

ISSUES RELATING TO LENDING ACTIVITY IN ALBANIAN BANKING SECTOR

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Abstract

The banking sector in Albania is among the most developed sectors of the Albanian economy and one of the few, whose development can be compared to that of other countries of the world. With the recent financial crisis of 2008 the world economy suffered a heavy blow, especially with regard to the global financial systems. Albania, although with no immediate consequences of this crisis by being less exposed to the international financial markets, has started to show problems in its development rates. One of the main problems of the Albanian economy, especially in recent years, is the high rate of non-performing loans in the Albanian economy. Following 2008 this indicator has seen a large increase making today Albania a country with the highest non-performing loans rate in region. The article is aimed at providing a detailed analysis on the problems encountered in Albania regarding private borrowing as well as at making a comparison with other countries in the region. This goal will be achieved by analyzing the banks' lending activity through a questionnaire addressed to the second-tier banks operating in Albania. This questionnaire shall help to make an assessment of monetary and economic development of the country, following the collection of certain data on some key issues of the lending process, such as loan approval standards, terms of lending to businesses and individuals, trends in demand for loans, etc

Keywords: Private borrowing, performing loans, lending activity, lack of liquidity, economic growth

Introduction

The financial crisis that seized many countries has attracted many economists to problems mainly related to public debt, leaving out another type of debt -just as important to the economy of a country - such as private borrowing. When alternative sources of financing business projects (outside

banking channels) are limited, private borrowing has a great influence on the economic growth. Thus, the private sector plays an important role in economic development of any country. On the other hand, credit to the economy is an important element of economic development, serving as a financial leverage and fueling economic growth.

In addition, it is also one of the most important channels of the transmission mechanism of monetary policy to the real economy.

Non-performing loans

Nonperforming loans are now the main threat to stability and development of the banking system. Despite the efforts the commercial banks and the Central Bank are doing, non-performing loans are still an issue of concern. Another reason for the increase of non-performing loans in recent years is the young age of the Albanian banking system. Most loans granted by our banks are long-term home loans that last about 15-25 years and we all know that theoretically most loans start to have problems following one third of their life. So it is time now that loans begin to exhibit their problems, which, so far had been concealed by the new age of the banking system hidden. Non-performing loans increase is closely related to the public debt indicator and at the same time it is one of the main causes of bank lending reduction. When businesses are insolvent, obtaining new debt without paying old ones cannot avoid bankruptcy and it will increase more the indicator of non-performing loans. Credit quality has steadily decreased, thus reflecting the high level of problematic loans in recent years.

Mainly after 2009, reflecting the effects of the economic crisis and the financial crisis, this indicator has increased significantly. The largest increase was in 2012, when nonperforming loans reached the level of 18, 8% having an increase of 4, 8% from the previous year.

In 2013 the index increased by 3.7%, while last year it increased by 1% showing declining growth rates. The slowdown in the growth of non-performing loans was mainly driven by the sale of non-performing loan portfolio from banks and by their deletion from the balance sheet. The index of non-performing loans to total loans in Albania is one of the highest compared with that of other regional countries such as Montenegro, Macedonia and Croatia. Serbia is closer to our level of problematic loans.

Considering the situation of this indicator and comparing it with other countries, we should say that the Albanian banking system should be very alert with regard to this indicator.

The low level of lending and lack of liquidity

The low level of lending and its inhibition slows economic growth and increases cash flow informality. The level of private debt in Albania in

relation to GDP is very low- less than 50% - compared with some developed countries, where this figure is more than 100% of GDP and in some places even 200% of GDP. The lack of liquidity not only in the banking sector but also in the real economy is another problem of private debt in Albania.

The rapid growth of savings deposits deepening economic slump reduces consumption and increases the debt burden, as the economy lacks sufficient funding. This phenomenon is also related to not promote private investment, not creation of new jobs and curbing economic development in general.

In these circumstances, the stimulation and encouragement of banks to grant loans is imperative given the need for real economic growth and the low percentage of this indicator to GDP. The poor performance of the loan is not just an isolated phenomenon of our economy; it is observed in all countries of Central and Eastern Europe. In the second half of 2013, the already weak pace of credit growth slowed further and for most countries it remained close to zero or in negative terms. In comparison with other countries of the region, Albania is among the best performing countries, at regional level and beyond.

In many countries such as Hungary, Bulgaria and Croatia, lower demand also relates to the high level of credit use in pre-crisis period. This is not observed in such countries as Albania and other Balkan countries.

According to IMF forecasts, the global economy grew by 3.4% in 2014 compared to the projected 3.6% and it is projected to grow by 4% in 2015.

Given the increased demand for exports, the Eurozone economy was revived in 2014. Some countries with good export base and close financial and commercial ties with the Eurozone have recorded high rates of growth as Hungary and Poland.

Three countries, Bosnia-Herzegovina, Montenegro and Macedonia saw deflation as a result of a weak economic environment and some external factors such as the decline in prices of raw materials and, in some cases, the local currency overestimating. Analyzing the Balkan countries, lending has been growing in Macedonia, Kosovo and Bosnia-Herzegovina, and has continued to shrink in Albania, Serbia and Montenegro, but the high level of non-performing loans remains a concern for many regional countries.

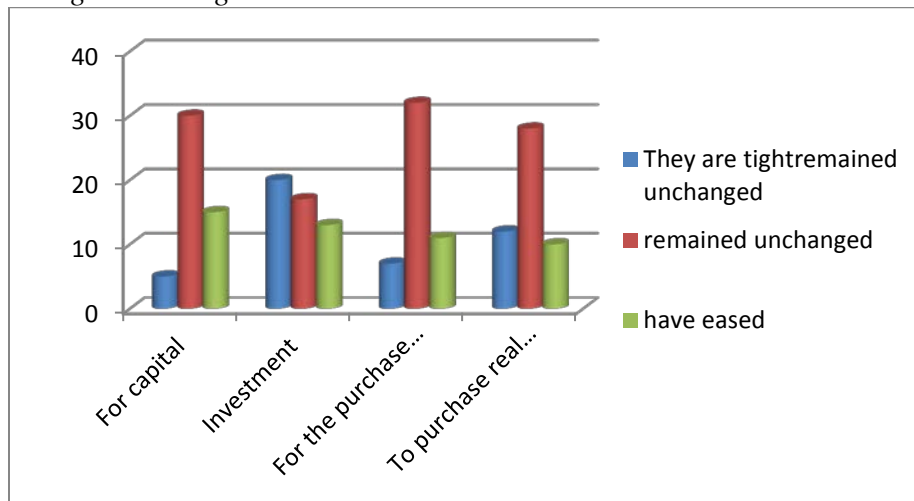
Analysis of bank lending questionnaires

To make a detailed lending analysis based on the methodology employed by the Bank of Albania and the European Central Bank, we built a questionnaire, which was distributed to second-tier banks in Vlore, Fier and Tirana; 50 questionnaires in total were distributed.

The questionnaire is aimed at evaluating lending by second-tier banks and at assessing loan demand and supply expectations through evaluative opinions collected. In order to make a realistic assessment of loan demand and supply, the questionnaire is directed to banks with a market weight of over 3% throughout the year (information obtained by statistic data of the Bank of Albania). Below are some results of the questionnaire:

a. Loans to businesses

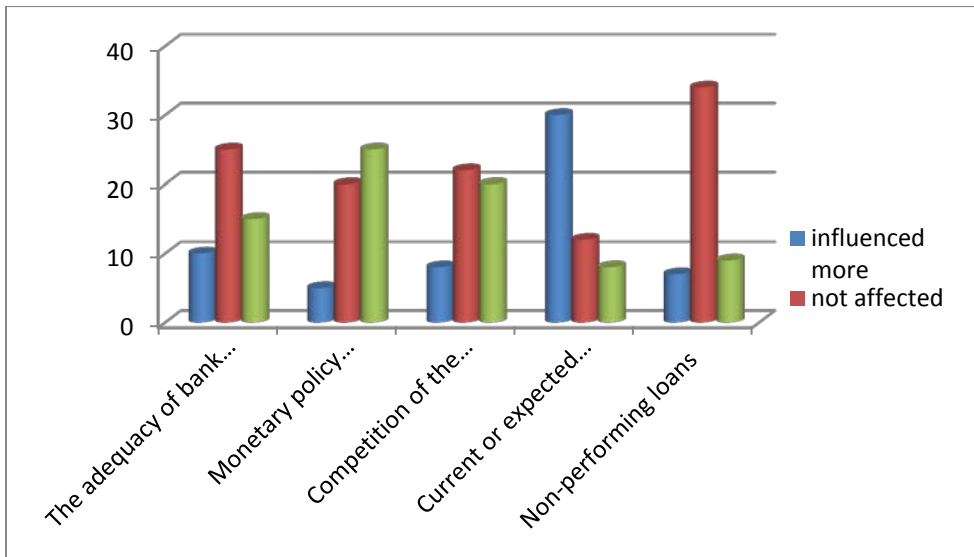
Question1. Over the past six months, how have your bank lending criteria changed with regard to business loans?



The answers show that, in general, the bank criteria for business loans have not changed in the past six months, divided by loan categories for working capital, equipment purchase; however investment loans criteria have been somewhat hampered due to collateral and increase of non-performing loans.

Question2. Over the past six months, how did the following factors affect the standards applied to business loans approval?

- The adequacy of bank capital
- Monetary policy decisions of the Bank of Albania
- Competition of the banking system
- Current or expected macroeconomic situation
- Non-performing loans



Standards applied to business loans approval are not affected by the bank's capital adequacy and non-performing loans; they are slightly affected by the monetary policy decisions of the Bank of Albania; whereas, they are greatly affected by the current or expected macroeconomic situation of the country.

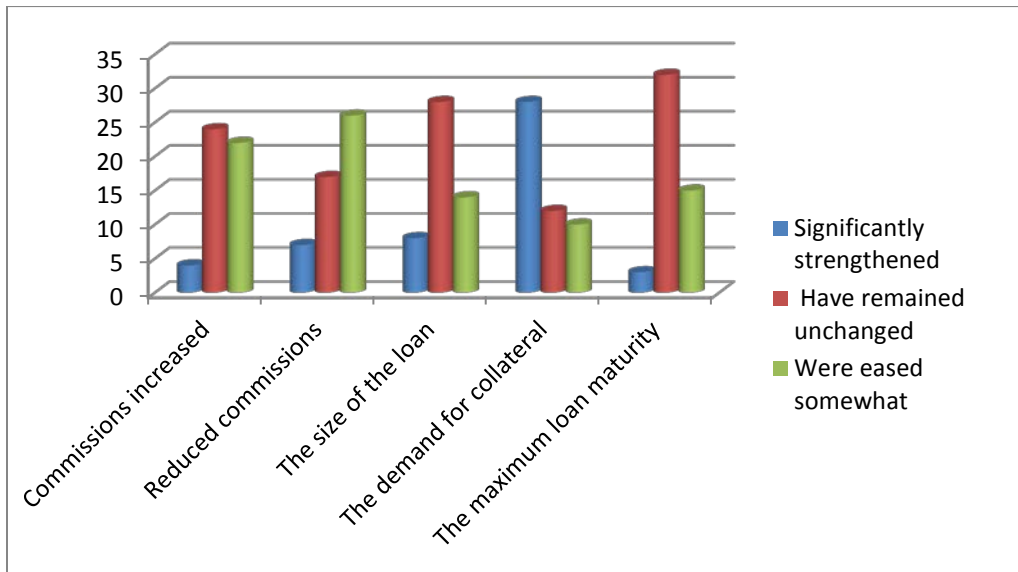
With regard to competition in the banking system, the answers were almost equal "does not affect" or "has little impact". This shows that roughly banks apply the same loan approval standards, with some exceptions.

Questions 3. Over the past six months, how have business loans approval criteria changed according the following scale:

- Significantly strengthened
- Have remained unchanged
- Were somewhat eased

Loan criteria to businesses:

- Increased commissions
- Reduced commissions
- Loan size
- Demand for collateral
- Maximum loan maturity



The questionnaire analysis shows that business loan criteria in general have remained unchanged, but the demand for collateral is significantly strengthened.

This is due to the difficult economic situation the country is facing and the increased level of non-performing loans.

Question 4. Over the past 6 months, how has the demand for business loans changed according to the following scale:

- Significantly higher
- Almost the same
- Significantly lower

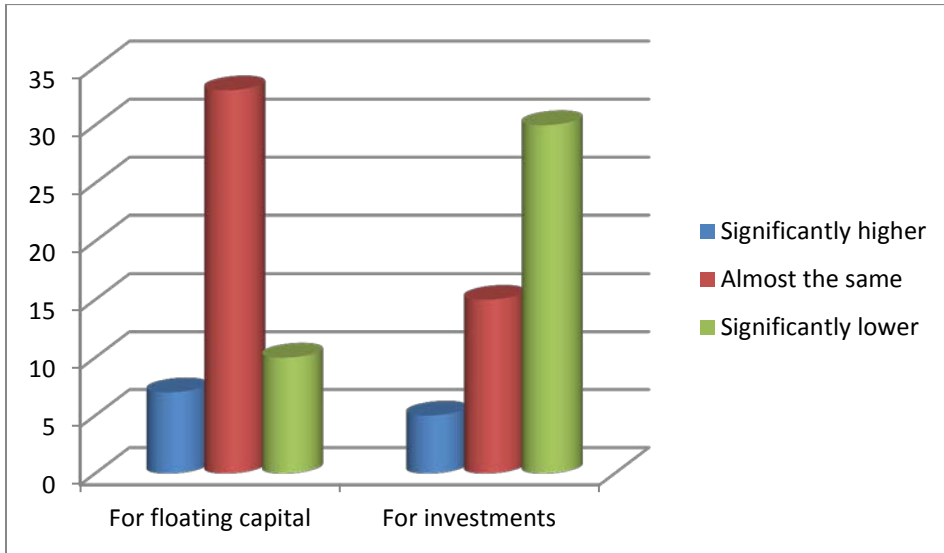
For:

- Floating capital
- Investments

The questionnaire analysis shows that the demand for business loans has either remained unchanged or has decreased, depending on the type of business loans.

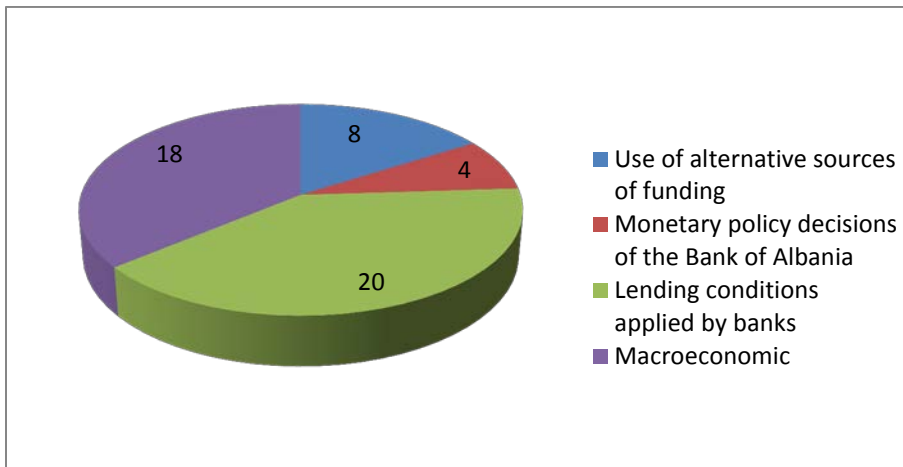
So the business demand for floating capital loans has remained almost unchanged, given the high interest rates on such loans and the reduction of consumption.

However, the demand for investment loans is significantly reduced, due to the macroeconomic situation, the collateral required by the banks, and also due to uncertainty of businesses to invest.



Question 5. If the demand for credit has changed, please make an assessment on how the following factors have contributed to such change:

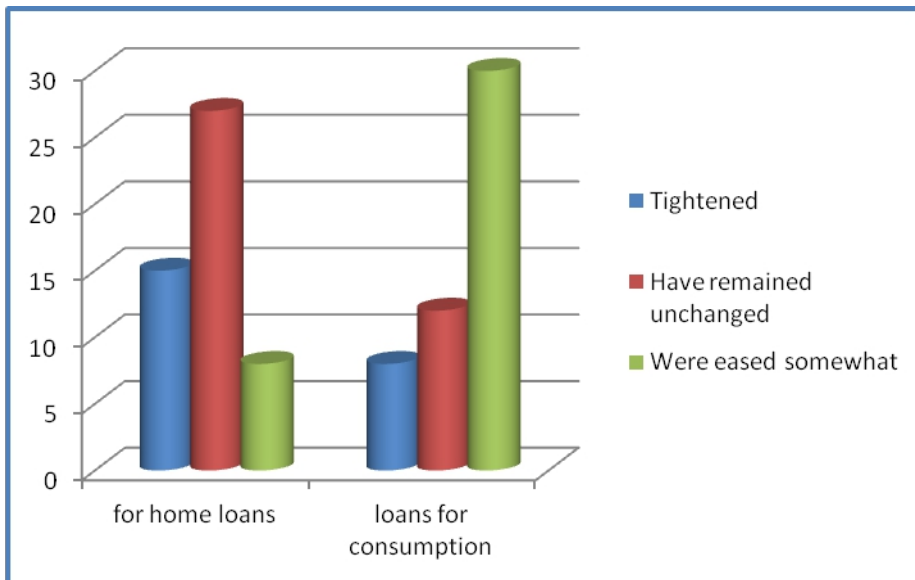
- Use of alternative funding sources
- Monetary policy decisions of the Bank of Albania
- Lending criteria applied by banks
- Macroeconomic situation



b. Loans to individuals

Question1. Over the past 6 months, how have your bank criteria for loans to individuals changed:

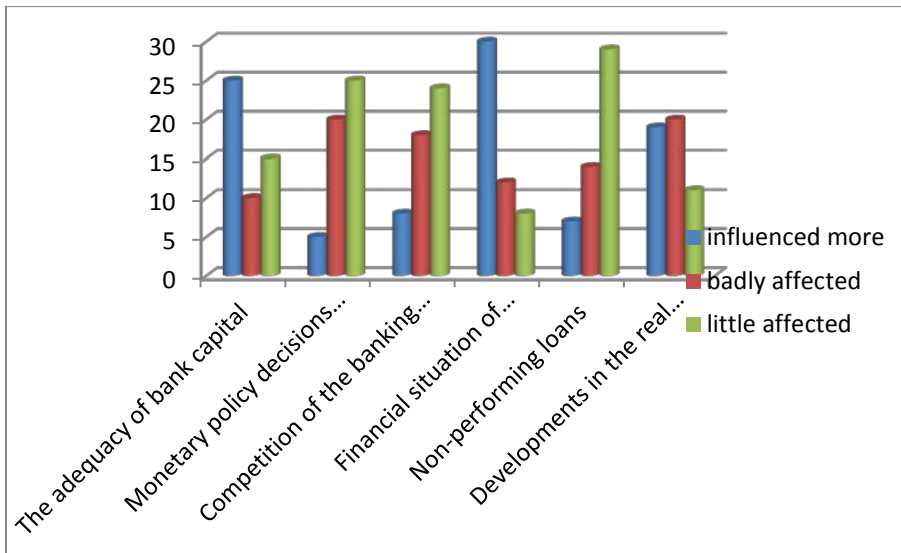
- Tightened
- Have remained unchanged
- Were eased somewhat



According to the answers provided by second-tier banks on the criteria for lending to individuals, only few of them state that such criteria have been tightened, due to increased non-performing loans and the volatility of the housing market, which has resulted in the difficulty of banks to sell the collateral and to provide cash for covering the liabilities of their clients. Most admitted that the criteria for home loans have not changed, while consumer loan criteria have been somewhat eased. This has come as a result of lower interest rates on consumer loans to individuals.

Question2. Over the past 6 months, how have the following factors affected the standards applied to the approval of loans to individuals:

- The adequacy of bank capital
- Monetary policy decisions of the Bank of Albania
- Competition of the banking system
- Financial situation of individuals
- Non-performing loans
- Developments in the real estate market

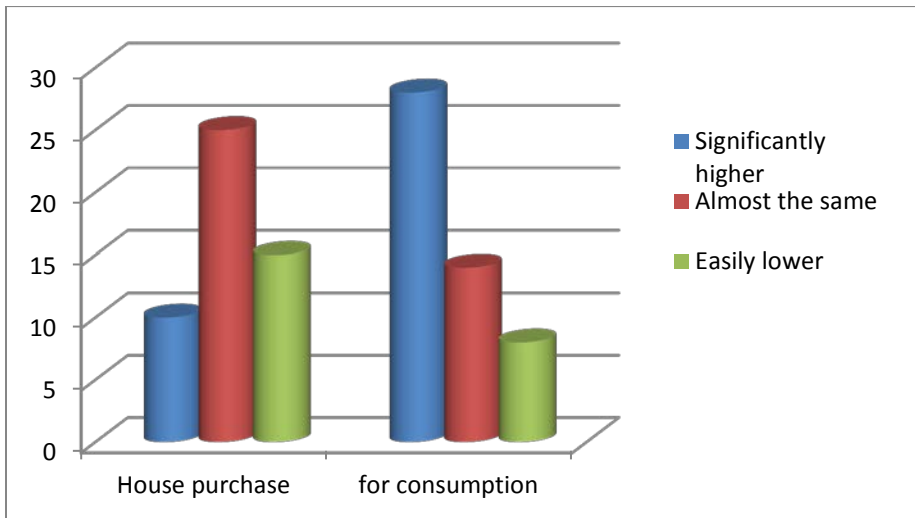


From answers received show that: capital adequacy of banks and individual financial situation are factors that have contributed more to the standards applied to loans to individuals, while monetary policy decisions of the Bank of Albania, the competitiveness of the banking sector, and non-performing loans have contributed less to the standards applied to loans to individuals.

With regard to developments in the real estate market the answers are almost identical, which means that the impact of these developments, either affects or non affects the application of standards for individual loans.

Question 3. Over the past 6 months, how has the demand for individual loans changed:

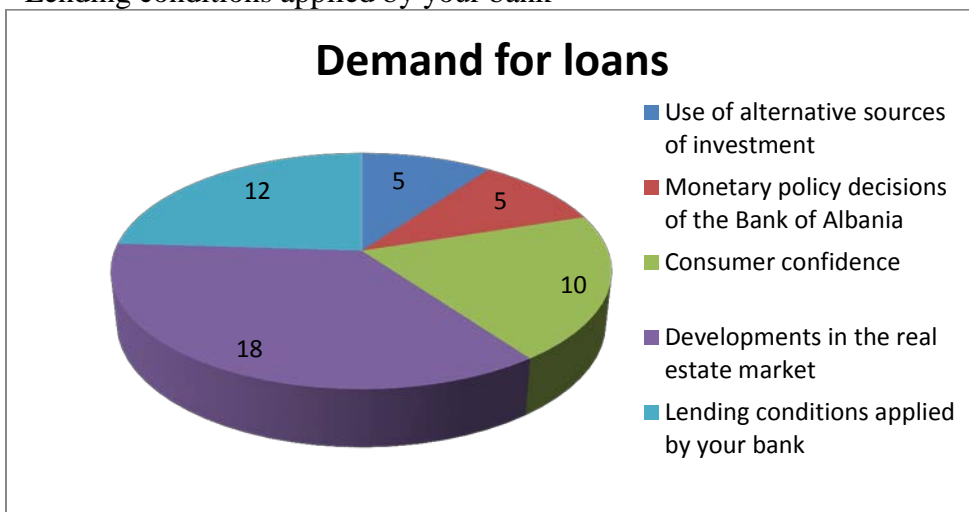
- Significantly higher
- Almost the same
- Slightly lower



The demand for individual loans to purchase houses has almost remained unchanged or is slightly lower, while the individual demand for consumer loans is significantly higher, because the performance of consumer prices continued to reflect weak inflationary pressures, either on the supply or the demand side.

Question 4. If the demand for credit has changed, please make an assessment on how the following factors have contributed to such change:

- Use of alternative sources of investment
- Monetary policy decisions of the Bank of Albania
- Consumer confidence
- Developments in the real estate market
- Lending conditions applied by your bank



The changes in the demand for loans have been affected by developments in the real estate market and the consumer confidence to banks; however the use of alternative funding resources has had an important negative impact, given that they have lower costs compared to bank loans. While monetary policy decisions of the Bank of Albania and credit criteria applied by banks have almost no impact on the demand for loans or their impact is almost poor.

Conclusion

- Problems and challenges of the Albanian banking system are numerous and dynamic. A serious concern of the banking system are loans, or otherwise referred to as non-performing loans.
- Non-performing loans today are the main threat to stability and development of the banking system. The number of non-performing loans has increased since the beginning of the financial crisis - economic.
- With the development and consolidation of the banking system it is also observed the decrease in loan interest rates reducing the cost of credit in the economy.
- An increase of one unit GDP lowers the ratio of non-performing loans by 1.1 units. The result shows that the growth rate of gross domestic product is negatively related to non-performing loans indicator confirming what previous literature suggests on this regard.
- GDP growth of a country makes the overall level of individual incomes rise, increasing consumption and helping further the development and growth of businesses and reducing problems with repayment of loans.
- In general the criteria of banks to extend credit businesses and individuals have not changed in the past six months.
- The analysis of the questionnaires shows that business loans criteria in general have remained unchanged; however the demand for collateral is significantly strengthened. This is due to the difficult economic situation the country is facing and because of the increased level of non-performing loans.

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