



SHOQATA E BANKAVE TË KOSOVËS KOSOVO BANKING ASSOCIATION



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PERIODIC OVERVIEW OF FINANCIAL SECTOR IN KOSOVO



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EFFECTIVE INTEREST RATES OF BANKING INDUSTRY

Banking industry in Kosovo has reached a record high for loans with 1,805 million euro at the end of 2013, while deposits reached the amount of 2,449 million euro at the end of December of 2013. As all other businesses that are operating in Kosovo, banking industry as well has been faced with difficulties and different challenges during its activity for the past 13 years, which have caused the operational costs and the level of the risk in the market to be higher. Nevertheless, some progress has been made in the recent years and the trends are showing that the interest rates are slowly falling to a level that makes loans more affordable for Kosovo businesses and households.

From table no. 1 we can see that the effective interest rates for loans (representing the total annual costs of the loans – interests and other commissions) of the banking industry in Kosovo at the end of 2010 were 14.31%, while the effective interest rates for deposits were 3.38%.

Effective interest rates(2010 - 2013)

| Description | Loans | Deposits | Margin |
|-------------|--------|----------|--------|
| 2010 | 14.31% | 3.38% | 10.93% |
| 2011 | 13.86% | 3.62% | 10.24% |
| 2012 | 12.86% | 3.74% | 9.12% |
| 2013 | 11.07% | 2.39% | 8.68% |

Tab. 1 | Source: CBK – Effective interest rates (December,2013)

From the table no. 1 and figure no. 1 presented, we can see that the effective interest rates for loans have a continuous trend of decreasing, as well as the effective interest rates for deposits have marked decrease, especially at the end of the previous year (2013).

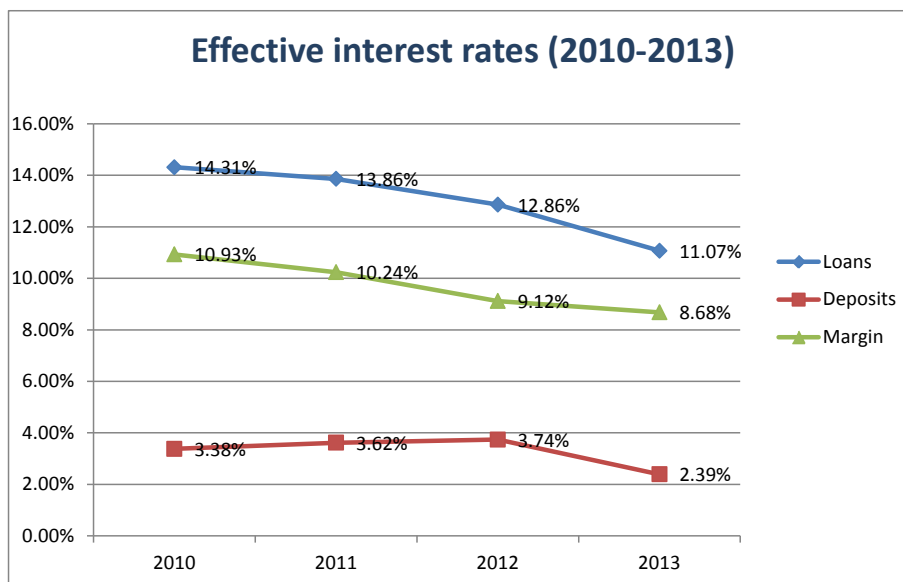


Fig. 1 | Source: CBK – Effective interest rates (December,2013)

It is interesting and important to emphasize that the margin of the effective interest rates between loans and deposits since 2010 have marked a decrease from 10.93% to 8.68% at the end of the year of 2013.

The continuous decrease of effective interest rates for loans indicates that the banking industry is continuously seeking to offer favorable conditions to its customers, in accordance with circumstances and environment in which the financial institutions are operating.

EFFECTIVE INTEREST RATES OF LOANS FOR NONFINANCIAL CORPORATIONS AND HOUSEHOLDS

Effective interest rates of loans for nonfinancial corporations

Depending on the nature of the businesses, types, products and services, the effective interest rates of loans for nonfinancial corporations varies from the lowest value which is 5.97% (2013) up to the highest one 12.90% (2013).

Effective interest rates of loans for nonfinancial corporations

| Description | Investment Loans | | | Other non-investments loans | | | Overdraft | Credit Lines | Loans with favourable conditions | |
|-------------|------------------|-----------|--------------|-----------------------------|-----------|--------------|-----------|--------------|----------------------------------|-------------|
| | Up to 1 year | 1-5 years | Over 5 years | Up to 1 years | 1-5 years | Over 5 years | | | Cash over loans | Other loans |
| 2010 | 16.13% | 13.95% | - | 18.66% | 14.44% | - | 12.65% | 13.27% | 7.69% | - |
| 2011 | 17.07% | 13.55% | - | 16.40% | 13.80% | - | 11.78% | 12.12% | 6.10% | 9.88% |
| 2012 | 15.37% | 12.03% | 10.19% | 15.29% | 13.66% | - | 10.70% | 11.90% | 5.92% | - |
| 2013 | 12.29% | 10.93% | 9.46% | 11.62% | 12.90% | - | 9.36% | 11.03% | 5.97% | - |

Tab. 2 | Source: CBK – Effective interest rates (December,2013)

This means that for particular clients with lower risk and better business plans banks offer better rates of interests based on their risk level.

From the table no. 2 we can conclude that almost all types of loans issued for nonfinancial corporations have marked decrease from 2010 up to the end of December 2013.

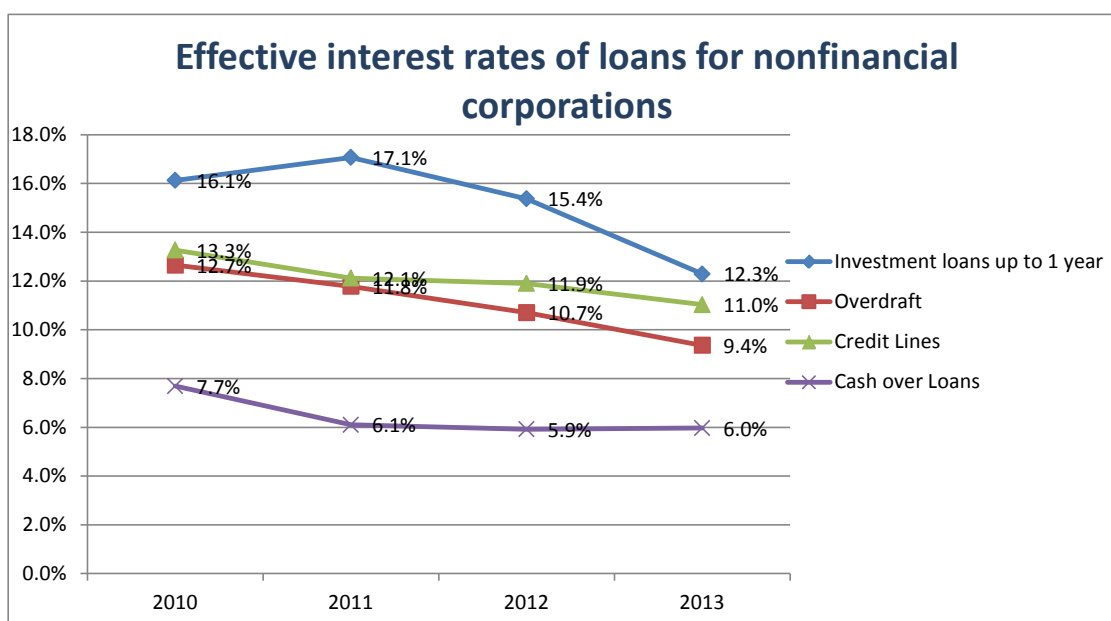


Fig. 2 | Source: CBK – Effective interest rates (December,2013)

Also in figure no. 2 we can see the decreasing trend of effective interest rates of loans for nonfinancial corporations, especially for investment loans up to 1 year, where from 16.13% that was at the end of 2010, they have dropped to 12.29% at the end of December of 2013.

Effective interest rates of loans for households

The effective interest rates of loans issued for households as well as for loans issued for nonfinancial corporations, vary depending on the type of the product and the fulfillment of the criteria's by the bank client. In the table no. 3 presented in this publication, we can see that the maximum value of effective interest rates at the end of December of 2013 was 14.41% issued for Overdraft product, while the lowest value of the rates was 7.28% issued for the loans with favorable conditions.

Effective interest rates of loans for households

| Description | Overdraft | Loans with favourable conditions | | Consumer Loans | Mortgage Loans | | |
|-------------|-----------|----------------------------------|-------------|----------------|----------------|------------|---------------|
| | | Cash over loans | Other loans | | Up to 5 years | 5-10 years | Over 10 years |
| 2010 | 22.57% | 6.57% | 8.56% | 14.56% | - | 11.67% | 10.26% |
| 2011 | 16.44% | 6.01% | 8.58% | 14.02% | 14.31% | 11.99% | 10.83% |
| 2012 | 12.46% | 6.11% | 7.97% | 13.06% | - | 10.78% | 9.79% |
| 2013 | 14.41% | 4.59% | 7.28% | 11.69% | - | 10.43% | 9.00% |

Tab. 3 | Source: CBK – Effective interest rates (December,2013)

The same decreasing trend of the effective interest rates of loans for households was followed almost in all types of loans issued from 2010-2013, including consumer loans, mortgages, overdraft or loans with favorable conditions. Banking industry offers favorable conditions for the clients which are evaluated with lower risk during the entire maturity process for the loan received.

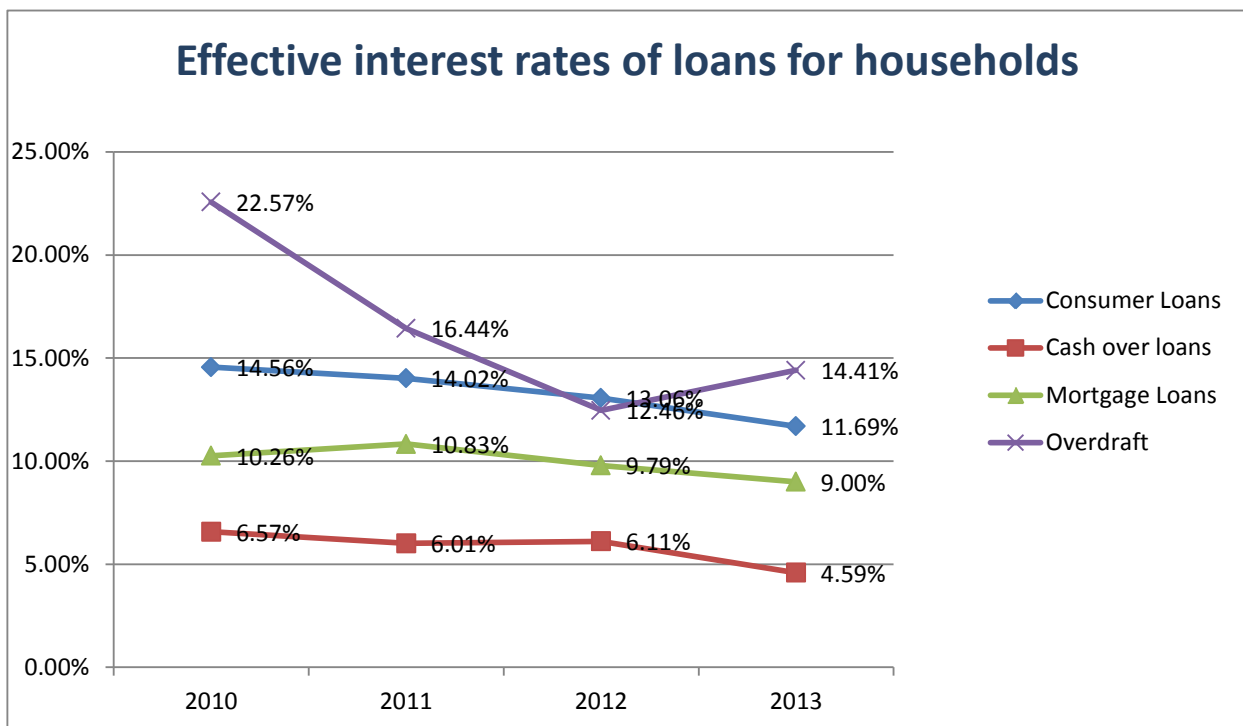


Fig. 3 | Source: CBK – Effective interest rates (December,2013)

From the figure no. 3, we can see that along with all other types of the loans where the interest rates have marked decrease, overdraft as special lending product has marked the highest decrease from 2010 up to the end of the year of 2013.

EFFECTIVE INTEREST RATES OF DEPOSITS FOR NONFINANCIAL CORPORATIONS AND HOUSEHOLDS

Similar to other expenditures of the banking industry, deposits represent itself a cost of funds for the industry. This is due to the fact that for the deposits that are received the banks are obliged to pay interest.

Margin created between the interest rates on loans issued by the banking industry and interest rates of deposits represent the interest margin for the banks. The banking industry carefully maintains this gap in order to achieve its strategic goals, where one of the most important objectives, in addition to profit, is also the financial sustainability and stability that enables citizens to feel secure with their assets that this sector manages with.

Effective interest rates of deposits for nonfinancial corporations

| Description | Transferable Deposits | Other Deposits | | | | | | | | | | | | Saving Deposits |
|-------------|-----------------------|------------------------|------------|------------|-------------------|-----------|--------------|---------------------------------|------------|------------|-------------------|-----------|--------------|-----------------|
| | | Less than 250.000 euro | | | | | | Equal or more than 250.000 euro | | | | | | |
| | | 1 months | 1-3 months | 3-6 months | 6 months – 1 year | 1-2 years | Over 2 years | 1 months | 1-3 months | 3-6 months | 6 months – 1 year | 1-2 years | Over 2 years | |
| 2010 | 0.63% | 2.44% | 3.08% | 3.87% | 4.96% | - | 5.14% | - | 3.74% | - | - | - | - | 2.07% |
| 2011 | 0.86% | 2.22% | 2.91% | 3.53% | 4.90% | - | 5.05% | 2.63% | 3.88% | - | 5.25% | - | - | 2.20% |
| 2012 | 0.83% | - | 2.79% | - | - | - | - | 2.67% | 4.02% | - | 4.75% | - | - | 2.15% |
| 2013 | 0.47% | 0.83% | - | 1.57% | 0.48% | 2.86% | - | - | - | - | - | - | 3.42% | 1.74% |

Tab. 4 | Source: CBK – Effective interest rates (December, 2013)

Table no. 4 depicts that in addition to lowering the effective interest rate for loans, the banking industry has been obliged to also reduce their overall costs of funding thus it has made the reduction of interest rates on deposits from year to year. But what should be emphasized is that the interest margin has decreased on continuous basis.

Effective interest rates of deposits for households

| Description | Transferable Deposits | Other Deposits | | | | | | Saving Deposits |
|-------------|-----------------------|----------------|------------|------------|-------------------|-----------|--------------|-----------------|
| | | 1 month | 1-3 months | 3-6 months | 6 months – 1 year | 1-2 years | Over 2 years | |
| 2010 | 0.55% | 2.58% | 2.63% | 3.15% | 4.49% | 4.77% | 5.14% | 2.21% |
| 2011 | 0.48% | 2.49% | 2.47% | 2.88% | 4.21% | 4.56% | 5.36% | 2.06% |
| 2012 | 0.54% | 2.30% | 2.46% | 2.84% | 4.20% | 4.52% | 4.76% | 2.06% |
| 2013 | 0.50% | 1.66% | 1.75% | 2.03% | 2.93% | 3.38% | 4.01% | 1.66% |

Tab. 5 | Source: CBK – Effective interest rates (December, 2013)

Similar to loan interest rates, when it comes to the effective rate of interest for deposits, their percentage varies depending on the type of product. What can be seen from the figure no. 4 and table no. 5 is that the greatest reduction in interest rates for deposits within households has been marked amongst deposits with maturity of over 2 years, where from 5.4% as it was in late 2011, it has dropped to 4.0% at the end of December 2013.

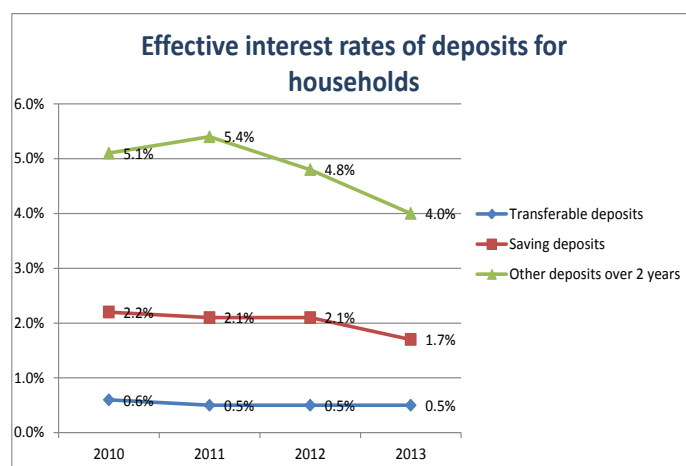


Fig. 4 | Source: CBK – Effective interest rates (December, 2013)

PART II

HIGHLIGHTED JUNE NEWS FROM THE BANKING INDUSTRY

Single-digit interest rates are expected for loans

Executive Director of the Kosovo Banking Association (KBA), Petrit Balijs, stated that the arrival of “Ziraat Bank” in Kosovo market is very good news because, according to him, the arrival of a serious bank in Kosovo will also enrich even more the level of competition within the sector.

“I think the competition always has a positive influence on raising the quality of services and improve the supply. We are constantly working to eliminate barriers for the banking business in Kosovo market, in order for this market to be more attractive to other banks and to generate interest in this regards,” stated Balijs. He stated that interest rates in Kosovo are decreasing. “Often various analysts are cited, saying that interest rates in Kosovo are over 15 percent, but the same cannot be said now, as the average interest rate on loans has decreased significantly to 10.6 percent at the end of April 2014”, he stressed.

Balijs in this interview for the newspaper “Epoka e Re” indicated that by next year it is expected a decrease on interest rates for loans. “I think that by next year we will reach single-digit interest rates,” he affirmed.

Regarding high interest rates for loans, he said that they cannot be as low as in developed countries due to the risk that appears in our market. “At the moment there is any difficulty or failure to return the loan, the bank is in a vulnerable position, because the law is not available to the bank to perform the contract in question, and this is a huge issue. We have over 10 thousand cases blocked in court, which worth about half a billion euros,” he added.

“Epoka e re”: How would you rate the banking market in Kosovo?

Balijs: The banking sector in Kosovo is relatively new when compared to the region and other countries. We started with the first licensed bank in 2001 and since then now we have nine banks, the 10th have been approved licenses just now. Hence, I think that there been significant development in the banking sector within a short period. At the same time performance is always improving. In 2013 we had very good performance, generating a profit of 26 million Euros for the year 2013 compared with 2012, was 18.5 million Euros more, so I think that the banking system has performed well in recent years despite difficulties that arise in the Kosovo market.

“Epoka e re”: Since there has been criticism of high interest rates, which is causes that banks are not lowering the interest rates?

Balijs: Interest rates in Kosovo are decreasing. Often various analysts are cited, saying that interest rates in Kosovo are over 15 percent, but the same cannot be said now, as the average interest rate on loans has decreased significantly to 10.6 percent at the end of April 2014. Therefore, I think that by next year we will be able to have single-digit interest rates. The reason why interest rates on loans cannot be as low as in developed countries is due to the risk that appear in our market. I have consistently stated that we are listed in 136th place out of 189 countries for the implementation of contracts, which means when a contract is signed between the bank and the borrower it is a problem to implement the contract strictly. At the moment there is any difficulty or failure to return the loan, the bank is in a vulnerable position, where the law is not available to the bank to perform the contract in question and this presents a huge problem. This is reflected in the fact that we have over 10 thousand cases blocked in court that are worth about half a billion Euros.

“Epoka e re”: Recent years Turkish banks have arrived in Kosovo. Is Kosovo turning into a banking market of Turkish banks?

Balija: When it comes to business I do not think it is very important where the investor comes from, but more importantly, what is their business concept and how it can affect job creation and economic development in Kosovo. In this case, it is world renowned banks that create new jobs and finance households and businesses in Kosovo.

“Epoka e re”: Do you think that last Turkish bank licensed will result in the reduction of interest rates on loans?

Balija: I think that it is very good news that we have a serious bank in Kosovo, and it certainly will enrich even more the level of competition within the sector. I think competition always has a positive influence on raising the quality of services and improve the supply. We are constantly working to eliminate barriers for banking business in the Kosovo market, in order for this market to be more attractive to other banks and to generate interest in this regard.

“Epoka e re”: The interest rate on deposits is already lowered. How it came to this?

Balija: Taking into account that the ratio between deposits and loans during 2013 was about 75 percent, it has created a higher liquidity and as a result the cost of funds has increased. Therefore, to preserve the stability of banking, banks had to lower deposit interest rates to stabilize the industry in terms of liquidity and funding costs.

“Epoka e re”: Some political parties have planned to create new economic policy, one of them the development fund, the other the Agrobank. How much does this hurt the banking system?

Balija: Different modalities are proposed by political parties during the election campaign, but we still do not have concrete proposals with enough information to give estimates. However, I think that any initiative that would help economic development we will support it, with a condition that these initiatives are within the legal framework and the principle of the free market.

“Epoka e re”: Have you had discussions with foreign investors who are interested to invest in Kosovo for higher lending rates? If so, how they perceive this?

Balija: We have not conducted any research in this regards, but I think a lot of foreign investors are more concerned about the rule of law, contracts enforcement and the level of economic development of Kosovo than to financing options. In Kosovo, interest rates are not fixed they are negotiated on the basis of risk that represents the client and if a foreign investor is a serious company with low risk, then you will be able to get loans at quite affordable rate of interest. *(June 13th, 2014 / Epoka e Re)*

COMPETITION REDUCES THE INTEREST RATES

In the first four months of this year, there is a decrease for 0.9 percent on deposits, whereas there is an increase for loans for 1.9 percent. Interest rates in Kosovo are over 15 percent, but it cannot be said now, as the average interest rate on loans has decreased significantly to 10.6 percent at the end of April 2014. The entry of a new bank in this market has increased the competition, which impacts positively on raising the quality of services, to improve the supply and reduce the interest rates, said Petrit Balija, Executive Director of the Kosovo Banking Association.

In Kosovo banking market, 10 commercial banks perform their banking activities, hence the entry of a new bank in this market has increased competition, which impacts positively on raising the quality of services, improving the supply and reduce the rates interest, said Petrit Balija, Executive Director of the Kosovo Banking Association. He said that the entry of the Bank "Ziraat Bank" from Turkey and its introduction into the Kosovo market it's a good news, because, according to him, the arrival of a serious bank in Kosovo will enrich even more the level of competition within the sector. "I think the competition always has a positive influence on raising the quality of services and improve the supply. We are constantly working to eliminate barriers for the banking business in Kosovo market, in order for this market to be more attractive to other banks and to generate interest in this regards," said Balija for the newspaper "Lajm". He stated that interest rates in Kosovo are decreasing. "Often various analysts are cited, saying that interest rates in Kosovo are over 15 percent, but the same cannot be said now, as the average interest rate on loans has decreased significantly to 10.6 percent at the end of April 2014" stressed Balija.

For newspaper "Lajm" he indicated that by next year it is expected to decline even further the interest rates on loans for citizens, by dropping them in single digits. "I think that by next year we will reach single-digit interest rates," he affirmed. Regarding high interest rates for loans, he said that they cannot be as low as in developed countries due to the risk that appears in our market. "At the moment there is any difficulty or failure to return the loan, the bank is in a vulnerable position, because the law is not available to the bank to perform the contract in question, and this is a huge issue. We have over 10 thousand cases blocked in court, which worth about half a billion euros," he added.

According to him, the arrival of new banks in Kosovo's banking market increase the competition, whereas according to him, the competition is positive, respectively impact positively on increasing the quality of services, and improve the supply and decrease the loan interest rates. "The arrival of "Ziraat Bank" in Kosovo market is very good news because, as it will enrich even more the level of competition within the sector and will bring new offers for the citizens and the businesses in Kosovo", stated Balija. "I think the competition always has a positive influence on raising the quality of services and improve the supply.

We are constantly working to eliminate barriers for the banking business in Kosovo market, in order for this market to be more attractive to other banks and to generate interest in this regards," stated Balija.

He announced that by April 2014 there is a decrease on deposit, over 20 million deposit less. "By the end of April 2014, the banking sector in Kosovo possesses 2,430.1 million deposits or 20.9 million euros less than at the end of 2013, when deposits have recorded 2,451 million euros. This means that we have a decrease for 0.9 percent of deposits for the first four months of 2014," explained Balija. According to him, households have bank deposits mostly or 73.7 percent. "Of the total deposits, 2,430.1 million euros, 1,793 million euros are household deposits. Thus, 73.7 percent of total deposits comprise deposits of households, while the rest of the deposit in the amount of 637 million euros, represent businesses, companies and other public institutions deposits", he stressed.

For the first four months of this year deposits have declined, while loans have increased. "Unlike deposits recorded a decrease in the first four months of this year, loans extended by the banking sector in April 2014 amounted to 1,839.7 million euros or 33.9 million euros more credit than the end of 2013, when the value total loans issued was 1,805.8 million euros", underlined Bali. "This means that 1.9 percent has increased the value of loans issued for the first four months of 2014. Out of the total loans extended by the banking sector by the end of the month of April 2014 amounts to 571.2 million euros, or 31 percent are loans issued to households, while 1,268 million euros are loans issued to businesses or to other sectors," said Balija. (June 18th, 2014 / Lajm, Kosova Sot, Telegraf).

CORPORATE GOVERNANCE, BUSINESS PRIORITY

Kosovo CSR Network, supported by the International Finance Cooperation (IFC), a member of the World Bank Group, has organized on Wednesday a meeting regarding the latest development in best practices of corporate governance, the highest standards of EU on declaration and integrated reporting. In this event, the chairman of the Board on CSR Network, Robert Wright stated that corporate governance should be a top priority for the business sector in Kosovo since according to him, unfortunately, this is not applied as much as it should. "The standards of corporate governance in Kosovo are lower than what is considered normal or acceptable in 2014 in Europe," he said. (June 12th, 2014 / Epoka e Re)

MILLIONAIRES, WHOSE MONEY SOURCE IS UNKNOWN

On all existing legal mechanisms for reporting any banking transaction over 10 thousand euro, whether by individuals or entities in various commercial banks, in Kosovo there are millionaire citizens without knowing the source of origin of their financial means, stated experts on economic issues.

Professor Musa Limani, said for Radio Evropa e Lire, that banking transaction should be controlled and financial institutions should seek the source of funds. "It is with no comment why they do not declare it, because in our country there is no responsibility and the 'big fish' are not subject to these procedures. Otherwise, by law no transaction can be implemented without knowing the source. For this reason we have millionaires who do not declare the source of income," said Limani.

On the other hand, Petrit Baliija, executive director of the Kosovo Banking Association, for Radio Evropa e Lire, says it is a legal obligation for commercial banks in the country to search for the source of the transactions. Meanwhile, under the laws it is banned the publication of data of these customers. (June 24th, 2014 / Telegrafi, Express, Tribuna, Radio Evropa e Lire).

BUDGET TRANSPARENCY, WEAKNESSES OF GOOD GOVERNANCE

Public budget is required to be transparent so that the general public is notified about the budget expenses and where budget funds are invested. According to experts of economic issues, budgetary transparency in Kosovo is considered to be at a non-satisfactory level, which is a weak point of good governance, and in the future to have higher budget transparency.

The director of the Kosovo Banking Association, Petrit Baliija for "Lajm" newspaper said that one of the most important instruments of a state is public budget, but it should also be transparent so that the public shall be notified about expenditures.

According to him, of course, budget transparency is needed. He explained that budget transparency in Kosovo is considered to be at not satisfactory level. "I think one of the most important economic instruments for state-building and economic development is exactly the state budget. Information on the state budget are generally available to interested parties, but according to the analysis of some independent institutes for economic research, it is considered that budget transparency in Kosovo is not at satisfactory level in terms of drafting, budget spending and reporting", Baliija said.

Furthermore he explained that the budget agencies should not rush and make rushed budget reports. "So I think that ministries and state agencies should not make rushed budget drafting. They should be more comprehensive in the process of drafting the budget and also make a better monitoring of costs and be more transparent in order and reports, in certain intervals, so that the public have greater access on this information and have a greater accountability to the citizens of Kosovo," Baliija said in the end. (June 25th, 2014 / Lajm)