Pursuant to provisions 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 18.12.2006 “On banks in the Republic of Albania”, as amended, to inform the Assembly of the Republic of Albania and the Council of Ministers, and promote awareness among financial institutions and the public at large of the situation in the Albanian financial system and potential risks to its stability, the Bank of Albania releases this periodic statement. This statement is an integral part of the Financial Stability Report for the same-stated period. The Financial Stability Report and the Statement prefacing it assess the exposure of the banking sector to risks arising from its interaction with the external and internal economic environment, real economy agents, financial markets in Albania, as well as operational risks in the activity of the banking sector. Furthermore, these risks are assessed through the stress test and placed vis-à-vis the financial situation of the banking sector to assess its resilience.

The Bank of Albania deems that in 2019 H2 (hereinafter ‘the period’), banking sector showed positive developments in its activity, based on the indicators of financial performance and exposure to risks. Banking sector, driven by the improvement of intermediation, contributed in the economic growth of Albania. Capitalisation indicators and stress tests show the resilience of the banking sector’s activity. This stability will be maintained, notwithstanding the serious and exceptional challenge countered by public health and the economic development due to the SARS-CoV-2 outbreak. For this purpose and to broadly contribute in the safeguard of financial stability at home Bank of Albania, in close cooperation with banking industry and in full harmonisation with other public authorities, will use all the legal necessary instruments both proactively and in a transparent manner.

This Report, as a rule, analyses the developments in the financial system up to the end of 2019. Overall, these developments, prior to pandemic outbreak, confirmed:

- **A stable framework of the economic developments in Albania and abroad.** Economic growth during 2019, although affected by November 2019 earthquake, remained positive and is assessed as broad-based, hence providing further fall in unemployment rate and supporting overall positive developments in the balance of payments, driven by the good performance of tourism sector and the stability of remittances. The consolidation trend of fiscal policy was useful to ensure a necessary correction for withstanding the short-term effects of the
earthquake. Globally, economic developments did not show notable changes from the previous period. They were determined by: the trade war amongst the largest economies; the regional conflicts; and the continuation of accommodative monetary policies given the contained inflationary pressures.

- **Smooth performance of financial markets in Albania.** During this period, these markets witnessed the increase of interest rates in the primary market of government debt securities, on both short and long-term issuances. Volume of transactions in the secondary market was down, and mainly concentrated in short-term issuances, by reflecting the investors’ preference to hold debt securities to maturity. The volume of overnight and 7-day transactions fell in the interbank market, but the interest rates remained close to the Bank of Albania’s policy rate. Lek exchange rate showed low fluctuations during the period. In the real estate market, the survey indicators showed an increase of prices, driven by the rise in both demand and supply. During the period, the operation of payment systems was optimal, with increases in both volume and number of processed payments.

- **More favourable financing conditions to households and enterprises.** Both households and enterprises increased their financing from banking sector during the period, but this growth was faster for enterprises. Deposits of both sectors at banks were risen. The expansion of households’ deposits was around 6 times higher than enterprises. The growth of households’ deposits, mainly in foreign currency, reflected also the fall in their holdings of securities. According to the regular surveys of the Bank of Albania, the share of households having a debt to repay is relatively low (24%), and the debt burden is estimated at affordable levels. For the next period, households appear more ready to increase the borrowing level. Also for enterprises, debt burden is estimated at appropriate levels given that the value of debt amounts to half the value of capital for 78% of enterprises, and almost 67% of them declare that the repayment of debt does not exceed 20% of the activity income. The debt burden is higher for small enterprises. Also, enterprises show a higher readiness to increase the borrowing level in the next period.

- **Good performance of the financial system.** During the period financial system activity expanded by around 2.6 percentage points, up to 107% of the Gross Domestic Product. The expansion of banking sector’s activity, by around 4% during the period, provided the main contribution in this growth. Lending and placements provided positive contribution in this performance, mainly the activity of investments in securities. Credit grew during the period, and over 2019 it expanded by 4.8% driven by lending to enterprises, credit in Lek and long-term credit. Deposits grew 5.4% during the year driven by households’ deposits, demand deposits and foreign currency denominated deposits.
Banking sector closed the year with a higher rate of profitability than in the previous year, with RoA and RoE standing at 1.4% and 13.5%, respectively. Financial result was notably affected by the expansion of profit from financial instruments, while net interest income, which dominates the banking activity income, fell by 4.8%. As a result, net interest margin dropped to 3.4% at the end of the period from 3.7% a year earlier. Although capital adequacy ratio fell by 0.2 percentage point during the period, its 18.3% level is assessed as rather good.

- **Controlled exposure of banking sector to risks.** During the period, credit portfolio quality continued to improve. As a result, non-performing loans ratio dropped to 8.4%, for the first time at a one-figure level during the last decade. Repayments, write offs and restructuring provided their contribution in the fall of nonperforming loans. The write-off of nonperforming loans have re-started after the regulatory amendments set forth by the Bank of Albania, to shorten to two years the classification time of the loan classified as “lost” beyond of which the bank should write-off the loan from the balance sheet. The improvement of credit quality is mainly noted in: credit portfolio to enterprises; credit in foreign currency; and credit with longer-term maturity. In their efforts to improve credit quality, banks proactively managed the situation created after the earthquake of November 2019, which was however a shock limited in time and damage. A rather more complex challenge is ahead and which relates to the effects resulting from the current situation of the health pandemic on the economic development of the country. Liquidity situation of the banking sector appears rather good, by showing few changes during 2019. Regarding market risks, banking sector is sensitive to exchange rate risk through the segment of unhedged loans in foreign currency. Exposure to interest rate risk remains present, but it is relatively limited.

Risks to banking activity reflect and are intertwined with developments of structural nature. Such one is the existence for a long period of the environment with low interest rates, which: maintains the pressure on the financial result of banks; urges the change of its financing structure towards shorter-term sources and the need for liquid assets; and maintains the potential for the increase of activity’s stress in case of a strong and unexpected correction. The high use of foreign currency in the banking sector is accompanied with risks for the liquidity risk management in foreign currency.

Through the regulatory actions of microprudential nature and macroprudencial policy instruments, Bank of Albania has sought to address these risks. New regulatory acts which are being implemented, including: liquidity coverage ratio; de-euroisation package of measures; and the Regulation on the implementation of macroprudential capital buffers; aim at decreasing risks and heighten the banking sector resilience to them.
ASSESSMENT ON THE IMPACT OF PANDEMIC

The situation of financial system and financial stability, and its capacity to counter risks should be assessed based on a forward-looking position. In this process, it is needed an overall assessment on the effects that the current coronavirus pandemic might have on both the economy and financial system stability.

This pandemic and the measures undertaken by the Government to protect the life of citizens and to eliminate the coronavirus emergency in the short-term, are accompanied unavoidably with changes on the way we carry out our daily life. These changes also include economic activities where the impact, while temporary, will be considerable. In more concrete terms, both public and private enterprises (with the probable exception of those that provide basic life services), depending on their ability to adopt even partially, may face a disruption in the chain of trade relationships and will experience on average a considerable drop in the sale of goods and services. This will cause a decline of revenues and difficulty to pay the financial liabilities related to fixed and variable expenses. This situation will also affect the employees and the overall households’ income, as the fall of the activity of enterprises may bring about a reduction of income or interruption of salary. In a chain reaction and for as much as it is not compensated by the savings of households and the state economic protective measures, it further may affect the weakening of their consumption and the difficulty to meet the financial obligations. The latter may include also the difficulty to repay loans taken at financial institutions, driving to a fall of credit quality in these institutions and a negative impact on their financial result.

It is necessary, for as far as it is possible, that public authorities undertake rapid and important actions to interrupt the free occurrence of the above-stated scenarios and to support enterprises, households and the financial system in mitigating and countering the negative effects that accompany such scenarios.

This is also the position of international financial institutions and structures of European Union on the face of a situation which is assessed as an unprecedented one. The International Monetary Fund and the World Bank have made available financial funds and specific instruments to be used with the purpose of providing for rapid borrowing from countries with low and average income. The European Commission announced the special financial package amounting up to EUR 37 billion to counter the economic and financial effects that accompany the pandemic outbreak in a member country. The focus is on households and small and medium-sized enterprises, which may face urgent needs for liquidity. Recently, the European Commission declared that it will support the suspension of the Stability and Growth Pact obligations on fiscal responsibility, enabling member countries’ governments to increase the necessary spending to counter the situation. In monetary sphere, the European Central Bank in the meeting of 12 March 2020, maintained the accommodative monetary conditions and increased at EUR 120 billion the size of the monthly package of liquidity injection through the purchasing
of securities, aiming at also mitigating the fluctuations of interest rates. A few days later, a second package was approved amounting to EUR 750 billion. Previously, the central banks in USA and the United Kingdom had taken similar measures. These rapid actions, offered hope and helped in preventing and partially correcting the deep losses experienced by the most important financial markets. From the banking supervision viewpoint in the European Union, the European Central Bank and the European Banking Authority have supported the need for flexibility in the regulatory treatment by the supervisory authorities, to enable banks to transform into a more effective transmission channel of liquidity in the economy during the current situation.

In Albania, public authorities have undertaken some measures which aim to mitigate the impact of pandemic on the economy, by expressing the need for a proportional and dynamic approach towards the developments of the situation and the uncertainties that surround it.

The initial financial package presented by the Government aims, in addition to strengthening the capacities of public health structures, to mitigating the financial consequences that this situation may bring about to the real agent of economy, hence to the economic growth of Albania. The package provides support to the population in need and ensures the basic income to employees of small enterprises and self-employed persons, in case their activity is interrupted due to the decisions taken by the Government. In parallel, the Government has offered state guarantees for the new borrowing of enterprises from the banking sector in order to meet their short-term needs for liquidity. The latter provides the possibility to entrepreneurs to maintain the labour force in the short run but also to prepare in advance for an appropriate restart of the activity whenever that is possible given the situation. Further on, some “relaxations” in fulfilling the terms on tax reports are made public. Lastly, the announcement of the state of natural disaster situation by the Government turns the addressing of the pandemic situation into an absolute priority to the public structures; it accelerates the expansion, detailing and focus of supporting policies and provides the mechanisms that ensure a higher synergy between public and private entities, which is necessary to counter the situation.

The Bank of Albania has undertaken its actions regarding the institutional management, communication with the supervised entities, particularly banks, and in the framework of its legal policies.

As an institution, Bank of Albania has activated its emergency plan where in the centre are the health security of its staff and the continuation of critical functions of the central bank. For the first point, actions have been taken in compliance with the instructions given by the Institution of Public Health and the Government to limit the interaction with external persons; to prepare the framework for the identification and treatment of the potentially infected staff; to request the maximum implementation of the hygiene conditions; and to regularly disinfect the institution premises. In order to improve the conditions for physical
distancing and reduce the infection possibility, a part of the staff is authorised to work from home. In parallel, it is ensured the continuation of the institution’s critical functions, to fulfil the legal and contractual obligations. The open market operations of the central bank, transactions of cash supply to commercial banks, the well-functioning of payment systems and the relationships with contractors, have been at the centre of the attention.

Also, regarding the communication with banks, the initial focus was the same: activation of emergency plans with the purpose of ensuring the health protection of the staff and the continuation of the institution’s critical functions. As the pandemic situation is unprecedented, the Bank of Albania shared with banks a Special Guideline regarding the actions of an organisation under such situation. In parallel, the communication with banks has continued to detail the organisation of their work and to agree the way of collaboration in order for Bank of Albania to provide supportive functions. So far, the volume of work is adapted to time limitations of activity and within these conditions, processes are carried out normally.

In the framework of its policies, the actions undertaken by the Bank of Albania may be divided into two groups: 1) in the monetary policy area; and 2) in the area of banking supervision and financial stability. The first group aim at supporting the liquidity situation of the financial system and the well-functioning of the money market. The Second group aim at, during this period of interruption of a considerable part of the economic activity in Albania, mitigating the impact of the situation on credit portfolio quality, releasing banks’ resources from activities that may be postponed, and maintaining the good situation of liquidity and capitalisation of banks, in order that the basis for a recovery of the activity at the end of pandemic situation remains solid.

In the framework of monetary policy, the Supervisory Council in its meeting of 25 March 2020, decided to:

a) reduce the policy rate by 0.50 percentage point, to 0.5%; in this way banks may receive loans from the Bank of Albania at a lower cost and may reflect this lower cost in the liquidity they pass through into the economy. This is the lowest historical level of the policy rate of the monetary policy;

b) narrow the spread between the interest rates on overnight lending facility and overnight deposit facility, by reducing the interest rate for the overnight lending facility to 0.9%; once more, in this way banks that may need short-term liquidity, may meet such need by the special facility of the Bank of Albania.

Previously the Bank of Albania had decided to change the type of the daily auction of liquidity injection, to provide banks with unlimited liquidity at the policy rate.
In the framework of the actions regarding banking supervision and financial stability, Bank of Albania is focused on the need to help borrowers to temporary ease their liabilities to banks and other lending institutions, in case the borrower face difficulties in conducting the activity due to the measures undertaken to restrict the pandemic effect. For this purpose, the Governor of the Bank of Albania and the Prime Minister of the Republic of Albania issued a joint order requiring credit institutions to rapidly address the requests submitted by affected borrowers (enterprises and households) and postpone the repayments of their loans up to 31 May 2020. Following that, the Bank of Albania expects banks and other credit institutions to implement a proactive approach whereby, in consultation with borrowers, they engage in other known forms to reduce the probability of borrower’s default, building on last years’ experience. It is also necessary to assess and support the need of economic agents for new finance throughout and at the end of the pandemic situation.

In order to facilitate the activity of banks and other entities that are supervised, as they operate with a reduced number of staff, the Bank of Albania has temporary interrupted their on-site examination. Deadlines on consultations of various draft-regulations which relate to the activity of supervised entities have been postponed.

Although the pandemic will be temporary, it is unknown the time and pace that economy will exit its effects. For this reason, the Bank of Albania in consultation with commercial banks and other entities, will work to draft other regulatory actions which would be responsive to the developments. It should be highlighted that all the actions that are and will be taken, will be always oriented by the main objective: that of safeguarding the banking sector resilience. In this process, the capacities of the banking sector will be assessed on an on-going basis and for this purpose the stress test exercises will also be used.

For the end of 2019 and in relation to conventional risks, results of stress test exercises on the capitalisation and liquidity indicators show a rather good situation of these capacities. But the pandemic situation, due to the dynamic effects it is bringing to the economy of Albania, seems to represent a non-conventional risk. Facing this situation contains uncertainties which need to be captured appropriately by the current models that assess financial system and banking sector capacities. For these reasons, banks should:

- enhance the priority and frequency in realising these stress tests, by adapting the nature, the severity and the complexity of relevant scenarios;
- assess the adequacy of the capacities they have, to counter the eventual shocks arising from these scenarios, both in the short run and longer-term period;
- ensure a rapid and effective decision-making process, to strengthen these capacities. The focus should be on the undertaking of actions that not only maintain but also improve the situation of capital and liquidity buffers;
- strengthen the communication with the Bank of Albania to analyse the developments and financial results.
Although this Report analyses the developments until the end of 2019, it affirms that the pandemic found both financial system and banking sector at a good financial position. This financial position will enable banking sector to absorb the possible shocks arising from the effects that pandemic will have on the economy of Albania.

The Bank of Albania, in the framework of its role and policies, and in coordination with other public authorities, will undertake all the necessary actions in order that the banking system and financial markets operate in this period at most possible appropriate conditions and in a stable manner.

Hereinafter, you will find the detailed content of the Financial Stability Report for the second semester of 2019.