The Influence of Financial System in Albanian Economy

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Abstract: *During the last years Albanian Financial System has continued its stable growth. The quite good financial outcome, in both banking sector and non-bank financial sector, was due to the better use of the financial sources and the ongoing relatively quick expansion of the investment activities with high return. The long-term trend for a gradual decline of the capital adequacy indicator of the financial system and particularly of the banking sector has continued, but the declining rate is reducing. The assets of the financial system have been steadily growing, but the weight of the non-banking financial sector still remains low, thus limiting the contribution of this sector on the stable development of the overall financial system. This article discusses the progress and the influence that the financial system has itself as a creator of money, not only lending. Is good for our analysis to remember how this concept has a direct impact on economic factors such as: the commercial debt that has been raised in recent months, inflation which has increased, and direct investments which have fallen. Naturally we are going to illustrate the principal methods that the financial management uses to prevent the various risks that represent the financial market, and which are the most appropriate indicators to analyze the situation of the Albanian financial system.*

Keywords: *Banking sector, financial system, GDP, FSA in Albania, banking indicators, creator of money, inflation, direct investment*.

1. Introduction

Banks have the important role of creating money, and therefore in changing the money supply. The process of money creation stands in the base of the monetary transmission mechanism which shows how the shifts of the money supply, through the bank products and expenditures, have its influence on changes that occur in aggregate demand, price levels and in real production. Banks that operate in Albanian territory are subjects of the Albanian Legislation; they are coordinated with each other through the Central Bank of Albania.

The Bank of Albania plays an important role in monitoring the activities of loan companies through the management of loans to commercial banks, particularly through the base interest rate and the direct control over the money supply. The measures taken by the Bank of Albania at changing the money supply through its interest rates monetary policies influence the size of aggregate demand.

Banks and loan companies are financial intermediaries, based on the fact that they make possible the transaction of money from the agents with surplus to the agents with deficit of money. Their main activity is the collection of funds "temporarily in surplus" by the various economic agents that have positive savings, and their transfer to the agents in

deficit, as businesses, government agencies or families for their investment activities or even for the consuming expenditures.

Unlike the other types of financial intermediaries, banks issue financial liabilities that perform the money functions (bank deposits) and we say that they have a monetary function.

Financial intermediaries collect the savings of various economic agents and transfer them in the form of credit, to the borrowers who may be consumers, or businesses, or even public entities. Banks and the other financial intermediaries pay an interest rate for borrowing the funds in the form of deposits. This interest rate of accepted deposits we call passive interest rate. Further, they charge with higher interest rates the funds which they lend to other agents. This loan interest rate we call active interest rate.

The difference between these two interest rates is called margin of interest or of intermediation which covers the operating costs and, it creates net profits. Banks and the other financial intermediaries make up the credit market where the interest rate presents the price.

Another advantage of financial intermediaries is their ability to reduce portfolio risk through portfolio diversification. They undertake the risk of the combination of maturities between assets and liabilities to best suit to the preferences of agents with surplus and of agents with deficit of the economy. Banks are often the only financing possibility for specific strategic sectors of the economy, serving to the most efficient allocation of collected funds.

Finally, the financial institutions play a special role in increasing the efficiency of payment service, which affects in economic development. There exist a large number of financial institutions that perform these functions and that have the above advantages, but starting by their characteristics, they are classified as: bank financial institutions, non-bank financial institutions and financial investment institutions.

In this paper, with financial intermediaries, we mean the bank financial institutions, because the banking system is the most developed segment of the financial sector in Albania.

2. Contribution and Benefits of the Study

The purpose of this paper is to identify the influence of the financial system in the performance of the Albanian economy reflected in the macroeconomic indicators. This influence will be seen in light of risk assessment, in the Central Bank's role in the creation of money, in lending activity, etc.

This technical article will serve to the Albanian politicians and legislators. It will serve even to the managers of the Bank of Albania, to the students and to the professors of the economy faculties and to the analysts or researchers of monetary policy field.

For this article we have used data available by the Bank of Albania, as well as by other competent authorities that supervise the financial market activity.

3. The methodology

In this paper we used the method of analysis of statistical data. Through method of comparison between different monetary indicators, statistical and econometric methods we have illustrate the relationship of monetary aggregates.

To assess the risks arising due to interaction with the surrounding environment, are analyzed macroeconomic developments as well as internally to market economies to foreign partners. There are evaluated and the overall economic growth expectations, the general price level, exchange rate and fiscal indicators. There are analyzed the latest developments in international financial markets and is making an assessment of their impact on the country's financial system and banking sector.

Also, is assessed the borrowers' solvency on the basis of personal income through the employment situation. To assess the risks arising from the operation of the financial system we have analyzed the developments of the key indicators of financial progress such as capital, asset quality and financial performance.

4. Hypotheses

Analyzing the Central Bank's decision making on Albanian economy in terms of impact of international economy we wondered:

> ➢ When the government applied expansionary fiscal policy, the Central Bank of Albania what kind of policies applied?

> ➢ Did the Central Bank accompany the policies of the other foreign central banks, as the ECB, Feed, etc.?
> ➢ Which was the impact of the expansionary fiscal policies over the public debt?

Exactly how did the banking system react as part of the General Albanian Financial System to foreign influences, to improve the negative impacts of macroeconomic indicators and economic development?

5. Statistical Data over the Current Situation of the Financial System in Albania

During the recent years, the financial sector has been moved toward a international banking system, where the majority of banks are foreign owned and where the presence of financial institutions of the EU is quite large. The Capital Flows channeled through the banking sector led to a rapid increase of domestic credit in almost the whole country.

The real economic indicators confirm that during the third quarter of 2011, the growth rate of the Albanian economy has improved. Each month of the period, the annual inflation rates have fluctuated around the targeted rate by the Bank of Albania (3%), followed by a stable exchange rate, a significant correction of the trade deficit and of the current account[1].

Deposit growth (individuals have increased their savings in the form of deposits with 17.5% in annual terms) has improved liquidity in the banking sector by providing better support for private investment[2]. Also, the average level of credit in the economy during the second half of 2010 has been in slower rates despite the marked improvement in the last two months of the year. The cost of financing remains an element that can be better used by banks to stimulate the growth of lending activity.

Actually the Albanian financial market is dominated by the actions of the interbank market, of debt securities of the government and of foreign exchange. The other segments related to insurance, reinsurance and pension funds represent a small fraction of the total volume of financial market. During 2010-2011, the financial market situation has improved.

The interest rates in the interbank market showed a downward trend as liquidity indicators have improved as a result of the steady growth of deposits and of supporting operations of the Bank of Albania. In the market of securities of government debt, the demand of participants generally has been greater than the supply[3].

Regarding to the cost of intermediation by the banking sector, it is noted that the difference between the average lending rate and the average deposits rate in domestic currency (ALL) operations has narrowed to 0.78 points of percentage. The reduction of loan interest rates, from 12.7% to 11.8%, gave the key contribute. The deposit rates in ALL are presented more stable, dropping during the period from 5.18% to 5.1%. For the foreign currencies this difference has narrowed with 0.28 points of percentage for the actions in American Dollars, and 0.8 points of percentage for actions in Euros, mainly due to the reduction of the loan rate in Euro[4].

In domestic market, the fight to narrow the trade and the budget deficit has helped to alleviate the depreciating pressures of Albanian currency. The depreciation of Albanian currency against the late currencies has reflected the developments in the international exchange markets. The better functioning of payment systems and AECH and AIPS, which are administered by the Bank of Albania, has supported the financial market activity.

Financial intermediation in Albania, estimated as the ratio of financial sector assets[5] to GDP[6] is estimated at 85.7% in late 2010, by 84.4%, which was estimated in the first half of the year and 82% at the end of year 2009. The banking sector continues to remain the leading segment of financial intermediation in Albania, while non-bank financial sector continues to occupy a small share to the entire financial system.

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[1] Mehilli T. Note that to get these results (29/09/2011) Bank of Albania has reduced the base interest rate by 0.5% in order to increase investment and reduce trade deficit, to increase the consumption that at the end of August (2011) amounted to 3.1% compared with that of January 2011 which marked out 4.1%.

[2] In late 2010, business borrowing increased by 14.7% compared with the same month a year ago. Source: Bank of Albania

[3] Mehilli T. I want to recall that, the Albanian Government in the second half of 2011 had increased the interest rate of his treasury bills from its 7.5% at 7.66%.

[4] Financial Stability Report for the second half of 2010 Author: Financial Stability Department, Dt. 20.04.2011 Published by: Bank of Albania, the square "Avni Rustem", Nr.24, Tirana

[5] Mehilli T. From theory we know that the financial system consists of: banks, non-bank financial institutions, insurance companies, savings & loan companies and supplementary private pension funds.

[6] The IMF's forecast for nominal GDP is distributed across quarters based on the distribution of quarterly real GDP, which is published by INSTAT, for 2010 the value of GDP has been realized about 1,224 billion lekë.

Thus, the total assets of the nonbank[7] financial sector, represents about 5.45% of total financial system assets, from 5.6% the previous semester. Non-banking sector activity represents about 4.8% of GDP of the country, almost at the same level, marking a six-month earlier and 0.45 percentage points more in comparison with year-end 2009.

To ensure a well-capitalized and balanced bank activity, as well as encouraging banks for a careful control of operating risks, aiming the increasing of bank transparences to customers, to improve the security environment in the business of lending the Bank of Albania has adopted regulatory changes to ensure the value of the loan. In this regard the development of "Register of Credit" is one of the achievements of the Central Bank.

But the most important improvement is that of making the regulation "On credit risk management." These improvements have been made to maintain the stability of the banking system but also the stability of the financial system too. A need which is particularly pronounced in the recent years when the credit of the banking system is associated with an increased ratio of problematic loans total loans (now over 18.4% of total loans). Improved regulation increases the demand for better management of developments in the field of credit and in maintaining its quality.

6. Risks of financial intermediaries and preventing methods

During recent years, the activity of financial intermediation has been subject to major changes. In fact, the activity of banks has expanded significantly and they do not have as duty only the mobilization and allocation of funds. As a result, have changed and increased the risk types that are commonly associated with the financial intermediation. In particular, we can mention here **the market risks** (Bundo SH. 2012) that may affect the value of stock portfolios, the value of bonds and of loans.

Among the market risks we can mention the three following:

- The risk of interest
- Foreign exchange risk,
- The risk of price.

Interest rate risk is the risk associated with assets and / or sensitive liabilities to changes of interest rate. In fact, a change in the interest rate may affect the value of assets and liabilities held in the portfolio. But, above all, such a change could adversely affect the "gap" created between assets and liabilities hold by an intermediary. In theory, to be protected from interest rate risk, there are introduced several methods and models that help us to manage this risk. In particular, we can mention the techniques of financial protection as "Gap Analysis" and "Duration Gap Analysis".

Referring to price risk, we say that it is the risk associated with stock prices of a portfolio. In particular, the portfolio may contain shares whose price varies according to the expectations that investors have. Usually, to cover this risk it is important to diversify the portfolio by selecting stocks / securities that are not related between them.

Foreign exchange risk is verified at the moment when a financial intermediary has established balance sheet assets and liabilities in other currencies than euro, taking the latter as reference currency. The risk of currency exchanges can be invalid in cases where the intermediaries do not have to conduct transactions in different currencies or where the assets and the liabilities denoted in foreign currency not only have the same expiration date but also have the same value.

In contrast, the bank assumes a risk of exchange rate, when the assets and liabilities have different values even if denoted in the same currency. In this case, an exchange in euro/ currency will result in a non-zero effect on economic performance, because there will be a disequilibrium at the end of the term in denoting in euro the transactions denominated in the currency in question. We can manage the identification, measurement and protection from currency risk using the methods of Asset & Liability Management, similar to what happens in credit risk management. In order to manage this risk, the intermediary should minimize the mismatch that is created within the portfolio. Another way to manage the currency risk is the use of derivatives / such contracts as swaps/currency swaps, spot, forwards, options and futures in foreign exchange rates. If we refer to the intermediaries who provide loans in foreign currency, we can say that they are subject not only to the exchange rate risk but event to the credit risk. In order to assess the risk of currency exchange, you first should design a cash budget in relation to monetary assets flows in foreign currencies, which makes

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[7] The data of non-bank financial institutions, of the insurance companies and SHKK refer to the third quarter of 2010, while for the non-bank financial institutions and pension funds supplementary information refer to the end of the year 2010 (as published by AMF).

known the exposures which are subject to risk. Thus, a preliminary analysis refers to the time of the various items in the balance sheet to see whether the assets and liabilities match or not.

In order to correct the exposure to exchange rate risk we can use additional financial transactions.

6.1 Statistical evaluation of the activity risks of the Albanian financial system

Relating to the assessment of risks to which is facing the banking sector, the Bank of Albania realizes steadily test of resistance in the sensitivity analysis form and of different scenarios show that the banking sector in general remains stable to different shocks referred to quality and adequacy of capital. As regards to the market risks, the results of these tests show for a moderate impact of the direct risk of exchange rate, due to the low value of open position in foreign currency of the banking sector. In relation to interest rate risk, the difference between sensitive assets and liabilities to interest rate dictates a lower risk for the maturity terms up to three months.

The risk appears more highlighted for longer terms of maturity. However, resistance exercise test shows that the impact of this risk in the indicator of capital adequacy of the banking sector appears moderate. In this context, the recent increase in food, energy and raw materials prices, can lead to higher interest rates in different countries due to the stability of increasing influence on of inflationary pressures. In the banking sector, for the existing portfolio of loans with variable interest rates, the possibility of increasing the interest rate for loans, although it may occur gradually, would be associated with increased burden for borrowers by affecting their ability to pay . For this reason, banks should consider such a possibility in their risk scenarios and should be ready to provide in the right time the relevant stocks.

In relation to liquidity risk[8], the ratio of liquid assets to short-term liabilities (with maturity up to one year) was estimated at 30.6%, versus 32.6% a year ago. The minimum value of this ratio determined from the regulatory framework is 20%. According to currencies, the value of this ratio is presented lower for the euro by about 15.6% and higher for ALL (lek) currency with about 42.9%. The differences between assets and liabilities according to the structures of maturity terms, both for the items of balance sheet, and even after the inclusion of the off-balance sheet items, result in negative values. However, these differences are covered for several times by the value of liquid assets, providing a full ability to pay the liabilities at the moment of their maturity. However, in this context, it is needed to be monitored carefully the situation of foreign currency liquidation, especially for the euro currency. Loans over deposits ratio was estimated at 60.4%, for about 4.8 percentage points lower than a year ago. The decline of this report was dictated by the slowdown of credit growth rate compared with the growth rate of deposits, especially for the foreign currency. Credit/deposits ratio for the transactions in foreign currency has resulted in a level of 86%, being about 13.4 percentage points lower than a year ago. Credit / deposits ratio in Lek has resulted 35.4%, being generally stable throughout the year.

However, the credit /deposit ratio is expected to grow again in the recovery phase of credit activity of banking sector. Another form of administration of short-term needs for liquidity is borrowing in the interbank market or borrowing to the Bank of Albania. Generally, this is a collateralized borrowing and the type and the sufficiency of assets that can serve as collateral in this case, is another element to be monitored for assessing the ability of banks on meeting their needs for liquidity in the short term.

Credit risk[9] remains the main risk for the Albanian banking sector. In late 2010, problematic loans were up at 68.5 billion, with an increase of 21.4 billion lek since the end of 2009. However, in the fourth quarter of 2010, the increase of problematic loans was 3.4 billion lek, the lowest in two years. Compared with November 2010, in December 2010 problematic loans have decreased by 1.1 billion lek. As a result, for the first time in the past two years, it results a decrease of the monthly index of problematic loans ratio, from 14.4% in November to 14.0% in December 2010. This performance can be a signal of the stability of problematic loans value, but however it is needed to be repeated in some other periods in order to be confirmed as a stable performance. The "net problematic loans to regulatory capital ratio", is increased at 35.9% compared with 28.2% a year ago. The loan portfolio quality has declined as for businesses, as well as for individuals. The ratio of problematic loans to the loans surplus for businesses and for individuals is estimated 15.5% and 11.7% respectively in December 2011. Also, the quality of loan portfolio according to the currency has declined for the credit portfolio in lek, and even for the credit portfolio in foreign currency. The indicators "problematic loans in lek/credit surplus in Lek" and "problematic loans in foreign currency / credit surplus in foreign currency" were

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[8] Financial Stability Report for the second half of 2010 Author: Financial Stability Department, Dt. 20.04.2011 Published by: Bank of Albania, the square "Avni Rustem", Nr.24, Tirana

[9] Financial Stability Report for the second half of 2010 Author: Financial Stability Department, Dt. 20.04.2011 Published by: Bank of Albania, the square "Avni Rustem", Nr.24, Tirana

estimated respectively at 14.4% and 13.7%. In response to the situation of credit risk, banking sector has created its own reserve funds to cope with potential losses. In late 2010, the reserve funds to manage the credit risk (provisioning) by lending to residents, went up to 36.1 billion leke, about 33% higher than their level at the end of 2009. The ratio of provisions to problematic credits was estimated at 52.7%, the highest historical level.

Regarding to the solvency, at the end of 2010, Albanian banking sector is considered as well capitalized. Capital adequacy ratio was estimated at 15.4%, being 0.8 percentage points lower than in June and compared to a year ago. The minimum level of this indicator determined by the regulatory framework is 12%. Regardless the level of capitalization of the banking sector is good at the individual level, the capital requirements should be carefully assessed and to be fulfilled at the right moment by the banks.

Though the tests of resistance in the sensitivity analysis show that the banking sector in general remains stable however, the sensitivity of individual banks' to these shocks has increased. For this reason, at the individual level, commercial banks need to assess their sustainability toward similar scenarios, and should act in advance for the strengthening of their capital state and for a better control of activity risks.

7. Correlation Executive - Central Banks (Albanian, EU) over the market problematic

The financial system has a special significance for the development of a country's economy.

This becomes even more specific when we talk for the economy of such countries as Albania, Macedonia, Kosovo and other eastern European countries, which represent different features compared to the other countries. It is this reason that in the analysis of these economies should be taken into account all the factors that that influencing.

Albanian economy is representing by a small market and depended on many economic aspects by the international economy, particularly those in terms of monetary policy. We say of monetary policy because even in Albania as well as in other countries of market economy the achievement of macroeconomic indicators is realized through policy instruments where the most prominent are fiscal instruments and monetary instruments.

Fiscal instruments are applied by the government in support of other instruments for the promotion and the development of the Economy. Generally, They imitate the other countries policies, in particular of those countries which have recently have as economic system the free market. This is seen to the structure of taxes and fiscal legislation, setting of the flat tax[10], and of other indirect taxes or in customs tariff system. Policies of Albanian Government in general are characterized by an expansionary fiscal policy on both sides: in the fiscal area and in the field of income distribution too. The Albanian Government, in the last 5 years, is generally concentrated to the growth of tax revenues according to two ways, first by reducing taxes and increasing the taxpaying entities and second fighting the tax evasion. The results of these policies have been and are visible in the budget indicators and in the macroeconomic indicators. Thus, from 2005 – 2011the Albanian economy has these key macroeconomic indicators.

Table No. 1: Some macroeconomic indicators

	Nominal GDP	Unemployment Rate	Inflation Rate	The Budget Deficit including grants. % to GDP	Public Debt in % to GDP	Current Account without Official Transfers in % to GDP	Exchange Rate Dollars - Lekë	Exchange Rate Euro - Lekë	GDP per capita in Dollars
2005	815	14.2	2	-3.5	57.4	-10	99.9	124.2	2597
2006	882	13.9	2.5	-3.3	56.1	-7.3	98.1	123.1	2854
2007	968	13.5	3.1	-3.5	53.5	-11.4	90.4	123.6	3394
2008	1089	13.2	2.6	-5.5	54.8	-15.8	83.9	122.8	4073
2009	1151	13.8	3.5	-7	59.5	-15.6	95	132.1	3765
2010		13.4	3.4		59.7		103.9	137.8	

Source: Bank of Albania, Monthly Statistical Report 05/2011

[10]) Mehilli T. Flat tax in reality corresponds at a proportional tax (10%)

The revenue in the budget from 2006 to 2010 are increased by 93.5 billion (324.7-229.4), and from 2008 to 2010 with 33.5 billion (324.7-291.2). The budget expenditures from 2006 to 2010 are increased with104 billion / ALL (362.8-258.8), while from 2008 to 2010 are increased by 11.3billion / ALL (362.8-351.5).

   According to the above data it is noted that the government has applied expansionary fiscal policies in that measure that has reached to an unsatisfactory debt limits. In 2011 the total debt to GDP has reached up to 59.7, so almost 60%. This is not a normal figure for an economy such as Albanian economy which in the recent years has mostly invested in infrastructure than in the other profitable sectors of the economy.

The Albanian government, particularly after 2008, the year which coincides with the aggravation of the global recession, applied highly expansionary fiscal policy. The sources of cash in domestic and foreign currency and were provided not only through incomes of taxation system, but also from the sale of state assets and the borrowing from foreign banks inside and outside the country. The Albanian government also tried to sell Eurobonds with a worth of 300 million Euros.

An important source of coverage of periodically deficits became the Government Bonds which were used widely.

In this way we emphasize that the Central Bank has a limited impact on the inflation indicator, which can be seen even from the relation of inflation rate with the base interest rate.

Table No.2: Base Interest Rate and the Inflation Rate

Nomination	2004	2005	2006	2007	2008	2009	2010
Interest Rate	5.25	5	5.5	6.25	6.25	5.25	5
Inflation Rate	2.2	2	2.5	3.1	2.6	3.5	3.4

Source: Bank of Albania, Monthly Statistical Report 05/2011

Table No.3: The relationship between interest rate and inflation rate
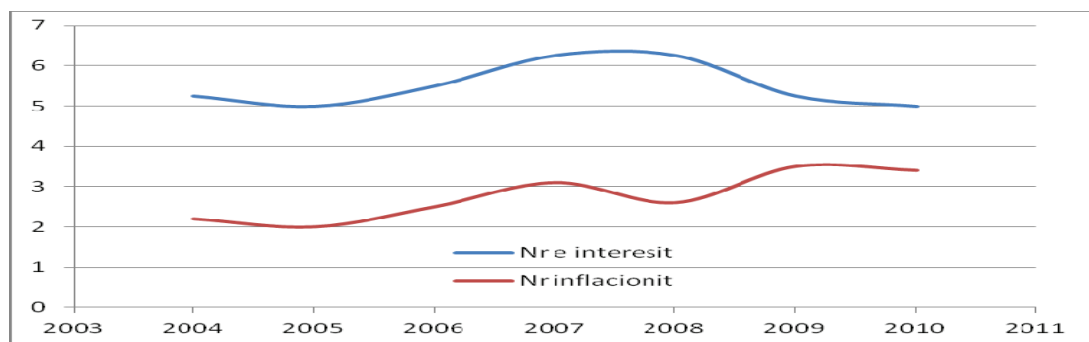
Source: Bank of Albania, Monthly Statistical Report 05/2011

The central bank should follow the example of the other central banks such as the European Central Banks and even the American FED. This is, because with the European countries we carry out the greatest volume of trade exchange and of circulation in general[11].

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[11] Naqellari A. Note that the lack of prompt reaction to the Central Bank to the interest rate has caused interest rate of the Albanian leke to be high at a time that the rate of loans in Euros and dollars to be much lower. So, the deposits have been high in domestic currency while the credit has been high in foreign currency. The remaining Leke as stock in bank, that stock that the private businesses did not withdraw for the account of high interest, it was the government who withdrew it by the government bonds. Thus, the Central Bank, with its restrictive policies, in place to withdraw the domestic currency toward the businesses, it stimulated the opposite effect of "reducing the investment spending"/ the crowding out.

Table No.4: Interest Rates for Loans from the Commercial Banks in%

	ALL Lek		Euro		Dollars	
	6m-1Year	1-3Year	6m-1Year	1-3 Year	6m-1 Year	1-3 Year
2008	11.11	13.29	6.72	7.89	6.98	6.96
2009	12.04	15.71	8.31	9.24	6.37	9.33
2010	11.52	15.42	6.18	8.49	6.66	7.84
2011(10)	11.17	12.16	6.34	8.61	6.88	7.68

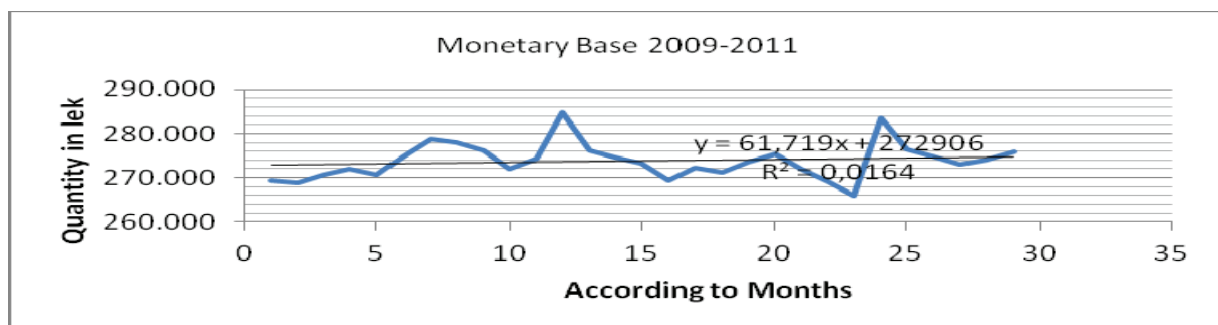**Source: Bank of Albania, Monthly Statistical Report 05/2011**

The above data show that the interest rate of credits in domestic currency is much higher than that in Euros and other foreign currency. This has led the economic agents to address to the foreign currency bypassing Albanian Lek currency. Under these conditions for the investment, the foreign currency takes importance rather than domestic lek currency which should not have happened and should not happen even today.

Besides the above indicators we have even a number of other indicators that point to the opposite effect Central Bank policies to development and market promotion. These are seen to the indicators or monetary aggregates as cash outside the bank, the monetary base, the aggregate M1, M2 and M3. The dynamics of these aggregates shows that they in general either have been increasing just a little or have been decreasing.

Table No.5: Monetary Aggregates

Average in billion/ALL lek	2008	2009	2010	2011
Monetary Base	229,108	274,212	205,829	274,889
Money outside mobilizing corporate	155,631	203,348	194,422	186,744
Aggregate M1	213,146	278,032	269,816	263,945
Aggregate M2	514,802	559,349	584,347	610,058
Aggregate M3	783,743	830,953	837,782	987,225

Source: Bank of Albania, Monthly Statistical Report 05/2011

Table No.6: Graphic of the monetary base indicator

Source: Bank of Albania, Monthly Statistical Report 05/2011

It is worth analyzing the first three aggregates because the latter aggregate requires a separate analysis because it deals not only with the loans in foreign currency granted within the country but has to do with the issuance of currency by commercial banks outside Albania as through earnings as well as through investments in financial products.

According to data, it is very clear that compared to 2009, we have stagnation of indicators, or we have to do with their decline. This situation is reflected to the indicator of economic growth. We cannot have economic growth without having an increased volume of the amount of money in circulation. It is suffice to recall the monetarist equation where V *M = p * GDP, and conclude that the policies of Albania Central Bank had not the required influence on economic growth and providing of other macroeconomic indicators.

8. Results

In Albania, actually, exist a insignificant classification for the risk. However, we can say that according to the indicators of the Albanian banking system, it represents a low risk, for the very fact that:

• Capital adequacy ratio is high (that is to say banks are well-capitalized)
• The level of credit provision is satisfactory and in accordance with international standards
• A good part of banks' assets are invested in government securities (that is to say with zero theoretical risk)
• In Albania is applied the deposit guarantied scheme

The financial system, actually represents at least three types of risks, which require a close monitoring:

First, it is perceived that a very large portion of credit finances more the consumption rather than the investment, which causes the risk of over-lending by individuals who have little experience in managing their debt.

Second, rapid credit growth makes it difficult to assess the quality of the loan. The large volume of new loans tends to reduce the proportion of bad loans in the short term, because the potential problems of portfolio quality usually are materialized with a significant delay. Rapid credit expansion may lead to lower standards for review, resulting in lending to those customers who are less reliable for credit. This can lead to a worsening, because the renewable ability of loan portfolios to economic downturns remains untested.

Third, the bulk of loans in foreign currency or indexed loans in banks' portfolios show for the risk of the increasing of major discrepancies to the values of currencies in non-financial private sector. While domestic borrowers do not earn their income in foreign currency, the unhedged foreign exchange risk becomes an important part of credit risk.

Financial intermediation is still low because the greater part of transactions in the economy continues to circulate outside the banking system.

Measurements undertaken by the responsible institutions for the reduction of currency in circulation are regarded as ineffective by business representatives.

In Albania, are not yet created the appropriate conditions for businesses to move towards the reduction of cash money.

Credit in Albania, expensive and with high risk. But the undertaken measurements in lending by commercial banks makes that at the statistics data to result that bad loans in the Albanian banking system are at lower levels than in European countries.

According to our judgment the Albanian banking system, and in this context, the Central Bank's policies were not responsive to the extent required by the economy. This is because the Albanian economy has different features in comparison with Western European countries that were affected by the economic problem.

There are many problems of ownership that impedes the development of businesses, most notably the entrance of foreign capital.

In Albania does not exist a real stock market and a real estate market.

Deposit growth has improved the liquidity in the banking sector by providing a better support for private investment.

The Central Bank should accommodate the government expansionary fiscal policies because:

First, it would diversify the money in circulation,

Second, it would reduce the opportunities to the government to withdraw cash in domestic currency from the money market

Third, it would spur the investment of the productive sectors,

Fourth, it would place the Albanian Currency in efficiency giving to it a wide breathing as the most portion of the credit is in foreign than in domestic currency

The lack of prompt reaction of the Central Bank to the reactions of the European Central Banks and American FED, made its policies to be apathetic and with not a positive impact on the growth of Albanian economy. Having these features, there is no way for the Albanian economy to have the same features of European economies and to be effected by the same economic phenomena that affected the Europeans economies too.

Central Bank of Albania, in the design and implementation of short and long term monetary policy must begin precisely even form these features of the Albanian economy, from its position in the economic fluctuation and from the major foreign effects in economy.

Bank of Albania has received the European Central Bank as an example for its organizational and functioning structure, and not only that but it has also got its short term and long term strategic objective as "achieving and maintaining the stability of prices". Thus Central Bank mostly in its policies is focused mainly on the inflation indicator as a

key indicator by passing the other indicators. It indirectly sees these indicators as fiscal policy objective, that is of the government, and not as an unchain indicator with that of inflation. According to our judgment, this focus solely on this indicator is not fair. It is not fair because it impedes the progress and economic development, the economic growth and consequently causes the decrease of unemployment rate.

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