Bank of Albania

2009

FINANCIAL STABILITY REPORT

Published by: Bank of Albania, Sheshi "Skënderbej", Nr.1, Tirana, Albania
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Printed in: 900 copies
Printed at 'AdelPrint' Printing House

C O N T E N T S

T A B L E S

C H A R T S

PREFACE

This is the third issue of the Bank of Albania Financial Stability Report. Starting from the year 2010, it will be released twice a year. This change arises from the need to integrate the Financial Stability Statement, the six-month release of which is required by law, into a single document. Information, in terms of the number of publications, topics discussed and time appropriateness, is thus better consolidated and focused. The Financial Stability Statement opens the Report and generally serves as its summary.

The purpose of this Report is to detect and assess the risks the financial system and its infrastructure are faced with, in order to provide the public authorities the opportunity to identify the relevant measures for the necessary corrections. For the compilation of this Report we have used data available at the Bank of Albania, and information has been exchanged with other authorities supervising the activity of the financial market. The Report has also made use of information and analyses of public and private international financial institutions.

The data and analyses mainly cover the developments over the course of the year 2009. The expectations for future developments extend until the first half of the year or the year-end 2010. Starting from the next issue of this Report, the focus of the analysis will be the developments over the preceding six-month periods.

The financial system stability has been assessed based on the performance and risks arising from its interaction with the overall internal and external economic environment, and from its activity. In order to assess the risks arising from its interaction with the surrounding environment, we have analyzed the latest developments in the international financial markets and in developed and regional economies. We have also assessed their impact on the Albanian financial system and the banking sector. As far as domestic indicators are concerned, the present Report makes an assessment of the overall developments and expectations for the economic growth, trade balance, overall price level, exchange rate and fiscal indicators. It also provides an analysis of employment, personal income and its impact on the banking sector borrowers' solvency.

In order to assess the risks arising from the financial system's activity, the present Report also provides an analysis of the developments in its main *financial soundness' indicators, namely the capital, asset quality and financial performance. The magnitude of risks has been assessed through the stress test analysis built on several scenarios. The Report also makes a brief assessment of the nonbank financial sector's performance.*

In order for this Report to have a wide and diverse audience, the language used and the information presented in it is aimed to be as clear and appropriate as possible. The improved quality of the Financial Stability Report, in particular in terms of the data it contains, will be our objective for the future issues of this Report.

1 FINANCIAL STABILITY STATEMENT

Pursuant to the requirement of the Law No. 8269, dated 23 December 1997 "On the Bank of Albania", as amended, Article 69, and the Law No. 9962, dated 18 December 2006 "On Banks in the Republic of Albania, Article 8, to inform the Council of Ministers, the Parliament of the Republic of Albania and to draw the attention of the financial institutions and the public at large on the situation of the financial system in the country and the potential risks that may jeopardize its stability, the Bank of Albania releases the following periodical statement as part of the Financial Stability Report.

As a result of the extraordinary fiscal and monetary stimulus provided during 2008 and 2009 and following the improvement of the financial sector situation, the global economy has stabilized and its stable recovery is underway. In more concrete terms:

The extraordinary monetary and fiscal stimulus provided by the public authorities global-wide proved effective in lowering the pressures on the financial markets and mitigating the negative impact of the crisis on the real sectors of the economy. The return of financial markets to a stable situation happened faster than expected, however many of the markets' parameters that relate to volumes, liquidity or prices remain far from their pre-crisis levels, reflecting the presence of uncertainty among the economic agents. Borrowing conditions are still difficult, particularly for small and medium-sized enterprises and consumers. Structured products markets remain impaired, encumbering the intermediation role of financial institutions, while the functioning of capital markets in uncollateralized or low-quality segments was poor and at a high cost.

The financial sector's performance affected the performance of the real sector of the economy; however the recovery of the latter has by and large been slow. Advanced economies' economic activity contracted 3.9 percent in 2009; however under the impact of stimulating policies there have been clear signs of stabilization in the second half of year. The recovery of these economies is expected to be slow and output will remain below its historical trend, at least until 2011. Emerging markets provided the major contribution to the global economic output, posting an average total growth of 2.1 percent in 2009. Within this group of countries, Asian emerging markets provided the major contribution to the economic growth, while the European emerging markets displayed a slower economic recovery.

Europe's economic performance improved ever-increasingly over the course of the year 2009, in particular during the last quarter; however, the improvement was slower than in the U.S. and there were marked differences among the countries in the region. Monetary and fiscal stimulus and the recovery of trade activity were the two key factors that boosted the region's economic stabilization. Central and South-East European countries contracted 4.3 percent in 2009. Euro Zone countries contracted 4 percent. The European

Commission forecasts that the latter will grow in 2010 at a modest rate of 0.7 percent, with the bigger countries like Germany and France expected to provide the major contribution. Some other countries like Greece or Spain will continue to face contraction of their economies. The recovery pace of the economy will by and large depend on the financial sector's intermediation capacity, the performance of non-financial asset markets, the fiscal situation and the developments in the labour market.

The developments in the foreign exchange markets have reflected the markets' perception of the impact of the international financial crisis on the most advanced economies. The U.S. dollar depreciated against the Euro and other major currencies in 2009. However, it seems that in the last two months of 2009 the expectations for a more rapid recovery of the major economies, the movements in the policy rates and the stable fiscal positions gave rise to the appreciation of the U.S. dollar against the Euro. Nonetheless, volatility in these markets remained high reflecting the investors' uncertainty and the higher sovereign credit risk.

Following the dramatic fall of energy and primary commodity prices in the second half of 2008, prices stabilized in the early part of 2009 to later rise after the second quarter the same year. This performance owes primarily to the recovery of economic activity in emerging markets and the improvement of conditions in the global financial markets.

Despite the expectations for the stable recovery of global economy there are certain risks that may give rise to episodes of instability in various countries or regions. These risks will provide their impact in a longer-term and they originate from the measures taken to withstand the short-term effects of the crisis. In more concrete terms:

Because the stabilization of global economy has been achieved against a backdrop of extraordinary fiscal and monetary stimulus, it was accompanied by a deteriorated fiscal position and an unstable rise of financial and non-financial asset prices. These consequences require the withdrawal of the stimulus gradually and prudently. A number of factors that relate to the difficulties in harmonizing these policies at a global-wide level, to the potential halt of the economic recovery process in advanced economies and to the appearance of considerable volatilities in the financial indicators have preserved the financial markets' uncertainty about the performance of global economy in the future and encumbered the development of economy at faster paces.

The fast increase of budget deficits and public debt worldwide has put the various governments' solvency into question. Given its set-up and other structure-related issues, the European Union perceives the investors' reluctance more than in the U.S. The strained fiscal situation in some Euro Zone countries require that the strong corrective measures taken to reduce the budget deficit at a national level be backed with sufficient financial support at a European Union level, so that the sustainability of this joint political and monetary project is not seriously put into question. On the other hand, in more practical terms, this financial assistance is also necessary to mitigate the higher cost of debt for the private sector and to alleviate the contraction of economy as a result of the substantial decline of the fiscal stimulus.

The economies of Central and South-East European countries are still facing important challenges. According to the ECB's report, unemployment, the fall in income and private sector failures will remain at high levels in 2010, maintaining the negative impact on the banking loan portfolio quality and economic growth. In addition, the private sector's sensitivity to the exchange rate risk remains high due to the existing foreign currency borrowing.

Private entrepreneurship may still face a hard year as long as the withdrawal of the fiscal stimulus is not coupled with the increase of the financial system's intermediation. The private sector's capacity to finance their investment needs in the capital markets will be adversely affected by the excess capacities and inventories against a background of lower demand and higher private debt issuance cost. The slow recovery of the economy would lead to the further correction of costs and profit margins, hence determining the capacity of private entrepreneurship to withstand the possible fall of demand for goods.

Albania posted a positive economic growth during 2009, despite the impact of the global financial and economic crisis. The financial system, dominated by the banking sector, was stable and the fiscal and monetary stimulus mitigated the difficulties of the real sector of the economy. More concretely:

The Albanian economy faced slower economic growth rates during 2009, however maintaining a positive economic growth and displaying satisfactory resilience to the impact of the international financial and economic crisis. Among the factors that led to lower economic growth rate we can mention: the trade balance deficit sustainability; harder times for the private entrepreneurship due to lower foreign demand and contraction of banking sector lending; and lower dynamics in household consumption owing to the decline of banks' lending, lower workers' remittances and uncertainty over the depreciation of the national currency. Among the factors that boosted economic growth over the course of 2009 we can mention the public authorities' measures to rapidly restore public confidence in the financial system and the banking sector, and the fiscal stimulus provided through the increase of public expenditure, particularly of public investments.

With regard to fiscal policy, as at end 2009 budget surplus was negative and amounted to ALL 79 billion or 7.1 percent of GDP. According to the Ministry of Finance, budget revenues totalled ALL 298 billion, meeting 93.2 percent of the Ministry of Finance's revised budget plan, up by 2.4 percent from 2008. Budget expenditure amounted to ALL 377 billion, meeting 94 percent of the Ministry of Finance's revised budget plan, up by 7.8 percent from 2008. The increase of the budget deficit was followed by higher borrowing needs to finance it. Domestic resources financed 64 percent of the budget deficit, wherein privatization receipts accounted for slightly more than half of domestic resources. The rest was financed through external resources, out of which

63 percent were loans extended from non-resident financial institutions. The share of financing provided through borrowing from resident entities, through debt securities or loans, totalled ALL 23.8 billion or 30.8 percent of total deficit financing needs. The same indicators for 2008 were ALL 19 billion or 31.5 percent, respectively. As regards the instruments employed, there was a lower issuance rate of long-term debt securities relative to 2008. The rationale behind is the greater preference of investors –mainly banks and individuals– to invest in short-term instruments against a background of higher uncertainty over their needs for liquid funds. In the short run, the expansionary fiscal policy provided a counter-cyclical response to the impact of the global crisis on the performance of domestic economy. Worth taking into consideration is the fact that this stimulus' effect on economic development was weaker in the last quarter of 2009, hence calling for a better acknowledgement of the structural factors that condition the transmission of fiscal and monetary stimulus to the development of the economy. Stated otherwise, the real efficiency of an expansionary fiscal policy may be more accurately defined only by assessing the efficiency of the fiscal stimulus use in different development projects.

With respect to the real sector of the economy during 2009, various indicators attest to a generally less satisfactory situation than in 2008. This trend was more pronounced in the last quarter of 2009. Among the indicators we can mention the decline of budget revenues collected in the form of tax, the fall of investment and consumption as a result of lower banking sector lending and workers' remittances, and the economic growth slowdown. The information obtained through surveys confirms the same situation. Although the nominal sales grew by an average of 6 percent in 2009, their growth was only 2 percent in the last quarter of 2009. Industry and construction provided a negative contribution to the performance of sales, while services provided the major positive contribution. As far as the business economic situation is concerned, there were higher unexploited capacities and investments declined. In addition, the expectations about the overall performance of the economy have deteriorated. As at year-end 2009, the use of business capacities declined to 66 percent compared to the long-term average of 74 percent. After recording a positive performance in the previous two quarters, in the last quarter of 2009 economic expectations index dropped 16.8 percentage points from its long-term average. Business confidence index recorded losses in the last quarter of 2009 in its main components of industry, construction and less in services. On the other hand, consumer expectations about the development of the economy were more stable. With respect to the performance of the balance of payments in 2009, the current account and trade deficit recorded a slight decline in absolute terms. However, as a share of GDP, trade deficit was 27 percent, similar as in 2007 and 2008. Annual workers' remittances amounted to EUR 780 million, down by EUR 53 million from the previous year.

The financial system expanded its activity in 2009 although at lower rates than in 2008. Financial intermediation in Albania, measured as the share of financial system's[1] assets to the GDP, rose to 83 percent as at year-end 2009 compared to 82 percent at year-end 2008. Financial institutions' assets grew 7 percent relative to the previous year. The banking sector dominates the overall assets of the financial system. As at year-end 2009, in Albania operated 16 banks and their assets accounted for about 94.7 percent of total financial system's assets and about 78.5 percent of GDP. The banking sector's assets grew to ALL 886.3 billion, posting an annual nominal growth of 6.3 percent or a real growth[2] of 1.2 percent relative to the year-end 2008. The performance of the financial system's financial resources, revenue and capital was affected by the international financial crisis and its impact on Albania's real economy. As far as the banking sector is concerned, the decline of public deposits terminated at the end of the first quarter, and their return to banks progressed at stable rates during the rest of 2009. However, the changes in the liquidity situation, the exchange rate depreciation and the difficulties encountered by the real sector of the economy gave rise to slower lending and deteriorated loan quality. As at end 2009, lending, including the accrued interests, accounted for about 50.8 percent of total banking sector's assets or as much as 40 percent of GDP. In the meantime, the ratio of non-performing loans to total loan portfolio rose to 10.5 percent. The need to increase the reserve funds for coping with the credit risk from banks led to the decline of the banking sector's net profit. For these reasons, the latter was positive for about ALL 3.5 billion, almost half as much as the previous year. Business capitalization was adequate during 2009, as a result of lower high-risk bank investments, injection of new capital by the shareholders and the preservation of a net positive profit. As at end 2009, capital adequacy ratio was 16.2 percent. The public authorities took several measures in 2009 to support the financial system and the banking sector in particular. Among these measures, we could mention the approval of the law which increased the insurance amount of public deposits, and the decisions of the Supervisory Council of the Bank of Albania to limit banks' exposure to foreign banking groups and to suspend the allocation of banks' profit in 2008 and 2009. Along with these decisions, during 2009 a number of other Bank of Albania decisions taken since the last quarter of 2008 continued to be implemented. These decisions related to the establishment of more facilitating conditions as far as the provision of liquidity in the interbank market is concerned. The Bank of Albania decisions in January and October, which cut the key interest rate by 1 percentage point to 5.25 percent, contributed further to increasing the banking sector's opportunities to provide liquidity at a lower cost.

Given the need to attain a stable economic development, some actions need to be taken in order to correct the imbalances generated in 2009. More precisely:

Economic development at home during 2010 will be supported by a more favourable global economic situation, which will provide a better setting for foreign investments and will better boost the demand for the Albanian exports. However, this positive development is expected to be limited owing to the negative developments in the Greek economy. In the domestic economy, the developments noted during 2009 as regards the increase of budget deficit and domestic debt, the lower banking sector lending, and a more rigid situation in production and consumption need to be addressed through quick and decisive actions and in the course of an adequate time span. It is therefore indispensable to keep the budget deficit for 2010 under check and at levels that guarantee the observance of the targets outlined in the Medium-Term Macroeconomic Framework as regards budget deficit and public debt level. The cut in expenditure, in particular current expenditure, should be the main instrument to achieve this objective in the conditions when the performance of public revenue remains unclear and their growth potential appears limited. The cut of public expenditure will improve the current account deficit in the balance of payments, hence providing a positive impact on the factors determining the exchange rate stability. On the other hand, the consolidation of public finances, reflected through the recovery of budget deficit's downward trend, is of great importance in terms of the decline of its financing cost. It will also lead to improved liquidity situation in the financial market, releasing more financial resources into the system, the use of which will boost the private sector lending. Private entrepreneurship and households will continue to experience difficulties during 2010 as long as the unstable performance of disposable income and consumption will affect the preservation of free capacities and the low growth rate in private investment. However, this period should be used by the private entrepreneurship to control the costs and take the necessary measures for restructuring the activity in order to enhance the efficiency. In general, these actions of the fiscal authority and the private economic agents are in the short-term necessary to provide a more adequate environment that will enable the undertaking of other measures for increasing the contribution of production to economic growth and increasing the domestic savings in a longer-term.

The financial system will continue to expand its activity during the year 2010. Given the low share in the financial system, non-bank financial institutions will continue to expand their activity naturally. The banking sector will expand its activity at higher rates than in 2009, however less than the average long-term annual growth. The growth in activity will likely be more rapid in the second half of the year. As regards the financial resources, the banking sector will benefit from the stable growth of public deposits. The growth of ALL deposits will continue to be supported by the more stable savers' flows, the positive real return and the expectation for greater exchange rate stability. The growth of foreign currency deposits will reflect the seasonal performance, hence being higher during summer. The maturity structure of deposits is not expected to display any significant changes from the present situation; however the average maturity term of deposits is expected to be longer in 2010 relative to 2009. The extent of this change will be determined by the performance of depositors' income and the stimulus set by banks to orient the structure of savings. The Bank of Albania will continue to provide the necessary liquidity to the interbank market. As far as the credit lines and shareholders' capital are concerned, the Bank of Albania will continue to require from banks that they maintain the necessary amounts not only in order to carry out a normal banking business and comply with the regulatory framework requirements, but also in order to support the recovery of banking business at well-controlled risks. With regard to bank investments, the Bank of Albania expects slightly higher lending rates by the banking sector in 2010 relative to 2009, with the largest part of growth expected to take place in the second half of the year.

ASSESSMENT OF THE BANKING SECTOR'S RISK SENSITIVITY

The financial system's and particularly the banking sector's stability is defined in terms of the financial relations with the internal and external economic developments, and their interaction with the internal situation in the financial system. Based on the development analysis of 2009, general evaluations indicate that the level of risk for the financial system and the banking sector has decreased. Despite the short-term improvement of some financial activity-related elements, several challenges emerged over the course of the year 2009 that will affect the financial system and particularly the banking sector's activity in the medium term, hence requiring careful monitoring.

In the short-term, the banking sector's financial situation has benefited positively from the following developments:

a) *Substantial improvement of liquidity against a background of public confidence recovery and stable deposit growth*. It is assessed that during 2009, the annual growth of public deposits was 7.6 percent, rising to ALL 694.3 billion. This deposit level is almost similar to that of end September 2008, prior to the beginning of the deposit withdrawal. However, when comparing, we need to take into account the depreciation of the ALL exchange rate during 2009, which increases the ALL value of foreign currency deposits. Nonetheless, it is important that the growth of public deposits during 2009 maintained the stable rates in the early part of 2010 as well. The growth rate of public deposits would have been higher if the situation in the real sector of the economy had improved and the banking sector lending had recovered.

b) *Lower growth rate of the banking sector's risk-weighted assets*. During 2009, the growth of the banking sector's risk-weighted assets reduced substantially, owing mainly to the much lower growth rate of lending and the lower expansion of banking business in general. In fact, during 2009 the banking sector increased lending by about 13.2 percent, compared to the growth by about 35.7 percent in 2008. It is assessed that ALL loans grew about 23 percent, while foreign currency loans grew about 9 percent. However, in real terms, the real growth of foreign currency lending was negative.

c) *The depreciation of the national currency exchange rate during 2009 is assessed to have been at a reasonable rate and extent, providing the banking sector and other economic agents with the necessary time to take adequate and protective measures*. There are greater expectations for a stable exchange rate during 2010. However, the movements in the exchange rate against a background of a flexible regime are normal and should be an expected phenomenon by the economic agents and which they should be prepared for.

d) *The sustainability of the financial system's and particularly the banking sector's fundamental technical infrastructure such as the payment systems*. In this respect, it is assessed that the payment systems managed by the Bank of Albania have operated properly and have been adequately oversighted by the central bank. In order to ensure a normal operation and oversight of the payment systems, large and small value payments, the Bank of Albania has assigned the necessary human, financial and technological resources and has further improved the regulatory framework that enhances the payment systems' efficiency and safety. In addition, in the light of the increase in transactions' volume, the need for the improvement of procedures and technological infrastructure in order to support the normal operation of these systems in the future will be regularly followed-up.

The main sources of risk primarily relate to the macroeconomic situation at home and the internal situation of some banking business indicators. More concretely:

By and large, the economic developments will exert pressure on the private entrepreneurship and households' economic situation, at least in the first half of 2010. The improvements in global economy are expected to mitigate the effect of the expected and required reduction of fiscal stimulus on Albania's economic growth. However, this positive impact is expected to be more pronounced in the second half of 2010 once the Greek economy stabilizes and after the seasonal impact of tourism. The improvement of global economy will improve Albania's position in relation to the international one and will provide a positive contribution to the size of current account deficit. Nonetheless, this effect is expected to be more pronounced in the medium run. The financial situation of the real sector of economy, private entrepreneurship and households is generally expected to remain unchanged and its recovery is expected to take place in the second half of the year. This implies that the banking sector's lending activity will continue to face a challenging environment and the improvements in the loan quality require more time.

The banking sector should aim at a gradual recovery of lending through the monitoring of loan quality. The recovery of lending is a desirable development; however it should be carried out on the basis of a prudential analysis, monitoring carefully the loan quality performance. It is assessed that the deterioration of loan quality will peak in the first half of 2010 to later stabilize in the second half of the year. Its gradual but stable improvement is expected to take place in 2011. However, these general estimations require the prudential monitoring of the situation at individual banks, which may display a different performance from the average of the sector. Taking this into account and in more practical terms, it is necessary that banks reflect fully the size of non-performing loans for the existing loans and create reserves for covering the risk of loan losses. As far as non-performing loans are concerned, banks must identify customers with temporary and surmountable problems, and should set up policies that provide support to these customers in exchange to additional elements that hedge the bank against such credit risk in the future. As regards the customers assessed as having low creditworthiness, banks should without hesitation follow the procedures for the execution of the collateral and other forms of collateral, in order to recover as large as possible amount of credit. The entire decision-making in this process should be clear and documented, and should be based on the analysis of specialized bank structures. With respect to new loans, taking into account the experience of banks faced with loan portfolio problems, there should be a better sectoral distribution and a more reasonable balance between public and private investment projects, between customers representing business or household undertaking, between the forms of lending in ALL or in foreign currency, etc., orienting lending in order to reduce the exposure to more problematic forms and the concentration of lending in general. Assessing first and foremost the borrowers' creditworthiness and lending safety, the Bank of Albania considers that there is sufficient room for commercial banks -depending on their size and opportunities- to support the SMEs with more lending and provide greater funding opportunities in ALL. The performance of loan portfolio quality will continue to exert pressure on banks' net profit. In this context, the prudential monitoring of banking activity capitalization rates is of great importance, despite its current sufficient levels.

The banking sector remains sensitive to highly volatile exchange rate movements, in particular considering their impact on the loan portfolio quality, which is dominated by the foreign currency lending. The best solution would be provided by implementing more balanced lending policies that aim at increasing the share of ALL lending. With respect to the foreign currency position, the banking sector will as previously maintain a net open position in low values, curbing the extent of possible losses substantially.

In a broader context, the experience of other countries as regards the 2008 and 2009 events should encourage the Albanian public authorities to improve the legal and procedural framework of the actions for managing the situations that may jeopardize the financial system's stability, based on the changes being outlined by the standard-setting international bodies. This process should be harmonized among the public authorities observing the share of individual financial system segments.

The Bank of Albania concludes that the financial system and the banking sector's situation has improved relative to the year-end 2008 as regards the business management in the short term. In a longer term, the banking sector should pay great attention to handling the loan portfolio quality-related concerns. In spite of these developments, stress-test analysis and different scenarios of the development of some important macroeconomic and financial indicators show a stable banking sector.

2 GLOBAL DEVELOPMENTS

2.1 OVERALL GLOBAL ECONOMIC DEVELOPMENTS

Following the deep economic crisis that swept over the world in 2008 and extended until the first quarter of 2009, global economy seems to have gradually entered the recovery phase. The extraordinary monetary, fiscal and financial policies, initiated in the fall of 2008, intensified further in 2009 and had a decisive role in lowering the pressures in the financial markets and mitigating the crisis effects on the real sectors of the economy. The stabilization of the financial markets was faster than expected, particularly in the second half of 2009; however most parameters remained far from the pre-crisis levels reflecting the persistent high level of uncertainty. The positive performance of the financial sector affected the performance of the real sector, however the recovery of the latter was somehow slower. In annual terms, global economic activity contracted 0.8 percent in 2009 but it is expected to grow 3.9 percent in 2010 (IMF - January 2010 forecast). Advanced economies, which were hit the hardest by the global crisis, posted a total economic decline by 3.2 percent in 2009; however under the influence of extensive fiscal policy they showed signs of stabilization in the second half of the year. Their recovery is expected to be slow and output will remain below the historical standards until 2011. For some of these countries, the high unemployment and public debt levels, at a time when the financial markets are not completely functional yet, are expected to generate strong challenges over the present year. The group of emerging markets provided the major contribution to global economic activity, posting an average total growth of 2.1 percent in 2009, with China (8.7 percent) and India (5.6 percent)[3] contributing the most. The higher capital inflows and primary commodity prices are expected to lead to their quick recovery, however with substantial differences within the group. The IMF forecasts a total output of 6 percent for 2010 in emerging countries, with the Asian emerging markets leading the growth (8.4 percent growth in 2010). Latin American countries are expected to post a satisfactory growth in 2010 (above 4 percent), while the recovery is expected to be slow for European emerging markets (2 percent).

Despite the overall positive performance, a number of risks will persist in the global macroeconomic environment in 2010. First, the premature withdrawal of macroeconomic policy support is considered one of the main risks that may impair the future global growth and the restoring of balances. Second, advanced economies' economic recovery may be slower than expected, jeopardizing the curb of economic growth in the rest of the world. Third, the rapid increase of budget deficit and public debt worldwide as a result of the stimulating fiscal policies in 2009 may yield unstable financial markets and increase of borrowing cost for the private sector hence lowering the recovery rates.

U.S. economy continued to suffer the economic crisis' effects in the first half of 2009 through further decline of output and higher unemployment to levels inexperienced since the 1980s. The extraordinary and continuous interventions of the Federal Reserve and the U.S. Government, through stimulating monetary and fiscal policies, stabilized the financial and real estate market and boosted demand and consumption in the second half of 2009. According to BEA's data[4], real U.S. GDP grew -2.4 percent in 2009 (0.4 percent in 2008), reflecting the fall in investment, exports and private consumption. On the other hand, GDP growth was positive in the third and fourth quarter of 2009 (2.2 and 5.9 percent, respectively), providing evidence that the U.S. economy has now entered the recovery phase. According to the IMF, despite the positive performance of the real and financial sectors over the last months of 2009, the impact of some factors namely the high unemployment rates, low consumption and investment, low trade exchanges etc., will cause the U.S. economic growth to be modest at 2.7 percent.

Current account deficit reduced by 2.3 percentage points in 2009, reflecting primarily the weakening of U.S. private consumption. Unemployment rate remained high. The U.S. real estate market showed signs of stabilization in the last months of the year and the fall of housing price terminated in July 2009. On the other hand, corporate sector's financial situation remained difficult and the rate of bankruptcy high, whilst the banking sector's lending conditions were tight. This was somewhat offset by the increase in the issuance of debt and new shares in the financial markets beginning from the second quarter of 2009. Inflation was negative in the first three quarters of 2009 increasing modestly by 1.4 percent in the last quarter.

Table 1 Key macroeconomic indicators in the U.S. for 2007-2009 and forecast for 2010

	2007	2008	2009	2010*
Real GDP growth (annual %)	2.1	0.4	-2.4	2.7
Annual inflation rate (%)	2.9	3.8	-0.3	1.7
Annual unemployment rate (%)	4.6	5.8	9.3	10.1
Current account deficit	5.2	4.9	2.6	2.2
Budget deficit (% of GDP)	-2.8	-5.9	-12.5	-10.0
Gross government debt (% of GDP)	61.9	70.4	84.8	93.6

Source: IMF, "World Economic Outlook", October 2009; IMF, "World Economic Outlook" Update, January 2010; BEA (Bureau of Economic Analysis), February 2010

The severe deepening of budget deficit and the fast increase of public debt as a result of the stimulating fiscal measures have turned into one of the major concerns of the U.S. markets. The recovery of these indicators is expected to represent one of the hardest challenges for the U.S economy in the following year.

Europe's economic perspective has been also improving over the course of the year 2009, but at slower rates than the U.S. and with pronounced differences among the countries. Europe's advanced economies continued to suffer decline of output in annual terms, particularly in the first half of 2009, owing to the fall of domestic demand, fall of investments and contraction of trade activity between the regional countries. According to Eurostat[5], over the whole year 2009, EU and Euro area's GDP decreased by 4.2 and 4.1 percent, respectively; however it posted a modest positive increase in the third (EU 0.3 percent and Euro area 0.4 percent) and fourth quarter (EU 0.1

percent and Euro area 0.1 percent), ending the longest recession in the history of this region. Exporting economies, like Germany and France, which were particularly affected by the fall of foreign demand during the crisis, began to recover more rapidly owing to the recovery of global trade and higher demand from the emerging markets.

Table 2 Key macroeconomic indicators in the EU and Euro area

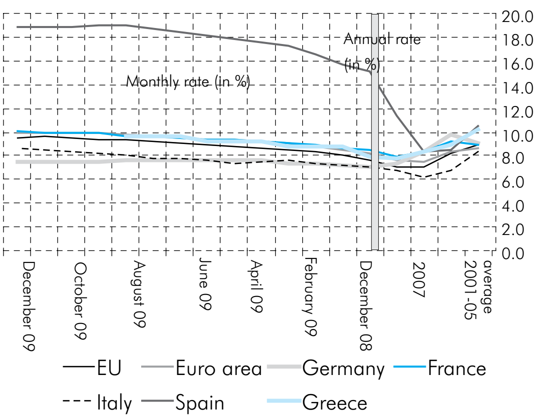
	Real GDP growth (%)				Inflation (annual average)				Current account balance (% of GDP)			
	2007	2008	2009	2010*	2007	2008	2009	2010*	2007	2008	2009	2010*
European Union	2.9	0.8	-4.1	0.7	2.3	3.7	1.0	1.4	-1.1	-2.0	-1.7	-1.5
Euro area	2.8	0.6	-4.0	0.7	2.1	3.3	0.3	1.1	0.1	-1.1	-1.0	-0.8
Germany	2.5	1.3	-4.8	1.2	2.3	2.8	0.2	0.7	7.9	6.6	4.0	3.8
France	2.3	0.4	-2.3	1.2	1.6	3.2	0.1	1.2	-2.3	-3.3	-2.3	-2.2
Italy	1.5	-1.0	-4.8	0.7	2.0	3.5	0.8	1.7	-1.8	-3.0	-2.4	-2.2
Greece	4.0	2.9	-1.1	-0.3	3.0	4.2	1.3	1.4	-14.7	-13.8	-8.8	-7.9
Spain	3.6	0.9	-3.6	-0.6	2.8	4.1	-0.3	1.1	-10.0	-9.5	-5.4	-4.6
Non-Euro area												
United Kingdom	2.6	0.5	-4.8	0.6	2.3	3.6	2.2	2.4	-2.7	-1.6	-2.4	-1.6

Source: Eurostat database, European Commission "European Economic Forecast", Autumn 2009; European Commission, Interim Forecast, February 2010

Monetary and fiscal measures taken by the EU, Eurosystem and authorities in individual countries, and the recovery of trade activity, were the key factors that generated the EU's (and Euro area's) economic resurgence. The European Commission forecasts[6] that the EU and Euro area's economy will grow 0.7 percent in 2010, with Germany and France posting the largest growth. In the meantime, other countries like Greece and Spain will continue to suffer economic contraction. The pace of economic recovery in some of the countries will be affected by the continuous pressures in the housing market, tensions in the banking sector and the labour market performance.

Inflation in the EU and Euro area was low throughout the year 2009. In summer it marked negative rates mainly as a result of the fall in food and energy prices and the sluggish economic situation. The situation in the labour market continued to deteriorate almost throughout the year 2009. In December 2009, unemployment rate reached to an average of 10 percent for the Euro area and 9.6 percent for the EU (see Chart 1). In some countries like Spain, Ireland and Slovakia, unemployment rates reached double-digit figures.

Chart 1 Unemployment rate in the EU and Euro area



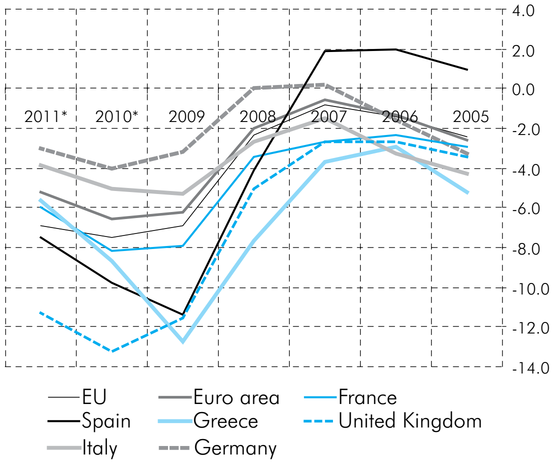
Source: Eurostat database, Eurostat News release, 1 March 2010

The European Commission forecasts that unemployment in Europe will continue to increase in 2010 and begin to fall modestly in 2011. Nonetheless, employment in Europe will largely depend on the performance of economic activity and the degree it will reflect into the labour market. In light of these developments, consumer demand will remain low, providing in turn a negative contribution to the growth of export-oriented countries.

In Europe's advanced economies, central banks lowered the interest rates substantially and took a number of non-conventional measures like the direct acquisition of assets (Bank of England) or the purchase of covered bonds (ECB). A considerable portion of public income was used by these countries to support the financial sector, mainly through guarantee schemes and injection of capital, and the real sector through stimulating fiscal packages.

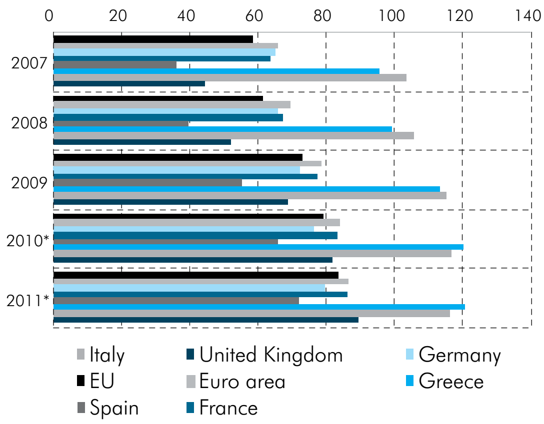
Consequently, the fiscal positions deteriorated substantially in the entire EU region (see Charts 2 and 3) and some countries like Greece, Ireland and Spain posted double-digit deficit figures in percentage of their respective GDP. Total fiscal deficit for the Euro area rose from 2.0 percent of GDP in 2008 to 6.2 percent of GDP in 2009, whilst the public debt rose from 69.4 percent of GDP in 2008 to 78.7 percent of GDP in 2009. Overall, 14 out of 16 Euro area countries recorded fiscal deficits above the reference value of 3 percent of GDP in 2009. These countries will be subject to the fiscal consolidation process in the following two years.

Chart 2 General Government balance in EU and Euro area



Source: ECB, Eurostat

Chart 3 General Government debt in EU and Euro area



Source: ECB, Eurostat

Greece suffered the largest deterioration of its fiscal balance in the Euro area, with the budget deficit reaching a minimum of 12.7 percent of GDP in 2009 (7.7 percent in 2008), whilst the public debt reached 113.4 percent of GDP (99.2 percent of GDP in 2008), increasing in turn the risk of Greece's financial destabilization and lowering the country's rating in the financial markets. Based on the recommendations of the ECOFIN Council summoned in 16 February 2010, Greece was given notice to undertake a comprehensive reform in order to reduce the budget deficit to within 3 percent of GDP by the deadline of 2012 (reduce by 3.5 percentage points in 2010 and 2011 and by at least 2.5 percentage points in 2012).

With respect to Central and South-East European countries, their macroeconomic situation deteriorated substantially until the first quarter of 2009. A number of countries like Romania, Bulgaria and the Baltic countries experienced a rapid decline in their exports and capital inflows, which in turn yielded considerable decline of output. Private sector credit declined substantially in almost the entire region, creating a vicious circle between the economic activity downturn and deterioration of banking system's asset quality. In the early months of 2009, the declining stock prices persisted, the currencies depreciated and the interest rate spreads in the capital markets continued to rise. Some Eastern European countries like Hungary, Lithuania, Romania, Serbia etc., sought the IMF's assistance to balance the balance of payments, whilst Poland gained access to the flexible credit line from the IMF.

The situation improved in the second half of 2009 following the implementation of a number of stimulating measures by central banks and the respective governments. The pace of economic downturn slowed down and some countries experienced modest economic growth. Risk perception moderated; however private sector credit remained weak and unemployment maintained upward rates throughout the year. Pressures on the financial markets eased, reflecting into the decrease of interest rates and spreads in the capital market; yet they were higher than the pre-crisis levels. The financial crisis pressure led to the mitigation of macroeconomic imbalances in the second half of 2009. Current account deficits declined substantially and a number of countries posted current account surplus.

Table 3 Key macroeconomic indicators in Central and Eastern Europe

	Real GDP growth (%)				Inflation (annual average)				Current account balance (% of GDP)			
	2007	2008	2009*	2010*	2007	2008	2009*	2010*	2007	2008	2009*	2010*
Central and Southeastern Europe		3.1	-4.3	2.0	6.0	8.1	4.8	4.2	-7.9	-8.0	-3.1	-3.9
Hungary	1.2	0.6	-6.7	-0.9	7.9	6.1	4.5	4.1	-6.5	-8.4	-2.9	-3.3
Poland	6.8	4.9	1.0	2.2	2.5	4.2	3.4	2.6	-4.7	-5.5	-2.2	-3.1
The Balkans												
Bulgaria	6.2	6.0	-6.5	-2.5	7.6	12.0	2.7	1.6	-25.2	-25.5	-11.4	-8.3
Romania	6.2	7.1	-8.5	0.5	4.8	7.8	5.5	3.6	-13.5	-12.4	-5.5	-5.6
FYROM	5.9	4.9	-2.0	1.5	2.2	8.3	-0.6	1.1	-7.2	-13.1	-9.6	-9.2
The Baltic countries	8.9	-0.7	-17	-3.7	7.3	12.2	2.6	-2.5	-17.7	-11.4	2.3	2.6

Source: IMF - "World Economic Outlook", October 2009; IMF, "World Economic Outlook" Update, January 2010; EC - "European Economic Forecast", Autumn 2009

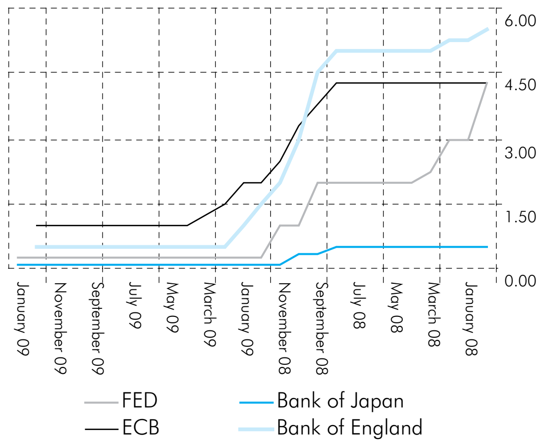
The IMF projects an average growth of 2 percent in 2010 and 3.7 percent in 2011[7] for the Central and Eastern Europe. This indicator is expected to show marked differences among the countries. The Baltic countries will continue to contract, whilst being offset by a considerable growth of production in other countries like Poland and Turkey.

Despite the positive signals, the environment is expected to remain challenging for most countries in this region, posing a number of risks to economic growth and financial stability. According to the ECB report, unemployment, the fall in revenue and private sector failures will remain high in 2010 increasing in turn the risk of banks' portfolio deterioration and economic growth slowdown. The large exposure to the exchange rate created by the private sector (households and firms) as a result of the large borrowing in foreign currency remains another major risk. At the same time, external debt and the financing cost in this region remain very high, while the risk of capital exit remains present. Lastly, considering the close financial and trade ties between this region and the EU countries, their economic recovery will depend largely on the economic stabilization of advanced EU economies.

2.2 MAIN GLOBAL FINANCIAL MARKET HIGHLIGHTS

The year 2009 and the second half in particular attested to an overall improvement of conditions in the global financial markets. Public intervention, the very low interest rates and the positive expectations for the recovery of global economy prompted the improvement of markets and gave a new impetus to the movement of capital flows. Initially, the main incentive was provided by the extraordinary public policies undertaken by the monetary authorities and governments worldwide in the late 2008 and in 2009. These policies included the guarantees to cover the financial institutions' deposits, capital injections, provision of additional liquidity and the support to credit markets. In the second half of 2009, the improvement of macroeconomic parameters contributed positively to restoring the lost investor confidence, being reflected in the decline of interest rates and increase of transaction volume in most capital market segments.

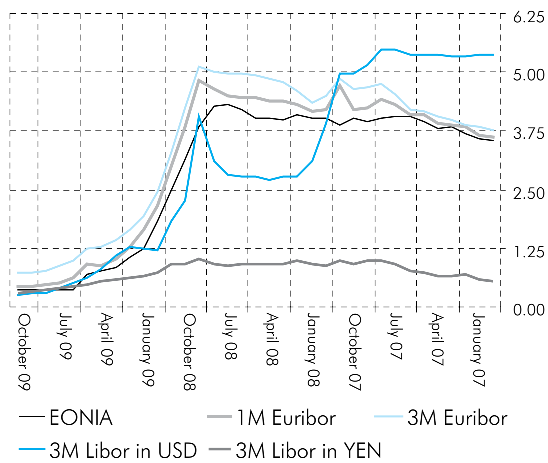
Chart 4 Key interest rate in advanced economies



Source: ECB, Federal Reserve, Bank of Japan

Despite the overall spirit of optimism, the situation in some financial market segments remains tense and highly dependent on public support. Borrowing conditions are still difficult for a good part of borrowers, particularly for small and medium-sized enterprises and consumers. Structured products markets remain impaired, hence encumbering the intermediary role of financial institution, whilst the functioning of capital markets in uncollateralized or low-quality segments was poor and at a high cost. Global financial and macroeconomic environment remains difficult and the public's perceived risk is high; therefore the complete recovery of financial markets will take time.

Chart 5 Money market rates



Source: ECB, Eurostat

Money market developments. As a result of central banks' support, activity in the money markets normalized, transaction volumes grew and the interest rates began to decline gradually, in several cases moving close to the pre-crisis levels. In the U.S., the release of stress-test results for the largest U.S. banks and the implementation of Troubled Asset Relief Program helped to recover confidence in the banking sector and the financial system in general. In Europe, the ECB's existing measures expanded further, putting into effect three new one-year refinancing operations[8] and the covered bonds acquisition programme. At the same time, central banks, mainly in advanced economies, pursued a largely expansionary monetary policy keeping the interest rates close to zero (see Chart 4).

The above measures proved successful in gradually reducing the credit and liquidity risk of banks and in easing the pressures in the money markets. This was reflected in the considerable decline of interest rates and narrowing of spreads (see Chart 5). In the U.S. money markets, the spread between the quarterly LIBOR and OIS (overnight index swap) rate, widely used as an indicator of banks' liquidity and counterparty risk, lowered to almost the pre-crisis levels. By contrast, the LIBOR-OIS spreads for maturities longer than 3 months remained above the historical levels reflecting the presence of pressures in longer term segments. In the Euro area markets, the EURIBOR-OIS spread continued to narrow for almost all maturities, gradually approaching the pre-crisis levels. However, in the last months of 2009, the downward rate of spreads moderated owing to a large part to the announcement of the beginning of the ECB's exit strategies. The exit strategies worldwide will put the stability of markets to a hard test and may yield higher interest rates in the money markets.

Capital market developments. Capital markets rebounded in the second half of 2009, being reflected in higher volumes of new issuances in the primary markets, decrease of interest rates, reopening of uncollaterized securities' markets etc. Government bond markets suffered a general decline of the yields in 2009, however showing high volatility among the government securities of different countries. Despite the large-quantity purchases by the Federal Reserve, the U.S. government bond market suffered a decline of demand in the second half of 2009. The latter was due to the shift of investors from safe to more profitable securities as a result of improved confidence in the financial markets, improved economic expectations and higher concerns over the deepening of government debt.

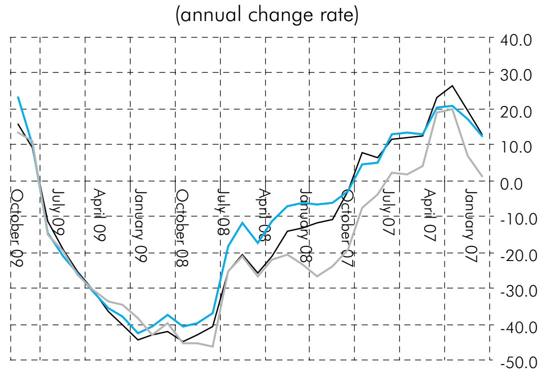
In the Euro area markets, long-term government bond yields have generally been declining owing to the positive expectations for the performance of economic activity and higher investor demand. However, the downward rate of the yields and spreads in the Euro area was dissimilar, reflecting the different market perceptions of the macroeconomic and fiscal situation in the Euro area countries. Therefore, the government securities' interest rates in countries affected the most by the crisis remained high.

The consequences of the financial crisis on the stock markets worldwide extended until the first quarter of 2009, reflecting the poor macroeconomic performance of advanced economies and the concerns related to the financial sector's exposures. The situation began to change positively after March 2009 and particularly in the second half of the year, as a result of a combination between increased economic activity, improved expectations and reduced perceived risk.

Despite the higher stock prices in almost all U.S. economic sectors, the increase in the financial sector's stocks dominated. The European stock markets attested to the same tendency. By late November 2009, the price/earnings ratio for most standard Euro area stocks had risen markedly. Significant increases in stock prices in the Euro area have pushed this ratio for the stocks of financial companies above the historical average level. The increase of earnings in these markets led to the rapid recovery of all indices (see Chart 6), however their performance suggests that uncertainty in the stock markets, albeit significantly lower, remains above the pre-crisis level. Despite the satisfactory performance, investors remain highly sensitive to any negative signals. The latter became evident in the immediate and negative response of the stock markets following the financial problems of Dubai World in November 2009. As for the future, the greatest concern for the stock markets, particularly in the USA and Europe, is the risk of an overturn of the positive performance once the support policies of the authorities are withdrawn or in case the recovery is slower than expected. In both cases, the performance of the activity and ultimately the private sector earnings would be hampered, therefore leading to a new wave of stock price decline.

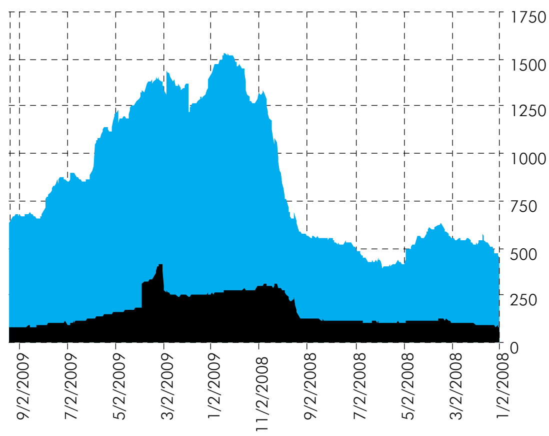
Chart 6 Main stock market indices

(annual change rate)



Source: ECB, Eurostat database

Chart 7 Corporate spreads BB and AAA



Source: IMF - "World Economic Outlook", October 2009

The global credit market conditions remained difficult in the first months of 2009, due to the further deterioration of the financial institutions' portfolio and the negative expectations for economic activity. Credit markets continued to suffer high volatility and upward rates until March 2009 to later make a positive turn that peaked in the third and last quarter of the same year. The recovery of stock market prices, the signs of stabilization in the financial system and the measures taken by the authorities in advanced economies to boost activity in the credit markets[9] yielded a general improvement of market sentiment. This was reflected in lower interest rates of debt securities and narrowing of credit spreads, initially for financial companies and later for non-financial ones. The issue volumes of new equity grew substantially in the second half of 2009 compared to 2008, however remaining below the pre-crisis levels. In the U.S. credit markets, the conditions improved considerably in corporate bonds reflecting the positive expectations for the U.S. economy and the higher investor interest in lucrative securities. The issue of corporate bonds in the Euro area capital markets grew substantially and a large number of companies managed to replace borrowing from banks with borrowing from the financial markets. Despite the overall positive performance of the capital markets, activity in structured products and securitization instruments remained weak and highly reliant on the central banks' support. This owes to the low demand and the high level of uncertainty related to these products.

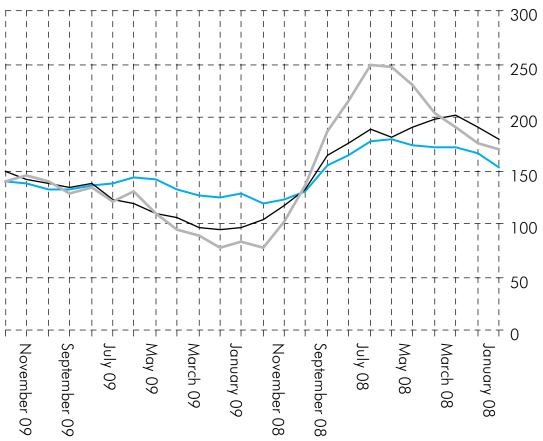
Emerging countries' markets. The good economic performance of emerging countries, particularly in the second half of 2009, and the general decline in perceived risk fuelled the recovery of capital inflows to emerging markets. This brought about considerable rise of stock prices, increase of issuance activity and decline of interest rates in the capital markets. The performance of stock and capital markets in emerging countries exceeded the performance of mature markets.

On the other hand, the high capital flows and the speed of recovery, particularly in Asia, has raised the concerns over the stability of growth in these markets and the risk of asset-price bubble. Another risk the emerging markets may be faced with is that the recovery of asset prices may take a reverse direction in the event global economic activity slows down once the monetary and fiscal stimulus is withdrawn. This would in turn increase the uncertainty and prompt a new wave of capital flow.

PRIMARY COMMODITY MARKETS

Following the marked fall of prices in the second half of 2008, primary commodity markets began to stabilize in the beginning of 2009, to later post a modest growth after the second quarter. This owes primarily to the recovery of economic activity in emerging countries and to the improved conditions in the global financial markets.

Chart 8 Primary commodity price indices



Source: IMF database

Oil price in the international markets was volatile throughout the year 2009. Average price per barrel was USD 61 or 38.7 percent lower than the average annual price in 2008. This change was a result of the dampened aggregate demand and decline of production in industrialized economies. On the other hand, the appreciation of the U.S. dollar against some major currencies and OPEC's production policies in 2009 kept the oil price in the international markets upward.

As for the future, primary commodity prices are expected to rise, fuelled by the growth of global demand – particularly from the emerging countries. However, this pressure is expected to be modest due to the high inventory levels and free capacities in many primary commodity sectors.

Box 1. An overview of the financial position of the foreign banking groups operating in Albania[10].

1. RAIFFEISEN INTERNATIONAL (AUSTRIA)
As at end December 2009, Raiffeisen International Bank's total assets declined 10.7 percent to EUR 76.3 billion from the year-end 2008. Customer deposits totalled EUR 42.6 billion, down by 3.7 percent from the year-end 2008. Customer loans declined 12.8 percent to EUR 50.5 billion. As at end September 2009, non-performing loans in South-Eastern Europe accounted for 5.7 percent of the portfolio, up by 4 percentage points, the lowest compared to all the other regions.

As at year-end 2009, Raiffeisen International's net consolidated profit was EUR 212 million, down by 78.4 percent y-o-y. Provisions amounted to EUR 1738 million, up by 122.8 percent y-o-y. The high provisions provided a negative impact – through the net profit – on the profitability indicators. As at year-end 2009, return on equity (before tax) was 5.7 percent, down by 16.3 percentage points y-o-y.

As at end of 2009, Raiffeisen Bank Albania accounted for 2.4 percent of total assets of Raiffeisen International.

2. INTESA SANPAOLO (ITALY)
Intesa Sanpaolo's (Italy) assets totalled EUR 624.8 billion as at year-end 2009, down by 1.8 percent from the year-end 2008. Customer loans declined 5.2 percent y-o-y to EUR 374 billion, whilst deposits amounted to EUR 421.9 billion, down by 0.2 percent y-o-y. Intesa Sanpaolo Italy closed the year 2009 with a net profit of EUR 2805 million, up by about 9.9 percent y-o-y. Net provisions and adjustments amounted to EUR 4,238 million, up by 11 percent from EUR 3,833 million in 2008. However, return on equity* is estimated at 5.2 percent for 2009, almost similar as in 2008 (5.1 percent).

As at end of 2009, Intesa Sanpaolo Bank Albania accounted for about 0.1 percent of total assets of Intesa Sanpaolo group.

* The sum of paid-up capital, reserves, revaluation reserves and net profit of the period.

3. ALPHA BANK (GREECE)
As at year-end 2009, Apha Bank's (Greece) assets totalled EUR 69.6 billion, up by 6.6 percent y-o-y. Total deposits amounted to EUR 42.9 billion, up by 0.9 percent y-o-y. Deposits in Greece (EUR 36 billion) were stable compared to December 2008, while in South-Eastern Europe they grew 3.7 percent y-o-y, to EUR 6.3 billion. Impairment losses were EUR 676.3 million, of which EUR 163 million in South-Eastern Europe (up by 81 percent from 2008). Non-performing loans increased by 50 basis points in the last quarter of 2009 to 5.7 percent as at December 2009, while for South-Eastern Europe non-performing loans accounted for 4.1 percent of total loan portfolio, up by 60 basis points for the last quarter of 2009 alone.

As at year-end 2009, Alpha Bank reported a net profit of EUR 349.8 million, a 32 percent y-o-y decline from 2008, due to the slowdown of economic activity in Greece and South-Eastern Europe. Net interest income reached EUR 1,762.6 million, down 2 percent y-o-y. In the last quarter, net interest income reached EUR 458 million, largely unchanged from the third quarter the same year.

Operating cost increased 2 percent to EUR 1,201.9 million, which corresponds to a cost-to-income ratio of 50.5 percent in 2009.

As at end of 2009, Alpha Bank in Albania accounted for about 0.7 percent of total assets of Alpha Bank (Greece).

4. PIRAEUS BANK (GREECE)
As at year-end 2009, total assets of Piraeus Bank Greece were EUR 54.3 billion, down by 1 percent compared to the same period the previous year. 2009 net profit amounted to EUR 235 million, 25 percent lower than in 2008 due to the considerably higher provisions. Net interest margin to average earning assets was 2.6 percent in 2009 versus 3.0 percent in 2008. This owes to the contraction generated from the higher deposit cost, which was particularly pronounced throughout the year 2009. Operating expenses stood at similar levels as in the same period the previous year (EUR 893 million versus EUR 897 million in 2008), despite the increase in the average number of branches. Cost/income ratio was 54 percent in 2009, close to the previous year's ratio. Return on equity (before taxes) stood at 7.9 percent in 2009, down by 271 basis points versus 2008.

As at end of 2009, Tirana Bank accounted for about 1.1 percent of total assets of Piraeus Bank group.

5. NATIONAL BANK OF GREECE (GREECE)
As at year-end 2009, total assets of NBG group amounted to EUR 113.4 billion. Net profit was EUR 971 million, 37 percent lower than the previous year's figure. About 59 percent of the group's profit in the third quarter was generated from foreign affiliates. Net profit of South-Eastern Europe's units amounted to EUR 93 million in 2009, down by about 51 percent from the previous year's figure (EUR 190 million). Net profit in Greece was about EUR 398 million, down by 57 percent y-o-y. The latter owes to the almost doubled provisions, which in 2009 amounted to EUR 618 million versus EUR 322 million in 2008. As a result of the provisioning policy, the group's provision funds totalled EUR 2.5 billion or 3.4 percent of aggregate lending, covering 64 percent of non-performing loans excluding the collateral. The main sources of the group's income grew 6 percent, owing primarily to the higher interest income (+5 percent on a quarterly basis and +10 percent on an annual basis). The interest margin increased on a quarterly basis, keeping the annual margin in over 4 percent.

As at end of 2009, the NBG branch in Albania accounted for 0.3 percent of total assets of NBG group.

6. SOCIÉTÉ GÉNÉRALE (FRANCE)
As at year-end 2009, Société Générale's total assets amounted to EUR 1023.7 billion, down by 9 percent versus 2008. The bank's international network reported an increase in income (+1.9 percent compared to 2008) amounting to EUR 4.7 billion and contributing to the group's 2009 net profit by about 22 percent. Deposits

in the international network grew 5.4 percent, whilst loans dropped 2.6 percent relative to 2008.

The group's 2009 net profit was EUR 678 million, down by 66.3 percent y-o-y. Net return on equity was 0.9 percent (versus 6.4 percent in 2008). In the last quarter alone, the latter improved markedly (1.5 percent versus 0.4 percent in the last quarter of 2008).

Société Générale's net banking income totalled EUR 21.7 billion, down by 0.6 percent versus 2008. Operating expenses increased 1.5 percent relative to 2008 to EUR 15.8 billion.

As at end of 2009, Banka Popullore in Albania accounted for about 0.03 percent of total assets of Société Générale's group.

7. CREDIT AGRICOLE (FRANCE) and EMPORIKI BANK (GREECE)
As at year-end 2009, Credit Agricole's total assets amounted to about EUR 1557.3 billion, down by 5.8 percent versus 2008. Net profit totalled EUR 1125 million, up by 9.9 percent versus 2008. Net banking income amounted to EUR 17.9 billion, up by 12.4 percent y-o-y. Operating expenses fell 3.6 percent to EUR 12.2 billion, whilst gross operating income increased 73.4 percent versus 2008 to about EUR 5.8 billion. Risk-related costs amounted to EUR 4.7 billion, growing significantly over the course of the year as a result of the strained economic conditions in Greece.

Emporiki Bank provided a negative contribution of EUR –458 million to the group's profit for 2009. Risk-related costs continued to be adversely affected by Emporiki, however they stabilized in the last quarter and almost reduced by half over the course of the year.

As at end of 2009, Emporiki Bank in Albania accounted for about 0.01 percent of total assets of Credit Agricole's group.

3 MACROECONOMIC DEVELOPMENTS

The Albanian economy posted a positive real economic growth in 2009, despite the negative impact of the global economy. Various demand indicators however suggest that the dynamics of economic growth was changeable over the course of the year 2009, slowing down in the last quarter. The factors to have led to the slowdown – in addition to external-related – include the liquidity shortages in some key sectors of the economy and the lack of investment opportunities, against a background of upward uncertainties that has affected the exchange rate performance as well. The economy has benefited from the stable fiscal stimulus, while private investments have declined. After some recovery in the early 2009, fuelled by the improved public confidence in the financial system, consumer demand suffered the effects of banks' reduced lending and decline of transfers from abroad in the last part of the year.

The contraction of demand curbed the inflationary pressures in economy. As at end of 2009, annual inflation marked 3.5 percent. Average annual inflation rate was 2.2 percent. On the other hand, the potential emergence of inflationary pressures in advanced economies and the negative exchange rate performance have led to higher cost of living. In order to keep inflation close to 3 percent, the Bank of Albania has employed its policy instruments, so as to provide the economy with monetary stimulus, and has cut the key interest rate by 1 percentage point. The injection of liquidity into the system has mitigated the effect of lower financial resources for banks and has in turn enabled lending to economy.

Table 4 Key macroeconomic indicators

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Annual real GDP growth, at constant prices versus 2008, in %[11]	7.94	4.23	5.77	5.71	5.72	5.4	6	7.8*	3.3*
GDP at current prices, in million ALL	583,369	622,711	694,098	750,785	814,797	882,209	966,651	1,087,867*	1,143,373*
GDP per capita, in USD	1,323	1,437	1,831	2,336	2,597	2,854	3,394	4,073*	3,765
Number of employed persons, in thousand	1,065	921	928	917	932	934	935	970	972**
Unemployment rate	14.6	15.8	15	14.6	14.2	13.8	13.4	12.6	12.8**
Inflation rate (y-o-y)	3.5	1.7	3.3	2.2	2	2.5	2.9	3.4	3.5
Budget deficit (including grants, in % of GDP)	-28.9	-6.6	-4.5	-5.1	-3.6	-3.1	-3.5	-5.7	-7.0*
Public debt (in % of GDP)[12]	66.8	65.3	61.7	56.6	56.7	55.9	52.2	55.9	59.5*
External debt (in % of GDP)[13]	25.8	23.5	20.6	18	17.5	17.2	14.4	18.3	23.1*
Current account (excluding official transfers, in % of GDP)	-6.1	-10	-7.9	-5.6	-7.7	-7.2	-11.2	-15.2	-15.6*
ALL/USD average exchange rate	143.5	140.1	121.9	102.8	99.8	98.1	90.4	83.9	95.0
ALL/EUR average exchange rate	128.5	132.4	137.5	127.7	124.2	123.1	123.6	122.8	132.1

** Preliminary estimates.*

*** As at end of the third quarter.*

Source: INSTAT, Bank of Albania, Ministry of Finance, IMF

The depreciating trend of the Albanian Lek against the major currencies that began in late 2008, persisted throughout 2009. The factors believed to have affected the exchange rate performance relate to the global crisis and its impact on the domestic market; we can mention the reduced workers' remittances, the decline of exports, the contraction of foreign currency-denominated loans and the wavering of economic agents' confidence. In addition, the imbalanced supply-demand ratio was coupled with the seasonal effect that has characterized the growth of demand for foreign currency in given periods of the year.

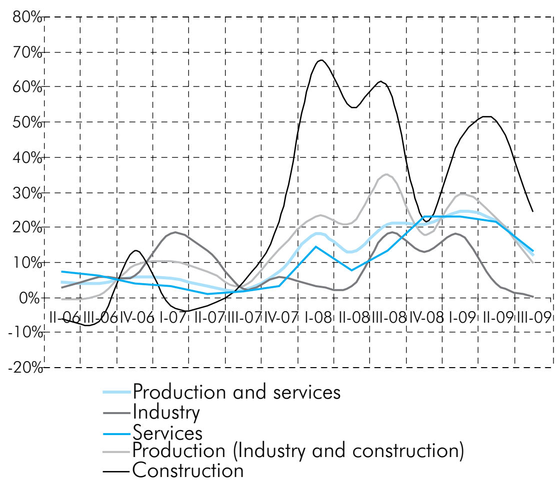
3.1 PERFORMANCE OF ALBANIAN ECONOMY AND BUSINESSES

Economic growth rates slowed down in 2009 as a result of external influences and materialization of some internal risks that brought about the contraction of aggregate demand. As at the end of the last quarter, preliminary estimates show that the GDP grew 3.3 percent in annual terms, slowing down from 5.4 percent in the first quarter to -0.8 percent in the last quarter. According to INSTAT's quarterly release of the GDP, post and telecommunication, trade and transportation posted the highest growth in the last quarter of 2009 versus the last quarter of 2008. They grew 8.3, 7.2 and 3.0 percent, respectively. Construction and industry posted a decline of 14.4 and 41 percent in this quarter versus the same period the previous year.

Business and consumer confidence indices, fiscal indicators of revenue and credit to economy signal worsened figures in the last quarter of 2009.

The Turnover Volume Index (see Table 5 and Chart 9) reached 152.7 in the third quarter of 2009, up 12 percent versus the third quarter of 2008. The Turnover Volume Index for industry and services declined 5 percent compared with the third quarter as a result of the lower performance of industry and construction in the third quarter. The Turnover Volume Index for industry is almost similar to the third quarter of 2008, while down by 1.5 percent from the previous quarter. The Turnover Volume Index for construction declined 8.3 percent versus the previous quarter, while up by 24.5 percent compared with the third quarter of 2008. The average annual increase of the first three quarters of 2009 is, however, 40 percent or 20 percentage points lower than the same period the previous year. The Turnover Volume for construction slowed down significantly versus 2008; in the third quarter it grew 21.5 percent versus 63.4 percent in the third quarter of 2008. Services grew 13 percent in annual terms.

Chart 9 Turnover Index



Source: INSTAT, Short-Term Statistics, third quarter of 2009

Table 5 Production by branches

Turnover Volume Indicator	I-07	II-07	III-07	IV-07	I-08	II-08	III-08	IV-08	I-09	II-09	III-09
Production and services	94.7	105.6	112.9	120.7	111.8	119.1	136.2	146	139.4	145.2	152.7
Production (industry and construction)	92.1	113.2	108.1	134.7	113.5	137.4	146	158.9	147	168.7	160.8
Industry	108.7	126.2	112.6	112.7	112.4	130.3	133.3	127.5	132.4	135.5	133.5
Extracting industry	116.2	172.5	144.5	125.3	117.6	177.3	147.3	109.5	88.5	128.6	149.9
Processing industry	108.3	127	117.4	117.7	109.7	132.1	138.8	131	130.7	140.1	131
Energy, gas and water	105.5	107.2	87.2	92.5	115.1	109	110.7	119.1	148.7	121.4	132.9
Construction	69	95.2	101.7	164.9	114.8	146.8	162.8	201	166.7	221	202.7
Services	96.3	101.2	115.6	112.7	110.1	109.1	130.8	138.9	135.5	132.8	148
-Trade	94.6	100.8	115.5	112.7	110.6	108.5	129.2	141.5	131.3	127.4	142.3
-Transportation and communication	103.7	102.1	115.5	112.7	111.1	110.7	138.8	126.5	142	142.3	167.3
-Hotels	78.7	117.2	141.6	129.7	103.1	114.1	142.9	108.6	111.2	130.2	149.6

Source: INSTAT, Short-Term Statistics, third quarter of 2009

Table 6 GDP by economic activity, percentage change of a quarter to the same quarter the previous year (Qy,i/Qy-1,i)

Data series are expressed in terms of prices of a base year (2005=100)												
	2007				2008				2009			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agriculture, hunting and forestry	1.6	1.4	2.7	5.7	8.6	7.7	7.1	7.7	3.1	3	2.7	1.7
Industry	-2.8	-5	-16.3	-21.5	-11.6	7.2	21.6	25.7	6.5	3.2	-8.3	-4.1
Construction	32.1	4.5	0.1	10.8	9.7	16.6	9.6	-9	-3.9	18.2	0.7	-14.4
Trade, hotels and restaurants	5.5	5.6	6	6.2	13.5	8.3	10.2	3.9	2.5	4	7	7.2
Transportation	15.2	17.7	1.7	-4.7	1.9	-10.7	-9.1	4.2	-1.3	13.4	16.7	3
Post and communication	9.5	34.7	18.9	10.9	7	19	17	32.3	52.9	23.7	37	8.3
Other services	6.1	9.5	13	17.5	22.3	12.5	8.8	-3.7	2.3	2.6	0.8	0.1
Total value added	7.5	5.7	3.9	6.3	10.6	9.4	9.4	3.1	4.1	6.6	4.2	-0.3
FISIM	25.3	25.7	23.1	19.6	9.4	1.5	1.4	6.7	10.5	14.8	14	10.6
Gross value added at base prices	6.8	5	3.2	5.9	10.7	9.7	9.7	2.9	3.8	6.3	3.9	-0.8

Source: INSTAT, Quarterly GDP, April 2010

Table 7 GDP by economic activity, annual percentage change

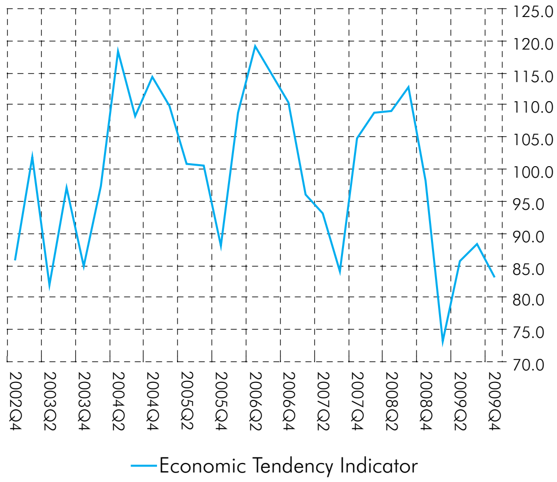
Data series are expressed in terms of prices of a base year (2005=100)												
	2007				2008				2009			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agriculture, hunting and forestry	2.5	1.6	1.7	2.6	4.2	6.3	7.4	7.7	6.4	4.9	3.9	2.7
Industry	6.3	3.9	-0.35	-11.7	-13.8	-10.9	-2	10.3	15.1	13.8	5.7	-1.2
Construction	15.2	16.7	13.5	10.1	6.5	9.2	11.6	4.8	1.9	2.8	0.8	-0.6
Trade, hotels and restaurants	1.9	2.8	5.1	5.9	7.6	8.2	9.3	8.6	6.3	5.3	4.5	5.4
Transportation	2.6	8.2	6.6	6.6	3.9	-3.2	-6.1	-4	-4.7	1.5	8.6	8.3
Post and communication	10.3	20.3	22.4	17.6	16.7	13.9	13.6	19.5	30	30.8	35.9	18.2
Other services	4.9	6.1	8.8	11.8	15.7	16.3	15.1	9.1	4.5	2.3	0.4	1.4
Total value added	5.4	6.3	6.3	5.8	6.5	7.5	8.9	7.9	6.5	5.8	4.5	3.6
FISIM	16.9	19.1	22.8	23.3	19	12.8	7.5	4.7	5	8.3	11.5	12.4
Gross value added at base prices	5	5.9	5.7	5.1	6	7.3	8.9	8.1	6.5	5.7	4.2	3.3

Source: INSTAT, Quarterly GDP, April 2010

The contraction of aggregate demand in the last quarter of 2009 is confirmed by the Economic Tendency Indicator (ETI), which decreased to 83.2

following its increase in the previous two quarters. In the first quarter of 2009, it recorded its lowest level (73.3) since 2002.

Chart 10 Economic Tendency Indicator



Source: Bank of Albania

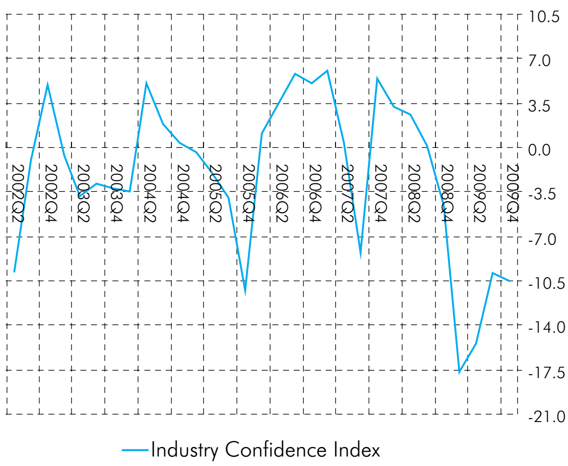
Construction provided the major adverse contribution to the ETI. Its confidence index recorded the lowest historical level. In addition, the confidence indices for industry and services were 127 and 126 percent lower than as at year-end 2008. Consumer confidence index is also lower than in 2008.

Businesses have reported lower current and expected demand for 2009 in the three surveyed sectors. Order contracts declined and the capacity utilization dropped to 65.6 percent in the last quarter of 2009. Business expectations for demand are also downward, although according to the consumer survey, current and expected purchases seem to have marked a turning point following the contraction in 2008.

The financial situation of the three surveyed sectors deteriorated due to the low demand, particularly in the second half of 2009. However, the year-end 2009 attested to marked improvement – excluding the construction sector, relative to the year-end 2008.

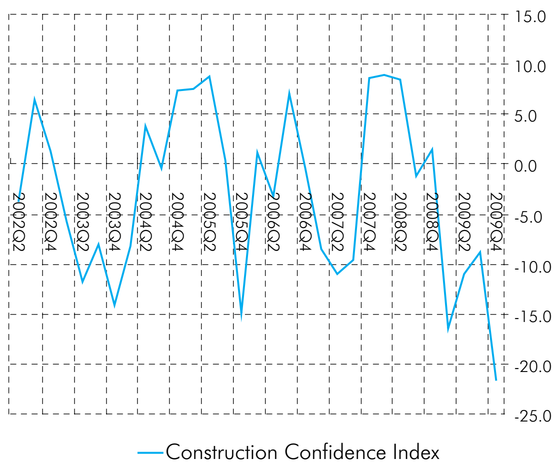
The severe economic situation in the second half of 2009 has been also reflected in consumers' financial position. As at the end of 2009, consumers' current financial position deteriorated substantially compared to the end of the first half the same year.

Chart 11 Industry Confidence Index



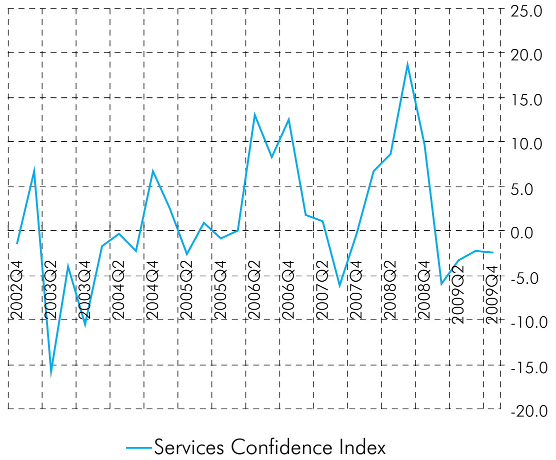
Source: Bank of Albania

Chart 12 Construction Confidence Index



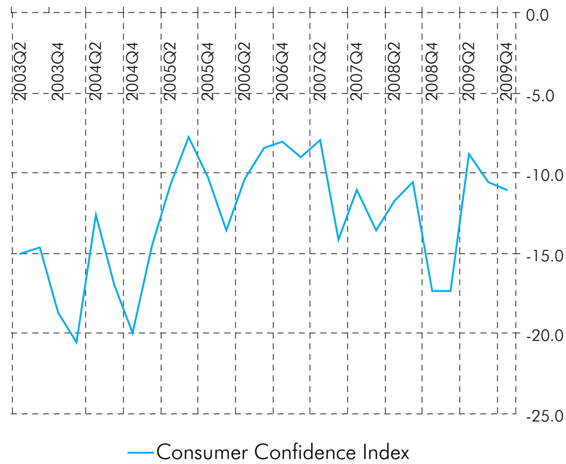
Source: Bank of Albania

Chart 13 Services Confidence Index



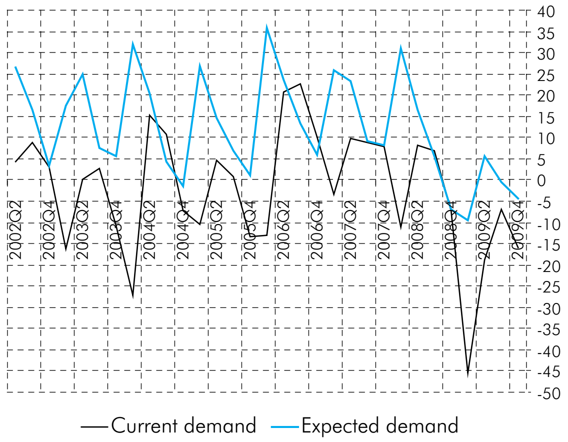
Source: Bank of Albania

Chart 14 Consumer Confidence Index



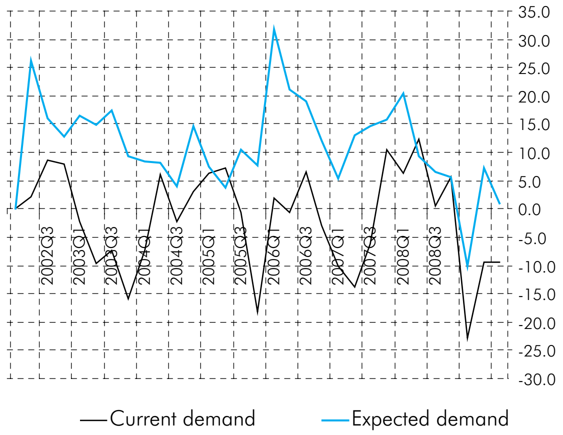
Source: Bank of Albania

Chart 15 Current and expected demand – Industry



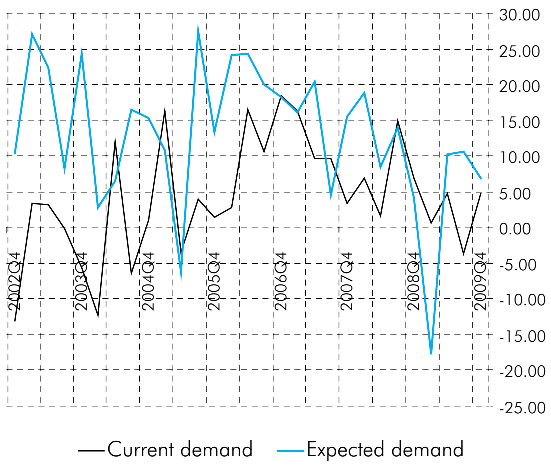
Source: Bank of Albania

Chart 16 Current and expected demand – Construction



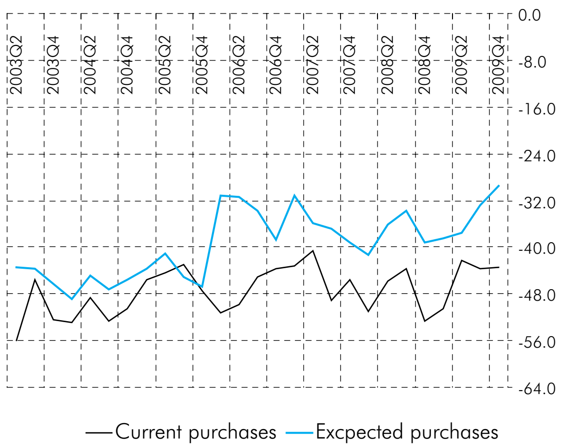
Source: Bank of Albania

Chart 17 Current and expected demand – Services



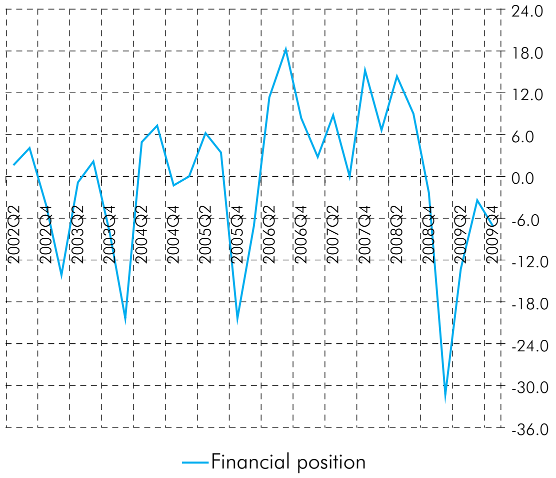
Source: Bank of Albania

Chart 18 Current and expected purchases – Consumers



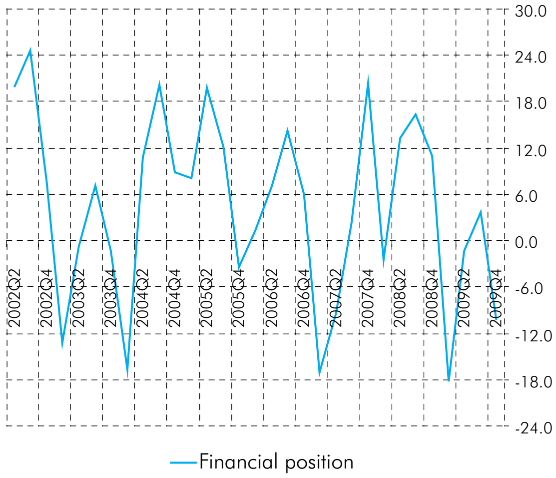
Source: Bank of Albania

Chart 19 Financial position – Industry



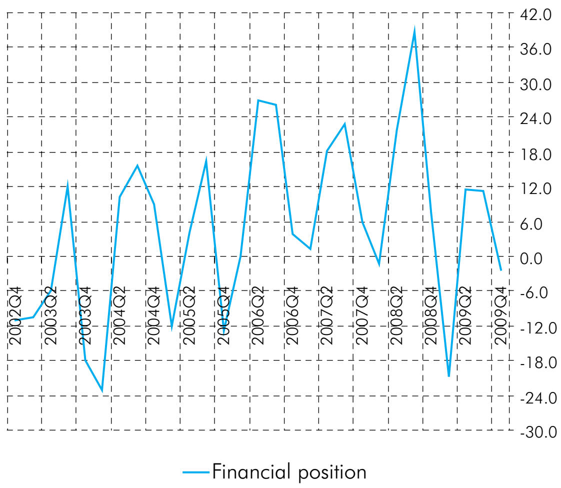
Source: Bank of Albania

Chart 20 Financial position – Construction



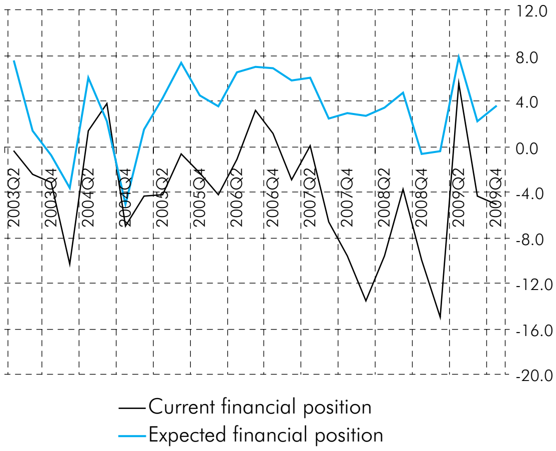
Source: Bank of Albania

Chart 21 Financial position – Services



Source: Bank of Albania

Chart 22 Current and expected financial position - Consumers



Source: Bank of Albania

3.2 EMPLOYMENT AND HOUSEHOLDS' WELFARE

As at the end of the third quarter of 2009, unemployment rate reached 12.76 percent. Private non-agriculture sector provided greater contribution to the employment of labour force compared to the same period the previous year.

According to INSTAT, in the third quarter of 2009, the number of employed persons in the private sector increased in all sectors of the economy, excluding industry, compared to the same period the previous year. In the meantime, wages recorded stable rise. Relative to the third quarter of 2008:

- In industry, the number of employed persons reduced 4.6 percent relative to the same period the previous year, while wages rose 2.0

percent;

- In construction, the number of employed persons increased 9.5 percent, while wages rose 12.7 percent;
- In trade, the number of employed persons increased 9.6 percent, while wages rose 14.4 percent;
- In hotels, the number of employed persons increased 18.3 percent, while wages rose 14.4 percent;
- In postal services, the number of employed persons increased 3.2 percent and wages rose 16.3 percent. In communication, the number of employed persons declined 8.7 percent and wages 14.7 percent.

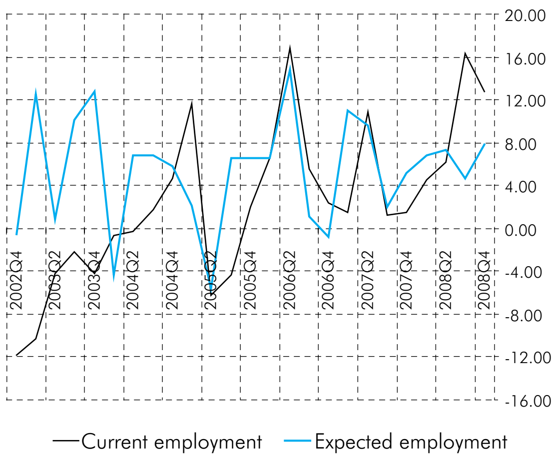
Table 8 Employment indicators

Labour market (in thousand people)	IV-07	I-08	II-08	III-08	IV-08	I-09	II-09	III-09
Labour forces	1082	1080	1079	1110	1116	1114	1114	1114
-Employed persons	939	939	939	970	974	973	973	972
a) Public sector	167	167	167	167	167	167	166	166
b) Private non-agriculture sector	230	231	231	235	239	238	238	237
c) Private agriculture sector	542	542	542	569	569	569	569	569
- Unemployed persons	143	141	140	140	141	141	141	142
- Unemployed persons benefitting unemployment payment	10	9	9	10	10	8	8	9
Unemployment rate	13.2%	13.04%	12.97%	12.62%	12.68%	12.68%	12.7%	12.76%

Source: INSTAT

According to the quarterly surveys of the Bank of Albania for the three business sectors (industry, construction and services – Charts 23-25), employment declined in the end of 2009. In addition, business expectations signal further decline of employment, excluding the services' sector.

Chart 23 Current and expected employment – Services



Source: Bank of Albania

Chart 24 Current and expected employment – Construction

Source: Bank of Albania

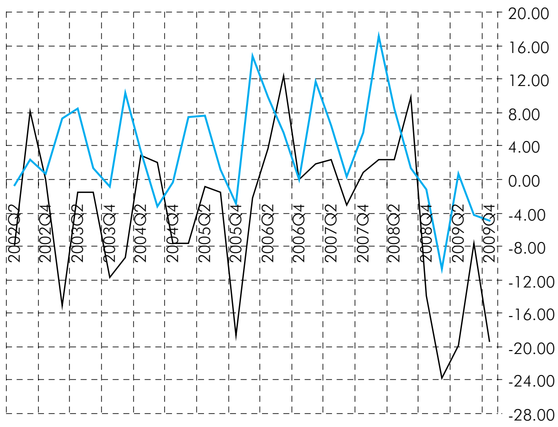
Workers' remittances are another important source of households' income. In 2009 they amounted to EUR 780 million, down 6.39 percent from 2008.

The decline of remittances was an expected performance given the employment indicators in advanced European countries. In the short-run, it is also expected to be affected by the contraction of demand and employment in these countries.

Chart 26 shows time-related concordance between the increase of the unemployment rate in EU countries, particularly in Greece and Italy, and the decline of workers' remittances.

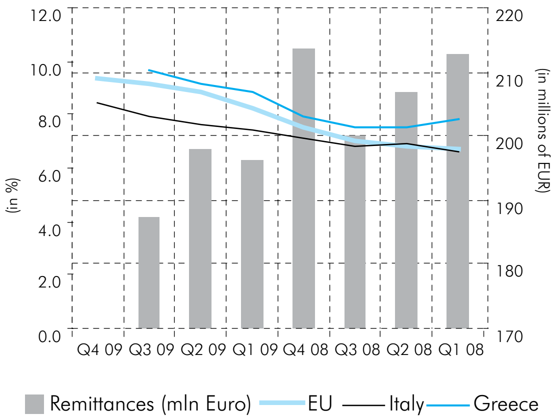
The performance of unemployment in EU countries is not the only rationale behind the decline of remittances. In light of the curtailed financial resources for European banks (elaborated in the global part of the present Report), the collection of deposits from the residents of respective economies may become a priority for these banks and emigrant savings may gradually shift to the countries of their economic interest. Consequently, the contraction of supply with foreign currency and household income may persist even after the EU countries have recovered. Therefore, measures are required to be taken in order to find domestic resources for Albanian household income and prevent a drastic correction of consumption. On the other hand, the maintenance of stable exchange rate levels would require an offsetting decline of demand for foreign currency, be it in the form of lower imports or demand for foreign currency borrowing.

Chart 25 Current and expected employment – Industry



Source: Bank of Albania

Chart 26 Workers' remittances and unemployment rate in selected EU countries



Source: Bank of Albania, Bureau of Labor Statistics, Eurostat

3.3 BALANCE OF PAYMENTS

In light of the low global demand and contraction of revenues, the balance of payments attests to the slight correction of trade deficit. The latter's impact on the exchange rate was lower and has moderated the remittances' contraction effect.

In 2009, the external sector of the economy attested to moderate trade deficit and decline of remittances and portfolio investments. On the other hand, the depreciation of the national currency throughout the year and the higher primary commodity prices smoothed the decline of exports. As at the end of 2009, reserve assets grew EUR 32 million, sufficient to cover 4.2 months of imports.

As at the end of 2009, current account deficit accounted for 15.6 percent of GDP versus 14.9 percent in 2008, down 3.2 percent from its 2008's value. Trade deficit accounted for 25 percent of GDP versus 27.9 percent in 2008, down 7 percent. The rationale behind its improvement is the reduction of the trade deficit in goods by EUR 127 million. Imports and exports declined on an annual basis. Imports were about 9 percent lower in 2009 versus 2008, while exports were down by 14 percent.

As at the end of 2009, capital and financial account surplus amounted to EUR 1018 million, down EUR 562.7 million versus 2008, owing primarily to the decline of portfolio investments and other investments, hence financing only 76.7 percent of the current account deficit.

Foreign direct investments slowed down by 3.4 percent in 2009 compared with the annual double-digit increase by 40.4 percent in 2008. Privatization receipts have played a key role in the increase of foreign investments. In 2009, they amounted to EUR 220 million.

Public borrowing totalled EUR 396 million, up 4.5 percent versus 2008. Private borrowing totalled EUR 39 million, down 53.6 percent versus 2008.

3.4 FISCAL DEVELOPMENTS IN 2009

As at year-end 2009, budget revenues and expenditure met 93 and 94 percent of the projection, respectively. Compared with the same period the previous year, budget revenues and expenditure were 2.4 and 7.8 percent higher, reflecting the expansionary fiscal policy and the slowdown effects of economic activity. The changes in the revenues and expenditure realization pace triggered a negative budget balance of ALL 79.9 billion.

Budget revenues showed a downward tendency particularly after the first quarter of 2009, owing primarily to the revenues from tax and customs, local government and non-tax revenue. Almost all other revenue items – except revenue from customs and social insurance – shifted from the projection. However, revenues from customs contracted in annual terms.

Personnel expenditure and social insurance expenditure remain the major contributors to the increase of expenditure. However, after the approval of the normative act, they were below the revised projection. The contribution of capital expenditure has become more significant in the last two years due to the expenditure on major infrastructure-related projects.

The performance of budget revenues and expenditure brought about the increase of budget deficit, which as at year-end 2009 accounted for 7 percent of GDP[14]. The nominal value of ALL 79.9 billion for the 12-month period is the peak level for the same period over the last decade. This budget deficit is 33 percent higher than the same period in 2008 and it was coupled with higher borrowing needs relative to the previous years. Syndicated loans were employed in 2009 in addition to the instruments widely employed to finance the budget deficit in the previous years. Revenues from the privatization of state-owned enterprises have played a key role in 2009 deficit financing, hence lowering the liquidity pressures in the money market.

Table 9 Budget deficit financing

	2006	2007	2008	2009
Revenues	229.4	251.6	291.2	299.2
Expenditure	258.8	285.7	351.5	379.1
Budget balance	-29.4	-34.1	-60.3	-79.9
Financing	29.4	34.1	60.3	79.9
Domestic financing	23.6	28.8	24.4	51.4
Domestic borrowing	20.7	17.0	15.0	18.7
Privatization receipts	2.0	13.2	5.5	27.6
Other[15]	0.9	-1.5	3.9	-1.1
Syndicated loans from residents	0.0	0.0	0.0	6.2
Foreign financing	5.7	5.3	35.8	28.5
Foreign resource projects	5.7	5.3	35.8	10.1
Syndicated loans from non-residents	0.0	0.0	0.0	18.4

Source: Ministry of Finance

The higher increase of the budget deficit in 2009 relative to 2008 increased the public debt to 59.6 percent of GDP versus 56 percent of GDP as at year-end 2008.

The deepening of budget deficit and its financing during 2009 affected the orientation of financial flows into the economy. The higher Government needs for borrowing generally leads to limited supply of private sector credit. The consolidation of public finances lowers the risk premia in economy, providing more room to private sector credit, hence favouring the flattening of the interest rate curve and lowering the cost of lending further. Therefore, the initiatives to lower the budget deficit and keep the public debt under check contribute to the country's stable and long-term growth.

Table10 Credit to economy, in million ALL

Indicator	December 2007	March 2008	June 2008	September 2008	December 2008	March 2009	June 2009	September 2009	November 2009	December 2009
Domestic assets	618,926	638,569	683,714	712,787	725,737	727,373	745,897	760,189	773,419	780,222
Net claims on Central Government	256,840	255,744	265,569	265,655	257,992	245,574	261,781	264,766	269,286	269,923
Claims on public non-financial corporations	3,923	4,450	4,557	7,205	12,899	14,228	12,634	12,815	12,012	12,056
Claims on private sector*	285,425	306,984	338,608	365,237	377,924	396,635	399,714	408,854	412,198	416,496

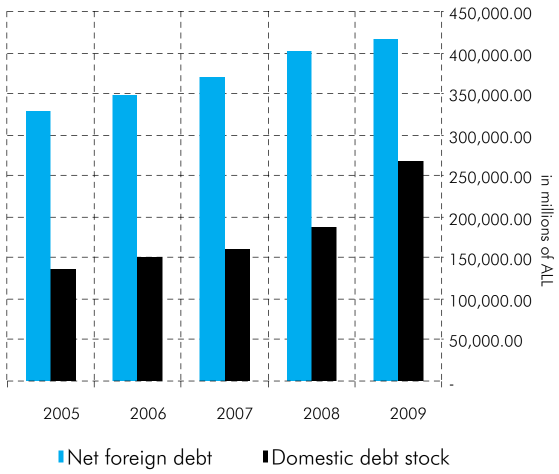
**It includes claims on other non-financial corporations and other resident sectors.*

Source: Bank of Albania

Foreign resources financed 35.66 percent of budget deficit in 2009 versus 64.33 percent of financing via domestic resources. In 2008, foreign and domestic financing accounted for 60 and 40 percent, respectively.

Pursuant to its policy, the Ministry of Finance has aimed at extending the average duration of public debt in 2009, hence providing more room for better debt management. However, the issuance policy of long-term

Chart 27 Public debt components



Source: Bank of Albania and Ministry of Finance

instruments did not progress as projected for 2009. The situation in the securities market was affected by the liquidity situation in the market, and it was associated with higher securities' yield and maturity spreads. After the third quarter of 2009, the focus shifted to shorter-term debt instruments, mainly 12-month T-bills.

Foreign financing provides room for establishing a better debt structure balance and aims at improving its cost in the medium run. The issuance of Government debt instruments in foreign currency and their purchase from non-resident institutional investors are supplemented with incentives for fiscal discipline.

It is imperative to monitor the upward trend of foreign financing in the future in order to assess the risk of refinancing under unfavourable terms and the capacity to cope with the cost of debt.

The possible refinancing of foreign debt under more favourable terms in the medium run should be duly considered in order to opt for alternative options in case of difficulties coming across in practice. Regarding the foreign debt performance, we note that the loan portfolio of variable interest rate increased substantially in the last two years. Against a similar setting, this portfolio becomes more sensitive to the volatility of benchmark interest rates in the international market and the exchange rate volatility that may in turn impact the budget considerably. Therefore, the utmost efficient use of debt should constitute a major objective.

Criteria need to be set and met diligently for foreign debt borrowing in order to cope with the cost of refinancing or settling on the maturity date. In addition to the borrowing terms, the amount of borrowing should be proportionate to the real capacity of the economy to generate stable funds in foreign currency over the same period, for instance from the performance of exports or entry of foreign direct investments. The forecast of foreign inflows is important in order to identify the impact of borrowing, use and settlement of foreign debt on the exchange rate performance.

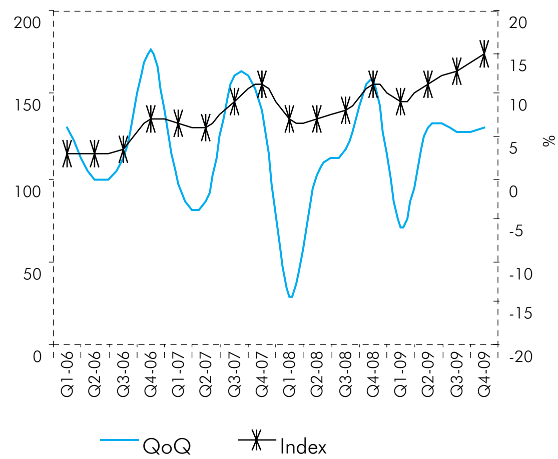
For the year 2010 it is crucial that general public expenditure be dependent on the performance of revenues. Restoring the downward tendency of the budget deficit is imperative for reducing its magnitude and financing cost, hence improving the liquidity situation in the financial market further and generating more financial resources in the system. Lowering this deficit provides greater guarantee for more favourable terms of debt refinancing over the course of time.

4 MARKETS

4.1 REAL ESTATE MARKET

The performance of housing prices is of prime importance to the financial system at home, the public and construction industry. Given the role that the real estate market plays in the financial system, the banking sector and the household's long-term consumption, the monitoring of the real estate price performance and the factors determining their change is highly important. Therefore, special attention needs to be paid to the real estate market. House Price Index for Tirana[16] posted high growth rates in 2009 after a period of declining prices in 2008.

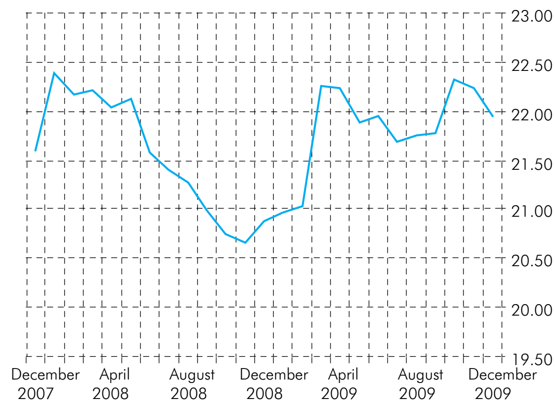
Chart 28 House Price Index for Tirana



Source: Bank of Albania

In annual terms, the House Price Index increased 11.6 percent in the last quarter. Its average increase for 2009 was 13.6 percent. After its negative quarterly changes in the first quarter of 2009, the changes remained close to a positive figure of 5.8 percent for the rest of the year. The increase reflected primarily the depreciation of the Albanian Lek over this period, given that the house prices are mainly expressed in Euro.

Chart 29 Share of real estate loans as a percentage to outstanding loans



Source: Bank of Albania

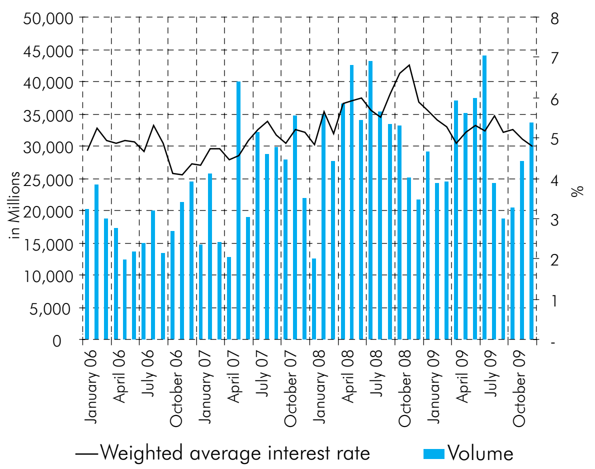
The factual increase of the House Price Index starting from the second quarter of 2009 was preceded by construction-related business' expectations for higher producer prices. Upward price trends in the construction sector suggest for a stable supply in the real estate market. On the other hand, the tight lending conditions on the demand-side suggest for its contraction. The slower real estate lending owes to the tighter banks' lending policies and standards, and to the contracted demand for this type of loan. Banks' tight lending policies were mainly applied on the increase of the collateral coverage ratio, increase of loan instalment to personal income coverage ratio, better collateral quality selection and reduced loan maturity term in several banks. Demand for housing loans was also affected by the expectations for lower housing prices.

Construction Cost Index that evaluates the performance of construction cost reached 128.4 percent (Q4 1999=100) in the last quarter of 2009, up 0.1 percent from the previous quarter and down 0.5 percent from the same period in 2008. The rationale behind the decline of this Index is the negative change of "direct expenditure" price index by 0.7 percent relative to the last quarter of 2008. This item accounts for 67.6 percent of total expenditure, hence sharing the main weight in construction costs. The index of "expenditure on materials" declined 1.5 percent relative to the same period in 2008. Prices of construction materials dropped 1.8 percent in the last quarter of 2009 compared with the last quarter of 2008. Prices of electrical and hydro-sanitary materials rose 8.3 and 1 percent, respectively. Construction Cost Index attested to an increase of expenditure on wages and transport by 2.1 and 3.1 percent, respectively. The same Index shows an annual increase by 0.1 percent of anticipated profits, while it does not show any significant changes for the other items relative to the previous quarter and the same period the previous year. Construction Cost Index shows that housing prices did not fully reflect the performance of construction costs, implying somehow the higher profit margins for the construction industry. In order to draw conclusions on the housing price performance in the future, it is imperative to improve the information collection methodology, which would in turn provide greater geographical coverage and a more accurate assessment of this market.

4.2 FINANCIAL MARKETS

The Albanian financial market is dominated by the operations in the interbank market, Government debt security market and the foreign exchange market. Other market segments that relate to the insurance, reinsurance and pension funds account for a small share to total financial market volume. As at the early 2009, the situation in the financial market deteriorated, the interbank interest rates increased due to lower liquidity levels and volatility in the foreign exchange market. In response to the measures taken by the Bank of Albania and the overall improvement of the liquidity conditions, the situation normalized in the second half of 2009.

Chart 30 Interbank market



Source: Bank of Albania

4.2.1 INTERBANK MARKET

Interest rates in the interbank market stabilized in 2009. Compared with the year 2008, weighted average interest rate was less volatile and ranged between 5 and 6 percent. The normalization of interest rates reflects improved confidence and liquidity situation in the interbank market as a result of the measures taken.

4.2.2 SECURITIES' PRIMARY MARKET

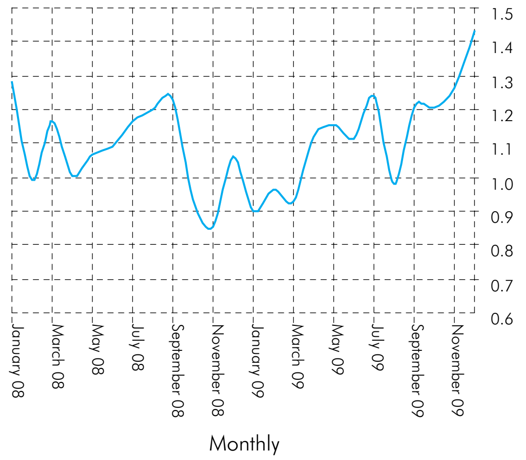
The yields in the primary market maintained an upward tendency throughout most of the year 2009, to later shift direction in November and December in response to the easy monetary policy. The key interest rate cut at end-October seems to have been passed through to the primary market yields at a time when the high participation of banks in this market and the previous interest rate cuts did not seem to provide a significant impact. Banks' participation in Government security auctions was high. In December 2009, total amount bid in Government securities' auctions was ALL 72 billion, out of ALL 51 billion covered by the Ministry of Finance. Consequently, bid-to-cover ratio (see Chart 31) reached its peak since January 2008, at 1.43[17].

However, this improvement did not seem to mitigate the yields' upward pressures, hence attesting to higher risk assessment. The increase of the T-bill yields was more pronounced for the longer maturity term – 12-month – which was later transmitted to the bond yields as well. As at end-October, 12-month T-bill interest rate reached 9.43 percent to late drop to 9.06 percent. Although the yields showed a downward tendency at the end of 2009, in average terms they were higher than in the first half of the same year. In average terms, one-year T-bill yield is 0.22 percentage points higher than in the first half of 2009.

6 and 3-month T-bill yields, albeit more contained, maintained a similar performance. After reaching 7.73 percent in October, 6-month yield dropped to 7.52 percent at end-December. 3-month yield was less volatile and maintained similar levels.

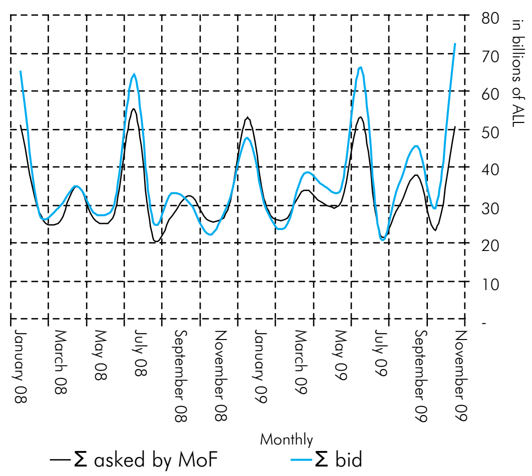
Primary bond market attested to a similar tendency as the T-bill market. Bond yields mainly increased in the third quarter as a result of the higher banks' risk assessment at a time when participation in auctions was satisfactory[18]. In the auctions held in November and onwards, 2-year bond yields dropped, hence maintaining the same trend as T-bills. As at the end of the last quarter of 2009, 2-year bond yields were 9.30 percent, down 0.05 percentage points from the average yield in the first half of 2009. 3 and 5-year bond yields maintained a similar tendency (at a variable rate of interest). As at the end of 2009, they were 9.60 and 10.93 percent, respectively (see Chart 33). Worth noting is that the increase of the bond yield at a variable rate of interest was

Chart 31 T-bills bid-to-cover ratio



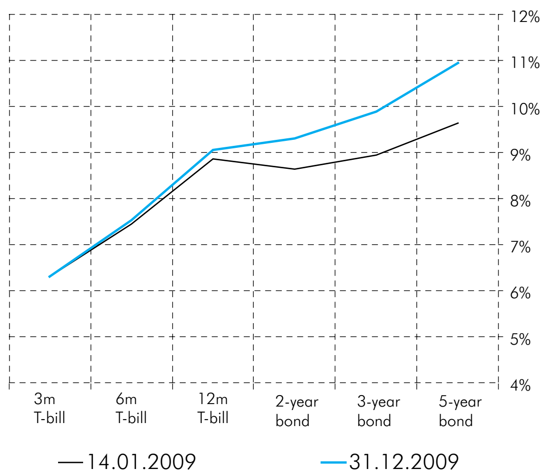
Source: Bank of Albania

Chart 32 T-bills bid-ask volume



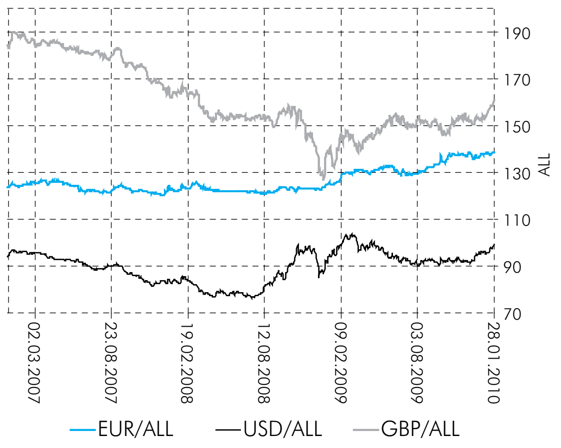
Source: Bank of Albania

Chart 33 Yield curve



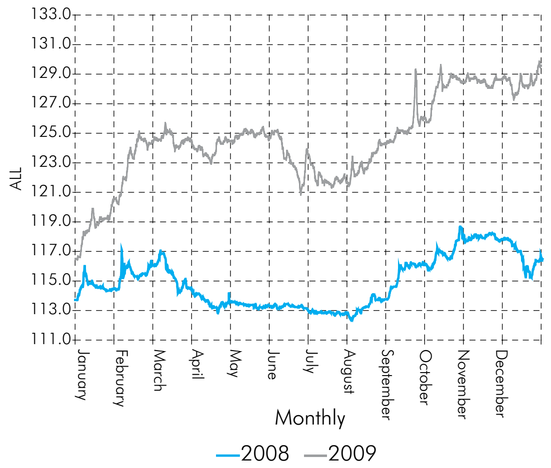
Source: Bank of Albania

Chart 34 EUR, USD and GBP daily exchange rate in ALL



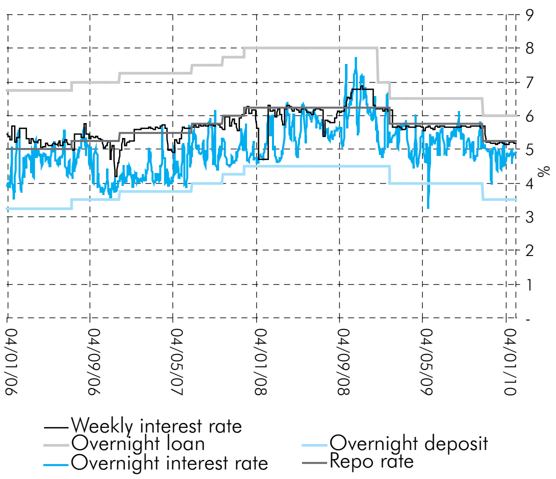
Source: Bank of Albania

Chart 35 Exchange rate by the 80:20 basket



Source: Bank of Albania

Chart 36 Market rates



Source: Bank of Albania

mainly affected by the performance of instruments it is parameterized with, since the accepted margin has always maintained a downward trend during this period.

4.3 FOREIGN EXCHANGE MARKET

In 2009, the Euro, the U.S. dollar and the British pound appreciated by 12, 6 and 18 percent, respectively, versus the Albanian Lek. The depreciation of the latter vis-à-vis the major currencies reflects the difficult economic situation at home and the appreciation of these currencies in the international markets. In the second half of 2009, GDP growth slowed down. Remittances and exports declined as a percentage of total GDP, hence exerting depreciating pressures on the national currency[19].

Volatility in the foreign exchange market increased substantially due to the crisis that swept over the global financial markets. This situation increased the business cost and risk for import and export-based enterprises and households' borrowing in foreign currency.

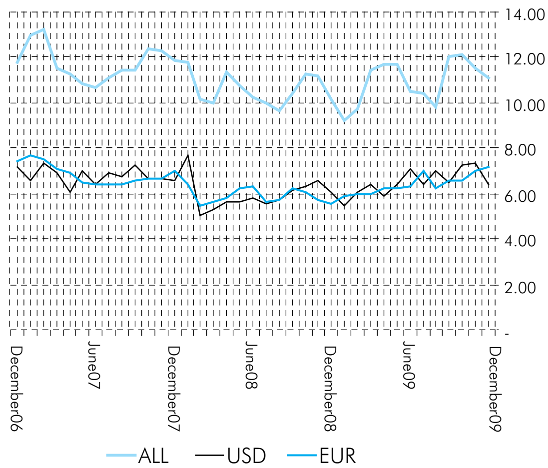
BANK OF ALBANIA OPERATIONS

On 24 December 2008, the Bank of Albania cut the interest rate on overnight loan by 100 basis points, shifting temporarily to an asymmetrical corridor of benchmark interest rates. A month later, on 28 January 2009, the Supervisory Council decided to cut the interest rate on the repurchase agreement by 50 basis points. In 2009, the Bank of Albania changed the open market auction form from fixed-amount to unlimited-amount auction, and the interest rate fixed at the key interest rate[20]. Banks were allowed to use up to 40 percent daily of their required ALL reserve (from 20 percent set in July 2008). Moreover, on 28 October 2009, the Supervisory Council of the Bank of Albania decided to cut the key interest rate again to 5.25 percent. These consecutive operations of the Bank of Albania helped to ease the liquidity situation in the financial system and normalized the interbank market position.

4.4 SPREAD BETWEEN INTEREST RATES ON NEW LOANS AND DEPOSITS

Average intermediation rates fluctuated for the three major currencies in 2009, attesting to a non-uniform performance of new loan and deposit spread. However, they increased over the course of the year (see Chart 37). By the end of 2008, lending rate tightened somehow for all currencies, while as at the end of 2009, the interest rates on ALL deposits increased[21]. As a result of the upward interest rates on new loans in ALL, EUR and USD, the interest rate spread between loans and deposits in these three currencies increased as well. As at the end of 2009, ALL interest rate spread was 11.14 percent[22], up 1 percentage point from the previous year. This change owes to the higher growth rate of interest rates on new ALL loans versus the deposit interest rates. Intermediation in EUR experienced the most sizeable change, with the spread increasing from 1.7 percentage points in 2008 to 7.19 percentage points as at the end 2009. The rationale behind this dramatic change does not only attribute to the higher interest rates on loans, but also to the lower interest rates on EUR deposits. The USD spread increased as well, owing to the higher loan interest rates and lower deposit interest rates. However, these changes were highly insignificant (0.3 percentage points) compared with the other two currencies.

Chart 37 Interest rate spread in percent



Source: Bank of Albania

Interest rates on new deposits increased over summer following banks' promotional campaigns to attract the public, particularly seasonal workers' remittances. Interest rates on ALL and USD deposits reached their peak in August. Despite the increasing lending volumes during this period, the interest rates did not manifest any substantial changes. This performance owes to the widening of new loan and deposit interest rate spreads for the three major currencies over the course of the year 2009.

5 PAYMENT SYSTEMS

The process of clearing and settlement of payments in the Republic of Albania, in the national currency – the Albanian Lek –, is carried out through banks via two payment systems: AIPS – Real-Time Gross Settlement System, and AECH – Automated Clearing House System, in compliance with the rules and procedures of the systems' operation.

The Bank of Albania plays a key role in promoting and developing the national payment systems, given their prime importance in achieving financial stability, ensuring proper functioning of the banking and financial system and in supporting the basic task for the implementation of monetary policy in the country.

The payment systems reflected security and efficiency in 2009, which are basic features for an effective banking system functioning. This implies that these are essential requirements to be met in the pursuit of financial stability.

As a result of the global financial crisis' effects, the year 2009 attested to the contraction of transactions volume, both in terms of number and value, in the Albanian payment systems. AIPS, the Real-Time Gross Settlement System, processed a total of 55701 transactions in 2009, amounting to ALL 4718 billion, about 2 and 8 percent less versus 2008. The volume of transactions processed through the AECH, the Automated Clearing House System, declined 10 percent in 2009, while their value reduced 12 percent versus 2008.

On average, 225 transactions a day were processed and settled in the AIPS system, with an average daily value of ALL 19 billion. Total liquidities settled in the AIPS system in 2009 are about 4.3 times higher than the GDP. Out of these transactions processed and settled in the AIPS system, 53 percent of them in terms of number, but only 9.5 percent in terms of value, is shared by payments that banks settle among them on behalf of their customers, including also payments that banks transfer daily to the state budget on behalf of customers. 57 percent of total transactions is shared by transactions initiated by the Bank of Albania in view of meeting its legal objectives, as well as payments ordered by banks but executed in the system by the Bank of Albania. Net settlement transactions for the clearing systems, which account for 11.6 percent of total transactions' value in the AIPS system, include transactions for the net settlement of results from the clearing systems, such as: clearing of small-value payments in the AECH system, clearing of bank and personal cheques in ALL, net settlement for the issue/maturity of Government securities and net settlement of ALL payments with VISA card, which the Bank of Albania plays the settling agent role for.

Concerning the transactions in the AECH system, which processes and clears customer payments below ALL 1 million, in 2009, a daily average of 413 payments were processed, with an average daily value of ALL 62.33 million. The largest volume and value of transactions cleared through the AECH were processed in the last quarter of 2009.

The concentration in the payment systems is assessed by viewing the share of transactions volume that the three and five most active banks have in each system, respectively. In the AIPS system, the transactions value of the three most active banks accounts for 73 percent of the total (versus 70 percent in 2008), while five banks (including the Bank of Albania) initiated in 2009 about 61 percent of transactions in terms of number, and 86 percent in terms of value, out of total transactions processed in the AIPS system. Regarding the AECH system, five banks initiated in 2009 about 61 percent of transactions in terms of number, and 67 percent in terms of value, out of the total transactions processed in the AECH system. The significant share that an inconsiderable number of banks have to total transactions in both systems provides evidence for a high level of concentration in terms of number and volume of transactions in the payment systems.

The year 2009 attested to positive developments in the use of overnight loan (in the form of interest-free collateralized loan) by the participants in the AIPS system. Compared with the year 2008, the use of overnight loan declined 64 percent in number and 46 percent in value. The main rationale behind the reduction of overnight loan is the change of the Bank of Albania policy for the increase of the daily use of the required reserve in ALL (from 20 to 40 percent) by banks for liquidity purposes.

Worth noting is the declining use of paper cheques as a payment instrument. Table 11 shows the number and value of interbank payment orders initiated with (personal and banking) cheques in ALL, and cleared and settled in the AIPS system. The table shows that the use of paper cheques declined in 2009, 51 percent in terms of number and 73 percent in terms of value, compared with the same period the previous year.

Table 11 Settlement of cheques in the AIPS system

Settlement of cheques in the AIPS	2007	2008	2009
Number of processed and settled cheques	544	403	199
Value of cheques (in billion ALL)	1,34	0,85	0,23

Source: Bank of Albania, Payment Systems Department

5.1 PAYMENT INSTRUMENTS[23]

The number of ATMs and POSs increased in 2009 by 15 and 48 percent, respectively, compared with the end of 2008. The total number of customer bank accounts, valid to make payments in ALL or in foreign currency, is 2,086,143, that is 33 percent new accounts more in 2009 than as at the end of 2008. About 93 percent of total accounts are individual accounts and over 99 percent are resident accounts.

Cards are being widely used in Albania, despite their still low use compared with the other regional countries. As at 31 December 2009, the number of cards in circulation increased 11 percent versus the end of 2008, out of which new credit cards issued in 2009 increased 50 percent versus 2008.

A total of 9 million transactions were processed via cards in 2009, with a total annual circulation of ALL 102 billion. Out of the total, ATM cash withdrawals account for 96 percent, providing evidence for the high use of cash in economy.

As at the end of 2009, 10 banks offered home banking services, implying the access of bank accounts from home via an internet line, telephone or software that the bank makes available to the customer. Relative to the year 2008, home banking transactions increased in 2009, in terms of number and value, by 55 and 25 percent, respectively.

BANK OF ALBANIA'S ROLE AS SUPERVISOR OF THE PAYMENT SYSTEM

The role of the central bank in reforming and surveilling the payments' system has become increasingly important against a background of turbulent global financial markets. In this context, the Bank of Albania is working on setting up a safe and efficient national payments' system that will boost the development of the Albanian financial market, aiming at the same time the prevention of risks arising from this development. The Bank of Albania's work has focused on these main directions:

1. Strengthening the legal framework in view of surveilling the payments' system.

The draft law "On the Payments' System" is currently at its final phase. The purpose of this draft law is to establish a legal framework that will ensure a safe and efficient national payments' system, the role and tasks of the Bank of Albania with respect to the development and surveillance of the payment and settlement systems in the Republic of Albania. The main chapters of this draft law are:

- Regulation and surveillance of the systems. The purpose of this chapter is to clearly establish the role of the Bank of Albania in surveilling the payment and settlement systems, be they systems operating within the Bank of Albania or outside the Bank by private operators, the licensing of entities that provide payment services in the Republic of Albania, inspection and decision-making competences of the Bank of Albania, etc.;
- Protection of systems. The purpose of this chapter is to regulate aspects that relate to the protection of systems from the participants' insolvency, the final nature and irreversibility of payment orders entering the system, the establishment of the moment when the insolvency proceedings are initiated, etc.;
- Protection of financial collateral arrangements. This chapter regulates concepts like the validity and enforcement of financial collateral arrangements in the payment and settlement systems, the settlement of pledge financial collateral and other legal concepts required for the normal functioning of the payment and settlement systems.

2. Improvement and promotion of changes in the national payments' system in view of reforming the payment systems.

The project for the implementation of IBAN, pursuant to Regulation No. 42, dated 16 July 2008 of the Supervisory Council of the Bank of Albania "On the Structure and Use of the International Bank Account Number (IBAN)", which aims at standardizing the account numbers used for making payments in the Republic of Albania, has been held in two phases: (a) all banks finalized the standardization of customers' accounts in the IBAN format and the customers' notification within June 1, 2009; (b) as from January 5, 2010, all banks use and validate the accuracy of IBAN numbers for all sent/received national or cross-border payments. For this purpose, the internal bank systems have been adapted to the payment systems (AIPS and AECH) in order to enable the creation, use and validation of IBAN in customers' payment instructions.

The project for the provision of the net settlement service of ALL card transactions for participant banks in MasterCard service initiated in August 2009 following the request of MasterCard company. Pursuant to the decision of the Supervisory Council for the approval of MasterCard's indirect participation in the AIPS, the Bank of Albania is working on finalizing the agreement with MasterCard and the internal Bank's procedures for the provision of this new service. After the signature of the agreement by both parties (Bank of Albania and MasterCard International) and the approval of the settlement operational procedures, soon the net settlement in the AIPS of ALL payments with MasterCard and Maestro will begin.

6 FINANCIAL SYSTEM PERFORMANCE

As at end 2009, financial intermediation in Albania, measured as the ratio of financial sector's assets[24] to GDP[25], increased slightly to 82 percent versus 80.4 percent at year-end 2008. Table 12 shows the share of financial system entities to GDP through the years. As at end 2009, the volume of financial institutions' assets grew 7 percent versus the year-end 2008. Banks have the main share to total financial system's assets. As at end 2009, their assets accounted for 94.7 percent of total financial system's assets and 77.5 percent of GDP.

Table 12 Share of financial system entities' assets to GDP through the years, in percent

Licensing and Supervisory Authority	Financial System	Years				
		2005	2006	2007	2008	2009
Bank of Albania	Banking system	60.4	69.6	75.9	76.7	77.5
	Non-bank institutions	1.32	1.52	1.48	1.66	2.1
	SLAs and their Unions	0.46	0.52	0.63	0.7	0.77
Financial Supervisory Authority	Insurance Companies	1.24	1.29	1.36	1.45	1.5
	Pension funds	-	-	-	-	0.01

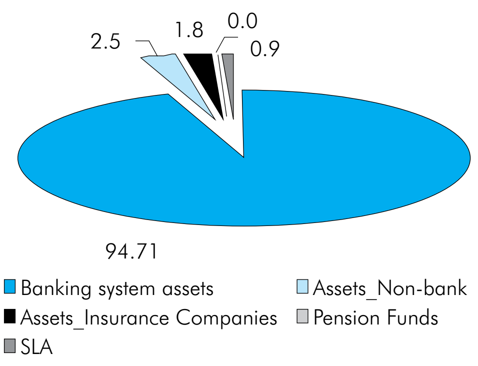
Source: Bank of Albania, Financial Supervisory Authority

Box 2 Non-bank Financial Sector

The non-bank financial sector has a relatively small share to total financial system. It is represented by non-bank financial institutions, savings and loan associations licensed by the Bank of Albania, and insurance companies and private supplementary pension funds licensed by the Financial Supervisory Authority (FSA).

The non-bank financial sector conducts financial intermediation-related activities but it does not accept public deposits. This sector comprises 13 non-bank financial institutions, 2 large savings and loan unions and their member associations, and a considerable number of foreign exchange bureaus. As at end 2009, assets of non-bank financial institutions accounted for 2.53 percent of total financial system's assets (versus 2 percent as at end 2008), accounting for 2.1 percent of GDP (versus 1.6 percent as at end 2008). The share of savings and loan associations is estimated at 0.94 percent of total financial system, quite close to the year-end 2008 level, and it accounts for 0.77 percent of GDP (versus 0.7 percent as at end 2008). Other non-bank financial sector segments that are monitored by the FSA are: insurance companies (life and non-life), private supplementary pension funds and the securities market. As at end of the third quarter of 2009, insurance companies' assets accounted for 1.8 percent of the financial system versus 1.7 percent as at end 2008. Their assets account for 1.5 percent as a share of GDP. Private pension funds have a negligible share to total financial system's assets and GDP. Chart 38 shows the structure of the financial system based on the most recent data on each entity operating in the Republic of Albania.

Chart 38 Share of financial system entities' assets to total financial system assets, in percent



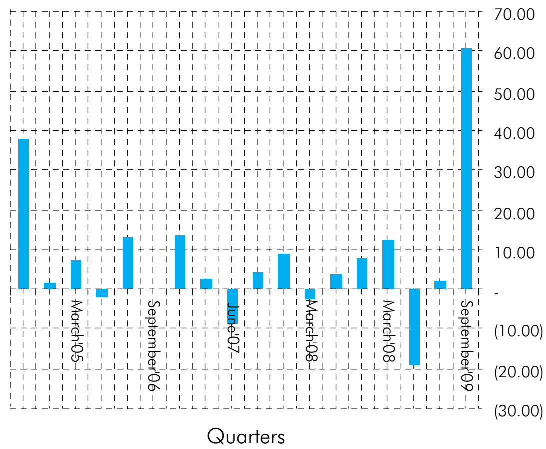
Source: Bank of Albania

FINANCIAL ANALYSIS OF NON-BANK FINANCIAL INSTITUTIONS' ACTIVITY

The activity carried out by non-bank financial institutions in 2009[26] attests to a positive performance in terms of the asset and loan portfolio growth. However, some financial indicators, like profit and capitalization and the loan portfolio quality, have worsened relative to the same period the previous year.

As at end of the third quarter of 2009, non-bank financial institutions' assets amounted to ALL 23.6 billion, up ALL 8.9 billion from the previous quarter (or 61 percent) and ALL 5.8 billion (or 32.7 percent) from the year-end 2008 (see Chart 39).

Chart 39 Non-bank asset growth, quarterly, in percent

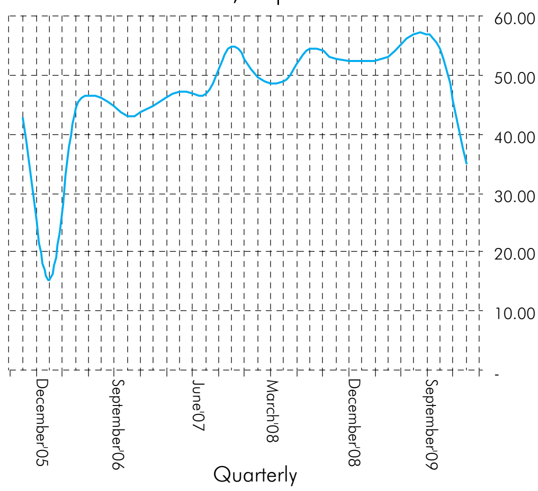


Source: Bank of Albania

As at end of the third quarter of 2009, in addition to the asset growth of two new non-bank institutions, "operations with customers", which represents lending activity, provided the largest contribution, 33 percent, followed by "cash in hand, deposits and accounts" with 8 percent.

Capitalization, expressed as the ratio of "capital account to total assets", fell to 34.9 percent as at end of the third quarter of 2009, versus 53 percent as at year-end 2008 (see Chart 40). This substantial fall owes to the higher growth of total assets (32.7 percent), while capital account declined 12.7 percent. "Loans received" provided a substantial contribution, 102.5 percent, to the growth of assets. As at end of the third quarter of 2009, this item amounted to ALL 11.6 billion versus ALL 5.7 billion as at year-end 2008. "Loans received" is mainly financed by deposit corporations and other financial institutions.

Chart 40 Capital account to total assets, in percent

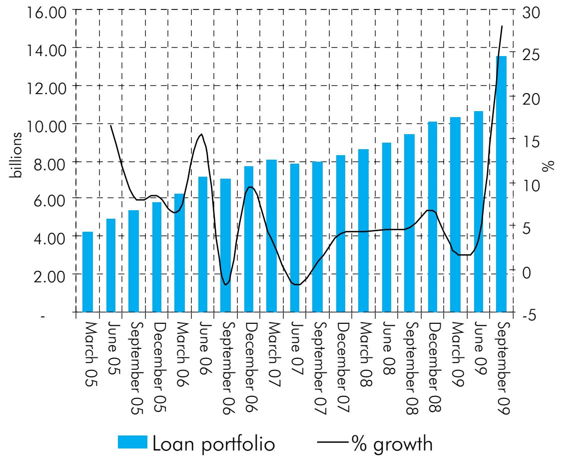


Source: Bank of Albania

The ratio of "capital account to total tangible and intangible assets, net" is another indicator that measures the capitalization level and limits the investments of non-bank financial institutions in fixed assets. As at end of the third quarter of 2009, this ratio stood at 427.3 percent versus 519 percent at year-end 2008. It stands far above the required level of 100 percent set as the regulatory rate for this ratio.

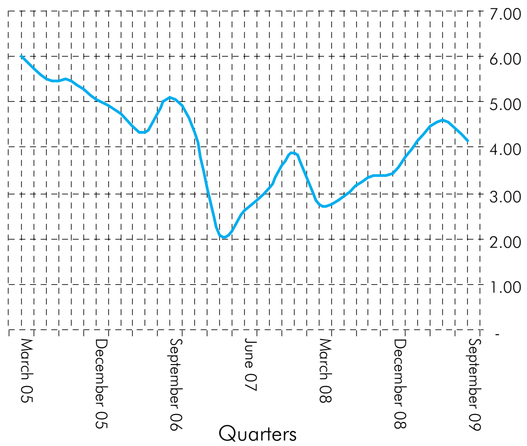
The loan portfolio has the main share to total assets of non-bank financial institutions, 66.8 percent in the first nine-month period of 2009 versus 59.4 percent in 2008. The loan portfolio grew throughout the year 2009. In the third quarter it grew to ALL 13.5 billion (up 28 and 34.6 percent versus the previous quarter and the last quarter of 2008) (see Chart 41).

Chart 41 Performance of loans, in billions of ALL, and their growth, in percent



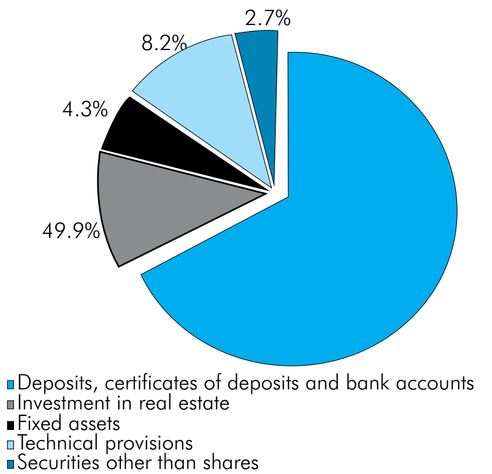
Source: Bank of Albania

Chart 42 Non-performing loans to total loans, in percent



Source: Bank of Albania

Chart 43 Share of insurance companies' asset items to total assets, in percent, Q3 2009



Source: AMF, Bank of Albania

Loan portfolio quality, expressed as the ratio of non-performing loans (gross) to outstanding loans, improved on a quarterly basis. However, it worsened relative to the year-end 2008. As at the end of the third quarter of 2009, non-performing loans were estimated at 4.1 percent versus 4.6 percent in the previous quarter and 3.42 percent in the last quarter of 2008 (see Chart 42). The ratio of total tangible and intangible assets, net, to total assets is another indicator that measures the asset quality. As at the end of the third quarter of 2009, it improved to 8.2 percent versus 13 percent the previous quarter and 10 percent in the last quarter of 2008.

Non-bank financial institutions' profitability declined in 2009. As at the end of the third quarter of 2009, net profit was ALL 439 million, down ALL 689 million (or -61 percent) from the same period the previous year.

Income amounted to ALL 3.8 billion, almost equal to the same period the previous year. Expenses were 27 percent higher relative to the first nine-month period of 2008. Within expenses, general operating expenses continue to have the largest share as in 2008, accounting for 40 percent of the total.

INSURANCE COMPANIES AND PRIVATE SUPPLEMENTARY PENSION FUNDS

Insurance market grew its assets 11.3 percent[27] in 2009 relative to the previous year, being supported by the increased number of insurance contracts, premium volume and insurance companies' investments in deposits or real estate. About 756 thousand insurance contracts, up 9.2 percent from 2008, were concluded in 2009. Income from insurance gross written premiums amounted to ALL 7.8 billion. Gross written premiums of voluntary and compulsory insurance shared 42 and 58 percent of the market. According to the FSA, although gross claims paid by insurance companies rose to ALL 1.7 billion (up 13 percent from 2008), the claims ratio remains 22 percent, similar for three consecutive years.

As at the third quarter of 2009, insurance sector's assets amounted to ALL 16.9 billion, slightly lower than the previous quarter and 9.4 percent higher than the year-end 2008. "Deposits, certificates of deposits and accounts with banks" have the largest share to total insurance companies' assets (50 percent), followed by "real estate investments" (9.4 percent) and "technical provisions" (8.2 percent). As at end of the third quarter of 2009, "fixed tangible and intangible assets" accounted for 4.3 percent of total assets (see Chart 43).

Capital to total assets ratio, which measures the insurance companies' capitalization, fell to 49 percent in the third quarter of 2009, down 2.8 percentage points from the previous quarter and 7.6 percentage points from the last quarter of 2008. Capital to technical reserves ratio is another indicator that measures the capacity to cover the losses arising from the exposure to potential risks. As at end of the third quarter of 2009, this ratio was 125 percent, declining substantially from the previous quarter and the last quarter of 2008 due to the higher technical reserves[28].

Technical provisions amounted to ALL 1.3 billion, growing considerably by 26 percent relative to the year-end 2008.

As at the end of the first nine-month period, insurance companies' profit totalled ALL 730 million versus ALL 805 million the same period the previous year. The slower net income was also reflected in the two return indicators, RoA and RoE[29], which stood at 4.4 and 2.5 percent as at the end of the first nine-month period, versus 5.5 and 10.7 percent the same period the previous year.

The FSA continued to improve the regulatory framework of this market and the technological infrastructure of its monitoring. In 2009 the following laws and regulations were adopted:

- Law No. 10076, dated 12 February 2009 "On Compulsory Insurance in Transportation Sector". The purpose of this Law is to improve the legal basis of the compulsory insurance.
- Regulation No.36, dated 30 April 2009 "On Electronic Register of Vehicle Compulsory Insurance Claims". The purpose of this Regulation is to establish the way and procedures for the reporting of compulsory insurance claims via the electronic register installed in the compulsory insurance information centre servers.
- Regulation No. 75, dated 28 August 2009 "On Compulsory Insurance Premiums in Transportation Sector". The purpose of this Regulation is to establish the level of premiums and technical provisions, methods for the calculation of premiums and technical provisions of compulsory insurance in the transportation sector.

Private supplementary pension market increased during January to December 2009 compared with the same period the previous year. The number of contributors increased to 4,429 versus 3,861 in 2008. In terms of value, contributions amounted to ALL 72.9 million versus ALL 53 million in 2008, up 37 percent.

The AMF improved the regulatory framework on private pension market further in 2009. More precisely:

- Law No. 10197, dated 10 December 2009 "On Voluntary Pension Fund". The purpose of this Law is to establish the required standards for the: a) effective management of voluntary pension funds through the diversification of investments aiming at increasing the contributions to pension funds; b) promotion of stability, safety and good governance of the pool of pension fund assets, etc.
- Regulation No. 1, dated 28 January 2010 "On Allowed Assets, Limitations and Maximum Investment Limit of the Pension Fund". The purpose of this Regulation is to establish the allowed assets, which the pension fund can be invested in, the limitations and the maximum investment limit.

SAVINGS AND LOAN ASSOCIATIONS (SLAs)

- Savings and Loan Associations (SLAs) are licensed and supervised by the Bank of Albania. Since they accept contributions from the members of associations in the form of deposits, they report to the Bank of Albania on their total activity, the financial position and supervisory norms. As at year-end 2009, 135 SLAs carried out their activity, in addition to their two unions.

In the last quarter of 2009, total assets of SLAs and their unions grew to ALL 8.8 billion, only 1.1 percent higher than the previous quarter and 14.5 percent higher than the same period the previous year. Assets of SLAs and their unions have almost maintained the same non-material share to total financial system as in 2008, about 0.9 percent, however their share as a percentage of GDP increased to 0.77 percent[30].

Lending activity continued to play the main role in the last quarter of 2009. SLAs and their unions reported a total of 78.6 percent of their assets invested in lending. In the second and third quarter of 2009, the share of their loan portfolio to total assets declined.

Table 13 Activity of SLAs, quarterly

	QIV-08	QI-09	QII-09	QIII-09	QIV-09
Total assets (in millions ALL)	7,657	7,866	8,251	8,670	8,765
Outstanding loans (in millions ALL)	6,284	6,419	6,438	6,634	6,893
Outstanding loans/total assets (in %)	82.1	81.6	78.03	76.5	78.6
Non-performing loans (in millions ALL)	82.4	103.8	118.6	132.1	135.2
Non-performing loans/outstanding loans (in %)	1.31	1.62	1.84	1.99	1.96

Source: Bank of Albania

Loan portfolio quality, on gross basis, of SLAs and their unions improved slightly as at year-end 2009, declining to 1.96 percent versus 2 percent the previous quarter. Relative to the same period the previous year, the loan portfolio quality has declined (see Table 12). This owes to the higher growth rate of non-performing loans (64.2 percent) to outstanding loans (9.7 percent) relative to the year-end 2008.

As at year-end 2009, the net profit of SLAs and their unions dropped to ALL 91.5 million versus ALL 109.2 million, down 19 percent from the previous year.

From this analysis, we conclude that SLAs and their unions expanded their activity throughout the year 2009, sustained by the increase in the number of member SLAs (to 135 from 133 associations) and loan portfolio growth, despite the lower quality and slower net profit relative to the previous year.

6.1 GENERAL DEVELOPMENTS IN THE ALBANIAN BANKING SYSTEM

6.1.1 PERFORMANCE OF ASSETS AND LIABILITIES AND THEIR COMPOSITION

As at end of 2009, banking sector's assets accounted for 77.5 percent of GDP (versus 76.7 percent in 2008) and 94.7 percent of total financial sector's assets. As at end-December 2009, the sector's assets amounted to ALL 886.3 billion, up 6.3 percent from the end of 2008[31]. The stable performance of assets also reflects the recovery of deposits (starting from the second quarter of 2009), which were withdrawn from the banking sector owing to the psychological effects of the international financial crisis.

As in other periods, the loan portfolio continues to make up the major share of assets: as at the end of 2009, the loan portfolio was reported to have amounted to ALL 450 billion[32] and it accounts for 50.8 percent of total banking sector's assets, up 3.2 percentage points from the year-end 2008.

"Treasury and interbank transactions"[33] is the second largest item in the banking sector's assets. As at the end of 2009, this item amounted to ALL 254.3 billion, accounting for 28.7 percent of total assets. Within the "Treasury and interbank transactions", T-bill transactions totalled ALL 106.3, hence providing evidence for a marked downward performance over the course of years.

The share of "Securities transactions" remained almost unchanged while the other asset items continue to have a negligible share.

Table 14 Share of assets by item (December 2003 – December 2009)

Share to total assets (in %)	December 2003	December 2004	December 2005	December 2006	December 2007	December 2008	December 2009
1. Treasury and interbank transactions, of which:	76.5	72.4	58.8	50.6	39.5	30.1	28.7
- Transactions with the Central Bank	8.7	8.7	9.3	8.9	9.0	8.3	7.8
- T-bills	49.6	45.8	35.3	26.3	17.1	12.8	12.0
- Transactions with other banks	16.2	15.6	12.2	13.2	11.2	6.6	6.5
2. Operations with customers (gross)	13.5	16.4	25.7	31.7	39.4	47.6	50.8
3. Securities transactions	5.4	7.0	12.2	14.7	18.0	20.0	20.1
4. Other assets	0.8	0.8	0.7	0.9	1.3	1.0	0.9
5. Fixed assets	1.5	1.9	1.5	1.5	1.5	1.8	1.7
Total assets	100	100	100	100	100	100	100

Source: Bank of Albania

On the liabilities side, customer deposits have the main share and they amounted to ALL 694.3 billion[34], accounting for 78.3 percent of total liabilities (see Table 15). This item declined in 2008 by 7.5 percentage points owing to the withdrawal of deposits from the banking system. However, they were restored over the course of the year 2009.

"Treasury and interbank transactions"[35] makes up the second largest liability item. As at the end of 2009, it amounted to ALL 90 billion. The increasing share of this item relative to the year 2007 is a result of the higher Bank of Albania's financing to commercial banks through repurchase agreements, while the year 2009 attested to the decline of financing from foreign banks.

The upward trend of "Permanent resources"[36] persisted in 2009 as well. "Shareholders' equity" makes up the main item of "Permanent resources". As at the end of 2009, it amounted to ALL 84.8 billion, up ALL 13.4 billion or 19 percent versus the year-end 2008. Paid-in capital totalled ALL 60.9 billion, up ALL 9.7 billion or 19 percent versus December 2008, providing evidence for banks' capital injections[37] during 2009 (see Table 15).

Table 15 Share of liabilities by item (December 2003 – December 2009)

Share to total liabilities (in %)	Dec. 2003	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Dec 2009
1. Treasury and interbank transactions, of which:	4.4	4.5	4.1	7.6	5.7	11.8	10.1
- Transactions with the Central Bank	0.2	0.2	0.2	0.2	0.0	0.1	0.0
- T-bills	0.0	0.0	0.0	1.4	0.2	2.4	3.6
- Interbank transactions	4.2	4.3	4.0	4.0	5.3	9.0	6.2
2. Operations with customers (gross)	88.7	88.1	88.1	84.2	84.9	77.3	78.3
3. Other liabilities	0.7	1.0	0.6	0.8	1.0	1.1	0.6
4. Permanent resources, of which:	6.2	6.3	7.2	7.4	8.4	9.6	10.8
- Shareholders' equity	5.9	6.1	6.6	6.8	7.5	8.6	9.6
Total liabilities	100	100	100	100	100	100	100

Source: Bank of Albania

As at the end of 2009, Group[38] 3 of banks shared 72.6 percent of total banking sector's assets, Group 2 shared 22.7 percent and Group 1 shared 4.7 percent. In terms of activity size, banking groups did not change their composition in 2009. Group 3's share reduced by 1 percentage point versus the year-end 2008, while Group 1's share increased by the same extent. Group 2's share to total banking sector's assets remained unchanged. In terms of asset distribution, the Albanian banking system remains concentrated.

6.1.2 BALANCE SHEET COMPOSITION BY CURRENCY AND NET OPEN POSITION IN FOREIGN CURRENCY

As at the end of 2009, the banking sector's assets denominated in foreign currency accounted for 50.2 percent of total assets, up by 1.3 percentage points from the year-end 2008. The banking sector's liabilities denominated in foreign currency accounted for 49 percent of total assets, up 0.4 percentage points from December 2008.

The banking sector's assets and liabilities in foreign currency have historically recorded similar values as shown in Table 16. However, starting from June 2009, the share of foreign currency assets has exceeded that of foreign currency liabilities by 1 percentage point. This figure increased in the third and last quarter of 2009[39].

The banking sector's activity in foreign currency is assessed as being balanced, while the increasing volume provides evidence for more considerable resources in foreign currency versus the national currency.

Table 16 Share of foreign currency-denominated assets and liabilities to total banking sector's assets, in percent (December 2005 – December 2009).

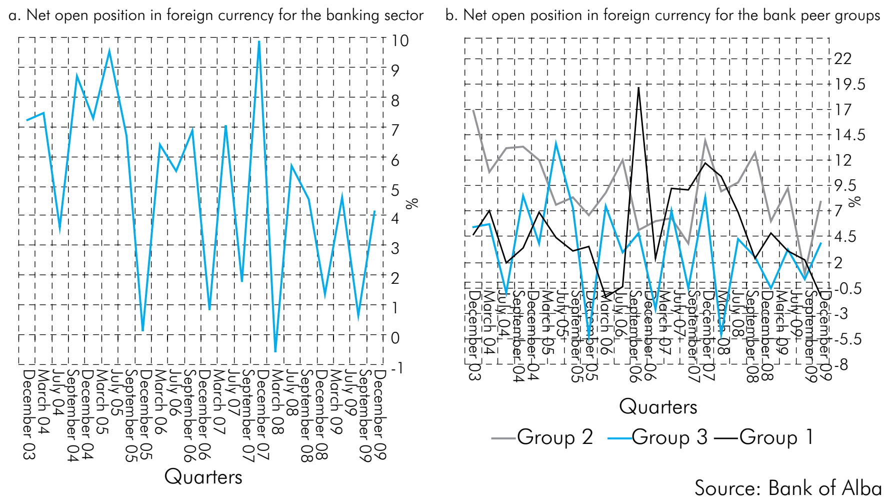
Period	Foreign currency assets	Foreign currency liabilities	Difference (1) - (2)
December 2005	41.1	41	0.1
March 2006	41.5	41	0.5
June	41.6	41.6	0
September	43.3	43.2	0.1
December 2006	44.2	44	0.2
March 2007	45.6	45.2	0.4
June	45.7	45.7	0
September	46.6	46.5	0.1
December 2007	46.8	46.9	-0.1
March 2008	47.9	47.7	0.2
June	48	48.1	-0.1
September	50.6	50.2	0.4
December 2008	48.9	48.5	0.4
March 2009	50.2	49.7	0.5
June	48.4	47.5	0.9
September	49.5	48.3	1.2
December 2009	50.2	48.9	1.3

Source: Bank of Albania

As at the end of 2009, the banking sector's net open position in foreign currency accounted for 4 percent of Tier 1 capital (see Chart 44.a). This indicator remained within the "long position" range of 0-10 percent (see Chart 44.b).

The banking sector's foreign currency positions are quite moderate, therefore they bear a modest potential risk from the exchange rate fluctuation effects.

Chart 44 Exposure to exchange rate risk for the banking sector and the bank peer groups by size

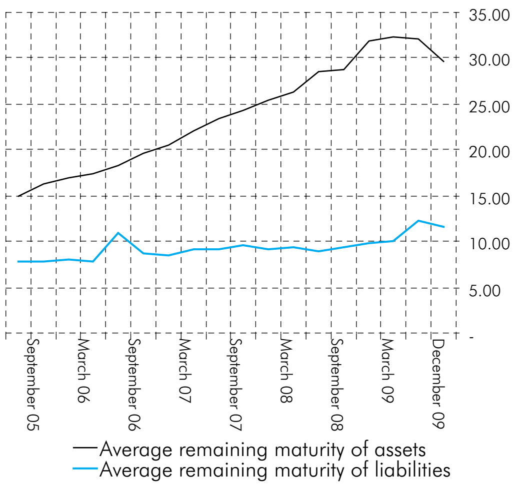


Source: Bank of Albania

6.1.3 COMPOSITION BY MATURITY TERM

As at the end of 2009, the banking sector's assets had an average remaining maturity[40] of 29.5 months versus 31.8 months as at the year-end 2008. For the same period, the banking sector's liabilities had an average remaining maturity[41] of about 11.6 months versus 9.7 months as at year-end 2008. Chart 45 shows the performance of average remaining maturity of assets and liabilities.

Chart 45 Average remaining maturity of assets and liabilities

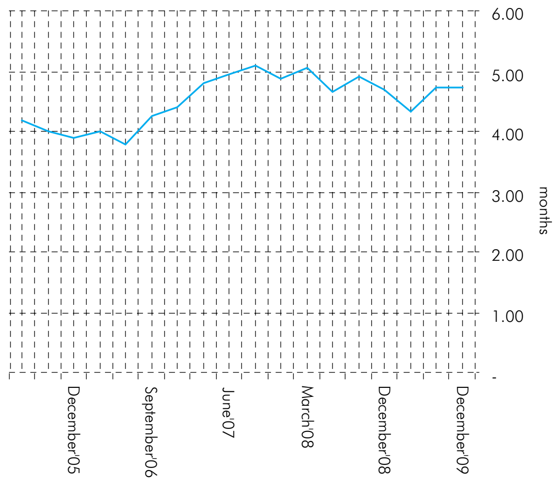


Source: Bank of Albania

The chart shows that the maturity gap between assets and liabilities narrowed to 17.9 months as at the end of 2009 versus 22.1 months the same period the previous year. The narrowing of the gap is a result of the improved asset and liability structure by remaining maturity, hence providing evidence for the banking sector's commitment to minimizing asset-liability mismatches.

Concerning the assessment of the maturity term by individual balance sheet items, we have focused on loans and deposits, as products that affect the maturity gap of the balance sheet items the most. As at the end of the last quarter of 2009, the average maturity of deposits[42] was 4.74 months, almost similar to the same period the previous year. As at the end of 2009, the loan portfolio average maturity[43] dropped to 44.7 months versus 47.4 months the same period the previous year. The downward performance of the loan portfolio average maturity led to the narrowing of the remaining maturity gap of the banking sector's assets and liabilities.

Chart 46 Remaining average maturity of deposits



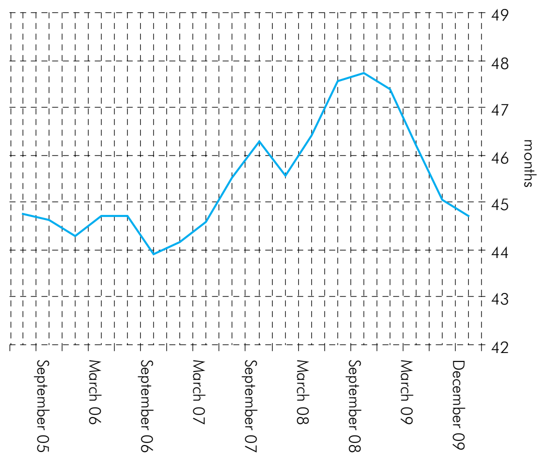
Source: Bank of Albania

6.1.4 OFF-BALANCE SHEET ITEMS

As at the end of 2009, off-balance sheet items amounted to ALL 833.5 billion (up ALL 92 billion or 12.4 percent from the previous year), accounting for 94 percent of total banking sector's assets.

The main rationale behind the increase of off-balance sheet items is the increase of "Guarantees received from customers[44]" during 2009 by ALL 128 billion or 21 percent, hence providing evidence for tighter bank lending standards.

Chart 47 Remaining average maturity of loans



Source: Bank of Albania

Within the off-balance sheet items, liabilities ("commitments received[45]" and "guarantees received") have the largest share accounting for 91.5 percent of the total versus 86.2 percent in 2008. Within the off-balance sheet liabilities, "guarantees received from customers" account for 98 percent of the total, while "commitments received" declined ALL 4.8 billion or 22 percent relative to the year-end 2008. The decline in "commitments received" from non-residents attests to the contraction of foreign financing for the Albanian banking system in 2009.

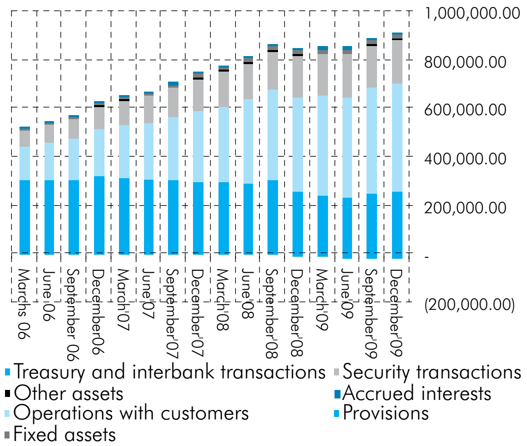
Within the off-balance sheet assets, "commitments and guarantees given" account for 6 percent of total off-balance sheet items. Relative to the year-end 2008, "commitments given" maintained a similar share in 2009, while "guarantees given" declined ALL 6 billion or 23 percent.

Among the off-balance sheet items, "foreign currency transactions: foreign currency purchased/sold" and "commitments for financial instruments" generated risk. As at the end of 2009, these accounts shared only 2.4 percent of total off-balance sheet items versus 7 percent as at the end of 2008, attesting to the banking sector's minimized exposure to risks.

6.1.5 DISTRIBUTION OF INVESTMENTS AND QUALITY

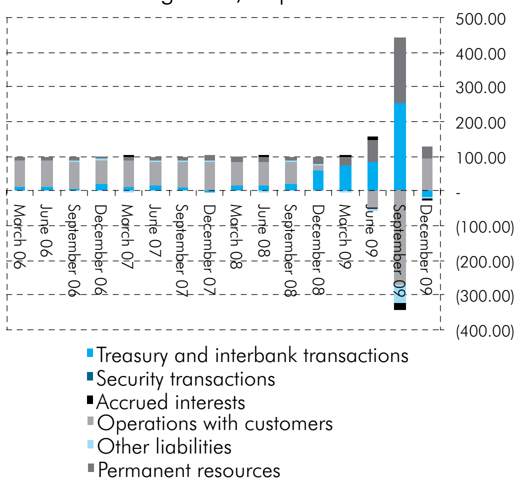
The distribution of investments in the banking system reflects the performance of asset items over the course of time, in order to observe the orientation of

Chart 48 Performance of asset items, in million ALL



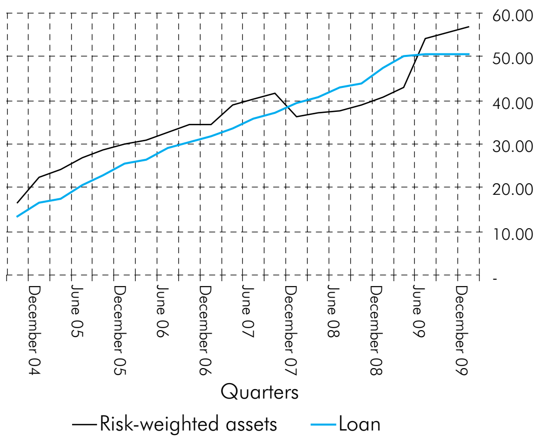
Source: Bank of Albania

Chart 49 Contribution of liabilities to asset growth, in percent



Source: Bank of Albania

Chart 50 Risk-weighted assets and loan portfolio to total assets



Source: Bank of Albania

investments and the level of risk undertaken by the banking sector in carrying out its activities. Chart 48 shows the performance of asset items and their stock.

The chart shows that the banking system assets recovered their upward trend in the third quarter of 2009, which persisted in the last quarter as well. "Operations with customers, gross" which represents the lending activity, grew 13 percent from the same period the previous year, hence contributing by 99.5 percent to the annual growth of banking sector's assets.

"Treasury and interbank transactions" grew 1.2 percent, providing an annual contribution of only 5.6 percent to the growth of the banking sector's assets. "Securities transactions" grew 6.6 percent from the same period the previous year, contributing by 21 percent to the annual growth of the banking system's assets.

"Other assets" and "provisions"[46] provided a negative annual contribution to the asset growth, -0.6 and -23 percent, respectively. In the meantime, "fixed assets" and "accrued interests" did not undergo any significant changes.

"Operations with customers" (deposit activity) and "permanent resources" provided the highest annual contribution to the asset growth in 2009, 96 and 30 percent, respectively, quite above their historical average[47] estimated at 37 and 28.4 percent. The other liability-side items provided a negative contribution to the asset growth, particularly "treasury and interbank transactions" (-16.9 percent) and "other liabilities" (-7.3 percent), which recorded figures well below their historical average.

In order to assess the level of risk attached to the bank investment, we make an analysis of the performance of banking sector's risk-weighted assets (see Chart 50).

The upward trend of the banking sector's risk-weighted assets persisted throughout the year 2009. As at the end of 2009, they amounted to ALL 502.8 billion and accounted for 56.7 percent of total assets versus 40.8 percent as at year-end 2008. The increasing share, mainly on an annual basis, owes to the considerable growth of risk-weighted assets and to the relatively low growth rate of the banking system's assets (6.25 percent).

The performance of risk-weighted assets is mainly determined by the loan portfolio performance, which in December 2009 accounted for 50.7 percent of total assets, very close to the previous quarter and previous year's share of 47.6 percent. In terms of bank peer groups, the ratio of "risk-weighted assets to total assets" posted considerable increase on an annual basis for Group 2 (from 45.9 percent in December 2008 to 73.5 percent in December 2009) and Group 3 (from 37.7 to 47.3 percent in December 2009), given their loan portfolio rapid growth rates (Group 2: from 61.6 percent of total assets in December 2008 to 68.3 percent in December 2009; Group 3: from 43.3 percent to 52.3 percent of total assets in December 2009).

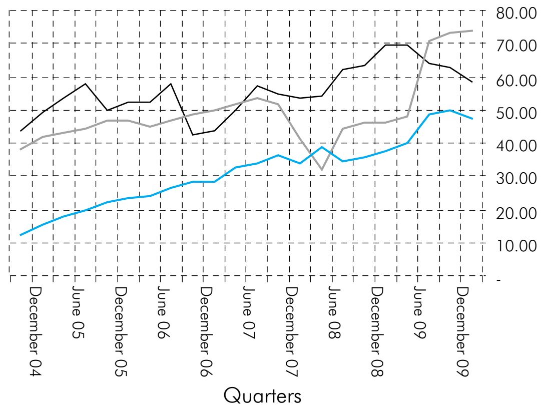
Special attention has been paid to the loan portfolio characteristics, making a thorough analysis of the loan growth rate and its use; loan portfolio composition by borrower, by currency, by maturity term, by sectoral breakdown; non-performing loans and collateral coverage. You may find below an analysis of new loans and outstanding loans.

New loans extended by the banking sector amounted to ALL 224 billion[48], down ALL 52.8 billion (or 19.1 percent) versus 2008. In terms of currency, new loans in ALL declined by ALL 14.6 billion (or 14 percent), new loans in foreign currency declined by USD 76 million (or 27.8 percent), EUR 333.7 million (or 27.6 percent) and other currencies by ALL 472 million (or 79 percent) compared with the same period the previous year.

Collected loans amounted to ALL 182.3 billion in 2009 versus ALL 176 billion in 2008.

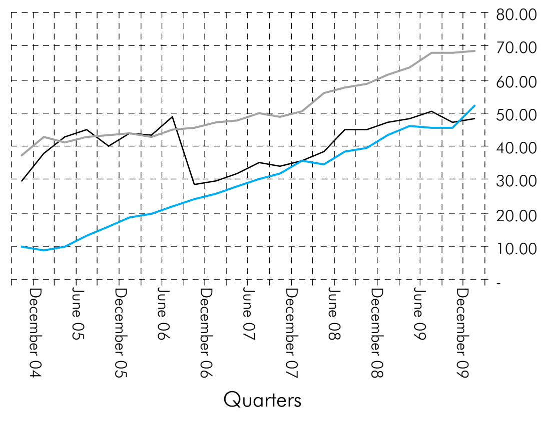
The ratio of collected loans to extended loans represents the loan use indicator. As at end December 2009, this ratio was 77.8 percent versus 86.3 percent in September 2009 and 73.6 percent the same period the previous year (see Chart 53).

Chart 51 Risk-weighted assets to total assets by bank peer group, in percent



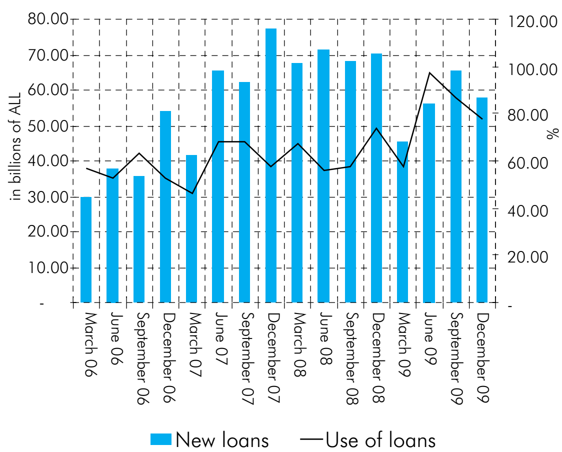
Source: Bank of Albania

Chart 52 Loan portfolio to total assets by bank peer group, in percent



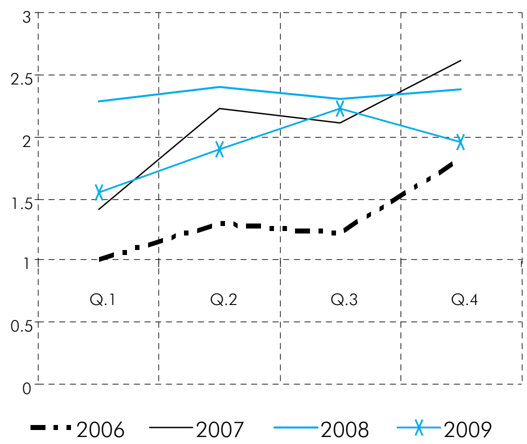
Source: Bank of Albania

Chart 53 New loans and use of loans



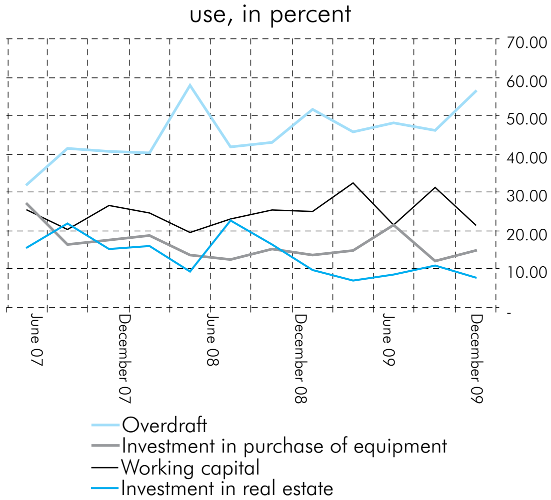
Source: Bank of Albania

Chart 54 New loans by quarters



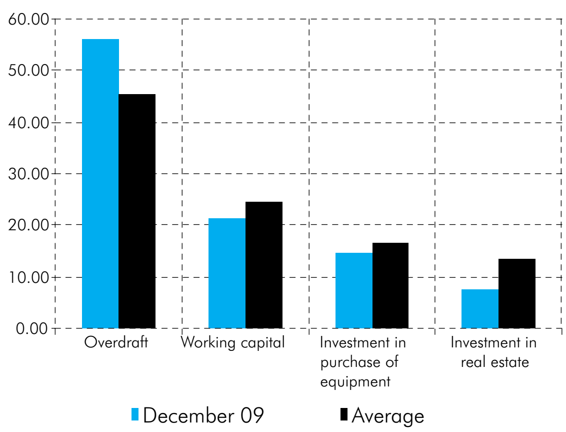
Source: Bank of Albania

Chart 55 New business loans by purpose of use, in percent



Source: Bank of Albania

Chart 56 New business loans by purpose of use, in percent



Source: Bank of Albania

The chart shows that the use of loans peaked in the third quarter of 2009 (97 percent). The same indicator posted its lowest level in the first quarter of 2009 owing to the decline in new loans and collected loans over this period. Since March 2006, this indicator has averaged 64.8 percent.

Chart 54 shows the level of new loans in quarterly terms through the years vis-à-vis the first quarter of 2006.

Chart 54 shows that new loans slowed down their rates over the quarters in 2009 compared with the previous year. In the last quarter of 2009, the banking sector extended 1.9 times more new loans versus the base period (March 2006). Relative to the same period the previous year, the banking sector extended 2.4 times more new loans.

In terms of users, the business sector accounted for 82 percent of new loans in 2009. Chart 55 shows the distribution of new business loans by purpose of use.

The chart shows that overdraft loans have the main share in new business loans in the last quarter of 2009, 56.2 percent versus 46.1 percent in the previous quarter and 51.6 percent the same period the previous year. Business overdrafts also stand above the average of March 2007-December 2009 (45.4 percent). New business loans for real estate purposes declined their share to 7.6 percent from their average of 13.5 percent.

Chart 57 shows the distribution of new household loans by purpose of use.

New household loans mainly concentrated in real estate investment, despite the latter's pronounced slowdown in the last quarter of 2009. The share of new household loans for real estate purposes declined to 35.9 percent versus 49.4 percent in the previous quarter and 42.9 percent the same period the previous year. For the same purpose of use, new household loans dropped to below the average of the period, 48.4 percent (see Chart 58). The share of new household loans for the consumption of non-durable goods increased in the last quarter of

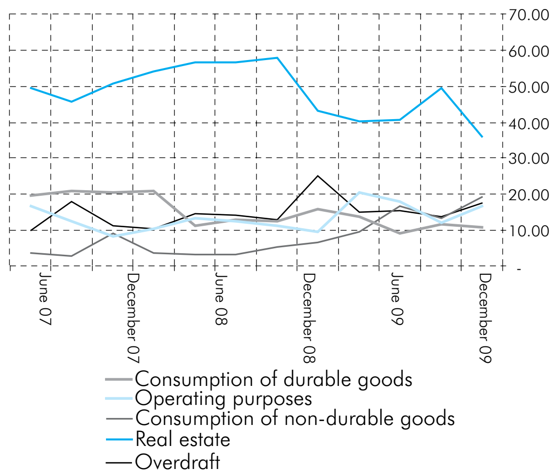
2009 to 19.1 percent, the peak level in the last three years.

In terms of currency, as at the end of 2009, new loans denominated in euro shared 55.4 percent versus the average of the period, 54.6 percent. New loans denominated in the Albanian Lek shared 37.2 percent, quite close to the average of the period, 36.5 percent. New loans denominated in U.S. dollar reduced their share to 7.4 percent versus 12.6 percent as at the end of 2008 and the average of the period, 8.6 percent.

In terms of maturity term, new short-term loans amounted to ALL 139.7 billion, down ALL 10.7 billion or 7 percent from the previous year. For the same period, there has been a shift of new long-term loans to medium-term loans. More specifically, new long-term loans totalled ALL 38.6 billion. New medium-term loans totalled ALL 46.6 billion. In quarterly terms, new short-term loans posted their highest share in the last quarter of 2009 (66 percent). The highest share of new medium-term loans and long-term loans was recorded in the second quarter (23 and 21 percent, respectively).

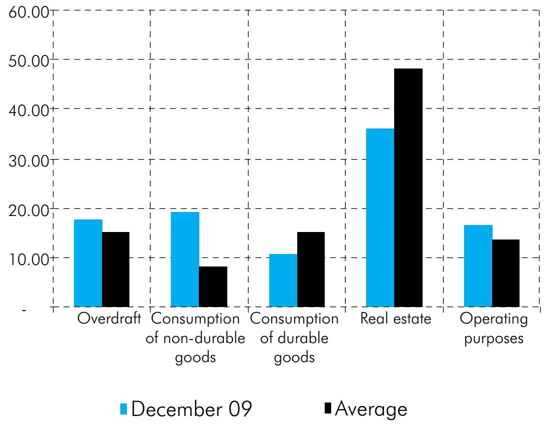
Table 17 provides the detailed composition of new business and household loans in the last quarter of 2009, by purpose of use and foreign currency:

Chart 57 New household loans by purpose of use, in percent



Source: Bank of Albania

Chart 58 New household loans, in percent



Source: Bank of Albania

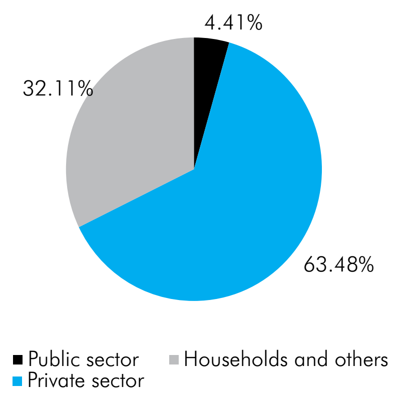
Table 17 New loan data, Q4 2009

Business (000 lek)	48,764,018	%	Households (000 lek)	8,968,482	%
ALL	16,063,969	32.94	ALL	5,419,264	60.43
Overdraft	9,171,303	57.09	Overdraft	893,426	16.49
Working capital	4,563,847	28.41	Consumption of non-durable goods	1,263,645	23.32
Investment in purchase of equipment	1,763,647	10.98	Consumption of durable goods	662,615	12.23
Investment in real estate	565,171	3.52	Real estate	1,663,008	30.69
USD	4,143,841	8.50	Operating purposes	936,569	17.28
Overdraft	2,131,298	51.43	USD	128,714	1.44
Working capital	1,473,064	35.55	Overdraft	19,326	15.01
Investment in purchase of equipment	513,991	12.40	Consumption of non-durable goods	16,678	12.96
Investment in real estate	25,488	0.62	Consumption of durable goods	60,904	47.32
EUR	28,556,209	58.56	Real estate	22,908	17.80
Overdraft	16,105,434	56.40	Operating purposes	8,898	6.91
Working capital	4,419,365	15.48	EUR	3,408,531	38.01
Investment in purchase of equipment	4,895,490	17.14	Overdraft	651,494	19.11
Investment in real estate	3,135,919	10.98	Consumption of non-durable goods	431,456	12.66
Other currencies	-	-	Consumption of durable goods	240,459	7.05
			Real estate	1,541,749	45.23
			Operating purposes	543,373	15.94
			Other currencies	11,974	0.13

Source: Bank of Albania

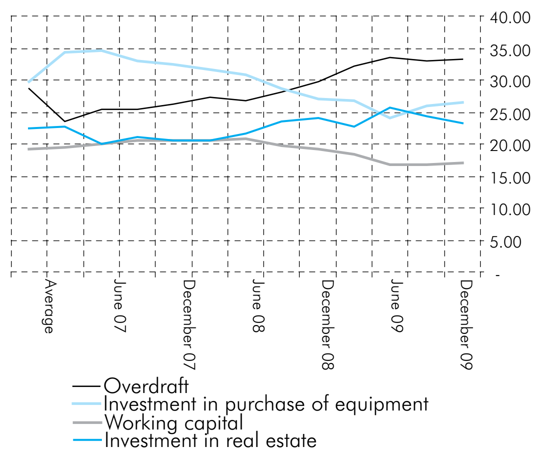
In terms of distribution of new loans by sectors of economy for the year 2009, 35.9 percent of loans were extended to the sector of trade, repair of vehicles and household appliances versus 26 percent in 2008; 14.3 percent of new loans were extended to the construction sector versus 12.3 percent in 2008; 3 percent of new loans were extended to transportation, storage and telecommunication versus 9.7 percent in 2008; and 11.8 percent of new loans were extended to processing industry versus 8.8 percent in 2008. From these figures, we note that the banking sector has provided greater financial support to the processing industry and the sector of trade and less to the transportation sector in 2009.

Chart 59 Distribution of outstanding loans



Source: Bank of Albania

Chart 60 Share of outstanding business loans by purpose of use to total outstanding business loans, in percent



Source: Bank of Albania

Regarding the outstanding loan portfolio, as at the end of 2009, the banking sector's outstanding loans increased to ALL 449.8 billion, accounting for 39.3 percent of GDP. The growth of loans was affected by the increase of ALL loans and the depreciation of the national currency versus the U.S. dollar and the Euro.

About 70.3 percent of outstanding loans is in foreign currency and 29.7 percent in the Albanian Lek. In terms of maturity term, short-term loans account for 33 percent of outstanding loans, medium-term loans about 20 percent and long-term loans about 47 percent, attesting to slight movements versus September 2009 and the same period the previous year. Chart 59 shows the distribution of outstanding loans to the public sector, businesses and households.

As at the end of 2009, outstanding business loans totalled ALL 291 billion, up 14.6 percent versus 2008. Outstanding household loans totalled ALL 139.7 billion, up 4.1 percent.

As at the end of 2009, business loans in the form of overdrafts amounted to ALL 96.7 billion[49] or 33.2 percent, above the average share of 28.7 percent[50] for the period March 2007 – December 2009.

In the last three years, outstanding business loans have been concentrated in overdrafts and investment in real estate. By contrast, loans for working capital and investments in the purchase of equipments have reduced their share to total outstanding loans to the business sector. Regarding the distribution of outstanding household loans by purpose of use[51], real estate loans have the main share, 70 percent, up 10.6 percent versus 2008.

In the last three years, outstanding household loans have shifted to loans for the consumption of non-durable goods. By contrast, loans for the consumption of durable goods have declined considerably. Loans for operating activity have declined slightly, while real estate loans have shown stable rates.

Table 18 shows the share of outstanding household loans by purpose of use.

Table 18 Share of outstanding household loans by purpose of use to total outstanding household loans, in percent

Households	QI-07	QII-07	QIII-07	QIV-07	QI-08	QII-08	QIII-08	QIV-08	QI-09	QII-09	QIII-09	QIV-09	Average
Overdraft	4.81	4.86	5.06	4.4	4.5	4.6	4.8	5.6	4.95	5.16	4.42	4.40	4.80
Consumption of non-durable goods	2.1	2.3	2.4	2.04	2.1	2.03	3.4	2.9	11.42	11.82	11.74	11.48	5.48
Consumption of durable goods	17.7	19	19.1	19	17.3	17	16.4	16.6	6.14	6.39	5.90	5.89	13.87
Investment in real estate	62	61.1	62.4	63.9	65.7	66.2	65.7	65.9	68.52	68.28	69.97	70.05	65.81
Operating activity	13.3	12.6	11.1	10.6	10.4	10.1	9.6	8.9	8.97	8.35	7.97	8.19	10.01

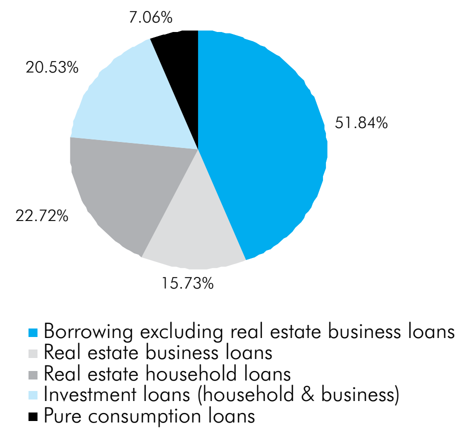
Source: Bank of Albania

As at the end of 2009, pure consumption loans, identified as household loans in the form of overdraft, for the consumption of non-durable and durable goods amounted to ALL 30.4 billion or 7 percent of total loan portfolio, 22 percent of household loan portfolio and 2.7 percent as a share of GDP. Loans for investment purposes (purchase of equipment and operating activity) amounted to ALL 88.5 billion or 20.5 percent of total loan portfolio and 7.7 percent as a share of GDP. Loans for real estate investments (business and household) totalled ALL 165.7 billion or 14.5 percent as a share of GDP.

Chart 61 shows the composition of loan portfolio by purpose of use.

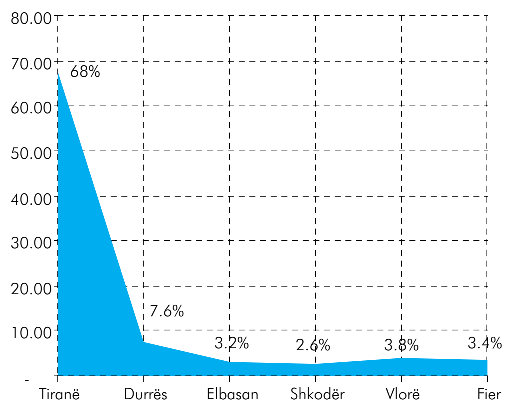
In terms of geographical distribution, the banking sector's lending activity has been mainly concentrated in Tirana, Durrës, Elbasan, Shkodra, Vlora and Fier. As at the end of 2009, the share of loans extended to these cities to total loans accounted for 88.9 percent. The lending activity has the largest concentration in Tirana, with the highest average share[52] of outstanding loans to the total, about 68 percent, followed by Durrës that shares 7.6 percent. Shkodra has the lowest average share, 2.6 percent. Chart 62 shows the distribution of average share of lending for the main cities.

Chart 61 Distribution of loans, as a percentage to total



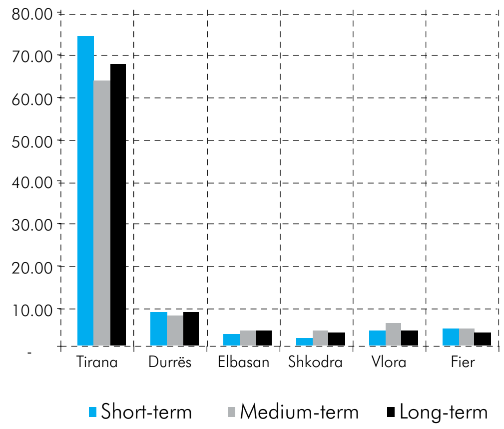
Source: Bank of Albania

Chart 62 Average share of loans by main cities



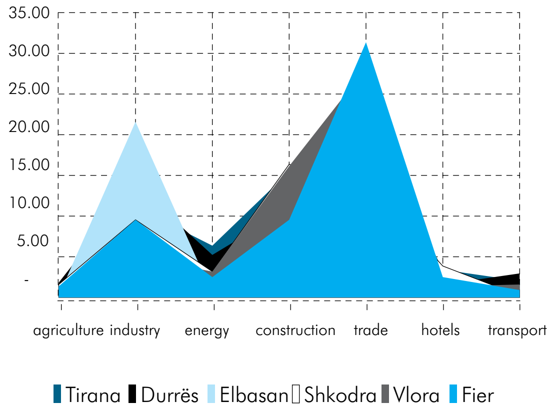
Source: Bank of Albania

Chart 63 Average share of loans by maturity terms and main cities[53]



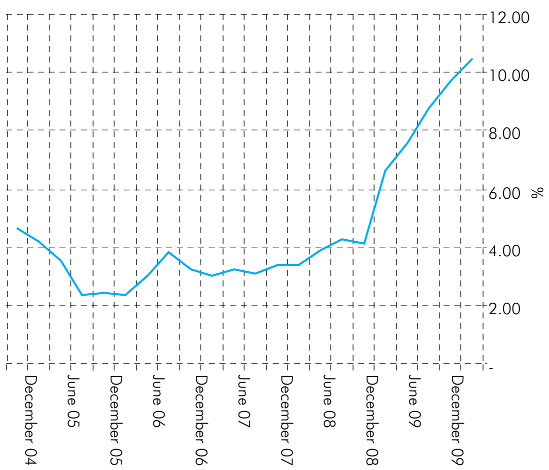
Source: Bank of Albania

Chart 64 Distribution of loans by sector of economy for main cities



Source: Bank of Albania

Chart 65 Non-performing loans (gross) to total loans, in percent



Source: Bank of Albania

Regarding the distribution of loans by sector of economy for the last quarter of 2009, loans to the trade sector mainly have the main share to total loans for each city. Worth distinguishing is Elbasan where loans to the industry sector have the largest concentration (21.7 percent), Shkodra with the largest concentration in the construction sector (16.4 percent). The sectors of agriculture and transportation received less financial support by the banking sector for all cities (see Chart 64).

6.1.6 LOAN QUALITY

Loan quality deteriorated in 2009. As at the end of 2009, the ratio of non-performing loans to total loan portfolio, on gross basis, rose to 10.5 percent versus 9.75 percent in the third quarter and 6.6 percent as at the end of 2008 (see Chart 65).

In the last quarter alone, non-performing loans grew ALL 4.5 billion or 10.4 percent from the previous quarter. For the same period, outstanding loans grew 2.8 percent. Compared with the same period the previous year, non-performing loans grew ALL 20.8 billion or 78.9 percent. Outstanding loans grew 13.4 percent. This performance attests to the considerable impact of the low growth rate of outstanding loans in 2009 on the deterioration of ratios measuring the quality of the loan portfolio.

In terms of rating, as at the end of 2009, 75 percent of the loan portfolio is considered as "standard" versus 78.3 percent the same period the previous year. In the meantime, there has been a shift of loans to lower quality rating, more specifically "doubtful loans" and "loss loans". Their share is estimated at 2.7 and 3 percent, from 1.4 and 1.3 percent as at the end of 2008.

Concerning the bank peer groups, as at the last quarter of 2009, Group 2 banks posted the largest increase of "non-performing loans to total loans" by 5.5 percentage points versus 2008 to 13 percent. Group 1 banks recorded the lowest annual increase by only 1.4 percentage points to 4.9 percent (see Chart 66).

In terms of users, the loan portfolio's quality has deteriorated for both groups, businesses and households. The ratio of non-performing loans to outstanding loans for businesses and households is estimated at 12.4 and 8.2 percent, respectively, versus 7.6 and 5.5 percent as at the end of 2008.

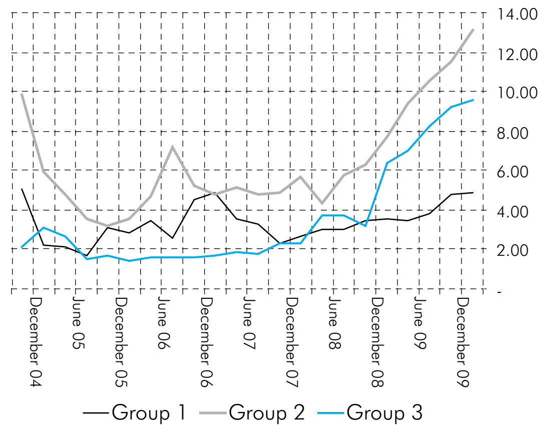
In terms of currency, as at the end of 2009, the ratio of non-performing loans in ALL to outstanding loans in ALL and the ratio of non-performing loans in foreign currency to outstanding loans in foreign currency were estimated at about 10 percent versus 7.5 and 6.3 percent, respectively, in 2008. The deteriorated quality of the loan portfolio in ALL, on an annual basis, owes to the higher growth rate of non-performing loans (67 percent) than the growth of outstanding loans in ALL (23 percent).

Another indicator that measures the quality of the loan portfolio in foreign currency is the ratio of non-performing loans in foreign currency, when the borrower is unhedged against the exchange rate fluctuations. More precisely, as at the end of 2009, the ratio of non-performing loans in foreign currency, when the borrower is unhedged against the exchange rate, to outstanding loans in foreign currency, when the borrower is unhedged against the exchange rate, was estimated at 9.6 percent versus 5.9 percent in 2008, providing evidence for the negative effect of the exchange rate depreciation on the loan portfolio quality[54].

As at the end of 2009, the loan portfolio quality declined substantially in some of the key sectors of the economy. Industry posted the highest ratio of non-performing loans to outstanding loans, 15.8 percent versus 6.7 percent in 2008, followed by construction, 13.9 percent versus 7.6 percent in 2008. Chart 67 shows the loan portfolio quality for several sectors of the economy.

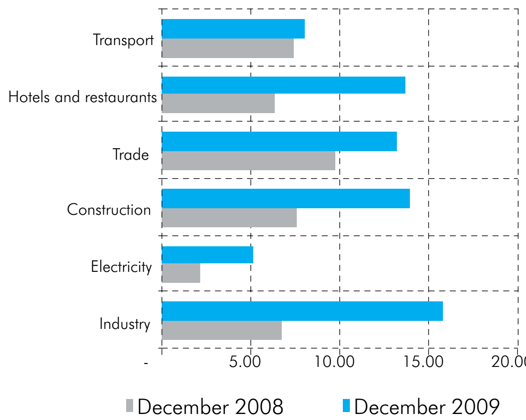
In order to assess the capacity of the banking sector to cope with unforeseen losses arising from the lending activity, we calculate the ratio of non-performing loans, net, to capital indicators. As at the end of 2009, non-performing loans, net, to capital indicators, increased compared with the same period the previous year, implying higher risk arising from non-performing loans. More specifically, as at

Chart 66 Non-performing loans to total loans by bank peer groups, in percent



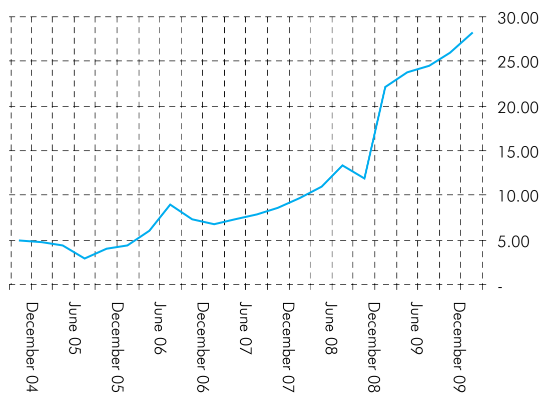
Source: Bank of Albania

Chart 67 Loan portfolio quality by sectors of economy, in percent



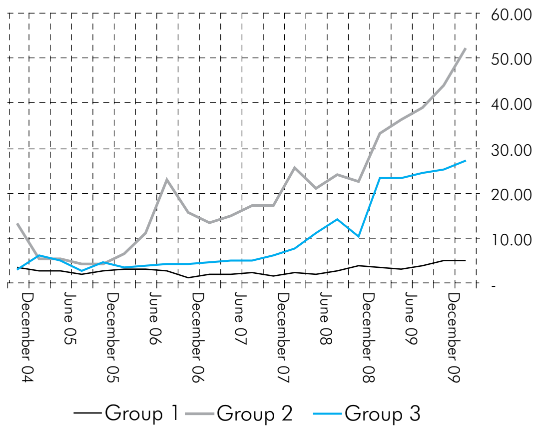
Source: Bank of Albania

Chart 68 Net non-performing loans to regulatory capital, in percent



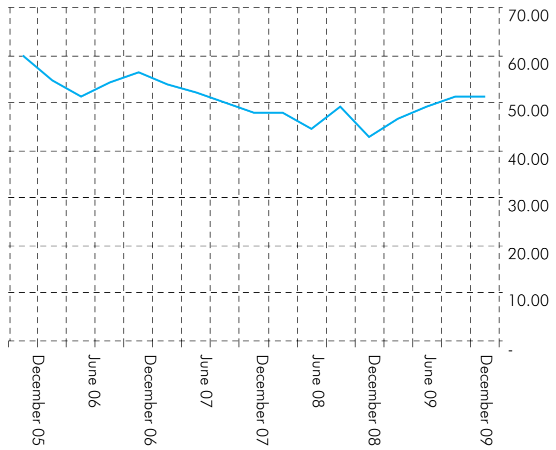
Source: Bank of Albania

Chart 69 Non-performing loans, net, to Tier 1 capital by bank peer groups, in percent



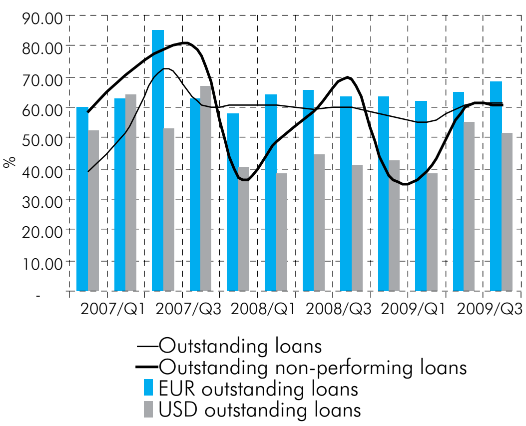
Source: Bank of Albania

Chart 70 Coverage ratio of non-performing loans with provisions, quarterly, in percent



Source: Bank of Albania

Chart 71 Collateral loans based on real estate, in percent



Source: Bank of Albania

the end of 2009, the ratio of non-performing loans, net, to Tier 1 capital increased to 29.9 percent, up 7 percentage points from 2008. The ratio of non-performing loans, net, to regulatory capital, and non-performing loans, net, to shareholders' equity were estimated at 28 and 27 percent, respectively, both up 6 percentage points from the previous year (see Chart 68).

In terms of bank peer groups, as at the end of 2009, Group 2 banks posted the highest average increase of non-performing loans, net, to capital. This indicator is estimated at 47.6 percent, up 16.8 percentage points compared with the end of 2008. Group 3 banks recorded an average gradual increase to 25.8 percent versus 22.3 percent in 2008. The same indicator remains low for Group 1 banks, 1.4 percentage points. In more specific terms, bank peer groups posted significant increase in the ratio of non-performing loans, net, to Tier 1 capital compared with 2008 (see Chart 69).

6.1.7 PROVISIONING FOR COVERING LOAN LOSSES AND COLLATERAL COVERAGE

Against a background of deteriorated loan quality, the banking sector has raised the provisions at a fast pace. As at the end of 2009, they amounted to ALL 24.2 billion, up 10.5 percent from the previous quarter and 114 percent from the previous year. As at the end of 2009, the ratio of provisions for non-performing loans to non-performing loans (coverage ratio) rose to 51.3 percent versus 42.8 percent as at the end of 2008, due to the higher increase of reserve funds (114 percent) than the increase of non-performing loans (78.9 percent).

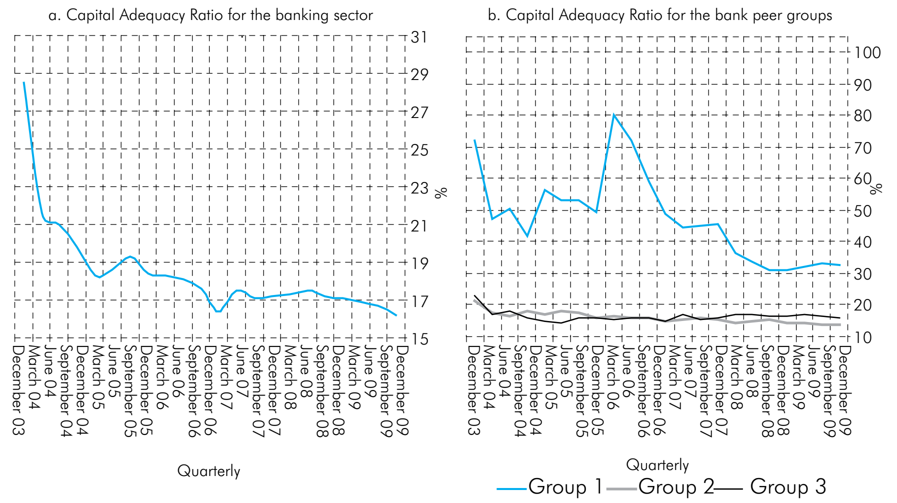
The collateral plays a key role in the lending process, as a source of recovering the value of non-performing loans, either partially or completely. As at the end of 2009, the value of guaranteed collateral loans[55] accounted for 79 percent of the loan portfolio. Collateral loans, mainly in the form of real estate, were estimated at 61 percent in the last quarter, very close to the previous year's percentage (60 percent). Regarding the coverage of non-performing loans portfolio by collateral, as at the end of 2009, it was estimated at 61 percent versus 69 percent in 2008. In the case of the coverage of foreign currency-denominated loan portfolio with collateral, it was estimated at 68.3 percent for the EUR outstanding loans and 51.6 for the USD outstanding loans (see Chart 71).

CAPITAL INDICATORS

The banking sector did now manifest large movements in capital indicators during the year 2009. As at the end of 2009, the banking sector's Capital Adequacy Ratio[56] was 16.2 percent, down 1 percentage point from the year-end 2008. This indicator attested to a slight downward performance over the course of the year; however it is quite higher than the minimum required (see Chart 72). As at the end of 2009, the banking sector's regulatory capital amounted to ALL 81.3 billion (ALL 22.7 billion, up 39 percent from 2008), maintaining an upward tendency over the quarters. Total risk-weighted assets and off-balance sheet items amounted to ALL 502.8 billion, up 48 percent from the year-end 2008. High-risk assets (risk-weighted at 150 percent) grew the highest relative to the year-end 2008 (185 percent versus the previous year).

In terms of bank peer groups, as at the end of 2009, Capital Adequacy Ratio was 32.7 percent for Group 1, 13.6 percent for Group 2 and 16 percent for Group 3. Banks under Groups 2 and 3 experienced lower CAR in 2009. Group 2's CAR was 1.7 percentage points lower than in 2008 (see Chart 72.b).

Chart 72 Capital Adequacy Ratio (regulatory capital to risk-weighted assets)



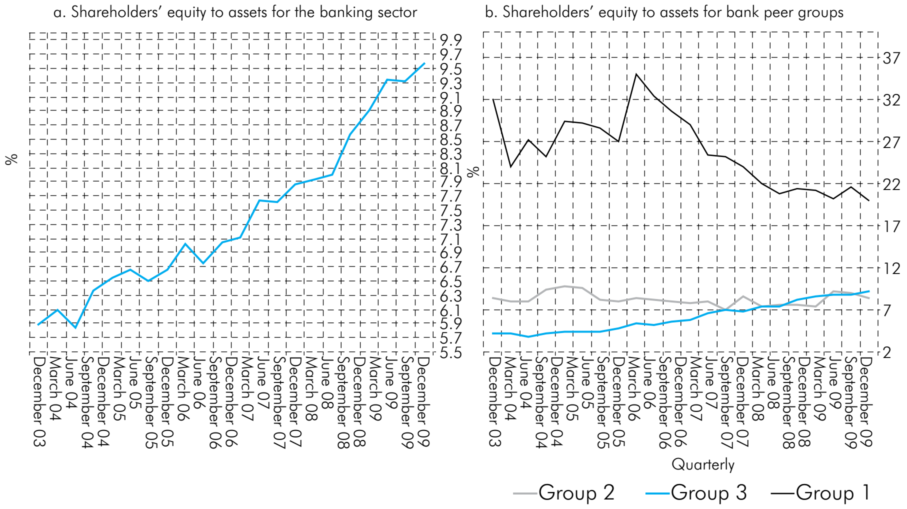
Source: Bank of Albania

As at the end of 2009, shareholders' equity to total assets was 9.6 percent for the banking sector, up 1 percentage point from 2008. This indicator maintained a stable upward tendency over the course of 2009 (see Chart

73.a). The majority of banks posted an increase in their paid-in capital, ALL 9.86 billion, hence increasing this indicator further.[57]

In terms of bank peer groups, as at the end of 2009, shareholders' equity to total assets was 20 percent for Group 1, 8.4 percent for Group 2 and 9.3 percent for Group 3 (see Chart 73.b). Groups 2 and 3 attest to a higher ratio versus the year-end 2008 by 0.8 and 1.1 percentage points, respectively. This ratio dropped 1.4 percentage points for Group 1, however being above the banking system's average. When comparing the year-end level to the quarterly levels, Group 3 shows an increase in the shareholders' equity to total assets versus all the quarters, whereas Group 2 increased versus the first quarter alone.

Chart 73 Shareholders' equity to assets



Source: Bank of Albania

As at the end of 2009, the Albanian banking sector remained well-capitalized. Capital Adequacy Ratio showed a slight decrease versus the year-end 2008, however much higher than the minimum required. The rationale behind the decline is the higher increase of risk-weighted assets than the regulatory capital. This change in risk-weighted assets, particularly the considerable growth of high-risk assets (risk-weighted at 150 percent), represents an additional risk element for the banking sector.

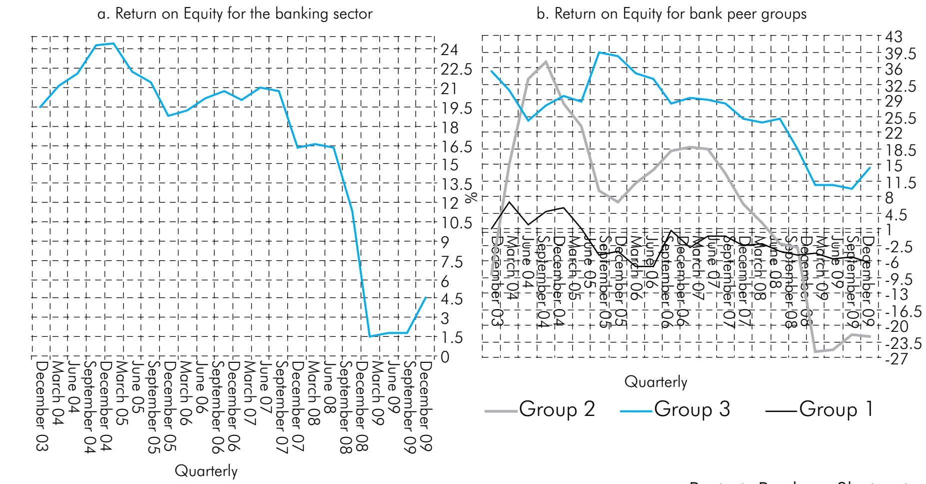
The increase of the paid-in capital, at a time when banks weathered the crisis' effects, attests to the shareholders' willingness to invest and constitutes a positive element for this year's developments.

6.1.8 FINANCIAL RESULT AND EFFICIENCY IN USING RESOURCES

As at end of 2009, the banking sector's net profit was ALL 3.5 billion, down ALL 3.8 billion or 51.7 percent from the previous year's profit, reflecting the effects of the global financial crisis on banks' performance more pronouncedly.

The annual rate of the Return on Equity (RoE)[58] of the banking sector was 4.6 percent, down 7 percentage points from the year-end 2008. The banking sector's net profit declined 51.7 percent while average shareholders' equity increased 20.8 percent versus the year-end 2008. This indicator was highly volatile in the early part of 2009, while increasingly steadily after July (see Chart 74.a).

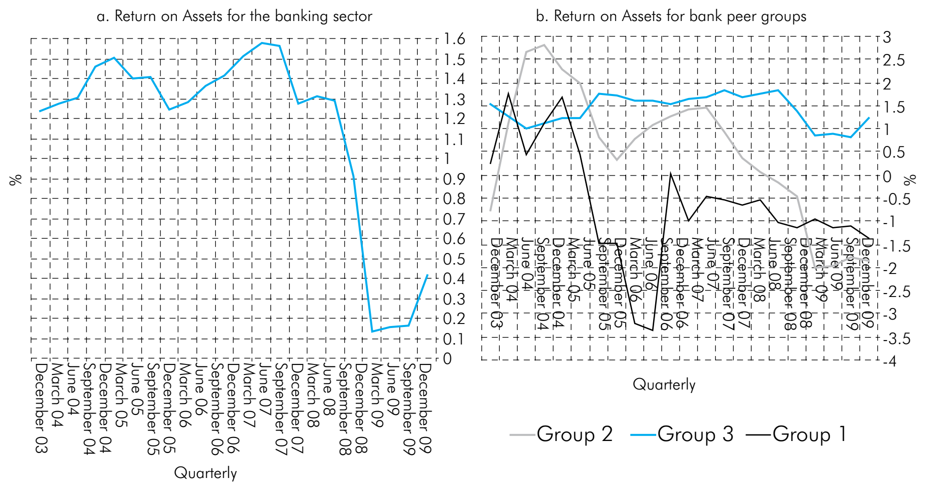
Chart 74 Return on Equity (RoE)



Burimi: Banka e Shqipërisë.

As at end of 2009, the banking sector's Return on Assets (RoA) was 0.4 percent, down 0.5 percentage points from the year-end 2008. RoA generally has a similar performance to RoE (see Chart 75).

Chart 75 Return on Assets (RoA)

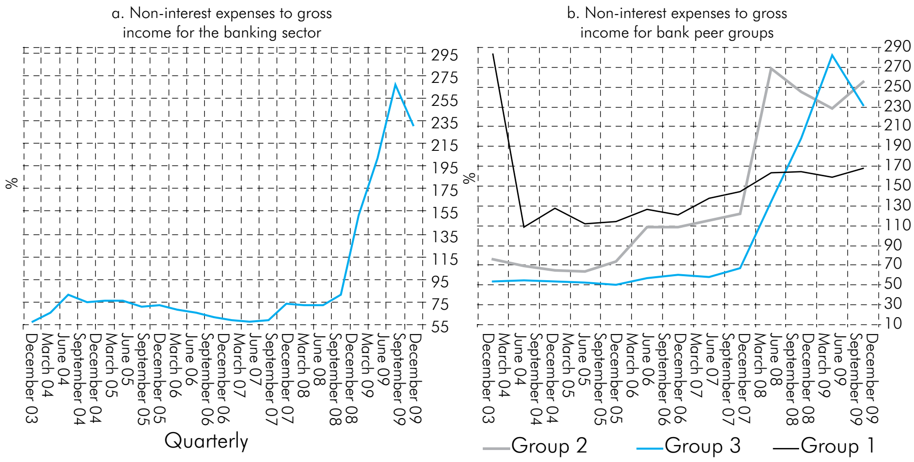


Source: Bank of Albania

Banks under Group 3 have determined the performance of both indicators. This group showed positive RoE and RoA figures throughout the year 2009.

If we analyze the factors with the main impact on banks' performance, we note that "non-interest expenses to gross operating income" grew markedly in the first nine-month period (peaking at 267 percent in September) to later fall in the last quarter (231.4 percent in December) (see Chart 76.a). In terms of bank peer groups, "non-interest expenses to gross income" fell in the last quarter for Group 3 (determining the performance of this ratio for the entire sector) and grew for Group 2 (see Chart 76.b). Non-interest expenses reached their peak in the third quarter of 2009.

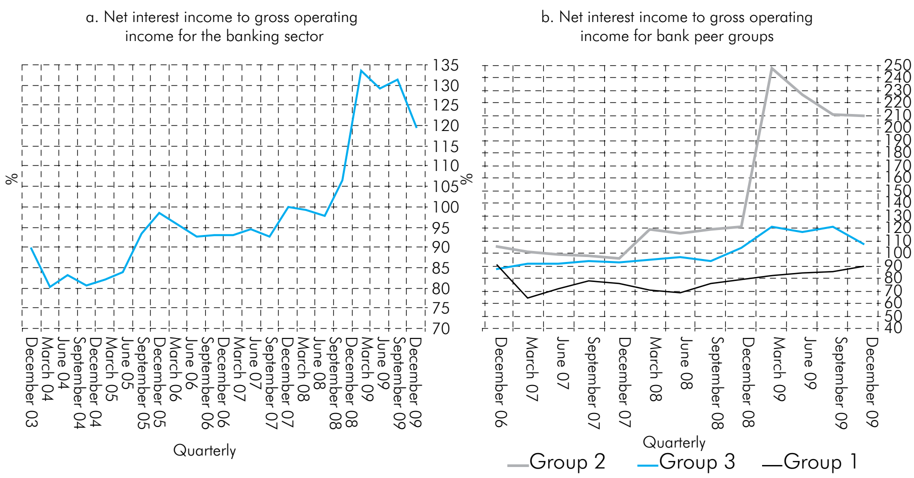
Chart 76 Non-interest expenses to gross operating income



Source: Bank of Albania

The performance of non-interest expenses relies heavily on the performance of provisions, which grew ALL 12 billion in 2009. Only 13 percent of this growth took place in the last quarter. On the other hand, gross income grew ALL 9 billion in the last quarter versus an average of ALL 5.7 billion in the previous quarters. As at end of 2009, the ratio of provisions to gross income was 45 percent, up 16 percentage points versus the year-end 2008.

Chart 77 Net interest income to gross operating income



Source: Bank of Albania

The ratio of "net interest income to gross operating income" is analyzed to assess the contribution of the underlying activity of financial intermediation to total banking sector's income. As at end of 2009, this ratio stood at 119.6 percent, up 13 percentage points from the year-end 2008 (see Chart 77.a). The analysis of the component parts of this ratio shows that interest income and gross operating income grew at almost similar rates in the last quarter of 2009. Vis-à-vis the year-end 2008, the banking sector's net interest income grew 19 percent versus the 9 percent decline of gross operating income. The rationale behind the decline of the latter, at a time when net interest income grew substantially, is the increase of loan loss provisions which curbed markedly in the last quarter of 2009.

The ratio of "net interest income to gross operating income" showed dissimilar performance for the bank peer groups. More specifically, this ratio increased pronouncedly for Group 2 until May 2009 (295 percent) to later fall to 210 percent in December. Group 3 showed a more moderate volatility of this ratio. In the last quarter of 2009 it declined moderately to 108 percent (see Chart 77.b.).

Box 3 Decomposition of RoE by DuPont Model[59].

The following decomposes the RoE ratio by using the DuPont model. The DuPont model breaks down the RoE (Return on Equity) into some components. More specifically:

RoE = Earnings After Taxes/Book Value of Equity = EAT/BVE;
*RoE = RoA * EM (EM = Equity Multiplier);*
EM = Total Assets/Book Value of Equity = TA/BVE

Table 19 shows the decomposition of RoE by components through 2003 – 2009.

Table 19 RoE components through 2003 – 2009

	2003	2004	2005	2006	2007	2008	2009
Return on Equity (in %), RoE= EAT/BVE	19.53	21.10	22.43	20.17	20.32	11.4	4.58
Return on Assets (in %), RoA= EAT/TA	1.24	1.28	1.41	1.36	1.48	0.92	0.42
RoE components, ROE=PM*AU*EM							
Profit Margin (in %), PM=EAT/TOI	14.29	15.80	17.24	17.67	17.95	10.43	3.26
Asset Utilization (in %), AU=TOI/TA	8.66	8.08	8.15	7.70	8.24	8.79	12.79
Equity Multiplier (in times), EM=TA/BVE	15.78	16.54	15.96	14.82	13.74	12.49	10.99
RoA components, ROA=AU-ER							
Asset Utilization (in %), AU=TOI/TA	8.66	8.08	8.15	7.70	8.24	8.79	12.79
Expenses Ratio (in %), ER=TOE/TA	7.42	6.80	6.75	6.34	6.76	7.87	12.37
RoA components, RoA=NIM*EAR+B-LLP/TA-T/TA							
Net Interest Margin (in %), NIM=NII/EA	3.23	3.08	3.75	4.22	4.35	4.13	4.04
Earning Assets Ratio (in %), EAR=EA/TA	95.85	94.80	93.33	93.19	93.34	93.12	91.30
Banks Burden (in %), B=NNII/TA	(1.11)	(0.93)	(1.45)	(1.69)	(1.62)	(1.69)	(1.75)
Loan Loss Provisions to Total Assets (in %), LLP/TA	0.25	0.26	0.19	0.48	0.53	1.06	1.39
Taxes to Total Assets (in %), T/TA	0.50	0.45	0.46	0.41	0.44	0.18	0.12
NIM components, NIM=REA-COL*LEA							
Return on Earning Assets (in %), REA=II/EA	8.07	6.96	6.84	7.05	7.72	8.07	8.10
Cost of Liabilities (in %), COL=IE/PL	5.23	4.14	3.28	3.05	3.70	4.31	4.43
Liabilities to Earning Assets (in %), LEA=PL/EA	92.47	93.80	94.36	92.90	91.15	91.58	91.71

Source: Bank of Albania

List of Abbreviations:

EAT = Earnings After Taxes
BVE = Book Value of Equity
TA = Total Assets
TOI = Total Operating Income
AU = Asset Utilization
EM = Equity Multiplier
TOE = Total Operating Expenses
PM = Profit Margin
ER = Expenses Ratio
NIM = Net Interest Margin
NII = Net Interest Income
EA = Earning Assets
EAR = Earning Assets Ratio
NNII = Net Non-Interest Income
LLP = Loan Loss Provisions
T = Taxes
REA = Return on Earning Assets
COL = Cost of Liabilities
LEA = Liabilities to Earning Assets
IE = Interest Expenses
PL = Paying Liabilities
B = Burden

From the analysis of the abovementioned components, we note that:

- *The profit margin (earnings after taxes/total operating income) increased during 2003 – 2007, but declined substantially in 2008 and 2009. In 2009, the profit margin was 3.3 percent, down 7.2 percentage points from 2008 and 14.7 percentage points from 2007. The rationale between this deterioration is the annual fall in earnings after taxes by 52 percent (versus 2008) and the annual increase of total income by 55 percent. The fall in the profit margin is one of the main factors to have caused the RoE decrease. A decline in the profit margin means that a smaller part of total income, after the deduction of expenses, remains at the shareholders' disposal (to be distributed in the form of dividends) or at the bank's disposal (to be re-invested).*

- *Meanwhile, asset utilization has increased: 12.8 percent in 2009, up 4 and 5 percentage points versus 2008 and 2007. This component ranged between 7.7-8.8 percent through 2003 – 2008.*

- *The equity multiplier (Total Assets/Book Value of Equity) continued its downward trend in 2009 as well, a tendency that had begun in 2005: in 2009, the value of the equity multiplier was 11 (versus 12.5 in 2008 and 13.7 in 2007). This performance has been triggered by the faster annual increase of shareholders' equity (by 20.8 percent in 2009) against the lower increase in average assets by 6.3 percent for the same period. The value of the equity multiplier at the end of 2009 shows that the assets cover the invested capital about 11 times. The annual increase of shareholders' equity by about 20.8 percent, as indicated in the analysis of capital indicators, represents a positive performance over the last year.*

After decomposing the RoE further, we have:

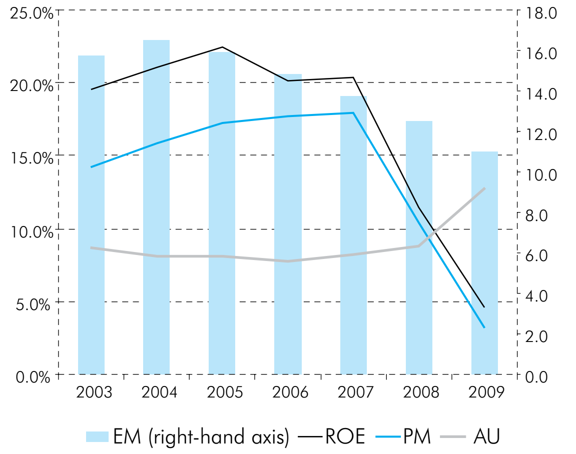
*RoE = [NIM*EAR + B – LLP/TA - T/TA] * EM*

- The net interest margin (NIM) is the ratio of net interest income to earning assets. As at end of 2009, this indicator was 4 percent, down 0.1 and 0.3 percentage points from 2008 and 2007. This ratio maintained an upward tendency until 2007 (to 4.35) and later fell.

Regarding the NIM components, the net interest income increased 1.9 percent in 2009 (the annual increase in 2008 was 12.3 percent and in 2007 27.3 percent). Earning assets increased 4.2 percent. The annual increase of earning assets was higher than that of net interest income, hence resulting in lower levels of the NIM.

- As at end of 2009, earning assets ratio (EAR) was 91.3 percent, down 1.8 percentage points versus the year-end 2008.

Chart 78 Graphical display of Roe components



Source: Bank of Albania

- Burden (B) is the ratio of net non-interest income to average assets. As at end of 2009, this indicator was -1.75 percent, down 1 percentage points from the year-end 2008. Net non-interest income recorded negative values (non-interest expenses exceeded non-interest income) and they deepened further (from -13.5 million to -14.9 million), while average assets increased 6.3 percent.

- As at end of 2009, the ratio of loan loss provisions to total assets (LLP/TA) was estimated at 1.4 percent, up 0.3 percentage points from the year-end 2008. The average of the ratio (LLP/TA) was 0.46 for the years 2003-2008. Loan loss provisions grew 40 percent in 2009 versus 2008, exceeding the increase of total assets by more than 6 times.

- The ratio of taxes to total assets (T/TA): As at end of 2009, this ratio was 0.12 percent, down 0.06 percentage points from the year-end 2008. The drop in taxes owes to the fall in earnings before taxes reported by the banking sector as at end of the year.

The performance of all RoE components in 2009, excluding taxes, shows that they triggered the decline of the RoE at the end of the year (to 4.6 percent from 11.4 percent in 2008). The ratio of total expenses to total assets, up 4.5 percentage points from 2008, marked the most significant change in 2009.

6.1.9 PERFORMANCE OF DEPOSITS

The decline of the banking sector deposits from the last quarter of 2008 to mid-2009 affected their performance throughout the year. The decline of deposits was triggered by the shaking of public confidence in the banking sector's stability, due to psychological effects related to the burst and severity of the global financial crisis and the uncertainty about its effects on the Albanian banking sector. However, deposits grew at constant rates during the second half of the year, attesting to the increase of public confidence in the banking system and the banks' efforts to attract new deposits by increasing the interest rates, particularly during summer.

Deposits remain concentrated in the largest banks of the banking sector[60], however the degree of their concentration has declined substantially.

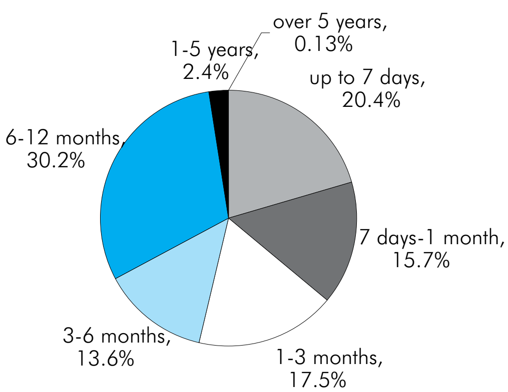
As at end of 2009, total deposits grew 7.6 percent from the year-end 2008, while their past year growth was 2.4 percent (see Table 20). Deposits have grown 8.45 percent starting from June, attesting to the difficulties of the banking system in attracting deposits in the early part of the year due to the withdrawal of customer deposits at the year-end 2008.

Table 20 Annual growth of total deposits during 2004-2009

	2004	2005	2006	2007	2008	2009
Total deposit growth (in %)	13.4	16.4	20.1	19.9	2.4	7.6

Source: Bank of Albania

Chart 79 Deposits by maturity term



Source: Bank of Albania

In terms of their maturity, we note that in December 2009 most banking sector's deposits, about 67 percent, were of up to one-year maturity (see Chart 79). Relative to September 2009, time deposits of up to 1-month maturity grew 3.3 percentage points; deposits of 6 to 12-month maturity grew 3 percentage points; deposits of over 5-year maturity, whose share is negligible, were almost unchanged, while deposits of other maturities declined. Against year-end 2008, deposits of up to 1-month maturity declined 1.7 percentage points; deposits of 6 to 12-month maturity grew 1.7 percentage points. The changes in the deposits of other maturity terms against the year-end 2008 were negligible.

In terms of currency, we note that as at year-end 2009, ALL deposits accounted for 54 percent of total deposits, amounting to ALL 376.2 billion. Foreign currency deposits accounted for 46 percent of total deposits and amounted to ALL 318 billion. The share of ALL deposits fell 0.6 percentage points versus the end-September and 2.7 percentage points versus the year-end 2008.

New deposits in the Albanian Lek grew starting from May 2009, after their decline in the last quarter of 2008. In December, a total of ALL 47.6 billion of new ALL deposits were accepted, up 17 percent from the new deposits in June and 6.7 percent from the new deposits in January 2009. The higher figure in September attests to the acceptance of more deposits from the banking system as a result of the promotional campaigns during summer and the lower interest rates on deposits after this month.

Regarding the new deposits by maturity term, as at year-end 2009, new deposits of up to 3-month maturity grew, while deposits of other maturity terms declined versus the year-end 2008.

Share of maturity (%)	December 2008	March 2009	June 2009	September 2009	December 2009
2-year	1.31	0.8	0.69	1.21	1.06
1-year	29.60	22.47	19.28	33.05	27.87
6-month	17.10	14.92	20.83	12.96	14.33
3-month	23.91	32.44	17.80	25.29	30.69
1-month	27.77	29.10	41.21	27.23	25.77

Source: Bank of Albania

Table 21 New ALL deposits by maturity term

Average interest rate on new ALL deposits was 5.37 percent in December versus 5.48 percent the same period the previous year. The higher interest rate in August reflected the higher demand of the banking sector for ALL deposits, while the decrease in the following months attests to the improved deposit situation in the banking system.

As at December 2009, new EUR deposits totalled EUR 487 million, attesting to a downward tendency over the course of the year. New EUR deposits accepted in December 2009 were 9.3 percent lower than in September, while being 35.1 percent lower than in December 2008. Regarding the new EUR deposits by maturity term, the public shifted the 1-month deposits to 3-month deposits in the last months of 2009. Therefore, new deposits of 3-month maturity term dominate the structure of new deposits (see Table 22).

Share of maturity (in %)	December 2008	March 2009	June 2009	September 2009	December 2009
2-year	0.13	0.19	0.13	0.55	0.32
1-year	3.56	2.40	4.40	11.98	10.59
6-month	2.18	3.62	5.70	6.92	7.47
3-month	8.78	8.17	7.40	14.80	66.62
1-month	85.31	85.60	82.34	65.68	14.94

Source: Bank of Albania

Table 22 New EUR deposits by maturity term

Average interest rate on new EUR deposits was 2.17 percent in December 2009 versus 3.14 percent the same period the previous year, providing evidence for the decline of new EUR deposits.

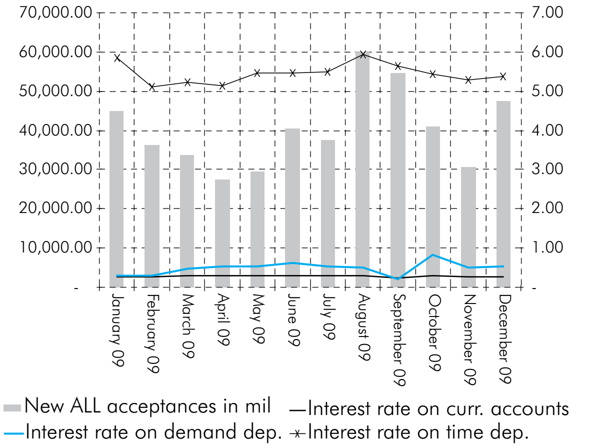
As at December 2009, new USD deposits totalled USD 87.3 million. USD deposits were downward in the last quarter of 2009, however upward versus the year 2008. New USD deposits accepted in December were 19 percent lower than in September 2009, but 37 percent higher than as at year-end 2008. Throughout the year 2009, deposits of less than 3-month maturity term accounted for over 70 percent of total new USD deposits, similar to the year-end 2008 (see Table 23).

Table 23 New USD deposits by maturity term

Share of maturity (in %)	December 2008	March 2009	June 2009	September 2009	December 2009
2-year	0.12	0.16	0.11	0.46	0.46
1-year	15.82	10.36	11.99	18.55	16.40
6-month	12.42	10.18	14.72	12.82	10.85
3-month	22.55	33.75	26.28	31.23	39.54
1-month	49.09	45.47	46.63	34.68	32.63

Source: Bank of Albania

Chart 80 Total volume of new ALL acceptances versus average interest rates on ALL current accounts, time and demand deposits



Source: Bank of Albania

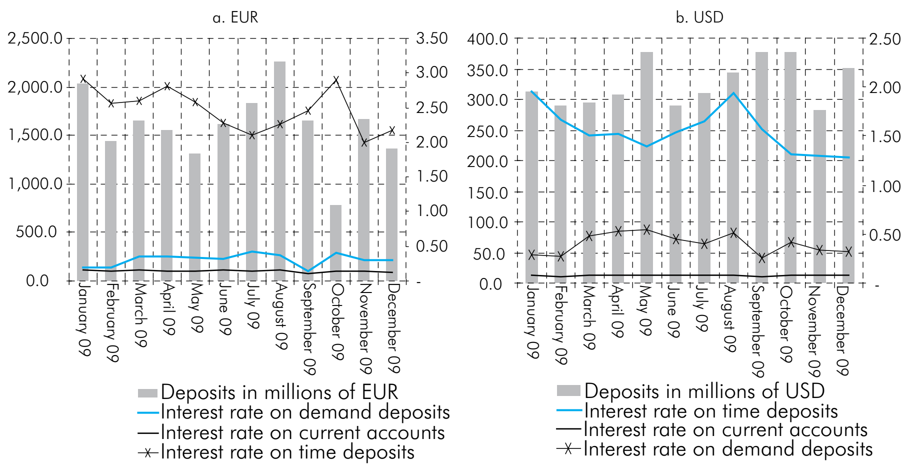
Average monthly interest rate on new USD deposits was 1.29 percent in December 2009 versus 2.01 percent the same period the previous year.

In the early months of 2009, new ALL deposits and current accounts showed a downward tendency on a monthly basis, though at a very slow downward rate. This has matched with persistent downward tendency of deposits in the first quarter of 2009. Since May, the stock of deposits resumed the growing rates, reflecting greater stability of existing deposits. The stock of deposits reached its peak in August. New ALL deposits show frequent fluctuation throughout the year. Worth noting however is that the situation improved substantially in the second half of 2009.

New EUR deposits and current accounts showed stable rates in the early months of 2009. In the meantime, new USD deposits and current accounts showed steadier improvement.

In general, the performance of new deposits supports the belief that the recovery of deposits in the banking sector seems to have been placed on stable

Chart 81 Total volume of new foreign currency acceptances versus average interest rates on EUR and USD current accounts, time and demand deposits



Source: Bank of Albania

growth rates following an early year 2009 that maintained the downward rates since the year-end 2008. The new deposit flow in the second half of 2009 attests to the fact that public confidence in the Albanian banking system has restored. However, the frequent fluctuations in new deposits call for the constant monitoring of banks' liquidity.

6.1.10 LIQUIDITY INDICATORS OF THE BANKING SECTOR

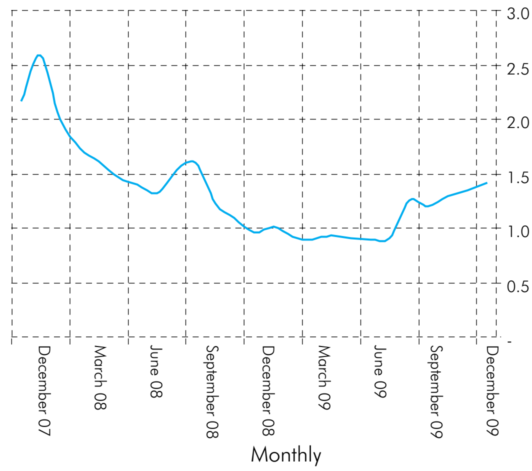
The withdrawal of deposits in the year-end 2008 and early 2009 called for the improvement of the regulatory framework on the management of liquidity risk by commercial banks. To this purpose, in October 2009, the Bank of Albania adopted the regulation "On Liquidity Risk Management". As at year-end 2009, the banking sector's liquid assets accounted for 27.6 percent of total assets and 32.6 percent of total short-term liabilities of up to one-year remaining maturity. These ratios show a satisfactory liquidity position of the Albanian banking sector.

Our analysis is more elaborate and considers all the following indicators as a supplementary assessment of banks' liquidity position.

As at year-end 2009, the "deposit/loan" ratio stood at 154.3 percent, down 8.3 percentage points from December 2008. This performance owes to higher growth of outstanding loans relative to the deposit growth. The change in outstanding loans for the period December 2008-December 2009 is ALL 53 billion. For the same period, the change in deposits is ALL 49 billion. This ratio did not show significant fluctuations throughout the year 2009. The "deposit/loan" ratio in foreign currency increased in 2009 to 112.6 percent versus 103 percent in December 2008, showing a much higher growth rate[61] of foreign currency-denominated deposits versus foreign currency-denominated loans.

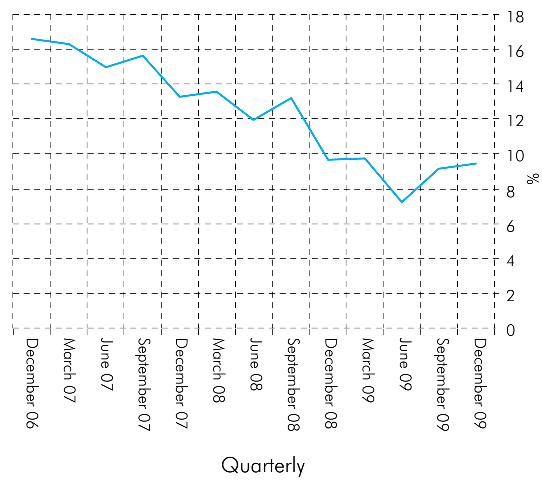
As at year-end 2009, the ratio of "non-resident assets" to "liabilities to non-residents" rose to 1.42 percent versus 0.96 percent as at year-end 2008. In the first half of 2009, the banking system was for the first time debtor to non-residents. The decline of assets and increase of non-resident liabilities was a result of the banking system's liquidity needs in the first half of 2009. In the second half of 2009, this ratio increased reflecting the improved liquidity position of the banking system.

Chart 82 Non-resident assets to liabilities to non-residents



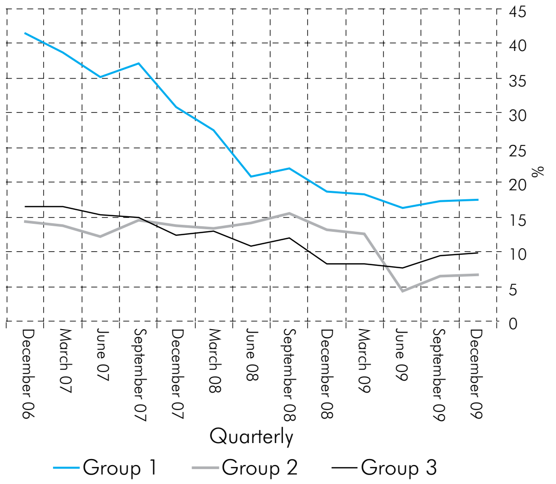
Source: Bank of Albania

Chart 83 Total non-resident assets to total assets



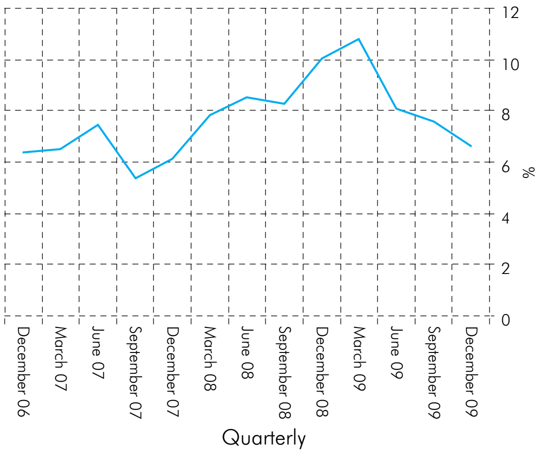
Source: Bank of Albania

Chart 84 Non-resident assets to total assets by bank peer groups



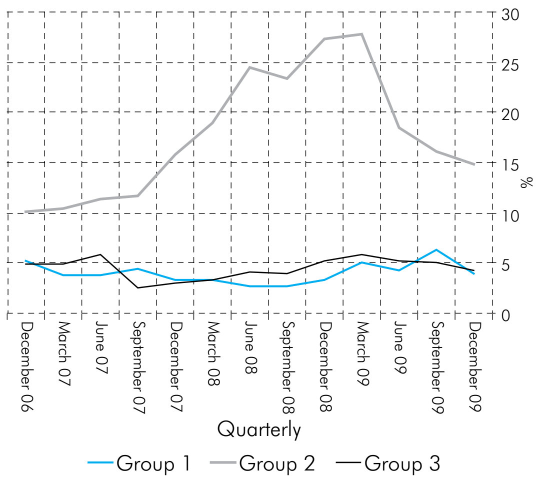
Source: Bank of Albania

Chart 85 Liabilities to non-residents to total liabilities



Source: Bank of Albania

Chart 86 Liabilities to non-residents to total liabilities by bank peer groups



Source: Bank of Albania

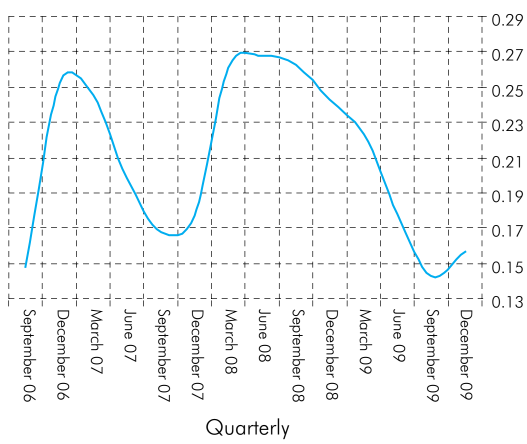
In the second half of 2009, the banking system's non-resident assets showed an upward tendency and returned to the figures posted in the last quarter of 2008. As at year-end 2009, non-resident assets accounted for 9.4 percent of total assets versus 9.7 percent as at year-end 2008.

In terms of bank peer groups, Group 2 is more sensitive to non-resident assets. As at year-end 2009, Group 2 lowered the level of non-resident assets to 6.7 percent of total assets versus 13.1 percent in October 2008. This marked decline of non-resident assets reflected the immediate need of Group 2 banks for liquid assets.

The ratio of liabilities to non-residents to total liabilities increased in the last quarter of 2008 and the first quarter of 2009. In the first quarter of 2009, liabilities to non-residents declined due to the improved liquidity position. In terms of bank peer groups, Group 2 is far more reliant on liabilities to non-residents. In the last quarter of 2008 and the first quarter of 2009, liabilities to non-residents increased. This performance showed a downward tendency in the last quarters of 2009 due to the improved liquidity position of Group 2 banks.

Chart 87 shows the performance of Herfindahl Index, which as of the first quarter of 2008, excluding the last quarter of 2009, shows lower concentration of liabilities to non-residents for the banking sector.

Chart 87 Concentration of liabilities to non-residents

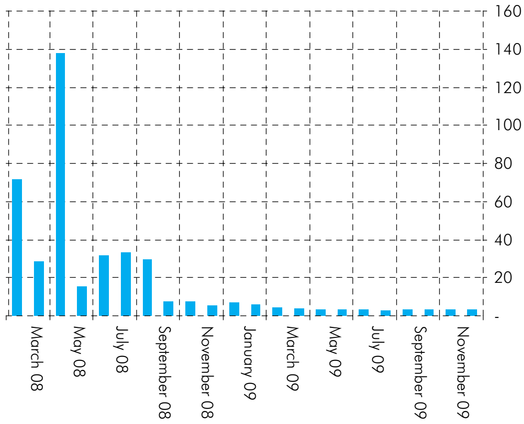


Source: Bank of Albania

In December 2009, the ratio of "T-bill portfolio" to "borrowing from the Bank of Albania" dropped to 3.3 from 30 in September 2008. This decline reflects the amount used as collateral for the borrowing from the Bank of Albania. The financing through borrowing from the Bank of Albania has reduced the amount of T-bills available for collateral, hence lowering the potential options for the provision of liquidity to the banking system.

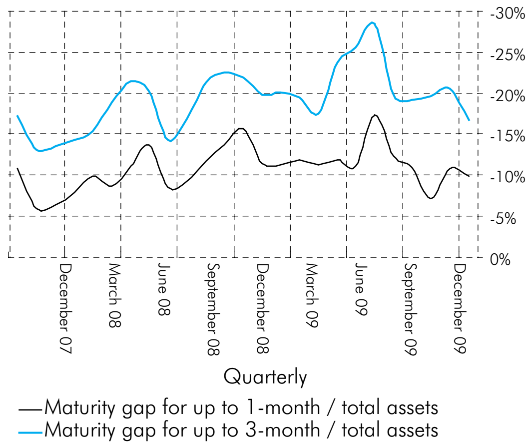
As at year-end 2009, the negative cumulative gap of assets and liabilities of up to 3-month maturity term narrowed to 16.7 percent from 21.9 percent in 2008. The narrowing was a result of the annual growth of up to 3-month assets by 6.3 percent, while liabilities declined 2.7 percent[62].

Chart 88 T-bill portfolio to borrowing from the Bank of Albania



Source: Bank of Albania

Chart 89 Maturity gap for "up to 1 and 3-month" baskets



Source: Bank of Albania

6.1.11 CAPITALIZATION OF THE BANKING SECTOR AND INDIVIDUAL BANKS ACCORDING TO THE STRESS TEST METHODOLOGY

The stress-test analysis estimates the financial system stability and the capital adequacy of the banking sector. The purpose of this analysis is to simulate situations beyond economic normality. Stress testing assesses the immediate impact of these conditions on the financial situation of the banking sector, excluding the possibility of injecting capital during the considered period. In practice, it is almost impossible, as the situation worsens gradually and banks usually have time to take the necessary actions by injecting capital. However, two scenarios are raised in this analysis, in order to measure capital adequacy of banks after the applied shocks. While the first scenario assumes a deterioration of the macroeconomic factors, the second scenario is extreme with a low probability of event.

Estimating the impact of the non-performing loan increase on the capital adequacy ratio for each individual bank and for the banking sector as a whole, along with the forecasts of other influential elements, conclude the following results reported below, regarding the capital adequacy ratio of the banking sector respectively at the two forthcoming year-ends, 2010 and 2011.

Table 24 Stress-test results of the first scenario

Undercapitalized Banks under Scenario 1				
	Year-end 2010		Year-end 2011	
	Individual banks	Banking system	Individual banks	Banking system
Regulatory Capital				
Modest Undercapitalization/1	Yes	Well-capitalized	Yes	Well-capitalized
Severe Undercapitalization/2	No		No	
Tier 1 Capital (Core Equity/Total Risk-Weighted Assets)		Well-capitalized		Well-capitalized
Modest Undercapitalization/3	No		No	
Severe Undercapitalization/4	No		No	

/1 = Below the 12% ratio;
/2 = Below the 6% ratio;
/3 = Below the 6% ratio;
/4 = Below the 3% ratio.

Under scenario 1, there are a few banks whose capital adequacy rate falls below the 12 percent threshold. Meanwhile, the banking sector is presented well-capitalized in the two forthcoming year-ends.

Table 25 Stress-test results of the second scenario

Undercapitalized Banks under Scenario 2				
	Year-end 2010		Year-end 2011	
	Individual banks	Banking system	Individual banks	Banking system
Regulatory Capital				
Modest Undercapitalization/1	Yes	Well-capitalized	Yes	Capitalized
Severe Undercapitalization/2	Yes		Yes	
Tier 1 Capital (Core Equity/Total Risk-Weighted Assets)		Well-capitalized		Capitalized
Modest Undercapitalization/3	Yes		Yes	
Severe Undercapitalization /4	Yes		Yes	

/1 = Below the 12% ratio;
/2 = Below the 6% ratio;
/3 = Below the 6% ratio;
/4 = Below the 3% ratio.

Under scenario 2, there are 3 and 4 banks whose capital adequacy rate falls below the 12 percent threshold at the year-ends 2010 and 2011.

In conclusion, the Albanian banking sector is presented stable to strong macroeconomic shocks that provide an adverse impact on the banks' portfolio and consequently on their net profit. In both scenarios, the banking sector's capital adequacy rate does not fall below the threshold, despite the banks' losses arising from the assumed shocks.

STRESS-TESTING ON CREDIT RISK

Stress-testing on credit risk measures the impact of several macroeconomic shocks on non-performing loan ratio, which can be considered as an indicator for the probable borrower's failure to pay the loan under certain conditions. Tables 26, 27, 28 and 29 provide assumptions for the hypothetical scenarios that combine an unfavourable performance of the economic growth, EUR exchange rate and Euribor interest rate. For comparative purposes, two baseline scenarios are also included (Tables 25 and 26), whose assumptions are closer to the expected developments or current situation[63]. Estimating the level of asset deterioration for each scenario allows assessing the need for additional capital in the event the capital adequacy ratio falls below the 12 percent threshold.

Table 26 Stress-test results of the first scenario

Scenario 1 (baseline)	Q3_09	Q4_09	Q1_10	Q2_10	Q3_10	Q4_10	
EUR/ALL exchange rate	134.51	137.96	139.05	138.6	137.3	137.0	Assumptions
Euribor rate						+ 40 basis points each year	Assumptions
Economic growth	2.8	2.8	3.25	3.25	3.25	3.25	Assumptions
Non-performing loan ratio	9.75%	10.48%	12.17%	12.47%	12.13%	11.54%	Assumption-based estimation
Need for additional capital	-	-	-	-	-	-	Assumption-based estimation

Table 27 Stress-test results of the second scenario

Scenario 2 (baseline)	Q3_09	Q4_09	Q1_10	Q2_10	Q3_10	Q4_10	
EUR/ALL exchange rate						Annual depreciation of 5%	Assumptions
Euribor rate						+ 100 basis points each year	Assumptions
Economic growth	2.8	2.8	3.25	3.25	3.25	3.25	Assumptions
Non-performing loan ratio	9.75%	10.48%	12.17%	13.60%	14.57%	15.47%	Assumption-based estimation
Need for additional capital	-	-	-	-	-	-	Assumption-based estimation

Table 28 Stress-test results of the third scenario

Scenario 3	Q3_09	Q4_09	Q1_10	Q2_10	Q3_10	Q4_10	
EUR/ALL exchange rate						Annual depreciation of 10%	Assumptions
Euribor rate						+ 100 basis points each year	Assumptions
Economic growth	2.8	2.8	3.25	3.25	3.25	3.25	Assumptions
Non-performing loan ratio	9.75%	10.48%	12.17%	13.52%	14.82%	16.18%	Assumption-based estimation
Need for additional capital	-	-	-	-	-	-	Assumption-based estimation

Table 29 Stress-test results of the fourth scenario

Scenario 4	Q3_09	Q4_09	Q1_10	Q2_10	Q3_10	Q4_10	
EUR/ALL exchange rate						Annual depreciation of 20%	Assumptions
Euribor rate						+ 400 basis points each year	Assumptions
Economic growth	2.8	2.8	-0.75	-0.75	-0.75	-0.75	Assumptions
Non-performing loan ratio			12.17%	15.00%	19.28%	24.63%	Assumption-based estimation
Need for additional capital (mil)	-	-	-	-	-	3,978	Assumption-based estimation

If scenario 3 occurs, as at end 2010, the non-performing loan ratio will reach 16 percent. Capital adequacy rate will remain above the threshold for the entire year, therefore no additional capital would be required (for the banking system as a whole, though additional capital would be required for individual banks).

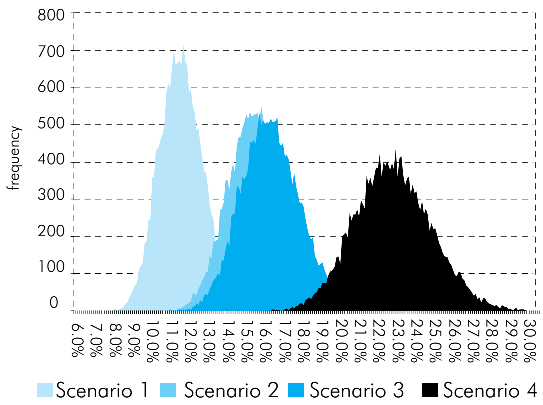
If scenario 4 occurs, as at end of 2010, the non-performing loan ratio will reach 25 percent. This is a highly extreme scenario, therefore less probable to occur. It estimates the extent of shocks that the current banking system's capitalization level can cope with. It results that as at end 2010, the system would need an additional level of capital of ALL 4 billion in order to reach the 12 percent CAR threshold.

Table 30 shows the standard deviations of the non-performing loan ratio for each scenario and the confidence interval estimates of 90 and 95 percent.

Table 30 Non-performing loan ratio as at end 2010

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Mean	11.54%	15.47%	16.18%	24.63%
Standard Deviation	0.011818	0.015123	0.01567	0.020169
A 90 percent confidence interval estimate	9.74%-13.63%	13.15%-18.13%	13.77%-18.93%	19.44%-26.08%
A 95 percent confidence interval estimate	9.41%-14.03%	12.72%-18.63%	13.32%-19.45%	18.84%-26.73%

Chart 90 Distribution of non-performing loan ratio for the four scenarios



Source: Bank of Albania

Chart 90 shows the density distribution of non-performing loan ratio for the year-end 2010, simulated using the Monte Carlo method, for these four scenarios. As the chart shows, the probability of having extreme values (far from the estimated average) of the non-performing loan ratio increases from scenario 1 to scenario 4.

In conclusion, the banking system is well-capitalized and has the capacity to cope with extreme shocks of economic factors that worsen the loan quality.

However, the stress-testing is conducted only on the credit risk and it does not consider other risks like the liquidity risk, the interest rate risk, etc. In addition, the conclusion is applicable for the banking system alone, while for individual banks a more careful loan portfolio management is required and additional capital may be needed.

BANKING SYSTEM INDICATORS

Table 31 Banking Sector

(%)	Dec-07	Dec-08	June-09	Sep-09	Dec-09
Capital-based indicators					
Regulatory capital to risk-weighted assets	17.08	17.23	16.85	16.67	16.1708917
Tier 1 capital to risk-weighted assets	16.01	16.31	16.10	15.88	15.27023
Tier 1 capital to total assets	6.57	7.83	8.74	8.83	8.66
Regulatory capital to total assets	7.01	8.28	9.15	9.27	9.17
Shareholders' equity to total assets	7.62	8.57	9.34	9.32	9.57
Net non-performing loans to capital					
Net non-performing loans to tier 1 capital	10.72	22.97	25.72	27.25	29.93
Net non-performing loans to regulatory capital	10.05	21.74	24.58	25.94	28.24
Net non-performing loans to shareholders' equity	9.14	21.08	24.07	25.80	27.07
Gross non-performing loans to total loans	3.36	6.64	8.73	9.75	10.48
Return on Equity, RoA (y-o-y)	20.74	11.35	1.78	1.79	4.58
Return on Assets, RoA (y-o-y)	1.57	0.91	0.16	0.16	0.42
Income and expenses					
Interest margin to gross income	92.67	106.50	129.11	131.51	119.55
Non-interest expenses to gross income	58.51	81.36	201.61	266.99	231.40
Liquidity					
Liquid assets to total assets	49.77	42.83	40.90	41.34	27.65
Liquid assets to short-term liabilities (up to 1-year)	73.96	64.86	56.85	63.93	32.58
Net open position in foreign currency to capital					
Net open position in foreign currency to tier 1 capital	1.80	4.54	4.60	0.63	4.12
Net open position in foreign currency to regulatory capital	1.69	4.30	4.40	0.60	3.89
Net open position in foreign currency to shareholders' equity	1.57	4.05	5.06	0.70	4.31

Source: Bank of Albania

Table 32 Bank Peer Groups

	Dec-07			Dec-08			June-09			Sep-09			Dec-09		
(%)	G1	G2	G3	G1	G2	G3	G1	G2	G3	G1	G2	G3	G1	G2	G3
Capital-based indicators															
Regulatory capital to risk-weighted assets	45.1	15.8	15.5	30.8	15.3	16.6	32.1	14.4	16.8	33.0	14.0	16.6	32.7	13.6	16.1
Tier 1 capital to risk-weighted assets	48.7	12.5	15.3	29.1	12.5	16.5	30.4	12.4	16.6	33.1	11.6	16.5	32.7	10.9	15.9
Tier 1 capital to total assets	29.5	6.2	5.8	20.3	8.1	7.0	19.4	8.8	8.1	20.6	8.5	8.2	19.1	8.0	8.2
Regulatory capital to total assets	29.5	7.9	5.8	21.5	10.0	7.1	20.5	10.2	8.2	20.6	10.2	8.3	19.1	10.0	8.3
Shareholders' equity to total assets	30.8	7.8	6.6	21.3	7.7	8.2	20.1	9.3	8.7	21.5	8.9	8.7	20.0	8.4	9.3
Net non-performing loans to capital															
Net non-performing loans to tier 1 capital	2.2	25.7	7.6	3.6	33.1	23.4	4.0	39.1	24.3	5.1	43.9	25.3	4.9	51.9	27.0
Net non-performing loans to regulatory capital	2.2	20.3	7.5	3.4	26.9	23.2	3.8	33.9	24.1	5.1	36.6	25.0	4.9	41.5	26.7
Net non-performing loans to shareholders' equity	2.1	16.2	6.6	3.5	32.1	20.3	3.8	37.2	22.6	4.9	42.0	23.8	4.7	49.3	23.8
Gross non-performing loans to total loans	3.6	4.3	2.7	3.5	7.7	6.4	3.8	10.5	8.2	4.8	11.5	9.2	4.9	13.1	9.6
Return on Equity, RoE (y-o-y)	2.5	15.3	29.0	(4.5)	(4.8)	18.5	(5.4)	(25.4)	10.4	(5.2)	(22.1)	9.7	(6.5)	####	14.1
Return on Assets, RoA (y-o-y)	0.8	1.4	1.7	(1.0)	(0.4)	1.4	(1.1)	(2.0)	0.9	(1.1)	(1.8)	0.8	(1.4)	(1.8)	1.2
Income and expenses															
Interest margin to gross income	74.9	96.8	91.6	79.0	121.0	104.5	84.8	227.2	117.6	85.0	210.7	121.5	89.9	209.6	107.6
Non-interest expenses to gross income	96.3	67.3	51.4	144.7	122.3	67.4	164.2	244.8	197.8	159.1	228.5	281.7	167.5	255.8	231.6
Liquidity															
Liquid assets to total assets	47.3	38.3	55.4	40.1	31.13	46.6	37.8	25.14	45.784	41.1	25.9	46.1	29.7	18.4	30.4
Liquid assets to short-term liabilities (up to 1-year)	79.9	55.3	83.3	63.6	49.52	69.3	59.51	39.28	61.206	74.0	44.7	68.5	38.6	23.2	34.9
Net open position in foreign currency to capital															
Net open position in foreign currency to tier 1 capital	5.3	3.9	(0.5)	2.4	12.8	2.6	3.1	9.3	3.3	2.3	0.9	0.3	(1.3)	8.0	3.8
Net open position in foreign currency to regulatory capital	5.3	3.1	(0.5)	2.3	10.4	2.6	2.9	8.0	3.3	2.3	0.8	0.3	(1.3)	6.4	3.7
Net open position in foreign currency to shareholders' equity	5.1	3.3	(0.4)	2.3	11.8	2.2	3.0	12.1	3.5	2.2	1.2	0.3	(1.3)	9.9	3.8

Source: Bank of Albania

Table 33 Bank Peer Groups by Origin of Capital

	Dec-07				Dec-08				June-09				Sept-09				Dec-09			
(%)	Italy	France	Greece	Albania	Italy	France	Greece	Albania	Italy	France	Greece	Albania	Italy	France	Greece	Albania	Italy	France	Greece	Albania
Capital-based indicators																				
Regulatory capital to risk-weighted assets	15.80	19.65	15.08	14.22	16.9	15.5	16.5	14.7	17.6	14.8	14.8	15.6	18.4	13.5	14.4	15.1	18.8	14.2	14.1	14.2
Tier 1 capital to risk-weighted assets	12.96	16.82	15.08	11.05	16.3	13.2	16.5	10.4	16.7	12.7	14.8	11.2	17.5	11.6	14.4	12.0	17.9	11.3	14.1	11.2
Tier 1 capital to total assets	5.45	8.75	9.52	4.56	7.9	8.3	10.8	7.5	8.4	8.8	11.1	7.8	8.8	8.6	11.3	8.2	8.5	8.6	11.2	7.8
Regulatory capital to total assets	6.65	10.22	9.52	6.63	8.2	9.7	10.8	10.6	8.9	10.3	11.1	10.9	9.2	10.0	11.3	10.3	9.0	10.8	11.2	9.9
Shareholders' equity to total assets	7.12	8.91	9.33	5.06	9.3	9.1	9.1	8.3	9.3	9.4	11.5	8.4	10.3	9.3	11.8	8.5	10.5	9.5	11.6	8.1
Net non-performing loans to capital																				
Net non-performing loans to tier 1 capital	13.4	15.7	7.2	18.0	12.5	47.6	10.5	16.4	25.2	57.3	21.1	25.2	20.0	59.6	22.9	22.7	25.0	70.0	22.8	42.4
Net non-performing loans to regulatory capital	11.0	13.4	7.2	12.4	12.1	40.7	10.5	11.6	24.0	49.1	21.1	18.1	19.1	51.2	22.9	18.0	23.8	55.4	22.8	33.4
Net non-performing loans to shareholders' equity	10.3	15.4	7.1	16.2	10.7	43.3	17.3	14.8	22.8	53.5	20.3	23.4	17.2	55.0	22.0	21.8	20.3	63.4	21.9	40.6
Gross non-performing loans to total loans	3.4	5.7	2.3	2.8	4.3	12.7	4.5	3.1	8.0	16.3	6.5	4.9	7.5	16.8	7.1	5.2	8.8	18.6	8.1	8.1
Return on equity, RoE (y-o-y)	20.6	0.3	18.7	32.9	11.8	(18.9)	8.2	19.1	9.5	(38.5)	(5.9)	6.9	14.4	(38.0)	(2.9)	6.8	15.7	(30.8)	(5.7)	4.5
Return on assets, RoA (y-o-y)	1.3	0.0	1.8	1.7	1.0	(1.7)	0.7	1.4	0.9	(3.4)	(0.6)	0.6	1.3	(3.4)	(0.3)	0.6	1.5	(2.8)	(0.6)	0.4
Income and expenses																				
Interest margin to gross income	77.1	122.0	101.7	83.7	83.9	206.3	116.7	88.1	89.0	8374.9	173.2	103.2	78.4	203104.3	147.9	106.4	73.3	381.8	171.7	110.8
Non-interest expenses to gross income	63.0	102.8	56.1	54.2	95.7	205.9	94.1	69.6	98.8	9156.2	796.4	85.1	79.4	215872.6	1045.4	85.7	74.8	537.3	1125.1	91.0
Liquidity																				
Liquid assets to total assets	51.5	42.5	26.7	43.9	47.6	34.0	24.9	29.9	47.3	30.3	19.1	26.4	46.5	29.2	18.0	30.3	34.0	26.7	18.6	21.7
Liquid assets to short-term liabilities (up to 1-year)	74.4	73.0	35.9	73.1	72.3	68.4	33.0	48.6	67.5	56.1	25.1	39.6	73.3	57.6	24.2	52.7	40.1	37.6	22.4	25.7
Net open position in foreign currency to capital																				
Net open position in foreign currency to tier 1 capital	(7.16)	3.32	(2.01)	11.92	(2.1)	21.1	(2.9)	1.5	1.6	31.4	(0.1)	8.5	0.6	1.1	0.4	1.2	0.6	15.6	(1.7)	6.8
Net open position in foreign currency to regulatory capital	(5.87)	2.84	(2.01)	8.20	(2.1)	18.0	(2.9)	1.1	1.5	27.0	(0.1)	6.1	0.5	0.9	0.4	0.9	0.6	12.4	(1.7)	5.3
Net open position in foreign currency to shareholders' equity	(5.48)	3.25	(1.82)	10.73	(1.8)	19.1	(2.6)	1.4	1.4	29.4	(0.3)	7.9	0.5	1.0	0.8	1.1	0.5	14.2	(3.3)	6.5

Source: Bank of Albania

ENDNOTES

[1] The financial system is composed of banks and all other non-bank financial institutions, where insurance companies are part of.
[2] Considering the lek's exchange rate against the major currencies unchanged throughout 2009.
[3] IMF, "World Economic Outlook" Update, January 2010.
[4] Bureau of Economic Analysis – Release of February 2010.
[5] News release of March 4, 2010.
[6] Interim Forecast - February 2010.
[7] IMF, "World Economic Outlook" Update, January 2010.
[8] LTRO – long-term refinancing operations.
[9] On 3 March, the Federal Reserve announced the launch of the Term Asset-Backed Securities Loan Facility (TALF), by means of which it would lend up to USD 200 billion to eligible owners of certain AAA-rated ABS. On 18 March, the Federal Reserve decided to purchase up to an additional USD 750 billion of agency mortgage-backed securities. In Europe, the Bank of England announced on 5 March the purchase of private sector's assets, while the ECB announced on 7 March a EUR 60 billion plan to buy covered bonds, which was implemented on 6 July 2009.
[10] All information is obtained from the reports released in the websites of respective banking groups. The data on the year-end 2009 is unaudited.
[11] The data on GDP and its real growth for 2001-2007 are provided by INSTAT. The data on 2008 are estimates of the Ministry of Finance, IMF and Bank of Albania data. The data on 2009 refer to INSTAT's Release of Quarterly GDP, April 2010.
[12] In absence of data on 2009, we have referred to data on the fiscal indicators in the 2011-2013 Macroeconomic and Fiscal Framework, approved by Decision of the Council of Ministers on 7 January 2010.
[13] Government debt including the Government guaranteed debt. For the conversion of the external debt stock into ALL, the exchange rate as at end of 2009 has been used.
[14] Annual budget deficit to nominal GDP of ALL 1,143,373 million (Ministry of Finance).
[15] "Other" includes the amount of Government deposit held with the Bank of Albania, social and health insurance deposit, assets held under custody and sub-loan principal.
[16] House Price Index considers only Tirana and excludes its suburban areas.
[17] A ratio above 2.0 indicates a successful auction.
[18] Bid-to-cover ratio in the bond auctions was above 1 on average.
[19] According to the Monetary Policy Report for the second half of 2009.
[20] In January 2010, the Bank of Albania re-set the fixed-amount auctions.
[21] As at year-end 2009, weighted average interest rates on new EUR and USD deposits declined relative to the year-end 2008.
[22] Current accounts have been also included in the calculation of interest rate spreads between new deposits and loans. However, current accounts are little sensitive to interest rates.
[23] Based on the analysis, measurements and estimates of Payment Systems Department at the Bank of Albania.
[24] The financial system is composed of: banks, non-bank financial institutions, insurance companies, savings and loan associations and private supplementary pension funds.
[25] According to the IMF and Ministry of Finance's estimate, the GDP amounted to ALL 1,143.37 billion.
[26] The data used to make the financial analysis of non-bank institutions refer to the third quarter of 2009, as the last period of their reporting to the Bank of Albania.
[27] According to the FSA report, December 2009. Currently, 9 non-life and 3 life insurance companies operate in the Republic of Albania.
[28] In the last quarter of 2008, this ratio was estimated at 172 percent. In the second quarter of 2009, it was estimated at 134 percent.
[29] RoA is measured as the ratio of net income for the period (the first nine-month period of 2009 for example) to average assets (average assets for two periods, 2009 and 2008). The same formula applies on RoE, but as a percentage of average equity.

[30] In the last quarter of 2008, assets of SLAs and their unions accounted for 0.7 percent of GDP.
[31] If, for comparative reasons, we remove the exchange rate fluctuations effect from the assets' value, the banking sector's assets show a 1.2 percent growth against December 2008 and September 2009. In 2009, the Albanian Lek depreciated 11 percent against the Euro and 9 percent against the USD.
[32] Including accrued interests.
[33] They include commercial banks' transactions with the Bank of Albania (deposits, required reserve, open market operations – repurchase agreements, T-bill transactions and operations among commercial banks (deposits, current accounts, loans etc.).
[34] Including accrued interests.
[35] In addition to the transactions with the Bank of Albania (reverse repurchase agreements), these also include the borrowings from foreign banks (mainly from the banking group they belong to).
[36] This item includes specific reserves, capital account (paid-in capital, retained earnings/loss, the year profit/loss, reserves, revaluation differences) etc.
[37] See "Capital Indicators".
[38] Banks are classified into groups based on their activity size, more concretely: G1 includes small banks (banks sharing below 2 percent of total banking system's assets each); G2 includes medium-sized banks (banks sharing 2 to 7 percent of total banking system's assets each) and G3 includes large banks (banks sharing more than 7 percent of total banking sector's assets each).
[39] In 2009, the banking sector's foreign currency assets grew ALL 37 billion. Foreign currency liabilities grew ALL 28.5 billion. This tendency was particularly noted in July to August 2009 and it has been a result of the deeper spreads between foreign currency assets and liabilities for some banks in the system, which show higher growth rate of foreign currency assets than foreign currency liabilities.
[40] The weighted average of the assets' distribution is calculated based on the reported maturity terms. For each interval, the mid-value is taken "a priori". Specifically, for the interval that includes the "0-7 days" remaining maturity assets, the average duration considered is 3.5 days; for the one of "7 days to 1 month", the average duration considered is 18.5 days; for the "1-3 months", the average duration considered is 2 months; for the "3-6 months", the average duration considered is 4.5 months; for the interval of "6-12 months", the average duration considered is 9 months; for the interval of "1-5 years", the average duration considered is 36 months; for the interval of "over 5 years", the average duration considered is 10 years or 120 months (since the majority of this segment is represented by mortgage loans with an initial maturity of 15 years).
[41] The weighted average of the liabilities' distribution is calculated based on the reported maturity terms. For each interval, the mid-value is taken "a priori". Specifically, for the interval that includes the "0-7 days" liabilities, the average duration considered is 3.5 days; for the one of "7 days-1 month", the average duration considered is 18.5 days; for the "1-3 months", the average duration considered is 2 months; for the "3-6 months", the average duration considered is 4.5 months; for the "6-12 months", the average duration considered is 9 months; for the interval of "1-5 years", the average duration considered is 36 months; for the interval of "over 5 years", the average duration is 6 years or 72 months.
[42] The weighted average of the deposits' distribution is calculated based on the reported maturity terms. For each interval, the mid-value is taken "a priori". Specifically, for the interval that includes the "up to 7 days" deposits, the average duration considered is 3.5 days; for the "7 days-1 month" interval, the average duration considered is 18.5 days; for the "3-6 months" interval, the average duration considered is 4.5 months; for the "6-12 months" interval, the average duration considered is 9 months; for the "1-5 years" interval, the average duration considered is 36 months; for the "over 5 years" interval, the average duration considered is 6 years or 72 months.
[43] The weighted average of the loans' distribution is calculated based on the reported maturity terms. For each interval, the mid-value is taken "a priori". Specifically, for the interval that includes the "up to 7 days" loans, the average duration considered is 3.5 months; for the "7 days-1 month" interval, the average duration considered is 18.5 days; for the "3-6 months" interval, the average duration considered is 4.5 months; for the "6-12 months" interval, the average duration considered is 9 months; for the "1-5 years" interval, the average duration considered is 36 months; for the "over 5 years" interval, the average duration considered is 10 years or 120 months.
[44] In the form of real estate or other collateral like deposits, vehicles, machinery and appliances,

etc.

[45] It includes credit lines, the unused part.

[46] The increase of "provisions" provides a negative effect on total assets due to their negative sign (provisions of the last three loan categories are reflected on the assets side and they have a negative sign).

[47] The historical average covers the period March 2006-December 2009.

[48] The amount of new loans, excluding the exchange rate effect.

[49] As the item with the highest share of outstanding business loans, the real growth for this item, excluding the exchange rate effect, is 18.3 percent versus the year-end 2008.

[50] About ALL 49.6 billion (or 17 percent) of outstanding business loans represent working capital loans, below the average for the period of 19 percent. About ALL 77 billion (or 26.5 percent) represent investments in the purchase of equipment, below the average of 29.6 percent, and about ALL 67.8 billion (or 23.3 percent) represent real estate investments moving slightly from the average of 22.5 percent.

[51] About ALL 6 billion (or 4.4 percent) of household loans represent overdraft loans, below the average for the period of 4.8 percent; about ALL 16 billion (or 11.5 percent) represent loans for the consumption of non-durable goods, growing considerably from the average of 5.5 percent. About ALL 8.2 billion (or 5.9 percent) represent loans for the consumption of durable goods, declining considerably from the average of 13.9 percent. Loans for operating activity declined their share to 8.2 percent from the average of 10 percent.

[52] The average share of outstanding loans by city to total loans covers the period December 2007 to December 2009.

[53] The distribution of loans by maturity term for the main cities shows that short-term loans in Tirana dominated the period Q4/07-Q4/09, sharing 73 percent on average. Long-term loans dominated in Durrës, sharing 7.9 percent on average. Medium-term loans dominated in Vlora, sharing 5.1 percent.

[54] More precisely, in terms of currency, this ratio in Euro is 9.8 percent versus 6.1 percent as at year-end 2008. This ratio in U.S. dollar rose to 8.5 percent versus 4.9 percent in 2008.

[55] Collateral in the form of (residential, commercial or land) real estate, cash etc.

[56] The ratio of regulatory capital to risk-weighted assets. The minimum Capital Adequacy Ratio required from the supervision regulatory framework is 12 percent.

[57] Ten banks increased their shareholders' equity in 2009.

[58] When we refer to RoE and RoA, they are on an annual basis.

[59] For a detailed analysis of DuPont Decomposition Model, refer to Irini Kalluci "Analysis of the Albanian banking system in a risk-performance framework", Bank of Albania, 2009.

[60] The concentration of deposits in the banking system has been measured using the Herfindahl index. As at year-end 2009, it was 1551 versus 1732 in December 2008. This figure shows for a still high concentration of deposits in the banking system, although downward.

[61] From December 2008 to year-end 2009, foreign currency deposits grew ALL 40 billion. Outstanding loans grew only ALL 12.5 billion.

[62] "7 days to 1 month" assets, which grew 12.2 percent in 2009, provided the largest contribution to up to 3-month asset growth. Assets of "up to 1-week" and "1 to 3-month", grew 10 percent and declined 9 percent, respectively. Liabilities of "up to 10 days", which declined 16 percent versus end December 2008, provided the main contribution to the decline of short-term liabilities. Liabilities of "10 days to 1-month" and "1 to 3-month" grew 16.2 and 4.2 percent, respectively. In December 2009, the basket of assets and liabilities of "up to 10 days" changed into "up to 1-week" and "10 days to 1-month" changed into "1-week to 1-month" (based on new reportings compliant with the Regulation "On Liquidity Risk Management").

[63] These scenarios do not make forecasts of NPLs, since their performance depends on a variety of micro and macroeconomic-related factors. They serve as a reference for evaluating the impact of the change of macroeconomic situation on loan quality.