

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, 27 March 2013.

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Today, on 27 March 2013, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the most recent monetary and economic developments in Albania, and following the discussions on their outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 3.75%. The Council notes that there are appropriate monetary conditions to ensure the achievement of the inflation target in the medium-term period, providing, at the same time, the required monetary stimulus to boost economic activity.

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

Annual inflation was 2.5% in February, down by 0.2 percentage points from January. The lower inflation was primarily driven by the falling oil price, due to the base effect of the environmental tax rise in 2012 and the falling global prices. Overall, inflation continues to be determined by the rise in food prices. Their inflation accounted for about 90% of February's headline inflation. Other basket prices have generally been stable and making low contribution to headline inflation.

In the macroeconomic aspect, the general economic and monetary conditions have contributed to keeping inflation low.

Aggregate demand, in particular, remains sluggish and insufficient to generate full utilisation of production capacities, hence exerting no pressures on producer prices, profit margins and, consequently, the final prices of goods and services. As we have constantly pointed out, below-potential economic growth is and will remain a key factor driving the low inflation. In parallel, global prices, liquidity situation in the Albanian economy and financial markets, and economic agents' inflation expectations have not and are not expected to generate strong inflation pressures in the medium-term period.

Indirect information on the performance of the Albanian **economic activity** in the last quarter of 2012 suggests sluggish growth. Aggregate demand was primarily driven by the higher exports, while the private domestic demand provided positive, albeit low, contribution. On the other hand, public sector expenditure shrank, hence making a negative contribution to the growth of aggregate demand.

There is scarce information on economic developments during the first quarter of 2013. However, the analysis of available indirect data suggests that aggregate demand remains sluggish and economic growth below potential. Economic activity has been mostly driven by the external demand and a higher fiscal stimulus, while the contribution of consumption and private investment remains low. The latter continue to suffer from the uncertain outlook, the lower increase in disposable income, the spare production capacities, and the relatively tight lending standards. These factors have been reflected in Albanian households' increasing propensity to save and businesses' reluctance to invest.

External demand and the favourable weather conditions increased Albanian exports by about 34.6% in January. In light of the poor consumption and investment levels, which have reflected in the decline of imports by 8.1% during this period, this tendency has improved the external position of the Albanian economy further.

Albania's trade deficit shrank 32.5% in January. The developments in the external sector of the Albanian economy reflected in improved foreign currency demand and supply ratios, contributing, in turn, to a stable exchange rate.

The Albanian government pursued an accommodating **fiscal policy** in the first two months of 2013, expressed in the increase of public expenditure and widening budget deficit. Budget expenditure increased at an annualised rate of 1.3% in January and February. This increase was reflected in both current and capital expenditure. Amidst the sluggish economy, budget revenues continued to contract, registering an annualised fall of 0.8% over the months under review. This performance of public expenditure and revenues increased the fiscal deficit by about 5.1%.

Reflecting upon the expected economic and financial developments, the Bank of Albania has been pursuing a stimulating **monetary policy**.

Through the constant key rate cuts and liquidity injections into the banking market, the Bank of Albania has aimed at ensuring more appropriate monetary conditions to meet its inflation target in the medium-term period. **The financial market** evidences low liquidity and inflation pressures, which, in turn, have enabled the pass-through of monetary easing into the money and primary market. Interbank market rates soon reflected the last key interest rate cut and the yields on government debt securities continued to drop. The falling interest rates were mostly reflected in the deposit market rather than in the credit market, signalling a more conservative bank approach to lending and a savings-oriented real sector.

Monetary indicators have performed in line with the developments in the real economy and the monetary inflationary pressures remain low. Money supply decelerated its growth rates further in January to 4.9%.

The slowing money supply has reflected the low business and household demand for borrowing, and the lower budget deficit financing from the banking system. The annual growth of lending to the economy continued to decelerate to record lows of 2.1% in January. The poor performance of lending is evidenced in all categories and currency denominations, both for businesses and households.

The new available information does not alter our baseline projection for **the performance of the economy over the current year**, however, it evidences a shift in the balance of risks to the downside. The Albanian economy is expected to grow at low and below-potential rates, reflecting the slowing external demand, poor consumption and private investment and a positive fiscal stimulus based on the planned budget for this year.

Against a background of a negative output gap and in the absence of global market and liquidity pressures on the Albanian economy, the inflationary pressures are expected to remain low.

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 3.75%. The outlook of economic and financial developments inside and outside Albania establishes the continuation of an accommodating monetary conditions cycle over the monetary policy-relevant horizon. This policy establishes the proper conditions to meet the inflation target in the medium-term period, contributing at the same time to the growth of aggregate demand and full utilisation of production capacities in the economy.

In its meeting today, the Supervisory Council decided to amend some regulations relating to banking system activity.

These amendments strengthen the monetary policy transmission mechanism and establish better conditions to boost lending. They harmonize well with the easing monetary policy and help stimulate economic activity in Albania. More specifically, the approved amendments increase the level of liquidity allowed for banks' use and provide the banking system with greater room to use the financial leverage. Both these initiatives provide a direct impact on a faster growth of lending to the economy.