Bank of Albania

TRENDS IN LENDING

2014 Q4

ERJONA SULJOTI, SOFIKA NOTE
MONETARY POLICY DEPARTMENT, BANK OF ALBANIA

JANUARY 2015

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

C O N T E N T S

This analysis presents a detailed overview of the most recent lending developments in Albania. It studies the monetary data on the credit portfolio by economic agents, as well as lending standards. In more details, lending standards will be addressed in both price - interest rate - and non-price terms. In addition, the analysis will present a summary of trends in lending in Central, East and South-East Europe (CESEE) countries.

The spillover effects of the global financial crisis in the CESEE countries and its consequences on Albania have often been the subject of our periodic analyses. In this context, regularly updating such information becomes crucial, in order to better understand the impact of both domestic and external factors on the performance of financial indicators in general and of lending in particular.

The main statistics taken into account in this analysis are:

- Monetary data[1] for the volume of bank lending in the two main portfolios, businesses and households.
- Qualitative data from the bank lending survey, with a special focus on analysing lending standards and demand, and the factors affecting them. Based on this survey results, non-price elements are also analysed.
- Statistics on credit price, represented by the average interest rate weighted with the new credit, denominated both in lek and in euro. The intermediation margin applied by banks to the cost of funds is also analysed.
- Monetary data on the volume of lending in the countries of our region include data from: Bulgaria, Croatia, Romania, Serbia, Poland, Hungary, the Czech Republic, and Former Yugoslav Republic of Macedonia.

The analysis covers data published as at 20 January 2015, which include information for monetary and financial data for November 2014 and data from the bank lending survey 2014 Q4.

[1] The monetary methodology is based on the resident and non-resident concept, and loan data include only loans to residents. For more information, refer to "Monetary and Financial Statistics Manual" of the International Monetary Fund, 2000 ed.

SUMMARY

Bank intermediation was sluggish during October - November 2014, characterised by the weak performance of loans and deposits. The positive developments in lek intermediation relied on both the growth of lending and the better growth of lek deposits. Foreign currency intermediation, on the other hand, was determined by the fall in foreign currency deposits, while foreign currency lending was almost inexistent. These developments have driven the shift of bank intermediation towards the national currency, creating therefore premises for strengthening financial stability and monetary policy effectiveness in the economy.

Lending to businesses was up during October - November. Bank lending to businesses was granted for both short-term liquidity and investment purposes. A highlight in the fourth quarter was lending to state enterprises, which was accompanied with preferential lending standards. Lending to businesses, however, remains segmented and suffers from the weak credit demand, especially for investment purposes. Lending supply remains concentrated in only a few banks of the system. Banks tightened the lending standards, driven by factors related to their balance sheets, parent bank policies, and economic-related concerns. This trend in lending to businesses is expected to persist in the next quarter.

Lending to households was sluggish, compared to both a year earlier, and to the first half of the year. Although the standards of lending to households remained on the easing side and interest rates on loans were downward, credit demand by households remains particularly weak. The volatility of the consumer confidence indicator, especially its deterioration in the last quarter, corroborates households' uncertainties and is materialised in the sluggish credit demand. Households demand was oriented towards financing consumption. The portfolio of mortgage loans continues to shrink, despite the more attractive products for the latter.

Interest rates on lek loans continued to fall, while those on euro loans remained unchanged, in October - November. The fall in interest rates on lek loans was noted across all the banks for all types of loans. It was, however, more pronounced for the businesses segment. The more contained drop in interest rates on lek deposits contributed to the further drop in the intermediation margin, supporting therefore the rise in lek intermediation. The latter appears to be also supported by the narrowing of the spread between lek and foreign currency interest rates.

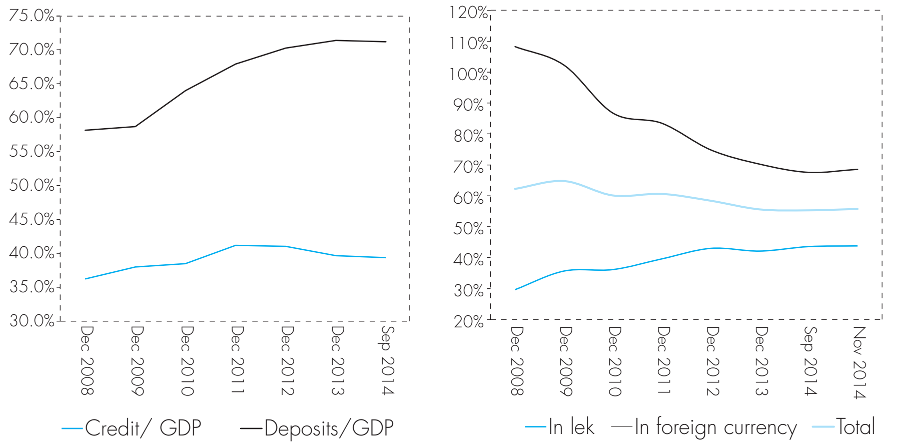
The analysis of lending to the private sector in other countries of our region points to a slow and fragile recovery. Characterised by a large presence of foreign banks, all the countries of the region have been affected by their deleveraging strategy in these countries. This approach has been more significant for Balkan countries and is expected to persist in 2015. On a regional basis, Albania is ranked above the region's average as regards lending to businesses, but below the region's average as regards lending to households.

1. GENERAL OVERVIEW

Banks financial intermediation in October - November remained sluggish, characterised by slow growth of credit and deposits. During the period, bank lending was characterised by further increase in lek intermediation against the weak foreign currency intermediation. This landscape reflects the orientation of the low demand towards lek loans, driven by the eased monetary standards. Meanwhile, deposits showed different dynamics from that in the third quarter. Lek deposits increased, whereas foreign currency ones decreased. The creation of lek deposits remains low, affected by the shift of households' savings toward investments in securities.

In October - November 2014, banks financial intermediation appears to have slightly improved from the third quarter, but the improvement reflects mostly the weak performance of deposits, while the credit performance remains sluggish. Thus, the ratio of credit to total deposits recorded the highest level, 55.7% in November. It stands 0.4 p.p. higher than in September and close to the 55.6% recorded in the end of 2013. The slow and fragile recovery of intermediation was determined by an unsteady credit recovery.

Chart 1. Intermediation indicators*



*Assessment of intermediation indicators, including deposits above two years.
Source: Bank of Albania.

In October - November, notwithstanding the annual credit growth to 3.8%[2] from 1.6% in September, the monthly net average flow, adjusted for the exchange rate volatility, was almost zero. Such performance was determined by economic agent's weak demand for loans and banks' risk aversion policies.

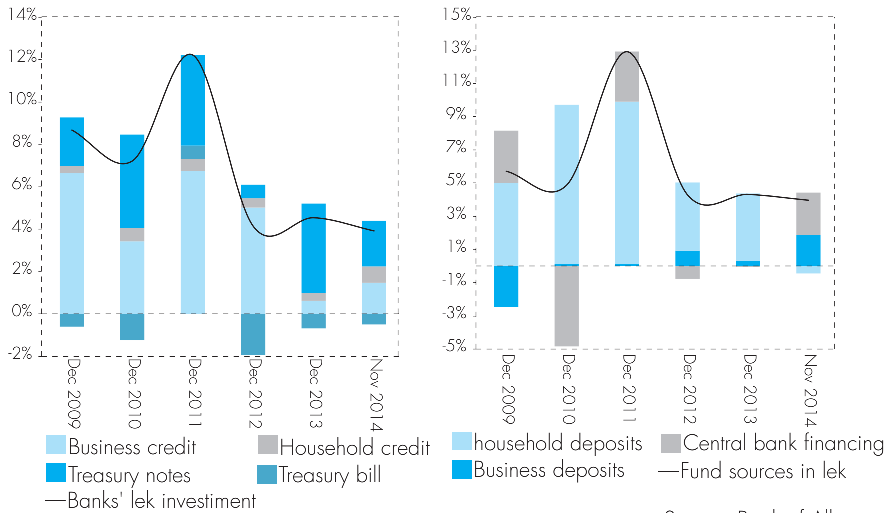
[2] The improvement of annual growth has mostly reflected the cancelling out of the negative effect from the reduction of the portfolio in October 2013.

Lending survey results for the fourth quarter confirmed both the weakening of demand for loans and the tightening of standards for businesses, compared to the third quarter of the year. In the meantime, the latest lending survey in the countries of our region[3] (EIB, November 2014), shows that large European banks have adopted policies for reducing their exposure to Albania. This trend is expected to continue, although at a slower pace, over the first half of 2015, and is expected to condition the recovery of banking system intermediary role in the economy.

During the fourth quarter, the pace of growth for total deposits[4] is slightly higher than in the third quarter, to 2.2% (from 1.7% in September). This pace, however, remains below the average growth rate of total deposits in the last two years. Low lending levels have been accompanied with low money creation levels in the economy and a subsequent poor performance of deposits. As at end September 2014, the ratio of total deposits and loans to GDP stood at 71.2% and 39.3%, respectively, unchanged from the second quarter of 2014.

Intermediation in the national currency continued to show positive developments, characterised by increase of investments in lek. In contrast to the third quarter, during October - November, banks were more involved in investing lek funds in the private sector and less so in financing the government. The ratio of lek loans to lek deposits rose to 43.8% from 42.1% in September 2014 and December 2013, respectively. The improvement of lek lending to businesses contributed to deepening intermediation, whereas that to households was lower than in the third quarter. As at end November, lek lending stood 9.3% higher than in the previous year, compared to 5.7% in September.

Chart 2 Annual growth of main investments and main sources of financing, in lek



Source: Bank of Albania.

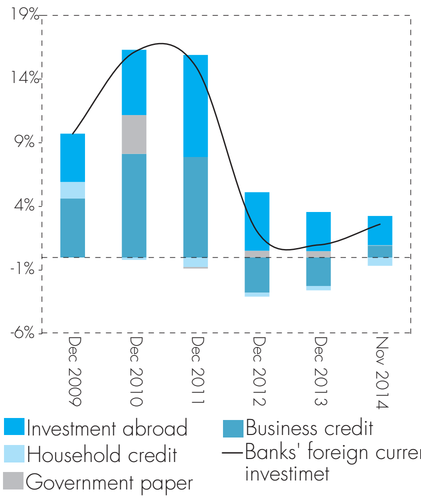
3 CESEE Bank Lending Survey – H2 2014, by the European Investment Bank (EIB).

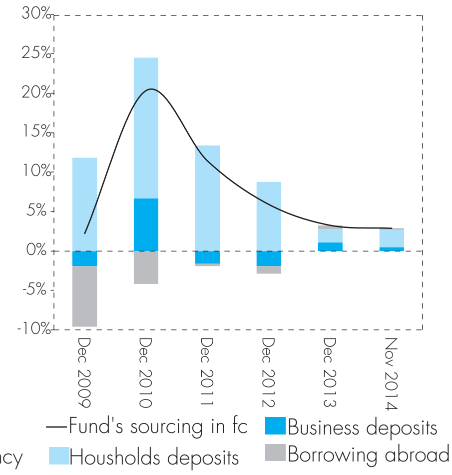
4 For the purposes of financial intermediation analysis, in this section of the analysis we have referred to the total deposits in the banking system, including those above two years, which are not included under the item deposits according to the monetary methodology, but serve as a source of financing/intermediation for banks.

The pace of growth in lek deposits improved to 1.3% against contracting by 0.2% in the third quarter, which is reflected in the deceleration of improvement in intermediation in lek. The performance of lek deposits in October and November continues to be affected by the shift in deposits to maturities above two years, though at a slower pace than in the previous quarter. Unlike the third quarter, developments in lek deposits were driven by businesses deposits. Liquidity withdrawal from Bank of Albania has been one of the sources of financing the activity in lek, but this source has given lower contribution to the increase in funds, compared to the previous quarter.

In November, the ratio of foreign currency loans to total deposits improved to 55.7%, or 0.3 percentage points higher than in September. This improvement reflected the drop in foreign currency deposits, while the foreign currency lending has been steady, since the end of third quarter of the year[5]; it continues to contract in annual terms by around 0.9%. While banks have lowered their placements abroad compared to September, among other due to the penalising macroprudential measures that have been applied for more than a year. Unlike the third quarter, banks have lowered short-term foreign-currency financing of the public sector. Businesses and households foreign currency deposits continue to be the main source of financing the activity. However, in contrast to the third quarter, they provided negative contribution to the performance of funding sources for October - November. Thus, at the end of November, foreign-currency deposits resulted 3.2% higher than in the previous year. This rate has been slowing down. Especially in November, foreign-currency deposits contracted mostly due to downward business deposits and less so due to households ones.

Chart 3 Annual growth of main investments and main sources of financing, in foreign currency





Source: Bank of Albania.

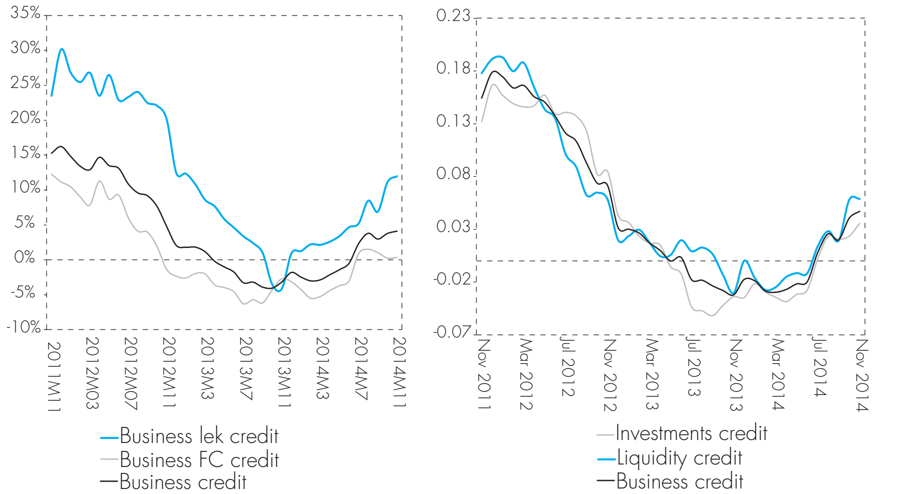
[5] Foreign-currency lending excluding the exchange rate effect, in order to analyse the real performance of the portfolio.

2. LENDING TO BUSINESSES

Lending to businesses continued to grow in October - November 2014, improving further in terms of financing liquidity needs. Despite the annual improvement, the loan portfolio continues to be dictated by the weak demand and the tight supply. Demand for loans continues to be conditioned by the economy performing below potential, unutilised production capacities and uncertainties. In the meantime, the tightening of lending standards for businesses corroborates banks' reluctance to further increase intermediation for this segment. These tendencies are expected to persist in the first quarter of 2015.

In November, lending to businesses amounted to 5.1% higher than in the previous year, against 2.7% in September.[6] Lending growth rates improved, owing to the significant growth in lek lending to businesses mainly for liquidity, whereas foreign-currency lending appears weaker than in the previous quarter. Under the conditions of downward lek lending costs during 2014 and due to the purposes of use, businesses demand was oriented to lek-denominated loans. By purpose of use, loans for liquidity showed accelerated growth to 5.9% in November, against 1.9% at the end of the third quarter. The performance of loans for liquidity purposes was affected, in October, by a loan for state enterprises. The annual growth rates for loans for investment purposes improved to 3.6% from 2.1% in September. Businesses demand for this product appears volatile and fragmented.

Chart 4 Annual increase of lending to businesses, by currency* and purpose of use



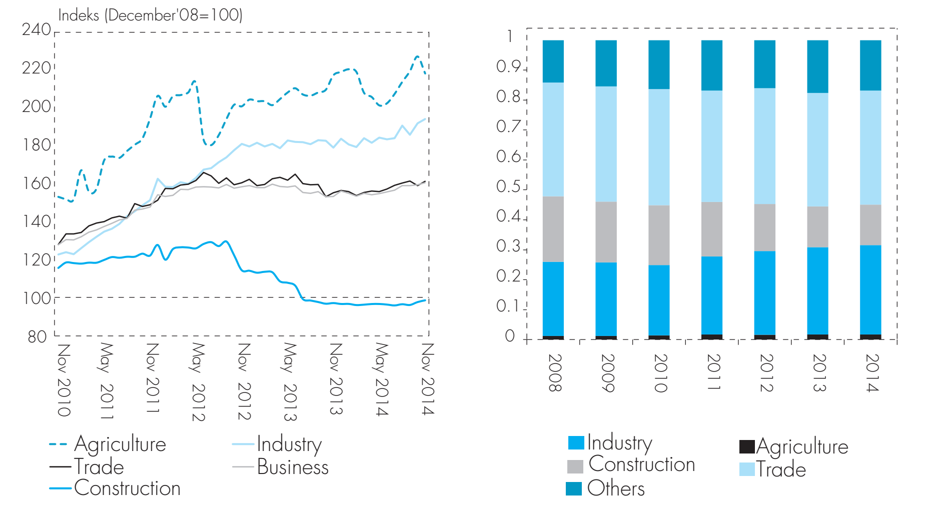
*Data on foreign currency lending exclude the exchange rate effect.
Source: Bank of Albania.

6 The annual performance of the portfolio of lending to businesses was affected by the strong contraction in the previous year.

The monthly dynamics of the lending portfolio to businesses reveals a poor performance. The monthly expansion of the portfolio was ALL 1 billion, less than half the average monthly expansion in the third quarter. This performance confirms once again that credit recovery remains sluggish, as a result of both low demand, and tightening of lending standards by banks. Lending for this segment was also conditioned by the banks re-orienting lending toward small and medium-sized enterprises, which is less credited by banks but bears more risks amid the conditions of slow economic recovery.

During October - November, banks increased their lending to businesses operating in industry and construction sectors, by ALL 5 billion and ALL 1.4 billion, respectively. In annual terms, the lending portfolio to the industry saw the highest growth by 8.3%, mostly driven by lending to the subsector of production and distribution of energy and gas. The acceleration of the growth pace for the industry portfolio in the last three quarters has contributed to the increase in the share of industry in the total, to 29.8%, or 1 p.p. higher than in the previous year. Lending to the construction sector, for the first time after two years, saw 1.5% annual growth. The share of lending to this sector in the total lending to businesses recorded 13.5%, unchanged from the end of 2013. In the meantime, the portfolio of lending to trade, albeit dominating the portfolio of lending to businesses by 38%, saw weak performance, remaining at the same levels as in the third quarter. In annual terms, it expanded by 3.8%.

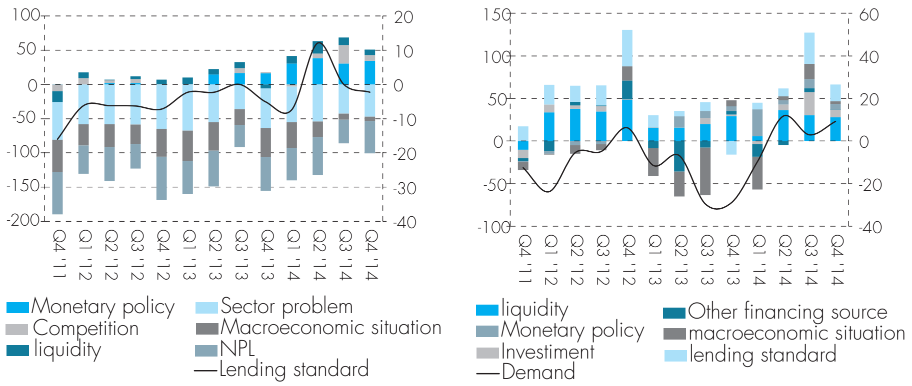
Chart 5 Lending by sector of the economy



Source: Bank of Albania.

In the fourth quarter, banks tightened the lending standards for businesses, driven by the high presence of non-performing loans and sector-specific problems. Standards were tightened for both the small and medium-sized enterprises and the larger corporations, while banks were more conservative, especially for investment loans. Banks expect easing of standards for small and medium-sized enterprises and for liquidity loans in the first quarter of 2015, whereas standards for larger corporations and investment loans are expected to remain tight.

Chart 6 Changes in credit demand and supply for businesses and factors affecting them*



*Charts are built with data (balance of answers, p.p.) from the bank lending survey. Positive/negative balances mean easing standards (upward demand) / tightening standards (downward demand). In demand-related factors, credit demand is calculated as the average of demand for liquidity purposes and need for financing investments.

Source: Bank of Albania.

In the last quarter, factors that led banks to ease standards are the easing of monetary conditions in the economy, competitiveness among banks, and good performance of liquidity. Irrespective of the good performance of these factors, the negative impact by non-performing loans and sector-specific problems has been a decisive factor on the performance of lending standards for businesses. Increasingly fewer banks assess that the overall macroeconomic situation has affected negatively banks decisions, being in line also with the overall improvement of the macro situation in Albania.

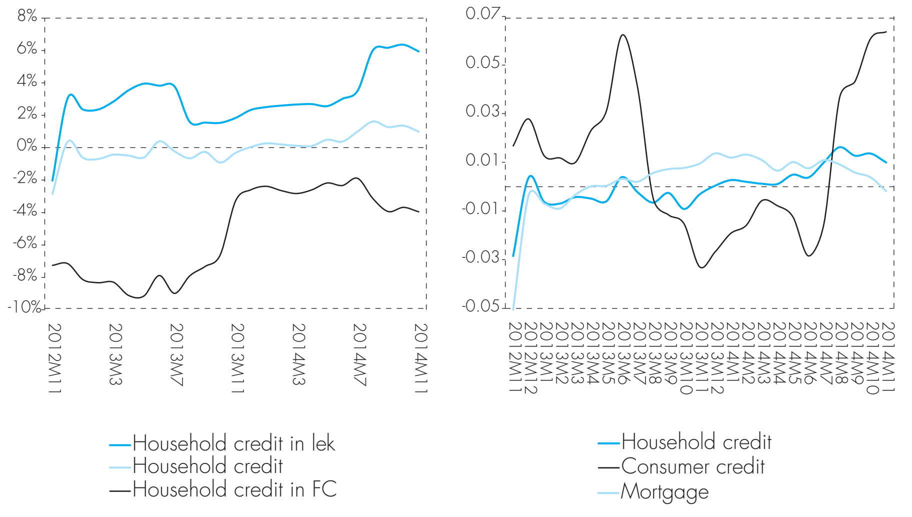
Businesses credit demand is assessed as slightly up in the fourth quarter and is expected to remain at these levels in the first quarter of 2015. According to banks, it has been driven mainly by the need for short-term financing for liquidity purposes, more favourable lending conditions and an improving economic situation. The latter is also confirmed by the performance of businesses confidence indicators, which have shown improvement over several quarters. This positive performance, however, has not been yet observed to stimulate a steady business demand for bank funding.

3. LENDING TO HOUSEHOLDS

Bank lending to households continued to perform moderately. Although banks have been easing the standards of lending to households for more than two years, households demand is still not picking up, reflecting the uncertainties for the future and deferment of home purchase. Banks expect that households' low credit demand will continue in the first quarter of 2015.

Lending to households continued to grow at low rates, 0.9%, compared to 0.4% recorded in the end of the third quarter. Although banks have been easing the standards of lending to households for more than two years, demand from households is still not picking up. This sluggish performance has reflected on the one hand the continuous improvement of consumer loans and, on the other, the contraction of the mortgage loan portfolio. The latter accounts for 76% of the loan portfolio dictating the sluggish performance of lending to households. In annual terms, the portfolio of consumer loans surged by 6.1% whereas mortgage loans contracted by 0.2%.

Chart 7 Annual increase of lending to households, by currency and purpose

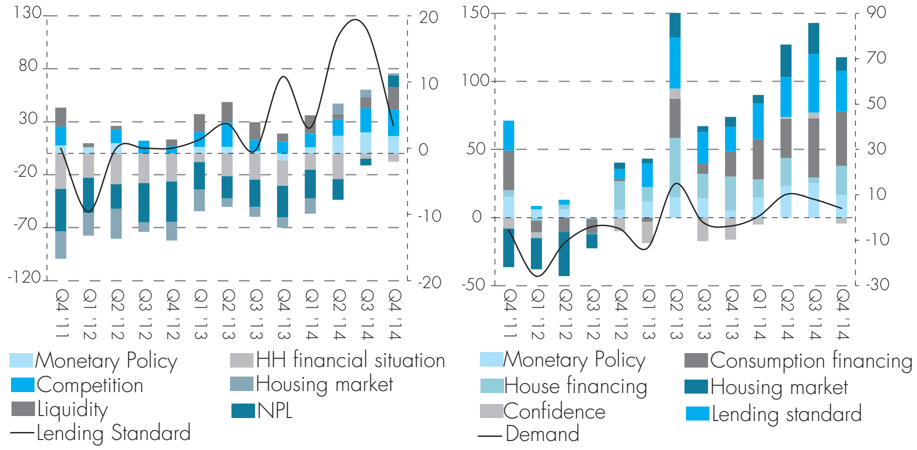


Source: Bank of Albania.

Regarding the performance of lending to households by currency, since July, lending to households in lek has been growing steadily. As at end-November, this portfolio was 5.9% higher than a year earlier. This performance has been dictated not only by the performance of consumer loans, which is mainly disbursed in lek, but also due to the waning of the statistical effect of cleaning up non-performing consumer loans from the balance sheet. Thus, consumer loans surged during the two months by ALL 0.4 billion, maintaining the same growth rates as in the third quarter.

Foreign-currency lending to households contracted throughout the year, at a higher pace during October - November. The performance of foreign-currency lending to households was related particularly to the weak performance of mortgage loans. The small number of transactions in the real estate market and the lag in the adjustment of house prices confirm the sluggish demand of households for financing. Credit outstanding for house purchase in November was ALL 0.4 billion lower than at end-September, contracting at slightly higher pace.

Chart 8 Changes in credit demand and supply for households and factors affecting them.



*Positive/negative balance means easing standards (upward demand) / tightening standards (downward demand).
Source: Bank of Albania.

Banks continued to implement easing policies on lending to households, albeit at a lower pace than in the third quarter. The easing of standards for households was supported by the better liquidity situation in banks, increasing competitiveness and easing of monetary conditions in the economy.

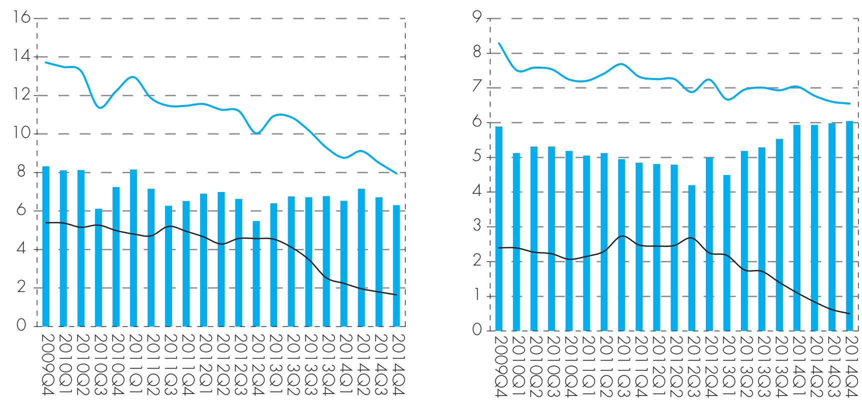
Households demand for bank lending, though positive, appears downward compared to the first quarter. The downward consumer confidence, as confirmed by the households' confidence survey in the fourth quarter, is the only factor with a negative impact on credit demand. All the other factors, such as lending standards, need for financing and housing market sustained the recovery of lending to households. This performance is expected to persist in the first quarter of 2015.

4. CREDIT PRICE AND OTHER STANDARDS

Interest rates on lek loans continued to fall, while those on euro loans remained unchanged, in October and November. The fall in interest rates on lek loans was noted across all the banks for all types of loans. It was, however, more pronounced for the businesses segment. The more contained drop in interest rates on lek deposits contributed to the further drop in the intermediation margin, supporting therefore the rise in lek intermediation. The latter appears to be also supported by the narrowing of the spread between lek and foreign-currency interest rates.

Interest rates on lek loans have trended down since the second quarter of 2014. On average for October - November 2014, the interest rate on lek loans stood at 8%, being 0.5 percentage points lower than in the third quarter of 2014 and 1.3 percentage point lower than in the last quarter of 2013. Notwithstanding the temporary fluctuations of the interest rate on lek loans, it has been constantly and gradually falling for more than four years, in line also with the easing of monetary conditions. The average interest rate on lek deposits has also trended down, but, unlike in the previous year, the fall was more gradual. The interest rate on deposits in the fourth quarter averaged 1.65%, against 1.79% and 2.23%, respectively, in the third quarter of 2014 and the last quarter of 2013. This performance contributed to the narrowing of the intermediation margin to 6.3 p.p., among the lowest in the last four years. The easing of monetary conditions, together with the favourable bank liquidity conditions has determined the downtrend of the intermediation margin in the

Chart 9 Interest rates in lek (left) and euro (right)

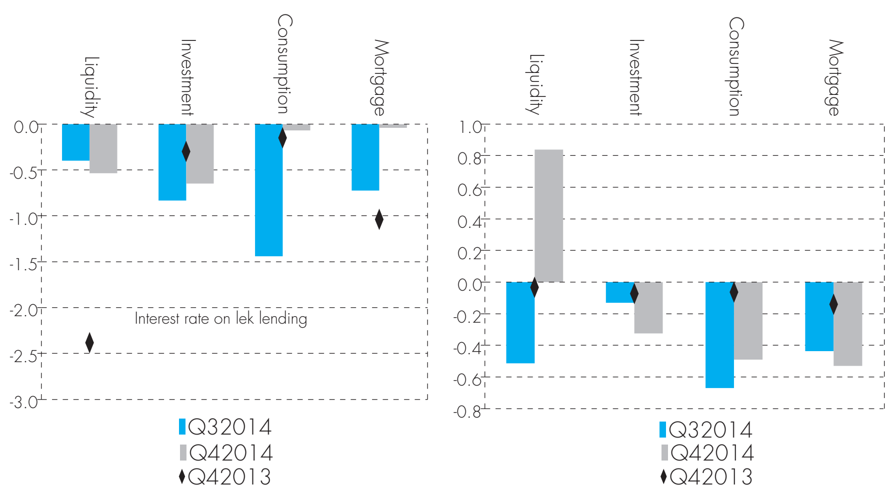


Source: Bank of Albania, European Central Bank.

national currency. In addition, the relatively low risk for lek loans, compared to the foreign currency loans, has created more space for banks to reduce the intermediation margin. The cost reduction on lek loans has been one of the main factors orienting loan demand towards the national currency. The shift of lending 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.

Reduction of interest rates on lek loans in the fourth quarter was noted across all the segments of lek loans, on a broad basis, in all banks that are active in lending. Thus, interest rates on loans by purpose of use show that they fell by 0.5 p.p. for liquidity loans, which account for most of new loans granted during the period. Interest rates on investment loans to businesses have also fallen, by 0.7 p.p. In the meantime, in the retail segment for households, changes in rates on both consumer loans and mortgage loans have been minimal, compared to the previous quarter, 0.1 p.p. But, interest rates on both these products showed significant drop in the third quarter. This performance is in accordance with the results obtained from the bank lending survey, which reports a lower easing in the households market.

Chart 10 Changes in interest rates on lek and euro loans for households



Source: Bank of Albania.

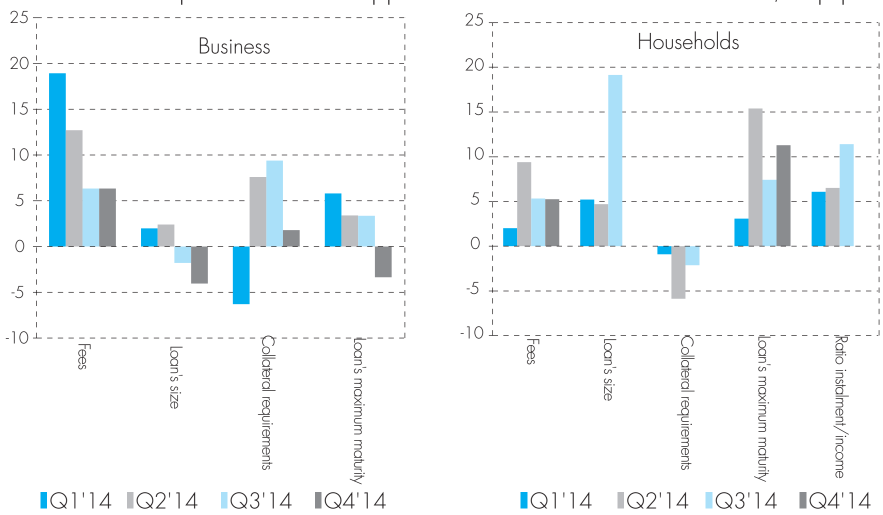
The average interest rate on euro loans stood at the same level as in the third quarter of 2014, at 6.6%. Compared to the end of 2013, this rate is 0.4 p.p. lower. Over four years, the 0.7 p.p. fall in euro interest rates is less than half the fall in lek interest rates on lek loans for 2014. This performance has also contributed to the significant narrowing of the spread between the interest rate on lek loans and the rate on euro loans, creating therefore better conditions for increasing the activity in lek and deepening intermediation.

On the deposits side, interest rates on euro deposits slowed down the accelerated decline that had been noted for more than a year. Thus, the 0.5% average interest rate on deposits for October - November 2014 was only 0.1 p.p. lower than the average of the third quarter. The weak performance of foreign-currency loans and low interest rates in international markets for foreign-currency investment has driven banks to lower interest rates on deposits. The intermediation margin in euro appears slightly upward. Throughout 2014, this margin fluctuated around 6 p.p. against 5 p.p. in the previous year. Furthermore, the spread of euro loans to the reference rate, Euribor 12M, remained at historically high levels, at 6.3 p.p.

The euro interest rates have been determined by the upward interest rates on short-term loans to businesses. Thus, the interest rate on loans for liquidity averaged 7.3%, around 0.8 p.p. higher than in the third quarter. Due to its high share in new loans granted during the period, the increase offset the decrease in rates on other segments of euro loans. The euro loan rates saw the highest drop in mortgage loans and consumer loans compared with the third quarter. However, it appears that this performance has not stimulated new foreign-currency loans from households, whose demand growth continues only for lek loans.

The easing of lending standards for households was reflected not only on the reduction of the credit price, but also on other lending standards. According to the lending survey, banks have reduced their commissions and have extended the maturity for households' loans. On the other hand, the loan size and instalment/income ratio have remained unchanged. Likewise, collateral requirement, in contrast to the third quarter, was not tightened.

Chart 11 Non-price standards applied to businesses and households, in p.p*



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

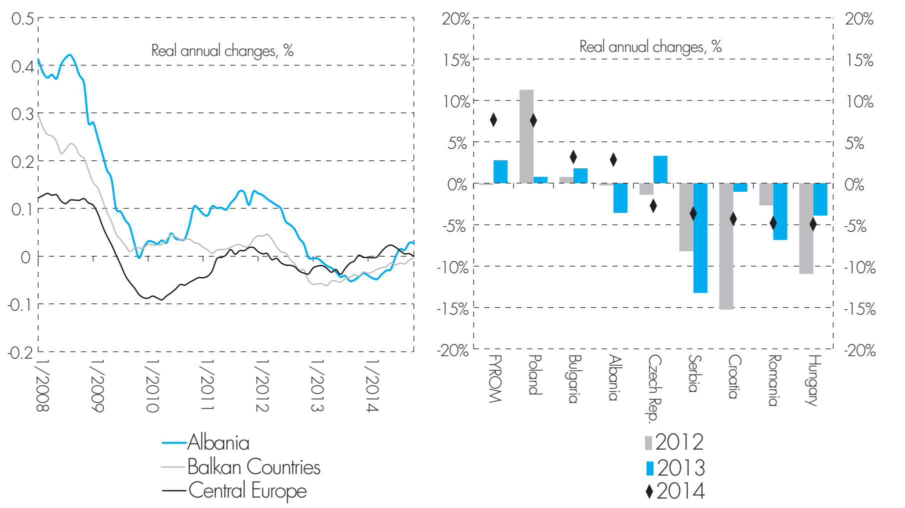
Tightening of standards for businesses was reflected not only in the upward interest rate on euro loans for liquidity purposes but also in the reduction of maturity and loan size. Meanwhile, banks state they have eased somewhat collateral requirements for businesses and have lowered the commissions. The latter have, throughout the year, served as a factor for easing lending standards.

5. TRENDS IN LENDING IN THE COUNTRIES OF THE REGION[7]

In the region, lending to the private sector continued to improve gradually in the fourth quarter of 2014. The improvement, however, continues to be segmented and fragile. From a regional comparison, Albania is ranked among countries that performed better in terms of lending to businesses, but stands below the region's average in terms of lending to households.

Lending to the private sector continued to improve gradually even during the second half of 2014. Overall, the recovery is slow and fragile. Characterised by a large presence of foreign banks, all the countries of the region have been affected by their deleveraging strategy in these countries. This approach has been more substantial for Balkan countries than the Central and Eastern European countries, and is expected to persist in 2015. Lending standards in these countries have shown easing trends, though unsteady, as a result of still-high levels of non-performing loans. Demand is assessed as upward, in line with economic activity recovery, but it is mostly concentrated on short-term financing (EIB 2015[8]).

Chart 12 Real annual growth of credit stock to businesses



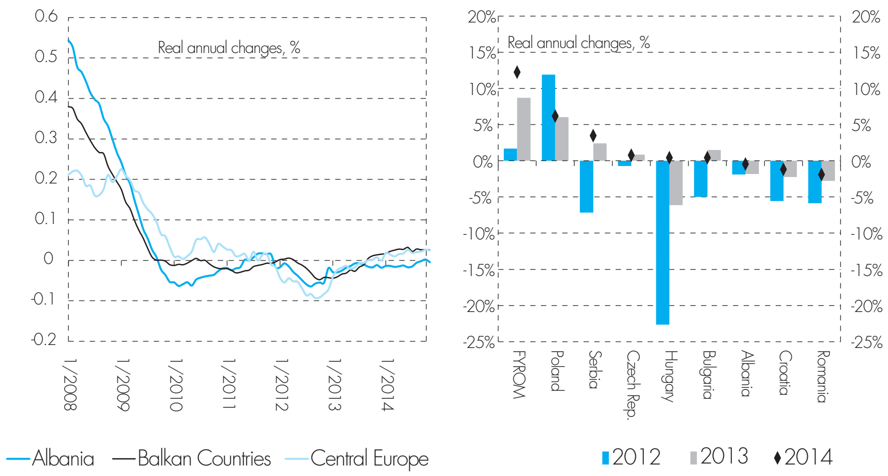
Source: Bank of Albania, central banks and respective statistics offices.

[7] For all the countries, most recent data for 2014 are from November, except for Bulgaria, whose data are from October. Lending in the countries of our region is analysed in real terms, that is, excluding the effects from the exchange rate and inflation.

[8] According to results from the CESEE Bank Lending Survey of the European Investment Bank (EIB) The results are published in November and may be accessed on EIB web site. http://www.eib.org/infocentre/publications/all/cesee-bls-2014-h2.htm

Lending to businesses continues to improve in most of the countries of our region. As at end-November, its annual average change resulted 0.1% from -2.2% at the end of 2013. In this landscape, the characteristics of lending to businesses vary across the countries. Thus, FYROM, Poland, Bulgaria and Albania are the only countries with positive growth rates of lending to businesses and saw improvement compared to the previous year. In Serbia and Romania, lending to business continues to shrink, but at a lower rate than before. In Croatia and Hungary, lending to businesses continued to contract in real terms. Also in the Czech Republic, lending to businesses continue to slow down in the second half of the year and shrank in November.

Chart 13 Real annual growth of credit stock to households



Source: Bank of Albania, central banks and respective statistics offices.

Overall, lending to households performed better than lending to businesses in the countries of our region. It suffered less by the financial crisis compared to lending to businesses and saw a faster recovery afterwards. In average terms, its real growth improved to 2.2% from 0.7% at the end of 2013. The improvement is more evident in FYROM, Poland, Hungary, and to a lesser extent, in Serbia. In the rest of the countries, the dynamics of lending to households was slower and the annual changes stand close to the levels as at the end of 2013.