



PLANNING FOR THE POST-COVID WORLD:

CENTRAL BANK POLICIES IN EMERGING ECONOMIES

Gent SEJKO

**Governor
Bank of Albania**

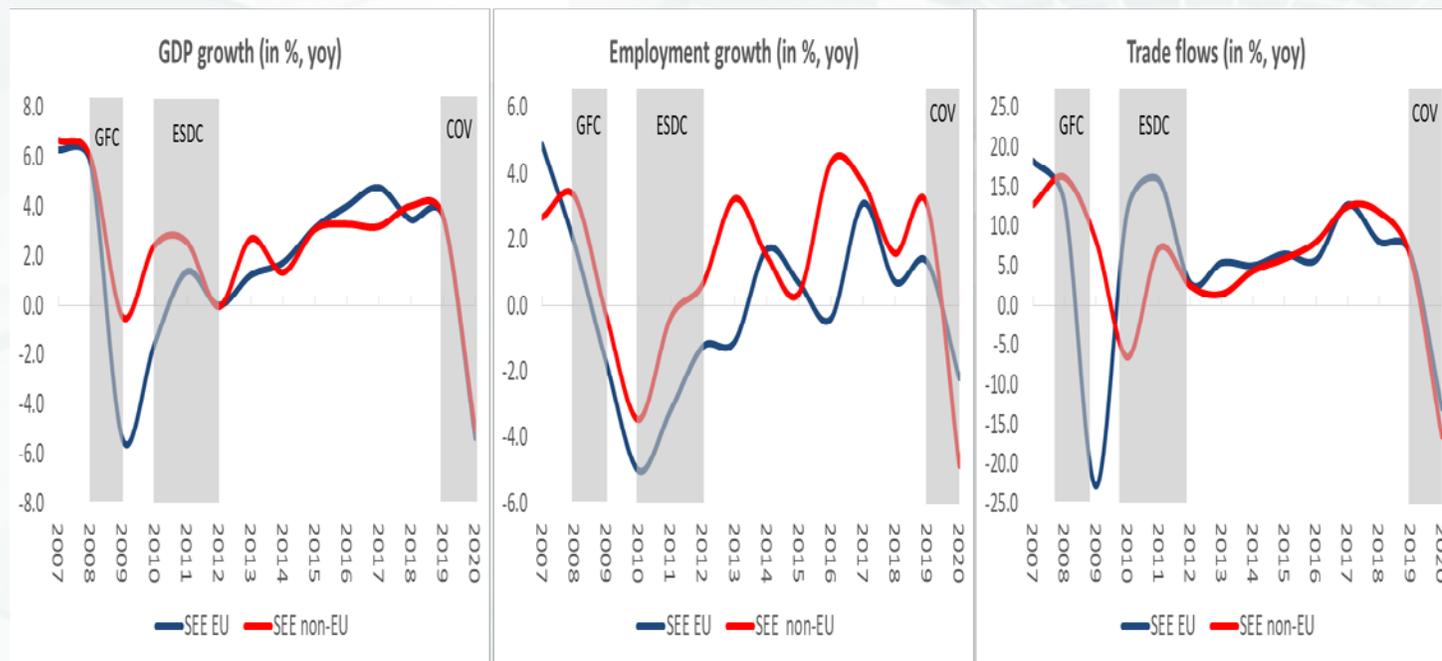
October 2021

Content

1. **SEE in a decade of crises**
2. **Pandemic impact and outlook in Albania**
3. **Structural Reforms**
4. **Policy Response**
5. **External policy coordination**
6. **Conclusions**

1.1 – SEE in a decade of crises

The SEE suffered three major crises over the past 15 years...



Source: EUROSTAT, National Statistical Institutes,

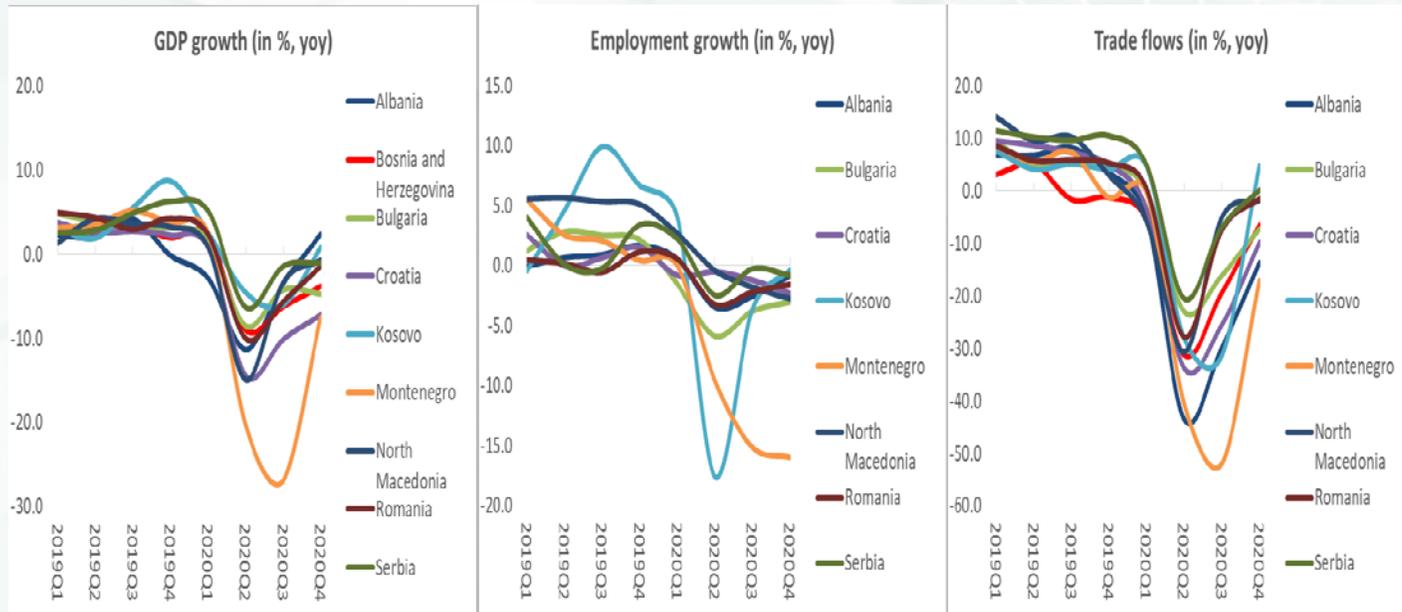
Notes: SEE EU: Bulgaria, Croatia, Romania; SEE non-EU: Albania, Bosnia Herzegovina, Kosovo, Montenegro, North Macedonia, Serbia.

- The Global Financial Crisis (2008-2009) exposed the limits of the domestic demand driven, debt-fueled, growth model. It resulted in high NPLs, high public debt and high financial volatility.
- The European Sovereign Debt Crisis (2010-2012) yielded a second round of deleverage across the SEE, causing additional losses in GDP and employment.
- The COVID-19 pandemic was, probably, the most severe crisis we have faced. However, the post-crisis SEE prospects appear to better...

1.2 – The Covid-19 crisis in the SEE region

The pandemic was a public health as well as an economic & financial crisis

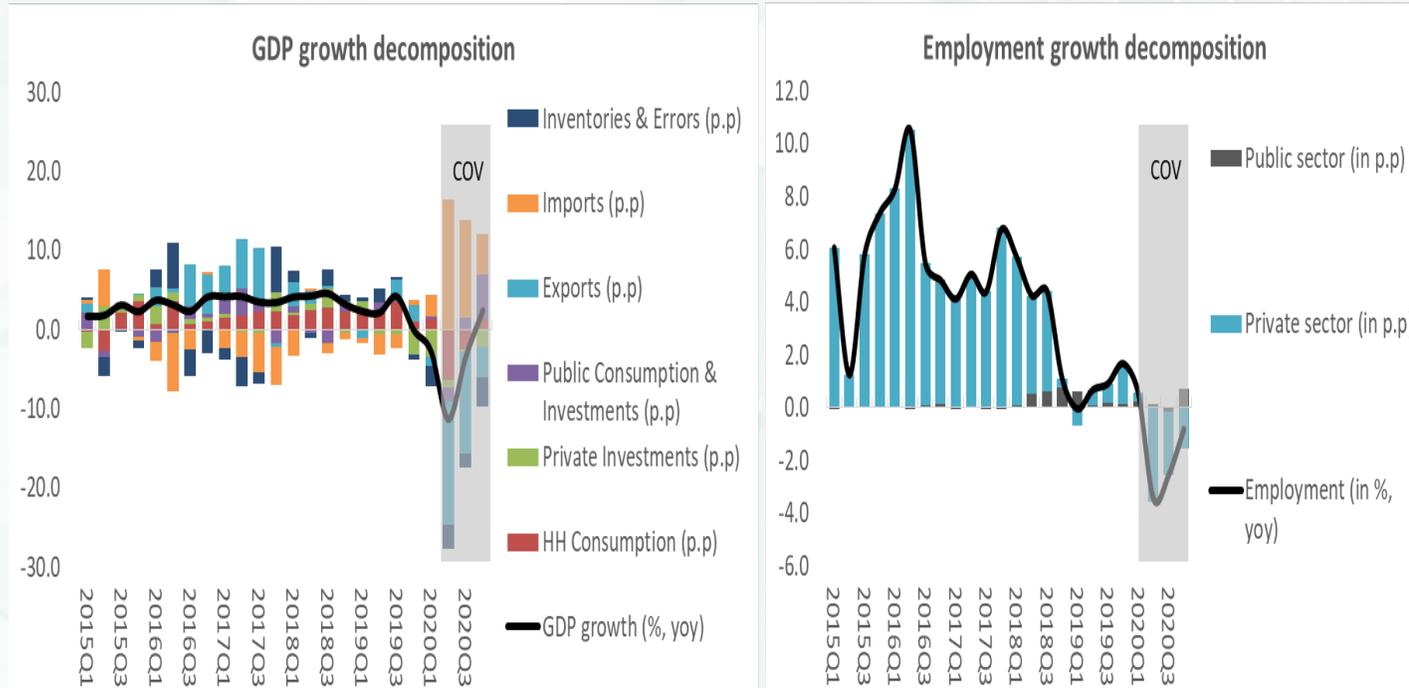
- The Covid-19 pandemic caught policymakers everywhere by surprise
- The pandemic induced high uncertainty and forced governments to impose severe lockdown measures
- From an economic point of view, it was a simultaneous demand and supply crisis
- It resulted in an abrupt drop in demand and production, causing severe financial stress amongst businesses and families



Source: EUROSTAT, national statistical institutes

2.1 – Covid-19 crisis impact in Albania

Albania’s experience with the pandemic was typical for the SEE region

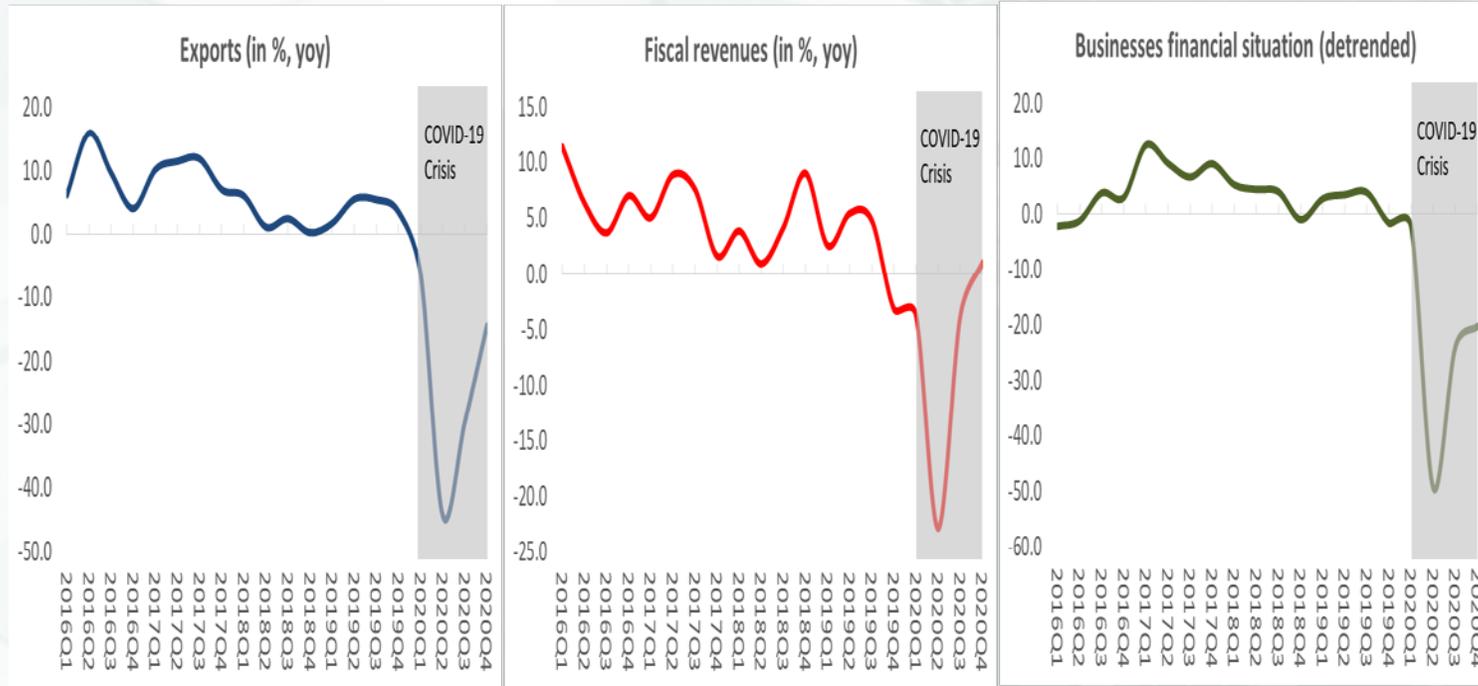


Source: INSTAT, Bank of Albania.

- In Albania, the pandemic induced a broad-based slump in GDP
- In particular, household consumption and the goods & services exports decreased abruptly
- In the presence of reduced demand and business turnover volumes, unemployment increased

2.1 – Covid-19 initial impact in Albania

The pandemic had immediate financial impact...



- The drop in sales and turnover resulted in deteriorated balance sheets across the economy
- In summary, the financial bill of the crisis had to be shared amongst the private, the financial and the public sector
- The primary challenge to policy makers was to find the appropriate solution to this equation

Source: Albanian Ministry of Finance, Bank of Albania.

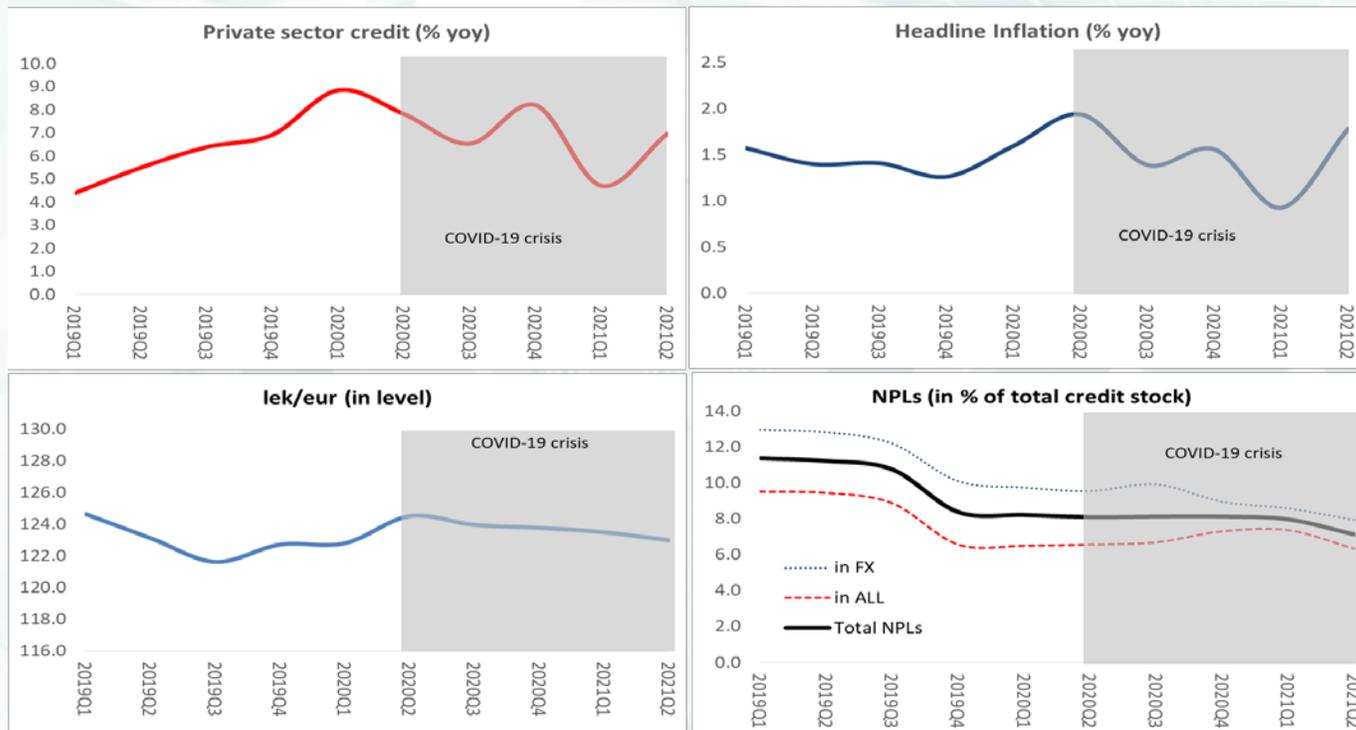
Notes: Financial position of businesses is a detrended series taken from business surveys conducted regularly by the BoA.

2.2 – Policy challenges

- How to deal with an unprecedented crisis, which originated outside the economic and financial system
- How to calibrate an effective policy response in order to:
 - Mitigate the short and avoid the negative long term impact in the economy (*avoid large scale business bankruptcies and minimize job layoffs*)
 - Preserve overall macroeconomic and financial stability
- How to deal with operational challenges of the pandemic

2.3 – Covid-19: interim results in Albania

Albania appears to have weathered reasonably well the crisis



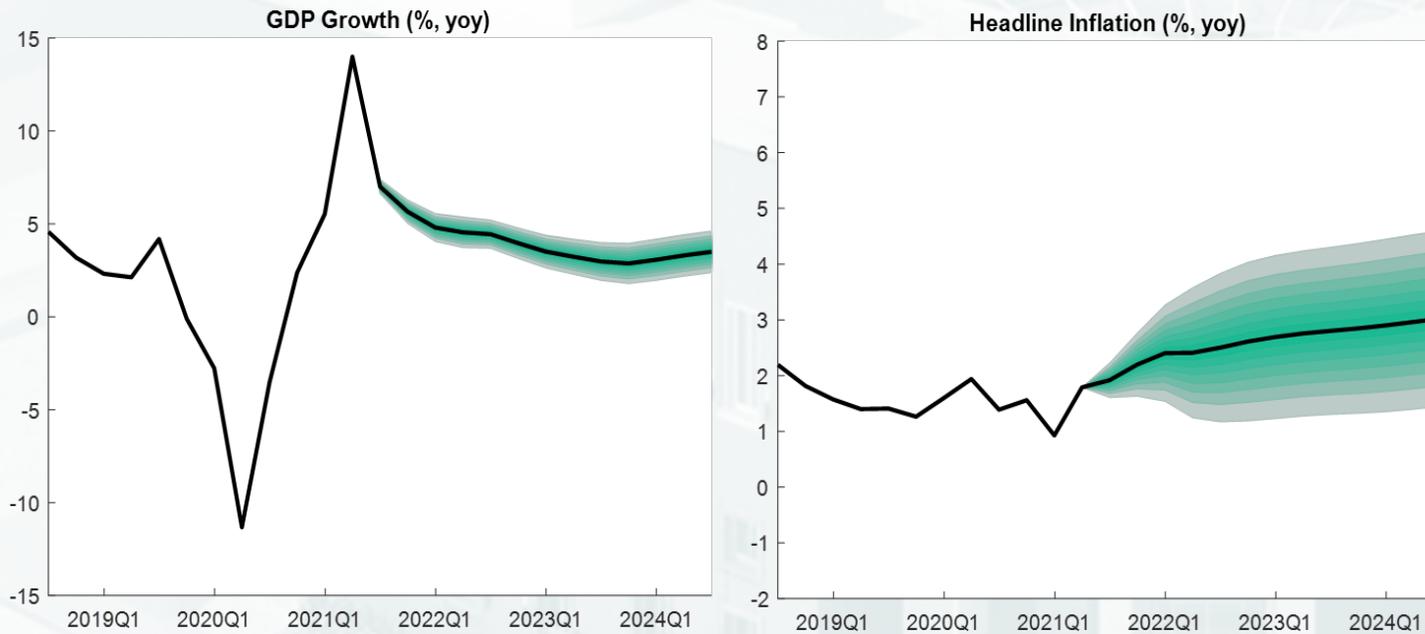
Source: Bank of Albania, INSTAT.

Despite the magnitude of the crisis, we have:

- Preserved monetary & financial stability, as evidenced by low inflation, stable exchange rate
- The timely policy response alleviated some of the burden to private sector, as evidenced by the positive NPL trajectory
- The resilient financial sector provided an uninterrupted flow of credit to the economy
- Overall, Albania managed to preserve macroeconomic stability and avoid large scale bankruptcies.

2.3 – Covid-19: interim results in Albania

Our future growth prospects remain positive, despite remaining challenges



Source: Bank of Albania.

The economic recovery appears to be solid, underpinned by:

- A stable monetary and financial environment
- Relatively low scars to the private sector, with low bankruptcies and solid balance sheets
- A broad-based recovery in aggregate demand

However, challenges remain:

- The recent spike in commodity crisis raises the prospect of pro-cyclical policy tightening
- The public and private sector balance sheets need to be fully recovered
- The long term impact of the pandemic is uncertain

2.4 – How did we succeed

- **Comprehensive structural reforms**
 - Reduced vulnerabilities
 - Increased resilience
 - Expanded policy space
- **Effective local policy response**
 - Timely and forceful
 - Comprehensive and coordinated
- **Coordinated global policy response**
 - Avoided negative externalities / spillovers
 - Provided funds and insurance to the SEE region

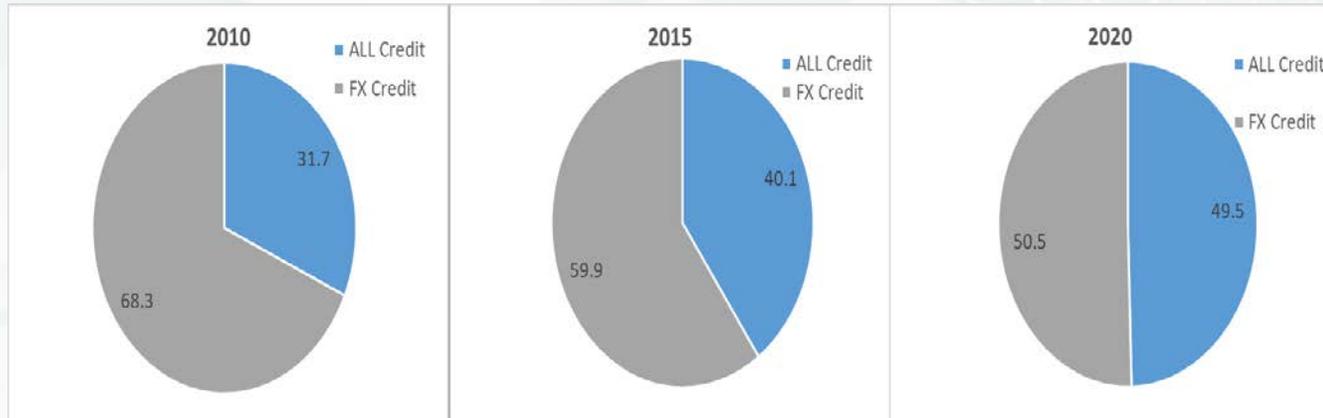
3.1 – Structural Vulnerabilities

GFC and then ESDC exposed inherent structural vulnerabilities, which limited the scope of our policy response and policy space

- **High euroisation** impaired the transmission mechanism and hampered financial stability
- **Weak credit environment and market bottlenecks** impeded credit growth and made it less responsive to economic conditions
- **Banking sector concentration**: an efficiency vs stability dilemma
- **Financial sector regulation and supervision** was crucial for avoiding financial imbalances/risks
- **Better institutional coordination** of economic and financial policies

3.2 – De-euroisation Strategy

De-euroisation strategy



Source: Bank of Albania.

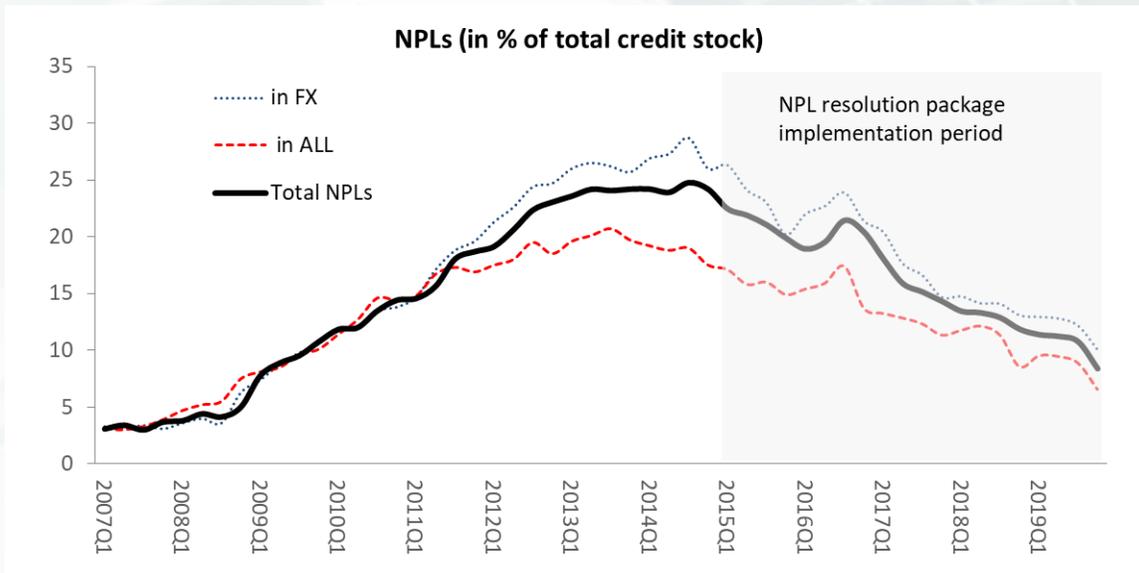
Albania adopted a comprehensive de-euroisation strategy:

- It aimed to promote financial stability and increase the effectiveness of monetary policy
- It did not aim to avoid the usage of euro altogether, but to reduce risks and promote efficiency across the economy
- It involved various stakeholders, such as the BoA, the MoFE and the AFSA

Within its domain, the BoA:

- Introduced differentiated reserve requirements for Lek and FX-denominated deposits
- Increased transparency requirement for FX lending
- Took corrective action to reduce lending to un-hedged borrowers

3.3 – Improving the credit environment



Source: Bank of Albania.

High NPLs undermine the capitalization of the banking sector, reduce its financial intermediation and impose higher credit risk on performing clients

High NPLs in the past indicative of an inefficient legal and regulatory environment

A comprehensive NPL resolution strategy aimed at:

- **Improving the legal environment** (revised Law on Bankruptcy and restructured the functioning of private bailiffs)
- **Improving the regulatory environment** (tighter credit underwriting standards imposed on banks, strengthened internal risk requirements, introduced regulation for out of court settlement)
- **Improving the credit support infrastructure** (upgraded Credit Registry)

3.4 – Banking sector consolidation

	2010	2018	2020
Banks	16	14	12
EU Banks	10	7	6
non-EU Banks	2	4	2
Domestic Banks	4	3	4

Source: Bank of Albania.

Tighter EU banking sector regulation induced a rapid deleverage process of EU headquartered banks.

The BoA research indicated the scope for a more consolidated banking sector, as the increased stability of the sector outweighed its potentially higher efficiency.

The BoA carefully managed the challenging process of bank ownership changes and mergers and acquisitions.

Currently, our banking sector has a greater share of local capital and more committed long-term owners.

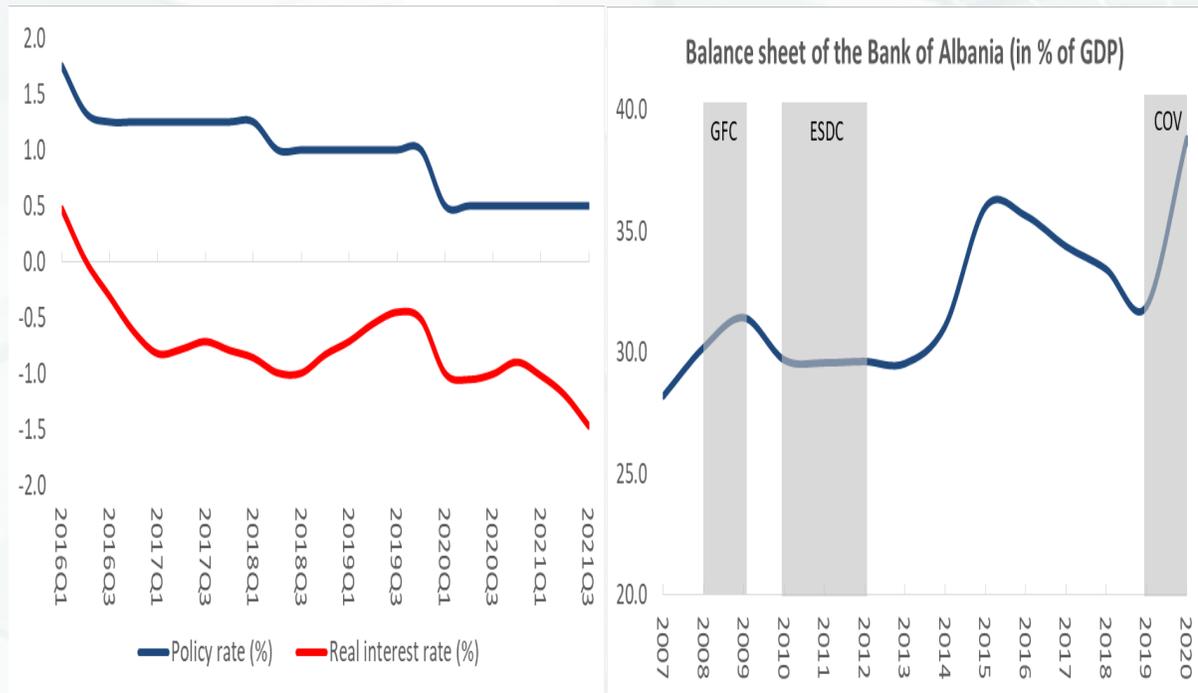
3.5 – Financial sector regulation and supervision

The internal financial sector regulation and supervision was considerably strengthened, through:

- The establishment of the Financial Stability Group, as an overall macro-prudential policy coordinator
- The adoption of risk based supervision and acceleration of efforts to implement Basel II/III standards across the banking sector
- Aligning the bank regulatory framework to ESCB standards, in order to reduce differences in risk considerations between home-host countries and increase international cooperation
- The adoption of a Bank Resolution Law and Bank Resolution fund, with BoA tasked as the bank resolution authority
- The adoption of a new Law on Albanian Financial Service Authority, greatly increasing its scope, instruments and independence
- The upgrade of the Deposit Insurance Agency, with the establishment of EBRD credit lines improving its liquidity position

4.1 – Monetary policy

Countercyclical monetary policy



The BoA made full use of available space for monetary accommodation:

- We lowered the policy rate to an all-time-low of 0.5%
- We adopted the strategy of quantitatively unrestricted injections of liquidity
- We engaged in transparent forward guidance, emphasizing our commitment to provide the necessary support to the economy

The BoA did not engage in unconventional monetary policy instruments (such as QE), though we made contingency planning on their depl

Source: Bank of Albania.

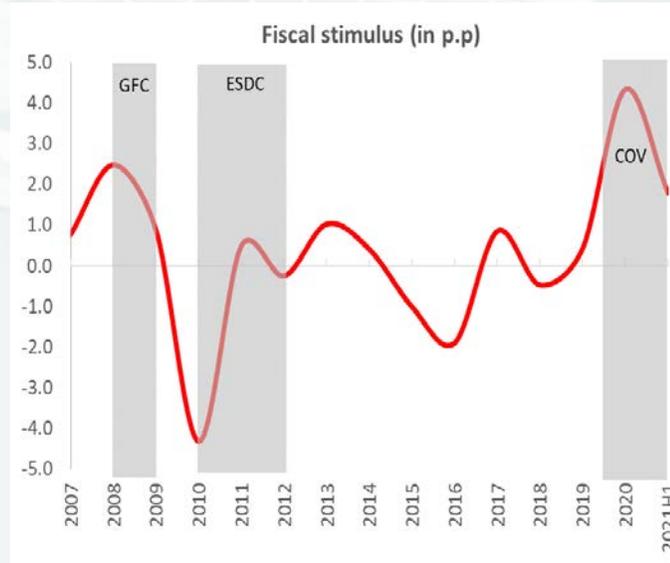
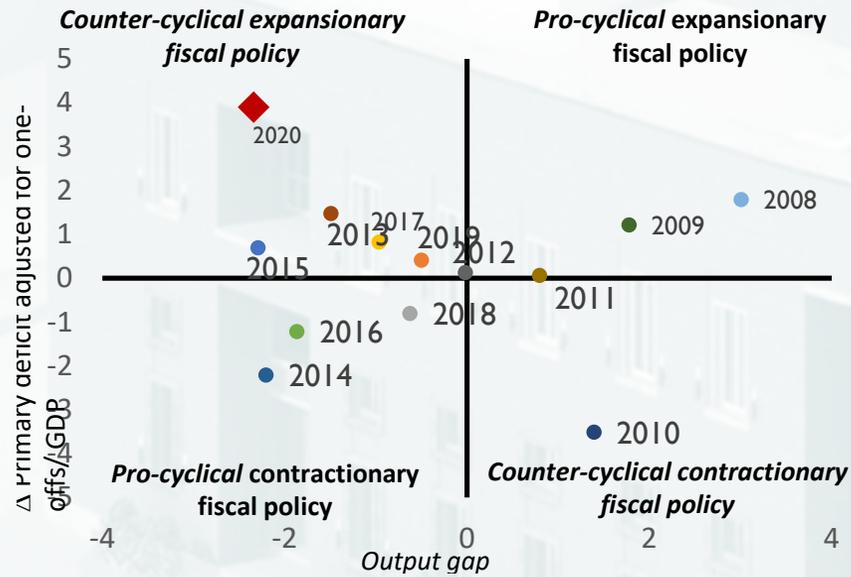
4.2 – Macropprudential policies

Targeted and provisional macropprudential easing, aimed at:

- **Improving the flow of credit to viable businesses facing temporary difficulties:**
 - The BoA introduced a short-term moratorium on credit instalments, benefiting about 50% of the total business portfolio and 15% of households
 - The BoA applied regulatory encouragement for targeted credit restructuring.
- **Insuring the health of the banking sector in order to boost banks' capital and to support lending:**
 - The BoA suspended the distribution of dividends
- **Encouraging the use of electronic payment platforms:**
 - The BoA forfeited any charges on using our electronic settlement clearing and settlement systems.

4.3 – Fiscal policy

Fiscal policy engaged in countercyclical stimulus



Countercyclical fiscal policy through: direct transfers:

- employment support schemes
- targeted tax reliefs and fiscal transfers amounting to about 1% of GDP
- credit guarantee schemes at 1.7% of GDP.

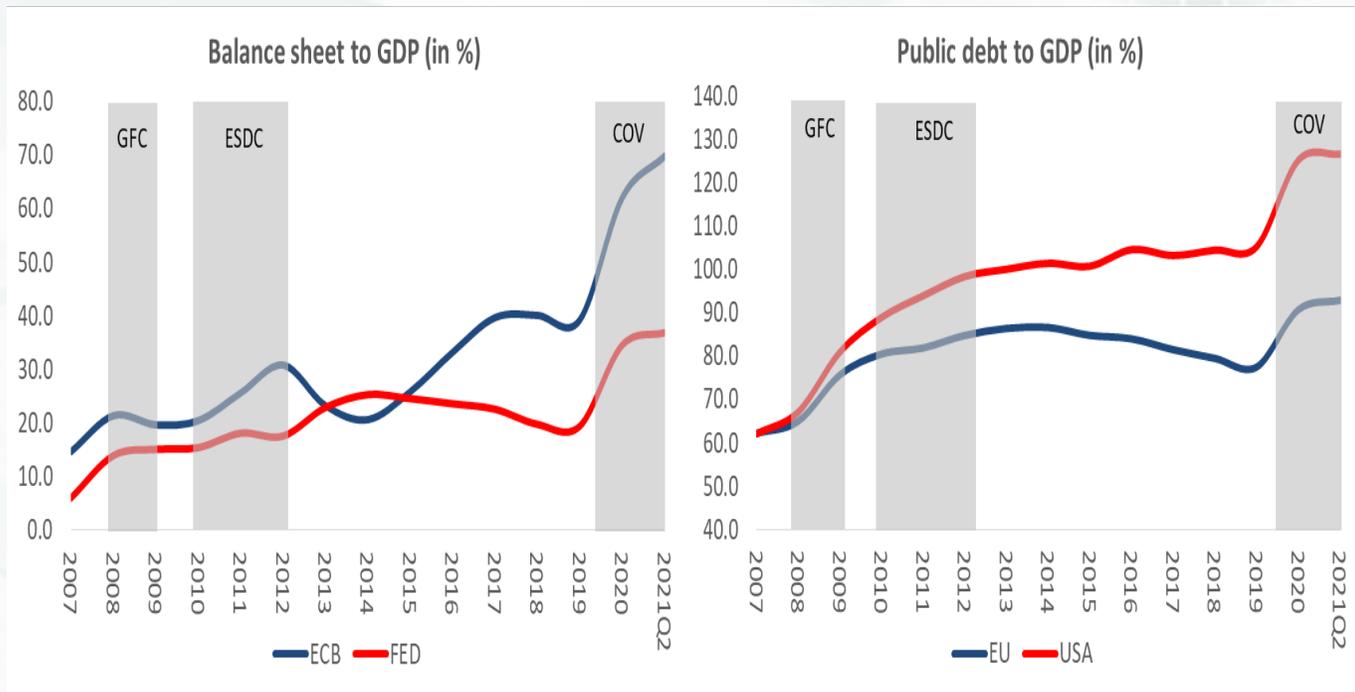
The overall fiscal stimulus amounted to about 3.5% of GDP.

Source: Albanian Ministry of Finance, Bank of Albania.

Note: Fiscal stimulus calculated as an annual change of the cyclically adjusted primary balance

5.1 – The role of central banks and governments

The overall global policy environment was accommodative



The coordinated and strong global policy response:

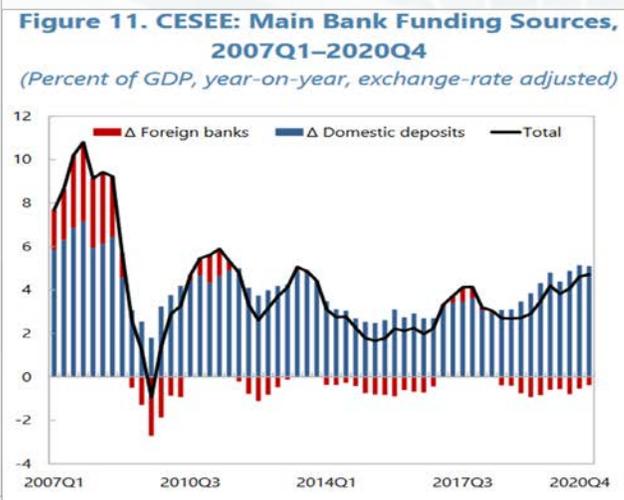
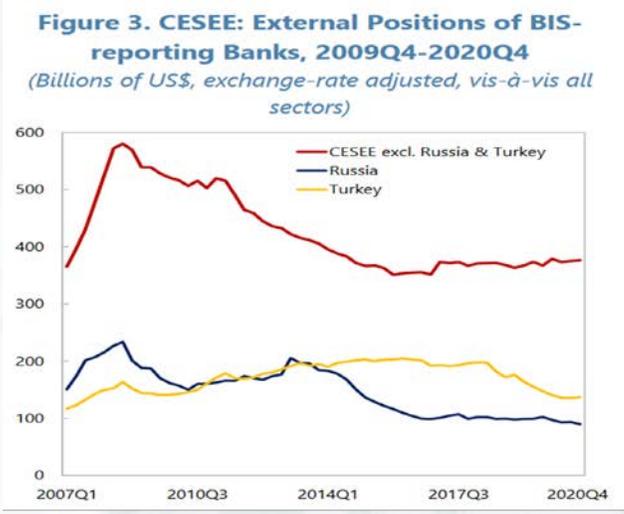
- Sheltered the drop in global aggregate demand
- Avoided liquidity crunch in global financial markets
- Facilitated market access for SEE countries and

Source: Federal Reserve Economic Data , EUROSTAT, European Central Bank, Federal Reserve.

5.2 – The role of banking system regulators

A more coordinated policy response amongst bank regulators

Improved international coordination helped avoid a banking sector deleverage, as experienced during the GFC and ESDC.



Source: Vienna Initiative, CESEE Deleveraging and Credit Monitor, June 2021

The Vienna Initiative has been instrumental in controlling financial outflows from the banking sector

5.3 – The role of International Bodies

The IB have delivered timely policy advice and essential funding to the region

- Immediate and upfront financial support from IFIs and EU institutions to help contain hike in risk premia and support financing the fiscal stimulus.
- Support instruments included:
 - An IMF's Rapid Financing Instrument
 - A European Commission's macro-financial assistance (MFA) package to ten enlargement and neighborhood partners
 - A repo line arrangement set up by the ECB with the Bank of Albania to provide euro liquidity

6.1 – Lessons learned

- **Crises cannot entirely be avoided or foreseen**
- **Hence, we always need to be prepared:**
 - **Structural reforms should continue in order to mitigate potential vulnerabilities**
 - **Policy space has to be preserved / rebuilt**
 - **External policy coordination is crucial to avoid negative spillovers**
- **If or when the crisis come, policy response needs to be timely and comprehensive**

6.2 – Remaining challenges

- Dealing with the recent supply-side shock of global commodity prices
- Navigating the policy normalization conundrum
- Assessing potential structural impacts on the economy



Thank You!