

De-Euroisation, Bank of Albania challenge and situation in Balkans Countries

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Abstract

The euroisation process in Albania started at the time of the opening of the borders and the launching of the integration procedures of Albania into the European Union. But the time period after the financial crisis and the debt crisis in 2007 put into question the use of the euro.

The monetary policy undergone by each central bank gives its effects on the domestic currency. Bank of Albania has begun to undertake the policy of de-euroisation, in such a way to increase the effectiveness of the monetary policy. The high level of loans and deposits in euro, compared to loans and deposits in lek in the last 3 years, has prompted the central bank to enter into this policy.

The de-euroisation process has started in other countries in the region, such as Macedonia, Croatia, etc.

This paper aims at identifying the costs of de-euroisation in the banking system in Albania, based on: credit portfolio and deposit base, based on comparison and analysis of data.

The costs of this process will also be met with the countries of the region, such as Macedonia, Croatia, etc.

Keyword: *de- euroisation, euroisation, Macedonia, Albania, comparative analysis.*

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1. Introduction

Official euroisation of the economy means that our domestic currency (Lek) is replaced with the new European currency – euro, one of the main currencies perhaps the second after the US dollar in international transactions. In this way, euro will have to be used in all classical functions of money.

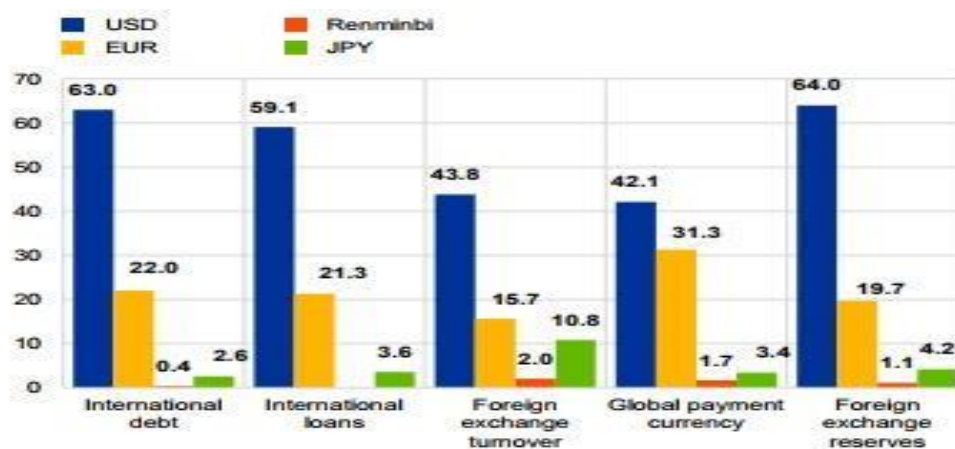
The currency substitution occurs when foreign currency denominated assets are being used as a way of payment, whereas asset substitution occurs when foreign currency denominated assets are used as a store of value.

The year 2017 was a year that put in doubt not only the uses of the euro but also the existence of the European Union, related with the events such as: elections in France, Brexit, elections in the US, etc.

2. Unofficial Euroisation

Although there is a decrease in the use of the euro all over the world, again the euro currency continues to be the second most used currency after the dollar.

Figure 1. Use of Euro, 2017



Source: European Central Bank, 2017

The euro continues to be the second most important currency used in the international monetary system, but with a significant dollar difference.

Unofficial Euroisation is a visible feature in the banking system in many potential candidate countries for the European Union, as well as countries that are candidates for EU, especially in

Albania, Bosnia and Herzegovina, Macedonia and Serbia. Unofficial Euroisation is also present in Turkey but at a lower level due to the fact that the US dollar has an important role in this country. The unofficial euroisation can increase the risk of the financial stability and a restriction of monetary policy decisions.

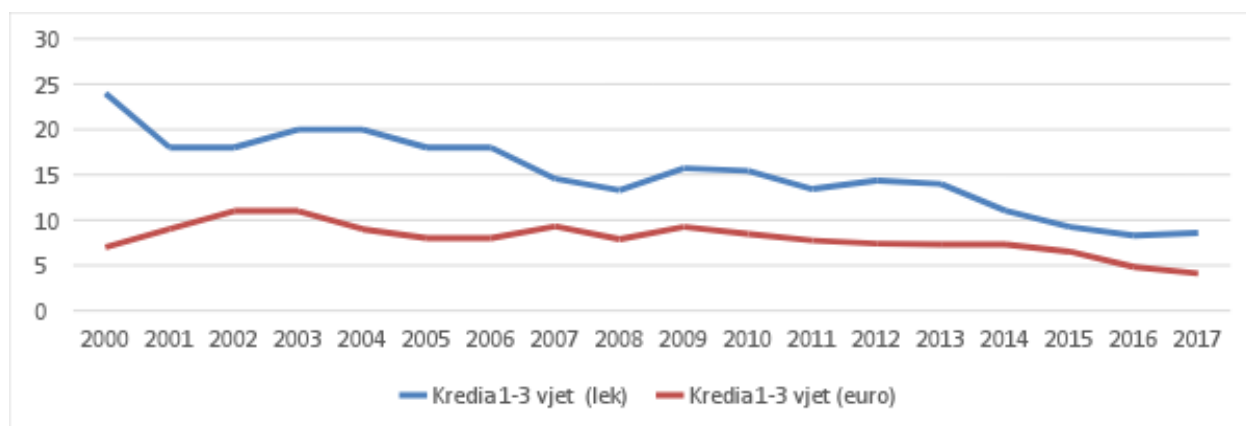
Factors that lead to unofficial Euroisation are:

- Confidence in local currency;
- Trade relations with European Union member countries (euro area);
- Remittances.

The first factor that has led to unofficial euroisation is the lack of confidence in the domestic currency. The creation of inefficient macroeconomic stability in the past, such as the high inflation period or even the hyperinflation or the considerable devaluation of the domestic currency which have led in lossing of the individuals whose holding savings in local currency. Consequently, the low confidence has led to use an another currency, respectively the euro for some of the money functions, including deposits and loans.

Also the difference between the foreign currency interest rate and the domestic currency interest rate has impacted the level of the deposits and the loans in the domestic currency..

Figure 2. Interest rates of euro and lek loans in Albania, 2000-2017



Source: Bank of Albania, 2017

As we can see from the above chart, there is a significant difference between the credit interest rate in lek and in euro, which making the lending in the domestic currency more expensive. The difference that has begun to narrow from 2013-2017.

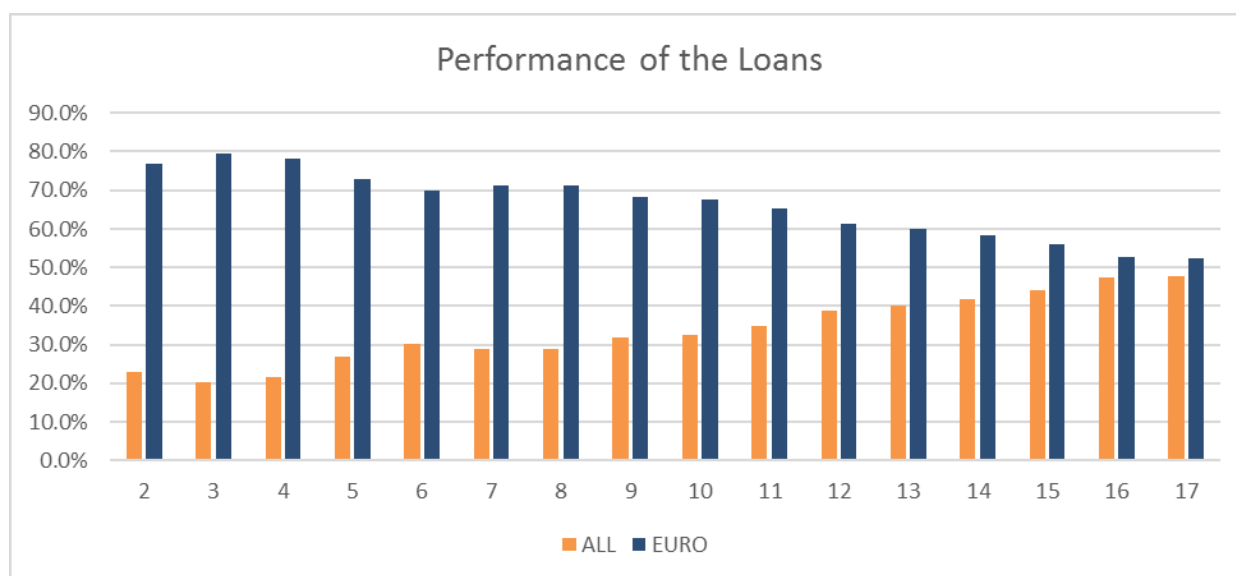
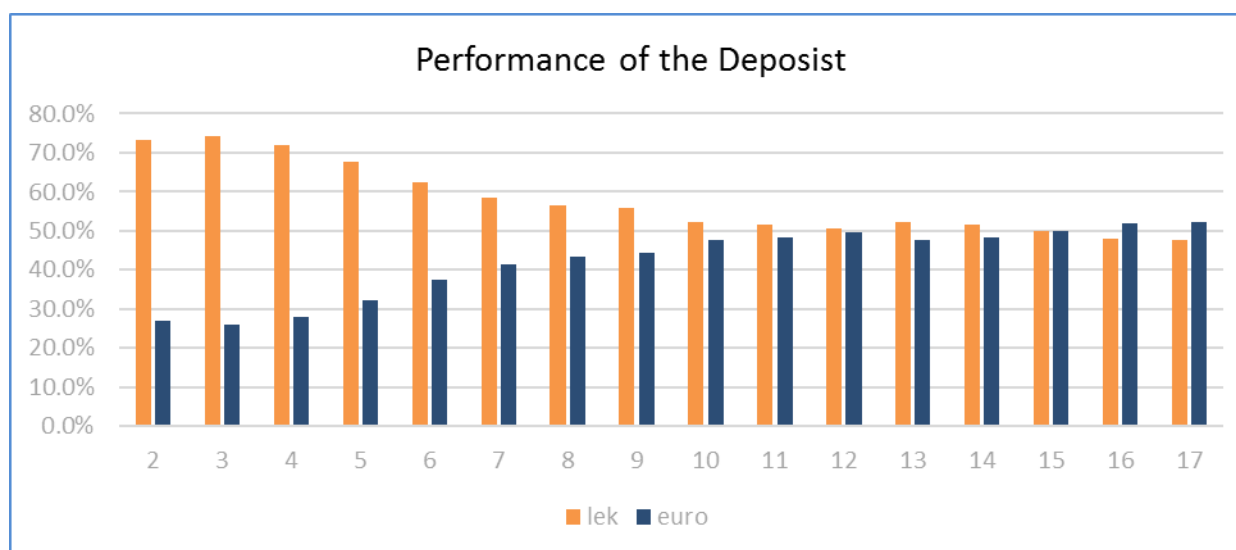


Figure 3. The performance of the loans in Lek and Euro, 2000-2017
Source: Bank of Albania, 2017

Figure 4. The performance of the deposits in Lek and Euro, 2000-2017



Source: Bank of Albania, 2017

Trade exchanges with Euro Zone, migration, remittances and financial channels also play an important role in using the euro in potential candidate countries in the European Union. The integration of the Albania's trade with countries using the euro is helped by several factors, including geographical distance, historical issues, etc.

Also has to mention that the labor market is another important factor, where the high level of unemployment in the countries of the region such as (Albania) has brought emigration toward the Euro Zone Countries, making the remittances the main source of incomes.

High euroisation levels, particularly in the banking sector activity provide a challenge for the effectiveness of monetary policy and for financial stability.

In terms of monetary policy, high euroisation level mean that the credit and exchange rate channel of monetary policy transmission mechanism may not operate well. In terms of financial stability, the still high level of Fx (euro) loans, particularly of those where the borrower doesn't have appropriate levels of Fx sources to serve the debt, represent a significant exchange rate and credit risk, that could materialize if the economy or the financial system is faced with a shock that causes exchange rate depreciation. The risk of the exchange rate for the bank automatically becomes a credit risk, affecting non-performing loans

Regarding to the financial system should be mention also, that the high number of the foreign banks has stimulated the use of the currency Euro.

Furthermore, large levels of Fx deposits, expose the system to Fx liquidity risk, where the ability of central bank to help if there is a need is more limited. Hence, it makes sense to have regulatory requirements asking for larger mandatory Fx liquid assets in banks, in order to strengthen the capacities of them to deal with such situation should they occur.

3. Measures taken by the central bank

In 2012, Serbia started the "dinarization" policy of the economy, where the Central Bank and the government took measures to encourage the use of the currency dinar as much as possible.

Macedonia is considered to be the country with the highest level of euroization in the Balkans, especially the level of the foreign currency loans. Based on this, Macedonia has taken measures for the de-euroization of the country such as the strengthening of the domestic currency and the changing of the level of foreign exchange reserves.

In Albania the "euroisation" policy of the economy started in 2017. Trying to decrease the euroisation levels only at the banking sector (financial system) without providing similar

incentives for the real economy agents, will not be sufficient and could not be successful. Based on this, is signed a cooperation agreement between Bank of Albania, Ministry of Finance and Financial Supervisory Authority in order to increase the usage of the domestic currency Lek.

This agreement is focused on three main groups of action. The first group associated with fiscal policy which should create the appropriate macroeconomic situation to promote the use of domestic currency. The second group related to monetary policy, the control of the banking system in relation to the increase the level of the uses of domestic currency in the banking system. The third group includes all activities that are not mentioned in the second group but are judged necessary for the progress of the de-euroisation process.

4. Recommendations

For the reduction of foreign currency loans, it is important to increase public awareness about the exchange rate risk related with the usage of the currency euro instead of the domestic currency.

The development of local capital markets is a premature condition in order to have a higher level of domestic currencies usage. Currently, the opening of the first stock exchange ALSE, has been made public in Albania, but we have not yet seen the start of the operation of this stock exchange, which will certainly help the de-euroization process. Also the domestic debt is an important part of promoting de-euroization policy, as well as the development of primary and secondary bond markets.

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