Bank of Albania

FINANCIAL STABILITY REPORT

2017/H2

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INTRODUCTION

This is the nineteenth issue of Bank of Albania's Financial Stability Report, which is published half-yearly. The purpose of this Report is to identify and assess risks to the financial system and its infrastructure, in order to provide the public authorities with the possibility to identify the relevant measures for adjustments, as necessary. The Financial Stability Statement, whose half-yearly release is a legal requirement, prefaces the Report.

In producing this Report, we have used data available at the Bank of Albania, and information from other authorities supervising the financial market. We have also used information and analyses by public and private, national and international financial institutions. The data and analyses cover mainly the developments over the second half of 2017 (hereinafter "the period"). Unless otherwise stated, the expectations for the economic and financial outlook extend through a period of up to 12 months.

The financial system stability has been assessed based on the performance and risks arising from its interaction with the overall internal and external economic environment, as well as from its activity. In order to assess the risks arising from its interaction with the surrounding environment, this report analyses the latest highlights in international financial markets, and in advanced and regional economies. We have also assessed their impact on the financial system and the banking sector in Albania. Concerning the domestic indicators, this report assesses the overall developments and expectations for economic growth, balance of trade, overall price level, exchange rate and fiscal indicators. Also, by analysing the performance of employment, income, and specific surveys, it evaluates enterprises and households' financial situation, and the impact on the solvency of the banking sector borrowers.

The report presents briefly the results of the stress test, which includes liquidity stress scenarios.

NOTES

As at end-December 2017, the banking sector in Albania shows as following:

(1) Banks operating in Albania are divided into the following peer groups by their share:

- *Peer Group 1*, each bank sharing 0-2% of total banking sector assets: United Bank of Albania (UBA) sh.a., Veneto Bank (VB) sh.a., International Commercial Bank (ICB) sh.a., First Investment Bank, Albania (FIB) sh.a., Credit Bank of Albania (CBA) sh.a.: They account for around 4.9% of the sector's total assets.
- *Peer Group 2*, each bank sharing 2-7% of total banking sector assets: Procredit Bank (PCB) sh.a., National Bank of Greece-Albania (NBG) sh.a., Societe Generale – Albania (SGA) sh.a., Alfa Bank – Albania (ABA) sh.a., Union Bank (UB) sh.a., Tirana Bank (TB) sh.a., American Bank of Investments (ABI) sh.a. They account for around 26.9% of the sector's total assets.
- *Peer Group 3*, each bank sharing over 7% of total banking assets: National Commercial Bank (NCB) sh.a., Raiffeisen Bank (RB) sh.a., Credins Bank (CB) sh.a., Intesa Sanpaolo Bank –Albania (ISBA) sh.a. They account for around 68.2% of the sector's total assets.

(2) By capital origin, the banks operating in Albania were divided as follows:

- *Banks with foreign capital*[2]: Raiffeisen Bank sh.a. (Austria); Intesa Sanpaolo Bank - Albania sh.a., Veneto Bank sh.a. (Italy); Alpha Bank Albania sh.a, Tirana Bank sh.a., National Bank of Greece Albania sh.a. (Greece); National Commercial Bank sh.a. (Turkey); Société Générale Albania sh.a. (France); ProCredit Bank sh.a. (Germany); First Investment Bank, Albania sh.a. (Bulgaria); International Commercial Bank sh.a. (Malaysia); United Bank of Albania sh.a. (Islamic Development Bank – Saudi Arabia); Credit Bank of Albania sh.a. (Kuwait). They account for around 81.4% of the sector's total assets.

- *Banks with Albanian capital*: Credins Bank sh.a., Union Bank sh.a., American Bank of Investments sh.a. They account for around 18.6% of the sector's total assets.

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

(3) Banks operating abroad:

Only the National Commercial Bank has a branch abroad, in Kosovo.

(4) The terms "loan" and "credit" are used interchangeably and have the same meaning in this Report; the same is valid for terms "enterprises" and "businesses".

(5) In this Report, outstanding credit refers to the balance of the account "relations with clients", as reported by banks in the balance sheets of the analysed reports. It includes outstanding credit granted by the banking sector to non-bank financial institutions, private and public, resident and non-resident ones. This outstanding is affected by the non-performing loans write off from the bank balance sheet in the reporting period. Hence, outstanding credit in this Report is a different concept from that of credit to the economy. The latter, in addition to the credit to banks, includes the credit granted to non-bank financial institutions. Also, the value of this credit includes only the resident private sector, and its value, is not affected by the written off loans from banks' balance sheets (these loans are already obtained by the economic entities and have affected in their economic value; their later write off does not affect this fact so far). The differentiation in this concepts on credit, should be considered even when it is interpreted the relevant analysis of credit indicators (growth rate, quality ratio, allocation by sector, by currency, etc.) in various reports of the Bank of Albania.

FINANCIAL STABILITY STATEMENT FOR 2017 H2

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 December 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 draw the attention of financial institutions and of the public on the Albanian financial system situation and the potential risks that may jeopardise 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. In addition, these risks face the financial situation of the banking sector and are stressed through stress tests to assess the banking sector's resilience.

The Bank of Albania assesses that developments in the real economy and financial markets in 2017 H2 (hereinafter "the period") sustained the expansion of the financial system's activity in Albania. The banking sector's exposure toward activity risks was more restrained, highlighting the significant improvement in the loan portfolio quality across all its components. Exposure to other risks is at manageable levels, but needs to be evaluated carefully on continuing basis. Hence, the banking sector's ability to further expand financial intermediation and improve its efficiency indicators has improved. Banking sector's capability to withstand activity risks, in view of high levels of liquidity, capitalization and profitability, remains robust. In the light of these developments, the Bank of Albania deems that the banking sector remains resilient.

HIGHLIGHTS IN ECONOMIC AND FINANCIAL DEVELOPMENTS

During the period, global economic developments were positive and stable. The expansion in economic activity was broad-based and harmonised across regions. Economic growth was driven by the favourable financing conditions and the continuation of stimulating policies; while oil price recovery contributed to boosting the economies of oil-exporting countries. Conditions in financial markets were favourable, notwithstanding the divergences among the monetary policies of the main central banks. Overall, global inflationary pressures were subdued, but showed an upward trend occasionally, supported also by the recovery in oil prices. In financial markets, the capital securities continued to increase; meanwhile, debt securities were more volatile. The Balkans region showed faster economic growth and improved employment indicators. Overall, lending remains low, in spite of the considerable progress in reducing the non-performing loans level. The accommodative monetary policy stance and investments, mainly private ones, are expected to support the global economic growth in 2018. The main risks to global economic growth arise from the geopolitical tensions, the possibility of implementing protectionist trade policies particularly in advanced economies, and the possibility that markets may face fast and unexpected corrections.

In Albania, the economic growth pace recorded positive levels throughout 2017. As at 2017 Q4, the annual growth reached 3.36%. Services and production provided positive contribution in this regard. The expansion of the final consumption of the population and gross fixed capital formation continued to support aggregate demand. In 2017 Q4, the positive contribution stemming from the narrowing of the current account deficit during the three previous quarters was halted. In the labour market, the unemployment rate dropped further, at 13.4%. The monetary policy implemented by the Bank of Albania remained accommodative, throughout the period, as the inflationary pressures remained moderate. Although the fiscal deficit in 2017, in absolute terms, was higher than in the previous year, the share of public debt to gross domestic product (GDP) decreased. In *financial markets*, the interest rates generally reflected the stable liquidity situation. In the primary market, although the average yield on government debt securities recorded slight changes over the period, it stood at somewhat higher annual levels by end of the year. The performance of average interest rates on T-bills provided the main contribution in this regard. Notwithstanding the increase of volumes in the interbank market, the average interest rate stood close to the monetary policy rate. In the real estate market, surveys show a more optimistic outlook of market participants. The average interest rate on real estate loans fell slightly. In the foreign exchange market, lek appreciated against the US dollar and slightly depreciated against the euro, over the period.

Liquidity situation of *households* and *enterprises* improved over the period. The net creditor position of households increased, given the faster growth of deposits in foreign currency; meanwhile, the net debtor position of enterprises decreased due to the faster growth of deposits in lek. In annual terms, unlike the half-yearly trend, households show a slight narrowing of the creditor position attributable to the creditor position in the domestic currency. Meanwhile, enterprises recorded again a narrowing debtor position, mainly attributable to the fall of foreign currency loan portfolio. Regarding households, credit growth over the period is realised almost only in lek, and credit quality improved in both domestic and foreign currencies. Non-performing loans ratio for households fell by 2.6 percentage points on annual basis, standing at 7.6% at the end of 2017. Regarding enterprises, loan portfolio recorded a slight annual fall, imposed by the lost loans write off from banks' balance sheets, mainly in foreign currency. Hence, the share of loans in domestic currency to total loan portfolio outstanding increased. Credit quality improved considerably over the period, also for enterprises. Non-performing loans ratio for enterprises fell at 16.9% at the end of year, around 6 percentage points lower on annual basis. To fully assess the financial situation and borrowing of households and enterprises, the Bank of Albania conducts two specific 6-monthly surveys, in collaboration with the Institute of Statistics. For the period, large and medium-sized enterprises report an improvement in their access to financing, while it continues to be a more difficult process for small enterprises. Overall, both enterprises and households show to currently have a moderate appetite for borrowing.

The activity of the *financial system* expanded over the period. The financial system assets to GDP ratio was at 102.6%, around 0.5 percentage point higher than in June 2017, but lower than in the previous year. The growth of financial system's share in GDP owed to the expansion of the activity in almost all the segments, including banks, non-bank financial institutions, insurance companies and investment funds. Banks continue to dominate the structure of the financial system assets, accounting for 93% of financial system assets. Over the period, the share of the banking sector was up at 92.5% of GDP. The activity increased driven mainly by the expansion of interbank transactions. In terms of financial soundness, banking sector was characterised by high levels of capitalisation, profitability and liquidity. The direct exposure of the banking sector to the non-banking sector is low, whereas the banking sector performance remains a critical factor for the resilience of the non-banking sector. In the structure of non-banking sector assets, the share of investments in Albanian government securities is significant, and has been increasing over 2017.

BANKING SECTOR'S EXPOSURE TO ACTIVITY RISKS

The Bank of Albania assesses banking sector's activity risks, as follows:

a) *The improvement of loan portfolio quality, over the period, led to the decrease of credit risk*. At the end of 2017, the annual fall of non-performing loans was 27.5% or ALL 30.2 billion. As a result, the non-performing loans ratio dropped by 5.1 percentage points compared with the previous year, standing at 13.2%. In the lowering of non-performing loans, the contribution from loan collection and restructuring was higher than the contribution from the write-offs from the banks' balance sheet. Non-performing loans decreased across all the categories, including the unhedged foreign currency loan portfolio from exchange rate fluctuations. Among the existing non-performing loans, the lowest quality is noted in the foreign currency loan portfolio, in the loans to enterprises and loans with longer-term maturity. The reduction of non-performing loans is accompanied by the improvement of their coverage with capital, while provisioning and collateralisation showed insignificant changes.

The increase of contribution from actions related with restructuring, helps to sustain the downward trend of non-performing loans over the period. In its supervision activity, the Bank of Albania shall encourage banks to carry out this process effectively, so that only enterprises with feasible financial projects may benefit from it, and, the fall in concentration of non-performing loans accelerates. In terms of new loans, banks need to carefully monitor the increasing exposure toward certain economic sectors, to ensure compliance with regulatory requirements for sound lending standards, and adequate diversification of the loan portfolio.

b) Liquidity risk in the banking activity is considered as low. The liquidity ratios, both in lek and foreign currency, to short-term liabilities stand significantly above the minimum regulatory requirements. Deposits remain the main source of funding, by covering almost twice the volume of loans, of the sector.

In the funding sources of banks, the growth of demand deposits and current accounts continued, as the time deposits fell. Nevertheless, the risk of this funding structure appears limited, given that banking sector deposits are dominated by well distributed household's savings; time deposits maintain the main share in the structure of banking sector deposits; and their downward pace has slowed down considerably in recent years. Within the time deposits, the value of deposits with maturity over two-years, continues to increase. But, the current structure of funding limits the banking sector's ability to finance long-term projects, mainly related to households and enterprises' investments, hence negatively affecting the effectiveness of its activity.

c) *The banking sector's exposure to market risks, although down over the period, remains important.* The direct exchange rate risk remains restrained, given that the movements in open foreign currency positions in banks' balance sheets show lower volatility against their long-term behaviour. The indirect foreign exchange rate risk shows a slight decrease, given the decrease in the value of the foreign currency credit unhedged against the unfavourable movements in the exchange rate. At the end of the period, this category of loans fell at 24.6% of total outstanding loan portfolio and continues to be dominated by the loans to enterprises. This fall is an encouraging one and is expected to be further positively affected by a better awareness of the public and banks, following the measures approved by the Bank of Albania on 7 February 2018, in the framework of de-euroisation process.

The banking sector remains exposed to interest rate fluctuations.

Nevertheless, the latest data of the period show that this exposure appears relatively more limited. In the current environment of low interest rates, the data on the performance of risk weighted assets and the average maturity of assets indicate that, overall, the banking sector has not shown an increasing appetite for higher risk investments in the last two years. In the light of risks management, this behaviour is positive. Nevertheless, that is imposed, to a large extent, by the considerable slowdown in lending, suggesting that the risks' analysis needs to encompass a longer period and include the impact of such behaviour on the effectiveness of banking activity

d) *The potential of banking market development in Albania needs to be expanded.* This is an important process for the banking sector in order to remain attractive for strategic institutional investors and improve its contribution to country's economic development in the long term. The assessment of banks on the potential of the domestic banking market may be perceived by the survey results that the European Investment Bank conducts regularly with the European banking groups that carry out their activity in the countries of Central, Eastern and South Eastern Europe. The European banking groups are more optimistic for the expansion of their exposure in the region in 2018. Regarding Albania, the banking groups operating in our market, consider the potential of the financial performance as average. Also, most of them assess that their position in the market as fair or optimal. The good assessment for the positioning in the market and the average expectations regarding the performance of the Albanian market suggests a moderate willingness to commit in actions that support the expansion of the activity through the purchase of other banks in the country. Nevertheless, their assessment for the Albanian market improved compared with the previous year. The underlying reasons for this performance may be the improvement in economic growth, the macroeconomic stability, and the improved bank credit quality, against the backdrop of proactive actions by public authorities and banking industry in this regard. As a result, the indicators of the banking sector financial performance improved. It is understandable that the Albanian market will become more attractive to the European banks if these processes continue at an adequate pace. In this case, the acceleration of the adoption of the European standards on banking and financial activities may be important, thus improving the competitiveness of the Albanian market for foreign banks. In this regard, the approval of the Law "On the recovery and resolution of banks in the Republic of Albania" at the end of 2016 was a concrete contribution. Further, the Bank of Albania is working also on adopting some important elements of Basel III standards on supervision processes, and on management of liquidity risk and systemic risk.

RISKS TO FINANCIAL STABILITY

To assess systemic risks, the performance of indicators related to the materialization and accumulation of systemic risk is analysed against the stress level in the financial system and the perception of the banking industry regarding its activities' exposure to systemic risks. Also, the financial stability map provides a consolidated approach of risk assessment to financial stability.

Overall, the financial stability map, the indices for the materialisation and accumulation of systemic risks and the financial stress index, show that risks to the financial stability are more contained. The economic growth, the fall of unemployment rate, the reduction of public debt ratio, the low exchange rate volatility, and the improvement of some indicators of the banking sector - mainly related with the financial result and the improved assets quality - provided a positive contribution in this regard. On the other hand, the increased value of budget deficit at the end of year and the slowdown in deposits growth in the banking sector provided a negative contribution. Banks' responses in the relevant survey show that they perceived lower levels of systemic risks over the period, and that the expectations, overall, are positive.

BANKING SECTOR RESILIENCE

The banking sector's capability to withstand risks is assessed by analysing its capitalization and profitability developments, and by testing the adequacy of these indicators through stress-test scenarios.

At the end of the period, the banking sector's capital adequacy ratio was 16.6%, around 0.6 percentage point higher than at the end of 2016, and notably higher than the 12% minimum regulatory requirement. The higher increase of regulatory capital compared to the increase of risk-weighted assets of the banking sector, led the improvement in the capital adequacy ratio. The financial result of the sector improved over the period. The profitability indicators of the sector, Return on Assets (RoA) and Return on Equity (RoE), resulted at 1.6% and 15.7%, standing 0.9 percentage points and 8.9 percentage points, respectively, higher than in the same period in the previous year. The performance of the financial sector shows a positive contribution from the downward expenditure for provisioning related to credit risk, reiterating the sensitivity of the banking sector to the continuation of this process. Meanwhile, the financial result from the core activity of financial intermediation, as reflected in net interest income continued to decrease. The net interest income decreased due to return on investments falling faster than the relevant expenditures, against the backdrop of operating in an environment of low interest rates for a relatively long period of time. Notwithstanding the fall by 0.3 percentage point in annual terms, banks maintained the net interest margin around the 3.9% level.

The adequacy of the above indicators was assessed through stress tests, with scenarios that assumed adverse developments in macroeconomic and financial indicators for 2018-2019. Similar to before, as part of extreme assumptions with a low probability of occurrence, the adverse scenario included the contraction of the economy, contraction of credit, rapid growth of interest rates and strong depreciation of the exchange rate. In addition to the stress test with a macroeconomic scenario, some other tests were conducted. In more concrete terms, banking sector's performance indicators were tested against the volatility in the banks' real estate balance sheet value, following the write off of non-performing loans, and the volatility in interest rates. Also, in November 2017, banks provided the necessary data to conduct the stress test on liquidity risk.

Overall, the results of the stress tests show that in the scenario containing assumptions closer to reality, the banking sector remains well capitalized and shows good performance. Liquidity in the banking sector remains ample. In the adverse scenario, individual banks and the banking sector would need to increase capital.

Based on this analysis, the Bank of Albania deems that capitalization and profitability of banks is actually adequate to withstand the activity risks. As previously, banks should analyse and test their capacity to withstand various risks regularly, in compliance with the supervisory and regulatory framework.

The next chapters will present in greater detail the report on financial stability for the second half of 2017.

1. OVERVIEW OF MAIN RISKS TO FINANCIAL STABILITY

The Financial Stability Map shows the distribution of risk among factors determining the stability of the financial system, which include the activity of the banking sector, the surrounding external and internal environment, and the real economy agents: government, enterprises and households.

(1) **As at the end of 2017, the financial stability map shows a slight increase in risk to certain categories, and a decrease in risks that may arise from the surrounding economic environment.** The decrease of risks in the overall economic environment reflects the positive economic growth rate and the overall macroeconomic stability. If considering the interaction of the banking sector categories, the performance of indicators mainly reflects an improvement of the banking activity.

(2) In more concrete terms,

a. In the overall economic environment:

i. Risk from "the domestic economy" is assessed as "average", but upward, following the increase in needs for external financing, due to the increase in current account deficit at the end of the year;

ii. Risk from the "external economic environment" is assessed as "low" and downward, driven by the positive economic performance of our trading partners, the improvement in labour market conditions in remittance-sending countries and the performance of CLI index[3]. This index shows the global economy has already entered into its growth stage.

b. Real economy agents:

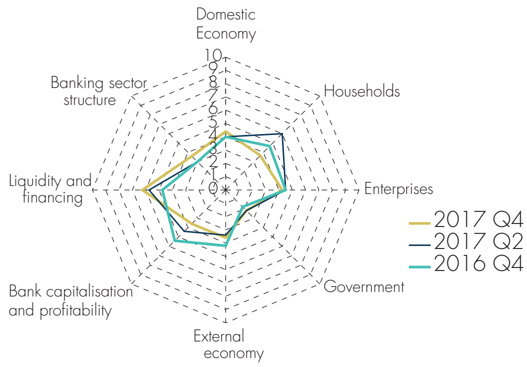
i. Risk from "households" is assessed as "average" and downward, attributable to the improvement in lending against its long-term trend, improvement in the quality of households' portfolio, the performance of unemployment and the improvement of households' expectations for the 2018.

[3] *OECD CLI – The composite leading indicator (CLI), is one of the main indicators, which signals the turning points in business cycles showing fluctuation of the economic activity around its long term potential level. The fall in index prices signals negative turning points in business cycle, meaning a slowdown in the global economic activity and an increase of risk from the "external environment".*

ii. Risk from "enterprises" is assessed as "average" and downward, given the improvement in: the quality of the credit portfolio to this category; the short-term expectations of enterprises; and the index of their financial situation;

iii. For the "government", risk continued to be assessed as "low", but trending upward, due to the developments in the budget balance over the period; in concrete terms, the shift from the positive budget (surplus) to budget deficit;

Chart 1.1 Financial stability map



*Risk is rated: low for scores 0-3 in the map, average for scores 4-5,moderate for scores 6-8 and high for scores 9-10. The farther from the center, the higher the risk.

Source: Bank of Albania.

c. In the banking sector activity:

i. Risk from "capitalisation and profitability" is assessed as "low" and downward over the period. Capitalisation of the sector and credit quality improved, contributing to the decrease of risk from this category. Also, "profit before taxes" as a ratio to "total assets" was up, contributing to the fall of risk from profitability. On the other hand, the continued fall in "net income from interests" contributed positively to the increase of risk to this category;

ii. Risk from "liquidity and financing" is assessed as "moderate" and slightly trending upward, reflecting the deepening of the banks' assets and liabilities gap up to three months[4], and a lower growth of households' deposits. Notwithstanding the above stated, the liquidity indicator of the sector remains at adequate levels, supportive to the banking activity;

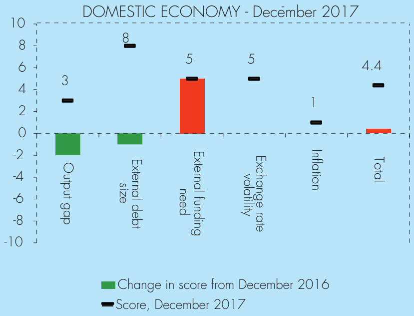
iii. Lastly, the risk related to "banking sector structure" remains unchanged, at "low" level, supported by a better diversification of financing funds and the improved allocation of credit in the banking sector.

[4] *Within this category, which overall is assessed with low risk, the deepening of the gap is mainly a result of the change in the definition of the proper term, for purposes of more detailed analyses by the supervisory authority.*

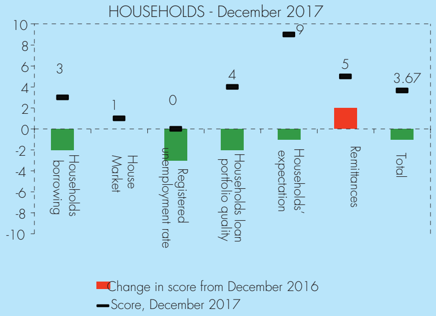
Box 1.1 shows the Financial Stability Map components over 2017 H2, the score for each risk level and comparison with the scores in the previous year.

BOX 1.1 FINANCIAL STABILITY MAP COMPONENTS

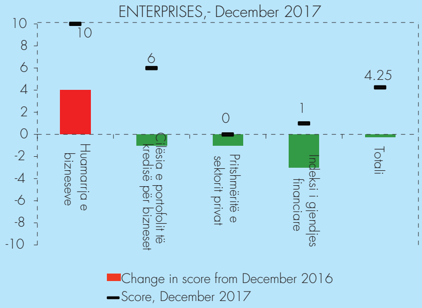
Risk from "domestic economy" is rated as average and trending upward, driven by the increase in needs for external financing.



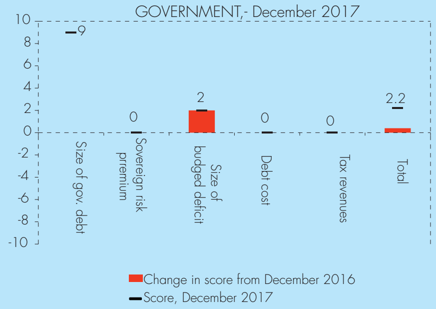
Risk from "households" is rated as "average" and downward, due to the improvement in lending; households' credit portfolio quality; unemployment rate; and their expectations.



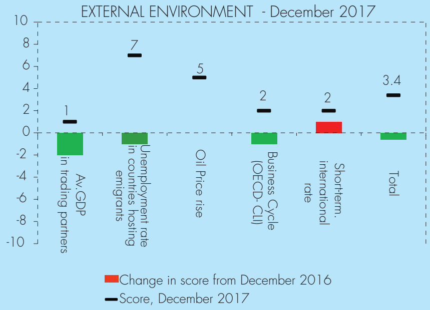
Risk from "enterprises" is rated as "average" and downward, reflecting the improvement in the credit quality, enterprises' expectations and their financial situation index.



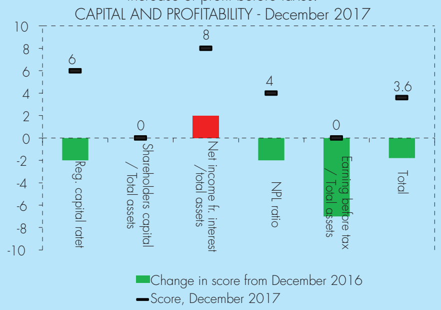
Risk from "Government" is rated as "low", but upward due to the change in the sign of the budget balance.



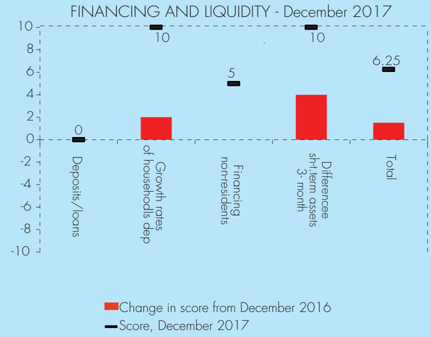
Risk from "external environment" is rated as "low" and downward, driven by the improved economic growth of trading partners and the performance of total CLI index.



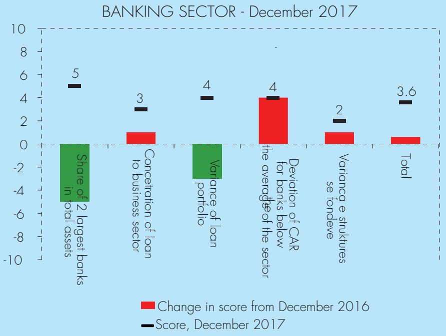
Risk from "capital and profitability" is rated as "low "and downward. The upward risk from the fall of interest income is offset by the improvement of other indicators, such as the f all of NPLs and the improvement of capital and the increase of profit before taxes.



Risk from "financing and liquidity" resulted as "moderate" and upward, due to the deepening of the gap between short-term, up to three months, assets and liabilities, and the slower expansion of households' deposits.



Risk related to the "banking sector structure" remains low and unchanged, given the good diversification of financing funds and the improvement of credit allocation.



Source: Bank of Albania.

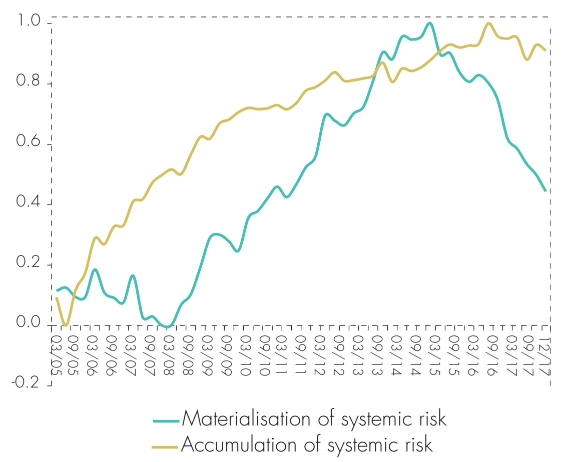
1.1 SYSTEMIC RISK[5]

To assess the banking sector's exposure to systemic risk, the performance of indicators related to: a) the materialization and accumulation of the systemic risk; b) the stress level in the financial system; and, c) the perception of the banking industry regarding the exposure to systemic risks, are analysed. The materialisation index of the systemic risk assesses the actual level of the risk, whilst indices of the risk accumulation, financial stress, and the banking industry perception on it, are mainly forward looking.

(3) Materialisation of systemic risk has been downward over the period and compared with the previous year. The improved credit quality to households and enterprises, the decline in the domestic unemployment rate, and the diminishing exchange rate volatility have contributed to the performance of this index (See Chart 1.2).

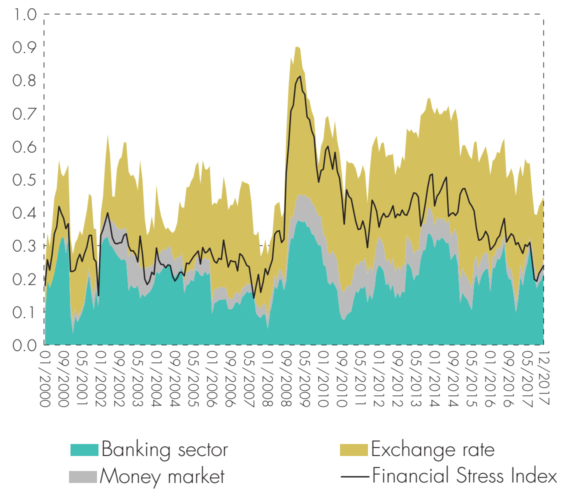
(4) Accumulation of systemic risk and financial stress index were downward over the period. Regarding the systemic risk accumulation index, the reduction of debt level to households, the fall of public debt and the narrowing of external debt provided the main contribution to the decrease of risk accumulation over the period compared with the previous year. Financial stress index was also down driven by the improved performance of banking sector indicators and the appreciation of the domestic currency (see Chart 1.3).

Chart 1.2 Accumulation and materialisation of systemic risk



Source: Bank of Albania.

Chart 1.3 Financial Stress Index



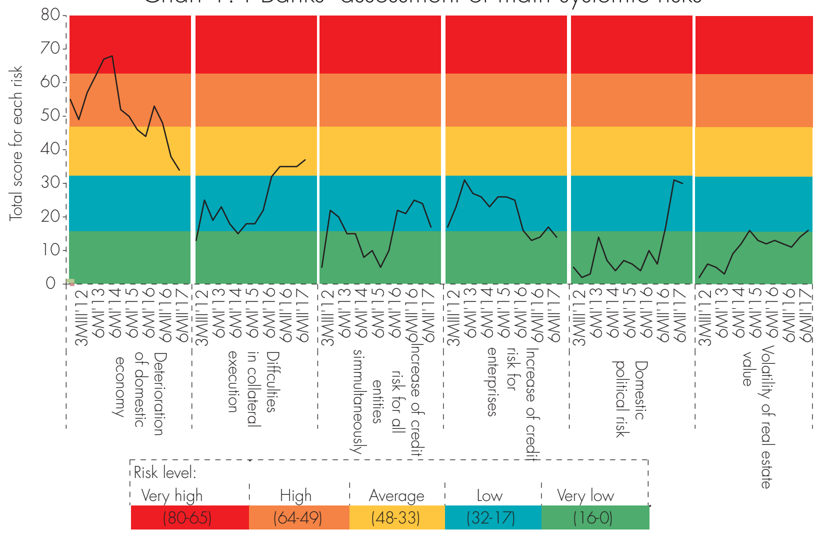
Source: Bank of Albania.

(5) Banking industry's perception provides an overall positive and downward assessment of systemic risk performance over the period. Hence, the potential risk from "Deterioration of the domestic economy" is perceived considerably

[5] *Systemic risk is defined as "the possibility for the materialization of shocks that impair the functioning of a financial system to the point where economic growth and welfare suffer materially".*

lower, due to positive and stable economic growth in Albania. Risk perception from the "the execution of collaterals" process remains relatively high and upward over the period, mainly driven by the perception of small and medium-sized banks. "Political risk at home" continued to remain in the group of main systemic risks, but its perception has been downward compared with 2017 H1[6]. Currently, banks perceive this risk mainly related with the performance of economic reforms and business climate in Albania. Risks related to lending continue to be classified as the most important systemic risks, but the perception on them has continued to decrease, particularly driven by the considerable fall of the non-performing loans ratio in the banking sector.

Chart 1.4 Banks' assessment of main systemic risks



Source: Bank of Albania.

[6] *In 2017 H1, banking sector's perception of "political risk at home" increased considerably due to the political climate in the run up to the June 2017 general elections.*

2. INTERNATIONAL DEVELOPMENTS

(6) Global economic developments were and stable over 2017 H2. The pickup in growth was broad based and synchronised across regions. Economic growth was driven by the favourable financing conditions and the continuation of stimulating policies; while oil price recovery contributed to boosting the economies of oil-exporting countries. Conditions in financial markets were favourable, notwithstanding the divergences among the monetary policies of main central banks. The European Central Bank continued to implement an accommodative policy supporting the regional economic growth, while Federal Reserve, Bank of England and other major central banks in developing countries have taken steps towards monetary tightening. Overall, global inflationary pressures, were subdued, but showed an upward trend occasionally, supported also by the recovery in oil prices.

(7) Economic activity in advanced economies continued to expand firmly, while emerging regions showed considerable recovery signs. Among advanced regions, the United States economy continued to grow positively over the period, driven by the good financing conditions and the strengthening of both domestic demand and investments. The inflationary pressures have remained low. Conditions in the labour market improved and the unemployment rate fell at 4.1%. In the United Kingdom, the economic activity recorded a modest growth in 2017 H2, after slowing down in 2017 H1. In emerging regions, China and India continue to lead the economic growth; meanwhile, the recovery of oil and primary commodity prices has boosted the economies of oil-exporting countries.

(8) Economic growth in the euro area continued to be firm and balanced across regional countries. All EU member countries recorded a positive annual economic growth over 2017 Q3, and this trend is expected to continue in 2017 Q4 as well. The activity is mainly supported by the increase in consumption and investments, as well as the growth of exports given a better situation of the global economic growth. Labour market conditions continued to improve, underpinning the increase in households' income and consumption. Unemployment fell at 8.7% at end 2017. Inflationary pressures, notwithstanding the upward trend at the end of 2017, remained subdued, with inflation rates below 2%. Given that, the European Central Bank continued to maintain the accommodative monetary policy, to support the economic activity of the region.

(9) In euro area banking sector, lending has been gradually recovering. Loans to enterprises and households grew firmly in most countries. This positive

trend noted since the beginning of 2014, resulted from the considerable fall of interest rates due to the ECB's accommodative policies and the recovery of credit demand. The pressure of increasing competitiveness and the decrease of the risk perception also boosted these developments. The European banks continued the efforts to clear and consolidate their balance sheets over the period. Nevertheless, the non-performing loans ratio remains high in certain countries, hence decelerating lending.

(10) Global economy is expected to continue to grow positively and firmly in the medium term[7], fluctuating around the long-term average. The economic expansion in advanced regions and further recovery in emerging regions, supported by better financing conditions, the continuation of stimulating policies and oil price recovery shall underpin global growth. Inflationary pressures are expected to increase driven by the pickup of demand and the narrowing of unutilised capacities. *Risks to the global growth outlook,* overall, appear balanced in the short term. Nevertheless, the considerable growth in assets value in financial markets, given the rather low rates and premia, has driven to the increase of risk of values correction in the future. Also, low interest rates have urged the channelling of funds towards higher-risk investments, searching higher profits, by dampening the imbalances in the financial markets. Last, geopolitical tensions and protectionist policies in certain regions pose risk to global economy performance.

(11) The forecast shows that the euro area economy will grow firmly in the next years. Monetary policy pass-through in the real economy has facilitated the consolidation of balance sheets in economy. This is expected to provide space for further increase of consumption and expenses, by supporting the economic growth of the region. The labour market improvement and the low financing rates will provide also a positive support to the growth of the domestic demand and investments, while the global economy recovery will boost the external demand for European exports. *Risks to economic outlook in euro area*, overall, are assessed as balanced. Currently, they are considered to be more related with external factors, such as developments in real exchange markets, clarity on trade relations with the United Kingdom after "Brexit", or the potentially strained trade relations with the United States.

Table 2.1 Selected macroeconomic indicators for the U.S. and euro area

	GDP change (annual %)				Annual inflation (annual %)		Unemployment (annual %)		Gross government debt (as a % of GDP)	
	2017 Q3	2017 Q4	2017f	2018f	Sept'17	Dec'17	Sept'17	Dec'17	2017 Q2	2017 Q3
U.S.	3.2	2.6	2.3	2.7	2.2	2.1	4.2	4.1	103.1	103.8
Euro area	2.8	2.7	2.4	2.2	1.5	1.4	8.9	8.7	89.0	88.1
- Germany	2.7	2.9	2.5	2.3	1.8	1.6	3.7	3.6	65.9	65.1
-France	2.3	2.4	1.8	1.9	1.1	1.2	9.6	9.2	99.3	98.4
-Italy	1.7	1.6	1.6	1.4	1.3	1.0	11.1	10.8	134.7	134.1
-Greece	1.4	1.9	-	-	1.0	1.1	20.8	-	176.1	177.4

Source: European Central Bank, Eurostat, International Monetary Fund (f- IMF estimates, January 2017), BEA –Bureau of Economic Analysis). "- ": no available data.

[7] *According to IMF Outlook (January 2018) global growth for 2018 and 2019 by 3.9%.*

(12) In Western Balkans, economic activity expanded further in 2017 Q3, but at a different pace across countries. *GDP growth* accelerated in Albania, Serbia, and Montenegro and it remained unchanged or towards slowdown in Kosovo, Bosnia & Herzegovina and Macedonia. The regional economic activity expanded by 2.8% over the period (y-o-y), mainly supported by private consumption and investments. Notwithstanding the economic growth, *labour market conditions* continue to remain challenging to all regional countries, particularly for generating new jobs. Except Serbia, unemployment was downward in the other regional countries in 2017 H2. Fiscal consolidation seems to have slowed down in some of countries, resulting in an increase of fiscal deficits compared to the previous year. Low inflation continued to remain a common characteristic of the region, reflecting low commodity prices and the stability of the exchange rate. In the banking sector, bank credit continued to increase positively and to support the regional economic activity. The growth of loans to households exceeded loans to enterprises across all regional countries. The major part of regional countries continued to reduce the non-performing loans ratio, partly due to the improvement in the regulatory framework addressing them and the mandatory write off from banks' balance sheets.

Table 2.2 Selected macroeconomic and financial indicators for Western Balkans

	GDP (real, % annual)			Unemployment (in %)		Sovereign debt (% of GDP)		Credit growth (%annual)		Non-performing loans ratio (in %)	
	2017 Q2	2017 Q3	2017f	2017 Q2	2017 Q3	2017 Q2	2017 Q3	2017 Q2	2017 Q3	2017 Q2	2017 Q3
B&H	2.9	2.9	-	20.5	-	37.8	-	5.1	6.4	11.1	10.8
Macedonia	-1.3	0.2	1.7	22.6	22.1	37.9	37.8	2.1	4.8	6.7	6.5
Montenegro	5.2	4.7	3.9	15.3	15.1	57.7	56.9	9.3	7.7	8.8	7.4
Kosovo	4.4	4.4	-	-	30.4	-	-	10.3	9.9	3.6	3.6
Serbia	1.4	2.1	2.0	11.8	12.9	65.7	64.6	2.9	-2.1	15.6	12.2

Note: "- ": no available data.
Source: European Commission, f- forecast November, 2017.

2.1 HIGHLIGHTS IN FINANCIAL AND PRIMARY COMMODITY MARKETS

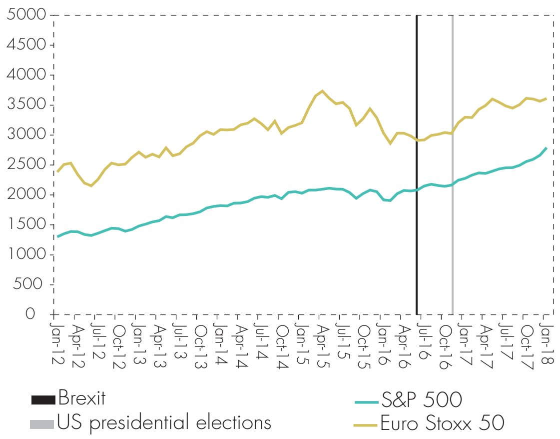
(13) Over the period, developments in global financial markets, overall, were favourable and firm, notwithstanding the deepening of political divergences across regions. Monetary policy decisions in advanced and emerging regions have addressed the economic performance of the countries. Thus, the ECB continued its accommodative monetary policy stance given the inflation undershooting, while the Federal Reserve undertook new steps toward tightening the monetary policy stance at the end of the year[8]. The Bank of England also changed its monetary policy direction, by raising its policy rate - at 0.5% - for the first time in the last 10 years in view of pound depreciation and inflation increase. The large economies also showed divergences. Hence,

[8] *In December 2017, the Federal Reserve raised the interval of the federal funds rate at 1.25% - 1.50%, and took steps to decrease its balance sheet.*

China raised the interest rate to tighten the financing condition and limit lending, while the rest, like India, and some oil-exporting countries, central banks have further accommodated the monetary policy in view of the weak inflationary pressures. Notwithstanding these divergences, developments in financial markets have been optimistic and dominated by the confidence that the re-balancing of policies by the main central banks shall take place very gradually.

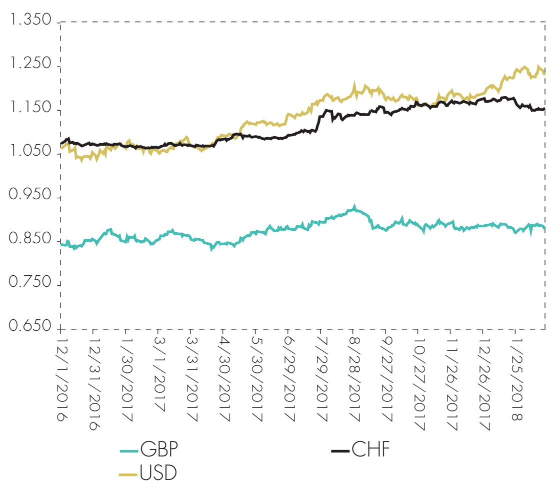
(14) The performance of values and rates in *advanced markets* has reflected the firm economic growth in these regions and the optimistic outlook for the future. Hence, the yield on sovereign securities in European markets, overall, have been unchanged, while in American and British markets they have trended up, throughout the period, driven by market expectations on the change of their monetary policy. In capital markets, developments were positive, characterised by increase of values, narrowing of spreads and fall of volatility. In *emerging markets*, the interest rates, overall, have been down, driving to a modest improvement in financing conditions and capital inflows. Equity prices in these markets have been down, supported by the expectations for a good economic outlook in oil and primary commodity-exporting countries.

Chart 2.1 Main indices in stock markets



Source: European Central Bank.

Chart 2.2 Euro exchange rate against other currencies



Source: European Central Bank.

(15) Currency markets have broadly reflected the distinctions in the stages of economic cycle across countries and the expectations on the monetary policy stance. Hence, euro depreciated against the US dollar and the British pound and against the currencies of some of developing countries, over the period. On the other hand, the euro appreciated against the currencies of some advanced and developing countries, including the Swiss franc, Japanese yen, Chinese renminbi and a good part of European currencies outside the euro area.

(16) Oil prices shifted up over 2017 H2, driven by a set of both supply and demand side-factors. Over the period August - mid December 2017, gross oil prices increased by around 20%, standing above 60 USD/barrel[9]. This increasing trend has continued in the first months of 2018 supported by some factors, including the optimistic market expectations on the performance of the global economy, the extension of OPEC countries agreement on the cut of oil production quota, the political tensions in the Middle East and the adverse weather conditions in the USA at the end of the year. Risks on the further increase in oil prices are mainly related with the great potential of its production by the United States. Commodity prices have been down in 2017 H2, mainly driven by the fall on food prices.

2.2 DEVELOPMENTS IN FOREIGN BANKING GROUPS OPERATING IN ALBANIA

(17) The following table shows some main indicators of the financial statements of the parent banking groups operating in Albania, in relative terms, compared to the same period in the previous year.

Table 2.3 Highlights of foreign banking groups operating in Albania

Change (%)	Raiffesen Bank International[I]	Intesa San Paolo[II]	Alpha Bank[III]	Piraeus Bank[IV]	National Bank of Greece[V]	Societe Generale[VI]
Assets	3.8%	3.0%	-7.4%	-18.0%	-19.5%	-5.9%
Credit	1.7%	3.1%	-2.9%	-6.0%	-5.8%	-0.3%
Deposits	4.3%	-1.3%	6.0%	6.0%	1.9%	-2.5%
Loan-loss provisions	-68.1%	-49.1%	-11.9%	-10.0%	21%	7.6%
Net profit	...	...	...	...	...	-27.6%
Operating income	4.0%	1.2%	4.5%	5.0%	0.0%	-25.4%
Net interest income	2.2%	-2.5%	2.0%	-5.0%	-5.0%	
Net commission income	7.7%	5.5%	1.7%	55.0%	43.0%	
Operating expenses	-0.1%	0.4%	-2.5%	-4.0%	-8.0%	6.1%
Net operating profit	10.7%	2.0%	-	-	...	-
Ratios						
Non-performing loans	6.7%	5.5%	37.3%	36.2%	-	4.4%
Net interest margin	2.46%	-	3.1%	2.73%	3.07%	-
Capital adequacy ratio	17.9%	17.9%	17.9%	16.6%	16.8%	17.0%
Bank's assets in Albania against the total group	1.31%	0.14%	0.91%	0.81%	0.42%	0.05%

[I] Report for 2017 Q3: http://investor.rbinternational.com
[II] Financial result for 2017: http://www.group.intesasanpaolo.com
[III] Financial result for 2017 Q3: http://www.alpha.gr
[IV] Financial result for 2017 Q3: http://www.piraeusbankgroup.com
[V] Financial result for 2017 Q3: https://www.nbg.gr
[VI] Financial result for 2017: http://www.societegenerale.com
Note: Note (...) shows pronounced change of this indicators (higher than 100%), in either positive or negative terms.
(-) shows not available data for this indicators in the releases of the relevant bank.
Source: Official websites of banking groups.

[9] *Economic Bulletin, ECB, December 2017.*

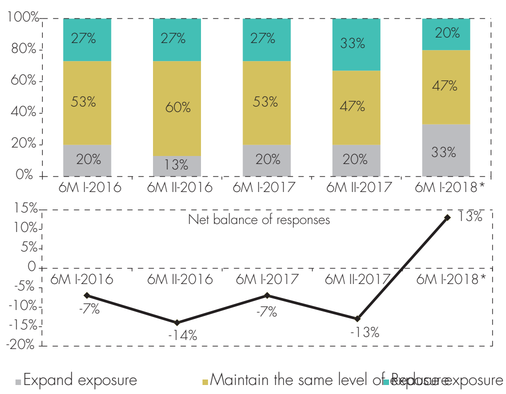
Indicators show a good capitalisation of all banking groups and an improvement of income level in some of them. The share of banks operating in Albania in total assets of the respective foreign banking groups remains low.

BOX 1. SELECTED RESULTS FROM THE CESEE BANK LENDING SURVEY H2-2017 (EIB) AND THE POSITIONING OF ALBANIA

A. International banking groups operating in the CESEE region

In the last survey of 2017 H2, banking groups operating in CESEE seem to be tilted towards a selective expansion in the region, in terms of their market positioning, market potential, and profitability. ***Exposures at group level to CESEE region have reduced over 2017 H2, compared with 2017 H1*** *(the net balance of responses fell from -7% to -13%), while the share of banks that have increased the exposure has remained the same. On the other hand, the forecast of groups for the next 6 months appears optimistic; around 33% of them expect to increase exposures to the region, against 20% that expect their further reduction (See Chart 2.3).*

Chart 2.3 Groups' total exposure to CESEE (Share of responses in %)



*forecast.

Note: Net balance is calculated as the difference between the responses Expand exposure" with the share of responses Reduce exposure".

Source: European Investment Bank.

Chart 2.4 Group-level long -term strategies (beyond 12 months) in CESEE

Source: European Investment Bank

Regarding the ***long term strategies (beyond 12 months)****, (See Chart 2.4), banking groups appear to reassess their country-by-country strategies in CESEE region. Thus, as the results from the responses for 2017 H2 show, around 50% of groups declare to have a long-term expansion strategy (total of "selective expansion of activity in some countries" and "expansion of the activity" of the business in the region. On the other hand, around 20% of banking groups, where Greek banking groups are included, but not only, state that may reduce their activity in the region in the long term (total of "reduction of the activity" and "selective reduction of the activity").*

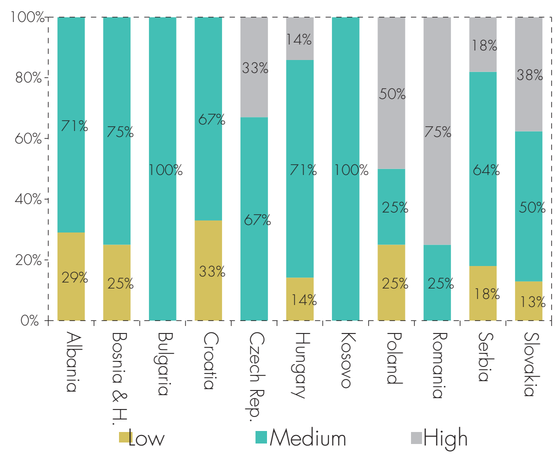
Overall, credit demand in the region is assessed as upward, while lending standards are eased over the surveyed period. *Nevertheless, banks perceive that there is a notable gap in CESEE region between the high credit demand and the still contained supply. The major part of banking groups included in the survey assess that average profitability indicators of the region as a return on assets (ROA) and equity (ROE), are higher than the average of the group.*

B. Positioning of Albania in the CESEE region

Most foreign banking groups (around 71%) that operate in Albania, for 2017 H2, see their market positioning as "fair", while 14% see their market positioning as "optimal" (see Chart 2.5). On the other hand, 71% of the parent banking groups see Albania as a market with medium potential market positioning but comparatively with lower profitability than the group, also due to the cleaning-up of the balance sheets of banks that is still in progress (Chart 2.6).

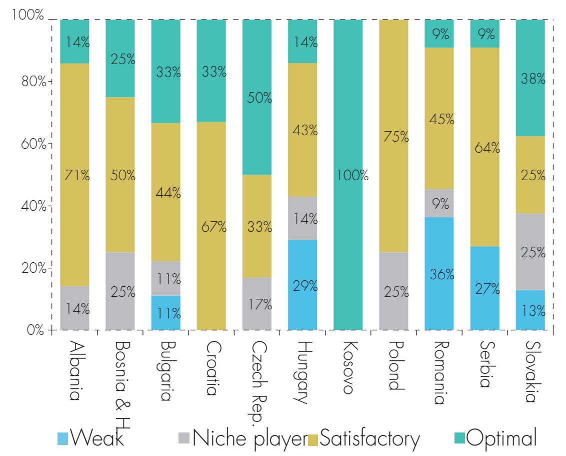
The majority of subsidiaries of banks operating in Albania are assessed to be less

Chart 2.5 Market potential in 2017-H2
(shares of responses, in %)



Source: European Investment Bank.

Chart 2.6 Market positioning in 2017 H2
(shares of responses, in %)



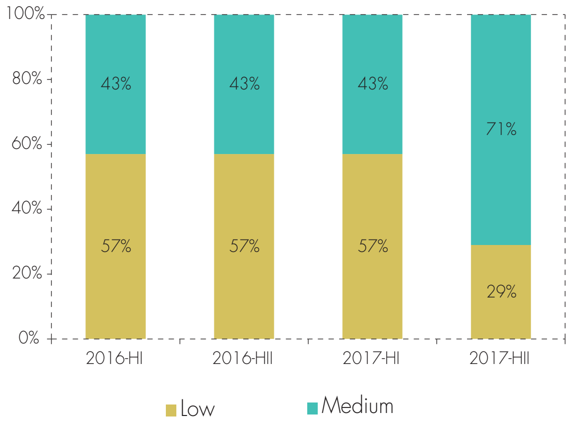
Source: European Investment Bank.

profitable than their parent banking groups in the last six months. The addressing of non-performing loans seems to have weighted negatively on banks profitability.

Currently, the satisfactory positioning of foreign banking groups, and their assessment for the market potential, suggest a relatively low willingness to expand in the Albanian market through either absorption or merger. On the other hand, the progress towards the cleaning-up of banks' balance sheets is expected to drive to an improvement in profitability indicators and to be followed by the improvement of market potential.

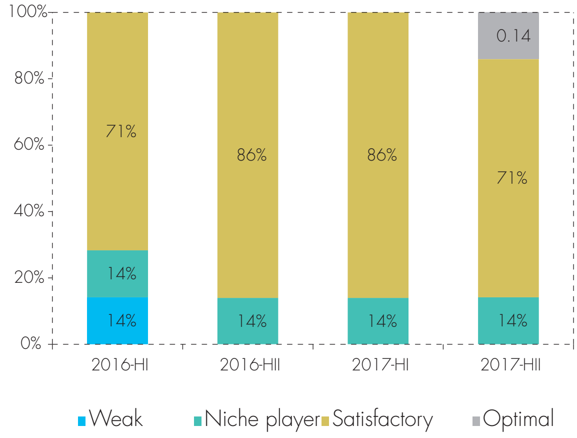
Nevertheless, the comparison with the results of this survey in 2016 H2, where banking groups see Albania a limited potentially market and low profitability compared with the other part of CESEE region, it appears that banks' point of view is somewhat more optimistic (Chart 2.7 and Chart 2.8).

Chart 2.7 Albanian market potential in the last two years



Source: European Investment Bank .

Chart 2.8 Banking groups positioning in the Albanian market



Source: European Investment Bank.

3. MACROECONOMIC DEVELOPMENTS IN ALBANIA

(18) In 2017 Q4, the economic activity in Albania continued to improve, although at a lower growth pace from the three previous quarters. In 2017 Q4, the annual growth was 3.36%[10], with positive contribution almost from all branches of services and production, mainly: "trade, hotels and restaurants", "transport", "construction" and "industry, energy and water". Aggregate demand was based on the expansion of the population's final consumption and the gross fixed capital formation, while the final consumption of the Government was down, unlike in the first nine months of 2017. In the labour market, the unemployment rate continued the falling trend since December 2015, down at 13.4%[11].

(19) Amid continued subdued inflationary pressures, the monetary policy remained accommodative over the period, although the policy rate did not change. Although the available data suggest that economic activity, employment and confidence of economic agents have been improved these developments are not yet reflected in the inflation values. Hence, in December, annual inflation stood at 1.8%, down, both in annual and half-yearly terms[12]. The Bank of Albania assesses that the continuation of economic growth and the good anchoring of inflationary expectations will establish the adequate premises for the increase of inflation and its return to target in the medium term.

(20) At the end of 2017, budget surplus was negative, around ALL 31 billion, up by around ALL 4.3 billion from the previous year. In relative terms, budget deficit is assesses to have increased 0.25 percentage point over 2017, at 2.15% of GDP. The budget surplus dampened due to the budget expenditures increasing faster than revenues[13]. Deficit was mainly financed by external funds, thus lowering the need for government borrowing from the domestic market. Volatility in budget deficit is expected in the short term, but fiscal consolidation is assessed as necessary to ensure the stability of economic growth in the long term. The need to realise budget expenses, in particular the capital ones, and compliance with the targets, remain challenges to planning and realising the budget.

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[10] *INSTAT preliminary estimations show that domestic economic activity annual growth is assessed at 3.84%.*

[11] *Unemployment rate marked 14.2% in 2016 Q4 and 13.9% in 2017 Q2.*

[12] *In more concrete terms, in December 2016 and June 2017, inflation rate was 2.2%, respectively.*

[13] *Annual income recorded and accumulative value of around ALL 431 million (5.7% annual growth), while overall expenses marked the value of around ALL 461 million (6.4% annual growth).*

(21) The overall balance of payments was positive. Foreign assets (reserve) expanded in 2017 Q4. After a downward performance till 2017 Q3, the current account deficit expanded considerably in annual terms, over 2017 Q4, up at EUR 295 million at the end of 2017, or around EUR 117 million higher. The further expansion of the trade deficit in goods, followed by the fall in positive surplus in the services and primary income account provided the main contribution to this performance. The dampening of trade deficit in goods derived from high imports of electrical energy and pharmaceutics products, and the fall in the exports of oil and its products. Inflows in the secondary income increased by 13% from the previous year, reaching at EUR 253 million. In this category, remittances share around 68% of the total and are assessed to have provided foreign currency inflows at around EUR 172 million. The flow of Albania financial liabilities to the world is assessed at EUR 359 million, almost doubled from the previous year. Foreign Direct Investments (FDIs) account for the major part of the financial liabilities. Net FDIs inflow marked EUR 232 million, around 2% lower from the previous year. Energy, hydrocarbon sectors and financial intermediation continue to provide the main contribution to their growth. Last, liabilities in the form of other investments expanded by EUR 123 million, while this category fell by EUR 60 million in the previous year.

4. FINANCIAL POSITION AND RISK EXPOSURE OF HOUSEHOLDS AND ENTERPRISES

(22) **In the second half of the year, households were more inclined toward saving.** The expansion of the deposit base, mainly in foreign currency, gave the main contribution to the expansion of the credit position of households during the period[14]. Business' liquidity improved as well, **given the narrowed debt position of businesses,** during the period, thanks to the increase of deposits in lek[15]. In *annual terms*, unlike the half-yearly trend, households show a slight expansion of the creditor position attributable to the creditor position in domestic currency[16]. Meanwhile, the debtor position of enterprises narrowed as a result of the decrease of foreign currency loans. [17]. The lost loans write off from bank balance sheets was accompanied by a high level of repayment and restructuring in the banking sector, hence, significantly improving credit quality in general and unhedged foreign currency loans in particular.

4.1 FINANCIAL POSITION OF HOUSEHOLDS AND ENTERPRISES

(23) During the period, the credit position of households increased to ALL 781 billion, with the main contribution from the expansion of the foreign currency position[18]. Although the growth rate of the loans was higher than that of deposits, the broader base of the latter affects the direction of the net position movement. Credit to households remained oriented to the domestic currency, contributing to the narrowing of the credit position in lek[19]. On the other hand, enterprises narrowed their debtor position against the banking sector, standing at ALL

[14] *Creditor position narrowed by around 2.0% during the period, affected mainly by the increase of deposits by 2.2%. Deposits in foreign currency and lek grew by 3.9% and 0.4% respectively. At the same time, credit granted to households increased by 2.8%. Within this portfolio, ALL credit increased by 4.4%, despite the 0.8% increase in foreign currency credit;*

[15] *The debtor position narrowed during the period by 5.8%, due to the narrowing of the position in lek (8.5%), mainly attributable to the increase of credit in this currency (13.3%). Credit fell slightly by 0.6% affected by the decrease of foreign currency credit by 1.8% compared to the 1.2% increase of credit in lek.*

[16] *In annual terms, creditor position of households narrowed by only 0.3%, attributable to the narrowing of the position in domestic currency by 3.1% and the expansion of the position in foreign currency by 2.2%.*

[17] *The narrowing of debtor position, in annual terms, was around 11% and was affected by the narrowing of position in foreign currency by 15.4%. The fall of foreign currency loans and deposits - 8.3% and 0.9%, respectively - was accompanied by credit growth and deposits in domestic currency: 3.3% and 10.5%, respectively.*

[18] *The foreign currency lending position expanded by about 4.5%, as a result of foreign currency deposits growth by 3.9%.*

[19] *The credit position in lek narrowed by about 1.0% as a result of lek credit growth by 4.4%.*

Chart 4.1 Financial position of households and enterprises, in ALL billion

Source: Bank of Albania.

149 billion. All currencies had positive impact[20], with the main contribution by the increase of enterprises' deposits.

(24) The developments of the period related to **resident households** show that their savings increased, mainly in the form of foreign currency deposits and bond investments, while investment in treasury bills narrowed, decreasing their share in the total portfolio of households' investments. Meanwhile, in annual terms, the savings of resident households increased mainly in the form of lek deposits and invest ment in investment funds.

Table 4.1 Households' assets in the financial system, ALL billion

	2010		2013		2016, Dec		2017, June		2017, Dec	
	ALL bln	Share %	ALL bln	Share %	ALL bln	Share %	ALL bln	Share %	ALL bln	Share %
Deposits, ALL	357.6	49.8	449.5	43.7	454.3	40.3	465.1	42.1	467.2	40.7
Deposits, FX	304	42.3	418.4	40.7	476.4	42.3	432.8	39.2	469.5	40.9
T-bills	56.7	7.9	70.6	6.7	65.2	5.8	67.3	6.1	63.6	5.5
Bonds	0.37	0.05	39.8	3.9	64.5	5.7	67.9	6.1	72.1	6.3
investment funds*	-	-	50.3	4.9	65.4	5.8	70.8	6.4	73.5	6.4
Supplementary private pensinon funds*	0.12		0.43	0.04	1.2	0.1	1.3	0.1	1.6	0.1
Portofoli i individëve	718.8	100	1,029	100	1,127	100	1,105	100	1,147	100

Source: Bank of Albania and FSA.

4.1.1 LOANS TO HOUSEHOLDS AND CREDIT RISK

(25) **During the period, the increase of loans to households by about 2.7%[21] is entirely attributable to the domestic currency, whereas loans in foreign currency remained at the same levels**. Hence, the share of credit in lek to households was up at 59.3%, around 1.1 percentage points higher than in June 2017. Unhedged loans to households in foreign currency fell both in annual and half-yearly terms, reducing the exposure against the unfavourable movements of the exchange rate. The share of unhedged credit in foreign currency against the total outstanding credit in foreign currency to households dropped at 51.9%, compared to 53.1% and 53.9% in June 2017 and December 2016[22]. Around 77% of household unhedged credit consists in "Mortgage loans", which fell by 2.3 percentage points, over a one year period. According to the maturity term,

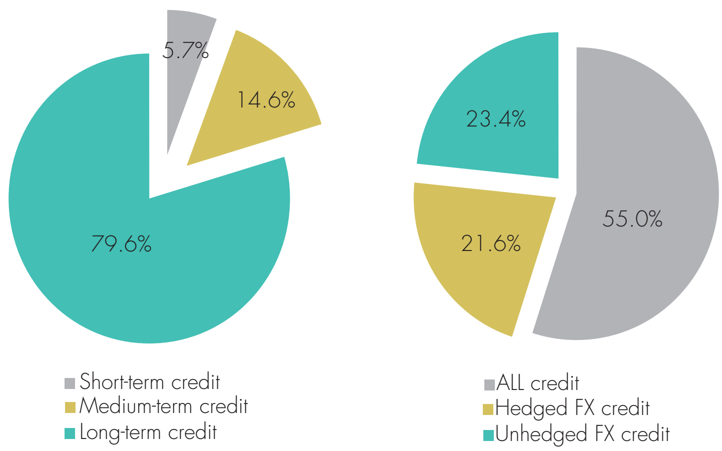
20 *The narrowing of the debt position was 8.5% and 3.7% respectively for the domestic and foreign currencies.*

21 *In annual terms, credit growth to households was 5.5%.*

22 *The developments in the share of unhedged credit in foreign currency against total outstanding credit to households are in the same direction. This ratio fell both in annual and semi-annual terms. It stood at 23.4% in December 2017, compared with 23.7% and 25.7%, in June and December 2016, respectively.*

the total credit to households shows no significant structural changes during the period[23]. Mid-term and long-term loans represent a minimal increase of 0.1 percentage point, respectively over the first half of the year; while short-term loans fell by 3 percentage points over the same period.

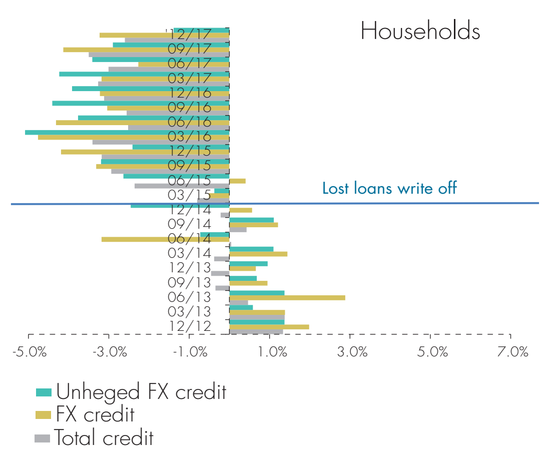
Chart 4.2 Structure of credit to households by maturity (left) and currency (right)



Source: Bank of Albania.

(26) The quality of the portfolio of loans to households continued to improve, attributable to the loan repayment and lost loans write off from banks' balance sheets. The ratio of non-performing loans to households fell at 7.6%, around 2.6 percentage points lower than in the previous year. Non-performing foreign currency loans improved in the total portfolio and in the unhedged portfolio against non-performing currency loans, the improvement was observed in the total portfolio and in the hedged against unfavourable exchange rate fluctuations. The ratio of non-performing loans in foreign currency fell at 8.7%, down by 3.2 and 2.4 percentage points, respectively, in annual and half-yearly terms. The non-performing loans ratio of foreign currency credit unhedged against the fluctuations in the exchange rate further dropped at 9.8%[24]. In lek, the ratio of non-performing loans dropped to 6.9%, nearly 1.1 percentage points and 1.7 percentage points down compared to June 2017 and December 2016 respectively.

Chart 4.3 Annual change of NPLR for households, in p.p.



Source: Bank of Albania.

[23] *The above developments are also confirmed in terms of annual developments.*

[24] *This ratio was 10.6% and 11.2% at the end of June 2017 and December 2016, respectively.*

(27) **Resident households have obtained loans at an accelerated rate of 2.8% and 5.5% respectively in half-yearly and annual terms**. Within this portfolio, similar to the previous period, the main contribution comes from the increase of credit for "non-durable goods" and "real estate". The latter does not change its share significantly (63.2%) and continues to be the main item within the total loans to households.

BOX 4.1 SURVEY RESULTS ON HOUSEHOLDS' FINANCIAL AND BORROWING SITUATION

The survey of households' financial and borrowing situation is conducted half yearly. The survey is based on a randomly selected sample of 1,209 households, in around 56% urban areas and 44% rural areas.

In 2017 H2, the ***number of employed persons*** *increased in annual terms, mainly supported by the employment in the public sector. The* ***level of household income*** *dropped during the six-month period, whilst expenditures continued to increase, resulting in a narrowing of the financial balance (income-expenditure). Around 28% of households say they have a loan to repay. This share is similar to that of the previous period, but slightly lower from the previous year.*

In 37% of cases, surveyed households responded they had borrowed from formal sources (banks and non-bank financial institutions) in the form of credit products, and in 63% of cases from informal sources, mainly in cash. Unlike the borrowing frequency structure above, the distribution of its outstanding appears different. About 82% of it is provided by formal sources and 18% by informal sources; this structure is in favour of formal borrowing compared to the previous six months and the previous year. Consumption (42% of cases), purchasing/renovating a property (26% of cases) and business development (12% of cases) remained the top three ***purposes of borrowing.*** *During the survey period, the shares of borrowing for consumption and real estate purchasing have been downward. By purpose of use, around 46% of outstanding credit was for 'Purchasing/renovating a property', 31% for 'business development' and only 6% for "consumption" purposes.* ***By currency,*** *92% of outstanding credit is in lek, and only 8% in euro.*

The borrowing households say credit instalment during the period has fallen, reflecting the reduction of the weighted credit interest rate to households. The major part of borrowing households stated that their repayment capacity has not changed during the period, while the rest mainly state a worsening. Most households (about 72%) do not expect change in repayment in the first half of 2018, while the rest (i.e. those who expect "deterioration" and those who except improvement) are almost equal in number.

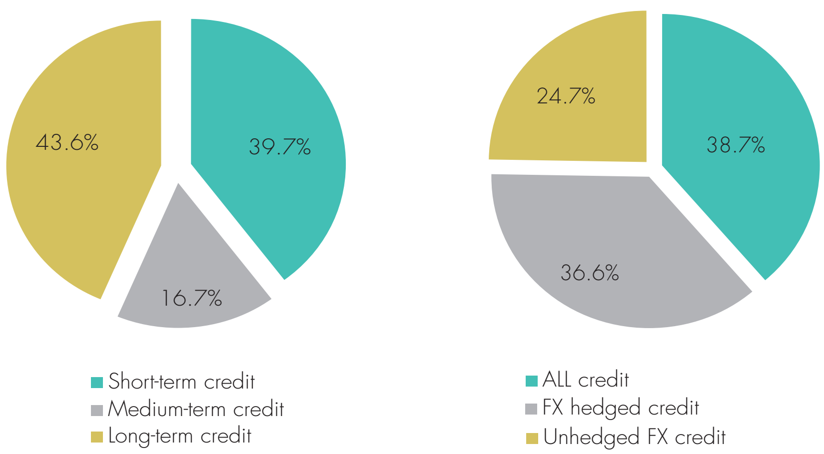
The possibility to receive a loan *during 2018 H1, has resulted almost at the level of the long-term average but slightly trending up, which may signal a recovery of credit demand by households.*

4.1.2 LOANS TO ENTERPRISES AND CREDIT RISK

(28) **Loans to enterprises** account for 65% of total outstanding credit from the banking sector and it fell slightly annually. In this portfolio, loans to resident enterprises had the main share, at 86%. The latter, despite the narrowing in annual terms, by 2.4%, increased slightly compared to the previous year by 0.5%. During the period under review, outstanding credit for "overdraft" and "equipment purchase" purposes expanded most[25]. Meanwhile, annual developments show a fall in the credit stock also for "working capital". Outstanding loans to non-resident enterprises shrank both in semi-annual and annual terms[26].

(29) **In the total structure of loans to enterprises, credit in lek further increased.** The share of foreign currency loans in the total loans to enterprises dropped at 61.3% or 1.4 percentage points lower from the previous year. The share of unhedged credit from unfavourable exchange rate fluctuations to total loans to enterprises also dropped to 24.7%[27]. In the structure of unhedged loans to enterprises, the shares of credit for "trade", "real estate development" and for "business development" fell at 46.4%, 10.5% and 14.2%, respectively.

Chart 4.4 Structure of credit to enterprises by maturity (left) and currency (right)



Source: Bank of Albania.

(30) **In the stock of loans to enterprises, loans to large and medium-sized enterprises** has increased. The share of loans for these enterprises was up, 60.2% and 23.8% of total loans to enterprises, respectively[28]. During the

25 *More concretely, loans for "overdraft" and "equipment purchase" increased half-yearly by ALL 4.1 billion.*

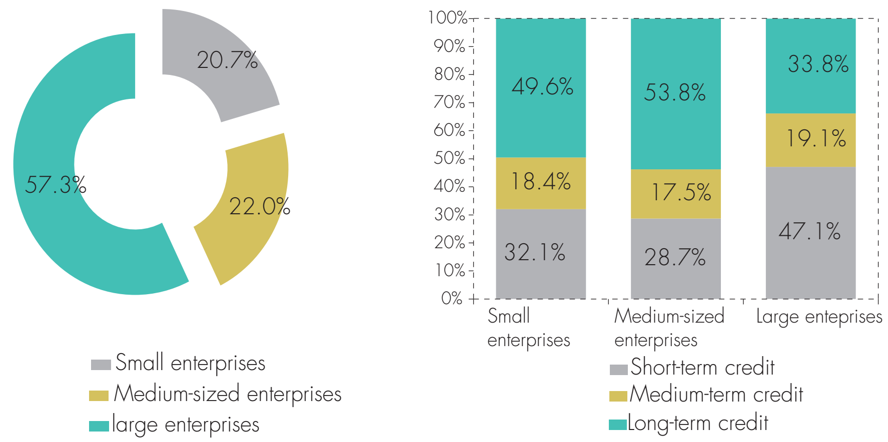
26 *For more details, refer to the developments in the outstanding loans in section 8.3.1 of the report.*

27 *Its share in June 2017 and December 2016 is 26.4% and 27.0%, respectively, of total loans to enterprises.*

28 *These values are: 57.3%; 22.0% and 20.7% in December 2016; whereas in June 2017, they were: 56.9%, 22.5% and 20.7%.*

period, the long-term credit continued to increase for the small enterprises, whereas the large enterprises continue to be oriented toward medium-term credit, recording small changes in the fall of long-term credit. **By currency,** the small enterprises decreased the share of credit in the Albanian currency in favour of the one in foreign currency; whereas medium-sized and large enterprises expanded the credit in the Albanian currency.

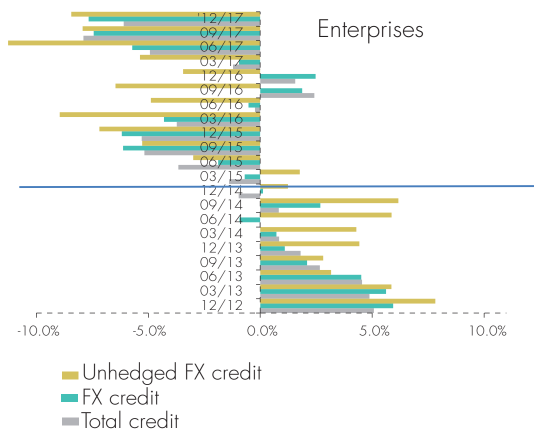
Chart 4.5 Structure of credit to enterprises by size



Source: Bank of Albania.

(31) The quality of the portfolio of loans to enterprises, almost in all its components, improved considerably in annual and half-yearly terms. In December 2017, the ratio of non-performing loans t o enterprises stood at 16.9%, from 19.5% in June 2017, and 23.0% in the previous year. The ratio of non-performing loans in foreign currency pursued a similar trend, falling at 16.6% at the end of the period, or 7.7 percentage points lower than the level of the previous year. The quality of the unhedged foreign currency credit portfolio also improved significantly, mainly annually, driven by the repayment and restructuring of loans and the lost loans write off from the balance sheets. At the end of the period, the ratio of non-performing loans for this category dropped at 13.8%, from 15.1% at the end of June, and 22.2% in the previous year. Also, the non-performing loans of lek credit dropped to 19.6% in December 2017, around 1.7 and 2.7 percentage points lower from June 2017 and December 2016.

Chart 4.6 Annual change of NPLR for enterprises, in p.p



Source: Bank of Albania.

BOX 4.2 SURVEY RESULTS OF ENTERPRISES FINANCIAL AND BORROWING SITUATION

The survey of enterprises financial and borrowing situation has been conducted half-yearly, for eight years. Since 2016 H1, this survey has been conducted on about 1200 large, medium-sized and small enterprises, across the country, which carry out their activity in the main sectors of the economy. In this survey, enterprises are asked on the performance of their business, financing needs, and debt, relationship with banks, etc.

During 2017 H2, enterprises estimate that **competition** *and finding a market are the main challenges interfering their activity, especially for small enterprises. Issues related to* **access to finance** *and* **financing costs** *are estimated as declining for all sizes of enterprises.*

The level of **sales** *was assessed as upward, for medium-sized and larger enterprises and downward for small enterprises in 2017 H2. Medium-sized and larger enterprises assessed the financial result, and the expansion of activity as upward, during the period. Overall, the positive expectations of enterprises about the sales, the* **financial result** *and* **the expansion of the activity** *provide optimistic signals regarding their performance in the short and medium term.*

During the period, almost half of the respondent enterprises **financed their activity through sales. Borrowing as a separate or combined source** *was used by 26.5% of larger enterprises, 23.5% of medium-sized enterprises and 15.7% of small enterprises.*

About 42.3% of total enterprises (443 in total) claim to **have a loan to repay,** *upward compared to the previous survey results. The result applies to all three groups of enterprises, but stands somewhat more pronounced for medium-sized enterprises. Around 91.3% of total borrowing enterprises state that they have turned to* **banks** *for borrowing. This share accounts for 93.3% of total* **formal sources** *(banks and non-bank financial institutions), ticking up during the period.*

*The main purpose of borrowing is for l***ong-term investments and to afford current expenditures.** *Compared to the previous period, the share of enterprises that have borrowed to carry out long-term investments was up for the small and larger enterprises, and slightly down for medium-sized enterprises. Around 78.7% of small enterprises, 83.8% of medium-sized enterprises and 80.6% of larger enterprises consider their* **level of borrowing for financing their activity as adequate.** *Compared to 2017 H1, this share has increased for all sizes of enterprises.*

Borrowing only in the **domestic currency** *accounts for 47.1% of the total of borrowing small enterprises, 48.9% of medium-sized enterprises and 29.3% of large enterprises. Loans in the* **euro** *account for the major share of large enterprises, at 56.3%.*

For small enterprises, this type of borrowing is 44.2%, while for the medium-sized it is 42.6%. Borrowing in **US dollars** *is low, not exceeding 2.9% of the total (small enterprises). Only 4.9% of small enterprises and 12.4% of medium-sized and 10.6% of larger enterprises report* **new borrowing** *during the period.*

The **overall value of the loan** *is about half the value of the enterprise's capital for 79.8% of borrowing enterprises. By size,* **debt share** *is higher for small enterprises, of which around 21.1% stated that the value of the loan is equal or higher than the value of capital. The majority of borrowing enterprises (81.9%) state that the loan* *to income ratio amounts up to 20% of revenues, up from the previous period. The burden of the loan payment appears to be heavier on small enterprises. The number of small enterprises reporting that the instalment of the loan exceeds 20% of revenues accounts for around 27.4% of the total group.*

BOX 4.2.1 ASSESSMENT OF PERSISTENCE IN CREDIT PLANNING

This box seeks to assess the persistence of credit planning by enterprises. Based on the survey data of the financial situation and borrowing, related to enterprises that have declared their intention to take a loan in the period ahead, their declaration is subject of verification to see whether they have succeeded in receiving the loan.

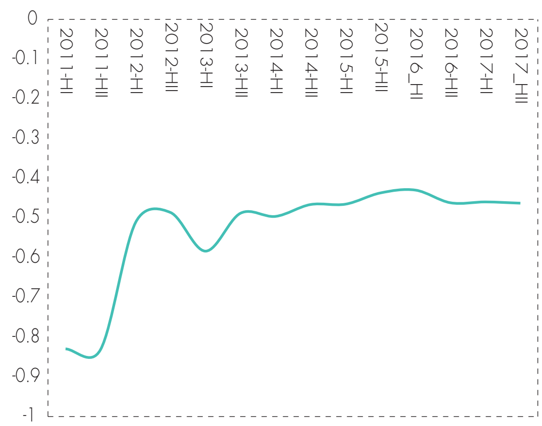
The data belong to 2010 H2 - 2017 H2, considering 14 periods. For each successive pair of periods, those enterprises that are active in replying in both samples are selected based on their unique business registration number (NUIS). For each of them, the submitted reports are surveyed for each enterprise in period t on the plan to receive a bank credit in the next six months, and it is compared to the report in the period t+1, if the enterprise has eventually received a loan.

The following table shows a matrix of possible alternatives of two questions on the planning of borrowing in period t and its realisation in the period t+1. The possible values of assessment range from "-1" if the firm plans to borrow and does not realise it, to "1" if it does not plan to borrow, but takes a loan.

Table 4.2 Matrix of enterprises' borrowing planning

Actual / Expect.	Has received a loan in actual 6M	Has not received a loan in actual 6M
Plans to borrow in the next 6M	0.5	-1
Does not plan to borrow in the next 6M	1	-0.5

Chart 4.7 Persistence of enterprises' credit planning index



Source: Bank of Albania.

For each period, the average assessment of the coefficients is constructed according to the table, by attaining the ***Persistence in Credit Planning Index*** *for the period 2011-2017.*

The results show that the average indicator for each period is at negative levels. In the first survey period, during 2011, the indicator is at around -0.8 (close score -1), implying that enterprises that had planned to take a loan, have not taken it. Based on the Bank Lending Survey data, at the beginning of 2011, banks tightened lending standards, tending to keep them tight till the end of the year. Related to the second period, after 2012, overall, the indicator improved, albeit remaining negative. Since 2014 H2, its value has fluctuated around -0.4 and -0.5 implying that, overall, enterprises did not plan and have not taken any loan. This development reflects the presence of a sluggish credit demand, and the correct assessment for a significant number of enterprises, that the current debt level is sufficient to conduct the activity.

The Theil Index is constructed to assess the distribution of enterprises' answers, within the period. This Index is used to measure the distribution degree of answers between the possible alternatives of borrowing, and provides information on the concentration of the enterprises answers in one of the provided alternatives.*

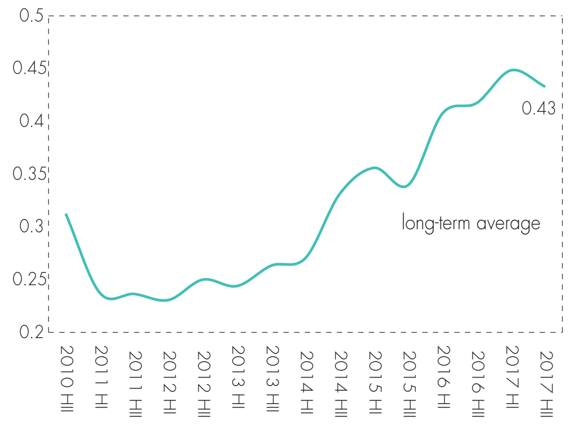
***Theil index** is calculated according to the following formula:*

$$T_T = T_{a=1} = \frac{1}{N} \sum_{i=1}^{N} \left(\frac{x_i}{\bar{x}} \cdot \ln \frac{x_i}{\bar{x}} \right)$$

*Where **N** is the number of alternatives to the question and x_i is the part of answers to one alternative.*

Theil Index takes values from 0 to 1. The lowest value 0 implies an equal distribution of answers according to all alternatives of the question, showing a high insecurity. The highest value 1 is obtained if all enterprises have chosen only one alternative, thus stating the lowest possible uncertainty.

Chart 4.8 Theil Index



Source: Bank of Albania.

As shown in the above chart the average of this index stands at 0.32, reflecting heterogeneity in response to the presence of enterprises uncertainty in assessing the possibility to borrow. In general, the index fluctuated close to its historical average level of several periods, concentrating in the period between 2014 H1 and 2015 H2. Moreover, enterprises express a lower uncertainty compared to previous periods, as of 2016 H1 onwards, showing an improvement of this indicator. In the last evaluation period, i.e. 2017 H2, the value of this indicator is 0.43, thus showing a higher concentration of responses in one of the alternatives. These results are in line with the persistence indicator of the borrowing plan, above, which improved in the same period.

***Bank borrowing** is assessed between "normal" and "difficult", while the **importance of relationship with banks** is assessed between "important" and "indispensable", for all the three groups of enterprises. More than half of the respondent enterprises (53.6%) have reported that **they do not have any possibility** to request a banking loan in the next half of year. This share is increasing for the three groups of enterprises. There is a decrease in the share of enterprises in the entire three groups reporting that there is a slight possibility to borrow in the next period.*

* *During the survey the firms (enterprises) are asked: What is the probability your enterprise receives a bank credit in the next six months (chose one alternative)?*
1. None.
2. Little possibility
3. Strong possibility
4 Certainly.

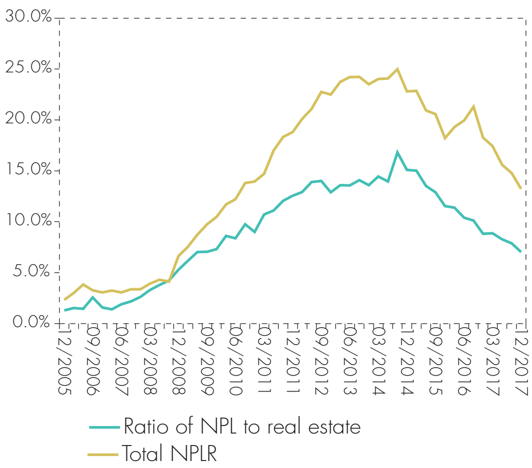
4.2 REAL ESTATE MARKET

(32) The banking sector is exposed either directly or indirectly to developments in the real estate market[29], related to supply and demand, the volume of sales and performance of prices in the market. According to INSTAT data for the end of 2017, in the real estate market, area and number of construction permits for residential buildings increased significantly. **Also, data reported by the banking sector for the period show an almost unchanged level of the outstanding loan for real estate, followed by a slight increase of interest rates on this type of loan and significant improvement of its quality**. The non-performing loans ratio for this type of loan dropped at 7%, from 8.3% in June 2017, and 8.8% a year earlier. Outstanding loans for construction increased by 2% compared to June 2017, but fell by 1% compared to one year earlier. This loan accounted for 14% of the enterprises outstanding loans, remaining significantly below the 20% average level recorded over 2007-2011.

Chart 4.9 Credit for real estate purchasing and cost of credit repayment

Source: Bank of Albania.

Chart 4.10 Non-performing loans ratio



Source: Bank of Albania.

(33) At the end of the period, **banks reported an uptick in real estate collaterized credits**, at 50.5%, from 50%, in the previous period with 63% of credit to households and 46% of credit to enterprises collateralised by real estate. This report has declined for households and increased for enterprises. Bank of Albania's bank lending survey for 2017 Q4 shows that households' demand for real estate credit was slightly up, while standards on credit approval were reported as eased to households and somewhat tight to enterprises[30].

(34) The weighted interest rate on the real estate credit[31] was 4.4%, slightly down during the period, but remaining in line with the downward trends in the recent years[32]. Along the same lines, the relative repayment cost[33] of loans for real estate

[29] *In this case, the exposure is represented by the loan granted for or collateralised by real estate; loans to enterprises operating in construction sector; and the real estate portfolio held by banks as a result of owing the collateral following the execution of the liability.*

[30] *According to the Bank Lending Survey 2017 Q4, banks report that households' credit demand was slightly up for house purchase (the balance was slightly positive, at 26.6%).*

[31] *To calculate this rate, the interest rate is weighted for credit for real estate purchase to households, and for enterprises for real estate investment.*

[32] *Average interest rate for real estate during 2008-2013 was 8.7%.*

[33] *The relative repayment cost of credit for real estate purchase is measured as the spread between the interest rate on real estate loans and the average house price rise rate for the four previous quarters. The increase in this spread implies higher relative costs.*

purchase continued to lower, reflecting more favourable conditions for real estate purchase from the borrower's perspective.

BOX 4.3 REAL ESTATE MARKET AND HOUSE PRICE INDEX, 2017 H2 SURVEY

The situation in the real estate market is assessed through the field survey of a sample of 230 real estate agents and construction firms, representing around 75-80% of the sample of these enterprises by size of activity. The Bank of Albania compiles the questionnaire and realises the data entry and processing, while the Institute of Statistics performs the field interviews, the main processes of sampling and the physical check of the filled in questionnaires.

*The net balance of responses– 1.6% for the question "How do you assess the market situation compared with the previous period" shows a higher number of agents providing negative response (worse) than the positive response (better). This balance value, albeit negative, shows a **significant improvement in agents' evaluation for the market situation compared to the previous period,** when the balance recorded -11.6%.*

As expected, the same indicator, assessed only for the entities reporting sales during the period, shows a considerably more positive assessment; the net balance of responses on the overall situation by the entities reporting sales is around +34%.

***Fischer House Price Index**, on a national level, was 0.6 % higher than the level of the base period, year 2013, and declined by 0.6% compared to the previous six months. The sales volume reported in Tirana were much higher compared with the previous periods, while the Price Index for Tirana fell 1.4% compared to the base period and increased 0.7% compared to the previous period. In the coastal areas, the agents reported 30% lower average prices than those of the base period, but around 7% lower than in the previous half of the year. For the other areas* agents reported an average increase of sales prices by 5% compared to the previous period and about 20% higher compared to the base period.*

*Agents **report lower stock of houses recorded in their books;** the net balance between those reporting increase and those reporting decrease recorded in their books stands at -9,6% from a slightly positive value of the previous period. Related to commercial properties, the net balance is negative -17.9% from -3.8% in the previous period. The number of unsold properties, both for residential and commercial buildings was down; the net balance was positive, showing less unsold properties, for the third consecutive period, since the start of the survey, though at more moderate values compared with previous period.*

***The average time of sale for real estate, at the national level, is 12.2 months, or around 2.3 months shorter compared to the previous period.** In Tirana, the respondents reported the average sales time was 8.2 months, shorter compared to 9.5 months reported in the previous six-months. For the coastal area, the average sales time increased, from 11.7 months to 19.3 months; the same was reported for the other areas- the respondents reported a considerable increase in the sale time from the previous period, from 9.7 months to 14 months.*

***According to agents, around 80%, of properties for both residential and commercial buildings sold by them are purchased with loans.** This figure is slightly up compared with 72% in the previous period. The loan-to-value ratio accounts for* *around 61% of the house value, lower from 64% in the previous period.*

Agents are optimistic about the market performance in the territory they operate in the short-term future and considerably more positive for the long-term period (up to two years). *The expected new listings for sale during the forthcoming period are assessed as downward. Agents expect increase of real estate prices. The net balance was positive (9.2%), agents are optimistic. This balance has a similar value to that reported over the past period (11.4%).*

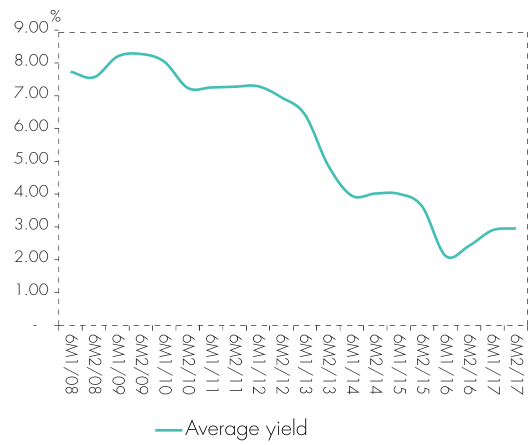
** "Other areas" include all the areas, except for Tirana and the coastal area.*

5. FINANCIAL MARKETS

5.1 SECURITIES MARKET

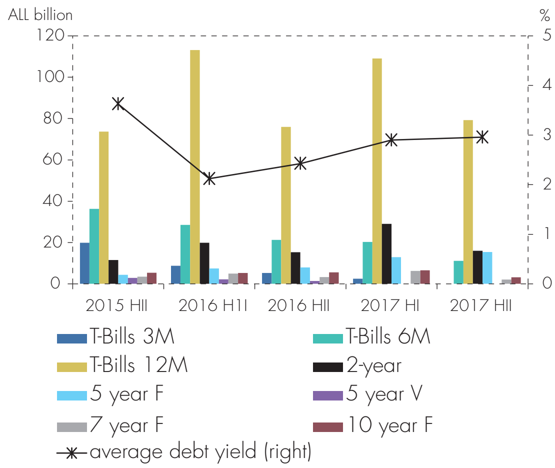
(35) During the period, the Albanian Government's debt denominated in lek was about ALL 127 billion, almost 32% lower than in 2017 H1 and 7% lower compared to 2016 H2. The debt structure of the Albanian Government in the lek continues to be dominated by treasury bills (70%). At the end of the year, the weighted average yield for the Albanian Government debt in lek was about 3%, maintaining almost the same value as in the first half of the year and about 0.5 percentage point higher compared to the previous year. Over the period, the average yield on treasury bills decreased, whereas the bonds' yield increased.

Chart 5.1 Average yield on debt securities, in %



Source: Bank of Albania.

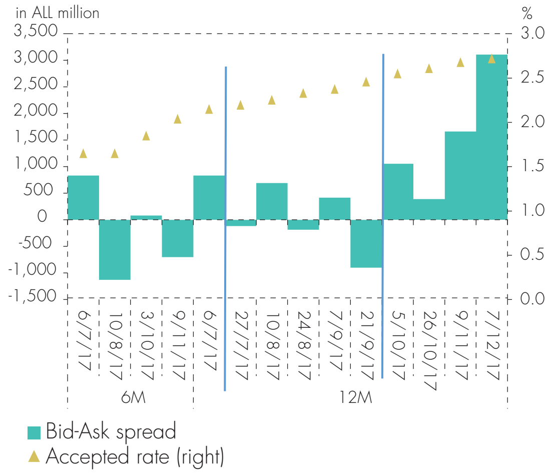
Chart 5.2 Composition of debt issued during 2015 H2-2017 H2



Source: Bank of Albania.

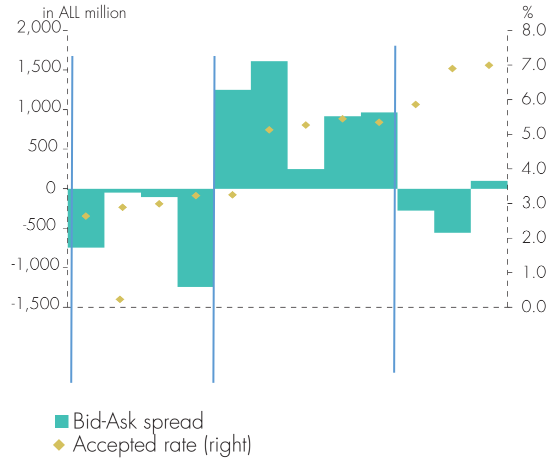
(36) **Issues and average yields on short-term government debt increased compared with the previous period.** Issues of government debt securities in the form of T-bills were around ALL 90 billion, or around 32% lower than in the previous period, and 12% lower than in the previous year. Within short-term debt, 12-month bills account for about 90% of the total. Average yield on T-bills for the three maturities (3, 6 and 12 months) was 2.4%, decreasing from the previous period and increasing by 0.8 p.p. from 2016 H2. Over the period, yields have been upward, from 2.2% in July 2017 to about 2.7% in the last auctions of 2017. In some T-bills auctions, and mainly those of 6-months maturity, the supply for investment was lower than the demand for borrowing or the amount announced by the government.

Chart 5.3 Investment announced amount surplus and T- bill yields for 2017 H2



Source: Bank of Albania.

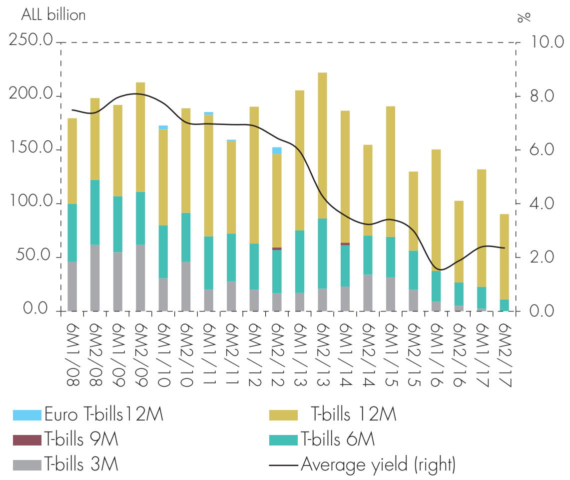
Chart 5.4 Investment announced amount surplus and bonds yields, for 2017 H2



Source: Bank of Albania.

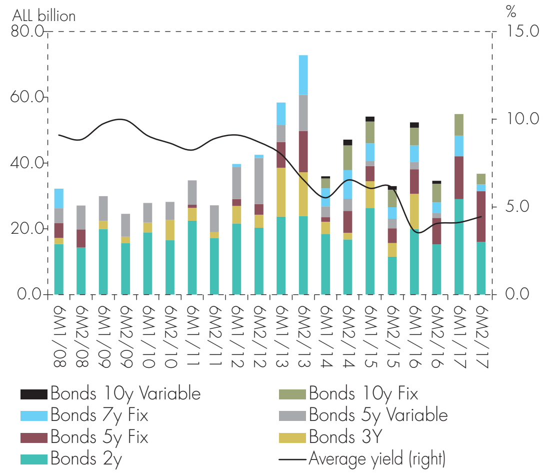
(37) Government long-term debt issued during the period was lower than in the previous period, while the yields increased for all maturities issued in this period. Issues of Government debt securities in the form of bonds were around ALL 37 billion, or around 33% less than in the previous period, but 6% higher than the same period the previous year. Around 85% of the issued bonds is composed by fixed rate for 2 to 5-year bonds. Bonds' weighted average yield in lek for the period was 4.5%, or 0.3 p.p. higher than in the previous period and 0.4 p.p. higher than in the previous year. The increase of the weighted interest rate of bonds in lek for three consecutive 6-month periods was not reflected in the increase of the demand for investment in these securities. In some auctions, the offer for investment was lower than the demand for borrowing.

Chart 5.5 Volume and weighted average yield of T-bills in the primary market



Source: Bank of Albania.

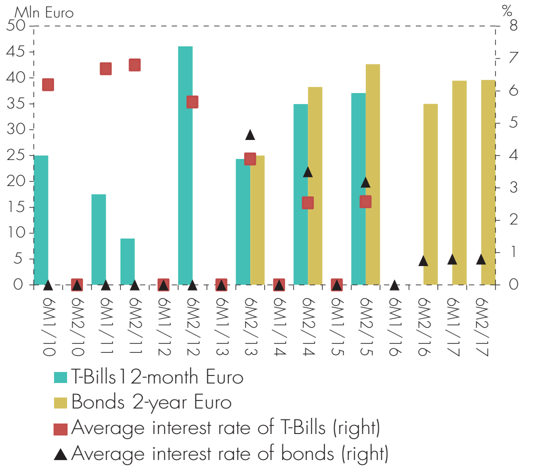
Chart 5.6 Volume and weighted average yield on bonds in the primary market



Source: Bank of Albania.

(38) At the beginning of the year, the government reissued in the domestic market medium-term debt in euro in the form of 2-year bonds. This was the only issue in euro in 2017 H2 and represents around 4.2% of the domestic debt issued during the period. The debt in euro was around EUR 39.6 million and the yield rate was around 0.8%.

Chart 5.7 Domestic borrowing in euro

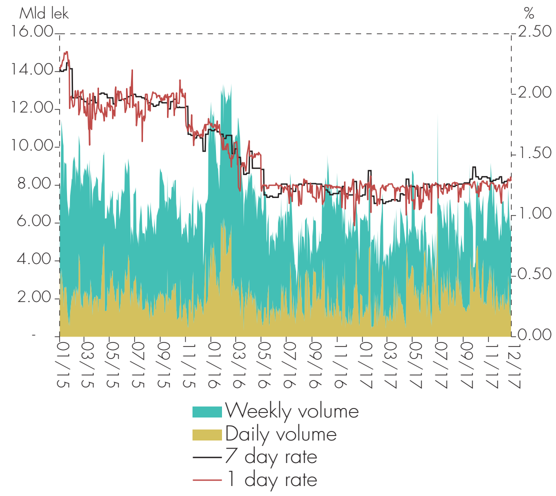


Source: Bank of Albania.

5.2 INTERBANK MARKET

(39) During the period, the average volume of transactions in the interbank market increased compared with the previous period, whereas interest rates remained close to the policy rate. The unchanged policy rate during the period favoured low interest rates in the interbank market. Banks have traded overall lower volumes at rates constantly below or close to the policy rate level, thus reflecting a stable liquidity situation. In 2017 H2, the average interbank overnight rate increased compared with the average of the previous period, at 1.24%. The average interest rate for one-week transactions was 1.28%, almost unchanged compared to the first half of the year. The average volume of overnight lending increased by 19% compared to the previous period. The same performance was also observed in the average volume of one-week transactions, up 18% compared to the previous period. The one-month borrowing rate also increased slightly during this period, although this instrument is rarely used and at lower volumes compared with the shorter-term borrowing instruments.

Chart 5.8 Interbank rates

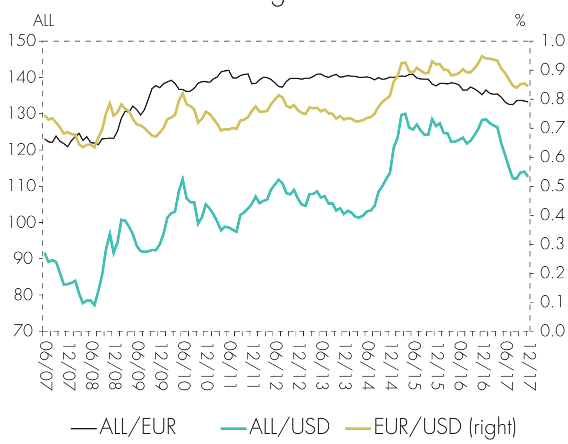


Source: Bank of Albania.

5.3 FOREIGN EXCHANGE MARKET

(40) During the period, the lek's exchange rate against the euro remained almost unchanged, showing a slight depreciation (0.05%) and appreciated against the US dollar (5.1%). In half-yearly terms, on average, compared to the previous year, the domestic currency appreciated against both currencies: 1.4% against the euro and 9.3% against the US dollar.

Chart 5.9 Exchange rate in the domestic foreign exchange market

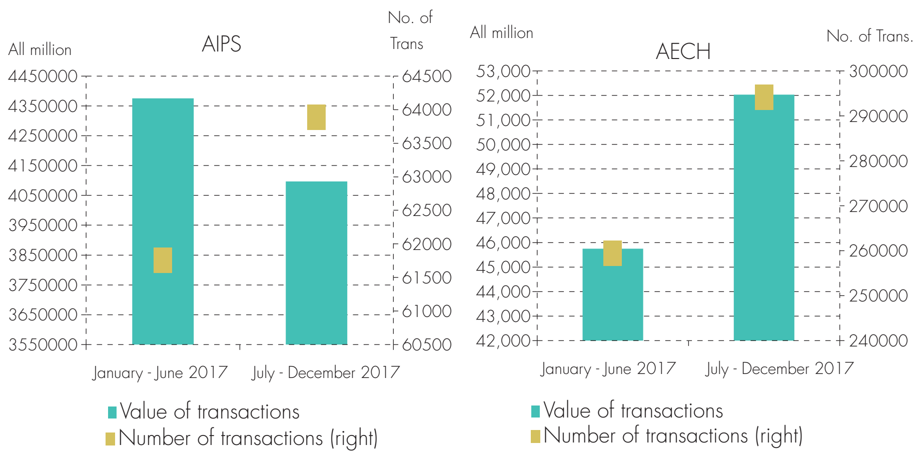


Source: Bank of Albania.

6. PAYMENT SYSTEM DEVELOPMENTS

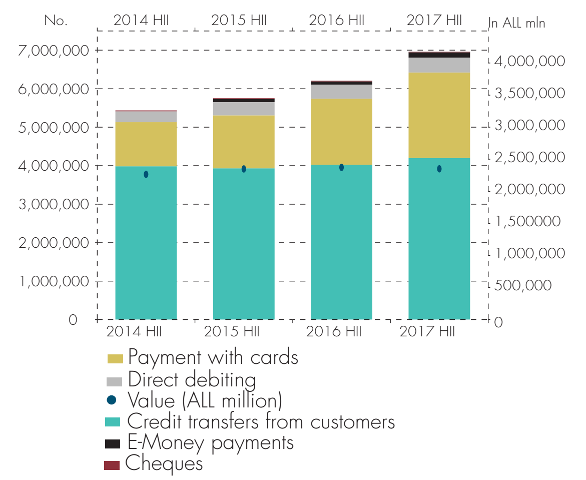
(41) The infrastructure for the clearing and settlement of payments in the domestic currency continued to function securely and efficiently, thus supporting financial stability and monetary policy implementation. In terms of processing, during the period, the AIPS system cleared 63,885 payments amounting to ALL 4,097 billion. The volume of transactions increased by 3.45%, whilst the value of transactions decreased by 6.36% from 2017 H1.

Chart 6.1 Activity in AIPS and AECH during 2017 H2



Source: Bank of Albania.

Chart 6.2 Payment instruments by volume and value



Source: Bank of Albania

In parallel, during the period the small-value payment system AECH, cleared 294,068 payments, with an average value per transaction amounting to around ALL 177,000. Compared with first half of the year, the activity of the AECH increased both in volume and value by 13.4% and 13.7%, respectively.

(42) Regarding ***payment instruments,*** around 7 million transactions were conducted, totalling ALL 2,350 billion. The volume of transactions increased by 10% compared to the first half of the year. Credit transfers continue to dominate payment instruments, but the share of this instrument has declined, dictated by the decrease in volume and in value of these instruments in the form of paper. On the other hand, the number of non-paper transactions[34], and card transactions increased.

[34] *Internet banking and mobile banking.*

7. FINANCIAL SYSTEM

(43) The financial system activity expanded over the period. The ratio of financial system assets to GDP[35] increased by 0.5 percentage point during the period, to 102.6%. The ratio of the financial system assets to GDP increased as a result of the expansion of the assets of almost all component segments of the system, including non-bank financial institutions, insurance companies and investment funds. The relative increase of these three segments altogether was higher than the GDP growth. The structure of financial system assets is dominated by banks, whose assets account for about 93% of the total assets of the system. Over the period, the share of banks in the financial system has increased.

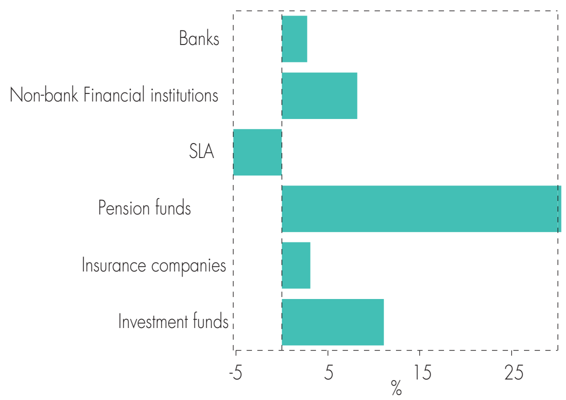
Table 7.1 The share of segments of the financial system to GDP over the years

Licencing and Supervising Authority	Financial system	2011	2012	2013	2014	2015	2016	2017
Bank of Albania	Banking system	84.7	89.6	90.5	91.7	91.3	94.9	92.5
	NBFIs	2.5	2.7	2.5	2.7	2.7	2.9	2.9
	SLAs and Unions	0.7	0.8	0.8	0.8	0.7	0.6	0.5
Financial Supervision Authority	Insurance companies	1.5	1.6	1.6	1.7	1.9	2.1	1.9
	Pension funds	0.01	0.02	0.03	0.04	0.1	0.1	0.1
	Investment funds		1.21	3.7	4.5	4.7	4.4	4.7
Financial intermediation		89.41	95.93	99.13	101.44	101.3	105.1	102.6

Source: Bank of Albania, Albanian Financial Supervisory Authority.

(44) At the end of the period, the share of banking sector assets to Gross Domestic Product (GDP) was estimated at 92.5%. This share has increased during the period, driven by the expansion of interbank transactions and the contraction of provisioning funds. In terms of financial soundness indicators, the banking sector was characterized by higher levels of capitalization, profitability and liquidity. The non-bank sector has maintained its share in GDP and almost all the component segments have contributed positively to its activity. The direct exposure of the banking sector in the non-banking sector is assessed as low, and the performance of the banking sector remains a critical factor for the activity and stability of the non-banking sector. In the structure of the non-

Chart 7.2 Annual growth of segments in the financial system



Source: Bank of Albania, Albanian Financial Supervisory Authority.

35 *The financial system consists of banks, non-bank financial institutions, savings and loan associations (SLAs), insurance companies, private supplementary pension funds and investment funds. In this chapter's analysis, please be aware that insurance companies and non-bank financial institutions balance sheet data belong to 2017 Q3 and, for other institutions, to the end of 2017.*

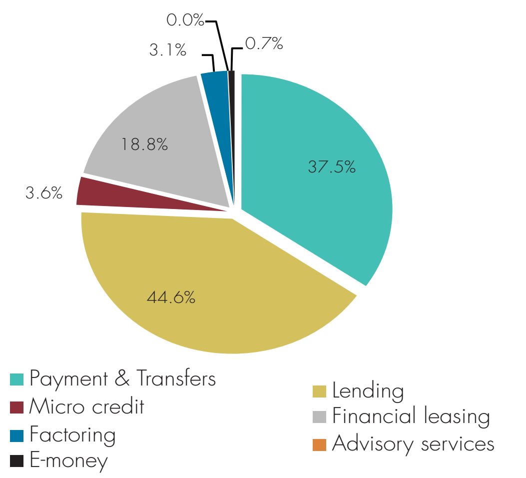
banking sector assets, investments in debt securities of the Albanian Government account for a significant share and marked an increase during 2017.

7.1 NON-BANKING SECTOR DEVELOPMENTS

INSTITUTIONS SUPERVISED BY THE BANK OF ALBANIA

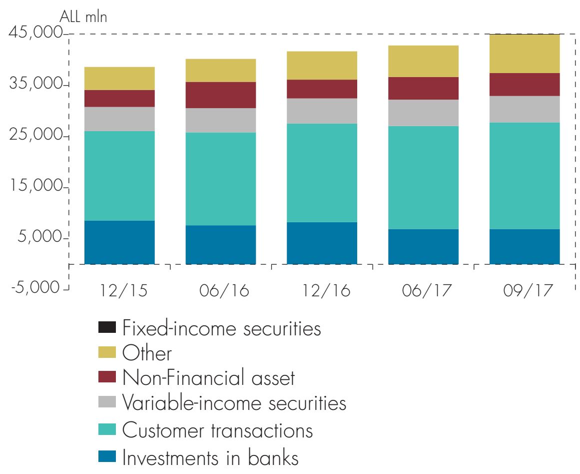
(45) During the period, non-banking financial institutions (NBFIs) expanded their activity and showed good financial indicators. Thus, assets increased mainly supported by the expansion of lending activity and the item "Cash and other receivables" ("other"), while investment in banks maintained the levels of the previous quarter. The NBFIs' financial result was positive, but lower compared to the previous year. The capitalisation level was adequate, although the assets' quality has declined. During the period, the financial system had 28 NBFIs, mainly engaged in the field of microcredit, lending, financial leasing, factoring and electronic money. The NBFIs that perform lending activity account for the main share, followed by payments and transfers. NBFIs' assets were ALL 45 billion, up by 5.2% over the first half of 2017 and 7.3% in annual terms. The main share in the assets structure consists of "customer transactions" that represent lending activity, followed by investments in banks in the form of deposits and current accounts. About 84% of NBFIs' loan portfolio consists of loans to firms operating mainly in the trade sector (22%) and agriculture (14%). The financial result of NBFIs was positive at All 1.2 billion, and slightly down from the previous year (ALL 1.3 billion).

Chart 7.3 Structure of NBFIs by type of activity



Source: Bank of Albania.

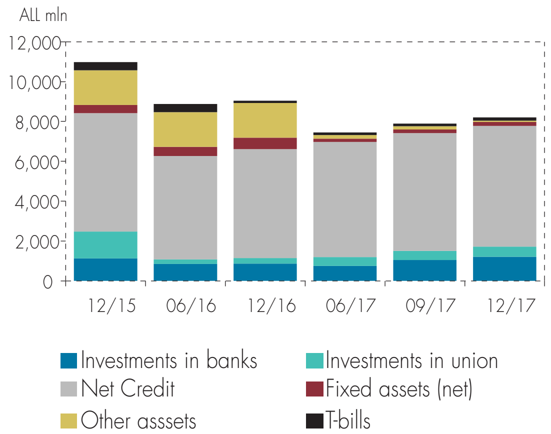
Chart 7.4 Asset structure of NBFIs



Source: Bank of Albania.

(46) The activity of Savings and Loan Associations (SLAs) was positive during the period; but contracted from a year earlier. The SLAs assets increase during the period was determined by the increase in current account, deposits and net credit, whereas their portfolio of treasury bills has also expanded. The financial result of SLAs was positive (around ALL 0.08 billion) significantly higher compared with the previous year. Loans to customers and investments in banks represent the main items of the assets of these institutions. During the period, 13 active SLAs operated in the market.

Chart 7.5 Asset structure of Savings and Loan Associations

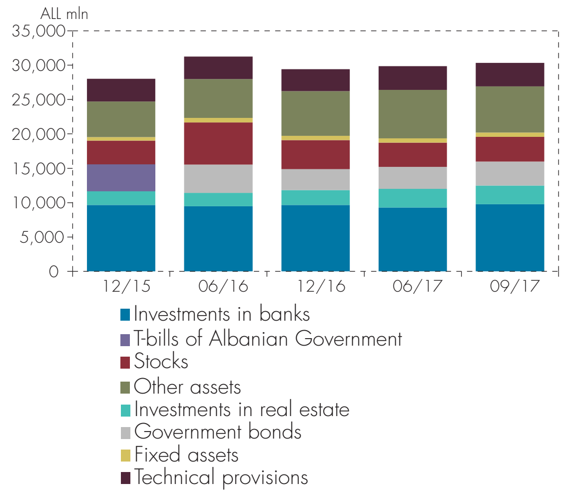


Source: Bank of Albania.

INSTITUTIONS SUPERVISED BY THE ALBANIAN FINANCIAL SUPERVISION AUTHORITY

(47) The activity of insurance companies expanded during the period. The assets of 12 insurance companies[36] increased by 1.6%, to ALL 30.3 billion. The increase of investments in the form of time deposits in banks and in government debt securities determined the behaviour of insurance companies' assets. Insurance companies reported a positive financial result and upward in annual terms.

Chart 7.6 Asset structure of insurance companies



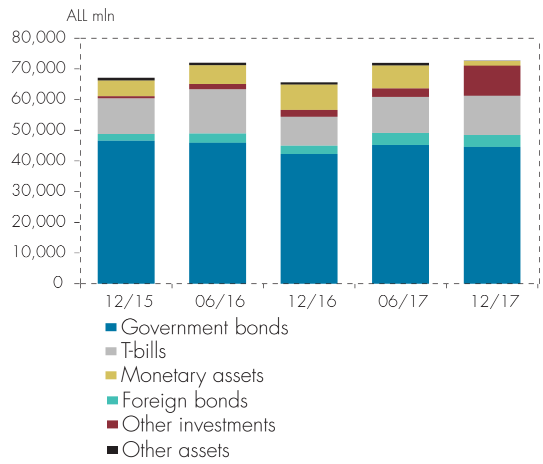
Source: Financial Supervision Authority and Bank of Albania

In the insurance activity, the premium income (paid in advance) is used for the payment of liabilities and the coverage of costs that may arise from the occurrence of an insurance event. Gross Written Premiums[37], which represent the main source of financing of insurance companies' activities, expanded by 5.4% in annual terms. The majority of the value of Gross Written Premiums consists of "non-life insurance" premiums of about 92.6%, compared to 7.4% of life insurance.

The insurance market penetration, measured as the ratio of \ premiums to GDP, is about 1%, while the average of the countries in the region reaches 2.24% and Europe's average reaches 7.4%. The loss indicator or the ratio of claims paid to gross written premiums increased to 34.1% from 27.6% a year earlier. The value of gross paid claims increased by 15.8% in annual terms to ALL 5.5 billion.

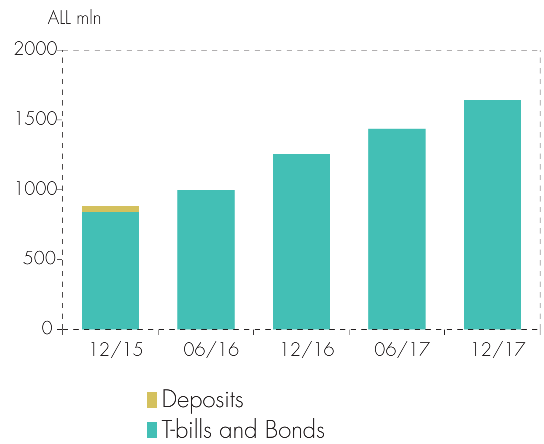
[36] *8 non-life insurance companies, 3 life insurance companies and 1 reinsurance company.*
[37] *AFSA, Statistical Bulletin "Insurance Market: 2017 ", published on 25 January 2018.*

Chart 7.7 Asset structure of investment funds



Source: Financial Supervision Authority and Bank of Albania.

Chart 7.8 Investments' structure of supplementary private pension funds



Source: Financial Supervision Authority.

(48) The activity of investment funds[38] expanded, as a result of the increase of investments in banks and government debt securities. The investment fund is an open-ended undertaking, established by contract, offering units to the public[39]. The funds' assets are invested by the principle of risk diversification. The yields from participation in investment funds is usually higher than that of deposits in banks, reflecting higher risk[40] that has been accepted by the investor for participation in the fund. Currently, three investment funds operate in the Albanian financial system. These funds' assets are invested mainly in securities issued by the Government of the Republic of Albania both in lek and in euro.

According to preliminary data from the Financial Supervisory Authority, at the end of 2017, the net value of investment fund assets is estimated at about All 72.7 billion or about 4.7% of the country's GDP.

(49) Supplementary Private Pension Funds[41] expanded their activity during the period. In Albania there are three supplementary private pension funds. At the end of 2017, the assets of these funds amounted to ALL 1.7 billion or 30.5% higher than in the previous year. The activity of pension funds is dominated by investments in government debt securities. The value of these investments was about All 1.6 billion or 30.7% higher, in annual terms. According to recent reports, the number of pension fund members is about 21,000.

7.2 ASSESSMENT OF RISKS AND EXPOSURES IN THE NON-BANKING SECTOR

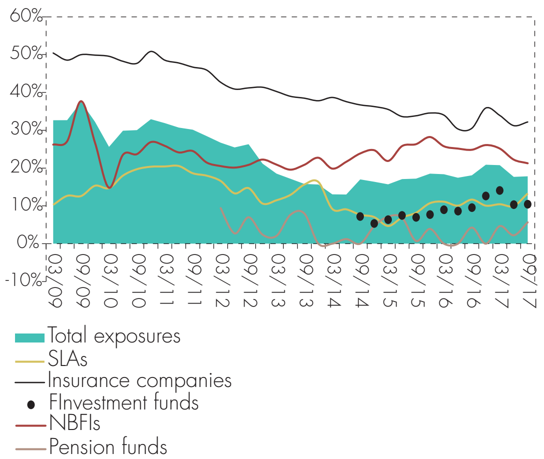
(50) The banking sector's exposure to the non-banking sector in Albania remains low. This exposure on the side of banks' assets is represented by loans and participation in the capital of non-bank financial institutions; meanwhile, on the side of liabilities it is represented in the form of funds collected by them

38 *AFSA, "General Investment Fund Data", 31 December 2017*
39 *Law No.10 198, date 10/12/2009 on "Collective Investment Undertakings", AFSA.*
40 *Investments in an investment fund are only guaranteed by fund performance as shown in the prospectus document for investors.*
41 *AFSA, Supplementary Private Pension Market Report, 31 December, 2017 published on 13 February 2018.*

(various accounts). In total, this exposure accounts for only 2% of the values of assets of the banking sector.

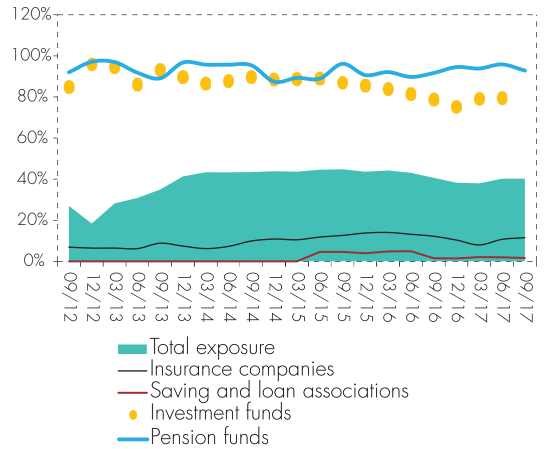
(51) On the other hand, the sensitivity of the non-banking sector to the activity of the banking sector remains high. In total, this exposure stands at 17.8% of the assets of the non-banking sector compared to 20.9% at the end of 2016. The decline in interest rates in the market has prompted non-bank institutions to invest in higher yield products such as government debt securities, resulting in a drop of the investment share of these institutions in banking products. Despite this performance, at the individual level, insurance companies and non-bank financial institutions exhibit greater exposure to the banking sector, as for other deposits they account for 32.2% and 21.3%, respectively, of the relevant assets. Investment funds and savings and loan associations also show upward exposures to the banking sector

Chart 7.9 Exposure of main NBFIs to the banking sector, toward their total assets



Source: Albanian Financial Supervision Authority, data processed by the Bank of Albania.

Chart 7.10 Investments of NBFIs in government securities, toward their total assets



Source: Albanian Financial Supervision Authority, data processed by the Bank of Albania

(52) Non-bank financial institutions and saving and loans associations, while active in lending, are exposed mainly to credit risk. In September 2017, the ratio of non-performing loans against total NBFIs loans increased at 12.5% from 11.6% at the end of 2016, while for SLAs the quality indicator registered an improvement at 4.8% from 6.7% at the end of 2016.

(53) Market risk affects investments in investment funds and private supplementary private pension funds. For ***investment funds,*** market risk, mainly due to interest rate fluctuation, poses the main risk of the activity together with the liquidity risk. Fund assets are invested in financial instruments whose price may change every day. In the structure of their investments, about 80% of the total belongs to T-bills and bonds. Interest rate fluctuations are inversely correlated to the value of these securities. In case interest rates increase, a revaluation of the portfolio of securities that investment funds hold would decrease the value of this portfolio and vice versa. The period of the investments is highly important, realizing that the longer the duration the more sensitive is the fund value as a result of interest rate fluctuations.

(54) *Supplementary private pension funds rely on defined contribution plans (and performance benefits).* In these cases, the influence of the interest rate is more limited compared to the case of fixed income investments. In their total investments, the main share (almost 100%) is invested in treasury bills and government bonds and in certain periods, bank deposits. The main source of income for supplementary private pension funds is the interest earned from these investments.

8. BANKING SECTOR DEVELOPMENTS

(55) During the period, the banking sector expanded its activity with the main contribution from treasury and interbank transactions, as well as by the contraction of the credit risk provisioning fund. The banking sector was characterised by a good level of capitalisation, liquidity and profitability. The continuation of the lost loans write off from the balance sheets of the banks as well as the increase of loan repayment and restructuring has led to the decrease of the non-performing loans. Despite this development, the credit risk must continue to be assessed carefully. Exposure to market risks is presented at limited levels, but needs to be monitored on a continuous basis.

8.1 PERFORMANCE OF BANKING ACTIVITY

(56) During the period, the banking sector expanded its activity, but the growth rate was lower in annual terms. Banking sector assets expanded by about 4%, to ALL 1,445 billion. The performance of assets was determined by the increase of the items ''Treasury and interbank transactions"[42] and "Customer transactions"[43] as well as by the significant contraction of the provisioning funds for credit risks. "Securities transactions" gave a positive contribution[44] to the performance of assets, mainly with non-resident entities. On the liabilities side, the main items continue to be "Customer transactions", which represent the depositing activity and "Permanent resources", which represents the equity of banks or own funds. The Albanian government's debt securities represent around 22% of the total assets from 23% in the previous period.

In the government securities portfolio, the share of T-bills expanded further.[45] In annual terms, the growth rate of total banking sector assets was 2.8%.

42 Treasury and interbank transactions marked an increase of about ALL 30 billion at ALL 483 billion during the period. The main contribution to the expansion of this item was from the increase of bank transactions with the Central Bank in the form of current accounts. They increased by about ALL 19 billion, to ALL 150 billion. The expansion of interbank transactions in the form of current and deposit accounts have a positive contribution. They expanded by ALL 4 and 7 billion, respectively, to ALL 61 billion and ALL 119 billion.

43 Customer transactions expanded by about ALL 5 billion to ALL 598 billion. Operations with resident customers increased by about ALL 8 billion, while those with non-resident customers decreased by about ALL 5 billion.

44 Investment in securities maintained the level of the previous 6 month period. They expanded by only ALL 180 million, to ALL 357 billion. These investments were mainly Held to Maturity securities with non-residents, in foreign currency.

45 The increase of investment in government debt securities was a result of the expansion of the treasury bills portfolio. In 2017 H2, this portfolio expanded by ALL 3 billion compared to June 2017, reaching ALL 64 billion; while the bond portfolio marked a slight decline and amounted to ALL 255 billion.

The expansion of assets in annual terms was supported by interbank investments and contraction of the provisioning funds, while securities transactions contributed negatively to the annual growth of assets.

Table 8.1. Structure of banks' balance sheet, December 2017

Asset	% of asset	Annual change, %	Liability	% of liability	Annual change, %
I. Treasury and interbank transactions	33.4	4.5	I. Treasury and interbank transactions	5.3	24.1
II. Customer transactions (credit)	41.4	0.2	II. Customer transactions (deposits)	80.4	0.8
Of which: public sector	2.2	13.2	Of which: public sector	1.9	-6.4
Of which: private sector	39.1	-0.8	Of which: private sector	78.8	0.9
III. Securities transactions	24.7	-3.1	III. Securities transactions	0.6	23.2
IV. Created provisioning??? funds	-4.03	-26.8	IV. Other liabilities	1.04	14.3
V. Other*	4.5	11.2	V. Permanent resources	12.4	7.3
			Of which: Subordinated debt	1.5	-1.2
			Of which: Equity	10.2	7.7
Total assets	100	2.8	Total liabilities	100	2.8

Source: Bank of Albania,
** 'Other" in the balance sheet refers to "other assets" and "fixed assets", '' Accrued interest'''*

(57) The loan portfolio[46] of the banking sector expanded by 1% in half-yearly terms and remained almost unchanged from the previous year, to about ALL 600 billion. The improvement of the loan portfolio quality, as a result of the ongoing process of lost loans write off and loan repayments led to the decrease in provisioning funds, during the period.

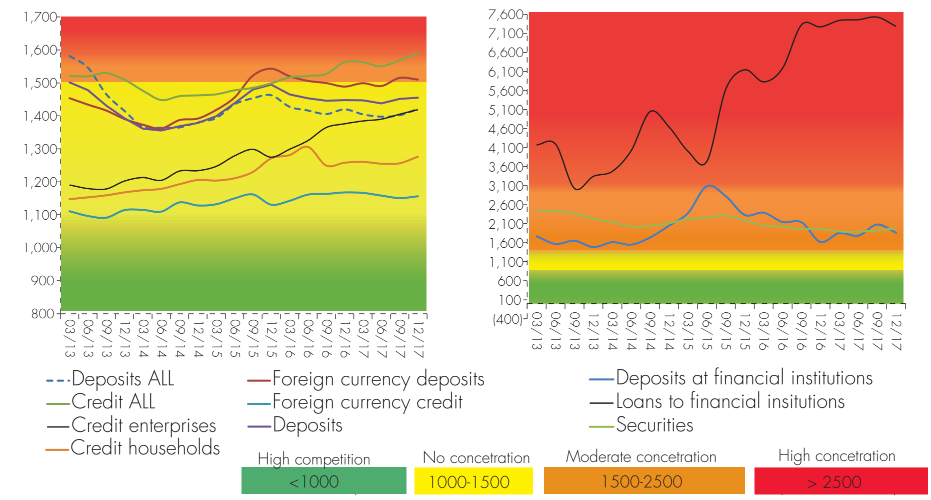
(58) Banking activity is mainly funded by deposits, which account for about 80% of total assets. Current accounts and demand deposits continued to determine the expansion of the deposit base, although their expansion was at lower rates. The change of the funding source structure toward short-term sources affects the ability of the banking sector regarding financial intermediation towards longer-term projects. However, the dependence on short-term funding sources (current and demand deposits, which currently represent 42% of the deposit base)[47], is mitigated by the fact that 83% of the volume of deposits is held by households and, overall, the residual maturity of liabilities has increased due to the increase in the level of deposits with longer-than-one year maturity. Banks have maintained the ratio of their capital use for funding the activity, while respecting the relevant requirements of the regulatory framework.

(59) The Albanian banking sector is characterized by a high concentration for some of its activities. Chart 8.1 on the left shows the banking products (in assets and liabilities of banks), for which the banking sector presents a moderate or low concentration. Among these products (services), the concentration of lending in lek and lending to enterprises increased during the year. Chart 8.1 on the right shows the activities for which the banking sector appears to have a higher concentration, mainly on the assets side of the its balance sheet. The highest concentration is observed in lending activity for financial institutions.

[46] *Excluding accrued interests.*
[47] *In December 2017, the share of current accounts was about 33%, while the share of demand deposits 9%. A year earlier, these shares were respectively 32% and 8%.*

The high concentration reflects the activity of a limited number of banks with non-resident financial institutions.

Chart 8.1 Herfindahl indicator for the main banking products



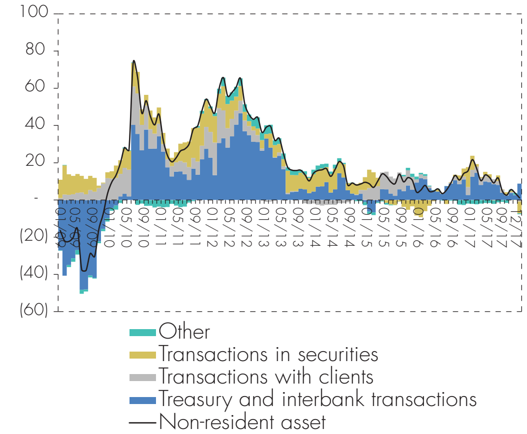
Source: Bank of Albania.

8.2 BANKING SECTOR POSITION TO NON RESIDENTS

(60) During the period, the banking sector has easily narrowed the credit position with non-resident entities. Compared to the end of the first 6 months, the net position with non-resident entities at the end of 2017 was somewhat lower and about ALL 295 billion. Liabilities to non-residents account for about 6% of total assets and are represented to a large extent, by ''Customer transactions'' or by deposits of non-residents in domestic banks, as well as by ''Permanent Resources'' or its own funds. Interbank transactions in the form of deposits and loans from non-resident financial institutions increased during the period, while the credit lines from parent banks decreased. On the assets side of the banking sector, claims on non-residents account for about 26% of total assets. Over the period, these claims grew slightly and at the end of the year they amounted to ALL 380 billion. At the end of the period, the annual growth of assets with non-residents marked a significant slowdown, falling to 1%, from about 16% a year earlier. The main contribution to the decline in the growth rate of non-resident claims has been the contraction of investments in securities issued by non-resident entities and the reduction of loans to non-residents. On the other hand, the increase in the item "Interbank transactions" with non-residents has contributed to the increase of general claims on non-residents.

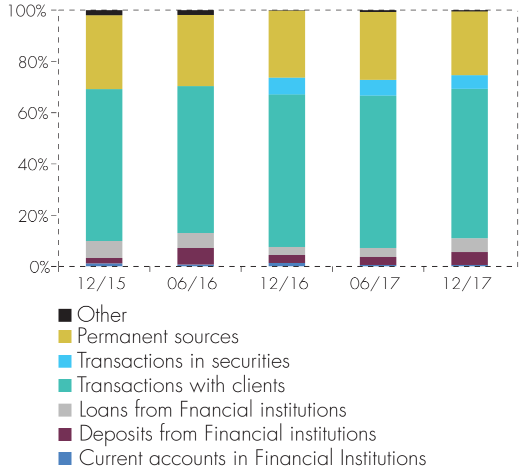
(61) The countercyclical measures taken by the Bank of Albania in May 2013 contributed to the deceleration of the growth pace of banking sector investments in non-resident entities. At the end of 2017, annual growth declined to the lowest historic level of 1%, from 25% in May 2013. Year 2017 was characterized by considerable fluctuations in foreign investments.

Chart 8.2 Contribution of balance sheet items to annual growth of assets with non-residents (in pp)



Source: Bank of Albania.

Chart 8.3 Components of non-resident liabilities



Source: Bank of Albania.

The increase of foreign investments marked relatively high levels during the first half of the year (about 22% in January 2017), but this trend was significantly reduced during the last two quarters. The share of assets with non-residents, which are subject to countercyclical measures[48], increased to 81% of total assets with non-residents, compared to 80% a year earlier. Within the group of assets with non-residents, which are subject to the aforementioned measures, the treasury and interbank transactions expanded 17%, with the main contribution given by the increase of "Deposits with banks, credit institutions and other financial institutions" at 42% in annual terms. On the other hand, the annual growth rate of assets with non-residents, not subject to countercyclical measures, narrowed by 7%.

8.3 LENDING DEVELOPMENTS

8.3.1 OUTSTANDING LOANS

(62) Over the period, outstanding loans increased slightly in the balance sheet of the banking sector. At the end of December 2017, outstanding loans in the balance sheet of the banking sector recorded ALL 600 billion[49], about 0.6% higher (or ALL 3.6 billion) compared to June 2017. Compared to the previous year, outstanding loans grew slightly, by about ALL 1 billion. The higher volume of new loans has contributed positively to this development, whereas the plan of actions to reduce the stock of non-performing loans (loan repayment, restructuring, and write off) as well as the exchange rate effect, which is reflected on the appreciation of lek against the US dollar and euro, have adversely affected the growth of outstanding loans.

[48] *Non-resident foreign currency assets that are subject to the measures relate mainly to investments in securities and treasury and interbank transactions.*

[49] *Including accrued interests. Excluding them, the outstanding loan is estimated at about ALL 598 billion.*

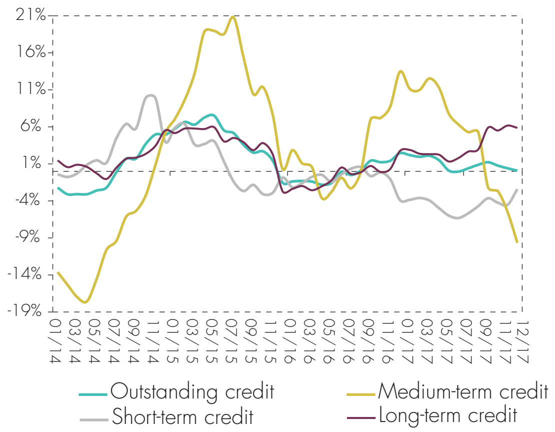
Table 8.2. Loan portfolio developments

	Indicator and unit	Amount (ALL bln)	Share in total credit %		Change	
	Period	12/2017	12/2017	12/2016	Vjetor	Gjashtëmujor
By currency	Credit ALL	262	44%	41%	5%	2%
	Credit FX	339	56%	59%	-4%	-1%
By entity	Public sector	32	5%	5%	13%	7%
	Enterprises	390	65%	67%	-3%	-1%
	Households	178	30%	28%	6%	3%
By product	Short term	186	31%	32%	-2%	1%
	Medium term	110	18%	20%	-1%	-8%
	Long term	305	51%	48%	6%	4%
	Credit outstanding	601	100%	100%	0.2%	0.6%

Source: Bank of Albania, Financial Stability Department.

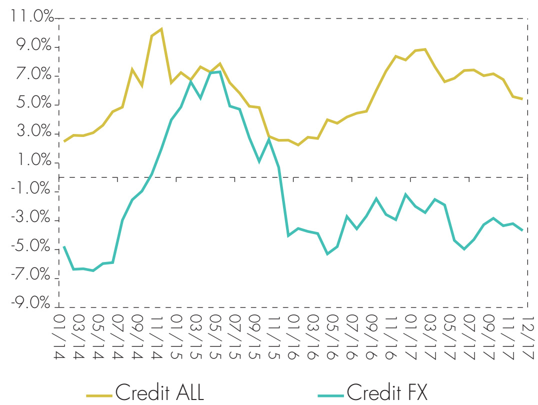
(63) By currency, lek was the only currency that gave a positive contribution to the performance of credit. In fact, lek's credit stock grew during the period by 2.2% (or ALL 5.4 billion), while foreign currency stocks shrank by about 1% (or ALL 1.9 billion). Due to the considerable share of foreign currency credit (56%), exchange rate developments play an important role in its nominal counter value to domestic currency. For the outstanding calculated in December 2017, the appreciation of the lek against the main currencies has contributed to the reduction of the reported loan value by about All 0.7 billion. Excluding this effect, the foreign currency credit would have expanded by 0.5% (from the 0.6% decline).[50] In annual terms, the exchange rate effect for the US dollar and euro is respectively ALL -4.8 billion and ALL -4.6 billion. Excluding the exchange rate effect, the annual growth of outstanding loans would be about 2% (from 0%) and foreign currency loans -1% (from -4%).

Chart 8.4 Loan performance by maturity annual growth



Source: Bank of Albania.

Chart 8.5 Loan performance by currency, annual growth



Source: Bank of Albania.

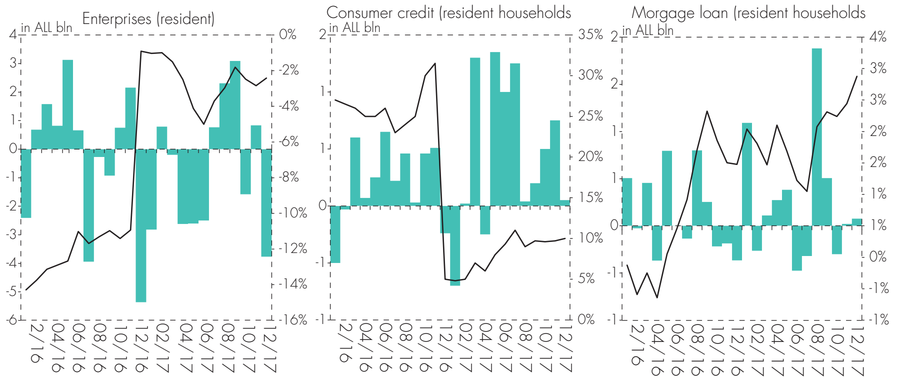
50 *The exchange rate effects for euro and the US dollar have trended differently. The dollar's effect has been more significant, giving a total negative effect on the growth of loans (and deposits).*

(64) By maturity, long-term debt, representing more than half of the outstanding loans, has provided the main positive contribution to the outstanding loan performance over the period. Compared to the end of 2017 H1, medium-term loans were the only one declining by 8%, while short-term and long-term loans increased by 1% and 4%, respectively. Year on year, short-term and medium-term loans declined respectively by 2% and 10%, whereas long-term loans increased by 6%.

(65) Loans to enterprises, which account for the main share in outstanding loans (about 65%), narrowed during the period by about 1%, to ALL 390 billion. Despite the fact that the new lending is dominated by loans to enterprises, the decline in their outstanding loans has been due to the decline in non-performing loans, as a result of lost loan write offs, loan repayment and loan restructuring. Loans to residents, which accounts for 86% of the loans to enterprises, expanded by about 0.5% (or about ALL 1.6 billion), while loans non-residents narrowed by 9% and at the end of the period recorded ALL 53 billion. Loans to the public sector account for only 5.4% of total loans, increasing by about ALL 2 billion over the period. In annual terms, loans to enterprises narrowed by 3% (about ALL 12.2 billion), reflecting the credit collection and restructuring processes as well as the write off of lost loans from the balance sheet. Public sector credit increased by 13% (or by ALL 3.8 billion). Over the past six months, about ALL 4.5 billion have been written off as "lost" loans to enterprises.

(66) Loans to households grew by 3% (or ALL 4.6 billion), supported by the expansion of new loans to residents. Loans to resident households, which account for 95% of total lending to households, have contributed most to the performance of this loan, although loans have increased also for non-resident households. Consumer credit expanded by 8% and mortgage credit by 2%.[51]

Chart 8.6 Loan performance by purpose of use, annual growth (left axis) and monthly change of stock (left axis).



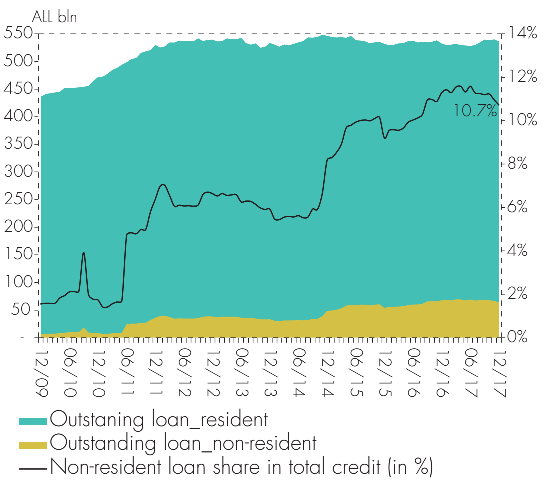
Source: Bank of Albania.

[51] *This loan accounts for about 63% of outstanding loans received by resident households.*

In annual terms, total outstanding loans to households expanded by about 6% (or ALL 9.3 billion). The expansion of loans to households was driven by new loans, mainly for consumption and house purchase purposes.

(67) The banking sector continued to provide loans to non-resident entities (enterprises and households), but its share has declined to 11% of the banking sector outstanding loans in December 2017, down from 11.3% a year earlier. Outstanding loans to non-residents recorded ALL 64.4 billion, narrowing by about 7% during the period and 5% from the previous year. The main contribution to this decline was from loans to non-resident enterprises (83% of total non-resident credit), shrinking by 9% during the period and 8% from the previous year. Almost all loans granted to non-residents are denominated in foreign currency, and mainly in euro. In general, credit to non-residents is oriented toward longer-term maturities, with the main share in the medium term (51%) and long term (by 25%).

Chart 8.7 Loans to non-residents



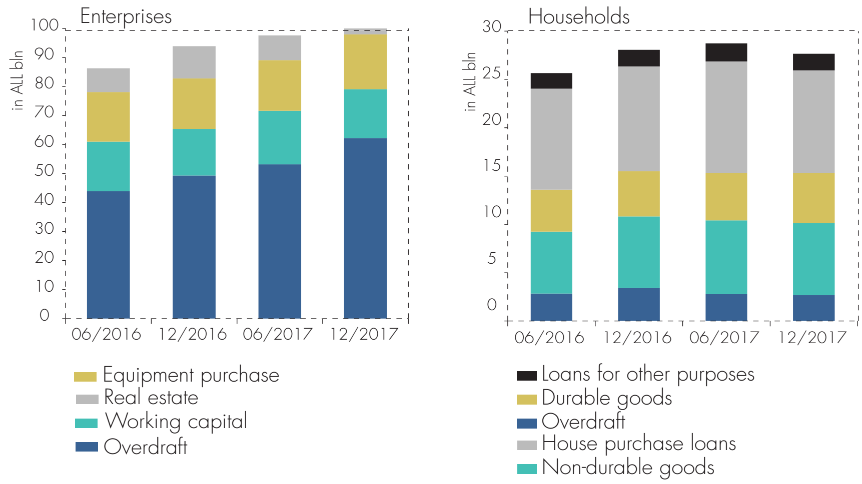
Source: Bank of Albania.

8.3.2 NEW CREDIT

(68) Over the period, the volume of new credit stood at a good level. The value of new credit was around ALL 140 billion, about 10% higher than in 2017 H1, but closer to the levels of the same period in the previous year. Collected credit (repayments) was around 2.3% higher compared with 2017 H1 and around 8.6% lower compared with the same period in the previous year. The loan use ratio (collected-to-extended new loans) registered 95% from 103% at the end of June 2017, and 104% in the previous year. The decrease in the ratio came mainly as a consequence of the increase of the new credit flow.

(69) Credit to the private sector gave the main positive contribution to the performance of new credit. New credit to enterprises was higher compared with 2017 H1 (5%), and 2016 H2 (13%). The increase was due to the growth of credit flow in the form "overdraft" and credit for "purchase of equipment" Over the period, new credit to households was ALL 1.1 billion lower than in 2017 H1, and similar to that in the previous year. The decrease was driven by the performance of new credit for housing, although it maintains the main share of new credit to households. New credit to the public sector continued to account for a very small part of total new credit, although during this period it was twice as high compared with 2017 H1.

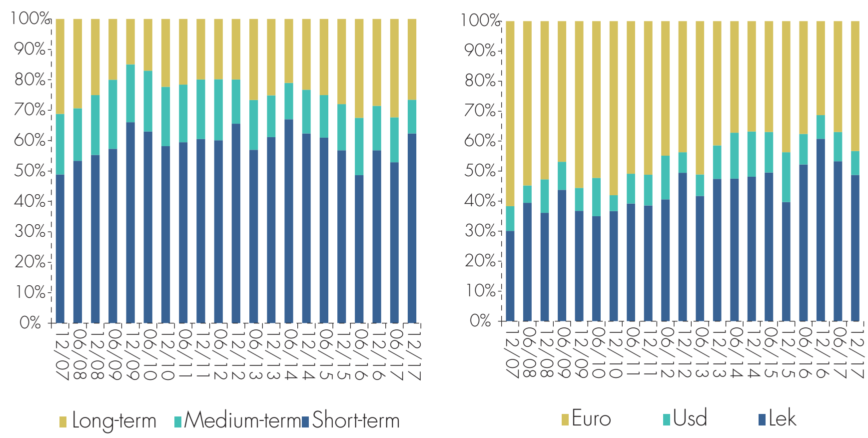
Chart 8.8 New credit by purpose



Source: Bank of Albania.

(70) By currency and maturity, euro credit and long-term credit provided the main contribution to the performance of new credit over the period. New credit in foreign currency increased b y around 20% compared with 2017 H1. Over the period, around 84% of new credit in foreign currency was in euro, while the new credit in US dollar was lower. New credit in euro was around 26% higher (or ALL 12.4 billion) than in 2017 H1 and almost 33% higher than in 2016 H2. The share of new credit in lek was almost half of the overall flow of new credit, and resulted in similar levels with 2017 H1.

Chart 8.9 Distribution of new credit by maturity (left) and currency (right)



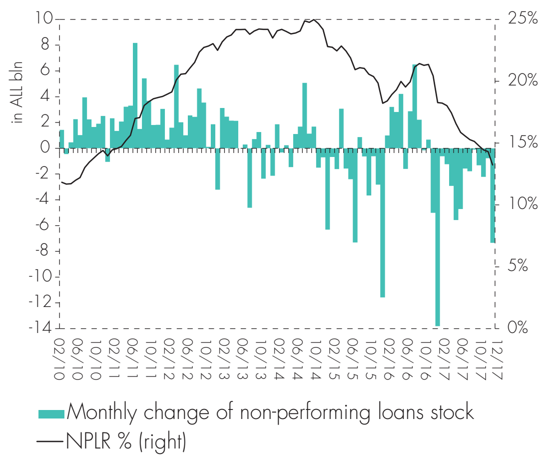
Source: Bank of Albania.

Compared with the same period of the previous year, new credit in lek was around ALL 17 billion lower. By maturity, long-term new credit (42% of the total) increased by 36% (ALL 14.8 billion), while the short-term one (53% of the total) increased by 8.5% (ALL 5.8 billion). Medium-term new credit was at ALL 10.2 billion, or almost twice as low as the previous period.

8.3.3 CREDIT RISK

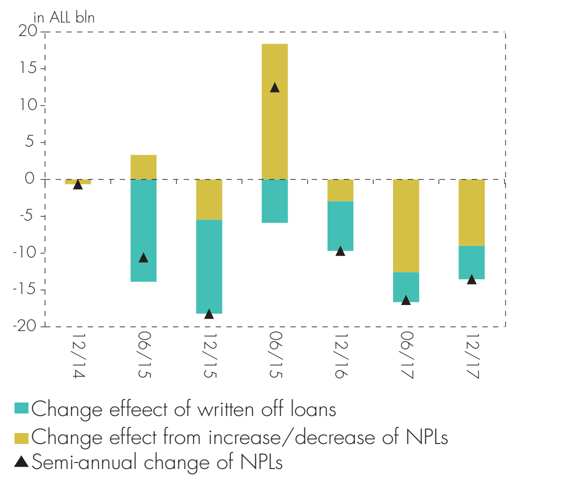
(71) Over the period the non-performing loans stock decreased significantly. In December 2017, the stock reached around ALL 80 billion or around 14.5% lower from the previous period. Compared with the previous year, NPLs contracted by around ALL 30 billion, or by 28%. The NPLs stock declined as a result of the restructuring of these loans, loan repayments in various classes of the NPL portfolio and the lost loans write off from banks' balance sheets. Over 2017 H2, from banks' balance sheets were written off ALL 4.5 billion of lost loans[52], mainly to enterprises and in foreign currency. Restructured credit over this period reached ALL 10 billion, of which around ALL 7 billion in the NPL portfolio. In 2017, the repayments of the banking sector aggregate credit portfolio registered ALL 70 billion. In December alone were repaid ALL 11.6 billion of NPL outstanding.

Chart 8.10 Non-performing loans ratio



Source: Bank of Albania.

Chart 8.11 Contribution in the half year change of the non-performing loans stock (ALL billion)

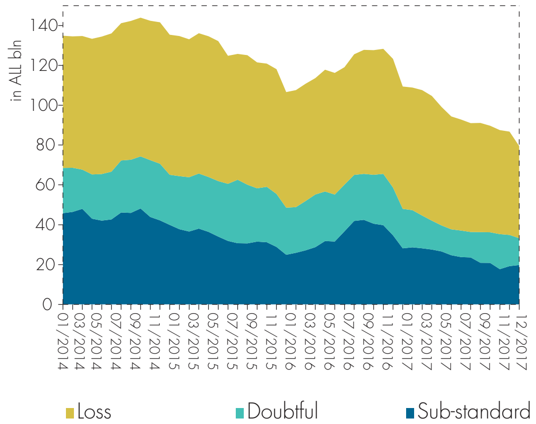


Source: Bank of Albania.

[52] Starting from January 2015, banks are obliged under the regulatory requirements to undertake the process of balance sheets cleaning - the write off of loans falling under the category "lost" for more than three years. Overall, since the start of the process ALL 47.8 billion of lost loans have been written off.

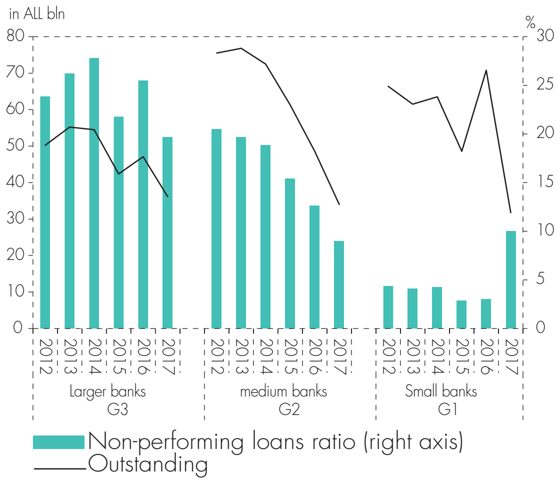
(72) The decrease of the non-performing loans stock is accompanied with the improvement of the qualitative indicator of the portfolio. At the end of the year, the NPL ratio was 13.2% from 15.6% in June 2017 and 18.2% in the previous year. Within the NPL structure, as result of restructuring, repayments and new credit, the outstanding loans in "special mention" and "sub-standard" contracted 14% and 17%, respectively and those in the "standard" category expanded around 6%. "Lost" loans, which account for around 58% of non-performing loans, contracted by 17% (around ALL 10 billion). The decrease was mainly due to the write off of some lost loans from the balance sheet.

Chart 8.12 Non-performing loans structure



Source: Bank of Albania.

Chart 8.13 NPL portfolio by bank groups

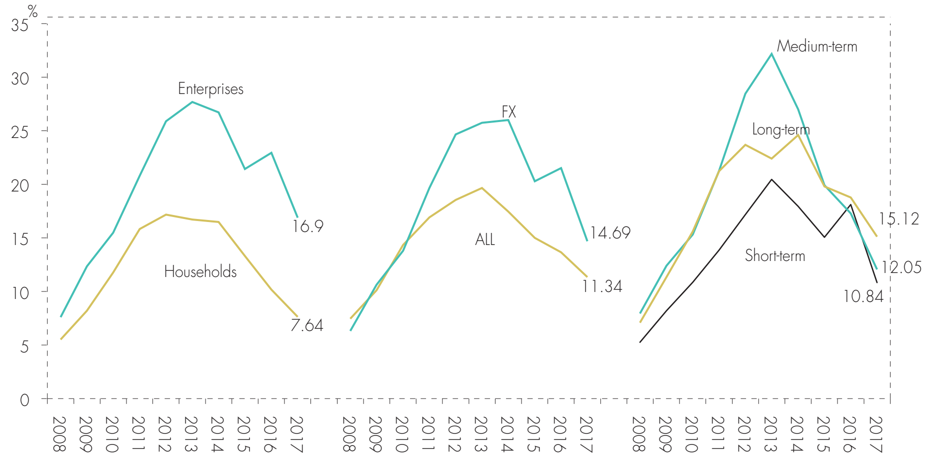


Source: Bank of Albania.

(73) Medium-sized and small banks gave the main contribution to the improvement of credit quality. In absolute values, at the end of the year, compared to the previous period, non-performing loans for this groups contracted by ALL 4 and 4.5 billion, respectively, whereas their NPLR decreased at 12.8% and 11.9% from the 15.5% and 24.6%.

(74) Credit quality appears lower for loans in foreign currency, loans to enterprises, and long-term loans. At the end of 2017, the credit quality for each of these segments stood at 14.7% (foreign currency), 16.9% (enterprises) and 15.1% (long-term). All these indicators have declined over the period.

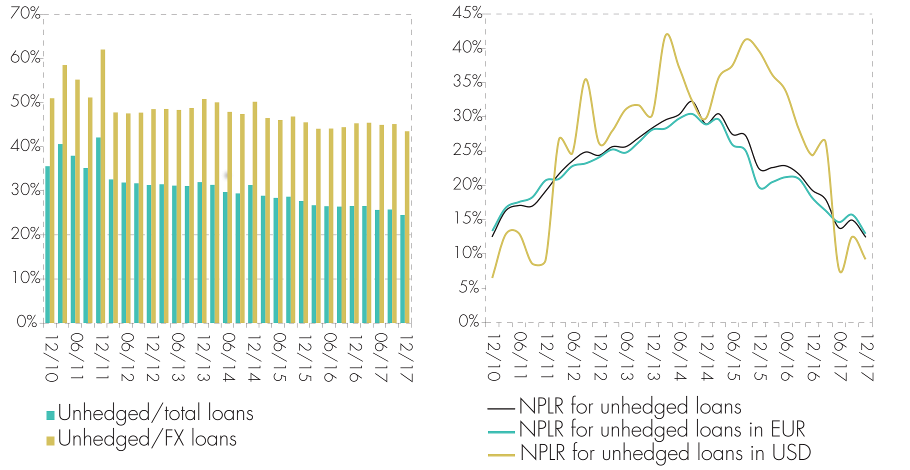
Chart 8.14 Non-performing loans in the Albanian banking sector



Source: Bank of Albania.

(75) The quality of unhedged foreign currency loans has continuously improved since the beginning of 2015. The NPLR for this credit category decreased at 12.5% from 13.8% at the end of 2017 H1, driven by the faster decrease of the non-performing loans stock than the contraction of the outstanding unhedged credit. Over the period, the unhedged non-performing loans outstanding contracted by around 13%. By currency, the main contribution to the improvement of the quality of unhedged credit came from loans in euro. The quality ratio for unhedged euro loans improved by 1.7 percentage points, declining to 12.9%, whereas for unhedged US dollar loans, it deteriorated by around 1.4 percentage points, to 9.2%.

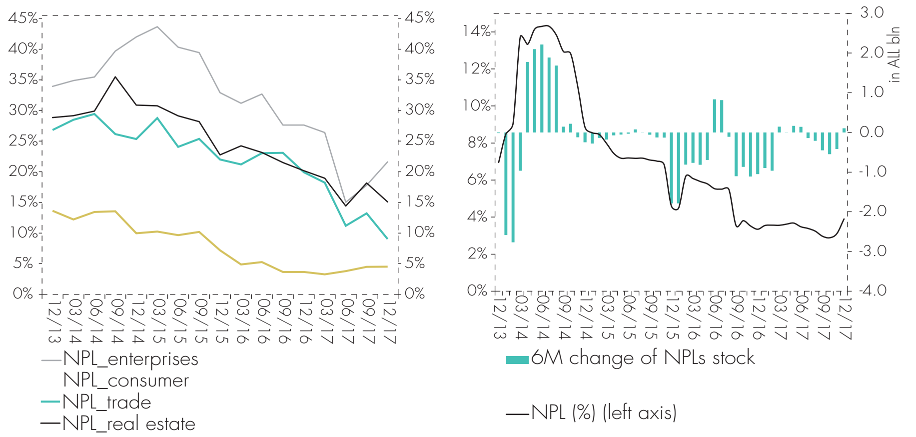
Chart 8.15 Quality of the unhedged loan portfolio against the exchange rate risk



Source: Bank of Albania.

(76) **By purpose,** the main share in the non-performing loans stock within loans unhedged against exchange rate risk were loans for "investments in real estate" (57%), which, during the period, decreased by 15%. This type of credit is classified among the three types with the highest level of non-performing loans ratio (around 15.1%), together with loans for business development (21.6%) and loans to enterprises for real estate - residential development (16.9%). Over the period, only the NPLR for loans for business development registered an increase. From the category of loans unhedged against the exchange rate risk, consumer credit shows the lowest NPLR level, at 4.5%.

Chart 8.16 Quality performance for the unhedged loan portfolio against exchange rate risk, by purpose (left) and non-performing loans for non-resident entities (right)



Source: Bank of Albania.

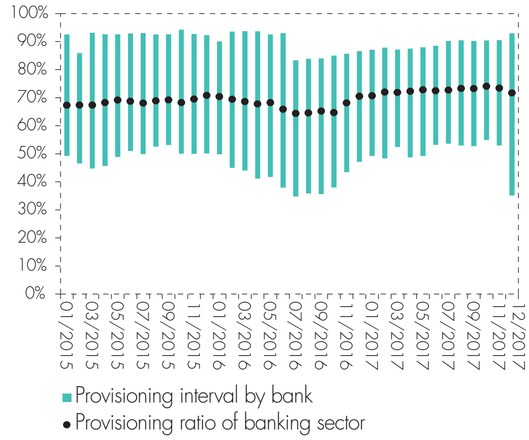
(77) **Credit quality to non-residents, while maintaining a good level, registered a decrease over the period.** During 2017 H2, credit outstanding for non-residents contracted by around 7%, reaching ALL 64 billion at the end of the year, whereas non-performing loans increased by 4.4%, reaching ALL 2.5 billion. As result of these developments, the NPLR for credit to non-residents increased at 3.9% from 3.3% of the previous year.

8.3.4 MITIGATING FACTORS OF CREDIT RISK

(78) **Although non-performing loans have decreased, the even faster decline of provisions for credit risk over the period has led to the decrease of the non-performing loans provisioning ratio by 0.7 percentage point.** The provisioning ratio continued to maintain good levels (71.7%). Compared with the previous year, most of the banks of the system report both improvements in credit quality and a higher level of provisioning.

(79) The decrease in the net non-performing loans stock[53] over the period has led to an improvement of their capital hedging. Over the period, the ratio of net non-performing loans to outstanding loans contracted by 0.5 percentage point, to 3.7%. In the previous year, the ratio stood at 5.3%. At the same time, as a result of the lower exposure to credit risk through the contraction of the net non-performing loans outstanding, the "net non-performing loans/ regulatory capital" ratio decreased to 15.7% from 18.6% in June 2017. In the previous year, the ratio stood at 23.1%.

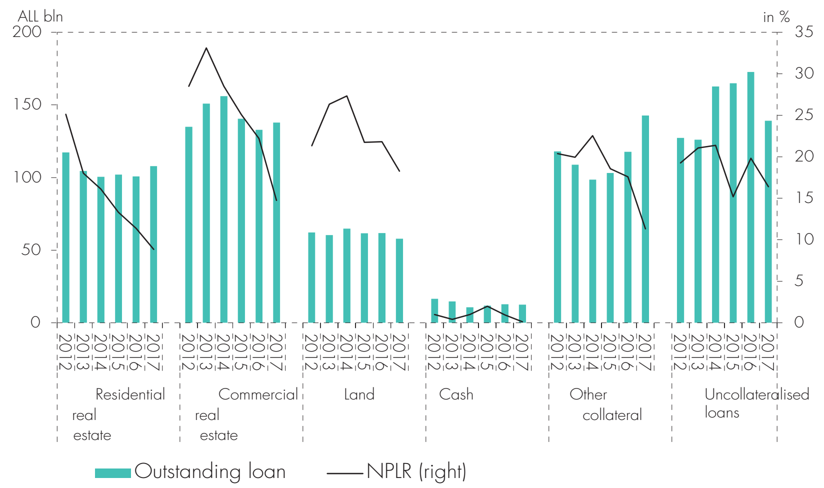
Chart 8.17 Provisioning over time



Source: Bank of Albania.

(80) Credit collateralisation, mainly with real estate, remains at good levels. At the end of 2017, collateralisation[54] registered 76.4%, from 71.6% in 2017 H1 and 71% in 2016 H2. Loans covered with collateral in the form of real estate account for around 66% of collateralized loans, and 50% of outstanding loans. The quality of collateralized loans has improved during the period compared with the previous year, and the NPLR registered 13.3%. Loans covered with collateral in the form of cash have the lowest level of non-performing loans (0.13%), while those covered with collateral in the form of "real estate - land" have the highest level (18.3%). The NPLR for this type of loans has declined. The quality of non-collateralized loans, which account for 23% of overall outstanding loans, has improved thus contributing to the decrease of the NPLR at 16.4% from 19.8% of the previous year.

Chart 8.18 Outstanding credit and non-performing loans ratio by collateral



Source: Bank of Albania.

[53] Net non-performing loans represent the value of non-performing loans that remains after provisions are deducted for these loans.

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

8.4 DEPOSITS AND LIQUIDITY RISK

(81) Outstanding deposits grew by 2.4% or ALL 27.2 billion over the period, reaching ALL 1,166 billion. The positive contribution came from current accounts and demand deposits. Time deposits remained almost unchanged compared with 2017 H1, but registered a decline compared with 2016 H2. In annual terms, the deposits' growth rate was 0.7%.

(82) Over the period, outstanding deposits in lek increased 1.7% or around ALL 9 billion, while in foreign currency outstanding increased around 3% or ALL 18.2 billion. In the performance of deposits the net effect of lek exchange rate against the euro and the US dollar was decreasing around ALL 1.7 billion[55]. Since deposits to households dominate the total deposit stock (over 80%), their growth as well as the growth of deposits in foreign currency were the two categories with the higher impact on the expansion of the deposits' base over the period.

(83) Deposits in foreign currency, by transactions in their original currencies[56] increased in total by around ALL 21 billion. In annual terms, the impact of the exchange rate for the US dollar and the euro is assessed at ALL -9.3 billion and ALL -8.7 billion, respectively. Excluding the exchange rate effect, the annual growth of total deposits base would have been 2.3% (from 0.7%), and of deposits in foreign currency 4% (from 1%).

(82) Interest rates on deposits continued to decrease, reflected in a further contraction of time deposits and increase in the share of current accounts and demand deposits.

Table 8.3 Main indicators of deposits in the banking system

	Indicator and unit	Value (in ALL billion)	Share to total deposits (%)		Change	
	Period	12/2017	12/2017	12/2016	Annual	Semi-annual
By currency	Lek deposits	549	47.1%	47.2%	0.5%	1.7%
	Foreign currency deposit	617	52.9%	52.8%	0.9%	3%
By institution	Public sector	27	2.3%	2.5%	-6.4%	-0.8%
	Enterprises	168	14.4%	14.1%	3.3%	4.8%
	Households	970	83.2%	83.4%	0.5%	2.1%
By product	Current account	383	32.9%	32.3%	2.5%	4.2%
	Demand deposits	107	9.1%	7.9%	16.8%	12.5%
	Time deposits	655	56.2%	57.8%	-2.1%	0.05%
	Deposits' stock	1.166	100.%	100.%	0.7%	2.4%

Source: Bank of Albania.

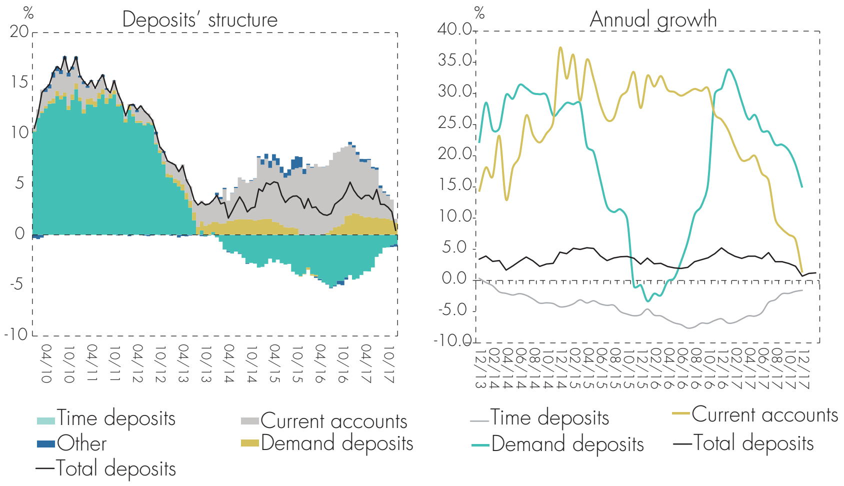
(85) Over the period, households and enterprises' deposits grew by 2.1% and 4.8%, respectively. The increase of deposits in foreign currency, around ALL 17 billion, provided the main contribution in the growth of households' deposits, by around ALL 20 billion. Only lek deposits provided positive

[55] *Excluding the impact of the exchange rate change, the growth of deposits in foreign currency over the period would have been 3.5%.*

[56] *This excludes the impact of the exchange rate, and reflects only net movements (inflows-outflows) of deposits by original currency.*

contribution to the increase of enterprises' deposits. In deposits in lek to enterprises, the main growth, by almost ALL 7.4 billion has been in the form of current accounts and demand deposits. In annual terms, to households and enterprises' deposits increased by 0.5% and 3.3%, respectively.

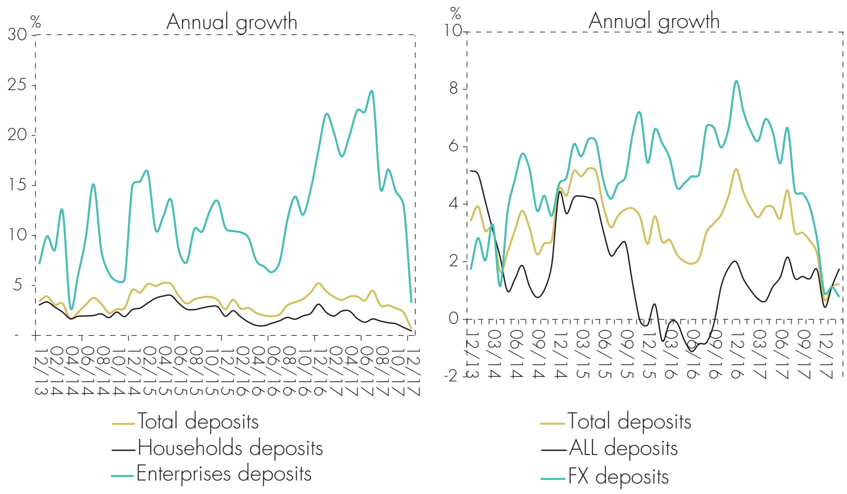
Chart 8.19 Deposits' structure and annual growth



Source: Bank of Albania.

(86) By maturity, time deposits continue to have the main share in total deposit. Although in absolute terms they did not change, the share of time deposits in the deposit stock decreased at 56.2%[57]. On the other hand, over the period, the stock of current accounts and stock of demand deposits expanded by around ALL 15 and ALL 12 billion, respectively.

Chart 8.20 Annual growth of deposits by type



Source: Bank of Albania.

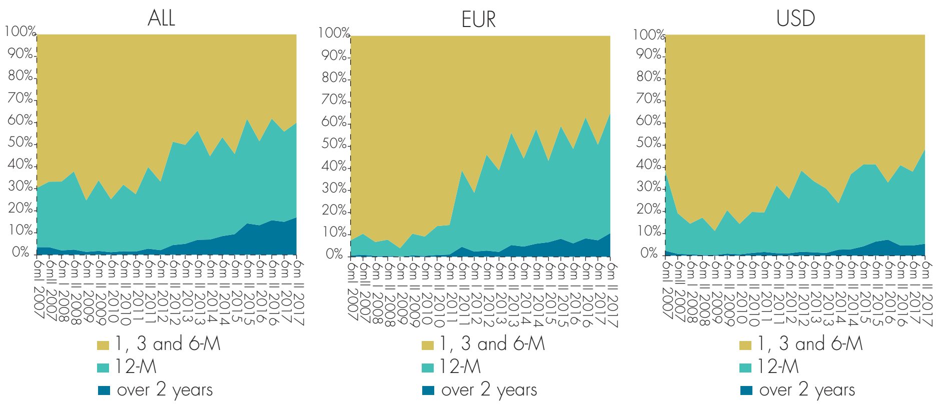
[57] *From October 2013, when the annual growth of time deposits started to register negative rates, time deposits have decreased in value by 17.2% and their share against total deposits decreased from 77% to 56.2%.*

(87) The increase of deposits is concentrated in the larger banks group (G3) and, at a lower degree in medium-sized banks (G2). Deposits in larger banks increased by ALL 19 billion, while those in medium-sized banks by around ALL 7 billion. Small banks registered minimum changes. According to the Herfindahl Index, the concentration of deposits stands below the moderate levels[58] (1.455 points), by showing a competitive banking market regarding the collection of deposits from the public.

(88) Over the period, the flow of new time deposits in the banking sector was ALL 282 billion, or around 16% higher than in 2017 H1. The share of new time deposits against the total new deposits has not changed from 2017 H1, at around 16%, but has decreased significantly against 2016 H2, at 19%. There was a slight shift of deposits to longer-term maturities within the structure of new time deposits for all three currencies.

(89) For the three main currencies, the flow of new deposits was significantly higher compared with 2017 H1, and interest rates showed low volatility. New deposits in lek and euro expanded by around 25% each and those in US dollar by around 14%. Over the period, the average interest rate for new time deposits in all three currencies maintained, overall, the levels of the previous period, registering very small fluctuations. The average rate on new time deposits in lek was around 0.9%, while those for deposits in US dollar and euro were 0.36% and 0.2%, respectively.

Chart 8.21 New time deposits by currency and maturity, 6 month flows



Source: Bank of Albania.

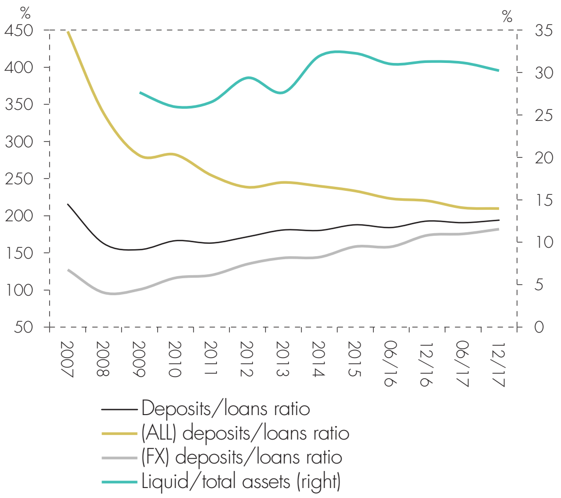
[58] *The values of the Herfindahl index up to 1500 show a competitive market, values 1500-2500 show a moderate competitiveness, and values above 2500 a high concentration.*

8.4.1 LIQUIDITY RISK

(90) Liquidity position of the banking sector is assessed at good levels. The liquidity indicators, both in lek and foreign currency, stand above the minimum regulatory ratios. Deposits remain the main source of funding, by covering almost twice the volume of loans for the sector. In December 2017, the loan-to deposit ratio stood at 51.6%, unchanged from the previous year, and slightly down from the level of June 2017. By currency, this ratio stands at 48% for the domestic currency and 55% for foreign currency. Compared with the previous year and with 2017 H1, the loan-to-deposit ratio increased for the lek and decreased for foreign currency. The increase of the ratio in lek was due to the higher relative increase of loans against deposits in lek, while the decrease of the ratio in foreign currency was due to the contraction of loans and the increase of deposits in foreign currency.

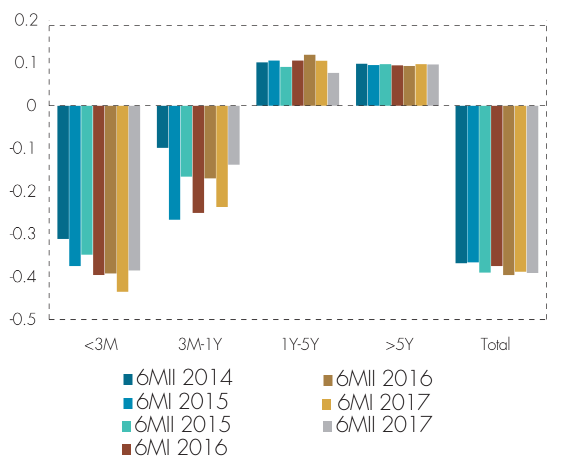
(91) Liquid assets in banks' balance sheets remain high, reflecting the performance below potential of lending. At the end of December 2017, the ratio of liquid to total assets of the banking sector was 30% or around 1 percentage point lower than in 2017 H1. The other liquidity indicator - "liquid assets to total short-term liabilities" - decreased slightly by 0.3 percentage point, down to 40.8%. Although banks are operating under ample liquidity conditions, the negative gap between assets and liabilities, by residual maturity segment, against total assets in the short-term, is considered as high and upward against previous periods.

Chart 8.22 Liquidity indicators



Source: Bank of Albania.

Chart 8.23 Assets and liabilities duration gap*

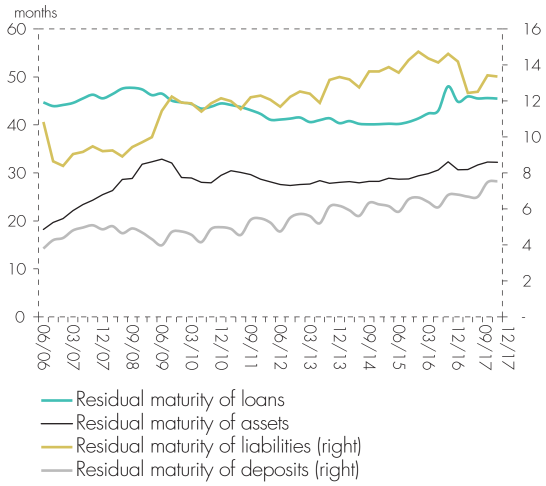


*Off balance sheet assets and liabilities are also included.

Source: Bank of Albania.

(92) The mismatch between medium-term assets and liabilities decreased over the period. At the end of December, this mismatch was around 17.3 months, against 19.1 months of June 2017, when it was registered the highest value of this mismatch since 2010. The reaming maturity of deposits, which

Chart 8.24 Average residual maturities



Source: Bank of Albania.

represent the most significant category of liabilities, increased by 7.5 (against 6.7) months over the period. The residual maturity for credit residual maturity has remained almost unchanged at 45.5 months (against 44.8 months in December 2016), reflecting the banks propensity to grant credit for longer-term periods.

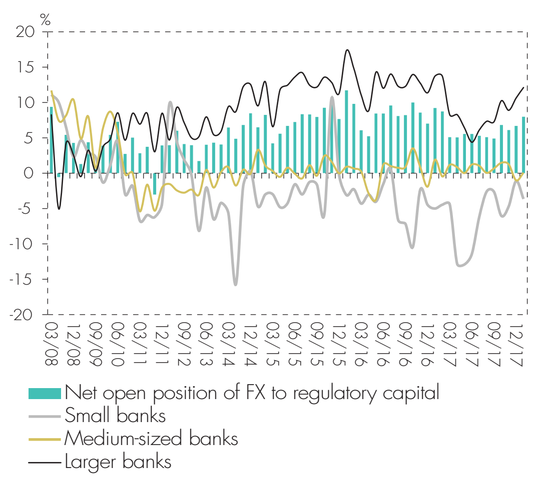
(93) The value of the financing lines by parent bank groups has a very low share in the banking sector's financing sources. Over the period, the total value of these lines was ALL 6.7 billion, from 8.7 billion at the end of the previous period. For banks that had credit lines with the parent bank groups, at the end of the period, the level of their usage was 12%, from 16.3% in June 2017.

8.5 MARKET AND OPERATIONAL RISK

8.5.1 EXCHANGE RATE RISK

(94) Over the period, the banking sector's net open foreign currency position to regulatory capital did not show significant movements. At the end of 2017, the net open foreign currency position of the banking sector was "long" at 6.7% of the regulatory capital, or 1.1 percentage points higher than at the end of 2017 H1, and 0.4 percentage point lower than the previous year. The performance of the banking sector indicator is driven mainly by the larger bank groups. At the end of the period, larger banks showed a net open long position, while medium-sized and small banks showed a net open short position. The values of the positions were relatively limited, suggesting a lower exposure of the banking sector to the direct exchange rate risk.

Chart 8.25 Net open foreign currency position to the regulatory capital by groups size



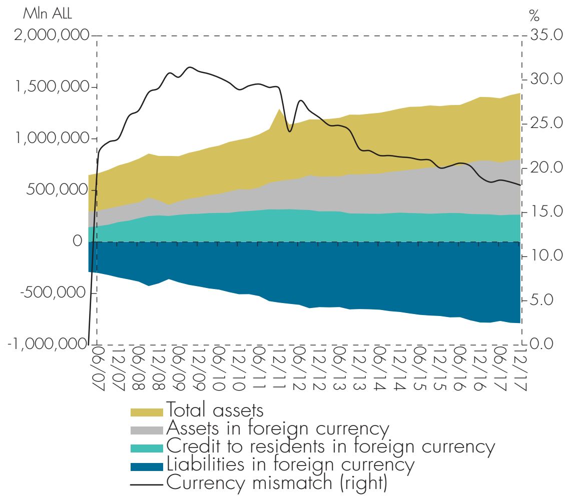
Source: Bank of Albania.

(95) At the end of 2017, the banking sector's exposure to indirect exchange rate risk was lower against 2017 H1 and against the previous year. At the end of December, the exchange rate mismatch indicator[59] for all currencies resulted at 17.7% of total assets, from 18.4% of total assets in 2017 H1 and

[59] *The foreign currency mismatch indicator measures the hedging rate of the banking sector's liabilities in foreign currency with foreign currency assets in in net foreign currency resident credit. A low value of this indicator's ratio to assets shows a low exposure to movements in the exchange rate. For the calculation of the foreign exchange mismatch indicator, refer to the Financial Stability Report 2016 H1.*

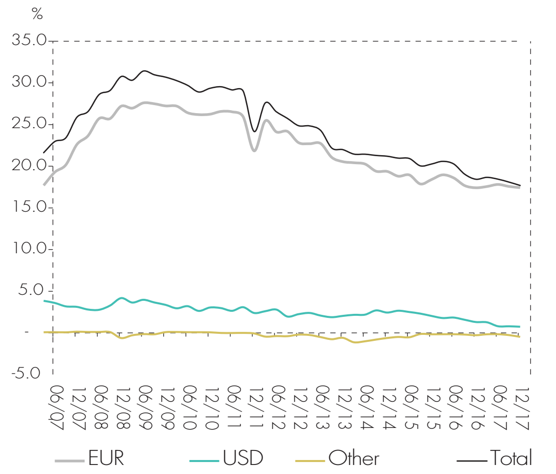
in 2016. The decrease in the value of this index was due to the faster increase of assets in foreign currency (+4%), compared with liabilities in foreign currency (+3%), and the slowdown of credit in foreign currency. By currency, the decrease of the index for the euro by 0.4 percentage point at 17.4% of total assets, dictated the overall performance of the indicator for the banking sector.

Chart 8.26 Foreign currency mismatch by components



Source: Bank of Albania.

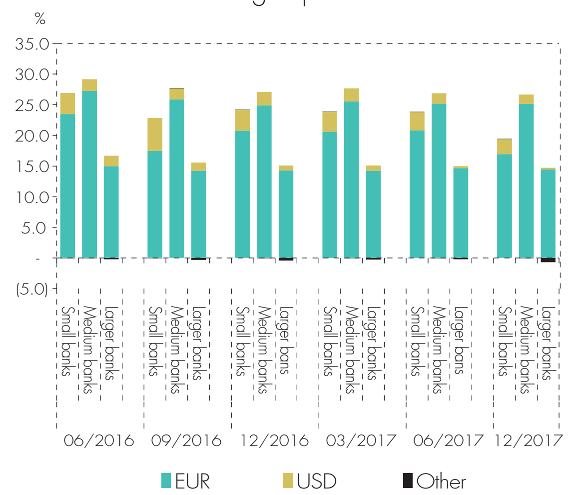
Chart 8.27 Foreign currency mismatch by currency



Source: Bank of Albania.

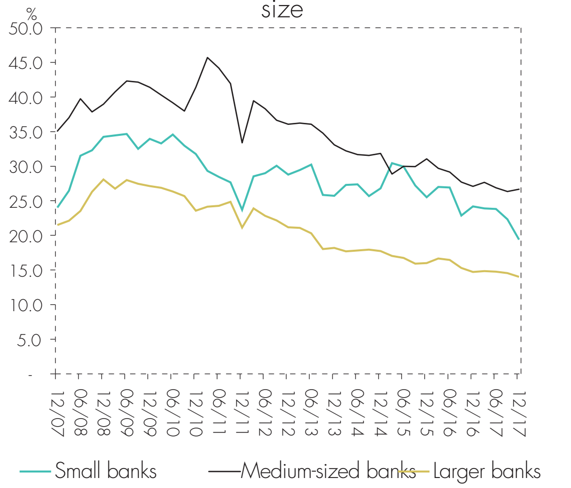
(96) For all three banking groups, the exposure to indirect exchange rate risk decreased over the period. Since the foreign currency mismatch index is related with the level of exposure to the indirect exchange rate risk, the larger banks group has the lowest level of exposure or the higher rate of foreign currency liabilities hedging with foreign currency assets, whereas medium-sized banks have the highest exposure or the lowest rate of foreign currency liabilities

Chart 8.28 Foreign currency mismatch by currency and group size



Source: Bank of Albania.

Chart 8.29 Foreign currency mismatch by group size



Source: Bank of Albania.

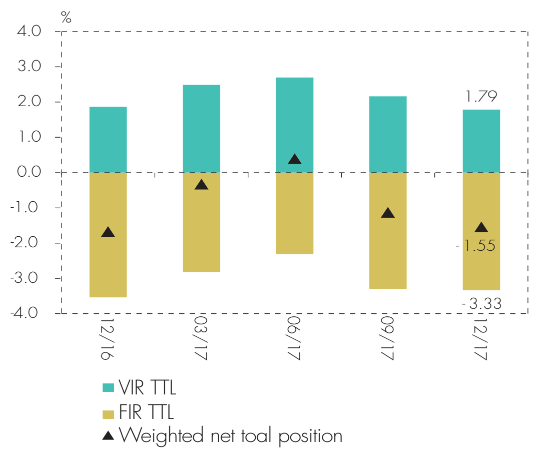
hedging with foreign currency assets. For these groups the foreign currency mismatch index at the end of 2017 H2 was 14.4% and 25.1%, respectively, while the small banks index registered 16.9%. Notably, in the last 5 years the exposure to indirect exchange rate risk has declined for larger and medium banks, whereas the exposure rate for small banks has had higher volatility compared with the exposure of the other two groups.

8.5.2 INTEREST RATE RISK

(97) The exposure to interest rate risk, at both banking group and sector level, is assessed as low, at 1.55% of the regulatory capital[60], reflecting the stability of the banking sector to immediate shocks of interest rates.

The re-pricing risk is the possibility that the bank may suffer financial losses as a result of the maturity mismatch between fixed interest rate (FIR) instruments, and as a result of the re-pricing of the interest rates of the variable interest rate (VIR) instruments[61]. The indicator measured for the calculation of the interest rate risk exposure is the total net position weighted with the relevant coefficients. This position, according the relevant act of the Bank of Albania[62], should not exceed the 20% limit of regulatory capital. At the end of the period, this position registered a negative value of 1.55%, dictated mainly by the negative position of balance sheet items with fixed interest rates at 3.3% of the regulatory capital. In 2017 H1, this position resulted positive, at 0.4% of regulatory capital. When the total net position is negative, meaning the volume of liabilities for which interests are paid exceeds the volume of claims for which interests are incurred, the banking sector is exposed to an immediate increase of interest rates.

Chart 8.30 Fixed (FIR) and variable (VIR) interest rates re-pricing risk, in % to regulatory capital



Source: Bank of Albania.

(98) By maturity, the weighted medium-term net position expanded at -6.1% of the regulatory capital, whereas the long-term gap expanded by 0.3 percentage point reaching 5.3% of the regulatory capital. Also, variable interest rate balance sheet items showed positive weighted position across all maturities, while the short-term maturity had the main share reaching 1.6% of regulatory capital.

[60] *The above indicator is expressed in absolute values.*

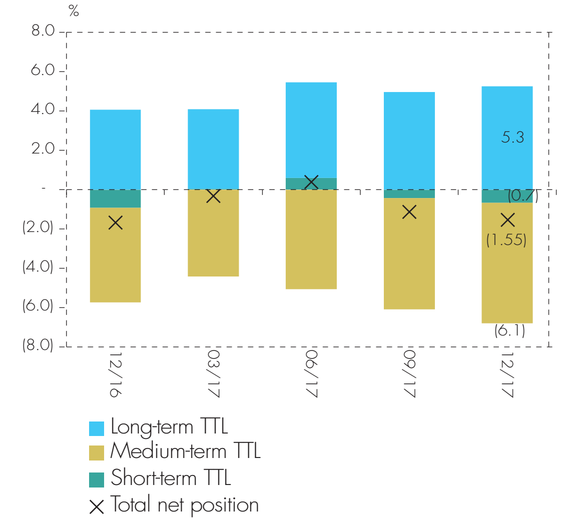
[61] *In FIR and VIR are included expected asset monetary flows (with fixed rate - FIR; and variable rate - VIR), such as relations with *BoA*, inter-banking relations, loans and advances, securities (except trade ones) and participation interests. These flows are set off by liabilities monetary flows (with fixed and variable rates) such as central banks, reserve/repo, inter-banking relations, consumer transactions (deposits), public administration transactions, liabilities from bonds and other securities, specific reserve funds and subordinated debt.*

[62] *Bank of Albania's Supervisory Council Decision No. 33, dated 30.04.2013, "On the approval of the guideline 'On managing the interest rate risk in the banking book'".*

Whereas fixed interest rate balance sheet items showed positive values for the long-term weighted net position (5.2% and negative values for short and medium-term weighted net positions (2.3 and 6.3%, respectively).

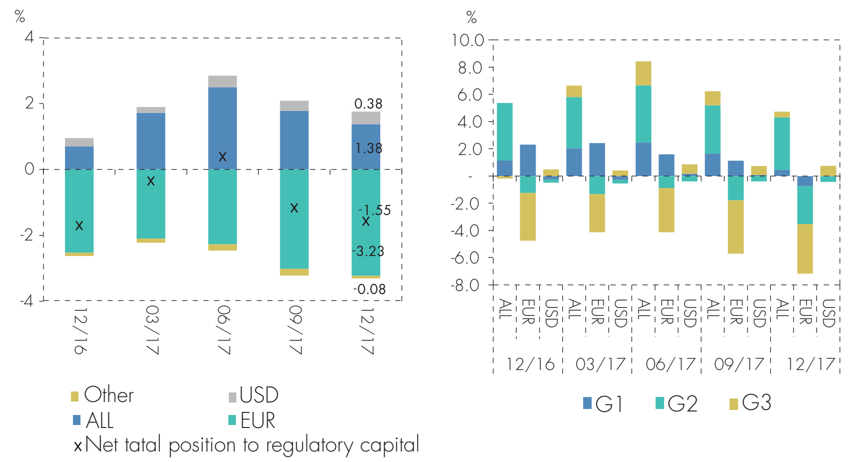
(99) The weighted net position by currency show that the weighted position in euro (-3.2%) has defined the positioning of the indicator for the banking sector. Chart 8.32 by currency and groups, larger and medium-sized banks show negative weighted net positions in euro. For the weighted position in the domestic currency, small and medium-sized banks maintain positive positions, while larger banks do not show significant positions in lek.

Chart 8.31 Duration gap, in % of regulatory capital



Source: Bank of Albania.

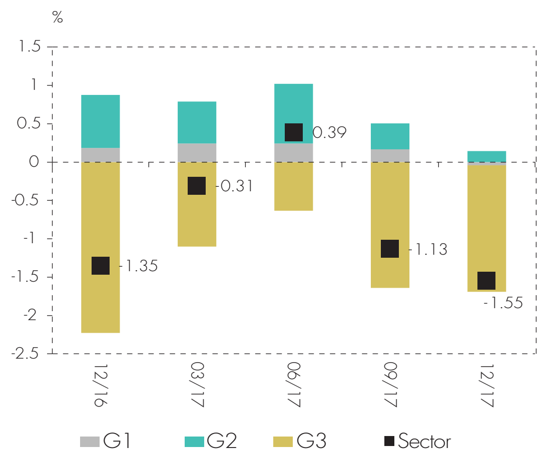
Chart 8.32 Weighted net position to regulatory capital, by currency and bank size



Source: Bank of Albania

(100) In the positions by banks' size, the larger bank group dictates the performance of the indicator for the sector. Small and medium-sized banks show positive weighted net positions to regulatory capital, so they held more interest rate-sensitive assets than. Larger banks have a contrary position since they held more interest rate-sensitive liabilities than assets. Despite the positioning of the banking groups, the exposure to interest rate risk, at group as well as at sector level, remains low, reflecting the stability of the banking sector to immediate shocks of interest rates.

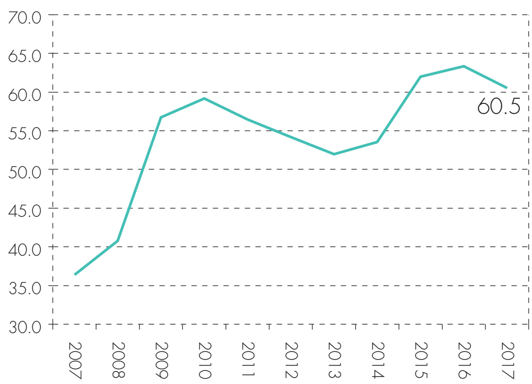
Chart 8.33 Weighted net position by bank size



Source: Bank of Albania.

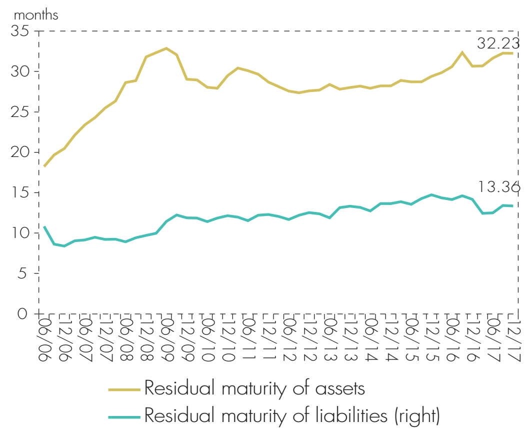
(101) The banking sector has not showed a highlighted preference on the growth of activities with risk, in the existing environment with low interest rates. Chart 8.34 shows the performance of banking sector's risk weighted assets since 2007. Risk-assets are defined by the relevant Regulation of the Bank of Albania and reflect the exposure quality by the point of view of risk. Besides the relatively fast growth in 2007-2010, the growth rate of banking sector's risk-assets in 2011-2015 has been slower, while in 2016-2017 the growth of risk-assets has stopped. The performance of the banking sector's risk-assets was affected by the significant slowdown of lending activity, due to the increase of non-performing loans, as well as the preference for investments in liquid assets with lower risk coefficient. Starting from 2013, the performance of risk-assets with is also defined by the changes in the risk coefficient as part of the regulatory change of the Bank of Albania on counter-cyclical measures.

Chart 8.34 Assets weighted with risk/ Total assets (%)



Source: Bank of Albania.

Chart 8.35 Banking sector's average assets and liabilities residual maturity (in months)



Source: Bank of Albania.

Overall, higher-risk is accompanied also by higher nominal rate of return on investment. In the conditions when risk-assets have not increased, a form of assuming risk by the banks to ensure the stability of rates of return on investment is also the extension of the investment maturity. Chart 8.35 represents the average residual maturity of the banking sector's assets and liabilities in months. Overall, we can observe the same performance for risk-assets. Since 2010 and on, the banking sector has not shown a preference to extend the maturity of its investments.

8.5.3. OPERATIONAL RISK

(102) At the end of 2017, the operational losses of the banking sector did not exceed the operational risk requirements for capital and their share was low.

Operational risk, according to the regulatory definition, means the risk that the entity may suffer losses as a result of the inadequacy or failure of internal processes and systems, human errors or external events. At the end of 2017, the capital requirement for the operational risk was ALL 6.7 billion, down from 2017 H1 and the previous year. The decline of the indicator has been driven by two factors:

i. first, the way of calculating capital requirement, where 12 banks of the sector use the simple indicator method[63] and 4 banks use the standard method[64];
ii. second, the continuous decline over the last three years of the net result from interests and non-interests.

Operational losses for 2017 registered ALL 0.7 billion. The average level of operational losses to the banking sector's capital requirement is 10%. In the previous year, this ratio stood at 7.4%.

8.6 FINANCIAL RESULT AND EFFICIENCY OF FUNDS

(103) The banking sector closed 2017 with a positive financial result of around ALL 22 billion, significantly higher than the previous year. The main reason for the increase of the financial result is related to the significant decrease of credit risk provisions, while net interest income continued to contract. The increase of the financial result is reflected in the significant growth of the average profitability indicators of the banking sector: RoA increased at 1.6% while RoE at 15.7%, from 0.7% and 6.8%, respectively, in the previous year. Different from the previous year, when the small banks group (G1) reported financial losses, at the end of 2017, all three banking groups classified by size reported a positive and higher net result than the previous year.

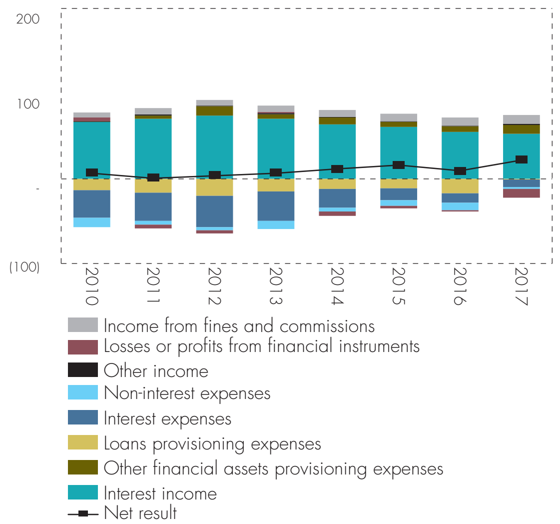
(104) The fall of interest income has brought a decrease in net interest margin at 3.9% from 4.2% in the previous year. This indicator has remained almost unchanged over the period. The decrease of the net interest margin is due to the higher contraction of net interest result than the decline of funding costs. Net interest result registered ALL 44 billion, around ALL 0.4 billion lower than in the previous year. In an overall environment of low interest rates,

[63] *Banks calculate the operational risk capital requirement with the simple indicator method, which considers net income from the banking activity over the last three years of banking activity and a coefficient* **α** *of 15%.*

[64] *The standard method considers the banking activity net income indicator by business lines and the respective lines' coefficients* **β**.

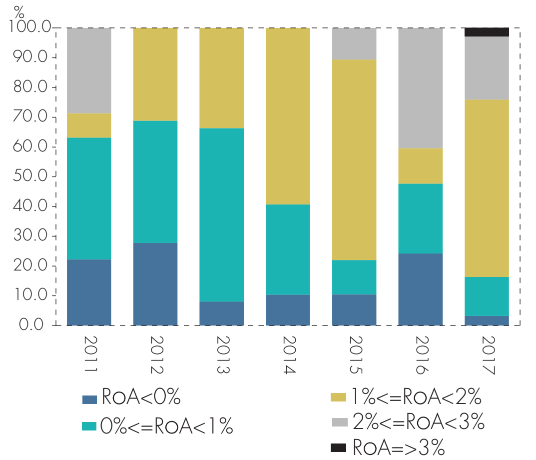
both interests' income and expenditures has continued to decrease, but the decrease of income from interest has been higher compared with the decrease of expenditures for interests. Net income from other activities also was down due to financial instruments' losses, while income from fines and commissions registered a slight increase compared with the previous year.

Chart 8.36 Financial result components



Source: Bank of Albania.

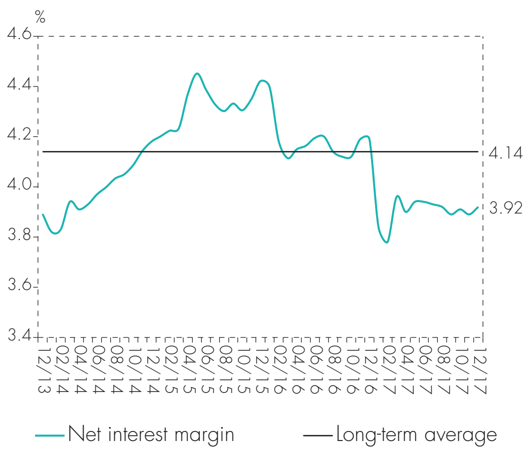
Chart 8.37 RoA by banks' share in the banking sector's total assets



Source: Bank of Albania.

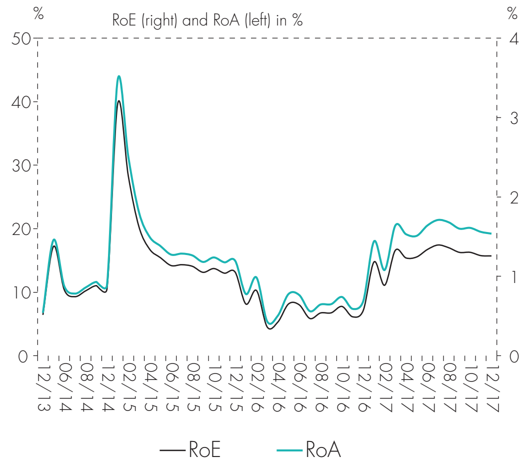
(105) Costs in the form of credit risk provisions decreased considerably by around ALL 16 billion and represent the main factor contributing in the growth of banking sector profitability. The decrease of provisions is due directly to the improvement of the quality of the credit portfolio, as consequence of the significant contraction of the outstanding non-performing loans. Expenditures for other financial assets were negative (reversal of provisions).

Chart 8.38 Net interest margin



Source: Bank of Albania.

Chart 8.39 Profitability indicators



Source: Bank of Albania.

The value of reversal of provisions was around ALL 3.3 billion higher compared with the end of the previous year, which provided an additional impact in the growth of the banking sector profit. The share of banks' assets that registered financial losses against of the banking sector's assets was around 3%; for 2017, only three small banks reported very low financial losses.

(106) **Activity costs were well hedged by activity income.** The operating expense to income ratio was 72%, upward in the last year, after the low volatility in the previous periods.

Chart 8.40 Activity's expenditure to income

Source: Bank of Albania.

BOX 8.3 COST OF EQUITY (CoE) PROXY IN THE ALBANIAN BANKING SECTOR

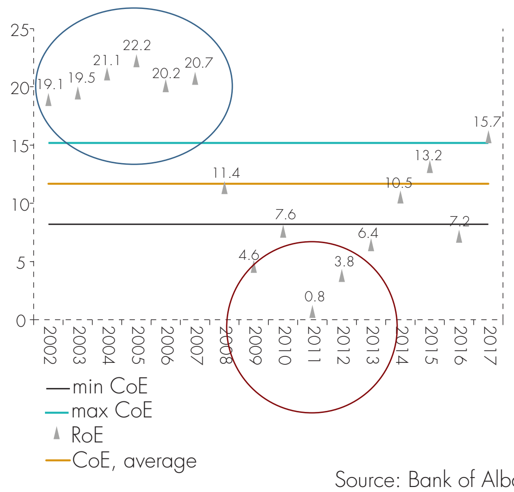
Cost of equity (CoE) refers to the return required by the shareholder for a capital investment. It is the return rate that may have been earned by investing the same money in another investment with the same risk. The difference between this indicator and the actual return on equity (RoE) is a measurement of the sufficiency of a bank's profit from the point of view of its shareholders. The Albanian banking sector presents volatile levels of return on equity, by banks y-o-y. Larger banks, overall, maintained higher RoE compared with small banks.

The literature assesses the cost of equity from the Capital Asset Pricing Model (CAPM), which is a model used to define a theoretically proper return on asset rate, so as to make decisions on adding assets to a well-diversified portfolio. According to CAPM, the cost of equity of a bank operating under a particular jurisdiction is calculated as the sum of risk of the country (typically measured according to the assessment of the sovereign debt) and the individual bank's risk.

In his study, Aswath Damodaran[I] used panel data from many countries to assess the risk of a country expressed as percentage points on the return of a safe asset, such as a US government bond, resulting in an assessment of Albania's risk as a country of 5.19%[II]. The direct measurement of a country risk is the risk of failure when the government of that country is credited. However, to calculate the cost of equity of the bank it is also necessary to include the risk premium of the individual bank itself. In the absence of these assessments in Albania, early studies for developed countries suggest that the specific premium risk for banks is in the range of 3 to 10%[III]. By adding to the assessment of Albania's risk the premium risk of the banks as well, the cost of equity for our banks is within 8.19% -15.19% range, with an *average assessment of 11.7%[IV]. This means that the actual returns (RoE) for a part of the banks that has 28.9% share of total assets of the banking sector do not cover the assessed cost of equity. However, at sector level, return on equity currently (December 2017) is at satisfactory levels, significantly covering the cost of equity at both the average and maximal level (Chart 8.41).*

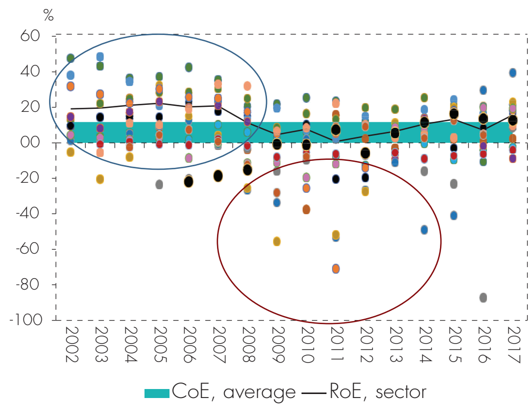
The international financial crisis of 2007 was also reflected in the financial soundness

Chart 8.41 Banking sector's return on equity (RoE) against cost of equity (CoE), pre and post-crisis



Source: Bank of Albania.

Chart 8.42 Return on equity (RoE) against cost of equity (CoE) at bank level, pre and post-crisis



Note: Coloured circles represent individual banks' RoE over the years.

Source: Bank of Albania

indicators of Albania, mainly over the 2008-2012 period, where one of these return on equity (ROE) indicators for the banking sector as a whole, but also for some banks in particular stands below the average CoE level of 11.7% and below the minimum cost of equity of 8.19%. Meanwhile, before 2018, the banking sector and a considerable number of banks had a return on equity above the average level of CoE, having space to expand their activity.

In the last years (2015-2017), although a considerable part of banks have a return on equity (RoE) very near the average CoE level, there are still banks that have difficulty to cover the cost of equity.

I Aswath Damodaran "Country risk: Definers, measurements and implications" - Sterns School of Business, 2016

II http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/ctryprem.html

III King, M.R., "The cost of equity for global banks: a CAPM perspective from 1990 to 2009" BIS Quarterly Report, September 2009, http://www.bis.org/publ/qtrpdf/r_qt0909g.pdf.

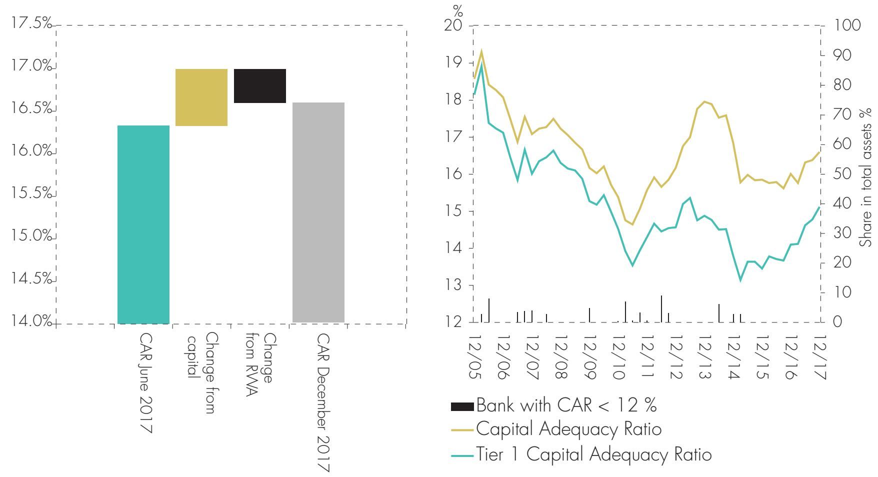
IV The average assessment of the cost of equity is calculated by the formula: 5.19% + 0.5(103) % =11.7%.*

8.7 ACTIVITY CAPITALISATION

(107) The capitalisation of the banking sector in December 2017 is assessed as good and its performance was determined by the increase of regulatory capital. The positive and increasing financial result remains the main factor that has affected the performance of regulatory capital over the period. On the other hand, the expansion of risk weighted assets due to the increase of credit risk capital requirements has given a negative contribution in the performance of the capital adequacy indicator. However, the Capital Adequacy Ratio stands significantly higher than the minimum required level required by the supervision regulatory framework of the Bank of Albania.

(108) In December 2017, the Capital Adequacy Ratio stood at 16.6%, from 16.3% in 2017 H1, and 16% in 2016. At the end of 2017, the risk weighted assets were around 2.5% higher compared with June 2017, contributing to the decrease of the Capital Adequacy Ratio by 0.4 percentage point. The increase of regulatory capital by 4.2% had an impact of +0.7 percentage point in the Capital Adequacy Ratio.

Chart 8.43 Capital adequacy ratio

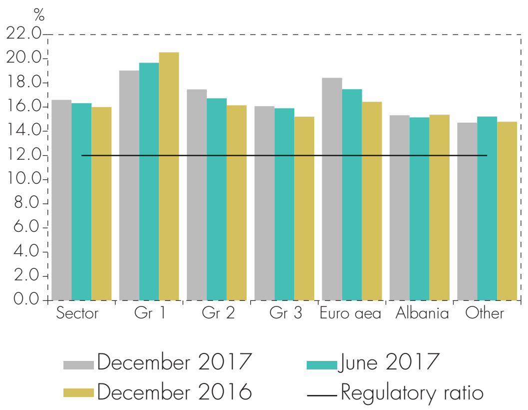


Source: Bank of Albania.

(109) At peer group level, G3 banks show a lower capitalization rate; while by capital origin, banks classified as "Other"[65] and those of Albanian origin show lower capital adequacy ratios. Most, individual banks maintain capital adequacy ratios in the 14-16% range. At the end of 2017 was observed an increase of the number of banks that have capital adequacy ratio in the ranges 18-20% and 20-30%, while the number of banks that have this ratio in the 16-18% range has decreased.

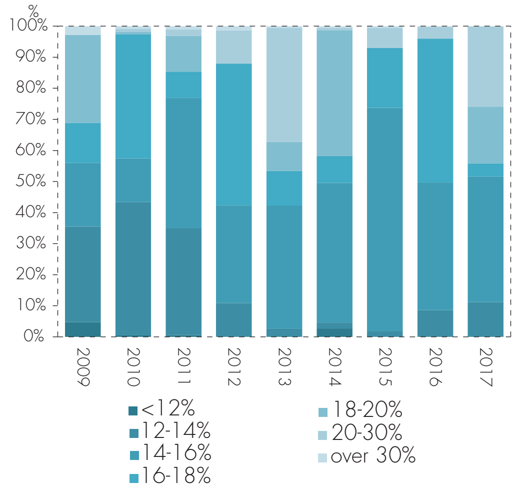
[65] *This group includes banks of Turkish, Arabian, Kuwaiti and Malaysian capital.*

Chart 8.44 The capital adequacy ratio of groups by size and by origin of capital



Source: Bank of Albania.

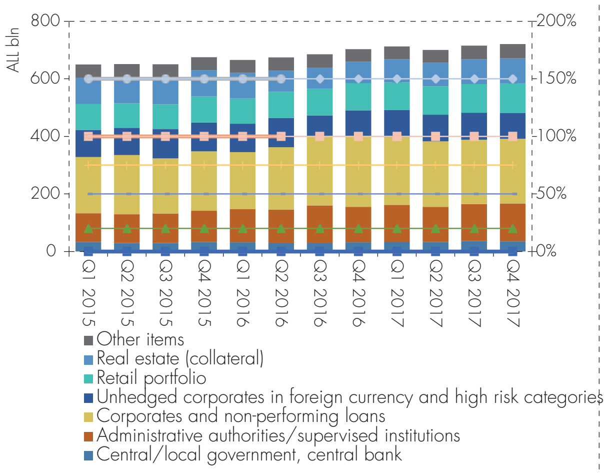
Chart 8.45 Asset allocation of banking sector, by Capital Adequacy Ratio



Source: Bank of Albania.

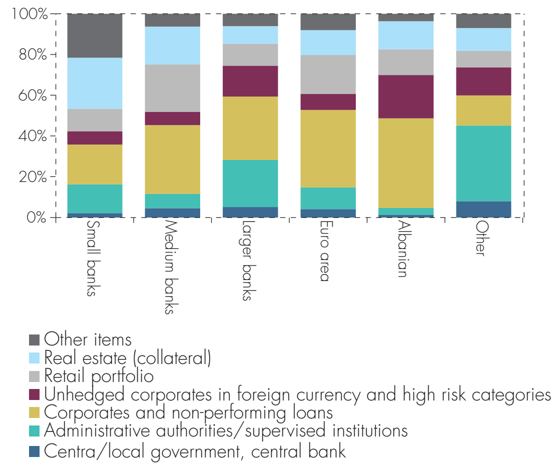
(110) The banking sector shows increasing exposure in terms of some credit risk classes, but this exposure is concentrated in classes with a low risk coefficient. Credit risk weighted assets expanded by around ALL 20 billion, compared with the end of 2017 H1, reaching ALL 720 billion. The categories that have registered an increase are related with exposures to administrative bodies and supervision institutions, which have a 20% risk coefficient (see Chart 8.46). Meanwhile, the categories that have registered an decrease are related with exposures to corporations and non-performing loans, as well as exchange rate risk unhedged loans, which are weighted with a high risk coefficient (100%-150%). Small banks show a high exposure to loans hedged with collateral in the form of real estate; medium-sized banks have a higher exposure to loans to corporations and non-performing loans; larger banks, in addition to the exposures that have medium banks, are exposed to administrative bodies and supervised institutions. By origin

Chart 8.46 Risk-weighted coefficients and the size of main credit portfolio classes



Source: Bank of Albania.

Chart 8.47 Credit classes' exposure of banks by size of activity and origin of capital, December 2017



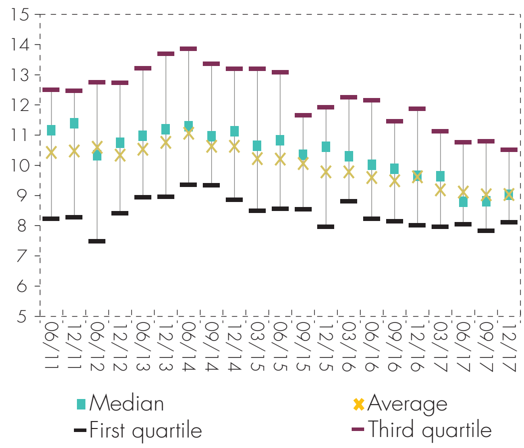
Source: Bank of Albania.

of capital, banks with Albanian capital have a higher exposure to the class "Loans for corporations and non-performing loans" (Chart 8.47).

(111) Capital requirements for market and operational risk decreased. At the end of the period, capital requirements for market risk registered ALL 14.3 billion, slightly down over 2017 H2. Capital requirements for operational risk decreased by ALL 1.6 billion, at ALL 83 billion. Capital requirements for market and operational risks share 1.7% and 9.6%, respectively, of total risk-weighted assets.

(112) The Albanian banking sector is characterized by a low financial leverage ratio, which confirms the maintenance of a good level of capitalisation. As of December 2017, the financial leverage ratio[66] was 9.8 times, from 10.3 times in the previous year. The financial leverage, at individual banks level, does not show any significant shift.

Chart 8.48 Financial leverage ratio



Source: Bank of Albania.

[66] *The financial leverage indicator is measured as the assets to equity ratio.*

9. ASSESSING BANKING SECTOR RESILIENCE THROUGH STRESS-TESTING[66]

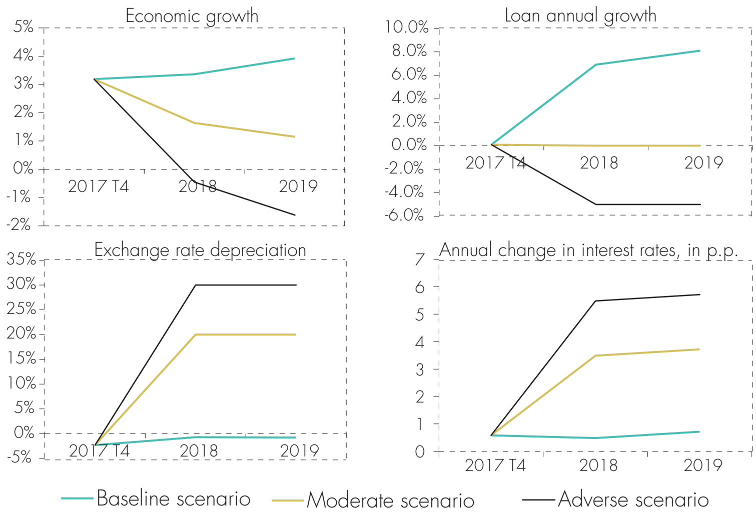
(113) Stress-testing assesses the banking sector resilience against the economic and financial developments for the next two years, until the end of 2019. The results show that the banking sector remains resilient. In terms of capital adequacy, the impact of these assumptions evidences the need for additional capital in some individual banks, particularly in the case of the adverse scenario, where the assumptions are also more extreme. The stress-testing also assessed the resilience of the banking sector against fluctuation of real estate prices, in the framework of added cost for the sector related to properties obtained as a consequence of a legal process. Furthermore, stress-testing this year also included the assessment of the sector resilience against fluctuation of the interest rates, in terms of its profitability. Finally, the stress test for the liquidity situation corroborates the assessment for a strong liquidity position of the banking sector. Stress-testing results show that the banking sector overall passes successfully the liquidity resilience test, and the liquidity situation reflected by the growth of expected inflows and the contraction of expected outflows until the end of the two year period has improved.

9.1 ASSESSING THE RESILIENCE TO MACROECONOMIC SHOCKS

(114) The stress test exercise assesses the banking sector's resilience and capital adequacy for the period 2018-2019. The assessment of the impact from macroeconomic situations on the financial situation of the banking sector excludes the possibility of increasing the paid-in capital during the period. The exercise is conducted by applying three scenarios: the baseline scenario, the moderate scenario and the adverse one. The last two scenarios contain more extreme assumptions and have a lower probability of occurrence.

67 Stress-testing does not represent a way of forecasting. Intentionally, the scenarios include adverse and extreme events with a low probability of occurrence to test the banking sector resilience. Although banks are urged to assess their financial position capacity to withstand the impact of these scenarios, they should not regard them as events the Bank of Albania expects to take place in the future. The scenarios vary over time, depending on economic and financial developments. In addition, the scenarios do not take into consideration operations that banks and authorities may carry out to constantly strengthen their financial position and resilience to bank risks.

Chart 9.1 Stress-test assumptions



Source: Bank of Albania.

(115) The baseline scenario assumes a positive economic growth throughout the two year period of the exercise. In this scenario, the economic growth is associated with higher growth paces of lending, supported by the further improvement of the credit portfolio quality until the end of 2019, as a result of the repayments, restructuring and non-performing loans write-offs from banks' balance sheets.

(116) In the moderate scenario, economic growth is also assumed to be positive but at a slower pace than the baseline scenario, whereas the adverse scenario assumes a contraction of the economy until the end of 2019. These developments, combined with a depreciation of the exchange rate of the domestic currency, increase of interest rates and shortage and contraction of lending affect the banking sector's performance in terms of its capitalisation. The credit portfolio quality for these scenarios reflects in addition to cleaning the balance sheets, the new flows in non-performing loans due to unfavourable assumptions. Consequently, the percentage points of the credit portfolio is presented as deteriorated until the end of 2019, where the non-performing loans ratio increases by 17.0 percentage points (moderate scenario) and by 21.6 percentage points (adverse scenario), compared with the level of the baseline scenario. The adverse scenarios, in addition to the reduction of the credit quality, assume also shocks in terms of market risk: the interest rate risk, securities re-pricing list, exchange rate risk, and operational risk.

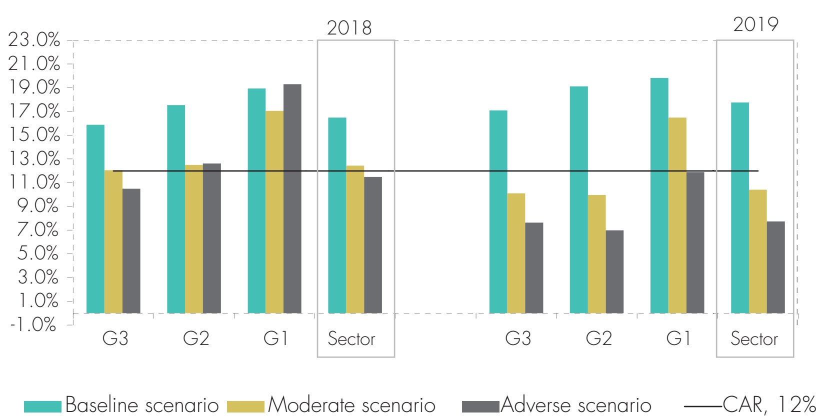
(117) Stress test results in terms of capital adequacy show that:

a. In the *baseline scenario*, the Capital Adequacy Ratio (CAR) of the sector tends to increase, registering 17.8% at the end of 2019. This development reflects the improvement of financial performance as a result of economic growth, acceleration of lending, further decrease of non-performing loans, as well as the more favourable exchange rate performance. Also, developments by banking group show a steady performance of their capital levels.

b. In the *moderate scenario*, the sector's CAR reaches 12.4% at end-2018, while it is down at 10.4% at end- 2019. This performance is affected by assumptions for a significantly lower growth pace; shortage of lending; increase in interest rates' and depreciation of lek's exchange rate. Based on the above assumptions and the results obtained, developments in particular banks evidence the need for capital injection. Specifically, the number of banks that are under-capitalised by the end of 2019 is 8 and their assets account for about half of the banking sector's total assets. In this case, the needs for additional capital amount up to ALL 19.4 billion until the end of 2019.

c. In the *adverse scenario*, the sector's CAR drops even further, below the regulatory minimum allowed until the end of 2019, at 7.7%. This rate is affected by the assumptions for a contraction of the economy and lending; increase of interest rates; and significant depreciation of the domestic currency. Given the extremely adverse assumptions contained in the scenario, the number of banks that will fall in under-capitalisation rises to 10. Their assets account for around 80% of the sector's assets. The extreme macroeconomic developments contained in the scenario affect the significant deterioration of credit quality, levels of losses in the securities portfolio and the increase of exposure to market and operational risks.

Chart 9.2 Capital adequacy ratio, by stress test scenarios



Source: Bank of Albania.

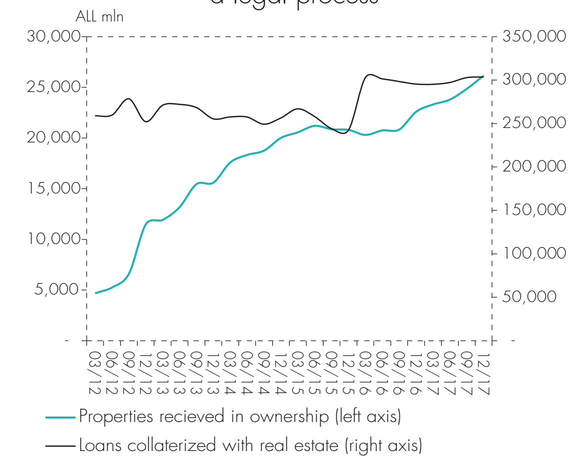
Despite the above results, which anyway remain assumed, the solvency of the Albanian banking sector and its capitalisation are assessed as good. In this light, it is important to highlight that over 2017 the sector's paid-in capital increased by around ALL 5.3 billion and the annualised profitability indicators (RoA and RoE) are at their highest levels since at end- 2007.

BOX 9.1 BANKS' EXPOSURE TO THE RISK RELATED WITH PROPRIETIES RECEIVED IN OWENERSHIP AT THE END OF THE RELEVANT LEGAL PROCESS

The non-performing loans management process has faced the banks with a relatively high number of cases of collateral execution and their receiving in ownership at the end of the relevant legal process. Furthermore, the risk related to the "collateral execution" is also identified as the most significant current risk by the latest survey results of "Perception of systemic risk by the banking industry" as well. From the point of view of financial stability it is important to assess the impact that has keeping these collaterals in the balance sheet in terms of capitalisation and profitability of the banking activity. This, since a fall in real estate price - during the keeping in the balance sheet period - may reduce not only the value of assets in the balance sheet, but also the income that may be realised from the sale of the collaterals. At the same time, a massive s of these collaterals by the banks may exert a downward pressure on the prices of the real estate market. The latter affects not only the income of the bank, but also the value of the real estates accepted as secondary source of guarantee during the lending process, with consequences on the quality of the credit portfolio and the capitalisation of the sector.

In Albania, till 2018, the value of properties received in ownership against the total assets of the balance sheet, as well as against regulatory capital was negligible. Over the five year period 2012-2017, where the credit quality registered a significant decline, the portfolio of these properties grew continuously, registering at end- 2017 around 2.1% of total assets of the banking sector, and 21.3% of the regulatory capital. The above view evidences once more the importance of monitoring this phenomenon in the framework of individual banks' soundness and of the whole banking sector as well.

Chart 9.3 Performance of the banking sector real estate portfolio related to properties owned through a legal process

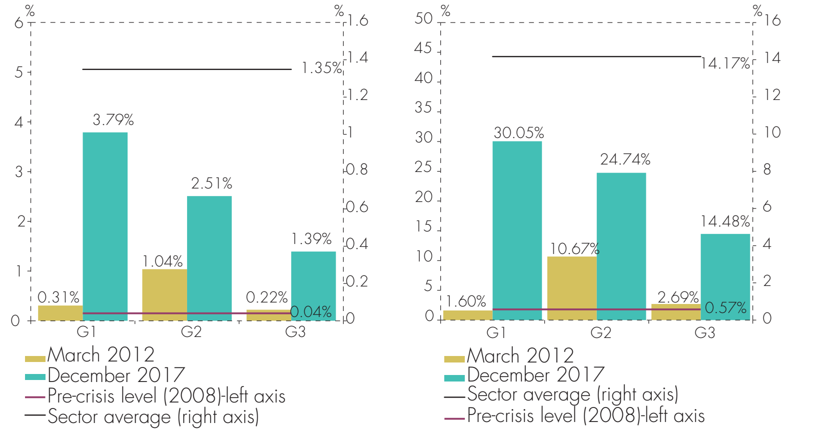


Source: Bank of Albania.

Based on this, the developments of the last years in the framework of collateral execution and the risk deriving from their accumulation in the balance sheet is addressed through an additional scenario: "Real estate scenario" In this scenario, assumptions on economic growth, exchange rate, the interest rate and increase of credit are equal to those in baseline scenario. But, different from the latter, it is assumed that in case of an immediate sale of these properties, the sector would suffer a loss calculated in 30-70% of the value in which they are kept in the balance sheet (December 2017) over the next two years, respectively.*

The results show that although the sector remains well-capitalised and profitable at the aggregate level in both years, in terms of profitability, individual banks have

Chart 9.4 Property owned through a legal process against total assets (left) and regulatory capital (right)



Source: Bank of Albania.

a decrease of the net financial result up to losses. More concretely, the number of affected banks is up to six, and their share is 18.3% of the banking sector's assets. Despite this, in this scenario for the first year and the second year the value of the Capital Adequacy Ratio reaches 16.3% and 18.0%, respectively, thus significantly above the required minimum of regulatory capital.

* *The values of 30% and 70% of losses for each year of the scenario, respectively, are defined taking into account the minimal level of stress where at least one bank would suffer losses in terms of financial results, thus affecting its capitalisation.*

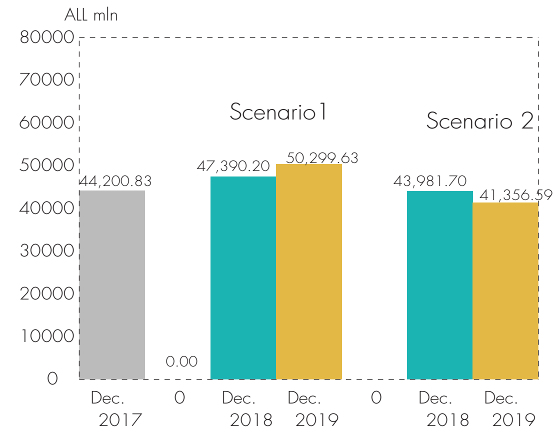
BOX 9.2 SENSITIVITY OF THE BANKING SECTOR TO MOVEMENTS IN THE INTEREST RATE

The sensitivity of the banking sector to the volatility of interest rates measured mainly through the impact that the movements in the interest rates have on net income and income from the reassessment of securities.*

The net interest income sensitivity is analysed through two scenarios: Scenario 1, where interest rates increase uniformly during each year of the exercise against the current rates, by 1 percentage point each year; and Scenario 2 where interest rates continued to remain downward, although slight against the factual values of 2017 (0.1-0.2 percentage point).

To analyse the impact of an increase of interest rates according to the two above-mentioned scenarios we have to take into account the structure of the banking sector's balance sheet. Specifically, the structure of the Albanian banking sector registers a positive gap between assets and liabilities sensitive to interest rates with maturities up to 12 months, evidencing an added sensitivity of the sector's to the structure of assets in the case of an increase of interest rates. This, since *for the same change in the interest rate, the assets of the balance sheet would be re-priced more than the liabilities, affecting the increase of net interest income. In the case of a decrease of the interest rate, the reverse is true. Factual data show that in December 2017 there is a positive gap of ALL 552 billion and the share of assets that are re-prices within a year is considerable (96% of the total) and higher than that of liabilities (64%).*

Chart 9.5 Assessment of net interest income for the banking sector, by scenarios



Source: Bank of Albania.

In Scenario 1, where interest rates are assumed to increase uniformly throughout the two years of the exercise by 1 percentage point, respectively, net interest income increase maximally by ALL 6.1 billion until the end of 2019 against the ALL 44.2 registered in December 2017. In Scenario 2, where interest rate start to decrease slightly, net interest rates contract maximally by ALL 2.8 billion at the end of 2019, against the level of 2017.

*But the inverse relation between the movement of the interest rate and the value of the security suggests that the assumed growth of interest rates also affects negatively the banking sector's securities portfolio in terms of reassessment, and vice versa. In this case, considering unchangeable the entire portfolio of securities kept to maturity and valid for sale at the end of 2017, the loss from the securities' reassessment due to the increase of the interest rate by 1% per year, is assessed maximally at ALL 15 billion at end-2019. In the case of the decrease of the interest rate assumed in this exercise, the change in the reassessed value of securities, is positive and reaches around ALL 13.3 billion at end- 2019. In both scenarios, is important to highlight that maximal losses/income constitute lower than 0.5% of the total value of the securities portfolio in the banking sector in December 2017**.*

Starting by the comparison between the two above scenarios, we may say that the impact of potential losses/income of interest rates in the financial result and consequently in the capitalisation indicators of the banking sector, seems currently manageable, but nevertheless needs to be carefully and continuously assessed by the sector itself.

* *Because of the sensitivity analysis, any indirect negative impact of the increase of the interest rate is related, e.g. with the decline of credit quality, is not been considered.*

** *The current value of the banking sector's securities portfolio in December 2017 is ALL 414.477 billion.*

9.2 LIQUIDITY STRESS TEST

(118) The purpose of the liquidity stress test is to assess the capability of individual banks and of the banking sector, overall, to withstand extreme but possible shocks in financing their activity. These tests aim to evidence weaknesses or deficiencies of the sector or particular banks in particular currencies, instruments or time periods; assess banks' readiness to cope with extreme liquidity shortfall scenarios; as well as assisting the supervision authority to undertake relevant policies that address liquidity management, including measures aimed at reducing exposures or creating specific reserves.

(119) The liquidity stress test is implemented according to the "up-down" approach, with data reported by banks twice a year (every May and November). The exercise uses data on inflows and outflows forecasts of money according to the main instruments and for a time period constituted by 8 maturity baskets that cover a period from "up to 1 day" to "over 1 and up to 2 years". The test is implemented for the lek, euro and US dollar and is supported on the condition that the liquidity outstanding on a currency may not be used to cover the liquidity shortfall in other currencies, due to the probability of fast depreciation of the exchange rate over liquidity crises.

(120) For the calculation of the liquidity gap are used specific coefficients for the withdrawal of financing sources (of deposits) and for the reinvestment of assets (loans) by all the maturity baskets. For financing sources, the coefficient shows only that part of the liabilities amount that matures in the relevant basket, which will be withdrawn to be reinvested by the client. For money inflows, the reinvestment coefficient means that part of the amount rights that mature in the relevant basket, which will be converted in money inflow and will not reinvested by the banks.

(121) A bank is considered as failing the stress test only if expanded liquid assets that are sold with haircuts defined by the exercise shrink to the level when additional liquidity is needed from the Bank of Albania in the form of "loan for liquidity support".

(122) Stress-testing results show that the banking sector overall passes with success the liquidity stress test and the liquidity situation reflected by the growth of expected inflows and the contraction of expected outflows until the end of the two year period has improved compared with the previous half year. The scenario that assumes the use of expanded liquid assets to close the liquidity gap shows that for the lek there are 2 banks that cannot close the gap until 6 months and 3 banks that cannot close the gap until the end of the two year period. For the euro the number of banks that do not pass the test for various baskets goes from 1 to 3, but the liquidity gap in relation with the assets of the sector in euro is very small, while for the US dollar the gap remains negative for 1 bank for some of the maturity baskets.

(121) Compared with the previous half year, referring to the number of banks that do not pass the test, we can observe an increase of their number for lek and euro and an almost identical situation of the US dollar. Despite the number of banks that continue to register a negative gap, liquidity has increased slightly[68], and the size of the liquidity gap in relation with the assets of the banking sector for each currency is fairly small.

(123) It is important to highlight that the simple liquidity gap or the negative spread between expected inflows and outflows of money for all three currencies has contracted significantly compared with the previous half year due to the increase of inflows in each currency. Also, the outflows for the US dollar and the euro are not expected to change, while the outflows for the lek according to banks will be lower. At the same time, the exercise results show that the situation of counterweight capacities (expanded liquid assets) of the banking sector have remained almost unchanged for the lek and the euro and have registered a slight improvement for the US dollar.

[68] *This result is also significant to the number of banks taking part in the exercise, which may change by 1 or 2 banks from period to period.*

ANNEX I

Table 1 Financial soundness indicators

In %	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Capital ratios											
Regulatory capital to risk-weighted assets	17.08	17.23	16.17	15.40	15.56	16.17	17.96	16.84	15.72	16.01	16.60
Tier I capital to risk-weighted capital	16.01	16.31	15.27	14.52	14.30	14.57	14.88	13.79	13.45	14.10	15.12
Shareholders equity to total assets	7.62	8.57	9.57	9.40	8.69	8.57	8.37	8.58	9.53	9.73	10.17
Asseet quality											
Net NPLs to regulatory capital	10.05	21.74	28.24	35.95	52.01	55.62	40.22	38.25	24.28	23.08	15.72
NPLs (gross) to total loans	3.36	6.64	10.48	13.96	18.77	22.49	23.49	22.80	18.22	18.27	13.23
Profitability											
ROE (annual basis)	20.74	11.35	4.58	7.58	0.76	3.78	6.43	10.53	13.16	7.15	15.71
ROA (annual basis)	1.57	0.91	0.42	0.72	0.07	0.33	0.54	0.89	1.20	0.69	1.54
Net open FX positino to capital											
Net open FX position to reguatory capital	1.69	4.30	3.89	5.03	3.94	3.98	4.08	8.49	7.66	7.03	6.68
Net open FX position to Tier I capital	1.80	4.54	4.12	5.33	4.29	4.41	4.92	10.37	8.95	8.00	7.34
Asset ratios											
Liquid assets to total assets	49.77	42.83	27.65	25.95	26.53	29.37	27.64	31.94	32.26	31.29	30.22
Liquid assetts to short-term (up to one year) liabilities	73.96	64.86	32.58	30.62	33.15	36.71	34.71	40.36	41.43	40.57	40.79
Client deposits to total loans	215.45	162.60	154.32	166.39	163.20	171.62	180.83	180.16	187.78	192.84	194.00

Source: Bank of Albania.