Bank of Albania

A BRAVE NEW WORLD? THE FUTURE OF BANKING IN EMERGING EUROPE

RETHINKING SIZE, STRUCTURE, OWNERSHIP, POLICIES AND INCENTIVES

Conference co-organized by the Bank of Albania and the London School of Economics and Political Science (LSE)
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Responsibility for the information and views set out in these presentations lies entirely with the authors.

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FOREWORD BY THE GOVERNOR

It is a great pleasure for me to present the proceedings of the Bank of Albania's Annual Conference of 2019, which we jointly organized with the Institute of Global Affairs of the London School of Economics and Political Science (LSE) for the second year.

The conference took place a year ago in October 2019 in Tirana – it feels like a different era, before the COVID pandemic hit.

Yet the focus of our conference titled "A Brave New World: The Future of Banking in Emerging Europe" captured many trends that subsequently became amplified during the COVID pandemic. We discussed significant ownership changes in the banking sector. We explored the role the non-bank sector can play in supporting financial sector transformation and economic development. We heard of "revolutionary" changes brought about by digitalisation. We considered challenges in the strategic development of financial markets in the small open economies of the Western Balkan countries. And what have become a tradition of our annual conference, we benefitted from the unique insights of current and former central bank governors at our "Governor's Panel".

The conference brought together well-known academics, distinguished central bankers, policy makers and practitioners. I am grateful for the experts who came to Tirana from abroad and also for our own specialists in the Bank of Albania and other institutions for the high ability contributions, to which this book is a testament.

Central banks are now fighting shoulder to shoulder with governments to address the ongoing pandemic. We take pride in the resilience and innovativeness of our institutions and societies to overcome hitherto unprecedented challenges. Deliberations engaging with academics and policy makers at gatherings such as the Bank of Albania's Annual Conference help us to design the best policy options to crisis management and to shape a better future in a post-COVID world.

Governor Gent Sejko
Tirana, October 2020

Family Picture of the conference

WELCOME AND GREETING SPEECHES

WELCOME ADDRESS

*Gent Sejko**

Your Excellency Mr President,
Honourable Madam Minister and Chairman of the Parliamentary Committee,
Dear representatives of the banking system, ladies and gentlemen, dear guests,

It gives me great pleasure to welcome you on behalf of the Bank of Albania to our Annual Conference. This year the conference is co-organised again with the London School of Economics and Political Science (LSE), namely its Institute of Global Affairs - internationally renowned for its leading expertise across the social sciences.

The Conference this year will seek to address the latest trends in the banking industry in Albania, in the region and the rest of the world, focusing on challenges and opportunities that lie ahead of us.

Naturally, these issues are of great interest not only to actors in the banking market but also to central banks and other regulators of the financial market. As we share experiences and engage in open discussions, we will be able to identify far-reaching approaches that are best fitted to meet the challenges ahead. We have invited distinguished speakers and experts from renowned international institutions as well as other actors and regulators from Albania and the region.

* *Gent Sejko, Governor of the Bank of Albania*

I am confident the conference will live up to its reputation.

Dear Ladies and Gentlemen,

The financial system and the banking sector at the heart of it play a unique role for economic development and welfare in Albania.

This system provides payment instruments, contributing to the free circulation of products and services. It also offers savings and credit instruments for households and enterprises, promoting therefore development and enhancing welfare. The financial system helps households, enterprises and the economy to withstand shocks, by undertaking risks on its balance sheets and offering products to insure life, business activities and against natural disasters.

Therefore, the efficiency, stability and sophistication of the financial system are essential preconditions for rapid, stable and comprehensive growth. The development level of an economy is inter-related and inter-dependent on the development level of its financial system. This has been extensively illustrated by the Albanian experience over the last three decades.

The progress marked in the first decade of transition was conditioned by, among other things, embryonic developments in the banking and financial sectors. In the second decade, the activity of the banking sector expanded and competitiveness in this sector increased, setting the stage for crediting and economic growth to gather speed. This performance was disrupted by the global financial crisis effects spilled over to Albanian economy. However, unlike in many countries of the region, the crisis did not trigger recession or a proper financial crisis in Albania. Yet, indirect effects were present both in the economy and in the financial system.

As a monetary, supervisory and regulatory authority of the banking sector, in recent years, the Bank of Albania has focused on addressing challenges introduced by the crisis.

Let me present a brief overview.

First, due to aggregate demand slowdown and exchange rate depreciation, the financial situation of households and enterprises worsened; hence non-performing loans rose rapidly and credit supply contracted. Among other things, the rise in non-performing loans pointed to the need for comprehensive improvement of the legal and regulatory environment, especially with regard to the execution of collateral. Against this backdrop, in cooperation with other public agencies, the Bank of Albania compiled and implemented a detailed programme of measures, which addressed thoroughly the identified inadequacies. As a result, the level of non-performing loans dropped rapidly and credit supply improved. This action also created adequate conditions for its growth to gradually pick up the pace.

Second, following the introduction of stricter regulatory requirements on banking activity in the European Union, foreign banks reduced their exposure to both regional economies and Albania. Known also as deleveraging, this effect showed that higher integration of the banking sector exposes us to monetary policies and regulatory requirements applied in home countries. In response, the Bank of Albania has worked towards aligning our domestic supervisory and regulatory framework with European Union standards. We have implemented, in this regard, a new macro-prudential strategy, after the model of the European System of Central Banks. We have also carried out a comprehensive review of the supervisory and regulatory frameworks, to better address the risks to the banking sector: operational risk, market risk, credit risk and liquidity risk. Finally, we have actively participated in an international forum for addressing this phenomenon, known as the Vienna Initiative, and have enhanced our communication with international partners and home-country regulatory agencies.

Third, we have spent a lot of time and energy administering a consolidation process in the banking sector. As a result of this process, which may now be considered as finalised, the number of banks has now been reduced to 12. This has created the premises for the banking sector to be more motivated to lend, innovative in terms of products, and more competitive in terms of cost.

From a broader perspective, the Bank of Albania has worked on improving the regulatory architecture of the financial system in Albania and strengthening financial safety nets. Together with other public agencies, we have, established the Financial Stability Advisory Group; improved the legal framework for the functioning of the Deposit Insurance Agency; approved the Resolution Law; drafted a sub-legal and regulatory framework; and, established the necessary structures for them to function.

In parallel, we have adopted a modern framework for formulating and implementing the monetary policy, and steadily maintained an accommodative stance. Monetary stimulus has enabled the financial environment in Albania to be transparent, and have low interest rates, ample liquidity and moderate exchange rate fluctuations. This has boosted consumption and private investments, reduced credit price, and eased debt servicing costs for all segments of the economy. Reflecting these actions, the Albanian economy has made notable progress towards steady and long-term growth. The progress has been characterised by gradual acceleration of the pace of growth, expansion of employment and decline in unemployment, as well as improvement of private sector balance sheets. In particular, the banking sector appears liquid, well capitalised, with good profitability indicators. Regulatory capital hovers around 18%, notably above the minimum requirement, whereas the ratio of non-performing loans has dropped to 11% against the 25% maximum level recorded in 2014.

Dear ladies and gentlemen,

The ultimate objective of our work has been and remains promoting sustainable development for the country. The philosophy of our work is built on four main pillars: professionalism, responsibility, accountability, and transparency.

This philosophy has been tested and enriched with some valuable lessons learned during the last decade:

- First, monetary, supervisory and regulatory authorities should adopt a proactive approach to the country's monetary and financial stability. This requires adequate institutional capacities and adopting a counter-cyclical approach, both toward monetary policy and macro-prudential policy. It also requires constantly identifying current and potential challenges in order to address them in due time.

- Second, long-term economic growth should be anchored in continuous structural reforms. Public authorities may find it virtually impossible to predict or avoid shocks completely; however, both public authorities and the private sector may minimise the effects of these shocks through structural reforms aimed at creating productive and flexible structures, and preserving balance sheet stability. Public authorities and the private sector should be aware of the fact that long-term benefits from reforms exceed their short-term costs.
- Third, financial integration provides an additional channel of exposures to foreign shocks, whether in the form of global financial crisis or volatility in the regulatory framework. Overall, financial integration has been and remains a positive factor for development. In the case of Albania, it brings in financial capital and managerial know-how, with a series of positive effects on the Albanian economy, spearheading the economic and political integration of the country. Yet, integration requires fostering cooperation and exchanging information with our international partners and counterpart institutions.
- Lastly, the monetary and financial stability of the country should not be seen as an exclusive responsibility of the central bank, notwithstanding its primary role in it. It requires the contribution and cooperation of all state authorities.

Dear ladies and gentlemen,

The Albanian economy has solid premises for continuing and even accelerating the pace of growth. Strengthened financial stability, coupled with prudent monetary policies, offers additional guarantees for its sustainability.

However, let me point out that many challenges lie ahead of us.

From a broader perspective, the financial industry, both in our region and globally, is under pressure from four powerful currents:

- Rapid development of information technology, which has created opportunities for financial innovation and has challenged classical banking models. New payment and credit instruments, new financial market actors, and new business models, such as digital and electronic banking and payments, boost the penetration of financial services. Conversely, they challenge not only classical actors of the financial sector but also its regulators.
- Globalisation, which has expanded the scope of market actors and regulators. This phenomenon significantly exposes emerging economies to volatility in the regulatory framework or in the risk appetite in advanced economies.
- Re-regulation, currently underway in the financial system in Europe and globally. This process is aimed at enhancing security in the banking sector, lowering the probability of systemic crisis, and enhancing the capacities of authorities for managing them. However, it imposes additional costs on the banking sector and places it under less favourable conditions vis-à-vis other market participants.
- Very low interest rates that characterise many segments of the global financial market. These rates reflect the accommodative monetary policy stance adopted by major central banks, the decline in global productivity and unfavourable demographic developments in advanced economies. These have a toll on the balance sheets of broader segments of the financial market such as banking sector, pension funds and insurance companies.

From a nearer-term perspective, Albania needs to improve financial literacy, across the board. Among other things, financial education would help both individuals and firms establish sounder financial situations and reduce financial risks such as unnecessary exposure to exchange rate volatility. The Bank of Albania has been on the vanguard of financial education in Albania and will continue to spearhead such efforts.

Albania needs also to develop further payment systems and improve access to finance for various segments of the society, such as small and medium-sized enterprises or the rural sector. The Bank of Albania has responsibly exercised its duties in the area of payment system development. In this regard, we:

- Established, in 2015, the National Payments System Committee, to coordinate the work of all relevant public and private sector agencies;
- Compiled the draft law "On payments services", which approximates the respective EU directive and paves the way for developing new payment products; and,
- Improved the technological infrastructure for payments, reducing therefore their costs.

However, our work may not be considered as completely finished.

Lastly, Albania should pay attention to the development of new financial market segments, such as capital markets and pension and investment funds. In this context, alignment of the legal and regulatory framework is of primary importance with a view to preventing the potential emergence of systemic risks or the possibility of regulatory arbitrage.

Dear ladies and gentlemen,

Our agenda for the work that lies ahead of us is as complex as ambitious. Its successful realisation will enable our economy to grow at a fast and steady pace, and will mark a step forward in our journey towards EU integration.

On behalf of the Bank of Albania, let me affirm our readiness to rise to the challenge. I am also confident that today's conference will provide a significant contribution to finding optimal solutions.

Hoping that you will find the Conference and your stay in Tirana both valuable and enjoyable, I wish the conference a great success! Thank you for your attention!

WELCOME ADDRESS

*Erik BERGLOF**

Good morning,

It is great to be back in Tirana. I have had the pleasure of being involved in Albania for quite a few years now.

Of course, we are very honoured to have His Excellency President Meta here, and also the current and the former Ministers of Finance and Economy.

We are excited for this collaboration with the Bank of Albania. For me personally, it has become an opportunity to, once a year, come here in Tirana and keep up my interest in Albania. It is also an opportunity to meet international friends and in such a wonderful setting.

The fact that I want to come here once a year does not mean that I do not think of Albania in-between. Watching Albania over the last year or so, you get worried about politics here and I think that this is something normal for someone who has tried to report and support the very major changes that have happened here in the last decade. The process of the EU accession is so critical and I very much hope

** Erik BERGLOF, Director, LSE Institute of Global Affairs.*

that we can get through this politically difficult times. There is so much potential in this country.

When discussing the topic for this Conference, we wanted to find a topic that was different from previous years. Last year, it was very much about global issues and about thinking from the perspective of Albania, in terms of these global issues. This year we wanted to really try to have a topic that is very much affecting what is going on locally and where there are policy options for Albania. Having been involved in the process of reinforcing the banking system during the financial crisis – and also remembering the role the Albanian central bank at the time played in supporting Vienna Initiative which tried to manage the impact of the global financial crisis on the banking systems of Emerging Europe – and I was involved to in this Initiative- I think, quite successful effort, it is of course, worrying to watch foreign banks leaving the region. We did so much to keep them engaged during the crisis and even though we knew it would happen to some extent, watching them leaving has been painful. It is very good therefore to see that the situation has stabilised and there is now time for reflection, to think about what has happened – and about the future.

The retreat of the foreign banks is not something that has happened only to Albania, or the Western Balkans. It is something that has happened to all Eastern Europe and actually it is a global trend. But, in many respects, Eastern Europe was ahead of the rest of the world in terms of integration of the banking system across borders.

We have learned some things from this experience, and we are trying now to see what the future of cross-border banking looks like. We know that you can have foreign banks operating in countries without really having any role in capital flows. We have Latin America where foreign banks are very important, but basically all that they do is to help intermediate domestic savings. Of course, that is a very important role and we shouldn't at all minimize this – foreign banks have played a major role in modernizing the banking systems in Latin America as they have in Central and Eastern Europe and in the Western Balkan as well.

One the other hand, one issue that we should think about during today is whether there is also some role that banks can play in making sure that there are safe and steady capital flows, less volatile than what happens in the financial markets, when capitals flows are not intermediated by banks, and particularly not in the way that banks have intermediated in Central Eastern Europe. We know that in the global crisis we complained about the withdrawal of funds by banks. But every other form of capital flow was much more volatile and withdrew much more quickly.

It is a fact that we now have professional banks operating all over the region. We may want to see how they could also play a role in securing investments into Albania and in the rest of the Western Balkans. We want capital to flow into the region for higher growth in the future. Of course, we also want to use domestic savings, but it is important to reflect on what role can banks play in making sure that we get steady flows of capitals. After all we need that banks be critical to financing economic growth for the foreseeable future in Albania. They will also play an important role in building the financial system that will support Albania's transition to a high-income economy.

Those are, I think, some of the issues that we want to talk about and I am very much looking forward to today's proceedings.

Thank you!

GREETING SPEECH

*Arben Ahmetaj**

Your Excellency Mr President,
Honourable Governor,
Honourable Minister,
Dear Erik,
Dear guests,

It is always a pleasure to address the Annual Conference of the Bank of Albania, which I believe is one of the most important economic and financial conferences in Albania.

We have come together to discuss in this format several times and, certainly deliberately so, and for a moment I was looking back at the discussions we had last year.

We were discussing then about how Albania had overcome the risk of a Greek scenario for the economy. Through a very careful work in favour of fiscal consolidation, which the Governor also referred to in his speech, we set the premises for a sustainable economic growth at 4%, driven by consumption and investments, and accompanied by a serious increase of employment.

* *Arben Ahmetaj, Chair of the Committee of Economy and Finance, Parliament of Albania.*

We were discussing at that time about how, you as the banking sector, would have to respond to the accelerated economic growth or to the call of the Government for further commitment in increasing lending and participating in substantial investments.

We also discussed about how for an economy like ours -and the regional economies as well - the line dividing success and failure remains extremely thin and threatening, in the absence of guarantees for continuing reforms.

Now, one year later, we may have another reflection, but in my view, the challenges are still the same and, again in my view, they have become even more threatening.

Albania's economy has accelerated its growth pace in the last five years. However, in the first half of 2019, it was around 2.3%, relatively low compared with our expectations and expectations of international institutions as well. I would like to prompt the debate a bit in this conference. I believe, the experts here will also dwell on these issues, consider the underlying factors of an underperforming economy and draw lessons for managers and decision-makers, whether in government or in legislative bodies, in order to expand and speed up the reform agenda.

Unemployment trended downwards in 2019 as well, reaching its historic low level at 11.5% and participation in the labour force remains the highest in the region. On the other hand, again to spur the debate, we need to evaluate or better still re-evaluate, if we have managed to do the right thing regarding capacity development and productivity growth.

Here, there is another though-provoking questions: practically factor productivity in Albania remains the lowest in the region. Is this the reason why exports slowed down this year, compared with the last year and previous years? If we refer to 2014, practically exports reached even double digits. These are questions that this auditorium and this audience may assimilate and draw lessons for all of us decision and policy-makers.

I am glad that in the financial aspect, a series of measures undertaken in the last years have produced tangible results in the economy, like the reduction of non-performing loans (NPLs). In my analysis of the causes that brought NPLs levels down, I noted loan repayment, which includes also the execution of collaterals. When we first started the reform of the financial system we also referred directly to the reasons why all these phenomena were happening, including the increase of NPLs. One of the experienced foreign bankers here in Albania, always mentioned the justice reform. I believe a debate that we will have to open during the day, but also in the future, should be on how the financial system reforms - in cooperation with the IMF, the World Bank and the Bank of Albania - have worked and draw conclusions from that. The reason why we must draw conclusions, and I believe we should turn this into a tradition– at least in the economic aspect because in the political aspect I am not as senior as other representatives in this hall, like the President of the Republic is that we will have to look back and come to understand where we have made mistakes. We have not turned this into a tradition yet. Building a tradition would force us to look back to the history, see why NPLs happened, why we lost fiscal consolidation, what fiscal measures we took to accelerate growth and whether they worked, so as not make the same mistake two, three or four times.

Then all of us, without exception, don't tell me no, need to learn that high debt is bad. High debt is bad. In discussions around tables, outside this illustrious auditorium on financial and economic aspects, unfortunately the debate on "let us raise the debt level a little" continues.

The Prime Minister had and has pressures, I had pressures, I believe the Minister today also has pressures to increase the debt level, but decreasing the debt level would become again a necessity. As I have said earlier in other public avenues, not only a necessity, but a patriotic duty. To assimilate this, we need to be educated and well-educated even more about the harm debt causes to the economy, public finances and, above all, the citizens.

Of course, this is not only an Albanian debate. Today, governments, central banks and other stakeholders in every economy are "recalculating their accounts".

In one of its latest assessments, the IMF forecasted that in 2019, around 90% of the economies of the word will register lower economic growth rates, close to the lowest level of this decade.

In advanced economies, the US, Japan and the euro area, the dynamism of economic activity has diminished. In China, growth is gradually slowing down after the rapid growth it registered foralmost three decades.

On the other hand, the trade war between major economies politicians all around the world claim they are right - has raised serious questions that dominate trade approaches and policies, and affect the confidence and responses of markets and stakeholders.

The conclusion is clear. All come out losing in a trade war. The IMF calculates that, for the global economy, the cumulative effect of trade tensions may cause a loss at the order of USD 700 billion by 2020, or around 0.8% of global GDP.

The same picture seems to be coming up in our region as well, according to the World Bank, which recently has revised its year-start forecasts due to heightened uncertainties. Last year we talked about the mitigation of all risks.

Then how would we need to modify the reform agenda, how do we reformulate the priorities, redesign policies and coordinate the actions among all economic, financial and political stakeholders, to respond to the challenges of this decade for Albania, even for the countries of the region? Remember, there is a threat for us – and the countries of the region, but I am focusing on Albania – and that is the slowdown of population growth, which all policy makers and scientists or experts of the field will need to take it into account with regard to all the factors of growth: whether they accelerate it, slow it down or even eliminate it altogether, if you like.

In the meantime, I will focus on the economic growth debate. There is often talking about the energy sector and its impact on the Albanian economy. It is undoubtedly true. For us, the energy sector constitutes a significant part of economic growth, and we have to rely on energy, the weather, God. However, to stir the interest of and some degree of debate among the audience, I would like to share with you some figures. In 2011, the negative shock from energy was -1%. In 2017, the shock from energy was -1.3%. What does this mean? How come in 2011, despite the energy shock, real growth was 2.55% while in 2017, despite the highest energy shock of the last 10 years, growth hit 3.82%? This needs to be analysed. I would refrain myself from drawing any conclusions, but for the same shock, economic growth rates are different. There is one non-negotiable factor, reforms. In 2017, the entire full speed reform agenda shook up positively all economic fundamentals, which we have discussed continuously.

Here, I want to highlight those reforms in energy sector to need to continue, absolutely, in order to consolidate all that has been achieved in the last years.

This country, this economy, these institutions, this society do not have the luxury of halting the reform engines even for a second. We just do not have this luxury. Beyond political discussions on continued or discontinued reforms, the day economic reforms (then definitely in all other fields) stop, the premises, not simply for a slowdown but also for an economic pitfall are much more eminent.

Referring to a quote of the former Prime Minister of Greece, Tsipras - brilliant words in my view - on reforms: "Reforms for an economy are like riding the bicycle. You stop pedalling, and you fall".

I will refer again to a study of IMF on the importance of reforms. The implementation of structural reforms in public finances, external finances, trade, labour market and governance may increase the national output by around 7% in a six-year period and by 1 percentage point the annual rate of GDP per capita. The challenges in front of us, in front all those that govern, all those that formulate policies, all those members of the legislative bodies are to keep up with the reforms.

Proper reforms, at the right time, may double the convergence speed of developing economies with advanced economies. Citizens' dissatisfaction is lack of convergence, citizens' dissatisfaction in the entire region and the world has to do with what you see, but you don't have. You want to reach that and then you find other instruments to do it. However, true achievement is through economic convergence, hence reducing the gap, and that can be attained only through proper and synchronized reforms.

I believe that fiscal consolidation is very important. We may not relax and lay back. We need to achieve sustainable levels of debt. I am not referring to the fact that when we come to power it was 74% and now we are bringing it down to 65%, I am not referring to that, 65% is still too high for the Albanian economy.

The justice reform is crucial. No need to argue at all about that. It will change the course of justice, but it will also greatly help economic development. Surely, it will help social development and institutional developments, but above all economic development.

The formalisation of the economy may sound painful, but it is necessary. There is no redistribution without formalisation; we can discuss it as you want. Without formalisation, there is no sound redistribution, because a lot of the distribution happens in the "grey space" where fiscal, financial and monetary policies are deformed. They have no impact if informality is at such levels that it hampers their efficiency.

Investments in human capacity development in line with the global economic/technological developments are also very important. I am glad that the World Bank has also reiterated this in the last report, Erik here referred to it as a challenge. Without such investment we cannot raise productivity, we are not competitive, we cannot maintain sustainable growth rates. Without sustainable growth, we would see what we often see: volatility in consumption.

Some points, before I conclude, on the banking system. I have noted everywhere I have been in Albania or abroad that, overall, banking and financial communities are somewhat self- congratulatory (I refer to commercial banks, not central authorities). Outside round tables and meetings they even believe that, without them, development is impossible. This is true. Without you, there is no development. But, I would like to challenge you on two points.

In August 2012, credit to the economy amounted to ALL 552 billion; economic growth was somewhere above 1%. In August 2019, credit amounts to ALL 561 billion. Thus, in seven years, growth has been only ALL 8.7 billion (or 1.6%). This figures, I suppose do not render the banking system very proud out there. Meanwhile, the economic growth rates reached 4.06%.

In relation with the countries of the region, lending is flat. Credit to non-financial corporations in 2004 was 61%. In 2012, 15.5%. But why then in 2018 it was only 3%? What happened? Has there been a lack of reforms? No, because the EBRD (of which, Eric has been the Chief Economist), the World Bank and the IMF have assessed the period 2013-2018 as the best time regarding reforms. What is the reason? A thought-provoking question for you.

The other point is very interesting. I was looking at the figures on credit growth – I am not referring to assets – of banks with Albanian capital. These data are public, I am not revealing any secret, and it is interesting to see that banks with Albanian capital have increased lending considerably. Banks with foreign capital (I am referring to them since ownership is one of the elements of the topic and title of this Conference) have been "taking their time". My question for you is – no need for an answer today because I do not think this is the place and time – but do you think that banks with Albanian capital are less risk conscious? Banks with foreign capital are more sophisticated in calculating risk in Albania? Just a question, I do not know, but I will point out some figures.

Credit growth in the period 2015-2019, BKT: -16%. Credins: +19.5%. Raiffeisen: -28.9%. Intesa San Paolo: +1%.

If you like, I here are some figures on credit in the period 2010-2019. BKT: 78.7%. Credins: 195.5%. Raiffeisen: -7.4% and Intesa San Paolo: -9%.

But how is it possible? What happened? Now that NPLs are decreasing, that reforms are being implemented, now there is no lending?! Banks with Albanian capital are lending, banks with foreign capital are somewhat more sophisticated towards risk. I believe the most of you, who are bankers, will be able to teach us.

In conclusion, another thought-provoking idea regarding cryptocurrencies. I believe, it is time for the regulatory authority, legislators as well, to think seriously about them, Cryptocurrencies, as much as they can be a blessing, can also turn into a curse, particularly for economies and systems like ours. I believe that this should be put in the agenda of discussions among you, the government and the legislators.

Thank you for the invitation, and best wishes for a successful Conference!

GREETING SPEECH

*Anila Denaj**

Your Excellency President Meta,
Your Excellency Governor Sejko,
Your Excellency Chair of the Parliamentary Committee on Economy and Finance Ahmetaj,
Dear partners from the London School of Economics and Political Science (LSE),
Dear guests,

It is a particular pleasure for me to address the Annual Conference of the Bank of Albania, which attends to all the concerns raised regarding the roles of institutions and how they can join forces in order to bring prosperity to all. The role of the consolidated institutions in Albania remains an imperative for the successful implementation of government policies. Over the years, the Bank of Albania has shown adequate institutional stability and an appropriate approach towards the commitment for a sustainable and continuous economic growth, and I congratulate you for this.

Albania's economy has been transformed in recent decades, thus clearing the path for a market filled with potentials and opportunities not only in terms of natural resources, but also of human capital. The steady economic growth and consolidation of the macro-

* *Anila Denaj, Minister of Finance and Economy*

fiscal framework in recent years have contributed to reducing unemployment and attracting foreign investors.

Is this enough though? Certainly not. Economic growth requires our attention in terms of figures and structures and certainly in terms of reducing the impact of concentration on particular sectors, such as energy. In the first half of the year, it made almost 1 percentage point less contribution to growth. Nonetheless, we should focus on the structure of the impact on economic growth and, above all, on the economic potential Albania offers in several sectors, such as agriculture and tourism. It is, therefore, understandable that infrastructural developments assume importance. Bolstering the competitiveness of medium-sized firms in Albania is equally important, the formalization of the economy holds also similar importance, and access to finance for all the elements mentioned above are necessary to make this growth sustainable in the medium run.

The economic outlook remains positive, the average level of inflation stands at 2% and the monetary policy stance is accommodative, creating a financial environment characterized by low interest rates. Such conditions may boost lending, albeit at low rates, and I believe that the questions raised today will receive adequate answers.

Moreover, some of the positive indicators in the banking sector, notably those related to capital adequacy, which currently stands at 18.5%, or the decrease of non-performing loans at 11.2% are to be commended and praised. Bank of Albania's data show the annual growth rate moderately increased by 6.8% in the second quarter of the year and we look forward to seeing all such elements be further promoted.

The World Bank has welcomed the adoption of the Bankruptcy Law and Bank of Albania's role in the improvement of the regulatory framework. Together with the commitment of the MoFE, the issue of non-performing loans will be further resolved, in the hope of eliminating this persistent concern conclusively. Access to finance for small and medium-sized enterprises is an imperative requirement. The Albanian government is engaged in many ways to help such access to be productive and efficient through schemes that promote lending by supporting an important element, the collateral, which is very helpful during financial analysis and assessment of risks. However, we see that the effectiveness of many of such initiatives is yet to be analysed and assessed in the framework of further enhancing access to finance.

In line with expectations to provide a sustainable economic growth in the order of 3-4% in the medium- term, the Albanian Government and the Ministry of Finance and Economy are continuing their reforms and commitment to improve the legal and institutional framework in various sectors of the economy.

We are cooperating with the IFC to finalize the Unified Investment Law. Also, in cooperation with the Bank of Albania and the Albanian Financial Supervisory Authority, we aim to improve the financial legal framework for the Payment Systems or for the Collective Investment Undertakings. In July, we approved the amendments to the Law on "Concessions and Public Private Partnership". We have completed the Public Consultation on the Law "On billing and the monitoring system of circulation", aiming for a higher impact on the formalization of the economy.

Implementing fiscal management reforms as part of the broader structural reforms will help foster competitiveness, boost productivity, and promote innovation while ensuring fair competition among market players.

During our chairmanship of Albania's Central European Free Trade Agreement, in 2019, we sought to promote dialogue for a common regional market, the advancement of e-commerce in the region, and promoting a region whose potential is yet to be fully explored by investors.

These are all initiatives aiming at a steady long-term governance and a stable legal and institutional framework. It is important to highlight that only through coordinated reforms with all stakeholders, we may look forward to a sustainable and long-term economic growth.

Central institutions will constantly support the development of the financial sector, possibly in the future also through legal packages, which offer new opportunities for exploring and developing bank and non-bank institutions in Albania.

Moreover, I am confident that your contribution and the valuable experiences shared here today will generate several duties for us at the Ministry of Finance and Economy, and we are happy to accommodate them.

Thank you, and I wish success to the conference!

GREETING SPEECH

*H.E.Mr. Ilir Meta**

It is a pleasure for me to address this important Annual Conference co-organised by the Bank of Albania and the prestigious "London School of Economics".

The focus of this Conference on the "Perspective of Financial Intermediation" highlights the importance of the financial system for the economic growth of regional countries and their European integration process.

The traditional model of financial intermediation based on channelling financial assets into the economy for development and growth is also supported by the long-standing experience of some banks based in the euro area.

Central banks and supervisory authorities are facing with a challenging environment for policymaking, not only in emerging but also in advanced economies.

At macro-economic level, the global trends, such as economic and financial situation; demographic and social changes; shifts in global

* *President of the Republic of Albania, H.E.Mr. Ilir Meta.*

economic powers; rapid urbanisation; climate change; insufficient resources, and technological advancement - are related to the banking sector. Notably, among them, the factors having a greater influence are the demographic and social changes, the establishment of new consumer demands, the expectations of groups of interest, and the new technologies - which bring about huge changes, from customer relations to the business model.

The global economic and macro-economic situation in the euro area, and particularly, in trading partner countries has a crucial impact on our regional economies.

Through trading and financial relations and migration, our economy is closely related with the economies in the euro area and is affected by the economic and financial developments in these countries.

European investments in the Albanian economy have been one of the most important factors for the economic development of the country, either directly or through the impact on the financial activity.

Various economic and financial shocks or regulatory and institutional changes imposed by these shocks originating from the euro area have had a significant impact, not only in terms of prices, exchange rate or the nature and degree of financial intermediation, but also of the structure, size and form of business in the banking system.

The experience of Albania has shown how difficult it has been to maintain the economic growth at the pace recorded in the pre-crisis years.

The slower growth pace is reflected also in other macro-economic indicators such as inflation undershooting Bank of Albania's target or credit to the private sector.

Against these trends, the policy implemented by the Bank of Albania has mitigated their negative effects.

The implementation of the conventional monetary policy by the Bank of Albania has provided adequate and duly interventions without jeopardising the core underlying principles for the good management of monetary policy and exchange rate regime.

Overall, the policy framework implemented by the Bank of Albania regarding the increase of foreign reserve, reducing the negative impact of the exchange rate on inflation, drafting a regulatory framework to promote lending to the economy in the domestic currency are important elements of a policy package that promote macro-economic and financial stability, which should be endorsed.

Nevertheless, the fact that banks operating in Albania have a low impact on the economy remains a concern, as their loans to the economy are much lower compared to the level of deposits they hold.

Referring to the assessment of the European Central Bank, during the last 10 years, Albania has the lowest loan-to-deposit ratio and the lowest banking system assets-to-GDP ratio.

According to the European Central Bank, one of the reasons why banks have reduced lending in Albania, relates to the weak rule of law. For this reason, a return to the lawfulness and strengthening the rule of law, complete, rapid and reliable functioning of courts and the genuine fight against corruption would bring a rather positive effect on strengthening the banking system's contribution to higher economic growth.

Albanian financial system has experienced important changes in terms of shares ownership.

Restructuring of financial system in the European economy is accompanied by the restructuring of these banks affiliates in the economies of our region.

Also, the changes in the regulatory framework of the euro area have encouraged banks present in Albania and region to review their position in the Western Balkans countries.

These changes have driven to a higher consolidation of the financial system in Albania and to the entry of new actors in the financial market.

Traditionally, banks have fulfilled a set of crucial functions in economic systems, including the transformation of clients' deposits into the long-term financing for corporates and households, as intermediaries in money transfer mechanisms, including payment systems; as intermediaries and market makers in securities markets; and as supporters of public policies for governments, by expanding lending to priority sectors, or to boost growth.

Secured deposits and the access to funds of the central bank have enabled banks to have higher access in liquidity at low cost.

Focusing on the importance of technology, I would like to emphasise that technological novelties introduce an important dimension of financial intermediation perspective.

The challenges and difficulties that financial industry, at global level, has faced, have promoted these new technologies for providing financial products and services.

Thanks to new technological tools, every day, new possibilities in the form of innovative products and services in financial markets are made available to the public.

Ladies and Gentlemen,

Traditional banks should update their strategic focus to keep up with the most recent developments. Their brand and reputation remain potentially powerful while confidence in alternative banking services providers is still lacking.

Banks should expand innovative products, which have the potential to promote productivity and effectiveness in financial intermediation.

The services and products provided by these technological novelties have the capacity to access levels of population, which still do not feel capable partner for traditional banks, or do not have shown the necessary flexibility to benefit from the financial services of the traditional banking.

A comprehensive assessment of potentials and risks that accompany the financial novelties helps to draft the regulatory frameworks of these activities for a stable economic growth, consumer protection and maintaining financial and macroeconomic balances of the country.

Co-existence of financial novelties with the existing banking industry should give rise to a development and expansion of new possibilities to both existing actors of financial industry and the real sector's entrepreneurs.

It is necessary for these developments become supportive and sustain small emerging economies, as they may increase financial inclusion.

A higher financial inclusion is accompanied by new potentials for both the so wished economic growth and the traditional entities operating in this industry.

The adoption of these new possibilities under the oversight and supervision of financial authorities serves to financial stability of the country itself.

Last, I would like to thank you for the invitation and commend the Bank of Albania and LSE for the rather positive contribution, addressing these issues at academic and institutional level. I wish for a successful conference. Also, in light of thought-provoking points raised by Mr Ahmetaj, I wish this Conference will generate new ideas for a higher and more stable economic growth.

FIRST SESSION:

FACTS ON THE GROUND: RESTRUCTURING, TECHNOLOGICAL CHANGE, AND THE EVOLVING REGULATORY AND MONETARY POLICY CONTEXT

The banking industry is facing a rapidly changing context. Technological change is disrupting existing bank business models. Supervisory and financial stability regulations and other potential impediments to global trade are threatening to pose new barriers to financial flows. Banking groups in Europe, which own much of the banking sectors in the SEE region, are in retreat. New market entrants have also emerged from Central Europe and beyond. In the meantime SEE region has become part of a "mini-Euro financial cycle", where the ECB's monetary policy decisions directly impact financial conditions in the region.

The session discusses the following questions:

- *How is the business models of banks changing in the emerging Europe, the SEE region and particularly in Albania?*
- *What are the potential implications of the EU-based financial groups' ongoing withdrawal from the SEE region for financial stability, banking supervision and financial market development in this region?*
- *Can non-bank finance fill the gap that the departure of EU-based bank groups is creating in financing sustained development? What is the role of Fintech and Bigtech in future finance in this region?*
- *What are the risks to macroeconomic and financial stability and economic development?*

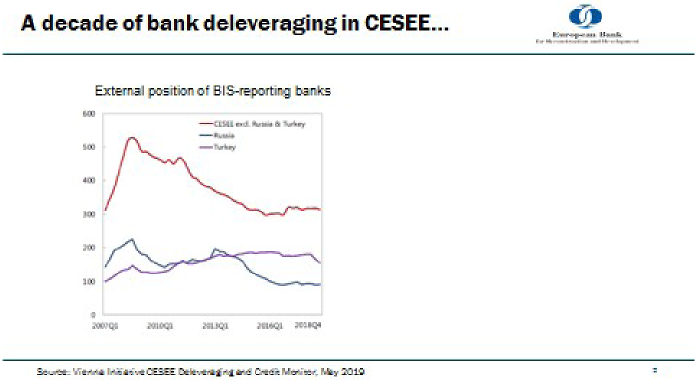
Chair: Natasha AHMETAJ, Second Deputy Governor, Bank of Albania

A GREEN FINANCE GAP IN EMERGING EUROPE?

*Ralph De Haas**

First, thank you very much for inviting me. It's a pleasure to be back here in Tirana. I would like to speak today not just about banks, but also about other forms of finance that are becoming increasingly important – or should become increasingly important – in this part of the world. The end of my presentation will also have a bit of a green focus, because I think this is something that has not been discussed and it is something that is going to be very central in the decades to come.

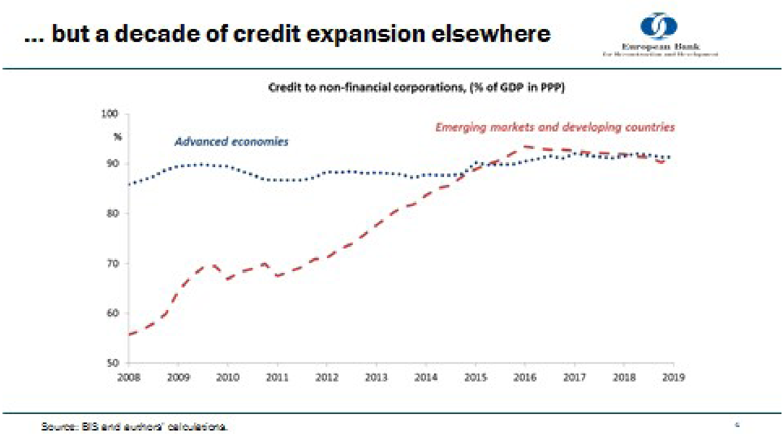
So, let me start by showing you this chart.



* *Ralph De Haas, Director of Research, European Bank for Reconstruction and Development*

I think you probably have seen this graph a million times. I look at it every six months when a new Vienna CESEE Monitor comes out and I am curious about what is happening in the region. We can focus on the red line, which is basically the external borrowing by banks in Central Eastern and South-Eastern Europe (CESEE). You will be very familiar with the fact of the deleveraging trend that we have seen for many years. But, as Eric mentioned this morning, there seems to be some good news in this graph as well. When I looked at it, I was pleasantly surprised that in the last couple of years, the problems seem to have bottomed out and there is some stabilization. What I found particularly interesting is the development in the loan-to-deposits ratio. In 2006, the average loan-to-deposits ratio was about 100 percent, depending on how exactly you define deposits. This number then went up for a couple of years as banks continued to borrow more and more abroad. Then a protracted deleveraging process occurred and now we are basically back where we were 13 years ago: a loan-to-deposit ratio of about 100%. On average, banks across the CESEE region now once again finance most of their loans through deposits. This means that the banking systems in this region have become smaller but that at the same time the funding structure of these banks has also become more sustainable and less risky. So, there is a little bit of silver lining when looking at these graphs.

What has happened in other parts of the world? If we look at other emerging markets and developing economies, the picture is quite different. I really like the following chart.

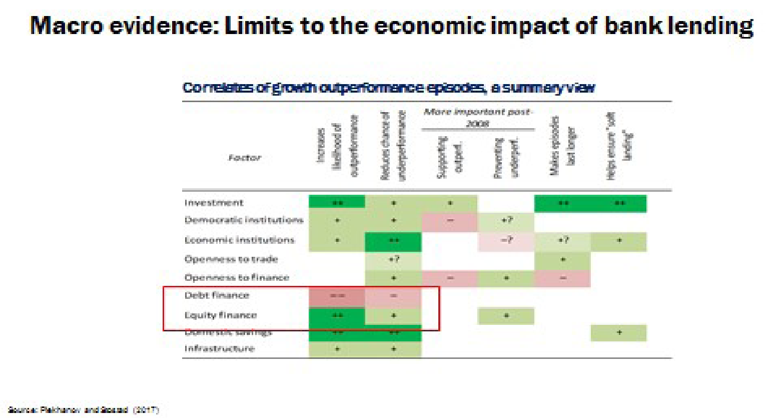


It shows credit to firms as a percentage of GDP. Ever since the global financial crisis, the ratio between firm credit and GDP in rich countries and advanced economies was about 90-95%. This ratio has not changed much over time. But in many emerging markets the trend has been very different. They have really caught up quickly and corporate debt as a percentage of GDP is now at similar levels as in richer parts of the world. However, let me also highlight three things you cannot see in this graph. First, a lot of debt in emerging markets is denominated in foreign currency, which is something you hardly see in advanced economies. Second, much of this debt is very short term. It is difficult to build up a yield curve for longer-term borrowing and I know efforts are being made here in Albania to build up such a curve. Third, corporate debt in emerging markets is also increasingly concentrated among a few large firms. So, concentration risk is also much bigger than what we typically see in more advanced economies.

In short, there has been a catch-up process in terms of the quantity of bank funding to corporates in many emerging economies. But in terms of the quality of that debt, I believe that the risks are much higher than a picture like this reveals.

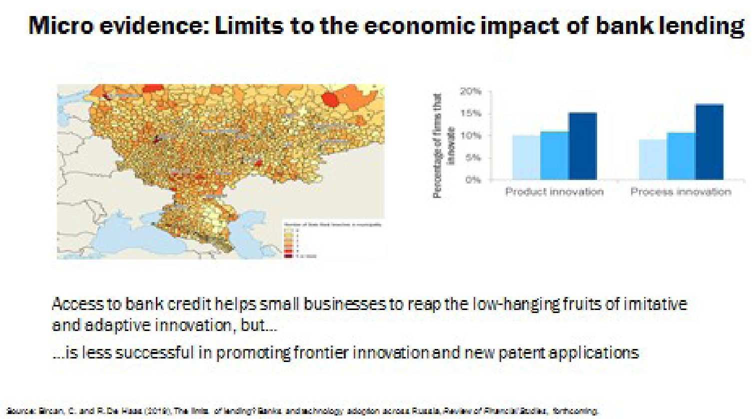
So, are banks the best option to finance economic growth? There is a long-standing academic debate about this, but I think most of us would agree, looking back at the 30 years or so since the Berlin wall fell, that banks have actually done a pretty good job in driving economic growth in emerging Europe. They have been instrumental in helping local firms to finance and implement new technologies and to catch up in terms of productivity growth. I think that is a very positive story, a story that we have seen in other countries as well and something that should be celebrated.

Now, if we look forward, what we observe is that many countries in emerging Europe are middle-income countries. We know that when countries approach middle-income status, the financial system will need to change. There will need to be a different structure, there will need to be much more emphasis on equity, both public and private equity. And the relative role of banking is typically reduced in those countries that successfully avoid a middle-income trap.



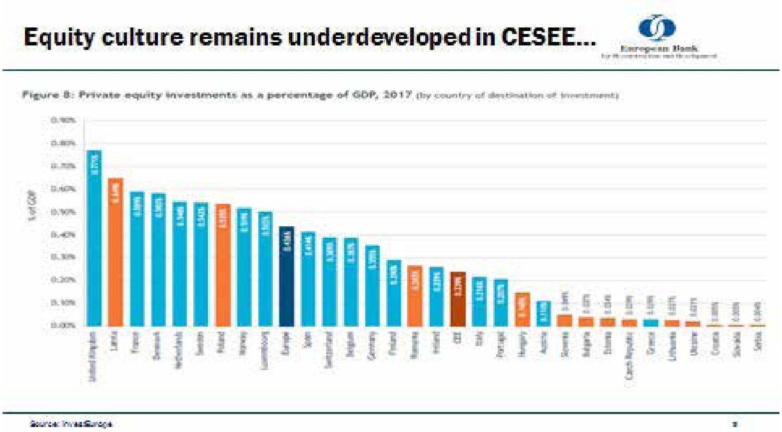
Factor	Increases likelihood of outperformance	Reduces chance of underperformance	More important post-2008: Supporting output	More important post-2008: Preventing underperf.	Makes episodes last longer	Helps ensure "soft landing"
Investment	++	+	+		++	++
Democratic institutions	+	+	–	+?		
Economic institutions	+	++		–?	+?	+
Openness to trade		+?			+	
Openness to finance		+	–	+	–	
Debt finance	––	–				
Equity finance	++	+		+		
Domestic savings	++	++				+
Infrastructure	+	+				

When countries get close to reaching middle-income status, it is no longer enough for firms to just adopt or buy foreign technologies. Instead, firms will increasingly need to develop their own new technologies as well. Albanian firms, for instance, really have to become more innovative and to conduct R&D to develop new technologies. The track record of banks in financing such innovation is, however, quite mixed. In recent research my colleague Cagatay Bircan and I used very granular data on firms and bank lending across Russia. What we found is that when there is more bank credit available, firms grow faster, they become more productive and they introduce more new technologies by working together with foreign companies. This is exactly what I was talking about earlier. But we only found limited evidence that bank lending can also help firms to conduct R&D and to introduce new 'frontier' technologies. For that, firms may need to be able to access different types of finance, in particular equity.

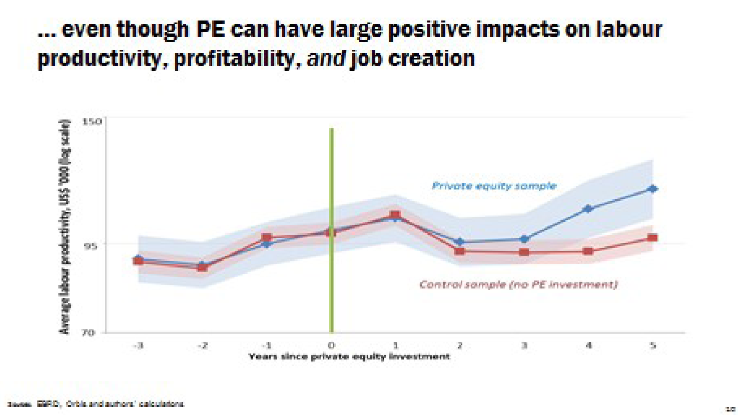


Secondly, I would argue, banks do not have a particularly good track record in financing green growth. The reason for that is that green growth, as part of which enterprises expand but become more energy efficient, tends to revolve around innovation. And stock markets and equity markets tend to have a better track record in financing innovative investments than do banks.

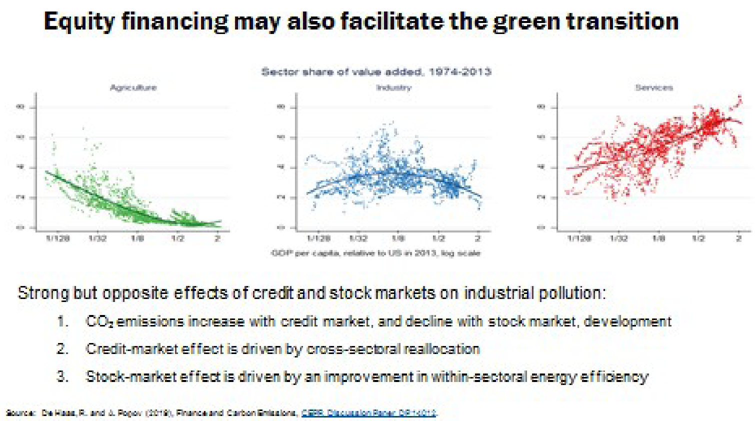
So, there are really two reasons why, even at a conference about the future of banking, to look slightly beyond banking and think about the role of equity markets. First, deep and liquid equity markets can help countries to finance more R&D and innovation and to avoid the middle income trap. Second, equity markets can also help to make economic growth greener.



Of course, I am not telling you anything new when I say that public and private equity markets in emerging Europe are still very small. There is a lot of work still to be done to change that and to instil a local equity culture. Every successful IPO in Albania would be a huge step in establishing such an equity culture. One of the reasons I keep going on about this, is that there is clear empirical evidence that once firms in emerging markets can access private equity, they gradually



start to become more productive and more profitable. Moreover, they also start to hire more people. The availability of private equity can therefore not only be important for economic growth but also for employment.



Finally, let me stress that in emerging Europe the production structure of many firms tends to be relatively energy inefficient: there is still a huge gap in terms of greenhouse gas emissions per unit of value added, compared to Western Europe. To reduce that gap and to make production greener, we will need not just more bank lending but also more equity funding. My own research has shown that having access to equity actually helps firms to clean up their production structure much faster as compared to firms in countries where most funding comes from banks. One of the reasons for this is that many banks tend to be quite conservative: they are not comfortable with financing relatively innovative and green firms and industries.

However, let me stress again that I think that banks have nevertheless been an impressive 'convergence motor' in this region in the past 30 years. Going forward, if we want to keep growth sustainable and sustained, and if we want to make sure that countries will not fall into a middle income trap, then the structure of the financial system will have to adjust. There will need to be a bigger role for both public equity markets and for private equity. But even then, banks will continue to play an important role in funding firms. Indeed, one of the reasons why private equity is so useful is that it actually allows many firms to access bank credit and leverage up.

Creating public and private equity markets it is of course not easy. It will be interesting to see how the Albanian stock exchange will develop. There are also alternatives and complements. One can for instance think about an Albanian market segment at a regional exchange or about regional order-routing platforms such as SEE Link. All of these options can be explored to ensure that a real equity culture becomes ingrained in the financial system here in Albania.

Thank you very much for your attention!

EU AND SEE BANKING SYSTEMS: COOPERATION AND COMMON CHALLENGES

*Davide STROPPA**

When the EBA was contacted to attend this conference and panel discussion, we thought: what is the contribution that the EBA can provide to this conference? We then considered two perspectives.

The first one is the work that the EBA is doing in terms of cooperation with third-country authorities and, in particular, with the SEE region.

The second one relates to the challenges that we can see for banks in the EU, as this experience can provide some perspective and some insight about how banks conduct business in a new challenging world.

In terms of a brief overview of its work with the SEE countries, the EBA has been engaging in numerous discussions about supervisory convergence since the establishment of the Vienna Initiative. The EBA has made great efforts in this area: first, assessing the equivalence for the confidentiality provisions for non-EU supervisory authorities, which enabled a number of non-European authorities to attend EU supervisory colleges; second, it has established a dedicated MoU between the EBA and South East European (SEE) countries, which

* *Davide STROPPA, Senior Bank Expert, Banking Markets, Innovation and Products Unit, European Banking Authority*

has been developed in close cooperation with representatives from the European Bank for Reconstruction and Development (EBRD). This MoU is a non-binding agreement between the EBA and other SEE supervisory authorities related to information exchange and cooperation and with the aim to establish a forum to discuss a number of issues, such as:

- convergence with supervisory standards and practices, to help SEE authorities in their efforts to adjust the regulatory and supervisory standards to those that are implemented in the EU;
- functioning of supervisory colleges, where the EBA has promoted the participation of SEE countries;
- exchange of information on main risks and vulnerabilities from a macro-prudential perspective;
- establish cooperation with regards to the work on equivalence assessments.

A couple of points that I would like to touch are related to the work that the EBA has done in terms of analysing the most recent challenges for supervisors and the banking sector, which can also provide some insight for the banking sector in the region.

The first one is the impact of FinTech. The EBA has done a lot of work in monitoring FinTech developments in the EU. The first impact is clearly on the business models. In terms of digital strategies, we have found that sometimes the risk comes from the fact that the incumbents are either not able to react adequately to the changes and remain quite passive, or they become aggressive frontrunners and alter the business model without a clear strategic vision or a clear strategic objective in mind.

The second impact is on the execution capabilities. An internal culture oriented towards a more technologically-driven environment is something that more and more incumbents will need in order to progress with innovation strategies. So, the transition from a traditional type of capabilities to more digital-related ones is a clear challenge.

Another impact is related to the access to the pool of talents in terms of IT expertise and technological talent, which is becoming quite a scarce resource for institutions regarding top front-end and back-end developers. Then there is increased competition, which can impact incumbents' profitability.

Finally, there are also some impacts in terms of banks' governance. The first one is on the organisation itself. Sometimes, cross-functional or separated teams are responsible for innovation activities and usually they tend to be under the wider business development division. Here, one of the challenges that we have often seen is the development of a clear reorganisation that can also adapt and support the business model. The second one is in terms of culture and resources. When there is an impact on the business model, on the organisation - internal culture and staff mind-set are key components. In our work, we have been interviewing through questionnaires a number of banking supervisors. What has emerged is that banks' internal culture and their current mind-set were considered by banks themselves as an impediment to the implementation of the innovation strategies.

Financial planning and budgeting is a third impact in terms of organisation. Why? Because sometimes, the new challenges are channelled into a single budget under the overall innovation expenditure, and there might not be clarity on how the project can deliver the benefits. This, in turn, creates difficulties in allocating the correct budget.

Finally, the other topic where the EBA is very much engaged, especially over the past couple of years, is its activity in terms of AML and CFT, with the objective of ensuring integrity, transparency and functioning of the financial market.

Financial crime and money laundering affect our objectives in two ways. First, they undermine the integrity of the financial market. Second, the EBA has also the legal mandate to foster the consistent application of AML-CFT laws. Here, the EBA contributed to the development of as many guidelines and opinions over the past three years, to provide the basis for a consistent application of AML rules across the EU.

Another challenge is the shift towards the effective implementation of these rules from the supervisory point of view, thus moving the AML activities into prudential supervision. That means strengthening the cooperation of AML and prudential supervisors, both domestically and cross-border, and then integrating the AML activities into prudential supervision.

This will require self-awareness, which means understanding the challenges and the risks from AML, adjusting supervisory activities and also ensuring that the focus of AML activities is directed towards those business models that are more exposed. Finally, AML will need to be integrated into the standard prudential toolkit.

These two broad challenges - the impact from FinTech and the impact from AML activities - are something that we think are affecting the EU banking landscape and that can offer some perspective that can be helpful also outside the EU. Of course, I have painted a broad-brush picture, and I am sure that the next panellists will provide you with much more insightful details on these topics.

Thank you very much!

THIRD ROUND OF THE EURO AREA ENLARGEMENT: ARE THE CANDIDATES READY?

*Milan DESKAR-ŠKRBIĆ**

Good morning everybody!

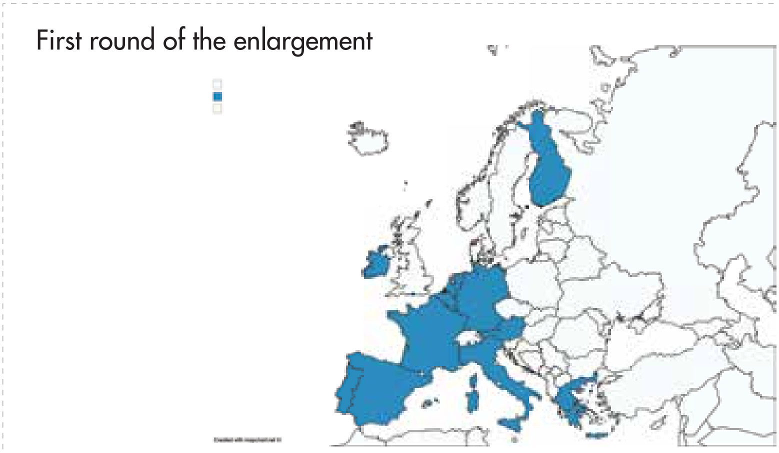
Thank you for inviting me here in Tirana! It is my first time and I really enjoyed it yesterday. I spent a lovely evening in the city. It is really full of life.

I would also like to thank the colleagues from the Research Department from the central Bank of Albania for providing me the data for Albania. I included Albania in our paper, which was not there in the original version. I was afraid that my paper would not fit in because the topic looked a little bit strange when you see the panel topic. But after yesterday's discussion I got encouraged. The title of the paper is "Third Round of the euro area enlargement" but it is mostly about the transmission of shocks from euro area countries to countries in this region. I will focus on Croatia, Bulgaria and Romania, but I also included Albania and some other countries from the CEE. I think it can be interesting for this conference because it is also important for local banks. In our paper we show that external shocks, euro area shocks, have important effects on non-euro area countries. So we have to be aware that, although Albania is geographically far away from Germany and Central Europe, when

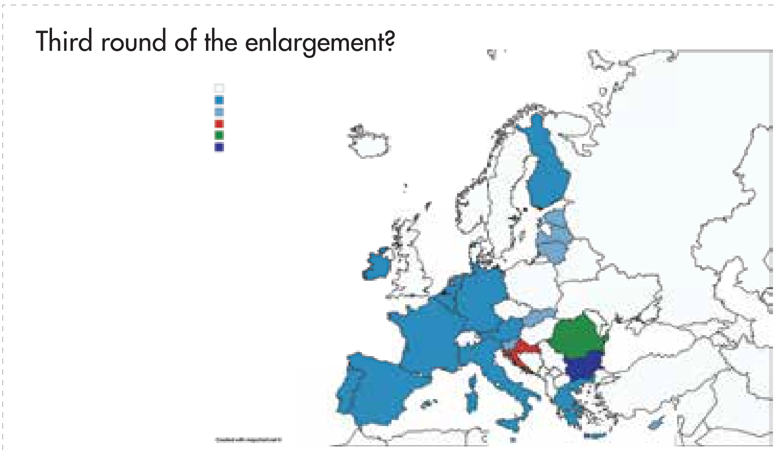
* *Milan DESKAR-ŠKRBIĆ, Advisor, Modelling Department, Croatian National Bank*

we are talking about trade linkages and financial linkages, it is pretty close.

After the euro was introduced in 1999 and after Greece joined the euro area in 2001 the first round of the enlargement came to the end.



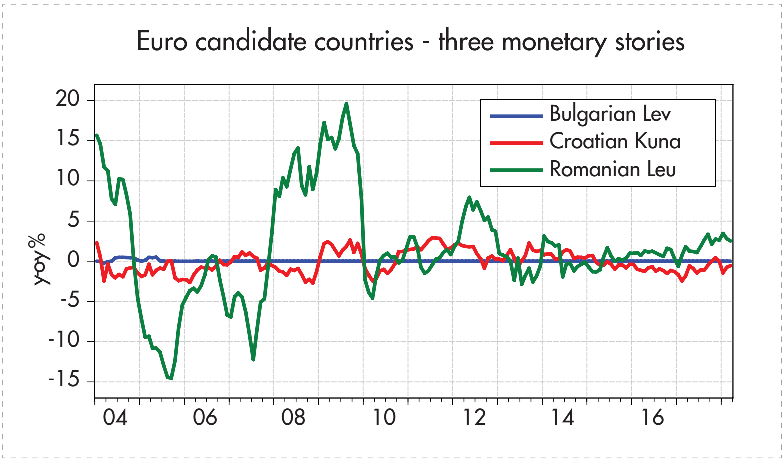
The second round of enlargement started with Slovenia in 2007 and ended with Lithuania in 2015. Now on the 20th anniversary of euro or the 20 birthday of the euro we started to talk about a potential third-round enlargement.



In recent years, Bulgaria, Croatia and Romania stressed out willingness to join the ERM II and the euro in the near future. Bulgaria sent a letter of intent to join the ERM in 2018, Croatia followed in July 2019, and Romania set up the official body for euro adoption in their country and also published a strategy for euro adoption. Currently, it is only available in Romanian, but we are waiting to see the English version. These countries are definitely preparing to join the euro area relatively soon. In Croatia, our goal is to enter the euro area around 2024 -2025. Bulgaria and Romania have similar ambitions. It may seem far away but it is not. It is only five years from now and five years in macroeconomics is not a long time really.

What is interesting in this paper is that we have three candidates for the euro area and they have completely different monetary and exchange rates stories.

You know that Bulgaria has a currency board; then we have Croatia which has a managed floating exchange rate regime and finally we have Romania, which is the only inflation targeting country in our paper. Romania also had a floating exchange rate regime.



Currently, if you look at the IMF classification, Romania is still a floater. But the Romanian central bank, on its website defines its exchange rate framework as a managed float. You can see that in the past, especially in the crisis 2009 and 2012, the Romanian currency depreciated largely. In these terms, we can say that in our sample, Romania is still a floater. No later than in last few years, we can see the stability of Romania leu. In a broader picture, we can say that Romania is still a floater. Definitely this is interesting because when we are talking about spill over of external shocks; one of the key questions is whether the exchange rate regime can affect transmission and whether the flexible exchange rate acts as shock absorber.

The key question for new candidates is "What is the cost of giving up your own monetary policy?" So, if we are looking at some pragmatically level, then you can say "ok, for example in Croatia, we don't use the policy rate as a policy instrument; we cannot change our exchange rate a lot because we have a huge degree of erotization in the country". We can say that we do not use some standard monetary policy tools. In some sense, if we give up our own monetary policy, we are not losing almost anything. Like Governor Vujčić said, citing Bob Dylan: "When you have nothing, then you have nothing to lose". But this is more of a policy view. However, I am speaking more from an academic point of view. If you look at empirical literature, the answer to the question "What is the cost of giving up the monetary policy" depends on three things.

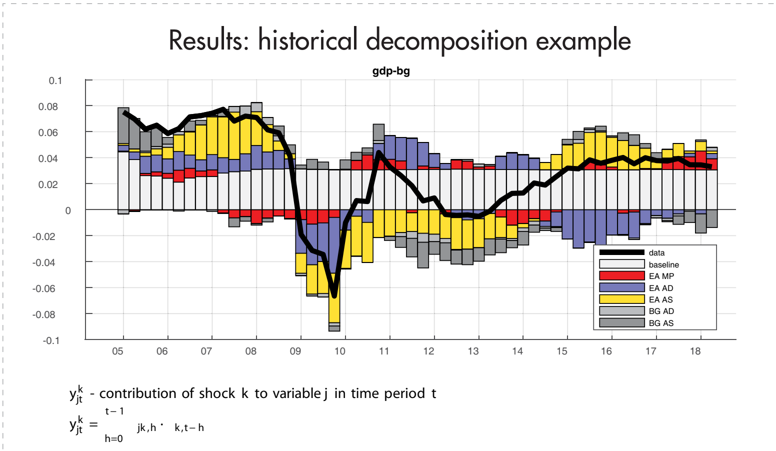
The first thing is coherence of economic shocks. If shocks in your country, Croatia, Bulgaria, Romania, are similar to shocks in the euro area, that means that your business cycle is also highly correlated with the euro area. In addition, it means there are some capital flows or even labour migration between these countries. So, if your shocks are coherent, that is the first sign that a common monetary policy could be suitable for you.

The second thing is definitely the relevance of common shocks, or ECB-relevant shocks for your economy. In this paper we are looking at shocks that are important for the ECB policy, and we call them "common shocks", because these shocks are affecting the euro area and our countries at the same time. These shocks do not have to originate in the euro area. For example, the ECB will react also to some oil price shocks as well as, for example, to a slowdown in Germany. We are taking all shocks in context, but these shocks are affecting both euro area and our countries. If these shocks are relevant for both the euro area and our countries it means that common monetary policy could be suitable.

And the last thing. If the effects of ECB's monetary policy on our countries are already similar with the effects in the euro area, this means that after joining the Eurozone these effects will become even more similar. In this case, we can also say that common monetary policy could be suitable.

In this paper we provide a new analytical framework that enables us to directly compare the relevance of euro area shocks in the euro area with the share of euro area shocks in our candidate countries.

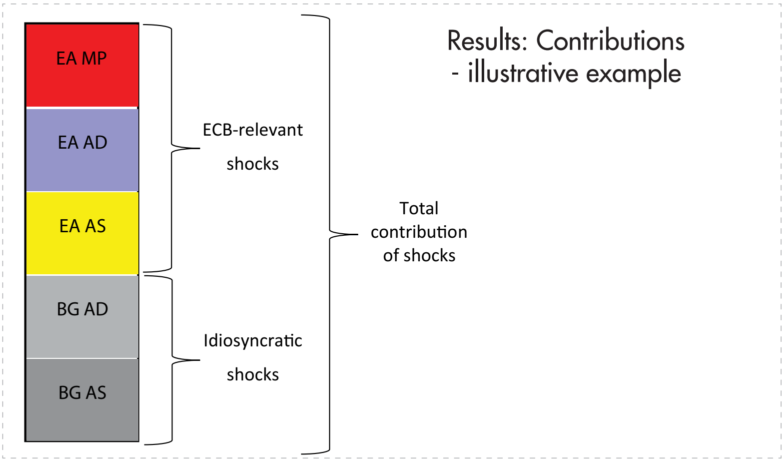
I will not deal with the methodology in details, because this is not a scientific conference, and we are a little bit behind schedule. So I will immediately go to results. What can we see here?



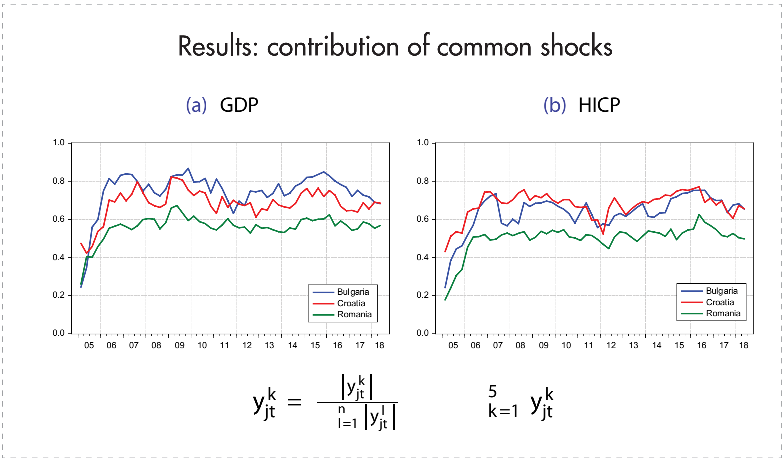
I took the example of Bulgaria because it has only two domestic shocks. So what we do is we take GDP in the country and we take inflation in the country and calculate the contribution of domestic shocks or idiosyncratic shocks and the contribution of euro area shocks. On this slide euro area shocks are: red, purple and yellow; while domestic shocks are in grey. At first sight, you can see that, for example, in Bulgaria, euro area shocks play dominant role, meaning that Bulgarian GDP is mostly determined by external shocks. We have similar results also for Rumania, and Croatia. And you can see also a similar trend for Albania.

What do we do next?

We calculate the share of these euro area shocks in total contribution. As you can see in this slide, we sum up EA monetary policy shock, EA AD shock, EA AS shock. We count these and then divide them by the total contribution and we get the share of euro area shocks in total contribution.



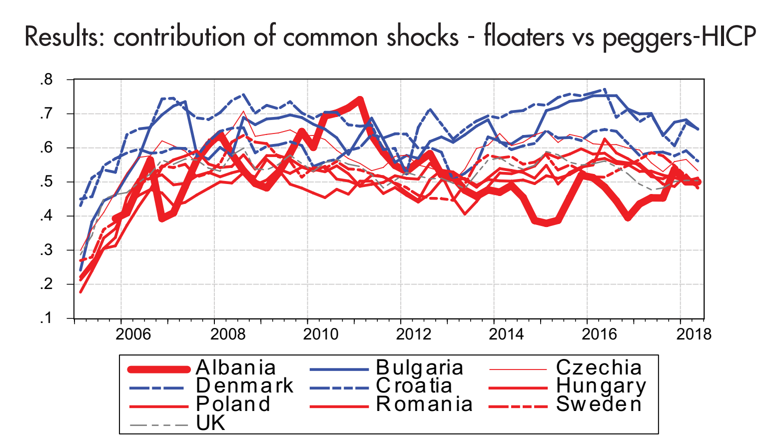
When we calculate this share we get the following picture for our candidate countries.



At first, you can see one very important thing for all three countries: the share of euro area shocks in GDP and inflation moves around 50% to 70%, which is significant. A second thing that you can see is that the share of euro area shocks in Romania is below Croatia and Bulgaria. Our question was: "Can we explain this difference by the exchange rate", - as I said - there is a difference, of the exchange rate and monetary policy regime in Romania compared to Bulgaria and Croatia.

To answer this question, we also included some other floaters from CEE region, and Albania.

In the following slide, floaters are in red and fixers are in blue, and you can see that, mostly floaters are really below the blue line.

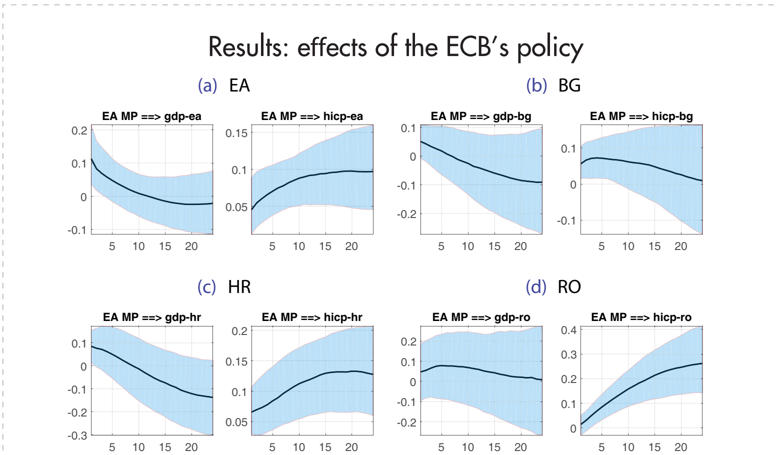


That means that exchange rate does effect the transmission of external shocks; or we can conclude that floating exchange rate can partially serve as buffer in this region, in terms of spill overs. However, the most important thing is that the share of euro area shocks is pretty high in all countries. If you look at Albania, which is presented with the bold red line, the share of euro area shocks in Albanian GDP moves around 55%. For inflation, it also moves around 55%. So, in Albania, as well as in the Czech Republic, Sweden, the UK and all other floaters, you still have a pronounced role of external shocks. A floating exchange rate can act as shock buffer, but the share of external shocks is still pretty high, which is really important.

We were talking yesterday at the Bank of Albania about the prospects of the euro area and they are not looking too good. We should, therefore, be aware that when things go bad over there, they can spill over really easily to this region. We also talked about some channels of transmission yesterday. Trade channel - main trading partners are Germany, Greece, Italy, all euro area members. I looked also at the structure of the banking system; two banks from the euro area are among the top-five banks. So, there are some financial linkages. Also, as Nadeem Iliahi of the IMF said yesterday there is also the important role of remittances. There are many linkages, there are many channels, through which euro area shocks can affect our countries.

The last thing, what we did in the paper is try to see how monetary policy shocks of the ECB affect our countries.

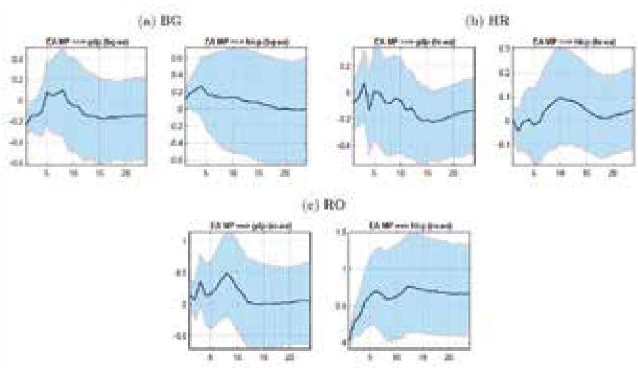
We define a monetary policy shock with the negative sign. It means easing of the monetary policy. Here we took a shadow rate. We did not use a Repo rate of the ECB. We took the shadow rate, because the shadow rate includes both conventional and unconventional measures. Throughout most of our sample the ECB uses unconventional measures.



What you can see here, if you compare the euro area, is the first picture, Bulgaria, Croatia, Romania, you can see that these effects are really similar. So, the expansionary monetary policy shock leads to both short-run increase in GDP and permanent effect in inflation in the euro area. We have similar results in all other countries. The only peculiar result is for Romania, for inflation, you can see that this effect is really different, but we had some problems with data, because, Romania had experienced hyperinflation, in part of the sample, and inflation rates are very volatile in Romania. But you can say that the effects of the ECB monetary policy shocks are really similar across countries.

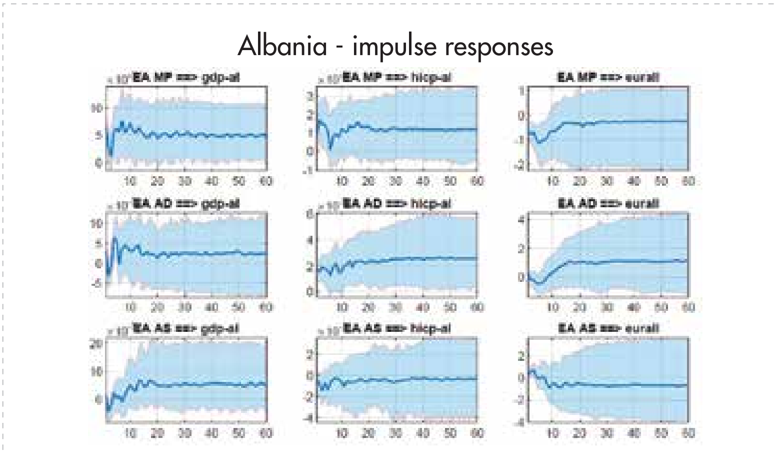
We also ran some statistical significant tests of these differences.

Results: effects of the ECB's policy - differences



At first, they look similar, but also we looked whether they are statistically different. And we can say they are not statistically significantly different. That means that ECB shocks really have similar effects on GDP and inflation in the euro area and on our candidate countries.

I also did calculations for Albania. First of all, as I already mentioned, thank you to the Bank of Albania for providing me with data, because it is really hard to find data on GDP and inflation in Albania. Results are similar.



What you can see here is that for example, monetary policy shock has positive effect on Albanian GDP, which is statistically significant. It also has a positive effect on inflation. It is interesting, because yesterday we discussed appreciation pressures on Albanian lek. We can see that monetary policy easing in the euro area leads to appreciation of Albanian lek. It is an important result. We can also see that euro area AD shock and AS shock also have positive effects on GDP in Albania, and it is statistically significant. So, we can say, that even though some people think that Albania is far away from the euro area, we already can see that euro area shocks have very important effects on the Albanian economy and other economies.

Thank you very much!

CHANGING BUSINESS MODEL OF BANKS

*Paola ANGELETTI**

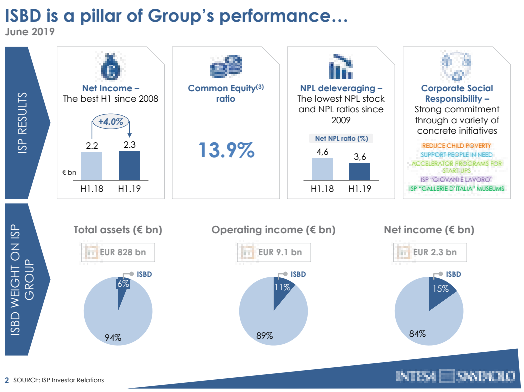
First of all thank you for inviting me at this very interesting and important event here in Tirana! I really thank the Bank of Albania for organising it and let me be part of this session.

I heard very interesting considerations, up to now, and I bring, let' say, a different point of view, the one of an international group that is actually thinking of its business model, every day, every time that the strategy is re-assessed and tested. I just want to put things in context, and I will give you some background information on how Intesa Sanpoalo is active in the region and then we go to the strategy.

* *Paola ANGELETTI, Head of the International Subsidiary Banks Division, Intesa Sanpaolo SpA*

I want to show you a few numbers of who Intesa Sanpaolo Group is and what Intesa Sanpaolo International Division is doing within the entire group.

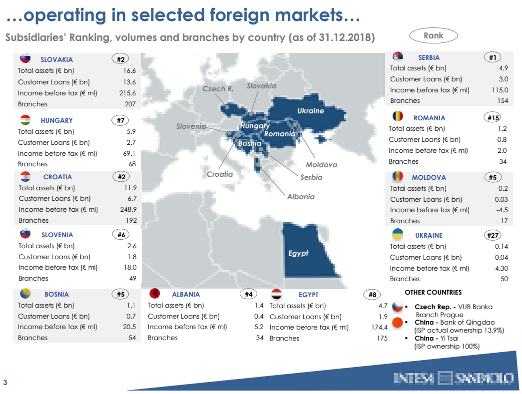
We are proud of our solid capital ratios and of our profitability which are shown here, with regard to the first half this year compared to last year. The International Subsidiary Division represents a relatively small part of the assets, 6% of the group, then higher percentage of operating income, and net income all over the group.



Intesa Sanpaolo is proud of not thinking only to profits, that is, of course, an essential part of our business, but also of corporate social responsibility in all countries where we operate.

So, of course our domestic country is Italy, but then all over the countries where we operate we are also taking care of the development of a sound environment where the financial institution like us can operate.

Just to give you an idea where we are spread. We are operating mainly in Central Eastern Europe and also in Egypt. We have also some project developing in China. So, it is quite a diverse situation. We have banks that are number one or two in some other countries, for example, our bank in Croatia is number two. We just heard about Croatia a few minutes ago. Then we are number one in Serbia and also in Slovakia where we have a very important market share. We have smaller banks in other countries. But this is the summary of our presence in the area and in the region.



What is our approach?

We have a long-lasting experience, as you remember. I joined the Division as the Head of the Division only recently, but we have a presence in different countries, even before the year 2000.

The last bank that joined the group is the bank in Moldova, a couple of years ago. But the number of countries where we are, as shown in the chart, is quite a long list and we are, a long -term investor in each country.

This, of course, poses important issues in terms of how we define and design our strategy. Given the fact that the environment around

us is rapidly changing - and we heard in the previous panellists which are the characteristics of the environment - that affects the international sector.

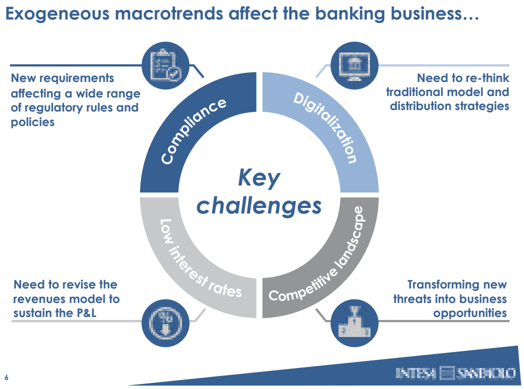
There are number of exogenous macro-trends that we need to take into account.

Let's start with compliance issues. This is just one word but it comprises a very complex world that financial institutions are facing. We have supervisors in each country where we operate, a part from, of course the ECB, but starting from there, we have to comply with all the rules that are designed by the supervisors in each country where we are present. Those, not only for the banking sector, but also for capital market, for insurance, for all the authorities that regulate the activity of a financial group like ours.

Then, of course there is another trend, that has already been mentioned, which is digitalisation. This poses the need to really deeply rethink the distribution strategies of a financial institution. We are a group involved in commercial banking, investment banking, insurance, asset management, but digitalisations affect all our activities and I will go back to this issue later on in my presentation.

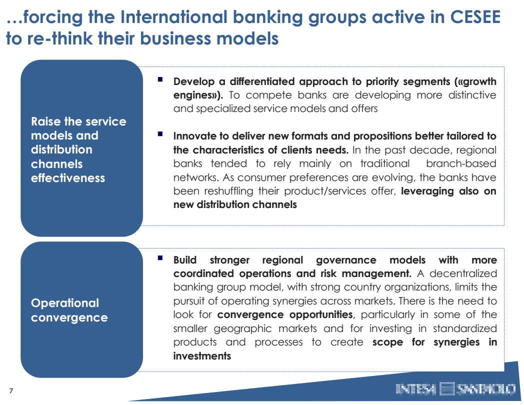
This evolution can represent threats, as it was mentioned, but also an opportunity. If this evolution is properly managed and understood and actually anticipated, this really can represents for a group like ours, an opportunity to better serve our clients.

Last but not least, we are living in an environment of low interest rates. The net interest margin cannot be going forward, as our only base for profitability and for remuneration of the capital. Therefore, we need to revise the business model to cope with this new environment and in fact in all the countries where we operate. It is not only something that affects euro area countries, but also countries in neighbouring areas where the interest rates tend to converge to the euro ones.



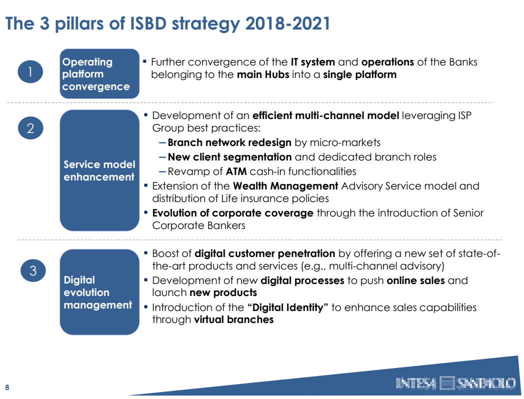
The above slide shows how complex the system is and all these issues need to be taken into consideration the design or activity strategy. I tried to explain what we are thinking of in terms of our business model.

Now what we need to do is to develop e business model that addresses the specific needs of every segment of our customers in the best possible way. This means to continuously evolve and update our way of servicing our clients and then also, as they said, to develop a digital strategy, in order not to be dependent only on the physical network, but also rely on our digital networks.



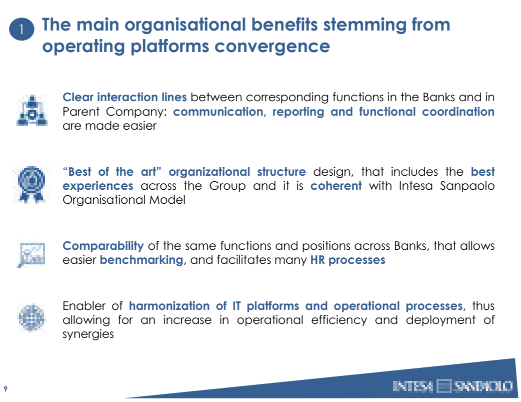
This is not something we can do, but something we have to. I don't think any financial institution will survive, if it has not a digital strategy in its plans. Another issue which is really extremely important for an institution like ours is that, as you see, Europe as a whole, not only this region, but Europe as a whole is relatively small if we compare it to the giants coming from the Unites States, or from China. So, every single euro that we invest needs to be deployed in order to obtain benefits all over our networks in all countries where we work. This means we need to work in order to have an operational convergence so that the business models, of course that are specific in each country, are working in the most similar way possible in order to really be in a position to take advantage of all the investments that we do at group level.

This has been taken into account when we designed our strategy that was published back at the beginning of last year. Our business plan spans from 2018 to 2021. The strategy for the international division is focused on these three pillars, trying to really develop a convergence of the operating platforms. Of course, this involves revolution of the IT systems. This is a huge work. It is a very difficult work. It does not happen overnight. It takes years in any investments. But it is something that is needed in order to be in a position to compete globally. The second element is the evolution of service model, the enhancement of the service model that takes into consideration both the retail business and the corporate business.

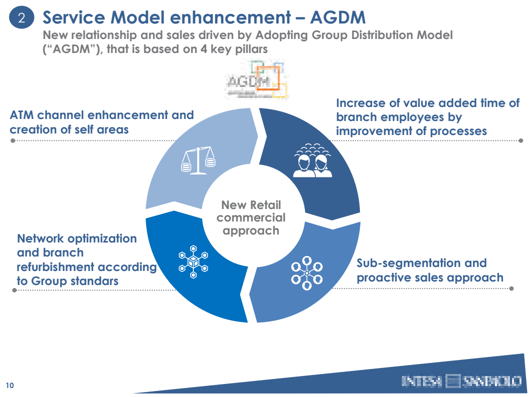


In the retail business, we are trying to work as much as possible in order to enhance our branch network, both in terms of localisation and optimisation, and in terms of processes that are underlying the activity within the branches so that the clients can be served the best. Then we are developing a Wealth Management Advisory Service Model that can be compliant with all the rules, but also designed in order to serve the clients at best. We are coordinating the activity for corporate banking, so we have senior bankers following the region, so that multinational companies can find their counterpart within our bank and within our group. They can leverage on all the banks that we have in other countries.

On the digital side, I would say DigiCal, because this is the word we use inside the group and I will explain this in one of the next slides. I wanted to highlight those organisational benefits that are stemming from the convergence of our operating platforms. This involves not only convergence of operation, but also an important rethinking of the governors of the entire processes throughout the group. This was mentioned also before, in another intervention. Really the fact that the coordination of processes within the banks of the division is very important in order to address, for example, the risks stemming from credit, in a coherent way, taking into account local specifies, but at the same time, a sound risk appetite that needs to be coordinated at group level. Also, having organisational structures that are comparable in every country: heads in managing HR processes, making benchmarks and increasing the professionality in each specific country.

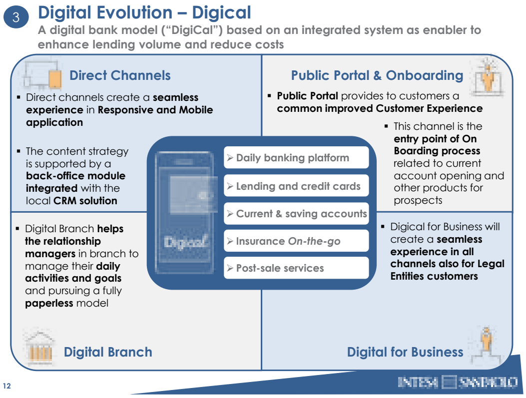


The following map shows what it means to have a convergence in the operations and the business model. We are developing a project at group level. We call it AGDM - Adopting Group Distribution Model- which does not mean at all that every bank is the same in every country. This would be crazy. This means underlying criteria by which we structure our networks are common across the area, across the region. This goes through channel enhancement, not only branch, but ATMs. This will progressively increase the time available for our people in branches to serve the clients and to talk to the clients, because, transaction will increasingly go to on-line channels and to ATMs. This also allows for us to understand better our clients and be in a position to make better segmentation of the clients in order to address specific needs.



I think it is also important to stress the digital evolution. As I said we call it "DigiCal" internally. Why that? It is the combination of digitalisation, but also physical improvement. Therefore, we put them together. We wanted our direct channels to be made available to our clients. This is mainly for the retail business. They are designed in a way that the clients experience what the ward calls "a seamless experience", an easy experience, not only for transactions and inquires, but also for acquiring products of our banks.

Then we have the second tailor that is a public portal where not only our clients, but also new clients, prospect clients can be on boarded. Which is an awful word, but this means we cannot just serve each client, unless we know the client, and therefore we want to on board the clients in order to proceed with all the necessary procedures required by know-your client activity also on line, not only physically.



The third pillar is to develop - and this is something that we are still ongoing- a digical for business. Not only privately, for retail business needs investments for digital bank, but also companies and small business needs to have a bank that can interact with them on a digital basis.

The last thing switch provides for the name of our project "DigiCal" is the digital branch. Our people in the branch need to have all the instruments in order to serve at best the client, once the client comes into the branch. The important thing is if the client sees something- for instance- on line, and wants to ask for a loan, and then makes some simulations on-line, but then he needs some advice. He goes to the branch. He does not want to waste his own time or her time to start all over again. So, once he goes to the branch, the branch manager has the ability to see what the client has already simulated. So he does not start all over again. He starts exactly from the point in which the client stopped and needed his help.

So the channels need to be integrated, so the branch system and the on-line channels work together to provide the best service to the clients.

I tried to make a synthesis of our initiatives, before really thanking you all, I just wanted to make this final remark: As you can understand in order to obtain what we want and we are evolving, a lot of investments are needed, and each single country where we operate, could not afford all the investments to develop this kind of instruments. Therefore, it is really important we are in a position to develop centre of excellence in each country, but each country develops an ability that can put at the disposal of all the other countries. Otherwise a group like ours could not sustain the investments needed to cope with the innovations that we are expected to provide to our clients.

Thank you!

THE ALBANIAN BANKING SYSTEM: EVOLUTION AND POTENTIAL DEVELOPMENTS

*Silvio PEDRAZZI**

Good afternoon!

While the other distinguished speakers brought their international experience, I will instead focus on the local one. I am proud saying I have been working in Albania for more than six years, so that I have had the opportunity to observe the evolution of the banking system and to realize how much has been done - under not so easy circumstances - in the path toward the integration with the best European practices. I'd like to particularly thank Bank of Albania that, with high professionalism, guided us in this journey envisaging big changes; Albania needs that and let's hope that we will succeed and finalize it as soon as possible.

Having said that, I'm going to present some slides. They contain many already well known information on Albania but I believe it is important to refresh the awareness, especially on the demographics, also in comparison with other neighbour countries. I think that not only for the banking system or for banking groups, but as well for all foreign investors this is a good starting point in order to think about the potential of Albania and of the larger Balkan region.

* *Silvio PEDRAZZI, Chairman, Albanian Association of Banks*

I'm not going to comment slide by slide, but I'll try to summarize the main concepts.

We see the Albanian economy is growing faster in the last years even if there is a significant slowdown in 2019, may be due to contingent circumstances (much lower rainfall, as it was mention by the former minister, had a huge impact on the GDP), but all in all the trend is quite positive. Moreover several economic sectors are not yet developed as they should be, having much higher potential to be exploited: tourism, energy, agriculture, services, are good examples.

It means that upside opportunities are currently higher than downside risks but Albania, alike many other neighbour countries, should face a relevant issue: the size of its economy in absolute amount. As a matter of facts, size matters: It matters for the country itself, it matters for an international banking group, it matters for a single bank no matter if with foreign or domestic capital, and it matters as well for all the investors.

I truly believe one of the main driver in the investors' decision-making process, for sure in the banking industry, is the size of the economy since a sustainable business requires a minimal critical mass. Missing a critical mass the trade-off between investments, profitability as well as required equity could end up in negative territory. This consideration is perhaps a reading key for explaining what has recently happened, almost all of a sudden, in the Albanian banking system

One more point that I would like to pick-up from the previous speeches refers to the reported criticism on the slow and not satisfactory growth of the loan portfolio in Albania. If on the one hand it's true the total stock is not growing so fast, on the other hand we don't have to forget the dramatic decrease of the NPL stock. Six years ago the NPL ratio was much higher; according to official data, likely underestimated, it was about 25%, but now such a level has dropped to about 11%. It means that about 15%-20% of the entire loan portfolio was either recovered or written-off: so if we normalize the data, focusing on the performing loans only, we can see the real growth looks totally different.

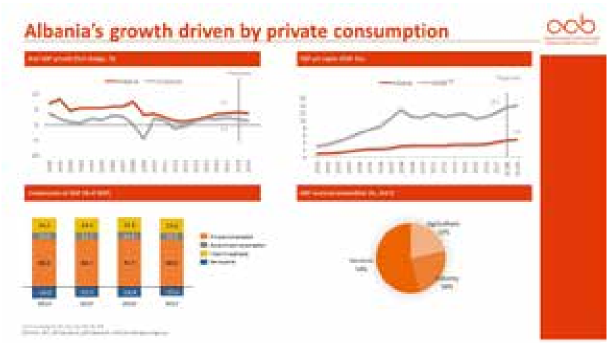
Now the quality of the loan portfolio is much better, allowing banks to positively look forward and pursue more aggressive credit strategies.

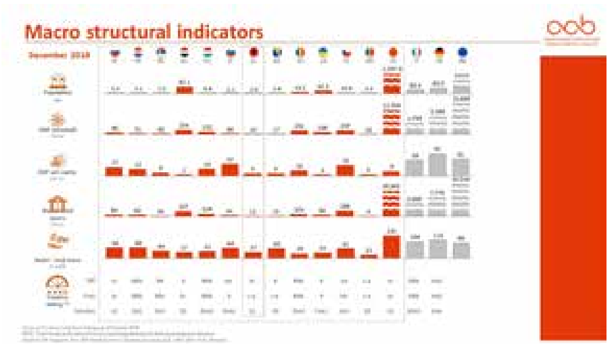
There is also another trend that is worth mentioning: like in the other countries, the underlying dynamics in retail and corporate markets differ significantly. While retail shows a strong demand both in mortgage and consumer loans, it seems there is a decline in corporate. This is not a good new for the whole economy since it could signal a lack of confidence in future investments from entrepreneurs' side and apparently the State is taking initiatives throughout very interesting infrastructural projects.

The banking system is looking to those projects with interest but, once more, I have to go back to the issue of the size.

The ability to finance large projects requires from Banks both the proper know-how and the adequate capacity. Such a capacity derives mainly from the regulatory capital and the related individual lending limit for single customer and group of related customers; moreover the concentration limit is also critical. These are concrete constrains in term of firepower, just in the moment in which the country needs those big infrastructural investments.

Some of these consideration are not included in the presentation, but I think they are quite pertinent to topics we are discussing today.



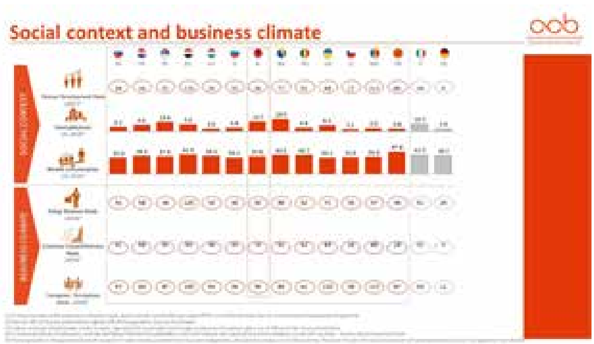


I think the first part of the presentation can be considered over and I hope you will be in the position to come some interesting conclusion. Once more I invite to pay specific attention comparing the reported other countries' macro indicators; the social context is also important and it signals improvement but room for further growth.

Now, let's move to the second part, maybe the most interesting, trying to analyse the recent events in the banking system and possible further developments.

What has happened all of a sudden in the last eighteen months as the consequence of a long maturing process?

We had six deals that occurred in the country. The first one was the acquisition of one of the Greek banks from ABI Bank, with American capital. It followed the acquisition of 100% of shares by the Hungary-based group OTP of the former Société Générale, from one European-based bank to another. There was the acquisition of another Greek bank from the largest domestic industrial and financial group in Albania, Balfin, so from European capital to Albanian capital. There was the incorporation of Veneto Banka in Intesa San Paolo, so Europe-Europe. Then there was the acquisition of International Commercial Bank by Union Bank, which is a domestic capital bank with EBRD as minority shareholder. Finally, in June this year, CBA decided to liquidate its operations and the Bank of Albania revoked its banking licence.



So, six banks disappeared in a short timeframe.

We, as Banking Association, can still hardly estimate – I am sure Bank of Albania has much more accurate figures - what has happened. "How and where have the asset, loans and deposits moved to, also taking into consideration another event which impact will be visible only since January, 1st 2019?"

I'm talking about the split of Kosovo operations from the books of the largest Albanian bank (with Turkish capital); in facts such an event changes the distribution and relative weight of the market share among the Banks.

It's also relevant to point out some normal processes that occur inside companies that decide to merge, acquire, buy or sell. Normally, in the transitory period until the finalization, we can observe actions aimed to clean the portfolio or to optimize the assets allocation, again influencing the market share: an example is the case of Intesa San Paolo with Veneto Banca that implied the sale of the whole NPLs portfolio of the latter.

The current situation, based on March 2019 data, is that we have now six banks with European capital, five foreign non-EU banks, and three Albanian banks. Before it was nine, five and two. We tried to summarize in this slide the movement over the last three years in the market share, dividing the banking system in groups: European banks, foreign non-European banks, and Albanian banks.

It is confirmed, as mentioned also in one of the morning speeches, that domestic banks have increased significantly their market share, both in total asset, loans as well as deposits. But I would say is not yet possible to affirm this is a consolidated trend, that this is something that will last in future. In my opinion only with the final figures of 2019 we can find a confirmation or not of the evidenced trends.

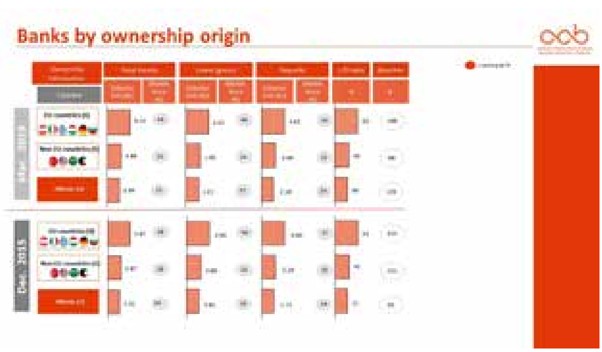
Moving to the next slide - and this is really a rough paper, I don't pretend that it is absolutely precise - you can see in the top left European banks decreasing in the three years horizon by 14% in total assets. The largest part, about 9-10% of this 14%, refers to the two Greek European banks, that changed ownership while no other European banks were interested in a takeover. The loss in the market share of European banks is 9%. The two Greek banks had 9%, so it is just a shift. Differently, deposits recorded -13%, out of which about 9% is the impact of the two Greek banks.

You can make more or less the same consideration for non-European capital banks and for Albanian banks bearing in mind that, according to our estimation, the mentioned split of Kosovo operations accounts for 3.5% in total assets, about 5% in total loans, and 3.5% in total deposits.

All these figures must be taken into consideration and, in my opinion, if we normalize data, we can see the dynamics of the Albanian banking system are much more interesting compared to what they look like. So growth is more dynamic, but for many different circumstances it seems we are slow in development. Once more, only when the final 2019 figures will be published, we will have conclusive considerations.

Now, let's try to come to some general conclusion and to foresee the main challenges we have to cope with in the near future.

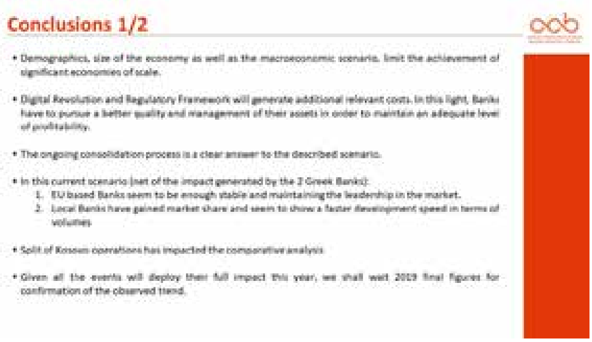
- demographics, size of the economy as well as the macro economic scenario could limit the achievement of significant economies of scale;
- Digital revolution and regulatory frameworks will trigger additional relevant costs for all the banks, no matter the origin of the capital;
- in this light all the banks, but in particular the domestic ones, need to pursue an higher assets quality and improve risk management framework in order to maintain adequate levels of profitability;
- the size of the loan portfolio and its level of concentration coupled with the current structure of P&Ls (whose operating margin is heavily depending on the interest margin) require improvements in order to avoid negative impacts in case of economic downturn;
- the loan portfolios are now healthier and sound but we must take into consideration that, having to face additional regulatory and technological costs, the cost of risk must be kept under very strict control;
- it is likely the main reasons that triggered the consolidation in the banking system were the demographics, the expected mentioned additional costs and the ongoing digital revolution;
- the Banks that left the country were the two Greek and the smallest ones;
- No aggregation occurred between the largest banks in order to create a real champion, it was just from the lower level that we saw movements.
- Still in the current scenario the European Banks have the market leadership keeping, all in all, a stable market share
- Domestic banks have gained market share and show a faster development compared to the others.



My Presentation did not take into consideration, on purpose, another quite important dimension: the profitability of the banking system. Let me make some other comments and considerations.

I'd like to underline that market share doesn't mean necessarily profitability but it is out of question the banks with higher profitability are the European and the non-European, while the domestic ones suffer from this viewpoint….. It means something.

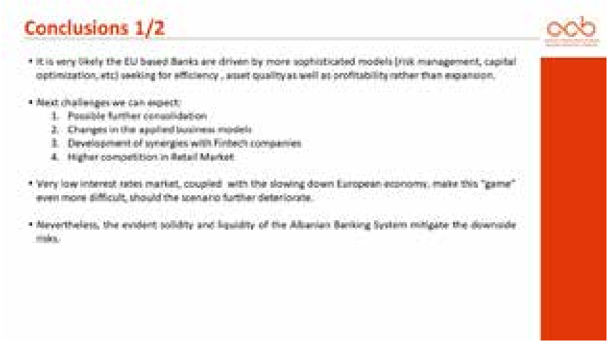
It seems evident that the local banks are pursuing increase in market share and are showing in general higher risk appetite. The former Minister of Economy this morning said that local banks lend much more: Yes it is true. They want to grow and moreover sometimes they operate following different policies. Please, take into account European banks have lower level of flexibility; they are bound to double regulations, are subject to more developed and sophisticated risk management models, to additional requirements in term of reporting, in term of systems' requirements as well as different standards. It is a different approach that, in the light of European integration, soon also the domestic banks should get familiar with. It is likely they have not yet reached the time when they will start feeling these additional constrains.



So, what can we expect in the end?

In my opinion the consolidation process is not necessarily to be considered over, we can even expect some more developments given the necessity to modify the industry business model. Digital revolution will be definitely a game changer, implying huge investments and synergies with Fintechs, synergies that can be achieved at Albanian level.

Moreover balancing risk and opportunities, given also the limited capacity of the single Albanian bank to afford bigger size loans, we can expect a further increase in the already existing competition in the retail market.



One of the main downside risk for the system is the extremely low interest rates market that, coupled with the evident slowdown in the European economy, makes our business even more difficult and let's hope the macro economic scenario will not further deteriorate. The good news is that, as I said at the beginning, huge efforts have been spent and extremely good results have been achieved by the Albanian banking system in the last years. It means even in case of material deterioration in the economic environment, the system can be considered quite resilient. From the liquidity and capital adequacy ratios point of view we are in much better position compared to years ago, being these the pre-conditions to cope with a possible downturn in the cycle.

Let's hope that all the fires around us will be extinguished, that the Chinese and the Americans will settle their disputes that Brexit will go smoothly. Let's hope the best for everything, but even if something negative occurs I am definitely confident the Albanian banking has all the means to succeed.

Thank you very much for your attention!

SECOND SESSION:

POLICY CHALLENGES AND IMPLICATIONS

This panel investigates how banks in the SEE and in particular in Albania deal with new challenges that arise both from regulators and non-bank financial entities. The session also analyze the new challenges these trends pose for authorities not only in terms of regulation and supervision but also in terms of policy implementation, including monetary transmission channel effectiveness and overall efficiency of market participants.

The session addresses the following questions:

- *How do ongoing trends alter banks business model and how should they engage/approach innovative trends in financial products and technology?*
- *How technological change in banking and finance can be harnessed for growth and financial stability?*
- *Should policy makers encourage non-bank finance to fill the gap that the potential departure of EU-based bank groups is creating? In your view to what extent Fintech can play a role in future finance in this region?*
- *What are the policy implications and policy options for central bankers, policy makers and the banking community?*

Chair: Luljeta MINXHOZI, First Deputy Governor, Bank of Albania

A CHANGING ENVIRONMENT - IMPLICATIONS FOR OUR ECONOMIES AND FOR THE FINANCIAL SYSTEM

*Marianne NESSÉN**

Thank You very much for the invitation to this honourable Conference! Thank You to the Governor of the Bank of Albania! Thank You to Erik and Piroska for the invitation!

I am very grateful to be here and to participate in this very important discussion.

I am a macro-economist. When I saw this slogan" A brave new World" I thought: "What would a macroeconomist say about this? What are the trends going on like now?"

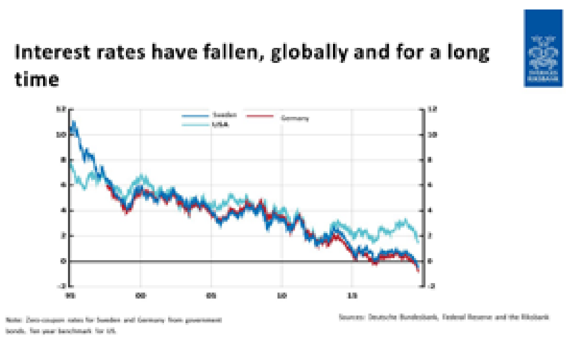
And the answers I am going to provide you have all heard before, but I am going to go through it again, because there are profound changes going on in the world global economy. Profound changes had been going on for a while, but will continue for the foreseeable future. Maybe as long as we live, they will affect our daily businesses, in particular, in the financial industry, and in particular in the banks.

I will be talking about low-interest rates environment, what this means. I will be talking a little bit about transformative new technologies, this is not my area expertise, but I will talk a little bit

* *Marianne NESSÉN, Senior Advisor to the Executive Board, Sveriges Riksbank*

about it; and then leave the rest of discussion to my co-panellists; and I will talk a little bit more about risks from climate change and what is going on in the international arena there in the financial sector.

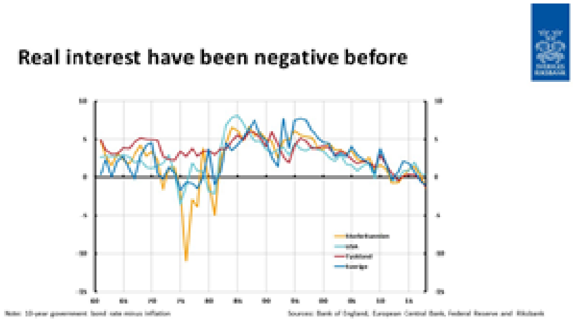
1. Let's start with the low interest rates. Let's look at this picture.



We have all seen it before. This is yields on 10-year bonds in the US, in Germany and Sweden. This is an extraordinary and remarkable graph. So, for the past 25 years, we have had a trend downwards in nominal interest rates. The global financial crisis gave this downward trend and added boost. Lately, this very long-term interest rates have indeed gone negative in Europe, not in the States. This has caused quite a lot of discussion, negative interest rates.

Now if we look at real interest rates. We all know that negative real interest rates are nothing new. The following graph shows the US, Germany, Sweden and the UK real interest rates since 60 years.

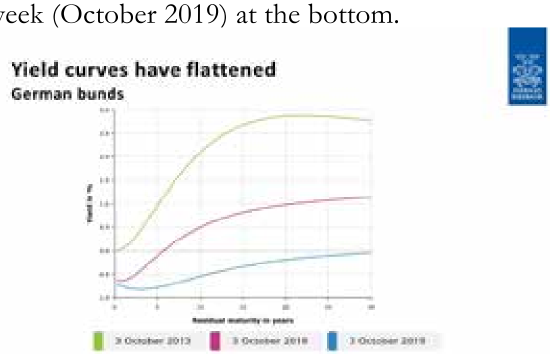
Many of us remember the 70s. I don't know if we remember that real interest rates were negative. We remember the high inflation. Real



interest rates were negative, then, or very low, but it was masked by high inflation. So, nominally, interest rates were positive. Why have real interest rates fallen? There is a huge literature at the moment; there are many distinguished economists studying this topic.

The usual explanations come down to demographics, aging populations who save more and therefore interest rates fall. It has to do with productivity, which has become much slower, in the 2000s than previously; and there is also a demand for safe assets, which drives down real interest rates, in particularly in the US and in the Europe. My point here is that these explanations, behind low real interest rates and negative real interest rates, these are slow moving factors. So it is very likely that, we will have these low real rates for many years to come. So, we have low real rates, we have low nominal rates, we even have negative nominal rates.

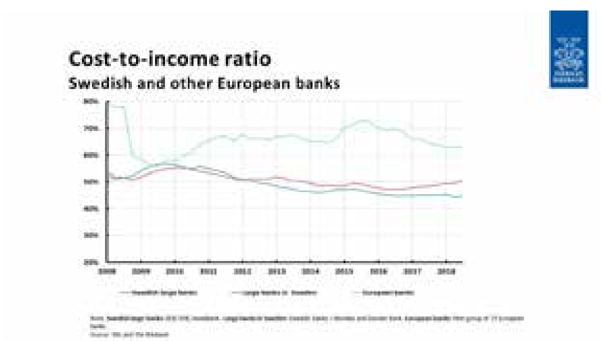
Another way of looking at interest rates is looking at the yield curves. These three lines are the yield curve for German bonds on three separate occasions. So, 2013, at the top, 2018 in the middle, and just the other week (October 2019) at the bottom.



What you see there, is that they have fallen, but also look at the most recent one, the whole yield curve is below zero. So, this interest rates environment creates challenges for banks - this has been mentioned today. So there are many different things: the level; negative rates; but it is also the shape of the yield curve. The one model of banking is that banks profit from an upward sloping yield curve. What many people now say is that this is not come to be the case for a long time going forward.

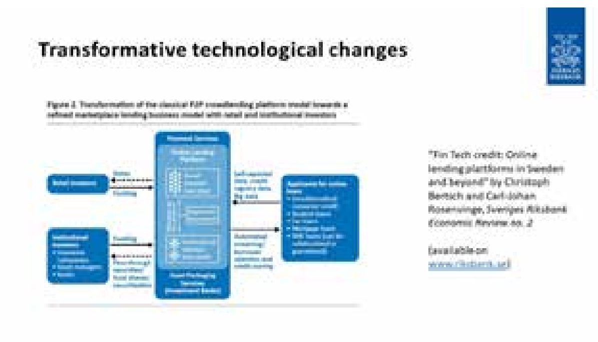
So, it is a very challenging environment for banks, and I come from a country, Sweden, where we have had negative policy rates, since 2015. There has been a lot of public debate about this, and it is even an understatement to say that people are not happy with negative interest rates, in particular not in the financial sector. It has been claimed, that this would hurt bank profitability. I would argue that this is not like the case in Sweden. Swedish banks have been able to handle this very well.

And I guess what the lesson teaches us in this case that in this type of environment, it will be even more important for banks to be cost-efficient and to cut costs as much as possible. I just want to show you an illustration of this. The following chart shows the cost-to-income ratio for three groups, partly overlapping three groups of banks.



First is Swedish banks- the bottom line; then if you add two banks to that group you will have what we call large banks in Sweden. And the top line is other European banks. And there is a star contrast here between the cost-to- income ratio in the Swedish banks and 15 large banks in Europe. An illustration that will be important for banks to keep their eyes on costs going forward, and there seems to be some scope for more efficient practices. So those were challenges from the low interest rates environment.

2. My next topic is this transformative technological changes. As I already said, I am a macro-economist; I cannot do justice to this important topic. I will show you one slide. I am using this slide as a piece of advertisement to an article that came out yesterday in the Economic Review of the Central Bank of Sweden.



There is an article there on Fin Tech credit: on line lending platforms in Sweden and beyond by two of our economists. They go through on-line lending platforms. This has been, mostly in the UK, in the US and in China. This has grown and developed, but also in Sweden it is growing. And they do a survey of these different markets. And they also try to explain what is going on. So this complicated graph taken from the article is an illustration of the latest technological innovations in the field of on-line lending platforms. This was just one example. There are many more examples. I am sure we will come back to it later on. There are huge developments in the area of instant payments. I come from a country where it is possible to make instant payments with the device called "Swish". I believe that Swish has become known worldwide and it is also now a verb in Swedish. We call it "Swishah", so transformative technological changes. Another area is digital money. I am not going to say so much about that.

This brings me to my final topic which is “climate change and its impact on the financial sector”.

In parts of the financial industry, climate change has been daily business for decades, for example in the insurance industry. They have been adapted to increase climate risks for many years. The new thing is that climate risk is sort of gaining attention in other areas as well. I would like to explain what this is. The NGFS is the “Network for Greening the Financial System”. This is a group of central bankers and supervisors. It is an international body; a coalition of the willing. It is not a standard setting body. But it is a group of central banks and supervisory authorities, who have come to gather in order to promote a greener financial system. It was set up only 18 months ago, and it is growing by the day. Right now there are about 50 central banks and supervisors. There are a number of organisations that are observers, for example the IMF, the BIS, the OECD, to name a few.

Why was this body set up?

The first bullet point is just about the urgency of this matter and the complexity of the problem that we are facing on the climate change and the risks this pose.

I would like to point your attention to the second bullet point. It is a very short sentence but it says it all. Climate-related risks are a source of financial risk. It is therefore within the mandate of central banks and supervisors to ensure that the financial system is resilient to these risks.

This is the reason why many central banks around the world are beginning to inter financial stability assessment and look at the effect of climate risks on the financial sector. In the future climate risks, climate scenarios will become part of stress-tests that central banks and supervisory authorities do when they look at the banks.

The last bullet point there, it is: highly likely those climate-related risks are not properly reflected in asset valuations. This insight is something which has really set regulators and central banks working. An example there is of course standard assets, different types of stranded assets.

I am going to finish off with one last slide which is about the NGFS.

It is a coalition of willing, so it is not a new standard setting body. What they did was they endorsed the six recommendations that the TSFT published in 2018. A number of recommendations with the top one are that "Central banks should integrate climate-related risks into the financial stability monitoring and macro supervision as well. The rest of those blue bars are about making sure that it happens: we need data, we need methods". There is also a suggestion the second blue box is about "If it is compatible with their mandates that sustainability factors should be incorporated into own portfolio management at central banks.". And a couple of other recommendations are there too.

To finish off, on-going and profound structural changes effecting policy makers, effecting banks, affecting the public at large. Huge challenges, but also huge opportunities.

Thank You!

MACROPRUDENTIAL POLICY AND INTERNATIONAL COOPERATION: THE (NEW) KIDS ON THE BLOCK

*Michael WUERZ**

Thank you very much for your nice introduction! Thank you very much for the invitation to Albania's central bank and personally to Piroska Nagy-Mohacsi! We know each other from the global financial crises and engagement to achieve a well-founded multilateral crisis management framework in the CESEE region. The Vienna Initiative established in 2008 was really, I would say, a well-founded European initiative in this area. Last time, when I was here in Tirana, we were in a very different macro-economic and political environment. We were in the last stages, I remember it very well, of the great moderation, high economic growth, moderate inflation and optimistic future expectations.

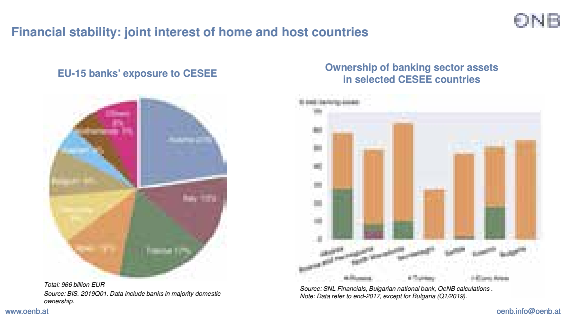
After the global financial crises and the great recession in 2008/2009, Europe and the European Union have drawn important lessons to maintain financial stability. We have really achieved a lot of positive developments, not only the establishment of the Banking Union but also in other areas. Therefore, the conference is taking place at the right -time to discuss challenges in banking in the very important region of emerging Europe. The title of this conference "A Brave New World", reminds me a little bit to Huxley who in 1932

* *Michael WUERZ, Head of Division, Financial Stability and Macroprudential Supervision, Oesterreichische Nationalbank*

published his famous novel "Brave New World". Under his specific assumptions and circumstances, he described a repressive society in 2540, which lived just formally under stability, peace and freedom. The society was under a kind of dictatorship and considered as the Brave New World. Contrary, we will now work together to really establish a financial system which is stable and sound, guaranteeing democracy and of course individual freedom.

At the Austrian Central Bank I am Head of Division of Financial Stability and Macroprudential Supervision and our main aim is to contribute to financial stability not only in our country but also to contribute to financial stability in so-called host countries of Austrian banks. Also coming from the spirit of Vienna Initiative where Albania is an active member, maintaining financial stability is really in the common interest of both home and host countries, as in a world of cross-border banking, risks are not confined to national borders. This is one of the major lessons we learnt from the global financial crisis. First, the spillover risks can be illustrated quite easily: For instance, the EU-15 banks' exposure to CESEE amounted to almost 1000 bn EUR, with almost a quarter of all those claims from Austrian banks. We also see that a lot of European banks from different countries have invested with a long-term view in this region and they remained committed to this region and benefited from the positive environment last year.

Second, the right-hand graph shows another indicator for spillover risk, namely the ownership of banking sector assets in the selected CESSEE countries.

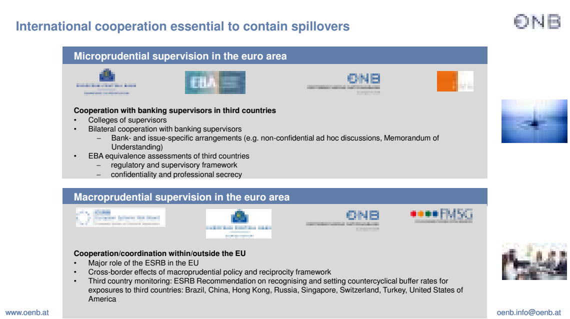


The statistic is based on SNL data. Foreign-ownership is in most CESEE countries higher than 50%. What is important is not only the share, but also its composition of foreign ownership. In the right graph we see that bank-ownership from Turkey and from Russia is at least in some CESEE countries substantial, also compared to ownership from the euro area. This has important consequences for multilateral cooperation.

As shown before and as we have heard today, there's a need for multilateral cooperation with non-EU member states. Sometimes this takes time to implement and to consider all issues seriously. I think that's a very important process.

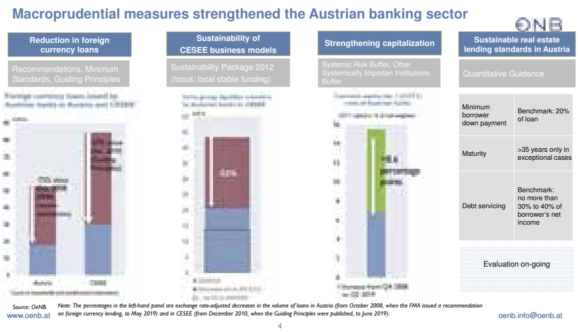
I remember really well 10-15 years ago, when we discussed our financial stability report at the central bank and we noticed for example some relevant developments in CESEE. We could only recommend to the concerned banks and express our financial stability concerns, but we lacked legal macroprudential instruments at that time to address systemic risks.

Now with the current EU-wide legal macroprudential framework, the so called European Systemic Risk Board (ESRB) and the existence of national mandates for macroprudential supervision, the situation has changed. The aim of course is not to overburden the banking sector but the aim is of course to foster financial stability in the home country but also in host countries. This shows there is room for improvement in international (bilateral and multilateral) cooperation also in the area of macro prudential policy, in particular with non-EU member states, as you know the ECB is very active in the EU. Of



course, the Vienna Initiative is one of such fora. You have first-hand information from non-EU member states and focussed information on developments and activities from the region.

I personally believe that also in the area of financial stability and macro prudential policy there would be room for improvements. For example, in my Division at the OeNB, we intend also in the future to have bilateral dialogues with host countries to discuss our measures and the impact for example of macro prudential policy .



The ECB has the right to make some further additional (tighter) measures, but the primary responsibility for financial stability (including the area of macro prudential policy) lies in the hands of the Members States. Why do I focus so much on this issue? The macroprudential supervisory activities developed by the OeNB in cooperation with the FMA and the Austrian Financial Market Stability Board (FMSB), including representatives from the Federal Ministry of Finance, do have mitigated systemic risks in Austria. The prevalence of foreign-currency loans required particular attention. You know, Austrian banks were providers of foreign-currency loans and we shouldn't be very proud of this product, because it is clear that it is a product which contributes to financial instability and could create problems, especially in crises times. The Austrian authorities decided to ban completely foreign-currency loans to unhedged-borrowers in Austria.

In the run-up to the crisis in 2008 we had intensive discussions with interest groups, because of course, they considered it as a "super" product. Also my colleagues from Raiffeisen Bank will agree with me, that I think it was a really good decision to ban it, and to refrain from foreign-currency lending in CESEE except for euro foreign-currency loans. The outstanding volumes were reduced substantially by the banks. I could truly recommend to limit/ban foreign-currency loans to unhedged borrowers. I know the situation in Albania is favourable in this regard. The second important measure was a recommendation in the area of sustainability of the CESEE business models of Austrian bank subsidiaries. It was not intended to reduce credit supply but to aim for a more local, stable and longer term funding of Austrian bank subsidiaries. The OeNB and the FMA have actively sought the dialogue with the European Commission, central banks and supervisory authorities in CESEE countries for instance when developing the so-called sustainability package. Through active communication we could address the concerns by some authorities that the loan to local stable funding requirement for Austrian CESEE subsidiaries could have procyclical effects on credit supply, namely leading to a credit crunch or deleveraging. The monitoring results show that there are no negative effects on credit supply in CESEE countries. Of course, capitalization is the second very important pillar of the package. Currently, we are addressing the sustainability of real estate lending standards in Austria.

There is an understanding among international rating agencies (e.g. Moody's) that the macroprudential measures taken have contributed to a strengthened banking sector in Austria and CESEE. Being a supervisory, of course, I also tend to see more the risks than banks might see, but together I think we really contributed to financial stability, not only for the home , but also for the host countries, taking into account the European banking system. Banks are now better capitalized and stronger at home, but it is also true in the host countries. Therefore, the banking systems tend to be more effective and efficient.

Coming to my last résumé , first financial stability is indeed a joint interest of home and host countries. Second, all the issue of macro prudential policy pays really off and there is a need for improvement in the cooperation, in the bilateral and multilateral area. And close cooperation in times of need has to be really based on close cooperation in good times.

Thank you very much.

FRIENDS WITH BENEFITS IN THE MODERN BANKING ERA: CHALLENGES, RISKS AND POLICY IMPLICATIONS

*Ioannis ASIMAKOPOULOS**

It is a great pleasure for me to be here today and I would to thank the Bank of Albania and the LSE for organizing this Conference. In my contribution, I would like to share some thought on the interplay between banks, non-banking financial intermediaries and FinTech companies, assessing the risks and benefits that this interplay may have, and providing policy guidance from a Central Bank point of view.

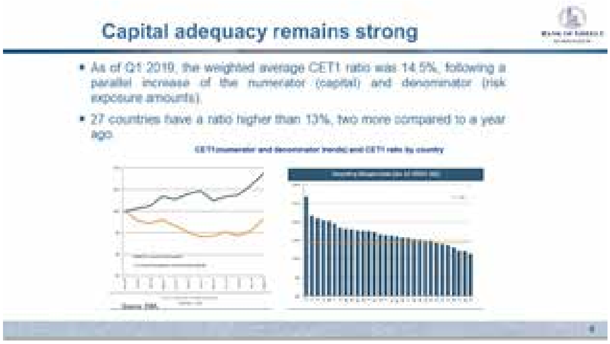
The decade since the onset of the crisis has brought significant structural changes in the banking and in the financial sector in general. Banks have reassessed their business models (i.e. balance sheet structure, cost base, scope of activities, governance, risk management practices, geographic presence); corporate debt financing has shifted to capital markets, while the global assets of insurance, pension funds and other financial intermediaries have increased relatively strongly. In addition, rapid advances in technology have underpinned a deeper digitalization of banking services providing banks with an opportunity to improve customer experience. On the other hand, technological innovation in financial services and its adoption by FinTech firms poses a competitive threat to some banks.

* *Ioannis ASIMAKOPOULOS, Senior Economist, Head of Banking & Capital Markets Section, Economic Analysis and Research Department, Bank of Greece*

Before discussing the new trends, allow me some brief comments on the current state of the European banking system since the developments in our region are not isolated from general European trends. On average, European banks show a marked improvement in resilience (strong capital ratios and improvement in asset quality), but weak profitability.

Capital ratios, on average, remain well above regulatory minima, while on asset quality, the NPL ratio remains in a downward trend for several years, standing just above 3%, although we still have cases of countries that report double digit figures. In absolute numbers, NPLs in the European market, based on data from EBA, are around EUR 660 billion.

Profitability remains subdued for European banks. It is striking that in many cases the Return on Equity (RoE) is below the Cost of Equity. One third of the euro area banking sector in 2018 had a RoE

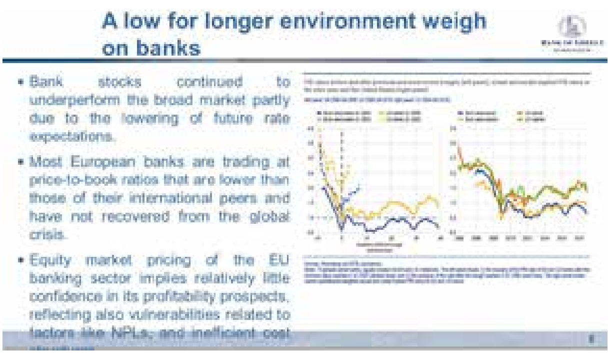


below 5% and 90% of the banks had a RoE below 10%. And this has happened in spite of the positive economic environment in which the European banks operate for a number of years now.

The Albanian banks, based on information we have heard by other speakers today, stand quite well in comparison with the European banks in terms of capital adequacy ratios and profitability. More work is needed on NPLs, but the reduction that has been achieved so far is considerable.

So, why European banks are struggling to improve profitability? A couple of reasons were already raised, notably the impact from the low interest rate environment and the problems with the cost efficiency, despite the substantial progress seen over the past few years (i.e. reduction in branches, in personnel and in staff costs).

The problem with low profitability is reflected in the equity market price of EU banks. The share price of European banks underperformed peers, and also the price to book ratios of European banks have not recovered from the global crisis.



As regards the non-banking financial sector, better known in the past as shadow banking, it has turned to a significant player in the market having a size of around USD 200 trillion. Of course, the importance of non-bank finance varies across jurisdictions and depends on the degree of financial development of the countries. It tends to be more significant in countries where financial development is more advanced, however we see cases that even in the smaller countries the activity is picking up considerably.

In Europe, the non-banking financial sector has increased its importance on the funding of non-financial corporations. The latest figures indicate that non-banks account for close to 30% of loans to NFCs, a percentage twice as much compared to ten years ago.

Moreover, non-banks provide a steady net flow financing to NFCs through the purchase of debt securities. In the ten years prior to the crisis the euro area NFCs obtained only 10% of their credit by issuing debt securities, now this is more than 50%. Also, in some jurisdictions, like the Netherlands, the non-banking financial sector has become a very important source of funding for households.

The increase in financial intermediation in the past decade is also affected by the developments in technology, where FinTech is the new animal in the game. Indicatively, a small search I did yesterday on Google using the FinTech term came up with 93 million hits.

By the end of 2018, FinTech global investment was around USD 112 billion compared to only USD 50 billion in 2017. Asia and the US lead followed by the UK, while Europe lags behind.

On a FinTech activity that is more related to the banking industry, FinTech credit, we observe an increased demand as during the crisis traditional lenders either withdrew completely from some market segments, or decided to underservice certain market segments like micro business loans. In these circumstances FinTech credit firms found the opportunity to jump in. Does it mean that banks have to fear the demand for FinTech credit?

It is certain that banks and FinTech credit firms have different set of competitive advantages and their interaction has benefits and risks. For example, the successful partnership between banks and FinTech platforms could create opportunities to improve risk analysis, to offer better service to particular segments of the market (i.e. small loan segment), or to help banks leapfrog some of the current challenges in legacy IT systems. On the other hand, there are voices warning on the possibility of increased financial discrimination, weaker lending standards, cyber risks, impact on the pass-through of monetary policy, and customer protection issues. Overall, however, I believe that banks and FinTech credit firms, although they start from a different base, can find a way to cooperate, offering more choice to consumers and improving the efficiency of the banks.

In a more general context, is the interaction of banks, non-banks and FinTech firms harmful? Following the Chinese view of risk, as can be seen in Professor Damodarans' webpage, risk is translated as danger and opportunity. A balanced financial system with multiple channels of finance intermediation is likely to provide healthier competition and better resilience to shocks. Also, non-bank intermediaries can tailor their service to specific needs. For example, they may serve clients that are either too small to be profitable to banks, or large in size but without having enough collateral to be served by banks. From the point of view of savers, collective investment vehicles, such as mutual funds or pension funds, can provide a wide range of investment options with different risk-return profiles.

The growing relevance of non-bank intermediation and the increased adoption of technology can however create potential new vulnerabilities. In the search for higher yield, non-banks have accumulated more risks in their investment portfolios. For instance, more than half of the bonds held by the euro area investment funds are BBB rated or lower. Also, we should not underestimate the fact that non-banks may also contribute to systemic risk through connections with the banking system. Overall, so far, no financial stability risks arise as a result of the activities in the non-banking financial sector and the adoption of technology. However, as seen in other occasions in the past, risks can be built up rather quickly. Therefore, the modern financial ecosystem needs careful monitoring and the innovation should be facilitated in a controlled environment. In this respect, regulatory sandboxes or innovation hubs through which authorities could navigate FinTech firms would be useful.

To provide an example, the Bank of Greece has launched its FinTech innovation hub through which it monitors innovative development in the financial sector and provides non-binding guidance to firms.

Looking ahead, under such a competitive and demanding environment, banks have to adapt their business models and authorities must adopt policies that would preserve financial stability. On banks' business models, the preferred strategy will depend on the starting point of each bank and its operating environment. Some banks may be incentivised to focus to the retail segment; other banks may try to address profitability pressures by investing in technology in order to improve cost efficiency. From a financial stability prospective, an important challenge is to ensure that the adaptation of the banks' business models to the new operating environment is not accompanied by excessive risk taking. Given the profitability challenge, banks might be tempted to take greater risks. This highlights the need for the close monitoring of the interaction between business model changes, bank risk-taking and systemic risk.

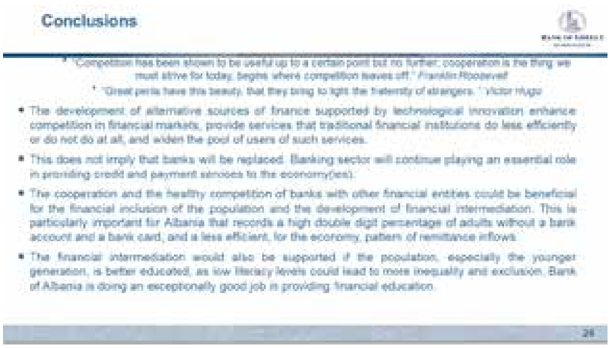
On policy responses to risks stemming from the non-bank financial sector, competent authorities should remain vigilant and continuously assessing how shocks originating in one part of the financial system can be transmitted to other components. In this respect, the non-bank financial sector needs to have solid prudential standards. We also need an extension of the macro-prudential toolkit (i.e. macro-prudential stress-testing or the development of stress-testing tools for non-banks) to the non-bank financial sector in order to provide the authorities with the means to address risks at the system level.

Regarding FinTech, regulation must not be too stringent to the point it prevents the creation and development of new technologies. On the other hand, it should not be too lax, so as to make sure that investors and users are adequately protected. Besides regulation, bankers and generally market participants should not get carried away by complex ways of doing things, as many times in the past we have witnessed significant sources of risk from such actions. In addition, we have to ensure a level playing field for banks and FinTechs so that banks are not in a situation of competitive disadvantage. Of course, the global dimension of technological innovation certainly requires international coordination and cooperation in the fields of supervision and regulation.

Finally, the changes in the financial landscape should be seen with caution but also as an opportunity to improve the ways we do our business. Banks must continue providing value and quality services to their clients, while supervisors must continue maintaining financial stability. Bottom-line is that the development of alternative sources of finance supported by technological innovation enhances competition of financial markets, provides services that traditional financial institutions do less efficiently or not at all, and widen the pool of users of such services. This does not imply that banks will be replaced in most of their functions. Bank competitors will always find more efficient ways to do things, yet banks who will adapt to changes will do the old things in a new way. Banking sector will continue playing an essential role in providing credit and payment services to the economy.

The cooperation and the healthy competition of banks with other financial entities will be beneficial for the financial inclusion of the population and the development of financial intermediation. This is particularly important for Albania that records a high double digit percentage of adults without a bank account and a less efficient, for the economy, pattern of remittance inflows.

The financial intermediation will also be supported if the population, especially the younger population, is better educated, and I think the Bank of Albania is doing an especially good job in this direction.



Having said this, allow me to finish by borrowing a phrase from one of the speeches of the First Deputy Governor, Professor Minxhozi, who has said, "Too young to speak in old lek", so, yes, we need education for the young people and education contributes positively to the livelihood of societies.

Thank you for your time!

THE ROLE OF NON-BANK FINANCE, HIGH-TECH AND FIN-TECH IN CONVENTIONAL COMMERCIAL BANKING

*Peter BOTOUCHAROV**

Good afternoon everybody!

Thank you for having me here. First of all, thank you to the central Bank of Albania, all the colleagues, Piroska, who invited me to this event and I am very glad to speak in front of you.

I have been to Albania only once before. It was 2012 and there have been a number of positive changes in the economy since then.

In fact I was very glad when I saw yesterday that we are speaking about rethinking size, structure and ownership, policies in commercial banking - to give you a view of a non-bank financial institution. In following up on the Governor's presentation and on other speakers' presentation about globalisation, about challenges, I would like to give an idea on what non-bank financial institutions do and how can we help or assist in banking sector development.

I wanted to raise three or four issues.

The first issue is to describe the context, the definition of non-banking financial institutions. What does it mean to be a non-

* *Peter BOTOUCHAROV, Vice President, Global Fixed Income, T. Rowe Price International Ltd*

banking financial institution in the global sphere? We are talking about asset managers; I am not talking about insurance companies. We can broadly divide the asset managers in three groups.

One is real money investors. We can call them pension fund managers or managers of global savings.

The second group is total return funds. I am not going to speak about them that much. To a great extent they are not involved in our smaller economies. So I am Bulgarian myself, used to work in the central Bank of Bulgaria. Our countries in fact are quite stable; there is no volatility where these types of investors get involved.

The third group are private equity investors. On them I will mention a few words just to indicate what they are doing in the banking sector.

This is the structure of this type of investors, operators in the financial market, and there are a number of trends going on in the industry, but for this particular discussion there are two important trends to mention. One, we continue to see considerable increase in assets under management, growth of assets. This is probably because the central banks have loose monetary policy; the world has large pool of savings. The second trend is that in addition to growth we see concentration of assets as well.

Just to give you an idea of the size of investments of assets under management that are coming: since 2015 to the end of 2018 the four hundred larger asset managers in the world have increased assets from USD 50 trillion to USD 70 trillion. We are talking about USD 70 trillion in the four hundred largest in the world of which 20% is concentrated in the first ten. So, which are the first ten? You know their names. There is BlackRock, they have about 6 trillion, Vanguard, State Street, and these are companies which are passive asset managers with huge amount of investments.

T. Rowe Price, which I represent, is a big company, but still is not among the ten largest asset managers, for we have USD 1.1 trillion.

This is the first trend: growth and concentration of assets. Now bringing it down to the level of banking systems in Central Eastern Europe and Albania there are challenges and there are opportunities. The opportunities are that as the money is concentrated in the largest asset managers we actually cannot invest short-term. We cannot invest in a bank, in corporate, in government bonds for a month or a year. It is really an investment with a long-term view, particularly in equity. One of our colleagues on the previous panel mentioned the importance of equity. In fact, we invest in Albania as fixed income investor, but even better is when equity investors come, the part of my company that invests in equity. Some of our colleagues here from Ukraine, from other countries, are fully aware how important equity investment is.

The challenge is that the markets are too small. So, even though you have these long-term investors, the market is too small and I will address some of the issues here. So this is point number one.

I will just mention the follow up points. So, I represent a large long-term real money investor. From one point of view this is very good for countries, for corporates and banks. From the other point of view, our own business model does not allow us - so, Madam Deputy Governor asked me what are the regulations we follow, what are the regulations we are under. As most of the central bankers here know, our companies are under domestic regulations, in our case we are a US company so we are regulated under the Securities and Exchange Commission in the US. In London we are regulated under the Financial Service Authority. In Europe we are regulated under ESMA. So of course we are regulated because we are responsible for pension funds, for the money of future pensioners. Of course when we come to a smaller country, Bulgaria, Albania or Ukraine, any country, we have to a certain extent to be followed by either the central bank regulator or a local non-central bank regulator like a financial services regulator, but generally these companies are very tightly regulated. In addition, we have internal regulations and risk management practices. I will give you one number and it is that we cannot invest in any asset, in Albania's Eurobond, in OTP Bank, more than 10% of the actual free flow, or the actual size of the asset. So if Albania has, as you have, a Eurobond of 500 million, we actually do not buy more than 50 million and this is a prudential risk internal practice. So this already puts a restriction to how much we can invest. The smaller the market is the more difficult it gets because the assets are smaller.

So, I am coming to the second point, which is about private equity. I am not going to talk about the total return funds, they are less important for our countries. Private equity companies are much smaller and more important for our markets, more active and they have the ability to actually invest in banks and support the local banking system. This is why one of the recommendations as a formal central bank person and a current investor is that we have to be flexible in our approach with different types of investors. So I will describe the structure – private equity funds can invest in conventional commercial banking, into local or regional banks. There are two three examples I wanted to give you and I am sure you know better than me. One is Addiko Bank, the Austrian bank, there is Czech bank called Moneta, and there is a somewhat new entrant which is called Robinhood, a US company. All these type of new banks, these new entrants, are based on new digital-based models. Of course, as you can imagine, they target the most profitable part of the lending market. They are not lending to governments or big companies: they are targeting SMEs and household lending.

Addiko is a good example. It is a regional player, I am not sure whether they are in Albania, but they are on the area across Croatia, Bosnia and so on. What is happening? Addiko by itself came out I believe from Hypo Group Alpe Adria and it was bought 80% by a private equity, 20% by EBRD. These people have a new model: specialisation in high yielding lending, simpler balance sheet, innovative digital structure. We could expect that this type of investor, this type of new entrants, will continue entering and using the opportunity of the new world, of new technologies. Moneta in Czech Republic is similar, there is a similar bank in Russia, and the big disruptor is the type of high tech and FinTech as Robinhood in the US, which is for the time being an asset manager but very soon will be in banking as well.

You as central banking or commercial banking have to get used to this business. Now, what is the role of T. Rowe Price or similar non-bank financing institutions? Since we actually have not the ability to buy a full bank, but only 10% of it, our role normally is that we invest either in these new entrants, these disruptors - but in a positive sense, I am not saying disruptors in a negative sense - or we invest into a banking group. For example, I am sure we have invested in Hi-Fi; we have invested in OTP, to get exposure to the whole industry in Albania or to the whole region. So, in a way, when working with companies like ours or similar companies you have a long-term investor who is not an active shareholder, but provides long-term equity funding and I believe from any government point of view this is welcome, long-term type of investor. If we find value, let's say in Advent, who is a private equity and bought into Addiko Bank we also invest into them, so we can go both ways.

These are the two-three points I wanted to mention.

The regulation was the final point. I already described how we are regulated and of course there are the recommendations which I wanted to make. One, we have to adapt to this new digital world, these new types of entrant disruptors either by speaking directly to them, in a way supervising them or supervising us as a final provider of liquidity, and by applying a differentiated approach.

Let me stop here. I believe these types of non-banking financial institutions and companies provide support to the conventional banking industry and the long-term investors, entrants create positive environment for the banking sector in our economies.

Thank you!

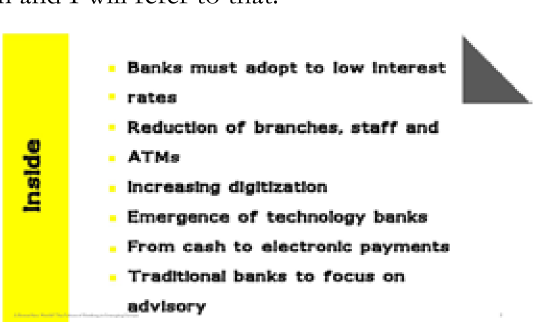
NEW TRENDS IN BANKING. WHAT'S IN STORE FOR ALBANIA?

*Heinz WIEDNER**

Thank you very much! I would also like to thank the organizers and the Governor of the central bank here in Albania for the invitation.

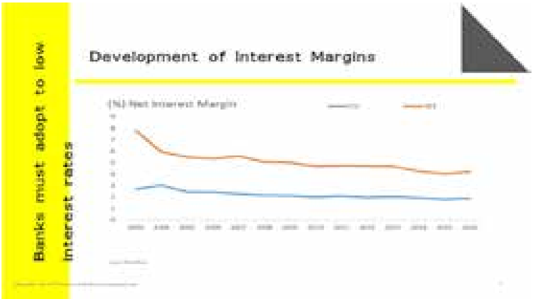
I am standing, I think, between you and the lunch now. I think you are getting hungry; I am getting hungry as well, so I will try to keep it short. At the same time I will try to keep you interested.

There are many things I will cover that have been touched before, so there is no surprise in that. I will discuss the trends in banking that affect globally the banks, regionally, but also most of them Albania, either now or in the short-term and some of them probably in a longer term and I will refer to that.



* *Heinz WIEDNER, Vice Chairman of the Supervisory Board, Raiffeisen Bank Albania*

Let me start with a subject that has been already mentioned several times. The banks must adapt to the low interest rate environment.



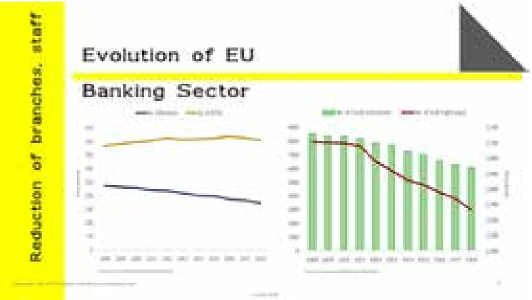
That sounds very simple, but is not so simple. I have seen several banks' business plans who predicted in 2013-14-15 that by now interest rates would have started to rise again and there are models for that how you could protect and keep interest income through effective maturity transformation. But this only worked for a temporary period. By now this time has passed.

Practically banks have to live now with the prospect of the 0 or close to 0 interest rates in many countries for the foreseeable future. I think that was mentioned before, but banks really have to change their business model to accommodate for that.

In the end, interest margins obviously at the level of 0 cannot be the same as at the level of 5%, for example. That is very clear and obvious, and while it doesn't look too dramatic on the graph as I said this has a big impact on banks.

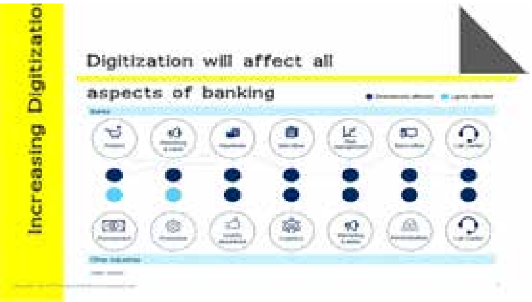
One of the reactions of the banks has to be to improve productivity and efficiency: to lower the cost base. That can be seen on the one side in the reduction of the staff. Reduction of staff in banking in Europe proportionally has been already quite high. I am predicting that this will continue and it will continue probably even at a faster pace for the next five years in order to really boost the efficiency as the digitalisation also plays its role and plays its impact in the banking world.

Branches are also being reduced. You can see that even in Central and Eastern Europe, that branch levels have increased until 2013-14 and then started to decrease again.



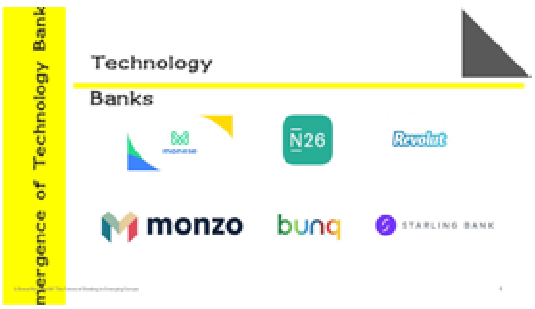
That is happening; I see that also happened here, as the online payment functions are being accepted more by the population. I mean, let's face it, you see in lot of countries branches that have only 30% of the traffic of people that they had before. This is a development that banks have to react to and therefore the number of branches will continue to decrease. It will not disappear, you need branches, I think, in the traditional banking system, but clearly there will be more concentration and a reduced number of branches.

Digitalisation is the other big factor that has played a huge role here, in the revolution I would almost call it, in banking, but I will tell you here that we are still at the beginning.



This might sound kind of strange, because you all are used now to apps on the smartphone etc., where you can do payments, even account openings, but banks still are lagging behind other industries in the level of digitalisation. That affects all areas: in products and services, in back office, mid office, to even risk management. Now, banks are starting to look at the possibility to use artificial intelligence in upgrading their scoring systems so that the system- through new data that are being fed constantly - can automatically adjust the risk approach. We will have to see how effective this actually is, but I think technology can also help very much on the risk management side. So, it will affect all aspects of banking in a very big way.

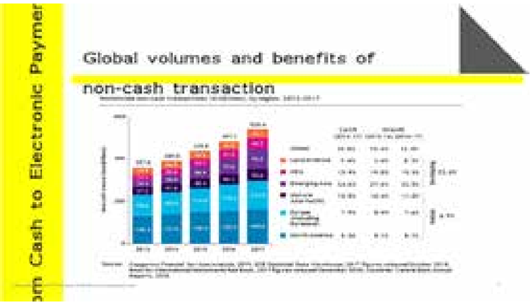
We talked about FinTechs. Fintechs are important, they can bring innovation, but you have to look beyond just the fashion of FinTechs. Many will fail and disappear.



I would say that probably two out of ten FinTechs are really value added and there are quite a number of those that are having gadgets or other types of solutions which really do not contribute that much. It is up to the banks to decide with which FinTechs to cooperate and where to invest and where to spend the money in order to get the digitization to level that is needed.

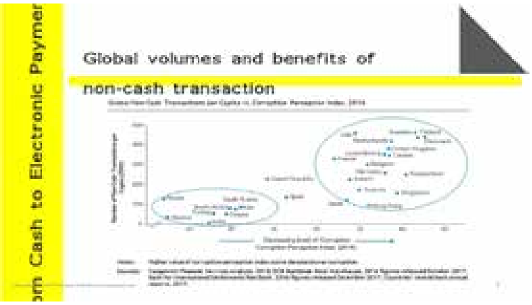
There are technology banks on the horizon which also put pressure on the banks. Some of them, or maybe all of them, I don't know, you probably have not heard yet about, but they are already having some millions of customers and they are quite active. I mention two; N26 and Revolut are banks that already have several million customers. They are acting in countries from Austria to the United States to the United Kingdom and other areas. They are not FinTechs, they are banks, but purely based on online services and they are not burdened by the infrastructure cost of traditional banks. That means that they don't have old-fashioned core banking systems. Actually the largest banks have banking systems that relate to 30 even 40 years ago. To change these is not an easy undertaking and there is a cost related to that. These technology banks in that sense are starting from scratch and we will have to see how successful they are, but I can assure you they are acting definitely more cost effective than traditional banks. We will have to see how successful they will be, but they are starting with a standardized offering. They obviously cannot offer all products, services, yet, but they offer those who can be standardized, can be digitized, in a relatively easy way. So, I think we have to watch out for them and they are a competitive threat to traditional banks.

Something else that plays a role and I actually forgot to mention earlier on when we talked about the reduction of staff and branches, is actually an interesting thing, it is ATMs which have grown in numbers up until 2016 and then also started to decline, including in the region.



The reason there is not cost effectiveness. The reason is that people are using payment methods that are outside the cash part, and the more they are used to it the more they will not go and need the cash even in the ATMs, not to speak about the branches. So, really we see also a reduction of ATMs going forward.

You can see that the global volumes of electronic payments are increasing double digits and they are increasing faster than before. So the growth is now 12-13%. Actually the highest growth in 2018, I don't have that on the slide, was in Russia, interestingly. I don't know exactly why, but the growth in electronic payments was 50% in Russia. So, they obviously must have put quite an emphasis on that part.

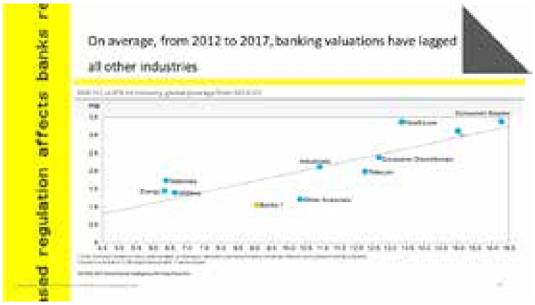


You can also see here a correlation between countries that have a high level of electronic payments per capita to very low levels of corruption index. This doesn't seem to be too surprising, but countries with higher electronic payment volumes have lower corruption and therefore there is an interest to increase the electronic payments, I believe, also in regulators, even though cash will not disappear. I am convinced that we will see cash for many decades to come.

What I want to say is that banks had to not only become more efficient and not only embrace technology; they also have to provide additional value added services to their customers. I am convinced that banks will only win the game if they are more customer-oriented and provide a kind of bonding to their customers, provide consultative services, and provide other value added services that pure technology banks through their online offering will not be able to do.

So, this will help traditional banks, it will not be the only solution, but together with productivity improvements and the digitalization this is a must if traditional universal banks want to continue to succeed.

This was also mentioned before. It is logical that banks with much higher capitalisation level today and high liquidity buffers are safer than before. Therefore it is also logical that returns on equity actually are lower than they used to be before the crisis.



This is not the only reason for the low evaluations, there are many other reasons for that, but here I can show that banks typically trade on the stock market below book value and it is the worst industry, if you look at all the other industries there currently. This is something that banks will need to see how they can get out of, because obviously analysts are looking at future earnings and at the moment there are too many clouds in terms of future earnings and they are not sure the banks will be able to deliver on that.

I have a final word about cryptocurrencies because I believe it will not come any time soon here, maybe here I am wrong.

But I don't believe that Bitcoin - which is s speculative currency - will really have a major effect. Libra, it was mentioned before, is something that I think already regulators and countries have gotten some cold feet about, so it is not clear how successful that will be.

In my view cryptocurrencies will only have a chance to be successful if regulators and also country governments will see that they can control the money flows, because this is an extremely important factor for an economy to control the money flows and with the cryptocurrencies it is difficult. So, I think there will be developments of cryptocurrencies which regulators and reserve banks will also support, and then it might have a bigger impact, but right now, for the next years, I don't see that.

In summary, let me just wrap up, I would say that banks have to embrace this change that is going on. It is more like a revolution than an evolution. I am convinced that the next five years will bring significant changes to the banking industry and therefore if they do and they do it well, I see it as an opportunity rather than a threat. I think they can succeed. If not then it will be a difficult future.

Thank you!

THE GOVERNORS' PANEL:

FINANCIAL SECTOR FOR GROWTH AND STABILITY

The traditional Governors' Panel addresses key issues in the future of banking and financial services. What are the most promising trends and where do future risk lie? What are the potential implications in terms of macroeconomic stability and risks, and main dilemmas for central bankers and regulators, not least in the context of the recurrence of "currency wars"? The discussion focus on policy and regulatory choices and incentives to reinvigorate financial intermediation in Albania, the SEE, and in the broader Emerging Europe region.

Chair: Piroska NAGY-MOHACSI, Programme Director, LSE Institute of Global Affairs

Panelists in the alphabetical order:
Erik BERGLOF, Director, LSE Institute of Global Affairs
Mario BLEJER, LSE and IDB; former Governor of Central Bank of Argentina
Ardo HANSSON, Former Governor, Bank of Estonia
Želimira RASPUDIĆ, Vice Governor, Central Bank of Bosnia and Herzegovina
Gent SEJKO, Governor, Bank of Albania
Dmytro SOLOGUB, Deputy Governor, National Bank of Ukraine

THE GOVERNORS' PANEL

ROUND: I

Chair Piroska Nagy-Mohacsi: Welcome back after lunch. We had a long but very substantive morning session. Now wait for the "ice on the cake", which will be this closing panel, the traditional Governor's panel at the Bank of Albania's Annual Conference. Before going ahead, I would like to thank personally the Governor, the staff of the Bank of Albania for this fantastic collaboration, which has allowed for the second joint Bank of Albania and LSE Conference to take place.

Mr. Governor, I would like to name three people from your staff who have been instrumental on your side to bring this conference to life: Altin Tanku, the Head of the Research Department at the Bank of Albania; Donald Duraj, the Head of Governor's Office and Enri Herri, who has been the brain behind the logistics of this organisation. Thank you to all the three of you.

We have had phenomenal discussions this morning, but as many of you may know, yesterday there was a preceding high-level panel on "Global and EU-wide trends reshaping the landscape for Southern-Eastern Europe". The panel consisting of Erik Berglof from LSE IGA, Nadeem Ilahi from the IMF and Vassilis Monastiriotis from the LSE Research on SEE discussed trends and developments in the global and regional contexts. The Governor's panel therefore could draw not only on the discussions this morning, but also on yesterday's high-level deliberations.

With your permission Governor, I would highlight a couple of points that would prepare us for the discourse in this panel.

One was what Heinz Wiedner from Raiffeisen Bank called the "revolution" that is going on in the financial sector and particularly in the banking sectors, globally, but particularly in this region. It is not simply a revolution, but a fundamental change in ownership: EU-based banks reducing a little their market shares and non-EU banks and local banks are gaining market share.

At the same time, we see these massive changes against the backdrop of major improvements in the economic and business fundamentals of the sector. From Michael Wuerz, from the Austrian National Bank as well as from other speakers, we heard that there has been a massive improvement in the resilience of the banking sector. So we have a revolution in the structure, while at the same time the resilience of the system overall has improved. That is a quite remarkable story.

These huge transformations have been well managed. So, while we need to identify problems and challenges in the future, it is important to recognise that we have a much more resilient system, with much better fundamentals, much better capital adequacy, better liquidity and healthier balance sheets. This is not a small list of improvements after all that the region has gone through in the wake of the global financial crisis.

The second important point was the impact of low or negative interest rates and how banks can cope with this situation. We have heard from Marianne Nessen of the Riksbank that we can rest assured that low or negative interest rates are here to stay.

So we'd better prepare for adjusting to them.

Another remarkable point was that negative rates can strengthen the banks' drive for cost efficiency. This adaptation comes with a lot of improvements, particularly when the competition from non-banks and FinTech industries is significant.

We heard a lot about digitalisation. It is something that probably the panel will want to discuss. It was reassuring in this regard to hear from the representatives of Intesa Sanpaolo Bank, Paola Angeletti and Silvio Pedrazzi, and from Raiffeisen representatives. From the policy side, Ioannis Asimakopoulos from the Bank of Greece and Davide Stroppa from EBA told us that banks are already preparing for this digital revolution.

We heard from Ralph de Haas of the EBRD, that five cross border banks have been really transformational in financing the transition from the communist system to where we are today, the democratic countries in the Central-Eastern Europe region. While these banks have been critical in the transformation, they are less equipped for what it is really needed now: finance innovation, which is needed to accelerate growth and avoid the middle income trap. This requires a lot of risk taking and it will also be interesting to hear from the panel what they think about the possible policy implications.

We also heard yesterday from Nadeem Ilahi from the IMF and today from Milan Deskar-Skrbic from the National Bank of Croatia that this Southern-Eastern European region is in the "wings" of the Eurozone. The BIS has said, as we heard at last year's conference, that this region is really a "shadow Eurozone area". Therefore, in this region there is a "mini-financial cycle" by the Eurozone; what really matters here is ECB policies.

We also heard finally from the role of non-bank finance. Peter Botoucharov spoke about possible involvement of asset managers in financial sector transformation. There could be some question marks about what this may mean for financial stability when, for example, asset managers want just to exit the banking sector for profitability reasons.

A very important final point which the panel may want to think about is the Eurozone's role and its self -perception that it is changing.

Erik Berglof and Vasilis Monastiriotis, both from the LSE, yesterday made the point that the whole sovereignty concept of Europe is maturing and that impacts, as Vasilis rightly pointed out, what kind of "membership game" is there for the non-EU members in this region.

To discuss these and other important things we have a fantastic panel. First, allow to introduce myself. My name is Piroska Nagy-Mohacsi. I am the Programme Director at the LSE Institute of Global Affairs (IGA). First of all we have Governor Sejko who needs no introduction. But let me mention one thing that comes out from your biography, Mr. Governor and of other participants in this panel: it is your extensive experience in the private sector. You bring to the public service the skills and the experience that you have accumulated at Raiffeisen, Societe Generale and auditing experience at Deloitte & Touche.

Erik Berglof is Professor of Economics at the LSE and the Director of the LSE IGA. Erik formerly worked as Chief Economist of the European Bank of Reconstruction and Development.

Madam Želimira Raspudić is the Vice Governor from the Central Bank of Bosnia and Herzegovina. Madam Raspudić has been Vice Governor since July 2017. She has an extensive commercial bank experience, for example with UniCredit.

To my left is Mr Dmytro Sologub, Deputy Governor of the National Bank of Ukraine. He has been serving since March 2015 as Deputy Governor in charge of monetary policy, macro prudential policy in a country which has been going through also sort of revolutionary changes in the past years. He also has had commercial experience at Raiffeisen and has held a number of public positions.

Our panel also includes distinguished former governors. On my very far left, is Ardo Hansson, who until a few months ago was serving as the Governor of the Bank of Estonia. When he took over in mid-2011, the Baltic region and his country was still facing formidable challenges in the wake of the global financial crisis. But the country stood in the Eurozone, having handled a very difficult adjustment.

Last but not least, is the former Governor of the Central Bank of Argentina, Mario Blejer. Mario is on the board of directors of IRSA, which is a major holding company in Argentina and Israel. He is also a visiting professor at the LSE. In addition to being the Governor of the Central Bank of Argentina, Mario has served also as Executive Director at the Bank of England and has taught in universities around the world. Finishing this introduction, let's now start the discussion.

Perhaps the first round would be giving you a little free way of describing major challenges that you have been facing during the past years.. We start with you, Governor Sejko and then go around through the panel.

Governor Sejko: Thank you very much Piroska! A very good summary. I will be brief in my introductory comments, as I believe the panel will address the issues in greater detail as we proceed. Banking sector restructuring has been at the focus of Bank of Albania policies and in this respect we have covered all relevant issues discussed by other colleagues in the panels yesterday and today's morning session. In the meantime, we have also been dealing with other traditional central bank challenges that have come our way during this period. We discussed some of these important issues that relate to banking system and financial market development also in our last year's conference. Bank of Albania has made a lot of progress and many changes have taken place. Consolidation of the banking system has been one of our aims. Some European banks operating in Albania, like Société Générale, banks with Greek capital, and other banks, adopted an exit strategy, due to tightening risk-related criteria by their parent banks and ECB policies. These strategies had been announced last year, and in a year's time, since the last conference, some banks decided to eventually exit. So, our challenge, from the supervisory point of view, was to oversee the banking system restructure and banks restructuring while preserving the stability of the system as whole, and without causing negative effects for the economy, their clients as well as for our monetary and financial stability policies. Now, considering the process is completed, we have 12 banks instead of 16 banks we had before. This consolidation process was achieved by the means of mergers and acquisitions which have introduced new names in the Albanian banking system. With the current structure, our banking system will be more focussed and in a better position to credit the economy and deal with financial market stability and development challenges. It will provide a better match for the current needs of the Albanian economy, the development of the financial market and will increase the efficiency of the Bank of Albania monetary policy.

Bank of Albania was well prepared for this process and has worked closely with the banking system and the parent groups throughout it. This consolidation process was something that we were looking forward. However, the challenge was to maintain the quality of the shareholding in the banking sector. The previous shareholders had a lot of experience, but, during the last year, since they had adopted an exit strategy, they were not proactive at all. As a result, these banks were not lending to the economy and at the same time resources and governance deteriorated somewhat too. So, it is a positive step forward that these banks changed their shareholding structure, although it introduced a challenge to Bank of Albania. The process required more frequent and focused supervision and monitoring of these banks during and after the ownership changes took place.

While still at an early stage, we are happy to see some positive developments and results. First of all, there is a positive growth in lending, mostly denominated in lek supported by our accommodative monetary policy with the lowest historical policy rate. Moreover, this year, growth in lending has been present in a wide range of sectors. Last year, the credit growth was concentrated mostly in retail and households segments. Now, we see growth in loans to business sector mostly to small and medium-sized enterprises, and to some extent to larger corporates. So it is a good signal, in terms of lending to the economy. In this regard, this also represents an improvement of the efficiency of the monetary transmission mechanism, and in the meantime we are happy to emphasise that we have been able to manage financial stability related risks and maintain the financial stability throughout the entire process.

I must confess it was not an easy process, as sometimes monetary policy and financial stability policies go in opposite directions. There have been other moments in the past when this coordination has been very stressful, especially during the Greek crisis. We worked in close cooperation with the IMF and I take this opportunity to thank also my friend Mario Blejer that helped us very much during this period with his advice. So, we successfully overcame a very difficult situation related to financial stress on the banking and financial sectors.

During the consolidation process, capital adequacy and liquidity in the banking system and in the rest of all banks' financial health parameters were in a very good condition. Capital and liquidity ratios have been consistently above the required limit, and continue to be in good levels. Sparing you of unnecessary details, this is what I would like to say about banking consolidation and changes in the banking system in Albania. Now we feel more confident about the future.

We have had other challenges, which we continue to face. One of the most pressing issues we were coping with is the appreciation of the exchange rate during the last three years, especially in the last year, when the exchange rate appreciated significantly. The appreciation has stopped and the exchange rate is now stable, on account of limited turbulences in domestic financial markets and reflecting developments in economic growth rate and other fundamentals. Our GDP is above 10 billion Euro and the growth is strong. There have been considerable FDIs inflows measured at roughly one billion Euro per year. Most of the FDIs originate from the Eurozone. Exports of services and especially tourism have made good progress during recent years. In addition to the increased number of foreign visitors, Albanians living abroad visit home either on vacation or to see their families, during summer months or winter times - mainly around Christmas - bringing in more remittances. Remittances have always been a significant contributor in Albania's economy, and recently we have seen a growth in remittances, owing to a new wave of emigration toward Eurozone. Like incomes from tourism, most of remittances are in euro. Altogether these activities uphold the supply of euros in our economy, and as a consequence increased pressures for appreciation of lek.

There has been a long debate about formal and informal sources of foreign currency inflows. The narrative is that lek appreciation could be also a result of euros entering in the economy via informal channels. We of course can measure only the domestic currency in circulation. Empirical analysis suggest that the appreciation was in line with the observed shock in supply of euro in the official market by identified formal sources in financial and real economy sectors.

Due to all this euro pressure, the exchange rate appreciated, hampering competitiveness and affecting exports negatively. Indeed, there were also complains from exporters about the appreciation eroding their competitive advantage. However they failed to see the overall picture. We are a country with an external trade deficit. We import more than we export. It is true that exporters were complaining because they were suffering the losses. However, on the other side, many businesses which generate their income in domestic currency were gaining from this story. Because of the characteristics of the Albanian economy, during this particular episode of appreciation, net gains from economic actors are prevailing.

However, despite these micro based concerns, our duty, as the central bank of the country, is to serve our main objective and manage the economy as a whole, rather than manage the exchange rate from particular groups of interests.

Albania is under a free floating exchange rate regime so it is understandable that this regime is in place to better amortise the external and internal shocks. However, at certain times and under specific conditions, large appreciation or depreciation exchange rate shocks have some consequences. In this case, the major consequence was on inflation. Exchange rate appreciation was having a negative effect on inflation by undermining Bank of Albania's monetary policy measures. Inflation was well below our 3% target and this became our main concern.

Given these concerns, the Supervisory Council approved then an intervention program. We withdrew the excess liquidity in euro from the market, and tried to stabilise the supply shock in the foreign exchange market. We succeeded to control it to some extent, and reach a new equilibrium of the foreign exchange rate. So, that was a major challenge that we were facing. We will see, but for the time being there is no considerable fluctuation.

Another important issue we are facing, is the high level of euroization in our economy. Our economy is highly euroized, not only in the financial sector, but also in the real economy. Euroization is almost 50/50, and has become a concern for macroeconomic and financial stability for the following reasons.

First, around 1/4 of the loan portfolio is unhedged in Albania. That means FX loan portfolio constitutes a significant risk for financial stability in case of depreciation of our national currency. People will face increasing difficulties to repay their loans because the exposure is in euro, but income is in the local currency. Potentially, this is a very serious risk exposure for the future.

Second, the high level of euroization is reducing the efficiency of the monetary policy transmission mechanism. Since only 50% of loans and deposits are in the local currency, the transmission of our monetary policy is limited.

To address these concerns, Bank of Albania has in cooperation with the Government and the Financial Supervision Authority signed a Memorandum of Understanding, according to which, the three institutions have agreed to develop and implement a de-euroization strategy for the economy. For the central bank, this strategy uses required reserve and other monetary operational tools to make the national currency more appealing for investment and savings relative to the foreign currency ones. Simultaneously, Bank of Albania is also working in terms of financial education and transparency for people to understand what the foreign exchange risk is.

Our de-euroization efforts in the framework of financial stability and the accommodative monetary policy stance has produced some very good effects.

First, only a few years ago, almost 80% of the outstanding loans stock was in foreign currency, mainly in euro, now this figure has dropped to around 50%. This is due to reduced interest rate differential between lek and euro. People are getting more loans in lek as the interest rate for such loans is much lower, and so is the interest rate differential.

On its side, the Government has to take its own measures to prevent the unnecessary use of euro as means of exchange transactions in specific markets. Many commodities are quoted and exchanged in euro. Why should they be quoted in euro!? We see all the countries in the region and everywhere they use local currency as means of exchange. Residents and foreigners cannot purchase goods and services in euro but they must go to a bank or exchange bureau and change it for domestic currency.

Of course, de-euroisation is a process that will take time. It is measurable but it is not easily achievable. It will take time because euro availability and usage is entrenched in our economic life, but we will be persistent and will do it step by step.

Another important challenge with the banking and financial sector is the introduction of fintech and financial innovation, and its adoption by the financial industry. There have been a lot of initiatives in Albania for implementation of new technologies in finance, starting first with commercial banks. There are several initiatives in the market aiming to offer innovative services for or in cooperation with the banking sector. However, this process is a bit fragmented, bank to bank, and there has not been very significant progress.

Compared to a few years ago, very good process has been made in this area because people are using mobile banking to access their bank accounts, make payments and transfer funds through their online or mobile banking, etc. However, these services are not broadly used by the general public in their everyday payments. We are working in this regard. Modernisation of the payment system is one of the main goals of the central bank, supported by the National Payment Committee that is chaired by the central bank. To this regard, The Committee has approved a National Strategy for Retail Payment Market in Albania, which aims to enhance financial inclusion and the use of electronic payments. One important step towards achieving the objectives of this strategy is the drafting of a Law "On payment services", which basically transpose the Payment Service Directive 2 in the Albanian legal and regulatory framework. We are amending the Law (as mentioned previously in my speech) for this purpose.

The aim is to enhance the role and operation of non-bank financial services in the payment service market aiming to increase competition and enhance innovations. There may be many risks from these non-bank financial services, but they are very attractive and have a lot of positive contributions for the banking industry and the financial sector, reducing the costs, and improving their reach to rural areas, and improving the formalisation of the economy.

In this context of implementation of banking and financial services and digitalization, we face another important issue, the low level of financial literacy and financial inclusion. Bank of Albania and other partner institutions surveys', show that we, not just in Albania but all countries in the region, have a low level of financial literacy and financial inclusion. Both issues are at the heart of monetary and financial stability policies, economic prosperity and economic convergence. Limitations in both areas of financial education and financial inclusion, have significant implications not only for the efficiency of monetary policy and financial stability, but they are first and foremost obstacles for the prosperity of households, economic development and economic convergence. Last but not least, for the development of the financial sector itself. Because of these two issues, many households, micro, small and medium enterprises are unable to work with the banking and financial institutions and benefit from financial intermediation either because they do not know how or, because they are unaware of the opportunities. In other cases they are either considered unbankable or, the banking and financial institutions and their products are beyond reach of small businesses and households and mismatch their needs. These limitations constrain their ability to invest and expand their business and reduce financial and economic efficiencies. We are trying hard in this process. We want to increase the financial literacy and financial access of people to the banking sector, and this comes through financial education. The central bank in cooperation with the Ministry of Education and other actors in the market are engaged in many financial education programs. However, this is also a very difficult process.

Digitalisation plays a crucial role in this process too. Educating people financially; offering banking products and services via traditional facilities or new digital platforms; helping banks to get a wider client base and cover unbanked areas, are all very important goals. These goals are better accomplished when they are developed simultaneously and in coordination as part of a National Strategy of financial education and financial inclusion. In spite of all positive examples of banking changes that were discussed by Heinz Wiedner, and other colleagues, such strategy goes beyond introducing new and innovative products. Most of the banks are optimising their business in this regard. They are changing and adapting their business models for the digital revolution and digital economy; new banking models, products and services have developed in the environment of digital banking and mobile banking platforms. This trend has opened a new chapter for financial and banking products and services. Everybody is working in this direction. Albania has to work on it as well. However, this process must be developed within a well-defined legal, institutional accredited infrastructure. Furthermore, it needs a good cooperation and coordination between the stakeholders: central bank, ministries, public entities and private companies. From the regulatory point of view, we are doing a lot of efforts, to prepare the basis in order to prevent risks, primarily two major risks: 1 cyber-related risk; 2. anti-money laundering risk. Together we must do more for financial education not only to introduce public and business to these new and innovative products and their benefits, but also to educate and protect them from potential risks related to these products. These are issues that receive more emphasis, in countries like ours, as we are transitioning toward European integration.

These are some of our challenges.

Chair Piroska Nagy-Mohacsi: Thank you very much Mr. Governor for this very comprehensive analysis. I am sure some of your colleagues have faced similar issues, but perhaps with some differences. Let me ask Madam Vice Governor Raspudić. How do you see similar challenges, a little bit north from Albania, in Bosnia and Herzegovina?

Vice Governor Želimira Raspudić: Thank you very much! First of all, I also want to thank the organisers, Bank of Albania and London School of Economics, for the invitation and for this excellent event in which I learnt a lot.

I would like to present some information about the Central Bank of Bosnia and Herzegovina. As you know, Bosnia and Herzegovina has gone through a very hard war experience and the central bank has been established only after Dayton Peace Agreement. The law on the central bank specifies the currency board for the foreign exchange regime as the most suitable one for an economically and politically weak country. Currency board means simply issuing notes and coins and offering the service of converting local currency into foreign currency, euro, in our case, at a fixed rate of exchange.

The currency board showed as really good for the foreign exchange regime because it contributed to the stability of the total economy, and I am sure that we will keep this regime until the Board will adopt the euro as our official currency.

Some words about our monetary policy. It is also very simple. The only monetary policy instrument is the required reserve. That means that commercial banks are required to hold 10% of total liability on the required reserve account with the central bank. That is something that imposes banks to have enough liquidity and this is also an instrument by which we can control lending activities.

For the total economy of Bosnia and Herzegovina, the currency board regime shows to be a good solution and has a really positive impact on price stability and the interest rate also is based on euro interest rates. So, there are no big fluctuations.

Meanwhile, speaking about banking sector, the Central Bank of Bosnia and Herzegovina does not have a role of regulator, but we have a very active coordination role between banking agencies. Banking agencies are actually banking regulators, and they are of course based on EU directives and on core principles. So, the central bank is authorised to coordinate their activities, and of course, it has a very active role in this regard.

Let me illustrate it with some information about the banking sector, which is the healthiest part of our economy. Banks have significant profitability, really good liquidity indicator - 29.7% of total assets is liquid assets - and capitalisation is also very good, the regulatory capital against total risk exposure is 17.5%, and we are very happy to have gradual decreasing NPLs. The latest data shows that it is 8.77%. So we can say that we manage NPLs relatively successfully.

Credit activity, now is somewhat slower than we expected. But this is a result of the overall economic situation, lack of significant investment projects, unemployment, etc.

Around 90% of banks are owned by foreign banking groups and it shows it is really good. Fifteen years ago, for example, we had around 40 banks. After merging and acquisition processes we have now 23 banks and 90% are foreign owned. We had a really good experience with foreign banking groups. At the central bank, recently we finished a project on the modernisation of the payments system, in view of some standards that enable us to include SEPA standards for example. We changed the platform. The central bank thrived in supporting and promoting the aspect of technical development of financial markets by supporting advance solutions in payment system and opening them for development. The goal was to improve the automation quality service, availability of payment system services by using new technologies. The central bank has been working on the EU standardisation, streamlining and extra rating payment sections introducing SEPA standards and setting up technical solutions for transaction clearing, processing a larger number of payments through a larger number of settlements, and so on. The technical solution emphasises on security and high availability of the system, innovative storing and innovative open data.

Regarding non-bank financial institutions in Bosnia and Herzegovina, they are not so developed, but we will face with it very soon. Our idea is to prepare following the EU directive in that area. Our financial system is predominately bank-based with a very high share of banking assets in the financial sector, between 84-90%. In Bosnia and Herzegovina, just as in other SEE countries, the reduction in the number of branches is not so pronounced as in Central Eastern and Northern Europe. Although bank customers in Bosnia and Herzegovina are undoubtedly more likely to use branches in comparison to banks in Western and Northern Europe, banks in Bosnia and Herzegovina should particularly consider the balance between number of branches and digital channels of financial services.

In the future, Bosnia and Herzegovina banking and financial industry will face some challenges related to investments funds and competition from non-banking financial institutions and the EU accession process. We will have consequences from the adoption of the legislative framework regarding the Payment Service Directive 2, and we also feel the effect of FinTech providers on the financial access to payment operations. Therefore, the close cooperation between FinTechs and banks will be the best part for a long-term growth having in mind the advantages of both. Thank you very much! That was all for Bosnia and Herzegovina.

Chair Piroska Nagy-Mohacsi: Thank you very much Madam Vice Governor! We are now turning to another country, which has always been on the news, for one reason or the other, from where Deputy Governor Sologub is coming, Ukraine, which has seen a phenomenal transformation. Since late 2014, with a lot of challenges: recent democratic changing government even appearing in the US political debate for some reason. Perhaps we would like to hear from you here, Mr Deputy Governor Sologub, what are the key challenges that you see in your country, which faces geopolitical challenges and risks, as well as continued domestic transformational issues. What have been the major achievements as well as the major challenges?

Deputy Governor Dmytro Sologub: Thank You Piroska! First of all, the central banking in Ukraine was never worrying. But, as all over the world, in Ukraine as well, central banking is a very interesting job, a very challenging one. I would like to talk about the challenges that the central bank is now facing and how it could be resolved, and point very much to our experience In Ukraine, there are many idiosyncratic things, on the other side, and it is a small and open economy. Therefore, the challenges we have in the central bank are very similar to those our colleagues in other countries are having.

There has been a very good discussion today on a lot of things, which are now faced by central banks. To be a successful for a central bank means to be pro-active and forward looking, because it is important to see what changes are coming. It is not easy. Also, you have to decide whether the changes are temporary or permanent. What we call a "brave new world" I would call it "a new normal". You should distinguish which things are the real new normal and which things are - let say - fake new normal.

Technology in the financial sector is definitely a new normal. There is no way we go back on this. It is pretty clear. And we, the central bankers, should be aware of it. Here, I would not go very much through of what has been already discussed. Rising importance of new financial institutions - BigTech; FinTech; digital currency. But there is also an important side of digitalisation. It is the digitalisation of supervisory practices and monetary policy. Because, in addition to BigTech and Fintech, there is also RegTech and SupTech. That is the improvement and digitalisation of supervisory practices. We are living in the 21 century and to conduct your supervisory role based on PDF reports and excel files is kind of no longer needed. I mean a lot of things could be very much done in real time, when you look at these registries, when you look at the rich transaction data in the real time, and so on. Yes, there are a lot of issues: data privacy; cyber-security issues, etc. But to me, it is a new normal. There is no way we can go back to this. Who would analyse PDF files in the 21 century? Therefore, this is the important part.

Going further, for our region, we have seen a changing pattern of international banking (it has been discussed already today). Indeed, there had been a substantial transformation. International banks have been very much on offensive here, before the global financial crisis. Then a lot of efforts were made, including by people in this room, as they tried to have an orderly system working on the peak of the global financial crisis. For a longer-term solution, now we see what was pointed out by Mr. Wiedner in his presentation, banking groups around the world now, especially in Europe, typically trade on the stock market below book value, which is quite depressed. Therefore banks are looking for the optimal model, which definitely does not envisage substantial international expansion. Sometimes, it envisages retreat, sometimes it envisages keeping the smaller scale of activity penetration, trying to digitalise, as the colleagues from other banks have been saying. This is an important factor. This factor is here to stay (I believe). Honestly, I would not see how global banking groups would come back to the offensive regime, in the foreign markets.

We talked about low interest rate environment. At this stage, it is difficult to understand how long it will last. It looks like the reason behind it is very much structural. Therefore this factor is here to stay.

The three other factors that I want to mention are:

The first one is the substantial changes in the global pattern of trade and financial flows. What is interesting is that we have seen in the last years the deglobalisation of trade flows. Some call it regionalisation while others call it deglobalisation. Actually, it is not about trade flows only, but it is about foreign direct investments as well. For example, in Ukraine we have a lot of talk about the country's need to attract foreign investments to an extent that Poland and the Czech Republic and Hungary had been attracting 15 years ago, when accessing the European Union, like 6-8% to GDP per year. But if you look around it looks like this is not feasible. This is not because of the domestic Ukrainian situation but because the world has changed. Now you have not seen global corporations going quite strongly and investing substantial amounts. Indeed, there have been quite a lot of retreats in terms of Foreign Direct Investments picture.

On the other side, what is interesting is that we actually have increased global financial integration. This year in the Jackson Hole Economic Symposium, all discussion was about global spill overs of monetary policy of US to emerging markets, rising role of the US dollar, how it affects emerging markets. Indeed, on this side, we seem to have globalisation. Everything seems to be so connected now in terms of monetary policies.

Geopolitical turbulences, another factor. While I talked to colleagues from advanced economies, I said that it is the central banks of emerging markets that always face uncertainty, - in economy, political landscape etc. In advanced economies, the main motto was: OK, we have our economy, we have also good macroeconomic models, which sometimes work better sometimes worse. But we can adjust them and they are working. But now if you look at our colleagues in US, there are issues which are not easy to quantify and to put them into macroeconomic models. Jay Powell, in his remarks at Jackson Hole symposium, kind of openly said: "The trade policy is designed by the congress. We have nothing to do with it". The US central bank is very much affected by it". So that is why geopolitical tensions are very important.

The last one is the rising populism and the political pressure on the central banks. So, quite a lot of factors. Some of them are definitely to stay, some, especially the last one I hope, would be quite temporary. Anyway, what you do is that -I think some elements of policy response of central bank- stay very much the same, implement prudent macro policies. I don't think that these factors could now justify that you should now be less prudent with your monetary policy, you should be going printing money and distributing them from a helicopter. Ukraine had helicopter money and ended up very badly. The same about fiscal policy. In advanced economies, there are countries with fiscal room and probably they will need to use it. But, in emerging markets, if you look around, fiscal prudence has been quite stellar in the last years and we have seen a lot of improvements in public debt, GDP ratios, Government balances, etc. Ukraine is one of the examples. We had a public debt restructuring episode back in 2015, external debt. At that time, public debt to GDP ratio was over 80%. Right now it is as low as 50%. It is not only because of restructuring, because the country grew out of this problem, but it is also because of pursuing prudent fiscal and monetary policies.

The second important factor is macro prudential policies. This has been very much a trend in the last 20 years, but it is there to stay. The central banks are doing a lot to combine macro prudential and monetary policies. We have seen a lot of academic discussion and policy discussion, so it has become an important tool of central bank policy making.

The third one is microprudential policies. The disputes that the banks should be regulated prudently and comprehensively, Basel III, anti-money laundering, etc. These things are very much on the agenda.

What are the new elements of the central banking policy toolkit? Talking about financial technologies. We are looking now in Ukraine the role of non- bank financial companies going forward. It is important to ensure what we call "open banking", because, at the end of the day, the financial system should provide efficient intermediation, channelling savings into investments. And it should not be only banks. If we see now, financial services are improving, and we see digitalisation. It is always the central bank to have a system where there is a very much fair competition. That is one side; the other side is regulation because, as a central bank, you should promote financial inclusion, which I agree with Governor Sejko. Now the region it is a big issue, because of informal economy, financial literacy. On the other side, regulation is important. Now in Ukraine, we are in the process of changing our supervisory framework. We used to have three financial sector regulators. So, we as the central bank, we were banking system regulator. But, we also had the securities commission and non-bank financial institutions' regulator in charge of regulating insurance companies, credit unions, and other non-bank financial institutions. This regulator is disbanded now, and the responsibility of the supervision of non-bank financial companies is very much put over to the central bank. On the one side, I think, it implies much more work for me and my colleagues, on the other side, I believe, it is important in this new world with a lot of interconnection between banks, non-bank financial companies, and in emerging markets you have a lot of problems with the institutions. I think it is better to have fewer stronger institutional regulators than have a dispersed and decentralised system of financial regulators.

While the issue provides open access to the financial services of banks and non-banks to customers, ensuring adequate supervision is extremely important. I mean, new supervisory practices, as I mentioned, it is right to introduce, using Big data, RegTech, SupTech, etc.

Talking about monetary policy. What you see now is that people talk a lot. Look at the latest BIS annual report is about increasing your own foreign exchange intervention. I mean, a lot of countries are applying inflation targeting. Pure inflation targeting started from what you have only inflation target and that's it. That might work for advanced economies, which first introduced it, because financial markets were matured, etc. When inflation targeting started to spread to emerging markets and, now even more so with this financial integration, it is pretty clear that some degree of management of the exchange rate is needed. We actually faced it in the first hand as well, because we had to introduce inflation targeting four years ago when we lost all reserves, and needed to change monetary policy regime. We abandoned the fixed exchange rate peg, which had been there for 20 years. But, from the very beginning there was not any alternative for us, a part from inflation targeting to use foreign exchange interventions. We are using them in a very transparent manner. On our website there is a strategy for foreign exchange interventions, where we explicitly say: that we intervened into the market only to mitigate fluctuations and to replenish the foreign exchange reserves. We do not give numerical guidelines on exchange rate levels and volatility. We try to use a principle of constructive ambiguity and obviously we quite openly say that we are not playing against fundamentals, if you see the exchange rate fundamentally misaligned, we would try to go to the fundamentally justified level. But, the role of foreign exchange interventions, which was highlighted in the BIS report, is indeed very important.

The last point, I would say very much tackling the issue populism and political pressure on the central bank. It is actually communication and transparency. The central banks made the huge leap from being much closed institutions 40 years ago. Mr. Greenspan said: “If I say something which you understand fully in this regard, I probably made a mistake”. Now they are completely open. Now communication is very much considered a monetary policy tool. We try to be at the lead here. Lately, we have been very aggressive on it and I am very pleased that our efforts are recognised as the National Bank of Ukraine was considered as the most transparent central bank in the world. And we are indeed paying a lot of attention to it, also by using new things like digital media. For example, the Governor has a twitter account which is very popular, Facebook page, Instagram, etc. We, this year in July became 8th central bank in the world which is now publishing interest rate projection. For this, we had a six-month discussion within the bank, also discussed very extensively with our colleagues from other banks, the IMF, etc. It has not been an easy solution to do. But, so far so good! I see now it is an important communication tool.

Chair Nagy-Mohacsi: Is it kind of forward guidance?

Deputy Governor Sologub: It is like a fan chart. We publish where we see our interest rates the next 18 months. But again, what we try to stress it is not a commitment, it is a forecast. It is not like I would like now to advice all central banks to do it. In advanced economies, where markets are quite educated and markets pay very attention to every blimps from central banks' Governor. It could be a difference tool. In emerging markets, where people and financial markets are not so sophisticated, not so far educated in terms of what the central bank is doing, you provide them with those interest rate projections as an additional information piece for monetary policy. I believe it could work.

Chair Nagy-Mohacsi: Thank very much! I think that, some of the elements, particularly communication and transparency we can pick up later on. Can I turn to Ardo Hansson, Former Governor of Central Bank of Estonia. You also stepped down from this very challenging position. The question to you is the same. You also may wish to reflect on some of the points that the governors have risen.

Former Governor Ardo Hansson: First of all thanks to co-organisers for inviting me!

I was here once, 15 years ago, and I see a big change. So, it is nice to be back.

We are in the euro area, and as central bankers have to wear two hats. We have to talk about both euro area issues and local issues. I think that for most of this audience the euro area issues are more important.

The starting point, I think, is 2017. That was a phenomenal year. I don't know how it was like here, but I don't think we realised in real time how good a year it was in the world: trade was booming, China was doing well; everybody was feeding off everyone else. It was a virtual cycle going on and in our country we had 4.5% GDP growth rate that year, and good outcomes in the euro area as well. It was well above the potential growth rate. That year, things developed very quickly from being used to a situation where the output gap was negative to a point where most of the countries had a positive output gap, meaning they were operating above potential. Let's assume that we had reached a point which is above potential. Then, going forward, we have to assume that we are going to trend back to that state of affairs, that is, maybe the growth rates going forward would be a bit lower. I think that measures of potential GDP growth in the euro area are about 1.5%. It may not be considered a good outcome, but for structural reasons that is a kind of potential growth rate. If we see, the ECB is looking at potential output growth rate in the next few years being 1.1; 1.2 or 1.5. It is not that bad. I think a lot of that was to be expected. There has been a change in the mood, in the world and also in Europe the last half year. The outcomes have been systematically worse than predicted. Frankly, I think it has got to do with these three words which are: populism, geopolitics; and trade wars.

If you look at four largest economies in Europe: the UK has its Brexit issue; Germany has structural problems in the car industry and also exposure to global manufacturing. Once you have trade wars, those impact Germany in particular. In France, manufacturing was holding pretty well, but services were hit quite hard. When you have demonstrations every week, people cannot go to the shops and, at the end of the day; it has to have some kind of impact. Then you have Italian macroeconomic policy.

So, if you have all of this kind of either misguided policy or populism, at the end of the day, there is a price to be paid for that. I think part of what we are seeing now is a kind of logical result of all this populism and bad policies.

Until about a year ago, we ran along a nice exit path, because we had achieved above potential output ranges, inflation was starting to pick up. So, it looked like we were on an exit path. All this softness came - which I think led to a fundamental re-thinking - not only in Europe, but also elsewhere.

However, if we look at labour market developments, we see that glasses are half-full rather than empty. I think the policy reaction was disproportional relatively to the problem, but that can be debated.

On the European supervisory front, there are some challenges. One is the issue of NPLs, which was discussed and the other related balance sheet issue is a review of the internal models of banks. There is a wish to look at the quality of those models to see if capital is being correctly reported. I think that is a euro area-wide undertaking. The other issue is then looking at the business models of banks, to see how to cut costs.

The third issue, I think, is cyber risk. Banks are becoming more technological. I think some of the bigger banks, if you count the staff; you probably see half of them can be called IT people. So, banks are becoming more like IT enterprises for better or worse. Supervisors that were looking at capital, that were looking at issues on market supervision, now have to have this third leg, which is operational risk related to cyber resilience.

When it comes to the Estonian economy, our major macroeconomic misbalance is that our labour market is overheating. Twelve years ago, all imbalances were in the financial sector, massive property bubbles, etc. Now, you see all of this convergence in the labour market. Of course, this should be good for workers, for voters, etc. The wage growth has been about 7% a year on average for the past six years. I think it is a common feature of most of the New Eastern European EU Member States that you see close to double digit wage growth. Central bankers, of course, worry about it, because you look at your labour cost and fear that competitiveness might be eroded. It is a rather big challenge, and there is not much a central bank can do about it, but it does complicate macroeconomic management.

Bigger foreign banks are retreating from the market and, it is a clear fact. Part of it comes from the fact that what we saw 12 years ago was absolute excess, completely out of control exuberance. To illustrate my point, 12 years ago, we would have had a 1.7:1 loan to deposit ratio because these banks relied on funding from the parent bank and we had this massive credit boom. You really wake up afterwards and you see you have gone too far. Getting from 1.7 down to where we are now, which is 1.0, actually involves a lot decrease in volumes. Credit volumes just became too big and banks had to retreat to find a new normal. I think it leaves then room for local banks, the small ones. The big banks want to be cheap, in their business models, so they offer much standardised products. They leave a lot of pretty good business for some of the small banks to pick up, because they are much more agile; they can offer tailor-made solutions; they can sit with the client that the Nordic bank, for example, left behind. Some of the small banks are in a good shape.

The second is the issue we talked about this morning, i.e. asset managers starting to play a bigger role. When the owners of banks want to exit, the ones who have deeper pockets and are looking for places to put their money are the fund managers. We had one case when two Nordic banks packaged their banks together and sold them to Blackstone. So, this new phenomenon having kind of hedge funds as the owners.

Finally, one new development, which I think started in some Nordic countries, is supermarkets assuming a greater role than just a retail agent, becoming banks in the region and so on. So, the supermarket becomes the point where you can get your postal services, get your basic banking services, and buy your groceries. This is a very encouraging development, kind of low cost, simple products that you get. In terms of financial inclusion it is a trend that seems to be quite popular and even profitable. This was my perspective and I think I will stop there.

Chair Nagy-Mohacsi. Excellent! Thank you so much! We will continue with Mario Blejer who is also a former Governor of the Central Bank of Argentina and of the Bank of England. So, perhaps Mario could also reflect on transparency issues.

Former Governor Mario Blejer: Thank you very much! I would like to thank the Governor for the invitation. It is always great to come to Tirana. I have very good memories of being here, since Albania started its reforms. It is very important for me to come back and see how things are developing.

I would like to make some general comments on where central banking theory, which is part of monetary theory, really stands.

I think we are really in confusion. I will try to put some points in a way I see them, and how the developing economies fit into this framework.

We are in confusion because, beforehand we had some certainties. We had a certainty which was quite clear: we "knew" that interest rates cannot be negative. Now it is possible for interest rates to be negative. We "knew" that too much money leads to inflation. Now the problem is what we should l do in order to produce inflation with much money. Money does not seem to create inflation, at least not yet, or we are not measuring correctly what we are measuring. We saw that wealth increases with nominal income; we saw that if we reduce interest rates then there would be more credit demand, but in fact there is less. So, I think we have a lot of questions that we don't know how to answer.

At the same time, we may believe that we know how to answer them. That is how we deepen the confusion.

I think there are a set of parameters. This confusion is not only confined to monetary policy issues in central banking, it is also confusion about the question, about the structure in monetary policy. How we design institutions is also the mother of the current discussion.

About the issue of recognising or not recognising the fact that central banks are political institutions, they are part of the policy tool that the government has. That might not be correct, but that is a fact. Because it is a stigma that a central bank becomes subject to political pressure. There are sort of tricks to avoid. But the fact is that central banks are subject to quite a lot of political pressure.

There is also confusion about the mode of operating of the central bank. I think it is very clear that the instruments that the central bank has are peculiar, different from the rest of the Government. But the question is how they should be used or how to maximise the effect of the policy?

One area where I have seen quite a lot of confusion also is the information products. What information should be released and when? In other words, how transparent should the central bank be and how transparent should the policies of the central bank be.

There was a time when we did not have a discussion on transparency in the central bank, because monetary theory responded to it adequately. It said: if you do not surprise the market we do not have any effect. Monetary policy had an effect only if it surprised. Lucas, a radical academic from Chicago, that got a Nobel prize on that theory. He said that only monetary shocks work which are surprising, that surprise the market, that are not coming from transparent policy. But, that was then. A lot of people followed that theory: little transparency for maximum market surprise. It is clear that this view has changed. The nature of a lot of theory that existed before, for example the Philips curve, the negative relationship between inflation and output. The idea is that if you have rational expectations, if you have full knowledge of what is going to happen, there is no way for trade-off. You only could have a temporary trade-off between monetary policy and growth, if your actions are surprising the market.

The question is what is the optimal for the central bank to do? I think one way of looking at this is the role of transparency, the role of information for the central bank, what the central banks try to do and do not try to do. We can see this in a general model.

Central banks try to maximise this function, generally: effectiveness of monetary policy and dynamics stability of the financial market. These are the two objectives of the central bank.

What is effectiveness? Effectiveness is the ability to produce a resilient result at the lower possible cost and at the most feasibility speed. So you have a clear definition of what central banks do; and the second one is dynamic stability of the financial market. Why the central banks should talk about dynamic stability? Because stability of the financial market which you can obtain by putting regulations and get the situation that you have, is the stability of symmetry, in which you don't move. You should have stability that makes possible or provides incentives to investments and to growth.

If you have these both, then you maximise the objectives: the effectiveness and the dynamic stability of the financial market.

However, the central banks are subject to constraints. There are budget constraints; also there is bias to our political objectives. The central bank is required, or pressured, to fulfil certain political objectives. They are mostly economic but are assigned to the central bank by the government. The government has some objectives and the central bank is to dare to play a part of it in a specific way.

The political system limits the degree of objectives that a central bank pursues for itself. But it is giving a price for this. What is the central bank giving for it? First of all an instrument. They are monetary instruments, they are monopoly on the issue of money, but the monopoly to some extent is shared with the banks. But, the most important thing is that the central bank has the ability to develop an instrument, which not all the institutions can have in this manner. And this is credibility. It is a demand to develop credibility because credibility is the asset of a central bank. Not the capital that people talk about: the capital of the central bank. Central banks need credibility. In order to obtain the results on the effectiveness and stability using the instruments that the central bank has, they have to have credibility and they also have to have independence. The independence makes the central bank more credible, because even it is under political pressure, and there are all sorts of the constraints, they need independence in order to be able to get credibility and deliver the objectives that the central bank has.

In order to have credibility, and particularly the independence, what is required is transparency. So, transparency became fashionable, together with the idea of independence, and also relevant to inflation targeting system. How much transparency can a central bank have?

Transparency could reduce the rate of achievement of the objective. Transparency would not gain any track, any power in the money market or in the financial market, if the only thing it does is to remove the surprise effect. So there is an issue on the one hand. On the other hand, we have transparency, but we do not have independence and credibility. So, transparency has two-fold effects.

As Alan Greenspan said: "If you have the choice between mumbling and saying the truth, then, choose mumbling". He thought that anything that makes transparency exaggerated to some extent will hamper the central bank's objectives. Because, he said that there is a lack of symmetry here. The private sector does not share the objectives and the strategies with the central banks, but the central bank will have to share the objectives with the private sector. That is an excess of transparency. It has been said that the Fed has changed completely, instead of having a problem of lack of transparency; they tried to make believe the market that they know everything. So, the moment they finished a meeting, there are minutes, thousand pieces of data flowing to the countries. But this increases confusion. You have this two-fold effect. How do we close this particular system? We may have various assumptions, but something is quite clear.

In order to fill this objective, you need to have credibility, because credibility increases effectiveness. To have credibility you need transparency, which also affects the effectiveness of the central bank. So, you have to go for an optimal amount of transparency. But this amount of transparency is a trade-off between transparency and credibility. What is credibility at the end of the day? Credibility is the trust of the people that you will do what you promised to do, no because it is the best, but because you promised to do it. So, the central banks without needing an excess amount of transparency will be better.

So, the lesson I wanted to emphasise here is that the issues that we do not have to be so much kind of pain to certain ideas and the issue is that the credibility of the central bank as we build on elements which are not only to do with the transparency of the action.

If we look at the objective of a central bank, to maximise the effectiveness and the dynamic stability through regulations and through the monetary policy, it looks to me that what you need is independence. You need to strive to find a way in which you are not pressured to adopt your instruments to political constraints that are imposed.

I think it would be a great idea to privatise central banks. If you privatise the central bank, then you make it clear that you have assets in the private sector, you will not have excess transparency, and you will only have what is required. You will be at the position to resist political pressure probably better, and the amount of transparency, the release of data is the same which will be optimal for the market because it is like the private sector.

So I have come to the conclusion - in my old age – that central banks to be privatised. That was a standard campaign for the privatisation of the central bank. The question is if this will improve the regulatory efficiency. I think that in a sense emerging markets should not follow that pattern of more advanced countries. For example, inflation targeting, we see that there have been many mistakes, and in this structural scene I think there are lot of problems. So let's see which will be the first country to privatise a central bank?

Chair Nagy-Mohacsi. Thank you Mario! You have talked about a revolution here, in Tirana Albania. A revolutionary idea to go back in central banking, from being a public institution to be privatised. Some provoking ideas also from Mario on the effectiveness of transparency given monetary policy theory.

We will turn now to Erik Berglof, whom I have to introduce longer. I mentioned your current affiliation, but of course you are very well known particularly for your role as Advisor to the President and Chief Economist of the European Bank for Reconstruction and Development. There you spent nine years and revolutionized the way the role economists play in public institutions, in analyses and helping also, informing then business decisions based on solid evidence. Erik, if you don't mind, we have heard a lot about central banking in this panel, naturally from incumbent governors and former governors, but in your recent work you participated in two very interesting global efforts to strengthen multilateral institutions and collaborations. One was the "G20 Eminent Persons Group", which provided their report a year ago. But then, you doubled down and you also had been member of a regional follow-up, "the European High-Level Group of Wise Persons" chaired by Thomas Wieser. You just produced this Report and it really goes to the core - as I understand it - into how Europe thinks of itself, how really identifies developments and the European identity in the area of foreign and development policies. Would you tell us a little bit about the key points, in addition to making comments? Yesterday, you spoke to a smaller high-level group. Could you share also some ideas about where exactly the European identity, in terms of developing a new development policy, takes us?

Erik Berglof, Director, LSE Institute of Global Affairs: Thank you Piroska! We have a very large panel and I have the fortune to be the last one to comment in this round. So, I can comment may be a bit on that, but I thought that what either these two groups or commissions were about is what we have talked about today. We had a request earlier, an innocent question about "you have all this liquidity globally and we don't see any of that really coming into developing countries". Of course, you can ask the question: "Why is that?" To me it is the fundamental question, and this was the focus of the so called "Eminent Persons Group". We asked: "How do we build the system, a global financial system, which makes capital flows from capital-rich countries to capital-poor countries?" How do we get this transformational role of capital? We spoke about foreign direct investments, in manufacturing and services. Of course, banking is part of that and how do we get that to function; how do we get those flows to come back? Because, yes, we clearly overshot in the period leading up to the global financial crisis, but, maybe we overshot also when we responded to the global financial crisis.

I would like to live in the hope that we can find a way again to get capital to flow and, again find a way for leveraging private sector money into the business of development. Both these exercises were very much about how to get developing finance architecture to function better, both at the global level and at the European level. That requires measures in the receiving countries. It is about reducing risk - the work the central bank does its part in that. Improving the investment climate, the rule of law; and building local financial markets that can also be partners of the global capital that comes in are important complements of this process. Naturally, a global investor is more likely to come in if there are local partners that might have some stake in that investment.

Much of this liquidity globally is institutional capital. And it is this institutional capital that seems so hard to get to move into more risky environments. Maybe this risk appetite would be greater if there were, for example, more local institutional investors that could influence or put pressures on the local environment to make sure those investments were made properly right or respected. There are measures that can be taken at the host country level, and of course there are measures that can be taken at the level of home countries, where this institutional capital is now sitting in abundance.

We saw in the global financial crisis that a lot of what happened in terms of reduction and deleveraging, particularly in the euro zone, was driven by the pressure on parent banks by home authorities, central banks and other regulators, and to some extent, by the euro area authorities. I think there are also now rules on local institutional investors that potentially could come into more risky environments and into emerging and developing economies. But there are rules that make it very difficult. So, maybe we need to look again at these rules and see whether they actually fit the purpose. Some distinct work that we had access to in this global commission shows that there is a systematic overestimation of riskiness in infrastructure investments in developing countries. So, maybe there are some distortions there that we can try to address. An issue is the fragmentation of capital markets. The United States used to have fragmented capital markets, and still has fragmented capital markets. But, somehow they have managed to get a regulatory framework that allows them to have transfers across state borders, or across different parts of the financial system.

We need to create that at the European level. If home country authorities can be willing to put aside some of their concerns and some of their ambitions to control their firms or these banks, for example, I think that would be a positive development.

Also, we saw in presentations today about banking models. The banking models are now very much driven by the group logic. That is fine as long as it also involves transferring capital. I think we need measures at the home level, at the EU level, and inside these financial institutions. What we saw in the global financial crisis exposed was this type of financial investment that the European banks had made.

They were more like foreign direct investments rather than normal capital flows or traditional debt flows. They were much more resilient to pressures, while the bond markets disappeared immediately, syndicated lending disappeared immediately. Of course it helped them to have these coordination exercises that were undertaken during the crisis.

I am hopeful that we can create some kind of structure at the EU level that will allow these capital flows, at least to open a little bit, and this can be integrated to the new business model of these banks. The greatest hope for me is that there is a whole new revolution and we have seen elements of it in today's discussions, in how banks and the financial system are generally operating. We were talking a bit over lunch today that what I have seen in the transformation of the Chinese financial system is truly impressive. It has really changed completely the way to think about - at least I think - of financial development. Now, you can see a combination of non-cash payment systems and on-line retailing, you can reach out into very remote areas, and in areas which could never be included in the traditional financial system.

That, to me, gives a lot of hope, not the least for this part of the world. I think the real challenge to the Central Europe, but is also true in Southeastern Europe, this discrepancy between rural areas and urban areas. This is a really fundamental social issue. I think we can get some of these transformational capital flow with this transformational capacity, which could be a real game change, in many parts of Eastern Europe and Southeastern Europe. Thank you!

Chair Nagy-Mohacsi: Excellent! Thank you!

THE GOVERNOR'S PANEL:

ROUND II

Chair Nagy-Mohacsi: This panel has opened several new grounds. We collectively raised issues of challenges of foreign exchange appreciation, related to the whole new world of the rules of the game for foreign exchange interventions, as becoming part of the new toolkit. We are talking about "currency wars" and the impact on emerging markets. Of such policies, extending the trade war to a renewed currency war in the central banking area. We discussed the new central bank's policy tools, for example the interest rate forecast in a fan chart, which is very original. We heard about kind of new fundamentals of central bank theory, about transparency, the capital of the central bank, and what is going to be and a propose that may be central bank should be made private.

There is one area, I think, we haven't covered yet: central bank digital currency. We have discussed already, particularly commercial banks representatives mentioned cyber currency. We know the pros and cons. We know already what regulators think about it. There has been a lot of thinking and some actions also in central banks about central banks moving into this space and issue regarding central bank currency in addition to cash. I would like to ask panellists and the colleague from Sveriges Riksbank, to tell us where you state on this thinking, central bank thinking, what are the main pros and benefits in introducing central banks digital currencies, not only in whole sale, but also maybe retail as well. What are the disadvantages? What is the position of current policy makers, or what is your suggestion for policy makers? Governor Sejko, with you permission, I would like to ask Marianne Nessén, who is from Sveriges Riksbank, the central bank which is an industry leader in this regard. Just a couple of sentences Marianne on where the thinking is.

Marianne Nessén: Senior Adviser, Monetary Policy Department, Sveriges Riksbank. The Riksbank is currently looking into e-krona. We are in the beginning of that journey. There has not been yet a decision to launch e-krona, but adequate preparations are being made. In this regard, we are analysing the pros and the cons. Let me just briefly say why the Riksbank started doing this. This is not a response to bitcoin, or other things like that. It is the fact that Swedish have stopped using cash. So the question arose: "Should there be an access in Sweden to central bank money?" Yes or No. And one answer to that was the e-krona project initiated.

Chair Nagy-Mohacsi: Thank you very much! Governor Hansson, I would kindly ask for your comment in this regard, because the Baltic area, perhaps your bank as well, has also advanced in digital area. Of course you are in Eurozone, but what is the thinking in terms of central bank e-currency in general, within the context. If you can give some insights.

Former Governor Hansson: Being in the Eurozone, if we do this we will do it in a bigger group and collectively. Some things one can do, in the sense central bank digital currency exists already for commercial banking. Even if you don't go all the way to households, you could go beyond commercial banks and give some other type of financial enterprises access to central bank accounts. That is a pretty easy thing to shift the perimeter; maybe payment companies getting access would be different. I think there are two motivations: one was mentioned by– Marianne, namely the dramatic drop in the use of cash in payments (I think this a mostly a Nordic phenomenon). The other issue is whether citizens have the right to a risk free asset that they got used to with cash and a bail-out regime. Now that you have bail-in, it creates uncertainty, and you do not have so much cash anymore. I think, one reason why you might not need to ensure people is that, at the same time you had deposits insurance going all the way to 200 000 euro per capita. So for most people, holding commercial bank money, if you believe that deposit insurance works, gives you access to 100 000 euros of electronic money that is pretty close to safe. So I think you largely solved that problem.

The other one is the zero-lower bound, where the argument is that if you could really kill off most of the rest of cash, central banks could go really negative on policy interest rates. That it is a bit scary you could do these things so easily. But, I personally don't think that central banks need to make life simple for monetary policy-makers. It is nice to have a floor below which one cannot go anymore. So I am rather sceptical. For example the Danish Central Bank reviewed and said: "We think that this does not make any sense at all. We are dropping this idea of central bank's e-currency". There are issues of AML, there are issues of bank runs, and you could move money to the central bank instantaneously. That is, you can have a bank run, which is not possible with cash.

One response, I think would be to more highly value the public good nature of cash in circulation. We somehow take it as very old-fashioned, but in the same area, where we have cyber risk, having a completely analogue technology with some critical mass is a very good thing. You may be in the situation where the private rate of return for moving to digital is higher than the social rate of return, and maybe one thing that we as central bankers can do, if we think there is a social value to this cash circulation, is to try to protect that a bit and slow this move towards electronic money. You are not going work against technology, but may be it is going too fast in a couple of places. So, I would be sceptical about this all.

Chair Nagy-Mohacsi: Thank you very much! Let me ask the opinion of the rest of the panel. ***Mario***, please.

Former Governor Blejer: In this century the idea that can be paper money not metal money, is completely ridiculous. The point I would like to make is that, if this technology develops, it definitely would privatise the function of the currency issue from the central banks. So, one more reason to privatise the central bank.

Chair Nagy-Mohacsi: Very consistent! Please Deputy Governor Sologub.

Deputy Governor Sologub: I would say that we had an experience with central bank digital currency. This issue popped out, around 4 years ago, by two things. One thing, we had been talking a lot to our colleagues from Riskbank, Governor Ingves; the second one, all this rising hype of bit coin, distributed ledgers. We, at the bank, decided to make a pilot project, to issue central bank digital currency, we called it "e-hryvnia", so very similar to "e-krona", based on DLT (Distributed Ledger Technology) and see how it would might work. So, this was just an experiment, there have been some electronic wallets, there have been some services you can use. There are actually reported as available at our website, you can look at it, a very detailed report. Also, there is some kind of review of other practices. The conclusion, I think is very similar to what Ardo said about their central bank. It does not work so far. There is nothing which can really be strong value added, for the moment. I think it is important to say "for the moment", as you need to put all these resources in creating this central bank digital currency. On the other side, we are very eagerly looking what Riskbank is doing, and see what will be the results of e-krona project. Let's see, maybe it will bring us somewhere.

Chair Nagy-Mohacsi: Thank you very much! Mr Governor, what is the thinking in Albania regarding central bank digital currency?

Governor Sejko: We have been discussing the issue of cryptocurrency in many conferences, especially in the Governors' Club meetings. We have been listening from big countries that represent large developed and developing economies like India, US, Russia and many other examples, which have also made significant inroads in introducing new technologies in banking and finance. Any central bank that I have heard has not been confident in progressing with cryptocurrency. All the governors or central bankers have been a bit reluctant, and seem to have the approach of "wait and see", rather than progressing with the adoption or regulation of such currencies. Of course, it is very understandable that the main role of the central bank is monetary policy and financial stability. How confident are central banks going to be on the ability to perform our mission in the presence of cryptocurrency? How will the central banks manage monetary policy targets and prevent and protect the financial stability in case of wide adoption of cryptocurrency? We are aware of all the risks of the cryptocurrency fluctuations, its prone nature to speculative and cyber-attacks, money laundering issues, and everything else that might be involved. So, in all these aspects, all the central banks should be studding cryptocurrencies deeper. We should be, at least, cleaner on cryptocurrency from the regulatory point of view. Because we are regulatory institutions and we have to regulate the market, and in order to regulate the market we have to control it. So far in Albania we have observed some tentative intentions or interests in the form of requests for operating ATMs for cryptocurrencies and nothing more There might be cryptocurrency ATMs in other Western Balkan countries but, there are no such ATMs in Albania. Our banking regulation clearly specifies that to have an ATM, you have to have a bank licence.. However, just to speak or think about cryptocurrency from a theoretical point of view is difficult because there are still many unknowns. How would we as central bankers feel and react if we were introduced to a request for applying cryptocurrency products and services in the market? I think there are many other challenges that we are facing right now, and this one is pretty new for Albania. So my answer would be let's wait and see.

Chair Nagy-Mohacsi: Madam Deputy Governor Raspudić, please what is your thinking about digital currency.

Deputy Governor Raspudić: The digital world, I think it is happening, very fast. Fortunately, for the moment we are far from the idea of central bank digital currency. But, the theory tells us that digital currency is being currently studied and tested by some governments and central banks in order to realise any positive implications. It contributes, for example, to financial inclusion, economic growth technology innovation and increases transactions efficiency. But there is also a general concern about unpredictable risks, like cyber security impact on financial stability, maybe the impact on weak bank funding position, etc. So, I hope it will be in the future but not so close.

Chair Nagy-Mohacsi: Thank you. The message is very clear. Some technological advancement, but very early in the process. We heard about negative implications; let us through into two areas. One is Governor Mark Carney, Governor of the Central Bank of England in the Jackson Hole Symposium 2019 speech, mentioned, that: "Central banks pooling on digital currency for cross border settlement purposes", which could be something to consider and the second is to Ardo's point that in a sense if you have households access to central bank digital currency you would need deposit insurance. And that is a big cost saving and a big removal of moral hazard from the system. Thank you very much and I would like to open up the floor for questions, including if there are some, from the second round, please feel free to raise them.

THE GOVERNOR'S PANEL: ROUND III QUESTIONS & ANSWERS/CONCLUDING REMARKS

QUESTIONS

Milan Deskar, Advisor at Croatian National Bank: Thank you very much! This was really interesting. I have three questions but they are short.

1. The first question is for Governor Sejko. You mentioned the de-euroisation strategy or we can call it lekisation strategy. I understood what you are doing on your part, but what is the Ministry of Finance doing in its part? Did they change their public debt management strategy? Are they taking more local currency denominated loans or they did not change anything in public debt management strategy?
2. The other question is for Mr. Sologub. It is very interesting that you have key rate forecast like, fan chart, which is transparent and I will look at this. The question is: are you also transparent in the model? Do you make the investors known what model do you use? Is it like tailor-rule or something else?
3. The last question is for everyone. Do you agree with Paul Volcker who said that: " the last good in innovation and finance was the invention of ATM'?

A. ANSWERS

1. Governor Sejko: Thank you very much for the question! We have signed a Memorandum of Understanding with the Ministry of Finance and Economy, but, yet there are some difficulties for the Ministry to progress with the de-euroisation project. First of all, we have a particular situation, as I have already mentioned. There are many transactions and contracts performed and denominated in euro. And I don't mean only luxury goods, cars, real estate etc., but many other goods and services are quoted in euro. There is no need to quote prices in euro in the presence of the free floating regime. However, shops unnecessarily denominate and advertise their prices mostly in euro. This practice must end! Sellers, byers and contractors should stop this habit and denominate prices, contracts and perform these transactions in lek. In a very basic point, this is where we should start with the deeuroization strategy because, it is really unnecessary that people pay in euro to buy goods and services when they should pay in lek.

Furthermore, the Ministry of Finance and Economy and Government should take additional measures in terms of better management of the public debt. Currently a significant share of public debt is in euro and servicing it could have positive or negative implications in the foreign exchange rate. The government needs euro to service this debt which means that government will have a known demand for euro to meet its obligations. If the Government applies a better debt management policy, it should collect and buy euros directly from the market when lek is strong and not at the moment when the payment is due. This management policy could positively influence and smooth foreign exchange market shocks and related fluctuations of lek exchange rate. This issue has also been addressed frequently by Bank of Albania and discussed during the meetings of Financial Stability Advisory Group, which constitutes a national forum for the discussion of Financial Stability with the participation of the Ministry of Economy and Finance, Financial Supervisory Authority and the Deposit Insurance Agency.

In conclusion, there are actions taken by the central bank, but of course they are not enough. We need to do more in cooperation with the Government for the de-euroisation because it is obvious, it creates obstacles to monetary policy transmission and to financial stability via exchange rate risk.

However, it must be emphasised that the de-euroization policy is not trying to eliminate euro from the market. There will still be a lot of euro denominated transactions and contracts in the market but, the unnecessary transactions do not have to be performed in euro. Of course, we would prefer to have 80/20% lek versus euro shares rather than the current 50/50% in the balance sheets of the banking sector. This is because our monetary policy will be really much better transmitted and there will be less forex risk for financial and price stability. This is very difficult to achieve with financial and macro prudential regulation when you have real rather than financial euroization. Despite the efforts of the central bank, de-euroization goal could be effectively achieved only in cooperation with the Ministry of Finance and Economy and Government. This is what we are trying to do, planning and cooperating together. Thank you!

Deputy Governor Sologub: Thank you Milan for your question! It is really relevant. A few weeks ago I was discussing with my EU colleagues on the next steps to increase transparency, because I am a big fan of transparency, and I believe it should be taken in stages and a properly sequence. Last year we started to publish minutes of monetary policy committee discussion, while this year it is the interest rate projection, and for the next step we are thinking over publishing a kind of overview of our macro-economic model. It probably will be less interesting for the market than the minutes or the interest rate projection. But, it is an important point of transparency, so the market could have all the available information that central bank uses for the monetary policy decisions.

Former Governor Blejer: Regarding what Volcker said, I think that a very big innovation was the ATM at McDonald where we can get money and a hamburger. I think it is a really innovation in the nature of innovation you have a big step in a long period with no innovations. I think that that the big innovations are coming now with these digital currencies.

Chair Nagy-Mohacsi: Thank you! Any other questions or we have addressed all of them.

CONCLUDING REMARKS

Gent SEJKO, Governor, Bank of Albania
Erik BERGLOF, Director, LSE Institute of Global Affairs

Governor Sejko: The Conference took a bit longer than planned, but all the topics were discussed at length and it was eventually a very good Conference. I would like to mention very briefly a few things that we may take home with us. From the Governor's panel in this Conference, we got the message that there are fundamental changes with regard to the banking sector, monetary policies and markets, not only in the euro area but also in the rest of the world, which affect our region. From all the presentations delivered from our colleagues in banking and financial sector, we heard that everybody is aware of the changes and, in this context, they are adapting their business model, philosophy and strategy to such changes. The same applies to central banks and regulators who are adapting to the changes following market developments and trying to better regulate and prevent risks.

With regard to Fintech, this is a very, very actual issue. Meanwhile, the cryptocurrencies, as we mentioned, remain a wait-and-see scenario for us. All central banks seem to be at this stage. Basically, the situation with negative interest rates is very stressful for the banking sector, and the stress is still around. Banks have, however, adapted their model. In Albania, we have not felt it very much but in some other countries, especially in the West, this burden is even heavier. These are few points we can take away in general from this Conference. Maybe Erik could add to the overall picture of the conference.

My feeling is that for the second round together, we had very good and fruitful discussions. Everything was perfectly presented and discussed. We had very interesting questions, and I want to thank also those who raised the questions. I take the opportunity to thank again for the cooperation, coordination and all the support the colleagues of LSE, Erik and Piroska. Thank you very much! We hope to continue the cooperation together.

Also, I would like to thank the participants and all the speakers for their presentations, opinions and insights.

Last but not least, I would like to thank my team, because this one and a half day conference takes a whole year to organize. Thank you my team for all the efforts on organizing this conference!

Erik Berglof: It has been a remarkably smooth collaboration. Once we agreed, which we did very quickly, we wanted to do something that had really touched on important issues in Albania. I think everything fell into place very smoothly and with good results so I am very grateful for that. Piroska in particular played an instrumental role on my side, so thank you very much for that.

I looked at what happened over the last year, or maybe a longer period, but there are a lot of positive signs in terms of consolidation of banking system in Albania. We spoke about the NPLs, we spoke about the greater domestic, and some new comers coming in also into the banking system.

There are also a number of positive developments. All this has happened within the context of the EU accession, and we got some somewhat troubling news just very recently about that. I think sustaining that role for all of us to make sure that that EU accession keeps on moving ahead, of course there is responsibility in Albania for dealing with the political situation but is also responsibility for those outside to really make the case for Albania in that process.

Of course not only in Albania, politics is always and everywhere, complicated. I can tell you that from the UK perspective, we are completely in uncharted territory in terms of politics and of course you can go to many other countries. We just need to have patience and persistence. To end at the same note as I ended my earlier remarks, I think there is a chance that the financial system, the banking system may be enhanced by other players that can really play a role in bringing about a more inclusive economy and a more inclusive economy and financial system as well. And that can be, also addressing some of these concerns that are underlying these political terms that we are seeing in many countries, by the way not only in this part of the world.

That's my optimistic note for thinking about the role of the banking sector and the financial system. Thank you!

Governor Sejko: Thank you very much to everybody for your participation!

PHOTO COLLAGE DURING THE CONFERENCE


nd Opening Speeches
Gent SEJKO
Governor
Bank of Albania
LSE


Welcome and Opening Speeches
Gent SEJKO
LSE
A BRAVE NEW WORLD
11 October 2019
Tirana, Albania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H.E.Mr. Ilir META
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Session I
EU and SEE banking systems: cooperation and common challenges
Davide STROPPA
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Croatian kuna
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Need to re-think traditional model and distribution strategies
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Session II
The role of non-bank finance, high-tech and fin-tech in conventional commercial banking
Peter BOTOUCHAROV
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