

Ardian Fullani: Recent developments in the global and the Albanian economy

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the regional meeting, Korça, 13 February 2009.

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I feel very privileged to be among you again, in this marvellous audience of intellectual values and professionalism. It is the second time I visit Korca in the capacity of the Governor of the Bank of Albania and I observe with pleasure that this city has made admirable progress. Allow me to emphasise once more that Korça, this charming and hospitable city, has given and will always give me pleasure.

Usually favourite topics for a Governor are monetary policy, financial stability, banks and money, structural reforms and economic-financial policies. However, the current situation makes inevitable the communication on recent developments the global economy in general and the Albanian economy in particular are being faced with.

Global economy is confronted with numerous challenges. 2008 year-end and January 2009 have definitely confirmed recession in the USA, Germany, Britain and Japan, let alone many other European emerging economies, such as Ukraine, Hungary, Byelorussia, Serbia and any other country.

While risk of further financial stability shocks is overcome for the developed economies, the economic situation is deteriorating more and more, where unemployment is increasing rapidly, along with output reduction. In the meantime, the emerging economies are experiencing a deterioration of financial conditions, tightening of lending, pressure on exchange rate and at the same time significant reduced demand for some very important branches of the economy.

I made this introduction to make you understand that global economy is experiencing a great contraction, which as concerns the shocking intensity and extension, has never been experienced before in the modern history or after the second world war. Many taboos have fallen and continue to fall. The grave financial crisis ignited and erupted at the heart of capitalism, in the USA and from there it spread up quickly all over the world.

Though it may sound paradoxical, our economy has been resistant to this tsunami. According to available official data and judging upon a number of indirect indicators, we have concluded that the economic activity over 2008 performed in line with the early 2008 projections.

Generally the economic activity at home has been sustained by domestic financial resources, while the Albanian banking system has been dynamic and effective in channelling the savings towards the funding of corporate production or household consumption. This process has been also facilitated by the macroeconomic stability, which has enabled the fall of risk perception in the economy.

Dwelling briefly on the fulfilment of legal obligations of the Bank of Albania, I would like to highlight that inflation returned within the 2-4 percent target of the Bank of Albania over the second half of the year. The relaxation of supply-side shocks and appropriate monetary conditions have been key factors enabling the balancing of demand and supply-side factors.

During 2008 the key interest rate was held unchanged, at 6.25 percent, aiming at and materializing the anchoring of economic agents' inflation expectations close to the 3 percent target of the Bank of Albania. Money market activity was conditioned by the performance of monetary indicators and the real economy. In response to these developments, the Bank of Albania intervened in the money market by injecting liquidity of different maturity terms. Also,

in order to better satisfy the banks' needs, the Bank of Albania changed in November the repo auction form to auctions with undetermined amounts.

In the end of January 2009 the Bank of Albania's Supervisory Council decided to reduce the key interest rate by 0.50 percentage point, recording a turning point in the monetary policy stance in terms of easing it.

However, I should underline that developments during 2008 year-end and early 2009 enable an objective and real assessment of the overall economic-financial situation of the country for the present and the future. Let me mention two or three of them, bringing our insight to your attention.

1. During January 2009 the logical reluctance of individuals towards their bank, reflected mainly in the form of deposit withdrawal over the period of October-December 2008, came to an end. Naturally this is a good news indicating that the Albanian banking system has passed a difficult exam, which many of its "colleagues" in the region and beyond could not pass. The liquidity situation has ameliorated. Symmetric distribution among banks has promoted increased volume of interbank market transactions, turning it back to normal trading levels. In response to Bank of Albania's reaction, this has been associated with reduced interest rates for all instruments and maturities.

Is it accidental? Is it merely destiny?

No, it has neither to do with destiny, nor with turning back to any slogans of the centralised economy era.

According to latest data, the banking system appears profitable. Return on equity is 11.35 percent for 2008. In the meantime, banks have extended their investments but they have also increased their equity. Capital adequacy rate is 17.23 percent of total assets and risk-rated off-balance sheet items, while loan portfolio quality is at satisfactory levels.

Year 2008 coincides with increased prudential policies of the Bank of Albania in terms of adopting a more conservatory approach. The passing of the new banking law, the 2007 developments once credit bubble exploded in the USA and high lending rates over 3-4 last years were assessed with prudence by the Bank of Albania. Therefore, in early 2008 the Bank of Albania organised the first open forum with the banking system, submitting through an open communication, a new packet of prudential regulations for being discussed there, aiming at consolidating the financial stability of the country.

The Bank of Albania's Supervisory Council gave way to the approval of the whole proposed packet, thus creating an effective vaccine, which has produced appropriate antibodies or has provided the immunity I mentioned earlier in my speech.

Which are these modifications that have increased our resistance so much?

- In compliance with the new law, there were approved new criteria for calculating, supervising and reporting large exposures of banks to parent banks and connected subjects, aiming at managing the risk deriving from concentrated exposure to them.
- In order to achieve a more effective management, a new regulation was drafted, strengthening the internal audit in banks and branches of foreign banks. It regards the internal audit as a part of the general governance of banks. It ensures the platform for creating an efficient internal audit system, as the main factor in management and administration of banks and branches of foreign banks.

- A special importance was given to transparency of banking and financial products and services. This is another aspect where we intervened during 2008. The new requirements standardise the way and form of supplying customers with information about banking products and services. Special emphasis was laid on obligatory publication of effective interest rates for deposits and loans. Through this information bank customers may get acquainted with calculation of loan effective interest rate, elements of credit and deposit contract, marketing of products and services, maintaining of customer data and confidentiality, dealing with customer complaints and establishment of specific structures relating to such complaints.
- Part of the new package was also the standardization of obligatory information the banks and branches of foreign banks should disclose about the main business of banks, their organisation and management, financial performance and position, risk management and accounting policies.
- Taking into consideration the international situation and aiming at a better diversification of risk deriving from the concentration of bank investments in international financial markets, the Bank of Albania's Supervisory Council made some other amendments to the Regulation on Risk Management, consisting mainly in putting more prudential benchmarks on large exposure indicators and on the techniques of collateral calculation and recognition.

After presenting the work we have done during 2008, naturally we have the right to claim that we have acted appropriately, taking many preventing actions, which have helped absorbing the negative effects of recent developments.

2. Initial data of December 2008 indicate a contraction of credit to the economy, particularly of credit in foreign currency. Allow me to explain once more that it has to do with one of the gravest symptoms accompanying the latest financial crisis internationally. This is so real that in developed economies, credit to the economy and the interbank channels have almost stopped functioning or are operating at minimum levels.

Though peripherally, this development has been materialised even in our economy. However, I believe that, what really matters is the future. Of specific contacts we have had with banks operating in Albania, we have drawn the conclusion that we share the same concern that a drastic stoppage of credit to the economy would gravely damage the economic activity of the country and the financial system's position. Therefore, we are constantly communicating with banks, to guarantee that during 2009 the Albanian economy will receive the deserved financial support from the banking system. I am confident that the presence of senior representatives of the banking system here in this hall testifies the awareness and understanding of this concern.

The decision made some days ago by the Bank of Albania, as also stated in the press release on the Supervisory Council's meeting, creates "more breath to the economic activity of the country". I feel well to observe that the banking system has already reacted. Treasury-bill and interbank market interest rate reduction has been evidenced.

3. Interbank money market development, as a necessary bridge for enhancing the effectiveness of monetary policy transmission, has been and will always be in Bank of Albania's focus. As such the interbank market development has been subject to discussion in many meetings conducted by the Bank of Albania. In these meetings banks have highlighted credit risk as one of the main obstacles for the development of this market. To minimise this risk, the Bank of Albania drafted the Law on Repurchase Agreements and sample contracts.

The passing of this Law finalised the Bank of Albania's endeavours to set up an appropriate legal infrastructure for the market of repurchase agreements among commercial banks. Following its passing, the Bank of Albania held a number of meetings, aiming to clarify its core elements. The main purpose of these meetings was to speed up the concluding of relevant contracts among banks, in order to materialise the practical implementation of this Law. The period we have left behind is regarded as sufficient for finalizing the process of drafting and signing individual contracts on repurchase agreements. Therefore, I draw the attention of the banking system to proceed quickly, sparing the time for signing respective contracts. The process finalization should be necessarily followed by daily quotations of banks in terms of interbank borrowing and lending.

The latest decision of the Bank of Albania's Supervisory Council serves the spirit of transparency increase and customer protection, making compulsory the quotation of mortgage loan rate on the basis of Bank of Albania's key interest rate.

Distinguished participants,

Recently the Bank of Albania has constantly stated that year 2009 carries over numerous challenges, which in the context of sharp global issues, make our task more difficult. However, I would highlight that assessing objectively the current situation and that of the near future is an expression of prudence. We at the Bank of Albania remain committed to monitor cautiously all the economic-financial developments, willing to take proper actions to further consolidate the macroeconomic and financial balances.

In this way we accomplish our constitutional service for the country's sustainable growth and development. In this difficult task, I avail myself of the opportunity to invite all the stakeholders and the broad public to become part of the dialogue for finding ways and optimal solutions, in order to minimize the negative effects the international economy transmits to our country.