

Ardian Fullani: The current performance and development prospects of the Albanian economy

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the Bank of Albania's forum with representatives of main businesses operating in Albania, Tirana, 23 November 2009.

* * *

Dear Ladies and Gentlemen,

It is my pleasure to be among you today, to share with you our views on the current performance and development prospects of the Albanian economy. As the most dynamic part of the Albanian economy, your contribution has been tangible in the country's economic development during transition. Your incentive, your willingness and devotion have brought about tangible results in the country's development. In a single figure, the Albanian economy performance may be summarized in the growth of above 65 percent of gross domestic product and well-being per citizen during these years of transition. Our development prospect remains as much positive. The country's macroeconomic stability, the continuation and deepening of structural reforms as well as the geopolitical reality of approximation to developed economies of the European Union, would help in a fuller release and remuneration of your potential and energies.

Today's forum aims to highlight the economic development of the country and initiate a broad public discussion on alternatives of the future economic growth models.

Now, let me start by making a brief statement of the latest developments of the Albanian economy, and further dwell upon our viewpoints on the country's economic development in the future.

Economy performance during the crisis

The developments over 2009 have indicated that the Albanian economy has been impacted by the recent global crisis, mainly as a consequence of decreased foreign demand and remittances, higher risk premiums, reduced and high-cost financing resources. However, our economy continued to record positive economic growth rate during this period, while the domestic inflationary pressures remain subdued. The country's economic activity has been sustained by the fiscal stimulus and the preservation of steady consumer demand, while investments and exports have recorded lower growth rate in the first nine-month period of the year.

The economic performance over the first 9-month period of the year, albeit positive, attests to growth rate slowdown, reflected even in the gradual slackening of inflationary pressures. In spite of a slight improvement during 2009, the current-account deficit remains high, reflecting high levels of consumption in the Albanian economy and unfeasibility of production capacities to meet it. The fiscal policy has had an expansionary nature during 2009, reflected mainly in increased budget spending, mainly due to rapid growth of capital expenditures. Budget revenues maintained a slower-than projected rate, due to slow-down in the economic growth rate during this period.

Consequently, the additional budget spending has been financed through the use of privatization receipts and the higher public borrowing.

This policy has exerted pressure over the increase of government debt securities' interest rates of long-term maturity. Financial markets attested to an improved liquidity situation and agent's recovered confidence in these markets. The persistent Bank of Albania's liquidity supply to the money market helped to calm the market participants down and supply the

market with funds, which served to the private sector's domestic currency intermediation. The needs for liquidity in the interbank market have decreased, hence exerting no pressure on short-term interest rates.

The prudent monetary policy of the Bank of Albania has helped relieve the tension in the financial market, while the latest base interest rate cut should be translated into greater lending to the private sector.

As we have already stated even previously, the Bank of Albania regards the future Albanian economic activity with a prudent optimism. I mean, in spite of the great shock we have gone through, the macroeconomic and financial stability of the country has not been affected. Furthermore, the restoring of confidence in the banking system opens the way to recovery of the lending process and sustaining of the economy with funds. On the other hand, the Bank of Albania keeps on pursuing a prudent stance, because the financial risks on the economy have not been completely overcome. The banking system has still liquidity shortages, whereas the global economy continues to be frail. Therefore, the economic prospect will depend on our joint work and on the performance of global economic and financial markets.

Dear participants,

In the optics of historical developments and particularly of recent events, I would like to briefly dwell upon several vulnerabilities that we, as the politic, supervisory and regulatory authority, have highlighted, as well as the lessons we should draw and the issues we should address for the country's further economic development.

Lessons from the crisis

Right from the beginning, I would like to emphasize that generally, the philosophy of the country's economic development has been accurate. Market openness and increased competition have made the Albanian economy benefit the fruits of private sector initiatives. The practice of economies based on free market principles has broadly indicated that this sector remains the most efficient engine of the economic activity.

This process has been sustained even by the constant reduction of the state's share to the economy, as well as by its focus on procurement of public goods and infrastructure development. Positive financial market development has generated the necessary funds for supporting investments and consumption in the economy. Though chiefly for historical reasons, our banking system has based its activity on the intermediation of domestic funds of the economy, the recent developments indicated that it remains as much capable in generating foreign funds to provide capital and liquidity backstop to the Albanian economy. On the other hand, the integration of our financial system into the European one has raised the resilience of the Albanian economy to various shocks, of which the latest is still under operation. It has also brought about a necessary expertise in terms of financial and economic business administration, has developed the infrastructure and means of payments in the economy and has helped efficient risk transfer in the economy.

In spite of accomplishments, I think the country's growth model needs modifications and improvements, aiming at enhancing its efficiency and stability. Under the conditions of an economy that requires dynamism for moving from a transition economy to an emerging one, the commitment for a sustainable and long-term development should be the subject of current and future economic reforms, at both, political and institutional level, and enterprise and consumer level.

Which are the vulnerabilities noticed in this regard?

First, domestic consumption and investments have been the main beneficiaries, while the Albanian economy has not yet succeeded in establishing a competitive export sector,

capable of generating steady foreign currency income, which would enable the preservation of external economic balances. From another viewpoint, this development does not seem as balanced in sectoral terms. So, some sectors such as trade, construction and services have contributed disproportionately the country's development while others, such as agriculture and industry have contributed less.

Second, Albanian economy continues to suffer from structural vulnerabilities, which contract its competitiveness in international markets of products and capital. This behaviour is illustrated even by international competitiveness indices compiled recently by the World Economic Forum, where Albania is ranked below regional countries. Some acute problems refer to the need for enhancing education and infrastructure, in all dimensions. Both these problems restrain the attraction of foreign investments and impede the country's development.

Third, efficiency in using the economy funds should be improved even at micro level. This implies the need for improving private businesses' management and control systems, enhancing analytic and forecasting capabilities, as well as transparency.

Allow me to further deal with some of the above-mentioned issues.

Stable economic development of the country

As we have continuously underlined in our periodical reports, the economic growth over the recent years has been strongly supported by the banking system lending. The growth of banking lending has provided an impulse of about 7 percentage points of GDP in the last five years, making a pronounced and evident contribution to the growth of consumption and investments in economy. Their growth has provided room for expanding the production basis and improving the welfare. However, it has also generated macro and microeconomic imbalances.

At macroeconomic level, the high consumption and investments were followed by increasing inflationary pressures and higher trade and current account deficit. These signs of overheating were clear signals that that level of consumption could not be kept for a long time, hence calling for controlling measures by the monetary authority.

This is also the key to understand our prudent monetary policy during the period 2006–2008. The institutional investment we have made during these years in terms of consolidating macroeconomic and financial stability was rewarded with a much more moderate and milder impact of the global crisis than in the regional countries. In concordance with the modern philosophy of macroeconomic administration, the Bank of Albania remains committed to not allowing that rapid and short-term economic growth impair the long-term development perspectives of our country.

At microeconomic level, the growth of consumption in economy was followed by increased indebtedness in Albanian households' and businesses' balance sheets and by over-investments in certain sectors of the economy. Both these indicators are either at lower levels than in the regional countries, or at similar levels; hence, they cannot be specified as problematic. However, their rapid growth rate creates the idea of a short-term vision of the economic agents, and in particular cases, even avoidance of rationality.

Dwelling upon household consumption, the Bank of Albania invites all economic agents to be more forward-looking and realistic in their consumption and savings plans. This invitation does not imply the contraction of consumption or the change of preferences related to it, but merely placing it in the context of long-term plans that equal income and expenditure at a household level. Beyond the time-related dimension, as we have continuously drawn the attention, borrowers should be cautious as regards their loan currency. This implies that the matching of their loan currency with that of their income would be their best protection. In a more pragmatic

approach, this advice may be reduced into an appeal for a close consultation with the banking system and the financial market's specialized agents.

The latest global crisis – in particular in the US and England – showed that the impaired households' balances sheets create room for strong economic shocks and condition the country's long term growth. On the other hand, it showed that the countries that succeeded in preserving a clear certificate of consumer's financial soundness, wherein Albania is part of, had a more moderate impact and enjoy good premises for a more rapid growth. In a philosophical approach, the key lesson of the market economy is that all consumption must be paid for. There is no free lunch.

*Back to businesses and investment loans, whose portfolio is 2/3 of the total banking system credit, my message is the same in principle: expand the time span of your decision-making and foreign investment and base them on detailed and scrutinized business plans' analysis. **What I would like to underline is that this message should be perceived by you urgently, since you have the necessary financial and human resources to be more prudent in borrowing and investments. Time is ripe for the Albanian businesses to avoid the group behaviour, where one business idea is almost automatically followed and adopted by other businesses, without first studying the market size, the competitive advantages, the level of expertise or the financial efficiency of using the funds, according to all the chains a careful and prudent decision-making should go through.***

The latest tendency for diversifying the Albanian businesses is useful in principle; however, it should not be made to the detriment of specialization and efficiency, or even less without first making the macroeconomic and sectoral analyses.

The inter-sectoral performance of the economy is another issue I would like to discuss with you today and which I briefly mentioned earlier in my speech. **The country's economic development has been characterized by a growth and investment model which has favoured the services and construction businesses, compared to the exporting industries or the competitive ones in imports. Although this performance somehow reflects the tendency to perform similarly to the economic structure of developed and advanced economies, it has resulted in over-investments in certain sectors. The economy development cannot be stable if the allocation of funds is not carried out by adhering to the principle of sector productivity and efficiency. The misuse of financial funds impairs the agents and the whole economy, providing severe and long-term consequences on corporate balances sheets and debts, on labour market and on capital and technology allocation among sectors of the economy.**

To minimize such risks, the Bank of Albania advises you to discontinue the inertial moves in your behaviour and realistically assess the regional and European context in your choices. The competitive advantages of Albania should not be sought only in natural resources, or in meeting of yet unserved demands of the Albanian market, but also in the cheap work force of the country and in its position as a future EU member. The increasing interaction with the banking system would help to clarify your plans and reduce the financial risk, providing you with the opportunity to focus on business risk administration you are specialized in.

Completing my discussion related to stable development of the country, I would like to underline that the banking system can and should do more in this respect.

The financial system is the brain of a market economy; it determines the expected return and risk of investments in the economy, enabling later on the prioritized use of limited financial funds. Despite its good performance, the Albanian banking system should do more to incorporate macroeconomic and sectoral analyses, and also the country's financial stability in decision-making. The development of research units within large banks is actually a requirement of the time we are living in. Moreover, more efforts should be made, to increase the support of small and medium-sized enterprises with

funds. In addition, a more aggressive marketing of derivative instruments, which will lower the corporate financial risk, particularly of those operating in the export sector, requires a greater attention from the banking system.

What I just mentioned will be an important part of the future philosophy of the Bank of Albania in the field of structural reforms in the financial market and in developing and advancing its supervisory and regulatory function in it.

Structural vulnerabilities and the need for reform

A useful lesson that the Bank of Albania has learnt from the crisis is the need to continue and deepen the structural reforms in the economy. These reforms, not only will create a more appropriate environment for promoting the private entrepreneurship, but will also increase the economy's resilience to shocks. They also help to absorb foreign direct investments, which are the best support to the country's development in the medium and long run. However, as stipulated even in the EBRD's report, Albania is among the few countries that have continued structural reforms even during 2009.

In this regard, Albania has lagged behind the regional countries, attracting in total only about USD 1100 per capita of FDI during the 20 years of transitions.

In the entire broad framework of reform-related problems, I would like to dwell today upon the need for investments in education and infrastructure. A well-known business maxim is that: Employees are a company's most precious asset. ***To the Bank of Albania it signifies that the higher the professionalism, the higher our institutional independence.***

To a broader sense, this is also relevant for the national economy. Our country's progress, the convergence with the developed countries of East Europe and even beyond, with the European Union countries, will depend on our level of education. Competition in national and international markets is above all based on the generation of ideas and their use in the final products. Referring again to the Global Competitiveness Index, Albania is ranked the 90th as regards the level of education and high-level training, and only the 109th and 126th respectively at the level of business sophistication and innovation. These vulnerabilities will ever-increasingly become an obstacle for the country's economic growth in the future, unless addressed on due time.

Public reform in the education system and the need for more backup funds should be a priority of every development policy. On the other hand, I consider that the Albanian business can and should do more for supporting the Albanian education. First, the business can and should be more supportive to higher education institutions, at the same time cooperating with them in the area of market research and student training. The economic development history shows that the countries, which have invested in education, are currently in the group of most developed countries of the global economy. Second, I think that more efforts should be made in attracting and absorbing the brain in the administration and management of your businesses.

Investing in education, in enhancing professionalism and expertise, is the best investment we can make for the future of our country.

Parallel to this, the enhancement of our development infrastructure should be a priority issue. Beyond the road infrastructure development, which rightly is a priority of the public sector, the Albanian business can and should do more in this regard. The use of common business resources to resolve problems in supplying electricity, water and sanitation, and local roads, should be regarded as an effective option of overcoming these problems. Creating differentiated and specialized development areas will open more opportunities to them to benefit from scale economies and common solution of problems. Also, computer and telecommunication infrastructure are sectors, which can and should be addressed more efficiently by the private sector.

Business administration and transparency

Though I addressed some problems even earlier in my speech, now I would like to dwell briefly upon the problem of administration and corporate transparency enhancement.

Corporate administration is the linking bridge between ideas and results. It affects funds usage efficiency and differentiates profitable from non-profitable businesses.

In light of this, I think that the above-mentioned issues, the extended time span of investments, their support in market researches and prudent business-plans, the orientation of businesses' positioning in national, regional and global context, the increase in specialization and professionalization, the fostering of cooperation with the financial system, require ongoing investments in terms of your management.

Finally, I think that transparency of your businesses is an aspect that deserves a greater attention. Its enhancement would help first of all the trading and financial transactions among businesses, fostering confidence and decreasing their risk. Also, the long-term and ongoing relation with the financial system is conditioned by reciprocal transparency between parties. Beyond the banking system relations, transparency is a serious obstacle in the establishment and operation of capital market in Albania. In this regard, I think that the Albanian business should be aware of the fact that transparency enhancement and increased formalization are in its long-term interest.

Dear participants,

Long-term visions are translated into success achieved through work and short-term sacrifices. The Bank of Albania invites you to foster the cooperation in resolving these problems of mutual interest.

Thank you!