

## **Ardian Fullani: Post-crisis challenges for Southeast Europe**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the annual meeting of the European Fund for Southeast Europe, Tirana, 8 June 2011.

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*Honourable Mr. Prime Minister,*

*Ladies and Gentlemen,*

It is a great pleasure and privilege for me to be here today, in this distinguished panel, to greet the start of the 2011 annual meeting of the European Fund for Southeast Europe, or EFSE as we are used to call it. More than four years ago, I was invited to the launching ceremony of this wonderful incentive here in Tirana. Two years ago, at its annual meeting that took place in Novi Sad, the Albanian government became a shareholder to the Fund. Today, we are gathered here again, in the capital city of Albania, to make the balance of this institution's work.

I avail myself of the opportunity to thank the European Fund for Southeast Europe, for its contribution to our region, for its financial support and expertise provided for the financial market development, without leaving behind specifically the EFSE's assistance to Albania through funding business projects at competitive terms, at a time when bank lending has posted slow paces of recovery.

The grave financial crisis of modern times has induced much volatility in the global economy. Today, the situation is assessed as more improved. In theoretical and scientific debate round-tables, efforts have been focused on identifying causes and taking measures to prevent recurrence of such events in the future. A new financial infrastructure is being designed. This is the context of this annual meeting, on whose focus is the identification of post-crisis challenges our region is faced with.

Allow me to briefly address two or three of my personal opinions about this situation.

Before the impact of international financial crisis, all countries in the region were involved in important reforms aimed at increasing the economic growth. At this stage, through necessary legal improvements and prudent development policies, there took place the opening of economies and the development of trade, increase in domestic and foreign investments, overall liberalization of markets and promotion of financial market development, to provide more qualitative and sustainable financial services to businesses and households.

From the macroeconomic viewpoint, fiscal policies in the region are aimed at fiscal consolidation through revenue growth and greater investment-oriented public spending. Monetary policies, thanks to different exchange rate regimes, have generally kept consumer price rise on track and interest rates have followed a downward trend. However, the global financial crisis has affected the countries in our region, due to some weaknesses that were present during the growth phase.

First, the closeness of our countries and the concentration of trade with the European Union area, as well as migratory movements, have brought about a large use of the euro in the regional economies. Economic growth has been financed, to a significant extent, by foreign resources, in the form of foreign-currency borrowing by the public sector, financial sector, businesses and households. A substantial share of the bank's liabilities and of the loan portfolio is in foreign currency. Foreign-currency lending has been dominant and preferable by parties.

This was due to a combination of factors, such as positive exchange rate trend, lower interest rates and good opportunities of the banking sector to fund these loans in the

wholesale markets. Foreign-currency lending to the private sector and households were used to a considerable extent for consumption.

Foreign investments in the tradable goods sectors, which would contribute positively to trade balance, were less than those in the non-tradable goods sectors. This is the case of Albania, Bosnia-Herzegovina or Serbia. It is estimated that in terms of the stock of foreign investments, at end-2008, the share of investments in the tradable goods sector ranged from 15% in Albania to 35% in Serbia. Therefore, in the pre-crisis period, some of the countries posted steady and even upward trade balance deficits.

Second, notwithstanding the efforts to develop the financial market, the banking sector continued to dominate the financial system of the countries in our region. This is a phenomenon of developing economies, which shows the great dependence of economic development on the banking sector condition.

The banking sector in some countries in the region is mostly owned by European banking groups. The financial crisis showed that the entry of foreign banking groups into a domestic market, besides advantages, it is also associated with elements of risk, which must be addressed duly and timely.

Third, the countries in our region have different needs for investments, highlighting those in road infrastructure, energy and health care. Also, demographic developments, including migration, and slowing population growth trend, have brought about increased costs of public pension schemes and other elements of social protection. Therefore, despite fiscal consolidation efforts, budget deficits have been present and steady all the time.

During the financial crisis period, public authorities were committed to overcoming the situation. Almost all governments of the countries in the region were committed to implementing fiscal stimulus policies, aimed at increasing the support to the real economy and the financial system. Monetary policy followed an easing trend, cutting the interest rates and satisfying the interbank market needs for liquidity.

Back to Albania's case, I would like to emphasize that our experience in absorbing the impacts of the crisis proved successful.

Albania, I think, is one of the countries that:

- Did not experience any bank failure or capital injection by the state;
- Courageously withstood the crisis of confidence in the banking system, where financial intermediation was never interrupted;
- The economy continued to grow in positive terms, albeit at a slower pace;
- Inflationary expectations remained anchored throughout all time.

During this period, the Albanian banking sector continued to increase its lending to the economy, albeit at lower paces. Difficulties added to the real sector of the economy and the exchange rate depreciation by about 12% in 2009 were followed by decreased credit quality and increased bank provisions to face the credit risk.

*Distinguished participants,*

The pre-crisis phenomena and those that occurred in 2008–2010, offer a valuable experience to economic actors and public authorities of each country in our region. Not to mention all, I would like to dwell only on some of them, which I consider important for enhancing the sustainability of our economy and of the financial system in the future.

First, the region needs a better balance in the factors supporting the sustainable economic growth. I think that the public authorities should assign priority to increase in investments and implementation of stimulus policies for developing the competitive sectors. In this way, the country's export capacity would grow by creating better conditions for a sustainable improvement of the external balance of our economy.

Second, closely related to the first issue, I would highlight the need for undertaking and deepening the structural reforms. This strategic objective remains a constant priority for each of our economy. Their focus should be comprehensive, meaning further adaptation of legislation, improvement of infrastructure, full privatization of public assets, improvement of the business climate, deepening and broadening of the financial market, comprehensive reform in pensions, as well as a number of other actions which I can not mention here because of objective reasons. I think that the inflow of foreign direct investments remains our major target. Without them the region would remain small, fragmented, with a low development, social and economic potential, with sporadic exports, with premature markets and high costs, or in other words, with a low productivity. Personally, I am of the opinion that each foreign investment means faster convergence to Europe.

Third, the financial market should develop to create other alternatives for savings, financing and risk management of economic entities, as well as for improving the conditions of these activities. Besides the banking sector, the share of non-bank financial institutions should also be rapidly developed, to enable a greater involvement and access to financial services for entities that can not benefit enough from banking services.

Furthermore, I think that it is important to pay more attention to development of capital markets, particularly those issuing and trading debt securities and equities by private entities.

Fourth, the regulatory framework and supervisory practices should be completed with some important elements in terms of prudential measures and emergency financial situation management. The prudential measures framework should cautiously treat capital and liquidity requests from banks, especially in the case of foreign currency. Simultaneously, it is necessary to assess the systemic risk in both, the financial system and the banking one, by constructing special indices and implementing best practices in stress-testing. In terms of completing the framework on management of emergency financial situations, importance should be given to the legal and regulatory reviewing and improvement process, the cooperation between public authorities and timely identification of various problems, particularly in systemically important institutions. The Bank of Albania has already entered in this reviewing and improvement process of the regulatory framework, on the basis of several pre-set objectives.

Concluding, I would like to emphasize that the countries in our region have successfully overcome a difficult period as a consequence of the international financial crisis. However, there are numerous challenges ahead. They require an ongoing commitment of all the factors of the country's economic and political life. The need for coordinating the actions both locally and regionally is an absolute priority.

I think there are in place all the prerogatives for making this cooperation effective, honest and of mutual benefits to each country in the region. To this end, I think that the European Fund for Southeast Europe will continue to play an important role, which once again I take this opportunity to congratulate for the work it has done and the commitments it has taken for the future.

Thank you!