

## THE GLOBAL CRISES AND THE ALBANIAN BANKING SYSTEM SITUATION.

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### Abstract

In this work are analyzed the problems of banking system development in Albania, in the frame of global crisis. More specifically the work covers: Central Bank in the frame of global crisis and the measures undertaken by the Bank of Albania in order to protect the Albanian banking system and *Indicators of the Albanian banking system*. In this part are introduced indicators of the Albanian banking system relevant to the end of the year 2009 and the end of the first half (six months) of the year 2010, as indicators that show the rentability, the situation of the assets, liquidity indicators, capital sufficiency, etc, in other words the indicators that reflect the banking system health. Furthermore is introduced an analysis of stress test based on data from the second half of the year 2010. Their analysis proves that the crisis has influenced the indicators deterioration but the paying ability of the system remains intact.

**Keywords:** Net Financial Result, Net Interest Margin, Assets, Capital Sufficiency, Stress test.

### 1. Introduction

The current global crisis started as a financial crisis in the USA, moving very quickly in the real economy and involving the whole world economy. This crisis has been the object of theoretical analysis and discussions of many analysts of economy. Considering its dimensions it has been compared to the big depression of the years 29-30.

This work has been prepared due to the importance of analysis of this crisis effects in our country.

The goal of this work is;

To identify the impact of the global crisis in the financial system of our country and more specifically in the banking system as well as the measures undertaken in order to mitigate the crisis effects.

**Methodology:** This work is prepared based on the analysis of the data found in the statistical year-books of the Bank of Albania, INSTAT, Ministry of Finance, etc., as well as in the works of different authors on the state and development of the banking system in Albania.

**2. The measures undertaken by the bank of Albania in order to protect the banking system from the global crisis.**

The effects of the global financial crisis had an impact in all the economic sectors in the countries of Central and Eastern Europe. At the beginning this impact was noticed in the diminishment and decrease of financial intermediation and continued with the decrease of trade volume. In a second moment it was visible in the real economy [3].

However, during the year 2010 a regain of the conditions of financial markets and improvement of the different financial and monetary indicators had occurred, thank to the interventions of the central bank and the efficient fiscal policies.

From the theoretical perspective this crisis opens the discussion on the role of the Central Bank under the new conditions of globalism.

The central banks must preserve the necessary balances in terms of objectives and consequences of their monetary policies, more specifically;

- To rigidly control inflation, while this control represents a risk of having an impact in the economic growth
- To support the economic activity, against the risk of inflation's increase [2].

There are several discussions in relation to this but the once that prevails is that a high and uncontrolled inflation represents a threat for the

national or international economy even in the cases when this fact leads to incitement of economic growth.

Which has been the monetary policy of the Bank of Albania?

Through the second half of the year 2010 the Bank of Albania has followed a careful monetary policy, having in focus the fulfilment of the inflation's objective.

More specifically the Bank of Albania has incited monetary incentives in economy under the qualitative and quantitative terms [1].

The interest margin for the treasury papers and bonds of the government have decreased during the whole duration of the period in question and this same tendency was noticed in the case of the interest rate for the deposits and loans in leke, but these terms have been moderated. Under these conditions the bank liquidity has improved, and it was noticed the moderation of the request for momentary means both from the governmental and private sectors.

All these permitted the transmission of an efficient policy in all the segments of the financial markets, and more specifically in the banking system. Further on the condition of the banking system will be introduced. The latest data are those of the second half of the year 2010.

### 3. Situation of second level banks.

#### 3.1 Indicators of the banking system

Even though our banking system was not involved in the global financial crisis, and was not part of the panic crisis the indicators of financial health of the system have deteriorated due to this crisis.

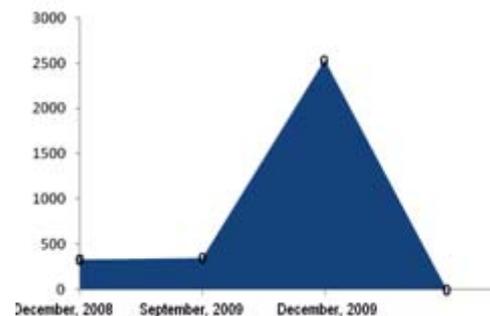
Some indicators providing a tabloid of the banking system at the end of the second half of the year 2010 are introduced here below.

#### *Net financial result*

During the last quarter of the year 2009 the financial result of the banking system has increased

significantly. This result increases 72 percent in comparison with the third quarter of the same year. It must be underlined that such a result is not representative for the banking system of the country. The net result of the banking system comparing it with the previous year and the third quarter of the year 2009 is explained by the low expenses for provisions and much less from the increase of the net interest income. Therefore there is no increase of income from the primary activity of the banks, income from the interests.

At the end of the year 2009, 11 banks present a negative net result. These banks belong to the group of small banks [4, 5].



**Figure 1:** Net financial result. In million leke. Years 2008-2009.

During the first half of the year 2010 the profit was 3.6 billion leke, almost 5 times higher than the profit during the same period of last year.

The average actives that lead to profit for the month of June 2010 are 833.5 billion leke reflecting almost 91.2 percent of the general value of average actives in the banking system.

The ratio "Average passives that cause average expenses/assets that lead to profit" is at a level of 93 percent, almost 1.3 percentage points higher than at the end of the year 2009.

The ratio of general expenses of the activity toward the incomes is 80.9 percent, being on the other side 94.5 percent at the end of the year 2009.

The progress of this ratio shows the attempts of the banks in order to compensate the increase of

expenses for provisions toward the decrease of operational costs of activity.

*Net interest margin.*

The rentability of the banking system from the main activity is provided by the NIM indicator. This indicator shows the equilibrium between the resources for which interest is paid and the investment in assets from which interest is gained. During the last quarter of the year 2009 this indicator is higher than the one of the third quarter, but lowers that the one of the fourth quarter of 2008.

This is explained by the fact that the banks have followed the strategy of more interest paying in order to avoid the further decrease of the deposits and to regain their lost market

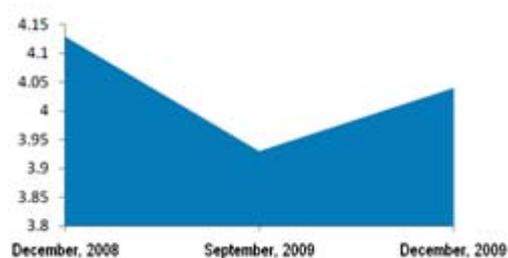


Figure 2. Net interest margin. In percent. Years 2008-2009

RoAA and RoAE, that represent respectively the return from the average activities and the return from the shareholders capital faced a visible decrease during the year 2008, which derives from the notable decrease of net financial result. This decrease continues during the year 2009. Only during the last quarter of the year 2009 there is an increase in comparison with the previous quarter, this explains the increase of net financial result.

Therefore RoAA increases to 0.42 percent during the last quarter of the year 2009 from 0.16 that it used to be during the third quarter of this year, while RoAE from 4.58 to 1.78 percent [4, 5].

At the end of the first half of the year 2010 the RoAA was 0.79 percent. This indicator is 0.4 percent points higher than that of the end of last year.

This indicator is 0.4 percent points higher than that of the end of last year [6].

While RoAE is 8.3 percent, having increased with 3.7 percent points comparing it to the end of last year.

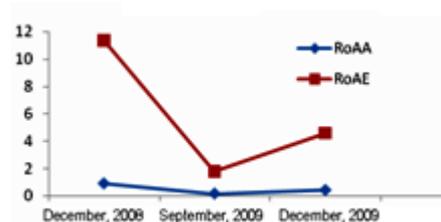


Figure 3. Rentability indicators. In percent. Years 2008-2009

**Assets.** There is a tendency of increase of the total of assets and loans toward PBB. During the year 2009 there is an increase with 52.2 billion leke of the total assets, while the increase during last year is 91.8 billion leke. A slowdown in the increase is noticed in the system loans portfolio that is 13.4 percent for the year 2009, while it is 35.6 and 47.7 percent respectively for 2008 and 2007.

In the mean time the impact level of the banking system in the economy has not decreased on the contrary there is a slide increase.

The following chart provides an illustrative tabloid of this fact.

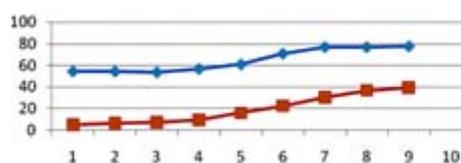


Figure 4. Total of assets and loans portfolio toward PBB. In percent. Years 2001-2009

At the end of the first half of the year 2010 the assets of the banking system represents 79.7 percent of the PBB, while it used to be 77.5 percent at the end of the year 2009, so we can notice an increase of 2.5 percent in comparison to the end of the year 2009.

The main items of the assets are “operations with the clients (gross)”, that represents the loans portfolio of the banks. By the end of the first half of the year 2010 this indicator represented 50.2 percent of the total assets of the banking system [6].

This indicator has been increasing through the years but during the years of crisis there was no increase of the loaning activity rate toward the total assets.

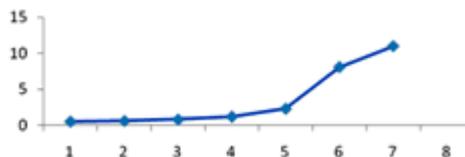
This can be explained with the perception of risk growth for the loaning activities, which has been accompanied by the growth of the position of the other banks and financial institutions, mostly the foreign ones. Nevertheless this suspension of growth in the loaning system is considered to be temporary.

*Loans with problems* The total of loans with problems during the year 2009 is at a level of 20.8 billion leke or 78.9 percent more comparing with the last period of 2008.

This fact is reflected in the indicators of assets quality and specifically;

The indicator of "loans with problems toward the total surplus of loans" has increased from 6.64 percent during the last quarter of the year 2008 to almost 11 percent during the last quarter of 2009 [4, 5].

This is the highest level of the indicator for the last seven years as it is shown here below:



**Figure 5** .Loans with problems toward the surplus of loans. In percent. Years 2003-2009.

The portfolio of loans with problems for the businesses is 12.3 percent at the end of the year 2009, and it was 7.6 percent at the end of 2008. While the loans with problems for individuals are 8.2 percent from almost 5.5 percent in December 2008.

Therefore we can say that the crisis second round has an impact in the indicator of assets quality and that of liquidity.

At the end of the first half of the year 2010 the problematic loans rate toward the total loans increased to 12.2 percent in comparison to the 10.48 percent that

it used to be at the end of the year 2009 or the 8.7 percent of the same period of the year 2009, therefore the decreasing tendency of the problematic loans has continued.

However from the beginning of the year 2010, the quarterly growth rate of the problematic loans has been decreasing.

During the first quarter of the year 2010, the increase rate of the problematic loan is 19.7 percent, while during the second quarter of 2010 it was only 7 percent.

Almost 72.7 percent of the loans portfolio is part of the "standard" category.

During this period some changes in the categorisation of the loans and their transfer from one class to another have occurred, for example by passing into the category "loans under the standard" or "lost loans", and these loans have increase respectively at a level of 5.4 percent and 3.6 percent, in comparison to the 4.7 percent and 3 percent that it used to be at the end of the year 2009.

In the mean time the ratio "Nett problematic loans toward basic capital" has increased to 32.8 percent from 30 percent that it used to be at the end of the year 2009 or the 25.7 percent calculated during the previous year [6].

*Capital sufficiency.* The capital sufficiency indicator for the system has decreased during 2009 by 1 point of percentage and more specifically it is 16.2 percent.

This fact is explained by the new regulation of assets classification based on risk.

Based on this classification the assets and items not included in the balance sheets classified based on risk have increased by 48 percent, while the regulatory capital has increased by 37.7 percent [4, 5].

During the first half of the year 2010 the capital indicators show some stability, therefore the indicator of capital sufficiency for the banking system is only 16.2 percent, the same as during the end of the year 2009.

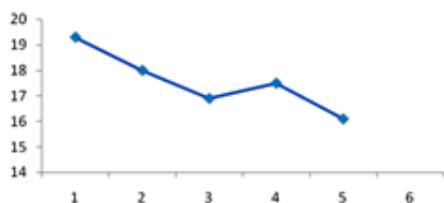


Figure 6: Capital sufficiency report. In percent. Yeras 2005-2009.

The indicator of the financial lever, calculated as the ratio of the *assets total toward the stockholding capital*, by the end of June 2010 is 10.4, the same with the one for the end of the year 2009 [6]. Generally the process of this indicator has been decreasing and this shows the preservation of the high rhythms of increase in the stockholding capital, in comparison to the one of the activity extension.

*Liquidity* The last quarter of 2009 shows a decrease in the liquidity indicators.

- The liquid assets have decreased. At the end of December 2009 the liquid assets of the system are 367 billion leke, they have increased by 2.8 percent in comparison with the year 2008. These assets are growing but with low rates.
- The indicator “*loans toward deposits*” gives a clear picture of the level of liquidity of the banking system.

The decreasing tendency of this indicator is a natural result of the banking system development during the past few years.

Gradually we are going from investments in liquid assets, that are consider to have a low risk, toward investments in long-term assets with a high risk, but also with a high margin of profit.

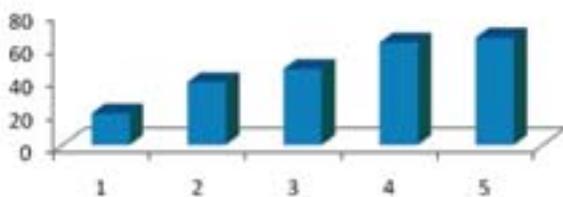


Figure7: Progress of the report of loans toward deposits. In percent. Years 2005-2009.

At the end of the year 2009 this indicator has increased from 62 to 65 percent.

This indicator is deteriorating. This is explained by the simple structure of our banks’ resources, where the deposits prevail. At the end of June 2010 the ratio “*liquid assets/total assets*” and “*liquid assets/short-term obligations*” were measured respectively as 27.85 and 32.85 percent, each showing a slight increase in comparison to the values of the end of the year 2009. Both this indicators are over a value of 20 percent, which represents the minimal allowed value according to the regulation “On the Administration of the Liquidity Risk”, approved by the Bank of Albania.

At the end of the year 2009 this indicator has increased from 62 to 65 percent [4, 5].

The ratio “*loans/deposits*” has decreased reaching the value 63.8 percent in the month of June 2010, 1.4 percent points lower than during December 2009 and 2.9 percent points lower than one year ago [6].

### 3.2 Evaluation of sustainability for the banking system based on the Stress-Testing methodology.

The stress-test analysis based on the data from the second half of the year 2010 is introduced here below. This analysis includes mainly the sensibility analysis of the banking system toward the loans market risks.

#### *The sensibility analysis of the banking system toward risks*

*The exchange rate risk:* Indicated the measurement of the sensibility of the banking system toward the changes in the Leke exchange rate measurement in comparison with the two major currencies, Euro and Dollars.

More specifically through this test we found out the application of different elements such as under pricing and over pricing of the exchange rate with 5 percent, 10 percent and so on leads to an inconsiderable decrease of the capital sufficiency indicator for the banking system. Only extraordinary changes in the exchange rate, which are practically

impossible, could cause a decrease above the allowed boundary of 12 percent of the capital sufficiency rate for the banking system.

*The interest rate risk:* Evaluates the sensibility of the capital sufficiency indicators as a result of the changes in the interest rate for Lek, Euro and Dollars.

From an assumed increase of the average interest rate for the Lek with 5 percent points, the capital sufficiency indicator for the banking sector decreases with 1.7 percent points, more specifically reaching a level of 14,5 percent.

From the assumed increase with of the average interest rate for the American currency with 5 percent points the banking system shows itself protected, for the changes in the capital sufficiency rate is not very relevant even after the assumed change.

On the other site the increase of the interest rate for the European currency with 5 percentage points leads to a decrease of the capital sufficiency rate indicator for the banking system with only 0.4 percent points [6].

*Loan risk:* This risk introduces the sensibility of the capital sufficiency indicator for the banking system, due to the increase of the problematic loans.

Therefore it is assumed an increase of the problematic loans by 95 percent and 110 percent. The first hit represents the boundary level where the capital sufficiency indicators for the banking system fall under the allowed level of rate.

### 3.3 Financial Strength Index

Based on the latest developments of the banking system was developed the “*Financial Strength Index*”, indicator, for the banking system.

Therefore at the end of the first half of the year 2010, the value of the financial strength index has reached a level of 85.2 percent showing a slight decrease with 0.3 percent in comparison with the end of the year 2009.

## 4. Conclusions

- The global crisis has not affected the paying capability of the Albanian banking system but it has influenced the deterioration of its indicators.
- The banking system health indicators analysis shows an increase in the risk level and a decrease in its financial capacity.
- Due to the global crisis and the decrease of the economical growth, the banks have revised their strategic plans by having a more conservative approach toward assets increasing.
- In addition the Bank of Albania has prepared a strategy on the changes of the respective regulations and on the use of monetary instruments, mainly the norm of interest.

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