



FINANCIAL DEVELOPMENT IN ALBANIA AND NORTHERN MACEDONIA LAST 10 YEARS

Enida Zhugri 

Ph.D. Student at University of National and World Economy,
Department of International Economics Relations and Business, Sofia, Bulgaria
Lecturer at “Aleksander Moisiu” University,
Durrës Albania Department of Finance and Accounting, Albania

Svetlana Koleva Aleksandrova – Zlatanska

Professor at University of National and World Economy,
Faculty of International Economics and Politics,
Department of International Economic Relations and Business, Sofia, Bulgaria
enida.istrefi@gmail.com

Abstract

This paper explores the main indicators of Financial Development in Albania and North Macedonia. Some of the similarities between these two countries are that both of them applied to the EU membership and are potential countries for future EU enlargement. In this countries, the monetary policy plays an essential role in macroeconomic and financial stability. The last three decades, Albanian's and North Macedonia's economy has passed through different changes aimed to establish market economy. The general aim of this paper is to describe some characteristic of the development of the financial sector and monetary policy in Albania and Macedonia. More specifically, in this paper we will examine the main indicators of the banking and financial system, focusing on the profitability of the banking sector, the ownership of this sector, etc. Due to the many structural similarities of these countries, the main conclusion of the paper is that both countries have almost the same level of financial development and the pace of recovery after the financial crisis is the same. This paper makes an analysis of the financial system development through literature review and through analysis on data for Albania and

North Macedonia obtain from respective Central Banks and World Bank Indicators. The data are obtain for the period 2010-2019. The main findings of this research paper to argue that key monetary policy indicators have played a very important role in the financial stability of Albania and Northern Macedonia. According to the data analyses, Albania and Northern Macedonia has a stable financial system.

Keywords: Financial stability, banking sector, macroeconomic indicators, ROA, ROE

INTRODUCTION

The process of globalization, along with all its challenges, has brought a high number of reforms, especially in transition countries during the last 25 years. According to Torre et al (2007), in transition countries, a large part of the population is not a user of banking services. Southeast European countries are also part of the studies on the importance of the financial sector in economic development. The results of these studies show that in almost all countries in transition, economic growth is strongly influenced by the extent of development of the financial sector. The banking sector in Albania and in the Republic of Northern Macedonia has become an increasingly important actor for sustainable development and social welfare in the economy of these countries. The economic importance of banks in a society begins with their structural role of accumulating savings and allocating resources in the economy, in terms of financially credible economic agents. The interest rates applied by financial institutions reflect the level of competitiveness and completeness of financial markets. Furthermore, banks provide the private sector with qualified expertise, enabling financial intermediaries to contribute to reducing risks in the economy. Optimal operational management enjoys quality support from the financial services industry aiming for consistently higher productivity. Banks serve as key actors in formalizing the economy and increasing its positive impact, exercising their role as fiscal agents, a key role in contributing to the reduction of the phenomenon of tax evasion. Banks help reduce transaction costs for the economy and create a more conducive environment for long-term business development¹. When it comes to customer needs, banking products are quite lucrative for individuals, starting with receiving and making payments anywhere in the world, assistance provided for the optimal distribution of personal funds, protection and saving of money, as well as the management and control of them accurately.

¹ Albanian Association of Banks (2018). "The contribution of the banking sector in the Albanian economy"

Scope of the study

This study focuses on analysing some of the key financial indicators and their impact on the financial stability of Albania and Northern Macedonia. This paper serves as a good basis for further studies which should expand the number of countries taken into analysis, include other financial indicators as well as bring data from recent years.

LITERATURE REVIEW

The banking sector helps citizens increase their savings through investment options and time deposits. The relationship between the development of the financial sector and economic growth has always been at the centre of theoretical and empirical research analysis of economists, in the form of contributing efforts to better understand and use more effectively the combined effects and mechanisms of this economic phenomenon in favour of development. Development process financial itself has evolved over time as a result of more efficient and productive financial markets and their growing impact on the development of the country.

The study of the financial sector and the reforms of this sector are the object of study of many scholars. Financial development can be achieved as part of the reforms undertaken to decentralize the system as a transition process (Imeraj. E, 2017).

Financial development in Albania and North Macedonia

Banking System in Albania and in the Republic of North Macedonia

The financial systems of developing countries, as in the case of Albania, are characterized by numerous institutional constraints which impede the effectiveness of these institutions in financial intermediation as well as impede the effectiveness of public policies. In developing countries there are difficulties in transmitting monetary policy due to underdeveloped financial markets as well as weaknesses in the legal system as a whole. Mishkin, (1995), argued that the main role of the monetary policy-making authorities is to make an accurate assessment of the effects of these policies on the economy. One of the main monetary policy mechanisms is the lending channel, and according to this mechanism, the impact of monetary policy extends both on the assets (loans) of banks and on the deposits (liabilities) side. The key point is that monetary policy besides shifting the supply of deposits also shifts the supply of bank loans. For instance, an expansionary monetary policy that increases bank reserves and bank deposits increase the number of bank loans available. A liberal monetary policy that expands lending helps increase private investment, thus increasing overall productivity in an economy.

The economic importance of banks in society starts with their structural crucial role of pooling savings and allocating resources in the economy towards financially reliable economic agents. The interest rates applied by financial institutions reflect the competitiveness and completeness of financial markets. The banking sector in Albania has served as the primary lending source for the economy. Banks' lending to the economy as a ratio to GDP peaked in 2011, before the sovereign debt crisis of the main trading partners. Since then, the lending activity has plateaued manifesting a downward trend, but banks and the central bank are committed to increasing financing.

Albania has experienced a continuous process of consolidation of the banking sector. For most of the 1990s, this process was relatively slow due to the "virus" of pyramid schemes, which had infected the country's economic and financial development. The role of banking intermediation is important, because it enables investment financing and, consequently, supports economic growth directly and indirectly. The direct impact on economic growth is provided by financial intermediation through the provision of funds for the realization of investments and the optimization of intermediate consumption. The indirect impact comes as a result of the multiplier effects that investments have on the economy, the opportunity created by financial intermediation for the more productive use of deposits by small savers, and the increase of social welfare. Several models show the mechanisms through which the financial sector can influence real developments, underlining that financial markets enable "small savers" to allocate their funds to investments with higher returns, lower risk, or more productivity. Empirically, research has shown that financial indicators such as the size and functioning of the financial system are positively related to economic growth.

After the financial crisis of 2009, the banking sector in Albania closely cooperated with the Bank of Albania and the Ministry of Finances to enable the minimization of the crisis's effects on the economy. The purpose of Central Bank of Albania is to support the lending in national currency, and to foster the financial stability towards effective liquidity situation management in the banking sector. During the period after the financial crisis, banks were very vigilant in how to distribute loans. The banking sector also served as the main pillar of government lending supporting public investment financing and government interventions during a time of crisis. Various theories emphasize that the development of financial intermediaries has a positive effect on the development of a country's financial system. These key intermediaries, by channelling funds towards more efficient innovative ideas in the market give impetus to economic growth. The loans provided by these financial institutions are considered essential for the financing of efficient production processes that ultimately generate a high return on the financial position of the companies. Banks help reduce transaction costs for the economy and

create a more conducive environment for long-term business development. When it comes to customer needs, banking products are quite lucrative for individuals, starting with receiving and making payments anywhere in the world, the assistance provided for the optimal distribution of personal funds, protection, and saving of money, as well as the management and control of them accurately.

According to the Albanian and Macedonian annual report of EBRD for 2019, there is a difference in the economic performance of these two countries. Table 1 shows the macroeconomic indicators for these two countries in a period of 5 years which covers the most delicate years.

Table 1: Macroeconomic Indicators of Albania and Republic of North Macedonia

Macroeconomic Indicators	2015		2016		2017		2018		2019	
	AL	N.M	AL	N.M	AL	N.M	AL	N.M	AL	N.M
GDP growth	2.2	3.9	3.3	2.8	3.8	1.1	4.1	2.9	2.2	3.2
External Debt as % of GNI	2.9	2.2	1.4	1.6	1.3	1.4	2.3	1.4	-	-
Exports as % of GDP	27.3	48.7	28.9	50.6	31.6	55.1	31.6	60.4	31.6	62.3
Imports as % of GDP	44.5	64.9	45.8	65.5	46.6	68.9	45.3	72.8	45.3	76.5
Remittances	11.3	3.04	11	2.7	10	2.8	9.2	2.7	9.6	2.5

Source: EBRD, 2019. AL-Albania, N.M-North Macedonia

GDP growth rate is one of the most important macroeconomic indicators of a country. The value of this indicator has been stable in both countries with an average of 3%. In Albania, the average value of the GDP growth rate is 3.12%, where the highest value of this indicator was recorded in 2018 around 4.1%, while the lowest value in 2015 and 2019 around 2.2%. The pace of economic growth has declined in recent years, also due to the negative effects that the financial crisis brought to our country's economic partners, but also the effects of the pandemic that have been felt throughout the globe. For Northern Macedonia, the average of this indicator is 2.8% over the last 5 years. The highest value of GDP growth in Northern Macedonia was recorded in 2015 with about 3.9%, while after this period the country entered stagnation due to political instability.

Trade balance of these countries is negative. The trade deficit for Albania and Northern Macedonia during the period 2015-2019 had an average value around 15.3%.

Remittances, on the other hand, have had a downward trend for both Northern Macedonia and Albania. The economic downturn in these two countries has recently been

affected by the decline in remittance inflows. From the data in the table above it seems that Albania has had higher levels of remittances compared to Macedonia, with a maximum value of them in 2015 respectively 11.3% and 3.04%.

The development of capital market in Albania and North Macedonia

The development of the Albanian financial system, even today after 20 years, operates with only one branch, the banking system, where the capital market is almost completely absent. The banking system, developed mainly by banks with foreign capital and two with Albanian capital, has been the only source of lending to the economy for many years. Problematic has been and is the development and consolidation of a capital market, the Albanian Stock Exchange, where Albanian business, individuals and local government could find alternative financing opportunities, as the banking sector still has restrictions on financing the operations of these actors. Currently, Albania is the only country in the Region that does not have an active Stock Exchange. We need to learn from the best models, where the Anglo-Saxon model has been the most aggressive, risky, but also the most effective. This model is suggested to be followed in Albania, equipped with as complete legislation as possible, to reflect the lessons from the bad European and world experiences. Moreover, the International Monetary Fund has been a stimulus for the creation of the Albanian capital market, as a mechanism to support banks' exposure to treasury bills and investment funds. Also, the consolidation of the capital market would offer Albania more opportunities to global markets and increase the confidence of the European market.

Albania is in urgent need of a Stock Exchange and the ongoing demand of stakeholders for its opening should be taken into account. The fact that several initiatives have been launched by the operators of this new sector is to be welcomed. This is proof that the economy expects and demands this component, but for them not to fail, legal regulation and institutional control are needed. It remains in the hands of the AFSA and the Bank of Albania to monitor and guarantee the development and positive operation of the capital market, as one of the forms to stabilize the supply-demand of capital interest groups. Albania, as an aspiring country for EU membership, must definitely develop the capital market, to increase fair competition and increase opportunities for capital investment and fundraising.

The start of the activity of the Albanian Stock Exchange (ALSE), licensed by the Financial Supervision Authority (FSA) in July 2017, it was one of the main steps for the development of capital market in Albania. At the end of June 2018, the trading volume on the Stock Exchange was ALL 1,263 million. The activity of the Albanian Stock Exchange has expanded in recent years, where its main activity was focused on securities transactions of the

Albanian government debt. At the end of 2018, ALSE consisted of 3 main shareholders, Credins Bank and American Investment Bank, which each own about 42.5% of the shares, and AK-Invest with 15% of the shares. From the statistical data reported in the AFSA, it is noticed that interbank transactions occupy about 81.5% of the trading volume, the rest belongs to transactions with customers. Depending on the decision of the FSA, in the future, the Stock Exchange plans to list and accept for trading other securities.

Strengthen the regulation for financial sector- Law on Banks and Supervision regulation

The financial system in Albania easily overcame the financial crisis of 2008, but despite this the banking system still continues to operate in a not very stable macroeconomic environment. Some of the main challenges that the banking system is facing in Albania is the increase of the level of non-performing loans (especially in 2012-2013 the law enforcement reached the max value with about 24% of the total loans); euroization reached high values especially after the financial crisis; The lack of a capital market is also a significant challenge for our banking system. The trade opening and economic connection with many partner countries of Europe and beyond, affects the real sector and the financial sector of Albania. Despite all the efforts made by the Bank of Albania to improve the regulatory framework of the functioning of the banking system as well as the capital requirements or stress tests it applies, banks still remain vulnerable different to shocks.

As Albania is a potential candidate country for the European Union, it has taken measures to improve financial reporting and the approximation of this legislation with the EU *acquis communautaire*. Some of the most radical changes that Albania needs to make in its legislation are the revision of the Law on Accounting and Financial Statements and the requirements for mandatory audits of financial statements must be fully in line with the *acquis* of the European Union, as this would reduce to some extent the number of audits and would ease the burden on smaller units. Given that the financial system in Albania has many weaknesses and is still in the early stages of its development, stress tests were conducted to assess the resilience of the banking system to the specific risks of its solvency. Most of these tests, which are based on a macroeconomic scenario, emphasize that over 80% of banks in Albania can be undercapitalized in case of unfavourable macroeconomic shocks. As we said above during the period 2013-2015 as a result of the depreciation of the lek against the euro and the dollar, as well as the decline in the level of GDP growth, were accompanied by a deterioration of the bad loan portfolio by up to 24%, which which predicted and stress tests conducted during the period of financial crisis.

The Central Bank plays a crucial role in managing crisis situations that inevitably affect the banking system. The BoA's methodology for crisis management is based on some key points which are addressed to commercial banks:

- To improve methodology to manage risk in specific areas;
- Drafting a strategic plan to effectively monitor future progress and adopt mitigation measures for specific situations.

Macro prudential Framework of Bank of Albania

The BOA has clear macro prudential mandate in the existing legislation to secure financial stability of the banking system. In order to assist the BoA in its main objective of maintaining price stability, in 2006 a consultative body such as the Financial Stability Advisory Group (FSAG) was established, which assists in the management of policies and the exchange of information between the authority of the Ministry of Finance, Financial Supervision Authority and the Bank of Albania. The banking system in Albania operates based on the Basel II regulation, but after the 2008 financial crisis, the BoA is also considering implementing the Basel III liquidity component to strengthen the banking system and reduce the level of bad loans.

The structure of the financial sector in Albania is composed of; Central Bank, commercial banks; savings and loan associations; insurance companies; pension funds, and investment funds. Until the end of June 2018, in the financial system operated 30 Non-Bank Financial Institutions engaged mainly in the field of microcredit, lending, leasing, factoring, electronic money, etc. Below we will briefly present the main components of the Financial System of Albania:

1. The performance of the activity of savings and loan associations has been positive and expanding, both in semi-annual and annual terms. The increase of investments in the banking sector in the form of deposits, and net credit, determined the behavior of savings and loan associations for the period 2018-2019. In June 2018, the market numbered 13 active savings and loan associations.
2. The activity of insurance companies has increased. By the end of the first half of 2018, eleven licensed insurance companies perform life and non-life activities and one reinsurance company. The assets of these institutions marked an annual increase of 4.1%, to ALL 30.5 billion. Investments in banks occupy the main share in the balance sheet of insurance companies, about 30% for the period.
3. The activity of private investment funds shrank compared to the end of 2017, as a result of the decline in the level of investment in government securities. The Albanian financial

system includes 5 active private investment funds. Investment fund assets are mainly invested in treasury bills and bonds issued by the Government of the Republic of Albania in lek and others in euro. As the investment fund market expanded with two new funds, the net value of assets invested in these funds in our country, in 2018, closed with a decline. Official data of the Financial Supervision Authority (FSA) showed that the net asset value of the Funds reached about ALL 66.09 billion, with a decrease of 9.12%, compared to the end of 2017.

- Private Supplementary Pension Funds have expanded their operations during the period. Three voluntary private pension funds are operating in Albania. The value of the assets of these funds in 2018 reached about 2 million euros, or about 16% more than their value in 2017. The main activity of pension funds is focused on investing in securities issued by the Albanian government.

Table 2. The weight of financial system components to GDP in Albania, 2011-2019

Licensing and Supervisory Authority	Financial system	2011	2012	2013	2014	2015	2016	2017	2018	2019
Bank of Albania	Banking sector	88.1	92.1	94.8	97.6	97.3	100.5	99.4	96	95.5
	NBFIs	2.7	2.7	2.7	3	2.9	3	3.1	3.5	4.2
	SLAs and their unions	0.8	0.8	0.7	0.8	0.8	0.6	0.6	0.6	0.7
Financial Supervisory Authority	Insurance companies	1.5	1.6	1.7	1.9	2.1	2.1	2.1	2.1	2.2
	Pension funds	0	0	0	0	0.1	0.1	0.1	0.2	0.2
	Investment funds		1.2	3.9	4.8	5	4.7	5	4.5	4.3
Financial intermediation		93.1	98.6	103.8	108.2	108	111	110.3	106.9	107.2

Source: Albania Central Bank, 2019

By composition, loans for the consumption of non-durable goods represent the largest share in consumer credit, by 54% at the end of 2019, and this share has been

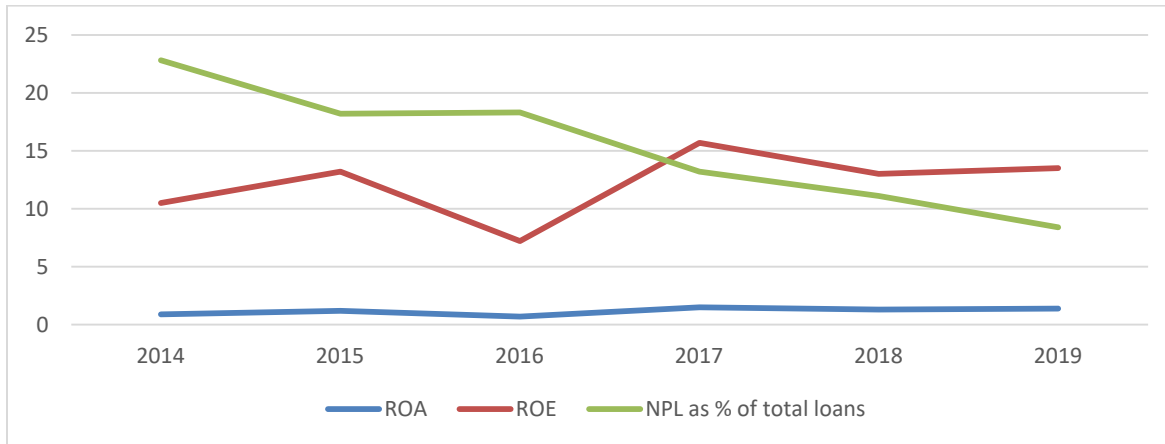
increasing over the past years. On the other hand, “overdraft” loans account for the lowest share in the consumer credit stock at 13% in the end of 2019, and this share has been shrinking. As consumer loans are characterized by a smaller principal and shorter maturities compared to housing loans, the composition of their outstanding stock in the banks’ balance sheet may change more rapidly. Consumer loans in ALL dominate in the portfolio of banking sector. At the end of 2019, consumer credit in foreign currency accounted for 13.7% of consumer credit. More than half of consumer loans in foreign currency (about 58%) is classified as unhedged against exchange rate risk, however the latter account for only 8% of consumer loan stock.

From the borrower’s solvency point of view, the risk that comes as a result of unfavourable exchange rate fluctuations remains limited. In terms of credit quality, consumer credit has historically had lower levels of non-performing loans, despite its higher-risk nature. The ratio of non-performing consumer loan has followed a downward trend since 2013, marking its lowest value at the end of 2019. Also, consumer loans contribution to the growth of total non-performing loans stock has been minimal. Albania has experienced an increasing trend of consumer lending from various sectors of the financial system, where the banking sector continues to play a dominant role. Credit demand, especially for the consumption of non-durable goods, played an important role to the expansion of consumer credit.

However, in Albania, the risks arising from the expansion of consumer credit are mitigated by its low weight. Although the current level of risk remains low and controlled, macro prudential policy actions should be forward-looking, aiming to prevent and mitigate the accumulation of risks that could lead to elevated levels of stress in the financial system.

The Albanian banking sector has managed to maintain positive profitability, despite the financial crises and sovereign debt affecting neighbour countries. Of course, the negative effects of the consequences of the economic crisis were transmitted to the economy, but this did not affect the overall health and stability of the banking sector. However, the financial crisis 2008-2009 has negatively affected the profits of the banking sector, leaving consequences in 2011. By 2019, the total assets (assets) of the banking sector in Albania reached the value of about 95% of GDP. The following chart presents the trend of the main indicators that measure the health of the banking system, the return on assets; return on equity of shareholders as well as the level of non-performing loans (NPL) during this period.

Graph 1. The profitability of the Banking Sector in Albania



Source: Annual Report, Bank of Albania, 2019

The banking sector has maintained an upward trend during the 2015-2019. Thanks to the healthy financial conditions of the banking sector, the financial crisis did not affect the growth of this sector in assets, which already reach almost the level of the value of the country's GDP.

In Albania, the stability of the banking system was stimulated by the significant decline in the level of non-performing loans (NPL) during the last 5 years. The highest level of NPL was recorded during the period 2013-2014 where on average their level goes to 23% of total credit. While after this period the level of not performing loans has been reduced, reaching the lowest historical level in 2019 with about 8.4% of total credit. Return on equity of the banking system in Albania has had a fluctuating trend from year to year, but after 2012 the return on equity has been higher compared to the period after the financial crisis. The average return on equity (ROE) is 12.2%, while the average return on assets (ROA) for our banking system in the last 5 years is 1.2%.

Stock Exchange regulations in Northern Macedonia

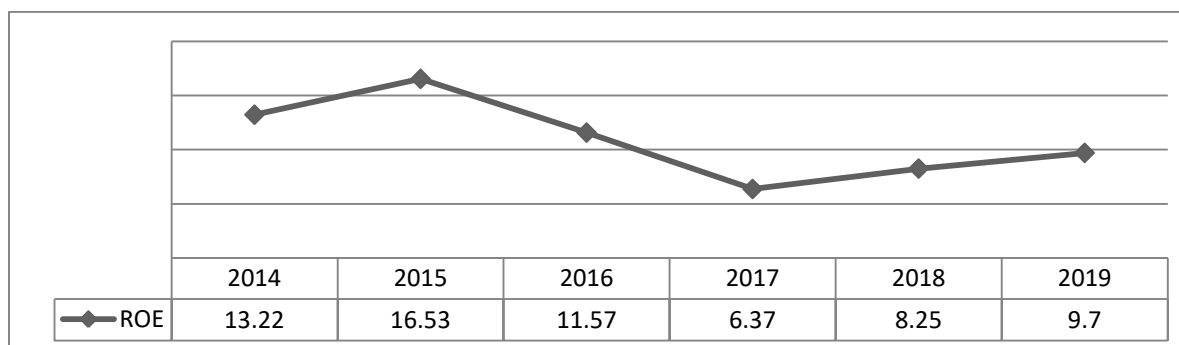
The capital market of Republic of North Macedonia is associated with structural changes in the 1990's, crossing the country's transitions to free market economy. The process of privatization has resulted in the formation of more joint stock companies, which raised the need for creating appropriate market infrastructure for the transfer of newly created securities. The official start of trending on Macedonia Stock Exchange (MSE) occurred in 1996. That was the year that limiting factors were detected for the development of secondary market securities. Thus factors were the impetus for the stock unit to initiate permanent solutions for developing trade and market expansions of securities in general. The years that followed showed that the

stock market grew gradually, along with the economic development and intensification of reform. With the introduction of the mandatory listing on the Macedonia Stock Exchange, the companies were obligated to submit periodic and annual financial reports. The “Listing Rules” is the basic act that imposes obligations and requirements for financial and corporate reporting for the listed companies of the MSE.

The financial system in Macedonia consists of the National Bank of the Republic of North Macedonia (NBRNM), commercial banks, financial companies, savings houses, exchange offices, the Deposit Insurance Fund, insurance companies, pension funds, investment funds, brokerage firms, and a stock exchange². If we compare it with Albania, the Republic of Northern Macedonia also has a banking system divided into two levels, the function of which is based on the Law on Banks and the Law on the National Bank. The National Bank of the Republic of North Macedonia has as its main objective the maintenance of price stability, the drafting of monetary policy and supply, the drafting of the exchange rate policy as well as the management of liquidity for payments inside and outside the country. In total, the RNM has 14 commercial banks, the Central Bank (Macedonian Bank for Development Promotion) and two savings banks.

A key relationship, which largely depends on the stability of the financial system, is the banking system. This is primarily due to its size, as it accounts for 83% of the financial system assets, although its share tends to slow down. As we can see in the chart, the return on equity indicator for the banking system in Northern Macedonia has been declining during the period 2015-2017. This can be explained by two main reasons: first, the financial crisis had an impact on the banking system of Northern Macedonia, reducing this indicator, and second, the political instability in the country led to a lack of credibility of individuals in the banking system.

Graph 2. The Return on Equity in Northern Macedonia 2014-2019,



Source: IMF, 2019

² <https://www.export.gov/apex/article2?id=North-Macedonia-Banking-Systems>

The banking system in Northern Macedonia maintained its stability. Banking activities, affected by the uncertainty in the internal environment and economic stagnation, increased slowly, mainly due to the slower growth of deposits of non-financial entities. Uncertainty in the internal environment caused economic agents to have restrained tendencies from investing activities, which in turn conditioned on a generally reduced demand for credit. In 2017, there were no significant changes regarding the banking system's exposure to operating risks. The risks from non-performing loans are not large, given the fact that banks offer high coverage in depreciation, as well as during their eventual repayment will not affect the solvency of banks. During 2017, the liquidity of the banking system slightly improved, causing the capital adequacy ratio to reach 15.7%. The high level of quality of assets available to banks enabled easy adaptability in meeting the new capital requirements that were brought to implement international standards in this area (Basel 3), which aims to strengthen the resilience of banks and the banking system. The liquidity of the banking system is satisfactory, enabling banks to carry out a profitable activity. In 2017, banks began activities to abandon the implementation of clauses for unilateral changes in the contractual interest rate for new loans and deposit agreements. This, in turn, increases transparency in customer relations and contributes to reducing the authoritative and legal risk of unilateral application of appropriate interest rates.

But, on the other hand, it will contribute to a greater impact of market variables, mainly the movement of market interest rates, the design of products and services offered by banks, and consequently the achievements of their activities. Such a change imposes the need to strengthen the capacity of banks to manage interest rate risk, to design the products and services they offer, and to set their prices according to the risk profile of customers, as well as expectations for future movements in the economy.

Another problem facing the banking system in Albania, is the high level of "euroization". In 2018, foreign currency loans (mainly in euros) accounted for 57% of total loan portfolios, from 72% in 2008, according to data from the Bank of Albania. Foreign currency deposits accounted for 53% of the total, up from 43% in 2008. Banking authorities are concerned about the high percentage of euro loans, as these are usually not protected from adverse exchange rate movements (income of borrowers are almost always in local currency in lek). Therefore the Central Bank wants to reduce their number to about 40% of the total. It has set relatively stricter requirements for banks for liquid assets in foreign currency compared to those in lek and is trying to raise citizens' awareness of the risks associated with euro loans.

At the end of 2019, the structure of the banking and financial system in Albania consisted of 12 banks, from which 8 are with foreign private capital and 4 others domestic and

foreign private capital³. The banking system's share in the economy, measured by the ratio of total assets to the Gross Domestic Product (GDP), continues to stay at high levels. This ratio decreased by 1.43 percentage points this year, standing at 87.92%⁴. Meanwhile, the loan to Gross Domestic Product ratio fell due to the growth of GDP against the decrease in the loan portfolio⁵.

Table 3. Banking system total assets and loan portfolio's share in GDP

Indicators	2014	2015	2016	2017	2018	2019
Total Assets (in billion)	1293.7	1318.1	1407.3	1445.3	1453.5	1475.6
Total Assets/GDP (in %)	91.56	91.33	95.05	92.5	89.35	87.92
Total Loans/GDP (in %)	42.12	40.61	40.55	38.46	35.71	34.31

Source: Bank of Albania, 2019

According to the annual Supervision Report, the three major banks (Raiffeisen Bank, National Commercial Bank and Intessa Sanpaolo), occupying 55.68% of assets (CR3), whereas as we said above this value should be around 18.75 %, in the case of full competition. We can conclude a complete avoidance of competition and the increase of market concentration in assets is about 3 times higher. Also based on the estimates of the Bank of Albania for specific weights of each bank, Raiffeisen Bank is the bank that owns most of the assets in the market, 28.28%, or more than a fifth of the total.

Table 4. Key banking system indicators of Albania and the Republic of Northern Macedonia (comparison).

Indicators	Albania	Northern Macedonia
Composed of Financial System	The financial system in Albania is composed by banks, insurance companies and other credit institutions.	The financial system in Macedonia consists of the National Bank of the Republic of North Macedonia (NBRNM), commercial banks, financial companies, savings houses, exchange offices, the Deposit Insurance Fund, insurance companies, pension funds, investment funds, brokerage firms, and a stock exchange.

³http://www.ijhssnet.com/journals/Vol_2_No_12_Special_Issue_June_2012/25.pdf?update/journals/Vol_2_No_12_Special_Issue_June_2012/25.pdf

⁴<https://www.sciencedirect.com/science/article/pii/S0047272797000571>

⁵<https://www.sciencedirect.com/science/article/pii/S0047272797000571>

ROA	In Albanian banking sector recently Return on Assets was significantly increased.	The same for Northern Macedonia banking sector, these indicator, return on Assets, was increased in this last years.
ROE	In Albanian banking sector recently Return on Equity was significantly increased. From 10.5% in 2014 increased to 13.5% on 2019.	The return on equity indicator for the banking system in Northern Macedonia has been declining during this period. This can be explained by two main reasons: first, the financial crisis had an impact on the banking system of Northern Macedonia, reducing this indicator, and second, the political instability in the country led to a lack of credibility of individuals in the banking system.
NPL (Non-performing loans)	NPL in Albania during the last 10 years was decrease from year to year. NPL decrease from 22.8% on 2013 to 8.45 of GDP in 2019.	NPL in Northern Macedonia ratio has been decreasing at 5.2% in 2019, which is below the NPL average for the region.
The banking system's share in the economy.	The banking system's share , measured by the ratio of total assets to the Gross Domestic Product (GDP), continues to stay at high levels. This ratio decreased by 1.43 percentage points this year, standing at 87.92%.	The banking system's share measured by the ratio of total assets to the Gross Domestic Product (GDP), continues to stay at high levels around 90%.

CONCLUSIONS

Albania and Northern Macedonia have much in common features. It is important to note that both economies undertake financial sector reforms monitored from EBRD and both are potential candidates of EU. Therefore, having the same goal these economies can be perceived that go parallel.

- In Albania, **the stability of the banking system** was stimulated by the significant decline in the level of non-performing loans (NPL) during the last 5 years. The highest level of NPL was recorded during the period 2013-2014 where on average their level goes to 23% of total credit. While after this period the level of not performing loans has been reduced, reaching the lowest historical level in 2019 with about 8.4% of total credit. Return on equity of the banking system in Albania has had a fluctuating trend from year

to year, but after 2012 the return on equity has been higher compared to the period after the financial crisis. The average return on equity (ROE) is 12.2%.

- **Loans and deposits growth rates in North Macedonia was** a slowdown in 2016 as a result of the political crisis and uncertainty, but have been recovering since 2017. NPL (Non-performing loans) ratio has been decreasing at 5.2% in 2018, which is below the NPL average for the region. Furthermore, the NPL portfolio is well covered, with an NPL coverage ratio of 110.2% in 2018. The banking system in Northern Macedonia maintained its stability.
- **GDP growth rate** is stable it is average of 3%. In Albania, the average value of the GDP growth rate is 3.12%, where the highest value of this indicator was recorded in 2018 around 4.1%, while the lowest value in 2015 and 2019 around 2.2%. For Northern Macedonia, the average of this indicator is 2.8% over the last 5 years. The highest value of GDP growth in Northern Macedonia was recorded in 2015 with about 3.9%, while after this period the country entered stagnation due to political instability.
- **In terms of the trade balance**, its value for the two countries reviewed above has resulted throughout the period in negative values. The trade balance is negative for most consumer goods. The trade deficit for Albania and Northern Macedonia during the period 2015-2019 is about 15.3% average.
- **Remittances**, has a downward trend for both Northern Macedonia and Albania. The economic downturn in these two countries has recently been affected by the decline in remittance inflows. Albania has higher levels of remittances compared to Macedonia, with a maximum value of them in 2015 respectively 11.3% and 3.04%.
- **Money supply in Albania continued to expand.** The increase in the monetary mass was supported by the government's high flows in foreign currency, in addition to the support undertaken by the Government and the Bank of Albania to stimulate lending, in the context of coping with the consequences of Covid-19. The growth rate of broad money, aggregate M3, accelerated to about 7.9% in the third quarter of the year (2019). The money holding structure continues to reflect the shift towards the liquid component, both in currency outside banks and in demand deposits. Money creation in the economy is faster for the domestic currency, supported by increased government activity and lending in domestic currency.
- The decline in **broad money supply** during the period 2014-2017 in Northern Macedonia was mainly due to the uncertain political environment in the country. While in Albania this indicator has had significant fluctuations from one year to another with an average value during this period of about 4.28%. The maximum value of broad money in

Albania and Northern Macedonia was recorded in 2010, respectively 12.5% and 11.6% for each country.

- **Rapid credit growth** was a common feature of transition countries especially after the 2000s, but it changed on the opposite side after the onset of the financial crisis. Classified by currency, the interest rate on Albanian currency loans continues to be higher, but this interest rate has shown a marked downward trend over the last year. In June 2020, the interest rate on loans marked 5.4%, from 6% a year earlier. The stability of the financial market and low-interest rates have been a factor that has helped control the impact of the crisis on the Albanian economy. *The policy of the Bank of Albania may have had a significant impact, lowering the key interest rate to the new historical minimum level of 0.5% and enabling unlimited liquidity supply to banks.*
- **Credit to the private sector in Albania** has had a downward and upward trend in recent years but in stable values with an average of about 37.5%, where the highest value of this indicator was recorded in 2011 about 41.2% and the lowest level was recorded in 2018 by 33% of GDP. While for **North Macedonia** this indicator has had higher values compared to Albania, where the average value of this indicator is 43.8%, the highest value was recorded in 2015 with about 52% while the lowest value in 2013 with about 47 % (for the observed period).
- **Loan interest rates for both countries have been declining.** The Central Bank of Northern Macedonia in the last 10 years has pursued a more liberal policy with interest rates, offering lower rates for lending and thus encouraging investment in business and borrowing from households. While the Central Bank of Albania has followed the same policy by lowering interest rates on loans, but interest rates on loans in Albania are higher than lending in North Macedonia.
- ***In 2019, the interest rate on loans in Albania was 0.6% higher compared to Northern Macedonia, respectively 6.2% and 5.6% for each country.***
- According to the latest reports published by the Bank of Albania in 2019, monetary policy continues to contribute positively to a financial environment with a low-interest rate and an annual inflation rate of 2%.
- ***In particular, a high degree of euroization*** (as the case of Albania and North Macedonia) reduces the effectiveness of the monetary policy, because it influences the equilibrium of money demand and money supply in the domestic economy and thus makes less effective central bank money supply and demand coordination.

REFERENCES

- Bank of Albania, "Monetary Policy First Trimester Report 2019"
- Cecchetti Stephen G., Krause Stefan, 2001. 'Financial Structure, Macroeconomic Stability, and Monetary Policy'. National Bureau of Economic Research, Working Paper, No.8354.
- EBRD (2019). Transition Report 2019. European Bank for Restructuring and Development, London.
- EBRD. (2014). Macedonian Annual Report. European Bank for Reconstruction and Development.
- Elbourne, Adam, de Haan, Jakob, Kiviet, Bas M.C., 2003. Financial Structure and Monetary Policy Transmission in Transition Countries. Mimeo, University of Groningen.
- Erinda. I., (2012). Comparative perspective of financial sector development of two EU candidate countries in transition: Albania and Macedonia.
- Financial Stability Report, (2019). Macro-prudential policy and risk assessment.
- Golubovic, S., & Golubovic, N. (2005). Financial Sector Reform in the Balkan Countries in Transition. Economics and Organization. , 229-236.
- Imeraj. E., (2018). Comparative Perspective of Financial Sector Development of Two EU Candidate Countries in Transition: Albania and Macedonia
- IMF working paper, (2017). Financial sector assessment update-Albania
- Lorena, S. (2020). Sektori financiar dhe nderlindhjet makroekonomike ne makromedelin ekonomik shqiptar. Bank of Albania
- Magdalena Petrovska Ljupka Georgievska. (2018). Alternative indicator of monetary policy stance for Macedonia.
- Mishkin, F.S. (1995). Symposium on the Monetary Transmission Mechanism. Journal of Economic Perspectives. Vol. 9 No 4
- Piotr Zuk, et al., (2018). Real convergence in central, eastern and south-eastern Europe.
- Torre, A. T., Gozzi, J. C., & Schmukler, S. L. (2007). Financial Development: Maturing and Emerging Policy Issue. The World Bank Research Observer , 67-102

APPENDIX

List of abbreviations

NPL	Non-performing loans
BoA	Bank of Albania
Lek	Albanian currency
PIE	Public interest entities
ELA	Emergency liquidity assistance
MoF	Ministry of Finance
MSE	Macedonia Stock Exchange
ALSE	Albanian Stock Exchange
FSAG	Financial Stability Advisory Group