

Ardian Fullani: Recent economic and monetary developments in Albania

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the press conference on the Monetary Policy Decision of the Bank of Albania Supervisory Council, Tirana, 30 November 2011.

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Today, on 30 November 2011, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the analysis of Albania's latest economic and financial developments and following discussions on the performance outlook, the Supervisory Council of the Bank of Albania decided to cut the key interest rate by 0.25 percentage points. Following this decision, the interest rate for one week repurchase agreements fell to 4.75%. This key interest rate cut was triggered by contained inflationary pressures along the monetary policy time span and expectations for a more prudent fiscal policy over the period ahead. The Supervisory Council judged that this decision would provide appropriate monetary conditions to meet the inflation target over the medium run. It would also increase monetary stimulus and promote economic activity in Albania.

(Let me now proceed with an overview of economic developments and main issues discussed at today's meeting.)

Annual inflation rate was 3% in October, slightly up compared with the previous month's figure. Annual consumer price rise continues to be influenced substantially by high food, oil, and primary commodity prices in global markets. These prices have been reflected in a higher contribution of imported inflation to domestic inflation throughout 2011. However, increase in domestic agricultural production, stable performance of exchange rate and price stabilization in global markets have reduced its impact in recent months. These factors, along with the cancelling out of regulated price inflation have led to a continuous slowdown in the inflation rate in recent months.

From the macroeconomic aspect, consumer prices were influenced by drivers of a different impact and intensity. The shocks arising from high prices in global markets, the increase in several regulated prices in 2010 and excise taxes in early 2011 were offset on the downside by the below-potential performance of economic activity and sluggish demand pressures. In the presence of anchored inflation expectations and low monetary inflationary pressures, the overall macroeconomic environment has favoured the reduction of inflationary pressures for the second half of the year.

In the absence of direct data, the Bank of Albania's estimates on **the country's economic performance**, based on indirect qualitative and quantitative indicators, suggest a moderate increase in aggregate demand over the second and third quarters, in line with the one registered over the first quarter. The economic activity has continued to be supported mainly by foreign demand and growth of exports, whereas the public sector's impact has been downward and private consumption and investments have remained weak. In particular, the private sector demand is assessed as sluggish. Notwithstanding the positive performance of real income, consumer spending is estimated as weak, affected by uncertainty surrounding the future and increased propensity of Albanian consumers to save. On the other hand, the need of private businesses to carry out new investments has been low, against the backdrop of a moderate demand for goods and services and the existence of spare capacities in production.

Fiscal policy has been stimulating during 2011. For the first ten-month period of the year, budget deficit posted ALL 30.9 billion or about 33.0% higher than a year earlier. The performance of budget deficit has been determined by the sluggish increase in expenditures and revenues by an annualized rate of 3.9% and 1.4%, respectively. The stimulating fiscal

policy has been winding down steadily following the first quarter of the year, as also shown by the decelerated increase in public spending and budget deficit. This fiscal stance has contributed to maintaining the level of public debt under control. The Bank of Albania assesses the latter as one of the most essential indicators of macroeconomic stability at home. In this context, we encourage fiscal authorities to take appropriate measures, in order to ensure long-term sustainability of public debt.

Foreign demand has supported the Albanian economic growth, notwithstanding the concerns surrounding the global economy and especially our trading partners. Albanian exports continue to grow, albeit at decelerated paces compared with the previous year. Exports grew 27.3% in the third quarter of the year, while imports grew 8.6% over the same period. Trade deficit increased 6.8% in the first nine-month period of the year. The Bank of Albania is very heedful to external balances of the Albanian economy, regarding their correction as one of the main priorities of the country's macroeconomic policies. This objective assumes more importance against the backdrop of recent developments in global financial markets. In the long run, its attainment requires ongoing structural reforms, which will enhance competitiveness of the Albanian economy and will generate higher revenues from the export of goods and services.

Monetary inflationary pressures remain subdued in the medium run. Monetary expansion has maintained stable annual growth rates during the year, resulting 10.4% in September. Public sector demand for funding has been downward in recent months, making the private sector's demand provide the largest contribution to money supply growth. Private sector credit grew 14.0% in September, marking a slight acceleration compared with the first half of the year. However, as we have constantly stated, the relatively sluggish performance of private sector credit reflects mostly its weak demand. The banking sector appears liquid and well capitalized to credit the Albanian economy, but it has increased its prudence in terms of lending, thus reflecting the new reality of the Albanian economy and global financial markets. The Bank of Albania assesses that, within the parameters of prudence, there is room for a more rapid growth of credit and for supporting sound investment projects by the banking sector. On our behalf, we will continue to support the financial system with liquidity and monetary stimuli in order to boost lending.

Financial markets continue to highlight downward liquidity premiums and inflation. The interbank interest rates have further declined, remaining close to the key interest rate and displaying low volatility. A more moderate government demand for funding and the short-term interest rate cut in the money market have been reflected in an overall decline in the yields on primary market government securities.

Our assessments on **economic outlook** suggest a moderate economic growth for the remainder of the year and for the next year. Boosted uncertainties surrounding the global economy make their impact on current and expected developments of the Albanian economy. In particular, the situation of our trading partners is expected to be reflected in a sluggish foreign demand for Albanian goods and services. Also, the need for maintaining budget deficit and public debt parameters is expected to materialize in the public sector's lower contribution to aggregate demand over the period ahead. Under these conditions, the performance of economic activity at home will be determined substantially by the extent and speed of recovery of the private sector demand – consumption and private investments. Despite the positive growth, aggregate demand is expected to remain below the potential of the Albanian economy, determining the incomplete capacity utilization in the economy and generating demand-driven low inflationary pressures. Considering the materialization of these expectations and projections for further weakening of inflationary pressures from global conjuncture, annual inflation is expected to be within the Bank of Albania's target in the medium run.

Taking into account the above overview, the Supervisory Council of the Bank of Albania deemed that inflationary pressures are downward and remain subdued over the monetary policy time span. Also, economic agents' inflation expectations remain anchored around the Bank of Albania's target.

At the conclusion of discussions, the Supervisory Council decided to cut the key interest rate by 0.25 percentage points, down to 4.75%. This decision serves to comply with the inflation target in the medium run and provides appropriate monetary conditions to stimulate the economic activity. The Bank of Albania remains heedful to future economic and financial developments at home and abroad, with a view to take the right steps for the fulfilment of its mandate.