Interest Rates by Banks In Kosovo

COMPARATIVE ANALYSIS – Between Kosovo and neighboring countries

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GENERAL OVERVIEW

Interest rates adopted by the banking sector in Kosovo have attracted great debate in the last few years. The wider public might have noticed that in the last few years, businesses and other stakeholders of the banking industry complain constantly about interest rates on lending being rather to high. On the other side banks operating in Kosovo and the Central Bank of Kosovo itself give explanations that the high interest rates on lending are linked to the business environment in which banks operate, somehow justifying high interest rates as being appropriate for such a business environment. For this reason, understanding where the truth stands on this discussion makes this area an interesting topic for studying and analysis.

The area of interest rates on lending by the banking sector could be analyzed from different points of view. One among those would be to analyze interest rates on lending by the banking sector through comparing lending activity in Kosovo with the lending activity in the neighboring countries. Countries in the region share more or less similar features, certainly each of them having own specifics as well. The comparison and analysis is expected to produce some indications and results that might be valuable for the subject matter. The discussion on this subject in Kosovo has intensified lately so much that any reliable argument would give some light and provide support on resolving the issue in the best interest of all stakeholders of the banking industry and the wider public interest.

The interest of the general public is that banks carry out their intermediary activity through producing services to depositors and borrowers at an efficient manner. The banking industry in Kosovo started its development after the war from almost the scratch, however, now ten years on after the war, the industry has consolidated and matured sufficiently to provide expected efficient services. Efficiency never ends; it only could be maintained, increased or even decreased. It is in the interest of the banks to continuously increase their efficiency therefore any light put on by this paper would be beneficial to the banks itself, to businesses and the wider public.

OBJECTIVES, APPROACH AND METHODOLOGY

This paper has been written in response to the call by Kosovo Bankers’ Association for papers on interest rates charged by banking sector in Kosovo. The call for papers outlined only some broad lines however did not state specif objectives to be achieved, methodology to be adopted and results that would be expected. This is understandable since the Association perhaps purportedly has left free room for authors to set objectives and to determine approach and methodology that would be adopted to achieve some results which would be useful for the banking industry and the wider public.

The objective of the paper is to bring forward views that would be challenging to the current view which is widely acceptable that lending interest rates charged by banks is appropriate for the business environment in Kosovo. By comparing data related to the field between Kosovo and neighboring countries and by conducting other analysis of issues and factors linked to the field it is expected to extract some results which would serve the purpose.

The call for papers on the subject described above had in itself some limitations on the time frame for the delivery of work. Under those circumstances, in the opinion of the author, the more appropriate approach and methodology is considered that based on the knowledge and experience of the author, to gather, select and analyze some official data that are ready available in Kosovo and the neighboring countries relating to the banking sector and the overall business environment.

For the purpose of this paper, the neighboring countries selected for comparison analysis are: Serbia, Macedonia, Albania and Montenegro. Those countries have been selected not because they share the border with Kosovo but rather because it was considered that they share the most common features with Kosovo both in the development of the banking industry and the development of the overall business as well. Selection of data for analytical purposes on this paper has been focused on data that are considered as sufficient to substantiate some abstracts and conclusions for the purpose of the paper. Also, the analysis is focused on high level review rather than more detailed analysis. This approach is considered as more appropriate for achieving the objectives stated above. The aim of the analysis is to understand certain relationships and positions rather than to establish trends and directions of development.

Data under review for the purposes of this paper have been gathered through internet search on web pages that maintain data and reports that are publically available. Those data have been prepared be Central Banks of each country for other purposes in which case as they are, may or may not have the best qualities, may or may not present the best view of or state of certain relationship or position. Also, those data have been prepared by different institutions which have not adopted a standardized format, standardised set of data or even standardised methodology in some cases..

As stated earlier, the approach adopted on this analysis is to have a high level review. Data used for analytical purposes on this paper tend to present general view . For this reason, the results extracted from the analysis it is expected to give an indication or express a tendency however it is not expected to give a full or completed picture. The analysis here are limited to the analysis of a few data and indicators therefore the results extracted would not be as extensive as had a more wider scope of work and deeper analysis been adopted.

LENDING BY THE BANKING SECTOR IN KOSOVO[1]

Overview of the banking sector in Kosovo

The banking sector of Kosova presents largest share of assets within the financial system currently standing at around 80% of the total assets of the financial sector. There are 8 licensed banks operating in Kosova. The banking market in Kosova is considered to have a high degree of concentration whereby three biggest banks share about 80% of the market.

Commercial banks have managed to build an infrastructure such as network of branches, ATM, etc that has resulted in the creation of conditions for easier access of clients to banking services. Kosovo appears to compare well with other regional countries with regard to the scope of banking sector infrastructure.

The activity of commercial banks operating in Kosovo is dominated by the intermediation activity within the country. The activity of the banking sector of Kosovo is concentrated in lending to the domestic economy, with loans accounting for 60% of total banking sector assets. Deposits collected within the country continue to be the main source of finance for banks, representing 79.0 percent of total banking sector liabilities. The other major source of finance for

[1] - Source of data: the official publications and statistics of Central Bank of Kosovo that are publicaly available on web page

commercial banks in Kosovo have been own resources, representing 10.1 percent of total banking sector liabilities, whereas the share of the subordinated debt to total liabilities continues to be low at only 1.1 percent.

Within the structure of deposits at the banking sector, the household deposits represent the main source of deposits for the banking sector (around 65 percent of total), followed by deposits of enterprises that represent around 17.5 percent of total. Government and other financial institutions' deposits are represented with 7.9 and 5.0 percent, respectively. It is worth mentioning that deposits were less sensitive to the latest financial crisis mainly because the Kosovo's banking sector is mainly dominated by deposits collected within the domestic economy.

The structure of the banking sector revenues continues to be dominated by the interest income from loans, which in June 2010 represented 79.3 percent of total banking sector revenues. Within the structure of the banking sector expenditures, general and administrative expenditures represent the largest category to total expenditures of the banking sector which as at June 2010 , were at 50.3 percent, the interest expenses at 33.9 percent and the non-interest expenses at 15.8 percent of total expenditures. After two years of declining trend in profitability, the annual increase of net profit in June 2010 led to an increase of the profitability indicators, such as the Return on Average Asset (ROAA) and the Return on Average Equity (ROAE) (see Figure 1)

Table 1 – Profitability indicators in percentage

Year	ROAE (%)	ROAA (%)
2008	20.20	2.20
2009	12.80	1.30
Jun-10	15.90	1.50

The banking sector of Kosovo is characterized with satisfactory level of liquidity. As at June 2010, loan-to-deposit ratio stood at 80.2 percent, the share of liquid assets to total assets stood at 34.4 percent, and the ratio between liquid assets and short term liabilities stood at 67 percent.

Capital Adequacy Ratio for the Kosovo's banking system as at June 2010 stood at 18.7 percent which is considered to be satisfactory since the minimum regulatory level required by the Central Bank of Kosovo is 12 percent. The Risk Weighted Assets (RWA) of Kosovo banking sector of assets with 100 percent risk weight in June 2010 stood at 69 percent of total RWA.

Lending activity by the banking sector of Kosovo

Loans issued by the banking sector of Kosovo still are dominated by loans to enterprises which as at June 2010 stood at 70.9 percent, while loans to households at 29.1 percent although loans to households are perceived as less risky. The structure of loans to enterprises continues to be dominated by loans to the services sector, which represent 67.1 percent of total loans to enterprises. Within services, the majority of loans are issued to the trade sector (51 percent of total loans to enterprises). Loans issued to the agriculture sector continue to represent only a small part of total loans issued to enterprises. As at June 2010, loans issued to the agriculture sector represented only for 4 percent of total loans. On the maturity level, loans with maturity of over two years represented 71.8 percent of total loans in June 2010. The share of loans with maturity of up to two years represented 28.2 percent of total loans in June 2010.

The average interest rate on loans (12-month moving average) as at June 2010 stood at 14.3 percent, whereby the average interest rate on loans to enterprises was 16.7 percent, while the average for household loans was 12.2 percent. The average interest rate on deposits in June 2010 was 4.0 percent.

The category of classified loans as a share to total loans stood at 10.2 percent in June 2010, whereas the category of loans with problems stood at 7.1 percent of total loans in June 2010. Regarding loan quality, in June 2010 the share of Nonperforming Loans (NPL) in the overall loan portfolio of Kosovo's banking sector was 4.5 percent. The structure of NPL is mainly dominated by loans classified as loss, which in June 2010 represented 62 percent of total NPL, while the rest consists of loans classified as doubtful. In June 2010, provisions for loan losses covered 135 percent of the total amount of NPL. According to the CBK rules, loans that exceed 10 percent of Tier 1 capital are classified as large exposures. The ratio between total large exposures and Tier 1 stood at 39.9 percent in June 2010 which is not considered to be a high credit risk for the banking sector.

AN OVERVIEW OF BANKING SECTOR AND LENDING IN NEIGHBOURING COUNTRIES

Overview of the banking sector of Serbia[2]

Banking sector of Serbia felt some effects of the global financial crisis occurred in the year 2008. After some strains on the liquidity in the year 2008, it recovered during the year 2009. The household deposits showed a return to the banking sector during the year 2009 however the Serbian banking sector still remains substantially reliant on the foreign financing. The average monthly liquidity ratio for the banking sector as a whole has been maintained significantly above the prescribed minimum (1). In the year 2009, the liquid holdings covered around 70% of total deposits in the banking sector.

After Q1 2009 that saw the end of net outflow under foreign exchange savings and foreign borrowing, banks in Serbia stepped up their efforts in terms of strengthening the deposit base, rolled over their cross-border loans resulted in reduced reliance on foreign sources of funding. Following a major net outflow in Q4 2008 and Q1 2009, household foreign exchange savings spurred by the record high inflow of remittances (close to EUR 3.5 bln) steadily increased until the end of the year reaching foreign exchange savings at EUR 6 bln.

A potential credit crunch in the year 2009 was avoided primarily owing to timely action by the National Bank and the government resulting in the bank lending to record a mild recovery. Serbia experienced a rapid credit expansion that started at end-2004 however it came to a halt in the last quarter of 2008. Lending in 2009 recorded a marginal real growth at around 6.8%.

The debt servicing capacity of companies and households in the year 2009 was impacted by the slackened economic activity, slower wage growth and weaker dinar. At end-2009, the share of net NPLs in total lending amounted to 8.53%, The corporate sector (excluding public enterprises), held an 11.8% share of NPLs in total loan portfolio at end-2009. It is worth mentioning that around 70% of corporate loans are FX-denominated. Household loan portfolio also deteriorated in 2009, though much less than that of the corporate sector. At end- 2009, NPLs made up 4.08%

[2] - Source of data: the official publications and statistics of Central Bank of Serbia that are publicaly available on web page

of total net household lending. Despite the reduced debt servicing capacity, NPLs are still fully covered with reserves for potential losses. In December 2009, around 142% of gross NPLs were covered with reserves.

Banking sector of Serbia is considered to stand well on the capitalization. The capital adequacy ratio at end of December 2009 was at 21.4%. Thanks to this, capital makes up today 20.7% of sector's balance sheet total. On the market risk, local banks feature low exposure to the capital market As at December 2009, net FX exposure of the banking sector remained low at 3.6%

In 2009, the Serbian banking sector operated with considerable profit, however, 13 out of the total 34 banks operated at a loss. The two major ratios (ROAE & ROAA) worsened in the year 2009 compared to the year 2008 however comparing to other regional countries banking sector of Serbia is considered to have satisfactory earnings (see the table below).

Table 2 - Profitability indicators in percentage

Year	ROAE	ROAA
2008	9.3	2.1
2009	4.6	1.0

Overview of the banking sector of Macedonia[3]

The effects of the global crisis on the banking sector of the Republic of Macedonia were noticed as a wave of effects on the real sector rolled over into the banking sector. However during the year 2009 the banking system managed to sustain its stability and safety.

The banking sector of Macedonia presents largest share of assets within the financial system of Macedonia which currently stands at around 89% of the total assets of the financial sector. There are 18 licensed banks operating in Macedonia out of which 14 are owned by majority of foreign investors.

The impact of the latest crisis mostly was noticed on the banks' loan portfolio quality. However, the year 2009 witnessed an increase in the deposits of the nonfinancial entities as well as an upward trend on the lending, although at slower pace. About 78% of the loans by banks and savings houses were in the local currency and 22% were in the foreign currency. Deposits on local currency at the end of 2009 were at 46.3% whereas on the foreign currency at 53.7%.

The increase of non-performing loans in 2009 accelerated which at the end of the year reached 39.1%. The rate of NPL at the end of 2009 stood at 9% which if compared to other neighboring countries does not stand very high.

During the year 2009 the liquidity of the banking system improved noticeably. The improvement in the liquidity is due to the increase of liquid assets standing at 25.7% of the total assets. Some of the liquidity indicators as at end of 2009 have been stated in the below table.

[3] - Source of data: the official publications and statistics of Central Bank of Macedonia that are publicaly available on web page

Table 3 – Liquidity indicators in percentage

Liquid assets / Household deposits	53,7%
Liquid assets / Short term liabilities	37,5%
Liquid assets / Total assets	25,7%

The banking sector of the Republic of Macedonia generally finances its activities from domestic sources of funds, primarily domestic deposits. The loan-to-deposit ratio on December 31, 2009 stood at 92.5%. On the solvency side, the capital adequacy ratio at the end of 2009 stood at 16.1% which about double the required level at 8%.

Financial difficulties of the banking system of the Republic of Macedonia were noticed in the year 2009 whereby profit of banks in the year 2009 is lower by 51% relative to 2008. Worsening of profit indicators resulted in halving ratios of the return on assets and return on capital (see the table below).

Table 4 - Profitability indicators in percentage

Year	ROAE	ROAA
2008	12.5	1.4
2009	5.6	0.6

Overview of the banking sector of Albania[4]

In the view of the Bank of Albania, the banking sector in the year 2010 is considered as stable with some difficulties on the quality of the loan portfolio. The banking sector of Albania as at end-2010 accounted for about 94.4% of total financial system assets. The banking sector is structured into three groups:

1. Banks Peer Group 1 - banks each sharing 0-2% of total banking sectors' assets and about 5% as a group,
2. Banks Peer Group 2 - banks each sharing 2-7% of total banking sector's assets and about 30% as a group,
3. Banks Peer Group 3 - banks each sharing over 7% of total banking sector's assets and about 65% as a group.

As at end-2010, outstanding loans in foreign currency and in Lek had a respective share of 69.8% and 30.2%. Short-term loans amounted to about 32.4%; medium-term loans 20.6%, and long-term loans 46.8%. Loans to private sector accounted for 67.3%, public sector 30.1 and household and other 2.6%.

Deposits represent the major source of financing for banks standing at 77% as end-2010. In terms of currency, as at end-2010, local currency deposits accounted for 51.2% of total deposits and foreign currency deposits for 48.8% of total deposits.

[4] - Source of data: the official publications and statistics of Central Bank of Albania that are publicaly available on web page

During the year 2010, banking sector's operating income increased 16.1% and the operating expensed by 7.9% from 2009. As a result, the ratio of operating costs to income as end-2010 was 53.3%. Annualized Return on Assets is estimated at 0.72% whereas annualized Return on Equity is estimated at 7.6%.

As at end-2010, banking sector assets denominated in foreign currency accounted for about 53.1% of total assets, whereas liabilities in foreign currency accounted for about 51% of total liabilities. Risk-weighted assets accounted for 59.2% of total assets. As at end-2010, the ratio of non-performing loans to total loan portfolio, on gross basis, stood at 14.0%. The ratio of non-performing loans to outstanding business and household loans is estimated at 15.5% and 11.7% respectively.

At end 2010, the ratio of liquid assets to short-term liabilities (of up to 1 year maturity) was 30.6% whereas liquid assets to total assets ratio was estimated at 26%. Loan to deposit ratio declined in the year 2010 and was estimated at 60.4%. The decline in this ratio owes to the slower credit growth rate compared to deposit growth rate, particular that in foreign currency.

Overview of the banking sector of Montenegro[5]

The global financial crisis, negative economic growth and problems in the real sector of Montenegro, supported by the earlier excessive borrowing by the corporate and household sectors, contributed to the banking system deterioration in 2009. The key balance-sheet positions: total assets, loans, deposits and borrowings recorded a decline.

The number of banks that operate in Montenegro in the year 2009 was 11 out of which 9 were owned by foreign investors. Foreign banks accounted for 82% on deposits and 84% on loans. The required CAR in Montenegro is 10% however the CAR at end-2009 was 15.8%

The banking sector of Montenegro operated at loss for year 2008 which worsened in the year 2009 by 9.6%. The two major profitability ratios for the year 2009 had negative figures: ROA -0.7 and ROE -8.

For the year 2009, deposits remained the major source of financing sharing about 60% of total liabilities whereas loans shared about 80% of the total assets. The Loans/Deposits ratio stood at 1.31. The share of liquid assets in total assets at end-2009 amounted to 15.3%

Although demand for loans was high, total loans granted at end-2009 were 14.3% lower than at end-2008. Loans to private sector as end-2009 were 56.4% whereas loans to households were 36.6%. The non-performing loans to total loans as at end-2009 which in the year 2010 increased to 20.9%.

[5] - Source of data: the official publications and statistics of Central Bank of Montenegro that are publicaly available on web page

COMPARISON AND ANALYSIS OF INTEREST RATES ON LENDING IN KOSOVO AND NEIGHBOURING COUNTRIES[6]

Comparison and analysis of economic development

For purposes of this paper, some of the basic economic data and indicators at macroeconimic level have been collected in the Table 5 in order to gain a general view on the postion of Kosovo compared to neighboring countries. Kosovo lags behind on the general wealth compared to all other countries. The GDP per capita is almost half of the neighboring coutnries such as Macedonia and more or less Albania and Montenegro and more than five time less than Serbia. Kosovo stands at the same or even worse position compared to other countries under review on indicators such as exports, imports and net current account. Kosovo shares by far the lowest proportion against GDP of exports, the lowest level of imports and the highest level of net current account deficit. The same position applies for the cover of exports with imports.

Looking from the perspective of banking business, based on the indicators stated in the Table 5 which were described above, Kosovo presents a rather small market for business establishment into banking industry. Kosovo would not be attractive for bringing in major international banking groups. Also, Kosovo is heavily depended on import. The effect of this level of dependency on imports indicates that Kosovo brings in goods and services and takes out cash. Under those conditions, there will always be a high demand for cash to finance trading activities since little cash is generated within Kosovo.

Table 5 – Various indicators for the countries under review as stated in the headings of the table

Year	Country	Nominal GDP (€)	GDP per capita (€)	Export/ GDP (%)	Import/ GDP (%)	Curr AC/ GDP (%)	Exp/Imp (%)
2008	Kosova	3,849	1,785	5.2	(50.1)	(44.9)	10%
	Albania	8,796	2,785	29.6	(56.5)	(26.8)	52%
	Serbia	30,722	10,805	22.7	(48.7)	(26.0)	45%
	Macedonia	6,720	3,278	40.0	(66.1)	(26.1)	60%
	Montenegro	3,086	4,898	14.6	(82.7)	(50.9)	18%
2009	Kosova	3,868	1,786	4.3	(50.0)	(45.8)	9%
	Albania	8,749	2,711	28.2	(53.2)	(25.0)	53%
	Serbia	29,357	10,577	20.7	(38.5)	(17.8)	52%
	Macedonia	6,677	3,253	28.8	(52.0)	(23.2)	55%
	Montenegro	2,981	4,770	9.9	(56.0)	(30.4)	18%
2010	Kosova	4,192	1,886	7.0	(51.2)	(44.2)	14%
	Albania	8,742	2,736	28.9	(51.6)	(22.7)	56%
	Serbia	28,825	10,808	26.1	(43.0)	(16.9)	59%
	Macedonia	6,917	3,374	34.6	(56.3)	(21.7)	63%
	Montenegro	3,023	4,876	11.8	(55.3)	(26.2)	21%

[6] - Source of data: the official publications and statistics of Central Banks of countries under review that are publicaly available on web pages (including IMF reports)

Comparison and analysis of interest rates on deposits and lending and NPL

The rates on deposits and loans on Table 6 present more or less a business envonment that banks operate. Under normal conditions, bank would apply interest rates conform market conditions based on the supply and demand for banking services. Generally banks would be keen to fully utiliaise what market offers, both on depost rates and loan rates.

Table 6 –Deposit and loan rates and other indicators for the countries under review as stated in the headings of the table

Year	Country	Curr	Deposit rates (%)	Loan rates (%)	Interest Spread	NPL/Gross Loans (%)
2008	Kosova	EUR	4.2	14.8	10.6	3.3
	Albania	Average	6.9	11.8	4.8	6.6
	Serbia	Average	7.3	17.6	10.2	11.3
	Macedonia	Denar	6.5	9.8	3.2	6.7
		Foreign	3.0	7.2	4.2	
	Montenegro	EUR	4.1	9.4	5.3	7.2
2009	Kosova	EUR	4.3	14.4	10.1	4.3
	Albania	Average	6.8	12.5	5.7	10.5
	Serbia	Average	5.1	15.1	10.0	12.2
	Macedonia	Denar	7.5	10.3	2.8	8.9
		Foreign	3.4	7.6	4.2	
	Montenegro	EUR	3.9	9.4	5.5	13.5
2010	Kosova	EUR	3.7	14.6	10.9	5.9
	Albania	Average	6.4	11.3	4.9	15.0
	Serbia	Average	5.6	13.6	8.1	16.9
	Macedonia	Denar	6.7	9.0	2.3	9.0
		Foreign	3.0	7.4	4.4	
	Montenegro	EUR	3.3	9.6	6.4	21.0

Appart from the relationship between market (demand and supply) and applicable interest rates, analysis become rather interesting when reviewing the realtionship between interest spread and ratio of NPL to Total Loans. The basic business principle is that the higher the risk the higher the interest spread, or, the lower the risk the lower the interest spread. Also the other business principle is that the higher the risk on lending, the higher rates on loans. Table 6 somehow does not clearly present those relationships within the business principles stated above.

Table 7 below shows averages of Loan Rates, Interest Spread and NPL/Total Loans for the years 2008 – 2010. The relationship between risk on lending which is indicated by the ratio of NPL/Total Loans and rates on lending exist to some extend to Serbia, Albania and Macedonia, for the Montenegro there is an indication of higher lending risk than the rates on loan charges whereas Kosovo maintains by far the lowest lending risk and charges almost the highest rates on loans. Clearly the relationships within the business principles described above in the case of Kosovo does not exist.

Generally, the relationship between the risk on lending (indicated by the ratio NPL/Total Loans) and interest spread as stated on the Table 7 follows to some extent the business principle however some exemption could be noted. While Serbia hold high risks and high interest cover, Macedonia, Montenegro and Albania hold high risk and low interest cover. On this relationship, Kosovo stands astray to all other countries, it holds by far the lowest risks and maintains the highest inerest cover.

Table 7 – Average for the years 2008 – 201 of interest spread and ration of NPL/Total Loans

	Kos	Alb	Serb	Mac	Mont
Interest Spread (Average 2008 - 2010)	10.5	5.1	9.4	3.5	5.7
NPL/Tot loans (Average 2008 - 2010)	4.5	10.7	13.5	8.2	13.9
Loan rates (average 2008 - 2010)	14.6	11.8	15.4	8.5	9.5

Comparison and analysis of business environment, interest rates on loans and NPL

Generally for the countries in the Balkans, international istitutions in their reports issed perscribe difficulties that businesses face regarding the level of informality, law compliance and other issues related to the rule of law. Table 8 presents on one side data regarding the Contract Enforcment Days and the Rule of Law Index (based on World Bank reports) and on the other side data related to Loan Rates and Ratio of NPL/Total Loans.

Table 8 – Data related to law compliance, loan rates and ratio of NPL/Total Loans

Year	**Country**	**Contract Enforc. Days**	**Rule of Law Index**	**Loan rates**	**NPL/ Tot Loans**
2010	Kosova	420	(0.5)	14.6	4.5
	Montenegro	xxx	xxx	n/a	n/a
	Albania	390	(0.5)	11.3	14
	Macedonia	370	(0.2)	8.2	9
	Serbia	635	(0.4)	13.6	14.1

The Contract Enforcment days present only one of the segments of the rule of law whereas the Rule of Law Index covers broader area. The Rule of Law Index is measured based on various aspects of the quality of institutions. It reflects among others, civil liberties, the freedom of press, political rights, crime, infrastructure, enforceability of government and private contracts, speediness and fairness of judicial process. It ranges from -2.5 to 2.5 and a higher score corresponds to better law enforcement.

Normal business principle would be that the better rule of law, the lower loan rates as well the lower ratio of NPL/Total Loans. Looking at the Table 8, those relationships between the business principle would be noted to exist to some extend to all other countries expept for Kosovo. The Rule of Law Index as well as Contract Enforcment Days between Kosovo and other countries under review do not have major difference. Despite this, Kosovo shares the highest rates on loans while maintaining by far the lowest ratio of NPL/Total Loans.

Comparison and analysis of other factors relevant to the financial system and bank lending

Appart from the factors analysed in the above paragraphs, there are other factors that have an impact on the overall financial system and consequently on the bank lending itself. There are numerous factors having effect on lending rates and not only those adopted in this paper, however the author considers that Foreign Direct Investment, Central Government Debt and Foreign Assets of the National Banks of countries under review would have a greater impact on the the bank lending in Kosovo for the existing conditions.

Generally, Foreign Direct Investment presents a strong source of finances to businesses. Kosovo and Serbia share the lovest rate of foreign direct investments as percentage of GDP. Going back to the paragraphs above on lending conditions, Kosovo and Serbia also shared the highest loan rates. At least this is an indication of the relationship between the sources of finances available and the loan interest rates.

Appart from the Foreign Direct Investment, Kosovo and Serbia share the highest level of Central Bank Foreign Assets. Although the indicator presented on Table 9 does not state the level amounts that have been invested abroad to ensure stability of the financial system and whether there are excesive amounts, higher level of Central Bank Foreign Assets than other countries give an indication of sources of finances that could have been used within own financial system which would increase finance sources within the country.

As regard to the Central Government Debt, Kosovo has not yet utiliaised this vehicle to increase its sources of finances available within the country. The level of public debt provided by the law on public debt of Kosova could posses a great source of finance. Especially this source of finance would have been very effective taking into consideration the chain effects on taxes as source of government budget income as well other similar effect in other business areas.

Table 9 – Data on FDI, Foreign Assets of Central Banks and Central Government Debt

Year	Country	FDI net/ GDP (%)	National Bank For Ass/GDP (%)	CG Debt/ GDP (%)
2008	Kosova	8.9	28.9	0.0
	Albania	16.7	18.5	55.2
	Serbia	8.4	23.2	35.9
	Macedonia	xxx	22.3	20.7
	Montenegro	18.9	9.4	29.0
2009	Kosova	7.0	28.1	0.0
	Albania	11.4	18.6	59.7
	Serbia	7.3	30.9	38.6
	Macedonia	xxx	23.9	23.9
	Montenegro	35.8	11.6	38.0
2010	Kosova	7.4	26.4	0.0
	Albania	10.2	17.5	62.8
	Serbia	5.7	31.0	40.7
	Macedonia	xxx	24.4	24.6
	Montenegro	17.9	12.0	44.1

CONCLUSIONS

Certainly the comparisons and analysis applied in the above paragraphs have been limited to only some of the data and indicators which have been considered to be suffiently representative in identifying certain relationships or the absence of relationships. Had other data and indicators been used, new relationships or issues may have been identified. Based on the results of the comparisons and analysis carried out in the above paragraphs, some conclusions could be stated as follows:

- Kosovo presents relatively small market for establishment and operation of banks, especially may not be attractive to major international banking groups. The level of economic development and general wealth as well as the structure of economic activity predominantly based on imports indicates that Kosovo is rather an isolated and small economy.

- Looking at some of the basic business principles for banks, Kosova presents exemption from those principles. On one side, Kosovo maintains by far the lowest lending risk however charges almost the highest rates on loans. Also on the other side, Kosovo holds by far the lowest loan risks and maintains the highest inerest cover. Certainly some certain factors have had an impact for this distortion on the basic business principles.

- It is widely distributed opinion that that the level of interest rates on loans in Kosovo is linked to the level of the rule of law and the business risks therefore rates are appropriate for the Kosovo conditions. As presented in the earlier paragraphs, this relationship does not exist in the case of Kosov since the Rule of Law Index as well as Contract Enforcment Days between Kosovo and other countries under review do not have major difference, however, Kosovo shares the highest rates on loans while maintaining by far the lowest ratio of NPL/Total Loans.

- As described in the earlier paragraphs, Kosovo holds rather limited sources of finances for banks and other commercial businesses. The FDI is at very low levels. Although the law on public debt exist for some time, Kosovo does not hold any public debt. Also, there is a fairly high level of Central Bank Foreign Assets. If we add to this the absence of the stock market, the limitation of finance sources becomes more obvious.

- Considering lending activity same as any other services activity that is offered to the market, the price of the service (in this case the interest rates on loans) would be determined based on the supply and demand for the said service. Consequently to the above paragraphs, it could be concluded that there is a high demand for finance in Kosovo and a limited supply of finance in Kosovo. Certainly market forces of the supply and demand have had their effect on the level of interest rates charged by banks on loans.