ABSTRACT

Building a diversified portfolio is considered one of the most important challenges of an enterprise. The banking sector is considered as one of the most developed sectors of the Albanian economy, but also as one of the sectors, that changes and invests in technology and financial products.

The banking market has evolved rapidly after 2005 and has contributed significantly to Albania’s economic growth. Comprised of 16 banks (14 with foreign capital and two with Albanian capital), the Albanian financial market fluctuated by the financial crisis in 2008, where its effect continues nowadays.

Banks have tried to diversify the loan portfolio with risky products and different maturities, but curbing credit began in 2010 as a result of the European crisis and in particular the Greek one. The negative effect of the economic crisis as well as the delays in loan liquidation brought about a considerable increase of the level of non-performing loans, reaching the extent of 24.8% (2015). In majority, these bad loans belong to big businesses which were the first to be affected and that reflected the economic and financial crisis. The largest share of businesses, which demonstrated impotence in the settlement of liabilities, were engaged in public work. The delay of payments by public contracting entities, together with the business economic illogic insistence to advance own in unpaid work, or without a security in the scheduling of payments worsened their financial situation to impotence to settle the obligation.

Under crisis conditions, the Bank of Albania took measures to prevent the deterioration of the financial situation and to give lending a boost, by reducing the level of interest rate. But, lending still remains at critical levels, as confidence in economic growth and a political-economic stability remains low.

KEYWORDS: Credit Portfolio; Public Debt; Non-Performing Loans
Banks and credit portfolio composition

Banks, as one of the main pillars of development, are at the same time the stabilizers of the economy. The Bank of Albania continuously develops stabilize policies even in the protection of the financial market. The lack of functioning of the Exchange has led to difficulties in the financial market, in the alternatives and the types of financial instruments that business and banks may finance themselves. But, on the other hand, the lack of Exchange helped Albania to positively cope with the global financial crisis since its exposure to international markets and foreign governments’ public debts was almost zero. Banks in Albania operate 100% with the Albanian market considering the traditional banking Deposits-Loans. The banking sector occupies 90.4% of total assets of the Albanian financial system and contributes to 91.7% to country GDP.

The question is: Why does Albania suffer from a level of non-performing loans? Why is this level the highest in the Region?

With the beginning of the financial-economic crisis, the United States of America and then in Europe, Albania was affected by this crisis, but with less negative effects. A great impact on this was the Greek and Italian crisis. Banking and business were the first to be affected and subsequently fell. The reduction of the demand for goods and services led to a general decrease in economy. Customers retreated from the consumption of normal and luxury goods; saving and protecting their deposits was essential. From the decrease of the total consumption, the business also suffered a significant contraction of production and investment. In these conditions, banks adopted an inhibitive policy for crediting the economy, because the risk was too high, considering the liquidity crisis that businesses were facing. Lack of sales and liquidity led the businesses and individuals encounter difficulties in repaying the installments of the loans taken out of the banking system. Non-performing loans appeared nearly three years after the crisis. It was after 2011 that we saw a notable increase in them. This increase of non-performing loans in relation to the total loans disbursed in economy came as a result of not granting new loans, leaving unchanged for a long time the denominator of the ratio.

The graph and the table show the non performing loans (in ALL, Euro – short-term, mid-term and long-term loans)
Table 1: Non performing loans

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
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<tbody>
<tr>
<td>Non-performing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>business loans</td>
<td>23.8%</td>
<td>24.2%</td>
<td>22.8%</td>
</tr>
<tr>
<td>Non-performing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>individual loans</td>
<td>17.7%</td>
<td>16.19%</td>
<td>16.13%</td>
</tr>
</tbody>
</table>

Source: Bank of Albania, 2015

Graph.1 Non-performing loans (Businesses, individuals)

Source: Bank of Albania, 2015

Which are the factors that affect the growth of bad loans? From studies, we can divide them in external factors:

1) Macroeconomic (GDP, inflation, unemployment, interest on loans, the exchange rate for foreign currencies mainly US dollar and Euro)

2) Internal factors: banking (credit levels growth, bank capitalization level, ROE Total loans / Total Assets ratio, mediation margin).

Study results show that from the first group of factors: a) economic growth and inflation are inversely related to non-performing loans; b) unemployment, interest on loans and exchange rate are directly related with non-performing loans. While from the second group of factors we have: a) an increase in the number of loans, mediation margin and Loans / Active ratio are positively related to non-performing loans; b) the level of bank capitalization and ROE are inversely related with non-performing loans.

By analyzing the economic situation of Albania 2009-2015, the theoretical and real results coincide. Albania has undergone a considerable decline in economic growth, although
it did not fall into recession. Inflation also has decreased, reaching a historic minimum value of 1.7% in January of 2015. So we can say that the decrease of GDP and inflation has led / influenced the growth of non-performing loans and there is less income for business and individual. Deflation weakens the local currency, leading to a more expensive exchange rate in relation to the US dollar and the euro.

The increase in unemployment rate led to a significant reduction in family income, causing automatically a decrease in consumption, an output decline and therefore a decrease of the loan payment power. Loan portfolio begins to display early signs of deterioration.

Table 2: GDP, inflation, unemployment, public debt

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<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
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<tbody>
<tr>
<td>% GDP</td>
<td>0.4%</td>
<td>2.1%</td>
<td>2%</td>
</tr>
<tr>
<td>Inflation</td>
<td>1.9%</td>
<td>1.8%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Unemployment</td>
<td>17%</td>
<td>18%</td>
<td>16.5%</td>
</tr>
<tr>
<td>Public Debt</td>
<td>70.5%</td>
<td>72.1%</td>
<td>71.6%</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance, 2015

Moreover, the surveys found that non-performing loans are cyclical by nature and depend totally on the economic cycle fluctuations. When the banking system increases lending substantially as a result of the targets set for the financial market dominance then the loan quality is expected to be weak and to face difficulties in the future.

The 5 biggest banks in Albania possess about 68.2% of the loan portfolio, and 75.4% (2014) of total deposits; taking in consideration that might be a problem in the financial sector, with such a concentration of credit and deposits. Moreover, from the information received by these banks, it is reported that most of the non-performing loans that come from business are as a result of state outstanding public works. Full identification of state debts towards business is very important in slightly reducing the negative impact of the lack of liquidity.

With the intervention of International Monetary Fund (IMF) and the agreement with the Albanian government, the government injected 250 million $ into the economy as state contractual obligation, repayment (procurement entities) to the business, but this intervention did not have the expected effect in economy. The time effect and business costs were much greater than the injection. In terms of lack of liquidity, businesses were forced to take overdraft to repay obligations.
Banks face difficulties and they may have problems with liquidity. In Albania, there are no cases where banks have such liquidity problems. Their bankruptcy would come just because of the bad assets quality. However, the analysis of the Bank of Albania, second-tier banks are well-capitalized where credit ratio is justified related to total deposits.

Another important problem is the concentration of loans in some major sectors such as the processing industry, construction and trade industry; vehicle repair industry. Lending geographical map is also in the zones of Tirana-Durres; Vlore, Fier and Shkodra. If banks would expand the geographical map and the business sectors as well, we would probably have a lower level of non-performing loans.

Graph 3: Credit according to economic activity
This fact tells us that concentrated funding has the highest probability to run into problems and difficulties. In crisis conditions, all three industries are significantly affected. The construction industry is virtually paralyzed since 2008. The processing and trade are directly related to the level of demand by domestic and foreign consumer.

The graph below shows the level of exports for each country of the Western Balkans toward Balkan countries, European countries and others. As we can see, Albania is the only country that most of its exports are related to the demand of European countries. Since, these countries (mostly Greece and Italy) are affected by the crisis; the demand for products is low. Many Albanian businesses have invested in technology by getting loans from banks, in order to meet European standards and quality of products. The crisis brought late installment payments from the businesses and in the worst case, the default of loan payment.

Graph 4

Another important investment of banks is the government bonds. From year to year we can see that buying treasury bonds and other government bonds has increased due to the increase of the risk of business lending and the difficult economic climate. Banks have chosen to invest in risk-free securities (government bonds and securities) in order to reduce the overall risk exposure of their portfolio and by diversifying credit.

Albanian banks hold about 60% of total internal government debt. At the end of year 2014, the banking sector holds Bonds and other government securities at 25.1% of their total asset (in value 324.5 miliard of Lek), while in the first trimester of 2015 it is about 32.5%.

However, even the government securities can be named risk free, the Greek state experience showed us that the state could meet strong liquidity crisis, to the limit of declaring bankruptcy, asking debt relief.
This objection is valid even though from the tests conducted, Albania is still far from the Greek negative scenario, as a result of not being too much exposed to international markets as well as the granting of loans within the Albanian territory.

An additional indication of the performance of the bank loan portfolio is the risk weight. The table below shows the credit quality and risk weight for the respective credits.

Table 3: Credit quality and risk weight

<table>
<thead>
<tr>
<th>Credit quality</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk weight</td>
<td>0%</td>
<td>20%</td>
<td>50%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Shingjergji, 2014

So, the lower the credit granting criteria, or the percentage of the collateral, the greater is the risk weight and the bad credit quality. In some cases, banks are obliged to give loans on concessional terms, because of the very competitive financial market and the ability to fully monitor the payment of installments or portfolio completeness.

Another element that has influenced the growth of bad loans is also the weak managerial ability of Albanian companies. This is observed precisely when they are exposed to very large investments. "One man show" mentality that administers Albanian companies is far from "Corporate governance" concept that would enable effective investment managers and efficient money management. This aspect and the overestimation of the real estate collateral are typical phenomena of countries like Albania, with a weak economy, a scarce managerial and legal culture and a high degree of informality.

The crisis exposed the problems of the banking system, the relatively poor quality of the portfolio, as bad loans rise to the level of 25% is worrisome, if we compare this level to the region.

Graph. 5
Central Bank of Albania, as instructed by the European Central Bank took measures to stabilize and tightly control the banking system by requiring recapitalization of banks, increasing of the procedures for obtaining loans and a better collateral quality.

Graph. 6

The implementation of Basel II required more specifications in order to meet the trends of banking development. Albania has started the adoption of Basel II, but there is still a lot to do in further strengthening and protecting the financial system.

The European Central Bank has forced the member countries to reinforce the rules and the measures, in order to further strengthen the banking system, by adopting the Basel III for the years 2013-2015.

Conclusion

Hence, we may conclude that the Albanian economy is still fragile and it will take time to stabilize the macroeconomic factors that affect the growth (political and economical). Since the GDP is very low and we do not have the potential to produce and to fulfill the consumers’ needs (domestic and foreign market), the trade deficit will be high in the next years. Furthermore, the level of non-performing loans will remain high, until the whole economy will show positive signals.

Moreover, the Bank of Albania requested to wipe bad loans from bank balance sheets, for alleviating banks from their negative weight. At first sight it may have a positive effect, but their cleaning and updating in other accounts will bring other problems in the banking system.
References