

Ardian Fullani: Achievements and challenges of the Albanian banking system

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the reception for the bankers and representatives of banks operating in Albania, organized by the Albanian Association of Banks, on the occasion of the closing year 2008, Tirana, 18 December 2008.

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Dear Chairman of the Albanian Association of Banks,
Dear managers of the Albanian banking system,

Thanking you for this invitation, I avail myself of this opportunity to provide some considerations of the path we have been through during 2008 and the challenges ahead us. What we have been through during this fall sounds unreal and somewhat unbelievable. Many taboos have overturned and the list of news enlarges day after day, including also schemes of financial mega-fraud.

I commenced my speech this way so as not to overlook this unusual global event, to provide an outline of the general economic and financial setting surrounding our environment and above all, to underline an immense truth: that the Albanian banking system has shown admirable resilience and that the immunity shown has not only been a matter of luck.

The year 2008 has been an intensive year of ceaseless changes, at the centre of which were the safeguard and consolidation of macroeconomic stability at home and the banking system's financial stability.

Taking a quick glance at the Albanian economy over the present years, I can state that it has maintained the projected growth for year 2008, under stable consumer prices and domestic currency exchange rate. Monetary policy has been throughout the year 2008 cautious and has kept the key policy rate unchanged at 6.25 percent. In addition, fiscal policy has been characterized by the collection of budget revenues beyond the Government's projections and by the concentration of expenditures in mainly infrastructure-related projects. As in the recent years, the banking system has sustained the economic activity and consumer demand with loans, hence providing numerous incentives for a stable economic growth.

The positive performance of the economy and of certain economic sectors – in particular trade and construction – has been propelled by the positive rates of domestic demand at home. Lending has maintained its high annual growth rates of 42 percent. As a share of GDP and the system's assets, loans have recorded further growth to 36 percent and 41 percent, respectively. Businesses were the main banking loans' users, accounting for 66 percent of loan portfolio growth. This positive performance was associated with a favourable macroeconomic and financial setting. During the second half of the year, the CPI has recorded an annual drop to 2.6 percent in November. In addition, other inflation measures, such as core inflation, traded and non-traded inflation, attest to the downward intensity of inflationary pressures at home. The inflationary expectations of the economic agents have also provided their contribution to this stability. According to our surveys they are anchored to around 3 per cent. These developments attest to the fact that monetary policy and the strengthening of supervisory measures by the Bank of Albania have proved to be effective in containing the inflationary pressures. Taking into account the central bank's role and objective, I would like to underline that our commitment and success in preserving price stability has been mirrored in the anchoring of the inflationary expectations close to our 3 percent target.

The banking system's performance for the present year proves to be positive. In the early year 2008, credit registry started to operate. Its establishment represents a key innovation of

the financial infrastructure in Albania. We all attest to the fact that by putting the credit registry into operation, we have contributed to:

- Having basic understanding of credibility of the borrower and avoiding careless borrowers;
- Reducing a bank's cost in collecting information on borrowers;
- Promoting increased borrower discipline;
- Identifying all borrower liabilities and providing such information to lenders; and
- Improving the banking industry database, through developing the borrower loan history.

According to the latest data, the banking system appears to be lucrative. Return on assets for the entire year 2008 is expected to be 1.17 percent, while return on equity 14.7 percent. During the present year, banks have expanded their investments while augmenting their capital on the other hand. Capital adequacy accounts for 17.5 percent of total assets and off-balance sheet items classified by risk. The liquidity situation of the banking system for year 2008 is presented as good. Despite the downward trend shown in the recent years (owing to the high credit growth rate), liquid assets to total assets in the system account for about 46 percent, which is considered as being satisfactory. The main resource of funds in the system – customer deposits – have been ever-increasingly consolidating their upward trend, mirroring public confidence in the Albanian banking system. As of end October, total deposits in the system amounted to 665.9 billion leks, up by 5.7 percent compared to end-year 2007.

Following the open forum this spring, the Supervisory Council paved the way to approving a package of new regulations, which aim at harmonizing the regulatory and supervisory framework with the best international practices.

In accordance with the new banking law, new criteria have been established for measuring, supervising and reporting of bank's large exposures to a person/customer or a group of related persons/customers or having a special relationship with the bank, aiming at managing the risk stemming from the concentrated exposure to them.

The strengthening of internal control in banks and branches of foreign banks has been another focus of the Bank of Albania during the present year. The new regulation considers internal control as part of bank's accountable governance. It provides the platform for establishing an efficient internal control system as key factor in the banks and branches of foreign banks' governance and management.

Special attention has been also paid to the transparency related to banking and financial products and services. The regulation harmonizes the requirements on the way and mode on providing information to customers on banking products and services, on the publication of effective interest rates on deposits and loans, on the method of calculating the effective interest rate on loans, on the constituent elements to be specified in loan and deposit contract, on the marketing of products and services, on keeping the customer's data confidentiality, on dealing with the customer's complaints and on the establishment of specific structures to deal with these complaints.

Part of this new package has also been the standardization of the required information that banks and branches of foreign banks have to make public, related to the bank's main activity, its organization and management, its financial performance, its financial situation, the risk management and the accounting policies.

In light of the international situation and in order to better diversify the risk stemming from the concentration in banks' investments in the international financial markets, the Supervisory Council of the Bank of Albania amended the regulation on the management of risk from banks' large exposures, aiming at reducing large exposures' threshold.

Enhancing the efficiency of the financial market and of the money market in particular, has also been at the central bank's focus. During the year 2008 was approved the regulation on the master repurchase agreement, hence providing a new instrument which reduces risk in borrowing transactions between banks.

After this short outline of our performance, of the Bank of Albania and of the banking system, it comes natural to claim that we have acted rightly by taking a number of preventive measures that have helped us absorb the negative effects of the latest events.

Dear bankers,

Year 2008 is leaving and a new year is coming now. Like the majority of various world economies, even our country is in front of many uncertainties. I would not like to overlook the domestic factors, but however, what is currently considered as the hottest issue, has to do with the overall global environment. For a long time from now, various agencies, and national and international institutions have forecasted a year of world contracted overall production. It would be utopian, and to a certain extent a lack of prudence, if we think that our economy would be slightly or not at all affected by global crisis. Though Albania is a small economy, it is open, with numerous relations for exchanging goods and financial funds.

I have emphasized in my public presentations that all the actors should be prepared for harder days. In light of this I would like to notify you of a number of statements, findings or actions that we (I mean the Bank of Albania and the banking system) are going to carry out in the coming months.

1. Based on the latest analysis of the country's economic and financial developments and on inflation forecasts for two forthcoming years, I would like to emphasise that there is a good anchoring of inflationary expectations around the Bank of Albania's 3 percent target. Latest developments and information suggest that risks balance to future inflation is shifted to downward trend, creating space for manoeuvring in the near future.
2. Based on recent empirical studies of the Bank of Albania, it comes out that the relation of credit to economy with the country's economic growth is positive and relatively strong. So, the credit growth leads to maintaining current paces of the country's economic activity. In the recent years credit to economy has eclipsed the contribution of the public sector to generating and using financial funds, also based on a long process of the country's fiscal consolidation. This process of more effective usage of funds impacts on increasing the efficiency and the economic growth. A contraction of credit to economy carries over the risk of reverse action, of eclipsing the credit to economy contribution from the public sector's spending. In this sense, being aware of all the difficulties ahead, I would insist once more on my request to you to continue to keep credit to economy paces.
3. Further to my previous requests, I would once again require from you to be more active in the money market, in the interbank market and in securities market. The Bank of Albania has repeated time and again that we will satisfy all the financial market liquidity needs, but on the other hand we require from you to be more independent from your headquarters, in the policies you apply with relation to domestic financial market, in terms of

investments portfolio. You are licensed and operating in Albania, therefore, you have under your management the Albanian citizens' savings and the essential task of every banking system is the financial intermediation in the country they are operating. The Bank of Albania will insist for the fastest implementation of repurchase agreements in the transactions you carry out in the interbank market. The Bank of Albania makes use of a systematic approach in its dealing with and operating in the interbank market, which necessarily requires an efficient liquidity re-allocation among banks. Such a thing is carried out by applying repurchase agreement, thus preventing credit risk. In the meantime, the Bank of Albania is completing the regulation on DVP (delivery versus payment), which will simultaneously bring about even the settlement risk prevention. This constitutes another step in terms of financial infrastructure improvement for an efficient banking market.

4. The Bank of Albania is also looking into some other measures to better precede the optimal functioning of the banking system. Under more concrete terms, the Bank of Albania will require that the dividends materialised over 2008 be destined to increase the capital of banks you manage. I have constantly pointed out that our system is well-capitalised, but however under current conditions I regard its further increase as a prudential measure.
5. One of the strategic goals for the central bank's objectives is the strengthening of its institutional independence and credibility, being a central and accountable institution for the mission entitled by law. One of the factors impacting directly and indirectly on the strengthening of this independence is also the fulfilment and improvement of the Bank of Albania's legal framework in line with contemporary standards. To this end, we are working under three main directions:
 - Drafting the Law "On Payment System in the Republic of Albania" is included in short-term priorities that the Republic of Albania, through the Bank of Albania, has undertaken in view of the obligations deriving from the SAA, the European Partnership, as well as in short-term and medium-term priorities required under the National Plan for the Implementation of the SAA. This draft law aims at:
 - Strengthening the system's institutional framework;
 - Enhancing legal framework transparency through tasks clarification of participants in the system;
 - Stipulating a complete regime for licensing and supervising the whole relevant systems.
 - Alterations in the legal framework of the Bank of Albania will be also associated with effective regulatory framework improvement, having banking supervision regulations on focus.
6. The Bank of Albania, starting from this year-end, will launch into circulation the new banknote with the face value of 2000 leks, while the whole existing series has been re-printed. I would like to highlight that the whole series of the re-printed banknotes and of the denomination 2000 leks is equipped with most modern security elements. In the meantime I avail myself of the opportunity to clarify to the public that the new denomination is an adjustment of the current structure, filling in a large gap between both existing denominations of a higher nominal value.

2009 will be a difficult year, and therefore everyone should take appropriate measures to correctly realise and interpret his role with professionalism. To maintain the dynamics of the country's steady development toward full European convergence, the banking system must further perfect its infrastructure. I would regard the improvement of customer service and the increase of public education and communication as sound foundations of this infrastructure. All the above-stated, along with technology investments, would enable a higher transparency to clients and more competitive service costs. This would lead to improved image to the public, enhancing the public confidence in the banking system.

Dear bankers,

Allow me to conclude my speech by emphasising once again the great importance the moment imposes to us. Wherever we are, inside the country or abroad, we must regard the challenge of overcoming this crisis as a patriotic task, which requires commitment and a high moral, social and political awareness.

Thanking you once again for the invitation, I avail myself of the opportunity to wish you happy year-end celebrations.