

## **Ardian Fullani: Recent economic developments in Albania**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the press conference on monetary policy decision-making of the Supervisory Council of the Bank of Albania, Tirana, 24 March 2010.

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The Supervisory Council of the Bank of Albania, in its meeting of 24 March 2010, analyzed and adopted the Monetary Policy Monthly Report. Given the latest economic and monetary developments at home, their projections in future and after assessing the balance of expected risks, the Supervisory Council of the Bank of Albania, at the conclusion of discussions decided to leave the key interest rate unchanged, at 5.25%.

After the heavy shock incurred over 2008 and during the first six months of 2009, the world economy has entered into a recovery stage of the economic activity, stimulated by the expansionist monetary and fiscal policy. The main central banks continued to follow an easing monetary policies with the purpose to sustain lending market and to guarantee the economic stability growth. The end of economic recession is accompanied by the invigoration of inflationary pressures, thus reflecting both statistical impact related to the performance of basic commodity prices, as well the demand growth in the world economy. The performance of financial markets was stable and the main indicators of risk are stabilized at lower rates. Notwithstanding, the attention of financial markets is dominated by the increase of uncertainty in terms of fiscal stability of some euro area countries. This is reflected on the increase of Government securities yields of these countries, as well as on the enhanced sensitivity of investors against fiscal developments.

The economic activity is assessed to have recorded a progressive slowdown of the growth pace, these last six months. The latest indicators of real economy, as sales' indicators, the monetary and confidence indicators, signal further hampering of the economic growth during the fourth quarter of year 2009 and in the early months of 2010. The stoppage of investments from the major part of businesses, the low exploitation of capacities, the decrease of capital goods' import, and the low increase of loans for investments, reveal a slower performance of private investments even in the early months of this year. On the other hand, the more moderated growth paces of employment and wages, the shrinking of consumer loans, the weak performance of retail sales, as well as the indices on the increase of consumers' preferences for savings, show a hampering even of the current and expected consumer in the short-term period.

External sector of economy has manifested positive signals during January, characterized by an exports' growth of 30 % and a tightening of trade deficit by 13%. This welcomed development remains however insufficient to direct the Albanian economy on the path of the persistent economic growth.

The high fiscal incentive transmitted over the first three quarters of 2009, has affected the increase of public debt at 59.5 percent of GDP. The upsurge of current and capital expenses over this period, financed by the expansion of the state deficit and the growth of public borrowing, affected considerably the economic activity, however in a short-term. Through the twice cuts of the key interest rate and the ongoing injection of liquidity, the monetary policy of the Bank of Albania manifested also a simulating character over 2009 and during the early months of 2010. The monetary conditions at home, under the presence of the exchange rate depreciation during this period, have progressively provided ground to the aggregate demand. However, monetary conditions have been and continue to remain in line with the medium term and long term stability of prices at home, serving also to the well functioning of financial markets and to the maintenance of financial systems stability.

In terms of the respond to the easing monetary policy and to the decrease of risk primes in economy, monetary indicators show improvement signs during the two first months of 2010. A decreasing trend of currency outside banks is materialized and a correspondent growth of deposits in the system. The resulted improvement of liquidity indicators of banking system and the reduction of the demand for funds of public sector are followed by the decrease of Government securities yields. The exchange rate also appears relatively stabilized, reflecting a slight correction of foreign trade indicators and of the country current deficit during the last two quarters. This correction has also affected the establishment of more steady balances of the demand and supply for foreign currency in this period.

Notwithstanding these encouraging developments, lending activity at home remains far from its potentiality, responding to the lower demand for banking loans and the tightened lending conditions as applied from banks. Lending to private sector marked an annual growth of 4% in real terms, providing an annual growth of 7.8 percent of monetary supply in January.

All denominated credit continues to rule the lending activity, which mainly covers the businesses' needs for circulating capital. January 2010 embodied a particularity, that is the improved state of the banking system assets denominated in foreign currency, has started to be mirrored on the growth of credit denominated in foreign currency. Notwithstanding, the stable increase of lending should be assisted by the re-activation of the demand for loans and the parallel easing of lending conditions as applied from the banking system. Bank of Albania deems that banking system should reveal more visionary in assessing potential sectors of economic growth and to take a more active role in encouraging the economic activity.

Annual inflation in February 2010 pointed to 4.4%, exceeding by 0.4 percentage points the upper limit of the Bank of Albania target's tolerance. The annual average inflation pointed to 2.6%. The recent developments of inflation have reflected the statistical impact of the comparison to a relatively low prices base in 2009, the more full transmission of exchange rate depreciation on consumer prices and the administrative increase of energy, since January 2010.

The later factor provided an effect of about 0.5 percentage points on inflation level, being the main reason of exceeding the level of 4%. On the other side, the increasing tendency of food goods inflation is owed to the global conjuncture of goods prices, which is revealing a gradual monthly increase since the half of 2009.

Our analysis recommends that the increasing trend of inflation owes mainly to supplying factors, which are estimated to manifest an uneven nature and a short-term action in time. The Bank of Albania expected these developments, being factorised on our projections regarding inflation and communicated timely and in terms of transparency to the public. In medium term period, the growth under potential of the Albanian economy owing to the slowdown of the domestic and external demand, shall establish an environment of low inflationary pressures, which are expected to balance the pressures deriving from the supply direction. This assessment is also supported by the sustained developments and at low historic rates of the long-term component of non-tradable goods inflation, as the most directed transmission of inflationary pressures generated from the internal demand in economy.

The rates of both key inflation and of the non-tradable goods in February pointed to 1.1 and 2.3%, respectively.

Throughout the discussions on the current and expected economic developments, the Supervisory Council of the Bank of Albania concluded that the inflationary pressures balance in medium term horizon is in line with the Bank of Albania inflation target, notwithstanding the latest tendencies of consumer prices' inflation. The assessments regarding the demand slowdown and the increase of negative production gap, the more controlled development of exchange rate and, the equilibrated expectations of economic agents about inflation, are

factors which shall condition the development of inflation within the target of the Bank of Albania.

At the conclusion of discussions, the Supervisory Council decided to leave the key interest rate unchanged, at 5.25 percent. This decision guarantees the appropriate monetary conditions on the preservation of the medium term inflation target. Bank of Albania, regarding the future, remains ready to operate in line with the real and expected performance of the economic indicators. In particular, its decision shall factorise the maintaining of inflationary expectations being anchored around the objective of the Bank of Albania regarding inflation, stability of financial system at home, in terms of maintaining and further consolidating the macroeconomic balances.

In this view, Bank of Albania assesses that the recent correcting tendencies of the balance of payment indicators are encouraging developments for the long-terms sustainability of the country financial indicators. On the other hand, Bank of Albania deems that this sustainability would be assisted by the application of a cautious fiscal policy, which should already factorize the long terms soundness of fiscal parameters in its decision-making process.