

Bank of Albania

TRENDS IN LENDING

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SOFIKA NOTE
MONETARY POLICY DEPARTMENT

The views expressed herein are solely of the authors and do not necessarily reflect those of the Bank of Albania.

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SUMMARY

Bank lending was characterised by acceleration of lek intermediation and further deceleration of foreign currency intermediation. Lek deposits slowed down, contributing to their higher use in crediting. Foreign currency deposits continued to grow, while the sluggish credit demand is oriented towards the domestic currency. This has resulted in excess foreign currency liquidity in the banking system and its investment abroad.

Lending to businesses stimulated credit growth in July and August. For businesses, credit was granted for both short-term liquidity and investment purposes. However, it was concentrated on two sectors of the economy and was extended by only a few banks of the system. Positive signals coming from business and banks surveys suggest rising credit demand and improved businesses sentiment. Moreover, for businesses, banks have kept lending standards unchanged in the third quarter of 2014. The same tendency is expected to persist in the next quarter. Lending to businesses remains sluggish, as long as it is not growing on a broader basis.

Lending to households was sluggish, compared to both a year earlier, and to the first part of the year. Banks report higher credit demand by households, and further easing of standards applied on them, compared with businesses. Consumer confidence indicators apparently improved in the third quarter of 2014. These signals, however, materialised only partially in the performance of lending to households. New demand by households was oriented more towards consumption, and less towards mortgage loans, despite the more attractive products for the latter.

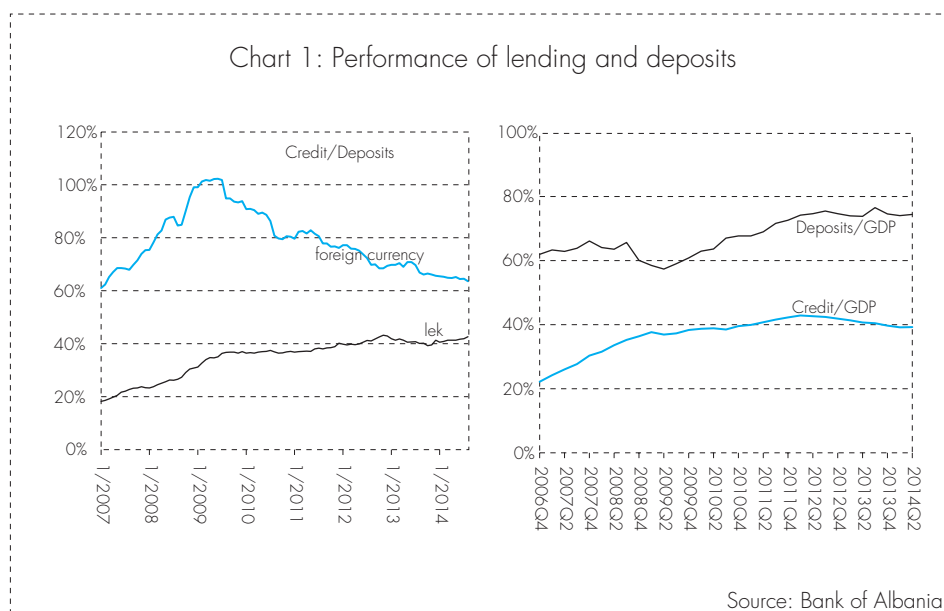
Interest rates on credit dropped further in July and August. Rates on lek loans dropped more significantly, whereas those on foreign currency loans were more contained. The lowering of interest rates is noted almost across all types of credit. The spread between the lek and foreign currency loans narrowed, hence stimulating more lending in the domestic currency. Regarding other lending standards, banks eased most of them, both for businesses and households.

The analysis of the performance of lending to the private sector in other countries of the region shows its improvement on average levels, driven by higher lending to households. In the meantime, divergences continue to persist across the countries. From a regional comparison, in contrast to most of the countries, in Albania, lending to businesses is the main driver to the recovery of lending to the private sector. Albania is ranked above the region's average as regards lending to businesses, but below this average as regards lending to households.

1. GENERAL OVERVIEW

During the period, bank lending was characterised by further increase of lek and decrease of foreign currency intermediation. This landscape reflects the orientation of the low demand towards lek loans, driven by eased monetary conditions. Meanwhile, deposits showed different dynamics. They continued to record low annual increase, driven mainly by the increase in foreign currency deposits.

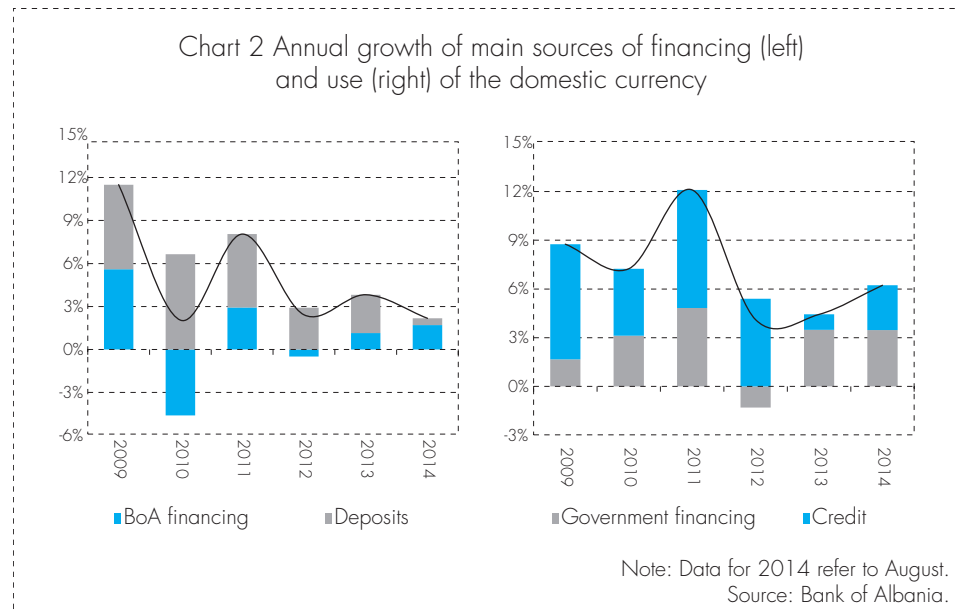
Banks financial intermediation in July and August was characterised by more positive tendencies than in the first part of the year. It reflected a slightly higher credit demand, mainly in the domestic currency. The annual credit growth shifted to positive territory in July and posted 2.2% in August. Beyond the cancelling out of the base effect due to the strong reduction of the portfolio in July 2013, annual growth improvement reflected a more revived dynamics in the last five months. Credit recovery remains gradual and still fragile, and is expected to become more steady as the economic activity improves and economic agents and banks uncertainties about the future subside. Deposits, in the meantime, continued to record low annual growth rates, driven mainly by the increase in foreign currency deposits. As of the end of August, they stood 2.3% higher than a year earlier.¹



Intermediation continues to slow down for foreign currencies, as a result of shrinking foreign currency lending. The foreign currency credit/deposit ratio

¹ Including deposits outside the scope of the definition of broad money. From the banks perspective, they equally serve to fund lending activity.

stood at 64.5% in August, down by 1.4 p.p. against the second quarter and 3.8 p.p. from a year earlier. In parallel, intermediation in lek increased further. At the end of August, the domestic currency credit/deposit ratio stood at 41.6%, up by 0.9 p.p. against the second quarter and 2.5 p.p. from a year earlier. This performance has reflected the acceleration of lek lending, whereas a part of households savings has shifted to government securities. The ratio of credit and deposits to GDP² has been steady throughout the year, averaging 39.2% and 74.2%.

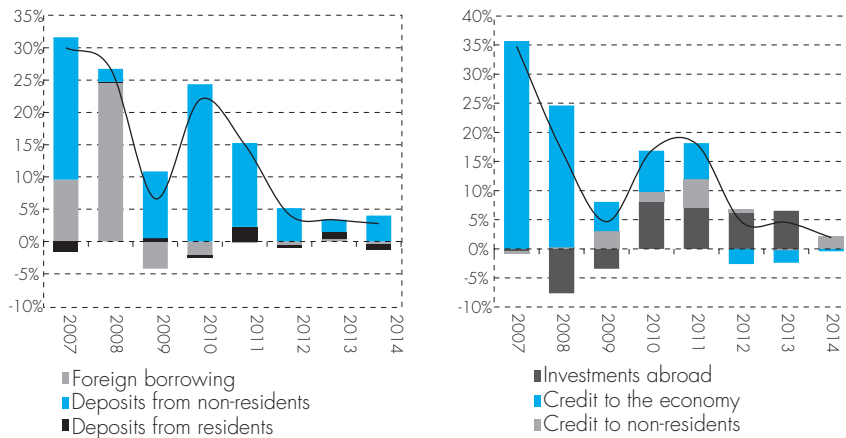


The growth of lek deposits was sluggish during 2014. Lek deposits included in the broad money continued to fall in annual terms, contracting by 1.8% in August. Structural changes in deposits persist. A part of them has shifted to deposits with maturities longer than two years, which are not included in the broad money. Taking into account the deposits excluded from the broad money, the annual growth of lek deposits posted 0.3% in August, improving from the second quarter of 2014. In addition to deposits, banks were financed by the Bank of Albania, through the reverse repurchase agreements.

Banks have been active in lek lending to the economy during 2014. This trend persisted in July and August. At end-August, annual credit growth in lek recorded 6.7% from 4.2% at end-2014 Q2. Financing in lek increased for both businesses and households, driven by the faster reduction of interest rates on lek loans. Banks continued to fund the public sector during these months. In August, their investment in government securities in lek amounted to 5.9% higher than a year earlier. Their expansion in July and August focused on higher-maturity instruments.

² MPD estimates based on real GDP and inflation.

Chart 3 Annual growth of main sources of financing (left) and use (right) of the foreign currency



Note: data for 2014 refer to August.
Source: Bank of Albania.

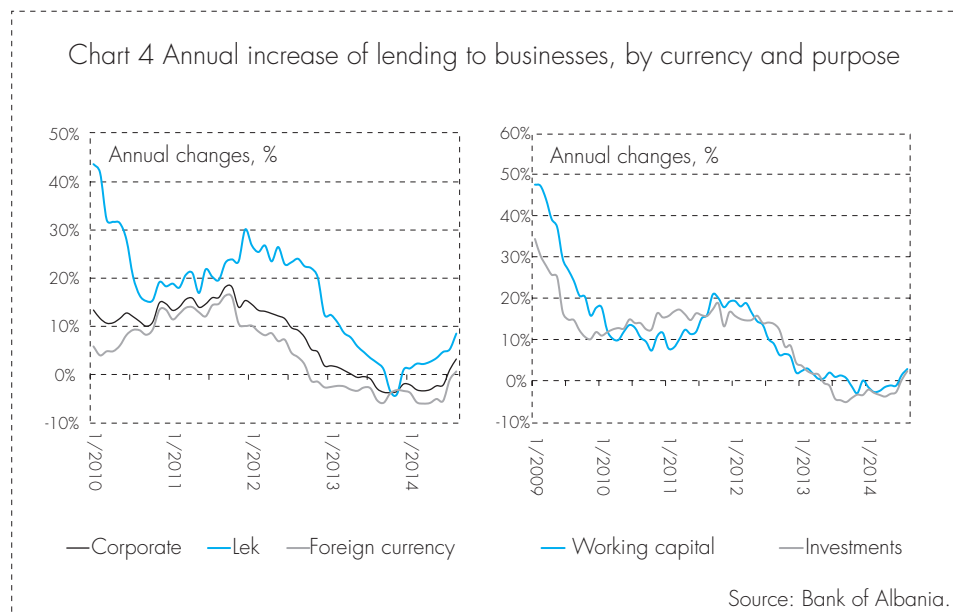
Sources of banking system funding in foreign currency until August 2014 maintained the growth rates shown in the previous two years. Their growth is attributed to resident deposits whose term to maturity is less than two years. They have increased significantly, since May of this year, and, at end-August resulted 5.2% higher than in the previous year. In addition, resident deposits whose term to maturity is higher than two years, increased as well. The higher attraction of deposits in the country has led to reduced bank liabilities to non-residents. Thus, deposits and credit from non-residents, which represent mainly credit lines from parent banks, fell during this year.

Foreign currency lending to the economy continued to shrink in July and August, but at lower rates than in the first part of the year. As of the end of August, it was 0.7% lower than a year earlier. Its performance was determined by a low credit demand, especially for investments and the shift of lending towards the domestic currency. Banks continue to invest their excess foreign currency liquidity abroad, in the form of investment in securities or loans to non-residents.

2. LENDING TO BUSINESSES

Lending to businesses performed well in July, for both liquidity and investment purposes. This improvement, however, remains segmented with regard to the sectors of the economy and banks that lend. Banks report that financing terms did not change and businesses' demand increased in the third quarter of the year. These tendencies are expected to persist in the next quarter. Positive signals from bank and business surveys are not reflected yet in a broad-based improvement of lending to businesses.

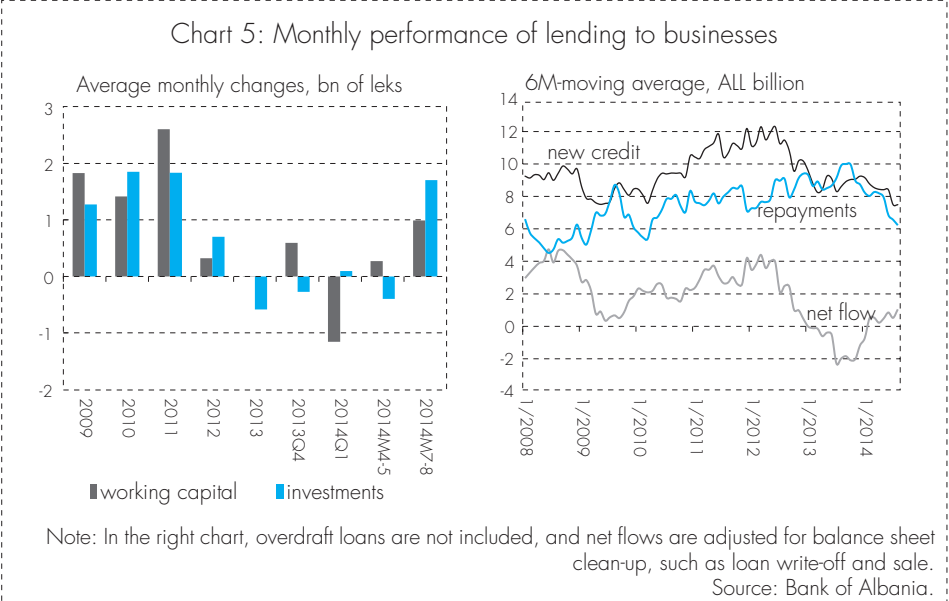
Annual growth of lending to businesses returned to positive pace in July and August, recording 0.9% and 3.2%, respectively.³ The annual credit growth recovery was present in lending for both liquidity and investment purposes. At end-August, the annual growth in both portfolios recorded 2.8% and 2.3%, respectively.⁴ Lek lending to businesses continued to perform well, which was reflected in higher annual growth rates, 8.5% in August. Foreign currency lending to businesses recorded positive growth rates, 0.6%, after contracting for almost two years.



³ As of July 2014, the base effect of growth rates of lending to businesses is cancelled out, due to the sale of a bad loan in July of the previous year. This sale has affected the annual growth rates of lending for investment purposes, foreign currency lending to businesses, and total credit during July 2013 - June 2014.

⁴ Data on lending to businesses and households by purpose of use do not include the calculated interest and their annual growth rates are not, therefore, compatible to the annual growth of lending to businesses and households reported in monetary statistics.

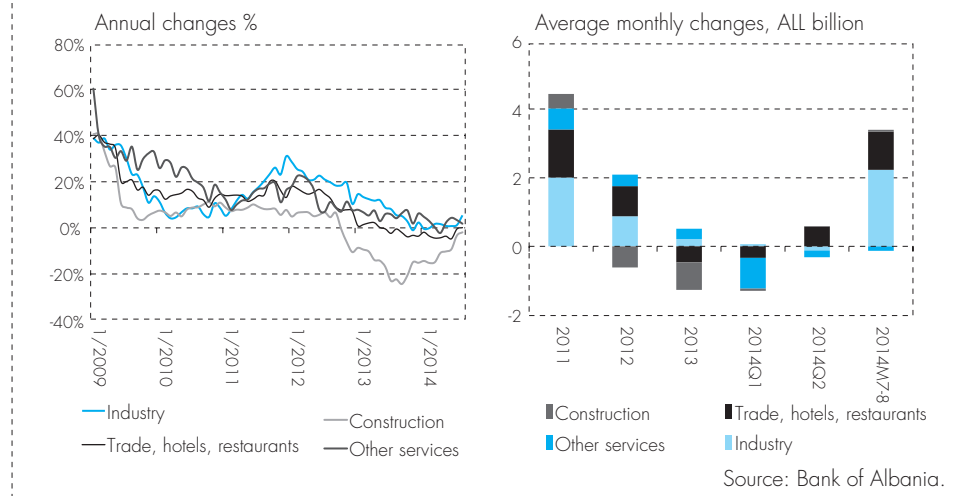
The monthly performance of lending to businesses was positive in July and August. It picked up by around ALL 9 billion, after a sluggish performance in the first half of the year. This financing was mainly in the form of lending for investment purposes, both in lek and in foreign currency, and lending for liquidity purposes, in foreign currency. Lending for investments during these two months has funded the purchase of machineries and equipment, and purchase of work facilities (immovable property). Despite the improvement in recent months, the growth of lending to businesses remains sluggish and the steadiness of these positive developments will have to be confirmed in the months ahead. New credit, excluding overdraft loans⁵ persisted to record low levels. Compared to the same period in the previous year, it stands about 8% lower.



The increased flow of lending to businesses in July and August was concentrated on two sectors of the economy. Banks increased their lending to the industry (extractive and processing) sector and the trade sector. Lending to agriculture also increased, but its share in the total lending to businesses is small, around 1.7%, notwithstanding the significant contribution this sector gives to economic growth. Most banks are becoming more interested in this sector, but the high informality and risks associated with the agricultural activity have a significant effect on their prudence and reluctance to be exposed to this sector. The schemes to support financing of the agricultural sector offered by foreign or public institutions have contributed to increasing bank lending to the agricultural sector.

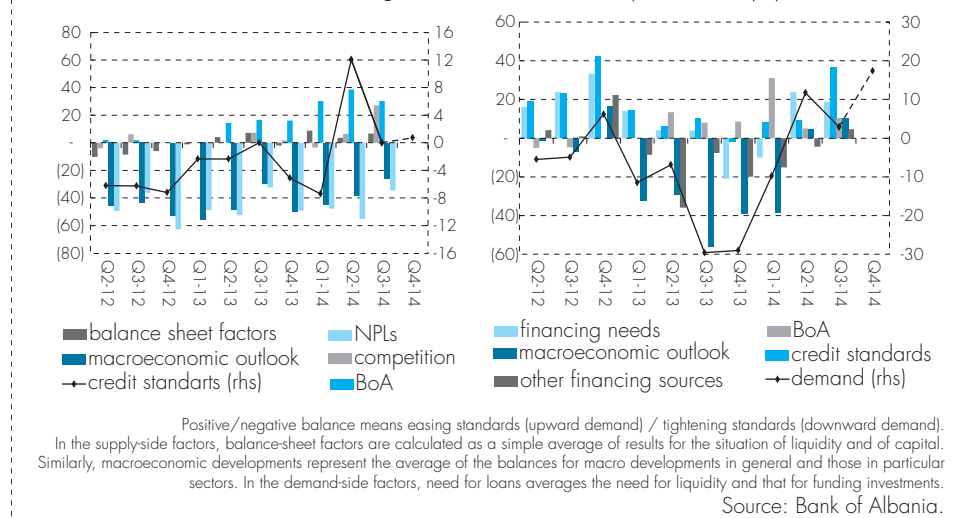
⁵ Overdraft loans are characterised by consecutive closure and renovation, and increase the new credit artificially by including renovations of existing loans.

Chart 6: Business loans by sector of the economy



After easing in the second quarter, banks did not change the standards of lending to businesses in the third quarter and expect to keep them unchanged even in the fourth quarter. Banks' approach to lending has been uniform across all the segments, with a slightly added preference over lending to small and medium-sized enterprises. Lending to the latter is very useful in supporting economic activity, at a time when the market of large corporations is considered as saturated with financing. But, the high informality in this segment and difficulties faced to assess the risks associated with financing it remain an obstacle to increasing bank lending towards these enterprises.

Chart 7: Changes in supply (left) and demand (right) for lending to businesses and factors affecting them, balance of responses, in p.p.



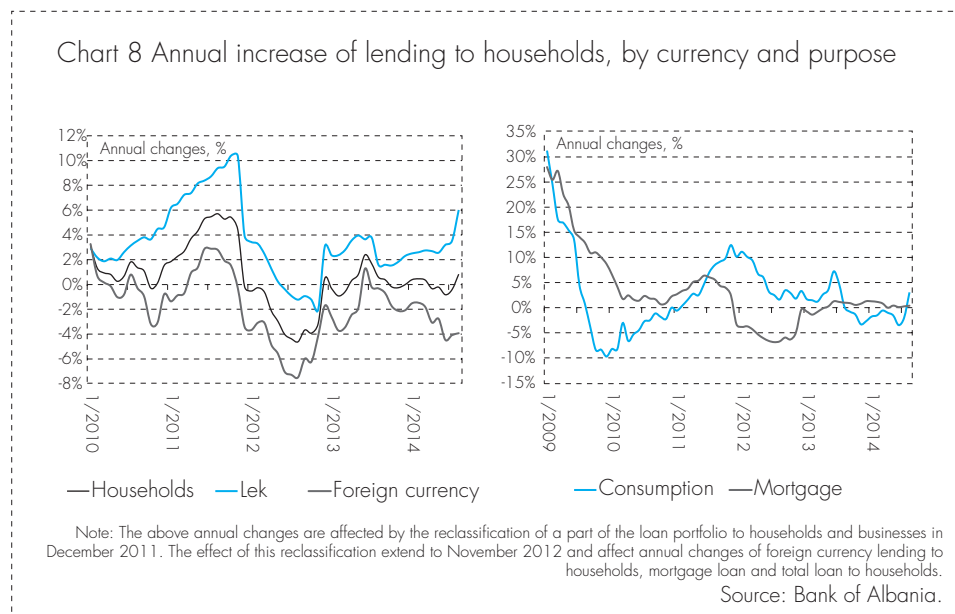
In addition to the improving banks' balance sheets and Bank of Albania's policies, standards of lending to businesses have reflected largely the enhanced interbank competition. The economic situation and non-performing loans persist as factors contributing to banks conservative behaviour towards lending to businesses, but less so compared to previous quarters.

Businesses credit demand is assessed as slightly up in the third quarter and is expected to increase further in the fourth quarter of the year. According to banks, it was driven mainly by more favourable lending standards and an improving economic situation. The information filtered from businesses confidence corroborates the assessment for an improvement of economic activity in the quarters ahead, and perhaps upward credit demand by businesses. It must be noted, however, that until now, the improvement of confidence and survey indicators has not been materialised yet in a broad base performance of lending to businesses.

3. LENDING TO HOUSEHOLDS

Lending to households continues to be sluggish. In August, it improved mostly thanks to the cancelling out of the base effect. Its monthly developments were weak. Banks report eased lending standards and added credit demand for the third quarter, but these signals have not materialised yet into the factual credit performance.

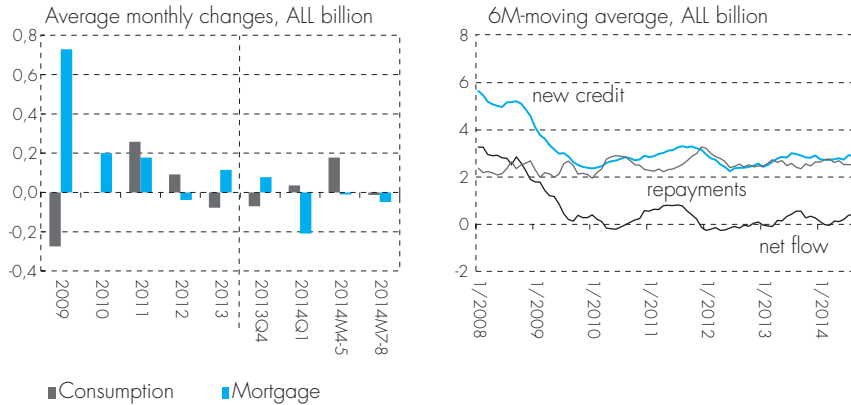
The annual growth of lending to households fluctuated around 0% during the past 12 months. As of the end of August, it stood 0.8% higher than a year earlier.⁶ Mortgage loans continued to post low annual increase, similarly to previous months. Annual change of consumer credit was 3.0% in August, returning to positive rates. Within the consumer credit, financing of consumer durable goods has shown an upward trend in the past 12 months, hence offsetting the decline of other types of consumer credit (overdraft and credit for consumer non-durable goods).



The shift of lending to households towards the domestic currency is still evident. The annual growth of lek lending rose to 6.0% in August, whereas foreign currency lending continues to shrink, in annual terms, resulting 3.9% lower than a year earlier, in August. This shift is noted in the main two segments of lending to households: mortgage and consumer loans. In addition to banks' policy to match the loan and income currencies, the significant narrowing of the spread between the interest rates on lek loans to those on foreign currency loans has contributed to this shift.

⁶ In August 2014, the base effect ceased due to the sale of a part of the loan portfolio for households by a bank in the system. The sold portfolio was a loan to finance consumption in lek, and the effect of sale contributed to the annual growth of the consumer credit, of lek lending to households and of total loans for households, during August 2013 - July 2014.

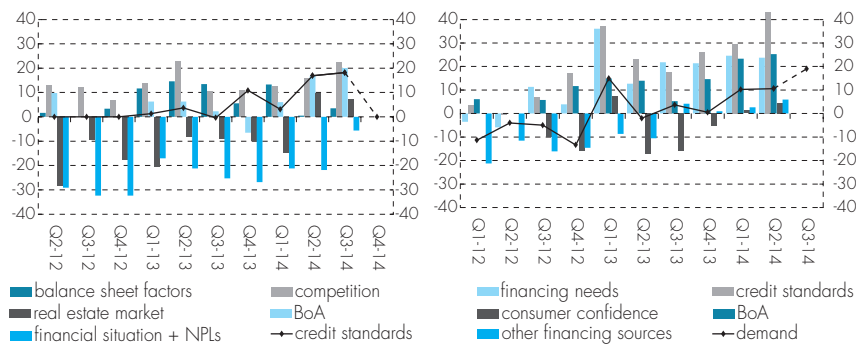
Chart 9 Lending to households, monthly performance



Note: Annual changes do not incorporate the effect of reclassification mentioned above. Also, the net flows in the right chart are adjusted for balance sheet clean up, such as credit write off and sale.
Source: Bank of Albania.

The monthly dynamic of lending to households was sluggish during July - August. Its balance fell ALL 0.2 billion in these months, reflecting primarily the downward mortgage loan. New lending to households has not yet shown clear signs of recovery. In the past two months, its average fluctuated close to its level in the previous year and in the first half of the current year. At the same time, households were inclined to repay their bank debts faster, especially foreign currency ones.

Chart 10 Changes in supply (left) and demand (right) for lending to households and factors affecting them, balance of responses, in p.p.



Positive/negative balance means easing standards (upward demand) / tightening standards (downward demand). In the supply-side factors, balance-sheet factors are calculated as a simple average of results for the situation of liquidity and of capital. Likewise, the changes in the following two factors were averaged: households financial situation and non-performing loans, which performed similarly. From the demands-side factors, need for financing averages the need for financing consumption and real estate purchasing.
Source: Bank of Albania.

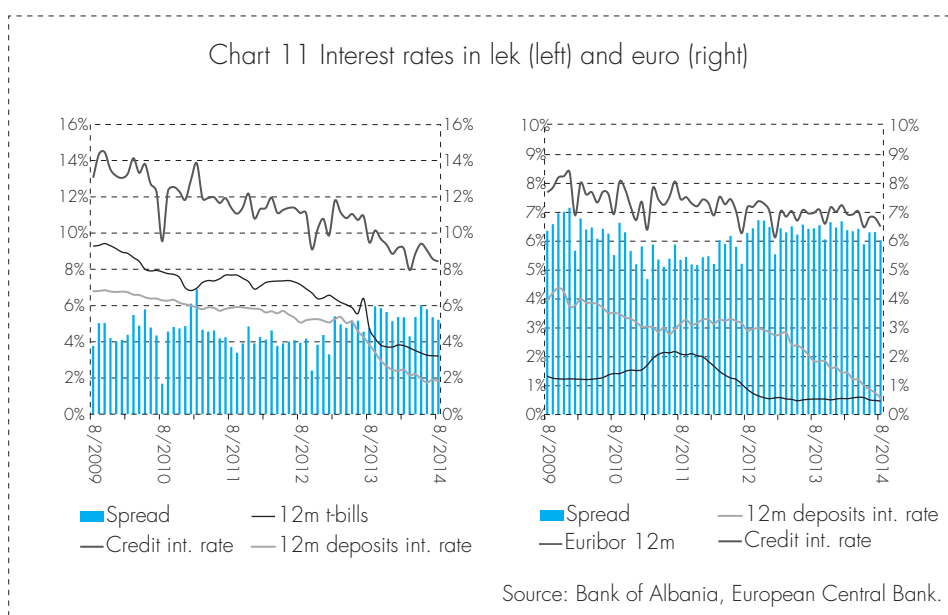
Banks continued to adopt a positive approach towards lending to households. The enhanced competition among banks, Bank of Albania's policy and more favourable situation in the real estate market have stimulated the further easing of standards of lending to households in the third quarter of the year. On the other hand, financial situation of households and level of non-performing loans continue to be factors of concern for banks, making banks adopt a selective behaviour when lending to households.

Banks report increased credit demand by households, mostly for financing consumption. Despite offering competitive standards in the mortgage loan segment, households hesitate to undertake long-term investments. The higher credit demand is driven by the eased lending standards, reflecting the policy of the Bank of Albania. However, demand remains limited to financing urgent and short-term needs. Similar to lending to businesses, positive signals from the bank lending survey and the improved consumer confidence, measured through the consumer surveys, have not yet materialised in an apparent improvement of lending to households.

4. CREDIT PRICE AND OTHER STANDARDS

Credit interest rates continued the downtrend in July and August, especially for lek credit. Their margins against deposit interest rates narrowed for lek, but expanded for the foreign currency. Interest rates on lek loans have approached those on euro ones, stimulating therefore lending in the domestic currency. In addition to lowering the interest rates, banks report easing of most of other lending standards during the third quarter of the year.

Interest rates on credit continued to drop in July and August. They dropped more significantly for lek loans, and fell only slightly for euro loans. The average interest rate on credit remains volatile month after month, as a result of the impact of interest rates for special loans, given the low levels of new credit.



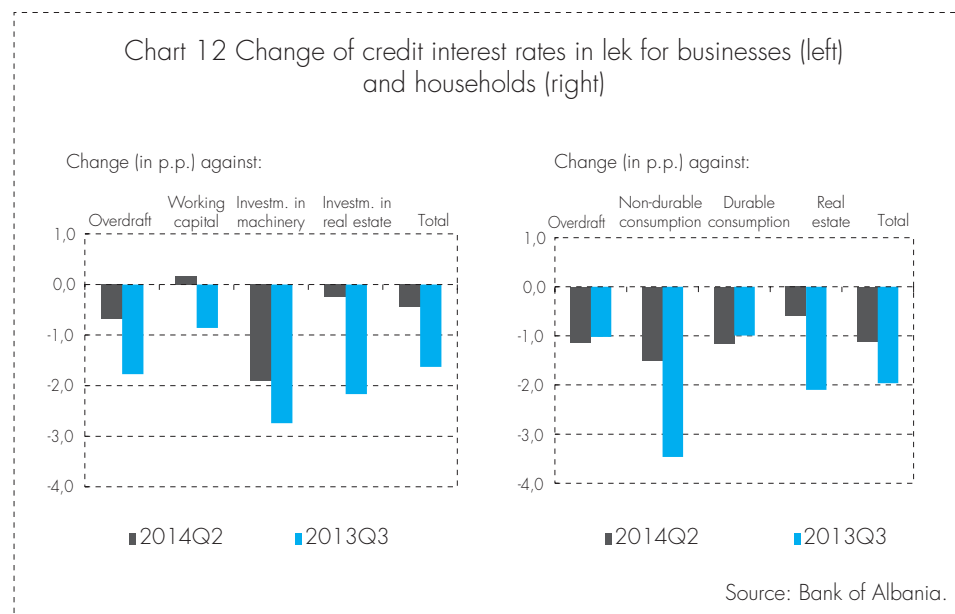
The interest rate on lek loans was 8.5% in July and August, down by 0.6 p.p. against the average rate recorded in the second quarter. It was on average 1.7 percentage points, lower than in the previous year. The downward interest rates on credit in July and August led to the narrowing of the spread and margins⁷ of the interest rate in these months. However, their spread to the interest rate on deposits and T-bills is higher than in the previous year, as a result of the faster decline in the latter.

The euro credit interest rate averaged 6.7% in July and August, slightly down from a quarter earlier. It was on average 0.4 percentage points, lower than in

⁷ The spread is calculated as the difference between loan interest rate and the loan reference rate (12-month T-bill for the lek and 12-month Euribor for the euro). The margin is calculated as the difference between loan and deposit interest rates.

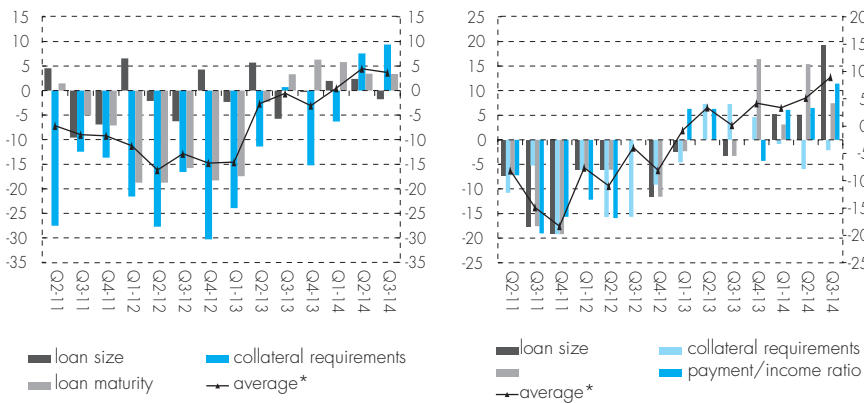
the previous year. On the other hand, the euro deposit interest rate showed a strong downward trend, reaching euro interest rates in the European interbank market. The lowering of the interest rate that banks pay for euro deposits reflects the increase of banks' liquidity in this currency, under the conditions when the possibilities for its investment in the country are limited. As a result of these developments, the margin of loan interest rates against deposit interest rates expanded. Meanwhile, the spread against the Euribor narrowed slightly, reflecting a slighter fall in recent months.

The faster decline of interest rates on lek credit against the interest rates on euro credit is reflected in the continuous narrowing of the spread between the two. Thus, in July and August, the spread was 1.8 p.p. on average, down by 0.5 p.p. and 1.3 p.p. from the previous quarter and the same quarter a year earlier, respectively. This development was among the primary factors stimulating the orientation of credit demand towards the domestic currency. The shift of credit from foreign to the domestic currency sustains the stability of the financial system and establishes the premises for enhancing the efficiency of the monetary policy.



Returning to the performance of lek interest rates, they lowered across almost all segments of credit, in the short and long term. Thus their analysis by purpose of use for July and August reveals reduction of interest rates on lending to businesses by around 1.6 p.p. from a year earlier, and about 0.4 p.p. from the second quarter of the current year. Their reduction is more evident in the investments segment. For the same period, the average interest rate on lending to households fell by around 2.0 p.p. and 1.1 p.p. year on year and quarter on quarter, respectively. The fall is more evident in the consumer credit for non-durable goods and mortgage loans. By purpose of use of euro loans, the fall is smaller and more segmented.

Chart 13: Non-price standards applied to businesses (left) and households (right), in p.p.



Note: positive/negative balance implies easing/tightening of standards.
 *Simple average of factors.
 Source: Bank of Albania.

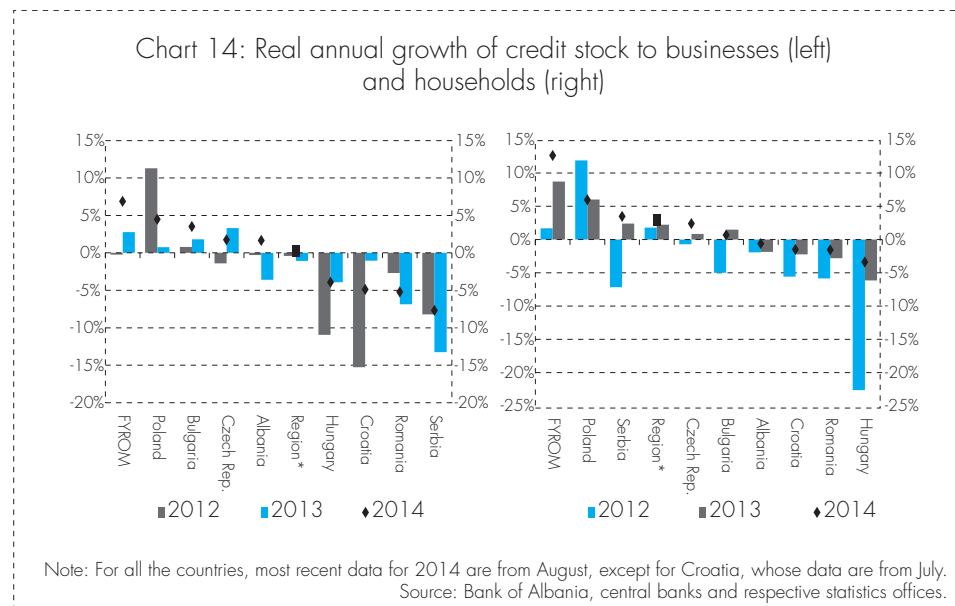
In addition to lowering the interest rates, banks report easing of other lending standards during the third quarter of the year. For businesses, banks eased even further the collateral requirements and extended the term to maturity for the offered loans. In the meantime, during this period, banks have revised on the tightening side the size of funding for businesses.

Among the standards for credit to households, size, term to maturity, and instalment/income ratio remain on the easing side. Meanwhile, similarly to the previous quarter, banks remain prudent in their collateral requirements for the extended loans.

5. TRENDS IN LENDING IN THE COUNTRIES OF THE REGION⁸

In the region, lending to the private sector appears improved during 2014, driven mainly by the steady growth of lending to households. This improvement, however, is segmented and driven by only some of the countries. From a regional comparison, performance of lending in Albania is close to the region's average. Unlike the overall trend, lending in Albania improved driven by lending to businesses rather than to households.

Developments of lending to businesses in the region show an improving trend of its growth in average terms. In August of the current year, the annual average change of lending to businesses resulted 0.2% from -1.1% at the end of the past year. Within this overall performance, lending to businesses varies across different countries. In Macedonia, Poland and Bulgaria, the annual growth of lending to businesses remains positive and higher than at the end of 2013. In Albania, the annual change of lending to businesses recorded positive rates, reflecting an improved situation from the past year and ranking above the region's average rate. In the case of Hungary, Croatia, Romania, and Serbia, the stock of credit to businesses continues to shrink in 2014, in some cases at a higher rate than in the past year.



⁸ We analyse lending in the countries in the region in real terms that is excluding the effects from the exchange rate and inflation. Moreover, the average of the region is calculated as weighted average. For that reason, the concrete figures are not comparable with the comparative analysis introduced in the last publication in July.

Lending to households in the countries of the region performed overall better than lending to businesses, even when referring to the previous years. No annual change deterioration is noted in any of the countries. Even in those countries where the portfolio continues to contract, it is generally happening at lower pace than lending to businesses. In average terms, the real growth of lending to households in the countries of the region improved to 3.0% from 2.2% at the end of 2013. Lending to households performed particularly well in Macedonia and Poland. In Serbia and the Czech Republic lending to households continues to record positive annual growth rates. In the case of Albania, annual growth of lending to households improved only slightly against the two previous years, and stands below the region's average. In the rest of the countries, lending to households continues to contract in 2014, at the same rate as in the case of Croatia, or more moderately as in the case of Romania or Hungary.