

The Growth in the Albanian Banking Sector in the Global Financial Crisis Period and Its Reflection to the Local Economy

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Abstract

The last global economic and financial crisis of 2007-2008 affected Albania considerably. However, it managed being one of the few countries with positive economic growth in Europe. But, the more remarkable event has happened in the country's banking system: the amount of its assets has almost doubled in the period of 2008-2020, from 845 billion to 1.581 billion Albanian LEK. This huge enlargement in the sector's balance sheet has occurred by the increase in the deposits. Moreover, it has happened in the period where the deposit interest rates saw the historically low levels by the continual decreases from year to year. In addition to economic slowdown, some country-specific factors, such as lack of alternative financial instruments, difficulties in reaching some of them, and unawareness of many savings holders about the existing choices- except putting in bank account- have played role in this happening. Meanwhile, the banks have generally preferred buying bond/obligation to giving loan in the same period, which caused the loans' share in the total assets to decrease from 48 percent to 39 percent and the securities' share in it to increase from 32 percent to 35 percent. The decline in credit demand is one of the factors of this change, but the credit-less economic recovery, which started in 2013 and continued till the Pandemic period, implies that it is mostly due to the banks' reluctance in making new loans. The huge rise in bad loans in the period of 2008-2013, and the limited effect of the following recovery on liquid assets as well as the increasing debt need of the government have led the banks to choose this way. The current structure of the banking sector's assets should change in favor of the private sector. The banks should have more desire to give credit to the economy, but this requires some positive changes in the potential borrowers' behaviors and management sense as well as improvement in non-performing loans issue. Meantime, the government should perform its functions more properly, and tend to meet its financial needs from outside, and thus a bigger part of the domestic resources will be presented to usage of the business enterprises and households. This change is crucial to launch a sustainable economic growth after the Pandemic period, and for the banking system's soundness in the long-run, which requires having strong and diversified relations with the clients, including meeting their financial needs.

Keywords: Albania, banking sector, financial crisis, asset allocation.

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1. Introduction

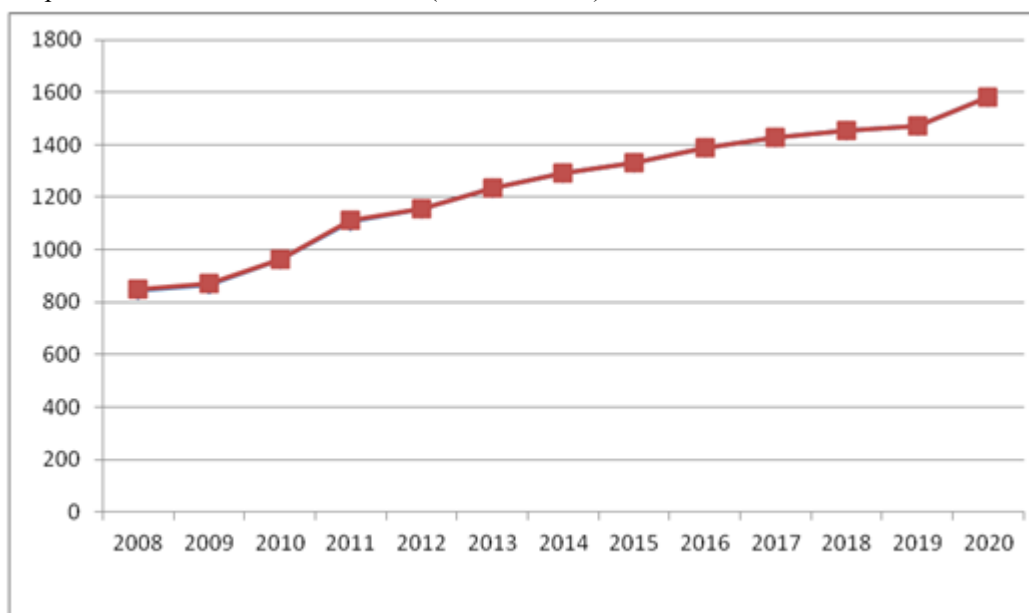
Banks, in general, compose the principal part of a country's financial system. They are the institutions people trust more than they do the other ones. Therefore, the banking system is the main place for people and business enterprises to keep their savings and funds. Firstly, banks have responsibility for deposit holders as giving back their money whenever they want with showing respect to the agreed conditions between them. Secondly, they should distribute these financial resources to different client segments by taking into consideration economic development of country and social welfare in society. Thirdly, they should pay attention to their lending decisions so as to allocate their available funds to proper clients. In this way, they will have strong financial figures without living serious trouble in collecting the given loans. Because of these reasons, appropriateness in the allocation of financial resources is very crucial for the soundness of banking system as well as the overall economic development and social stability. Shortly, the management policies and styles applied in the banking sector play a significant role in determining the direction of economic, financial, and social development in a country.

2. The Enlargement of the Banking Sector and Its Contribution to the Local Economy

Albania has been affected considerably by the last global economic and financial crisis of 2007-2008, especially due to its close and strong relations with Italy and Greece, the two most worsened countries in Europe. However, it always had positive gross domestic product (GDP) growth rates, a yearly average of 2.76 percent, in the 2009-2019 period (Financial Stability Reports of Bank of Albania, 2009-2019). Bakker and Klingen (2012) determined that the total output continued to grow in Albania in contrast to most of the emerging Europe countries, where the total production remained below the pre-crisis levels. Albania is one of the very few European countries those that did not have a serious damage in their economies in the 2008-09 crisis period.

Meanwhile, the amount of banking sector's assets has always been in rise, increased from 845 billion Albanian Lek (ALL) in 2008 to 1.581 billion ALL in 2020¹([graph 1](#)).

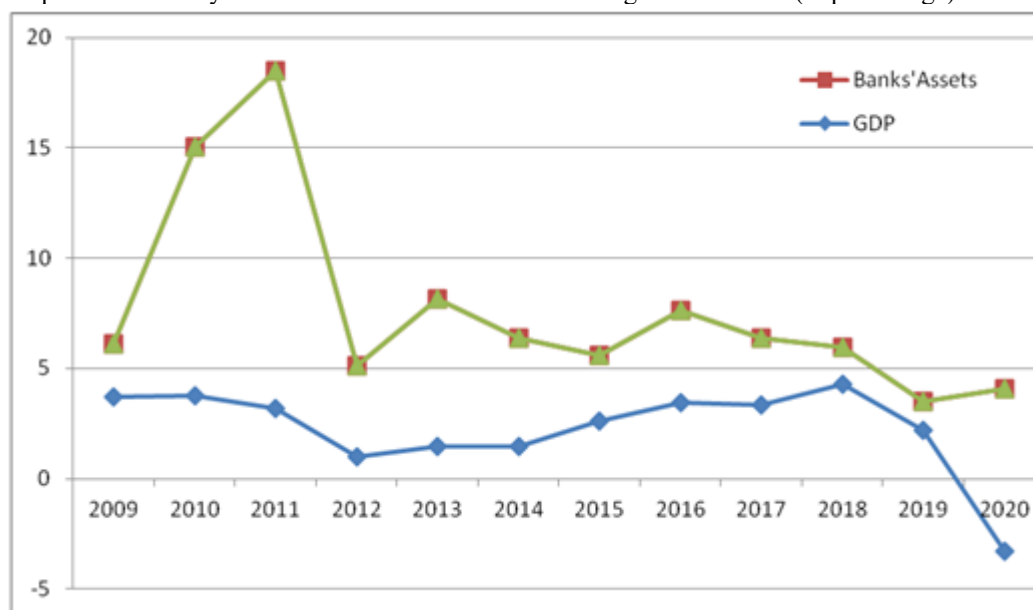
Graph 1: The Amount of Banks' Assets (in billion ALL)



Source: Monthly Statistical Reports of Bank of Albania (2008-2020)

When the growth rates of GDP and of banking sector assets are compared, it is seen that the latter has always had higher levels and continued to be in positive figure even after the start of COVID-19 pandemic ([graph 2](#))

Graph 2 The Yearly Growth Rates of GDP and of Banking Sector Assets (in percentage)



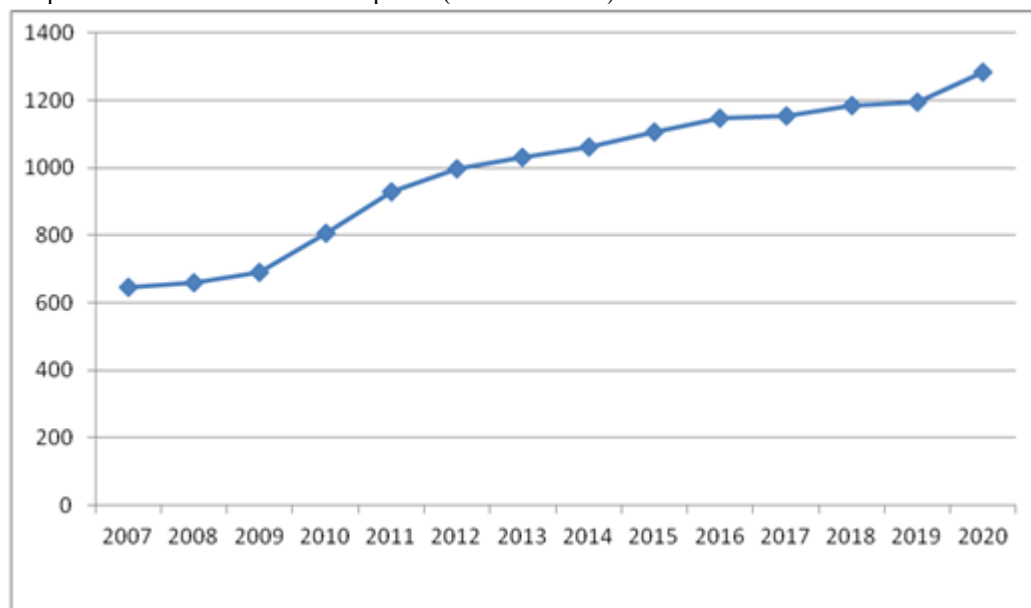
Source: Financial Stability and Monthly Statistical Reports of Bank of Albania (2009-2020)

To identify the sources of this considerable enlargement in the sector's balance sheet, it is necessary to look at its liability side. Deposits by clients has always been the main item of that side. Its share in the total liabilities has made some ups-and-downs -in the range of 80-86 percent- during the examined term. This means that the growth in the sector has occurred by the increase in the clients' deposits. Thanks to this positive development, the banking sector has not lived any liquidity problem though non-performing loans (NPLs) ratio reached very high levels. The amount of total deposits has always been in the rise, increasing from 646 billion ALL in 2007 to 1.283

¹ Quite a big part of the foreign currency assets and liabilities (about 90 percent) are in EURO. Its value against ALL increased in the first years of the global crisis, but turned back to the pre-crisis level later. The average of EURO/ALL rate in 2008 and 2020 are 122.8 and 123.8 respectively (Monthly Statistical Reports of Bank of Albania, 2008-2020).As the effect of exchange rate on this item and the other ones mentioned hereafter is very small, it is not taken into consideration in this study.

billion ALL in 2020 (graph 3)

Graph: 3 The Amount of Total Deposits (in billion ALL)



Source: Monthly Statistical Reports of Bank of Albania (2007-2020)

The deposit increases of 2008 and 2009 remained at low levels as some deposit holders took their money from the banking system¹ in the period of September 2008-March 2009, the early months of the global crisis's effects in Albania. After the first shock of the crisis passed, people brought back their savings to the banks. Meanwhile, they started to prefer saving to consuming, which resulted in contraction in the economy, and increase in the business owners' deposits too. All these factors led the deposits to increase in remarkable amounts from year to year. The speed of this movement slowed down in 2013, where the economic growth rate of the country started to go up. Business enterprises and households began to canalize a part of their money in the bank accounts to run their economic activities and to invest in real estate, in the environment where the banks tightened the lending conditions extremely. It is interesting that this continual upward movement in savings, which resulted in a considerable increase of the total deposits, has occurred in the period where the deposit interest rates fell down very drastically as a result of the continual downward movements. The monthly average rates of time deposits in ALL, EURO, and USD went down from 6.11, 4.22, and 2.58 percent in August 2008 to 0.59, 0.16, and 0.38 percent in December 2020 respectively. Likewise, the rates for current accounts in ALL, EURO, and USD decreased from 0.29, 0.16, and 0.13 percent to 0.1, 0, and 0 percent respectively (Monthly Statistical Reports of Bank of Albania, 2008-2020). It is normal that in economic slowdown periods, business enterprises and households keep a bigger part of their funds in bank accounts instead of using for economic and commercial activities. But, such a big increase in the bank deposits indicates to existence of some country-specific reasons behind this event. First of all, there are few financial instruments as alternative to keeping money in bank account. For instance, a stock exchange market still does not exist in the country. Most of the banks do not offer any special product, such as investment fund, but only time deposit account to their clients. Meanwhile, to access to some of the existing financial instruments -like government bonds/obligations- and to sell them immediately is not practical because of the complicated and costly transactions as well as of the highness of minimum investment amount. Moreover, issuance of bond by the private sector is a rare event and those bonds are traded with the financial institutions, mostly with the banks. In addition to these factors, a big part of the deposit holders are not aware about the existence of the investment choices, except putting money in bank account.

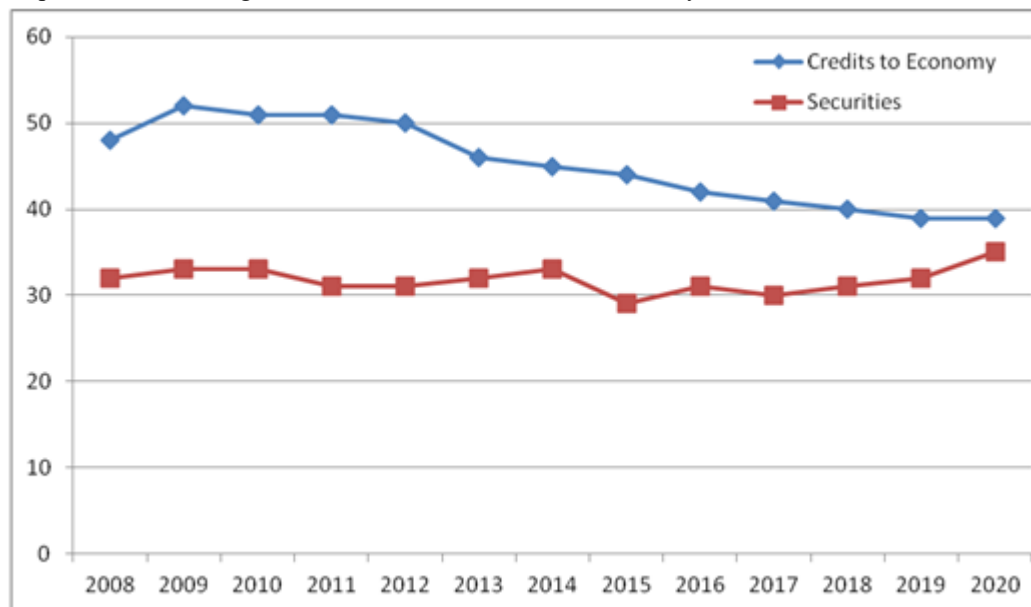
The banks in Albania, as it happens in many countries, use their available funds for placement² mainly either by giving credit to business enterprises and households or buying public and private bonds/obligations of local and foreign institutions. The recent trend in the distribution of the assets shows that the sector has preferred the latter to the former. More concretely, the total amount of the placements in securities has doubled, from 274 billion ALL to 550 billion ALL, while the credit to economy has increased from 397 billion ALL to 609 billion ALL in the period of 2008-2020 (Monthly Statistical Reports of Bank of Albania, 2008-2020). The graph below shows how

¹ The total amount of money withdrawn because of the panic was equal to 9.5 percent of total deposits in the banks.

² The banks have to keep a certain amount of their funds as reserve in BoA, and another part in liquid form for transactions with BoA, among themselves, and with other credit/financial institutions. The remaining amount after these requirements is considered as the available part for placement.

the shares of these two major placement items in the total assets have changed during this term. It is possible to mention about two significant determinations. The shares of the credits-except 2009, where the total assets increased very little due to deposit withdrawals- went down continually till 2020¹. On the other hand, the share of government bonds/obligations remained at the same levels till 2018 and then has been in an upward trend. It comes close to the credits' share, with reaching its record level of 35 percent in 2020 ([graph 4](#)).

Graph: 4 The Percentage of Securities and of Credits to Economy in the Total Assets



Source: Monthly Statistical Reports of Bank of Albania (2008-2020)

The banking sector has lived a very big problem related with credit repayments. NPLs ratio increased from 3.4 percent in 2007 to 23.5 percent in 2013. In the following years, it went down remarkably, becoming 8.4 percent as end of 2019. However, a considerable part of the recovery has not come from the payments by clients or collections by execution, but taking bad loans out of the banks' balance sheets by the write-off transactions² and/or transfer of collaterals' ownership in favor of the banks. This huge rise in bad loans, and the undesirable way of improvement undoubtedly is the main reason of the banks' reluctance on making new loans. The second important factor is the increasing debt request of the government from year to year³. The tendency of the banks to meet the government's financing needs led the interest rate of treasury bills, and obligations to see very low rates as a result of continual downward movements, from 9.14 percent as at end-2009 to 1.43 percent as at end-2018⁴. The banks reflected these permanent decreases to their clients by applying lower and lower interest rates for deposits. Meanwhile, the banks still have the chance of making high profits from their assets in EURO. The government opens Eurobond auctions from time to time with the interest rate in the range of 3-3.5 percent while the banks have not been giving any interest for the moneys in the EURO current accounts since September 2016 and applying very low rates for time deposits in EURO⁵ for a long time. As a summary, the banks have preferred making placement in more secured, but with lower yield investment instruments to giving credit to the economy because of the recently lived bad experience in lending, and of not finding the current situation and future expectations comfortable. Meantime, the government has met a big part of its financing demand in the domestic market with good conditions, especially the borrowings in ALL. In addition to the tightened lending policies of the banks, the decrease in credit demand has certainly played an important role in the changing trend of the assets distribution too. Meanwhile, the yearly economic growth rate switched from downward to upward trend in 2013 and the economy grew with a relatively good rate, a yearly average of 2.68 percent, in the period of 2013-2019 (Financial Stability and Monthly Statistical Reports of Bank of Albania 2007-2020). This development happened in a period where the total credit stock showed very slight changes, indicating to occurrence of economic recovery without

¹ It remained at the same level though the loan repayment postponements and the support credits with the government guarantee given to mitigate the negative effects of Covid-19 Pandemic.

² Starting 2015, the banks are obliged to take the bad loans, which stay in the lost category for more than 3 years, out of their balance sheets. The total amount of written-off loans in the period of 2015-2019 is 65 billion ALL, a remarkable amount for the Albanian banking sector.

³ The government's debt increased from 370 billion ALL in 2007 to 631 billion ALL in 2020.

⁴ With slight increases it reached 1.77 percent as at end-2020.

⁵ The monthly average rate of time deposits in EURO is 0.16 percent in December 2020.

bank credits, but by some other resources such as potential credit clients' owned funds, and/or borrowings from other financial institutions or people. This event is not a peculiar case only to Albania, but happens in many countries from time to time. Suljoti and Note (2013) determined that drastic slowdowns in credit growth occurred in all the Central, Eastern and South Eastern European countries starting 2009 and have gotten for worse since the second half of 2012. The results of a research by the European Investment Bank in January 2013 indicate that *"a similar behaviour has been noted in the other economies of Central, Eastern and South Eastern Europe (CESEE). In these countries, re-emerging from one of the most severe recessions in the last decades, the recovery of the economic activity was not accompanied by a recovery in lending activity. ... In literature, this is known as the decoupling effect. The recovery of economic activity, without a rebound in credit, is also known as credit-less growth, suggesting recovery and expansion of economic activity immediately or a few years after a crisis, in the absence of credit"*. It is also stated in the same research that *"decoupling of these indicators and credit-less recoveries are not rare events, as financial cycles caused by credit shocks tend to last twice longer than economic recessions, whereas economic activity expands even when credit falls. Some empirical studies (Calvo et al. 2006; Biggs et al. 2009; Aghion et al., 2009) show that, in post-crisis periods, the correlation between bank lending and the pace of economic activity recovery loosens. ... Calvo et al. (2006) explains this phenomenon as the output "rising from its own ashes", implying a process where domestic businesses and private enterprises, in the presence of a credit shock, generate liquidity and investment funds not only through credit, but also from alternative sources. In the absence of bank lending, businesses use their own funds, accumulated profit, informal borrowing, or other types of funding. In a study examining data from 25 financial crises, they show that businesses facing liquidity and working capital shortfalls cut on their spending and investments. A credit-less recovery of economic activity may be sustained through other channels such as fiscal stimulus, expansion of foreign direct investments or export growth. ...However, the above-mentioned findings and theories present short-term correlations, which are more valid in post-crisis periods. This should not imply that lending is insignificant (Calvo et al, 2006). Abundant literature shows that in the longer term, developments in the banking sector and real sector influence one another"* (Manjani,2014).

3. Literature Review

Credit to private sector is the main indicator of the banking system's asset allocation policy. It shows to what extent the banks want to support economic activities. Therefore, its trend and proportion to the related macroeconomic figures, especially in economic slowdown periods, is very crucial for economic development of a country.

3.1 The Studies for Albania

Matuka (2019) aimed to identify the determinants of credit to the private sector in the period of 2000-2017. The findings show that economic growth makes positive impact on it while increase in lending interest rates, NPLs, and domestic government debt amount affect it negatively. Inflation is in a positive relation with it.

In the research paper by Shijaku and Kalluci (2013), the factors influencing the lending to the private sector are explained. Higher confidence among the economic agents, sustainable economic growth, and lower NPLs ratio would encourage the banks to make more new loans. In addition to that lower interest rates and financial liberalization would decrease the risk of lending, and increase its efficiency, and thus would lead to a rise in credit supply. Besides that lower level of government deficit would enhance financial intermediation, and hence lead to meeting the financial needs of the private sector at a higher level.

3.2 The Studies for the Other Countries

Bertay, Demirgüç-Kunt, and Huizinga (2015) examined the lending behavior of state-owned banks over the business cycles by using the selected data of 1.633 banks from 111 countries for the period of 1999-2010. They find that lending by these banks is less affected by change in macroeconomic situation compared to that by private banks in the countries with good governance. It even increases in the properly administrated high income level countries. State-owned banks' lending applications during economic and financial crises play a stabilizer role in market, but their performance regarding credit quality, in general, is not good. Therefore, to enforce a prudential banking regulation is more appropriate as it is more flexible and does not create bad loans as state ownership does. It is also stated that foreign private banks' lending policies is the most procyclical among that of the other banking groups.

Coleman and Feler (2015) examined the lending activity of the banks in Brazil during the 2008-2009 financial crisis. It was determined that the state-owned banks increased lending to offset the decline in the new credits by the private banks. This behavior maintained economic growth and prevented unemployment rise, but later led to deterioration in productivity due to high level of misallocation in the given credits.

4. Conclusion and Recommendations

The last economic and financial crisis has affected the Albanian economy remarkably and its reflection on the banking sector has been in the form of very huge rise in the bad loans. However, the sector has not had any trouble in meeting its financial obligations owing to continual increases with considerable amounts in its current assets thanks to rise in deposits. Moreover, this event has happened when the deposit interest saw the historically low levels, mostly through the less developed financial market and lack of financial knowledge in the society. The bigness of the sector's balance has almost doubled in the period of 2008-2020. During this period, the banks' asset allocation policies, in general, have been in favor of the government securities, bringing their share in the total assets to 35 percent in 2020 from 32 percent in 2008 while decreasing the loans' share in the total assets to 39 percent from 48 percent in the respective years. The economic slowdown certainly led to a decline in credit demand. But, having permanently positive economic growth rates and the increase in the growth speed starting the year 2013 show that the domestic economy did not have a serious deterioration. It would even have been in a better position if it was supported more by bank credits. On the other hand, the huge increase in NPLs and the unsatisfying way of the following recovery in it -mostly by write-offs and/or transfer of collaterals' ownership in favor of banks instead of collection- have made the banks very reluctant to give new loans. These events imply that the supply side's effect has been bigger than that of the demand side. Shortly, in the asset allocation, the banks have usually preferred less risky/risk-free instruments to lending though the former's return is considerably lower comparing to that of the latter. Their increasing focus on these financial products led the yields of the Albanian government bonds/obligations to see the historically low levels. Meanwhile, the banks naturally reflected a big part of this decrease to their deposit clients. In this present situation, the government meets the major part of its borrowing need in the local market with good conditions, especially in ALL and the banks make a really good profit from these securities comparing to the taken risk.

The existing asset allocation policy of the Albanian banking system is not favorable not only for the private sector, but also for its soundness in the long-term. The private sector needs the banking sector's financial support to maintain the economic development. Meantime, the banks cannot improve the relations with the existing clients and find new ones without meeting their credit requests, which are of great importance to keep up their activities with becoming stronger in the future. Therefore, they should change their lending policies in favor of the private sector. In other words, the banks should have more desire to increase the credit to the economy considerably. More recovery -mostly by collection- in NPLs issue will motivate the banks to lend more. Meantime, the potential borrowers and the government should make some improvements in their systems/functions in order to encourage the banks being flexible and willingness in credit request evaluations. Business enterprises should be more trusty and transparent as well as rehabilitate their organization structure and management styles. The government should perform its regulatory, controlling, judicial, and motivating functions properly. It should also tend to international markets to arrange a bigger part of its financial need, which will force the banks to change their asset allocation policies in favor of business enterprises and households.

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