

Summary

- The euro area economy recorded a real growth of 0.1% in the first quarter of 2023, according to Eurostat, representing a slow growth that was mainly attributed to the high inflation rate, the decline in industrial activity and the deterioration of the world economic outlook. The inflation rate in Q1 2023 continued the growth trend, reaching 8.0%, prompting the ECB to increase the base interest rate for the fourth time within the first six months of the year. The inflation rate for 2022 was 8.4%, while ECB projections suggest a drop in inflation to 5.4% in 2023, and 3.0% in 2024. Whereas in Q1 2023, the real GDP of Western Balkan countries has recorded a slight increase of 2.8%, being impacted by the slowdown economic growth in the euro area and the increase in prices in international markets.
- **The real Gross Domestic Product (GDP) growth in Kosovo, in Q1 2023, was higher compared to the previous quarters of 2022.** Estimates of KAS suggest that Kosovo's economy marked an economic growth of 3.9%, in Q1 2023. Private consumption, investments and export of services contributed positively to the real economic growth, while the decline of goods export and the increase of services import had a negative impact. A same increase of the economic activity is estimated to have characterized also Q2 2023. Investments are estimated to have had a positive effect on overall economic activity, while consumption growth slowed down, mainly due to high inflation rate. Despite the significant decrease, inflation rate continues to remain high, affecting negatively the consumers' purchasing power.
- **Kosovo's budget has recorded a positive primary budget balance in Q1 2023,** as a result of the higher growth of budget revenues compared to expenditures, while public debt has declined to 18.1% of GDP, compared to the level of 20.3%, marked in Q1 2022. The improvement of the government's budget balance and the increase in nominal GDP, which reduces the debt to GDP ratio, mainly influenced the decrease in the level of public debt.
- Inflationary pressures eased in Q1 2023 with headline inflation decelerating as a result of easing supply chains and commodity prices in international markets, and slowing the domestic consumption in the country. A slower growth was observed in most of the components in the consumer's basket, while energy prices fell to their levels that were recorded before the war started in Ukraine. Also, core inflation showed signs of slowdown increase in Q1 2023, after it had recorded the highest rate in December 2022,
- Current account recorded a negative balance of EU 225.5 million in Q1 2023, a dynamic which was mainly 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, thus declining the income from this category. 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, being represented by remittances, recorded an increase of 12.4%, reaching EUR 271.3 million.
- The financial system has been characterized by stability and without any materialized risk despite the fluctuations in the international financial markets as a result of the failure of several medium-sized banks in the USA and a bank of overall global systemic importance in Europe.
 - **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. Compared to the same period of the previous year, the banking sector has improved the main financial soundness indicators, increasing the sector's capacities to absorb potential shocks in case of crises that can be generated (mainly from abroad). In Q1 2023, lending activity was the main contributor to the increase in assets of the financial system, followed by investments in securities. Tightening of monetary policies since the previous year was reflected in an increase of interest rates in loans and deposits also in the domestic market. The increase of interest rates on deposits has had an impact on the increase of deposited assets, where the increase rate reached a record level marked in the last 13 years, for all the segments (household deposits, nonfinancial corporations and other financial corporation deposits).
 - **The pension sector** recorded a slowdown in growth and a lower level of gross return from investments compared to the first quarter of the previous year, mainly as a result of unfavorable dynamics in the international financial markets, however compared to the first quarter of 2022, the financial performance of the pension sector marked an improvement. Income collected from the contributors have increased, compared to the same quarter of the previous year and represent a stable funding source, especially in periods when the pension sector results in negative returns from investments (caused by shocks in the global economy, and especially in the financial sector).
 - Insurance sector was characterized with an approximate level of assets increase as in the previous year, being supported by the high level of collected premiums. Claims paid during this period were higher compared to the previous year, albeit the significant increase of received premiums has had an impact on the sector to further improve its financial position compared to the previous year statement.
 - **Microfinance sector** was characterized with an accelerated increase of assets, mainly being attributable to the increase of lending activity and to a lower level the increase of leasing, which primarily were financed by loans from the external sector (credit lines). Financial soundness indicators also show a stability of the sector in general, while the financial result was similar to the first quarter of the previous year, as a result of the higher growth of expenses compared to income. In the following periods, the dynamics of the increase in interest rates in the international markets are expected to be reflected in the increase of financing costs for the microfinance sector.

Contents

| | |
|--|----|
| Summary | 0 |
| Euro area and Western Balkans | 2 |
| Main commodity prices in international markets | 3 |
| Economic growth..... | 4 |
| Prices | 6 |
| Fiscal Sector | 8 |
| External Sector..... | 9 |
| Financial system | 13 |
| 1. Banking Sector..... | 13 |
| Lending..... | 14 |
| 1.1. Liabilities and own resources | 16 |
| 1.2. Interest rates | 17 |
| Pension sector | 20 |
| Insurance sector..... | 22 |
| Microfinance sector | 23 |
| Loans..... | 24 |
| Kosovo's Government securities market | 27 |

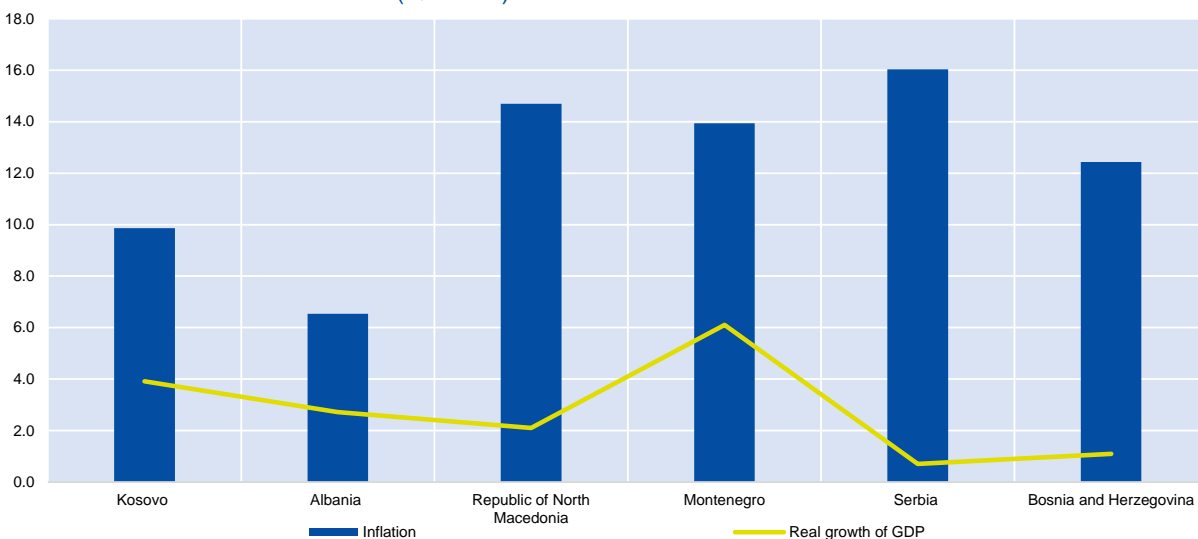
Euro area and Western Balkans

The euro area economy marked a growth of 0.1% in the first quarter of 2023, according to Eurostat, a slower but positive increase, given the expectations for a possible recession. The high inflation rate, the decline in industry activities and the deterioration of the world economic outlook were some of the main factors of the weakening of the general economic activity. The economy of the euro area has been significantly affected by the apparent increase in consumer prices, a dynamic that was accompanied by a decrease in the final household expenditures of consumption. Furthermore, the tightening of monetary policy by the European Central Bank, the fastest in more than two decades, has affected the level of confidence in businesses and consumers. Within the larger economies of the euro area, Germany has recorded a decrease in economic activity of 0.3%, mainly attributed to the decrease in household consumption. **ECB projections for economic growth in the euro area were revised downward in June against the projections of March, to 0.9% for 2023 and 1.5% for 2024.**

The inflation rate, in Q1 2023, has continued the growth trend, reaching 8.0% (6.1% in Q1 2022), mainly influenced by the increase in food prices. In June 2023, for the fourth time within the first half of the year, the ECB proceeded with the increase of three key ECB interest rates: the interest rate on deposits (to 3.5% in June 2023), the rate on refinancing the operations (4.0% in June 2023) and the marginal lending rate (4.25%). Moreover, the increase of interest rate will continue also in the second half of 2023, according to the ECB, until prices normalize and the inflation is curbed. **The inflation rate for 2022 was 8.4%, while the ECB projections suggest a slower increase of prices and of inflation rate to 5.4% in 2023 and 3.0% in 2024.**

The slowdown in economic growth in the euro area and the increase in prices in international markets affected the general economic dynamics in the countries of the Western Balkans, reflected through high inflationary pressures and weakening of demand. In Q1 2023, real GDP in the region countries marked an increase of 2.8% (4.7% in Q1 2022). IMF projections suggest that the Western Balkan countries are expected to record an economic growth of 2.1% in 2023 and 3.2% in 2024. The average inflation rate in Q1 2023 in the countries of the region turns out to have been 12.3%, with the highest rate recorded in Serbia of 16.0% and in the North Macedonia of 14.7%, while Albania recorded the lowest inflation rate with 6.5%. In an effort to combat the inflation hikes, Central Banks in the region countries have increased the base interest rate in Q1 2023 (chart 1).

Chart 1. Western Balkan countries(Q1 2023)



Source: CBK.

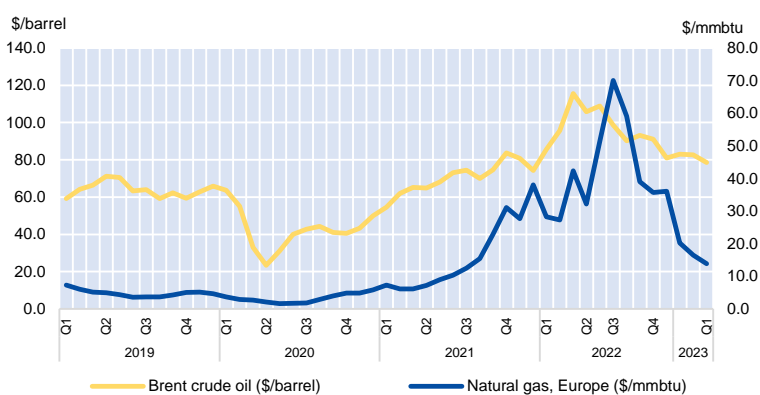
In Q1 2023, the currency exchange market of the EUR against the currencies of the trading partners, namely of British pound and Turkish lira was appreciated. The value of EUR currency remained almost the same against the Serbian dinar and Macedonian denar, whereas it was depreciated against the Albanian lek and American dollar.

Main commodity prices in international markets

The prices of basic goods in the international markets eased in the first quarter of 2023, supported by the slowdown of the global economic growth after the tightening of monetary policies as well as the the continuous ease of obstacles in the supply chain bottlenecks. However, prices of basic goods in international markets remained high compared to their levels marked before the beginning of the energetic crises in 2021 and the war in Ukraine, and continued to be reflected in high consumer prices.

Prices of Brent crude oil, according to the World Bank, reached \$81.4 per barrel in Q1 2023, marking a decline of 17.7% compared to the same period of the previous year (\$99.0 per barrel, in Q1 2022) (chart 2). Whereas compared to the previous quarter, oil prices declined by 7.8% (\$88.4 per barrel in Q4 2022). Oil prices were relatively stable in the first two months of 2023, whereas in March declined at their levels as at end-2021. This decline came as a result of the slowdown in overall demand following the tightening of monetary policies and increased concerns about the challenges of the banking sector in the USA and the implications in financial markets. However, given the expectations of a slowdown in global demand throughout 2023 and the impact on oil prices, OPEC announced a reduction in oil production of 1.7 million barrels per day from May to the end of 2023, which affected the rise of the oil prices to \$84.1 per barrel in April 2023, which coincides with the level foreseen by the World Bank in terms of the Brent crude oil prices for 2023.

Chart 2. Oil and natural gas prices in international markets



Source: World Bank

Prices of natural gas in Europe continued to decline in Q1 2023, reaching their levels of the beginning of energetic crises in the mid-2021. In Q1 2023, natural gas prices reached a quarterly average of \$16.8 / mmbtu representing a decline of 48.4% compared to the same quarter of the previous year (\$32.6 / mmbtu in Q1 2022) (chart 2). Also, prices of natural gas marked a decline of 54.4% against the previous quarter when they had reached the quarterly average of \$36.9 / mmbtu. The price decline of natural gas came as a result of the increase of the import of liquefied natural gas (LNG) from the USA which supported in filling the reserves of natural gas in EU, thus mitigating the concerns of securing the supply during the winter. Moreover, the EU's efforts to increase efficiency and save energy, as well as the mild winter significantly influenced the reduction of the demand for the use of natural gas for heating, which was consequently reflected in the decrease in the price of natural gas.

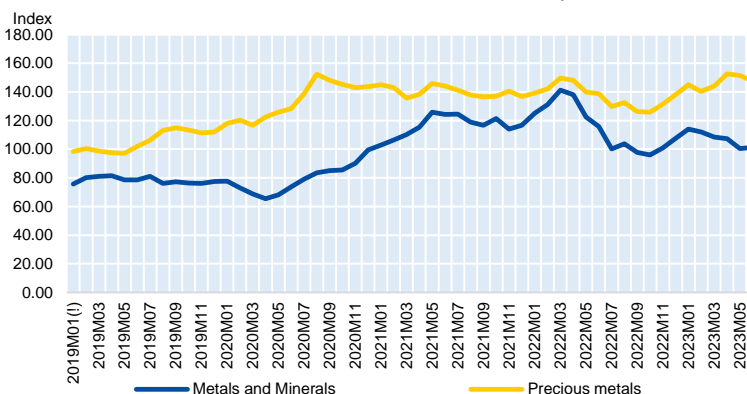
Metal and mineral prices marked a decline of 15.9% compared to same quarter of the previous year as a consequence of the slowdown of the global demand (chart 3). However, compared to the previous quarter, metal and mineral prices marked an increase of 9.8%, driven by market expectations of increased demand for metals following the reopening of China's economy, with the construction sector expected to make a strong recovery after subsidies granted to this sector. However, China's demand for metals was not as strong as expected, and thus alongside the slowdown in global demand, this affected metal and mineral prices to follow

a downward trajectory in March 2023. Similarly, the prices of precious metals increased by 8.6% compared to the previous quarter, thus reaching their levels at the beginning of the war in Ukraine when uncertainties increased, while in Q1 2023 uncertainties intensified after the challenges of the USA banking system as a result of the increase in interest rates. In addition, the price increase of precious metals was also affected by the weakening of the US dollar and increased demand for platinum and silver in the automotive, electronics, energy, and other industries.

In Q1 2023, the food price index according to FAO marked a relatively slight decline of -3.7% compared to the previous quarter (chart 4). Whereas, compared to Q1 2022, food prices decreased by 11.3% as a result of the progress of the agreement between Russia and Ukraine for the export of grain from Ukraine to international markets, higher yield, and the decline in energy prices. Consequently, an annual decrease of 36.2% was recorded in oil prices and 5.1% in grain prices, while dairy and meat prices, as well, recorded an annual decrease of 7.0 and 1.8%, respectively.

On the other hand, prices of sugar recorded an annual increase of 8.5% as a result of the reduction in global supply, the atmospheric conditions that negatively affected the harvest in Brazil, as well as the appreciation of the Brazilian currency real that affected the increase in the export prices of sugar. Despite easing supply chains and food prices in Q1 2023, Russia's breach of the agreement in July 2023, threatens the ability of ensuring food supplies for importing countries of grain and oil from Ukraine, as well as the further increases in the prices of these products and the intensification of inflationary pressures in the prices of other goods.

Chart 3. Prices of metals and minerals and of precious metals



Source: World Bank

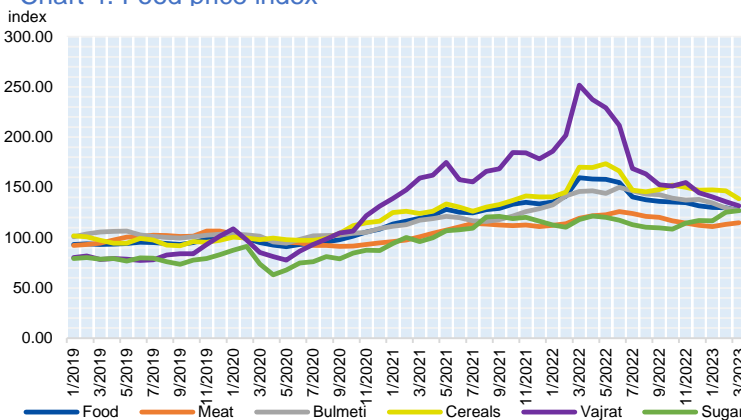
Kosovo's Economy

Economic growth

Economic activity in Kosovo, according to Kosovo Agency of Statistics (KAS) estimates, marked a real growth of 3.9% in Q1 2023 (chart 5). Domestic demand of net exports still contributed positively to the real GDP growth with 1.0 and 2.9 percentage points, respectively.

Consumption contributed with 0.6 percentage points to the real GDP growth rate, marking a lower contribution compared to the previous quarters. The slowdown increase of consumption has mainly influenced the decline of consumers purchasing power, due to the prices increase,

Chart 4. Food price index



Source: FAO.

due to the prices increase,

while the main financing sources such as remittances, new consumer credit, public consumption, etc., marked an increase. Investments gave a positive contribution, as well, with 0.4 percentage points to the real GDP growth rate, mainly as a result of the increase of FDI and public investments. Concerning the external trade, net exports contributed positively with 2.9 percentage points to the real GDP growth. The highest contribution came from the export of goods and services, which gave a positive contribution with 4.8 percentage points, while import contributed negatively with 1.9 percentage points.

Chart 5. Real GDP growth rate and main contributors to the growth



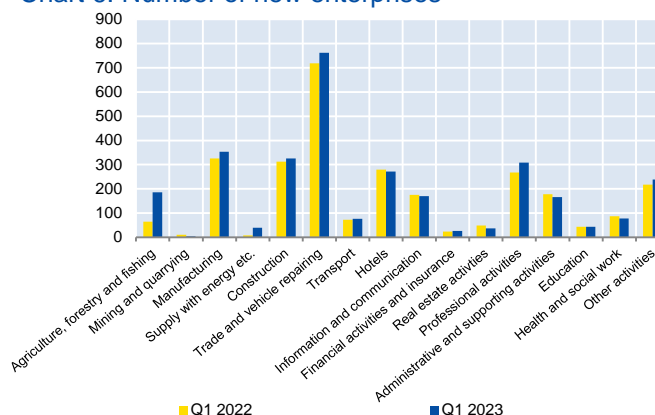
Source: KAS and CBK calculations.

The increase of the economic activity in Q1 2023 was mainly supported by the increase in the added value in the trade sector (9.8%), the sector of the processing industry (9.2%), the sector of financial and insurance activities (7.4%), etc. Business turnover data confirm this increase, where the turnover in the trade sector has increased by 10.1%, while in the processing industry sector it has increased by 7.6%. The activity of the financial and insurance sector has marked a significant increase of 22.3%. Conversely, the construction sector, due to the cost increase of construction, was characterized with a weak performance during the previous year. However, in Q1 2023, due to the slowdown of cost increase of construction, this industry marked an increase of added value with 1.4% and an increase of its turnover with 12.4%.

Economic activity was also reflected in the number of registered enterprises, which reached 3,086 enterprises in Q1 2023, namely 9.0% more compared to Q1 2022. Trade, manufacturing, construction, professional activities, hotels and other sectors, marked the highest number of registered enterprises (chart 6). These sectors showed a significant increase in the number of enterprises compared to the same period of 2022 (chart 6). On the other hand, during Q1 2023, 446 enterprises were closed, representing a reduction of the number of enterprises of 9.9% compared to Q1 2022.

Concerning Q2 2023, it is estimated to have been marked a similar increase of the economic activity. **CBK forecasts suggest an economic real growth rate of 4.0%.** Domestic demand is estimated as the main factor that has contributed to the economic growth during this quarter. Investments are estimated to have had a positive effect on overall economic activity, while consumption growth slowed down, mainly due to high inflation rate. Although inflation has decreased significantly, it continues to remain high, affecting negatively the consumers' purchasing power. Regarding the external trade, it is estimated that net exports have had a negative impact on the increase of the economic activity.

Chart 6. Number of new enterprises

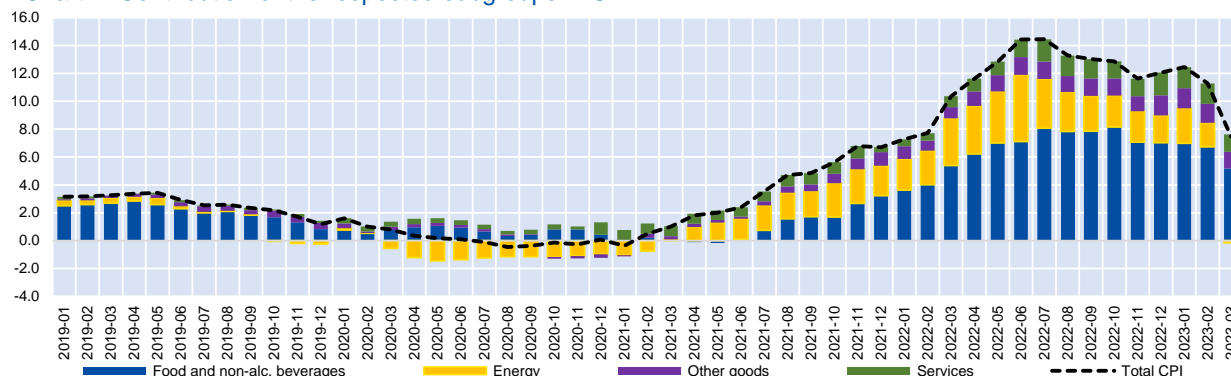


Source: KAS.

Prices

Annual inflation rate reached 9.9% in Q1 2023 from 12.1% as it was in the previous quarter. Despite of the base effect and the slowdown increase of prices of goods in the international markets, the slowdown increase of prices in the country is attributable also to the slowdown level of consumption in the country. Although there was a slowdown in price increase in most of the components of the consumption basket, the inflation rate continues to remain high as a result of high prices of food, non-food goods, non-energy prices and prices of services (chart 7). On the other hand, the slowdown increase and possibly the decline of oil prices, in March 2023, had a positive effect in curbing the inflation.

Chart 7. Contribution of the respected subgroups in CPI



Source: KAS and CBK calculations.

Food prices marked an annual increase of 17.6% in Q1 2023, which represents a slowdown increase of prices of food against the annual increase of 20.5% marked in the previous quarter. A higher annual growth was recorded in prices of milk, cheese and eggs (24.6%), which comprises a category that marked an increase within the consumption basket for the year 2023. Also, a significant increase was noted in prices of bread and cereals (17.9%), meat (17.7%), sugar, jam, honey, chocolates and sweets (17.2%), oils and fats (17.0%), and others.

Prices of electricity and other fuels within the housing category recorded an average annual increase of 14.4% in Q1 2023, but slowed down compared to the previous quarter (18.4% in Q4 2022) as a result of the mild winter and the slowdown in prices of energy in international markets. Similarly, transport prices recorded an annual growth of 6.0% in Q1 2023 (10.9% in Q4 2022), with the subcategory of operation of personal transport equipment which marked a slower growth of 4.1% against 15.6% in Q4 2022, as a result of the decline of fuel prices in international markets. The highest annual increase within the category of transport was marked in the prices of transport services (15.1%).

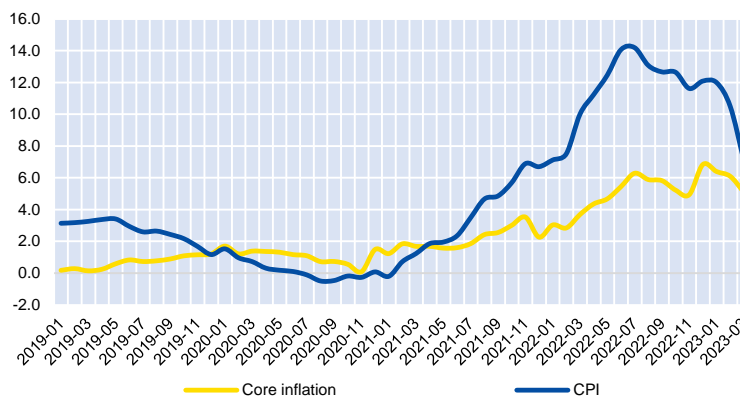
The contribution of food to the average inflation rate in Q1 2023 was 5.9 percentage points, with the highest contribution marked by the increase in the prices of milk, cheese and eggs with 2.0 percentage points, bread and cereals with 1.5 percentage points, meat with 1.4 percentage points, and others. Whereas, the contribution of transport to general inflation in Q1 2023 was 1.0 percentage points (a slowdown of 1.7 percentage points, in Q4 2022), with a 0.4 percentage point contribution from the subcategory of operation of personal transport equipment, where fuel is mostly included. An increase was also marked in the contribution of the purchase of vehicles and transport services in Q1 2023, where the contribution of both categories was 0.3 percentage points each.

Whereas, the contribution of prices of goods marked an increase of 0.1 percentage points reaching 1.3 percentage points in Q1 2023 compared to the previous quarter, mainly as a result of the price increase of alcoholic beverages and tobacco. However, in March there was a slowdown of the contribution of goods prices

with 1.2 percentage points, given the reduction of the contribution of all categories of goods, with the exception of the contribution of alcoholic beverages and tobacco which remained almost unchanged. The quarterly average contribution of services to total CPI remained unchanged compared to the previous quarter (1.4 percentage points), however, in monthly terms there was also a decrease in the contribution of services, which slowed down to 1.2 percentage points, in March 2023. This slowdown in the contribution of goods and services came as a result of the slowdown in the prices of transport, hotels and accommodation services, marked in March.

Core inflation, in Q4 2022, marked an annual increase of 5.9%, which compared to the previous quarter, represents a slowdown of 0.2 percentage points (chart 8). Primarily, the contribution to the increase of core inflation was marked by the category of 'furniture, household appliances and house maintenance' with 1.6 percentage points and by the category of 'transport services' with 1.5 percentage points. However, core inflation is following the downward trend, albeit at a slower pace, slowing to 5.1 percent in March 2023 after having reached the peak of 6.8%, in December 2022.

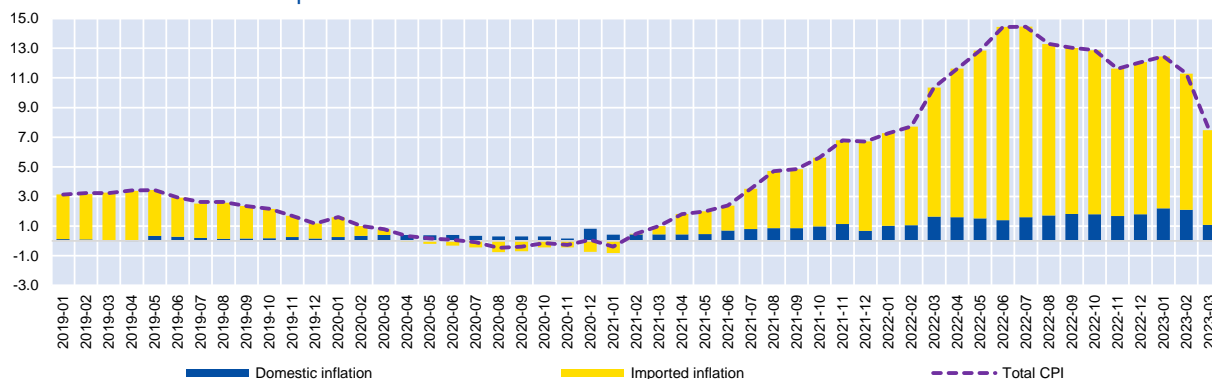
Chart 8. Core and headline inflation of consumption



Source: KAS and CBK calculations.

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, have had an impact on the inflation rate in Kosovo and is largely determined by the prices of imported goods. In Q1 2023, 8.3 percentage points of inflation in Kosovo was imported, while 1.6 percentage points was generated by internal inflationary pressures (chart 9). As a result of the continuous easing of prices of basic goods in international markets, imported inflation in Q1 2023 showed a slowdown pace compared to the previous quarter, which was consequently also reflected in the curbing of domestic inflation.

Chart 9. Domestic and imported inflation



Source: KAS and CBK calculations.

Fluctuations in the prices of basic goods in international markets, reflected in Kosovo through the prices of imported goods, are summarized through the import price index (IPI), which in Q1 2023 marked an annual increase of 8.7%, representing a slowdown increase against the annual growth of 13.1% marked in Q4 2022. Compared to Q1 2022, the highest weighted categories within this index include i) prepared food items,

beverages and tobacco, ii) mineral products, iii) base metals and related items, and iv) machinery and electrical equipment recorded an annual growth of 7.8%, 12.8%, -1.3%, and 5.7%, respectively. Whereas, compared to the previous quarter, IPI recorded an increase of 1.1%, as a result of the acceleration of the prices of i) plant products, ii) prepared food items, beverages and tobacco, iii) machinery and electrical equipment, iv) transport means, and others.

The producer price index (PPI) resulted in a decrease of 0.1% in Q1 2023 compared to the same quarter of the previous year as a result of the decrease in the production price i) electricity, gas, steam and air conditioning supply (an annual decline of 14.8%), ii) metals (-2.5 percent), manufacturing of iii) fabricated metal products, except for machinery and equipment (-3.1 percent), as well as the slowdown in the prices of other components with a significant weight in the PPI such as the production of non-metallic mineral products and rubber and plastic products. Compared to the previous quarter, the CPI resulted in an increase of 3.2% mainly as a result of the growth, which nevertheless was a slowed down increase of the prices of production of non-metallic mineral products and the acceleration of the prices of i) production in ore and quarry, ii) processing of food products, iii) production of drinks, and others.

The Construction Cost Index (CCI) recorded an annual increase of 3.3% in Q1 2023, driven by the increase in the prices of transport (an annual increase of 16.4%), machinery (11.1%), other costs with annual increase of 10.1%, and others. On the other hand, the acceleration of this index, in Q1 2023, was neutralized partially by the annual decline in prices of energy of 14.9%. Whereas, in relation to the previous quarter there was observed a decline in CCI of 1.3%, mainly as a result of the price decline of transport, construction and electrical materials, and wages.

Regarding the perspective of inflation in Kosovo, the CBK forecasts show that inflation in 2023 will slow down to 2.7%, and for the year of 2023 at 4.8%. 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 are on the upside direction and mainly consist of risks of new disruptions in supply chains as a result of the war in Ukraine, rising of food prices following Russia's violation of the agreement on grain exports from Ukraine, increase in the prices of oil in foreign markets and reduction in the amount of production by OPEC+, shift in inflation expectations, pressures for wage increases, and others. As regards to the banks' expectations for annual inflation in Kosovo for 2023, these have declined to 5.4% in June from expectations for annual inflation of 6.4% in March 2023.

Fiscal Sector

Budget revenues¹, in Q1 2023, reached a net value of EUR 658.5 million, representing an annual increase of 21.4%. The increase of budget revenues was mainly a result of the high inflation rate, which was reflected mainly in indirect taxes, as the main category of budget revenues. Also, Capital expenditures² marked an increase of 14.4% and reached the value of EUR 489.9 million. Consequently, Kosovo's budget recorded a primary positive balance of EUR 168.5 million.

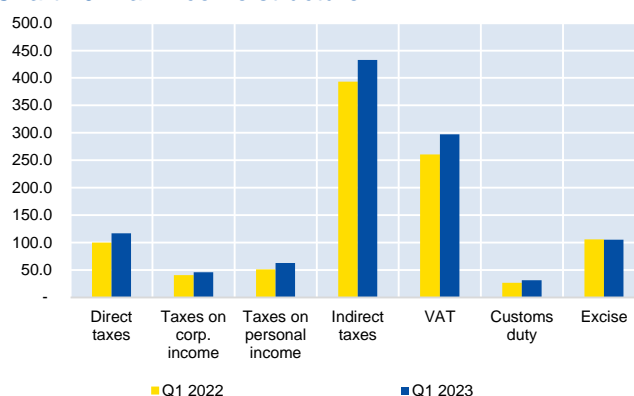
Tax revenues reached a value of EUR 534.1 million or 10.7% more compared to Q1 2022. Within tax revenues, almost all the categories have marked an increase. With a higher increasing rate were

¹ Within the budget revenues it is also included the EU grant of energy with a value of EUR 67.5 million, whereas the receipts from financing and receipts from designated donor grants are not included.

² Within the primary income were not included the revenues from borrowings, income from privatization and donor defined grant receipts.

characterized direct tax revenues, which reached a value of EUR 116.8 million or 16.8% more compared with Q1 2022. Within this category, personal income tax, which comprises the main category, marked an annual increase of 23.1%, while corporate income tax, marked an annual increase of 11.7%. Indirect tax revenues marked an increase of 10.2% and reached the value of EUR 433.1 million. Within indirect taxes, VAT income and customs duty marked an increase of 14.1% and 16.4%, respectively, being significantly affected by increase of prices. Whereas, as a result of the decline of the quantity of import, income from excise tax marked a slight decline of 0.8% (chart 10). Unlike tax revenues, **non-tax revenues marked a decline of 5.6%, reaching the value of EUR 56.9 million.** Within non-tax revenues, the revenues from the central government reached the value of EUR 30.4 million, marking a decline of 22.9%, while the revenues from the local government increased by 35.3%, amounting to EUR 14.9 million.

Chart 10. Tax income structure

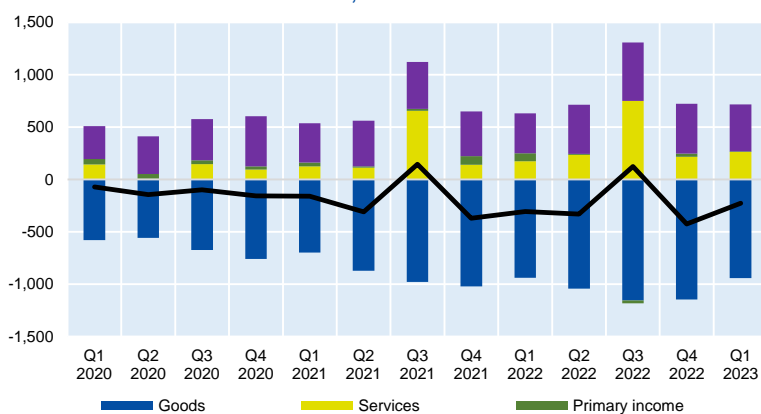


Source: MFLT and CBK calculations.

Regarding budget expenditures, current expenditures increased by 14.4%, while capital expenditures increased by 44.6%. Within current expenditures, subsidies and transfers marked an increase of 21.2%, reaching the value of EUR 207.4 million. Government expenses on salaries marked an increase of 10.2%, reaching the value of EUR 181.0 million, while government expenditures on goods and services (including municipal expenditures) marked a decline of 5.9% and reached the value of EUR 61.1 million. Capital expenditures marked an increase of 44.6% and reached the value of EUR 40.5 million.

Debt to GDP ratio was 18.1% in Q1 2023, compared to 20.3%, as it was in Q1 2022. 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 1.76 billion in Q1 2023, which is 4.7% higher compared to Q1 2022. The increase of public debt is attributed to the growth of external public debt of 14.9% reaching EUR 644.8 million, while domestic debt marked a decline 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 (15%), International Monetary Fund (8%), etc. Whereas, domestic debt primarily is comprised of Kosovo's Government debt to pension funds (49%), commercial banks (24%), public institutions (20%), etc.

Chart 11. Financial account, EUR million



Source: CBK.

External Sector

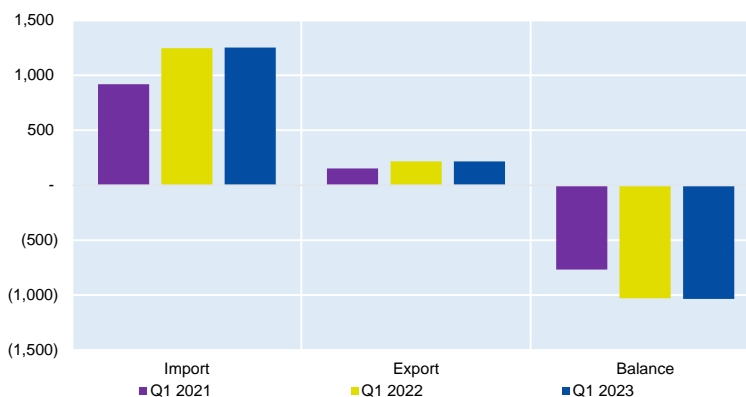
Current account, in Q1 2023, marked an annual decline of the negative balance of 26.7%, reaching EUR 225.5 million. Dynamics in the current account in the first quarter of 2023

continued to be determined mainly by the developments in the trade balance of goods (chart 11). Within the current account, primary income marked a negative balance, while the secondary income and services had an impact on the reduction of the negative balance of the current account.

Trade balance of goods in Kosovo in the first quarter marked an annual increase of trade deficit of 0.7%, reaching EUR 1.04 billion. The main reason for the increase in the trade deficit is related to the high value of goods import, a dynamic that mainly was impacted by the increase in prices in international markets. The economy of Kosovo turns out to have imported an amount of EUR 1.25 billion, while in the same period, it exported in the amount of EUR 217.1 million (chart 12). Exports have covered import by only 17.3%, representing a trade ratio of 1:5.7. The high rate of trade deficit increases the sensitivity to the dynamics in the international markets.

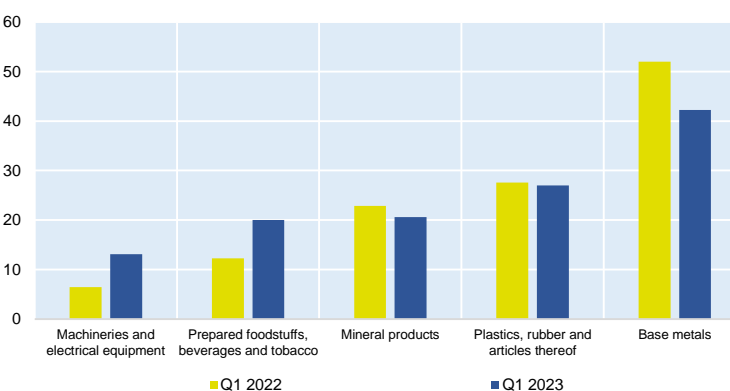
The total value of export was EUR 217.1 million, in Q1 2023, representing a decline of 0.1% compared to the same period of the previous year. The slight decrease in exports was mainly influenced by the export of base metal products, which recorded a decrease of 18.7% and recorded a value of EUR 42.2 million, a decrease that is mainly attributed to the weakening of external demand as a result of high metal prices. To the decline of export an impact was also given by the category of other manufactured articles, a category which marked a decline of 56.5% and reached the value of EUR 25.2 million. The main export trading partners in Q1 2023 were: Western Balkans with 39.3%, and EU countries with 32.9% of total exported goods. The structure of goods by categories remains unchanged, where the economy of Kosovo exports base metals with the main focus on the countries of the region, followed by the category of plastic products including rubber and minerals which were exported mainly to EU countries (chart 13).

Chart 12. Trade balance of goods



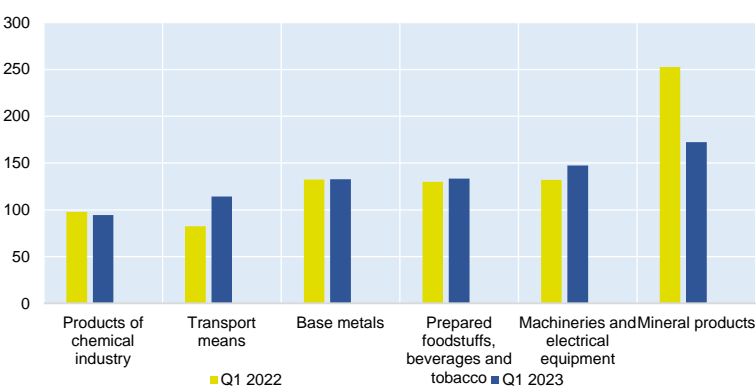
Source: KAS.

Chart 13. Main categories of goods export, EUR million



Source: CBK.

Chart 14. Main categories of goods import, EUR million

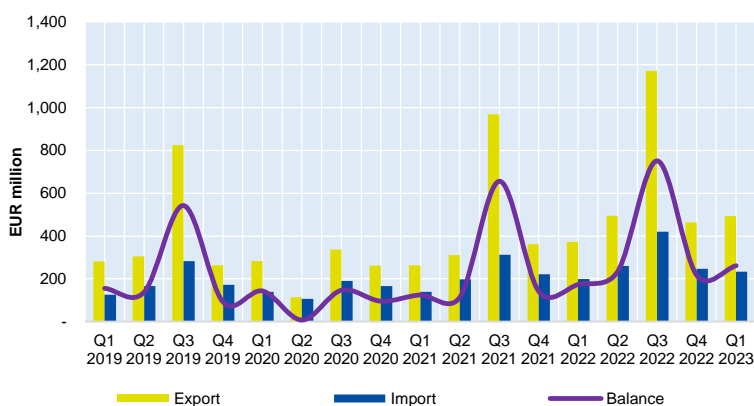


Source: CBK.

The value of imports, in Q1 2023, reached EUR 1.25 billion, representing an annual increase of 0.5%. The slight increase in the import of goods was influenced by the overall quantity and weight, marking an annual increase of 1.8% and 6.9%, respectively, being impacted, both, by the drop in prices of mineral products (EUR 80.2 million less than the category of import of mineral products), as well as from the weakening of the general demand in the country. The structure of imported goods continued to be dominated by import of mineral products, machineries including household appliances and food commodities. The share by the main categories of imported goods was dominated by the category of intermediate goods of 47.9%, consumer goods 33.3%, while the category of capital goods continues to remain low at 10.3% of total import (chart 14). According to the main economic categories, intermediate goods recorded a decrease of 14.0%, mainly influenced by price dynamics in international markets and the weakening of demand in the country, while the category of capital and consumer goods recorded an annual growth of 14.3 and 14.7%, respectively, mainly as a result of inflationary pressures. Around 43.9% of goods imported came from European Union countries (EUR 550.6 million), among which, Germany continues to have the main weight with 12.2% of total imports. Kosovo imported from the region countries 16.7% of total imports or EUR 208.8 million. Meanwhile, the import of goods from Turkey has reached the amount of EUR 180.3 million or 14.4% of the total imports.

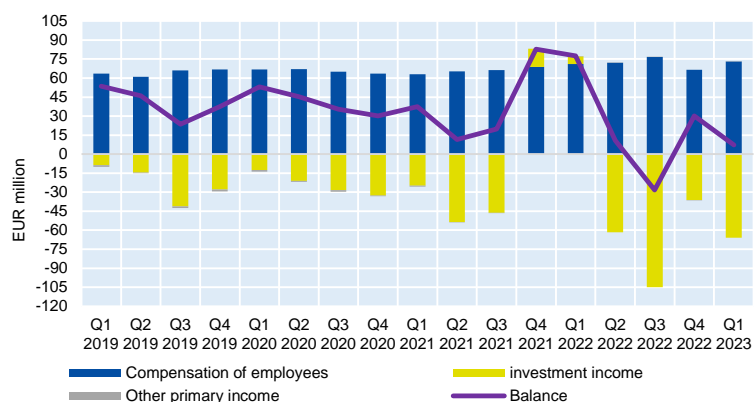
Services continued to increase their positive contribution within the current account, with an annual growth of positive balance of 50.6%, reaching the value of EUR 261.0 million, in Q1 2023. The export of services was mainly attributed to the growth of services in the travel category with 20.8%, a category which reached the value of EUR 330.5 million (chart 15). Export of computer services results to have marked an increase of 56.9%, reaching a value of EUR 57.9 million. On the other hand, the increase in import of services was attributed to the increase in travel and transport components, which comprise 60.9% of the total import of services.

Chart 15. Balance of services



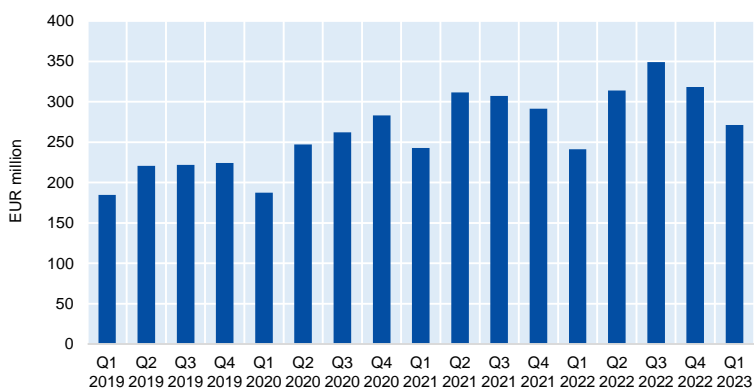
Source: CBK.

Chart 16. Balance of primary income



Source: CBK.

Chart 17. Remittances



Source: CBK.

The balance of primary income recorded a decrease of 90.7%, reaching the value of EUR 7.2 million (EUR 77.4 million in Q1 2022). The decrease in primary income was mainly influenced by the balance of income from investments, as a result of the return of dividend in the amount of EUR 64.5 million from direct investments. Meanwhile, the balance of income from employees' compensation has recorded an increase of 2.7%, being impacted by the increase in income from resident workers employed abroad (chart 16).

Chart 18. Foreign direct investments



Source: CBK.

The value of remittances received, in Q1 2023, reached EUR 271.3 million, representing an increase of 12.4% compared to the same period of the previous year. Structure of remittances by countries remains unchanged: Germany has a share of 38.8% of remittances, Switzerland with 17.2% and USA with 7.6% of total remittances received in Kosovo. Remittances by formal channels (banks and other institutions) have recorded an increase in the value of EUR 19.8 million, while there has been a slight increase in remittances through non-formal channels. Considering that the largest amount of remittances received in Kosovo have the main source the euro area countries (57.2%), the slowdown economic activity in the euro area may have implications on remittances received in Kosovo, and consequently in the economy of the country.

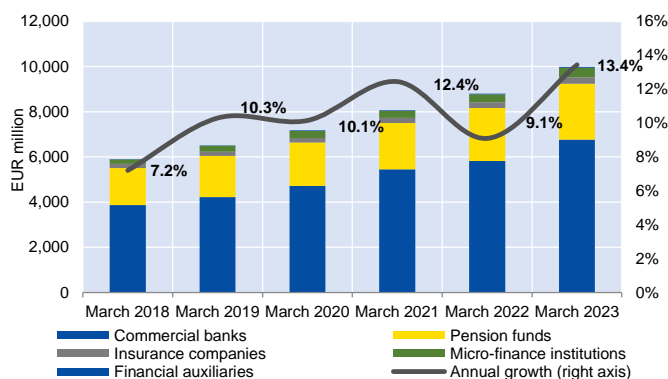
Foreign direct investments, in Q1 2023, result to have marked an increase of 62.8%, reaching the value of EUR 189.8 million. The increase of FDI was recorded mainly in the sectors of real estate, financial and insurance sector. The real estate sector covers 55.5% of total FDI or EUR 105.3 million. The increase of FDI value in the real estate sector is estimated to have been impacted mainly by the increase of prices in this sector. Foreign direct investments of residents from Kosovo in other countries have marked high increase in Q1 2023, reaching the value of EUR 49.1 million (EUR 31.2 million in Q1 2022), investments destined to the countries of the region and mainly oriented to the real estate sector (chart 18).

Financial system

Despite the challenges from the higher risks with which the economy was facing, such as increased inflation and the weaker economic outlook, the financial system in the country expanded with an accelerated pace.

Financial system assets in the country accelerated their annual growth for 4.4 percentage points against the previous year, and their value reached EUR 9.98 billion, at the end of March 2023. The accelerated increase was mainly impacted by the developments in the banking sector, while other sectors had a lower contribution to the increase of total assets of the financial system (chart 19).

Chart 19. Assets value of Kosovo's financial system



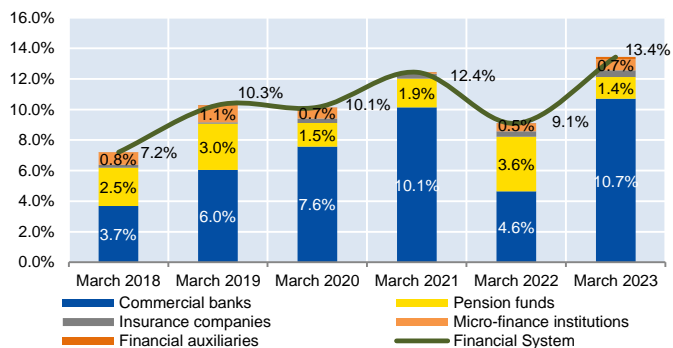
Source: CBK.

The banking sector, in March 2023, represented around 67.8% of total assets of the financial system, thus giving the main contribution to the expansion of the total assets of the financial system (chart 20). The second sector by weight to the financial system was presented by pension funds, which marked a slower increase of assets compared to the previous year (chart 20). Whereas other sectors, the one of microfinance, insurance and financial auxiliaries marked a double-digit increase of the activity, hence significantly contributing to total assets of the financial system, despite their low weight of share they have.

1. Banking Sector

Banking sector and the overall financial system is exposed to external risks as a result of geopolitical tensions which may escalate in Southern Europe, whereas the inflation remains the main risk. Although the situations that have an impact on the increase of inflation have softened and the monetary policies of central banks are having an effect, the consequences of inflation transmitted to other segments are still a concern, inflation is persistent (stable) and with a slow decline. The banking sector in Kosovo due to its weight, structure and low complexity, does have high exposure to the external sector and any potential consequences of any crises or panic in the financial sector would not put at risk the banking sector in a direct way. Whereas, the negative effects which come from inflation have a more direct impact in the domestic banking market, and the main soundness indicators of the banking sector should be monitored.

Chart 20. Contribution to assets growth of financial system, percentage points



Source: CBK.

Assets

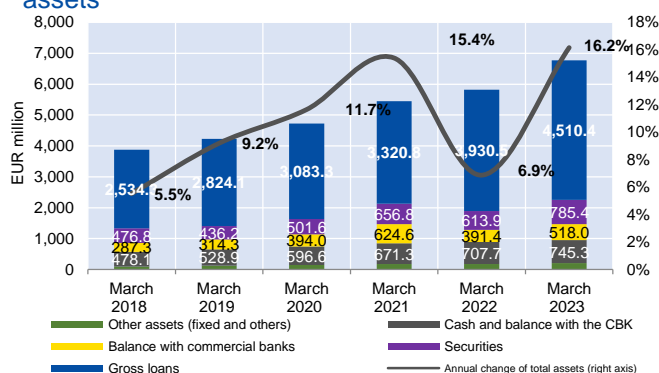
Banking sector assets reached the value of EUR 6.77 billion in March 2023, which corresponds with an accelerated annual increase of 16.2% compared to the increase of 6.9% in the same period of the previous year (chart 21). The main contribution to the growth was given by lending expansion which is the main activity of the banking sector. Investments in securities was the second component which contributed to the acceleration of assets increase, followed by the category of assets held at other banks. Both of these latter categories marked an accelerated increase compared to the annual decline marked in the same period of the previous year. However, the amount of cash and the balance with the CBK maintained the same level of annual growth of about 5.3%, and has a share of 11.0% in the total assets of the banking sector.

Lending

Lending activity of the sector marked an annual growth of 14.8%, which corresponds to a lower increasing rate compared to the previous year when it had been marked an increase of 18.4%. According to the Bank Lending Survey report, lending dynamics in the first quarter of 2023, were largely influenced by demands for loans, since credit supply had marginal positive changes in Q1 2023. These developments were the same as for enterprises and households, as well. Similar developments to the current quarter are also expected for Q2 2023, where the demand is expected to be the driver of the credit activity.

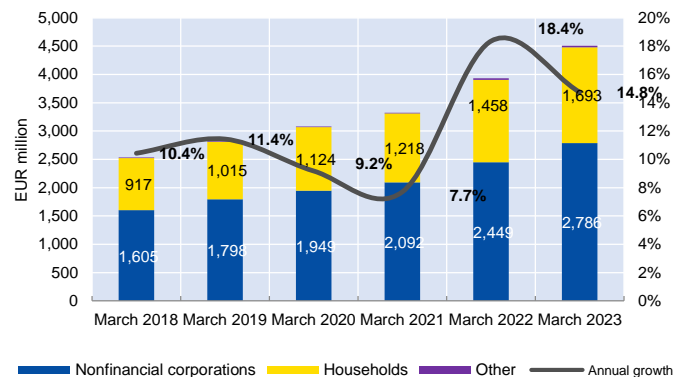
The segment of nonfinancial corporations recorded an annual loans stock of 13.8%, which coincides with the acceleration of the annual growth trend of 3.3 percentage points (chart 22). Meanwhile, loans to households recorded an annual increase of 16.1%, which compared to the previous year represents a slowdown in growth by 3.7 percentage points. Due to the higher share in total loans, the segment of nonfinancial corporations had the highest contribution to the growth of 14.8% of lending to the banking sector (chart 23).

Chart 21. Balance sheet of the banking sector - assets



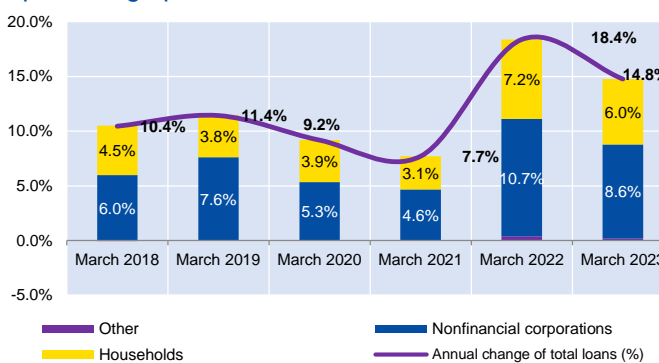
Source: CBK.

Chart 22. Stock of total loans, annual change



Source: CBK.

Chart 23. Contribution to the growth of total loans, in percentage points



Source: CBK.

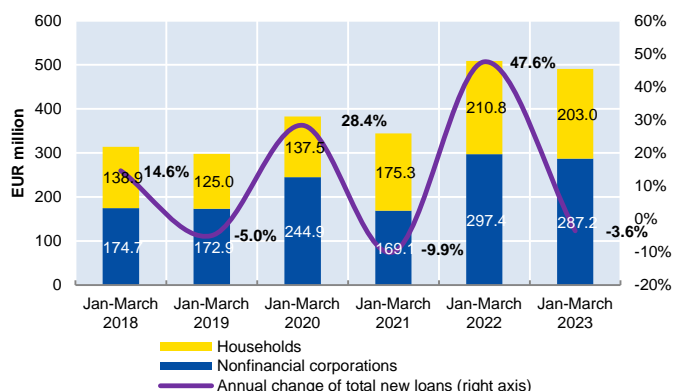
New loans in the first quarter of 2023 marked an annual decline of 3.6% (an increase of 47.6% in the first quarter of 2022). The high growth of new loans in the first quarter of 2022 had reflected their low base in 2021 (affected by the restrictive pandemic measures in that period), since the pandemic in the country emerged in the second half of March 2020, having a limited impact on the performance of new loans in the first quarter of 2020. Therefore, the level of loans issued during the first quarters of 2023 and 2022 reflects the real absorptive capacities of the domestic market - expansion through lending, and not necessarily the easing policies of banks (credit offer) or the large demand from the real sector.

Both segments of the private sector marked an annual decline of new loans during the first quarter of 2023. New loans to the household segment recorded a higher decline, albeit nonfinancial corporations had the highest contribution to the overall decline of 3.6% in new loans to the banking sector (chart 24).

Until March 2023, new loans to nonfinancial corporations declined by 3.4%. Loans with investments purpose marked a decline of 3.9%, whereas loans with non-investment purpose marked an annual increase of 4.6%. New loans to households marked a decline of 3.7% during the first quarter. New consumer loans marked an annual increase of 5.9% from the quarterly increase of 3.8% marked in the first quarter of 2022, while new mortgage loans marked an annual decline of 22.8%, for the first time in 11 previous years, for the reporting period (January-March). Also, compared to the first quarter of the previous year, there is a decline of foreign direct investments in the real estate segment (at EUR 105.3 million in Q1 2023 from EUR 111.7 million in Q1 2022). Moreover, also the component of construction within the Gross Domestic Product (GDP), for the first quarter of 2023, marked a slower real increase of 1.37% (3.04% in Q1 2022).

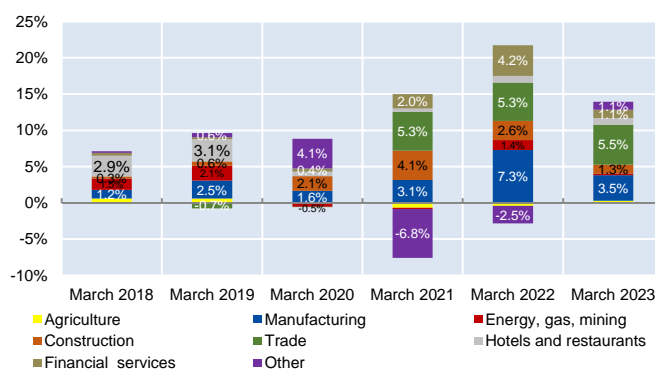
In terms of loans to nonfinancial corporations, lending to the trade sector was at the highest levels over the years, followed by the manufacturing and construction sector, which have gradually expanded in the recent

Chart 24. New loans, annual change



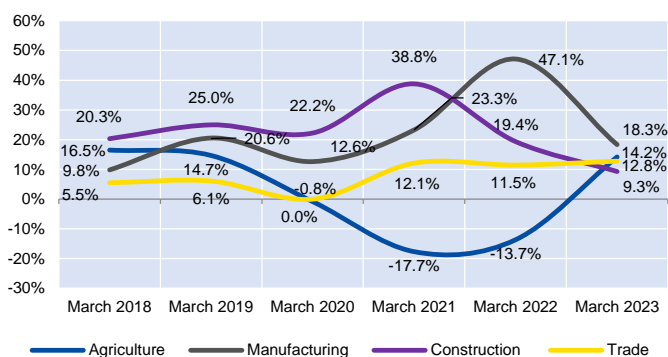
Source: CBK.

Chart 25. Contribution to the growth of total lending to nonfinancial corporations, by economic activity



Source: CBK.

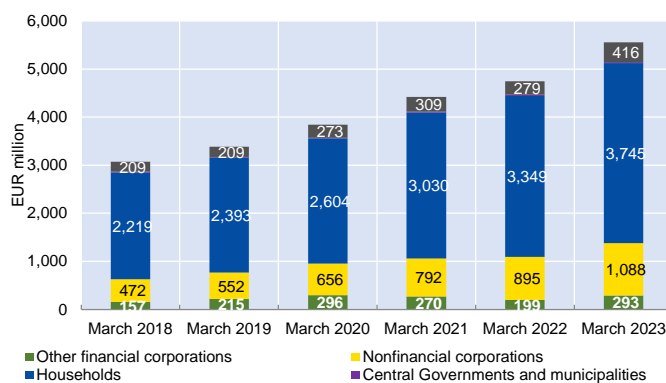
Chart 26. Annual change on loans to nonfinancial corporations, by economic activity



Source: CBK.

years, thus increasing their share in total loans of the banking sector. As at end of March 2023, lending to trade sector had the highest contribution to the growth of total loans to nonfinancial corporate segment (chart 25), as a result of annual growth of 12.8% (chart 26). The manufacturing sector, which in the previous year had the highest weight in the growth of total lending for this segment, in March 2023 recorded a slower annual growth of 18.3% from 47.1% as it had been marked in the previous year. Lending to the construction sector marked a significantly slower annual growth compared to trade and especially manufacturing sector, of 9.3% in March 2023, from 19.4% marked in the previous year. The slowdown in lending for this sector may also have been influenced by the high rate of inflation marked in 2022 - the increase in the price of construction materials that has been transmitted to the slowdown of construction dynamic or their temporary interruption, but have shown a downward trend (prices in construction) in this quarter. Banks lend the least to agriculture sector, which at the same time was characterized with a positive increase of 14.2%, unlike the significant decline of 13.7% marked in the previous year.

Chart 27. Stock of total deposits

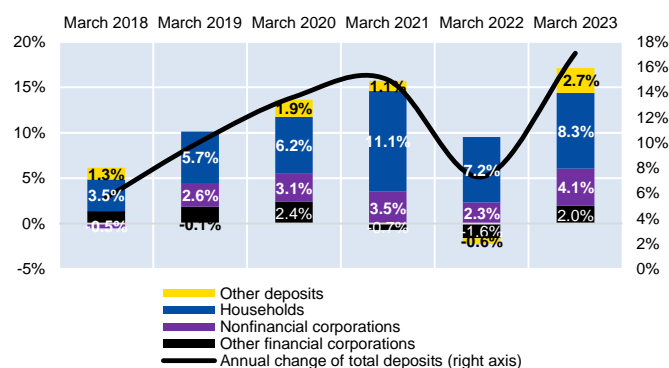


Source: CBK.

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 from the previous periods and realized earnings during the first quarter of 2023. Both of these items comprise 93.1% of liabilities and equity, where 82.2% is comprised only by deposits. The tightening of monetary policies on the global level which has had an impact on the overall increase of interest rates, and also being reflected on the domestic market since the second half of 2022 was associated with a sustainable increase of the total value of deposits.

Chart 28. Contribution to annual growth of total deposits, percentage points



Source: CBK.

1.1.1 Deposits

The value of the stock of deposits, at the end of March 2023, reached EUR 5.56 billion (chart 27), representing an accelerated annual growth of 17.1%, from 7.3% in December 2022. Deposits of both private sector segments marked an accelerated increase and determined the growth trend of total deposits. Moreover, also deposits collected from the public corporations and pension funds marked a significant increase, thus contributing to the highest increasing rate marked in the last 13 years.

Household deposits marked an annual growth of 11.8% in March 2023, from the increase of 10.5% marked in the previous year, representing a dynamic which was impacted by the increase of interest rates on deposits. In March 2023, the value of household deposits reached EUR 3.74 billion, thus, also determining the overall trend of deposits in the banking sector (chart 28). Regarding the level of new deposits collected from households,

which include only time deposits, during the period of the first quarter of 2023, reached the value of EUR 96.4 million, representing an annual increase of 29.3%, compared to the annual increase of the previous year of 3.5% (chart 29).

The stock of nonfinancial corporation deposits reached EUR 1.09 billion at the end of March 2023, representing an annual increase of 21.5% from 13.1% marked in the same period of the previous year. New deposits collected during the first quarter of 2023 from this segment increased to EUR 56.2 million from EUR 19.0 until March 2022. The tightening of financing conditions by the measures taken to control inflation, has influenced the continuous increase in competition in the country for securing and holding deposits, thus offering more attractive conditions for depositing funds mainly through the increase of interest rates on deposits.

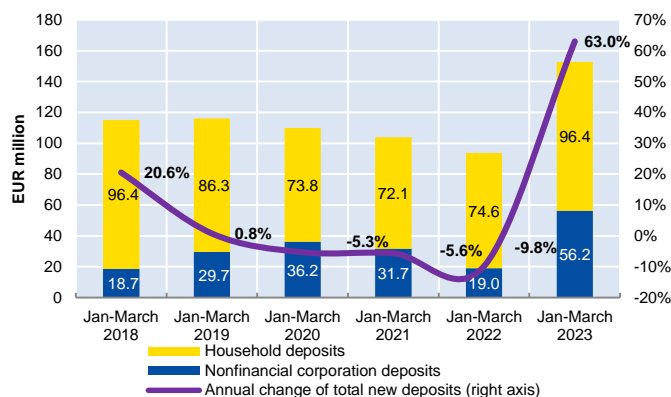
1.2. Interest rates

Interest rates on new loans and deposits in the recent years have marked a gradual decline, albeit since the beginning of the previous year changed direction. The application of tight monetary policies in curbing inflation have created an environment with increased interest rates, a situation that has also been followed in the domestic market, since the second half of 2022. In the banking market, interest rates on new deposits have been affected at a higher level than interest rates on new loans. In March 2023, the interest rate on loans reached 6.3% from 5.8% in March 2022, and 6.0% as it was in June 2022, when inflation intensified and discussions on monetary policy intervention began. Also, the average interest rate on deposits increased to 1.8% from 1.2% as it was in March 2022, and 1.9% in September 2022, when concerns over holding deposits in the banking sector and consequently the liquidity risk were further highlighted. The margin of interest rate spread of loans and deposits narrowed to 4.5 percentage points from 4.6 percentage points (chart 30).

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.

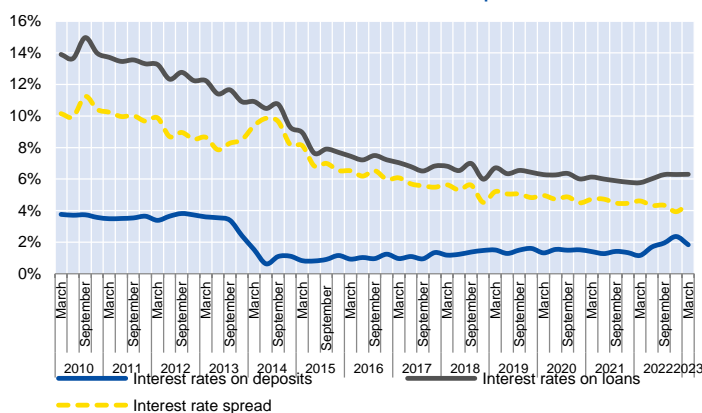
While during the years 2020-2021, loans with variable interest rates, which are mainly determined by the movements of the Euribor rate for the additional margin, accounted for an average of 16.8% of the loan portfolio and 21.0%, respectively, where this level has risen to 28.8% in March 2023 (chart 30a).

Chart 29. New deposits, annual change



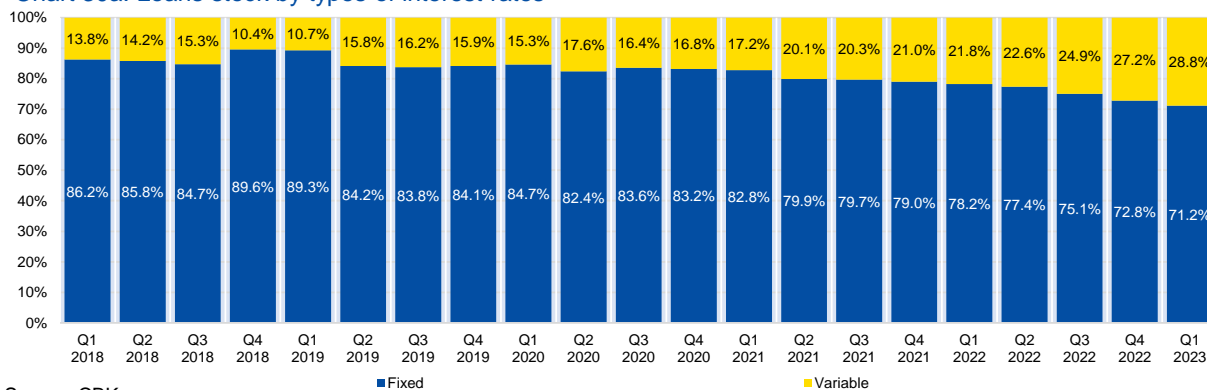
Source: CBK.

Chart 30. Interest rate on loans and deposits



Source: CBK.

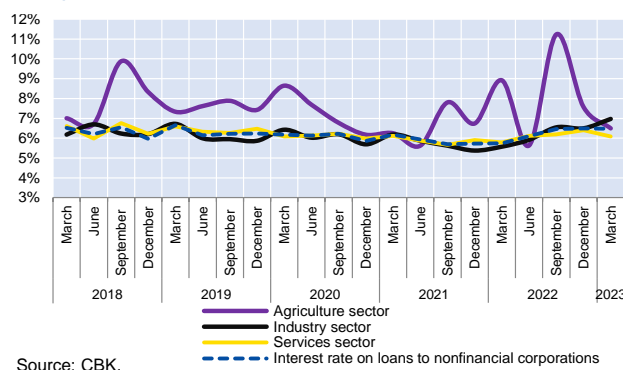
Chart 30a. Loans stock by types of interest rates



Source: CBK.

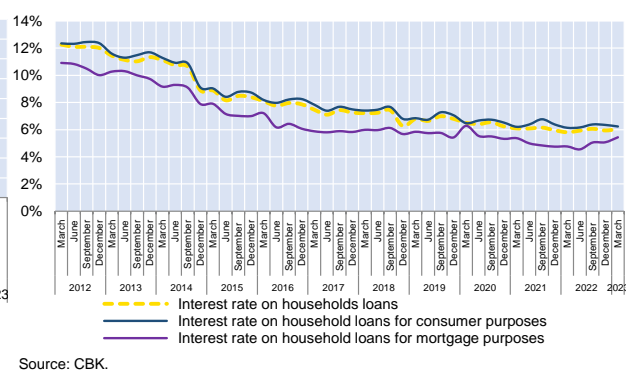
The average interest rate on loans to nonfinancial corporations stood at 6.5% in March 2023, or for 0.7 percentage points higher compared to the same period of the previous year. More favorable interest rates on loans were offered for services segment (6.1%), while the highest average interest rate of 7.0% was for Industry sector (chart 31).

Chart 31. Interest rate on loans to nonfinancial corporations



Source: CBK.

Chart 32. Interest rate on loans to households

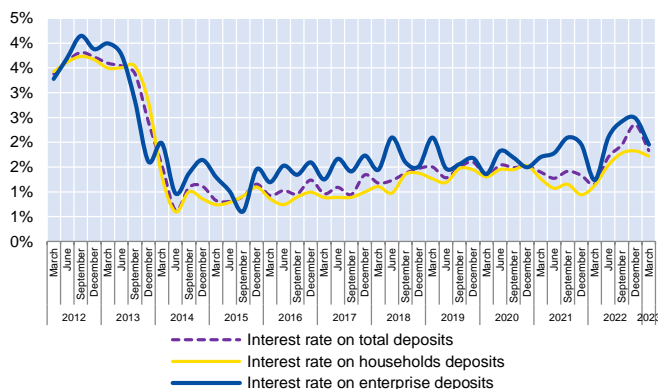


Source: CBK.

The average interest rate on loans to households was 6.0%, which is for 0.2 percentage points higher compared to the same period of the previous year. The more favorable interest rates have been applied to mortgage loans at an average of 5.4%, since they are considered to have a lower risk when they are covered by collateral (mortgage). However, consumer credit continue to have higher interest rates with an average of 6.2% (chart 32).

Interest rates on deposits started the upward trend since June 2022, reaching an average of 2.4% at the end of the previous year, while in March 2023 it decreased to 1.8%, for 0.7 percentage points higher than in March 2022. The average interest rate on nonfinancial corporation deposits increased by 0.7 percentage points, reaching 1.9%, while for households there was marked an increase of more than 0.6 percentage points, reaching 1.7% compared to March 2022 (chart 33).

Chart 33. Interest rates on deposits



Source: CBK.

Performance of the banking sector

Banking sector enclosed the first quarter of 2023 with a record net profit amounting to EUR 40.3 million. Such a financial result was enabled by the higher increase of income compared to a slower increase of expenditures (chart 34).

Total income reached the value of EUR 92.9 million, at the end of the first quarter of 2023, representing an annual increase of 13.1% (an increase of 12.0% until March 2022). Interest income, which represent 74.4% of total income, gave the main contribution to the growth of income. In the context of interest income, the

collection of interest from loans had the main contribution to this increase, a category which was influenced by the significant increase in lending in the last two years. Moreover, the yield from securities were increased significantly compared to the same period of the previous year. Whereas, the category of non-interest income, mainly from fees and commissions, marked an annual decline of 2.6% after the significant increase of 13.8% marked in the previous year, reaching the value of EUR 20.0 million at the end of March 2023.

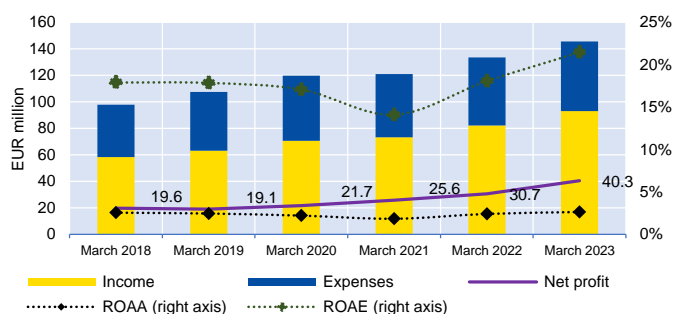
With an increase were characterized also expenditures of the sector, albeit with a slower pace compared to the previous year, standing at 2.2% from 7.9% until March of the previous year, thus reaching the value of EUR 52.6 million, at the end of March 2023. The highest contribution to this increase was given by expenditures interest increase, which reached the value of EUR 8.5 million from EUR 5.6 million in the first quarter of the previous year. The category with the largest weight in total expenditures, which consists of general and administrative expenses with a share of 61.5%, increased by 5.8% compared to the previous year, and reached the value of EUR 32.3 million at the end of March 2023. The increase in general and administrative expenses mainly reflects the increase in personnel expenses, in order to adapt the salary level to the rate of inflation rise since the last year and the increase in the number of personnel compared to the previous year (also influenced by the entry of new banks into the market, in the last two years).

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 the slowdown of economic activity.

Credit quality marked an improvement starting from the last quarter of 2021 until September of the previous year, where the value of nonperforming loans had a downward trend with an average of 2.5%. Since the last quarter of 2022, the declining trend changed direction, where the value of NPL increased by 4.5% and 6.0% at the end of Q4 2022 and in Q1 2023, respectively. The value of nonperforming loans for households has increased, compared to the previous year, reaching EUR 22.5 million from EUR 18.1 million as they were at the end of Q1 2022. The increase of NPL for around EUR 4.3 million was a result of the high increase of lending for this segment in the last two years. Whereas, NPL to total loans ratio for the household segment continued to remain low, with 1.3%. The NPL value for the segment of nonfinancial corporations marked an annual increase of only 1.0% compared to the first quarter of the previous year, reaching the value of EUR 65.7 million, at the end of March 2023. With an increase of NPL value was characterized the manufacturing sector, which increased

Chart 34. Profit and profitability indicators of the banking sector



Source: CBK.

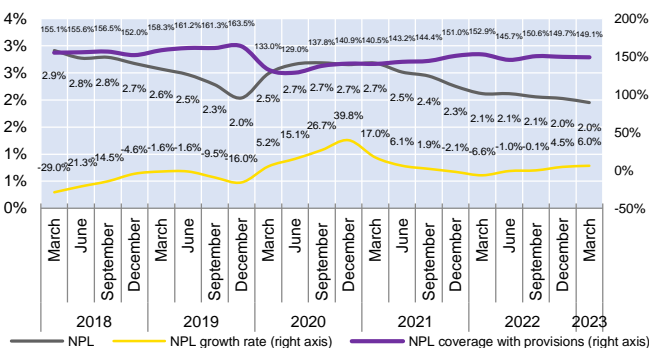
by EUR 1.9 million, whereas as a ratio to loans it increased for only 0.1 percentage points, reaching 1.6%. The value and the level of NPL for other economic sectors, have not suffered significant movements compared to the previous year.

A more significant increase in lending in the reporting period had an impact on the overall nonperforming loans to total loans ratio of the banking sector, thus consequently decreasing to 2.0%, from 2.1% as it was in March of the previous year. The coverage by loan loss provisions declined slightly to 149.1%, from 152.9% as it was in March 2022, due to the higher increase marked in the value of nonperforming loans than the value of provisions dedicated for loan losses (chart 35).

The capital adequacy ratio increased to 15.7% from 15.1% as it was in March 2022, as a result of a more significant increase in capital compared to risk-weighted assets. The profit retained from the previous year and the one realized in the first quarter of 2023 has had an impact on the equity to record a more significant increase compared to the lending activity (which has a slower growth trend compared to the previous year) (chart 36).

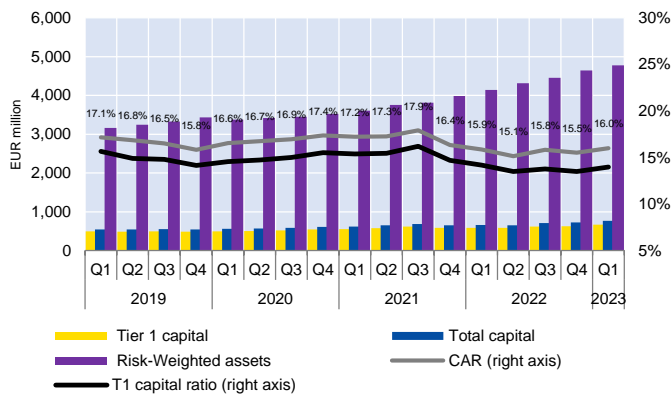
Liquid assets to total short-term liabilities ratio marked an increase of 1.9 percentage points compared to the previous year, reaching 33.8% at the end of March 2023 (chart 37). The increase in the level of liquidity compared to the previous year is a result of the increase in liquid assets by 19.1% compared to the increase in short-term liabilities of 12.5%. Within the framework of liquid assets, investments in securities of foreign governments marked the most significant increase, followed by deposits and placements in foreign banks. Meanwhile, short-term liabilities marked an increase due to the increase of deposits, compared to March 2022. Loans to deposits ratio was increased to 81.1% from 82.8% that was in the previous year, which is a result of the higher increase of deposits compared to the increase of loans, during this period.

Chart 35. Nonperforming loans and loan loss provisions



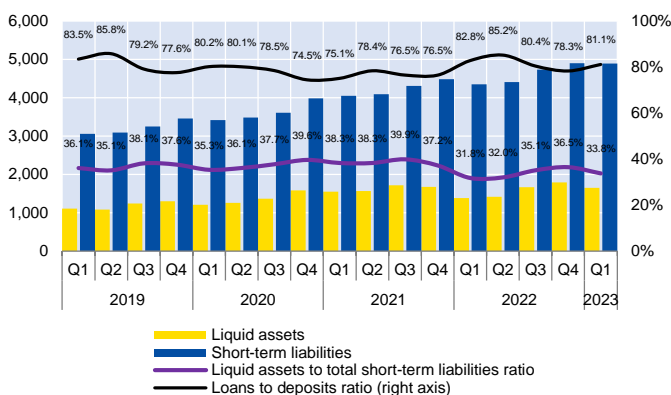
Source: CBK.

Chart 36. Solvency indicator



Source: CBK.

Chart 37. Liquidity indicators

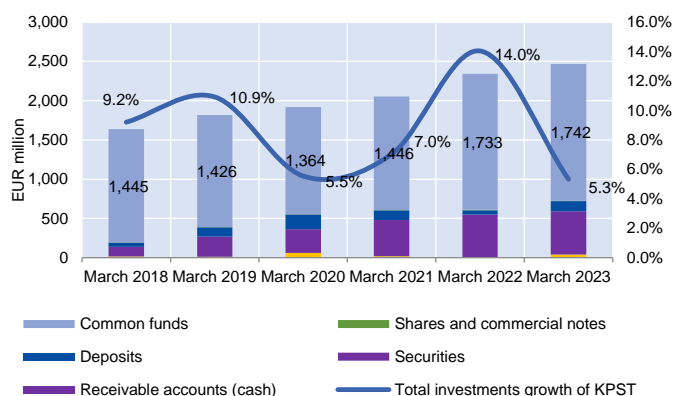


Source: CBK.

Pension sector

Assets of the pension sector, until March 2023, marked a significant slowdown increase compared to the previous year, and a lower return on investments during the period of January-March 2023. As a result, of the unfavorable macroeconomic developments that have simultaneously been affected by the turbulences of the financial markets and the unexpected crisis in several regional banks in the USA and Credit Suisse in Switzerland in March of this year, which, despite being isolated cases, have raised concerns about amplification of a potential wider financial crisis.

Chart 38. Assets of the pension sector



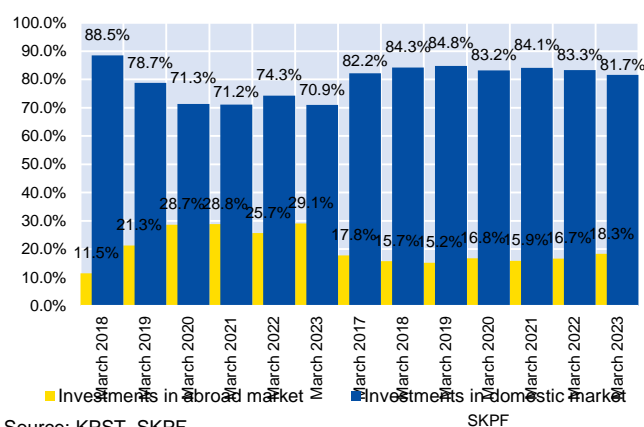
Source: CBK.

With the second highest share in total assets of the financial system, assets of pension funds increased by 5.3% at the end of March 2023, albeit it presented an increase which was significantly slower than in the previous year, when it had reached 14.0% (chart 38). The value of pension funds' assets reached EUR 2.47 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 annual asset increase of 5.4%, assets of the Slovenian-Kosovar Pension Fund (SKPF) recorded an annual decrease of 2.2%, in March 2023.

Assets of KPST are mainly invested in external market (70.9% of investment portfolio), in mutual funds with a value of EUR 1.75 billion (or 70.8% of KPST total assets). The remainder of investments are diversified in securities of the Government of Kosovo in the amount of EUR 549.8 million or 22.4% of the total investment portfolio and certificates of deposit in the local banking sector in the amount of EUR 128.2 million (5.2% of the total investments). Also, the structure of SKPF investment portfolio is similar to that of KPST structure, being mainly oriented to the external market, in the shares that comprise 69.7% of the investment portfolio, and in securities with an investment share of 4.8%, of total investments. Meanwhile, investments within the country are mainly focused on Kosovo's Government securities which account for 14.1% of total investments portfolio.

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 March of the previous year, while investments in securities of the Kosovo's Government continued to increase, albeit with a slower pace, reaching 1.4% from the increase of 17.5% that had been marked in the previous year (chart 38a).

Chart 38a. Structure of pension funds investments



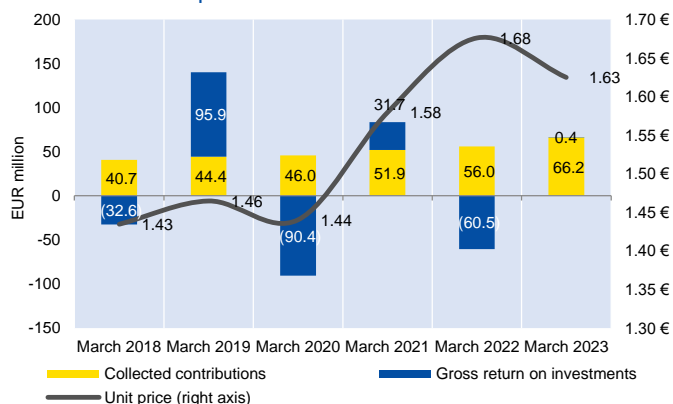
Source: KPST, SKPF

The value of contributions collected by SKPF, for the first quarter of 2023, reached EUR 156.8 thousand, representing an annual increase of 5.7%, influenced by the increase of the number of contributors. Meanwhile,

the gross cumulative return from investments in the first quarter of 2023 reached EUR 247.3 thousand, compared to losses in the amount of EUR 295.8 thousand marked in the previous year, which was the result of the turbulences created in the financial markets.

The value of contributions collected by the KPST, for the first quarter of 2023, marked an annual growth of 18.1%, reaching the value of EUR 66.2 million. The high double digit increase of collected contributions, among others, reflects also the increase in salaries of civil servants, which was effective as of the beginning of 2023. Whereas, gross return on investments in the first quarter of 2023 was only EUR 427.5 thousands against the losses of the value of EUR 60.5 million marked in the previous year. The low level of gross return on investments in the first quarter of 2023 is mainly the result of fluctuations in the global markets following the failure of several banks in the USA and carryover effects in Europe³. Moreover, financial markets have not yet recovered from a difficult year (2022) that was characterized by high inflation, tight monetary policies and weaker activity in the world's major economies.

Chart 39. KPST performance



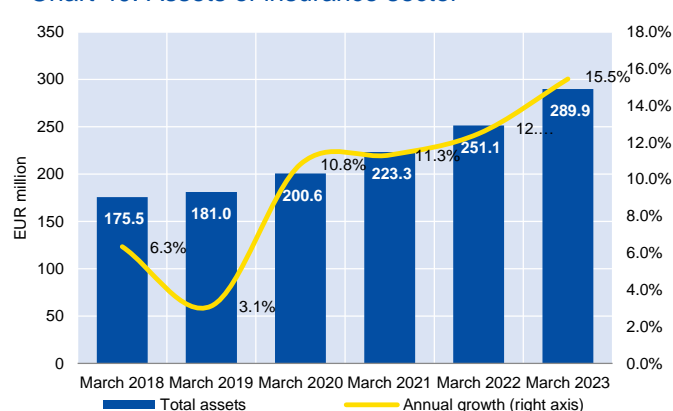
Source: KPST

Insurance sector

Insurance sector marked a high increase of the activity for the fourth consecutive year, despite the challenges with which the sector and the whole financial system were facing.

Insurance sector assets represented 2.9% of total financial system assets, at the end of March 2023. Total assets value reached EUR 289.9 million at the end of the period, representing an annual increase of 15.5%, thus continuing the double digit growth trend marked in the recent four years (chart 40). 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 in this quarter compared to the statement of March 2022, 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.

Chart 40. Assets of insurance sector



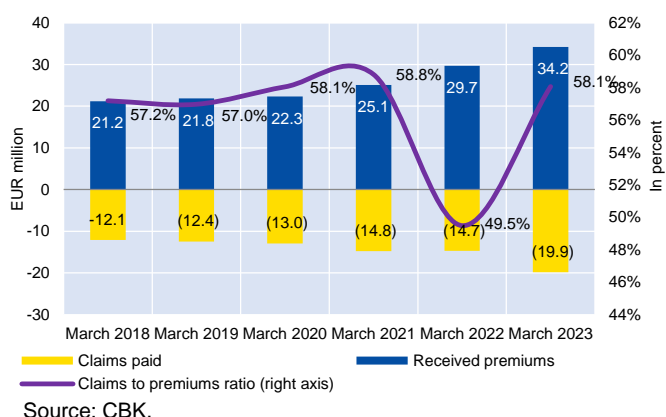
Source: CBK.

The value of written premiums reached EUR 34.2 million in the first quarter of 2023, representing an annual increase of 15.1%. The increase in written premiums mainly reflects the increase in written premiums of

³ The acquisition of Credit Suisse by UBS, where both of these banks have an overall importance of the system on the global level.

'accident and health', a category within the framework of voluntary insurance and "motor third party liability" within the compulsory insurance. The written premiums against compulsory insurance continue to have the largest weight, reaching 53.2% of the total non-life written premiums. The increase in premiums within the "accident and health" insurance (for 25.8%) 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 10.2%.

Chart 41. Written premiums and claims paid



On the other hand, the value of claims paid by insurance companies and the Kosovo Insurance Bureau, in the first quarter of 2023, reached the value of EUR 19.9 million, representing an annual growth of 35.0% (-0.5% in the previous year)(chart 41). The value of claims paid by KIB decreased by 31.9%, while the claims paid by insurance companies marked an annual increase of 48.0%. The significant increase of claims paid originated from the segment of "non-life insurance", namely "fire and natural disasters insurance", and "motor third party liability - MTPL". The insurance sector, in the first quarter of 2023, realized a profit in the amount of EUR 2.3 million (EUR 0.4 million in the same period of the previous year). The highest value of realized profit against the previous year came as a result of the higher value of income collected from the written premiums compared to expenditures value for claims paid.

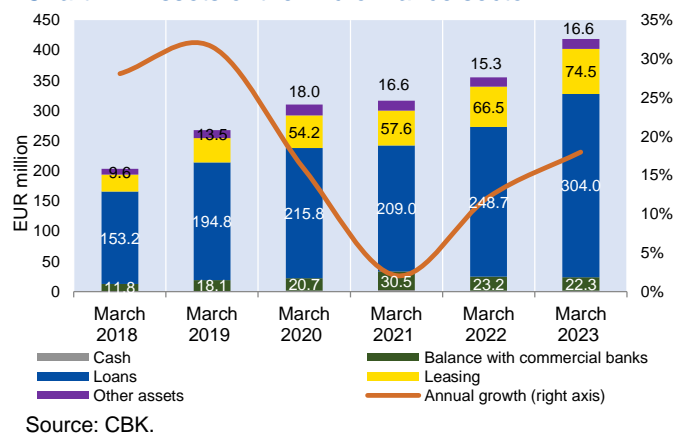
Microfinance sector

Microfinance sector, in the first quarter of 2023, marked an accelerated growth of assets, mainly influenced by the expansion of lending and leasing, which were financed by borrowings received from the external sector and own capital. Financial result was similar with that of the previous year while the credit portfolio quality indicators continued to be at the optimal levels. However, the microfinance sector is expected to face increased funding costs due to the increase in base interest rates as part of the tight monetary policies applied by many central banks in terms of managing inflation. These dynamics can be reflected in further increase of interest rates for loans, due to the high dependence on financing the activity from the external borrowings (60.7% of liabilities and equity).

Assets

Assets of the microfinance sector recorded an accelerated annual growth of 18.0% in March 2023, reaching the value of EUR 419.0 million at the end of the period (chart 42). The main contribution to this growth was given by the increase of lending and to a lesser level by the increase of leasing. Lending activity of the sector continued to be supported by borrowings (credit lines) from abroad which increased by 17.1%. Also, the increase of the level of capital contributed to the

Chart 42. Assets of the microfinance sector



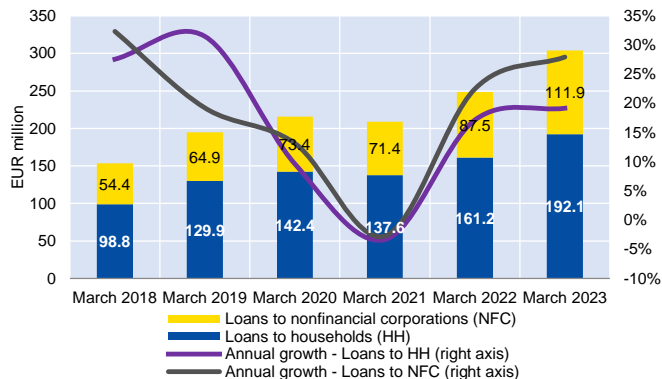
increase of the activity of the sector, mainly through the profit retained over the years, and the profit realized until March 2023.

Loans

The activity of the microfinance sector continued to increase with a more accelerated pace for the second consecutive year, reaching the trend as it was before the pandemics (2016-2019).

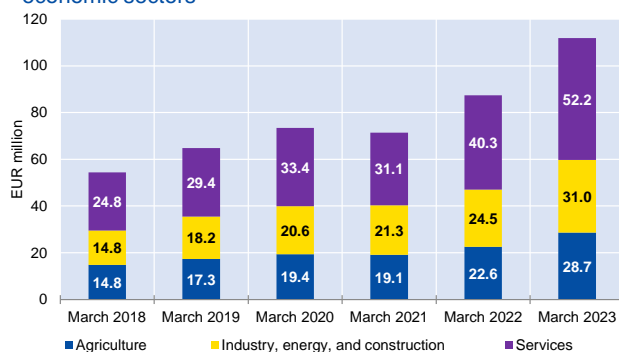
Total loans issued by the microfinance sector marked an accelerated growth of 22.2% at the end of March 2023, while their stock reached the value of EUR 304.0 million. Lending of the sector increased for both economic segments, namely for nonfinancial corporations and households. More specifically, lending to households marked an annual increase of 19.2% (an annual increase of 17.1% marked in 2022), reaching the value of EUR 192.1 million at the end of March 2023 (chart 43). Loans stock to nonfinancial corporations marked a value of EUR 111.9 million, representing an annual increase of 27.9% (an increase of 22.5%, in March 2022).

Chart 43. Value of loans to households and to nonfinancial corporations



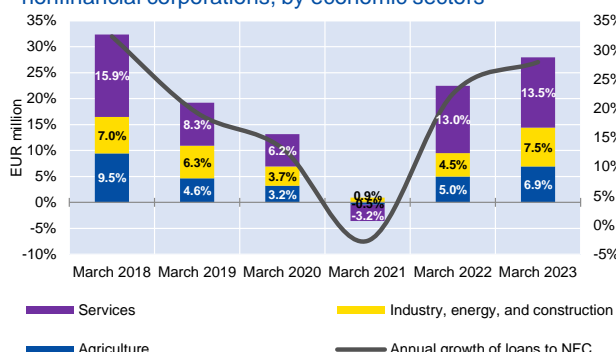
Source: CBK.

Chart 44. Value of loans to nonfinancial corporations, by economic sectors



Source: CBK.

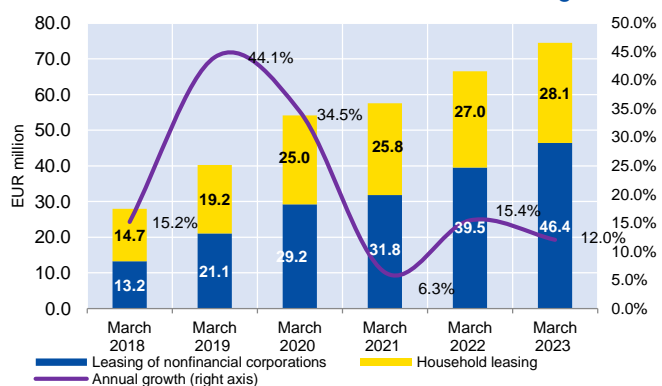
Chart 45. Contribution to the growth of lending to nonfinancial corporations, by economic sectors



Source: CBK.

Lending to nonfinancial corporations by economic sectors has followed an increasing trend, marking a rise in each of the economic sectors (chart 44). In contrast to the banking sector, the stock of loans to the agriculture segment has the largest weight to total lending to nonfinancial corporations MFI-s/NBFI-s, with 25.6%. Moreover, this segment had the second highest contribution to the growth of total lending to nonfinancial corporations (chart 45), marking an annual growth of 26.8% in March 2023 and reaching the value of EUR 28.7 million.

Chart 46. Value of microfinance sector leasing



Source: CBK.

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 537.4 million, or 23.1% more than in the

previous year. As a result of the guarantee on loans given by the KCGF, microfinance institutions 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. Also, with a double digit increase during this period was characterized the segment of industry, construction and trade, while lending to other services segment, had the contribution and the highest growth during this period.

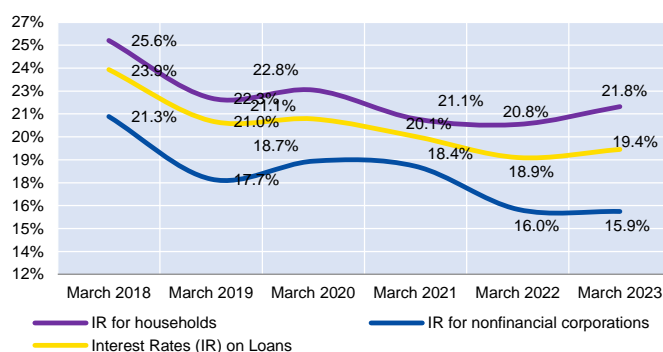
Leasing

Leasing continue to be the second most important category in terms of weight in the assets structure of the microfinance sector (17.8%). Leasing activity for the second consecutive year recorded a double-digit growth, and reached the value of EUR 74.5 million at the end of March 2023 (chart 46). 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 19.4% in March 2023, or for 0.5 percentage points lower compared to the same period of the previous year (chart 47). 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 a further increase of interest rate on loans offered by this sector.

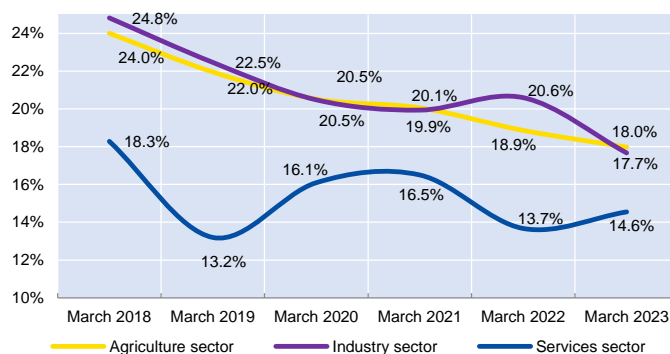
Chart 47. Average interest rate on microfinance sector loans



Source: CBK.

Interest rates on loans to households marked an increase of 1.0 percentage points, reaching 21.8%. According to loans classification, the average interest rate on consumer credit increased by 0.4 percentage points, reaching 23.0%. Meanwhile, mortgage loans continue to have the lowest interest rates, at an average of 19.5% in March 2023, albeit compared to the previous year it marked a significant increase of 3.1 percentage points.

Chart 48. Average interest rate on loans to enterprises, by economic sectors



Source: CBK.

Average interest rates for nonfinancial corporations decreased almost for all economic activities (chart 48). The interest rate on loans to the agriculture and industry sector decreased by 0.9 and 2.9 percentage points, standing at 18.0% and 17.7%, respectively, at the end of March 2023. Whereas, loans to services sector, which have a more favorable interest rate, at the end of March 2023, had an interest rate of 14.6%, representing an annual increase of 0.9 percentage points.

Performance of the Microfinance Sector

Microfinance sector, in the first quarter of 2023 managed to maintain the profitability level marked in the same period of the previous year, despite that the sector was facing a cost increase of financing its activities. At the end of March 2023, this sector marked a net profit with a value of EUR 4.1 million, representing the same level marked at the end of March of the previous year (chart 49).

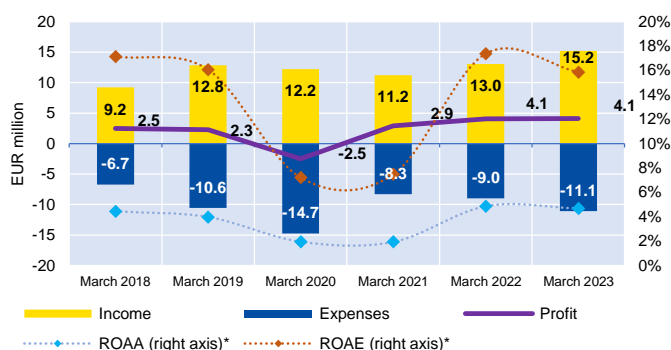
The more significant increase in expenses for 23.6%, compared to the lower increase in income for 16.6%, had an impact on the sector to manage maintaining the level of profits as in the previous year, albeit not being able to expand the profit margin.

Within income, interest income, which represent the dominant category of income (91.6%), recorded an annual increase of 16.6% (the same as in the first quarter 2022), as a result of the significant increase in lending, in the last two years. The category of non-interest income, in the first quarter of 2023, marked an annual increase of 16.6% (13.6% in the previous year), albeit their contribution to the increase in total income was limited due to the low weight in total income (a share of 8.4%).

In the context of expenses, the increase mainly was attributable to personnel and administrative expenses. This subcategory marked an annual increase of 16.6% (20.8% in the previous year), which may be attributed to the increase of expenses for employees' salaries in order to maintain inflation adjustment, and to a lower extent to administrative expenses. Moreover, the increase in the number of personnel as well as the increase in salaries to adjust to the rising inflation, have contributed to the increase of this subcategory of non-interest expenses, the costs of which have been carried over to the first quarter of 2023. Meanwhile, the

category of interest expenses (23.5% of total expenses) recorded an annual increase of 35.2% at the end of March 2023 (-3.6% in the previous year), reflecting the increase in the level of borrowings from the external sector. The level of nonperforming loans to total loans remains low and it further declined by 0.5 percentage points, dropping to 1.8%. Whereas, the coverage level of nonperforming loans with loan loss provisions, in March 2023, reached 152.1% (143.5% in March 2022) (chart 50).

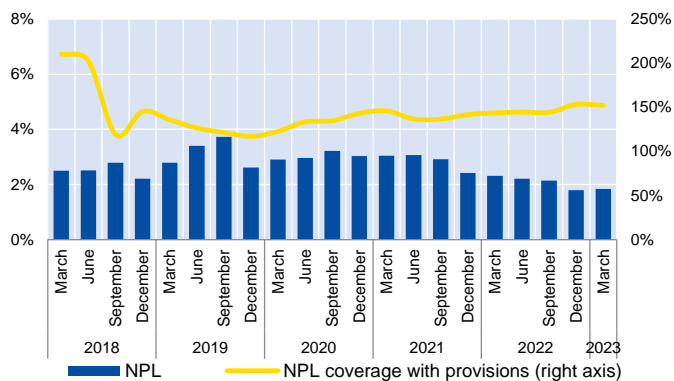
Chart 49. Profit and profitability indicators of the microfinance sector



Source: CBK.

*The value of September 2022 is

Chart 50. Indicators of loans portfolio quality

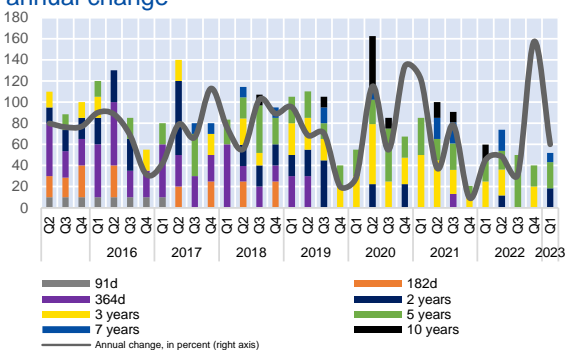


Source: CBK.

Kosovo's Government securities market

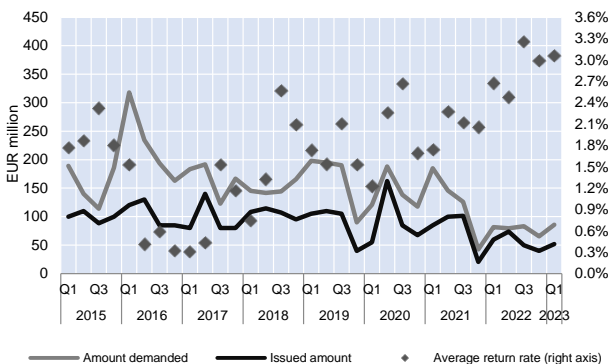
Issuance of government securities up to March 2023 was significantly lower compared to the same period of the previous year, while the demand to invest in these securities continued to exceed the supply side of the government.

Chart 51. Amount and maturity of issued debt, annual change



Source: Ministry of Finance, Labor and Transfers.

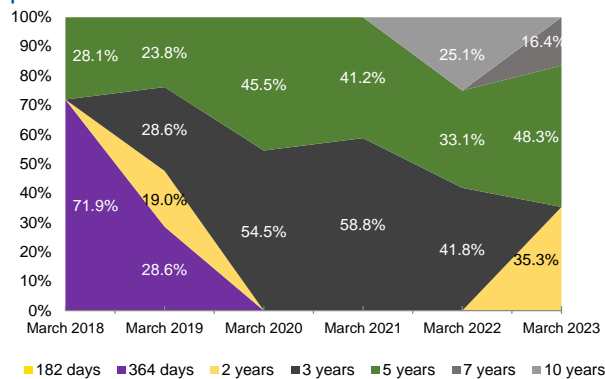
Chart 51a. Bid to cover ratio



Source: Ministry of Finance, Labor and Transfers.

Until March 2023, Kosovo's Government issued debt with a value of EUR 51.8 million, which is for 13.4% less than in the previous year (chart 51). Meanwhile, the demand to invest, in the absence of investment alternatives for asset diversification, has continuously exceeded the supply side. The demand to invest in securities of Kosovo's Government was 1.66 times higher than the amount offered by the Government, while in the previous year it was 1.37 times higher (chart 51a). 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 64.1% from 62.5% in March 2022, while commercial banks have reduced their share to 30.4% from 32.7% as it was in the previous year. Until March 2023, the stock of Kosovo's Government securities held by commercial banks, pension funds and insurance companies reached the value of EUR 859.2 million (EUR 873.3 million in March of the previous year). The structure of Kosovo's Government securities, over the years, has undergone gradual changes towards the issuance of securities with longer maturities.

Chart 52. Government securities structure, in percent



Source: Ministry of Finance, Labor and Transfers.

During the period of January-March 2023, the structure was dominated with 48.3% 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 41.8% (chart 52).

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World Bank: Commodity Markets: [Commodity Markets \(www.worldbank.org\)](#)



Str. Garibaldi, no. 33, 10000 Prishtina,
Republic of Kosovo
Tel: +383 38 222 055; Fax: +383, 38, 243 763
Web: www.bqk-kos.org