

## **Ardian Fullani: The Albanian economy and the banking sector in 2010**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the reception of the Albanian Association of Banks, with bankers and representatives of banks operating in Albania, Tirana, 17 December 2010.

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Dear bank executive managers,  
Dear participants,

It is always a pleasure to meet once the year-end approaches to make a summary of events that characterized the Albanian economy and the banking sector over the course of 2010.

The Albanian economy is forecast to grow in 2010 slightly higher than in 2009. Industry and services provided the largest contribution to the positive economic growth, yielding as well a relative improvement in the balance of payments' current account. Lek's exchange rate was more stable compared with the preceding year, whilst consumer prices fluctuated within the Bank of Albania's target of 3%.

Fiscal policy engaged in a process of fiscal consolidation during the present year, which we consider as critical in order to preserve the budget deficit and domestic debt levels and keep the level of interest payments in check.

Developments in the financial system attest to the full recovery of public confidence in the banking system. As at end of the third quarter of 2010, total banking sector assets accounted for 81.7% of GDP, up 12.2% y-o-y versus merely 0.9% in the same period in 2009.

Deposit growth and higher capital account provided the major positive contribution to the expansion of banking sector activity. Deposits have grown by 18% y-o-y, out of which more than 2/3 of this figure represents foreign currency-denominated deposit growth. Banking sector treasury and interbank operations declined versus the same period in 2009. Liabilities to non-residents have dropped by 32% y-o-y.

Concerning the composition of banking sector assets, we note that lending has grown by 8% on a yearly basis. The annual growth rate of lending has been constantly downward in the last couple of years. Banking sector and interbank operations have grown by about 25% on a yearly basis.

Banking sector investments in non-resident assets increased by 53% y-o-y. Net profit was positive and substantially higher than in the same period in 2009. Return on Assets and Equity stood at 0.6% and 6%, respectively. Capitalization and liquidity figures were at adequate levels. Capital adequacy ratio was estimated at 15.7%, while liquid assets accounted for 28.9% of total assets. As part of the regular stress-test analyses conducted by the Bank of Albania, in the context of a more comprehensive risk evaluation, the banking sector results stable.

Let me now elaborate on some issues I find critically important for the future.

The banking sector weathered the hard liquidity situation in year-end 2008 and early 2009 successfully. Following that period, public deposits in banks have grown at stable rates and liquidity has improved markedly. However, lending has contracted pronouncedly, initially as a result of the higher credit risk and later, due to the fall of business and consumer demand for loans.

Therefore, the free funds were invested in non-resident assets against a background of lower return on investment in the global market. The deteriorated loan quality, the obligation to increase the reserve funds and the lower average rate of return were followed by the decline in the banking sector net profit.

For some banks, this situation needs careful monitoring by the governing structures and shareholders in order to identify those operations that would improve the expenditure and income structure and maintain its capitalization levels.

With regard to lending, the Bank of Albania has continuously called for greater banking sector commitment in this regard. This has not been a rhetorical-like request considering that we have taken all the necessary actions to meet the banking sector needs with ample liquidity and we have cut the key interest rate several times. These measures, coupled with lower Government borrowing, have provided room for lower interest rates on ALL lending.

Nonetheless, their decrease still seems insufficient to push credit demand higher. Loan quality remains a challenge both for ALL and foreign currency-denominated loans. Against this setting, it is essential that banks do not only create in a prompt and rigorous fashion reserve funds according to the regulatory requirements, but they should also complete and improve the procedures and human and financial capacities that enable following-up insolvent borrowers. Complete acknowledgement of loan quality-related concerns and the full commitment of governing structures and shareholders allow for its more rapid and ultimate handling.

Otherwise, the banking sector's capacity to intermediate more effectively would be impaired for a longer time. Banks need to be determined to follow collateral execution procedures for insolvent borrowers. On the other hand, court decisions and particularly the actions of bailiff officers should be prompt and effective. I take this opportunity to appeal to the authorities to prioritize these actions.

If legal procedures need to be complemented and improved further in order to enhance efficiency, the banking industry should make the necessary proposals in a prompt fashion and the public authorities should commit to considering them.

Lastly, I want to elaborate on two other issues. The first relates to governance and accountability in banking operations and the second to the improvement of capacities for the identification, evaluation and management of risks.

These two issues have continuously been part of our regular communication as they rest on the cornerstone of a safe and successful banking activity, public confidence on which remains unwavering.

Concerning governance, last year I constantly highlighted the need for professionalism, commitment, responsibility, farsightedness and accountability to be reflected not only by you but they should also be embodied in your staff.

To make this happen, policies and rules for defining strategies for the development, concrete decision-making, control of particular activities and their reporting to the institution and the public need to be continuously completed and improved. Internal control systems are the ones to determine the institution's capacity to operate safely. They are indispensable to avoid any room that may be used for abusive actions that would impair the institution. I therefore request that you take the necessary measures in terms of financial, human and technological capacities in order to ensure the safety of each banking operation.

In pursuing its supervisory function, the Bank of Albania will have this matter under close focus and I assure you that any decision that may have hampered the safety of the activity will be handled with utmost stringency by the law. In a broader context, banking activity, in addition to operational risks, is faced with other financial-related risks.

We will therefore increase the regulatory requirements for banks to be engaged in an integrated process of risk evaluation and management proportionate to the level of development and sophistication. In a more practical approach, this implies that banks should have specific functional structures that monitor risks in the main activity areas and endeavour to anticipate their possible evolution and impact on banks' activity. These structures must be

in place in the largest banks and their products should be an integral part of the decision-making process.

Dear participants,

We are leaving behind a challenging year but other numerous challenges will follow for banking activity. They provide us the opportunity to put our vision into practice, in order to ensure a stable banking activity as a precondition for conducting an efficient intermediation activity with remarkable contribution to economic development at home.

Weathering the challenges requires courage and professionalism. In addition, banking institutions should provide an environment where accountable and professional human capacities are in the service of the public and the institution. I am confident that you will prioritize the foregoing matters in 2011.

I wish you success in your work and many wishes for the New Year!

Thank you.