BANK OF ALBANIA

TRENDS IN LENDING
2021 Q2

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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

INTRODUCTION

"Trends in Lending" presents an overview of the 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 a summary 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 the Republic of North Macedonia (RNM).

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 22 April 2021, which include information for monetary and financial data as at March 2021, and data from the Bank Lending Survey for 2021 Q1. Data on credit in regional countries are as at February 2021.

OVERVIEW OF RESULTS

Lending developments in the first quarter of 2021 show that:

- *Credit to the private sector improved its growth rate, supported by both loans to enterprises and households. The stable recovery of credit demand by the private sector and a more active approach adopted by banks to address this demand have led to the broad-based expansion of the lending activity.*

- *The improvement in loans to enterprises continues to be supported by loans for investments, but, in contrast with the previous six months, this improvement was mostly in lek. Also, loans to large enterprises has determined the improvement of growth rates of the portfolio. By sectors, lending to construction and industry gave the main contribution to this improvement, by offsetting the slower pace in the other sectors.*

- *Loans to households have also had a good performance, where growth rates are the highest recorded over the last years, supported by loans for housing which were mainly in lek. On the contrary, consumer credit appears weak with moderate growth rates, reflecting both the weak consumption as well as banks 'approach regarding riskier loans.*

- *Interest rates for new loans in lek have increased for certain segment, but they continue to reflect the accommodative monetary policy and to support credit growth. Non-price conditions and terms were tightened for enterprises and eased for households in 2021 Q1.*

- *Interest rates for loans to enterprises increased in 2021 Q1, restricted only to small loans, remaining however below the level of the previous two years. Households continue to benefit from funding with low interest rates by banks. During this quarter, interest rate for loans in euro has increased for both enterprises and households.*

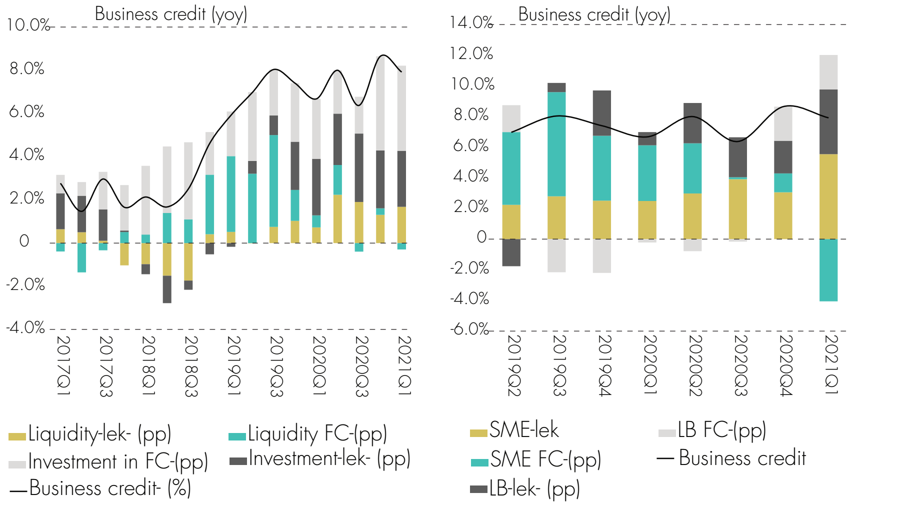
- *Credit to the private sector in the CESEE region has continued to show decelerating growth during 2021 H1. This performance is affected by the contraction of loans to enterprises, while households' portfolio has been expanding, but at a slowing pace. In geographical terms, the reduction of credit to the private sector is more significant in the Central Europe countries, whereas Balkan countries have continued to record increasing rates.*

1. LOANS TO ENTERPRISES[1]

Loans to enterprises continue to follow an upwards trajectory, supported by lending in lek to enterprises and credit for investments. During the first quarter, the growth was driven by lending to large enterprises, while banks hesitate to lend to small and medium-sized enterprises. By economic sectors, banks have lent to the production sector, while they have reduced funding for the services sector.

Loans to enterprises improved in 2021 Q1, as the annual growth rate averaging 8.2% is 1 p.p. higher than the previous quarter. The expansion of loans to enterprises during this quarter was supported by lending in lek for liquidity and investments. Therefore, lending for liquidity maintained low growth rates of 3.5% on average, similar to the previous two quarters. On the other hand, lending for investments continue to have high growth rates, supported by both loans in lek and in foreign currency. Investment credit increased on average by 11.8% year-to-year, and its quarterly growth of around ALL 3.2 billion was affected by both currencies, which have contributed at almost equally.

Chart 1 Lending to enterprises by purpose of use, currency and size in annual term



Source: Bank of Albania.

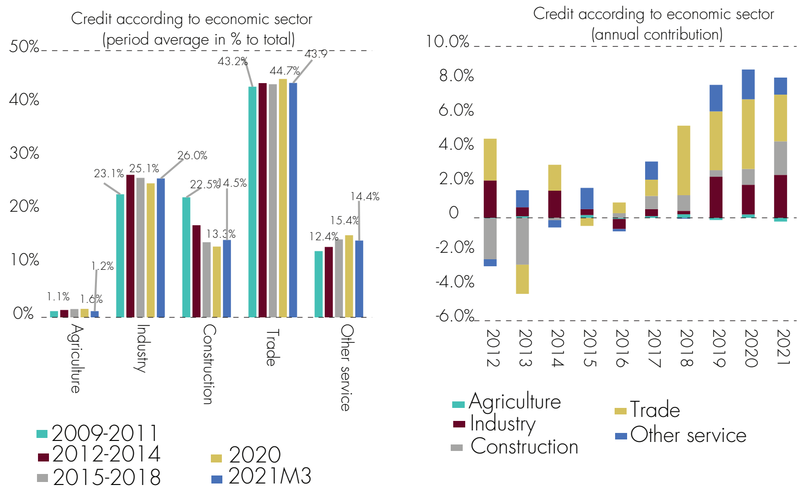
By size of enterprises, lending has slowed down for small and medium-sized enterprises (SMEs), while it has accelerated for large enterprises during 2021 Q1. Banks continue to remain cautious in financing the needs of SMEs, due to their higher risk, particularly while accounting for the challenges caused by the pandemic. Loans to SMEs has decreased compared to the end of 2020, and the annual growth rate of this portfolio of around 5.0% is the lowest in the last five years. Loans to large enterprises appears to have improved and its

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

annual growth has accelerated at close to 11.0%. The quarterly growth rate of this portfolio, of around ALL 4.5 billion, has mainly reflected the increase of loans in foreign currency, by around ALL 4.0 billion.

The financing of enterprises by economic sectors shows that the growth of the portfolio in the first quarter was concentrated in the industry and construction sectors. Growth rates for loans to the both sectors has improved by 10.0% and 14.0%, respectively. Also, the significant quarterly growth in both these portfolios has offset the contraction of lending to agriculture, trade and services sectors, which are dominated by SMEs. Compared to the previous year, the growth rate of lending to the latter two sectors contracted by 6.0% and 7.0%, respectively. Meanwhile, lending to the agriculture sector contracted for the first time in the last two years. These developments were reflected by an increase in the share of the industry and construction sectors to the total credit portfolio at 26.0% and 14.5%, respectively. Meanwhile, the share of loans to the trade, services and agriculture sectors to the total loans to enterprises contracted by 43.9%, 14.4% and 1.2%, respectively.

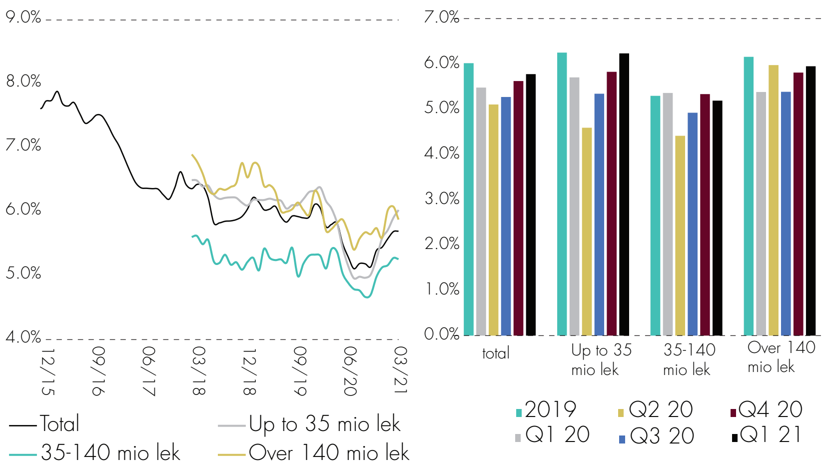
Chart 2 Credit by sectors of the economy



Source: Bank of Albania.

Interest rates on loans to enterprises in lek have increased in the first quarter of 2021 for the segment of micro loans. However, overall, they continue to reflect the more accommodative monetary policy from the end of March of the previous year and remain favourable in encouraging lending. The interest rates of loans in euro have decreased during this quarter on all sizes of loans.

Chart 3 Interest rates on loans to enterprises in lek



Source: Bank of Albania.

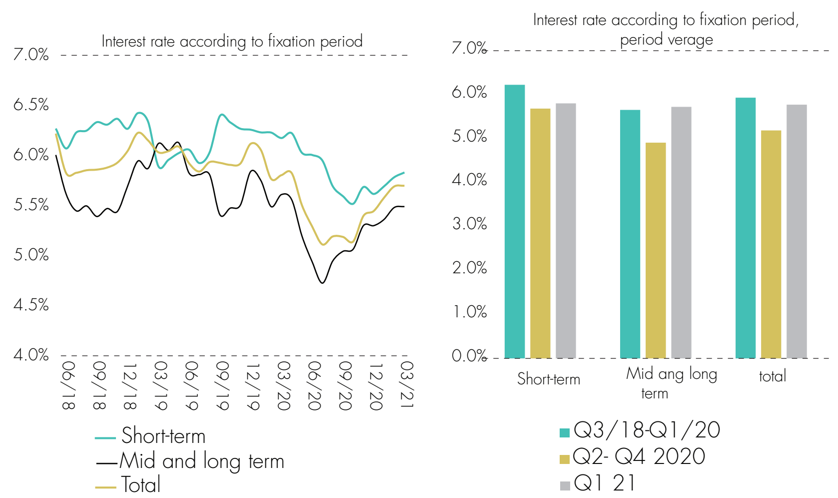
The increase in interest rates, being observed gradually since August, reflects the impact of two key factors. First, the impact of sovereign guarantee schemes, which serve as an instrument for transferring a part of credit risk from banks to the government, has decreased, and as such more credit risk is materialising in the current level of interest rates. Secondly, banks have continuously reported tighter lending conditions for enterprises during the last quarter, where one of the main factors is also the concern on the financial situation of enterprises caused as a result of difficulties created by the pandemic in the last year. In this regard, the most vulnerable sector is small and medium-sized enterprises, as they don't possess the liquidity of large enterprises to withstand prolonged economic hiccups.

The impact of monetary policy in supporting lower interest rates on loans is clearly reflected in the analysis by interest rate fixation period[2]. The short-term interest rate – variable or fixed for the first year of lending - in which monetary policy signals pass through more directly in view that credit risk does not change, has remained stable on average, after its last decline in March 2020. It stood at 5.8% in 2021 Q1, very close to the 5.7% value of the last three months of the previous year. Since the mid-2018 up to the reduction of the policy rate at the end of March 2020, its average level was 6.2%[3].

[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.*

[3] *This period coincides with the policy rate of 1.00%.*

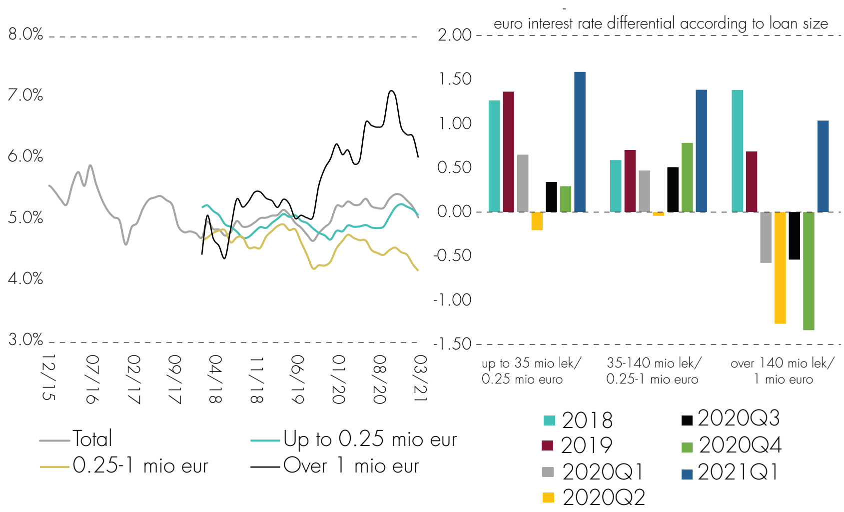
Chart 4 Interest rates by fixation period



Source: Bank of Albania.

On the other hand, fixed interest rates for a medium- or long-term period, which, despite the expectations on future monetary policy, factorize a multitude of risk, have continued to increase in 2021 Q1 as well. Their level is close to the 2020 Q1 level, by factorizing potential higher risk premia.

Chart 5 Interest rates on loans to enterprises in euro



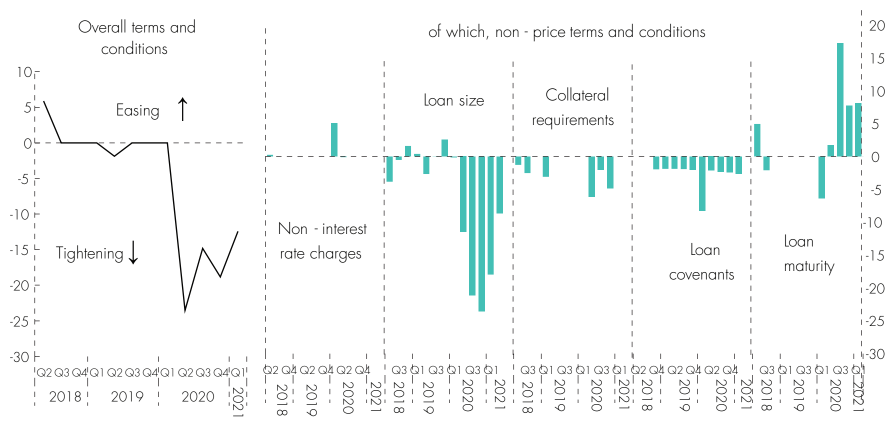
Source: Bank of Albania.

Interest rates on loans to enterprises in euro decreased significantly in 2021 Q1. The average interest rates loans to enterprises in euro declined at 4.4%, from the 5.4% average in the previous year. The decrease of interest rates was observed on all sizes of loans. This was also reflected in interest spreads of lek-euro, which had positive results during this quarter for all sizes of loans. Although low interest rates on loans in euro was a trend observed only in a few banks in the system, their large share on lending has defined the overall downward trend.

Non-price terms and conditions to enterprises tightened, by mostly reflecting the aversion of banks towards lending to small and medium-sized enterprises.

Banks continue to perceive risk in the macroeconomic and political situation in Albania in 2021 Q1 as well. The pandemic duration and uncertainties presented by it in its different stages, have rendered banks sceptic as regards lending to enterprises. These developments have pushed banks to continue their prudential approach in lending to enterprises over the first quarter, as well. Therefore, the terms and conditions of loans to enterprises tightened in 2021 Q1, particularly for small and mediums-sized enterprises.

Chart 6 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 the lending terms and conditions, alongside with the application of higher margins on loans, particularly towards riskier ones, was achieved also through non-price conditions. In this quarter, the tightening of non-price terms and conditions was reached through: (i) approval of a lower loan size than that required by enterprises and (ii) increasing conditionality in loan agreements signed between banks and enterprises. In contrast, banks continue to offer extended maximum maturity of loans to enterprises. Other non-price elements such as commissions or collateral requirements related to the granted loan remained unchanged during this quarter.

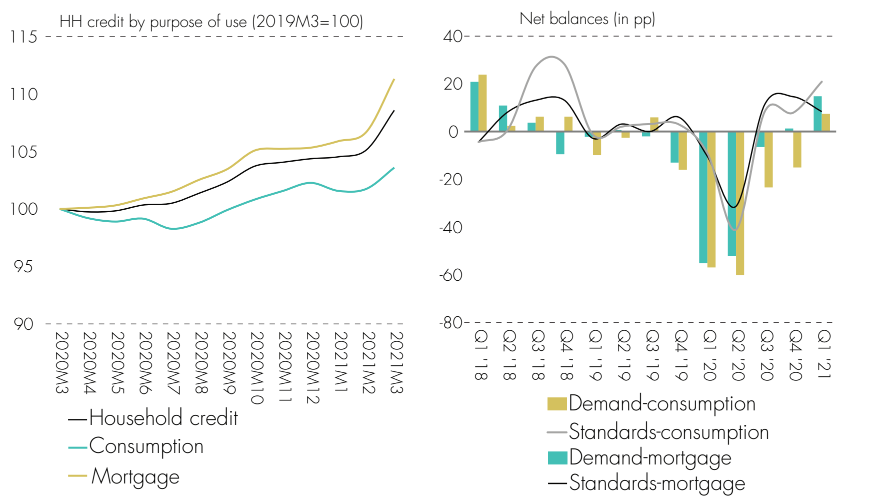
2. LOANS TO HOUSEHOLDS

Loans to households have continued to improve with stable growth rates in 2021 Q1. This performance is reflected in both its segments: mortgage loans and consumer loans. Currency developments confirm that the orientation of lending to households is towards lek.

The stock of loans to households shows a positive trajectory, during 2021 Q1, which started since 2020 Q3. Mortgage loans dominated the growth of credit portfolio to households since the beginning of the pandemic, but, in the last two quarters, there has been an improvement in consumer loans as well. The recovery of demand for financing by households and easing of standards have engendered these positive developments and the expansion of credit to households during the period.

The structure of loans to households is dominated by the mortgage loans portfolio. At the end of the first quarter, mortgage loans accounted for 70% of loans to households, and its share increased by 0.7 percentage point against the same period in the previous year. By currency, mortgage loans are easily dominated by domestic currency, which constitute about 56% of the total, as a result of the continuous growth of lending in lek for house purchase, in the past five years. The performance of this portfolio is supported by more favourable supply conditions, as confirmed by the easing of mortgage standards for three consecutive quarters, since 2020 Q3 and continuing in the two consecutive quarters. Also, households' demand for mortgages has entered into positive territory in the last two quarters.

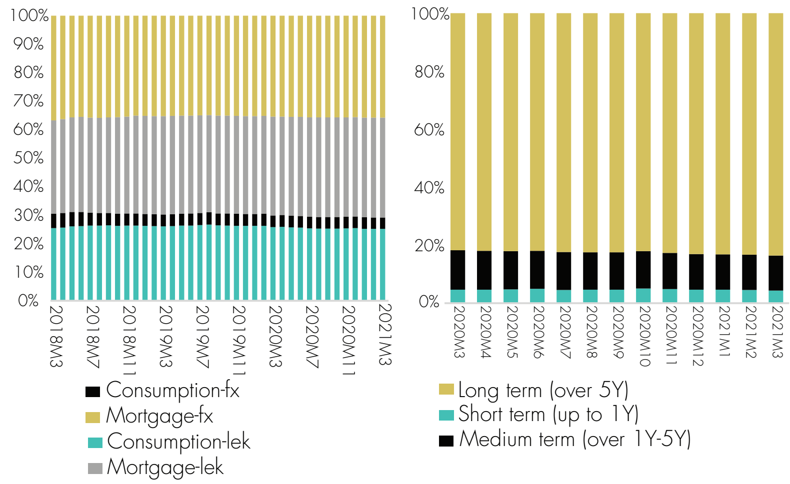
Chart 7 Loans to households by purpose of use; credit demand and standards



Source: Bank of Albania.

The dynamic of consumer credit has been somewhat weaker, affected by both the forced reduction of consumption during the period of social isolation, as well as the uncertainties regarding the course of the pandemic and its impact on the future economic activity. The improved Consumer Confidence index has brought about a better demand and supply for consumer loans as well. Thus, for the first time after three consecutive quarters, in the first quarter of 2021, consumer loans have entered into positive territory. Lending standards are also reported as easing for three consecutive quarters. Consumer loans constitute less than 30% of loans to households. In terms of currency, the composition of this portfolio is less balanced. This structure reflects the higher disbursement of consumer loans in domestic currency, in accordance with the daily needs of consumers.

Chart 8 Structure of loans to households by purpose of use and maturity



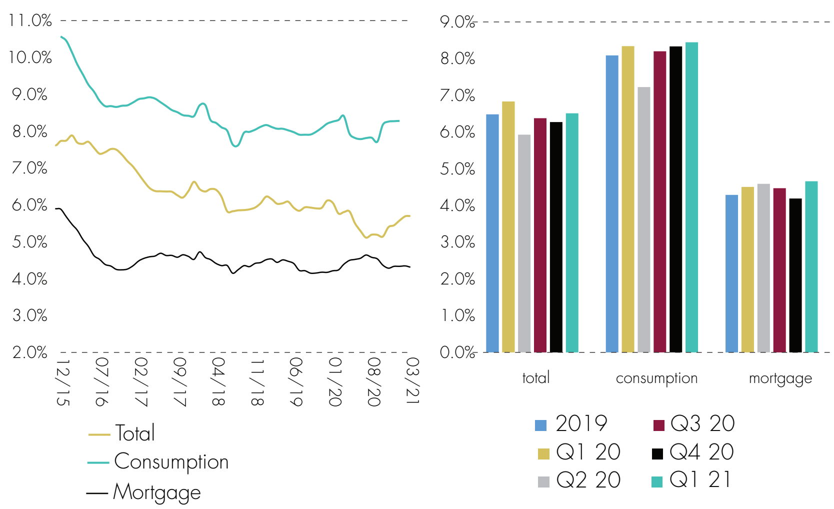
Source: Bank of Albania.

Maturity structure of loans to households is dominated by the long-term credit portfolio – loans with maturity term higher than five years. At the end of 2021 Q1, this portfolio accounts for around 84% of loans to households, up by around 2 percentage points compared to the same period in the previous year. The time structure of loans is in line with the structure of loans by purpose of use. Medium-term loans – with maturity term up to 5 years - and short-term loans - with maturity term below 1 year – account for around 12% and 14%, respectively, of the portfolio of loans to households, at the end of 2021 Q1. Compared to the same period in the previous year, both these portfolios have recorded a decline of their shares to the total, by 1.6 percentage points and 0.3 percentage point, respectively.

Interest rates on loans to households in lek remain at low levels, for both consumption financing and mortgage loans. This month stands out due to the fall of the interest rates for mortgages in euro.

The average interest rate on loans to households in lek stood at 6.5% in 2021 Q1, slightly up from the 6.3% average recorded in the previous two quarters. Over this time period, the interest rate on consumer loans remained almost unchanged at 8.4%. The interest rate on mortgage loans, on the other hand, have shown a higher volatility in the past month. Hence, after the fall recorded in the previous quarter, at 4.2%, they fluctuated to an average of 4.4% in the first two months of this year, being close to their average of the last three years. March stands out, during which interest rate on mortgage loans increased significantly to 5.1%. This month was accompanied also by an increase of the volume of credit disbursed. Such fluctuations, although not frequent, have happened before as well, but without creating a direct trend in interest rates.

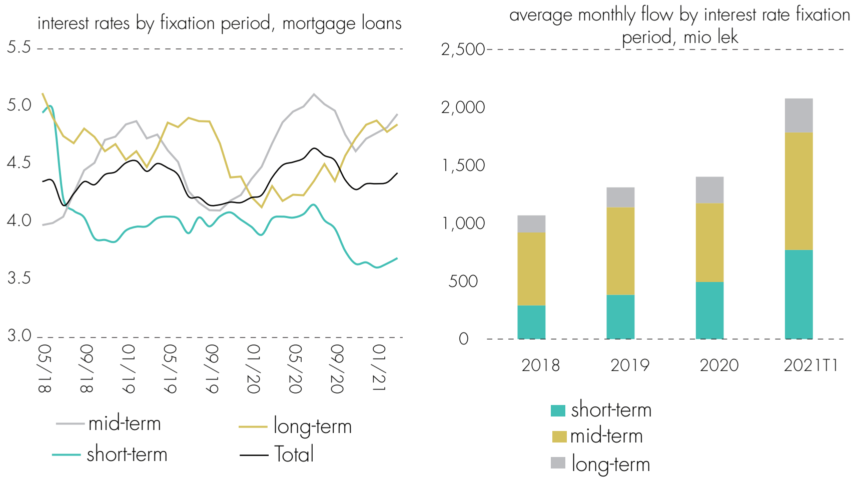
Chart 9 Interest rates on lek loans to households



Source: Bank of Albania.

The dynamic described above regarding interest rate on mortgage loans, in the first quarter of this year, is valuable for all segments according to the fixation period of the interest rate. Beyond these fluctuations, the interest rate on mortgage loans with variable or fixed interest rate, only for the first year, remains significantly below its average up to the second half of 2020. Fixed interest rates for over 1 year, despite being typically higher, have increased over the last months, reflecting the uncertainty that materialises in their fixation.

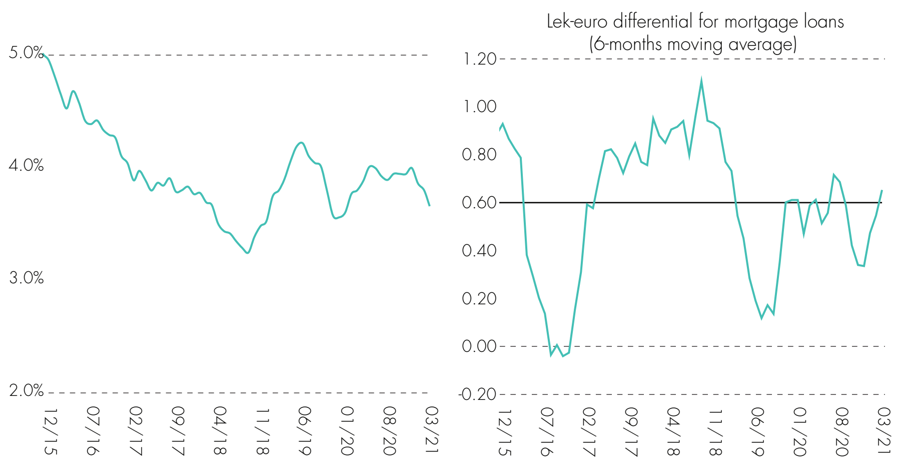
Chart 10 Interest rates by fixation period, mortgage loans



Source: Bank of Albania.

The average interest rate on mortgage loans to households in euro fell significantly in 2021 Q1. This rate was 3.3%, from the relatively stable average of 4.0% in the previous year. All the three months of this quarter were characterised by low interest rates. The increase of interest rates in lek and the decrease of interest rates in euro was reflected in the widening of the gap between them during this quarter. However, looking beyond the high volatility that characterises these interest rates in the short term, the difference between them in the last seven years has fluctuated at a narrow range, by an average of around 0.6 p.p.

Chart 11 Interest rates on loans to households in euro

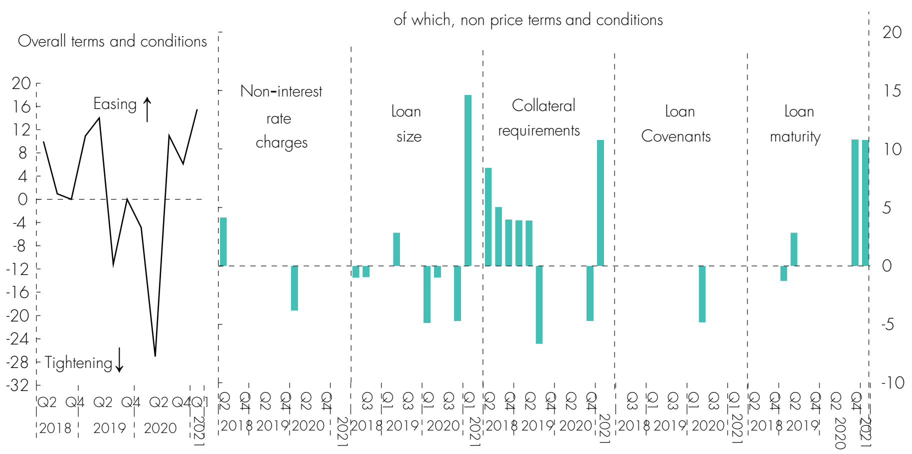


Source: Bank of Albania.

Lending terms and conditions for new loans to households were eased in 2021 Q1.

In contrast to enterprises, banks continued to ease the lending terms and conditions for loans to households in 2021 Q1. The factors that drove banks to favour lending to households were the additional competition in the banking sector and the perception of a lower risk for this segment of banks' customers. Non-price elements of loans to households were eased through: (i) increasing the size of the loan required; (ii) the lower collateral requirements related to the granted loan; and (iii) extending the maximum maturity of loans. On the other hand, commissions and restrictions in loan agreements remained unchanged from the previous quarter.

Chart 12 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/Mon-etary_Policy/Surveys_11282/Bank_Lending_Survey

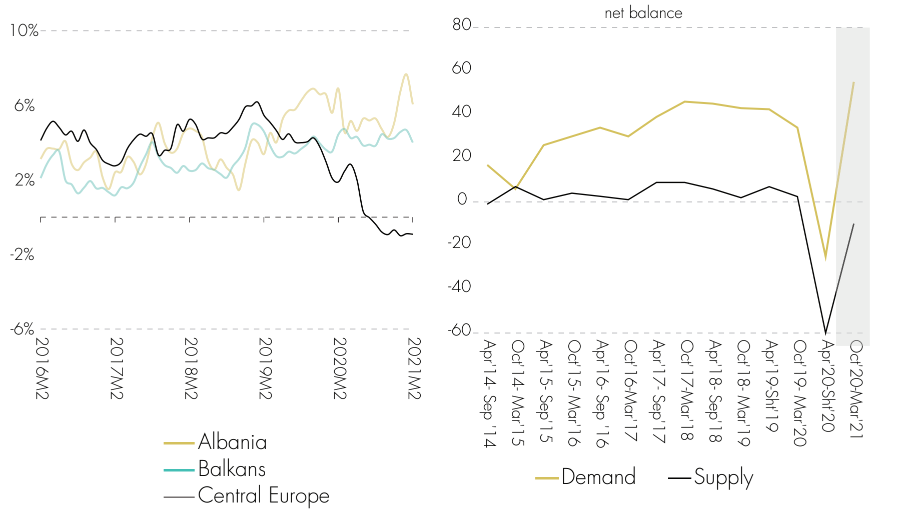
Source: Bank of Albania and staff estimates.

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

Credit to the private sector in the region has continued to appear weak in the first two months of the year. This development has reflected, on the one hand, the increase of credit in the Balkans and, on the other hand, the decrease of credit in the Central Europe. Credit shrinkage in this region appeared in the portfolio of credit to enterprises, while the annual growth rates in the credit portfolio to households have slowed down.

In January and February 2021, the stock of credit to the private sector in the CESEE region registered a low annual growth rate of around 0.2%, similar to the average rate of the last quarter in 2020. This performance reflected the decrease of the demand for loans – particularly in the countries of the Central Europe region, which hold the largest share of this portfolio – according to the latest Bank Lending Survey in the countries of the region[5]. The low demand for financing in these countries is mainly related to future uncertainties created by the pandemic and, as a result, to the drop on enterprises' activity, particularly investments. Meanwhile, credit to the private sector in the Balkan region has recorded positive growth rates in both the enterprises' portfolio, which is in a positive trajectory, as well as households' portfolio, which has followed a decelerating trajectory of growth rates. The growth rates of loans in Albania are above the average growth of countries in the region during this period.

Chart 13 Credit to the private sector in the CESEE region



Source: Bank of Albania; Banks of regional countries; EIB Bank Lending Survey in CESEE, authors' calculations.

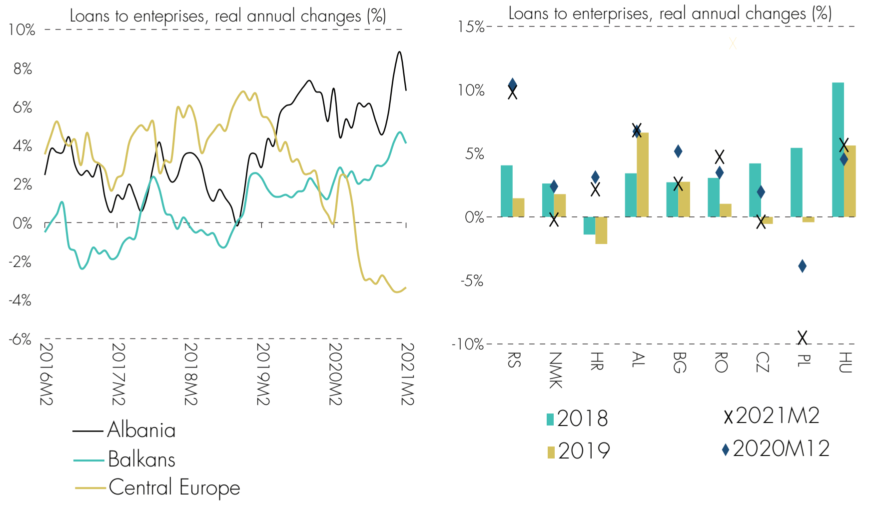
4 *In this analysis are included 9 countries of the Central, Eastern and South-eastern Europe: Albania, North Macedonia, Croatia, Serbia, Bulgaria, Romania, the Czech Republic, Poland and Hungary. The credit to the private sector stock is adjusted for the impact of inflation and exchange rate.*

5 *The latest BLS of CESEE countries covers April 2020 – September 2021 period and further details are referred in the following address: https://www.eib.org/attachments/efs/economics_cesee_bls_2020_h2_en.pdf*

The performance of **loans to enterprises** has continued to remain in the negative territory since the second half of the previous year. This portfolio contracted by around 1.6% in annual terms, on average, similar to the rate recorded in the previous quarter. The expansion of loans to enterprises in the Balkan region has been compensated by its contraction in the main countries of the Central Europe. In countries such as Poland, which holds the main share of loans to enterprises in this region, credit shrinkage is related to the demand decrease for loans as a result of the direct benefit derived from the supporting measures taken by the Government in the framework of mitigating the effects of the pandemic.

The decrease in the demand for loans as reported by banks in CESEE Bank Lending Survey was concentrated in the segment for investments, while credit demand for liquidity has remained positive, reflecting the imminent short-term needs of enterprises in the situation created by the pandemic.

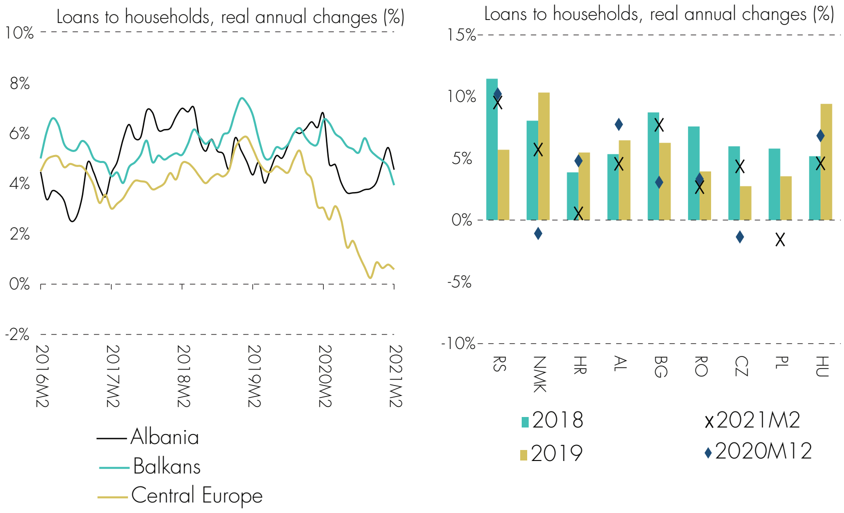
Chart 14 Loans to enterprises in the CESEE region



Source: Bank of Albania; Banks of regional countries; authors' calculations.

The performance of loans to households in the CESEE region appears relatively stable, and this portfolio recorded an annual average growth of around 1.3%, in January and February. In geographical terms, the expansion of loans to households is led by Balkan countries. However, the trajectory of credit growth rates in both the Balkan and the Central Europe region has slowed down. The decrease in the household demand for financing reflects their natural preference to reduce spending and borrowing under the pandemic restraints.

Chart 15 Loans to households in the CESEE region



Source: Bank of Albania; Banks of regional countries; authors' calculations.