Quarterly Assessment of the Economy

No. 45, Q IV/2023

Summary

- **The euro area economy, according to Eurostat, has a marked a slowdown growth of 0.5% in 2023, while in the last quarter of 2023 a growth of only 0.1%.** This increase was driven by persistently high interest rates, inflation, and weakening exports. ECB projections for economic growth in the euro area suggest a growth rate of 0.6 in 2024 and 1.5% in 2025. The inflation rate in Q4 2023 reached 2.7%, marking a significant decrease compared to the same period of the previous year (9.9% in Q4 2022). The ECB projections suggest a slowdown in inflation to 2.3% in 2024 and 2.0% in 2025.

- **Similar to the euro area, economic activity in Kosovo in 2023 is estimated to have experienced a slowdown, with an increase of 3.3%. The last quarter of the year, however, was characterized by a GDP growth rate of 4.0%.** The dynamics of the fourth quarter of 2023 were primarily influenced by developments in consumption and investments, while net exports had a negative impact on the real GDP growth rate. Consumption turns out to have marked higher increase, whereas increase of investments was determined mainly by public investments increase. The CBK anticipates an economic growth rate of 3.9% for 2024, supported by overall investments, consumption, and export of services. However, a forecasted decline in the export of goods, and the increase in imports of goods and services, are expected to negatively impact the overall economic activity.

- **Inflation followed a downward trend throughout 2023, averaging 4.9%. This trend was more pronounced in Q4 2023, with inflation at 2.8%,** due to base effects, easing in supply chains, and commodity prices in international markets. Most components of the consumer basket marked a slow growth, while fuel prices and some food commodities declined. Core inflation also decreased, reaching 3.6% in Q4 2023. The CBK projects that inflation will continue to slow down, reaching 2.5% in 2024.

- **The budget of Kosovo marked a positive budget balance in 2023, whereas in the last quarter was marked a deficit.** Budget revenues marked an annual growth of 14.5% in 2023, with a same growth rate also marked in the last quarter of the year. Also budget expenditures marked a double digit growth rate of 13.2% along the whole of the year, whereas in the last quarter it was marked a growth of 10.0%. **Public debt was declined to 17.2% of the GDP, compared to 19.9% as it was at the end of 2022.** The improvement of the government's budget balance, as a result of the increase of revenues and nominal GDP growth, which reduces the debt to GDP ratio, have been the main factors which influenced the decrease of the level of public debt.

- **The current account in 2023 decreased for 19.5%, while in Q4 2023, it was characterized with an increase of 3.3%, reaching EUR 415.5 million.** Dynamics in the current account, in Q4 2023, continued to be determined mainly by developments in the trade balance of goods. Remittances, as one of the crucial source of financing the consumption, rose by 5.0%, reaching the value of EUR 334.1 million. Foreign direct investments surged by 86.6%, reaching EUR 223.0 million.

- **The financial system continued to expand in the last quarter of the year, ending the year with accelerated assets growth. Future developments are expected to be influenced by overall macroeconomic dynamics and the ability to raise funds through increased deposits and external financing.** Excluding the banking sector, which marked a slowdown in assets growth, all other sectors experienced accelerated annual growth rates.

- **The banking sector** maintained high levels of capitalization, liquidity, and asset quality, with low levels of non-performing loans. Capitalization levels exceeded regulatory requirements, making the sector more resilient to uncertainties from geopolitical crises, rising inflation, and slower economic activity. **Lending activity** was the main contributor to asset growth in the banking sector, despite a slower trend compared to the previous year. Investments in securities provided higher returns in a high-interest-rate environment. Dynamics of the ECB monetary policy have partially had an impact also in interest rates applied by domestic banks, albeit the recent decision taken in September and the signaling from the ECB to not have further increase of the relevant rates, results to have reflected in a decline of interest rates on loans - while interest rates on deposits continued to follow a growing trend. Assets of the pension sector recorded high growth in 2023, after the significant slowdown marked in the previous year, where both pension funds recorded positive returns from investments in foreign markets, benefiting from high interest rates. **The insurance sector** was characterized by double-digit growth in assets for the fifth year in a row. The expansion of the sector came from the increase in technical reserves, which is a result of the written premiums throughout the year 2023, as well as the insurers' own capital. Moreover, in the last three years, the sector has achieved positive financial performance, unlike the losses created in the previous years.**The microfinance sector** recorded high activity growth in 2023, supported mainly by borrowings from the external sector to finance lending and leasing. The sector has maintained low level of loans with problems and realized high level of profitability.

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This publication includes the data available until 31 December 2023.

List of abbreviations

CBK	Central Bank of the Republic of Kosovo
CPI	Consumer Price Index
ECB	European Central Bank
EUR	Euro currency
FAO	Food and Agriculture Organization
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
IÇIMP	Import Price Index
IMF	International Monetary Fund
KAS	Kosovo Agency of Statistics
MFLT	Ministry of Finance, Labor and Transfers of Kosovo
MMBTU	Metric Million British Thermal Unit
NFC	Nonfinancial corporations
WEO	World Economic Outlook

Contents

1. Euro area and Western Balkans

According to Eurostat's preliminary estimates, the euro area economy grew by just 0.5% in 2023, constrained by high interest rates that hampered consumption and investments, the impact of prices on consumption trends, and weakened exports due to the global economic slowdown. **In Q4 2023, real GDP growth in the euro area remained flat compared to the previous quarter but increased by 0.1% compared to the same period of the previous year.** Key drivers of economic growth in the euro area in Q4 2023 were final government consumption and gross capital formation, contributing 0.1 and 0.2 percentage points respectively, while net exports negatively impacted the growth by 0.3 percentage points. **The ECB projections for economic growth in the euro area were revised in March 2024 against projections of December 2023, to 0.6% for 2024 and 1.5% for 2025.** Private consumption is expected to be the main driver of economic growth, attributed to the decline of inflation and the increase of real income. Moreover, the decline of uncertainties and the improvement of consumers' confidence are expected to give additional support for private consumption.

The inflation rate in Q4 2023 reached 2.7%, marking a significant decrease compared to the same period of the previous year (9.9% in Q4 2022). The ECB projections suggest a slowdown in inflation to 2.3% in 2024 and 2.0% in 2025. However, inflation dynamics may be affected throughout the projection years with the further deterioration of current geopolitical tensions, especially in the Middle East, reflecting on potential energy prices and commodity costs. At the ECB meeting held in March 2024, interest rates were kept unchanged, with the interest rate on deposits at 4.0%, the rate on re-financing operations at 4.5% and the marginal lending rate at 4.7%. These high rates may negatively impact economic growth in the following months, possibly prompting the ECB to lower the key interest rates in 2024.

IMF projections, realized in April 2024, suggest that the Western Balkan countries recorded an average economic growth of 3.0% in 2023 and are expected to mark a growth rate of 3.2% in 2024. The economic growth is expected to be affected by external pressures, including the slowdown of the economic activity in the euro area, and by internal effects as facing with inflation and the increase of financing cost. The average inflation rate, in Q4 2023, turns out to have been 4.4%, with the highest rate recorded in Serbia of 8.0%, while Bosnia and Herzegovina results to have marked the lowest inflation rate of 2.0%.

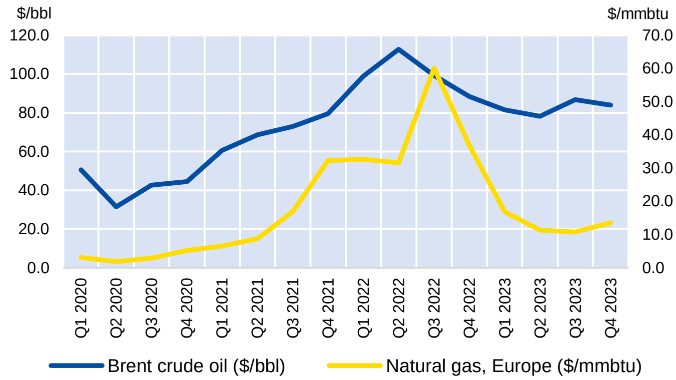
In Q4 2023, the currency exchange market of the EUR against the currencies of the trading partners, namely of British pound and Turkish lira was appreciated against to the previous quarter. The value of EUR depreciated against Albanian lek, US dollar and Swiss franc, whereas remained almost the same against the Macedonian denar.

2. Main commodity prices in international markets

Main commodity prices in international markets continued to decrease in Q4 2023 as a result of the slowdown in global demand and after the non-realization of concerns about the increase in prices as a result of the conflict in the Middle East. The World Bank reported a decline in the major commodities price index, driven by lower oil, food, and metal prices, some food commodities and prices of metals. Also, upward trends in the prices of other goods were observed, partly as a result of obstacles in the supply of other food products and natural gas, as well as the increase in demand for some metals in China. Major commodity prices are expected to continue easing throughout 2024, based on forecasts for a slowdown in global economic activity and the limited impact of geopolitical tensions. However, risks to these expectations include, among others, potential trade restrictions and the impact of climate conditions on food commodity prices.

In Q4 2023, Brent crude oil prices, according to the World Bank, reached $84.0 per barrel, marking a decline of 4.9% compared to the same period of the previous year (chart 1). This had an impact on closing the year of 2023 with an average price of $82.6 per barrel (bbl).

Chart 1. Oil and natural gas prices in international markets



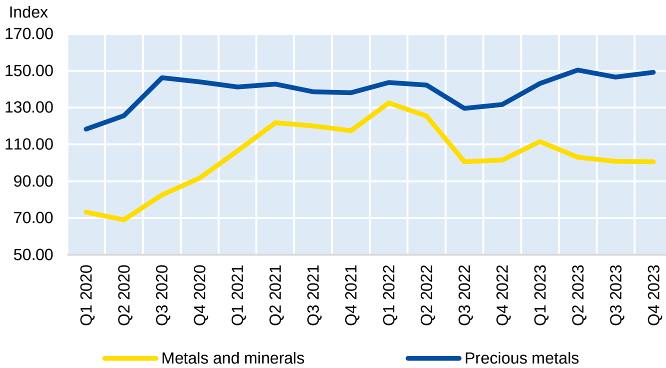
Source: World Bank

Despite the reduction in global oil supply by OPEC and other exporting countries, Brent crude oil prices fell by 3.1% compared to the previous quarter ($86.8/bbl in Q3 2023). This decline was mainly a result of concerns about the slowdown economic growth on the global level. The annual price average of oil for 2024 based on the World Bank projections, are expected to be around $84/bbl. However, this forecast is accompanied by risks such as the worsening of geopolitical tensions intensified by the conflict in the Middle East and the further potential cuts of oil supply from exporting countries. Meanwhile, the slowdown of economic activity on the global level is expected to reflect on the slowdown of oil prices.

Natural gas prices in Europe, in Q4 2023, reached $13.5/mmbtu, resulting in an annual decline of 63.4% compared to the same period of the previous year when the prices continued to be high as a consequence of supply disruptions caused by Russia (chart 1). On the other hand, compared to the previous quarter, the prices of natural gas in Europe increased by 25.6%, with a more pronounced increases in October and November. This increase was caused by strikes in the gas industry in Australia, the conflict in the Middle East, disruptions in the global market after the closure of the Tamar gas field in Israel, as well as after the explosion in the gas pipeline in the Baltic Sea. However, sufficient reserves in Europe, LNG (liquefied natural gas) imports, as well as mild climate conditions, relatively mitigated inflationary pressures, with prices falling to $11.5/mmbtu in December 2023. Natural gas prices in Europe are expected to mark an annual average price of $9.5/mmbtu in 2024 based on nearly full reserves in Europe, declining demand for gas for industrial and heating purposes, and on the assumption of the limitation of conflict in the Middle East.

The price index of metals and minerals marked a decrease of 0.1% compared to the previous quarter, as a result of the slowdown of economic activity in advanced economies, in addition to the stabilization of the supply of metals throughout the year. Declines were recorded in nickel and copper prices based on increased production, while aluminum, zinc, and iron ore prices increased as a result of improved sentiment in China and supply constraints. Similarly, the price index of precious metals recorded an annual decline of 0.9% compared to the same period of the previous year. Metal prices are expected to remain almost unchanged through 2024, but the outlook is accompanied by risks that could affect the demand for metals such as global economic activity, particularly in China, as well as trade restrictions and geopolitical tensions. The price index of precious metals was higher for 13.2% in Q4 2023, compared to the same quarter of the previous year. An increase was marked also compared to the previous quarter, when this index rose by 1.8% as a result of the increase in the price of gold of 2.4% with the beginning of the conflict in the Middle East, which increased the demand for gold as a safe haven asset. Meanwhile, the prices of platinum and silver decreased by 2.3% and 1.5%, respectively, compared to the previous quarter.

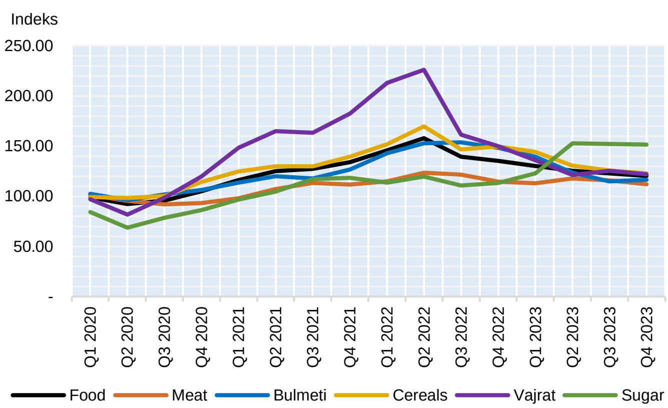
Chart 2. Prices of metals and minerals and of precious metals



Source: World Bank

The food price index In Q4 2023. according to FAO[1], marked a decline of 2.0% compared to the previous quarter. All the categories recorded a decrease, except for dairy products, which recorded an increase of 1.3% and continued to follow an upward trend, influenced, among other things, by the increase in demand on the eve of the year-end holidays (chart 3). The decline of food prices was mainly driven by the increase of yields and lower demand from importing countries. However, the dynamics during this quarter were volatile for cereals, edible oils and sugar, as a result of fluctuations in demand for edible oils, concerns about the security of sugar supply due to climatic conditions, and logistical problems in the supply of cereals. In relation to Q4 2022, food prices recorded an annual decrease of 11.1%, driven by a significant decline in the prices of dairy products (-21.4%), edible oils (-18.7%), cereals (-18.0%) and meat (-2.2%), while sugar prices recorded an annual growth of 33.7%. The ease in food prices are expected to continue also along the year of 2024, based on expectations on yield increases and a sustainability on the supply side.

Chart 3. Food price index



Source: FAO.

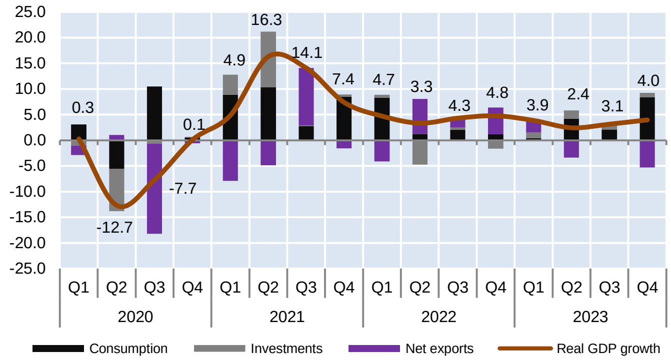
[1] Food and Agricultural Organization of the United Nations (FAO) Food Price Index.

3. Kosovo's Economy

3.1. Economic growth

Kosovo's economy, based on KAS estimates, has marked a slowdown growth rate of 3.3% in 2023. In Q4 2023, economic activity is estimated to have recorded a real growth rate of 4.0%, representing a higher increase compared to the previous quarters of 2023, albeit at lower rates compared to the same period of 2022. The slower growth of economic activity compared to the same period of the previous year can be mainly attributed to the dynamics in exports, which is estimated to have been influenced by the dynamics of prices in international markets and the effects they have on exports of goods such as metals, minerals and plastics, weakened demand in the euro area and weakened performance of a manufacturer. **The generated increase from the economic activity in Q4 2023** is attributable to the positive contribution of consumption and investments with 8.3 and 0.9 percentage points, respectively. Conversely, net exports have had a negative contribution to the GDP growth with 5.3 percentage points (chart 4).

Chart 4. Real GDP growth rate and main contributors to the growth

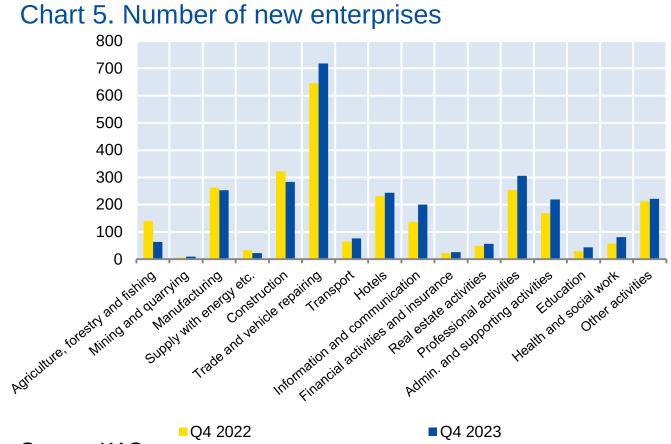


Source: KAS and CBK calculations.

Consumption recorded an increase of 8.2% in Q4 2023, which is a higher increase compared to the same quarter of the previous year, which can be attributed to the increase of the main sources of financing and the improvement of consumer confidence under the weakening dynamics of inflationary pressures. Investments marked an increase of 2.5%, primarily as a result of the increase of public investments and foreign direct investments. As regards to external trade, net exports have deepened the trade deficit for 13.9% in Q4 2023. The increase in trade deficit was a result of the increase in import of goods and services of 10.8% (import of goods marked an increase of 8.0%, while the import of services marked an increase of 26.1%), as well as the decrease in the export of goods of 5.8%, while export of services recorded an increase of 12.9%.

The increase of the economic activity in Q4 2023 was mainly supported by the increase in the added value in the administrative and supporting activities (6.8%), hotels and restaurants (2.8%), processing industry (2.7%), extracting industry (2.6%), trade sector (2.1%), etc. Business turnover data confirm this increase, where the turnover in the administrative and supporting services marked an increase of 66.6%, while the increase in the sector of extracting industry reached 2.4%, etc. Trade sector marked a significant increase of 7.4%.

Chart 5. Number of new enterprises



Source: KAS.

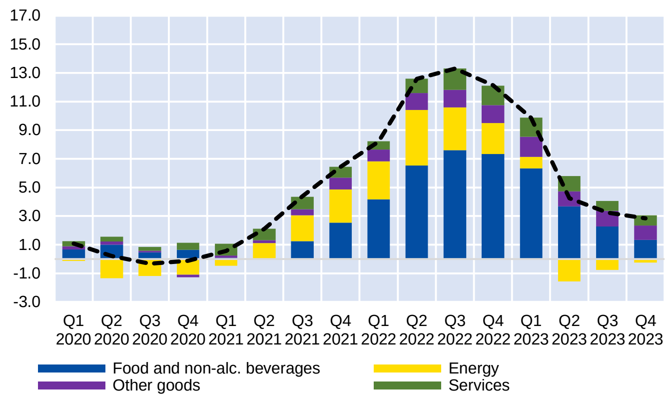
Economic activity was reflected in the increase of the number of registered enterprises, reaching 2,821 enterprises in Q4 2023, namely an increase of 7.0% compared to Q4 2022. Trade sector, the sector of professional activities, manufacturing, hotels, etc., marked a high number of registered enterprises. These sectors showed a significant increase in the number of enterprises compared to the same period of 2022 (chart 5). On the other hand, during Q4 2023, 397 enterprises were closed or 13.1% less compared to Q4 2022.

The CBK projections for 2024 suggest an economic growth of 3.9% as a result of an increase in real disposable income, due to the fall in inflation and the increase in other financing sources. However, in Q1 2024, it is estimated that there has been a slowdown in growth (3.3%), as a result of estimates for the decrease in the export of goods as well as the increase in the import of goods and services, while overall investments, consumption, as well as the export of services, are estimated to have had positive impact on the growth of GDP.

3.2. Prices

Inflation continued to follow a slowing trend throughout 2023, closing the year with an average rate of 4.9% compared to 11.6%, as it was in 2022. The slowdown was more pronounced in Q4 2023, where the inflation rate reached 2.8%, from 3.2% in the previous quarter. The factors that influenced this slowdown were the high base of the previous year as well as the easing of major commodity prices in international markets. The slowdown in inflation reflects the slowdown growth of food prices, the drop in oil prices and the softening of inflationary pressures in services, while the contribution of prices of other goods remained almost unchanged (chart 6).

Chart 6. Inflation by respective subgroups



Source: KAS and CBK calculations.

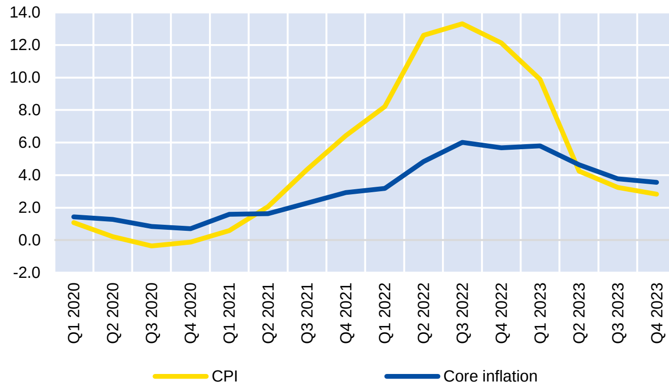
Food prices marked an annual increase of 3.0% in Q4 2023, which represents a slowdown against the annual increase of 5.5%, marked in the previous quarter. A slowdown was observed in almost all categories of food except in prices of fish, fruits, and edible oils. However, annual growth continued to remain high in the prices of vegetables and fruits (16.1% and 16.0%, respectively, in Q4 2023), fish (8.7%), sugar and its products (7.1%) and food products (6.9%). Whereas, prices of milk, cheese and eggs marked a decline of 2.8%, while prices of edible oils marked a decline of 10.7%. Despite the decline/slowdown in some food products, food prices remain almost 30% above their levels that were marked before the war in Ukraine, continuing to burden the disposable household income, given the weight of food in the consumption basket in the country (32.2%).

Transport prices recorded an annual decline of 1.5% in Q4 2023, with the subcategory of personal transport equipment, which recorded an annual decline of 5.8% due to the base effect and the decline in fuel prices in international markets compared to the previous year. Moreover, the rise in fuel prices recorded in the previous quarter resulted to be a one-off increase, in line with price trends in international markets, fuel prices in the country slowed down during the last quarter of the year.

The contribution of food to the average inflation rate in Q4 2023 was 1.0 percentage points (from 2.0 percentage points in Q3 2023), with the highest contribution marked by the increase in the prices of vegetables, bread and cereals, fruits, meat, and others . Meanwhile, the contribution of energy in the headline inflation, in Q4 2023, reached -0.2 percentage points, mainly defined by fuels. The contribution of prices of other non-energy goods marked a slight decrease at 1.0 percentage points in Q4 2023 based on the slowdown prices of miscellaneous goods, with the emphasis on the prices of vehicles. Whereas, the contribution of services to total CPI edged down to 0.7 percentage points (from 0.8 percentage points, in Q3 2023) after the slowdown in the price increase of transport services and of the usual maintenance of the house.

Core inflation in Q4 2023 marked an annual increase of 3.6%, which compared to the previous quarter represents a slowdown of 0.2 percentage points as a result of the slowdown of inflationary pressures in transport, hotel services, as well as the slowdown in the prices of furniture, household appliances and maintenance of the house (chart 7). Whereas, an increase was observed in prices of services of recreation and culture, footwear and clothing, and outpatient services.

Chart 7. Core and headline inflation of consumption

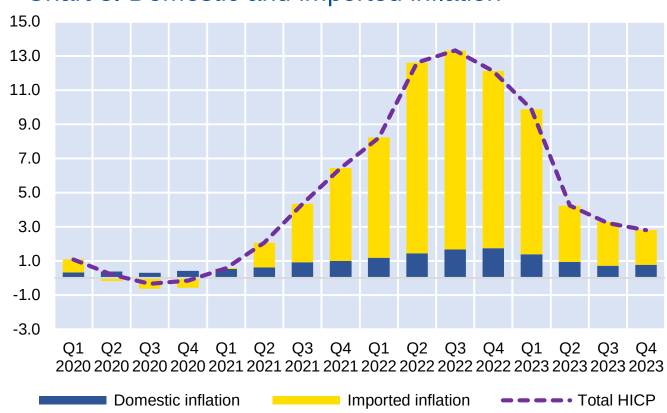


Source: KAS and CBK calculations.

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 an impact on the inflation rate in Kosovo and is largely determined by the prices of imported goods. In Q4 2023, 2.0 percentage points of inflation in Kosovo was imported, while 0.8 percentage points was generated by internal inflationary pressures (chart 8).

Import price index (IPI) marked an annual increase of 1.0% in Q4 2023, which represents a slowdown against the increase of 3.0%, marked in the previous quarter. Compared to the same quarter of the previous year, the categories with the highest weight within this index which include i) prepared food products, beverages and tobacco, and ii) machinery and electrical equipment recorded an annual growth of 7.3% and 0.6%, respectively, while iii) base metals and related articles and iv) mineral products, marked an annual decrease of 5.3% and 7.4%, respectively. Compared to the previous quarter, IPI recorded a decrease of 1.0% mainly as a result of the price drop in the four main categories mentioned above, and also being supported by the slowdown in other categories.

Chart 8. Domestic and imported inflation



Source: KAS and CBK calculations.

The producer price index (PPI) resulted in an increase of 2.7% in Q4 2023, compared to the same quarter of the previous year, mainly as a result of the increase in the price of electricity production (1.2%). Other categories with significant weight in PPI, such as the production of non-metallic minerals (3.2% annual increase), processing of food products (6.4%), production of beverages (4.5%), rubber and plastic and related products (1.6%), also contributed to this growth.

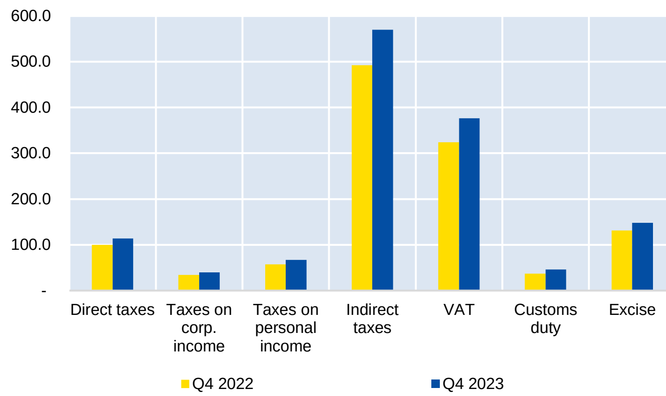
Construction cost index (CCI) marked an annual increase of 0.3%, in Q4 2023. This decline was mainly impacted by the price decrease of construction materials (-1.7%) and transport (-8.1%). Whereas, there was observed an inflationary pressure of salaries in the construction sector, and the increase of energy prices, machinery and other costs. In relation to Q3 2023, there was an increase in CCI of 0.7%, mainly as a result of the increase in salaries and energy prices; while there was a slight decrease in the prices of construction materials.

Regarding the perspective of inflation in Kosovo, the CBK forecasts that inflation in 2024 will slow down to 2.5%. Factors expected to contribute to these dynamics include the stabilization of supply side and the prices of major commodities in international markets along with the slowdown global economic activity, the downward trend in inflation in the euro area, the transmission of tightening of financing conditions in the domestic demand, etc. Risks interlinked to inflation tend towards an upward direction and mainly consist of the risks of disruptions in supply chains as a result of the geopolitical tensions, the production cuts by OPEC+, and others.

3.3. Fiscal Sector

Primary budget revenues in 2023 reached a net value of EUR 2.85 billion, representing an annual increase of 14.5%. The increase in budgetary revenues came as a result of the growth of economic activity, the persistent high inflation rate, as well as the efforts undertaken to narrow the tax gap in the country by formalizing the economy. Also budget expenditures marked a double digit increase of 13.2% and reached the value of EUR 2.84 billion. Consequently, Kosovo's budget recorded a primary budget deficit of EUR 14.6 million. **Primary budget revenues[2], only in Q4 2023, reached a net value of EUR 737.4 million, representing an annual increase of 15.0%. On the other hand, primary budget expenditures[3] marked a growth of 10.0% and reached the value of EUR 1.04 billion. As a result of the higher level of budget expenditures, only in Q4 2023, Kosovo's budget recorded a primary deficit of EUR 304.7 million.**

Chart 9. Tax income structure



Source: MFLT and CBK calculations.

Tax revenues In Q4 2023 reached the value of EUR 666.6 million, marking an increase of 16.2% compared to Q4 2022. All the categories of taxes marked an increase during this period. The highest growth was observed in indirect tax revenues, which comprised around 77% of the total budget revenues in Q4 2023. Indirect tax revenues marked an increase of 15.7%, reaching the value of EUR 570.2 million. The increase of indirect tax revenues, among others was also interlinked with the high inflation rate, which despite of being significantly decreased, continued to remain high. Within indirect taxes, VAT income and customs duty marked an increase of 16.2% and 23.0%, respectively, being significantly affected by increase of prices. Also, the excise tax recorded a slowdown increase of 12.4%, as a result of the accelerated increase of import of goods in Q4 2023 (chart 9). Direct tax revenues marked an increase of 14.2%, reaching the value of EUR 114.2 million. The increase of the direct tax revenues which are mainly realized by Kosovo Tax Administration, was a result of an improvement of the collected income, the activities undertaken to combat and prevent tax invasion and the strengthening of the voluntary fulfillment of tax payments by taxpayers, etc. Within this category, personal income tax, which comprises the main category, marked an annual increase of 17.0%, while corporate income tax, marked an annual increase of 15.4%.

Besides tax revenues, also non-tax revenues marked a growth of 3.4%, reaching the value of EUR 67.5 million. Within this category, revenues from the central government reached the value of EUR 38.1 million, marking a growth of 4.9%, while the revenues from the local government declined by 2.4%, amounting to EUR 16.8 million.

Regarding budget expenditures, current expenditures increased by 9.3%, while capital expenditures increased by 11.5%. In the category of current expenditures, expenses for salaries increased by 14.5% and

[2]Within budget revenues are not included receipts from financing.
[3]Within budget expenditures are not included financing payments.

reached the value of EUR 200.4 million, expenses for goods and services, including the utilities, increased by 18.3% and reached the value of EUR 166.7 million, while expenses for subsidies and transfers increased by 3.4% and reached the value of EUR 378.1 million. Capital expenditures marked an increase of 11.5%, reaching the value of EUR 291.3 million.

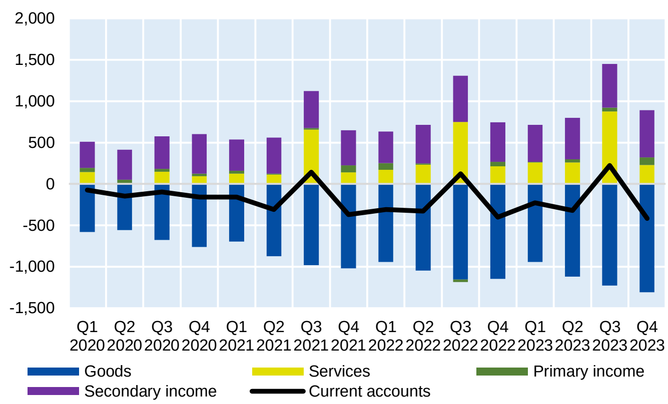
Debt to GDP ratio declined to 17.2% in Q4 2023, compared to 19.9%, as it was in Q4 2022. This decrease in public debt to GDP ratio resulted from the improvement of the government's budget balance in 2023 and the growth in nominal GDP. In absolute terms, the public debt has reached EUR 1.66 billion in Q4 2023, marking a decline of 5.1% compared to Q4 2022. The decrease of public debt is attributed to the decline of domestic public debt of 12.8%, reaching EUR 970.2 million, while external public debt marked a growth of 8.1%, reaching EUR 692.9 million.

External public debt is comprised of liabilities to International Agency for Development (36%), European Union (14%), International Bank for Reconstruction and Developments (13%), International Monetary Fund (11%), etc. Conversely, domestic debt primarily is comprised of Kosovo's Government debt (securities) to pension funds (46%), commercial banks (24%), public institutions (22%), etc.

3.4. External Sector

The current account deficit in 2023 was reduced by 19.5%, reaching the value of EUR 738.4 million (EUR 917.1 million in 2022). Only in Q4 2023, current account deficit was EUR 415.5 million (EUR 402.3 million in Q4 2022). The balance of the current account in Q4 2023 continued to be determined mainly by developments in the trade balance of goods, a component which worsened as a result of the increase in import of goods and the decrease in exports. Meanwhile, primary income, secondary income and services contributed to the reduction of the current account deficit (chart 10).

Chart 10. Current account, EUR million

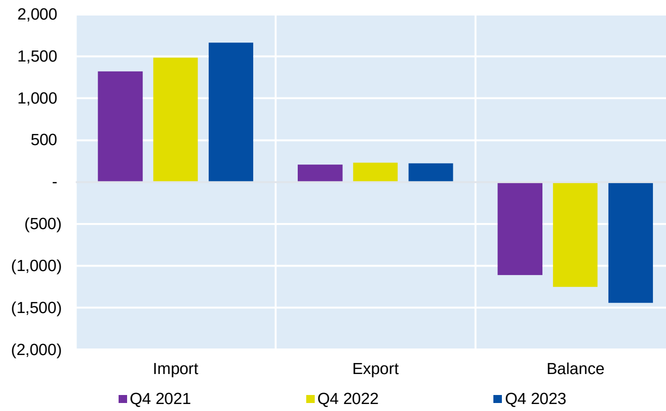


Source: CBK.

The category of goods in Q4 2023, marked an annual increase of deficit of 15.1%, reaching EUR 1.4 billion (chart 11) . The main reason for the increase in the trade deficit is related to the significant increase in the import of goods and the decline in exports. Export of goods have covered import by only 13.4%, representing a trade ratio of 1:7.5, in Q4 2023.

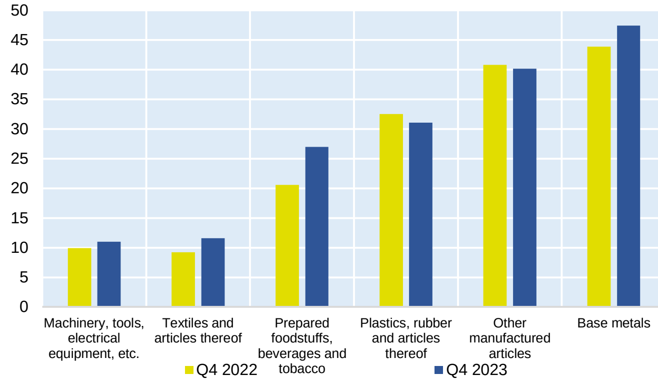
The export of goods recorded a decrease of 6.2% in 2023, reaching the value of EUR 863.1 million (EUR 920.4 million in 2022). Only in Q4 2023, the total value of goods export was EUR 222.3 million, representing a decline of 4.3% compared to the same period of 2022. Structure of goods by categories remains unchanged. The export of base metals marked an increase of 8.1% in Q4 2023, reaching the value of EUR 47.4 million from EUR 43.9 million as it was in Q4 2022. The decline in export of goods was mainly influenced by the drop in export to the US market by 5.9%, as well as plastic and rubber products, which recorded a decline of 4.6% (chart 12). The main partners for the export of goods, in Q4 2023, were the countries of the Western Balkans with a share of 39.0% of the total goods exported and the EU countries with a share of 33.7%, among which the main share continues to have Germany, with 10.8% of total Kosovan exports.

Chart 11. Trade balance of goods



Source: KAS.

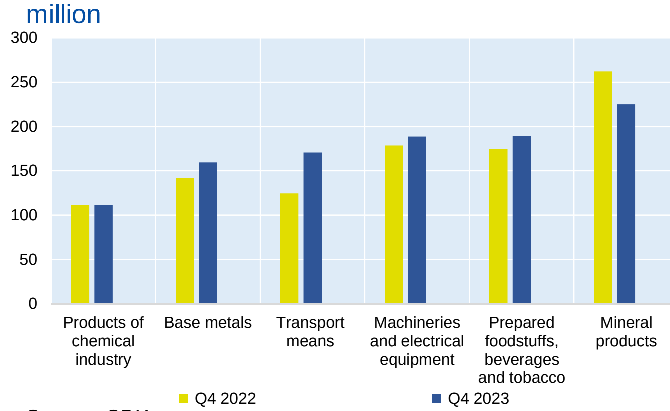
Chart 12. Main categories of exported goods, EUR million



Source: CBK.

The goods imported in 2023 reached the value of EUR 5.9 billion, marking an annual increase of 4.9%. While, the value of imports, only in Q4 2023, reached EUR 1.6 billion, representing an annual increase of 12.0%. The structure of imported goods continued to be dominated by import of mineral products, food commodities, and machineries, including household appliances (chart 13). Import by the main categories was dominated by the category of intermediary goods, with 44.0%, consumer goods 30.8%, while the category of capital goods remains low at 10.2% of total **import.** The dynamics of prices in international markets influenced the increase in the amount of imported goods, especially in the category of capital goods and consumer goods, which recorded an increase in import of 11.9% and 11.2%, respectively. The structure of trade partners remained unchanged, with the European Union leading with around 43.1% of imports, where Germany continues to have the main share of 13.0% of total Kosovan imports. Kosovo imported from the region countries 13.6% of total imports or EUR 226.2 million. Meanwhile, the import of goods from Turkey has reached the amount of EUR 293.2 million or 17.6% of the overall value of imports.

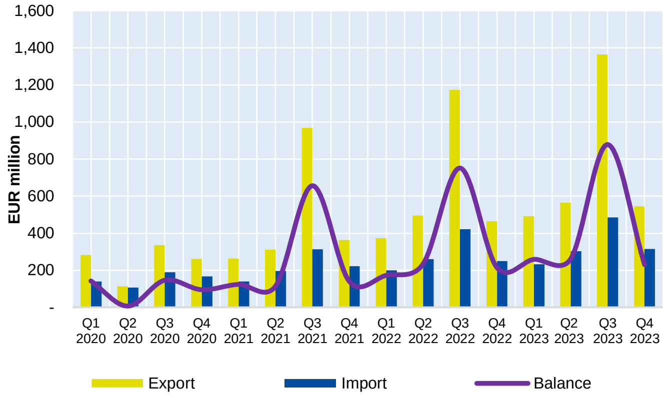
Chart 13. Main categories of imported goods, EUR million



Source: CBK.

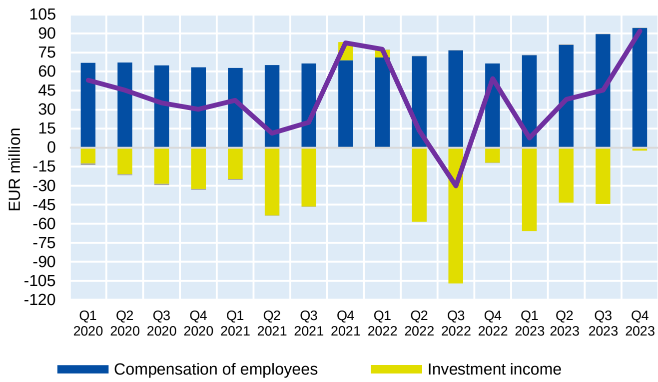
Services have continued to contribute positively within the current account, with an annual growth of the positive balance of 7.3%, reaching a value of EUR 230.5 million in Q4 2023 (chart 14). The export of services increased by 17.7%, amounting to EUR 546.2 million. The increase in the export of services was mainly a result of an increase in travel services of 19.0%, a category that reached the value of EUR 331.7 million, mainly influenced by the increase in the number of travelers by 15.8% compared to the same period of the previous year. Also the category of information technology services contributed to the increase in the export of services, which marked an increase of 41.0% and reached the value of EUR 82.1 million from EUR 58.2 million, as it was in Q4 2022. Conversely, import of services reached the value of Eur 315.7 million, representing an annual increase of 26.8%. The import of services was attributed to the increase in travel services and transport, which comprise 58.4% of the overall value of import of services. After the liberalization of visas which started since January 2024, the import of travel services is expected to be affected, a dynamic that could weaken the balance of services.

Chart 14. Balance of services



Source: CBK.

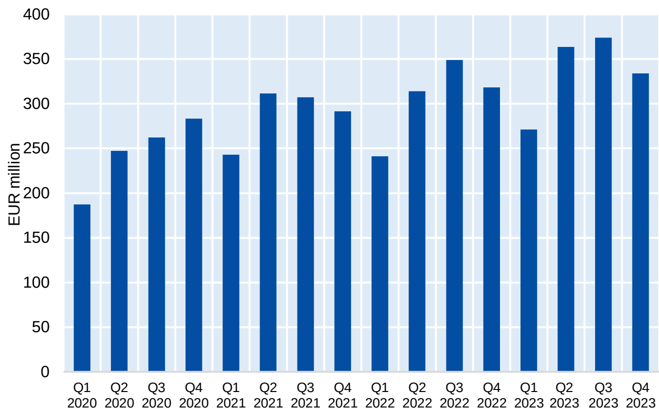
Chart 15. Balance of primary income



Source: CBK.

Current account balance reached EUR 92.0 million, in Q4 2023 (EUR 54.5 million, in Q4 2022). The increase in primary income was mainly influenced by employees' compensation income, the balance of which reached the value of EUR 94.3 million, representing an increase of 41.9% compared to the same period of the previous year. At the same time, the balance of investment income was negative with EUR 2.3 million, in Q4 2023, as a result of the return of the dividend from foreign direct investments (chart 15). Meanwhile, portfolio investments recorded a positive balance of EUR 18.1 million, mainly influenced by securities, followed by other investments with a negative balance of EUR 2.9 million and reserve assets with a positive balance of EUR 13.8 million.

Chart 16. Remittances

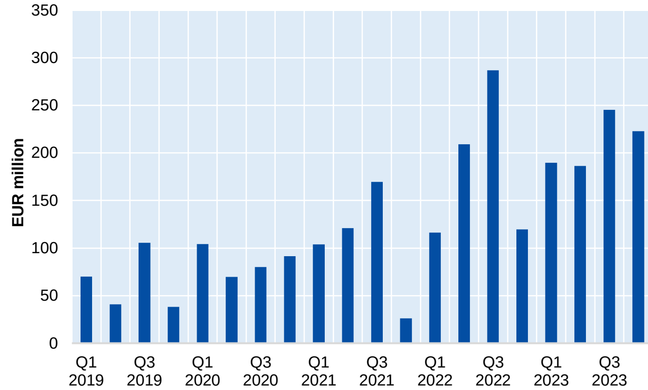


Source: CBK.

The value of remittances received in 2023 reached EUR 1.3 billion, marking an increase of 9.9% compared to the previous year. The value of remittances received only in Q4 2023, reached EUR 334.1 million, representing an increase of 5.0% compared to Q4 2022 (chart 16). Remittances mainly come from Germany and Switzerland, which comprise around 59.2% of total remittances received. Remittances by formal channels (banks and other institutions) have recorded an increase of 2.2%, while there has been an increase of EUR 13.1% of remittances received through non-formal channels.

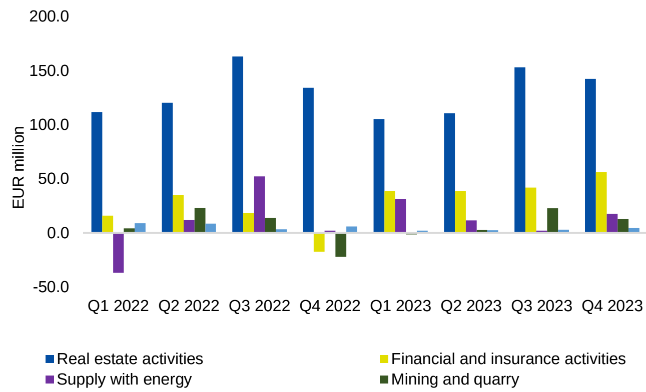
Foreign direct investments reached a value of EUR 844.3 million in 2023, marking an annual increase of 15.3% compared to the value of EUR 732.0 million, as it was in 2022. Foreign direct investments, in Q4 2023, result to have marked an increase of 86.6% compared to the same period of the previous year, reaching the value of EUR 223.0 million (chart 17). The increase of FDI was mainly recorded in the real estate sector, reaching 6.0%, which amounted EUR 142.4 million, compared to EUR 134.3 million marked in Q4 2022. Although the real estate sector remains the main sector for FDI, in Q4 2023 a slight increase in FDI was observed in the electricity supply sector and the mining sector including quarrying (chart 18). Direct investments invested by residents from Kosovo in other countries marked a decline of 48.0% in Q4 2023, reaching the value of EUR 28.1 million compared to EUR 53.9 million marked in Q4 2022, investments which were mainly destined to the region countries in the real estate sector.

Chart 17. Foreign Direct Investments



Source: CBK.

Chart 18. FDI by main activities



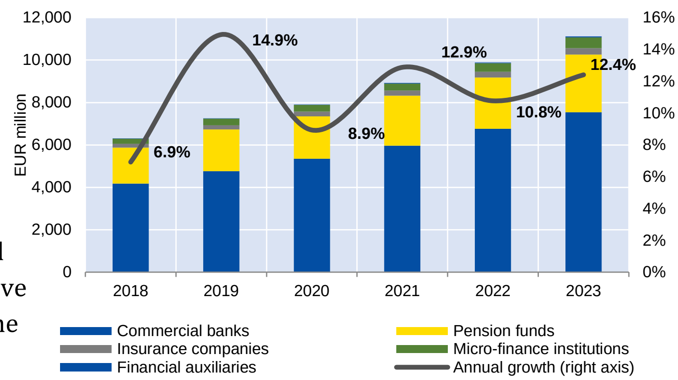
Source: CBK.

4. Financial system

Financial system in the country has continued with a higher trend of expansion also in the last quarter of the year, closing the year with an accelerated annual growth rate of assets, while the developments in the following year are expected to be subject of overall macroeconomic dynamics, which are expected to be more positive and the capacity of raising funds - the increase of deposits and external financing.

In December 2023, financial system assets reached the value of EUR 11.1 billion, representing an annual increase of 12.4% (chart 19). Excluding the banking sector, which marked a slowdown of increase in assets, all other sectors were characterized with an accelerated annual growth rate.

Chart 19. Assets valueof Kosovo's financial system

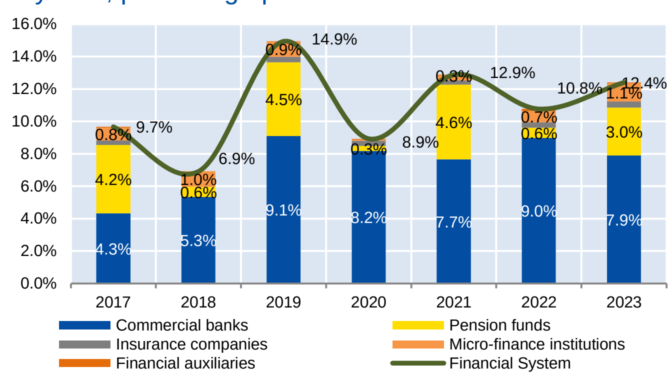


Source: CBK.

The banking sector, in December 2023, represented 67.9% of total assets of the financial system, and due to its high weight in the system, gave the main contribution to its expansion despite the slower annual growth (chart 20). Pension funds, which represent the second sector by weight to the financial system, marked an accelerated increase of assets compared to the previous year. The other sectors, microfinance, insurance and financial auxiliaries, recorded, as well, significant growth during this period, albeit due to their low weight, they had a low contribution to the growth of the total financial system assets.

4.1. Banking Sector

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



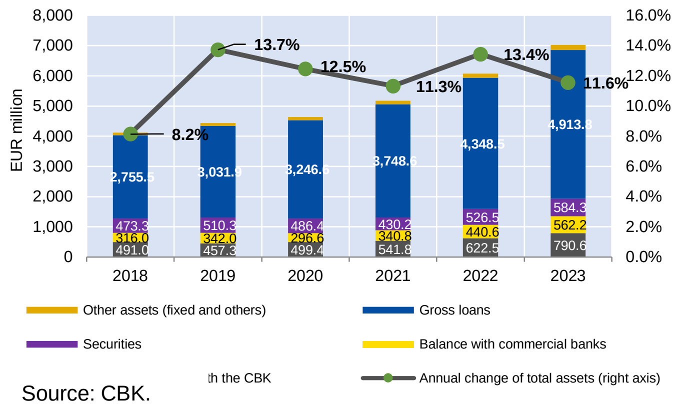
Source: CBK.

The banking sector throughout 2023 was exposed to risks coming from worsening macroeconomic factors, influenced by the geopolitical situation as well as the accumulated effects of inflation. Effects from the tightened monetary policies impacted on the level of inflation in the euro area and beyond, being reflected in the decline of inflationary pressures in Kosovo, as well. However, the higher inflation for a longer period of time produced negative consequences in other economic segments, namely a negative effect in the consumer basket, an increase in interest rates in the first half of 2023 with a stabilizing tendency in the second half of the year, an increase of prices in real estate sector, and a pressure for a rise in salaries in the labor market. In the following year, it is expected that the inflationary pressures will soften further, reducing the uncertainties for investments which are expected to contribute to the overall economic growth. The banking sector in Kosovo, due to its weight, structure and low complexity, does not have high exposure to the external sector. However, the negative effects coming from macroeconomic dynamics such as economic growth in the euro area, the inflation rate and the increase in the cost of financing have a more direct impact on domestic demand in Kosovo and, consequently, implications on the dynamics in the banking sector.

Assets

In December 2023, banking sector assets reached the value of EUR 7.5 billion, corresponding with an annual increase of 11.6%, which is for 1.9 percentage points lower compared to the same period of the previous year (chart 21). This dynamic was influenced by lending activity - as the main activity of the banking sector - which grew at a slower pace compared to the previous year. The environment of higher interest rates influenced the amount of investments in securities to grow at a faster pace, while the items with lower return such as the balance in other banks and the amount of cash and the balance with the CBK recorded a slowdown in growth.

Chart 21. Balance sheet of the banking sector - assets

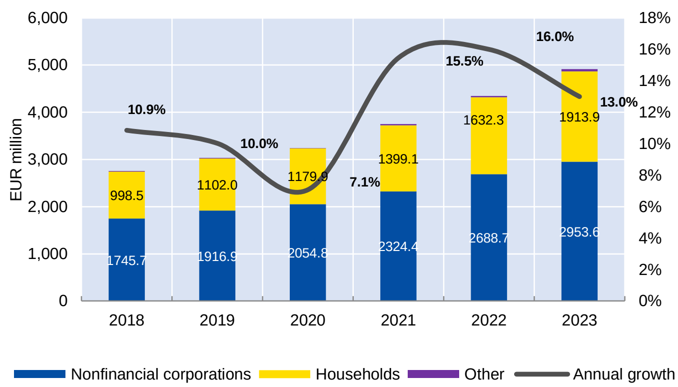


Source: CBK.

Lending

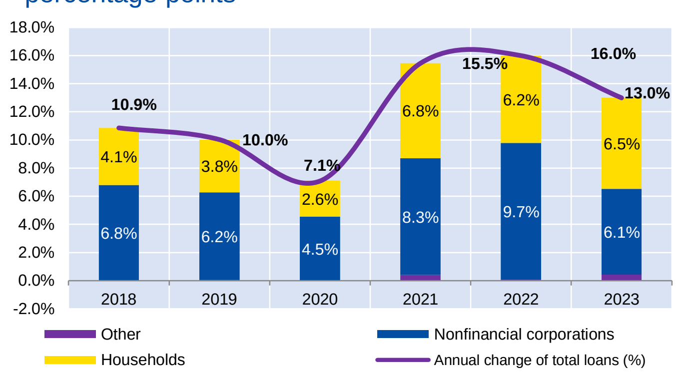
Lending activity of the sector marked an annual growth of 13.0%, which corresponds to a lower annual increasing rate of 3 percentage points. This development reflects the slower trend of credit growth for nonfinancial corporations as well as the prepayment of a part of loans by some large borrowers within the limits requirements for large exposures. Meanwhile, loans to households accelerated their annual growth trend. According to the Bank Lending Survey in Kosovo (BLSK), lending dynamics also in the fourth quarter of 2023, as during the rest of the year, were largely influenced by credit demand, whereas credit supply was characterized with marginal changes. Such a development, characterized by a slowdown in the upward trend in lending activity, is in line with the orientation of the ECB's monetary policy towards curbing inflation.

Chart 22. Stock of total loans, annual change



Source: CBK.

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

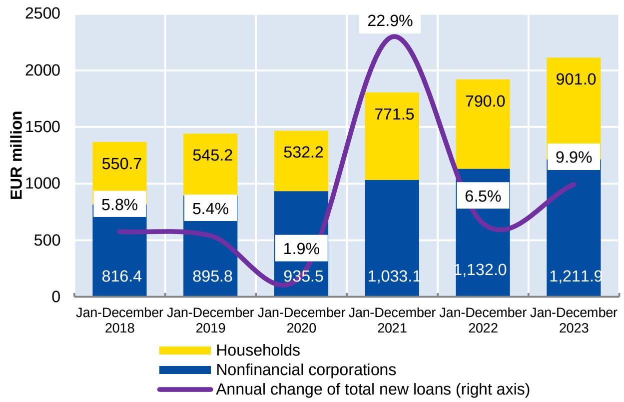


Source: CBK.

The segment of nonfinancial corporations recorded an annual growth of loans stock of 9.9%, which is for 5.8 percentage points lower compared to the previous year (chart 22). A slowdown increase in lending was marked for almost all economic sectors, especially in the sectors with higher weight of lending, as the trade sector, manufacturing and construction. This development is suggested to have been influenced more by demand factors, while the credit supply remained unchanged. Banks stated that credit standards mainly remained unchanged for both large enterprises and SMEs. While there was a slight increase in loan demand from SMEs, demand from large enterprises remained widely unchanged. The slower growth of lending to enterprises is in line with general macroeconomic developments, namely the slower growth of GDP compared to the previous year. Loans to households accelerated the annual growth to 17.3% from 16.7%, as it was in the previous year. Due to the higher share to total loans, the segment of nonfinancial corporations had the main contribution to the deceleration of total lending activity (chart 23).

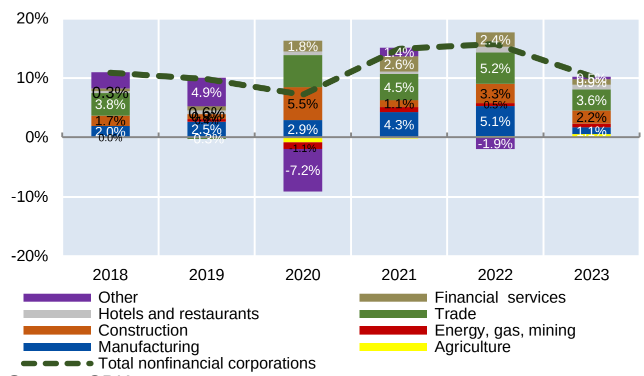
New **loans, in 2023, marked an annual growth of 9.9% from 6.5% marked in the same period of the previous year.** The segment of nonfinancial corporations was characterized by a slowdown in the annual growth rate of new loans at 7.1% from 9.6%, while loans to households marked an accelerated increase of 14.1% from 2.4%, marked in the previous year (chart 24). Within the NFC, a slowdown growth was marked by new loans for investments purpose, which reached 3.6% compared to the growth of 9.0%, whereas loans with non-investment purpose marked an annual accelerated increase of 15.6% from 7.8% marked in 2022. Within the household segment, new consumer credit recorded an annual increase of 23.2% from the decrease of 6.3% marked in 2022. Whereas, new mortgage loans marked an annual decline of 11.3% from the increase of 13.5% marked in 2022. Also, foreign direct investments in the real estate sector showed a declining trend in 2023. This, along with the decline in mortgage loans, in addition to the base effect of higher growth in the previous year, may suggest a downward trend in overall real estate investment, influenced by rising interest rates as well as the real estate prices.

Chart 24. New loans, annual change



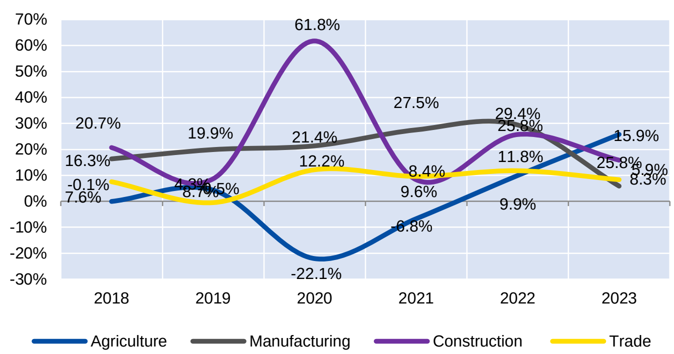
Source: CBK.

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.

The credit structure of the nonfinancial corporate sector is dominated by the trade sector, which has been the most credited sector over the years, followed by the manufacturing and construction sectors, which have grown with the fastest trend in recent years, gradually expanding the share in total loans of the banking sector. During 2023, lending to trade sector continued to have the highest contribution to the growth of total loans to nonfinancial corporate segment (chart 25), as a result of the high weight in this segment and the annual growth of 8.3% (chart 26).

The manufacturing sector in 2023 marked a significantly slower annual growth of 5.9% from 29.4% in 2022, when it also had the highest weight in the increase of total lending to NFC, also influenced by the support from the government's subsidy measures within the economic recovery package. Lending to the construction sector marked a low annual growth as well, reaching 15.9% from 25.8% marked in the previous year. The slowdown in lending for this sector may have also 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. The agriculture sector, which has a low share in the total lending of the banking sector, was characterized by accelerated annual growth of 25.8% from the growth of 9.9% marked in the previous year.

Liabilities and own resources

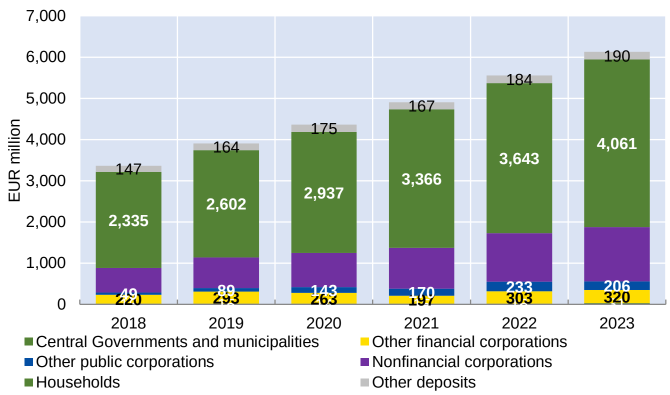
Financing of the banking sector activities continued to rely on customer's deposits and own capital, namely retained earnings from the previous periods and realized earnings during the year. Both of these items comprise 92.6% of liabilities and equity, while 81.3% accounts for only deposits, which are therefore the categories that determine the direction of the banking sector activities.

Deposits

Deposits marked slower growth of 10.4% from 13.3% marked in the previous year, which primarily attributed to a slowdown in nonfinancial corporate deposit growth to 12.6% from the increase of 18.9% marked in the previous year. Meanwhile, household deposits experienced a more stable and consistent growth of 11.4% compared to the increase of 8.2%, as it was in the previous year.

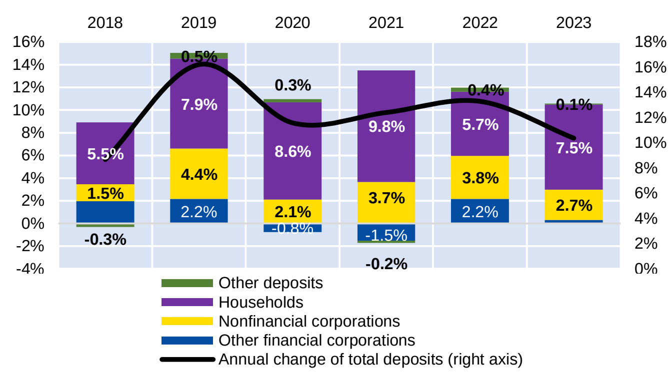
The value of the stock of deposits at the end of 2023 reached EUR 6.13 billion (chart 27), of which EUR 1.32 billion belong to nonfinancial corporations and EUR 4.06 billion are household deposits. The slower growth of deposits this year was determined by the slowdown in the growth of deposits of financial and nonfinancial corporations as well as the decline of deposits of public corporations which have increased investments in securities that offer more attractive rates of return. However, it should be noted that the average annual growth along all months of the year was higher this year with an average of 14.0% compared to 10.7% marked in the previous year.

Chart 27. Stock of total deposits



Source: CBK.

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

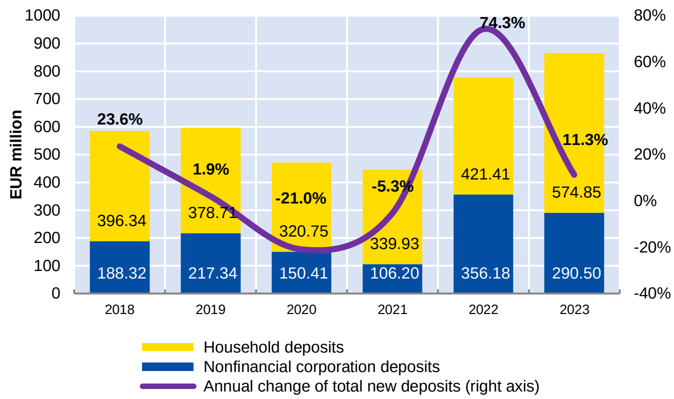


Source: CBK.

Deposits of public corporations and local government marked e decrease, while central government deposits increased. Other financial corporation deposits, which are comprised mainly by pension funds deposits, marked a significantly slower increase compared to the high growth marked in the previous year (chart 28).

New deposits, which consist only from time deposits, reached the value of EUR 865.4 million by the end of the year, representing an annual increase of 11.3%, which is much lower than the increase of 74.3%, marked in the previous year . This slowdown growth of deposits is the effect of the high growth in the previous year that was driven by the dynamics in the market with increased interest rates and attractive campaigns by the banks for term assets deposited at banks (chart 29). The stock of nonfinancial corporate deposits reached EUR 1.32 billion at the end of the year, representing a slower increase compared to the previous year. New deposits coming form this segment declined to EUR 290.5 million from EUR 356.2 million in the previous year, which corresponds to an annual decline of 18.4% from the increase of 235.4% marked in the previous year. Meanwhile, household deposits recorded a higher growth, in which case also new deposits grew at a higher rate of 36.4% from the increase of 24.0%, marked in the previous year.

Chart 29. New deposits, annual change

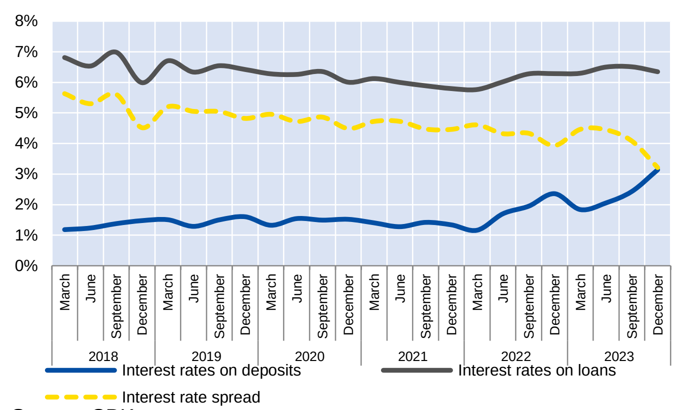


Source: CBK.

Interest rates

The rise in interest rates on the global level has been translated into increased competitive pressures to secure sustainable financing. Interest rates on deposits were affected to a greater extent than interest rates on new loans due to their initial positions, being generally characterized with higher rates on loans with limited room for further increase, compared to the lower rates on deposits. In 2023, interest rates on new loans reached an average of 6.5%, from 6.0% as they were in 2022. Interest rates on new deposits increased at an average of 2.3% during 2023, from 1.7% and 1.3% as they were in 2022 and 2021, respectively. This caused the average interest rate spread on loans and deposits to narrow slightly to 4.2% from 4.3%, due to the higher increase of interest rates on deposits compared to the increase of interest rates on loans.

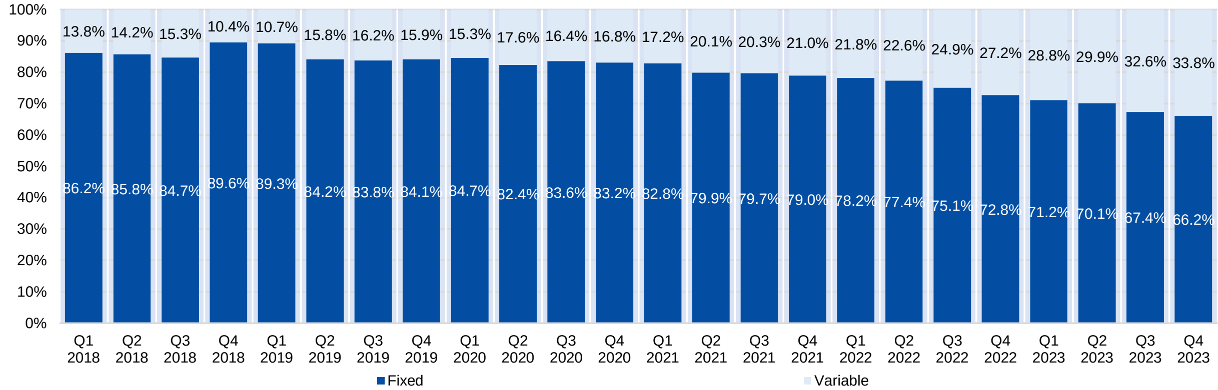
Chart 30. Interest rate on loans and deposits



Source: CBK.

However, since the last decision of the European Central Bank to increase interest rates, taken place in September 2023, it has not further increased the basic interest rates, a policy which has nevertheless succeeded in curbing inflation, which is expected to gradually decrease in 2024, while in 2025 it is expected to fall to the level of 2.0%. These developments in the ECB's monetary policy have also partially had an impact on the interest rates applied by local banks, which, however, have gradually started to decrease there rates, more specifically the loan interest rates, with further downward expectations. Meanwhile, interest rates on deposits continued to follow an upward trend. Moreover, in the last survey conducted with banks, it was emphasized that there will be no increase in interest rates on loans, and these rates are not expected to have an impact on credit supply and demand.

Chart 30a. Loans stock by types of interest rates

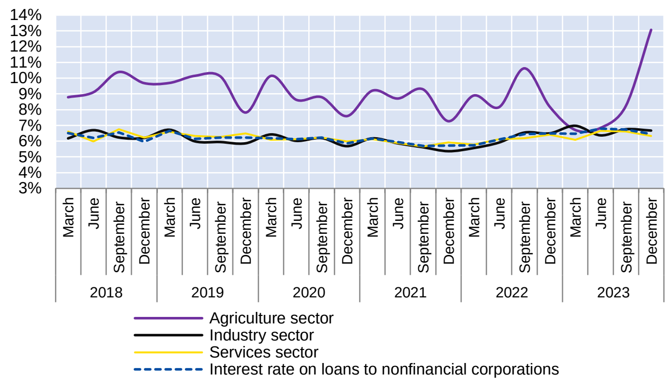


Source: CBK.

In December 2023, interest rate on loans fell to 6.3% from 6.6%, as it was in the beginning of the year. While the average interest rate on deposits rose to 3.1% from 1.9%, as it was in the beginning of 2023, and 2.4 percent in December 2022. The interest rate spread of loans and deposits narrowed down to 3.2 percentage points (pp) from 3.9 percentage points in December 2022 (or 4.7 pp in January 2023), due to the higher increase of interest rates on deposits than the increase of interest rates marked on loans (chart 30).

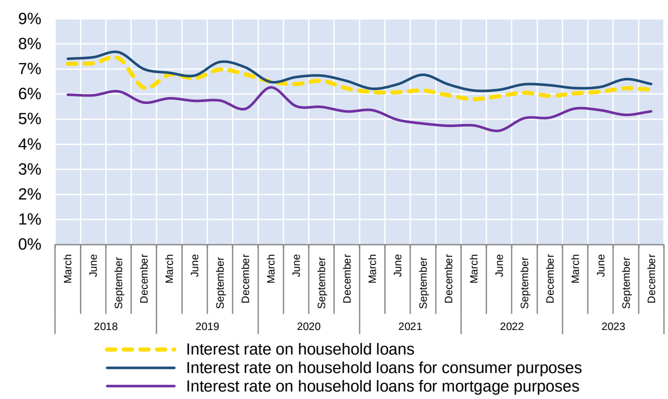
Moreover, the dynamics of interest rates, in the last two years, have also changed the structure of loans according to the type of interest rates, especially being reflected in the increase of the share of loans with variable interest rates, where any additional increase of interest rate is determined by the movements of the Euribor rate. In 2021, these loans accounted for 19.6% of the total loan portfolio, expanding to 24.1% in 2022 and 31.3% on average in 2023. Whereas, in December 2023, loans with variable rates comprised 33.8% of total loan portfolio. (chart 30a).

Chart 31. Interest rate on loans to nonfinancial corporations



Source: CBK.

Chart 32. Interest rate on loans to households

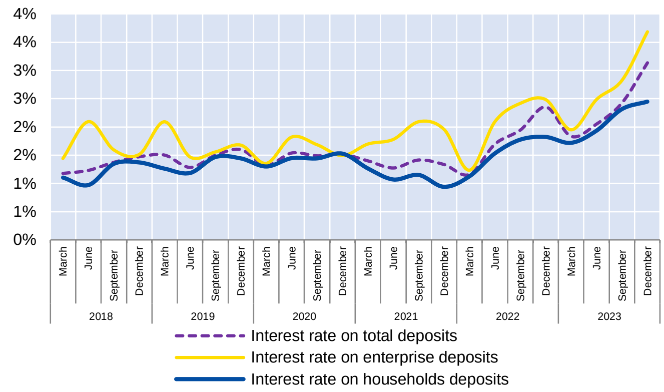


Source: CBK.

The average interest rate on loans to nonfinancial corporations, in December 2023, was 6.5%, or for 0.03 percentage points lower compared to the same period of the previous year. More favorable interest rates on loans were offered for industry sector with 6.3%, while the highest average interest rate of 13.1% was for agriculture sector (chart 31).

The average interest rate on loans to households reached 6.2%, which is for 0.24 percentage points higher compared to the same period of the previous year. More favorable interest rates have been applied to mortgage loans, with an average of 5.3%, since they are considered to have a lower risk as being covered by collateral (mortgage). However, consumer credit continues to have higher interest rates with an average of 6.4% as they were in December 2023 (chart 32).

Chart 33. Interest rates on deposits



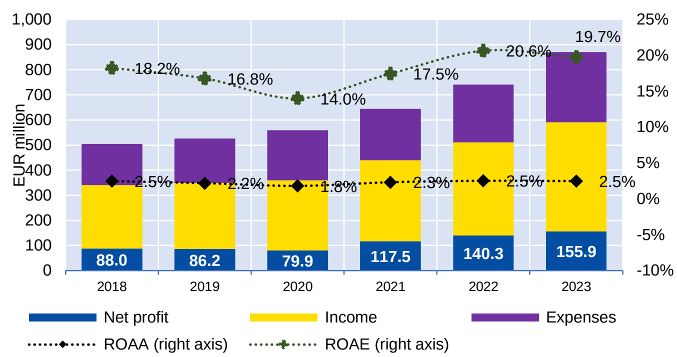
Source: CBK.

Interest rates on deposits began with a growth trend since June 2022. In December 2023 the average interest rate on deposits marked an increase of 0.8 percentage points, reaching a rate of 3.1% in December 2023. Interest rates on nonfinancial corporation deposits increased by 1.2 percentage points, reaching 3.7%. Interest rates were also increased for household deposits by 0.6 percentage points, reaching 2.5% in December 2023 (chart 33).

Performance of the banking sector

The banking sector's profitability was notably impacted by rising interest rates, with some banks benefiting from increased interest income on loans, while others faced higher expenditures, particularly related to interest on deposits and administrative expenses.

Chart 34. Profit and profitability indicators of the banking sector



Source: CBK.

By the end of 2023, the sector realized a net profit of EUR 155.9 million, reflecting a slower annual growth rate of 11.1%, down from 19.4% marked in the previous year. This financial outcome was driven by higher interest income from loans, although this growth was constrained by the substantial rise in interest expenses on deposits and administrative expenses (chart 34).

Total income reached EUR 435.5 million, marking a 17.6% annual increase compared to the previous year's 15.0%. Within income increase, interest income from loans were the main driver, which represent 74.6% of total income. Within the interest income, the collection of interest from loans had the main contribution to this increase, a category which was influenced mainly by the significant increase in lending and the increased rates on loans in the last two years. Additionally, income from securities increased due to higher investment returns, while growth in placements with banks slowed significantly compared to the previous year. Non-interest income, primarily from fees and commissions, grew at a slower annual rate of 3.2%, down from 8.0% the previous year, reaching EUR 95.7 million by year-end.

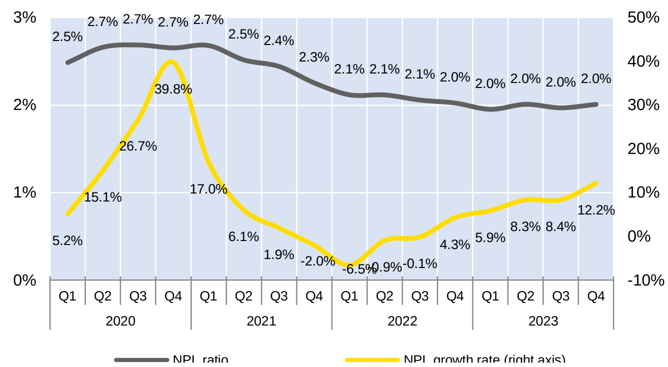
Total expenses for the banking sector reached EUR 279.6 million, characterized by a more rapid annual growth of 21.5%, compared to 12.4% in the previous year. The highest contribution to this increase was given by general and administrative expenses and interest expenses. The category with the highest weight to total expenditures, which consists of general and administrative expenses with a share of 56.1%, increased by 15.9%

compared to the increase of 12.1% marked in the previous year, and reached the nominal value of EUR 156.8 million at the end of the year. The increase of general and administrative expenses mainly reflects the increase of personnel expenses. Furthermore, interest expenses recorded an annual increase of 55.4% from the increase of 9.1% marked in the previous year, which is attributed to the increase of all categories that yield interest expenses and simultaneously an increase in the stock of deposits. Such profit dynamics had an impact on the return on capital to be lower, where this ratio fell to 19.7% from 20.6% as it was in the previous year. While, the return on assets remained at the same level of 2.5%.

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 levels of these indicators beyond the regulatory requirements give priority to the sector in absorbing possible losses that would be caused in case of any possible macroeconomic and financial shocks.

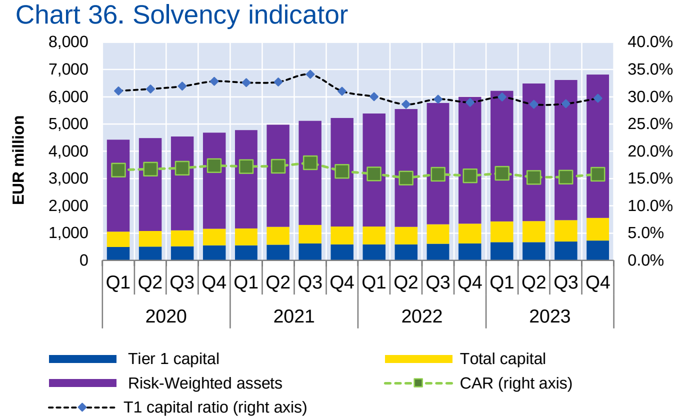
Chart 35. Nonperforming loans and loan loss provisions



Source: CBK.

Nonperforming exposures increased by 12.2% compared to the increase of 4.3% marked in the previous year, however, the ratio of nonperforming loans remained at the same low level of 2.0%, which is a result of the significant increase in lending. The coverage by loan loss provisions declined to 147.2%, from 151.7% as it was in previous year, due to the higher increase marked in the value of nonperforming loans than the value of provisions allocated for loan losses (chart 35).

Chart 36. Solvency indicator

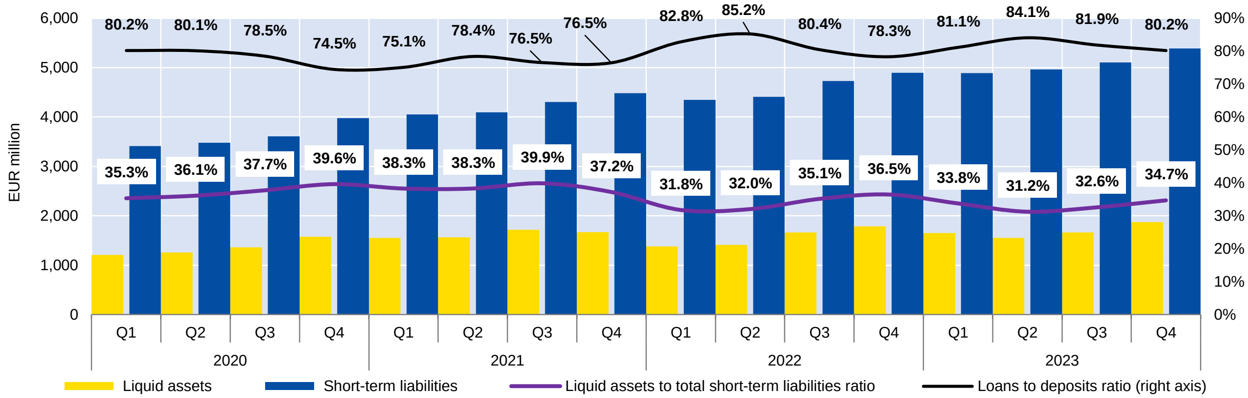


Source: CBK.

The rate of nonperforming loans for the household segment continues to be low, standing at 1.4% in December 2023, although this ratio has increased from the rate of 1.2% marked in the previous year, due to the more pronounced increases in nonperforming exposures with a value of EUR 7.0 million or 36.1%, compared to the increase in lending for this segment of 17.5%. For the segment of nonfinancial corporations, the NPL to total loans ratio decreased to 2.4% from 2.5% marked in the previous year, due to the higher growth of lending to this sector (10.4%) compared to the annual increase of 5.0% in the value of NPL. With an increase of NPL value was characterized the sector of energy and manufacturing, which increased by EUR 3.7 million and EUR 5.0 million, respectively, whereas as a ratio to loans, it increased for 7.2 percentage points and 0.8 percentage points, respectively, reaching the level of 9.5% for the sector of energy and 2.2% for the manufacturing sector. The NPL value compared to 2022 for the trade and services sector decreased by EUR 2.4 million and EUR 1.3 million, respectively, while as a ratio to loans it decreased to 1.9% from 2.3%, whereas the NPL ratio for the services sector decreased to 3.9% from 5.1%. Conversely, for other sectors, the NPL value and its ratio suffered more marginal movements compared to the previous year.

The capital position, expressed through the ratio of regulatory capital to risk-weighted assets, increased slightly to 15.8% from 15.5% as it was in the previous year. The increase in the capitalization rate was influenced both by the increase in profit and the lower level of dividend distribution, as well as by the slowdown in the growth of risk-weighted assets, namely credit activity (chart 36). Despite the high level of liquidity and the stable source of funding such as deposits, liquidity risk continues to require continuous monitoring, considering market conditions.

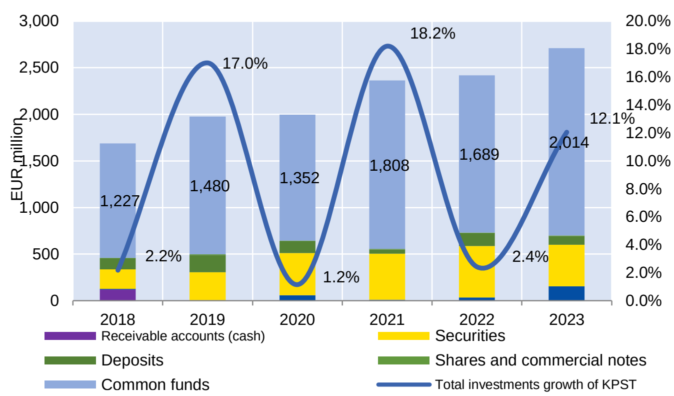
Chart 37. Liquidity indicators



Source: CBK.

The sector witnessed changes in the structure of investments, suggesting continuous adaptation to the new conditions created in the market, with an increase in the cost of financing and at the same time an increase in attractive opportunities for investments. In particular, there has been an increase in investments in financial instruments of foreign markets, while investments in government securities in the country have generally decreased. Some banks have started and others have increased investments in global markets, with the objective of ensuring liquidity while being faced with the current market dynamics. This is also reflected by the not so pronounced decline of the liquidity ratio of 1.8 percentage points, falling to 34.7% in December 2023, compared to the ratio of 36.5% marked in the previous year. The slight decrease of this ratio is attributed to the more pronounced increase in short-term liabilities of 10.0% than the increase in liquid assets of 4.7% (a result of the reduction of current account balances, placements and deposits in local banks as well as investments in local government bonds) (chart 37). Meanwhile, the loan to deposit ratio has increased to 80.2% from 78.3%, due to the more pronounced growth of lending compared to the increase of deposits. The liquidity coverage ratio stood at 279.7% at the end of 2023 from 228.2% as it was in the beginning of 2023.

Chart 38. Assets of the pension sector



Source: CBK.

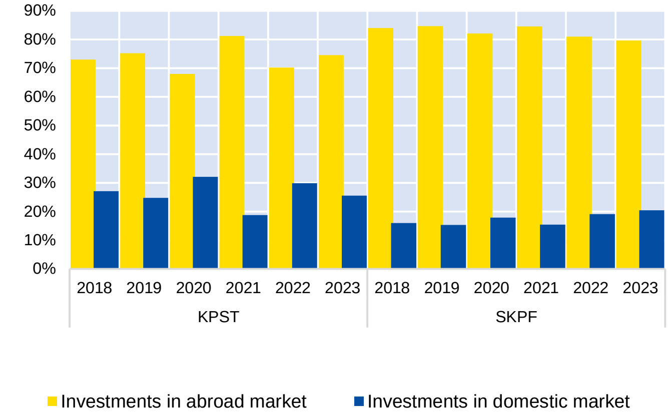
4.2. Pension sector

The pension sector assets experienced a robust growth in 2023 following a year of significant slowed expansion. Despite challenges such as slower economic growth, inflationary pressures, and global geopolitical tensions, both pension funds reported positive returns from foreign market investments, benefiting from high interest rates and conservative monetary policies aimed at controlling inflation. Accounting for 24.4% of the financial system's total assets, pension fund assets grew by 12.1% in 2023, a significant increase compared to the 2.4% growth in the previous year (chart 38). The total value of pension fund assets reached EUR 2.71 billion, with the Kosovo Pension Saving Trust (KPST) representing 99.7% of this amount, and the Slovenian-Kosovo Pension Fund (SKPF) accounting for the remainder. KPST assets grew by 12.1% annually, while SKPF assets increased by 9.9% compared to the previous year.

KPST primarily invests in foreign markets, which constitute 74.5% of its total investment portfolio. These investments, mainly in mutual fund portfolios, rose significantly to EUR 2.01 billion, while the remainder of investments is diversified in the domestic market. While investments in foreign markets have increased, those in the domestic market decreased, with the exception of cash, consisting of a balance held at the CBK, which was characterized with an increase. Investments in Kosovo government securities, at the end of 2023, decreased to EUR 447.1 million from EUR 553.8 million as they were at the end of the previous year, or to 16.5% of the total investment portfolio from 23.0% marked at the end of 2022. Certificates of deposit in local banks, at the end of 2023, decreased to EUR 90.1 million or 3.3% of total investments, down from 5.7%, as they were in the previous year.

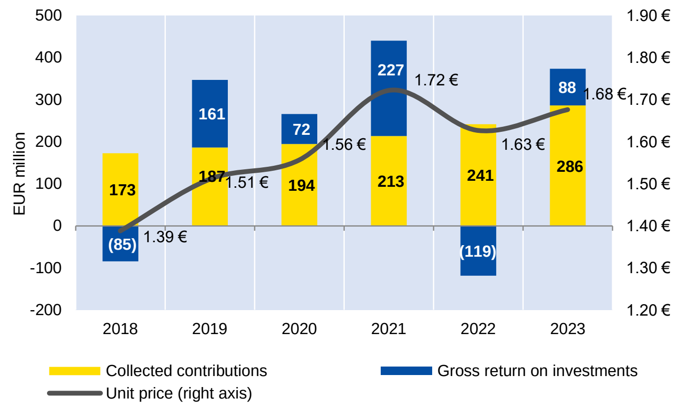
The value of contributions collected by the KPST, in 2023, marked an annual growth of 18.5%, reaching the value of EUR 286.2 million (chart 40b). The high double-digit increase of collected contributions reflects, among others, the increase in the salary level, including the adjustment to inflation, as well as the increase in the salaries of civil servants at the beginning of 2023. Meanwhile, the gross return on investments, in 2023, reached EUR 87.7 million, significantly recovering the losses of the previous year in the amount of EUR 118.8 million. The positive return on investments, especially in Q4 2023, in the amount of EUR 40.1 million, was influenced by the increase in the value of shares, which were influenced by the monetary policy signals not to further increase the basic interest rates.

Chart 39. Structure of pension funds investments



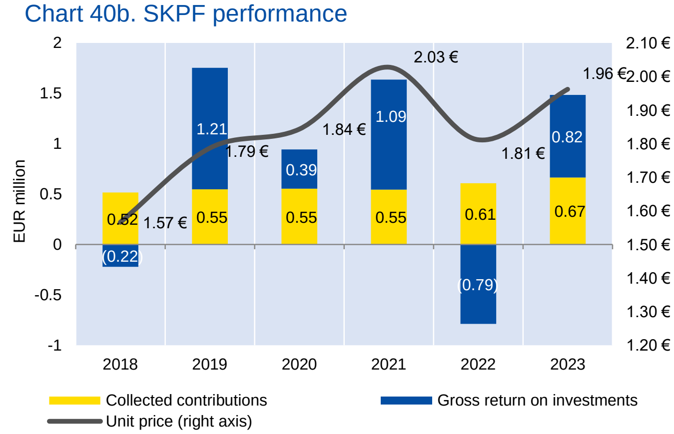
Source: KPST, SKPF

Chart 40a. KPST performance



Source: KPST

Chart 40b. SKPF performance



Source: SKPF

The structure of SKPF investment portfolio is similarly diversified as the KPST investment portfolio, being mainly oriented in the foreign market, more specifically in shares which comprise 77.2% of the investment portfolio and the remainder in cash, which comprise 2.4%, of total investments. Meanwhile, investments within the country are mainly focused on Kosovo's Government securities which account for 18.0% of total investments portfolio. The remainder of assets held in the country, which is comprised of cash and deposits held at commercial banks, account for 2.4% of portfolio.

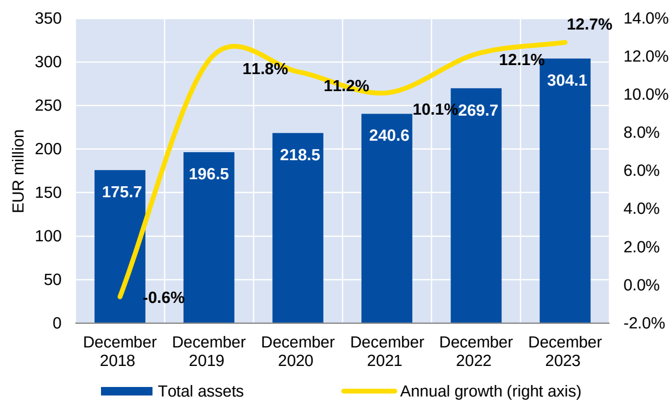
Unlike the previous year, throughout this year, both KPST and SKPF have increased investments in the foreign market against the reduction of investments in the domestic sector (chart 39).

The value of contributions collected by SKPF, in 2023, reached EUR 667.0 thousand, representing an annual increase of 9.6%, influenced by the increase of the number of contributors and at the same time by the increase of salaries in line with inflation indexation (chart 40a). Meanwhile, the cumulative gross return on investments, in 2023, reached EUR 817.0 thousand compared to the losses of the previous year in the amount of EUR 788.6 thousand.

4.3. Insurance sector

The insurance sector, representing 2.7% of the financial system's total assets, marked a significant growth driven by increased written premiums. The sector reported a positive financial return for the third consecutive year, contrasting with previous years' losses marked in the previous years. At the end of December 2023, total assets grew by 12.7% to EUR 304.1 million (chart 41). The expansion of the sector was enabled by the increase of technical reserves, which are a result of written premiums throughout the year 2023, as well as the insurers' own capital. 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, being financed by income from written premiums. The second category in terms of weight, which is comprised of Kosovo's Government securities, recorded an accelerated growth compared to the previous year. Despite improvements, there is still room for enhancing asset quality and key indicators.

Chart 41. Assets of insurance sector

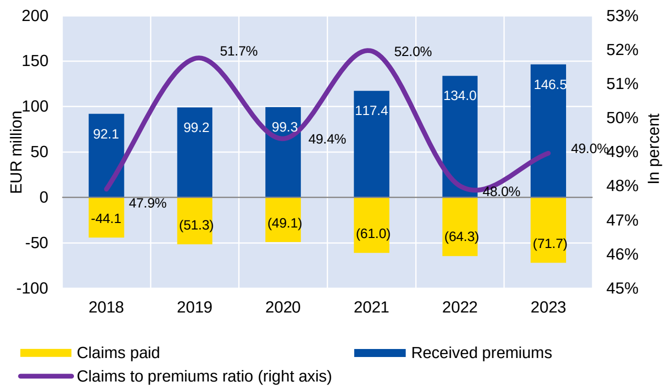


Source: CBK.

In 2023, the value of written premiums reached EUR 146.5 million, reflecting an annual increase of 9.4%. This growth was primarily driven by increases in written premiums for "third party liabilities" within compulsory insurance, as well as "land vehicle insurance" and "health insurance" within voluntary insurance. Compulsory insurance premiums continue to hold the largest share, accounting for 59.1% of total non-life written premiums. These premiums marked an increase in value of 9.7% compared to the previous year, while the number of sold policies rose by 10.5%. The value of "health insurance" premiums increased by 6.5% compared to the previous year, while the number of policies increased by 10.3%. Meanwhile, the value of premiums for "land vehicle insurance" increased by 20.8%, while the number of policies marked an increase 13.2% compared to the previous year. Conversely, the value of written premiums for "life insurance" in 2023 reached EUR 6.6 million, marking an annual increase of 3.5%.

In 2023, the value of claims paid by insurance companies and the Kosovo Insurance Bureau reached EUR 71.7 million, representing an annual growth of 11.6%, compared to the 5.4% growth recorded in the previous year (chart 42). The value of claims paid only by insurance companies marked an annual increase of 18.4% (EUR 10.2 million more than in the previous year), reaching EUR 65.7 million, in 2023. Meanwhile, the value of claims paid by KIB marked an annual decrease of 31.2%, falling to EUR 6.1 million from EUR 8.8 million in 2022. The most pronounced increase in claims paid by insurance companies resulted from the "non-life" segment, namely claims of "Insurance against fire and natural forces", "Motor third party liability" and "health insurance", of which the category of "Motor third party liability' continues to have the largest share of 49.4% of total claims paid by the "non-life" segment.

Chart 42. Written premiums and claims paid



Source: CBK.

In 2023, insurance sector recorded a profit in the amount of EUR 10.7 million from EUR 2.1 million marked in the previous year. The higher profit realized in 2023 is a result of the higher growth of collections from written premiums against the slower growth of expenses, namely "incurred claims" and operational expenses (which include personnel and administrative expenses). The progress of treatment, reservation and payment of claims remains in the high focus of the CBK.

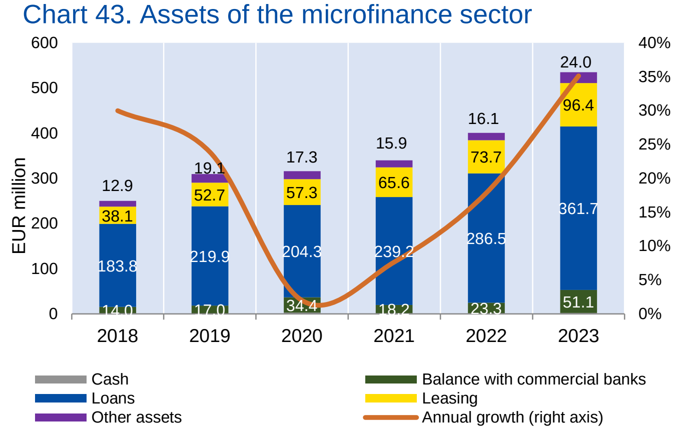
4.4. Microfinance sector

The microfinance sector experienced substantial growth in 2023, driven by external borrowings and increased lending activity while maintaining credit portfolio quality and profitability. The sector, sensitive to foreign market dynamics, faced higher financing costs due to rising global interest rates.T

Assets

The value of assets of the microfinance sector amounted to EUR 541.5 million at the end of 2023, marking an annual growth of 35.1% (chart 43).[4] The main contribution to this growth was given by the increase of lending and to a lesser extent by increase of leasing. Lending activity of the sector continued to be supported by borrowings (credit lines) from abroad, which increased by 32.2%. Also, the level increase of the capital contributed to the increase of the activity of the sector, mainly through the retained profit and the realized profit during this period.

Chart 43. Assets of the microfinance sector



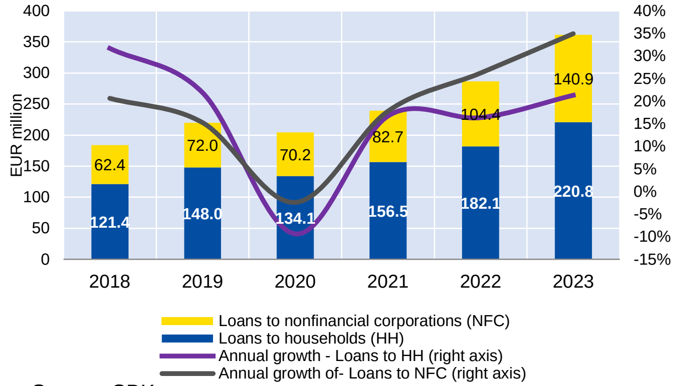
Source: CBK.

[4] As of November 2023, two financial institutions have been re-classified from Financial Auxiliaries to Other Financial Intermediaries (MFI&NBFI). This has influenced to increase the value of assets in the microfinance sector (it has mainly influenced the increase of the balance item with other banks).

Loans

The credit activity of the microfinance sector has marked an upward trend again after the pandemic year, with special emphasis in 2023, the value of which reached EUR 361.7 million, representing an annual increase of 26.3%. The pronounced increase of the microfinance sector lending may be a result of the higher demand from citizens for loans, but also the provision of funds from external borrowings. The bank lending survey suggests that the dynamics of lending has been determined mainly by the high credit demand, despite the marginally changed credit supply by banks, a dynamic which can explain the increased demand for loans also from micro-financial institutions.

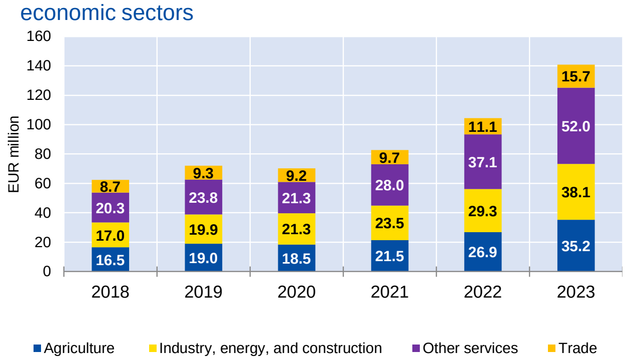
Chart 44. Value of loans to households and to nonfinancial corporations



Source: CBK.

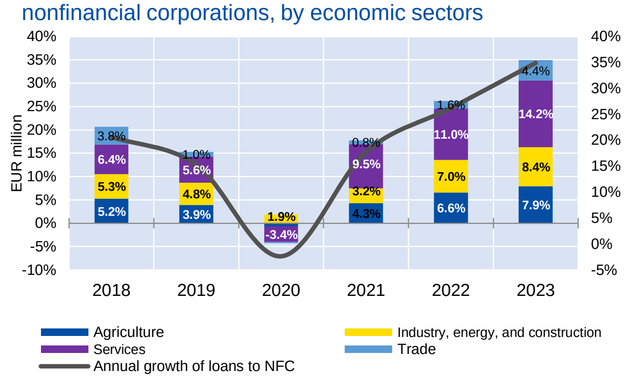
Both segments of the private sector, non-financial corporations and households, were characterized by a similar credit growth trend, in which case loans to households recorded an annual increase of 21.3% from 16.4% in 2022, reaching the value of EUR 220.8 million (chart 44). Loans stock to nonfinancial corporations reached the value of EUR 140.9 million, representing an annual increase of 34.9% from 26.2%, in 2022. Lending to nonfinancial corporations has followed a growth trend in all the economic sectors (chart 45). Unlike the banking sector, the stock of loans to the agriculture segment has the largest share of 25.0% in the total portfolio of loans to nonfinancial corporations, being the sector with the highest contribution to the increase in lending to nonfinancial corporations (chart 46).

Chart 45. Value of loans to nonfinancial corporations, by economic sectors



Source: CBK.

Chart 46. Contribution to the growth of lending to nonfinancial corporations, by economic sectors



Source: CBK.

The value of loans to agriculture sector reached EUR 35.2 million, corresponding to an annual growth of 30.7%. The significant increase in loans for the agriculture sector is also supported by credit guarantees from the Kosovo Credit Guarantee Fund.

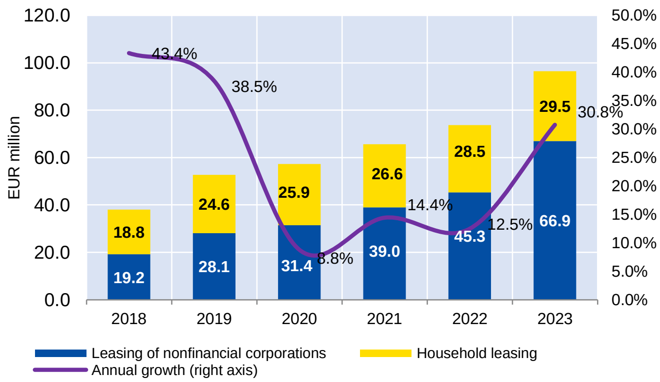
Leasing

Leasing continued to be the second most important category in terms of weight in the assets structure of the microfinance sector with a share of 17.8%. Leasing activity marked an annual increase of 30.8%, whereas, their value reached EUR 96.4 million (chart 47). Nonfinancial corporations continued to give the main contribution to the increase in leasing, which also have the highest weight of 69.4% of total leasing, while the contribution of leasing to households was lower.

Interest Rates

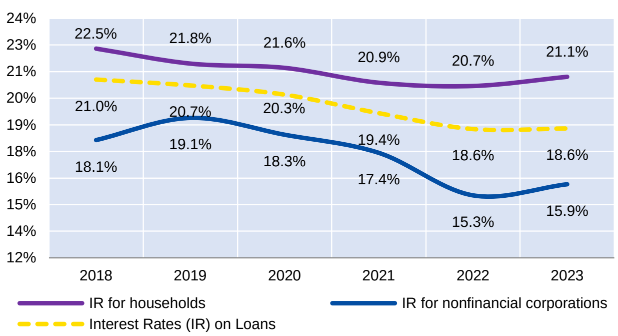
The microfinance sector was also equally affected by the dynamics of interest rates at the global level, although with more limited possibilities for further increases in interest rates. The average interest rate on MFI loans continued to be high standing at 18.62%, similar to the same period in the previous year of 18.59% (chart 48). Interest rates on loans to households marked an increase of 0.5 percentage points, reaching 21.1%. The average interest rate on consumer credit has increased by 1.4 percentage points, reaching 23.8%, while that of mortgage loans has increased by 1.5 percentage points, reaching an average of 15.8%.

Chart 47. Value of microfinance sector leasing



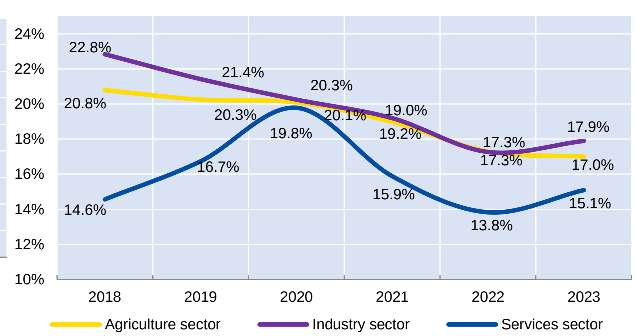
Source: CBK.

Chart 48. Average interest rate on microfinance sector



Source: CBK.

Chart 49. Average interest rate on loans to enterprises, by economic sectors



Source: CBK.

Nonfinancial corporations average interest rate increased by 0.5 percentage points, standing at 15.9% (chart 49). The interest rate on loans to industry and services sector increased by 0.6 and 1.3 percentage points, respectively, standing at 17.9% and 15.1%, respectively. Whereas, the average interest rate on loans to agriculture sector declined for 0.3 percentage points, reaching 17.0%, compared to the previous year.

Performance of the microfinance sector

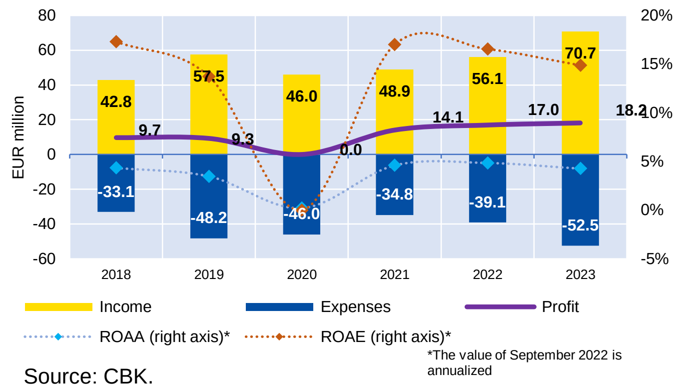
The microfinance sector, realized a net profit with a value of EUR 18.2 million, which is for EUR 7.1% higher compared to the same period of the previous year. The highest contribution to the profit growth was given by the increase in income as a result of the increase of the lending activity. Accordingly, income recorded an annual increase of 26.0%, or a growth in value for EUR 14.6 million compared to the previous year, reaching EUR 70.7 million, at the end of 2023. Whereas, expenses recorded an annual increase of 34.1%, or a growth in value for EUR 13.4 million compared to the previous year, reaching EUR 52.5 million, at the end of 2023 (chart 50).

Within income, interest income representing the main category with 87.0%, recorded an annual increase of 22.0% from 15.9% in 2022, mainly as a result of the high credit growth, and reached the value of EUR 61.5 million at the end of 2023. The category of non-interest income, which accounts for 13.0% of total income, recorded an annual increase of 61.6% from 6.6% in the previous year, as a result of the increase in income from fees and commissions of EUR 4.4 million from EUR 0.9 million as they were in the previous year due to the expansion of their activity and license[5] that contribute to access to finance and financial inclusion.

Within expenses, the category which marked the highest increase was the one of interest expenses. This category reached the value of EUR 8.4 million at the end of 2023, which coincides with an annual growth of 70.8% (an increase of 4.6% marked in the previous year), and had the highest contribution to the overall growth of microfinance sector expenses. The significant increase in this category is a result of the increase in interest expenses from borrowing, which is the category of financing the credit activity of microfinance institutions. The category that has the largest weight of 52.6% in the sector's expenses, that of non-interest expenses, at the end of 2023, reached the value of EUR 27.6 million, marking an annual increase of 20.2% from 21.2% marked in the previous year, representing a slower growth due to the more pronounced slowdown in the growth of personnel expenses, while expenses for provisions had increased. However, microfinance sector did not reflect this financing cost increase from external sources on their loans. Financing sources with favorable conditions and therefore affordable for the borrower remain the main challenge of these financial institutions.

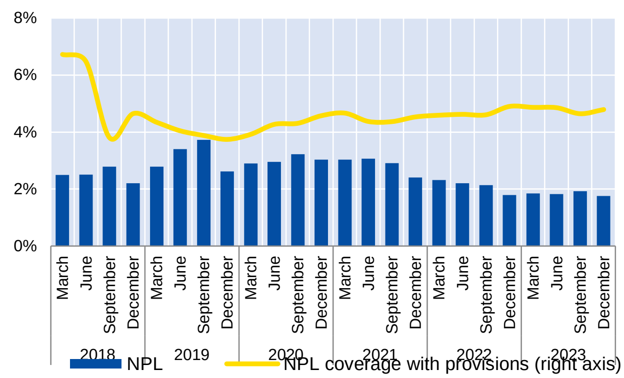
The level of nonperforming loans to total loans ratio, at the end of December 2023, was 1.8%, similar to the previous year. However, the value of nonperforming exposures increased by 20.6% from a decrease of 12.4% marked in the previous year, reaching the value of 7.5 million at the end of December 2023 from EUR 6.2 million as it was in the previous year. The coverage level of nonperforming loans with loan loss provisions, in December 2023, decreased by 3.4 percentage points, to 149.7% (chart 51), which is a result of the higher

Chart 50. Profit and profitability indicators of the microfinance sector



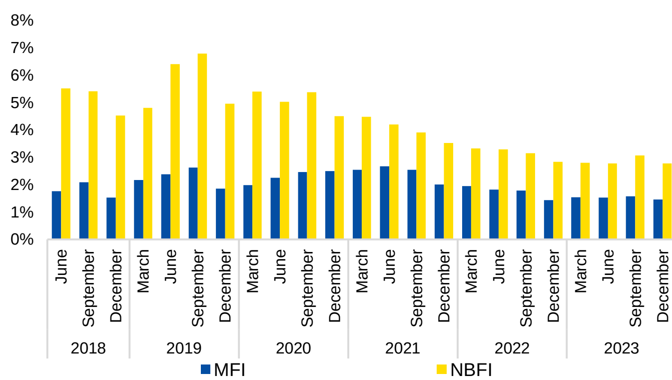
Source: CBK.

Chart 51. Indicators of loans portfolio quality



Source: CBK.

Chart 52. MFI and NBFI NPL level



Source: CBK.

[5] As of November 2023, two financial institutions have been re-classified from Financial Auxiliaries to Other Financial Intermediaries (MFI&NBFI). These changes have also affected the income statement, especially the subcategory of income from fees and commissions, since these institutions operate as NBFI and the nature of their activity is such that they generate income mainly from fees and commissions in the services they provide with.

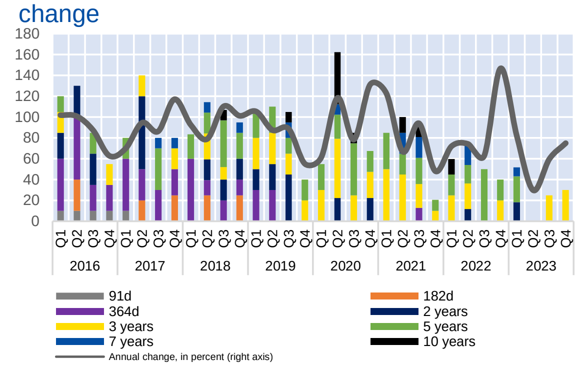
increase of nonperforming loans than the increase of provisions. Moreover, the level of nonperforming loans continued to be higher for NBFI against MFI, which gradually has decreased along the years (chart 52).

4.5. Republic of Kosovo’s Government securities market

The value of debt issued through auctioned securities in 2023 was half of the previous year's amount, compared to the previous year.

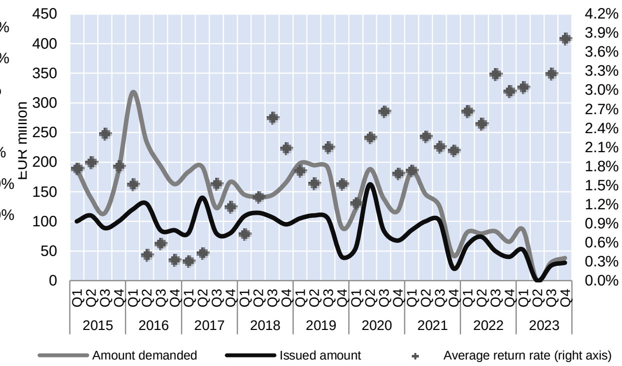
Unlike in the previous year, in the fourth quarter of this year there was not realized any issuance of debt. The total value of issued securities was EUR 106.9 million, 52.2% lower than the previous year (chart 53). The demand for government securities slightly exceeded the offering amount, with a bid-to-cover ratio of 1.07 compared to 1.27 of the previous year (chart 54).

Chart 53. Amount and maturity of issued debt, annual change



Source: Ministry of Finance, Labor and Transfers.

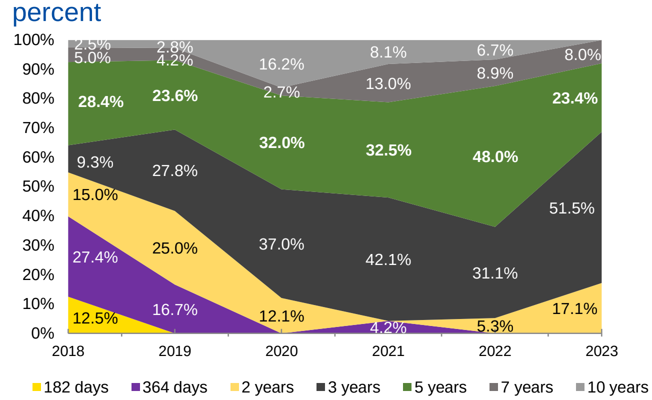
Chart 54. Bid to cover ratio



Source: Ministry of Finance, Labor and Transfers.

The decrease in the bid-to-cover ratio was influenced by a 40.8% reduction in the government's offer and a 50.2% decline in the submitted bidding amount. Pension funds held the largest share of government securities at 46.2%, followed by commercial banks (23.6%), public institutions (22.1%), insurance companies (5.1%), and other investors (3.0%).

Chart 55. Government securities structure, in percent



Source: Ministry of Finance, Labor and Transfers.

At the end of 2023, the internal debt stock of Kosovo's government securities held by banks, pension funds, public institutions and insurance companies was EUR 970.19 million, down from EUR 1.11 billion in the previous year. The structure of securities by maturity has gradually shifted towards longer maturities In the period of January-December 2023, the structure was dominated by the government bonds with a maturity of “5 years”, which comprise half of the securities issued during this period, followed by those with a maturity of “3 years”, (chart 55).

The suggested citation of this publication:

CBK. Quarterly Assessment of the Economy No. 45 Q4 2023, Central Bank of the Republic of Kosovo

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b) Official CBK statistics, Time series: time series | Central Bank of the Republic of Kosovo (bqk-kos.org)

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b) Producer Price Index: https://ask.rks-gov.net/en/kosovo-agency-of-statistics
c) Import Price Index: https://ask.rks-gov.net/en/kosovo-agency-of-statistics
d) Construction cost index: https://ask.rks-gov.net/
e) Statistical Report on economic enterprises: https://ask.rks-gov.net/en/kosovo-agency-of-statistics
f) External trade statistics: https://ask.rks-gov.net/en/kosovo-agency-of-statistics

Other:

a) Announcements and Results of Auctions for Government securities: https://mf.rks-gov.net/
b) Kosovo Credit Guarantee Fund: http://fondikgk.org/
c) Kosovo Pension Saving Trust: http://www.trusti.org/en/
d) Ministry of Finance, Labor and Transfers - Nine-month data on state debt and state guarantees: file:///C:/Users/bbojaj/Downloads/NINE-MONTH%20DATA%20ON%20STATE%20DEBT%20AND%20STATE%20GUARANTEES%20JANUARY%20-%20SEPTEMBER%202023.pdf
e) Ministry of Finance Labor and Transfers - Nine-Month Financial Report, Budget of the Republic of Kosovo: file:///C:/Users/bbojaj/Downloads/Nine-%20Monthly%20Financial%20Report%202023.pdf

Euribor: Euribor Historical Rates: http:// www.euribor-ebf.eu/euribor-org/euribor-rates.html

ECB: Economic Bulletin Research & Publications (europa.eu); Key ECB interest rates (europa.eu)

FAO. Home | Food and Agriculture Organization of the United Nations (fao.org)

IMF: International Monetary Fund (IMF)

World Economic Outlook: World Economic Outlook (www.imf.org)

World Bank: Commodity Markets: Commodity Markets (www.worldbank.org)

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