

Ardian Fullani: Review of economic policies for Albania's fast, sound and stable growth

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the Meeting with the Chairman of the Socialist Party and the Albanian Banking System Executives and Representatives, Tirana, 25 July 2013.

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Dear Mr. Rama,

Dear Mr. Pencabliligil,

Dear banking system executives,

First of all I would like to thank you for the invitation. This round table is a follow-up of our philosophy of a dialogue between the Bank of Albania, the banking system and the Government to discuss the economic policies for Albania's fast, sound and stable growth. The presence of Mr. Rama, the incoming Prime Minister of Albania, gives this meeting special significance.

The banking sector is not only the greatest and the most efficient driver of economic growth in Albania, but also the custodian of Albanian household savings and the determiner of funds destination in the economy. Today's round table precedes discussions on the economic programme and budget of the incoming government.

Dear guests,

The Bank of Albania has just completed its periodic analysis of the Albanian economy. Also, in view of the Financial Sector Assessment Program (FSAP), we have maintained regular contacts with the international institutions to assess Albania's financial soundness. Availing myself of this opportunity, I would like to share with you some preliminary conclusions and present the central bank's vision for future development policies.

The Albanian economy is facing big cyclical and structural challenges. The cyclical weakness of aggregate demand restricts Albania's economic growth in the short and medium term, whereas the solution of structural problems will determine its long-term development. Overcoming these challenges requires joint, brave, coordinated and forward-looking action. The Bank of Albania deems that this action should be based on four pillars: (i) safeguarding macrofinancial stability in the country and pursuing stimulating economic policies; (ii) reducing uncertainty in economy; (iii) ongoing structural reform and (iv) convergence with the European Union.

1. First pillar: Macroeconomic stability and economic stimulus

As already known, Albania's economic development is in a fragile stage. Against the backdrop of the global crisis, the economic growth rates have decelerated, posing difficulties to the public and private sectors, to businesses, households and the financial system.

In plain terms, the aggregate demand is weak and does not manage to fully utilise the country's productive capacity. Consumer spending is low, primarily due to households' uncertainties about the future, but also due to their slowing income. The two other aggregate demand components also show limited ability in providing stable economic growth impulses: public spending is limited, due to lack of fiscal room because of a higher public debt, while Albania's exports suffer the sluggish demand from the international markets and the low degree of diversification. Finally, business investments are downward, reflecting businesses' restricted room for boosting their sales and banks' tighter lending standards.

The economy is a complex and interdependent mechanism. All the afore-mentioned factors have led to a sluggish labour market and elevated pressures on public finances. They have also increased vulnerabilities to many businesses and the non-performing loans in the banking system.

In Bank of Albania's opinion, this situation requires pursuit of stimulating macroeconomic policies. Economic theory and practice suggest that the maintenance of macroeconomic balances is a prerequisite to pursue these policies. I have reiterated that these balances do exist in the Albanian economy. They constitute a strong point for its future outlook. Inflationary pressures remain weak, external balances of the economy are improving and the Albanian financial system is healthy. But the macroeconomic balances should be maintained and further strengthened in the future. This objective is a preliminary filter and every macroeconomic incentive should pass through it.

Every macroeconomic stimulus should also consider another vital equilibrium: that of financial stability in the country, otherwise it is at risk of becoming unproductive. The global crisis has significantly elevated a country's exposure to risks related to financial stability. Therefore, this equilibrium should remain a constant priority and in concert with stimulating development policies. The healthier we are financially, the broader the spaces available to stimulate the development of the country.

Having said the above and availing myself of the presence of the three main stakeholders responsible for designing and implementing the macroeconomic policies, let me now share with you Bank of Albania's opinion about promoting the country's development in the short term.

The Bank of Albania, being an ***independent institution***, responsible for the monetary policy and for the supervision and regulation of the banking system, has taken concrete actions to boost demand in the economy. We have lowered the key interest rate to record lows and are considering other spaces available in this regard. We have also supplied the banking system with the liquidity needed for a smooth functioning of the financial markets. Finally, we have introduced a new regulatory package to boost lending. Our policies have been successful in maintaining macroeconomic balances, which is also the Bank of Albania's goal. However, their transmission to boosting economic activity requires better reflection by the banking system.

The banking system has worked well to preserve its soundness. It has supported the Albanian economy in its expansion phase and has shared a part of the economic slowdown costs with it. ***Unlike many other experiences, the Albanian banking system succeeded in withstanding the global crisis without using any public funds. On the contrary, at the peak of the crisis, many banks managed to bring fresh capital in the country, against the setting of fiscal contraction and funds withdrawal by the European banking groups and higher non-performing loans.***

However, we deem that the banking system is capable of boosting lending. First, the banking system should intensify its efforts to cleanse its balance sheets through collateral enforcement and realistic assessment of borrowers' creditworthiness. Second, without violating the culture of observing the contractual obligations, it should be more active in the loan restructuring process to provide more room to businesses deserving it. Third, we think that Albania has in place business and development projects of a long-term interest that deserve greater attention. Lack of the loan demand is an already-known and well-understood problem. However, the banking system should be more flexible when assessing the submitted applications.

In all my public pronouncements, I have iterated the prudence needed for sound public finances in the country. We deem that the country's sustainable development economic paradigm requires taking swift measures for making the public finances healthier. ***Beyond the short-term challenges about the current year's budget, putting in place a***

reliable and transparent fiscal rule is a necessity to discipline the fiscal policy in the long term and guarantee the trust of the financial markets in the Albanian public debt.

Finally, the Bank of Albania deems that the macroeconomic stimulus should continue to be based on a stimulating monetary policy and a banking system more focused on the needs of the economy. Also, we believe that the fiscal policy lacks the room for such actions. This action path preserves the macroeconomic stimulus and the soundness of macroeconomic balances, hence providing the shape to the first pillar of development policies.

2. Second pillar: Reducing uncertainty in economy

The second pillar (of a short-term action, as well) relates to reducing uncertainty in the economy. This uncertainty is multidimensional and affects the private sector decisions intricately, hence making consumers and businesses reluctant to spend and invest.

The uncertainty is not only related to domestic developments, but a significant part of it also originates from there. Several above-mentioned incentives – concrete-term recommitment to preserving the soundness of public finances and enhancing balance-sheet transparency in the Albanian economy – are the appropriate steps in this regard. Other incentives to reduce uncertainty would be to:

- strengthen the contingency plans and relations with international financial institutions;
- enhance transparency and consistency of development programs, both at national and intersectoral levels;
- strengthen the legal, regulatory and fiscal framework, and minimise their volatility;
- improve the business climate in its relations with the tax administration and the judicial system.

Taking these steps would be a significant progress towards development.

3. Third pillar: Structural reforms

The third pillar of development, i.e., the structural reforms in economy, should be stronger and deeper. Sticking to today's agenda, I would like to say that these reforms would open the way to a healthier and more competitive economy, with a balanced development across sectors. Our resolution and success in implementing these reforms would determine the long-term development of the Albanian economy.

4. Fourth pillar: Convergence with the European Union

I think that the identification, design and implementation of the structural reform package by closely cooperating with the specialised international institutions would be productive. Currently, Albania meets all the conditions for a fast convergence with the European Union. I also think that the European integration is the best way to withstand the current crisis and guarantee stable economic growth in the long term. The Bank of Albania, being an integral part of the Vienna II Initiative, is greatly committed to the process of reshaping the financial structure supporting the development of South-Eastern Europe.

Thanking you for your attention, I am open to further discussions.