

Gent Sejko: Role of the banking industry in the future development of Albania - challenges and opportunities

Address by Mr Gent Sejko, Governor of the Bank of Albania, to the discussion meeting with senior banking sector officials, Tirana, 29 May 2019.

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Dear banking system executives,

Dear guests, dear colleagues,

I have the pleasure of welcoming you to this event, which brings us together to address some issues of particular importance to the banking sector and the Albanian economy as a whole.

Today, we will be discussing the role of the banking sector in the development of Albania's economy, from short, medium, and long-term perspectives. This is, in our opinion, a matter of both private and public interest.

I am confident that the discussions around this table will yield a tangible product. Our aim is to adopt a common development philosophy that will guide the banking industry into the future, as well as to agree on a concrete and detailed plan of measures for improving the quantity and quality of lending and enriching the array of financial products.

This meeting takes place only two weeks after the Third Conference of the Albanian Association of Banks, which was dedicated to the sustainable development of the banking sector in the future. At this Conference, where I had the honour and pleasure to address, I underlined the valuable contribution of the banking industry to Albania's development over the past two decades and identified some challenges and opportunities that may lie ahead for all of us, together, in the future. In our vision, these challenges and opportunities are related to the degree and quality of intermediation of funds in the economy – in other words, the volume and structure of credit, and the expansion of the range of financial products – to boost financial inclusion of the population and innovative technological development in the economy.

The premises of this meeting remain consistent with what I said earlier.

The Albanian banking sector has developed rapidly over the past two decades. Now, this sector administers around 2.4 million bank accounts of individuals, and provides credit to around 327,000 economic units, of which around 307,000 are households and around 19,000 are small or large enterprises; the rest are other public or private entities. In macroeconomic terms, the volume of financial savings administered by the banking sector accounts for around 70% of the GDP, whereas the volume of credit accounts for around 35% of the GDP. Moreover, in the past two decades, the banking sector has expanded its operational network across the territory of the country and has introduced bank products and payment instruments in line with global developments in this sector.

In brief, the banking industry has contributed to the development of the Albanian economy by encouraging savings and generating credit. It has also contributed to the development of financial markets and the expansion of payment instruments, by offering advice and expertise to enterprises and providing for risk diversification in the economy.

In return to these contributions, the banking sector – now entirely privately owned – has constantly generated positive returns and has experienced relatively low volatility in its profitability indicators. It has offered and continues to offer a positive business prospect for all investors that have a long-term vision and are dedicated to accompanying Albania on its journey toward progress and European integration.

The banking sector has been and remains the backbone of the financial system and the most professionally avant-garde segment of the Albanian economy. I am confident that – irrespective of the trend for expansion and diversification of other segments of the financial market – the banking sector will continue to play a unique role in the near and distant future.

In this context, I would like to share with you the vision of the Bank of Albania on development challenges.

1. Credit as an instrument that brings together the interests of both the economy and the banking sector

Sustainable development of the banking sector requires increased attention to its primary role: transforming savings into financing instruments to the economy. In practical terms, the banking industry should ensure that the credit supply concords in terms of time and diversity to the needs of the economy, while factoring risk in directly and responsibly.

Before I elaborate on this topic, let me emphasise two key moments.

The first moment pertains to a misunderstanding we often encounter in the public opinion, even within the professional discourse, that is the Albanian banking sector is not lending. This is not true. Our data show that, excluding the accounting effect of the exchange rate and the write offs, the portfolio of bank loans has recorded 6% annual growth in the last year. Moreover, the pace of growth has shown an improving trend, in line with the overall context of the performance of the economy. In parallel, the expansion of the bank loan portfolio has shown a more balanced composition in terms of both the currency structure and the destination of funds. I would also like to underline that the term to maturity of the bank loans portfolio is short, which means that it is renovated frequently. Thus, regardless of the pace of change in the size of the portfolio, the Albanian banking sector continues to lend. To illustrate my point, only in 2018, the banking sector has granted new loans amounting to around EUR 1.1 billion (equivalent) to fund business investments, house purchase and consumption.

The second moment pertains to the responsibility and the diligence of the banking sector vis-à-vis lending. As the administrator of public savings, responsibility and due diligence in lending are non-negotiable conditions. Measures undertaken to bolster the short and medium-term development of Albania should not run against its financial stability in the long term.

Yet, in coherence with my observations above, I judge that the banking sector should pay more attention to lending. This judgement is based on two theoretical premises and is enabled by an important precondition.

First, a more proactive approach to lending is beneficial for the sustainable and long-term development of the banking industry. Low return on assets is one of the problems facing the banking sector in Albania, in the region, and beyond. Such low rates of return – which in Albania are induced also by ample foreign currency liquidity and will continue to be favoured by the reduction trend of the public debt and domestic borrowing by the Government – increase the vulnerability of the sector to shocks. Against this backdrop, the banking sector should increase its orientation toward lending as an instrument to enhance asset profitability and boost its long-term stability. In the same vein, leaving potential sectors or clients outside the focus will push them to turn to other segments of the financial market. This implies less income for the banking sector not only in the form of less income from lending, but also in the form of less income from other products in the package of services that banks offer to clients.

Second, a more proactive approach to lending is beneficial for the sustainable and long-term development of the Albanian economy. Our analyses, based on the available information and the bank lending survey for Albania suggest a divergence in the pace of improvement in loan demand and supply. While this divergence does not seem to have, as of yet, a substantial impact on

lending, if it deepens further it will jeopardise the performance of credit and the pace of economic growth. In this light, I would like to underline that a series of studies, both at home and abroad, emphasise the fact that the Albanian economy would benefit from credit growth, for as long as and provided that such growth is based on firm structural and institutional premises. It is our common duty not to let this opportunity pass.

This conclusion leads me naturally to the precondition I mentioned earlier.

The Albanian economy offers positive business prospects, coupled with a high crediting potential and reduced credit risk. This reality dictates the need and the possibility for a bolder approach toward crediting. I have had the opportunity to elaborate – on a continuous basis – our standpoint on the economic development perspective. I would like, however, to bring today to your attention again that, in cooperation with the Albanian Association of Banks and the Government of Albania, we are implementing an ambitious plan of measures for reducing non-performing loans. From a strategic point of view, the objective of this plan was not only to simply clean banks' balance sheets, but also to provide for a qualitative improvement of the crediting environment in Albania. In this context, the banking industry now has a more adequate legal and regulatory framework on protecting the interests of the creditor, repossessing collateral and executing it, and a more transparent environment for assessing the risk of individual borrowers.

On this basis, the Bank of Albania deems that the banking sector, should:

- ♦ Pay additional attention to crediting as a commitment that generates mutual benefits both for it and the Albanian economy;
- ♦ Empower internal structures and its analytical and managerial capacities in terms of crediting;
- ♦ Ensure prioritized implementation of outstanding commitments under the plan of measures for reducing non-performing loans; and,
- ♦ Be more vocal and more transparent in identifying obstacles or deficiencies it finds in the crediting environment, both in legal and in regulatory aspects.

These recommendations should not be addressed separately from the second challenge.

2. Efficient allocation of bank loans as a precondition for sustainable and long-term development

Increased attention to crediting does not imply merely increased attention to the volume of credit, but also additional attention to its quality. These two aspects are complementary and do not contradict each other in the long run.

The history of credit in transition economies, including Albania, features some problematic elements which we need to avoid in the future.

First, credit has been notably concentrated in non-tradable goods and services, such as residential buildings and services, which are oriented solely – or primarily – toward the domestic market. Clearly, this trend reflects, at the same time, the lack of managerial knowledge and capacities in the Albanian economy, and the banks' behaviour in terms of crediting. This has produced two negative consequences: it has failed to promote the growth of productivity and the improvement of the long-term growth pace of the domestic economy; and, it has restrained the diversification of the production base in the economy, limiting its resilience to various shocks.

Second, a part of the credit portfolio, not quite insignificant, has been granted to borrowers who have been exposed to and unhedged against exchange rate volatility. These borrowers have often had limited and deficient knowledge on the exchange rate risk and have suffered the consequences.

Beyond macroeconomic aspects, the structural deficiencies of crediting are, in part, responsible for the rapid growth of non-performing loans in the post-financial crisis period.

In this context, the Bank of Albania deems that the banking sector should:

- ♦ Expand the range of credit products, especially with regard to funding projects, so as to ensure a better coverage of the sectors of the Albanian economy and of the needs of borrowing households;
- ♦ Increase its attention to sectors that offer a high potential for returns, given the low usage of financial leverage, such as agriculture and innovative business start-ups in information technology;
- ♦ Supplement the range of financial products with derivative instruments for hedging against the exchange rate, especially for borrowers exposed to it.

3. Enriching the array of financial products and payment instruments

In addition to its primary function, intermediation of funds, the banking sector has an essential role to play in providing payment services to the economy. The scale and efficiency of accomplishing this role is in proportionate correlation to the scale of financial inclusion of the population, the overall efficiency of the economy, and – why not – the level of its formalisation.

In the framework of its role as overseer of payment systems, the Bank of Albania has undertaken a series of measures to further improve legal and regulatory frameworks. These improvements aim to accommodate innovative technological developments in the field of payments, enhance effectiveness by promoting competition and ensure transparency and consumer protection.

Acknowledging the role of other institutions, the Bank of Albania, together with the National Payment Systems Committee, have drafted for the first time the National Retail Payments Strategy, which identified market needs and relevant measures for intervention. The goal of the Strategy is to improve the retail payment market by providing Albanian citizens with more choices for their daily transactions, in an easy-to-use cost-effective way, as well as to increase financial inclusion. The Strategy has a detailed action plan; the Bank of Albania is fully committed to its implementation.

In this framework, I would like to emphasise a notable achievement, the finalisation of the draft law on “Payment services”, which transposes the Revised EU Directive on Payment Services (PSD2). The draft is currently subject to public consultations. The approval of this draft-law would provide the preconditions for promoting innovative technological solutions, and introduction of more efficient and less-costly instruments. At the same time, it contributes to enhancing the security of payment services by addressing risks related to the implementation of innovative technological developments in these services.

In the period ahead, we will continue to improve payment services; an important initiative in this regard is the preparation of a draft-law “On payments account” which transposes another EU Directive. It seeks to underpin the objectives for increasing financial inclusion of the population, which is currently at relatively low levels.

I am confident that the expansion of financial inclusion, notwithstanding its short-term costs, will contribute significantly to bolstering your intermediation activity in the long run.

In addition to regulatory improvements, we are engaged in a series of projects on infrastructure improvements. Such as:

- ♦ Creating a national platform for real-time processing of payments. Such platforms have proven to be very effective, as they realise a payment within seconds and may replace or supplement areas where the activity of card payments have not been effective.

- ♦ Creating a national SWITCH, which implies processing a card payment through a domestic platform, avoiding prolonged cycles via international card processors.
- ♦ Creating a system for the settlement of euro payments domestically in order to lower the existing very high commissions resulting from the use of correspondent banks, which are very costly.

All these legal improvements and technological modules, which are being made available to you should be followed by concrete actions on your side, to expand the range of instruments and lower their costs.

Dear ladies and gentlemen,

The banking sector has had and will continue to have a positive development prospect in Albania. That does not mean, however, that there are no challenges lying ahead of us. On the contrary, there are numerous, complex and dynamic ones, often combined with unpredictable development, domestically and internationally.

It is our duty, as actors and regulators of this industry, to respond in a timely and decisive fashion, to turn the already identified challenges into development opportunities, as well as to enhance the stability and resilience of the sector against unforeseeable shocks.

As we proceed, I would like to invite you all to openly share your thoughts on these issues. I am certain that a constructive dialogue will enable us to prepare a concrete, realistic, and – why not – ambitious plan.

Once again, let me reiterate that the banking sector is a national treasure and a strategic sector. This status allows it to have an important voice in the formulation of development policies, along with an obligation to serve with utmost commitment to the economy and the society.

Thank You!