

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, 29 May 2012.

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Today, on 29 May 2012, 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 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 Supervisory Council's opinion that the actual monetary conditions are adequate to meet the Bank of Albania's inflation target in the medium run. It holds the key interest rate at a record low, thereby maintaining the strong stimulating nature of monetary policy, in order to boost aggregate demand and economic growth. This decision also reflects the heightened uncertainty deriving from the external economic environment and, particularly, from the recent economic developments in Greece.

Let me now proceed with an overview of the economic developments and key topics discussed at today's meeting.

Annual inflation marked 1.6% in April, continuing to pursue an upward trajectory over the last two months and approaching the lower limit of the target band. After marking a minimum low in February, the rising trend of inflation was expected and communicated by the Bank of Albania. It reflects, to a large extent, the gradually subsiding supply-side shocks on inflation. The decelerated rise in primary commodity prices in the global markets, the low inflation in Albania's trading partners and the stable exchange rate have generated reduced imported inflation rates.

However, despite increasing, inflation remains low due to the incomplete utilisation of capacities in the economy, which is reflected in weak pressures on the rise of wages and producer prices. At the same time, economic agents' inflation expectations are low and growth of money is in line with the demand of the economy for money. In addition, the absent rise in regulated prices has contributed to the low inflation rate over 2012.

While making an analysis of the economic developments, the Supervisory Council noted that the reappearance of stress in the global financial markets in the current month has heightened the uncertainties in these markets markedly, being translated into more strained financing conditions for the public and private sector. The fall of foreign demand and the higher perceived risk for the entire area have started to affect the performance of economic activity in the countries of the region.

The statistical information available for the first quarter of 2012 provides evidence for a sluggish economic activity. This performance, among others, has been also affected by temporary factors arising from the severe weather conditions. However, the analysis of available indicators reaches the conclusion that both domestic and foreign demand remain sluggish.

After recovering in the last quarter of 2011, **private consumption** slowed down in the first quarter of 2012. The performance of imports of consumer goods and the low annual growth of VAT revenues suggest sluggish consumer demand over the quarter under review. This assessment is also supported by qualitative data obtained from consumer, business and banking sector surveys. The dynamic of quantitative and qualitative indicators also suggests a sluggish performance of **investment**.

Against a background of low demand and spare production capacities, and in the presence of uncertainties for the developments at home and abroad, businesses have postponed their new investment-related decisions. In addition, the contribution of public investment to aggregate demand growth was negative in the first quarter of 2012.

The Government pursued a prudent **fiscal policy** in the first four months of the present year, translated into the annual reduction of the budget deficit by 28% during this period. Budget revenues continue to record moderate annual growth rates, reflecting the performance of economic activity and providing evidence for the mutual impact between the public and private sector dynamics. The Bank of Albania, however, points out that pursuing a fiscal policy oriented toward the long-term sustainability of budget and public debt figures will provide clear medium- and long-term benefits to the Albanian economy, in the form of lower risk premiums, greater room for private sector financing and, ultimately, lower financing costs. This policy is also in line with the developments in domestic and foreign financial markets.

Foreign demand continued to contribute to the expansion of the economy in the first quarter of 2012, albeit to a markedly lower extent. The sluggish increase in exports remains a concern as long as it affects the performance of the economy during 2012. It also provides evidence for Albania's strong reliance on certain geographical markets or products.

The analysis of **monetary data** suggests that the performance of monetary indicators was in line with the developments in the real economy. Money supply maintained the growth rate of end-2011, recording in March an annualized growth of 8.8%. Our analyses suggest that its growth is in line with the demand of the economy for real money, signalling contained monetary inflationary pressures in the medium run. Lending to the private sector recorded an annual growth of 9.0% in March. Its performance, particularly in the recent months, was determined by the low private sector demand for credit and the cautious bank lending behaviour.

Financial markets were liquid and stable. Interbank market rates dropped significantly in April and the trading volume in this market increased. The pass-through of easing monetary policy signals persisted in the lek deposit market as well, as reflected by the lower interest rates.

Government security yields in the primary market remained at similar levels to the previous month. Their increase in the first quarter of 2012 reflects the developments in supply and demand-side structural factors, hence signalling no added inflation premiums. Interest rates on lek-denominated loans did not fully respond to the easing monetary policy signals due to the higher credit risk premiums in particular branches of the economy.

New information supports our previous projection that the GDP growth will remain below its potential in the quarters ahead, owing to the moderate contribution of foreign demand, lack of fiscal stimulus and sluggish domestic demand. The two main components of the latter, consumption and private investment, remain slow. The incomplete utilisation of capacities, coupled with the slow rise in wages and unit labour costs, are expected to exert contained inflationary pressures in the period ahead.

Economic agents' inflation expectations are anchored close to the target. They, however, may be subject to the response to global developments in the short run. The gradually subsiding supply-side shocks in the period ahead, the termination of base effects' impact and the extended effect of the Bank of Albania's stimulating policy are expected to be followed by an rising inflation trend, thereby approaching the Bank of Albania's target in the medium run.

The Bank of Albania has continuously eased the monetary policy in the recent months, aiming at meeting the inflation target in the medium run, and keeping the inflation expectations and risk premiums in the economy under control. This policy has aimed at responding to a situation where the main obstacle to the recovery of private sector demand and foreign direct investment relates to the uncertainty for the future and approach to risk, in the short and medium run. We consider that the provision of a cautious monetary stimulus,

conditioned by the control of risk premiums and safeguard of financial stability, is major contribution the Bank of Albania can make to the stable and long-term economic growth in Albania.

Based on the analysis of the information set out above, the Supervisory Council holds that the risks around the expected inflation trajectory remain balanced. On the demand-side, below-potential economic growth will continue to generate low inflationary pressures, while supply-side shocks are also expected to remain contained. ***At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged at 4.25%.*** This decision aims to create adequate monetary conditions for meeting the inflation target in the medium run. It also provides proper support to boost aggregate demand.