

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, 30 April 2013.

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Today, on 30 April 2013, the Supervisory Council of the Bank of Albania reviewed and approved the quarterly 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 Supervisory Council deems that the current monetary conditions are adequate to meet Bank of Albania's inflation target in the medium term.

The present interest rates and liquidity situation in the economy provide simultaneously the necessary monetary stimulus to boost domestic demand.

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

According to INSTAT data, **economic activity** in Albania increased 1.6% in 2012. The Albanian economy showed signs of weakness during the past year, reflecting an overall uncertainty in the internal and external environment. Nonetheless, against the backdrop of unfavourable developments, the main indicators of domestic and external balances remained within healthy parameters. During this period, inflation ranged within the Bank of Albania target band and indicators of banking system soundness improved.

Maintaining these balances provides the right macroeconomic premises for sustainable and long-term growth.

Referring back to the performance of **inflation**, INSTAT data reveal that consumer prices rose on average 2.5% in the first quarter of 2013. Inflation continues to be determined by food prices; their contribution accounts for about 90% of headline inflation. Moreover, food inflation was offset by the lower inflation of non-food consumer goods. Inflation of this category reflected the downward oil price, following its decline in international markets. Also, the price fall of long-term consumer goods provided downward effects, whereas prices of other consumer goods did not change significantly.

From the **macroeconomic** perspective, inflation continues to reflect the weak pressures from the aggregate demand-side and the absence of supply-side shocks.

Below-potential growth of aggregate demand leads to underutilisation of production capacities and generates weak pressures on increasing wages, producer prices and profit margins. Under these circumstances, internal pressures on consumer prices appear weak, as reflected by the low core inflation. On the other hand, imported inflation was subdued due to the low inflation in Albania's trading partners and the stable exchange rate.

The most recent data on the **real economy** are as at 2012 Q4. According to these data, the Albanian economy grew 1.7% driven by expanded activity in the services, industry and agriculture sectors. The activity of the construction sector continued to shrink. Data on economic activity for the first quarter of this year remain limited.

Based on indirect indicators, our analyses point to low economic growth, relying mainly on foreign demand, while the domestic demand components continue their sluggish performance. **Private consumption and investment** remain weak in the presence of uncertainties for the future, decelerating disposable income, tighter lending terms and spare production capacities.

The performance of budget indicators in the first quarter of the year shows increased fiscal stimulus. Budget deficit increased 41.5% during this quarter, reflecting the 3.6% decline of fiscal revenues and 1.4% increase in public expenditure. The Bank of Albania once again draws the attention on maintaining the fiscal equilibriums and keeping the budget deficit and public debt at affordable and harmless levels for the Albanian economy. In our opinion, the medium-term priority for the fiscal policy should be maintaining budget discipline.

In the long term, the Albanian public debt should be reduced and anchored in a reliable, effective and transparent fiscal rule.

Developments in the **external sector of the economy** reveal continued positive contribution of net exports to aggregate demand growth. Data on foreign trade for January and February show that trade deficit narrowed 27.1% annually, reflecting at the same time the further surge in exports and the weak performance of imports. During this period, imports shrank 9.5% in annual terms, while exports maintained their high annual growth rates, at 18.6%.

Monetary developments were in line with the performance of the real economy during the first quarter. In January and February, credit to the economy was weak across all its segments.

As at end-February, the loan portfolio of the banking sector stood only 1.7% higher than a year earlier. As we have already underlined, the main problem with regard to lending remains the low business and consumer demand for loans. However, banks' lending policies appear more conservative, as reflected in the relatively tight lending standards.

The forecast for subdued consumer prices and weak economic growth in the period ahead motivated the further easing of the **monetary policy** at the outset of the current year. In January, the Supervisory Council of the Bank of Albania cut the key interest rate by 0.25 percentage points to 3.75%. Through anchoring inflation expectations, easing liquidity pressures and cutting the short-term interest rates, the monetary policy has aimed at reducing the costs of long-term lending to the economy and supporting the growth of credit, consumption and investments in Albania.

The Bank of Albania's easing policy did not reflect uniformly across the financial market segments. The latest key interest rate cut was reflected swiftly and completely both in the interbank market and the primary market of government securities. On the other hand, it was only partially transmitted to the deposits market and even less to the credit market. These developments illustrate the fact that, in the presence of added risk premiums and structural changes of behaviour in the financial market and the real economy, the effectiveness of monetary policy action is lower. Based on these reasons, the Bank of Albania decided to support its stimulating monetary policy with a number of changes on the easing side of the supervisory, regulatory and macroprudential framework. Set out in details in the previous month, these measures aim at further reducing liquidity premiums and intermediation costs in the financial markets, in order to boost lending and economic growth.

Our projections for 2013 support the assessment for Albania's economic growth ranging close to past year's rates. Foreign demand will be the main driver of economic growth, while the fiscal policy is expected to contribute to growth on the same direction, but at lower intensity, in the period ahead. On the other hand, private consumption and investment remain weak and unstable. The continuation of below-potential economic growth will determine weak inflationary pressures in the upcoming months as well. In the absence of unexpected supply-side shocks, consumer prices will continue to rise at low rates. With a 90% probability, four-quarter-ahead annual inflation will range within the 0.6–3.6% band. **The low annual inflation rates and forecast for their continuation over the monetary policy-relevant horizon call for maintaining the stimulating nature of the monetary policy over the next quarters.**

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 3.75%. It concluded that stimulating monetary conditions establish the proper premises for meeting the inflation target in the medium term, and contribute to the growth of aggregate demand and full utilisation of production capacities. The weak inflationary pressures determine the continuation of a stimulating monetary policy by the Bank of Albania. Lastly, the Supervisory Council reiterates the need to continue and deepen structural reforms, which boost productivity and enhance the competitiveness of the Albanian economy. These reforms pave the way for expanding the economic potential and should be seen as the main instrument supporting sustainable and long-term growth for Albania.