

## **Ardian Fullani: Recent financial and economic developments in Albania**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, while presenting the 2004 Annual Report to the Albanian Parliament Audience, Tirana, 9 April 2005.

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Honored deputies,

I am here with you presenting my first address as Governor of the Bank of Albania, to share with you the Bank of Albania estimations on the economic developments of year 2004, to present our viewpoints on the Albanian economy perspective for the years to come, and to present some other important aspects of the Bank of Albania activity during this period. Bank of Albania is an institution that plays a crucial role in the decision-making of economic and financial policies and for establishing and maintaining the financial stability of the country. For this purpose, on behalf of the institution I govern, I would welcome any opinion, comment or suggestion relating to the past, the present and the future of the institutional development, of monetary policy and banking supervision.

### **Albanian economy during 2004**

According to the Bank of Albania estimates, the development of the Albanian economy over 2004 was in line with the objectives of the strategy on the economic development of the country. Based on the latest estimates, it results that Albanian economy grew by 6.0 percent in real terms, keeping the average development rate of the last five years. The economic growth rate of Albania has been throughout this period higher than the one of other Southeastern European countries or even the one of the countries being recently members of the European Union.

The activity conducted by the Albanian economy, as a relatively open economy, was fuelled by the invigoration on a world-wide scale of the economic activity throughout 2004. A slow but a safe growth of the European economy experienced over 2004 has been a positive factor for the Albanian economy, fostering the demand for our exports and sustaining the rise of remittances inflow in foreign currency from emigrants. The average inflation rate of the euro area has been around 2.4 percent over this year, without exerting any influence on the rise of the imported inflation rate in Albania. Simultaneously, the impact of shocks on the world economy during 2004 resulted to be smoother in the Albanian economy. Oil price rise in the international market was amortised partially due to Lek appreciation and partially due to the rising competitiveness and the emerging of a certain flexibility of demand for this product. The impact of oil price rise on the inflation rate in the country has been restricted. Also, its impact on the Albanian economy, though hard to be measured, is believed to have been rather a smooth one according to the estimations on the performance of the most exposed sectors to oil price, the transport and industry.

Exchange rates have been fluctuating over 2004. The American dollar was appreciated in the first part of the year, as a consequence of expectations for a tightening of the United States monetary policy. But, during the second part of the year, the attention of financial markets mainly focused on the structural problems of the American economy, that of the budget deficit and current account deficit. These concerns brought about a quick decrease in the American dollar value, reaching the minimum levels against the common European currency.

In face of these developments, both monetary policy and fiscal policy of larger economies maintained expansionist features. Notwithstanding the rise of US dollar interest rates, they remained at low historical levels while Euro interest rates remained unchanged. The fiscal policy has impacted the growth of domestic demand, either in the euro area or in the United States. The progressive integration of the Albanian economy in the international markets of products and capitals makes that this economy benefits from these incentive policies, in the form of lower interest rates for foreign currency and in the form of higher demand for its exports.

Placed in this positive background, the Albanian economy growth continues to be generated from the dynamic development of the private sector, while maintenance of the macroeconomic stability and economic growth support through investments in the priority development fields: infrastructure, education and health, have been a priority to the public sector.

During 2004, investments in the economy marked the same level as during 2003, representing nearly 25.4 percent of GDP. These investments are mainly represented by the private investments, which count for about 80 percent of total investments. The financial sector has given an ever-stronger support to this development, through the increase of lending activity and the range of services provided. Thus, credit to the economy increased by an average of 34 percent during the last two years, being at the same time accompanied by a prolongation of maturity term.

The sectoral development of the Albanian economy has been a dynamic development over the last years. Sectors that have provided a major contribution to the annual growth rate are considered to be: "Trade, hotels, restaurants", "Construction", "Transport" and "Other services". These sectors have contributed about 75 percent of the economic growth over 2004. This development is accompanied by a redistribution of the relative contribution of economy sectors to GDP, and also by a redistribution of the production factors, the labour forces and capital support.

The large demand for the infrastructure development, for increasing and expanding the productive capacities as well as for housing made that construction sector be characterized by high development rates. It contributed by an average of 17 percent to the economic growth of the last three years, although the added value in this sector represented only 10 percent of GDP in 2004. Sales of the "Trade, hotels, restaurants" sector increased by 6.2 percent over the nine-month period of 2004, in comparison with the same period of the previous year. This sector performed nearly 44 percent of total sales for this period. A positive development of year 2004 was also the agricultural production, which increased by 4.9 percent. The industry sector performance has been characterized by a mixed performance. Sub-branches of the processing industry like foodstuff industry, manufacturing of mineral products and metallurgy, performed higher sales during the nine-month period of 2004, while sales of the textile industry and processing leather industry marked rather low levels. The energetic sector experienced a positive performance during 2004. The electric energy production marked an annual growth of 12 percent, being expressed in the rise of exports by 20 percent and the decline of energy imports by 30 percent. Sales of the transport sector increased by 5 percent over the nine-month period of the year.

**An important aspect of the Albanian economy over the last years is the fact that the economic growth did not generate macroeconomic imbalances.** On the contrary, it is accompanied by the ongoing consolidation of this stability, being expressed in the low and stable inflation rates, in the reduction of budget deficit and public debt, in the improvement of the balance of payments position and in the overall stability of monetary indicators.

Some indicators of the economy over the years

	1999	2000	2001	2002	2003	2004
Real growth of GDP (in %) <sup>1</sup>	8.9	7.7	6.5	4.7	6.0	6.0
PBB (with current prices, in millions of Lek <sup>2</sup> )	488611	530900	588700	630000	695100	780100
PBB (with current prices, in millions of USD)	3548.4	3694.5	4102.4	4496.8	5702.2	7,581
PBB (in USD per capita) <sup>3</sup>	1052.0	1086.3	1329.0	1460.0	1833.5	2,434
Number of the employed (in thousands)	1081.0	1068.0	1065.0	921.0	928.0	917.0
Unemployment rate (in %)	18.0	16.9	14.6	15.8	15.0	14.6

1 Data on GDP and its real growth for the period 1999-2000 are originated from INSTAT. For the rest data are estimates from Ministry of Finance, IMF and also data from Bank of Albania.

2 The table is being constructed based on the reviewed nominal GDP.

3 Nominal GDP converted at the average rate of the period.

Inflation rate – in % (year/year)	-1.0	4.2	3.5	2.1	3.3	2.2
Budget deficit (with grants, as a percentage of GDP)	-12.1	-8.2	-7.9	-6.6	-4.9	-4.9
Public debt (as a percentage of GDP)	69.7	71.3	66.8	65.1	60.7	55.3
External debt (as a percentage of GDP) <sup>4</sup>	-32.3	29.4	25.8	23.4	20.7	17.8
Current account (without government transfers, as a percentage of GDP)	-8.5	-7.0	-6.1	-10.2	-8.2	-6.2
Average exchange rate, Lek/USD	137.7	143.7	143.5	140.1	121.9	102.8
Average exchange rate, Lek/EUR	147.0	132.6	128.5	132.4	137.5	127.7

Source: INSTAT, Ministry of Finance, Bank of Albania and the IMF estimates.

**The 2004 data suggest a gradual easing of unemployment rate.** Although the demographic changes over the last years make difficult the statistical disclosure of labour forces displacement, according to official data the unemployment rate is estimated to have decreased from 15 percent to 14.6 percent throughout 2004.

### ***Fiscal indicators***

Based on the developments of fiscal indicators, it results that the fiscal policy followed during 2004 has been a prudential policy, which relied upon the Medium-term Budget Program for the period 2004-2006. Expressed in terms of GDP, the budget indicators are presented at approximate levels as those of year 2003, where one can distinguish the unchanged figure of budget deficit, of 4.9 percent. State budget income grew by 10.4 percent over 2004, reaching 23.7 percent of GDP. Also, budget expenses recorded an annual growth rate of 10.7 percent, reaching 28.6 percent of GDP. These indicators remained, however, below the projected levels in the 2004 budget, imposing the necessity for a more cautious follow-up of the budget in its two principal phases: the design and implementation. Also, performance of capital expenses still remains a problem, which deserves more attention in the future, given the particular importance it has for the development of infrastructure capacities of the country.

### ***External sector of the economy***

The favourable economic situation in the country was also reflected in the field of foreign transactions. The current deficit marked a significant decline over 2004, reaching 5.3 percent of GDP and marking a significant decrease compared to the last two years. This development resulted to be a consequence of trade deficit improvement, which lowered to 21 percent of GDP in 2004, from 23.4 percent of GDP it was in 2003. Exports of goods marked a higher growth rate than imports, while the positive balance of current transfers increased in parallel with trade deficit, thus impeding the deepening of current deficit. The coverage of imports by exports of goods reached 27.5 percent, marking rather an improvement relative to year 2003 when this ratio was 25 percent. During 2004, Albania's balance of payments recorded a flow of financial assets and capitals of about 1.5 times higher than the previous year. The rise of inflows in the financial account and the non-deepening of current deficit brought about the increase of foreign reserves by about USD 290 million over 2004. Albania's foreign reserve is sufficient to cover about 5.2 months of imports of goods and services.

4 Government debt including other sectors debt guaranteed by Government.

Notwithstanding the positive developments of the recent years, the economic growth and the macroeconomic stability of the country are two parameters, which, according to our consideration, cannot and should be considered as issues already accomplished. The high trade deficit requires the ability to find stable long-term coverage resources, especially to promote foreign direct investments, which will raise the productive capacities of the Albanian economy. A major interest should be given particularly to the sectors such as agriculture and tourism.

Fiscal policy must continue to conserve its positive contribution in the consolidation of the macroeconomic stability, a contribution being expressed in the reduction of budget deficit, in the increase of income and in the establishment of priorities according to the National Strategy for the Socio-economic Development, in the performance of budget expenses. We deem that financial sector development should be balanced in all its segments, and this requires the successful completion of the privatisation process and the harmonization of the regulatory and supervisory legislation, in accordance with the best practices of the developed countries.

These issues require a continuous attention and cooperative contribution. On this opportunity, I deem appropriate to highlight that Bank of Albania shall be a prompt and open partner, assuming the responsibilities belonging to it, and collaborating with all the actors interested in the economic and financial development of the country.

### **Inflation and monetary policy developments**

The primary objective of the Bank of Albania, provided in the Law "On the Bank of Albania" is maintaining the price stability. This objective is expressed in the achieving of a low and stable inflation rate, measured as an annual change of Consumer Price Index. For year 2004 inflation rate, according to the Monetary Policy Document, was fixed to be within the two-to-four percent targeted range.

According to the actual developments, Bank of Albania has achieved its objective on the inflation control within the two-to-four percent targeted range. The annual inflation rate resulted 2.2 percent by the end of 2004, while the average annual inflation rate was 2.9 percent. Inflation rate remained about 3 percent during the first half of the year and, later on, marked a downward trend during the second half, approximating to the lower limit of the targeted band.

The main role in creating the inflation rate during 2004 has been played by the "Rent, water, fuels, energy" group, unlike the past years when this role was played by the "Foodstuffs and non-alcoholics" group. The price index of the "Rent, water, fuels and energy" group marked high annual growth rates over 2004. Despite the increase of the energy price by 31.2 percent in February of this year, this group recorded a rise even in the price of rent and imputed rent. The annual inflation rate of the "Foodstuffs and non-alcoholics" group has been a negative one during May-November, due to the growth of domestic agricultural production, including the production of greenhouses.

The positive inflation performance during the last two years was facilitated by the absence of shocks, the positive developments of productive capacities and the consolidation of macroeconomic and macrofinancial indicators. The concern that oil price rise in the international markets would have caused a consumer price rise even in Albania, has not become a reality. The appreciation of exchange rate in Lek against US dollar during 2004 has eased the effect of oil price rise in the international markets. Also, the inflation value of the two main partner countries, Italy and Greece, has been low, compared to inflation rates in Albania. As a consequence, imported inflationary pressures did not accompany Albania's trade activity.

The favourable macroeconomic developments during 2004 have provided an appropriate environment for the inflation control. Two basic macroeconomic policies, monetary policy and fiscal policy, have contributed toward the economic activity stabilization, without exerting increasing pressures on the inflation rate. The budget expenses during 2004 have been relatively uniform throughout the year, without jeopardizing the rise of inflationary pressures in the economy in given periods. The domestic borrowing of Government has been 2.0 percent of GDP over 2004, compared to 2.9 percent in 2003.

### **Monetary policy**

The monetary policy followed during 2004 maintained the easing trend of the policy being followed during 2003. Bank of Albania has cut 5 times the core interest rate over 2004, with a total effect of 1.25 percentage points. The core interest rate reached new minimum historical levels through every cut occurred during 2004, remaining by the end of the year 5.25 percent. The easing monetary policy

has been in compliance with the inflation developments during 2004 and the positive expectations on this indicator in the future. These developments seem to have been perceived by the public, who is increasingly anchoring the inflationary expectations to the inflation target announced by the Bank of Albania. This is reflected in the increase of public interest in depositing their savings in Lek, generating also appreciation pressures on the exchange rate in Lek. The appreciation of exchange rate in Lek, accompanied by stable inflation values in the largest trade partners of Albania, has impacted the decrease of inflation value imported during 2004.

The easing of monetary conditions in the economy aimed at fostering the economic activity and creating more spaces to crediting to the economy, without infringing the long-term perspective of the inflation target. This monetary policy resulted to be a right one. Bank of Albania has been successful in achieving its objective on inflation, easing simultaneously the appreciation pressures on the domestic currency. Notwithstanding the easing monetary policy, Bank of Albania has kept under control the growth rate of monetary aggregates.

The weak inflationary pressures from the fiscal policy, the good-management of money supply, as well as Lek appreciation, have provided appropriate conditions for a moderate rise of consumer price over 2004. In general terms, Bank of Albania believes that this favourable situation will continue to prevail even during the current year. It will be supported by the favourable monetary conditions of the economy and by the controlled development of domestic demand. Based on the available information and in absence of shocks, the consumer price rise for year 2005 is expected to be within the two-to-four percent targeted range of the Bank of Albania.

### ***Monetary indicators performance***

To achieve its primary objective, that is maintenance of price stability, Bank of Albania relies on the monetary aggregates control as an intermediate instrument. Expectations on monetary indicators performance are provided in detail in the annual monetary program, which serves to orient the Bank of Albania monetary policy. Based on this strategy, the objective of increasing money supply for 2004 was fixed to be 12.4 percent. This increase is believed to have been adequate to supply the demand of the economy for money under the conditions of an economic growth of 6 percent and of an inflation rate within the two-to-four percent targeted range.

Money supply and the closest money aggregate (M1) have known faster growth rates during 2004 compared to year 2003. This is a consequence of a rising demand of the economy for monetary assets, reflected even in the invigoration process of lending to the economy throughout the year. Also, the controlled inflation level has rendered possible the maintenance of a real interest rate in positive terms, despite the ongoing reduction of nominal interest rates. The real positive interest rate has maintained the tendency of households to deposit their savings in the banking system, bringing about further reductions of the relative level of currency outside banks that circulates in the economy.

The rising demand for monetary assets has been shaped mainly as the demand for monetary balances in Lek. The demand for Lek has been particularly evident in the summer time, being partially supplied even by means of liquidity injection through the Bank of Albania intermediations in the foreign exchange market.

The annual growth rate of deposits in Lek was 12.9 percent, being a satisfactory growth compared to the average historical rate. It was adequate to cover Government demand for the financing of deficit and the economy demand for credits in Lek. Meanwhile, deposits in foreign currency grew by 17.1 percent during 2004. The main source of the high growth rate of deposits in foreign currency continues to be the large inflows of remittances in foreign currency from emigrants.

Under these conditions, credit to the economy increased by Lek 19.4 billion during 2004, from Lek 16.5 billion being projected in the monetary program. This implies an increase of credit to the economy by an average of Lek 1.6 billion monthly compared to year 2003. Credit to the economy constituted 8.4 percent of GDP, marking an increase of 1.6 percentage points compared to year 2003. Also, credit/deposit ratio reached 19 percent at the end of 2004, from 15.7 percent being in 2003.

Banking system financing was done through purchasing Treasury bills and two-year bonds and constituted the largest weight of domestic financing during the year. Commercial banks and households increased the Treasury bills portfolios in comparison to the previous year, respectively by Lek 6.5 and 6.2 billion. Meanwhile, revenues from the Savings Bank's privatization constituted a significant financing source, particularly during the second half of the year.

## **Exchange rate**

2004 was associated with appreciating pressures for the Lek, impacted by country's macroeconomic stability, rise of confidence in domestic currency and largest influence of seasonal effects. Compared to the previous year, the Lek was appreciated on average by 7.2 percent versus the euro and by 15.7 percent versus the dollar. The Lek appreciation is not a tendency observed only in 2004. According to assessments made by the Bank of Albania, there exist some long-term factors whose operation has influenced on appreciating the Lek's value:

- Constant consolidation of the country's economic stability.
- Interest rate spread between the Lek and the foreign currencies.
- Consolidation of public finances and budget deficit, dictating a low government demand for monetary assets.
- Stable remittances by Albanian emigrants working abroad.

In the meantime, during 2004 the exchange rate performance was also impacted by specific factors of the year. Specific factors relate to starting of tourism earlier than in the previous years, rise of agricultural produce and decline of demand for agricultural merchandise imports, impacting on the supply and demand for foreign currency in terms of the Lek appreciation. Also, the international foreign exchange market developments are reflected in our foreign exchange market. The euro appreciation versus the dollar over more than a year is reflected in the reduction of the dollar's value even in our country, though no strengthening of the euro is observed. During 2004, the dollar was depreciated by 7.5 percent against the euro in the international market.

During 2004, the Bank of Albania intervened in the foreign exchange market in terms of purchasing foreign currency, in an effort to prevent large exchange rate fluctuations reflected mainly during the summer and end-year period.

## **Financial markets**

Growth of deposits in Lek, in the presence of a low government demand for monetary assets, created premises for increasing banks' liquidity and extending interbank market activity. Low inflation rates made real interest rates rest close to historical levels, regardless of nominal interest rate cut. This has impacted on maintaining high annual growth rates for time deposits in Lek. The main features of money market over 2004 were the market activity intensification and interest rate cut. 2004 recorded rise of weekly and monthly interbank transactions.

Under the impact of easing monetary policy, the interest rates in all markets continued the downward trend of the previous year, reaching the minimum historical levels at end of 2004. Besides the easing monetary policy of the Bank of Albania, these trends have also reflected the enhancement of competition in the banking system, due to the Savings Bank's privatization. The banks' supply to invest in government Treasury bills has been larger than the amount issued in the primary market, being reflected in pressures for constant yield cut. Therefore, the Treasury bills yield gradually dropped during 2004, reaching the lowest historical levels at end of the year. 2004 testified a strengthening of banking system interest in investing in longer-term securities, such as two-year bonds. The weight of two-year bonds in the securities portfolio of the banking system rose to 6.1 percent over 2004, from 2.4 percent at end of 2003; whereas that of quarterly Treasury bills dropped from 9.2 to 2.8 percent. Albanian authorities aim at capitalizing this positive development of financial market in terms of further increasing the maturity term and structure of domestic public debt.

Interest rates of foreign currency deposits demonstrated adverse tendency to that of Lek deposits during 2004. This market was impacted by rise of LIBOR and EURIBOR interests in international markets.

The Bank of Albania has successfully managed the banking system liquidity, using its framework of monetary policy instruments. Aiming at improving its operational framework and easing the functioning of Albania Interbank Payment System (AIPS), the Bank of Albania approved the Regulation "On intraday credit" on March 2004. The use of this credit, which started in May, has assisted in meeting the needs for effecting commercial banks' intraday payments.

## **Banking system performance**

Financial position of the banking system at end of 2004 is presented as good. Main profitability indicators have generally had a steady performance, reflecting the prudential overall banking system growth and the activity extension of most banks through more products and larger presence in the market.

The banking system evidenced positive net income over 2004, about Lek 5.11 billion or about 0.66 billion more than in the previous year. This figure constitutes 0.66 percent of GDP accrued for 2004. Good position of the banking system is reflected even in the main profitability indicators, RoA and RoE. These indicators have rested in high levels; furthermore, they have undergone a slight growth in comparison to the previous years. This indicates that the net result growth was not only due to banking system assets growth but also due to productivity growth of assets and capital.

During 2004 the banking system assets were raised by Lek 52.8 billion (or 14.1 percent), about Lek 18.5 billion more than the growth of assets evidenced over 2003. Year 2004 underwent a significant rise in lending activity, with a growth rate of 38 percent (or Lek 19.3 billion) at end of 2004, compared to 30.5 percent at end of 2003. Therefore, lending rose to 16.4 percent of total assets of the system at end of 2004, from 13.5 percent in the same period of 2003.

Lending quality indicator (problem loans to credit balance ratio) is estimated at 4.2 percent, from 4.6 percent at end of 2003. The lowest level of this indicator highlights improvement in lending quality and limited banking system exposure to credit risk.

Downward trend of capital adequacy ratio during 2004 was due to a better exploitation of banks' capacities in terms of extending in riskier investments. During 2004 the supervision process, trying to be proactive and continuous, had on its focus the risk assessment of banks' activity. Following up the requirements of Supervision Development Plan, the document on "Operative Supervision Policy" was drafted and approved, prescribing banks' supervision principles. In view of this policy, the supervision cycle for banks that present less concern to supervision is lengthened from 12 months to 18 months, whereas for problematic banks it is reduced to 6 months.

## ***Licensing and regulatory framework***

During 2004 the banking system in Albania was characterized by dynamic developments, either in terms of increasing the number of banks operating in the market or in terms of extending the banking network in various areas of the country. At end of 2004 the number of banks in Albania was 16, from which 2 banks are totally with domestic capital and 14 other banks have foreign capital. On April 2004 the banking system was further consolidated with the approval on the ownership transfer of 100 percent of the Savings Banks' stock to Raiffeisen Zentralbank, as a crowning of the privatization process of this bank. Also, the Popular Bank Jnt. Stk., the second bank with totally Albanian capital entered into Albanian market. An application for establishing a new bank with wholly Albanian capital was also submitted. This application has recently received the preliminary approval for licence, pursuant to requirements of the Law "On Banking System in the Republic of Albania".

Parallel to development and extension of the banking system and the products it offers, further improvements and amendments have taken place in the regulatory packet of banking supervision. During 2004, the Guideline "On bank regulatory capital, the Regulation "On capital adequacy", the Regulation "On credit risk management" were revised, and the Regulation "On money laundering prevention" was adopted. Also, during 2004 work was done for making improvements in the existing Law "On Banking System in the Republic of Albania", with the goal to realize its adoption by the Albanian Parliament within 2005.

These improvements were dictated by the need to adjust to and implement the European directives in this area, and the Basel principles for an effective supervision.

## **Other activities of the Bank of Albania**

During 2004 the legal status of the Bank of Albania remained unchanged. Meanwhile, the revising of the Law "On Banking System in the Republic of Albania" started with the purpose to further perfect the legal framework of commercial banks' activity in accordance with the aspirations of our country for membership in the European Union.

Also, during the last autumn the Bank of Albania regenerated most of its Supervisory Council (7 members) and new administrators of the institution were elected. This process did not impact on normal flowing of the Bank's activity, indicating the consolidation of this institution.

During 2004 the inter-institutional cooperation was another feature characterizing the Bank of Albania performance. In this aspect, we have been open and ready to design and implement the country's development programs, to advise the Albanian executive on various economic issues and we have participated actively in all tables of negotiations with the international factor.

In view of meeting the objectives and obligations deriving from the agreements between Albanian authorities and international institutions, during 2004 the Bank of Albania closely cooperated with the latter ones.

In the framework of consultations on assessing the fulfilment of obligations deriving from the agreement between Albanian authorities and the IMF, Albania was visited by three monitoring missions of the IMF. In general, the accomplishments of the Bank of Albania were assessed in the framework of the Memorandum of Economic and Financial Policies signed between the Bank of Albania, Ministry of Finance and this institution. Particularly, they evaluated the maintaining of inflation within the Bank of Albania targeted band (2-4 percent), the maintaining of a relatively stable exchange rate and the efforts for modernizing the banking system. At the same time, the missions expressed their support and encouraged the mid-term plan on cash reduction in economy. Rising the lending, developing the real sector and amending the regulatory framework of banking supervision were other topics discussed in these meetings and in the contacts of the members of the mission with the Bank of Albania experts.

The Bank of Albania was visited by the Mission of Technical Assistance of the IMF, which was focused on banking supervision area, implementation of international accounting and payment standards, application of monetary statistics standards and integration of the Bank of Albania into the European Monetary System. The Bank of Albania required assistance in inflation targeting area. The so-far assistance by the IMF to the Bank of Albania is regarded as a stable and fruitful one, impacting significantly on the accomplishment of up date central banking standards.

Also, in the framework of cooperation with the World Bank and its financial support, the Bank of Albania has initiated the Automated Electronic Clearing House Project, which will serve the further modernization of payment system and its approximation to international standards. The work for implementation of this project was inaugurated on November 2004, with the participation of senior managers of the World Bank.

During 2004, the Bank of Albania, together with the banking system and the Ministry of Finance designed a number of operations, which were intended to reduce cash in economy. In view of meeting these commitments during 2004, a number of concrete steps were taken, among which I would highlight the following: completion on January 2004 of the interbank payment system, initiation of the big project for building the Automated Electronic Clearing House and the transfer of wages of public administration personnel through a bank account.

Both above projects are regarded as an essential infrastructure, connecting almost the whole banking system. The implementation of the systems is done in accordance with best international standards and principles, based on modern and up date technology.

On the other hand, I would emphasize that we have also organized meetings with various groups and representatives of economic interest, who not only have helped us to better understand our weak points, but have also served for clarifying mutual benefits to the participants.

We are determined to continue our efforts in this direction even during 2005. Therefore, we are working to complete the project on small-size payments in time, to start cooperation with the World Bank for creating a credit information register. On the other hand, we are constantly holding the banking system under pressure not only for its further geographical extension, but also for raising its quality and inventory of payment instruments. The establishment of an ever update payment infrastructure, side skipping investments in technology or out-dated solutions, will be a clear orientation of the Bank of Albania.

In this sense, there is room for further increasing the use of electronic credit cards, on which I have observed that certain banks have been very active. In the quality of the central bank, we welcome any rationalism in terms of simplifying and unifying the use of various cards issued by the banking system.

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Further to my speech, allow me to make a summary of the financial activity of the Bank of Albania over 2004:

Meeting the objective of price stability and financial sustainability of the country has dictated the need for a more active policy by the Bank of Albania. Also, the developments of two main foreign currencies, Euro and US dollar, have had significant effects on the financial indicators and the Bank of Albania balance sheet.

During 2004, the total assets of the Bank of Albania were increased by 4.8 percent, reflecting growth of foreign assets by 14.7 percent. The growth of the latter ones was due to two factors: the Bank of Albania intervention in foreign exchange market by purchases, and the converting of foreign currency government income. In absolute value, the total foreign assets were raised by Lek 17.2 billion. Contribution to foreign assets growth was also given by foreign reserve investment in foreign markets.

However, the appreciation of domestic currency versus two main currencies, Euro and US dollar, has negatively impacted on existing foreign assets value by about Lek 8.5 billion, expressed in the reduction of Revaluation Reserve, on which the Ministry of Finance has projected the issuing of securities, in compliance with the Law "On the Bank of Albania" and the Law "On State Budget for 2005".

Also, the Bank of Albania, in implementation of its monetary policy, has used the instrument of outright Treasury bills sales. This has brought about the reduction of portfolio of domestic assets of the Bank of Albania by 10.5 percent or Lek 8.0 billion. On the other hand, the easing policy has impacted on the decrease of Treasury bills yield through interest rate cut.

The combination of both factors has impacted on the level of income from investment in securities portfolio of Albanian Government for Lek 2.3 billion or 30 percent less in comparison to the plan. This reduction constitutes 100 percent of the dropping of total income from operations. Under the conditions of almost the same level of operative expenses, compared to the previous year, the net profit of the Bank of Albania over 2004 resulted to Lek 5.5 billion or Lek 2.4 billion less than in 2003.

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Honored deputies!

Allow me to emphasize once more the willingness of the institution I govern for meeting all the obligations deriving from the Constitution of the Republic of Albania and from the Law "On the Bank of Albania". This will be achieved through further perfecting the framework of monetary policy and monetary operations and simultaneously through deepening our knowledge in terms of functioning and causative inter-dependence characterizing the Albanian economy. I believe that year 2005 will be a successful year in terms of research, particularly in increasing the forecasting power on inflationary developments and in improving the Bank of Albania governance. I would like to cite that adaptation of inflation targeting regime remains our political aspiration, a fact that makes us be seriously committed to prudentially follow the relevant pre-conditions.

For this purpose, we will continue the relevant theses we need for finding understanding and proper support of the Assembly and other state institutions.

I would like to ensure the Assembly of Albania that our recent steps and expected ones take into account even our national aspiration for a faster integration into the European Union.

We have already understood that no genuine integration can exist without financial integration. The country needs more income, more political stability, more social and cultural integration, but as much important is the financial integration as well. From this viewpoint, I think that the role of the institution I govern, the role of the banking system and of the financial sector is primary and we have many challenges ahead of us.

Strengthening of the country's financial stability, enhancement of effectiveness of monetary policy and other economic policies, financial market flexibility, increase of geographical coverage of the country with banking business and financial intermediation rise are indispensable conditions for a real integration of the country with the developed part of the European Continent.