

## **Gent Sejko: Banking developments and financial market infrastructure. The role of structure, size and market infrastructure in risk mitigation and financial intermediation**

Welcome address by Mr Gent Sejko, Governor of the Bank of Albania, at the Annual Conference 2017 of the Bank of Albania, Tirana, 9 November 2017.

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Your Excellency Mr President,

Honourable Mr Minister,

Dear Prof. Anastasakis,

Honourable Governors,

Your excellencies Ambassadors, dear guests and participants,

I would like to warmly welcome you to the Annual Conference of the Bank of Albania. For almost two decades, the Conference has become a prevalent event in the research and professional activity of the Bank. Our analyses and conclusions, over the years, have endeavoured to respond to many challenges and dilemmas for our national economy and beyond. Thanks to the cooperation with the University of Oxford, more specifically with St. Anthony's College, this Conference has aimed, and I believe it has succeeded in doing so, at exploring and providing answers for a number of issues, which, given their nature, effect and interlinking, are present across the region of the South East Europe.

The theme of this year focuses on similar issues. During the day, national and international experts of the economy and finance as well as academics will analyse the latest trends and developments in the financial sector in the region, focusing on potential implications on the macroeconomic equilibrium and financial stability of each economy. The theme of the Conference is relevant to both the current and the future developments. From the international perspective, it seems that the overall situation is increasingly more supportive. Advanced economies, together with large emerging economies are in a phase of full recovery, underpinned mainly by the boost in aggregate demand. Interestingly, the euro area, which includes most of our trading partners, is experiencing an overall positive momentum concerning economic growth, and forecasts are optimistic.

There is a broad consensus that the economies of the South East Europe region, in the first half of 2017, registered a satisfactory performance in terms of recovery; in the meantime, according to key indicators, such performance is expected to strengthen further in the third quarter of this year. Albania is no exception to the regional context.

In the previous quarter, the economic and financial situation in Albania was set on a path of constant improvement. Growth and employment indicators followed an upward curve and expectations for 2018 remain positive. Consumption and foreign investments have contributed positively to economic activity and are expected to generate further increase in productivity and competitiveness. At the same time, income from the export of goods, and especially of services contributed to the reduction of the current deficit and the strengthening of the external position of the economy. The effects of the monetary policy have maintained the stimulating trend, aiming at closing the negative gaps of prices and output.

Financial stability is also characterised by a positive situation. The notable decline in non-performing loans in the balance sheet of the banking system is the most prominent achievement

in this aspect. The measures taken in mid-2016 have produced a substantial effect, materialised in the reduction of non-performing loans by around 10 percentage points, below the maximum level registered in 2015. It is always a pleasure to note that credit growth has been positive. In particular, the lek credit has grown rapidly, compared to the foreign currency credit, which makes the banking system and the private sector healthier, and enhances the effectiveness of Bank of Albania's monetary policy. Positive developments in the banking sector and the economy have supported the further improvement of capitalisation, liquidity and profitability indicators. Two months from the end of the year, in our assessment, the banking industry in Albania enjoys full financial soundness, against the backdrop of an optimal liquidity and capitalisation situation, a key prerequisite for financially supporting the economic developments of the country.

We have also paid particular attention to legal, institutional, regulatory and supervisory developments, notably the drafting and implementation of the resolution law.

Dear participants,

This year marked 25 years from the establishment of a two-tier system in Albania, which stipulates the banking system as the provider of financial and banking services in the economy, and the central bank as the administrator of the monetary policy and regulator and supervisor of the banking system. This first step was followed by other steps related to other segments of the financial market, such as the securities and capital markets, including the establishment of the relevant supervisory and regulatory institutions.

Initiatives in these aspects have promoted a constant expansion of the financial market, in terms of both diverse institutions and number of financial products and trading volumes. Yet, despite these developments, the financial system remains dominated by the banking system and relevant developments in it. The last financial stability report of the Bank of Albania states that banks account for around 90% of total financial system assets, equivalent to 92% of the GDP, whereas the rest of the financial sector shares only 10% of the financial system total assets.

Assessments and studies of the Bank of Albania, as well as comparative studies by third parties, particularly by the International Monetary Fund, show that the financial distribution and expansion in the Albanian financial market is close to the equilibrium, dictated by the Albanian economy and consumers. Moreover, financial intermediation indicators, as a percentage of the Gross Domestic Product, are at similar levels to those in other countries of the region.

The dominance of the banking segment has naturally led to a higher level of concentration of financial products and services in its favour. More than 80% of resident investments in the financial system are in the form of deposits and current accounts in banks. Only little more than 12% are in the form of government securities, whereas the rest, around 6.5%, are invested in investment or private pension funds, accounting for only 0.1% of total financial system assets. Statistics show that only a small number of companies operate in other segments of the financial sector, and their activity in terms of the Domestic Product or of the financial market remains insignificant.

Regarding the above, we may logically conclude that the financial market architecture may not be considered complete yet. Financial instruments with long-term maturities are rare, whereas the short-term ones outside the banking system are apathetic and fragmented, in terms of both products and markets. An outcome of such a financial architecture is a kind of added pressure on the banking system, depriving the economy of other financing alternatives, beyond what the banks offer.

This vacuum may not be filled with strained efforts by the banking system. It has been broadly accepted that each segment of the financial market plays a complementary rather than substituting role. I could mention a number of examples to illustrate my point, but for the moment I would rather not, as in the next panels these issues will be discussed in greater detail by other

colleagues and academics during the day.

Overall, the above elaboration regards investment-related financial institutions and financial instruments. However, it must be noted that similar problems characterise the other extreme of the financial market, the corporate – or enterprises sector – as we call it in Albania. Bank of Albania surveys show that micro units face shortage of financial resources and have limited access to credit. Thus, more than 1/3 of respondent enterprises consider the low level of access to finance and the cost related to it as the main cause for not expanding the activity. These micro units, which are basically family-run businesses, have a greater need to cooperate with non-bank financial institutions, due to difficulties they have in fulfilling the requirements for collateral or detailed financial documentation, criteria that banks require. This is another argument that leads to the logical conclusion that, in addition to own capital and bank credit, these enterprises would benefit greatly from other segments of the financial market.

The low level of financial inclusion of the population is another element that prevents the deepening and expansion of the financial market in Albania. Latest data from the World Development Indicators show that only 38% of adults have an account with a financial institution, while only 6% and 22% of adults have a credit card and a debit card, respectively. Financial inclusion may not be increased only through the banking system. The financial system, especially the capital market and the corporate securities market should play a significant role in increasing financial inclusion.

I take this opportunity to emphasise that, in addition to the need for expanding and deepening the financial market, it is necessary to increasingly pay attention to the management of risk that accompanies any financial investment. We are witnesses of a rapid technological evolution, which has practically eliminated physical boundaries, has eased access to electronic investment platforms, and has rendered very difficult the supervision and regulation of many innovative financial instruments that are traded in these platforms. The phenomenon of informality coupled with the speed of innovation in the field of financial instruments are a real risk for every investor that is naively driven by profit and does not stop to analyse the magnitude and nature of risk to which he is exposed. Anyhow, inclusion should take place carefully, relying on specialised financial intermediaries and auxiliaries, whose activity is regulated and supervised by a legitimate authority in Albania or abroad.

Dear participants,

The depth and expansion of the financial markets determines the set of financial instruments eligible for trading, in a broad spectrum from the maturity perspective. These instruments are nothing more than consecutive steps in the monetary policy decisions pass-through mechanism. The whole process of instrument trading serves to determine the value of assets, the price of risk and savings, and, eventually, the propensity toward consumption, savings or investments. In this sense, the existence, completeness, and effectiveness of the financial market play a significant role in the monetary policy pass-through. This is the reason why the central bank places its focus on these markets and on their proper functioning.

Based on these specific reasons, the Bank of Albania has initiated, time ago, a series of actions for creating a more dynamic financial market. The macro-prudential measures taken with regard to liquidity and capitalisation; limitations placed on positions with non-resident banks, provisions and collateral; and the package of measures for reducing non-performing loans are steps to remedy problems related to the shallowness and narrowness of the market, the low financial inclusion, and the inadequate financial education.

Studies and analyses of the Bank of Albania support the logical conclusion that the development of the financial market is an important factor for boosting economic activity and enhancing welfare in general. At the Bank of Albania, we believe that the current structure of the banking market promotes competition in relation to banking products and services. However, the further

expansion and deepening of the market is a present challenge for all the relevant actors involved. The banking industry, the Bank of Albania, other segments of the financial market as both as actors and as regulators, the government, the academia and experts of the field, should be all involved in this effort. Our ambitions should aim at having a dynamic and liquid financial market, with upward trading volumes, and a widening spectrum of instruments, including a prolongation of maturity horizons and prudent risk management. This framework should be accompanied by added transparency in all the phases of trading, with financial education assuming a special place. Only in this way would we be able to deepen and expand, in real terms, the financial market, and through it a higher efficiency in implementing economic and financial policies, in mobilising and using national savings, in financial inclusion, in economic activity growth, and in enhancing the welfare of the population in the long run.

In the hope that the proceedings of this conference will be characterised by a fruitful exchange of ideas and views by the participants in this room,

Thank you for your attention!