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Effects of the Global Financial Crisis in Banking System of Kosovo in Comparison to the Banking System of Romania

INTRODUCTION

The financial crises continue to remain unsolved phenomena even nowadays. The number of crises rises every day, while the factors that are causing the crises can be different; economic, political, social, climatic, financial, etc. However, it is evident that in today’s condition of globalization, the effects of the crisis spread quickly around the world, due to financial and trade cooperation that states have among each other.

Since the crises of year 1929, the world has faced many other crises (1961, 1973, 1998), but the crises of 2007 is the biggest whose consequences are felt even today. This crisis begun in American’s banking system which soon turned into the deepest recession in the history of the U.S.A and ended as the global economic crisis. This crisis led to the increase of the unemployment rates to their highest levels in the last thirty years, to the deep declines of stock markets, while the fall of the customers’ demand made the positive trends of economic growth to turn negative and to decline massively in many states of the world. More specifically, in industrialized economies the real GDP growth rate fell from 2.7% in 2007 to -3.8% in 2009, in developing countries it fell from 10.6% to 4.8%, and in developed countries it fell from 5.4% to -3.7% [IMF, 2009] for the years 2007 and 2009, respectively.

The overall losses, officially recorded and which were as a result of the global crisis, reached up to 969 billion dollars. The International Monetary Fund foresees that the official losses to be recorded will grew up to 1.4 trillion dollars as the crisis has not ended yet.

Even though there have not been any significant signs that Kosovo is absorbed from the financial crisis, the possibility that it may suffer in the future should be taken into consideration, as most of the European countries already are involved in deep debt problems due to the global financial crisis. The country's economic experts emphasize that Kosovo is in crisis actually, because Kosovo's economy is fragile with a high level of imports while exports cover the imports with only 10–12%, but the effects are modest. On the other hand, the Central Bank of Kosovo (CBK) is limited on its powers as it uses as its currency the Euro, which make the Central Bank of Kosovo be very dependent and unable to manipulate with monetary policies. It can be said that the effect of global financial crisis in Kosova's financial sector were lower in comparison to neighbouring countries e.g. Greece. The situation in Kosovo was characterized by a law degree of credit crunch, and declines in remittances and Foreign Direct Investments (FDI) but it could maintain sustainability in its financial sector because in not exposed much to foreign bank capital (banks work more with deposits of the clients rather than foreign lending).

Also Romania was affected by the global financial crisis, which could be detected from the decline of remittances, decline in the confidence of economic agents in the local currency which caused the depreciation of the home currency, tightening of liquidity conditions and the impossibility of government to obtain credits in the international markets. The Central Bank of Romania adopted a new regulation, to enforce regulatory framework on the management of risk. In addition, Romania applied for financial assistance in some of the major international institutions like International Monetary Fund (IMF), World Bank (WB), and European Bank for Reconstruction and Development (EBRD).

BURST OF THE GLOBAL FINANCIAL CRISIS

The global financial and economic system was involved in trouble and uncertainty during the year of 2008. This crisis was due to high level of globalization and financial integration that all countries have among each other nowadays. In the first phase, the crisis touched the financial markets of the most developed countries in the world. While the second phase was characterized more by a significant impact of the crisis on the real economic indicators in both developed and developing countries, including also poor countries.

The financial crisis began in the second half of the year 2006 with the decline of the returns on mortgage debts (subprime) in U.S.A. which made many debtors incapable of repaying their debts. This crisis, also referred as 'subprime mortgage meltdown', is a crisis that affected severely the mortgage sector in the U.S.A and is considered to be the main factor of the international financial crisis of the years 2007–2008. This crisis emerged through real estate loans (or mortgage) with high risk in the U.S.A also called as “subprimes”, holders of which were mainly the people with poor or unstable incomes and unable to repay them [Paulson, 2007].

In February of 2007 the crisis was spread to banking sector by becoming now as financial crisis which included the largest mortgage loans, since the summer of 2007. This crisis caused the stock market to collapse in the summer of 2007. State authorities and financial experts suggested that the crisis was more due to the lack of interbank liquidity, and as such they reacted by introducing monetary amounts in the interbank market. But the crisis slowly turned into crisis of banking and financial insolvency. This situation caused the growth of interbank liquidity crisis, growth of the crisis of mutual integrity and increase in the interest rate of interbank debts. The financial crisis reached its peak in September 2008, where many American financial institutions were in a situation of bankruptcy or were rescued by the intervention of the FED [Sylvian de Boissieu, 2008]. Thus, the crisis turned from the U.S. financial crisis into the financial and banking crisis in other developed countries. GDP fell drastically and many businesses reduced the workplaces causing the unemployment rates to rise. According to the figure below, also the GDP growth declined drastically in U.S.A, Canada, and some other countries of the EU.

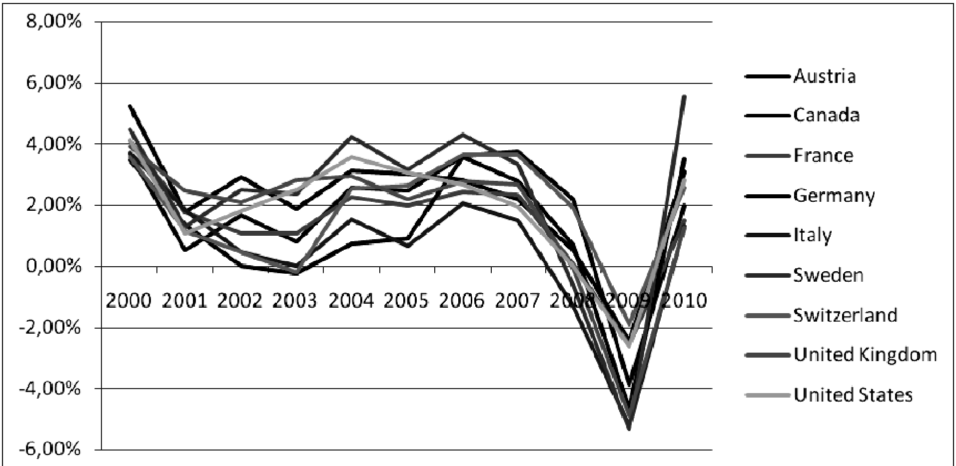

Figure 1. GDP Growth in USA, Canada, and some other countries in EU (2000– 2010)

Source: [IMF, 2009].

Given that the countries were sinking into deep financial problems, the governments tried to buy as much as possible illiquid assets to make the lending possible again. On the other hand, the CBs tried to reduce the interest rates, but because the interest rates were already very low (they already were down to 1%-FED) as a result there was no way to be rescued from the crisis. In 2008, the Europe was officially in recession.

KOSOVO'S ECONOMY AND THE PERFORMANCE OF BANKING SECTOR IN KOSOVO

Although in the years of post-war Kosovo has seen economic growth, it still remains as one of the most underdeveloped country in the Europe. In 2009, Kosovo's economy recorded a real GDP growth of 4.0%, while in 2010 the GDP growth was 4.6% which in nominal terms is 4.2 billion Euros. This economic growth during the last years was generated from the growth of both private consumptions and public investments, which were mainly financed from the loans of banking sector, remittances, substantial growth of public spending, and also from the foreign assistance. However, the economic growth of 2010 was primarily as a result of private sector contribution, namely consumption and investment in this sector, in contrast to 2009 when the GDP growth was due to the public sector. Year 2010 is characterized also by an increase in general consumption for 3.3% (0.9% in 2009), influenced by an increase in the consumption of private and public sector. Also investments grew in 2010, this increase was 7.8%, but was 2 percentage points slower than in 2009 (9.8% in 2009).

While in 2009 Kosovo's economy was characterized with deflation (-2.4%), during the 2010 the inflation rates rose when the consumer price index reached 3.5%. The high dependence of the economy on imports also affected the price movements in Kosovo, so inflationary pressures on the global level during 2010 made the economy of Kosovo to have increased inflation (increased prices of food products, oil derivatives).

Labour market is in deep problems, where the unemployment rate reached up to 45% [Statistical Office in Kosovo, 2010], and continues to be a challenge for the economy of Kosovo. Based on the data from the Ministry of Labour and Social Welfare (MLSW), during 2004–2010, on average 30,000 people per year were registered as new jobseekers, while the average number of new job places for one year was about 7,500. It is suggested that 80% of employees in Kosovo are employed in the private sector, while in the public sector which is considered as an important employer, work the remaining (20%) of the total number of employees in the country (MLSW).

The effects of the global financial crisis were felt indirectly in the economy of Kosovo.

Table 1. The most important macroeconomic indicators for Kosovo, 2006–2010

Description	2006	2007	2008	2009	2010
Gross Domestic Product (GDP) in millions of Euro	3,120	3,400	3,757	3,917	4,119
GDP growth (annual % based on constant local currency)	4.0	5.0	5.4	4.0	4.6
Inflation, average consumer prices (annual %)	0.6	4.5	9.2	-2.4	3.5
Unemployment as % of total labour force	44.9	43.6	47.5	45.4	45.0
Remittances in millions of Euros	-	515.6	535.4	505.6	511.6
Gross Domestic Product per capita in Euros	1,486	1,593	1,789	1,795	-

Source: Central Bank of Kosovo, 2010; Macroeconomic Department MEFRK; Statistical Office...]

The increased unemployment rates in Europe and in Northern America had contributed to the reduction of remittances from the Diaspora in Kosovo, which in 2009 decreased by 5.6%, but in 2010 the Kosovar Diaspora remittances recorded a slight increase compared to 2009 due to recovery of the economy. While remittances have contributed to the reduction of poverty, they had no significant role on the acceleration of the economic activity. In 2010, in the banking market of Kosovo operated eight commercial banks, six of which were with foreign capital and two of them with domestic capital. The Banks with foreign capital dominate the banking market in Kosovo and which managed 90.2% of total banking assets in 2010 (91.1% in 2009). The remaining assets (9.8% in December 2010) were managed by two locally owned banks [Central Bank of Kosovo, 2010]. The performance of the banking system in Kosovo in 2009 was weaker than in 2008. Kosovo's banking system closed in 2009 with a net profit of 29.6 million Euros, which represented a profit of about 30.5% lower than in 2008. It may be concluded that this reduction in profits, as seen above, is a result of the decline in lending, while spending followed a trend of growing at higher pace than revenues. This reduction of net profit had a negative effect on the main indicators of profitability of banking sector such as on the average return on assets (ROA) and average return on equity (ROE). While the ROA fell from 2.4 in 2008 to 1.4 in 2009, the ROE fell from 24.7% in 2008 to 13% in 2009. The banking sector had revenues with amount of 201.5 million Euros during 2009 which was only 3.3% higher than the revenues in 2008, while this revenue growth in 2008 was about 24% compared to 2007. The main reason for the decline in the revenues of the banking sector was the decrease in lending by this sector which then caused the decline in the revenue from interest on loans and as such had a negative effect on the total revenues. If in 2008 the annual growth of interest income was about 36.3%, during 2009 the revenues from interest on loans would record an annual increase of only 13.9%. Also, another important factor in the decline of the banking sector's revenues was the decline of the interest rate of EURIBOR European interbank market, which caused a sharp decline in revenues from placements in foreign commercial banks. These revenues in 2008 were 12.0 million Euros, while in 2009 they were only 2.8 million Euros. In general, the revenue structure of the banking sector is similar to previous years, and interest incomes are the main drivers of the banking sector revenues by participating with 81% in total revenues.

On the other hand, while the revenues fell, the expenses in 2009 in the banking sector grew at a higher pace than the revenues did but fortunately did not cause losses as the revenues were much higher. The expenses in 2009 rose by 17.7% compared to 2008, reaching a value of about 171.3 million Euros. However, a positive factor in this regard is the fact that also in expenses there was observed a lower rate of growth compared to 2008, when expenses grew by an annual rate of growth of 26.3%. This happened mainly because of the increase in general administrative expenses during 2009 by only 1.2%, in contrast to 2008 when these expenses increased by about 23.4%.

Table 2. Income Statement of banking sector in Kosovo, in millions of Euro

Description	2006	2007	2008	2009
Revenues				
Revenues from Interest	88.8	117.9	155.7	163.2
Revenues from Non- Interest	25.2	39.5	39.3	38.2
Total Revenues	114	157.3	195	201.5
Expenses				
Interest Expenses	19.9	26	37.3	51.6
Other Expenses, except Interest	19.6	19.9	21.9	32.6
General Administrative Expenses	54.8	69.7	86	87
Total Expenses	94	115.6	145	171.3
Net Revenues				
Operating Net Revenues	25.5	41.7	49	29.6
Net Revenues before Taxes	26.6	41.3	47.6	28.9
Provisions for Taxes	6.4	7.9	11.2	3.6
Net Profit/Losses of the period	20.2	33.5	36.4	25.3

Source: [Central Bank of Kosovo, Annual Report 2010].

The category of general expenses and administrative expenses continue to represent about 50.6 % of total expenses, representing the largest category of expenditures, even though their participation in 2009 was 8.3 pp lower than last year. From the above table, it can be seen that the expenses for provisions on loans, which are part of the Non-Interest Expenses, reached a value of 25.7 million Euros in 2009 or in growth terms an increase of 51.3%. This increase was caused by the growth of non-performing loan which increased from 3.3% in 2008 to 4.3% in 2009. The participation on non-performing loans on total loans recorded even more increase in 2010. In 2010 the non-performing loans increased for 1.4 pp (from 4.3% in 2009 to 5.8% in 2010), but even though the non-performing loans of the banking sector of Kosovo increased they remain to be the lowest compared to the courtiers of South East Europe [Central Bank of Kosovo, 2010].

THE IMPACT OF THE GLOBAL FINANCIAL CRISIS IN THE BANKING SECTOR OF KOSOVO

The financial institutions operating in Kosovo, such as banks and microfinance institutions, base their operation mainly on local deposits and loans. As a result there is no much presence of the international financial markets which in one form or another was beneficial in isolating our country from its exposure to the recent financial crisis. Most of the banks use fixed interest rate, more specifically there is only one bank that offers interest rates using EURIBOR as the basic interest that may be affected from the behaviour of the international financial markets.

Secondly, the financial crisis may have had an effect on remittances sent to Kosovo from the emigrants working and operating in the Diaspora. The money sent from abroad countries to Kosovo, for many families serve the only source of income as the unemployment rate in Kosovo is high up to 45% in 2010 according to the SOK. As a result of financial crisis the remittances decreased because some of the Kosovar employees working abroad lost their jobs as big corporations reduced the number of workers in order to reduce the costs to survive the crisis. Specifically, the increase in the unemployment rate in Europe and North America has contributed to the reduction of remittances from the Diaspora in Kosovo, which in 2009 decreased by 5.6% compared to 2008.

Thirdly, Kosovo faced also a negative effect in the FDIs, because many strong economy fear to enter in investments during the recession phase which was due to the financial crisis. During the recent years, the highest level of FDI in Kosovo was in 2007 when it reached up to 440 million Euros, followed by a slight decrease in 2008 and 2009, due to many domestic factors including the impact of global financial crisis. During the 2009 the FDI in Kosovo declined by 20%, compared to 2008.

Overall, due to the decrease in the amount of lending, decrease of remittances and FDI, it can be suggested that the recent financial crisis did have an effect in the Economy of Kosovo but which was lower than in other countries. The Central Bank of Kosovo has taken all the reasonable steps to prevent the economy from the crisis. Capital index indicates capitalization for 17%, the liquidity reserves are quite safe, there was an increase in assets by 30%, with a slight increase also in profit. The Banks in Kosovo are quite dependent on local markets, they have more deposits than loans, which in this case is a positive indicator to prevent occurrence of the crisis in Kosovo. During 2009, the new banks entered in the banking market have increased the competition making the interest rates offered to the client to be somehow more favorable. However, all the financial institutions operating in Kosovo indicate that they are very careful in evaluating loan applicants, in order to ensure the highest probability on the returning capacity of the borrower. Despite the fears expressed by the banks for possible effects of financial crisis, during the year there has been a sustainable growth of new customers who are registered with their bank.

The main conclusions that can be made from the research are:

- The effects of the global financial crisis in Kosovo were very low,
- Kosovo's banking sector is secure and will not be affected from the global financial crisis because of low exposure to international financial markets,
- There is the possibility of decline of FDI and other donations and also of remittances,

THE IMPACT OF THE GLOBAL FINANCIAL CRISIS IN THE BANKING SECTOR OF ROMANIA

The financial crisis of 2008, which started in the summer of 2007, has now assumed global manifestations. The initial channel of the crisis was the real estate market, which hit major companies in European countries (Great Britain, Ireland, Italy, and France). In addition, the real estate crisis followed by the financial crisis led to a significant worsening of the credit risks in these countries.

At the end of 2008, in Romania there were 42 banks with assets totaling 79 billion Euros. The Romanian banking system is dominated by banks with foreign capital and foreign owned. Their assets represent 88.1% of total banking assets in December 2008.Market share of the banks with state capital was only 5.3% at the end of 2008.

Competition in the banking sector remained strong, banks continuing to expand rapidly their network units. The number of their units stood at 6,549 in December 2008, increasing by 19.5% compared to the end of 2007. The dynamic of credit activity remained high up in September 2008, but it stopped rapidly in the last quarter of 2008, when the credit international market has been blocked (the capacity of local banks to attract funds from outside dropped).

Since October, banks' aversion to risk increased, and they started to restrict credit terms.

In the second half of 2008, the banks have focused their attention mainly on the attraction of deposits. They have aggressively increased interest rate paid on deposits to attract individual and business depositors, both in the national currency and in foreign currency. Increases in the interest rates paid on deposits were higher than increases in interest rates on loans and it started to put pressure on the decline of the net margin of interest in the last quarter of 2008 [Nistor, et al., 2010].

According to the Romanian economic experts, Romanian banking sector is very affected by the global financial crisis, there are made changes of interest rate of monetary policy, of interest rates charged on loans and deposits, while the banks' bad debts were increasing. Overall, the crisis led to a loss of confidence in the banking system, and it was a priority now to regain the trust of bank's customers.

In Romania, the international financial crisis and changes in credit standards have resulted in a decrease in applications for mortgages. Lending in Romania contracted significantly since the fall of last year for two reasons. On one hand, the central bank's new crediting norms intended to limit borrowing risks, entered into force in October 2008 and forced banks to take extra-measures. On the other hand, the first buds of the economic crisis started to show in Romania at the same time and affected the lenders' liquidity, hampering lending. As an effect of the economic crisis, loans to people and companies in Romania clutched by 1.5 billion Euros in January 2009 to 48.26 billion Euros despite a 4.2 percent advance in December 2008 [Driga, Guta, 2010].

According to the data of the National Bank of Romania, the loans in local currency decreased by 1.1% in January in real terms, for the fourth month in a row, while loans in foreign currency (expressed in Euros) dropped by 0.1%, compared with 1% last December. At the end of 2008, development of lending standards and terms regarding both, companies and households, has confirmed the significant tightening, more pronounced in household lending.

There are an increasing number of individuals experiencing significant delays in reimbursement rates so the bad debts of population increased in December 2008, with 71% compared to the same period last year. Most bad debts (of population and companies) are loans in the national currency, totaling over 400 million Euros. A conspicuous place in the list is occupied by the persons from Bucharest, that have total bad debts of 170 million Euros (one of the reasons is that they have the biggest value of loans from banks – over 18 billion Euros) [Nistor, et al., 2009].

Share of loans classified as doubtful or loss in total household borrowing increased almost three times at the end of March, to 6.03% from 2.17% at the end of first quarter of 2008. While the loans affected by arrears on at least one day, reported to total loans of the population increased from 6.08% in March 2008 to 13.3% in February 2009. In table number 3 is presented the percentage of nonperforming loans to total loans.

Table 3. Bank Nonperforming Loans to Total Loans

%	2006	2007	2008
Austria	2,1	1,7	…
Bulgaria	2,2	2,1	2,4
Czech Republic	3,6	2,7	3,1
Greece	5,4	4,5	4,7
Italy	4,9	4,6	…
Poland	7,4	5,2	4,4
Romania	7,9	9,7	9,8
Serbia	4,1	3,8	5,3
Hungary	2,5	2,5	2,9

Source: [IMF, 2009].

It is imperative to use every lever available to try to solve the current problems but, however, banks must not lose sight of the need for innovation and development of all aspects of banking activity. This goal will be reached by the need of the credit institutions to improve efficiency and productivity. Operations must be streamlined, transactions' cost reduced as possible and the products and banking services rethought.

CONCLUSIONS AND RECOMMENDATIONS

It can be concluded that Kosovo as the least integrated region could avoid the full impact of the global financial crisis on its economy. Research has suggested that the effects of the crisis have been particularly apparent in connection with the trade sector and remittances, where the crisis has mainly hit the exports of goods by making them lower. The crisis has affected the employment of emigrants living in the Diaspora which has direct negative impact in the remittances to Kosovo. Regarding the banking system, it is suggested that it has not been hit by the crisis, expressing the main effect of the significant decline in lending in comparison to the previous year.

The data for the GDP growth for 2009 is admirable as Kosovo recorded a growth rate of 3.8% when most of neighbouring countries were in deep debt problems. However, it should be clarified that the main drivers of growth in Kosovo, which has helped in the alleviation of the crisis, has been the high level of public investment that has absorbed about 20% of the state budget [EC, 2009; IMF, 2009]. This stimulation, which incidentally coincided with the offset of the crisis, helped the economy to considerably maintain a sustainable level of aggregate demand.

In fact, there have been two events that have offset the impact of the crisis in the case of Kosovo: there has been a low level of economic integration of Kosovo, and, there has been the definition of government priorities in terms of capital investment.

However, the policymakers in Kosovo should reassess the economic integration particularly in the future, because even though it proved to be a fortunate element in mitigating the crisis, the economic disintegration is actually one of the main obstacles for further economic development of Kosovo. In the medium term, political steps should be concentrated to the direction of increasing the level of economic integration, which is shown as the determined for economic development in the ex-communist countries during the past two decades.

However, the best answer to the economic crisis remains on the maintenance of macroeconomic stability – an increase of consumer price control, consolidation of public finances, aiming at the reduction of public debt in periods of economic growth, which would increase the scope for countercyclical budgetary policies in periods of economic downturn. Money and loans should follow a moderate growth, to the extent necessary to facilitate economic transactions and not be threat to the country's financial system.

The most fundamental and undeniable conclusion by all for the recent financial crisis is this: the high level of globalization of the economy, trades, or global finances favoured the rapid spread of crises in global level as well as its infection of almost all countries of the world. On the other hand, because Romania is much more open to international financial institutions compared to Kosovo (88.1% of the assets of the banking sector of Romania are with foreign capital), the effects on the global financial crisis were much higher. Even though the banks tried to mitigate the effect of crisis by changing the interest rate on loans and deposits, the banks' bad debts were increasing.

Overall, the crisis led to a loss of confidence in the banking system, and it was a priority now to regain the trust of bank's customers. One of the consequences is the decrease in applications for mortgages, and where the loans in local currency and foreign currency decreased. In the same time also the non-performing loans rose up to 9.8% in 2008.

To prevent the crisis the Central Bank of Kosovo has taken all the reasonable such as the capital index indicates capitalization for 17%, keep safe the liquidity reserves, and increased the assets by 30%, with a slight increase also in profit also the National Bank of Romani followed prudent policies to mitigate the crisis such as slowing down the expansion of credit to the private sector, supporting lending in domestic currency to the detriment of foreign currency credit, limited overall risk exposure, low share of overdue and doubtful loans in total loan portfolio (1.1% as of September 2008) [Driga, Guta, 2010].

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Summary

Financial crises are neither a new nor an unknown phenomenon. They often occurred over the recent centuries, one after another, creating the impression that no one wanted to learn to draw the appropriate conclusions as to the causes of their occurrence and consequences, often disastrous for countries, continents or the entire globe.

Effects of the 2007 financial crisis, which originally broke in the USA, continue to have impact even today not only in the country where it broke first. Its extension in almost all developed countries seems to have revealed all the negative consequences of globalization, where the dependence of economies on one another would cause the domino effect affecting all the countries. Finances of the world were shocked and rapid fluctuations were reflected in the stock.

Despite the fact that the global financial crisis has not hit directly Kosovo, its economy indirectly has felt the effect of the crisis. The purpose of this research is to assess the implications of the global financial crisis in the banking system of Kosovo, and also to identify measures that the Central Bank and the Government should undertake in order to protect the economy from external implications. This research also will compare the impact of global financial crisis in the banking system of Kosovo with the one of Romania, as a country which has a larger coverage than Kosovo in the international financial markets.

Porównanie skutków globalnego kryzysu finansowego dla systemu bankowego w Kosowie i Rumunii

Streszczenie

Kryzysy finansowe nie są ani nowym, ani nieznanym zjawiskiem. Często pojawiały się na przestrzeni ostatnich stuleci, co może sugerować brak chęci wyciągnięcia właściwych wniosków odnośnie ich przyczyn i konsekwencji, często katastrofalnych dla państw, kontynentów czy całego globu.

Skutki kryzysu finansowego z 2007 r., który rozpoczął się w USA, wciąż oddziałują nie tylko na to państwo. W niemal wszystkich rozwiniętych krajach kryzys ten ujawnił negatywne konsekwencje globalizacji, która powoduje, że współzależności gospodarek mogą być przyczyną efektu domino oddziałującego na wszystkie kraje. Światowe finanse doznały wstrząsu, a gwałtowne fluktuacje miały swoje odzwierciedlenie w aktywach.

Pomimo faktu, że globalny kryzys finansowy nie dotknął bezpośrednio Kosowa, gospodarka ta pośrednio odczuła jego skutki. Celem badań jest ocena implikacji globalnego kryzysu finansowego dla systemu bankowego w Kosowie, jak również identyfikacja środków jakie powinien podjąć bank centralny i rząd dla ochrony gospodarki przed zewnętrznym oddziaływaniem. W badaniach porównuje się także wpływ globalnego kryzysu finansowego na system bankowy w Kosowie i Rumunii, jako państwa, które ma większy niż Kosowo udział w międzynarodowych rynkach finansowych.