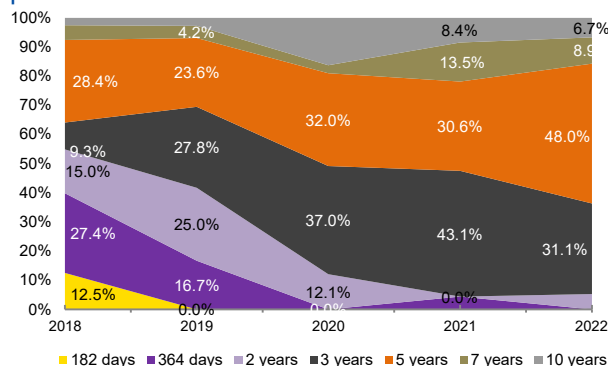
Until December 2022, Kosovo’s Government issued debt with a value of EUR 223.8 million, which is for 24.5% less than in the previous year (chart 48). Meanwhile, the demand to invest, in the absence of investment alternatives for asset diversification, has continuously exceeded the supply, albeit this ratio was lower than in the previous year. The demand for securities of Kosovo’s Government was 1.39 times higher than the amount offered by the Government, while in the previous year it was 1.63 times higher. The drop in the ratio reflects the most pronounced drop in demand by 37.8% compared to the previous year and also in the offer from the Government or the announced amount, which was 27.1% lower (chart 48a). The main investors in government debt in the form of securities are pension funds, which, this year have increased their share to total government debt to 49.0% from 44.0% in 2021, while commercial banks have reduced their share to 25.0% from 29.0%. Banks may have reduced the demand for securities, in the period when lending was at a relatively higher level. The average interest rate on securities during the period of January- December 2022 was 2.9%, marking an increase of 0.9 percentage points compared to the same period of the previous year. The increase of interest rate, among others, reflects the competition, namely the narrowing of the demand/supply gap. The structure of Kosovo’s Government securities over the years has undergone gradual changes towards the issuance of securities with longer maturities. During the period of Jan- December 2022, the structure was dominated with 48.0% by government bonds with a maturity of “5 years”, unlike in the previous year, when the issuances of “3 years” government bonds had a share of 43.1% (chart 49).

Chart 48a. Bid to cover ratio



Source: Ministry of Finance, Labor and Transfers.

Chart 49. Government securities structure, in percent



Source: Ministry of Finance, Labor and Transfers.

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