B a n k   o f   A l b a n i a

ANALYSIS OF FINANCIAL INTERMEDIATION

2013 Q1

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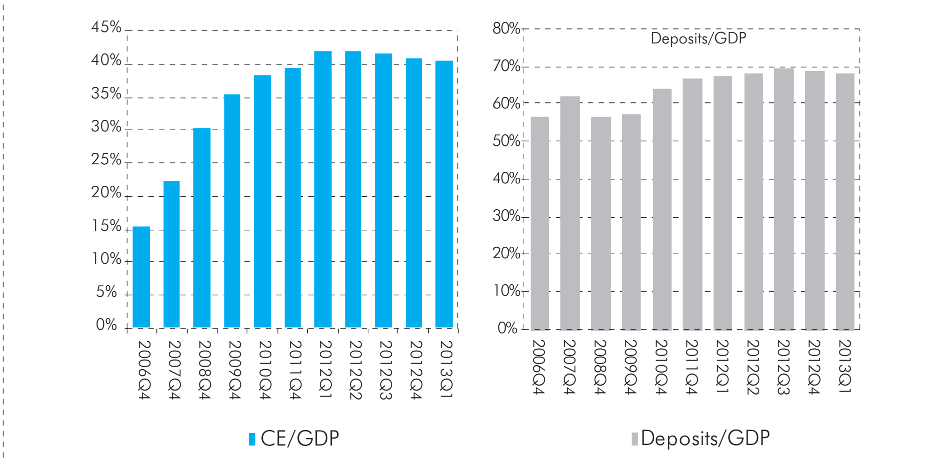
C O N T E N T S

1. BANKS AND INTERMEDIATION

The Albanian financial system consists of 16 commercial banks and other financial institutions such as savings and loans associations, investment private funds and other financial corporations. Banking sector continues to dominate the financial system structure, sharing more than 90% of the system's total assets. Thus, the banking sector covers the largest part of financial intermediation in economy and financial intermediation and banking intermediation are exchangeable. Depositing and lending dictated the performance of financial intermediation. Banking system plays the main role to intermediate funds from economic agents as savers - mainly households - to users of these funds such as private businesses and other households.

Indicators of financial intermediation during 2013 Q1[1] recorded a slight declining trend. Deposits- to--GDP ratio stood at 68.7% in February, compared to 68.9% at the end of the previous quarter. Credit to economy-to-GDP ratio was 40.6% in February, about 0.5 percentage point lower than at the end-2012. Demand and supply continue to impact the decrease in lending to economy. In the framework of the overall sluggish economic activity , and due to psychological factors related to the perceived doubts for the economic developments in future, the demand for monetary assets by economic agents is low. On the supply side, although well-capitalised and liquid, banks continued to maintain tightened lending standards and appeared rather selective related to the projects they finance. The low use of this liquidity for the intermediation of funds to lending has persisted to simulate maintaining funds as net foreign assets.

Chart 1 Credit to economy and deposits as a percentage of GDP (in %)

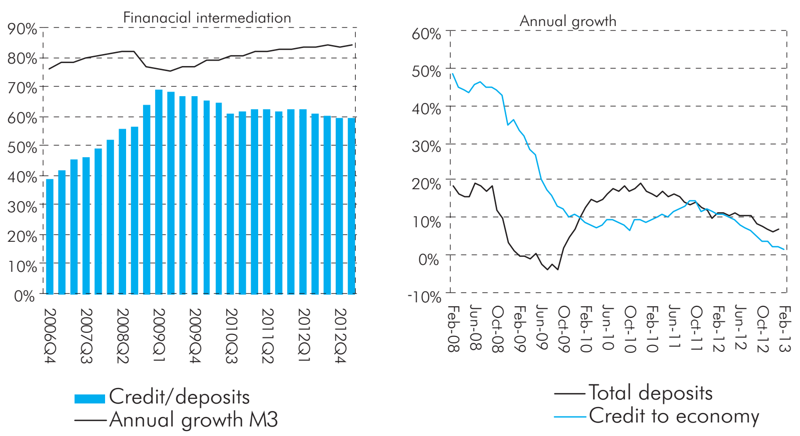


Source: Bank of Albania.

[1] *The latest monetary data in the analysis refer to the period January-February 2013.*

Financial intermediation measured as credit-to-system deposits ratio in the banking system was low and almost at the same levels of the previous quarter, albeit a slight falling tendency. Notwithstanding the increasing monetisation, banking system intermediated about 59.1% of funds from deposits in credit to economy in February, or 0.5 percentage point lower compared to the end-2012. This fall in intermediation rate is mainly due to the high savings of economic agents in deposits. Deposits-to-broad money ratio was about 83.4% in February, against the low demand for lending from the banking system. Thus, the annual growth of total deposits was 6.1% in February, standing close to the rate of end-2012. This performance is close to long-term average increase of banking system's total deposits in the last 10 years (excluding 2008-09). On the other hand, the increasing annual paces of loan portfolio continued to reduce. In February, this portfolio was only 1.7% higher than a year earlier. This is the lowest historical rate of loan portfolio increase in the last 10 years.

Chart 2 Intermediary indicators for banking system



Source: Bank of Albania.

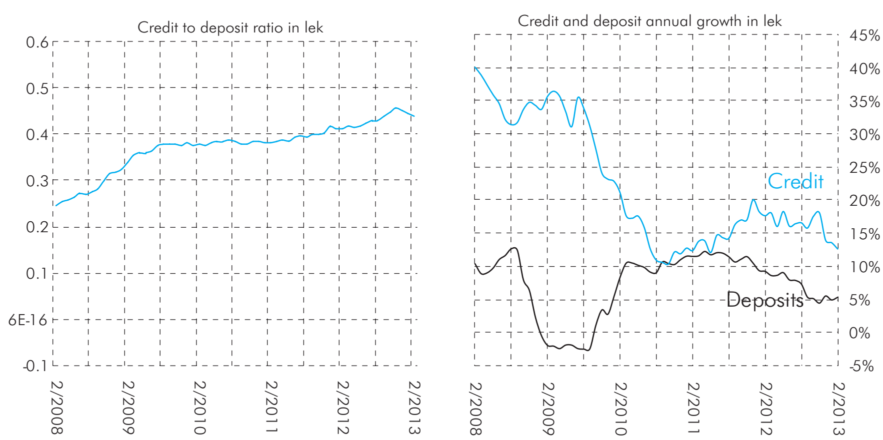
2. INTERMEDIATION

Intermediation in the first two months of 2013 is characterised by a good performance in deposits, but a low mobilisation of them in lending. Lending to economy appeared sluggish, reflecting the low demand of economic agents and the conservative position of banks, expressed in tightened lending standards. Intermediation margins had a high monthly volatility and were affected by the low credit supply and volatile credit interest rates. In average terms, these rates are lower than a year earlier. The majority of non-cost elements of lending conditions continue to operate on the tightening side, particularly regarding the loan to businesses.

2.1 INTERMEDIATION IN LEK

Intermediation in lek slowed down in 2013 Q1. The loan-to-deposits ratio in lek stood at 44.0% as at end-February, down by 1.1 percentage points compared to a year earlier. The fall in the intermediation ratio in lek in the last two months was due to the lending slowdown in lek.

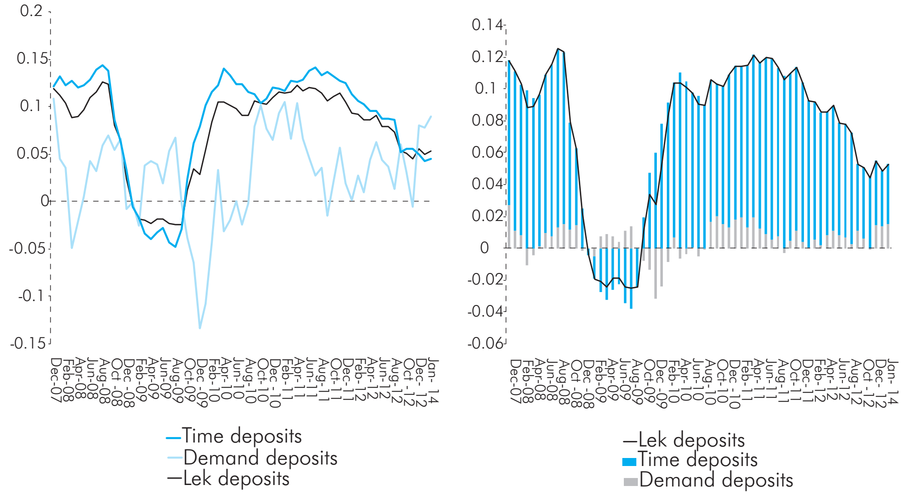
Chart 3 Intermediation in lek



Source: Bank of Albania.

Deposits denominated in lek performed better in 2013 Q1, compared to 2012 Q4, with an annual increase of 5.3%. The good performance of lending in lek and the increased demand for financing by the Government in the first two months of the year helped the circulation/creation of money in lek in economy. By maturity, demand deposits in lek maintained high annual growth rates, standing at 8.9% in February. The good performance of lek deposits owed mainly to the demand deposits of businesses, which appeared considerably volatile during the year. Time deposits in lek grew 4.5%, y-o-y, supported by a moderate but steady increase in households time deposits in lek.

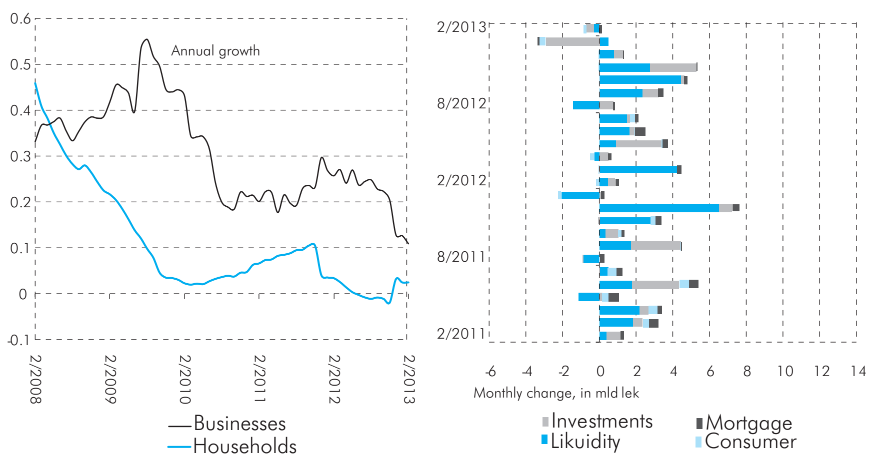
Chart 4 Deposits in lek by maturity



Source: Bank of Albania.

Lending denominated in lek was the main driver of lending during the previous year, mainly oriented towards lending to businesses, despite the considerable slowdown in the first two months of the year. Its stock was down by ALL 3.6 billion during this period, mostly investment credit. Its annual growth stood at 12.6% in February, down by 1.3 percentage points, compared to end-year and by 5.0 percentage points compared to the same period a year earlier.

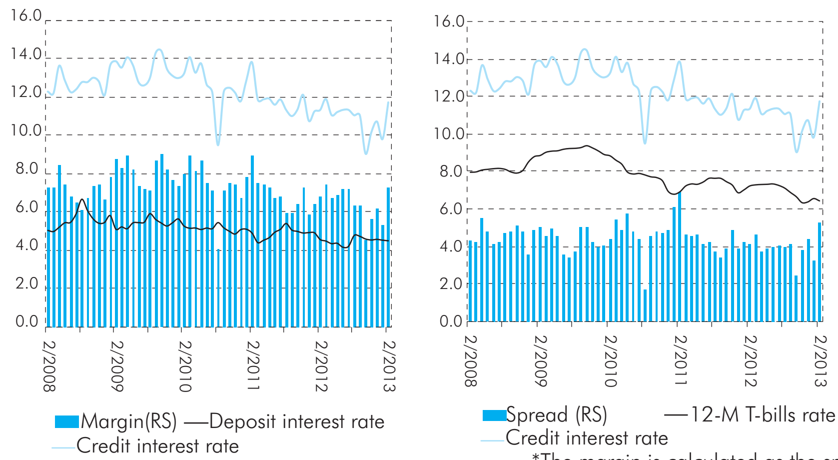
Chart 5 Lending in lek



Source: Bank of Albania.

Intermediation cost in lek, was volatile in the first two months of the year. Thus, after the fall at 5.35 percentage points in January, it increased, standing at 7.29 percentage points in February. In presence of the downward tendency of deposits interest rate, its volatility owed mainly to the fluctuations in credit interest rates. Due to the low level of new loans, the average interest rate is considerably affected by the credit with particular risk and return characteristics. In annual average terms, , lek loan interest rates declined at higher rates than deposits ones, compared to a year earlier, leading to a fall in lek intermediation cost during this period.

Chart 6 Intermediation cost in lek*.



*The margin is calculated as the spread between loan and deposit interest rates. The spread is calculated as the difference between loan/deposit interest rate and the reference rate (12-month T-bill yield for the lek and 12-month euribor for the euro).

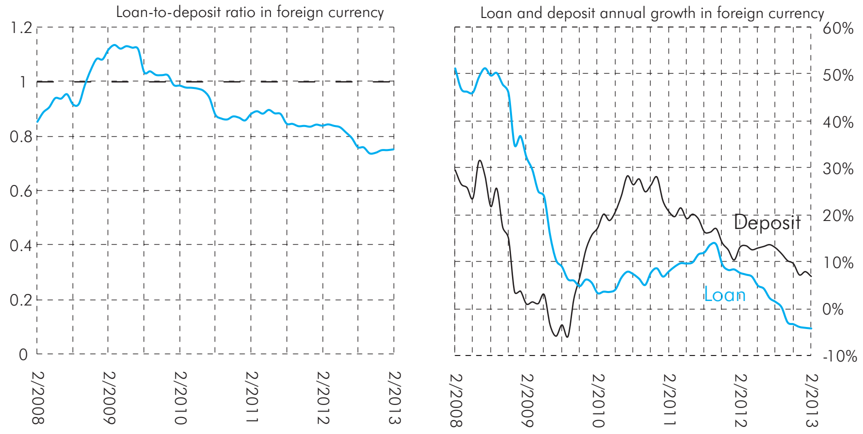
Source: Bank of Albania.

Volatility in lek loan interest rate in the first two months of 2013 is reflected on their spread with the 12-monthT-bill yield. After the fall in 2012 Q1, the average spread in these two months was 4.3 percentage points, unchanged from the previous year.

2.2 INTERMEDIATION IN FOREIGN CURRENCY

Intermediation in foreign currency, after the fall in 2012 Q4, remained almost steady in 2013 Q1. Credit-to-deposits ratio was 75.1% as at end-February, 8.7 percentage points lower compared to a year earlier. The decrease in foreign currency intermediation mainly owed to the drop in credit in foreign currency. Meanwhile, low intermediation rates in the last months were mainly due to the slowed increase in deposits denominated in foreign currency.

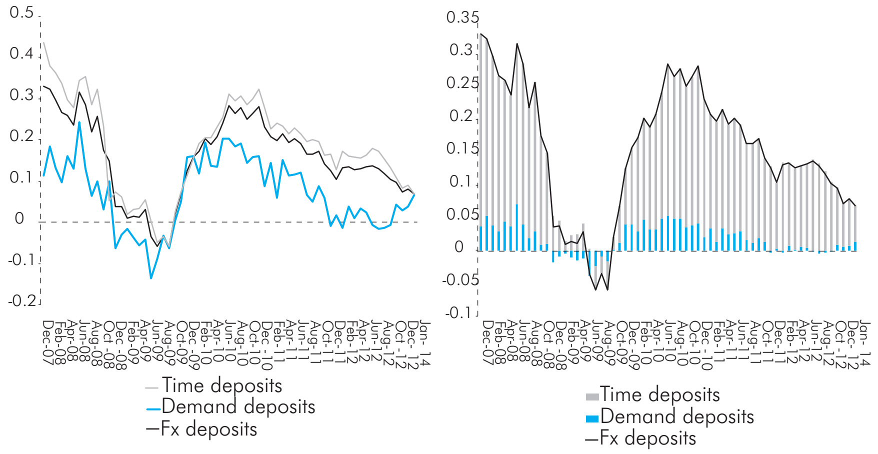
Chart 7 Intermediation in foreign currency



Source: Bank of Albania.

Annual growth rates of deposits in foreign currency slowed down further in 2013 Q1, pointing at 6.9%. This slowdown reflected both lower cross-border foreign currency inflows and the lower creation in foreign currency, due to the weak performance of lending in foreign currency. Also, this performance was triggered by the transfer of investments in foreign currency savings of households at other non-bank financial institutions in the last three months. Time deposits of households provided the main contribution to the increase in deposits in foreign currency, albeit this contribution has been lowering since July 2012. Meanwhile, the improved annual rate of demand deposits denominated in foreign currency, at 6.7% in during the first two months of 2013 driven by the increase in the demand deposits of households.

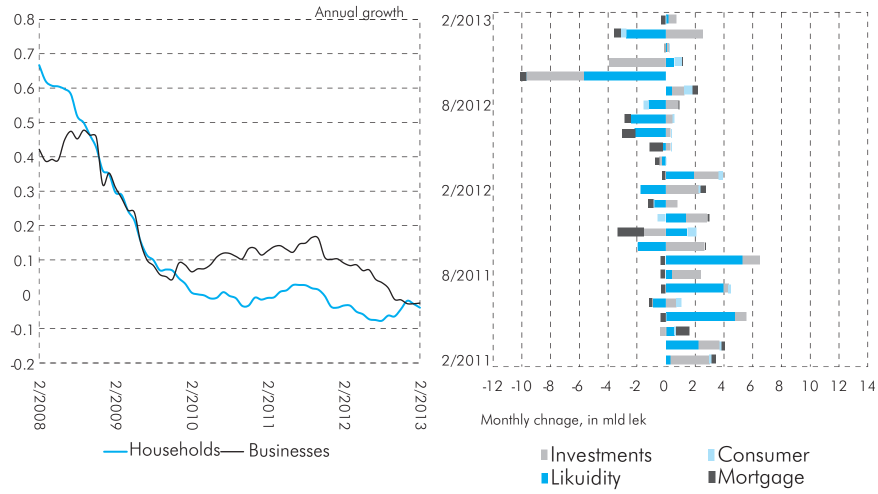
Chart 8 Deposits in foreign currency by maturity



Source: Bank of Albania.

Lending in foreign currency continued to show a weak performance during the first two months of the year. Outstanding credit contracted by ALL 0.6 billion in this period. Although it recorded an increase of credit for investments in foreign currency in these two months, it failed to balance the tightening in other types of credit in foreign currency. The continuing reduction of loan portfolio in foreign currency is reflected in the deepening of its annual tightening. As at end-February, it was 4.2% lower than a year earlier.

Chart 9 Lending in foreign currency



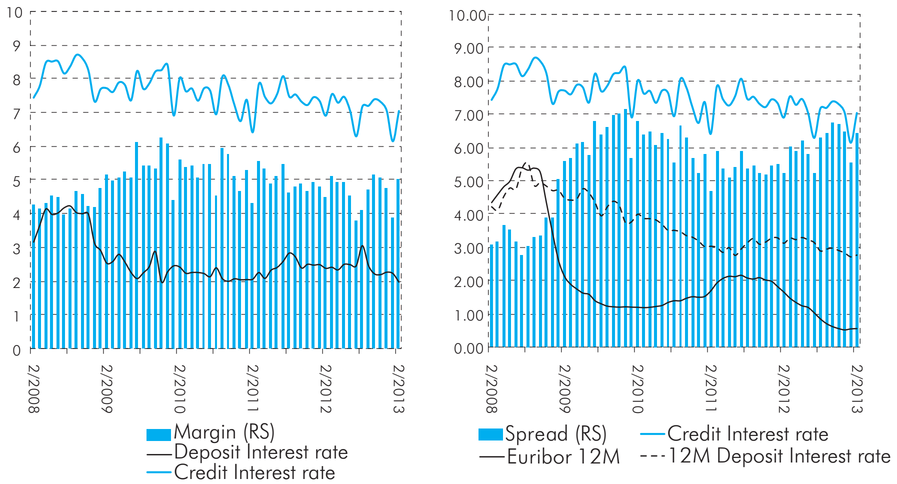
Source: Bank of Albania.

The weak performance of lending in foreign currency was notable to both businesses and households. Along with the low demand and tight standards characterising the overall performance of lending, the weak performance of lending in foreign currency reflected a shift in tendencies of customers from foreign currencies to the domestic currency. This phenomenon was more notable for mortgage loans to households and liquidity loans to businesses.

Intermediation cost in euro[2] also appeared volatile in January and February, because of the fluctuations in credit interest rates and the intermediation cost in lek. Thus, in January it was 3.88 percentage points, down by 1 percentage point from the average of 2012 Q4. It fell the particularly due to the low rate of a preferential loan. In February, the average credit interest rate increased again, close to the rates of the previous months. On the other hand, the average interest rate of deposits continued to decline in January and February, thus reflecting the ample liquidity situation in foreign currency.

[2] *Banks' activity in foreign currency is dominated by that in euro, which accounts for more than 80% of foreign currency operations.*

Chart 10 Intermediation cost in euro



Source: Bank of Albania.

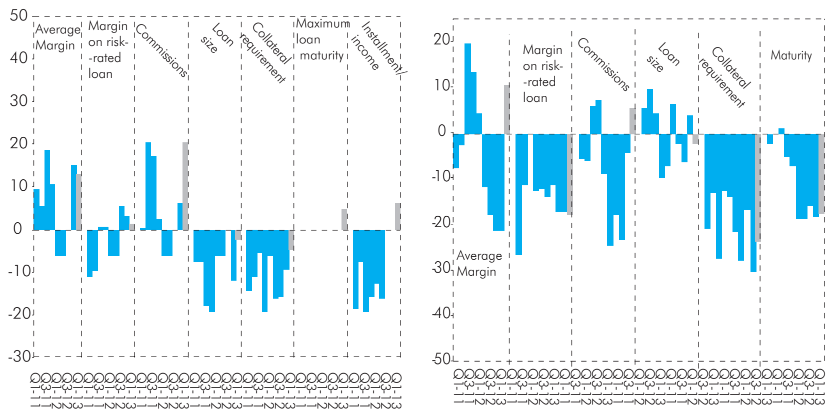
Euro interest rates in Albania remain significantly higher than in the international markets, reflecting the structural features of the domestic market. However, the decrease in interest rates for deposits in euro at home notable in 2012 Q4 and in the first months of 2013 is reflected in the narrowing of this spread. Also, such a performance establishes the premises for a decline in loan interest rates in euro in the future.

3. NON-PRICE CRITERIA IN INTERMEDIATION

According to the Bank Lending Survey 2013 Q1, lending standards applied to businesses tightened further for all types of loans. Lending conditions to households eased slightly for mortgage loan, but tightened for the consumer loan. The majority of non-price criteria of lending standards continue to operate on the tightening side, particularly regarding the loan to businesses.

The lending standards applied to businesses continued to tighten in 2013

Chart 11 Lending standards applied to businesses (left) and households (right) *



*Net balance of responses in this survey
Source: Bank of Albania.

Q1, but at a lower level compared to the previous quarters. All the non-price criteria of these conditions have acted on the tightening side. Among them, the collateral requirement and loan maximum maturity continue to affect most the tightening of lending standards applied to businesses.

Lending standards applied to households, after remaining unchanged during the last three quarters of 2012, recorded a marginal easing in 2013 Q1. The easing of lending standards, along with price criteria (interest rate, commissions), is realised through the loan maximum maturity and instalment/ income ratio. Two other non-price criteria of lending standards, loan amount and collateral requirement remain tight, but lower than in 2012 Q4.