

INTEREST RATES IMPACT AND LOAN SYSTEM IN THE ECONOMIC DEVELOPMENT IN REPUBLIC OF KOSOVO

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ABSTRACT

The Republic of Kosovo is now at the end of the transition period and namely the commercial banks were the biggest contributors of the extinction of centralized system towards a free market economy. The way how commercial banks and other financial agents performed and whether the impact was the biggest possible one, is a matter of analysis and conclusions from the macroeconomic aspect. Due to the recent global crisis that have occurred in recent years throughout the world, it was thought that they will affect in great deal the banking sector of the Republic of Kosovo, since most of the commercial banks operating in the country are banks with foreign capital, but the stability shown by them, was of the highest level, thus minimizing the delivery of the crisis to other economic agents. Unattractive loan interest rates had an impact in businesses to have requests for decrease of interest rates which they consider as high, therefore finding modalities and drafting of more convenient loan policies for local NVM and especially for start-up businesses is the key point in building a healthy economic development within an economy which is marching slowly. This paper will treat analytically and give modest conclusions regarding the possibilities and steps that need to be taken in order to create a favourable environment not only for the banking system, favourable legal infrastructure, but also for other economic and social agents.

Keywords: Interest rates, SME, NPL, Legal system .

INTRODUCTION

Private banking sector plays an extraordinary role in the financial system, especially in an economy in transition and an economy that has emerged from a centralized system as has been the Republic of Kosovo. Commercial banks are intermediators of the interaction between business entities and other economic, legal and social agents. Today, banks do not have the approach towards the classic model, whose function was only to offer classic services of deposits and loans,; with evolution of global trends and technology banks have created nowadays a modern system of operating that applies techniques and methods that are the trend of globalization.

Until the end of 90's in the Republic of Kosovo we've had a poor banking market that had contributed greatly to the stagnation of the economy as a whole. But by the end of 90's and the country's opening towards international markets influenced the instalment of the new banking system in the Republic of Kosovo that was accepted quite well by individuals, having in mind the fact that everything had started from point zero.

Economic stagnation or slow growth of economic cycle, insufficient rule of law and other strategic and political factors, have directly affected the banking system, which as well is a reflection of the country's general situation.

The source of funding represents one of the most important factors in the business development, however many financial limitations as well as those from legal aspects, are contributing in a great deal to have a smaller number of newly created businesses in Kosovo.

Many companies are forced to reduce their capital projects due to the high interest rates, but also there are cases when they have renounced from capital investments due to the impossibility of finding investment resources.

Therefore, this study will treat analytically all the points that have an impact on banks to provide loans with high interest rates, the options banks can use to decrease these rates, as well as various recommendations for changing the economic environment and in particular the banking system and rule of law.

The role of banks in economic development

Republic of Kosovo as well as a large part of Balkan countries is not able to get rid of the cash. Replacement of cash with electronic money would enable flexibility and bigger facilitation towards progress and economic development of the country, even though there is a legislation which prohibits the businesses realizing the transactions with cash, this continues to remain an occurrence that is being ignored by businesses and which affects in great deal the tax evasion or the high degree of the tax evasion phenomenon.

Banks play an important role in the economic life of one country. They do not only collect deposits and cash them only for savings; banks allocate collected funds so that they reach the right destination for investment. The role of banks is not only in the national aspect. Their impact is directly connected to the international aspect, the ease and efficiency of the payments between two countries helps and accelerates the economical communication and contributes to the creation of economic relations through mediation of respective banks.

SME development is closely linked to the banking system, respectively loaning the monetary funds with specific interest and the allocation of these funds to increase capital investment or even creating a new one. Another pillar of economic development is an agricultural loan. In Kosovo there is a lack of adequate offered programs for agricultural loans, with convenient interest rates or even by offering modalities in the form of grace¹ periods, during which time farmers are passive in their activity due to the weather conditions and are not able to pay the loan instalments. However there are many other components that influence the inactivity of this sector with so much influence in the development of the country; therefore we have to find a solution by economic experts and those from related fields, by creating strategic policies and convenient modalities, where agricultural sector should expand by using favourable agricultural loans in order to have domestic products which could later be exported and which could have an immediate impact on the overall trade balance.

Bank sector in Kosovo

There is no discussion today in Kosovo over the pattern of the establishment of commercial banking sector, which is now well established and organized. Public opinion discussion today in Kosovo is about bank operating system, the program that they offer, challenges and opportunities for banks to offer more favourable products for physical and legal entities, relying in legislation which leaves a lot to be desired as well as the other interactive components of the whole political, economic and legal system.

¹ A **grace period** is a period immediately after the deadline for an obligation during which a [late fee](#), or other action that would have been taken as a result of failing to meet the deadline, is waived provided that the obligation is satisfied during the grace period

It is impossible to have sustainable economic growth if we don't have a stable financial system. According to the macroeconomic development report, drafted by CBK² and published in February of 2015, all macroeconomic aggregates show that Kosovo's financial system has good liquidity position and good quality of loan portfolio as well as high level of capitalization. The first part of 2014 marks annual growth compared to the first part of 2013, an increase of financial assets for 12.20% or expressed in value, it has reached the amount of 4.3 billion Euros. All this performance is attributed to increased commercial bank³ assets as well as pension funds.

When we speak of commercial banks, it is clear that their influence in the financial system of Kosovo is very high. Activity and licensing of the commercial banks in Kosovo is enabled by the regulator of bank sector which is Central Bank of Kosovo. Based on the last report of CBK, there are 10 commercial banks that are licensed and operational in Kosovo as well as several other financial institutions.

Table 1 Number of financial institutions in Kosovo

Description	June 2011	June 2012	June 2013	June 2014
Commercial Banks	8	8	9	10
Insurance Companies	11	13	13	13
Pension Funds	2	2	2	2
Financial Aids	32	39	40	41
Microfinance Institutions	17	19	18	18

Source: CBK (2014)

Majority of Commercial Banks in Kosovo are of foreign capital (investment), whereas from 10 licensed banks, 8 of them are of foreign capital (investment)⁴; while the total number of bank units in Kosovo is 273, of which only three banking institutions constitute the highest degree of asset concentration in proportion of 66.0%, while the assets of banks with foreign capital (investment) constitute a very high rate reaching 90.4%. The total number of employed people by commercial banks is 3.513.

Loaning

Business development and normal process of living is influenced by direct cash funding, either from loans or other sources of investment such as savings, salary and other cash borrowing from relatives. It is impossible to have development or sustainability of businesses without financing projects through loans, which often has been emergency assistance in business development, but knew also affect negatively the progress of the further development of the business plan by not adapting to business needs and their initial destination. Early 2000s were extremely important for establishment and development of the banking sector in the Republic of Kosovo. Lack of banking market and the lack of legal infrastructure was major obstacle which influenced greatly in direct slowdown of economic growth cycle.

² CBK- Central Bank of Kosovo

³ Macroeconomic developments Report no: 2, February 2015, Central Bank of Republik of Kosovo, page 42

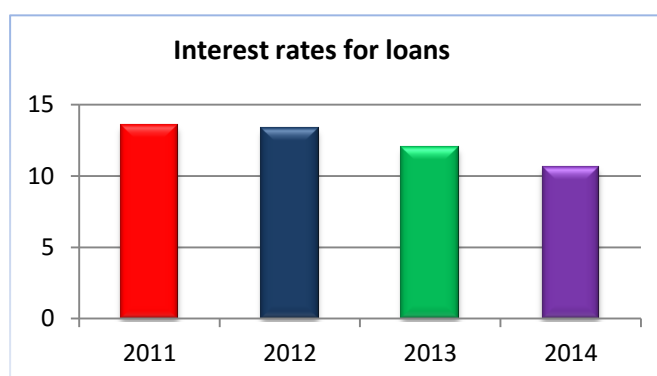
⁴ Financial system, monthly information, April 2015, Central Bank of Republik of Kosovo

Lack of competition and other legal acts, influences the banks to offer loans with high interest rates and without any attractive offer, by taking advantage of the economic situation our country was. Over the time and the construction of banking market things started to change, but the interest rate for loans was still high, thus causing problems in the payment of installments borrowed from the private but also from business sector.

Interes Rates

Up to mid-2014 interest rates have been at a high level, but then they started to have a slight decrease, giving hope and at the same time sign that banking system as part of the economic, legislative and political system will change by offering a significant increase in quality and services to private individuals and businesses. The main objective of all stakeholders remains the reduction of interest rates under double-digit rate.

Figure 1 Graphic presentation of the interest rates



Source: CBK

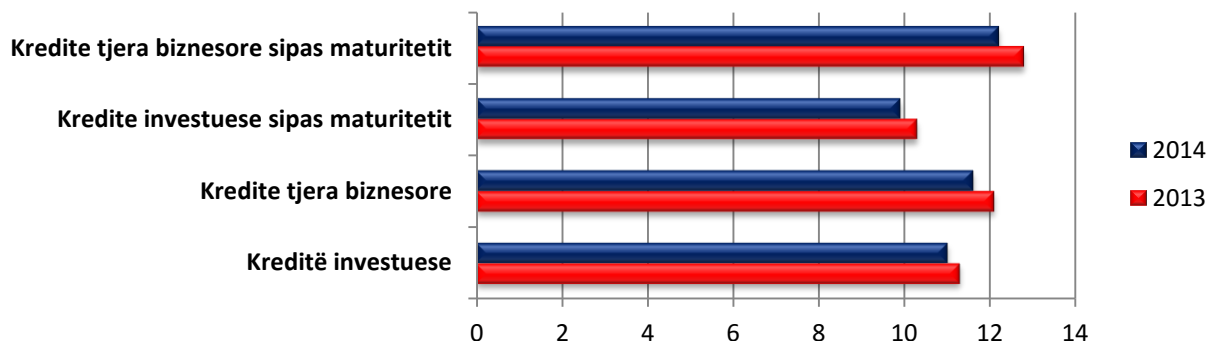
If we apply the method of comparing interest rates to previous years, there is a tendency of lowering interest rates but at a lower rate, while in 2013 the interest rate on loans was 12:00%, in 2014 it has decreased to 10.60% which represents the largest reduction until now. All economic aggregates give indications that the decrease of interest rates is closely related to the decrease of interest for deposits. A big influence in reducing of interest rates has played also the decrease of the business requests for loans as well as the decreased trend of the need for loans by families. Decreasing the average interest rates on loans for enterprises, since 2013 when they were in average from 12.10% to 10.50 % in 2014, are a positive indicator towards the normalization of the credit market, given that businesses are the backbone of an economic system of a country. Therefore interest rates are vital in this sector.

Financing of enterprises through loans

Finding investment resources is a challenge itself for all enterprises, but also the activity of the enterprises over a business cycle without having problems with cash flow and liquidity maintenance demands and entails special planning to provide the money. So how can we achieve that kind of business flow without loan financing from respective banks of the country? It is a sound logic that is practised in countries where SME sector is now the main factor of economic development, but is this happening in Kosovo as well? Do high interest rates impact the obtaining of investment loans as well as other business loans? This issue is present in transitive economy which Kosovo is going through, being characterized by high business rates and the declining trend of lower interest rates.

If until now we took as a comparison two last periods of 2013 and 2014, empirical data reveal such results that show the real situation of interest rates according to their categories including their destination and maturity (time) for which they were obtained.

Figure 1 Categorization of business loans



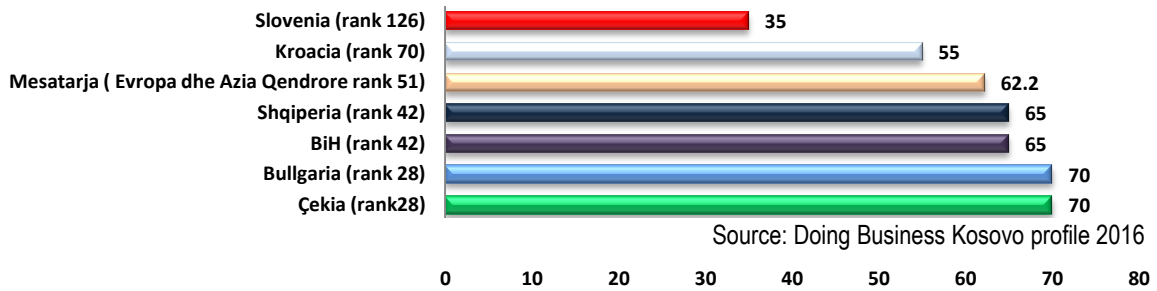
Source: CBK

According to empiric data presented in figure 2 we can conclude that interest rate for investment loans of businesses has decreased from 2013, where average interest rate was 11.30%, in 2014 it went down to 11.00%. Yet still these figures are still high and adversely affect the psychology of doing business in such an environment within the territory of the Republic of Kosovo. Other business loans had an average interest rate in the range of 12.10%, which in 2014 suffered a decrease at the rate of 11.60%. Based on the maturity in the gap between 1-5 years, in 2014, the highest interest rate for other business loans was 12.20%, as opposed to investment loans with maturity deadline over 1-5 years, where interest rates were lower and at the rate of 9.90%.

Getting a loan

Banks offer loans for those businesses that have a good loan history, all information is based on bank's the risk management and the possibility of the repayment of the loan taken from economic agents with the agreed period. The collateral left by companies are mainly tools and real estate assets by which they operate in their business. What loan and legal information system Kosovo has is best shown by the measurement index from the research of the World Bank in Doing Business Kosovo 2016 report. The economy result is 6.0 in the depth of the loan information index, while 8.00 in the legal right power index. The bigger the outcome, the more security and information will be available for lenders and borrowers. In the global ranking, Kosovo is 28th among 189 economies in terms of how easy it is to get a loan. In this aspect, Kosovo ranks even better than countries of the region and even beyond.

Figure 2 Kosovo’s ranking regarding how easy it is to get a loan



Regarding the legal rights index and finding of the loan information, Kosovo has achieved following results as presented below:

Figure 4. Legal rights index

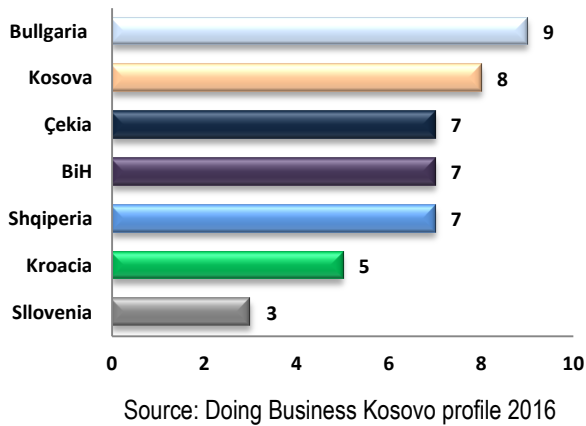
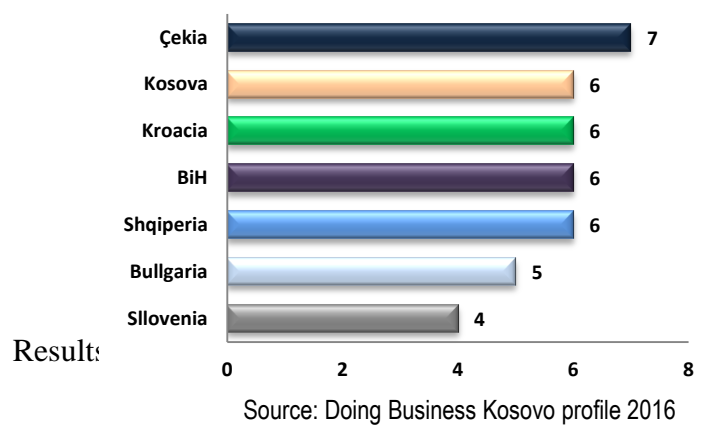


Figure 5. Access to loan information

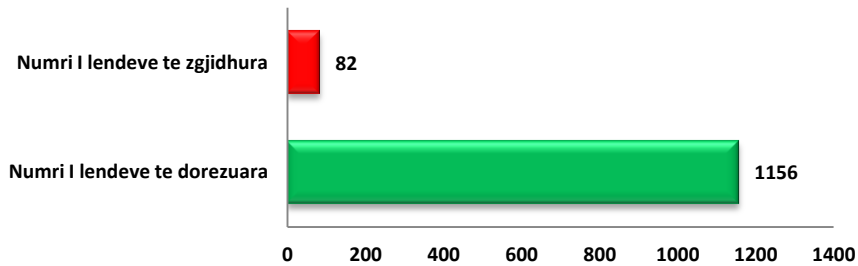


from figure 4 presented above, show that if we have high index results, it is an indication that collateral and bankruptcy incorporated under the laws of the respective countries are designed quite well; only Bulgaria has better results than the Republic of Kosovo regarding this aspect. But it is a matter which should analyze the implementation and application of relevant laws. While access to credit information is presented in Figure 5 which represents the index of the Republic of Kosovo in relation to other countries of the region, the bigger the outcome of the index it is, it will show greater availability of information on loan, all this must be considered as an information for easier decision making while granting an easy loan.

Processing of cases in Enforcement Procedure (legislative aspects) for 2014

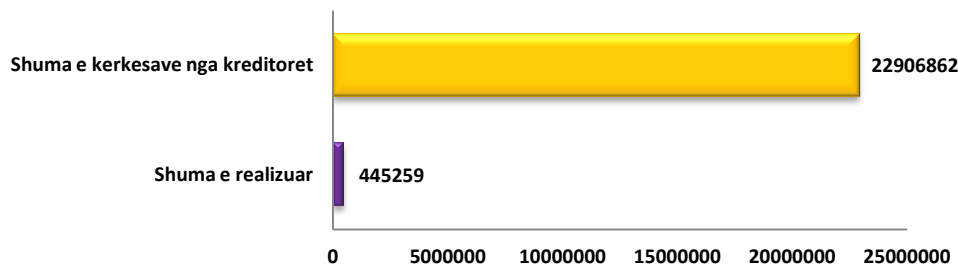
The total number of cases in the enforcement procedure of private enforcers and the implementation of requirements-debts to creditors (among them the banks) are as follows:

Figure 6. Cases in the Enforcement Procedure



Source: Author calculations

Figure 7. Monetary amount realized in the Enforcement Procedure

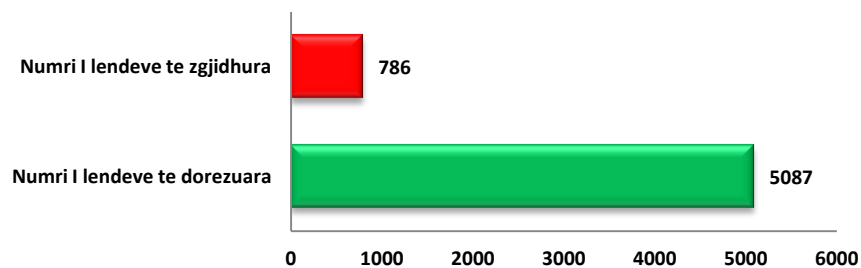


Source: Author calculations

From the total number of 1156 cases that have been handed over to enforcement procedure at private enforcers during 2014 in Dukagjini Region, only 82 cases were solved, while in the monetary aspect, from the total number of requests by creditors, that was around 22.906.862,00€, only 445.259,00€ were realized. From those qualitative and empirical data we can conclude that the number of handed cases as well as the amount of money submitted by creditors compared to the solved cases and the realized amount of money is in disproportion. All the above answers our question, why the interest rates are that high? One of the reasons for high rates of interest on loans is greater risk in the implementation of non-performing loans (NPL).

Processing of cases in Enforcement Procedure (legislative aspects) for 2015

Figure 8. Cases in the Enforcement Procedure



Source: Author calculations

From the total number of 5087 cases that have been handed over to enforcement procedure at private enforcers during 2015 in Dukagjini Region, only 786 cases were solved, while in the monetary aspect, from the total number of requests by creditors, that was around 45.071.622,00€, only 12,429,408€ were realized. From those qualitative and empirical data we can conclude that the number of handed cases as well as the amount of money submitted by creditors compared to the solved cases and the realized amount of money is in disproportion. All the above answers our question, why the interest rates are that high? One of the reasons for high rates of interest on loans is greater risk in the implementation of non-performing loans (NPL).

Limitations of the paper

The direct impact of interest rates on the social and business life is quite big, the lack of scientific researches and statistical publications with regressive and descriptive analysis expresses faults even with the produced document. There are some articles published in a package that give information and literature concerning this field, therefore future studies should focus more on giving information about the influence, advantages as well as extensive and concrete analysis.

Difficult access to the database and reluctance in giving of information by banks, make that the paper has only empiric, statistic results, and not for the impact of respective strategies within the enterprises and household economies in particular.

RECOMMENDATIONS

Based on the analysis and scientific studies made, we can come to very meaningful recommendations as far as the steps that need to be taken towards the improvement of the general environment of the bank sector.

Establishing loan and financial capacities in a higher level

Poor offer of the loan system comparing net profits of banks that are in imbalance, where vast majority of these profits are based on the high interest rates on loans. *Therefore capacity building and openness to new financing alternatives will directly result in the reduction of interest rates.*

Drafting of loan policies by the Central Bank

Central Bank as a regulator of commercial banks should cooperate with them in order to create favourable loan policies, especially for financing the start-up businesses, since promoters of the economic development are exactly these enterprises. Therefore creation of adequate loan and financing policies leads us towards progress and economic development in general.

Efficiency of the Judicial System

From the data presented above it was clear that there are major delays in the issue of processing and realization of assets through the judiciary system. Reducing the time and efficiency of processing the cases would impact directly on the reduction of interest rates,

decentralization and involvement of professionals within the judiciary would be a crucial turning point in getting together of all participating stakeholders.

CONCLUSIONS

Banking system in Kosovo is relatively new. Vast majority of the banks that operate are of foreign capital and there is a lack of domestic capital invested in the financial system. The role of banks is not only in national aspect, their impact is also directly connected to the international aspect, the ease and efficiency of payments between the two countries helps and accelerates economic communication and influences the creation of economic relations with respective banks as mediators.

SME development is closely linked to the banking system, respectively borrowing monetary assets on a specific interest and the allocation of these funds to increase capital investment or even its creation from scratch.

The source of funding represents one of the most important factors for the development of business, but many financial and in legislative terms limitations, are contributing greatly to the fact that the number of new businesses in Kosovo is very small.

Many enterprises are forced to reduce their capital projects because of high interest rates, but there also cases when they have renounced capital investments due to the impossibility of finding investment resources. Thus as a conclusion, we can say that the interest rates and banking system in general are the key element in social and economic aspect; there is a need for implementation and involvement of all stakeholders of the economic, political and legal cycle towards the improvement of the wellbeing and life standard of each one of us.

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