The Policies of Bank of Albania for Providing Financial Stability. The Role and the Effects of the Macroprudential Instruments 2006-2014

Orkida Ilollari
Lecturer at European University of Tirana
orkida.ilollari@uet.edu.al

Abstract

This study is an attempt to look onto the hypothesis, forecasts and questions that are now at the center of the economic world debates on ensuring financial stablity. The purpose of this study is to give a contribution in improving the use of the macroprudential instruments and the real impact they have on the economy. This study aims to collect and analyse data in assessing the performance of the macroprudential instruments, to create institutional regulations in regards to monetary policy and to make a prediction about the right moment when these instruments should be activated. It may be possible that crises are less costly for the economy and achieve the financial stability. These macroprudential instruments, adapted acording the characteristics of each country, may be able to utilise all the appropriate means to contain the systemic risk.The main focus of this study is to analyse the monetary policies and the macroprudential instruments used by central banks as the supervisory authorities in ensuring financial stability. As also stated by the IMF in its report: "Lessons from the Crisis" (May, 2010b), macroprudential supervision policies are the main instruments to ensure the financial stability".The macroprudential instruments include the inherited requests and the accumulation of the capital in the perspective of the provisions of liquidity indicators and the prudential assessment of the collateral. The implementation of the macroprudential instruments involves directly the European Central Bank whose objectives are not limited to the traditional control inflation and output gap. The latter are focused on the accumulation of risks in the financial system of a macroprudential nature to gain an increased resilience of the financial system. Central bankers should consider

the consequences of their decisions on the financial stability. They are often called as "the defenders of the currency".In this study we aim to examine the issues mentioned above and lead the reader in exploring an important topic to the global economy and macroprudential measures taken by central banks to manage the recent crisis.

Keywords: *Financial stability, Macro–prudential regulation, Micro–prudential regulation Innovation, Fiscal crises*

The aim of the study

- To contribute to the further improvement of the implementation of the macroprudential instruments in Albania and the real impact they have on the economy.
- To look into the monetary policies and the macroprudential instruments used by the Central Bank as the supervisory body that provides economic stability and improves the difficult situations.
- To collect, to analyse and assess the performance of macroprudential instruments, institutional arrangements for the direction of monetary policy and make a prediction about the moment when these instruments should be activated.
- To hihglight the role of the Central Bank in this new macro-regulating asset, because the implementation of the macroprudential instruments involves directly the Central Bank. Its monetary policies should also rely on other objectives in addition to the traditional ones.
- To study the accumulation of the financial system risks and the use of macroprudential instruments in conjunction with fiscal and monetary policies; aiming the financial stability.

Limitations

A broad research study has its own limitations due to the fact that the subject of the study is still a hot topic that is being discussed at high levels of banking and important international institutions. There are rapid developments and findings on this matter and this is one of the limitations of this study. BOA is adapting the macroprudential instruments since the begining of the crisis in 2007 till present. This adaptation is acocmompanied by the inevitable limitations.

There are a number of challenges and limitations when it comes to macroprudential policies:

- A strong governance is difficult to be achieved when success is not easily measurable but the costs are immediate.
- The calibration of macroprudential instruments is difficult due to the uncertainty of transmitting of macro tools.
- It is difficult to identify systemic risk eventhough there are developments on the quantitative approaches.
- Closing regulatory gaps is necessary and challenging as it often requires legislative changes.
- The macroprudential policies tend to be disregarded in the national level and through cross-border arbitrage.
- The flexible use of these instruments is needed to keep pace with the developments in the financial sector, but it may clash with the political and legal traditions (IMF, 2013c).

In a few years time more experience would have been gained in using macroprudential instruments. Further research will contribute to improving the policies and in identifying systemic risk and consequently reduce the odds of a deeper crisis. The policymakers need to be engaged with the challenges and avoid pitfalls in the design and implementation of macroprudential policies (IMF, 2013c).

Hypothesis 1: In order to ensure positive effect of macro-prudential measures, adopted by the Bank of Albania, on non-performing loans as well for banking and financial stability, it requires that the macro-prudential instruments should be conceived in complexity, they should be applied as preventive measures and to anticipate difficult economic and financial situations of the country.

Hypothesis 2: To ensure an effective banking supervision, that ensures long-term financial and macroeconomic stability, also to be effective in preventing potential crises, is required the adoption of micro and macro prudential qualitative structures, as complementary elements of the accompanying monetary policy.

Research questions: During this study arised few issues for the importance of using macro-prudential instruments, research questions are as follows:

- In addition to traditional instruments, what measures should be implemented to facilitate crisis management, banking and financial sustainability?
- Does the Central Bank provides long-term financial and macroeconomic sustainability, using macroprudential instruments and non-conventional monetary policy?
- Does exist the interaction between monetary, microprudential and macro-prudential policy?

- If the Central Bank of Albania has implemented macro-prudential instruments, which are their effects, also what is the cost of their implementation?
- Can we admitt that the successful macro-prudential measures in a country are functional for all the other countries?

Survey Methodology

This study will analyse the relation between the macroprudential policies and the real economy stability and its growth. The methodology of this study deals with the macroeconomic data, financial instability and lack of macroprudential supervision. The data used are taken prior and during the recent crisis of 2007. The opinions on this topic range from the critics of the application of models being used to the newest almost unpredictable applications, significant for the living costs of the population. This study will focus on the effect of macroprudential policies to improve the economy, inflation, as well as creating a favorable economic environment for business in general. One of the main objectives of the European model is the creation of a favorable economic environment. The data sources used for this study are from international statistics, IMF financial (IFS), Eurostat, INSTAT, BoA, ECB, Fed, ESRB, BIS, BB etc.

Questionnaire

For the benefits of this study and to have a better understanding on the impact of the macroprudential instruments, a survey has been conducted. The respondents are important people working in commercial banks, managing important businesses, specialists, members of the Supervisory Board of BoA, economists and academics. There have been completed correctly 68 out of 75 surveys. During the interview, the respondents were not limited only to answering the questions but they have given their opinion in regards to the macroprudential instruments used in our country. All survey data are processed with the SPSS software.

Crisis Mechanism

From the first half of the nineteenth century, crises have occurred periodically or cyclically in the capitalist economies. What characterises the crises of this era is that they are different from those that erupted in pre-capitalist economies. In the ancient societies the crises were manifested by hunger. Crises were caused by natural disasters, epidemics and famine which caused death. One example that can be mentioned is the epidemic of year 1348 year which killed about one third of the European population. It took many generations until normal living conditions were achieved.

According to Porter (2010), unlike what happened in the previous crisis, the global crisis of 2007 was caused by the abundance as well as surplus production. The business crisis appear on one side with excessive production and on the other side with a significant lack of buyers that consequently had a lack of money. Classical economists based on the "Say" law have agreed that such an event may happen. According to this law, "all sales are purchased immediately and conversely, every purchase is a sale" (Clower and Leijonhufvud, 1981). What this law means is that "the capitalist economy is nothing more but a simple monetary economy, where money is a medium of exchange which makes it easier to trade under normal conditions between varied types of products". Based on this law, "those who sell goods use immediately all the money earned from the sale to buy goods in the market which are brought from other manufacturers." In this way supply and demand match and consequently the economic system will be in balance.

The economic cycles and crises

It is acknowledged by renowned economists that the capitalist economy has a cyclical pattern. The debates amongst academics, economists and historians are in regards the duration of economic cycles, with the ability to adjust these cycles and prevent crises. Crisis are a crucial element of the economic cycle that reach the maximum point when crises break. As Kuznets (2010) states it is important to show the economic cyclical movement before the compiling the crisis analysis.

Economic cycle goes through several stages:

- Recovery
- Expansion
- Recession
- Depression

During the recovery phase, prices, production, employment rate and incomes rise until they reach a maximum point, which is also known as the expansion phase, whereas during the recession it occurs the opposite. In recession the employment rate, production, prices and revenues drop until they reach the minimum level. This is known as the stage of depression. After this phase the recovery starts again. In this way the cycle continues its normal course. If the cycle is repeated with the regularity, we say that the economy will be in a stable phase, i.e. after every last phase the economy will return to the previous one. During the "welfare" (prosperity) phase which coincides with the recovery- expansion phase of the economic cycle there is an increase of the demand for goods. This leads to an increase in prices and consequently in a growth of the production capacity.

Types of financial crisis

The literature has provided for years some types of financial crises. According to Jeffrey D. Sachs (1995), financial crises are categorised into three types:

Fiscal crises: occurring when the governments lose in an immediate way the prospects of impacting on the foreign debt and attract foreign investors. In this case the government is forced to revise the terms of repayment of its obligations or fail to pay.

Exchange rate crises: Occur when the market participants shift instantly their demand from the domestic currency assets to foreign currency assets by emptying the the foreign currency reserves of the central bank.

Banking Crises: Occur when the commercial banks lose instantly the ability to cope with an immediate withdrawal of deposits and to influence market instruments. This leads the bank to an illiquid situation with higher chances of bankruptcy. On the other hand, the banking panic is considered as one of the main types of financial crises. This was the main reason that this type of crisis has been part of many studies.

The activity of the banks is to invest in long-term illiquid assets in the form of loans and to issue short-term liabilities in the form of deposit contracts. Banks are highly vulnerable towards the withdrawal of the deposits and this can lead to the closure and liquidation of a bank. A financial crisis which bears the form of a banking panic occurs when the depositors of some or all banks in the system tend to withdraw their funds instantly (Sachs, 1995). The only institution that can intervene to minimize the panic up to eliminating this phenomenon is the Central Bank. A sound functioning of these institutions by identifying and implementing specific policies and regulations can eliminate panic and ensure financial sustainability.

The relation between Central Bank and Financial stability

The origin of the term "macroprudential" dates back to the 1970s in the context of the internal documents of Cooke Commission's (predecessor of the Basel Committee on Banking Supervision). Parties involved in the monetary policies have various definitions of the "macroprudential" term. According to the IMF (2011a) this term means a policy that aims to maintain the financial stability.Public references to macroprudential policies have started in the mid 1980s and it was developed in the 2000s. This term is used today as a continuous approach to financial regulation and supervision. It started to be used with the exact term "macro-prudential policy" only after the recent global crisis (Galati & Moessner, 2011).

What is the macroprudential policy?

It is important to give a definition to this policy. With macroprudential policy, we come to understand the efforts made by all the macroprudential policy makers that tend to contain the systemic risk, i.e. the risk of breaking the offer for financial services caused by a damage to the financial system. Gerlach (2013) states that this leads to serious adverse situations like the economy and prosperity. Normally, there are used the same prudential tools that the macroprudential supervisors use to contain the risk of individual financial companies.

It is worth mentioning even though there are many policies that may be used to strengthen the financial system as a whole, only those policies that are controlled by macroprudential policy constitute the so-called macroprudential policy (Gerlach, 2013).

The last global crisis of 2007-2013 highlighted the fact that the traditional policies used to achieve macroeconomic stability were not enough to ensure the financial stability. The interactions between individual companies could create interdependence and it was more likely to develop the systemic risk (Gerlach, 2013). According this author there were three main factors that led to using macroprudential policy:

Firstly, the tendency of the financial system as a whole one to amplify strong shocks, for example, banks can react to a declining economy by stopping lending.

Secondly, the auxiliary instruments should expose by adverse shocks. For example, the interdependence between the loan price and assets may lead to a situation where the loan of the bank increases the price of assets including the value of collateral.

Thirdly, the financial links that increase the vulnerability of the system to strong shocks. Although many of these links may appear in the form of direct exposure, they can be "captured" by regulators and appear as implied warranties in derivatives and financial markets (Gerlach, 2013).

What are the options of macroprudential policy?

Macroprudential policy topped the international financial policy agenda in the wake of the recent crisis and it is relatively not tested as an area of economic policies (BIS, 2010).

As a result, there isn't still a broad consensus on best practices proven in the field. The policymakers trying to implement it faced a series of difficult choices.

Firstly, the macroprudential policymakers should exercise one or more policy instruments to address a specific systemic risk. The use of multiple instruments is useful because it allows the policymakers to pursue different aspects of the same systemic risk. It may have negative results due to the fact that many instruments means more unintended consequences and these cases are often recognized as regulatory leaks. Aiyar et al (2012) state in their recent research on English banks that the "regulated"[1] banks reduce lending in response to tighter macroprudential requirements for capital that aim to mitigate the credit cycle. While the "unregulated" banks increase lending in response to tighter requirements for capital to a respective group of regulated banks. Regulatory flow is significant (ESRB, 2011).

Secondly, the policymakers must choose between the systemic risk objectives. For example, targeting certain types of transactions the policy instruments could be potentially more effective and accurate.

Thirdly, the macroprudential policy should balance the confidentiality and rules. The instruments based on rules operate through a principle of systemic risk indicators. These rules act as a protector against the inability of policymakers and tolerance, to predict the timing and magnitude of the effects of policy.

These rules are difficult to design and implement, while discretion allows policymakers to learn from the interaction between the financial system, economy and macroprudential policy.

Fourth, the policies should be calibrated with time. An effective macro-prudential policy interweaves both; the unchanging rules that hinder the formation of systemic risk and the policies that tighten up when the systemic risk is perceived to be significantly increased (BIS, 2011).

The difference between macro and microprudential perspectives

In order to identify the difference between macroprudential and microprudential financial stability we should look at the objectives of each them. The objective of macroprudential policy perspective can be defined as limiting the costs in economy by the financial concerns as a result of the policies used. The target in this case can be thought of as limiting the possibility of failure and related costs that accompany this failure. The latter is often expressed as limiting systemic risk. While, for the objective of microprudential policy perspective we can say that it is in regards to limiting the possibility of failure of individual institutions (Crockett, 2000).

[1] This term originates from microeconomic problems in regards to the ability of creditors of the bank to monitor risks originating from loans as well as micro and macroeconomic problems about the stability of the banking system in the event of crisis (Bigar & Himler, 2005)

The macroprudential perspective is focused more on the risks and failures associated with these risks rather than in the comparative analysis between institutions. The latter are considered less important as they do not lead to the right track. Significant emphasis is given to the organization's characteristics, such as its size.

The microprudential perspective on the other hand, is the opposite. This perspective considers any institution in its own right and does not deal with correlations. It considers the comparison between rganizations as a monitoring tool (Crockett, 2000). Based on the same study Crockett states that the traditional microprudential regulation aims to increase the safety and soundness of individual financial institutions, while the macroprudential one focuses on the wellbeing of the financial system as a whole. On the microprudential perspective, risk is taken as exogenous assuming a "potential shock", which could cause a financial crisis. The macroprudential perspective on the other hand, recognizes that risk factors can be considered endogenous. In addition to what is said above, the macroprudential policies is directed to individual financial institutions, markets and their shared exposure to economic risk factors. It also focuses on pro-cyclical behavior of the financial system in an effort to promote stability in the whole (Hahm et al, 2011). The role of microprudential and monetary policy are intertwined with each other, while the role of macro-prudential policy is separated from the first two. The macroprudential policy aims to stabilize the combined price of goods and services in an economy. Another key objective of this policy is the provision of financial stability, which constantly provides services to financial intermediaries throughout the credit cycle. What happened in the economy in the last decade shows the difference. In this period of increased demand it was as much as the supply capacity of the economy. The goals of macro-prudential policies are in fact similar to macroeconomic policy goals.

The effectiveness of macroprudential instruments

If macro-prudential instruments are used accordingly they can be applied to identify successfully the specific risks (IMF, 2010). There have been three different approaches to assess the effectiveness of the macroprudential instruments (IMF, 2011b). The first is a case study that examines the use of instruments in a small number of countries to see if they have achieved the intended objectives.

The second is a simple approach that examines the performance of objective risk variables before and after the macroprudential instrument goes in action. The third is a more sophisticated approach that uses regression model. The effect of macro-prudential instruments is assessed with different risk variables by comparing it to the activation of an adversarial scenario where the instrument does not apply any macroprudential instrument. Parts of the evaluation are also the objections and difficulties encountered.

First, there were difficulties in obtaining data and their quality. The preferred data were those of companies since many of the macroprudential instruments aimed the trial balances of these financial institutions, but these are not easily obtainable and consistent over time and states. Moreover, the number of countries that use macroprudential instruments is small due to the fact that these policies are implemented in the recent years. This limits the level of security in the statistical analysis (IMF, 2011b). The relation between cause and effect is not direct and in some cases is not even possible because the selection would favor only those countries that have high risks and whose policies are implemented in response to developments in the economy and the market.

Even the empirical analysis does not take into account issues such as costs and distortions which are both important factors when using these instruments. Despite this, the data provided is valuable on assessing the effectiveness of macroprudential instruments. The experiences of several countries show that the use of instruments to achieve the intended objectives has managed to succeed. Some countries use the instruments by their own, and the others combine and coordinate them with other policies (IMF, 2013).

Instruments are comprehensive but may be targeted too. Some countries do not change the instruments meanwhile others regulate them according to their discretion. Experience shows that the instruments can be considered effective at various levels for specific circumstances of a country, regardless of the size of the financial sector or the exchange rate regime. For example, in China the authorities managed in 2010 to reduce credit growth and house price inflation by taking a series of measures including fiscal and monetary measures (Borges & Gon, 2013).

In Eastern Europe, the authorities adopted various measures to control bank loans in foreign currency. The instruments seem to have had an effect in slowing credit growth, capital formation and liquidity coverage. While in Spain, for example, the authorities introduced dynamic provisioning as their macroprudential instrument. This instrument appears to have had an effect on the coverage of lost loans during the global financial crisis, but the coverage was incomplete because of the scale of losses. A range of instruments can be effective to treat systemic risks. The degree of effectiveness does not depend on the stage of economic development or the exchange rate. Developing economies with a fixed exchange rate and interest rate limited tend to use more widely macroprudential instruments. The same instruments are equally effective when used in developed countries with flexible exchange regimes rate. The cost of the implementation of macroprudential instruments should be taken into account when calculating the benefits from these instruments (IMF, 2011a).

Important on implementing successfully the macroprudential instruments are a good structure and strong supervision. According to IMF (2011b) when the macroprudential instruments are applied, it should be taken into account that the same instruments are not equally effective in all countries where they are applied. Instruments used are needed to address the systemic risks as listed below:

- The appropriate instruments that can be used for the systemic risks caused by inflation or credit growth are those related to the loans, such as cap DTI and LTV (IMF, 2011b).
- In the cases of system liquidity risks, the instruments that may be used are in regards to the mismatch of liquidity restrictions or limitations in the net position in foreign currency (if the liquidity risk derives from the foreign currency funding) (IMF, 2011b).
- For risks caused by the effect of the financial leverage it can be used the instruments related to capital. The latter creates a countercyclical situation through changes in capital requirements and asset risk weight. In this way it is possible restriction of excessive growth of financial leverage. If this growth is due to the demand of banks to expand lending, these measures can be filled with instruments related to credit (IMF, 2011b).
- If the above risks are created as a result of capital flows then the above listed instruments can be used. Instruments used for liquidity are effective in limiting foreign currency funding. In this context, the instruments related to capital may be useful for limiting the credit growth (IMF, 2011b).

Different countries have adopted the design and calibration of instruments based on their particular circumstances such as resource and risk type, their system's ability to avoid instruments, the quality of surveillance, implementation, management and arrangements regarding the macroprudential policy.

Based on the report of IMF (2011b) the use of multiple instruments can impose a higher cost for banks, so it is important to be chose those instruments that will minimize the cost in order not to incur losses in the financial sector.

Some of macroprudential instruments can be used to address specific risks, but of course there are exceptions. The adaptation of macroprudential instruments is used at different stages of the cycle to mitigate the cyclical nature. Instruments that have obvious benefits should be used more often. Two examples that can be given are: dynamic provisioning and capital buffer cover.

The use of these instruments helps in predicting the regulatory environment. These two instruments are an exception, because the other instruments as the cap LTV and DTI may need to be adjusted according to the decision makers (IMF, 2011a). To use freely these instruments it is necessary to have a structure to manage the development of macroprudential policies. Within this structure should also be a mechanism to identify and monitor systemic risk. Also, there are many fiscal and monetary instruments used to treat systemic risk, so it is needed a clear communication strategy and an important set of rules to make it work. The use of macro-prudential instruments combined with instruments of monetary and fiscal policy to address systemic risk tends to be more effective when the financial sector risks are related to those of other sectors (IMF, 2013).

The macroprudential policy should only be used as a complement to monetary policy, which is the most direct way. On the other hand, the macroprudential policy is the most appropriate one for specific areas and the main reason for using the macroprudential policies is the financial stability (CANUTO & Cavallari, 2013).

The effects of the global crisis of 2007 in Albania

Albania could not be spared from the global crisis of 2007 and its negative consequences. Compared to other countries, our country has an economy that generates less revenue. The GDP and exports are not as big as in other countries of the developed world. The effects of the international financial crisis emerged in the last quarter of 2008. This was distinguished by the slowdown in credit growth, balance payments, marked slowdown in economic growth and declining incomes. These negative effects appeared by the end of 2008 and they deepened even more in 2009.Even though the international financial markets are non-existent in Albania they are extremely important to their parents Albanian banks, due to the simple fact of obtaining the necessary funds. Currently, these funds are also more expensive than before the crisis began. These banks depend on borrowed funds to support their credit activities, which are vital for their activities in Albania. The banks that have a sound ratio of loans - deposits could be more successful in avoiding such expenses. Additional costs will be translated into a higher cost of borrowing, which would then be reflected to the economy whose players are heavily dependent on loans to finance their activities. One of the main measures undertaken by the banking system in Albania was to curb lending, which was very aggressive not long ago.

The banking system at that moment was characterized by the difficulties in the process of lending because the well costs of loaning were also high. It occurred that the ratio of nonperforming loans grew. The high level of nonperforming loans slowed also the growth rate of credit activities. Even in Albania the global trend was reflected. There was a price drop in the real estate sector which would jeopardize the situation in the banking system and the real economy. A reduction on the cash flow from the immigrants and a decrease of the exports were some of the effects that Albania faced. Depreciation of the country's currency (ALL) clearly showed that Albanians are faced with the global crisis.

Some factors that showed the effects of the global crisis in Albania were: 1) Inflation growth and the gradual depreciation of ALL in the foreign exchange market; 2) a sharp decline in sales of real estate; 3) Decrease in the process of obtaining bank loans and deposits; 4) The gradual increase prices closely related to consumer items. The financial crisis triggered a decline in purchasing power; this fact was confirmed by the decline in imports.

The impact of the crisis in Albania was shown in: 1) the decrease of foreign investments; 2) A reduction on the cash flow from the immigrants 3) increase in prices of groceries and non-food products; 4) tightening of loans by commercial banks; 5) the impact on the housing market, as a result of a change in the prices of imported materials; 6) a decrease of the interest rate on deposits in commercial banks.

Remittances impacted the Albanian economy. The cash flow provided from the immigrants are a valuable economic assistance not only for their families, but also for the whole economy. The remittance flows for the developing countries are estimated as approximately two times more than the aid that these countries have taken for development, given the fact that the only source of income were the remittance from the immigrants. Albania has a very limited financial network, which does not allow its citizens to spend more than their income. Also, most of the families have a low level of incomes. A drop of this level due to the impact of the global financial crisis, particularly as a result of lower income from remittances has forced the families to cut costs. Less developed countries are exposed to the crisis as they are more integrated than before the global economy through trade, foreign investment and the immigrants' remittances.

Which sectors are affected by the crisis in our country?

BoA highlights on the Financial Sustainability Report (2013) that due to the consequences of the global economic crisis the construction sector, exporting businesses as well as processing industry were the most affected sectors. According to the commercial banks in Albania there are the businesses of these sectors, which have more difficulty in repaying bank loans. As a result of the contraction of lending to the economy in general the construction sector showed liquidity problems as a result even hesitation customers to invest. Even the export sector had liquidity problems, delays by the foreign partners. Commercial banks in turn, began to make careful analysis of lending, while interest rates rose, particularly those in the euro. Banks were reserved by long-term financing. Another reason for the tightening of lending was also increasing "bad loans" (NPL). The conditions of granting credit, commercial banks tightened credit standards applied by the increasing demand for collateral in relation to the size of the loan. Business already, you will need to possess the greatest amount of real estate to enable disbursement of credit by banks.

The functioning of the monetary policy in Albania by implementing macroprudential instruments

The monetary policy is the macroeconomic policy established by the Central Bank. It includes the management of currencies, interest rates and it is a tool used by the government of a country to achieve macroeconomic objectives such as economic growth, inflation, consumption and liquidity.

Monetary policy includes the legal basis on which is laid the theoretical framework that is used for its modeling as well as the intermediate and operational objectives of monetary policy in the context of the instruments used for their implementation. This policy includes intervention of the Bank of Albania to the financial markets to achieve the objectives set.

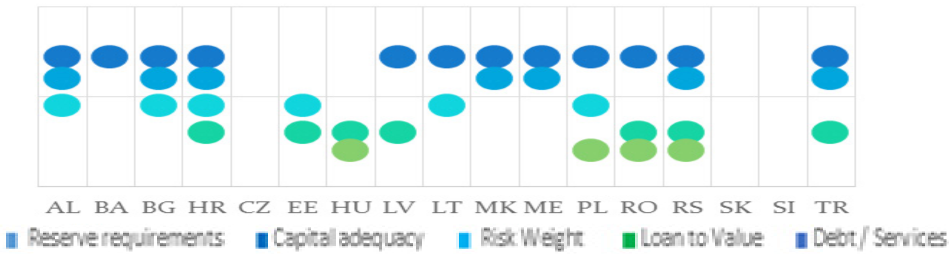
The development of the appropriate macroprudential policiy is closely related to the identification and implementation of prudential measures for the prevention, restriction and treatment of systemic financial risks. In the framework of macro-prudential policies, the Bank of Albania was based on institutional independence and maintaining the primary objective of control over the annual inflation rate (X International Conference of BoA, 2012). Bank of Albania began discussing about engaging macroprudential instruments in order to rely on the most consolidated instruments of the monetary policy. In order to have effective macroprudential policies it is required the establishment of an adequate institutional framework, where the responsibilities and harmonization of actions between the public authorities concerned are well defined. Also, these policies require the development of specific instruments, which assess the possibilities of developing systemic risks in time and scope of these risks in different sectors. These macroprudential instruments also enable the treatment of these risks. Many renowned economists stress the importance of macro-prudential policy interaction with monetary policy.

When the economic cycle is caused mainly by supply shocks, the macroprudential policy generates only modest benefits for macroeconomic stability. There are considerable benefits of macroprudential policies when the financial shocks affect loan offers. In such cases, a central bank helps the macropudential authority improve the overall economic stability of the country.

The implementation of macroprudential instruments from the Bank of Albania and various countries in Central and Eastern Europe

Many emerging market economies, such as our country, have used and use macro-prudential measures based on active and maintain liquidity to the financial system from possible shocks. In an attempt to reduce the risk of exchange rate, many countries followed the rules to limit the open currency positions. In the following table are shown the macroprudential measures implemented in Albania and in some countries in Central and Eastern Europe. Many of the countries in the region use macroprudential instruments for risk management purposes. Almost all of these countries use reserve requirements as an instrument of monetary policy and the capital adequacy ratio (Madhusudan Mohanty: X Conference BOA 2012). In fact, these countries have been amongst the first ones to implement macroprudential instruments.

FIGURE 1: Macroprudential instruments used by central banks **AND REGULATORS** of Central and Eastern Europe (2004-2012)



Sources: IMF, Banks' official websites (Kuruc and Takats 2004-2012), as cited by Madhusudan Mohanty in his article: "Capital flows, monetary policy and the Impossible Trinity" (The 10th BoA's conference2012).

Countries that are shown in the above table: Al = Albania; BA = Bosnia & Herzegovina; BG = Bulgaria; HR = Croatia; CZ = Czech Republic; EE = Estonia; HU = Hungary; LV = Latvia; LT = Lithuania; MK = Macedonia; ME = Montenegro; PL = Poland; RO = Romania; RS = Serbia; SK = Slovakia; SI = Slovenia; TR = Turkey. So, the period that these countries have used macro-prudential instruments, starts from 2004 until 2012.If we refer to our country, we see that the measures that were used before the crisis period were:

- Demand for reserve
- Capital Adequacy
- Risk weighting

Macroprudential instruments implemented from the Bank of Albania

By highlighting the economic slowdown, BoA began to analyze new tools and techniques to fulfill its mission. The economic slowdown was seen by BoA as the main risk faced by the Albanian economy and financial system. Appreciating the role that bank loans have in the economic activity, the Bank of Albania adopted a package of macro-prudential measures oriented towards promoting loans and reducing risk in the banking system (Bulletin of BoA, 2012).
In March, 2013 the Bank of Albania adopted another set of macroprudential instruments, aiming to promote credit, provide liquidity in the country and reduce risk in the banking system. These instruments consist:

- facilitating capital requirements for credit growth;
- relieve liquidity requirements;
- to increase the capital requirements for assets abroad based on rates required by the Bank of Albania;
- encouraging the domestic loans in the foreign currency;
- reduce the restructured loan provisioning;
- higher risk weight: risk weights are prudential indicators set by the regulatory authority.

For certain instruments this provides a better coverage of risk capital, as well as incentives for conservative management of exposure levels to entities / certain sectors.

BoA is implementing conservative standards for the classification and provisioning of non-performing loans. These standards provide a clear reflection of the quality of the loan portfolio, to identify the effects on financial performance and consequently the position of their capitalization.

Bank of Albania has adopted tightening regulations for capital commercial banks that invest outside the Albanian border. These regulations itself aimed at increasing the availability of resources for domestic lending. It can be said that these regulations have contributed in this regard. The set of regulations implemented by BoA to promote lending has given tangible results in the case of some commercial banks (BOA, 2014). However, their effectiveness at the system level is conditioned by important exogenous factors, especially from low tolerance to risk that banks originating from the EU exhibit. The latter is conditioned by the situation in the eurozone and the measures taken by the authorities of the EU, but also because of an overall lower domestic demand for credit and economic agents' uncertainty on future developments in the economy.One of the key instruments launched BoA was restructuring loans. This is an important process that affects the proactive administration of risk of further deterioration of NPLs.

All this effort comes to enable repayment of obligations in terms of the specific difficulties the borrower faces. The full effects of these instruments depend on the level of involvement of banks in this process, which still need to be verified. BoA took adequate measures for ensuring liquidity in the country. BoA insured that the banking system remains liquid and able to pay obligations to counterparties and depositors at any time through regulatory changes that improved the level and quality of liquidity to commercial banks forced to wear (BOA, 2014).

One of the key moments during the crisis was to encouraging domestic loans in foreign currency. This was influenced by a number of factors that are given below:

- interest rate differences on loans in ALL and foreign currency
- historical fluctuations in the exchange rate, which could be considered little or no impact
- presence of many foreign-owned banks
- high level of «euroism» in the economy
- lack of long-term debt in local currency
- large opening of the economy
- bank prudential rules for direct management of risks in exchange rate.

In terms of macro-prudential measures that BoA implemented during the recent crisis, as well as for to assist this study, it became necessary to conducting a survey to the relevant people specialized in banking institutions, academics, financial supervisory authorities, businesses, economists, etc. The questions asked in the survey are in regards to the macroprudential instruments that BoA implemented during the recent crisis, if these instruments succeeded to protect the country from the strong crisis shocks, etc. Based on the analysis as well as a comparison with surveys conducted, this study offers its conclusions and recommendations.

Conclusions

Micro and macro prudential measures put in place by the Bank of Albania led to preventing difficult economic and financial situations. Macroprudential measures implemented by the Bank of Albania aimed at maintaining banking and financial stability in the country, as well as handle the shocks caused by the crisis.

Through regulatory changes which improved the level and quality of liquidity of commercial banks, Bank of Albania assured that our banking system remained liquid and that was able to pay its obligations to depositors at any time. At the conditions of a banking and financial market like ours, the Bank of Albania undertook measures that buffered potential problems in advance. BoA managed to curb the effect of the loans, the emergence of currency abroad, provided sufficient capital duly undertaken and strictly supervised commercial banks.

BoA has been using macro-prudential instruments during the recent crisis in order to maintain banking and financial stability. In 2007 it used the highest risk weights, stricter LTV and DTI for the commercial banks by exceeding the limits of the credit growth rate and levels of NPL. The use of micro and macroprudential instruments combined with fiscal monetary policy instruments becomes effective when the risks of the banking and financial sector are intertwined with other sectors of the economy. If BoA uses properly the macroprudential instruments by BoA, they can be applied to effectively identify specific risks. Micro and macroprudential measures put in place by the Bank of Albania have led not only to banking stability but also in improving the profitability of commercial banks. Effective macroprudential policies facilitate the scope of the monetary policy, avoid the implication to additional objectives beyond that of price stability. Not only the monetary policies but also the macroprudential and economic ones which should be seriously involved in the administration of financial instability.

Monetary policies alone cannot fight the economic crisis and financial instability. Not all instruments used can provide immediate effects and on time. Effective macroprudential policies designed to increase the resiliency of the financial system make it easier for the scope of monetary policy. Implementation of multiple macroprudential instruments constitutes a greater regulatory and administrative burden. The value and the importance of the stability of the financial system must be understood separately and not as the sum of intermediaries and the markets in which it is composed. The challenge of financial stability is closely related to the ability to identify and measure risks and to put in place effective macro-prudential policies. There is still much work that needs to be done in establishing an effective system for the analysis of systemic risks and immediate intervention. Effective macro-prudential policies, designed to increase the resistance of financial systems, make it easier for the scope of monetary policies. Financial stability should be supervised with macroprudential policies, which should be in place to control the risk of the financial system. The implementation of short-term macroprudential policies is associated with costs. The wider is the effect of macroprudential instruments and the tighter it is, the more costly will be the implementation of that instrument. It would cause a major failure of the banking and financial stability if we relied solely on microprudential financial regulation.

Recommendations

For the macroprudential policies to be effective it is required the establishment of an appropriate institutional framework, where the responsibilities and harmonization of actions between the public authorities concerned are well defined. The macroprudential policies should be complemented by strong macroeconomic policies including fiscal, monetary and structural as these policies are not effective in limiting systemic risk. Policymakers should not believe that any quantitative approach is sufficient for systemic risk assessment. They must be aware of the limitations of the techniques used to assess the full dimension of systemic risks. Policymakers should not be "misled" by the present macroeconomic stability as inequalities often grow under the surface of apparent tranquility.

It cannot be expected that macro-prudential policies to prevent all future crises. Policymakers must recognize that the crisis will continue to occur. They should be prepared for crisis management through appropriate policies. The use of macro-prudential instruments may be useful when it is not desirable a tight monetary policy, as these instruments only affect some sectors without reducing economic activity. Commercial banks should be able to understand, address and address their weaknesses. There should be a closer cooperation between BoA and commercial banks because the suggestion to adopt mitigation measures of enforcement and risk management more effectively will give positive effects. The risk for those commercial banks which have lent in foreign currency should be mitigated through appropriate pricing mechanisms, while the risk for borrowers with income in local currency which are credited in foreign currency may be adopted by implementing tighter rates of LTV and DTI.

The use of prudential measures that BoA implemented in 2013 requires attention particularly when trying to stimulate lending. Prudential measures to stimulate lending usually bear the risk of financial instability. To help banks on the quality of new loans, BoA should encourage more strict practices of financial reporting by large corporate borrowers. Macro-prudential instruments used by the Bank of Albania have been effective in resolving the deficiencies, but their use should be expanded to cover more risk management issues

References

Angelini, et al., 2012

Aiyer, S., Calomiris, C. & Wieladek, T. (2012), Does Macro-Pru Leak? Evidence from a UK Policy Experiment, NBER Working Paper Series, 17822.

Banka e Shqipërisë, 2013, Raporti i Stabilitetit Financiar për gjashtëmujorin e parë të vitit 2013 http://www.bankofalbania.org/web/pub/sektori_bankar_copy_2_6187_1.pdf accessed on 01/03/2014.

Banka e Shqipërisë, 2013, Raporti i Stabilitetit Financiar për gjashtëmujorin e dytë të vitit 2013,http://www.bankofalbania.org/web/Raporti i Stabilitetit Financiar për gjashtëmujorin e dytë të vitit 2013 7065 1.php

BIS (2009a), 80th BIS Annual Report 2009/10, Macroprudential policy and addressing

procyclicality, Bank for International Settlements, 89-102.
Biggar, D & Heimler, A. (2005), International competition network - antitrust enforcement in regulated sectors - an increasing role for competition in the regulation of banks, Bonn.
Borges, C. S. & Gon, P. B., (2013), Emerging Countries' Perspectives on Development and Financial Regulation: Brazil and China's Approaches to Macroprudential Policy.
Buletini i Bankës së Shqipërisë (201), Banka e Shqipërisë 47, 6M-1.
Canuto, O., Cavallari, M., (2013), Monetary Policy and Macroprudential Regulation: Whither Emerging Markets, World Bank Policy Research Working Paper, 6310.
Clower, R.W. and Leijonhufvud, A. (1981). Say's principle, what it means and doesn't mean. Intermountain Economic Review, Oxford University press.
Crockett, A. 2000. Marrying the micro-and macro-prudential dimensions of financial stability. BIS speeches, 21.
ESRB, (2011), Recommendation on the macroprudential mandate of national authorities, Official Journal of the European Union, 3.
Galati, G. & Moessner, R., (2011), Macroprudential policy – a literature review, Working Papers BIS, 337, February.
Gerlach, S. (2013), Macroprudential Policy in Ireland, Central Bank of Ireland.
Hahm, J., Mishkin, F.S.,Shin, H.S., & Shin K, 2011, Asia economic policy conference Asia's role in the post-crisis global economy : Macroprudential Policies in Open Emerging Economies.
International Monetary Fund, (2011a), Macroprudential Policy: An Organizing Framework
International Monetary Fund (2011b), Macroprudential Policy: What Instruments and how to use them, Lessons from Country Experiences.
International Monetary Fund 2011c, Developments in Financial Supervision and the Use of Macroprudential Measures in Central America, Board Paper (Washington: International Monetary Fund).
International Monetary Fund, (2011a), Macroprudential Policy: An Organizing Framework
International Monetary Fund, (2013b). The Interaction of Monetary and Macroprudential Policies, 2013, International Settlements.
Porteri, A., (2010), La crisi, le banche e i merchati finanziari,102.
Sachs, D. J. (1995), Alternative Approaches to Financial Crises in Emerging Markets, Background paper for dis cussion during meetings in Basel, SZ, December 9-10, 1995
Simon Kuznets, "Schumpeter's Business Cycles", American Economic Review, vol. 30, n. 2, pp. 257-271