

Ardian Fullani: Overview of Albania's latest economic and financial developments

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, on the Monetary Policy Decision-Making of the Bank of Albania's Supervisory Council, Tirana, 27 November 2012.

* * *

Today, on 27 November 2012, the Bank of Albania's Supervisory Council reviewed and approved the monthly Monetary Policy Report. Based on the latest monetary and economic developments in Albania, and following the discussions on their future outlook, the Bank of Albania's Supervisory Council decided to keep the key interest rate unchanged, at 4.00%. The Supervisory Council deems that the current monetary conditions are adequate to meet Bank of Albania's inflation target in the medium term. These conditions ensure the necessary monetary stimulus to support the domestic demand.

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

Annual inflation fell for the second consecutive month, down to 2.4% in October. Its performance was driven by food price developments, which account for almost 70% of the inflation rate. Prices of other consumer basket items moved in different directions, retaining their contribution at the same levels as in the previous months.

From the macroeconomic viewpoint, inflation rate continued to be determined by temporary externally-generated supply factors and structural changes in the domestic market. The slow performance of economic activity is associated with low increase in producer costs and low pressures on inflation.

Also, moderate growth of monetary indicators, low increases in global prices and well-anchored inflationary expectations have generated contained inflationary pressures. In general, this situation is expected to continue over the period ahead.

Data on third-quarter economic activity are partial and are based on indirect indicators. Their analysis suggests positive but low growth of the domestic economy over this period. Industry, agriculture and services are the sectors that have supported the economic growth, while construction does not highlight any signs of improvement in the current and expected activity. In the aggregate demand, foreign demand remained the main driver to economic growth in the third quarter. The domestic demand appears to have weakened due to lack of fiscal stimulus and sluggish private investments and consumption.

Fiscal policy was consolidating in 2012. It is reflected in the 19% decline in the budget deficit of the first ten months of the year, leading to maintaining of fiscal indicators sustainability over this period. On the other hand, the performance of expenditure and budget deficit did not support the aggregate demand growth.

Public spending for the first ten months of the year resulted 0.2% less than a year earlier, reflecting the low increase in the budget revenues. The latter increased at low annualised rates during the year, resulting at the end of October only 2% higher than a year earlier. The Bank of Albania deems that though the cautious consumer behaviour has not made any direct impact on economic growth over this period, it has helped keep risk premia on track and has led to low long-term interest rates, thus contributing to boosting private investments. Looking forward, we deem that the fiscal policy should retain its orientation toward fiscal indicators sustainability, supporting Albania's economic and monetary stability and being an important pre-requisite for a stable and long-term growth.

Foreign demand continued to support the growth of exports and economic activity throughout 2012. Trade deficit narrowed by 7.9% in the third quarter, reflecting mainly the good performance of exports. The latter increased by 17% in the third quarter, retaining the previous quarters' positive trend. On the other hand, imports performed poorly, reflecting the low demand for consumption and investment. In the third quarter, imports recorded positive annual growth of only 0.7%.

Performance of **monetary indicators** attests to moderate pressures on monetary inflation. The annualised broad money growth rate decelerated to 6.8% in September. Reflecting the sluggish domestic demand, economic agents' demand for money has been low.

The weak demand for money has been associated with a constantly falling contribution of funding from public and private sectors to increasing the monetary supply throughout 2012. Private sector's contribution continued to slow during this month; its annual growth rate reached 4.2%, recording one of the lowest historical levels.

Latest financial market developments have reflected the easing monetary conditions and low or downward premia of inflation and liquidity risks. Interbank rates have been downward, following the monetary policy signals. Also, upon resolving the structural problems in the primary market, the treasury bill yields dropped sharply on all maturities. In a tranquil financial market and lacking additional shocks in the future, the previous monetary policy easing is expected to be passed on to other financial market segments. Under these conditions, raising the monetary stimulus in the economy would further boost aggregate demand, without affecting the price stability in the medium term.

Developments in lending and financial markets reflect households' and businesses' reluctance to make long-term commitments. However, the low degree of credit growth reflects the banks' cautious in terms of lending. In this context, the Bank of Albania points out that, notwithstanding the externally generated short-term risks, the medium and long-term outlook for Albania remains sound. Albanian consumers and businesses should be more realistic about their development plans and adopt a more pragmatist approach to increase current investments and consumption.

Also, the banks' sound balance sheets should provide more financial funds to support the economy by increasing lending.

Looking forward, the new information obtained during the last month confirms our previous projections on the expected performance of the Albanian economy over the monetary policy-relevant horizon. The Albanian economic activity is expected to grow at positive but low and below potential rates. The poor performance of private investments and consumption restricts the room for economic growth. On the other hand, preliminary information suggests that the fiscal stimulus may be upward in the next year, complementing the foreign demand as a **short-term contributor to next year's economic growth. However, the overall effect of fiscal stimulus will depend on the response by the private sector and financial markets. At the same time, its long-term effect will depend on additional costs that it will bring about on the budget.**

The Bank of Albania deems that the aggregate demand will not exert upward pressures on inflation. Against the backdrop of a stable monetary environment, well-anchored inflation expectations and moderate impact from import prices and exchange rate, inflation is expected to remain within the Bank of Albania's target over the period ahead. Under these circumstances, our monetary policy is expected to retain its stimulating nature in the medium term.

Concluding the discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 4.0%.