

Ardian Fullani: Recent developments in the Albanian economy

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the press conference on monetary policy decision of the Supervisory Council of the Bank of Albania, Tirana, 30 September 2009.

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The Supervisory Council of the Bank of Albania reviewed the Monthly Report of Monetary Policy, at its meeting of September 30, 2009. After getting acquainted with the latest economic – financial developments at home and at the conclusion of the discussions on their expected future performance, decided to keep the key interest rate unchanged, at 5.75 percent. This interest rate is in consistency with the maintaining of inflation close to the Bank of Albania target for a medium-term period.

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The analysis of the latest economic and monetary developments confirmed our expectations for an overall downturn of the economic activity at home and a reduction of the domestic inflationary pressures, for a relaxation of monetary markets and a slowing recovery of financial intermediation, and has also highlighted the still fragile equilibrium of the economic and monetary indicators.

The conclusions of our discussions converged to a decision-taking to keep the key interest rate unchanged. The purpose of this position is to further maintain and consolidate the established balances, thus considering the macroeconomic stability as an indispensable precondition for a stable and long-term growth.

The economic activity at home is backed up by an improvement of the overall global climate, during the last two months, by attempting improvement signs of lending activity and by the seasonal effect of summer time. Global economy is being characterised by a more moderated downturn of the economic activity at industrialised countries, accompanied with a growth of the world trading activity and low inflationary pressures at global level. Nevertheless statistical data regarding the Albanian economy still remain at low level, the indirect indicators suggest this later is characterised by a positive economic growth, but slower compared to the succeeding years. The low pace of both retail sales and budget revenues increase, the exports slowdown, the lower expansion of lending to the economy and business and consumer's confidence indexes show that Albanian economy is going through a slower growth phase relative to the one of previous year.

This situation is also mirrored on the low inflationary pressures, revealed by the low level of core inflation, which is a proper appraiser of the domestic demand pressures. In August 2009, annual inflation pointed to 2.2 percent, remaining within the targeted band of the Bank of Albania, but close to its lower limit. Seasonal tendency of prices' behaviour was confirmed to have the same intensity even during this period, by keeping the inflation value at the same rate with that of the preceding month. The average annual inflation marked 2.2 percent, equal to the value of the previous year, revealing the full elimination of the first round effects of the previous year increases in terms of raw material and electric prices.

Fiscal policy persisted to be also expansionary during July, notwithstanding at more moderated paces. Budget revenues stood at the same rates of projection fulfilment with the previous months – accounting for 94 percent – while expenditure were met by 98 percent of the projected target, maintaining the same level with the three previous months. This effect provided advantage to the expansion of budget deficit in this period. As we have underscored even previously, the increase of both budget deficit and public expenditure does support the economic activity in terms of a low demand of the economy, but it also is accompanied by the increasing tendency of the public debt interest rates. The increasing review of public expenditures and budget deficit rate is forecasted to preserve this effect

even during the remaining part of 2009, while a more balanced fiscal position for 2010 would reduce the pressures on monetary markets, by establishing more spaces for the rise of monetary stimulus.

The external sector data regarding second quarter 2009 reveal a further reduction of the Albania trade exchanges with the rest of the world in annual terms. According to preliminary data, these development tendencies have persisted even during July 2009. Exports decreased by 17 percent relative to the same month of previous year. Imports performance incurred the same development declining by about 8 percent in annual terms. External economy developments are accompanied by the maintenance of high trade deficit rates, which affect the imbalance of the demand to supply ratios for foreign currency in the economy.

Nevertheless, the maintaining of the exchange rate flexibility, the correcting tendency of trade deficit and the attraction of savings denominated in ALL, as higher interest rates and of low inflation, serve to relaxed and prudential volatilities of the exchange rate and to a strong position of ALL in the short-term and medium-term period.

Monetary indicators of July have reflected the more relaxed dynamic of financial intermediation. External sector highlights of the economy have affected the negative paces of the foreign currency component of money stock. However, banking system carried out the intermediation to increase lending in ALL extended to private and public sector with positive paces. Thus, while monetary supply picked up at slower annual paces, about 4.4 percent, M2 aggregate maintained high paces of the annual growth at 9.7 percent as at July. The slowdown of lending pace to economy in foreign currency and the lower supply of foreign currency inflows from external sector have led to a negative annual pace of deposits growth denominated in foreign currency of the system. Lending to private sector increased by 15.8 percent in real annual terms, relative to 17.9 percent in June. Lending to business provided the main contribution on the monthly growth of credit, a constant phenomenon, which this month appeared particularly more emphasised. Credit denominated in ALL maintained the average annual increase rate, by about 28-30 percent, but the slowdown of lending denominated in foreign currency has led to the decline of credit growth pace.

The open market operations of the Bank of Albania met the liquidity needs of the banking system. Bank of Albania has injected all liquidity demanded from commercial banks, by preserving at the same time an accurate time structure of this injection. Notwithstanding the improved liquidity situation, yields rates in primary market have persuaded the increasing tendency of the current months. The increase of risk evaluation from banks is mainly reflected in the determination of long-term yields that is confirmed by the rise of 2 and 5-year bonds yields. The performance of new deposits interest rates denominated in Euro and ALL appears stable during July. New credits interests' rates denominated in ALL have persuaded the decline in July, while this month recorded a tightening of new loan cost denominated in Euro.

At the conclusion, by framing the forecasts for a relaxed inflation and within the target set out by the Bank of Albania for the future, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged. This movement is a continuance of the careful monetary policy pursued by the Bank of Albania during the year 2009, a policy which has aimed the transmission of controlled monetary stimulus and the keeping of inflationary expectations close to the targeted band of the Bank of Albania. Recent developments suggest that the expose of inflationary pressures is being shifted in general on the falling direction. The higher transmission of the recent increasing trend of the raw material prices in the world market composes a risk in terms of the increasing direction of consumer prices. The performance of exchange rate, of inflationary expectations and the country fiscal position, shall continue to condition the balance of risks in future.

The expected relaxation of these occurrences in terms of a well-stabilised financial environment shall provide the needed spaces for the growth of monetary stimulus in the economy.