

Ardian Fullani: Analysis of economic and financial developments in Albania

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the 24th Conference of Banking Supervisors from Central and Eastern Europe, Tirana, 12 April 2011.

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Distinguished ladies and gentlemen,

Allow me to first wish you a warm welcome in the 24th conference of banking supervisors from Central and Eastern Europe, which this time is taking place in Tirana. The Bank of Albania considers this forum as very important and a platform where participants may exchange their institutions experiences with each-other. This forum is a modern highway that allows for a rapid convergence of our supervision practices with the best standards.

Let me now continue with a summarised analysis of economic and financial developments in Albania over the last two years, focusing on some concrete issues requiring more attention by the banking industry and the supervisory authority in the future.

The Albanian economy was characterised by positive developments during the pre-crisis period. Annual economic growth was on average 6 per cent, with admirable and stable core macroeconomic indicators. Growth relied on a firm strengthening of internal demand components while funded by internal resources, mainly through rapidly increasing loans to the private sector and loans for investments.

The banking sector, which dominates the domestic financial system, has also undergone a significant transformation in recent years. This is due to the entrance in the market of renowned European banking groups, expansion of banking infrastructure and upgrade of customer services. Financial performance has been good, recording average levels of return on equity and on assets, respectively over 20 per cent and 1.5 per cent. Over the years, the banking system has chosen to capitalise the majority of its profit in order to best support its activity with liquidity and capital.

During this period of a rapid and qualitatively better expansion of the banking activity, the Bank of Albania found it necessary to revise the supervision philosophy. *The main ambition was its orientation towards sources of risk, in other words to strengthen control over banking activity.* For that reason, at the end of 2006 a new law "On Banks" was adopted. This law imposed, on the banking industry, more contemporary standards as regards realisation, direction, and control of the banking activity.

The main concerns consisted in high crediting levels, significant concentration of crediting in foreign currency, and the absence of sectorial diversification. Consequently, at the end of 2006, the Bank of Albania introduced a number of regulatory amendments aiming at slowing down crediting growth levels, through imposing higher capital requirements on more aggressive banks. These measures were further supplemented in 2008, targeting more directly cases when borrowers had no income in foreign currency.

Another strategic move during this period was integration of banking supervision and financial stability with monetary policy decision-making. This action is as bold as it is innovative in establishing more optimum equilibriums between our function of drafting and implementing the monetary policy and that of maintaining the system's financial stability. ***From that moment on, the Financial Stability report would not be merely another book in the library shelves of the Bank of Albania, but a valuable input to policy decision-making.*** Therefore, information becomes more complete, including the assessment of banking activity risks performance. This would mean that our philosophy becomes more preventive and more farsighted, because the collected information is used to minimise future risks.

We believe that these actions were the right therapy to buffer the effects of the global economic and financial crisis on the domestic banking sector and economy that appeared at the end of 2008. The shocks in the global financial system transmitted insecurity to the Albanian public and, subsequently, huge amount of deposits were withdrawn from the banking system.

Additional need for liquidity as well as contraction of crediting during this period had a negative effect on the situation of financial resources, revenues and capital of the banking sector.

Under these circumstances, public authorities undertook a series of actions to support the banking sector, in particular the following:

- Approval of a law which increased the insured amount of public deposits;
- Decisions of the Supervisory Council of the Bank of Albania to limit bank exposure against their foreign bank owner groups and suspend the distribution of dividend for banks during 2008 and 2009;
- Implementation of a number of other decisions taken by the Bank of Albania in relation to the establishment of more easing conditions to provide liquidity in the inter-bank market; and
- Further improvement of the regulatory supervisory framework, aiming at maintaining banking activity stability.

Overall, during this stage, the Bank of Albania has played an essential role for the identification of short-term problems of the banking sector and their immediate addressing. This process was necessary to identify later longer-term implications on the banking activity performance and further alignment of the supervisory framework.

Banking activity performance over the past two years, has shown that these measures proved to be effective and the Albanian banking system overcame with success the global crisis effects. The withdrawal of public deposits from the banking sector was staunch at the end of 2009 Q1 and, from that moment, their return to the banks continues consistently. The current financial situation continues to be stable, overall, compared with previous periods, with a firm public confidence and satisfactory condition of liquidity and capitalisation. The stress tests of the banking sector against unfavourable potential developments – economic and financial ones – indicate that the banking system is capable of coping with them.

Banking activity performance during this period has reflected the overall performance of the economy. During the last two years, albeit a negative output gap, the country's economy has continued its positive growth in the range of 3.5–4.5 per cent. Other macroeconomic indicators have ranged within admissible and expectable values.

We believe that this financial and macroeconomic stability reflects the commitment and coordination of core economic policies, the monetary and fiscal policies, over the time. They will continue to support the solid economic growth further on, in light of the world's economy resurgence.

Dear participants, ladies and gentlemen,

The world's financial system faced an extraordinary crisis. Equally extraordinary were the measures that were taken. Naturally, its effects will continue to be present in the global economy, while decisionmakers, experts and scholars will continue to analyse the causes and lessons that may be drawn from it. Taking advantage of being present in this panel of supervisors, I would like to list some of our conclusions:

- Macroprudential supervision policies constitute an essential argument of recent discussions. The role of the central bank is a part of them, especially in terms of its

preventive role. Randall Kroszner, in his recent document “Challenges for Macro-Prudential Supervision” says: “... central banks should move from their traditional role of the fire extinguisher (which means that if something goes wrong, central banks will intervene in the market and provide liquidity to extinguish the fire or prevent its expansion) to the role of the smoke detector (which means to try and prevent the fire)...” More specifically this implies the identification of a group of measurable indicators, which together create warning systems for macro prudential problems. Stress tests are necessary and they should be more frequent, real, and transparent and shared with supervisory authorities of other countries. Equally indispensable are integrity, professionalism and independence that should characterise the activity of each banking supervisor.

- Macroprudential supervisory policies, post-crisis, despite the progress made recently, need further regulation. For that purpose, specialised international institutions need to concentrate on a more detailed definition and cooperation in order to adapt them continuously with markets development. Taking into consideration regional, demographic, historic and cultural specific characteristics is also important.
- The banking system needs to represent a culture based on best values of ethics, service and integrity. This should be the primary objective of all banking system managing structures, which will in turn lead to enhanced responsibility in banking institutions management. Bank managing structures are responsible for a balanced management of their institution, where the objective for profit should serve to identify, analyse and professionally assess risks that accompany relevant actions. In addition, banking institutions and their staff need to reflect, in their public relations, the highest standards of security, communication and transparency, care and support so that this relationship of trust and confidence becomes a characteristic of mutual developments. The supervisory regulatory framework is being completed with a view to take these developments even further.
- Banking supervisors, in turn, need to pay more attention to examinations and reports they prepare, integrity and behaviour that characterises the work of each bank.
- Another great lesson we may draw from the crisis is to avoid at any cost huge concentrations and dependency on short-term financial funds. A top priority remains the adoption of prudent practices on risk management.
- Composition and capacities of banks managing structures is another challenge for the banking industry in the future. The last crisis showed that in many cases, board members represented only short-term interests of shareholders, at the expense of other interests of the group. Likewise, their expertise and knowledge should be closely connected to specific activities of the bank.
- The market and innovation move faster than the supervisor does. Therefore, any innovation or new banking product, prior to being marketed, needs to be tested responsibly, assessing carefully all potential accompanying risks.

In a more national context, it is necessary and actually completely possible for the banking sector to accelerate the process of crediting revitalisation, a development that supports not only the economy and the clients, but also the banks.

Crediting should be supported better through a solid growth of funding sources, especially deposits. In crediting, it is necessary to have a better sectorial distribution and a more reasonable balance among public and private investment projects, Albanian Lek or foreign currency denominated credits, therefore orienting crediting towards supporting the national economy.

In this context, there is sufficient room for banks to support more crediting to small and medium enterprises and provide more opportunities in Lek crediting. In any case, the process of analysis, assessment, follow up and evidencing the credit quality should be pivotal to relevant structures in banks and should be carried out with maximum seriousness and commitment, conform to supervisory requirements.

In this process, cooperation is needed with clients that are facing temporary difficulties. However, in the case of non-performing loans, it is necessary to undertake envisaged and timely actions to execute the guarantees and other forms of collateral, in order to recover maximum values.

These actions are important while the Bank of Albania deems that the crediting activity of the banking sector will continue to face a challenging environment and targeted improvements for the credit quality will require more time to be realised.

In conclusion, let me underline that, movement in the above-mentioned directions make a complex process which requires a two-way commitment and cooperation. It is with pleasure that I find that cooperation between us and the banking sector is seeing progress, both in field of supervision and monetary policy implementation.

I believe this cooperation will grow among supervisors in the South Eastern Europe. On behalf of the Bank of Albania I would like to assure you that we will offer full cooperation in this regard.

Taking advantage of this opportunity, I would like to underscore that the Bank of Albania will always respect the public expectations and will fulfil, on time, its legal responsibilities in terms of maintaining the banking system and price stability. I thank You for your attention and wish you success!