Aligning monetary policy with financial stability in South East Europe

March 2017
Aligning monetary policy with financial stability
in South East Europe
Objectives, responses and interaction in times of uncertainty

Tirana, 27 October, 2016

This report draws on discussions at the conference on “Aligning Monetary Policy with Financial Stability”, which was held in Tirana, Albania, on 27th October, 2016, jointly organised by the Bank of Albania and SEESOX, and in cooperation with PEFM (Political Economy of Financial Markets) of the European Studies Centre, Oxford. The participants included academics and officials from Albania, and others countries in South East Europe, as well as from Oxford University, the IMF, and the wider banking community. The report represents SEESOX’s interpretation of discussions at the workshop and does not purport to reflect the views of any of the participants (except where specified).

Preamble
The conference was convened by the Bank of Albania in collaboration with SEESOX. Its purpose was to explore the benefits and implications of central bank policy coordination in managing current and future developments in the political, institutional, economic, trade and financial landscape in Europe and the global economy. Taking into account the prospect of Brexit as a potentially seismic event on the European stage, the conference sought to assess the potential consequences for the political, institutional, economic and financial environment of the Balkans, with a particular focus on central bank objectives and policies. In particular, the conference sought answers to the following questions: (i) what might be the immediate consequences of Brexit for the Eurozone and for Balkan countries?; (ii) how might European financial flows to the Balkans be affected in the future; and (iii) how will the new challenges affect the task of central bankers in the region?

The conference was opened by two keynote speeches by Edi Rama (Prime Minister of Albania), and by Gent Sejko (Governor of the Bank of Albania). Rama set the scene for the discussions by stressing that the speed of recent events had clouded the future with unusual uncertainty. He referred to comments made by Joseph Stiglitz regarding Brexit and the EU, and argued that the EU faced the choice between reform or divorce (or rather a series of divorces). However, he stressed that this overarching dilemma should not be allowed to impede the progress of new member states or aspiring members in seeking convergence with the EU. He ended on an upbeat note that Albania, despite the unpromising environment of the last ten years, had performed well and was continuing to do so, with growth and living standards picking up, while at the
same time progress was being made to clean up banks’ balance sheets and other debts. Sejko mirrored this upbeat story, noting that Brexit’s implications for Albania would be more indirect than direct, given the rather small direct economic and financial relationship that Albania shared with the UK. Nevertheless, he acknowledged that Brexit carried risks for the EU, especially in the context of a resurgent sentiment against globalization across the world, with a growing threat of a return to protectionism and isolationism. Othon Anastasakis (Director of SEESOX) concluded the opening session by referring to the recently signed renewal of the cooperation agreement between SEESOX and the Bank of Albania and citing this relationship as an example of Albania playing a lead role in the region. The Governor’s panel—now a regular feature of the annual SEESOX/Bank of Albania conference—showed what could be achieved in strengthening dialogue within the region on monetary policy and financial coordination. He stressed the importance that SEESOX attaches to its relationship with Albania, seeing a role for assisting in the education of young scholars.¹

Europe’s Political economy after Brexit

Changes and challenges in transmission policy mechanism and economic behaviour in the face of recent developments in European and global markets.

¹ Othon Anastasakis gave a public lecture entitled “Europe’s existential crisis in the wake of the Brexit vote” at the Mediterranean University in Tirana on October 26, 2016.
confirmed the view that Brexit should not have a profound direct effect on South East Europe (SEE), due to the relatively thin direct linkages between the region and the UK. Nevertheless, there will be negative implications for the EU budget (and thereby largesse for SEE), as well as for enthusiasm for enlargement (of which the UK was the most enthusiastic supporter). Despite this, support for EU membership in SEE remains generally quite high—especially in Albania—and SEE would doubtless benefit from further integration with the EU.

Robin McConnachie, a former Bank of England official now with Oxford Analytica, provided an economist’s perspective on what Brexit might mean for the UK. On the one hand, he warned that the UK’s buoyant car industry, whose recovery belied its apparent death in the 1980s, could suffer given its close relationship with suppliers and markets in Europe (and Germany in particular). The City of London could also be a big loser, if passporting rights are lost, given that about as third of its business is Europe-related. Certainly, there are ambitions in Europe to win business away from London (e.g., Euro-clearing). On the other hand, London banks are in much better shape than their European rivals. And the UK still has the option of offering a more favourable tax regime. Valeria Rolli looked at Brexit from the position of a Eurozone central banker. Based on existing relationships, the options for the UK included (i) membership of the European economic Area, (ii) a free trade agreement (FTA), or no agreement at all (and rules under the WTO). She was not optimistic that the UK could carve out a special deal. The trade-off between access to the single market and the “Four Freedoms” is likely to be immutable. To retain existing banking relationships would require adherence to option (i) and require acceptance of all EU financial legislation. Option (ii) would be more restrictive to financial services and would likely rule out passporting arrangements. Either way, the protracted negotiations would add considerable uncertainty to global economic prospects and especially to Europe. Erald Themeli narrowed the perspective to that of Albania, and provided convincing graphic representation that the direct effects of Brexit for Albania were not likely to be significant, given the limited economic and financial relationship between the two countries. However, he cautioned that the indirect effects of Brexit could include (a) a less liberal regulatory environment in the EU, and (b) less enthusiasm for further enlargement.

Monetary policy and financial stability and their coordination in the wake of current developments

How will current developments affect aggregate demand conditions and concerns for financial stability in the Eurozone and the region? What does all this mean for central banks objectives (price vs. financial stability) and policy coordination (monetary policy vs. financial stability)? What is to be gained or lost from coordination?

The second session concentrated more on financial and economic issues. Charles Enoch noted that Brexit would likely lead to the departure of some major banks and their services from London, especially if there is a hard Brexit. This in turn could lead to the loss of large numbers of highly paid personnel,
which could have knock-on effects on London property prices. The direct effects on the EU, on the other hand, are not likely to be comparably significant, since the EU is much larger than the UK and the UK’s share of trade with the EU thereby correspondingly smaller. But Brexit would alter the political task of European policy makers—probably toward avoiding further defections. It is also likely to lead to greater scrutiny of new entrants, which has obvious implications for SEE. Gilles Noblet took leave of the Brexit debate, and concentrated his remarks on the role of monetary policy in securing financial stability and how this can conflict with the companion objective of securing price stability (i.e., low inflation). In such circumstances, policy makers can now avail themselves of other financial instruments, such as regulatory frameworks for banks and for other markets (including housing), as well as macroprudential tools. In addition, more efficient ways are needed to resolve bad loans on banks’ balance sheets, as well as for monitoring shadow banking and credit developments generally. Andrew Filardo picked up on the theme of macroprudential tools, cautioning that their effectiveness is limited (citing some international case studies) and warned that they can be circumvented and are vulnerable to regulatory arbitrage. Such policy tools can strengthened when they are supported also by monetary policies which lean against the wind in combating asset price bubbles. Anita Tuladhar, the IMF’s mission Chief for Albania who was in Tirana to discuss progress in implementing the Extended Fund Arrangement with the IMF, updated delegates on Albania’s monetary policy stance, oriented as it is towards an inflation targeting framework. Albania is one of the relatively few countries in the region with a genuinely independent monetary policy, setting its own interest rates and with a flexible exchange rate. In Albania, as elsewhere, inflation has been on a downward track, allowing interest rates to decline. She cited the main risks being a still high level of non-performing loans, extensive euroization, banking exposure to sovereign risk, and a relatively high concentration of large financial institutions. Klodion Shehu, for the Bank of Albania, echoed these concerns, but pointed out through a series of impressive flow charts that the Bank is well placed to handle these challenges through its evolving organizational structure and growing experience, including through the implementation of macroprudential tools.

The Governors’ panel

What are the most pressing issues in the opinion of central bank governors? How have things changed since Brexit? Will these changes affect monetary policy and financial stability? What policy instruments are best suited to address current problems? Is there any trade off in using monetary policy and financial stability tools and instruments interchangeably?

The central bankers’ panel comprised Gent Sejko (Governor of the Bank of Albania), Bedri Hamza (Governor of the Central Bank of the Republic of Kosovo), Dimitar Bogov (Governor of the National Bank of the Republic of Macedonia), Iannis Mourmouris (Deputy Governor of the Bank of
Greece), Johannes Beerman (Member of the Executive Board of the Deutsche Bundesbank, Michael Faulend (Vice Governor of the Croatian National Bank, and Nikola Fabris (Vice Governor of the Central Bank of Montenegro), and was chaired by Charles Enoch. Participants agreed that the region continued to suffer from euroization—not a problem for countries that were deliberately euroized or in the Euro, but a source of concern for countries seeking to exercise an independent monetary policy. Relatively high levels of nonperforming loans on banks' balance sheets remained a constraint on new credit and thereby for growth, as was the cautious stance of foreign parent banks of local subsidiaries upon whom the pressure to maintain regional exposure from the Vienna Initiatives (I & II) had largely ended. Most saw scope for macroprudential measures to make up for some of the lost monetary autonomy, though it was recognized that the power of these instruments was limited. The role of coordination was discussed, including between governments and central banks in organizing the clearance of bad debts, in using monetary policy (via low interest rates) to buy time for governments to consolidate, and also for a possible Vienna III initiative. There was, however, some scepticism—coordination was compared to the Loch Ness Monster (much talked about but never seen). As for the global environment of Unconventional Monetary Policies (UMP), there was a consensus that such policies should, almost by definition, be temporary and that the longer the policy of very low interest rates prevailed, the more dangerous this strategy for sustaining growth would become.

**Summing up**

Governor Sejko summarized his take-aways from the conference's findings in the following ten points:

(i) the effects of the global financial crisis and the high levels of debt incurred remain important for the region of SEE;

(ii) continuing reforms to strengthen the Eurozone are therefore imperative;

(iii) Europe needs to make further progress with fiscal consolidation and structural reform;

(iv) Brexit has increased global uncertainty;

(v) SEE will need to navigate this more uncertain world, but

(vi) the direct effects of Brexit on SEE are not likely to be large;

(vii) monetary and fiscal policies are separate but should be connected through appropriate coordination;

(viii) a better framework for managing financial system risk is needed;

(ix) economic recovery and growth cannot come without sustainable policies, and

(x) the future of the EU is the main source of concern for European countries.
Speakers

Othon Anastasakis    Director of SEESOX, St Antony's College, Oxford
Bas Bakker           IMF Senior European Resident Representative
Johannes Beerman     Member of Executive Board, Deutsche Bundesbank
Adam Bennett         Deputy Director of PEFM, St Antony's College, Oxford
Nikola Bogov         Governor, National Bank of the Republic of Macedonia
Charles Enoch        Deputy Director of Western Hemisphere Department, IMF
Nicola Fabris        Vice Governor, Central Bank of Montenegro
Michael Faulend      Vice Governor, Croatian National Bank
Andrew Filardo       Head of Monetary Policy and Economic Department, BIS
Bedri Hamza          Governor, Central Bank of Kosovo
Robin McConnachie    Oxford Analytica
Iannis Mourmouras    Vice Governor, Bank of Greece
Gilles Noblet        Deputy Director General, International and European Relations, ECB
Edi Rama             Prime Minister of Albania
Valeria Rolli        International Relations Directorate, Banca d'Italia
Gent Sejko           Governor, Bank of Albania
Klodian Shehu        Director of Financial Stability Department, Bank of Albania
Altin Tanku          Director of Research, Bank of Albania
Erald Themeli        Director of Monetary Policy Department, Bank of Albania
Anita Tuladhar       Mission Chief for Albania, IMF
Aligning Monetary Policy with Financial Stability - Their Objectives: Responses and Interaction in Times of Uncertainty

The Plaza Tirana Hotel
27 October 2016

Programme

Brief Summary: The conference will address the implications of Brexit, and of potential pressure elsewhere in the EU to repatriate powers from Brussels, for the political and economic environment of the Balkans, with a particular focus on central bank objectives and its policies. Will the departure of the UK affect the attractiveness of EU membership for Central & Eastern Europe and the Balkans? How European finance, and financial flows to the Balkans might, be affected by the changing status of London in the EU’s financial map? What are the immediate economic and financial system implications of the uncertain Brexit phenomenon for the Eurozone, and for Balkan countries (both in and out of the Eurozone)? How will these challenges affect the task of central bankers in the region and their potential policy responses?

09:00 - 09:30 Registration

09:30 - 10:00 Welcome and opening speeches
Gent Sejko Governor of the Bank of Albania
Edi Rama Prime Minister of Albania
Othon Anastasakis Director of SEESOX

10:00 - 11:30 Session 1: Europe’s political economy after Brexit
What are potential political and economic challenges and implications resulting from Brexit in the European integration process? Is Brexit an isolated phenomenon, or could the EU disintegrate further? What are the implications for the relationship between the EC and member states, and for the cohesion of the Eurozone? What does all this mean for the Balkans? How can Balkan economies co-ordinate better with more advanced EU economies to sustain growth and stability after Brexit.

Chair: Adam Bennett
Deputy Director of PEFM & Associate of SEESOX, St Antony’s College

Speakers: Othon Anastasakis
Director of SEESOX
Bas B. Bakker
IMF Senior Regional Representative for CEE
Robin McConnachie
Associate of PEFM and Member of the International Advisory Board of Oxford Analytica
Valeria Rolli
Senior Economist, Bank of Italy
Erald Themeli
Director of Monetary Policy, Bank of Albania

11:30 - 11:45 Coffee break
Session 2: Monetary policy and financial stability and their coordination in the wake of current developments

How will current developments affect aggregate demand conditions and concerns for financial stability in Eurozone and the region? What does all this mean for central banks objectives (price vs. financial stability) and policy coordination (monetary policy vs. financial stability)? What is to gain and loose from coordination?

Chair: Robin McConnachie  
Associate of PEFM and Member of the International Advisory Board of Oxford Analytica

Speakers: Charles Enoch  
Academic Visitor at PEFM and SEESOX, St Antony’s College  
Gilles Noblet  
Deputy Director General of International and European Relation, ECB  
Andrew Filardo  
Head of the Monetary Policy, Monetary Policy and Economic Department, BIS  
Anita Tuladhar  
IMF Mission Chief for Albania  
Klodion Shehu  
Director of Financial Stability, Bank of Albania

13:15 - 14:44  
Lunch

14:45 - 16:30  
Session 3: The Governor’s panel: providing the central bank point of view and experience!

What are the most pressing current problems in Governors’ opinion? How have things changed since Brexit? Do these changes affect monetary policy and financial stability situation? What policy instruments are best suited to address current problems? Is there any trade off in using monetary policy and financial stability tools and instruments interchangeably?

Chair: Charles Enoch  
PEFM and SEESOX, St Antony’s College

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Bedri Hamza  
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Dimitar Bogov  
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Johannes Beermann  
Member of the Executive Board, Deutsche Bundesbank  
Michael Faulend  
Vice Governor, Croatian National Bank  
John (Ioannis) Mourmouras  
Deputy Governor, Bank of Greece  
Nikola Fabris  
Vice Governor, Central Bank of Montenegro

16:30 - 16:45  
Summary and closing remarks
South East European Studies at Oxford (SEESOX) is part of the European Studies Centre at St Antony’s College, Oxford. It focuses on the interdisciplinary study of the Balkans, Greece, Turkey and Cyprus. Drawing on the academic excellence of the University and an international network of associates, it conducts policy relevant research on the multifaceted transformations of the region in the 21st century. It follows closely conflict and post-conflict situations and analyses the historical and intellectual influences which have shaped perceptions and actions in the region. In Oxford’s best tradition, the SEESOX team is committed to understanding the present through the *longue durée* and reflecting on the future through high quality scholarship.

SEESOX has the following objectives:

- To support high-quality teaching and research on South East Europe;
- To organise conferences, workshops and research seminars;
- To promote the multi-disciplinary study of the region within the University of Oxford (e.g. politics, international relations, anthropology, sociology, economics) working in collaboration with other Centres and Programmes within the University, including student societies;
- To spearhead intellectual exchanges and debate on these issues among networks of individuals and institutions beyond Oxford;
- To foster cooperation between the academic and the policy making communities.