

The banking system of liquidity risk management in commercial banks in Kosovo for 2015

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Abstract

The financial system in general and banking system in particular in Kosovo, is one of the most stable sectors, even though the Kosovo Economy is not in any enviable position and a stable financial system which would have an impact on greater economic growth.

The focus of this research will be in the structure and organization of the financial system in Kosovo with particular emphasis on Kosovo's banking system for 2015. In this research we are focused on the Commercial Banks operating in the framework of the banking sector in Kosovo, what is their capital, how many banks have local- and how many have foreign capital, by whom are licensed and supervised, how is the loans potential of commercial banks in Kosovo, how much and how was the variation of interest rates on loans and deposits for 2015 and their comparison with the previous year, what is capital sufficiency and how many commercial banks do have liquidity in Kosovo?

Kosovo banking sector exposure to risk will also have a special attention where it is known that there are several types of financial risk and they are: crediting risk, liquidity risk, market risk, operational risk, etc. Our interest in this research will be focused on liquidity risk and the analysis about the management of each bank including some specific regulative frameworks such as: framework of the Basel Committee known as Basel I, Basel II and more recently Basel III, which have strict rules and which change from time to time depending on financial flows or potential crises.

Keywords: banking system, liquidity, risk management, commercial banks, Kosovo.

Introduction

Banks are financial institutions which play an important role because they are institutions which manage money towards those who are most in need and have a significant contribution to the economy of a country. Banks are created based on the system which will deal with monetary deposits; maintenance of customer's savings and providing loans for financial purpose. So, banks are institutions in which loans are provided, receiving deposits and in later stages awarding these deposits in form of loans, mediation on performance of local and international payments, transfer of financial means etc. Banks present the most important institutions in an economy because they are the main source for loans to be used for meeting various needs of different sectors such as: house holding, business as well as various institutions (Luboteni, 2015, 9).

Banks are regular businesses worldwide institutions, due that the bank can not be opened or closed without the permission of the regulatory authority or central bank. Activities and/or banking affairs with which the bank deals are divided as follows (Drenovska, 2010, 52):

- Passive banking works which deal with collections and allocation of financial means or otherwise called as mobilized banking activities and are called passive because the bank presents the role of debtor towards the property and means. Regarding the passive activities included depository activities and other banking activities through which is done the mobilization of the released financial means, in this way is formed passive credit potential, for this mobilization the bank pays Passive interest. , due to that mobilization activities are included in passive works.
- Active banking works - otherwise are recognised banking placements works. In this case the bank plays the role of creditor; these works are considered bank's requirements on the asset side of the balance.
- Neutral banking works. These works are included in mediation activities, and are performed by bank to the account of third party; here bank does not appear either as Debtor or as Creditors.

Nowadays banks perform financial services, care for its customers deposits. The success of bank nowadays depends of the ability to identify financial services, to clients who need them in order to perform much more efficiently and with favourable conditions (Luboteni, 2015, 18).

Nowadays the main roles of banks are:

- The role of Intermediator-Who provides the service of savings for credits to enable investments;
- The role payments executor;
- The Role of guarantor- is to guarantee payment of its Clients and to pay debts if they are not able to pay;
- Role of Agency-preservation of property to its clients;
- Political role-implementation of the government's efforts to regulate the growth and realization of social goals.

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Financial system in Kosovo is a system which enables the functionality of payment system of various natures, local and international transfers, execution of payments of bills (Kosovo Banking Association). Financial system includes markets of capital, mediation institutions, financial regulators and other financial institutions which perform various financial activities of family economies, governmental enterprises and institutions. Financial System in Kosovo, after the war has increased the most of the values and has shown sustainability, who actually testifies that the financial Institutions in Kosovo are build on sustainable operation basis Financial system has given great contribution to economic development of Country through lending institutions and through services offered by insurance companies.

Kosovo banking system consists of: Commercial Banks, Insurance Companies,

Pension funds, financial support, micro-financial institutions etc. The structure of financial system in Kosovo consists of 10 Commercial Banks, 15 Insurance Companies, 13 Micro-financial Institutions, 49 Nonbanking Institution and 2 Pension Funds. In table 1 we have presented the structure of Financial System of Kosovo.

Table 1. The structure of the Financial System of Kosovo

No.	Description	Total number	With domestic capital	With foreign capital
1	Commercial Bank	10	2	8
2	Insurance Companies	15	6	9
3	Micro-financial Institutions	13	3	10
4	Non-banking Financial Institutions	49	45	4
5	Pension Funds	2	1	1

Source: Kosovo Central Bank (KCB) annual report 2015, published on 11 August 2016, processed by author.

Banking System in Kosovo

Banking system is a group or network of institutions which provide financial services. These institutions are responsible for providing loans of different needs, deposit taking and as well as providing various investment assistance. Banking system in Kosovo is relatively new, but it has developed very fast, especially after the 1999 (Kosovo Banking Association). Banking System in Kosovo consists of: Central Bank, Commercial Banks and Micro-financial Institutions. Regarding the institutional structure, the banking system consists of Commercial Banks, Insurance companies, Pension funds, Credit Societies etc., all licensed and monitored by Department of Licensing and Standardization (DLS) that is within the Central Bank of Kosovo. Central bank is the authority which operates through DLS licenses and monitors financial institutions. In Kosovo operate about 10 Commercial banks which represent 69% of assets in financial sector and which are: ProCredit Bank, Raiffeisen Bank J.S.C., NLB sh.a (JSCO), Banka për Biznes (Bank for Business), Banka Ekonomike (Economic Bank), TEB Sh.a. (JSC), Banka Kombetare Tregtare (National Trade Bank), Komericialna Banka in Mitrovica (Commercial Bank in Mitrovica), Turkyie is Bankassi, T.C Zirat Bankassi A.S.

About 90% of capital of banking sector in Kosovo is capital from foreign origin, while the remaining part belongs to banks with local capital. The value of each commercial bank is presented in the following table 2.

Table 2. Capital structure of the banking system in Kosovo in 2015

No.	Bank	Branches	Domestic capital	Foreign capital	Value of domestic capital	Value of foreign capital
1	ProCredit Bank	55	0%	100%	-	61,346.210.00

2	Raiffesisen Bank Kosovo J.S.C	52	0%	100%	-	63,000.000.00
3	NLB Bank sh.a.	50	0%	100%	-	59,725.000.00
4	Banka për Biznes	41	43%	57%	4,836.006.00	6,410.520.00
5	Banka Ekonomike	40	100%	0%	14,778.813.00	-
6	TEB sh.a.	26	0%	100%	-	24,000.000.00
7	Banka Kobëtare Tregtare	24	0%	100%	-	17,000.000.00
8	Komercijalna Banka-Mitrovicë	9	0%	100%	-	25,000.00
9	Turkiye Is Bankasi	1	0%	100%	-	8,093.000.00
10	T.C. Ziraat Bankasi A.S	1	0%	100%	-	2,540.544.00

Source: KCB annual report 2015, published on 11 August 2016, processed by author. Products and services of Commercial Banks in Kosovo, include: banking accounts, credits (loans), domestic and foreign transactions, banking cards, credit letters, e-banking, and other services and products (Kosovo Banking Association). Regarding the trade concentration in banking sector, in 2015 the assets trend is decreased, regarding loans and deposits if we compare the previous year. This is as result of rapid increase of assets of small Banks in comparison with the slow increase of assets in three bigger banks. Decrease of deposits is as result of decrease of loans in big banks in comparison with the higher increase of deposits in other banks. Assets of Banking Sector in Kosovo 2015, reached the value of € 3.39 billion expressed in percentage 6.3% increase where the bigger role of increase is the expansion of the loan portfolio that represents the dominant category of structure of assets in banking sector. Loans in 2015 reached the value of € 2.02 billion which presents 7.3% increase and this is attributed to the easing of lending standards by banks and with particular attention to the reduction of interest rates, credit expansion potential and extending the maturity on loans provided and the growth of demand for loans from enterprises and family businesses. Family business loans in 2015 increased 9.7%, mortgage loans by 27, 7%, while new loans with favourable conditions by 55.8%. Loans for enterprises are increased by 6.1%, loans which bear the main load within the total loans (65.9% of total loans). Participation of loans in total assets in banking sector is 59,6% Securities increased in 2015 by 29.4%, while securities of Kosovo Government increased by 17.4%. Regarding the cash, it has increased by 9.9% which reflects the increase of deposits in banking sector and the low interest rates in international markets limiting the possibility of commercial banks for investment in these markets and this has also contributed to the reduction of the balance of commercial banks including deposits and loans with banks abroad. Cash participates by 9.3% in total assets. Structure of assets for 2015 and comparison with 2014 is presented in table 3.

Table 3. Structure of assets in banking sector for 2015 in comparison with 2014

Description	2014			2015	
	Value in €	Participation %	Value in €	Participation %	
Cash	447.10	14.00%	491.2	14.50%	
Balance with Commercial Banks	360.70	12.30%	316	9.30%	

Securities	383.80	12.00%	473.5	15.00%
Gross loans	1.882.40	59.10%	2.019.40	59.60%
Fixed assets	53.70	1.70%	57.3	1.70%
Other assets	27.90	0.90%	29.8	0.90%
Total	3,185.60	100%	3,387.30	100%

Source: KCB annual report 2016, published on 11 August 2016, processed by author. Regarding the liabilities, their structure is dominated by deposits which consist of 79% of total liabilities and present the main source of banking financial activity. The high support in domestic deposits and especially in deposits of Family Economies is considered to be a sustainable source of funding and prevents exposure of the sector to external movements in financial markets. Deposit in 2015 reached the value of € 2.70 billion or in percentage 6.5% increase, which represents the performance of deposit recovery in comparison with previous years. Greater participation in the total deposits are deposits of family economies which consist of about 72.7% of deposits. Deposits of enterprises have a participation of 21.6% in the total amount of deposits. Increase of deposits in 2015 is attributed to termination of the declining trend in interest rates on deposits since the second quarter of 2015.

The balance category with other banks has reached the value of € 43.4 million or an increase of 37.2%. Other borrowings amount an increase of € 17.6 million or an increase of 24.7%. Own resources in banking sector have an increase by 21.9% and comprise 11.6% of total liabilities. Increase of own sources is as a result of profit realized from the banking sector in 2015. The structure of liabilities is presented in table 4.

Table 4. Structure of liabilities of banking sector in 2015 and comparison to 2014.

Description	2014			2015	
	Value in €	Participation %	Value in €	Participation %	
Balance from other banks	31.60	1.00%	43.40	1.30%	
Deposits	2,537.50	79.70%	2.701.40	79.80%	
Other loans	14.10	0.40%	17.60	0.50%	
Other liabilities	232.10	7.30%	194.30	5.70%	
Subordinated debt	47.30	1.50%	36.80	1.10%	
Own sources	323.00	10.10%	394.00	11.60%	
Total of liabilities	3,185.60	100%	3,387.30	100%	

Source: KCB annual report 2015, published on 11 August 2016, processed by author. Regarding the performance of banking Sector in Kosovo 2015 based on the annual report of KCB and other annual report published by Commercial Banks we can notice that banking sector in 2015 has realized profit which reaches the value of € 94.7 million and this profit results as the reduction expenses in banking sector. Incomes for 2015 reached the amount of € 238.2 million which presents 2.9% decrease as a result of decrease of revenues from the interest which decreased 5, 7%, this decrease is attributed to the decrease of interest rates in loans. Revenues from non-interest

increased by 7.2% as result of increase from fees and commissions which means that services at branches of banks got more expensive. Expenses in banking sector reach a value of € 143.5 million which presents the annual decrease of 22.3% as result of reduction of non-interest expenses which in 2015 declined at the rate of 88.6%, and within this considerable decline are recorded costs of provisions for loans which decreased by 141.1%. Also impact in decrease of expenses were recorded the interest expenses which were decreased by 48.7%.

Interest Rates

Through 2015, regarding loans, the interest rates decreased by an average rate from 9.4% to 7.7% as it was in previous year but regarding the interest rates on deposits increased from 1.1% as it was in 2014 to 1.2%. So, as mentioned above the interest rates on loans decreased on loans to households and loans for enterprises and for other types of loans as well. The average interest rates to households decreased by 8.4% (mortgage loans to 7%, while those of consumer 8.7%) regarding the enterprise's loan the interest rates decreased by 7.4%, where this type of loan it should be mentioned that for the investment loans the average interest rates decreased by 7.8%. In table 5 we have presented the interest rates for some types of loans.

Table 5. Interest rates on loans 2015 and comparison with 2014

Types of loans	Interest rates 2014	Interest rates 2015
Loans for Households	8.9%	8.4%
Loans for Enterprises	9.6%	7.4%
Loans for Services	10.0%	7.4%
Agricultural Loans	11.3%	7.1%
Loans for Industry	8.9%	7.4%
Overdraft	9.4%	7.1%
Various lines of loans	11.8%	8.5%

Source: KCB annual report 2015, published on 11 August 2016, processed by author Regarding the interest rates on deposits in 2015, the average interest rate has started to rise by 1.1% to 1.2% as it was in 2014. Regarding the household loans this rate changed from 0.9% to 1.1% as it was in previous year while for Enterprises is decreased to 1.5% to 1.6% as it was in 2014, and the same happened and term deposits the interest rate decreased from 1.6% to 1.5%. The average interest rates on savings deposits decreased to 0.1% in 2015 from 07% as it was in 2014.

The Risks on which the Banking Sector in Kosovo is exposed

The Risks on which the Banking Sector in Kosovo is exposed are: the liquidity risk, market risk, operational risk etc. The Risks on which the Banking Sector in Kosovo is

exposed are at low level and in 2015 Banking Sector of Kosovo has recorded decrease regarding the exposure to loans risk and solvency. In table 6 are presented risk indicators in banking sector.

Table 6 Risks indicators of banking sector 2014 and 2015

Description	2014	2015
Capital sufficiency indicator	17.8%	19.0%
The report of nonperforming loans (NPL) to total loans	8.3%	6.2%
Coverage of NPL with provisions	114.4%	115.1%
Loan/Deposit Report	74.2%	74.8%
Report of liquid assets to short-term liabilities	43.6%	44.9%
Report of the total value of large loans exposures towards the capital of first class	97.1%	67.1%

Source: KCB annual report 2015, published on 11 August 2016, processed by author. Regarding the risks to which is exposed banking system, we will be focused on the liquidity risk. Liquidity represents the ability to provide sufficient funds to meet short-terms liabilities. Liquidity is a phenomenon that is on the strict control of the management of the bank, the aim of which is as close to achieving liquidity point of optimal which means that the sufficiency of liquidity for overcoming unexpected changes in the liquid necessities and sources. Optional liquidity is a goal of bank's Management because and in the cases where there is excess of liquidity, banks faces unnecessary or wasteful expenses such as: expense for maintenance of liquidity and expenses for insufficient liquidity. Bank can preserve its liquidity if it manages to harmonize the placement of funds within the deadline of overdue. Bank should attempt to reach the optimal liquidity, so, should have bank account in Central Bank, sufficient funds of reserves for liquidity which will be used in situations when the inflow of funds are not harmonized with placement of funds in Bank. The liquidity ratio and capital adequacy ratio of capital are regulated with standardization framework of the Basel Committee known as Basel I, Basel II (this framework is based on three pillars: Minimal demands for capital, review of surveillance and market discipline) and lastly the Basel Framework III which appeared as new Framework for various demands of capital and liquidity. These frameworks regulate the activity of crediting institutions and define requirement for their capital. These frameworks had been amended very often due to addressing issues which are considered as the driving factor of the financial crisis (Kosovo Banking Association). These frameworks are supplement of each other. In 2015, regarding the exposure of Kosovo Banking Sector towards liquidity risk is at low level although the landing acceleration has increased as result of increase of deposits. In 2015, relation of loans towards deposits increased by 74.2% as it was in 2014 to 74.8% (Table 6). In Regulation XVII of KCB on supervision of Banka is fixed the rate of reserves of liquidity which is 10% of deposits (Kosovo Central Bank).

As a result of growth of deposits in 2015 there was a slight increase of liquidity assets in relation to short-time liabilities, which are consider to be sufficient indicators above the minimal level defined by regulations. In relations towards short-term liabilities

in 2015 has increased to 44.9%. Through 2015 the capital of Kosovo Banking System increased due to increase of net profit. The adequate indicator of capital reached the rate of 19% towards 17.8% as it was in previous year. In this aspect Kosovo should be in a better position and continues to be among the countries which have higher levels of capital adequacy ratios. The liquidity risk presents the situation where the bank is not in situation to fulfil its current and future liabilities on time or in full. The liquidity risk is considered to be a risk of disability to insure additional funding or the funding which can be achieved in unfavourable conditions with the increase of interest rates. Therefore, to avoid this situation at any time banks must hold sufficient liquid funds which are available for the fulfilment of liabilities to the bank. In order to soften the liquidity risk, bank needs to diversify funding sources and manage liquid assets carefully by maintaining a balance of cash and its equivalents to be sufficient to meet the needs of liabilities immediately.

Regarding the liquidity risk in Kosovo Banking System, based on the published annual data report by Kosovo Central Bank and Commercial Banks which operate in Kosovo Banking Sector it is estimated that banks are quite liquid and the exposure of the liquidity risk is at very low level. We came to this conclusion based in the relation of liquid assets against short-term liabilities, a relation which in 2015 runs at 44% which is almost the double of the minimum required by the Kosovo Central Bank. This level is required from KCB and it should be at least 25%. Kosovo also has a good position in terms of capital ratios indicator which is growing from year to year and in 2015 reached 19% level.

Conclusions

Referring to findings which are presented above, we can see that Kosovo Financial System (which is composed by a large number of financial institutions) is in a good position and shows a high-level consistency and definitely we should be mentioned Kosovo Banking System.

Based on the data published by Kosovo Central Bank and by Commercial Banks which operate in Kosovo Banking Market we can see that Kosovo Banking System It is quite stable and it is one of the sectors that is developing very quickly.

Data from the financial report for 2015 and annual reports presents that there were increase of assets as a result of expansion of loans portfolio. Also we do have an increase of deposits as result of increase of average interest rates on deposits which reflected on the increase of cash.

The average interest rates on loans have decreased which had an impact on increase defends on loans. The portfolio of securities is also extended and we have the increase of securities from the foreign Governments and smaller increase of securities from the Government of Kosovo.

Regarding the financial risk, Kosovo Banking Sector in 2015 is in a low level of exposure to these risks and it is as result of sufficient reserves for covering liabilities which means and strict observance of rules related to the mandatory reserves and liquidity reserve. This means that the Management of liquidity risk is in a satisfactory level and based on data provided, we can notice that banking system has showed no

signs of uncertainty in the fulfilment of liabilities.

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