

Interview of the CBK Governor for Radio Free Europe

The Governor of the Central Bank of Kosovo, Mr. Fehmi Mehmeti, says that the trade deficit is negatively affecting the economic activity of Kosovo, as well as the high inflation.

While the inflation rate, according to him, is expected to fall in the second half of 2023, Mehmeti says that more work should be done to change the structure of the economy in favor of manufacturing companies.

Kosovo is extremely dependent on imported products, while the value of its exports is many times smaller.

In an interview for Radio Free Europe, Mehmeti also talks about the national currency and says that the CBK has taken all measures to mitigate the negative effects of not having it.

For the creation of gold reserves, he says that there should be a decision from the government authorities.

Radio Free Europe: Mr. Mehmeti, I am starting with an issue that has been problematic almost throughout 2022 in the countries of the European Union, but also in Kosovo: the economic impact of the war in Ukraine. How did Kosovo's economy cope with this?

Governor Mehmeti: The economy of Kosovo started the year 2022 with a good perspective, given that we left a very successful year. According to the preliminary estimates of the Statistics Agency [of Kosovo], the real growth rate of the gross domestic product in 2021 was 10.75 percent. However, during 2022, the change in global dynamics, due to the war in Ukraine - which was accompanied by an increase in inflation, a change in monetary policies, an increase in interest rates, a slowdown in the growth of world trade, as a result of the disruption of the chain of supply - was also reflected in the economic activity of Kosovo. According to the estimates of the Central Bank of the Republic of Kosovo, economic growth during 2023 is expected to be 3-4 percent. This is mainly due to the contraction of domestic demands and the increase in imports. Based on data recorded up to September 2022, non-resident expenses in Kosovo - most of which comes from the diaspora - was more than 1.48 billion euros. This amount represents an annual increase of 26 percent, if compared to the same period last year. Also, the year 2022 marked a rapid pace of remittances. Their value reached over one billion euros - or annual growth of 5.5 percent. The value of remittances in the last five years in Kosovo has reached more than 4.5 billion euros. According to data from the Central Bank of the Republic of Kosovo, the highest value of remittances was recorded in 2021. The increase in domestic demand in the country was reflected in the increase in the import of goods, which reached the value of 4.2 billion euros - or annual growth of 24 percent. On the other hand, the export of goods reached the value of 688 million euros - or an annual increase of 27 percent. As a result of these developments, the trade deficit reached 3.47 billion euros. Regarding direct investments, their value until September 2022 reached 567 million euros, compared to 395 million euros recorded in 2021. As for other macroeconomic indicators, it is worth noting that the average inflation until November ,2022 was 11.5 percent, compared to the annual average of 3.4 percent in 2021.

Radio Free Europe: When it comes to inflation, will it follow Kosovo in 2023?

Governor Mehmeti: This depends on the Russian aggression in Ukraine. It is one of the factors that has influenced the global economy, as well as in Kosovo. And, realistically, our expectations are that in the second half of 2023, we will have a decrease in inflation up to 6 percent. This, to a large extent, will affect the solvency of citizens, which will then affect the increase in consumption as the main component of economic growth in the country.

Radio Free Europe: You mentioned that economic growth will be around 4 percent. Do you consider that this increase can address the economic and social problems in Kosovo?

Governor Mehmeti: I consider that such economic growth - after all these negative pressures, after the pandemic and the Russian aggression in Ukraine - will largely address all the problems faced by the citizens of Kosovo and will positively influence the growth of their well-being. When I talked about imports, exports, I mentioned the trade deficit. Trade deficit is one of those [factors] that negatively affects economic growth or economic activity in the country. More work should be done in order to change the structure of the country's economy. While our economy is dominated by commercial enterprises, more work should be done to change the structure of the economy in favor of manufacturing enterprises.

Radio Free Europe: Let's stop at the banking system. So far, this system has proved stable. Has there been an increase in loans and deposits?

Governor Mehmeti: The financial system in the country continues to be well capitalized and liquid. The value of assets in this system has reached 9.4 billion euros - with an annual increase of 12 percent. Loans have increased by 18 percent, reaching the value of 4.2 billion euros. If we look at the structure of loans, over 65 percent is dedicated to businesses and the rest goes to households. The banking sector continues to have high credibility with the public, and this is expressed through the increase in deposits, which have reached the value of 5.3 billion euros. The structure of deposits is the opposite of loans: over 67 percent of deposits belong to households, the rest belong to businesses. On the other hand, non-performing or bad loans continue to be very low.

Radio Free Europe: How do you assess the growth of deposits at a time when Kosovo is facing inflation, low wages - the minimum wage is the lowest in Europe - high unemployment rate?

Governor Mehmeti: I see it more in the aspect that citizens have high confidence in the banking system. A lot of work has been done in this direction. The interest rate on deposits has reached 1.5 percent - it has increased compared to a year earlier, when it was 1.2 percent. And, it is their security [citizens], to generate a profit, an additional interest from the deposits they leave.

Radio Free Europe: You say that interest rates on deposits have increased. And the interest rates for loans have increased?

Governor Mehmeti: The effective interest rate for loans in October 2022 was 6.2 percent, compared to 6 percent, which was a year earlier. The European Central Bank has taken three decisions to increase the interest rate. I am mentioning only two categories - for loans, the interest rate is 2.75 percent, and for deposits, 2 percent. This, to a large extent, increases the cost in commercial banks in Kosovo as well as

in the Eurozone. This action was taken to prevent inflation. However, I have not seen any indication that the banks in Kosovo tend to increase the loan rates

Radio Free Europe: Mr. Mehmeti, Kosovo does not yet have a national currency. What conditions must be fulfilled for this?

Governor Mehmeti: It is a historical issue for the currency issue. You know that immediately after the war, we used the German mark as official currency, through an UNMIK [United Nations mission in Kosovo] regulation. Then, in 2002, we started using the euro as the official currency. If we look at the benefits, we have more benefits that we use the euro as an official currency. We have tried to eliminate the drawbacks or negative effects of not having the [national] currency through the creation of the Emergency Liquidity Fund - so that as CBK we can play the role of the last innovator, or support. To a large extent, we can mitigate the negative effect and we have no reason to think of having currency in the future, considering that the effects are very positive that we have the euro as an official currency. The way we use it - we are known to use it unilaterally because we are not part of the Eurozone.

Radio Free Europe: Kosovo is the only country in the region, which has no reserves of gold and other precious metals. Are there any plans to create such reserves?

Governor Mehmeti: It is a fact that we have no gold reserves. The opportunity exists. These are decisions that must be made in the future in coordination with the Government. We, as CBK, have the opportunities, we are ready, we have the capacity. We have the place to store it. From our side, as CBK, we are ready to make such a [reserve], but these are decisions that must also be taken by the Government.

Radio Free Europe: Does CBK have a portfolio to store gold and precious metals of private clients?

Governor Mehmeti: We have such opportunities, but this is not regulated by law and is currently not implemented in the CBK.

Radio Free Europe: Has any citizen expressed interest in this?

Governor Mehmeti: Not yet.

Radio Free Europe: Mr. Mehmeti, the total debt of Kosovo has reached 1.6 billion euros. Is there a risk that this debt will increase and what could be the consequences?

Governor Mehmeti: We are very low in terms of debt percentage; according to the law up to 40 percent of the gross domestic product, is allowed to be debt. But, I say this way, the public debt is never high as long as it is dedicated to added economic value. The debt is always high, in case it is dedicated to a country, where there is no added value for the economy.

Radio Free Europe: Do you think that this debt should be increased for capital projects?

Governor Mehmeti: We need foreign investments. Policies are built in terms of what is encouraging to foreign investors. Now the last case, the arbitration case that Kosovo has won, which is related to the financial company Iute Credit, is a good message for all investors interested in coming to Kosovo, that it is being worked on, there are good laws and have their applicability.