

The Banking and Credit System and its Impact on Economic Development

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Abstract

The banking system in Republic of Kosovo is new.

The functioning of this system began one year after the war.

Approximately 90% of bank assets primarily belong to the foreign capital. Apart from the Central Bank there are also 8 commercial banks operating in Kosovo, and only two of them are with domestic capital.

The required products for a financial institution to fulfill the main conditions for being a bank are deposits and credit operations, as well as other products and services which have recently increased.

Functioning of the banking system has been characterized by a rapid development of deposits and credits. While at the end of the year 2000 the amount of client deposits was 93 million Euros, at the end of 2010 the growth of deposits marked a value of 1. 952 billion Euros.

At the end of 2000 the amount of the allowed loans for individuals and businesses reached the amount of 3 million Euros, while in December of 2010, we have an amount of 1. 439 billion Euro.

In Kosovo's banks during 2006 and 2007 the bad loans were at a level of 4.1%, in 2008 there was a recession of 3.3%, in 2009 it was 4.3 %, and in the first half of 2010 the percentage of entire loans was 4.5 %.

The interest rates for loans are extremely high in comparison to commercial banks in the region and beyond. The banking system is poor; the demands for loans and other bank services are huge.

Key words: Banking system, Central Bank, bank products, deposits, loans, interest rates.

Introduction

The bank activities in the Republic of Kosovo are defined and regulated within their constitutional act. In general, the banking system is very similar to the banking system of other countries in transition.

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Some characteristic of economic policy and economic development of a country, apart from different ways of achievements, also include granting loans for clients, businesses and various citizens in different amounts and terms set by commercial banks.

From the beginning of functioning and operation of commercial banks - a period of more than 10 years - market is still dominated by high interest rates for loans, which to an extent present a burden for economic subjects and for the economy in general.

Viewed from the aspect of development and functioning of this system, and of the needs and great demands of the wider economy for these institutions, we found that the banking system in Kosovo is not developed enough yet!

Bank functioning aspects

In the book "Introduction to economics", authors define that banks perform an economic activity which relies on the principles similar to those of a usual business. The features of this business remain on the specificity and on the activity that the bank performs. The bank is a financial enterprise that performs certain services, which enable a transfer of free financial means from the ones who saves to those in need for them.

The banking activity firstly includes the acceptance of deposits of individuals, enterprises etc.

Secondly, the banking activity includes granting loans required by enterprises and individuals. For these services the bank requires interest which is higher than the interest given for deposits.¹

The commercial banks, similar to other businesses, have a targeted profit. The profit of banks consists of the difference between the incomes and the expenses realized.

¹ Ahmet Mançellari, Sulo Hadëri etj.: *Hyrje në Ekonomi*, Pegi. Tiranë, 2002. p. 371 & 373.

Overall, considering all assets, the banking system functions in two levels. The first level is identified with the function of the Central Bank, while the second level with the functioning of all other banks.

The Central Bank of Republic of Kosovo

The Central Bank of the Republic of Kosovo is an independent institution responding to the Assembly of Kosovo for all activities and operations. This bank exercises its competences in accordance to the State's constitution and its activities are regulated by law.

Pursuant to the law on Central Bank², article 4.2, the Central Bank of Kosovo as an independent public institution, enjoys independent autonomy in performing operational and administrative activities. At the same time functions and acts outside the framework of Kosovo's governmental structures.

Therefore, it is understandable that the Central Bank of the Republic of Kosovo is independent towards the governmental bodies, similar to what happens in other countries.

In this regard, the Central Bank of Kosovo as a financial institution also sets the rules and internal procedures for leading the employment of all staff including the administrative staff, advisors, experts and procurement. These are general rules by which the public services are directed.

The Central Bank of Republic of Kosovo has its own objectives.

Among the main objectives of the Central Bank of Kosovo are:

- To promote safety, the ability of payment and efficient functioning of the stable financial system based on the market, by encouraging the outcome of safe financial instruments on the market, and
- To support the general policies of the economy of Kosovo, aiming to contribute to the efficient share of resources according to the principle of free market economy.

² Law Nr. 03/L-074 on the Central Bank of Republic of Kosovo

Apart from the general objectives the Central Bank also has specific competences. Amongst these competences it is important to stress its role:

- To recommend wide political instructions to the Assembly and Government
- To set and implement measures for the agreement systems on the national and foreign currencies in Kosovo, to supervise and adjust the payments;
- To possess and to act with more payment systems
- To act as a banker to the Ministry of Economy and Finance
- To act as fiscal agent of the Ministry of Economy and Finance
- To maintain deposits of foreign currencies for the Ministry of Economy and Finance
- To maintain supply with banknotes and coins for regulating the cash transactions
- To keep thesaurus for the safe storage of the currencies and bonds
- To license, supervise and adjust the financial institutions
- To perform regular economic and monetary analysis of the Kosovo economy
- To publish the results and to present proposals and measures to the Assembly and Government
- To supervise and adjust the sales agents in currency exchange
- To approve the external auditors of the financial institutions
- To set accounting standards for the financial institutions of Kosovo in harmony with the international reporting financial standards, etc.

The Central Bank of Republic of Kosovo as a financial institution provides to the state institutions, financial community and the wider audience the common financial services which are offered by a Central Bank, excepting any loans or temporary liquidations since it is not an issuing bank.

The Central Bank is responsible to maintain an appropriate supply of banknotes and € coins of Kosovo. The supply with Euros by the Central Bank is done for performing cash transactions in economy.

Since in Kosovo Euro is the main currency allowed for usage, a payment and circulation mean, only the Central Bank is authorized to make the supply of this coin.

The responsibilities of the Central Bank are closely related to the operations and cash management, which have to do with the currency of Euro which is being used in Euro zone countries and beyond.

In this regard, the entire banking system is enabled to function based on the competences which the Central Bank has and which are harmonized according to the law of the Central Bank.

In addition to operations, activities, products and services which are harmonized with the law of the bank, the Central Bank is also responsible for licensing of commercial banks and other financial institutions ³

The development history of Kosovo's banking system

In Kosovo the commercial banks or the private banks operate their financial activities since the postwar period (the last war of 1999), respectively since 2000. Even before the war, different banks functioned in Kosovo, but those were of an exceeded political and economical system.

The second level banks, or the commercial banks, perform their tasks according to the law on banks and according to the instructions from the Central Bank.

In the market economy within the territory of Republic of Kosovo currently the commercial banks which operate and exercise their activity and their branches all over the country are:

- Banka Ekonomike (started its financial activity on May 28th, 2001)
- Banka për Biznes (started its banking activity on April 5th, 2001)
- NLB Prishtina

³ The financial institutions registered in the Central Bank of Kosovo are: Commercial Banks, Insurance Companies, Microfinance Institutions, Non-bank Financial Institutions, Money Transfer Agencies and Exchange Agencies.

- ProCredit Bank (started its activity in Kosovo from the postwar period)
- Reiffeisen Bank Kosovo J.S.C (in June,2003)
- Banka Kombëtare Tregtare (started its activity in 2007)
- TEB Sh.A. Bank (started on January 2nd, 2008)

All these banks have jointly performed a valuable function for Kosovo's economy, for investments on it and for deposits of citizens.

A deposit growth has been noted which in a way reflects the development of banks and their products.

Below we will present the statement of client's deposits in commercial banks in Kosovo for the period from 2000 until 2010.

Tab.nr.1. Statement of client's deposits in commercial banks for the period 2000-2010

Description	Deposits - the period from 2000-2010										
	The monthly dynamic of deposits through years										
Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
January		105.6	431.4	441.1	536.0	691.0	839.3	942.6	1,153	1,422	1,754
Feb.		107.3	433.6	440.9	537.3	703.5	856.1	973.5	1,150	1,445	1,775
March		114.5	392.9	435.9	563.6	709.7	825.3	973.5	1,183	1,469	1,777
April		120.4	388.4	438.2	559.0	712.6	825.3	967.7	1,196	1,466	1,747
May		133.2	382.5	437.9	568.2	731.2	825.2	984.6	1,236	1,501	1,750
June		152.2	386.3	454.3	577.5	742.2	845.4	981.6	1,265	1,513	1,752
July		170.1	380.8	477.7	608.0	746.3	846.9	1,027	1,317	1,553	1,734
August		186.4	398.0	495.9	616.1	765.8	884.8	1,074	1,373	1,617	1,797
Sept.		198.0	398.0	490.7	633.1	790.3	887.7	1,061	1,404	1,646	1,805
Octob.		207.6	404.8	505.9	628.0	784.3	889.0	1,103	1,415	1,640	1,757
Nov.		245.2	406.2	501.5	648.1	808.6	910.5	1,125	1,387	1,649	1,836
Dec.	93.0	492.3	427.2	514.0	694.5	836.7	924.3	1,143	1,444	1,745	1,952

Table 1 represents the amount of means deposited in commercial banks from various clients. The data on this table are processed and the parameters on the deposit development are shown. The growth dynamic throughout months during a number of years and the growth of deposits from one year to another is also shown on the table.

While at the end of the year 2000, the amount of client deposits in banks was 93 million €, at the end of the year 2010 the deposits have grown in a value of 1. 952 billion Euros⁴

The table shows that in our country the client deposits are large against the trust they have and the dilemmas they had for the banks in one side, and the position of economic development of the country on the other side.

The credit system in the function of economic development

Credits/ loans are one of the main banking activities through which the bank allows financial means to the clients. The commercial bank, through the granted loans and the fixed interest rates, provides its own incomes which are needed to pay the promised interest to depositors for the received deposits, and also cover the expenses and assure profit which is the bank's objective.

In other words granting loans to individuals, businesses and other subjects who require loans from the banks is the process of borrowing the funds placed in the bank and according to the conditions agreed between the bank itself and the borrowers.

The function of loaning (which is dedicated to the clients) means that this is the main function of financial usage of funds.

One of the main activities of commercial banks is granting loans for their clients. In the sphere of activities of the credit system in Kosovo for their own clients commercial banks, which function and exercise their activities according to this central system, offer these types of loans:

1. Consumer loans, various kinds
2. Loans for improving the housing conditions
3. Loans for business development, the development of SME-s
4. Bank guarantees etc.

As a result of the development of the credit system in Kosovo the mortgage loan has lately begun to spread, and this is considered as a success achieved by the development of commercial bank products.

⁴ The report of the Central Bank, 2010

Based on characteristics and importance that the credit system has on country's economic development, the bank credits or the commercial credits, even though they have high interest rates, in one way and to an extent have influenced the development of economic processes and wider system developments.

By developing the banking system the credit system is also greatly developed.

This functioning system has led not only to increase the number of credits, but this way the amount of allowed means is also growing rapidly year after year.

Thus, as a result of public demands and needs and huge increase of requirements for loans by citizens and the economic sector, despite the high interest norms which function in today's credits system, the credit system dynamic is still well developed.

Table 2 provides a picture of the statement of allowed loans from the commercial banks for the citizens of economic subjects for the period 2000- 2010

Description		Loans (period from 2000 to 2010)									
		Monthly dynamic of loans through years									
Muajt	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
January		3.5	29.8	90.4	240.6	381.8	520.1	639.5	902.5	1,189	1,293
Feb.		4.0	34.0	102	252.8	396.7	533.0	662.3	937.0	1,211	1,298
March		5.0	47.6	116	268.1	414.4	555.4	687.7	970.2	1,230	1,336
April		7.1	51.2	134	281.0	433.1	588.9	716.4	1,020	1,239	1,360
May		8.4	56.6	146	297.5	457.6	604.5	748.2	1,053	1,268	1,381
June		10.7	58.7	163	313.7	466.2	617.1	784.4	1,090	1,281	1,405
July		13.0	61.6	171	328.0	471.0	612.4	790.8	1,114	1,274	1,413
August		13.9	65.3	177	336.0	468.8	616.4	803.9	1,124	1,265	1,407
Sept.		14.9	68.2	188	350.1	476.9	620.7	825.0	1,131	1,279	1,419
Octob.		16.7	75.4	206	364.5	489.2	620.7	852.0	1,161	1,292	1,428
Nov.		21.3	76.9	217	373.8	508.5	629.5	877.1	1,188	1,299	1,453
Dec.	3.3	25.9	86.5	233	373.7	513.9	636.6	892.1	1,183	1,289	1,439

Source: Reports of the Central Bank of Kosovo 2000-2010. The data on the table are processed

While at the end of 2000, when the banking and credit system started to function, the amount of allowed loans for clients, individuals and businesses has reached an amount of 3 million Euros,

in December of 2010, the amount of loans for these categories reached a value of 1.439 billion Euros.⁵

The conditions and criteria for commercial bank loans

Banks mainly offer consumer loans for buying different goods from the products' program of certain enterprises.

The amount of credit means is set to 1/3 of the monthly salary.⁶ The monthly annuity of the loan is up to 1/3 of the salary. In these cases, the clients get the documentation at the bank where they process the loan⁷

The bank's high interest rates do not stem from bad loans

With activities and operations, the commercial banks realize huge profits by applying high interest rates for the granted loans.

Regarding the high interest rates which currently dominate, the bankers in front of the clients, economic subjects and others make justifications saying that there are various factors that banks allegedly are followed by and different risks which derive from clients not returning the loans in the set period as a result of the domination of bad loans.

Thus, even though banks have high interest rates for credits, the level of bad loans in Kosovo is lower than in the countries in region and beyond.

Recently, the European Bank for Reconstruction and Development (EBRD) has warned that the Eastern European countries may face a second wave of financial crisis as a consequence of strong growth of bad loans and business' financial difficulties.

⁵ The Central Bank Report, 2010

⁶ Such loans are allowed to those who are employed

⁷ The clients find and set their warrantor. They have to be persons who work posses a work contract and their history card is viewed. The loan officer informs the client for the approval or rejection of the loan.

Therefore, EBRD is warning that the bad loans are growing in the whole region, but in some countries such as Turkey, Albania, Romania and Ukraine, they have doubled within one year.⁸

The recently published list - the ranking of the most problematic countries in region with bad loans - showed that the list is headed by Serbia which participated with 17.5 % and Montenegro with 17.2 % of the bad loans from the total of allowed loans. In the third place is Albania with 12.87 % and then comes Macedonia with 9.9%, Croatia with 9.5% and Bosnia with 8.7 %.⁹

The information about Albania's banks shows that in the period April-June 2010, the growth rhythm of bad loans has dropped to 7% from 19.7% registered in the first trimester of 2009. At the end of 2009 was 10.42 %, while this year (year 2010) has reached 12.2 percent.¹⁰

In the report it is said that most of these percentages in the above-mentioned countries, show that businesses participate with 13.8 % and then the loans for individuals with 10.3% where the biggest part of the amount is in foreign currency.¹¹

Table 3. Bad loans in the period 2006-2009 and in the first half of 2010

N.r.	Vitet	Kreditë e këqija (pjesëmarrja në gjithsej kreditë e lejuara)
1.	2006	4.1%
2.	2007	4.1 %
3.	2008	3.3 %
4.	2009	4.3 %
5.	Qershor 2010	4.5 %

Source: Central bank of Kosovo

⁸ The Report of European Bank for Reconstruction and Development (EBRD), published on July 28th, 2009

⁹ The Bank Association of Republic of Albania- Information, Sources from the internet.

¹⁰ The Report of Central Bank of Albania, 2010

¹¹ In Republic of Albania the loans on foreign currency e.g. in American dollars and in Euros, the banks apply lower rates of interest while the interest rates in the national currency "leke" - are higher.

In the Republic of Kosovo, from the beginning of functioning of banking and credit system, the bad loans, respectively the problematic loans, until 2005 did not reach more than 3 % from the general loans allowed.

As shown on table 3, this practice shows that in 2006 the bad loans were 4.1% in relation to general loans.

The same trend, following this percentage was also evident in 2007. In 2008 we have a decrease in 3.3%, while in 2009 we have a participation of 4.3%, also in the first half of 2010 with 4.5%.

From the data shown and based on the volume and dynamics of the deposits, loans and bad loans it is obvious that banks which operate in our country are healthy and financially stable. In order to stay in this position and to develop even further aiming to reduce participation of problematic loans, banks have to be careful when granting loans to their clients and to lower the interest rates.

To reduce lending to those individuals or businesses which are not safe for returning the money in time (the money of the loan received), and in order to avoid further growth of the level of unreturned loans, banks can achieve this by lowering the interest rates but also extend loan repayment periods, and thus the borrowers would return their loans easier since their development is more possible.

The knowledge of consumers for loans and bank products

Clients who receive loans must search the banking market before they apply in order to have good conditions, even though there are minor differences among the criteria set by banks. For this reason it is necessary to inform citizens and clients for bank products and services, for fulfilling of their requirements and for the intensification of bank activities to face the competition which has resulted in a growth of bank products.

In a time when the level of clients' knowledge of banks is affected by a range of factors such as: diversity and sophistication of financial products and services, the rapid development of technology, the demographic movement of the population from the rural to urban areas, the demands for finances, for loans and other services, have

made loaning to be more prevalent. However, as a consequence, the lack of knowledge makes it impossible to earn information in the right time¹²

Recommendations

In the context of deliberation of problems regarding the banking and credit system, and the possibility to further development it we provide the following recommendations:

1. The Central Bank should be engaged in licensing new banks; to add commercial banks, especially the local banks, in order to increase competition where the effects and the impact in economic development will be greater than it currently is.
2. Considering current circumstances we propose to scrutinize the possibility of initiating a new crediting policy, and to apply lower percentages of interest rates and the prolongation of the loan repayment for some perspective sectors, in order to provide further support for them.
3. Undertake an initiative to implement a project towards a common organization of banking institutions; creation of an information centre for citizens and economic subjects who require loans or give deposits (savings) in financial institutions, in order to have sufficient information for their conditions and criteria.

¹² Eugenie Gjuraj: Sistemi banker dhe biznesi si faktorë zhvillimi. Interneti. E vendosur më datën 15.09.2009. Autorja është Drejtore Ekzekutive, Dhoma e Tregtisë & Industrisë, Tiranë.

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