

SCIENTIFIC NOVELTIES AT THE BANK OF ALBANIA

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I. FRIDAY SEMINAR

The first paper, presented in January by Irini Kalluci, Research Department, was entitled "Determinants of Net Interest Margin in the Albanian Banking System". This paper analyses the net interest margin as a measure of efficiency for the banks operating in the Albanian banking system and the main focus is the identification of the factors that may affect this indicator. According to the estimations made for the Albanian banking system, the results show that the net interest margin is positively affected by the interest rate volatility (mainly of EURIBOR, domestic currency's and slightly of the LIBOR rate), by the level of operating expenses which have had an increasing tendency, and by the amount of banks' reserves in the Central Bank.

February was opened with the paper of Holger Kächelein, Drini Imami and Endrit Lami entitled "A New View into Political Business Cycles: Household Expenditures in Albania". Political business cycles relate to the use of fiscal and monetary instruments to stimulate economic growth before elections to impress the voters. Following other researches for

political business cycles in Albania, in which there was found clear evidence of fiscal expansion before elections, the authors analyze the public expectations related to election outcomes and the way these expectations affect their spending decisions and consequently the macroeconomic variables.

The other paper was entitled "DEVINPRO – Consortium Members with Key Findings and Headline Figures related to the Quantitative Surveys of Migrants and Migrants' Households", and it was prepared by Nicolaas de Zwager, NEXUS, and Dr. Ilir Gëdeshi, CESS. The survey consisted in 4500 field interviewing carried out between mid-December 2008 and early 2009 in Albania and Kosovo. The purpose of this survey was to identify the migrants and the people benefiting from remittances as a special market segment. The analysis showed that the contribution of migration-related financial initiatives may be further developed if savings and investments are encouraged and that they could support Albania's economic development better.

The last paper for February was presented by Elona Dushku, Research Department, and it was entitled "Financial Development and Economic Growth: The Albanian Case". The main purpose of this paper is to examine the causality relations between financial development and economic growth for the Albanian economy using the Granger causality test for five different indicators of financial development based on data covering the 1996-2007 period. The empirical findings of the study showed that there is a positive relation between all indicators measuring the financial development and economic growth in the long term. While in the short term this relation is quite vague since different indicators provide different results.

Altin Tanku and Risan Shllaku, Research Department, presented in March the paper entitled "Feasibility of Inflation Targeting in the Case of Albania". Given that theoretical considerations over the characteristics and regime preconditions have been covered by previous works of the Bank of Albania, the authors try to address this issue based on the empirical investigation of the monetary policy transmission. The main purpose is to identify the optimal intermediate target for the monetary policy set-up of the Bank of Albania.

The last paper for this quarter was presented by Ilir Vika, Research Department, entitled "Assessing Motives Behind Bank of Albania's Purchase Interventions in the Foreign Exchange Market". In countries with floating exchange rates, central banks generally intervene to reduce high market volatility or put a stop to exchange rate overshooting,

but not to influence the exchange rate trend. Using a Probit model, the study tries to figure out what has prompted the Bank of Albania's interventions during the period 2000-2007. The final aim of the study is to assess whether the central bank's interventions have been effective in stabilizing the exchange rate by reducing unwelcome market volatility and smoothening or returning it towards an underlying direction.

The first paper for the quarter April to June 2009 was presented by Vasil Zaho, winner of the 2008 Governor's Award for the Best Diploma Thesis, and it was entitled "Efficiency and Productivity Growth of Albanian Banks". This study uses data envelopment analysis to distinguish between cost, allocative, technical, pure technical and scale efficiency, and a distance function approach to derive Malmquist productivity indexes for 12 Albanian banks over the period 1999 to 2006.

In May, Prof. Murat Karagoz from Epoka University presented the paper entitled "Reflections on the late 2000 Recession". Although some casual comparisons between the late 2000s recession and the Great Depression in 1929 have been made, there remain large differences between the two events. Unlike the Great Depression, this recession was synchronized by global integration of markets, causing the synchronized recession to last longer than typical economic downturns and have slower recoveries.

The third study for this quarter was presented by Arjan Kadareja, Member of the Bank of Albania's Supervisory

Council, and it was entitled “Financial and Real Variables for Euro Area Countries with International Linkages. A Global VAR Approach”. The study provides a quantitative evaluation of the effects of shocks (country-specific or global) on a number of economic variables for US, UK and Euro area countries. The latter are analyzed individually, which is vindicated by the asymmetric behaviour of the single economies in the current crisis.

The next study discussed at the Friday Seminar was presented by Elona Dushku, Research Department, and it was entitled “Gap Model”. Ms. Dushku outlined the work to date for the construction of a new model for the Bank of Albania monetary policy called the Gap Model. This model contains 4 equations for the real GDP, real interest rate, real exchange rate and inflation rate. All variables are presented in the form of deviations from their equilibrium levels. This model provides a good merger of neo-Keynesian and real business cycle characteristics.

Irini Kalluci from the Research

Department presented another study entitled “Analysis of the Albanian Banking System from the Risk-Performance Viewpoint”. This study makes a theoretical and analytical analysis of risk and return indicators of the Albanian banking system. It introduces for the first time the estimation methodology of a risk index for the system. The purpose of this study is to analyze the risk and performance indicators and to suggest some indicators and an index that may be used by the supervisors during their work.

The last study for this quarter was presented by Ilir Vika from the Research Department, and it was entitled “Measuring the ALL Exchange Rate Equilibrium”. The purpose of this study is to measure the exchange rate equilibrium in Albania using the ARDL model for the real exchange rate of the ALL versus the EUR. The determinants of the equilibrium real exchange rate considered in this study include the output gap, net foreign assets, government expenditure, interest rate spread and the economic openness.

II. RECENTLY PUBLISHED RESEARCH PAPERS

1. “INDEX OF FOREIGN PRICES/ UNIT VALUES OF ALBANIAN IMPORTS”, RISAN SHLLAKU, RESEARCH DEPARTMENT

(full pdf text)

Economic data and statistics are a key element for successful economic analysis and economic policy formulation, by both the public and the private sector. Actually, economic data and statistics fulfil

all the requirements to be considered a public good. Unfortunately, the quality of economic data and statistics in Albania is not very satisfactory at the moment. Recognizing the importance of the economic data and statistics, the Bank of Albania has taken concrete steps in terms of improving the construction, reliability, availability and dissemination of such data.

In this respect, the Index of Foreign

Prices/Unit Values of Albanian Imports marks yet another effort by the Bank of Albania to contribute to the improvement of the economic data and statistics. The original index is focused on capturing only the movements of the prices of Albanian imports in the markets where they are imported from, but not the exchange rate effect. This would allow the effects that import price movements in the foreign markets and exchange rate movements have on different macroeconomic indicators of interest, as for instance on the inflation rate, to be analyzed and quantified separately. The importance of the index at hand for Albania is quite high, taking into consideration the fact that Albania is a small open economy.

Obviously, calculating a sort of weighted-average of the CPI movements in the main countries from where Albania imports – weighted by the share of imports from each of these countries – can also serve as a proxy for the purpose at hand. However, such a proxy can be quite vague and largely unrepresentative of the price movements of the Albanian imports in the foreign countries. Other attempts to construct more representative proxy indices can potentially satisfy the cost/benefit criteria.

The paper is organized in the following sections. Section 2 offers a brief discussion of index number theory and of the main issues related to price indices. Section 3 presents an approach based on the indices of export unit values/export prices of the main countries from where Albania imports. Because of data availability reasons, the indices of export unit values are used

for some of the foreign countries and the indices of export prices are used for other foreign countries. The advantages and disadvantages of this approach are obviously elaborated. Finally, section 4 offers a brief conclusion.

2. "THE ROLE OF EXCHANGE RATE IN AN IT FRAMEWORK, WHAT DO WE DO?", ALTIN TANKU, ILIR VIKA AND MARIAN GJERMEI, RESEARCH DEPARTMENT, MONETARY OPERATIONS DEPARTMENT

(full pdf text)

This paper analyses the relationship between exchange rate and inflation in Albania. The first aim is to investigate the impact of exchange rate changes on domestic consumer prices and secondly throw some light on the importance of currency movements on the conduct of monetary policy. The findings could be useful to policymakers at the central bank before adopting a full-fledged inflation targeting regime.

3. "AN ESTIMATION OF BALASSA-SAMUELSON EFFECT IN ALBANIA", EVELINA ÇELIKU AND RAJNA HOXHOLLI, MONETARY POLICY DEPARTMENT

(full pdf text)

The purpose of this paper is to verify the presence of Balassa-Samuelson (BS) effect and estimate it for the Albanian economy. The investigation of the BS effect constitutes an important aspect for

the monetary policy pursued by central banks because it lays emphasis on the relation between relative productivity of tradable to non-tradable sectors of a small and open economy and relative prices of both sectors. Theoretically, the presence of a positive relation would support the fact that inflation is influenced by relative productivity growth. Making use of econometric models, this paper estimates the domestic and foreign BS effect on inflation. In order to carry out the estimations, data on value added and employees' number in the economy sectors are made use of. Various proxies for productivity of tradable and non-tradable sectors of the economy are estimated through them. Also, proxies for various relative prices and different classifications of the economy sectors are employed to fully test the BS effect.

The results indicate that there is a positive correlation between relative productivity and relative prices, a fact that supports the research on BS effect in Albania. Quantitative estimates indicate that this effect has had a moderate impact on inflation. The paper also shows the results of a more specific model of this effect on real exchange rate trend. Co-integration analysis between REER and relative productivity differential concludes that in the long-run, the implications are more obvious on the REER. It is assessed that shocks only from productivity differentials lead to disequilibrium of the REER, which may return to equilibrium after a relatively long period.

The results of the study help in exploring the model of the general exchange rate equilibrium in Albania.

4. "ROLE OF BANKS IN THE MONETARY POLICY TRANSMISSION IN ALBANIA", ILIR VIKI, RESEARCH DEPARTMENT

(full pdf text)

This paper contributes to the empirical findings on the bank lending channel of monetary policy in Albania by using the individual data from the main twelve commercial banks. In particular, it is aimed to analyze whether the private loans developments can be explained by changes in the monetary policy indicator, as measured by the rate of one-week repurchase agreements.

The empirical findings suggest that bank loans have responded only modestly to monetary policy decisions during the 2004 Q1:2006 Q4 period. Coefficients of the monetary policy indicator are statistically significant and have the expected negative sign, thus supporting the theoretical relationship between interest rates and the volume of loans.

Nevertheless, the empirical evidence to support the existence of a bank lending channel in Albania is mixed. While the smaller banks are found to be less sensitive to the monetary policy stance compared to the larger banks - and which is contrary to theoretical and intuitive expectations -, the results show that yet the more liquid banks are better shielded to monetary policy changes - which is in line with the bank lending channel theory.

5. "ALBANIAN CURRENT ACCOUNT DEFICIT: DOES IT POSSESS MEAN

**REVERTING PROPERTIES?“,
ALTIN TANKU, EVIS RUÇAJ,
ARGITA FRASHËRI, RESEARCH
DEPARTMENT, STATISTICS
DEPARTMENT**

(full pdf text)

During the last 15 years, Albania's current account has wandered in deficits, which in most of the cases have reached well beyond the 5 percent of GDP, a broadly accepted measure of sustainability. This research investigates the sustainability properties of the Albanian current account deficit, based on the LRBC method developed

by Trehan and Walsh (1991), and extended by Taylor (2002). We make use of quarterly current account observations for the 1994–2006 period and unit root testing to investigate the mean reverting properties of current account. We pay special attention to the role of remittances and aim to assess whether they play a significant role in the sustainability of current account. Our results show that despite the latest widening deficit, current account seems to be sustainable in the long run. However this sustainability might be vulnerable and deserves the attention of the Albanian authorities.

III. FORTHCOMING WORKING PAPERS AND ARTICLES

The following research papers are currently being explored at the Bank of Albania:

**1. “STOCK-FLOW APPROACH TO
THE LEK/EUR EXCHANGE RATE
EQUILIBRIUM“, ILIR VIKI**

This study estimates the real exchange rate equilibrium in Albania following the stock-flow approach, which has been used in the literature for industrialized countries as well as for Eastern European economies. Using the ARDL method, we try to find out the longer-term factors that determine the real ALL/EUR exchange rate. First, the link between CPI-based real exchange rate, productivity differential and net foreign assets is estimated for the period from 1999 Q1 to 2008 Q4. To check for the robustness of the results, several control variables have been later

added to the reduced-form equation, which include government expenditure, terms of trade, economic openness, and public debt. Public consumption is often used to account for demand-side factors that may change the relative price of non-tradables and thus move the real exchange rate. Overall improvement in the terms of trade of Albania should cause a real appreciation of the domestic currency. Openness may be viewed as a transition component of the real exchange rate dynamics, since a full-grown economy would experience limited variation in its total trade to GDP. In the case of Albania, an increase of openness resulting from trade liberalization is expected to deteriorate the current account position, hence depreciating the real exchange rate. Due to a shortage of data, the country risk premium is approximated by using the ratio of public debt to GDP. Surging government debt is

generally perceived as a higher risk, thus reducing the desire of holding more of that country's currency.

Preliminary findings suggest that during the 1999 Q1:2008 Q4 period the real exchange rate against euro has been more sensitive to productivity differential and less to net foreign assets. Further, the parameters before the controlling variables are in general statistically insignificant, or even have an unexpected sign.

2. "INDIRECT CREDIT RISK STRESS TESTING IN ALBANIA, BASED ON THE BANK SPECIFIC CHARACTERISTICS", HILDA SHIJAKU AND KLITI CECA

The main objective of this paper is to evaluate indirect credit risk faced by different groups of banks rather than from the system as a whole. The paper investigates the response of the non-performing loans ratio to the macroeconomic conditions causing deterioration in the solvency of borrowers via the channels of the credit risk under

bank specific characteristics, such as size, ownership, capitalisation and other features of the loan portfolio. The empirical modelling is enabled through panel estimation of Albanian banks data and would be of value added in evaluating parameters used for stress testing for individual banks. This study will be also useful to identify vulnerable parts of banks' balance under different scenarios, especially as diversification of banks' portfolio in Albania is lacking.

3. "LENDING GROWTH IN ALBANIA; ALREADY IN EQUILIBRIUM?", IRINI KALLUCI

The main objective of this study is to evaluate lending growth performance in Albania and determine whether it has reached its equilibrium level. The results will be especially useful as Albania has been experiencing high credit growth rates during the recent years.

These research papers will be soon discussed with the group of experts, whose opinion has often proved to be very useful to the authors of the papers.

V. OTHER

The Bank of Albania has announced its **8th International Conference on: "Monetary & Financial Stability Policies - Lessons from the Crisis"**.
(full pdf text)

The event will take place in Tirana during 17- 18 September and will bring together around 250 guests

from central banks, the academic world, representatives of national and international financial and research institutions. Organized in three thematic panels, the Conference will try to discuss very important issues of the moment, like the global financial crisis and its effects. The first two panels will host speakers from the academic community, as well as

the international banking and financial community. They will analyze the crisis together with all of its components and impacts on the South-East European economies. The third panel will consist of a joint discussion held by the Governors and Deputy Governors of the region on their stands, measures and experiences concerning a crisis situation.

The Bank of Albania has declared open this year's **"Governor's Award for the Best Diploma Thesis"** competition. Like in previous years, the competition is open to Albanian students graduated in national or overseas universities during this academic year. The thesis must address subjects on monetary economics, financial stability, the European economic integration of the Balkan region, Bank of Albania's activity, the Albanian banking system and the economy in general. The application deadline is 1 September, 2009. After

this date, the Evaluation Committee will review the accepted work.

Third Regional Meeting: "South-Eastern European Economic Workshop"
(full pdf text)

The Bank of Albania in collaboration with the Bank of Greece will organize the third annual "South-Eastern European Economic Workshop", in Athens during 19-21 November, 2009. This round table discussion will bring together around 30 regional and non-regional discussants.

The discussions will focus on three major issues concerning central banks operating in transitional countries and the small open economies of South-Eastern Europe:

1. Economic and financial stability.
2. Banking and finance.
3. Internal and external imbalances

LINKS:**RESEARCH AT OTHER CENTRAL BANKS**

European Central Bank (<http://www.ecb.int/home/html/researcher.en.html>)

Bank of Greece (<http://eng.bankofgreece.gr/en/publications/research.asp>)

Deutsche Bundesbank (http://www.bundesbank.de/vfz/vfz_diskussionspapiere_2009.en.php)

Oesterreichische Nationalbank (http://www.oenb.at/en/presse_pub/research/research.jsp)

Banca d'Italia (<http://www.bancaditalia.it/studiricerche>)

Czech National Bank (<http://www.cnb.cz/en/research/>)

Banco de Espana (<http://www.bde.es/informes/be/docs/docse.htm>)

Bank of Finland (http://www.bof.fi/en/julkaisut/bofit_julkaisut/index.htm)

Bank of England (<http://www.bankofengland.co.uk/publications/workingpapers/index.htm>)

Federal Reserve (<http://www.federalreserve.gov/econresdata/default.htm>)

OTHER

BIS Central Bank Research Hub (<http://www.bis.org/cbhub/index.htm>)

International Journal of Central Banking (<http://www.ijcb.org/>)

National Bureau of Economic Research (<http://www.nber.org/>)

International Monetary Fund (<http://www.imf.org/external/pubind.htm>)



If you use data from this publication, you are requested to cite the source.
Published by: Bank of Albania, Sheshi "Skënderbej", Nr.1, Tirana, Albania
Tel.: 355-4-2222230; 2235568; 2235569
Fax.: 355-4-2223558
E-mail: public@bankofalbania.org

www.bankofalbania.org

Printed in: 500 copies