

## **Gent Sejko: Albania's economic and financial developments in 2023**

Speech by Mr Gent Sejko, Governor of the Bank of Albania, presenting the Annual Report 2023 to the Parliamentary Committee on Economy and Finance of the Albanian Parliament, Tirana, 28 May 2024.

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Honourable Chair,  
Honourable Members of the Committee,

Thank you for the invitation and the opportunity to present to the Committee, the main messages delineated in the Bank of Albania's Annual Report for 2023. The presentation of BoA's Annual report, an integral part of our transparency process, serves both the institutional dialogue with the Parliament of Albania, as well as the enhancement of public confidence in our institution.

Over the past year, the Bank of Albania oriented its activity on three main pillars. First, we have taken care for strengthening the monetary and financial stability of Albania, as an important prerequisite for the sustainable and long-term growth of the country and the improvement of social welfare. Second, aiming at being a promoter of the financial industry development and a reliable partner of the Albanian public, we have accomplished all the institutional commitments. Third, and equally important, we have been attentive to fulfilling all the recommendations left by the Assembly of Albania for the year 2023.

Honourable Committee members,

Year 2023 was a year of progress for the Albanian economy.

The volume of economic activity, despite a difficult external environment, continued to grow, generating a surge in the income for businesses and a lift in the welfare of households, in the form of expanded employment and increased wages. In parallel, consumer price inflation, came down continuously, helping in maintaining the value of Albanian households' income and savings, and supporting the smooth functioning of financial markets. At the same time, the domestic and external equilibriums of the economy have been improving. In particular, budget and current account deficits were reduced, leading to an increased sustainability in domestic debt and external debt of Albania. Finally, and just as importantly, the financial stability of the economy strengthened further: liquidity, capital and profitability indicators of the banking sector improved, while the non-performing loans ratio fell to the lowest level recorded in more than a decade.

The Albanian economy, in a longer time perspective, has displayed an admirable degree of resilience and flexibility, despite the huge challenges of recent years. This fact is reflected in the improved risk ranking of the country's public debt by foreign rating agencies, now at BB-, as well as in the increased interest of international operators to invest in Albania.

This positive momentum in the development of Albania reflects, to a large extent, our prudential monetary policy, our supervisory, regulatory and macroprudential measures, as well as the continuous work we have carried out for the advancement and modernization of payment systems. In more concrete terms, the prudential normalisation of monetary policy stance, first enabled to keep inflation under control and then its continuous reduction, without jeopardising- at the same time - the positive trend of economic growth and the financial stability of Albania. In addition, our rigorous micro and macroprudential measures strengthened the stability of the banking system, while the continuous alignment of our regulations with the European Union standards has led to a considerable regulatory convergence, by reducing financial risk premia in Albania. Last, the ongoing advancement regarding the infrastructure and regulatory basis of payment systems has driven to an increased financial participation, and has helped strengthening both the efficiency and formalization of the private sector.

We deem that these positive development trends will continue in the future as well.

In the baseline scenario, we expect the Albanian economy to grow further in the next years, underpinned by the increase in consumption, investments and in the export of services, as employment and wages will pick up further. In addition, we expect inflation to stay close to our 3% target. This level protect the purchasing power of Albanian households and helps the overall financial soundness of the economy.

However, many challenges lie ahead of us. External environment continues to be characterised by various uncertainties, geopolitical tensions and an increasing economic and trade fragmentism. In addition, the effects of population ageing and labour force constraints are evolving into ever more important factors for the economic development, in Albania and globally, while technological innovation and climate change have turned out to be the challenges of the day.

Economic policies, which ensure economic and financial stability and establish a more innovative, efficient, resilient and inclusive economy, enable the successful navigation through such an environment. In this context, I would like to ensure you that the work of the Bank of Albania in the future will continue to focus on the following areas:

- First, guaranteeing price stability and strengthening the financial health of the economy, as the best contribution a central bank can make to the sustainable, long-term and comprehensive growth of the country.
- Second, promoting financial progress, as a key instrument for boosting the efficiency of the Albanian economy, through continuously investing for the development of: financial markets; the payment systems; as well as innovation and digitalization of financial services.
- Third, boosting financial education and inclusion, as a prerequisite for expanding access to financial services and payment services and for a prudential approach towards the personal finances management.
- Fourth, enhancing attention to green finance and strengthening public awareness regarding climate change, as a necessity for the sustainable growth of the country.

Last, I would like to emphasise that our policies must be coordinated with prudent fiscal policies and supported by structural reforms. In particular, the creation of a more

stimulating environment for promoting domestic and foreign investments, coupled with the investments in human capital and infrastructure should be encompassed in the priorities of structural reforms. Also, these reforms should aim at expanding the sectoral base of economic growth and bolstering its sustainability.

Honourable Committee members,

Allow me to focus more specifically on the main directions of our work over the past year, highlighting the measures taken and the results achieved.

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## **1. Economy, inflation and monetary policy of the Bank of Albania**

The 2023 was characterized by a solid growth in economic activity, employment and wages, as well as by the improvement in the main indicators of Albania's economic and financial stability.

According to INSTAT data, the volume of economic activity in Albania grew by 3.4% over the past year, by gradually improving the growth pace over the course of the quarters. In parallel, employment rose by 2.2%, while the unemployment rate dropped to a new historic low of 10.7% at the end of the year.

From the demand perspective, the expansion in family consumption, private investments, and in the export of tourism services underpinned the economic growth. On the other hand, the fiscal policy maintained a consolidating stance while the export of goods has been declining. The expansion in the demand for goods and services reflected the sound financial balance sheets of private sector, the gradual improvement in businesses and household's confidence, the stable financial environment, the increasing bank credit, inflation coming down, and the rapid growth in the income from tourism. In the sectoral perspective, economic growth was reflected in the expansion of the activity in the sectors of services and construction, while the volume of activity in industry and agriculture trended downwards.

The heightened demand for goods and services drove to the increased demand for labour force from businesses. Meanwhile labour shortages turned increasingly apparent. These factors led to the rapid and broad-based wage growth in the private sector, which recorded an average growth of almost 13%. Wage growth – at higher rates than inflation – sustained the expansion in both households' incomes and consumption. On the other hand, wage growth pushed up rapidly the production costs, by exerting pressure on final prices.

Also, year 2023 recorded improvements in the domestic and external balances of the economy. Among them, I single out:

- The improvement in the external position of Albania, as the country's current account deficit recorded an unprecedented fall of five percentage points. This deficit dropped to 0.9% of GDP over 2023, recording a historical minimum of post-transition period. In addition, the external debt of Albania dropped below 50% of GDP, while foreign direct investments marked a historical record of EUR 1.5

billion. The good performance of Albanian exports, climbing by EUR 1.7 billion over the past year, and the two-fold attractiveness of Albania, both as tourism and investment destination, dictated this performance. In parallel, the international reserve of the Bank of Albania registered a historical record of EUR 5.8 billion, by significantly increasing the solvency of the country.

- The improvement of Albania's fiscal position, reflected in both the reduced budget deficit and public debt, which dropped to the minimum levels of more than a decade, to 1.4% and 59.2% of GDP, respectively. The reduced public debt drives to increased fiscal spaces for reaction against potential shocks in the future, as well as decreases risk premiums and financing costs for all economic operators.
- The sustainability of the banking sector, reflected in the improved indicators of capitalization, profitability, as well as of the loan portfolio quality. The non-performing loans ratio stood at 4.8%. These positive trends enable the banking sector to supply efficiently and in a continuous manner the economy with financial funds and payment and savings instruments.

In parallel with these developments, inflation recorded a gradual decline, but steadily, over 2023. As at end of 2023, inflation dropped to 4%, from 7.4% at the beginning of 2023, and to 2.7% in the first quarter of 2024. The decline in inflation in foreign markets, the exchange rate appreciation and the normalisation of the monetary policy stance drove inflation coming down. The fall in inflation was initially focused on food and oil prices, but it further spread to other items of the basket. However, this decline was uneven: it has appeared faster in goods items, and in particular food items, and slower in service items. The higher inflation inertia of these items is dictated by the positive cyclical position of the Albanian economy, which is characterized by a sustainable demand for goods and services and by the relatively rapid growth in wages and production costs.

The inflation above the target, coupled with the positive cyclical position of the economy dictated maintaining the normalisation stance of monetary policy, even over the course of 2023. This normalisation was carried out through the further rise of the policy rate, the attentive and transparent forward guidance tool, while it took place through meeting all the liquidity needs of the banking sector.

The normalisation of monetary policy over 2023 had certain features, which I think are important to evidence.

- First, the normalisation pace was slower than in the previous year. We increased the policy rate five times over 2022, for a cumulative effect of 2.25 percentage points, while in 2023 we rose the policy rate only twice, with a cumulative effect of 0.5 percentage points.

This slowdown reflected the exchange rate strengthening and the consolidation stance of fiscal policy. Lek rapid appreciation helped in mitigating external inflationary pressures, while fiscal consolidation helped in curbing domestic pressures.

In particular, lek strengthening has been and continues to be one of the most discussed economic issues of this period. Our analyses have focused on this indicator as it turned out significant for the economic developments in Albania. These analyses aimed at identifying its reasons, consequences and implications for the monetary and financial

stability of Albania. Conclusions in these analyses show that the strengthening trend of lek is due to the structural improvement in the external trade balances, reflected in the increase of exports, mainly in tourism, remittances and foreign direct investments. In these circumstances, lek strengthening provided an overall positive impact on the economy. It contributed to keep inflation under control, by enhancing the purchasing power of Albanian families, as well as enabling a more gradual normalisation of our monetary policy stance, thus keeping financing costs to businesses low. Consequently, Albania, compared to regional countries, has one of the highest economic growth rates, the lowest inflation rates and the slowest increase in financing costs.

However, the Albanian economy has been and remains an economy with a relatively high level of informality. This phenomenon has its consequences in many economic indicators of the country, including - potentially - the exchange rate. The Bank of Albania has continuously taken measures to reduce informality, through the continuous improvement of the payment system, the introduction of regulatory requirements that enable the granting of loans only against certified fiscal balances of businesses, as well as through the implementation of all necessary supervisory regulatory changes, which fall in our field of competence, within the plan of measures for the prevention of money laundering and terrorism combating. However, fully addressing this problem requires further attention. Among other things, it should be addressed both through strengthening and coordinating the work of all law enforcement agencies, as well as through further structural reforms in support of the economy formalization.

- Second, the pass through of monetary policy decisions to financial markets was satisfactory. The increase in policy rate engendered an overall rise in interest rates, though the overall financing condition in Albania still remain simulating.

Credit portfolio to the private sector, in response to them and banks' positive approach towards lending, recorded a fast and stable growth over 2023, around 10%. Lending growth also had some positive features: the new credit had a broad sectoral base; it was focused on our domestic currency; it had an upward orientation towards investment financing; and did not harm the overall quality of the portfolio. These features suggest a sustainable and sound credit growth in the future as well.

- Third, the normalisation of monetary policy stance enabled the reduction of inflation, without jeopardising the positive economic growth trend.

The positive contribution of the monetary policy was materialised through three channels. First, there was willpower exhibited and concrete measures undertaken to meet the price stability objective, which helped to anchor inflationary expectations and mitigate economic agents' uncertainties. Second, the prudential increase of financing costs led to a more balanced performance of demand and supply in the economy, enabling the curbing of the domestic inflationary pressures. Third, the normalisation of the monetary policy stance helped financial markets to operate smoothly, keeping down their risk premia.

Inflation and expectations on inflation, as a result of this reaction, stay already close to our 3% target, while second-round effects remain under control and the outlook for the future is positive. However, domestic inflationary pressures still appear relatively high, while uncertainties about the future are heightened.

In these circumstances, our monetary policy decisions in the future will be new- data oriented. They will always be consistent with our price stability objective, continuously factoring both the overall balance of price stability and the factors affecting it, and in particular the fiscal policy stance and the exchange rate performance.

## **2. Banking supervision and financial stability**

The increase in interest rates and heightened uncertainties experienced over the past two years by both the domestic and external environment, have posed a challenging environment to the activity of the banking sector and our financial stability. However, the banking sector in Albania has responded positively to this challenge, and financial stability appears consolidated. The Albanian banking sector concluded 2023 with a positive financial result, a high level of liquidity and capitalization indicators, and improved credit quality. Our regular analyses show that the systemic risks to the banking system remain contained.

The resilience, stability and flexibility of the financial system against these continuous challenges reflects a level of supervision which is both meticulous and efficient. This is also the result of the structural reforms of the financial market undertaken throughout the years by the Bank of Albania. The continuous investment made over the years has strengthened the resilience of the banking sector against shocks and has enabled it to continue to meet the demands for funds of the economy.

In 2023, we have continued to work for the supervision and prudential regulation of the banking sector, for the development of financial markets and payment systems, as well as for strengthening the safety nets in the system.

Two important achievements were recorded by the Albanian banking sector last year.

- First, Albania has been taken off the list of places continuously monitored by the Financial Action Task Force (FATF) regarding the development of infrastructure for anti- money laundering and countering financing of terrorism, also known as "grey list". This event consists a pivotal point of the reforms undertaken by national institutions, including the Bank of Albania, to fulfil the necessary criteria. Being removed from the grey list of FATF, marks an important achievement for our country, the economy and the reputation of Albania, because it is a demonstration of trust by the international community on our dedication in the fight against money laundering and combating financing of terrorism.
- Second, upon the exit from the "grey list" we have started the procedures to receive the equivalence status of our supervisory and regulatory frameworks with the EU standards. Our preliminary assessments suggest a high convergence level of the Bank of Albania with these standards. Therefore, we have submitted the official request to the European Banking Authority (EBA), and we are expecting to start our discussions on the equivalence assessment process for Albania. Obtaining the equivalence status is expected to directly affect the increase in lending from European banks that operate in Albania.

In the same vein, we have continued our work on further strengthening the banking regulation and supervision, as well as consolidating the resolution plans. Below, I will list some of the priorities of the Bank of Albania in this regard.

- First, the Bank of Albania has improved its supervisory and regulatory framework aiming to approximate it with the EU acquis and Basel principles. Some regulations have been revised in order to strengthen the capitalisation standards of the banking system and supervision, the regulation on the reporting systems of payment institutions and electronic money institutions.
- Second, the approval of the law "On payment account with basic features" by the Assembly of the Republic of Albania, which was drafted by the Bank of Albania with the assistance of the World Bank, and the regulation of the Bank of Albania "On the comparability of the fees related to payment account and payment account switching service", concluded the transposition of Directive 2014/92 of the European Union to the regulatory framework of the Bank of Albania. The transposition of this directive marks the fulfilment of the requirements of the European Integration National Plan 2022-2024. The law on payment account with basic features provides the consumer the possibility to access basic banking services, through "the payment account with basic features", avoiding discrimination of consumers based on their employment status or financial situation.
- Third, the Bank of Albania drafted the document on the banking sector financial reporting, which is the first step toward the adoption of the international standards on financial reporting and accounting. The document consists of the standards delineated by the European Banking Authority (EBA). The final document, distributed to commercial banks, has served to open the discussion on the challenges and respective obligations springing from its implementation.
- Fourth, the Bank of Albania has developed and approved the Medium-Term Green Strategy 2023-2025 for "The Management and Supervision of Climate-Related Financial Risks in the Financial Sector" in cooperation with the World Bank. The strategy lays down a detailed action-plan based on best international practices and complaint with the EU Commission Action Plan. This strategy comprises all the aspects and policies of the Bank of Albania which contribute directly to the effective management of climate risks in the financial sector.
- Fifth, the Bank of Albania continued to monitor rigorously the banking sector through on-site examinations and off-site analyses. The examinations' focus was the monitoring of compliance with the regulatory requirements on capital, the assessment of governance systems and culture, the assessment of the management of credit and market risk, and operational, IT and liquidity risks, and the assessment of transparency with clients. The above monitoring suggests that financial institutions under the regulatory and supervision authority of the Bank of Albania follow a meticulous approach in managing risks, have a stable management culture, and are overall compliant with the regularity framework.
- Lastly, the Bank of Albania has continued to enhance its ability for resolution. In the capacity of Resolution Authority, the Bank of Albania has completed and communicated the resolution plans to all banks, including the resolution strategies of specific banks, the minimum requirements on financial assets needed for loss absorption and recapitalisation, as well as requirements for increasing resolvability. Banks have made steps forward in regards to governance, capacity enhancement, the ability for loss absorption and their capitalisation, and ensuring business continuity and preserving market access. Along with the primary objective of preserving monetary and financial stability, the Bank of Albania is responsible for other activities as well, which are considerably

important for the development and growth of society's welfare. Further on I will provide a brief summary on some of these.

### **3. Other activities**

The Bank of Albania plays a key role in promoting the smooth functioning of payment systems through the operation and management of three main infrastructures for processing interbank payments and one infrastructure for securities settlement. All the systems have been fully available. The newest system of Euro payment settlements within Albania experienced a further increase in its use during 2023. As a result, it has been assessed that Albanian businesses and consumers saved around EUR 37 million from the use of this system in 2023.

The development of payment services infrastructure has supported the expanded use of e-payment instruments and the financial inclusion of the population. Our statistics show a growth of 25.5% in card payments, e-money payments and home banking payments. The use of electronic payments per capita reached 21 payments, from the 10 payments objective set in the National Retail Payment Strategy for 2023. The Bank of Albania has worked intensively to ensure the safety, efficiency and availability of the payment systems. In 2023, we started our work to receive membership in the Single Euro Payment Area (SEPA), which is an integral part of the Growth Plan for the Western Balkan area, drafted by the European Commission. This membership is our chance to integrate our payment platforms and electronic trade with the European market, and it will enable equal fees to be applied to national as well as international and electronic payments in the euro.

The preliminary assessments on the compliance criteria with the EU legislation, adopted with the assistance of the World Bank, have shown that Albania is leading the Western Balkan region in the approximation of the legislation that enables its membership in SEPA. The application process is being led by the Bank of Albania, but it also reflects the contribution of several other public institutions. In addition, we have undertaken important steps for the implementation of a new payment infrastructure, such as that of instant payment. This infrastructure allows the electronic settlements of small-value payments, in a safe and prompt manner and at any given moment of the day. The Bank of Albania is being actively supported by the Bank of Italy for the development and implementation of this system, according to the TIPS instant payment system model of the euro area. Eventually, this solution facilitates the integration of our payment system with the ones of the EU in the future.

In parallel, by encouraging and ensuring electronic payments, we have also accommodated the economy's demand for cash. Following the issuance of the new series of banknotes in 2022, we have fulfilled all the demand of the Albanian economy for cash, in both value and structure, over 2023.

Also, the Bank of Albania has fulfilled the institutional obligations stemming from the Stabilization and Association Agreement, the Progress Reports of the European Commission, joint EU-Albania subcommittees and the National Plan for European Integration. Upon the opening of negotiations, the Bank of Albania has actively contributed in bilateral meetings (i.e., screenings) for each of the Acquis chapters between the Albanian delegation and the representatives of the European Commission.

Furthermore, we have continued to lead the drafting of Chapter 4 and 17 on "Free movement of capital" and "Economic and monetary policy", respectively.

The Bank of Albania has scrupulously managed the international reserve, by observing the main objectives of liquidity and safety. The level of our international reserve is in accordance with our adequacy criteria and best international practices. In addition, returns from reserve management have been positive, due to the increase of interest rates in international market in 2023.

At the same time, our relationship with the public and stakeholders were motivated by the principles of transparency and accountability, keeping open channels of communication at all times. This approach helps to increase the efficiency of the policies adopted by the Bank of Albania. However, it requires a satisfactory degree of financial education of the public. In order to improve the latter, we adopted the Strategy of the Bank of Albania for Financial Literacy and Inclusion, the first institutional document that promotes financial literacy. Some of the main objectives incorporated in this strategy are: the well management of personal finances and sound borrowing; planning and saving for the future; and consumer protection. The Bank of Albania has now started to implement this strategy.

Finally, significant improvements have taken place in terms of improving the governance of the institution, through updating risk management systems and the infrastructure of information technology. Considering the latest cyberattacks, which have targeted public and private Albanian institutions, we have dedicated attention to strengthening cybersecurity that supports the continuation of the Bank of Albania's daily activity and the functioning of the banking and financial system. In this context, we have strengthened security and monitoring measures as well as technical and procedural ones, based on the best international practices and standards, in cooperation with the national and international institutions, and for the resilience against potential cyber-attacks.

Honourable Members of Parliament,

Allow me to ensure you that the Annual Report is a faithful reflection of our opinion on the economic outlook and the banking system in Albania, the work results of the Bank of Albania over the year in regards to fulfilling the legal objectives and our institutional engagements, as well as of our financial results.

Also, I would like to reiterate the engagement and dedication of the Bank of Albania in respecting all legal obligations and institutional engagements. This commitment is documented in the Medium-term Strategy of the Bank of Albania, a summary of which is an integral part of this Report.

Thank you for your attention!