Bank of Albania

TRENDS IN LENDING

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C O N T E N T S

This analysis presents a detailed overview of the most recent lending developments in Albania. To this end, the analysis studies the monetary data on the credit portfolio by economic agents, as well as the lending standards. In more details, lending standards will be addressed in both price - interest rate - and non-price terms. In addition, this analysis presents 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 of lending activity 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 for the countries in the 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 23 April 2015, which include information for monetary and financial data for February 2015 and data from the bank lending survey 2015 Q1.

[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 the "Monetary and Financial Statistics Manual" of the International Monetary Fund, 2000 ed.

SUMMARY

Bank lending in January - February 2015 continued to be sluggish, reflecting in part the seasonal effect of this period of the year and banks' balance sheet cleaning from non-performing loans. Regardless of the improving trend in the longer term, lek lending appeared weaker in this quarter. Foreign-currency lending showed a more pronounced fall, cleaned from the exchange rate effect.

Lending to businesses appeared downward in January-February. In the short term, lending to business contracted, due to the sluggish seasonal activity during the period. In a longer-term context, business demand for financing remains weak, conditioned by the presence of unutilised capacities and businesses low appetite for investment. From the supply side, only a few banks respond to business demand for loans, concentrated in certain segments of the economy. Banks report tightening of lending standards for businesses, and a similar trend is expected to continue in the second quarter of the year.

Lending to households performed better than both in the previous quarter and the previous year, although it remains fragile. Households demand in this quarter is oriented mainly for house purchase, driven by attractive offers from banks for this product. Banks report demand for consumer loans slowed down. Consumers' confidence indicator also appears downward in this quarter, and banks report that the easing of lending standards decelerated and were slightly tightened for this segment.

Interest rates on loans remained low, despite the slight seasonal increase in January - February. The interest rates rose both in the lek and foreign currency segments, after a long period of easing. In December, they recoded overall the lowest historical levels.

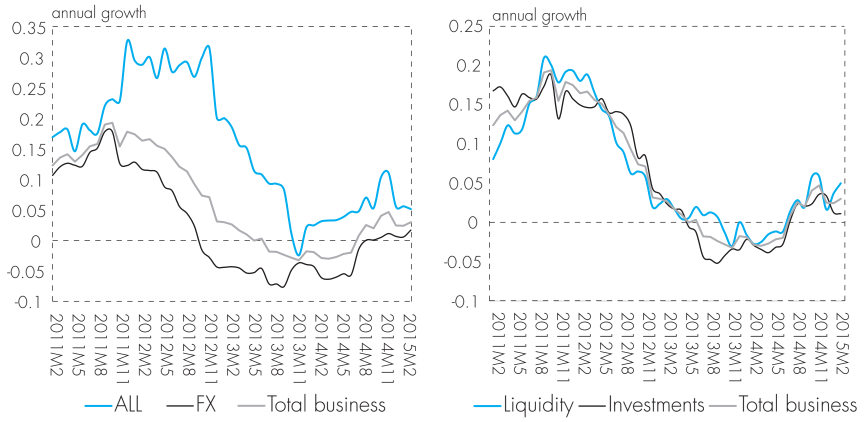
A comparative analysis of loans in the countries of the region shows a gradual improvement at the beginning of 2015. Geographical differences, however, remain. Central European countries show clear and steady tendency of credit recovery, both for businesses and households. Excluding FYROM, lending in the other Balkan countries is not recovering yet, mainly as a result of the sluggish performance of business loans. Among the other Balkans countries, Albania is ranked better with regard to business loans and close to the average with regard to household loans.

1. LENDING TO BUSINESSES

Lending to businesses appeared sluggish in January-February 2015. In absolute terms, it contracted for both investment and liquidity purposes. In this period, some non-performing loans were written off from banks' balance sheets. In the meantime, banks report for tightening of lending standards for businesses in the first quarter of the year. A similar trend is expected to persist in the second quarter.

The business loan portfolio was up 2.8% annually in February against 2.4% at the end of the previous year. But, cleaned from exchange rate fluctuations, the increase is lower, 0.6% (from 1.2% in December 2014). The weak increase in this portfolio reflects the weak business demand for financing, conditioned by the sluggish recovery of economic activity and businesses' uncertainties for the outlook. From the supply side, banks maintain their conservative lending policies. At the end of February, the annual growth of the credit portfolio for liquidity and investment purposes stood at 5.0% and 1.1%, respectively.

Chart 1 Annual increase of lending to businesses, by currency and purpose of use

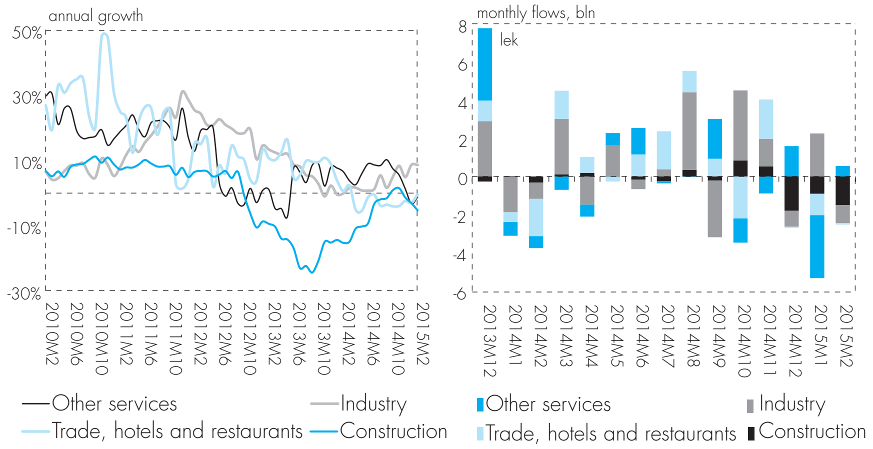


Source: Bank of Albania.

Monthly credit flows for businesses resulted downward in January and February, for outstanding loans denominated both in lek and foreign currency. By purpose of use, the investment loan portfolio contracted most, with the working capital loan portfolio contracting to a lesser extent. Demand for funding for investment purposes continues to appear volatile and unsteady. In the meantime, credit for liquidity purposes was driven by seasonal developments and the lower flow of new loans in average terms, compared to the previous quarter.

Lending expanded mainly concentrated in the industry sector. This sector posted 8.6% growth, year on year. The constant expansion of lending to the industry sector contributed to the growth of its share in the loan portfolio for businesses

Chart 2 Credit by sector of the economy



Source: Bank of Albania.

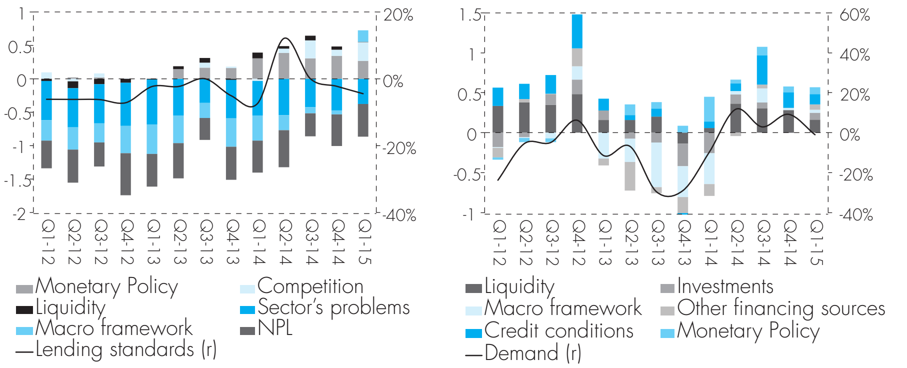
to 30.4% in February. The subsector of the extractive and processing industry recorded growth in credit outstanding in the first quarter. The transport and telecommunication sector also recorded positive growth rates 3.9% at the end of February, although its share in the credit outstanding for business is small. In the meantime, fall in net flows of the total loan portfolio for businesses in January-February affected mainly construction, other services and trade, hotels and restaurants. Even in annual terms, at the end of February, these sectors fell 5.3%, 1.2% and 0.4% respectively. Notwithstanding the fall, the sector of trade, hotels and restaurants decelerated significantly the downward rate in annual terms, reflecting the increase in new loans granted to this sector. In the meantime, the weak performance of the construction sector continues to reflect problems characterising this sector.

In the first quarter of the year, banks tightened the standards of lending to businesses even further, dictated by the high level of non-performing loans and problems facing specific sectors of the economy.[2] The tightening of lending standards has determined the banks selective approach to finance business projects. Tightening has affected lending to larger businesses, mainly in the segment of loans for liquidity purposes. Banks expectations for the second quarter are oriented towards further tightening for lending to both small and medium-sized enterprises and corporations. This tightening is expected to be significant especially in the segment of loans for investment purposes as well as for working capital.

The factors contributing to the easing of lending standards are competition in the banking market, accommodative monetary policy and improved economic situation. For the first time, after a long period. the macroeconomic situation is perceived as positive by banks, in line with the signals for overall improvement of the macroeconomic situation in Albania.

[2] *More details about lending are given in the quarterly bank lending survey: http://www.bankofalbania.org/web/Bank_lending_survey_5311_2.php?kc=0,22,15,2,0*

Chart 3 Changes in credit demand and supply for businesses and factors affecting them*



*Charts are built with data (balance of answers, in percentage points) from the bank lending survey. Positive/negative balances mean easing standards (upward demand) / tightening standards (downward demand).

Source: Bank of Albania.

Business demand for loans in the first quarter is assessed as downward, but expected to improve in the next quarter. According to banks, it has been driven by the fall in demand from small and medium-sized enterprises and demand for working capital. Demand for short-term financing to liquidity fell after a one-year period, driven also by the tightening of lending standards for this segment in the first quarter.

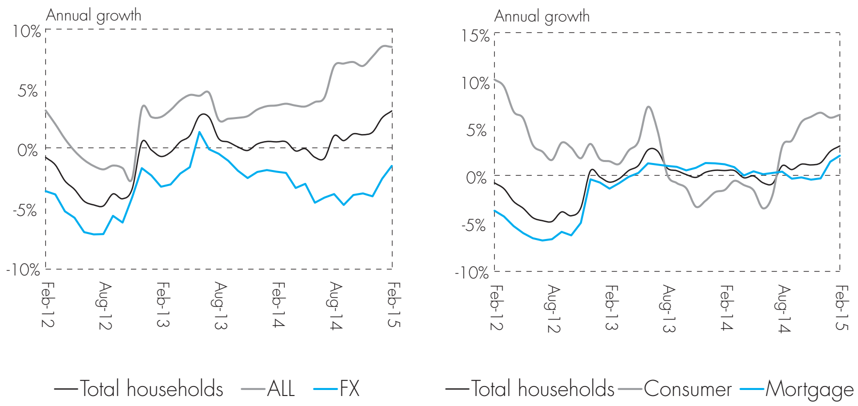
2. LENDING TO HOUSEHOLDS

Lending to households showed signs of a slight improvement in the first quarter. While the annual rate improved, households demand for loans remains sluggish. Banks report tightening of lending standards in the first quarter for both consumer and mortgage loans.

The loan portfolio for households has generally pursued an upward, though moderate, trajectory since August 2014. At end February, outstanding household loans stood 2.6% higher than a year earlier. The annual performance of lending to households reflects mostly the sluggish performance of mortgage loans (2.1% yoy), which has the largest share in this portfolio. Meanwhile, developments in the consumer credit portfolio point to its annual growth by 6.4%. In the short term, the mortgage loan portfolio expanded in the first quarter, against the contraction of the consumer credit portfolio. The latter was dictated by the tightening of lending standards for this segment after a long period of easing.

By currency, lending to households continued to shift toward the national currency, driven by banks policy to lend in the same currency of the borrower's income, as well as by the small difference in the interest rate. The annual expansion of lek lending to households improved steadily, recording 7.9% in February, in annual terms. The absolute changes in this portfolio showed

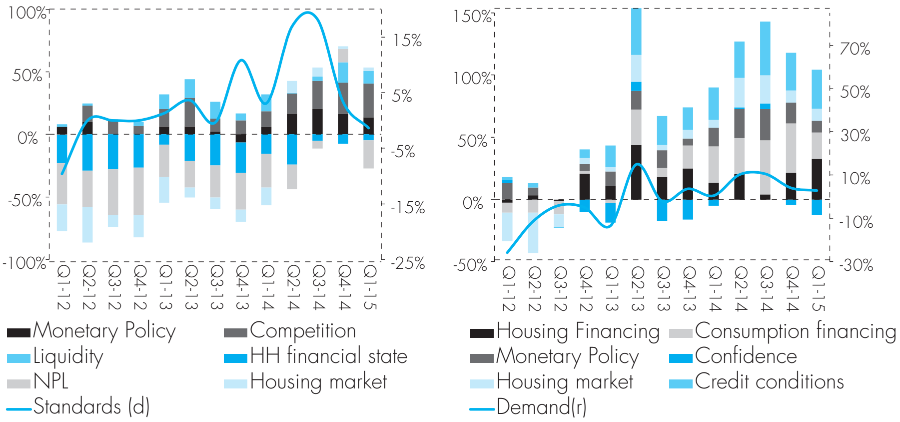
Chart 4 Annual increase of lending to households, by currency and purpose of use



Source: Bank of Albania.

a modest increase in January-February, by ALL 0.3 billion. Foreign-currency lending to households continued to contract, but at slower pace. As at end-February, this portfolio stood 2.3% lower than a year earlier. Its performance is broadly determined by the performance of mortgage loans, which increased in January-February, due to competitive offers by banks during this period.

Chart 5 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.

After easing the standards for some consecutive quarters, banks decelerated this trend, pursuing a slightly tightening policy in lending to households during January-February. The level of non-performing loans and households financial situation were the main factors underlying banks decision to tighten the standards. On the other hand, inter-bank competition, the accommodative stance of Bank of Albania's monetary policy and the good liquidity situation in the banking system have contributed to the easing side of lending standards.

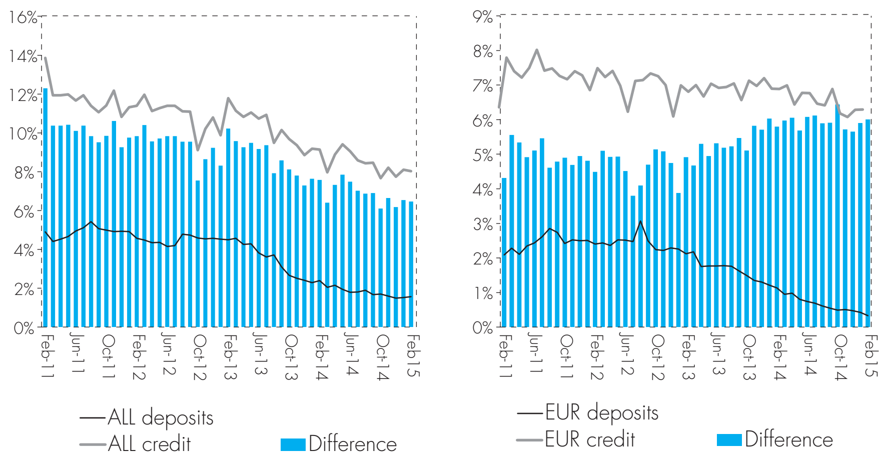
Households demand for bank loans, albeit positive, appears decelerated in January-February. This behaviour was mainly dictated by the deceleration of demand for consumer credit, with the fall in consumer confidence being the factor having the largest share. Other factors such as lending standards, households needs to finance consumption and house purchase contributed to the recovery side of lending. In the next quarter, banks expect households demand for loans to recover.

3. CREDIT PRICE AND OTHER STANDARDS

Interest rates on loans in January-February stand slightly higher than at the end of 2014. This difference reflects mostly the seasonal fall in interest rates in December. The spread between interest rates on loans and deposits expanded also for both the lek and the euro. The more decelerated increase in interest rates on deposits versus loans has driven the slight increase of the intermediation margin. In addition to the increase in interest rates, banks report tightening of lending standards, especially for businesses.

Interest rates on loans were slightly up in January-February[3]. The increase was more significant for lek loans, which recorded an average rate 8.06%, against 7.87% in the previous quarter. Notwithstanding the temporary fluctuations in the interest rate on lek loans, it showed overall a downward trajectory in the past four-five years, following the accommodative monetary policy implemented by the Bank of Albania. The same trend is noted in interest rates on lek deposits; in this segment the accommodative monetary policy has been transmitted more rapidly and fully. Short-term fluctuations of interest rates point to a slight increase of lek deposits during January-February, compared to the lowest historical level of lek deposits registered in December. The intermediation margin also rose

Chart 6 Interest rates in lek (left) and euro (right)



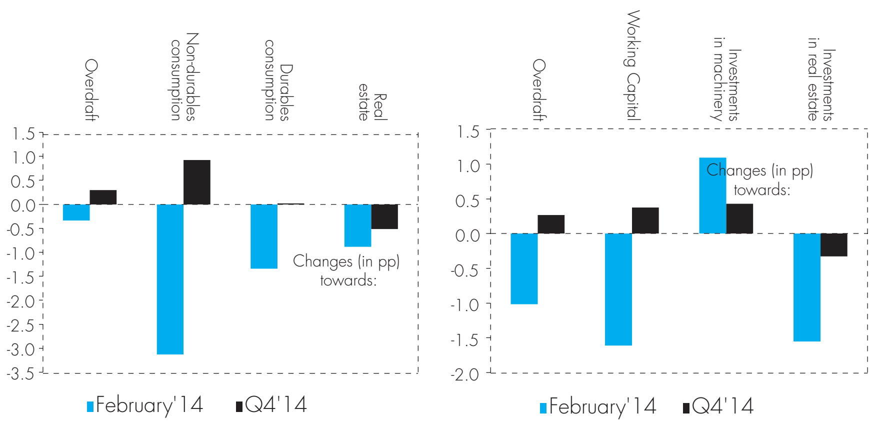
Source: Bank of Albania, European Central Bank.

[3] *This increase is related mainly to the low amount of loans granted at preferential rates in January-February, compared to the end of 2014.*

slightly; however, it remained low, at 6.46 percentage points in February. Moreover, the faster fall of interest rates in lek against those in euro oriented the economic agents demand for funding towards the national currency.

The interest rates on lek loans, in January-February, increased for both households and business loans. This increase was noted mainly in the segment of short-term credit. Interest rates on loans by purpose of use show a more significant increase in the rates on household loans for non-durable consumer goods (0.9 percentage points) and of rates on overdraft against the end of the year. The increase in interest rates on lek loans to businesses was less significant, mainly for the segments of financing short-term liquidity and equipment purchase, reflecting also the seasonal effect in the period. Compared to the previous year, across almost all credit segments, interest rates denominated in lek are downward, 1.14 percentage points on average.

Chart 7 Change of interest rates on lek loans for households (left) and businesses (right)

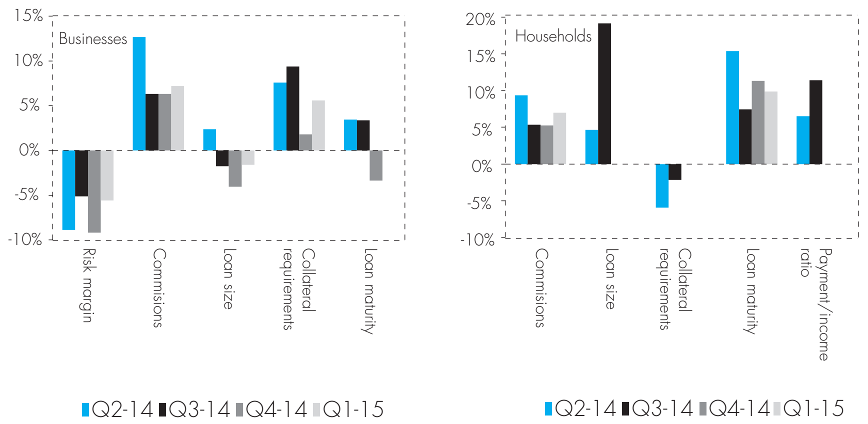


Source: Bank of Albania.

Interest rates on euro loans also increased for the end of the previous year. In January-February, the rate averaged 6.33%, from the 6.12% all-time low registered in December. The increase was driven mainly by the expansion of interest rates in the segment of liquid credit, both for businesses and households. However, compared to February 2014, the interest rates on euro loans stood 0.6 percentage point lower. Meanwhile, the more decelerated fall in interest rates on euro loans compared to lek loans contributed to the narrowing of the spread between them. In January-February, the spread expanded slightly, to 1.7 percentage points on average from 1.4 percentage points in the last quarter of the year; however, from the long-term perspective, it remains low, contributing to better monetary policy transmission.

From the deposits side, lek interest rates rose slightly, from the historic low rates recorded at the end of the year. Thus, the average rate on lek deposits in January-February averaged 1.54% from 1.48% in December. In the meantime, interest rate on euro deposits continued to trend down. In February, the interest rate on euro loans fell to the record low of 0.33%. It fell by 0.14 percentage point compared to end-December, and around 0.81 percentage point compared to the same period in the previous year. The low interest rates in international markets, ample liquidity and the scarce foreign currency lending remain contributing factors to banks decisions to lower interest rates on deposits.

Chart 8 Non-price standards applied to businesses and households, in percentage points*



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

In addition to the slight increase in interest rates, banks report tightening of lending standards for businesses and to a lesser extent for households. Lending standards for businesses continued to tighten for the second quarter consecutively. The increase in the margins for risk-bearing loans has contributed to the tightening of the standards for businesses. On their side, banks reduced commissions and collateral requirements, which have contributed to the easing of lending standards.

Banks also report slightly tightening lending standards for households. Collateral requirements have contributed to the low tightening. The reduction of commissions and extension of term to maturity have contributed to the easing of lending standards.

4. TRENDS IN LENDING IN THE COUNTRIES OF THE REGION[4]

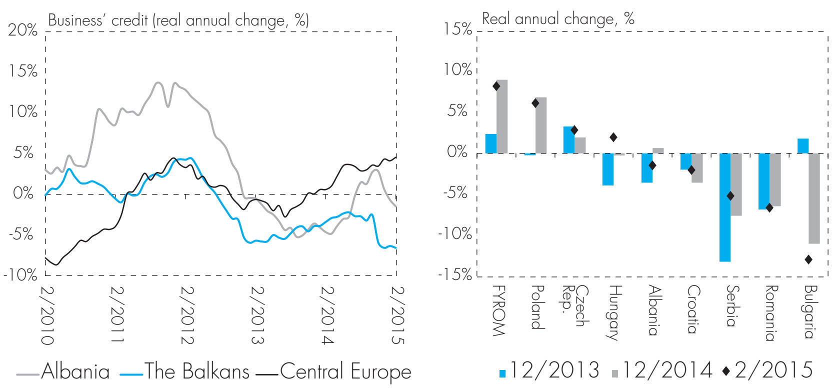
In the region, lending to the private sector continued to improve gradually at the beginning of 2015, but the improvement remains segmented. Central European countries and the FYROM differ significantly from the rest of the Balkan countries, characterised by steady credit growth for both businesses

[4] *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.*

and households. Compared to other Balkan countries, Albania performed better with regard to lending to businesses, and in line with the average of these countries with regard to lending to households.

Lending to the private sector continued to trend up, though gradually, in the first two months of the year. In real average terms, annual growth reached 2.5% in the first two months of the year, from 2.1% in the fourth quarter of the previous year. The improvement was driven by the credit recovery for households, which is performing better than business credit, across almost all the countries in the region. By geography, credit recovery for the private sector is not uniform. In Central Europe and the FYROM, credit is growing steadily, whereas in the rest of the Balkan countries, the recovery of positive credit pace remains slow. Among the main factors contributing to this difference is the strategy of parent banks to reduce operations in their subsidiaries in these countries. This approach has been more present in the Balkans than in Central Europe and is expected to persist in 2015, though to a lesser extent.

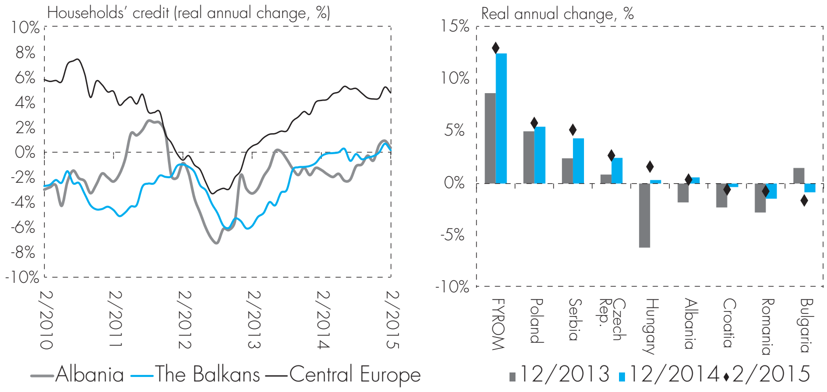
Chart 9 Real annual growth of credit stock to businesses



Note: The Balkan region includes Serbia, FYROM, Croatia, Bulgaria and Romania. Central Europe includes the Czech Republic, Poland and Hungary. Annual growth for each region is calculated as the weighted average with the share of the credit portfolio in the total credit for the region.
Source: Bank of Albania, central banks and respective statistics institutions.

Aggregate developments for lending to businesses in the region appeared stable in the first two months of the year. The real annual growth (weighted average) for the region was 0.6%, similar to that in the last quarter of the previous year. The overall situation continues to be characterised by different developments across the countries. Credit growth for businesses is driven by the positive and steady developments of this portfolio in Central Europe (Poland, the Czech Republic, Hungary). In Balkan countries, however, lending to businesses continues to shrink in real terms in most of the countries, although in some of them the pace is slower than before. Unlike the other countries in this group, the FYROM has seen a high and steady growth of lending to businesses over the past two years. Lending to businesses in Albania is evidently better than in the rest of Balkan countries, but the weakness it showed at the year start, does not confirm a steady trend of recovery yet.

Chart 10 Real annual growth of credit stock to households



*Note: The Balkan region includes Serbia, FYROM, Croatia, Bulgaria and Romania. Central Europe includes the Czech Republic, Poland and Hungary. Annual growth for each region is calculated as the weighted average with the share of the credit portfolio in the total credit for the region.

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

Lending to households is the main source of credit growth in the region. In the first two months of the year it grew 4.0%, in real terms, improving from the fourth quarter of the previous year. The improvement is present across almost all the countries. Similar to lending to businesses, Central European countries lead credit recovery for households. Again, the FYROM has seen the fastest and steadiest growth of this portfolio. In average (weighted) terms, lending to households in Balkan countries is showing recovery signals, registering positive growth rates. Lending to households in Albania has been weak for the most part of the previous year. But, its recovery at the beginning of the current year ranks Albania close to the average of the other Balkan countries.