

Ardian Fullani: Economic developments during the second semester of 2004 and expectations for year 2005

Statement by Mr Ardian Fullani, Governor of the Bank of Albania, Tirana, 28 January 2005.

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The second part of 2004 has generated a larger economic activity, marking a certain general impulse, especially after a relatively quiet start of the year. The acceleration of production growth is reflected almost in all the economy sectors, while the major objectives of the economy have been achieved in conformity with the overall programme of the country's economic and financial development.

At international level, this semester coincided with an acceleration of the confirmed tendencies in the first part of the year, especially with regard to US dollar performance and oil price rise. The Fed monetary policy has changed the monetary policy tendency, during this period, through some successive increases of the core interest rate, in attempting to prevent the inflationary pressures in the economy. On the other side, the European Central Bank, considering the inflation performance and the strong pressure against the Euro has deemed unreasonable to change the core interest rate, keeping it at the level of 2 percent for almost a year and half.

Annual inflation in December resulted 2.2 percent, while the average annual inflation was only 2.9 percent. The maintenance of inflation within the targeted range was mainly attributed to the stable macroeconomic situation, the control of domestic demand of the economy and monetary indicators stability.

Year 2004 was characterized by the achievement of fiscal objectives in terms of budget expenditures and budget deficit, and also by a more uniform allocation of fiscal expenditures. Government demand for loans has been distinguished by a rising level during the second semester, however remaining within the projected levels. Also, the annual rate of the change of current budget expenditures was stable. The implementation of a prudential fiscal policy has provided the appropriate conditions to better control inflation rate.

During the second half of 2004, the Bank of Albania monetary policy has kept an easing tendency, aiming above all at reducing the borrowing cost in the economy. Bank of Albania has twice cut the core interest rate, in July and November, by 0.25 percentage points. These cuts have brought the core interest rate to the lowest historical rate, by 5.25 percent.

The banking system was characterized by an accelerated lending activity to the economy during 2004. The credit balance increased by LEK 9.2 billion during June-November 2004, being 51 percent higher than the balance growth in the first semester of the year. Lending to the economy is given an ever-increasing importance in the assets structure of the banking system, constituting a considerable source of the demand for monetary assets. The credit/deposit ratio increases on a continuous basis, an indication that positively introduces the function of the intermediation role of the banking system in supporting the economic development. The balance credit rise marked during the eleven-month period of the year the value of LEK 15.3 billion, reflecting a rise of 30 percent relative to the yearend of 2003.

The easing monetary policy of the Bank of Albania has helped smooth the appreciation pressure of the Lek exchange rate. The differences between interest rates in foreign currency and those in domestic currency incurred a decline during 2004. However, the rising foreign currency inflows on one hand, and the reduction of imports volume on the other one, have created a temporary difference between the foreign currency supply and demand during the summer period. This misbalance has exerted a significant pressure on the appreciation of the Lek exchange rate, fostering the foreign market volatility. The exchange rate volatility through this temporary rise of foreign currency supply has imposed the necessity of the Bank of Albania intermediation to the foreign market during the summer period, towards purchasing the foreign currency.

Though trade deficit increased, the current deficit in the third quarter has been lower than in the previous quarters, thanks to increased and positive balances of income, services, and particularly current transfers. The current transfers balance is estimated at USD 295 million, being higher than the

one of the first two quarters, and nearly 44 percent higher than the one of the third quarter of the previous year. Overall, the balance of payments performance during 2004 was positive. The gross foreign reserve level, at the end of this period, was estimated at USD 1 billion and 244 million, adequate to cover 5.1 months of imports of goods and services.

Based on the aforementioned developments, we may conclude that year 2004 contributed generally in further consolidating the country's macroeconomic equilibrium. Although full data for the yearend of 2004 are not yet available, there is a crystallization of the idea that the primary targets projected in the medium-term plan on the country's development have been met satisfactorily. According to the latest estimations, the Albanian economy grew by 6 percent under the conditions of a low inflation rate, far closer to the bottom level of the targeted band. The structural reforms, through their problematic concerns, have progressed during 2004.

All this consolidating process has created the premises for a better stability in the future. The development program of the country for year 2005 already exists, part of which are the primary targets of monetary policy.

The primary target of monetary policy for 2005, projected in the monetary program, remains the maintenance of the annual inflation rate within the two-to-four percent targeted range. This target is supposed to be met through the control of the monetary supply growth at an approximate level with the nominal growth of GDP, presuming that the velocity of currency circulation in the economy is stable. In this light, the annual growth rate of money supply for year 2005, projected in the monetary program, is 9.4 percent. This rate is in compliance with the provided demand of the economy for money, coming from its real growth by 6 percent.

The Bank of Albania monetary program is designed in line with other policies of the economy, where its harmonisation with the government fiscal policy is highlighted. The Bank of Albania estimates that like in the past years, even in 2005, the country's economic development will be in conformity with the overall development program objectives. The last developments of the banking system consolidate the optimism that it will fulfil to the best of its knowledge the role of financial intermediation in the economy. We deem that its consolidation will continue with accelerated rhythms throughout this year, providing to the large public more credits, more services and more security in the savings conduct.