

Ardian Fullani: Overview of Albania's recent economic and financial market developments

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the technical meeting to promote regional cooperation in the framework of Vienna Initiative II, Tirana, 3 October 2013.

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Dear representatives of supervisory authorities,

I take this opportunity to thank you for your participation in the first regional meeting on the Vienna Initiative.

The performance of EU and regional economies over the last few years have clearly demonstrated that in Europe's highly interconnected markets, the financial tensions, regardless of their origin, go beyond local or regional boundaries. The euro area sovereign crisis, which started as a localized episode in the euro area periphery, evolved gradually into a European predicament involving almost all European Union (EU) members, heavily affecting non-EU member countries in the CESEE region as well. At the core of the transmission mechanism of financial pressures from EU to non-EU countries are large euro area banking groups, which operate throughout the continent with their branches and subsidiaries. In a matter of months, the sovereign-bank vicious cycle encompassing the euro area was exported to non-EU host countries, first through lower risk tolerance and second through interruption of lending to our economies by euro area banks that operate in our region through their branches and subsidiaries.

In some countries, lending dampened in the form of the so-called deleveraging, i.e. reduction of lending by EU bank subsidiaries to non-EU host countries, through the simultaneous reduction of their foreign liabilities. In other countries, such as in Albania, where EU bank subsidiaries relied heavily in domestic retail funding (domestic deposits), the reduction of lending occurred without the corresponding reduction of liabilities. This led to an outflow of domestic funding sources towards EU economies. In both cases, the phenomenon illustrates the reduction of banks exposure to risk, i.e. the derisking process, driven by financial pressures from the parent banks, which they tried to mitigate in part through their business strategy in non-EU host countries. This phenomenon was largely exacerbated by macroprudential decisions and regulatory incentives undertaken at the EU level. Requirements of the European Banking Authority (EBA) for additional capital on large internationally active banks prompted these EU-based banks to adopt restrictive measures on their activity in the periphery "to save" regulatory capital, under conditions when raising additional capital would be too costly or even impossible in the market. To illustrate the magnitude of the reduction of exposure, I will bring an example from Albania. Last year, the largest EU-based bank operating in our country decided to contribute to meeting the group's required capitalization levels through reducing its exposure to the Albanian government securities by almost 3% of the GDP, within a very short period of time.

Apparently, a more coordinated approach to implementing these requirements, implying the presence of non-EU host countries at an early stage of macroprudential decision making at the EU level, would contribute to a less painful absorption of the subsequent effects in our countries' financial systems.

To address the pressing issues facing home and host country relations in this context, the Vienna Initiative was relaunched as "The Vienna Initiative II". It focuses on fostering home-host authority coordination to support stable cross-border banking, and help protect the economy from disorderly deleveraging.

As a member of the Steering Committee of the Vienna Initiative II, I have underlined the need for a more effective home-host coordination, promoting Albania's position as a host country. Given the geographical proximity and high exposure to recent developments in the EU

financial markets, I am confident that our countries would significantly benefit from developing a regional perspective on risks and opportunities arising from such developments, and major supervisory reforms at the regional level. In this context, Albania's membership in the Steering Committee of the Vienna Initiative, and the Working Group on Banking Union and Emerging Europe is a solid foundation to build upon and synthesize the common concerns of our countries vis-à-vis EU authorities.

Allow me now to summarize the insofar position of the Bank of Albania, articulated in the framework of the Vienna Initiative II, and propose a number of discussion topics, which I am confident will lead to a fruitful exchange of views today.

The Bank of Albania has called for effective mechanisms to restore healthy lending to the economies of non-EU countries, where systemic subsidiaries of EU banking groups operate. In this context, EU authorities and EU banking groups should provide their active contribution. This is not merely a short-term objective, but rather an important anchor for the region's economic recovery with significant effects on both the economies of the region and the banking groups, which have declared their commitment to our region.

We are currently witnessing a period of massive reforms in the EU supervisory architecture, with the establishment of the Banking Union. These reforms correspond to the reactivation of the Vienna Initiative II, hence providing a great opportunity to convey our relevant views as host countries to EU authorities. To support the Steering Committee of the Vienna Initiative, a Working Group has been established to take stock of the Banking Union implications, especially on non-member countries. We consider the creation of the Banking Union as both an ambitious challenge, and a great opportunity to lay down the groundwork for better and more coordinated supervision, especially in a cross-border context. The Banking Union shall involve a Single Supervisory Mechanism (SSM) under the guidance of the ECB, charged with supervising systemically important EU banks involved in cross-border operations. The measure is expected to change the coordination framework between home and host supervisors. This means that the insofar relationship of host countries with a number of national supervisory authorities will now be concentrated on bilateral relationships with the SSM in the case of branches or subsidiaries of systemically important EU banks. ***In this respect, the Bank of Albania has emphasized the need to establish a permanent working relationship with the ECB, and, possibly, appropriate mechanisms to achieve this.*** Our experience with regard to the effects arising from EU banking groups' activity in response to EBA's requirements has provided a useful lesson for the future. In meetings on the Vienna Initiative II, we have many a times iterated that macroprudential policies undertaken in the euro area must take into account the relevant impact on non-EU host countries where systemically important EU bank subsidiaries operate. The home-host cooperation framework must help achieve better policy harmonization in the future, or, at least, provide for an early exchange of information in order to allow host countries to prepare in response to potential shocks. ***Furthermore, the functioning of supervisory colleges should provide for an effective exchange of supervisory information, and barriers to successful participation by non-EU host countries must be eliminated through combined efforts.***

Your institutions' position on each of these issues is extremely valuable to provide a comprehensive view of the implications of EU authorities' policies and banking groups' activity in our region, as well as to assess the implications of the banking reforms currently underway in the EU. More specifically, I think that it would be useful for us to discuss along the following lines:

- What mechanisms may we use to revive credit growth in our economies, and what contribution do you expect by EU authorities and EU banking groups in this regard?
- How can we practically establish a permanent mechanism for coordination with the ECB, in the framework of the Banking Union? What characteristics should this mechanism have to better serve the needs of our countries?

- How were the effects of euro area macroprudential measures transmitted to our countries? How can we achieve better policy coordination with EU authorities?
- What is our insofar experience of participation in supervisory colleges? How effective would you consider these colleges, and what are your concerns about their functioning?

A clear understanding of each country's perspective and experience so far shall be very helpful in that respect. I hope the discussions today will be of practical relevance, and allow us to converge on more concrete proposals for consideration in future Vienna Initiative meetings.

In conclusion, I am confident that today's meeting is an important step to build a regional approach for addressing our common challenges. Sharing experiences will help us all to better understand our own national challenges through putting them in the right context. We may tap into significant synergies in this context, which may be leveraged only through constant cooperation. Most importantly, regional cooperation is a prerequisite for achieving better coordination with EU authorities, through better technical expertise, comprehensive region-wide experience, and better negotiating power. As a member of the Steering Committee of Vienna Initiative II, allow me to reiterate my commitment to be a good advocate of our common stance, in this authoritative forum.

Thank you!