

Ardian Fullani: Economic and monetary developments in Albania

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the press conference on the decision of the Supervisory Council of the Bank of Albania, Tirana, 25 November 2009.

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In its meeting of November 25, 2009, the Supervisory Council of the Bank of Albania analysed "The Monetary Policy Report for November 2009". After becoming acquainted with the latest economic and financial developments at home, and following the discussions related to their expected performance in the future, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 5.25 percent. The Supervisory Council assessed that this interest rate is in line with Bank of Albania's goal to keep inflation close to the target over the medium run.

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Economic and monetary developments over the latest months are featured by low inflationary pressures. Annual consumer-price inflation for October recorded 2.3 percent, being almost in line with its performance over the last quarter. The steady and low inflation rate has been conditioned by moderate pressures from domestic economy, due to:

- Economic activity slowdown during this period;
- Low exchange rate pass-through of exchange rate depreciation on Lek prices of import goods; and
- Stabilized inflationary expectations.

Easing of monetary conditions by the Bank of Albania, through key interest rate cut in October and continuation of liquidity injecting operations have provided appropriate impulses for promoting the economic activity in the future. These impulses, as always, are administered under the conditions of an expected inflation performance close to the three-percent target of the Bank of Albania, and stabilized expectations of economic agents for it. The key interest rate cut by 0.5 percentage point by the Bank of Albania at end-October aimed at strengthening the domestic demand and reviving the lending activity. Its effect on the economy is not fully reflected yet, due to the short period of time and the time lags in transmitting the monetary policy. However, its pass-through to the money market, which constitutes the first link in the transmission chain, is a premise for its reflection to credit cost in a second round. In the meantime, our liquidity injecting operations have been successful in guaranteeing the backup of economy with funds, mainly short-term ones.

Allow me to make a more detailed description of the economic and monetary developments during this period.

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At global level, the economic activity has been supported by improved overall economic climate, impacting on the improvement of the global economic activity, reduction of risk premiums and stability of global financial markets. However, the global economy and the European one continue to reflect economic vulnerabilities, which are transmitted to low inflationary pressures. This situation conditions also the pursuit of a stimulating monetary and fiscal policy by keeping interest rates at the historical low and by high liquidity injections.

Back to the domestic economy, we should state that the new economic data were insufficient during October. Performance of inflation and of monetary and fiscal indicators, external trade data and consumer and business indices confirm that the Albanian economy continues to record positive growth rates. This growth is sustained by maintaining steady levels of the consumer demand and fiscal stimulus given during 2009. However, available data from the

economy speak for an economic activity slowdown during the current year. Foreign demand for Albanian products has decreased, being illustrated by export slowdown along this period, while investments have declined.

The steady trend of core inflation and low non-traded inflation rate also indicate the presence of low aggregate demand-induced inflationary pressures in the country's economy during January–October 2009. This performance has contributed to absorption of shocks generated from traded inflation, due to weakening of national currency's position in the domestic foreign-exchange market.

Inflation during 2009 has fluctuated around the lower limit of the Bank of Albania's target. Headline inflation in October was 2.3 percent, recording a slight rise in comparison to September, but resting below the record of the previous year. Average annual inflation recorded 2.1 percent, resting at the same level with that of September. Parallel to demand factors, inflation performance is influenced even from the development of several supply factors, such as slight downward trend in the labour cost per unit, reduced import and producer prices, statistical effect of administered prices, thus creating an overall environment with reduced inflationary pressures.

Fiscal policy during the third quarter of 2009 has revealed signs of mitigating its expansionary nature. Revenues have recorded a slight rise related to the previous months, while there is noticed a reduction in realised expenditure pace. In annual terms, during the first nine months of the year the budget revenues have recorded a growth of 6 percent, whereas the budget spending has increased by 22 percent. The budget deficit remains at comparably high historical levels, but within the budget limits reviewed lately.

To a great extent, this deficit reflects the high level of public capital expenditures during 2009. Public expenditures and fiscal policy have provided a tangible contribution to the maintaining of the economic activity along this period, but they have been associated with increased pressures over the money markets. The Bank of Albania considers that the fiscal policy should continue to be prudent towards these balances in the future, and should take into consideration the long-term fiscal stability while drafting and implementing mid-term and long-term budget plans.

External trade was featured by weakening in the trade volume during the first nine months of the year. However, trade exchanges value recorded during September is the highest recorded since 2009. After about three months of constant narrowing, the trade deficit enlarged during this month by about 9 percent in annual terms. Exports dropped by about 18 percent in annual terms, though the lek's weak position vis-à-vis the Euro is a favourable factor for exports. Imports recorded positive growth rates for the first time since January of the current year. In annual terms, they grew approximately 1 percent, due to positive growth rate of consumer goods import, whereas import of intermediate goods and capital has declined.

Monetary indicators of September presented a slower performance of the banking system's intermediating activity. In annual terms, broad money recorded a nominal growth of 2.8 percent in September, against 4.5 percent in August.

Foreign currency credit contraction and intermediation of the public sector credit by non-banking agents have influenced the slowdown of monetary indicators growth rate.

In September, loan portfolio of economy grew at lower rates than in the previous months. Annual credit growth rate decreased to 13.2 percent. The credit slowdown is totally a consequence of foreign currency credit tightening, while the ALL credit increased by 31 percent in annual terms. The major part of the new credit, around 85 percent of it, was absorbed by businesses and was used mainly for meeting the needs for liquidity, whereas credit for long-term investments decreased. Also, household loan portfolio growth decreased, chiefly due to consumer credit contraction. Housing loan to households continues to maintain positive growth rates, remaining at 5 percent in annual terms.

Domestic credit intermediation in ALL has raised the need for Bank of Albania's presence by injecting liquidity. The banking system needs for liquidity have been met through open market operations of the Bank of Albania, preserving an appropriate time structure of this injection. Short-term interest rates in the interbank market have reflected decreased borrowing cost by the Bank of Albania and have been steady. Furthermore, the primary market was featured by agents' response to loan pricing, reducing the T-bill yield. The 12-month yield, which serves as a reference rate in determining other costs, has decreased by 0.15 percentage points during November, down to 9.28 percent.

The supply for financing the government demand has been sufficient, without exerting upward pressures on interest rates. Interest rate performance of new deposits denominated in lek and in Euro has also been stable during September, enabling deposits return to the system. In the meantime, new ALL and Euro credit interest rates continue to carry over tightening lending policies by the banking system in general, and fluctuate around isolated preferential policies.

After discussions, the Supervisory Council agreed on keeping the key interest rate unchanged. This decision aims at further preservation and consolidation of macroeconomic balances, regarding the macroeconomic stability as an indispensable precondition for the long-term sustainable growth. It also guarantees appropriate monetary support for the economy during this stage of its development. In the future, the Bank of Albania is willing to operate in line with the actual and expected performance of economic indicators. The shifting to the downward side of inflationary risks balance and the consolidation of financial stability and inflationary expectations in the economy will be taken into consideration in Bank of Albania's future decision-making.