MONETARY POLICY AMIDST RAPID STRUCTURAL CHANGES

Bank of Albania’s experience with the post-crisis “new normal”

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Motivation

New challenges facing central banks in their quest for monetary stability:

- Low equilibrium real interest rates (Laubach & Williams (2001), Giammarioli & Valla (2003))
- Disrupted transmission mechanism and heightened financial stability concerns (IMF (2014))
- Flatter Philips Curves (Blanchard (2016), Watson (2014), Yellen (2012))

Proposed solutions:

- Modify central bank’s mandates

  A range of alternatives have been proposed, such as nominal GDP or price level targets, increasing the inflation target or even setting policy by a mechanical formula like a Taylor Rule

- Enhance the policy toolkit

  Should new instruments become a permanent feature of the central bank toolkit?
  What role for financial stability?

What is the experience in Albania?
Overview

1. Crises implications for monetary policy in Albania
2. BoA policy response and policy results
3. Lessons for the future
4. Concluding remarks
Accounting for lower equilibrium interest rates implied a more aggressive monetary policy easing.

Weakened Transmission Mechanism

Tighter external regulations, higher domestic credit risk and high euroization levels constrained the monetary policy transmission mechanism.

Albania, a predominantly bank-intermediated financial system

NPLs increased in the crisis aftermath

A euroized financial system which tends to correlate with foreign-bank

EU regulations contrain lending activity of EU Banks

Source: Bank of Albania
A Flattened Philips Curve

Internal studies* indicate the Phillips curve in Albania has flattened after the crisis, driven mainly by labor market dynamics.

It requires for a more pro-active and forward looking monetary policy.

**Policy response**

Accommodative monetary policy, delivered through standard (policy rate cuts & liquidity injections) and non-standards tools (forward guidance) to support economic recovery and price stability.

Balanced regulation and supervision, aiming at providing countercyclical stimulus (lower risk weights for credit growth, encourage credit restructuring) while reducing systemic risks (enhanced coordination, risk-based supervision).

Structural reforms (NPL resolution, de-euroization, enhanced financial supervision & regulation, financial market development) – to increase monetary policy effectiveness and reduce financial vulnerabilities.

Contingency planning, to prepare for additional crisis scenarios and to enhance resilience to shocks.
Policy results: Financial Market

Policy rate and the exchange rate performance

Factors behind exchange rate developments

Source: Bank of Albania
**Policy results : GDP & Inflation**

Monetary policy has been effective in strengthening domestic inflationary pressures.

Our measures have boosted the growth momentum of the Albanian economy.

Source: Bank of Albania
A cautious, data-driven monetary policy normalization is envisaged. Timing and pace of normalization will aim to balance the risk of hampering the ongoing recovery against the risk of overheating & stoking financial imbalances.

Growth is expected to remain solid in near to medium term... ...supporting the gradual increase of inflation over the medium term

Source: Bank of Albania
Lessons for the future

What do we need to preserve:
- Maintain a clear focus on price stability
- Avoid multiple objectives
- Preserve central bank independence

What do we need to improve:
- Enhance policy coordination
- Avoid financial imbalances and maintain a healthy transmission mechanism

What do we need to incorporate anew:
- Contingency planning in the face of the effective / zero lower bound
- Make greater use of selective non-standard tools, such as fwd-guidance
The BoA monetary policy was affected by the impact of the GFC

The crisis response required a mix of conventional, non-conventional and structural response

For the future we should:

• strive to enhance policy option and increase its degrees of freedom
• avoid burdening it with untenable / conflicting objectives
THANK YOU!
Anex: Monetary policy response in the aftermath of the crisis

Expansionary monetary policy through a series of policy rate cuts...

... and liquidity injections

Source: Bank of Albania
Anex: Policy results

Policy rate and the exchange rate performance

Factors behind exchange rate developments

Source: Bank of Albania
References


