

## **Ardian Fullani: Overview of Albania's latest economic and financial developments**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, on the Monetary Policy Decision-Making of the Bank of Albania's Supervisory Council, Tirana, 28 August 2012.

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Today, on 28 August 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 keep the key interest rate unchanged at 4.00%.

The Supervisory Council deems that the monetary conditions are appropriate to meet the inflation target in the medium run and provide the needed monetary incentive to support the domestic demand.

Let me now proceed with an overview of the economic and monetary developments and key topics discussed at today's meeting.

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**Annual inflation** marked 2.7% in July, up 0.5 percentage points from a month earlier. The inflation rate went up mainly due to higher unprocessed food prices during this month. Similarly, non-food consumer prices added their contribution to annual inflation as a result of higher oil prices. Regardless of minor fluctuations, the contribution of other goods of the basket to inflation remained steady.

Despite rising, consumer price inflation remains in the lower interval of Bank of Albania's inflation target band. From the macroeconomic viewpoint, it rose due to impact of transient factors, while the poor performance of aggregate demand continues to generate low pressures on consumer prices. Furthermore, increase in production costs remains weak, imported inflation remains low, and inflation expectations of economic agents remain anchored.

Second-quarter data on the economy point to slow growth of economic activity during this period. While some of the indirect indicators signal improvement from the first quarter, consumers' propensity to save continues. This behaviour is reflected in the postponement of substantial expenditures, increase in deposits and investments in securities, and decline in consumers' demand for bank loans. Private investments remain weak, reflecting the poor performance of the final demand in the economy. Capacity utilisation rate remains low, whereas exports of machineries and equipment fell 9.5% in the second quarter, in annual terms, after expanding about 1.5% in the first quarter of the year. The banking system continued to grant credits for private investments at rates comparable to those of the first quarter of the current year.

**The fiscal policy** pursued its consolidation during the first six months of 2012, materialising in budget deficit narrowing during this period. In the presence of slow growth of budget revenues, this behaviour was reflected in the contraction of budget expenditures by 1.2%. On the other hand, budget revenues increased 4.0% in annual terms, driven by low increase in tax revenues. The performance of revenues, expenditures and public borrowing materialised in a budget deficit about 31.6% lower than the corresponding period of a year earlier. The Bank of Albania notes that maintaining the fiscal discipline has contributed positively to the financial soundness of the Albanian economy and to the control of risk premia in the economy during the first half of 2012. Ongoing efforts to maintain long-term stability of the public debt will contribute to boost fiscal policy credibility and reduce funding costs to the Albanian economy.

**Foreign demand** improved in the second quarter. After shrinking in the first quarter, exports of goods recorded nominal annual growth by 19.2%. Imports of goods, in value, curbed by 4.4% in annual terms, reflected in budget deficit narrowing by 16.5% during this period. Stronger orientation of the Albanian economy towards exports and enhanced competitiveness of our products should be a priority for the public and private sectors. In spite of the unfavourable situation in international markets due to the prolonged crisis in our trade partner countries, boosting our exports should be seen as a national long-term strategy for supporting sustainable economic growth and converging with EU standards.

**Monetary developments** were in line with the real-economy performance. Annual monetary supply growth slowed down to 8.3% in June, reflecting the reduction of public sector's funding by the banking system and the weak demand for monetary assets from the private sector. Influenced by added uncertainties about macroeconomic developments at home and abroad, the private sector's demand for bank loans was low. For the same reasons, the banks continue their added prudence as regards lending. Consequently, the annual growth rates of lending to the private sector decelerated to 6.8% in June. Promoting healthy crediting has been and remains a constant priority of Bank of Albania's policies. In this regard, we have cut the key interest rate to historically low levels, reviewed and revised the regulatory and supervisory framework, and supplied the banking system with the required liquidity. Therefore, the Albanian banking system is among the few ones in the region that has maintained positive credit expansion rates over the recent years.

**Financial markets** were characterised by adequate liquidity and low interest rate fluctuations. Interest rates on the national currency continued their downtrend in July, following the easing cycle of the monetary policy and the improved demand and supply ratios in the domestic public debt market. Particularly, in the primary market, yields on government securities slowed down their pace of increase and there are signals for their further reduction in the period ahead. Overall, financial market developments point to low liquidity and inflation risk premia.

Projections for the **expected performance of the economy** sustain earlier assessments for slow growth of the Albanian economy for the period ahead. Having performed poorly in the first half of the year, domestic demand is expected to continue to be conditioned by economic agents' reluctance to undertake private consumption and investments.

In parallel, meeting of public debt sustainability thresholds determines a consolidating stance and lower contribution of the fiscal policy to economic growth. On the other hand, foreign demand is expected to provide a positive but weak contribution to aggregate demand growth. Under these circumstances, economic growth is estimated to remain below its potential and generate low inflationary pressures during the upcoming period. Taking into consideration the other variables contributing to inflation, the Bank of Albania deems that in the medium run inflationary pressures remain controlled, determining therefore the maintaining of the stimulating monetary policy during this period.

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**At the end of discussions, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 4.00%.** For the period ahead, the Bank of Albania remains heedful to economic and financial developments at home and abroad and stands ready to intervene timely and duly, in compliance with its mandate.