

## **Ardian Fullani: Development of the interbank market in Albania and the Bank of Albania**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the Forum “Interbank Market Development and Improvement of Operational Policy at the Bank of Albania”, Tirana, 21 June 2010.

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Dear bank managers,

Dear colleagues,

We are gathered here today to discuss an essential issue concerning the performance of our financial market and the Albanian economy on the whole: interbank market development and strengthening.

I do believe that the role and importance of the interbank market is clear to all attendees. It represents the first link of liquidity trading in economy and the most transparent price setting mechanism.

By providing the appropriate instruments and partners for liquidity trading, the interbank market allows the refinancing of short and medium-term positions and facilitates the mitigation of your business' liquidity risk.

The banking system and the interbank market represent the exclusive setting monetary policy operates in. A developed, active and efficient interbank market enhances the efficiency of central bank's monetary policy, transmitting its impulses into the economy best. Thus, the development of the interbank market smoothes the progress of financial intermediation and boosts lending to economy, hence improving the country's economic and social welfare.

The deepening and broadening of the financial market is one of the key structural reforms in economy. It should be ceaseless and it requires the commitment of domestic and external factors. It naturally adapts to the different economic development stages the country and the state go through. I do believe there cannot be a developed and well-integrated economy without open, integrated, efficient, transparent and well-regulated markets.

Therefore, it comes out clearly that the development of the interbank market is in all stakeholders' interests: the banking system itself, the Bank of Albania and the economy on the whole.

Being fully aware of this, the Bank of Albania has built a clear strategy in terms of:

1. Deepening and broadening the money market in Albania further;
2. Creating relevant market instruments;
3. Establishing a close and rational cooperation with the banking system and the financial market in general;
4. Ensuring a clear and constant communication with the market operators and the public at large;
5. Providing modern technological solution.

As a result of these initiatives, our monetary policy is now entirely based on indirect instruments of monetary management, which operate in line with the open market logic. Our operational framework allows the banking system to manage the liquidity effectively, being a counterparty of the last resort to meet the system's aggregate needs for liquidity or invest it.

Via the required reserve, the Bank of Albania has provided you with enough room to cover your unexpected liquidity needs, at a remuneration rate close to the market interest rates that

avoid the distortions the required reserve may yield to your banking business. Our regulations, which restrain the banking business operational, liquidity or market risks, are in full compliance with the international standards, providing at the same time enough room for the development of the interbank market. We have also taken major steps in terms of the institutional development of this market, through the establishment and maintenance of TRIBOR and TRIBID reference rates, through constant communication with the dealers' association and promotion of new interbank market instruments.

I would like to inform you today of the last Bank of Albania's step in this regard, and also ask for your greater attention in terms of taking prompt actions that will boost the activity and role of the interbank market.

### **Change of the Bank of Albania's operational target framework**

The Bank of Albania is in the final phase of reviewing its operational targets. The latter will soon change their form, shifting from the quantitative targeting of the Bank of Albania's balance sheet to the targeting of interbank market interest rates.

The operational targets of monetary policy play a key role in the formulation and conduct of monetary policy. In a theoretical background, these targets serve as a link between the monetary authority's interventions in the interbank market and the intermediate target of monetary policy. Thus, the operational targets serve as the starting point of the monetary policy transmission mechanism. In practice, these targets serve to steer and discipline the monetary authority's interventions in the money market quantitatively. The rapid transformation of economic structure and the development of interbank markets and economic agents were coupled with fundamental changes in the monetary policy transmission mechanism. The latter has now become more complex, involving more players whose sophistication is ever-increasing, and incorporating more instruments and financial contracts that are timely structured and indexed to different indicators. The Albanian economy is now economically and financially integrated into the global economy, having the characteristics of a market economy but at the same time featuring the typical challenges of economic management that such an economy entails.

These changes have called for the constant monitoring by the monetary authority in order to make the necessary changes in the monetary policy regime and the operational aspects of its implementation.

Against this background, the Bank of Albania has been committed to a process of constant evaluation of the interbank market performance and at the same time fine-tune its monetary policy regime.

The Monetary Policy Document for the 2009–2011 Period was a major step in this regard. In this Document, the role of monetary aggregates as indicators of inflationary pressures in economy and as intermediate targets of monetary policy was complemented with a wide range of information provided by the real sector of the economy, which is systemized and finalized in the inflation forecast performance. This change was entirely based on the Albanian experience.

The development of money markets and progress in financial innovation, the rapid growth of lending and dollarization of the economy, and the increasing role of real estate in the investment opportunities caused the functioning of the Albanian economy to become even more complex. They were supplemented with unstable velocity of money circulation hence toning down the short and medium-term link between monetary aggregates and inflation.

This change materializes the modernization of monetary policy decision-making based on a more complete information analysis that aims at managing the market operators' expectations.

One of the directions the Bank of Albania's work has been focusing on during the past year, as we have transparently stated in our Monetary Policy Document, was the assessment of the suitability of operational targets and the adoption of more advanced forms. The quantitative targeting of the Bank of Albania's balance sheet, in the form of a ceiling on the net domestic assets and a floor on the net international reserves, has for quite a long time acted as a guide to our interventions in the interbank market.

In spite of that, the abovementioned developments suggest that there is plenty of room for improvement in this philosophy and practice. Targeting the interbank market interest rates seems a practical option that finds ample theoretical support and whose application has proved successful in a number of advanced economies.

Broadly speaking, this operational philosophy is guided by the need to steer the short-term interest rates in the interbank market close to the key interest rate set by the monetary authority. As such, it serves better to keeping the short-term horizon of the interest rates' curve under check, making the conduct of monetary policy more transparent and providing clearer signals for the economic activity. Steering our operations to the stability of interbank market interest rates will serve to a more relaxed functioning of the interbank market and lowering of risk premiums. In addition, this operational target is well-framed in our medium-term steering and commitment to adopting the inflation targeting regime, making up an important link of its successful adoption.

Concluding my theoretical discussion of this change, I would like to underline that our long-term commitment to keeping our foreign reserve at optimal levels to cope with the shocks Albania may be faced with remains an unquestionable objective of our monetary policy.

In an institutional aspect, I would like to note that such a move does not only attest to the level of maturity of our interbank market. It also crowns our constant efforts in achieving its utmost efficient management.

In this context, the Bank of Albania has made utmost efforts to develop liquidity forecast models, to dampen the impact of fiscal flows into the money markets and to develop optimal procedures and modalities of interbank market interventions. I do strongly believe that our efforts will persist in the future as well, enabling a smooth shift of the operational target and optimal functioning of their new form.

## **Interbank market development**

Dear colleagues,

Bank of Albania's role in promoting the interbank market is indisputable. However, we are fully aware that the development of this market mostly reflects the results of the banking system's own development and efforts.

Therefore, the Bank of Albania requires your utmost attention in this regard. More precisely, in our discussion today we would like to have your opinion on the three steps we consider will boost the development of the interbank market. First, setting the prime rates in the functioning of commercial banks. These rates can and should serve as a guide to setting prices on banking products, both on the assets and liabilities' side. Second, the functioning of the collateralized market through repo or reverse repo contracts. Although in its classical concept the interbank market is an uncollateralized market, its enhancement with the abovementioned instruments would open the way to its thorough development, ensuring a more efficient distribution of liquidity among the market operators. Third, banks can and should be active in quoting the liquidity in the Albanian lek, keeping the same stance as in the foreign exchange market. The constant quotation will encourage a more active liquidity management and it will enable its continuous price setting.

Dear bank managers,

The Bank of Albania considers the development of the interbank and financial market as a process that requires our constant commitment but which provides tangible benefits to all of us. I invite you now to an open and fruitful discussion to share our opinions on the right paths that will encourage this market further.