

# **Gent Sejko: Albania's economic and financial developments in 2018**

Introductory statement by Mr Gent Sejko, Governor of the Bank of Albania, presenting the Annual Report 2018 to the Parliamentary Committee on Economy and Finance, Tirana, 23 April 2019.

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**Honourable Chair,**

**Honourable Members of the Committee,**

**Thank you for your invitation!**

The Annual Report and the financial statements are the key instrument for the accountability of our institution. In this light, the Bank of Albania considers the presentation of this Report as an opportunity to foster and enhance the dialogue with the Assembly.

During 2018, the work of the Bank of Albania focused on three main aspects:

- ♦ First, on the objectives and duties set out in the legal and sublegal framework, which regulates the work of the Bank;
- ♦ Second, on the objectives set out in our Medium-term Development Strategy; and,
- ♦ Third, recommendations left by the Assembly of the Republic of Albania in the Resolution “On the assessment of the activity of the Bank of Albania for 2017”.

The results of our work show that the Bank of Albania marked progress in all the three above-mentioned aspects. Let me present a brief overview of developments.

In accordance with the applicable legal framework, the Bank of Albania: strives to maintain price stability, as a precondition for sustainable and long-term growth in the country; licences, supervises and regulates the activity of the banking sector, hence promoting financial stability; administers the issue and circulation of the Albanian currency; contributes to the development of the payment system; and performs a number of other specific duties, which affect the economic life and financial system in Albania.

Based on the available information, the Bank of Albania finds that in 2018 the Albanian economy and finances marked progress. Economic activity and employment continued to expand, wages and domestic inflationary pressures trended upward, main banking sector's soundness indicators improved, and a series of indicators of domestic and external economic balances strengthened. This dynamics of developments reflects, significantly, the effect of policies, measures and instruments we have adopted on continuous basis.

Concretely, in 2018 the Bank of Albania has:

1. implemented an accommodative monetary policy, which has boosted economic growth and the convergence of inflation toward the target, and has contributed to improving the balance sheets of enterprises, households, public sector and financial institutions in Albania.
2. strengthened and improved the policy, regulatory and operational framework for supervising the banking sector, mindful of the administration of the consolidation process; and
3. created incentives for the development of the payment system and expansion and deepening of the financial market.

With regard to fulfilling strategy objectives, the Bank of Albania has worked intensively for adopting best central banking practices and standards. Thus, we have made progress with regard to improving statistics; research; compliance with EU integration criteria, strengthening

the governance; and in many other aspects.

Lastly, I would like to underline that the Bank of Albania has fulfilled all the recommendations left by the Assembly.

The Annual Report presents in greater detail the activity of the Bank of Albania in 2018, across all the dimensions of its activity. I will present first an overview of the activity of the Supervisory Council, the decision-making body, which also monitors the activity of the Bank of Albania. I will then continue to present the activity of the Bank of Albania, in accordance with the main domains of its activity.

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### **Activity of the Supervisory Council**

The Supervisory Council exercises its powers in accordance with the provisions of the organic law and the procedures established in the internal regulation on its organisation and functioning.

In 2018, the Supervisory Council met 15 times and approved 76 decisions, of which 55 were acts approved for the first time and 21 were amendments to existing acts. These decisions affect the activity of the Bank of Albania across the board. In addition to the monetary policy decisions and revisions to regulations that govern the activity of the banking sector, other important decisions include: (i) approval of the policy and measures for increasing the use of the national currency in the activity of banks; (ii) approval of the policy for the oversight of payment and settlement systems; (iii) approval of the accounting policy in accordance with the International Financial Reporting Standards; and, approval of the Medium-term Development Strategy of the Bank of Albania for 2019–2021. The strategy upheld the existing mission, vision, and values and updated the list of duties for fulfilling them.

Beyond the realisation of the legal objectives of the Bank, the Supervisory Council has monitored continuously the governance of the institution and has worked towards its improvement.

- ♦ As the body responsible for the financial reporting and internal audit system, the Council has been informed regularly, by internal and external audit functions, on the compliance with the legislation and other acts that govern the activity of the institution. The Council has been informed also about the institution's management policies and the use of financial assets for the realisation of the operational activity of the Bank of Albania. Information was presented regularly on the financial position and result of the Bank of Albania and the international reserve management.
- ♦ The internal audit has been monitored through the Audit Committee, established in 2015. The committee, has discussed issues such as: (i) annual work plan and internal audit engagements for the year; (ii) periodic reporting by the Inspector General on the auditing activity; (iii) financial statements; and, (iv) performance of operational risk management at the Bank of Albania. It has met regularly, without the presence of the administrators, with the Inspector General.

Lastly, I would like to emphasise that the Council has regularly complied with Bank of Albania's accountability obligations to the Assembly and its transparency obligations to the public, and the financial system.

### **Albanian economy and monetary policy in 2018**

The monetary policy maintained, even strengthened, the accommodative stance in 2018. The policy was in line with our inflation target convergence objective, consistent with the cyclical position of the Albanian economy, and aligned with the consolidation trend of the fiscal policy.

The Albanian economy performed positively throughout 2018. Aggregate demand increasingly expanded, enabling thus a further increase in production, employment and wages, and contributing to the improvement of the main economic and financial balances of the country's economy. A few figures to illustrate it.

- ♦ According to INSTAT data, the pace of economic growth accelerated to 4.1% in 2018. Economic growth was broad based; it reflected positive contributions from the expansion of the consumption of households and enterprises, and of exports.
- ♦ According to INSTAT data, employment in the economy rose by 1.6% in the previous year, whereas the unemployment rate fell to 12.3% from 13.4% a year earlier.
- ♦ The current account deficit decreased at 6.7% of the GDP in 2018, from 7.5% in the previous year. Its improvement reflected to a large extent the increase in the tourism-related activity.
- ♦ Budget deficit and public debt continued to record a downward trend, reflecting both the consolidation path of the fiscal policy and the economic growth as well as the exchange rate appreciation.
- ♦ The main banking sector soundness indicators, in particular liquidity, profitability and capitalisation, remain at satisfactory levels.

Against this backdrop, annual inflation averaged 2.0%, remaining unchanged from 2017 and below our 3% target. Inflation stood stable owing to two effects of opposite directions. The build-up in domestic inflationary pressures, generated by the rise in employment, wages and production costs was offset by the rapid appreciation of the domestic currency over the first half of the year.

The exchange rate appreciation was a decelerating factor for achieving the inflation target. The exchange rate has moved along a slight appreciation path over the last three years, driven by fundamental factors that dictate its behaviour such as: improvement of the balance of trade exchanges with abroad, high levels of foreign direct investments, and reduction of risk premia in domestic financial markets. Yet, beyond these effects, the exchange rate was subject to certain shocks in the first half of 2018. These shocks led to a temporary imbalance of the demand and supply for foreign currency and contributed to creating expectations for further appreciation of the exchange rate, and were accompanied also by a change in the behaviour of certain operators in the economy. They initiated a fast appreciation spiral in the second quarter and were accompanied by a disorder of the functioning of the domestic foreign exchange market.

Under these circumstances, the Supervisory Council judged that the rapid appreciation of the exchange rate jeopardised the achievement of our inflation target in the medium-term horizon. Consequently, in full compliance with the price stability objective and without affecting the free exchange rate regime, in June the Council decided:

- ♦ To lower the policy rate from 1.25% to 1.00%. In parallel, overnight loan and overnight deposit rates were also reduced; and,
- ♦ To initiate a foreign currency purchasing programme, aimed at decelerating the pace of exchange rate appreciation and creating the premises for a normal trading activity in the domestic foreign currency market.

Lowering the policy rate was aimed at further reducing the costs of financing and mitigating appreciation pressures on the exchange rate. The intervention in the domestic foreign exchange market, as a temporary and extraordinary instrument of the monetary policy, was considered as necessary under the conditions when the space for further lowering the policy rate was limited.

Interventions in the foreign exchange market were concentrated in the summer months. Further on, Bank of Albania market interventions have been practically inexistent and the exchange rate

reflected the supply and demand situation in the market. Insofar results show that Bank of Albania interventions have accomplished the objectives. The appreciation pace of the exchange rate has diminished and the activity in the foreign exchange market has returned to normal parameters.

In line with these developments, the Bank of Albania kept the direction and intensity of the monetary stimulus unchanged over the second half of the year. The policy rate remained unchanged at 1.0% while the financial market was supplied with the necessary liquidity and informed through the forward guidance on the future path of the monetary policy stance.

The accommodative monetary policy implemented by the Bank of Albania has proven successful for boosting economic growth, inducing better utilisation of production capacities and building up inflationary pressures in the economy. The transmission of the monetary stimulus is noted in several aspects:

- ♦ First, the monetary stimulus has led to the reduction of financing costs for households and enterprises. Interest rates are close to historical lows, across all the range of financial instruments.
- ♦ Second, the accommodative monetary policy has led to the expansion of credit in lek, and to the reduction of existing debt service costs. Lek credit to the private sector increased at 6.7%, on average, in 2018. In parallel, the reduction by 5.6 percentage points of the interest rate on lek credit compared to 2011 – when the monetary policy easing started – helps Albanian firms and households to save around ALL 15 billion per year.
- ♦ Third, the accommodative monetary policy has supported Albania's financial stability. Growth of demand for goods and services and reduction of debt costs led to the improvement of the solvency of firms and households, and has encouraged loan restructuring. Also, the orientation of lending toward lek credit has reduced the exposure of the economy and of the financial system against exchange rate volatilities.

Monetary policy-related measures undertaken by the Bank of Albania have contributed to the expansion of aggregate demand and boosting economic growth. Our assessments suggest that the accommodative monetary policy stance has contributed positively, on average by 0.5 percentage point, to economic growth in the last two years. Also the accommodative monetary policy stance has contributed to the stability of the domestic currency. Both transmission channels have contributed and will continue to contribute to price stability in Albania. The current trends in the development of the economy and our projections suggest that inflation will converge toward the target within a two-year horizon.

### **Banking supervision and financial stability**

The main aspects of our work for safeguarding financial stability were strengthening the stability of the banking system, enhancing its resilience to shocks, adopting international standards on supervision and regulation, and administration of consolidation processes in the banking sector.

The Bank of Albania judges that the ability of the banking sector to withstand risks is high.

The activity of the banking sector in 2018 was stable with good performance and resilience indicators. The financial result was positive: Return on Assets (RoA) stood at 1.3% and the Return on Equity (RoE) reached 13%. Capitalisation and liquidity levels were above the respective regulatory requirements. Credit risk continues to represent the main risk to the activity of the banking sector, but the credit quality has improved from the previous year. At the end of 2018, the non-performing loans ratio was 11.1% from 13.2% a year earlier, whereas the outstanding non-performing loans reduced by 20%.

The Bank of Albania remains committed to fulfilling all its obligations in the framework of the

national plan for the reduction of non-performing loans. In view of this goal, it has: (i) prepared a draft-regulation on the out-of-court addressing of borrowers; (ii) expanded the requirements for using official financial statements in the assessment of credit risk for all categories of borrowers; (iii) initiated measures for improving the Credit Registry, and has started work for harmonising credit reporting in accordance with international standards.

With respect to safeguarding financial stability, the Bank of Albania has continued to work for establishing and developing macro-prudential policy instruments and for establishing early warning systems for systemic risks. In this context, I would like to point out to two key developments.

- ♦ First one is about measures in the framework of increasing the use of the domestic currency as an instrument for increasing the effectiveness of economic policies and decreasing financial risks. In 2018, the Bank of Albania approved some regulatory amendments in this aspect: (i) decreasing the required reserve for deposits in lek and increasing the required reserve for foreign currency deposits, (ii) raising the required minimum level for the ratio of liquid assets to short-term liabilities in foreign currency, and (iii) setting out requirements to enhance transparency related to risks to the borrower in the case of foreign currency loans.
- ♦ Second one is about preparing the regulatory basis for setting up macro-prudential capital buffers, in accordance with best international standards and practices. Capital buffers mitigate cyclical and systemic risks in the banking activity, designed with a view to preventing a fast credit growth and build-up of indebtedness; restricting direct and indirect exposure concentration; and, restricting excessive risk in financial institutions.

With regard to improving the supervisory processes, the Bank of Albania has worked for appraising internal risk assessment procedures, reviewing individual recovery and capital adequacy plans of banks; adapting the regulatory framework with the legal and regulatory acts of the European Union and Basel documents.

Financial system monitoring has been supported by on-site inspections. In 2018, full-scope and partial examinations were carried out in 7 banks, 10 non-bank financial institutions, and 31 foreign exchange bureaus. Particular attention has been paid to the examination of banks with a major share in the activity of the financial market, those subject to acquisition or merger processes, or banks experiencing rapid growth. Overall, the monitored institutions have responded duly to the recommendations, by undertaking the relevant measures.

Increased attention has been paid to the supervision for the implementation of measures for the prevention of money laundering, in cooperation with the Directorate General on the Prevention of Money Laundering (DG PML). Cooperation with the DG PML was more intensive in the framework of the evaluation process for Albania by the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL). The Bank of Albania participated actively in fulfilling the comments related to the technical and effectiveness questionnaires. In the final MONEYVAL report, the effectiveness level of financial institutions was rated as “substantial/considerable”. In particular, banks show better awareness of the AML/CFT risks and of legal obligations, and have generally taken due measures in a way that is commensurate to the assessed level of AML/CFT risk. The evaluation process was accompanied by a plan of measures for addressing the main problems identified in the report; their realisation will continue in 2019 as well.

In the framework of consolidation in the banking sector, in 2018 some changes took place in the ownership structure of the banking system. As a result of these changes, 14 banks operated in the Albanian banking system as at the end of the year. Intesa SanPaolo Bank acquired and merged with Veneto Bank, and the American Bank of Investments acquired and merged with NBG Bank Albania. I would like to underline that these changes were dictated by developments in

the banks' home country or their international strategies rather than by domestic issues in the Albanian market. Moreover, at the beginning of 2019, changes in ownership were rendered possible in the case of International Commercial Bank and Societe Generale Albania. Changes in ownership took place also in two other banks, with one of them reflected in a higher share for domestic capital in the market. The Bank of Albania deems that the consolidation of the banking system is a welcomed development, which will revitalise the banking activity, will enhance the efficiency of the banking industry and will bolster development and innovative policies with regard to credit and payments.

In the capacity of the Resolution Authority, in 2018, the regulatory and procedural framework for resolution planning was prepared for harmonisation with international standards. In addition, the initial phase for the preparation of individual resolution plans has started. Also, during 2018 was established the Resolution Fund and the procedures for monitoring its management by deepening the cooperation agreements with the Deposit Insurance Agency.

Lastly, I would like to reiterate that safeguarding financial stability is a responsibility not only of the Bank of Albania but also of other regulatory agencies and the Government of Albania. Policies and measures for safeguarding financial stability and strengthening banking system's resilience require all parties to continue the coordinated, inter-institutional and multi-dimensional efforts.

### **Functioning of safe and efficient payment systems**

The Bank of Albania has dedicated particular attention to guaranteeing the security and efficiency of the core infrastructure of payments in lek, through its role as both operator as well as overseer and catalyst of the payment systems. Both systems operated by the Bank of Albania, the Albanian Interbank Payment (AIPS) and Albanian Electronic Clearing House (AECH) have operated with no disruptions, efficiently and safely. In 2018, the Bank of Albania undertook a set of measures to further improve the legal and regulatory framework on the oversight of payment systems and payment instruments. The changes are aimed at adopting the European practices for promoting innovation in the field of payments and establishing premises for private initiatives.

One of the main achievements on the improvement of the legal framework is the finalisation of the draft-law "On Payment Services" (PSD 2) which transposes the relevant EU Directive. Its approval and implementation will promote competition and innovation in retail payments, will enhance transparency of these services and will provide a framework on consumer's protection.

The National Payment System Committee (NPSC), which is chaired by the Bank of Albania and brings together public and private stakeholders in the field of payments, approved the Albanian National Retail Payments Strategy (2018–2023). The purpose of the strategy is to improve the retail payments market, promoting the use of electronic payment instruments and broadening the financial inclusion of the population. The strategy will be implemented through the improvement of the legal and the regulatory frameworks, through improvements in infrastructure and financial education.

### **Other activities**

In the field of statistics, the Bank of Albania continued its work for the methodological approximation of statistics with international standards and their alignment with the acquis communautaire. In cooperation with INSTAT and with expertise from the European Union, the Bank of Albania coordinated the work to develop indicators of macroeconomic imbalances for Albania. During 2018, the EUROSTAT carried out an evaluation mission of the Statistical System in Albania, which assessed that the statistics of the Bank of Albania are in line with the principles of the European statistics Code of Practice.

As at the end of 2018, the international reserve reached EUR 3.4 billion, sufficient to cover 6.7 months of imports of goods and services and 156% of the short-term external debt. In order to

increase the flexibility of managing the needs for foreign currency liquidity, an agreement was finalised with the Bank for International Settlements for a foreign currency credit line. The agreement constitutes an important mechanism available to the Bank of Albania in the event of an emergency situation.

Research continued to support the decision-making process for formulating and implementing Bank of Albania's policies. During 2018, the focus of scientific research was on issues related to monetary policy, safeguarding financial stability, and coordinating these two objectives. The results of the research are shared with national and international experts in scientific panels and are published in discussion papers.

An important part of Bank of Albania's development strategy is the establishment of transparent and long-standing relations with the public. The Bank of Albania has fostered its communication with the public to provide its opinion on economic and financial developments, as well as on the Bank's role in keeping macro-financial balances. Also, it complied with the obligations under the law "On the right to information" duly informing the public, as requested.

During the year several national and international conferences and forums were organized, discussing topics that are at the centre of the current debates and of interest for the country's development. Notably, the annual conference organized in cooperation with the London School of Economics and Political Science this year was dedicated to new approaches in the framework of monetary policy and the challenges to economic integration. This conference brought together distinguished personalities of central banking from advanced economies and regional countries, central bank governors, academics and representatives of international regulatory authorities. Conferences and discussion forums served to foster cooperation with our key partners such as the Albanian financial system, central banks of European countries and international financial institutions. Fostering co-operation was rendered more concrete with several agreements concluded, notably with the European Central Bank and the Single Resolution Board. These agreements pave the way for the Bank of Albania's full participation in the supervisory colleges of relevant European banks present in the country and for exchanging information on resolution planning for cross-border banking groups.

Financial education is an important tool for enhancing the effectiveness of the transmission of Bank's decisions to the economy. In addition to educational publications, various activities were organized throughout the year, mainly targeting the younger generation. Also, the Museum situated within the Bank of Albania has facilitated the logistics arrangements for undertaking educational campaigns.

Last but not least, the Bank of Albania remains a serious partner in the national commitments for joining the European Union. The Bank of Albania's obligations under the European integration process are included in the medium-term development objectives of the Bank of Albania. It coordinates Chapter 4 "Free movement of capital" and Chapter 17 "Economic and monetary policy", and it contributes to 6 other chapters of the acquis. The Bank of Albania has fulfilled the obligations deriving from the Stabilization and Association Agreement, the National Plan for European Integration and the recommendations of the European Commission. Specifically, it continued to implement measures to (i) reduce the level of non-performing loans, (ii) reduce the level of euroization in the financial system; (iii) harmonise the regulatory supervisory framework with the requirements of Basel III and Basel IV; (iv) approximate directives on payment services; and (v) increase the transparency of monetary policy.

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As part of this report, I would like to highlight an important aspect for guaranteeing good governance at the institution: the internal audit systems. The internal audit is independent from the management, guaranteed through the Inspector General, appointed by the Parliament.

## **Fostering internal control and monitoring systems and procedures**

In 2018, the operational risk management function – a new function at the Bank of Albania – consolidated and matured. It is based on the international risk management standards as well as on the best practices of central banks. In the last assessment, the level of Operational Risk Management has shifted from ‘ad-hoc’ to ‘managed’, thus overcoming the ‘basic’ level. This assessment exceeds the Bank of Albania’s objective.

This year, the project for “Drafting and Implementing the Bank of Albania’s Business Continuity Management Program” continued and is currently in the final phase of its completion. The purpose of this project is to ensure the continuity of critical processes and to restore normal business as soon as possible in the event of a crisis or emergency situation.

Audit engagements in 2018 focused on: (i) giving an opinion on the adequacy of internal audits set by the Management for the audited functions / processes, including supporting applications for the activities; and (ii) other not planned audit and non-audit engagements upon special request by Administrators or other external institutions.

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**Honourable Chairman,**

**Honourable Members of the Committee,**

At the end of my presentation, I would like to assure you that the Bank of Albania will continue to be committed to complying with our legal objectives, and to implement our institutional duties and commitments.

The perspectives on country’s development remain positive, yet challenges lie ahead. Addressing them requires the attention and the commitment of all policy makers and regulatory agencies in the country.

The economy, the financial system and the Albanian public, as well as our domestic and international partners will continue to find in the Bank of Albania a reliable, professional and transparent partner.

**Thank you for your attention!**