

Ardian Fullani: Health passes through .. bank

Interview given by Mr Ardian Fullani, Governor of the Bank of Albania, to Klan magazine, published on 23 June 2007.

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- Mr. Fullani, initially we would like to listen to your comment about the efforts of the government to channel financial business transactions through banks. Is this effort somewhat strained, given that the other party (the business) expresses itself that high transaction commissions of commercial banks increase business costs and the banks themselves are not ready to carry out the transactions?

The channelling of financial transactions through the banking system, as a process already tested and under development, is a much expected action, which outside the propaganda contours will really contribute to weakening of the infrastructure that nourishes the informality. In recent years, the banking system has passed through an irresistible process of development and consolidation. Actually it may be stated without hesitation that the banking system in Albania is completely capable of encountering with dignity this requirement of the time.

Dealing briefly with two or three important moments, I would start with the operation of two modern payment systems: Albanian Interbank Payment System (AIPS) where gross and real time settlements are made, and the Automated Electronic Clearing House (AECH) (small-value payments of clearing systems). Further on, I would highlight the significant growth of e-payments, the entry into the system of two well-known international banks, the increased number of branches, as well as increase of ATMs and POS terminals for card payments in the whole territory. Encountering successfully the channelling of public sector salaries through bank accounts, followed also by those of the private sector and by a number of other banking services, I think are indicators of the proactive, ever increasing role of the banking system.

To clearly understand what progress we have made so far in this direction, it's worth mentioning some statistics. The number of payments processed in AIPS system has increased by 11 percent, while the value has increased by 21 percent compared to 2005. In the meantime, both systems, the AIPS and the AECH have a much higher capacity than the current number of payments processed in them. At end of 2006, compared to end of 2004, the number of POS terminals was 7 times higher, while the number of electronic cards in use has increased more than 10 times and the transactions carried out through them was above 12 millions, with a value of about ALL 188 billion. During 2006, 62 branches and agencies of commercial banks were established, leading the number to 294 at year-end.

In this sense, I think that the current infrastructure of the national system of payments we provide is completely capable of facing the Albanian market demand for speed, number, quality, size and security of payments carried out through these systems. Furthermore, the Bank of Albania, in its role as the regulator of this system, is working for further standardization of payment instruments, which will lead to increased quality of services offered by banks to their clients.

On the other hand, the increased inflow of transactions in the banking system will further encourage competition within the banking system. Banks would be encouraged, in exchange of low commissions, to attract as many clients as possible, who in turn, would bring about more financial resources to banks. The banking activity, as any other business, aims at profit maximisation. Therefore, it is natural to charge commissions for services offered by the system, while their amount is an individual policy that changes from one bank into the other, in accordance with the size and other specifications. I am convinced that the increased volume of work will bring about reduced banking commissions. I do not have any doubt in

this regard. What I would assure you, as the governor of the Bank of Albania, is the meeting of an early requirement of the banking system to be very transparent about its products, services, commissions and prices they generally apply.

- As the process of channelling the financial transactions of business through banks had to be carried out since time ago, is it better to pass the costs of the moment and to channel the economy through the banking system?

I would refer to "costs of the moment" as "benefits of the future". Imagine the other side of the medal. How much informed will the banking system be in relation to the potential the various businesses have, and how much safe will it feel in crediting them without any hesitation? From this viewpoint, it is concluded that the operation is necessary and furthermore, in the final analysis, businesses, and particularly individuals will be the beneficiaries. In a broader aspect, the information on economic-financial potential of the country would increase; the banking system effectiveness would increase; the variety of banking products and services would increase; the geographic coverage by banking services would increase; and in consequence the mobilization and re-allocation of funds would be more appropriate; the competition would increase and costs would decrease. All these achievements would contribute to creating a more complete economic infrastructure of the country, which would raise the formality of the economy and would accelerate the economic growth rates of the country.

- Credit extension has increased fourfold during four last years, but this has not influenced on interest cut: Is this normal?

It is true that during last years we have had a rapid credit growth. During 2005 credit increased by ALL 57.6 billion or about 82 percent in annual terms, whereas during 2006, it increased by 70.2 billion or about 55%. Upward trends are as strong even in the first half of 2007. According to latest estimates, credit balance at end of 2007 will be around 21 percent of GDP. Without doubt, this view reveals that Albania, likewise most similar countries, has entered into the group of countries with high growth paces of credit to the economy. The first cause listed by experts is the so-called "catching – up process", which in other words means high growth caused by a rather low starting base.

Naturally, there are also other factors, such as: macroeconomic stability, the maintaining of inflation under control, low interest rates in Albania, Europe and the USA, exchange rate stability, increased banks' ambitions to lend and the public confidence in receiving credit. The banking system development in the recent years, its successful privatisation and the process of consolidation characterising it in 2006 are other factors that have influenced on rapid credit growth. Also we may mention the introduction of new credit products, such as consumer loans, house loans, and the efforts to make them more popular through aggressive marketing forms.

Rise of credit to the economy at so high levels carries over the potential of cutting the interest rates through which it is offered. Referring to Bank of Albania statistics, if an ALL loan of 6-12 month maturity at the beginning of 2002 was given on average by above 18 percent rate, in April 2007 it was given by only 10.16 percent. However, we should be prudent and always bear in mind the fact that about 75 percent of credit is in foreign currency and therefore, in forming the price of this kind of credit, banks refer to international financial market rates, such as euribor for the euro and libor for the American dollar. What is evidenced recently, thanks to increasing competition, is that ALL credit rates as an average expression of new credits have remained almost constant during the latest years, though euribor has increased almost throughout the whole period.

- Is the default risk the one that keeps high interest rates or do we have a situation of profit by banks from an economy in transition, as randomly happens?

It is not the high default risk the one that obliges banks to apply high rates. In price formation policies, banks, inter alia, factorise also the country risk, which for many objective reasons is

higher than that of the developed countries. Also, besides this risk, there exists also the economy informality, problems about ownership, mortgage of properties and collateral execution. All these factors make banks work hard to ensure information about the borrowers. This leads to increased costs and to the risk of misleading financial analysis of the borrower, which would influence negatively on credit portfolio quality in the future.

- Time ago you have issued the warning of “bad loans” risk; what is the current situation like in this regard?

A governor should always be concerned about such an important problem, related to loans portfolio quality. The current situation of credit quality remains satisfactory. The ratio of “non-performing loans to (gross) outstanding loans, which measures the net size of exposure to credit risk is estimated to 1.5 percent.

Constantly the Bank of Albania’s attention has been to strengthening of banking supervision measures. Some amendments have been made to the Regulation on credit management, consisting in improvement of the lending process of banks, improvement of risk management and some measures have been taken for enhancing transparency with the public. Also, this regulation has provided some requirements on additional capital of banks, in case they have a high lending pace.

However, we have to do with a process, which never ends and which will always be at the top-list of Bank of Albania priorities. We will continue to monitor prudentially credit growth and its quality. We will further improve prudential regulations, making them in consistency with best standards used by European central banks. Only in this way a good credit quality will be ensured, for preventing any probable negative consequences on the financial stability of the country.

- Until a year or so ago, treasury bills could be purchased only at central bank’s windows, while the selling of treasury bills may be also carried out at some commercial banks. Has the liberalization process influenced on yield cut?

The possibility of participation of individuals in primary treasury bill market through the banking system dates back to 1996, while the Bank of Albania was included in this process only during the second half of 2001. The Bank of Albania, in its role as a central bank, having the main target to achieve and maintain price stability, since the moment of opening its windows has regarded this presence as temporary. In essence, the establishment of these windows was another possibility for the people to have greater access in purchasing treasury bills. The participation of individuals in the primary market is of non-competitive nature, meaning that they do not influence on price formation. They just accept the resulting auction price. Therefore, we may state that their impact on yield rate fluctuations is almost insignificant. Since my taking office, I have insisted that the selling of treasury bills is an operation that naturally belongs to commercial banks. To this end, we have discussed more than once with the banking system and with the Ministry of Finance for designing a strategy for the Bank of Albania’s gradual leaving from this “business” not natural to it, believing that the market forces and its principles are the ones that should manage this process. Therefore the banking system was required to be aggressive in this regard, providing to the clients the service of selling T-bills in primary and secondary markets.

Parallel to that, the Bank of Albania, concerning this service at its windows, made two important steps, charging a service commission that covers connected costs and deciding not to accept cash inflows of individuals who intend to invest in T-bills. Since then, participation in treasury bill auctions through Bank of Albania windows may be made possible only in case the intended amount for investment comes in the form of banking transfers.

- Can you mention the positive sides of this liberalization?

These measures may rightly create the idea of a liberalization process, which I think will really lead to further deepening and expansion of the financial market in Albania. Presently, we are working for presenting a new practice in the primary market of government securities,

that of the main mediators, or as already known in other terms, “primary dealers”. We believe that this relatively long period in transition has served as a school also for the public at large. What is more important in the whole process is the fact that individuals are getting more and more acquainted with market instruments. The better and with more conscience we know them, the easier is the path to real financial market development. In such an economy, individuals make the choice.

- Recently you have received evaluations, since the institution you govern has succeeded in maintaining macroeconomic parameters and price level. Can you mention some of the measures you have taken during this period?

It is true that the Bank of Albania’s role in maintaining macroeconomic stability , particularly in controlling inflationary pressures, has been recently highlighted by a number of institutions within the country and abroad. However, I would highlight the public evaluation for the institution I govern as the greatest success we have achieved. This evaluation is expressed clearly in anchoring inflationary pressures in the country and in increasing the degree of using their products. Naturally I regard it a direct reflection of high technical and professional investment the Bank of Albania has made in setting up an equilibrated framework of macroeconomic policies, in increasing financial markets, in developing the monetary market infrastructure and in consolidating the banking institutions. On the political plane, the Bank of Albania has kept unchanged its focus on monetary policy, to guarantee price stability in the economy. It has monitored prudentially the liquidity conditions and interest rates in the economy, as well as other factors of potential negative impact on inflation, raising twice the key interest rate in the economy. Also, the Bank of Albania has been a productive partner in coordinating the economic policies of the country and in the performance of the agreement with the IMF.

On the financial market development plane, the Bank of Albania has undertaken a number of incentives for completing the banking infrastructure and the legal framework. Reflecting largely on macroeconomic stability and on improvement of banking infrastructure, lending to the economy has undergone very rapid paces during three latest years. On the other hand, the strengthening of banking supervision measures and the prudential regulations serve as a guarantee that the banking system expansion and rapid credit growth to the economy will not create problems for the financial health of banks and for their long-term sustainability. The Bank of Albania is raising the degree of professionalism, which is a guarantee for strengthening the independence, transparency and accountability. Therefore, the decision-making process has been further perfected, thus increasing the credibility of the Bank of Albania to the public.