of end-year 2007, return on investment of average assets was 1.6%, while return on equity totalled 20.7% being close to end-year 2006. Despite the negative impact of the high credit rate pushed by the market competition, credit quality has changed moderately relative to end June 2007 and is considered as good. Credit denominated in foreign currency continues to dominate in the total credit portfolio while average maturity term of credit has been extended. As a result of investments in higher risk assets, the banking sector has maintained the annual downward tendency of capitalization and liquidity indicators, although the latter are considered in satisfactory levels and are higher than the other regional countries'. The capitalization of the banking sector as of end period, obtained through the capital adequacy indicator, was 17.1%, which is 0.9 percentage points lower than the previous year. Liquid assets of the banking sector share 49.8% of total assets, dropping by about 7.8 percentage points relative to the end-year 2006.

Given the increased level of risk in the Albanian financial system, there is a an ever-increasing need for developing an efficient financial market, which enhances the capacities of the market participants and the economic agents in general to effectively manage the consequences of an unfavourable financial setting. The inadequacy in the current development of the financial market may serve as a natural protection mechanism to the transmission of financial difficulties to the different market mechanisms and in the relations with the international financial markets. However, this effect will be temporary. It is for this reason that the market participants should contribute to building a developed and efficient financial market as in this way they enhance the opportunities to rightly set the price of their products, to identify the exaggerated shifts in the price of different assets and to carry out the necessary transactions in the properly extent and duly time. By acting so, the market will provide an effective and automatic mechanism, which alleviates the consequences of a difficult financial situation. On the other side, by taking certain actions in a market which acts efficiently, the central banks achieve better their monetary policy objectives, hence contributing to the overall financial stability.

2. INTERNATIONAL DEVELOPMENTS DURING THE YEAR 2007

The developments in the international financial markets and the macroeconomic indicators of developed countries generally showed an ongoing deteriorated situation during the year 2007. Meanwhile, emerging countries have displayed a satisfactory resistance to this unfavourable situation. The upsurge of problems related to the non-performing mortgage loans in the USA in July 2007 shoved a deteriorated chain process which peaked with the significant and almost complete reduction of liquidity in the interbank markets and with the thorough absence of trading for certain instruments. The latter were created to facilitate the constant financing of mortgage loans from institutional investors (including banks, investment funds, other intermediators etc.) with different preferences with regard to the level of financial risk or return on investment. Central banks have continuously intervened to provide the necessary liquidity in the market. At the same time, the growth of global demand for foods, raw material and energy, pushed by the swift development of countries like China, India and Brazil and by the consequences on the supply of foods, increased the inflationary pressures in particular in the EU and the surrounding countries. However, the economic activity in the emerging countries grew at stable rates as a result of the proper macroeconomic policies, the enhanced productivity and the growth of foreign investments. In the foreign exchange markets, the US dollar has reflected the difficulties the US economy is going through and the expectations for the interest rates in the developed markets, and has depreciated to other main foreign currencies and to the euro in particular.

2. 1. MACROECONOMIC ENVIRONMENT

2.1.1 USA

The US financial crisis generated by the fall in the price of real estates spread swiftly in the real economy through the reassessment of risk, the drop in the credit supply and the increase in the costs of debt financing. Subsequently, there is an increased possibility for a twist in the credit cycle and the decline of the economic growth. However, the drop of the US aggregate demand is expected to re-establish a better equilibrium in the international trade.

The deepening of US trade deficit and the relatively low interest rates during 2000-2005 affected the augmentation of capital inflows and the growth of investors' demand for debt securities with high return (and risk), including mortgage-backed securities. The containment of the price rise in real estates and the deterioration of the mortgage loans' quality for non-creditworthy borrowers caused problems not only in this market but also in other financial markets which due to the complexity and the lack of transparency in the recently established financial instruments were closely related to the performance of loans in this sector. The shock derived from the financial market deteriorated sharply the situation of some of the largest financial institutions, including banks reputable for their global activity and subsequently, the influence on real economy is assessed as being considerable.

Households' financial situation experienced a great shock as a result of the fall in the price of real estates, where most of their savings were invested in. Many of them who have been bank borrowers have found it impossible to renew the existing credit terms with more favourable terms and were obliged to accept new terms involving higher interest rates. It is for this reason that the number of household borrowers who have stated their incapacity to pay off the loan has increased significantly. On the other side, the corporates' financial situation may deteriorate in case of a turn in the credit cycle and of the tightening of financing terms as a result of the risk reassessment from the financial institutions and banks. The time extension of the tightening of financing terms for households and corporates will have a significant effect on the economic growth slowdown.

In order to reduce the negative effects the financial crisis may have on economic growth, the Federal Reserve has cut the key interest rates several times within a short period of time. At the same time, the US administration has approved a package for the tax relief of 150 billion US dollars to improve the households and corporates' finances. Despite these measures, there were strong doubts that the US economy would experience an economic recession (a significant decline in economic activity lasting for two quarters in a row), during 2007-2008. However, despite the significant decline in economic growth (which was positive but less than 1%), the US economy has not had a quarter with a negative economic growth yet. On the other side, the drop of demand and the economic slowdown, along with the depreciation of the US dollar in the foreign markets, are expected to affect the capital and merchandise trade inflows. The improvement of the trading terms is expected to reduce the trade deficit and augment the positive contribution of foreign trade to economic growth. Lastly, the continuous price rise in the energy products is propelling inflationary behaviours and has augmented the pressure on the Federal Reserve to attentively revise the loosened monetary policy conducted during the year 2007.

2.1.2 Euro area countries

The European economic growth decreased slightly during the past year, both for developed euro area countries and for emerging countries. As a result of the financial crisis, consumer confidence fell during the second half of the year 2007 and the expectations for the Euro area economic growth during the year 2008 were reassessed as downward. During the last quarter of 2007 and the beginning of 2008 were shown supply-side inflationary pressures which forewarn a neutral or tightening policy of the ECB, regardless of the expectations for the decline of economic growth.

Economic growth in the European countries grew by 3.7% on average in 2007, which is 0.1 percentage points less relative to the previous year (table 1). This decline has affected both developed and emerging countries. Economic growth mainly attributes to the high domestic demand, in particular in construction and transportation, and it has been advocated by a favourable financial environment which has been present in Europe for several years in a row. Reforms in the labour market and the moderate rise of wages in the developed EU countries have encouraged the establishment of new jobs and the fall of unemployment, hence providing a stable flow of remittances to emerging countries. The generated shock in the US real estates market is expected to affect the performance of non-financial corporates in the euro area in the future. The shock will be transmitted through the difficulties that several euro area financial institutions will experience in the form of large financial losses from the exposure to mortgage loans-related instruments in the USA. However, this influence is expected to be moderate.

The transmission of this shock may first occur through the tightening of financing (credit) terms as a result of the spread of shocks to different segments of the financial market, of the expectations for an unfavourable macroeconomic environment and of the increase in the cost of debt financing. In the period to follow, this could have consequences on the corporates' capital, the productive activity and on the corporates' return. Given the high financial leverage in some sectors – pushed by a stable and historical economic growth and by low debt interest rates – and the increase of debt payment costs, a similar situation increases the probability for the deterioration of financial institutions' loan portfolio, in particular of loans extended to high-risk businesses and to small companies. Corporates' return is expected to remain stable in the future owing to the stable domestic demand. However, there are certain factors such as the price rise of oil and raw materials and the fall of US aggregate demand that may influence the decrease of the return. The swift changes in the market vulnerability which would lead to the risk reassessment/repricing are also a concern. A long period of turbulences in the market may affect the companies and households' capacity to receive loans, hence contributing to the decline of economic growth.

Table 1 GDP growth and inflation in Europe

	GDP (real annual growth)			Inflation		
	2006	2007	2008	2006	2007	2008
Europe	3.8	3.7	3.2	3.5	3.3	3.1
Developed European countries	2.9	2.7	2.2	2.2	2.0	2.0
Developing European countries	6.6	6.3	5.7	7.2	6.8	6
European Union	3.2	3.0	2.5	2.3	2.3	2.3
Euro area	2.8	2.5	2.1	2.2	2.0	2.0
Austria	3.3	3.3	2.5	1.7	1.9	1.9
Italy	1.9	1.7	1.3	2.2	1.9	1.9
Greece	4.3	3.9	3.6	3.3	3.0	3.2
France	2.0	1.9	2.0	1.9	1.6	1.8
Germany	2.9	2.4	2.0	1.8	2.1	1.8
United Kingdom	2.8	3.1	2.3	2.3	2.4	2.0
Bosnia and Herzegovina	6.0	5.8	6.5	7.5	2.5	1.9
Serbia	5.7	6.0	5.0	12.7	6.4	8.8
Croatia	4.8	5.6	4.7	3.2	2.3	2.8
Macedonia	3.0	5.0	5.0	3.2	2.0	3.0
Montenegro	8.3	6.9			4.2	
Kosovo	3.8	1.7	6.2	0.7	1.3	-2.0

Source: European Central Bank estimations

Meanwhile, the inflationary pressures have become more persisting. At end-year 2007 inflation in the euro area jumped considerably over the ECB's objective, standing close to 3.3%, as a result of the price rise of oil and grains in particular in the last quarter of 2007. These unfavourable developments determined the stance of the ECB[1] not to lower the key interest rate of 4% which was maintained until the end-year. Inflation was even higher in the European emerging countries, signalling the risk for the overheating of the economy in particular in those countries which implement a fixed exchange rate regime.

Investments and consumption may drop in 2008 although the projections for households indicate a stable growth in employment and the decrease of the unemployment rate which would improve the available income during the projected time frame. ECB's macroeconomic projections published in March

2008[2] anticipate average annual real GDP growth in the range of 1.3% and 2.1%.

In the short-term future, the conditions of the financial stability in the Euro area cannot be defined with certainty. They will depend on the developments in the economic conditions – in particular of the US house market – and on the way banks will respond to an operational environment with numerous new challenges. The future will also depend on the way various initiatives and measures taken by the decision-makers and the financial industry will be implemented. They will aim at restoring confidence in the financial system and increasing its stability.

The influence of the financial markets turbulences on emerging markets was moderate due to their low exposure to the phenomena that generated the crisis. The velocity at which the situation of the liquidity in the market will return to normality and the extent of risk reassessment will determine in the future the indirect effects that the turbulences in the financial markets will have on emerging markets.

However, there are certain factors which may increase the impact of the financial crisis on the emerging markets as well. They mostly relate to the possible reduction of capital inflows owing to the reassessment of risk from investors; the deterioration of trading terms and remittances as a result of the economic growth slowdown in developed partner countries, the dollarization of the economy and the effects it has on the currency used in lending and of the tightening of financing terms in the domestic market because of the difficulties encountered in financing the activity in the foreign money markets. These factors will certainly have different effects on various countries depending on their production structure, financial market structure, on their position in foreign trade etc.

The Albanian economy is expected to be affected by the developments in the external macroeconomic environment. The Albanian banking system may be affected through the deterioration of households and corporates' financial conditions or through the shocks transmitted by the international financial markets. Consequently, these events anticipate an increasing credit risk, exchange rate risk and interest rate risk. The banking sector's vulnerability to these risks is further elaborated in part 5 of the present report.

2.2 FINANCIAL MARKETS

The relation between different financial market segments in the money markets strengthened, as a result of the return of loans in tradable instruments and of their repackaging and re-sale in several stages for investors with different risk preferentials. This situation caused the financial crisis effects to spread swiftly. Short-term interest rates increased substantially in the USA and in the Euro area, reflecting the shortage of liquidity and the reduced trading volume in a considerable part of the money market instruments. Foreign monetary authorities responded in order to stabilize the market by injecting liquidity (ECB, Federal Reserve, Bank of England, Swiss National Bank) and by cutting the key interest rates (Federal Reserve). These measures generated a temporary stabilization; however, credit risk and liquidity risk, expressed in the reduction of trading volume and the high interest rates for short-term borrowing, remained high. A gradual recovery of liquidity is expected to occur in the future, after the losses of financial institutions as a result of the risk repricing are made known. These losses may be directly or indirectly related to the mortgage-backed securities market and their liquidity positions.

The US financial crisis that arose in the mortgage market had an enormous impact over the money market given the strong relation between the financial instruments and the business nature of the institutions issuing them (box 2.1). Short-term interest rates in the money markets increased substantially as it is shown by the LIBOR rate (chart 1), although the expectations over the interest rate showed a downward tendency. The Federal Reserve has conducted an aggressive policy with regard to the cut of the key interest rate and the change of the open market operations framework, in order to improve the liquidity conditions in the financial markets and to prevent the excessive tightening of financing conditions and the decline of the economy. In September 2007, the key interest rate began to experience a rapid dropping cycle. By the end of 2007, the key interest rate had dropped to 4.25%, while in the first part of the year 2008 has reached 2.25%. To increase the opportunities for providing short-term liquidity in the market and maintain the trading conditions for some financial instruments, the Federal Reserve expanded the list of instruments to be used as collaterals by the financial institutions which are provided with liquidity by the central bank. It also increased the number of institutions by including non-bank financial institutions which are active in the securities trading and in risk undertaking. Despite the Federal Reserve actions in response to the crisis, the market conditions remained tense and the money market is expected to recover and stabilize at gradual rates. The uncertainties related to the evaluation of financial assets will remain present for as long as the extent of risk reassessment and of losses in the balance sheets of financial institutions and banks in particular, remains entirely unidentified.

Box 2.1 Relation between financial instruments and the spreading of financial crisis to different market segments[3].

The deterioration of mortgage loans in the United States and the decrease in the value of mortgage-backed securities led to turbulences in the financial system that spread swiftly to all its segments.

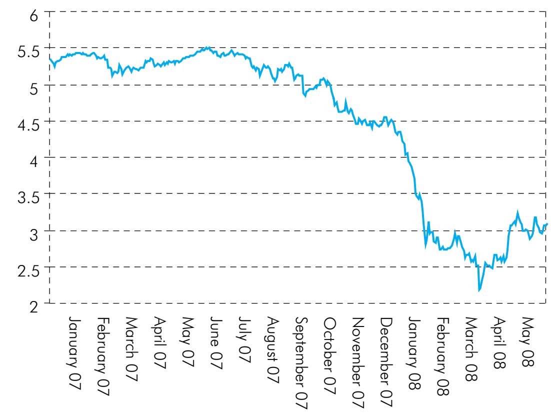
US money market was the most affected market, given that its participants began to worry about the risk of credit that funded these securities and began to collect liquidity in case of abrupt need.

A large part of mortgage loans in the USA is not held to maturity by banks or other institutions. They are sold to other investors in return to liquid funds. This process allows banks to grow their credit portfolio rapidly and fragmentize risk. Investors fund the purchase of these loans through the issuance of some securities known as 'Asset Backed Securities - ABS'). As the name itself indicates, these securities bear the risk characteristics of the credits they fund. Then, some investors repackage the ABSs in Collateralized Debt Obligations – CDO and resell these securities into tranches according to the risk profile. Some CDO investors exposed to credit risk are Structured Investment Vehicles - SIV, which issue debt to finance their investments and widely use financial leverage to increase their profits. A large part of SIV issued debt is in the form of asset-backed commercial papers (ABCP) – short-term debt instrument usually bought by money market funds and related investors from the risk-taking viewpoint. The difficulties in the ABCP renegotiation from SIV allowed the spread of mortgage crisis to the money market. The uncertainty in assessing the assets of ABCP issuers even when it did not relate with the mortgage market obliged the investors to eliminate their ABCP positions, by purchasing government liquid securities. As a result, the treasury bills' yield and the maturity of ABCP that could be re-issued fell considerably. Given the impossibility to find longer-term funds, issuing commercial papers' companies addressed to banks they had signed an agreement with to obtain liquidity, hence causing turbulences in the interbank market. Many banks outside the USA tried to exchange their euro liquidities to dollar in order to meet their agent's needs in the foreign currency swap markets. Since there were very few USD sellers, liquidity issues were sharper in this market segment. This process is known as originate-to-distribute model, implying that a loan only originates from a financial institution but later credit risk is spread through the sale of credit to other investors. Prior to the financial crisis, this model was considered successful due to the opportunity provided to the financial institutions to intermediate rapidly ensuring funds to expand further credit or other investments.

The consequences of the turbulences in the US mortgage-backed securities market on European developed markets affected the approach to investors' risk and as a result they were followed by volatilities in the value of financial assets in all markets. In July 2007, the statements of many reputable European banks that they were directly exposed to the US mortgage market, or indirectly exposed through the position in mortgage-backed securities, increased the expectations for the declining capacity of banks to pay off as a result of their losses. Hence, trade volume in money market instruments of longer-term maturity term and in the repurchase agreements with other institutions, except for governmental ones, reduced considerably. The shocks were also later spread over the instruments of shorter than one week maturity term, in all currencies (euro, British pound and the Swiss franc).

Chart 1 Annual LIBOR rate in USD

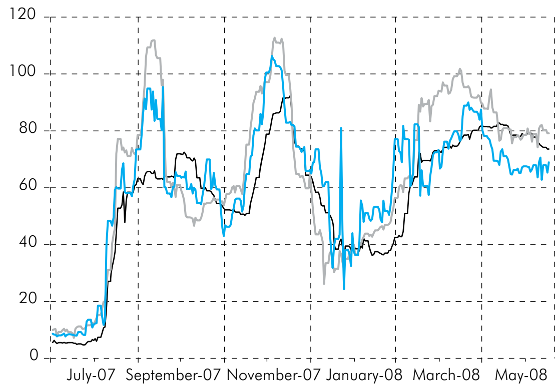
(January '07 - May '08)



Source: British Bankers' Association web page

The interest rates of money market short-term instruments increased substantially above the key interest rate set by monetary policy and the market conditions tightened further. Banks were reluctant to lend in the interbank market, even for short durations, for as long as the other party's exposure to the financial crisis effects could not be identified clearly. In response to this situation, the ECB was engaged in re-financing operations, initially of short-term maturity term and later of quarterly maturity term, in order to mitigate the pressures on the longer-term instruments' market. These operations had a stabilizing effect in the short-term market; however, the market activity remains limited in particular in non-guaranteed interbank market instruments.

Chart 2 Difference between the interest rate for 3-month and overnight credit, in basis points (1% = 100 basis points), prior and during the crisis



Source: Bloomberg

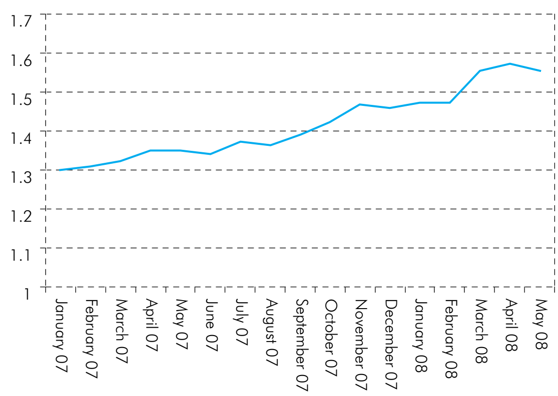
In the beginning stages of the financial crisis, the difference between the interest rates of credit to the non-financial sector relative to the financial sector was narrower. This also reflected the low failures of non-financial companies, the corporates' stable profits and the absence of non-financial companies' direct exposure to segments of the financial market which were mostly affected by the financial crisis. However, during the second half of the year 2007, many rating agencies began to lower the ranking of corporates' debt quality as a result of risk reassessment, especially for other assets-backed securities. In general, the credit markets in the Euro area were characterized by a decline in the corporates' ranking given the general risk reassessment from investors, despite the absence of non-financial sector's direct exposure to the events that generated the crisis. Therefore, an increase in the financing cost for non-financial corporations is expected to occur in the near future.

2.3 FOREIGN EXCHANGE AND RAW MATERIALS' TRADING MARKETS

The different responses of monetary authorities in the foreign exchange markets to the financial crisis threats, the presence of inflationary pressures – in particular in the Euro area, and the price rise of energy were followed by increased volatilities in the foreign exchange rates and by the depreciation of the US dollar to the euro. The appreciation of the euro against the US dollar increased rapidly during the last quarter (chart 3). In the international markets, this appreciation was offset by its depreciation against the Japanese yen, reflecting the differences in the medium-term interest rates and the turbulences in the financial market. A future drop in the perception of liquidity risk, the non-occurrence of negative scenarios with regard to the US economy performance, and the possible measures for halting the price rise of energy may encourage the trading of the US currency in the international markets.

Chart 3 EUR/USD exchange rate

(January '07 - May '08)

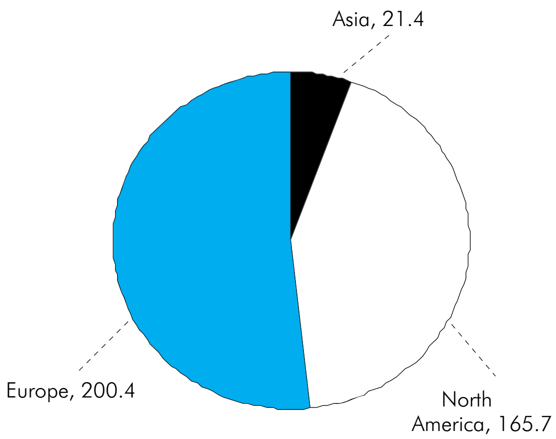


Source: ECB web page

Raw materials' prices, in particular of oil and commodities, went high reflecting the growth of demand in emerging markets (China, India, Brazil and Russia), the more tightened market conditions and the political tensions in some regions (Iraq, Iran, Middle East, Nigeria). Oil prices rose owing to the upward demand and the low supply from the OPEC countries. Future expectations, as indicated in the quotations of the futures markets and the derivatives markets, signal that the oil price will continue to rise in case no changes are made in OPEC's policies or if global economic growth does not decline. However, the upward pressures of oil price are expected to reduce following a possible slowdown in the rates of global economic growth.

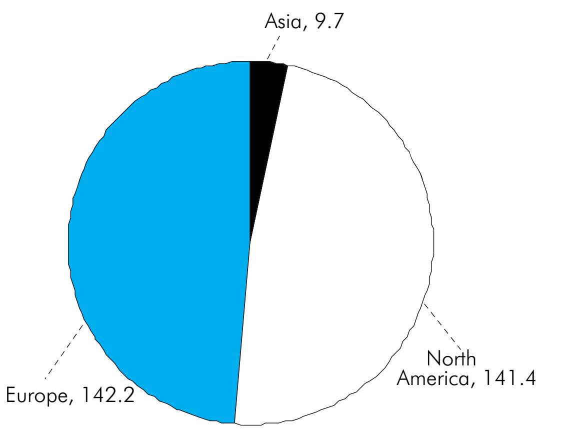
2.4 GLOBAL AND EUROPEAN BANKING SECTOR[4]

Chart 4 Banks losses stemming from the financial crisis since the early 2007 (in billions of USD)



Source: ECB assessment

Chart 5 Capital increase from banks since the early 2007 (in billions of USD)



Source: ECB assessment

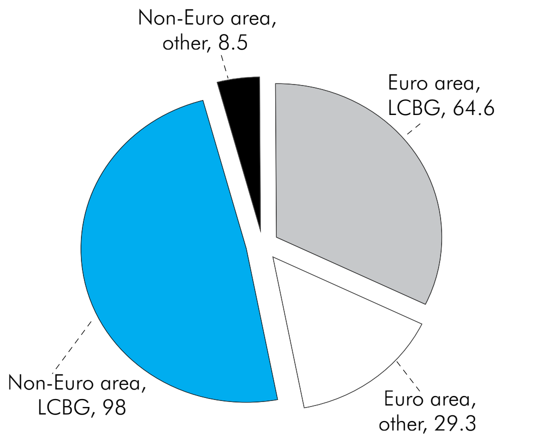
Many large banking groups' profits were affected by the financial crisis, through the losses caused by the exposure to instruments and markets hit by the financial crisis. A probable shift in the credit cycle remains an important source of risk and there is great concern for the reduction of interest income. Although the consequences of the crisis on the European banking groups operating in Albania are not completely acknowledged, the available information shows a very moderate influence.

The crisis the credit market is going through has generated financial losses for the banking industry worldwide. These banks were at the same time faced with the need to increase their capital, in order to reset the equilibrium in their balance sheets and meet the regulatory requirements. The European banks seem to have been more affected by this crisis, recording larger losses and higher capital requirements. Asian banks on the contrary have been less exposed.

The further improved financial performance of large and complex banking groups[5] (LCBG) in Europe during the first half of 2007 enhanced their capacity to handle the shocks. However, their ever-increasing dependence on non-interest income sources made their profits more vulnerable to the abrupt changes in the capital markets' conditions and consequently more volatile. In addition, the increasing dependence of some Euro area LCBGs on deposits placed by big clients may have exposed them to a greater liquidity risk. The full influence of the change in the market value as a result of the credit risk that broke in the second half of the year

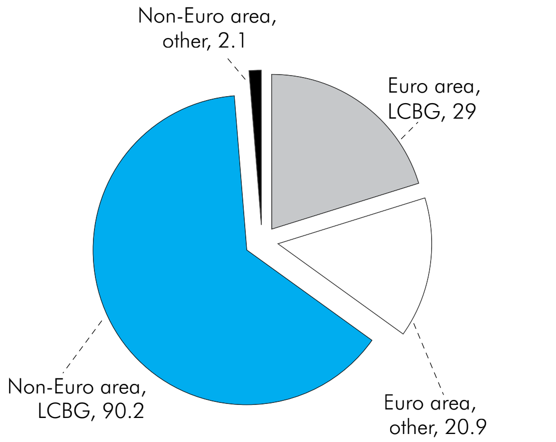
2007 will be identified only gradually; however, many LCBGs' profits have been affected negatively and these institutions may continue to face liquidity challenges in finding funding sources. At the worst, the loss may reach 300% of the bank's net income or about 15% of its shareholder's equity. The following chart provides assessments on the losses of European banks by origin. The most considerable financial losses were experienced by the LCBGs out of the Euro area, mainly Swiss ones. The European banks' needs for capital have reflected the financial losses caused by the exposure to the financial crisis in the global market. The gradual stabilization or the decelerated growth of lending to households and non-financial companies and the signs of tightened lending standards signal that banks are acting to be protected by the risk of their assets' quality deterioration. However, the share of concerns created by low-income borrowing households and by unrated companies with high debts and the banks' exposure to these borrowers requires careful attention in the future.

Chart 6 European banks' losses since the early 2007 (in billions of USD)



Source: ECB assessment

Chart 7 Capital increase from European banks since the early 2007 (in billions of USD)



Source: ECB assessment

The completion of the implementation phases of Basel II in early 2008 and the IFRS accounting standards[6] will help to further enhance the transparency in financial reporting and risk management practices of the Euro area LCBGs. Despite structural changes, this crisis showed once more the need for banks to have liquidity contingency plans to handle the crisis and to have set aside enough capital for their partners' exposure to credit risk. In addition, constant investments are required from the LCBGs in methods and practices of stress-tests and different scenarios, including here those related to liquidity risk.

2.5 EUROPEAN BANKING GROUPS OPERATING IN ALBANIA

With regard to the financial situation of European banking groups operating in Albania the available data show that the US mortgage crisis did not have significant consequences on their balance sheets. Boxes 2.2 and 2.3 provide assessments made of these banking groups and statements of the central banks of Italy and Greece on the financial crisis impact over the banks operating in these two countries. In both cases, the influence is assessed as being moderate. However, the final consequences of the crisis on the banks' balance sheets still requires time to be shown clearly and completely.

We assess that the difficult situation the international financial markets are going through represents a new risk for the Albanian financial system. However, its impact on the Albanian economy and more specifically on the Albanian financial system will be more overwhelming if it develops into a global crisis with consequences on the global and the European real economy, which will extend in time. Presently, the influence on the Albanian financial system and the banking sector has been quite moderate since:

a) There is a relatively low development of the domestic financial market where related and sophisticated products, whose value has recently experienced turmoil in the international financial markets, are absent. The regulatory supervisory framework of banking business in Albania does not provide for the differentiated treatment of borrowers (and of credit they are extended) because of the perception as being 'good' and 'less good', including those who apply or receive a loan for the purchase or investment in real estates. On the contrary, the regulatory supervisory framework orients banks towards the financial analysis of the borrower regardless of his/her characteristics and the purpose of the loan, setting some basic and uniform requirements which banks must apply at any case;
b) The provision of funding sources in the international financial markets by the Albanian financial institutions and in particular by the banking sector is quite low, given the fact that there is still enough extent to provide funding for the activity development from domestic sources. The lower share in the banking sector of loans to deposits and to the GDP relative to developed European countries and to some regional countries provide evidence for this fact;
c) There is no direct exposure of Albanian financial institutions and banks to other institutions and financial products, whose value has been impacted negatively by the liquidity concerns in the international financial markets. If such exposure may indirectly stem from a certain category of debt securities' portfolio in foreign currency, its impact becomes insignificant given the low share of these investments for each bank and the banking sector in general, and the good financial performance of the banking sector;
d) There is limited exposure of the European banking groups operating in Albania to the scheme and products financing the subprime loans in the USA and it may be financially handled. The available financial data published by these institutions, different market analysts and by the supervisory authorities of the country of origin confirm this assessment;
e) The good financial performance in the recent years of the financial institutions and the European banking groups has created a sound financial protection through the establishment of necessary reserves and the buoyant business capitalization to absorb such shocks.

Box 2.2 Foreign banking groups present in Albania

1. Raiffeisen Bank (Austria)

Raiffeisen Zentralbank Österreich AG (RZB) is the third-largest bank in Austria. It is headquartered in Vienna and it is the central institution of the Austrian Raiffeisen Banking Group (RBG).

Consolidated profit excluding one-off effects surged in 2007 by 42% or by 248 million euros relative to the previous year. This figure reached 841 million euros this year relative to 594 million euros in 2006. Last year Raiffeisen International sold two bank holdings: Raiffeisenbank Ukraine (486 million euros) and the minority participation in a bank in Kazakhstan (102 million euros). As a result of the non-allocation of last year's profit and the increase of capital in 2007, average equity increased strongly and consequently, the return on equity sank by 1.6 percentage points to 25.7%.

Raiffeisen International operates one of the leading banking networks in Central and Eastern Europe with 12.7 million clients. In eight of the markets in this region, the group's banks are ranked among the first three in the market, while in Albania and Serbia they are ranked first. Raiffeisen International was not affected directly by the financial crisis, however the shares' price was negatively affected by this crisis in the first quarter of 2008. As of March 2008, it totalled 16 banks and 17 leasing companies. The figures of March 2008 exceeded the analysts' expectations, contributing to the increase in the shares' price of Raiffeisen International. Net consolidated profit reached 254 million euros, increasing by 32% relative to the previous year as a result of the organic growth. Return on equity reduced by 3.2 percentage points to 22.5% relative to the entire year 2007. Derivative instruments brought a loss of 37 million euros from depreciation. Provisioning for impairment losses increased by 23% or 17 million euros, reaching 93 million euros.

Raiffeisen Albania accounts for about 2.68% of total assets of Raiffeisen International and about 31% of total assets in the Albanian banking sector (March 2008).

2. Intesa Sanpaolo (Italy)

Intesa-Sanpaolo is the first bank in all Italian banking market segments with a market share of 19% of credits and deposits. In terms of capitalization, it ranks fourth in the Euro area with about 60.7 billion euros as of 31 December 2007. Intesa-Sanpaolo is present in Central and Eastern Europe and in the Mediterranean region, with about 7.2 million clients and over 1200 branches in 12 countries.

Net consolidated income amounted to over 7.2 billion euros in 2007, including the proceeds from the sale of group's shares (2006: 4.7 billion euros). Operating income margin increased by 5.5% to 8,740 million euros. Net exposure to structured credit products, namely subprime credit, is negative totalling 49 million euros as of 31 December 2007 (due to the combination of an 'acquisition' position of 73 million euros with a 'sale' position of 122 million euros). Net income totalled 1.7 billion euros in the first quarter of 2008, while in the first quarter of 2007 it totalled 4 billion euros). Excluding the profit from securities trading which was higher in the first quarter of the previous year, this figure would show an increase of 34.2%. Operating profit margin dropped by 7.1% relative to the previous year. Net exposure to structured credit products, namely subprime credit, remained negative (28 million euros) as *of end March 2008. In order to handle the financial crisis, Intesa-Sanpaolo found support in the strong basis of clients' deposits and in the sound liquidity position of core capital. The main negative effect of the crisis was the depreciation of some securities.*

American Bank of Albania accounts for about 0.15% of total assets of Intesa-Sanpaolo group and about 14.5% of total assets in the Albanian banking sector (March 2008).

3. Emporiki Bank (Greece)

72% of Emporiki Bank's shareholder's equity is shared by Credit Agricole banking group. Emporiki Bank is active in capital and money markets in and out of Greece. With 370 branches in Greece and 54 branches in Cyprus, Romania, Bulgaria and Albania, Emporiki offers a wide range of banking and financial services, such as leasing, portfolio management, real estate management, etc. As of end 2007, net profit totalled 48.5 million euros (from a loss of 238 million euros the previous year), and shareholder's equity amounted to 840 million euros. In annual basis, credit portfolio grew by 27% in the first quarter of 2008, relative to the 13.7% growth in 2007. The impact of portfolio revaluation by 24 million euros in the first quarter and the increase in the funding cost caused a negative net result of 15.3 million euros. Total portfolio losses of 24 million euros mainly stem from marking to market its securities and particularly its bond portfolio. With respect to the international presence, total credit portfolio in three Balkan countries (Albania, Bulgaria and Romania) and in Cyprus grew in the first quarter by 7.1%, while total deposits grew by 4.5%. The reputable rating agency Standard&Poor's rated this group from A to A+.

Emporiki Bank in Albania accounts for about 0.64% of total assets of Emporiki group.

4. Credit Agricole SA (France)

In 2007, Crédit Agricole S.A. generated a net profit of 4,044 million euros. These results, representing a 16.8% decline, still demonstrate the Group's resilience in a climate of severe international financial crisis. They reflect the strength of the Group's model, which is based on maintaining an even balance among the three business lines - retail banking, specialised financial services and corporate and investment banking. The negative impact of the crisis on revenues in capital market activities was offset by solid growth across all other business lines. Overall, net banking income rose by 3.6%. Excluding the impact of the crisis, net banking income would have risen by 25.5% and gross operating income would have increased by 30.5%. This very good operating performance attests to the quality of the different business lines' growth engines and particularly international contributions. The group is diversified; however its rapid expansion has displayed some weaknesses: it is still unclear whether the decentralized model of retail banking may be implemented successfully in centralized banks that have been added to the group, as is the case of Emporiki Bank. Fourth-quarter results were severely affected by the crisis in the structured credit markets and Calyon booked 3.3 billion euros in exceptional impairment charges relating to its capital market activities. As a result, Crédit Agricole S.A.'s net income (Group share) was a loss of 857 million euros for the quarter. In order to fully support the business lines' growth going forward, Chief Executive Officer proposed that a part of the capital gains on disposal from two transactions be allocated to strengthening risk management and control systems within the Group.

Net profit amounted to 892 million euros in the first quarter of 2008. Devaluations in the subprime portfolio are considerable: 1,249 thousand euros (2007: 4 290 thousand) and they have had a negative impact on the net income from banking business and on gross operating income (-56.6% relative to the same period the previous year). Business lines, excluding Corporate and Investment Banking, have shown stability. Their gross income totalled almost as much as in the first quarter of 2007 (1.5 billion euros).

Emporiki Bank in Albania accounts for about 0.01% of total assets of Credit Agricole group and about 2.8% of total assets in the Albanian banking sector (March 2008).

5. Piraeus Bank (Greece)

This group's net profit increased by 50% to 652.6 million euros in 2007 relative to the previous year. Return on equity reached 29.5% (from 29% in 2006). The crisis in the international financial markets found Piraeus group with an improved capital adequacy and liquidity situation. As of end 2007, the ratio of credit to deposits was 127% from 130% in the last quarter. Credit portfolio grew by 48% and deposits by 33% relative to the previous year, recording considerable growth in the last quarter of 2007. Non-performing loans accounted for 2.05% (as of end 2006: 2.37%). Coverage ratio of non-performing loans from accumulated provisions is 66%; the same ratio exceeds considerably 100% in case collaterals are considered. In the first quarter of 2008, deposits' growth rate reached 39% (relative to the previous year); credit growth rate remained at 48% and profit growth rate reached 46%, excluding the extraordinary profit from the sale of Bank of Cyprus' shares. In terms of international activities, Piraeus Bank group expanded. Credit portfolio grew by 106% and deposits increased by 71% relative to the previous year. Branches network expanded from 545 in March 2007 to 782 in March 2008 (43%), out of which 322 in Greece and 460 abroad. Only during the first quarter of 2008 were opened 38 new branches. As of end March 2008, the group's non-performing loans amounted to 2.0% (relative to 2.1% as of end 2007). Their coverage ratio from accumulated provisions is 69%; the same ratio exceeds 100% in case collaterals are considered. Credit/deposits indicator improved to 122% as of end March 08 from 127% as of end 2007.

Tirana Bank accounts for about 1.19% of total assets of Piraeus Bank group and about 9.6% of total assets in the Albanian banking sector (March 2008).

6 - National Bank of Greece (Greece)

NBG has the largest banking network in Greece with a total of 571 banks covering the entire country. With its expansion to the South Eastern Europe, foreign network entails 989 banks. NBG has been listed in New York Stock Exchange since 1999.

In the last quarter of 2007, NBG reported a net profit of 312 million euros. Banks operating in South Eastern Europe contributed to this growth by about 41% or 155 million euros, mainly stemmed from the growth in lending. Net profit for the entire year 2007 amounted to about 1,644 million euros.

Although the group's lending activity had recorded as of end year 2007 a growth of 28% relative to the previous year and deposits had grown by 13%, the ratio of credit to deposits was 93%, one of the lowest in Europe. This low ratio provides a funding source for the group's future expansion. Credit portfolio quality improved:

the ratio of non-performing loans dropped to 3.4% (from 3.6% in the third quarter of the year). In South Eastern Europe, this ratio fell to 4.3% (from 4.9% in the third quarter).

In the current conditions of international money and capital markets, NBG has a competitive advantage given the fact that its lending capacity and the funding costs were not affected by the current liquidity crisis. NBG is not exposed to US subprime instruments or other risk-weighted assets. Almost the entire securities portfolio is invested in bonds of the Greek Government.

Group's net profit grew by 25% to 423 million euros in the first quarter of 2008 relative to the same period the previous year. Return on equity reached 28%, which is 5% more than the previous year. Greece's operations grew 8% from last year to 255 million euros and South Eastern Europe operations profitability increased 72%, year on year to 50 million euros, accounting for 12% of the group profit. Despite the strong competition in the deposits market and the increase in funding costs, net interest margin improved to 4.31%, from 4.19% last year and flat quarter on quarter.

Total lending rose by 25% year on year to 57.1 billion euros in March 2008. New loans for all segments doubled relative to the previous quarter. The rapid growth of credit did not affect the assets' quality negatively. Non-performing loan ratio was unchanged from the end-year 2007 at 3.5% and 0.5 percentage points less relative to March 2007. Consumer deposits grew by 13% to 60.5 billion euros, leading to an increase in loans-to-deposit ratio to 92% (from 82% as of March 2007).

The group's solid performance in the first quarter of 2007, in particular in terms of interest income, provides evidence for the stability in the group's main indicators, which remained unaffected by the international credit crisis.

National Bank of Greece, Tirana Branch, accounts for about 0.28% of total assets of NBG group and about 5.9% of total assets in the Albanian banking sector (March 2008).

7. Societe Generale (France)

Group's profit fell by 2.8% in 2007 due to the US financial crisis. Its net profit amounted to 947 million euros which is 81.9% less than the previous year. Due to a gigantic financial fraud by a company trader, the last quarter of 2007 recorded an overwhelming loss of 4.9 billion euros. In addition, the group's Corporate and Investment Banking was affected by the US financial crisis and ended the year with a net financial loss of 2,221 million euros. South Eastern Europe provided a positive contribution: net income in these countries grew by 17.3% excluding Russia and by 58.3% in Russia. The fact that Societe Generale ended the year 2007 in a net profit despite the hard time it went through provides evidence for the stable income sources and the portfolio diversification. During the first quarter of 2008, Societe Generale managed the consequences of the financial fraud. The injection of 5.5 billion euros helped the group to recover the indicators to a satisfactory level and promote a better personnel-client communication. Group's net profit amounted to 1,096 million euros, down -23.4%. Net banking income for the quarter came to 5,679 million euros, down -8.6% versus a very high Q1 2007 comparison base. Developments in the US financial crisis and credit market tensions had a limited impact on the group's consolidated revenues. Overall, the consequences are estimated at -231 million euros and concern Corporate and Investment Banking as well as Asset Management. The group's other businesses have seen generally resilient or increased revenues.

Popular Bank accounts for about 0.03% of total assets of Societe Generale and about 4.6% of total assets in the Albanian banking sector (March 2008).

8. Alpha Bank (Greece)

Alpha Bank is one of the main banks in Greece. With a total number of 675 branches, the group is also present in the international market, Cyprus, South Eastern Europe, USA, United Kingdom, etc. In 2007, the bank had a net profit of 850 million euros, increasing by 44% relative to the previous year. 85% of issued debt in 2007 was qualitative, but in 2008 is planned the exposure of 1.5 billion euros in mortgage-backed securities (covered bonds), which generally have high rating (AAA).

Net profit in the first quarter of 2008 rose 18% to 205 million euros. Net interest income grew 24.9% to 374.4 million euros, while the margin increased by 30 basis points. Net loans grew rapidly by 31.1% to 44.4 billion euros, with new loan balances of 2.3 billion in the first quarter, of which 1.3 billion euros in Greece and 0.9 billion euros in South Eastern Europe. Gross profit in South Eastern Europe amounted to 42.9 million euros, up by 74% and accounting for 16.5% of group's gross profit. Credit and deposits in South Eastern Europe grew considerably by 80% and 34%, respectively, accounting for 18.8% and 14.9% of total groups' credits and deposits. Non-performing loans indicator, measured by IFRS 7 standards, was 3.7% as of end March 2008, improving from 4.8% the previous year. Deposits in Greece amounted to 29.8 billion euros (+8%), while in South Eastern Europe the deposits' base grew by 34%, totalling 5.4 billion euros as of end March. According to bank's officials, during the turbulences in the global financial markets, Alpha generated sustainable profits for shareholders in a risk balanced way. In addition, the group's Agenda 2010 targets remain achievable.

Alpha Bank – Albania accounts for about 0.79% of total assets of the group and about 6.4% of total assets in the Albanian banking sector (March 2008).

Source: According to information obtained from these institutions' reports in their websites.

Box 2.3 Global financial crisis' impact on the Greek and Italian banking sector

Impact of the international financial crisis on the Greek banking sector

According to the Bank of Greece, Greek banks present in Albania were not affected directly and negatively by the subprime credit crisis. In particular, the four largest Greek banks which account for 70% of the Greek banking industry as of end the first quarter of 2008 do not report a direct exposure to non-performing mortgage loans to households or an indirect exposure through investment in related securities. Other institutions have had some inconsiderable indirect exposures to mortgage loans; however, they were not exposed directly.

Impact of the international financial crisis on the Italian banking sector

In a statement of the Governor of Banca d'Italia, Draghi, it is stated that the Italian bank's exposure to subprime mortgage market 'is limited at a global level'. The data