

Gent Sejko: Welcome address - Annual Conference of the Bank of Albania

Welcome address by Mr Gent Sejko, Governor of the Bank of Albania, at the Annual Conference of the Bank of Albania, Tirana, 1 November 2018.

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Your Excellency Prime Minister,

Your Excellency Minister of Finance,

Dear Professor Berglof,

Dear Governors and Deputy Governors, Your Excellencies, Ambassadors, dear professors and representatives of the banking system,

Dear ladies and gentlemen,

It is always a pleasure for me, as the Governor of the Bank of Albania, to have the opportunity to open the proceedings of our annual conference. This year we are organising it in cooperation with the London School of Economics and Political Science (LSE), one of the foremost academic institutions in the field of research on economic and political sciences. The LSE's interest and the professional investment testifies that the cycle of our conferences has matured.

I am sure that this year's conference will uphold and even forge ahead the frontiers of our standards. Engaging in open discussions and sharing our experiences will eventually help us to identify the optimum way for addressing the challenges that lie ahead.

This year's theme is especially important not only to central banks but also to all the decision-makers for the economy. While focusing on the direct implications for the monetary policy, it touches on issues that address strong and dynamic changes that economic structures, financial markets, doctrines of economic management, and societies and human communities are experiencing at the local and global level.

Recent reports by prestigious international financial institutions point out that the prospects of economic development remain positive. Likewise, Albania is set on a steady positive trajectory of economic growth.

Our prudent economic policies, the constant improvement of balance sheets in the real and financial sectors, and the ongoing restructuring of the economy and of the growth model have created adequate premises for an increasingly fuller utilisation of production capacities and the convergence of inflation toward the target.

Let me explain this in greater detail. According to official statistics, economic growth in Albania accelerated to 4.4% in 2018 H1, showing a broad base in terms of aggregate demand components, and a diverse composition in terms of sectors contributing to growth.

In particular, Albanian exports showed growth, while the level of foreign direct investments remained high, contributing to the narrowing of the current account deficit and the stability of the external position. The dynamism of the exporting sector and the high level of foreign investments are encouraging for a steady economic growth, and testify to the increasing competitiveness and attractiveness of the Albanian economy.

The effects of economic growth have begun to be present in almost all economic and financial

indicators. Participation in the labour force and employment has increased, the unemployment rate decreased to 12.4% in 2018 Q2, and wages have started to trend upward.

Also, the growth in aggregate demand has contributed to the improvement of balance sheets of Albanian enterprises and has enabled a clearly downward trend in non-performing loans (NPL). The NPL ratio dropped to 12.9% in 2018 Q3, almost halved from its peak recorded in the wake of the crisis.

Reflecting its performance and the recovery of economic activity, against the backdrop of low interest rates triggered by our accommodative monetary policy stance, the Albanian banking sector remains liquid, profitable, and well capitalised. This sector appears resilient to potential shocks and has adequate capital and liquidity to cover the needs of the economy for financing.

The currently positive momentum of the Albanian economy has created adequate premises for the growth trend to continue in the period ahead. The expansion of aggregate demand, the favourable financial environment, the improvement of balance sheets, and the restoration of confidence in the economy form a virtuous circle, which will support growth in the medium-term horizon.

Furthermore, the long series of structural reforms – whether already undertaken or being currently implemented – should pave the way for faster, sustainable and comprehensive economic growth.

Dear ladies and gentlemen,

The topic of today's conference is related with the challenges that policy makers face in terms of growth as well as of economic and financial stability. From a general perspective, these challenges pertain to:

- ♦ Implications arising from the monetary policy normalisation in major central banks on developing countries, especially those that have adopted the short-term debt as their growth model;
- ♦ Populist phenomena, which fuel a protectionist rhetoric, are detrimental to global trade, and refrain the free movement of production factors; and
- ♦ Risks that remain present in the global financial system.

From a more specific perspective, today's economic, monetary and financial reality appears especially challenging for the monetary policy. This reality is labelled as the new "normal" of the monetary policy. Let me identify a few of these challenges.

- ♦ The natural interest rates appear downward, potentially as a result of a combination of several factors: slowdown of productivity and of the pace of innovation; unfavourable demographic trends in advanced economies; and the recycling of savings from developing economies toward advanced economies. The rate fall leads to the reduction of space for conventional stimulating monetary policies in the future.
- ♦ The correlation between aggregate demand and the inflation rate has weakened in the short and medium term, as a result of developments in the labour market and increasing integration of the global economy. This phenomenon renders the monetary policy action more costly.
- ♦ The financial innovation and the increasing awareness of the correlation between economic and monetary stability, on the one hand, and the financial system, on the other, have reduced the space for conventional monetary policy instruments.

Despite the complexity, recommendations for dealing with these challenges have been put forward. They range from the modification of the monetary policy mandate to enriching the array of instruments it employs, and its better combination with the macro-prudential policy.

I am certain that the issues set out above will be addressed at length during the day.

From my perspective, the consensus on the shape of the new 'normal' of the monetary policy should maintain three key elements:

- ♦ First, avoiding multiple, ambiguous and non-transparent objectives related to the monetary policy. This principle would sustain the credibility of the monetary policy, as a prerequisite for increasing the effectiveness and decreasing the side effects from its intervention.
- ♦ Second, acknowledging the limits of the monetary policy, both in the short and medium term, and in the long term.

In the short and medium term, the monetary policy often encounters limited effectiveness, especially in the case of financial crises, or negative side effects in the form of heightened risk in the financial system. This limitation stresses the need for supplementing and coordinating it with other economic management policies.

In parallel, the monetary policy alone does not have adequate instruments for generating a sustainable acceleration of the growth pace in the long term. This limitation underlines the argument that the monetary policy is not and may not be a substitute for structural reforms.

- ♦ Third, in designing the range of instruments at the disposal of the monetary policy, care should be taken to avoid the risk in the central banks' balance sheet, which would negatively affect their independence.

The experience of the Bank of Albania in withstanding the crisis and fostering growth in the wake of the crisis illustrates some of the key topics I mentioned above.

In response to the aggregate demand slowdown and the subsequent negative implications on employment, soundness of financial balance sheets and inflation, the Bank of Albania undertook a progressive easing of the monetary policy stance, by lowering the policy rate and injecting liquidity vis-a-vis an expanded collateral base.

The monetary expansion policy was supported by a clear focus on price stability and was favoured by the operation of a free exchange rate regime. The latter has served and will serve to absorb short-term shocks to the Albanian economy and financial system.

I want to emphasise a very important principle to uphold, that is maintaining a free exchange rate regime and activating market interventions only in situations when the primary objectives are affected. The sustaining reason is that movements in specific moments toward a new and more stable equilibrium enable our monetary policy to focus on its primary objective – price stability – and contribute to a more productive orientation of human and financial resources in the economy.

The monetary stimulus transmitted through conventional instruments proved successful in containing negative effects from the crisis. It contributed to a calm operation of financial markets, eased the cost of debt servicing, and helped start a restructuring process of the economy.

Yet, some features of the development of the Albanian financial markets limited the effectiveness of the monetary policy action. The low level of development of the financial markets, the phenomenon of the increase in non-performing loans and the high level of foreign currency

borrowing decelerated the full transmission of the monetary stimulus to the economy.

In response, the Bank of Albania adopted an integrated approach to boost the effectiveness of the monetary stimulus, which implied the adoption of new instruments as well as the initiation of a series of structural reforms aimed at improving the monetary policy transmission mechanism.

- ♦ With regard to instruments, the Bank of Albania began to employ the forward guidance tool, and applied countercyclical macro-prudential measures to support the growth of lending to the economy.
- ♦ With regard to the transmission mechanism, the Bank of Albania undertook in cooperation with the Government of Albania a series of structural reforms in the financial system. These reforms were aimed at further developing the financial market, improving the legal and regulatory environment with regard to contract compliance, collateral execution and lowering the credit risk, as well as reducing the phenomenon of foreign currency borrowing.

This integrated approach has yielded the first results, creating a financial environment that is more responsive to our policies, being an additional guarantee for convergence with our price stability objective and maintaining the sustainability of economic growth.

This investment, however, should be further supplemented by creating and maintaining the necessary fiscal space for withstanding shocks, and should be accompanied by structural reforms across the board to boost the resilience and flexibility of our economy.

Dear ladies and gentlemen,

Looking ahead, I would like to underline that one of the valuable lessons we have learned from the crisis is that safeguarding financial stability and maintaining a functioning monetary policy pass through are among the most important investments that a central bank can make for the future of the country.

Nonetheless, the challenges that lie ahead of the global economies will be increasingly complex, implying the need for informed and courageous decision-making in line with the developments of the time.

What in today's terminology is known as the "New Normal" is characterised by many unknowns, while all policymakers require finding appropriate and necessary options to facilitate the decision-making of a central bank not only from the perspective of the good management of the monetary policy, but also from the perspective of the financial stability, protection of the consumers and of the economy against economic and financial shocks.

Hence, we have brought together with the LSE the best experts from the academia, central banking, international institutions and the financial market to discuss the potential effects of these developments, to generate ideas as to which might be the adequate and optimum policies for addressing these challenges.

The need to coordinate domestic policies, and fostering the cooperation and interaction between the markets and the Authorities is evident. Our experience in this regard is positive. The lessons learned from the crisis, and the scanning of the development level of the financial sector, have enabled us – under a successful cooperation with the Government of Albania – to pave the way for a full restructuring of the architecture for the regulation and monitoring of the financial sector, create functional mechanisms for exchanging information and coordination among regulatory agencies, and pave the way for concrete reforms for the development of the financial system, especially in the field of capital markets and payment systems.

This need for cooperation and coordination crosses the national borders. A comprehensive approach, at global and regional level, would contribute to preventing unwanted consequences, not only for small and developing economies – which are often consumers of financial regulation policies at the global level – but also for the large economies, which originate them.

I believe that the conclusions of the conference panels will be very useful for all of us and will thoroughly portray and present the risks and benefits from the issues mentioned above, with particular focus on their treatment from the perspective of decisionmakers.

Thanking you once again for your participation, I wish the conference a complete success and hope all of you will enjoy your stay in Tirana!