

GOVERNOR'S PRESENTATION AT THE PARLIAMENTARY COMMISSION OF ECONOMY FINANCE AND PRIVATIZATION, MAY 4, 2000

Governor's speech,

The Annual Report of Bank of Albania, already at your disposal deals in detail the Albanian economy developments in the monetary area, exchange rates, bank supervision, payments system and the central bank institution, itself.

After the crisis in the first half of 1997 and the successive implementation of the six-month program on domestic stability, Albania signed with IMF the ESAF-2 arrangement. Central elements of this arrangement were still the assurance of rapid growth rate of domestic economy, inflation decrease, disciplination of fiscal developments to reduce budget deficit especially that financed on domestic resources, development of institutional reforms to consolidate any achievement in macroeconomics area as well as the improvement of the legal and regulatory framework.

Economic developments during 1998 were within the established objectives. On the whole, the established quantitative targets were achieved. It was ensured a better disciplination of fiscal developments first cited in the compliance of all limits set on budget deficit. Above all, inflation was managed to reduce from 42 per cent at the end of 1997 to 8.7 less than the established objective, at the end of 1998.

This reduction was on no doubt attributed to the important role conducted by the tight and prudent monetary policy practiced by Bank of Albania. It could be said that year 1998 serves as a starting point for the economic recovery of the country.

Based on the relatively stable economic and political situation inherited from 1998, 1999 objectives were still defined ambitious.

The substance of economic program was still the assurance of an annual growth rate of 8 per cent, inflation decrease at 7 per cent rate,

budget deficit financing on domestic resources at 5.9 per cent of GDP.

The procedure of institutional reforms, strengthening of the struggle against corruption and illegal traffic, strengthening of the legal and regulatory framework and supervision, strengthening of judicial system, privatization and strengthening of public order and tranquillity still remained significant elements of the economic program on 1999. Two were the main reasons which required stronger emphasis of these elements:

- ♦ In 1998, it was poorly worked with these respects.
- ♦ The need to ensure consolidation of macroeconomics balances.

We were all witnesses of the unexpected developments of the regional situation in the previous year, which could not pass on no impact to the Albanian economy. The war in Kosova and the massive expulsion of whole population established a general uncertainty, making us feel pessimistic on the achievement of economic program at early crises developments.

Kosova crises had very complex impacts on Albania. However, the instant and overall aid offered as well as the government and public engagement led no infringement to the achievement of quantitative targets.

Actually, it can be fully confirmed that the Albanian economy during 1999 was developed within the programmed framework. In this way, **the previous year contributed in the growing stability of country's economy.**

The gross domestic production increased at 8 per cent rate on 1999. The structure of domestic economy as well as the substituting effect between the growing activity of different branches of the economy reduced the negative effects of Kosova crises.

In short, the **agricultural production**, on over 50 per cent share to of the total production, was observed to keep the same growing rate (5 per cent), as in the previous year.

Agriculture was not significantly affected by regional developments, ensuring the main basis for growth on overall domestic production. **Industrial production**, increased at 6.4 per cent extent, occupied 12 per cent of the total domestic production. This growth is totally attributed to the private sector, for according to the official data under disposition, industrial production by the public sector records a stationary position. **Construction and transport branches recorded** a relatively high growing rate of 15 per cent on each.

Whereas, the **service branch** recorded a growing rate of 12 per cent.

Kosova crises is assessed amongst the main growth determinants for these sectors.

Notwithstanding the economic growth, it was poorly done to increase the employment rate in the country. Official figures indicate employment decrease by about 4 thousand persons.

At 18 per cent rate, unemployment constitutes the highest citing recorded after 1995. Moreover, this figure was further increased for the third year in succession.

If until now there have been recorded no severe reactions, this is due to the high migration rate of Albania and employment by the informal sector of domestic economy. If the number of Albanian emigrants according to various studies is estimated at 500-600 thousand, it will be impossible to give an employment figure of the informal market. It is sufficient to mention the fact that during April-June period, there were established many temporary work positions, although official figures reported growing rates of unemployment.

The external sector was more affected by the regional situation. The conflict period was accompanied by considerable inflows of goods and foreign exchange. This led to a relatively high growth of foreign exchange reserves and a

clear tendency of appreciation of domestic currency.

During 1999, the USD 97 million or 25 per cent growth of foreign exchange reserves was considerably affected by the aids granted to the Albanian Government to afford the crises expense. The foreign exchange reserve of the country was sufficient to afford 5.2 months of imports of goods and aids.

The domestic currency strengthened about 3.9 per cent against USD and nearly 16.8 per cent against Deutsche Mark and other component currencies of ECU. The rather high foreign exchange inflows were estimated as the main determinant in the strengthening of the domestic currency value.

Accounted in the form of tourism incomes, current and capital transfers as well as government services, the USD 300 million inflows which entered the country in the period April-September 1999 were almost equal to the annual income from emigrant remittances of Albania.

Fiscal policy was drafted to serve the reduction of budget deficit and inflation, consequently. **The deficit covered by domestic resources reached in 4.9 per cent of GDP or 1 point per cent below the target** or 1.7 point per cent less than in the previous year. Lek incomes resulted at about 90 billion and/or 73 per cent of them were accomplished by tax incomes. However, in absolute values all income duties and taxes showed non-fulfillment by clearly revealing once more the working trouble of customs, fiscal evasion, corruption etc. Expenditures indicate non-fulfillment as well.

The total of expenditures in ratio to GDP reached in 28 per cent from the 31 per cent expected. Surviving problems of performing budget expenditures had negative effects in monetary policy implementation. First budget expenditures are not rhythmically performed.

Nearly 33 per cent of budget expenditures were carried in the last quarter of 1999 and only half of them in December 1999 (51 per cent of the last quarter expenditures). On the other hand, disorders of yielding taxes were mostly offset by the abbreviation of planned expenditures, especially by capital expenditures.

Capital expenditures were accomplished at 6.4 per cent of GDP from the 7.5 per cent planned. As in 1998, budget expenditures showed no structural improvement on 1999. This means less investments, less employment and reduced prospect for economic growth in the future.

The monetary policy in compliance with the principal objective of Bank of Albania, achieving and maintaining price stability, was drafted to follow further reduction of inflation.

The monetary policy effect with this bearing would be measured by the compliance with of the three quantitative targets, the floor on the net foreign assets of Bank of Albania, the ceiling on the net domestic assets of Bank of Albania and the net government credit of the banking system. The three of these of targets have been complied.

The monetary policy applied in Albania during the recent years is defined as a tight and prudent policy. Containing "prudent" element, the monetary policy is extended of the possibility to be flexible and adjusted to domestic developments.

During 1999, the monetary policy followed its mitigating momentum commenced in 1998. This is reflected in the continuous reduction of interest rates on term deposits in LEK. The minimum rate on 12-month deposits had a significant reduction from 27 per cent at the end of 1997 to 16.5 and 9 per cent, respectively at the end of 1998 and 1999. The rate, approved at the end of 1999, is the lowest historic level achieved since 1992. Even in 2000, Bank of Albania has two times trimmed the interest rate to reach at the current rate of 8 per cent. These decisions were undertaken, basing on the current development of consumer prices, price strengthening of domestic currency and the deposit performance of the banking system.

They are aimed at lowering the financing cost of the economy, the cost of government debt service and economic growth incentive on a longer term.

However, it must be emphasized that any decision on interest rate lowering is based on the interest to hold depositors' confidence by

the banking system, by maintaining positive interest rates in real terms. At the end of 1999, the annual average level of real interest on 12 month deposits was about 7.6 per cent whereas at the end of March this level was reduced to 5.3 per cent.

The consumer price performance on 1999 was unusual for the period 1992-1997. Monthly inflation rates resulted negative or at insignificant positive rates ensuring a negative inflation rate of 1 per cent, much below the target at the end of 1999.

There are several the factors of significant effect in this behavior, stating from the strengthening of fiscal discipline, the effect of the monetary policy applied by Bank of Albania, the exchange rate performance etc.

But, the main influence was exerted by the *shock* factor that is Kosovo crises which as above explained was accompanied by a high excessive inflow of tangible foreign exchange and goods in Albania, meeting either the additional claim of expelled population and the demand of the Albanian population.

Thus, the basic factor of reducing inflation has been appreciation of domestic currency by 16.8 per cent during 1999. However, the inflation decrease has been affected by many other factors as shrinking of credits and investments, the low level of imported inflation or even public "accommodation" by a low inflation rate.

Meantime the same tendency is following even this year. The annual inflation rate until the end of March reached in -2.1 per cent. Based on this level as well as knowing the seasonal behavior of consumer prices, **the inflation target on 2000 is considered achieved.**

However, Bank of Albania won't be constant in interest rate reduction.

First, as above stressed, the consumer price performance has been unusual and imposed by *shock* factor.

Second, maintaining public confidence by the banking system through relatively high real positive interest rates is of excessive importance for Bank of Albania and bank development in Albania.

At last, the inefficient functioning of economic mechanisms should not be considered less significant. This must be understood that decisions undertaken by Bank of Albania did not bear the expected effect in reality.

The reasons for the inefficient functioning of these mechanisms may be assorted but what I want to specify is the considerable size of informal economy, reducing the effects of economic policy decisions. Thus, the Albanian markets are at their initial stage of their development, for not mentioning their non-existence. In this way, the economy is lacking channels through which undertaken decisions and drafted policies are effectively applied.

Bank of Albania's decisions on interest rate cuttings were accompanied by a significant lowering of treasury bills' yield. Within an annual framework, the level of treasury bills' yield lowered respectively by 5.1, 6.0 and 7.2 per cent for treasury bills on three, six and 12 month maturity. Whereas, the difference between deposit rates in domestic currency and treasury bills on annual maturity remained almost the same by about 6.5 per cent extent.

Moreover, taking into account the level of political risk and the country's risk as well as the abiding monopoly of bank market, the current treasury bills' yield is considered appropriate. On the whole, persons operating in market of government securities are noted to have reacted in compliance with Bank of Albania decisions and after a rational period of time. This has happened because this market has been effective and is amongst the most active markets in Albania.

The same position can not be confirmed on the lending market. It's not excessive to affirm that this market has practically reflected nothing from Bank of Albania decisions. Deposit rate reduction was not accompanied by increase of lending rates. Furthermore, the average lending expense increased from 25 per cent at the end of 1998 in 25,8 per cent at the end of 1999. Whereas, the difference between the average rate of annual loans and deposits increased by almost 2 times (from 8.5 per cent in 16,7 per cent).

On the other side, in November 1999, Bank of Albania took the decision of revoking the credit ceiling on second-tier banks. But, lending rates still remained by low levels.

From Lek 8 billion (the established credit ceiling on non-government sector), the credit sock of the banking system at year-end resulted by about Lek 2.2 billion increase or 27,5 per cent of the credit ceiling. There could be mentioned many reasons on credit refusal. The most important are the following:

- the high lending risk in Albania forces private banks to be very conservative with this respect;
- Albanian firms do not work with banks and as such they are considered unsafe customers for them;
- Albanian firms reflect a low level of transparency concerning bank relations, becoming less credible for them;
- the impediment of state-owned banks from their lending activity due to their high level of bad credits was also based on the need to protect them from suffering further losses which would increase their privatization expense;
- the ineffective functioning of judicial and executor system
- obstacles in recording ownership, etc.

Thus, the credit market is not practically functioning in Albania. Only some private banks extend credits mainly in foreign exchange and less in domestic currency. Realizing that the central bank has no power to compel second-tier banks to increase their lending rates, these banks based on the law "On the banking system in the Republic of Albania" enjoy independence in their decision-making activity.

Bank of Albania exerts its own control through the decisions it undertakes and the instruments it applies. Since these decisions have not resulted fully effective, the central bank is widely engaged in initiating a credit campaign to the economy.

This campaign is largely pointed at announcing credit procedures, required terms to acquiring bank credits to bank customers, business individuals and firms.

On the other hand, this campaign aims to identify some other reasons that could bring restriction of lending activity and respective measures to be undertaken taken to reduce obstacles in succession. Based on the lending significance to the economy, Bank of Albania together with its human resources will be engaged and will financially support this credit campaign to ever so little contribute in any improvement and functioning of this market.

However, it is other institutions' duty to contribute in establishing a necessary climate for credit. The country needs order and peace in order to have business firms interested in investments and banks feel safe in financing these investments. Strengthening of legal judicial system practice is highly required.

The legal efficiency is closely linked with credit performance for it establishes the necessary support and guaranty that the granted money will be returned to the bank. The strengthening of control by fiscal structures is also of importance. Reducing the possibility for double record of balances by business firms makes them credible customers for banks.

The level of non-performing loans is another restraining factor on lending activities and increase of bank confidence by their customers. According to the recent data, non-performing loans reach in Lek 13,4 billion or 33 per cent of credit aggregate on the most part of state-owned banks. Nearly 95 per cent of non-performing loans is situated in state-owned banks. The level of lost loans remains high by Lek 7 billion or 76 per cent of non-performing loans. If we consider the level of lost interests, the lost loans will result Lek 10.7 billion.

A considerable part of these loans have been inherited from the previous years, however, a similar figure is accounted as risky for the banking system.

Bank of Albania has reacted by strengthening is supervisory skills on second-tier banks and by intensifying application of requirements for establishing reserves funds to cover the loss from loans.

This situation of credit portfolio does not mean that everything goes wrong in the banking

system. On the contrary, there are noticed many positive developments by it.

- First, three other banks commenced operation during 1999, the FEFAD Bank, the First Investment Bank and the Intercommercial Bank. This is an indicator of the relatively higher confidence of foreign investors to invest in the Albanian bank market. Only FEFAD Bank added to the loan portfolio of the banking system about Lek 700 million.
- Second, the number of bank branches is further extended in the country geography. Two bank branches and three agencies were opened during 1999.
- Third, despite the surviving deformation of bank market and the monopoly of the Savings Bank, it is strengthening the tendency to increase the private banks' role promising a more normal and efficient functioning of this market in the future.
- Fourth, banking system improved its financial situation during 1999. Whether, at 1998's end, the financial result counted negative for Lek 33 billion, at the end of 1999 it resulted on a Lek 1,3 billion profit. Even the net result from interest earnings, which was historically negative, recorded the positive value of Lek 5.2 billion at the end of 1999.
- Fifth, the capital position of banks was strengthened on the account of some reasons. On March 31, 1998, Bank of Albania's Supervisory Council took the decision to increase the minimum required capital for the current banks at Lek 500 million within September 1999. This decision was almost complied all banks. Only three of them did not obey the required schedule. Based on facts and terms of disobedience, Bank of Albania approved this schedule postponement until February 2000 on one bank and until the end of 2000 for the other two banks. The newly established schedule has been obeyed. So the subscribed capital of the whole banking system has been paid up to 90 per cent rate. The capital amount of banks is expected to increase due to

the application of another Bank of Albania's decision, that the paid-up capital should beat the amount of Lek 700 million at the end of March 2001. On the other hand, the capital deficiency is significantly reduced by state-owned bank group and by the banking system, consequently. However, the state-owned banks' group continued to have capital inadequacy owing to the inherited loss from the previous years.

But, year 1999 did not record any qualitative improvement, concerning the development of the payments system. On the whole, the payments system reflected the same problems as in the previous years: the high rate of circulating cash, delays in money transfers especially within the country, the high difference in technology and network extension by the domestic banking system ect.

In addition to the higher transaction volume mainly due to the banking system extension by new banks and branches, some private banks began to apply new payments instruments as ATM, DINERS CLUB card and VISA card etc which still have low usage.

The low level of payments system development in Albania is another additional factor which keeps customers out from banks.

Bank of Albania has its own responsibility with this bearing and is engaged in the framework of National Payments Committee as well as through the initiation of some projects to contribute in the payments area.

At last I want to draw the attention on one fact. During my speech I made use of some phrases as "referring to the official data" or "based on the official date it is deemed that". This not a play of words but reflection of a very high deficiency in our country; lack of complete statistical data which should be given exactly and in time.

Yet, there is not established a system of national accounts. **On a single sentence, the statistical situation in Albania is defined deplorable.** Notwithstanding INSTAT attempts, the lack of statistical data is providing difficulty to all specialists and decision-making units.

This situation requires immediate intervention by governing authorities. It should be strengthened the legal basis on statistics and responsibilities for statistical reporting.

It is necessary to financially support units, dealing with statistical collection and processing, by first listing INSTAT. Official institutions, especially ministries, should increase the level of transparency concerning statistical data and should better collaborate at data reciprocation. From Bank of Albania's experience, relationship with these institutions I assess that there is surviving durability in exchange of information and even in non-fulfilling of legal requirements with this respect.

Second, it's worth beginning an educational campaign on the private sector of the economy and individuals to be more opened and not rigid in reporting required data.

The statistical information required for collection is worth for study aims and to undertake as more valuable decisions as possible. We all profit from them.

In 1999, a special importance was paid to the institutional development of Bank of Albania. For this, in November 1999, the Supervisory Council of Bank of Albania approved the strategy of medium term development of the central bank.

This document is already published. It ranks in a well-selected mode all stages to be traveled through, all problems to be faced with while moving towards the selected model, and above all the reliable resources of the institution that is the human potentiality, their skills and good will to work.

The strategy paper was drafted in order to:

- ♦ Assess the achieved development of the institution.
- ♦ Set short term, medium term objectives for the institutional development of Bank of Albania.
- ♦ Fix time schedules on objectives' achieving.
- ♦ Define development priorities of Bank of Albania.

The overall strategic targets of Bank of Albania have to do with its entire activity.

- ♦ First the document defines the institutional model to be followed by Bank of Albania that is the **Central European Bank**.
- ♦ Second Bank of Albania cites its commitment to increase its real, legal independence as the central bank of the Albanian state to best serve its legal offices sanctioned by law.
- ♦ Third Bank of Albania is also engaged **to increase the liability of its actions and decisions**. For this it is involved in increasing public transparency and its "education" with problems of economic and financial nature.

In this framework, Bank of Albania for the first time since its establishment reports its financial condition accompanied by the opinion of its off-site public inspector. This is an important step to increase Bank of Albania's transparency on own activity and obedience of international standards at accounting and self-reporting areas.

According to the auditors' opinion, the balance-sheet of Bank of Albania presents fairly all material aspects of the financial position of Bank of Albania on December 31, 1999 in compliance with International Standards of Accounting adjusted on the general accepted policies of applicable accounting for central banks.

- ♦ Fourth, Bank of Albania seeks to act in a legal, stable environment, something attempted to be achieved through **completion and improvement of legal and regulatory framework of financial area**.
- ♦ "Achieving and maintaining price stability" is the most important strategic objective of Bank of Albania.

This objective is materialized in the commitment to hold an annual inflation by 2-3 per cent rate. The monetary and foreign exchange policy will be harmonized and oriented in achieving this target.

- ♦ **Statistics improvement** is another prospect objective of Bank of Albania. In the situation when the level of developing statistics is not so satisfactory in Albania, Bank of Albania considered necessary the commitment by this process and initiation of two projects on statistics development, intending membership by GDDS and SDDS.
- ♦ **Development and improvement of the payments system**, intending increase of cash circulation through the banking system. For this, it will be worked under two bearings: in improving the system of interbank payments and small amount payments.
- ♦ At last, as previously established, fulfillment of strategic targets will be achieved through training of the human resources of Bank of Albania and development of information technology.

The economic activity of the banking system and Bank of Albania is broader than that described above. However, I believe that, the clear and the correct reflection of these developments, given so far, will be really estimated by you and the public.

Thank you,

Shkëlqim Cani

Governor