THE PROMISE OF MACROPRUDENTIAL POLICY

Reykjavik Economic Conference

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Confidential

Outline

- Kosovo economy characteristics
- Macroprudential Policy Framework – Mandate and Surveillance
- Macroprudential Policy into action
- Scope and Application of Policy Instruments
- Minimizing Disruptions and Addressing Lessons from Past Crises
- Promoting Sustainable Economic Growth
- Challenges and Institutional Initiatives

Kosovo Economy characteristics:

- Euroized economy
- Large diaspora-related BoP inflows – remittances, services exports, capital transfers for investment (FDI) (around 40% of GDP)
- Our GDP growth has been around 4%, while inflation has dropped to 2.5%.
- Fast-growing ICT services offshoring sector
- Visa free-regime (EU): Migration risk (regional dynamic)
- Volatile & uncertain trend growth (data gaps, short time series, data quality issues)
- Bank dominated financial system (banking assets accounting for 66.6% of total financial sector assets in 2024 Q1).
- Banking sector comprises of 11 banks, five of which are systemically important. EU headquarters banks dominate the market (51.7% in 2024 Q1), and all of them result as systemically important.
- Nevertheless, their share has declined constantly, due to increased competition from other banks, mostly of Albanian origin (17.2% in 2024 Q1) as well as domestic banks (16.2% in 2024 Q1).

Macroprudential Policy Framework in Kosovo – Purpose and Institutional setup

- Purpose of Macroprudential Policy
  - Within Kosovo's euroized economy, the Central Bank as sole authority, operates with a keen awareness of the challenges that beset our financial system.
  - As we reflect on the lessons learned from past crises, it becomes clear that a regulatory framework—one that encompasses both microprudential and macroprudential dimensions— is the building block towards ensuring our mandate of financial stability.
- The mandate and Institutional setup of CBK for MaPP
  - The introduction of macroprudential policy by the Central Bank of Kosovo in 2016 marked a pivotal moment in our regulatory journey. Recognizing the importance of proactive risk management in maintaining financial stability, macroprudential policy is designed to identify, monitor, and mitigate systemic risks that have the potential to disrupt our economy at its core.

Macroprudential Surveillance at the CBK

- The comprehensive risk assessment for the Kosovo financial system in the short and medium term in order to fulfill our national financial stability mandate aims in:

  - Early identification of emerging vulnerabilities within the financial sector segments, real economy and in diaspora host countries, and assessment of their potential to impact on the financial system stability as a whole;

  - Systematic and cross-segmental monitoring of identified vulnerabilities in the financial system and resilience assessment, accounting for contagion and amplification effects;

  - Summarizing and presenting the findings that serve as a basis for the discussion meeting of the Macroprudential Committee and assessing macroprudential policy options based on instrument-specific frameworks.

Putting policy into action

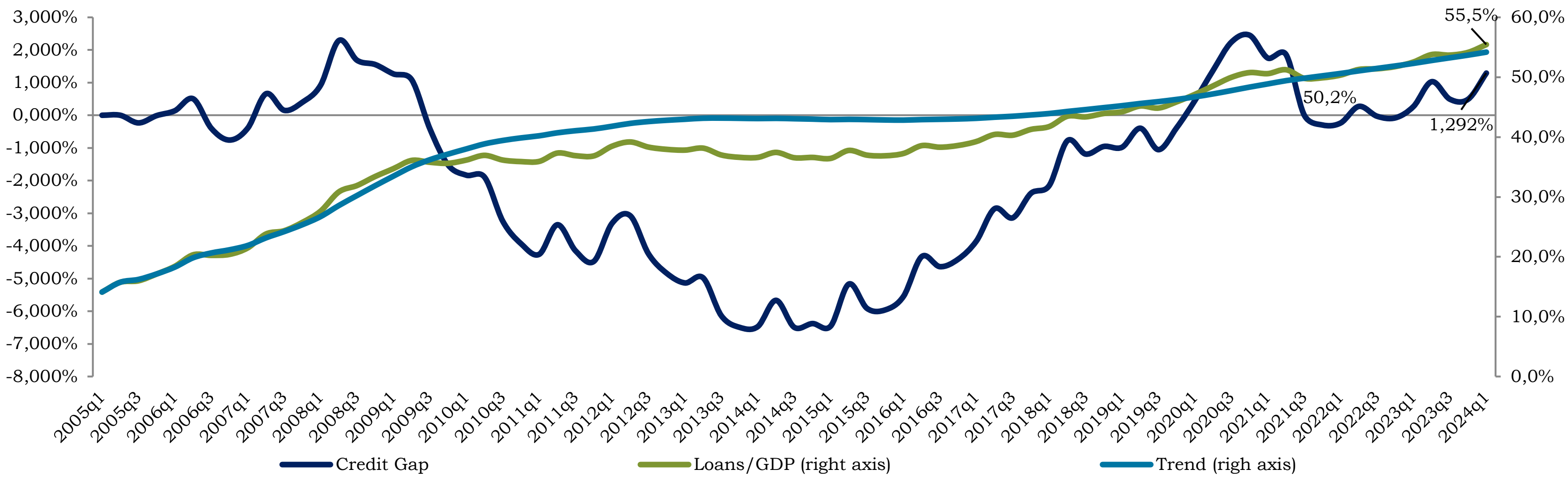
- The establishment of the Macroprudential Advisory Committee (MPAC) serves as a testament to our resolve to remain vigilant in the face of evolving risks. Through **regular reviews and assessments**, we strive to stay ahead of the curve, preempting crises before they materialize.
- The Macroprudential Policy Framework we adopted in August 2016 draws on the approach of the European Systemic Risk Board framework, that specifies:
  - **Intermediate objectives** in support of financial stability;
  - A **set of indicators to monitor changes** in the associated systemic risks and
  - A **set of policy instruments** that can be used for mitigation purposes
- The ultimate objective of macroprudential policy is to help safeguard the stability of the Kosovo financial system, primarily by strengthening the resilience of the financial system and decreasing the build-up of systemic risk
  - Within this policy, assessment frameworks for many macroprudential tools have been developed, each methodically crafted to address specific features of systemic risk. From broad-based tools applied to the banking sector, such as **risk-based capital requirements** and **countercyclical capital buffers**, **to targeted measures** aimed at addressing risks from systemically important institutions and interconnectedness within the financial system.

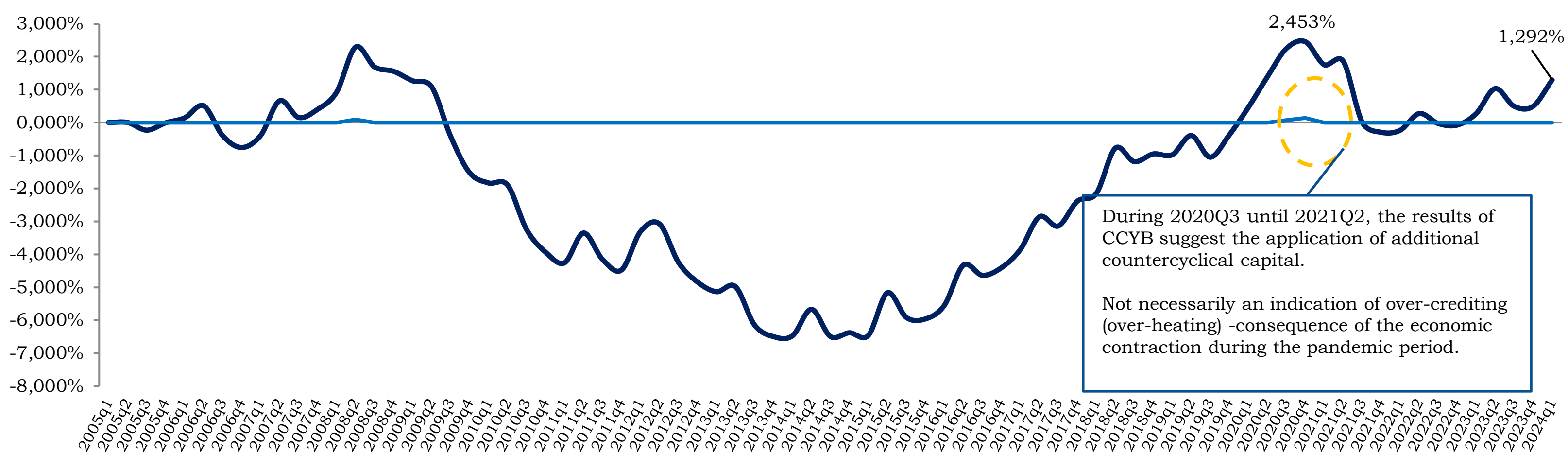
Scope and Application of Policy Instruments

Instruments used by the CBK are those that take a preventive approach by putting limits on the level and types of risks the financial institutions can take so that the probability and magnitude of future financial crisis is reduced. In this sense of the term, many of the prudential tools that the CBK already has in place also have macroprudential effects.

	OBJECTIVES	RISK INDICATORS DETERMINED BY OBJECTIVES	SUPPORTING INSTRUMENTS
1	Reducing and preventing an excessive increase of Lending and leverage		**Capital based measures:**
			1. Countercyclical capital buffer (CCyB)
		-Macroeconomic environment (GDP, inflation)	2. Sectoral capital buffer
		-Lending by segments and economic sectors	3. Buffers on Leverage ratio
		-Capitalization	**Borrower based measures:**
		-Loan-to-GDP gap	1. Loan-to-Value ratio (LTV)
			2. Debt-to-income ratio (DTI) & Debt-service-to-income (DSTI)
2	Reducing and preventing excessive inconsistencies of maturity and liquidity in the market		**Liquidity based measures:**
		-Liquidity indicator (liquid assets to short-term liabilities	1. Liquidity-coverage-ratio (LCR)
		-Loans to deposits ratio	2. Net-stable-funding-ratio (NSFR)
		-Liquidity reserves	3. Restrictions on funding resources
		-Liquidity gap	4. Large exposure limits
3	Direct and indirect credit exposures	-Credit risk concentration (large credit exposures); large credit exposures to Tier 1 capital	**Other measures:** 1. Large exposure restrictions
4	Limitation on systemic impact from incorrect initiative in order to reduce moral hazard	- Banks financial performance	
		-Interest rate on loans and deposits	Capital based measures:
		-Assets concentration	1. SIFI capital surcharges
		-Banks with systemic importance	

Scope and Application of Policy Instruments-Capital based measures
Countercyclical capital buffer framework





Scope and Application of Policy Instruments-Capital based measures

Systemically Important Financial Institutions-Framework

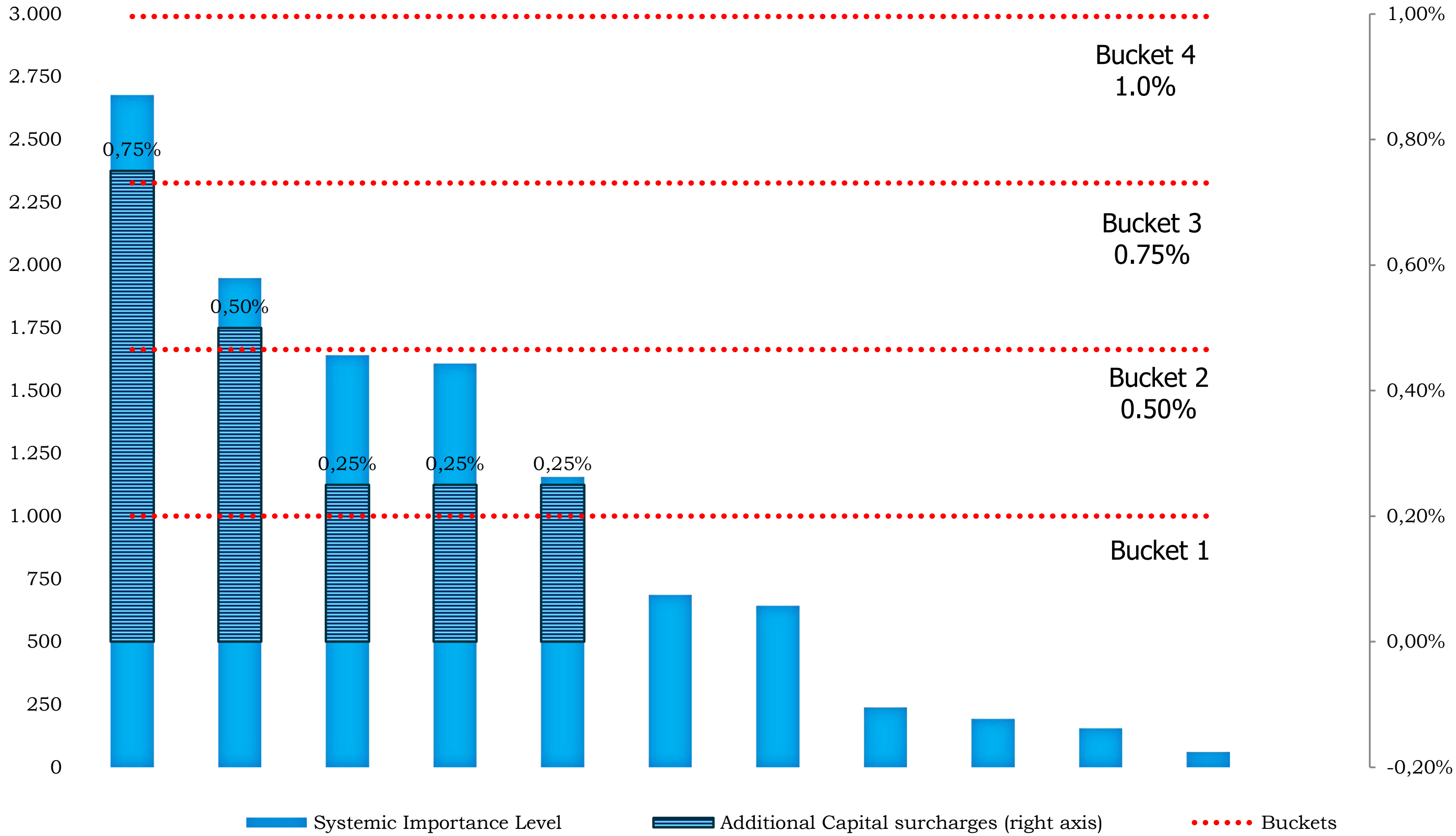
- Kosovo's financial sector is mainly based on banks (around 70 percent of the financial sector). The systemic importance model has been continually modified in order to adapt to changes in the international regulatory and guidance framework:
- The final modification complies with the guidelines of the European Banking Authority published in 2014. The weight of the criteria is equal, which in turn reduces the space for subjectivity and eliminates the possibility of risk underestimation as a result of the sector's evolution and the increasing importance of the criteria which were paid less importance

The systemic importance limit for the banking sector in Kosovo is estimated to be 1,000 basis points (capital buffer 0.25%-1.00%, ECB recently revised it to 1.50% from Jan 2024).

Criteria	Indicators	Weights
Size	Assets (net of provisions)	25%
Substitutability	Value of domestic payment transactions Loans to households Loans to non financial corporations Households deposits	25%
Interconnectedness	Intra-financial liabilities (deposits and other borrowings to FC) Intra-financial assets (loans to FC and placements in other banks, incl.securities investments in financial corporations) Outstanding of Debt Securitites	25%
Complexity/Cross-border activity	Cross-jurdisdictional assets (claims to nonresidents) Cross-jurdisdictional liabilities (liabilities to nonresident Off balance sheet items	25%

…(3.1) Scope and Application of Policy Instruments-**Capital based measures**

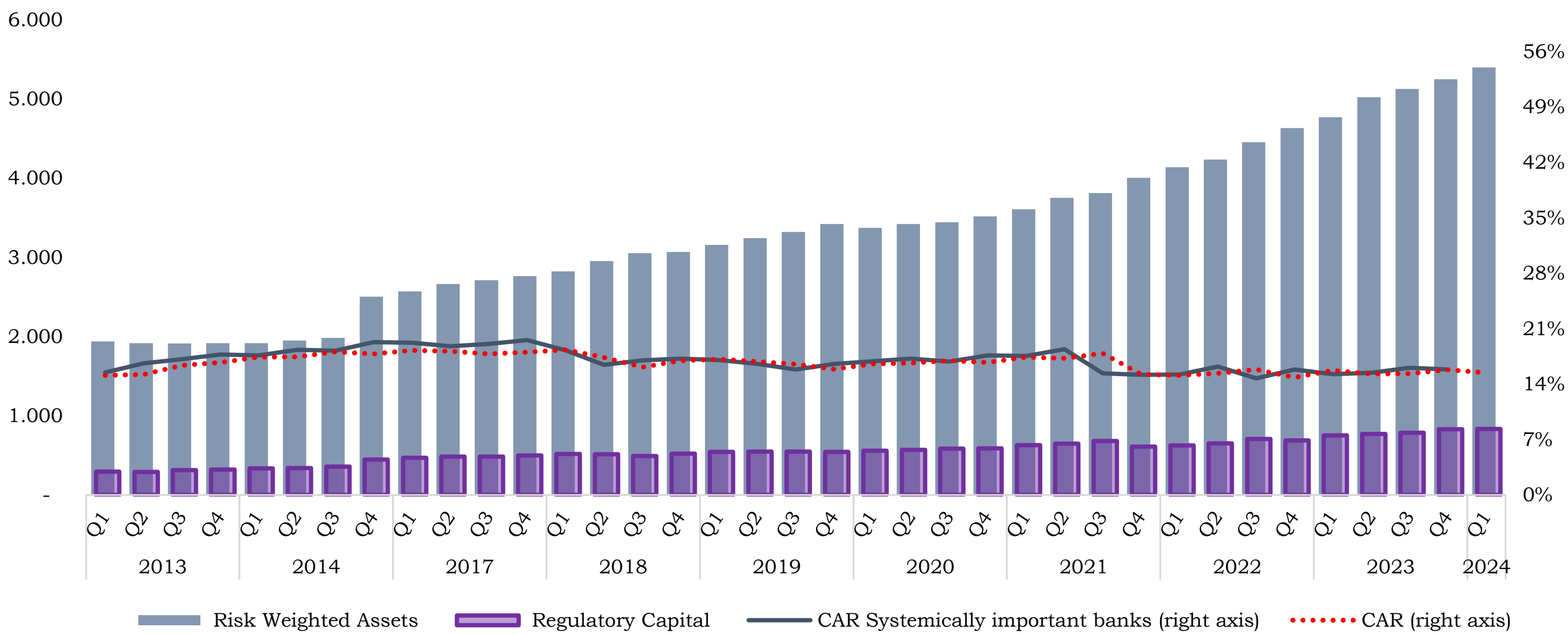
Systemically Important Financial Institutions - Capital Surcharges (bucketing)



CBK, 2024

Scope and Application of Policy Instruments-Capital based measures

- The capital buffers have not been activated yet – Buffer regulation underway; the voluntary capital base has been high throughout the years.



Scope and Application of Policy Instruments-**Borrower based measures**

Amid the challenges that these instruments carry, **CBK has the aim towards calibrating the instruments based on credit registry data.** Regulation revisions are underway, improving significantly the reporting system, including the verification and validation mechanisms of data input.

- ***Loan To Value ratio*** is applicable only for residential mortgages and should not exceed 90% in any case. Residential mortgages with LTV of higher than 80% are risk weighted 100% and are classified as other residential mortgages.
- ***Debt Service To Income ratio*** effective January 2016 - there are two forms of DSTI ratio limits on residential mortgage loans: (1) Pay-to-Income ratio should not exceed 50% for a Qualifying Residential Mortgage Loans or 60% for any other residential mortgage loan. (2) Debt to Income ratio should not exceed 60% for a QRML or 70% for any other residential mortgage.

LTV

- 42.0% actual
- 90.0% limit set by the regulation on mortgage residential loans

LTI

- 29.4% actual (by lending banks)
- no limit

DTI

- 28.07% (as of 2023 preliminary results based on CRK data)
- 27.4% (as of 2021 a study on household indebtedness based on credit registry and individual data received from banks)
- no regulation limit

INDEBTEDNESS OF BANK CLIENTS IN KOSOVO | Banka Qendrore e Republikës së Kosovës (bqk-kos.org)

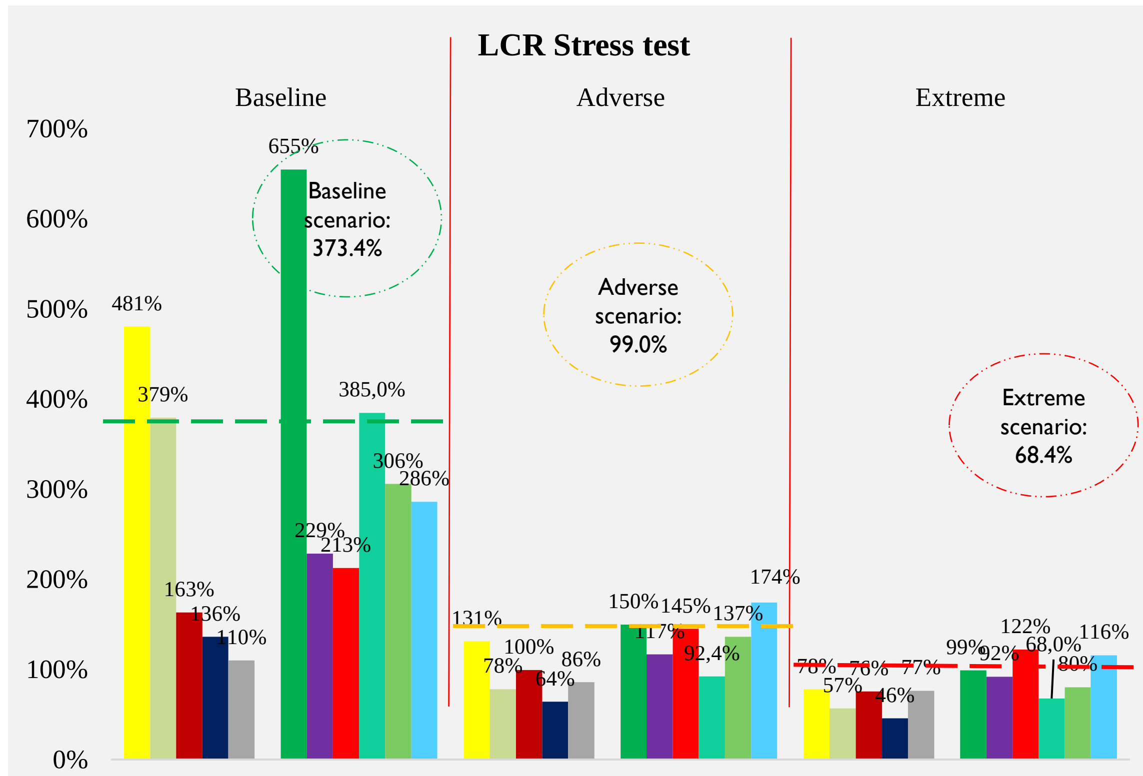
Scope and Application of Policy Instruments-**Liquidity based measures**

Basel III liquidity ratios effective as of January 2023

Liquidity Coverage Ratio – banks shall calculate the liquidity coverage ratio as equal to the ratio between the bank's liquidity buffer to net liquidity outflows over 30 calendar days stress period. Banks should maintain a liquidity coverage ratio of at least 100%. **The LCR is significantly above the minimum requirement and stands at the level of 216%.**

Net Stable Funding Ratio – the ratio between the amount of bank's available stable funding to the amount of bank's required stable funding. Banks shall maintain their stable net funding ratio of at least one hundred percent (>=100%). The NSFR stands at the level of 143%.

And, the old (effective as of 2013) **Liquid asset ratio** : the banks must calculate and provide at any time the observation of the ratio of liquid assets against the short-term liabilities: (1) denominated in the euro currency and in foreign currency at the minimum level 20% and (2) denominated as total currencies at the minimum level 25%.



Minimizing Disruptions and Addressing Lessons from Past Crises:

The pandemic shock – the drop in GDP and the associated macro risks have not materialized and the financial system exhibited robustness both financially and operationally as a result of the macroprudential proactive stance. The banking sector continued to support households and businesses contributing to the fast recovery of the consumption and investment needs in 2021 and onwards.

Measures we undertook to counteract the Pandemic effects on the financial health of the agents in the economy:

1. **Dividend policy limitations** – dividend suspended for financial years 2019 and 2020; thereafter reverted standard supervisory practice

Minimizing Disruptions and Addressing Lessons from Past Crises:

2. Loan Moratoria:

Banks have largely used the loan repayment moratoria measures. The CBK guidelines on moratoria (first issued in March 2020 and extended afterwards) provided relief to the borrowers. The guidelines have been phased out as of 31 March 2021.

Loans benefitting from CBK moratoria reached their maximum in May 2020 at the level of Euro 1.3 bn or 42% of total loans of the banking sector (businesses accounted for the 73% of total loans under moratoria; households accounted for the remaining 27%).

Meanwhile, CBK introduced **supervisory flexibility regarding the treatment of non-performing loans (NPLs),** to allow banks to fully benefit from the moratoria put in place to tackle the pandemic distress.

Minimizing Disruptions and Addressing Lessons from Past Crises:

3. Supervisory Dialogue: Qualitative discussions with the banking sector, both for macroprudential and microprudential supervision purposes.

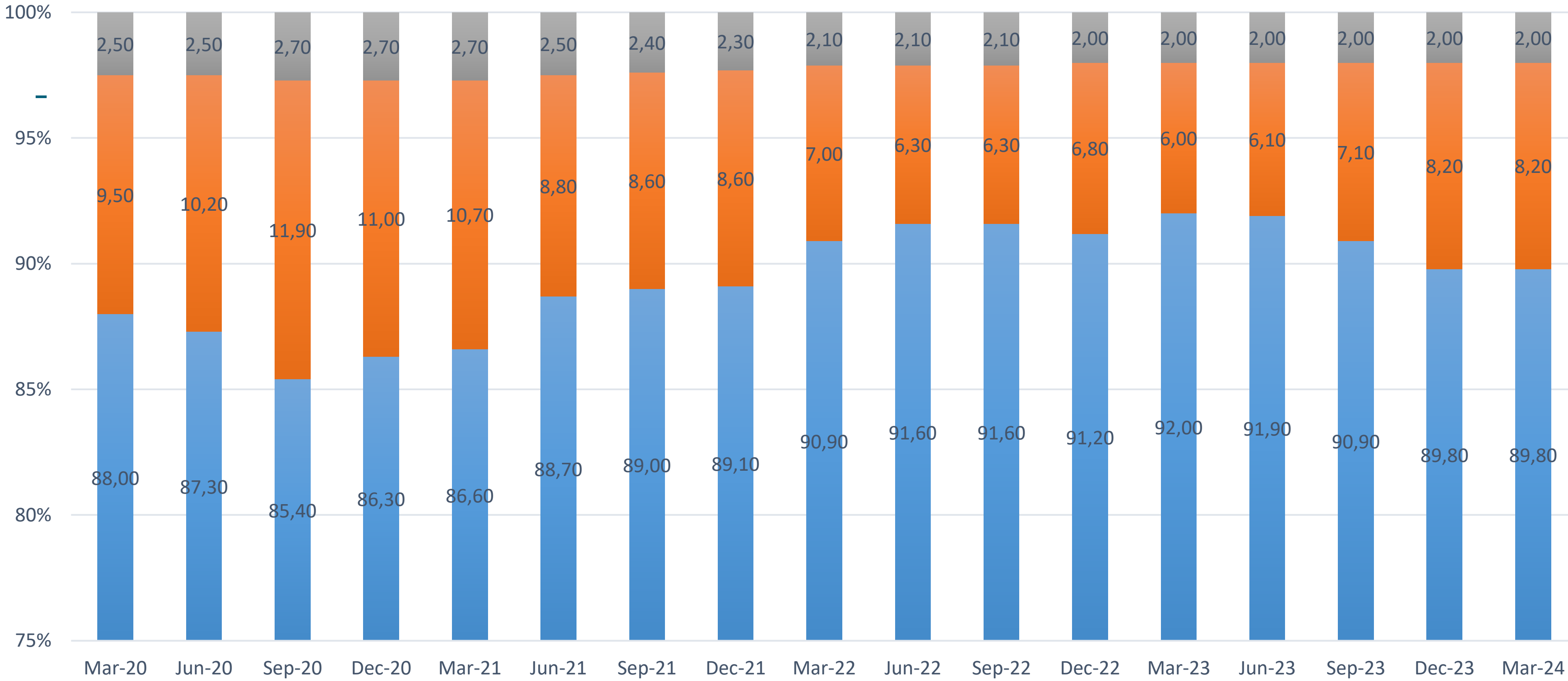
CBK started supervisory dialogue meetings during pandemics. Meeting were initially conducted on monthly basis, to continue thereafter on quarterly basis.

These meetings, with bank CRO's, proved very effective by providing qualitative feedback on systemic risk dynamics and banks short term individual outlooks. Moreover, they served as a direct channel for communicating our expectations regarding the banks' actions to minimize the cliff effects and on the identification and measurement of credit risk in the context of the COVID-19 pandemic and the following inflation crisis.

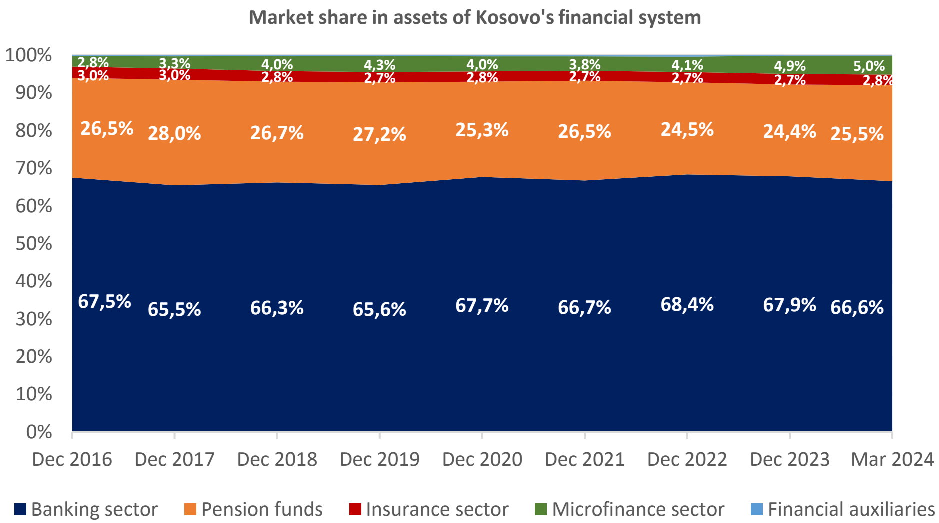
These measures were in line with actions taken by other supervisory authorities, such as the European Central Bank, the US Federal Reserve System, the UK Regulatory Authority and others.

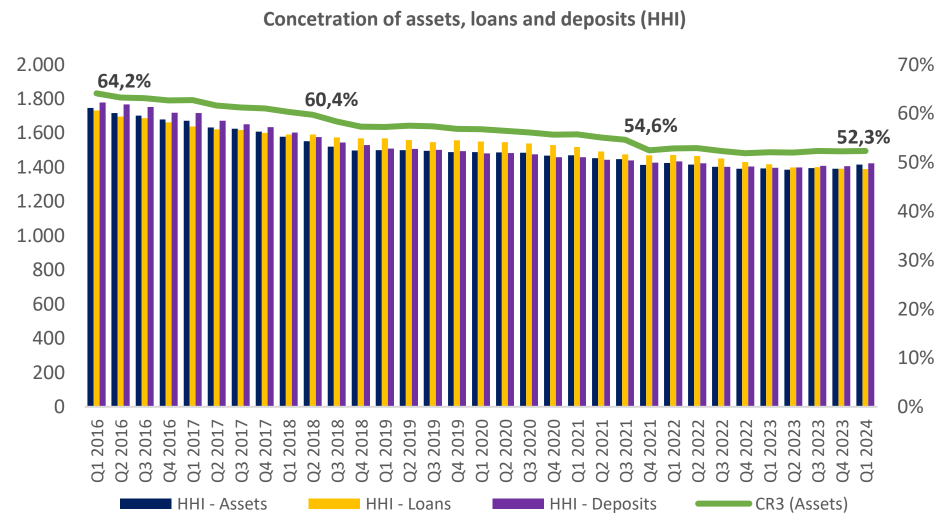
Minimizing Disruptions and Addressing Lessons from Past Crises:

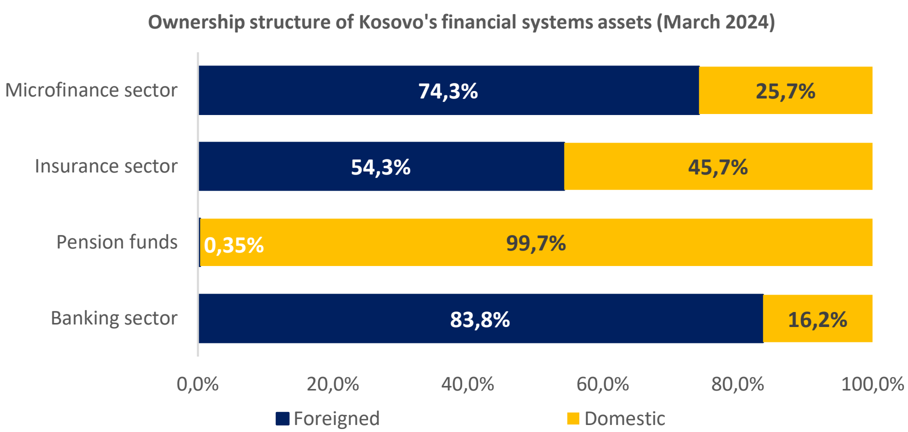
- Banks have markedly increased the classification of loans in stage 2 as they have maintained a significant buffer of overlay provisions. After a peak in SEP 2020 (11.9%), the share of stage 2 loans has started to decline. As of MAR 2024, they are at the level of 8.2%.
- The NPL ratio maintained a downward trend reaching 2% in MAR 2024. The Coverage ratio remains at a very high level of 73%.

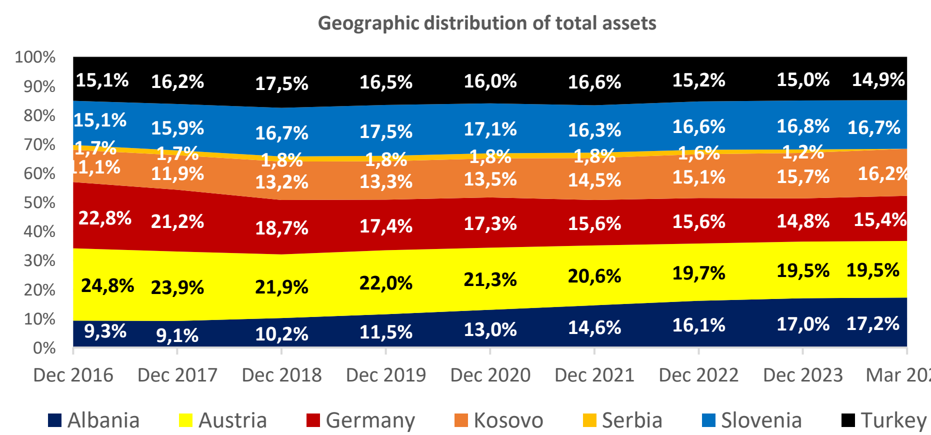


Promoting Sustainable Economic Growth – Some stylized facts:



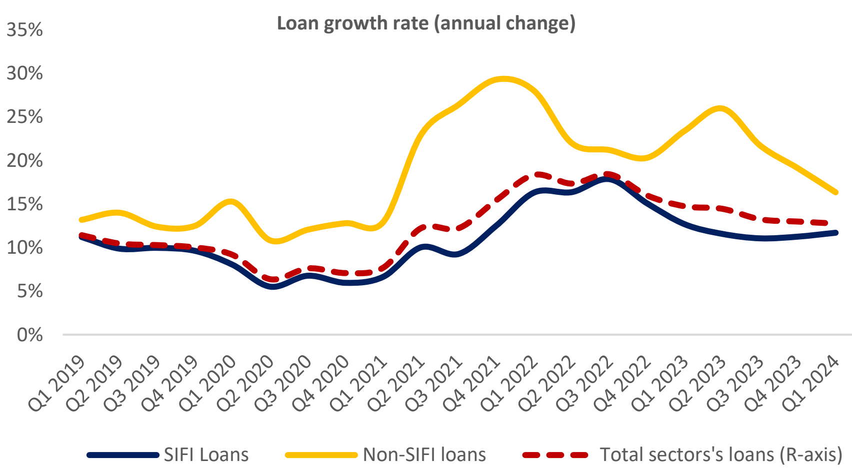


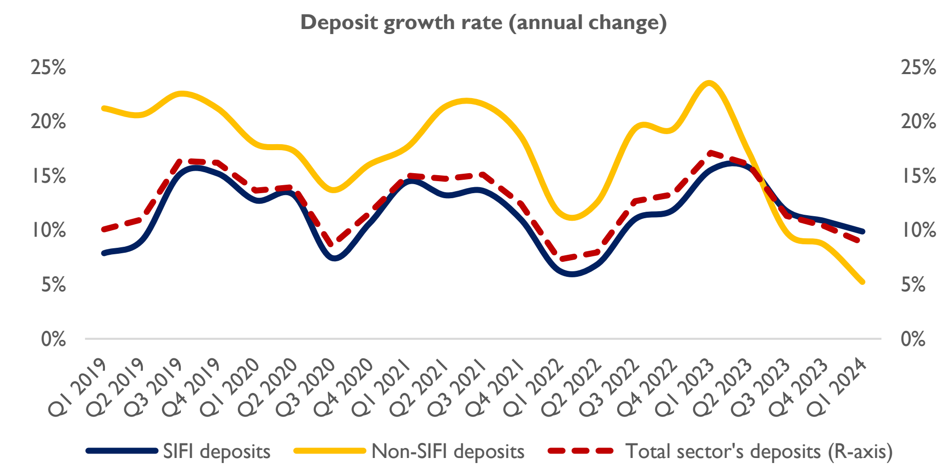


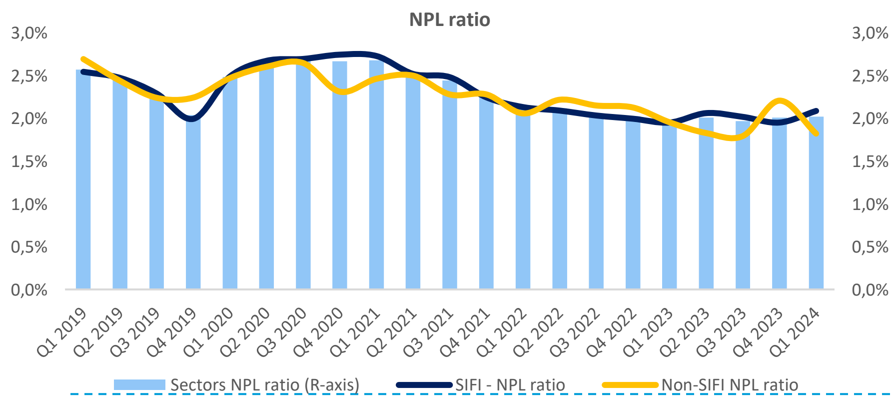


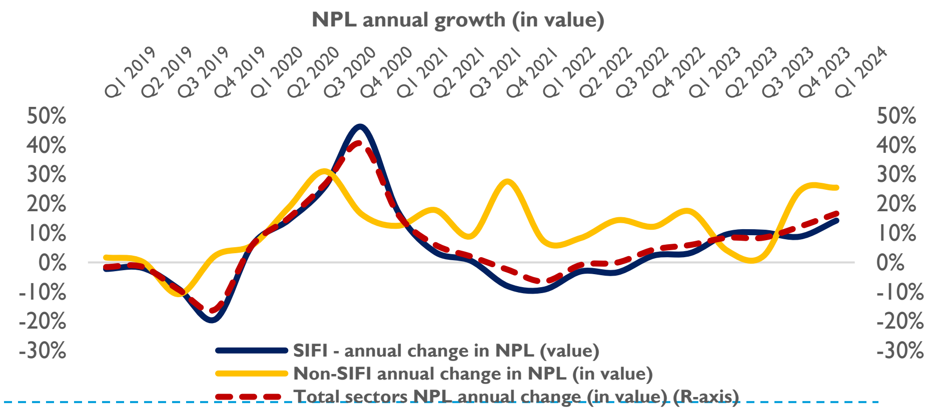
Promoting Sustainable Economic Growth

- SIFI banks determined the growth trend of lending activity, while Non-SIFI banks grew at an accelerated pace. On average, during the last 5 years, lending activity by SIFI banks increase y-o-y on avg. 10.9% while by Non-SIFI banks on avg. by 18.7%
- SIFI banks also determined the growth trend of deposits, while Non-SIFI banks grew also at an accelerated pace. On average, during the last 5 years, deposits collected by SIFI banks increase y-o-y on avg. 11.6% while by Non-SIFI banks on avg. by 17.0%
- Non-performing loans (NPL) remain at low level, at 2.0% in Q1 2024. Similar patterns have SIFI & Non-SIFI banks. On the other hand, as a value, NPLs grew at an accelerated pace from Non-SIFI banks compare to SIFI banks in recent periods.



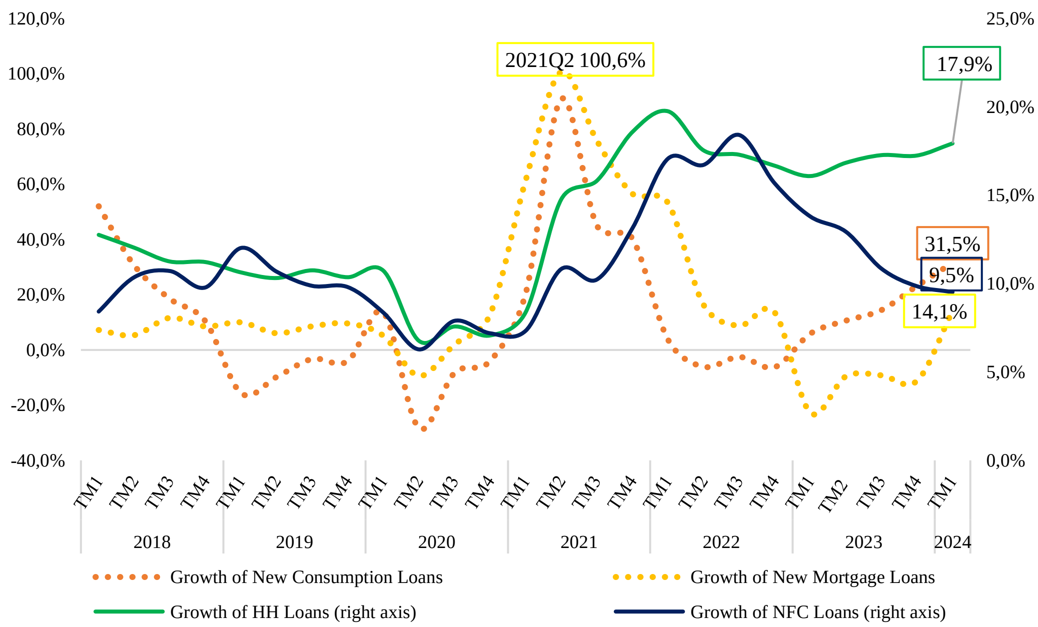






Promoting Sustainable Economic Growth

Financial intermediation within the banking sector, particularly in lending, continued to grow, accounting for 51.3% of GDP compared to 49.2% the previous year. Although the non-financial corporation intermediation rate at 30.2% in 2023 exceeded regional levels, household intermediation at 19.2% still lags behind the region.



	2021	2022	2023
Growth in loans to households:	18.6%	16.7%	17.3%
Growth in mortgage new loans:	56.5%	13.5%	-11.3%
Growth in consumer new loans:	40.3%	-6.3%	23.2%
Non-performing loan ratio for household loans:	**0.9%**	**1.2%**	**1.4%**
Growth in loans to non-financial corporations:	13.1%	15.7%	9.9%
Non-performing loan ratio for NFC loans:	**2.8%**	**2.5%**	**2.4%**

Challenges and Institutional Initiatives

Data Gaps

As we navigate the complexities of modern finance, **data remains a cornerstone** of our accomplishments. Recognizing the critical importance of information in risk assessment, we are aware of the data gaps that inhibit the development of an effective early warning system. Initiatives are underway to address these gaps, from building and synchronizing internal databases to leveraging administrative data sources, underscoring our commitment to informed decision-making.

Information gaps in CBK's macroprudential policy framework, which mostly inhibit the development of an early warning system for risks and vulnerabilities in Kosovo:

- Real estate prices
- Private sector (Corporate and Household) income data
- Quality of available data (many structural breaks), and short time-series

Institutional Initiatives

- Real Estate Risks: building the database and a house price index. The KAS, through a specified IMF TA, is expected to finalize the roadmap to produce a residential housing price index and compile related surveillance data.
- The Credit Registry regulation is being amended and our contribution as the most important user of Credit Registry database is to require the disaggregation of the **Loan Purpose categorization** and include **LTV** and **DTI** in regular reporting. Already a mine which assists us in conducting more granular analysis.
- Enhancing the inter-agency cooperation to assist us into building databases for financial stability purposes.
- In the process of advancing our stress-testing capacities and capabilities: working towards completing the infrastructure of our Macroprudential Stress Test model.

THANK YOU FOR YOUR ATTENTION!

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