

Credit –to- GDP gap as an early warning indicator of banking stress in Albania

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Abstract

This paper investigates the performance of credit-to-GDP gap as a potential early warning indicator of systemic banking distress in the case of Albania. Following the “signal extraction approach” by Kaminsky and Reinhart (1999), we test the early warning abilities of indicators of credit-to-GDP gap for total credit to private sector, credit to households and credit to firms, computed using one sided HP filter with different smoothing parameters. These indicators are tested upon various thresholds and time horizons. We find that credit to GDP gap for total credit to private sector, computed using HP filter 25000 or 400000 work best as EWI in terms of our evaluation criteria and up to years ahead of a potential episode of distress or crisis.

Keywords: early warning indicators, credit-to-GDP gap, banking stress, signal extraction approach.

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European Journal of Economics, Law and Social Sciences ISSN 2519-1284 (print) ISSN

2510-0429 (online)

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