



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?

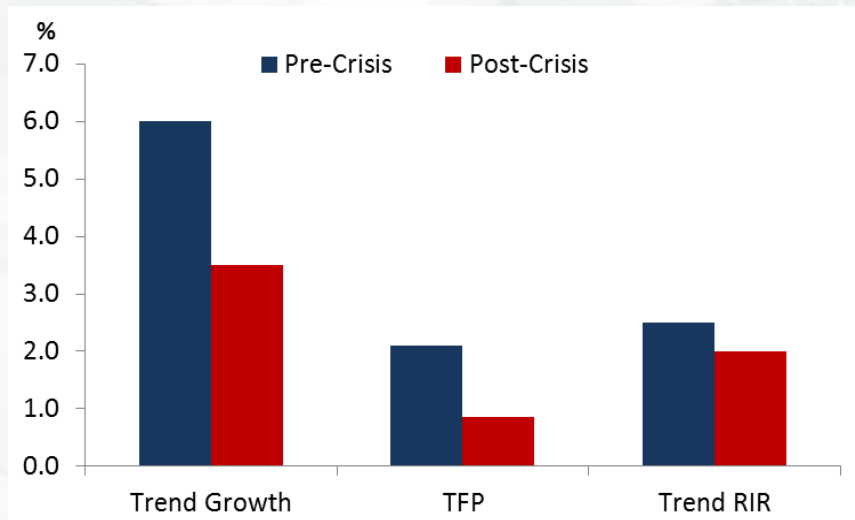
Overview



1. Crises implications for monetary policy in Albania
2. BoA policy response and policy results
3. Lessons for the future
4. Concluding remarks

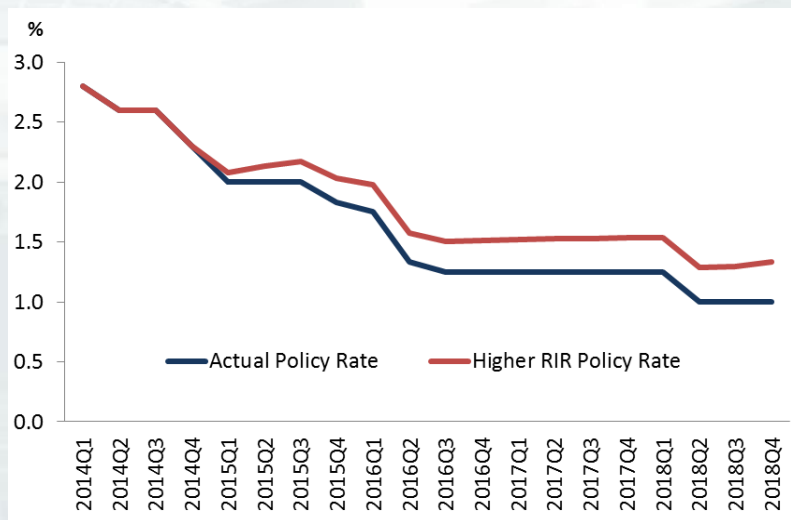
Lower Equilibrium Real Interest Rates

Lower equilibrium RIR due to lower TFP growth*...



Source: BoA, author's calculations. Pre-crisis refers to years 2000-2008, post-crisis to 2009-2018

...factored in our decision-making process



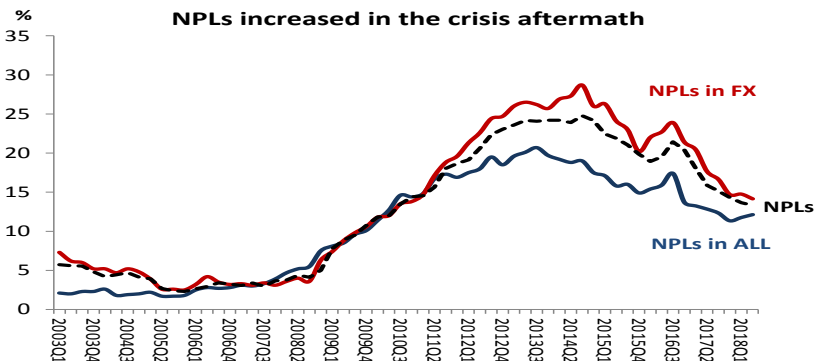
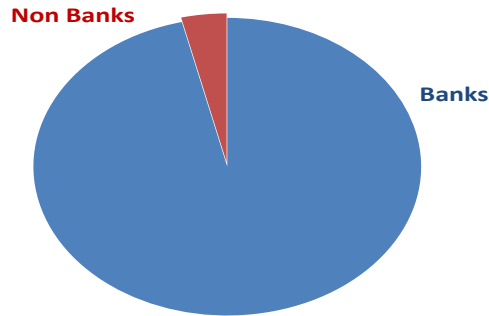
Accounting for lower equilibrium interest rates implied a more aggressive monetary policy easing.

* See Çeliku, Çela & Metani, Working paper, no. 38 2018, Bank of Albania.

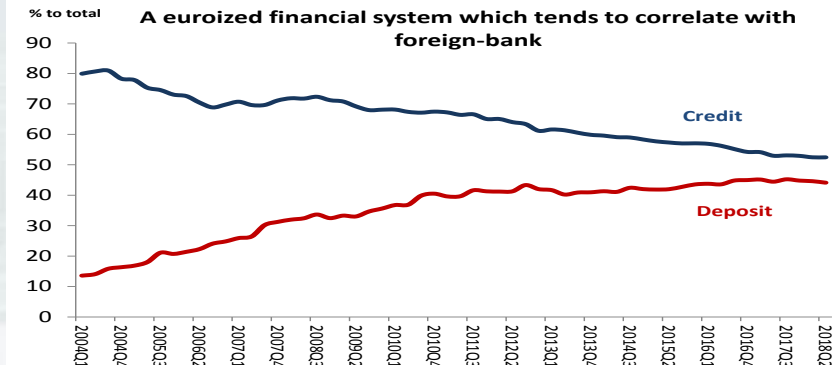
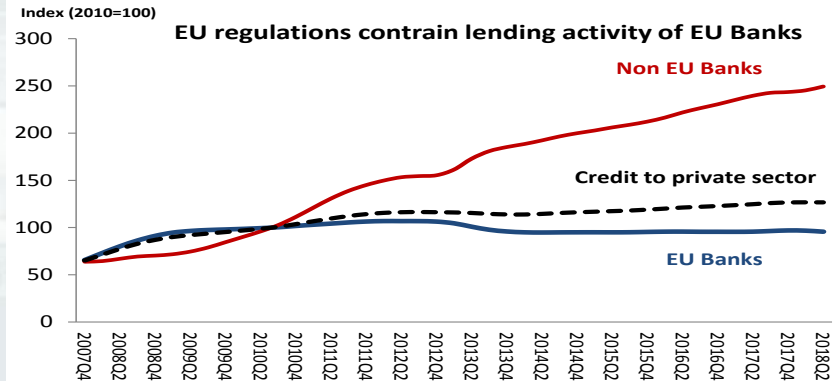
Weakened Transmission Mechanism

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

Albania, a predominantly bank-intermediated financial system

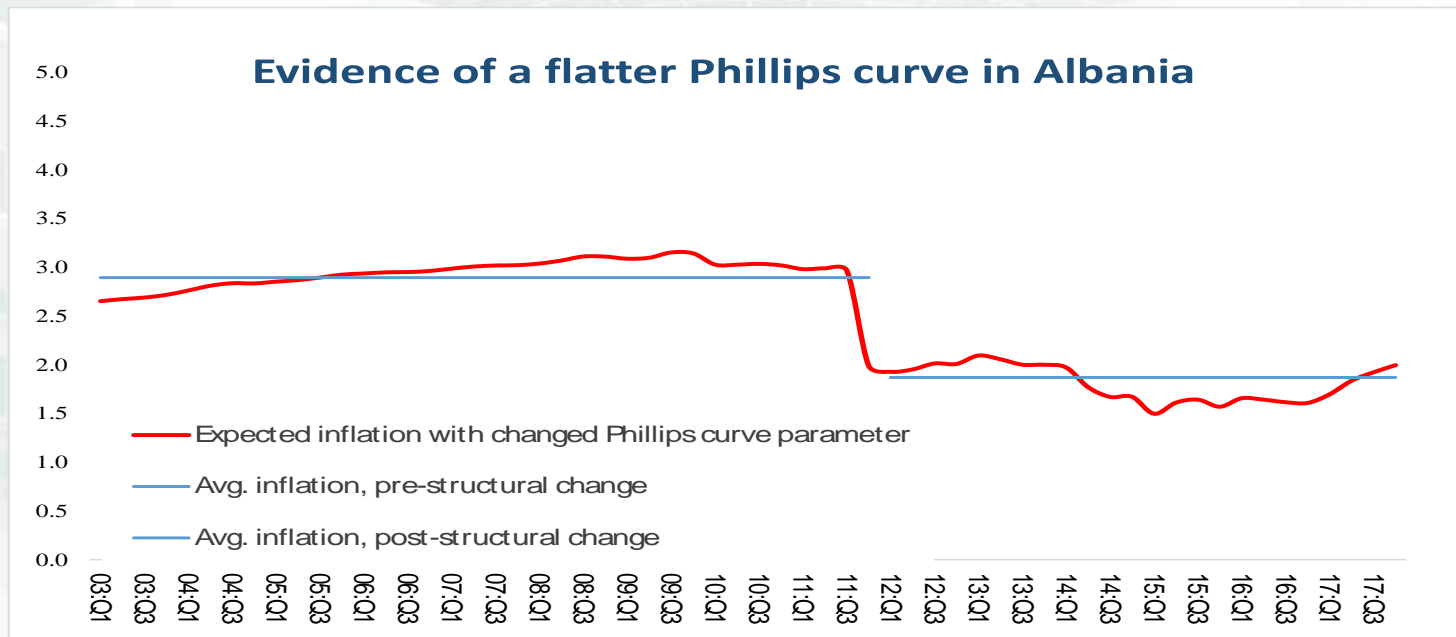


Source: Bank of Albania



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

* See forthcoming Celiku et al, "Factors leading to low inflation in Albania", Bank of Albania.

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

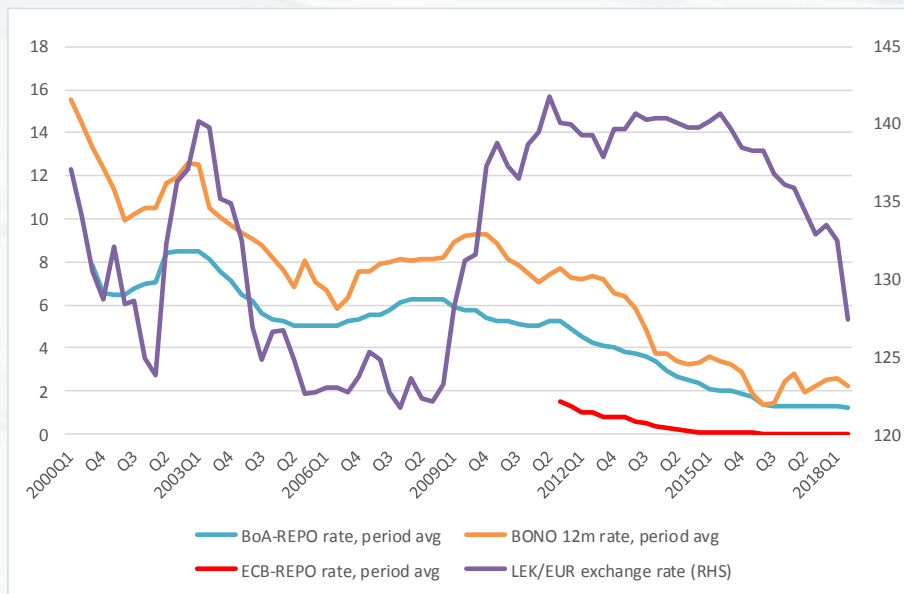
Balanced regulation and supervision, aiming at providing countercyclical stimulus (*lower risk weights for credit growth, encourage credit restructuring*) while reducing systemic risks (*enhanced coordination, risk-based supervision*)

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

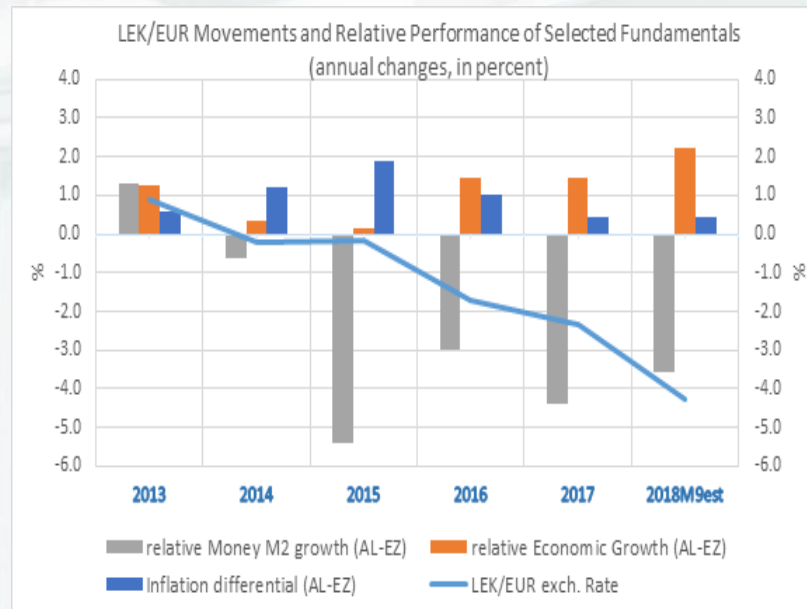
Contingency planning, to prepare for additional crisis scenarios and to enhance resilience to shocks

Policy results: Financial Market

Policy rate and the exchange rate performance

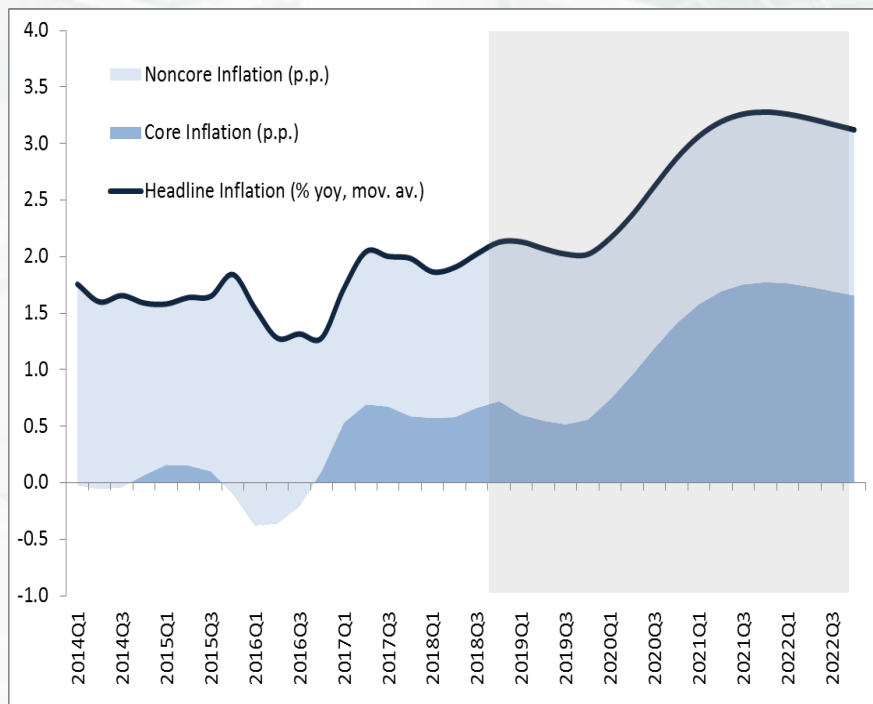


Factors behind exchange rate developments



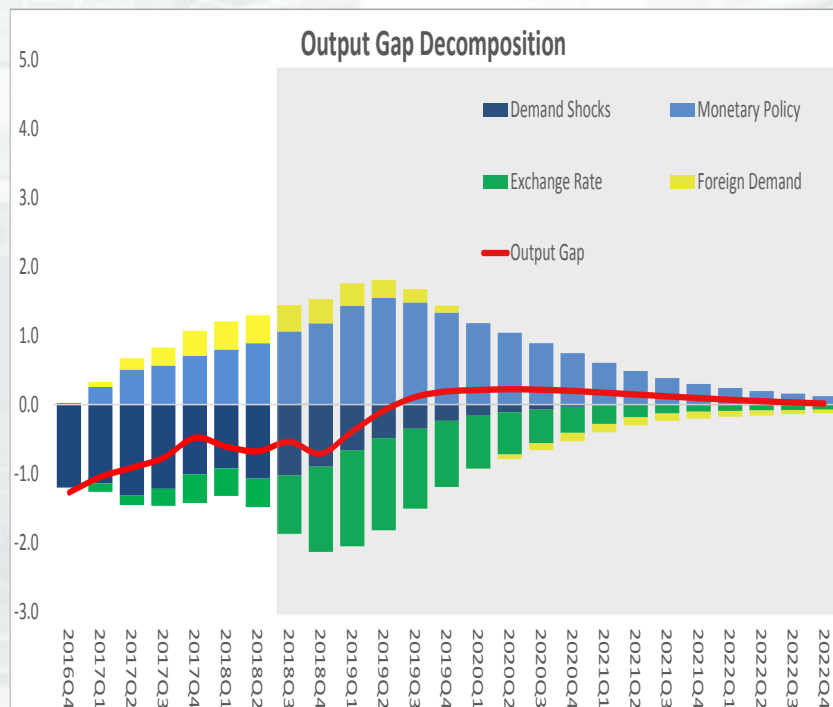
Policy results : GDP & Inflation

Monetary policy has been effective in strengthening domestic inflationary pressures.



Source: Bank of Albania

Our measures have boosted the growth momentum of the Albanian economy



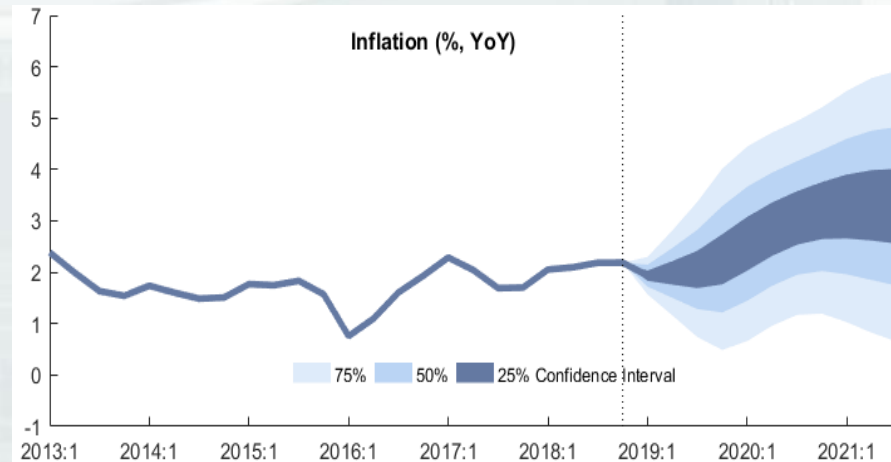
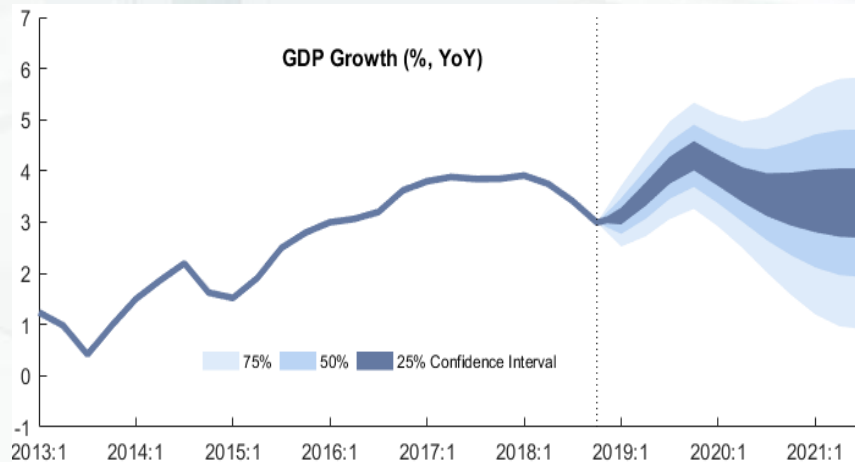
Policy expectation

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

Concluding remarks

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:

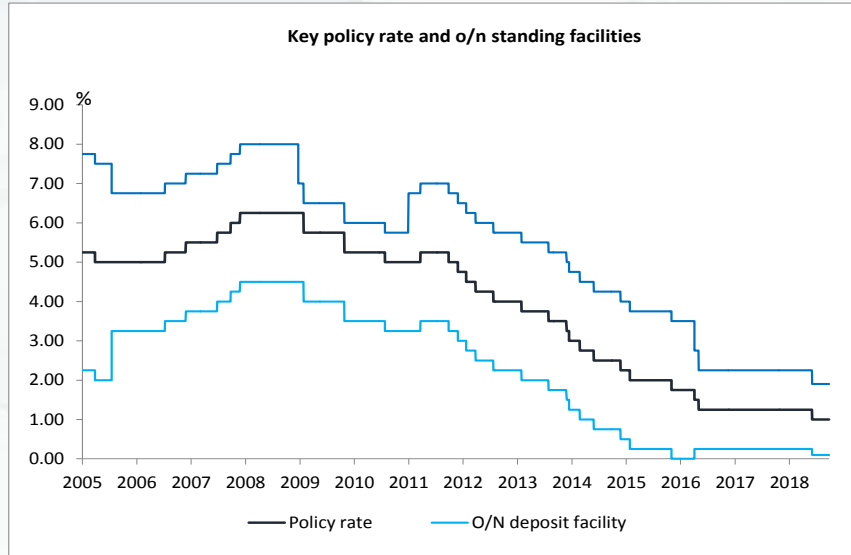
- strive to enhance policy option and increase its degrees of freedom
- avoid burdening it with untenable / conflicting objectives



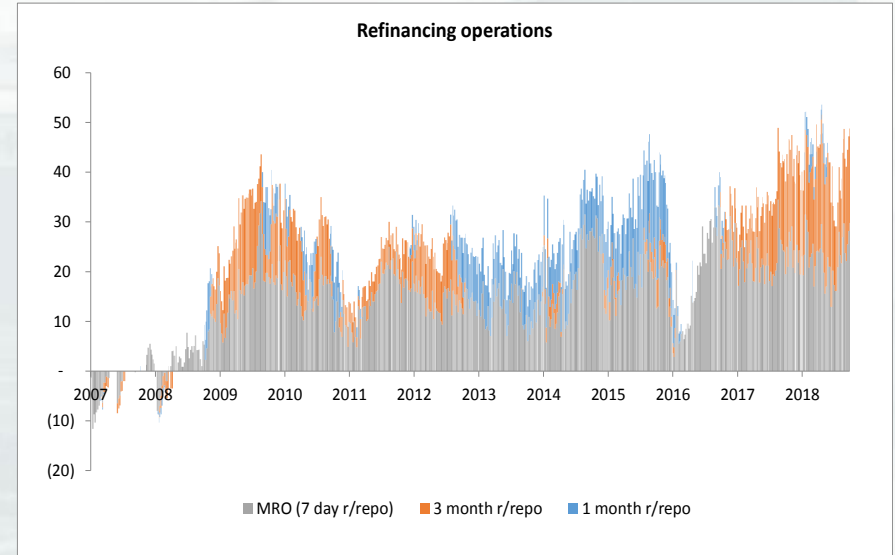
THANK YOU!

Anex: Monetary policy response in the aftermath of the crisis

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



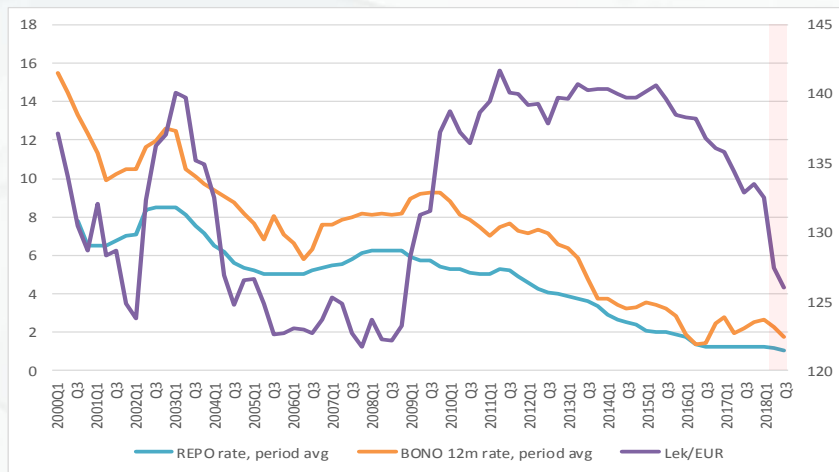
... and liquidity injections



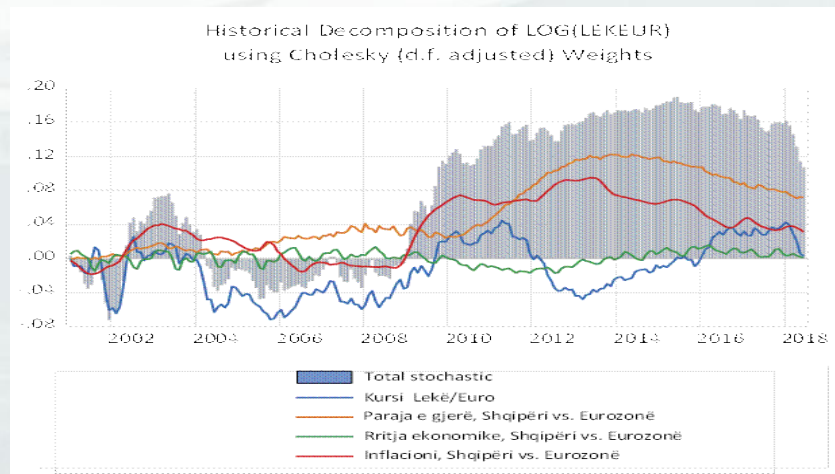
Source: Bank of Albania

Anex: Policy results

Policy rate and the exchange rate performance



Factors behind exchange rate developments



Source: Bank of Albania

References

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