

Ardian Fullani: Overview of Albania's latest monetary and economic developments and outlook

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, on the Monetary Policy Decision of the Bank of Albania's Supervisory Council, Tirana, 26 February 2014.

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Today, on 26 February 2014, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on Albania's latest monetary and economic developments and discussions about their outlook, the Supervisory Council of the Bank of Albania decided to lower the key interest rate by 0.25 percentage points, to 2.75%. The Supervisory Council deems that increasing the monetary stimulus creates proper conditions to meet inflation target in the medium term, by boosting aggregate demand and anchoring inflation expectations.

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

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Macroeconomic developments in 2013 were characterised by weak economic growth and downward pressures on inflation. For 2014, the Bank of Albania expects that the economic activity will improve gradually but the Albanian economy will remain below potential and inflation will be low. In particular, excise tax increase will make lower than expected impact on inflation. Against this backdrop, easing of monetary conditions aims to create proper monetary stimulus to push inflation back to its target in the medium term.

Annual inflation was 1.7% in January, falling slightly from the previous month due to lower unprocessed food inflation, as a consequence of lower prices in Albania's trading partners and higher domestic agricultural production. Excise tax increase for certain product categories made additional impact by 0.5 percentage points to headline inflation but the fall in food inflation fully offset it. Prices of other CPI basket items fluctuated around past months' levels.

Overall economic and financial environment transmitted weak inflationary pressures over the last two years. The sluggish private demand continued to determine the cyclical vulnerability of the economy, being associated with slight increase in employment and producer prices, and putting pressure on profit margins. This factors chain was further transmitted to weak pressures for raising the final prices of domestically produced consumer goods and was reflected in low core inflation rates. Besides, the low inflation global-wide and exchange rate stability were reflected in low imported inflation rates. This picture is likely to be present over the next quarters.

Albanian economy showed clear signs of slowdown in 2013. External demand and fiscal stimulus were main drivers of economic growth, while private investments and consumption shrank. Incoming information on real-sector developments over the fourth quarter has confirmed our projections for a weak aggregate demand and below-potential economic growth. However, it has shifted to the downside the balance of risks around the projection.

Low business and consumer confidence, sluggish labour market and tight lending terms continue to weigh on **private demand**.

Disposable income increased and consumer balances were liquid. However, consumers are reluctant to spend and tend to save. On the other hand, lack of final demand and unutilised capacities curbed private investments.

The latest data on external trade show an annualised 13.5% widening of the trade deficit for December. Exports of goods continued to trend up but import growth at double-digit paces

led to a higher trade deficit for this period. Imports widened as traders intensified their importing activity, one month in advance, awaiting the entry into force of the new fiscal package in January 2014. Imports rose 15.8%, while exports rose 19.5%.

Fiscal policy was easing in 2013, giving 1.3 percentage points impulse to economic growth. Fiscal stimulus was reflected in higher expenditures and lower fiscal revenues. Thus, budget spending increased 4.7% in annual terms, while fiscal revenues fell 0.5%. However, budget deficit was lower than expected, reaching 4.8% of the gross domestic product, from 6.2% projected.

In 2014, the fiscal policy is expected to be cautious, reducing the budget deficit and fiscal stimulus. In view of this policy, arrears payment will improve the private sector balances and will create better conditions for the recovery of demand.

The Bank of Albania has requested and supported taking of measures to maintain public debt sustainability. In spite of short-term costs, maintaining public debt at subdued and sustainable levels would lead to lower uncertainty, higher space for private sector and higher flexibility of public finances. In a longer term, we deem that an efficient and transparent fiscal rule should be adopted.

In response to easing monetary policy and calm liquidity situation, financial markets appear calm in terms of trading and tend to slightly reduce the interest rates. The inter-bank market is characterised by higher volumes and low interest rates.

Following the seasonal increase at year start, the government security yields tended to fall again in February but did not reach December's levels. As already expected, deposit and loan interest rates fell over the last months.

Monetary indicators performed in line with the real-economy developments and our analyses show weak monetary pressures on inflation. Money supply expanded at slow paces during 2013, supported mainly by the private-sector demand, which was marked in the first half of the year. **Lending** remained weak, reflecting economic agents' low demand for financing and banks' conservative lending policies. Lowering credit interest rates in the fourth quarter did not boost the credit demand. At year-end, the annual change in the banks' loan portfolio settled at -1.2%.

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Our baseline projections for future economic developments show a gradually recovered growth rate in 2014. Alongside the positive external demand, private-sector demand will improve this year. Private-sector arrears payment is believed to improve this sector's liquidity and ease the banks' balance sheets. Also, accumulating financial savings and easing monetary policy stimulus will materialise into better performance of private investment and consumption. Besides improvement, the Albanian economy is expected to operate below potential over the period ahead. Below-potential economic growth and weak inflation pressures from the external sector will lead to a low inflation rate.

At the end of discussions, the Supervisory Council decided to lower the key interest rate by 0.25 percentage points, to 2.75%. Given the available information, the Bank of Albania deems that the expected economic and financial outlook requires maintaining an easing monetary policy over the quarters ahead to help create the proper conditions for meeting inflation target in the medium term.