

## 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, 1 March 2012.

\* \* \*

Today, on 29 February 2012, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the analyses 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 keep the key interest rate unchanged at 4.50%. The Supervisory Council deemed that this decision provides the appropriate monetary conditions to meet the inflation target over the medium term. Moreover, it provides the necessary monetary stimulus to the economy in Albania.

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

\*\*\*

**Annual inflation rate** was 1.6% in January, slightly down by 0.1 percentage points compared with the previous month. The annual inflation rates have been pursuing a downward trend since the second half of 2011, reflecting the mitigation of inflationary pressures from the supply side: cancelling out of effects from administered price rise; increase of domestic agricultural production; and slowdown of imported inflation. The downward annual inflation in January reflected the further decrease of imported inflation from the external sector of the economy, materialised in the lower contribution of the prices of processed goods and foods. Prices of unprocessed foods continued to contribute to downward annual inflation, while the contribution of other categories was relatively stable.

Inflationary pressures from the demand side remain low and are conditioned by the continued negative output gap and lack of cost-related pressures on the economy. Moreover, low increase of consumer prices has reflected economic agents' expectations on inflation.

According to INSTAT data, **Albania's economy growth rates** improved over the third quarter of 2011, posting an annual growth of 2.6% over this quarter. On the production side, growth was supported by branches of the industry sector and services. On the demand side, economic growth continues to be driven by foreign demand, while domestic demand remains sluggish. A similar growth model is assessed to have taken place in the fourth quarter of 2011.

Based on the analysis of aggregate demand components, the Bank of Albania judges that **foreign demand** was the main driver of demand increase during 2011. Although not at the levels of previous year, exports continue to grow. Latest foreign trade data point to our exports annual growth by 20.7% in December. On the other hand, imports accelerated their growth rates in this month, posting an annual growth of 14.5%. This performance is reflected in the widening of the trade deficit by 12.0%, year on year. To a large degree, the trade deficit reflects price developments in international markets. In real terms, the trade deficit is assessed to have narrowed during 2011.

Indirect data show that **consumption** was poor over the second half of 2011. In the fourth quarter, however, it showed improvement. Indirect data obtained from the import of consumer goods, fiscal indicators and consumer confidence indices signal the recovery of consumption during this period. On the other hand, the presence of uncertainties for the future amongst Albanian consumers continues to discourage consumption and dictate the consumer's behaviour towards saving.

**Private investment** is assessed as improved in the fourth quarter for certain branches of the economy, while across the sectors of the economy the improvement remains low. Furthermore, below potential growth and low capacity utilisation rates have reduced incentives to undertake new investments.

The contribution of **fiscal expenditures** to aggregate demand growth has been positive over 2011, reflecting a moderate fiscal stimulus, especially during the first and fourth quarters of the year. The fiscal policy has been prudent with a view to keeping fiscal indicators within sound parameters. Budget deficit for 2011 was ALL 45.7 billion, remaining within the envisaged level. Its performance has reflected low rates, both in terms of fiscal income and expenditures, recording an annual growth of 1.8% and 3.7%, respectively, in 2011.

**Monetary indicators** performance suggests the existence of contained monetary inflationary pressures.

The annual growth rate of M3 monetary aggregate was 9.2% in December, in line with the deceleration over the second half of 2011.

According to our analysis, the expansion of money is in conformity with the demand for real money in the economy. The expansion of money has been sustained by the increased demand of the public sector for funds at end-2011, as well as the stable contribution of the demand by the private sector.

The latter continues to reflect developments in the real economy, being conditioned mainly by weak demand for loans by businesses and households. In December, the loan portfolio of the banking system to the private sector was 10.4% higher than a year earlier. Similar to the most part of 2011, it has reflected the demand of the private sector to fund its liquidity, consumption and investment needs, materialising also the hesitation of the private sector to commit to long-term projects. In addition to demand factors, the supply of loans is assessed to have been more tightened in the second half of 2011, reflecting the added prudence of the banking system in lending.

Latest developments in **financial markets** are influenced by the normal and quiet performance of demand and supply, which is in line with the monetary policy signals. The key interest rate cut to 4.50% is reflected in eased borrowing costs for banks, while it is expected to be completely transmitted to other higher-maturity market segments. Overall, risk, liquidity and inflation premiums in financial markets remain contained.

Projections for the **expected performance of the economy** support the assessment for positive, though below potential, growth of the Albanian economy for the year ahead. Foreign demand is expected to continue to provide positive, but more moderate, contribution to aggregate demand increase.

Likewise, the impulse by the fiscal sector is expected to be lower than in the past year. Under these circumstances, the growth speed and rate of the economy at home will be determined largely by the performance of private domestic demand components: consumption and investments.

Our analyses reveal the existence of room for higher growth in the future. This growth will be supported also by stimulating monetary and financial conditions, in response to the monetary policy of the Bank of Albania.

\*\*\*

Taking into account the above overview, the Supervisory Council of the Bank of Albania deemed that the inflationary pressures remain subdued over the monetary policy horizon. The output gap will continue to be negative in the period ahead, materialising in low inflationary pressures originating from domestic demand. Moreover, inflationary pressures from developments in the global economy are expected to be downward, whereas inflation expectations remain anchored.

The expected performance of real and monetary indicators is reflected in projections for the inflation, which is expected to range within the target of the Bank of Albania for the period ahead.

***At the conclusion of discussions, the Supervisory Council decided to keep the key interest rate unchanged at 4.50%.*** This decision serves to comply with our medium-term inflation target and provides the appropriate monetary conditions to stimulate Albania's economic activity. The Bank of Albania remains heedful to future economic and financial developments at home and abroad as well as diligent to accomplish its mandate.