

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

Address by Mr Gent Sejko, Governor of the Bank of Albania, presenting the Annual Report 2017 to the Assembly of the Republic of Albania, Tirana, 8 May 2019.

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Honourable Speaker,

Honourable Members of Parliament,

The Bank of Albania pays particular attention to fostering institutional relations with the Assembly of the Republic of Albania, based on the spirit of accountability and transparency, and nourished by a constant and reciprocal dialogue.

In this light, I thank you for the invitation and the opportunity to present in a plenary session to the Assembly, the main conclusions of the Annual Report of the Bank of Albania.

Let me start by emphasising that the Bank of Albania has made progress with regard to all the three underlying aspects of our work:

- ♦ *Institutional objectives and duties set out in the legal and sublegal framework;*
- ♦ *Internal objectives set out in our Medium-term Development Strategy; and,*
- ♦ *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 Bank of Albania estimates that, in 2018, the Albanian economy and financial system made 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.

Let me present a few indicators to illustrate this.

- ♦ 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 households’ consumption, enterprises’ investments, and exports.
- ♦ According to INSTAT data, employment in the economy rose by 1.6%, whereas the unemployment rate at the end of the year fell to 12.3% from 13.4% a year earlier.
- ♦ The external position of the economy improved: the current account deficit declined at 6.7% of the GDP in 2018, and the indicators of external debt stability strengthened.
- ♦ Budget deficit and public debt continued on a downward trend, reflecting the consolidation path of the fiscal policy, the economic growth and the exchange rate appreciation.
- ♦ The main indicators of banking sector soundness – in particular liquidity, profitability and capitalisation – remained at satisfactory levels.

This dynamics of developments reflects, to a significant extent, the effect of policies, measures and instruments the Bank of Albania has adopted on continuous basis. In the following, I will focus in greater detail on the measures taken by the Bank of Albania on monetary policy, banking regulation and supervision and financial market development.

1. Monetary policy in 2018

In line with our primary objective – achieving and maintaining price stability – our monetary policy retained, even strengthened, the accommodative stance in 2018. This stance is consistent with

the cyclical position of the Albanian economy, and aligned with the consolidation trend of the fiscal policy.

Albeit the positive performance of the economy, for 2018, annual inflation averaged 2.0%, remaining unchanged from the previous year and undershooting our 3% target. Inflation reflected the effects from two developments in 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.

Beyond fundamental factors, the appreciation reflected the effect from specific shocks, which led to a temporary imbalance of demand and supply for foreign currency and contributed to a change in the behaviour of certain operators in the economy. They initiated a rapid appreciation spiral in the second quarter and were accompanied by a disorder in the functioning of the domestic foreign exchange market.

Against this backdrop, 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 Supervisory Council decided to:

- ♦ Lower the policy rate from 1.25% to 1.00%, aiming to further ease monetary conditions in the economy.
- ♦ Initiate a foreign currency purchasing programme, aimed at curbing the exchange rate appreciation and creating the premises for a normal trading activity in the domestic foreign exchange market. This programme, concentrated mainly in the summer period, was a temporary and extraordinary monetary policy instrument. Once the objectives were achieved, the Bank of Albania has not intervened in the market and the exchange rate stability has reflected the market equilibriums.

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

- ♦ *First*, the monetary stimulus has contributed to the expansion of private consumption and investments, by lowering financing costs and boosting lending. Lek credit to the private sector increased at 6.7%, on average, in 2018.
- ♦ *Second*, the accommodative monetary policy has reduced the existing debt service costs, by alleviating the balance sheets of borrowing households and enterprises, and further bolstering the expansion of aggregate demand.
- ♦ *Third*, the accommodative monetary policy has supported Albania's financial stability, by improving the solvency of the private sector, and encouraging loan restructuring.

Thus, monetary policy-related measures undertaken by the Bank of Albania have contributed to 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.

2. Banking supervision and financial stability

The activity of the banking sector in 2018 was stable showing good performance and resilience indicators. The financial result was positive: the Return on Assets (RoA) stood at 1.3% and the Return on Equity (RoE) reached 13%. In addition, capitalisation and liquidity levels were above

the respective regulatory requirements.

The Bank of Albania judges that the capability of the banking sector to withstand risks is high. 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 stood at 11.1% from 13.2% a year earlier, whereas the outstanding non-performing loans decreased by 20%.

In 2018, the ownership structure of the banking system underwent some changes, bringing the number of banks down to 14, as at the end of the year. Taking into account the changes in ownership taking place in 2019, the actual number of banks is 12. The Bank of Albania deems that the consolidation of the banking system is a welcomed development, which will revitalize the banking activity, will enhance the efficiency of the banking industry and will bolster development and innovative policies with regard to credit and payments.

The main aspects of our work for safeguarding financial stability consisted in strengthening the stability of the banking system, enhancing its resilience to shocks, and adopting international standards in the fields of supervision and regulation. Thus, in concrete terms:

- ♦ The Bank of Albania has worked toward fulfilling all its obligations in the framework of the national plan for the reduction of non-performing loans. In view of this goal, the Bank of Albania has: (i) prepared a draft-regulation on the out-of-court treatment of non-performing borrowers; (ii) extended 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, (iv) started work for harmonising credit reporting in accordance with international standards.
- ♦ The Bank of Albania has initiated concrete measures to promote the use of the domestic currency in our financial system and has continued working on the development of the macro-prudential policy and on establishing early warning systems for systemic risks.
- ♦ Increased attention has been paid to the oversight of the implementation of measures for the prevention of money laundering, in cooperation with the Directorate General on the Prevention of Money Laundering. The final evaluation report of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL), rated the effectiveness of financial institutions as “*substantial*”. In particular, banks show they know well their legal obligations and risks, and have generally taken due measures commensurate to the risk level. The evaluation process was accompanied by a plan of measures for addressing the main problems; their implementation will continue in 2019.
- ♦ In the capacity of the Resolution Authority, in 2018, the regulatory and procedural framework for resolution planning was prepared and the compilation of individual resolution plans started. Also, in 2018, the Resolution Fund was established and the procedure for its management was put in place.

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 that all parties continue the coordinated, inter-institutional and multi-dimensional efforts.

3. Improvement of financial markets and payment systems

In view of its duties and commitments, the Bank of Albania has continued to promote the development of the financial market and to improve further the payment system.

Thus, in cooperation with the Ministry of Finance and Economy, the project for promoting the development of the primary and secondary markets for government securities continued

successfully. This project paves the way for deepening the financial market, expanding and diversifying the base of investors in government debt and reducing its cost in the long term.

Moreover, 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 operator, overseer and catalyst of the payment systems. The finalisation of the draft-law “On Payment Services”, which transposes the relevant EU Directive (PSD 2), is one of the main achievements on the improvement of the legal framework. Its approval and implementation is expected to foster competition and promote innovation in retail payments, cut costs, enhance transparency of these services, and provide a framework on consumer’s protection.

In parallel, the National Payment System Committee, chaired by the Bank of Albania and bringing together public and private stakeholders in the field of payments, approved the Albanian National Retail Payments Strategy (2018–2023). The scope of the strategy is to improve the retail payments market, promote the use of electronic payment instruments and broaden the financial inclusion of the population.

4. Governance and other activities

The accomplishment of our primary development objectives evidences the professional work of Bank of Albania staff and of the constant prudence of the Supervisory Council, as the steering and monitoring body over the activity of the Bank of Albania.

In addition to the monetary policy and financial stability-related issues, other important decisions of the Supervisory Council in 2018, were: (i) approval of the policy for the oversight of payment and settlement systems;(ii) approval of the Accounting Policy in accordance with the International Financial Reporting Standards; and, (iii) 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. In parallel, the Supervisory Council has monitored continuously the governance of the institution and has worked towards its improvement.

In conclusion, I would like to emphasise that the Bank of Albania has realised its duties and accomplished its commitments in other fields of its activity, which have a direct or indirect impact on economic and financial developments in Albania. More specifically, progress has been made on:

- ♦ Support for European integration processes, through both specific contributions to the respective chapters and constant dialogue with European partners;
- ♦ Administration of the circulation of the national currency and the adaptation of its structure to the needs of the economy;
- ♦ Management of the foreign exchange reserve, in line with reserve-holding objectives and in the presence of a challenging external financial environment;
- ♦ Improvement of scientific research, to support informed and efficient decision-making;
- ♦ The quantitative and qualitative improvement of financial statistics, in accordance with the best relevant standards;
- ♦ Continuation of financial education of the public, by increasing the role of the Museum of the Bank of Albania and continuing with targeted educational programmes;
- ♦ Enhancing institutional transparency, by expanding the span of the published information with a view to foster trust and confidence in the institution and its reputation.

Honourable Speaker,

Honourable Members of Parliament,

The outlook on Albania'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.

In particular, in Bank of Albania's opinion, guaranteeing sustainable and long-term growth requires maintaining the focus on monetary and fiscal policies that are oriented toward stability, by using in a wiser and more efficient way the available space for stimulating the economy, without affecting the stability of public finances and of the financial sector. In parallel, development policies should aim to reduce risks and mitigate structural vulnerabilities in the economy.

In the long term, the further acceleration of the economic growth pace and a fairer allocation of resulting benefits from it to various economic and social categories will require continuing and revving up the structural reform agenda.

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

Thank you for your attention!