

Ardian Fullani: Monetary & financial stability policies – lessons from the crisis

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the 8th International Conference of the Bank of Albania: "Monetary & Financial Stability Policies – Lessons from the Crisis", Tirana, 17 September 2009.

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Honourable Mr. Prime Minister,
Dear Governors,
Distinguished guests,

I feel deeply privileged to open the proceedings of the 8th International Conference of the Bank of Albania entitled: "Monetary & Financial Stability Policies – Lessons from the Crisis". I hope the proceedings will help the participants better realize the issues facing the global economy during this period and draw the proper lessons. I am personally convinced that the prominent speakers' reputation is a guarantee in this regard. Before I invite the guests to discuss the features and lessons drawn from the global and regional crisis according to their viewpoints and experiences, allow me to say a few words on this conference.

The topic chosen to be dealt with in this conference is at the forefront of the institutions' agenda, responsible for macroeconomic policies and financial system surveillance at a national and international level. The panic that followed the Lehman Brothers' failure almost a year ago transformed the turmoil in the U.S. mortgage loan market into a genuine global-wide financial crisis. The integration of the financial markets caused the crisis to spread swiftly, while the vital role of the credit system in free market economies transformed it into a global recession, hitting the East and South-East European countries as well.

The experience gained so far has allowed a better acknowledgment of the causes that led to the crisis and the factors that triggered and accelerated its spreading, and a reassessment of the diverse supervisory and regulatory practices. I would like our discussions on the crisis to focus on two directions: what we learnt and what we could not learn from the crisis. Among the numerous aspects debated at length, I would like to distinguish three of them: the dichotomy between the state and the market, the degree of confidence in the forecast models, and the importance of coordinating the pre-emptive measures.

With respect to the "state vs. market" debate, I would like to re-stress my unwavering confidence in the market and our commitment as policy-makers to make it operate by the rules and efficiently 24/24. The last few years have witnessed the rapid development of forest models and techniques. Avoiding the tendency to underestimate their high importance to the day-to-day work of every analyst and policy-maker, we have to be aware of the restraints in these models and of the risks arising from the excessive reliance on them. The high cost of coping with the consequences of the crisis makes us aware of the importance of building pre-emptive mechanisms and above all, of the importance of coordinating them at a national and international level.

Today, nearly two years after the first signs of the crisis, the global economy and financial market are in a more optimistic situation. The economic recovery has been reflected in improved business and consumer confidence indices, mitigated deflationary pressures, normal functioning of banking and financial systems and higher economic activity growth rates in almost all production sectors. As in the other regional countries, these developments have been present in Albania as well.

The last quarters have attested to higher lending to economy, improved confidence in the banking system, relative exchange rate sustainability and the anchoring of inflation expectations.

There is now a global consensus that the hardest part of the crisis belongs to the past. This is certainly good news although not sufficient. Time is ripe to consider all the options for the so-called “exit strategy”. The mitigation of anti-crisis measures’ side-effects calls for co-ordinated, proper and timely actions. Policy-makers need to reassess macroeconomic and financial policy objectives in the light of the most recent positive developments.

Narrowing down the geographic extension of my discussion from global to regional, I will briefly dwell on some of the above-mentioned issues.

I once told a friend of mine that small open economies, as is the case with the Balkan economies, are net importer of goods, services and crises. The crisis did not originate in the region. It was gradually transmitted as a result of the integration of the region with the global markets and economy and a consequence of the presence of large international banking groups. Our countries are all as similar as they are different. Consequently, the form, outburst and consequences of the crisis were as similar as they were different. The economic and social structure, the level of convergence and integration with the global markets, the legal and institutional norms and the nature of exchange rate regimes in particular, have established the features of the crisis for each country. The experience of the distinguished governors present in this conference will throw light on the above aspects.

As regards the Albanian case, the last 12 months have been challenging for the banking industry. Despite the turbulent times, the banking system has in no case shown any signs of panic or confusion. The Bank of Albania considers that the rationale behind is the prudence shown in the recent years with respect to the banking system’s financial stability.

The high level of resilience and the quick recovery were a consequence of a number of important decisions. By adopting the new banking law in the Republic of Albania and a range of other monetary policy and banking supervision-related decisions, we have aimed at firming up the macroeconomic balances further and strengthening financial stability. At the focus of the Bank of Albania’s strategy were the good governance and better risk management, improved banking activity transparency to the customer and the strengthening of internal control. This strategy peaked with a large-scale, exceptional and contemporary programme of open and constant communication with the public.

I believe that the favourable liquidity and capital situation characterizing the Albanian banking system on the eve of the financial crisis last fall helped to cope with the withdrawal of deposits during September-October 2008. However, the Bank of Albania deemed as necessary the prudent monitoring of the situation and took a number of actions, which alleviated the pressures over the banking system substantially. These actions helped to relax the liquidity situation and they were in harmony with the ECB’s operational response to the crisis.

First, an ad-hoc task force was set up. Its main responsibility was and remains the daily monitoring of each individual bank. Our direct conclusion was that the analysis should consider all micro-level aspects, each and every cell of the system and indicators.

Second, a number of facilities were adopted for the incessant supply of the system with the required liquidity. The type of auction for the injection of liquidity changed to fixed-price auctions, the collateral base for repo agreements expanded, the use of the required reserve increased from 20 to 40 percent, and the spread between the Bank of Albania’s key interest rate and overnight loan reduced from 175 to 75 basis points.

Third, through a special act, the Bank of Albania required higher capitalization of banking activity from the banking sector, adding to the guarantee of the banking sector’s financial soundness.

Current financial system developments show that the overall situation in the banking sector has improved constantly. Deposits are back to the banking system, attesting to the improved public confidence.

Credit to economy has also shown signs of recovery. Another positive development relates to the fact that lending in the Albanian Lek has increased considerably. The European markets have been performing amid a more optimistic climate. Statistics show that the recovery of the crisis began even before the most optimistic forecast.

Distinguished guests,

I believe the prominent panellists and the central bank governors of our region will address all the issues related to the crisis and the lessons drawn from it thoroughly. However, allow me to briefly address some issues I believe are of interest to the audience.

First, the large-scale globalization of the world economy in the past two decades could not but spread the crisis throughout the world; consequently, there was an immense need for co-ordinated protection at an international level. In the early days of the crisis, we saw biased actions which led to arbitrage of negative effects.

Globalization requires the financial infrastructure to be everywhere similar in shape, contents, and human and technological capacities. It should operate under similar standards and practices and have the proper flexibility to precede the financial novelties.

Second, the last crisis calls for the pre-emptive and forerunning nature of supervision and legal regulations in general. I believe a regulatory framework is genuinely effective and successful when it intertwines the simplicity and transparency of a rule-based approach with the flexible and far-sighted characteristics of a principle-based approach. At any case, this is indispensable to make banks accountable, to convince the supervision inspector on the risk characteristics and on the transformation of new different on- and off-balance sheet products, before they exceed a certain threshold in terms of magnitude and exposure. The Bank of Albania is making efforts in terms of identifying the aspects that need further improvement. In this undertaking, we will take into account the similar developments in the region and broader, to preserve the market competitiveness and the convergence in supervisory practices.

Third, I believe that the crisis requires the existence of an international institution which should guide the financial stability, assess the systemic risk and determine the quantitative indicators measuring it. In this process, it is important that the regulatory norms be transparent to everyone. At the same time, it should be followed by an accelerated convergence process of the supervisory and regulatory practices according to the financial centres of influence.

Fourth, the current crisis confirmed our concern related to the exposure of the Balkan region to a relatively small group of banking operators of vast regional extension. Shocks affecting parent banks would affect one or several regional countries. A similar risk still persists even in the case when one of the branches in the region is hit by a shock. Similarly, the contagion risk is still present.

Fifth, I believe the region should scrutinize carefully lending in foreign currency. It is essential to set a better balance between lending in the national currency and lending in foreign currency.

To this aim, the nature of the exchange rate regime and the impracticability of central banks in the region to act as lender of last resort should be taken into account. In this context, we should support a stronger role of the national currency in bank lending, making lending in foreign currency more costly for banks if it is not supported by savings in foreign currency. The strong reliance of banks on foreign currency financial resources to support the rapid lending should be addressed and managed timely.

Sixth, I think the current crisis will make the financial funds, which for a long time have rushed in numerous forms across all former communist countries of East Europe, scarcer. This situation may have considerable implications for the long-term economic growth rates in the regional countries, which still are in need for foreign financial funds to support their

convergence process. Therefore, I believe that the crisis has called for another lesson: the need to draft and implement joint regional programmes and structural reforms to absorb projects and financing lines, which will in turn expand and deepen our joint Balkan market.

It is true that after each crisis, macroeconomics as a science has made steps forward. Each crisis represents an event with specific characteristics, dissimilar or partly dissimilar from the previous crises. Each crisis brings in new information, regardless of the intensity, geographic extension or duration. Each crisis fills in a piece of the hard puzzle of free-market economy functioning, helping to a better understanding of the whole.

I hope to provide a consensual conclusion if I say that we, the administrators, had the fortune to govern in a time of crisis and that we have a motive to feel privileged – and why not proud – to have coped with the challenge, being witnesses and active players in that regard.

Thank you for your attention.