

Ardian Fullani: Economy and key interest rate 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, 26 May 2010.

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The Supervisory Council of the Bank of Albania on its meeting of 26 May, 2010 reviewed and approved the Monetary Policy Monthly Report. Taking into account all the latest economic and financial development at home and their projections on the future, at the conclusion of discussions, the Supervisory Council of the Bank of Albania decided to leave the key interest rate unchanged, at 5.25 percent.

The improvement of the world economic activity, as shown by the sharp growth of the emerging countries' economies and by the moderate rise of the major part of developed countries' economies, has characterised the early months of 2010. Economic recovery is accompanied by the increase of trade activity, in the meantime central banks and fiscal authorities have pursued to support the aggregate demand through easing policies.

Notwithstanding the climbing trend of commodities prices, the inflationary pressures continue to be still low owing to the negative gap of production. However, the events occurring in the last weeks have revealed that both euro area and world economies are characterised by high uncertainties as regard the future. The economic and political discussions are particularly focused on the fiscal situation. The implementation of quick and concrete measures, which guarantee the long-term stability of public debt, seems that shall condition considerably the future development. World financial markets have reacted tensely against these developments, being characterised by a high volatility and an increase of risk primes throughout the instruments variety, markets and financial agents.

Turning to the domestic economy, the latest qualitative and quantitative indicators show a slow performance of economy in the early months of 2010. The deceleration of domestic demand is compensated by a positive and growing performance of the Albanian exports.

The domestic inflationary pressures were low and the consumer price inflation declining. Monetary markets revealed more calm, characterised by a dropping trend of interest rates, liquidity situation improvement of the banking system and a more stable performance of the exchange rate. However, lending to economy continues to maintain low growth paces.

Indirect and prior estimates suggest that the paces of private **consumption** have been controlled, conditioned by restricted sources of its financing and by the higher tendency of consumers regarding savings. The low level of capacities utilisation in economy, the low paces of loan for investments and the fall of capital and intermediate goods import, signal a contraction of **private investments** even during the first three months of this year. The demand for monetary assets of private sector continues to be low, thus reflecting a deceleration of the economic activity.

The annual pace of lending growth, excluding the exchange rate effect, for this sector slowed down onwards, at 4.8 percent in March. Business' demand for loans persists to be the sole lending increase source, whereas loan to households continues to shrink in annual terms, for the fifth consecutive month. During this period there are transmitted also the first signals on an easing of lending standards from banks, but this step is applied only on large-sized business.

Fiscal stimuli developed at more controlled paces in the first 4-month period of year, providing a lower contribution on the economic activity during this period. Fiscal policy has

maintained an encouraging character, but at a lower rate relative to the same period of previous year. Budget deficit amounted to ALL 5.3 billion, contracted by 47 percent in annual terms. The low economic activity is reflected on the low growth by about 3 percent of budgeted revenues during the first 4-month period of year.

On the other side, budget expense recorded a reduction by about 2 percent from the rate recorded in the previous year. Bank of Albania continues to draw the attention that, notwithstanding the short-term positive effects the fiscal stimuli may generate; the long-term stability of public sector should remain the main leader of fiscal policy. The lesson from the current problematic situation involving many European Union countries, is the indispensability for consolidation of public finances and for that purpose the implementation of important correcting measures at quickest time, is a target of strategic importance.

Given the balancing of above stated developments, the accelerated growth of exports has provided a positive contribution on the total demand and on the economic growth. Exports climbed by 45.1 percent in annual terms, during the first quarter of 2010, whereas imports recorded an annual drop by about 2.3 percent.

Accelerated upsurge of exports and the fall of imports at more moderate paces led to the contraction by about 17.1 percent of trade deficit, pursuing the trend observed even during the second half of 2009. The ratio of imports covering from exports pointed to 35.4 percent, about 11.6 percentage points higher than in the previous year. The above stated developments in the foreign economy sector have established a more sustained balance of the supply and demand for foreign currency, thereby providing a higher stability of the domestic currency value during the last months of year. It is needed this momentum adopts a stability over the medium term, through the accelerated implementation of facilitating supporting policies.

Economic background and monetary developments have established an environment with moderate inflationary pressures. Annual **Inflation** in April pointed to 3.5 percent, thereby recording a drop of 0.4 percentage points relative to March 2010. The return of inflation within the target of the Bank of Albania was an expected development, forecasted previously.

Consumer price inflation in Albania, during the last months, owes to a greater extend, to the increase of administered prices, the uprising trend of prices in the world conjuncture and by the subsequent effects of exchange rate depreciation on inflation. Given the lack of second round effects on inflation, these latter's impact, as previewed, results to be a transitional one. Inflationary domestic pressures remain low, as showed by the core inflation performance of non-tradable goods. The rates of these important factors of inflation remain at 1.2 and 2.4 percent, respectively in April. This trend is expected to be observed even in the near future, as long the Albanian economy shall continue to be characterised by low rates of capacities utilisation, by a controlled expansion of monetary indicators and by the anchored inflationary expectations.

Bank of Albania, to fulfil its target for inflation, has observed a cautious **monetary policy**, supplying the needed liquidity in the market, in line with economy needs. **Financial markets** are shown stable, by downward interest rates, low and dampen risk primes. Monetary developments during March have confirmed the uprising expansion of monetary supply in economy, which rose by 10.2% in annual nominal term. This performance is grounded by the drop of currency outside banks rate and the stable growth of deposits in the banking system.

The Supervisory Council of the Bank of Albania, during its discussions concluded that inflationary pressures on the domestic economy are expected to be balanced over the medium term.

Under the conditions when the temporary operation of pressures on supply direction is expected to be cancelled out, the non-inflationary pressures as a result of production negative gap from the demand side is estimated to set out the inflation volatility around the

Bank of Albania target regarding inflation. The expectations of economic agents regarding inflation remain anchored over the medium term horizon.

At the conclusion of discussion, the Supervisory Council decided to leave the key interest rate unchanged, at 5.25 percent. This decision is in line with the accomplishment of inflation target over the medium term period, and provides at the same time the needed monetary conditions to support the sound development of economy. Looking ahead, Bank of Albania shall continue to observe carefully the developments in inflation and in the other indicators of the economic progress, by analysing the need and time span in terms of a reaction from the monetary policy.