

## **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, 25 April 2012.

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In its meeting of 25 April 2012, the Supervisory Council of the Bank of Albania reviewed and approved the quarterly Monetary Policy Report.

**Based on the analysis of Albania's latest economic and monetary developments and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 4.25%.** This decision reflects the balance of inflationary pressures and the need to maintain the macroeconomic stimulus to the economy, under the conditions of a more prudent fiscal policy during the in the course of the year.

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

During the first quarter of 2012, the Albanian economy continued to maintain the parameters of macroeconomic stability even in the context of the ongoing global crisis.

International financial markets are characterised by high risk premiums and, despite measures taken to solve the public debt crisis in the euro area, signals for a normal progress of in the short run are absent. These developments, as expected, have provided a reining impact on our economy, which is mainly expressed in the continuation of below-potential economic growth.

**Annual inflation** slowed down significantly in the first quarter of the year. On average, it was 1.1% in this period, dropping 1.8 percentage points from the previous quarter.

The rapid decline of annual inflation rates, which has started in the third quarter of the past year, is driven mainly by the slowdown of price rise in food items during this period, as well as the stability of prices of other consumer goods.

Inflation performance has reflected the simultaneous action of supply and demand factors. On the supply side, slowdown of commodity prices in international markets and of inflation in our trade partners, combined with the stable exchange rate, have transmitted lower imported inflation rates to our economy. Likewise, contribution of administered prices has been lower.

Inflation expectations have been anchored and production cost pressures contained.

On the demand side, pressures remain low, conditioned by the continuation of the negative output gap.

Reduction of factual inflation rates, shifting of the inflationary pressures balance to the down side and the increase of aggregate demand below its potential, under the conditions of a controlled fiscal policy, have created the space for further increase of the **monetary stimulus** to the economy during the first quarter of the year. The Bank of Albania has lowered the key interest rate twice, bringing it down to the historic low of 4.25%. Such a decision, besides being in line with maintaining price stability over the medium term, provides the appropriate conditions for boosting private demand at home.

According to recent data from INSTAT, **the Albanian economy** accelerated the growth rate in the fourth quarter of the previous year, posting 3.8% annual growth. The economic activity upturn was driven mainly by output increase in the services sector. Value added of this sector surged 7.5% in annual terms, with a higher contribution by the branch of trade, transport and other services. Similarly, the construction and agriculture sectors posted

positive but low annual growth rates, 1.2% and 1.9%, respectively. Positive contribution to economic growth was also provided by the branches of extractive industry and the processing industry, but they did not manage to balance the significant contraction in the branch of “Electrical energy, water and gas”, which has resulted in negative contribution by the industry sector to the domestic product growth.

From the perspective of **aggregate demand** components, economic growth in Albania continued to be driven by foreign demand also in the last quarter of the past year. Notwithstanding unfavourable developments in the global economy, net exports in real terms have shown higher growth rates in this period. In addition to foreign demand, the public sector demand provided a high contribution, in the fourth quarter of the past year, in the form of increased capital expenditure. In turn, private consumption and investments, while showing signals of recovery, were assessed as slow during the fourth quarter of 2011.

Statistics on the real economy for the first quarter of 2012 are only partially available. Indirect data suggest that aggregate demand has carried forward positive growth rates, but growth remains significantly below the potential of the Albanian economy.

Macroeconomic factors determining private consumption and investments, and a prudent fiscal policy sustain the assessment for contained growth of the domestic demand in the first quarter of the year. Moreover, in the absence of complete data and in real terms on developments in the external sector of the economy, assessments suggest that the contribution of foreign demand to economic growth will be lower than in the past year.

**Fiscal policy** was subject to a consolidation nature over the first quarter of 2012, in line with its objectives to keep budget deficit and public debt in check. The contained fiscal approach has been reflected in minimum public expenditure in the first quarter of the year, with an annualised rate of 0.7%. Furthermore, low growth rates of fiscal revenues continued their trend, settling at 1.2% in this quarter.

The budget deficit was ALL 11.5 billion, or about 2.5% down compared with the first quarter of a year earlier.

Developments in foreign trade over the first two-month period of the year point to contracted trade exchange in annual terms. Value of exports in these two months dipped by 20.5% against the corresponding period of a year earlier, reflecting the moderation of foreign demand and price developments in global markets. On the imports side, their growth rates were significantly decelerated, reaching a nominal annual growth of 1.8% during this period.

These developments were reflected in the widening of the trade deficit in the first two months of the year by the annualised rate of 21.9%. This deficit is determined mostly by electrical energy trade exchanges. Excluding this effect, imports of goods would be lower from a year earlier and the trade deficit would be down by about 9.2% in annual terms.

The **monetary analysis** reveals the existence of contained monetary pressures on the economy. The underlying pace of monetary expansion is assessed as being in line with the demand of economic agents for real money. The annual growth of M3 was 9.1% in February, unchanged from the end of the previous year. Money expansion in the economy was supported more by the foreign currency component, whereas domestic demand for money slowed down. The public sector showed lower demand for funding, in line with fiscal developments in the first quarter of the year.

Furthermore, private sector demand for money increased at moderate rates, as evidenced by the slow growth rates of loans to the private sector, 9.2% as at end-February.

Crediting slowdown has also reflected a low demand by households and businesses for bank loans and higher prudence by banks in lending, which was materialised in tightened credit conditions. Notwithstanding this performance, supply-side determining factors on lending performance provide the appropriate conditions for further credit growth. The Albanian

banking system remains well capitalised and liquid, capable to satisfy the credit demand by the private sector.

**Financial markets** in the first quarter of 2012 were serene, reflecting relatively low premiums of liquidity and inflation risks. The interest rate in the interbank money market has followed swiftly the recent key interest cuts.

The transmission of eased monetary policy signals is also observable in the deposits market, while it is expected to be transmitted in the future also in other market segments, conform to the time lag of the transmission mechanism. In the primary market, government security yields showed upward trend reflecting developments in relevant structural factors of the demand and supply, without signalling added risk or inflation premiums.

Verified developments insofar, change the basic projections for economic developments in the future. Year 2012 is expected to be influenced by unfavourable developments in the global economy, which may affect the Albanian economy as well. Foreign demand is expected to provide lower contribution over the course of the year, impacted by economic slowdown in our trade partners.

Fiscal policy orientation towards further consolidation of fiscal parameters limits the space for a substantial fiscal stimulus to foster the economic activity. Under these circumstances, private domestic demand remains determinant for aggregate demand increase in the future. Overall, analyses suggest a better performance of private consumption and spending, helped also by the eased monetary policy stimulus.

Estimates of the Bank of Albania suggest that, in the course of the year, demand growth below the potential of the economy will continue to exercise low inflationary pressures from the demand side. At the same time, the balance of inflationary pressures generated by supply-side factors is assessed as contained, given the reduced imported inflation and anchored inflation expectations.

Taking into account the insofar developments and expectations for the future, Bank of Albania projections show that, with 90% probability, consumer price inflation for 2012 will range within the 0.7%–2.8% band. Materialisation of this baseline scenario will be reflected in retaining the stimulating nature of the monetary policy in the course of the year. Moreover, the Bank of Albania remains heedful to future developments and ready to respond in the appropriate time and extent in order to comply with its target on inflation.

***Based on the analysis of the information set out above, the Supervisory Council holds that pressures on consumer prices at home remain low over the monetary policy relevant horizon; they have been, however, on the down side over the recent months.***

On the demand side, below-potential economic growth will continue to generate low inflationary pressures, while shocks from the supply side are expected to be moderate.

***At the conclusion of discussions, the Supervisory Council decided to keep the key interest rate unchanged at 4.25%.*** This decision aims to establish the appropriate monetary conditions to comply with the inflation target in the medium run. Given these conditions, we deem that the monetary policy provides the necessary support to stimulate the aggregate demand.