TRENDS IN LENDING

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OCTOBER 2019

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INTRODUCTION

Trends in Lending presents a detailed overview of the most recent credit developments in Albania. To this end, it studies the monetary data and credit conditions based on the Bank Lending Survey. In addition, Trends in Lending includes an overview of the most recent credit developments in Central, Eastern and South Eastern European (CESEE) countries.

Trends in Lending takes into account the following key statistics: a) Data on bank lending activity in the resident sector of the economy; b) Qualitative data from the Bank Lending Survey; c) Statistics on credit interest rates in both lek and euro; d) Monetary data for credit volumes in the countries of the region. The countries covered in the analysis are: Bulgaria (BU), Croatia (CR), Romania (RO), Serbia (SR), Poland (PL), Hungary (HU), the Czech Republic (CZ), and North Macedonia (NMK).

Data on lending are obtained from banks’ balance sheets and refer to funding by domestic banks to the resident private sector - enterprises and households. The loan portfolio analysis is based on data adjusted for the exchange rate effect. Also, these data take into account written-off loans, a process that banks have taken pursuant to Decision No 50, dated 30.03.2015 “On amendments to the Regulation ‘On Credit Risk Management’.

The analysis covers data available as at 21 October 2019, which include information for monetary and financial data as at September 2019, and data from the Bank Lending Survey 2019 Q3. Data on credit in regional countries are of August 2019.

1 Data for September 2019 are preliminary.
OVERVIEW OF RESULTS

Credit to the private sector growth rates improved further in 2019 Q3. This improvement was supported by a broad based, but it has been higher for enterprises and in domestic currency. The expansion of lending activity reflects the increased demand for loans from economic agents for several consecutive quarters. Meanwhile, the active return to the credit market of banks with a change of ownership has led to the improvement of credit supply, as a result of a more favourable approach to enterprises, but also as a result of banking competition boost.

The growth of loans to enterprises in this quarter was driven by the growth of credit to small and medium-sized enterprises (SME), while lending to corporations slightly contracted. From a longer-term perspective, the banking sector has been showing, for a number of years, a more favourable approach to SMEs, as a less credited segment, yet with a potential for contributing to economic development in the future. Sector developments in the loan portfolio show an improvement of growth rates in all sectors of the economy, except from the agricultural sector.

In 2019 Q3, loans to households continued to record stable growth rates. The expansion of this portfolio is supported by the increased demand and the continuous easing of lending terms and conditions in this segment, reflected both in mortgage and consumer loans. Developments in terms of currency reaffirm the demand orientation of households for financing in domestic currency.

Interest rates on new lek loans continued to fall for enterprises, dictated by the decrease of interest rates on liquidity loans. The balance of non-price terms and conditions of loans to enterprises remained unchanged in this quarter. Regarding households, interest rates remained at the same average levels observed during the first half of the year, while non-price terms and conditions slightly tightened this quarter. Overall, banks’ re-activation in lending following the system restructuring process of last year is being reflected in increased competition in the banking system and in decreased interest rates.

Lending activity in the CSEE region shows a relatively steady growth, but yet at moderate levels. The expansion of the private sector credit portfolio continues to be driven by Central European countries, further deepening the geographical breakdown in the CSEE region. Loans to enterprises appear to be relatively volatile, with frequent and relatively short-term acceleration and deceleration cycles for this segment. Loans to households show a consistent growth, both in geographical terms and behaviour during the period.
1. LOANS TO ENTERPRISES\textsuperscript{2}

In 2019 Q3, loans to enterprises showed higher growth rates, supported by lending to small and medium-sized enterprises.

Loans to enterprises improved further the annual growth rates, peaking at 8.2% in September. During 2019 Q3, this portfolio grew by ALL 8.7 billion, the highest growth in the last three years. The expansion of loans to enterprises reflected a steady increase of demand for financing and a more positive approach of banks toward the increased demand from enterprises. Meanwhile, overall credit standards are improved and financial conditions are generally easier\textsuperscript{3}.

The improvement in loans to enterprises reflected the growth of the portfolio of small and medium-sized enterprises (SMEs), on average by 15.5% in 2019 Q3. In absolute terms, this portfolio increased by ALL 9 billion, two times more than the previous quarter. Recovery of demand, coupled with continues easing of credit standards for this segment, supported the expansion of the loan portfolio and the pickup of its share to loans to enterprises, at 47.5%, or 1.3 pp more than the previous quarter. As a ratio to GDP, loans to SMEs increased at 11.3%, or 0.4 pp higher than at the end of 2018. Within the SME segment, the medium-sized enterprises showed the best performance.

Loans to corporates slowed down their annual growth rate to 1.7%, from 5.3% on average, a quarter earlier. Loans to corporates shrank by ALL 0.5 billion during 2019 Q3, taking into account exchange rate fluctuations. The demand for financing from this segment seems to have been stagnant for years now, while banks have not changed the standards for this subgroup.

\textsuperscript{2} Data for loans to enterprises are adjusted for written off loans and exchange rate volatility.

\textsuperscript{3} Information on rejected loans indicates that banks have decreased the number of rejected loans, especially to enterprises. For more on lending standards and loan demand see Lending Activity Survey.
From a longer-term perspective, banks appear to apply tighter standards to corporates compared to SMEs, the credit standards for the latter have generally been on the easing side since 2015. The preference of banks for SMEs is related not only to the need for a better balancing of the enterprises portfolio toward SMEs, but also to the increase of this segment’s formalization in recent years, the smaller use of financial leverage, as well as its support with projects from international institutions. This segment of enterprises, as mentioned in many documents of international institutions (World Bank, OECD, etc.), is underfunded and its access to finance is limited. Increase of funding for this segment would not only enable a more effective support of the economy by the banking sector, but also create premises for the growth of these enterprises on sounder basis.

- The improvement of loans to enterprises has reflected higher lending to trade, industry and services sectors, in line with economic activity growth in these sectors.

Broken down by sector, credit to industry showed a significant improvement, by about 15.7% year-on-year. An important factor in this improvement is related to the lending to “Electricity, gas, steam and air conditioning supply”, driven by the energy situation in the country. Excluding this effect, the growth of loans to industry were at moderate levels, close to the average growth rate of the first half of the year. Other sectors of the economy showing improved credit growth rates are trade, services and construction, recording 8.3%, 3.2% and 2.5%, annual growth, respectively, in September. Agriculture was the only sector whose portfolio shrank, by 3.5% in annual terms.

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*The chart on the right shows the 3 year average of net balances according to the Bank Lending Survey.
Source: Bank of Albania.

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**SME Policy Index for the Western Balkans and Turkey** - OECD September 2019.
**Interest rates on loans to enterprises** fell in 2019 Q3, while non-price terms did not change.

The average interest rate on loans to private enterprises in lek decreased further in 2019 Q3 - at 6.1% from 6.4% in 2019 Q2. In the last two quarters, rates were lower than in 2019 Q1 and the average of the previous two years, of 6.7%. By purpose of use, interest rates on loans to enterprises for liquidity purposes declined, mainly in the segment of overdraft loans. This rate was 6.3%, down from 6.8% in the first two quarters of the year and from 7.0% in the previous two years. Interest rates of loans for investment purposes, increased in this quarter to 5.7%, from 5.2% in 2019 Q2, but were lower than in 2019 Q1 (6.6%). They were more volatile during 2019 and were on average 0.2 pp - 0.4 pp higher than their average in the previous two years.
Analysis by bank size shows that the group of small banks offer better interest rates than the large banks, for all types of loan to enterprises. In the last two years, the interest rates offered by small banks have been on average about 2.4 pp lower for liquidity loans and 1.3 pp lower for investment loans, compared to the interest rates applied by large banks. Small banks have dictated the slight downward trend in interest rates on liquidity loans in the last two years, although, in 2019 Q3, large banks gave the biggest contribution to their decrease. In the segment of investment loans, small banks have applied relatively stable rates compared to the volatile rates applied by large banks; the latter have also dictated the increase in interest rates on investment loans during this year.

The average interest rates on euro loans to enterprises remained low. On average, they were 4.1% in 2019 Q3, almost as much as in 2019 Q2 (4.0%). Except for their growth in 2019 Q1 (4.7%), mainly in the liquidity loans segment, these rates hovered close to 4.1% since 2018. Interest rates have been stable for all types of loans in the last two quarters.
Meanwhile, compared to the previous year, interest rates on investment loans have declined. The average interest rate on loans to enterprises remains lower for euro loans than for lek loans, but the gap between them narrowed this year, due to the reduction of the latter.

The average balance of non-price terms and conditions that banks apply for loans to enterprises remained unchanged in 2019 Q3. Within them, the conditions stipulated in the loan covenant were on the tightening side, to the same extent as in other quarters of the year. Meanwhile, this tightening effect in this quarter was somewhat offset by the increase of the size of granted loans. Other non-price elements of loans to enterprises remained unchanged.

2. LOANS TO HOUSEHOLDS

LOANS TO HOUSEHOLDS CONTINUED TO GROW AT A STABLE PACE

The ratio of household credit to GDP was assessed at around 12.4% at the end of 2019 Q3, up by 0.3 percentage points from the same period in the previous year. Banks have consistently reported improved credit conditions for this segment, which, in parallel with the growing demand for financing by households, have contributed to the stable growth of this portfolio. Following the easing of standards in the previous quarter, they are reported as unchanged in 2019 Q3, while banks continued to perceive a growing demand for loans from households. With the introduction of new, both domestic and foreign, banks in Albania in 2019, competition in the credit market increased. Banks have responded to this new environment by further easing the credit conditions to households in both segments.

The data for loans to households are adjusted for written off loans and exchange rate fluctuations.
The structure of loans to households is dominated by the mortgage loans portfolio. At the end of 2019 Q3, this portfolio accounted for about 69.4% of household loans. However, in the last three years, the mortgage loan stock has shrunk by about 2.5 percentage points. The faster growth of loans to households have also been supported by the improved credit conditions in the last two years, especially for the consumer segment. In terms of currency (composition), loans to households are mainly granted in the domestic currency. Mortgage and consumer loans in lek account for about 35% and 27% respectively (62% in total) of total household loans.

In the third quarter of the year, loans to households increased by about 7% on average, in annual terms, compared to 6.4% in the previous quarter. From a longer term perspective, mortgage loans contribute the most to the annual growth. In 2019 Q3, they contributed by 5.2% to the expansion of loans to households, similar to the previous quarter. Meanwhile, consumer loans’ contribution increased by 1.8% on average, about 0.6 percentage point higher than in the second quarter of the year.

Absolute changes in the households loan stock 2019 Q3 indicate an increase of about ALL 4.5 billion, the highest since the global financial crisis for the same period of the year. New loans disbursed by the banking system during this period were also at high levels. In 2019 Q3, loans to households accounted for about 26% of the new loan flows granted to the private sector. It appears to be balanced between consumer and mortgage loan segments, 13% in each portfolio.

- The interest rate on loans to households did not change in 2019 Q3, but non-price conditions were slightly tightened.
Interest rates on lek loans to households remained at their lowest levels throughout 2019, at 6.6%. During 2018, they averaged 7.0%. By purpose of loan, their fluctuations were also marginal. Average rates for house purchase, consumer and overdraft loans were 3.4%, 7.6% and 11.8%, respectively, staying very close to their averages in 2019 H1.

In the case of households, the interest rates spread between large and small banks is not very big, but the rates offered by large banks are lower than those offered by small banks. The spread is on average 0.7 pp for consumer loans and 0.9 pp for mortgage loans, with the latter slightly increasing during the last year. Interest rate stability during this year is noted in both small and large banks for all types of loans.

Following the increase in 2019 Q2 (4.1%), the average rate on loans in euro to households fell again in 2019 Q3 at 3.6%, close to the levels of 2019 Q1. Beside short-term changes, interest rates on euro loans fluctuated around
the average level of 3.8% in the last three years. Their reduction in 2019 Q3 was present in the mortgage and consumer loans segments, of 3.0% and 3.6%, respectively, down by 0.5 pp compared to 2019 Q2. Meanwhile, this quarter, rates on overdraft loans were 9.4%, up by 1.0 pp. The spread between lek and euro interest rates on loans to households was at minimum levels for mortgage loans, averaging at 0.2 pp this year. For consumer loans, this spread is 3.7 pp, decreasing marginally from the previous year.

Non-price terms and conditions applied to loans to households were tighter in 2019 Q3. This impact came as a result of the tightening of collateral demand for loan coverage, a condition which has been continuously eased by banks for several consecutive quarters. All other non-price elements remained unchanged this quarter.

3. TRENDS IN LENDING IN THE COUNTRIES OF THE REGION

LENDING IN THE CESEE REGION CONTINUED TO EXPAND, ALBEIT AT A MODERATE PACE.

Credit to the private sector in the CESEE region increased by about 3.9% on average in July-August, compared to 4.2% in 2019 Q2. Fluctuations in the annual rates of this portfolio mainly reflect the volatility of developments in the enterprises segment. From a longer-term perspective, Central Europe has experienced a faster growth of credit to the private sector since 2008, creating a gap in the growth rates of this portfolio compared to the Balkan countries. The expansion of credit to the private sector in this region is led by the performance in the Czech Republic and Poland, while annual rates of this portfolio in Hungary have entered into positive territory only in 2018 Q2.

This analysis includes 9 countries of the CESEE region: Albania, North Macedonia, Croatia, Serbia, Bulgaria, Romania, Czech Republic, Poland and Hungary. The stock of credit to the private sector is adjusted for fluctuations of inflation and exchange rate.
Credit to the private sector in the Balkans has followed a relatively different trajectory. Following the shrinkage of this portfolio in most of the Balkan countries, this behaviour reversed in 2015, when the effects of the global financial crisis began to wane. However, lending during this period was fragile, unable to return to its pre-crisis levels. Albania ranks among the Balkan countries with relatively faster growth compared to the average of the Balkan region. Loans to households have expanded steadily, whilst loans to enterprises have been more volatile, similar to the general trend across the CESEE region. The good performance of households’ portfolio was supported by the high demand for financing and the continuously eased conditions of supply in this segment, both in Albania and the region.

At the same time, the high ratio of NPLs in the CESEE region during the global financial crisis appeared mainly in the segment of enterprises, especially in the segment of small and medium-sized enterprises.
This segment is more sensitive to business cycles, responding more strongly to changes in economic activity, unemployment rate, or monetary policy rate changes compared to households (Bykova and Pindyuk, 2019). This may be an additional factor influencing the shift of banks’ attention towards a segment less sensitive to these cycles.

The business loan portfolio in the CESEE region currently accounts for about 40% of total credit to the private sector. Compared to the pre-crisis period, this portfolio lost ground; at the beginning of 2008, the share of enterprises-to-households segments to the total was more balanced, around 50-50% respectively. In the short run, loans to enterprises slowed down its annual growth rate to 2.7% in July-August, compared to the average of 3.4% in 2019 Q2. Recovery of this portfolio over time has been slow and relatively unstable. Its expansion has been largely supported by the performance in Central Europe. Despite its faster - but fragmented - growth in the past 2-3 years, this portfolio has not yet reached the pre-crisis levels in the Balkans. Meanwhile, loans to enterprises in the country expanded moderately, but have improved during the previous year.

Loans to households account for the main share of credit to the private sector in the CESEE region, by about 60%. The performance of this portfolio is relatively stable compared with loans to enterprises. Since 2015, lending in this segment has entered into positive territory in almost all countries in the region. After this period, the performance of loans to households has generally followed a positive development trajectory, recovering at faster rates. In the shorter term, during July-August, loans to households maintained the growth rates of 2019 Q2, 4.7% year-on-year. Geographical distribution shows a positive credit performance for this segment across the CESEE sub-regions, driven by the faster growth in the countries of Central Europe.