

CHALLENGES TO MONETARY POLICY CONDUCT IN ALBANIA

Session IV: Currency substitution implications for monetary and credit policy

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Bank of Albania

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CBBH Conference "The Future of Cash"

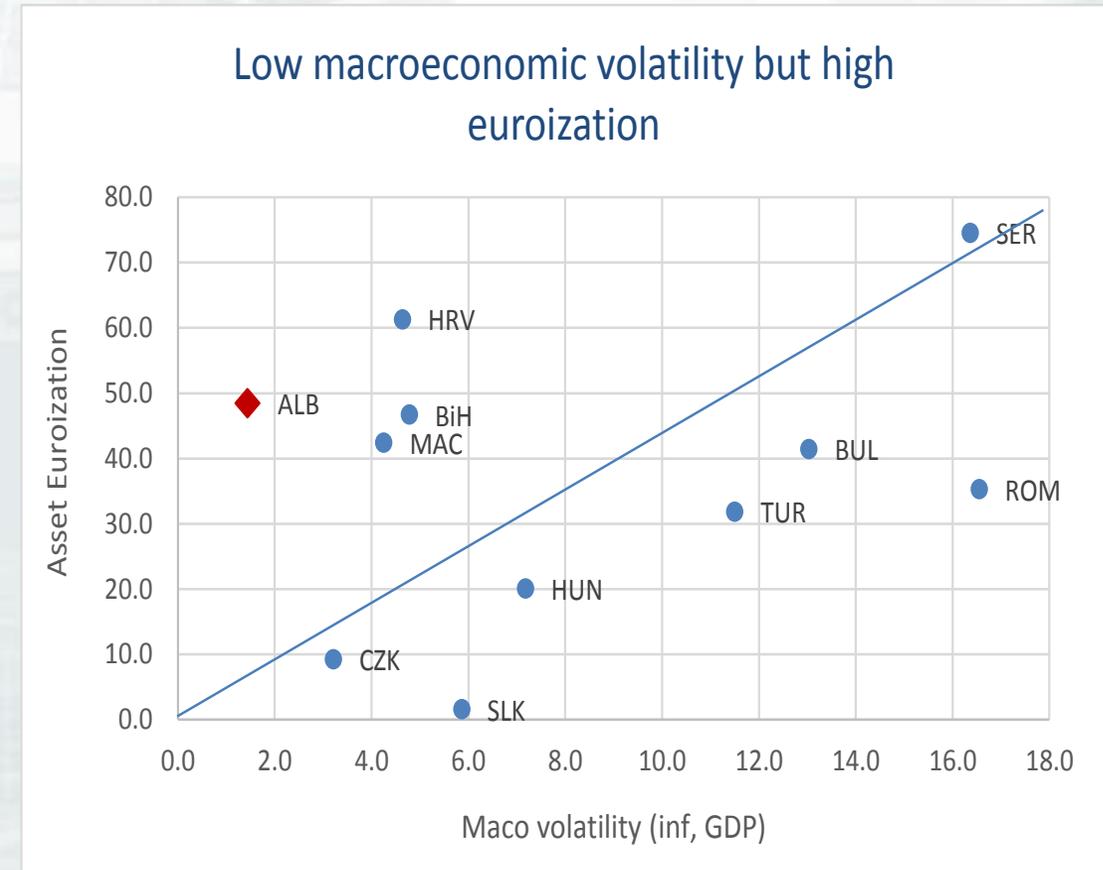
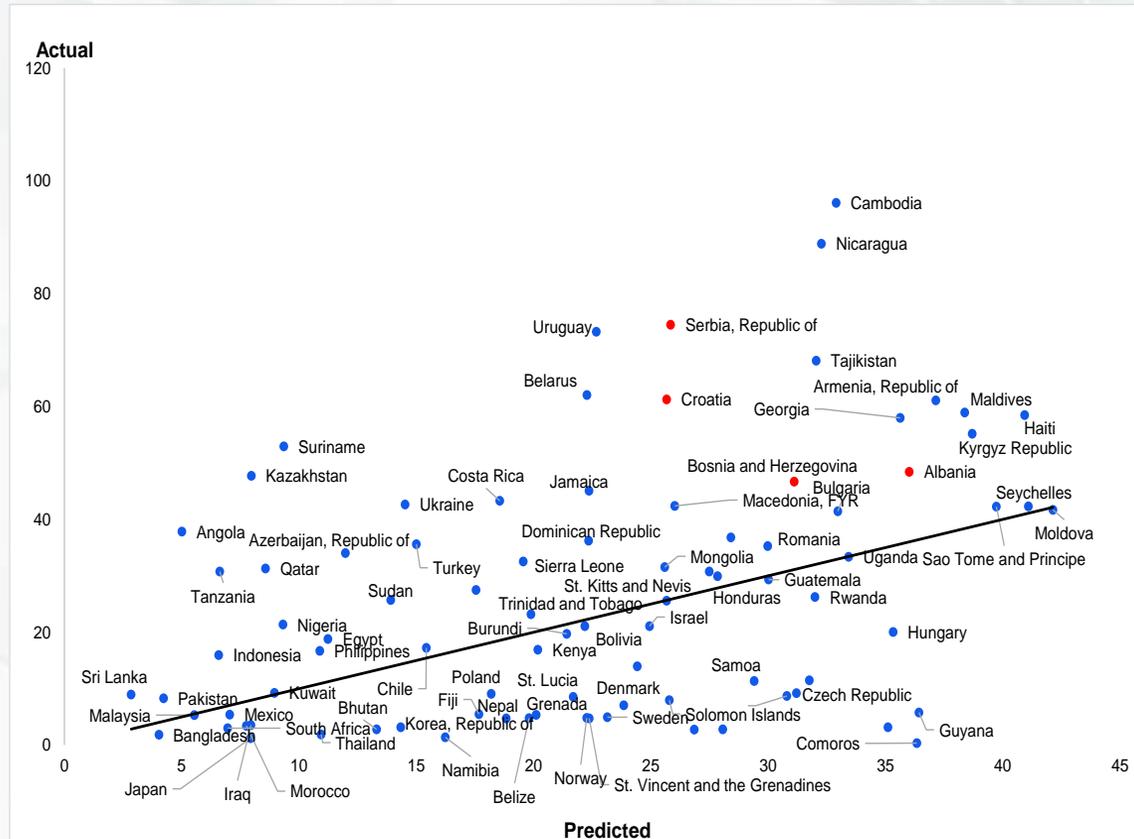
Overview



1. **Currency substitution: where do we stand**
2. **Monetary policy implications**
3. **Bank of Albania policy response**
4. **Conclusions**

Currency substitution highly pervasive and widely spread among transition countries

Despite, the track record of low inflation and macroeconomic stabilization



IMF Working Paper “Euroization Drivers and Effective Policy Response: An Application to the case of Albania”, Guido della Valle, Vasilika Kota, Romain Veyrune, Ezequiel Cabezon, and Shaoyu Guo

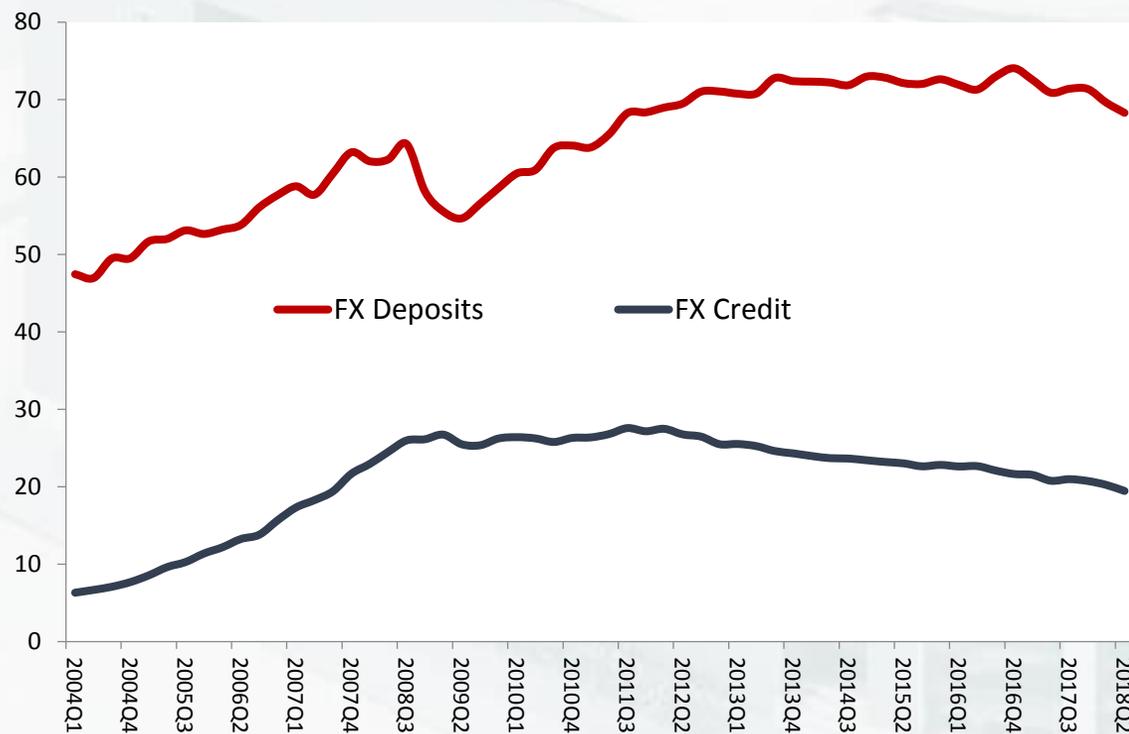
Source: IMF, WEO and Eurostat

Albania classifies as a highly euroized economy

Euroization has been decreasing on the assets' side

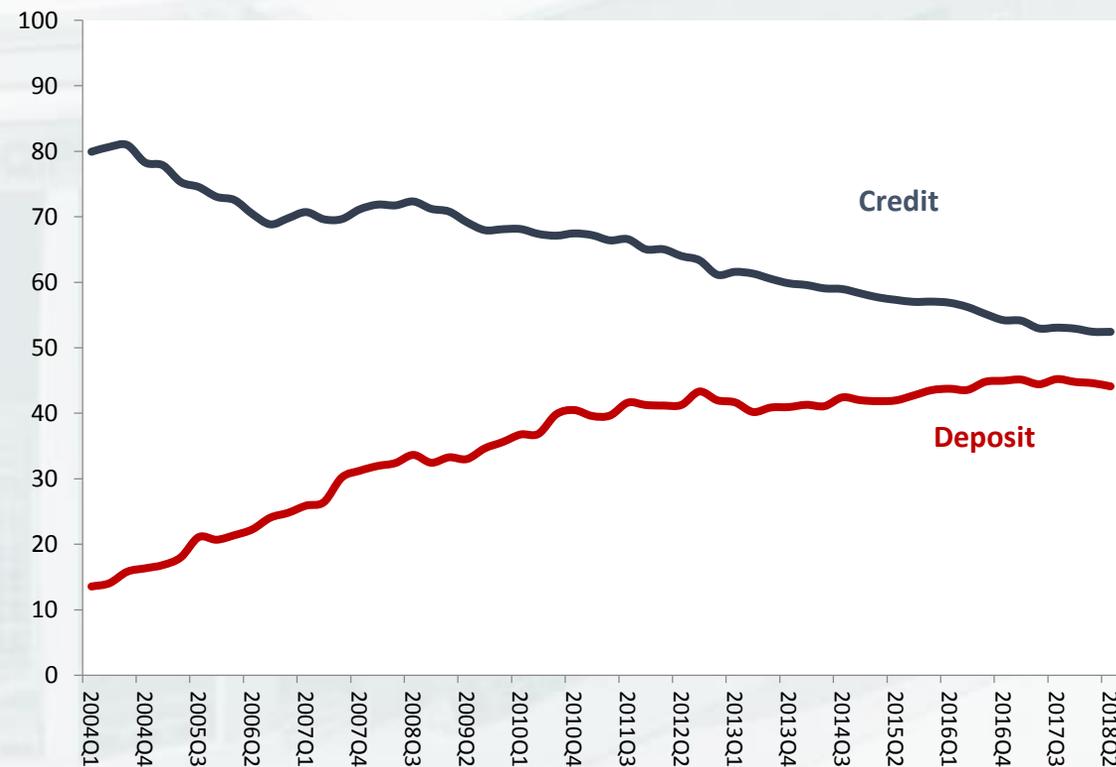
% to GDP

Euroisation Indicators



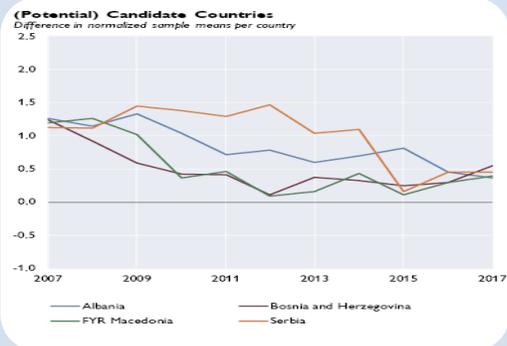
% to total

Declining share of Fx loans, while increasing share of Fx deposits

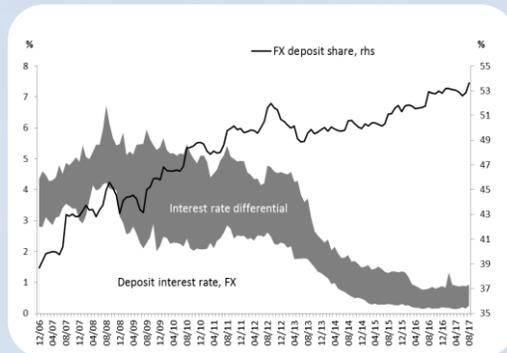


Source: BoA

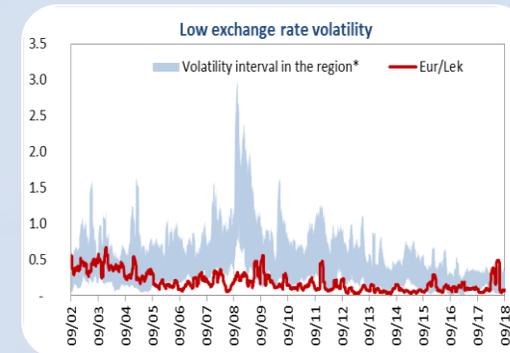
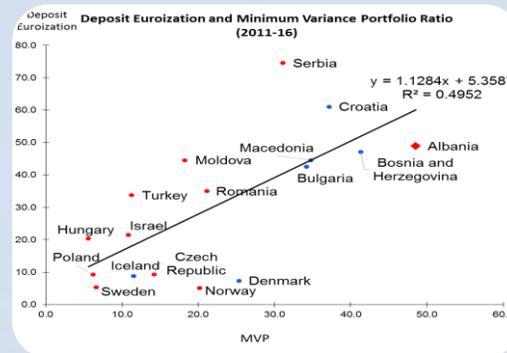
Euroization drivers in Albania



Source: OeNB "Euro survey" 2017, Relative Trust



Source: WP Euroization Drivers and Effective Policy Response: An Application to the case of Albania



Source: BoA, National Central Banks

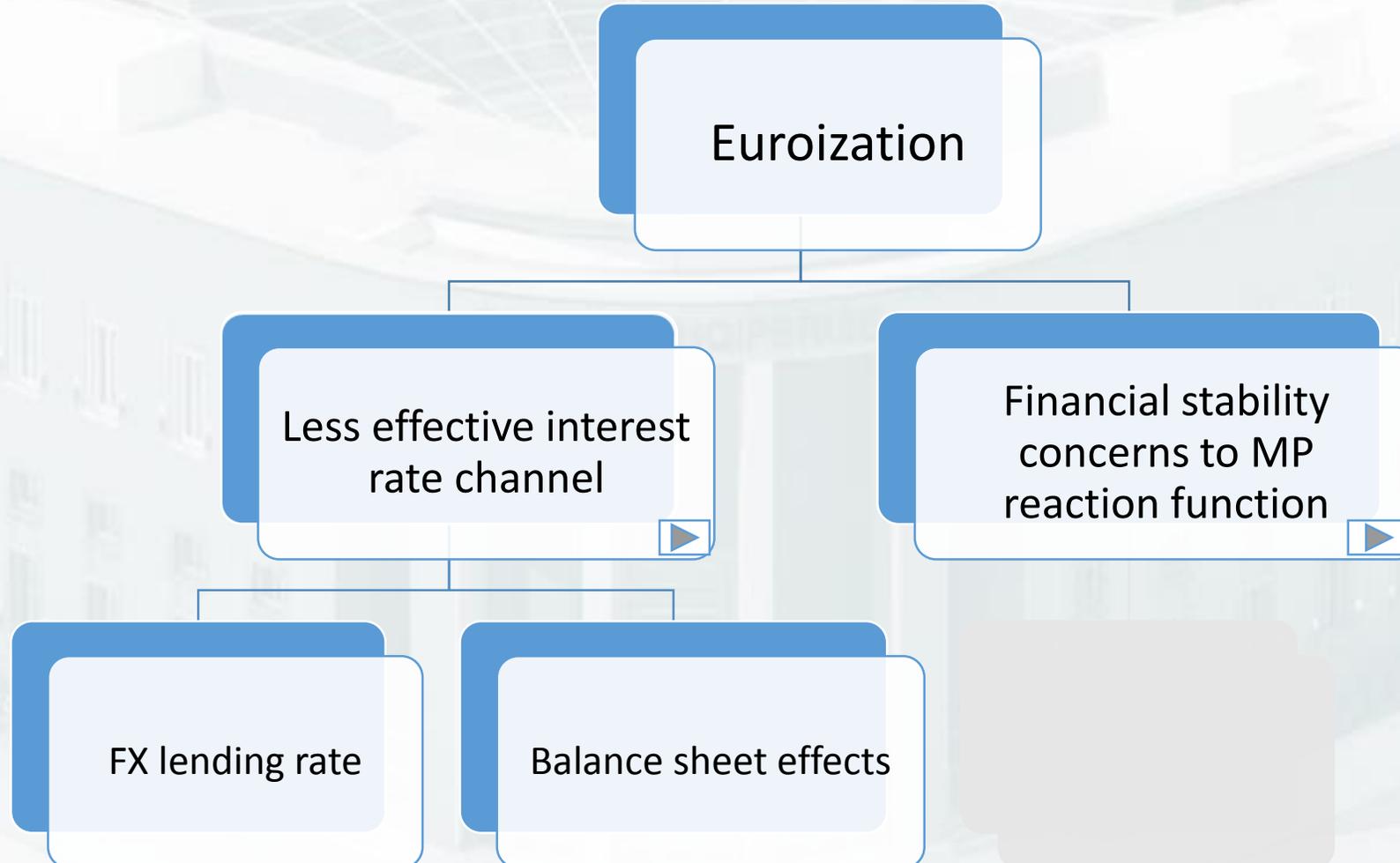
Hysteresis has been a historical driver of euroization ...

Partly driven by interest rate differential...

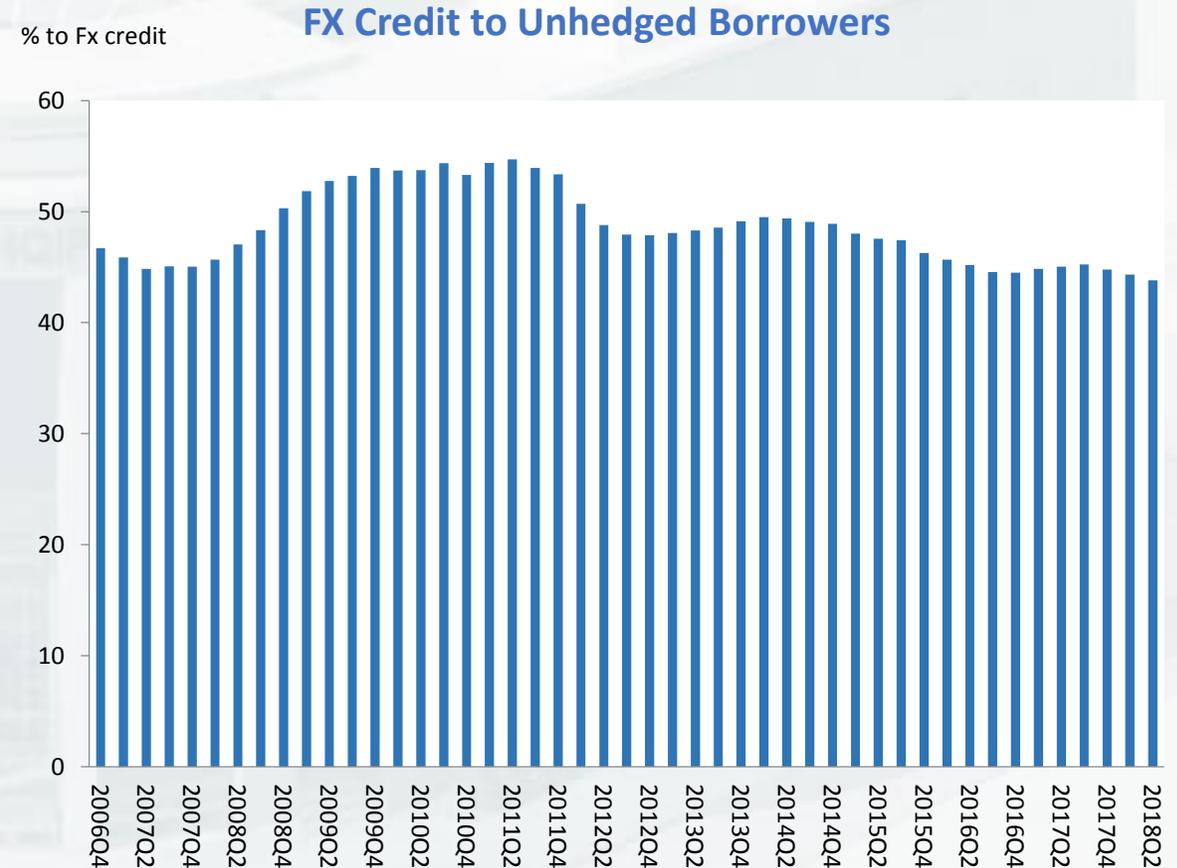
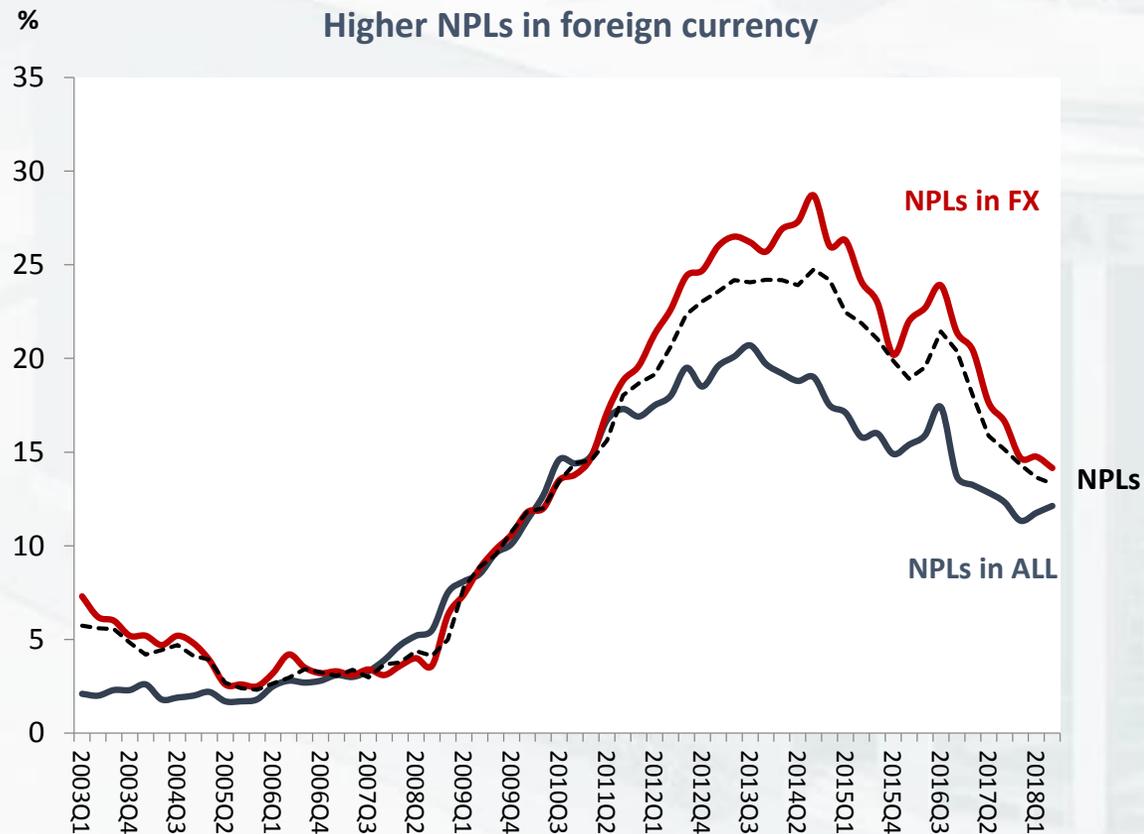
...partly facilitated by portfolio optimization...

... and exchange rate mispricing due to lower ER volatility in the domestic market

Euroization complicates monetary policy transmission in various ways



Euroization complicates monetary policy transmission by introducing financial stability concerns to the MP reaction function

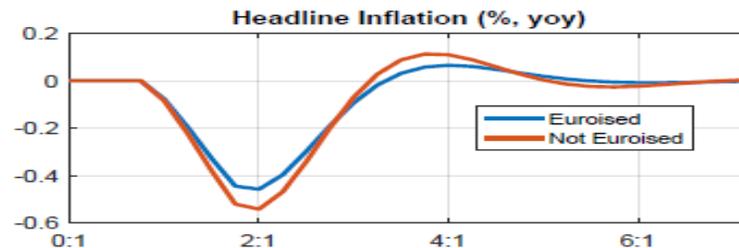
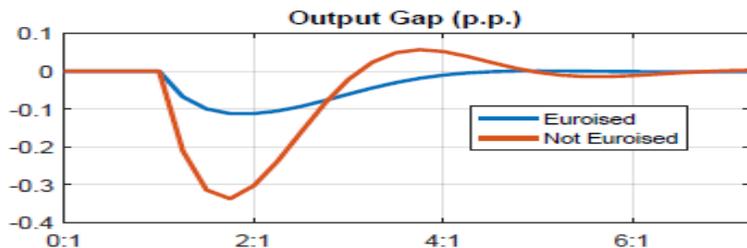
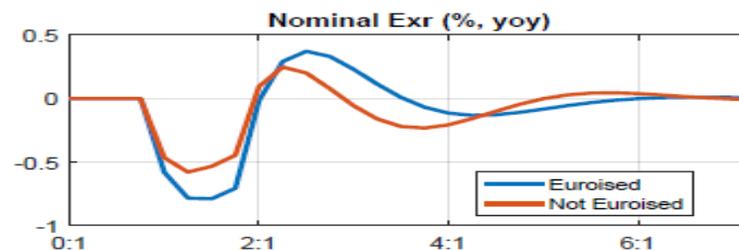
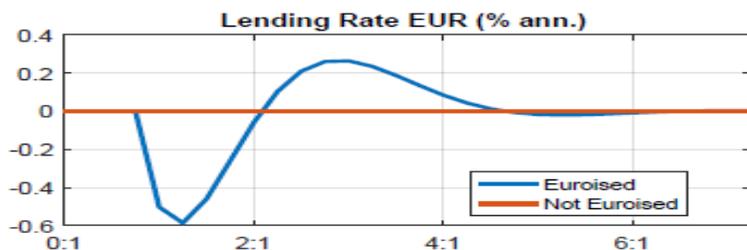
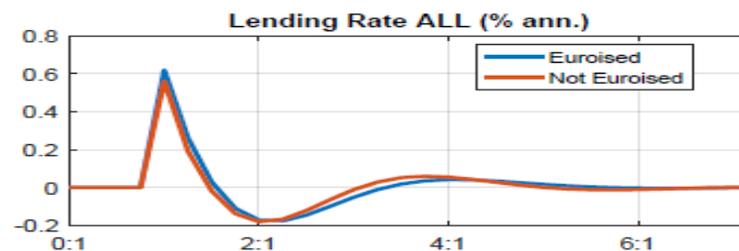
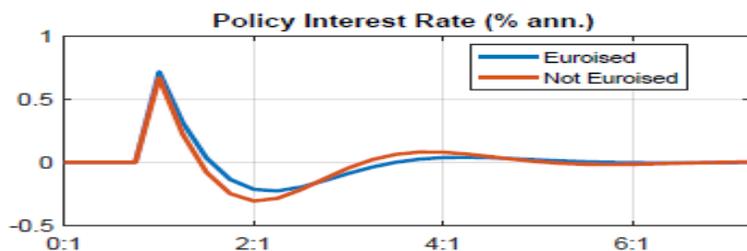


Source: BoA

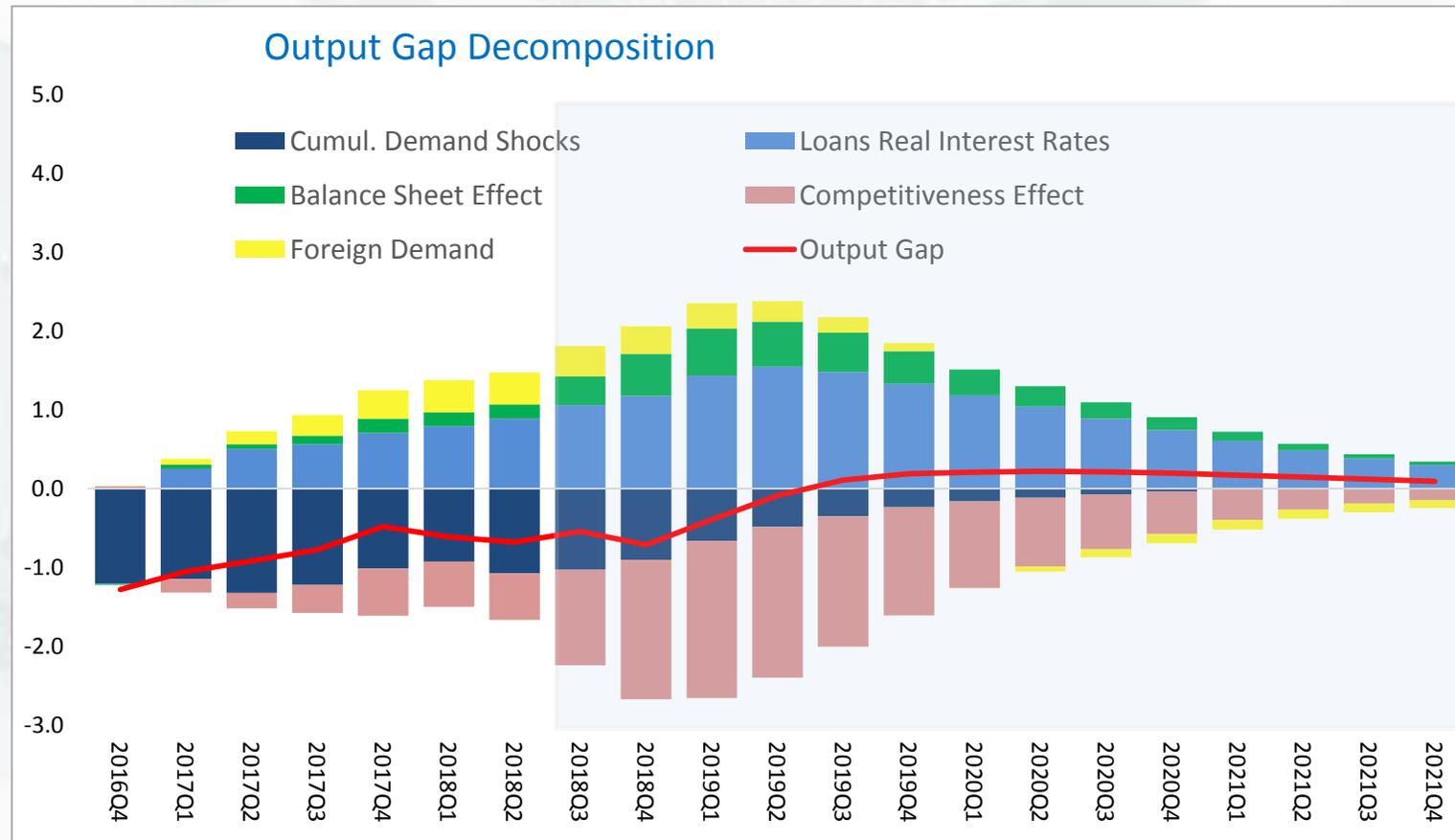
Financial euroization limits policy rate impact to real variables in Albania

MP shock propagation in Albanian economy and in hypothetical non euroized Albanian economy

+1 p.p. Shock to Policy Rate

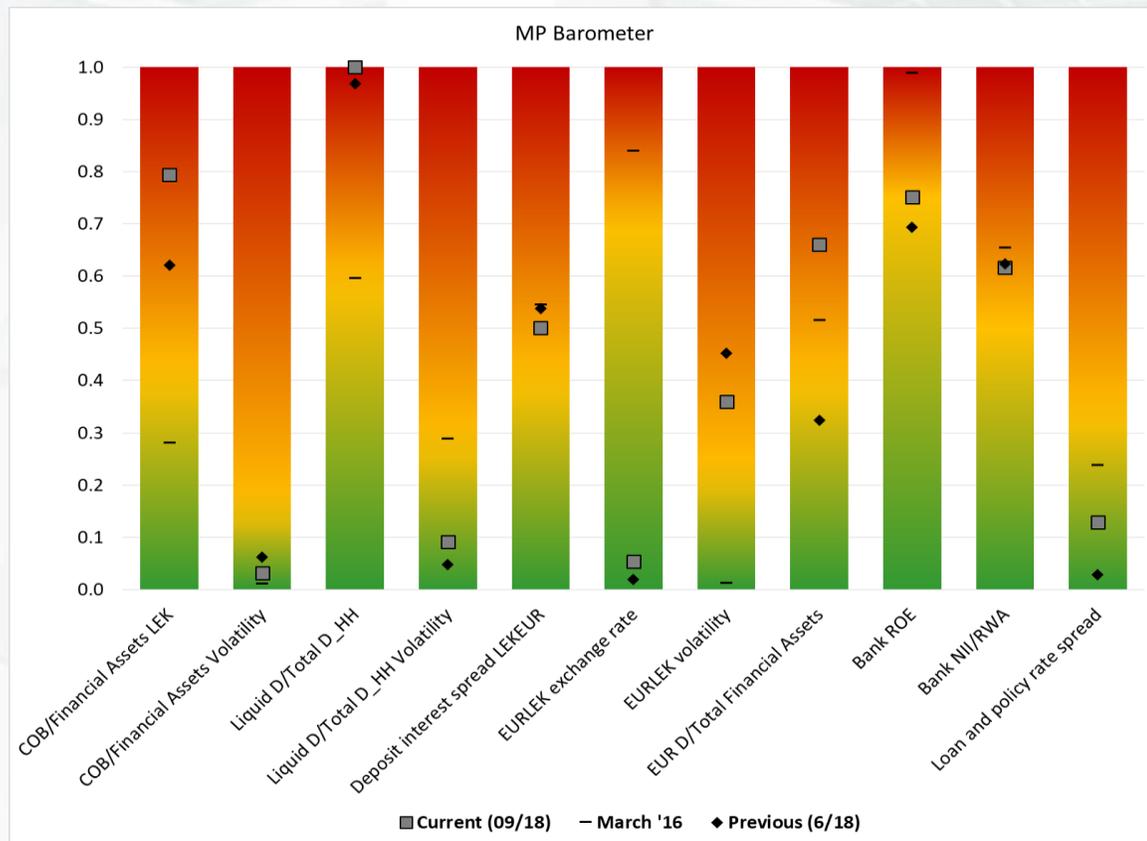


BoA monetary policy decisions and analyses take into account implications from financial euroization



Source: BoA

BoA monetary policy decisions and analyses take into account the impact of MP on financial stability



- The monetary policy barometer as non-parametric tool to account for the impact of monetary policy on the:
 - Composition and maturity of banking system liabilities
 - Impact on exchange rate (and, potentially, on the balance sheets)
 - The impact on RoA & RoE of the banking system
 - The impact on the volatility (and implied risk premia) of financial markets

*IMF Working Paper 'The Effective Lower Policy Rate Bound in Albania', by Guido della Valle, Romain Veyrune, Erald Themeli, Ezequiel Cabezon, and Shaoyu Guo

Bank of Albania has taken various macro-prudential measures to directly and indirectly address financial euroization

Higher risk weights
(150%) for FX loans to
un-hedged borrowers
(since from 2008)

Higher liquidity
ratios requirements
(since 2013)

Lower capital requirements
for domestic loans
(since 2013)

4 times the regulatory
capital backing for FX
loans
(since 2008)

Higher capital
requirements for
placements abroad
(since 2013)

Bank of Albania has embarked on a set of structural reforms

Structural reforms to improve the effectiveness of the transmission mechanism and reduce financial vulnerabilities

Develop domestic financial market to improve liquidity, enhance efficiency and promote resilience

NPL resolution strategy to reduce credit risk and enhance financial intermediation

Promotion of the use of the national currency. The set of measures introduced in 2018, include:

- Differentiation between required reserve ratios for Lek and FX liabilities
- Differentiation between the regulatory liquidity ratios for Lek and FX liabilities
- Increase awareness of borrowers for risks related to credit in foreign currency

Conclusions

- Euroization imposes challenges to the conduct of monetary policy through altering the relative importance of interest rate and exchange rate transmission channels;
- Monetary policy decisions and analyses conducted by BoA corroborates this feature;
- The BoA has taken an active role in the process of promoting the use of Lek though the implementation of an appropriate mix of sound macroeconomic policies, structural reforms, micro and macro prudential measures;
- Successful policies requires time, persistence and coordinated efforts

References

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- Olta Manjani, (2013), “Determinants of financial euroization in Albania”;
- Guido della Valle, Vasilika Kota, Romain Veyrune, Ezequiel Cabezon, and Shaoyu Guo, (2018), “Euroization Drivers and Effective Policy Response An Application to the Case of Albania”;
- Guido della Valle, Erald Themeli, Romain Veyrune, Ezequiel Cabezon, and Shaoyu Guo, (2018), “The Effective Lower Bound for the Policy Rate in Euroized Economies—An Application to the Case of Albania”
- Ulrich Windischbauer, April 2016, Occasional Paper Series, “Strengthening the role of local currencies in EU candidate and potential candidate countries”
- *Nazim Belhocine, Ernesto Crivelli, Nan Geng, Tiberiu Scutaru, Johannes Wiegand, and Zaijin Zhan, (2016), “Taking Stock of Monetary and Exchange Rate Regimes in Emerging Europe”*

Monetary policy framework in Albania

Albania is one of the few Western Balkans with an explicit inflation targeting framework

Pre-crisis

Inflation targeting
adopted in 2009

Goal:
Price stability
Numerical target of 3%

Free floating
exchange rate

Monetary policy
toolkit

Reverse Repo
(seven day maturity)

Reserve requirement

Standing Facilities
(corridor)

Post-crisis

Inflation targeting

Goal:
Price stability
Numerical target of 3%

Free floating
exchange rate

Increased focus
on financial
stability

Monetary policy
toolkit

Reverse Repo
(expansion of eligible
collateral)

Reserve requirement
(differentiation)

Standing Facilities
(corridor)

Forward Guidance
since 2013