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FINANCIAL STABILITY REPORT 2010 H2

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C O N T E N T S

B O X E S

T B L E S

C H A R T S

PREFACE

This is the fifth issue of the Bank of Albania's Financial Stability Report, which is produced half-yearly. 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 adjustments. The Report is opened with the Financial Stability Statement, whose half-yearly release is a legal requirement.

In producing 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. We have also used information and analyses of public and private, national and international financial institutions. The data and analyses mainly cover the developments over the second half of 2010. Unless otherwise stated, the expectations for the economic and financial future outlook generally extend until year-end 2011.

The financial system stability has been assessed on the basis of the performance and risks arising from its interaction with the overall internal and external economic environment, as well as 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 advanced and regional economies. We have also assessed their impact on the Albanian financial system and banking sector. As far as domestic indicators are concerned, the present Report makes an assessment of the overall developments and expectations for economic growth, balance of trade, overall price level, exchange rate and fiscal indicators. By making an analysis of employment and income, it also provides an assessment of businesses and households' financial situation and impact on the banking sector borrowers' solvency.

NOTES

As at end-December 2010:

a) Banks Peer Group 1 (banks each sharing 0-2% of total banking sectors' assets) were: United Bank of Albania, Veneto Bank (former Italian Development Bank), International Commercial Bank, First Investment Bank, Credit Bank of Albania, and Union Bank;
b) Banks Peer Group 2 (banks each sharing 2-7% of total banking sector's assets) were: ProCredit Bank, Emporiki Bank, Branch of National Bank of Greece, Credins Bank, Société Générale Albania Bank (former Banka Popullore), and Alpha Bank - Albania;
c) Banks Peer Group 3 (banks each sharing over 7% of total banking sector's assets) were: Raiffeisen Bank, National Commercial Bank, Intesa Sanpaolo Bank– Albania, and Tirana Bank.

As at end-December 2010:

a) Austrian-owned banks[1] were: Raiffeisen Bank;
b) Italian-owned banks were: Intesa Sanpaolo Bank – Albania, and Veneto Bank (former Italian Development Bank);
c) Greek-owned banks were: Alpha Bank - Albania, Tirana Bank, and Branch of National Bank of Greece;
d) French-owned banks were: Société Générale Albania Bank (former Banka Popullore), and Emporiki Bank;
e) Albanian-owned banks were: Credins Bank, and Union Bank;
f) Branches of foreign banks were: Alpha Bank - Albania, and Branch of National Bank of Greece.

Abbreviations: RB – Raiffeisen Bank, UBA – United Bank of Albania, VB – Veneto Bank (former Italian Development Bank), NCB – National Commercial Bank, TB – Tirana Bank, ICB – International Commercial Bank, ISBA – Intesa Sanpaolo Bank Albania, PCB –ProCredit Bank, EB – Emporiki Bank, NBG – Tirana Branch of National Bank of Greece, AB –Alpha Bank, Albania, FIB – First Investment Bank, CBA – Credit Bank of Albania, CB –Credins Bank, SGAB – Société Générale Albania Bank (former Banka Popullore), UB – Union Bank.

[1] *By capital origin, when foreign capital accounts for more than 50% of bank's paid-in capital.*

FINANCIAL STABILITY STATEMENT FOR 2010 H2

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

As at end-2010 H2, Albania's financial system and banking sector were assessed as being stable. The banking sector's activity has expanded further and its share to the Albanian economy has increased. Profit indicators have improved relative to the previous period. Capitalization and operating liquidity position is assessed as being good. The need to improve the loan quality remains the main challenge facing the banking sector. Stress-test exercise results show banks' resilience to assumed adverse economic and financial shocks.

The financial system and banking sector's stability is assessed on the basis of risks arising from its interaction with the surrounding economic environment, as well as from the financial system's activity.

The risks arising from internal economic developments have by and large been declining. Their performance has mainly been determined by the contained budget and trade deficit, the more stable exchange rate and the declining interest rates. Inflationary pressures were moderate and economic agents' expectations set the inflation rate around the Bank of Albania's target. Liquidity in the interbank market was sufficient to meet banks' short-term demand. The financial market has operated smoothly, although the transaction volume was generally lower. Based on the performance of investment, income and employment, businesses and households' financial situation appears stable.

Global economy grew at stable rates in 2010 H2, 4.7% in annual terms. Advanced economies grew by 2.9% versus the 7.2% growth posted by emerging and developing economies. The lower growth in advanced economies owes mainly to the fiscal consolidation and the withdrawal of stimulating policies by the public authorities. Private demand in these countries improved but the tight lending terms, the low consumer confidence indices and the unsatisfactory labour market conditions continued to affect the modest economic growth performance. Nonetheless, inflationary pressures were subdued, unlike emerging and developing economies in which economic growth was coupled with higher price pressures.

Albania's financial system expanded its activity in 2010 H2, thus increasing its share in the GDP to 85.7%. Banking sector's assets amounted to ALL 990.6 billion, accounting for 94.5% of total financial system assets. Excluding accrued interests, loans rose to ALL 486.5 billion, up ALL 21.1 billion or 4.5% versus end-June. The annual growth rate of loans is estimated at 9.1%, out of which about 7.1 pp represents the growth rate of business loans. Banking sector deposits rose to ALL 805 billion, up 9.3% versus end-June and 17.7% versus the previous year. The positive performance of the banking sector owes also to the smooth operation of payment systems infrastructure. Liquid assets accounted for 26% of total banking sector assets. At the sectoral level, banking activity is well-capitalized, although Capital Adequacy Ratio (CAR) has slightly dropped to 15.4%. The banking sector's profit was positive at ALL 6.7 billion, almost twice higher than profit in 2009. Annualized return on assets is estimated at 0.72% versus 0.42% in the same corresponding period in 2009. Annualized return on equity is estimated at 7.6% versus 4.6% the same period the previous year. The higher profit attributes to the increase in net interest income and better operating cost control. Nevertheless, the positive profit requires better allocation and it has to be higher in order to sustain the banking sector's activity better.

Concerning the assessment of risks facing the banking sector, the Bank of Albania conducts periodic stress tests in order to assess the resilience of the banking sector to possible adverse economic developments in several macroeconomic and financial indicators, on an individual or combined basis.

With regard to market risks, the stress-test results show some moderate impact of direct exchange rate risk due to the low open foreign exchange position of the banking sector. Concerning the interest rate risk, the spread between assets and liabilities sensitive to the interest rate shows low risk for maturity terms up to three months. The risk appears higher for longer maturity terms. However, the stress-test exercise shows that the impact of this risk on the banking sector's CAR is moderate. The last rise in food, energy and primary commodity prices may give rise to higher interest rate in a number of countries due to the stable and upward impact on inflationary pressures. In the case of the Albanian banking sector, for the outstanding loan portfolio at variable interest rates, the possible increase in the interest rate on loans, albeit gradually, would couple with greater burden on borrowers, thus in turn, affecting their solvency. Banks should, therefore, consider the probability of this occurrence in their risk scenarios and be willing to create reserves duly.

With respect to liquidity risk, the ratio of liquid assets to liabilities of up to 1-year maturity shows a very good liquidity situation for operations in the Albanian lek. In the meantime, operations in Euro call for constant monitoring. In addition, the banking sector's liquid assets provide sufficient coverage for the values resulting from the maturity gap between assets and liabilities. Borrowing in the interbank market or from the Bank of Albania is another way banks manage their short-term needs for liquidity. This is generally collaterized borrowing, and the type and adequacy of assets that may serve as collateral is another element that calls for monitoring in order to assess banks' capacity to meet their short-term needs for liquidity.

Direct and indirect credit risk remains the main risk facing the Albanian banking sector. As at year-end 2010, non-performing loans accounted for 14.0% of total loan portfolio. Loan quality worsened for both businesses and households. The banking sector's capacity to cover the non-performing loans, net, with capital is weaker. In response to these developments, it has increased the provisions and has improved the collateral coverage indicators of non-performing loans. Worth noting is that banks were more active in lending in Q4. In addition, loans for investment purposes have revitalized and the growth rate of non-performing loans was the lowest in the last two years. Although these developments need to be confirmed in the periods ahead, they are considered preliminary signs signalling the possible stabilization of non-performing loans.

In conclusion, stress-test exercises in the form of sensitivity and scenario analyses show that the banking sector is by and large resilient to various shocks in respect to capital adequacy and quality. However, the sensitivity of individual banks to these shocks has increased. Individual banks should, therefore, assess their resilience to similar scenarios, and take advance measures to strengthen their capital and ensure better control of their operational risks.

In view of the challenges facing the banking activity and pursuant to the legal objective to ensure a sound banking sector activity, the Bank of Albania will take all necessary operational actions and it will assess the need for further amendments and improvements in the regulatory and supervisory framework.

SUMMARY

Global economy and financial markets highlights. Global economy improved at moderate rates in 2010 H2. World output[2] expanded at an annualized rate of 4.7%. Advanced economies grew by 2.9% versus 7.2% posted by emerging and developing economies. The lower growth in advanced economies owes mainly to the fiscal consolidation and the withdrawal of stimulating policies. Private demand in these countries improved but the tight lending terms, the low consumer confidence indices and the unsatisfactory labour market conditions continued to affect the modest economic growth performance. Nonetheless, inflationary pressures were subdued, unlike emerging and developing economies in which economic growth was coupled with higher price pressures.

U.S. economy showed signs of improvement in 2010 H2, thus shifting from the slower growth rates of H1. GDP increased at an annual rate of 2.6% in Q3 and 3.1%[3] in Q4, owing mainly to consumption expenditure and investment. Trade balance surplus contributed positively to this figure due to the high growth rate of exports in Q4 versus the decline of imports. Inflationary pressures have been declining and annual inflation marked 1.3% at year-end 2010. Hence, the Fed kept the key policy rate unchanged at 0.25%. Annual unemployment rate remained almost similar to 2010 H1 (9.6%). House prices dropped further by about 1.2% at end-Q3 and by 4.3% at end-November. The continuous decline of budget revenue versus expenditure, and the stimulating fiscal policy led to considerable fiscal imbalances. Nonetheless, the new fiscal package passed in late 2010 is considered as justifiable at this juncture, given the weak labour and housing markets. These stimulating measures are expected to boost economic growth this year by 0.5% more than preliminary estimates, thus approaching the potential output.

The recovery of EU's economy, which began in 2010 Q2, continued in H2. Economic growth has been supported by the recovery of exporting industries, which was also an outcome of the improved global output and recovery of trade. Eurostat's preliminary estimates show that EU's economy grew at an annualized rate of 2.1% in 2010 Q4, up 1.9 pp from the previous year and down 0.1 pp from the previous quarter. However, economic growth rates vary across countries. Germany and Austria lead the economic growth, while Greece and Romania continue to post a declining growth. The Euro area grew at an annualized rate of 1.9% and 2% in 2010 Q3 and Q4, respectively.

[2] *According to World Economic Outlook Update, IMF.*
[3] *According to Bureau of Economic Analysis.*

Inflation in EU remains moderate; at year-end 2010, it marked 2.6%. Price pressures are lower in the Euro area, at an annualized rate of 2.2%, which is very close to the ECB's target.

Euro area's fiscal indicators continued to show the signs of improvement that began in early 2010. Budget deficit reached 5.9% of GDP in 2010 Q3, about 0.9 pp less than the same quarter the previous year. Public debt remains however high at 82.7% of GDP in 2010 Q3 from 78.3% of GDP in the same period in 2009.

The improvement of economic activity in Central and South-Eastern Europe was gradual, although the rates of improvement are uneven across countries. The changes have mainly arisen from exports, while domestic demand remains subdued. In Poland, Czech Republic and Estonia, the growth rates showed an increasing tendency. Hungary and Bulgaria recorded weaker growth rates, while Romania registered a decline by 0.6% as at end-2010. Except for Poland, domestic demand was subdued across the entire region. Private consumption continued to fall in countries like Bulgaria, Hungary and the Baltics, while unemployment scored high levels particularly in Serbia and Macedonia. Inflation rate increased again in countries adopting a fixed exchange rate regime like Bulgaria and Baltic countries. Inflation marked very high rates in Romania and Serbia. There are, however, positive signals for an improvement in the economies of Central and South-Eastern Europe in the periods ahead, albeit at a contained rate in some of them. Domestic demand is expected to provide higher contribution to real growth in 2011, although exports are expected to be significant to economic activity in the region. In light of the expected positive impact of domestic and foreign demand in the year ahead, projections for real GDP growth[4] point to 3.5% for the Baltic countries and Poland, 2.3% for the Czech Republic, Hungary and Bulgaria, and 1.5% for Romania.

As at early 2011, the performance of global financial markets appeared promising, reflecting a more positive economic climate, sufficient liquidity and a more "risk-tolerant" investor behaviour. Despite the improved current conditions in the markets, the perception for slow economic recovery increased investors' anticipation of a further easing of central banks' measures. In addition, the concerns over the increase of credit risk in sovereign debt securities re-emerged in some Euro area economies, affecting in turn the performance of the banking sector in these economies.

Interest rates in the Euro area money and government bond market increased, while volatility has remained high, mainly in the market segment of guaranteed debt securities. In the U.S., the rates of return on debt investment showed a declining tendency due to the unstable expectations for the overall global economic outlook and the U.S. in particular.

In the foreign exchange markets, the Euro re-appreciated against all the major currencies. The performance of the Euro exchange rate is, however,

[4] *According to the International Monetary Fund.*

expected to continue to be conditioned by the sustainability of public finances in some Euro area countries.

Prices rose substantially in the primary commodity markets. The outlook for the latter's performance depends on the speed and stability of global economic resurgence. Global economic growth is expected to keep demand high, which in turn is expected to contribute positively to the performance of oil and other raw material prices. On the other hand, the rise in raw material prices may be coupled with higher economic and investment-related costs, thus repressing economic growth.

The performance of the banking sector global-wide was generally positive, hence making significant steps towards financial recovery. Net income of Global Large and Complex Banking Groups (GLCBG) was by and large stable and for the first time since 2007, no bank from this group reported any losses of financial activity. Return on Equity (RoE) rose substantially to 9.1% in 2010 H1 versus 3.4% in 2009 and -5.12% in 2008. For the same stated period, Return on Assets (RoA) was 0.6%. Nonetheless, the continuous presence of investors' concerns over sovereign debt risk in some Euro area countries and the great needs of banks for refinancing in the periods ahead, give rise to high banks' financing costs.

Albanian economy highlights. Real economy indicators confirm that the growth rates of the Albanian economy improved in 2010 Q3. In each month over the stated period, annual inflation marked rates around the Bank of Albania's target, 3%. In addition, the exchange rate was stable, and the trade and current account deficit corrected considerably. Private consumption was slow due to the higher unemployment rate relative to the previous year and the moderate rise in average wage and workers' remittances. Fiscal policy was tighter, which in turn reflected in lower fiscal deficit.

Fiscal policy continued to contribute positively to aggregate demand, but at a lower level than in the previous year. Revenue increased by 8.4% relative to 2009, while expenditure declined by 4.5%. The realization of revenue and expenditure met 97.3% and 97.6%, respectively, of the annual plan. The changes in total expenditure owe to the considerable decline in capital expenditure by 29.6% versus the previous year-end. Current expenditure increased by 6%. The performance of general revenue and expenditure over the course of 2010 brought about marked changes in the annual fiscal deficit, which was estimated at ALL 38 billion, about 53% lower than in December 2009.

As at end-2010, current account deficit was estimated at EUR 1,056.3 million or 11.9% of GDP, narrowing by about 3.6 pp versus year-end 2009. For the same stated period, trade balance deficit was estimated at EUR 2,082.7 million or 23.5% of GDP, narrowing by 3 pp compared to year-end 2009. This performance attributes to the dynamics of exports and imports. At an annual level, exports of goods amounted to EUR 1,171.5 million, increasing by 56%; imports of goods amounted to EUR 3,254.2 million, increasing by

7%. However, compared to 2010 H1, exports declined by about 3.2% in 2010 H2, while imports increased by 17.3%. “Manufactured goods” and “Fuel and energy” provided the main contribution to the increase in exports.

Inflationary pressures were contained in 2010 H2, and the price rise rate fluctuated within the Bank of Albania’s target of 2-4%.

The growth of deposits has improved liquidity in the banking sector, thus providing better support to private investment. Although industry and service-related sectors report higher capacity utilization rates close to the long-term average, the expectations for higher investment in the future remain uncertain. In addition, average lending to the economy was slow in 2010 H2, despite the improvement in the last two months of 2010. Financing cost remains a component that may be used better by banks in order to stimulate the growth of lending.

As at end-2010, business borrowing increased by 14.7% compared to the same month in 2009. Household borrowing increased by only 1.5% for the same stated period. Total deposits placed with the financial system by businesses grew at an annualized rate of 25.4%, while households grew their savings in the form of deposits by 17.5%. Subsequently, businesses’ debt position, which shows the difference between their claims on the financial system (deposits) and loans received, was estimated at ALL 228 billion at year-end 2010, deepening by ALL 23 billion compared to end-2009. On the other hand, households deepened their borrowers’ position significantly to ALL 519 billion, about ALL 97 billion more than in 2009.

Financial market highlights. The Albanian financial market is dominated by operations in the interbank market, Government debt securities and foreign exchange. Other segments that relate to insurance, reinsurance and pension funds account for a small share of total financial market volume. Financial market situation improved in 2010. Interest rates in the interbank market showed a downward tendency due to the improved liquidity indicators, which were a result of the stable growth of deposits and the liquidity providing operations of the Bank of Albania.

Trading volume in the interbank market increased by 19.8% in 2010 H2 versus the previous year, while weighted average interest rate fell by 0.15 pp. In the Government debt security market, the ask amount was generally higher than the bid. In response to the easing monetary policy, improved liquidity figures and better bid-ask spreads, debt security yields in the primary market maintained the downward tendency that had commenced in November 2009. The decline was more pronounced in the 12-month debt security yields.

As far as the banking sector’s intermediation cost is concerned, we note that the average interest rate spread between loans and deposits for Lek operations narrowed by 0.78 pp. This owes to the decrease in the loan interest rates from 12.7% to 11.8%. Interest rates on Lek time deposits were more stable over the stated period, and declined from 5.18% to 5.1%. With respect to foreign currencies, the average interest rate spread between loans and deposits narrowed by 0.28 pp for U.S. dollar operations and by 0.8 pp for Euro operations, mainly due to the Euro interest rate cut.

The narrowing in the trade and budget deficit in the domestic market dampened the Lek's depreciation pressures. In 2010 H2, the Euro appreciated by 1.7% against the Lek, while the U.S. dollar and the British Pound depreciated by 6.7% and 3.5%, respectively, against the Lek. The appreciation of the latter against these two currencies has generally reflected the developments in the international foreign exchange markets.

The smooth functioning of the AIPS and AECH payments systems, which are managed by the Bank of Albania, has supported the financial market activity. The number of transactions in the AIPS (Real-Time Gross Settlement System) and the AECH (Automated Clearing House System) increased in 2010 H2 by about 1.4 and 3.3 times, respectively. During January –December 2010 were processed a total of about 10.5 million card transactions (ATM and POS), which amounted to ALL 108 billion. Out of the total, about 95% represent cash withdrawals from ATMs and only 5% customer payments executed via POSs, thus providing evidence for the large use of cash in the Albanian economy.

Financial system highlights. Financial intermediation in Albania, measured as the ratio of financial sector[5] assets to GDP[6] is estimated at 85.7% at year-end 2010 compared to 84.4% in 2010 H1 and 82% at year-end 2009. Financial institutions' assets grew by about 5.8% versus 2010 H1. The banking sector remains the dominant segment of financial intermediation in Albania. As at end-2010 H2, banking sector assets accounted for 94.5% of total financial system assets and 81% of GDP. Non-bank financial sector continues to have a small share in total financial system. Non-bank financial sector's total assets[7] accounted for 5.45% of total financial system assets, compared to 5.6% in 2010 H1. As a share of GDP, this sector's activity accounts for about 4.8%, almost similar to H1 and 0.45 pp higher than at year-end 2009.

Banking sector highlights. At year-end 2010, banking sector assets totalled ALL 990.6 billion, up about 6% from 2010 H1 and 11.8% from end-2009. The four largest banks shared 64.8% of total sector assets.

In terms of banking sector assets' composition, the loan portfolio (excluding accrued interests[8]) rose to ALL 486.5 billion, up 9.1% from 2009. Foreign currency-denominated loans account for about 69.8% of total loans. Banking sector assets denominated in foreign currency amounted to ALL 525.6 billion,

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5 *The financial system is composed of banks, non-bank financial institutions, insurance companies, savings and loan associations and private supplementary pension funds.*

6 *IMF's forecast for quarterly nominal GDP based on the quarterly real GDP released by INSTAT. In 2010, GDP totalled about ALL 1,224 billion.*

7 *The data on insurance companies and SLAs refers to 2010 Q3, while the data on non-bank financial institutions and supplementary pension funds refer to end-2010 (according to AFSA's release).*

8 *Estimated at about ALL 4.4 billion.*

up 18.1% versus end-2009. Banking sector investments in non-resident entities' assets increased to ALL 122 billion, up 46.1% versus the previous year. Banks' placements with non-resident banking groups are estimated at ALL 70.6 billion, out of which ALL 63.2 billion are in the form of current account deposits, and ALL 7.4 billion in the form of loans.

In terms of banking sector liabilities' composition, deposits (excluding accrued interests[9]) amounted to ALL 805 billion, up 17.7% versus year-end 2009. Shareholders' equity totalled ALL 104.8 billion, up 9.1% from year-end 2009. Liabilities denominated in foreign currency amounted to ALL 505.2 billion, up 16.6% from the previous year. Banking sector liabilities to non-residents were estimated at ALL 48.4 billion, down 17.9% versus 2009. Credit lines extended from bank holding companies and the used part are estimated at about ALL 18.9 billion. The committed and unused[10] credit lines are estimated at ALL 36 billion. As at year-end 2010, off-balance sheet items accounted for 88.7% of total banking sector assets, down 3.5% versus June and up 5.3% versus year-end 2009.

Paid-in capital amounted to ALL 70.7 billion, up 16.2% relative to the previous year. It accounted for 7.1% of total assets compared to 6.9% at year-end 2009. With respect to the banking sector's liquidity position, we note that as at December 2010, banking sector deposits accounted for 82.4% of total liabilities, about 4.1 pp higher than in the same period in 2009. Banking sector liquid assets amounted to ALL 257 billion, accounting for 25.9% of total assets. This indicator has declined by about 0.7 pp relative to December 2009.

As at year-end 2010, the banking sector's net profit was positive at ALL 6.7 billion, almost twice higher than in 2009. However, the banking sector's profit remains concentrated in the largest banks. Annualized Return on Assets (RoA) is estimated at 0.72% versus 0.42% the same period the previous year. Annualized Return on Equity is estimated at 7.6% versus 4.6% the same period in 2009.

Risk assessment. Concerning the assessment of risks facing the banking sector, the Bank of Albania conducts periodic stress tests in order to assess the resilience of the banking sector to possible adverse economic developments in several macroeconomic and financial indicators, on an individual or combined basis. With regard to market risks, the stress-test results show some moderate impact of direct exchange rate risk due to the low open foreign exchange position of the banking sector. Concerning the interest rate risk, the spread between assets and liabilities sensitive to the interest rate shows low risk for maturity terms up to three months. The risk appears higher for longer maturity terms. However, the stress-test exercise shows that the impact of this risk on the banking sector's CAR is moderate. The last rise in food, energy and primary commodity prices may give rise to higher interest rate in a number of countries due to the stable and upward impact on inflationary pressures.

[9] *Estimated at ALL 11.7 billion.*
[10] *Off-balance.*

In the case of the Albanian banking sector, for the outstanding loan portfolio at variable interest rates, the possible increase in the interest rate on loans, albeit gradually, would couple with greater burden on borrowers, thus in turn affecting their solvency. Banks should, therefore, consider the probability of this occurrence in their risk scenarios and be willing to create reserves duly.

With respect to liquidity risk, the ratio of liquid assets to short-term liabilities (of up to 1-year maturity) was 30.6% at year-end 2010 versus 32.6% in 2009. The regulatory framework sets a minimum threshold of 20%. By currency, this ratio is lower for the Euro, 15.6%, and higher for the Lek, 42.9%. The spreads between assets and liabilities by maturity[11], for both balance and off-balance sheet items, result negative. However, these spreads are covered several times by the value of liquid assets, thus providing evidence for the full capacity for paying off the liabilities when they come due. Liquidity in foreign currency, particularly that denominated in Euro, requires prudent monitoring. Loan to deposit ratio was 60.4%, 4.8 pp lower than in 2009. The decline in this ratio attributes to the slower credit growth rate than deposit growth rate, particularly for that denominated in foreign currency. Loan to deposit ratio for operations in foreign currency was 86%, down 13.4 pp from the previous year. Loan to deposit ratio in Lek was estimated at 35.4%, remaining generally stable throughout the year. This ratio is, however, expected to increase again once bank lending recovers. Borrowing in the interbank market or from the Bank of Albania is another way banks manage their short-term needs for liquidity. This is generally collaterized borrowing, and the type and adequacy of assets that may serve as collateral is another element that calls for monitoring in order to assess banks' capacity to meet their short-term needs for liquidity.

Credit risk remains the main risk facing the Albanian banking sector. As at year-end 2010, non-performing loans amounted to ALL 68.5 billion, increasing by ALL 21.4 billion from year-end 2009. Non-performing loans, however, increased by ALL 3.4 billion in 2010 Q4, the lowest growth in the last two years. Relative to November 2010, non-performing loans declined by ALL 1.1 billion in December 2010. Hence, for the first time in the last two years, monthly non-performing loans ratio declined from 14.4% in November to 14.0% in December 2010. This performance may signal the stabilization of non-performing loans figure; however, it has to be repeated in several other periods ahead in order to be confirmed as a stable performance. The ratio of non-performing loans, net, to regulatory capital rose to 35.9% versus 28.2% in 2009. Loan portfolio quality worsened for both businesses and households. The ratio of non-performing loans to business and household outstanding loans was 15.5% and 11.7%, respectively. In terms of currency, the loan portfolio quality worsened for both Lek and foreign currency denomination. The ratios of "Non-performing loans in Lek to outstanding loans in Lek" and "Non-performing loans in foreign currency to outstanding loans in foreign currency" were 14.4% and 13.7%, respectively. In response to the credit risk situation, the banking sector has created its own reserve fund in order to cover possible losses. As at end-2010, reserve funds to cover credit risk (provisioning) from lending to residents, increased to ALL 36.1 billion, about 33% higher

[11] *Assuming assets and liabilities are left to maturity.*

than at year-end 2009. The ratio of provisioning to non-performing loans reached the historic peak of 52.7%. Provisioning to total outstanding loans increased to 7.4% versus 5.4% in 2009. Coverage of non-performing loans with collateral is estimated at 79.3% of the loan portfolio, relative to 78% in 2010 H1.

As at year-end 2010, the Albanian banking sector was assessed as being well-capitalized. The CAR was 15.4%, about 0.8 pp lower than in June and the previous year. The regulatory framework sets a minimum threshold of the CAR of 12%. Despite the quite satisfactory banking sector capitalization, capital requirements, on an individual basis, need to be assessed prudently and met duly by banks.

Stress-test exercises in the form of sensitivity and scenario analyses show that the banking sector is by and large resilient to various shocks in respect to capital adequacy and quality. However, the sensitivity of individual banks to these shocks has increased. Individual banks should, therefore, assess their resilience to similar scenarios, and take advance measures to strengthen their capital and ensure better control of their operational risks.

1. GLOBAL DEVELOPMENTS

1.1 OVERALL GLOBAL ECONOMIC DEVELOPMENTS

Global economy improved at moderate rates in 2010 H2. Global output[12] expanded at an annualized rate of 4.7%. Advanced economies grew by 2.9% versus 7.2% posted by emerging and developing economies. The lower growth in advanced economies owes mainly to the fiscal consolidation and the withdrawal of stimulating policies. Private demand in these countries improved but the tight lending terms, the low consumer confidence indices and the unsatisfactory labour market conditions continued to affect the modest economic growth performance. Nonetheless, inflationary pressures were subdued, unlike emerging and developing economies in which economic growth was coupled with higher price pressures. Global output is projected to expand by 4.5% in 2011, an upward revision of about 0.25 pp relative to preliminary projections.

U.S. Economy. U.S. economy showed signs of improvement in 2010 H2, thus shifting from the slower growth rates of H1. GDP increased at an annual rate of 2.6% in Q3 and 3.1%[13] in Q4. The growth is mainly a contribution of consumption expenditure, private investment and exports. Trade balance contributed positively to this figure due to the high growth rate of exports in Q4 versus the decline of imports. At year-end 2010, annual inflation marked 1.3%.

Annual unemployment rate remained almost similar to 2010 H1, 9.6% at end-Q4. Improvements in the labour market are expected to be gradual. House prices dropped further by about 1.2% at end-Q3 and by 4.3% at end-November[14]. Housing market still remains weak and the difficulties in its recovery mainly attribute to the low demand and excess supply.

Household income still remain low, and the Consumer Confidence Index, albeit higher than at year-end 2009, declined compared to 2010 H1. The Fed kept the key policy rate unchanged at 0.25% throughout the stated period.

Table 1 Key indicators of U.S. economy during 2009-2010

	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4
Real GDP growth (y-o-y %)	1.6	5.0	3.7	1.7	2.6	3.1
Inflation rate (y-o-y %)	-1.6	1.4	2.4	1.8	1.2	1.3*
Unemployment rate (y-o-y %)	9.6	10	9.7	9.6	9.6	9.6
Budget deficit (% of GDP)	-11.6	-11.1	-10.7	-11.1	-10.4	-
Government debt, gross (% of GDP)	65.8	68.6	71.7	73.3	75.3	-

** According to ECB – Monthly Bulletin March 2011.*
Source: BEA, ECB - Monthly Bulletin January 2011

12 According to World Economic Outlook Update, IMF.
13 According to Bureau of Economic Analysis.
14 According to Bank for International Settlements.

The continuous decline of budget revenue versus expenditure, and the stimulating fiscal policy led to considerable fiscal imbalances. Nonetheless, the new fiscal package passed in late 2010 is considered as justifiable at this juncture, given the weak labour and housing markets. These stimulating measures are expected to boost economic growth this year by 0.5% more than preliminary estimates, thus approaching the potential output.

This change in real growth is, however, considered insufficient relative to the cost and size of fiscal stimulus, taking also into account the difficulties in achieving medium-term fiscal sustainability. U.S. debt to GDP ratio remains high. Government bond yields showed a declining tendency, owing to investors' expectations that Fed's further easing of policies, particularly in terms of the debt instrument purchase programme, will continue.

U.S. economy is the only major advanced economy implementing procyclical fiscal policies this year, albeit in the face of a still-sizable output gap. Hence, the lowering of budget deficit for 2011 is expected to be slower than preliminary forecast. Delays in medium-term fiscal consolidation may lead to higher security yields, thus impacting adversely the global financial markets and economy. Based on the overall performance of macroeconomic and fiscal indicators in the U.S. and preliminary assessments, the economy is expected to expand moderately in the medium run.

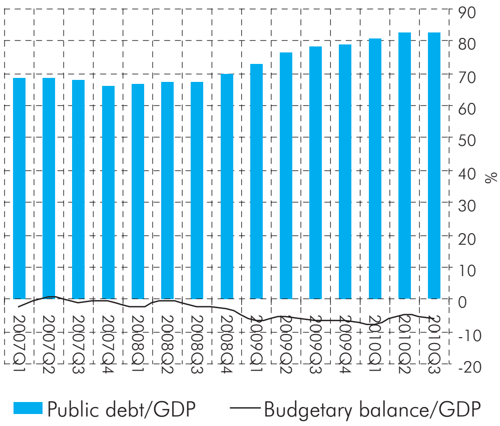
EU's economy. The recovery of EU's economy, which began in 2010 Q2, continued in H2. Economic growth has been supported by the recovery of exporting industries, which was also an outcome of the improved global output and recovery of trade. Eurostat's preliminary estimates show that EU's economy grew at an annualized rate of 2.1% in 2010 Q4, up 1.9 pp from the previous year and down 0.1 pp from the previous quarter. However, economic growth rates vary across countries. Germany and Austria lead the economic growth, while Greece and Romania continue to post a declining growth. The Euro area grew at an annualized rate of 1.9% and 2% in 2010 Q3 and Q4, respectively. The economic growth was also coupled with higher capacity utilization to 79% at year-end 2010.

Table 2 Key macroeconomic indicators in EU and Euro area

	GDP growth (annual rate, in %)				Inflation (annual rate, in %)				Unemployment (%)			
	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4
EU	0.6	2	2.2	2.1	1.9	1.9	2.2	2.6	9.7	9.7	9.7	9.7
Euro area	0.8	2	1.9	2	1.4	1.4	1.8	2.2	9.9	10.0	10.0	10.0
Germany	2.1	3.9	3.9	4	1.2	0.8	1.3	1.9	7.1	6.8	6.6	6.6
France	1.2	1.6	1.7	1.5	1.7	1.7	1.8	2.0	9.8	9.7	9.7	9.7
Italy	0.5	1.3	1.2	1.3	1.4	1.5	1.6	2.1	8.5	8.4	8.5	8.6
Greece	-0.7	-5.1	-5.7	-6.6	3.9	5.2	5.7	5.2	11.0	12.2	12.9	..
Non-Euro area												
United Kingdom	-0.3	1.6	2.5	1.5	3.4	3.2	3.1	3.4	7.8	7.8	7.8	..

Source: ECB - Monthly Bulletin January 2011 and Eurostat's release of March 3, 2011

Chart 1 Euro area's fiscal position (quarterly figures)



Source: ECB

Inflation in EU remains moderate; at year-end 2010, it marked 2.6%. Price pressures are lower in the Euro area, at an annualized rate of 2.2%, which is very close to the ECB's target. Euro area's unemployment rate is 10%. The low economic growth rates in France and Italy, and the economic downturn in Greece, drove unemployment rates to high levels.

Euro area's fiscal indicators showed signs of improvement throughout 2010. Budget deficit reached 5.9% of GDP in 2010 Q3, about 0.9 pp less than the same quarter the previous year. Public debt remains, however, high at 82.7% of GDP in 2010 Q3 from 78.3% of GDP in the same period in 2009.

The expectations for the recovery of EU's economy remain uneven across countries. Despite the high exports in Germany, the growth rate is expected to be moderate due to the expectations for weak growth rates in its trading partners. In France, economic growth is expected to be more modest, while private consumption has contracted due to the high unemployment and Government's withdrawal of stimulating measures. Italy's economic growth is projected to be even more contracted due to the lower exports and the planned fiscal consolidation, which undermines private demand. In addition, fiscal restraints and competitive imbalances give rise to a much lower growth rate in Spain, Portugal, Ireland and Greece. Projections for economic growth in non-Euro area countries are diverse. In Great Britain, the measures taken to rein in budget deficit are expected to curb domestic demand.

Table 3 Key macroeconomic indicators in Europe

	Real GDP (in %)		Inflation (in %)		Unemployment (in %)	
	2010	2011	2010	2011	2010	2011
Europe	2.0	1.8	2.3	2.0	..	..
Euro area	1.7	1.5	1.6	1.5	10.1	10.0
Germany	3.3	2.0	1.3	1.4	7.1	7.1
France	1.6	1.6	1.6	1.6	9.8	9.8
Italy	1.0	1.0	1.6	1.7	8.7	8.6
Spain	-0.3	0.7	1.5	1.1	19.9	19.3
Portugal	1.1	0.0	0.9	1.2	10.7	10.9
Netherlands	1.8	1.7	1.3	1.1	4.2	4.4
Belgium	1.6	1.7	2.0	1.9	8.7	8.5
Great Britain	1.7	2.0	3.1	2.5	7.9	7.4
Ireland	-0.3	2.3	-1.6	-0.5	13.5	13.0

Source: IMF, World Economic Outlook, October 2010

Monetary policy is expected to remain underlying support for the majority of European countries. Interest rates in the Euro area are very low, which will in turn offset the short-term effects of fiscal consolidation in domestic demand. Inflation remains low and expectations thereof are considered well-anchored.

There are, however, risks related to the performance of energy and primary commodity prices, which may give rise to higher inflationary pressures.

Central and South-Eastern Europe. The improvement of economic activity in Central and South-Eastern European countries was gradual, mainly due to exports. In the meantime, domestic demand remained subdued. The growth rates were uneven across countries in this region. In Poland, Czech Republic and Estonia, the growth rates showed an increasing tendency. Hungary and Bulgaria recorded weaker growth rates, while Romania registered a decline by 0.6% as at end-2010. Except for Poland, domestic demand was subdued across the entire region. Private consumption continued to fall in countries like Bulgaria, Hungary and the Baltics, while unemployment scored high levels particularly in Serbia and Macedonia. The inflation rate increased again in countries adopting a fixed exchange rate regime like Bulgaria and the Baltics. Inflation marked very high rates in Romania and Serbia.

Table 4 Key macroeconomic indicators in Central and South-Eastern Europe

	Real GDP growth (annual rate, in %)			Inflation (annual rate, in %)			Monthly unemployment (in %)		
	2010 Q2/ 2009 Q2	2010 Q3/ 2009 Q3	2010 Q4/ 2009 Q4	Oct. 2010/ Oct. 2009	Nov. 2010/ Nov. 2009	Dec. 2010/ Dec. 2009	Oct. 2010	Nov. 2010	Dec. 2010
Hungary	0.8	2.2	2.4	4.3	4.0	4.6	11.2	11.4	11.7
Czech Rep.	2.3	2.8	2.9	1.8	1.9	2.3	7.2	7.3	7.7
Poland	3.7	4.6	3.9	2.6	2.6	2.9	9.7	9.7	9.7
The Balkans									
Bulgaria	-0.3	0.5	2.1	3.6	4.0	4.4	10.0	10.1	10.1
Romania	-0.5	-2.1	-0.6	7.9	7.7	7.9	..	..	..
Serbia	2.0	2.7	1.8	8.9	9.6	10.3	19.2	..	..
FYROM	1.1	1.3	..	2.0*	..	3.0	31.7*	..	..
The Baltics									
Estonia	3.1	5.0	6.6	4.5	5.0	5.4	14.3	14.3	14.3
Latvia	-2.6	2.5	3.7	0.9	1.7	2.4	..	..	..
Lithuania	1.2	1.2	4.6	2.6	2.5	3.6	17.4	17.4	17.4

** Data for 2010 Q3.*
Source: Eurostat database, Eurostat News release, respective central banks

There are, however, positive signals for an improvement in the economies of Central and South-Eastern Europe in the periods ahead, albeit at a contained rate in some of them. Domestic demand is expected to provide higher contribution to real growth in 2011, although exports are expected to be significant to economic activity in the region. In light of the expected positive impact of domestic and foreign demand in the year ahead, projections for real GDP growth[15] point to 3.5% for the Baltic countries and Poland, 2.3% for the Czech Republic, Hungary and Bulgaria, and 1.5% for Romania. In the meantime, even though the unemployment rate in the countries of this region has declined gradually over the course of 2010, the high unemployment rates are expected to affect private consumption for a considerable period of time.

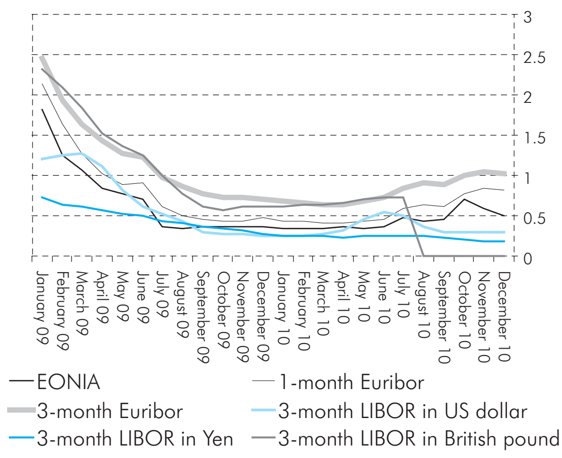
[15] *According to the International Monetary Fund.*

1.2 MAIN HIGHLIGHTS IN GLOBAL FINANCIAL MARKETS

Global financial market performance was more favourable in 2010 H2, reflecting the more positive economic climate, ample liquidity, and a more "risk-tolerant" investor behaviour. This performance was, however, affected by two factors: first, the perception for a slow economic recovery increased investors' anticipation of a further easing of central banks' measures; and second, the concerns over the increase of credit risk in sovereign debt securities re-emerged in some Euro area economies (Ireland and Portugal), affecting in turn the performance of the banking sector in these economies[16].

The deepening of concerns in some Euro area countries related to the sustainability of public finances contributed to higher instability in the international financial markets. Government bond spreads in some cases reached highs that were significantly above the levels seen during the turmoil last May[17]. Pressures on Ireland were particularly severe and led to an EU-ECB-IMF programme. Correlations between the average sovereign yields of Greece and Ireland and the yields of Portugal have remained high, but they have increased sharply in recent months with the yields of Spain, and to a lesser extent, Italy, as the tensions spread[18]. Euro area financial markets have materialized the heightened uncertainty reigning over these months and manifested an upward tendency of the risk premium.

Chart 2 Key money market rates



Source: ECB, Monthly Bulletin – December 2010

During the last three months[19], movements in long-term U.S. Government bond yields have been influenced by mixed, but overall positive, macroeconomic news. At the same time, changing perceptions among investors regarding the timing, extent, and nature of further easing measures probably contributed to increasing volatility in the U.S. Government bond market. In fact, in November, the Fed announced its liquidity injection programme by purchasing USD 600 billion of Treasury securities by June 2011.

Money market rates[20] increased in 2010 H2, while volatility remained high. Interest rates on unsecured deposits have increased across all maturities over the past three months. On 1 December 2010, the one-month, three-month, six-month and twelve-month EURIBOR stood at 0.81%, 1.02%, 1.25% and 1.53%, respectively, compared to 0.45%, 0.73%, 1.01% and 1.28%

16 *BIS Quarterly Review, December 2010 "International Banking and Financial Market Developments".*

17 *10-year Government bond yields for Ireland, Portugal and Spain rose 0.305, 0.130 and 0.125 pp. The general increase for Italy and Greece was lower, 0.70 pp and 0.50 pp (ECB – Monthly Bulletin, December 2010).*

18 *Global Financial Stability Report, IMF, January 2011.*

19 *ECB – Monthly Bulletin, December 2010.*

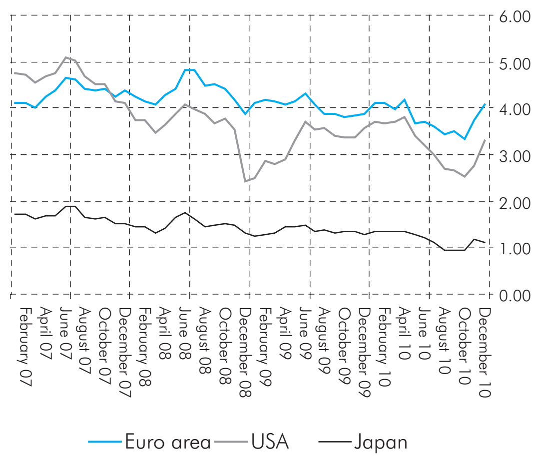
20 *ECB – Monthly Bulletin, December 2010.*

as at 2010 H1. Overnight maturity became more volatile. Since October 2010, they peaked at 0.70%, and later declined abruptly to 0.50% in December 2010 (see Chart 2).

The ECB has, since 13 May 2009, decided to keep the interest rate on the main refinancing operations unchanged at 1%, the interest rate on the marginal lending facility at 1.75% and that on the deposit facility at 0.25%.

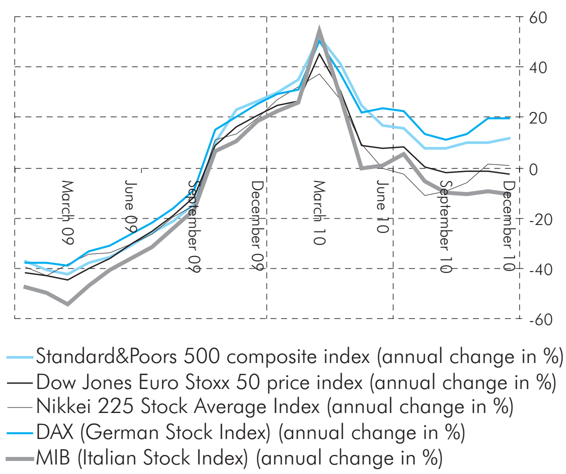
In the Euro area, long-term real yields rose significantly, reflecting the positive underlying momentum of the economic recovery. In December, 10-year Government bond yields increased to 4.1%, up about 0.38 pp from June. At the same time, heightened tensions in sovereign debt markets contributed to the rise in the spreads of some Euro area sovereign issuers to new highs. Spreads on bonds issued by both non-financial and financial corporations did not change much, when viewed over the review period. U.S. Government bond yields showed a dissimilar performance: they fell in June-October from 3.2% to 2.5%, to later rise again in December to 3.3%. This performance has been affected by the overall economic developments and the considerations that Fed's further easing of policies will continue. Japanese Government bond yields showed a similar tendency; in November 2010, they stood at 1.2%.

Chart 3 10-year Government bond yields



Source: ECB's database

Chart 4 Main stock price indices



Source: ECB's database, Reuters

As at end-2010, broad-based stock price indices in the equity markets[21] of the Euro area[22] and the U.S. [23] increased compared to 2010 H1. In the Euro area, this development was supported by robust actual and expected corporate earnings growth and overall positive macroeconomic news. At the same time, equity prices have probably been negatively affected by renewed tensions in sovereign debt markets. The extent of these two adverse effects has differed fairly widely across Euro area countries and sectors, with the banking sector being the most affected. Tokyo stock exchange in Japan[24] showed a similar performance (see Chart 4).

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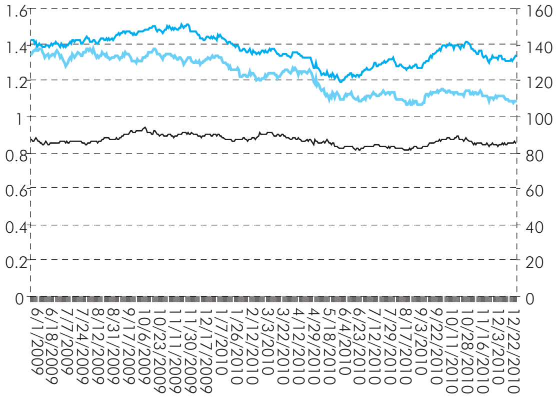
[21] *ECB, Monthly Bulletin, December 2010.*

[22] *EURO STOXX 50 index stood at 2,827.07 in December 2010; in June, it stood at 2,641.7 (ECB's database, Reuters).*

[23] *Standard & Poor's 500 index stood at 1,241.5 in December 2010; in June, it stood at 1,083.4 (ECB's database, Reuters).*

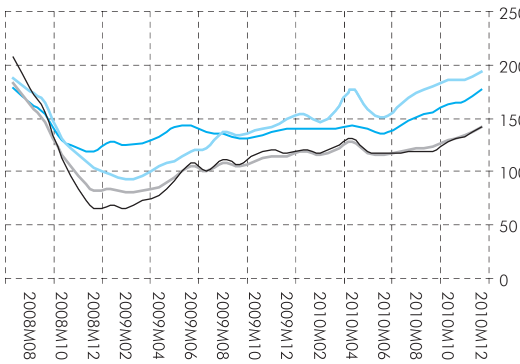
[24] *Japanese Nikkei 225 index stood at 10,254.4 in December 2010; in June, it stood at 9,786.1 (ECB's database, Reuters).*

Chart 5 Euro exchange rate against the major currencies



Source: Eurostat, Reuters

Chart 6 Primary commodity price indices



Source: IMF's database

In the foreign exchange markets, the strong depreciation of the Euro in 2010 H1 reversed in H2 when it appreciated against all major currencies. In more concrete terms, from mid-June 2010 to early November 2010, the exchange rate of the Euro showed significant appreciation against the U.S. dollar, the British Pound and the Japanese Yen. In October, it marked the peak appreciation (see Chart 5)[25]. Compared to end-June 2010, at the end of December 2010, the Euro appreciated by about 8.3% against the U.S. dollar, 2.4% against the British Pound, while it depreciated slightly by 0.8% against the Japanese Yen. The stability of the Euro exchange rate is expected to be mainly affected by the outlook for public finances in the Euro area countries.

Primary commodity prices rose sharply in the primary commodity markets as evidenced by the representative indices (see Chart 6). The increasing food price index[26] was mainly driven by the change in the demand and supply ratio, due to the adverse weather conditions. Metal[27] and oil[28] price index has generally reflected the growth of demand in the global markets. The performance of individual commodity price indices contributed to the increase of the aggregate index.

The outlook for the performance of primary commodity markets will depend on the speed and stability of global economic rebound. On the other hand, the rise in primary commodity prices may be coupled with higher economic and investment-related costs, thus repressing economic growth.

Gold and silver prices rose by 29.5% and 83.4% in 2010. In H2, they rose by 14.3% and 66.4%, respectively. On 31 December 2010, gold traded at USD 1,419.45 an ounce[29] versus USD 1,241.35 on 30 June 2010. When the situation in the money market seems unstable, investors tend to invest more in gold and silver, which perform on the opposite side of the market.

25 1 EUR traded at USD 1.39, GBP 0.88, and JPY 113.68.

26 Food price index reached the peak of the last two years in December 2010, when it stood at 176.9.

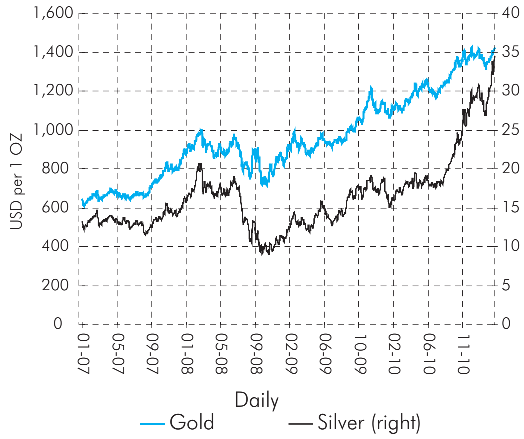
27 Over the course of 2010 H2, metal price index showed the highest monthly increase in July and August, when it increased by 7.6% and 7.1% to 162.6 and 174.2, from 151.2 in June 2010. In December 2010, this index pointed to 193.7.

28 In December 2010, oil price index increased to 169.2 from 140.1 in June 2010 and 140.3 the same period in 2009. In December 2010, the price of oil went up to USD 92.06 per barrel (Brent) from USD 74.95 in June (Source: International Energy Agency –IEA).

29 One ounce is equal to about 28.35 grams.

The performance of the banking sector global-wide is assessed by monitoring the performance of Global Large and Complex Banking Groups (GLCBGs[30]), and based on the data available[31]. They performed well and, for the first time since 2007, no bank in this group reported a loss. Several banks' income declined slightly, due to poorer trading revenues, whereas others saw improvement in their net incomes as a result of decreasing loan loss provisioning. Return on Equity rose markedly to 9.1% in 2010 H1, compared to 3.4% in 2009 and -5.12% in 2008. Over the same stated period, Return on Assets was estimated at 0.6%. The leverage ratio, measured by shareholders' equity as a percentage of total assets, was stable. CAR was above the regulatory requirement. In the Euro area[32], the earnings of Large and Complex Banking Groups (LCBGs[33]) continued recovering in the first three quarters of 2010, mainly driven by further buoyant net interest income, lower loan loss provisions and a steady stream of fee and commission income.

Chart 7 Gold and silver trading
(in USD per 28.35 grams)



Source: Reuters

Nonetheless, part of the improvement in profitability indicators could be temporary. The public support measures introduced in several countries have been removed or are expiring; trading profits, linked to the favourable financial market conditions of recent months, could diminish. The fiscal sustainability of some countries remains a constant concern for investors, and it will affect the risk premium. Over the next two years, banks will need to refinance a very large volume of bonds, at a time when sovereign borrowers and firms are greatly increasing their recourse to the market[34].

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30 *The institutions included in the analysis of GLCBGs are Bank of America, Bank of New York Mellon, Barclays, Citigroup, Credit Suisse, Goldman Sachs, HSBC, JPMorgan Chase & Co., Lloyds Banking Group, Morgan Stanley, Royal Bank of Scotland, State Street and UBS.*

31 *The database showing the performance of the banking sector global-wide covers 2010 H1. Financial Stability Review, December 2010, ECB, ECB's database and Monthly Bulletin – December 2010.*

32 *Financial Stability Review, December 2010, ECB.*

33 *Financial Stability Review, December 2010, ECB, in the analysis of this group includes 20 Euro area banks. The criteria for identifying them are described in ECB "Identifying large and complex banking groups for financial system stability assessment", Financial Stability Review, December 2006.*

34 *Financial Stability Report, No. 1, December 2010, Banca d'Italia.*

BOX 1 FINANCIAL DATA ON FOREIGN BANKING GROUPS OPERATING IN ALBANIA

1. RAIFFEISEN INTERNATIONAL (AUSTRIA)[1]

As at end-2010 Q3, Raiffeisen International's total assets fell by about 1%, or EUR 0.5 billion compared to the end of 2009, to EUR 75.8 billion. Deposits from customers rose by 1.7% compared to end-2009, to EUR 43.29 billion, whilst loans and advances to customers were reported at EUR 51.8 billion as at end-2010 Q3. Consolidated profit, net, reported for the nine-month period, increased to EUR 318 million, or 104.5% higher than the same period in 2009. The operating result fell by 16%, or EUR 249 million compared to the same period in 2009, to EUR 1.35 billion. The main reasons were lower net interest income, higher general administrative expenses, and negative other operating income. Return on Equity (before tax) increased by 3.7 pp to 9.8%; while Return on Equity (after tax) improved by only 3.1 pp to 6.9%.

As at end-2010 Q3, Raiffeisen Bank Albania accounted for about 2.59% of total assets of Raiffeisen International.

2. INTESA SANPAOLO (ITALY)[2]

As at end-2010 Q3, Intesa Sanpaolo's total assets increased by 3.8% compared to the end of 2009 to EUR 677.4 billion. Loans to customers amounted to EUR 378.8 billion, up 0.9% compared to end-2009, whilst customer deposits amounted to EUR 408.5 billion, up 2.9% compared to end-2009. At the end of the nine-month period, net income was reported at EUR 2.2 billion compared to EUR 2.26 billion at the same period in 2009 (-2.7%). Operating margin was EUR 5.5 billion, down 13.1% on the corresponding period of the previous year. Net adjustments to loans declined by 14.2% to EUR 2.26 billion. As at end-2010 Q3, RoE was 5.1% (compared to 5.7% at 2009 Q3). CAR was estimated at 12.5% compared to 11.8% at end-2009.

As at end-2010 Q3, Intesa Sanpaolo Bank Albania accounted for 0.13% of total assets of Intesa Sanpaolo Group.

3. ALPHA BANK (GREECE)[3]

As at year-end 2010, Alpha Bank's total assets were reported EUR 63.8 billion, down 6% from end-2009. Deposits held with this bank declined by EUR 4.4 billion or 11.4% compared to end-2009. Loans totalled EUR 39.92 billion, down 4.5% from end-2009. As at end-2010, net income was reported negative at EUR 56.3 million, compared to the positive income of EUR 372 million in 2009. The rationale behind this figure is the decline of income to EUR 1.66 billion (compared to EUR 2 billion in 2009), and the higher provisions to cover credit risk to EUR 758.2 million (compared to EUR 532.3 million in 2009). Concerning financial leverage (expressed as the ratio of assets to shareholders' equity), Alpha Bank reports a slight increase to 14.4 in 2010.

As at end-2010, Alpha Bank – Albania accounted for about 0.73% of total assets of Alpha Bank (Greece).

4. PIRAEUS BANK (GREECE)[4]

As at year-end 2010, Piraeus Bank Group's total assets were reported at EUR 57.7 billion, up 6% compared to 2009. Net loans amounted to about EUR 37.6 billion versus EUR 37.7 billion in 2009, while clients' deposits totalled EUR 30 billion, down 2%. Pre-tax profit was EUR 11 million in 2010 compared to EUR 287 million in 2009, declining dramatically by about 96%. Net interest income increased by 9% compared to end-2009, while net trading and commission income fell by 100% and 3%, respectively. Provisions increased by 22% to EUR 601 million. RoE (after tax) was 0.1% in 2010 compared to about 7.6% in 2009. CAR is reported at 11.2% from 9.8% in 2009, up about 1.4 pp.

As at end-2010, Tirana Bank accounted for about 1.13% of total assets of Piraeus Bank.

5. NATIONAL BANK OF GREECE (GREECE)[5]

As at year-end 2010, National Bank of Greece's total assets were reported at about EUR 120.7 billion, up 6% compared to end-2009. Total lending (gross) amounted to EUR 75.1 billion, up 5% compared to end-2009. Deposits declined 4% to EUR 68 billion. Loan (net)/deposit ratio increased to 103% compared to 95% in 2009. Total revenues increased by 3% to EUR 4.8 billion. Operating expenses increased by 1% to EUR 2.5 billion. Provisions to cover credit risk totalled EUR 1,365 million, up 31%. Net interest margin fell to 3.92% from 4.12% in 2009. Group's profit, net, fell to EUR 406 million compared to EUR 922 million as at end-2009. ROE declined to 4.2% compared to 10.9% in 2009.

As at end-2010, the National Bank of Greece – Albania Branch accounted for about 0.26% of total assets of National Bank of Greece.

6. SOCIÉTÉ GÉNÉRALE (FRANCE)[6]

As at year-end 2010, Société Générale's total assets were reported at EUR 1,132.1 billion, up 11% compared to end-2009. Customer loans amounted to EUR 371.8 billion, up 8% compared to end-2009. Customer deposits increased by 12% to EUR 337.4 billion. Société Générale Group's net income was reported at about EUR 3.9 billion compared to EUR 678 million in 2009. Group's RoE after tax was 9.8% from 0.9% in 2009. Net banking income amounted to about EUR 26.4 billion, up 21.6% from 2009. Operating expenses increased by 4.9% to EUR 16.5 billion. As a result of the decline in provisions to EUR 4.16 billion compared to EUR 5.85 billion in 2009, Group's net operating income grew to EUR 5.7 billion from EUR 116 million in the same period in 2009. Tier 1 ratio at end of period was 10.6%, reducing by only 0.1 pp from end-2009.

As at end-2010, Société Générale Albania Bank accounted for 0.03% of total assets of Société Générale Group.

7. CRÉDIT AGRICOLE (FRANCE) and EMPORIKI (GREECE)[7]

As at end-2010 Q3, Crédit Agricole's total assets were reported at EUR 1,859.7 billion, up 9.8% compared to the same period in 2009. Loans amounted to EUR 745.6 billion, up 3.6% y-o-y; deposits grew by 4.9% y-o-y to EUR 606.3 billion. Group's net income was reported at EUR 3.3 billion at end-2010 Q3, up 84.3%

from the corresponding period in 2009. Banking income amounted to EUR 25.75 billion, up 10.5% from the same period in 2009. Operating expenses increased by about 6.5% to EUR 15.4 billion, whilst cost of risk totalled EUR 4.1 billion, down 12.8% from 2009 Q3. Net operating income grew to EUR 6.2 billion, about 51.4% higher than in 2009 Q3. As at end-2010 Q3, Crédit Agricole's CAR was 11.6% compared to 11.4% at end-2010 H1.

As at end-2010 Q3, Emporiki Bank, as part of Crédit Agricole Group, reported an increase in net banking income by 11.9% to EUR 196 million. Operating expenses declined by 4.5%, thus causing the cost/income ratio to fall to 70%. In all, Greece's Emporiki Bank's contribution to the Group's net income was a loss of EUR 191 million in the third quarter of 2010; in the first nine months, it was a loss of EUR 670 million compared to EUR 358 million in the corresponding period of 2009.

As at end-2010 Q3, Emporiki Bank in Albania accounted for about 0.01% of total assets of Crédit Agricole Group.

ENDNOTES

1 Source: qr032010.ri.co.at "Third Quarter Report, 2010".
2 Source: group.intesasanpaolo.com "Interim Statement – Intesa Sanpaolo, as at 30 September 2010".
3 Source: alpha.gr/page/ "Financial Statements of 2010".
4 Source: piraeusbank.gr/ "Financial Data of End-2010".
5 Source: nbg.gr/ "NBG Group 2010 Results".
6 Source: societegenerale.com/ "Financial Information as at year-end 2010".
7 Source: credit-agricole.fr "Financial Report as at 30 September 2010".

2. MACROECONOMIC DEVELOPMENTS IN ALBANIA OVER 2010 H2

Real economy indicators confirm that the growth rates of the Albanian economy improved in 2010 Q3. In each month over the stated period, annual inflation marked rates around the Bank of Albania's target, 3%. In addition, the exchange rate was stable, and the trade and current account deficit corrected considerably. Private consumption was slow due to the higher unemployment rate relative to the previous year and the moderate rise in average wage and workers' remittances. Fiscal policy was tighter, which in turn reflected in lower fiscal deficit.

The growth of deposits has improved liquidity in the banking sector, thus providing better support to private investment. Although industry and service-related sectors report higher capacity utilization rates close to the long-term average, the expectations for higher investment in the future remain uncertain. In addition, average lending to the economy was slow in 2010 H2, despite the improvement in the last two months of 2010. Financing cost remains a component that may be used better by banks in order to stimulate the growth of lending.

Fiscal policy continued to contribute positively to aggregate demand, but at a lower level than in the previous year. Revenue increased by 8.4% relative to 2009, while expenditure declined by 4.5%. The realization of revenue and expenditure met 97.3% and 97.6%, respectively, of the annual plan. The changes in total expenditure owe to the considerable decline in capital expenditure by 29.6% versus the previous year-end. Current expenditure increased by 6%. The performance of general revenue and expenditure over the course of 2010 brought about marked changes in the annual fiscal deficit, which was estimated at ALL 38 billion, about 53% lower than in December 2009.

As at end-2010[35], current account deficit was estimated at EUR 1,056.3 million or 11.9% of GDP, narrowing by about 3.6 pp versus year-end 2009. For the same stated period, trade balance deficit was estimated at EUR 2,082.7 million or 23.5% of GDP, narrowing by 3 pp compared to year-end 2009. This performance attributes to the dynamics of exports and imports. At an annual level, exports of goods amounted to EUR 1,171.5 million, increasing by 56%; imports of goods amounted to EUR 3,254.2 million, increasing by 7%. However, compared to 2010 H1, exports declined by about 3.2% in 2010 H2, while imports increased by 17.3%. "Manufactured goods" and "Fuel and energy" provided the main contribution to the increase in exports.

[35] *Balance of payments' data on Q4 is still unreleased and remains confidential until 30 March 2011.*

Inflationary pressures were contained in 2010 H2, and the inflation rate fluctuated within the Bank of Albania's target of 2-4%.

Table 5 Selected macroeconomic indicators

	2006	2007	2008	2009	2010_H1	2010_H2
Annual real GDP growth, in %	5.4	6	7.7	3.3	3.3	4.9*
GDP at current prices, in millions of ALL	882,209	966,651	1,087,867	1,153,000		1,223,850**
Number of employed (in thousand)	934	935	970	899	905	917
Unemployment rate	13.8	13.4	12.6	13.75	13.78	13.49
Inflation rate (y-o-y)	2.5	2.9	3.4	3.5	3.2	3.4
Budget deficit (including grants, in % of GDP)	-3.1	-3.5	-5.7	-7	-1.7***	-3.1***
Public debt (in % of GDP)	55.9	52.2	55.9	59.6	57.8	58.4****
External debt (in % of GDP)	17.2	14.4	18.3	23.38	23.6	23.5*
ALL/USD average exchange rate	98.1	90.4	83.9	95.0	104.25	105.08
ALL/EUR average exchange rate	123.1	123.6	122.8	132.1	137.99	137.44

** 2010 Q3.*
*** IMF.*
****Cumulative deficit to annual GDP.*
*****According to annual preliminary data.*
Source: INSTAT, Bank of Albania, Ministry of Finance, IMF

2.1 ALBANIAN ECONOMIC ACTIVITY

The Albanian real GDP grew by about 4.9% in 2010 Q3, quite similar to the same quarter in 2009 (4.4%), and 1.6 pp higher than in 2010 Q2. Industry posted the highest growth rate in the three quarters of 2010, driven by the high demand for raw materials. In annual and quarterly terms, industry grew by 18.2% and 1.8%, respectively. Services sector resumed the previous year's trend and posted an annual growth rate of 8.3% compared to 1.5% in early 2010. Within services, transportation provided the major contribution to growth, while postal and telecommunication services have been contracting since early 2010. In annual terms, construction contracted by 22% in Q3. In quarterly terms, it worsened further by -2.5%. The continuous contraction of construction sector since 2009 Q4 attributes to the decline of household and business investment in real estate and the curbing of real estate lending by the banking sector.

Table 6 GDP by economic activity, annual changes

	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Agriculture, animal farming, hunting and forestry	8.0	7.0	6.7	7.8	2.5	4.7	2.5	2.9	9.7	9.8	7.6
Industry	-9.1	7.0	26.1	30.6	7.8	1.8	-1.7	0.2	21.6	19.5	18.2
Construction	15.0	25.1	16.4	-4.6	-2.9	18.2	0.9	-12.7	-18.2	-29.1	-22.0
Trade, hotels and restaurants	12.6	6.7	9.0	3.6	0.8	5.1	3.5	3.2	4.0	10.0	8.1
Transportation	4.8	-10.7	-10.0	3.0	-6.2	5.0	8.1	-3.9	10.6	9.5	12.9
Post and communication	6.8	18.7	17.4	30.9	52.2	23.5	33.7	8.7	-10.6	-3.2	-7.9
Other services	17.5	7.9	5.0	-3.8	4.4	6.3	5.3	2.6	1.2	6.4	12.0
Total value added	10.2	8.9	9.5	4.1	4.2	7.7	4.6	-0.2	2.3	3.1	4.6
FISIM	10.3	2.1	1.4	5.4	7.2	10.3	9.3	6.7	-2.2	-2.9	-2.7
GDP at basic prices	10.2	9.2	9.8	4.1	4.0	7.6	4.4	-0.5	2.6	3.3	4.9

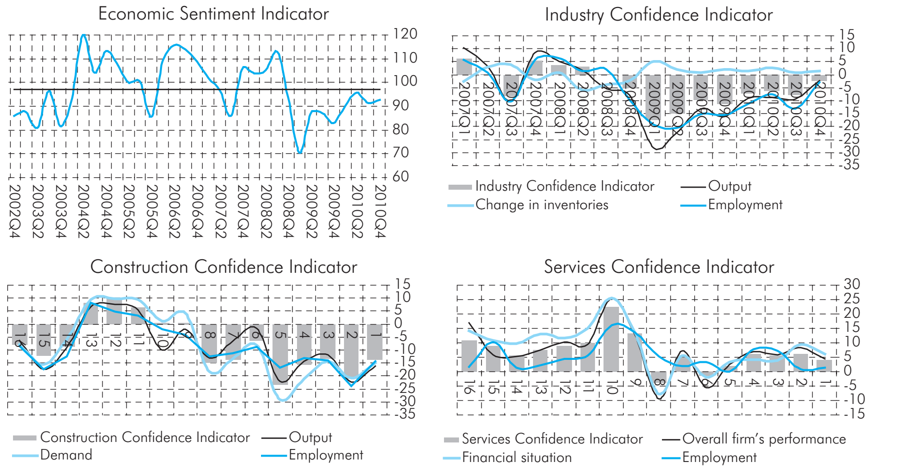
Source: INSTAT, Quarterly GDP, January 2011

In order to analyze the performance of the Albanian economic activity, we focus on the Business Confidence Survey and Turnover Volume Index.

- *BUSINESS CONFIDENCE SURVEY*

Economic Sentiment Indicator (ESI) improved to 92.8 pp in 2010 Q4, about 9.9 pp higher than in 2009, but still below its long-term average.

Chart 8 Economic Sentiment Indicator and Confidence Indicators by sector (quarterly figures)



Source: Bank of Albania

By sector, construction confidence index improved by 9.4 pp versus the previous year, due to the higher demand and output, and ultimately, reflecting in higher employment. Industry-related developments mainly featured enhanced demand for its products, whilst services showed improved financial position in 2010 Q4. Capacity utilization increased in all sectors, albeit still remaining below the long-term average, particularly for construction.

The outlook for economic developments in 2011 Q1 is positive for industry, with demand and output expected to grow higher. Services sector expects the performance of businesses to decline in early 2011 due to the fall of demand. The improved performance of construction in 2010 Q4 has been also reflected in the positive outlook for early 2011. Hence, the construction sector expects demand and output to grow in early 2011, which in turn, has reflected in a positive outlook for employment.

- *TURNOVER VOLUME INDEX*

Turnover Volume Index, which is a good proxy for the assessment of Albanian sectors' economic activity, shows a similar sectoral performance. The common index for the sectors of production and services pointed to 188% in 2010 Q3, up 18.9% compared to 2009 Q3. The same index for industry and construction posted an annual increase by 17.3% in Q3, but it declined by 2.9% compared to 2009 Q4. These developments attributed to the increase in annual turnover volume in industry and services by 37.5% and 19.9%, respectively. In the meantime, construction has been reducing its turnover indicator since early 2010 (-11.3%).

2.2 HOUSEHOLD WELFARE

The analysis of employment and income indicators help us analyze the performance of household welfare.

- *EMPLOYMENT*

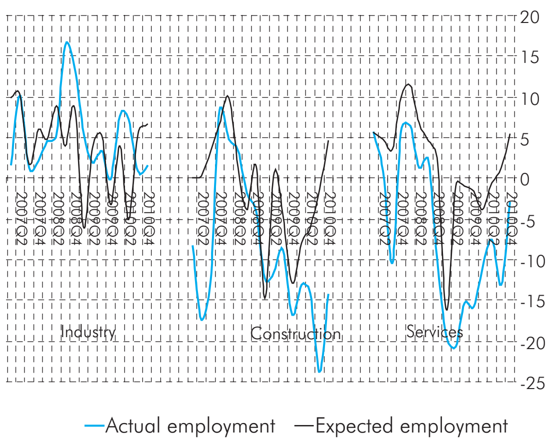
As at end-2010, unemployment rate was 13.49%. The number of employed increased by 17,641 persons relative to the previous year. Coupled with the small decrease in the number of registered unemployed (300 persons), this has, in turn, reflected in higher labour force.

Table 7 Employment figures

	Unit	08-Q1	08-Q2	08-Q3	08-Q4	09-Q1	09-Q2	09-Q3	09-Q4	10-Q1	10-Q2	10-Q3	10-Q4
Labour force	thousand	1,080	1,106	1,110	1,116	1,114	1,114	1,114	1,043	1,045	1,049	1,059	1,060
Total employed	thousand	939	966	970	974	973	973	972	899	901	905	916	917
Employed in the public sector	thousand	167	167	167	167	167	166	166	166	166	167	167	166
Employed in agriculture sector	thousand	542	569	569	569	569	569	569	496	496	496	507	507
Employed in private non-agriculture sector	thousand	231	231	235	239	238	238	237	237	238	242	243	244
Registered unemployed	thousand	141	140	140	141	141	141	142	143	145	145	143	143
Unemployment rate	%	13.04	12.66	12.62	12.68	12.68	12.7	12.76	13.75	13.83	13.78	13.52	13.49

Source: INSTAT

Chart 9 Employment figures according to Business Confidence Survey (quarterly figures)



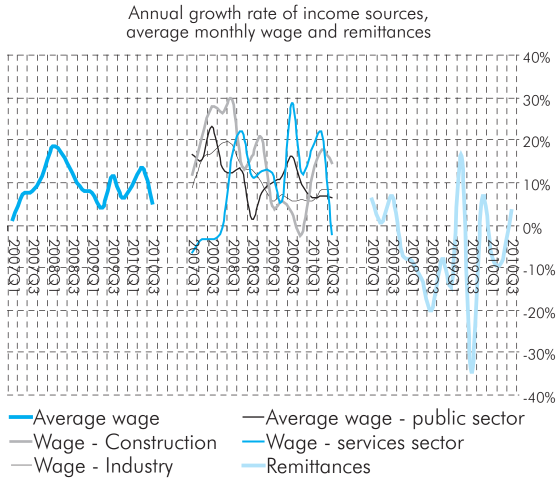
Source: Bank of Albania

Business Confidence Survey shows a positive outlook for employment in the sectors of industry, construction and services in 2011 Q3. The three sectors expect higher employment in late 2010. The lower unemployment rate for two consecutive quarters, following its continuous increase since 2008 Q3, and the positive outlook for employment in the period ahead, suggest that the labour market is recovering after the peak unemployment rate registered in 2010 Q1 due to the financial crisis effect.

- *INCOME*

In annual nominal terms, average monthly wage rose 5.25% in 2010 Q3 compared to the same period in 2009. In real terms, it rose 1.75%, about 7.5 pp lower than in 2009. Despite the downturn in economic activity, the construction sector continued to raise the average monthly wage by about 14.5% in annual nominal terms. Average monthly wage in industry rose 8.5%, while in services it dropped 2%. The annual nominal growth rate of monthly wage in the public sector slowed to 6.4% compared to 16.4% in 2009.

Chart 10 Sources of income (quarterly figures)



Source: Bank of Albania and INSTAT

With regard to workers' remittances, they amounted to EUR 135 million in 2010 Q3, increasing slightly by 3% versus the same period in 2009. The projections[36] for the worsening of unemployment rate in Greece in 2011, and for its persistence at a similar level in Italy, suggest that the recovery of workers' remittances will not be swift and substantial.

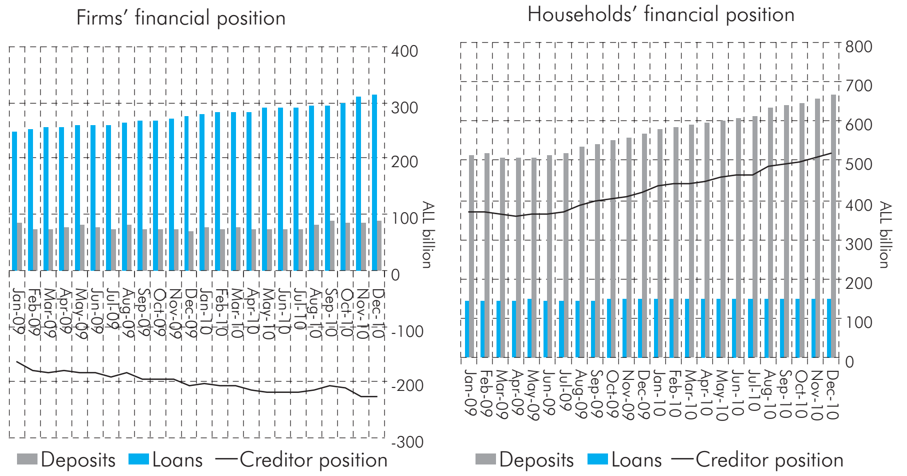
According to Consumer Confidence Survey, there was a higher consumer propensity to save in 2010 Q4 compared to the same period in 2009. In addition, households expect their savings to grow in the beginning of 2011. The slower increase in the sources of income, combined with the higher unemployment rate and lower lending to households by the banking sector, has been reflected in the increase of the marginal propensity to save, thus lowering the propensity to consume.

2.3 FIRMS AND HOUSEHOLDS' BORROWING

In order to analyze the performance of firms and households' borrowing, we use the indicator of total borrowing from depository financial institutions (commercial banks and savings and loan associations) in the form of loans and other debt instruments. As at December 2010, firms' borrowing increased by 14.7% compared to the same corresponding month in 2009. Household borrowing increased by only 1.5% for the same period. Total firms' deposits placed with all depository financial institutions grew at an annualized rate of 25.4%, whilst households increased their savings in the form of deposits by 17.5%. As a result, the debtor position of firms, which produces the difference between their claims on financial institutions (in the form of deposits) and their liabilities to these institutions (in the form of loans) amounted to ALL 228 billion in December, deepening by ALL 23 billion compared to the previous year and ALL 3 billion compared to the previous month. On the other hand, households expanded their creditor position substantially to ALL 519 billion, about ALL 97 billion higher than in 2009 and ALL 10 billion higher than in November 2010.

[36] *IMF's database.*

Chart 11 Firms and households' financial position



Source: Bank of Albania

- *INDIRECT EXCHANGE RATE-RELATED CREDIT RISK*

Indirect exchange rate-related credit risk determines the effect that exchange rate fluctuations have on firms and households' capacity to pay back their foreign currency-denominated loans. In the case of Albania, due to the high lending in foreign currency, it is important to assess its performance. As at December 2010, foreign currency-denominated loans accounted for 67.5% of total loans made by financial institutions, quite similar to the previous year (68.1%). In order to assess the performance of exchange rate risk for firms and households, we use two indicators: a) financial position in foreign currency, and b) the ratio of "outstanding loans unhedged against the exchange rate risk to total outstanding loans".

Financial position in foreign currency shows the difference between foreign currency deposits and loans made to firms or households by the financial institutions. The deepening of firms or households' debtor position in foreign currency implies larger exposure to the exchange rate risk. This indicator reflects the long-term exposure of firms or households to indirect exchange rate risk.

Outstanding loans unhedged against the exchange rate risk measures the performance of borrowing in foreign currency by firms or households, whose income is in the domestic currency. The increase in the ratio of outstanding loans unhedged against the exchange rate risk to total outstanding loans signals higher exposure to the exchange rate risk. This indicator measures indirectly firms or households' exposure to indirect exchange rate risk.

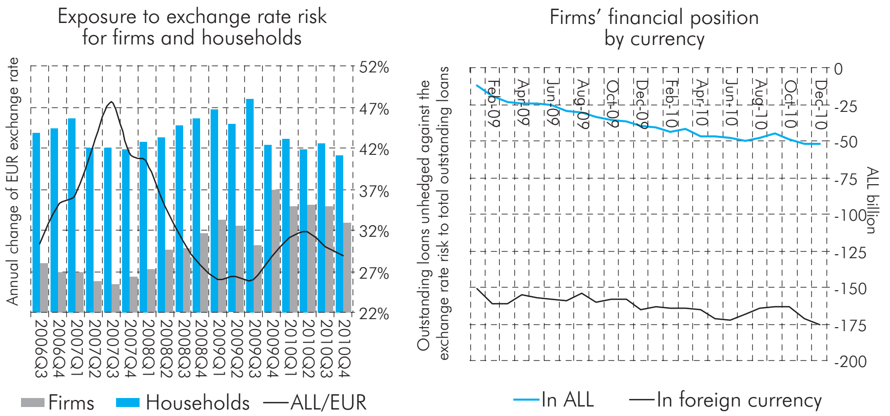
Concerning the first indicator, firms' financial position (net debtor) is much deeper in foreign currency than in Lek. As at November 2010, firms were debtors to financial institutions for an amount totalling about ALL 175 billion in the form of foreign currency-denominated loans, and for only about ALL

52 billion in the Albanian Lek. In 2009, firms' debtor position amounted to ALL 167 billion in foreign currency and ALL 40 billion in the Albanian Lek. However, due to the growth in lending, the ratio of "outstanding loans unhedged against the exchange rate risk to total outstanding loans" for firms declined in December 2010 to 33% compared to 36.9% in 2009.

On the other hand, households borrowed from the financial system a total of ALL 219 billion in foreign currency, thus suggesting that households are by and large hedged against the exchange rate depreciation risk. It is, however, estimated that about 41% of total outstanding household loans made by banks is unhedged against the exchange rate risk, providing evidence for the presence of exposure to this type of risk. In 2009, the same ratio was 42.5%.

Possible exchange rate movements are the ones to materialize the exchange rate risk to which firms and households are potentially exposed to. Due to the ALL/EUR exchange rate stability in 2010 Q4, firms and households' exposure to the exchange rate risk has not increased. In 2010 Q4, the Euro appreciated at an annualized rate of 1% compared to 11.4% in the same period in 2009.

Chart 12 Loans unhedged against the exchange rate risk and ALL/EUR exchange rate for firms and households (left), and firms' financial position by currency (right)



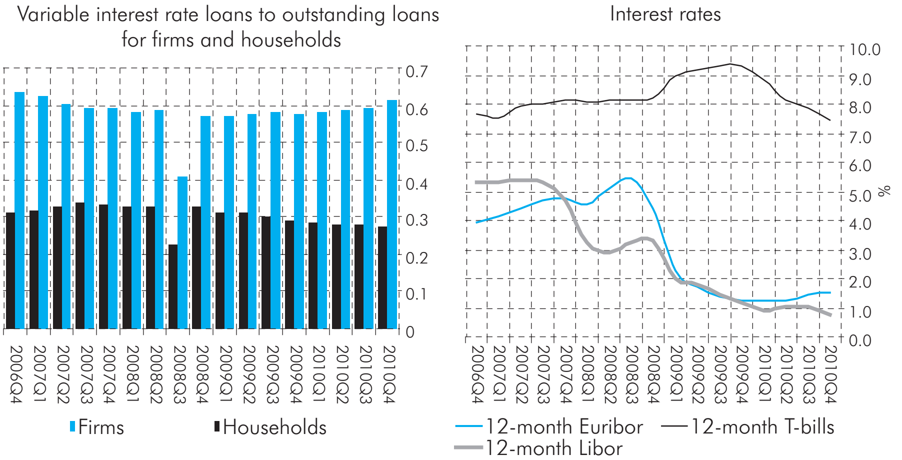
Source: Bank of Albania

- *INDIRECT INTEREST RATE-RELATED CREDIT RISK*

Indirect interest rate-related credit risk for firms and households determines the effect that the change in interest rates has on their capacity to pay back their loans. In order to measure this type of risk, we use the ratio of "variable interest rate loans to outstanding loans" for firms or households. An increase in this ratio implies higher exposure to the interest rate risk.

After the sharp decline at the onset of the global financial crisis, firms' exposure to this type of risk resumed its historical rates. As at end-2010 Q4, 61% of firms' outstanding loans accounts for variable interest rate loans. In December 2009, this ratio was 57.8%, thus exposing firms more to interest rate fluctuations. Concerning households, about 27.4% of outstanding loans accounts for variable interest rate loans, down 1.9 pp from 2009 and 0.5 pp from the previous quarter.

Chart 13 Ratio of variable interest rate loans to outstanding loans and benchmark interest rates in quarterly figures



Source: Bank of Albania, Bloomberg

The major benchmark interest rates on loans, such as EURIBOR, LIBOR and 12-month T-bills, have been declining in 2010 H2, thus curbing the impact on firms and households' solvency. Nominal interest rates on foreign currency are at historical lows; however, there is plausible risk that they will increase in the future. Risk to firms or households will, therefore, be increasing, which will in turn require due monitoring and management.

Worth noting, however, is that, as in other cases, there is a risk that the aggregate-level analysis does not consider exposure of individual entities to risk. For instance, despite aggregate-level households are more protected against indirect exchange rate-related credit risk than firms, each individual or household exposed to foreign currency borrowing should assess the sufficiency of foreign currency resources in order to judge upon the long-term solvency.

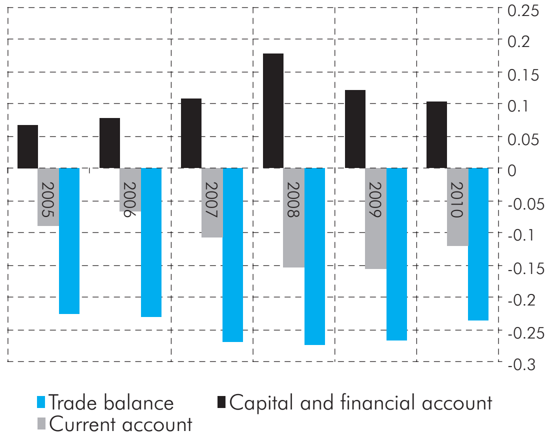
2.4 BALANCE OF PAYMENTS

As at end-2010, current account deficit was estimated at EUR 1,056.3 million or 11.9% of GDP, narrowing by about 3.6 pp versus year-end 2009. For the same stated period, trade balance deficit was estimated at EUR 2,082.7 million or 23.5% of GDP, narrowing by 3 pp compared to year-end 2009. This performance attributes to the dynamics of exports and imports. At an annual level, exports of goods amounted to EUR 1,171.5 million, increasing by 56%; imports of goods amounted to EUR 3,254.2 million, increasing by 7%. However, compared to 2010 H1, exports declined by about 3.2% in 2010 H2, while imports increased by 17.3%. "Manufactured goods" and "Fuel and energy" provided the main contribution to the increase in exports.

The improvement of the trade deficit by EUR 221 million has offset the decline of net foreign inflows into the capital and financial account, which in 2010 declined to EUR 116.8 million, or down 11.2% compared to 2009.

Chart 14 shows the performance of balance of payments items.

Chart 14 Balance of payments



Source: Bank of Albania

2.5 FISCAL DEVELOPMENTS OVER 2010 H2

Fiscal policy continued to aim at lowering the fiscal stimulus in 2010 H2. Compared[37] to the previous year's data, revenue increased by 8.4%, while general expenditure declined by 4.5%. The realization of revenue and expenditure met 97.3% and 97.6%, respectively, of the annual plan. Tax and non-tax revenue increased by 6.6% and 29.9%, respectively. In the meantime, capital expenditure declined by 29.6% relative to year-end 2009, while current expenditure increased by 6%. Subsequently, annual fiscal deficit amounted to ALL 38 billion, about 53% lower than in December 2009.

Table 8 Key fiscal indicators

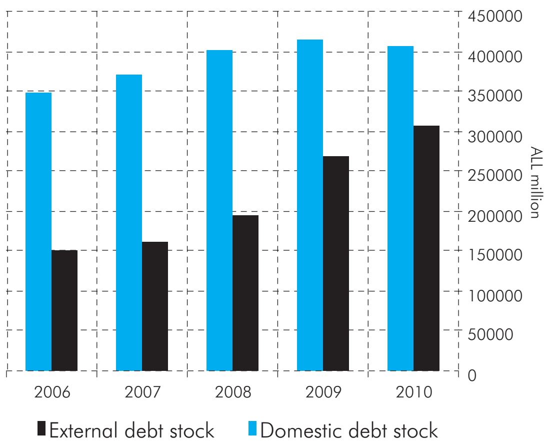
	December 2008	December 2009	December 2010	Annual change, in %	
				December 2009	December 2010
Total revenue	291,238	299,502	324,700	2.84	8.41
-Grants	4,228	4,430	4,605	4.78	3.95
-Tax revenue	264,421	270,830	288,609	2.42	6.56
-Non-tax revenue	22,588	24,241	31,486	7.32	29.89
Total expenditure	351,492	379,863	362,752	8.07	-4.50
-Current expenditure	250,298	283,897	300,878	13.42	5.98
-Capital expenditure	93,783	95,881	67,492	2.24	-29.61
Budget deficit	-60,254	-80,361	-38,052	33.37	-52.65

Data in millions of ALL, progressive.
Source: Ministry of Finance

Budget deficit financing lowered duly and in line with the debt strategy. The negative budget surplus mainly relied on domestic financing (73.2%), wherein domestic borrowing accounts for 68.2% and privatization receipts only 1.1%. "Other" accounts for 3.9% of domestic financing, out of which 1.8% is Government's deposit held with the Bank of Albania. Foreign borrowing financed 26.8% of the budget deficit, substantially higher than the previous periods, particularly due to the first Albanian Government Eurobond issued

[37] *Based on preliminary data on fiscal indicators according to 2010 consolidated budget, Ministry of Finance.*

Chart 15 Public debt components



Source: Ministry of Finance

over the period under review. As a result, as at year-end 2010, external debt stock accounted for 43% of the total, and domestic debt stock accounted for the rest, 57%.

As at year-end 2010[38], public debt stock accounted for 58.44% of GDP, out of which 25.15% is external debt and 33.29% domestic debt. Regarding the domestic debt portfolio, there was a slight fall in banks' share and an increase in individuals' share, thus providing evidence for banks' improved liquidity position and the greater room for private sector lending.

Weighted average yield showed a declining tendency in H2 for all types of debt instruments. This tendency owes to the improved banking sector liquidity position, reflected in the stable participation in auctions and the lower debt issuance rates by the Government. If it persists, the drop in the yields will have a positive effect on the debt service cost in the future. The latter, however, remains considerable due to the yields on the existing debt portfolio.

In terms of the composition of the external debt stock by currency, the Euro had the largest share at end-Q3, 54.7%. In 2010 Q4, the first Eurobond of 5-year maturity was issued with an annual interest rate of 7.5%. Eurobond revenue will generally be used to settle the actual syndicated loan. Borrowing through the Eurobond has, in the short run, improved the external debt conditions and its trading quality; while in the medium run, it provides an instrument that requires strong fiscal discipline in general, and good management of risks arising from foreign currency borrowing in particular.

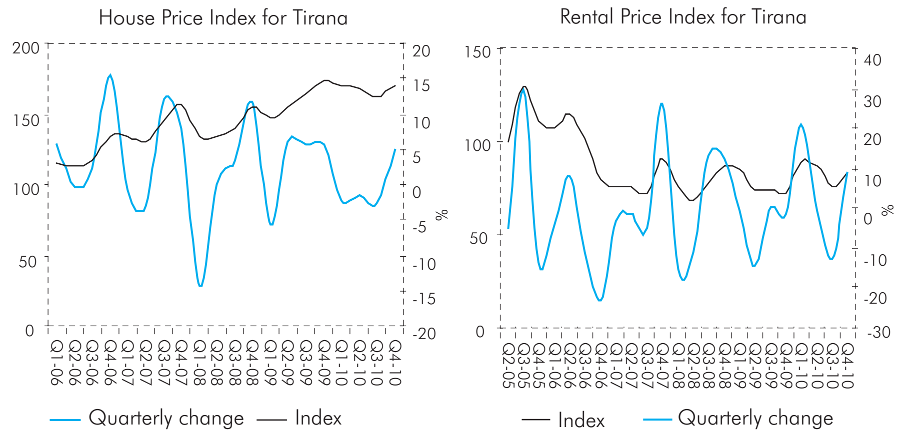
[38] *Annual preliminary data.*

3. DOMESTIC MARKETS

3.1 REAL ESTATE MARKET

In order to analyze the performance of the real estate market, we use proxy indicators[39], namely the House and Rental Price Index, which are calculated for the capital, Tirana. In 2010 H2, the House Price Index fell slightly by 1.6% on an annual basis. However, based on its quarterly changes, the HPI increased by 5% following the continuous falls in the first quarters of 2010.

Chart 16 House and Rental Price Index for Tirana



Source: Bank of Albania

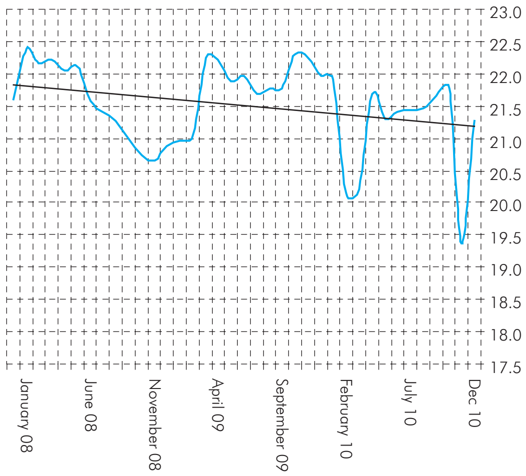
Rental Price Index shows a similar performance increasing by 9.1% in 2010 Q4. It increased on an annual basis throughout 2010. Relative to 2009 Q4, it increased by 13.9%.

Real estate market figures are broadly consistent with the developments in the construction sector. Turnover Volume Index for the construction sector declined throughout the first nine months of 2010. According to the Construction Cost Index, construction-related costs remained at similar levels (up 0.5% in annual terms). The mismatch between supply, represented by the construction stock, and the contracted demand for real estate confirm the crunch facing the construction sector.

The banking sector support to the construction sector was relatively stable in 2010, albeit lower than in 2009. However, a slight, but stable, lowering of

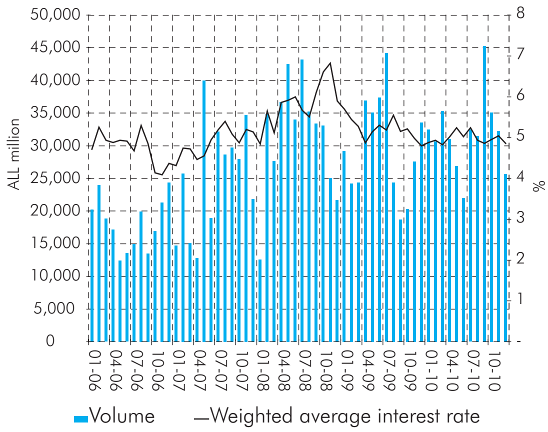
[39] *These two indices are calculated only for Tirana and they exclude the suburb areas.*

Chart 17 Share of real estate loans as a percentage of outstanding loans



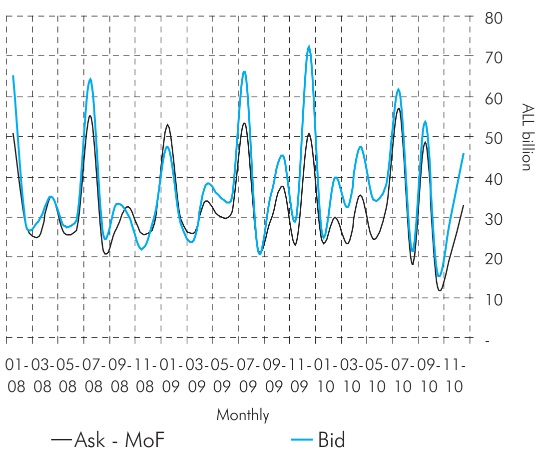
Source: Bank of Albania

Chart 18 Interbank market volume and interest rates



Source: Bank of Albania

Chart 19 T-bill bid-ask volume



Source: Bank of Albania

banking sector's exposure to the construction sector has been registered in the last three years, providing evidence for the contraction of demand and new investment in this sector.

3.2 FINANCIAL MARKETS

The Albanian financial market is dominated by operations in the interbank market, Government debt securities and foreign exchange. Other segments that relate to insurance, reinsurance and pension funds account for a small share in total financial market volume. Financial market situation improved in 2010. Interest rates in the interbank market showed a declining tendency. Liquidity in the financial system has normalized, being reflected in lower and more stable interest rates. The normalization attributes to the overall improvement of liquidity and the liquidity providing operations of the Bank of Albania.

3.2.1 INTERBANK MARKET

Interbank market conditions improved in 2010 H2 compared to H1. The volume traded grew 13.3%, at a time when the weighted average interest rate has almost maintained the same rate, from 4.97% to 4.98%. Relative to 2009 H2, the volume traded grew 19.8%, while the weighted average interest rate has declined by 0.15 pp. The rationale behind the lower cost of interbank loan is the improved liquidity conditions in the interbank market.

3.2.2 PRIMARY SECURITY MARKET

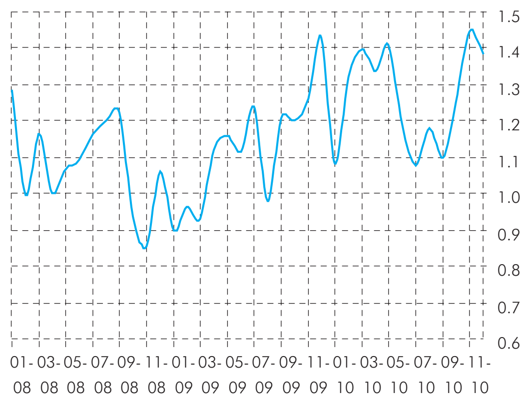
The volume asked in the primary security market grew 11.48% in 2010 H2 compared to H1, while declining by 11.38% compared to 2009 H2. The yields have, however, shown a declining tendency. In 2010 H2, the total amount asked in the Government security auctions amounted to ALL 213 billion or ALL 14 billion higher than in 2010 H1 and about ALL 27 billion less than in 2009 H2.

In December 2010, bid-to-cover ratio, which expresses the ratio between demand and supply of securities in auctions, was 1.39, lower than the previous month but higher than in June 2010. Compared to December 2009, bid-to-cover ratio fell 0.04 pp (see Chart 20).

The downward trend of yields in the primary Government security market continued in 2010 H2. This trend commenced in November 2009 as a response to monetary policy easing that materialized in the key interest rate cut in January 2009, October 2009, and July 2010. Chart 21 shows the volume and weighted average yield on T-bills since January 2008.

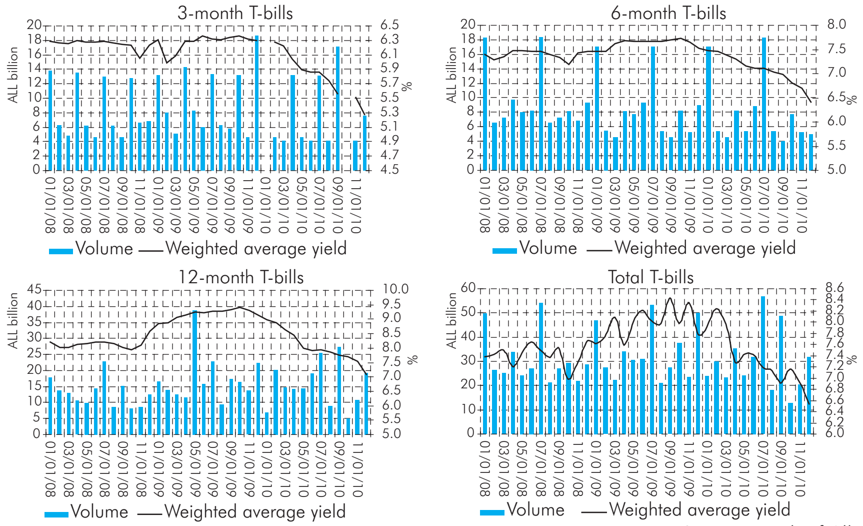
Yields on 12-month T-bills recorded the sharpest decline, which was later reflected in bond yields. As at end-December 2010, the yield on 12-month T-bills reached 7.08% versus 7.9% in June 2010. Yields on 6 and 3-month T-bills had a similar performance but at a lower extent. The yield on 6-month T-bills dropped to 6.41% in December 2010 compared to 7.73% in October 2009. The yield on 3-month T-bills dropped to 5.28% in December 2010 compared to 6.36% in November 2009.

Chart 20 Bid-to cover ratio



Source: Bank of Albania

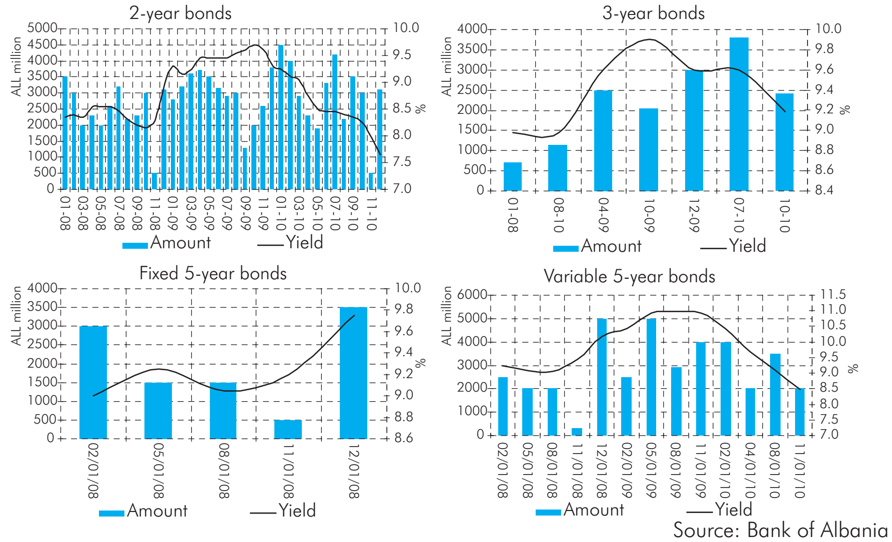
Chart 21 Volume and T-bill yields in the primary market



Source: Bank of Albania

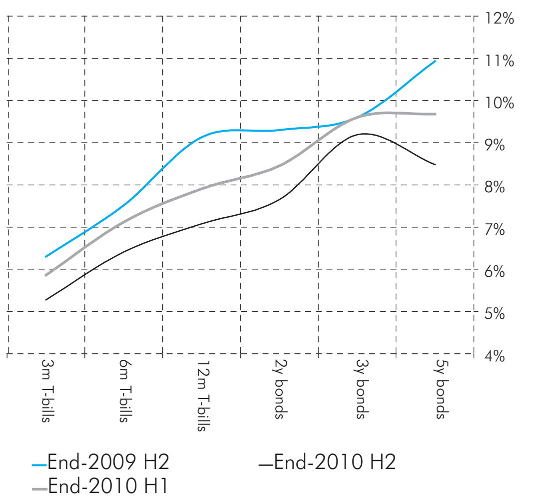
Yields on bonds showed a similar tendency as T-bills. They dropped in Q4 mainly due to the improved liquidity figures in the banking sector. As at end-2010 H2, the yield on 2-year bonds dropped to 7.65% from 8.45% at end-H1. The same yield dropped by 1.65 pp compared to 2009 H2. Variable yields on 3 and 5-year bonds had a similar performance. As at end-2010 H2, they stood at 9.19% and 8.48%.

Chart 22 Volume and bond yields in the primary market



Source: Bank of Albania

Chart 23 Yield curve



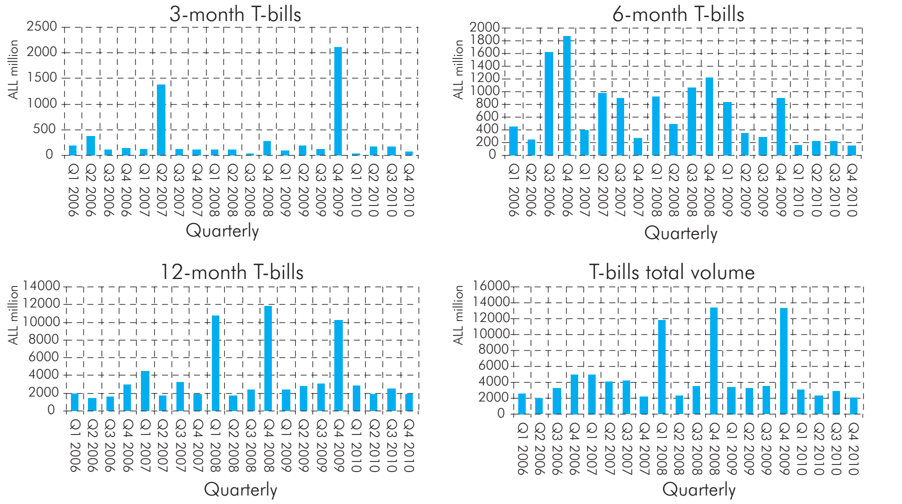
Source: Bank of Albania

Chart 23 shows the yield curve for Government debt securities in the Albanian Lek as at end 2010 H2.

3.2.3 SECONDARY SECURITY MARKET

Volume in the secondary market, or debt security trading market, has been volatile, albeit low. In 2010 H2, it declined to ALL 5 billion compared to ALL 5.4 billion in 2010 H1. In 2009 H1 and H2, the volume traded in the secondary market totalled ALL 6.7 and 16.7 billion, respectively. The rationale behind this decline is the lower volume of debt issued by the Ministry of Finance and the lower yields. 12-month

Chart 24 Volume of T-bills traded in the secondary market



Source: Bank of Albania

T-bills have the largest share in operations carried out in the secondary market.

3.2.4 FOREIGN EXCHANGE MARKET

In 2010 H2, the Euro appreciated 1.7% against the Lek, whilst the US dollar and the British Pound depreciated 6.7% and 3.5%, respectively. The appreciation of the Lek against these two currencies has generally reflected the developments in the global foreign exchange markets.

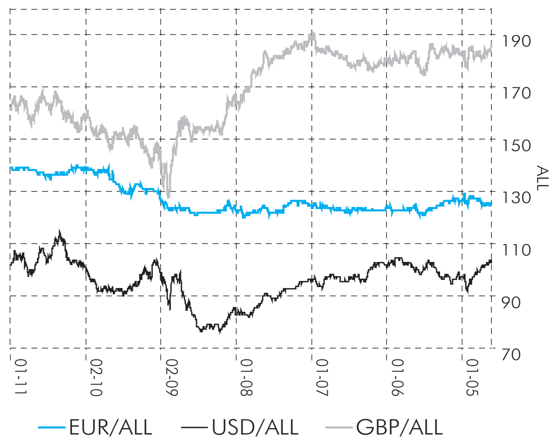
Volatility in the foreign exchange market increased substantially in 2009 due to the crisis that swept accross the global financial markets. This situation increased the cost and activity risk for firms involved in the import and export of goods, and for borrowers of foreign currency-denominated loans. In 2010, Lek's exchange rate, particularly against the Euro, was more stable, resulting in turn in lower depreciation and volatility. This performance improved the conditions of firms and individuals' activity. Chart 26 shows Lek's exchange rate against the basket of the two major currencies, Euro (80%) and US dollar (20%) for 2008, 2009 and 2010.

In order to assess the performance of Lek's exchange rate, we monitor the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) of the Lek, which are constructed based on the share of trade with Italy, Greece, Turkey, China and Germany, Albania's main trading partners. The indicators are expressed in "Lek per unit of foreign currency", therefore, the increase of the index shows the depreciation of the Lek. The slope of indicators, which shows the velocity and the extent of Lek's depreciation, is flatter in 2010, thus reflecting the more stable exchange rate compared to 2009.

3.2.5 BANK OF ALBANIA OPERATIONS

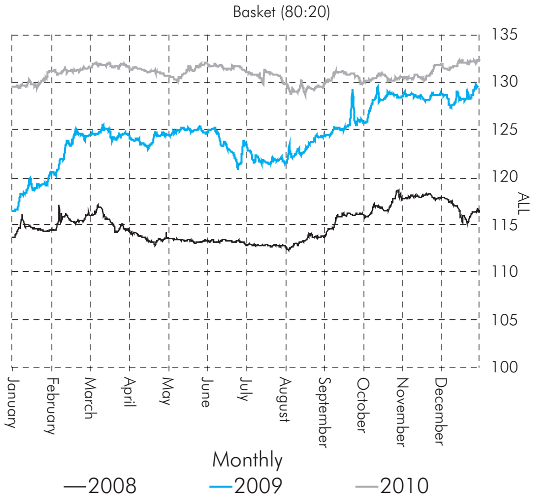
As from January 2010, the Bank of Albania continued to inject liquidity in the interbank market and restored the fixed-amount and competitive bid auctions. Once the banking sector's liquidity improved through the growth of deposits since early

Chart 25 Lek's exchange rate against major currencies



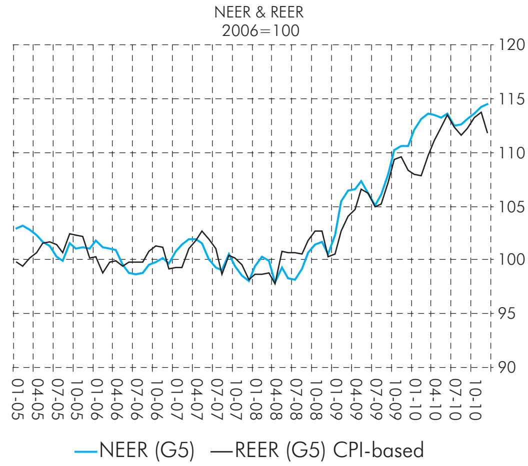
Source: Bank of Albania

Chart 26 Foreign currency basket



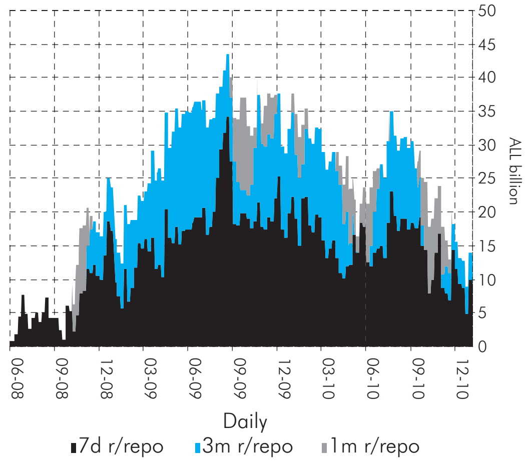
Source: Bank of Albania

Chart 27 Nominal Effective Exchange Rate Index (NEER)



Source: Bank of Albania

Chart 28 Volume of liquidity provided by the Bank of Albania in the open market



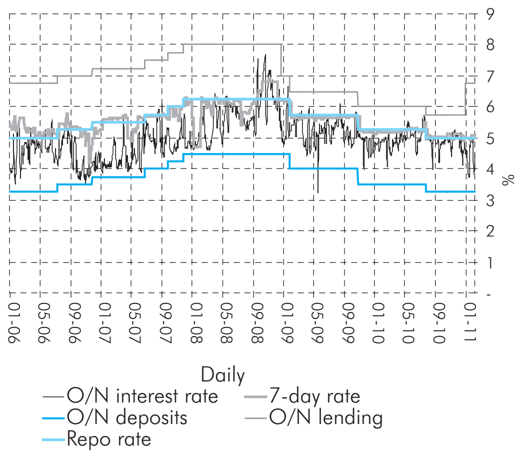
Source: Bank of Albania, MPD

year-2009, banks' bidding for liquidity from the Bank of Albania was lower. Hence, the volume of Bank of Albania's transactions has been declining. The amount of liquidity injected at end-December 2010 was about ALL 13.9 billion from ALL 26.6 billion at end-June 2010.

Throughout 2010, banks were allowed to use daily up to 40% of their required reserve in Lek (from 20% decided in July 2008). These successive operations of the Bank of Albania have aided the financial system's liquidity and have smoothed the interbank market situation, thus allowing for stable interest rates in the market.

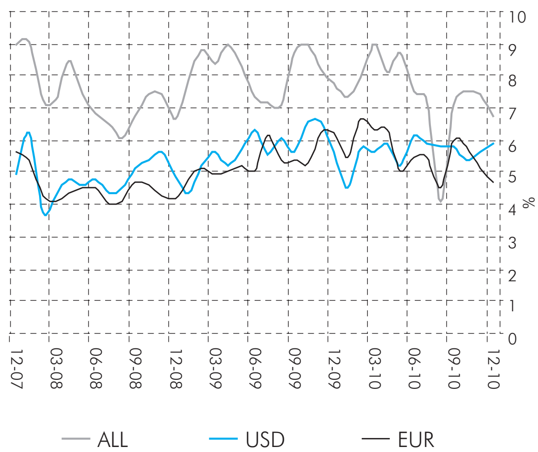
With respect to monetary policy-related decisions, on 28 July 2010, the Bank of Albania decided to cut the key interest rate by 0.25 pp to 5.00%.

Chart 29 Money market rates



Source: Bank of Albania

Chart 30 Loan and time deposit spread



Source: Bank of Albania

3.2.6 SPREAD BETWEEN INTEREST RATES ON NEW LOANS AND DEPOSITS

In 2010 H2, the spread between average interest rate on loans and deposits was volatile for the three major currencies[40]. This spread narrowed by 0.78 pp, 0.28 pp and 0.8 pp for Lek, US dollar and Euro operations. The decrease of the interest rate on loans from 12.7% to 11.8% provided the main contribution to the narrowing of the spread for operations in Lek. Interest rates on time deposits denominated in Lek are more stable, declining over the

[40] *In order to calculate the interest rate spreads, we have used the spread between the weighted average interest rate on new time deposits and loans.*

stated period from 5.18% to 5.1%[41]. The spread between interest rates on Euro loans and deposits has been mainly conditioned by the decrease of interest rates on loans, which at end-December 2010 declined to 6.7% from 7.7% in June 2010. Interest rates on Euro time deposits were more stable in 2010 H2 and dropped from 2.25% to 2.1%. Interest rates on US dollar time deposits dropped at end period to 1.1% from 1.2% in June 2010. Interest rates on US dollar loans dropped to 7% from 7.4%.

[41] *The interest rate on time deposits has varied between 5% and 6% since September 2008.*

4. PAYMENT SYSTEMS DEVELOPMENTS DURING 2010[42]

The 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 that are managed by the Bank of Albania: "Real-Time Gross Settlement System - AIPS" and "Automated Clearing House System – AECH". As at end-2010, all banks licensed by the Bank of Albania are direct participants in the AIPS, of which 15 banks are also participants in the AECH.

TECHNOLOGICAL UGRADE

In March 2010, in collaboration with the Ministry of Finance, the payment systems of the Bank of Albania were integrated with the MoF's treasury system (AMoFTS). This technological upgrade enables the automation of MoF's treasury payments, thus enhancing the safety and efficiency of these payments considerably, and improving the planning capacity of all entities involved in these transactions.

REAL-TIME GROSS SETTLEMENT SYSTEM - AIPS

The payment systems reflected security and efficiency in 2010. AIPS processed a total of 80,356 transactions, amounting to ALL 4,437 billion. Relative to 2009, the number of transactions settled in 2010 increased by 44%, while their value declined 6%. The largest number of transactions settled in 2010 concentrated in Q4, while the largest value was settled in Q3. On average, 321 transactions a day were processed and settled in the AIPS, with an average daily value of ALL 17.7 billion.

Table 9 Volume of transactions processed in AIPS

AIPS	2007	2008	2009	2010
Number of transactions	45,480	56,717	55,701	80,356
Value of transactions (in billions of ALL)	3,745	5,146	4,718	4,437
Average value per transaction (in millions of ALL)	82	91	85	55

Source: Bank of Albania

Out of total transactions processed and settled in the AIPS in 2010, about 68% in terms of number of transactions are payments that banks settle among them on behalf of their customers. They increased by 85% relative to 2009. To a large extent, this increase attributes to the automation of MoF's treasury payments, which account for 50% in terms of number, and 31% in terms of value of total payments in the AIPS. Worth noting is that 4 banks share about

[42] *This section is based on the Annual Report of Payment Systems Developments, prepared by the Payment Systems Department at the Bank of Albania.*

23% of total transactions in the AIPS.

AUTOMATED CLEARING HOUSE SYSTEM – AECH

The AECH processes and clears customer payments amounting to below ALL 1 million. In 2010, a total of 332,777 payment orders were cleared in the AECH, with an average value settled per transaction of ALL 130 thousand. About 1,330 payments were processed daily in the AECH, with an average daily value amounting to ALL 176 million. Relative to 2009, the number of payments cleared in 2010 increased by 225%, while their value increased by 185%. This increase attributes to the automation of MoF's treasury payments.

AECH	2007	2008	2009	2010
Number of transactions	71,857	113,682	102,304	332,777
Value of transactions (in billions of ALL)	12.01	17.61	15.46	43.98
Average value per transaction (in millions of ALL)	0.17	0.15	0.15	0.13

Source: Bank of Albania

Table 10 Volume of transactions processed in AECH

PAYMENT INSTRUMENTS

As at end-2010, the total number of customer bank accounts, valid to make payments in Lek or in foreign currency, is about 2.5 million, 17% higher than at end-2009. Out of these, about 27 thousand accounts are accessible via the internet – to make payments or check the bank account statement online –, up 82% compared to end-2009. Despite this increase, online access is still low.

As at end-2010, the number of banks licensed as card issuers, which provide the service of cash withdrawal from ATMs, was 14. Out of these card issuing banks, only 7 banks are also licensed to accept cards, by offering the service of card payment acceptance at points of sale terminals via POS equipment placed in shops, restaurants, hotels or trade centres. The number of ATMs increased by 4% versus end-2009, while the POS terminals increased by 12%.

During January to December 2010, a total of 10.5 million transactions amounting to ALL 108 billion were processed via cards (ATM and POS). About 95% of total transactions are cash withdrawals from ATMs, and only 5% are customer payments made via cards at POS terminals, thus providing evidence for the high use of cash in economy.

Home Banking is another banking service being ever-increasingly used. It allows customers to access their bank accounts using an internet line, phone line or software that the bank makes available to its customer. This service was first provided in Albania in 2005. As at 2010, home banking was provided by 11 banks. About 163 thousand home banking electronic transactions for the entire banking system were reported in 2010. They amounted to ALL 92 billion and accounted for 3% of total customer payments.

5. FINANCIAL SYSTEM DEVELOPMENTS

As at end-2010 H2, financial intermediation in Albania, measured as the ratio of financial sector[43] assets to the GDP[44], was estimated at 85.7% compared to 84.4% at H1 and 82% at end-2009. Financial institutions' assets grew 6% from 2010 H1. The banking sector remains the dominant segment of financial intermediation in Albania. As at end-2010, its assets accounted for about 94.4% of total financial system assets, and about 80.9% of GDP.

Table 11 Share of financial system segments in GDP through the years (in %)

Licensing and Supervisory Authority	Financial system	Year 2005	2006	2007	2008	2009	2010
Bank of Albania	Banking system	60.4	69.6	75.9	76.7	77.5	80.9
	Non-bank institutions	1.32	1.52	1.48	1.66	2.2	2.7
	SLAs and their Unions	0.46	0.52	0.63	0.7	0.77	0.78
Albanian Financial Supervisory Authority	Insurance Companies	1.24	1.29	1.36	1.45	1.5	1.4
	Pension Funds	-	-	-	-	0.01	0.01

Source: Bank of Albania, Albanian Financial Supervisory Authority

BOX 2 NON-BANK FINANCIAL SECTOR

Non-bank financial sector includes financial institutions supervised by the Bank of Albania and the Albanian Financial Supervisory Authority (AFSA). The institutions supervised by the Bank of Albania are a) non-bank financial institutions (credit and leasing associations), b) savings and loan associations and their unions, and c) other institutions providing payment and foreign exchange services. The institutions supervised by the AFSA are a) insurance companies, and b) private supplementary pension funds. Securities trading associations are also supervised by the AFSA but their share is negligible.

In 2010 H2, the non-bank financial sector's share in the entire financial system was relatively small. Total non-bank financial sector assets[1] accounted for about 5.6% of the financial system, quite similar to H1 and end-2009 (5.3%). As a percent of GDP, they accounted for 4.8% compared to 4.7% in H1 and 0.45 pp higher than at year-end 2009.

Based on the latest data, non-bank financial institutions' assets account for 3.1% of total financial system assets (versus 3% in 2010 H1), accounting for about 2.7% of GDP, similar as in H1. Assets of insurance companies account for 1.6% of total financial system, while their share in GDP is about 1.4%. Assets of savings and loan associations account for about 0.91% of total financial system assets and 0.78% of

[43] The financial system is composed of banks, non-bank financial institutions, insurance companies, savings and loan associations and private supplementary pension funds.
[44] IMF's forecast for nominal GDP. GDP for 2010 amounted to ALL 1,224 billion.

GDP, thus without undergoing any significant changes versus 2010 H1. Private pension funds continue to have a negligible share in total financial system assets and GDP (about 0.01%).

Chart 31 shows the structure of the financial system for each segment operating in Albania.

FINANCIAL ANALYSIS OF NON-BANK FINANCIAL INSTITUTIONS' ACTIVITY[2]

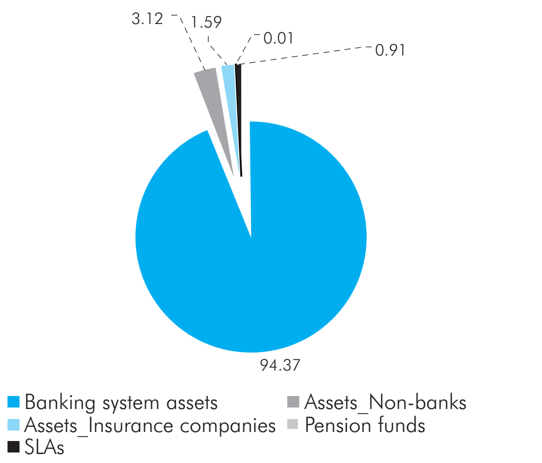
The activity of non-bank financial institutions was positive in 2010 Q4 in terms of asset and loan portfolio growth. However, capitalization, loan portfolio quality and profit declined over the stated period.

As at 2010 Q4, assets of non-bank financial institutions amounted to ALL 32.7 billion, up 6.4% from the previous quarter. "Cash, deposits and accounts" and "Operations with customers" provided the largest contribution to the growth of assets, 61.5% and 22.9%, respectively. In the meantime, "Loans received" provided the main contribution to the increase in liabilities, 69.6%.

Capitalization, expressed as the ratio of "capital account" to "total assets", fell to 34.4% in 2010 Q4 from 36% in Q3, thus observing the regulatory requirement of over 10% (see Chart 33).

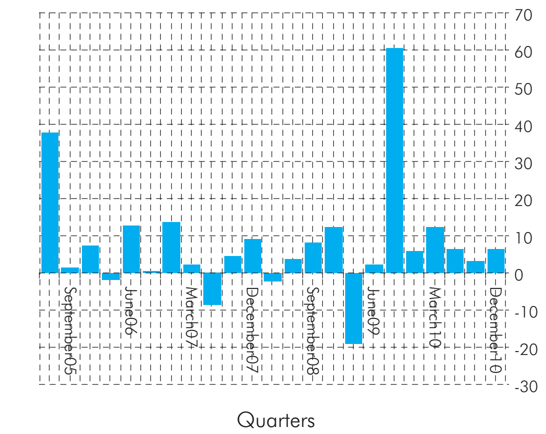
The loan portfolio has the main share in total non-bank financial institutions' assets, accounting for 58.2% in 2010 Q4. Total loans (gross) grew to ALL 19 billion, up 3.1% from the previous quarter.

Chart 31 Share of financial system entities in total assets



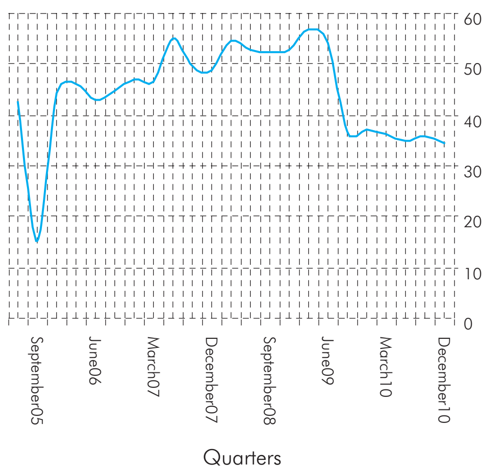
Source: Bank of Albania

Chart 32 Growth of non-bank financial institutions' assets, quarterly



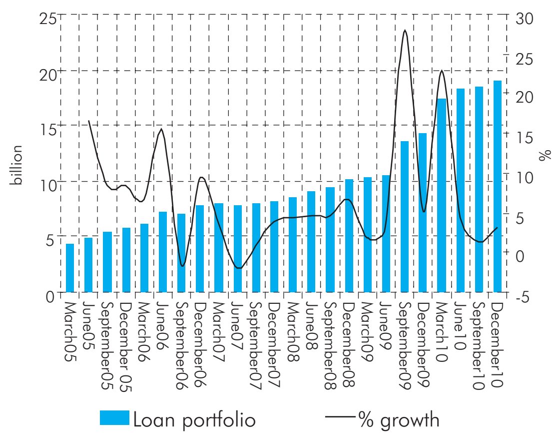
Source: Bank of Albania

Chart 33 Capital account to total assets



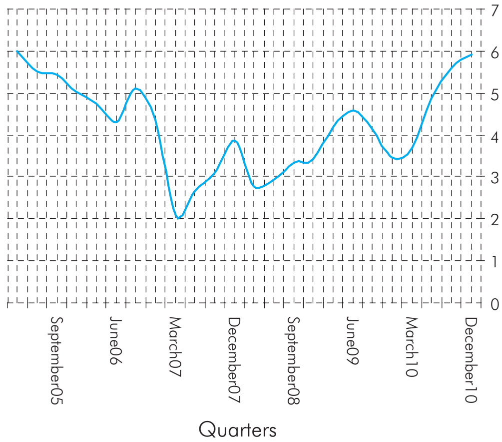
Source: Bank of Albania

Chart 34 Loan portfolio for non-bank financial institutions



Source: Bank of Albania

Chart 35 Non-performing loans to total loans



Source: Bank of Albania

Loan portfolio quality for non-bank financial institutions worsened further in 2010 Q4. Quality indicator rose to 5.9% from 5.6% in Q3. The increase in this indicator owes to the greater increase in NPLs (9.1%) than in outstanding loans (3.1%).

Profitability of non-bank financial institutions fell in 2010. Net profit amounted to ALL 937.2 million, compared to ALL 1.1 billion in 2009. Income for the period under review totalled ALL 6.2 billion, about ALL 95.5 million more than in the same period in 2009. "Interest income" and "Commissions" have the largest share in income, 48.3% and 17%, respectively. Concerning expenditure, "operating expenses" have the largest share. During the same corresponding period, they accounted for 39.8% of total expenditure compared to 40.9% in 2009.

SAVINGS AND LOAN ASSOCIATIONS (SLAs)

Total assets of SLAs and their unions grew 2.16% in 2010 Q3 versus Q2 to ALL 9.6 billion. Lending continues to represent the main financial activity of SLAs and their unions. In 2010 Q3, they reported that 74.4% of total assets were invested in lending. The share of non-performing loans in total loans, on a gross basis, for SLAs and their unions rose slightly to 3.7% from 3.3% at end-Q2.

Net profit of SLAs and their unions dropped to ALL 50.7 million in 2010 Q3 compared to ALL 56.9 million in the same corresponding quarter last year.

Table 12 shows the performance of some indicators on the activity of SLAs and their unions.

Table 12 Indicators of SLAs' activity

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Total assets (in millions of ALL)	7,866	8,251	8,670	8,765	8,825	9,378	9,581
Outstanding loans (in millions of ALL)	6,419	6,438	6,634	6,893	7,003	7,125	7,124
Outstanding loans/total assets (in %)	81.6	78.03	76.5	78.6	79.4	75.9	74.4
Non-performing loans (in millions of ALL)	104	118.6	132.1	135.2	198.8	237.1	262.6
Non-performing loans/ outstanding loans (in %)	1.62	1.84	1.99	1.96	2.84	3.3	3.69

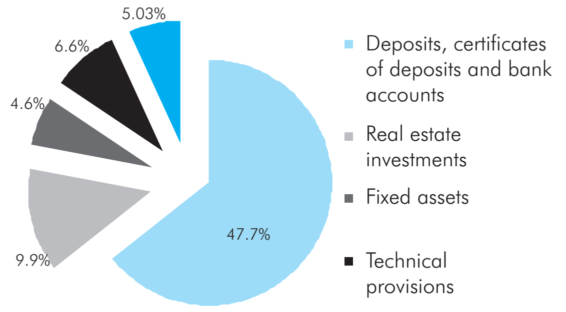
Source: Bank of Albania

From the above analysis, we conclude that as at end-2010 Q3, the activity of SLAs and their unions expanded, their loan portfolio quality worsened slightly, and profit declined compared to same corresponding period in 2009.

INSURANCE COMPANIES AND PRIVATE SUPPLEMENTARY PENSION FUNDS

Concerning insurance companies, income from insurance premiums amounted to ALL 8,207 million in 2010, or 4.17% higher than in 2009[3]. The number of insurance contracts declined 2.57% in 2010 compared to 2009. The insurance market remains *more oriented towards non-life insurance, which accounted for about 88.98% of total premiums. The rest is shared by life insurance (10.34%) and re-insurance (0.67%). In terms of market share, gross written premiums of voluntary and compulsory insurance share 48.1% and 51.9% of the total market. Paid claims increased by about 32.6% in 2010, with motor insurance paid claims, gross, having the largest share, ALL 1,908 million or 83.2% of total paid claims, gross. As a result, claim/premium ratio, which also measures the insurance market penetration in the financial system, rose to 27.9% on a national level, compared to 21.9% in 2009.*

Chart 36 Share of insurance companies' asset items



Source: AFSA, Bank of Albania

As at 2010 Q3, insurance sector's assets[4] amounted to ALL 16.7 billion, up slightly by ALL 263 million or 1.6% from the previous quarter. "Deposits, certificates of deposits and accounts with banks" have the largest share in total insurance companies' assets (47.7%), followed by "real estate investments" (9.9%) and "technical provisions" (6.6%).

Capital to total assets ratio, which measures the insurance companies' capitalization, dropped slightly to 54.1% in 2010 Q3 from 54.9% in Q2. It was, however, higher than the corresponding period in 2009, when it stood at 49.2%. Capital to technical provisions ratio is another indicator that measures the capacity to cover the losses arising from the exposure to potential risks. As at 2010 Q3, it stood at 140.4% compared to 144% in Q2 and 124.6% in the corresponding period in 2009. The increase in this indicator signals higher absorption of losses arising from the insurance activity.

As at 2010 Q3, insurance companies' profit amounted to about ALL 843 million, up ALL 113 million or 15.4% from the same period in 2009. The higher profit was also reflected in the two return indicators, RoA and RoE, which at 2010 Q3 stood at 5% and 9.7%, respectively, from 4.5% and 8.5% in the corresponding period in 2009.

Private supplementary pension market[5] expanded in January to December 2010 compared to the same period a year earlier. The number of contributors increased to 4,992 at end-2010 versus 4,429 the same corresponding period in 2009. In terms of value, these contributions rose to ALL 111.9 million, up 53.4% from 2009.

ENDNOTES

1 *The data on insurance companies and SLAs refer to 2010 Q3. The data on non-bank financial institutions and supplementary pension funds refer to end-2010 (according to AFSA's release).*

2 *The financial analysis of non-bank financial institutions is based on data of 2010 Q3, according to their latest reporting to the Bank of Albania.*

3 *AFSA – Statistical Bulletin, Year 2010. Released on 25 January 2011.*

4 *The financial analysis presented here is based on data as of 2010 Q3, according to the last reporting of insurance companies to the Bank of Albania.*

5 *AFSA, Publication "Selected data for the voluntary pension market, January-December 2010".*

5.1 GENERAL DEVELOPMENTS IN THE ALBANIAN BANKING SECTOR

5.1.1 ASSETS AND LIABILITIES AND THEIR RESPECTIVE COMPOSITION

As at end-2010, banking sector assets accounted for 80.9% of GDP versus 79.7% at end-H1 and 77.5% at end-2009. Banking sector assets amounted to ALL 990.6 billion, up 6% from June and 11.8% from end-2009.

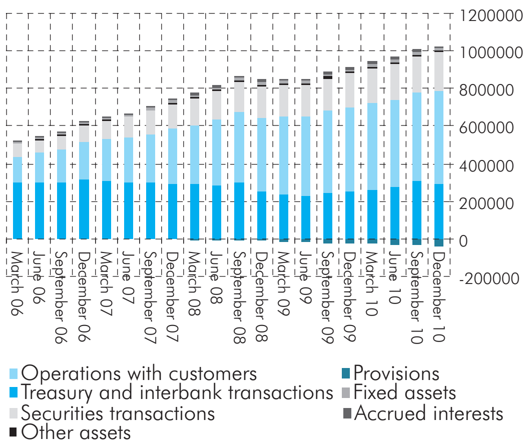
Table 13 shows the composition of banking sector assets and their respective share.

Table 13 Share of asset items (December 2004 – December 2010).

Share in total assets (in %)	December 2004	December 2005	December 2006	December 2007	December 2008	December 2009	December 2010	In billions of ALL (December 2010)
1. Treasury and interbank transactions, of which:	72.4	58.8	50.6	39.5	30.1	28.7	29.9	296.2
- Transactions with the Central Bank	8.7	9.3	8.9	9	8.3	7.8	8.3	82.2
- T-bills	45.8	35.3	26.3	17.1	12.8	12	10.4	103.0
- Transactions with other banks	15.6	12.2	13.2	11.2	6.6	6.5	9.28	91.9
2. Operations with customers (gross)	16.4	25.7	31.7	39.4	47.6	50.8	49.11	486.5
Provisions*	(0.46)	(0.36)	(5.45)	(6.24)	(1.51)	(2.83)	(3.77)	(37.4)
3. Securities transactions	7	12.2	14.7	18	20	20.1	21.27	210.6
4. Other assets	0.8	0.7	0.9	1.3	1	0.9	0.92	9.1
5. Fixed assets	1.9	1.5	1.5	1.5	1.8	1.7	1.4	13.8
Accrued interests (total)	2.13	1.60	1.27	1.32	1.30	1.18	1.19	11.7
Total assets	100	100	100	100	100	100	100	990.6

** Only the volume of reserves reflected on the asset-side with a negative sign.*
Source: Bank of Albania

Chart 37 Assets items, in millions of ALL



Source: Bank of Albania

In terms of the composition of banking sector assets, we note:

- The loan portfolio (excluding accrued interests[45]) amounted to ALL 486.5 billion, up 4.5% versus H1 and 9.1% versus 2009. Foreign currency-denominated loans account for about 69.8% of total loans.
- Treasury and interbank transactions (excluding accrued interests) amounted to ALL 296.2 billion, up 7.5% versus H1 and 16.5% versus end-2009;
- Banking sector's investments in public and private, national and foreign, debt securities amounted to ALL 210.6 billion, up 9.6% versus H1 and 17.8% versus 2009. Investments in the debt securities of the Government of the Republic of Albania with an initial maturity of more than 1 year account for 87.1% of total investment value.

Chart 37 shows the composition and performance of banking sector assets.

[45] Estimated at about ALL 4.4 billion.

Table 14 shows the composition of banking sector liabilities and their respective share.

Table 14 Share of liabilities (December 2004 – December 2010)

Share in total liabilities (in %)	December 2004	December 2005	December 2006	December 2007	December 2008	December 2009	December 2010	In billions of ALL (December 2010)
1. Treasury and interbank transactions, of which:	4.5	4.1	7.6	5.7	11.8	4.5	6.18	61.2
- Transactions with the Central Bank	0.2	0.2	0.2	0	0.1	0.2	0.05	0.5
- T-bills	0	0	1.4	0.2	2.4	3.6	1.31	13
- Transactions with other banks	4.3	4	4	5.3	9	4.3	4.7	46.5
2. Operations with customers (gross)	88.1	88.1	84.2	84.9	77.3	88.1	81.27	805
3. Other liabilities	1	0.6	0.8	1	1.1	1	0.76	7.5
4. Accrued interests	1.10	0.93	0.86	1.14	1.40	1.22	1.21	12
5. Permanent resources, of which:	6.3	7.2	7.4	8.4	9.6	10.8	10.58	104.8
- Shareholders' equity	6.1	6.6	6.8	7.5	8.6	9.6	9.4	93.1
Total liabilities	100	100	100	100	100	100	100	990.6

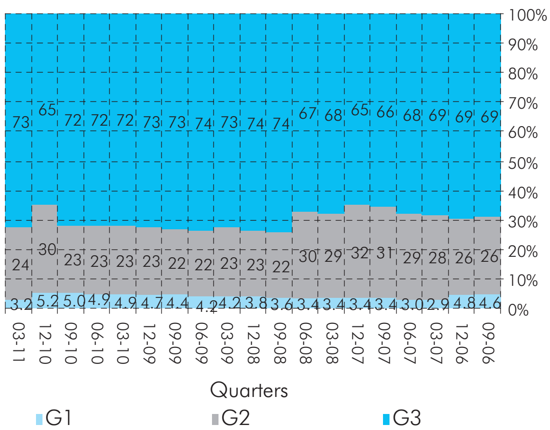
Source: Bank of Albania

In terms of the composition of banking sector liabilities, we note:

- Deposits (excluding accrued interests[46]) amounted to about 805 billion, up 9.3% versus June and 17.7% versus end-2009. Banks peer group 3 account for 66.5% of total deposits;
- "Treasury and interbank transactions"[47] amounted to ALL 61.2 billion. As at end-period, their volume declined ALL 28.7 billion or 31.9% relative to end-2009, due to the improved banks' liquidity position.

As at year-end 2010, the share of banks peer groups (by size of activity) in total banking sector assets was 64.8%, 30% and 5.2%, respectively, for groups 3, 2 and 1 (see Chart 38). The lower share of large banks peer group owes to the decrease in the number of participant banks in this bank peer group at end-2010 from 5 to 4. Chart 38 shows the share of bank assets by banks peer groups.

Chart 38 Share of banks peer groups in total assets



Source: Bank of Albania

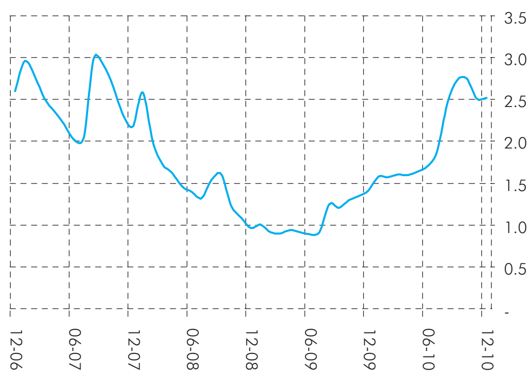
46 *Estimated at about ALL 11.7 billion.*

47 *"Treasury and interbank transactions" include transactions with the Central Bank, T-bills and transactions (borrowings from) with foreign banks (mainly of the banking group they belong to).*

5.1.2 BANKING SECTOR'S POSITION TO NON-RESIDENTS

In order to assess the banking sector's position to non-residents, we need to analyze the performance of banking sector assets and liabilities to non-residents.

Chart 39 Investments in non-resident assets to liabilities to non-residents



Source: Bank of Albania

Chart 40 Banking sector position to non-residents

Source: Bank of Albania

Banking sector investments in non-resident assets amounted to ALL 122 billion, up 16.4% versus H1 and 46.1% versus end-2009. G3 banks account for 70.4% of total investments in non-resident assets. Banking sector placements with non-resident institutions are estimated at ALL 70.6 billion, out of which ALL 63.2 billion are in the form of current deposit accounts and ALL 7.4 billion in the form of loans. Relative to year-end 2009, placements with non-resident institutions grew 26.8%.

Banking sector liabilities to non-residents amounted to ALL 48.4 billion, down 21.3% versus June and 17.9% versus end-2009. Credit lines extended from bank holding companies and the used part are estimated at about ALL 18.9 billion. The committed and unused[48] credit lines extended from bank holding companies are estimated at ALL 36 billion.

The ratio of liabilities to non-residents to total liabilities was estimated at 4.9% at end-2010 H2, compared to 6.6% at end-H1. The pronounced decline of liabilities to non-residents in H2 reflects the lower need for the support of bank holding companies due to the stable growth of deposits and the improved liquidity position with domestic resources. As at end-2010 H2, non-resident assets to total assets rose to 12.3% compared to 11.2% at end-H1. The banking sector has, since September 2009, turned into a net lender to non-residents, thus reflecting the improved financial liquidity.

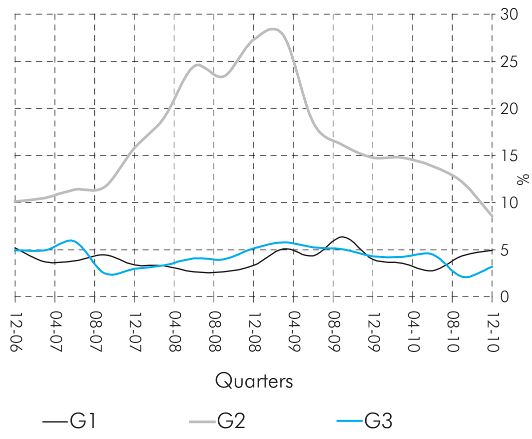
Banks peer group 2, which are more exposed to non-resident institutions, have provided the main impact to the ratio of liabilities to non-residents to total liabilities. However, the situation in the last quarters appears more normal and the ratio has manifested a declining tendency, thus reflecting the financial stability.

[48] *Off-balance sheet item.*

Borrowing from bank holding companies is currently almost always in foreign currency. These funds compete other banks' financing sources in foreign currency, mainly customer deposits in foreign currency. It is, therefore, of interest to know the share of liabilities to non-residents to total liabilities in foreign currency. As at end-2010 H2, it stood at 9.6% versus 13.6% at end-2009 H2. This decline reflects banks' capacity to acquire foreign financing from resident entities, more precisely customer deposits in foreign currency.

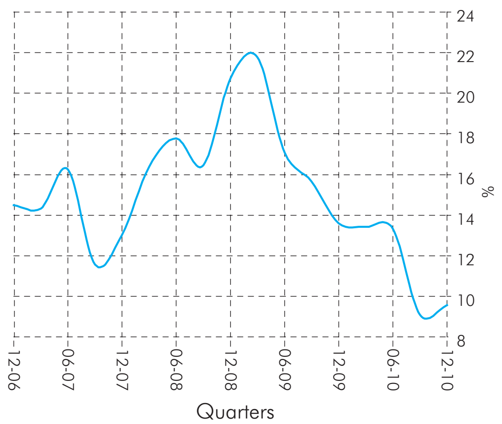
Herfindahl Index in Chart 43 shows the concentration of exposure to non-residents[49]. The banking sector's concentration to non-resident liabilities in 2010 H2 is considered as moderate at 1,700 (or 0.17). Relative to end-2010 H1, the concentration has slightly increased due to the rapid decline of liabilities to non-residents in several banks.

Chart 41 Liabilities to non-residents to total liabilities, by bank peer groups



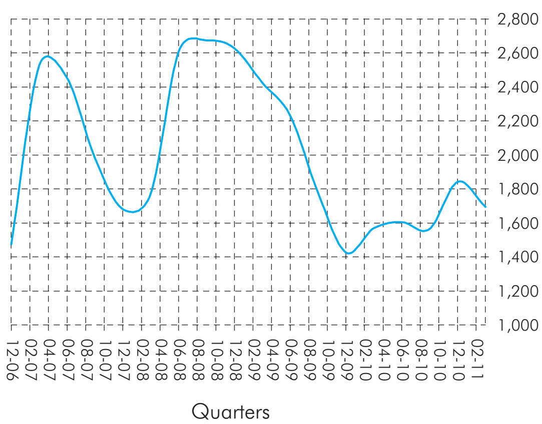
Source: Bank of Albania

Chart 42 Total liabilities to non-residents to total liabilities in foreign currency



Source: Bank of Albania

Chart 43 Herfindal Index for liabilities to non-residents



Source: Bank of Albania

[49] *A HHI index below 0.01 (or 100) indicates a highly competitive index; 0.1 (or 1,000) = an unconcentrated index; 0.1 – 0.18 (or 1,000 to 1,800) = moderate concentration; above 0.18 (or 1,800) = high concentration.*

BOX 3 BANKING SECTOR PLACEMENTS WITH NON-RESIDENT FINANCIAL INSTITUTIONS

Operational data provide information about the composition of placements by country, currency and type of institution.

Concerning their geographical distribution, placements with Austria have the main share in the total (20%), followed by placements with non-resident institutions in Italy (16%), Germany (13.9%) and Turkey (12.6%). Placements with financial institutions in Greece, Belgium, France, Great Britain and the U.S. have a smaller share.

With respect to currencies, placements in Euro account for about 71.7% of the total, followed by the US dollar (20.8%) and the British pound (6.9%). Placements in other currencies have a relatively negligible share.

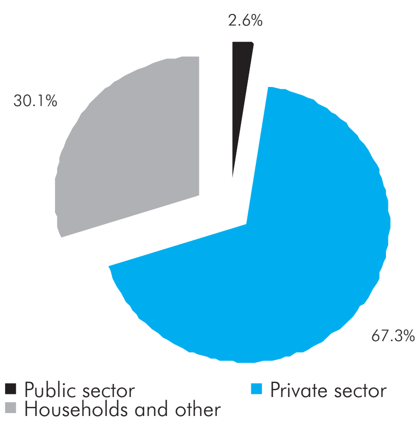
As at end-December 2010, placements with bank holding companies accounted for 8.6% of total placements with non-resident financial institutions, increasing slightly relative to end-2010 H1. The main currency used in placements with bank holding companies is the Euro (80.2%), followed by the US dollar (18.8%).

5.1.3 OUTSTANDING LOANS

As at end-2010 H2, banking sector's outstanding loans amounted to ALL 486.5 billion[50], up ALL 21.1 billion or 4.5% from H1. It is estimated that outstanding loans account for about 40% of Albania's GDP.

The growth of outstanding loans mainly attributes to the increase in Lek loans by about ALL 7.6 billion or 5.4%, and in Euro loans by about EUR 125.5 million or 6.4%. US loans have declined USD 14.8 million or 4.5%. Loans denominated in other foreign currencies have also declined ALL 354.3 million or 29.8%.

Chart 44 Distribution of loans, December 2010



Source: Bank of Albania

As at end-2010, outstanding loans in foreign currency and in Lek had a respective share of 69.8% and 30.2%, thus without undergoing any substantial changes from the previous corresponding period.

Short-term loans amounted to about ALL 158.9 billion or 32.4%; medium-term loans to about ALL 101.4 billion or 20.6%, and long-term loans to about ALL 230 billion or 46.8%. The three types of loans by maturity showed slight changes compared to end-2010 H1.

Chart 44 shows the distribution of outstanding loans by public sector, firms and households.

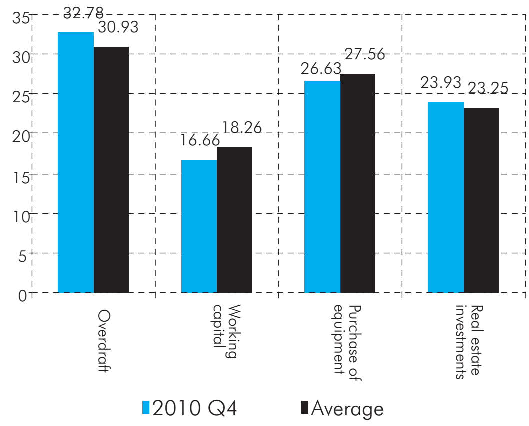
50 Including accrued interests, the loan portfolio amounted to ALL 490.8 billion.

As at end-2010 H2, outstanding loans to businesses[51] were estimated at ALL 330.4 billion, up ALL 22 billion or 7.1% from 2010 H1. Outstanding loans to households amounted to ALL 142.2 billion, up ALL 3 billion or 2.2% for the same corresponding period.

Charts 45 and 46 show the composition of loans to businesses and households by purpose of use, and their comparison to the average of 2007-2010.

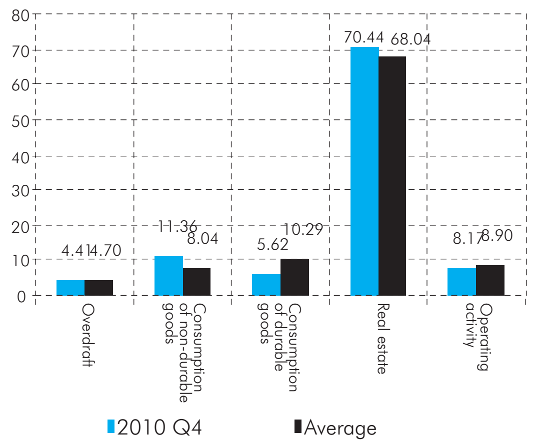
With respect to the distribution of loans to the two main sectors, businesses and households, over the course of the last three years, outstanding loans to businesses in the form of overdraft has had the largest share. Loans for working capital purposes

Chart 45 Distribution of outstanding loans to businesses



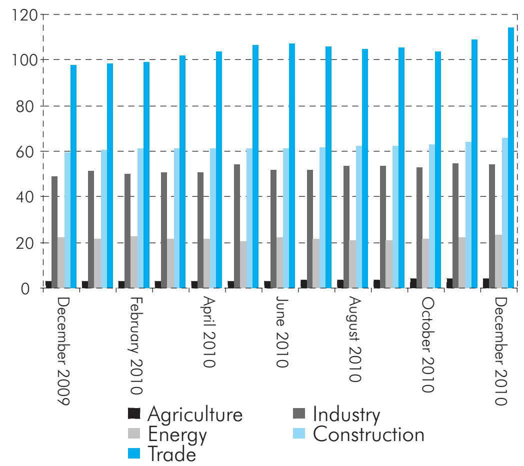
Source: Bank of Albania

Chart 46 Distribution of outstanding loans to households



Source: Bank of Albania

Chart 46.1 Distribution of outstanding loans by sectors of economy



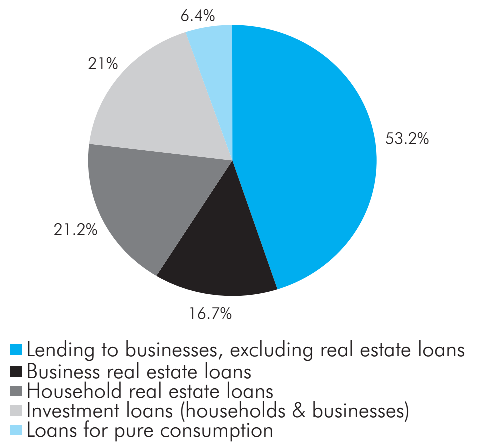
Source: Bank of Albania

have reduced their share in total outstanding loans to businesses. Concerning household loans, there has been a shift to loans for the consumption of non-durable goods, a substantial decline in the share of loans for the consumption of durable goods, and an increase in the share of loans for real estate purposes.

As at end-2010 H2, consumer loans, identified as loans to households in the form of overdrafts for the consumption of durable and non-durable goods, are estimated at ALL 30.4 billion or as much as 6.4% of total loan portfolio, 21.4% of the household loan portfolio and 2.5% of Albania's GDP. Loans for investment purposes (purchase of equipment and operating activity) are estimated at ALL 99.6 billion or 21% of total loan portfolio and 8.1% of

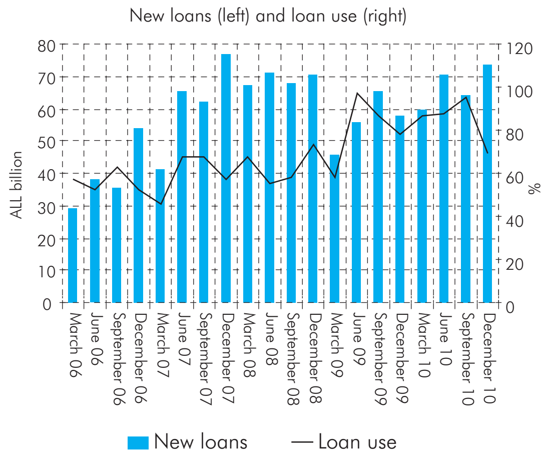
[51] *It includes lending to residents, excluding accrued interest, and lending to non-bank financial institutions.*

Chart 47 Distribution of total outstanding loans



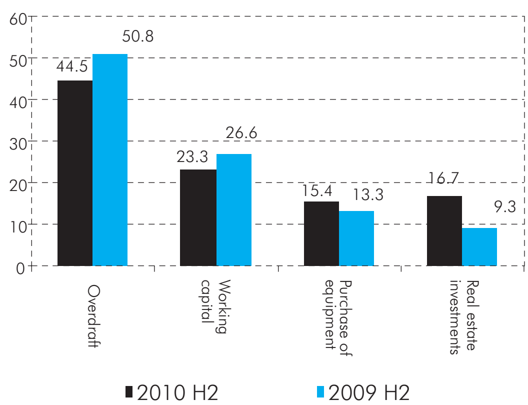
Source: Bank of Albania

Chart 48 New loans and loan use



Source: Bank of Albania

Chart 49 New business loans by purpose of use, in %



Source: Bank of Albania

GDP. Loans for real estate investment purposes, to businesses and households, amounted to ALL 179 billion or 14.6% of Albania's GDP.

BOX 4 NEW LOANS[1]

In 2010 H2, the banking sector's new loans amounted to ALL 137.8 billion, up ALL 14.4 billion or 11.6% from the same corresponding period in 2009. For the same period, collected loans amounted to ALL 112.7 billion compared to ALL 101.6 billion in the same corresponding period in 2009. The ratio of collected loans to extended loans represents the loan use indicator. As at 2010 H2, this ratio stood at 81.8% versus 82.4% at end-2009 H2[2]*.*

In terms of users, in 2010 H2, businesses were extended a total of ALL 117.4 billion new loans or 85% of total new loans. Households were extended ALL 20.4 billion or 15% of total new loans.

Chart 48 shows the performance of new loans and loan use indicator.

In 2010 H2, new business loans by purpose of use were distributed as follows: about 44.5% (compared to 50.8% in 2009 H2) were new overdraft loans; 23.3% (compared to 26.6% in 2009 H2) were new working capital loans; 15.4% (compared to 13.3% in 2009 H2) were new loans for investment in purchase of equipment; and 16.7% (compared to 9.3% in 2009 H2) were new loans for real estate investment. Compared to the same corresponding period in 2009, in 2010 H2, new business loans for overdraft and working capital purposes seem to have shifted to new loans for investment in purchase of equipment and real estate.

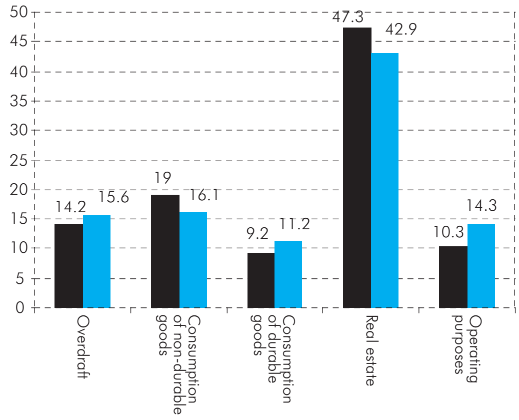
Concerning households, the distribution of new loans by purpose of use attests to the following main developments: higher share of new loans for the consumption of non-durable goods and real estate; and lower share of new loans for the other three types of loans by purpose of use: overdrafts, consumption of durable goods and operating activity.

In terms of currency, as at end-2010 H2, new loans denominated in the Albanian Lek and Euro increased 11.4% and 16.6% to ALL 50.6 billion and ALL 80 billion. The share of new loans denominated in US dollar declined 23.4% to ALL 7.2 billion.

In terms of maturity, there has been a shift of new loans to long-term loans, whose share rose to 22.3% compared to 14.8% in the same corresponding period in 2009.

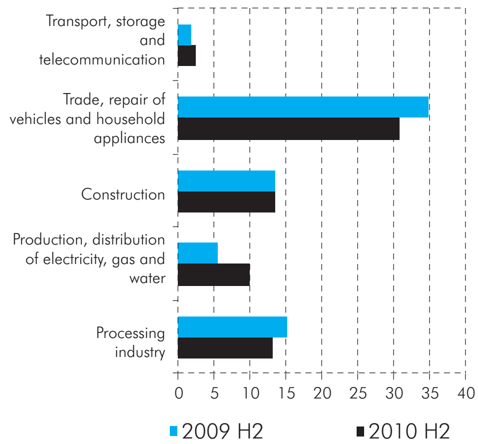
In 2010 H2, the banking sector has financially supported almost all the sectors of the economy. The analysis of the distribution of new loans by main sectors of the economy shows that: first, the share of new loans to the sector of production and distribution of energy, gas and water has increased to 10% from 5.4% in the same corresponding period in 2009; and second, the share of new loans to the sector of trade, repair of vehicles and home appliances has decreased to 31% from 35% in the same corresponding period in 2009.

Chart 50 New household loans by purpose of use, in %



Source: Bank of Albania

Chart 51 New loans by sector of economy, in %



Source: Bank of Albania

ENDNOTES

1 *New loan data are derived from the URS forms designed for monetary policy purposes, which consider lending to residents, excluding accrued interests, and lending to non-bank financial institutions.*

2 *Compared to the previous year, collected loans grew 10.9% compared to the new loans growth by 11.6%, which in turn gave rise to the slight decline in the loan use indicator.*

5.1.4 DEPOSITS

The level and performance of banking sector deposits showed steady growth in 2010 H2. They remain concentrated in the largest banks of the banking sector[52]; however, the degree of their concentration has declined substantially.

As at December, total deposits grew 17.7% from the year-end 2009. Compared to end-June, they grew 9.9%.

	2004	2005	2006	2007	2008	2009	2010 H1	2010 H2
Total deposit growth, in %	13.4	16.4	20.1	19.9	2.4	7.6	7.04	9.9

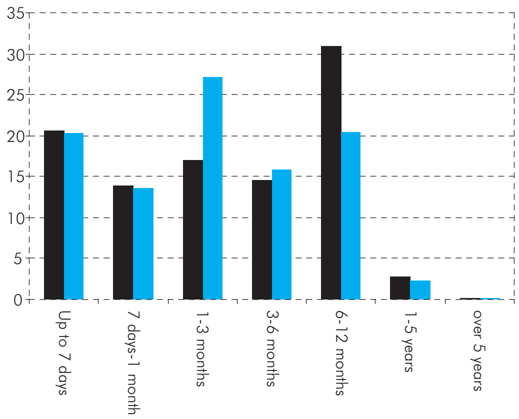
Source: Bank of Albania

Table 15 Annual growth of total banking sector deposits during 2004-2009

52 *The concentration of deposits in the banking system is measured using the Herfindahl Index. As at December 2010, it pointed to 1,502 from 1,525 in June 2010.*

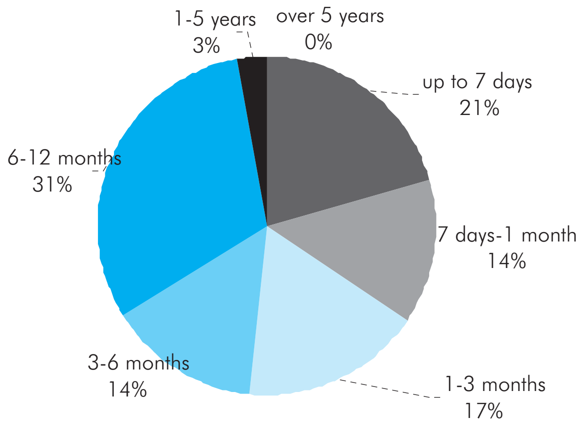
Charts 52 and 53 show the composition of deposits by maturity and change between the two halves of 2010. Deposits of 6-12 month maturity have increased mainly due to the decline in deposits of 1-3 month maturity. The share of deposits of 1-5 year maturity, albeit small, has grown 30% over the period.

Chart 52 Banking sector deposits by maturity (compared to the previous period)



Source: Bank of Albania

Chart 53 Banking sector deposits by maturity, as at end-2010



Source: Bank of Albania

In terms of currency, as at December 2010, ALL deposits accounted for 51.2% of total deposits and amounted to ALL 417 billion. Foreign currency deposits accounted for 48.8% of total deposits and amounted to ALL 399 billion. The share of ALL deposits has dropped by 2.3 pp versus end-June 2010 and 3 pp versus December 2009.

BOX 5 NEW DEPOSITS[1]

New ALL deposits grew in 2010 H2. As at December 2010, new ALL deposits accepted amounted to ALL 369 billion, or as much as 36% higher than new deposits accepted in 2009 H2. Worth noting is that this increase comes at a time when the interest rates on ALL deposits have dropped. More specifically, average interest rate on new ALL deposits was 5.16% in 2010 H2 compared to 5.57% in the same corresponding period in 2009.

In terms of maturity, as at December 2010, the share of new ALL deposits of 3-month maturity dropped 7.7 pp from the same corresponding period in 2009. New ALL deposits of 1-month maturity have increased 11.6 pp.

New EUR deposits amounted to EUR 4.2 billion in 2010 H2, up 16.2% from 2009 H2. Concerning the maturity of new EUR deposits, 1-month deposits continue to dominate, though new deposits of 6 and 12-month maturity have also increased.

Average interest rate on new EUR deposits was 2.16% in 2010 H2 compared to 2.25% in the same corresponding period in 2009.

New USD deposits amounted to USD 643.2 million, up 17.1% from 2009 H2. Deposits of up to 3-month maturity continue to account for almost 80% of total USD deposits.

Average monthly interest rate on new USD deposits was 1.36% in 2010 H2 compared to 1.54% in the same corresponding period in 2009.

Table 16 Share of maturities of new deposits, by currency

	ALL		USD		EUR	
Share of maturities, in %	2009 H2	2010 H2	2009 H2	2010 H2	2009 H2	2010 H2
2-year	1.41	1.41	0.42	0.40	0.47	0.73
1-year	32.06	30.2	19.65	18.57	9.84	13.07
6-month	13.28	11.4	12.34	10.61	5.71	6.42
3-month	21.99	14.27	30.44	17.64	17.62	10.43
1-month	30.9	42.48	36.61	51.97	66.22	69.23

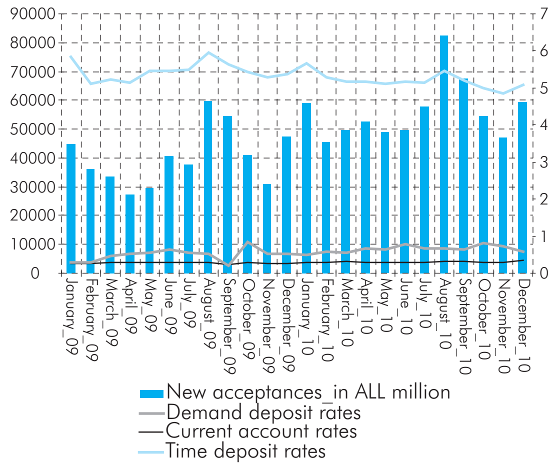
Source: Bank of Albania

New ALL deposits and current accounts in 2010 H2 generally reflected the performance of interest rates. The largest value of new deposits corresponds to the highest interest rate for the period. The fluctuations were not substantial over the course of months, and they reflected stability and an ever-improving situation.

New EUR deposits and current accounts declined and were volatile in 2010 H1 to later become more stable. New USD deposits and current accounts showed a similar performance. Worth noting is that in 2010 H2, flows in both currencies – EUR and USD – were higher than in early 2010.

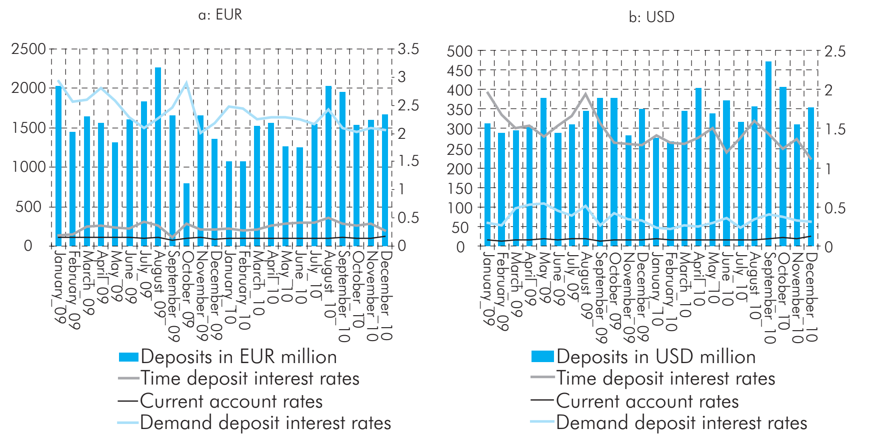
The performance of new deposits in 2010 H2 generally confirms the stable growth of public deposits in the banking sector. This element helps to improve the structure of financial resources in the banking sector and the efficiency of financial intermediation.

Chart 54 Total volume of new ALL deposits against average interest rates on current accounts and ALL time and demand deposits



Source: Bank of Albania

Chart 55 Total volume of new foreign currency deposits against average interest rates on current accounts, and EUR and USD time and demand deposits



Source: Bank of Albania

ENDNOTE

[1] Current accounts, first-time time and demand deposits and redeposits.

5.1.5 CAPITAL

As at year-end 2010, "Permanent resources"[53] totalled ALL 104.8 billion, thus maintaining their upward trend. Their main item, "Shareholders' equity", amounted to ALL 93.1 billion at end-period, up ALL 8.3 billion or 9.8% from year-end 2009. Shareholders' equity accounted for 9.4% of total assets compared to 9.6% in 2009. Banks peer group 3 accounted for 64.4% of total banking sector's shareholders' equity.

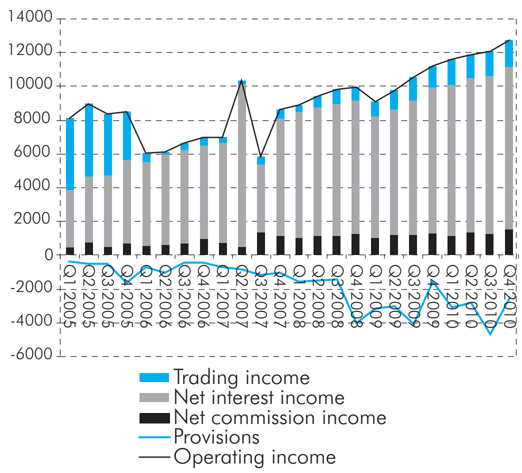
Paid-in capital totalled ALL 70.7 billion, up ALL 9.9 billion or 16.2% from year-end 2009, due to the injection of capital in several banks in the system. It accounted for 7.1% of total assets compared to 6.9% at end-2009.

5.1.6 PROFITABILITY AND EFFICIENCY IN USING RESOURCES

As at year-end 2010, average earning assets rose to ALL 855.4 billion, accounting for about 91.1% of banking sector's total average assets. This indicator was almost similar to end-June 2010 and end-2009. Average paying liabilities to average earning assets stood at 92.9%, almost similar to June 2010 and 1.2 pp higher than at end-2009.

Banking sector's operating income[54] amounted to ALL 44.2 billion or 16.1% higher than in 2009. Operating expenses[55] were ALL 23.5 billion or up 7.9% from 2009. As a result, the ratio of operating costs to income was 53.3%, almost similar to June 2010 and lower than in 2009 (57.2%). General operating expenses[56] to income was 85.7% compared to 80.9% in June 2010 and 94.5% in 2009. The performance of these ratios confirms banks' efforts to offset the increase of provisioning expenses (and other reserves) by reducing operating costs.

Chart 56 Selected operating income components



Source: Bank of Albania

Chart 56 shows the composition of the banking sector's operating income, which is expressed as the sum of net interest income, net commission income and net trading income.

As at year-end 2010, the banking sector's net profit was positive at ALL 6.7 billion, almost twice higher than in 2009. However, the banking sector's profit remains concentrated in the largest banks. Annualized Return on Assets (RoA) is estimated at 0.72% versus 0.42% the same period the previous year. Annualized Return on Equity (RoE) is estimated at 7.6% versus 4.6% the same period in 2009.

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[53] *It includes the capital (shareholders' equity, retained earnings/loss, the year's profit/loss), reserves (general, specific), revaluation, etc.*

[54] *Net interest income plus other net income.*

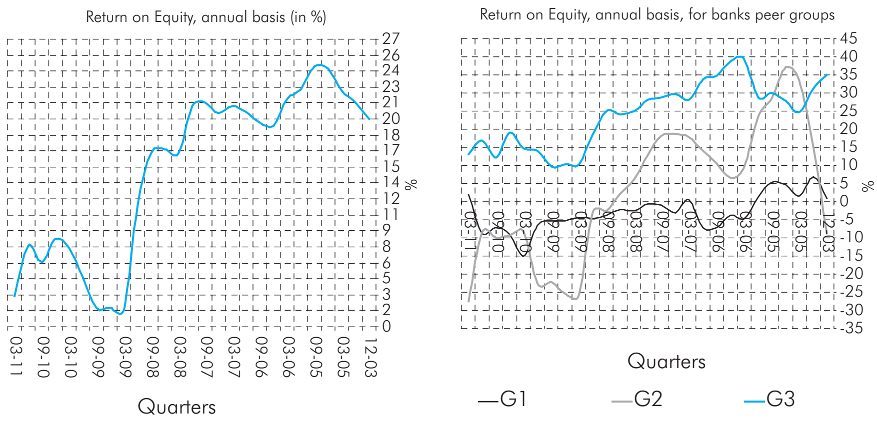
[55] *Excluding provisioning expenses.*

[56] *Operational costs plus provisioning expenses and other reserves.*

Chart 57 Return on Equity (RoE)

a. RoE for the banking sector

b. RoE for banks peer groups

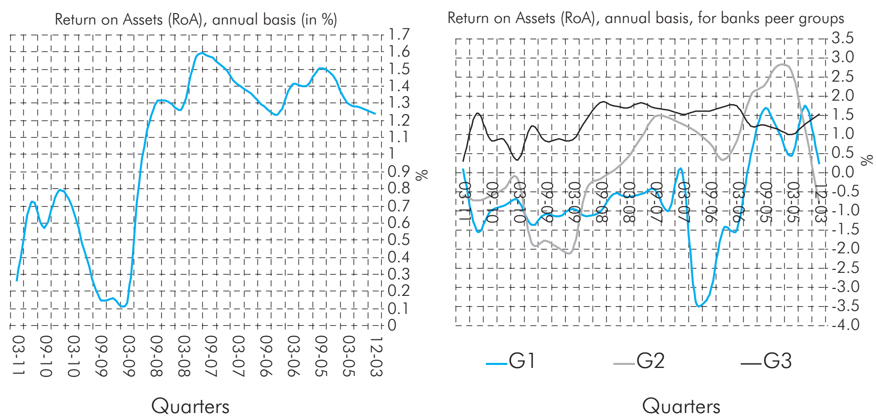


Source: Bank of Albania

Chart 58 Return on Assets (RoA)

a. RoA for the banking sector

b. RoA for banks peer groups



Source: Bank of Albania

BOX 6 DECOMPOSITION OF ROE ACCORDING TO DUPONT MODEL[1]

The following decomposes the RoE 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 17 shows the decomposition of RoE by components through 2003-2010.

Table 17 RoE components through 2003-2010

	2003	2004	2005	2006	2007	2008	2009	2010
Return on Equity (in %), RoE= EAT/BVE	19.53	21.10	22.43	20.17	20.32	11.4	4.58	7.58
Return on Assets (in %), RoA= EAT/TA	1.24	1.28	1.41	1.36	1.48	0.92	0.42	0.72
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	5.39
Asset Utilization (in %), AU=TOI/TA	8.66	8.08	8.15	7.70	8.24	8.79	12.79	13.26
Equity Multiplier (in times), EM=TA/BVE	15.78	16.54	15.96	14.82	13.74	12.49	10.99	10.60
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	13.26
Expenses Ratio (in %), ER=TOE/TA	7.42	6.80	6.75	6.34	6.76	7.87	12.37	12.55
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	4.32
Earning Assets Ratio (in %), EAR=EA/TA	95.85	94.80	93.33	93.19	93.34	93.12	91.30	91.12
Banks Burden (in %), B=NNII/TA	(1.11)	(0.93)	(1.45)	(1.69)	(1.62)	(1.69)	(1.75)	-1.67
Loan Loss Provisions to Total Assets (in %), LLP/TA	0.25	0.26	0.19	0.48	0.53	1.06	1.39	1.39
Taxes to Total Assets (in %), T/TA	0.50	0.45	0.46	0.41	0.44	0.18	0.12	0.16
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	8.11
Cost of Liabilities (in %), COL=IE/PL	5.23	4.14	3.28	3.05	3.70	4.31	4.43	4.07
Liabilities to Earning Assets (in %), LEA=PL/EA	92.47	93.80	94.36	92.90	91.15	91.58	91.71	92.93

Source: Bank of Albania

List of abbreviations:

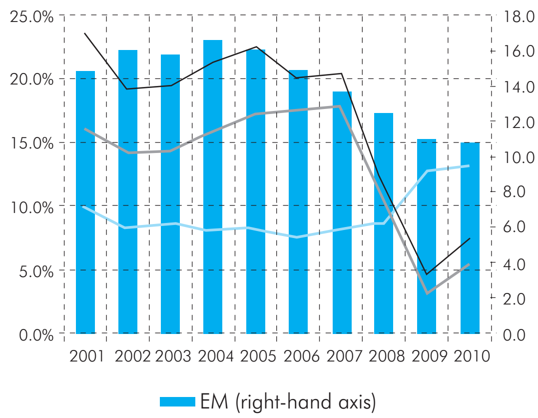
AU = Asset Utilization	T = Taxes
EM = Equity Multiplier	REA = Return on Earning Assets
TOE = Total Operating Expenses	COL = Cost of Liabilities
PM = Profit Margin	LEA = Liabilities to Earning Assets
ER = Expenses Ratio	IE = Interest Expenses
NIM = Net Interest Margin	II = Interest Income
NII = Net Interest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

From the analysis of the above-mentioned indicators, we note:

- Profit margin (earnings after taxes/total operating income) increased to 5.4% in 2010, but it still remains low compared to the pre-crisis period. This was triggered by the increase in earnings after taxes by 89% (against 2009), whilst total operating income increased by only 14.5%. This means that the net profit accounts for a larger share of net income than in 2009.

- Asset utilization, which stood at 13.3% in 2010, up 0.5 pp versus 2009, shows that a higher level of net income has been generated from the use of assets. Since net incomes are formed by the sum of net interest income and net non-interest income, we note that the increase in net interest income is higher than the deepening of the negative value of net non-interest income.

Chart 59 Graphical display of RoE components



Source: Bank of Albania

- Worth noting is that the cost of borrowed funds declined in 2010. This means that interest expenses (mainly on customer deposits) have declined as a ratio to paying liabilities, thus providing evidence for lower costs for banks to provide assets.

- Net interest margin (NIM) is the ratio of net interest income to earning assets and it has been another factor to have triggered the increase in RoE. The higher growth rate of net interest income (+18%) than earning assets (+10%) provides evidence for a more efficient banking system as far as financial intermediation is concerned.

In conclusion, the performance of RoE components attests to a more efficient banking system in using resources. Against this background, the main factors to have triggered the increase in RoE are:

1. The net interest margin: Higher efficiency in financial intermediation.
2. The decline in the cost of borrowed funds: Banks have had less interest expenses than paying liabilities, which in turn supports paragraph 1 with respect to financial intermediation.

These two factors have triggered the increase in asset utilization, thus generating more net income for each asset unit.

ENDNOTE

[1] 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.

6. MONITORING RISKS THE ALBANIAN BANKING SECTOR IS EXPOSED TO

6.1 MARKET RISKS

6.1.1 EXCHANGE RATE RISK

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

As at end-2010, banking sector assets denominated in foreign currency amounted to ALL 525.6 billion, up 9.7% from H1 and 18.1% from year-end 2009. Banks peer group 3 accounted for 66.3% of total assets in foreign currency. Foreign currency liabilities amounted to ALL 505.2 billion, up 9.4% from H1 and 16.6% from year-end 2009. Banks peer group 3 accounted for 57.4% of total liabilities denominated in foreign currency.

Banking sector assets denominated in foreign currency accounted for about 53.1% of total assets, up 2.9 pp from end-2009. Banking sector liabilities in foreign currency accounted for about 51% of total assets, up 2.1 pp from end-2009. The gap between assets and liabilities denominated in foreign currency reached the peak of the recent years, 2.05 pp, although it is still considered low.

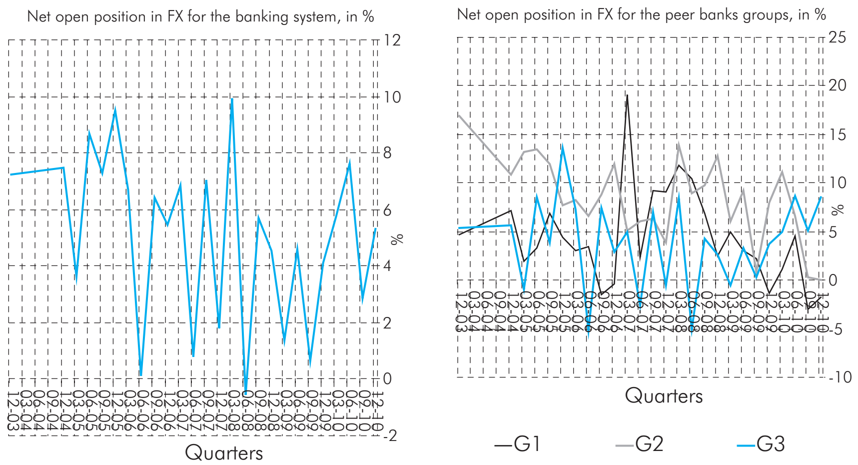
Table 18 Share of assets and liabilities in foreign currency in total banking sector assets, in % (December 2005 - June 2010)

Share in total banking sector assets, in %			
Period	Foreign currency assets	Foreign currency liabilities	Gap (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	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	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	0.6
June	48.4	47.5	0.9
September	49.5	48.3	1.2
December 2009	50.2	48.9	1.3
March 2010	50.9	49.3	1.6
June 2010	51.3	49.4	1.9
September 2010	52	50.2	1.8
December 2010	53.05	51	2.05

Source: Bank of Albania

As at end-December 2010, the net open position in foreign currency accounted for about 5.3% of banking sector's Tier 1 capital. This indicator remains in the "long position" and within the 0-10% range of the recent years.

Chart 60 Exposure to exchange rate risk for the banking sector and banks peer groups



Source: Bank of Albania

The magnitude of the open position is considered limited; therefore, the exchange rate risk for banks is moderate. In terms of banks peer groups, G1 banks shifted to a short position in the last months of 2010, while G3 banks deepened their long position.

BOX 7 MODIFIED CURRENCY MISMATCH INDEX

This index is a new indicator based on the methodology provided by the IMF experts, Romain Ranciere, Aaron Tornell and Athanasios Vamvakidis in their working paper entitled "A New Index of Currency Mismatch and Systemic Risk". This index enables a more complete measurement of bank exposure to exchange rate risk. Unlike previous indices, the index provided by Ranciere, Tornell and Vamvakidis takes into account the indirect credit risk through the exchange rate, which increased considerably during the financial crisis.

The authors use the following formula to measure this index:

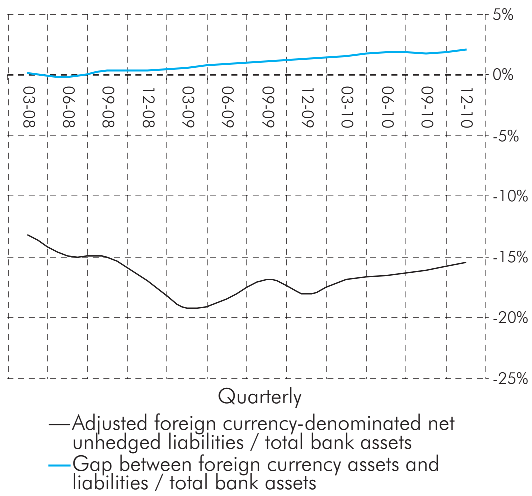
Foreign currency-denominated net unhedged liabilities/total bank assets = {[foreign currency foreign liabilities + foreign currency domestic liabilities] – [foreign currency foreign assets + foreign currency domestic assets] + [foreign currency lending to unhedged households + foreign currency lending to unhedged nonfinancial firms]} / [total bank assets]

This formula is the difference between foreign currency assets and liabilities, plus foreign currency lending to unhedged borrowers, which is later calculated as a percentage to total assets. In the Financial Stability Reports, this difference has been derived by subtracting liabilities from assets. We have, therefore, tried to use *the same logic by making some changes to the formula. The absolute values of currency mismatches remain the same but the sign changes to "negative". In this way, it comes out more clearly that foreign currency liabilities are higher than foreign currency assets (since the latter are adjusted/reduced for the amount of unhedged borrowing). In this case, the exchange rate depreciation would have a negative impact on bank's balance sheet, which would then add to the indirect credit risk effects, and later on, might affect the liquidity situation.*

The new formula has transformed into the following:

Transformed foreign currency-denominated net unhedged liabilities/total bank assets = {[foreign currency foreign assets + foreign currency domestic assets] – [foreign currency foreign liabilities + foreign currency domestic liabilities] – [foreign currency lending to unhedged households + foreign currency lending to unhedged nonfinancial firms]} / [total bank assets]

Chart 61 Currency Mismatch Index

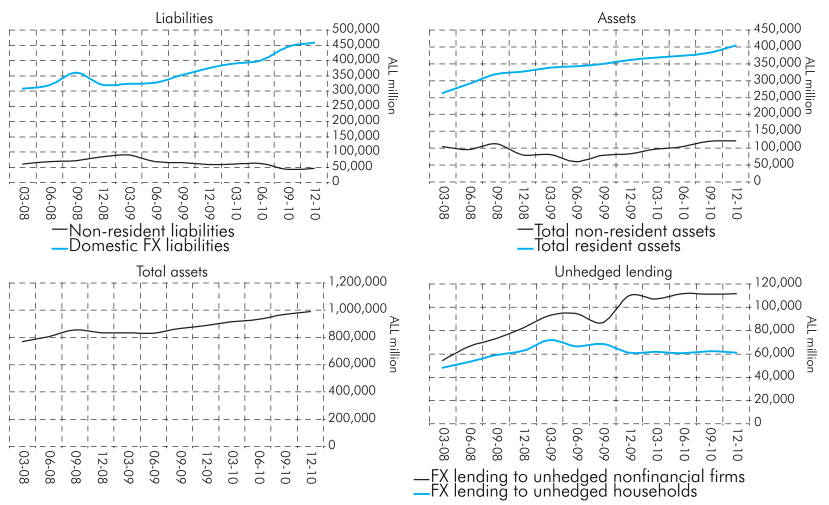


Source: Bank of Albania, FSD's estimations

Chart 61 shows the quarterly performance of this index for the banking system. In 2010 H2, the index improved to -15.4% from -16.6% at end-June. In March 2009, it reached the peak of -19.2% (the absolute value shows the magnitude of exposure). The index has improved due to the recovery of the financial and economic situation in Albania and the more stable exchange rate. Unhedged loans were the key indicator to have affected this performance. In 2008 H2 and 2009 H1, they increased by 21% and 11.2%, respectively. In addition, over the same corresponding period, total bank assets have declined, thus deteriorating the index.

Charts 61 and 62 shows the performance of the currency mismatch index and its components through 2008-2010.

Chart 62 Components of Currency Mismatch Index



Source: Bank of Albania, FSD's estimations

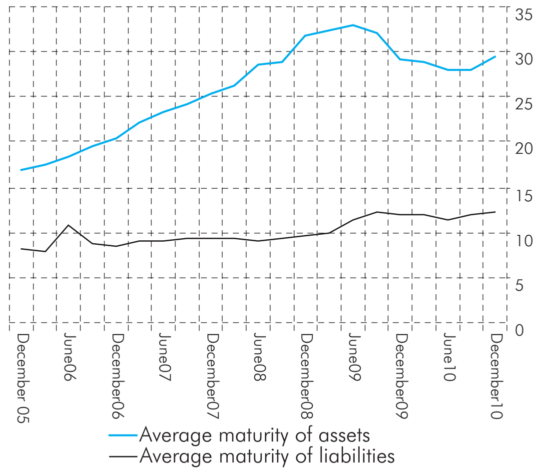
6.1.2 INTEREST RATE RISK

COMPOSITION BY MATURITY TERM

As at end of 2010 H2, banking sector assets had an average remaining maturity[57] of 29.5 months, from 28 months at end-2010 H1. For the same corresponding period, banking sector liabilities had an average remaining maturity[58] of about 12.1 months from 11.4 months at end-H1. Chart 63 shows the average remaining maturity of assets and liabilities.

The maturity gap between assets and liabilities widened in 2010 H2 due to the increase in the remaining maturity of loans by about 1 month compared to the increase in the remaining maturity of deposits by about 0.8 months.

Chart 63 Average remaining maturity of assets and liabilities, in months



Source: Bank of Albania

As at end-2010 H2, the average remaining maturity of loans[59] was 44.5 months compared to 43.4 months in H1. For the same corresponding period, the average remaining maturity of deposits[60] was 4.9 months compared to 4.15 months at end-H1.

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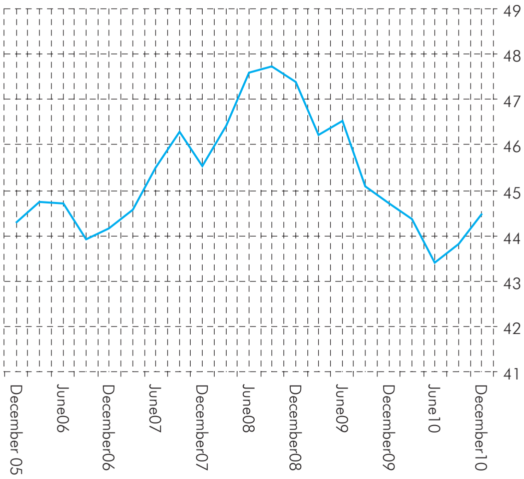
[57] *The weighted average of the assets' distribution is calculated based on the reported maturity terms. For each interval, the mid-value is taken "a priori". Specifically, the interval which includes the "0-7 days" remaining maturity assets, the average duration considered is 3.5 days; for the one 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).*

[58] *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, the interval which 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.*

[59] *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, the interval which 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.*

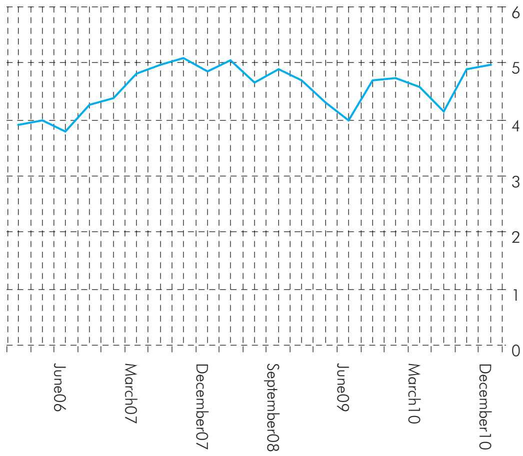
[60] *The weighted average of the deposits' distribution is calculated based on the reported maturity terms. For each interval, the mid-value is taken "a priori". Specifically, the interval which includes the "up to 7 days" deposits, the average duration considered is 3.5 days; for the "7 days-1 month" 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.*

Chart 64 Average remaining maturity of loans, in months



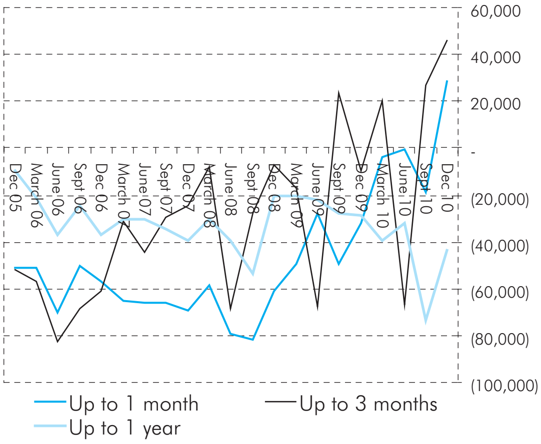
Source: Bank of Albania

Chart 65 Average remaining maturity of deposits, in months



Source: Bank of Albania

Chart 66 Gap between assets and liabilities by repricing period



Source: Bank of Albania

MISMATCH BETWEEN INTEREST RATE-SENSITIVE ASSETS AND LIABILITIES

As at end-2010, interest rate-sensitive assets and liabilities by maturity term were at similar levels. Their gap for "up to 1 month" and "up to 3-month" period was positive at ALL 28.5 and 46.1 billion. Asset and liability gap for "up to 12-month" period was ALL -43.9 billion. Making a general reasoning, "up to 12-month" period means that an increase in the interest rate will cause additional net costs to the banking sector, thus affecting its profit and capital indicators negatively. However, this impact is rather curbed and, according to the sensitivity analysis, which is part of the stress-test exercise, it does not jeopardize the banking sector's capital adequacy.

6.1.3 CREDIT RISK

In order to assess the level of credit risk attached to banking activity, we first make an analysis of the performance of risk-weighted assets as a ratio to total assets[61]. As at end-2010, banking sector's risk-weighted assets[62] amounted to ALL 586 billion, while risk-free assets (0% risk) amounted to ALL 409.7 billion.

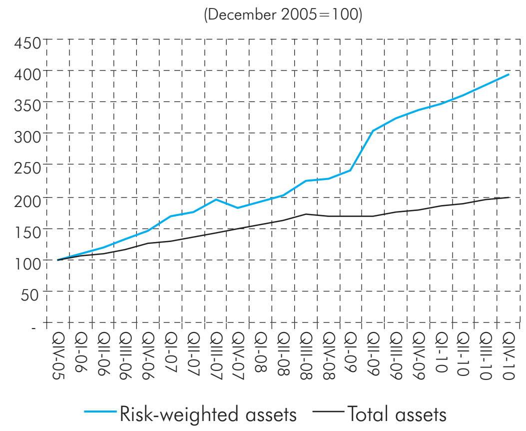
[61] *Total assets and total risk-weighted assets have been presented in the form of a ratio to a base period (in our case, December 2005=100).*

[62] *For the purpose of calculating the CAR, they are weighted by a specific risk coefficient (20%, 50%, 100%, or 150%). In general, risk-weighted assets are dominated by the loan portfolio and they also include investments in debt securities and placements with financial institutions.*

Out of risk-weighted assets, high risk assets[63] amounted to ALL 440.4 billion. Risk-weighted assets were 9.1% higher than end-June 2010 and 16.5% higher than end-2009. They accounted for 59.2% of total assets or 1.7 pp higher than at end-June 2010 and 2.5 pp higher than at end-2009. Their increase compared to the previous year attributes to the increase in assets weighted at the highest risk coefficients (including loans) as a result of the provisions in the regulatory framework.

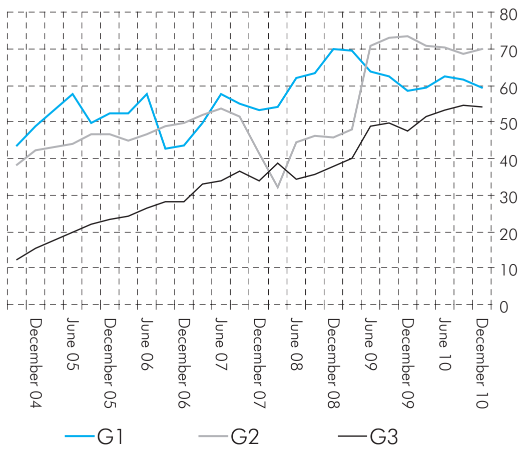
In terms of banks peer groups, the ratio of risk-weighted assets to total assets dropped to 59.2% for G3 banks, from 62.4% in 2010 H1.

Chart 67 Risk-weighted assets in comparison to total asset growth rate



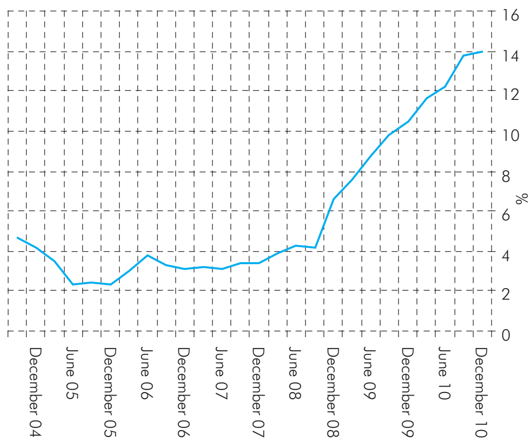
Source: Bank of Albania

Chart 68 Risk-weighted assets by banks peer groups



Source: Bank of Albania

Chart 69 Non-performing loans to total loans



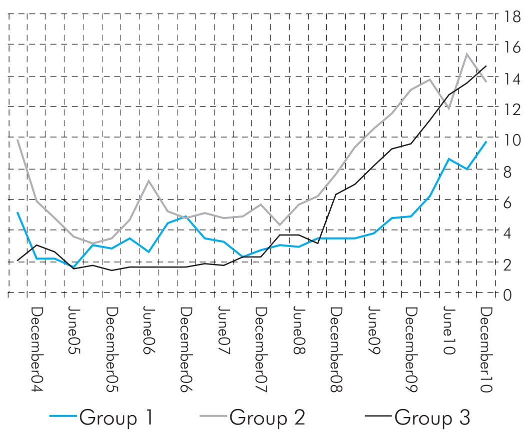
Source: Bank of Albania

As at end-2010, the ratio of non-performing loans to total loan portfolio, on gross basis, rose to 14.0% compared to 12.2% at end-June 2010 and 10.5% at end-2009.

Banking sector's non-performing loans amounted to ALL 68.5 billion, up ALL 11.2 billion or 19.5% from 2010 H1. In terms of credit rating, around 72.5% of total loan portfolio is considered as "standard". There has been a shift of loans to lower quality ratings, such as "substandard loans", "doubtful loans" and "loss loans", whose share rose to 6.2%, 3.7% and 4.1%, respectively, of the loan portfolio, compared to 5.4%, 3.2% and 3.6% in June 2010. Worth noting is that for the first time in the last two years, in December 2010,

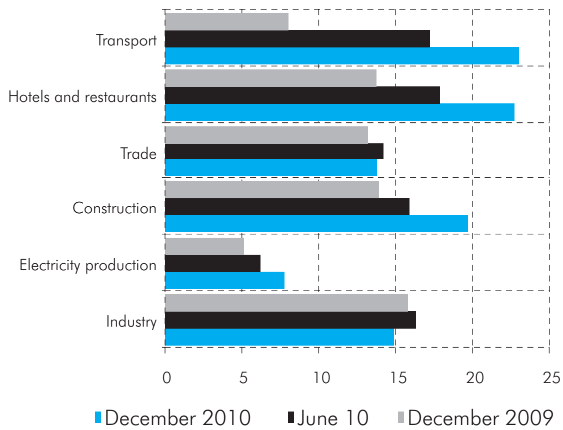
[63] *For the purpose of calculating the CAR, they are weighted by the risk coefficients of 100% and 150%. They are generally represented by loans, including foreign currency lending to borrowers whose income is in Lek.*

Chart 70 Non-performing loans to total loans by banks peer groups



Source: Bank of Albania

Chart 71 Loan portfolio quality by sector of economy, in %



Source: Bank of Albania

non-performing loans declined by ALL 1.1 billion from November 2010. This change may signal the beginning of the recovery in the quality of banking sector credit, which however needs to be confirmed in the periods ahead.

G2 and G3 banks recorded the highest increase in the ratio of "non-performing loans to total loans" relative to end-June 2010, by 1.76 pp and 1.83 pp, respectively, to 13.6% and 14.6%.

The loan portfolio quality worsened for businesses and households. The ratio of non-performing loans to outstanding business and household loans is estimated at 15.5% and 11.7% compared to 13.8% and 10.3% in June 2010. In terms of currency, the loan portfolio quality worsened for both Lek and foreign currency loans. The ratios of "non-performing loans in Lek to outstanding loans in Lek" and "non-performing loans in foreign currency to outstanding loans in foreign currency" were estimated at 14.4% and 13.7%, compared to 12.7% and 11.9% in June 2010.

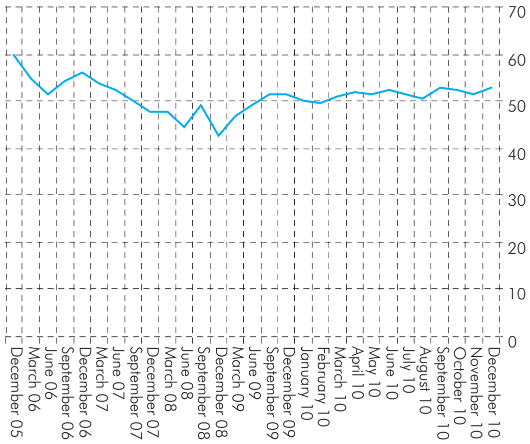
The loan portfolio quality worsened for the sectors of construction, hotels and restaurants, and transportation. More specifically, in December 2010, the share of non-performing loans for these sectors rose to 19.7%, 22.7% and 23%, compared to 15.9%, 17.9% and 17.2% in June 2010, and 13.9%, 13.7% and 8% at end-2009. Chart 71 shows the loan portfolio quality for selected sectors of the economy, showing clearly its declining tendency in 2010 H2.

Outstanding loans in foreign currency when the borrower's income is in Lek amounted to ALL 174.8 billion, accounting for 35.6% of total outstanding loans and about 51% of outstanding loans in foreign currency. In terms of currency, around 89% of this type of loans is in Euro and the rest, 11%, in US dollar. As a percentage of total outstanding loans in foreign currency, the share of this loan in EUR accounts for 45.3% and in US dollar 5.5%. This part of credit represents a potential channel for a negative impact of adverse exchange rate changes on the banking sector. These changes may be also combined with an indirect increase of credit risk as a result of borrower's difficulties in repaying the loan. As at end-2010 H2, the ratio of "non-performing loans in foreign currency, when the borrower is unhedged against the exchange rate risk, to outstanding loans in foreign currency, when the borrower is unhedged against the exchange rate risk" was estimated at 12.5%, compared to 11.5% in 2010 H1[64].

[64] *More specifically, in terms of currency, this ratio in Euro was 13.3% in December 2010, compared to 11.9% in June 2010. For the same corresponding period, this ratio in US dollar declined to 6.5% from 8.1% in June 2010.*

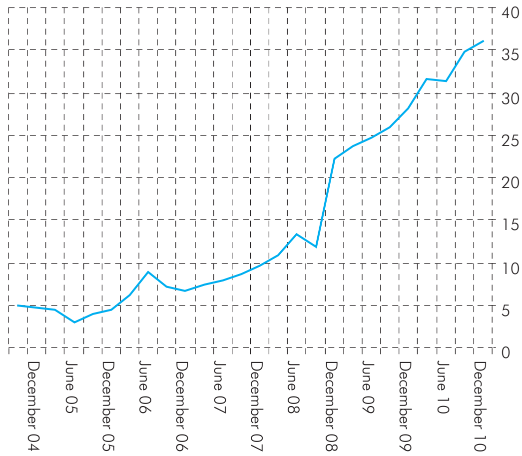
Loan loss provisions rose to ALL 36.1 billion, up 20% from June 2010. The ratio of provisions to non-performing loans reached 52.7% compared to 52.5% at end-2010 H1, and above the three-year average of 49.9%. The ratio of provisions to total outstanding loans rose to 7.4% from 6.3% at end-June 2010 and 5.4% in 2009.

Chart 72 Coverage ratio of non-performing loans with provisions, in %



Source: Bank of Albania

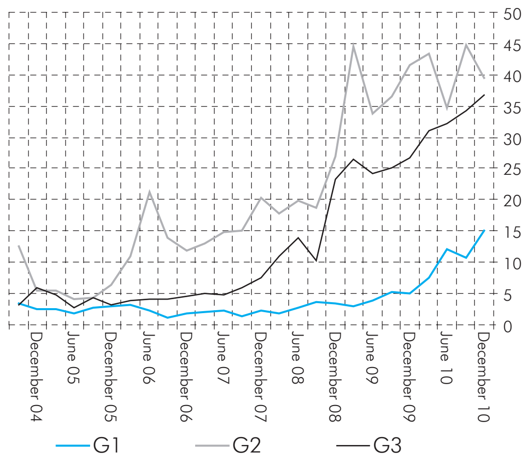
Chart 73 Net non-performing loans to regulatory capital, in %



Source: Bank of Albania

As at end-2010, banking sector's capacity to cover the non-performing loans with capital was weaker. More precisely, "non-performing loans, net, to capital" rose by an average of 4.8 pp versus end-2010 H1 to 36.3%. In addition, the ratio of "non-performing loans, net, to Tier 1 capital" rose to 38.1% from 32.8% in H1. "Non-performing loans, net, to regulatory capital" and "non-performing loans, net, to shareholders' equity" were estimated at 35.9% and 34.8%, respectively, compared to 31.2% and 30.3% at end-H1.

Chart 74 Net non-performing loans to regulatory capital by banks peer groups, in %



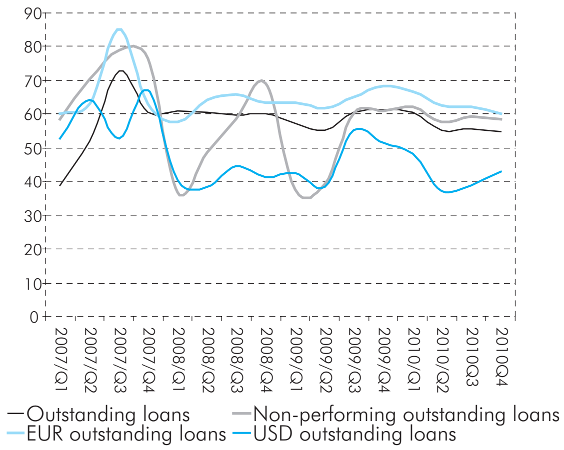
Source: Bank of Albania

In terms of banks peer groups, G2 and G3 banks posted the highest average increase in non-performing loans, net, to regulatory capital. More specifically, for G2 banks, this indicator increased by an average of 5.9 pp from June 2010 to 43.6%. The same indicator for G3 banks increased by 4.4 pp to an average of 35.7%.

As at end-2010, the collateral[65] coverage of non-performing loans was estimated at 79.3% of the loan portfolio compared to 78% in H1.

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

Chart 75 Collateral loans based on real estate, in %

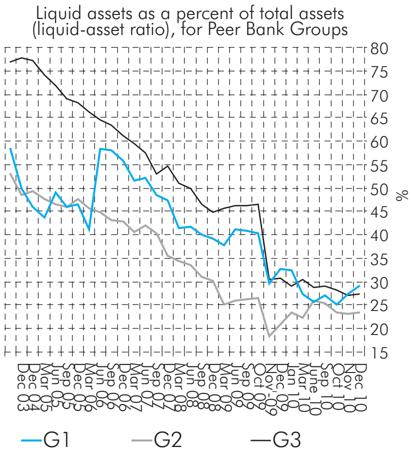


Source: Bank of Albania

6.1.4 LIQUIDITY RISK

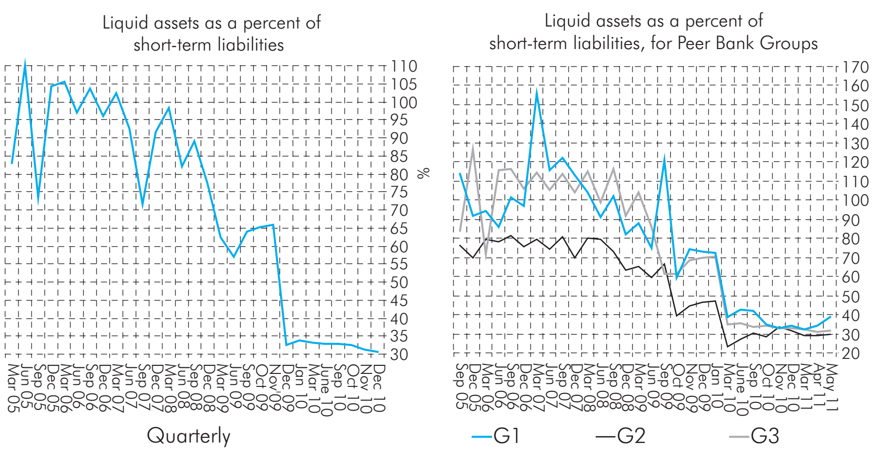
At end-2010, the ratio of liquid assets to short-term liabilities (of up to 1-year maturity) was 30.6%, compared to 32.9% at end-June 2010 and 32.6% in 2009. The regulatory framework sets a minimum threshold of 20% for this ratio. In terms of currency, the ratio is lower for the Euro (15.6%) and higher for the Lek (42.9%). Liquid assets to total assets ratio was estimated at 26%. In terms of banks peer groups, G1 and G2 banks showed a slight decrease of this ratio for both indicators, while for G3 banks they increased by 3.4 pp and 3.5 pp, respectively.

Chart 76 Liquid assets to total assets for the banking sector and banks peer groups



Source: Bank of Albania

Chart 77 Liquid assets to total short-term liabilities for the banking sector and banks peer groups

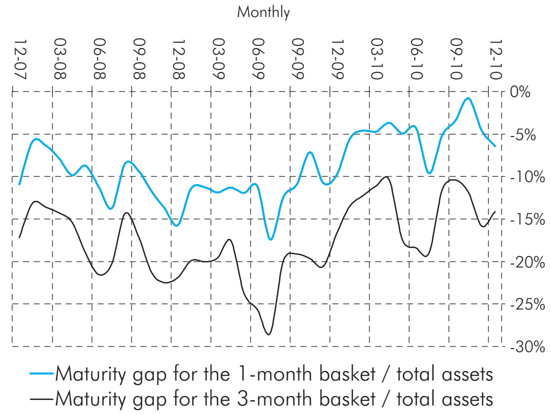


Source: Bank of Albania

The maturity gap between assets and liabilities by maturity structure[66] – for balance sheet and off-balance sheet items – is negative.

These gaps are, however, covered several times by the value of liquid assets, thus providing evidence for the full capacity to pay the obligations when they come due. Nonetheless, the liquidity situation in foreign currency, particularly that in Euro, needs careful monitoring.

Chart 78 Maturity gap for up to 1-month and up to 3-month basket



Source: Bank of Albania

Loan to deposit ratio was estimated at 60.4%, down 3 pp from end-June and 4.8 pp from 2009. The decline in this ratio owes to the slower credit growth rate compared to deposit growth rate, particular that in foreign currency. Loan to deposit ratio for foreign currency was estimated at 86%, down 9.2 pp from end-June and 13.4 pp from 2009. The same ratio for Lek was 35.4%, remaining generally stable throughout the year. Loan to deposit ratio is, however, expected to increase again during the recovery phase of banking sector lending.

Borrowing in the interbank market or from the Bank of Albania is another form of managing the short-term needs for liquidity. This is generally a collateralized-type of borrowing; the type and the adequacy of assets that may serve as collateral is another element that needs careful monitoring in order to assess banks' capacity to meet their short-term liquidity needs.

6.1.5 BUSINESS CAPITALIZATION

Business capitalization represents the long-term stability of the banking sector. In order to assess banks' business capitalization, we monitor regulatory capital and capital adequacy.

At end-2010, regulatory capital[67] rose to ALL 90.2 billion, up 3.5% from June and 10.9% from end-2009. Tier 1 capital rose to ALL 85.1 billion, up ALL 2.2 billion or 2.7% from June 2010, and ALL 8.4 billion or 11% from end-2009. Tier 1 capital accounts for 94% of regulatory capital, thus providing evidence for the high share and quality of the liquid part of the banking sector capital.

At end-2010, capital adequacy ratio (CAR), which measures the coverage ratio of risky banking sector activities with capital, was estimated at 15.4%, about 0.8 pp lower than in June and in 2009. The regulatory framework

[66] *Assuming assets and liabilities are held to maturity.*

[67] *It is a supervisory concept that is composed of Tier 1 capital and supplementary capital. It consists of paid-in capital, reserves, undistributed profit, profit for the financial period, subordinated liabilities, etc.*

envisages a minimum CAR of 12%. In terms of banks peer groups, G2 banks have the lowest CAR of 13.4%. Although banking business capitalization is considered to be good, capital requirements for individual banks call for careful monitoring.

6.2 ASSESSING BANKING SECTOR RESILIENCE THROUGH STRESS TESTING EXERCISE[68]

Stress testing exercise involves two approaches: a) an analysis of banking sector's sensitivity to market and credit risk, which assesses the sensitivity of banking sector's CAR to specific exchange rate or interest rate changes, or to the increase in non-performing loans; and b) an analysis of scenarios, which assesses the CAR's response to the combined effect of several (macroeconomic and financial) interacting factors. The assessment is based on data as at December 2010.

6.2.1 ANALYSIS OF BANKING SECTOR'S SENSITIVITY TO RISKS

Direct Exchange Rate Risk. The banking sector's sensitivity to the Lek's exchange rate movements (depreciation/appreciation) is measured by considering the impact of the magnitude of open foreign currency positions – in the two major currencies, Euro and US dollar, on the balance sheet. The magnitude of open foreign currency positions in the balance sheet is held constant[69] for the purpose of the stress test exercise. Certain changes, which cause financial loss that erodes the capital value, are applied on the exchange rate. The exercise shows that the application of a number of shocks, such as the depreciation/ appreciation of the exchange rate by 5%, 10%, etc, results in a negligible fall of the banking sector's CAR. The curbed open foreign currency position values hedge the banking sector against the direct exchange rate risk. In terms of banks peer groups, G3 and G1 banks appear more sensitive to exchange rate movements. However, the impact on the CAR remains very low, down only 0.1 pp. Hence, extraordinary exchange rate movements, which are almost impossible in practice, would alone cause a drop in the CAR to below 12%.

Interest Rate Risk. This exercise assesses the CAR's sensitivity to interest rate changes (average interest rate on assets and liabilities) for the three currencies, Lek, US dollar and Euro.

68 *We emphasize that stress testing is not a way of forecasting. The scenarios intentionally assume adverse events in order to test the banking sector resilience to them. The scenarios assume extreme events of low probability of occurrence. Although banks are encouraged to assess their financial capacity to cope with the impact of these scenarios, they should not consider them as events expected by the Bank of Albania to occur in the future. The scenarios change over time in light of the economic and financial developments. On the other hand, these scenarios do not consider the actions banks may take to strengthen their financial position and resilience to risks.*

69 *In fact, banks may change their open foreign currency position depending on their expectations for the exchange rate movements. In this way, they may mitigate the losses, and even tend to increase their earnings.*

An assumed increase of the average interest rate on the Lek by 5 pp (from 6.1% to 11.1%) causes the CAR to fall by 1.6 pp to 13.8%. G3 banks, whose CAR falls by 2 pp, provide the major contribution to this fall.

In the case of an assumed increase of the average interest rate on the US dollar by 5 pp (from 2.3% to 7.3%), the banking sector emerges as hedged as the CAR falls by only 0.3 pp to 15%. Even in the case of the US dollar, G3 banks, whose CAR falls by 0.5 pp, provide the major contribution to this fall.

An assumed increase of the average interest rate on the Euro by 5 pp (from 3% to 8%) causes the CAR to fall by only 0.1 pp. G2 banks, whose CAR falls by 0.2 pp to 14.1%, appear with the largest exposure to the interest rate shock on the Euro.

In order for the CAR to fall to below the minimum threshold, the average interest rate on the Lek would have to increase by 12.5 pp. In the case of the Euro and US dollar, the increase would have to be much higher[70].

Credit Risk. This risk represents the CAR's sensitivity to the deterioration of the loan portfolio as a result of an increase in non-performing loans. This exercise assumes an increase in non-performing loans by 67% and 110%[71]. The first shock represents the limit level where the banking sector's CAR falls to below the minimum threshold, to 11.9%. Concerning the second shock, the fall of the CAR is more sensitive, to 9.5%. After the application of each shock, G2 banks appear more sensitive to credit risk.

Indirect Exchange-Rate Related Credit Risk. This type of risk mainly relates to foreign currency lending to borrowers, whose income is in the domestic currency.

A depreciation of the Lek against the Euro by 5% causes the CAR to fall by 0.8 pp to 14.6%. The banking sector would breach the minimum regulatory requirement and appear undercapitalized if the Lek depreciates by 21.5% against the Euro.

A depreciation of the Lek against the US dollar by 5% causes the CAR to fall very slightly by 0.04 pp. The banking sector would appear undercapitalized only under an extreme depreciation of the Lek against the US dollar.

6.2.2 SCENARIO ANALYSIS

This exercise assesses the impact of scenarios combining selected economic and financial indicators on the banking sector's financial position and CAR in the next two years, considering the capital value unchangeable. The shock is

[70] *Concerning the interest rates on Euro and US dollar, the banking sector does not show any critical levels (below 12% CAR) in any of the shocks.*

[71] *The loan portfolio growth by 110% has been considered "a priori" as a shock to the loan portfolio.*

applied by assuming that the loan portfolio quality deteriorates. The exercise is applied in two versions.

In the first version, the deterioration of the loan portfolio quality is measured by making assumptions of the performance of macroeconomic indicators and internal banking activity-related indicators based on empirically-assessed correlations. In this case, we identify situations when the banking sector's capital falls to below the regulatory requirement. In the second version, the deterioration of the loan portfolio quality is assessed through a model that determines the correlations between the macroeconomic indicators. In this case, we assess the change in NPL ratio and the requirements for supplementary capital in order to meet the minimum CAR threshold.

The first version considers two scenarios. The first scenario is built on the forecast of economic and financial indicators based generally on their historical performance. The second scenario assumes a "stressed" situation of low probability of occurrence.

Table 19 Assumptions of economic and financial indicators under Scenario 1 and 2

Assumptions	Scenario 1		Scenario 2	
	2011	2012	2011	2012
Annual GDP growth, in %	3.4%	3.6%[1]	-0.6[2]	1.6%
Annual increase in market rates	0.73 p.p.	0.5 p.p.	2 p.p.	2 p.p.
Lek's depreciation against the two major currencies, Euro and US dollar	1.7%	0.3%	20%[3]	20%
Net Interest Income	Projection for 2011 based on 2010	Projection for 2011	80% of 2010 level[4]	Projection for 2011 (scenario 2)
Other operating income (net)	Projection for 2011 based on 2010	Projection for 2011 (scenario 1)	90% of 2010 level[5]	Projection for 2011 (scenario 2)
Projected outstanding loan growth	8.4%	13%	0%[6]	0%

1 *IMF's projection of Albania's economic growth in 2012 is 3.6%. The figure is based on World Economic Outlook, February 2010.*
2 *Concerning GDP in 2011, the stressed scenario (no. 2) assumes a 4 pp fall from the macroeconomic model forecast and a 2 pp fall from the latest forecast for 2012.*
3 *In the stressed scenario, the Financial Stability Department assumes the worst possible situation of low probability of occurrence: the depreciation of the Lek by 20% against the Euro and the US dollar in 2011 and 2012.*
4 *Based on the assumed growth of loans by 0% in this scenario, and the NPL growth, for 2011 it has been assumed a level of 80% of net interest income in 2010.*
5 *The stressed scenario does not assume the growth in banking sector activity; operating expenses are therefore assumed to remain similar to 2010, while incomes from other activities are assumed lower. Hence, other net operating incomes are assumed to equal 90% of 2010 level in 2011.*
6 *The stressed scenario (no. 2) assumes a 0% growth in outstanding loans in 2011 and 2012.*

Table 20 Assessment of non-performing loans by each scenario

Assessment of non-performing loans by each scenario	Scenario 1		Scenario 2	
	2011	2012	2011	2012
Increase in non-performing loans for the remaining period, in %	21.25%	13.77%	105.29%	107.59%

Table 21 shows the estimates of the impact of non-performing loan growth on bank-specific or the banking sector's risk-weighted assets and size of capital for year-end 2011 and 2012.

Table 21 Undercapitalized banks under Scenario 1

Undercapitalized banks under Scenario 1				
	Year-end 2011		Year-end 2012	
	Individual banks	Banking sector	Individual banks	Banking sector
Regulatory capital				
Modest undercapitalization /1	Yes	Well-capitalized	Yes	Well-capitalized
Severe undercapitalization /2	Yes		Yes	
Tier 1 capital (Core equity capital/Total risk-weighted assets)				
Modest undercapitalization /3	Yes	Well-capitalized	Yes	Well-capitalized
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.

Table 22 Undercapitalized banks under Scenario 2

Undercapitalized banks under Scenario 2				
	Year-end 2011		Year-end 2012	
	Individual banks	Banking sector	Individual banks	Banking sector
Regulatory capital				
Modest undercapitalization /1	Yes	Well-capitalized	Yes	Modest undercapitalization
Severe undercapitalization /2	Yes		Yes	
Tier 1 capital (Core equity capital/ Total risk-weighted assets)				
Modest undercapitalization /3	Yes	Well-capitalized	Yes	Well-capitalized
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.

The banking sector emerges as well-capitalized in most cases, excluding the second scenario for 2012 where the CAR falls to below the regulatory requirement. Concerning the performance of individual banks, it results that the NPLs and net profit are directly related to the stress test exercise results. Banks reporting losses at end-2010 also show the highest impact in the stress test exercise.

The second version of the exercise analyses the impact of selected macroeconomic factors on the NPLs to outstanding loans ratio for the four quarters in 2011. Tables 23-27 show some hypothetical scenarios that combine the adverse performance of economic growth in Albania, exchange rate against the Euro and EURIBOR. This version assumes four scenarios; the first is considered the baseline scenario, and the other three are considered as risk scenarios of low probability of occurrence. The estimation of the loan impairment magnitude for each scenario enables the assessment of needs for supplementary capital should the CAR fall to below the minimum threshold of 12%. In all cases, it is assumed that banks will not adjust their regulatory capital needs under stressed periods.

The first baseline scenario, which describes a situation similar to the current one, shows that in light of macroeconomic developments, the average NPL ratio for 2011 is estimated at 15.2%. Assuming that banks do not adjust their regulatory capital needs under stressed periods, the need for supplementary capital will amount to ALL 250 million by the end of 2011 or 1.1% of the current regulatory capital.

Table 23[72] Scenario 1 (baseline)

Scenario 1 (baseline)	Q3_10	Q4_10	Q1_11	Q2_11	Q3_11	Q4_11	
ALL/EUR exchange rate	Depreciation in the first 3 quarters and slight appreciation in Q4						Assumptions
EURIBOR	constant						Assumptions
Economic growth	4.9	3.4	4.0	4.5	4.9	5.3	Assumptions
NPL ratio	13.8%	14.0%	15.3%	15.4%	15.8%	15.2%	Assumption-based estimates
Need for supplementary capital (as a percentage of the system's regulatory capital)			0.5%	0.7%	1.2%	1.1%	Assumption-based estimates

If scenario 2 occurs, which assumes a lower growth of outstanding loans compared to the baseline scenario, as at end-2011 H1, the NPL ratio will reach 15.8%, and at end-2011, it will reach 17.1%. Assuming that banks do not adjust their regulatory capital needs under stressed periods, the need for supplementary capital will amount to ALL 1.6 billion by the end of 2011 or 1.9% of the current regulatory capital.

Table 24 Scenario 2 (baseline)

Scenario 2	Q3_10	Q4_10	Q1_11	Q2_11	Q3_11	Q4_11	
ALL/EUR exchange rate	As in the baseline scenario						Assumptions
Outstanding loans	Lower growth than the baseline scenario						Assumptions
EURIBOR	25 bp each quarter						Assumptions
Economic growth	4.9	3.4	3.2	3.4	3.5	3.6	Assumptions
NPL ratio	13.8%	14.0%	15.3%	15.8%	17.0%	17.1%	Assumption-based estimates
Need for supplementary capital (as a percentage of the system's regulatory capital)			0.4%	0.7%	1.6%	1.9%	Assumption-based estimates

If scenario 3 occurs, which assumes a lower growth of outstanding loans and the depreciation of the domestic currency by 10%, the NPL ratio will average 23.6%. Assuming that banks do not adjust their regulatory capital needs under stressed periods, the need for regulatory capital will grow to ALL 9.5 billion by the end of 2011 or by 10.6% of the current one.

[72] *The baseline scenario assumes that the growth of outstanding loans in the next 12 months will be 12%.*

Table 25 Scenario 3

Scenario 3	Q3_10	Q4_10	Q1_11	Q2_11	Q3_11	Q4_11	
ALL/EUR exchange rate	Depreciation by 10%						Assumptions
Outstanding loans	Lower growth than the baseline scenario						Assumptions
EURIBOR	100 bp each quarter						Assumptions
Economic growth	4.9	3.4	3.23	4.18	4.87	5.31	Assumptions
NPL ratio	13.8%	14.0%	15.3%	17.7%	20.5%	23.5%	Assumption-based estimates
Need for supplementary capital (as a percentage of the system's regulatory capital)			0.4%	1.8%	5.6%	10.6%	Assumption-based estimates

If scenario 4 occurs, which assumes a lower growth of loans than the baseline scenario and the depreciation of the domestic currency by 20%, the NPL ratio will average 29.7%. Assuming that banks do not adjust their regulatory capital needs under stressed periods, the need for regulatory capital will grow to ALL 21.3 billion by the end of 2011 or by 23.7% of the current one.

Table 26 Scenario 4

Scenario 4	Q3_10	Q4_10	Q1_11	Q2_11	Q3_11	Q4_11	
ALL/EUR exchange rate	Depreciation by 20%						Assumptions
Outstanding loans	Lower growth than the baseline scenario						Assumptions
EURIBOR	100 bp each quarter						Assumptions
Economic growth	4.9	3.4	3.2	4.8	6.0	6.8	Assumptions
NPL ratio	13.8%	14.0%	15.3%	18.4%	24.7%	29.7%	Assumption-based estimates
Need for supplementary capital (as a percentage of the system's regulatory capital)			0.4%	2.3%	11.2%	23.7%	Assumption-based estimates

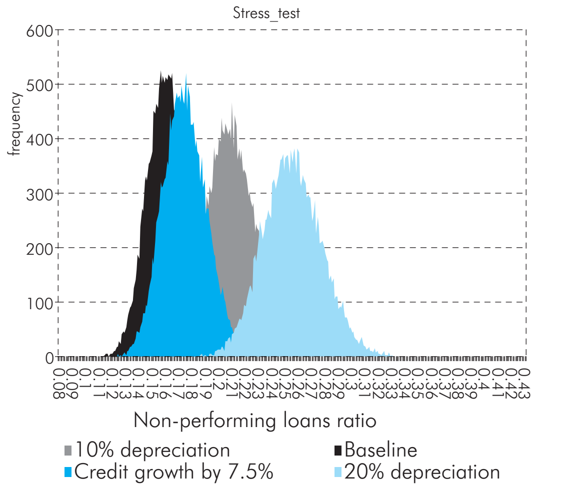
Table 27 shows the standard deviations of NPL ratio in each scenario and the confidence interval estimates of 90% and 80%.

Table 27 Standard deviations of NPL ratio in each scenario and the interval estimates

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Mean	15.2%	17.1%	23.6%	29.7%
Standard deviation	0.015	0.016	0.021	0.024
A 90% confidence interval estimate	13.4%-17.2%	15.1%-19.3%	21%-26.3%	26.7%-32.9%
A 80% confidence interval estimate	13.9%-16.5%	15.7%-18.5%	21.8%-25.3%	27.7%-31.8%

Chart 79 shows the density distribution of NPL ratio for 2011 Q4, simulated using the Monte Carlo method for the four scenarios described above. As the chart shows, the probability of having extreme values (far from the estimated average) of the NPL ratio increases from scenario 1 to scenario 4.

Chart 79 Stress Test results



Source: Bank of Albania

Stress-test results show that the banking sector is resilient to different shocks. However, there is higher sensitivity of individual banks to these shocks. Individual banks should, therefore, not only assess their resilience to similar scenarios, but also be encouraged to take measures in view of strengthening their capital position and ensuring a better control of operating risks.

ANNEXES

ANNEX 1 FINANCIAL STRENGTH INDEX

Financial Strength Index (FSI) is constructed and calculated based on the latest banking sector developments.

Table 28 shows the financial indicators that help calculate the index. These indicators assess the banking sector's financial strength, and the developments and magnitude of the main risks it is exposed to. The table also shows the sign of the impact of indicators, and their weights in the formula used to calculate each sub-index. The positive sign shows the positive effect that the increase of each specific indicator has on the sub-index, while the negative sign shows the negative effect of this increase[73] on the sub-index.

Table 28 FSI components

	Financial Strength Indicators	Direction of the impact	Weights
Asset quality	NPLs, gross/Total loans	negative	0.33
	NPLs, net/Shareholders' equity	negative	0.33
	Fixed assets/Total assets	negative	0.33
Liquidity	Liquid assets/Total assets	positive	0.40
	Assets of up to 3-month maturity/Liabilities of up to 3-month maturity	positive	0.60
Exchange rate risk	On-Balance Sheet FX Position / Own Funds	negative	0.50
	FX Net General Position / Own Funds	negative	0.50
Profitability	Net Profit / Total Assets	positive	0.50
	Net Profit / Shareholders Equity	positive	0.50
Capital adequacy	Free capital/Total assets**	positive	0.50
	Capital Adequacy Ratio	positive	0.50
Interest rate risk	ALL Gap sensitive to interest rate up to 1-month/Shareholders' equity***	negative	0.50
	FX Gap sensitive to interest rate up to 1-month/Shareholders' equity	negative	0.50

* *Fixed assets are calculated as the sum of fixed assets and net NPLs.*

** *Free capital is calculated as the difference between shareholders' equity and fixed assets.*

*** *The difference between assets and liabilities of up to 1 month, both in domestic and foreign currency, shows the mismatching between interest rate-sensitive short-term assets and liabilities, which may trigger losses in case of adverse movements in this rate.*

The time series of indicators (ratios) used to construct the sub-indices are standardized. The standardization process is carried out by measuring the distance between the real value of the indicator (ratio) in a given moment and the average of values over the period, in terms of standard deviation[74].

[73] *According to this methodology, the negative sign does not mean a negative value. The sign shows only the direction of the effect of each specific indicator (ratio) on the index. The positive sign means that the index increases due to an increase in the ratio, while the negative sign means that the index falls because of this increase.*

[74] *In this way, we derive the difference between the ratio in each period and the average for the entire stated period (In our case December 2005-December 2010). This difference is later divided by the standard deviation of the selected period.*

A new series Z is derived using the formula:

$Z=X-\mu/\sigma$ (1)

where X is the value of the ratio in each given moment, μ is the average value of the ratio over the selected period, and σ is the standard deviation. To construct the sub-indices referred to above, the standardized values of the ratios according to the formula (1) are multiplied by the weights assigned to the ratios in the table above and ultimately, they are summed. An adjustment has been made in order to turn all the standardized values of the Z series positive. According to the methodology, a base period is selected, which is assigned the value of 100[75], and the indices are calculated using direct proportions if the increase in the ratios making up the sub-indices is favourable; otherwise, indirect proportions are used[76]. Finally, the FSI is calculated as the arithmetic average of the sub-indices.

You will find below the assessment of the sub-indices forming the FSI for the banking system and banks peers groups as at December 2010.

Asset Quality Sub-Index[77]: Its downward performance signals the negative impact on the banking sector's position and vice versa. Asset quality sub-index continued to show a declining tendency. In 2010 H2, it fell to 68.45 from 71.4 in H1. Compared to the base period (December 2005=100), this sub-index has recorded considerable drop by about 31.5%. It has fluctuated markedly from the average of the period of 86.3 (see the broken lines in the Chart). The base ratios forming this sub-index increased in December 2010 compared to the base period.

Liquidity Risk Sub-Index: Its downward performance signals the negative impact on the banking sector's position and vice versa. In 2010 H2, the liquidity sub-index increased to 78.4 compared to 74.9 in H1. It, however, remains below the base period value and the average of 85.5.

Exchange Rate Risk Sub-Index[78]: Its downward performance signals the negative impact on the banking sector's position. The exchange rate sub-index has been volatile in its historical values, declining at end-2010 to 110.4 from 110.8 in June 2010, and below the average of 123.4. This fall has been mainly triggered by the increase in the ratio of "net open positions (balance sheet items) to regulatory capital"[79]. The fall of this sub-index signals the increase in the magnitude of the banking system's exposure to exchange rate movements.

75 *In our case December 2005.*

76 *A typical case in the use of indirect proportions relates to the Asset Quality Sub-Index where the increase in the ratios forming this sub-index (such as NPLs to total loans ratio or net NPLs to shareholders' equity) in fact causes the fall in the asset quality sub-index, as their increase is unfavourable to the banking system. The signs or the direction of the effects shown in Table 28 help in deciding whether direct or indirect proportions should be used.*

77 *Indirect proportion is used to construct this sub-index.*

78 *Indirect proportions have been used to construct this sub-index due to the negative sign in the table.*

79 *In December 2010, this ratio was 5.96% from 3.94% in June 2010.*

Profitability Sub-Index: Its downward performance signals the negative impact on the banking sector's position and vice versa. This sub-index is equally composed of the net profit/total assets and net profit/shareholders' equity ratios. At end-2010, this sub-index fell to 83.5 from 85.3 in H1 and below the average of the period of 92.1.

Capital Adequacy Sub-Index: Its downward performance signals the negative impact on the banking sector's position and vice versa. This sub-index is equally composed of the free capital/total assets ratio and the CAR. In December 2010, it fell to 69.5 from 86.3 in June 2010, and below the average of the period of 88.8. The substantial fall in this sub-index owes mainly to the decline in the banking system's CAR, which in December 2010 fell to 15.4% from 16.2% in June 2010.

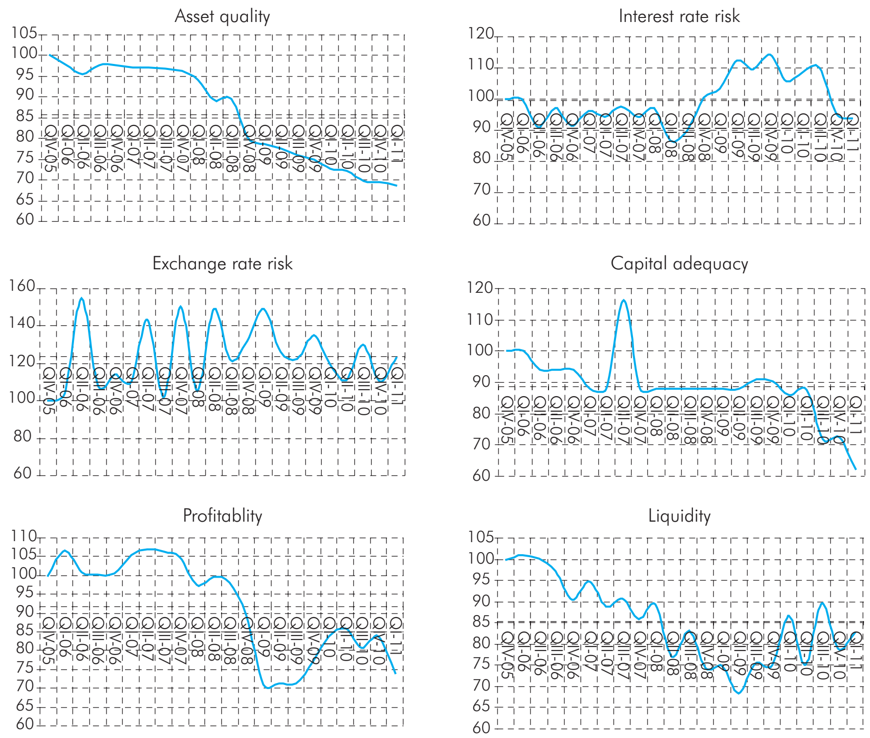
Interest Rate Risk Sub-Index[80]: Its downward performance signals the negative impact on the banking sector's position. At end-2010, the interest rate risk sub-index fell to 94.2 from 108.1 at end-H1. The fall in this sub-index has been triggered by the increase in the ratio of "up to 1-month foreign currency asset and liability gap to shareholders' equity", which exposes the banking system's more to the interest rate movements risk.

Financial Strength Index (FSI) is calculated as the arithmetic average of all the sub-indices referred to above. Their combined effect caused the banking system's FSI to fall to 84.1 at end-2010 from about 89.5 in H1, which however is below the average of the period of 95.9. The fall in the FSI by about 5.4 points owes to the decline in the banking system's portfolio quality, the lower CAR, and the relatively higher exposure to interest rate and exchange rate movements. The liquidity sub-index showed an increasing positive performance.

Charts 80 and 81 show the graphical performance of the sub-indices and the FSI for the banking system.

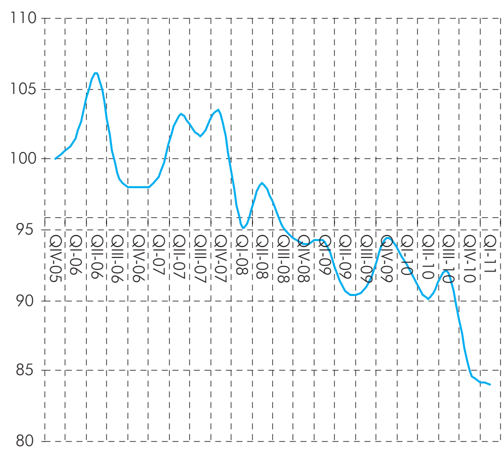
[80] *Interest rate risk is measured through the time inconsistency of assets and liabilities that exposes the banking system to interest rate movements. Indirect proportion has been used to measure this sub-index.*

Chart 80 Financial Strength Sub-Indices for the banking sector
(December 2005=100)



Source: Bank of Albania

Chart 81 FSI for the banking sector



Source: Bank of Albania

Table 29 Figures on sub-indices and the FSI

Sub-indices	Asset quality	Liquidity risk	Exchange rate risk	Profitability	Capital adequacy	Interest Rate risk	Financial Strength Index
December 05	100.00	100.00	100.00	100.00	100.00	100.00	100.00
March 06	97.63	100.88	103.78	106.85	100.00	100.20	101.56
June 06	95.37	100.09	153.73	100.84	93.35	90.48	105.64
September 06	97.63	97.15	107.57	100.24	93.35	96.64	98.77
December 06	97.63	90.39	113.83	100.63	93.35	90.83	97.78
March 07	97.13	94.70	110.35	105.53	86.70	95.89	98.38
June 07	97.13	88.81	142.53	107.21	86.70	93.55	102.65
September 07	96.63	90.57	101.97	106.67	117.75	97.04	101.77
December 07	96.15	85.96	149.30	104.94	86.70	93.53	102.76
March 08	93.95	89.39	105.39	97.27	86.70	96.44	94.86
June 08	88.87	77.14	148.37	99.63	86.70	85.23	97.66
September 08	89.29	83.11	121.48	98.01	86.70	88.95	94.59
December 08	79.43	74.29	131.25	88.97	86.70	99.76	93.40
March 09	77.93	74.78	148.37	69.63	86.70	102.58	93.33
June 09	76.79	68.41	125.74	70.23	86.70	112.60	90.08
September 09	75.35	75.38	122.14	70.16	89.92	109.52	90.41
December 09	74.01	74.82	134.80	76.14	89.13	113.59	93.75
March 10	71.83	86.33	119.68	83.27	84.50	104.60	91.70
June 10	71.43	74.93	110.81	85.27	86.27	108.07	89.46
September 10	68.83	89.26	129.83	79.89	68.97	109.02	90.97
December 10	68.45	78.42	110.42	83.46	69.49	94.25	84.08

ANNEX 2 BANKING SECTOR INDICATORS

Table 30 Banking Sector

(%)	Dec'08	June'09	Dec'09	June'10	Dec '10
CAPITAL-BASED INDICATORS					
Regulatory capital to risk-weighted assets	17.2	16.9	16.2	16.2	15.4
Core capital to risk-weighted assets	16.3	16.1	15.3	15.4	14.5
Core capital to total assets	7.8	8.7	8.7	8.9	8.6
Regulatory capital to total assets	8.3	9.2	9.2	9.3	9.1
Shareholders' equity to total assets	8.6	9.3	9.6	9.6	9.4
NON-PERFORMING LOANS TO CAPITAL					
Net non-performing loans to core capital	23.0	25.7	29.9	32.8	38.1
Net non-performing loans to regulatory capital	21.7	24.6	28.2	31.2	35.9
Net non-performing loans to shareholders' capital	21.1	24.1	27.1	30.3	34.8
GROSS NON-PERFORMING LOANS TO TOTAL LOANS	6.64	8.73	10.48	12.21	13.96
RETURN ON EQUITY (RoE) (annual basis)	11.4	1.8	4.6	8.3	7.6
RETURN ON ASSETS (RoA) (annual basis)	0.9	0.2	0.4	0.8	0.7
INDICATORS OF INCOME AND EXPENDITURES					
Interest margin to gross income	106.5	129.1	119.6	116.2	118.9
Non-interest expenditures to gross income	81.4	201.6	231.4	213.1	227.5
LIQUIDITY					
Liquid assets to total assets	42.8	40.9	27.6	27.9	25.9
Liquid assets to short-term liabilities	64.9	56.8	32.6	32.8	30.6
Deposit/Loan ratio	162.6	151.7	154.3	158.2	166.4
NET OPEN FOREIGN CURRENCY POSITION TO CAPITAL					
Net open foreign currency position to core capital	4.5	4.6	4.1	7.6	5.3
Net open foreign currency position to regulatory capital	4.3	4.4	3.9	7.3	5.0
Net open foreign currency position to shareholders' capital	4.0	5.1	4.3	8.1	5.4

Table 31 Banks Peer Groups

	Dec'08			June'09			Dec'09			June'10			Dec'10		
(%)	G1	G2	G3	G1	G2	G3	G1	G2	G3	G1	G2	G3	G1	G2	G3
CAPITAL-BASED INDICATORS															
Regulatory capital to risk-weighted assets	30.8	15.3	16.6	32.1	14.4	16.8	32.7	13.6	16.1	27.0	14.0	16.3	23.4	13.8	15.6
Core capital to risk-weighted assets	29.1	12.5	16.5	30.4	12.4	16.6	32.7	10.9	15.9	27.0	11.6	16.1	23.4	11.6	15.5
Core capital to total assets	20.3	8.1	7.0	19.4	8.8	8.1	19.1	8.0	8.2	16.9	8.8	8.3	13.9	8.1	8.4
Regulatory capital to total assets	21.5	10.0	7.1	20.5	10.2	8.2	19.1	10.0	8.3	16.9	10.1	8.4	13.9	9.6	8.5
Shareholders' equity to total assets	21.3	7.7	8.2	20.1	9.3	8.7	20.0	8.4	9.3	17.6	9.1	9.2	14.8	8.6	9.3
NON-PERFORMING LOANS TO CAPITAL															
Net non-performing loans to core capital	3.62	33.07	23.42	4.0	39.1	24.3	4.9	51.9	27.0	12.1	39.9	32.5	15.1	46.9	37.2
Net non-performing loans to regulatory capital	3.42	26.91	23.24	3.8	33.9	24.1	4.9	41.5	26.7	12.1	34.7	32.2	15.1	39.5	36.8
Net non-performing loans to shareholders' capital	3.45	32.07	20.31	3.8	37.2	22.6	4.7	49.3	23.8	11.6	38.5	29.3	14.2	44.5	33.3
GROSS NON-PERFORMING LOANS TO TOTAL LOANS	3.50	7.67	6.37	3.8	10.5	8.2	4.9	13.1	9.6	8.6	11.9	12.8	9.7	13.6	14.6
RETURN ON EQUITY (RoE) (annual basis)	(4.48)	(4.83)	18.52	(5.38)	(25.38)	10.45	(6.54)	(22.48)	14.07	(9.09)	(9.40)	19.05	(8.78)	(8.29)	17.00
RETURN ON ASSETS (RoA) (annual basis)	(1.02)	(0.37)	1.39	(1.14)	(1.96)	0.89	(1.36)	(1.85)	1.22	(0.86)	(0.42)	0.86	(1.53)	(0.73)	1.55
INDICATORS OF INCOME AND EXPENDITURES															
Interest margin to gross income	79	121	105	85	227	118	90	210	108	99	148	108	103	152	111
Non-interest expenditures to gross income	145	122	67	164	245	198	168	256	232	182	771	59	178	831	62
LIQUIDITY															
Liquid assets to total assets	40.1	31.1	46.6	37.8	25.1	45.8	29.7	18.4	30.4	27.3	22.3	30.4	27.5	23.2	27.1
Liquid assets to short-term liabilities	63.6	49.5	69.3	59.5	39.3	61.2	38.6	23.2	34.9	34.7	28.5	34.5	34.3	29.1	31.0
Deposit/Loan ratio	149.5	100.77	190.32	135.7	99.524	176	147	103.72	178.63	147.4	112.9	192.11	157.3	120	200.71
NET OPEN FOREIGN CURRENCY POSITION TO CAPITAL															
Net open foreign currency position to core capital	2.4	12.8	2.6	3.1	9.3	3.3	(1.32)	7.97	3.77	4.5	6.6	8.6	(1.78)	0.07	8.54
Net open foreign currency position to regulatory capital	2.3	10.4	2.6	2.9	8.0	3.3	(1.32)	6.38	3.73	4.5	5.7	8.6	(1.78)	0.06	8.45
Net open foreign currency position to shareholders' capital	2.3	11.8	2.2	3.0	12.1	3.5	(1.26)	9.89	3.80	4.3	11.5	7.8	(1.67)	0.11	7.65

Table 32 Banks Peer Groups by Origin of Capital

	Dec '08				June'09				Dec '09				June'10				Dec'10			
(%)	Ital.	Fr.	Gr.	Al.	Ital.	Fr.	Gr.	Al	Ital.	Fr.	Gr.	Al	Ital.	Fr.	Gr.	Al	Ital.	Fr.	Gr.	Al
CAPITAL-BASED INDICATORS																				
Regulatory capital to risk-weighted assets	16.9	15.5	16.5	14.7	17.6	14.8	14.8	15.6	18.8	14.2	14.1	14.2	19.4	15.4	14.6	13.3	17.6	13.2	14.8	13.6
Core capital to risk-weighted assets	16.3	13.2	16.5	10.4	16.7	12.7	14.8	11.2	17.9	11.3	14.1	11.2	18.6	12.5	14.4	10.6	16.9	12.8	12.0	11.1
Core capital to total assets	7.9	8.3	10.8	7.5	8.4	8.8	11.1	7.8	8.5	8.6	11.2	7.8	9.5	8.7	11.4	7.1	9.4	8.4	10.2	6.8
Regulatory capital to total assets	8.2	9.7	10.8	10.6	8.9	10.3	11.1	10.9	9.0	10.8	11.2	9.9	10.0	10.7	11.6	8.9	9.8	10.3	10.5	8.4
Shareholders' equity to total assets	9.3	9.1	9.1	8.3	9.3	9.4	11.5	8.4	10.5	9.5	11.6	8.1	10.2	9.4	11.9	7.2	10.3	9.3	10.9	7.3
NON-PERFORMING LOANS TO CAPITAL																				
Net non-performing loans to core capital	12.5	47.6	10.5	16.4	25.2	57.3	21.1	25.2	25.0	70.0	22.8	42.4	29.9	62.5	23.1	50.8	47.1	50.7	35.5	41.0
Net non-performing loans to regulatory capital	12.1	40.7	10.5	11.6	24.0	49.1	21.1	18.1	23.8	55.4	22.8	33.4	28.6	50.9	22.7	40.3	45.1	41.2	34.3	33.5
Net non-performing loans to shareholders' capital	10.7	43.3	17.3	14.8	22.8	53.5	20.3	23.4	20.3	63.4	21.9	40.6	27.9	57.9	22.2	49.4	42.6	45.9	33.0	38.2
GROSS NON-PERFORMING LOANS TO TOTAL LOANS	4.3	12.7	4.5	3.1	8.0	16.3	6.5	4.9	8.8	18.6	8.1	8.1	12.0	19.6	8.7	10.5	17.8	18.2	12.1	9.1
RETURN ON EQUITY (RoE) (annual basis)	11.8	(18.9)	8.2	19.1	9.5	(38.5)	(5.9)	6.9	15.7	(30.8)	(5.7)	4.5	5.1	(20.1)	5.0	(10.8)	5.1	(3.2)	(3.8)	5.2
RETURN ON ASSETS (RoA) (annual basis)	1.0	(1.7)	0.7	1.4	0.9	(3.4)	(0.6)	0.6	1.5	(2.8)	(0.6)	0.4	0.3	(0.9)	0.3	(0.4)	0.5	(0.3)	(0.4)	0.4
INDICATORS OF INCOME AND EXPENDITURES																				
Interest margin to gross income	83.9	206.3	116.7	0.9	89.0	8,374.9	173.2	103.2	73.3	381.8	171.7	110.8	101.5	225.9	112.0	180.6	100.9	127.5	161.2	116.0
Non-interest expenditures to gross income	95.7	205.9	94.1	0.7	98.8	9,156.2	796.4	85.1	74.8	537.3	1,125	91.0	103.6	540.8	636.4	144.1	97.1	321.3	988.2	89.6
LIQUIDITY																				
Liquid assets to total assets	47.6	34.0	24.9	29.9	47.3	30.3	19.1	26.4	34.0	26.7	18.6	21.7	32.7	30.7	20.3	24.1	29.8	30.5	22.2	23.0
Liquid assets to short-term liabilities	72.3	68.4	33.0	48.6	67.5	56.1	25.1	39.6	40.1	37.6	22.4	25.7	38.4	45.6	24.4	28.2	35.7	44.3	26.1	26.8
Deposit/Loan ratio	197	107	91	140	185	99	85	135	190	94	91	134	192	104	95	138	202	114	107	149
NET OPEN FOREIGN CURRENCY POSITION TO CAPITAL																				
Net open foreign currency position to core capital	-2.1	21.1	-2.9	1.5	1.6	31.4	-0.1	8.5	0.6	15.6	-1.7	6.8	2.7	12.8	-0.8	16.4	-3.2	-1.1	-0.5	14.9
Net open foreign currency position to regulatory capital	-2.1	18.0	-2.9	1.1	1.5	27.0	-0.1	6.1	0.6	12.4	-1.7	5.3	2.5	10.4	-0.8	13.0	-3.1	-0.9	-0.4	12.1
Net open foreign currency position to shareholders' capital	-1.8	19.1	-2.6	1.4	1.4	29.4	-0.3	7.9	0.5	14.2	-3.3	6.5	2.5	11.9	-1.6	15.9	-2.9	-1.0	-0.8	13.8