

BANK OF ALBANIA

**FOREIGN EXCHANGE MARKET
IN ALBANIA, IN YEAR 2000**

Executive summary

Teuta Baleta
Dr. Evelina Çeliku

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Tel: 355- 4- 222152; 222153; 222156;
Fax: 355-4-223558

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INTRODUCTION

Foreign exchange market in Albania consists of two components: the formal and informal market. The formal market includes licensed operators to perform foreign exchange transactions. Bank of Albania is the licensing authority. Currently, the formal foreign exchange market includes 13 commercial banks and 21 foreign exchange bureaus operating throughout the country as well as the Bank of Albania.

The informal market includes a group of unlicensed individuals who perform foreign exchange activity. They do not follow to any rule on the foreign exchange market enforced by the Bank of Albania and do not report to it. In the daily slang, they are called “free dealers”. They appeared in early ‘90’s, and were mostly located in the centre of Tirana next to Bank of Albania’s headquarters. Between these two markets or groups of operators stand business companies and individuals that exchange currency for investment, for savings and for daily needs. The rate of using each component of foreign exchange market differs.

The use of foreign currencies is legally free in Albania, as they may be used as payment means of and any concluded transaction or contract, which defines the price in foreign currency, is valid. This means that it is legally free to execute payments, receive collections, sign contracts, or deposit in foreign currency or convert the domestic currency to any foreign exchange in unlimited amounts. The applicable foreign exchange regime in Albania is that of a free-floating rate. Bank of Albania operates in the foreign exchange market only to alleviate the speculative movements of exchange rate. In this “free” space, it is noted that Lek oscillates between US dollar and European currencies.

In order to understand operators and customers’ behaviour in foreign exchange market in relation to their mostly used currency, their attitude on the strongest or the most appropriate currency to save, invest or hold as a guide in decision making, a statistical survey was conducted. The survey involved all banks (13) and foreign exchange bureau (21), informal market dealers (50), largest and large enterprises (150) and individuals (100). The main purpose of survey was finding answers to the following questions: Which from the following exchange rates must be closely followed, Lek/USD or Lek /Euro? Are both currencies important and to what degree? Which is the currency used mostly for saving? Which foreign currencies actually guide decision-making?

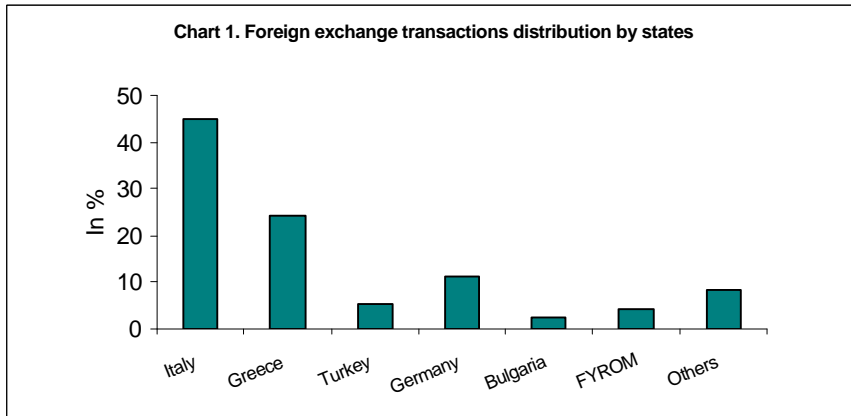
However, survey results bring in additional information that may be very interesting and useful.

Foreign exchange market in Albania, in year 2000.



TRANSACTIONS' GEOGRAPHY

Banks, foreign exchange bureaus (hereinafter referred to as “bureaus”) and business companies have expressed their opinion on the frequency of performing foreign exchange transactions with other countries. It is noted that Italy and Greece occupy the main share in performing transactions whereas Germany ranks third. These three countries are all mentioned by 80.5 per cent of the interviewees. This structure matches with the pattern of Albanian main trading partners. Trade relations with Italy, Greece and Germany comprise about 74 per cent of the overall volume of Albania’s foreign trade with the rest of the world.



Italy represents the state with which Albania performs the largest number of foreign exchange transactions.

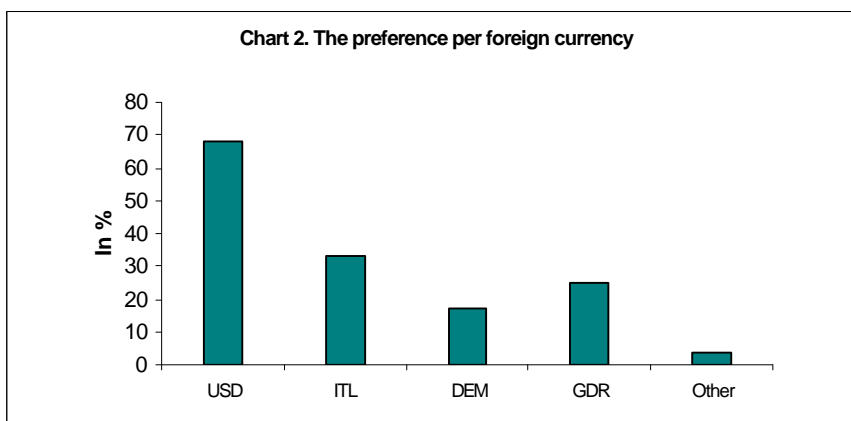


This structure matches with the pattern of Albanian main trading partners.

While the transactions' geography places Italy and Greece in the first place, USD is the most preferred currency.

THE MOST PREFERRED CURRENCY FOR USE

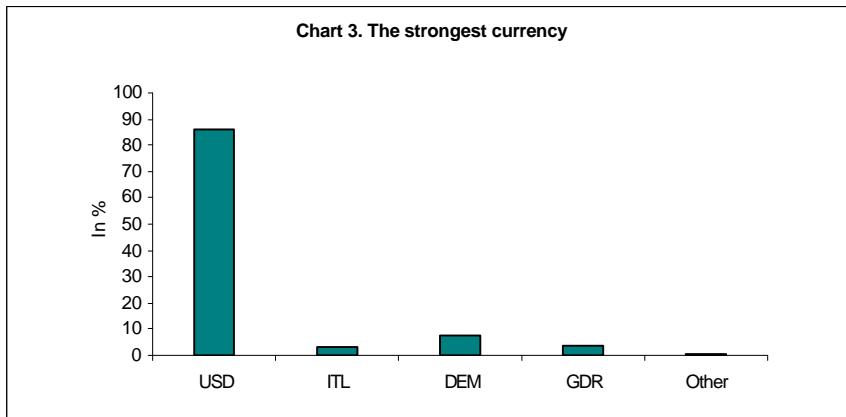
Banks, bureaus, informal market dealers and business companies have given their preferences on the use and frequency of performing foreign exchange transactions with other countries. As designated, USD is the most preferred currency by 67.8 per cent of interviewees and ITL and GDR are the less preferred ones by 33 and 24.8 per cent, respectively. Compared to the average use of Euro components, USD has on average a frequency about 2.7 times higher than any of them.



THE STRONGEST CURRENCY. THE GUIDE CURRENCY IN DECISION MAKING PROCESS

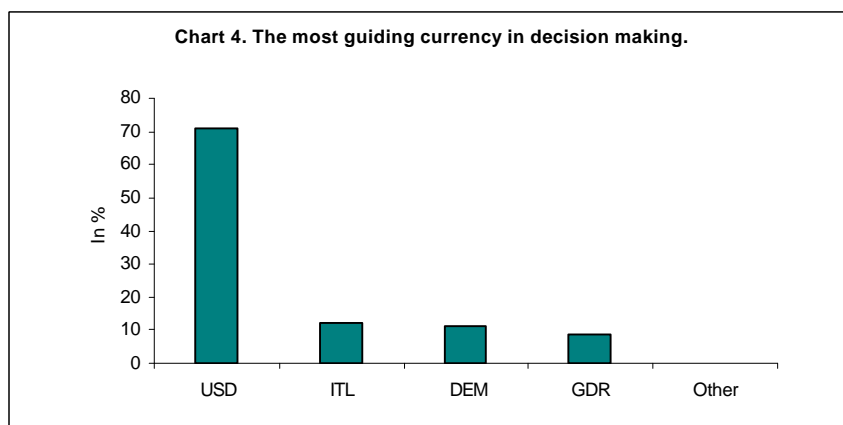
Banks, bureaus, dealers and business companies have expressed different opinions on their perception of the strongest and the most important currency, which guides them in decision-making. USD is evidenced as the strongest currency by 86.2 per cent of interviewees. As such, it is quite distant from any other foreign currency.

US dollar is considered as the strongest currency.



USD is considered as a guiding currency in decision-making by 70.6 per cent of interviewees. Whereas, all Euro components are considered as important currency by only 32.1 per cent of interviewees.

USD is considered as the main currency guiding the decision-making process (70.6 per cent of interviewees). Euro components are also considered as relatively important in decision-making. It is also noticed that although they are not perceived as very strong they still play a bigger role in orientation, yet less significant than USD.



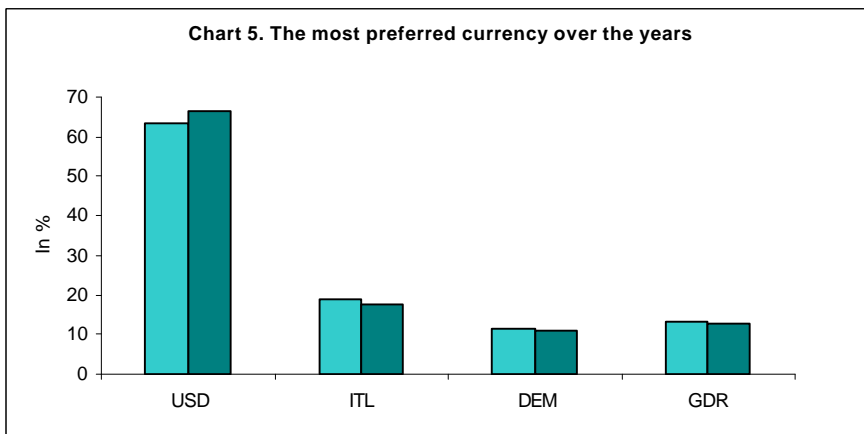
THE MOST PREFERRED CURRENCY

Banks, bureaus, dealers, business companies and citizens have expressed their opinion on the most preferred currency and the evolution of this tendency during 1999, 2000.

The preference for the American currency is much higher than that any other foreign currency. This is signification, both years, by 63.5 and 66.3 per cent, respectively. In addition to that, the USD preference has also strengthened by 2.8 percentage points in 2000.

The preference for Euro components varied from 43.6 per cent to 41.4 per cent for years 1999 and 2000, respectively, thus indicating a declining tendency. This result corresponds to the reality of the foreign exchange performance in the market. The period 1999-2000 is characterised by Euro depreciation, which increased the preference for USD.

USD is the most preferred currency either in 1999 or 2000. This preference has been increasing.



The informal market is preferred the most for foreign exchange transactions. The preference for informal market is about 6 percentage points than that for the formal market (banks and bureaus together).

THE MOST PREFERRED OPERATOR FOR FOREIGN EXCHANGE TRANSACTIONS

Banks, bureaus, free dealers, business companies and citizens have expressed their opinions on their preferred foreign exchange operators. In general, it is noted a relatively uniform distribution of preferences, which confirms a broad use of each operator at comparable levels. However, the most preferred operator is the informal market, occupying 38.7 per cent of the total preferences. There is also a considerable number of respondents who combine the operators. Frequently, in cases when the combination of elements is clearly specified, one of the combined operators is the informal market. In general, the latter is still more preferred than other operators are.

Table 1. The preference for foreign exchange operators.

Operators	In %
1. Dealers (informal market)	38.7
2. Combined operators	28.5
3. Banks	21.5
4. Foreign exchange bureaus	11.3

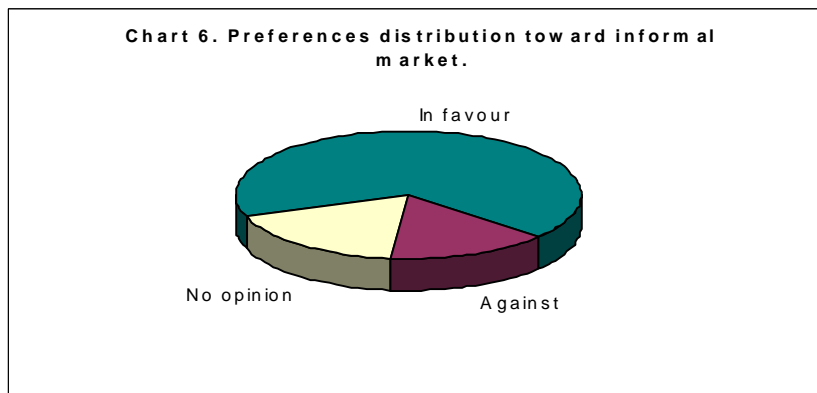
INFORMAL MARKET FEATURES

This survey analysis and the logic in it reveal three typical (most conspicuous) features of informal market.

1. **Low cost.** Transactions in this market are less costly due to the more favourable exchange rates it provides compared to formal market operators.
2. **Higher operation velocity.** Foreign exchange operations are instantly performed, and as such they save time by further reducing the cost of transactions.
3. **Higher liquidity.** The informal market is highly liquid so that anyone may exchange at any time, any amount (small or large) and to any kind of currency. The informal market provides the opportunity to exchange even those currencies (coins) considered as being rare.

These three features increase the efficiency of the informal market by making it highly competitive. For these reasons, the most preferred operators are informal market dealers. Also, for the same reasons, about 67 per cent of banks, bureaus, informal market dealers and business companies say that there is still need to have such a market.

The informal market is very competitive. It offers low cost, velocity in service and high liquidity.



It is approximately estimated that the total volume of informal market transactions drives in USD 2,4 billion, annually.

The size of informal market, estimated according to the free dealer statements, is considerable. The average annual turnover of transactions performed in the informal market is estimated at USD 2.4 billion.

The market size and its functioning features make it highly competitive and advantageous. In this framework, it is recommended that the reduction of informal market be made gradually and very carefully. It is necessary to exercise pressure to improve the competition of formal operators, on one hand, and reduce the advantage of informal market on the other.

BANK OF ALBANIA'S FOREIGN EXCHANGE POLICY

Based on the central bank law, Bank of Albania is the authority responsible to determine the foreign exchange regime and design the foreign exchange policy of the country. Bank of Albania also approves operating rules and regulations of foreign exchange market, grants operating licences for foreign exchange operators or acts through buying or selling foreign exchange. All Bank of Albania's transactions are mostly assessed as positive.

Banks, bureaus, informal market dealers and business companies answer:

- ? in favour of the flexible regime of exchange rate in 39.4 per cent of cases (while 37.5 per cent have no opinion);
- ? that Bank of Albania's interventions in the foreign exchange market are undertaken at appropriate moments in 32.1 per cent of cases (while 44 per cent have no opinion);
- ? that Bank of Albania achieves its goal through its operations, in 39.6 per cent of cases (while 46.1 per cent have no opinion);
- ? that Bank of Albania should act to maintain a stable exchange rate in 76.1 per cent of cases;
- ? that USD is designated as the most appropriate currency for market transactions by Bank of Albania in 85.8 per cent of cases.

Table 2. Distribution as of available answers to the most appropriate currency/ies to perform foreign exchange transactions.

Currency	Answers (in %)
USD	85.8
ITL	3.7
DEM	9.6
GDR	4.1

Bank of Albania's policy related to the foreign exchange market is generally assessed as positive.



Bank of Albania needs to be more transparent with regard to the foreign exchange policy it pursues and foreign exchange activity it performs.

However, there is a relatively high number of respondents who do not express any opinion regarding Bank of Albania foreign exchange policy and activity. Hence, it is recommended for Bank of Albania to enhance its transparency on the issue as well as make efforts to increase education of the public.

EURO PERFORMANCE

Comparing 1999 with 2000 in relation to the relative importance of Euro transactions in the foreign exchange activity of banks, bureaus, dealers and business companies, we observed that 65.6 per cent of the respondents say that the European currency has not strengthened its position.

Table 3. The performance of Euro relative importance.

Euro	Answers (in %)
Not increased	65.6
Increased	15.1
Unchanged	4.1
No opinion	15.1

Generally, Euro's relative importance on the overall foreign exchange transactions during 2000 did not reveal a significant increase compared to 1999.

USD is particularly evidenced, as Albania's most preferred currency, which instantly appears as a stable currency, guiding the decision-making process. It is also considered as the most appropriate currency for foreign exchange operations conducted by Bank of Albania.

Foreign exchange market in Albania, in year 2000.

