

Gent Sejko: Overview of Albania's latest monetary and economic developments and outlook

Speech by Mr Gent Sejko, Governor of the Bank of Albania, on the Monetary Policy Decision of the Bank of Albania's Supervisory Council, Tirana, 4 March 2015.

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Today, on the 4 of March 2015, the Supervisory Council of the Bank of Albania reviewed and approved the Interim Monetary Policy Report. After scrutinising the current and expected performance of inflation and other economic indicators, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 2.0%.

The domestic and external economic environment has generated low inflationary pressures.

According to INSTAT data, annual inflation was 1.3% in January, up from the rate registered in December. Inflation fluctuations in the last two months have been determined mainly by the volatility in food prices. The fall in food inflation in December and its rise in January were driven by developments in international markets and the performance of domestic production. In parallel, the decline in oil prices has generated downward pressure on inflation. Prices of other consumer goods' categories did not display any significant change. The rise in inflation in January was in line with our projections; however, the rate of inflation remains below Bank of Albania's target.

The Bank of Albania evaluates that inflationary pressures will increase gradually and inflation will return to target within the medium term. However, Bank of Albania evaluates that inflation will remain below the target for the most of this period. Its performance will continue to be determined by the degree of recovery in economic growth, supply-side domestic and external shocks, and economic and financial agents' inflation expectations.

The Albanian economy is assessed to have improved in 2014. According to INSTAT data, the economic activity grew by 1.4% during the first nine months of the year. We expect the growth rate to accelerate in the fourth quarter, driven by the strong fiscal stimulus in this period.

Due to damages caused by floods in the south of the country, our projections on the performance of the economy during 2015 are revised slightly downwards. However, their effect is expected to be temporary and the economy is projected to remain in an upward trend in the medium term. Economic growth for 2015 is projected to be higher than that in the previous year. The expansion of economic activity will continue to be driven, to a large extent, by private sector growth. Foreign demand is expected to play a small positive role and the speed of fiscal consolidation is expected to be reduced.

While upward, our projections suggest that the economic activity at home will remain below its potential in 2015, generating incomplete utilisation of production capacities. Incomplete capacity utilisation is underpinned by a relatively high unemployment rate and is reflected in low pressures on wage increases and production costs. In parallel, the weak aggregate demand does not allow for the increase in businesses profit margins. In the medium term, the expected improvement in economic growth will bring the economy back to equilibrium and will increase demand-side inflationary pressures.

From the supply side, the decline in food and commodity prices in global markets and the increase of domestic agricultural production are expected to exercise downward pressures on inflation during 2015. However, their negative impact on inflation is expected to phase out in the coming years.

Inflation expectations will have a similar direction of their impact. In the short term, economic agents expect low inflation rates. This projection does not encourage the growth of consumption and of investments. Moreover, it tends to be factorised in low prices in future contracts between economic agents. Inflation expectations will shift upward, as inflation rises.

Considering the above arguments, the Bank of Albania estimates that – with a high probability of occurrence – inflation will range 1.8–4.4% four quarters ahead.

The balance of risks to the inflation projections remains on the down side. Downward risk factors to the inflation projections are slower economic growth, stronger decline of global prices and materialisation of second-round effects from lower oil prices at home. On the other hand, a factor that may contribute to a faster increase in inflation in the future is the increase in prices of agricultural products as a result of damages to agricultural land from recent floods.

In line with these assessments, the monetary policy should remain stimulating in the period ahead. The monetary stimulus will support the recovery of domestic demand and ensure the return of inflation to target.

In January, the Bank of Albania lowered its key interest rate to 2.0% and signalled the continuation of this monetary policy trend for some quarters ahead. The monetary stimulus increased progressively through the lowering of the key interest rate, through the continuation of eased conditions of liquidity injecting operations, and through forward guidance to the public. This policy is aimed at cutting the costs of lending to the economy with the ultimate goal supporting demand growth and return of the economy to equilibrium. It has also signalled the commitment of the Bank of Albania to comply with its inflation target.

Taking into consideration the time lag, the structural problems and the various shocks on financial markets and economic activity, the transmission of the monetary policy has been adequate, but not yet complete.

The monetary stimulus has been transmitted to the financial markets, but the response of the economy to better lending terms continues to remain weak. The accommodative monetary policy is reflected in lower interest rates for lek loans and has contributed to the constant growth of this loan's portfolio. Credit expansion, however, remains low as a result of the sluggish demand for credit and banks' conservative lending policies. The Bank of Albania asserts that the financial markets and agents have sound and liquid balance sheets, but they continue to be risk averse into undertaking long-term investments.

In conclusion, the Supervisory Council decided that the actual monetary policy stance is appropriate and decided to keep the key interest rate unchanged at 2.0%. The new information analysed at the meeting does not change our evaluations for the current situation of the economy and financial markets, and expectations for their outlook. The current monetary conditions are adequate for ensuring the return of inflation to our 3.0 % target in the medium term. Judging from the expected developments and the balance of risks surrounding them, the Supervisory Council deems that the monetary policy of the Bank of Albania will continue to maintain its stimulating nature, for some quarters ahead.