

Gent Sejko: Albania's economic and financial developments in 2017

Introductory statement by Mr Gent Sejko, Governor of the Bank of Albania, presenting the Annual Report 2017 to the Parliamentary Committee on Economy and Finance, Tirana, 17 May 2018.

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Honourable Speaker,

Honourable Members of Parliament

The Bank of Albania views the accountability process as an essential element in its activity. This process complements our institutional independence, enhances transparency and reliability of the Bank of Albania and improves the effectiveness of our policies.

Therefore, I have the pleasure of presenting today the work and the achievements of the Bank of Albania in 2017.

I would like to start my reporting with three key messages that reflect the conclusions of our analysis and have been the common thread in our public communications over the past year.

First, the economy and financial system in Albania marked progress during 2017. The positive development trend is illustrated by the acceleration of economic growth pace, upswing in employment and decline in unemployment, and the improvement of financial balance sheets of the public and private sectors. This progress has brought our economy closer to its potential and has strengthened short and medium-term factors that support economic growth.

Second, the activity of the Bank of Albania in the past year has been in line with our legal obligations and the Recommendations of the Parliament. Our policy and instruments have had a positive, across-the-board contribution to our activities:

- ♦ Promoting economic growth, through an accommodative monetary policy stance;
- ♦ Strengthening financial stability, through a prudent and proactive supervisory and regulatory policy;
- ♦ Fostering development and enhancing financial system efficiency, through continued financial education, and cooperation and joint initiatives with other foreign and domestic agencies and partners.

Third, I would like to draw the attention on the fact that, albeit positive development outlook, the Albanian economy continues to face medium and long-term development challenges. Identification and mitigation of economic and financial vulnerabilities, prevention of potential risks, and continuation of structural reforms to accelerate the growth pace, are among the main challenges we face. Our duty, as policy makers, is to draft and implement action plans consistently and persistently, in order to duly address all the problems we face.

Let me now explain these issues in greater detail the issues, starting with a general overview of key economic and financial developments in the past year.

1. Albanian economy and financial system in 2017

Year 2017 marked progress for the Albanian economy and financial system.

According to INSTAT data, the volume of economic activity grew 3.8% in 2017, registering a positive dynamics compared to 2.2% and 3.4% growth rates recorded in 2015 and 2016.

The economic activity expanded on a broad base and was underpinned, from the perspective of aggregate demand, by the growth in consumption, investments and exports. Economic growth benefitted from the improvement in the external environment, and was supported by the domestic favourable financing conditions and economic agents' confidence.

From the sectoral perspective, the expansion of aggregate demand contributed to the growth of activity mainly in the services sector and in certain branches of the industry sector. A notable development in 2017 was the positive performance in tourism, which provided a positive impulse to economic growth.

Owing to economic growth, 79 thousand new jobs were created in the private non-agricultural sector. Total employment increased by 3.3% in 2017, driven largely by the increase in the services sector. In parallel to the increase in employment, the unemployment rate fell, from 14.2% at the end of 2016, to 13.4% at the end of 2017.

Inflation has trended upward in 2017, averaging 2.0% from 1.3% in the previous year. The uptick in inflation reflected the improvement of economic activity and strengthening of domestic inflationary pressures. Yet, this indicator continues to undershoot our target, reflecting the presence of spare capacities in the economy, the low inflation rates in our trading partners and the appreciated exchange rate.

The expansion of economic activity is accompanied by the improvement of some of the main economic and financial balances for Albania. Thus:

- ♦ The current account deficit decreased at 6.9% of the GDP in 2017, from 7.6% recorded in the previous year. Its improvement reflected the growth in tourism and other services of the business.
- ♦ Fiscal indicators registered consolidation, reflected in a low level of the budget deficit and in maintaining control over public debt.
- ♦ Lastly, the financial situation of enterprises has been improving, as illustrated by their high liquidity levels and the progressive decline in the non-performing loans ratio.

Interest rates in the financial markets remained low and soundness indicators of the banking system have been improving. The Albanian banking system maintained good levels of liquidity, and improved the profitability and capitalisation indicators. The Capital Adequacy Ratio recorded 16.6% at the end of 2017, upward by around 0.2 percentage point from a year earlier. As at end of 2017, the share of banking sector assets stood at 92.5% of the GDP.

The activity of the banking sector was stable, reducing the risks to financial stability. In particular, the credit risk marked significant reduction in this year. The ratio of non-performing loans fell to 13.2% at the end of the year, down by around 5 percentage points from a year earlier. The liquidity risk in banking activity continues to be low, while the banking system exposure to market risks remains present and subject to monitoring.

The improvement of the cyclical position of Albania and the encouraging signals on the economic growth outlook have also reflected the results of the work of the Bank of Albania. Let me explain in greater detail.

2. Bank of Albania activity highlights in 2017

The activity of the Bank of Albania has been and remains oriented toward fulfilling our mission and legal obligations. Regarding the operational aspect, our activity in 2017 was guided by the Medium-term Development Strategy 2016–2018.

The two main aspects in our activity were monetary policy and banking sector supervision and regulation.

The monetary policy of the Bank of Albania continued to maintain the accommodative stance during 2017, in the presence of still incomplete utilisation of production capacities and weak inflationary pressures. The monetary stimulus was transmitted through maintaining the policy rate at the lowest historical level, at 1.25%, increasing the volume and average duration of the liquidity injected in the interbank market and the forward guidance tool.

The positive effects of the monetary policy were present in several aspects.

- ♦ *First, in lower costs of financing consumption and investments.* The volume of lek credit to the private sector increased by 7.2% in 2017, providing the main contribution to total credit growth.
- ♦ *Second, in reducing uncertainties of economic agents,* encouraging them toward consumption and investments.
- ♦ *Third, in mitigating appreciation pressures of the exchange rate,* contributing to the improvement of the balance of trade exchanges and further growth of economic activity.
- ♦ *Fourth, in strengthening of financial stability.* The financial environment with low interest rates has improved the financial balances of borrowers, through boosting aggregate demand, easing the service cost of debt, as well as encouraging the restructuring of existing loans.

Our assessments on the monetary policy impact show that its contribution to economic growth for 2015, 2016 and 2017 is around 0.2, 0.4 and 0.7 percentage points, respectively.

Also, the Bank of Albania has continued the efforts to improve the monetary policy transmission mechanism. Throughout 2017, we have worked on three main aspects:

- ♦ *First, promoting the use of the national currency.*

The high euroization renders the monetary policy pass-through more difficult, as it exposes the private agents and the financial system to exchange rate volatility. Aware of this fact, the Bank of Albania, the Ministry of Finance and Economy and the Albanian Financial Supervision Authority signed a Memorandum of Cooperation “*On increasing the use of the national currency (ALL) in the Albanian financial system and economy*”. In this memorandum, the signatory institutions commit to identifying and undertaking actions within their area of competence. In this framework, the Bank of Albania identified a package of measures, following the consultations with the banking industry, and which shall enter into force over the second half of 2018.

- ♦ *Second, enhancing the appetite of banks to expand lending.*

Banks’ appetite for lending continues to remain relatively low, by reflecting the effect of two factors: (i) deleveraging policies for reducing exposure in the countries of the region, including Albania, implemented by parent banks from the euro area; and, (ii) perception of credit risk at home. The Bank of Albania, to address this issue, has continued the collaboration with the European Banking Authority Supervisory College, to exchange information and harmonise the supervisory policies. Also, our institution continues to implement the measures set out in the national plan for reducing the non-performing loans and improving the lending environment.

- ♦ *Third, fostering the development of financial markets and expanding the range of financial instruments.*

In 2017, the Bank of Albania, the Ministry of Finance and Economy and the World Bank explored options for developing the secondary market of Government securities and improving the functioning of the primary market. This project will help to: increase the Government securities trading; enhance the investors’ base, and better manage the liquidity.

Regarding the financial stability, the Bank of Albania has continued to implement a prudential and pro-active regulatory and supervisory policy.

In 2017, fourteen full-scope and partial examinations were performed in banks, non-bank financial institutions, and savings and loan associations. The examinations showed that the performance of the banking sector improved in terms of: the quality of internal policies and their implementation; the establishment of adequate risk management processes; and, the implementation of the supervisory regulatory framework. Moreover, the non-bank financial institutions are assessed to have still space to ensure proper effectiveness, independence and authority. The supervisory practice improved, regarding the methodology for banks control, the approximation of standards with Basel principles and the efforts to adopt the best international practices.

Particular attention was given to the consolidating processes and strategic plans of the banking system.

Also, the Bank of Albania, in 2017:

- ♦ compiled and approved the *Macro-prudential Policy Strategy*, which orients the use of regulatory instruments for enhancing the financial stability of Albania;
- ♦ prepared the regulatory framework on the *Internal Capital Adequacy Assessment*, compiled in the light of Basel principles and EU directives. The Internal Capital Adequacy Assessment Process complements the supervisory perspective with the self-assessment dimension of banks;
- ♦ made significant changes regarding the prevention process of money laundering, through the revision of the relevant regulatory framework;
- ♦ continued the work for the revision of the supervisory methodology on the assessment of the corporate governance in banks; of the functioning and independence of their committees; of the internal audit structure in assessing the risks and their functioning. In this project, we partnered with the European Bank for Reconstruction and Development.

Notwithstanding the progress made in reducing the non-performing loans, attention has been paid to the achievement of banks' annual objectives regarding non-performing loans and the compilation of the Recovery and Resolution Plans for larger borrowers. Banks report regularly to the Bank of Albania on the level of their relations with every borrower, as well as the expectations and plans on future developments, in compliance with our requirements. With assistance from the World Bank and the International Monetary Fund, a regulatory framework, aiming to foster banks collaboration and coordination for addressing common borrowers, is being compiled.

The Law "On the recovery and resolution of banks in the Republic of Albania" entered into force in 2017. This Law designates the Bank of Albania as the Resolution Authority for banks and branches of foreign banks that conduct their activity in Albania. This Law is another step toward adopting the European standards in the regulatory framework of the Bank of Albania. In its role as the Resolution Authority, the Bank of Albania increases the security of the banking system.

In parallel with the above-mentioned aspects of its work, the Bank of Albania has paid attention and has worked to: strengthen the development of the payment system; improve the procedures and modalities for foreign reserve management; improve communication with public; deepen the research work; expand and improve statistics; increase financial literacy and financial inclusion; collaborate with domestic and international institutions.

I would like to highlight that Bank of Albania has been attentive not only to realising the legal objectives, but also to strengthen its institutional governance. In this context, the Medium-term Development Strategy of the Bank of Albania, together with the medium-term budget, was updated in 2017. For the first time, the capital expenditures and the projects included in the

budget were preliminary approved by the Capital Expenditure Committee. Also, the Audit Committee continued the work throughout 2017. This committee conducts a monitoring function independently from the Bank of Albania management. In 2017, the Supervisory Council approved, for the first time, the level of tolerance to the operational risk at the Bank of Albania. It will help the efficient risk management, through the early identification and management of operational risk, in line with the established procedures.

We deem that the implemented policies and the undertaken measures have served to promoting monetary and financial stability, by contributing to safeguarding the economic and financial balances, necessary for a sustainable economic growth.

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As I stated at the beginning of my speech, the development perspective of Albania remains positive. Nevertheless, we have and will continue to face challenges, which should be addressed with courage, vision and determination.

At the end of my presentation, allow me to present the vision of the Bank of Albania on the future of the economy and financial system, as well as on adequate development policies.

3. Development perspectives and challenges

Supported by the favourable financing conditions, the further recovery of global economy and the strengthening of confidence in economy, the cyclical improvement of the Albanian economy is expected to continue in the medium-term horizon in the next two-three years. The growth of aggregate demand will encourage the further increase of employment and a faster rise in wages. The fuller utilisation of production capacities will enable the return of inflation to target within the medium-term horizon and will help improving the overall economic and financial equilibriums.

The realisation of this scenario is conditioned by the lack of internal or external shocks on the Albanian economy or financial system. Also, it requires continuing the accommodative monetary policy stance and maintaining the consolidating fiscal policy trend. These policies' coordination is vital for strengthening the macroeconomic stability of Albania. On the one hand, it maintains a stimulating resultant trend of main economic policies and, on the other hand, it addresses the various vulnerabilities.

Looking beyond the medium-term horizon, the Bank of Albania assesses that more needs to be done for strengthening the economic growth pace and increasing the Albanian economy's resilience against shocks. Though the accommodative monetary policy provides a support in this regard, it cannot substitute the structural reforms needed for improving the whole functioning of the Albanian economy.

We deem these structural reforms should address some key issues:

- ♦ *Further improvement of business climate, through:* continuation of measures to reduce informality and promote fair competition; a thorough improvement and harmonisation of the legal framework and law enforcement; and cutting on bureaucracy and improving public administration efficiency. The improvement of the business climate is vital for attracting foreign investments and promoting domestic ones.
- ♦ *Expansion of markets for Albanian products, through:* promotion of Albanian products trademarks; promotion of regional integration; and acceleration of European integration process.
- ♦ *Increase of Albanian economy efficiency, through:* further investments in infrastructure, education and health; encouraging the increase of participation in labour force; and

improvement of business management standards. Increased efficiency in the economy implies higher growth rates and higher welfare standards for the Albanian society.

- ♦ *Increase flexibility and resilience of the Albanian economy, through:* encouraging the restructuring process of enterprises; further improving the supervisory architecture and financial system regulation; and increasing prudence for public and private debt indicators. A more resilient and flexible economy weathers shocks easier and is re-oriented faster to development opportunities.
- ♦ *Further expansion and diversification of financial markets,* by working in parallel with the increase of savings in the Albanian economy, for a studied development of other segments of the financial market and for the prudent introduction of new products and financial instruments. The development and diversification of financial markets improves access to finance, by increasing the base of potential entrepreneurs and by providing a better management of personal finances. Also, it improves the financing structure of the Albanian economy and paves the way to the development of the country, in non-distant future, when, potentially, the role of banks and banking industry will be more reduced.

The Bank of Albania deems that the European integration process should be the guiding anchor to all development policies of the country. The pursuit of this objective requires collaboration and energies by all the relevant actors in this process, implying their willingness to afford the costs of the necessary policies and reforms for the integration of the country.

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Concluding, I would like to assure you that the Bank of Albania remains committed to complying with its legal objectives, and to fulfilling our institutional tasks and engagements.

Thank you for your attention!