

THE BANKING INDUSTRY, AND THEIR ROLE IN LENDING TO ECONOMY AND THE LOCAL GOVERNMENT

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Abstract

As regards in the case of Albania, at no point banking system showed signs of panic and confusion. The high level of resistance and the quick recovery were the result of a number of important decisions. By adopting the new law "On banking system in the Republic of Albania" and by continuing with a number of other decisions of monetary policy and banking supervision, the focus of the strategy of the Bank of Albania has been the best governance of the risk, increased transparency of the monetary policy to the customer and the strengthening of internal control. This strategy has been peaked with a large, special and contemporary education, open and constant communication with the public. Current developments in the financial system show that the overall situation in the banking sector has improved continuously. There is a return of deposits in the banking system, which speaks to strengthen public confidence. Also, and credit to the economy has shown signs of recovery. Another positive development is that currently lending in domestic currency. All these developments are occurring in a more optimistic climate in European markets. Statistics show that the recovery from the crisis, began, even faster than even the most optimistic forecasts.

Keywords: The banking industry ,monetary policy , banking system

As regards in the case of Albania, at no point banking system showed signs of panic and confusion. The high level of resistance and the quick recovery were the result of a number of important decisions. By adopting the new law "On banking system in the Republic of Albania" and by continuing with a number of other decisions of monetary policy and banking supervision, the focus of the strategy of the Bank of Albania has been the best governance of the risk, increased transparency of the banking business to the customer and the strengthening of internal control. This strategy has been peaked with a large, special and contemporary education, open and constant communication with the public.

Current developments in the financial system show that the overall situation in the banking sector has improved continuously. There is a return of deposits in the banking system, which speaks to strengthen public confidence. Also, and credit to the economy has shown signs of recovery. Another positive development is that currently lending in domestic currency. All these developments are occurring in a more optimistic climate in European markets. Statistics show that the recovery from the crisis, began, even faster than even the most optimistic forecasts.

The banking industry and their role in crediting the economy and local power

Regarding¹ the case of Albania, the banking system has in no moment shown signs of panic and confusion. The high level of resistance and the fast returning into normality, were a consequence of a range of important decisions. Starting from the endorsement of the new law "For the banking system in the Republic of Albania" and continuing

with a range of decisions of the monetary politics and banking surveillance, it has been in the focus of the strategy of the Bank of Albania, the governing and the better risk administration, growth of transparency of the banking activity towards the customers and the strengthening of the inner control. This strategy has culminated with a large, special and contemporary program of communication and education, which is open and continuous with the public.

The actual developments in the financial system indicate that the general situation in the banking sector is indicating continuous improvements. There is a return of the deposits in the banking system that indicates a strengthening of the public trust. As well, there are signs of vivacity for the economy credit as well. Another positive development is the fact that actually is being preferred the loaning in national currency. All these developments are happening in a more optimistic climate in the European markets. The statistics indicate that it has started the recovery from the crisis, even faster than the most optimistic forecasts.

The being effective and the failure of the banking markets

The banking markets, seen by the economic point of view are effective to be such. Nowadays, it is understandable that the markets are effective if they are compared with the monopoly but it cannot be confirmed that they have reached their highest effectiveness. But even by the economic point of view, the markets can be considered non-effective.

The economic and social effectiveness of the banking markets

It is already clear that with effectiveness of banking market, it is to be understood the optimal distribution of the sources or the placing and preservation of the "optimum paretian" condition. This means that the banking markets are effective when the sources are distributed in a way that none of the actors on the market, can profit without damaging someone else. The most optimal distribution of the sources is reached only when the banking markets are in perfect free competition. Shpërndarja me optimale e burimeve arrihet vetëm kur tregjet bankare me konkurrence perfekte janë të lira. The banking market is considered to be

1 THE 8TH INTERNATIONAL CONFERENCE OF THE BANK OF ALBANIA "Policies of monetary and financial stability – lectures from the crisis" 17 September 2009, Hotel Sheraton, Tiranë, Greeting speech of the Governor, Mr. Ardian Fullani

free where the operating forces of offer and request operate without outer intervention. Tregu bankar konsiderohet i lire ku forcat e ofertës dhe e kërkesës operojnë pa ndërhyrje të jashtme. In this case, these markets, generate the greatest economic prosperity.

The economic effectiveness of banking markets is related to the wealth distribution. Therefore, it is based simply on a pure optimal distribution. But the optimumi paretian is a necessary condition, but not a sufficient one for the maximisation of the social welfare. By the social point of view, the society would look for an optimum for social welfare and not simply a paretian optimum, that in the end, is only an economic optimum.

The failure of banking markets

In case the market does not decide and preserve the optimum pareto, then someone will profit to the detriment of another participant of the market and in this case, it is said that the banking market has failed.

The reasons for the banking markets to fail

The reasons of the effective malfunctioning of the banking markets are the so-called market failures, where apart for the banking monopole, are included the asymetrics of information, the public goods and the outside factors.

Monopole. The defect of the pure monopole is the absolute control in prices by the seller. In the case of a monopole banking market, it is to be noticed that the bank controls the interest norm of the deposits or loans. In fact, in practice it is not to be encountered the banking monopole. But in general, it is to be encountered "a certain monopole power" as for example an oligopole with a price and formation of cartel, that represents a certain level of the price control. The effects of this defect are widely treated in the paragraph when the characteristics of the banking activities in the monopol markets are given.

The asymetrics of information. The banks are entities that create intermediate relations through which they collect, they preserve, process and transmit information for themselves and for their customers. The modern the classical example of this influence is the case of the used cars. If the potential buyer of a used car (Principle) uses the prices to evaluate the value of the used car, the seller (agent) is encountered with the dilemma that maybe the lowering of the price of the used cars, makes the buyer consider the fact that he has no qualitative goods to sell. When the information is not perfect or expensive, then the market will fail. In the used cars market, the sellers can try to solve their dilemma by defending their reputation or offering guarantees or using the two methods together. The buyers can try to solve the problem by adding and facing the search cost to find agents with reputation, by buying used cars with guarantee, or by making the two of them together. The same issue could happen with the deposit market. If the bank, in order to attract new clients, raises the interest rate of the deposits, the depositor might think that the bank is in a bad financial situation and such a thing could deform the market. The bank can solve its dilemma by offering supplementary guarantees or by keeping up its name, or offering them together. As well, even in the loan market there can be

noticed deformations of the market because of the asymmetrical information of the participants in the loan market. If the bank lowers the forms of the loan interest, the loan borrowers could think that the bank is in financial difficulty and such a thing will deform the loan market. The bank, in order to protect itself from the asymmetrical information, should either keep high its reputation or should ask for additional guarantees (such as liquid guarantee as the mortgage)

Outer factors

There are two kinds of influences by outer factors, positive and negative influences. When the negative influences have larger effect than the positive ones, the banking market will fail. The influences could be at the offer or at the demand of the banking markets. For example, if the Central Bank of a country, implementing its monetary policy, places crediting tavane kufiri for the trade banks, then it is understood that the loan offer will be influenced by outside. As well, if the Central Bank places minimal interest rates for accepting the deposits by the trade banks, then the deposit market will be deformed and will start failing. However, in case the outer influences aim at raising the growth of the banking competition, in the loan market, as well as in the deposit one, then these influences have to be considered positive. If their influences are larger than the effects of the negative influences, then it is to be expected that the market will be more effective than it was in the beginning.

The prevention of the failure of banking markets

The prevention of the failure of banking markets is a political and emotional issue. On one extreme, there are the interventions that the state should perform (through regulating authority) in order to protect the bank customers from the non-efficiency of the banking markets. On the other extreme, there are the ones that demand the state to keep hands off the banking markets. The followers of Adam Smith [1776], Milton Friedman [1962] and George Stigler [1982] favour the free markets, for the outer interventions lead the markets to operate worse than they did before the interventions. For instance, Stigler says:

It is better to leave the leading of the economic issues to the private citizens...the state will do a good work if it is successful in its inevitable duties to win over wars, to preserve justice and to affirm different market canals.

As the politics is the art of compromise, none of these attitudes can be welcomed. In general, the idea of "benevolent" state interventions as the best choice and the most reasonable compromise. Thus, they argue that the state creates an environment for ethical attitude and ensures procedures for choice on not so ethical attitudes when they happen. What everyone wants to stop is what makes the things worse than they could be and that Friedman [1962] said:

Monetary reforms, that aimed at promoting the stability in the economic activity and in prices, worsened the inflation during and after the First World War and afterwards, it fed a high rate of inflation never met before. The monetary authorities that they created took on them a primary responsibility to convert a serious economic contract into a

catastrophe of the Huge depression 1929-1933. A system created to prevent the banking panic, produced the greatest panic in the american history (page 198).

The functioning of the market in the most efficient way, as it is made clear, is not a simple problem. Apart from decising a just relation between social and economic efficiency, is finding ways to intervene in protecting the consumers from the state.

BANKING INDUSTRY

The study is about 12 million dollars. However, related to this loss, some later studies have argued that the complete loss calculated by this study would be greater if there would have been taken into consiferation some other factors.

From has been previously explained, the evaluation of negative influences in a monopole banking market, is a difficult problem. However, what is visible and proved by every study is that the characteristics of the monopole markets are unwanted by the theoretical point of view. Although they are such, it will be then noticed that they are often taken into consideration without negative effects for the owners and the society in genera,, therefore they are not given the proper importance.

Evaluations by Albanian researchers²

The firt study for the domination and concentration of the banking system in Albania, has been realised by a group of researchers, working in the Bank of Albania, in 2000. The main conclusion of the study was that "The Albanian market, compared to the concentration raports and values of index H, is presented as deformed market and dominated by the state banking group, especially by the Savings Bank". In addition, according to the same study "The domination of the market by the Savings Bank is very high in the total activity of the Banking system in the depositing activity, mainly the one in leke, in investing in the tresure bonds market, in the banking network and the volume of the payments service. Whereas, in the crediting market it is to be noticed the ruling of the Savings Bank, caused by the surplus of the loans, in reality it has no influence on it, because of the administrative decisions that are taken. A more visible influence is the obe in the market of the treasure bonds. The domination of the banking market according to this study: "It lowers the efficiency of the policy of the interests of the Bank of Albania and it does not allow the defining of the prices such the one of the treasure bonds and credits on market basis. Such, regardless the whole favourable economic situation, the financing of the economy remains expensive (our accetntuation)". On the otherhand, the study claims that in 2000 there is a strengthening of the tendency of "reduction of concentration and intensification of the competition".

The later attitude of the other authors in 2002, the developing of the banking system is attributed to the banking competition. "The banking competition as a key factor of the banking business has influenced that the banks improve the structure of their activity..." what means that

after 2002 there is a raise of the banking competition. However, even these authors imply that the banking competition is at the beginning phase, what means that in general, still in 2002 the banking market in Albania is wtill very concentrated. The possession of the former Savings Bank by the Raiffeisen Banl, made competition to enter and important phase.

There is still no study for the Albanian banking market, for its quantity effects of domination or the concentration of this market, by the market point of view and by the social one.

Developments of the financial system

The level³ of mediation in Albania, evaluated as a raport of the activities of the financial sector towards the Gross Domestic Product (GDP), is evaluated to be 84.5% in the first 6 months of the 2010, from 82% calculated in the end of 2009 and about 76.3% during the same period of one year previous to that. The volume of the activities of the financial institutions raised with about 5.8% compared to the end of 2009 and 13.6% referred to one year before. The banking sector is still the leading segment of the financial mediation in Albania, where in the end of the first 6 months of the 2010, its actives included about 94.4% of the total of actives of the financial system and about 79.7% of the Gross Domestic Product (GDP). During the first 6 months of 2010, it has ben evidenced a raise of the contribution of the financial non-banking sector, even though it still reflects a relatively low total weight towards the whole financial system. Related to the total of the actives of the financial system, the total of the actives in the non-banking financial sector takes about 5.6% from 5.3% and 4.6% that were respectively end of 2009 and end of the first 6 months of the 2009. Related to the GDP, the total of the actives of the non-banking financial sector takes about 4.8% from about 4.4% and 3.5%

In the end of the first 6 months of the 2010, the financial situation of the financial system and the banking sector was stable. The need to stabilize and improve the quality of the credit, presents the main challenge facing the banking system. The situation of the capitalism and liquidity of the activity is presented to be good. Testing the stability of the banking system towards unfavourable supposed economic and financial developments indicated a good endurance by their side. Related to the risks that might come to the financial system and the banking sector from the domestic economic development during the first 6 months of the 2010, the evaluation is lower. The main positive factors include the lowering of the budget and trade deficit, the stability of the exchange rate, the moderate inflationist pressures and the drop of the interest norms. During this period, the liquidity in the inter-banking market has been appropriate to fulfill the short-term requests of the trade banks and the financial market has normally functioned. These positive developments would encourage a faster improvement of the financial situation of the businesses and individuals/families, stimulating thus the domestic demand.

2 BANKING LEADERSHIP, DRINI SALKO, ORFEA DHUCI TIRANE 2005 ,pg 135 ,139

3 Published by the Bank of Albania, Square "Skënderbej", Nr.1, Tiranë, Raport of the financial stability for 2010

Even the international economic developments present an improved situation. During this period, the world economy raised with 4.7% in annual terms. The inflations pressures have been moderated. The financial markets were generally more stabilized and the financial situation of the banking groups was generally better. However, the levels of crediting by the banking sector remain limited and the public authorities have taken measures for a fiscal consolidation. As a result, the new investments in the economy are weak and the level of unemployment, especially in the South of the Euro zone, remains high. Therefore, the stability of the rhythm of the economic growth for the continuous period remains to be discussed.

The situation of the finance of the public sector in the Euro zone is predicted to continue being difficult during the remaining of the 2010, whereas the average value of the budget deficit it expected to be about 6.6% of the GDP. A gradual improvement is expected during the coming year, when the average value of the budget deficit of the Euro zone is expected to fall under the level 6.1% of the GDP. In general, during the coming year, the budget deficits of the majority of the member states are expected to stabilize and in some cases to decrease. In Central and South-Eastern Europe, the macro-economic situation has been gradually improving.

The economic developments

After a negative economic growth in the fourth trimester of the 2009, the growth of 2% in the first trimester of the 2010 and the real sector indicators, suggest that the Albanian economy has had a positive performance during the first half of the year. During this period it has been noticed a moderate inflation performance, a stability of the exchange rate, growth of foreign investment and an important correction of the position of the foreign trade. The slower growth of the payments and the employment indicators, the decrease of the consignments of the emigrants and the difficult conditions of financing, have negatively influenced the performance of private consuming. The fiscal policy has been more constrained, related to the objective in order to decrease the annual budget deficit. In the economic growth of the first trimester of the year, the stable demand for export of first raw material supported the high growth of the sector of the industry with 27.5% compared to the same period of one year before. The building sector shrank with 21.1 % in annual terms. The sector of the services, which has the major eight of the domestic production, increased with 3.4% in the first trimester of the 2010, by following the slowing down of the second 6 months of the 2009. The improvement of the liquidity in the banking sector, showed by the increase of deposits, offered better conditions for the support of private investments. However, the lower usage of the capacities by the firms because of the decrease of demand has not supported the growth of private investments. Observing the trust of the consumers during this period indicates that they have more tendencies to increase the savings and to postpone in time the non-necessary expenditures. On the other hand, the cost of the financing of the banking sector remains relatively high. However, some signals related to the growth of the import

of capital means by private subjects and a higher interest of the businesses by the banks, offer optimism, a contained optimism for a revival of the demand for credit by the private sector. The contribution of the public sector in the aggregate demand has continued to be positive, but less important than last year. The fiscal policy has been more careful towards the debt indicators, which has been evaluated as positive for the perception of the prime of risk for the public debt. In the first six months of the 2010 the budget deficit decreased with 36% compared to the previous year. A higher influence in this proceeding was given by the decrease of budget expenditures, as the increase of the income was in lower levels than the prediction. Regarding the financing of the budget deficit, there has been a high demand of the market participants for bonds of the government debt.

Fiscal developments for the 2010

In the first six months of the 2010, the fiscal policy has been much less expansionistic compared to the same period of the previous year. During the six months, the general income of the budget increased with 3.3% whereas the general expenditure decreased about 4%. In general the income and the expenditure in the budget were realized at 45% and 46% of the annual planned level. The slowing down tendency of the income is reflected almost in every budget line. The income from the help and taxes has positively contributed in the performance of the general income, while the non-tax income have decreased. On the hand of the expenditure, the current expenditure has increased 7%, while the capital expenditure has considerably decreased at 3.6% compared to the first six months of the previous year. The changes in the realization of the budget income and expenditure, have dictated the level of the deficit budget, which in the end of the first six months of the 2010 was about 21 milliards leke 36.4% lower than in the same period of the previous year. However, based on the objectives for the realization of the budget deficit according to the budget review of the 2010, the deficit realized in the first 6 months represents 55.2% of the level of the annual planning. Thus, it is necessary to be careful in the realization of the annual planned deficit for the rest of the year. In the end of the first six months of the 2010, taking into consideration the unstable performance of the income, the government made public the objective for the revise of the budget, by aiming at correcting the decrease of the income and expenditure, and a further decrease of the budget deficit. This necessary process of the fiscal consolidation will serve the fulfilling of the middle-term objective to decrease the value of the public debt till 54% of the GDP in 2013, according to the objectives of the Macroeconomic and Fiscal Framework for 2011-2013. According to the review, the decrease of the expenditure will be mainly realized through the decrease of capital expenditure, which in 2009 reached 8.8% of the Domestic Gross Product (GDP). It seems that the need for a fast consolidation of the fiscal position, has conditioned this choice. In other conditions, a higher level of contribution for current expenditures should be chosen, in order to generally reduce the expenditures of the budget. Even after the

reviewing of the values of the budget for the 2010, the realization of the planned budget deficit will be sensitively influenced by the ability to realize the income. The financing of the budget deficit in the first 6 months of the 2010 is supported by the domestic financing at 85% and from the foreign financing at 15% bringing the respective changes in the debt stock. Differently from the previous years, the domestic financing consisting by the emitting of bonds of the debt in leke (bonds and obligations) the income by the privatizing occupies a very small part, only 0.4% reflecting the decrease of possibilities for further privatizing during the time and the hesitation of the investors. The stock of the general public debt is composed by the domestic debt at 60% of the total and the rest represents the external debt. Related to the term of the portfolio of the domestic debt, the number of the average days till the maturation, in the first six months of the 2010, decreased 382 days from the 406 days till the end of the 2009. During this period, it has been ascertained an active participation of the investors in the auctions of bonds of the government debt, where the demand has been on higher levels than the offer. This phenomenon, as well as the transmission of the effect of further relief of monetary policy in October 2009, has brought the decrease of the norms for the return from investing of the bonds of the government debt, influencing thus, the decrease of the cost of the debt and by improving the possibilities for its service. In defining the objectives for constituting the public debt, apart from the main objective to control the size and service cost of the debt, there should be taken into consideration other factors related to: a) stability of financing through time; b) preservation of the financing spaces for the needs of private sector; c) the risks produced by the dynamics of the economic developments and their influence in the market liquidity, level of norms of interest and the exchange rate.

The risks related to the process of debt administration would be more controlled if there could be preserved the public and investors' trust for a more stable fiscal long-term policy. This could be realized through giving stronger legal guarantees, more controllable and transparent ones, as part of the process that is also known as "the definition of the fiscal rule". Such a process would make possible a better harmonization between the fiscal and monetary policy, aiming at preserving the macro-economic indicators and the securing of a financial stability. For this reason, the Bank of Albania, has publicly expressed its support related to the need for defining the fiscal rule, according to the best international standards, as soon as possible.

country is always actual. Our economy does live actually relatively high growth rhythms. As a market economy, it is passing from the birth phase to the growth phase. With the characteristics and difficulties of the phase in which it is, our economy carries still unused potential of development. The financial system is, without the smallest doubt, the catalyze or better, the lab where the economic developments take their proper shape and form. One should not overact and identify the economy with the financial system of a country. But it cannot be neglected and decrease the irreplaceable role of the financial system in the economic development and welfare of a national economy. In the theory on the finance science and on the role of the financial system, there is an important postulate: The level of development and of the role of the financial system on the economy, defines the phase in which the economic development in a country is.

The discussion and training wouldn't be complete, if we wouldn't leave the necessary spaces to indicate the progress of the Albanian financial system in these years of market economy. Apart from the extension, reformation and consolidation of the banking system, it has been talked and it will be talked about in this conference. Apart from the liberalization and adding the number of operators in the system of trade for propriety, life and health insurance, there have been made serious steps and with perspective even in the installing and functioning of the savings-credit institution, there have been installed mechanism and policies which are more stable in the fields of taxability, taxes and tariffs in the system of public financing, without forgetting the diversity and variegation in the organization, functioning and directing the financing of entrepreneurship

THE ALBANIAN FINANCIAL MARKET

In⁴ the economic Albanian environments, and not only in them, the topic for the development of the financial system and its role in accelerating the economic growth of the

4 Sherif Bundo, Edlira Luçi, Gentiana Cane, *THE ALBANIAN FINANCIAL SYSTEM AND THE ROLE OF THE MEDIATE INSTITUTIONS INSIDE IT*

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