

## **Ardian Fullani: The banking system – promoter of economic development**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the regional meeting “The banking system – promoter of economic development”, Kukës, 12 September 2008.

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Dear Governor,  
Dear Mayor of Kukës Municipality,  
Dear Mayor of Prizren Municipality,  
Dear Mr. Uldedaj,  
Dear Mr. Basha,  
Dear participants,

I am delighted to be here today and there are many good reasons why I was looking forward to this gathering.

For the second time within a relatively short period of time I see this gigantic engineering work growing every day and taking its final shape. Every single person visiting the road segment Rëshen – Kalimash understands that what they have in front of them is an extraordinary engineering, civil, useful, far-sighted and patriotic work.

Similarly, my return to Kukës after quite a long time has surprised me. There is now a completed airport, cross-border activity has intensified, the climate is extraordinary and soon this town will turn into a city with modern infrastructure. Numerous opportunities are ahead of you. Your cleverness stands in perceiving them and making use of them cleverly in order to enhance the opportunities of the Kukës community and the North-East region.

The other reason for making me feel delighted is the presence of my Kosovar counterpart, Mr. Hashim Rexhepi. This meeting is of special significance. The Central Bank of the Republic of Kosovo is now growing and consolidating day after day under the management of an Albanian professional unlike some time ago when the management of the central bank was the task of a foreign central banker.

Meetings of this kind are now turning into a tradition. After holding similar meetings in Korça, Gjirokastra, Shkodra and Saranda we are now being introduced with a new reality of the North-East region, and I believe that the town of Kukës plays a key role in this area. Through these regional meetings we aim to be in touch with the economic and financial reality of different regions in Albania. Given the weather, cultural, social, geographical, demographic, objective and subjective characteristics, each region has different economic and social development opportunities and levels. From this viewpoint, we aim to fully be acquainted with these specific characteristics, identify all the financial and natural resources, formulate “recipes” and other advice which would help in making more rational use of them.

Beyond what I previously stated, I would like to clarify that the exploration of the potentials that the different regions have to offer and the identification of their level of use is also essential in terms of the banking system’s activity, in particular of the geographic expansion and financial intermediation.

Another major reason motivating the Bank of Albania to organize these meetings relates with the establishment of a more effective communication channel between the Bank of Albania and the public. We believe that the direct contact with various social groups in different geographic regions (that is to each and every family), in addition to the traditional means of communication, press conferences, monetary policy or financial stability reports, is a very efficient tool and frequently determinant.

I would like to dwell today on some matters of interest to the entire audience. First I would like to make a brief outline of the Bank of Albania's latest analysis of the economic and financial situation in Albania:

In brief, three are the main developments of greatest interest to the audience:

With regard to the international developments, the economic and financial situation has been very complex in the last months. Inflation has turned into a point of concern in most foreign economies, mainly driven by the high prices of raw materials, oil and food. In addition, economic activity in developed economies has experienced sharp turns. Euro area economy is at present in front of many questions, while the US and some Asian economies have shown slow rates of economic growth. Credit crisis has caused many reputable international institutions to experience large financial losses and its contamination process is still present. Recently, the two US mortgage giants, Freddie Mac and Fannie Mae, which were on the verge of collapse, were subject to an unprecedented and costly rescue plan designed by the US Treasury Department. All these issues have triggered uncertainties in the markets, causing the future forecasts to be more challenging and the participants' exasperation to peak.

I would consider the immunity shown by our economy in terms of price stability as the most outstanding development. Albania's economic activity is progressing in line with our previous expectations. A few days ago, INSTAT published the inflation figure for August 2008, according to which annual inflation marked 2.5%. Following a 12-month period of inflation rates standing at around 4-4.5%, in line with our forecasts, it is assessed that inflation will fluctuate in the next few months at around 3%, which is our quantitative objective.

Worth to note, however, is that the risk for its upward deviation is still present and it mostly relates with the international developments mentioned above. The main risks stemming from the internal environment relate to any possible deterioration of the energy situation and the plausible implications with the fiscal situation in the future. For the moment, the main risk stems from the lagged effects (otherwise referred to as second round effects) of certain developments such as the rise of wages beyond an acknowledged logical level. Any similar rise would generate new inflation, to later impose another rise in wages, which in turn would again and again trigger inflation. I do not think this is the right path. Wage-inflation spirals have been studied relatively early and they represent the least appropriate recipes to offset the inflation effects.

I would like now to move to the latest performance of the banking system, with both its good sides and the risks associated with them. The Albanian banking system is going through a phase of swift development and promotion of new products. I believe you have noticed that many banks have been engaged in aggressive marketing strategies which promote different types of household loans and terms and attractive interest rates for deposits collection. In addition, banks' branches and agencies have constantly expanded. Only during the present year, 73 new branches and agencies have been opened and 15 others are in the process of being opened.

The same characteristics more or less apply to the District of Kukës as well. Currently, six private banks perform their banking business in Kukës, while two other banks are in the process of commencing to operate. As of end June 2008, the banking system has extended a total of about 1.2 billion leks of new credit (around 15 million USD) of which 66% to households and the rest to the businesses in the area. It is nice to notice that this figure accounts for about 66% of deposits collected in this region, providing evidence for a relatively high financial intermediation level.

The rapid development of the banking system, the high competition in the banking market and banks' eagerness to win their market shares requires greater prudence. The Bank of Albania has taken a number of measures to increase prudence in view of attaining the banking system stability. In its last meeting, the Supervisory Council of the Bank of Albania took the following decisions:

- Some amendments to the regulation “On risk management in the activity of foreign banks’ branches”;
- Some amendments to the regulation “On capital adequacy ratio”;
- Some amendments to the regulation “On credit risk management”;
- Approval of the regulation “On minimum requirements for information disclosure from banks and branches of foreign banks”;
- Approval of the regulation “On transparency of banking and financial products and services”.

The entire package of regulations was launched in the open forum we had this spring with the banking system. This package aims to better discipline the banking system in terms of assessing credit risks, setting penalties for banks when non-performing loans increase, encouraging lending in lek and enhancing transparency with bank clients for each product and service.

Dwelling further on the issue of financial stability, I would like to underline that the Bank of Albania is scrutinizing cautiously the developments in the external sector of the economy, which for the moment remain a concern in terms of long-term developments in economy. The stable growth of imports in goods and services and the current deficit deepening require special attention. The main implications relate among others with the financial stability at home while they have their roots in the imposed correction of long-term imbalances within a very short period of time.

Triggered by the increase of real estates prices, the steady appreciation of the lek, workers’ remittances and the rapid growth of credit and budget expenditure during the present year, the high current deficits have become a dominant phenomenon in the external sector of the economy. Their automatic and abrupt adjustment would prompt the correction of exchange rates to the rapid and strong depreciation of the lek, drop in private and public consumption and reduced economic activity which could generate crisis in the external sector and spread to economy, hence, jeopardizing the financial stability at home. Availing myself of this opportunity to address to the audience I would like to explore this issue further. Skipping the theoretical arguments, I would note that the high current deficits mainly originate from the consumers’ behaviour.

In plain words, what I am trying to say is that in a general economic level we consume more than we produce. This extra consumption, which is mainly financed by borrowing, is mainly driven by our expectations for higher income in the future. That is, in a household level, there is deficit, triggered by the insufficient income to cover household consumption.

The international financial crisis and the negative consequences on the global economic and financial activity stem from household consumption beyond the sources (providing additional financing from banking loans) and the rise of real estates prices. This consumption approach was followed by the increase of current deficit and long-term liabilities for households.

When these liabilities exceeded the long-term equilibrium level, the household sector could no longer pay off the accumulated debt.

What were the consequences?

An extreme and constrained adjustment of consumer behaviour and approach. Households could no longer pay their debts to banks and maintain the same level of consumption. These individual imbalances altogether appeared in a macro level, mainly in the form of abrupt fall of demand, slower economic activity and depreciation of the exchange rate (US dollar depreciation). Naturally, the financial system could not escape from being affected by this challenging contagion.

What I have stated above points out the necessity of making thorough analysis at a micro level in addition to the macro ones. That is, the recipes for attaining a stable macroeconomic situation should begin and be sustained by prudent analyses at a micro level.

It is for this reason that I would like to dwell on and explore one of the indicators that affects the structure and modelling of household budget. I refer here to workers' remittances which have played a key role in smoothing consumption and at a lower level, meeting investment needs, mainly for real estates and small household businesses. Remittances have somehow offset the low productivity and the negative effects triggered by unemployment. In addition, they have helped to preserve financial stability, by establishing more balanced ratios between income and expenditure.

Given the importance of workers' remittances, one would rightly raise the following question: What is their perspective? How can they be managed more effectively?

For a relatively long period of time, they have been vital to our country. According to a Bank of Albania survey on the first quarter of 2008, about 26% of Albanian households living in the territory of the Republic of Albania are recipients of remittances from abroad. Households' geographical distribution indicates that 59% of recipient families live in the rural areas while the rest in the urban ones, receiving about 66% and 34% of total workers' remittances, respectively. Remittances represent the most important component of rural families' monthly income, accounting for about 40%.

The largest part of workers' remittances (about 70%) for the first quarter of 2008 was used for non-productive purposes. About 48% was used for consumption, which entails meeting households' everyday needs for food, clothes, furniture, etc., 16% for construction and reconstruction and 10% for education and medical purposes.

Around 19% of remittances are used for investment and savings, providing evidence for their economic impact on Albania.

Despite these figures, their future prospective is yet unclear. The integration of Albanians into their host countries, their economic and financial situation and other similar reasons have a negative impact in the long term. Our analyses and assessments show that the difficult economic situation the developed economies have been experiencing, expressed in the economic slowdown, unemployment growth and increase of inflation, has also provided its impact on the performance of remittances which have grown less this year relative to the previous years. Empirical studies of the Bank of Albania show that the cease of these flows would put our consumption model and the long-term balance of the external sector of the economy in the difficult position.

Our concern related to the household budget stands in the fact that the behaviour model we adopt at a household level can also affect the behaviour model of given regions.

The Albanian economy has by and large made evident progress, detaching itself from the IDA country group. Macroeconomic indicators have for a relatively long period been positive and stable. However, beyond the nationwide average indicators, detailed statistics by regions indicate that welfare in mountain areas has progressed at slower rates relative to the other regions. According to World Bank assessments, an average resident in the mountain area has 12% less per capita real consumption than the average resident in Tirana, while in 2002 this figure was 9%. According to the same source, the average rural coast resident has 34% higher per capita consumption than the average mountain rural resident. Generally, poverty has a strong positive relation with the family size and a negative relation with age and education.

In contrast, the District of Kukës has great potentials for more prosperity in this area. First, your district is distinguished for its rare natural beauty and diversity from the mountain and ethnographic tourism viewpoint. The opening of the border with Kosovo in particular has provided us with real opportunities to perceive the Northern Alps as a single complex with their continuity to Kosovo and why not to Montenegro. I think the completed airport, which

could very well be used for the transportation of winter sports fanatics, is another strong point. It is the local authorities' task, to undertake in co-operation with the local stakeholders projects and feasibility studies, which in a later time may be submitted and presented to the central authorities or the specialized international operators. I would like to inform you that at the moment, their interest is overwhelming and concrete. Time is ripe for you to increase the marketing of these potentials and point out their strong advantages accurately.

Second, your district is well-known for being rich in minerals. I do not know if you have any geological inventories or maps which accurately identify the mineral resources. If you don't, this is too late. The current price structure is very favourable and I believe that any reactivation of existing mines and the opening of new mines implies more employment, more hope for this region and fewer migratory movements.

Third, your district, in particular the town of Kukës, finds itself in a crucial economic crossroad, not only in terms of roads but also of air. Unfortunately, statistical information related to cross-border economic and financial activity is missing. Nonetheless, I have to admit that the potentials are not being rightly handled. We are the same people, speaking the same language and sharing the same customs, hence, there is no point for us to be held back by the absurd barriers of time. The completion of the new road and its stretch to the largest harbour in the country create the proper grounds to turn the Kukës town into an extraordinary transit point for passengers, goods, services, art and culture.

Fourth, your district should make clever and great use of the presence of a university in this town. My call is just plain: invest in mobilizing a professional and specialized teaching team. Spend on education, on knowledge and the culture it produces. In this context, the local government could set financial stimuli. The final goal will be to establish a national educational centre, which serves to the local community living on both sides of the border. I honestly hope the future managers grow and be a product of this university.

Fifth, I believe you should pay your utmost attention to the presentation and spreading out of information on the potentials your district has to offer. Pretending you possess something that is worth it is only one side of the coin. The other is how able you are to find buyers, to get them buy what you want to sell. In this context, the complete identification, regulation, presentation and promotion of these great potentials are of prime priority. For analogy purposes, I would like to bring an example: It is now for two years that the Bank of Albania has been organizing the yearly competition "The Governor's Award for the best diploma thesis". Last year, the third prize went to a student of the University of Shkodra for a very original thesis which introduced the potentials and opportunities of the Puka Region, the development of mountain tourism and the positive macroeconomic impact it will bring to the region. This paper was assigned a prize for the originality of the topic chosen to be explored and the economic impact its presentation may have. The thesis did not only seek to present a profitable business opportunity, but also make an assessment of the positive impact this investment would have on the life of the community. The positive influence on the latter is crucial for important strategic investors. We awarded this paper not only for its original exploration by a passionate student from Puka, but also to increase public awareness and promote this new and modern mentality. When a single student manages to produce this much, a university, a local community and all of us together have great potentials to achieve even more. I brought with me today a copy of this thesis.

Dear participants,

I tried to briefly discuss some issues that I personally find vital and benefiting for you and the Bank of Albania. Perhaps my speech may have sounded somehow provoking; however I believe this is the right time for us to put a halt to some transition phenomena or impairments. Although I am aware of the numerous and complex problems, I can clearly see some light at the end of the tunnel. The chances are right there. Our duty is not to waste them. On behalf of the Bank of Albania I assure each institution, individual, company,

undertaking or initiative that we are open to collaborate for the best of future progress and prosperity of this community.

Thank you once again for your attention and hospitality.