

## CBK (CENTRAL BANK OF KOSOVO) AND ITS IMPACT ON BANKING AND FINANCIAL SECTOR

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### Abstract:

In Economic development of every country, banking and financial sector play a major role.

There is a strong link between bank and finance sector and the economic growth and it means that in each country should exist a strong and independent Central Bank, which has its impact on banking and finance sector.

We find that banking crises tend to emerge when the macroeconomic environment is weak

in particular, low GDP growth is significantly and robustly correlated with increased risk to the banking sector.

However, the slowdown in economic growth in most countries of the region as well as in the euro area has influenced the economy of Kosovo to slow the pace of growth compared with the previous year, marking an increase about 3.8 percent. External sector is regarded as the most influential factor in slowing economic growth as a result of the decline in exports, the marked fall of foreign direct investment as well as easy to fall recorded deliveries from immigrants.

Experience from past financial crises, suggests that lasting recovery requires a review of the policies and procedures of banking and financial sector and in particular of Central Bank, also our country need to come out with a clear view of what kind of coordination device they want to "invent" in order to be more efficient in control and monitor the banks in particular and the economy in general.

Moreover, the economic outlook for the entire region is clouded by the crisis in the euro area. Current projections are for a pronounced drop of growth in 2012, with further downside risks, so in this paper I will focus more on the points that the central bank should take care for sustainable and stable development of the economy.

Keywords: CBK (Central Bank of Kosovo), Development, Banking Sector, Banking Crisis, Economy, etc.

### ABBREVIATIONS AND ACRONYMS

BS	Banking System
CBK	Central bank of Kosovo
CB	Central Banks
CAR	Capital Adequacy Ratio
EU	European Union
EC	European Committee
FS	Financial System
GDP	Gross Domestic product
IMF	International Monetary Fund
KPST	Kosovo Pension Savings Trust
MFI	Micro financial Institutions
NLP	Non-performing Loans
RKS	Republic of Kosovo
WB	World Bank

#### 1. Introduction

The recent crisis and the following recession have given an important role to sharp movements in confidence as a key driver of economic developments. Heightened uncertainty about the future, and the associated pessimism, has constrained the usual drivers of economic recoveries. Because of that, businesses and households preferred more to wait-and-see before engaging in decisions which can cause high costs after are costly to reverse. Households and firms have preferred to adopt a wait-and-see attitude before engaging in decisions that are costly to reverse.

#### 2. Functions of cbk

The Central Bank of Republic of Kosovo, after the Banking and Payments Authority of Kosovo and the Central Banking Authority of Kosovo was established on June 2008 with the

approval of the Law No. 03/L-074, by the Assembly of Kosovo.

CBK is an independent legal entity with full authority according to law in force in Kosovo, and of it has to report to the Assembly of Kosovo.

BQK-ja takes care about its financial independence through stable profit while controlling its efficiency of activities and operations cost. Because the CBK doesn't generate incomes from monetary operations, its incomes are determined from the market. CBK puts different charges for its services, based on good standards and practices. Crucial objective of CBK is to save the value of financial assets and also its capacity, in order to support the liquidity of financial sector, together with Treasury of Ministry of Economy and Finance.

#### The CBK principal objectives are to:

- Foster the solvency and efficient functioning of a stable market based on financial system, encouraging market emergence of safe financial instruments and
- To support the general economic policies in Kosovo with a view to contributing to an efficient allocation of resources in accordance with the principles of an open market economy.

#### The CBK has the following specific powers<sup>1</sup>:

- to recommend broad policy guidelines to the Assembly and GOV in areas under its responsibility;
- to formulate and implement, to supervise and regulate payments and measures for payments and settlement systems for transactions in domestic and foreign currency in Kosovo;

<sup>1</sup> CBK official website: [www.bqk-ks.org](http://www.bqk-ks.org)

- c) to own operate one or more payments systems;
- d) to act as banker to the Ministry of Finance and Economy and to provide financial advice at Ministry request;
- e) to act as fiscal agent to the Ministry of Finance and Economy;
- f) to maintain a depository for safe keeping of currency and securities;
- g) to hold foreign currency deposits of banks, Ministry of Finance and Economy and other public entities;
- h) to ensure an adequate supply of bank notes and coins for the settlement of cash transactions;
- i) to license, supervise and regulate financial institutions;
- j) to conduct regular economic and monetary analysis of the Kosovo economy, make public the results, and submit proposals and measures to the Assembly and the Government on the basis of such analysis;
- k) to supervise and regulate dealers in foreign exchange, broker-dealers and mutual funds;
- l) to approve external auditors of financial institutions;
- m) to set accounting standards for financial institutions in Kosovo in line with International Financial Reporting Standards.

Within the powers provided by law, the CBK is independent of any other power in accomplishing main objectives of its activity and exercising of its duties. Each subject is obliged to respect the independence of Central Bank of the Republic of Kosovo, and shall not seek to influence any CBK Governing Board member or employee in the discharge of his or her duties or to interfere in the activities of the Central bank of Republic of Kosovo.

### 2.1 Strategic goals of cbk

In accordance with its strategic vision and mission, CBK has identify some strategic goals, which reflect the responsibility of CBK to national economy and also will make eligible to promote and ensure financial stability and contribute to the growth of stable development of our economy, in the future.

Some of the main strategic goals are<sup>2</sup>:

1. Promote and enforce the financial stability of the RKS,
2. Supporting of national economic policies, in order to achieve stable economic growth.
3. Ensure a modern banking system development and offering effective banking services to clients,
4. Promoting stable development of financial sector in RKS.
5. Contribution on the process of European Union Integration and also in other international institutions.

### 2.2 Mission of cbk

CBK mission is to maintain monetary and financial stability, to ensure effective payment system, as well as the supply of cash, offering economic advices to public institutions and through financial market development, to contribute on the sustainable economic development of the

Republic of Kosovo. In all areas of CBK activities, there is a high level of integrity, efficiency and transparency.

### 3. Independence of central bank

Financial Stability is the main goal and difficult to define for every developed country and also for developing countries. Variety of instruments are in function of resolving or supporting for achieving of that goal, like: regulation and supervision and also fiscal support of public banks recapitalization, etc.

From this meaning it is worthy to emphasis, an efficient system of the bank governance should prevent abuses of government and self-driven services from bank managers-officers and such governance should prevent, detect and resolve conflicts between their private interests and their official duties<sup>3</sup>.

It is also very important for CB to be **Accountability**<sup>4</sup> on meaning of explaining and justifying to the public and their elected representatives, for the decision which have been made from the staff of CB.

Even because a lot of economic researches and results are ambiguous, there has been a positive movement toward the independence of CB as a key of success, in order to improve a long term economic performance.

The literature on independence of CB has defined a number of types of independence, like:

#### 3.1 Legal Independence

Central bank independence is enshrined in law. This kind of independence is limited in a democratic state, in almost all cases the central bank is responsible on a par with government officials, either through a minister or directly to a legislature.

#### 3.2 Financial Independence

CB has the right to set fees for its services, to the Financial Institutions, in order to be independent on financial way and also to pay the expenses for staff and other operations.

#### 3.3 Operational Independence

Central bank independence to determine the best way to achieve its policy goals, including the types of instruments used and the time of their use. This is the most common form of central bank independence.

The central bank has the right to decide their own political goals, whether inflation targeting, control of the money supply, or maintaining a fixed exchange rate. While this kind of independence is the most common, many central banks prefer to announce their policy goals in partnership with relevant government departments.

#### 3.4 Managing Independence

The central bank has the authority to run its own operations (appointing staff, setting budgets, and so on.) without excessive government involvement. Other forms of

<sup>2</sup> CENTRAL BANK OF KOSOVO, Prishtinë, October 2009 Strategic Plan for period, 2010-2015, P.9

<sup>3</sup> Amendment of Rule VIII for Governance of Banks

Authorized by Articles 23 and 24 of Regulation, 7 February 2007 – Pristine, pg.1.

<sup>4</sup> The European Central Bank, History, Role and Function by Hanspeter K. Scheller, second revised edition 2006, p.205

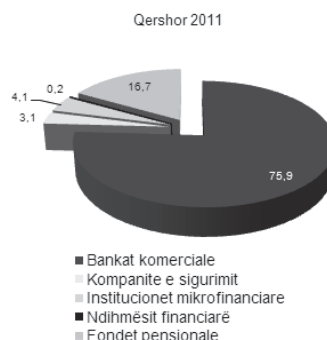
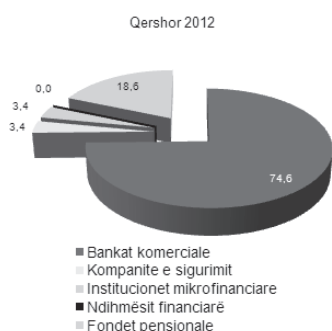
independence are not possible unless the CB has a significant degree of management independence.

It is argued that an independent central bank can run a more credible monetary policy, making market expectations more responsive to signals from the central bank. An independent CB will score higher results in the review than a CB which is not independent!

#### 4. Indicators of banking and financial system

Below will be presented some of the main indicators of BS and FC, on tables and charts, included the explanation for each one,

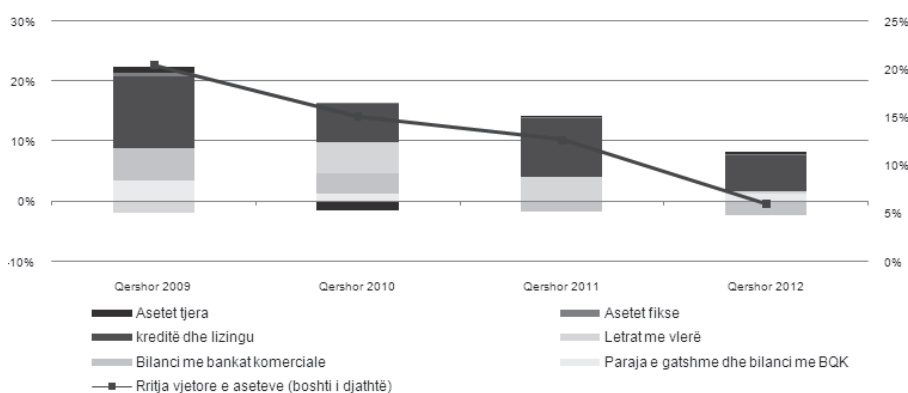
Fig.1 Asset Structure of financial system by sektor



Source: Central Bank of Kosovo

- Total of financial system assets achieve 3.5 bil. Euro (72.5% of GDP)
- 74.6% of financial system assets consists from banking system.
- 89% of banking assets are owned by foreigners.

Fig.2 Balance Sheet (Assets)

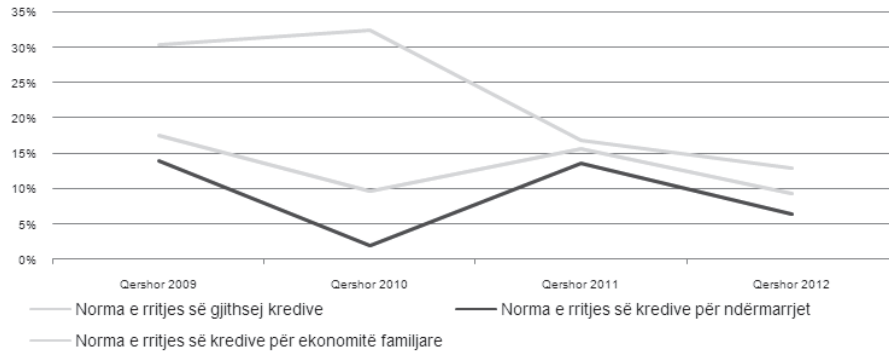


Source: Central Bank of Kosovo, Financial Stability Report – December 2012

- Assets of banking system growth for 6.1% (12.7% growth on 2011),
- Total value of assets become 2.65 bil. Euro (54% of GDP),
- Loans consists 67% of total assets on June 2012.
- On January 2012 started trade of treasury bonds of RKS, where primary actors are commercial banks.

Fig.3 Loans

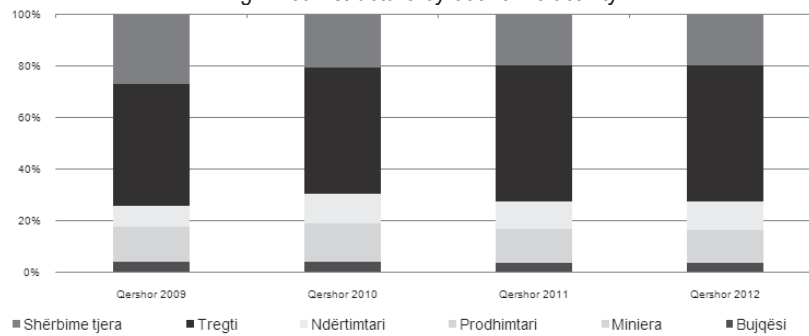
Growth rate of Loans by sectors.



Source: Central Bank of Kosovo, Financial Stability Report – December 2012

- Loans reached on 1.77 Bil. Euro (36.2% of GDP),
- Credit activity continue growing, but with slower rhythm (increase from 9.3% on June 2012 vs. 15.7% on June 2011).

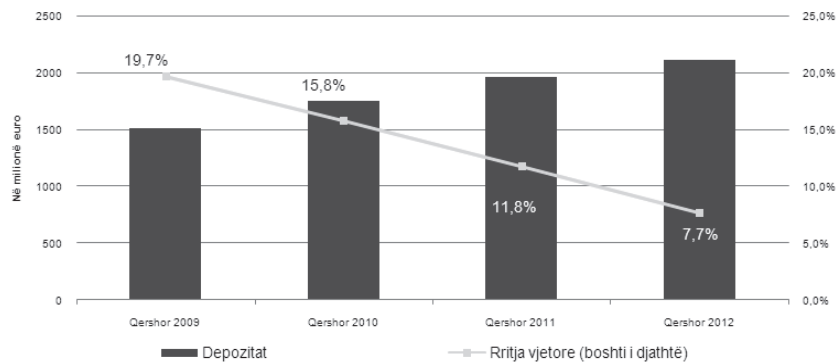
Fig.4 Loan structure by economic activity



Source: Central Bank of Kosovo, Financial Stability Report – December 2012

- Loans increased on amount of 1.77 bil. Euro (36.2 % of GDP).
- Credit activity continue to grow, but with slower rhythm (increase of 9.3% on June 2012 vs. 15.7% on June 2011).
- 67 % of total loans were for businesses.
- Trade sector received 51.3% of loans for businesses.
- The agricultural sector continues to have the lowest access to credit, with only 4%.

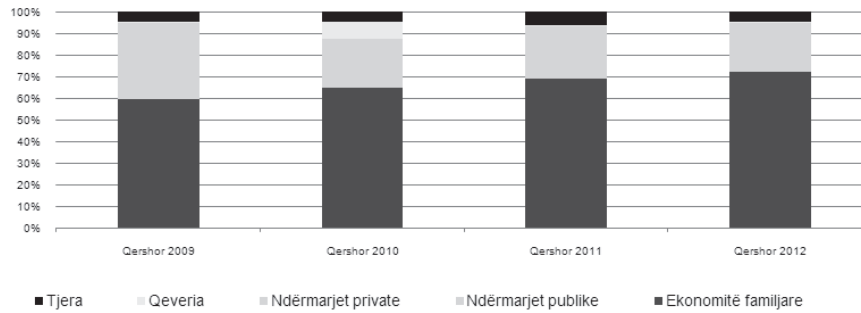
Fig.6 Growth trend of Deposits, in percentage



Source: Central Bank of Kosovo, Financial Stability Report – December 2012

- Deposits continue to be the main source of financing of Banking System (97.5% of total liabilities),
- Deposit value amounted to 2.1 bil. Euro. 72.1% of deposits are from households.
- Deposit growth rate slowed to 7.7% from 11.8% on June 2011

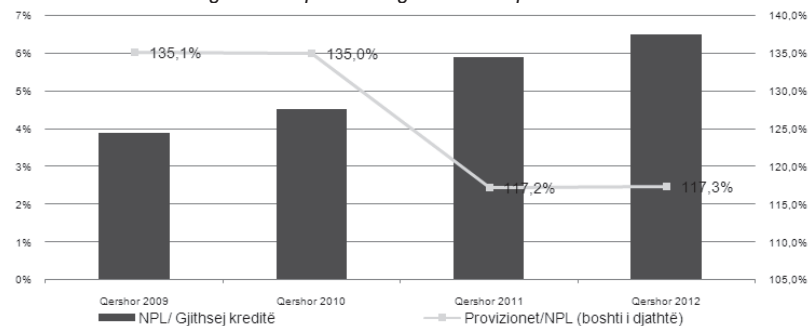
Fig.6 Deposits structure by economic activity



Source: Central Bank of Kosovo, Financial Stability Report – December 2012

- To public enterprises the deposits are almost halved of last year.
- Also our economy has deposit reduction to non-residents for 23.9%
- Slowdown of growth in deposits for households and private enterprises.

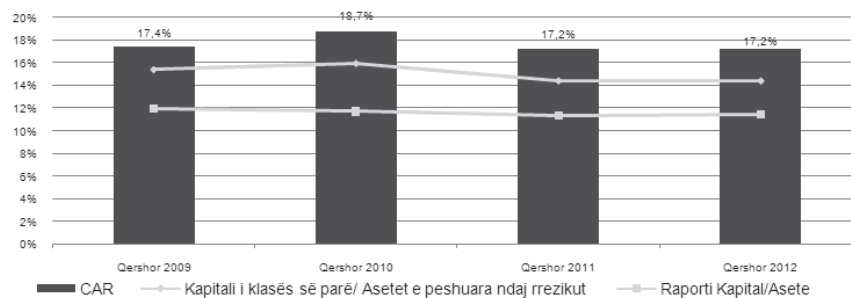
Fig. 7. Non-performing loans and provisions



Source: Central Bank of Kosovo, Financial Stability Report – December 2012

- Banking System has slow transformation of loans toward poor quality categories,
- Ration between NPL / total loans increased to 6.5% (5.9% on June 2011),
- This increase is mainly attributed to reduction of growth rate of total loans.
- NPL are 117.3% covered by provisions for loan losses, so the value of shared amount for provisions continue to be larger than value of total NPL. On June 2012 provisions for loan losses exceeded the total value of loans which were classified as NPL, for 117.3%,
- The most problematic loans in terms of repaying continue to be the loans for private enterprises ,
- On June 2012, credit risk concentration increased to 72% from 55.6% as it was on June 2011,
- The number of large exposures is increased to 54 (from 41 in June 2011), through diversification of credit risk concentration in more borrowers.

Fig. 8. Banking System Capitalization



Source: Central Bank of Kosovo, Financial Stability Report – December 2012

BS still continue to have high level of profit, even that in 2012 (10.2 mil. Euro) net profit was decreased for 31.2%, compared with year 2011 as it was 14.2 mil. Euro. Incomes from loan interest still remains dominant category of incomes (78% of total incomes).

High level of profit shows that banking system is stable and it going on right way.

Because of that, current level of banking system capitalization expressed through indicator "Capital

Adequacy Ratio - CAR<sup>1</sup> is quite satisfactory considering that this ratio exceeded the minimum rate of 12% which is determined by the CBK.

- On June 2012 CAR ratio of banking system was 17.2%, same as the last year (June 2011).
- Banking System capital on June 2012 was 303.9 mil. Euro, 92.2 mil. More than the required of regulatory capital.

In the beginning of 2012 the loan interest rates decreased slightly (from 14.3% January-June 2011 to 13.7% January-June 2012), while deposit interest rate remains unchanged (3.4% January-June 2012) compared with same period of last year.

- Deposits with maturity of over 2 years recorded higher interest rate,
- To the private enterprises loans, low interest rate recorded investment loans with longer maturities.
- To the household loans, low interest rate recorded real estate loans with maturity up to 5 years.

Since beginning of 2012, except foreign markets, there is also one other possibility of investing in Commercial Banks in Kosovo and it is investing on securities issued from Government of Kosovo and this new possibility was acceptable for Banks. On June 2012, 13.8% of investment funds, invested in securities consisted of treasury bonds issued from Government of Kosovo.

#### **5. Other financial institutions**

Except Banking System, CBK has the rights and it is obligatory to give licence and to monitor-supervise also these other parts of Financial System, which are also important part of it.

Below we will present shortly some records<sup>2</sup> of the other part of FS:

- **Insurance Sector:**
  - Assets: 120.2 mil. Euro, annual growth from 16.3%.
  - The value of accepted premiums was 39.6 mil. Euro annual growth from 4%.
- **Pension System:**
  - Pension System assets recorded annual growth from 19.5%.
  - KPST recorded positive performing because of investment funds.
- **Microfinancial Institutions:**
  - Number of MFI increased from 17 to 19.
  - Loan value: 102.6 mil. Euro, annual decreases from 10.9%.

#### **6. Conclusions**

Last Financial crisis (2008-2010) will be remembered as a seismic event in the history of financial markets. CB as usually responses to the crisis through monetary policy, liquidity assistance and in some cases, bank support operation. Through this paper we explained the status and functions of CB in context of maintaining the financial stability and the concept of accountable independence.

We can say that CB independence is never absolute, it is always relative. It is independence within government and it is accountable independence. And if public funds exposes to risk and are in danger, it is limited by the government's necessary involvement in the destiny of the financial institutions that have received government assistance.

The points below are as main conclusions:

- The main task of the Central Bank is to maintain a stable financial sector and financial stability under the direction of market forces, but acting in accordance with prudent regulatory and oversight policy framework that is harmonized with the EU directives and EC.

- CBK should attract new investors which are in good financial condition and that can bring an added value to the Kosovo market, so helping to strengthen the financial sector, increasing reliability, increasing competition and reducing the cost of financing.

- CBK should be in close cooperation with the IMF, WB, CB's and regulatory authorities, increasing the credibility of the Central Bank of Kosovo in the international arena.

Also we can mention here some other points which CBK should be focused on, like below:

- To be permanently in touch with government of RKS
- To follow regional initiatives for integration of financial market.
- Identifying of hazards and estimation commercial banks sustainability
- Advancement of strict supervisory methods, in order to assess the ability of banking system to manage risks.
- Capital adequacy in the banking system in general will continue to be over 12%, except in a few individual banks that will appear the need for capital injection in value and in particular CB should be focused more over those banks, in order to avoid the same case that Kosovo had before, which caused bankruptcy of one of our Banks.

<sup>1</sup> According to CBK rules, commercial banks are obliged to have a rate of at least 12% of regulatory capital to risk weighted assets ratio.

<sup>2</sup> [www.bqk-kos.org](http://www.bqk-kos.org), Central Bank of Kosovo, Financial Stability Report – December 2012