

## 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 August 2014.

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Today, on 27 August 2014, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. After discussions on the recent economic and monetary developments in Albania, and their future course, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 2.50%. The Supervisory Council deems that the current monetary conditions are adequate to ensure the return of inflation to target in the medium term.

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

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After falling in the previous three months, **annual inflation** picked up in July, standing at 1.8%. As in the previous months, annual inflation continued to be determined by the performance of food prices, especially seasonal fresh food. Other CPI items continued to provide low and steady contribution to the increase of inflation.

From the **macroeconomic** perspective, prices continue to be determined by low inflationary pressures, from both the demand and supply side. Below-potential economic growth and the negative output gap exerted contained pressures on prices. Imported inflation was also moderate and downward, due to low inflation in our trading partners' economies and the steady exchange rate. Inflation expectations remain low, and monetary expansion is in line with moderate price rises in the medium term.

New data on the **real sector** analysed in the last meeting are scarce. Signals from indirect indicators corroborate our previous assessments for a faster economic growth in the second quarter, in line with forecasts for a gradual recovery throughout the year. During the period, the positive performance of **private domestic demand** was driven by the more favourable lending standards and the enhanced confidence of both businesses and households. At the same time, **foreign demand for goods and services** continued to grow, but the increase in imports due to the recovery of consumption and investment has weakened its contribution to economic growth. Exports and imports of goods continued to grow, by 9.2% and 10.4%, respectively, in annual terms during the second quarter, and the trade deficit by 11.6%.

As expected, the consolidating **fiscal policy** conditioned the drop of public sector demand and its direct negative contribution to aggregate demand. The consolidation path of the fiscal policy is reflected in both revenue increase and spending decrease. The performance of revenues was affected by the rapid increase of tax revenues, due to the effects of the new fiscal package and improvement of the tax system administration. On the other hand, budget expenditure fell both for current and capital expenditure categories. Budget deficit stood at around ALL 22.2 billion, at the end of the first six months, or around 54% lower than in the previous year. The Bank of Albania supports the measures for fiscal consolidation, as the pursuit of such a policy contributes to maintaining long-term stability and reducing risk premiums in the economy. However, the Bank of Albania reiterates the need for a more uniform distribution of expenditure and budget deficit throughout the year, in order to minimise the volatility in economic activity and financial markets.

**Financial markets were relatively calm during July and August.** The activity in these markets ranged in normal levels, characterised by contained liquidity pressures and small fluctuations in interest rates. In response to the stimulating monetary policy, markets tended

to reduce interest rates, although the intensity of reduction varied across market segments. Thus, a faster reduction of interest rates has been noted in the interbank market, on lek deposits and in the short-term segment of government securities. On the other hand, the interest rates on long-term government securities and on credit fell at a slower pace. The latter continue to reflect high risk premiums, related both to the burdened balance sheet of Albanian businesses and the conservative lending policies adopted by banking groups.

Annual growth of money supply was 0.9% in June. Its performance reflected the low need for funds by the public sector and the decline in credit to the private sector. The annual decline of credit to the private sector was 1.8% in June, maintaining the same pace as in May. In the meantime, in monthly terms, credit grew for the second consecutive month, albeit at lower levels than the historical ones. Signals for eased standards of supply and growth of credit demand, obtained from the surveys conducted in the second quarter, seem to materialise slowly in improved credit performance. As we have previously stated, the tightened lending standards and the sluggish credit performance is a regional and European phenomenon, which may be solved only in the presence of the steady growth of the domestic economy and the complete calming down of European financial markets. The Bank of Albania deems that the country's reality and perspective require adopting more realistic strategies for a faster crediting to the economy. While upholding the financial stability, we have taken and will continue to take the right measures to support this process. On the other hand, sound and improving balance sheets of the Albanian banking system guarantee the funding of the Albanian economy in the medium and long term.

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At the end of the discussions, the Supervisory Council concluded that the incoming available information does not change our baseline projections. The economy is expected to grow gradually during the year, driven primarily by domestic demand. Reflecting the monetary stimulus, the heightened confidence in the economy, as well as the expected improvement of financial conditions and business climate in our trading partners, the Albanian economy is expected to converge gradually towards its potential in the medium term. Closure of the negative output gap will lead to the gradual return of inflation to target.

***At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 2.50%.*** Based on available information and in line with our projections, the Supervisory Council deems that the stable return of inflation to target will require keeping the key interest rate at low levels for some quarters ahead. Risks surrounding the basic projections remain on the downside, closely related to the stability of sources of growth, as well as economic and financial developments in trading partners. The Bank of Albania remains vigilant and is monitoring the situation; it is totally committed and has all the necessary instruments for meeting the inflation target.