Bank of Albania

TRENDS IN LENDING
Q2 - 2016

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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 an overview of the most recent trends in lending in Albania. To this end, the analysis studies the monetary data on the credit portfolio, as well as lending standards. In addition, the analysis includes an overview of most recent trends in lending in Central, Eastern and South Eastern European (CESEE) countries.

The main statistics taken into account in this analysis are:

- *Data on the lending activity for the resident sector of the economy;*
- *Qualitative data from the bank lending survey;*
- *Statistics on credit price both for the Albanian lek and the euro;*
- *Monetary data for the credit volume for the regional countries. The countries included in the analysis are: Bulgaria (BU), Croatia (CR), Romania (RO), Serbia (SR), Poland (PL), Hungary (HU), the Czech Republic (CZ), and Macedonia (FYROM).*

The analysis covers data published as at 20 July 2016, including information for monetary and financial data for May 2016 and data from the bank lending survey for the second quarter of 2016.

SUMMARY

Credit to the private sector grew steadily in April-May, although its rates remain still moderated, around 2.5%. Lending improved driven largely by the positive developments in the portfolio of loans to enterprises. Loans to households also showed increase, albeit more slowly compared with the previous quarter. Lending in lek continues to be stable, providing the main contribution to the expansion of credit surplus.

Loans to enterprises showed 2.1% average annual improvement in April-May, compared with the 1.9% growth in the first quarter. However, enterprises' demand for financing remained largely unchanged, while credit conditions tightened during the second quarter. Investment loans provided the main contribution to the expansion of loans to enterprises, mainly concentrated in May, while loans for liquidity purposes slowed down. Lending by currency shows the concentration of growth in local currency.

Loans to households increased around 3.5% in April-May, supported by further easing of the credit conditions and increased demand. The expansion of loans to households is fully supported by lending in the local currency, offsetting the contraction of the surplus in foreign currency. By purpose of use, mortgage loans saw steady annual growth, while consumer loans slowed down.

Interest rates on credit in April and May decreased, compared to both the previous quarter and the previous year. The decline in interest rates in lek remains more prominent in consumer loans to households, as well as mortgage loans. Banks have lowered the applied margins for normal risk loans and commissions, but continue to implement their tightening policies through the majority of the non-interest lending standards.

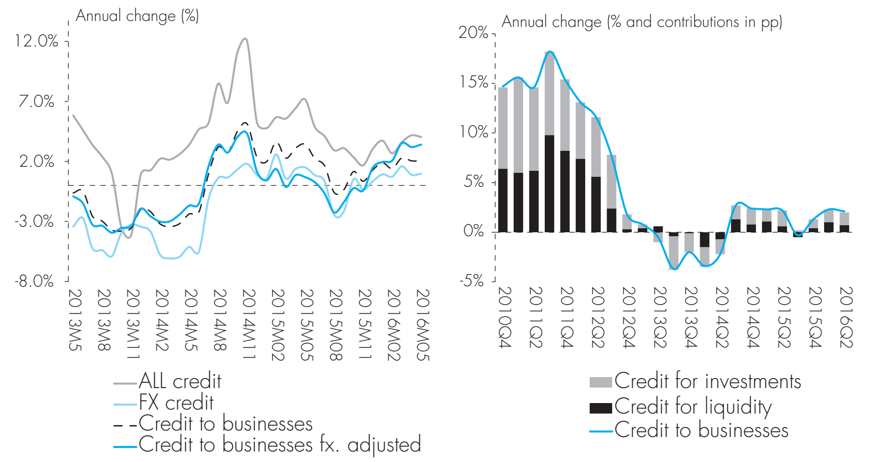
Credit to the private sector continues to gradually improve across the region, driven by the faster recovery of loans to households. Growth continued to be stronger in the Central European countries, and its acceleration in the Balkan countries has narrowed the gap between these two regions. In comparison with other Balkan countries, Albania is ranked best in terms of loans to enterprises, but lags behind in the growth of loans to households.

1. LOANS TO ENTERPRISES[1]

Loans to enterprises showed improvement in 2016 Q2. Its monthly expansion has been fluctuating, but the annual dynamic has confirmed the positive trend started in the beginning of the year. Given the trend of the exchange rate as well, this dynamic is significantly more positive than 2015. The expansion by 2.1% of this portfolio is supported mostly by the improvements in the trend of the loans for investments. The banks continue to pursue conservative policies toward loans for enterprises, and their standards have tightened during the second quarter. Enterprises demand for financing is weak, especially in the corporation segment. For the third quarter, the banks expect an easing in the lending standards and a growth of demand only in the segment of small and medium-sized enterprises.

Loans to enterprises in April and May grew by ALL 4.5 billion, among the highest rates registered in the last two years. The main contribution came from loans for investments, which showed a relevant growth in May. In these two months, the portfolio of loans to enterprises expanded by 2.1% on average, compared with the previous year, an improvement against the 1.9% growth in 2016 Q1. However, the annual dynamics of the corporate loans portfolio was also affected by the appreciation of the Albanian lek against the euro, due to the dominance of the portfolio by foreign currency credit. Excluding the effect of the exchange rate, the developments in loans to enterprises surplus improved during 2016 H1. The annual growth by 3.4% in this portfolio is the highest registered in this segment in the last two years. Lek loans provided the main contribution to the improvement of loans to enterprises. The annual expansion of this portfolio improved at 4.2% for 2016 Q2. In May, lek loans to enterprises accounted for 36% of the total, or 0.7 percentage point higher than the same period in the previous year.

Chart 1 Loans to enterprises by currency and purpose

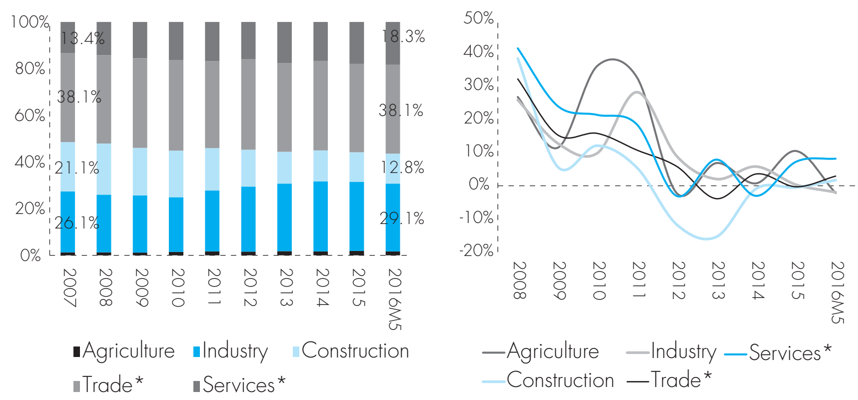


Source: Bank of Albania.

[1] *The data for loans to enterprises exclude the efekt of loans reclassified outside the balance sheet.*

By purpose of use, the expansion of loans to enterprises is supported by loans for investments, being also in line with the higher contribution by private investments to economic growth in Albania. The annual changes of loans for investment purposes showed an improvement to 2.7% in May, against 2.5% in March, while those for the loans for liquidity slowed down to 1.4% against the 2.1% in March.

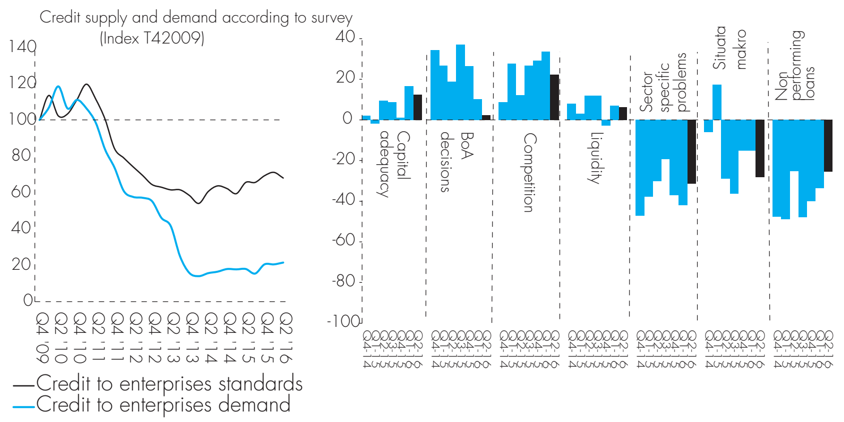
Chart 2 Loans for enterprises by sector of the economy



*Including trade, hotels and restaurants sector; services include all services' sectors excluding these.
Source: Bank of Albania.

By sector of the economy, the portfolio of loans to enterprises is dominated by loans to trade, hotels and restaurants. The share of this sector reached 38.1%, providing the main contribution to the expansion of the portfolio of loans to enterprises in 2016 Q2. This portfolio recorded 2.9% annual growth at the end of May. Loans to the construction sector showed improvement as well, growing by 1.7% compared with the previous year and accounting for 12.8% of loans to enterprises as at the end of May. Meanwhile, loans to the

Chart 3 Standards and demand for loans to enterprises*



*Data in the chart represent the cumulative net balance index (Q4'09=100) calculated based on bank lending survey results https://www.bankofalbania.org/previewdoc.php?file_id=8629
Source: Bank of Albania.

industrial sector shrank by around 2%, year on year. This performance seems to be mainly driven by the reduction of loans to the energy production and other fuels sub-sector. These sectorial developments of enterprises' financing are in line with the economic activity trend of each sector.

The analysis of the bank lending survey results for 2016 Q2 shows that banks have tightened the standards for loans to enterprises during this period. The main contributing factors are considered to be the macroeconomic situation and credit risk, as observed by the performance indicators of the non-performing loans of the banks. Despite the reduction, the ratio of the non-performing loans remains high. Structural problems in specific sectors of the economy affect the conservative policies the banks apply to enterprises. For the third quarter, banks expect lending standards to ease only for the small and medium-sized enterprises, in line with their lending policies to expand the portfolio in this segment. In line with these developments, they expect demand to grow for loans to enterprises in the third quarter, which is expected to be generated by small and medium-sized enterprises.

2. LOAN TO HOUSEHOLDS[2]

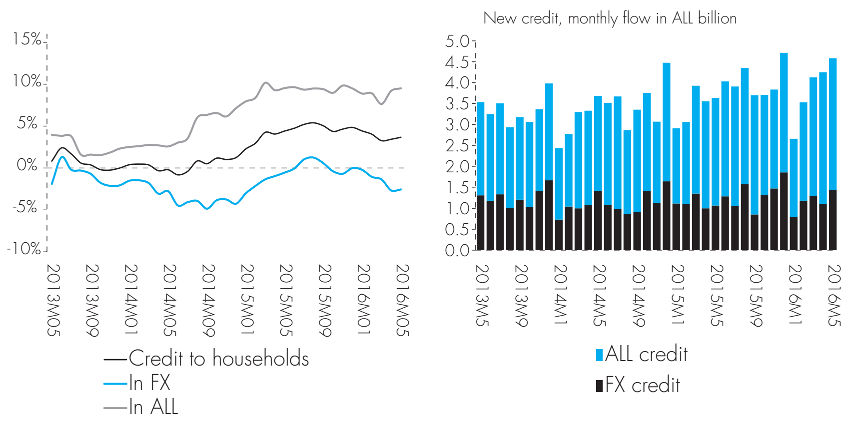
Loans to households continued to show steady growth in 2016 Q2. The continuous improvement of lending standards in the last years contributed to the positive trend of the portfolio for loans to households. Its expansion in annual terms is supported by consumer loans as well as by mortgage loans. The lek loans fully supported the expansion of the portfolio of loans to households. The banks report for a growth of demand for credit in 2016 Q2. For the third quarter of 2016, banks expect credit conditions to ease and households demand for loans to increase.

Loans to households grew by around 3.5% in April-May, comparatively lower than the average rate of 3.9% in 2016 Q1. This trend is dictated by the slowdown of consumer loans during April-May. In annual terms, consumer loans grew around 10.8%, against 12.4% in 2016 Q1. In monthly terms, the expansion of loans to households is supported mainly by mortgage loans. The performance of this portfolio results stable, reflecting the increased supply for this segment with products at favourable standards. Although the banks report growth of demand for mortgage loans in the last quarter, the expansion of this portfolio remains sluggish. The annual growth rate of mortgage loans fluctuated around 2.5% in April-May, resulting lower than the 3% average rate registered in 2016 Q1.

The trend of loans to households by currency is fully supported by the loans denominated in the domestic currency. Loans to households in lek increased by 9.3% on average in April-May, thus offsetting the contraction of foreign currency loans. Loans shifted toward the domestic currency driven by both demand and supply factors. On the demand side, the process of formalization has affected the approach of new clients to the banking system, promoting the demand for credit in accordance with the currency of their income. At the same time, the economic agents have become aware of the risk of exposure to the exchange rate for loans in foreign currency. On the supply side, the reduction of the spread of interest rates between lek and euro loans, as well as banks' policies for attractive supply in the domestic currency have increased the attention for borrowing in the domestic currency. Credit in lek shares around 54.5% in the total loans to households, showing a further growth compared with the 51.6% at the same period in the previous year. On the other hand, outstanding foreign currency loans fell by around 2.6%, on average, in April-May. This trend reflects the low demand for foreign currency loans, which is confirmed by the small growth of new foreign currency loans. The contraction of the portfolio of foreign currency loans to households materialized in both consumer loan and mortgage loan portfolios. However, the performance of this portfolio has also reflected the appreciation of the lek against the euro. Excluding this effect, the annual reduction of foreign currency loans to households would be lower. The total portfolio of loans to households, excluding the effect of the exchange rate, would show 4.7% an annual growth.

[2] *Data for loans to households exclude the effect of loans written off from the balance sheet.*

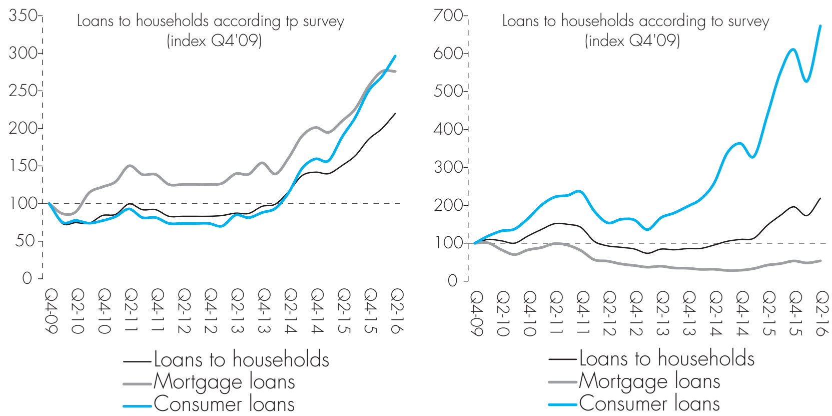
Chart 4 Trend of loans to households by currency
(growth and new credit)



Source: Bank of Albania.

Bank lending survey results confirm the easing of standards for loans to households in 2016 Q2. The easing of lending standards is supported by the good situation of liquidity of the banks and the adequacy of their capital. In line with the standards easing, the banks report that households have increased the demand for financing during this period, which has been observed also for the growth of new credit given to households in the months April-May. The households demand for loans in the 2016 Q2 is estimated to driven by their need for financing consumption and house purchase as well as by the easing of lending standards and the decisions of the Bank of Albania. Unlike in 2016 Q1, other factors such as developments in the real estate market and alternative sources of financing have contributed positively to boosting households' demand for loans.

Chart 5 Standards and demand for loans to households by purpose of use*



*The cumulative net balance index (Q4'09=100) is calculated based on the results of the credit activity survey. *https://www.bankofalbania.org/previewdoc.php?file_id=8629*

Source: Bank of Albania.

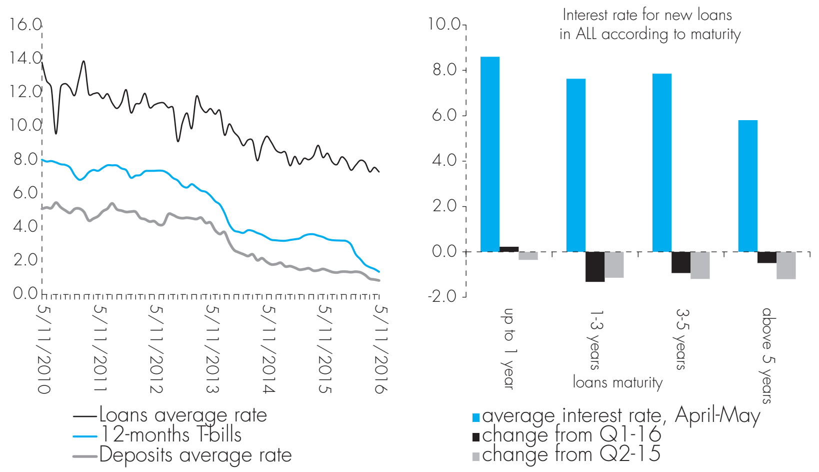
3. CREDIT PRICE AND OTHER LENDING STANDARDS

The credit interest rates fell in April and May, from both the previous quarter and the previous year. The decrease of the interest rate on lek-denominated credit remains more pronounced for households' consumer and mortgage loans. Banks lowered the applied margins for credit with normal risk and commissions, while they apply tightening policies through the major part of non-interest standards of lending.

The interest rate on lek loans decreased in April and May[3], respectively 6.00% and 7.29%. The value particularly low in April is related to the short-term financing of a public company. Excluding this loan, the average interest rate for April results would be 7.56%. In average terms, lek loan interests in April and May stand around 0.2 percentage point lower than in 2016 Q1, and around 1.0 percentage point lower than in 2015 Q2.

The intermediation margin – the difference between the credit interest rate against the deposits one – has been stable over the first five months of the year, fluctuating around its average value of the last four years, at 6.6 p.p. The accommodative monetary policy of the Bank of Albania has been equally reflected in bank price policies, both in lending and in deposits accumulation. The interest rate for the latter decreased in April and May as well, resulting on average in 0.87%, from 1.14% registered in 2016 Q1.

Chart 6 Interest rates on lek loans



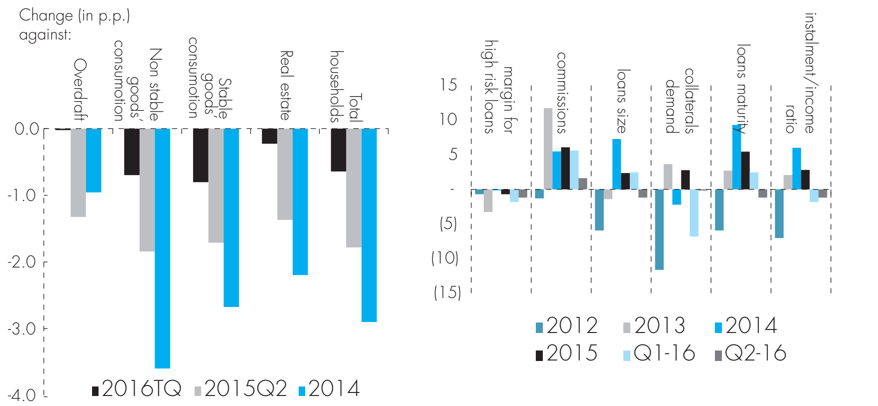
Source: Bank of Albania.

The reduction of the interest rate remains more relevant in the loans to households. Their average interest rate in April and May stood around 0.64 percentage point lower than the first quarter and around 1.78 percentage

[3] *All the continuing calculations exclude the abovementioned loan to the public company.*

points lower than the previous year. In these months, households benefited from lower rates particularly on consumer loans. Meanwhile, the interest rate for mortgage loans decreased a little and that for overdraft loans remained unchanged from the first quarter.

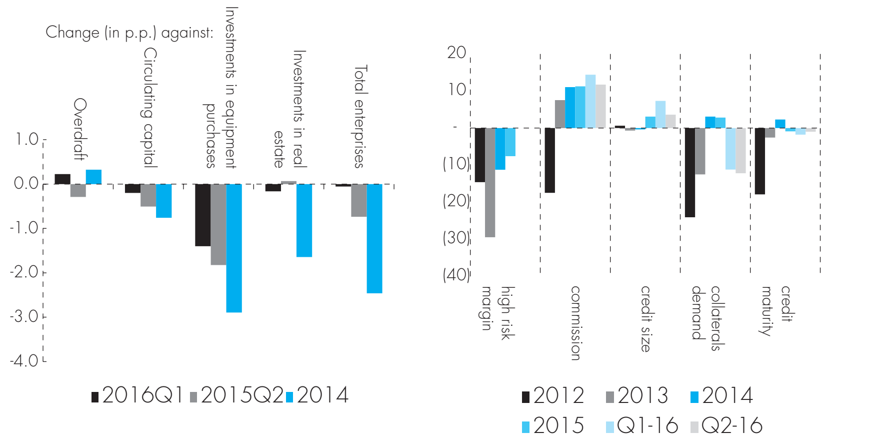
Chart 7 Change of interest rates in ALL (left) and trend other lending standards* (right) to households



*The positive/negative balances mean standards' easing/tightening.
Source: Bank of Albania.

Banks eased further the lending standards for households in 2016 Q2. In addition to lowering the interest rates, they have also implemented lower commissions. On the other hand, banks admit to an increase in the applied margin for risk-rated loans. Other non-interest standards have trended mainly toward the tightening side, although with minor changes compared with the previous quarter. Thus, credit size, its maturity and the instalment/income ratio have been used by the banks in lending to households.

Chart 8 Change of interest rates on ALL loans (left) and other lending standards (right), enterprises

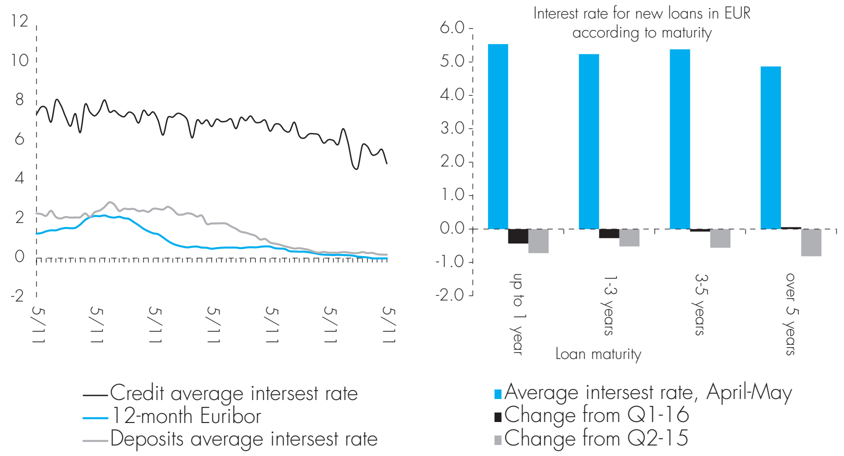


Source: Bank of Albania.

The average interest rate for lek loans to enterprises for April and May remained largely unchanged from the average level registered in 2016 Q1. However, its stability in these two months reflects a different trend of the interest rates by purpose of the loans. Thus, interest rates for loans for investments decreased significantly compared with the previous quarter. The interest rates for real estate financing and those for working capital showed a slight decrease, those for overdraft loans rose. Compared with the previous year, the interest rate for loans to enterprises was around 0.74 percentage point lower, reflecting the higher decrease of the interest rates for investment loans.

Banks were more conservative for loans to enterprises compared with loans to households. They report for a further tightening of lending standards for enterprises 2016 Q2, realized mainly through the increased collateral requirements and marginally through the decrease of the loan maturity. Meanwhile, the decrease of commissions and increase of loan size had an easing effect on lending standards to enterprises.

Chart 9 Interest rates on euro loans



Source: Bank of Albania, European Central Bank.

The interest rates on euro loans in April and May were 5.54% and 4.23%, respectively. Interest rates in May were affected by a loan at particularly low rate. Excluding this loan, the interest rate for May resulted in 4.82%. In average terms[4], the interest rate on euro loans in these two months was around 0.24 percentage point lower than in 2016 Q1, reflecting the reduction of the interest rate for short-term (up to 1 year) and medium-term (1-3 years) loans. The interest rates in the other credit segments have remained unchanged from the first quarter. By purpose of use, the reduction of the interest rates on euro loans has been present for liquidity loans to enterprises and consumer loans to households. Fe average interest rate in April and May was around 0.79 percentage point lower than in the second quarter of the previous year, reflecting a reduction across all the segments of the euro loans.

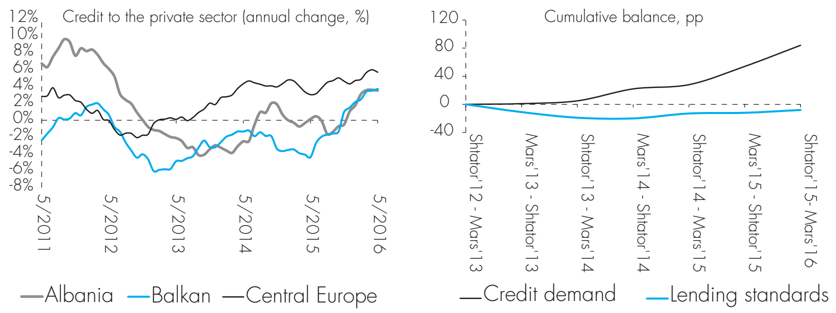
[4] *All the continuing calculations exclude the abovementioned loan in May.*

4. LENDING TRENDS IN THE COUNTRIES OF THE REGION

In the region, credit to the private sector continued to improve gradually in April and May, driven by the faster recovery of loans to households. Credit growth continued stronger in Central Europe countries; however, its growth pace in the Balkan countries has narrowed the gap between these two regions. Compared with other countries in the Balkans, Albania ranks better in loans to enterprises, but lags behind in the growth rates of loans to households.

1 continued to grow in most countries of the region in April and May. Its annual growth resulted 5.1% on average in these two months, from 4.9% registered at the end of 2016 Q1. Credit recovery in the region continues to be supported by increased loans to households, which has performed better than loans to enterprises in almost all the countries. The trend of large banking groups to decrease exposure in the region has continued, but at a more moderate pace. Overall, foreign banks present in the region point to a recovery of the demand for loans, while credit conditions remain essentially unchanged, thereby widening the gap between supply and demand for credit[5] . In the rest of the year, lending standards are expected to ease in the region, in average terms, while responding better to the increased demand for loans.

Chart 10 Credit to the private sector in CESEE countries*



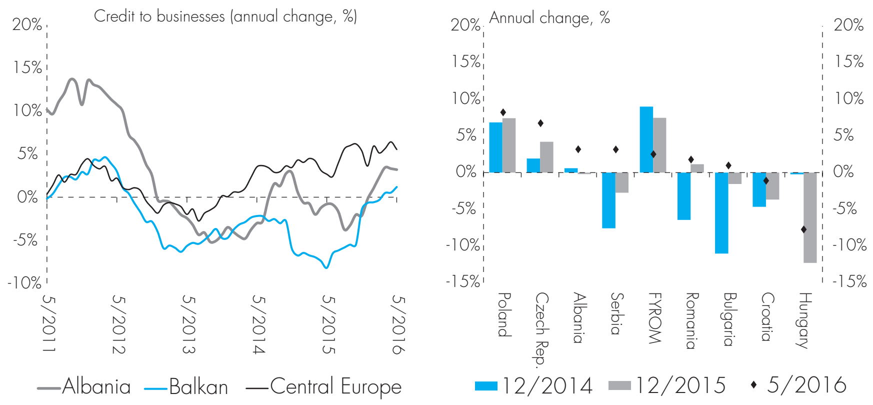
*The Balkan region includes Serbia, FYROM, Croatia, Bulgaria and Romania. The Central European region includes the Czech Republic, Poland and Hungary. In the right chart, the positive/negative balances represent easing (improving) / tightening (worsening) of the standards (for credit demand).
Source: Bank of Albania, central banks and statistical offices of the respective countries. Lending standards and credit demand for the region are taken from the CESEE Bank Lending Survey, European Bank of Investments.

In a regional comparison, credit to the private sector in Albania registered growth comparable with the average of the Balkan countries. It ranks after FYROM, Romania and Serbia, leaving Bulgaria and Croatia behind. Except

5 *CESEE Bank Lending Survey, H1-2016 http://www.eib.org/attachments/efs/economics_cesee_bls_2016_h1_en.pdf*

Hungary, which continues to register a reduction of credit to the private sector, the other countries of Central Europe – Poland and the Czech Republic – have maintained stable growth rates, at higher levels than the Balkan countries. However, the increased pace in the credit of the latter has narrowed the gap between them and Central European countries.

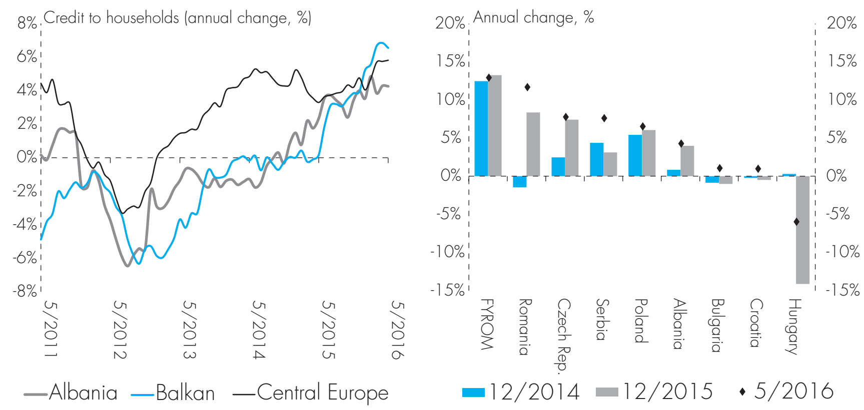
Chart 11 Loans to enterprises in CESEE countries



Source: Bank of Albania, central banks and statistical offices of the respective countries.

Loans to enterprises in the region improved in April and May. It marked 4.1% annual growth on average in these months, from 3.4% in 2016 Q1. Its annual change shifted to positive territory in most of the countries, except Croatia and Hungary, where this portfolio continued to contract, but with moderated rates. Central European countries – Czech Republic and Poland – maintain the best trends for loans to enterprises. Compared with the end of the previous year, we note significant improvement in Albania and Serbia as well. Meanwhile, in FYROM loans to enterprises have continued the slowdown started since 2015.

Chart 12 Loans to households in CESEE countries



Source: Bank of Albania, central banks and statistical offices of the respective countries.

Loans to households continued the steady growth and remain the main driver of lending in the region. In April and May, it grew at 5.8% on average, showing an improvement against the first quarter (4.7%). Unlike loans to enterprises, the Balkan region has seen faster growth of loans to households. Thus, loans to households maintained high growth rates in FYROM and accelerated in Romania and Serbia. In Albania, it remains in the levels registered at the end of the previous year, which are more moderated than those in the above-mentioned countries. Meanwhile, in Bulgaria and Croatia loans to households have shown signs of recovery after a period of contraction. In the Central European countries - Poland and the Czech Republic – loans to households grew at stable rates, while in Hungary they continue to contract, but at a slower pace.