

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 March 2012.

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Today, on 28 March 2012, 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 cut the key interest rate by 0.25 percentage points, bringing it down to 4.25%.** This decision was motivated by the further decline of the balance of inflationary pressures as well as the need for increased macroeconomic stimulus to the economy under the conditions of a more prudent fiscal policy for the period ahead.

The Supervisory Council deemed that, following the successive easing of the monetary policy, the latest key interest rate cut will provide more appropriate monetary conditions to meet the inflation target and stimulate economic activity in Albania.

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

Annual inflation in February was 0.6%, recording sharp decline from 1.6% recorded a month earlier. The rapid deceleration of inflation was a result of the annual drop of food prices during this month and the high base of comparison with the corresponding month a year earlier. Overall, factors that affect inflation showed low activity intensity and prices of other goods of the basket do not signal for inflationary pressures on the economy.

From the macroeconomic perspective, the downtrend of annual inflation is dictated primarily by rapid decline of pressures on the supply side, notably: slowdown of commodities price rise in international markets and low inflation in our main trade partner countries; cancelling out of the administered price rise effect; and stability of the national currency. Although these developments had been factorised by our analyses and projections, their influence was higher than expected. On the other hand, inflationary pressures originating from the aggregate demand continued to be low, in the context of below-potential economic growth and anchored expectations on inflation.

Figures on **real economy** developments in early 2012 are scarce. Indirect statistical data, available for the monetary, fiscal and trade sectors of the economy, signal for slow economic growth in the first quarter of the year.

As expected, aggregate demand was sustained less by the fiscal stimulus, in response to the prudent fiscal behaviour for 2012. Similarly, the contribution of foreign demand, during this period, is assessed as low, owing to economic activity slowdown in our partner countries. Moreover, despite signals for its recovery, the domestic private demand remains slow, given the consumers and private business hesitation to spend and invest.

Fiscal sector data for January reveal positive budget balance for this year, about ALL 1.6 billion. The fiscal surplus has reflected the simultaneous decline of public income and expenditure, respectively 5.3% and 5.5%, year on year. As regards expenditures, capital expenditures decreased whereas current expenditures increased during this period.

Foreign trade data point to about 8.7% annual contraction of Albanian exports, in January, while imports annual growth rates slowed down to 4.5%. These developments in the foreign trade were materialised in wider trade deficit, which expanded by about 13.8% from a year

earlier. The performance of this indicator during the first two months of the year may be subject to temporary factors. Its dynamic and developments in the future will be monitored. **Foreign demand** has been the main driver of our aggregate demand over the last two years and, in Bank of Albania's view, will continue to provide small positive impact in 2012.

Monetary developments were in line with the performance of the real economy. Their analysis confirms the existence of low monetary inflationary pressures on the economy. Broad money, monetary aggregate M3, decelerated its annual growth to 8.1% in January.

On the demand side, this performance has been affected by low demand for funds by the public and private sectors in January. Annual private sector credit pursued the downtrend that had started in the last quarter of 2011, settling at 9.9% in January. Its performance has reflected lower demand for credit by both businesses and households. Private sector credit is oriented towards funding the working capital and consumption, illustrating the private agents' reluctant behaviour to make investments and banks' high prudence to lend. Furthermore, deposits in the system have shifted towards longer maturity terms, thus illustrating the Albanian consumers' disposition to save.

Latest developments in **financial markets** have reflected contained liquidity and inflation premiums. In the interbank market, short-term interest rates were downward, following successive cuts of the key interest rates.

Furthermore, government security yields in the primary market were slightly up. This increase is mostly due to the interaction of demand and supply factors in this market and does not signal for risk premiums increase in the economy. Interest rates in the deposit and credit markets followed the Bank of Albania's easing monetary policy over the last six months, while its transmission is expected to be more complete in the future, conform to the time lag that characterises the monetary policy transmission mechanism.

Projections for the **expected economic outlook in the future** sustain our earlier assessments for positive, but below potential, growth of the Albanian economy in the period ahead. However, risks about this scenario have increased, mainly as a result of unfavourable developments in the global economy and financial markets.

Overall, the economy in our trade partner countries is expected to be sluggish and lending terms in the euro area are expected to be tight for the period ahead. Moreover, the space for fiscal stimulus has narrowed, as a result of the orientation of the fiscal policy towards maintaining fiscal parameters stability. Under these circumstances, Albania's economic growth will be determined mainly by the performance of consumption and private investment. The latter is expected to be driven by eased domestic lending terms during 2012, but will suffer, at the same time, from the uncertainty and hesitation of consumers and private businesses. **The Bank of Albania deems that the second half of 2011 marked a turning point towards a more normal consumer behaviour, which should be encouraged and supported in 2012.**

Taking into consideration the information set out above, the Supervisory Council holds that pressures on consumer prices at home remain low over the monetary policy relevant horizon and they have shifted on the down side over the past months.

On the demand side, below-potential economic growth will continue to generate low inflationary pressures as shocks from the supply side are expected to be moderate.

At the conclusion of discussions, the Supervisory Council decided to cut the key interest rate by 0.25 percentage points bringing it down to 4.25%. This decision aims to provide the appropriate monetary conditions to meet the medium-term inflation target. In addition, the easing of monetary policy provides higher support for the development of the private sector's demand in our economy.