Credit Conditions, Effects of Economic Shocks and Monetary Policy

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"Banking Developments and Financial Market Infrastructure: The role of structure, size and market infrastructure in risks mitigation and financial intermediation"

Bank of Albania, 9 November 2017

Credit Conditions and the Macroeconomy

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  3. the effect of uncertainty on unemployment changes over the cycle (Caggiano et al, 2014).

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- We address these questions using a particular econometric model, labeled ST-MAI-SV: smooth transition (ST) multivariate autoregressive index (MAI) stochastic volatility (SV) model, details in Carriero, Galvao and Marcellino (2017). Here we focus on the results.

	Factor	Trans.
Employees nonfarm	activity	Log-diff
Avg hourly earnings	activity	Log-diff
Personal income	activity	Log-diff
Consumption	activity	Log-diff
Industrial Production	activity	Log-diff
Capacity utilization	activity	Log-diff
Unemp. Rate	activity	Log-diff
Housing Starts	activity	Log-diff
CPI	inflation	Log-diff
PPI	inflation	Log-diff
PCE deflator	inflation	Log-diff
PPI ex food and energy	inflation	Log-diff
FedFunds + shadow rate	Mon. Pol.	diff
1year_rate	Mon. Pol.	diff
EBP	Credit	levels
BAA spread	Credit	levels
Mortgage Spread	Credit	levels
TED Spread	Credit	levels
CommPaper Spread	Credit	levels
Term Spread (10y-3mo)	Credit	levels

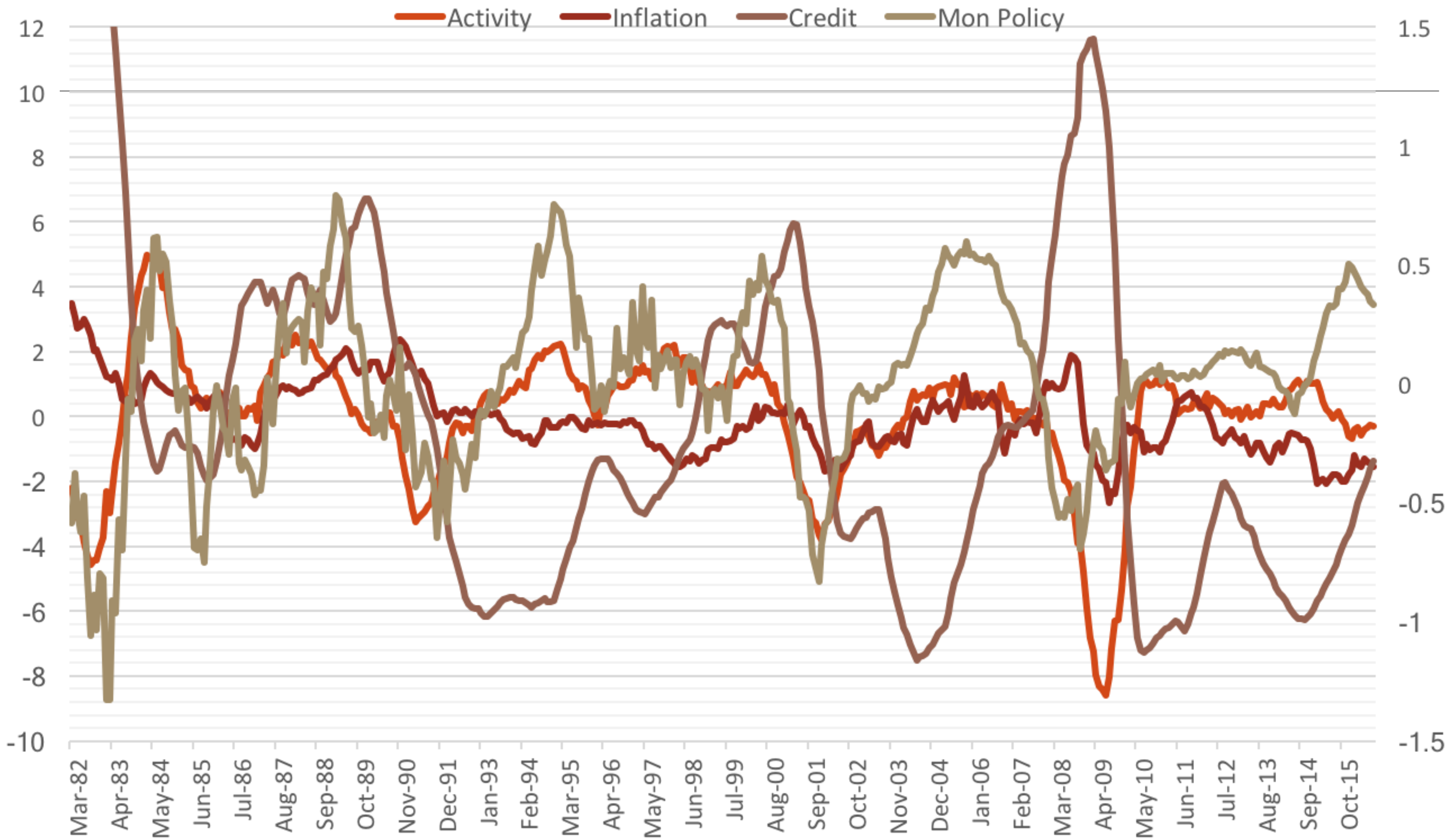
Variables and Factors (USA)

Estimation period: 1982M3-2016M8 (pre-sample from 1974 for B RW priors).

Series are standardized.

N=20; p=13;

MAI model: Y on Y Factors



Note: Monetary policy factor in the right axis.

Correlation with MAI Factors

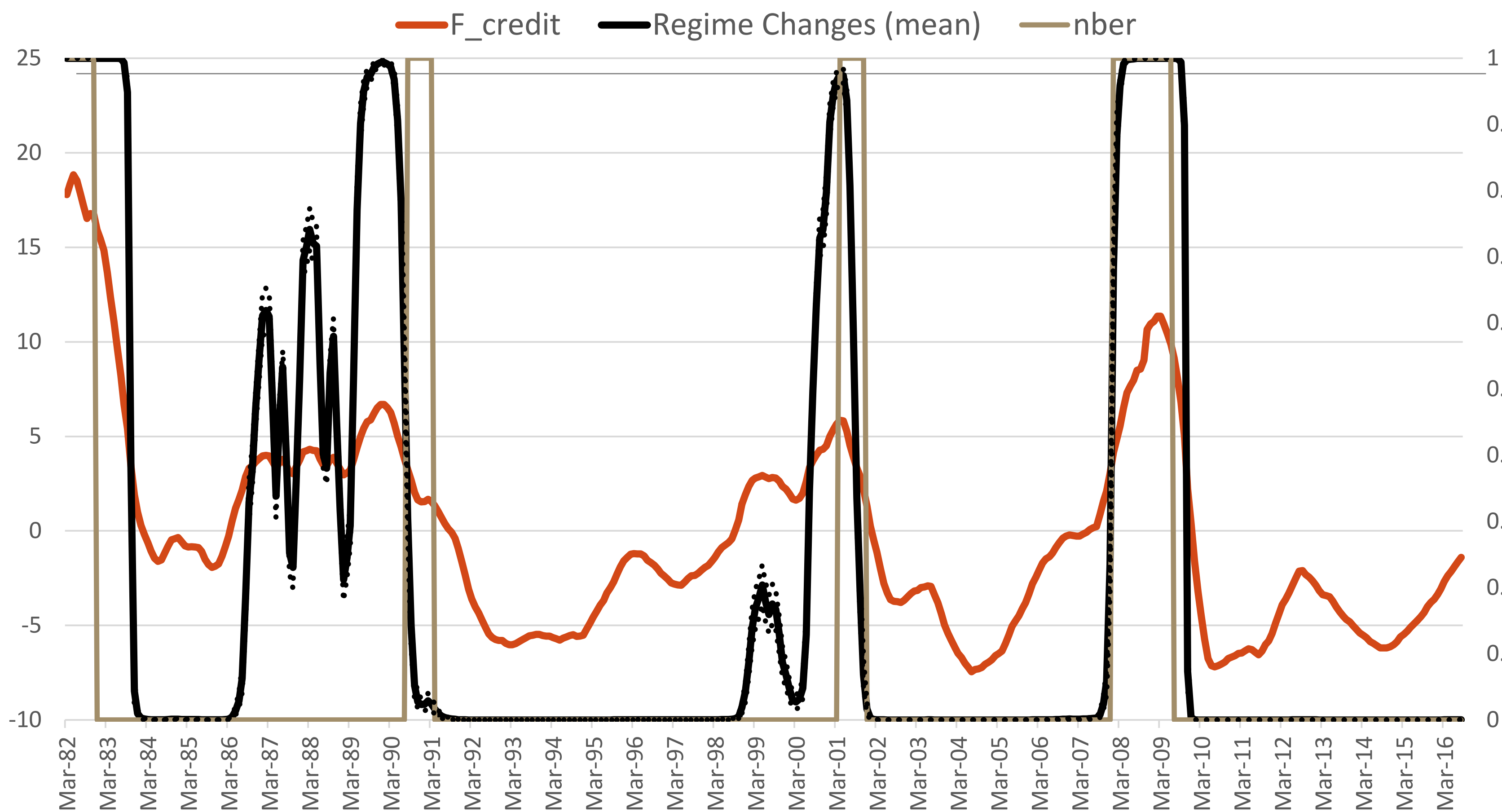
	F_infl	F_mp	F_cred	PhilFed Activity	Chicago FCI	Adjusted CFCI
F_activity	0.06	0.61	-0.47	**0.86**	-0.39	-0.02
F_inflation	1	-0.13	0.48	-0.11	0.54	0.12
F_mp	-0.13	1	-0.49	0.63	-0.34	-0.07
F_credit	0.48	-0.49	1	-0.51	**0.78**	**0.53**

Choosing ST-MAI Specification

	Average Likelihood $E_\theta(\ln f(y\|\theta))$	BIC
MAI (λ_1=3.5)	-8267.981	22899.225
ST-MAI with F_activity (λ_1=1;Δ_Σ=25/110; $\Delta_{\gamma,c}$=0.01)	-7820.760	28271.735
ST-MAI with F_inflation (λ_1=1;Δ_Σ=120/20; $\Delta_{\gamma,c}$=0.01)	-8004.157	28638.529
ST-MAI with F_mp (λ_1=1;Δ_Σ=20/120; $\Delta_{\gamma,c}$=0.01)	-7859.639	28349.493
ST-MAI with F_credit (λ_1=1;Δ_Σ=120/20; $\Delta_{\gamma,c}$=0.01)	-7749.376	**28128.967**

All with 4 factors. Hyperparameters are chosen to maximise the average likelihood and/or set acceptance rates to about 30%.

ST-MAI regimes

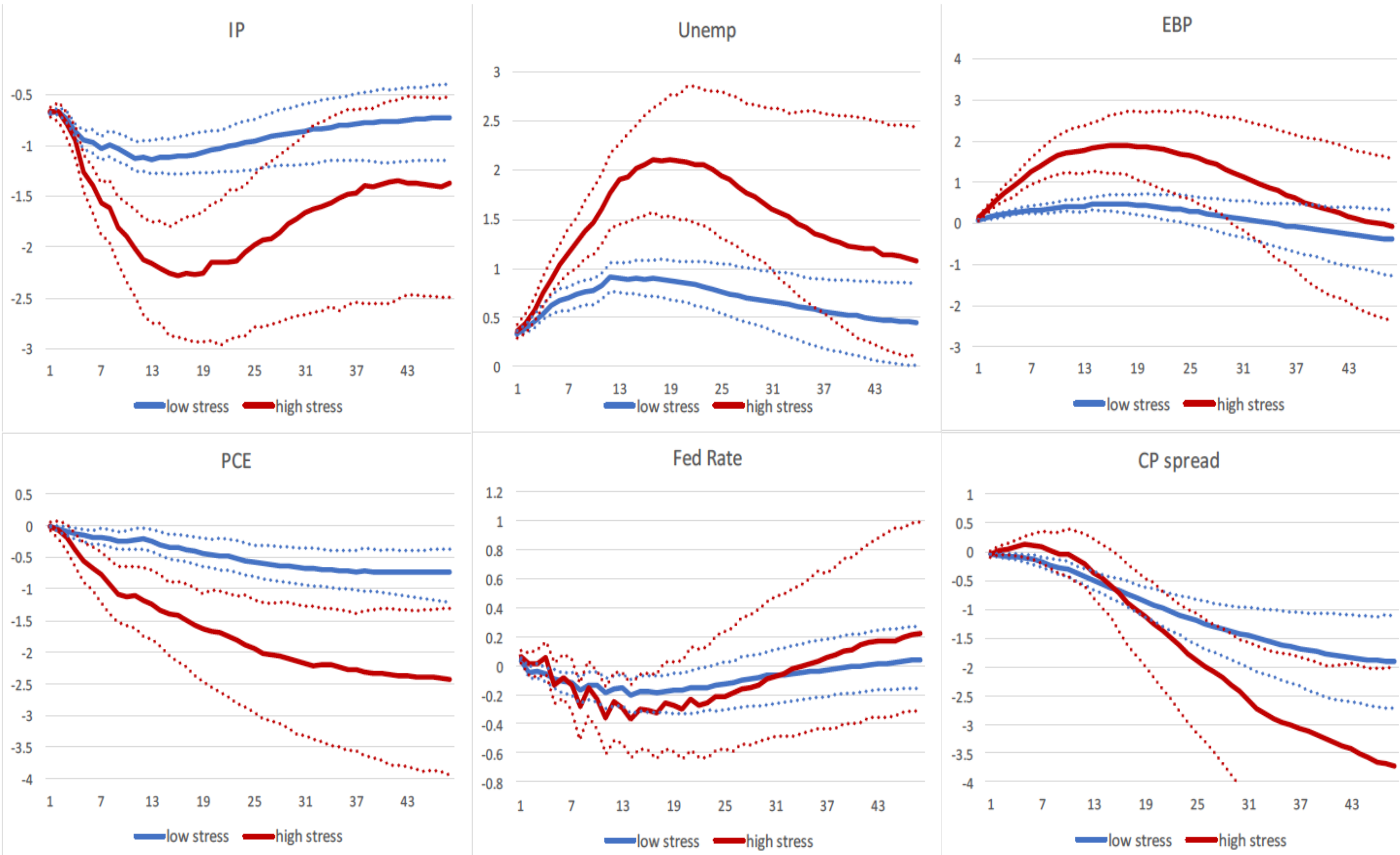


NBER recessions: greyish line.

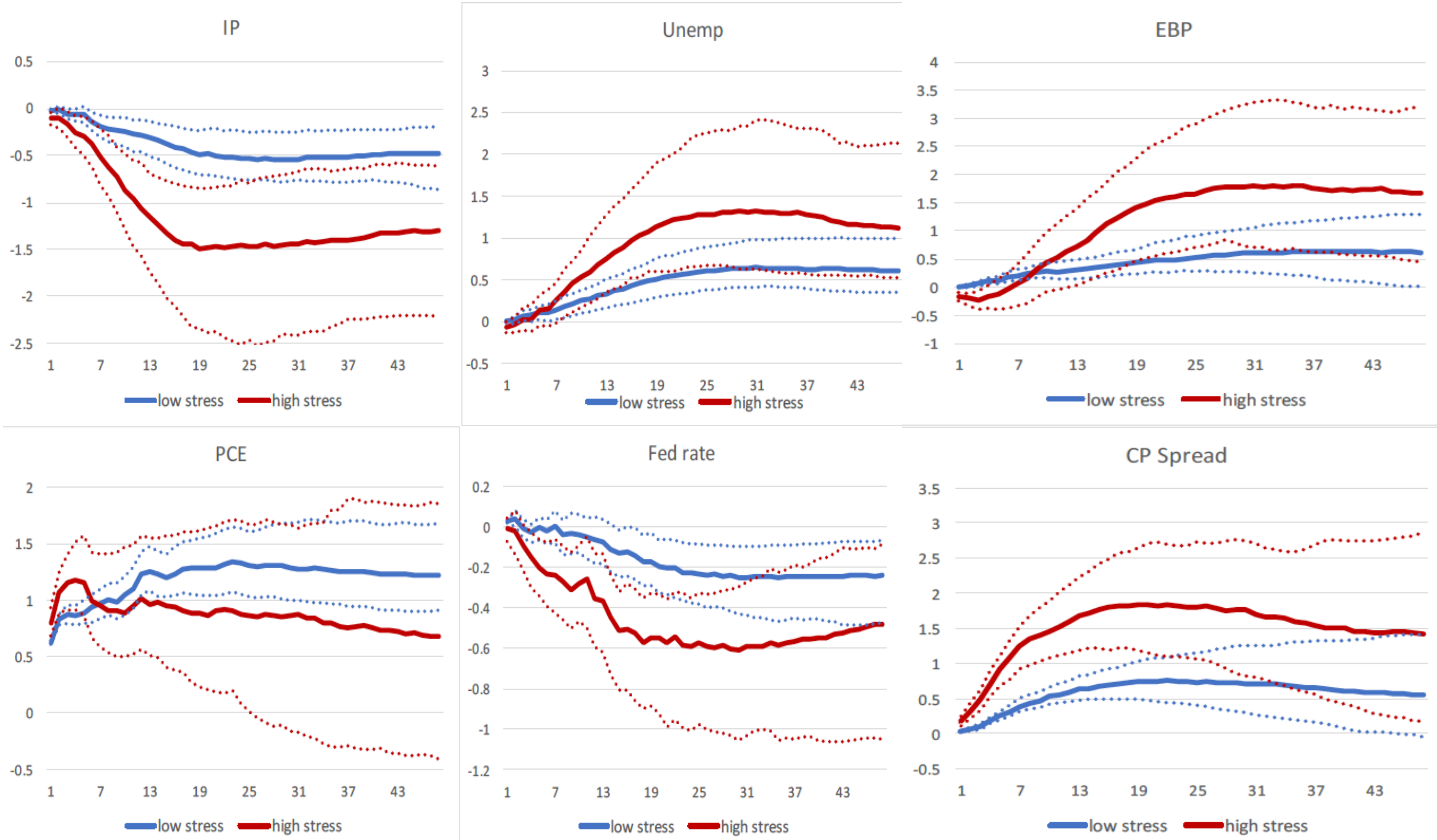
Responses computed for:

- Four structural common shocks.
- Negative shocks on economic activity:
  - Weak-demand (consumer and business lack of confidence, for example).
  - Price-pressure (a supply-type shock).
  - Monetary policy tightening.
  - Credit Stress (deterioration of credit conditions).
- Plots for key variables: Industrial Production, Unemployment, PCE inflation, EBP, Fed Rate, CP spread.
- All include 68% confidence bands. Cumulative responses.

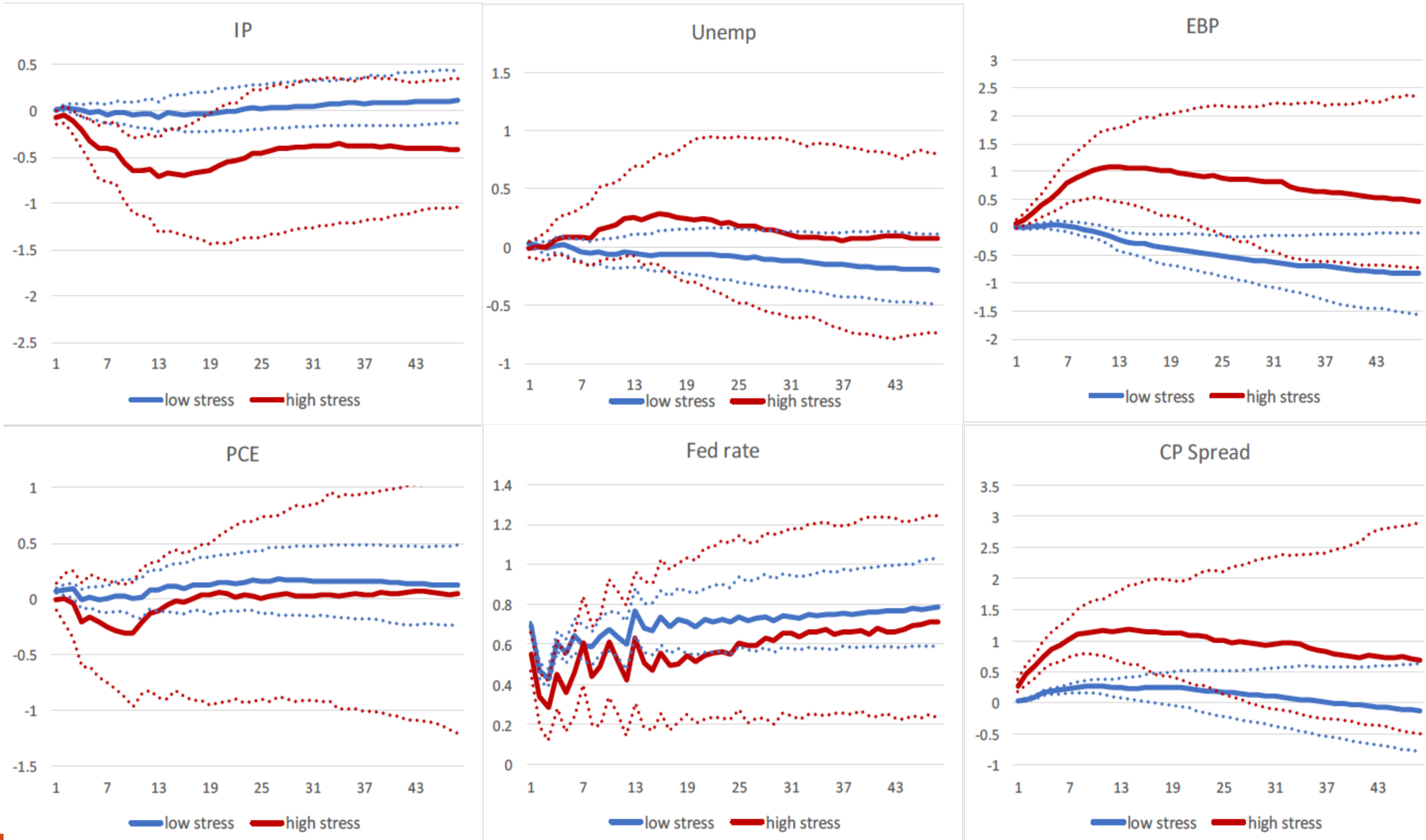
Responses to a Demand Shock



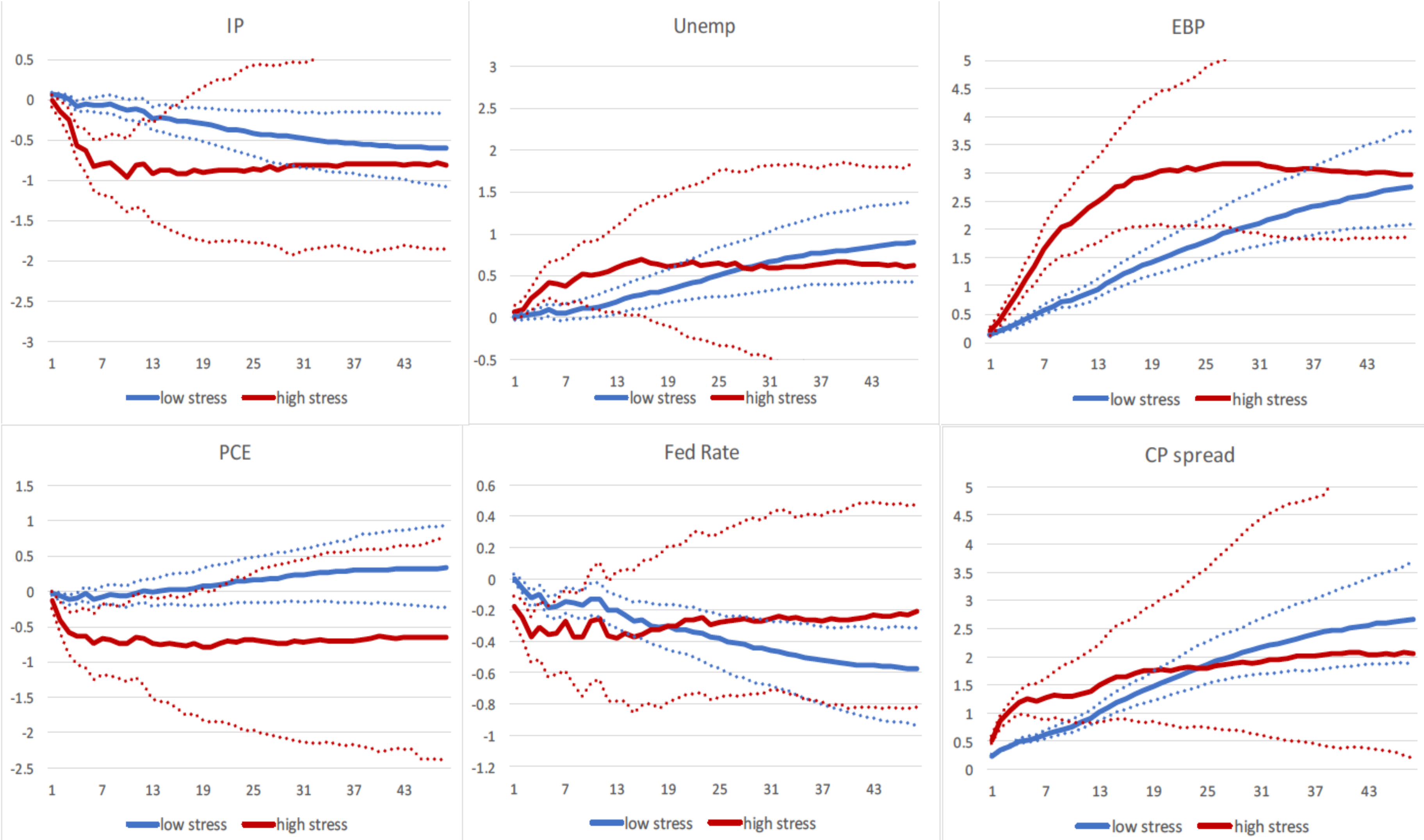
Responses to a Supply Shock



Responses to a MP shock



Responses to a Credit Shock



Conclusions

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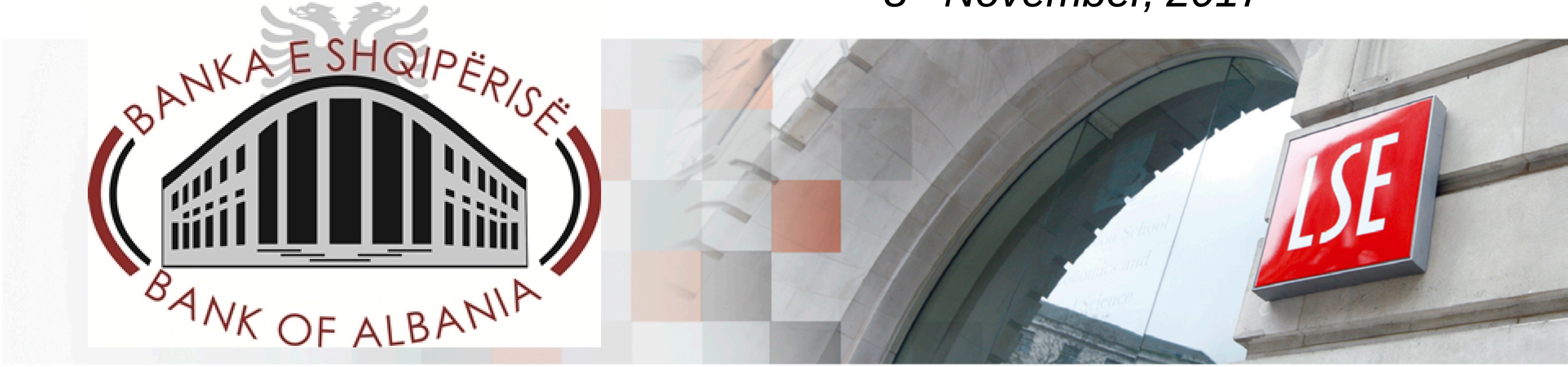
- Credit spreads shrink with expansionary monetary policy, in particular in the credit stress regime. This amplifies the positive effects of expansionary monetary policy on economic activity and prices during credit stress periods (but also the negative effects of a restrictive policy).
- Therefore, monetary policy even more useful in problematic times, if properly used...

NPLs – Legacy Issue & Future Prevention

Bank of Albania/SEESOX Annual Conference

8th November, 2017



LSE Institute of Global Affairs

Piroska Nagy-Mohacsi

Programme Director

Outline

1. NPLs in the broader policy context – impediment to transformational finance & growth

2. Albania’s NPL “Report Card”

3. Today’s key issues for financial sector resilience

New Growth Model : Policies according to level of development

- Growth is the ultimate objective even for central banks
- Getting to High Income country group requires different set of policies than before
- New Spence-Stiglitz Commission on Global Economic Transformation

Key: Switching from **physical investment-led** growth into **innovation-led** growth

Advanced economies

- Invest in high education
- Liberalise product markets
- Liberalise labour markets
- Liberalise financial markets
- Competition, external account liberalisation

Emerging Economies

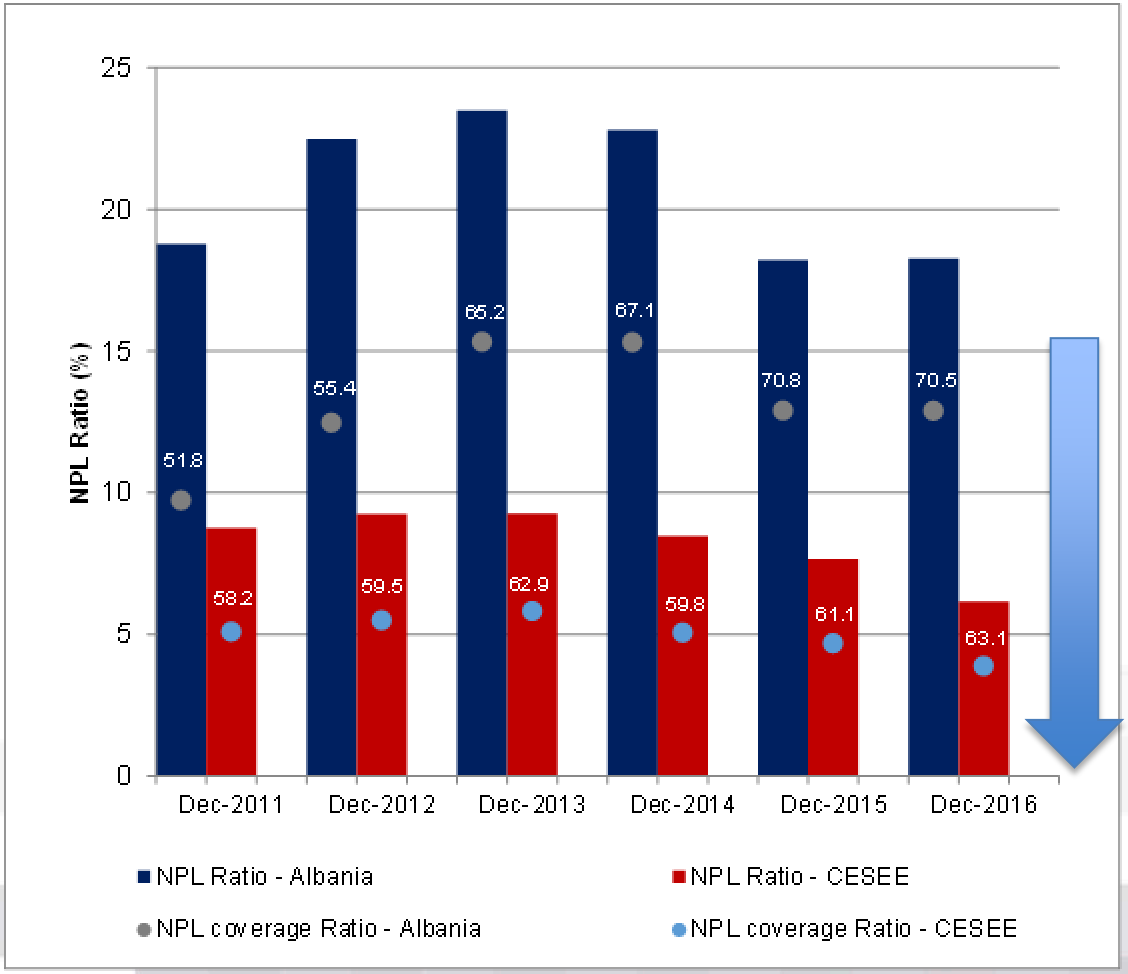
- Foster technology transfers
- Reallocate factors of production
- Improve management practices
- These can be activated via:
  - Relaxing credit constraints
  - Reducing corruption
  - Improving education quality

Most to do with transformational finance

Benefits of NPL reduction

- Increased bank profitability
  - ECB simulation: up to 5% increase on ROE
- Capital relief that can spur lending growth
  - ECB: if NPL elimination leading to freed up capital could raise credit growth between 2 ½ -6 %
  - Higher the NPL the higher the credit benefit
- Benefits from confidence boost
  - Difficult to quantify but there
- Freeing up managerial time
  - As they say – “priceless”

An unfinished business: NPLs in Albania coming down but still too high



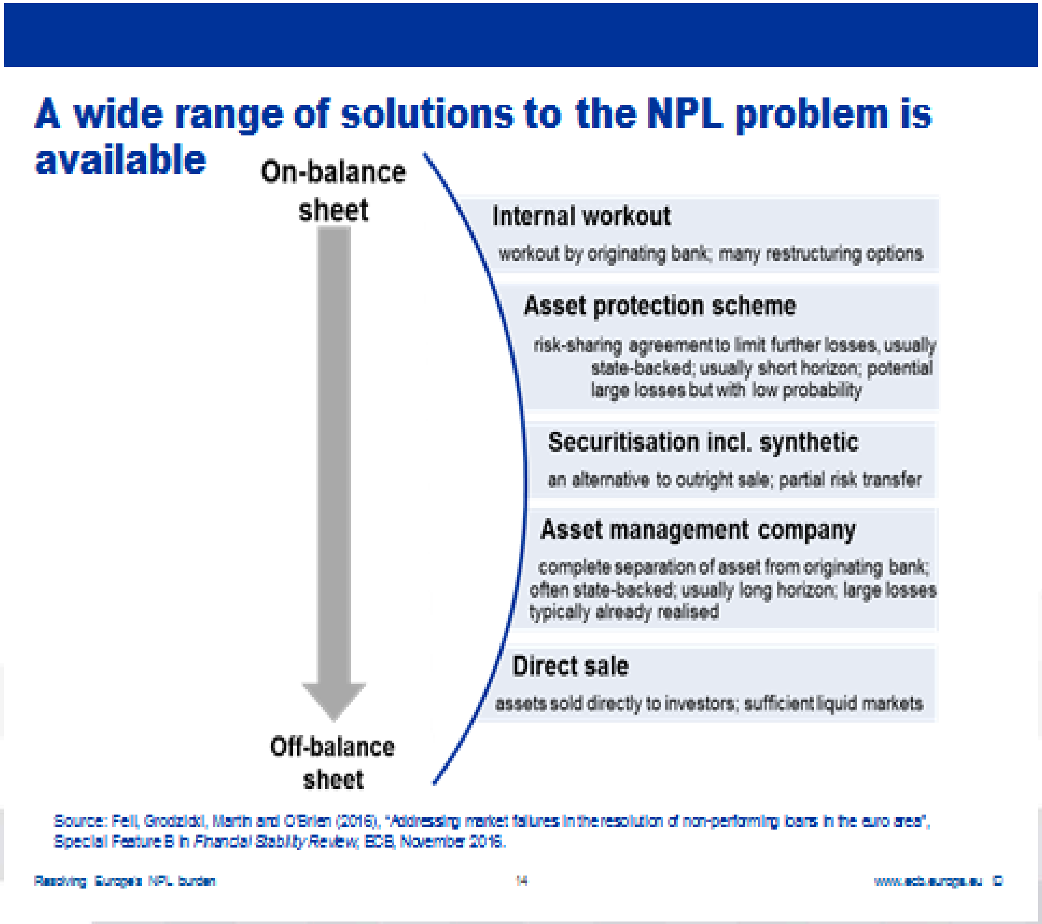
- 15.6% at end June-2017
- Quite concentrated

Source: NPL Monitor 2017, EBRD, Vienna Initiative (forthcoming)

Albania's "NPL Report Card"

- **NPL Working Group (NPL WG) and action plan,** November 2015
- **Bankruptcy law:** Prepared in collaboration with IFC and approved by the Parliament in October 2016. Implementation limited
- **Upgrade of Credit Register and establishment of a credit bureau,** April 2016: BoA's credit register was upgraded; Albanian Association of Banks has proposed the setup of a private credit bureau with EBRD assistance
- **Regulatory write-off:** BoA regulation from 2015 mandating the write-offs of loans of NPLs over 3 yrs (ECB's latest: 2 yrs for unsecured, 7 yrs secured loans)
- **Out-of-Court debt Restructuring (OOCR):** Guidelines on "corporate OOCR" and "OOCR for individuals" isued by BoA in 2013; in 2016 BoA unified and revised these. The final draft, prepared with the World Bank, is yet to be made official by BoA.
- **Series of Amendments to the Civil Code & Civil Procedure Code, Private Bailiffs Law and Law on Judicial Bailiff Service, Law on securing charges, October-** November 2016

Menu of solutions is clear. Not all but several applicable in Albania



Bottomline on NPLs

It is clear

Why to do it…

What to do and

How to do it …

“Just Do It”

Post-Crisis Regulatory Reform: Extensive…

- **Micro-prudential**
  - Quality and quantity of capital (RW)
  - Leverage ratio (LR)
  - Liquidity coverage ratio (LCR)
  - Net stable funding ratio (NSFR)
  - Resolution mechanism/Total loss absorbing capacity (TLAC)
- **Macro-prudential**
  - Countercyclical cap buffer
  - G-SIBs; D-SIBs capital req
  - Lending standards (LTV, LTI etc)
- **Other**: pay limits, governance…

…. yet big issues persist

- **Too much regulation?**
  - Multiple problem – multiple instruments
  - Compliance issue for small bank & entry
  - Maybe also MacroConduct not only MacroPru (Kevin James et al 2017)
- **Is regulatory capital sufficient?**
  - "Optimal": Tier 1 ~ 16-19% - Today 2/3 of G-SIBs and D-SIBs have less
  - Does higher capital result in less lending? Good news: No (Cecchetti 2014)
  - Trade-off: capital – credible resolution mechanism TLAC (Holdane 2017)
  - Maybe it is all about leverage by "small" & "large" (Hyuan Song Shin 2017)
- **Is the Too-Big-To-Fail problem solved?**
  - No
  - Big size does not help performance only bank lobby power (Hubert 2017)
- **Complicated political economy of central banks**
  - Deeper into political territory; joint tasks with fiscal authority
  - Central bankers are primary target of populism

Conclusion: What this all means for Albania?

- **Do your own homework**: finish the job of legacy issues and do your best on domestic policies
- **Beyond that choices are limited for a small open economy next to the Eurozone** and banking sectors deeply integrated with it - but not a bad situation. EBA, ECB, EU
- **Make alliances in EZ/EU for growth-friendly**, transformational, innovation-promoting monetary and regulatory policies
- **Strengthen ex ante bank resolution commitments** (to the extent possible). BRRD is enforced for smaller players (only)
- **Fight insurgent populism in the region with more accountability** and communication.

THANK YOU!

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Bank of Albania Annual Conference:
Banking Developments and Financial Market Infrastructure
Tirana, 9 November 2017

Session 2: Economic financial and institutional challenges and policy solutions

Macro-prudential policies and their spillover effects

Pietro Catte
Banca d'Italia

Outline

- Macroprudential policies: rationale, objectives, tools
- MPPs in an international context: implications of growing international financial integration
- Assessing spillover effects: recent empirical literature
- Policy implications

Macroprudential policies: rationale and objectives

- The Global Financial Crisis has shown that macroeconomic and microprudential policies are not enough to contain systemic risks. Specific policy tools are needed
- These tools have been identified as “macroprudential”: they are mostly prudential tools, but used to address macro-financial objectives
- The GFC also showed that systemic risks tend to spill over across borders. Domestic financial stability policies have positive externalities. This provides an argument for international cooperation in macroprudential policies.

Objectives of MPPs

- To make the financial system more resilient to aggregate systemic shocks (e.g. by building up buffers)
- To contain the build-up of systemic vulnerabilities over time (time dimension)
- To contain vulnerabilities arising from interlinkages and the role of large institutions in key markets (structural dimension)

Macroprudential tools

- Countercyclical capital buffers (CCB) and loan-loss provisions
- Sectoral tools:
  - Sectoral capital requirements
  - Limits on LTV and DTI ratios
  - Risk weights
  - Limits on large exposures
- Liquidity/funding tools:
  - Liquidity Coverage Ratio; Net Stable Funding Ratio
  - Limits to loan-to-deposit ratios, maturity mismatches; open forex positions
  - Reserve requirements
- Capital surcharges on global and domestic systemically important financial institutions (SIFIs)
- Changes to market infrastructures

Implications of growing international financial integration for macroprudential policies

- Domestic inaction bias may be exacerbated
  - Assessment of systemic risks is more complicated (e.g. for global banks)
  - National authorities might be reluctant to put domestic banks at competitive disadvantage, in view of potential regulatory arbitrage ("race to the bottom")

    → Need for international cooperation
      - procedures for the exchange of information (e.g. supervisory colleges)
      - global systemic risk monitoring by FSB, BIS, IMF
      - international standards and peer pressure to address collective action problem (Basel Committee and FSB guidance; IMF surveillance)

- Greater scope for cross-border spillovers from national MPPs
  - Outward spillovers: credit and financial conditions in other countries may be affected
  - Inward spillovers: foreign institutions are able to circumvent MPP measures, via either local branches or direct cross-border lending, partly offsetting their effects.

Spillover effects tend to vary according to circumstances

- The sign and intensity of spillover effects is likely to depend on several factors:
  - Type of instrument: its transmission mechanism and the regulatory perimeter to which it applies
  - Each country’s degree of financial openness; presence of foreign banks
  - Organizational structure and business model of the international banks involved (e.g. branches vs. subsidiaries)
  - Banks’ balance sheet positions (strong vs. weak capital/liquidity positions)

- The policy implications of spillovers (desirable/undesirable) will also depend on:
  - The objective for which the MPP tool was used
  - Degree of financial cycle synchronization across countries

- Experience in Europe

Empirical assessments of spillover effects from MPP measures (1)

- International Banking Research Network
  - 15 country studies using confidential micro data, common methodology, 2000-2014 period
  - 2 cross-country studies by BIS, ECB
  - Common database of MPP measures, developed with IMF
  - Results published in *International Journal of Central Banking*, March 2017
- Main results:
  - No single dominant pattern; signs of spillover effects vary; spillovers are statistically significant in about one-third of specifications
  - Heterogeneity of results seems to be connected to bank balance sheet positions, banks' business models and liquidity management; cyclical positions do not seem to matter
  - Response of cross-border bank credit to liquidity and sectoral MMP measures more frequently significant than response to capital measures
  - In general, size of spillover effects is not large
  - No systematic difference between AEs and EMEs
- Some limitations of the results / qualifications of their implications:
  - MMPs were not used very frequently in the sample period; relevance of spillovers may increase in the future as MPPs are used more frequently and in a variety of situations
  - Analysis focused on adjustments along the intensive margin, excluding those via entry/exit and M&A (extensive margin). Also, it focused on quantity adjustments, not prices.

Empirical assessments of spillover effects from MPP measures (2)

- IMF study (Kang et al, 2017: IMF WP/17/170)
  - Panel regression with 64 countries, quarterly data 2000Q1-2015Q1
  - Non-parametric event study analysis
  - Structural analysis with estimated DSGE to assess economic significance of effects

- Main findings:
  - Measures targeted at banks' funding/liquidity and sectoral measures have stronger spillover effects than measures targeted at capital buffers

    (finding similar to IBRN study; however, contradicted by other studies, e.g. Reinhardt and Sowerbutts, 2015, Akinci and Olmstead-Rumsey, 2015)
  - Spillovers are stronger for tightening than for loosening measures
  - Effects are stronger in Europe (regional concentration)

Spillover effects: implications

What can we conclude from this (very) brief survey?

- Spillovers from MPP measures can be relevant in some cases, although it is still difficult to quantify them, due to limited experience in using these tools
- We know that the size and direction of spillovers depend on a number of circumstances (bank business models, bank balance sheet positions), and that their policy implications depend on financial cycle synchronization, objectives of MPPs; thus, there is no single one-size-fits-all story.
- Inward spillovers (leakages) can pose a problem to the authorities enacting the MPP measures, as they tend to weaken their effects. They can also pose a problem to other jurisdictions, as foreign banks take greater risks. Incentives may be aligned for cooperation, although there are asymmetries.
- Outward spillovers are mainly a problem to countries at the receiving end. However, cooperation is needed to stem the risk of uncoordinated, disorderly and possibly inefficient responses (capital controls, ring-fencing)

Policy responses

- Inward spillovers, where necessary (depending on the nature of the MPP tool), can be addressed through reciprocity agreements:
  - The Basel agreement on reciprocity in the imposition of the Basel III CCB (up to a buffer rate of 2.5%) is an important step forward
  - In the EU, the ESRB has put in place a framework of voluntary reciprocity for macroprudential policy measures (the ESRB can only make recommendations; only the European Commission can prescribe compulsory reciprocation).

    The purpose is to enhance the effectiveness and consistency of MPPs in the EU and to contribute to a level playing field in the single market.
  - Reciprocity is easier to achieve when MPP toolkits are harmonized
  - Transparency is very important in applying reciprocity
- For outward spillovers, it is more difficult to envisage general solutions
  - Transparency of MPP measures can help other authorities assess whether they need to take countermeasures
  - Ad hoc measures (e.g. Vienna Initiative) can be helpful to build confidence in some circumstances.

Real and Financial Shocks in Albania

Should monetary policy be supplemented with additional tools?

Erald Themeli

Monetary Policy Department

Bank of Albania

Presentation at the “Banking Developments and Financial Market Infrastructure: The role of structure, size and market infrastructure in risks mitigation and financial intermediation”

09 November 2017

Motivation

Small, open and financially integrated economies, tend to suffer frequently from financial shocks. Under these premises, the economic literature seems to concur on the need for supplementing monetary policy with other tools, such as macroprudential policy.

Does Albania’s history highlight the need for such a coordination?

What might some of the relevant areas for coordination be ?

Overview

1. Coordination of monetary and macro prudential policies: a brief literature overview
2. Real vs financial shocks in Albania
3. Some relevant coordination areas
4. Concluding remarks

1. Pre-crisis consensus

- Under simplified assumptions, monetary stability was thought of as a sufficient condition for overall economic stability
  - Prevailing frictions in the economy were perceived to be limited to the real sector
  - Under the premise of rational expectations, economic management policies increasingly become rule-based
    - Accounting for the time-inconsistency problem, economic stabilization duties were delegated to 'technocratic', independent and accountable central banks
- Financial markets were assumed to be self-regulating and efficient
  - Financial regulation and supervision did mostly have a micro-prudential perspective
  - Second-guessing asset-prices was deemed to be futile and leaning against the wind undesirable
  - Under a correct system of incentives, financial stability would originate as a result of sound individual institutions & sound individual market segments
- Monetary and macro-prudential policies were thought of as non-overlapping domains
  - Financial crisis: mopping up the effects rather than leaning against the wind

2. Lessons learned during the crisis and the current state of the debate

Lessons learned from the latest financial crises (IMF 2013, IMF 2015, Smet 2014):

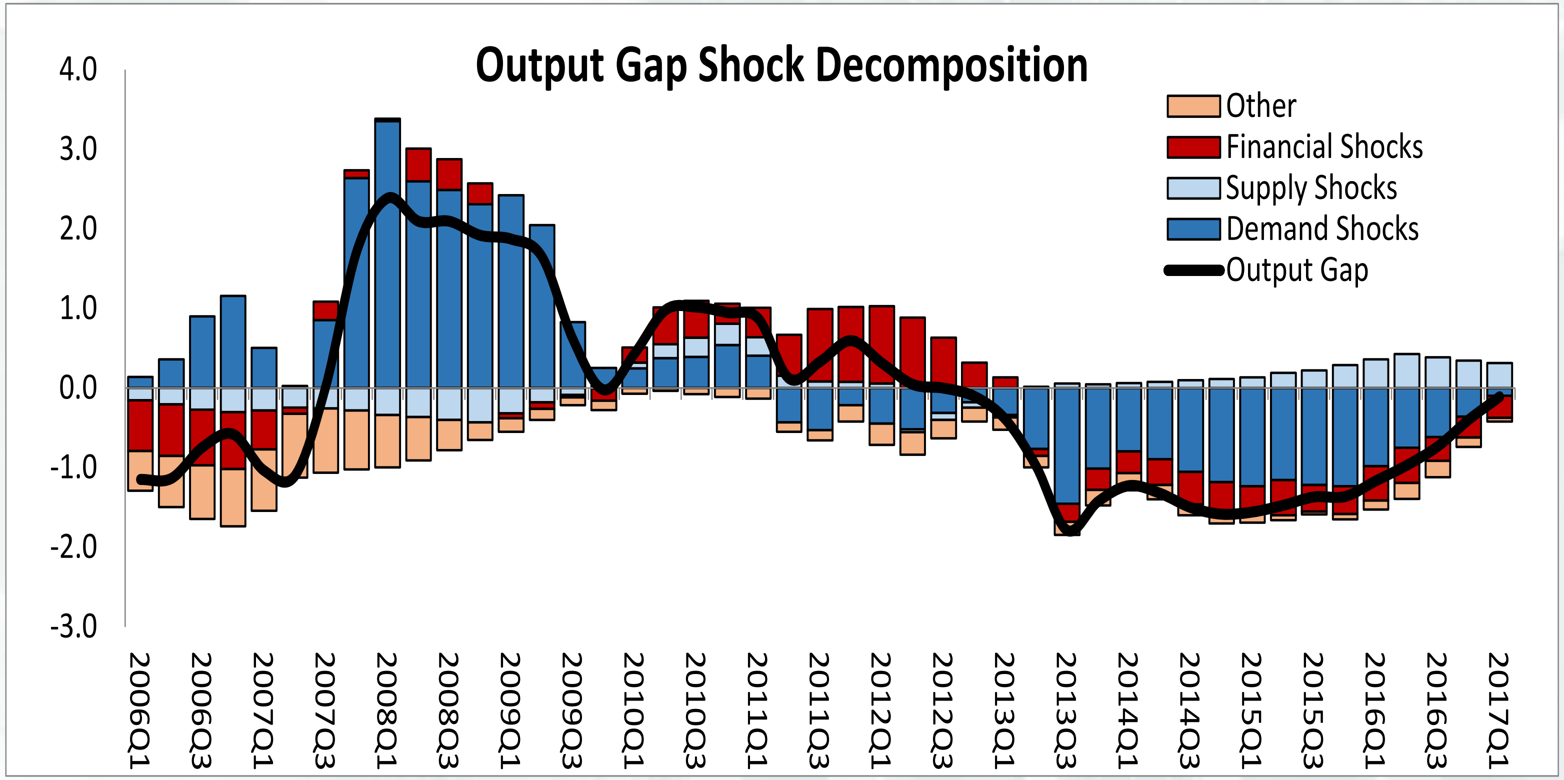
- Financial crisis are costly: macro and microprudential policies have to be strengthened
- Price stability is not a sufficient condition for financial stability
- Prudential tools alone can not ensure financial stability
- Other policy tools might be used to decrease the likelihood of a crisis

Towards a post-crisis consensus:

- For advanced economies, the debate is not yet settled:
  - MP has to lean against financial booms (Borio 2016):
  - Using MP to achieve financial stability may be counterproductive (Svensson (2016); Bernanke (2015))
  - IMF (2013) and Smets (2013) argue MP can be deployed to enhance financial stability, albeit imperfectly and only as a last resort
- For SOEs, the debate seems to converge on the benefits of combining monetary and macro-prudential tools in order to maximize welfare (IMF, 2013)

1. Real vs Financial Shocks in the Albanian Economy

The Albanian economy remains susceptible to financial shocks



Source: Bank of Albania, authors own calculation

Demand shocks are by far the prevailing type of shocks in our economy.

However, shocks to:

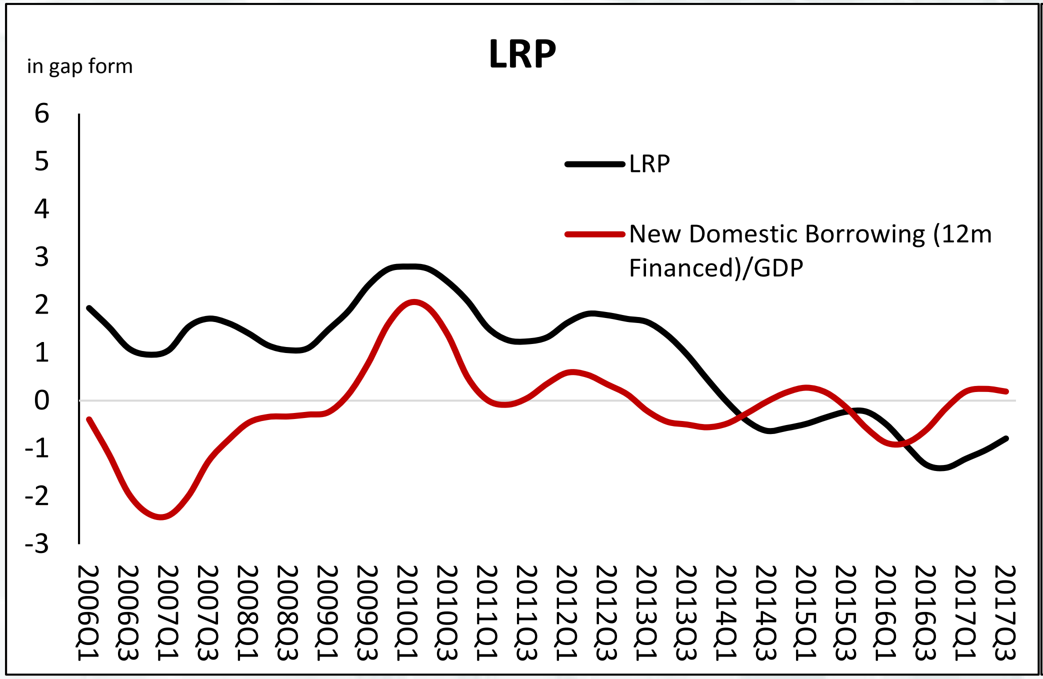
- liquidity risk premia;
- credit default risk premia;
- exchange rate risk premia;

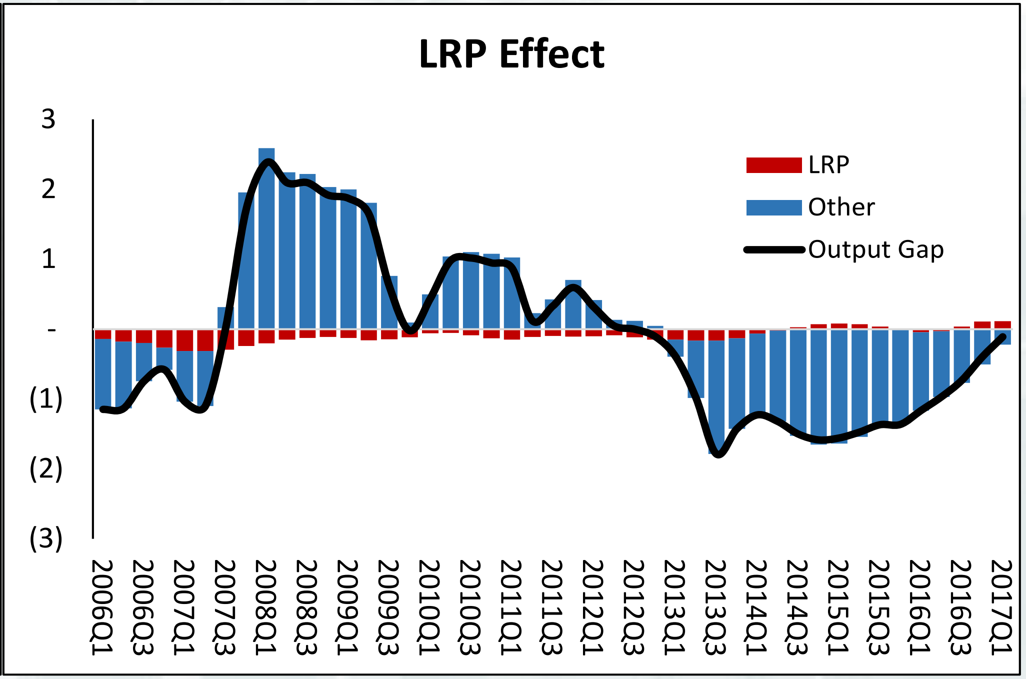
tend to have an impact on the economy.

Furthermore, this impact appears to be consistently procyclical.

2. Liquidity Risk Premia (LRP): propagation channels and effects

LRP shocks tend to be frequent. Their impact appears to be rather limited…





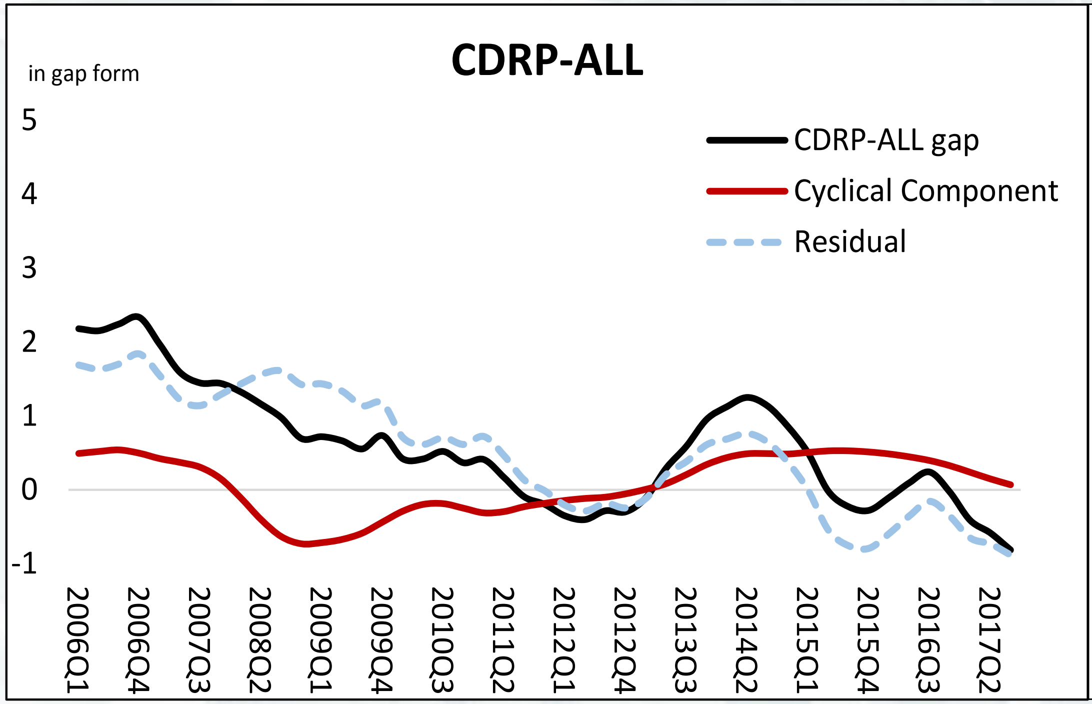
Source: Bank of Albania, authors own calculation

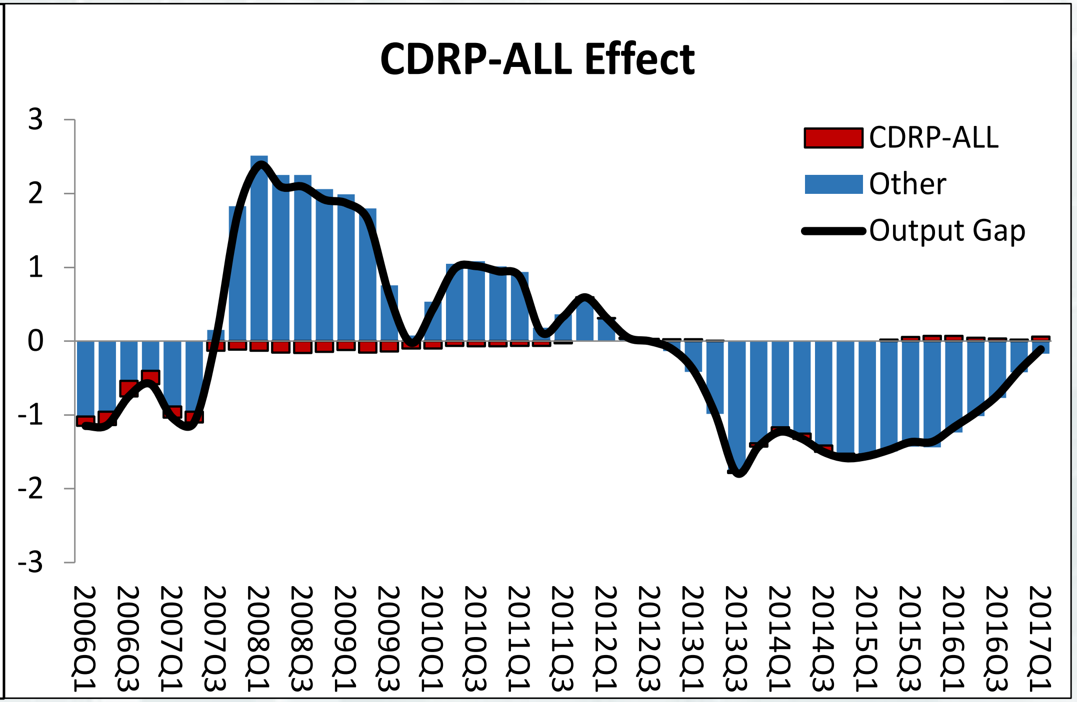
The propagation channel is straightforward. A negative (positive) LRP shock would:

- Raise (lower) financial market interest rates
- Lower (raise) output gap / inflation

3. Credit Default Risk Premia (CDRP-ALL): propagation channels and effects

CDRP-ALL appears both to have a trend and to be subject to infrequent shocks. Their detected impact appears to be small…



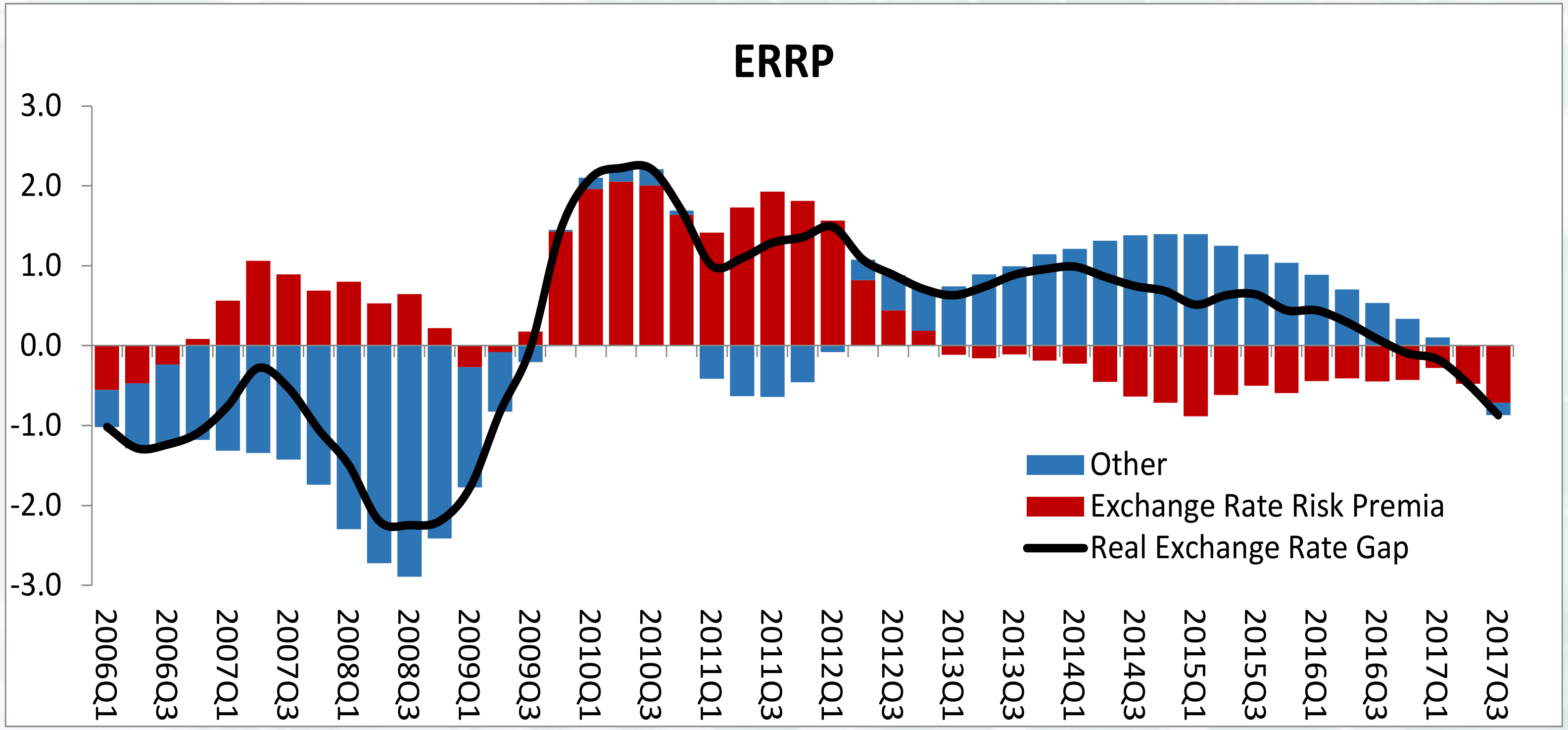


Source: Bank of Albania, authors own calculation

- CDRP-ALL appears to trend downward, probably on account of improved credit / business environment and higher competition
- However, it also appears to be subject to shocks, originating from:
  - Abrupt changes in credit risk aversion
  - Abrupt changes in competition
- The propagation channel: higher (lower) CDRP-ALL tends to raise (lower) credit interest rates

4. Exchange Rate Risk Premia (ERRP): propagation channels and effects

Shocks to ERRP affect both the nominal and the real exchange rate



Source: Bank of Albania, authors own calculation

Shocks to ERRP risk premia are the dominant form of financial shock in Albania

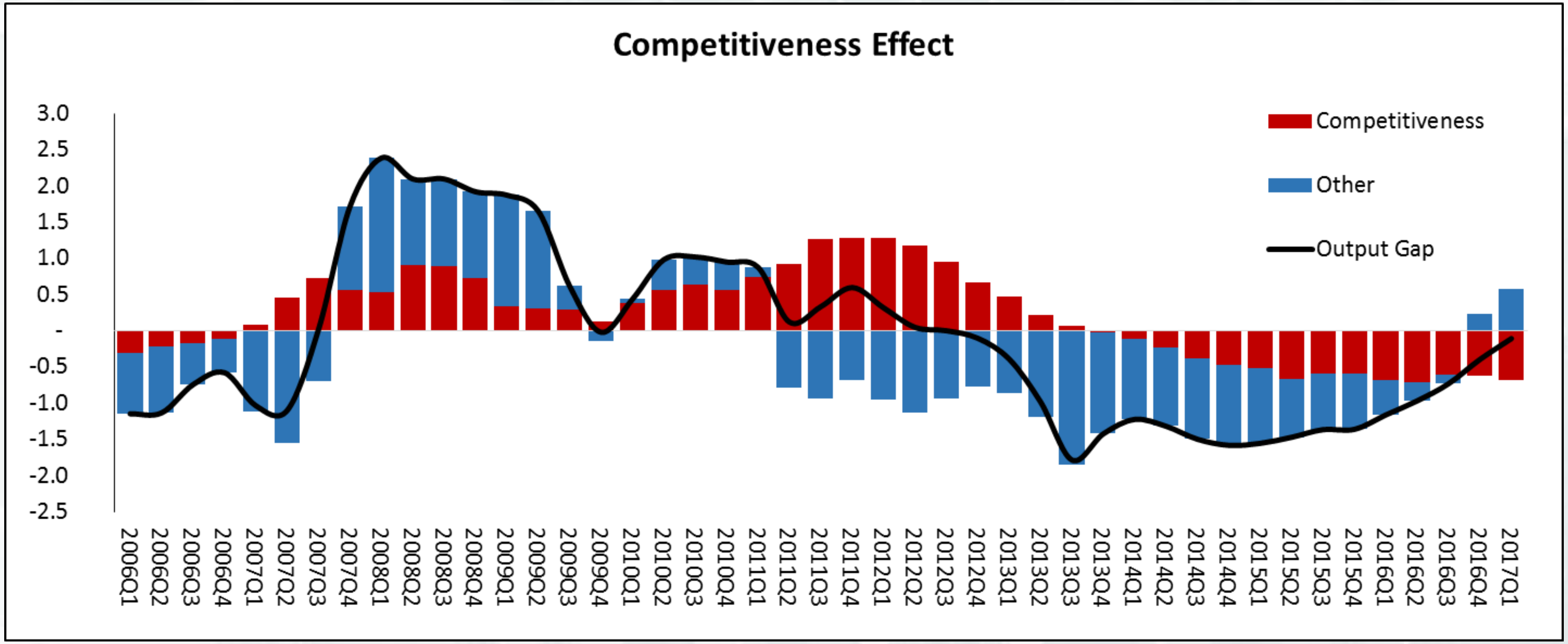
The ERRP shocks are transmitted through (at least) three separate channels:

- Impact on competitiveness and net trade;
- Impact on FX loans lending rates;
- Impact on un-hedged borrowers balance sheet.

The latter two work in opposite direction to the first. However, the first channel dominates

5. Exchange Rate Risk Premia (ERRP): the competitiveness channel

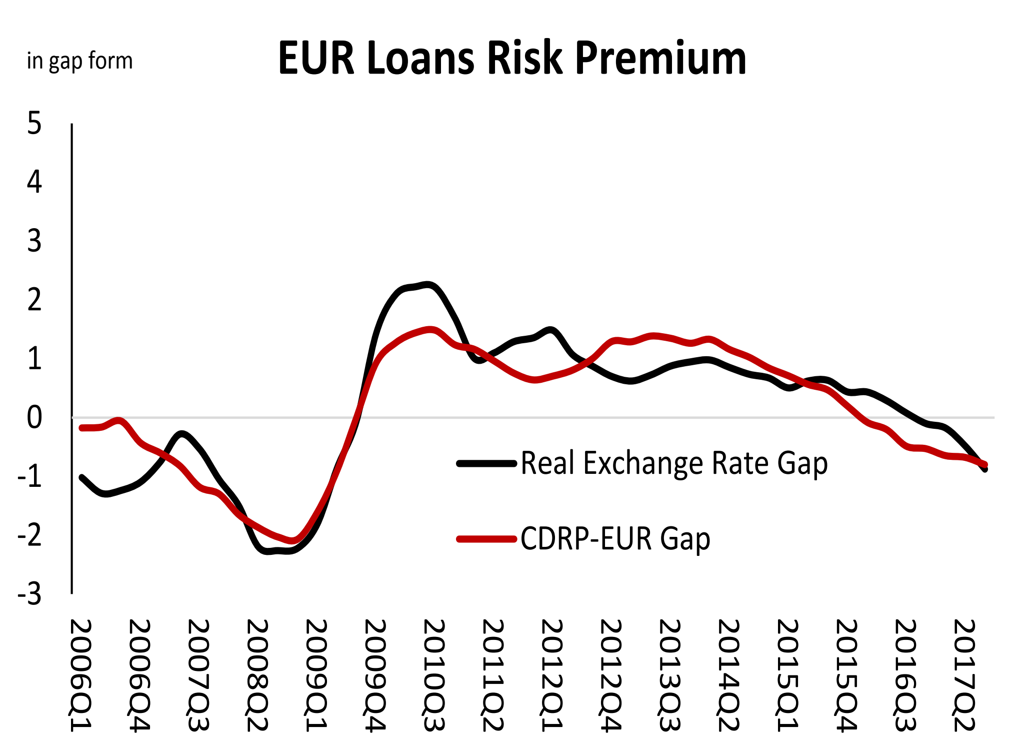
The external trade position appears to be the main propagation channel of ERRP (and financial) shocks…

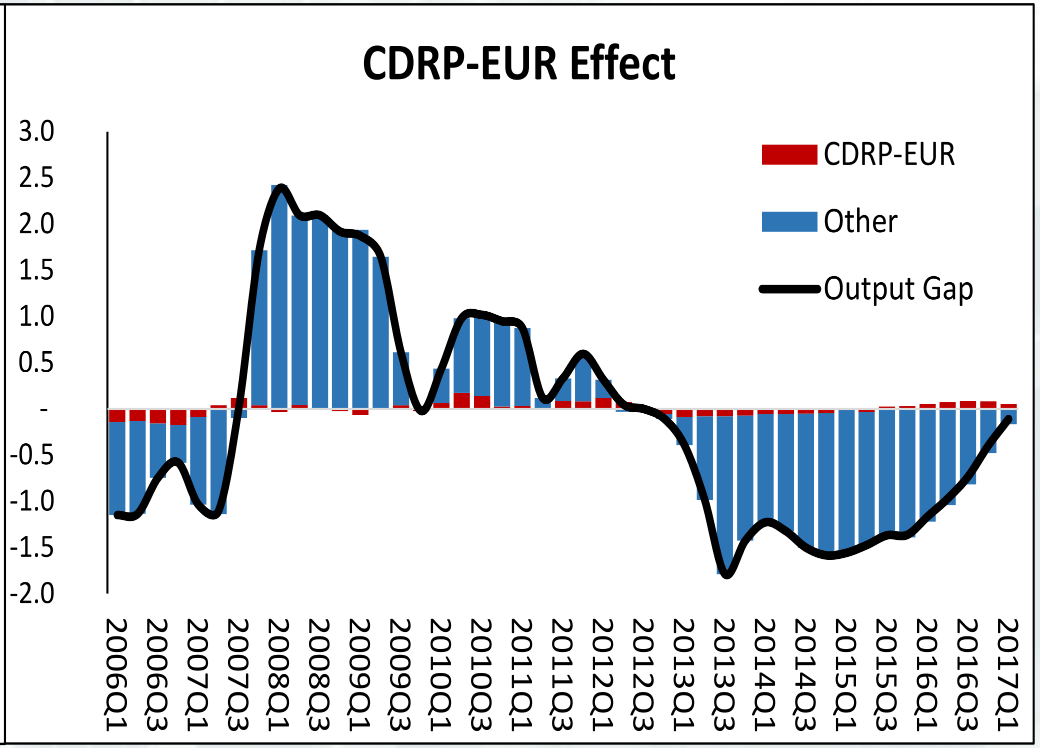


Source: Bank of Albania, authors own calculation

6. Exchange Rate Risk Premia (ERRP): the FX loans interest rate channel

The FX loan interest rate channel has an impact of the opposite sign. Its impact size however appears to be marginal…





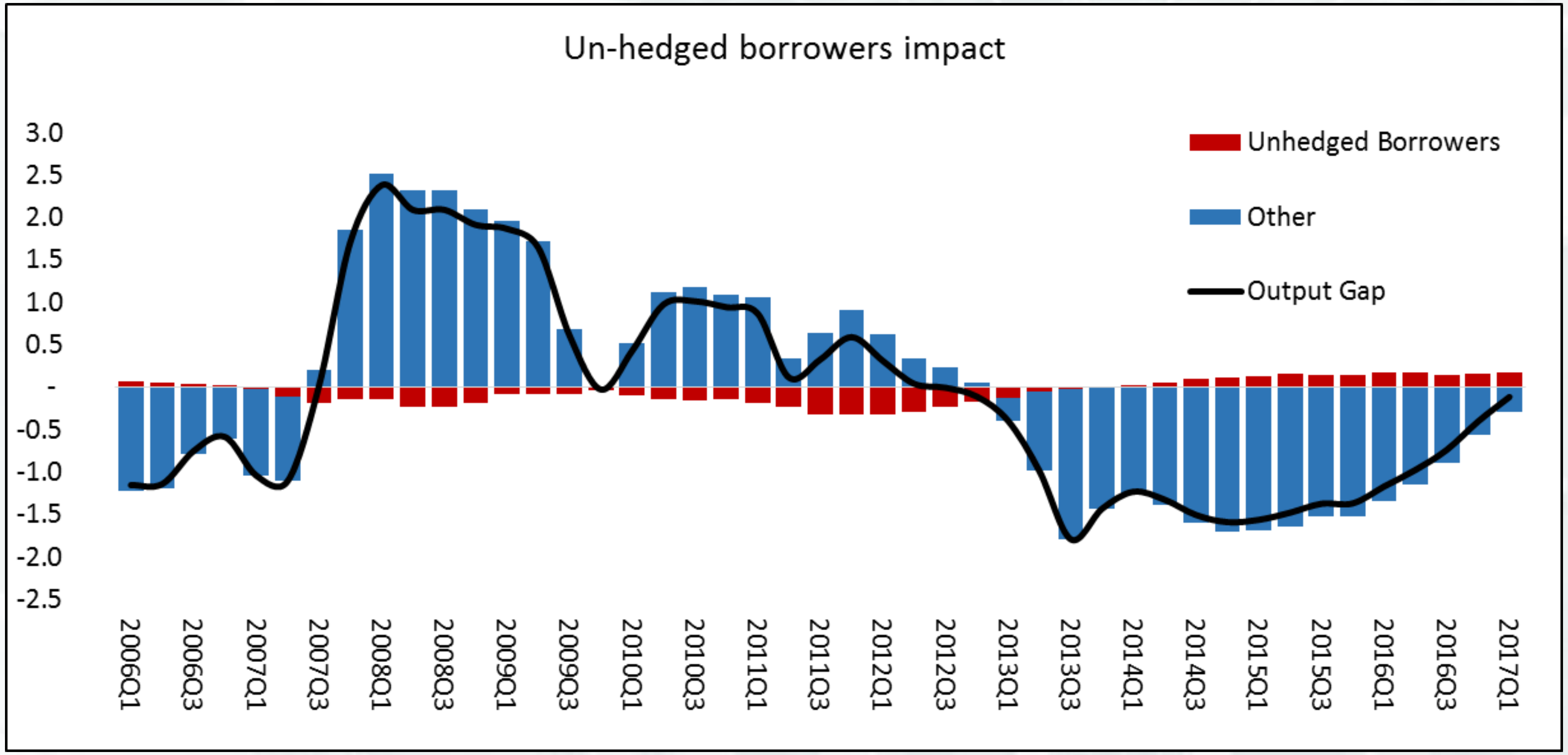
Source: Bank of Albania, authors own calculation

The propagation channel appears to be:

- Positive (negative) shock to ERRP => ER appreciation (depreciation) => lower (higher) perceived risk premia on FX loans => lower (higher) interest rates => positive (negative) shock to GDP

7. Exchange Rate Risk Premia (ERRP): the un-hedged borrowers channel

Shocks to ERRP induce balance sheet effects in GDP



Source: Bank of Albania, authors own calculation

This channel appears to be stronger than the previous, and it also work in reverse

The propagation channel: a positive (negative) shock to ERRP would:

- Positively (negatively) impact un-hedged borrowers balance sheets
- Increase (decrease) their spending and investment

1. Reducing the likelihood and impact of LRP shocks

Current state of play:

- BoA: continued upgrades to our liquidity management framework, efforts to improve the functioning of interbank markets, maintaining sufficient liquidity buffers through prudent regulation
- MoF: efforts to contain public debt and lengthen its average maturity

Objectives for the future: develop the government securities market

- The government securities market is the lynchpin of efficient, liquid and well-functioning capital markets;
- A more liquid and deeper government securities market should lower liquidity risk premia and contain their volatility;
- Its development requires a comprehensive set of actions, in order to allow a modification of the holding patterns of existing investors and to attract new investors;
- A stable macro economic environment, credible and effective monetary policy, sustainable public finances, benign global market conditions provide ideal conditions to pursue a government securities market development strategy;
- BoA is ready to act as catalyst in the process to be led by MoF and to which the banking system should contribute. Eventually a better functioning market is a common good from which all stakeholders can benefit.

2. Reducing CDRP shocks

Current state of play:

- BoA: maintaining a stable banking system and encouraging competition, employing prudent regulation and improving credit infrastructure
- Albanian Government: improving the business and credit environment, improving collateral recovery and execution, fight against informality

Objectives for the future:

- BoA: converging to EU regulation standards and supervisory practices
- Albanian Government: pursue the formalization campaign, implement the judicial system reform, improve the functioning of private bailiffs

3. Reducing the impact of ERP shocks

Current state of play:

- BoA: actively lean against the euroization of assets and liabilities (applying a 150% risk weight on FX loans to un-hedged borrowers (2006 / 2008), demanding full capital backing for FX loans above four times the regulatory capital (2013), employing higher required liquidity ratios for banks)

Objectives for the future: implementation of the national strategy to reduce the use of foreign currency

- Aims to improve the effectiveness of monetary policy and reduce financial vulnerabilities / strengthen financial stability
- Joint commitment of Bank of Albania, Financial Supervision Authority and Government laid out in an MoU (2017)
- Set of measures to be introduced by BoA, starting in 2018:
  - Differentiate between reserve requirement ratios for lek and FX liabilities
  - Differentiate between the regulatory liquidity ratios for lek and FX liabilities
  - Increase awareness of borrowers for risks related to credit in foreign currency
- FSA to actively work towards promoting the use of local currency in Albanian capital markets / rest of financial system
- MoF to make efforts to further develop primary and secondary markets for debt instruments in Lek, adopt regulatory changes to foster transactions in domestic currency

Concluding Remarks

- Albania is prone to financial shocks:
  - Liquidity risk premia
  - Credit default risk premia
  - Exchange rate risk premia
- Monetary policy needs to rely on additional tools
- The ongoing drive to develop secondary markets and to lean against high euroization are a clear illustration of this recognition

THANK YOU!

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Confederaziun svizra

Swiss Confederation

Federal Department of Economic Affairs,
Education and Research EAER
State Secretariat for Economic Affairs SECO

Financial Deepening in Albania. Opportunities and key policy priorities

*Guido Della Valle**

*IMF Monetary Policy Resident Advisor***

**The views expressed are those of the author and do not necessarily reflect those of the IMF.*
This presentation should not be reported as representing the views of the IMF.

*** Project sponsored by Switzerland*

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I. SCOPE FOR FINANCIAL DEEPENING

II. POLICY PRIORITIES

III. CONCLUSIONS

CONTENT

I. SCOPE FOR FINANCIAL DEEPENING

II. POLICY PRIORITIES

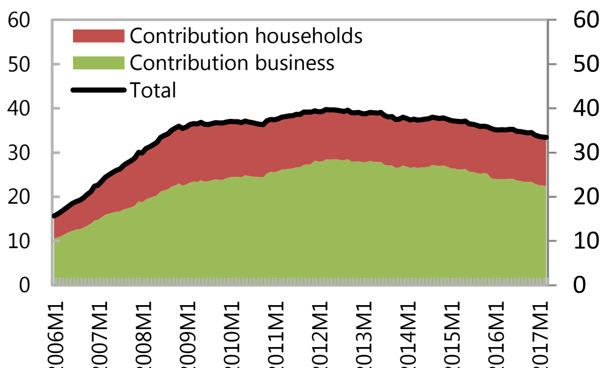
III. CONCLUSIONS

I. FINANCIAL DEEPENING SCOPE(i)

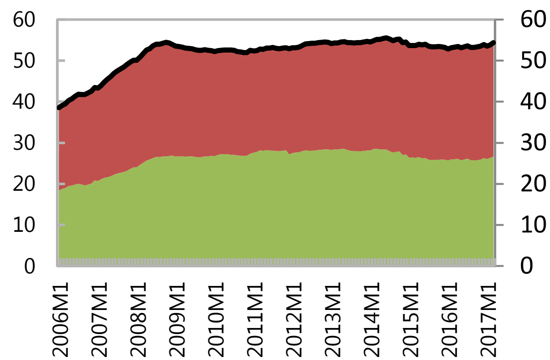
CPS-to-GDP ratio is in Albania the lowest in the Western Balkans region:

- Lower level of credit to household
- Relatively higher share of credit to the government

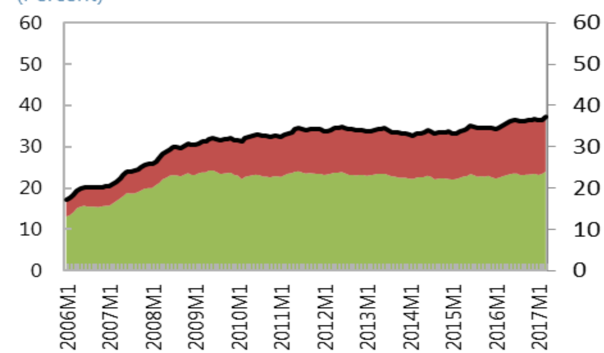
Albania
(Percent)



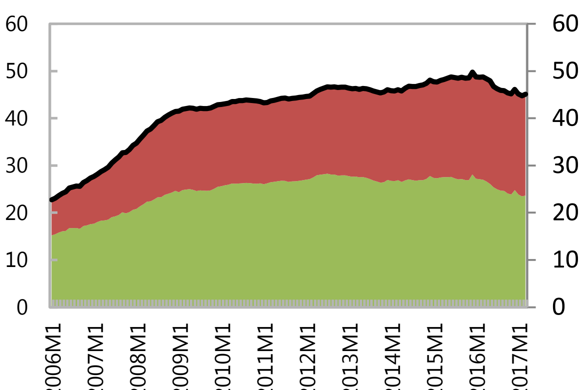
Bosnia Herzegovina
(Percent)



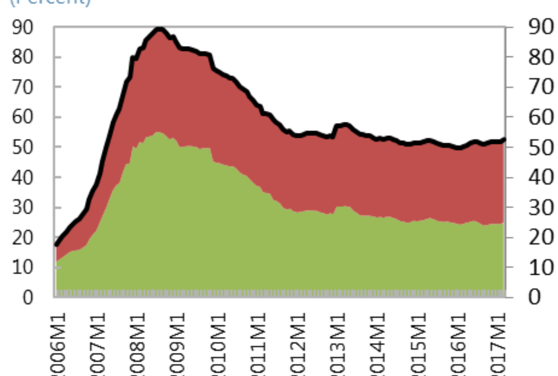
Kosovo
(Percent)



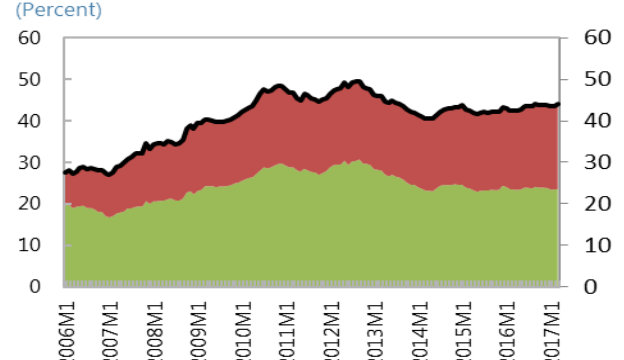
Macedonia
(Percent)



Montenegro
(Percent)



Serbia
(Percent)

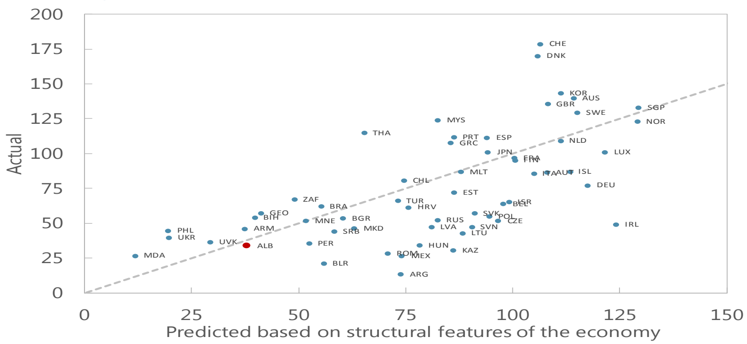


I. FINANCIAL DEEPENING SCOPE (ii)

Albeit small, credit gaps are negative in Albania:

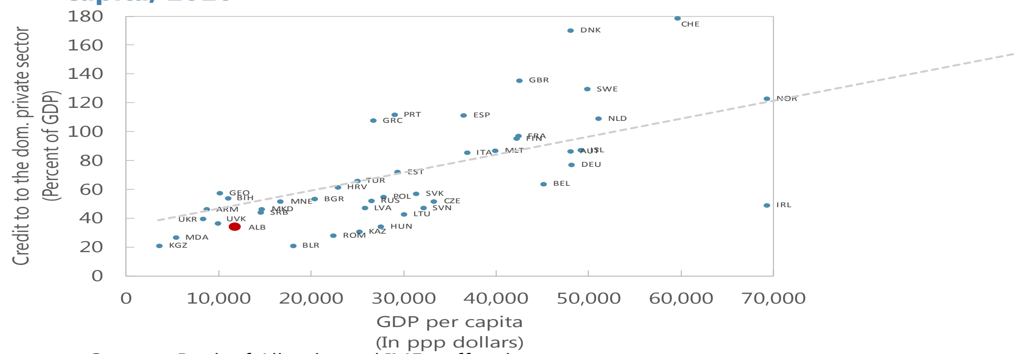
- **CPS largely explained by income and institutional levels**
- **Informality and poor judicial quality weigh on CPS potential**

Private Credit to Domestic Private Sector
(In percent of GDP)



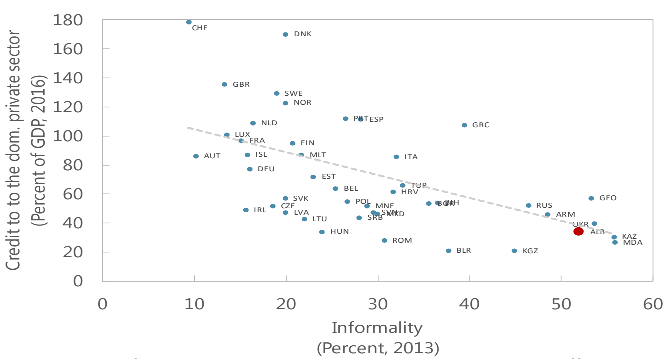
Source: IMF staff estimates.

Credit to the Domestic Private Sector and GDP per capita, 2016



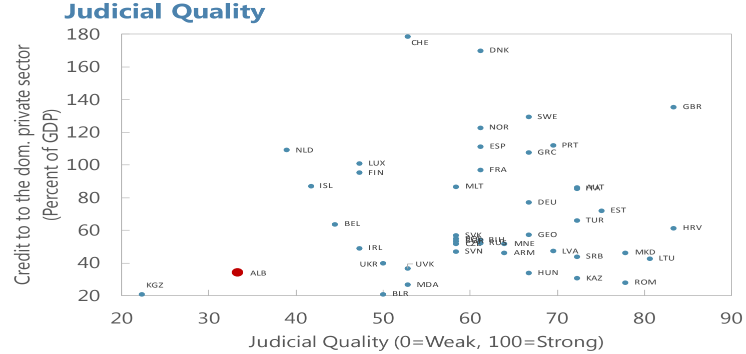
Sources: Bank of Albania; and IMF staff estimates.

Credit to the Domestic Private Sector and Informality



Sources: Bank of Albania; Hassan and Schneider (2016); and IMF staff estimates.

Private Credit to the Domestic Private Sector and Judicial Quality



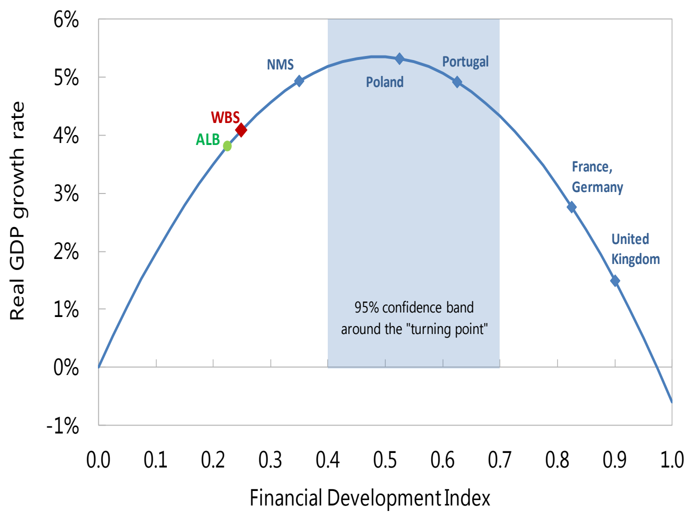
Sources: Bank of Albania; World Bank, Doing Business Report; and IMF staff

I. FINANCIAL DEEPENING (iii)

Given limited financial development, financial deepening may have positive effects on medium term growth:

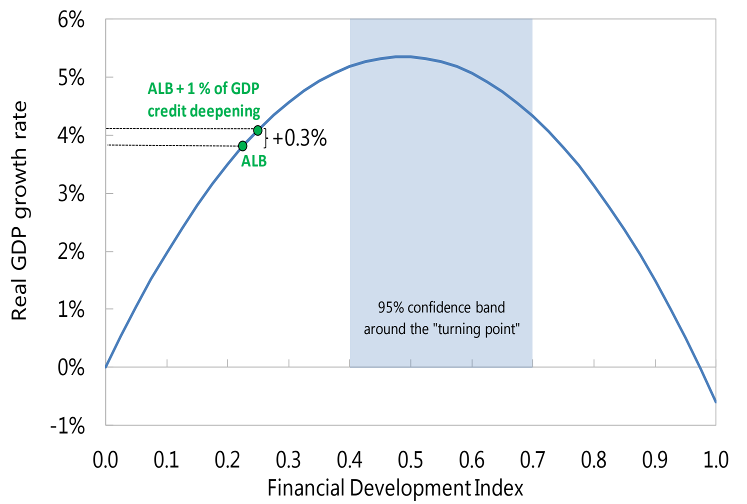
- **A 1% credit deepening may add 0,3% to medium-term GDP growth**
- **Financial deepening can encourage productive investments, increase labor productivity and potential growth rates**

Financial Development Effect on Growth



Sources: IMF SDN/15/08; and IMF staff estimates.

Impact of 1 percent of GDP Credit Deepeing on Growth[1]



1/ Assuming institutions improve to allow a 1 percent increase in credit-to-GDP.
Sources: IMF SDN/15/08; and IMF staff estimates.

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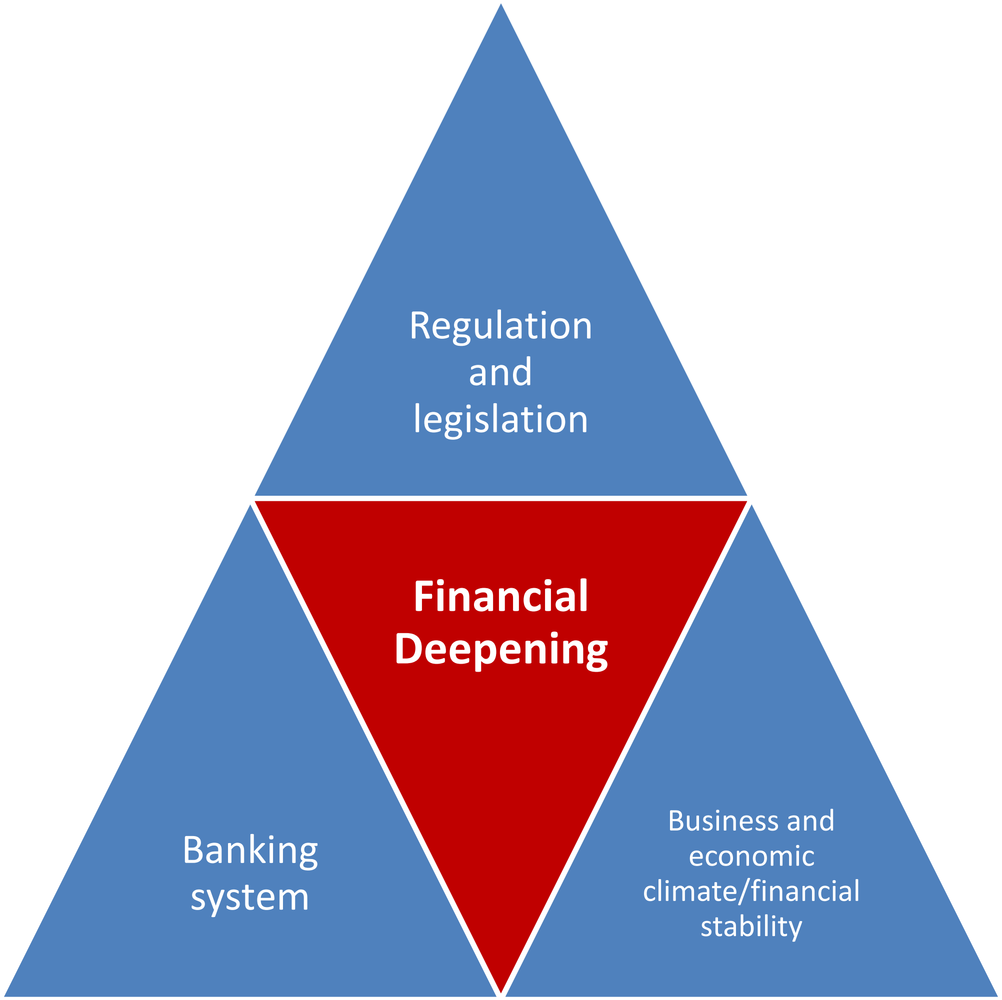
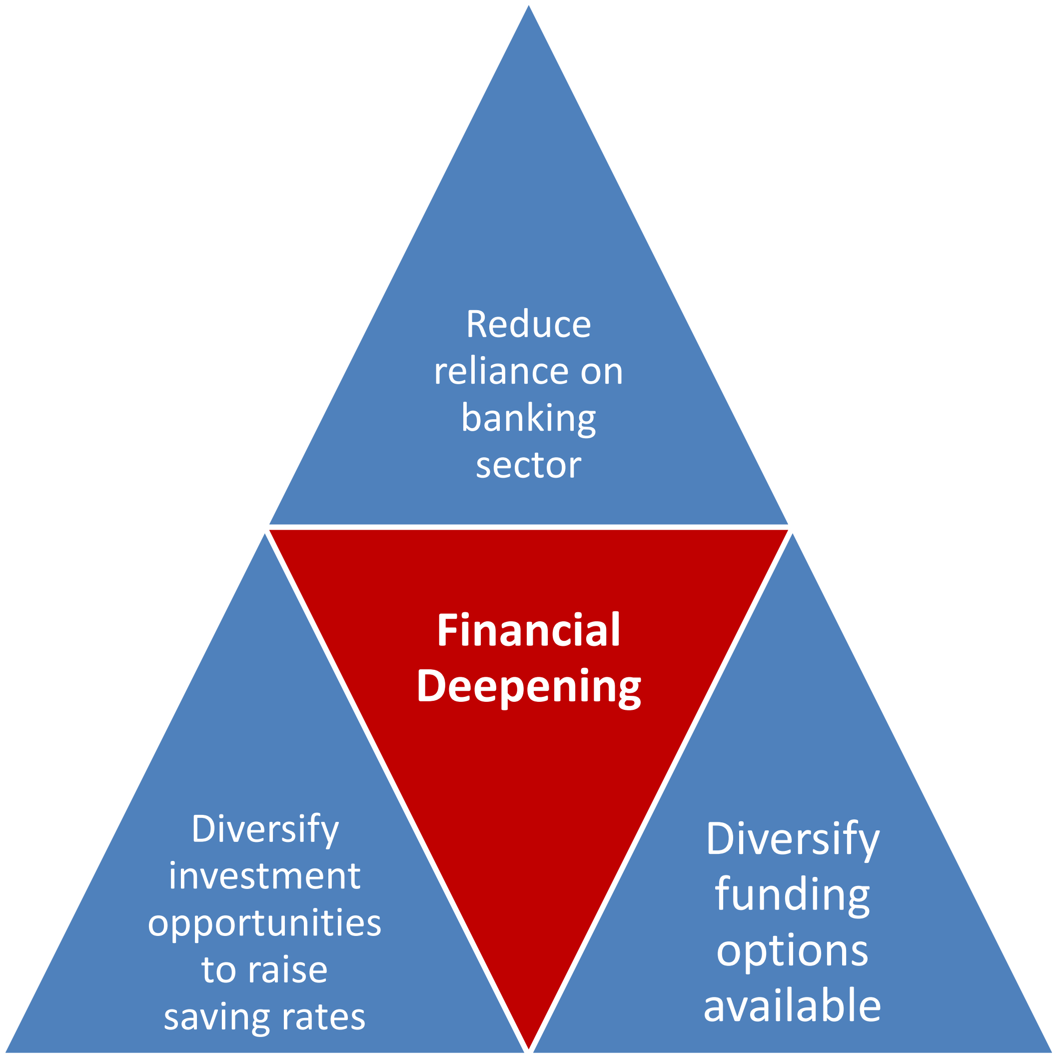
II. POLICY PRIORITIES (i)

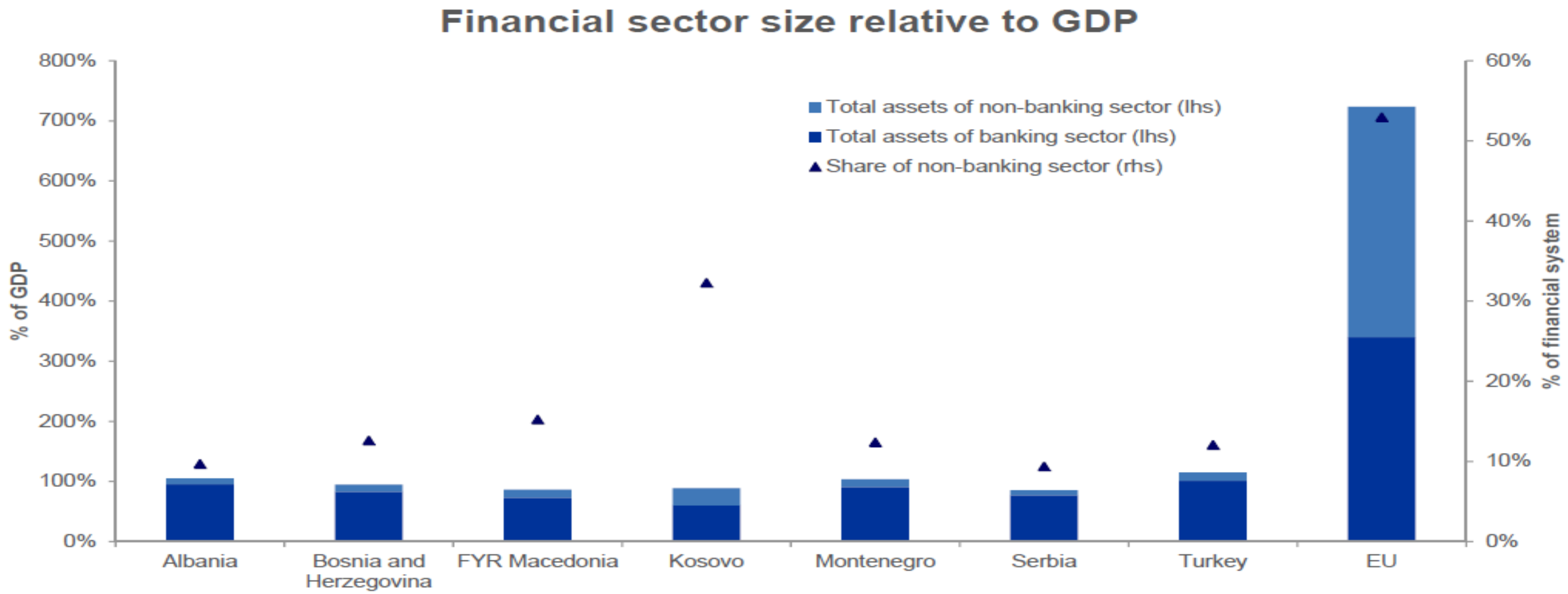


II. POLICY PRIORITIES (ii)



II. POLICY PRIORITIES (iii)

Diversify financial sector. **Reduce reliance on banking sector/expand funding bases**



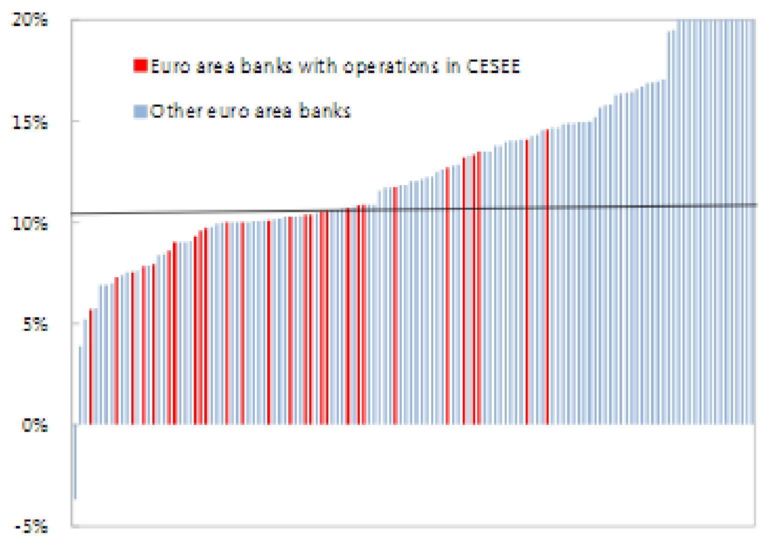
Source: NCBs and NCAs, ESRB, IMF, ECB staff calculations. Data as of end-2016, except BiH, Turkey (2015) and Montenegro (2014).

II. POLICY PRIORITIES (iv)

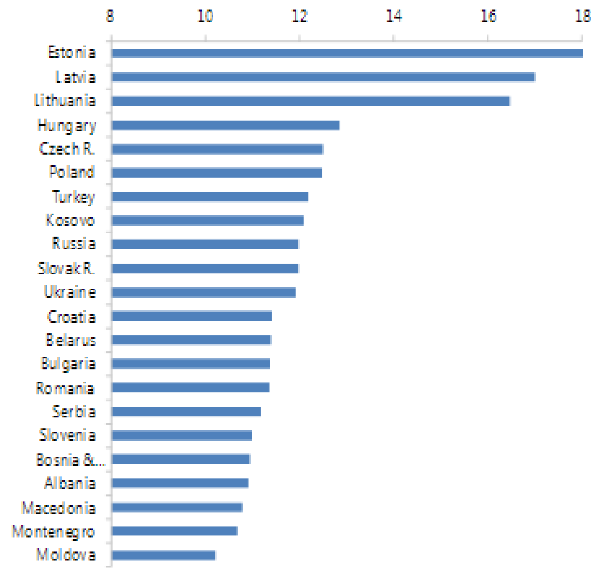
Diversify financial sector. **Reduce reliance on banking sector/expand funding bases**

EU banks have been deleveraging and may continue to do so in the coming years
EU banks with subsidiaries in CESEE have a relatively weaker capital position
General reassessment of pace of convergence, profitability and regional attractiveness
Rapid bank credit growth unlikely

Common Equity Tier 1 Capital Ratios of euro area banks after the Asset Quality Review and Common Equity Tier 1 Capital Ratios of foreign parent banks in different CESEE countries



Source: European Central Bank, Comprehensive Assessment.

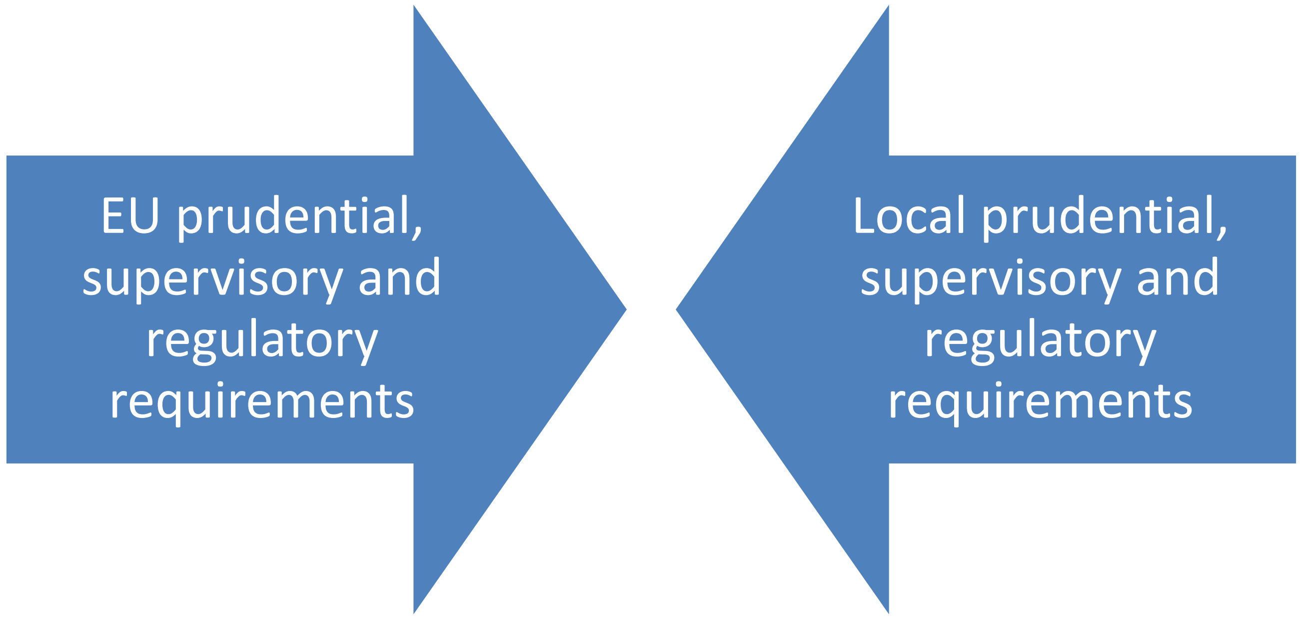


Sources: Bankscope; and SNL Database.
1/ Weighted by subsidiaries' assets in a given country.
Data are as of 2013 or latest available.

II. POLICY PRIORITIES (v)

Diversify financial sector. **Reduce reliance on banking sector/expand funding bases**

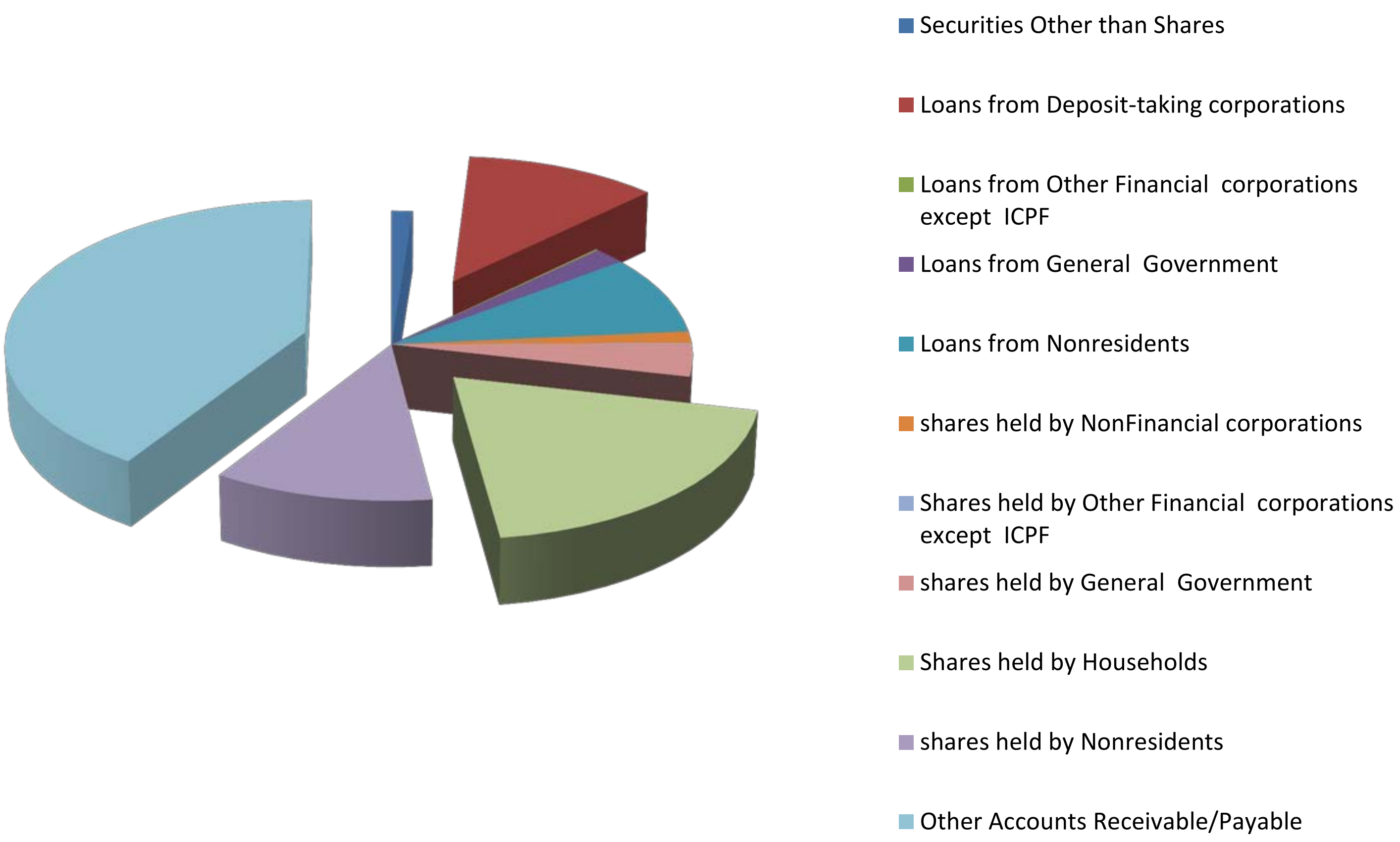
Equivalence regime of supervisory and regulatory standards may release capital and increase country attractiveness via lower risk weights on selected local exposures (credit institutions, central government, central bank)



II. POLICY PRIORITIES (vi)

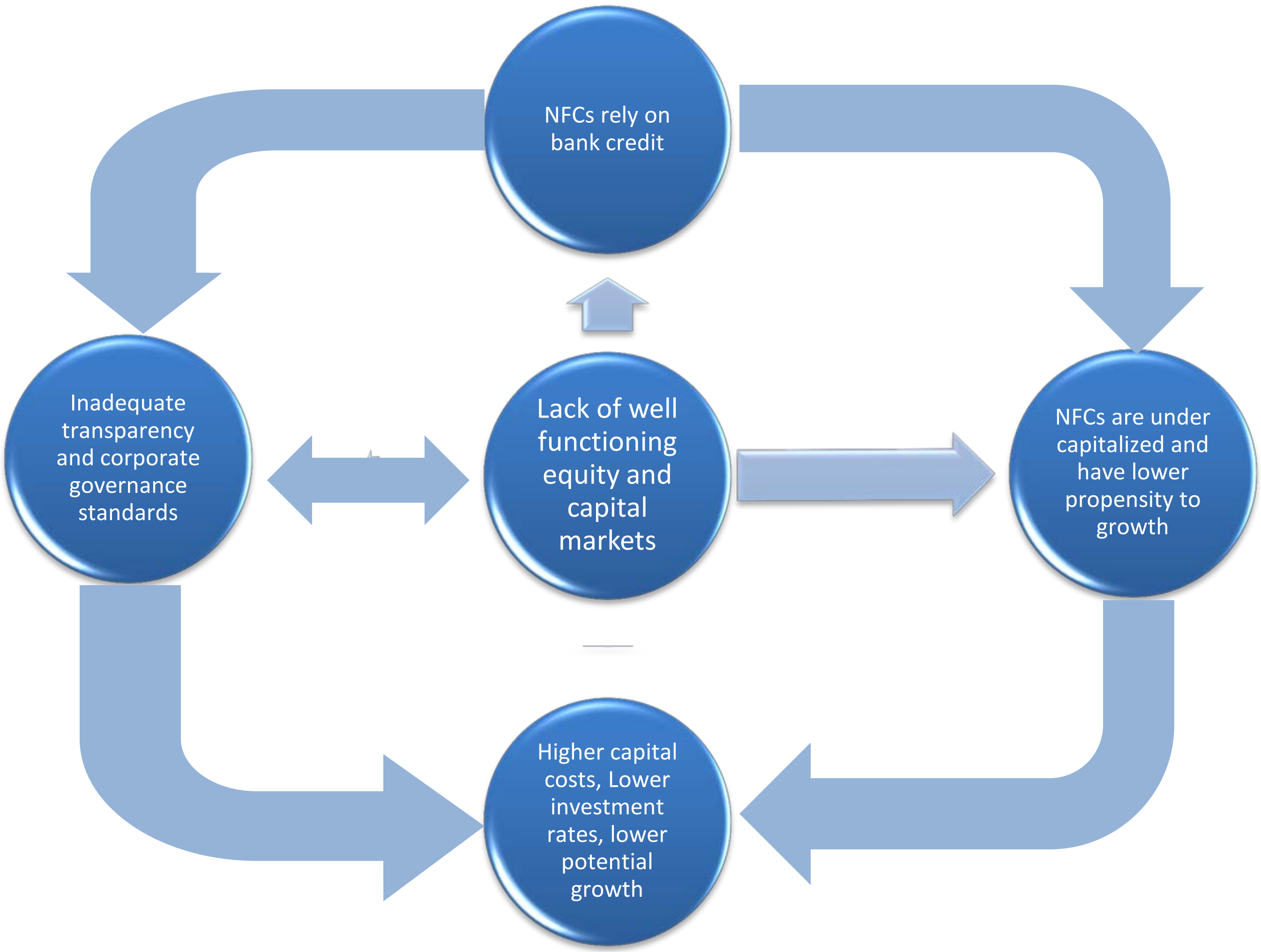
Diversify financial sector. **Diversify funding options available**

Liabilities of non-financial corporations



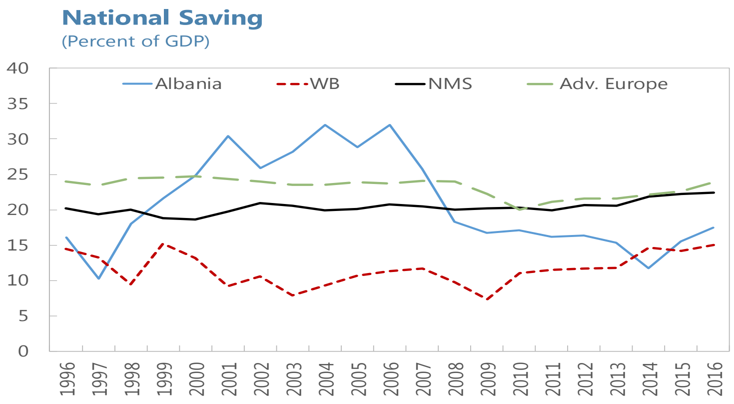
II. POLICY PRIORITIES (vii)

Diversify financial sector. **Diversify funding options available**

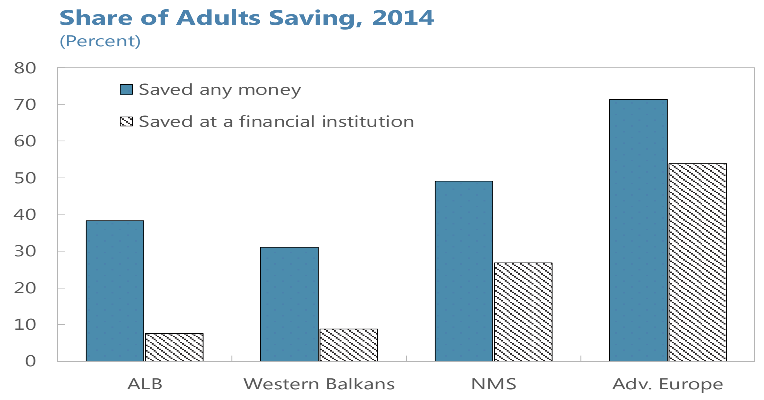


II. POLICY PRIORITIES (viii)

Diversify financial sector. Diversify investment opportunities to raise saving rates

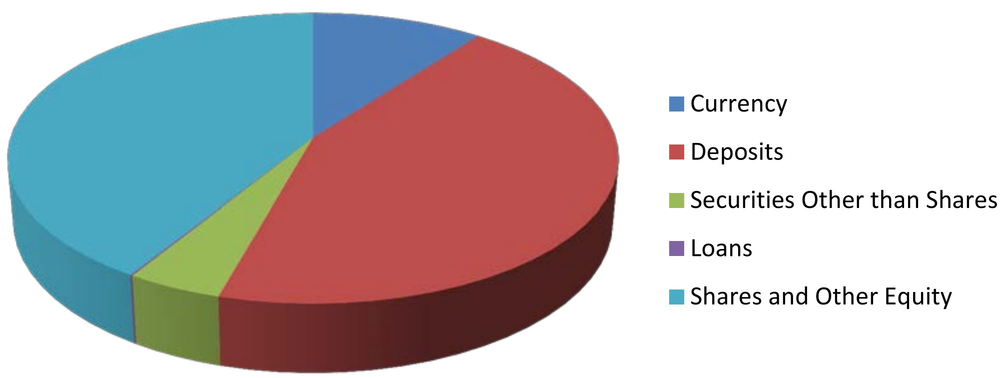


Sources: INSTAT; and IMF staff calculations.



Sources: World Bank, Global Financial Inclusion database; and IMF staff estimates.

Financial Assets of households



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I. SCOPE FOR FINANCIAL DEEPENING

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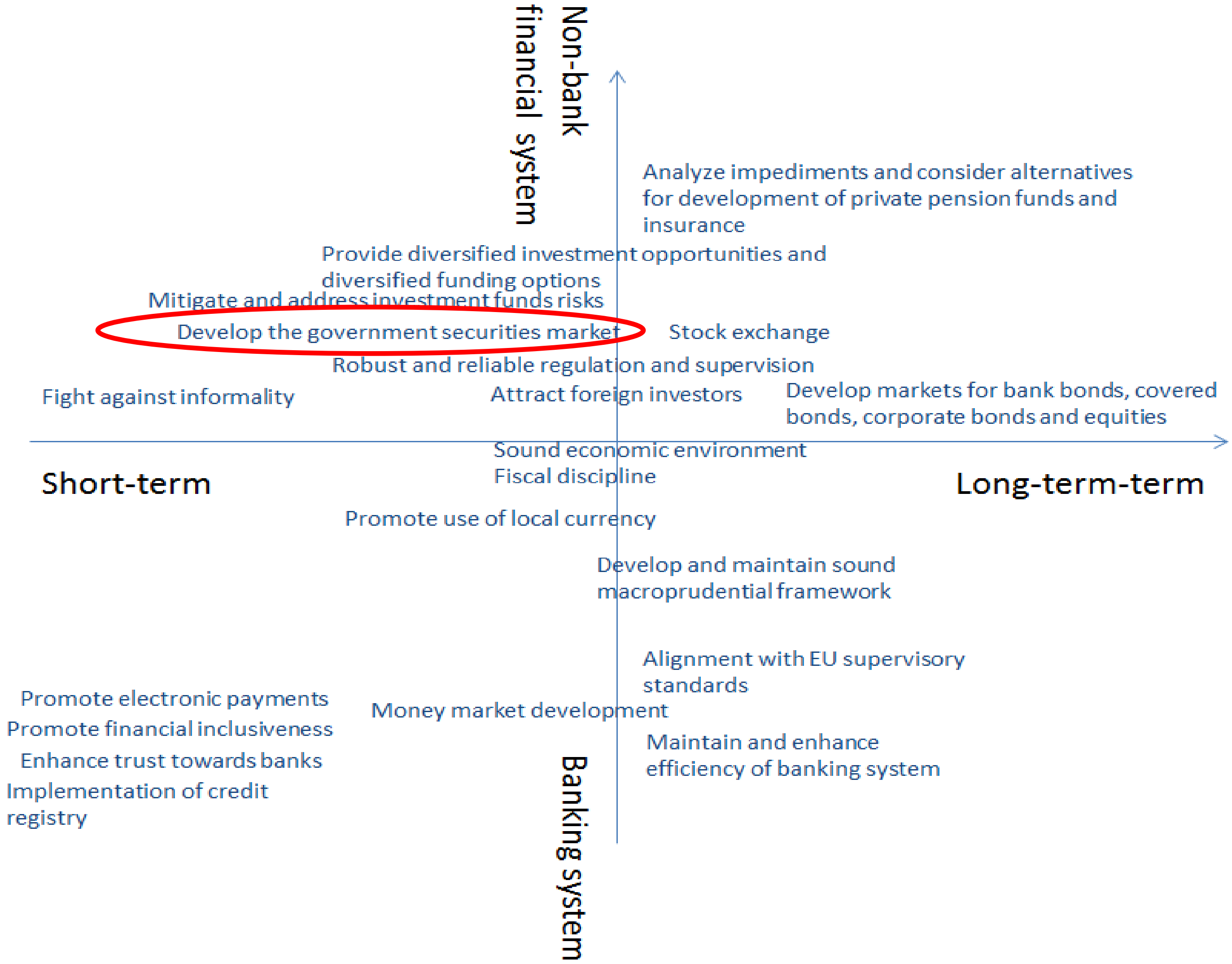
VII. CONCLUSIONS



Speeches & Transcripts | November 10, 2017

Remarks by Regional Director Linda Van Gelder at the Bank of Albania Conference

Linda Van Gelder
Bank of Albania Annual Conference
Tirana, Albania

As Prepared for Delivery

Honorable authorities and distinguished participants,

Thank you for the opportunity to speak on the role that financial inclusion plays in growth and poverty reduction as well as in the Central Banks' objective to maintain financial stability.

Financial inclusion is important.

When we have financial inclusion, people and businesses access financial products and services that are affordable and meet their needs.

Financial inclusion facilitates day-to-day living. It helps families and businesses plan for long-term goals and weather unexpected emergencies. When people hold accounts, they are more likely to use credit and insurance, to start and expand businesses, to invest in education and health, to manage risk, and to weather shocks, all of which can improve the overall quality of their lives.

For businesses, financial inclusion helps to finance investments, to lower transaction costs, to manage shocks, and to make safe and secure payments. For small and young firms that often face greater constraints, we see that access to finance is associated with innovation, growth and job creation.

And as an aside, financial inclusion has become a global priority. It is an enabler for 7 of the 17 Sustainable Development Goals, and it is recognized as a priority by the G20. The World Bank Group also considers financial inclusion a key enabler to reduce extreme poverty and boost shared prosperity, and has put forward an ambitious global goal to reach Universal Financial Access by 2020.

There has been progress toward financial inclusion globally, but significant challenges remain:

- 2 billion adults worldwide do not have a basic account, mostly because financial services are not yet affordable or designed to fit low income users. Other barriers to opening accounts include long distances to financial service providers, lack of necessary documents, and lack of trust in financial service providers.

- In addition to people, micro small and medium sized enterprises often lack adequate financing to thrive and grow. This is often due to lack of collateral and credit history, and business informality.
- Some groups are more financially excluded than others: Women, rural poor, and other remote or hard-to-reach populations, as well as informal micro and small firms are most affected.

How financially included are the Western Balkans?

In the Western Balkans financial inclusion remains low compared to European standards. According to the World Bank Findex Survey conducted in 2014 only about 6 out of 10 adults have a bank account at a formal institution. In Albania, it is less than 4 out of 10 (38 percent). Figures are even lower for the poor and for women.

Despite highly liquid banking systems, MSMEs – the backbone of the Western Balkan economies - continue to have limited access to credit, and when they do, it is often high cost and with stringent conditions. Around 15 percent of MSMEs in the region consider Access to Finance the biggest obstacle in doing business (*Enterprise Survey 2013)* compared to around 7 percent of large enterprises. Moreover, survey results show that more than two thirds of investments in the region were financed from internal funds. At the same time, the proportion of new investments financed via banks remains low at an average of 15 percent.

In order to improve financial inclusion, there needs to be a wider range of financing instruments that meet needs of households and enterprises. Improvements in credit and financial reporting would help reduce information asymmetries. Strengthening financial sector infrastructure as well as the legal and regulatory framework for secured transaction and insolvency can support an expansion of lending to underserved segments of the population. Moreover, financial institutions should be encouraged to develop delivery models tailored to the characteristics of MSMEs.

And I should also mention that advances in technology can help financial services to reach low-income individuals and small firms at lower cost and risk. Digitization of cash-payments is introducing more people to transaction accounts, and mobile-based financial services bring convenient access even to remote areas. Technology advances also bring in nontraditional providers of financial services such as peer-to-peer lending firms like Lending Tree or nonfinancial institutions such as e-commerce sites like eBay or Amazon that set up financing arms.

Financial Inclusion is linked to financial stability.

I've talked to you about Financial Inclusion. But how is this linked to Central Bank's objective of financial stability? An inclusive financial system that reaches all citizens provides a more stable and diversified retail deposit base and therefore a positive impact on financial stability. But on the other hand, too much loose credit can lead to financial bubbles and crises. And digital technologies and the growth of innovative non-bank financial institutions pose new regulatory challenges.

When designing and implementing financial sector policies, policymakers and regulators need to strike a balance that foster synergies and avoid trade-offs between the objectives of financial stability and financial inclusion.

Countries that have achieved the most progress toward financial inclusion while safeguarding financial stability have put in place an enabling regulatory and policy environment, that encourages competition (allowing banks and non-banks) and innovation that expand access to financial services. However, creating this innovative and competitive space has to be accompanied by appropriate consumer protection measures and regulations to ensure responsible provision of financial services in order to maintain financial stability.

A recent World Bank publication (Risks and Returns: Managing Financial Trade-Offs for Inclusive Growth in Europe and Central Asia) explores the right balance across the dimensions of financial development (stability, efficiency, inclusion, and broad depth). Considering the tradeoff between household use of credit and financial stability, and the synergy between higher firm savings and stability, the study recommends countries in the region to reduce barriers to firm savings while monitoring closely the growth of household credit.

WB engagement with the Bank of Albania

From our perspective at the World Bank, I am proud to say that we look back at years of collaboration with the Bank of Albania focused on balanced financial sector development, including financial stability, efficiency, and inclusion.

The Bank of Albania has shown strong leadership in advancing reforms in several areas of financial inclusion. For example, we have partnered on strengthening the regulatory, supervisory and resolution regime for Savings and Credit Associations, that provide financial services to the underserved, mostly rural, segments of the population. This led to a sounder and consolidated sector. The World Bank also supports the Government in its land and property registration reforms, an important contribution to enhanced financial inclusion and stability, but also vital for attracting investment.

We also support the Bank of Albania's efforts on strengthening the legal and regulatory frameworks for payment systems and remittances. Remittances are often the first entry point into the financial sector for both the sender and beneficiary. And remittances are important to Albania, at 8,84 percent of GDP, but remittances in Albania are also costly. For every 100 Euro sent in remittances, the cost is 8.47 Euro. The Remittances and Payments Program, generously supported by SECO, aims to increase efficiency of retail payments.

Lower cost means more money to beneficiaries. And by linking remittances to transaction account, this can be a stepping stone to access other financial products. The program will also help increase the competitive space for innovative payment service providers, enhance transparency, and promote consumer protection. The World Bank is very pleased to support these efforts.

In recent years, Bank of Albania and the World Bank have also worked closely together on other important financial sector issues aimed at strengthening financial stability and efficiency. For example, the adoption and ongoing implementation of a bank resolution framework has been key to strengthening the financial safety net in Albania. I also want to acknowledge the efforts aimed at the development of a voluntary corporate debt restructuring framework for the resolution of NPLs, and the development of a government bond market, all of which the World Bank has been pleased to support.

I would like to thank the Bank of Albania for the excellent collaboration. We look forward to continue working together with you and other financial sector stakeholders in the country on ongoing financial sector reform efforts on issues of inclusion, stability and efficiency.

Thank you.