

Ardian Fullani: Recent economic and monetary developments in Albania

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the press conference on the Monetary Policy Decision of the Bank of Albania Supervisory Council, Tirana, 28 December 2011.

* * *

Today, on 28 December 2011, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the analysis of Albania's latest economic and monetary developments and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to leave the key interest rate unchanged at 4.75%. The Supervisory Council deemed that the actual monetary conditions are appropriate to meet the inflation target over the medium run and provide the necessary monetary stimulus and to support economic activity in Albania.

(Let me now proceed with an overview of economic developments and main issues discussed at today's meeting.)

Inflation rate in November was 2.9%, slightly down by 0.1 percentage points from the previous month. Most of inflation in November was formed by higher prices of processed foods and non-food consumption goods, whereas other items of the consumer goods basket had low inflation rates.

Recent months were characterised by progressive reduction of inflationary pressures on the economy. On the supply side, price rise slowdown for main products in international markets and national currency stability were reflected in dampened imported inflation. Moreover, the cancelling out of direct administered price increase effects contributed to lower inflation rates during this period. On the demand side, below-potential growth of the Albanian economy and under-utilised capacities in the labour and capital markets were reflected in limited pressures on production costs and ultimate prices in the economy. Furthermore, the Bank of Albania's positive experience on inflation control and its reliable monetary policy have contributed to controlling inflation expectations and mitigating transmission of supply shocks on headline inflation. Overall, this trend is expected to continue in the period ahead.

The absence of direct data on real economy indicators makes a comprehensive analysis of the Albanian economy difficult. Our judgement is thus based on indirect data, which proxy developments in various sectors of the economy, as well as information filtered from monetary indicators, fiscal indicators, external sector indicators, and businesses and consumer confidence surveys.

The analysis of these indicators supports the assessment for positive-but-below potential performance of the Albanian economy in the second and third quarters. Economic growth was also supported by external demand and public sector demand, whereas private consumption and investments continued to be sluggish. Production growth was mainly driven by the industry and services sectors, whereas the construction sector continued to suffer from low demand for residential properties.

Performance of **private consumption and investments** was sluggish. In line with the performance of the economy, available income of Albanian households were assessed as growing at lower rates in this period. The sluggish consumption has reflected mostly higher inclination of Albanian households towards savings. Private consumption was more supported by consumer credit in 2011. Nevertheless, banks report feeble demand for consumer credits, while consumers continued their hesitation for large purchases in 2011.

Moreover, investments in the economy are restricted by the ultimate demand, existence of spare capacities in production and added prudence by banks in lending.

In this context, monetary policy easing of the second half of 2011 is expected to be reflected in better lending terms to Albanian businesses and households to support their consumption and investment. I have often reiterated that their performance will condition economic growth in the short and medium run.

Fiscal policy has been stimulating in 2011, though this stimulus has fluctuated over the quarters. As indicated by the expenditures and budget deficit performance, the fiscal stimulus was stronger in the first quarter and moderate in the second and third quarters. Data for the fourth quarter point to its acceleration.

Budget deficit in the first 11 months was ALL 38 billion, reflecting mainly public spending. Their annualised increase rate for the first 11 months was 5.6%, with added contribution by capital expenditures during October–November. On the other hand, fiscal revenues continue to have slow annual increase, at 0.7% for this period.

Foreign demand continued to contribute to aggregate demand growth in the economy, albeit less than in earlier periods. Its performance was affected by the unfavourable economic situation of our main trade partners. In October, exports were up 16.3 %, recording slower annual growth rates.

On the other hand, under the effect of high prices in international markets, annualised imports rates remained high and were materialised in Albania's trade deficit expansion, which in October was 11.6% higher than a year earlier.

Monetary sector's analysis indicates contained inflationary pressures of monetary nature in Albania's economy. Broad money expansion was 10.6% in October, lower than the average rates of 2011. In real terms, monetary supply growth rates were stable and are deemed to be in accordance with economic agents' demand for real money. During the last months, public sector demand decelerated, whereas private sector demand for monetary assets increased. Private sector credit growth rates were upward and settled at 14.0% in October.

Credit demand was higher both by businesses and by households; however, this growth is slow. Overall, lending terms offered by the banking system and parameters of capitalisation, liquidity and health are appropriate for funding higher demand for private consumption or investments in the future.

Latest developments in **financial markets** continue to be characterised by controlled risk, liquidity and inflation premiums. Successive key interest cuts appear to have been transmitted forthwith in the money market. Government securities yields in the primary **market** dropped further, reflecting the key interest rate cut in the economy and the low public sector demand for funding. The key interest rate cut is expected to be transmitted in the future to interest rates on deposits and loans, in accordance with the time lag of the monetary policy transmission mechanism.

Lastly, a positive development in financial markets at home is the reconfirmation of the actual government bond rating and the country's stable outlook by Moody's and Standard & Poor rating agencies.

Projections for the **economic outlook** remain subject to high uncertainties, dictated mainly by developments in the global economy. Our analysis and estimates suggest continuation of moderate economic growth rates for the remainder of the year and the next year.

Economic slowdown in our trade partner countries may be reflected in weaker foreign demand and further deceleration of Albanian exports.

In addition, space for implementing fiscal stimuli narrowed in response to the growing need for maintaining fiscal stability and controlling public deficit and debt levels. Consequently, public sector contribution to aggregate demand growth is expected to be downward in 2012. Under these circumstances, the extent and speed of recovery of private sector demand will be crucial for the country's economic growth. As we have stated in earlier communications,

the actual monetary conditions are appropriate to encourage private consumption and investments.

Taking into consideration the information set out above, in the Supervisory Council assessment, inflationary pressures remain controlled over the monetary policy relevant horizon.

The presence of the negative output gap in the period ahead will be accompanied by low inflationary pressures originating from internal demand.

In addition, inflationary pressures from global economy developments are projected to be more moderate, whereas inflation expectations are anchored. These assessments are materialised in annual inflation projections ranging within the target band of the Bank of Albania for the medium run.

At the conclusion of discussions, the Supervisory Council decided to leave the key interest rate unchanged at 4.75%. This decision serves to comply with the medium term inflation target and provides the appropriate monetary conditions for Albania's economic activity.

Bank of Albania remains heedful to future economic and financial developments, both at home and internationally, as well as vigilant to fulfil its mandate.