

## Ardian Fullani: Latest economic and financial developments in Albania

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the press conference on the monetary policy decision-making of the Supervisory Council of the Bank of Albania, Tirana, 30 June 2010.

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In its meeting of 30 June 2010, the Supervisory Council of the Bank of Albania analyzed and approved the Monetary Policy Monthly Report. After being introduced to the latest economic and financial developments at home and their projections for the future, at the end of discussion, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 5.25 percent.

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Global economy attested to higher economic activity in the early months of 2010 fuelled by the recovery of demand in emerging countries, stimulating policies pursued by advanced economies and higher foreign trade. The prospects for global economy suggest that the recovery will persist in most economies. However, unemployment remains high, reflecting the low business confidence and scarce investments in expanding production capacities. Inflation pressures, albeit low, maintained their upward trend in 2010 owing to the recovery of global demand. The financial markets were highly volatile in response to the key market players' concerns over the public debt-related issues in some Euro area countries. The need for budget consolidation in most of these countries due to the deteriorated fiscal indicators is expected to affect the future economic developments on a large scale.

The last G20 meeting, which represents the world's premier forum for discussing economic policies, came up with a clear message about the need for fiscal consolidation and immediate efforts to rein in public debt.

Concerning the Albanian economy, the available data attest to slow economic performance in the first four months of 2010. The poor performance of domestic demand components was offset by the higher contribution of foreign demand due to the considerable growth in exports. However, in line with our expectations, the Bank of Albania considers that economic activity has recovered gradually during this period. The recovery is expected to persist in the second half of 2010 as well. Inflation has maintained downward rates due to the low inflation pressures generated by the domestic economic environment.

The financial markets have been stable, featuring downward interest rates, an improved liquidity situation in the banking system and a more relaxed exchange rate.

**Consumer spending** continued to be affected by the restrained financial resources and low consumer confidence in the first half of 2010.

Indirect indicators like:

- the low growth of retail sales;
- the decline of remittances and consumer loans; and
- the slower employment indicators,

attest to slower private consumption in the early months of 2010.

**Private investments** have provided a negative contribution to economic growth. The historical low of the free capacity utilization, the worsened figures of business confidence, the contraction of the import of intermediate and capital goods and the slowdown in credit suggest that investments were low during this period.

On the other hand, the slight recovery of credit for investment purposes and the increase in the imports of intermediate goods in the first months of the second quarter of 2010 may signal a possible shift of this aggregate demand component in the second quarter of the present year.

**The public sector** continued to pursue a stimulating fiscal policy in the first five months of 2010. Budget deficit amounted to ALL 11.6 billion, owing to the annual growth of budget revenue by 4 percent and the annual contraction of public spending by 3 percent.

After careful monitoring of the current and expected economic performance and its implications for fiscal indicators, the Bank of Albania considers that fiscal policy should be watchful at keeping the budget deficit and public debt levels in check.

Keeping the budget deficit within sound parameters increases confidence in the long-term sustainability of public debt, hence lowering the risk premiums in the financial markets. In addition, the lowering of pressures in the domestic financial markets helps to keep the long-term interest rates in check, hence facilitating the private sector access to the credit market. Therefore, the projected revision to the 2010 state budget needs to be based on a realistic budget revenue plan, making at the same time projections of the required correction measures for the reduction of public spending and control of budget deficit.

**Net exports** increased their positive contribution to aggregate demand in the first four months of 2010. This performance was triggered by the annual increase of exports by 47 percent, while imports were comparable to the previous year. Hence, in the first four months of the present year, trade deficit narrowed further by 14 percent y-o-y. In addition to the positive impact on economic growth, this necessary correction aided the stability of the national currency. Lek's exchange rate was more stable and less volatile during this period.

The performance of other balance of payments items in the first quarter of the present year attests to the significant reduction of foreign financing. Remittances declined 6.7 percent, hence financing only 40.6 percent of the trade deficit.

Despite the positive performance of foreign direct investments, posting an annual growth of 26 percent, the surplus in capital and financial account financed only 41.2 percent of the current deficit. The surplus was 63 percent lower than the previous year.

The long-term stability of the external position of our economy remains a weakness that requires constant consideration in terms of the formulation and implementation of economic policies.

The slow growth rates of domestic demand were reflected in the low demand for money. In April, money supply posted an annual nominal growth of 7.5 percent. The creation of money in economy continues to be primarily sustained by the growth of the banking system's net foreign assets. In April, private sector credit posted an annual growth of 7 percent.

Banking loan data show a positive dynamics for the last two months, displaying higher monthly growth rates of loans and particularly of investment loans. However, the lending growth rates are still low owing to the economic agents' moderate demand for loans and the tight lending standards applied by the banking system as a result of its increased prudence.

The growth of deposits improved the banking system's balance sheet and its liquidity and capitalization indicators. This positive performance needs to be reflected in a more active role of the banking system in terms of lending.

The improved liquidity indicators, the contained public sector borrowing in the domestic financial market, the lower risk premiums and the anchored inflation expectations have led to lower interest rates in the financial market. The latter appears more relaxed and the trading volumes have increased. The decrease of interest rates on deposits, loans and Government securities persisted in the last two months; hence providing appropriate conditions for boosting economic activity. The Bank of Albania considers that the same tendency should continue to be sustained by the contribution of all abovementioned factors.

This year's economic developments have yielded low inflation pressures. CPI annual inflation marked 3.1 percent in May, close to the Bank of Albania's target. Annual inflation rate was downward for the third consecutive month, confirming our expectations and forecast for the transitory supply-side shock effects. On the other hand, domestic demand-side pressures have been downward; this has been attested by the historical lows of core and non-traded inflation, 1.2 and 1.3 percent, respectively.

The Bank of Albania has pursued a prudent monetary policy. In full observance of the inflation target, the Bank of Albania continued to be present in the market through the provision of the required liquidity to the banking system.

In its meeting today, the Supervisory Council approved the change of its monetary policy operational objective, which as from today will be steering the short-term interest rates in the interbank market close to the Bank of Albania's key interest rate.

This change enhances the efficiency and transparency of monetary policy and promotes the further development of the interbank market. The Bank of Albania has taken all the necessary measures to successfully implement this project.

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In its discussions today, the Supervisory Council of the Bank of Albania concluded that in absence of unanticipated shocks, CPI inflation will be in line with the Bank of Albania's target in the medium-term. In addition, the Supervisory Council concluded that the monetary conditions are fully adequate to observe this target. In conclusion, the Supervisory Council decided to keep the key interest rate unchanged at 5.25 percent.

This decision is considered appropriate for the situation the Albanian economy is in, providing at the same time the necessary monetary conditions for sustaining its sound development.

Concerning the future, the Bank of Albania remains fully committed to consider and follow up the actual and expected performance of economic indicators in view of maintaining price stability and firm up macroeconomic balances at home.

The Bank of Albania invites all economic stakeholders to join this philosophy and provide their contribution to the stable and long-term growth of Albania.