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Comparative Analysis of Interest Rates in Western Ballkan Countries, Kosova Perspective

Qazim TMAVA[1], Shefket JAKUPI[2,*]

Faculty of Economy, University of Mitrovica "Isa Boletini", n.n. 40000 Mitrovica, Republik of Kosovo
[1]qazim.tmava@umib.net; [2]shefket.jakupi@umib.net
*Coresponding author

Abstract— *Interest rates in savings, lending as well as interest rate spread, for years has been the topic of debate in many developed and developing countries.*
Interest rates in Western Balkan Countries, due to major structural, political and economic changes have incited debate within academics, businesses, households, public and even state agencies.
Therefore, in this paper we aim to shed light on interest rates of deposits, loans as well astheir spread in WBC, with a special focus in Kosovo.
Keywords— ***Interest rate, deposits, lending, interest rate spread, non-performing loans.***

I. INTRODUCTION

Western Balkan Countries (WBC)[1], despite their distinctive economic, political and social traits they are characterized with sluggish economic recovery rates, trade imbalances, fiscal deficits and dependency from Foreign Direct Investments (FDI). Moreover, the level of remittances in comparison to the GDP is very high.
The financial structure of these countries is dominated by banks, therefore it can be concluded that they are bank-centered. Among the main functions of the banks from WBC is allocating financial resources from surplus units to deficit units. It can be rightfully concluded that the financial system of these countries constitutes for the "fresh meat" of these economies, therefore it is of outmost importance that it is healthy and stable. In financial systems dominated by banks, it is precisely banks that represent the main channel of financing the needs of the economy. Therefore, malfunctions of the banking sector have consequences in both macroeconomic and microeconomic aspects of the economy.
In this regard, interest rates, due to major structural, political and economic changes in these countries have incited debate within academics, businesses, households, public and even state agencies.
Therefore, in this paper we aim to shed light on interest rates of deposits, loans as well as their spread in WBC, with a special focus in Kosovo and the impact of interest rates on its economy.

1.1 Objective, Approach and Methodology

The objective of this paper is to review, compare and analyze interest rates (on deposits and loans) as well as the interest rate spread in WBC and their impact on the overall economy.
Due to the nature of the research, the only available option to study remains the analysis of the quantitative data collected from secondary sources.
While comparing the yearly statistical data (2008-2015), collected from different secondary sources: World Bank, IMF, annual reports from monetary authorities of respective countries, concrete results and the follow-up recommendations will be generated.
The paper is structured as follows: the second section reviews the literature regarding interest rates and their spread in different countries of the world, as well as WBC where Kosovo lies. The third section provides stylized facts and statistics regarding Kosovo economy and its banking system. Fourth section treats the comparative analysis of interest rates and their spread in WBC and specifically Kosovo. Conclusions are offered in the last section.

II. LITERATURE REVIEW

Interest rates, for years have incited debate at academics, the public, politicians, financial industry and businesses be it in developed or developing nations.
The starting point for analyzing the determinants of interest rate is the model established by Ho and Sanders (1981). They used two-stage procedures for econometrical assessment of the relative impact of indicators relative to micro as well as macroeconomic aspect, in shaping interest rates and their spread. They reviewed a sample of banks

[1] Western Balkan Countries (WBC): Albania, Kosovo, Monte Negro, Serbia, FYR Macedonia, Bosnia and Herzegovina.

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during 1976-1979 evaluating the so called "pure margin"[2] for the first level in the relationship of this margin with a preset number of variables posited by the theoretical background.

A similar approach is used by Brock and Rojas-Suarez (2000) while reviewing interest rates in six countries of Latin America. They conclude that interest margin is dependent from liquidity and adequacy of capital in micro level while in macro level it is dependent from interest rate volatility, inflation and economic growth. The same approach is also used by Muados and Fernandez de Guevara (2004) who review nominal interest margin (NIM) through one and two-leveled empirical approach.

Demirguc-Kunt and Huizinga (1999) examined interest rate margin in 80 different countries of the world during the 1988-95 period. While reviewing different variables regarding bank features, macroeconomic indicators, taxes and financial regulations, they conclude that the interest rate margin is impacted directly in a positive correlation by bank capitalization, the total participation of loans in general assets, participation of foreign capital in banking system, operating cost but also from inflation and real interest rates in a short term financial market.

Angbazo (1997) examined net interest margin in US banks during period 1989-1993, and find out that default risk, opportunity cost of noninterest bearing reserves, leverage and the management efficiency are positively related with interest margin, while likuidity have a inverse impact.

Naceur (2000) while working on interest rate margin in Tunisia during 1988-2000 period, also concludes similar results.

Wong (1999) finds out that interest rates are positively related with the power of the banking sector in the financial market, operating cost, credit risk and interest rate risk. Nevertheless, the increase of bank equity, where bank faces low risk of interest rate, is found out to have a negative impact in the interest rate margin.

Beck and Hesse (2009) review the reasons why interest rates in Ugana, consistently are high and with excessive margins. They found out that T-bill interest rates and the institutional deficiency are the main determinants of high interest rates. Nevertheless, macroeconomic factors: high inflation and exchange rate have a significant impact in interest rate spread.

Moreover, Maudos and Guevara (2004) include operating cost as a determinant of Net Interest Income and evaluate the model for some core European countries (Germany, France, Great Britain, Italy and Spain) during the 1993-2000 period. Further on, Hawtrey and Liang (2008) examine determinants of Nominal Interest Margin (NIM) in 14 countries of OECD, during the 1987-2001 period.

Rebei (2014) in Solomon Isles, examined determinants of bank interest rates while including banking features, banking sector, macroeconomic indicators and legal indicators. The generated results indicate that the level of activities, income expenditure (overhead cost), level of bank concentration as well as some other macroeconomic variables (such as monetary policy rate, economic growth) significantly impact the Nominal Interest Margin.

Different authors use similar variables, Crowley (2007) for English-speaking African countries, Samuel and Valderrama(2006) and Gelos (2006) for Latin America countries. Gounder andSharma and Gounder (2011) research determinants of Nominal Interest Margin (NIM) of banks in Fiji for the 2000-2010 period, during which they conclude that NIM is positively correlated with implicit interest payments, operating cost, market power and credit risk; whilst NIM is negatively correlated with management quality and liquidity risk.

Cihak (2004) while analyzing interest rates and the spread between them in Croatia during the 1999-2003 period, concludes that interest rate spread is a function of deposit interest rate, total assets, market participation, nonprrforming loans participation in Total Assets, liquidity, capital adequacy, T-bills rate and EURIBOR rate. Empirical results show an inverse relationship of interest rate in one side and total assets (bank size), liquidity and foreign ownership of assets on the other side.

Lepetit et al., (2008), on the other hand, while studying 602 European banks during the .period, finds out that the majority of income is generated by fees and commissions and is accompanied with low net interest margin.

Durguti, Arifi, Tmava and Kryeziu (2014) using the time series for period 2006-2013, investigates empiricaly the main factors (capital adequaty ratio, management efficiency ratio, asset quality ratio, liquidity ratio, investment to asset ratio, loan to asset ratio, and deposit to asset ratio) which have positive or negative impact on interest rate on loans, in Kosovo.

Lastly, Neli (2015) while analyzing macroeconomic and market determinants, in interest rate spread in Albania, by analyzing panel data for the 2005-2014 period concludes that Net Interest Rate Spread is negatively correlated with the level of banking sector development and discount rate while positively correlated with inflation and money supply. Furthermore, Claeys and Vennet (2008) conclude that Nominal Interest Margin in developing nations is higher

[2] The pure margin, shows the difference between interest rates on loans and deposits.

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due to low efficiency and low level of competition in the market.

III. SOME STYLIZED FACTS REGARDING KOSOVO ECONOMY

The following section present a panoramic view regarding Kosovo economy.

Table.1: Some macroeconomic indicators in Kosovo 2008-2015 (mil EUR)

Indicators	2008	2009	2010	2011	2012	2013	2014	2015
GDP nominal (EUR Milions)	3.616	4.070	4.402	4.815	5.059	5.327	5.567	5.807
GDP per capita (EUR)	2.008	2.261	2.446	2.675	2.810	2.959	3.075	3.277
Inflation-deflation % (HCPI)	9.4	-2.4	3.5	7.3	2.5	1.8	0.4	-0.5
Export	0.198	0.165	0.296	0.309	0.276	0.294	0.324	0.325
Import	1.928	1.935	2.157	2.492	2.508	2.449	2.538	2.635
Cover percentage	10.3	8.5	13.7	12.8.	11.0	12.0	12.77	12.33
IHD	0.370	0.287	0.369	0.384	0.229	0.280	0.151	0.309
Remitances	0.609	0.586	0.584	0.492	0.516	0.573	0.622	0.665
Unemployment rate%	47.5	45.4	n|a	n|a	30.9	30.0	35.3	32.9

Source: Annual Reports of CBK, by years,
Annual Reports of Kosovo Agency of Statistics, by years

Kosovo economy, despite the permanent increase of GDP, it still remains the least developed nations of Europe.
GDP per capita achieves only 3.277,00Eur (KAS, 2015). Kosovo's economy is highly supported by imports while export is at a relatively low level. The coverage of imports by exports is at a very low percentage, approximately at 8.5% (2009) and 13.7 % (2010). In 2015, this percentage would only go up to 12.33%. This results at a large trade deficit. FDI level is relatively low and is approximately 2.7% of the GDP (2014) respectively 10.23% (2009).
Remittances injected into the economy through official channels display a more stable state and on average vary from 14.39% (2009) to 10.19 % (2012). It is argued that this value is three times greater due to remittances injected through unofficial channels. Nevertheless, the majority of these assets are used for consumption rather than investment.
A major problem for the economy of Kosovo is the unemployment rate in Kosovo which is the highest on Europe. This rate varies around 47.5% (2008) and 30.0% (2013). Furthermore, youth unemployment according to KAS(2016) is approximately 60% which illustrates a major economic issue for the country.

3.1 Banking sector framework in Kosovo

Kosovo as a new economy, established after the armed conflict of 1999, started from the very bottom. Institution building also started from this year. The first financial institution created was the Bankingand Payment Authority (forerunner of Central Bank of Kosovo, established 2008), Shortly after the establishment of the legislative framework, ten commercial banks also were established their offices.
Despite the fact that the banking system is relatively young, all financial parameters in a permanent manner have shown growth of the financial system, where at the end of 2017, the assets of this sector are valued at 3,387.3 billion euro. In this regard even the value of deposits, loans, the total amount of transactions, income… show permanent growth.
Therefore according to IMF (2011) the Kosovo banking system is a success story. This in fact reflect confidence, stability and sustainability, as very important factors that influence the trust in the banking system. Nevertheless, it is argued that interest rates in Kosovo, especially in credit loans have been and still are very high.
The following section, illustrates some macroeconomic indicators of the banking system in Kosovo.

IV. ANALAYSIS AND COMPARISONS OF INTEREST RATES WITH WESTERN BALKAN COUNTRIES

Interest rates in WBC, for years have incited debate at academics and business circles. Interest rates on deposits and loans reflect the business environment where banks operate.

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The following section reviews interest rates (on deposits, loans and the interest rate spread), as well as their trends throughout the years.

Table.2: Interest Rates on Deposits

Countries	2008	2009	2010	2011	2012	2013	2014	2015
Albania	6.8	6.8	6.4	5.9	5.4	4.2	1.9	1.39
Kosova	4.4	4.0	3.4	3.6	3.7	2.4	1.1	1.15
Macedonia	5.9	7.0	7.1	5.9	5.1	4.4	3.7	2.88
Montenegro	3.8	3.8	3.7	3.1	3.3	2.9	2.1	1.46
Serbia	7.3	5.1	11.3	9.8	10.6	7.9	6.8	-
B and H	3.5	3.6	3.2	2.8	3.2	3.0	2.7	2.06

Source: World Bank,
Annual reports of National banks of respective countries, by years

Initially in Kosovo interest rates on deposits in the banking system, especially during the initial years of the banking system establishment, have been relatively high therefore quite attractive for savings. The main reason behind this was lack of financial assets in financial markets, given that deposits were the only source of financial income for commercial banks. Afterwards, especially during the last three to four years, there is a drastic decrease of interest rate on deposits. As seen from the table above, the interest rate on deposit from 4.4% in 2008 decreases to 1.1% in 2014, with tendency for further decrease. This due to increase of the financial supply by savings on one side, while credit offer from commercial banks is limited, due to limited demand in economy for finantial assets on the other. Compared with the countries of the region, Kosovo and Albania have the lowest interest rate on deposits which in the year 2015 was only 1.15% and 1.39% respectively. Montenegro is the following one with 1.46%, Bosnia and Herzegovina with 2.06% and Macedonia with 2.88%. Currently, the highest interest rate on deposit is offered by Serbia with 6.8% which is three time higher than the majority of the region.

The following section reviews interest rate in credit loans in different WB countries by years:

Table.3: Interest rates on bank credit to the private sector

Countries	2008	2009	2010	2011	2012	2013	2014	2015
Albania	13.02	12.70	12.82	12.43	10.88	9.83	8.66	8.7
Kosova	13.80	14.10	14.31	13.86	12.86	11.07	9.60	7.40
Macedonia	9.68	10.10	9.48	8.87	8.50	8.04	7.46	7.00
Montenegro	9.24	9.40	9.53	9.69	9.56	9.39	9.41	8.93
Serbia	16.13	11.80	17.30	17.17	18.20	17.10	14.80	na
B and H	6.98	7.90	7.89	7.43	7.33	7.04	6.64	5.79

Source: World Bank,
Annual reports of National banks of respective countries, by years

From the table above it can be concluded that the interest rate on loans in Kosovo despite the fact that it experienced a decline throughout the years from 13.8% in 2008 to 7.4% in 2015, it still remains high. The highest interest rate on loans is currently in Serbia, Albania and Montenegro while the lowest is in Macedonia with 7.0% and BiH with 5.79.

The following paragraphs describe the Loan/Deposit ratio in the region throughout the years.

Table.4: Bank Credit to Deposits (Raporti:Kredi\Depozit)

Countries	2008	2010	2011	2012	2013	2014
Albania	54.80	61.11	58.71	57.06	54.79	53.61
Kosova	82.00	75.30	80.80	76.40	73.70	74.80
Macedonia	90.97	92.51	89.70	89.50	89.72	89.54
Montenegro	142.96	148.61	129.56	148.61	142.96	79.94
Serbia	109.34	116.81	119.98	116.81	109.34	119.84
B and H	141.32	137.26	124.60	115.33	111.57	106.03

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Source: World Bank,
Annual reports of National banks of respective countries, by years

The loan/deposit ratio in Kosovo, expressed in percentage, on average is one of the lowest in the region and varies from 82% in 2008 to 73.75% in 2013. Albania is the only WB country with a lower ratio where the average varies from 61.11% in 2010 to 53.61% in 2014. The rest of the WBCountries have a higher ratio, namely Montenegro has a radio of over 148.61% in 2013.

It is quite interesting to treat the interest rate sppread, which indicates the difference between the interest rate paid by the borrowers and the interest rate paid to the depositors.

In Kosovo, the net interest spread varies from 10.93% in 2010 to 6.5% in 2014. From this it can be argued that Kosovo, regarding net interest spread remains in a stable position.

The following section presents the net interest spread between borrowers and depositors in WBC, throughout the years.

Table.5: Lending-deposit interest rate spread

Countries	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Albania	6.2	5.9	6.4	6.57	5.46	5.66	6.74	7.3
Kosova	**9.4**	**10.1**	**10.93**	**10.24**	**9.12**	**8.68**	**8.20**	**6.54**
Macedonia	3.8	3.0	2.42	2.96	3.41	3.62	3.76	4.2
Montenegro	5.4	5.5	5.8	6.6	6.3	6.5	7.3	7.47
Serbia	8.8	6.7	5.97	7.41	7.63	9.15	8.00	-
B and H	3.5	4.3	4.73	4.64	3.68	3.96	3.97	3.17

Source: The Global economy.com The IMF,
Annual reports of National banks of respective countries, by year Author's calculations

As seen from the trend above, Kosovo has experienced a slight narrowing of the Net Interest Margin, especially during the last year whilst being comparable with the majority of the countries in the region. In this comparative analysis, BiH and Macedonia diplay the lowest difference noted between the two interest rates with respectively 3.17% and 4.2 % in 2015 while other countries reflect a larger interest rate spread.

Many authors draw direct lines between interest rates and non-performing loans. Therefore Farhan et.al (2012) emphasizes interest rates as the main indicator of non-performing loans. While, Ombala (2013) emphasizes that the increase of interest rates impact the bank's performance, increases lending cost which burdens the borrower and reduces the capacity of the borrower to pay.

The following section analyzes the level of non-performing loans from WB countries, throughout the years.

Table.6: Non-performing loansin WBC, throughout the years

Countries	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Albania	6.6	10.5	14.0	18.8	22.5	23.5	22.8	18.2
Kosova	**3.3**	**4.4**	**5.9**	**5.8**	**7.5**	**8.7**	**8.3**	**6.2**
Macedonia	6.7	8.9	9.0	9.5	10.1	10.9	10.8	10.31
Montenegro	7.2	13.5	21.0	15.5	17.6	18.4	17.2	16.7
Serbia	11.3	15.7	16.9	19.0	18.6	21.1	23.0	21.58
B and H	3.1	5.9	11.4	11.9	13.5	14.9	13.5	13.7

Source: The Global economy.com The IMF,
Annual reports of National banks of respective countries, by year

According to data from IMF as well as national banks from respective countries, Albania and Serbia are the countries with the highest level of non-performing loans (NPL) on the region.

The average NPL for these countries is 7-8 percentage points higher than the average of the region with 15-16%. Kosovo has the lowest level of non-performing loans which in 2015 was the only country with a one digit indicator with

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a total of 6.2%, which in fact is in the average of the analyzed period 2008-2015 with a total of 6.25%.

This is an important indicator which displays that in Kosovo, non-performing loans are not the cause of high interest rates on loans and the margin between them.

V. CONCLUSIONS

Interest rates on deposits, loans and the spread between them, for years have incited debate at cademics circles as well as business owners in all Western Balkan countries. Therefore, analyzing and comparing the generate data enabled the drawing of conclusion and their respective recommendations.

So far, after the review we can conclude that interest rates on loans in Kosovo have always been some of the highest on the region. Despite the fact that the gap between interest rates on savings and loans, has narrowed over the last couple of years, it still remains relatively high and above the average of the region.

So far, after the analysis, it can be concluded that the volatility of interest rates on loans in Kosovo is not dependent from interest rates on deposits as expected from the economic theory. Changes in interest rates on loans occur despite changes in interest rates on deposits. This conclusion is derived by the fact that during period of time there were major changes in interest rates on loans, whilst interest rates on deposits were almost static or vice versa, as it occurred in 2010 and 2013 respectively. This shows that interest rates on deposits are not a determinant of interest rates on loans (as would be expected from economic banking theory), but it is influenced by other indicators elaborated as follows:

- *Very high informal economy*: This is against fair competition and stimulates unfair competition. It is evaluated that in Kosovo, the informal economy varies from 30-35% of the GDP of the country (BTI, 2016)

- *Unstable and unaudited financial statements for businesses:* Many business maintain double-entry bookkeeping and do not have audited financial statements. Businesses provide different financial statements when applying for loans at commercial banks while they provide different financial statements at tax agencies. This increases the cost of obtaining genuine and honest information for the actual position of the business and, in turn, increases the cost of their financing which directly reflects in the interest rate on loans.

- *Currently banks in Kosovo have created an oligopoly***:** three of the "big banks" in Kosovo (Procredit Bank, Raifeissen Bank and NLB Bank), cover 70% of the banking market in total and do not face serious competition. This big three is interested in maintaining the status quo as they harvest good profit in a country where the GDP per capita is only 3.277 Euro (KAS, 2015).

- *Credit risk (measured by the nonperforming loans / total loans):* shows that the level of non-perfforming loans in Kosovo, in permanent manner has shown the lowest values in the region. This is an important indicator which implies that interest rates could lower even further and consequently even the net interest margin to narrow. However, as an economic indicator, has not influenced, or the influence was abysmal in decreasing interest rates or the net interest spread.

- *The drastic fall of interest rates on deposits:*it was expected that this would reflect in decreasing interest rates on loans as well if the competition would be fair. Despite the fall of interest rates on loans, this was insignificant therefore even the net interest margin of 8.2 % in 2014 is still relatively high.

- *The business environment has high risk:*(economic, financial and institutional environment in Kosovo is far from perfect). This happens not due to the lack of adequate legislative framework but due to the poor implementation and enforcing of these laws. Contacts enforcement and the executing of collateral is made difficult.

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