

Ardian Fullani: Recent regulatory amendments in Albania – causes and expectations

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the forum with the Albanian banking system on “Recent regulatory amendments: causes and expectations”, Tirana, 28 February 2014.

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Dear bank executives,

Dear participants,

I would like to welcome you to this discussion forum between the Bank of Albania and the banking system. The topic of discussion for this roundtable is to inform you on the recent decisions of the Supervisory Council of the Bank of Albania in more details. We are on the last day of the second month of 2014 and we are all witnessing an intensive period of discussion and suggestions between Albanian authorities on the one side and international institutions on the other. Recovery of economic activity, potential structural reforms, lending to the economy, and financial soundness have been at the core of the discussions. Taking into account its role and significance in decision-making, the Bank of Albania has been an important part of them, materialising its contribution with a number of decisions relating to both macroeconomic and banking supervision.

Following, I would like to share with you in brief the reasons, expectations and the way we will monitor this decision-making.

1. Decision-making on monetary policy and money market operations

As we have constantly informed, the Albanian economy is facing cyclical weakness. In response to the weak demand, the Albanian economy is growing below its potential, inflation is low, public and private balance sheets show difficulties, and the banking system has been facing upward non-performing loans. These problems have been detected at an early stage by the Bank of Albania and we have, therefore, taken relevant measures to tackle them.

The monetary policy of the Bank of Albania has been constantly on the easing cycle. The key interest rate reached the record low 2.75% last Wednesday, from 5.25% in 2011. In line with the best practices of central banking, we have adopted a forward-looking communication strategy. I am convinced that not only the financial market, but also the real economy has received our message that the monetary policy is and will continue to be on the easing side in the quarters ahead. Moreover, we have intensified our liquidity injection operations, which have succeeded in meeting all the market liquidity needs, by extending the horizon for injection and facilitating access to liquidity by broadening the collateral base.

Time has proven our monetary and operational policies successful. The Bank of Albania has managed to contain and control the downward inflation pressures. We are convinced that the steps we have taken will bring inflation back to our 3% target, in the medium term. We have managed to anchor the economic agents' expectations on inflation. This has enhanced the effectiveness of the monetary policy and contributed to maintaining confidence in the national currency and the Albanian financial system. The continuous liquidity injection through transparent and time consistent operations has managed to relieve pressures in financial markets. The key interest rate cut was followed by an overall decline of interest rates in the financial market. Bank lending costs, government borrowing costs, and business and consumer borrowing costs have dropped rapidly.

All these factors have laid a sound foundation for economic and financial stability in Albania. Stability is a precondition for sustainable and long-term growth, financial system development, functioning market economy that generates growth, employment and welfare for the country. I take this opportunity to emphasise that this philosophy of prudence and

stability will guide our decision-making in the future, as well. The businesses, consumers and financial system will find in the Bank of Albania an institution determined to maintain economic balances of the country, uphold the value of the national currency, encourage financial markets and support sustainable and long-term development for the country.

However, the monetary policy has not been transmitted in full to the real sector of the economy. We are aware of the causes of this phenomenon, which is not an isolated case in Albania, but a global-wide one.

Economic agents' uncertainties, economic and financial problems in the euro area, and problems with the balance sheets that characterise a part of the economy are objective obstacles to the monetary stimulus transmission to the economy. Nevertheless, we are aware that within this reality, there is room for a more positive approach to consumption and investments, and more lending. Uncertainties and reluctance are the main problems standing in the way of the Albanian economy. The purpose of this forum is to identify, together, ways to overcome this situation. In this context, I would like to quote President Roosevelt: the only thing we have to fear is fear itself.

2. Decision-making on banking supervision and financial stability

Recently, non-performing loans have been mentioned frequently. I will take this opportunity to make the following necessary clarification:

First, I would like to underline that we have identified this problem at an early stage and have been very scrupulous with the banking system to evidence every penny of a loan that is not being repaid duly. This is why non-performing loans increased rapidly in the first period, and have stayed at the current levels for a long time. In contrast to other countries in our region, we have persisted not to conceal the non-performing loans, but evidence them accurately and comply with our rules to make provisions for every loss penny.

Second, we have adopted a rather conservative approach to non-performing loans classification. In our case, when we calculate the value of non-performing loans, we do not take into account the value of collateral, as is the practice in many countries. If we deducted this value from that of the non-performing loans, the NPLs' value would be significantly down. I am confident we have made the right choice as it has produced more security for the stability of both the banking system and the deposits of Albanian citizens.

Third, in the recent negotiations with the International Monetary Fund and the World Bank, under the conditionalities of the new arrangement that will be approved today by the IMF Executive Board, we have agreed to include the write off of banks' loss loans that are provisioned and have no hope of being collected, having no financial effect on the banking system. Amendments are formalised in a draft law that is expected to be passed by the Assembly in the near future.

Fourth, the recovery of lending is considered one of the main instruments contributing to improving the level of non-performing loans. I would like to dwell a little longer on this aspect.

Despite some optimistic developments in terms of the increased number of credit applications submitted for execution or restructuring, the larger banks, which have considerable potential to lend, are not using properly the measures promoting lending recovery, as opposed to the smaller banks, which appear more active. We believe the main reasons forestalling a more significant effect of these measures are as follows:

First, actions taken to boost credit supply need to be complemented by other actions to boost credit demand. The latter remains unstable in the face of sluggish economic growth and weak consumption and investments. As a result, credit risk perception by banks remains considerable;

Second, in spite of a better reflection of the key interest rate cut in the last quarter of 2013, the credit price (including other related costs) is considered still relatively high. For that

reason, banks need to cut the credit price down, having better control of their operational costs, especially foreign currency funding costs.

Third, credit restructuring should be conceived as a broader process of deep restructuring of the activity of borrowing businesses. Each non-performing loan should be seen as a new opportunity. Our approach should extend to the micro level, according to the motto: door to door and case by case. From the bank's perspective, this would mean that credit restructuring is not merely a rescheduling of credit instalments in agreement with the businesses, but an in-depth analysis to assess the possibilities of its future existence in the market and acknowledge on time the loss of a part or full credit value.

Fourth, infrastructure and legal practice concerning collateral execution remains subject to adaptation to the new situation.

Fifth, it may be necessary to allow longer time to see the effect of the measures taken until now, and other measures that should further address the above-listed problems.

Despite the existing problems listed above, the Bank of Albania believes that the circumstances are better for banks to be more active in this year in tackling non-performing loans. Economic growth prospects are better, mainly thanks to the improved foreign demand and eased monetary conditions. Furthermore, payment in arrears to the private sector will begin this year, accounting for a considerable amount. We expect banks to assist in this regard for a smooth and effective process, and orient the cashed-in amount towards further lending to the economy.

From this process, we expect the business restructuring to ease and their borrowing demand to grow. Likewise, the fiscal policy will gradually orient towards a steady consolidation process, which will create more room for lending to the private sector. The banking sector may serve as a catalyser to render the effect of such policies sustainable, and benefit maximally from them in the form of expanded activity, improved asset quality and enhanced income stability.

As you know, last November the financial system was subjected to the IMF and WB appraisal. The banking industry was engaged in this process and I take the opportunity to thank you for this! Today, the IMF Executive Board is expected to approve the evaluation report. Overall, the financial system and its supervision infrastructure have managed to successfully weather the global financial crisis.

In the meantime, risks facing it are analysed and assessed, and a series of actions that need to be taken are identified. For banks, the focus is on strengthening their human and technical resources to assess operational risks and undertake concrete actions to mitigate these risks. The need to improve asset quality and maintain financial soundness indicators is also a focal issue. The Bank of Albania will support this process by cooperating with the banking industry and improving the regulatory and supervisory framework. For the supervisory authorities of the financial system, the recommendations relate to strengthening the preventive and management framework of risks and, in this regard, improvement of the legal, operational and inter-institutional cooperation infrastructure is recommended.

Concluding, I would like to reiterate our message: the prospects for Albania's development remain positive.

The economic and financial stability, geographical position and natural resources, and integration with the European Union make us optimistic about Albania's future development.

I invite you all to share in this vision and work together to make it a reality.

I assure you that the Bank of Albania, as the supervisory authority, will undertake all the necessary actions, under its scope of activity, to support the industry to successfully overcome these challenges and ensure that the sector remains well capitalised and liquid.

Thank you!