

## FINANCIAL STABILITY STATEMENT FOR 2011 H1

Pursuant to provisions stipulated under Article 69 of the Law No. 8269, dated 23 December 1997 "On the Bank of Albania", as amended, and Article 8 of the Law No. 9962, dated 18 December 2006 "On Banks in the Republic of Albania", to inform the Parliament of the Republic of Albania and the Council of Ministers, and to draw the attention of financial institutions and the public at large on the situation of the Albanian financial system and the potential risks that may jeopardize its stability, the Bank of Albania releases the following interim statement, which is an integral part of the Financial Stability Report for the same stated period.

The financial system and the banking sector, through their financial intermediation, provide a valuable contribution to the country's economic development and the welfare of the society. However, the banking activity is associated with several risks from the surrounding economic environment and the development of its activity. These risks should be analyzed and assessed in order to be addressed in due time and to ensure the financial system stability.

Concerning developments in the surrounding economic environment, it is assessed that despite a good economic growth in 2011 H1, the growth outlook for 2011 H2 remains more uncertain, against the backdrop of expected slowdown in the global economic growth, lack of room to deploy fiscal policy stimulus, and pressures on the contribution of consumption and investments to economic growth, in consequence of households' increased propensity to save. Should the economy slow down, it might adversely affect the volume of activity and businesses' decisions on investment expansion, hence restraining the vigour of the demand for bank loans.

In terms of the financial system performance, as at end-2011 H1, the financial system and the banking sector position is assessed as stable. The banking sector continues to dominate the financial system activity. It has further expanded its operations and increased its share in the domestic economy. Liquidity situation appears better due to satisfactory paces of public deposit growth. They cover the value of loans more than one time and borrowing from non-residents is at low levels. The pace of credit growth is getting better; however the loan portfolio quality has continued to decline. The banking sector has maintained stable growth rates of net interest income and gross operating profit. Nevertheless, the necessary increase in loan-loss provisions has led to the decline in the banking sector's net financial profit, compared with the same period last year. However, the financial profit remains positive and concentrated. Capital adequacy indicator has been downward; however, it remains well above the minimum capital requirement.

The generation of an insufficient positive financial profit and the decline in capital adequacy have increased the banks' vulnerability to various risks, as also confirmed by the stress-testing exercises. Among these risks, the banking sector appears more resilient to direct market risks; however, it remains exposed to the impact of adverse exchange rate and interest rate fluctuations on credit quality. Credit risk represents the main risk facing the Albanian banking sector. Related to this matter, the Bank of Albania, through its supervisory function, has required from commercial banks to ensure, in parallel, the duly and timely identification of non-performing loans and the establishment of respective loan-loss provisions, as well as to take appropriate actions in order to recover loan-loss funds through the execution of collaterals. These actions, coupled with the measures taken to further reduce the operating costs, will gradually create conditions for generating a stable and positive financial profit, which would better support the banking sector's mid-term needs for capital.

In the short-term outlook, the Bank of Albania has assessed and required that the banking sector should strengthen the capitalization of its activity, raising the capital from shareholders. The Bank of Albania has oriented and monitored this process, so that it is carried out in line with the banking activity development strategies and the performance of relevant risks. The process of strengthening the banking sector's capitalization indicators involves creating adequate capital sizes above its required minimum level. The process is taking place in line with the communications of the Bank of Albania with the banking sector. Subsequently, the banking sector will remain stable and will create conditions for enhancing its contribution to the economic development in Albania.