

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 February 2013.

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Today, on 27 February 2013, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the latest monetary and economic developments in Albania, and following discussions on their future outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 3.75%. The Supervisory Council deems that the monetary conditions are adequate to comply with the medium-term inflation target, providing the necessary monetary stimulus to boost domestic demand.

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

Annual inflation was 2.7% in January. Higher food prices were the major contributor, about 75%, to inflation formation. In this regard, unprocessed foods, which recorded double-digit growth rates, contributed the most to this formation. The prices of the other consumer basket items fluctuated narrowly, maintaining their low contribution to inflation.

In the macroeconomic aspect, inflation was formed by the presence of spare production capacities, while supply-side shocks were absent. The slow growth of production costs and low profit margin for businesses were reflected in low core and headline inflation rates.

In addition, the stable exchange rate, anchored inflation expectations and low monetary expansion contributed to maintaining price stability.

The Albanian economy is estimated to have grown below its potential in 2012. Recent economic and monetary data confirm, overall, our earlier assessment for the presence of a negative output gap. On the **demand** side, economic growth was driven mainly by **net exports growth**, whereas domestic demand is estimated to have provided low contribution. Data on trade in goods during the fourth quarter show that exports increased 12% and imports fell 9.5%, year on year. Subsequently, the nominal trade deficit narrowed 20.1%, in annual terms, boosting aggregate demand in this quarter. On its side, domestic demand remains weak, due to consumers and businesses hesitation to consume and invest.

Lending standards continue to be tight as banks are more prudent about lending. Budget expenditure fell about 0.3%, year on year, owing mainly to contracting capital expenditure. Collected revenue was also downward, eventually reducing the budget deficit by 1.2% compared to 2011. However, the **fiscal policy** was stimulating during the fourth quarter, materialising in 35% expansion of the budget deficit for this period. Though at low rates, public expenditure is expected to have positive contribution to economic activity in 2013.

The **monetary policy** eased further in January, through the key interest rate cut to the record low of 3.75%. The easing was transmitted into the interbank market interest rates during February, while it is expected to be transmitted into other segments of the financial market.

Low government demand for borrowing has exercised downward pressures on government securities yield.

Overall, monetary and financial developments point to low inflationary pressures and liquidity risk. **Monetary indicators** continued to slow down in December, as well. Annual money supply growth fell to 5.0%. Developments in the external sector were the main drivers of

money growth, whereas domestic demand for money was low. The relatively low demand of the government for borrowing and higher demand of households to invest in public debt securities reflected in reduced funding of the budget deficit by the banking system. Similarly, credit to the economy recorded low annual growth rates both for businesses and households. The domestic currency prevailed over foreign currencies in the credit market, hence enabling better transmission of the monetary policy signals to the economy.

Recent information reconfirms our projections for future economic developments.

In the period ahead, economic growth will be driven by economic developments in the global setting and in our trading partners, the fiscal policy nature and enhanced productivity. In 2013, economic activity is expected to remain weak and will continue to be driven by net exports growth, although at lower rates from 2012. The forecast is based on a non-encouraging economic outlook for our trading partners. It also reflects the low diversification of Albanian exports. Domestic demand is expected to remain at low levels, reflecting the sluggish private consumption and investments and the positive contribution of the public sector. Taking into account the available information, the Bank of Albania deems that, with 90% probability, the consumer price inflation is expected to range between 0.8–3.8%, after 12 months.

This assessment takes into account our projections for the continued negative output gap, low pressures from global market prices, and anchored expectations of economic agents.

Concluding, the Bank of Albania expects the inflationary pressures to remain weak in the medium run.

At the end of the discussions, the Supervisory Council decided to keep the key interest rate unchanged at 3.75%. The Bank of Albania will continue to implement a stimulating monetary policy for as long as inflationary pressures will remain weak. Stimulating monetary conditions support aggregate demand growth and full utilisation of production capacities, creating, therefore, the premises for complying with the medium-term inflation target.