EFFECTS OF GLOBAL RISK IN THE BANK SYSTEM, ON TRANSITION COUNTRIES PARTICULARLY IN KOSOVO

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Abstract
The purpose of the paper is to discuss the effects of global risk in the banking system and in the field of Finances in transition countries particularly in Kosovo. With this paper I will try to cover the following issues:
The first part of the paper deals with the definition of the bank as a financial institution and the way banks work. In this section I have at great length elaborated and tried to answer the following questions:
How do the banks work in Kosovo? Where do banks get their Financial Capital? Are the banks an investment instruments? Have they been affected from the global risk and at last have they succeeded to manage the crisis?
In the second part of this paper I will explain what is the global risk and which financial institution were more attacked from global risk.
In the third part will be discussed about the Central Bank of Republic of Kosovo and what was the reaction of this institution on global crises and global risk? Further will be explained which measures were taken in order to manage crisis and how central bank succeeded to maintain the financial stability. In the end of paper, I will explain how global risk and global crises effected on bank deposits in Kosovo.
Key words: Bankcrisis, Investment, the role of Central bank, Financial crisis, Risk

Introduction

In the globalized world where the economies are very interdependent to each other, the crisis has affected almost every part of the world. For many economic experts the simpliest way to explain the cause of the crisis is that too much foreign money was flowing into the US from the Asian countries especially from China. The availability of easy credit made possible that too many people borrowed to buy properties that they could not afford. The bankers bundled up these loans and sold them to investors that could not understand the complexity of these bundles and the risks inherent in them. Once US borrowers started defaulting on their mortgages, they lost their houses and investors all around the world, including banks and hedge funds, lost their investments.The global economic crisis had almost a global reach, the effects of the crisis has been felt disproportionately in the transition countries generally, and in the economies of Western Balkans countries in particular. Economies of transition countries, with their higher income inequality and high unemployment, were affected of the economic crisis more strongly. Besides being relatively poor, the countries of the Western Balkans including Kosovo too were particularly vulnerable to the crisis due to extremely high external debt to GDP.

On the other side the global crisis affects global banking systems in many ways. The banking system faces large losses and capital shortfalls, this is the reason that many banks in affected countries are undergoing major restructurings in order to minimize their losses and capital shortfalls relying on own capacities and abilities or on government support. And almost all the banks are responding to new global economic models, which correspond to the economic slowdown in developed countries and the growing economic importance of emerging markets.

The characteristics of banking system of the Republic of Kosova

Development of the banking sector in sector of Kosova in the last decade was very dynamic, in this period of time were created many banks and the number of the created banks increased rapidly from year to year. The territory of the country was gradually covered from new created banks offering various bank services and products. Despite creation of many banks and continuous efforts of the bank operators to ensure a wider base of clients by increasing the competition, this growth did not succeed on decreasing the interest rates for loans and reduction of difference between the interest on loans and the deposits, which is still very high.

The banking sector in Kosovo consists of two levels. First level of the banking system of Kosova is Kosovo Central Bank and as the second level banks are commercial banks.

Banking system of Kosova was formed as an important component of the Kosovar financial system which consists of the Banking Sector, the Insurance Market and the Microfinance Institutions. Analysis of Monitoring the competition in the Banking Sector in Kosovo

The structure of the banking system of Kosova can be presented as follows[1]:

Description	2009	2010	2011	2012
Commercial banks	8	8	8	8
Insurance companies	11	11	11	13
Pension funds	2	2	2	2
Financial auxiliaries	28	29	32	36
Microfinance institutions	19	17	17	19

Source: CBK, 2012

Banks and other financial institutions that operate in Kosovo base their operation mainly on local deposits and loans. As a result of absence of the international financial institutions which was hit by the recent global crisis, Kosovo at the large scale remained respoecyively was not

[1] Central Bank of the Republic of Kosovo; Financial Stability Report; 2012

exposed to the global crises. Most of the banks operating in Kosovo use fixed interest rate.

The liquidity of the banking sector in Kosovo continues to be balanced. Currently, liquid funds in total assets participate with 31% covering 37% of total deposits and 35% of total liabilities. The 'loan to deposit' ratio of 81% is within the recommended limit of 80%. The structure of deposits is favorable too, with core deposits constituting about 85% of total deposits. Moreover, the appropriateness of liquidity risk management is satisfactory. This qualification has been proven, particularly in the case of withdrawal of liquid assets from the banking sector during the last two years, with about 200 million Euros in deposits of Post and Telecom of Kosovo, paid as dividends to the Republic of Kosovo[2].

On the other side the financial crisis may have had an effect on remittances sent to Kosovo from the emigrants. The estimated figures show that migrants from Kosovo represent 20 to 25 % of total population. This suggests that around half a million Kosovars live abroad. With a relatively large share of migration which is mostly concentrated in developed countries. Kosovar emigrants appear to have a substantial earning power. Estimates indicate that the yearly earnings of Kosovar emigrants are over euro 4 billion. Based on estimates from several surveys (UNDP, 2011 and Nexus, 2010), it may be suggested that savings and remittances comprise around 28% and 12% of total emigrant earnings, respectively.

The banking sector has proven astonishingly resilient to the deterioration of the external environment—principally in consequence of its conservative outlook and risk-averse lending decisions. The largely foreign-owned commercial banks have remained well capitalized, liquid, and profitable. During the first seven months of 2012, Kosovars entrusted the banks with an average of €2.1 billion in deposits, an increase of 8.9 percent relative to the same period in 2011, while borrowing €1.7 billion (+10.7 percent) from the local banks. The average loan-to-deposit ratio increased marginally from 79.7 percent duringJanuary–July 2011 to 81.6 percent during the same period one year later.[3]

Consequently, the potential of the Kosovar emigrants to invest in their home countries is substantial. However, the investments of the emigrants in home country are dependent on the relationship that the emigrants have with their families and relatives. Other social and economic factors play a role, however, most importantly, it is expected that the overall economic environment in the country is also equally important factor. With savings and remittances level at nearly 2 billion € per year, migrants are the main source for economic development in Kosovo. Moreover, with the FDI level of around 7-8 % of the GDP, around 30% is capital of emigrants from Kosovo who jointly invested with foreign companies.

Effects of global crises in transition economies

Firstly the mainly foreign owned banking sector transmitted the collapse in global credit flows to SEE. Secondly, there has been a sharp reduction in inflows of foreign direct investment which has hit some countries harder than others.

Thirdly, reduced demand for labour in the core market economies has had a dramatic effect on remittance flows on which some SEE countries are heavily dependent.

Fourthly, reduced global demand for imports significantly impacted on the exports from the transition countries. The weakening of economic activity is confirmed by foreign trade activities, reduction of foreign exchange reserves, rising unemployment and increasing fiscal deficit. The crisis was transmitted through trade and financial channels, and the result was collapsing exports, declining capital inflows and remittances, loss of external financing, lower tax revenue, tightened domestic credit conditions, and pressures on exchange rates.

In this way GDP growth slowed down abruptly, and in 2009 turned negative in all countries but Albania, where it remained positive (at over 3 percent). Croatia and Montenegro suffered the most severe recessions, with GDP plunging by about 6 percent, while the downturn was modest in FYR Macedonia, where output declined by less than 1 percent[4].

Kosovo has overcome the international global crisis whithout extraordinary consequences, with economic growth rates consistently above those in neighboring countries, relatively strong fiscal fundamentals, and a healthy banking sector5. The present global crisis has had only a limited impact on Kosovo's financial sector. The banking system in Kosova remains exposed to the risk of potential financial difficulties at foreign parent banks and possibly result in a liquidity shortage, in this case it is important for CBK to improve collaboration and follow close policy coordination between the CBK relevant financial instiutution to minimize such risks.

According to IMF studies and reports Kosovo has remained largely shielded from the euro-area crisis due to its limited trade and financial links with the rest of Europe. The economy is forecast to expand 3.8 percent this year, supported by "robust remittances and capital inflows coming from Kosovars living outside the country.

And it is known that Kosovo's economy is driven by investments and cash sent from its residents living in Europe. It is well know that Kosovo has a huge diaspora that contributes enormous in the growth of economy, but in the situation created by global crises many of them has lost their jobs so the level of remittances has decrease evidently in this period of time.

Around half a million Kosovars live abroad. This large number of emigrants is mostly concentrated in developed countries of EU and USA as well. Comparing to resident population of Kosova emigrants have mush more earning power. According to many studies the yearly earnings of Kosovar emigrants are over 4 billion euro Based on estimates from several surveys (UNDP, 2011), it may be

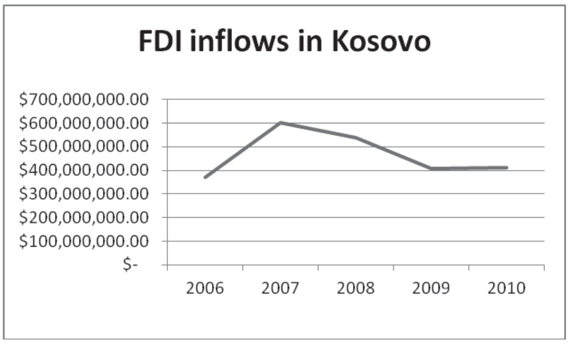
[2] The Kosovo Banker;The sustainability of the bankig system in Kosovo; 2012

[3] Worldbank/document; country report; kosovo-snapshot; september-2012

[4] International Monetary Fund; The Impact of the Global Crisis on South-Eastern Europe;2011

[5] Worldbank/document; country report; kosovo-snapshot; september-2012

suggested that savings and remittances comprise around 28% and 12% of total emigrant earnings, respectively.



Source: World Bank

The role of the Central Bank of Kosovo in the current crisis

The Central Bank of Kosovo (CBK) is an independent institution responsible for development of competitive, sound, and transparent banking and financial sectors. CBK is responsible for supervising and regulating Kosovo's banking sector, insurance industry, pension funds, microfinance institutions, and performing other normal central bank tasks, including: cash management, transfers, clearing, management of funds deposited by the Ministry of Finance and other public institutions, collection of financial data, and management of a credit register[6].

Central banks have preferences and constraints that differ from those of private banks. The objectives of central banks are defined in their statutes, and their primary mandate is to maintain the price stability[7].For central banking policies to be successful, they need to remain credible by making sure that at least two conditions are met.

First, a central bank should be sufficiently capitalised and run in such a way that it remains financially independent. Financial independence helps to keep external parties from unduly interfering in the conduct of monetary policy.

Second, the long-term profitability of a central bank needs to be ensured, so that the bank's reaction to specific economic circumstances is not influenced by considerations of the short-term financial impact of such policies on its profit and loss accounts.

Consequently, the capital position of a central bank, its profitability and the degree of financial risk protection provided by its risk control framework seem to be crucial elements that contribute to its credibility, hence facilitating monetary policy. This consideration, along with the principles of prudence and transparency that are required for all public institutions entrusted with the management of public funds, calls for the establishment of state-of-the-art risk management frameworks and the highest governance standards.

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Regardless difficult macroeconomic environment and declining profitability, Kosovo's banking system has succeeded to overcome all the difficulties and to manage the risks that the financial institution faces during the financial crisis such as: liquidity, credit and solvency risks. Regardless of the slight decline of the leading liquidity indicators, Kosovo's banking system is very liquid, mainly due to the structure of liabilities that is dominated by more-stable funding sources such as deposits, as well as due to the prudent management of liquid assets. According to the studies and reports issued from the CBK authorities in June of 2012, the loan to-deposit ratio increased to 83.2 percent, yet remaining close to the 80 percent recommended by the CBK. Deposits comprise about 80 percent of commercial banks liabilities, loans count for 67 percent of total banking system assets. In June 2012, loan-to-deposit ratio stood at 83.2 percent, which slightly exceeds the level of 80 percent recommended by the Central Bank

Conclusion

This study shows that the global financial crisis has a significant effect on the economies and financial institutions of countries in transition. Banks in the transition economies will seek their credit sources from foreign banks. The financial sector in Kosovo continues to be stable and sustainable as a result of the partial integration with the European financial sector and effective supervision by the Central Bank of Kosovo.

The main tasks of CB in general are promotion and fostering of soundness solvency and efficient functioning of a stable market based financial system, encouraging market emergence of safe financial instruments; and 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 Governments and Central Banks introduced programs to recapitalize banks, guarantee bank liabilities, and provide liquidity to banks by funding markets and in some cases support troubled asset markets.

These measures have somewhat proved efficient in managing the negatives effects that the crisis could have brought on these economies. The problems created from the recent crisis may require global multilateral solutions. If the crisis will continue for long period, governments and financial institution may become restrictive as they try to find new financing solution for their operations.

[6] http://www.state.gov;2012 Investment Climate Statement; Kosovo
[7]International Risk Management Conference 2011; Risk Management in Central Banking; Free University of Amsterdam,

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