

## SURVEY OF DEPOSIT AND CREDIT ACTIVITY DURING JULY - DECEMBER 2006\*

### SUMMARY

After processing the opinions of the commercial bank specialists about the development in the deposits and credit activity during the second half of 2006, it resulted that:

### DEPOSITS ACTIVITY

- Commercial banks' specialists consider that deposit activity performance has improved during the second half of 2006, in comparison with the first half of the year;
- The majority of commercial banks have fulfilled almost 100 per cent of their quantitative targets about deposits, sometimes exceeded, for both lek and foreign currency deposits;
- Positive performance of deposits has been affected by increases in interest rates, for both lek and foreign currency deposits, high credibility toward the bank and the provision of services of a higher quality;
- In the majority of the cases, commercial banks have developed strategies to maintain and increase the deposit clientele. As frequently met, elements in commercial banks strategies are: "introduction of new products and marketing them", "competitive interest rates", "qualitative and fast service", "preferential treatment of existing clients" etc.,
- Actual levels of lek interest rates are considered as normal;
- Based on the specialists opinions, in the future is expected:
  - A better performance of deposit activity, especially for foreign currency deposits;
  - a growing tendency of the interest rates in lek and in foreign currency;

### CREDIT ACTIVITY

- Credit activity in the banking system has shown a good performance in the second half of 2006 compared to the first one. The average level of the fulfillment of the quantitative targets for credit in lek is higher than for credit in foreign currency.

- Credit risk has been estimated to be higher than in the first half of the year. Electricity crises have been mentioned as an important factor which threatens the future of the economic and financial statement of the business, affecting credit payments.
- Banks have shown higher preference for lending to small business and to individuals. Under higher competitive pressures in the market, banks have been oriented toward new segments of the credit market, facilitating the procedures and policies for credit approval for these groups. Credit policies and procedures have remained unchanged for the large business clientele.
- The demand for credit is estimated to be higher than in the first half of the year for all bank clients. Evidently the small business and individuals have had higher demand for credit.
- According to the opinions of the bankers, in the first half of 2007, is expected:
  - The same level of credit risk;
  - Further increases in credit level. Credit activity is expected to accelerate in forms of mortgages, consumer credit and credit for business.
  - The same preference toward economic sectors, trade sector being the preferred one.
  - An acceleration of credit in lek more than in foreign currency.

## INFLATION EXPECTATIONS

- The majority of the commercial bank specialists expect an increase in the rate of inflation during the first half of 2007. The main reasons behind this expectation are: lack of political stability, local elections which are expected to be followed by higher government expenditures and actual electricity crises.
- Expectations for unchanged levels of inflation and those for a lower inflation rate are mainly based on the confidence in the Bank of Albania policy for maintaining price stability.

## ANALYSIS OF THE SURVEYED DATA FOR THE SECOND HALF OF 2006

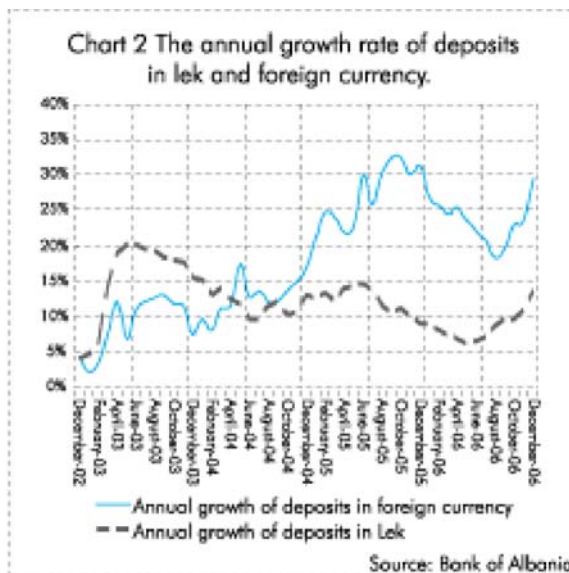
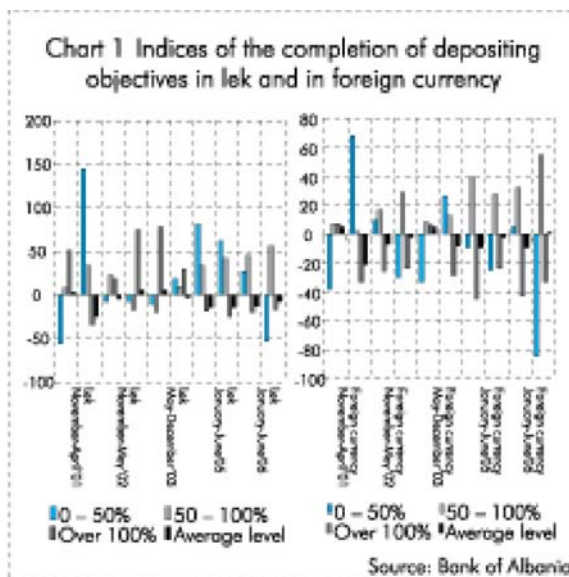
During January 2007, Bank of Albania conducted the survey on deposit and credit activity for the second half of 2006. The purpose of this survey is to collect the commercial bank specialists' opinions about the latest developments in the deposit and credit activities. In this survey there are included the opinions of about 86 deposits specialists and 93 credit specialists.

## I. DEPOSIT ACTIVITY<sup>1</sup>

About 82 percent of commercial banks' representatives regard the deposit activity of the second half of 2006 as better than that of the preceding six-month period. The remaining part does not see a difference between these periods. Around 70 percent of depositing specialists claim their quantitative targets about deposits have been completed at 50-100 percent levels. About 27 percent of the banks exceeded their targets. A satisfactory situation is observed in foreign currency deposits, where 72 percent claimed fulfillment of targets at 50-100 percent levels while 25 percent surpassed their targets.

In overall, the positive performance of depositing activity during the second half of the year has been affected by: interest rate increases, both in lek and foreign currency, a high level of credibility toward banks and a high quality of the services provided to the public. In the mean time, some of the reasons

for poor performance in deposits are mentioned: high competition, other options for public to invest their savings, such as real estate (foreign currency mostly) etc.



Indeed, the banking service has shown positive developments during 2006. It enlarged to 17 banks from 16 in the previous year and a lot of existing banks expanded their branches, creating more options for the public to invest their savings. Commercial banks seem more cautious toward their clients, and especially their competitors. During 2006, banks have been pretty active and somehow aggressive, in order to attract more deposits. About 94 percent of the surveyed specialists claimed that their banks have been following a strategy for preserving and increasing the number of their clients. Elements such as: "introduction of new products and marketing them", "competitive interest rates", "qualitative and fast service", "preferential treatment to existing clients" etc., have been part of these strategies. Commercial banks' specialists have named a lot of new products and offers focused toward different market segments, such as products for clients under 18 years old, promotional offers during periods of emigrants' arrival, internet banking service to businesses, etc. When asked about the proportion of internet banking in their depositing activity, a lot of specialists said that internet banking is in its initials but with a good perspective for the future.

Opinions about the positive performance of depositing activity during the second half of the year

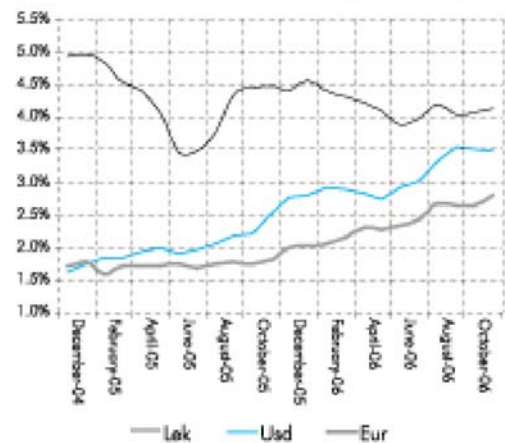
are well supported by real data on commercial bank deposits during this period. Contrary to previous part of the year, growth rates of both lek and foreign currency deposits have been increasing. Foreign currency deposits have continued to show high rates of growth. The ratio of foreign currency deposits to total deposits increased to 38.3 percent or by 1.7 percentage point higher than in June. Interest rates in lek and foreign currency have shown an increasing trend during the second part of the year. These rates have reflected changes of policy rates of Bank of Albania, ECB and Federal Reserve, during this period.

Specialists seem optimistic regarding the development of the deposit activity during the first half of 2007. Further more, this optimism remains higher for foreign currency deposits. About 77 percent of the specialists foresee an increase in lek deposits during the first half of 2007 whereas, 20 percent do not expect changes. Regarding foreign currency deposits, about 82 percent of the specialists expect increases of them and 16 per cent do not expect changes. As main factors that will influence mostly the future tendency of deposits in their respective banks, specialists rank: the quality of the service, market interest rates developments and offering good conditions (relatively high interest rates, low commissions). Confidence index on expectations, in both deposits in lek and in foreign currency, shows an enforcement of the growth tendency.

About 83 percent of the specialists have assessed as normal the level of interest rates of lek deposits. About 13 percent of the specialists assessed actual levels as high whereas 4 percent of them described them as low. About 52 per cent of the specialists that have described the level of actual interest rates as normal forecast increase on lek interest rates in the first half of 2007. The other part, 36 percent, does not expect changes in lek interest rates.

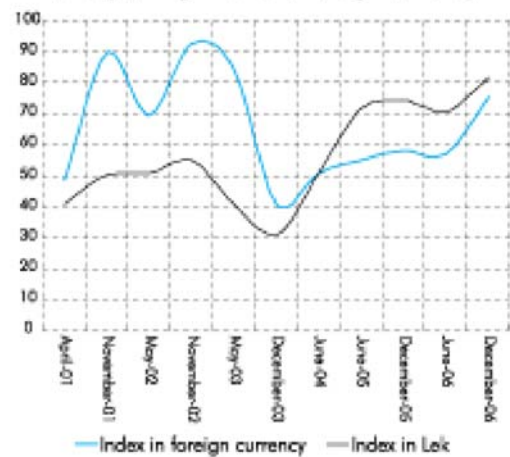
Specialists' expectations for interest rates in foreign currency are divided between alternatives for increase (about 47 per cent) and remaining the same (about 45 per cent). Confidence index on expectations in interest rates indicates an increasing tendency for interest rates in lek and in foreign currency. Specialists rank central bank policy

Chart 3 Developments on weighted average interest rate in lek and foreign currency



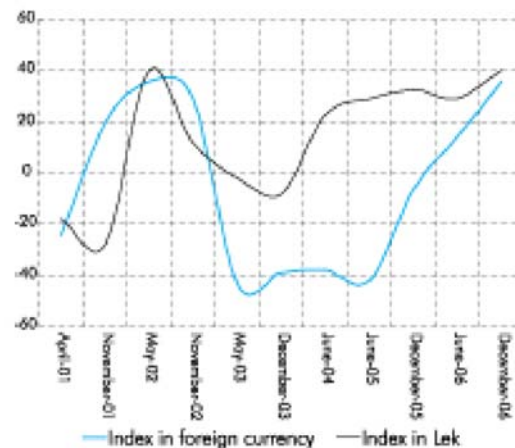
Source: Bank of Albania

Chart 4 Confidence index on expectation for depositing in lek and foreign currency<sup>2</sup>

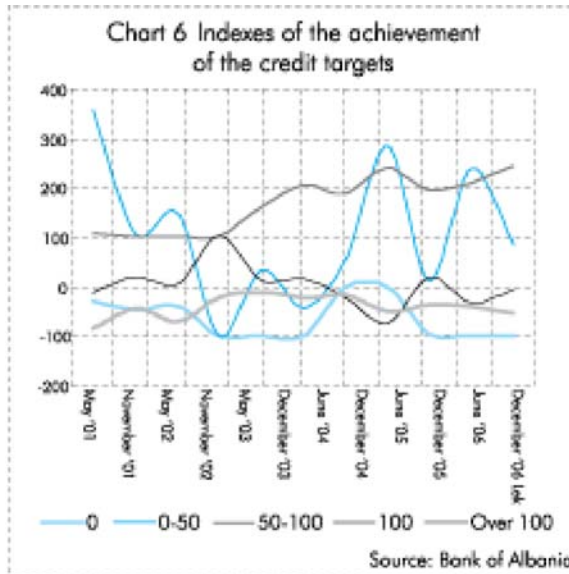


Source: Bank of Albania

Chart 5 Confidence index on expectation for interest rates in lek and foreign currency



Source: Bank of Albania



via repo auctions as the most important factor in determining future tendencies of lek interest rates. Then are ranked development in inflation rate and in the yields of the treasury bills.

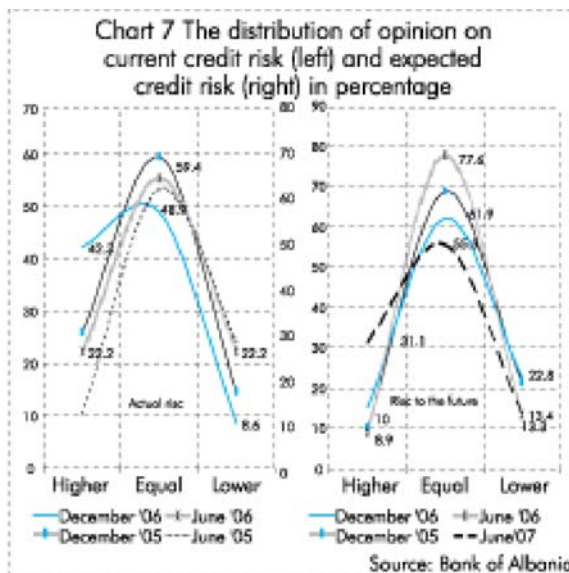
Approximately, 86 percent of the specialists affirm that:

- The depositing decision (in lek or foreign currency) is mostly affected by interest rates;
- Monetary policy of the Bank of Albania and interest rates defined in repo auctions, affect lek deposits interest rates and aftermath the change in preferences for deposits in lek or in foreign currency.
- Bank of Albania's interventions in the banking sector market are effective.

## II. LENDING ACTIVITY<sup>3</sup>

The survey on commercial banks in January 2007, shows that credit activity in the second half of 2006, has performed better than in the first one. The average level of the quantitative targets about credit in lek is 83 percent, being 4 percentages point above the June survey. The opinions show an increase in the number of banks which fulfilled or exceeded their credit targets. This survey shows a decrease in the number of banks or their branches, achieving less than 50 percent of their quantitative target in lek credit.

Foreign currency lending has shown positive improvement in quantitative targets. In average, banks have fulfilled 70 per cent of their targets. According to commercial banks specialists, the fulfillment of targets for lending in lek is substantially higher compared with the foreign currency lending. Still the number of branches or agencies that do not disburse foreign currency lending continues to be significant.



Credit risk is estimated to be higher than six months ago. The statistical distribution of opinions demonstrate significant asymmetric deviation on the left in the upper side (see chart 7). This shows a considerable increase of opinions for higher credit risk. The acceleration of the lending activity and, in particular, the involvement of banking system in lending more to small business and individuals has made them more aware of the higher credit risk they take. Besides the acceleration of lending activity, major part of the specialist judge the electricity crises as a threat to the future of economic and financial business activity, and as such to poor performance



of repayments. In the same way the distortion in the political area and lack of register for credit are also regarded as important factors in influencing the growth of credit risk. Some specialists have also mentioned that aggressive policies of the banks, in order to maintain and extend their market size, may bring to unexplored disbursement of loans.

The majority of specialists expect the credit risk to remain unchanged in the first half of 2007. However the high positive value of the index for the future emphasizes the upper pressures in credit risk. These expectations are highly influenced from further acceleration of the lending activity and the lack of prompt solution of the energy crises. However the index of the future stands in a low level from the current one, showing a moderate postponement of the opinions in the low risk side.

The interviewers judged as high the quality of the loan portfolio, in the second half of 2006. Compared with the previous survey is evident the increase of opinions on the same quality of loan portfolio and also a decrease of opinions for higher quality of it.

The interviewers stress the presentation of nonrealistic balance sheet and the deficiency in business plan as main problems of business applying for a loan. These factors have shown an increase in importance comparing with the results in the previous survey. Also, banking specialists think that businesses suffer from lack of managerial skills to manage properly their activity. The fulfillment of the collateral criteria is judged to be a medium importance factor in the lending process.

In the second half of 2006, banks have not changed the credit procedures and policies for the large businesses. Commercial banks initiated their lending activity with the large businesses and as such the products for this group may have been consolidated during the last five years. Statistical distribution of the opinions shows that; with the decrease of the business size it increases the number of opinions for facilitating the procedure and policies of credit agreement. This result goes in line with the conclusions of the previous survey, which has demonstrated an attraction of the banking system toward the small business and individuals. In the second half of 2006 banks have been more policy oriented toward individuals. The majority of the opinions (66 per cent) show further easing of the procedures and policies for the individual's credit. The official data demonstrate from more than a year, an acceleration of annual growth rate of credit to individuals. However the bank orientation toward retail banking may be seen as a response to stronger competitiveness in the credit market. Under the pressure of higher competition, banks are exploring new segments of the credit market, easing the criteria of credit agreement, especially for individuals. The attraction of individuals, as it has

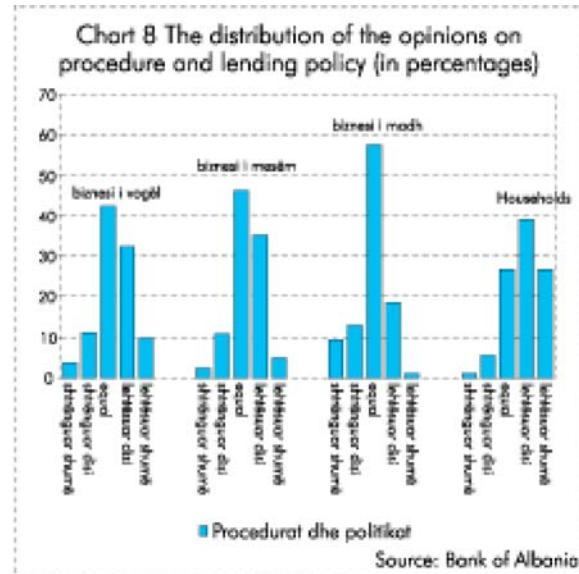
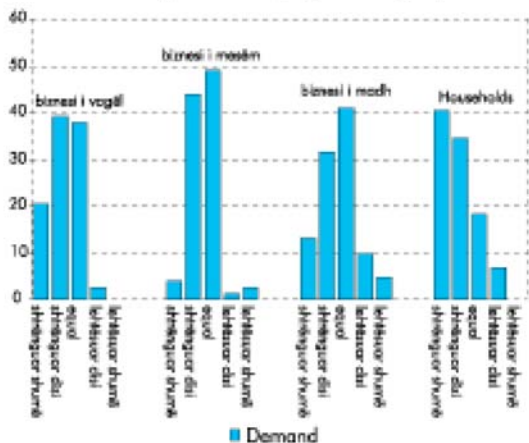


Chart 9 The distribution of the opinions on lending demand (in percentages)

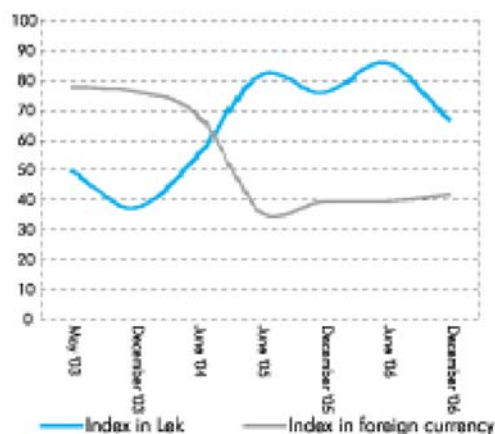


Source: Bank of Albania

been mentioned from the interviewers, will increase the possibility of deterioration of the loan portfolio quality, in the future.

According to credit specialists, the Bank of Albania policy has influenced the tightening of lending procedures. This is consistent with the recent announcement of Bank of Albania to increase the prudential measure in order to control the credit acceleration and the quality of loan portfolio. The deterioration of some of prudential indicators, such as capital adequacy ratio and the increase of nonperforming loan has also influenced the decisions of banks to tight procedures for credit agreement. The competitiveness from non-bank institutions is not considered to influence the policy orientation of commercial banks.

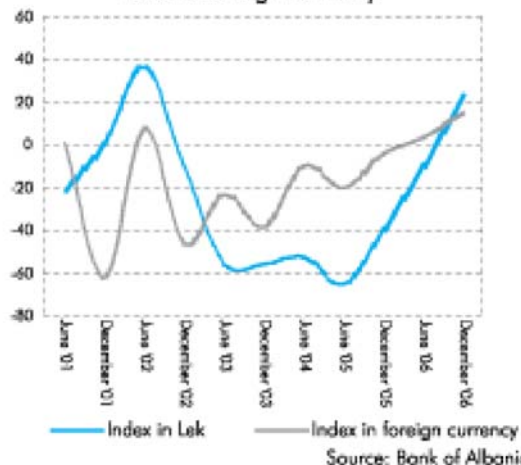
Chart 10 The development of expectation for credit activity in lek and foreign currency



Source: Bank of Albania

Demand for credit from all bank's client is reported to be higher compared to the previous period. The distribution of the opinions shows a stronger demand from small business and individuals, affected by easing of procedures and policies for credit disbursement. Easing the conditions for credit approval is accompanied with higher demand of businesses to finance fix asset and liquidity shortage. In mean time, there are opinions that credit demand from large business is reduced.

Chart 11 The development of interest rate expectations for credit activity in lek and foreign currency



Source: Bank of Albania

The trade sector will continue to be the most attractive sector regarding credit disbursement in the future. Opinions of the current survey do not show any substantial change in the bank preference to credit distribution by the economy sectors. The service sector preference results higher than six months ago. This result is also supported from the banking system orientation to lend more to small and medium enterprises, which operate mainly in the service sector. Less favorite sectors will remain agriculture and transport. The official data confirm the results of this survey.

According to specialists' opinions, credit will continue to accelerate in the near future. The lending activity will be channeled in mortgages and credit to fulfill business needs for funds. The index of credit in lek, eventually higher than the one of credit in foreign currency, transmits the signal that banks in the upcoming six months will aim at lending

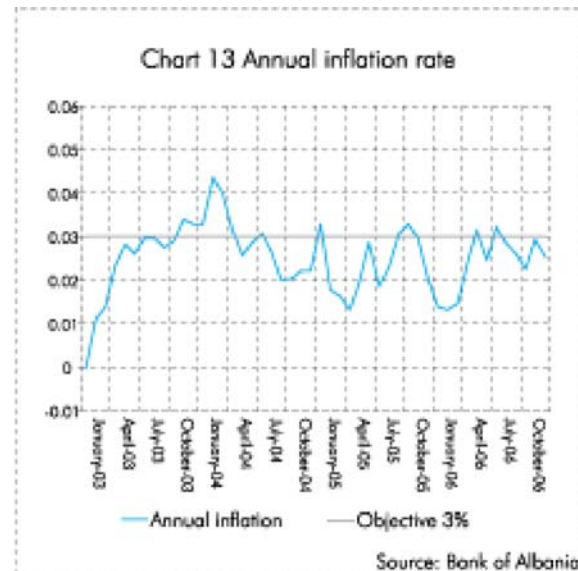
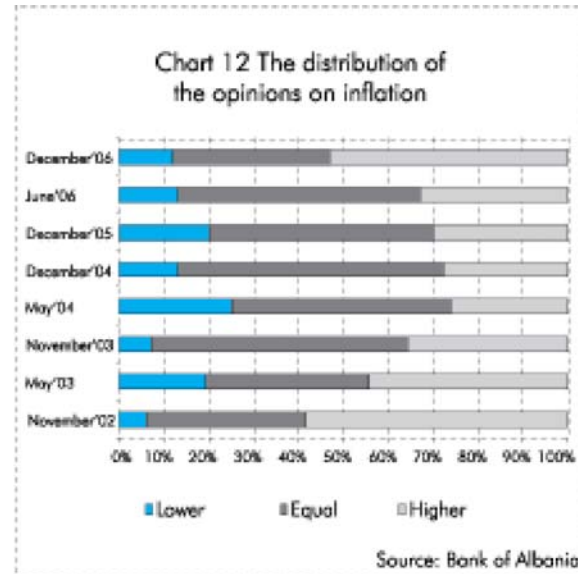
more in lek. However, compared with the historical development of this index, the current figure is at the lowest value in the last 2 years, showing a restrained growth of lek credit. Meanwhile, lending in foreign currency is expected to remain at stable levels as the current one.

The further increase of lending activity is expected to be accompanied with interest rate increases. Such an increase of credit interest rate is a respond to higher risk of credit activity. The specialists are more confident about interest rate increases for credit in lek than in foreign currency. Credit interest rates in lek are going to reflect the policy of Bank of Albania. Credit interest rates in foreign currency will follow the developments on the international markets, which are expected mainly to remain in the same level.

#### INFLATION EXPECTATIONS

About 53 percent of the specialists expect an increase in the inflation rate for the first half of 2007. About 35 percent do not expect changes on inflation from actual levels. Factors that shaped the expectations of an increased inflation level on this survey are: lack of political stability, local elections accompanied by increases on government expenditures and the electricity crises. Whereas, expectations for unchanged inflation rate or a lower one are based mainly on the confidence that the Bank of Albania will take all the required measures to maintain price stability.

In the previous survey, the majority of specialists predicted inflation in the same levels with that of the first half of the year. Anyhow, this percentage had been decreasing in the past surveys and the percentage of the specialists predicting an increase in inflation is enhanced. According to the official data, the average annual inflation rate for the second half of the year 2006 was 2.7 per cent from 2 per cent in the first half of the year.





## ENDNOTES

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<sup>1</sup> The level of response is about 97 percent.

<sup>2</sup> The confidence index is the difference of percentage between positive (increase) and negative (decrease) responses.

<sup>3</sup> The interviewers in lending activity have an average experience at work of about 4.3 years and they are mainly in management position.