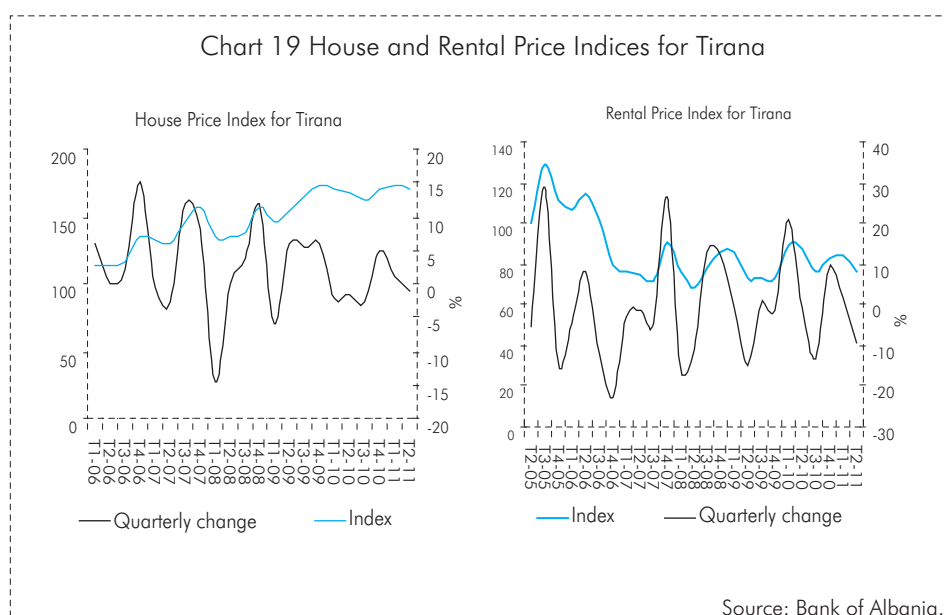


### 3. DOMESTIC MARKETS

#### 3.1 REAL ESTATE MARKET

The performance of the real estate market is assessed by the House and Rental Price Indices, which are proxy indicators calculated for Tirana, the capital city<sup>32</sup>. In 2011 H1, the House Price Index increased by 1.6% y-o-y; however, compared with the preceding periods, this increase was slower. It reflects a slight decrease by 1.3% compared with 2011 Q1, following two quarters of growth.



Rental Price Index decreased throughout 2011 H1, both y-o-y and q-o-q, by 12.8% and 9.4%, respectively.

Turnover Volume Index<sup>33</sup> for the construction sector has improved, up 9% in 2011 Q1 compared with 2010 Q1. However, it declined significantly by 26.4%, compared with the previous quarter, i.e., end-2010.

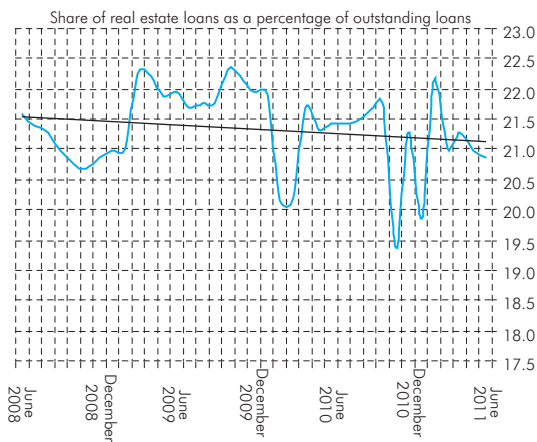
Construction Cost Index<sup>34</sup>, which represents construction-related costs, remained constant, increasing by 0.2% y-o-y at end-2011 H1, driven by slightly higher costs of construction materials and electricity, as a key sub-item of material costs.

<sup>32</sup> Both indices are calculated only for Tirana, excluding its suburban areas.

<sup>33</sup> Source: INSTAT.

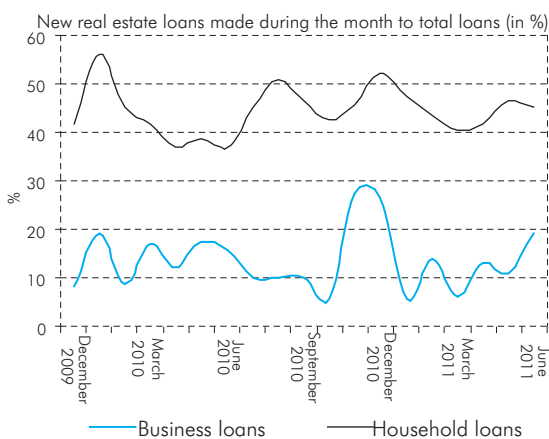
<sup>34</sup> Source: INSTAT.

Chart 20 Share of real estate loans as a percentage of outstanding loans



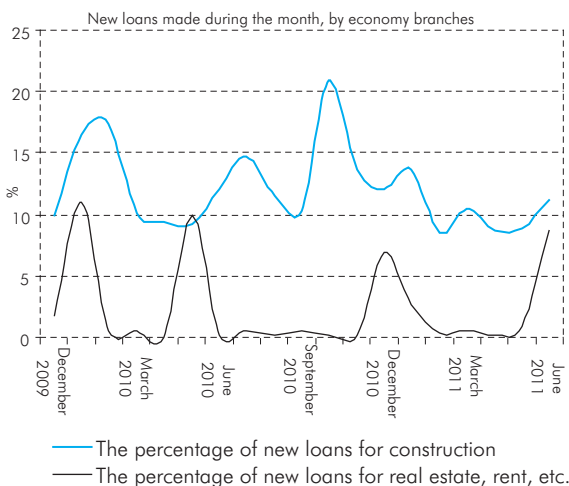
Source: Bank of Albania.

Chart 21 New real estate loans made during the month



Source: Bank of Albania.

Chart 22 New loans made during the month, by economy branches



Source: Bank of Albania.

By analyzing the banking sector data, we note that the share of real estate loans in outstanding loans has maintained almost the same rate, in spite of marginal fluctuations. The downward trend observed over the recent years is still present during the period, as a reflection of the supply and demand in this market.

New loans made in June, by purpose of use, account for a high percentage of real estate household loans, standing at 45.4% in June 2011, while real estate business loans account for 19.3% in the same month. However, the recent months have shown an upward tendency of business loans used for this purpose and a slight decline in new household loans. This fact may be indicative of the risk that banks want to take over in selecting their clients, as well as of the demand of these two categories for real estate loans.

In the meantime, out of the new business loans made each month, classified by economy branches, the percentage of new construction loans was 11.2 in June and for real estate and renting 8.7%, thus narrowing the spread between them. Construction loans have been downward since end-2010, with a slight recovery at end-2011 H1.

### 3.2 FINANCIAL MARKETS

The Albanian financial market is dominated by operations in the interbank market, government debt securities and foreign exchange. Other segments that relate to insurance, reinsurance and pension funds account for a small share in the total financial market volume. In 2011 H1, the financial market situation experienced increased liquidity through Bank of Albania's open market operations versus the downward volume of interbank market transactions.

#### 3.2.1 INTERBANK MARKET

In 2011 H1, the volume of interbank market transactions fell by 22.7% compared with 2010 H2, at a time when the weighted average interest rate

maintained almost the same value, from 4.98% in 2010 H2 to 5.07% in 2011 H1. Compared with 2010 H1, the volume of transactions declined by 16%, while the weighted average interest rate increased by only 0.1 percentage points. For the period under review, the interbank loan cost slope is almost flat, but open market liquidity provision through reverse repurchase agreements has replaced this form of financing.

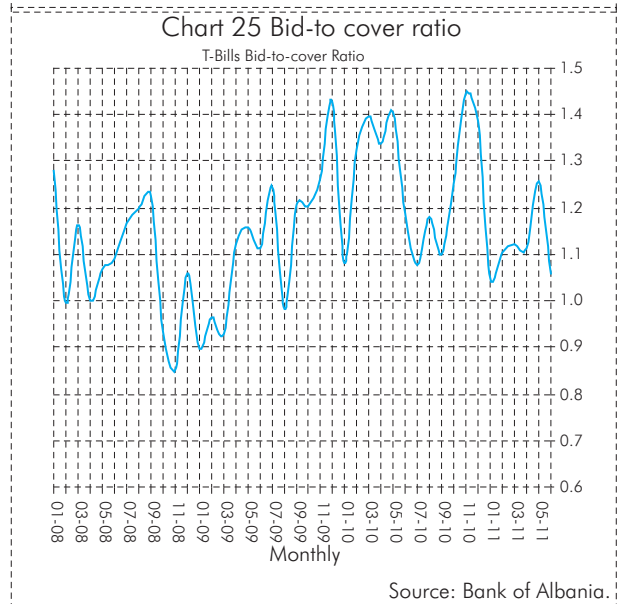
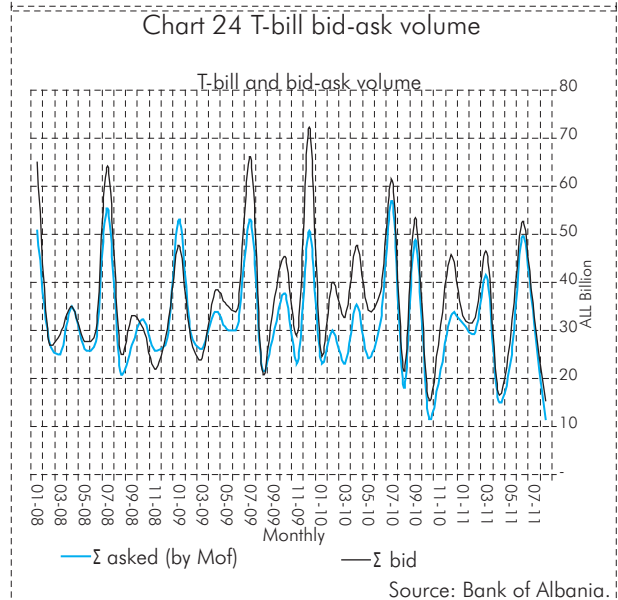
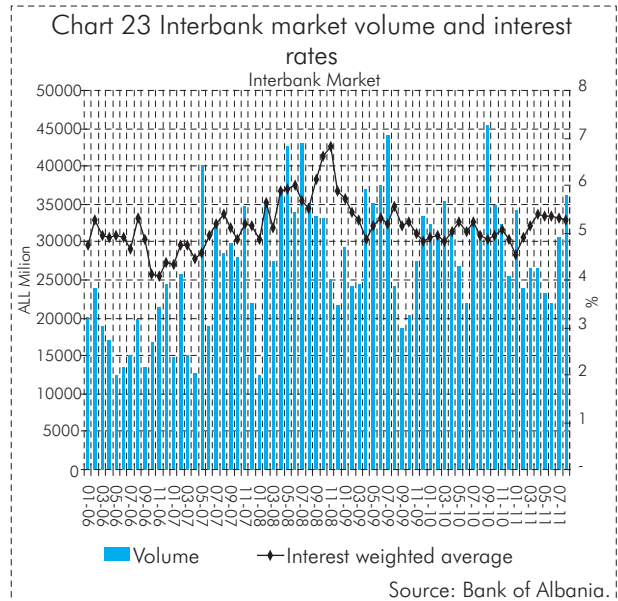
### 3.2.2 PRIMARY SECURITY MARKET

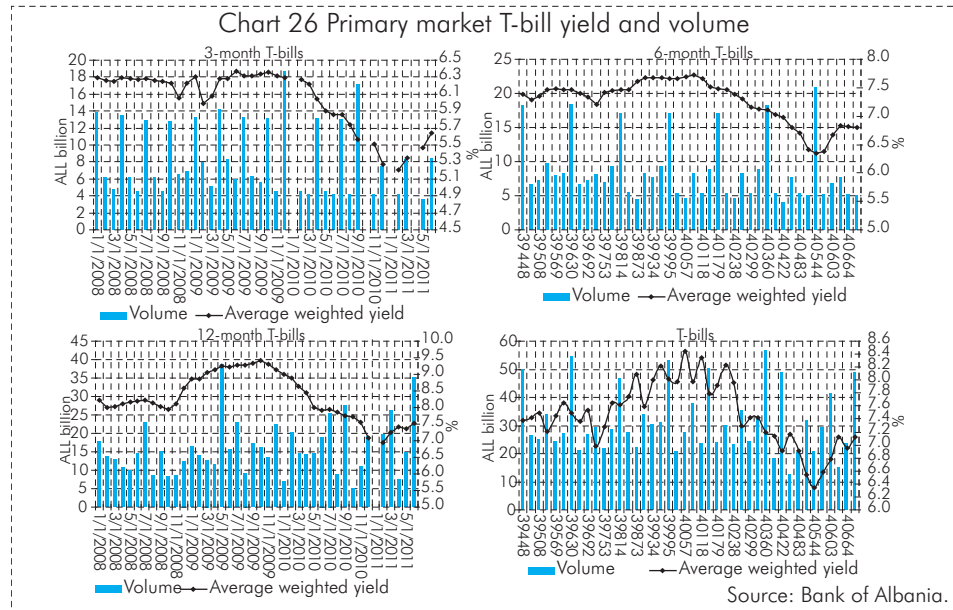
The volume asked in the Albanian government primary security market fell by 5.2% in 2011 H1 compared with 2010 H2, but it increased by 5.7% compared with a year ago. During 2011 H1, the total amount asked in the Albanian government security auctions amounted to ALL 204.2 billion or ALL 8.9 billion less than in 2010 H2 and around ALL 7 billion higher than in 2010 H1.

In June 2011, the bid-to-cover ratio, which measures the bid-to-cover ratio of T-bills in auctions, was 1.06. This ratio was 0.33 points lower than in December 2010 and 0.13 points lower than in June 2010 (see Chart 24).

The performance of primary market government debt yields changed its downward trend in 2011 H1, turning upward since January 2011. The following charts show the performance of the volume and the weighted average of T-bill yield, since January 2008.

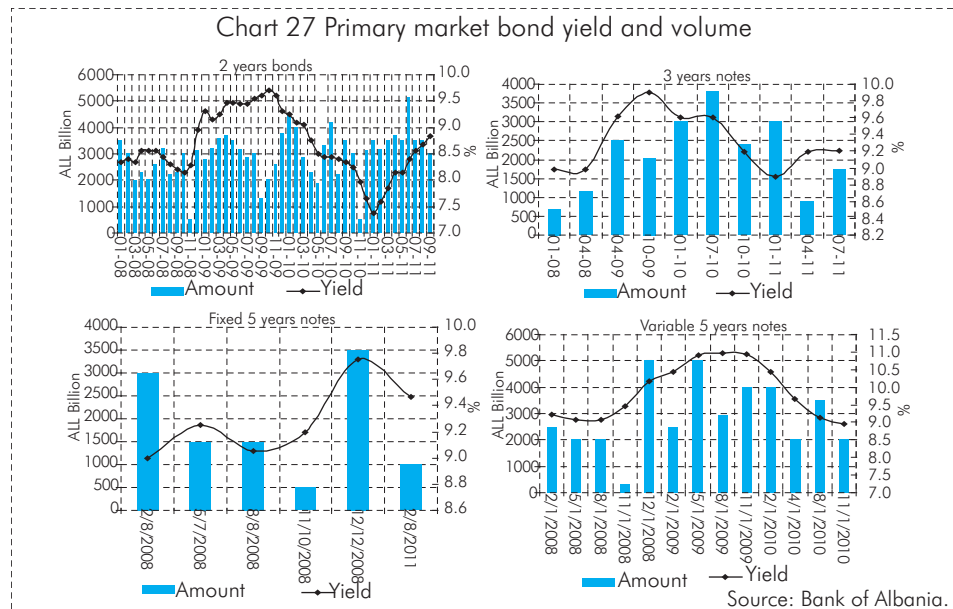
A more pronounced increase in T-bill yield, likewise the decline in the previous half, is noted for the 12-month maturity, followed subsequently by bond yield indexed to it. As at end-June 2011, the 12-month T-bill yield reached 7.52%, from 7.08% in December 2010 and 7.91% in June 2010. The same performance is noted also for 3-month and 6-month T-bill yields, albeit at a lesser extent. The 6-month T-bill yield, which marked 6.41% in December 2010 and 7.12% in June 2010, rose to 6.8% in June 2011. The 3-month T-bill yield rose to 5.64% in June 2011, from 5.28% in December 2010 and 5.86% in June 2010.





The yield on 2-year and 3-year bonds showed a similar tendency as T-bills. At end-2011 H1, the 2-year bond yield was 8.4%, from 7.65% at end-2010 H2 and 8.45% at end-2010 H1. The 3-year bond yield has also shown a similar performance, estimated at 9.21% at end-2011 H1, from 9.19% at end-2010 and 9.6% at end-2010 H1. Yields on (fixed and variable) 5-year bonds have decreased from the latest auction levels. As at end-2011 H1, they were 9.45% and 8.94%, respectively.

Chart 28 shows the yield curve of government debt securities as at end-2011 H1.



### 3.2.3 SECONDARY SECURITY MARKET

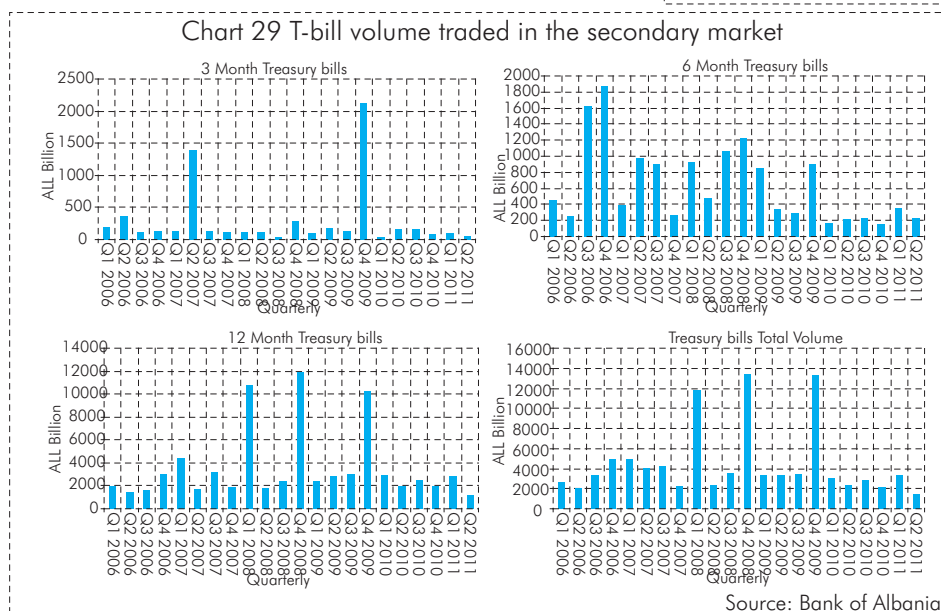
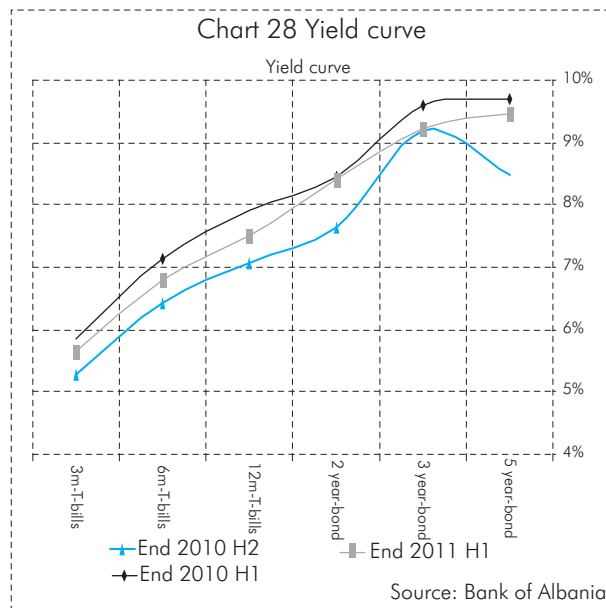
The volume in the secondary market, or debt security trading market, has been volatile, though still at low levels. In 2011 H1, the volume of transactions traded

in the secondary market fell to ALL 4.7 billion, from ALL 5 billion in 2010 H2. In 2011 H1, the volume traded in the secondary market totalled ALL 5.4 billion. The 12-month T-bills account for the largest share in transactions carried out in the secondary market.

### 3.2.4 FOREIGN EXCHANGE MARKET

In 2011 H1, the euro appreciated 1.9% against the lek, whereas the US dollar and the British pound depreciated 6.1% and 3.3%, respectively. The lek's appreciation against both major currencies has reflected mainly the developments in the global foreign exchange markets.

The foreign exchange market volatility increased markedly in 2009 due to the financial crisis that



swept across the global financial markets. This situation increased the operating cost and risk to firms whose business is based on merchandise import and export, and to entities whose loans are denominated in foreign currency. In 2010 and 2011 H1, the lek's exchange rate, particularly against the euro, was more stable, resulting, in turn, in lower depreciation and volatility. Chart 31 shows the performance of the lek's exchange rate against the virtual basket of both major currencies, the euro (80%) and the U.S. dollar (20%) for 2008, 2009, 2010 and 2011 H1.

In order to assess the performance of the lek's exchange rate, we monitor the nominal effective

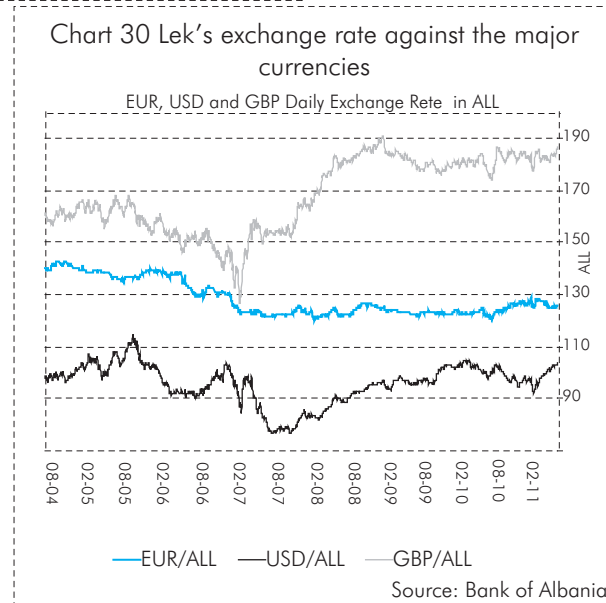
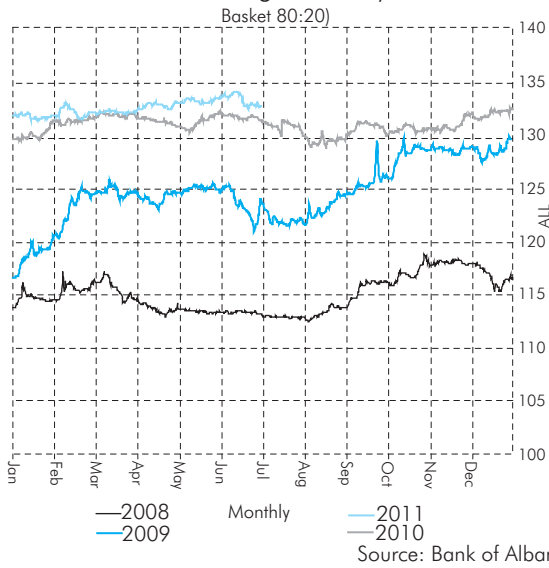


Chart 31 Foreign currency basket



exchange rate (NEER) and the real effective exchange rate (REER) of the lek, which are constructed based on the share of trade with Italy, Greece, Turkey, China and Germany, Albania’s five main trading partners. The indicators are expressed in lek per unit of foreign currency; therefore, the increase in the index shows the lek’s depreciation. The slope of indicators, which shows the velocity and extent of the lek’s depreciation, remained flatter, moreover downward during 2011 H1, reflecting a stable exchange rate over the period compared with 2010.

### 3.2.5 BANK OF ALBANIA OPERATIONS

Since January 2010, the Bank of Albania has continued to inject liquidity into the interbank market and restored the fixed-amount and competitive bid auctions. Upon the improvement of the banking sector liquidity through deposit growth since 2009, the banks’ bidding for liquidity from the Bank of Albania was lower during end-2010 and 2011 Q1.

Chart 32 Nominal Effective Exchange Rate Index (NEER)

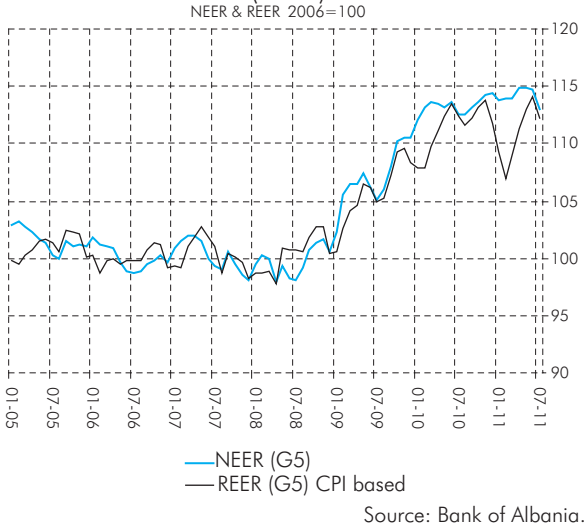
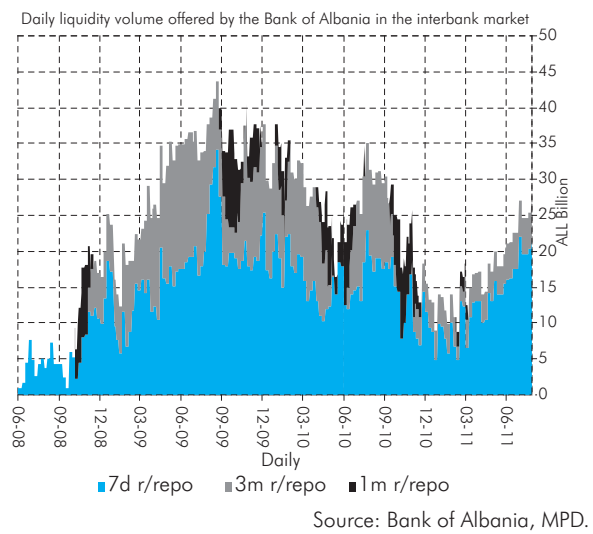


Chart 33 Daily liquidity volume offered by the Bank of Albania in the interbank market

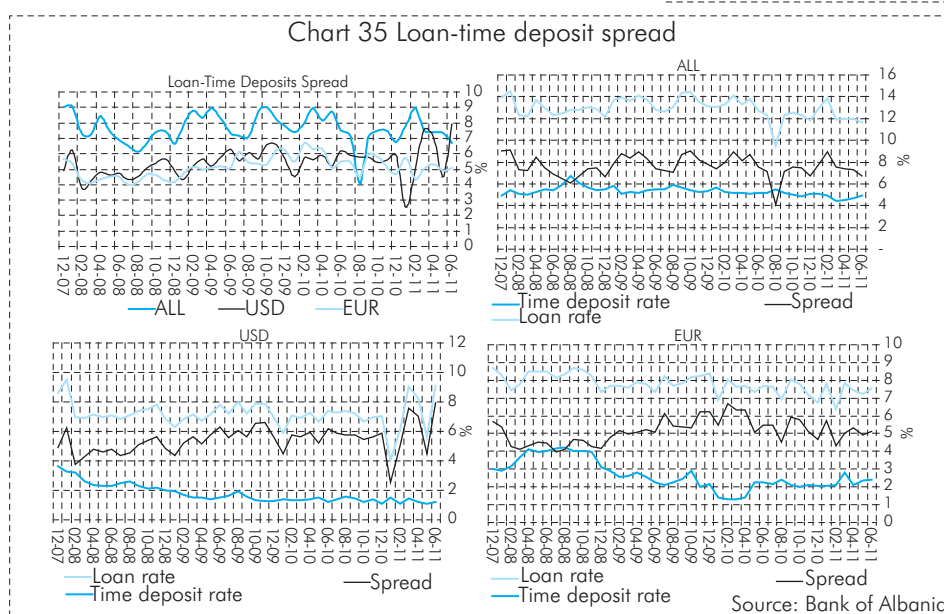
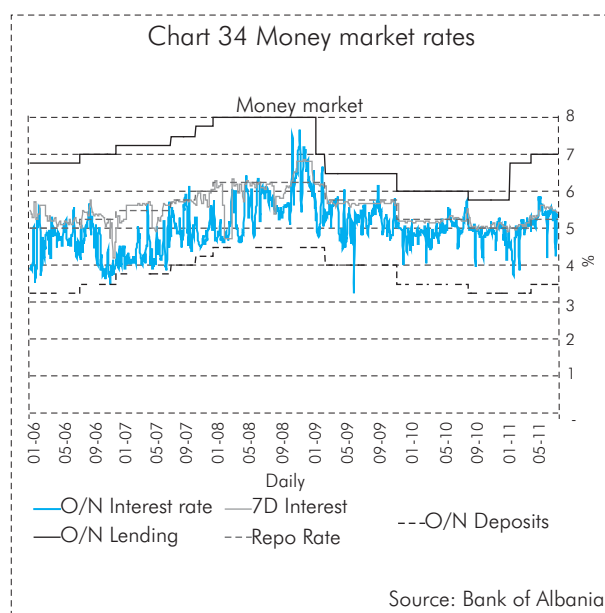


Therefore, the volume of Bank of Albania’s transactions has been falling over these periods. However, 2011 Q2 evidenced the increase in liquidity injected by the Bank of Albania. The amount of liquidity injected by end-June 2011 was about ALL 26.8 billion, from ALL 13.9 billion in December 2010 and ALL 26.6 billion as at end-June 2010.

Concerning the monetary policy decisions, on 23 March 2011, the Bank of Albania decided to lift the key interest rate by 0.25 percentage points to 5.25%.

### 3.2.6 INTEREST RATE SPREAD BETWEEN NEW LOANS AND DEPOSITS

As at 2011 H1, the interest rate spread<sup>35</sup> between loans and deposits was volatile for the three major currencies. Over the period, this spread narrowed by 0.04 percentage points for operations in lek and widened by 2.04 and 0.44 percentage points, respectively, for operations in US dollar and euro.



<sup>35</sup> The spread is measured as a difference between the weighted average interest rate on new time deposits and the average interest rate on new loans.