Bank of Albania

FINANCIAL STABILITY REPORT

2024/HI

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INTRODUCTION

This is the thirty-second issue of the Bank of Albania's Financial Stability Report (hereinafter "the Report"), which is published half-yearly. The Financial Stability Statement, whose half-yearly release is a legal requirement, prefaces the Report. The purpose of this Report is to identify and assess risks to the financial system of the Republic of Albania and its infrastructure, and it assesses the ability of the financial system to absorb these risks. This Report equips public authorities to be able, in a timely manner, to identify relevant measures for corrections, as necessary.

In producing this Report, we have used data available to the Bank of Albania, and information from other authorities supervising the financial market. We have also used information and analyses from public and private, national and international financial institutions. The data and analyses primarily cover developments over the first half of 2024 (hereinafter "the period"). Overall, unless otherwise stated, expectations for the economic and financial outlook extend through a period of up to 12 months.

The stability of the financial system has been assessed based on its performance, from its activity, and taking into account the risks arising from the system's interaction with the overall internal and external economic environment. In order to assess these risks, this report analyses the latest developments in international financial markets, and in advanced and regional economies. We have also assessed their impact on the financial system and the banking sector in Albania. In order to assess the developments and risks related to the Albanian economy., the Report assesses the economic growth indicators, balance of payments, overall price levels, exchange rates and fiscal indicators. Also, by analysing the performance of employment and income, and by referencing specific surveys, it evaluates the financial situation of enterprises and households, and the impact on the solvency of borrowers in the banking sector. The Report presents the results of the stress test results, which assesses the banking sector's resilience against various macroeconomic expressed in terms of capital adequacy.

The Financial Stability Report is compiled by the Financial Stability Department and is approved by the Supervisory Council of the Bank of Albania.

NOTES:

As of the end of June 2024, the classification of banks in the Albanian banking sector is as follows:

I. According to the marginal contribution of each institution to systemic risk

in Albania[1] banks are classified as:

- **Systemically important banks:** National Commercial Bank, Credins Bank, Raiffeisen Bank, and OTP Bank. These banks share around 64.8% of the banking sector's total assets.
- **Other banks**: Intesa Sanpaolo Bank Albania, Procredit Bank, First Investment Bank Albania, United Bank of Albania, Union Bank, American Bank of Investments, and Tirana Bank. These banks share around 35.2 % of the banking sector's total assets.

II. According to capital origin, banks are classified as:

- **Banks with foreign capital**[2]: Raiffeisen Bank (Austria); Intesa Sanpaolo Albania (Italy), National Commercial Bank (Turkey), OTP Bank, Albania (Hungary), Procredit Bank (Germany); First Investment Bank, Albania (Bulgaria). These banks share around 64% of the banking sector's total assets.
- **Banks with Albanian capital:** Credins Bank, Union Bank, American Bank of Investments, Tirana Bank, and United Bank of Albania. These banks share around 36% in total assets of the banking sector.

III. According to the expansion of geographical network. Banks showing an expansion of their network abroad are, the National Commercial Bank and Credins Bank with their respective affiliates in Kosovo.

Regarding the analysis used in the Report, it should be taken into account that:

(1) The terms "loan" and "credit" are used interchangeably in this Report. Likewise, the terms "enterprises" and "firms," and "households" and "families" are used interchangeably.

(2) In this Report, "outstanding credit" refers to the balance of the account "relations with clients", as reported by banks. It includes outstanding

[1] *For more information on the index and determining banks with systemic risk consult the Methodology "On determining banks with systemic risk and the relevant capital buffer", on: https://www.bankofalbania.org/Financial_Stability/Macro prudential_policies/Instruments_of_Macroprudential_Policy/test*

[2] *A bank is classified as having foreign capital, whenever the foreign capital amounts to more than 50% of the bank's paid-in capital.*

credit granted by the banking sector to non-financial private and public, resident and non-resident entities. Outstanding credit is affected by non-performing loans (NPL) which have been written off from banks' balance sheets in the period under review. Hence, outstanding credit that is analysed in the Financial Stability Report is a different concept from that of credit to the economy that is addressed in the monetary policy reports.

The latter, in addition to credit by banks, includes the credit by non-bank financial institutions. Credit to economy includes only credit to the resident private sector and its value is not affected by the NPL's write off from banks' balance sheets, as these loans have already been obtained by the economic entities and have affected their economic value; their later write off does not change this fact. The differentiation in these concepts on credit should be considered when interpreting the relevant analysis of credit indicators (growth rate, quality ratio, allocation by sector, by currency, etc.) in various reports of the Bank of Albania.

FINANCIAL STABILITY STATEMENT FOR 2024 H1

Pursuant to provisions under Article 69 of Law No. 8269, dated 23 December 1997 "On the Bank of Albania", as amended; and Article 8 of Law No. 9962, dated 18 December 2006 "On banks in the Republic of Albania", as amended; to inform the Assembly of the Republic of Albania and the Council of Ministers, and promote awareness among financial institutions and the public at large of the situation in the Albanian financial system and potential risks to its stability, the Bank of Albania (BoA) releases this periodic statement, which is part of the Financial Stability Report for the same period.

The Financial Stability Report and the Statement prefacing it assess the exposure of the banking sector to risks arising from its interaction with the external and internal economic environment, real economy agents, financial markets in Albania, as well as operational risks in the activity of the banking sector. Furthermore, these risks are assessed by means of the stress testing exercise and placed vis-à-vis the financial situation of the banking sector to assess its resilience.

The Bank of Albania deems that in 2024 H1 (hereinafter 'the period'), the financial system maintained its positive trajectory. Despite the mitigating effect of the exchange rate appreciation, deposits in the banking sector increased and the credit growth rate accelerated. Risks related to the activity were presented at controlled levels, but the upward trend of the financial cycle requires moderation. Overall, the resilience of the banking business to risks was good, in a context in which the capitalisation of the business remained stable and the profit continued to improve at a satisfactory pace.

Economic developments during the period were positive, affected by the good performance of consumption and investments, and particularly by the stability of the tourism performance. Economic growth is followed by the increase in both employment and wages and the fall in the unemployment rate. The financial situation of households and businesses is estimated to have improved during the period. Fiscal policy maintained a consolidating trend under the significant growth in fiscal revenue. Inflationary pressures continued to decline and the inflation rate fell below the Bank of Albania's target, leading to the reduction of the policy interest rate. Risks to the economic and financial developments in Albania remain present. They mainly arise from the uncertainty that geopolitical developments entail, but they can also develop in conditions of optimism accompanied by imprudent actions by economic operators. It is therefore estimated that all economic agents have the opportunity to use this period of activity to consolidate their financial balances, to improve administrative capacities in general and risk in particular, as well as to increase the efficiency of their activity.

In more concrete terms, the developments over the period showed that:

Global economic activity continued to expand. The overall positive developments in the labour market and services sectors as well as the eased financing conditions helped consumption and private investments to recover over. Inflationary pressures have continued to decline, but at a slower pace compared to last year. Financing conditions were easier overall. However, the fall in interest rates in the money and capital markets was slower than expectations, reflecting the persistence of inflationary pressures and the lower speed of the monetary policy normalisation enacted by central banks. The economy of the euro area has shown modest, albeit stable rebound signs over the first half of the year, mainly underpinned by trade and services sectors. The European Central Bank embarked on a monetary easing through the cut of policy rate in June. Volatility and the overall weak lending dynamics of banks characterised developments in European financial markets. In 2024 Q3, economies in Western Balkans grew at goods rates and higher compared to the end of last year. Inflationary pressures declined. This performance drove to improved fiscal balances and reduced public debt. Nevertheless, the current account in external sector deteriorated in most countries, by partially fading out the improvement recorded in the second half of 2023. Credit quality remained stable, across the region, and non-performing loans ratio stand at relatively low levels. Risks to the regions also accompany both the European and global economies. The global economy is expected to continue to grow at a stable, albeit slow rate during 2024-2025, as developing countries will lead this growth. Risks to the global economic outlook are assessed as balanced overall. Nonetheless, uncertainty remains high, impacted by the speed of inflation decline and the escalation of geopolitical tensions that might engender new shocks on the production chains. In addition to these short-term factors, the effect of structural changes related to climate change and technology should be also taken into account.

Over this period, the Albanian economy continued to grow, while the annual economic growth reached 3.6% at the end of the first quarter. This growth has been broadly based across sectors, particularly driven by construction, trade, and transportation, and has mainly been supported by domestic demand. On the demand side, economic activity was supported by final consumption and private sector investments, while the deepening of trade deficit has contributed to a downward trend in economic growth. Positive developments, such as growth in employment, the fall in the number of registered unemployed persons and the increase of wages in both public and sectors characterised the labour market. Inflation rate displayed a fast decline over the period. This performance reflected the impact of the monetary policy normalisation, the appreciation of domestic currency, and the fall of imported inflation. Next, at the beginning of July, the Bank of Albania cut the policy rate by 25 basis points, down to 3%. During the period, the fiscal policy maintained the consolidation trend. The budget balance targets exceeded projections by the end of the first half of 2024. Budget deficit and public debt indicators as a ratio to Gross Domestic

Product (GDP) decreased considerably. In 2024 H1, current account deficit expanded considerably, during the first half of the year 2024, as a result of the increase in the trade deficit in goods. The increase of net foreign currency flows from travel services and remittances provided a positive contribution. In addition foreign direct investments continued to edge up. The country's stock debtor position to non-residents expanded in first quarter of 2024, as the net private sector's liabilities in the form of foreign direct investments and portfolio investments increased.

The structural financial position of enterprises and households did not experience any considerable change during the period. According to financial accounts data, enterprises maintained the debtor position, which became more pronounced. By instrument, this development is related to the further increase of liabilities in the form of foreign direct investments. In terms of counterparties, enterprises have reduced their net liabilities to financial corporations due to the faster growth of deposits compared to loans that they have with banks, and have expanded net liabilities toward non-residents. Bank credit to enterprises accelerated the growth pace over the period. This growth has been report for loans in both lek and foreign currency. This hike is more significant when adjusted for the diminishing effect of the exchange rate appreciation. The average interest rate on new loans to enterprises in lek and foreign currency increased compared to the previous six months. Despite the increase in interest rate, enterprises' loan demand was higher, while banks eased the overall terms and conditions on loans. According to the Survey conducted by the Bank of Albania, most of enterprises reported profits over the period. The performance of sales and financial result are assessed as positive, although at lower levels compared to the previous six months. Expectations remain optimistic, despite the existing issues, particularly those regarding to higher financing costs and labour production costs. The share of borrowing enterprises increased during the period. The debt burden, in the form of loan-to-equity ratio and in the form of debt servicing to enterprises' income, was assessed as trending up for most of enterprises, compared to the previous six months. Enterprises expect their loan demand to remain stable and upward in the second half of 2024. Households represent the most important resident sector in financing financial corporations and enterprises, with the main form of financing being the capital invested in domestic enterprises and bank deposits. The creditor position of resident households in the banking system slightly expanded during the period, due to the higher growth of deposits compared to loans. In relative terms, credit growth in both annual and semi-annual terms was higher than deposits growth. Loan demand was supported by the need for consumption and for real estate purchase, mainly in the domestic currency. The interest rates on new loans in lek to households remained virtually unchanged during the period. Banks eased the overall conditions on loans to households, but signal a tightening of credit standards. Banks expect loan demand of households remains stable, despite the survey conducted by the Bank of Albania with households, the latter reported a weaker demand in the next period. In addition, the survey results show the share of borrowing households has remained stable, while their solvency declined over the period, though remaining better than a year earlier. Expectations on the repayment capacity for the upcoming six months appear more optimistic.

Developments in financial markets were stable. In the primary market of government's debt securities, the volume of issuance was comparable to the volume of the same period in the previous year, but almost 50% higher than in the previous six months. In the volume of the issuance of the period, the short-term issuances doubled and accounted for around 60 of total debt. The weighted average yield on all maturities of securities issued in lek increased slightly by 0.1 percentage point (p.p), reaching at 4.2%. The average interest yield on short-term securities was up by 0.3 p.p at 3.5%, while on long-term securities it fell by 0.1 p.p., at 5.1%. Investors' supply was higher and in most cases covered the Government's needs for borrowing. Secondary market of debt securities continued to be characterised by a low volume and number of transactions. In interbank market, the volume of financing transactions increased, mainly as a result of the higher volume of one-week transactions. Interest applied by banks in money market stood close to the policy rate determined by the Bank of Albania. Lek exchange rate - driven by the ample inflows of foreign currency, continued appreciating against the main foreign currencies over the period, but the appreciation speed slowed down also as a result of foreign currency purchase by the Bank of Albania.

Stable demand supported the surge in prices in real estate market. The Bank of Albania's specific survey on the market for residential real estate shows that the overall demand, including that from non-residents, remained stable. The growth of bank credit for real estate purchase has supported the stability of the demand. Banks have applied somewhat tight standards on this credit to households. Number of proprieties unsold has fallen. On the supply side, number and surface of construction permits have declined compared to a year earlier, though standing close to the recent years' average. Bank credit for construction has not change ove5r the period. Construction costs have gone up as expenses for wages and energy increased. Against this backdrop, the Survey shows that the Fischer House Price Index at country level rose by 16.9% in semi-annual terms and by 8% compared to the previous year. The increase in index value for Tirana was even stronger. Rent prices were also up. Agents' reports on conducted transactions reveal that the share of transactions with selling price equal to the one demanded by the seller has been declining, while the share of transactions for which the selling price is lower than the price requested has increased. Agents assess positively the performance of house market in the short run, and remain optimistic on its performance in a longer period.

Payments infrastructure functioned smoothly and managed with no problem the increase in the volume of transactions. The core infrastructure for the clearing and settlement of payments in the domestic currency and the euro continued to operate safely and effectively. The value and number of transactions in the payment systems has increased during the period. Payments via cards (debit and credit cards) and non-paper form credit transfers increased sharply. Currently, payments via cards have the main share in the total number of conducted payments.

Developments in the financial system and banking sector were positive. During the period, the share of financial system assets[3] to GDP was slightly up by 0.2 p.p., at 94.2%. In annual terms, this indicator rose by 2 percentage points, as the annual growth rate of the financial system's balance was higher compared to GDP growth rate. Banking system contributed by almost 1.5 percentage points to this growth. Banking sector, within the financial system, continues to dominate accounting for around 90% of total assets. The exposure of banking sector to the non-banking sector remains low, despite recording a slight increase over the period. The sensitivity of the non-banking sector to the activity of the banking sector remains high, but unchanged during the period. The Bank of Albania regularly monitors the correlation indicators within the periodic assessment of systemic risks.

The banking sector's balance sheet expanded over the period. The growth in annual terms reached 7%. Investments in loans, securities, and interbank transactions drove to the expansion of banking sector's activity. The statistical effect of exchange rate appreciation remained negative for around ALL 30 billion, affecting the reduction in the value of the balance reported in lek. Though, this effect has been declining over the past year. The share of assets and liabilities in foreign currency to the total balance sheet slightly decreased 50% and 49%, respectively. Meanwhile the net creditor position to non-residents expanded, reaching at 19% of banks' assets. Deposits and own funds continued to remain the main financing sources of the activity of banks. During the period, the banking soundness index affirmed a good and stable financial situation of the banking sector.

Bank credit edged up considerably during the period. In annual terms, credit expanded by 11.1%, while compared to the end of 2023, it increased by 7.1%. The sharp growth in lek-denominated loans, the increase in long-term loans and the rise in loans to enterprises mainly drove to this performance. Loans to non-residents were also up during the period, though remaining close to the levels in the previous year. Adjusted for the exchange rate effect, the annual growth rate of loans would have been 14%. Loan restructuring and lost loans write-offs have continued during the period. The volumes of restructurings decreased, while those of write-offs were comparable to the previous period. Outstanding loans in foreign currency unhedged against the exchange rate has decreased compared to the previous six-months and the previous year. The decline is observed in both absolute and relative value, but when adjusted for exchange rate effects, this loan would show an increase during the period. The

[3] *The financial system consists of the banking sector and the non-banking sector. Database for all entities of the financial system and GDP are for the first quarter of 2024, excluding banks, whose balance sheet refers to the second quarter of 2024.*

fall in unhedged foreign currency-denominated loans to households provided the main contribution in this performance, as unhedged foreign currency loans to enterprises remained unchanged. The quality of these loans remains quite good.

New loans granted during the period were slightly up compared to the previous six months. Loans to households provided the only positive contribution to this growth. These loans were mainly used for real estate purchase. The increase in new loans during the period was significantly higher than that in the previous year. The increase in new loons in lek provided the main contribution in this change. Meanwhile the increase in new loans in the euro stated in le was lower due to the statistical effect of the exchange rate. **The weighted interest rate on new loans granted during the period remained almost unchanged, at 6.8%** Interest rates on new loans in lek appear somewhat higher than those in euro, while both rates have exhibited minimum fluctuations in the last periods.

At the end of period, deposits held with banking sector amounted ALL 1,610 million. These deposits grew by 0.4% during the period, primarily reflecting the growth of time deposits, deposits from households, and those in lek. Current accounts and demand deposits were slightly down. In annual terms, deposits in lek and in foreign currency expanded by 8% and 6%, respectively, while total deposits increased by 7%. The annual growth of deposits in foreign currency, adjusted for the exchange rate effect, would be around 12%. The expansion in current accounts and households' time deposits underpinned the annual growth of deposits in lek. Meanwhile, the annual growth in foreign currency deposits reflects also the increase in businesses' time deposits. Interest rates on new deposits continued to climb, while new deposit inflows were lower than in the previous six months, but comparable to the same period last year.

Overall, the Albanian economy and financial system are assessed to have exhibited positive developments over the period, despite the phalanges. Economic growth remained sustainable, despite income from tourism slowed down. Wages and employment continued to increase in the labour market, while unemployment rate was slightly down. Fiscal performance evidenced the strong consolidating trend coupled with the need for improving the realisation degree of public investments. Inflation rate continued to come down, while exchange rate appreciation helped in offset the domestic inflationary pressures. The financial position of both the banking sector and the financial system was sound, and profits grew, though at a slower pace. These positive economic and financial developments are also confirmed by the components in the Financial Stability Map, which reflect lower and relatively contained risks for almost all economic actors. On the other hand, international economic developments were positive though subdued due to the heightened uncertainty originating form geopolitical tensions. In the regular survey conducted with banks, this factor has been reported by them as the main source of risk, followed by the sensitivity arising from potential cyber attacks.

In terms of specific risks to banking sector activity, it is assessed that:

The acceleration of lending has been accompanied by a slight increase in non-performing loans (NPLs) stock, although the NPL ratio remains at low levels. The stock of non-performing loans increased by around 6%, up to ALL 37 billion, mostly in lek-denominated loans portfolio, in short-term loans and in loans top enterprises. The value of non-performing loans stock has remained unchanged compared to a year ago. On the other hand, the NPLs ratio dropped to 4.7% at the end of the period, as the total outstanding loans grew faster, in turn slighly improving the credit quality. The NPLs ratio also decreased for real estate investment loans, consumer loans, and loans unhedged against exchange rate risk. As at end of the period, portfolios of: medium-term loans, loans to enterprises, trade loans, and lek -denominated loans, had the highest NPLs ratios: (6.5%), (5.9%), (5.4%), (5.3%), respectively. Credit quality has improved notably and NPLR has decreased by 0.5 pp, compared to the previous year. The collateral coverage of loans remains high. The provisioning ratio for the non-performing loans fell by 0.4 percentage point, during the period, at 67%. This ratio has increased by 0.3 percentage point from the previous year.

Liquidity position of the banking sector remains at good levels. Compared to the previous six month, banks have reported a somewhat lower volume of liquid assets as a ratio to total assets and short-term liabilities. However, these indicators still exceed regulatory minimum thresholds. During this period, banks reported an expansions of the negative gap between assets and liabilities for maturities up to 3 months. The average maturity mismatch between assets and liabilities has slightly increased. For several consecutive six-month periods, the banking sector has reported no use of funding lines by the parent banking groups.

Indirect and direct risks of marked have been contained. During the period, the net open foreign currency position of the banking sector, which signals exposure to direct exchange rate risk was long, standing at 4.6% of regulatory capital. That was the lowest value of the indicator over the last year, and it stands notably below the maximum regulatory limit of 30%. During the period, the exposure to the indirect exchange rate risk, measured by the foreign currency mismatch indicator, recorded a slight increase due to the expansion in foreign currency loans to residents, though it remains near the historical minimum level. The indicator that measures the banking sector's exposure to direct interest rate risk also increased during the period. Nevertheless, it remains considerably below the upper regulatory threshold. The banking sector is more exposed to the interest rate risk for the positions in lek; those with variable interest rate; and the long-term maturity. The exposure of banking sector to indirect interest rate risk remains contained.

Despite the risks present, the banking sector's resilience, in terms of capitalization and profitability, is considered good. In more concrete terms, the capital adequacy ratio of the banking sector stood at 19.3%, as at end of the period. Over the period, this indicator decreased, mainly as risk-weighted assets grew in a fast manner, though this indicator increased by 0.3p.p. Compared to the previous year. Currently, banks are required to fulfil certain requirements on capital levels, including macro-prudential capital buffers and Minimum Requirement for Regulatory Capital Instruments and Eligible Liabilities (MREL). In order to strengthen capital situation during the period, banks injected capital, increased retained earnings and have and increased their use of subordinated debt. The banking sector as a whole managed to fulfil these capital requirements in the first half of period, by to the defined schedule and registered a positive capital surplus. The profit of the banking sector, as at end of June 2024, was positive amounting ALL 18.6 billion. This result was around 26% higher compared to the previous year, but the profit growth rate was lower than in 2023. Net income from interests provided the main positive impact on this performance. Non-interest income also increased, reflecting better performance of investments in financial instruments and higher commission income. Alongside the increase in revenues, the income and expense statement shows a rise in the activity expenses and a slight increase in provisions. The improvement in financial results has been reflected in a better distribution of Return on Assets (RoA) values among banks.

The stress-tests exercises evidence the good resilience of the banking the good sector against risks. Results of stress test exercises in terms of banking sector's solvency against the assumed scenarios for the period 2024-2026, show banking sector appears resilient against the assumed macroeconomic shocks. The sensitivity of the banking sector has improved significantly compared to the previous year, since the number of banks that would need to strengthen their capital positions and the necessary level of capital, in less favourable scenarios, have decreased.

Despite the overall positive development, supervision will pay maximum attention to ensure the performance of banking sector remains positive and stable. To this end, the Bank of Albania analyses on regular basis, the effects of all its policies, and particularly combines the macro-prudential supervision, resolution and micro-prudential supervision processes. The latter includes a set of rules, analysis and instruments through which the Bank of Albania identifies, monitors and addresses systemic risks. Analyses conducted in the framework of macroprudential policy implementation have evidenced the good financial situation of the banking sector and its overall contained exposure to systemic risks, in addition to the need for preventive measures. These measures mainly related to the need for moderating the financial cycle (credit growth) pace and enhancing banks' resilience to risk exposures.

To this end, the Bank of Albania raised the countercyclical capital buffer (CCyB) rate by 25 basis points, bringing it to 0.25%, at end of June 2024. Banks were informed on further raises of this instrument level, if overall credit or specific segments continue to grow at rapid rates. Loans for real estate purchase was one of the fastest-growing credit segments in recent years. Due to the requirements of the banking sector to cover this type of loan with collateral in the form of real estate, this type of loan and collateral mutually support each other's changing values, increasing the exposure of the banking sector to developments in the real estate market. For this reason, this category of loans require a prudential assessment to prevent or address potentially adverse developments. For this purpose, pursuant to the special regulation approved in October 2023, the first reports from banks on the standards applied to real estate lending, have been collected and are being analysed. After a needed process of ensuring quality and consistency, indicators collected from banks will support the implementation of macro-prudential instruments which will control this risk originating from these exposures.

1. MACRO-PRUDENTIAL POLICY AND SYSTEMIC RISKS

Identification and management of systemic risk in the activity of financial system is crucial for safeguarding financial stability. The Bank of Albania - in capacity of monetary authority and supervision authority of the banking sector, which dominates the financial system - gives a primary contribution to dealing with systemic risks, through the combination of its policies, and especially through the implementation of macro-prudential policy. The latter includes a set of rules, analysis and instruments through which the Bank of Albania identifies, monitors and addresses systemic risks. Systemic risks are analysed every six months by monitoring the indicators of the macro-prudential map. These indicators are organized into groups according to the four intermediate objectives of macro-prudential policy, in order to control developments in terms of fast lending, liquidity stress, systemic risk arising from concentrations and interconnections, as well the risk originating from the size or complexity of financial institutions (banks).

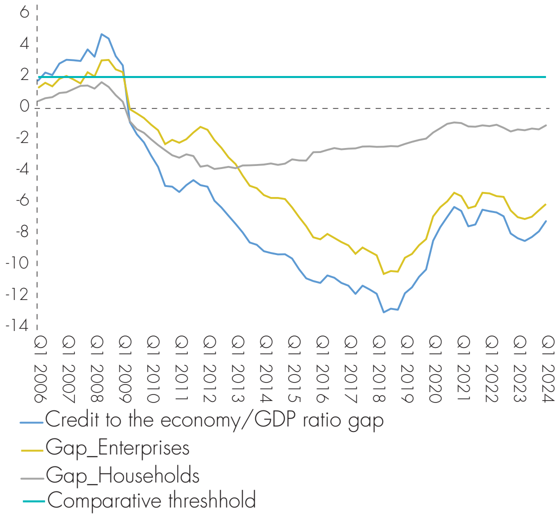
Over the period, the macro-prudential map indicators have evidenced the good financial situation of the banking sector and its overall contained exposure to systemic risks, in addition to the need for preventive measures. For example, the indicators that are monitored within the second objective (liquidity risk) show that the short-term gap between the assets and liabilities of banks as a ratio to total assets remains high, but in the last two years, a decrease in the average value of this gap is observed. At the same time, liquid assets to short-term liabilities ratio remains high and notably above the minimum threshold allowed by the regulatory framework[4]. In addition, indicators that are monitored in the framework of third objective (concentrations and interconnections risk), confirm that that interconnection levels in the banking activity have remained stable and relatively low. Foreign currency has recorded high levels of use and concentration in the activity of banking sector, despite the values of foreign currency loans unhedged against the exchange rate risk have continued to gradually decline. These developments are detailed and confirmed also in the analysis published every six months "On the indicators monitored by the Bank of Albania, in the framework of de-euroization process"[5]. For the end year 2023 (the analysis published in February 2024) and for the end of 2024 H1 (analysis published in August 2024) conclude that the performance of indicators has been on the right direction, though the recorded changes are differentiated among indicators. This development evidences the variety of economic and social factors that impact the progress of indicators of the euroization levels of the economy and the financial system, as well as identifies the need to maintain

4 See "Box 1"

5 This report is published pursuant to the Memorandum of Cooperation between the Ministry of Finance and Economy, the Bank of Albania, and the Financial Supervisory Authority "On extending the use of the national currency in the financial system and the Albanian economy Cooperation signed in 18.07.2017 and published at: https://www.bankofalbania.org/web/Collaboration_3452_2.php?kc=0,25,4,0,0 a long-term focus and coordinate measures to reduce euroization in both the financial system and real economy.

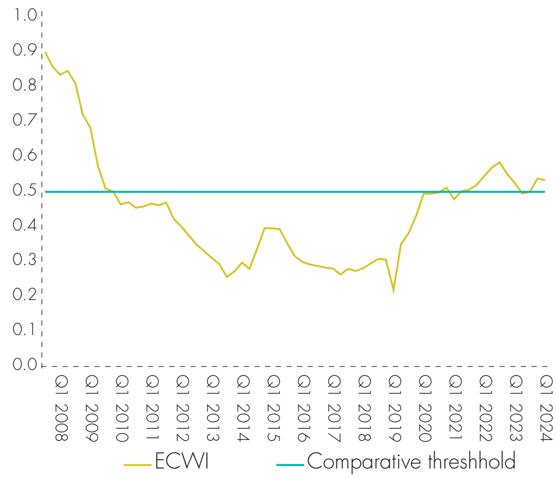
On the other hand, the indicators of the first objective that monitors the progress of the financial cycle, have evidenced the acceleration of credit growth as a whole, and in particular of certain segments of it, such as that for real estate purchase and consumer loans. On the one hand, such periods are associated with good financial performance of real economy agents and financial institutions, and Albania needs to increase the levels of financial intermediation, to come closer to the average indicators of the region and further, of the European Union. On the other hand, these periods can also bring the beginning of risks related to the decline of credit standards, the increase in the concentration of credit in certain sectors or markets, the rise in the debt levels of enterprises and households beyond healthy levels, the surge in non-performing loans stock. If not controlled, these situations can make the economy and the financial system more sensitive to various shocks, undermining the country's financial stability. For these reasons, it is necessary to use macro-prudential instruments that act in a countercyclical manner, prevent the uncontrolled spread of these risks and enhance the banks' resilience to the possibility of their materialization

Chart 1 Credit to the economy/GDP ratio gap



Source: Bank of Albania.

Chart 2 Early Complementary Warning Indicator



Source: Bank of Albania.

For these reasons, at the end of June, the Bank of Albania announced the increase of the countercyclical buffer rate (CCyB rate) by 25 basis points, to 0.25%[6]. This decision was based on specific indicators, such as the gap between the credit-to-GDP ratio or the primary indicator, and the early complementary warning indicator. International experience has shown that the use of these complementary indicators is necessary to capture and react more quickly to rapid developments in the financial cycle. In the published analysis

[6] *Decision of the Governor No. 2852, dated 28.6.2024, "On designing the countercyclical capital buffer". Pursuant to the regulatory framework, banks should take measure to meet the capital buffer within 30 June 2025.*

that accompanied the above decision, the Bank of Albania emphasized the possibility of further increases in the CCyB if the rates of growth of the overall credit and its certain segments will remain high.

In addition to the closer monitoring of the financial cycle, work has continued to assess the exposure of the banking sector to the real estate market. During the period, all banks operating in Albania reported for the first time, in a standardized manner, on the data required by regulation No. 44/2023 "On data reporting, identification and monitoring of indicators on lending and real estate investments"[7]. The reporting focuses on new loans granted during the first quarter of the year and is undergoing a necessary quality control and improvement process, which will require at least one more quarterly reporting to ensure the necessary consistency through comparability. Data on new loans will continue to be reported at the end of each quarter, while data on existing loans or loan stock will be reported on an annual basis, starting from September 2024. These data will be used by the Bank of Albania to build the most representative indicators of lending standards and banks' investments in real estate (residential and commercial), such as the indicators of loan to income, loan to property value, service loan against the borrower's income, etc. In the future, these indicators will support the policies of the Bank of Albania in the implementation of macro-prudential instruments aimed at borrowers.

In parallel, during the period, the implementation of other requirements provided for in Regulation No. 41/2019 "On Macro-prudential Capital Buffers"[8] continued, (Regulation 41/2019), as well as the banks' quarterly reports on the degree of fulfilment of these requirements." Since 2020, banks have started to fulfil their annual buffers of 0.5 p.p. in compliance with the requirement on capital conservation buffer (CCB), and capital buffers for systemically important banks (SIST), announced once a year, at the end of March. According to the decisions announced until the end of the first half of 2024, the combined requirement of capital buffers applied to banks for macro-prudential purposes moves from a minimum value of 2.75% for a non-systemic bank, to a maximum value of 4.25% for the bank with the highest buffer for systemic importance and the deadlines for fulfilling these requirements are as in the table below. Overall, the banking sector, supported by a satisfactory initial capital position, has been able to fulfil these requirements. The Bank of Albania assesses that their implementation, combined with the implementation of new requirements related to the resolution function[9], requires banks to maintain attention to strengthening the capital position, both through the issuance of eligible liabilities and by capitalizing earnings for the period.

[7] *Published at: https://www.bankofalbania.org/Stabiliteti_Financiar/Politika_makroprudenciale/Instrumentet_e_politikes_makroprudenciale/Akte_te_miratuara/Rregullore_44_2023_Per_raportimin_e_te_dhenave_identifikimin_dhe_monitorimin_e_treguesve_mbi_kredidhenien_dhe_investimet_per_prona_te_paluajtshme.html*

[8] *For more information see: https://www.bankofalbania.org/Financial_Stability/Macro-prudential_policies/Instruments_of_Macroprudential_Policy/Instruments_and_Decisions/*

[9] *Requirements laid down in the Regulation No.78/2020 "The minimum requirement for regulatory capital instruments and eligible liabilities".*

Table 1 Values of macro-prudential capital buffers that banks should meet and the respective deadlines

No.	MPCB:		Classification of bank		Deadline	Legal ground	Name of buffer
			SMBA (Systemically important banks)	Non-SMBA			
1	SYST		National Commercial Bank (NCB) sh.a., - 1.50% Credins Bank - 1.00% Raiffeisen Banka - 1.00% OTP Bank Albania - 0.50%	Not applicable	1 January 2025	Decision of the Governor 1481/2024	Systemic risk buffer (SyRB)
2	CONS =		2.50%	2.50%	Ongoing	Regulation 41/2019	Capital conservation buffer
3	SpecCCyB		0.25%	0.25%	30 June 2025	Decision of the Governor 2825/2024	Countercyclical capital buffer for Albania
4	SyRB		Not applicable	Not applicable		Regulation 41/2019	Systemic risk buffer (SyRB)
5= 1 +2	CMPB		CONS (2.5%) + SYST (from 0.5% up to 1.5%) + SpecCCyB (0.25%)	CONS (2.5%) + SPEKUNC (0.25%)			Combined capital buffers

BOX 1 MACROPRUDENTIAL POLICY – TOOLS AND OBJECTIVES

The objective of macroprudential policy is to achieve and safeguard financial stability, by (a) preventing and mitigating risks to financial stability and (b) strengthening the resilience of financial institutions and agents. Financial stability, as the main objective of a policy, is a very general concept, given, that cannot be measured easily. The implementation and analysis of macroprudential policy aim at achieving certain intermediate objectives, which are oriented toward the mitigation of main risks that threaten financial stability. The Macroprudential Policy Strategy outlines these objectives, for Albania, along with the instruments that can be used to achieve them, the indicators that analyse and measure the impact of these instruments and the overall framework of the macroprudential policy, including the institutional organization, the decision-making process and the relevant communication to the public. The strategy presents a general framework of the macro-prudential policy, stating that the selection of instruments, indicators and analytical models will be performed in accordance with the risks, the structure of the financial system, the legal basis, the available data and the capacities of the entities which fall under the scope of these policies application. The Strategy, in introducing a non-exhaustive list of possible macro-prudential instruments, underlines that an instrument can be used to achieve more than one intermediate objective and to achieve each objective, the instruments can be used alone or in combination. The Bank of Albania, since the adoption of the Strategy, has undertaken several measures to limit the use of foreign currencies and support the use of the domestic currency, within the "de-euroization policy"**, has approved and implemented the Regulation 41/2019 "On macro-prudential capital additions", has approved and started data collection according to Regulation 44/2023 "On data reporting, identification and monitoring of indicators on lending and investments for real estate", as well as approved or revised a number of other regulations of a mainly supervisory nature, which directly or indirectly contribute to the achievement of some of the intermediate objectives of the macro-prudential policy.*

*As indicated in the table***, all instruments employed to achieve the first objective of macro-prudential policy – mitigation or restriction of excessive credit and financial leverage growth – aim at a) increasing the capacity of banks to absorb losses, b) reducing the quantity of losses of banks in case of bankruptcy; c) decreasing the bankruptcy probability of the borrower or a combination of these objectives. The strengthened capacity of banks to absorb losses, as a rule is achieved by requiring banks to hold more capital per each loan granted, meaning they should hold capital buffers, depending on the risk required, classified as countercyclical capital buffer (CCyB), systemic risk buffer (SyRB) or capital conservation buffer (CCoB). In parallel or instead of the requirements for capital buffers, for the same intermediate objective, the macroprudential authorities can use instruments that apply to the borrower and that aim to a) decrease the loan demand, by reducing the number of borrowers who meet the conditions for obtaining a loan, as well as b) decrease the probability of bankruptcy of the borrower. For example, determining an upper limit on "debt service to income" ratio for each customer applying for a loan would exclude customers with a higher value of this ratio than the limit set by the bank, or resulted in a review of the value of the loan, so that the loan servicing cost is affordable for the borrower. In the first case, the measure would affect the reduction of the credit risk for the bank, while in the second case, the result of the measure would be a reduction in the risk of bankruptcy for the borrower, since he has sufficient income to repay the loan.*

Table 2 Macroprudential policy – tools and objectives

Instrument (a)	Enhancing resilience (b)	Mitigating accumulation of deficiencies/risk (c)	Regulatory act of the Bank of Albania (d)
Objective 1: The core instrument to address excessive credit growth and leverage			
Countercyclical capital buffer (CCyB)	Increases the capacity of banks to absorb losses;	Decelerates credit growth, by increasing funding costs;	Regulation 41/2019 ''On macro-prudential capital buffers''
Imposes limits on: "loan value/collateral value" ratio; "loan value/ income" ratio; "debt service/income" ratio;	Decreases the loss given default Decreased the probability of borrower's failure	Direct limitation of credit	Regulation 44/2023 "On data reporting, identification and monitoring of indicators on lending and real estate investments"
Sectoral requirement	Increases the capacity of banks to absorb losses;; Reduces potential losses; Reduces credit in regulated sector;	Possible impact on financial cycle through the increase of funding costs;	
Structural systemic risk buffer (SyRB)	Increases the capacity of banks to absorb losses;		Regulation 41/2019 ''On macro-prudential capital buffers''
Capital conservation buffer (CCoB)	Increases the capacity of banks to absorb losses;		Regulation 41/2019 ''On macro-prudential capital buffers''
Financial leverage ratio	Reduces borrowing: protects against error in capital risked-based buffers.		Regulation 63/2020 "On the financial leverage ratio of banks"

Objective 2: Core instruments to address excessive maturity mismatch and market illiquidity			
Net stable funding ratio of banks	Strengthens the funding base of banks, against sudden outflows;	Possible dampening effect on financial cycle if requirements are binding	Regulation 70/2020 "On the net sustainable funding ratio of banks"
Other requirements on stable funding (for example, limits on the credit/deposit ratio;			
Liquidity coverage ratio	Increase stock of liquid assets to cover sudden outflows		Regulation 27/2019 "On liquidity coverage ratio"
Other liquidity requirements			Regulation 71/2009 ''On liquidity risk management''
Objective 3: Core instruments to address concentration of exposures			
Sectoral capital requirements	Increases the capacity of banks to absorb losses;	Possible impact on financial cycle through the increase of funding costs;	
Structural systemic risk buffer (SyRB)	Increases the capacity of banks to absorb losses;		Regulation 41/2019 ''On macro-prudential capital buffers''
Limitation of large exposures	Mitigate risks arising from counterparty, concentration and dissemination	Direct limit on credit amount	Regulation 10/2014 ''On risk managment from large exposures of banks"
Capital conservation buffer (CCoB)	Increases the capacity of banks to absorb losses;	Possible impact on financial cycle through the increase of funding costs;	Regulation 41/2019 ''On macro-prudential capital buffers''
Objective 4: Core instruments to address contribution in systemic risk of financial institutions			
Capital buffer for Global systemically important banks (G-SII buffer)			
Capital buffer for Other systemically important banks at country level (O-SII/SyS buffer)	Increases the capacity of banks to absorb losses;	Possible impact on financial cycle through the increase of funding costs;	Regulation 41/2019 ''On macro-prudential capital buffers''
Structural systemic risk buffer (SyRB)			Regulation 41/2019 ''On macro-prudential capital buffers''
Other liquidity requirements for SISBA	Strengthens the sustainability of funding core and/or liquid assets stock	It is transmitted through the increase of funding costs	

Instruments employed to reach the second objective - address excessive maturity mismatch and market illiquidity - are in the form of regulatory limits on the ratios between assets (credit) and liabilities (deposits and funding through debt), pursuant to definitions set forth in the Regulation. Most of these measures, despite *being included in macroprudential instruments, have been used by supervision authorities for a long period, to manage liquidity risk in the financial system. For Albania, these restrictions are laid down in the regulation approved in 2019 and 2020, on liquidity coverage ratio and net stable funding ratio, as well as in the earlier regulations on liquidity risk management.*

To limit the exposure concentration in a specific sector or category of clients - third objective - may use capital instruments, which increase banks' sustainability and loss absorption capacity, or regulatory limits as quantity restrictions on a specific exposure. In Albania, these limits apply on the bank's large exposures to a person/client or group of persons/clients related to each other or to the bank, in order to manage the risk arising from the concentrated exposure to them. Of the capital instruments, as a means of restricting the concentration of exposures, the Bank of Albania currently applies only the capital conservation buffer (CONS), which generally serves to strengthen the banks' capacity to absorb losses from loan repayment failure. Sectoral capital requirements and the systemic risk buffer (SyRB) may be used in the future as ways of controlling or mitigating a particular risk (e.g. high level of currency use), or exposure to a specific sector (e.g. construction sector/real estate market).

Fourth objective related to restriction on misaligned incentives, mainly regrading systemically important institutions (SIIs), overall is addressed through general capital requirements (for all banks) or for specific (individual) bank. The systemic risk buffer (SyRB) is a capital buffer imposed on banks identified as globally or at local level systemically important, aimed to Increase banks' loss absorption capacity. If a systemic bank, in relative terms to its loan portfolio, holds more capital than a non-systemic bank, for the same shock to the financial system, the systemic bank is relatively better able to absorb the loss of its exposures. This higher resistance of the systemic bank would reduce the risk of its bankruptcy, thereby lowering the risk that other banks in the sector would be damaged by the bankruptcy of the systemic bank. The systemic risk buffer apply together with other buffers related to supervisory and macroprudential functions, and are proportionate to the systemic importance rating of the respective bank. This means that, the more important a bank is in a given jurisdiction, the higher should be the requirement for additional capital required of the bank due to its systemic importance.

* "Macro-prudential Strategy/", adopted by the Supervisory Council of the Bank of Albania with the Decision No. 38, dated 2.8.2017, published at: https://www.bankofalbania.org/Financial_Stability/Macro-prudential_policies/Macro-prudential_strategy/

** Decision of the Supervisory Council of the Bank of Albania, No. 9, dated 7.2.2018, "Approval of the Policy "On enhancement of national currency use in the activity of banks and non-bank financial institutions which are regulated and supervised by the Bank of Albania", published at: https://www.bankofalbania.org/Financial_Stability/De-euroization_Package/

***Abbreviations for instrument names in the table and in the text refer to the definitions in the Regulation 41/2019 "On macro-prudential capital buffers"".

The framework on the implementation of macro-prudential policy needs to be improved on an ongoing basis. Developments in banking and financial activity, as well as in international standards in the field dictate the improving continuously this framework. In this context, aimed at improving and expanding the analytical and methodological packages of macro-prudential function, the methodology "On the method of calculating and changing the systemic importance of banks and the corresponding macro-prudential capital buffer" was revised in 2024 H1[10]. The revision of the Methodology[11] aimed at increasing the level of care of the Bank of Albania during the process in identifying systemically important. Structural changes in the banking sector related to mergers, divisions, and other events, which immediately affect the banks' systemic importance rating are also addressed in this document. Also, the work on the operationalization of the capital buffer for systemic risk (SyRB) has continued, aiming to include the changes that have occurred in the international standards for the objective and the way of using this instrument. Analysing the experience of other countries in the use of the countercyclical capital buffer (CCyB), the possibility of revising certain aspects of its use, including the implementation of a positive value for the neutral level of the instrument, is being assessed.

The strong and sound connection between the financial system and the real economy, is the base for a sustainable economic development. Though, alongside providing opportunities for development, this interconnection is associated with risks to financial institutions and other actors operating in this environment, which should be monitored and analysed on a regular basis. Focusing on the activity of the banking sector, through market data, reports, surveys, stress test exercises, etc., this report aims to assess the developments that have affected the business of the banking sector over the first half of 2024.

[10] *Published at: https://www.bankofalbania.org/Financial_Stability/Macro-prudential_policies/Instruments_of_Macroprudential_Policy/test/*

[11] *Realised pursuant to the Document approved by the Second Deputy Governor of the Bank of Albania, No. 828, dated 1.2.2024.*

2. MACROECONOMIC DEVELOPMENTS

2.1 FINANCIAL STABILITY MAP

Over 2024 H2, risks monitored by the Financial Stability Map have been at contained levels and overall mitigating.

This performance, as compared to a year earlier, is driven by the indicators on the economic agents' activity. Meanwhile, the overall level of risks from domestic and external economic developments appears higher.

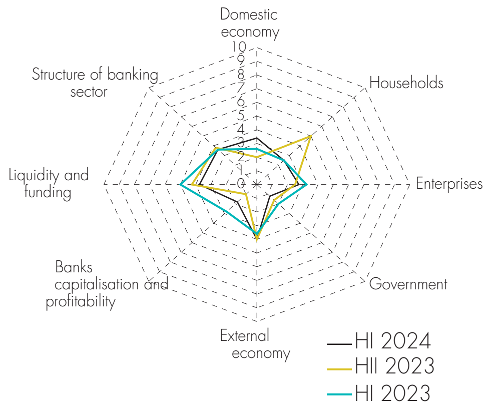
Also, risks related to the activity of the banking sector are asses as contained and overall mitigating, affected by the improvement of profitability and good liquidity and capitalisation levels.

The Financial Stability Map shows an overall contained and declining level for a part of risks from macroeconomic environment. A mitigating trend of the assessed risk level from "enterprises" and government is observed compared to the previous year. Meanwhile risk from "households" remains "low" and unchanged during the period. Risks related to the activity of banking sector have also been declining, particularly in for the category "Capitalisation and profitability" and "Liquidity'.

RISKS IN THE OVERALL ECONOMIC ENVIRONMENT

Risk from the "domestic economy", by indicators presenting the situation up to the end of 2024 Q1, is rated as "average" and slightly upward compared to the previous year. This performance reflects the fluctuation of composing sub-indicators of this dimension. The decline in inflation rate during the period, the strengthening of the exchange rate and the fall of external debt ratio to GDP, as aggregate risk rate reduced, have partially offset the increase in the risk related to the surge in both external financing needs and output gap indicators.

Chart 3 Financial Stability Map



*Risk is assessed as: low for scores 0-3 in the map, average for scores 4-5, moderate for scores 6-8 and high for scores 9-10. The closer to the center, the lower the risk.
Source: Bank of Albania.

Risk from external environment, despite the slight increase compared to the previous year, continues to be classified as "average" and unchanged over the period. The rise in oil prices and the still high level of short-term interest rates in international markets have dictated the upward trend of this risk. On the Other hand, the improved economic performance in the main trading partners of our country and the fall in unemployment rates in countries which are the main source of remittances have contributing in diminishing this risk.

RISKS RELATED TO THE REAL ECONOMY AGENTS[12]

Risk from "households" remained "low" and unchanged compared to a year earlier, while risk from the activity of "enterprises" and "government has been mitigated. The overall risk level from households sector has remained almost unchanged from the previous year, as its slight increase due to the developments in housing market and remittances, has been balanced by the improvement on households' borrowing indicators. Risk level for enterprises

[12] *Assessments have been conducted based on the latest official data published for 2024 Q1.*

sector has resulted "low" and downwards in annual terms, as its increase from the deteriorated expectations of enterprises has been mitigated by the improved indicators in both level and quality of enterprises' borrowing. Overall risk level from "Government" is also assessed as "low" and unchanged, thanks to the contracted share of public debt to GDP, which has balanced the risks related to the budget deficit performance over the period.

Chart 4 Annual change of the risk rating by sector

Source: Bank of Albania.
*Assessment on the risk from "Government" have been conducted based on the official data for 2024 Q1.

RISKS FROM THE ACTIVITY OF THE BANKING SECTOR

Risk from "capitalisation and profitability" is assessed as "low", and downward compared to the previous year. The increase in banking sector's revenues and the improvement in capital indicators mainly drove to this fall. Risk form liquidity and financing is assessed as "average" and downward, affected by the mitigating effect of households' deposits growth and the improvement of short-term liquidity indicator. Risk associated with the banking sector structure has remained "average" and unchanged from a year earlier, as a result of the improved indicators of credit concentration.

2.2 EXTERNAL MACROECONOMIC ENVIRONMENT

The world economy expanded at modest, albeit stable pace, over the first half of 2024. The generally positive developments in the labour market and the services sector as well as the relaxed financing conditions helped consumption and private investments to recover over this period. The activity of global production and distribution chains continued to normalise, although concerns related to the escalation of the conflict in the Middle East and the future of trade policies have been on the rise. Uncertainties attached to geopolitical developments remain high, endangering the future of the global economic activity. The macroeconomic indicators support expectations for a modest growth in the second half of the year, and its acceleration in the upcoming year.

Following last year's strong performance, economic growth in the United States has decelerated in the first quarter, driven by a decline in consumption and net trade, while the European economy has exhibited signs of steady recovery, primarily supported by a revival of activity within the services sectors.

The global inflation have continued to subside, but at a slower pace compared to last year. In developed regions, inflation trends have shown different sectoral dynamics, as inflationary pressures have been more stable in the service sectors compared to those in goods, influenced also by the rising cost of labour in some areas. As a result, although they have halted interest rate increases since the end of last year, central banks have delayed decisions on normalizing monetary policy, emphasizing their commitment to sustainably bring inflation back to targeted objectives.

The financing conditions in the financial market have generally become more favourable during the period, reflecting expectations of monetary policy easing and the economic outlook of different regions. However, there continues to be uncertainty regarding the performance of inflation in the future, and the hesitation of central banks to swiftly ease monetary policy has reduced market expectations for a fast decline in interest rates. For these reasons, in developed markets, long-term bond yields have slowly declined, while in emerging markets, they have remained relatively stable, increasing pressure on future fiscal policies. In capital markets, the satisfactory profits of corporation in the USA and Europe have caused volatility to go down and values to go up. In developing markets, financing conditions were generally stable, but pressures springing from currency devaluations have increased, and in some markets, capital outflows have also been recorded. In foreign exchange markets, dynamics have been dictated by divergences in the speed of monetary policy normalization by central banks. Euro has generally depreciated against the US dollar and British pound, becoming stable at the end of the period, while it has slightly appreciated the other currencies such as the Japanese Yuan, Swiss Franc, and those of large developing countries.

The global economic activity has continued to expand over this period. The generally positive developments in the labour market and the services sector as well as the relaxed financing conditions helped consumption and private investments to recover over this period.

Inflationary pressures have continued to subside, but at a slower pace compared to last year.

Financing conditions were more relaxed overall. However, the falling interest rates in the money and capital markets were slower against the expectations, reflecting the persistence of inflationary pressures and the lower speed of the monetary policy normalisation enacted by central banks.

The global economy is expected to continue to grow at a stable, albeit slow rate during 2024-2025, as developing regions have taken the lead.

Risks to the global economic outlook are assessed as balanced overall. Nonetheless, the uncertainty level remains high, impacted by the speed of inflation decline and the escalation of geopolitical tensions that might engender new blows to the production chains. In addition to these short-term factors, the effect of structural changes related to climate change and technology should be also taken into account.

In the commodity markets, oil prices have risen during the summer months, reflecting expectations of a reduction in production quantities from OPEC+ countries and growing concerns over escalating geopolitical tensions in the Middle East. On the other hand, natural gas prices in Europe has dropped due to a reduction in dependence on Russian gas and the stabilization of supply from alternative sources. Food and non-energy commodity prices have also continued their downward trajectory during the period.

Experts forecast that the global economy will continue to expand at a steady, albeit slow rate, during the second half of 2024 and 2025[13]. According to the IMF, the economic growth of developed regions is expected to converge around an average of 1.7%-1.8%. The US economy is expected to slow down, due to a decline in domestic consumption, while the economy of the Euro area is expected to gradually recover, supported by strengthening demand and increased investments. Developing economies are anticipated to grow at a stable rate, supported largely by the further expansion of the activity in large economies such as China and India. Global inflation is expected to continue to fall[14]. In developed countries, the speed of inflation decline is expected to slow down during this year and the next, as the services sector continue to exert high pressures. However, the gradual cooling of the labour market, combined with an expected decline in energy commodity prices, is expected to bring the inflation rates closer to the target set by central banks within the next year.

Risks to the global economic outlook are assessed as balanced overall. Nonetheless, uncertainty remains high, driven by short-term risks related primarily to the future performance of inflation, particularly in the services sector. There is also concerns about potential delays in the normalization of monetary policy, which could bring financial and fiscal risks and unfavourable capital movements. In the medium-term, the escalation of geopolitical tensions, possible adjustments to trade fees and barriers following elections in the USA, and events related to climate change may bring about new shocks to global production and distribution chains.

EURO AREA

After a period of stagnation, the economy of the Euro area has shown signs of recovery in 2024 H1. Activity expanded by 0.3% in the first quarter of the year, and by 0.5% in annual terms, supported mainly by the positive performance of net exports, whilst domestic demand had a negative contribution. Preliminary assessments show that the economy of the Euro area has continued to grow in the second quarter as well, albeit at a slower pace. The growth was led primarily by the services sector, whereas the recovery of industrial production

[13] *In their latest update, the IMF forecasts that the global economy will expand by 3.2% in 2024, and 3.3% in 2025.*

[14] *IMF predicts that the global inflation will drop on average, from 6.8% in 2023 to 5.9% and 4.4% in 2024 and 2025, respectively.*

and investments has continued to remain weak, affected by continuing high financing costs and prevailing uncertainties. Experts forecast that the economy of the Euro area will continue its recovery during the second half of the year, largely supported by the strengthening of domestic consumption due to the decline in inflation and the increase in real incomes. On the other hand, exports are expected to get the support of the recovery of external demand, while the monetary easing of the European Central Bank (ECB) is predicted to further mitigate financial market pressures.

The economy of the Euro area has shown modest, albeit stable signs of recovery over the first half of the year, supported primarily by trade and services sector.

Inflation rates have continued to fall down, but at a slower pace, reflecting the dimming impact of monetary tightening and the comparative base effect.

The European Central Bank has started monetary easing by lowering the policy rate in June, although it remains focused in achieving its inflation target of 2%.

The European financial markets were volatile, while bank lending has remained relatively weak.

Despite the present uncertainties, the economic growth of the Euro area is anticipated to recover gradually over the year, whereas inflationary pressures are expected to diminish. Inflation rate is forecasted to return to the ECB target within 2025.

Despite small fluctuations, the annual inflation rate of the Euro area continues to fall at a steady pace. It recorded 2.6% in May and 2.5% in June. In Q1, inflation dynamics were primarily driven by the performance of energy and services prices, while food inflation has continued to fall. At the end of Q2, compared to the previous year, majority of inflation components have not changed, reflecting the mitigation of pressures and the dimming of comparative base effect. Developments in labour markets have been positive and stable. The employment level has increased and the most significant growth was registered in the services sector. The average unemployment rate in June was 6.5%. Together with the value recorded in May, this is one of the lowest historical values since the start of the use of the common currency, the Euro.

Developments in the European financial markets were led by the expectations on inflation performance and the pace of monetary policy easing by the ECB. As inflation pressures continue to subside, the ECB has lowered the policy rate by 25 base points (0.25%) during their meetings held on June 6. They declared that its policy remains oriented toward achieving its medium-term inflation target of 2%. These positions have been reflected in the decline of short-term rates in the second quarter, while financial conditions in longer-term markets have been more volatile.

The dynamics of lending to enterprises and households have remained generally weak during the period. The continuing effect of monetary tightening from last year, has kept loan rates high for both enterprises and households. By the end of 2024 H1, lending standards to households have become more flexible somewhat, leading to an increase in their demand for loans for the first time since the beginning of 2022. In contrast, business demand continued to decline.

According to the latest forecasts published by the ECB, the economic activity in the Euro area is expected to recover over 2024, despite growing uncertainties. This performance will be underpinned by the rise in disposable income, owing to a stable growth of wages and the weakening of inflationary pressures, whereas European exports are expected to recover with the strengthening of external demand. These forecasts are surrounded by a high level of uncertainty, as trade and geopolitical pressures are on the rise, which might hinder the recovery of production and investments. Inflation rates are expected to fluctuate around their current levels in the second half of the year, as well, and return close (and below) the 2% in 2025. Until then, the ECB has declared its mission to return inflation toward its aimed target, by simultaneously preserving the economic and financial stability of the Euro area.

Table 3 Selected macroeconomic indicators for the USA and Euro area

	GDP change (annual %)			Annual inflation (annual %)		Unemployment (annual %)		Gross government debt (% of GDP)	
	2024*	2024 Q1	2024 Q1	March'24	June '24	March '24	June '24	2024 Q4	2024 Q1
USA	2.6	1.4	2.8	3.5	3.0	3.8	4.1	121.6	122.3
Euro area	0.9	0.5	0.6	2.4	2.5	6.6	6.4	88.2	88.7
Germany	0.2	-0.1	-0.1	2.3	2.5	3.3	3.3	63.6	63.4
France	0.9	1.5	1.1	2.4	2.5	7.4	7.4	109.9	110.8
Italy	0.7	0.6	0.9	1.2	0.9	7.1	6.8	137.3	137.7
Greece	:	2,1	:	3,4	2,5	10,7	10,6	161,9	159,8

*Source: ECB, Eurostat, *-IMF Assessment (July 2023), Economic Analysis Office; Bureau of Economic Analysis (US Bureau of Labour Statistics.);'': "- ": no available data.*

THE WESTERN BALKANS

In 2024 Q1, the economies of the countries in the Western Balkan have grown at satisfactory and high rates compared to the last year. This growth has improved fiscal balances and reduced public debt.

The external sector's current account has deteriorated for the majority of the region.

The tightening of the monetary policy during last year has had its effects in the further decline of inflation rates.

Credit quality remained stable, across the region, and non-performing loans ratio stand at relatively low levels.

The economy of the countries in the Western Balkan grew by 3.9% on average in 2024 Q1, compared to the previous year (from 3.2% in the preceding quarter). All the countries registered a positive Gross Domestic Product (GDP) growth, as Serbia and Kosovo recorded the highest rates. Growth in these countries was mainly supported by a boost in domestic demand, while trade generally had a negative contribution. The expansion of activity contributed in higher budget revenues and an improvement in fiscal balances in all the countries of the region, with the exception of North Macedonia. This trend has created room for a further decline of debt-to-GDP ratio during 2024 Q1, with a more pronounced decline in the case of Albania and Serbia. In the same vein with the economic performance, employment grew in most countries of the region, and unemployment rate fell to its lowest historical values, although it remains notably above the EU level.

In the foreign sector, in contrast from the positive trend which started in 2022, current account, in most countries of the region, has deteriorated during the period, as a result of a larger trade deficit, lower level of remittances and, in some cases, a weaker export of services. On the other hand, direct investments remain stable and recorded an increase in some of the countries.

Inflationary pressures have continued to mitigate across all the region, and the annual average inflation rate slowed down to 4.1% in 2024 Q1, fluctuating from 2% in Bosnia to 5.4% in Montenegro. Inflation has continued to decelerate in Albania and Serbia, giving central banks the possibility to slowly ease monetary policy through lowering the policy rate.

Developments in the banking sector have been positive and lending activity has continued to expand with an accelerated pace in most of the countries.

As central banks have loosened their grip on monetary tightening, lending conditions have become more relaxed and banks have increased their loan supply to households and enterprises across all the region. The ratio of non-performing loans remains low, recording a decline in some of the countries. Despite the expectations, the increase of interest rates during last year has not engendered a sizeable negative impact to credit quality.

Table 4 Key macroeconomic and financial indicators for the Western Balkan countries

	GDP (real, annual %)			Unemployment (in %)		Credit growth (% annual)		Non-performing loans ratio (in %)	
	2024 Q4	2024 Q1	2024p	2024 Q4	2024 Q1	24 Q1	2024 Q2*	2024 Q1	2024 Q2*
Bosnia & Herzegovina	1.7	2.7	2.3	12.7	13.5	7.7	9.4	3.6	:
North Macedonia	0.9	1.2	2.9	13.2	12.9	6.1	6.8	3.1	:
Montenegro	4.3	4.4	3.4	12.4	12.0	10.8	13.4	4.9	4.6
Kosovo	4.0	5.6	:	:	:	12,9	12,5	2,0	2,1
Serbia	3.8	4.7	3.5	9.1	9.4	0.8	2.6	3.2:	:
Albania**	3.8	3.6	3.3	11.2	:	6,6	11,1	4,6	4,7

Source: European Commission, respective central banks, INSTAT. Explanations f- Forecast of ECFIN for July, 2024; ':' no available information; "": data refer to May 2024; "**": data refer to June 2024.2.3 Macroeconomic environment in Albania*

2.3 MACROECONOMIC ENVIRONMENT IN ALBANIA

THE REAL SECTOR AND THE LABOUR MARKET

At the end of first quarter, the annual economic growth recorded 3.6%. This rate was slightly higher than the 3.5% recorded at the end of 2023. Economic growth has been driven by both the manufacturing sector and the services sector. Data from the period indicate that the primary contributions to growth came from the "construction," "public administration, education, and healthcare," and "trade, transportation, accommodation, and food service" sectors[15]. On the demand side, economic growth was primarily driven by domestic demand, with significant contributions from private sector investments and final consumption by households. The stability of demand manifested in a widening of current account deficit in the balance of payments, driven by an increase in the goods deficit, which caused net exports to exert a dampening effect on economic growth. The economic sentiment indicator, although remaining above its historical average, experienced a decline in June, primarily influenced by the performance of trade, services, and construction indicators. Although at a lower degree, the industry and consumer confidence indicator recorded a decline.

During this period, the Albanian economy continued to grow at a positive pace, and by the end of the first quarter, the annual economic growth rate reached 3.6%.

This growth has been broadly based across sectors, particularly driven by construction, trade, and transportation, and has primarily been supported by domestic demand.

On the demand side, economic activity was supported by final consumption and private sector investments, while the deepening of trade deficit has contributed to a downward trend in economic growth.

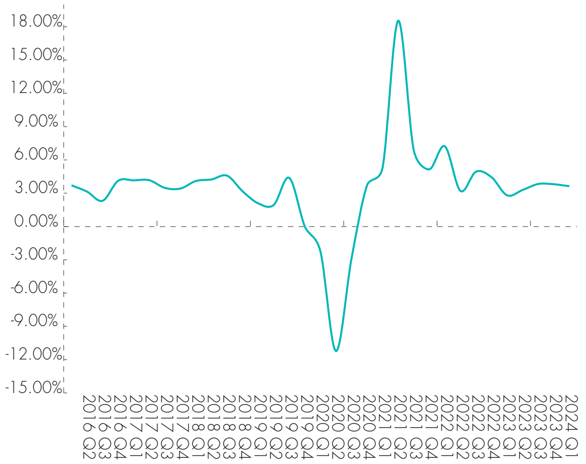
Positive developments, such as growth in employment and the increase in wages characterised the labour market.

Developments in the labour market during the first quarter of the year were positive. The number of unemployed job seekers slightly increase compared to the end of 2023, but decreased by 3% or approximately 2,600 individuals

15 *These sectors contributed by 1.19 p.p., 0.92 p.p. and 0.76 p.p., respectively in annual terms.*

compared to a year earlier. The total number of employed individuals during the same period increased by 1% or 8,000 people compared to a year earlier, with this growth largely attributed to a similar rise in employment within the private sector. The most recent report on the unemployment rate is from the end of 2023, with a corresponding value of 10.7%.

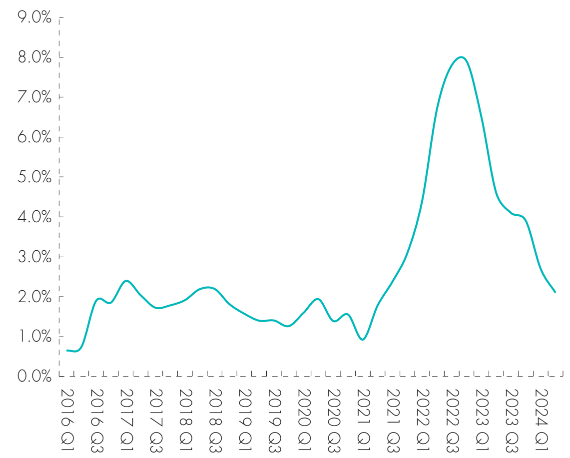
Chart 5 Annual GDP growth



Source: INSTAT.

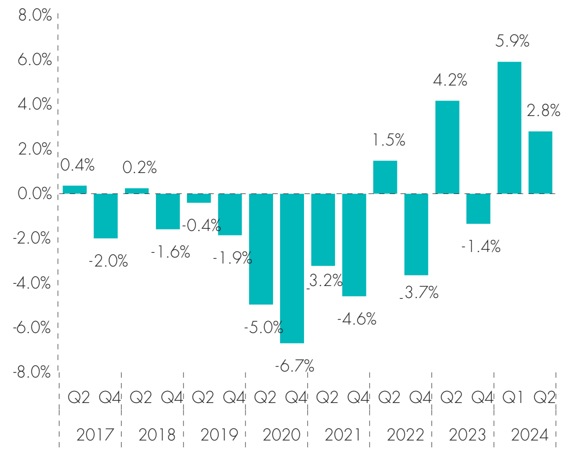
Wage growth has continued in both the public and private sectors. In annual terms, the average growth rate of gross wages reached round 14% during the first quarter of the year, reflecting the rise of both private and public sector's wages (by around 13% and 16%, respectively). In the private sector, the increase of wages extended across all the sectors, but was more pronounced in the services sector. The broad-based increase in wages represents a positive foundation for anticipated developments in the financial sector, as it enhances borrowers' repayment capacity and improves credit conditions, such as the income-to-debt ratio and the debt service-to-income ratio.

Chart 6 Inflation rate*



*Average quarterly rate of annual CPI growth.
Source: INSTAT.

Chart 7 Budget deficit to GDP



Source: Ministry of Finance and Economy, INSTAT, and Bank of Albania's calculations.

MONETARY AND FINANCIAL DEVELOPMENTS

Inflation performance recorded a continuous decline. The normalisation of the monetary policy stance during 2023 has engendered a gradual and persistent decline of inflationary pressures, keeping the economic growth outlook of the country intact. The average annual inflation rate dropped to 2.1% in Q2, compared to 4.6% in the previous year. This price performance was driven by a rapid decline of inflation of food articles, largely reflecting the fall of imported inflation, and the appreciating trend of the exchange rate. On the other hand, internal inflationary pressures remain stable due to the steady economic growth in Albania and the positive performance of the labour market and wages. As a result, the Bank of Albania decreased the policy rate by 0.25 percentage points, to 3.0%, in July. Although inflationary pressures are declining, overall, the monetary policy stance will be conditioned upon the performance of economic and financial data as well as and the risk factors.

During the period, the fiscal policy was in general, consolidating. The budget surplus exceeded projections by the end of the period, as revenues were higher and expenditures lower than planned. In relation to GDP, the fiscal stability indicators - budget deficit and total public debt - were significantly downward over the period.[16]. At the end of June 2024, the budged balance recorded a surplus of about ALL 51 billion, against a surplus of ALL 46 billion in the previous year. In annual terms, fiscal surplus expanded due to the higher growth of revenues (primarily from taxes and custom fees), by ALL 23 billion, or 7%. On the other hand, expenses increased by about ALL 18 billion or by 6%, and were oriented towards current expenses for special funds and those for wages. The budget deficit has been financed more by domestic borrowing than by foreign borrowing. The increase in the budget surplus has maintained the consolidating trend of fiscal policy and positively impacted inflation control.

EXTERNAL SECTOR

The first half of the year was characterised by a significant widening of the current deficit compared to the previous year, mainly as a result of the strong increase in the goods deficit during the first quarter. The current deficit recorded during the period was EUR 580 million, and this value was 50% higher than in 2023 H1. Almost the entire deterioration is related to the steep increase in the current account deficit and the goods trade deficit during the first quarter of the year. The increase in the import of goods by around 15% against a 4% decline in exports, resulted in a trade deficit increase from EUR 2,100 million to EUR 2,600 million, or 23%. The increase in the import of goods is related to higher imports from the groups of "transportation equipment," "food," and "basic metals." The trade of services, dominated by travel services or cross-border tourism, remittances from immigrants and other primary and secondary income, recorded improvements in their balances and contributed to a reduction in current account deficit by around EUR 280 million. Remittances reached EUR 510 million over the period, increasing by 15% compared to the previous year, while imports and exports of travel services registered EUR 1,210 million

Inflation rate fell rapidly during the first half of the year. This performance reflected the impact of the monetary policy normalisation, the appreciation of domestic currency, and the fall of imported inflation. At the commencement of July, the Bank of Albania lowered its key interest rate by 25 base points, down to 3%.

During the period, the fiscal policy was in general, consolidating. The budget balance targets exceeded projections by the end of the first half of 2024. In relation to GDP, the fiscal stability indicators - budget deficit and total public debt - were significantly downward over the period.

Current account deficit widened during the first half of the year, as a result of an increase in the trade deficit of goods. Positive contributions came from the increase in net foreign exchange flows from travel services and remittances from emigrants.

The increase in foreign direct investments, coupled with net outflows of portfolio investments, was insufficient to cover the widening current account deficit, resulting in a contraction of reserve assets during the period.

The country's debtor position with non-residents expanded during the first quarter of 2024, due to an increase in net liabilities of the private sector in the form of foreign direct and portfolio investments.

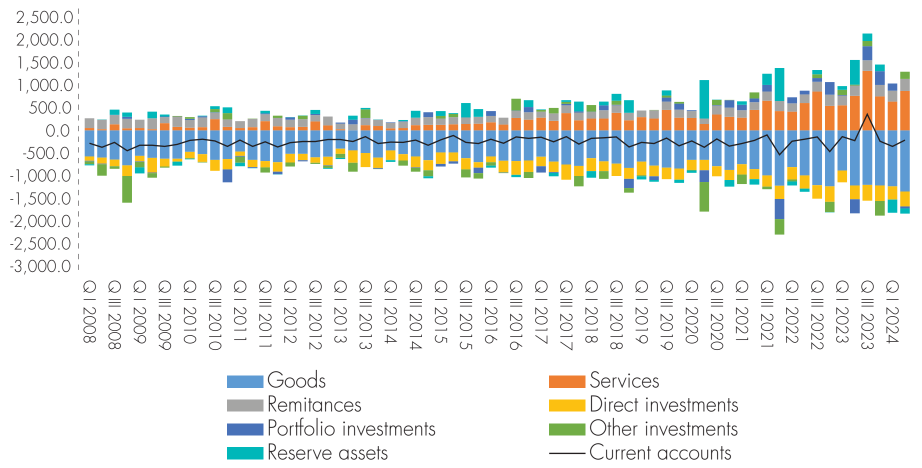
[16] *Based on the Ministry of Finance's data, public debt dropped to around 56% at the end of June 2024, the lowest level recorded since 2010. At the same time, the primary budget balance recorded positive values.*

and EUR 1,950 million, respectively, with an annual growth of 25%.
The coverage of the current account deficit by inflows from the financial account has significantly declined compared to the previous year, due to the performance of portfolio investments, while foreign direct investments have increased. The level of exposure of the domestic economy, measured as the sum of the current account balance and the capital account balance recorded during the period, has tripled compared to the previous year, rising to EUR 710 million from EUR 240 million, due to a strong increase in net demand for foreign goods." Concurrently, net inflows in the financial account have not expanded at a pace comparable to the deepening of the current account deficit, resulting in a decline of foreign exchange reserve by approximately EUR 400 million. Up to the end of the first half of the year, the foreign exchange reserve totalled EUR 5,520 million, sufficient to cover 6.4 months of imports of goods and services. Obligations in the form of foreign direct investments have continued to increase, with net inflows reaching EUR 620 million during the period, representing an increase of around 9% compared to last year. These investments were primarily concentrated on real estate, the financial intermediation sector, hydrocarbons and energy, as well as telecommunications. Conversely, the net financing of current account deficit through portfolio investment during the period had an opposite trend compared to the first half of the year, when the government issued its Eurobond. In 2024 Q1, the financial account recorded an increase by EUR 100 million and a decrease by EUR 110 million, respectively, in the domestic banks' assets in the form of securities invested abroad. Additionally, there was a contraction by EUR 130 million of obligations toward non-residents in the form of debt securities exposure, resulting from the increased participation of resident banks in the government's Eurobond.

The external position of Albania remains that of a debtor, and its value expanded mainly due to the increase of net liabilities of the private sector. At the end of 2024 Q1, Albania's financial assets and liabilities to non-residents were EUR 12,4 bln and EUR 22,4 bln, respectively, while the net position expanded by about 12% in annual terms[17]. This deepening of the debtor position is associated with the increase in liabilities related to portfolio investments and those linked to foreign direct investments. The latter amounted to EUR 13.7 billion at the end of 2024 Q1, 21% higher than last year. The external debt expanded somewhat in the first quarter, standing at EUR 10.4 billion at the end of the period. The main share in the stock of external debt, of about 48%, continues to be occupied by the general government sector, as it registers a EUR 3.5 billion debt in the form of loan and a EUR 1.4 billion in the form of debt securities. The sector of depositing corporations have an external debt of EUR 2 billion, represented almost entirely by deposits to non-resident in the domestic financial system, whereas the debt of other sectors and debt in the form of inter-company loans derived from foreign investment relationships stand at EUR 1.6 bln and EUR 1.7 bln, respectively, at the last quarter of the year.

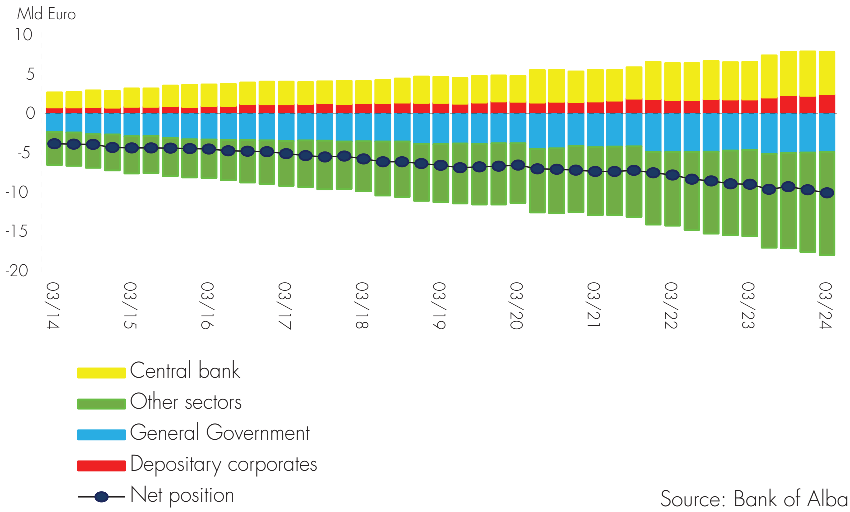
[17] *Compared to the previous quarter, net international investments have expanded their negative position by EUR 408 million, or around 4%.*

Chart 8 Payment balance flows and current account balance



Source: Bank of Albania and INSTAT.

Chart 9 Position of International investments by sector

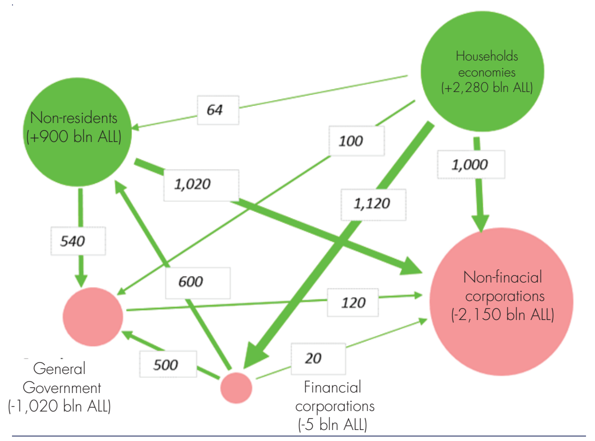


Source: Bank of Albania.

3. FINANCIAL ACCOUNTS AND FINANCIAL POSITION OF HOUSEHOLDS AND ENTERPRISES

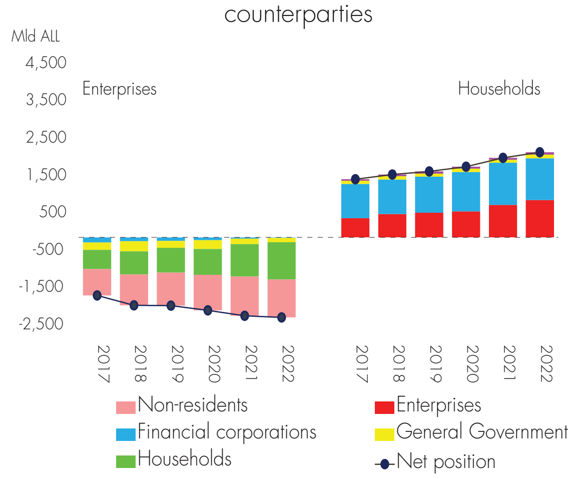
Albania remains a net debtor or borrower in relation to the rest of the world. The country's obligations to non-residents in the form of loans, government debt, foreign direct investments, and non-residents deposits with domestic banks are higher compared to the residents' claims toward non-residents (i.e., loans to non-residents, investments and deposits abroad etc.). Until the end of 2022 this position was around ALL 900 million. The majority of liabilities to non-residents is held by the business sector, with a stock of liabilities amounting to ALL 1.02 trillion, followed by the general government sector, which has liabilities totalling around ALL 540 billion. On the other hand, the sector of financial corporations appears as a net lender to non-residents with net claims reaching ALL 600 billion until the end of 2022. Financing between resident sectors is covered by the sector of households/family businesses, which mainly finance businesses with capital and the financial corporation sector with deposits; by the financial corporate sector that finances businesses and households with loans, and the general government sector, investing in securities, which has a small net claim compared to domestic businesses. The data available for 2024 H1 show that businesses' liabilities to non-residents have increased due to an increase in the stock of foreign direct investments, a considerable deepening of businesses' net liabilities to the financial sector in terms of deposits and loans, and a slight increase of the net creditor position of households to the financial sector.

Chart 10 The net position and financing between the sectors



Source: Bank of Albania.

Chart 11 Net position of enterprises and households by counterparties



Source: Bank of Albania.

3.1 FINANCIAL POSITION OF ENTERPRISES

The higher net liabilities of enterprises continues to be associated with financing from the households sector and that of non-residents, while the main form of liabilities remains capital followed by loans from financial institutions. The vast majority of enterprises' financial assets consist of receivables or claims of enterprises against other enterprises and against the government sector, while liabilities are dominated by the capital invested in domestic enterprises by resident households and foreign investors, as well as by payables among corporations. The expansion of the debtor position during the last ten years was driven by the rapid increase of liabilities in the form of capital invested by the households sector and that of non-residents. Both these items were up by ALL 500 bln and ALL 300 bln in 2013-2022 and by the end of 2022, they recorded, respectively, ALL 1,000 bln and ALL 1,020 bln.

Over the period, enterprises have considerably expanded their debtor position with non-residents, as well as the negative gap between deposits and bank loans[18]. In relation to the non-resident sector, the net position of domestic enterprises deepened by around 20% in annual terms, until the end of 2024 Q1, reflecting an increase by the same degree in the stock of foreign direct investments. Enterprises' debtor position with the banking sector, measured as the difference between deposits (assets) and loans (liabilities), up to the end of first half of the year, widened by around 30% compared to the level recorded at the end of 2023, and by 15% compared to a year earlier. This performance is related to the fact that as compared to last year, deposits and loans of enterprises recorded a positive growth, but nominal credit growth was around 2 times higher than that of deposits. In 2024 H2, short-term deposits of enterprises shrank by ALL 11 bln, or 3%, whereas credit to enterprises expanded by ALL 30 bln, or 6%.

Net liabilities of enterprises to non-residents continued to increase as the foreign direct investment stock rose rapidly. These investments comprise almost the entire value of net liabilities of enterprises to non-residents and, at the end of the first quarter, the stock of foreign direct investment was EUR 14 bln, whereas the net balance of direct investments[19] was EUR 12 bln. The performance of the external debt of domestic enterprises, which excludes the capital involved in direct investments, has continued to be affected by developments in

According to data on financial accounts, enterprises hold a debtor position, which became more pronounced in 2024 H1.

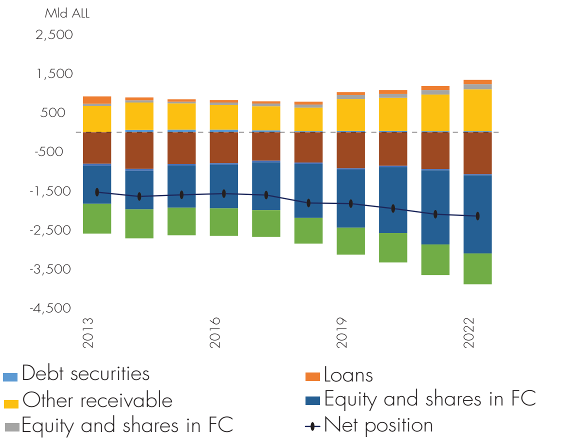
By instruments, this trend is related to the further increase of liabilities in the form of foreign direct investments and bank loans. In terms of counterparties, enterprises have increased their net liabilities to financial corporations due to the faster increase of loans compared to deposits which they have with banks.

Bank lending to enterprises in both lek and foreign currency has increased at an accelerated pace during the period. Lending in foreign currency would have been slightly higher were it to include the diminishing effect of the exchange rate appreciation.

The average interest rate on new loans to enterprises increased somewhat compared to the end of the previous six months.

Enterprises' demand for loans was considerably higher than in the previous six months, while the overall loan approval conditions from banks were more relaxed in Q2.

Chart 12 Assets (+), liabilities (-) and the net position of enterprises by instruments



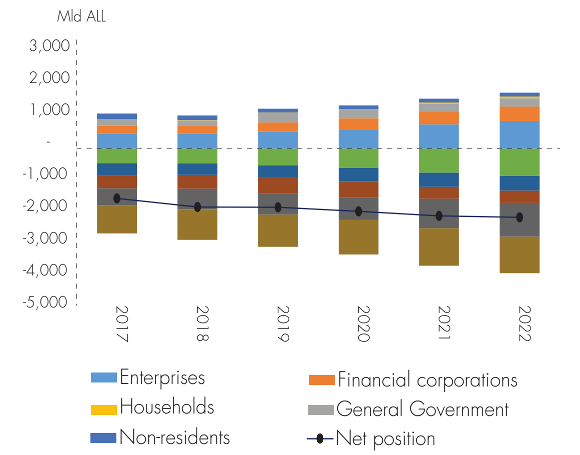
Source: Bank of Albania.

[18] *While data on financial accounts for 2023 is still incomplete, the analysis is based on the external sector indicators up to the end of the third quarter, and the banking activity indicators up to December 2023.*

[19] *Foreign direct investments (liabilities) minus direct investments abroad (assets).*

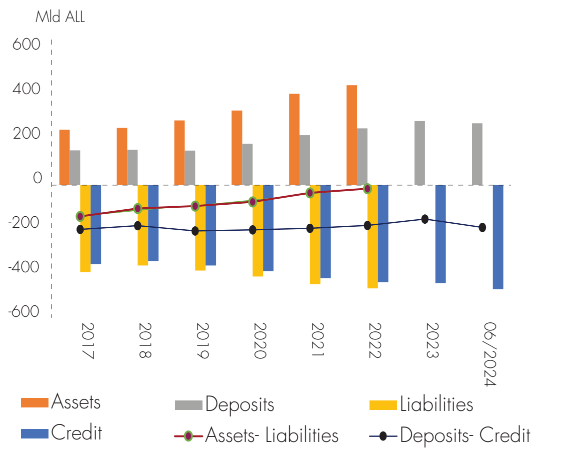
the stock of inter-company loans [20] springing from the relationship of direct investment. At the end of March 2024, this loan reached EUR 2.5 bln, with EUR 17.7 bln comprising obligations in the form of loans between domestic and foreign companies. The sector of enterprises holds around a quarter of the external debt of the country that currently amounts to EUR 10.4 bln. The increase in cross-border obligations in the form of foreign direct investments (capital investments) represent a positive development for the financial stability of enterprises and Albania. This is related to the fact that these investments are long-term, have a higher withdrawal cost, and are less sensitive to short-term speculative shocks as compared to portfolio investments or other financial instruments. Up to the end of first quarter, the sectors with the largest stock in foreign investments were the sectors of energy, gas and steam (EUR 3.4 bln) and the quarrying industry (EUR 2.3 bln). The sector of real estate was characterised by a rapid increase of foreign direct investments over the past years. At the end of the period, these investments amounted to EUR 1.7 bln, slightly exceeding the stock of EUR 1.6 bln invested by non-residents in the sector of financial and insurance activities.

Chart 13 Assets (+), liabilities (-) and the net position of enterprises by sectors



Source: Bank of Albania.

Chart 14 Assets and liabilities of enterprises to the financial sector



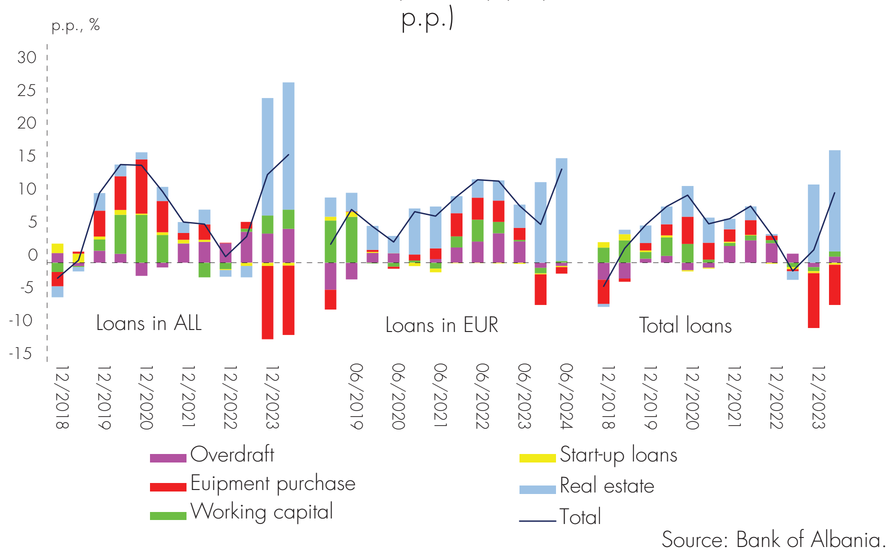
Source: Bank of Albania.

The gap difference between the deposits and loans of resident enterprises with banks significantly deepened during the first half of the year, as credit expanded at a faster pace compared to deposits, which experienced a decline. In 2020-2023, the deposits of enterprises expanded faster than loans, resulting in a narrowing of the deposit-loan gap by approximately ALL 50 billion, or over 20%, during this period. During 2024 H1, this trend was substituted by a sharp increase of credit, accompanied by a contraction in the short-term deposits of enterprises, which resulted in the return of the gap to values observed in 2018-2019. The loans-to-deposit ratio for enterprises has improved, and by the end of June 2024 it stood at 1.7 times from 2.3 times registered at the end of 2017. Enterprises' claims against the banking sector and the financial

[20] *Loan from the corporation/entity from which the foreign direct investment originates*

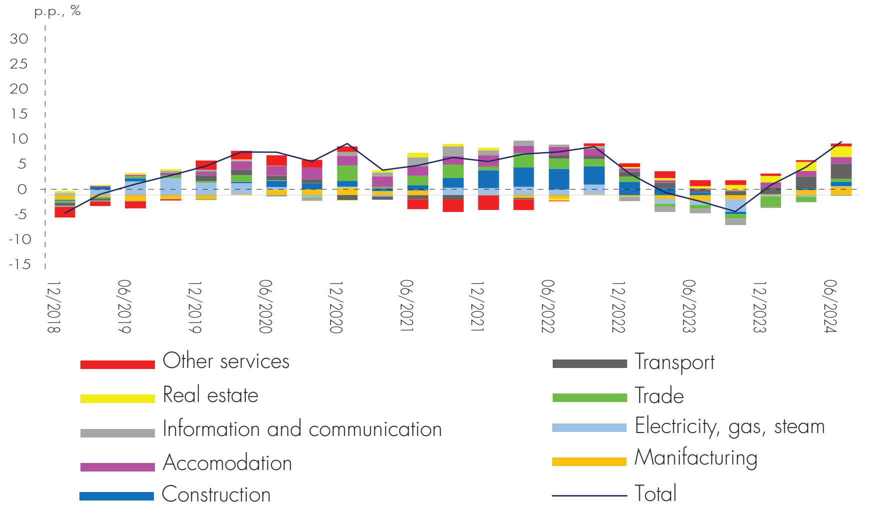
system, in general, include not only deposits but also other indicators such as the capital invested by businesses in financial entities, claims in the form of subordinated debt issued by banks, and participation in collective investment ventures[21]. On the other hand, businesses' obligations against financial entities are similar in value to the credit obtained by businesses, since the value of other obligations, other than loans, is insignificant. Consequently, the net position of the business sector in relation to the financial sector (or the difference between assets and liabilities) is very low, and has narrowed down over 2017-2022. Meaning that, overall, the dependence of domestic businesses on the financial sector is limited and has been on the decline. However, these are aggregated data that encompass all domestic companies and financial entities, and the position of specific businesses or sectors regarding their exposure to the financial sector may vary significantly from these values.

Chart 15 Growth of loans to enterprises by purpose of use (contribution in p.p.)



Source: Bank of Albania.

Chart 16 Growth of loans to enterprises by sector (contribution in p.p.)

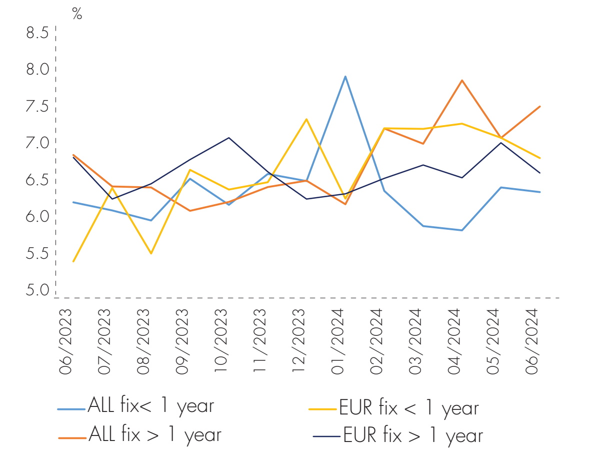


Source: Bank of Albania.

[21] *Investment funds.*

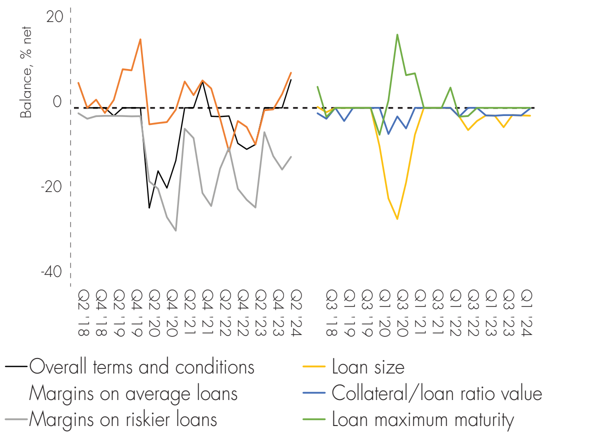
Bank lending to enterprises grew by 6% during the period, and by 11% compared to last year. Both lending in foreign currency and lending in lek had a contribution in this regard. In annual terms, the credit portfolio of enterprises in lek expanded by 17%, credit in foreign currency grew by 8%, while the credit in foreign currency in its original currency increased by 14%. The portfolio of lending to enterprises expanded due to the increase of loans granted to the sectors of transportation, extracting industry, accommodation, and real estate. The credit stock of enterprises, classified by purpose, is dominated by mortgages (loans for real estate purchases), which account for 38%. This is followed by overdraft loans at 24%, loans for equipment purchases at 20%, and working capital loans at 15%. The indicators measuring loans to enterprises by purpose of use, reflect a steep increase of mortgages and a decline in loans used for equipment purchases. This performance is affected by a reclassification of a portion of the loan portfolio by the banking sector between these two categories. This statistical effect will be apparent in the annual adjustments on respective loan indicators until the third quarter of 2024.

Chart 17 Interest rates on new loans in lek and euro, excluding overdraft



Source: Bank of Albania.

Chart 18 Loan approval conditions (+) ease; (-) restrict



Source: Bank of Albania.

The interest rate on new loans to the sector of enterprises has risen during the period, due to higher rates on new loans in lek and euro. The average interest rate on all new loans to enterprises in June were around 7%, or somewhat higher compared to the previous six months. The highest new rates on loans to enterprises were recorded for loans with variable interest rates and a fixed interest rate period of over one year, granted in the local currency. These rates fluctuated between 7% and 7.5% during the first half of the year. On the other hand, new loans in lek with a fixed interest rate period less than one year recorded rates fluctuating between 6% and 6.5%, which is lower than the new loans in euro and other loans in lek.

According to Bank Surveys[22], enterprises' demand for loans have increased significantly over the period. The net balance of the specific indicator has

[22] *The Bank Lending Survey is published on: https://www.bankofalbania.org/Monetary_Policy/Surveys_11282/Bank_Lending_Survey/*

recorded the highest value in the segment of large enterprises, as compared to medium-sized and small enterprises, as well as in loans for liquidity purpose rather than loans for fixed investments. Expectations on the overall demand of enterprises for loans remain optimistic for the following quarter. Bank credit standards have remained almost unchanged during this period. Factors such as the costs associated with banks' capital and liquidity have played a role in easing standards. Conversely, the perceived risk by banks regarding the borrowing industry or enterprise, as well as the quality of credit collateral, have influenced the tightening of the standards. After three consecutive quarters without any changes, the overall conditions of credit approval were slightly eased during the second quarter of the year. The easing is primarily related to margins on average loans, meanwhile other conditions including the loan size experienced a slight contraction.

3.2 SOLVENCY AND EXPECTATIONS OF ENTERPRISES FOR THE FUTURE

According to the survey "On the financial situation and the debt burden of enterprises", around 95% of surveyed enterprises reported a profit during the period. The medium-term enterprises dominated this group. The performance of sales is assessed as positive during the period, not least for the group of medium-sized enterprises and construction and services businesses, although they have been declining compared to the previous period. In the first half of 2024, all three sizes of enterprises (i.e., small, medium and large) expect a further increase of their sales and financial results. These expectation are more optimistic compared to the previous period, although at values below those of last year. Small and medium-sized enterprises list 'competition' and 'labour production costs' as the challenges faced by their activity, whereas the main challenges of large enterprises are related to 'the increase in the cost of financing' and 'adopting the legislation in force.

According to the Survey conducted by the Bank of Albania, majority of enterprises have registered profits over the period. The performance of sales and the financial result are assessed as positive, although recording lower values compared to the previous six months. Expectations remain optimistic, despite the existing issues, particularly those regarding to higher financing costs and labour production costs.

The share of borrowing enterprises increased during the period. The debt burden, in the form of loan-to-equity ratio and the debt service as a percentage of enterprise revenues, is assessed to be increasing for most businesses compared to the previous six-month period.

Enterprises expect their credit demand to remain stable and upward in the second half of 2024.

The share of enterprises that have a loan to pay increased during the period. About 37% responding enterprises declare that they currently have a loan to pay. This share increased by 1 p.p. compared to the previous six months, and it has declined by the same degree against last year, which is expected given the higher financing conditions in Albania. Around 87% of enterprises consider their level of borrowing as adequate, but small enterprises express a higher demand for financing.

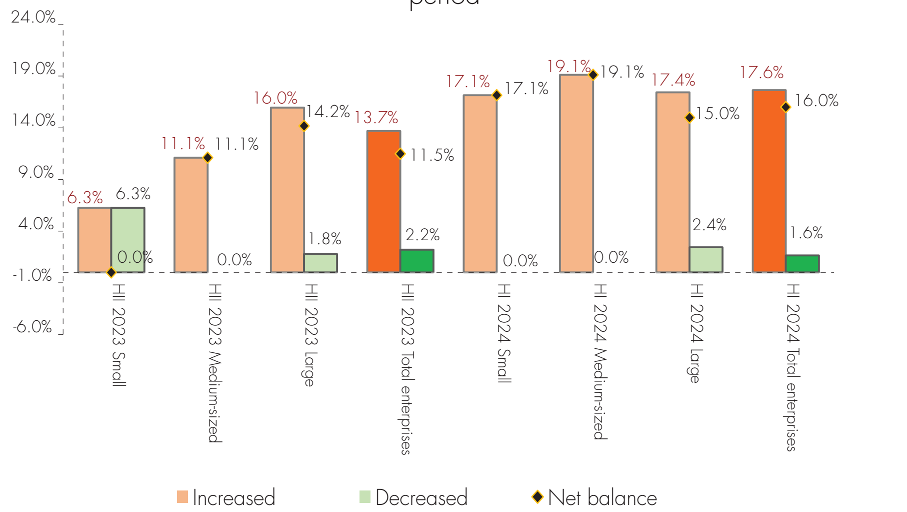
The debt-to-capital ratio increased for the total of surveyed enterprises compared to the previous six months. Around 87% of enterprises declare that the total loan value is approximately half of the enterprise's capital, 12% state that it is nearly equal to the value of the capital, and 7% indicate that this value exceeds that of the capital, resulting in an average debt-to-capital ratio of 78%. This ratio has risen compared to the previous period, particularly for medium-sized enterprises, as around 21% of them declare that their loan value is equal or above the value of capital. In the sectorial level, the debt burden increased for all branches of the economy, with the exception of the services sector, where the debt-to-capital ratio has remained the same from last period. This sector has the highest debt-to-capital ratio recorded, with 22% of enterprises that declare that the value of loan is equal or above the value of capital.

Table 5 Share of enterprises with an equal/higher value of debt to equity

	Industry	Services	Construction	Trade
2022 H1	21%	21%	25%	22%
2022 H2	22%	29%	26%	25%
2023 H1	10%	20%	24%	18%
2023 H2	15%	15%	18%	15%
2024 H1	20%	22%	18%	18%

Source: Bank of Albania.

Chart 19 Enterprises that declare a change in the loan instalment during the period



Source: Bank of Albania.

Around 81% of enterprises declare that their loan payment has not changed over the period, and this share has dropped compared to last period. The rest of responses result in a positive and increasing net balance, indicating an increase in this expenditure during the first half of this year. This result has been observed for all three groups of enterprises, but is more pronounced for small and medium-sized enterprises. Around 82% of enterprises do not expect a change in the cost of their loans in the second half of 2024; 15% anticipate a further increase, and 3% expect lower costs. Large and medium-sized enterprises expect the most for costs to rise. Debt servicing cost reached 20% of revenues for 76% of enterprises, and 20%-50% of revenues for 21% of them. The loan with the highest cost in terms of revenues is assessed for large and medium-sized enterprises.

As regards planning for borrowing in the next six months, enterprises stated that the demand for loan is expected to remain in the positive direction, and somewhat upward compared to the previous six months. Thus, around 41% stated that there is "no possibility" for them to request a bank loan during the future period, and this share has dropped for the group of large and medium-sized enterprises, and has remained unchanged for small enterprises. Whereas the share of those that admit at various degree of certainty that "there is little possibility", "high possibility" or "it is certain" that they will be requesting a bank loan in 2024 H2, has increased, signalling a reinvigoration of enterprises' demand for credit.

3.3 FINANCIAL POSITION OF HOUSEHOLDS

With the exception of the non-resident sector, households represent the most important resident sector in financing financial corporations and businesses, with the main form of financing being the capital invested in local enterprises and bank deposits. By the end of 2022, the household sector had assets, liabilities and a net financial position equal to ALL 2.640 bln, ALL 360 bln and ALL 2.280 bln, respectively. Over 50% of the assets of households, or around ALL 1.420 bln are in the form of deposits and other claims[23] toward banks and other financial institutions. The stock of claims in the form of capital invested by households in domestic enterprises up to the end of 2022, or around ALL 1.050 bln. In relation to savings in the form of currencies and deposits, household loans are 4.5 times lower, and this ratio has been stable during the past decade. The financial sector is the main creditor and debtor of the household sector.

Households represent the most important resident sector in financing financial corporations and businesses, with the main form of financing being the capital invested in local enterprises and bank deposits.

The credit position of resident households in the banking system slightly expanded during the period, due to the higher growth of deposits compared to loans. The rate of credit growth, in both annual and semi-annual terms was higher than the rate of deposit growth.

Consumption and real estate purchase supported demand for loans particularly in the domestic currency. The interest rates on new loans in lek to households increased slightly during the period.

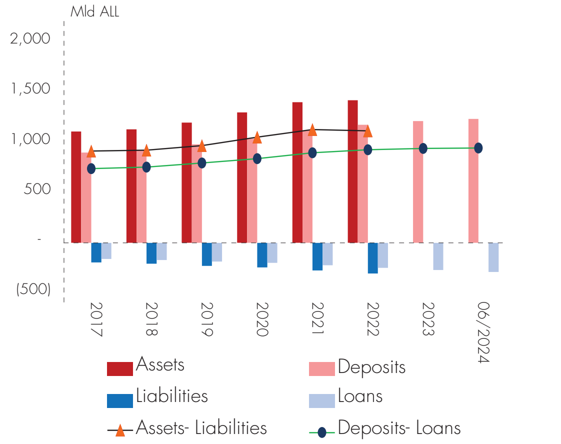
Banks have eased their overall lending conditions on households, focusing on its size and maximum maturity. On the other hand, they have somewhat constricted their loan standards, and they expect this trend to continue for the remaining part of the year. Households' demand for loans is expected to remain stable.

In 2024 H1, the net creditor position of resident households to the banking sector expanded by around ALL 5 bln, to ALL 947 bln. This performance reflected the higher growth of deposits compared to loans. By the end of June, the deposits and loans of resident households in banks amounted to ALL 1.240 bln and ALL 290 bln, respectively, with corresponding increases during the period of ALL 23 bln and ALL 19 bln. In relative terms, loans to households expanded quicker than deposits to households, compared to both the end of last six months and last year. Savings of resident households in the form of bank deposits increased by 2% during the first half of the year, and by 6% compare to the previous year, whereas corresponding changes in the credit stock were 7% and 12%.

Deposits in banks account for the largest share of households' savings and their increase during the period has given the main contribution to the expansion of the creditor position of households. Around 84% of the contribution to the growth of households' deposit stock is related to deposits in lek. Investments in government securities in the form of treasury bills have declined compared to the end of 2023, while investments in government bonds, private investment funds, and pension funds provided a positive contribution to the financial position of individuals.

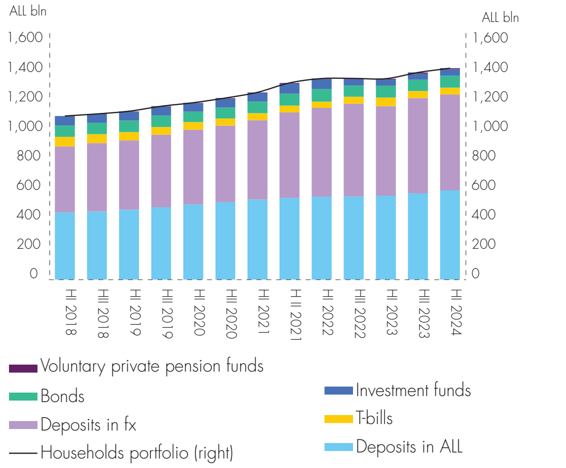
[23] *For example participation in the investment funds securities.*

Chart 20 Assets and liabilities of resident households to the financial sector



Source: Bank of Albania.

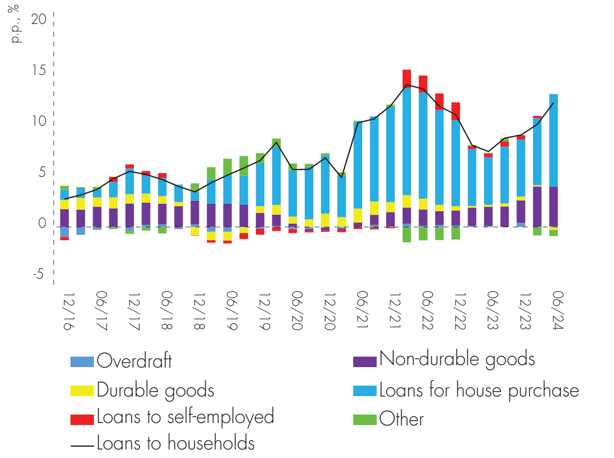
Chart 21 Savings of resident households by instruments



Source: Bank of Albania.

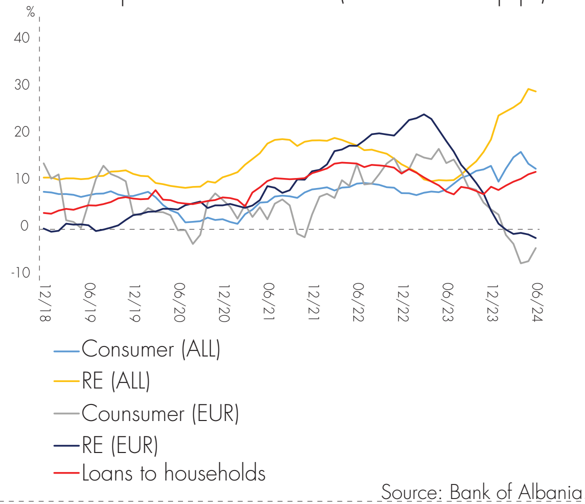
During the period, loans to resident households increased at a higher pace compared to the last six months, and the annual growth of this credit was 12%. The main contributor to the annual growth of this loan was the approximately 14% growth in the excess of loans taken by individuals for purchasing homes, whereas loans for purchasing non-durable goods recorded a sizeable increase of 26% compared to last year. The structure of the loan portfolio of resident households has not recorded important changes over the past years; the main share, or 2/3rd of this portfolio continues to be dominated by loans to house purchases, followed by loans for durable or non-durable goods. The appreciation of the local currency exchange rate against the euro which continued during 2024 H1 has led to a slowdown in the growth rate, even resulting in a decline in the stock of loans for purchasing homes and consumer loans in Euro, while there has been a strong increase in the stock of mortgages and consumption loans in lek. The increase in the stock of consumer loans is related to the steep annual growth by 15% in loans for non-durable goods, which include loans for services and goods that are consumed for a period shorter than one year. Loans for durable goods represents about 10% of the total loans for resident households, and by the end of the first half of the year, this type of loan recorded a decline of approximately 3% compared to one year ago.

Chart 22 Annual growth of loans to households (contribution in p.p.)



Source: Bank of Albania.

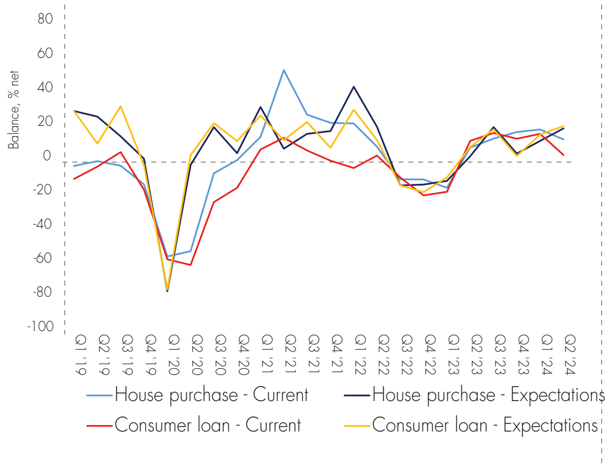
Chart 23 The annual growth of loans to households for consumption and real estate (contribution in p.p.)



Source: Bank of Albania.

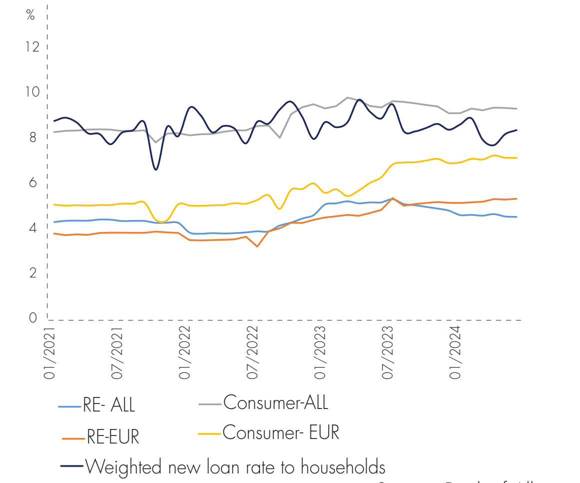
At the end of the period, the weighted interest rate on new loans to households [24] remained almost unchanged compared to the rate recorded in 2023, standing at 8.4%. Over the period, it leaned downward during the first quarter, and recorded a slight increase over the second quarter. The higher interest rates paid by households are those on consumer loans in lek, for which banks reported an interest rate of around 9.4% at the end of the period. Since the mid-2023, interest rates on new loans to household reflect an upward trend for consumer loans in Euro, and a slightly downward trend on mortgage loan rates in the domestic currency. In 2024 H1, this fluctuated around 4-5% and represents the lowest interest rate on loans to households from domestic banks.

Chart 24 The performance of household demand for loans



Source: Bank of Albania.

Chart 25 Interest rates on new loans to households



Source: Bank of Albania.

An increase in the demand for loans from households were noticed during the period, where loans for purchasing real estate was more pronounced. By banks,

[24] *Including overdrafts and credit cards.*

factors which have restrained the households' demand for loans were: the overall interest rate, the use of alternative financing sources, consumer trust, and recent and expected developments in the housing market. Banks' expectations on households' demand over the second half of the year were optimistic, and this forecast applies to both main categories of loans for households: consumer loans and loans for purchasing real estate.

Banks eased the overall lending terms and conditions to households, although they simultaneously tightened its standards. They increased the maximum sum of the loan or the maximum maturity deadline, but they became more restricted on collateral requirements and increased the margins on riskier loans. The main factors behind this are banks' assessments on the performance of housing market and borrowers' repayment abilities. For the preceding period, as well, banks signal that standards will tighten, not least in the segment of consumer loans.

3.4 SOLEVENCY AND EXPECTATIONS OF HOUSEHOLDS FOR THE FUTURE

Bank of Albania's survey results show that the share of borrowing households is stable, while they debt-repayment capacity shows signs of decline over the period.

The share of households that have a loan to pay has not changed during the past two six-month period.

The borrowers' repayment capacity has become weaker compared to the previous six-month period, but it is better than a year ago. Expectations on the repayment capacity for the upcoming six months appear more optimistic.

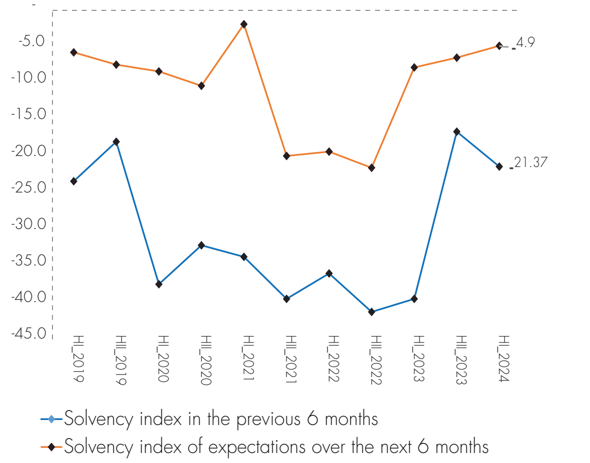
Households expect their demand for loans to decrease in the second half of 2024.

Over the period, the level of households' borrowing remained stable, whereas their repayment ability has slightly weakened. The results of the survey "On the financial situation and debt burden of households"[25] in 2024 H1, show that about 24% of households had at least one loan to repay at the time of the survey. This share remained unchanged compared to the previous six-month period and the previous year, remaining below the historical average of the indicator of about 27% Around 74% of households declare that the loan settlement accounts for "less than 30% of the monthly income"[26] and this indicator decreased by 9 p.p. compared to the previous six-month term, remaining around 5 p.p. above the last year's level. The same changes in annual and semi-annual terms are recorded by the share of households for which the loan settlement "exceed 30% of their income". This performance suggest that, compared to the previous six months, the debt burden for households has increased, but compared to the previous year, the situation has improved. About 58% of borrowing households declare that their repayment capacity "has not changed" during the period, while the rest declare "a deterioration of their repayment capacity" compared to the preceding six months, although this has remained above the level recorded last year. The index of borrowers' repayment capacity in 2024 H2 shows a contrary trend, and although it has a negative value, it signals more optimistic expectations among households compared to the previous six-month period and previous year.

[25] *The survey is semi-annual and for the first half of 2024 was conducted on a sample of 1,200 families, with a response rate of 88%. The sample is selected and periodically reviewed by the Institute of Statistics based on the registrars used by the of households' questionnaires.*

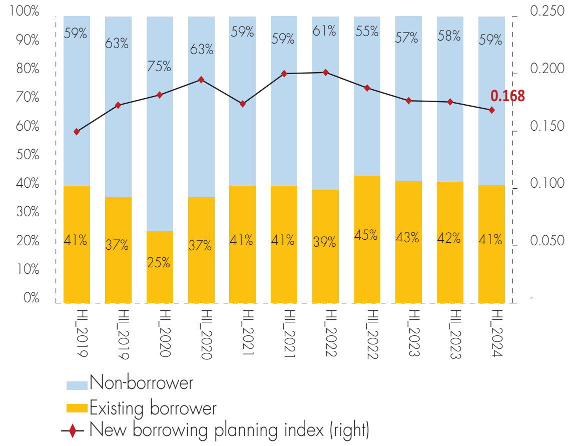
[26] *"Up to 10% of income" for 27% of borrowing households, "10-30% of income" for 47% of households, and "over 30% of income" for 26% of households.*

Chart 26 Debt repayment capacity in the previous 6 months and the next 6 months



Source: Bank of Albania.

Chart 27 New borrowing planning/rollover index and households planning to borrow



Source: Bank of Albania.

Households expect a slowdown of their loan demand during 2024 H2. Around 60% of respondents declared that they "do not expect to take a new loan in the next six months". The share of those who declare that they consider the possibility of obtaining/recovering a new loan with varying degrees of certainty[27] decreased by 3 p.p. compared to the previous six months and with 1 p.p. compared to the previous year. The annual decline in the value of the loan borrowing planning index may signal a slowdown in the households' demand for credit during 2024 H2.

[27] *The given alternatives are: "somewhat likely", "very likely" and "definitely."*

4. MARKETS AND PAYMENT SYSTEMS

4.1 SECURITIES MARKET

in the primary market of government debt securities, the volume of issues during the period was 50% higher compared to the previous six months, although it was comparable to the volume of the previous year. The volume of short-term issuances doubled during the period, while they accounted for around 60% of total debt.

In the same line with the policy rate of November 2023, the interest rates of some securities increased, slightly spiking up the cost of government securities as a result.

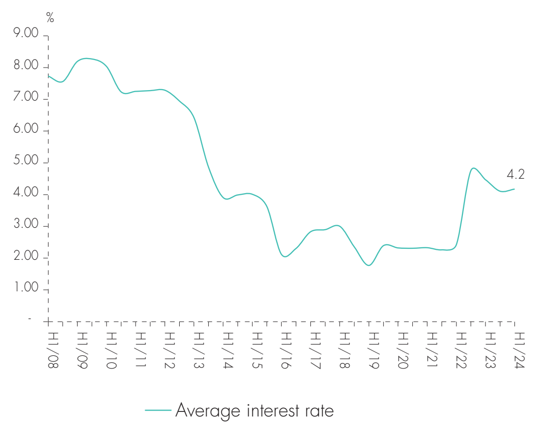
Over the period, the weighted average yield on all maturities of securities issued in lek slightly increased by 0.1 p.p, reaching at 4.2%. The average interest yield on short-term securities was up by 0.3 p.p at 3.5%, while on long-term securities it fell by 0.1 p.p., at 5.1%.

Investors' bid has been high and, in most cases, it has met government's borrowing needs.

The primary market of the Albanian government debt securities experienced a growth in the volume of issuances, mainly short-term ones, and the average interest (yield) was relatively stable. ALL 240 billion worth of government debt was issued in this market, and the entire sum was in the domestic currency. Almost 60% of the issues were in short-term debt securities, which are dominated by those with 12-months maturity. Bonds with 2-year maturity (40% of long-term debt) had the main share in long-term securities issued. The value of issuances during the period was around 7% higher compared to the volume issued during the first half of 2023, and around 50% higher compared to the previous six months. During this period, non-resident entities have, for the first time, acquired Albanian government securities in lek. At the end of the first half of the year, the portfolio of non-residents in lek was ALL 6 billion, or around 1% of the overall government debt securities issued in the domestic currency. The weighted average yield on all maturities of securities issued in lek slightly increased by 0.1 p.p, reaching at 4.2%. The debt incurred through the issuance of short-term securities doubled over the period, approaching the value issued during the same six-month period a year ago, following the decline recorded in the preceding six-months.

The short-term securities issued were ALL 140 billion, or 66% higher compared to the previous six months. Almost the entire of the value issuance (97%) were in securities with 12-month maturity. Compared with the same period of the previous year, the volume issued was slightly lower. Investors' demand for short-term debt securities has fulfilled government's demand for borrowing in about 95% of the cases

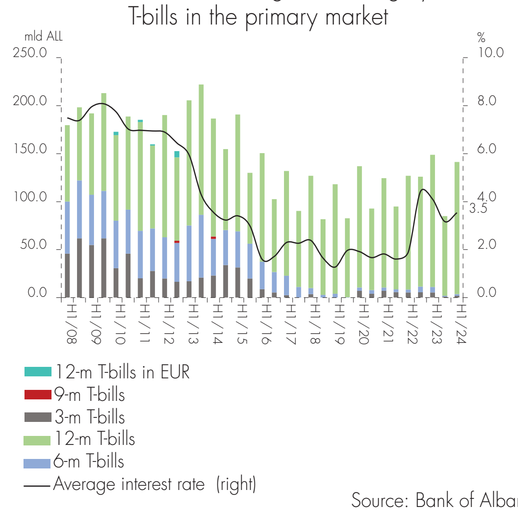
Chart 28 The performance of the weighted average interest rate on debt securities (in %)



Source: Bank of Albania.

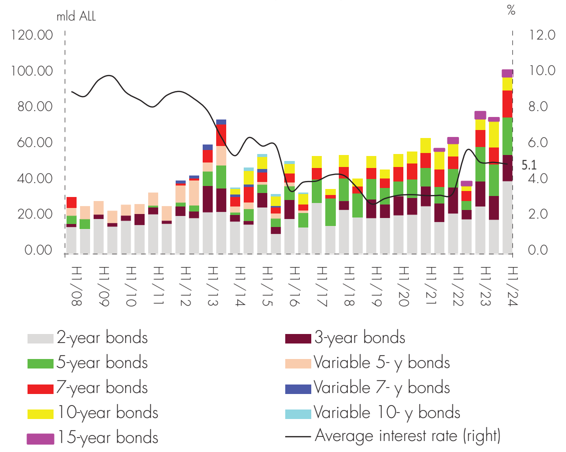
The volume of long-term securities issued during the period was around ALL 100 billion, or 35% and 29% higher compared to the previous two semesters. With the exception of securities with 10-year maturity, the volume of the other long-term securities issued increased. Securities with a 2-year maturity recorded the highest volume issued during the period, with their volume doubling to ALL 40 bln. Compared to the same six-month period a year ago, the issuance of 2-year bonds grew by 52%. The volume of 3-year and 5-year maturity securities issued amount to around ALL 15 bln and ALL 20 bln, or 11% and 18% higher compared to the issuances in the previous six-months, and 4% and 9% higher compared to the previous year. The volume of securities with 7-year maturity issued was around ALL 15 billion, and increased by around 60% compared to the previous two semesters. The issuance of 10-year bonds halved compared to the previous six-month period, but it was around 20% higher compared to the previous year. Securities with 15-year maturity account for around 3% of the volume of long-term debt, and it doubled by ALL 3.6 bln during the period. The volume of 15-year bonds was around 7% lower compared to the previous year.

Chart 29 Volume and weighted average yield on T-bills in the primary market



Source: Bank of Albania.

Chart 30 Volume and weighted average yield on bonds in the primary market



Source: Bank of Albania.

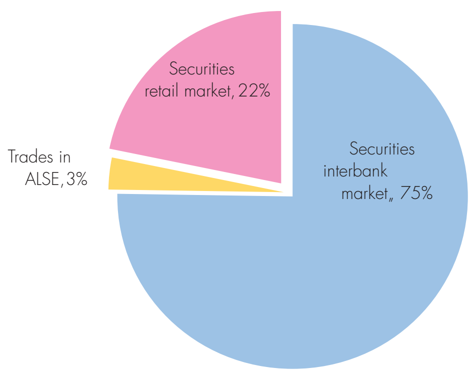
The weighted average yield on short-term securities for the first six months increased by 3.5%, form 3.2% in the previous six-month period. Compared to the previous year, the interest rate was around 0.6 percentage points lower. Due to its dominant weight, the performance of the average yield has been determined by the interest rate of 12-month maturity securities. This rate was 3.4% at the beginning of the year, and has gradually increased, recording the highest value of 3.7% in the issuances of March, April and May, gradually decreasing once again until June, when it stood at 3.3%, the lowest value recorded in the six-month period.

Over the period, the weighted average yield on long-term securities was 5.1%, from an average of 5.2% in the previous two semesters. The average interest rates for 2-year, 5-year, and 7-year securities slightly increased by 0.2-0.3 percentage points, reaching 4.2%, 5.3%, and 5.8%, respectively. The average interest rates for 3-year securities dropped by 0.1 p.p. to 4.7%. In contrast, the average interest rates for 10-year and 15-year securities stood close to the level of the previous six months, standing at 6.6% and 7.7%, respectively. The demand from participants for long-term securities in the primary market met has around 90% of supply, standing higher than the previous semester, where approximately 70% of the offered volume was fulfilled.

The volume of trade in the secondary market of securities remain low and are dominated by securities of the Albanian government. Securities transactions between banks for their portfolios account for about ¾ of the total transactions in this market, including transactions between banks for their clients. Trade in the Albanian Securities Exchange (ALSE) continues to remain low, dealing mainly in government securities. However, during the first six-month period, private bonds were traded in ALSE as well, valued at ALL 0.06 bln, double the value traded in the previous semester. This accounted for around 6% of securities traded in ALSE. Although low in value, the trading of private securities is a positive signal for the future development of the capital market, toward non-government instruments. Aiming at developing this market, the model of market-makers has been operating for a few years now, offering daily quotes of benchmarks with 3- and 5-year maturities. Daily quotation of benchmark securities allows for the calculation of the yield curve, which serves as a reference for other debt securities in the market and enables the pricing of those securities.

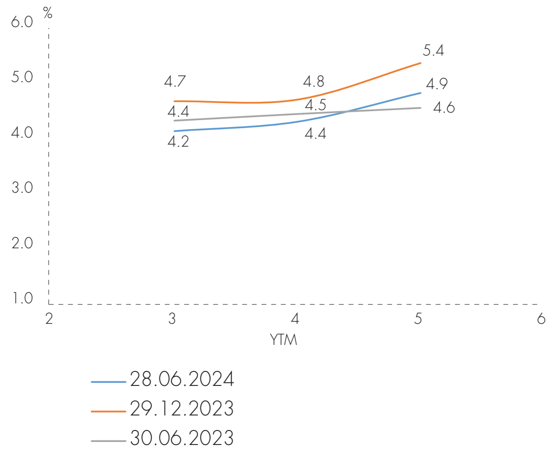
The yield curve for benchmark securities has a normal slope (with lower yields on short-term securities and higher yields on long-term ones). As compared to the previous six-month period, the curve has shifted down, reflecting the lower yields on all maturities. In contrast to the previous year, the yield curve is somewhat steeper. In addition to the demand for a higher return on long-term maturities, movements in the yield curve may also reflect the structure of issuances during the period.

Chart 31 The volume of transactions in the secondary market of government securities



Source: Ministry of Finance and Economy.

Chart 32 Yield to Maturity (YTM)



Source: Bank of Albania.

4.2 THE INTERBANK FINANCING MARKET

Over the period, the volume of financing transactions in the interbank market increased, mainly as a result of the higher volume of one-week transactions.

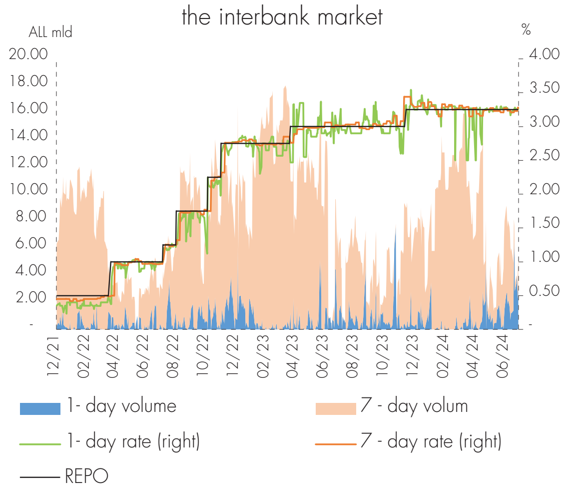
The interest rates applied by banks in the money market have remained close to the key interest rate of 3.25% during the period, reflecting the monetary policy decisions of the Bank of Albania.

The volume of transactions in the interbank market increased, and the average interest rate remained anchored to the key interest rate. The volume of transactions rose by 60% compared to the previous six-month period, but it was 30% lower compared to the same six-month period one year ago. The interest rates in the interbank market continued to fluctuate close to the key interest rate. In the first half of the year, the key interest rate announced by the Bank of Albania remained unchanged at 3.25%, and this was reflected in higher interbank rates compared to the previous two semester, where the key interest rate was lower[28].

[28] *During 2023, the key interest rate increased in March and November by 25 base points (0.25 percentage points).*

The higher volume of interbank transactions is related to the increase by around 80% of one-week transactions, which account for 90% of the volume of interbank borrowing. During the period, one-week transactions registered ALL 940 billion. Compared to the previous year, the volume of one-week transactions issued was 31% lower. The one-day transactions carried out over this six months were slightly up by 5% at the level of ALL 110 billion, although compared to last year, their volume doubled. The volume of 1-day transactions account for about 10% of the total volume of transactions carried out during the period. The rest of transactions is represented by 2-day, 3-day and 2-week transactions, monthly and quarterly ones, which together account for 2% of interbank transactions. During the period, the Bank of Albania continued to carry out regular operations, injecting liquidity through one-week reverse repurchase agreements, which represent its main instrument.

Chart 33 Volume of transactions and interest rates in the interbank market



Source: Bank of Albania.

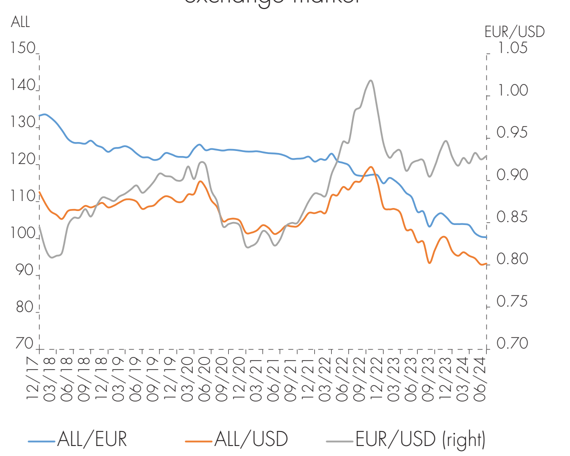
4.3 FOREIGN EXCHANGE MARKET

The exchange rate of the lek continued to appreciate against the main foreign currencies, but the speed of appreciation in the first half of the year was lower compared to previous year.

The Bank of Albania has continued to hold auctions for the purchase of the Euro, in order to fulfil its objective of increasing the foreign exchange reserves and contributed to the stability of the exchange rate during the last months of the semester.

Following the significant increase in the inflows of foreign exchange in the balance of payments, the first half of the year continued to be characterized by the appreciation of the lek against major currencies, although the pace of appreciation slowed down. The exchange rate was relatively stable in the first half of the year, but the pressures stemming from the appreciation of Lek which were identified during March continued in the following months as well, in line with the seasonal behaviour of the exchange rate. In June, the average exchange rate of Euro recorded the lowest historical value of ALL 100.4 per EUR 1. This value represented an appreciation of lek by about 4% compared to the previous six-month period. The annual rate of lek appreciation dropped to 6% by the end of June, from 11% and 10% in the previous six-month period and the previous year, respectively. In the last two months of the period, the exchange rate appears more stable, affected also by foreign currency purchases by the Bank of Albania.

Chart 34 Exchange rate in the domestic foreign exchange market



Source: Bank of Albania.

Lek appreciated against the US dollar as well, reflecting developments in the domestic market and those in the international currency exchange market. In June, USD 1 was converted to ALL 93.2 on average, which reflects an appreciation of the domestic currency by 3% compared to the previous six months and by 6% compared to the previous year. Even against the US dollar, the appreciation of the lek was slower than the average change recorded during 2023.

The Bank of Albania's specific survey on the market for residential real estate shows that the overall demand remained stable.

Demand from non-residents has been comparable to the previous period.

The growth of bank credit for real estate purchase has supported the stability of the demand. Banks have applied somewhat tight standards on this credit to households.

Number of unsold proprieties has fallen.

Overall, the increase in the supply of housing units, expressed in the form of new construction permits, appears somewhat subdued compared to a year ago, but is considered stable in recent years. Bank credit for construction has not change over the period. Construction costs have gone up as expenses for wages and energy increased.

The Survey shows that the Fischer House Price Index at country level rose by 16.9% in semi-annual terms and by 8% compared to the previous year. The increase in index value was even stronger for Tirana. Rent prices has also gone up. Agents report that the share of transactions for which the selling price is equal to the asked price has decreased.

Agents remain positive regarding the performance of the housing market in the short term, and remain optimistic for the longer-term horizon.

4.4 THE REAL ESTATE MARKET

The analysis of the trend in the (residential) real estate market is conducted based on the data on the real estate market survey and the developments of house prices, the data reported by banks and other administrative data.

In the residential real estate market, demand has continued to be stable. According to the survey, real estate agents report a good performance regarding the sales volume and a decline in the number of unsold properties. Demand from non-residents has been high, accounting for around 27% of purchases during the period. Furthermore, banks report[29] that households' demand for financing house purchases appears upwards over the period.

The banking sector continues to support households with financing their residential real estate purchases. At the end of the six-month period, the outstanding loans for this segment registered ALL 180 bln, up by 7% and 13% in semi-annual and annual terms. The lending terms and conditions on mortgages became somewhat more restricted by enacting higher interest rates and collateral requirements. The quality of these loans remains satisfactory, and the non-performing loans ratio decreased to 1.7% from around 2% in the previous six months, and 2.2% in the previous year. At the end of the period, the stock of loans collateralized with real estate was over ALL 360 billion, slightly higher than the level of six months ago. Around 48% of real estate collateralized loans are held by the household sector. The stock of real estate loans granted to resident businesses reached ALL 170 billion at the end of the period, increasing by 10% compared to the end of last year. In contrast to loans for the households sector, where 66% are denominated in lek, about 60% of the loans taken by businesses for purchasing real estate are in foreign currency loans.

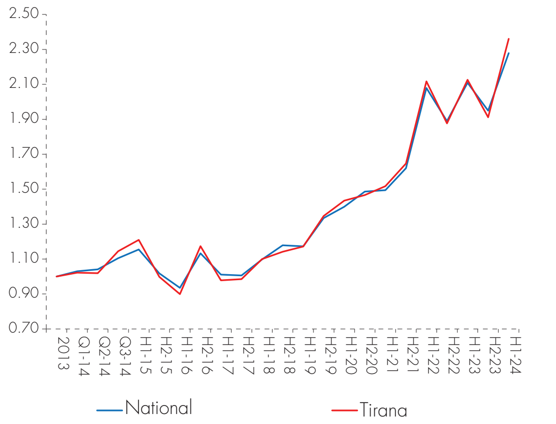
The supply indicators for residential buildings suggest a slowdown in their growth. According to INSTAT, the number of construction permits in the first six-month period of 2024 were 235, from a quarterly average of 323 permits reported in 2023. Furthermore, the number of permits expressed in residential plot surface has recorded a decline in the new building surface. In the medium term, the share of plots of residential houses and residential buildings with three floors and up, has remained high and stable. The construction costs measured according to the Construction Cost Index, continued to rise. The annual change in the overall index was 3.4%, while the items with the highest growth were energy expenses (+7.5%), wages expenses (+4.4%) transport expenses (+3.9%) other expenses (+3.9%).

[29] *More information can be found on the " Bank Lending Survey" at https://www.bankofalbania.org/Monetary_Policy/Surveys_11282/Bank_Lending_Survey/*

Loans to the construction sector increased by 3.3% over the first half of the year and by 4.6% compared to the previous year, reaching ALL 75 billion at the end of June. However, it is noted that the share of construction loans to the outstanding loans to enterprises has remained nearly unchanged from previous periods, accounting for about 17% at the end of the period.

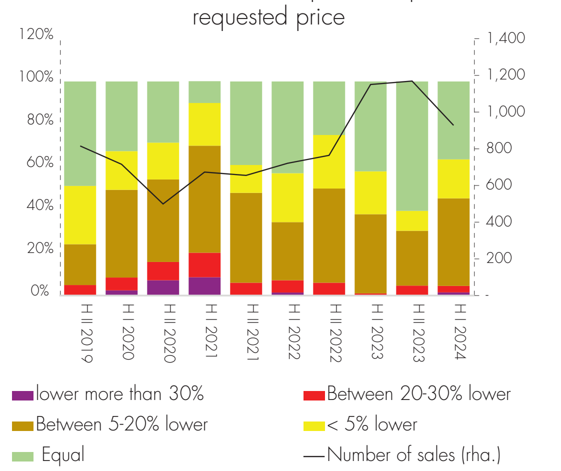
According to the survey, real estate trading agents and representatives of construction firms, have reported higher selling prices compared with the previous six months. The average house prices calculated according to the Fischer Index[30] for sales made during the period, increased by 16.9% compared to the previous six months and by 8% compared to the previous year. The index of sales prices in the Tirana increased by 23.5% compared to the previous period, and by 11% compared to the previous year. At the same time, the share of transactions where the purchase price for the sold properties was equal to price requested by the seller, has decreased. Simultaneously, the share of transactions where the purchase price for the sold properties was 20% lower than price requested by the seller, has increased.

Chart 35 Fischer House Price Index for Tirana and the entire territory



Source: Bank of Albania.

Chart 36 The sale transaction price compared to the requested price



Source: Bank of Albania.

According to the agents rent prices have increased during the period. This data on rent demand and prices is derived primarily from agents that operate in Tirana. The overall demand for rent is reported higher compared to the previous six months. Entities' assessments of the market situation and prices in the housing market remain generally positive for the short term and longer term.

[30] *This index is built based on a specific survey. This survey is published in full on the website of the Bank of Albania (www.bankofalbania.org).*

BOX 2 SUMMARY OF THE RESULTS FROM THE "REAL ESTATE MARKET" SURVEY AND HOUSE PRICES INDEX FOR 2023 H2

Data on the developments of prices and the assessment of the situation by real estate market agents was collected through a field survey with a sample of 230 entities, whose main activity is the trading of real estate. The selected entities are real estate agents and construction companies whose sales represent about 75%-80% of the turnover of the entire population. The Bank of Albania compiles the questionnaire and realises the data entry and processing, while the Institute of Statistics performs the field interviews, the main processes of sampling and the physical check of the filled-in questionnaire. In addition to the data on performance of the Fischer House Prices Index, for Albania, aforementioned in this report, the data from the survey shows that:

The assessment of agents for the overall situation of the market was slightly more positive compared with the previous period. Responding to the question "How do you assess the market situation compared with the previous period (six-months)?" the net balance of responses was 10%, with particularly optimistic responses from coastal areas, where the balance value was significantly more positive compared to the long-term average. The same indicator assessed only for entities that reported sales was significantly more positive during the period, with a net balance of around 48%.

The number of new registered houses by the agents appears similar compared with the previous period. The net balance of those reporting an increase in the number of listed properties and those that report a decrease was almost neutral. The number of unsold properties, both for residential and commercial buildings has been declining for several consecutive semesters.

The average selling period at the national level slightly decreased to10.5 months, from 10.9 months in the previous survey. In the case of Tirana, the average selling period has risen slightly, from 8.3 months to 9.7 months. The average selling time in coastal areas decreased significantly to 5.9 months from 10.9 months, while for other areas the selling duration was slightly lower than in the previous semester, from 13.6 to 12.9 months.

Financing through bank credit continued to support a considerable number of properties sold. According to agents, in a similar vein with the previous period, around 53% of both residential and commercial buildings sold by them were acquired through bank loans. Around 65% of these properties were mortgaged with up to 60% of the property's value.

During the first six months of 2024, around 27% of properties sold were purchased by non-residents. Around 61% of these residents were EU citizens. Overall, the share of transactions involving non-resident buyers has begun to rise again after a declining trend observed since 2020.

Future expectations appear positive. Agents have positive expectations about market performance in the territory they operate in the short-term future and a longer-term period (up to two years).

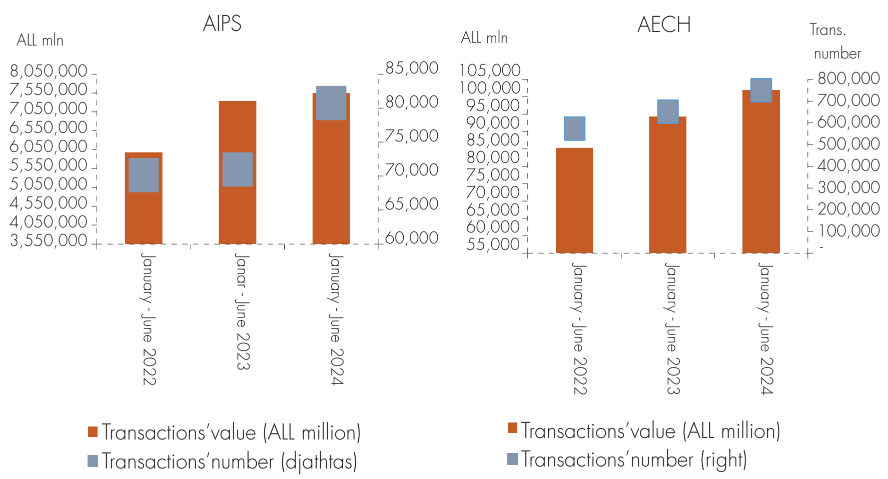
4.5 PAYMENT SYSTEMS

The core infrastructure for the clearing and settlement of payments in the domestic currency continued to operate safely and effectively, thus supporting the financial stability and the implementation of monetary policy. As regards the processing activity, AIPS system cleared around 80,000 payments valued at ALL 7,550 billion. The number of transactions was up by 14%, while their value was up by 3%, compared to the same period of the previous year. In parallel, in the retail payment system, AECH, 750 payments were cleared during the period, with an average value per transaction of around ALL 136 000. The number of transaction has continued to increase over the years, and the decline in the average value of transaction shows that the use of AECH system by the general public has increased. Compared with the first half of 2023, the activity of the AECH system registered an increase both in volume and value, by 15% and 8%, respectively.

The core infrastructure for the clearing and settlement of payments in the domestic currency and the Euro has continued to operate safely and effectively.

The value and number of transaction in the payment systems has increased during the period. Payments via cards (debit and credit cards) and non-paper form credit transfers has increased sharply. Currently, payments via cards have the main share in the total number of conducted payments.

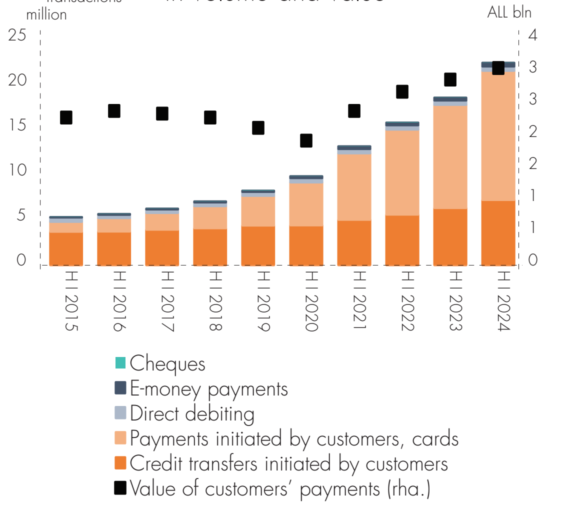
Chart 37 The performance of AIPS and AECH in 2023 H1 and 2024 H1



Source: Bank of Albania.

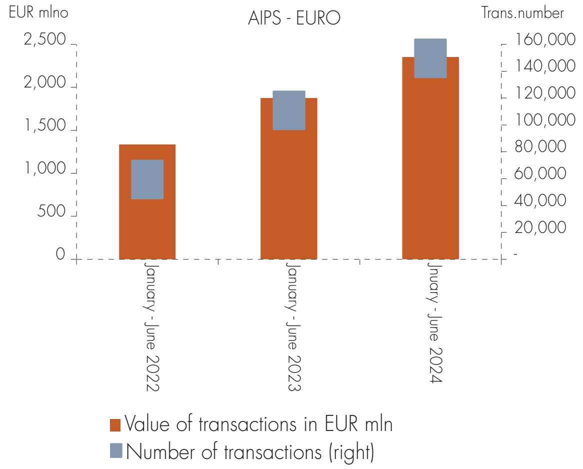
This period experienced a sizeable increase in the number and value of payments carried out through the AIPS-EURO system. Up to the end of June 2024, this system cleared around 150 thousand payments at a value equal to EUR 2.350 million Compared with the first half of 2023, the activity of the AIPS-EURO system registered a considerable increase both in number and value, by 35% and 26%, respectively. The AIPS-EURO system is an additional mechanism for the Bank of Albania that not only enables the reduction of the entities expenses that perform payment transactions in Euro, but also helps monitor this market segment and formalize the economy.

Chart 38 The performance of payment instruments in volume and value



Source: Bank of Albania.

Chart 39 Performance of payments for customers in the AIPS - EURO system 2022-2024



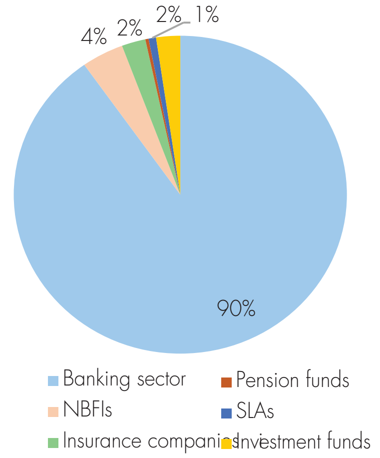
Source: Bank of Albania.

Debit and credit cards are the main means used by the banks' clients to carry out payments, and their usage has continued to expand. During the period, a total of 22.5 million payments, with a total value of ALL 3,070 billion were carried out for clients (households and enterprises), reflecting an increase in the number of transactions by 20%, and the value by 6%, compared to 2023 H1. Card payment account for 64% of the total number of payments. Compared to the same period last year, the number and value of payments with cards were 25% and 14% higher. However, their value remains lower compared to the value of transactions of transfers in paper and non-paper form. In parallel, over the period, the number and volume of credit transfers in non-paper form (internet banking, mobile banking) has increased by 20%.

5. FINANCIAL SYSTEM

During the first half of 2024, the share of financial system assets[31] to Gross Domestic Product (GDP) was slightly up by 2 p.p. at 94.2%. In annual terms, this indicator rose by 2 percentage points, as the annual growth rate of the financial system's balance was higher compared to the growth rate of GDP. Banking system contributed by almost 1.5 percentage points to this growth. Within the financial system, the banking sector continues to dominate, accounting for nearly 90% of total assets. The exposure of the banking sector to the non-banking sector remains low although it has seen a slight increase during the period. Meanwhile, the sensitivity of the non-banking sector to the activity of the banking sector remains high and stable. The Bank of Albania regularly monitors the correlation indicators within the periodic assessment of systemic risks.

Chart 40 Share of financial system segments to total financial system assets, June 2024



Source: Bank of Albania, Albanian Financial Supervisory Authority, INSTAT.

Table 6 Share of the financial system segments to GDP13 over the years (in %)

Autoriteti Licencues dhe Mbikëqyrës	Banka e Shqipërisë			Autoriteti i Mbikëqyrjes Financiare			Ndërmjetësimi financiar
Sistemi financiar	Sektori bankar	IFJB	SHKK dhe Unioni	Shoqëri sigurimi	Fonde pensioni	Fonde investimi	
2011	86.1	2.6	0.8	1.5	0.0		91.0
2012	89.1	2.7	0.8	1.6	0.0	1.2	95.4
2013	91.4	2.6	0.7	1.6	0.0	3.7	100.2
2014	92.7	2.8	0.8	1.8	0.0	4.6	102.7
2015	91.9	2.7	0.7	2.0	0.1	4.7	102.0
2016	95.5	2.8	0.6	2.0	0.1	4.5	105.5
2017	93.2	2.9	0.5	2.0	0.1	4.7	103.4
2018	88.8	3.2	0.6	1.9	0.1	4.2	98.8
2019	87.2	3.9	0.6	2.0	0.2	4.0	97.9
2020	97.8	4.2	0.7	2.4	0.2	4.2	107.5
2021	95.5	4.1	0.7	2.2	0.2	4.2	107.0
2022	87.8	3.8	0.7	2.0	0.3	1.9	96.5
2023	84.9	3.8	0.7	2.2	0.3	2.2	94.0
2024	85.0	3.9	0.7	2.2	0.3	2.2	94.2

Source: Bank of Albania, Albanian Financial Supervisory Authority, INSTAT.

[31] *The financial system consists of the banking sector and the non-banking sector. The database for all entities in the financial system and GDP pertains to the first quarter of 2024, with the exception of banks, whose balance sheets refer to the second quarter of 2024.*

5.1 THE BANKING SECTOR

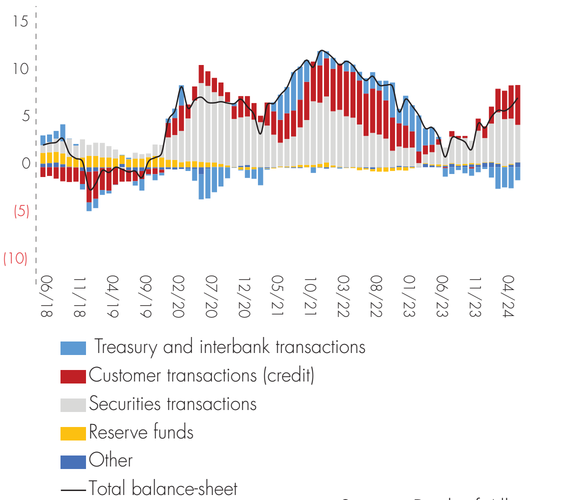
5.1.1 MAIN DEVELOPMENTS IN THE BANKING SECTOR

The banking sector's balance sheet expanded over the period. The growth in annual terms reached 7%. Investments in loans, securities, and interbank transactions contributed to the expansion of banking sector's activity. The statistical effect of exchange rate appreciation remained negative for around ALL 30 billion. Although this effect has been declining over the past year.

The share of assets and liabilities in foreign currency to the total balance sheet slightly decreased at 50% and 49%, respectively. Meanwhile the net creditor position to non-residents expanded, reaching at 9% of banks' assets. The financing of bank operations has continued to rely on retail deposits and the banks' own funds.

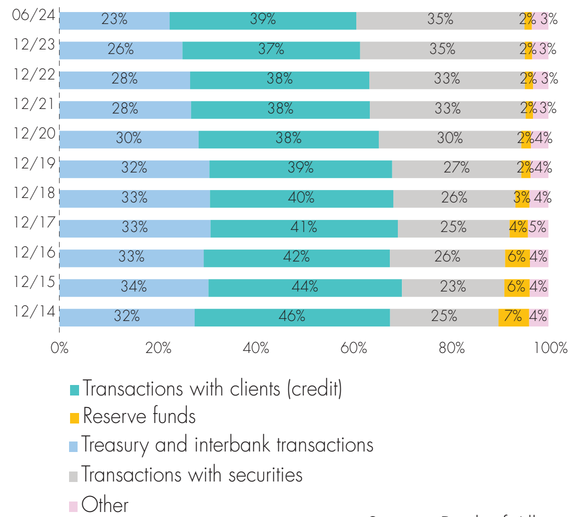
The balance sheet of the banking sector expanded during the period, and the annual growth accelerated compared to the previous two six-month periods. In annual terms, the activity of the banking sector expanded by around 7%. During the first half of the year, the reported value of assets increased by about ALL 36 billion (or 1.8%), reaching around ALL 2,000 billion at the end of the June. The main contribution to the growth of assets came from the expansion of lending activity by around ALL 52 billion and investments in securities by around ALL 26 billion. The only item registering a decline during the period was that of treasury and interbank transactions, which declined by around ALL 45 billion (or 9%). This item mainly reflected the performance of "Relations with the central bank," highlighting the decrease in the stock of banks' current accounts at the central bank. At the same time, interbank transactions increased by about ALL 18 billion (or 12%), influenced by the expansion of deposits with banks and other financial institutions, mainly non-residents. The increase in provisioning funds of the banking sector contributed to the contraction of assets by approximately ALL 0.6 billion. During the period, the negative statistical effect of the appreciation of lek against foreign currencies on the banking sector's balance sheet indicators was more mitigated compared to last year.

Chart 41 Asset performance by components, contribution in p.p



Source: Bank of Albania.

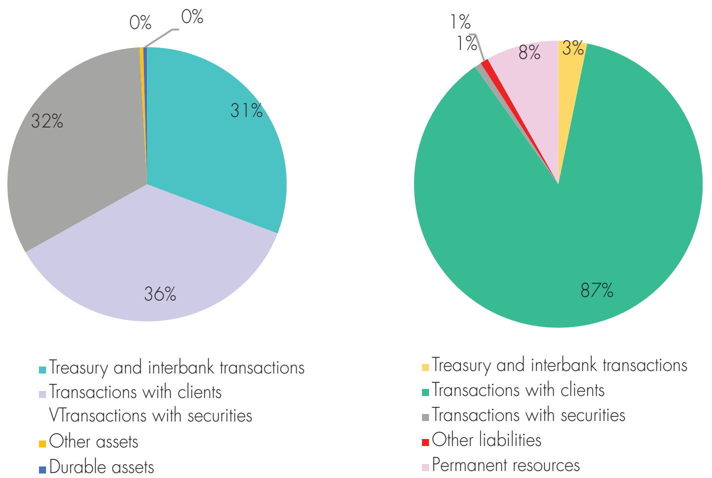
Chart 42 Structure of banks' balance sheet in %



Source: Bank of Albania.

The share of assets and liabilities in foreign currency to the total balance sheet recorded a slight decline compared to the end of last year. At the end of the period, assets and liabilities in foreign currency accounted for 50% and 49% of total balance, respectively. In absolute value, banks reported similar levels of assets and liabilities in foreign currency, of ALL 994 billion and ALL 976 billion, respectively, thus maintaining the balance of the foreign currency activity within the banking sector. As regards assets in foreign currency, the items with the largest share are investments in loans and government securities. In terms of liabilities in foreign currency, the structure has been more stable over the years, and is dominated by deposits in foreign currency. The aforementioned items have determined for the most part the limited sensitivity of the banking sector toward exchange rate fluctuations.

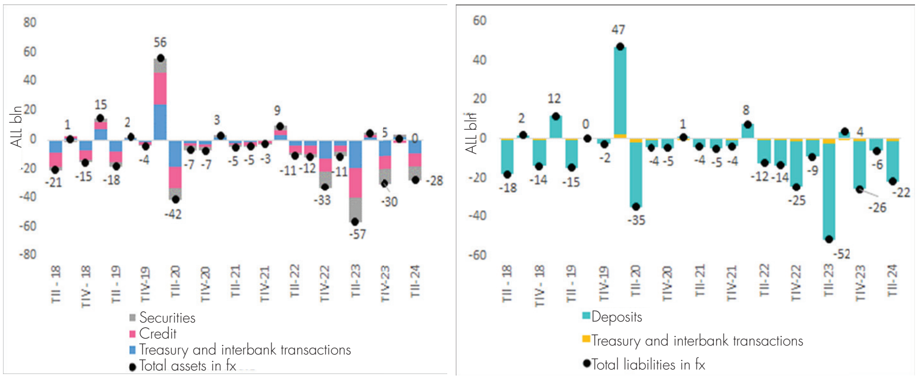
Chart 43 Structure of assets and liabilities in foreign currency, June 2024



Source: Bank of Albania.

In annual terms, foreign currency assets and liabilities expanded by 4% each, but corrected for the effect of exchange rate changes, these growth rates are calculated at 9% and 10%, respectively. The statistical effect of the appreciation of the exchange rate of lek remains negative, reducing the reported value of the banking sector' foreign currency balance by about ALL 28 billion compared to the previous year. Over the past year, the value of this impact has been on the decline. On the assets side, the strengthening of the domestic currency had a greater impact on the main balance sheet items such as treasury and interbank transactions (from about ALL 10 billion each). On the liability side, the exchange rate effect on the reported value of deposits in foreign currency was around ALL 21 billion. The depreciating statistical effect of the exchange rate has also impacted that part of the banking sector's capital which is in foreign currency, with a value of around ALL 15 billion.

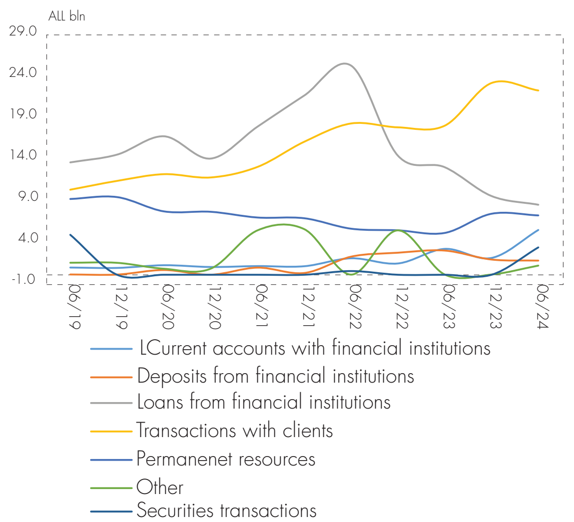
Chart 44 The effect of the exchange rate on the equivalent value in lek of the main items of assets (left) and liabilities (right)



Source: Bank of Albania.

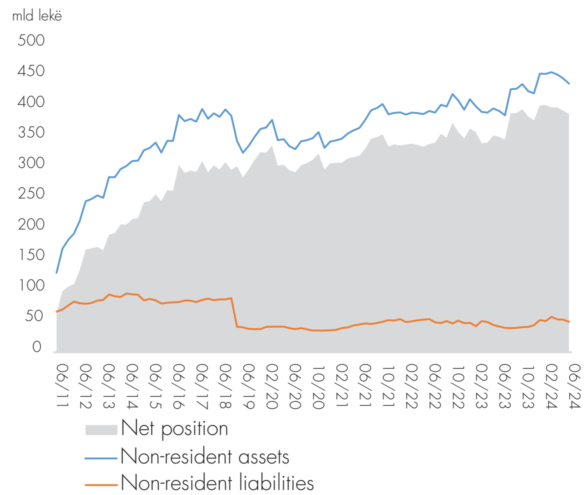
The financing of bank operations has continued to rely on retail deposits and the banks' own funds. Deposits and own funds account for 92% of total liabilities, and this structure has been stable during the period. Reliance on external funding remains low and has further decreased during the period, as a result of the increase in banks' liabilities to non-residents. The increase in liabilities to non-residents was due to the expansion of interbank activities in the form of current accounts with non-resident entities and securities sold under repurchase agreements with non-resident financial institutions. Both of these categories account for 11% and 6%, respectively, of the total liabilities to non-residents. The decrease in assets of non-resident entities came from the Increase the form of deposits and loans with banks for credit institutions and and financial institutions. At the end of the period, claims to non-residents accounted for 22% of total assets, while liabilities to non-residents accounted for around 3% of the total balance sheet. The net creditor position to non-residents increased compared to the previous six months and the previous year, in both absolute and relative terms.

Chart 45 Liabilities to non-residents



Source: Bank of Albania.

Chart 46 Net position with non-residents



Source: Bank of Albania.

5.1.1.1 Banking Soundness index

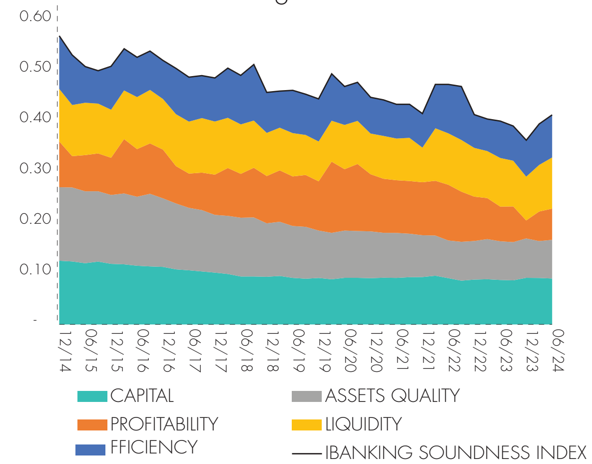
The banking soundness index shows good financial situation of banking sector as at end of the period. The index, with a value of 0.41 units, reflects a weakening of profitability, linked to a relatively lower growth rate in the banking sector's profits and productivity indicators compared to the previous period. This is a normal performance given the high levels of profits achieved by banks during last year. In fact, compared to the same period in the previous year, the profitability indicator slightly improved, mainly driven by an increase in "return on assets" and "net interest margin." Efficiency and liquidity indicators weakened compared to the previous six months and previous year, as a result of increasing staff expenses and a decline in liquid assets as a ratio to total assets. However, the contribution of these indicators to the overall increase in risk levels is smaller. The sub-indices for capitalization and asset quality were stable with no significant changes.

During the period, the banking soundness indicator shows a good financial situation of the banking sector. The slowdown of the profit growth pace was expected given the high levels of profit achieved previous year and the increase in operating expenses. This performance was observed across all banking groups, but it was more pronounced in banks with foreign capital.

In a longer term, the performance of the index reflects the improvement of the activity of the banking sector in terms of asset quality and level of capitalization.

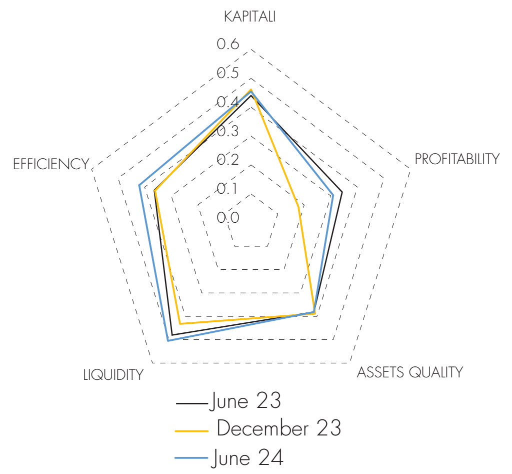
Soundness index for the group of systemic banks shows a slight increase of risk compared to the two previous six-months. This development is related to the performance of the sub-indices for asset quality, liquidity, and efficiency in particular, which reflects a faster increase in expenses compared to operational income.

Chart 47 Banking Soundness Index*



*The higher the value, the higher the risk. The breadth of each dimension means its contribution to risk.
Source: Bank of Albania.

Chart 48 Banking Soundness map*



*Away from the centre means increased risk, in a 0 to 1 range.
Source: Bank of Albania.

The banking soundness indicator shows that banks with foreign capital have performed better compared to banks with Albanian capital. However, during the period, the banking soundness index showed a more pronounced decline for banks with foreign capital compared to banks with domestic capital. Compared to the end of 2023, foreign banks exhibited a weakening across all indicators, except for asset quality. In comparison to the same period in the previous year, the index shows a stable situation with no significant changes. For banks with domestic capital, there was a slight decline in capital quality, liquidity, and especially efficiency during the period. Compared to the previous year, the banking soundness index for domestic banks improved slightly due to increased profitability and asset quality.

Overall, during 2014-2024, the aggregated banking soundness index indicates an improvement of soundness in the banking sector and increase in sustainability of the entire banking sector. This improvement affected the quality of assets and capital. At the same time, the sensitivity of the index to profitability levels has become more important starting from 2020 Q1.

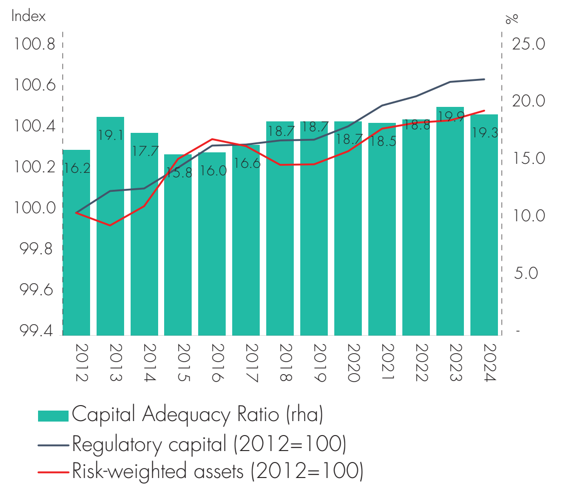
5.1.1.2 Capitalisation of activity

CAPITAL ADEQUACY RATIO

At the end of the period, the capital adequacy ratio of the banking sector stood at 19.3%. During the period, the indicator declined primarily due to the rapid growth of risk-weighted assets. Compared to the previous year, the ratio increased by 0.3 percentage points.

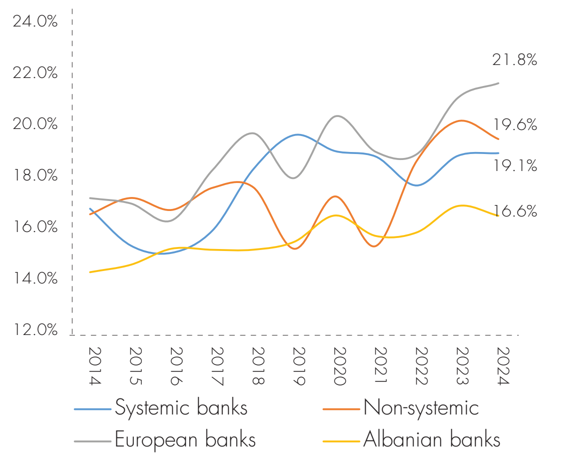
The increase in the banks' regulatory capital during the period drove the decrease of the capital adequacy ratio to at 19.3% from 19.9% at the end of 2023. This indicator stands above the minimal level required from each bank of 12%. During this period, this rate decreased by 0.7 percentage points, whilst annually it increased by 0.3 percentage points. On average, banks with European capital and non-systemic banks have the highest capital adequacy ratio. Banks with Albanian capital report a lower level of the capital adequacy ratio compared to other bank groups, and this level decreased during the first half of 2024.

Chart 49 Capital Adequacy Ratio



Source: Bank of Albania.

Chart 50 Capital Adequacy Ratio of groups by importance and origin of capital

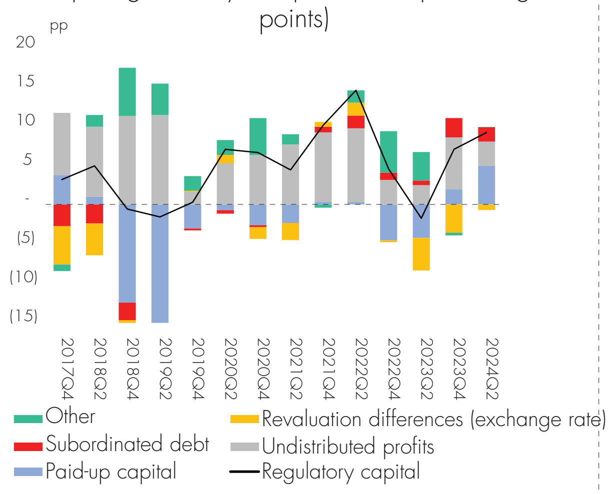


Source: Bank of Albania.

The performance of the capital adequacy ratio during the period was positively impacted by a 1.3% increase in regulatory capital and negatively impacted by a 5% increase in risk-weighted assets. During this period, the regulatory capital of banks rose by approximately ALL 2.5 billion, reaching ALL 195 billion. The performance of regulatory capital was determined by the increase in paid-in capital, the expansion of retained earnings as well as the mitigation of the negative credit spreads of revaluation. In annual terms, the growth of regulatory capital was higher, primarily influenced by the increase in paid-up capital and the growth of subordinated debt." The retained earnings of the previous periods have helped to increase the regulatory capital and this contribution has been upward.

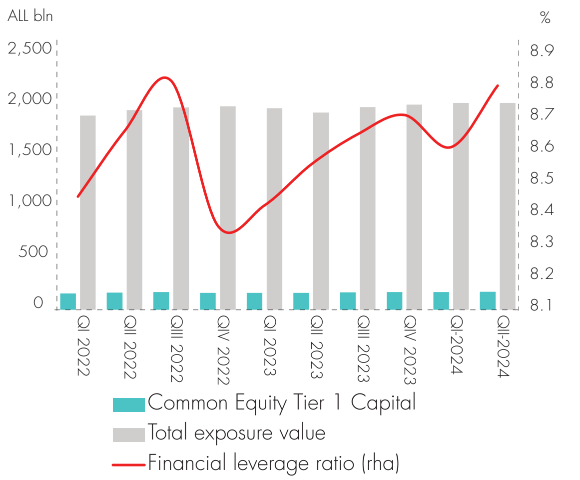
At the end of the period, risk-weighted assets reached ALL 1,010 billion, with the main contribution to growth coming from credit risk. The latter accounted for the largest share of the total risk-weighted assets (86%), followed by market risk (1%) and operational risk (12%). As a ratio to the total assets, the share of risk-weighted assets increased to 51% (up from 49% at the end of 2023), mainly as a result of the growth in risk exposures to trading companies (corporates) and to real estate secured by collateral.

Chart 51 Annual contribution on the regulatory capital growth by components (in percentage points)



Source: Bank of Albania.

Chart 52 Performance of financial leverage by components



Source: Bank of Albania.

During the period, the financial leverage ratio[32] increased by around 1 percentage point, reaching 8.8%. This performance resulted from a faster growth of Tier 1 capital compared to the growth of total exposures calculated for leverage ratio effect. Banks have provided a financial leverage ratio above minimum regulatory level by 5.75% on an individual basis. For the banking sector this ratio is mainly determined by the systemically important banks. Banks with foreign capital have the highest level of financial leverage ratio, thus increasing the potential to finance the continuity of activity. Banks with Albanian capital report a lower leverage ratio compared to other groups, and this funding structure needs a higher level of debt utilization besides their funds for financing banking activities.

THE SURPLUS CAPITAL AND FULFILMENT OF REGULATORY REQUIREMENTS ON MACRO PRUDENTIAL CAPITAL BUFFERS.

In 2023, the transitional phase of the gradual implementation of macroprudential capital requirements, as outlined in Regulation No. 41/201916 (hereinafter referred to as 'the regulation'), was completed. According to the Regulation, the conservative capital buffer increased from 2% to 2.5% during the period. Macro prudential capital buffers are aimed at

[32] *On 1 January 2022, regulation No. 63/2020 "On the leverage ratio of banks" according to which the financial leverage ratio is calculated as the ratio of the bank's Tier 1 capital to the bank's total exposure on the reporting date.*

Currently, banks are required to meet several requirements for capital levels, which include macroprudential capital buffers and those for regulatory capital instruments and eligible liabilities (MREL).

In order to strengthen capital situation during the period, banks injected capital, increased retained earnings and have and increased their use of subordinated debt.

The banking sector as a whole managed to fulfil these requirements in the first half of 2024 according to the relevant calendar, and register a positive capital surplus.

improving banks' resilience to systemic risks of a cyclical and structural nature. To this end, banks build capital reserves to absorb potential losses, and these reserves create room to support the real economy with funding in more difficult situations. In compliance with the regulation, banks are subject to the capital conservation buffer (CCoB), the countercyclical capital buffer (CCyB); the buffers for systemically important banks (SIB) and the systemic risk buffer (SyRB) The capital conservation buffer for 2024 was 2.5% for all banks of the sector, while the effective buffer for systemically important banks varies from 0.5% to 1.5% depending on the systemic importance of the bank. The countercyclical capital buffer has been at 0% since its implementation. Based on the need to act countercyclically and increase reserves in the context of rapid credit growth, by decision no. 2852, dated 28.06.2024, the Bank of Albania decided for the first time to raise the countercyclical capital buffer rate to 0.25%. Banks will report the fulfillment of the countercyclical capital buffer level for the first time at the end of the second quarter of 2025. As of the time of preparing this report, the Bank of Albania has not announced an additional buffer for systemic risk (STRUK).

In banks that are subject to requirements for regulatory capital instruments and eligible liabilities (MREL)[33] have continued with the fulfilment of additional requirements according to the approved calendar. MREL increased by 1.5 percentage points compared to - 1.7 p.p. in the previous year. These banks can fill this buffer by increasing their capital and/or issuing debt securities that serve as eligible liabilities. Depending on the extent to which the requirement is met through the issuance of debt securities as eligible liabilities, it is also possible to simultaneously meet the macroprudential capital buffers. The By taking into consideration the above buffers, as well as specific buffers that some banks in the sector have, the limit of the required capital adequacy ratio ranges between 18% and 16% for systemically important and 15% and 18% for other banks.

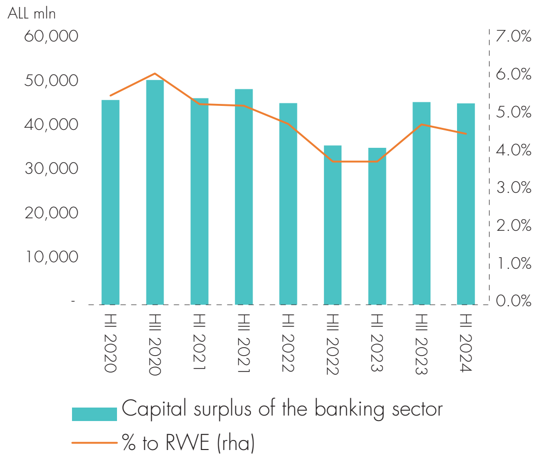
At the end of the period, the banking sector, overall, had a positive capital surplus, sufficient to meet the relevant regulatory requirements. The performance of the capital surplus is dictated by the performance of the banks' profit, the behaviour of the elements regulatory capital, and the capital requirements that must be fulfilled (Macro prudential Capital Buffers and MREL requirements). At the end of the period, the capital surplus remained stable at ALL 46 billion (the same as at the end of 2023), but compared to the previous year, it decreased by around ALL 5 billion. The performance of available equity was determined by the component indicators of regulatory capital.[34]. In order to strengthen capital situation, banks injected capital, increased retained earnings

[33] Five banks are subject to meeting the "minimum requirement for regulatory capital instruments and eligible liabilities" (MREL), in accordance with the requirements provided for in regulation No. 78, dated 16.12.2020 of the Supervisory Council of the Bank of Albania. Its the responsibility of the Bank to meet the minimum requirements for regulatory capital, the minimum requirement for MREL and for macroprudential capital buffers.

[34] The performance of regulatory capital in December 2024 was determined by the increase in paid-in capital and the expansion of retained earnings.

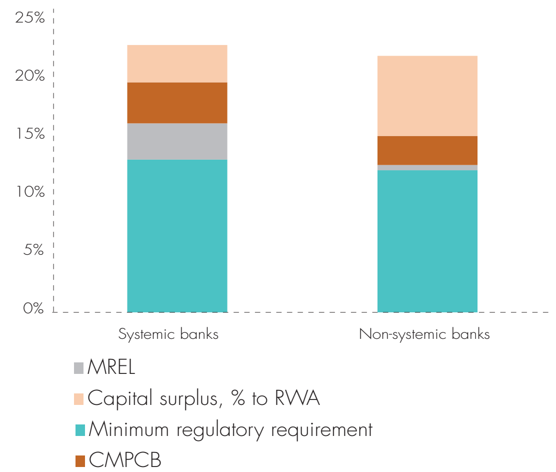
and have and increased their use of subordinated debt. Systemically important banks determine the performance of the capital surplus of the banking sector, given that these banks own more capital compared to other banks. At the end of the period, the capital surplus for these banks was ALL 18 billion, or ALL 1 billion more than the surplus in the previous six months, and it accounted for around 3% of risk-weighted assets. Other banks have a higher capital surplus than systemic banks as a result of the lower level of regulatory requirements to be met by these banks. In June 2024, this capital surplus was ALL about 28 billion, or up by ALL 2 billion compared to the previous six-months.

Chart 53 Capital surplus for the banking sector



Source: Bank of Albania.

Chart 54 Structure of regulatory capital buffers, June 2024



Source: Bank of Albania.

5.1.1.3 Financial result

The banking sector's profit at the end of June was positive at ALL 18.6 billion, which is about 26% higher compared to the previous year.

This performance was mainly positively impacted from net interest income, but there was also an increase in non-interest income, reflecting better performance in investments in financial instruments and higher income from commissions.

Alongside the increase in revenues, the income and expense statement shows a rise in the activity expenses and a slight increase in provisions.

The improvement in financial results has been reflected in a better distribution of returns on assets among banks.

The net profit and profitability indicators of the banking sector increased compared to the previous year, mainly due to the rise in net interest income. The banking sector's profit at the end of June was positive at ALL 18.6 billion, which is about 26% higher compared to the previous year. The increase in profit is reflected in higher average profitability indicators of the banking sector, where the return on assets (RoA) was 1.9% and the return on equity (RoE) 18.5%, compared to 1.6% and 15.6%, respectively, in the previous year. The banking sector registered a significant growth in net interest income. However, income from other activities also showed a positive trend, mainly due to the recovery of losses from financial instruments into positive values. Commission income continues to be an important revenue source for the banking sector and has increased during the period. Activity expenses and net provisioning expenses have also increased, but this increase was smaller than the growth of income.

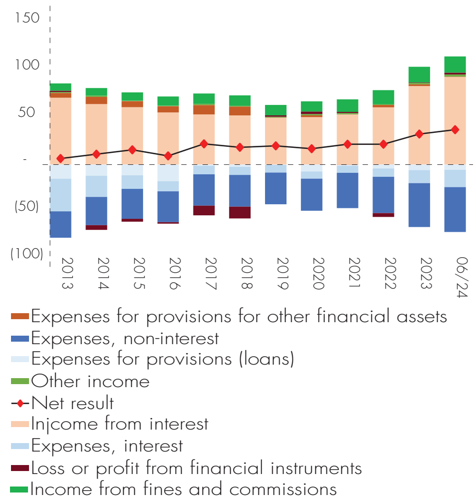
Net income from interest grew by ALL 4.2 billion compared to the previous year, climbing to ALL 37.4 bln. This result reflects a much faster growth in interest income (by around ALL 7 billion, at ALL 46.5 billion) compared to interest expenses, which increased by about ALL 3 billion. About 85% of the contribution to the growth in net interest income is related to activities in the domestic currency. The growth in interest income was also reflected by the higher net interest margin which reached 4.4% from 4.2% in the previous year. Non-interest income collected by banks during the period increased by ALL 3.1 billion, reaching a total of ALL 10.7 billion. This growth was driven by profits from financial instruments, contributing around ALL 2 billion, and income from commissions, by ALL 1 billion.

Table 7 Income and expenses of the banking system 2023-2024 (ALL billion)

	June 2024			June 2023
	In ALL	In FX	Total	Total
Interest income	25.6	20.9	46.5	39.5
Interest expenses	5.7	3.5	9.1	6.3
Net interest income	20.0	17.4	37.4	33.2
Non-interest income	6.2	3.9	10.7	7.6
Income from fines and commissions	4.7	3.8	8.6	7.7
Losses and earnings from financial instruments	1.0	0.0	1.0	-0.9
Non-interest expenses	18.8	4.9	23.8	21.4
Provisions (net)	2.2	0.4	2.6	2.1
for loans	2.3	0.5	2.8	2.9
for other financial assets	-0.1	-0.1	-0.2	-0.8
Uncommon items	-0.4	-0.1	-0.5	-0.1
Income taxes	3.1	0.0	3.1	2.5
Net result	2.5	16.1	18.6	14.7

Source: Bank of Albania.

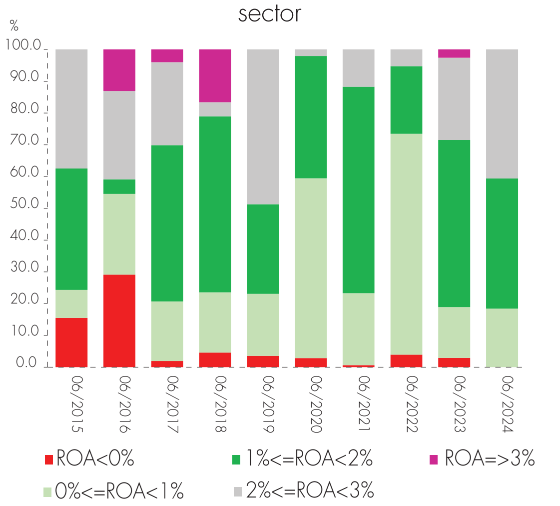
Chart 55 Financial result components ALL billion

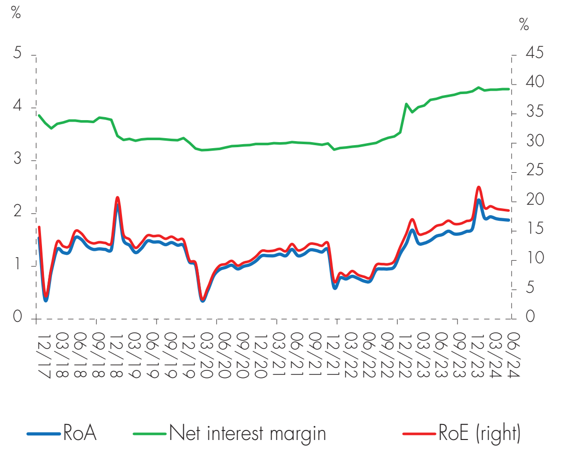


Source: Bank of Albania.

The coverage of activity costs by banks' income has improved since operating expenses increased at a much lower rate than income. Compared to the previous year, activity's expenses increased by ALL 2.4 billion to around ALL 23.8 billion. The ratio of operating expenses to income fell considerably, to 49% from 53 % at the end of 2023. In 2024 H1, provision expenses for loans were reported to be almost unchanged compared to the previous year, at around ALL 2.8 billion. At the same time, the banking sector continued to report a recovery provision expenses for other financial assets, but to a lesser extent than the previous year. Concluding, provision expenses increased slightly by ALL 0.4 billion, reaching 2.6 billion ALL at the end of this period.

The improvement in financial results has been reflected in a better distribution of returns on assets (RoA). Currently, banks with a Return on Assets (RoA) between 2% and 3% account for 40% of the banking sector's assets (from about 16% in the same periods during 2018-2023). Those with a RoA between 1% and 2% account for 40% of the banking sector, while those with a RoA between 0% and 1% hold 20% of the banking sector's assets.





5.1.1.4 Loans

The loan stock[35] granted by banks has expanded rapidly during the period and in annual terms. Outstanding loans on the banking sector's balance sheet reached ALL 792 billion at the end of the period, 7.1% and 11.1% higher compared to the previous six months and year. The main impact on the expansion of the loan stock during the period came from the increase in new loans, which were approximately 30% higher compared to new loans recorded for the same period in the previous year. Loan growth was recorded in all entities, maturities, and currencies, but the largest contribution during the period came from loans granted in domestic currency (5 percentage points), loans to enterprises (4.1 percentage points), and long-term loans (4 percentage points).

The outstanding credit growth was largely supported by the performance of the loan portfolio in lek. Loans in lek expanded at particularly rapid rates, with the annual change in June 2024 reaching 19%. The annual growth of foreign currency loans was 2.7%, but excluding the statistical effect of the exchange rate, which was negative by about ALL 19 billion, the annual growth of foreign currency loans would have been 8.1%, while the outstanding credit growth would have been 13.7%. In annual terms, credit to households expanded by 12.5%, while credit to enterprises increased by 10.7%. However, the contribution that credit to enterprises have given to the overall credit growth is greater, and this contribution is about twice as high as the value recorded at the end of the previous six-month period.

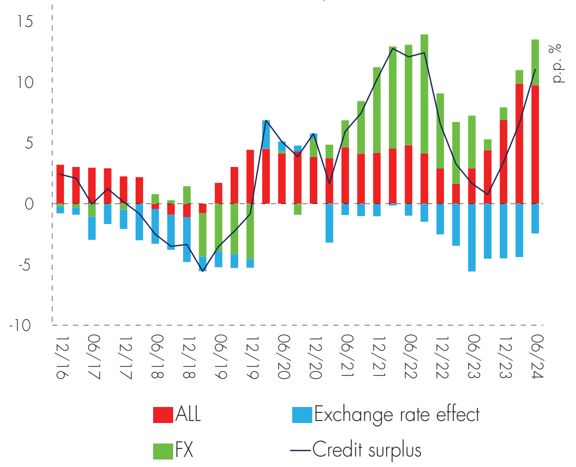
Bank credit grew considerably during the period. In annual terms, credit expanded by 11.1%, while compared to the end of 2023, it increased by 7.1%.

The sharp growth in lek-denominated loans, the increase in long-term loans and the rise in loans to enterprises mainly drove to this performance. Loans to non-residents were also up during the period, though remaining close to the levels of the previous year. Adjusted for the exchange rate effect, the annual growth of loans is about 14%.

Loan restructuring and write-offs of non-performing loans during the period have continued. The volumes of restructurings decreased, while those of write-offs were comparable to the previous period.

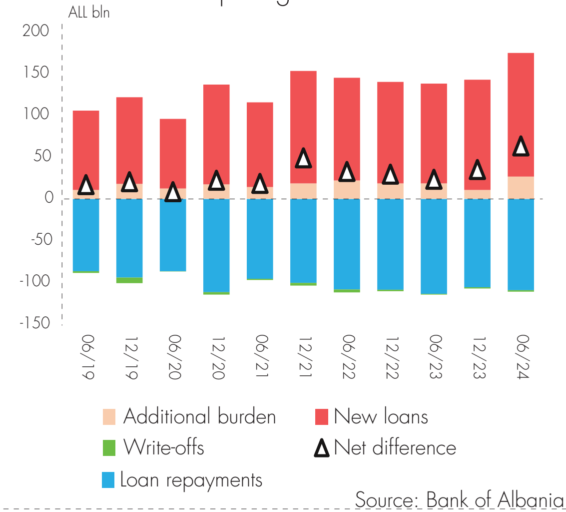
[35] *This definition includes all loans granted by domestic banks to resident and non-resident entities.*

Chart 58 Annual growth of Credit by foreign currency



Source: Bank of Albania.

Chart 59 Six-month change in outstanding credit by composing elements



Source: Bank of Albania.

The volume of restructured loans was lower, while write-offs of lost loans were comparable to the previous period. The restructured credit during 2024 H2 was around ALL 2 billion, or about 1% of the new credit flow for the period and about 5.2% of the stock of non-performing loans. The portfolios affected by credit restructuring are primarily linked to loans in lek and foreign currency to the enterprises sector. The main form of restructuring required by clients and approved by banks was the extension of maturity term. The annual flow of restructured loan has decreased during the last two years. Thus, the value of restructured loans during 2024 H1 is only 35% of the value of restructured loans in 2021 H1. The process of written-off of non-performing loans from banks' balance sheets has continued in 2024 H1, with the value of written-off loans around ALL 1.4 billion. During the last twelve months, around ALL 3 billion of non-performing loans were written off, and around 63% of this volume consisted of loans granted to enterprises. The value of written-off loans in the recent period accounted for 4% of outstanding non-performing loans in the banks' portfolios, and this value was the same as the relative value of write-off during the previous six-months.

LOANS TO NON-RESIDENT ENTITIES

The loans for non-residents increased during the period, but their share of the total loans in the banking sector remains low. The stock of loans for non-resident entities rose by about 18% during this period, but it was almost the same as the level reported by banks in the previous year. At the end of the period, loans to non-residents amounted to around ALL 34 billion, or 4% of the outstanding loans in the banking sector.

UNHEDGED FOREIGN CURRENCY LOANS

Unhedged loans in foreign currency, expressed in lek, have slightly contracted compared to the previous six-months due to exchange rate effects. During the period, the stock of unhedged loans in foreign currency decreased by less than ALL 1 billion, or by 1%, while the year-on-year decline was 5.7%. If adjusted for exchange rate effects, unhedged loans in foreign currency would show an increase of 2.1% during the period. The share of unhedged loans relative to the outstanding loans in foreign currency fell to 24% from 26% in the previous six-months, due to the combined effect of the decline in the stock of unhedged loans and the increase in the stock of loans in foreign currency. In relation to the outstanding loans, this share decreased to 11% from 12% in the previous six months. The absolute and relative decline of unhedged loans in foreign currency indicates that the exposure of the banking sector toward the indirect exchange rate effect has decreased, representing a positive development toward protecting both borrowers and the stability of the banking sector.

Unhedged outstanding loans in foreign currency has decreased compared to the previous six-months and the previous year. The decline is observed in both absolute and relative value, but when adjusted for exchange rate effects, this loan would show an increase during the period.

The main contribution to this development came from the decrease in unhedged loans in foreign currency to households. Unhedged loans in foreign currency to enterprises did not change during the period. The quality of these loans remains quite good.

Overall, this trend represents a positive development in terms of protecting borrowers and the stability of the banking sector.

The annual decline of unhedged outstanding loans in foreign currency is entirely linked to the credit granted to households, which shrank by 11.4%. The major share of outstanding unhedged loans in foreign currency consists of loans in Euro (over 90%), and the stock of this portfolio has not changed during the period. Half of the stock of unhedged loans is accounted by loans to enterprises, which showed no changes during the period. By economic sectors, the main share of this credit is represented by "real estate," accounting for about 60%, followed by "trade" with 15%.

Unhedged loans to households granted for the purchase of real estate continues to account for about 60% of the outstanding ungedged loans granted for the purchase and development of real estate. The outstanding loan granted for this purpose shrank slightly, by about 2% during the period, and the decline was due to a contraction of loans in the households sector. The ratio of non-performing loans ratio for unhedged loans against the exchange rate was 4.3% at the end of the year, comparable to the overall ratio of non-performing loans. The same ratio only for real estate loans was 3.3%.

NEW LOANS

New credit during the period increased slightly compared to the previous six-months, but it was significantly higher than in the previous year. In annual terms, this trend is linked to a better performance of loans in lek, while the flow of credit in euro increased slightly.

The new credit granted by banks during the period was around ALL 182 billion, comparable to the previous period but about 30% higher than the previous year. Compared to the flow in 2023 H2, the growth was about 2%, indicating that the increase has been stable over the last 12 months. According to reports by banks, the number of loan applications increased during the period, both from enterprises and households. At the same time, the number of rejections by banks also rose. This increase in declines was directed almost entirely toward households and was primarily concentrated among banks with foreign capital.

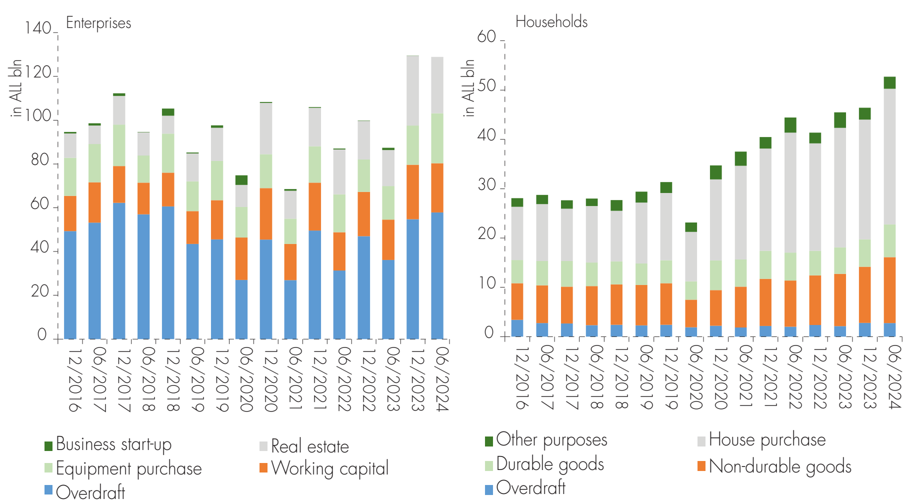
In the slight increase in new credit during the period, the only positive contribution came from credit to households. This loan was used mainly for the purchase of real estates.

The weighted interest rate on all types of new loans granted over the period, has gone remained almost unchanged in 6.5%. Interest rates on new loans in lek appear somewhat higher than those in euro, while both rates have exhibited minimum fluctuations in the last periods.

In annual terms, credit to the enterprises sector contributed about 83% of the value of new credit flow. During the period, this credit amounted to around ALL 130 billion, approximately 3 billion lek less than in the previous six-month period and ALL 36 billion more than the same period in the previous year. Over 60% of the credit granted by enterprises was in the form of overdraft and working capital, while the remainder of the new credit was used for purchasing equipment and real estate purchase. By currency, the increase in the flow of new credit is almost entirely linked to new loans in lek, while the flow of new credit in euro and US Dollar, expressed in lek, showed only slight increases compared to the same six-months in the previous year. Compared to the second half of last year, new credit in lek was somewhat lower, while new credit in euro and USD, expressed in the local currency, recorded a higher flow.

In six-month terms, the increase in the flow of new credit during the period was entirely related to credit granted to households. This credit grew by 13.5% compared to the previous six-month period and by 16% compared to the previous year. The annual growth was primarily due to the increase in the flow of new credit granted to households for purchase of real estate. On average, this type of credit represents about 52% of the total flow of new credit to households.

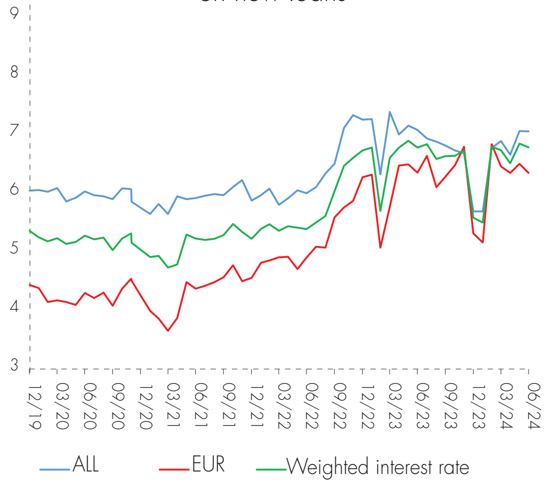
Chart 60 New loans to enterprises and households by purpose of use



Source: Bank of Albania.

The weighted interest rate on all types of new loans granted over the period remained almost unchanged at 6.5%. The average value for the interest rate on loans in the domestic currency reached 6.7%, marking a slight increase compared to the previous period. The interest rate for new loans in lek began to rise primarily during the second quarter of the year. The interest rate for new loans in euro remained almost unchanged at 6.3%. Overall, the interest rates for new loans in the local currency and in euro have shown slight increases since 2022 and have exhibited low volatility since that period.

Chart 61 The performance of interest rates on new loans

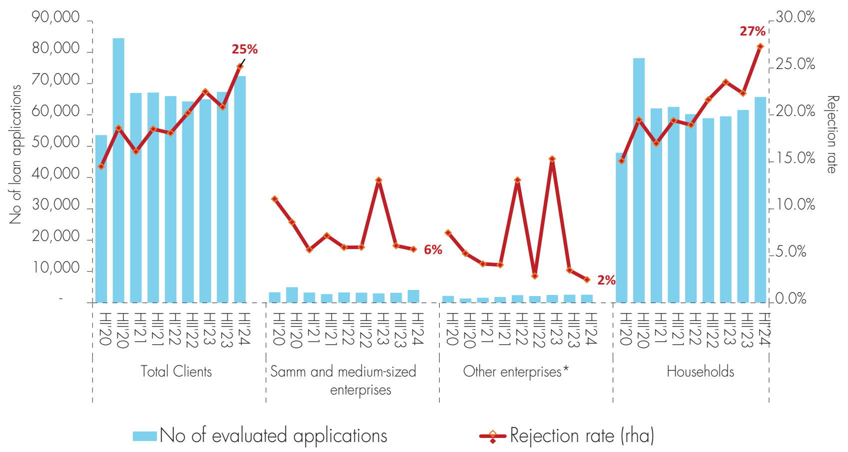


Source: Bank of Albania.

INFORMATION BOX 3 PERFORMANCE OF LOAN APPLICATIONS AND ANALYSIS OF REJECTION RATES BY BANKS DURING 2024 H1

During the first half of 2024 (from 1 January to 30 June 2024), banks reported that they received a total of 72,418 loan applications, of which 10% are linked to "enterprises" (5.7% or 4,093 applications from "small and medium enterprises" and 3.6% or 2,596 applications from "other enterprises"), while 91% (or 65,729 applications) were from the "households" sector. This distribution shows a slight shift in favour of enterprises, both compared to the previous period and to the previous year.

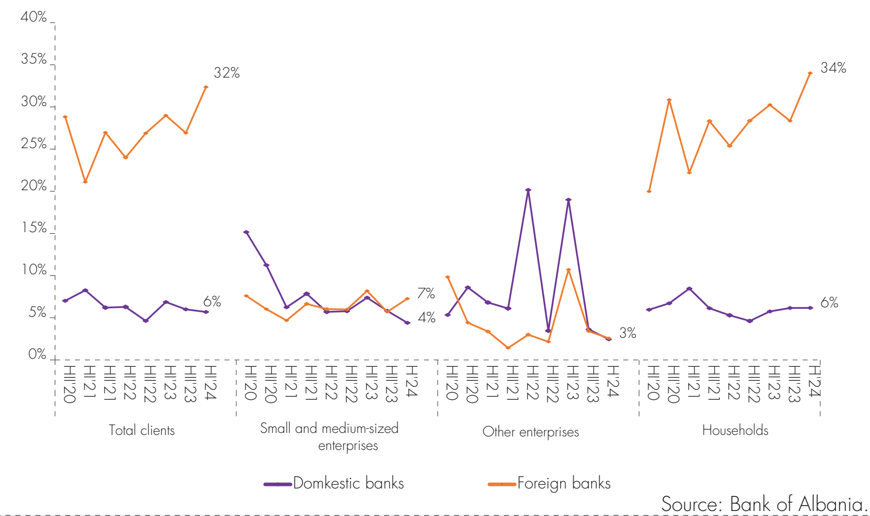
Chart 62 Number of evaluated applications and rejection rate analysis



Source: Bank of Albania.

The total number of employed households in the surveyed sample registered a decline by 7.5% compared to the previous six months, and by 11.4% to the previous year. In both periods, the growth came from all three customer segments, but it was most notable in the "small and medium-sized enterprises" group (up by 29% and 37%, respectively) and in the "households" sector (up by 6.4% and 10.4%, respectively).

Chart 63 Rejection rate of loans, by domestic and foreign banks



Source: Bank of Albania.

From the total applications screened during the period, around 25% of them were rejected by banks. This rate has increased, resulting in a rise of 4.3 percentage points compared to the previous six months and 2.7 percentage points compared the previous year. The increase in bank rejections in 2024 H1 was observed only for the "households" category, while this indicator showed a decline for both categories of enterprises, both in semi-annual and annual terms.

The overall rejection rate decreased for banks with domestic capital but increased for those with foreign capital. It is noted that during this period, the two banking groups exhibited opposing attitudes toward loan applications from "small and medium-sized enterprises" and the "households" category. Domestic banks showed a more easing trend, rejecting only 4% and 6% of these applications, respectively, while foreign banks increased their rejection rates to 7% and 34%. At the same time, both banking groups appear to have similar preferences for large enterprises, refusing only 3% of their applications.

Overall, from the above analysis, it can be concluded that the trend in applications reviewed by banks during the first half of 2024 indicates a gradual increase in demand for credit, primarily driven by the households sector and small and medium-sized enterprises, along with a relatively selective position from banks, especially concerning lending to households.

5.1.1.5 Deposits

Deposits held in the banking sector increased by 0.4% during the period. This growth reflected a slight expansion of time deposits, deposits from households, and deposits in the domestic currency, while other categories of deposits slightly declined. When adjusting the change in the stock of deposits for the exchange rate effect, the six-month growth is estimated to be around 2%. The structure of deposits did not show significant changes. The volume of deposits by term is distributed almost equally between current accounts and time deposits, which comprise 44% and 43% of the total, whilst household's deposits and foreign-currency deposits account for 79% and 53% of the total stock of deposits.

In annual terms, the growth of deposits was around 7%, and by the end of June, deposits reached ALL 1,610 billion. Deposits from households contributed approximately 5 percentage points to the annual growth of the deposit stock. According to maturity and currency, the contribution was broad, coming from both time deposits and current accounts, as well as from deposits in lek and in foreign currency. During the first half of the year, enterprises deposits decreased by ALL 11 billion or 4%, but compared to the previous year, they increased by about 9%. By currency, deposits in lek grew by only 1.8%, while those in foreign currency decreased by 0.9%. In annual terms, deposits in lek and foreign currency expanded by ALL 57 billion and ALL 48 billion, or by 8% and 6%, respectively. When adjusted for the statistical effect of the exchange rate18 the base of deposits and foreign currency deposits are estimated to have increased by 10-12% compared to the levels in the previous year.

In terms of maturity, the growth of deposits was most noticeable in time deposits and current accounts. Time deposits expanded by around 9% annually and continued to provide a significant contribution to the overall growth of deposits. Current accounts slightly declined during the period but expanded by 7.3% annually. Meanwhile, the stock of demand deposits fell slightly during the period and compared to the previous year. Since 2022 H1, there has been an increasing preference among depositors for time deposits, and this period has also been characterized by a relatively faster growth- pace of interest rates.

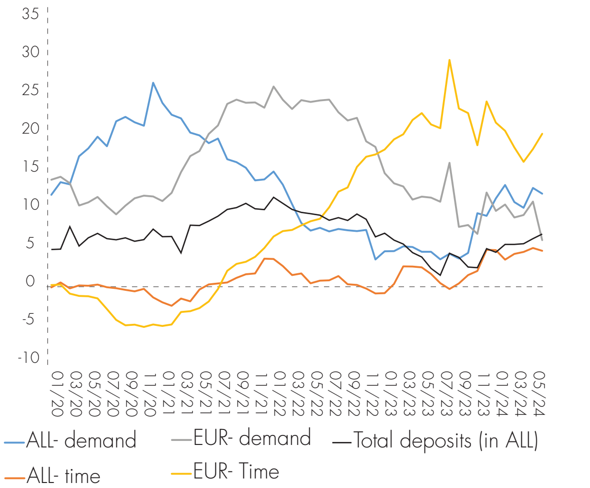
At the end of the period, deposits held in the banking sector reached ALL 1,610 billion. These deposits increased by 0.4% during the period, primarily reflecting the growth of time deposits, deposits from households, and those in lek. Current accounts and demand deposits slightly declined.

In annual terms, deposits grew by 7%; deposits in lek and foreign currency increased by 8% and 6%, respectively. Adjusted for the exchange rate effect, the annual growth rate of deposits in foreign currency is about 12%.

The increase in deposits in lek is underpinned by the expansion of current accounts and time deposits from households, while the annual growth of foreign currency deposits reflects the rise in time deposits from both sectors.

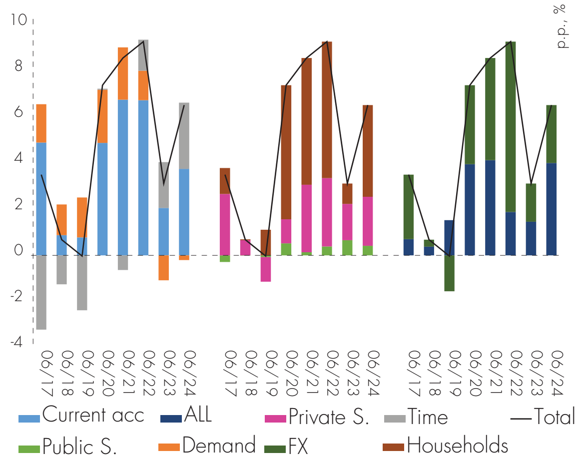
Interest rates on new deposits continued to rise, while the flows of new deposits were lower than those in the previous six-months but comparable to those in the first half of 2023.

Chart 64 The annual growth of deposits by term and currency, in the original currency



Source: Bank of Albania.

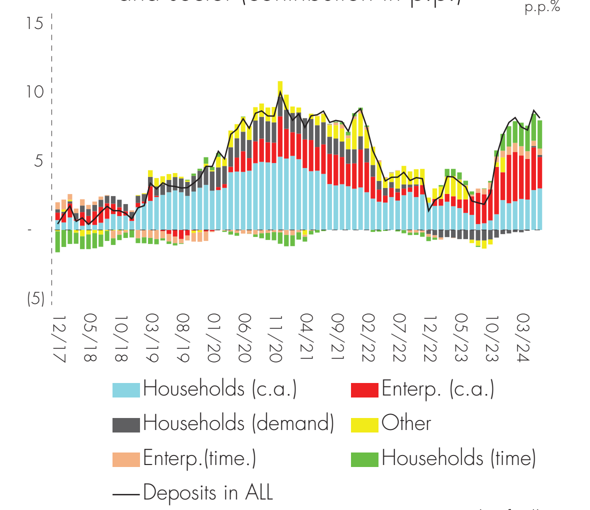
Chart 65 Deposit growth by term, sector and foreign currency (contribution in p.p.)



Source: Bank of Albania.

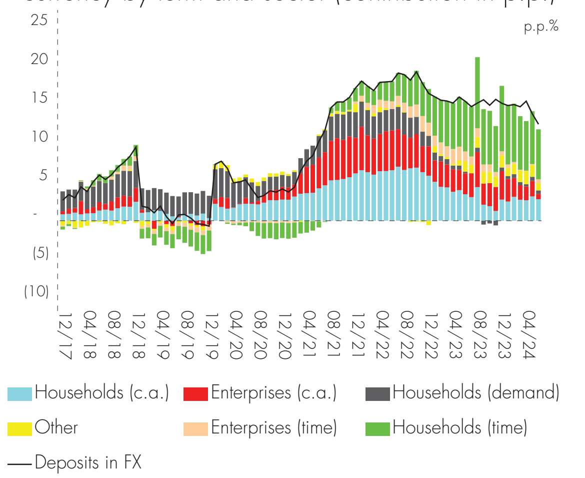
The annual growth of deposits in lek was 8%, primarily reflecting the expansion of current accounts and time deposits of households. At the end of the period, current accounts and time deposits of households in lek amounted to ALL 210 and 340 billion, respectively, which is 11% and 4% above the level of the previous year. Demand deposits in lek expanded easily during the period, while time deposits increased by 1% during the period and by 5% year-on-year. Almost the entire stock of ALL 350 billion in time deposits in lek is represented by individual deposits, which grew by about 3-4% in semi-annual and annual terms.

Chart 66 Performance of deposits in lek by term and sector (contribution in p.p.)



Source: Bank of Albania.

Chart 67 Performance of deposits in Foreign currency by term and sector (contribution in p.p.)



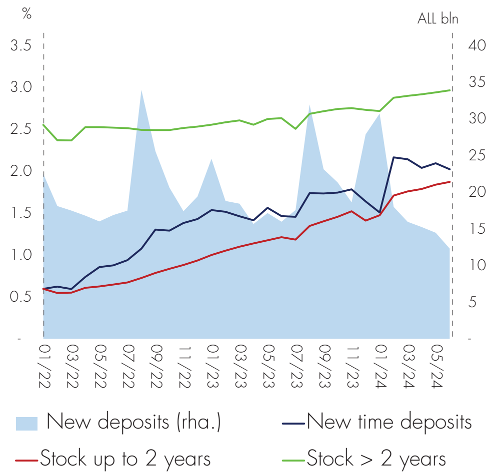
Source: Bank of Albania.

**Adjusted for the exchange rate effect*

The annual growth of deposits in euro was 13%. At the end of the period, time deposits in Euro of households and enterprises were up by 30% and 20%, respectively, compared to the previous year, whereas the annual change in total deposits in euro for each sector was 11% and 14%. Compared to

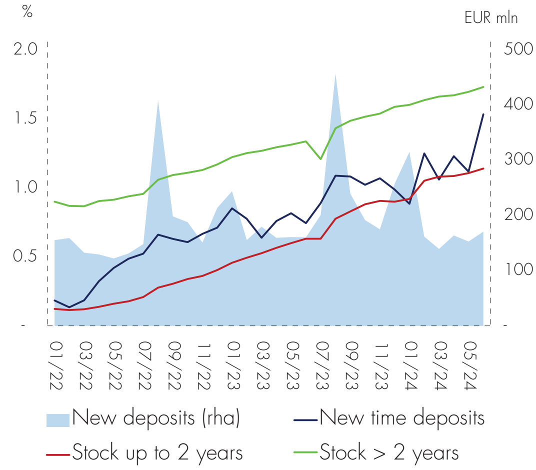
2023 H2, the growth of deposits during the period was significantly slower, as households' deposits in euro increased by about EUR 240 million, while those to enterprises remained unchanged. In the same period of the previous year, the respective increases were Eur 230 and 110 million. In line with the seasonal performance of deposits, the second quarter of recent years has recorded higher values compared to the first quarter, especially for household's deposits."

Chart 68 New deposits and interest rates on the stock and new deposits in LEK to households



Source: Bank of Albania.

Chart 69 New deposits and interest rates on the stock and new deposits in EUR to households



Source: Bank of Albania.

Despite the increase in deposit interest rates for both sectors and all three major currencies, new deposits were fewer than in the previous six-months. The average monthly flows of new deposits to households were, respectively, ALL 18 bln (lek deposits) and ALL 180 bln (new deposits in Euro), from ALL 23 billion and ALL 250 million in the previous six-months. On the other hand, the performance of new deposits during the period was comparable to that recorded in the same period of the previous year. The average weighted interest rates during the period on new deposits of enterprises and households in lek were 2.8% and 1.9%, respectively, while the new time deposits in euro to enterprises and households reached 1.9% and 1.1%. Regarding time deposits in lek with over two years maturity, this rate increased to around 3% by the end of the period, whilst, the weighted interest rate of time deposits of households in Euro reached 1.7% (from 1.3% in the previous year).

5.1.2 RISKS TO THE ACTIVITY OF THE BANKING SECTOR

5.1.2.1 Credit risk

The stock of non-performing loans increased by around 6%, up to ALL 37 billion. The increase in the stock of non-performing loans was mostly in lek-denominated loans portfolio, in short-term loans and in loans to enterprises. The value of non-performing loans stock has remained unchanged compared to a year ago.

Due to the faster growth of outstanding loan, the ratio of non-performing loans (NPL) decreased to 4.7% at the end of the period, slightly improving the credit quality. The NPLs ratio also decreawsed for real estate investment loans, cosumer loans, and loans unhedged against exchange rate. At the end of the period, the credit portfolios with the highest NPL ratios were medium-term loans (6.5%), loans to enterprises (5.9%), trade loans (5.4%), and lek-denominated loans (5.3%).

Compared to the previous year, credit quality significantly improved, and the NPL ratio decreased by 0.5 percentage point.

Collateral coverage of loans remains high, around 75%, but during the period, this ratio fell by 5 percentage points. Collateralized loans in the form of real estate accounted for 45% of the outstanding loans or about 61% of collateralized loans.

The provisioning ratio for non-performing loans decreased by 0.4 percentage point during the period, down to 67%. Compared to the previous year, this indicator increased by 0.3 percentage point.

The NPL ratio improved slightly during the period, by the end of the period it stood at 4.7%. This performance reflected the faster growth of outstanding loans compared to the expansion of the stock of non-performing loans. The stock of non-performing loans increased by about ALL 2 billion or 6%, reaching approximately ALL 37 billion by the end of June. Within this stock, lost loans decreased by ALL 1.8 billion, mainly due to repayments of obligations by clients and their write-offs from bank portfolios. Compared to the previous year the stock of non-performing loans showed no changes, and the NPL ratio has decreased by about 0.5 percentage point.

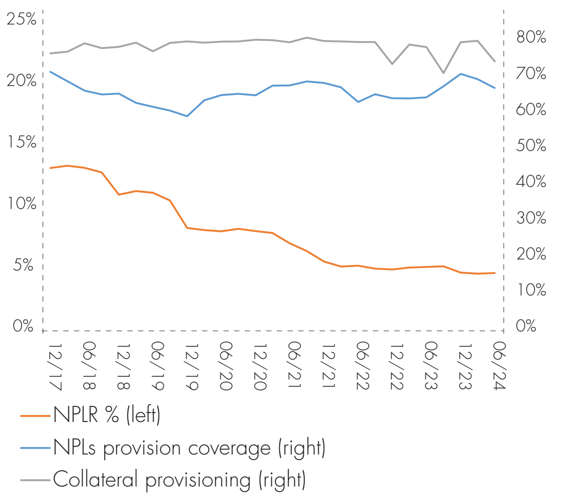
The increase in non-performing loans during the period was influenced by short-term loans, loans to enterprises, and lek-denominated loans. Within the portfolio of non-performing loans, banks reported an increase in the class of the outstanding doubtful loans, which now accounts for 23% of non-performing loans, up from 15% in December 2023. Lost loans continue to account for the majority share in the portfolio of non-performing loans, by 49% (down from 57% at the end of 2023).

During the last 12 months, the value of loans written off from the banking sector's balance sheets was around ALL 3 billion. Most of the written off loans were loans in lek held by the enterprises sector. From January 2015 to June 2024, banks have written off approximately ALL 80 billion in lost loans from their balance sheets.

Collateral coverage of loans remains high, around 75%, but during the period, this ratio fell by 5 percentage points. Collateralized loans in the form of real estate accounted for 45% of the outstanding loans or about 61% of collateralized loans. The stock of loans collateralized with real estate decreased by 4% compared to the previous year as a result of the contraction in commercial real estate collateralized loans, while portfolios of loans collateralized with other collateral have increased.

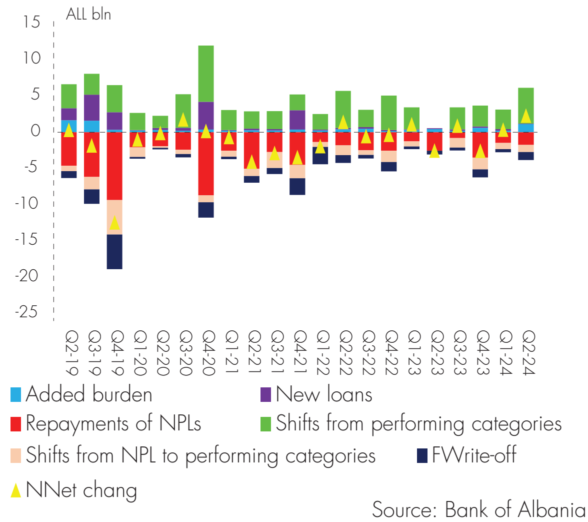
The provisioning ratio for the non-performing loans decreased to 67%. This level is 0.4 percentage points lower than at the end of 2023 but 0.3 percentage point higher than a year ago. The decline in the ratio during the period was influenced by the faster growth of the stock of non-performing loans compared to the increase of the provisioning fund.

Chart 70 Non-performing loan ratio and provisioning and collateral coverage



Source: Bank of Albania.

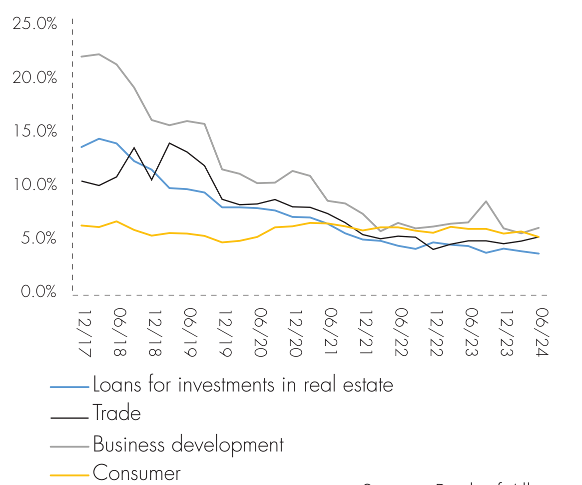
Chart 71 Contribution to the quarterly mismatch in the stock of non-performing loans



Source: Bank of Albania.

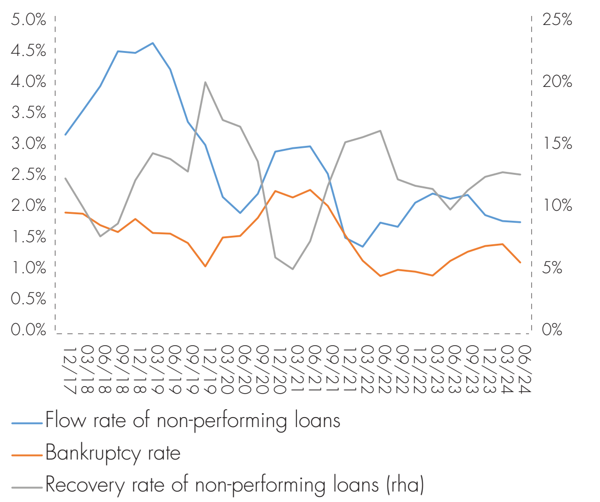
By purpose of use the quality of loans improved for the portfolio of loans for real estate investments and for consumption. The ratio of non-performing loans in these categories fell to 3.9% and 5.4%, respectively, in June 2024, from 4.3% and 5.7% in December 2023. During the period, the portfolio quality decreased for trade loans, as the non-performing loans ratio for this category rose to 5.4%, from 4.8% in December 2023. The portfolios with the highest non-performing loans ratio are medium-term loans, enterprises loans, and loans in Lek. At the end of June 2024, the non-performing loans ratios for these types of loans were 6.5%, 5.9%, and 5.3%, respectively.

Chart 72 NPLR by purpose of use



Source: Bank of Albania.

Chart 73 Credit risk assessment indicators



Source: Bank of Albania.

The non-performing loans flow indicator[36] and that of recovered non-performing loans[37] suggest that a year, there were fewer new non-performing loans in the banking sector. In June 2024, the annual flow of new non-performing loans was 1.8% of good loans, from 1.9% and 2.2% in the previous six-months and previous year, respectively. This performance was determined by the expansion of the outstanding loans. The recovery rate of non-performing loans increased to 13%, from 10% in the previous year. This performance shows an increase in bank's ability to recover non-performing loans. On the other hand, the "bankruptcy rate"[38] that shows the rate by which the lost loans are accumulated compared to the overall loan portfolio, decreased to 1.1% from 1.4% and 1.2% in the previous six months and previous year, influenced by the expansion of the outstanding and the contraction of lost loans. The decline in the bankruptcy rate over the past 12 months signals a lower risk in credit activity; however, the expansion of the loan portfolio could lead to an increase in the flow of non performing loans in the future.

The quality of loans unhedged against exchange rate volatility remained unchanged compared to the end of the previous six-months and but it has declined slightly compared to the previous year. The ratio of non-performing loans (NPL) for this loan portfolio stood at 4.3% at the end of June 2024, compared to 4.4% in the previous year. This performance was influenced by the reduction in the stock of non-performing loans for loans to enterprises for real estate development (residential) and consumer loans. The main share, at around 45%, of the outstanding non-performing loans unhedged from exchange rate fluctuations continues to be accounted by loans for real estate investments, but the NPLs for this category of loans decreased to approximately 3.3%, compared to 4.8% in the previous year.

5.1.2.2 Liquidity risk

The liquidity risk in the activity of the banking sector remains contained The main liquidity indicators, both in the domestic and foreign currency have declined during the period, but they continue to be notably above the minimum regulatory rations. During the first half of the year, the liquidity position of banks was affected by a faster decline in liquid assets compared to short-term liabilities, particularly for the Lek currency. Compared to the same period of the previous year, the main liquidity indicator improved only for activities carried out in foreign currency.

During this period, banks reported an expansions of the negative gap between assets and liabilities for maturities up to 3 months. The overall gap between assets and liabilities, has remained almost unchanged at around

[36] The flow of non-performing loans over the year compared to the outstanding regular loans at the end of the period.

[37] The flow of new non-performing loans that have been reclassified to performing classes against the outstanding non-performing loans at the end of the period.

[38] The flow of new lost loans during the year against the overall outstanding loans at the (excluding lost credits) end of the period.

5% of the overall assets of the banking sector. The gap between the average remaining maturity of assets and liabilities widened slightly, primarily due to an increase in the average remaining maturity of assets. The same gap between the remaining maturities of loans and deposits has remained nearly unchanged.

The liquidity position of the banking sector remains at good levels and the liquidity indicators continue to remain notably above the regulatory ratios.

Compared to the previous six months and a previous year, banks have somewhat lower volumes of liquid assets as a ratio to total assets and short-term liabilities.

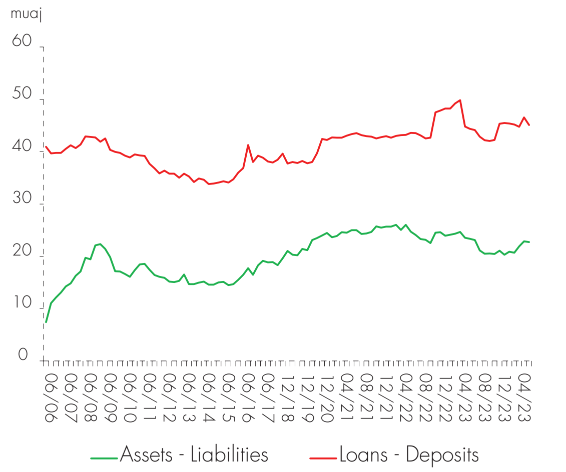
During this period, banks reported an expansion of the negative gap between assets and liabilities for maturities up to 3 months.

The average maturity mismatch between assets and liabilities has slightly increased. For several semesters (six-months), the banking sector has not reported any financing lines from the parent banking groups.

Deposits remain the main source of funding the lending activity of banks, by covering above twice the volume of the sector's loans. At the end of the period, the loan-to-deposit ratio was 49%, up from 46% six months earlier, influenced by a stronger increase in outstanding loan compared to the deposit base. This ratio is lower than the average for Western Balkan countries and significantly lower than the European Union average. By currency, during the period, this ratio increased to 57% (from 53%) for the Lek currency and to 42% (from 40%) for foreign currency.

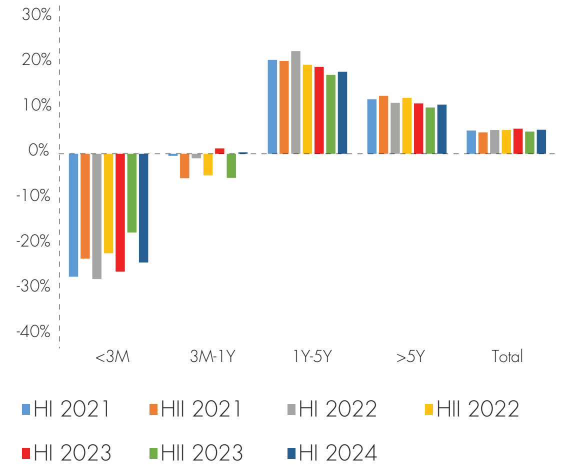
Compared to the previous six months and previous year, banks have a lower volume of liquid assets as a ratio to total assets and short-term liabilities. At the end of the period, banks accounted for approximately ALL 570 billion in liquid assets, with the majority (about 56%) are related to investments in government debt securities. Liquid assets account for 28.4% of total assets on banks' balance sheets, and this ratio slightly decreased compared to the previous six months due to the combined effect of a decline in liquid assets and an increase in total assets. The ratio of liquid assets to short-term liabilities has slightly fallen to 41.2% (from 43.4% in the previous six-months) but remains significantly above the minimum regulatory level[39]. The indicator decreased for both the Lek and the Euro currency, mainly as a result of the decline in liquid assets in these currencies.

Chart 74 Average residual maturity mismatch between assets-liabilities and loans-deposits



Source: Bank of Albania.

Chart 75 Maturity mismatch between assets and liabilities



Source: Bank of Albania.

During the period, the bank's balance sheets show a decrease in assets with a residual contractual maturity up to three months, while their liabilities

[39] *Banks are required to maintain liquid assets covering 15% of short-term liabilities for the Lek and 20% for foreign currency, with a total requirements of 20%.*

for the same basket remain almost unchanged. As a result, the negative gap between assets and liabilities for this basket[40] has increased to 24% of total assets, compared to 17% to the previous six months. That continues to remain the largest negative gap for the whole horizon of maturities. At the same time, the negative gap for maturities of 3 months to up to 1 year has also returned to neutral values, after the negative value by 5% in the previous six-months. Despite these developments, the size of the total gap between assets and liabilities remains limited close to a -5% average in relation to overall assets. The overall gap across all maturities continues to be positive and has recorded no notable changes compared with the previous periods, due to the stability in the positive positions for longer-term maturities.

The gap between the average maturity of assets and liabilities has increased to 22.7 months (from 21.1 months), as the average remaining maturity of assets has expanded, while that of liabilities has not changed. On the other hand, the gap between the average remaining maturities of loans and deposits remained almost unchanged at 45.1 months (from 45.4 months), due to the average remaining maturities of loans and deposits increasing at the same rate. For several consecutive six-months, the banking sector has not reported any financing lines from the parent groups.

5.1.2.3 Market risks

EXCHANGE RATE RISK

During the period, the net open foreign currency position of the banking sector was" " long" and as much as 4.6% of the regulatory capital. That was the lowest value of the indicator over the last year, and it stands notably below the maximum regulatory limit of 30%.

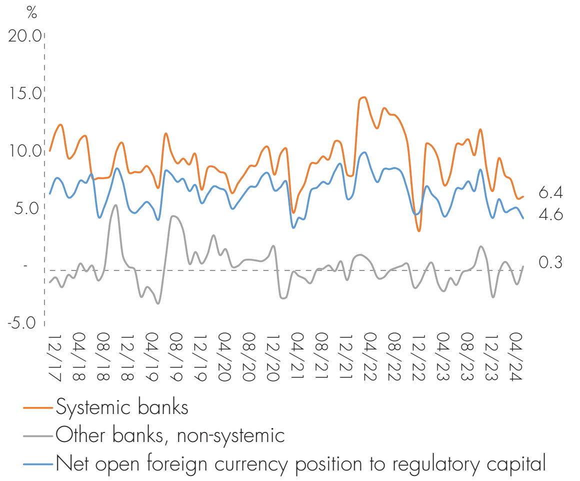
During the period, the exposure to the indirect exchange rate risk, measured by the foreign currency mismatch indicator, recorded a slight increase due to the expansion in foreign currency loans to residents, though it remains near the historical minimum level.

During the period, the net open foreign exchange position of the banking sector remained "long," but at lower values compared to the end of last year and a year ago. The level of this position was 4.6% of regulatory capital, which is 1.6 percentage points and 0.9 percentage point lower than the levels recorded six months and a year ago, respectively, and significantly below the maximum regulatory limit of 30%. This position fluctuated around 5-6% during the first half of the year, compared to the average of 7% recorded in 2023 H2.

The overall indicator's performance is mainly determined by the performance of systemic banks, for which the net open foreign exchange position "long" was 6.4% of their regulatory capital. Non-systemic banks generally show low and stable exposure against exchange rate fluctuations. The net open position of non-systemic banks was "long" at 0.3% of regulatory capital, which is 0.6 percentage points lower compared to the previous six months. Despite occasional changes in the direction of the net open position, whether "long" or "short," the exposure of non-systemic banks does not exceed 2% of their regulatory capital.

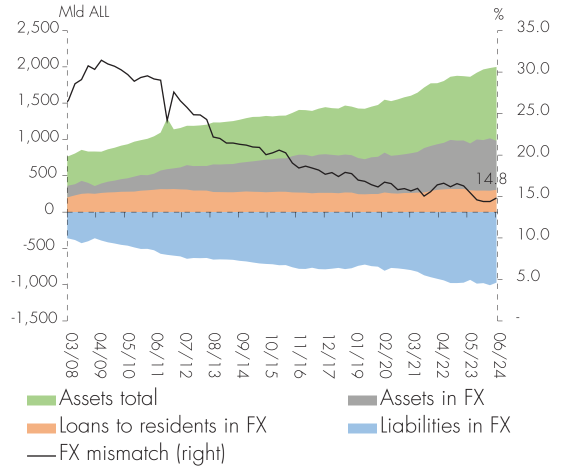
40 *Calculated as a ''mismatch between assets and liabilities'' to ''total assets'' for each basket of residual maturity. Off-balance sheet items are included in the value of assets and liabilities.*

Chart 76 Open foreign currency position to regulatory capital for the sector and groups



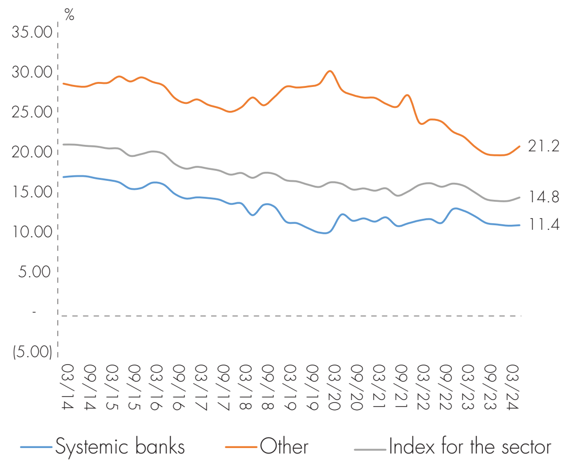
Source: Bank of Albania.

Chart 77. Performance of foreign currency mismatch indicator for banking sector



Source: Bank of Albania.

Chart 78 Performance of foreign currency mismatch indicator for banking groups



Source: Bank of Albania.

The exposure of the banking sector to indirect exchange rate risk increased slightly during the period, as measured by foreign currency mismatch indicator, but remained at low levels compared to the historical average. At the end of the period, the indicator stood at 14.8% of the banking sector's assets, up by 0.4 percentage point from the historically low level recorded in the previous six months. However, it remained 0.6 percentage points below the level recorded during the same period a year ago and below the five-year average (of 15.7%). Liabilities and assets in foreign currency increased at similar rates, expanding by around 1% during the period, while loans in foreign currency to residents rose by approximately 3.5%, contributing significantly to the performance of the overall indicator. The indicator reflects a lower exposure for systemic banks compared to the banking sector as a whole. For this group of banks, the indicator remained close to the level of 11.4% of the previous six months and was about 1.1 percentage points lower than in the previous year. The group of non-systemic banks recorded higher values for the currency mismatch index, which at the end of the period was 1.1 percentage points higher, reaching 21.2% compared to 20.1% six months earlier, contributing to the increase in the indicator for the banking sector. Compared to the same period in the previous year, the indicator did not register significant changes.

INTEREST RATE RISK

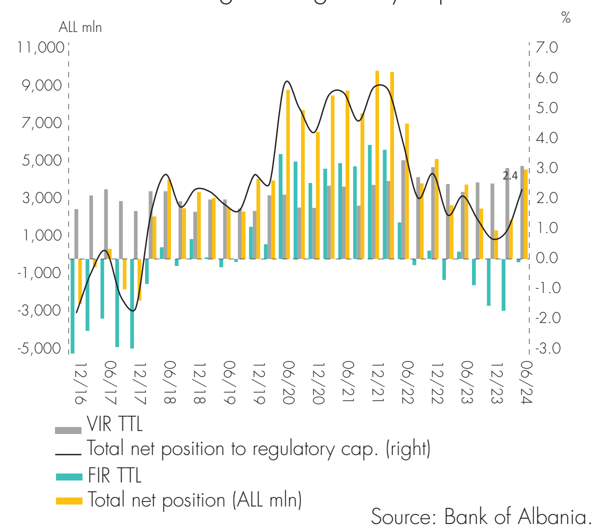
The indicator that measures the banking sector's exposure to direct interest rate risk also increased during the period. Nevertheless, it remains considerably below the upper regulatory threshold.

The banking sector is more exposed to the interest rate risk for the positions in Lek; those with variable interest rate; and the long-term maturity.

The exposure of the banking sector to the indirect risk of interest rates, measured by the spread indicator, increased during the period but remains close to the long-term average.

The banking sector's exposure to interest rate volatility remains low and well below the regulatory maximum limit of 20%. The weighted total net position of interest rate exposures in banks' book at the end of period was at 2.4% of regulatory capital, or around 1.7 p.p. and 0.2 p.p. above the level recorded in the previous six months and the previous year, respectively. The maximum regulatory limit for this indicator is 20% of regulatory capital. This performance was influenced by the simultaneous action of the contraction of the negative position of fixed interest rate assets and liabilities (FIR) by 1.2 percentage points (to -0.1% of regulatory capital), and the expansion of the positive position of variable interest rate assets and liabilities (VIR) by 0.5 percentage point (2.5% of regulatory capital). The weighted mismatch between variable interest rate assets and liabilities (VIR) constitutes the main share in the total net position. It is also worth mentioning that last year, the weighted mismatch between fixed interest rate assets and liabilities (FIR) was positive at 0.2% of the regulatory capital of the banking sector.

Chart 79 Weighted total net position in bank's balance sheets against regulatory capital. in %



Source: Bank of Albania.

The exposure indicator for systemic banks increased to 3.1% of regulatory capital, up from 0% and 2.5% six months and one year ago, respectively. This exposure was entirely in variable interest rate instruments (VIR), while the exposure to fixed interest rate instruments (FIR) during the period was 0%. For non-systemic banks, the total net weighted position of interest rate exposures in the bank's book recorded 1.3% of their regulatory capital, which is somewhat lower compared to six months and one year ago. Liabilities with fixed interest rate were higher than assets, resulting in a negative exposure to fixed interest rate instruments (FIR) of 0.3% of regulatory capital[41]. The exposure to interest rate fluctuations for variable interest rate instruments (VIR) remained nearly unchanged at 1.5% of regulatory capital for non-systemic banks.

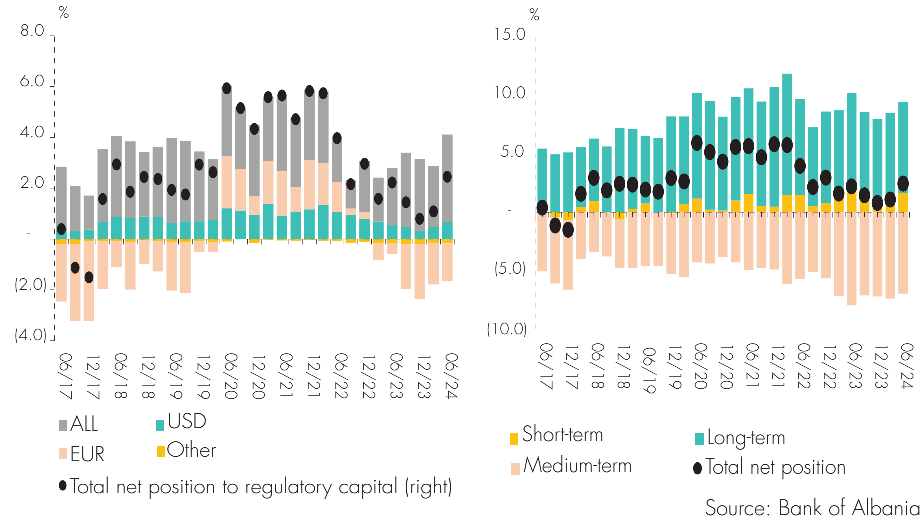
The net position in the domestic currency continues to give the main contribution to the banks' exposure against interest rate fluctuations. During the period, the expansion of the overall position was influenced by the combined effect of the open position in Lek and the contraction of the negative position in Euro. The net position value in Lek was 3.4% of regulatory capital, which is 0.6 percentage points and 1.2 percentage points above the level caalculated in the previous six months and previous year. For the Euro, liabilities continue to register higher values compared to assets sensitive to

[41] *In the previous six months and year this indicator had positive values (assets were higher in number than fixed interest rate liabilities) at 0.8% and 0.3% of the regulatory capital of non-systemic banks.*

interest rate fluctuations, but this mismatch decreased by 0.7 percentage points compared to the previous period, reaching 1.5% of regulatory capital.

In terms of maturities in the banks' position over the last 12 months, there has been an increase in exposure to both short-term and long-term instruments. Compared to the previous six months, exposure to short-term instruments increased by 1.0 percentage points to 1.6% of regulatory capital, though it slightly declined compared to 2.5% in the last year. The weighted net position indicator for medium-term maturity exposures continue to be negative; it was 7.0% of the regulatory capital and contracted during the period and compared to the previous year. The exposure of the long-term maturity basket remains positive, as the value of long-term maturity assets is higher than the value of banks' long-term liabilities. The relevant indicator is 7.8% of regulatory capital, up by 0.4 percentage point compared to the previous six months, but it remains at a comparable level with the previous year.

Chart 80 Weighted net position by currencies (left) and maturity (right) to the regulatory capital, in %



Source: Bank of Albania.

The indicator of the indirect risk[42] from changes in interest rates signals an increase in risk compared to the previous six months. During the period, the mismatch between the loan and new deposit rate[43] fluctuated between 4.2-5.2% and in June it was 4.9% or 0.8 p.p. higher compared to the previous six months. This performance was driven by a larger increase in the loan interest rate (by 1.2 percentage point), compared to that of deposits (by 0.4 p.p).

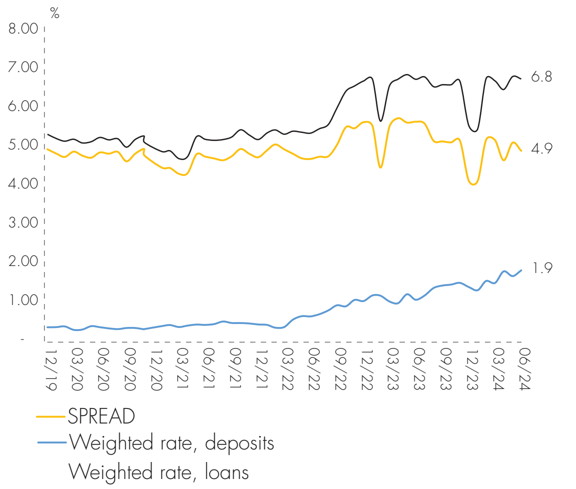
[42] *This risk refers to the impact that the change in the interest rate has on banks' customers. For example, despite the fact that the increase of the interest rate may have a positive impact on bank's balance sheet (due to positive value of the net position between assets and liabilities sensitive to the interest rate), this increase will have a negative impact on the solvency of bank's borrowers when the loans is granted with variable interest rates (indirect risk). However, it is assumed that this effect will be offset to a greater extent if, on the contrary, we have an increase in the interest rate on deposits.*

[43] *In this report and thereafter, we will refer to the data on interest rates according to the new methodological standard for harmonized interest rate statistics of financial monetary institutions, based on the regulation "On Reporting Interest Rate Statistics to the Bank of Albania" decision No. 48, dated 06.09.2017.*

Despite the fluctuations during the period, the interest rate spread remained close to the annual average value of 5.0%. In contrast to the previous year, the interest rate spread decreased by 0.7 percentage points due to a rise in the deposit interest rate by 0.8 percentage point, while the loan interest rate did not change.

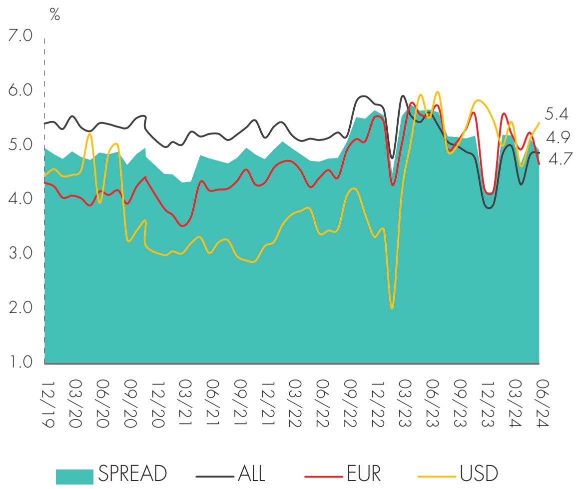
The spreads between the Lek and Euro currencies widened as a result of the developments in loan interest rates for these currencies during the first half of the year. The spread for the domestic currency was 4.9%, up by 0.9 percentage point compared to the previous six months, due to a larger increase in the interest rate for new loans (by 1.4 percentage points) at 7.0%, compared to the increase in the deposit rate (by 0.4 percentage points) at 2.2%. The interest rate for new loans in Euro increased by 1.0 percentage point (to 6.3%), while the deposit rate in Euro rose by 0.6 percentage points (to 1.7%), resulting in a spread that expanded by 0.5 percentage points compared to six months ago, at 4.7%. Compared to last year, the spreads for both the Lek and Euro currencies narrowed by 0.7 and 0.9 percentage point, respectively, due to the increase in deposits' interest rates during the year.

Chart 81 Loans and time deposits weighted interest rates and interest rates spread, in %



Source: Bank of Albania.

Chart 82. Spread of weighted interest rates of loans and time deposits by currency, in p.p.



Source: Bank of Albania.

Given that the weighted net position of banks continue to be dominated by the position in variable interest rate instruments, their fluctuation may be associated with volatility in credit quality. The fluctuation of interest rates is associated with the increase in volatility of spreads and may bring changes in the weighted net position of banks for maturities, currencies and certain types of instruments. Hence, relevant to the scenarios, it is necessary to increase the awareness of banks on the impact that these factors have on the solvency of borrowers with loans with variable interest rates, especially for segments where exposures are larger or are growing faster.

5.1.3 BANKING SECTOR'S RESILIENCE

Results of stress test exercises in terms of solvency show that the banking sector is resilient against assumed macroeconomic shocks for the 2024-2026 period.

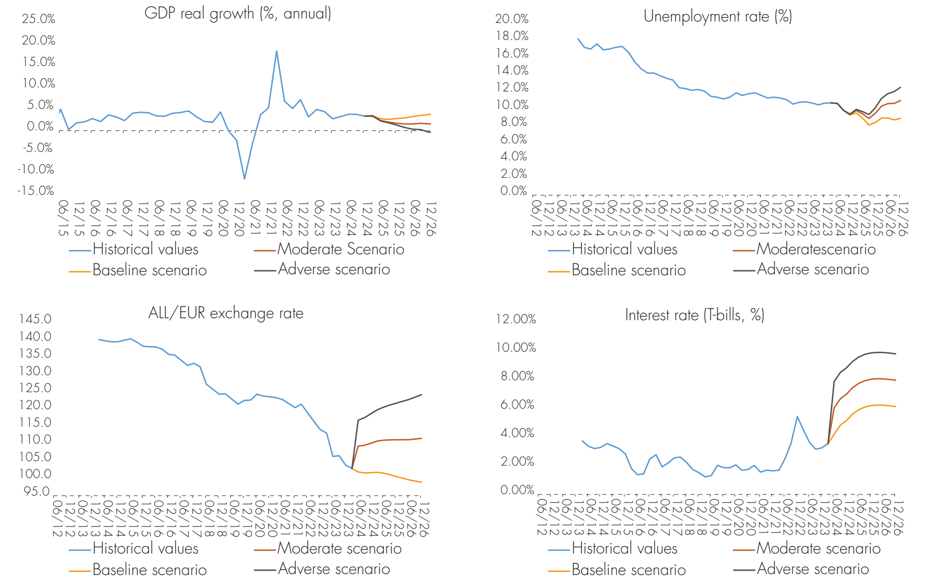
The sensitivity of the banking sector has improved significantly compared to the previous year, since the number of banks that would need to strengthen their capital positions and the necessary level of capital, in less favourable scenarios, have decreased.

Results of stress test exercises in terms of capital adequacy show that the banking sector is resilient against macroeconomic shocks and its sensitivity to adverse developments has mitigated compared to the previous year. However, a limited number of banks are more sensitive under more extreme assumptions.

The capital adequacy stress test assesses the stability of individual banks in terms of capital and aims to highlight the sector's ability to withstand assumed shocks to economic growth and unemployment, exchange rate fluctuations, credit portfolio volumes and quality, interest rates, and prices performance of non-financial assets.

The exercise is conducted by applying three scenarios- the baseline scenario; the moderate scenario; and the adverse scenario- for the period up to the end of 2026. The baseline scenario assumes positive economic growth during this time frame, accompanied by positive credit growth, appreciation of the domestic currency, and a decrease in unemployment. In the moderate scenario, economic growth remains positive throughout the period, but the growth rate is lower than in the baseline scenario. Meanwhile, in the adverse scenario, starting from the third quarter of the second year (2025), the economic growth rate is assumed to be negative.

Chart 83 Projections on the key indicators – (top), and the new macroeconomic indicators – (bottom)



Source: Bank of Albania.

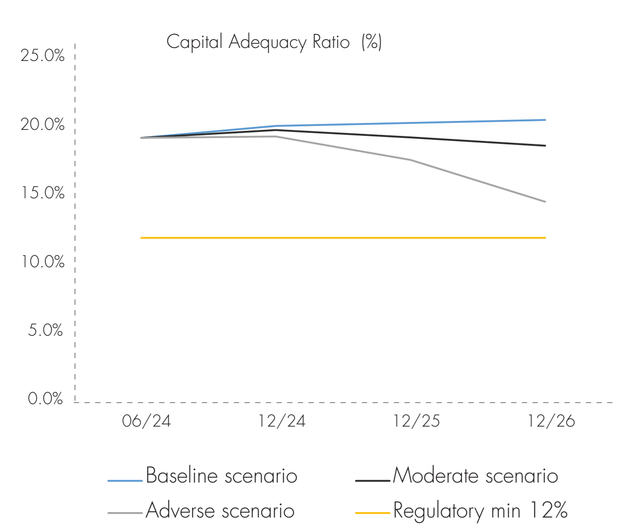
Both the moderate and adverse scenarios include assumptions about currency depreciation, increase of interest rates, and a slowdown in credit growth, leading to a halt during the final year of the exercise (2026). These developments result in a deterioration in the quality of the credit portfolio for both households and enterprises. This deterioration is more pronounced for the business portfolio in the case of systemic banks and for the household's portfolio in the case of other banks.

Other macroeconomic indicators included in the exercise, assume a fall in housing prices by the end of the exercise period under the most unfavourable scenarios, along with an increase of unemployment rate. These assumptions affect the level of capitalization of specific banks and the overall banking sector, mainly during 2026.

In terms of capital adequacy, the results of the stress test exercise show:

- In the baseline scenario, the capital adequacy ratio (CAR) is assessed at around 21%, up to the end of 2026. These developments present a stable situation and high levels of capitalisation for the entire banking sector. The number of banks needing capital injection is only two. These banks share acoount for 3.2% of the banking sector's total assets. In this case, the need for additional capital is assessed to amount up to around ALL 0.6 million or 0.06% of GDP.
- In the moderate scenario, the banking sector's CAR falls at around 19% at the end of 2026, by continuing to preserve adequate capital levels throughout the exercise time frame. Only three banks, accounting for 19% of the sector's assets, needs capital injection, in this scenario. In this case, the need for additional capital is assessed to amount up to around ALL 8 million or 0.44% of GDP.
- In the adversed scenario, the banking sector continues to be capitalized up to the end of 2026, with a CAR of around 15%. In this scenario, the number of banks that need capital injection reaches up to six and these banks account for around 40% of the sector's assets. In this case, the need for additional capital is assessed to amount up to around ALL 29 billion or 1.23% of GDP.

Chart 84 CAR over the time frame of the exercise

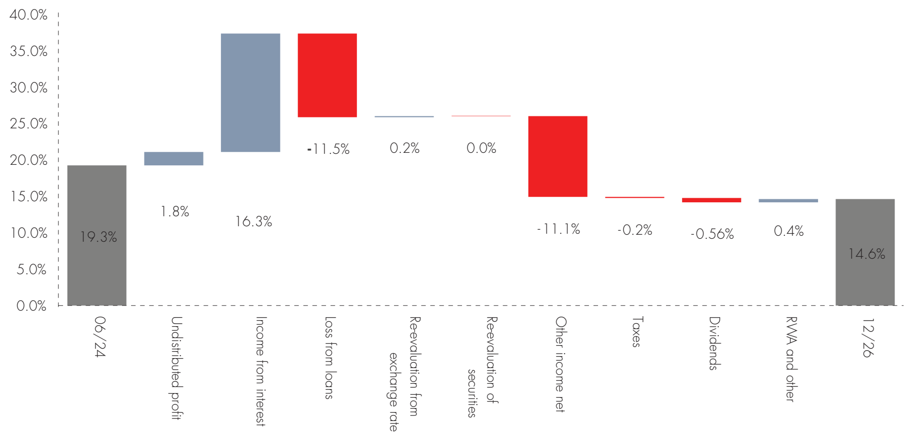


Source: Bank of Albania.

In this scenario, for systemically important banks and non-systemic banks, the capital adequacy ratio reaches 14.2% and 15%, respectively. The group of banks with foreign capital show a capitalisation ratio of around 18%, remaining well-capitalized, while banks with Albanian capital has a lower CAR of around 9%. The main contribution to the fall of capitalization in the adversed scenario at the end of 2026 is given by the items "Loss from loans" and the decline in "other operating income."

These results show that the banking, despite the developments in particular banks sector is resilient to macroeconomic shocks and its resilience to adverse developments is stronger than a year ago. The number of banks requiring a capital increase is six compared to eight banks a year ago. As a result, the need for additional capital is estimated to have halved to around 1.2% of GDP.

Chart 85 Contribution of the main balance sheet's items in CAR change in adverse scenario (end of 2026)



Source: Bank of Albania.

5.1.4 THE PERCEPTION OF THE BANKING SECTOR FOR SYSTEMIC RISKS

Survey results on the perception of systemic risks in Albania from the banking industry have presented a somewhat altered view of the main types of systemic risks and their assessment during 2024 H1.

The banking sector continues to consider "external shock risk" as the primary systemic risk, and the perception of its significance has not changed. Despite positive global developments related to inflation and financing conditions in the markets, other factors such as high geopolitical tensions (especially the conflict in Gaza and the possibility of its escalation in neighbouring countries, as well as the ongoing war in Ukraine) seem to have kept banks' concerns high regarding the risk of potential negative shocks being transmitted from abroad, classifying it as the most significant systemic risk of the period. "The risk of cyberattacks has remained second on the list of most important risks and although perceptions on this risk has increased during the period. The increase in cyberattack episodes over the past year has already raised the banks' awareness of the risk and the potential consequences for their operations. As a result, some of them report that they have already taken concrete measures to improve their defence systems. The fluctuations, primarily in the appreciating direction of the Lek against the Euro and the Us Dollar during this period, highlight the impact of the exchange rate on the stability of banks' portfolios. For this reason, they have chosen this indicator among five developments that need to be closely monitored, even though the level of contribution to risk is considered low.

The survey carried out on banks on their perception of systemic risks shows a mitigation of the perception of risks due from domestic factors and an increase in the risk from external shocks.

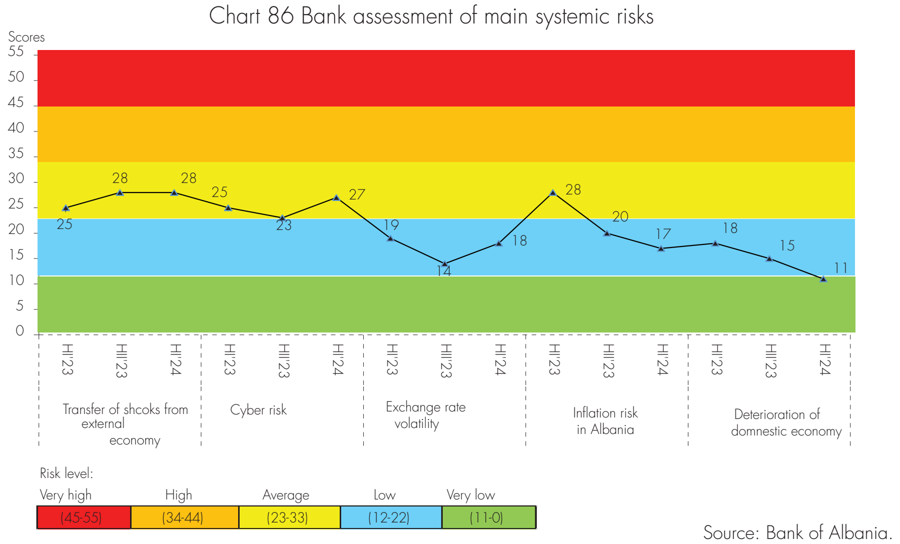
Banks have assessed the "risk of external shocks" as the main systemic risk of the period and this assessment has remained unchanged compared to the previous period.

Cyber risk is ranked in the second place, and the rate of this risk has increased compared to the previous period.

The banks' perception on inflation risk has significantly mitigated during the period.

The likelihood of the materialization of one or more significant systemic risks in the short term is assessed as low, but it appears somewhat higher when discussing a longer time horizon.

Chart 86 Bank assessment of main systemic risks



Source: Bank of Albania.

Although it continues to remain in the group of major systemic risks, banks' perception of "inflation risk" in the country has significantly mitigated. This assessment has been influenced by its steady decline and stabilization within the targeted limits. "The risk of deterioration of the domestic economy resulting from the effect pass-through of tight domestic and external policies or the materialization of various shocks, continues to remain present, but the perception of banking sector on it has continued to decrease. Recently, the banking sector has perceived "Imbalances in real estate markets values" as a new risk. However, the assessment of this risk has remained unchanged during the period, and it is not ranked among the five main systemic risks identified by the banks.

Overall, banks perceive that the likelihood of materializing one (or several) of the aforementioned risks in the short run (up to one year) is low but it increases when when discussing is carried out for a longer- time horizon (1-3 years), affected by the uncertainty surrounding the future developments Despite the current challenges, the strong capital and liquidity position of the sector has ensured that banks' confidence in the stability of the financial system in the future remains unchanged.

5.2 NON-BANKING SECTOR

5.2.1 NON-BANKING SECTOR PERFORMANCE

During the first half, all segments of the financial system recorded a growth of the activity.

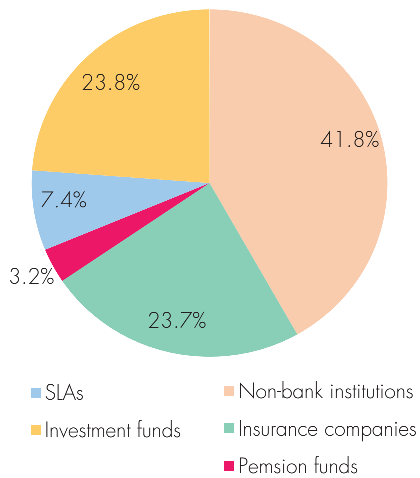
Various financial institutions, apart from banks, continue to be well-capitalized. The quality of the loan portfolio is reported to be good in lending institutions.

The exposure of the banking sector to the non-banking sector remains low albeit slightly increasing during the period, while the sensitivity of the non-banking sector to the activity of the banking sector remains high but has not changed during the period.

Alongside the banking sector, other segments of the financial system have also recorded growth in their activity during the first half of the year[44]. The main contributions came from non-banking financial institutions and investment funds, which hold a significant share in the activities of the non-banking sector. In relation to the total assets of the financial system, the non-banking sector has increased its share by 1 percentage point, while its assets against the country' GDP remained unchanged at 9%. Non-bank financial institutions supervised by the Bank of Albania continue to dominate the structure of non-banking sector, followed by investment funds and insurance companies that are licensed and supervised by the Albanian Financial Supervisory Authority.

Currently, there are 40 non-banking financial institutions (NBFIs) operating in the financial market, of which: 25 are credit institutions, microcredit institutions, factoring companies, financial leasing firms, and non-performing loans purchasing entities; 5 are payment institutions; and 10 are electronic money institutions. The main activity of NBFIs is lending (37%), followed by payment and transfer services (31%), and electronic money (20%). Currently, 16 NBFIs of saving and loans associations (SLA) 1 Union, 12 insurance companies, 16 investment funds, and 6 pension funds operate in the financial market. Non-bank financial entities with insurance company's institutions have the main share in the activity of non-banking sector, followed by investment funds.

Chart 87 Non-banking sector structure



Source: Bank of Albania, Albanian Financial Supervisory Authority.

Non-bank financial institutions that exercise lending activities[45] reported expansion of the activity, better financial performance and a good level of capitalization. Total assets increased by ALL 4 billion, reaching ALL 68 billion. By sectors of the economy, the most financed sectors are the sector of other activities and the sector of whole sale and retail trade (by around 22% and 18%, respectively), followed by construction (10%). Credit to households accounted for 52% of total loans, while the rest was granted to enterprises. Credit quality increased during the period, and CAR dropped at 12.8% from 13.3% a year earlier. NBFIs reported a positive financial result (around ALL 1 billion) at the end of the period, lower than the level in the previous year (ALL 1.8 billion). The activity capitalisation of these entities continues to remain high.

[44] The database of non-banking sector entities belongs to the first quarter of 2024.
[45] All forms of lending include microcredit, financial leasing, factoring, and purchasing of non-performing loans.

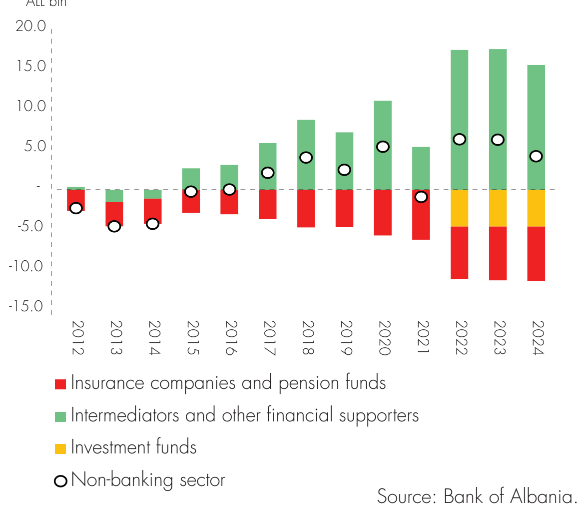
About 76% of the paid-in capital of non-banking institutions engaged in lending is of domestic capital.

Payment institutions and electronic money institutions (IPEs) maintained their asset level from a year ago at ALL 36 billion. Currently, there are 5 entities that exercise their activity in the payment sector and 10 in the electronic money sector. IPEs account for around 35% of the total assets of NBFIs, while the rest belongs to institutions engaged in lending activities. The main focus of their activity is investments in banks in the form of current accounts and guarantees (29%), followed by payment services to clients (27%) and investments in securities with variable income in the form of stocks (15%). The financial performance of IPEs was positive, reporting a financial profit of ALL 0.3 billion

Savings and Loan Associations recorded a growth in the volume of assets. This segment has experienced a decline in the quality of the loan portfolio compared to a year ago, with a non-performing loan ratio (NPL) at 5.1%. In the investment portfolio of SLAs, the main share is held by investments in loans (74%) and investments in banks in the form of current accounts (14%). The sector that has attracted the largest share of financing is the agricultural sector (21%), followed by the wholesale and retail trade sector (16%). SLAs ended the period with a positive net profit.

Insurance companies and pension funds expanded their activity, as a result of the increase in gross written premiums and investments in government debt securities.

Chart 88 Net position of non-banking sector by entity in years



Source: Bank of Albania.

Chart 89. Mapping of assets, liabilities and net position by entity of non-banking sector (March 2024)

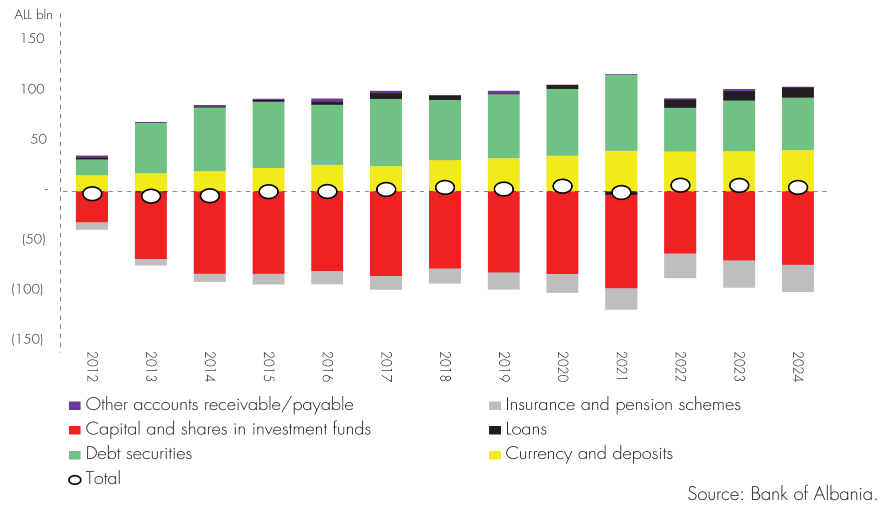
Source: Bank of Albania.

The non-banking sector continues to maintain a balanced position of financial assets and liabilities[46]. Loans and debt securities represent the main assets, while capital and shares in investment funds represent liabilities. The

[46] *The analysis of assets and liabilities of non-banking sector is based on the data of financial accounts for the first quarter of 2024.*

non-banking sector has narrowed its net credit position compared to the end of the previous year, influenced by the increase in obligations of other financial intermediaries (non-banking institutions, SLAs) in the form of capital and shares in investment funds. Investment funds, insurance companies and pension funds, within banking sector, have a net negative position (debtor), while the other financial intermediaries (non-banks and SLAs) have a net positive position (creditor). For the sub-sector of investment funds and insurance companies with pension funds, debtor position amounted to 6% of total assets as at end of 2024 Q1.

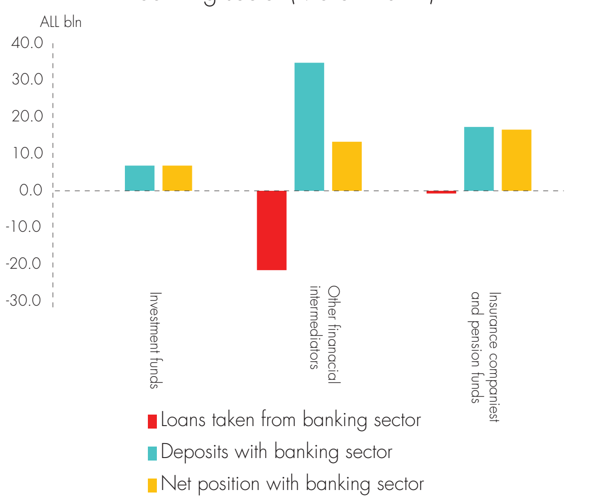
Chart 90 Net position of non-banking sector by instrument over the years



Source: Bank of Albania.

Loans and and debt securities continue to have the main share in the assets of financial entities other than banks. Debt securities account for 26% of the financial assets of the non-banking sector, while loans and currency and deposits account for 28% and 21% respectively. Nevertheless these ratios differ across entities of this sector. Debt securities in investment funds account for around 82% of their assets, while loans have the highest share with around 52%, in the assets of other financial intermediaries. Both insurance companies and pension funds, have the most heterogeneous distribution of assets, into: currency and deposits (34%); debt securities (26%); insurance and pension schemes (14%); and capital and shares in investment fund (15%). By instrument, non-banking sector has a net debtor position for the capital and shares in investment funds, in insurances and pension schemes, whilst it has a net creditor position for debt securities, loans and currency and deposits.

Chart 91 Non-banking sector interconnection with banking sector (March 2024)



Source: Bank of Albania.

5.2.2 RISKS AND EXPOSURES BETWEEN BANKING AND NON-BANKING SECTORS

The exposure of banking sector to the non-banking sector remains low, despite recording a slight increase in annual terms. The exposure to non-banking sector, on the side of banks' assets is mainly represented by loans granted to non-bank financial institutions. Financial intermediators (non-banks and SLAs) are the segments with the highest financing stock from the banking sector, with a loan stock of ALL 21.5 billion, followed by insurance companies and pension funds with rather low loan values. Banking sector' total financing stock amounts to around ALL 22 billion, and accounts for 1.1% of the value of banking sector's balance sheet, from 0.94% in the previous year.

The sensitivity of the non-bank sector to the activity of the banking sector remains high and stable. Claims of non-banking sector to banks are in the form of placements (current accounts, demand and time deposits). Stock of funds placed in banks, as at end of first quarter, amounted around ALL 59 billion, or accounting for 29% of total assets of the non-banking sector. The largest placements in the banking sector, or 59% of the total, come from other financial intermediaries (non-banking institutions, SLAs), and these placements increased compared to the end of the previous year. As a ratio to their assets, insurance companies and pension funds have the highest exposure to the banking sector, as their placements in banks account for around 34% of their assets. The non-banking sector has narrowed its net creditor position to the banking sector, reaching ALL 37 billion, from ALL 43 billion reported at the end of December 2023. The contracted net position mitigates the sensitivity of non-banking system to the activity of the banking sector. Insurance companies and pension funds have the highest net creditor position, as they have more claims in the banking sector compared to liabilities, followed by the other financial intermediaries. The Bank of Albania monitors regularly the exposure of non-banking sector to the banking sector, in the framework of the regular assessment of systemic risks and for monitoring the fulfilment of intermediate objectives of macro-prudential policy.

ANNEX. FINANCIAL SOUNDNESS INDICATORS

In %	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	06/2024
Capital-based indicators																		
Regulatory capital to risk-weighted assets	17.1	17.2	16.2	15.4	15.6	16.2	18.0	16.8	15.7	16.0	17.0	18.7	18.5	18.7	18.5	18.8	19.9	19.3
Tier 1 capital to risk-weighted assets	16.0	16.3	15.3	14.5	14.3	14.6	14.9	13.8	13.5	14.1	15.5	17.4	17.3	17.6	17.4	17.5	18.2	17.7
Shareholders equity to total assets	7.6	8.6	9.6	9.4	8.7	8.6	8.4	8.6	9.5	9.7	10.2	10.1	10.5	10.4	9.9	9.8	9.9	10.3
Assets quality																		
Net NPLs to regulatory capital	10.1	21.7	28.2	35.9	52.0	55.6	40.2	38.3	24.3	23.1	15.7	15.5	13.6	11.3	7.1	7.3	5.5	6.3
NPLs (gross) to total loans	3.4	6.6	10.5	14.0	18.8	22.5	23.5	22.8	18.2	18.3	13.2	11.1	8.4	8.1	5.6	5.0	4.7	4.7
Profitability																		
ROE (annual basis)	20.7	11.4	4.6	7.6	0.8	3.8	6.4	10.5	13.2	7.2	15.7	13.0	13.5	10.7	12.9	12.3	17.3	18.5
ROA (annual basis)	1.6	0.9	0.4	0.7	0.1	0.3	0.5	0.9	1.2	0.7	1.5	1.3	1.4	1.1	1.3	1.2	1.7	1.9
FX net open position to captial																		
FX net open position to regulatory capital	1.7	4.3	3.9	5.0	3.9	4.0	4.1	8.5	7.7	7.0	6.7	7.8	7.4	8.4	9.2	5.0	6.1	4.6
FX net open position to Tier 1 capital	1.8	4.5	4.1	5.3	4.3	4.4	4.9	10.4	9.0	8.0	7.3	8.4	8.0	9.0	9.8	5.4	6.7	5.0
Asset-based indicators																		
Liquid assets to total assets	49.8	42.8	27.6	25.9	26.5	29.4	27.6	31.9	32.3	31.3	30.2	34.2	35.7	34.8	33.3	29.6	30.8	28.4
Liquid assets to sh.t. liabilities (up to 1 year)	74.0	64.9	32.6	30.6	33.1	36.7	34.7	40.4	41.4	40.6	40.8	46.2	49.4	47.4	45.4	41.1	43.4	41.2
Client deposits to total loans	215.5	162.6	154.3	166.4	163.2	171.6	180.8	180.2	187.8	192.8	194.0	203.2	207.2	211.3	213.6	212.4	217.1	203.5