

## **Ardian Fullani: Current development stage of the Albanian economy**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the regional meeting of the Bank of Albania, Fier District, 31 January 2012.

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Dear guests,

It is an honour and great privilege to be here with you today to share some reflections and ideas on the current development stage of the Albanian economy in general, and your region in particular. Regional meetings have now become a consolidated tradition in our public communication philosophy. We believe that meetings of this kind serve to accomplish the Bank of Albania's objectives by ensuring a better explanation of the monetary policy-making. In addition to enhancing the transparency of our decision-making, this direct communication also embodies another function, that of public education. We ultimately believe that this communication contributes to a greater efficiency in transmitting the monetary policy decisions to the economy.

I cannot, however, refrain myself from sharing some personal impressions I have made over the years on Fier and its people.

Your city is an important crossroad connecting the lower part of Albania to the south, including the Ionian Riviera. I think this makes a strong point in favour of Fier, a comparative advantage relative to many other cities in Albania. And not just that.

Fier opens wide into the Adriatic Sea, beginning from the embouchure of Seman River in the north to that of Vjosa River in the south. The whole territory is part of Myzeqe Lowlands, one of the most fertile lands in Albania, while worth noting is that this represents the oil-bearing region in our country. And last, and probably the most important, the people of Fier have historically been distinguished as hard-working, peace-loving and hospitable people. I am truly happy to be here with you today.

Dear guests,

The Albanian economy has progressed positively, being manifested in positive economic growth, low inflation, stable national currency, and fiscal and financial sustainability.

The Albanian financial sector – dominated by the banking system – has increased its financial intermediation, materialized in the growth of deposits and lending to the economy. On the other hand, it enjoys full financial soundness, expressed primarily in terms of its capital adequacy, liquidity position and profit.

During all this time, the Bank of Albania has monitored closely the banking system developments, and has carried out stress testing exercises, which show that all banks are resilient to shocks in extreme adverse scenarios and can operate normally. On the other hand, the Bank of Albania has also been very attentive to the performance of the economy.

As you may have heard, last week, the Supervisory Council of the Bank of Albania cut the key interest rate by 0.25 percentage points. This was the third cut we made having a well-defined aim to support and boost economic activity in Albania further. Due to the unprecedented financial crisis facing the global economy in general, and the euro area economy in particular, the economic growth in Albania remains below its long-term equilibrium. I refer here to the potential economic growth, or put into more simple words, to the level our economy would grow if it used all its production capacities.

We have made attempts in our analyses to find the reasons behind this performance, the consequences and some of the measures that would help smooth out this concern. In the following, I would like to elaborate on some of our conclusions.

I will begin the analysis of the economic and financial situation in Albania dwelling on what we have considered as the major cause and source of risks for the future: the severe global crisis. The situation in our trading partners is a product of the developments in global economy, which is facing a hard period in terms of the macroeconomic and financial stability. The high debt levels of governments and the individuals have curbed the capacity of many advanced economies to spend and make investments, thus affecting the economic activity and their capacity to pay off debt adversely.

Many reputable representatives from the academia and the business attribute the cause of the crisis (debt-burdened balance sheets of the governments and individuals) to globalization and the competition it generates. Due to the rising costs, advanced economies have generally lost their historical advantages in producing goods and services, replacing the absent income with debt, which now they have to pay off.

Why are these developments important to the Albanian economy?

- First, it is necessary to understand that these advanced economies are our major trading partners. They are the main users of our exports and, at the same time, the source of imported consumer goods and fuels.
- Second, these economies are the major investors in the Albanian economy and the financial system.
- Third, these countries are hosting the Albanian migrants.
- Fourth, we believe that another effect relates to the psychological factor, which emerges in the form of consumers' and firms' hesitation to consume and invest.

Subsequently, the difficulties facing our neighbouring partners are converted into difficulties for the Albanian economy. Any cuts in consumer and investment spending, be it private or public, will later yield cuts in these countries' investments in Albania, lower demand for exports, lower remittances; in short, the fall in all aggregate demand components in Albania. This would generate the fall in output, the creation of spare capacities, the deterioration of firms' and consumers' balance sheets, and a number of other adverse phenomena.

At present, the Albanian economy generates nearly as much as half of its potential growth. This gap, which in our terminology is known as "output gap", is partly explained by the difficulties facing our trading partners.

In addition to the above-mentioned factors, the lower economic growth rate also attributes to the sluggish activity in some industries, which, until two years ago, generated a considerable portion of the economic growth.

These industries operate in the non-tradable sector, implying that the created product remains in the domestic economy, that is, it cannot be traded in the global markets. To be clearer, I refer to the construction sector and the entire chain of economic activities fuelling it.

The sluggish economic activity, or the presence of the negative output gap, leads to the conclusion that there are spare production capacities in the economy. According to the latest analyses, these spare capacities have led to lower inflationary pressures in the economy. Against this background, the Bank of Albania has pursued an accommodative policy, trying to lower the financial intermediation costs (and affecting the cost of credit indirectly), in order to boost investment and consumption and, subsequently, economic activity. We have also supplied the banking system and the Albanian economy with the necessary monetary liquidity, in view of meeting the needs of commercial and economic activity. In addition, through our successful monetary policy, we have accomplished our low inflation objective and have guaranteed a stable macroeconomic and financial environment. This stability, which is the core mission of a modern central bank, allows households, businesses and financial institutions to make financial decisions and take business initiatives amid higher future certainty.

The credibility of the central bank and our monetary policy is now a tangible reality for Albania. It is reflected in the trust of our economy in the national currency and its purchasing power in the future. The investment made by the Bank of Albania to earn the public trust has required a lot of efforts to be made, but they get rewarded multiple times with the greater opportunities we have now to stimulate the economy without prejudice to the inflation outlook. Against this background, the Bank of Albania has provided the necessary economic stimulus, while there is still room for other additional monetary stimulus in the medium run. The accommodative policies generally aim at boosting economic activity and domestic demand, in order to keep the consumer prices within the Bank of Albania's target in the medium run.

We have also other reasons to support economic growth. We believe that if the economy grows at its potential rate, there will be substantial impact on the improvement of public and private sectors' and individuals' financial balance sheets. Their capacity to pay off past-due financial liabilities will subsequently improve, and their creditworthiness will enhance.

I think this is one of the challenges that, on one hand, would restore the macroeconomic equilibrium to the pre-crisis level and, on the other hand, would guarantee the financial sector's stability in the long run.

I would like to dwell now on another argument, which relates to the current crisis, but also has significant potential for development if identified and addressed in due time.

In addition to the negative effects, the global crisis provides some opportunities which I believe time is ripe to identify promptly and get the most benefit from them.

Let me state a fact from last year, which I think illustrates my observation better. There is an observation that the Arab Spring is one of the factors that led to the increase of the re-export industry in Albania. Not only wasn't it hit by the crisis, but it also grew its activity further. One could rightly say that the Arab Spring comes only once in a lifetime.

This is true but what I see as a comparative advantage of our economy in relation to the economies of many countries that traditionally make the active processing of the orderer's materials (re-export industry) is the cheap labour force. Countries like China, Turkey, Vietnam etc, have raised the labour cost, while it has to be admitted that they have a high level of productivity. Hence, what we need to do is to qualify the labour force of these sectors in order to increase productivity. I think that the qualification of the labour force, the increase of human capital and the formulation of more stimulating policies to support these sectors represent a resource and potential we have to rely on to create competitive advantages.

The absorption of higher capital for the country's development is another opportunity the global crisis provides us. It is a well-known fact now that technology and financial capital tend to move towards sectors, branches and countries that offer higher return on investment. In my personal opinion, but also based on a thorough analysis of the Albanian economy, Albania is a great destination in this respect.

There is undoubtedly a high perceived risk in the global markets, not only for Albania but also for all the countries in the region. We should, however, make our competitive advantages clear to the global markets and continue to work on the structural reform in order to release more development potentials and energy.

Another lesson drawn from the crisis is that consumption should be re-oriented from imported goods to domestic production. I have addressed it before too that the list of imports should get shorter through their substitution with domestic products, which has to be the priority of the new economic growth model in Albania.

To this purpose, time is ripe perhaps to give priority to the organization of financing schemes to support the traded sector. In more concrete terms, I refer to development financial institutions that support the agriculture sector, agro-business industry, extracting and processing industry, where the Albanian economy offers competitive advantages. The

economic benefits provided by these financial institutions to domestic production go beyond the low financing cost.

These are specialized institutions and they are very well-acquainted with the emerging economies and the relevant sectors. In addition to providing financing, they are equipped with and offer technical and financial expertise to enhance the efficiency, transparency and management, and increase employment in the sectors they support; to boost domestic production; to increase employment and, ultimately, stimulate the balancing of external sector's deficits.

Re-orienting the free labour force, capital and the private and public interest towards these advantages offers a simultaneous solution to a number of concerns facing the Albanian economy. This re-orientation is the essence of the economic growth model and it should be the main objective of economic policies and stimulus at a local-level as well.

The economic activity of Fier region is a perfect example proving the success of the orientation towards the traded sector. Fier has generally recorded growth above the average of the Albanian economy, and it is ranked the second (after Tirana prefecture) in terms of its contribution to real GDP growth and share in total GDP.

At the same time, its current employment rate is about 4% higher than the average employment in the Albanian economy. These economic indicators provide evidence for the direct outcome of the competitive advantages that Fier region offers compared to the other economic regions in Albania.

This performance is grounded on a number of characteristics that guarantee the diversity in industry-level production at high tradability. In other words, Fier offers the following competitive advantages:

- ***Favourable geographical location:*** Fier is situated in the western part of the Republic of Albania. In the antiquity, the ancient city of Apollonia was the second largest city in the Illyrian territory and the starting point of Via Egnatia, which connected Rome and Byzantium. This favourable geographical location has offered the city and the suburb areas a priority in the economic, commercial and cultural development since the antiquity.
- ***Natural resources:*** Favoured by its geographical location in the Western Lowlands, Fier is rich in agriculture lands and natural resources, mainly oil and bitumen.
- ***Industrial concentration and diversity:*** Fier has always been and remains an area with diversified industrial production in oil extraction and processing, construction, agriculture and processing of agricultural products. The concentration of industrial and agricultural plants has, therefore, led to the concentration of human and financial capital.

The district of Fier has generated about 6.1% of total deposits in the banking system, while the amount of loans received accounts for only 28% of total deposits at a district-level. This level of intermediation tells it all. It seems that the banking sector's attention and support to this district is not in direct proportion to the capacities. This situation does not only attribute to the lack of attention by businesses but also by banks. It is imperative that businesses and banks sit together and discuss the opportunities for new ideas and projects of mutual benefit.

In conclusion, I would like to bring another matter of concern to your attention. While preparing for this meeting, we faced difficulties in finding useful statistical information on the demographic and economic activity of Fier district. Taking into account the opportunities it has to offer, the reported statistics do not make this district distinguishable or comparable to the other regions inside or outside Albania.

It would be of interest, for instance, to have detailed information on the free capacities in agriculture and industry; average profitability; non-utilized labour market resources, the level of education and human capital; unit labour costs, and capital and final product cost per unit;

prices of other factors of production, and so on. The lack of these indicators makes it hard, and even impossible, to evaluate and compare the business plans that may potentially be introduced to the financial institutions or other national or international partners.

It should not be forgotten that in the global era, the real competition for Fier region does not stand in the other regions of Albania, but in those similar in the European economies and emerging countries. At present, we do not compete with these economies as we are not and won't be able to be part of the global market as long as we are not "quoted" in real time, using the same methodology and figures that allow the comparison of costs and opportunities.

The creation of these indicators, their calculation and rating in the relevant markets would create the conditions for the real assessment of the competitive advantages that this district has to offer. The help that the local authorities can give in identifying the competitive advantages and the provision of local statistics are perhaps the best investment they can make for the regional and national development.

Today, more than ever before, all the attention of global economy is oriented towards the markets, as the best estimators of the competitive advantages in the global economy. The developments in these markets are bringing about the reconfiguration of the economic powers at a global level.

The new commercial and financial trends appear to be in favour of the utilization of natural resources and competitive advantages, through investments in emerging economies, to later import them in the form of final products, ready for consumption. These are advantages for the Albanian economy, which, with the major structural reforms taking place (privatizations, natural and human resources, creativity and the entrepreneurship spirit), enjoys all the opportunities and should play an active role in the regional market and beyond, in the global market. I am optimistic and I do believe in our economy and its potentials.

Thanking you for your attention, I welcome any comments.