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## RESEARCHARTICLE

### MONETARY AND CREDIT POLICIES IN KOSOVO

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#### ABSTRACT

The economic system has been facing tough challenges worldwide in the last several years. In Kosovo, it seems like the monetary and credit system was untouched by the global financial crisis and the worldwide lost of confidence. Monetary policy in Kosovo has its own characteristics in the post-war period, because after war as it is known Kosovo became part of the Euro Zone. The CBK estimates that the banking sector stands well as regards to capital and especially bad credits. Still, the interest rate on deposits is considered very low as compared to the interest rate on loans. Arguably, this has an important impact on investments and in economic growth also. Furthermore, the lack of a strong competition has its share at the pie of this problem, mentioning the fact that all of the banks have some unused capacity of crediting as they remain over-liquid. At the end we conclude that the monetary and credit system faces many challenges and as such it has its own issues although it seems immune to the global financial crisis.

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#### INTRODUCTION

This research has reviewed and analyzed the impact of monetary and credit policy in the economic development of a country in a professional, scientific and practical matter. Although in the professional literature we come across the term monetary-credit policy, the word is actually two policies: monetary policy and credit policy, but that functional correlation in their action in implementing economic policy. For this reason, this paper analyzes monetary policy and credit policy separately in the post-war Republic of Kosovo (1999). The first part of this research analyzes the monetary policy in Kosovo. Monetary policy in Kosovo has its own characteristics in the post-war period, because after war as it is known Kosovo became part of the Euro Zone. Therefore, Kosovo cannot make a proper monetary policy due to lack of competence in the primary mission. However, this does not mean that Kosovo has failed to lead an effective monetary policy management; this is exactly what was lacking in the post-war period in Kosovo. Right here we should emphasize analytical- professional dysfunctional management in the capital market, namely the mass of money is the source of the economy and consumer citizens. In the second part of this research we analyze the credit policy. As it is known, the credit policy has particular impact on macroeconomic policy applied. In this part we analyze practically and professionally the credit policy in Kosovo.

Special emphasis in this part of the paper is given to high loan interest rates, on the one hand, and low deposit rates, on the other hand. High rate of loans and other charges is affecting fiscal policy and sufficiently slowing the development of businesses, namely the Kosovo economy. In comparison with neighboring countries, Kosovo leads up to the high interest rates on loans and low interest rates in deposits.

#### Monetary and Credit Policy in Kosovo

##### Monetary Policy

System and monetary policies represent a very important tool in the implementation of economic policies. Monetary policy instruments ranks among the most important economic policy whereby a state government intervenes in the economic situation, especially in financial transactions. Through monetary policy, the government intervenes in the supply (M) and demand (L) flows, stabilize prices, the fight against inflation, increase employment, balance of payments etc. Monetary policy has functional liaison with the credit policy. While monetary policy assesses how the allocation of short-term loans (cash flow), the lending policy tool for monetary policy implementation. Thus, the monetary policy, the government can achieve the goals set forth macroeconomic development. In each country, the monetary policy is monitored and supervised by the Central Bank of the country concerned, the country through monetary institutions (commercial banks and other financial institutions). Monetary

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policy is an instrument of particular importance in the field of monetary aggregates. Therefore, through monetary policy, the Government through the Central Bank regulates the amount of money in turnover, the height of interest rates (interest), promoting or curbing inflation etc. In economic theory, it is concluded that the purpose of promoting economic development, state of consciousness can cause inflation by 3-5%, which the inflation rate is affordable and has a positive influence on economic development. In contrast, if the state wants to curb inflation, then draws a mass amount of currency in circulation and thus prevents further growth of inflation. This example shows that monetary policy is too important an instrument of economic policy, on the one hand, and through the state intervenes in the economic processes of the country, on the other hand.

Below we will see how monetary policy is implemented in Kosovo. Regarding this, the first question is that can Kosovo make sound policies, and what monetary policy is now implemented in our country? The answer to the first question is that Kosovo cannot make sound monetary policy, because is found in the Euro zone, the unique monetary system of the European Union. This applies to all EU member states taking part in the Euro zone. Meanwhile, countries that have not recognized the unique monetary system of the EU, are those countries that are not in the Euro zone, independently implement their monetary policy within their own country, such as the United Kingdom and countries of Eastern Europe. There may be genuine monetary policy without the right of the primary emission (emission of money). Any member of the EU that is involved in the Euro zone does not have this right, therefore nor does Kosovo enjoy this right. The primary with emissions rights belongs to the European Central Bank, but not the Central Banks of countries belonging to the Euro zone. Therefore, central banks in the Euro zone, including the Central Bank of Kosovo, is not entitled to the primary emission, but this does not mean that monetary policy can do anything in other areas of the financial system, for example public finance.

As in other areas, as well as the financial sector in Kosovo is faced with several challenges, which are expressed in the capital market and credit policy, namely to implement economic policy. Government, with a consistent policy and strategy development (which currently lacks), must mobilize all development factors, including capital market in the economic development of local business. The government, besides other factors, through the banking system should include all cash free subjects and citizens, and through credit policy to bring in the economic development of Kosovo. This is a responsibility and duty of the Kosovo Government.

### **Credit Policy**

Credit policy, as well as monetary policy, represents a very important instrument of economic policy to achieve macroeconomic objectives. Monetary policy is implemented through credit policy. Meanwhile, the monetary and credit policy together represent an important subsystem of macroeconomic applied policy. In all countries with free market economies, even in the most developed countries of the

world, they support macroeconomic development policies through the main instruments, namely: fiscal policy, monetary and credit policies, and the ratio between price and wage policy and economic relations with the outside. Each of these instruments has its place and role in macroeconomic policies. Credit policy, along with the investment policy, serving the state (government) to give direction and form the economic structure of the national economy. Without an appropriate credit policy namely investment, government cannot achieve set development goals, regardless of the economy in general, or the territorial sector development. This is because the credit policy represents an integral part of the general policy of national economic development. In other words, this means that through the Central Bank and commercial banks, budget policy and other measures undertaken by the government, affects the orientation and more rational use of credit funds. In theory and practice of economic development, as it is known, credit represents the additional source and a very important accumulation sum, namely investment.

Especially, loans provide and enable the continuity of the production process for economic entities, in particular the expanded social reproduction. In this regard the Government through the Central Bank develops and implements a consistent credit policy, by creating conditions more favorable criteria for credit borrowers, especially local businesses. Banks should not grant loans to all claimants, so all those seeking loans, but only those that meet the criteria and thus avoid the risk of loan default. These criteria serve banks not to grant loans without cover, not to put excessive credit expansion, etc., because these situations will cause inflation and create price instability in the domestic market and in general. The credit policy is a result of the overall economic policy, because it is a subsystem of it, or better to say a very important instrument of policy application. Thus, it is with the case of Kosovo in the post war period, economic policy is under the influence of applied economic policy. As is known, in this period in Kosovo was not formed any adequate policy, real, objective, consistent macroeconomic development, which is reflected in the credit policy.

The lack of a consistent development strategy and macroeconomic policy effected the economic development of Kosovo in the post war period to develop "ad hoc" and that partially. Imports and exports were made without any economic criteria, which approach has been completely wrong policy of foreign trade. At the level of development of productive forces in which Kosovo was immediately after the war and in which is now, a protectionist foreign trade policy should be implemented, namely economic relations with other countries of the world, as the most developed countries in the world do as well. Protectionism or economic protection would impact positively because with the instruments of foreign trade policy, especially through the taxation system would protect the local economy from foreign competition, and in this way will create more favorable conditions for local economic development, namely, Kosovo economy. Following closely the analysis will elaborate credit policy in Kosovo. As is known, modern credit policies are implemented through the banking system. Creating, developing and implementing credit policy is the responsibility of the Government and the Central Bank of

Kosovo, not second tier banks (commercial banks). Government through the Central Bank should not meddle with the commercial banks, but should define generic frameworks of credit policies, and create favorable conditions for obtaining loans by economic entities and other private borrowers, favoring loan obtaining and by orienting the loan borrowers towards the overall interest of economic development of Kosovo. E.g. in order to develop productive branches of the economy, which now lacks the Kosovo economy. The Government through the Central Bank should develop such credit policies which will be in favor of the development of these branches. As a result, for all those that will orient credit borrowers (loans) towards the investments in the productive sector, loan conditions should be more favorable (lower rate of interest, longer term of credit returns, with the beginning of the return of installments (annuity) with a "break period", for example from one to three years after the start of production, etc.). Thus, the government on the one hand does sector orientation of economic development, and achieve the set out objectives of macroeconomic development, on the other hand.

because of malfunctioning of financial markets, respectively securities on one hand and the allocation of loans with unfavorable terms on the other hand. In Kosovo, in the period after the war until now, there was not any real policy and credit objective implemented, from which businesses would benefit and the economy as a whole. This conclusion is best confirmed by the information for the effective interest rate of allocated loans presented in Table 1. Thus, as it is shown from the above data in the Table 1 effective interest rates on loans granted are too high, comparing to the low level of economic development. Relying more on the data table shows that the average effective interest rate on investment loans was very high, which for the period 2004-2013 revolved around 14.0%. Also, the effective rate of interest on consumer loans was very high and for the period said revolved around 13.09%. Therefore, knowing that private sector businesses have started from the beginning with no major capital, with non favorable economizing conditions and uncertain political-social situation, with this level of interest rates for loans allocated not only those local businesses are not stimulated, but they are

**Table 1. The effective interest rates on loans allocated in Kosovoin the period 2004-2013 (CBK, 2014)**

| Year               | Interest rates (average) | Nonfinancial corporations |               |                                      |               | Family economies |
|--------------------|--------------------------|---------------------------|---------------|--------------------------------------|---------------|------------------|
|                    |                          | Investment loans          |               | Other business loans (noninvestment) |               | Consumer loans   |
|                    |                          | Up to 1 year              | From 1-5years | Up to 1 year                         | From 1-5years |                  |
| 2004               | 15,17                    | 15,16                     | 14,47         | 15,04                                | 15,32         | 12,53            |
| 2005               | 14,47                    | 17,34                     | 13,29         | 15,18                                | 14,38         | 11,51            |
| 2006               | 14,70                    | -                         | 14,50         | 13,60                                | 15,18         | 12,36            |
| 2007               | 14,06                    | -                         | 13,76         | -                                    | 14,64         | 13,72            |
| 2008               | 13,79                    | -                         | 13,92         | 14,20                                | 13,45         | 13,50            |
| 2009               | 14,09                    | -                         | 14,34         | -                                    | -             | 13,31            |
| 2010               | 14,31                    | 16,13                     | 13,95         | 18,66                                | 14,44         | 14,56            |
| 2011               | 13,69                    | 15,89                     | 13,55         | 16,40                                | 13,80         | 14,02            |
| 2012               | 12,86                    | 15,37                     | 12,03         | 15,29                                | 13,66         | 13,06            |
| 2013 <sup>*)</sup> | 12,19                    | 13,82                     | 11,35         | 14,47                                | 13,54         | 12,36            |

**Table 2. Loans allocated by sectors of the economy in the period 2000-2013 (in millions of Euros) (CBK, 2014)**

| Year               | The general loans | Services <sup>1)</sup> | Industry, energy, construction | Agriculture |
|--------------------|-------------------|------------------------|--------------------------------|-------------|
| 2000               | 3,3               | 2,5                    | 0,8                            | -           |
| 2001               | 25,9              | 22,2                   | 3,8                            | -           |
| 2002               | 86,5              | 71,4                   | 13,6                           | 1,5         |
| 2003               | 232,6             | 205,8                  | 22,2                           | 4,7         |
| 2004               | 289,9             | 234,2                  | 47,8                           | 7,9         |
| 2005               | 387,9             | 301,1                  | 74,2                           | 12,5        |
| 2006               | 490,5             | 376,4                  | 97,7                           | 16,4        |
| 2007               | 691,5             | 518,0                  | 144,5                          | 20,0        |
| 2008               | 902,4             | 704,8                  | 160,2                          | 37,4        |
| 2009               | 945,5             | 670,5                  | 236,7                          | 38,2        |
| 2010               | 1.022,8           | 715,3                  | 269,3                          | 38,2        |
| 2011               | 1.149,5           | 824,4                  | 284,7                          | 40,5        |
| 2012               | 1.194,2           | 860,2                  | 290,4                          | 43,6        |
| 2013 <sup>*)</sup> | 1.214,7           | 876,4                  | 292,1                          | 46,2        |

<sup>\*)</sup> The data are until the month of November,

These include: wholesale trade and retail, hotels and restaurants, other trade and services

With such a credit policy, government enables businesses larger investment for advancement than just the accumulation of their own capital and thereby achieves increased output (aggregate supply), employment and unemployment reduction, respectively, to a more intensive development of the local economy. Credit policy as it is implemented and how it is currently, it does not have the right function for the development of local businesses. In the post war period in Kosovo, a problem itself created in the credit policy; was

overwhelmed with obligations to return the installments of loans taken. Credit policy, the way is being implemented during this period in Kosovo, instead of stimulation, actually it is not stimulating the local business, and with these economic policies is slowing overall economic development of the country. On the level of the economic development Kosovo now represents the most undeveloped country in the region, while applies very high interest rates on credit assets, higher than any other country in the region.

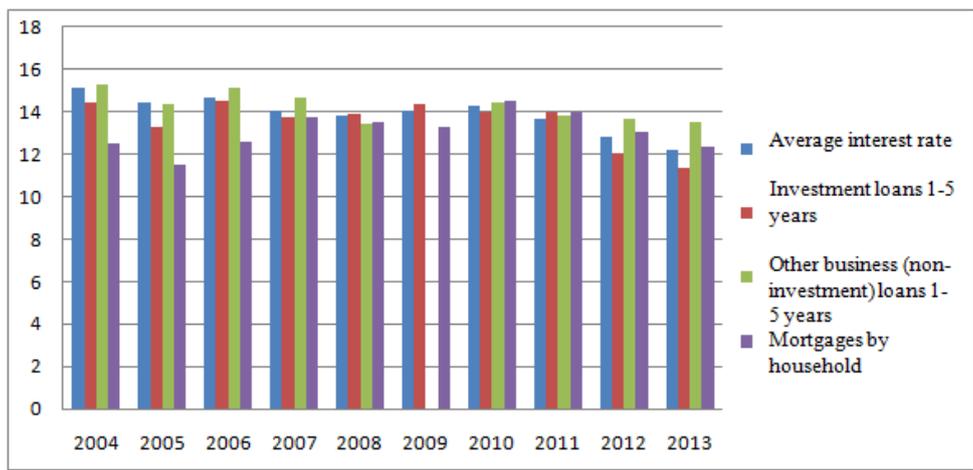


Figure 1. The effective interest rates for loans allocated in Kosovo in the period 2004-2013

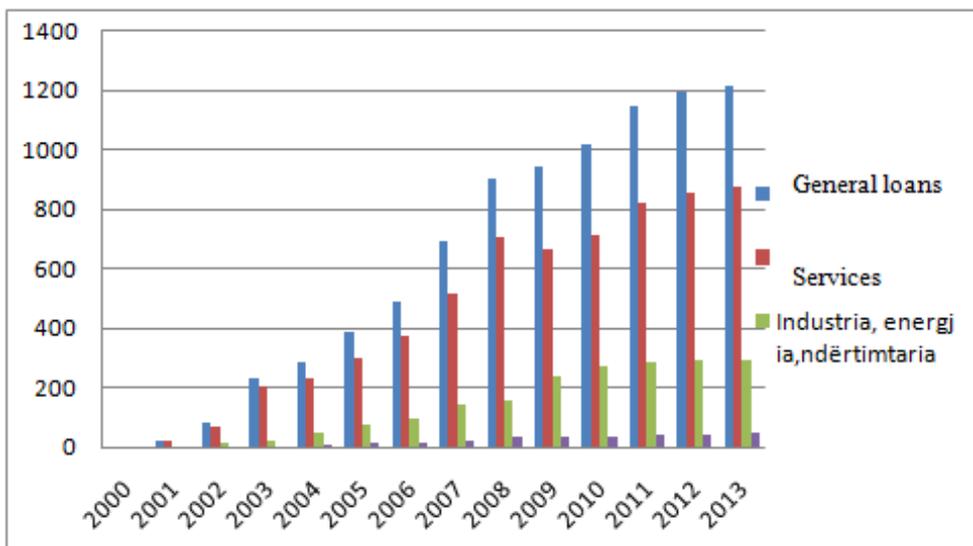


Figure 2. Loans allocated by sectors of economy in the period 2000-2013 (in million euros)

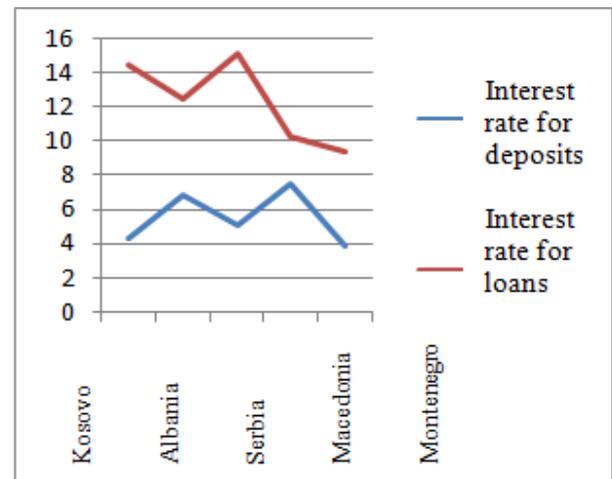
When we add to this burden of fiscal policy (customs, VAT, excise, profit tax etc.), Which economic subjects are charged with, this brings into a conclusion that the way credit policies are implemented in our country, this does not help the advancement of businesses, but it can be said that it suffocates, because through these instruments they handle the bulk of revenues (revenues - profits), normally expressed in the reduction of the material base to increase their productivity. Loans based on the economic sectors also reflect inadequate credit policy implemented in Kosovo after the war. Analyzed in terms of the overall majority of loans were granted to the economic entities, as opposed to loans to households. In the lack of a consistent policy in the post-war period in Kosovo, mainly investments (loans) were oriented in the service branches, and less was oriented in the productive branches. This assertion is proved best by loan borrowings by sectors of the economy. Thus, in the period 2000 - 2013, in loans taking dominate the service branches, which absorbed the majority of loans in this period. Value of loans at the branch of service sectors grew by 2.5 million as it was in 2000, to 301.1 in 2005, to reach in October 2013 to 869.2 million euros. Therefore, from these data it is shown that the services sector was dominant in getting loans in the post-war period, which

indicates that this sector was developed faster than other sectors of the economy of Kosovo. The dominance of loans in the servicing branches shows that private capital, in the lack of institutional orientation of loans (investment) by the Government towards the interest for the development of the national economy, by supporting the credit policy, fiscal and foreign trade was mainly oriented on service activities, such as trade, catering and other branches because in these branches profit comes faster and easier. Small value loans in the industry, at the same time the main source of investment, shows that although the development of this area is of particular importance for the overall economic development of Kosovo, it was very slow. Another paradox in credit policy implemented by commercial banks in Kosovo, it is low interest rates for deposits (negative rate for banks), and very high rates for loans (positive rate for banks). Low rate of interest on deposit does not attract citizens, economic entities, institutions etc. to deposit the savings in banks (which says the extent of capital market), which then affects the bank's credit potential. In contrast, if the interest rates on deposits was higher (within the reasonableness and objectivity of monetary policy), the value of cash deposits will increase, thus will come to raising potential creditor, which means that savings funds will be

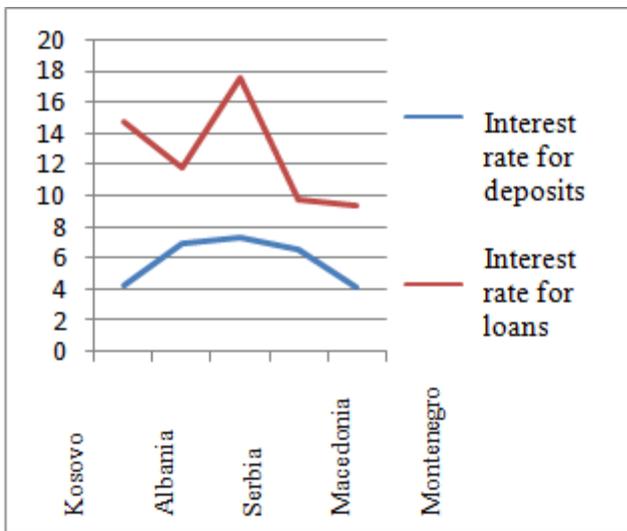
**Table 3. The level of interest rates on deposits and loans in Kosovo and several neighboring countries in the period 2008-2010**

| Year | Countries  | Interest rate on deposits | The interest rate for loans | Difference |
|------|------------|---------------------------|-----------------------------|------------|
| 2008 | Kosovo     | 4,2                       | 14,8                        | 10,6       |
|      | Albania    | 6,9                       | 11,8                        | 4,8        |
|      | Serbia     | 7,3                       | 17,6                        | 10,2       |
|      | Macedonia  | 6,5                       | 9,8                         | 3,2        |
|      | Montenegro | 4,1                       | 9,4                         | 5,3        |
| 2009 | Kosovo     | 4,3                       | 14,4                        | 10,1       |
|      | Albania    | 6,8                       | 12,5                        | 5,7        |
|      | Serbia     | 5,1                       | 15,1                        | 10,3       |
|      | Macedonia  | 7,5                       | 10,3                        | 2,8        |
|      | Montenegro | 3,9                       | 9,4                         | 5,5        |
| 2010 | Kosovo     | 3,7                       | 14,6                        | 10,9       |
|      | Albania    | 6,4                       | 11,3                        | 4,9        |
|      | Serbia     | 5,6                       | 13,6                        | 8,1        |
|      | Macedonia  | 6,7                       | 7,4                         | 2,3        |
|      | Montenegro | 3,3                       | 9,6                         | 6,4        |

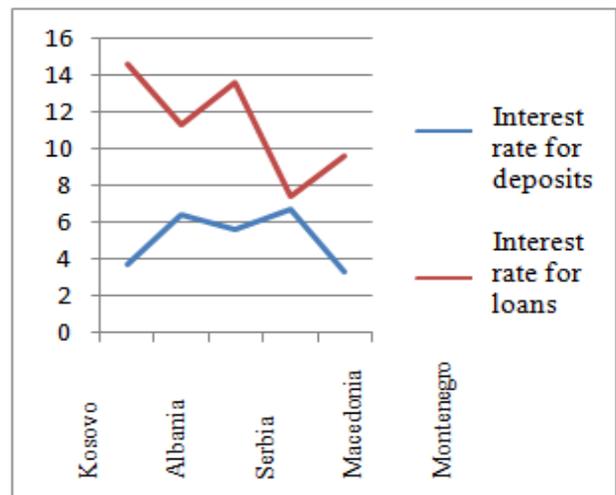
embedded in business development, respectively economic development of Kosovo. Also, the high rate of interest on loans, reduces the demand for loans, and also reduces the financial opportunity for businesses to develop their activities. There are major differences when comparing Kosovo with neighboring countries, as to how high interest rates on deposits and loans are. This is best shown from the data presented in the table below. Referring to data from the Table 3 clearly shows significant difference regarding the level of the deposit interest rate and the level of the interest rates for loans. These differences are clear even by the countries compared, presented in Table 3. Within these countries, except Montenegro, Kosovo stands for lower interest rate on deposit, and high level of the interest rate on the loan, and leads in difference of comparative level between these two rates.



**Figure 4. Interest rates on deposits and loans in the region (2008)**



**Figure 3. Interest rates for deposits and loans in the region (2009)**



**Figure 5. Interest rates on deposits and loans in the region (2010)**

Among neighboring countries that we have introduced in Table 3, Macedonia has a more favorable policy for both deposits and loans. In this country, the level of the deposit interest rate ranges from 6.5% to 7.5%, whereas the level of the loan rate from 7.4% to 10.3% for the comparative years. So, the difference between the positive and negative interest rate is small, which allows the introduction of potential bank credit for the development of businesses and the overall economy of this country.

Based on the realistic situation, it can be said that Kosovo does not implement favorable monetary and credit policy for businesses and the economy in general. Credit policy as implemented now in Kosovo is in favor of commercial banks to the detriment of businesses and the local economy. Just as, credit policies are implemented, commercial banks enabled the realization of extra profit, thus caused a noticeable difference

in terms of the level of wages for employees in the banking sector. High profit of commercial banks is achieved by the big difference between the level of the positive interest rate (loans) and the level of negative interest rates (deposits), which for the comparative years in Kosovo was approximately 10.5%.

### Conclusion

Monetary policy in the post-war in Kosovo has its own characteristics, because as is known, it is found in the Euro zone. Kosovo cannot make sound monetary policy, because it does not have the power of the primary mission. However, this does not mean that Kosovo could not lead a more effective monetary policy management. Regarding credit policy, our country has high rates for loans (on one side) and low level of deposit rates (on the other side). In comparison with neighboring countries, Kosovo leads with high interest rates on loans and low level interest rates on deposit. High level of interest rate for loans, and other burden of fiscal policies have contributed sufficiently to the slowdown in business development, namely the Kosovo economy. The way this policy is being implemented now in Kosovo, is in favor of commercial banks and to the detriment of businesses and the local economy. Based on the realistic situation, it can be said that Kosovo does not implement the monetary policy of preferential loans for businesses and the economy in general. Government of Kosovo, with a consistent policy and appropriate development strategy (which is lacking now), should mobilize all the factors of development, including the capital market, which should be carried out to economic development of local businesses.

From this scientific analysis we can conclude that monetary and credit policy as implemented after the war and which has been implemented yet, is not in the proper function of local businesses, namely economic development of Kosovo. Thus, in order for the monetary and credit policy to be serving the local business, Government of Kosovo has to make major economic reforms, fiscal policy, monetary and credit policy and economic relations with the outside. We had to choose the periodic analyzers to be from the year 2008 (in most cases) because in this year Kosovo declared political independence and began to implement in most cases independent economic policy, with the constituent attributes.

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