Ardian Fullani: Overview of economic developments and key issues in Albania

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, on the monetary policy decision by the Supervisory Council of the Bank of Albania, Tirana, 20 December 2012.

*   *   *

Today, on 20 December 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. Moreover, these conditions ensure the right 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 in November stood at 2.5%. The major part of inflation continues to be determined by the performance of food prices. Contribution of other goods was steady from the previous month. Inflation fluctuation owed mainly to the supply-side factors, of external and internal origin. Nonetheless, the intensity of supply shocks was low and lasted for a short period of time. The Supervisory Council finds that developments in the real economy and financial markets produced low inflationary pressures. The Albanian economy continues to remain below its potential. This development is reflected in the low increase of wages and production costs. Prices in the global markets and the exchange rate were relatively stable; hence, they did not exercise pressures for upward prices at home. Likewise, expected inflation remains anchored around Bank of Albania's 3% target. Finally, monetary developments are characterised by low demand for liquid monetary assets. The monetary policy pursued by the Bank of Albania has contributed to stimulating the aggregate demand, administrating the liquidity in the system, and keeping inflationary expectations in check. This situation of inflationary pressures is expected to remain steady in the medium run.

Available figures on the ***economic activity*** over the second half of the year are partial. Indirect data analysis, however, confirm earlier estimates for positive growth during this period, at levels similar to the second quarter of the year. Economic growth was mainly driven by foreign demand, while domestic demand was weak.

Consumer spending is assessed to have been up during the third quarter, reflecting also better activity of the services sector. Private consumption, however, remains weak, due to the slow economic performance and the perceived uncertainties about the future. Its prospect in the medium run remains unclear. Private investments remain at low levels, in the presence of partial utilisation of production capacities, uncertainties about foreign and domestic demand, and tightened lending terms by the financial sector.

Public sector demand was also low during the third quarter and did not, therefore, contribute to higher aggregate demand. As at end-October, the budget deficit for this year was about 19.0% lower than a year earlier. The fiscal policy applied during the three first quarters of the year materialised in the annual fall of public spending for this period, whereas income growth was low and budget deficit was in check. On the other hand, the fourth quarter of 2012 and year 2013 are expected to be characterised by upward fiscal spending and budget deficit. This fiscal policy increases the macroeconomic stimulus in the short run; however, it should be sensitive to the need for medium and long-term stability of the public debt.

Foreign demand was the main driver of economic activity in the third quarter of the year. Latest foreign trade data confirm the same trend for the successive period. Thus, in October, the trade deficit continued the corrective trend, narrowing down to 10.3% in annual terms. Its performance has reflected mainly the good performance of exports, which maintained positive rates of their annual growth, 12.0% in this month. Imports have also contributed to narrowing the trade deficit, contacting 2.3% in annual terms, in this month.

The analysis of monetary ***indicators*** points to low monetary pressures on prices. Higher money supply, the M3 aggregate, continued to decelerate in October, settling at 6.2%. In particular, lending to the private sector slowed down significantly. Annual credit growth for the private sector was 2.4% in October, reaching its all-time low. To a large extent, it is influenced by the low demand of households and business for loans, as reflected by the performance of consumption and private investments. On the other hand, the banking system continues to apply additional prudence with regard to lending, albeit it is under good liquidity and capital conditions.

Financial markets are characterised by downward liquidity risk premiums. Interest rates in the inter-bank market fell even further in November, reflecting the ample liquidity and eased monetary conditions. In the primary market, government security yields continued to fall. Moreover, the interest rate on deposits and loans denominated in the Albanian lek were downward, in response to monetary policy signals. In the period ahead, a more comprehensive response of the real economy to the eased monetary conditions is expected.

***

The Supervisory Council of the Bank of Albania deems that inflation will remain at low levels and close to the medium-term inflation target of the Bank of Albania. The performance of the domestic economy, global economy, and financial markets is not expected to generate any deviation from the 3.0% inflation target. Under these conditions and in the absence of unexpected shocks from the supply side, consumer prices will increase at low rates and will range within the target of the Bank of Albania.

***

At the conclusion of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 4.00%. Keeping the key interest rate at minimum rates helps maintain the stimulating character of the monetary policy, thus enabling the real economy to take advantage of better lending terms in 2013. Furthermore, this policy contributes to keeping inflation expectations in control, by helping lower long-term interest rates.