

How Albania's central bank dealt successfully with the COVID crisis

Gent Sejko (Governor of the Bank of Albania) explains how Albania's central bank responded to the pandemic.

For south-eastern European countries, COVID was the third major upheaval in 15 years. The global financial crisis (GFC) had exposed the limits of the domestic demand-driven, debt-fuelled growth model. The subsequent European sovereign led to financial deleverage of EU bank subsidiaries. Both these crises exposed vulnerabilities across our financial sectors and put pressure on growth and employment. The SEE region took several years to fully recover, and it was only in the latter half of the 2010s that central bankers were discussing policy normalisation. Then the pandemic arrived and took us all by surprise. It turned into the most serious economic and policy crisis in our lifetimes.

As the crisis unfolded, we intervened early on with combined macroeconomic – fiscal and monetary – policies, and so far we have been quite successful in containing output losses while preserving overall economic and financial stability, something which was lacking during the previous crises. We have a solid basis now for the future. Arguably, our experience of the GFC and the eurozone crisis meant we had experience to draw on and could open up enough policy space.

In Albania, we imposed a full quarter of lockdown that led to a significant drop in demand and production. Unemployment rose. It was clear that the financial bill for the pandemic had to be shared between the public, private and financial sectors: the challenge was how to achieve that. I believe we found the correct answer to this policy dilemma.

How did we manage the crisis successfully? We drew on our comprehensive structural reforms and launched an effective local policy response. Both these actions were facilitated by the coordinated and global policy response. Our aim was to mitigate the short-term and avoid the long-term impacts on the economy by preventing bankruptcies and large-scale layoffs, and we achieved that by preserving macroeconomic stability, providing an uninterrupted flow of credit to the economy. We also succeeded in avoiding the depreciation of Albanian currency through our initial intervention and international coordination measures.

The two previous crises exposed inherent structural vulnerabilities which limited the scope of our policy response. Albania has high euroisation: half the financial balance sheets of the banking sector are in euros, and the use of euros as a means of transaction is spread across the real economy. So our de-euroisation strategy was intended to promote financial stability and increase the effectiveness of monetary policy. It did not aim to avoid usage of the euro altogether, but to reduce risks and promote efficiency across the economy. The Bank of Albania earlier introduced differentiated reserve requirements for foreign currency (FX) lending. We increased the transparency requirements for banks' lending in FX, and took corrective actions to reduce lending to un-hedged borrowers.

Our weak credit environment and market bottlenecks impeded credit growth and made it less responsive to economic conditions. In the wake of the GFC, high non-performing loans (NPLs) were undermining the capitalisation of the banking sector, reducing its financial intermediation and imposing a higher credit risk on performing clients. In the past, high NPLs have been indicative of an inefficient legal and regulatory environment. We subsequently introduced a comprehensive NPL resolution strategy aimed at improving the legal environment (by revising the law on bankruptcy and restructuring the functioning of private bailiffs), the regulatory environment (with tighter credit underwriting standards imposed on banks, strengthened internal risk requirements, and new regulation for out-of-court settlements), and by improving credit support infrastructure (such as the Credit Registry, operated by the BoA). The non-performing loans trajectory is now positive and there has been a broad-based recovery in aggregate demand.

We also encouraged consolidation in the banking sector, where 16 banks were operating. After some EU-based banks left Albania, the number fell to 12. As a result the sector has a greater share of local capital and more committed long-term owners.



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Better financial sector regulation and supervision was crucial to avoid imbalances and risks, and we launched extensive structural reforms to achieve that. Albania created a new Financial Stability Group which meets every quarter to coordinate macro-prudential policy. We adopted risk-based supervision and accelerated our efforts to implement the Basel II/III international banking standards across the sector. The bank regulatory framework was aligned to the European System of Central Banks' standards. The Bank of Albania was tasked as the resolution authority by the Bank Resolution Law and it operates the Bank Resolution Fund. We upgraded the coverage offered by the Deposit Insurance Agency and its institutional capabilities, enacted a new law on the Albanian Financial Supervisory Authority, and established European Bank for Reconstruction and Development credit lines to improve liquidity.

On the policy front, we cut interest rates early on, bringing them to an all-time low of 0.5%. We also adopted a strategy of quantitatively unrestricted injections of liquidity and gave transparent forward guidance that emphasised our commitment to supporting the economy. The Bank of Albania did not engage in quantitative easing, although we did have a contingency plan for deploying it.

The policy space we opened up during the pandemic must be preserved

Our macroprudential policy response facilitated the flow of credit to viable businesses. This was initially achieved through a short-term moratorium on credit instalments which benefited around half of businesses and households. Later on, the BoA applied regulatory encouragement for targeted credit restructuring and suspended the distribution of dividends to ensure the health of the banking sector. We also forfeited any charges for using our electronic settlement and clearing systems, to encourage them to move online.

At the same time, the Albanian government took several measures aimed at targeted tax relief for businesses, job and welfare support for families, and credit guarantee schemes. Altogether they provided a fiscal stimulus of around 3.5% of GDP and proved to be quite effective in sheltering the private sector from the financial impact of the crisis.

The [Vienna Initiative](#) was instrumental in controlling financial outflows from the banking sector. We were able to draw on the International Monetary Fund's rapid financing instrument, the European Commission's macro-financial assistance to 10 enlargement and neighbourhood partners, and a repo line set up the European Central Bank to provide Albania with euro liquidity.

Crises like this one cannot be entirely avoided or foreseen. That is why we always need to be prepared for the worst and should continue to mitigate our potential vulnerabilities. The policy space we opened up during the pandemic must be preserved. External policy coordination is crucial to avoid negative spillovers, and the better the coordination, the more effective the policy.

However, plenty of challenges remain. The supply-side shock in global commodity prices raises the prospect of pro-cyclical policy tightening. We need to navigate the conundrum of policy normalisation and assess the structural impacts COVID will have on the economy. The public and private balance sheets need to be fully recovered, and the long-term impact of the pandemic is uncertain.

This post represents the views of the author and not those of the COVID-19 blog, the LSE, nor the Bank of Albania. It is based on Gent Sejko's contribution to [Planning for the Post-COVID World: central bank policies in emerging economies](#), an event hosted by LSEE Research on South-Eastern Europe on 7 October 2021.