Ardian Fullani: Financial stability issues and cooperation at a regional level

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, 31 October 2006.

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Dear participants,
Ladies and gentlemen,

When we thought about the topic of this annual conference, there was no doubt about the need to dedicate it to financial stability issues and the cooperation at a regional level. The current time seem to be appropriate because of the developments in the national financial markets and economic developments, as well as in the speed with which the region is moving ahead in adopting best international standards in good governance, market openness and integration, technological improvements and multilateral cooperation.

In my speech today, I will touch upon similarities and differences, but also uncertainties and risks that our financial markets are experiencing in the path toward modernisation and integration in the global financial markets, and will try to address the importance of regional cooperation in better facing these challenges. I will conclude with some thoughts about practical regional cooperation, which I am sharing with you, hoping to generate further discussions.

At a regional level, our countries are experiencing nowadays a higher growth rate of the financial markets, compared to that of the economic growth. As a consequence, the weight of the financial sector in the national economies, strictly from a quantitative perspective, is growing. At the same time, expansion is accompanied with changes in the market ability to better accommodate market participants needs for funding, diversification and risk appetite. Undoubtedly, institutional participants in the financial markets find themselves with a larger number of possibilities for business developments and financial specialization.

In addition, general public interest in using financial market products and services has increased dramatically based on the benefit they perceive from improved efficiency in everyday life activities. These developments highlight the importance of financial markets for our economic well-being, from a qualitative perspective. Let's also recall that economic improvements trigger and support changes in social and cultural aspects of our life, bringing our nations closer to international values and principles, and to each other.

As expected, because of the historical background, our countries have differed in the speed and in the depth, with which they have moved along the transition phase in the last decade. While we had many similarities in adopting the first basic and urgent reforms including price liberalization, enterprise restructuring and privatization in some economic areas, we were more distinctive in completing other reforms that would allow for institutional building capacities, which on the other hand, would make these changes root deeper in our societies.

Today, our countries enjoy stable macroeconomic environments. We are experiencing low inflation levels, stable exchange rates, a more prudent and responsible fiscal policy associated with limited and manageable budget deficits. National Central Banks have established their independence and are perceived in public as respectable and reliable authorities. There are also common efforts to fully open our economies and to attract foreign capital. As we are in the process of fully opening our markets, we are benefiting from increased competition, improved productivity and efficiency, and increasing quality of services for our citizens.

But, we are also facing several uncertainties and risks. Markets remain segmented and their infrastructure faces difficulties in supporting new and imposed developments. Market infrastructure deficiencies exacerbate their shallowness and make it difficult for various market participants to act in order to meet their business objectives and manage their risks. The technological improvements have to fully show their effect in meaningfully reducing costs of financial services. Regulatory gaps in different areas of local financial markets create the conditions for regulatory arbitrage and may adversely affect the supervisory work.

Therefore, erroneous and costly decisions are unavoidable. The financial situation of single market participants, due to market segmentation, is highly affected by their capacity to find financial support in the international financial markets. In reality, this leads to an increasing gap among so called “big” and “small” or among foreign and locally owned financial institutions. Real economy development is an additional source of risk for financial markets.

Such interaction should be carefully watched to better understand financial market trend in the future and identify financial imbalances in a country and regional level. Indeed, we are all experiencing a construction “boom”, where residential house prices have increased considerably. In some countries this is fuelled by credit expansion but in the whole region there different views whether this is affordable. At the same time, the pace of general credit expansion, particularly for consumption and in foreign currency is alarming and is forcing us to think of several “what if” scenarios and take preventive actions.

It is our task as monetary and supervisory authorities, to provide a proper environment for a balanced and stable development of our financial markets. This is not an easy task for us, especially when there is no simple indicator to measure our success in achieving financial stability, and when we realize that this is a multifaceted issue that we do not fully control, and even can not fully predict. Above all, pursuing the target for financial stability is a never ending race, where the “finish line” is continuously moving ahead of us.

We have to find and implement appropriate policies, knowing that these policies represent a trade-off between making the system more resilient on one side and affecting its short-term efficiency on the other. In this challenge we must bring in the financial market industry through consistent communication and promote the adoption of the international standards in good governance a proportionate or risk-based supervision.

Based on our legal responsibilities, we have to approach these challenges in a national level. But, due to increasing liberalization of both labour and capital movement, and herd behaviour of financial market participants, we understand that that is not sufficient. We have nowadays in our countries the same financial institutions and the same behaviour of such financial institutions in response to a centralized business development policy, growing cross-border interaction among businesses and households, similar trends in social life.

Monetary and supervisory authorities in different countries in the region, to a large extent have responded to such developments with establishing formal cooperation with home country supervisory authorities, particularly in the area of banking system supervision, by signing bilateral Memoranda of Understanding (MoU). The fact that our countries are at the borders of the European Union (EU) has caused an increased presence of EU financial institutions, including banks.

Hence, the MoU’s have been signed with these EU countries supervisory authorities. The quality of cooperation varies in different countries but one can say with reasonable confidence that the willingness of the host countries to cooperate has not always met the same interest from our counterparts. To an extent this is expected, because the assets of their banks in our single countries sometimes represent only a fraction of their total assets. Nonetheless, they should take notice of our concern that this cooperation is very important for us, particularly in cases where these foreign banks dominate our local markets.

The liberalisation of the financial markets in Albania has been a desirable move. We consider the inflow of foreign capital an important factor to upgrade the level of our banking system, improve its efficiency and the quality of its products, by improving competition conditions in the marketplace. In most cases, foreign banks have brought with them the expertise and the mentality of modern business development from the more developed countries they come from. As Mr. Bini Smaghi mentioned in his key note speech, the increase of foreign presence in our financial market has also triggered new ideas on how financial institutions and particularly banks intend to adjust their business volume and size to position themselves better in the marketplace. But this is something where we would like to see a more active and consistent approach, in both establishing active business development policies and bringing in good quality and experienced management in applying those policies.

It is indispensable for our supervisory authorities to be informed of the policy of different important financial or banking groups that operate throughout our region. Host to host cooperation can help in this regard because some of us enjoy better communication links with the home country supervisory authority and they can share this information with the rest of the supervisory authorities in the region, within ethics and transparency principles. In practise, this can turn out to be a very valuable approach, because these regional foreign banks tend to adopt similar policies in countries with similar characteristics.

Another area where we could establish a strong cooperation is the discussion that should occur when any of us is adopting certain measures that are intended to control risks that appear from trends in the financial business developments. In return, we would be able to adopt similar supervisory policies, thus reducing damaging regulatory arbitrage possibilities and other risks associated with it.

One implication of the supervision/regulation heterogeneity across counties in the region is the ineffectiveness of indirect measures to control for credit growth. Therefore finding ways and pushing homogeneity in this regard would at the same time be also important to compensate the lost effectiveness of monetary policy and the eventual demand pressures.

There are also a few other ideas that stress the importance of pre-emptive regional cooperation, in bringing us as a region closer to fulfilling our target of European integration. By setting up and pursuing coordinated financial market development policies, we help to integrate our national financial markets into the international financial markets, and pave the way for other economic and social reforms to follow.

The modalities of such cooperation vary. Ad-hoc periodical meetings of Governors in the region, supported by more frequent meetings in a technical level to support the discussion agenda, could be one way of approaching the objective for stronger cooperation. In addition, through a more consistent communication, we can try to identify particular issues which are relevant for our regional financial markets, and pose those issues to our counterparties, being common home country authorities, other supervisory authorities where we turn for assistance, or even professional organizations where our supervisory authorities participate. I am sure our concerns can be taken more seriously if raised as a region. Furthermore, we must avail of the efficiency provided by the technology, in sharing our information.

A joint web-site can be established, where we can find important information, interpretations, or share its experience regarding supervisory issues or financial stability issues. When mentioning this ways of cooperation, I am not trying to neglect what is already happening and I am mindful of the fact that there is a trade-off between the advantages of such cooperation and its costs.

We should also point out that Memoranda of Understanding’s can not act as a substitution for cooperation in practice. It is important we maintain close contacts with our counterparts, on exchanging regular information on general trends and issues of respective banking systems in normal times, as it serves to establish confidence for future cooperation, particularly during distress times. Otherwise, such official cooperation agreements will do little in making a real difference.

Let me conclude by saying that the objective of reaching and maintaining the financial stability is not an easy task but we could contribute a lot in its achievements by enhancing our efforts to make sure that financial market institutions are performing soundly in a stable macroeconomic environment. Our contribution can be much more effective if it is properly coordinated regionally.

Such cooperation will ease our efforts in improving supervision capacities, avoid cross-border regulatory arbitrage and will serve our efforts to meet our objective of integration in European financial markets. We can enrich the modalities of such cooperation, keeping in mind that the basis of good cooperation is established in normal times, through regular contacts.

Thank you.