



ORIGINAL PAPER

Credit Activity in the Western Balkan Countries in Terms of Bank-Specific Indicators: A Comparative Analysis

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Abstract:

This paper aims to explain some current considerations and approaches about the credit activity in Albania compared to the other countries in the Western Balkan's region in terms of bank-specific indicators. During 2020 and in the first half of 2021, the evolution of bank credit in the Western Balkan countries continued to be positive, influenced by monetary easing, support for credit risk reduction and other support policies offered by central banks. The balance sheet of banks in the region has improved over the period, and the non-performing loan rate has declined compared to a year ago in most countries. Among the various lending measures, the study of credit activity will be focused on bank credit (loans and advances) to the private sector, one of the most important indicators of bank development. Using a qualitative and quantitative analysis, the main objective of this paper is to generate and explain through a descriptive and graphical analysis, the evolution of the bank credit to the private sector for the six countries of the Western Balkans, Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia. Countries in the region have benefited from a substantial inflow of foreign funds and cross-border loans before the crisis. When the financial crisis broke out, credit growth declined dramatically and did not begin to recover, in part due to the banking sector's reversal in external financing. The COVID-19 pandemic also brought a sudden negative revision of expectations.

Keywords: *Bank Credit to the Private Sector, Credit Activity, Western Balkans.*

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Introduction

The countries of the Western Balkans have some common features: the history of socio-economic development, the transformations that have taken place, the reforms undertaken, the liberalization, the restructuring and the path to development. The structure of their financial system is mainly based on the banking sector, and capital markets are underdeveloped or inactive as in the case of Albania. Another common feature that makes them even more exposed to financial instability is that most banks are owned by the largest banks operating in European countries.

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This paper aims to explain some current considerations and approaches about the credit activity in Albania compared to the other countries in the Western Balkan's region in terms of bank-specific indicators. Among the various lending measures, the study of credit activity will be focused on bank credit (loans and advances) to the private sector, one of the most important indicators of bank development. Using a qualitative and quantitative analysis, the main objective of this paper is to generate and explain through a descriptive and graphical analysis, the evolution of the bank credit to the private sector for the six countries of the Western Balkans, Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia.

Literature Review

The economies of the Western Balkan countries are among the most affected by the effects of the recent recession, which has been strongly affected by the evolution of the region's economies. According to PFS (2011), the most exposed of the Western Balkan countries to foreign capital are Montenegro, Albania and Northern Macedonia. All these savings have been directly or indirectly affected by the crisis of recent years. The economies of these countries are small, but all have the goal of joining the European Union, despite the different levels of development.

The profitability indicators of the banking sector in the Western Balkans, based on the study by Varesi (2015), follow the same negative trend with the growth rates, and the recovery rates are lower than forecast. The efficiency of the banking sector in the Western Balkans has declined for the period observed by the author, and the overall banking profitability and performance have shown a declining trend. The financial depth of the results of the countries studied has worsened compared to the pre-crisis period. Non-performing loans remained the main risk, as they tended to increase.

From the analysis of the profitability of the banking system in the Western Balkan countries of Tmava et.al. (2019), it can be concluded that both performance indicators (ROA and ROE) in the Western Balkan countries, for the comparative period (2008-2015), performed on average better in the period before the global financial crisis than in the next and that some of these countries need to fully recover from the crisis.

The COVID-19 pandemic has hit six Western Balkan countries amid a resurgence in economic activity and promising economic prospects for 2020. The region's central banks have responded by lowering key policy rates and providing liquidity to banks and financial institutions. non-banking, which in turn eases the burden on companies and individuals affected by abrupt disruptions (Gabeshi, 2021).

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In 2021, the Western Balkans is accelerating a recovery from the COVID-19-induced recession experienced by all six economies in 2020. The recovery is picking up faster than expected, with strong growth performance in the region in the second quarter of 2021, in contrast to the poor performance observed in the first quarter (Regular Economic Report, 2021).

Study of Credit Activity in Albania Compared to the Other Countries in the Region

During 2020 and in the first half of 2021, the evolution of bank credit in the Western Balkan countries continued to be positive, influenced by monetary easing, support for credit risk reduction and other support policies offered by central banks. The balance sheet of banks in the region has improved over the period, and the non-performing loan rate has declined compared to a year ago in most countries. This indicator was also affected by the extension of the measures on the temporary suspension of the credit rating, so that it did not fully reflect the impact of the pandemic on the financial system. In the banking sector, various support policies have contributed to the revitalization of lending, especially in the second quarter of 2021. The balance sheet of banks in the region has improved due to the further decline in non-performing loans.

Table 1. shows some key financial indicators, such as the increase in annual lending and the percentage of non-performing loans for Bosnia and Herzegovina, North Macedonia, Montenegro, Kosovo, Serbia and Albania.

Table 1. Some key financial indicators for the Western Balkan countries

	Credit growth (% annual)			Non-performing loan rate (%)		
	Q4'20	Q1'21	Q2'21	Q4'20	Q1'21	Q2'21
Bosnia and Herzegovina	-1,2	-0,4	1,9	:	6	:
North Macedonia	5,5	5,6	5,5	:	3,3	3,4
Montenegro	5	3,8	8	5,9	5,5	5,5
Kosovo	6,9	6,9	11,1	2,5	2,5	2,4
Serbia	13,4	10,8	9,1	:	3,9	:
Albania	6,7	1,6	5,9	8,1	8	7,1

Source: data processing from the Financial Stability Report, Semester 1, 2021, Bank of Albania and data from INSTAT. Explanations: ":" lack of information.

Among the various lending measures, the study of credit activity will be focused on bank credit (loans and advances) to the private sector, one of the most important indicators of bank development. This indicator will be further explained and graphically demonstrated for all Western Balkan countries. Figure 1. shows the evolution of bank credit to the private sector as percent of GDP for Albania over the period 2001-2020. The average value for Albania during this period was 28.06%, with a minimum of 6.2% in 2001 and a maximum of 39.31% in 2011. The most recent value in 2020 is 35.95%.

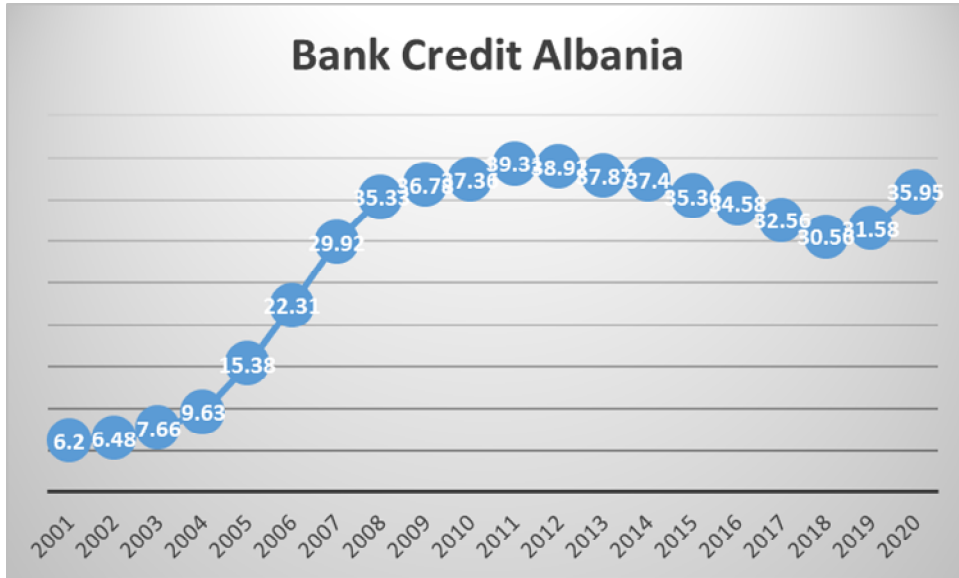


Figure 1. Evolution of bank credit to the private sector as percent of GDP in Albania (2001-2020)

Source: own processing according to data taken from <https://www.theglobaleconomy.com/>

Like all countries that have switched from totalitarian regimes to a market economy, Albania in the first years after economic and political changes has experienced a very low level of credit to GDP. After 2004, when bank loans started to grow rapidly, their ratio to GDP increased significantly.

The rapid growth of lending in the period 2004-2009 was also supported by the country's economic growth, both of these indicators moved in the same direction. Dushku (2010) highlights a long-term double link between financial intermediation and Albania's economic growth. To better explain, the acceleration in bank lending was caused in a way by convergence with the country's macroeconomic conditions and the economy's greater need to be credited. The relationship between these factors is interdependent, and in studies conducted for different countries, it is often not possible to identify the cause and the consequence.

From a very low initial base, lending to the Albanian economy in the banking system grew at a very rapid pace, especially after the privatization of the country's largest bank in 2004. In order to keep up with the latest trends in the services they offer, but also to create, maintain or increase market share, all banks have started lending to both businesses and individuals. As can be seen from Figure 2., the annual growth rate of total credit peaked in 2008, precisely because the initial basis on which this growth was calculated was at very low levels.

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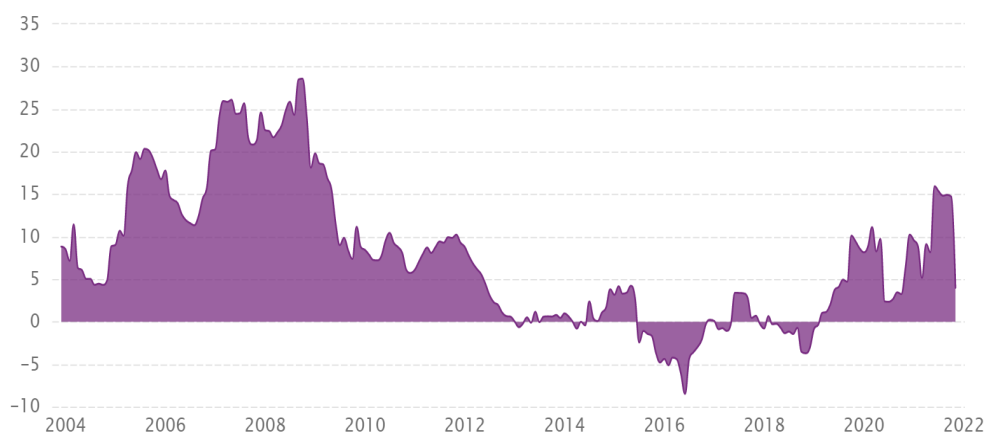


Figure 2. Annual growth rate of domestic credit in Albania (2004- November 2021)

Source: <https://www.ceicdata.com/en/indicator/albania/domestic-credit-growth>

Over the years, the bank loan portfolio has reached significant levels, rising significantly from the levels of the early 2000s. The financial crisis has significantly affected the Albanian banking system, causing the credit market to shrink and tightening bank lending conditions. The last decade has seen an upward and downward fluctuation in the growth rate of credit, reaching negative values up to -8.5% in 2016 and positive values after 2018, with a tendency to maintain this trend in the next period, due to improvements to the components of the financial system and especially the banking system. Albania's domestic credit averaged 6.4%, available from december 2003 to november 2021.

Figure 3. below shows the evolution of bank credit to the private sector as percent of GDP for Bosnia and Herzegovina over the period 2001-2020. The average value for Bosnia and Herzegovina during this period was 47.96%, with a minimum of 26.15% in 2001 and a maximum of 54.85% in 2013. The most recent value in 2020 is 54.61%.

Bosnia and Herzegovina's financial system is bank-based, which means that most external financing is provided by commercial banks. In 2007-2012, BiH governments were less active in the domestic financial market, so the main driver of economic activity was domestic demand from commercial bank loans (Jovic, 2021). During this period, BiH went through an expansionary and crisis-ridden credit cycle, and the credit crunch took place in 2009. In 2020, the volume of lending decreased by 2%, and the level of non-performing loans continued to decline (due to the extension of temporary measures) to 6.1%, which is the lowest level since the beginning of the global financial crisis.

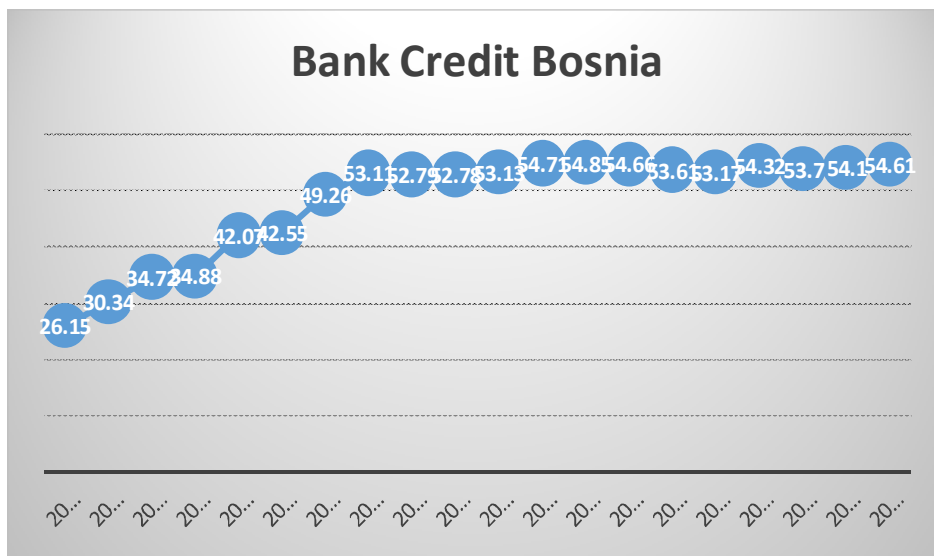


Figure 3. Evolution of bank credit to the private sector as percent of GDP in BiH (2001-2020)

Source: own processing according to data taken from <https://www.theglobaleconomy.com/>

Figure 4. shows the evolution of bank credit to the private sector as percent of GDP for Montenegro in the period 2002-2020. The average value for Montenegro during this period was 48.4%, with a minimum of 7.95% in 2002 and a maximum of 86.45 in 2008. The most recent value in 2020 is 59.9%.

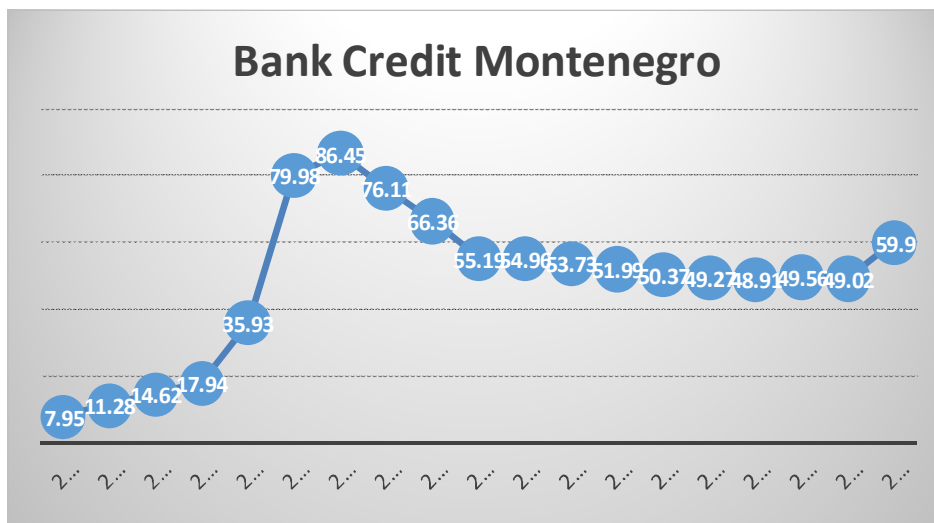


Figure 4. Evolution of bank credit to the private sector as percent of GDP in Montenegro (2002-2020)

Source: own processing according to data taken from <https://www.theglobaleconomy.com/>

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Montenegro's financial system is based on the banking sector, with banks holding the main market share (over 90% of total financial system assets) and most of the financial intermediation takes place through them. Considered by the structure of banks' balance sheets, the main activities of Montenegrin banks are: accepting deposits and lending, as well as providing various types of payment services, while banking investments or active investments in financial instruments are negligible.

In the pre-crisis period caused by the Covid-19 pandemic and after the financial crisis, the Montenegrin banking sector has strengthened its capital position, liquidity and asset quality, making it easier to play a significant role in mitigating the consequences of the crisis and leading to the recovery of the Montenegrin economy. During the year 2020, and in the period after the declaration of the pandemic, a satisfactory level of bank liquidity was maintained (CBCG 2020).

According to EBF (2021), the structure of total credits by destination has changed slightly in favor of credits to refinance debt to other banks, whose share has increased by 2.94 percentage points from 2019 to 2020. Such a credit trend was to be expected, given the liquidity of the real sector and the population and the difficult possibility of meeting the obligations assumed. While loans for the construction and adaptation of buildings have decreased, housing loans have increased.

In figure 5. it is represented the evolution of bank credit to the private sector as percent of GDP for the Republic of North Macedonia over the period 2001-2020. The average value for North Macedonia during this period was 38.8%, with a minimum of 16.3% in 2001 and a maximum of 54.1 in 2020.

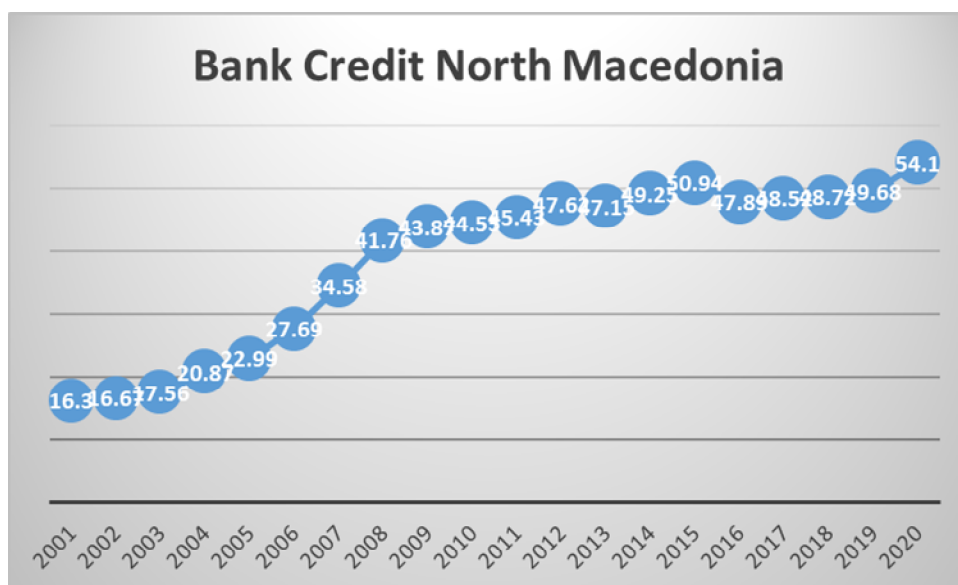


Figure 5. Evolution of bank credit to the private sector as percent of GDP in North Macedonia (2001-2020)

Source: own processing according to data taken from <https://www.theglobaleconomy.com/>

The banking sector, which accounts for almost the entire financial system in North Macedonia, is of particular importance in terms of withdrawing capital into the

economy in the form of credit. This sharp surge in bank lending over the years has been disrupted by the global financial crisis, although loans have continued to grow at a slower pace, the post-crisis period also marks the slowest pace of credit growth (Ademi, 2015).

In 2020, the banking sector saw a 4.1% increase in the volume of lending, supported by a 6.2% increase in deposits. Certainly, the most important activity that banks and savings banks carried out in 2020 was the postponement of the repayment of loans to households and legal entities.

Figure 6. shows the evolution of bank credit to the private sector as percent of GDP for Serbia over the period 2001-2020. The average value for Serbia during this period was 35.73%, with a minimum of 15.23% in 2002 and a maximum of 47.08 in 2010. The most recent value in 2020 is 45.78%.

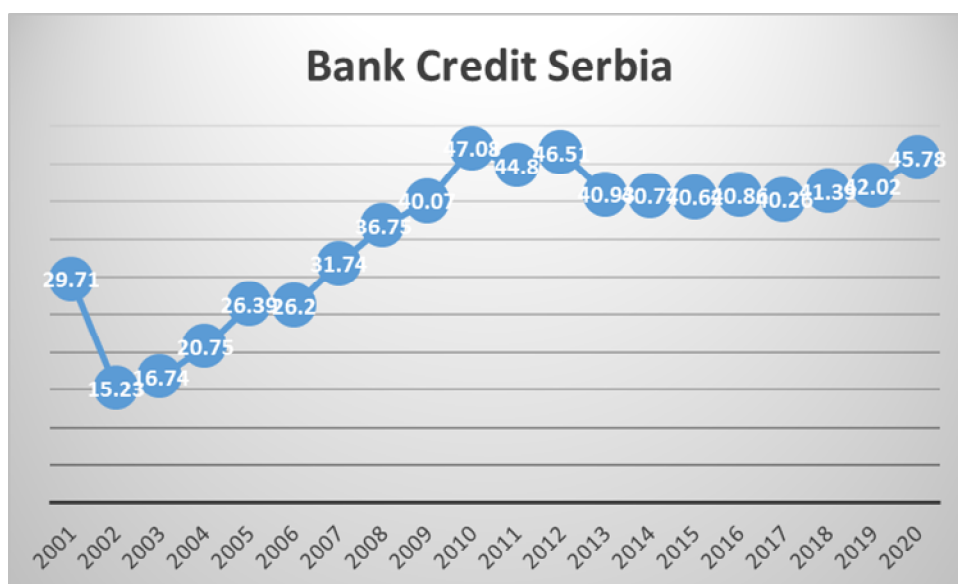


Figure 6. Evolution of bank credit to the private sector as percent of GDP in Serbia (2001-2020)

Source: own processing according to data taken from <https://www.theglobaleconomy.com/>

The banking sector of the Republic of Serbia is the dominant form of financial intermediation and the most important source of meeting the demand for financial resources. In addition, the financial sector, especially the banking sector, is one of the best reformed parts of the Serbian economy. The strengthening of the deposit potential has allowed an expansion of credit, especially in the field of lending to the household sector.

The Serbian banking sector has remained resilient to the shocks, including the 2020 pandemic. Credit supply has been boosted by the continued easing of the NBS's monetary policy, the approval of loans under the Guarantee Scheme, and low interest rates on the money market. International. On the other hand, the demand for loans has increased due to the increased needs for liquidity, debt restructuring and the purchase of

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real estate. “At the end of 2020, excluding the effect of the exchange rate, total domestic loans increased by 9.9% year-on-year” (EBF, 2021).

Figure 7. below shows the evolution of domestic credit to the private sector as percent of GDP for Kosovo over the period 2002-2020. Domestic credit to the private sector as percent of GDP in Kosovo was reported at 51.62% in 2020.

Kosovo is by far a new economy in which profound economic transformations have taken place from a centralized economy to a market economy. Banks in Kosovo are considered to be rated with the best financial performance in the country's economy. In recent years, deposits and loans are on the rise, and financial services are constantly being modernized (Sahiti et.al, 2019).

Accumulation of financial capital has been highlighted as the main driver of development to some extent - and since economies have grown in Kosovo, the question of how a growth of economies contributes to the overall economic growth of developing countries such as Kosovo (Ribaj & Mexhuani, 2021).



Figure 7. Evolution of domestic credit to the private sector as percent of GDP in Kosovo (2002-2020)

Source: <https://tradingeconomics.com/kosovo/domestic-credit-to-private-sector-percent-of-gdp-wb-data.html>

Conclusions

Countries in the region have benefited from a substantial inflow of foreign funds and cross-border loans before the crisis. When the financial crisis broke out, credit growth declined dramatically and did not begin to recover, in part due to the banking sector's reversal in external financing.

The COVID-19 pandemic also brought a sudden negative revision of expectations. Regional demand is expected to contract, supply conditions will be significantly tightened and approval rates will be reduced. As the quality of credit demand declines, non-performing loans are expected to increase. Compared to 2008, when the crisis started from the financial-banking system, the current crisis generated by the new coronavirus, which produces strong effects both on the financial markets and at the social level, puts banks in a position to react.

Over time, the banking sectors in the Balkan countries have faced many challenges, but they have demonstrated adequate preparedness to respond to all risks and have remained stable. As the Western Balkans begin to look beyond the pandemic, the focus of policy will need to shift back to addressing major structural impediments to job creation and economic transformation.

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