BANK OF ALBANIA

TRENDS IN LENDING

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C O N T E N T S

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 various 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 analysis of the loan portfolio is based on the adjusted lending data on the impact of the exchange rate and on loans written-off banks' balance sheet, a process which banks have undertaken based on the Decision No 50, dated 30.3.2015 "On amendments to the Regulation 'On Credit Risk Management".

The analysis covers data available as at 23 October 2020, which include information for monetary and financial data as at September 2020, and data from the Bank Lending Survey 2020 Q3. Data on credit in regional countries are of August 2020.

Current financial data in Albania indicate a contained impact of the pandemic on the lending activity. The measures taken by the government and the Bank of Albania to cope with the consequences of the pandemic have had a positive impact, thus mitigating the negative effects on lending activity.

OVERVIEW OF RESULTS

Lending activity developments in 2020 Q3 show that:

- *Credit to the private sector continues to grow at a steady pace, aided by measures taken by the authorities to promote it. These measures have helped expand the loan portfolio in lek, leading to an increase in its share of the total.*

- *Loan growth rates for enterprises remained close to the average level of 2020 H1. The third quarter confirmed once again the role of the measures taken to support enterprises facing difficulties from the consequences of the Covid-19 pandemic. The higher rates of credit growth for corporations have balanced the slowdown of credit growth for small and medium-sized enterprises. By sector, lending to services, construction and hotel - restaurants recorded the best performance during this quarter.*

- *Loans to households decelerated the growth pace for the third consequent quarter. This performance is driven by the rapid contraction of the growth rates of consumer credit. Meanwhile, in 2020 Q3, loans for housing have maintained stable growth rates as in the first months of the year.*

- *Interest rates for new loans to enterprises in lek registered an increase in 2020 Q3, but remain lower than in 2020 Q1, before the reduction of the policy rate. Interest rates on loans to households have increased for consumer credit, but have remained lower for mortgages. Meanwhile, interest rates for loans in euro have continued to be relatively stable, for both enterprises and households. Other non-price conditions have tightened for enterprises and eased for households in 2020 Q3.*

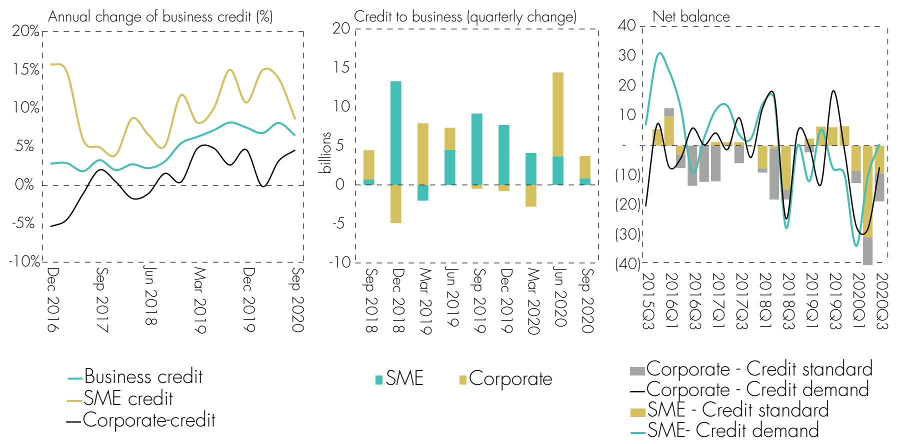
- *The lending activity in the CESEE region is affected by the consequences of the Covid-19 pandemic. Credit to the private sector in this region have had a slowdown trajectory since May, registering a contraction in the enterprises' segment and slowed down annual rates in the households' segment in the period July-August. In geographic terms the performance is somewhat more heterogeneous, where this trend is more significant in the Central Europe countries, whereas some of the Balkan countries registered increasing annual rates.*

1. LOANS TO ENTERPRISES[1]

Loans to enterprises increased at a steady pace in 2020 Q3. The measures taken to stimulate lending have widely supported this group. Easing monetary conditions and sovereign guarantee credit schemes have helped shift the loan portfolio to enterprises towards the domestic currency.

Loans to enterprises increased in annual terms by around 7% in 2020 Q3, close to the average of 2020 H1. The improvement of the growth rate of loans to corporations has balanced the slowdown of loans to small and medium-sized enterprises (SMEs). For the second consecutive quarter, lending to this group has registered a weak quarterly growth, reflecting the stronger decline of credit demand, as well as the tightening of credit standards by banks. The group of small and medium-sized enterprises has been mostly affected by the consequences of Covid-19. Loans to large enterprises have registered higher growth rates, helped as well by the higher level of new loans disbursed to this group.

Chart 1 Structure of loans to enterprises by size

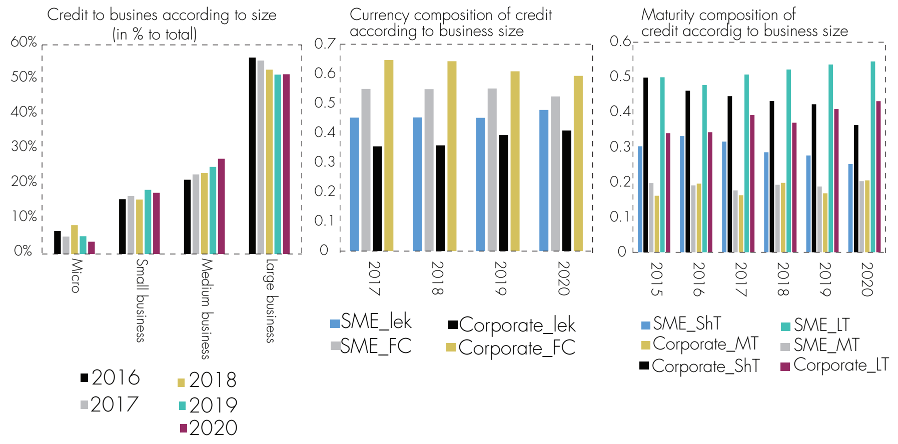


Source: Bank of Albania and staff estimates.

The loan portfolio for SMEs is dominated by foreign currency loans, which have maintained a constant share of around 55% in the last five years. During 2020, the rapid increase of lending in lek for this segment helped in the expansion of its share by around 2.5 percentage points. The landscape is somewhat different for loans to corporations, where the shift of the portfolio towards lek loans has been gradual in these five years. At end-September, this portfolio represented around 41% of loans to corporations, around 1.5 percentage points higher than at end-December 2019. These dynamics reflect the easing of monetary conditions, expressed in the decrease of the interest rates of lek loans for several years. Also, during 2020, this shift has been helped by the presence of sovereign guarantee lending schemes.

[1] *Data for loans to enterprises are adjusted for written off loans and exchange rate volatility.*

Chart 2 Structure of loans to enterprises by size, currency and maturity

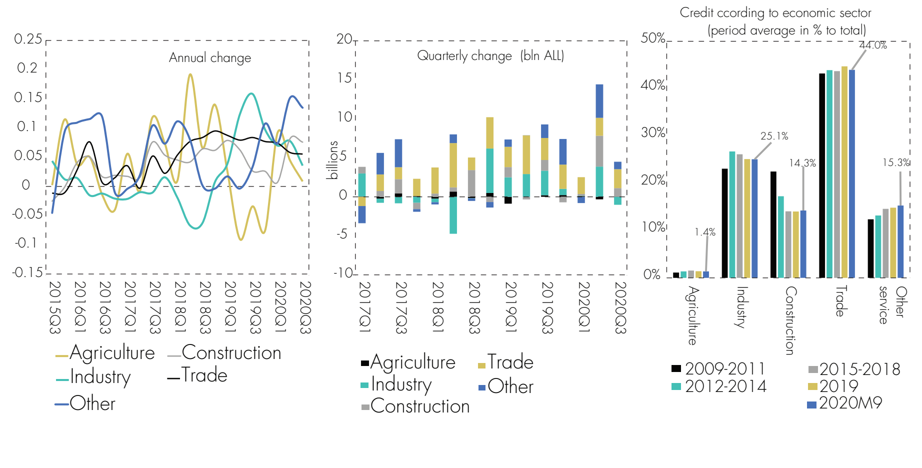


Source: Bank of Albania and staff estimates.

The lending dynamics within the SMEs group indicates that, during the pandemic period, loans to micro-enterprises have contracted significantly, whereas the growth of loans to medium-sized enterprises for several years has been confirmed. In the last five years, banks have expanded gradually the share of loans to medium-sized enterprises, while at the same time decreasing the exposure to large enterprises. During 2020, the share of loans to large enterprises against the total loans to enterprises has not changed since end-2019, at around 52%. These developments are accompanied also by the shift of the portfolio of SMEs towards long maturity term loans. Meanwhile, for loans to large enterprises, the structure by maturity has remained overall unchanged.

In 2020 Q3, the expansion of loans to enterprises was supported by three main sectors: trade, hotels and restaurants, construction and services. Credit for the first group maintained a similar growth rate to the previous quarter, at 5.5%. A particular contribution to this growth derived from the expansion of loans for hotels and restaurants, which is one of the most affected sectors by the consequences of the Covid-19 pandemic. At end-September, the share of this sector against loans to enterprises reached 6.4%, or around 2 percentage points higher than the average over the years. Growth rates for loans to enterprises in the services and construction sectors were in a positive trajectory until 2020 Q2, but had a turnaround in 2020 Q3, recording growth rates of 13.5% and 7.6%, respectively. These dynamics were accompanied by the expansion of their share against the total at 15.3% and 14.3%, respectively.

Chart 3 Loans to enterprises by sector of the economy



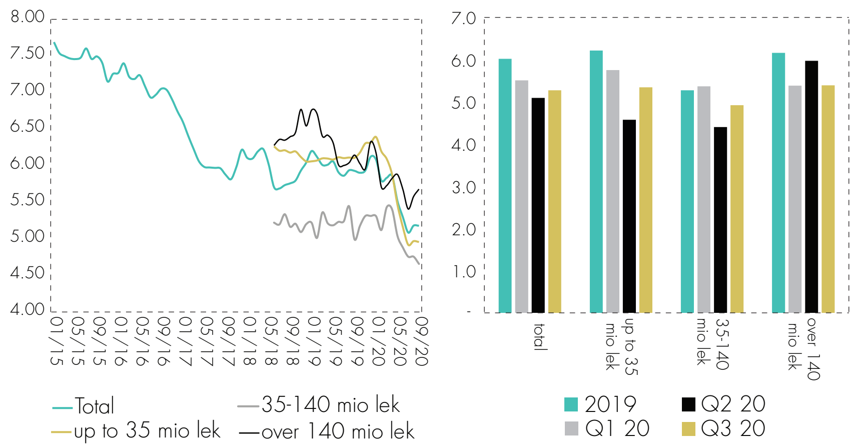
Source: Bank of Albania. 'Trade' represents trade, hotels and restaurants sector.

Meanwhile, the industry sector was the only sector that contracted compared to the previous quarter, confirming the signs of a slowdown in growth rates that started since the previous year. The share of lending for this sector against the total slightly declined to 25.1%. The agriculture sector, which profited from 1.4% of funds granted to enterprises, maintained a similar share to end-2019.

Interest rates for loans to enterprises in lek registered an increase in 2020 Q3, reflecting the smaller impact of sovereign guarantee schemes, but they have remained below their levels before the policy rate cut in March.

Average interest rates for new loans to enterprises registered an increase in 2020 Q3. It averaged at 5.3%, from 5.1% in 2020 Q2, but remained below the level of 2020 Q1, at 5.5%. The increase of interest rates, observed gradually in August and September, was registered mostly in small loans (up to ALL 35 million) and medium-sized (ALL 35-140 million), whereas interest rates also registered higher decline in 2020 Q2.

Chart 4 Interest rates on lek loans to private enterprises

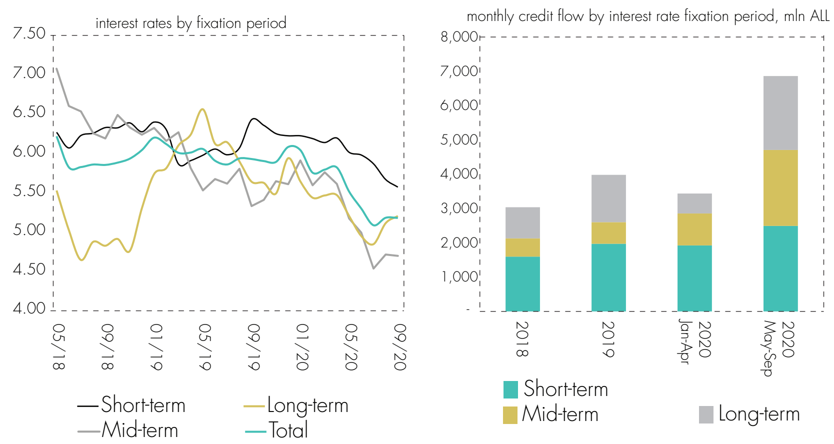


Source: Bank of Albania.

They were recorded at 5.3% and 4.9%, respectively, from 4.6% and 4.4% in the previous quarter. Interest rates on large loans (over ALL 140 million) reflected a different performance, returning to the average level of 2020 Q1, at 5.4%, after the increase at 6.0% in 2020 Q2.

The analysis by interest rate fixation period[2] indicates that the short-term interest rate reflects a less fluctuating dynamic in time. During the current year, it has been declining continuously, reaching 5.8% and 5.4% in 2020 Q2 and Q3, after the relatively stable average of 6.2% in 2018 H2. Theoretically, this is the segment where monetary policy signals can be most directly transmitted, provided the credit risk does not change.

Chart 5 Interest rates by fixation period



Source: Bank of Albania.

On the other hand, fixed interest rates for a medium- or long-term period factorize, among other things, the expectations on future monetary policy as well, but their premia include a multitude of risks, which makes it difficult to separate the pure impact of monetary policy.

During this year, it was observed a significant increase of the volume of loans granted with a fixed rate over a year in the period May-September, which coincides with the use of sovereign guarantee schemes. Exactly in these months, interest rates on loans to enterprises were mainly affected by medium-term and long-term rates, which had a strong downwards trajectory until July, only to increase later in August and September.

[2] *Fixed-term implies the period in which the loan's interest rate is fixed and doesn't change. A loan may be granted: a) with variable interest rate, b) with some period fixed and others variable, or c) fixed throughout until its maturity. For the purposes of this analysis, the interest rate for loans granted with variable rates and those with fixed rate up to a year is called short-term rate, that for loans granted with over a year and up to 5 fixed rate is called medium-term rate, that for loans granted with fixed rate over 5 years is called long-term rate. Thus, the concept short-term/long-term is related with the period in which the interest rate is fixed, and not with the maturity of the loan.*

Interest rates on loans in euro registered a decrease in this quarter, after the increase in 2020 Q2, thus returning to their average value of the last three years.

The average interest rate loans to enterprises in euro registered a decline in 2020 Q3, at 5.1% from 5.3% in 2020 H1. Their current level is the same as the average level of 2018 and 2019. By loan size, interest rates registered small fluctuations for loans up to EUR 1 million. Meanwhile, interest rates on loans larger than EUR 1 million declined again after the reduction recorded in the previous quarter, reaching the average levels of 2020Q1 and 2019.

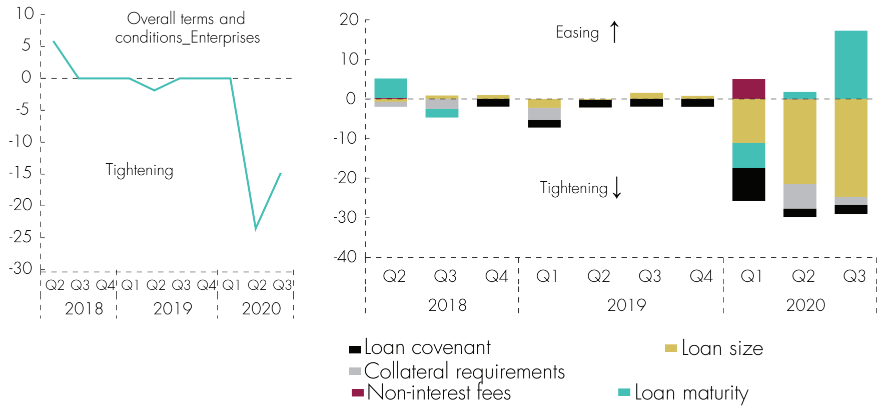
Chart 6 Interest rates on loans to private enterprises in euro

Source: Bank of Albania.

Non-price terms and conditions tightened reflecting the higher risk perceived by banks for this category.

Banks continue to closely monitor the situation caused by the pandemic. Risks on key economic indicators in Albania continue to be present. Consequently, agreements on new loans to enterprises have been reached by tolerating a lower risk interval compared to previous quarters. The combination of all these factors has forced banks to apply tighter lending terms and conditions to the new loans they have granted during 2020 Q3. The tightening of lending terms and conditions is reflected in both the price elements - rising interest rates on new loans - and non-price ones.

Chart 7 Non-price terms and conditions for new loans to enterprises



For more detailed information please refer to the Bank Lending Survey section at: https://www.bankofalbania.org/Monetary_Policy/Surveys_11282/Bank_Lending_Survey/

Source: Bank of Albania and staff estimates.

The tightening of non-price terms and conditions was reached through: approval of a lower loan size than that required by enterprises; increasing conditionality in loan agreements; as well as the increase in collateral requirements related to the loan taken. In contrast, banks have extended the maximum maturity of loans to enterprises, which has served as a factor in easing lending terms and conditions, but not enough to offset the tightening effect that other lending non-price elements have had. The extension of maturity for loans to enterprises may also be related to the easing measures in 2020 Q3 undertaken by the Bank of Albania and the Albanian government to address the liquidity issues faced by enterprises and caused by the pandemic. The rescheduling of loans to enterprises - extending the repayment period for loans taken - is perceived by banks as well, as a necessary instrument to overcome the situation for enterprises with a sound credit history before the Covid-19 pandemic.

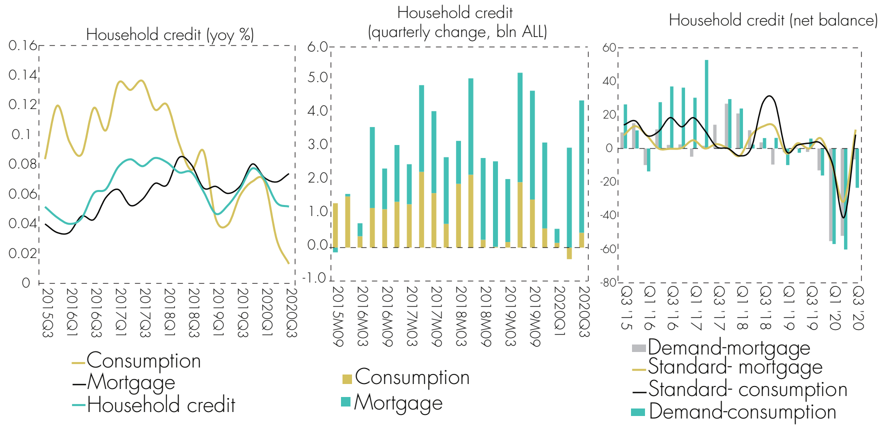
2. LOANS TO HOUSEHOLDS[3]

Loans to households registered a slowdown of growth rates in 2020 Q3, affected by the weak performance of consumer loans.

The situation created by the Covid-19 pandemic has negatively affected the financing of households with loans by banks. On one hand we see a strong contraction of demand for financing due to the uncertainty for the future and negative developments in the labour market. On the other hand, banks as well have been wary in expanding lending in this segment due to the perceived risk and their reluctance to take on more risk. In 2020 Q3, loans to households increase by 5.1% y-o-y, or 1 percentage point less than in 2020 Q2. This trajectory is driven by the strong slowdown of growth rates of consumer loans. This trend is partially balance by the positive performance of mortgage loans.

[3] *The data for loans to households are adjusted for written off loans and exchange rate fluctuations.*

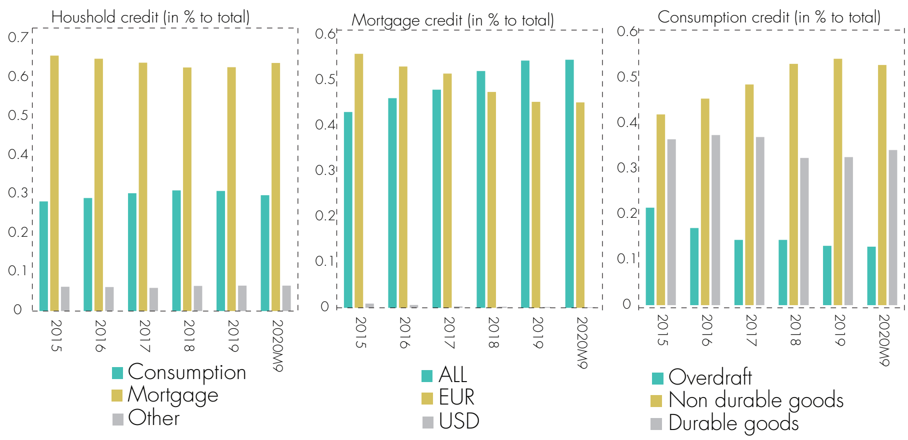
Chart 8 Performance of loans to households by purpose of use



Source: Bank of Albania.

The portfolio of loans to households is dominated by mortgage loans, which comprise around 64% of the total. In 2020 Q3, the growth of loans to households is almost entirely for mortgages, and its annual rate registered around 7%, similar to the previous quarters. Data from the Bank Lending Survey indicate that in 2020 Q3, this credit has profited from both the improvement of standards and of demand. The main factors that have driven the shift towards lek loans of this portfolio seem to be the low interest rates, policies pursued by banks, as well as the awareness of households for the exchange rate risk (as illustrated in Chart 9).

Chart 9 Structure of loans to households by purpose of use



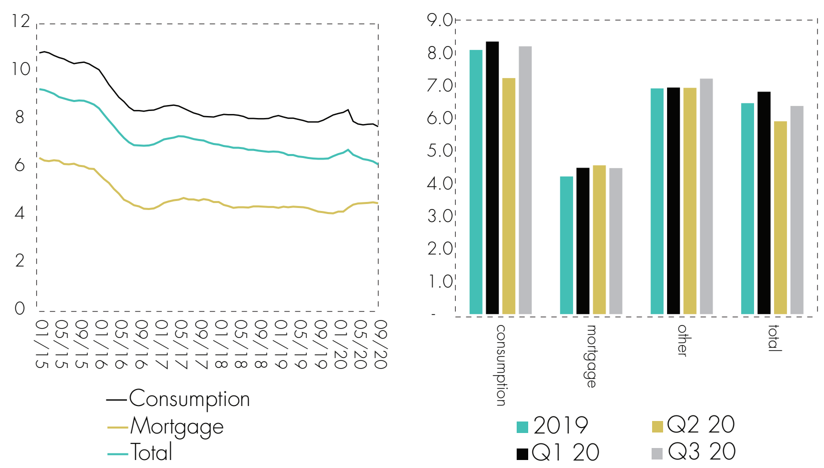
Source: Bank of Albania.

In 2020 Q3, consumer loans registered a modest increase of 1.3%, thus registering the lowest growth rate of the last three years. In particular, the segment most strongly affected is the one of consumer loans with long-term maturity. The share of this portfolio to the total declined to 68% compared with 71% at end-2019. Meanwhile, short-term and overdraft loans reflected a slight increase. Consumer loans are dominated by domestic currency, which constitute 87% of the total. The share of lek to the total has been stable at these levels throughout the last years.

Interest rates on loans to households in lek have increased for consumer loans in this quarter, whereas they remain at a low level for mortgage loans. Interest rates on loans in euro remain stable.

The average interest rate on loans to households in lek increased in 2020 Q3, after the decrease registered in the previous quarter. It was recorded at 6.4%, from 5.9% in 2020 Q2, however it remained below the level of 2020 Q1, at 6.8%. The dynamic of the average interest rate of lending during this year is entirely driven by interests on consumer loans. After the decline in 2020 Q2, at 7.2%, they increased again in 2020 Q3, reaching the levels of 2020 Q1, at around 8.2%.

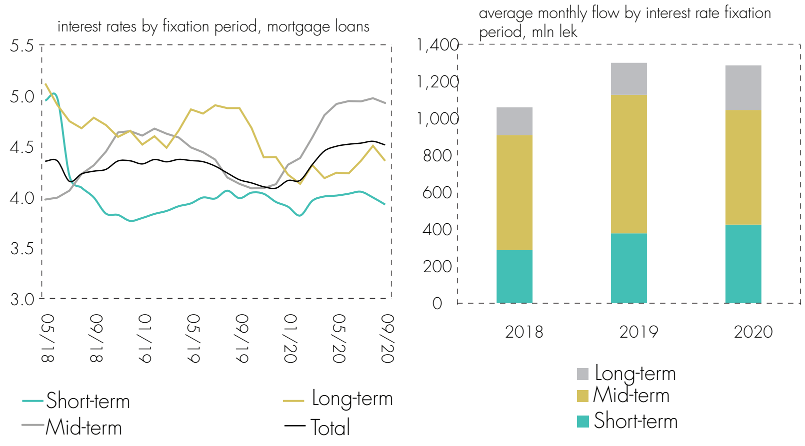
Chart 10 Interest rates on lek loans to households



Source: Bank of Albania.

The average interest rate on loans to enterprises in euro remained unchanged in the first three quarters of the year, at 4.5% on average. Only around 1/3 of mortgage loans have variable or up-to- one-year fixed interest rates; around 50% have fixed interest rates for 1-5 years, and the rest has a fixed interest rate over 5 years. Overall, the short-term interest rate on mortgage loans, in addition to being the lowest, is also the less volatile compared to the long-term fixed interest rates. It was recorded at 3.8% on average in 2020 Q3, from 4.0% in 2020 H1 and in 2019. Fixed interest rates for 1-5 years and over 5 years are overall higher and more volatile, reflecting the uncertainty that materialises in their fixation.

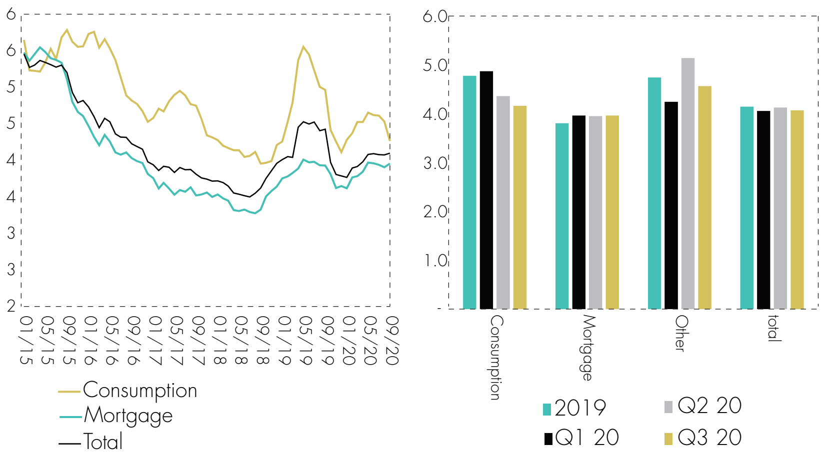
Chart 11 Interest rates by fixation period, mortgage loans



Source: Bank of Albania.

The average rate on euro loans to households remains stable in this quarter, at 4.1% as in 2020 H1 and 2019. By purpose of use, the interest rate for mortgage loans continues to maintain the same level, at 4.0%, throughout the year. The interest rate on consumer loans decreased further, registering 4.2% in this quarter, from 4.4% and 4.9%, respectively, in 2020 Q2 and Q1. The interest rate gap between lek and euro loans to households fluctuated around the average of 2.3 percentage points during this year, the same as in 2019. For mortgage loans, this gap is minimal, at 0.4 percentage points.

Chart 12 Interest rates on loans to households in euro

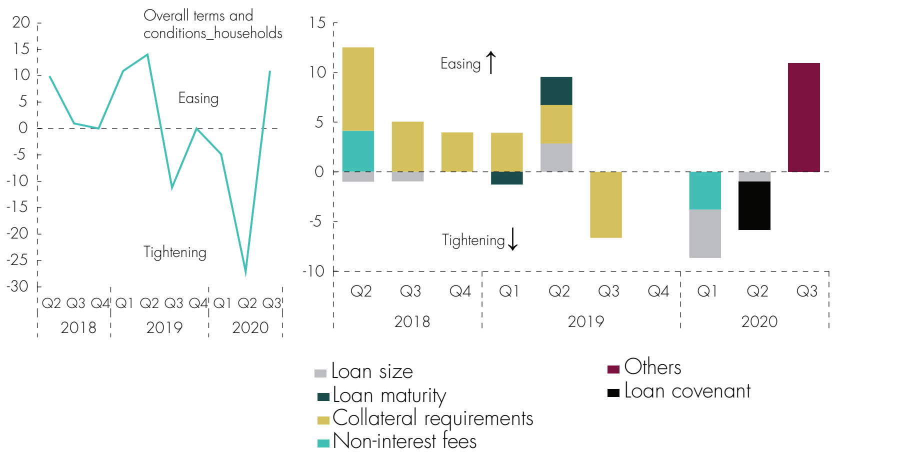


Source: Bank of Albania.

Lending terms and conditions for new loans to households were eased in 2020 Q3.

Overall, lending terms and conditions for new loans to households were eased in 2020 Q3. The aggregate result from the responses of the 10 banks of the banking system was driven by a single bank. Conventional non-price lending terms and conditions remained unchanged for new loans to households. The only factor that drove their easing in this quarter was the improvement of the risk analysis for existing clients. This factor also overcame the tightening impact on general lending terms and conditions from the application of higher margins - interest rates –on riskier loans to households.

Chart 13 Non-price terms and conditions for new loans to households



For more detailed information please refer to the Bank Lending Survey section at: https://www.bankofalbania.org/Monetary_Policy/Surveys_11282/Bank_Lending_Survey/

Source: Bank of Albania and staff estimates.

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

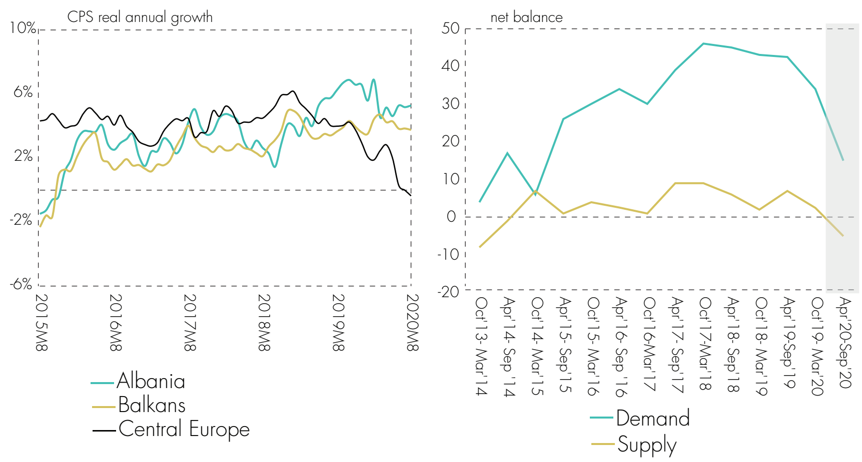
Credit to the private sector in the countries of the CESEE region have had a slowdown trajectory since May, recording a contraction in the enterprises' segment and a slowdown in the households' segment.

The portfolio of credit to the private sector registered an average annual rate of 0.6% in July and August, around 1.6 percentage points lower compared to 2020 Q2. After the first signs of slowdown observed in May, credit to the private sector remained on a slowing trajectory. The slowdown of growth rates in this portfolio reflects, among others, the added uncertainties for the future in the context of Covid-19. Developments in geographical terms indicate a heterogeneous performance of credit to the private sector in this region. Various countries of the region have undertaken several measures to minimize

4 In this analysis are included 9 countries of the Central, Eastern and South-eastern Europe: Albania, North Macedonia, Croatia, Serbia, Bulgaria, Romania, the Czech Republic, Poland and Hungary. The credit to the private sector stock is adjusted for the impact of inflation and exchange rate.

the consequences of the Covid-19 pandemic[5]. In addition to the measures in support of lending to households and enterprises - in the form of sovereign guarantee - through the banking system, some of these countries also approved measures that offer direct support to these economic agents, without financial intermediation.

Chart 14 Credit to the private sector in the CESEE region



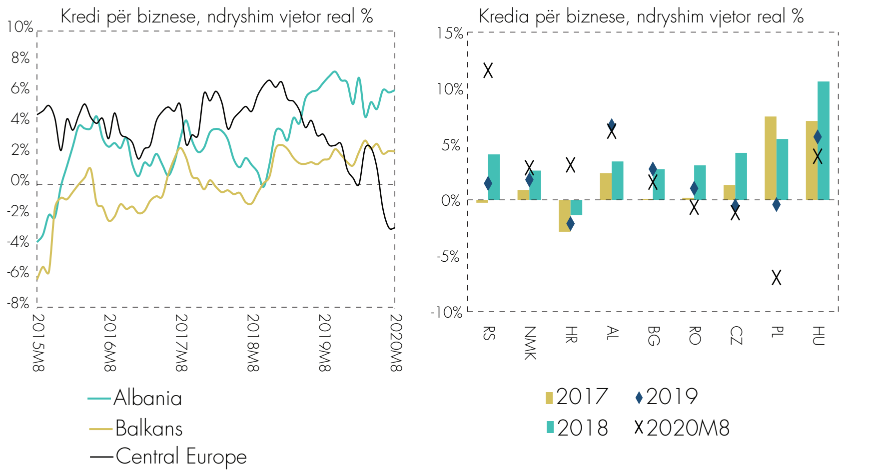
Source: Bank of Albania, banks of other countries of the region, EIB - CESEE Bank Lending Survey, authors' estimates.

Hence in countries like Croatia, North Macedonia and Serbia, the portfolio of credit to the private sector registered increased annual rates compared to 2020 Q2. Meanwhile, the rest of the Balkan countries and those of Central Europe registered slowing or declining rates, which may be partially related to alternative forms of financing outside the banking system. In the last Bank Lending Survey in the countries of the region[6] (October 10 - March 20), banks have revised their expectations for the developments in the following 6-months (April 20 - September 20), due to the spread of the pandemic. They perceived a tightening supply, reducing demand, declining loan approval ratio, as well as declining quality of loans application. Demand expectations are projected to be in negative territory for the first time in six years. The potential materialisation of these expectations in most of the CESEE region seems to have affected the slowdown of the annual rates of the portfolio of credit to the private sector.

[5] *For a summary of these measures in the region, see the Box in "Trend in Lending 2020 Q1 at: https://www.bankofalbania.org/Monetary_Policy/Analyses/Trends_in_lendings/*

[6] *The results of the Bank Lending Survey of EIB are detailed at: https://www.eib.org/attachments/efs/economics_cesee_bls_2020_h1_en.pdf*

Chart 15 Credit to the private sector in the CESEE region

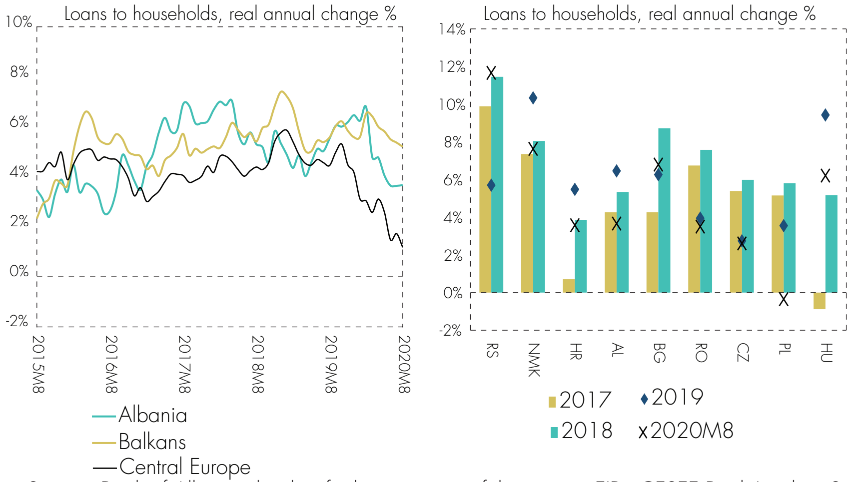


Source: Bank of Albania, banks of other countries of the region, EIB - CESEE Bank Lending Survey, authors' estimates.

Loans to enterprises in the CESEE region have been more affected by the negative consequences and the chain impacts of the Covid-19 pandemic, entering negative territory since June. Lending to this segment has been the priority of the measures taken by the respective governments and central banks to mitigate the impact of the pandemic. In the period July-August, the portfolio of loans to enterprises contracted by around 1.6%. According to the last Bank Lending Survey in the region, some of the demand and supply factors that were expected to have a positive impact in the previous round, after the spread of the pandemic, have passed into negative territory. On the demand side, banks have expected a contraction in enterprises' demand for investment loans and retention at similar levels of working capital credit demand in the period April 20 - September 20. On the supply side, expectations have been also in negative territory for the same period, in almost all market segments, both for small and medium-sized enterprises and large enterprises. Developments in geographical terms indicate a contraction in annual terms of the loan portfolio to enterprises in the region of Central Europe. This performance was influenced by the reduction of this portfolio in Poland and the Czech Republic, as well as by the slowdown in growth rates in Hungary.

The stock of loans to households registered annual growth of around 2.1% in July-August, compared to the 3% rate in 2020 Q2. However, despite the more pessimistic expectations in the segment of households compared to that of enterprises, developments in this portfolio are characterized by a more positive inertia. Expectations for tightening of the supply conditions and contraction of demand seem to have partially materialized. Similar performance has been also observed in the growth of the loans to households in absolute terms since June in all countries of the region, unlike the loan portfolio for enterprises, which has shrunk in some of them in the same period. Overall, the loan portfolio for households shows a more stable and consistent performance, both in geographical terms and over time. The expansion of this portfolio is driven by the rapid growth of this portfolio in the Balkan region.

Chart 16 Loans to households in the CESEE region



Source: Bank of Albania, banks of other countries of the region, EIB - CESEE Bank Lending Survey, authors'estimates.