

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, 27 March 2014.

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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. Given Albania's latest monetary and economic developments and discussions on their outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 2.75%.

The Council deems that inflationary pressures on the economy remain subdued. Under these circumstances, the monetary policy will continue to be stimulating in the period ahead to provide the necessary conditions for compliance with our inflation target in the medium run.

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

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Annual inflation stood at 1.9% in February, slightly up from a month earlier. The increase resulted from higher prices of agricultural products, tariffs of potable water in some regions of the country, and vehicle insurance premiums. Prices of other items of the consumer basket are stable and their inflation is low.

New information obtained during the last month is limited. It does not alter our assessment that the overall economic and financial setting is characterised by low inflationary pressures. Our projections have remained overall unchanged, but near-term downside risks are assessed as high.

Reflecting the **weakness in aggregate demand**, the output gap remains negative and the Albanian economy is still characterised by incomplete utilisation of production capacities. The lower economic growth and poor performance of the employment index have led to weaker pressures on increasing wages and production costs. Also, the sluggish aggregate demand keeps profit margins low. Weak pressures from production costs and downward inflation expectations were the main drivers lowering core and headline inflation rates. In parallel, imported inflation was contained due to low inflation rates internationally and the exchange rate stability. This situation is expected to continue in the quarters ahead.

The macroeconomic analysis, updated with information for the first two months of the year, suggests **low economic growth** during this period. Private investments and consumption remained weak because of the low confidence of economic agents, slowdown of disposable income, tight lending terms, and presence of spare production capacities.

Trade deficit expanded 3.6% in January, primarily as a result of declining exports, in contrast to a month earlier, when it expanded due to unusual import growth. "Minerals, fuels and electric energy" were the main drivers of contraction in exports of goods. On the other hand, exports of goods in the category of "Textiles and footwear" increased.

In response to enhanced competitiveness and shifting of financial and human resources towards exporting sectors, export growth should be one of the main pillars of Albania's economic development in the period ahead. In the near future, the exporting sector of the economy is expected to be sustained by improved demand in Albania's trading partners.

Fiscal indicators were characterised by higher revenues and lower expenditures during the first two months of the year. As of February, budget revenues increased 4.9%, year on year, whereas expenditure and budget deficit fell 9% and 82%, respectively. Expenditures

decreased mainly due to downward capital spending, while revenues upped thanks to increase in tax revenues.

These developments have determined a consolidating trend of the fiscal policy and have kept its impact on aggregate demand and economic growth subdued. Excluding the effect of payment arrears, the consolidating trend of the **fiscal policy** is expected to be maintained over the medium-term period. As always, the Bank of Albania endorses and encourages measures for fiscal consolidation, considering them as necessary for reducing risk premia in the economy and maintaining the country's medium and long-term stability. Moreover, the Government will pay a part of its arrears to businesses within this budget year. This development is expected to improve the private sector's balance sheets and demand.

In response to the easing **monetary policy** and the liquidity situation, financial markets have been calm, in terms of trading, showing a tendency to cut interest rates. The latest key interest rate cut in February is transmitted to short-term interest rates in the money market. The yields of government securities and interest rates on lek deposits have also fallen, whereas the interest rate on lek loans continues to move in line with a medium-term downward trend. Overall, while downward, the credit cost takes into account high risk levels arising from loan default.

Monetary indicators have reflected developments in the real economy and exercised low inflationary pressures. Broad money expanded 2.8% in January, from 2.3% a month earlier, in annual terms, driven mainly by the expansion of the forex component.

Credit to the private sector maintained the annual contraction rates in January, standing at – 1.4%. The banking system continues to be well capitalised, with sound financial parameters. But, the banking system's lending continues to reflect the private sector's weak demand for funds, resulting from the downward credit demand and added prudence by banks when lending.

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New available data support our assessment for gradual growth of the economy in the quarters ahead. The transmission of the monetary stimulus, payment of arrears by the Government to businesses, and improvement of confidence are expected to boost consumption and investments in Albania.

Also, the steady recovery of the global economy is expected to boost foreign demand and its contribution to aggregate demand. The Albanian economy, however, is expected to operate below its potential in the period ahead. Below-potential economic growth and low inflationary pressures from the foreign sector are expected to be reflected in low inflation rates, in the short-term period.

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 2.75%. This policy will help provide the requisites for complying with the inflation target and is consistent with our projections for inflation rates returning within the target band in the medium term.

In this context, I avail myself of this opportunity to underline that the Bank of Albania expects a better response by the banking system with regard to lending. This response should take into account, among others, the positive prospective of economic development in Albania and the stimulating policies applied by the Bank of Albania.

Based on the available information, the Bank of Albania deems that expected economic and financial development requires maintaining the easing monetary policy stance in the quarters ahead.