

APPLICATION OF LOANS AND THEIR IMPACT ON ECONOMIC DEVELOPMENT ASPECTS IN KOSOVO

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Abstract: *Studies on the functioning of loan management models in banking institutions are of special significance for the ascertainment of efficient credit disbursement modalities and policies, with the aim of ensuring strategic and financial development.*

In their monetary programs, banks among other make assumptions on the increase of the demand for cash from loans for their respective economies and businesses. Supporting the economy through loans represents one of the main tasks of any banking system, and this is especially applicable in countries with specifics similar to our country. During the last half of the previous decade, the structure of deposits in the banking system underwent severe changes, which were generally in function of the country's development, but also assisted in the development of the banking system itself. The overall tendency of the deposits in the banking system was positive, and charts and series matrixes show their ever growing tendencies. However, the vulnerability and problems of the first decade after the establishment of any banking system are reflected in crises and problems noted in the structure and level of deposits of such banking systems, which in the case of Kosovo was further reflected in external and internal factors affecting loans and their overall default.

Keywords: Loans, Credit risk management, banking systems of Kosovo.

1.Strategies and policies

Banks are supposed to develop strategies and policies for the purpose of managing credit risks. Credit risk management strategies and policies should be effectively communicated throughout the banking system. All relevant bank staff should clearly understand the bank's approach to credit provision and management and should contribute to the implementation of such relevant credit policies and procedures. The basic purpose of the credit risk strategy is to determine the bank's risk appetite. After the determination of the credit risk level, banks may develop an optimized repayment plan, thus maintaining the credit risk within the preset limits.

Credit risk strategies should comprise, at minimum:

- Statements on the bank's willingness to lend to different segments of borrowers and products, types of exposure (trade, production, consumption, real estate, etc.
- Targeted economic sectors, geographic regions, currency, maturity terms and profitability;
- Identification of targeted markets and overall characteristics banks wish to accomplish in their credit portfolios;
- Acquaintance with credit quality, profit and growth objectives;
- Ensure a constant approach that takes into consideration cyclical economic aspects and fluctuations which are reflected in credit composition, quality and portfolio.

2.Credit risk management organizational structure

Banks need to establish appropriate organizational structures for credit risk management, while clearly determining management responsibilities and competencies for such structures. Banks need to ensure that functions of credit sales, from the organizational and operational perspective, are clearly separated from operational support and credit risk control functions, including protection from possible impacts of senior management levels. Banks need to ensure necessary structures for assessment, measurement and control of the concentration of credit risk by sector, by geographic location, currency, loan type, etc.

3.Structure of loans disbursed in 2011

Household loans continued to show an increasing trend in 2011, with an annual increase of 17.7%, compared to the 24.6% increase in 2010. On the other hand, there is an accelerated growth of business loans in the last two years (12.5% in 2011 and 7.9% in 2010, compared to 4.8% in 2009). Contrary to growth acceleration, the increase of the credit rate for businesses loans continues to be lower than the level of growth for household loans. This is also reflected in the overall loan structure, which shows a slight increase in the rate of household loans and a decrease in the part of business loans (figure 1). The share of household loans in the total portfolio of loans issued in the banking system reached 30.1% by the end of 2011. Therefore, business loans continue to dominate the overall loan structure, comprising 69.9% of such structure.

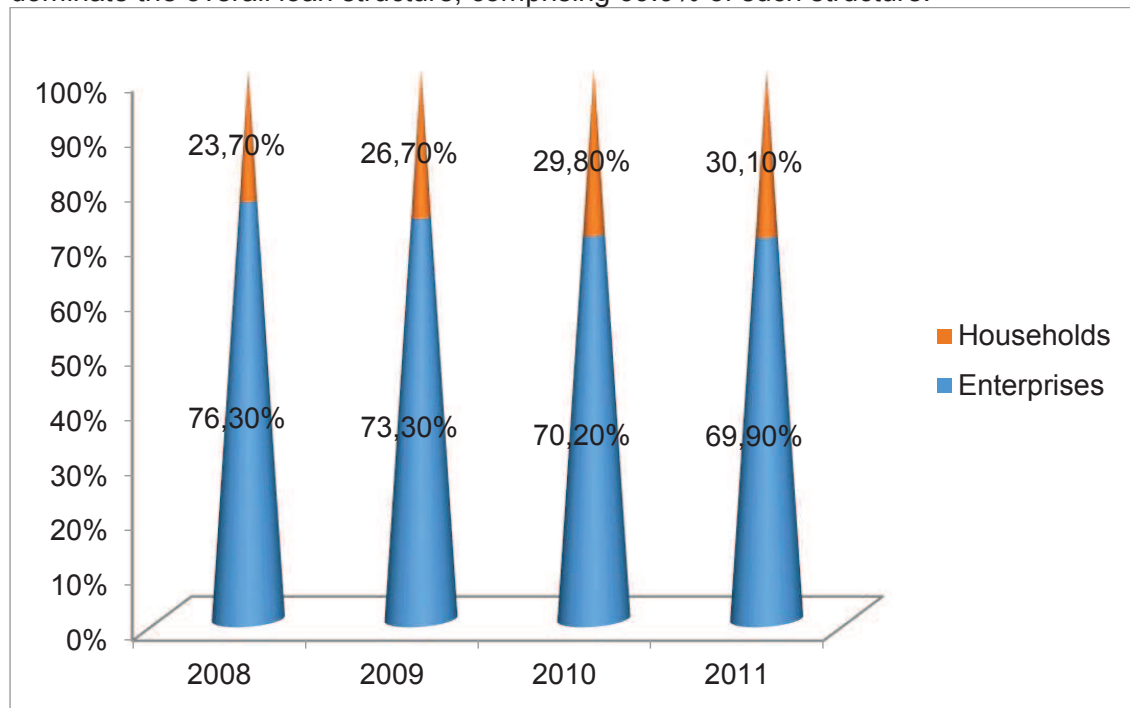


Figure.1 Loan structure in percentage

In 2011, the level of loans increased in all economic sectors, including the business sector (Figure 2). In 2011, the amount of loans for the commercial sector reached 606.2 million euro, thus noting an increase of 16.3% in comparison to the previous year (increase by 13.6% in 2010).

On the other hand, loans for the construction sector reached 116.3 million euro in 2011, thus diminishing by 6.6% (annual increase rate of 22.5% in 2010). Loans for the agricultural sector reached 40.5 million euro, rebounding from a 0.1% decrease in 2010 to a 6.1% increase in 2011. Loans disbursed for other services remain the only category of business loans that decreased (annual decrease by 12.1%). Loan structure by maturity date remains similar to the previous years, with the largest portion of loans with long-term maturity dates.

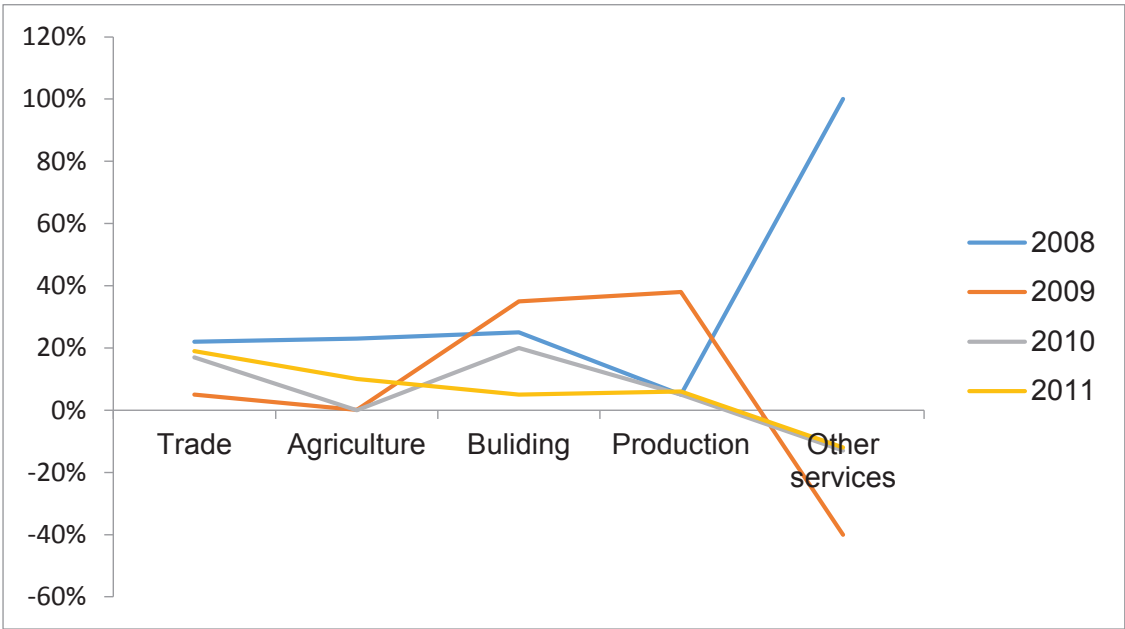


Figure 2. Annual growth rate by economic sector.

4.Loans disbursed between 2000 and 2011

Loans represent an important instrument for the development of any country, as they support new production capacities of the given economy, and enhance production, trade, services and other similar activities. In the last twelve years, loan-related activities in our country were assessed to have carried numerous risks, especially in the sense of default and suspicious loans, which forced banks to be very cautious in their lending practices.

Table 1: Loans disbursed in the industrial, services and agricultural sector

Description	Overall Total									
	Total	Agriculture			Energy and construction industry			Services		
		Agriculture	Up to 1 year	Over 1 year	Industry energy building	Up to 1 year	Over 1 year	Total Services	Up to 1 year	Over 1 year
12/2000	3.3	-	-	-	0.8	0.8	-	2.5	2.5	-
12/2001	25.9	-	-	-	3.8	3.8	-	22.2	22.2	-
12/2002	86.5	1.5	1.5	-	13.6	13.6	-	71.4	71.4	-
12/2003	232.8	4.7	3.9	0.8	22.2	12.6	9.7	205.8	119.7	86.1
12/2004	289.9	7.9	3.9	4.1	47.8	22.5	25.3	234.2	89.5	144.8
12/2005	387.9	12.5	4.1	8.4	74.2	24.5	49.7	301.1	92.4	208.8
12/2006	490.5	16.4	3.4	13.0	97.7	28.0	69.7	376.4	120.6	255.8
12/2007	6915	29.0	4.1	24.9	144.5	32.8	111.7	518.0	149.5	368.5
12/2008	902.4	37.4	4.1	33.3	160.2	28.9	131.2	704.8	126.4	578.4
12/2009	945.5	38.2	3.8	34.4	236.7	54.8	181.9	670.5	113.2	557.3
12/2010	1,022.8	38.2	1.7	36.5	269.3	77.1	192.2	715.3	188.5	526.8
12/2011	1,149.5	40.5	0.8	39.7	284.7	82.3	202.4	824.3	220.5	603.8

The data presented in the table shows that during the abovementioned period, in average 95% of the loans were disbursed in these sectors. The structure of the loans shows that over 70% of the loans were disbursed in the services sector, 25% in the industrial sector, and 3% in the agricultural sector. Loans in the agricultural sector in 2000 and 2001 were at zero value, while beneficiaries from the energy industry, construction and services sectors were also scarce.

5. Interest rates

2011 was characterized with decreased interest rates in both deposits and loans. Subsequently, difference between interest rates in loans and deposits diminished from 10.9% in 2010 to 10.6% in 2011. The improvement of the overall business environment and increased bank efficiency are expected to yield in continuous decrease of interest rates. Average interest rates for deposits for the period January - December 2011 diminished to 3.5%, compared to the 3.7% interest rate for the period January - December 2010 (Fig 3).

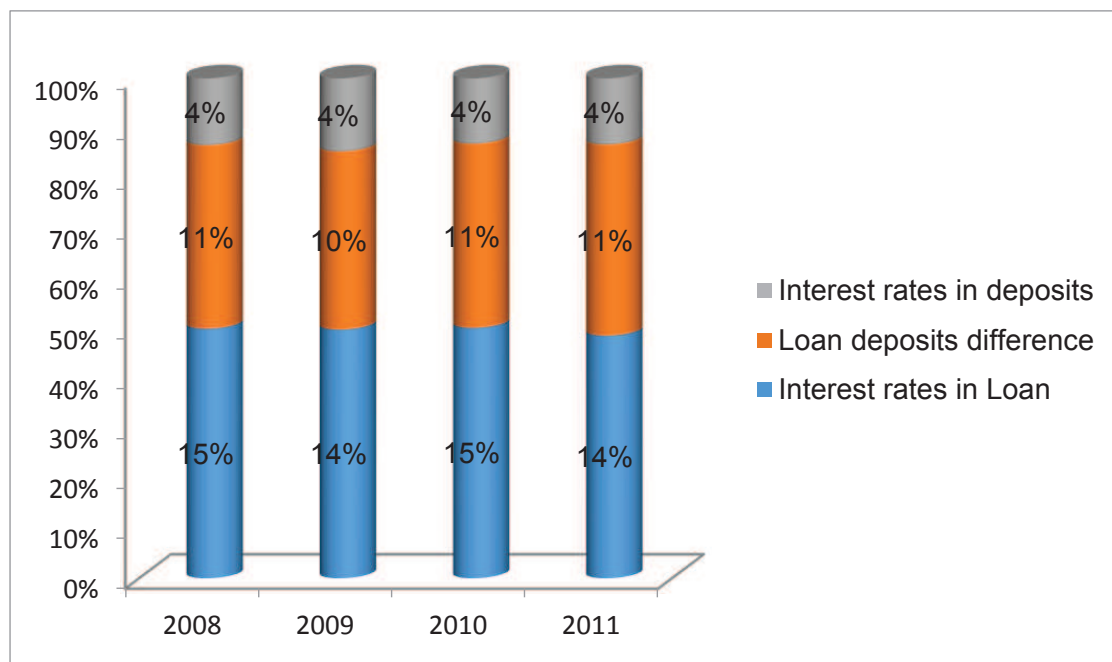


Figure 3 Average interest rates in percentage

Average interest rates in loans diminished from 14.6% in the period January - December 2010, to 14.1% in the period January - December 2011.

In 2011, average interest rates for household and business deposits were at a similar level. The highest interest rate average for businesses (5.25%) was noted in December 2011, for deposits over 250 thousand Euros with maturity terms of six months to one year. The highest average interest rate for household deposits was in December 5.36% (deposits with maturity terms exceeding two years).

6. Causes of increased loan rates

Numerous studies conducted during the last decade define Kosovo as a beautiful yet sleeping country. This determination is based on the fact that in the period between 2000 and 2004, the ratio between loans distributed in the country's economy and its gross domestic product was rather small - among the lowest in European transition economies. Meanwhile, credit provision changed after 2005 and showed a satisfactory increase pattern until 2011.

An important factor for stimulating demand is productivity growth. Banking systems and other non-banking financial institutions represent the loan supply side, while the demand side encompasses individuals and businesses.

Increased loan demand is a result of stimulating policies followed by financial institutions in their credit-related activities, including decreased interest rates or lowering of crediting standards, such as, for instance, collateral requirements or practices for assessing the financial state of businesses. On the other hand, enhancement of the number of loans could be a result of increased demand among borrowers, i.e. on the demand side. Enhancement of the demand among borrowers could occur due to increased productivity, better projects or technological advancements, or based on a series of other factors related to their financial situation.

For a number of years, commercial banks have followed a conservatory business strategy. Funds collected from the public as deposits were mostly invested in governmental bond or similar instruments, with a high security and low return rate. Loans

disbursed in the economy to both businesses and individuals were limited, with high interest rates and subject to long and prudent procedures.

7.Results and conclusions

This paper analyzed the most recent developments in the banking system, with a special focus on credit risk policies and activities. Loan provision, as an activity that represents the foundation of any banking system development, has shown a significant increase in the recent years. It is envisaged that the macroeconomic stability and increased public trust in banking institutions, which operate under the watchful eye of responsible authorities, provided the necessary prerequisites for normal operation of the banking system. This fact supported the banks in developing their financial and human capacities, which, aided by increased competition, materialized in growing credit-related activity for the economy. Increased competition and loans, on the other hand, were accompanied with further deepening of banks' intermediary activities, which are characterized by products provided, expanded geographical scope, etc.

Developments in the banking system are expected to be transformed in economy's real sectors. By providing more products and services, banks support their clients in saving and investment processes, thus stimulating economic growth. Also, the banking system could improve the environment in which local and international firms operate and could stimulate the introduction of foreign capital in the country.

However, on the other hand, a large increase on the credit side also increases the risk level. Credit trends in general follow economic trends, and are high in expansion and low in recession, whereas performance indicators show a similar behavior but in the other direction.

Therefore, risks that banks are taking over during this phase, which is considered a phase of economic growth, will be fully evidenced at the moment when economic activities decelerate. In addition to this effect, uncontrolled credit growth can increase inflationist pressures, deteriorate trade balance and increase economy's exposure to impacts that may derive from developments in foreign markets, which are related to unfavorable fluctuations in savings, currency exchange and interest rate growth. The very banking institutions are also subject to individual crises, as a consequence of unfavorable choices and risk situations they face. In such circumstances, timely and mature interventions by monetary and supervisory authorities are necessary for maintaining control over negative consequences and for the mainstreaming of developments towards ensuring sustainable growth.

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