SPEECH BY THE GOVERNOR OF THE BANK OF ALBANIA, MR. ARDIAN FULLANI

At the joint press conference of the IMF Mission, the Ministry of Finance and the Bank of Albania
27 October 2009

At the beginning, I would like to thank the IMF Mission and especially the IMF Mission Chief, Mr. Gerwin Bell on the huge work they have carried out during the last week.

This regular visit of IMF, in the framework of Article IV consultations, coincides with a rather difficult period, as regards to the pressures streaming from the big crisis, which has blown up throughout the world economy since last year.

We have concluded with pleasure that, Bank of Albania shares equal appraisals regarding a lot of developments the Albanian economy has been going through during the first half of 2009. I take advantage to flag once more the conclusion articulated for some time: (1) that Albanian economy and its financial system showed sufficiently resistant; and (2) the policies undertaken from both authorities, the Bank of Albania and the Ministry of Finance, resulted useful for both the establishment and transmission of the right incentives towards financial stability and economic activity at home.

Speaking in more concrete terms about the monetary policy of the Bank of Albania, I would like to emphasise that it has been measured throughout this period, by prudentially reflecting the latest macroeconomic developments, the banking system developments and the agents' expectations. Also, the strategies used by the Bank of Albania in the money market, are part of this prudence, with the purpose to increase liquidity injection in the system.

Overall, turning the attention to the short-term and long-term horizon, briefly I would like to deal with two or three issues that Bank of Albania has decided to have in its agenda of priorities, for the succeeding months.

First, I would like to emphasise, once more, my idea launched during the Third Forum of the Bank of Albania with the banking system, as regards to the shift of the economy towards a new equilibrium, different from the pre-crisis one. This is an argument which dominates the today debate, and I share the opinion we should factorise this conclusion on our macro- projections of the country development for the forthcoming years.

Second, Bank of Albania considers indispensable to increase the attention and financial vigilance during the succeeding periods. This may imply a further strengthening of macro-financial stability, particularly as regards to the best harmonisation of both basic policies in economy, to pursue the required simulation of the country's economic activity.

Third, I would assess as highly important the continuance of lending to economy, the attraction of foreign investments and the deepening of structural reforms. The Bank of Albania is committed to provide long-term stability of prices and for that purpose, its decision-making shall continue to be anchored by this legal target. Under the circumstances of a new post-crisis reality, we are not going to draw the attention away from the structural processes of the economy, to further customise the Albanian economy in encountering the post-crisis effects and to turn the latter on a vibrant economy, not only in the region but even more broadly.

SPEECH BY THE GOVERNOR OF THE BANK OF ALBANIA, MR. ARDIAN FULLANI

At the Press Conference on the Decision of the Supervisory Council of the Bank of Albania to reduce the key interest rate by 50 basis points
28 October 2009

In today's meeting of 28 October 2009, the Supervisory Council of the Bank of Albania, after analyzing the latest economic and financial developments in the country, the macroeconomic projections and the balance of risks for the months to follow, decided to reduce the key interest rate by 50 basis points to 5.25 percent.

The Supervisory Council of the Bank of Albania concludes that the third quarter of 2009 witnessed positive signs in the Albanian economy and financial markets. It particularly marked a turning point in terms of restoring confidence in the Albanian banking system. The stable liquidity situation, the preservation of financial stability and the banking system's capitalization parameters constitute a solid platform for restoring its intermediation and financial role in economy. In tandem with the latest positive tendencies of the global economy, which still remain frail in terms of their nature and permanence, these developments prompt us to consider the future Albanian economic activity under the optics of a prudent optimism.

Over the course of the year 2009, the Albanian economy has been affected by the global economic and financial crisis primarily through the decline of foreign demand and remittances, higher risk premiums and reduced and high-cost financial support. However, our economy continued to record positive economic growth rates during this period, while the domestic inflationary pressures remain contained. Economic activity at home has been sustained by the fiscal stimulus and the preservation of relatively high consumer demand rates. In the meantime, investments and export demand have recorded lower growth rates in the first nine-month period.

At a global level, the second quarter of 2009 and the following period witnessed stable economic activity. Although the world economy continued to contract in annual terms, the consumed stock cycle replacement set a floor on the downturn of Euro area and US economies. Moreover, this cycle served as a short-term catalyser for the reactivation of their industry and production sectors. In a longer-term perspective, the stable economic activity of the Asian countries -China in particular,- and the global trade growth will fuel the global economic growth. However, the world economy path to a sound and stable growth is a long one. The existing model of global economy has relied on the high consumption and the severe debt situation of the USA, against an Asian countries' strategy that favours exports and savings. Coupled with below potential economic growth and downward inflationary pressures for a relatively long period of time, the addressing of these imbalances at a global level requires time.

The global financial system, the capital markets, the banking sector and other financial intermediaries seem to be recovering. The monetary and fiscal stimulus has provided its effect at a global level, helping first the recapitalization of the financial system and restoring the lending system. Despite the high risk perception and low risk readiness across the financial agents, the resumption of global financial flows will provide assistance to emerging countries through higher available funds.

Amidst the global development challenges, the Albanian economy recorded positive economic growth during the first half of 2009. According to preliminary data reported by the INSTAT, the GDP grew at an annual rate of 5.3 percent in the second quarter, maintaining similar growth rates as in the preceding quarter. Activity in services provided the main contribution to the GDP growth. The production sector provided additional contribution to the annual GDP growth, mainly owing to the performance of the construction sector. By contrast, industry deepened the downward growth rates that began in early 2009.

The economic growth tendency, albeit at lower magnitude, is also present in several indirect indicators of the economy, namely the higher budget revenues, higher lending to the economy and more stable labour market indicators. However, these indicators, particularly monetary and business and consumer confidence indicators, reflect slower economic growth rates relative to the previous year.

In a macroeconomic context, the slowdown is mostly a reflection of the fall in investment and foreign demand, while consumption and public expenditure have led to higher economic activity.

The economic performance of the first half of 2009, albeit positive, attests to a slowdown of about 1.4 percentage points compared with the same period in 2008. In addition to the general slackening of global inflationary pressures, this situation has been translated into the gradual reduction of inflationary pressures on the Albanian economy. Average inflation marked 2.0 percent in January to September 2009, fully reflecting the exclusion of the first round effects generated from the rise in raw material prices during 2007-2008 and the cessation of effects arising from the latest administrative rise in the energy price. The downward trend of core and non-traded goods' and services' inflation attest to the fact that the inflationary pressures generated from the domestic demand-side are subsiding. On the other hand, the relatively strong depreciating movements of the domestic currency, the ALL, during 2009 have pushed the traded goods' inflation higher to about 3.1 percent in the third quarter. Developments in the labour market and wages do not signal higher future inflationary pressures on the supply-side. Unemployment rate was 12.7 percent in the first half of 2009, similar to the year-end 2008 level. For the same periods, the growth rates of average real wage in economy have been more contained.

The Bank of Albania forecasts and the anchoring of economic agents' expectations for consumer prices support the preservation and firming up of consumer price stability in the medium run, expressed in low and stable inflation rates.

Current account deficit narrowed slightly by 1 percentage point y-o-y in the second quarter of 2009, reflecting slower imports and exports in the Albanian economy. In the meantime, workers' remittances have reduced at relatively lower rates than in the preceding quarters. However, the current account deficit remains high, reflecting the high levels of consumption in the Albanian economy and the unfeasibility of the production capacities at home to meet it. Privatization receipts and the public sector's foreign currency borrowing led to a positive balance of payments; however, its future stability should rely on longer-term factors.

The government ran an expansionary fiscal policy in the first eight months of 2009. In annual terms, budget expenditure increased by 23 percent, reflecting primarily the rapid increase of capital expenditure. Budget revenues maintained a slower rate than expenditure due to the slower economic growth rate during this period. Consequently, the additional budget expenditure was financed through the use of privatization receipts and the higher public borrowing. This policy has exerted pressure over the increase of Government debt securities' interest rates of long maturity term.

The influence of fiscal policy on the domestic monetary markets was more moderate during this period since the public debt was to a large extent borrowed from the international capital markets. However, the future persistence of this policy will face less funding potentials of both the Albanian and the international market. This fact calls for the quick return to the consolidating trajectory that the fiscal policy pursued in the pre-crisis years.

The monetary indicators of the third quarter of 2009 attested to the slow money growth tendency. Money supply, M3, recorded an annual growth of 4.5 percent in August vis-à-vis the average growth rate of about 7 percent in the first half of 2009, owing mainly to the lower credit flows to the private sector. Deposits grew substantially in August – about ALL 25.4 billion in monthly terms – in line with their seasonal performance during this period of the year. As at end of period, about 70 percent of the total deposits' stock growth was time deposits, hence signalling the higher confidence in the banking system.

Private sector credit maintained its slower growth rates in July and August 2009, reflecting both the tightening of credit supply and the contraction of credit demand. Coupled with the reduced use of capacities as reported by businesses in the Bank of Albania survey, this performance signals that the private sector's investments in economy are downward. Banks continue to apply tight lending standards, while consumer demand and private sector investments have fallen.

In nominal terms, private sector credit grew by an annual average of 16 percent in June to August, markedly lower than the first five months' average (29 percent). Despite the low growth rates, business credit provided the main contribution to the private sector credit growth, accounting for about 65 percent. The downward trend of credit attributes to the deceleration of foreign currency lending, whose growth rate was zero in August. In the meantime, ALL lending continued to maintain its average growth rate of 30 percent throughout the year 2009. As a result, the share of foreign currency credit in the private sector's loan portfolio dropped to 67 percent. The understanding of the consequences of exchange rate movements and the greater tightening of lending for loans denominated in a currency other than that of the borrower's income, caused the individuals to borrow less foreign currency credit than businesses.

The financial markets attested to an improved liquidity situation and the recovery of the agents' confidence in these markets. The persistent Bank of Albania's liquidity supply to the money market helped to calm the market participants down and to supply the market with funds, which served to the private sector's domestic currency intermediation. The liquidity needs in the interbank market have been declining, hence exerting no pressure over the short-term interest rates. By contrast, the Government securities' primary market experienced a reverse situation, with the T-bill yields of long-term maturity going up despite the ample liquidity. In September's last auction, the 12-month yield was 9.40 percent, up by 0.64 percentage points from the year-end 2008.

The high risk premium on long maturity terms and the existence of a shallow financial market were the rationale behind the high Government securities' long-term yields. On the other hand, the high yields attracted the individuals' investment in this market, hence providing them with an alternative instrument to keep their savings and at the same time, increasing the share of budget deficit financing from this item. The individuals' deposits held in the banking system have had a satisfactory return. Weighted average interest rate on ALL deposits marked 5.94 percent in August or up by 0.48 percentage points from the end of the second quarter. This increase led to lower intermediation cost for the ALL during the recent months. Interest rates on new ALL loans declined to an average of 12.86 percent in July and August, down by 0.79 percentage points from the average rate of the first half of 2009. The banking system's inclination to relieve the cost of ALL loans is attested by the narrowing of its margin and the corresponding reference rate, the T-bills. The spread declined to an average of 3.6 percentage points in summer, from 4.8 percentage points in early 2009.

Going back to today's decision of the Supervisory Council of the Bank of Albania, allow me to underline that the long-term development perspective of the Albanian economy is positive. Macroeconomic stability and the confidence in the Albanian financial system are the product of our responsible macroeconomic and financial policies undertaken continuously over the course of the recent years. Macro financial stability is a solid foundation for boosting the country's development in the future.

This development will to a large extent depend on the capacity of the Albanian economy to attract funds, which will buttress its growth. The monetary conditions are relaxed in line with the dynamics of economic and financial developments in Albania, in our main trading partners and broader in the global economy. This decision represents a new incentive for the economic developments at home, aiming at reducing the financing cost of the economy further.

The performance of lending to economy will be of prime importance in the medium run. The Bank of Albania deems that the stabilization of the banking system's liquidity and balance sheet indicators will pave the way for the lending process. In this context, the Bank of Albania has been engaged in an active role in terms of stimulating demand and supply with funds. The relaxation of monetary conditions will fuel the growth of business and consumer demand for funds, while the Bank of Albania's injection of liquidity will assist the banking system in meeting the demand for funds in quantitative terms. The Albanian banking system should understand its role rightly and transmit the relaxation of monetary policy in economy completely and rapidly. On the other hand, a lower pressure of the fiscal sector over the domestic financial markets will in the future lower the risk premium in economy, will create more room for private sector lending and will facilitate the smoothing out of the interest rate curb in favour of lowering the cost of credit further. The efficiency of the monetary policy decision will depend on the market and its participants' behaviour, wherein fiscal policy plays a key role.

In the long run, the attraction of foreign direct investments and other forms of stable capital inflows should be at the core of our development policies. These funds will not only improve the external position in terms of its stability, but also sustain the country's long-term growth. Time is ripe for all the actors to carefully analyze the country's economic growth model in the decade we are approaching. The future economic growth model should in particular consider the competitive advantages of the Albanian economy more, mitigating its reliance on short-term capital inflows and expanding the economic basis, which generates stable and long-term capital flows. In this context, the Bank of Albania remains committed to playing a key role in the periods to follow.

In compliance with our legal and institutional commitment, the Bank of Albania's monetary policy will aim at creating the proper conditions for a balanced development, characterized by low consumer price inflation environment, moderate fluctuations of monetary indicators and sound macroeconomic agents' balance sheets.

SPEECH BY THE GOVERNOR OF THE BANK OF ALBANIA, MR. ARDIAN FULLANI

At the International Conference for the 10th Anniversary of the Central Bank of the Republic of Kosovo
Prishtina, 30 October, 2009

Dear Governor Rexhepi,
Distinguished ladies and gentlemen,

It is a pleasure for me to participate in this Conference which is perfectly organized by the Central Bank of the Republic of Kosovo, and to witness the amazing progress this institution has achieved in such a short but intense period of time. The energy and desire of the local staff to contribute to the history of this institution, has been rightly channeled by the vision and experience of several managing professionals that have given a valuable contribution in chairing this institution in the last years. I am sure this story will continue to be a successful one, based on the commitment of the management of the Central Bank of Kosovo to achieve and comply with the best work organizational and efficiency standards, by pursuing a clear long-term policy of investing in the quality of its personnel, and by supporting actions that contribute to maintaining fruitful inter-institutional cooperation.

In addition, I want to thank the organizers for giving me the honor to speak in front of you today, regarding a topic that has become so relevant in the last year, following this unprecedented international financial crisis. Given the fact that the causes and consequences of this crisis have been broadly identified and discussed, in the first part of my speech I will focus more on the main findings of the professional discussion that is taking place nowadays to identify a new financial supervision approach. I am sure you will elaborate on these issues further during this Conference. In the second part of my speech, I will try to give you more detailed information on how we at the Bank of Albania are thinking about the future approach of the public authorities and of the financial industry, in relation to necessary measures to strengthen financial stability.

Very shortly I want to reiterate what has now become clear to many: the recent crisis was a consequence of wrong incentives which supported unbalanced financial activity development and misconception of risk assessment, pricing and management. Such wrong incentives were present not only to the financial industry and markets, but also to the balance sheet of households, businesses and entire countries. Given the nature, the size and the impact of this crisis, not only to the financial industry and markets but also to the real economy, public authorities in many countries were forced to adopt swift, coordinated and extraordinary measures, both in the area of monetary and fiscal policies. Central banks abandoned almost any restriction and even adopted unconventional measures in providing ample and low-cost liquidity to the financial markets. Governments showed a strong commitment to reduce systemic risk by saving important financial institutions, by providing guarantees for inter-bank lending, by raising the level of deposit guarantees for the public etc.. Such measures, most of the times designed as temporary, appear to have been successful in restoring the market confidence and steering the world economy back in the gradual recovery path.

Focusing on the financial markets and institutions in the aftermath of the crisis, a number of issues, previously known but many times neglected, have re-appeared forcefully to request a serious and thorough response by the authorities. Many of these issues relate to the financial activity itself, others are connected more with the surrounding economic environment.

It can be said now that the supervisory authorities of the financial markets and institutions are partly responsible for what happened. Despite the rhetoric, they failed to properly and timely identify and control the risk in the financial industry. Here one can mention the soft-hand on bank wholesale borrowing that financed the foreign currency credit in a certain jurisdiction, the neglect for the special purpose entities that were created to by-pass balance sheet prudential requirements etc.. There are many reasons for this weakness and a number of them, in my opinion, go beyond the legal and resource capabilities of the supervisory authorities to act. On their own, the supervisory authorities were wrong in basing their work on the misconception that strong individual financial institutions are sufficient for the entire financial system stability. By doing so, they missed the negative effects and excesses that arise from the herd behavior of the financial institutions, many times a consequence of the pro-cyclicality that is inherent in the financial activity and the regulatory framework itself. The attention of the supervision was focused on the banking sector, but insufficient attention was given to its interaction with the non-banking financial sector, that by being much less regulated, in the meantime was increasing in size and importance. Also, as part of their general and commending goal to focus their supervisory approach on the most important risk sources of the financial industry, but also as a sign of their objective difficulty to keep the pace with the financial markets developments and innovations, the supervisory authorities relied more and more on the market discipline and on the sophisticated and unclear risk models of the financial industry, that also proved to be deficient. Some times, the structure of the supervisory authorities has proven to be fragmented or too complicated, giving rise to regulatory arbitrage by the market players. Other times, the resources needed to effectively perform the supervisory role have been limited, negatively affecting the supervisor's performance.

But this crisis showed that risk came also from other sources, out of the direct control of the supervisory authorities in a given jurisdiction. For example, the increasing asset prices were fueled by ample liquidity and credit conditions, which were often affected by international developments and financial flows. The borrowing in the international markets by the financial institutions was also affected by increasing fiscal and current accounts deficits, arising due to wrong policies that created imbalances in the saving-consumption behavior of most important economic players in the economy, including the households.

It is now a question, whether some of these issues could be addressed by a more powerful role of the monetary policy. Financial integration, among other things, has also contributed in the rapid expansion of the financial activity, and many financial institutions have become too big for a single country. This has occurred at a time when, for the same reason, the "de facto" power of regulation has shifted away from the local supervisors toward their host counterparties. Hence, despite a steady trend of convergence between financial legislation in many countries, there are still marked differences that, particularly at a crisis situation, create strong tensions between public authorities in different countries.

A very strong effort by the public authorities in the world to address the abovementioned issues in order to improve the supervisory standards and superstructure is now underway. Both in the United States of America and in the European Union, the creation of special institutions is being envisaged, whose role will be to identify and control systemic risk through a different supervisory approach for financial institutions with systemic importance. At the same time, such financial institutions are expected to become subject of a more stringent regulatory framework in terms of capital and liquidity requirements, balance sheet composition and expansion, and governance relationships. Revising the liquidation procedures for similar financial institutions with cross-border presence is another area that will confront the public authorities in the world with a stronger challenge.

The main purpose of the reform of the financial regulatory framework will be to accommodate new incentives that will create a stronger environment for risk management in the financial industry. The main principle here is "prevention is the better cure". In this regard, the perimeter of the supervision regulatory framework will be extended to include other important non-bank financial institutions and probably the bank holding companies. At the same time, the approach in the regulatory framework is expected to feature more automatic requirements (and less discretionary ones), as it tries to move toward more simplicity and clarity. The move toward simplicity and clarity, will certainly reduce manipulability and enhance transparency and credibility of the banking and financial activity. These changes will be complemented by similar ones in the area of customer protection and market transparency. The regulatory framework of the financial industry is also expected to be less pro-cyclical, as new interesting proposals are being identified to adopt a countercyclical approach for capital requirements, provisioning and accounting. Ensuring responsible governance for the banking and financial institutions is going to be another area of developments. New regulatory requirements and instruments to seek more involvement and higher responsibility of boards of directors for risk management and discourage uncontrolled risk undertaking are being identified. On the other hand, the supervisory authorities will need to strengthen their macro-prudential risk assessment capacities, by focusing more on systemic behaviors of the financial institutions. The central bank is expected to take a larger responsibility in this area, particularly in those countries where it did not use to have a strong supervisory role. Whatever the approach in this direction, the supervisors will need stronger legal powers which will ensure their ability to act in a timely and flexible way. As mentioned also above, procedures for managing distressed financial institutions and for crisis management will need to be revised to ensure stronger and more effective inter-institutional and cross-border cooperation, and in general to better address the potential conflict between ex-ante supervision and ex-post intervention.

This important process of financial regulatory reform is not without risks. I believe that the public authorities will pay particular attention to control the tendency for over-regulation, and to avoid a "blind" adoption of the regulatory changes as well as asymmetric/unilateral approach. Regulating more should mean regulating better. Undertaking risks is a natural thing for the financial industry in their valuable role of financial intermediation. Such undertaking of risk, when well identified and properly managed, is useful for increasing efficiency and returns of the activity, two important elements for a viable and solid on-going financial performance. Every country should certainly follow with particular attention the discussion and the changes that are being proposed for the financial regulatory reform, as this process will affect them for sure. In this regard, it is important for the public authorities to start a process that would analyze and assess the impact in their financial industry of the expected and well identified proposed changes. Clearly, the practical adoption of the proposed changes should be driven by the goal for achieving a higher convergence with international standards, but it should be determined by the characteristics of the national or regional financial system, and their development goals. In addition, focusing only at better regulating the financial industry, without addressing other important and probably unsustainable economic developments, is an asymmetric approach that will not deal properly with the risks to financial stability. In this regard, governments, businesses and households, should identify measures and adopt actions to reduce imbalances in their own balance sheets, as this will, on the other side, improve the quality of the financial industry and reduce risk.

Dear participants,

Let me now focus more on how the Albanian economy and our financial system was challenged by the international crisis, and what are some of the future measures the Bank of Albania believes are important to strengthen the stability of the financial system and of our economy.

The recent international crisis showed that at the time of continuing financial integration and economic globalization, small economies like Albania's or other countries' in the region, should not count only on some natural protection coming from less developed financial markets and a much lower level of indebtedness from the households and businesses, to compensate over time for potential risks coming from less diversified economic growth, overreliance in remittances, insufficient culture of risk management in financial institutions and other economic agents - in particular for the exchange rate and liquidity risk, and very limited space from the public authorities to introduce anti-crisis financial measures similar to those in the developed countries. Hence, policy measures should address these and other deficiencies to find a proper solution in the medium-term. Such measures should reflect the preference for preventive approaches.

In fact, over the last 4 to 5 years the Bank of Albania was vigilant over time to point out areas of the banking activity that required attention from the industry. We have expressed our concern regarding the rapid increase in lending, as we believed that this could negatively affect the credit quality. The composition of the loan portfolio, which is dominated by the euro-denominated loans, has also been identified as a point of concern. Despite the fact that this position is supported by a strong presence of foreign currency denominated liabilities in banks balance sheets and very close economic links to Euro-area countries like Italy and Greece, Bank of Albania has been consistent in its approach to introduce gradually regulatory measures that would discourage rapid increase in lending, encourage banks to lend more in domestic currency and increase transparency toward clients on banks products and services. On the other side, the monetary policy has successfully anchored expectations of very moderate growth in the price level and has supported demand for local currency financial assets by offering sufficient positive real return.

As the crisis hit, the first impact in our economy was shown on the balance of payments, reflecting the relationships of our economy with the world. The increase of unemployment and the tightening of financing conditions in the neighboring countries of European Union were followed by the decline of Albanian emigrants' remittances that live and work in those countries. While the gap between the domestic and external demand was widened, this was accompanied with an increase of current account deficit and the mounting pressure on the exchange rate. At the same time, the banking sector, which heavily dominates the financial system in Albania, reduced its funding contribution to the domestic economy as a response to the increasing demand for liquidity, following the deposit withdrawal from the public and an increasing borrowing demand from the Government. The combined effect of these developments affected negatively the real sector of the economy, mainly the business sector. In the first quarter of this year, business confidence index fell under its historic average, reflecting a more difficult financial situation. The latter was also shown by the lower-than-planned realization of fiscal revenues as well as by the decline of loan portfolio quality that banking sector has encountered throughout the period.

In the short-term, the public authorities took measures to lessen the impact of the global financial crisis in the economy. Through the significant increase of the fiscal expenditures share designated for investments, mainly in infrastructure, the government supplied an important impetus for the support of the real sector of economy to cope with the global crisis effects. The Bank of Albania has also been active to provide liquidity in the interbank market, with the aim to preserve the stability of the banking sector and to lessen the expected decrease of its intermediation role. We removed quantitative limits in the size of the liquidity injections through our week-long reverse repurchase agreements, and extended the maturity of our injection operations up to three months. Following a cut of the policy rate by 0.5 percentage points in January and the subdued inflationary pressures at home, the monetary policy paid an important attention to the financial stability, by keeping the policy interest rate unchanged throughout the period[1]. Through this policy, we intended to maintain strong incentives that would support the public demand for financial assets denominated in the national currency, in the short term. At the same time, along with the Ministry of Finance, the Bank of Albania initiated legislative changes to increase the deposit insurance level, as a necessary measure to restore the public confidence for the safety of their banking deposits. From the supervision point of view, the Bank of Albania established a stronger day-to-day monitoring of the banking sector developments, focusing particularly in the liquidity situation. This was part of a broader approach that included also changes in the regulatory framework, better analysis through improving stress-test methodologies, stronger communication with the banking sector, increasing number of publications and more presence in the media. We believe that such policies were important for the effective management of the banking sector liquidity needs, provided an orientation of lending in national currency and maintained strong capitalization parameters for our banks. The situation entered into a qualitative improvement phase after the return of public deposits growth in the banking sector. This process, which was developed gradually and in a stable way in the second quarter of 2009, continues with a steady pace.

We believe that, after coping with the short-term effects of the international financial crisis and following the improvement of the international economic situation, it is the time for the public authorities at home to initiate a process of assessment for the legal and financial operations framework, with the goal to re-establish appropriate balances in the fiscal, monetary and banking activity, to further sustain a stable economic growth and maintain financial stability. In this regard we consider important for the fiscal policy to take respective correcting measures in order to keep the confidence of the resident and non-resident market agents and investors. At the same time, the monetary policy should assess the possible effects on inflation of the financial incentives it provided to the banking sector and to the economy, and later analyze the possibilities to support the financial intermediation of the banking sector in the economy at a lower cost. To provide a longer-term response to the stable economic growth, public authorities should insist on the compilation and implementation of the strategies for future economic development, which in a medium term shall provide for:

a) the establishment of a better balance on the contribution that different sectors give for the economic growth. In this regard, it is important to increase the support for economic sectors with strong growth potential, like agriculture and tourism;
b) the increase of our economy's competitiveness and its further formalization. In this regard, the debate should focus on finding the incentives to increase the domestic production and support domestic savings. Over the time these would improve our current account balance, and improve the availability of our foreign currency assets;

c) the expansion of the economic agents' funding sources. In this regard the authorities should implement policies that support the development of the non-banking financial sector and that sustain the establishment of capital and debt market for private entities. The accomplishment of these targets shall firstly require the strengthening of the financial reporting standards; the completion and improvement of the legal framework for the developments of business relationships and the improvements in the protection of creditors and consumer rights, regarding the financial institutions and products. In more practical terms, these measures are expected to improve the availability of the funding sources for the economic growth, and gradually decrease its dependence from the banking sector;

d) the improvement and the completion of the legal and operational framework to strengthen the crisis management capacities of the public authorities. In this regard, the authorities should identify the necessary measures for the prevention, the treatment and the elimination of financial crisis consequences. Bank of Albania believes it is important that each public authority carry out an assessment of its legal, financial, human and technological capabilities, to perform its role in the crisis-prone situations. Needless to say, throughout this process, the coordination among the public authorities should be at the highest level.

The banking industry itself is required to carry out a process of re-assessment of its development objectives and models for the future, so as to ensure consistent and stable profits. In this regard, the managing structures of the banks are expected to undertake a process with the purpose of: a) re-assessing the development priorities; b) establishing a better balance regarding income sources and focus on cost control; c) enabling a higher specialization of their business and identify competitive priorities; d) achieving a better balance regarding the composition of their assets and liabilities according to the currency, maturity structure, etc.; e) implementing more active policies to approach and maintain the public (customers) close to the institution; f) strengthening the internal audit structure and risks management and research capacities.

Bank of Albania is now working with the goal that, within the needed time frame and after properly consulting with the financial industry, to support this process through the introduction of changes in the regulatory and supervisory framework. With this in mind, we shall aim at strengthening the internal mechanisms of the banking activity that incentivize its more controlled and balanced expansion, with adequate characteristics of liquidity and capitalization. At the same time, Bank of Albania shall assess the need for a new supervisory approach for the banks with systematic importance. The transparency of banking activity in its relationships with customers and public in general, shall remain at the centre of our supervisory activity. In general, in this process the Bank of Albania, shall consider the alternations that shall occur in the European standards, by supporting the strong collaboration with other central banks and supervisory authorities.

In conclusion, let me point out that the ultimate goal of the new financial regulatory changes that is being identified in the international level is to provide the right incentives, which over time will ensure a more balanced, risk-averse and stable financial markets and institutions activity in the future. On a global and national level, such changes should be complemented by other more general economic measures that should enable an adjustment process to ensure a better alignment of asset and liabilities in the balance sheets of the various economic agents. All this should be achieved, as we still want the social benefits of economic and financial integration. This means the path ahead will witness a continuous and challenging effort to find and strike a new and more appropriate balance between risk appetite and more stable returns by the economic agents, and between short-term national concerns and long-term regional economic and political integration objectives.

Once again, I wish to the Central Bank of the Republic of Kosovo, to its management and staff, a successful future!

Thank you for your attention!

SPEECH BY THE GOVERNOR OF THE BANK OF ALBANIA, MR. ARDIAN FULLANI

At the Bank of Albania's forum with representatives of main businesses operating in Albania
23.11.2009

Dear Ladies and Gentlemen,

It is my pleasure to be among you today, to share with you our views on the current performance and development prospects of the Albanian economy. As the most dynamic part of the Albanian economy, your contribution has been tangible in the country's economic development during transition. Your incentive, your willingness and devotion have brought about tangible results in the country's development. In a single figure, the Albanian economy performance may be summarized in the growth of above 65 percent of gross domestic product and well-being per citizen during these years of transition. Our development prospect remains as much positive. The country's macroeconomic stability, the continuation and deepening of structural reforms as well as the geopolitical reality of approximation to developed economies of the European Union, would help in a fuller release and remuneration of your potential and energies.

Today's forum aims to highlight the economic development of the country and initiate a broad public discussion on alternatives of the future economic growth models.

Now, let me start by making a brief statement of the latest developments of the Albanian economy, and further dwell upon our viewpoints on the country's economic development in the future.

ECONOMY PERFORMANCE DURING THE CRISIS

The developments over 2009 have indicated that the Albanian economy has been impacted by the recent global crisis, mainly as a consequence of decreased foreign demand and remittances, higher risk premiums, reduced and high-cost financing resources. However, our economy continued to record positive economic growth rate during this period, while the domestic inflationary pressures remain subdued. The country's economic activity has been sustained by the fiscal stimulus and the preservation of steady consumer demand, while investments and exports have recorded lower growth rate in the first nine-month period of the year.

The economic performance over the first 9-month period of the year, albeit positive, attests to growth rate slowdown, reflected even in the gradual slackening of inflationary pressures. In spite of a slight improvement during 2009, the current-account deficit remains high, reflecting high levels of consumption in the Albanian economy and unfeasibility of production capacities to meet it. The fiscal policy has had an expansionary nature during 2009, reflected mainly in increased budget spending, mainly due to rapid growth of capital expenditures. Budget revenues maintained a slower-than projected rate, due to slow-down in the economic growth rate during this period.

Consequently, the additional budget spending has been financed through the use of privatization receipts and the higher public borrowing.

This policy has exerted pressure over the increase of government debt securities' interest rates of long-term maturity. Financial markets attested to an improved liquidity situation and agent's recovered confidence in these markets. The persistent Bank of Albania's liquidity supply to the money market helped to calm the market participants down and supply the market with funds, which served to the private sector's domestic currency intermediation. The needs for liquidity in the interbank market have decreased, hence exerting no pressure on short-term interest rates.

The prudent monetary policy of the Bank of Albania has helped relieve the tension in the financial market, while the latest base interest rate cut should be translated into greater lending to the private sector.

As we have already stated even previously, the Bank of Albania regards the future Albanian economic activity with a prudent optimism. I mean, in spite of the great shock we have gone through, the macroeconomic and financial stability of the country has not been affected. Furthermore, the restoring of confidence in the banking system opens the way to recovery of the lending process and sustaining of the economy with funds. On the other hand, the Bank of Albania keeps on pursuing a prudent stance, because the financial risks on the economy have not been completely overcome. The banking system has still liquidity shortages, whereas the global economy continues to be frail. Therefore, the economic prospect will depend on our joint work and on the performance of global economic and financial markets.

Dear participants,

In the optics of historical developments and particularly of recent events, I would like to briefly dwell upon several vulnerabilities that we, as the politic, supervisory and regulatory authority, have highlighted, as well as the lessons we should draw and the issues we should address for the country's further economic development.

LESSONS FROM THE CRISIS

Right from the beginning, I would like to emphasize that generally, the philosophy of the country's economic development has been accurate. Market openness and increased competition have made the Albanian economy benefit the fruits of private sector initiatives. The practice of economies based on free market principles has broadly indicated that this sector remains the most efficient engine of the economic activity.

This process has been sustained even by the constant reduction of the state's share to the economy, as well as by its focus on procurement of public goods and infrastructure development. Positive financial market development has generated the necessary funds for supporting investments and consumption in the economy. Though chiefly for historical reasons, our banking system has based its activity on the intermediation of domestic funds of the economy, the recent developments indicated that it remains as much capable in generating foreign funds to provide capital and liquidity backstop to the Albanian economy. On the other hand, the integration of our financial system into the European one has raised the resilience of the Albanian economy to various shocks, of which the latest is still under operation. It has also brought about a necessary expertise in terms of financial and economic business administration, has developed the infrastructure and means of payments in the economy and has helped efficient risk transfer in the economy.

In spite of accomplishments, I think the country's growth model needs modifications and improvements, aiming at enhancing its efficiency and stability. Under the conditions of an economy that requires dynamism for moving from a transition economy to an emerging one, the commitment for a sustainable and long-term development should be the subject of current and future economic reforms, at both, political and institutional level, and enterprise and consumer level.

WHICH ARE THE VULNERABILITIES NOTICED IN THIS REGARD?

First, domestic consumption and investments have been the main beneficiaries, while the Albanian economy has not yet succeeded in establishing a competitive export sector, capable of generating steady foreign currency income, which would enable the preservation of external economic balances. From another viewpoint, this development does not seem as balanced in sectoral terms. So, some sectors such as trade, construction and services have contributed disproportionally the country's development while others, such as agriculture and industry have contributed less.

Second, Albanian economy continues to suffer from structural vulnerabilities, which contract its competitiveness in international markets of products and capital. This behaviour is illustrated even by international competitiveness indices compiled recently by the World Economic Forum, where Albania is ranked below regional countries. Some acute problems refer to the need for enhancing education and infrastructure, in all dimensions. Both these problems restrain the attraction of foreign investments and impede the country's development.

Third, efficiency in using the economy funds should be improved even at micro level. This implies the need for improving private businesses' management and control systems, enhancing analytic and forecasting capabilities, as well as transparency.

Allow me to further deal with some of the above-mentioned issues.

STABLE ECONOMIC DEVELOPMENT OF THE COUNTRY

As we have continuously underlined in our periodical reports, the economic growth over the recent years has been strongly supported by the banking system lending. The growth of banking lending has provided an impulse of about 7 percentage points of GDP in the last five years, making a pronounced and evident contribution to the growth of consumption and investments in economy. Their growth has provided room for expanding the production basis and improving the welfare. However, it has also generated macro and microeconomic imbalances.

At macroeconomic level, the high consumption and investments were followed by increasing inflationary pressures and higher trade and current account deficit. These signs of overheating were clear signals that that level of consumption could not be kept for a long time, hence calling for controlling measures by the monetary authority.

This is also the key to understand our prudent monetary policy during the period 2006-2008. The institutional investment we have made during these years in terms of consolidating macroeconomic and financial stability was rewarded with a much more moderate and milder impact of the global crisis than in the regional countries. In concordance with the modern philosophy of macroeconomic administration, the Bank of Albania remains committed to not allowing that rapid and short-term economic growth impair the long-term development perspectives of our country. At microeconomic level, the growth of consumption in economy was followed by increased indebtedness in Albanian households' and businesses' balance sheets and by over-investments in certain sectors of the economy. Both these indicators are either at lower levels than in the regional countries, or at similar levels; hence, they cannot be specified as problematic. However, their rapid growth rate creates the idea of a short-term vision of the economic agents, and in particular cases, even avoidance of rationality.

Dwelling upon household consumption, the Bank of Albania invites all economic agents to be more forward-looking and realistic in their consumption and savings plans. This invitation does not imply the contraction of consumption or the change of preferences related to it, but merely placing it in the context of long-term plans that equal income and expenditure at a household level. Beyond the time-related dimension, as we have continuously drawn the attention, borrowers should be cautious as regards their loan currency. This implies that the matching of their loan currency with that of their income would be their best protection. In a more pragmatic approach, this advice may be reduced into an appeal for a close consultation with the banking system and the financial market's specialized agents.

The latest global crisis – in particular in the US and England – showed that the impaired households' balances sheets create room for strong economic shocks and condition the country's long term growth. On the other hand, it showed that the countries that succeeded in preserving a clear certificate of consumer's financial soundness, wherein Albania is part of, had a more moderate impact and enjoy good premises for a more rapid growth. In a philosophical approach, the key lesson of the market economy is that all consumption must be paid for. There is no free lunch.

Back to businesses and investment loans, whose portfolio is 2/3 of the total banking system credit, my message is the same in principle: expand the time span of your decision-making and foreign investment and base them on detailed and scrutinized business plans' analysis. What I would like to underline is that this message should be perceived by you urgently, since you have the necessary financial and human resources to be more prudent in borrowing and investments. Time is ripe for the Albanian businesses to avoid the group behaviour, where one business idea is almost automatically followed and adopted by other businesses, without first studying the market size, the competitive advantages, the level of expertise or the financial efficiency of using the funds, according to all the chains a careful and prudent decision-making should go through.

The latest tendency for diversifying the Albanian businesses is useful in principle; however, it should not be made to the detriment of specialization and efficiency, or even less without first making the macroeconomic and sectoral analyses.

The inter-sectoral performance of the economy is another issue I would like to discuss with you today and which I briefly mentioned earlier in my speech. The country's economic development has been characterized by a growth and investment model which has favoured the services and construction businesses, compared to the exporting industries or the competitive ones in imports. Although this performance somehow reflects the tendency to perform similarly to the economic structure of developed and advanced economies, it has resulted in over-investments in certain sectors. The economy development cannot be stable if the allocation of funds is not carried out by adhering to the principle of sector productivity and efficiency. The misuse of financial funds impairs the agents and the whole economy, providing severe and long-term consequences on corporate balances sheets and debts, on labour market and on capital and technology allocation among sectors of the economy.

To minimize such risks, the Bank of Albania advises you to discontinue the inertial moves in your behaviour and realistically assess the regional and European context in your choices. The competitive advantages of Albania should not be sought only in natural resources, or in meeting of yet unserved demands of the Albanian market, but also in the cheap work force of the country and in its position as a future EU member. The increasing interaction with the banking system would help to clarify your plans and reduce the financial risk, providing you with the opportunity to focus on business risk administration you are specialized in.

Completing my discussion related to stable development of the country, I would like to underline that the banking system can and should do more in this respect.

The financial system is the brain of a market economy; it determines the expected return and risk of investments in the economy, enabling later on the prioritized use of limited financial funds. Despite its good performance, the Albanian banking system should do more to incorporate macroeconomic and sectoral analyses, and also the country's financial stability in decision-making. The development of research units within large banks is actually a requirement of the time we are living in. Moreover, more efforts should be made, to increase the support of small and medium-sized enterprises with funds. In addition, a more aggressive marketing of derivative instruments, which will lower the corporate financial risk, particularly of those operating in the export sector, requires a greater attention from the banking system.

What I just mentioned will be an important part of the future philosophy of the Bank of Albania in the field of structural reforms in the financial market and in developing and advancing its supervisory and regulatory function in it.

STRUCTURAL VULNERABILITIES AND THE NEED FOR REFORM

A useful lesson that the Bank of Albania has learnt from the crisis is the need to continue and deepen the structural reforms in the economy. These reforms, not only will create a more appropriate environment for promoting the private entrepreneurship, but will also increase the economy's resilience to shocks. They also help to absorb foreign direct investments, which are the best support to the country's development in the medium and long run. However, as stipulated even in the EBRD's report, Albania is among the few countries that have continued structural reforms even during 2009.

In this regard, Albania has lagged behind the regional countries, attracting in total only about USD 1100 per capita of FDI during the 20 years of transitions.

In the entire broad framework of reform-related problems, I would like to dwell today upon the need for investments in education and infrastructure. A well-known business maxim is that: Employees are a company's most precious asset. To the Bank of Albania it signifies that the higher the professionalism, the higher our institutional independence.

To a broader sense, this is also relevant for the national economy. Our country's progress, the convergence with the developed countries of East Europe and even beyond, with the European Union countries, will depend on our level of education. Competition in national and international markets is above all based on the generation of ideas and their use in the final products. Referring again to the Global Competitiveness Index, Albania is ranked the 90th as regards the level of education and high-level training, and only the

109th and 126th respectively at the level of business sophistication and innovation. These vulnerabilities will ever-increasingly become an obstacle for the country's economic growth in the future, unless addressed on due time.

Public reform in the education system and the need for more backup funds should be a priority of every development policy. On the other hand, I consider that the Albanian business can and should do more for supporting the Albanian education. First, the business can and should be more supportive to higher education institutions, at the same time cooperating with them in the area of market research and student training. The economic development history shows that the countries, which have invested in education, are currently in the group of most developed countries of the global economy. Second, I think that more efforts should be made in attracting and absorbing the brain in the administration and management of your businesses.

Investing in education, in enhancing professionalism and expertise, is the best investment we can make for the future of our country.

Parallel to this, the enhancement of our development infrastructure should be a priority issue. Beyond the road infrastructure development, which rightly is a priority of the public sector, the Albanian business can and should do more in this regard. The use of common business resources to resolve problems in supplying electricity, water and sanitation, and local roads, should be regarded as an effective option of overcoming these problems. Creating differentiated and specialized development areas will open more opportunities to them to benefit from scale economies and common solution of problems. Also, computer and telecommunication infrastructure are sectors, which can and should be addressed more efficiently by the private sector.

BUSINESS ADMINISTRATION AND TRANSPARENCY

Though I addressed some problems even earlier in my speech, now I would like to dwell briefly upon the problem of administration and corporate transparency enhancement.

Corporate administration is the linking bridge between ideas and results. It affects funds usage efficiency and differentiates profitable from non-profitable businesses.

In light of this, I think that the above-mentioned issues, the extended time span of investments, their support in market researches and prudent business-plans, the orientation of businesses' positioning in national, regional and global context, the increase in specialization and professionalization, the fostering of cooperation with the financial system, require ongoing investments in terms of your management.

Finally, I think that transparency of your businesses is an aspect that deserves a greater attention. Its enhancement would help first of all the trading and financial transactions among businesses, fostering confidence and decreasing their risk. Also, the long-term and ongoing relation with the financial system is conditioned by reciprocal transparency between parties. Beyond the banking system relations, transparency is a serious obstacle in the establishment and operation of capital market in Albania. In this regard, I think that the Albanian business should be aware of the fact that transparency enhancement and increased formalization are in its long-term interest.

Dear participants,

Long-term visions are translated into success achieved through work and short-term sacrifices. The Bank of Albania invites you to foster the cooperation in resolving these problems of mutual interest.

Thank you!

SPEECH BY THE GOVERNOR OF THE BANK OF ALBANIA, MR. ARDIAN FULLANI

At the Press Conference on the Decision of the Supervisory Council of the Bank of Albania
25 November 2009

In its meeting of November 25, 2009, The Supervisory Council of the Bank of Albania analysed "The Monetary Policy Report for November 2009". After becoming acquainted with the latest economic and financial developments at home, and following the discussions related to their expected performance in the future, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 5.25 percent. The Supervisory Council assessed that this interest rate is in line with Bank of Albania's goal to keep inflation close to the target over the medium run.

Economic and monetary developments over the latest months are featured by low inflationary pressures. Annual consumer-price inflation for October recorded 2.3 percent, being almost in line with its performance over the last quarter. The steady and low inflation rate has been conditioned by moderate pressures from domestic economy, due to:

- Economic activity slowdown during this period;
- Low exchange rate pass-through of exchange rate depreciation on Lek prices of import goods ; and
- Stabilized inflationary expectations.

Easing of monetary conditions by the Bank of Albania, through key interest rate cut in October and continuation of liquidity injecting operations have provided appropriate impulses for promoting the economic activity in the future. These impulses, as always, are administered under the conditions of an expected inflation performance close to the three-percent target of the Bank of Albania, and stabilized expectations of economic agents for it. The key interest rate cut by 0.5 percentage point by the Bank of Albania at end-October aimed at strengthening the domestic demand and reviving the lending activity. Its effect on the economy is not fully reflected yet, due to the short period of time and the time lags in transmitting the monetary policy. However, its pass-through to the money market, which constitutes the first link in the transmission chain, is a premise for its reflection to credit cost in a second round. In the meantime, our liquidity injecting operations have been successful in guaranteeing the backup of economy with funds, mainly short-term ones.

Allow me to make a more detailed description of the economic and monetary developments during this period.

At global level, the economic activity has been supported by improved overall economic climate, impacting on the improvement of the global economic activity, reduction of risk premiums and stability of global financial markets. However, the global economy and the European one continue to reflect economic vulnerabilities, which are transmitted to low inflationary pressures. This situation conditions also the pursuit of a stimulating monetary and fiscal policy by keeping interest rates at the historical low and by high liquidity injections.

Back to the domestic economy, we should state that the new economic data were insufficient during October. Performance of inflation and of monetary and fiscal indicators, external trade data and consumer and business indices confirm that the Albanian economy continues to record positive growth rates. This growth is sustained by maintaining steady levels of the consumer demand and fiscal stimulus given during 2009. However, available data from the economy speak for an economic activity slowdown during the current year. Foreign demand for Albanian products has decreased, being illustrated by export slowdown along this period, while investments have declined.

The steady trend of core inflation and low non-traded inflation rate also indicate the presence of low aggregate demand-induced inflationary pressures in the country's economy during January-October 2009. This performance has contributed to absorption of shocks generated from traded inflation, due to weakening of national currency's position in the domestic foreign-exchange market.

Inflation during 2009 has fluctuated around the lower limit of the Bank of Albania's target. Headline inflation in October was 2.3 percent, recording a slight rise in comparison to September, but resting below the record of the previous year. Average annual inflation recorded 2.1 percent, resting at the same level with that of September. Parallel to demand factors, inflation performance is influenced even from the development of several supply factors, such as slight downward trend in the labour cost per unit, reduced import and producer prices, statistical effect of administered prices, thus creating an overall environment with reduced inflationary pressures.

Fiscal policy during the third quarter of 2009 has revealed signs of mitigating its expansionary nature. Revenues have recorded a slight rise related to the previous months, while there is noticed a reduction in realised expenditure pace. In annual terms, during the first nine months of the year the budget revenues have recorded a growth of 6 percent, whereas the budget spending has increased by 22 percent. The budget deficit remains at comparably high historical levels, but within the budget limits reviewed lately.

To a great extent, this deficit reflects the high level of public capital expenditures during 2009. Public expenditures and fiscal policy have provided a tangible contribution to the maintaining of the economic activity along this period, but they have been associated with increased pressures over the money markets. The Bank of Albania considers that the fiscal policy should continue to be prudent towards these balances in the future, and should take into consideration the long-term fiscal stability while drafting and implementing mid-term and long-term budget plans.

External trade was featured by weakening in the trade volume during the first nine months of the year. However, trade exchanges value recorded during September is the highest recorded since 2009. After about three months of constant narrowing, the trade deficit enlarged during this month by about 9 percent in annual terms. Exports dropped by about 18 percent in annual terms, though the lek's weak position vis-à-vis the Euro is a favourable factor for exports. Imports recorded positive growth rates for the first time since January of the current year. In annual terms, they grew approximately 1 percent, due to positive growth rate of consumer goods import, whereas import of intermediate goods and capital has declined.

Monetary indicators of September presented a slower performance of the banking system's intermediating activity. In annual terms, broad money recorded a nominal growth of 2.8 percent in September, against 4.5 percent in August.

Foreign currency credit contraction and intermediation of the public sector credit by non-banking agents have influenced the slowdown of monetary indicators growth rate.

In September, loan portfolio of economy grew at lower rates than in the previous months. Annual credit growth rate decreased to 13.2 percent. The credit slowdown is totally a consequence of foreign currency credit tightening, while the ALL credit increased by 31 percent in annual terms. The major part of the new credit, around 85 percent of it, was absorbed by businesses and was used mainly for meeting the needs for liquidity, whereas credit for long-term investments decreased. Also, household loan portfolio growth decreased, chiefly due to consumer credit contraction. Housing loan to households continues to maintain positive growth rates, remaining at 5 percent in annual terms.

Domestic credit intermediation in ALL has raised the need for Bank of Albania's presence by injecting liquidity. The banking system needs for liquidity have been met through open market operations of the Bank of Albania, preserving an appropriate time structure of this injection. Short-term interest rates in the interbank market have reflected decreased borrowing cost by the Bank of Albania and have been steady. Furthermore, the primary market was featured by agents' response to loan pricing, reducing the T-bill yield. The 12-month yield, which serves as a reference rate in determining other costs, has decreased by 0.15 percentage points during November, down to 9.28 percent.

The supply for financing the government demand has been sufficient, without exerting upward pressures on interest rates. Interest rate performance of new deposits denominated in lek and in Euro has also been stable during September, enabling deposits return to the system. In the meantime, new ALL and Euro credit interest rates continue to carry over tightening lending policies by the banking system in general, and fluctuate around isolated preferential policies.

After discussions, the Supervisory Council agreed on keeping the key interest rate unchanged. This decision aims at further preservation and consolidation of macroeconomic balances, regarding the macroeconomic stability as an indispensable precondition for the long-term sustainable growth. It also guarantees appropriate monetary support for the economy during this stage of its development. In the future, the Bank of Albania is willing to operate in line with the actual and expected performance of economic indicators. The shifting to the downward side of inflationary risks balance and the consolidation of financial stability and inflationary expectations in the economy will be taken into consideration in Bank of Albania's future decision-making.

OPENING REMARKS BY THE GOVERNOR OF THE BANK OF ALBANIA, MR. ARDIAN FULLANI

At the workshop "On building capacities for Policy Design and Implementation"
Tirana, December 3, 2009

Dear participants,

It is a very great pleasure for me to open the proceedings of this two-day workshop, entitled "Building Capacities for Policy Design and Implementation", organised for the first time in Albania by the Bank of Albania, in co-operation with the Center of Excellence in Finance (CEF), Ljubljana, with support from the European Commission, European Central Bank, and International Monetary Fund. Welcoming you here in Tirana, allow me to express my gratitude for the excellent work done by the CEF in the course of these years, to the benefit of our region.

Since our Washington meeting last April, the effects of the global crisis increased their presence in our region; however, as I have already emphasised even earlier, they did not immediately concert to full blown economic and financial problems. The extension of crisis effects to the real economy, to the budgets of governments and to financial sectors of the region, was mitigated by sound macroeconomic policies pursued in the recent years and by the availability of International Monetary Fund funding on an unprecedented scale, in coordination with support from the European Commission and the EBRD.

Due to this intervention, and mostly due to prudential policies pursued by the central banks with regard to financial stability and financial supervision, the region prevented not only twin crises in our banking systems and foreign exchange markets, but also any kind of meltdown.

Nonetheless, this crisis has been a wake-up call. We agreed on this in our meeting last April, in Washington, among senior policy-makers from the region and from EU and IFIs.

Now that we have managed to prevent the crisis, we must start the evaluation of the collateral damage of our response to the crisis. In this respect, it is very important to asses not only the long run sustainability of our region's equilibrium, but also the effectiveness of our short run response. It is crucial to plan and implement our future moves intelligently for its reversal in line with new normalities.

While we are not out of the woods yet, it is important to make sure that the past year's fiscal appetite that characterised our region does not become part of this new normality. Actually, we need to do some deep thinking about aspects of our policy regimes – starting with the design of monetary policies, continuing with the way they are anchored and the building of due capacities for a greater effectiveness of monetary policy in the future.

That is why we agreed to put in place today's workshop, as part of a continuing process of reflection and reform.

In our discussions here in Tirana, we will begin with questions of policy design, which are fundamental to set the stage for the later topics we will come to. We have suggested in advance several questions that may help stimulate the discussion, covering some of the key questions that are certainly left in my mind, as a practitioner, after navigating through the crisis so far.

The issues of policy design include the questions how much room for manoeuvre there has been to use discretionary macro policy measures; how far fiscal policy in future should build up a buffer against macro-financial risks; how far national monetary and prudential regimes have been able to shield us from turbulence; and whether we now see a need to attract new kinds of capital flow – perhaps to change the growth model in the region.

This discussion of policy design will bring us to our second issue. It concerns the role of external anchors for monetary policy. One point of consensus in our Washington meeting was that we need to revisit some aspects of this anchoring process, and the way it interfaces with countries' efforts to build up their own internal anchors over time.

There are several questions about the future role of external and internal anchors. They include some reflection whether there is a need for more co-ordination and synergy between our policy dialogues with the IMF and the Commission; how the Commission's fiscal surveillance (through Economic and Fiscal Programmes, Pre-Accession Economic Programmes, Convergence Programmes) can be deepened and serve more as a commitment device; how far there are lessons to learn about monetary anchors and prudential coordination mechanisms for the EU accession of our region; and how we – including the external actors – can foster stronger domestic anchors in various forms, ranging from medium-term fiscal frameworks to more effective policy co-ordination mechanisms.

Finally, we will turn to the issue of capacity-building. This is a question on which we agreed, at this workshop, to already provide some operational input to the CEF as it develops its work programme in this area. There is a long lead-time in the effectiveness of capacity-building, although fortunately the CEF had already taken the initiative a few years ago to ramp up its contribution in areas such as financial stability and policy co-ordination, so it has a head-start.

In the field of capacity-building, we need to consider: what are the top priorities, and where are the gaps to be filled through initiatives in terms of training workshops, technical assistance, and cross-country exchanges of experience.

This will bring us to look carefully at the design and implementation of fiscal policy, among others, and the way policies come together through domestic co-ordination processes. And we also need to identify the needs in the areas of monetary and prudential policies, where the CEF's member countries have urged it to continue expanding its activities.

This is a full agenda, and I am sure it will not be the last time we get together to exchange views on these issues.

I believe strongly that we stand to gain immeasurably from considering these challenges on a regional basis.

We can learn from each other's experience; we can engage at times in a joint dialogue with the external actors in the region; and perhaps our political leaders can find some opportunities to launch reform initiatives in parallel – for example, in developing structural reforms to help promote a flow of new capital to, and within, this region.

In this spirit, I look forward to very fruitful discussions – now in Tirana and in the future!

SPEECH BY THE GOVERNOR OF THE BANK OF ALBANIA, MR. ARDIAN FULLANI

At the reception of the Albanian Association of Banks with bankers and representatives of banks operating in Albania
18.12.2009

On the occasion of 2009 year-end, the Albanian Association of Banks held a reception with bankers and representatives of banks operating in Albania. With invitation from the Albanian Association of Banks, the Governor of the Bank of Albania, Mr. Ardian Fullani, addressed a speech to the participants.

You will find below the speech held by the Governor of the Bank of Albania on this occasion.

Dear bank executive managers,
Dear colleagues and friends,

It is a pleasure to be here with you today, to celebrate the anniversary of the Albanian Association of Banks. It coincides with year-end and as such, it provides an additional reason to analyse the performance of the Albanian banking system over this year and the contribution of the Association in this regard.

In general, this period has had its ups and downs; however, it has witnessed a remarkable progress of the Albanian banking sector, which has become the main engine of our country's economic growth.

Let me start by highlighting some of the main elements that show the progress of the Albanian banking sector over these years. The banking sector, which dominates the financial sector in Albania, has been moving from a sector with 3 banks, where all of them were state-owned and suffered various inefficiencies, into a sector that nowadays counts 16 banks, all in private hands, where the foreign capital dominates.

In the course of this time the banking sector has expanded its activity, accounting for 77% of the country's GDP, has raised the number of branches, has increased its products to the public and has improved their quality, thus rendering a significant contribution to the country's economic development. At the same time, the entrance of well-known European banking groups from Greece, Austria, Italy and France, has been associated with episodes of consolidation in the banking industry.

Higher standards have been adopted for a better governance of banks and for more transparent relationships with the public. During these years, the banking sector has been considerably profitable and has operated in compliance with the regulatory and supervisory framework in terms of capital and liquidity. The Board of Directors and shareholders have been prompt in introducing the necessary measures to maintain a sound financial situation and support their banks' expansion with additional capital. The supervisory work of the Bank of Albania has pursued and monitored the development of the banking sector along this time, in an effort to adopt the best international standards in the area.

But of course, nothing is absolute. The banking industry has been faced with a number of issues, many of which are part of our financial sector's development phase towards its consolidation, towards the development of the economy and the society. We have been discussing these issues in many other occasions, but I could not help mentioning the importance of having good risk management frameworks, balanced expansion of activity, clear and transparent procedures, and many other issues.

However, I would like to reiterate the importance of a sole element that incorporates all of them: the good governance. For the management team of a bank, it means:

- Professionalism, or the ability to make the right business decisions after balancing the risks and benefits;
- Dedication, or the ability to instil a hard-working environment in the institution;
- Responsibility, or the ability to achieve the objectives in a qualitative manner;
- Vision, or the ability to adopt a long-term view in projecting your institutions performance; and
- Accountability, or the ability to establish an efficient system of controls and balances for the processes and structures at your institutions.

These elements, which are indispensable for the management philosophy, should be endorsed by the entire staff as its normal work culture. Certainly, we all agree that these issues should be further improved in our banking sector.

Dear friends,

During 2009, our banking sector faced a unique and challenging situation. The international financial and economic crisis affected considerably the public confidence in our banking sector. It showed how sensitive to financial shocks our social environment is. It also showed how important is to be prepared for the worse. Financial crises are the most difficult to be managed and their consequences need a long time to be absorbed.

Indeed, thanks to the liquidity of the banking sector, the support of the shareholders and the measures of the Bank of Albania, the banking sector has overcome the situation caused by deposit withdrawal at year-start. We have certainly left behind the short-term shock, but the skies are not yet clear. To manage the liquidity situation, you were forced to cut short on the lending supply. This has coincided with more pronounced difficulties in the real sector of the economy, which in turn, has affected the demand for credit. We are now facing a deterioration of credit portfolio quality, which is going to weight on your financial result over the medium run.

The Bank of Albania acknowledges and supports the efforts of the banking sector to early recognize and quickly provision the non-performing loans. We urge you to keep exercising the necessary caution when assessing the credit quality. On the other hand, you must support your clients and continue lending to good borrowers, since this is beneficial to your clients, to you and to the whole economy. I will keep stressing this to you, because I do believe that there are real opportunities for you to do this in competitive terms, particularly for loans denominated in the national currency. The Bank of Albania will continue to provide the necessary support, by maintaining the liquidity flow, in order to satisfy your needs. Lending requires more work and analysis, not only off-site but also on site. It requires an in-depth knowledge and pursuit of the client and the market. But it is vital to bank balance sheets and to the country's economic activity.

The international financial crisis impact on our banking sector should serve as a lesson we must learn for the future. As we have also mentioned in our recent publications, you should carry out a process of re-assessment of your development objectives and models for the future, so as to ensure a consistent, stable, and profitable activity.

Furthermore, you must develop policies and structures that improve your capacity to act under unusual circumstances and maintain "business as usual" for the most important areas. The Bank of Albania is now working with the goal to support this process, in due time and after proper consultations with you, by introducing changes to the regulatory and supervisory framework. With broader consideration, and following the changes to the supervisory standards at European level, we must work together to ensure a more balanced, risk-adverse and stable financial market and institutions' activity in the future. I want to express my belief that the banking industry in Albania will be an active actor in meeting these objectives.

Let me now conclude with a sincere wish for a happy and successful New Year to you, your families and the institutions you manage! To the Association of Banks, I wish that the New Year represents yet another period of meaningful progress and achievements!

Thank you!

SPEECH BY THE GOVERNOR OF THE BANK OF ALBANIA, MR. ARDIAN FULLANI

At the Press Conference on Monetary Policy Decision of the Supervisory Council of the Bank of Albania
23.12.2009

In its meeting of December 23, 2009, the Supervisory Council of the Bank of Albania analysed the Monthly Report of Monetary Policy. After dwelling upon the latest economic and financial developments of the country, their projections for the future and the expected balance of risks, at the end of discussions, the Supervisory Council of Bank of Albania decided to keep the base interest rate unchanged, at 5.25 percent.

Recent developments in the global economy have given positive signals for improvement in the economic activity performance. The main developed and developing countries have experienced an economic growth on a quarterly basis, while the world trade and confidence indices have shown improvement signs. The world economy is still far from full utilization of capacities, thus impacting on the maintaining of high unemployment rates. The limited capacity utilization rate impacts also on keeping inflationary pressures at low levels.

However, these pressures have lately been upward, due to optimistic news of oil and raw materials prices.

The latest data on the domestic economy performance indicate a slowdown in the economic activity. Unlike the first half of the year, when the economic growth was supported by the preservation of consumer demand and fiscal incentive provided over this period, the economic data for the third quarter and for the coming months indicate a more moderate pace of demand and production in the economy. This is evidenced by a number of indicators published in November, such as: the slow progress in retail sales index rise; data on external economy, which continue to be featured by decline in exports; performance of fiscal indicators, which seem to be below the projected level; and lending curbing, due to the decreased demand for it. The economy slowdown is also perceived by consumers and businesses, whose confidence indicators continue to be low. The future performance of the economy will significantly depend on the revival of consumer spending and investments in the country, the degree of their coverage from bank loans, foreign direct investments or any other form of long-term financing.

In general, the macroeconomic situation of the country has created an environment of weak inflationary pressures. Also, supply factors or those originating outside the Albanian economy have not produced strong inflationary pressures over this period.

Annual consumer price inflation recorded 2.8 per cent in November, close to the Bank of Albania's target. Average annual inflation rate stood at 2.1 percent for the third consecutive month. Lack of pressure from domestic demand and low inflation rate in partner countries have balanced the pressures exerted by the domestic currency's depreciation during 2009. This performance is manifested even by the steady performance of core inflation, whose low levels confirm the presence of a controlled inflationary environment.

Latest upward trend of consumer price inflation was an expected development for the Bank of Albania. It mostly reflects either the temporary or the technical factors, which, though operating for a short period of time, they do not comprise a persistent source of inflationary pressure.

The latest data on the external economy indicate trade deficit widening during the first nine months of 2009, recording a rise of 20 percent related to the previous year. In relative terms, the current deficit level accounts for 17.3 percent of GDP. On the other hand, foreign currency inflows to capital and financial account resulted 21 percent higher than in the previous year. Their share to GDP is estimated at 19.8 percent, making the country's balance of payments turn out positive during the first three quarters of 2009. However, high and upward levels of current account deficit will require more quantities of foreign currency funds to finance it.

Therefore, long-term sustainability of the balance of payments requires a greater attention by policy makers, projecting also the political measures and structural reforms.

Short-term developments in foreign trade for October reflect a different performance compared to the first nine months of the year, showing correction attempts of the trends observed earlier. Country's exports fell by about 9 percent in annual terms, while imports recorded an annual decline of 21.4 percent. In consequence, the trade deficit for the first ten months of the year contracted by 5 percent compared to the previous year, thus giving signals for its stable performance.

Fiscal policy continued to be expansionary during 2009, but this feature was diminishing during the second half of the year. The country's economic activity slowdown is also reflected in the performance of fiscal indicators. Fiscal developments during the last two months were characterized by a smaller increase of budget revenues - only 4.5 percent in annual terms - mainly due to the declining contribution of VAT and profit tax revenues. Meanwhile, public expenditures continued to maintain high growth rates - by 16 percent. Most of the deficit is financed from foreign borrowing and privatizations receipts, without exerting any pressure on the domestic market.

Though the growth rates of the budget deficit have slowed down during the last two months and its level in late October was in line with the projected limit for this period, this deficit continues to be high compared to its historical levels.

The Bank of Albania deems that accomplishment of the medium-term fiscal target for reducing public debt (in relative terms) should guide the fiscal policy over the coming periods. Its accomplishment will foster the public confidence in the country's macroeconomic policies, will serve as a stable basis for the country's macroeconomic stability, will reduce risk premiums in the economy and will create more breathing space to the private sector. This goal should be materialized into practice by pursuing prudent fiscal policies, always in line with the real economic developments.

Turning to monetary developments, the Bank of Albania deems that their overview for November is mixed. The pace of monetary supply growth has accelerated and interest rates have been falling, but credit to the economy has slowed down during this period. In November, the broad money increased by 5.6 percent in annual terms, reflecting the stabilization of banking system liquidity as a result of continuous return of deposits and improved foreign exchange position. Positive developments in deposits performance during the month and their time frame shifting towards time deposits confirm the tendency to restore confidence in the banking system.

Meanwhile, the lending activity of banks has slowed down, recording an annual growth of the loan portfolio by only 12 percent. Business credit has the major share to loan portfolio expansion, while consumer credit and mortgage loans are contracted.

Low levels of loan portfolio expansion reflect not only the liquidity constraints in the banking system, but also the decline, to a certain extent, of the demand for consumption and investment, as a consequence of weakening economic activity. The future credit performance will be an important determinant of the economic activity. The Bank of Albania deems that the banking system can and should make more efforts to transmit its easing monetary policy to a higher lending to the economy. Subject to fulfilling our mandate to control inflation, we are willing to help the banking system by taking the necessary measures to revive the lending market.

In this context, even during November, the Bank of Albania continued to fully meet the demand of the banking system for liquidity, through the repo instrument. Interbank market indicators attest to an increased trading volume, while interest rates have reflected a downward trend, following the base interest rate cut at the end of October. The base interest rate cut is also reflected in the primary market, when for the first time during 2009 the government securities yields have recorded a decline, for all maturity terms. The banking system has responded by reflecting it to Lek-denominated loan and deposit interest rates. The agents' response to base interest rate cut is expected to be further conveyed to the credit and deposit market, keeping to time lags in monetary policy transmission.

Exchange rate performance continued its depreciating trend even during November, but at a slower pace. The Lek's depreciation, which has been present throughout this year, is balanced by lower prices of imported goods, without comprising any material risk for exceeding the targeted inflation rate.

At the end of discussions on current and expected performance of economic developments, the Supervisory Council of Bank of Albania concluded that inflationary pressures are expected to be low in the medium run, being reflected in consumer price inflation around the lower limit of the Bank of Albania's target. On the other hand, risks to price stability are currently estimated as relatively balanced. Restraining factors, such as the monetary supply slowdown, assessments regarding the slowdown of domestic demand and economic activity rates, low level of utilization of free capacities in the economy and low rates of price rise in the main partner countries, would balance the inflationary pressures deriving from the exchange rate and price rise in world markets.

The Supervisory Council decided to keep the base interest rate unchanged. This decision aims at preserving and further consolidating the macroeconomic balances, considering the macroeconomic stability as a necessary precondition for a sustainable and long-term growth. It also ensures the due monetary support to the economy during this stage of its development.

In the future, the Bank of Albania remains committed to operate in line with the actual and expected performance of the economic indicators. Aiming at curtailing the inflationary risks, the consolidation of financial stability and of inflationary expectations in the economy will be taken into consideration by the Bank of Albania's decision-making.