

Ardian Fullani: Regional financial markets and financial stability

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the Bank of Albania's 6th International Conference, "Regional financial markets and financial stability – a concept between national sovereignty and globalisation", Tirana, 30 October 2006.

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Honorable Mr. Prime Minister,
Honorable Colleagues,
Honorable participants!

It's a great pleasure and a privilege to open the proceedings of the Sixth Annual Conference of the Bank of Albania and to welcome you in Tirana.

This conference will focus on financial stability. The analysis and understanding of imbalances in the financial markets and of their causes is essential in central banking. The extent of social benefits and advantages that money, as a public good, creates for the society is dependent on the efficiency and capacity of financial markets to facilitate trade, production, capital accumulation, economic growth and social welfare.

Therefore, financial stability may be regarded as a "public good" and hence represents a public economic policy objective. The question is who is in charge of providing this good? Personally, my attention has been drawn by Paul Volker who describes the natural role of central banks in ensuring the financial stability. The central bank's traditional role, as lender of last resort on one hand, and as monetary policy authority on the other, requires that central banks ensure financial stability in both standpoints as a provider and a beneficiary. Our role of monitoring the contagion process and financial and monetary crises, illustrates this idea very well. At the same time, the monetary transmission mechanism is another factor that witnesses the vested interest of the central bank in preserving the soundness of the financial system.

The developments observed in the last decades, and particularly in the '90, brought the importance of financial stability to the fore and highlighted its key position among the most important economic policy objectives assigned to monetary authorities across the world. In spite of the emphasis and the vast literature on the issue, it is difficult to give a widely accepted definition of "financial stability". Definitions of well-known academics and colleagues describe financial stability as a set of decisions and policies that deal with macroeconomic, monetary, supervisory aspects of economy and regulations of financial markets. I am confident, that those characteristics of financial stability will be widely covered in the proceedings of this conference.

After a long deliberation of literature, I chose Garry Schinasi (2005) to define the financial stability, and I quote him: "*Financial stability is a condition, in which an economy's mechanisms for pricing, allocating, and managing financial risks are functioning well enough to contribute to the performance of the economy*"¹. This definition implies that the financial system is capable of accomplishing appropriately its three main roles. Firstly, the financial system is capable to achieve effective distribution of economic resources over time. Secondly, it identifies and manages appropriately financial risks. Thirdly, it can softly absorb shocks and surprises that occur in the financial system and the real economy.

I think that the goal of this conference is to analyze financial markets concentrating on these three aspects, and to steer our efforts towards evaluating and guaranteeing the achievement of financial stability in our region. Our economies are quickly developing, and they are experiencing rapid changes, and we, as representatives of central banking in our countries, must adapt to these changes and promote growth without losing sight of prudential supervision. Latest trends towards expansion, liberalization and privatization of the financial system in the context of a fast-paced globalization of the world economy have put the goal of financial stability on top of the priorities in our region.

During the last few years, the financial sector has recorded positive growth rates in all countries in our region. However, I think that the merit for such a growth goes to the most vital segment of the financial

¹ *Safeguarding Financial Stability, Theory and Practice (2005), International Monetary Fund, page 83, last paragraph.*

system, that is, the banking system. The key factor to the successful growth and consolidation of the banking system has been the rapid privatization of banks, which is, at present, almost complete. This process has opened the way to the arrival of well-known international banks that have brought foreign capital, expertise and confidence in the region. The entry of those banks, besides the positive aspect of fostering growth and development, calls for higher prudence in the supervisory role of the central banks.

As a result of the above developments, the degree of financial intermediation in our region has further increased. Credit to economy has played a considerable role towards the deepening of financial intermediation. Albania has recently joined the group of countries experiencing a credit boom, as annual growth rates have been in the range of 60-70 per cent in the last two years.

An interesting indicator of banking system transformation is the EBRD indicator regarding “*banking system reform and liberalization of interest rates*”, which combines the quality of supervisory and regulatory base, the ownership structure of banking system and the degree of public access into the banking system. Based on latest data, Southeastern European Countries have progressed admirably with regard to their banking systems. It is crucial to understand that transformation of the banking system has been a key element in the long transition to a market economy. I want to emphasize that this process has brought development, has strengthened the macroeconomic stability, by positively influencing institution built-up and its consolidation, by encouraging faster structural reforms and the set up of regulatory frameworks related to economic policies.

Giving a glance at the Albanian banking system, I would emphasize that qualitative developments have taken place during 2006. The banking system assets during eight first months of the year have been increased by 12 percent and are estimated at about 60 percent of Gross Domestic Product. The banking system results in profit, is liquid and capitalized. I would like to mention the entry of a new bank in our system, the Sao Paolo IMI Bank, which, besides its shares at the Italian-Albanian Bank, has preliminary agreed with the owners of American-Albanian Bank to buy its 80 per cent of the shares. This opens the way to further consolidation of the banking system in Albania.

Now, let us give a glance at the rest of the financial system. It should be accepted that it still manifests problems of development and consolidation. The concerns relate to the magnitude of operators, the regulatory framework and particularly the supervision. In this way, their contribution to financial intermediation is low.

It should be understood that, besides our role, the establishment and consolidation of the financial stability can not be ensured only through banking supervision. Therefore, further to FSAP recommendations for a more updated supervision and regulation, the new public agency of financial sector supervision is established. **We as the Bank of Albania are deeply open to provide our assistance, so that the financial vigilance precedes the development.** This will precede the expected developments in the insurance companies, pension funds, financial mediators in general.

Elaborating this matter further, I would briefly bring up some weaknesses of the financial systems in the region.

Financial systems in all countries of the region are still dominated by commercial banks. Other segments play a second hand role. Capital markets, despite the recent developments, are still lagging behind. The number of banks in our region is relatively high. Taking into consideration the size of economies in our region, **there is space for further consolidation**, mainly through mergers and acquisitions. On a regional level, notwithstanding the credit growth rates, outstanding credit as a share of GDP is small compared to that of the new members of EU. This shows that banking sectors have a limited role in financing the needs of the economies for investments. One of the main factors slowing financial intermediation growth is the high intermediation margin of interest rates between loan and deposit rates.

This phenomenon could be the result of several developments, among which we can mention the lack of efficiency and competition among banks, the crediting risk that still remains high, problems with the collateral, and problems in the functioning of the rule of law as well as other issues of similar nature. The low level of efficiency and competitiveness in banking activities is also reflected even by the high capital adequacy ratios. The injection of foreign capital in our countries has remained low, showing, among other things, the inability of our financial systems to facilitate the absorption of foreign investments in our national economies. The absorbing capacities can be improved significantly, if investors and banks conceive their strategies in regional level and not fragmented in separate

countries. In this way, the financial system may serve as an accelerator of the inevitable process of the region's integration to the European Union.

Dear honorable participants,

I believe our mission is vital to our future. What I have just said should not be linked only to the issues already mentioned above but to a greater goal, to that which for the moment has become the main aspiration of each country in the region, to the European integration. Mr. Trichet has emphasized that *“the speed at which South-East European countries progress towards accession to the EU depends on the policies followed. It is the culture of stability and the exercise of the responsibility in economic policy making that are the crucial ingredients to achieve the bright prospects that lie ahead for the region”*.

Personally, I have often mentioned in my public speeches that the opportunities of the region for quick and stable prosperity are linked, among other things, to our capability to act as a team. In line with that, we do not exclude financial stability in all its complexity.

It is a pleasure for me to observe that in the field of central banking, through our activity in the last couple of years, we have achieved a fruitful and productive cooperation. The presence of the regional Governors in the Conference of the Bank of Albania makes the case evident.

I am confident that I share the same opinion with my colleagues present in this room, that financial stability is a delicate matter that must always be part of our agenda. Today, the Bank of Albania is honored to act as the host of this event, but I am sure that in the future this forum will be hosted by other countries in the region.

I believe that this conference today opens a door, which I consider a door of the region. On this occasion, I would like to ask you to consider this conference not only as a sign of the willingness for cooperation. I think that it is our obligation and responsibility to identify future priorities for consolidating the financial stability in the region, as an important precondition towards its European integration.