

## The interest rate of the commercial banks in Kosovo and competition

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**Abstract.** The objective of this study is to analyze factors having impact in determination of the interest rates for loans and deposits in Kosovo and in the region. In the study paper are also analyzed the reasons why interest rates for loans in Kosovo are evidently higher than in the countries in region and EU. The optimal policy of the interest rate is one of the essential preconditions for proper orientation of economic development of the country. High interest rates in credits (loans) make it difficult crediting conditions whereas the lower ones discourage depositors, impact of which is directly reflected into economic development. The spread of interest rate in credits and deposits is an indicator of insufficient effective competition and gives a chance for intervention with monetary and other policies to improve business environment.

**Keywords:** interest rate, commercial banks, competition.

### 1 Introduction

To evaluate the competition in banking sector, firstly it is very important to study the financial stability and its influence in development of the banking sector. Factors which condition the financial stability are: sustainable macro-economic environment, safe and effective supervision by the authorities, functional infrastructure of the banking market which means banks, insurance companies and micro-financial institutions and their behavior in the market be functional, competitive and transparent. Despite the challenges and risks which are linked-up with financial stability as are: loan risk, liquidity risk, interest rate risk and risk of capital, for these years Kosovo continues to be characterized with enviable stability and modest growth of the financial activities as are: liquidity, profitability and capital.

### 2 Financial stability and banking competition in Kosovo

Financial Institutions in Kosovo are licensed and monitored by Central Bank of Kosovo (CBK). Financial sector covers banking industry, insurance industry, pension funds and other financial institutions mainly made by micro-credit schemes. Despite the fact that these industries are very profitable and continuously have expanded their activities which make an important factor to attract new financial institutions to become a part of the market. Regarding to the number of the financial institutions operating in Kosovo, the structure of the financial system in Kosovo almost has remained unchanged for several years. A small increase of the number of financial institutions was recorded in 2013. To the financial system in Kosovo was added another commercial bank and two insurance companies (CBK, [www.bqk-kos.org](http://www.bqk-kos.org)).

**Table 1** The number of financial institutions in Kosovo

<b>Description</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Commercial Banks	8	8	8	9	9
Insurance Companies	11	11	11	13	13
Pension Funds	2	2	2	2	2
Financial Intermediaries	28	29	32	39	40
Micro-Finance Institutions	19	17	17	19	18

Source: CBK; A report of Financial Stability (2011-2013)

### **3 Commercial banks**

The banking sector in Kosovo has been developed successfully and this is seen by many monitors and analysts (IMF 2012) as a successful history, despite the fact that there are many complaints by citizens and community of business for unfavorable crediting conditions. The banking sector in Kosovo is characterized with big presence of the foreign capital, where 89.2% of the total assets are managed by foreign banks. The presence of the foreign international financial institutions in Kosovo has given contribution in modernization of the financial system, bringing the best practices in financing and managing of the banking operations.

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Today in the Kosovo's banking market operate nine commercial banks, seven of them with full or majority of foreign capital. The Kosovo's banking sector remains highly concentrated, where the participation in the market of three largest banks for 2011 have occupied about 74% of the total of assets, 74% of deposits and 71.7% of loans. High concentration in the banking sector has been shown by Herfindahl - Hirschman (IHH) Index. The concentration rate of the banking system was noticed to be continuously decreased since 2008 for deposits and loans.

In 2012 IHH for assets, the concentration marks a rate of 1.939 points and comparing to 2011 where there is a recession of this indicator for 150 points. In this way to bring the banking services closer to the clients, commercial banks have continued to expand their infrastructure even that last years that tempo is slowing.

This might happen due to the fact that banks operating in Kosovo have achieved to be consolidated and expanded in the market in the aspect of their banking units throughout Kosovo and in this way the slow tempo of expansion might be the reason of the measures taken by the banks to reduce their expenses.

### **4 Determinating factors of the interest rates and deposits, monitoring and comparative analyse for Balkan region**

The policy of the interest rates is one of the most important instruments of the monetary policy. From the collected literature from South East European Countries (SEE), including Kosovo it is indicated that interest rate is determined by the market. In general, experts have evaluated that this region has relatively

high interest rates in credits (nominal and real). The analyse that the spread of interest rates in credits (loans) and deposits is considered as an indicator of efficacy of financial intermediation.

The extension of the high percentage of interest rates are an obstacle for financial intercession, because they discourage possible savings from low returns of deposits increasing financial cost to borrowers (individuals and business) lowering chances for investments and economic growth. In particular this is disturbing for economies in transition where the chance for alternative financial sources through market of capital are almost minimal and do not exist in the case of Kosovo and Albania and in a number of other South East Europe Countries (SEE).

According to many data sources and literature of this field we can conclude that many factors have influence in determination of the interest rates:

- a) Low level of saviungs in certain countries, whereas the request for crediting is presented as high and with tendencies of growth
- b) Limited sources and with relatively high cost of financing
- c) Limited access in financial markets and international market of currency
- d) Market structure (bank ownership, the level of the bank concentration, level of competition, etc)
- e) The existence of high primary risk for each country, especially lack of financial discipline and problems with law implementation
- f) Relatively high cost of banking operations
- h) High level of informality and inaccuracy/manipulations with financial statements of the business, etc.

Except the abovementioned factors it is considered that in determination of the interest rates have impact other specific factors as are: managerial capacities of the bank, operational costs, analytical skills and risk management of liquidity, management and investment portfolio, the level of capital sufficiency etc.

Specifically in the majority of the countries in the Balkan region the high interest rates are justified by lack of the scale economy, due to the limited size of the market and relatively low level of competition in financial and banking market in general.

A common characteristic of the banking systems in South east Europe Countries (SEE) and those in Balkan there is increase of the presence of foreign banks in last 15 years. Such case can be mentioned in Macedonia (93%), Bosnia and Hezegovina (92%), Albania (92%), Croatia (90.4%), Kosovo (89.2%), Montenegro (88%) and Serbia (74%). The increase of loan interest rates has been a perception of high risk in these countries from foreign banks which very often are sustained in analyse or statistical models of the loan risk assesemnt. In the market of the Balkan region the concentration of three largest bnanks vary from 54% in the Croatian market (minimal), in 66% in BH (maximum), and in 74% in banking market of Kosovo, dictating a very high level of differences of interest rates. Also foreign banks have a tendence to have the highest limits of the interest in developing countries as are: Albania, Kosovo, Montenegro, etc. because they have priority in technology if compared with local banks. Lastely, adjustments and differences in legal and institutional issues are very important and have a great influence in determination of the interest rates. Indicators of better enforcement of contracts, efficassy of the legal system or lack of corruption are associated with liumits of low interest

rates. Besides these factors, in determining the impact of interest rates also have non-performing loans. (Riinvest 2011 Banking Sector, A research report, march 2012).

## 5 Interest rates in Kosovo

The interest rates in the banking system of Kosovo still remain in high level; even though have continued to decline. The average rate for loans in the first part of 2012 have declined in 13.7 % from 14.3 % as it was in June of 2011. Whereas, the average interest rate on deposits did not change, so staying at 3.4 percent. Therefore the margin of interest was reduced into 10.2 % from 10.9 % as it was in June of 2011. The profitability of the banking system was decreased, where the net profit was decreased for 28.5 %, while return on capital was decreased into 8.1 % from 12.9 % as it was in June of 2011. The deterioration of the profitability indicators for 2012 came as a result of the slowdown of revenue growth, resulting from the slowdown in credit activity, and increased costs, particularly for provision of loan losses.

**Table 2** Interest rates on deposits

(New businesses, unless otherwise indicated)

Description	Deposit rates	Nonfinancial corporations									Households								
		Transferable deposits	Other deposits								Saving deposits	Transferable deposits	Other deposits					Saving deposits	
			Less than 250.000 euro				More than 250.000 euro						Up to 1 month	Over 1 month and up to 3 months	Over 3 months and up to 6 months	Over 6 months and up to 1 year	Over 1 year and up to 2 years		Over 2 years
			Up to 1 month	Over 1 month and up to 3	Over 6 months and up to 1 year	Over 2 years	Up to 1 month	Over 1 month and up to 3	Over 6 months and up to 1 year										
2006 December	3.12	0.26	2.07	2.37	3.40	*	2.90	*	*	1.71	0.04	1.85	2.24	*	3.33	3.87	4.04	1.74	
2006 December	3.11	0.39	2.06	2.85	4.32	*	3.11	*	*	1.53	0.03	1.93	2.35	*	3.44	4.16	4.51	1.65	
2007 December	4.00	0.48	2.88	2.93	4.35	*	4.27	4.15	*	2.45	0.02	2.55	2.75	*	3.60	4.72	5.27	2.25	
2008 December	4.42	0.53	3.09	3.97	5.32	*	3.61	4.92	*	2.85	0.11	3.21	4.60	*	4.45	4.99	3.95	2.74	
2009 December	3.98	0.72	3.42	3.42	5.03	*	3.88	4.88	*	2.63	0.34	3.09	3.28	*	4.39	5.00	5.50	2.51	
2010 December	3.38	0.63	2.44	3.08	4.96	5.14	*	3.74	*	2.07	0.55	2.58	2.63	3.15	4.49	4.77	5.14	2.21	
2011 December	3.71	0.86	0.00	2.91	4.90	5.05	*	3.88	5.25	2.20	0.48	2.49	2.47	2.88	4.21	4.56	5.36	2.06	
2012 December	3.74	0.83	*	2.79	*	*	2.67	4.02	4.75	2.15	0.54	2.30	2.46	2.84	4.20	4.52	4.76	2.06	

Source: Annual report of CBK, 2012

**Table 3** Interest rates in loans

(New businesses, unless otherwise indicated)

Description	Loan rates	Non-financial corporations (loans)									Households						
		Investment business loans			Other business loans (non-investing)		Overdrafts	Credit lines	Loans with favourable conditions		Overdrafts	Loans with favourable conditions		Consumer loans	Mortgage loans		
		Up to 1 year	Over 1 year up to 5 years	Over 5 years	Up to 1 year	Over 1 year up to 5 years			Loans covered by deposits	Other loans		Loans covered by deposits	Other loans		Up to 5 years	Over 5 years up to 10 years	Over 10 years
2005 December	14.47	17.34	13.29	13.29	15.16	14.35	15.11	11.51	...	*	*	...	*	11.51	*	*	*
2006 December	14.70	*	14.50	14.50	13.60	15.16	15.72	12.36	...	*	*	...	*	12.36	*	13.36	*
2007 December	14.06	*	13.76	13.76	*	14.64	15.09	13.72	...	*	*	...	*	13.72	12.92	12.36	*
2008 December	13.79	*	13.92	13.92	14.20	13.45	15.03	13.50	...	*	19.48	...	...	13.50	9.81	10.82	8.13
2009 December	14.09	*	14.34	14.34	*	*	*	*	...	*	17.63	...	...	13.31	*	10.67	*
2010 December	14.31	15.13	13.95	*	13.66	14.44	12.65	13.27	7.69	*	22.57	6.55	8.56	14.56	*	11.67	10.26
2011 December	13.69	15.89	13.55	11.68	16.40	13.30	11.78	12.12	6.10	9.88	16.44	6.01	8.58	14.02	14.31	11.99	10.83
2012 December	12.86	15.37	12.03	10.19	15.29	13.66	10.70	11.90	5.92	*	12.46	6.11	7.97	13.06	*	10.76	9.79

Source: Annual report of CBK, 2012

The interest rates for loans and deposits for each bank in modest percentage change. These differences exist depending on the type of loans and deposits, their duration and costs associated with provisions and other administrative chores.

**Table 4** Indicators of the interest rates of economies in transition for 2011 (%)

	Loans for SME in sectors /GDP	Interest rate		Non-Performing Loans (of total loans)
		Deposit	Loans (< 1 year)	
Kosovo	28.3	3.5	14.15	5.9
Albania in euro)	41.2	2.16	6.88	18
Bosnia	46.0	n/a	n/a	11
Serbia	47.5	4.1	11.0	19
Macedonia	49.9	5.3	9.9	8.5
Montenegro	121.2	4.8	9.2	25

Source: EBRD Transition Reports, for Kosovo IMF estimation of GDP and CBK Annual Report

Table 4 indicates that Kosovo has the lowest crediting of the SME sector, so GDP in region. Also, interest rates on loans up to one year show that to be the highest among all countries of the region, indicating that loans are most expensive in the region.

**Table 5** Interest rate on loans in local and foreign monetary unit in %.

Countries	Albania	Croatia	Serbia	Montenegro	Macedonia	Kosovo
Local currency	12,11	9,78	17,91	-	9,63	-
EUR	7,44	6,35	8,36	-	7,65	14,3
USD	7,56	-	-	-	5,07	-



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CHF	-	-	5,22	-	-	-
Other	-	7,45	10,03	9,67	-	-
Average	7,50	6,90	7,87	9,67	6,36	14,3

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Source: Riinvest. 2011. *Banking Sector, research report, march 2012,*

From the table 5 we can see that Kosovo is among the countries with highest average interest rate for loans comparing to other regional countries. Based on the analyses, many evaluations, to answer in the question why such interest rates are high it has been estimated that factors which have had impact in determination of the interest rate are external (mainly linked unsustainable political and macro-economic condition) and internal risks as listed below:

- The way how the problematic loans are managed
- Very problematic judicial and cadastral system
- The low level of competition as consequence of the small number of commercial banks, which passed by high merger scale to a several of biggest banks
- The high level of informality and unaccuracy /manipulation with the financial statements of the business
- A High unsafe environment in loaning and a higher risk on return of such loans.
- Lacks of projects – do not exist god projects that justify getting of loans and their return in time.

Interest rates, especially loan interest rates depend on many factors that are under the control of commercial banks, as well as by factors beyond their control. Impact of Central Bank of Kosovo through monetary policy instruments is limited and prevents the use of traditional instruments which can be used to have an effect on interest rates.

## 6 Conclusion

By treating factors and obstacles having influence in establishment of sustainable financial stability and at the same time to growth the competetiveness of commercial banks in Kosovo, the Government, CBK and other stakeholders must continue to work towards:

- Strengthening of economic growth at macr-economic level through reformation of business environment. Reforms should mainly aim at promoting competition and private sector development as a tool for economic growth
- Solution of the problems in cadastral systema as well as the increase of the efficiency of the judicial system shall result in execurtion of cases
- Increasing the competitiveness of the financial system could prove to be the solution of the problem, in this regard to continue with market liberalization and licensing of banks
- To avoid potential crises coming from the financial sector and the overall economy, the government should start the process of implementing quality requirements of conditions from the IMF, WB and EU. The government should try to encourage more competition in the financial sector and to take action to improve the supply of credit to the private sector, especially through the issuance of government bonds

•To increase the transparency of commercial banks regarding to the crediting conditions and interest rates applied by them and they must be accompanied by relevant provisions.

All these actions will undoubtedly have positive reflections on improving crediting conditions, reducing loan interest rates and therefore the growth of economic activities and the economy in general.

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