

## **Ardian Fullani: Press conference at the presentation of the First Financial Stability Report of the Central Bank of the Republic of Kosovo**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the presentation of the First Financial Stability Report of the Central Bank of the Republic of Kosovo, Priština, 20 December 2010.

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Dear Mr. Gërguri,

Dear Members of the Governing Board of the Central Bank of the Republic of Kosovo,

Dear Mr. Yilmaz,

Dear guests,

It is always a great pleasure for myself and my colleagues to come to the Central Bank of the Republic of Kosovo. I would like to express my positive consideration that this institution is now well-shaped and is growing stronger at a stable and rapid pace. This development is an outcome of the clear vision of the governing structures and the commitment of the central bank's staff in implementing the best standards relevant to the area. This time I am invited to testify another achievement of this institution, the first release of the Financial Stability Report.

I have the conviction that the public authorities, economic operators in Kosovo and the public will appreciate the contribution of the central bank with respect to the identification and management of risks facing the financial system's activity.

In my speech I will first provide a general assessment of the great deal of importance given to financial stability issues and the central bank's role in this regard. Then I will share our experience at the Bank of Albania with the institutional approach to financial stability assessment function.

The global crisis, which originally emerged as a financial system crisis, very soon transformed into a real economy crisis. Due to the high integration of financial markets as a result of the presence of financial institutions engaged in cross-border activities and the manifold interinstitutional exposures, a financial system crisis can spread rapidly across many countries. On the other hand, due to the exceptional role in financial intermediation, a financial system crisis may hit the real sectors of the economy, placing the economic mechanism in a negative spiral that tends to reinforce itself.

These developments will likely result threatening to the sustainability of the entire financial system and be followed by severe social consequences that are costly to public wealth.

This two-year experience triggered an accelerated identification process of the mechanisms and measures that aim at preventing and handling similar situations in the future. At a broader economic context, these measures aimed at reforming the international monetary framework and reduce imbalances in the global macroeconomic framework.

G-20 policy-makers, the Basel Committee, the Financial Stability Board and the international financial institutions have set out some measures, which in fact have only one aim: reduce systemic risk and create the conditions for its proper management.

At a global level, these measures envisage:

- a) Reforming the supervisory superstructure by establishing institutions that focus on assessing systemic risk;

- b) Setting higher quantitative and qualitative capital and liquidity requirements for systemically-important financial institutions, hence reduce their appetite for excessive risk-taking;
- c) Determining the mechanisms that reduce procyclicality in financial activity, mainly by creating reserve funds (in the form of capital or provisions) that may be used for countercyclical purposes;
- d) Strengthening the capacity of national authorities to address systemic financial crises.

For this purpose, legal changes need to be made in order to regulate the harmonization of interinstitutional relationships at home and abroad. I would summarize the following:

- Actions between supervisory authorities of different countries,
- Actions between public authorities at home, and
- The implementation of actions that enable a smooth exit from the market of those financial institutions that cannot be recovered.

Central banks play an important role in this process, which in some respects is unique and exclusive. In the monetary area, it should be guaranteed that the liquidity injection and collateral evaluation procedures are complete and adequate.

In the meantime, the sustainability of systemically-important infrastructure, more precisely the payment systems', must be monitored and guaranteed. Moreover, if the central bank is also responsible for the licensing and supervision of the banking sector, there should be a modern supervisory framework that prevents and reduces systemic risk in accordance with the new international standards.

Public authorities should be prepared to act in situations of financial emergency, aiming at preserving public confidence in the financial system and ensure that there is a limited and efficient use of public resources. In the context of the role of a central bank that carries out an independent monetary policy, the integration of financial stability considerations into the monetary policy decision-making is particularly important.

Countries of our region share similar features in terms of the financial system and the economic structure. Banks make up the bulk of activity and they are regulated and supervised by central banks. We almost share similar banks operating in our banking sector. Hence, the developments are similar and the dynamics of the emergence and performance of risk is often alike.

Though we do share similarities, we also have certain differences, mainly related to the monetary area and the capacity to implement an independent monetary policy.

Both similarities and differences are important in order to understand the role of our institutions in the assessment and availability of actions taken to safeguard financial stability. Despite the arsenal of these actions, central banks cannot carry out this mission alone. Central banks are in possession of a full arsenal of measures and instruments, but their implementation, albeit timely and complete, cannot have full effect unless they are coordinated and supported by other agents' actions.

It is thus essential that all economically-important agents, public authorities, the public at large and the media are fully aware of this matter. Apart from legal definitions, this awareness requires receiving comprehensive, regular and timely information on the events that may jeopardize financial stability and identifying the necessary protective actions. The regular release of reports dedicated to financial stability is the key instrument that meets this obligation.

Let me now share with you our experience at the Bank of Albania. According to our concept, the Bank of Albania has full legal responsibility for safeguarding financial stability.

The Bank of Albania is attributed the exclusive role in terms of licensing and supervising the banking activity, the right to organize and monitor the operation of the payment systems, the lender-of-last-resort function to assist banks facing difficulties, the liquidity management function in the interbank market, and the determinant role in foreign exchange policy.

The Bank of Albania has the obligation to inform the public about the events that may jeopardize the financial stability. In early 2007, the Supervisory Council of the Bank of Albania considered a better coverage of developments in the financial system – that is, not only in the banking sector's alone – as highly important. In addition, it required strengthening the analysis of interaction between macroeconomic developments and the financial system's activity.

Our ultimate goal was setting up a more sustainable mechanism that would allow the conversion of these analyses into proposals for concrete actions, in order to reduce systemic risk not only through the Bank of Albania's actions but also through measures taken by other public authorities that have a role in monitoring the developments in the financial market.

From the institutional viewpoint, in September that year, the Supervisory Council of the Bank of Albania, approved the establishment of the Financial Stability Department, by selecting the most outstanding human capacities in the area of monetary operations, banking supervision, research and statistics.

The conclusions derived from the analysis of this department would be regularly discussed at a higher central bank level, thus providing a useful filtering and enriching mechanism prior to the decision-making of the Supervisory Council of the Bank of Albania.

For this purpose, in November 2007, the Supervisory Council approved the establishment of the Advisory Committee on Financial Stability (ACFS), which gathers the high executives of the Bank of Albania and the heads of the main departments.

According to the regulation on the functioning of the ACFS, representatives of other public authorities are also invited to attend the meetings in cases when matters of particular interest are being discussed.

In addition to analyses for internal use, the Financial Stability Department is responsible for releasing two main products: a) Financial Stability Statement, which is also mandated by law; and b) Financial Stability Report. From the institutional viewpoint, this process has progressed. Very soon, the Financial Stability Department became operational and the Financial Stability Report, which was prepared and released from the first year this Department was established, has been released regularly and at an ever-increasing quality.

However, we had to face several challenges along this process, which I think exist no matter if the financial stability's assessment function operates as a single structure within the central bank or not. Among them I could mention:

- a) The necessity to obtain complete information from all the sectors of the economy and produce complete, reliable and timely statistics;
- b) The necessity to establish better communication among different departments within the central bank, as well as between the central bank and other institutions that may have a role in monitoring the financial market. This communication creates optimal conditions for the clear identification and full assessment of the most important issues that have affected and are expected to affect financial stability during the periods under consideration. Ultimately, a good level of communication allows interinstitutional cooperation in addressing the concerns that may jeopardize financial stability effectively;
- c) The need to quantify systemic risk. This objective is obviously not easy but our endeavours in this regard must be ongoing and begin from the easiest and concrete approaches;

d) The need to have a balanced content of the Financial Stability Report. In this regard, we focused on the following considerations:

- First, this report attempts to clearly identify the underlying risks to financial stability, not only those created as a result of the financial system's activity, but also those stemming from its interaction with the surrounding economic environment.
- Second, the Financial Stability Report is an essential element of the monetary policy decision-making, thus providing a real understanding to macro prudence (Stability and monetary policy slogan).
- Third, we intend this report to be part of the dialogue philosophy, which involves the Bank of Albania, the Government and the market, at an appropriate level of transparency before the media and the public at large.
- Fourth, we intend not only to produce a report that limits to the description of past event, but also enrich it gradually and to a certain extent with research analyses and incorporate elements of forecast.
- Fifth, the report should arrive at some conclusions on the issues it addresses, which enable the identification of relevant recommendations.
- Sixth, the contents of the report should include a main part, which must be consistent over time for the effect of consistency of analysis and its comparability, and another part which provides greater degree of freedom to elaborate on more specific issues that materialize the main analysis.
- Lastly, we have paid special attention to the language used in producing this report, aiming at using plain and clear language, free of equivokes and understandable to the professionals of this area and the public at large.

We are fully aware that this process requires constant improvement.

Dear guests,

In conclusion, let me offer the support of the Bank of Albania in cooperating with the Central Bank of the Republic of Kosovo on matters relating to financial stability. This cooperation may aim at identifying matters of importance for both institutions, which later may turn into joint projects.

More concretely, we can cooperate on the assessment of the suitability of stress-test methodologies or on the process of systemic risk quantification. In a more informal fashion, the parties may exchange information on the issues to be addressed in the next Financial Stability Report.

The parties may also discuss the way of transforming the findings in the Financial Stability Report into concrete actions of the central bank and other public authorities. I am fully convinced that regular and constant communication on these issues will expand into possible directions of cooperation.

Once again, I wish you success in your work!

Thank you for your attention.