

BANK OF ALBANIA

MONETARY POLICY
MONTHLY REPORT

OCTOBER 2006

MAIN HIGHLIGHTS

INFLATION DEVELOPMENTS

- Annual inflation in October experienced a slight decrease to the level of 2.2 per cent, being close to the Bank of Albania target rate of 3 per cent and within its tolerance band.
- “Rent, water, fuels and energy” continues to provide the main contribution to the annual inflation, influenced by the energy price rise in August. Meanwhile, the fall in consumer prices over October came as a consequence of the ongoing supply of domestic agricultural products in the market, influencing on a low inflation of “Foodstuffs and non-alcoholic beverages”. The contribution of other basket groups to total inflation was low.
- The controlled levels of budget expenditure and of budget deficit, the maintenance of money market stability, the stable Lek against the other foreign currencies and the proper administration of public expectations regarding inflation have all had a positive impact on the maintenance of price stability.
- Moreover, the absence of external shocks and the oil price fall in the international markets over this period have brought the deceleration of external inflationary impulses.

MONETARY DEVELOPMENTS

- The Bank of Albania monetary operations have aimed at steadying the money market and enhancing the monetary policy efficiency. In response to the increasing demand of both the public and private sector for money, the Bank of Albania has reassessed the orientation of the operational instruments in the money market, orienting them towards the injection of liquidity in the system over October.
- The latest months’ developments have been characterized by high monetary expansion rates, due to the increase of the public sector demand over September and October. However, credit to economy remains the main constituent of demand for money. The foreign currency component of demand for money results to be in line with the seasonal behaviour.
- Following the increase in July, the annual growth rate of credit continued its downward trajectory over the following months. Outstanding credit to the private sector amounted to ALL 165.6 billion in September, accounting for 18.7 per cent of the GDP. Credit to households recorded the most rapid growth, while the share of the Lek in the foreign currency structure continues to increase.
- The Government increased the demand for money over September, expressed in the decrease of the negative level of

domestic financing and the increase of the external financing. Government's debt financing is being shifted towards long-terms. At the beginning of November, bonds of five-year maturity were issued for the first time. This policy is expected to provide its effect on the improvement of the Government's debt portfolio structure.

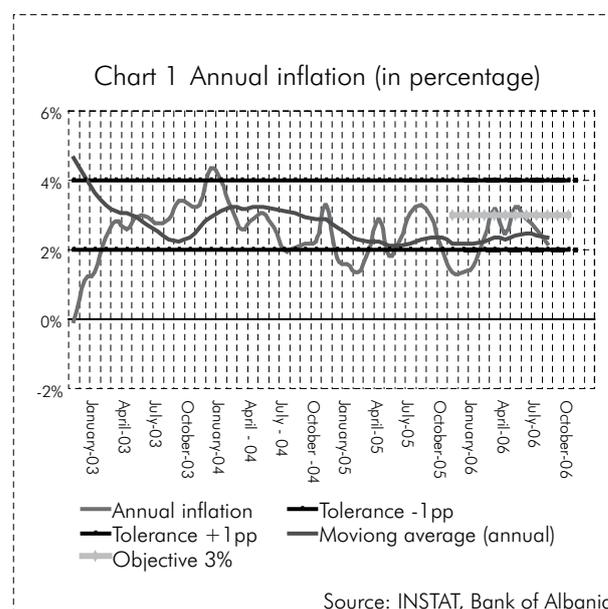
- The markets' reaction to the tightening policy pursued by the Bank of Albania continued over September and October. There was a steady and evident increase of interests in the primary market and in the bonds market of 2 and 3-year maturity. Increasing tendencies of the interest rate were also observed in the lek deposits market and in the lek credit market.
- Unlike the first semester of 2006, there was a slight depreciating tendency of the lek against the main currencies over the second semester, in particular over October and November. However, the lek maintained the appreciating tendency in nominal effective annual terms.

1 INFLATION PERFORMANCE IN OCTOBER

Annual inflation recorded a slight decrease in October, falling to 2.2 per cent. Annual inflation rate in October was close to the Bank of Albania target rate of 3 per cent and within its tolerance band. The fall of annual inflation came as a consequence of the low monthly growth rate of consumer prices. The monthly price rise in October recorded 0.1 per cent, which is lower than the average rate recorded over the recent years. Consumer prices performance mainly relates to the constant supply of domestic agricultural products in the market, while there was a controlled contribution of other basket groups to total inflation. The overall economic and monetary conditions have generally been favourable for the economic development and the maintenance of price stability, despite the slight increase of risks related to the performance of consumer prices in the medium-term.

1.1 PERFORMANCE OF INFLATION AND OF CONSTITUENT GROUPS

Inflation of the consumer basket constituent groups maintained almost the same performance and contribution over October. Total inflation performance mainly reflects the performance of "Foodstuffs and non-alcoholic beverages", "Rent, water, fuels and energy" and "Transport" groups. The inflation contribution of "Foodstuffs and non-alcoholic beverages"



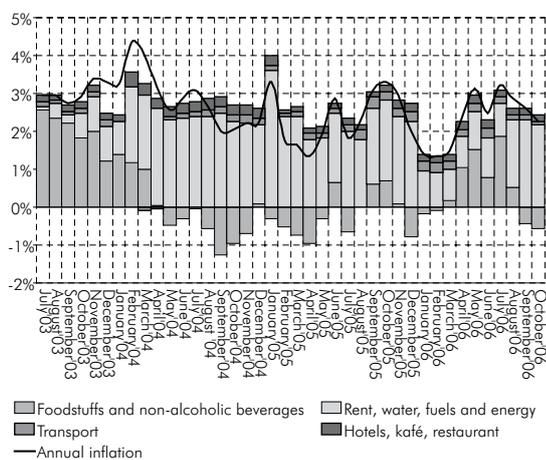
group¹ to the total annual inflation rate resulted to be negative over October. This group almost recorded the same prices as in the previous

month. The low monthly inflation was mainly a consequence of the late seasonal summer effect (due to the stable weather conditions) and of the entry in the market of autumn foodstuffs with lower prices than normally².

The prices performance of agricultural products (mainly of fruit and vegetables) suggests that this fall in prices was present throughout the month, as opposed to the previous year when these products' prices recorded a rise.

The fall in prices is believed to have been a consequence of the growing supply of domestic products, since the import prices have raised slightly in the two main importing countries of these products.

Chart 2 Contribution of main groups to annual inflation (in percentage points)



Source: INSTAT, Bank of Albania

Table 1 Annual inflation of "Foodstuffs and non-alcoholic beverages" (in and out of the country) and its contribution to total inflation

	Annual inflation '05	Contribution (pp)	Annual inflation '06	Contribution (pp)	Italy ³ Annual inflation '06	Greece ⁴ Annual inflation '06	Euro zone (12 countries)
March	-1.7	-0.7	0.4	0.2	1.0	2.1	1.3
June	1.6	0.7	1.9	0.8	1.3	3.5	2.0
September	1.5	0.6	-1.1	-0.5	2.5	4.6	3.0
October	1.7	0.7	-1.5	-0.6	2.7	5.1	--

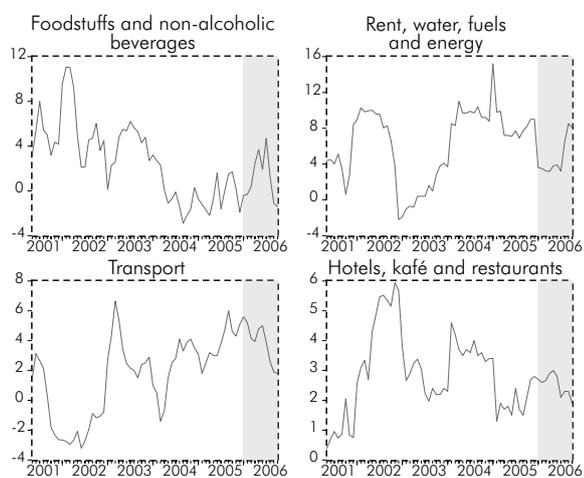
Source: Bank of Albania

The low inflation of "Foodstuffs and non-alcoholic beverages" prices balanced the positive contribution of the second largest group in the basket, that is, of "Rent, water, fuels and energy" group.

After the electricity price rise in August, this group continues to provide the main contribution to total annual inflation rate. The average inflation contribution of this group to total inflation, over the last three months, was about 2.1 percentage points, while the average annual inflation rate was 2.6 per cent.

The oil price fall in October influenced on the inflation performance of "Transport" group, which has been recording the lowest monthly and annual rates starting from 2005. However, the effect of this fall on total inflation resulted to be low, due to the small share this group has in the consumer basket.

Chart 3 Annual inflation of 4 main groups in the CPI basket (in percentage)



Source: INSTAT, Bank of Albania

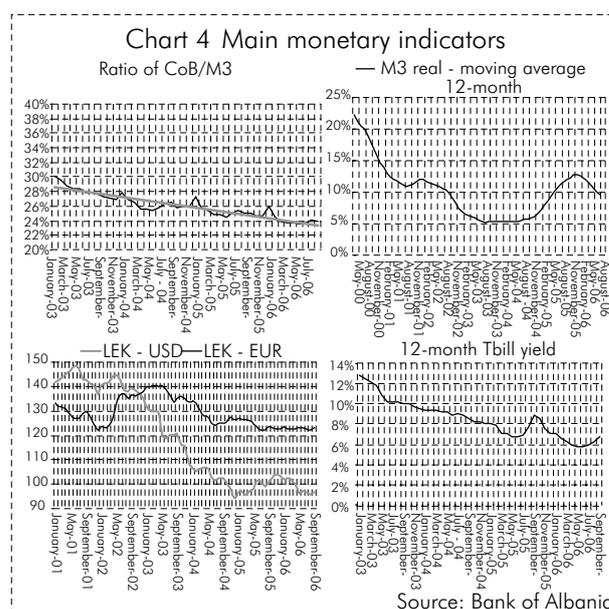
As opposed to the other basket groups, “Education service” recorded the highest growth, marking a monthly growth of 4.8 per cent. October corresponds to the beginning of the new academic school year for universities. This group’s annual inflation rate increased from 3.3 per cent to 8.1 per cent. The higher enrolment fees this year, both for public and private education, compared to the previous year, is the reason behind this shift of the inflation rate. Meanwhile, the contribution of other consumer basket groups to inflation may be considered moderate.

1.2 MACROECONOMIC ENVIRONMENT AND INFLATION

The balancing of demand and supply factors has created a favourable macroeconomic environment for the control of inflationary pressures over 2006. The controlled levels of budget expenditure and of budget deficit, the preservation of money market stability and the stable position of the lek against the other currencies, the proper administration of public expectations related to inflation have all had a positive impact on maintaining the price stability. While the lending activity in the private sector of economy continued to grow, the fiscal policy contributed to further discipline the aggregate demand and the inflationary pressures. The interest rate increase in July 2006 may have begun to provide its impact by prompting the withdrawal of currency in circulation, which is of prime importance for the suppressing of inflationary pressures in economy. Moreover, the absence of external shocks and the oil price fall in the international markets for this period have brought about the control of external inflationary impulses.

MONETARY POLICY AND MONETARY INDICATORS

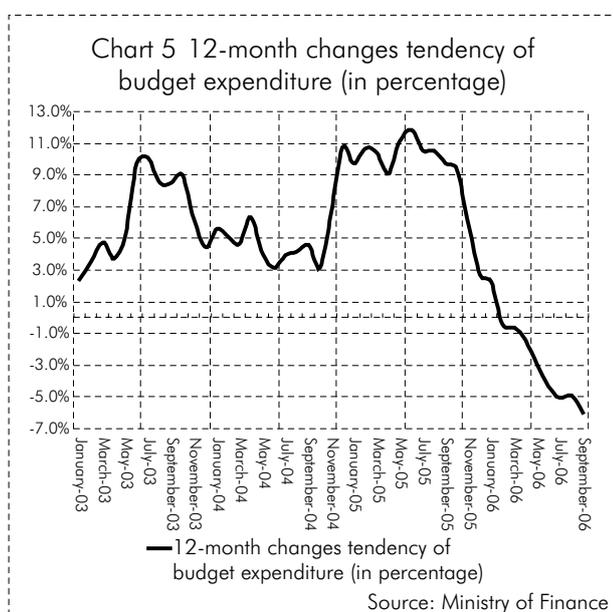
The monetary conditions in economy have resulted favourable for the control of inflationary pressures and expectations. The growth of broad money in economy and its liquidity structure were in line with the monetary programme projections. The real interest rates remain in positive levels and the exchange rate has recorded stable figures. The increase of the core interest rate in July 2006 was followed by the interest rates’ increase of monetary assets in lek, of deposits, credit and of the Government securities. It partly supported the balance of demand and supply of liquidity in the money market and also the reassessment of incentives for holding monetary assets in lek. Although it is too early to assess the effect of monetary conditions’ tightening on inflation, its rapid transmission to the money market may be considered as a positive signal. The consolidation of relations between the financial and real sector of economy will cause the feedback of economy to the new monetary



conditions to be more extensive over the following months. The Bank of Albania remains committed to maintain a monetary environment which is in line with its inflation objective in the medium run, by taking all the necessary measures.

FISCAL POLICY

The fiscal data reported by the Ministry of Finance indicate that the fiscal policy continues to be active in collecting the revenue, while budget expenditure remains in the projected level. As of end September 2006 was collected 98.5 per cent of projected revenue and realized about 93.8 per cent of expenditure planned according to the most recent budget figures review. Budget deficit by the end September was about ALL 10 billion, compared to the projected ALL 2.3 billion. This performance has caused the reduction of the economy's domestic demand, somehow balancing its rapid crediting effect.



However, the expected growth rate of carrying out the budget expenditure and the domestic borrowing over the rest of the year may be followed by high fluctuations in the money market and by excessive inflationary pressure in the short run.

EXCHANGE RATE AND IMPORTED INFLATION

The lek exchange rate continues to remain strong, despite the gradual decrease of its appreciating tendencies. The performance of domestic currency over October and November was in line with the performance of foreign currencies in the foreign currency international market, due to the absence of the seasonal factor influence. This has caused the exchange rate behaviour to remain in favour to further relax the supply-side inflationary pressures. By

the end October, the lek has appreciated in annual nominal effective terms.

On the other hand, consumer prices performance in the trade partner countries did not transmit rising tendencies in the domestic consumer prices. As a result of the oil price fall, total inflation annual rate in the Euro zone and in the main trade partners recorded more moderate levels over October 2006. However, the inflation of "Foodstuffs and non-alcoholic beverages" for the Euro zone recorded high levels, around the level of 3 per cent. In addition, the transmission of this group's inflation to the domestic inflation is assessed to have been controlled this year, especially due to the shifted seasonal factor in October and to the favourable weather conditions.

Table 2 Annual inflation of partner countries and exchange rate change (in percentage)

	January	February	March	April	May	June	July	August	September	October
Greece ⁵	3.2	3.2	3.3	3.3	3.1	3.2	3.8	3.5	2.9	2.8
Italy ⁶	2.2	2.1	2.1	2.2	2.2	2.3	2.2	2.2	2.2	1.8
Euro zone -12 countries ⁷	2.4	2.4	2.2	2.4	2.5	2.4	2.5	2.3*		1.6
Lek/Euro	-2.5	-3.3	-2.9	-2.5	-1.4	-0.4	0.5	0.3	-0.5	0.2
Lek/Usd	5.4	5.4	6.4	3.0	-2.1	-4.3	-4.5	-3.7	-4.2	-4.4

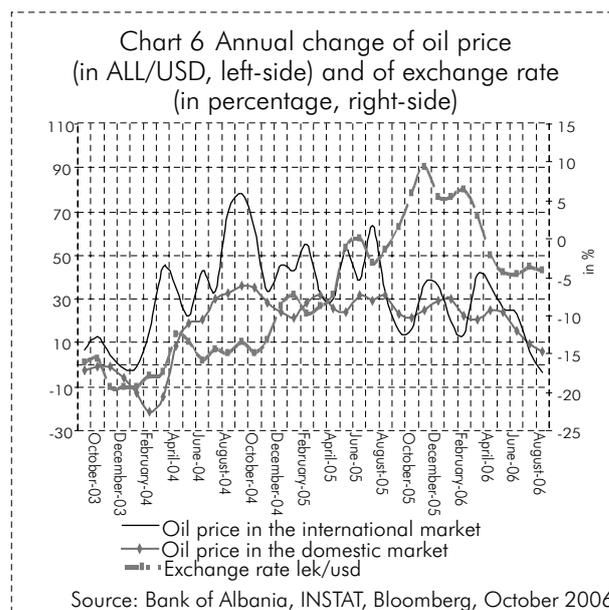
Source: CPI, INSTAT

Note: (*) Preliminary value

EXTERNAL ENVIRONMENT AND OIL PRICES

Supply-side factors deriving from outside the country's economy are assessed not to have exerted excessive pressures on domestic inflation over October 2006. The more stable oil price situation in the international stock markets and the reflection of their fall in the domestic fuels' market price; the complete non-transmission of upward tendencies of Foodstuffs inflation in the Euro zone and in Albania's main trade partners to the domestic market, due to the proceeding summer seasonal effect in October, outline the framework of the most significant external factors in the consumer price fluctuations.

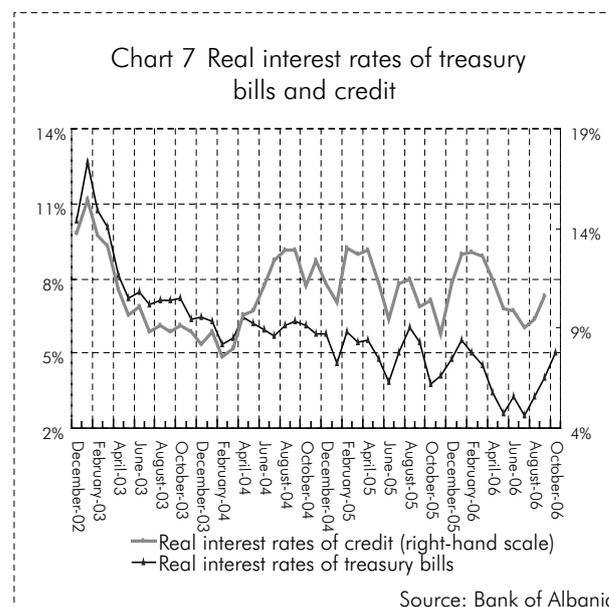
Oil prices in the international market fell over the last two months, leading to some certain serenity in this market. However, this situation is assessed as being temporary, since they are expected to be put under pressure near the end of 2006 by the main oil exporters' policy. Their statements for a reduction in production may yet again cause rising oil price pressures.



II MONETARY DEVELOPMENTS AND FINANCIAL MARKETS

II.1 BANK OF ALBANIA MONETARY POLICY

The Bank of Albania has oriented its monetary policy towards the accomplishment of its inflation objective. The interest rate increase in July aimed at providing more adequate monetary conditions for keeping the inflationary pressures under control in the medium-run. This increase was reflected in the money markets, influencing on their stability and on maintaining the ratio of demand-supply for monetary assets



under stable rates. Based on the historical tendency and the reaction lag, these effects will intensify over the last two months of the year.

The Bank of Albania monetary operations have aimed at steadying the money market and enhancing the monetary policy efficiency. The increasing demand of both the public and private sector for money was accompanied by the lack of liquidity in the system and by the interest rate increase tendency. In response to these developments, the Bank of Albania has reassessed the orientation of the operational instruments in the money markets, orienting them towards the injection of liquidity in the system over October. The injection of ALL 4 billion of liquidity in the system by the Bank of Albania through reverse repos aims at meeting the short-term demand and at relaxing these pressures on the interest rates. In total, the cumulative effect of the Bank of Albania monetary operations over 2006 results in the injection of about ALL 10.2 billion of liquidity⁸ in the system. Moreover, the Bank of Albania presence over the third quarter in the money markets, through the monetary operations, has managed to keep its quantitative indicators within the objectives for October.

Table 3 Accomplishment of the Bank of Albania quantitative objectives

	December'05	March'06	June '06	September'06	October'06	December'06 *
Net international reserve of the Bank of Albania (in millions of USD)						
Objective	1,172	1,117	1,112	1,252	1,257	1,268
Current	1,172	1,202	1,224	1,296	1,301	--
Difference (C-Obj)	--	85	112	44.5	43.6	--
Net domestic assets of the Bank of Albania (in billions of ALL)						
Objective	82.0	85.0	90.0	82.9	84.2	86.9
Current	76.9	61.9	67.8	71.2	71.5	--
Difference (C-Obj)	-5.1	-23.1	-22.2	-11.7	-12.7	--
Net domestic credit to the Government (in billions of ALL)						
Objective	317.8	325.8	329.8	335.8	337.8	341.8
Current	317.8	311.8	306.6	303.7	--	--
Difference (C-Obj)	--	-14.0	-23.3	-32.1	--	--

*Floor level for the NIR objective and ceiling level for the NDA and NCG objective.

Source: Bank of Albania

The high demand for money will continue to require the injection of liquidity and to exert pressures on the increase of securities' interest rates over the rest of the year. The Bank of Albania will continue to be present in the money market to stabilize its indicators' performance, by providing the necessary liquidity and minimizing the interests' fluctuations. The meeting of the system demand for liquidity will be carried out in conformity with the observance of the Bank of Albania operational objectives.

II.2 PERFORMANCE OF MONETARY AGGREGATES

The latest months' developments have marked the return of the monetary expansion to higher rates, projected for the end year. Money supply grew by 10.7 per cent in September. This growth was reflected

in the more liquid monetary components of money supply, of currency outside banks and of M2. Public sector demand over September and October has brought higher growth rates of monetary aggregates. However, the private sector demand for credit remains the main source of monetary expansion, while the foreign currency component of demand for money results to be in line with the seasonal behaviour.

Both time and foreign currency structure of money supply has resulted to be in line with the medium-term tendencies of their performance. The liquid component share of money supply to the M3 and M2 monetary aggregates has maintained the downward tendency, while the share of deposits in foreign currency has increased. The ratio of currency outside banks to M3 recorded the lowest historical rate of 23.3 per cent in September. The share increase tendency of deposits in foreign currency to M3 also affects the time structure of M3. However, the tendency of the reduction of cash is evidenced in the share performance of currency outside banks to M2. In August, the share of currency outside banks resulted to be 33.0 per cent or 0.5 percentage points lower than the share of M2 aggregate.

These tendencies are also confirmed by the time composition of deposits in lek. The ratio of time deposits in lek to total deposits in lek has marked a slight upward tendency. In September, this ratio resulted in about 73 per cent, compared to 72.6 per cent in August. The level of demand deposits in lek fluctuated within a stable interval, while time deposits in lek increased in relation to M2 and to the demand for domestic monetary assets.

Chart 8 M3 growth sources (in billions of ALL)

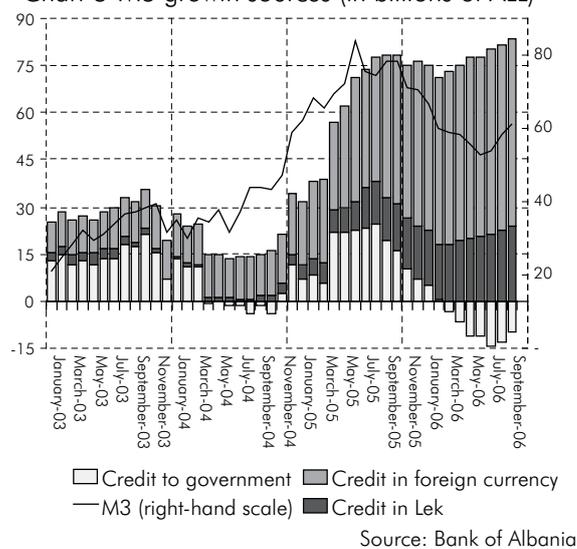


Chart 9 Annual growth of monetary aggregates

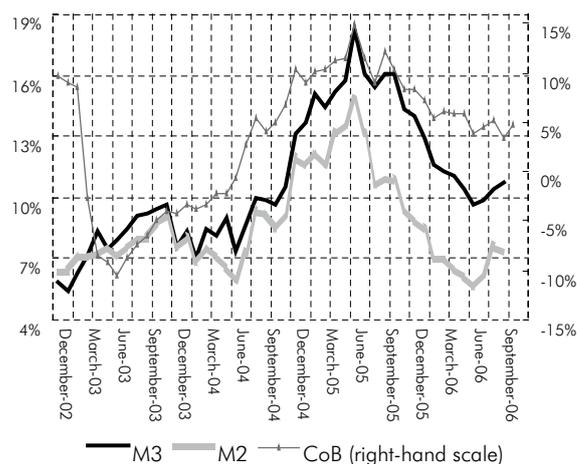


Table 4 Performance of monetary indicators in September (in billions of ALL)

	September 2006	Monthly change		Annual change	
		Absolute	Percentage	Absolute	Percentage
Currency outside banks	146.2	-1.5	-1.0	4.7	3.3
Total deposits	480.8	10.6	2.3	56.1	13.2
- in lek	297.1	4.3	1.5	25.8	9.5
- in foreign currency	183.8	6.3	3.6	30.3	19.8
M1	226.6	-1.4	-0.6	14.2	6.7
M2	443.3	2.8	0.6	30.5	7.4
M3	627.0	9.1	1.5	60.9	10.7
Monetary base	205.4	4.0	2.0	11.3	5.8

Source: Bank of Albania

The foreign currency structure of broad money has maintained the trend observed in the previous quarters. The share of deposits in foreign currency to M3 increased to 29.3 per cent compared to 28.7 per cent in August. The foreign currency composition of deposits has continued to reflect the seasonal inflows and the generation of foreign currency as a result of the growth of credit in foreign currency. In September, the ratio of deposits in foreign currency to total deposits increased to 38.2 per cent, compared to 37.7 per cent recorded in August.

II.3 DEMAND FOR MONEY

II.3.1 Credit to economy

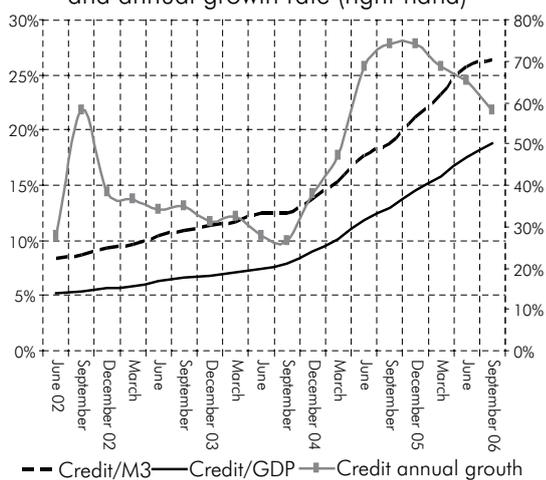
Annual growth rate of credit decreased to 56.5 per cent in September.

After the expansion in July, the annual growth rate of credit continued to follow a downward trajectory over the following months. These shifts were accompanied by an increasing tendency of credit interest rates over the recent months, in response to the monetary policy pursued by central banks. However, credit to economy remains the most dynamic component of monetary developments. Outstanding credit to the private sector amounted to ALL 165.6 billion in September, accounting for 18.7 per cent of the GDP. Credit portfolio accounts for 30 per cent of the banking system assets and 26.4 per cent of money supply.

Over September 2006 was extended ALL 11.8 billion of new credit, remaining in the same levels as in the previous year. Unlike September 2005, banks have grown the credit portfolio in lek and that of credit to households. This tendency was observed throughout 2006, resulting in the increase of the share of both these credit groups to the total. Credit portfolio in lek accounts for 29.8 per cent of the total from 25.5 per cent it accounted for in December 2005. Meanwhile, credit to households grew by more moderate rates accounting for 33.4 per cent, from 31.5 per cent over the same period the previous year.

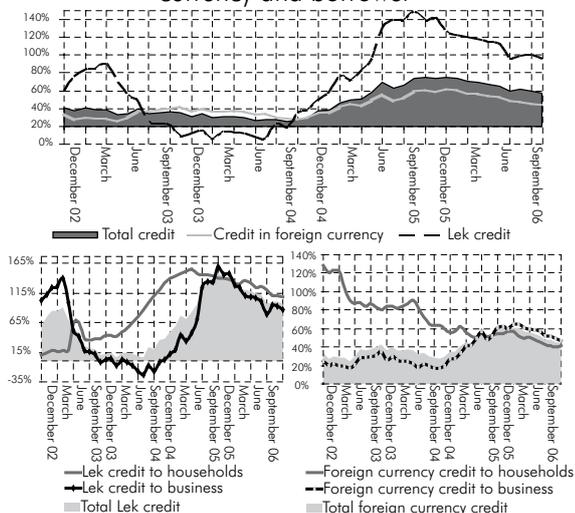
Credit in lek is ever-increasingly providing a high contribution to the credit expansion. As opposed to the previous year, credit in lek was 96 per cent higher. Credit in lek seems to

Chart 10 Performance of outstanding credit to economy to GDP and M3 (left-hand) and annual growth rate (right-hand)



Source: Bank of Albania

Chart 11 Credit growth rate by currency and borrower



Source: Bank of Albania

have also been pushed by the increased attention of banks to meet the households' needs and to launch new forms of credit in the market. Despite the positive developments of credit market in lek, banks' portfolio continues to be dominated by credit in foreign currency, accounting for 70 per cent of total portfolio, being also influenced by the changes in the exchange rate⁹.

Credit to households has had an annual growth of 66 per cent and it is mainly used for the financing of real estates purchase (62 per cent of total credit to households). Over the first nine-month period of 2006, this credit has on average grown by ALL 1.2 billion per month. On the other hand, consumer credit accounts for only 23 per cent of credit to households' portfolio and reflects a monthly increase of ALL 0.5 billion.

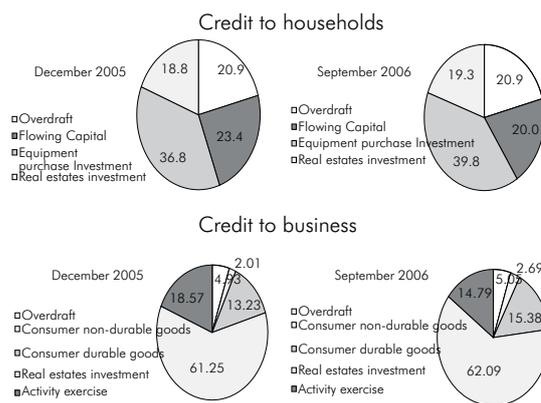
III.3.2 Net foreign assets

After the rapid increase in August, the level of net foreign assets of the banking system did not experience significant developments in September, increasing slightly by about USD 3.2 million. The Bank of Albania has increased the net foreign reserve by USD 2.9 million in September. In the absence of the exchange rate effect, the increase of these assets amounted to USD 17.8 million. This net increase is a result of the foreign currency purchase by the Ministry of Finance and of the decrease of foreign liabilities level.

The level of net foreign assets of commercial banks increased slightly in September, by about USD 0.3 million. In the absence of the exchange rate effect, their increase amounted to about USD 4.7 million. The performance of these assets over September was influenced by higher foreign currency inflows than credit in foreign currency.

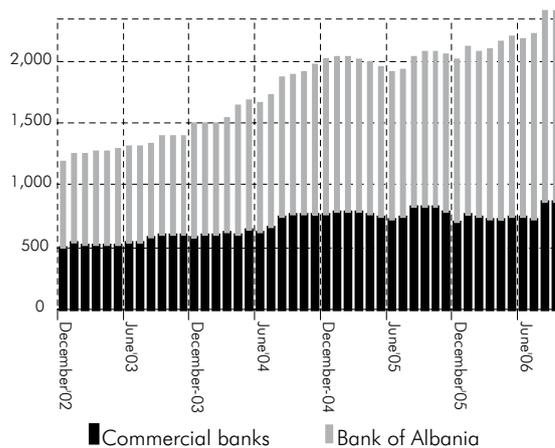
With regard to the foreign currency assets structure of commercial banks, the US dollar held most of the share in this structure in September, accounting for about 50 per cent. Most of non-residents' securities and time deposits held at foreign banks were denominated in dollar. While non-residents' cash and credit were mostly denominated in euro. On the other hand, about 70 per cent of foreign liabilities are denominated in euro, most of which are shared by credit from foreign banks.

Chart 12 Annual performance of the banking system credit portfolio



Source: Bank of Albania

Chart 13 Net foreign assets of the banking system (in millions of USD)



Source: Bank of Albania

II.3.3 Government demand for money

In response to the increase of budget expenditure, budget surplus decreased by ALL 1.2 billion over September. Over the same month, the Government increased the demand for money, expressed in the decrease of the negative level of domestic financing by ALL 1.2 billion. On the other hand, the Government demand for money was also met by the foreign financing. This financing has increased by about ALL 1.6 billion compared to the previous month. However, both these indicators are still below the projected level in the budget.

Over September, domestic financing was carried out through the sales of two-year bonds, amounting to about ALL 1.3 billion. The Government's objective in creating a long-term debt portfolio has led to the contraction of Treasury bills issued in the primary market. The net level of Treasury bills purchased in the primary market has reached to the negative level of ALL -20.7 billion, a deepening of ALL 0.83 billion more than the previous month.

The Government continued to invest the excess liquidity in the banking system. However, it decreased the level of reverse repos to commercial banks by ALL 0.8 billion for September. The deposit level held with the Bank of Albania increased by ALL 1.6 billion.

The operative data for October indicate that the Government increased the demand for money, in the form of bonds of two and three-year maturity, by ALL 2 billion and ALL 3.75 billion, respectively.

Chart 14 Developments in the gross financing of budget deficit (in billions of ALL)

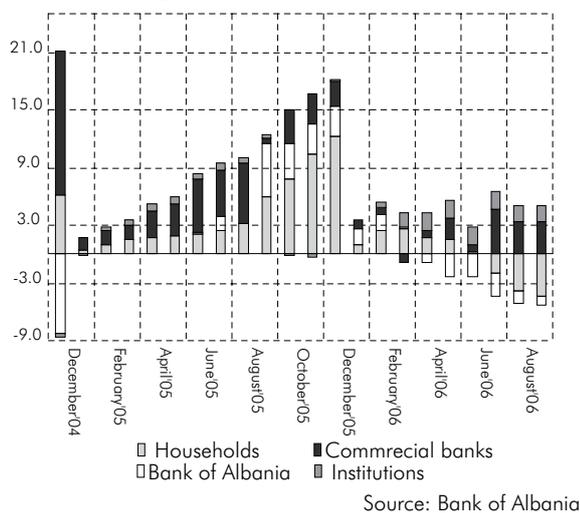
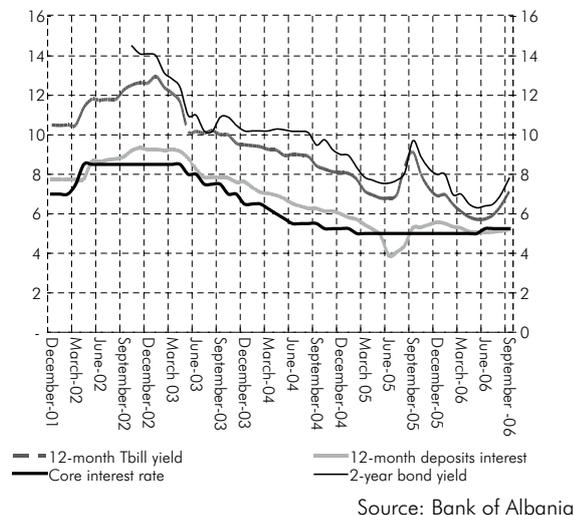


Chart 15 Long-term interest rates in the markets and the core interest rate



II.4 FINANCIAL MARKETS, INTEREST RATES AND EXCHANGE RATE

The markets' reaction to the tightening policy pursued by the Bank of Albania continued over September and October. There was a steady and more evident increase of interests in the primary market and in the bonds market of two and three-year maturity. Increasing tendencies of the interest rate were also observed in the lek deposits market (of 6, 12 and 36-month maturity)¹⁰ and in the lek credit market (except for over five-year credit market).

II.4.1 Performance of interest rates

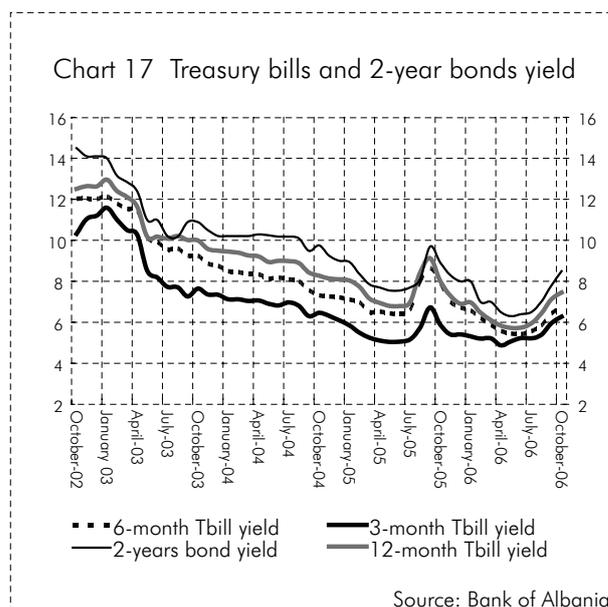
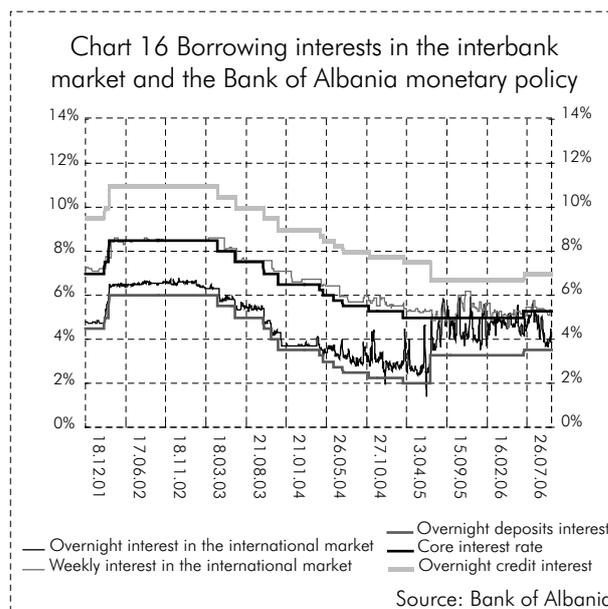
The interbank market was characterized by stable interest rates, although they decreased over September and October 2006. The liquidity level in this period resulted high (the average daily amount amounted to ALL 6.5 billion, or ALL 1.7 billion more than in August), causing the borrowing demand in the interbank market to decline. The average daily volume of transactions in the interbank market amounted to ALL 0.8 billion in October.

Thus, by the end October 2006, overnight and weekly borrowing interests reached 3.78 per cent and 5.25 per cent, respectively, from 4.17 per cent and 5.32 per cent at the end September, and 4.96 per cent and 5.31 per cent at the end of August.

With regard to the interest rates performance, we observe that banks have preferred to mainly increase the investment interests¹¹, while they have been quite reserved in increasing the deposits' interests in lek, since it is costly. In September, the increase of deposits' interests in lek was lower than the increase signalled by the Bank of Albania, while there has been a decrease in the deposits' interests of 1, 3 and 24-month maturity and in the demand deposits' interests in lek (see the tables in Statistical Annex, Financial Markets).

By the end of October 2006, the Treasury bills yields of 3, 6 and 12-month maturity reached to 6.28 per cent, 6.72 per cent and 7.45 per cent, respectively, getting close to the levels of the same period the previous year (even exceed those of 3-month Treasury bills). Two and three-year bonds yield reached 8.5 per cent and 8.8 per cent, respectively, increasing by 0.7 per cent and 1.7 per cent, compared to the previous auctions. In several cases, the participants' demand for the purchase of Treasury bills was lower than the amounts announced to be issued, leading as such to the decrease of the Treasury bills investment portfolio. Meanwhile, the opposite occurred with the investment of bonds of two and three-year maturity.

Government's debt financing is being shifted towards long-terms. At the beginning of November, bonds of five-year maturity were issued for the first time, the demand of which



exceeded the amount announced to be issued. This policy is expected to provide its effect on the improvement of the Government's debt portfolio structure.

After the tightening of the monetary policy, the intermediation cost¹² has been increasing, which is opposite from the previous downward tendencies. This increase came as a consequence of the more rapid increase of credit interests in lek than those of deposits in lek. In September, this cost reached to 11.3 per cent and 7.8 per cent for the interests of 6 and 12-month maturity, from 6.2 per cent and 6.6 per cent, respectively, in July.

The tightening monetary policy pursued by the European Central Bank influenced on the increase of deposits' interests in euro of all terms over September. Meanwhile, the neutral policy pursued by the Federal Reserve and the expectations for the decrease of its core rate, have begun to be reflected in the deposits' market in dollar.

In September, deposits' interests of 12 and 24-month maturity decreased by 0.02 per cent and 0.05 per cent, respectively.

Over the same month, credit market in euro and in dollar displayed opposite interest rates tendencies. There has mainly been a decrease in the credit interests of less than one year maturity and an increase in the interests of over one year maturity (excluding here over 5-year credit interests in euro, which decreased by 1.18 per cent).

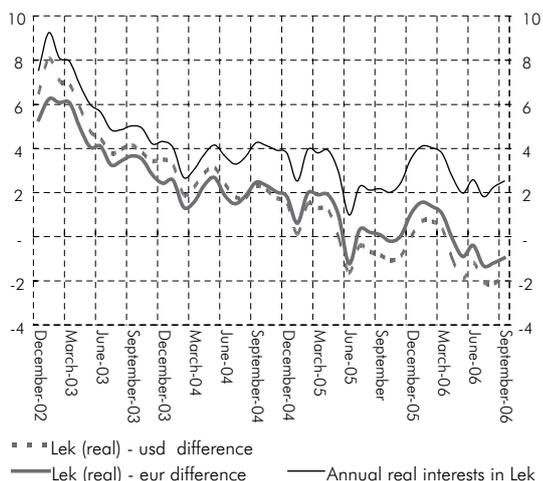
The change of the interests spread of lek-foreign currency deposits of 12-month maturity marked a turn towards their increase, while it resulted negative, -0.32 per cent, for the interest of 3-month maturity (ALL-USD).

The real spread becomes more evident due to the small differences in the inflation rates of the relevant areas, over September.

11.4.2 Exchange rate

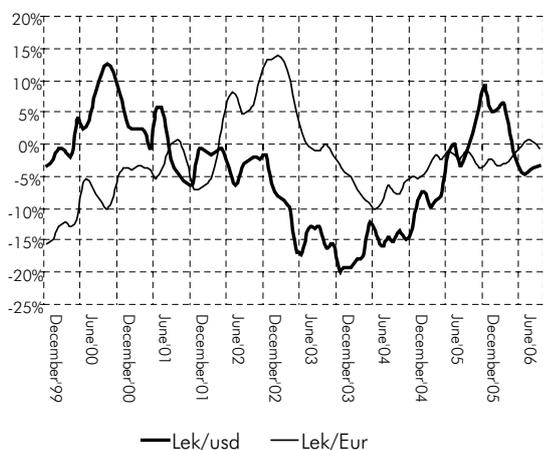
Unlike the first semester of 2006, there was a slight depreciating tendency of the lek against the main currencies over the second semester, in particular over October and November. However, in annual terms, the lek continues to maintain appreciating tendencies. In October,

Chart 18 Real interest spread of deposits in Lek to deposits in foreign currency



Source: Bank of Albania

Chart 19 Annual changes in the lek exchange



Source: Bank of Albania

the lek appreciated by about 4.4 per cent against the dollar and depreciated by 0.2 per cent against the euro. In annual nominal effective terms, the lek appreciated by 0.8 per cent. After the end of summer, the lek performance over October and November seemed to mostly reflect the foreign currency fluctuations in the foreign international market. The euro appreciated against the dollar, which was also reflected in the Albanian foreign exchange market. The increase of the euro interest rate in the international market and the expectations for further increase has encouraged depreciating tendencies for both the dollar and the lek.

Chart 20 Performance of lek in nominal effective terms (NEER¹³)



Source: Bank of Albania

ENDNOTES

¹ “Foodstuffs and non-alcoholic beverages” has most of the share in the consumer basket.

² INSTAT, “Consumer Price Index”, October 2006.

³ Source: ISTAT; web page <http://www.istat.it>

⁴ Source: National Statistical Service of Greece; web page: <http://www.statistics.gr>

⁵ Source: National Statistical Service of Greece; web page: <http://www.statistics.gr>

⁶ Source: Italian National Statistics Institute; web page: <http://www.istat.it>

⁷ Source: EUROSTAT; web page: <http://epp.eurostat.cec.eu.int>

⁸ The liquidity of ALL 10.2 billion was injected through the reverse repos, amounting to ALL 4 billion and through the trading of outright securities, amounting to ALL 1.6 billion. Moreover, the Bank of Albania presence in the foreign market resulted in the increase of liquidity by about ALL 7.8 billion.

⁹ The depreciation of the lek against the dollar and the maintenance of the same level against the euro caused the real monthly growth of credit in foreign currency to be about ALL 0.8 billion less in September.

¹⁰ The most recent data refer to September 2006, while according to the operative data, a slight increase in the deposits interests of 3, 6 and 24-month maturity in lek is expected in October.

¹¹ In the primary market, bonds market and in the lek credit market.

¹² Expressed as the difference between the interest rates of credit and deposits in lek.

¹³ NEER – nominal effective exchange rate, calculated against two currencies according to an approximate share they have in trade with abroad, EUR (80 per cent) and USD (20 per cent). Since April 2004, NEER has been above the level of 100. An increase of the NEER implies the lek appreciation.

STATISTICAL ANNEX

Chart 1 Contribution of main groups to annual inflation (in percentage)

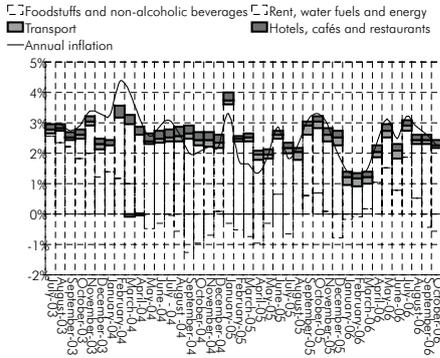


Chart 2 Annual inflation (in percentage)

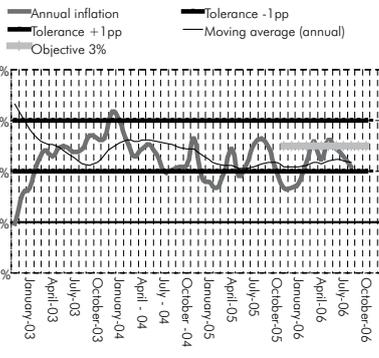


Chart 3 Cumulative and actual fiscal expenditure (in percentage)

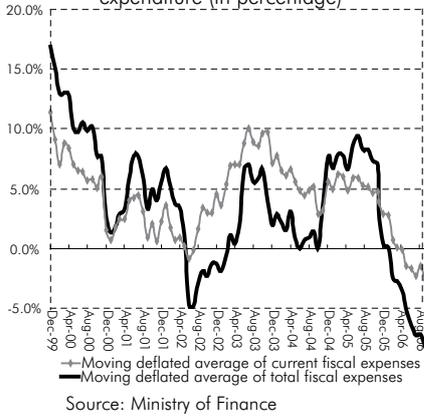


Chart 4 Total and primary deficit (in percentage)

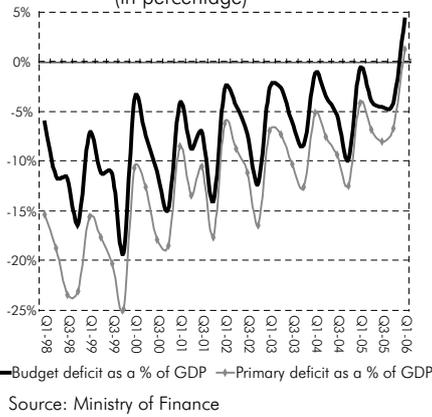


Chart 5 Monthly trade balance and current account (in billions of USD)

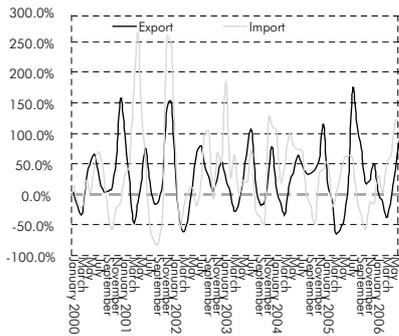


Chart 6 Annual growth of imports and exports (in percentage)

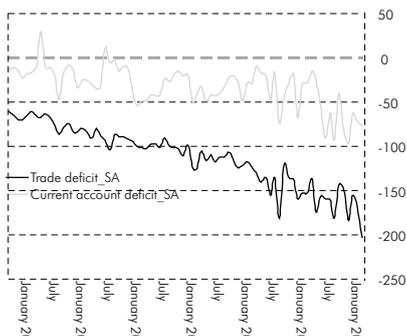
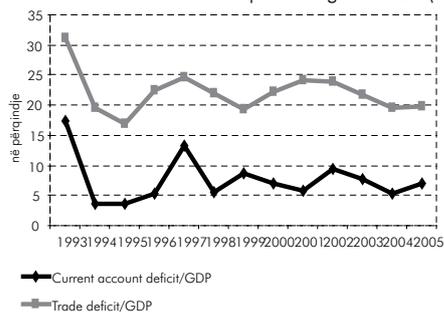


Chart 7 Current account and trade deficit in percentage to GDP (in percentage)



INFLATION

Table 1 Annual inflation rate (in percentage)

	2001	2002	2003	2004	2005	2006
January	2.2	6.5	0.0	3.3	3.3	1.4
February	1.5	7.6	1.1	4.4	1.8	1.3
March	2.9	7.5	1.3	4.0	1.6	1.5
April	3.0	6.5	2.3	3.2	1.3	2.4
May	2.5	4.6	2.8	2.6	2.0	3.1
June	4.0	3.7	2.6	2.9	2.9	2.4
July	5.6	4.2	3.0	3.1	1.8	3.2
August	4.1	5.5	3.0	2.7	2.3	2.8
September	3.5	5.3	2.8	2.0	3.1	2.6
October	1.8	5.8	2.9	2.0	3.3	2.2
November	2.8	3.7	3.4	2.2	3.0	
December	3.5	1.7	3.3	2.2	2.0	
Average	3.1	5.2	2.2	3.0	2.4	2.3

Source: INSTAT

Table 2 Contribution of basket constituent groups to total inflation

	February 06	March 06	April 06	May 06	June 06	July 06	August 06	September 06	October 06
Foodstuffs and non-alcoholic beverages	-0.11	0.16	1.03	1.51	0.80	1.86	0.51	-0.45	-0.59
Rent, water, fuels and energy	0.93	0.85	0.84	1.00	1.04	0.88	1.78	2.32	2.19
Transport	0.1	0.14	0.13	0.23	0.24	0.19	0.13	0.10	0.09
Hotels, café and restaurants	0.19	0.20	0.22	0.22	0.22	0.16	0.18	0.18	0.15
Other	0.10	0.11	0.12	0.10	0.15	0.15	0.24	0.40	0.40
Total	1.33	1.48	2.35	3.1	2.45	3.24	2.84	2.55	2.24

Source: INSTAT, Bank of Albania

MONETARY AGGREGATES

Table 3 Performance of monetary indicators (in billions of ALL)

	September - 06	Monthly change		Annual change	
		Absolute	Percentage	Absolute	Absolute
Currency outside banks	146.2	-1.5	-1.0	4.7	3.3
Total deposits	480.8	10.6	2.3	56.1	13.2
- in lek	297.1	4.3	1.5	25.8	9.5
- in foreign currency	183.8	6.3	3.6	30.3	19.8
Demand deposits	147.5	3.1	2.2	23.1	18.5
- in lek	80.4	0.1	0.1	9.5	13.4
- in foreign currency	67.1	3.1	4.8	13.6	25.3
Time deposits	333.3	7.5	2.3	33.1	11.0
- in lek	216.6	4.2	2.0	16.3	8.1
- in foreign currency	116.7	3.3	2.9	16.8	16.8
M1	226.6	-1.4	-0.6	14.2	6.7
M2	443.3	2.8	0.6	30.5	7.4
M3	627.0	9.1	1.5	60.9	10.7
Monetary base	205.4	4.0	2.0	11.3	5.8

Source: Bank of Albania

Table 4 Performance of NFA indicators by main groups (in millions of USD)

	September - 06	Monthly change	Annual change
Net foreign assets	2,403.4	3.1	336.5
Foreign assets			
Bank of Albania	1,639.7	- 4.4	293.4
ODC	1,087.0	- 2.7	148.1
Foreign liabilities			
Bank of Albania	104.2	- 7.2	- 4.2
ODC	219.4	- 2.8	109.6

Source: Bank of Albania

Table 5 Performance of Net Credit to Government indicators by main groups

	September - 06	Monthly changes	Annual changes
Net claims on the Government	271,966.4	1,538.8	- 12,946.3
Bank of Albania			
ODC	54,389.3	1,040.6	- 8,930.4
Deposits with the Bank of Albania	217,577.2	498.3	- 4,015.7
Budget deficit	4,978.3	1,329.3	3,600.3

Source: Bank of Albania

Table 6 Performance of some main indicators

	2003	2004	2005		2006	
			S1	S2	S1	September
Money supply (in billions of ALL)	448.4	507.2	541.8	578.04	594.5	627.9
Domestic credit (in percentage to M3)	71.5	68.9	69.9	70.03	71.0	69.8
Credit to the Government (in percentage to M3)	60.2	55.1	52.2	48.94	45.3	43.4
Credit to economy (in percentage to M3)	11.3	13.8	17.7	21.10	25.71	26.43
Credit to economy (in percentage to total assets)	13.7	16.9	20.8	25.11	28.7	29.8
Credit to economy (in percentage to GDP)	6.8	9.0	11.2	14.57	17.6	18.7
Credit/deposits ratio (in percentage)	15.7	19.0	23.6	28.47	33.7	34.5

Source: Bank of Albania

Table 7 Outstanding credit indicators as a percentage to total

	2003	2004	September '05	Q1-06	Q2- 06	August '06	September '06
Outstanding credit (in billions of ALL)	50.7	69.3	106.0	134.6	152.8	159.5	165.3
Credit to households	24.5	30.6	31.4	31.9	32.3	33.3	33.3
Credit to the private sector	75.5	69.4	68.6	68.1	67.6	66.7	66.7
Short-term credit	46.0	34.0	33.7	32.5	31.1	30.2	30.0
Medium-term credit	33.3	36.0	33.1	30	31.2	32.6	32.6
Long-term credit	20.7	30.0	33.1	37.5	37.7	37.2	37.4
Lek	19.6	19.5	23.7	26.0	28.2	29.6	29.8
Foreign currency	80.4	80.5	76.3	74.0	71.8	70.4	70.2

Source: Bank of Albania

Table 8 New credit indicators as a percentage to total

	Total 2004	2005				2006			
		Q1	Q2	Q3	Q4	Q1	Q2	August	September '06
New credit (in billions of ALL)	99.7	22.1	32.8	32.1	32.9	29.4	35.7	11.3	11.7
Short-term credit	62.54	53.2	47	47.4	48.7	44.2	42	46	46.1
Medium-term credit	22.53	22.4	31	30.3	25.6	30.1	33	33	30.4
Long-term credit	14.93	24.4	22	22.2	25.7	25.7	26	21	23.6
Credit in lek	32.59	30.1	32.8	30.2	31.4	27.7	35	37	41.6
Credit in foreign currency	67.41	70	67.2	69.8	68.6	72.3	65	63	58.4

Source: Bank of Albania

Table 9 Distribution of credit by sectors of economy

	2004	Q1 '05	Q2 '05	Q3 '05	Q4 '05	Q1 '06	Q2 '06	September '06
Agriculture, Hunting and Silviculture	1.5	1.3	1.5	2.4	2.7	2.2	0.9	0.75
Fishing	0.1	0.01	0.1	0.1	0.1	0.1	0.1	0.11
Extracting Industry	0.3	2.35	0.6	0.5	0.5	1.4	2.3	0.96
Processing Industry	17.1	15.8	15.6	13.9	13.8	14.2	15.3	15.48
Production, Distribution of Electricity, Gas and Water	2.8	6.27	2.9	2.9	2.6	2.4	1.1	1.20
Construction	9.8	10.61	11.2	12.8	13	13.0	12.2	12.56
Trade, Repairing of Vehicles and Household Equipment	23.3	20.46	19.1	20	18.9	19.0	22.5	23.14
Hotels and Restaurants	8.3	2.5	4.7	4.4	4.3	4.8	4.1	3.87
Transport and Telecommunication	2	2.5	1.7	1.7	1.5	1.3	1.6	1.55
Financial Activities	0.2	0.19	1.1	0.7	0.8	0.7	1.3	0.69
Health and Social Activities	0.5	0.08	0.4	0.6	0.7	0.6	0.6	5.04
Collective, Social and Personal Services	4.8	8.31	7.4	5.9	5.8	4.6	1.7	2.05
Other*	29.1	29.64	33.7	34.1	35.4	35.7	36.2	32.0
Total	100	100	100	100	100	100.0	100.0	100.0

Source: Bank of Albania

* "Other" includes credit extended to some sectors sharing a small weight in the country's economic activity and credit to households. Upon the introduction of new credit forms was required to review the credit distribution by sectors, where the new classification was introduced.

FINANCIAL MARKETS

Table 10 Interest rates at the end of the month and their change compared to previous periods (in percentage points)

	October '06	Change October '06 – September '06	Change October '06 – October '05
Core interest rate	5.25%	0.00	0.25
Interbank market			
Overnight interest	3.78%	-0.39	-1.84
Weekly interest	5.25%	-0.07	-0.76
Primary market			
3-month Treasury bills yield	6.28%	+0.33	+0.41
6-month Treasury bills yield	6.72%	+0.29	-1.18
12-month Treasury bills yield	7.45%	+0.32	-0.55
Bonds market			
2-year bonds yield	8.5%	+0.70	-1.20

Source: Bank of Albania and commercial banks

Table 11 Interest rates and their change in the lek deposits and credit market (in percentage points)

	September '06	Change September '06 – August '06	Change September '06 – September '05
Core interest rate	5.25	0.00	0.25
Interest of deposits in lek			
3-month	3.65%	-0.01	-0.46
6-month	4.31%	+0.05	-0.43
12-month	5.19%	+0.07	-0.13
24-month	5.68%	-0.16	-0.89
Interest of credit in lek			
Up to 6-month credit	15.64%	+3.68	+3.10
6-month to 1 year credit	13.00%	+1.05	+0.09
1-3 years credit	16.19%	+0.49	-0.11
Over 3-year credit	11.70%	-0.19	-0.49

Source: Bank of Albania and commercial banks

Table 12 Interest rates of deposits in foreign currency (in percentage points)

	September - '06	Change September '06 – August '06	Change September '06 – September '05
Fed – Core interest rate	5.25%	+0.00	+1.50
Interest of deposits in USD			
1-month	3.05%	+0.07	+1.08
3-month	3.97%	+0.56	+1.62
6-month	3.83%	+0.26	+1.20
12-month	4.35%	-0.02	+1.27
24-month	4.87%	-0.05	+1.04
ECB – Core interest rate	3.00%	+0.00	+1.00
Interest of deposits in EUR			
1-month	2.40%	+0.05	+0.70
3-month	2.76%	+0.01	+1.07
6-month	3.08%	+0.06	+1.08
12-month	3.48%	+0.04	+1.25
24-month	3.82%	+0.02	+0.16

Source: Bank of Albania and commercial banks

Table 13 Interest rate spread of deposit-credit in lek and in foreign currency

Spread of deposits interest				
	ALL-USD		ALL-EUR	
	September '05	September '06	September '05	September '06
3-month	1.55%	-0.32%	2.08%	0.89%
6-month	2.00%	0.48%	2.64%	1.23%
12-month	2.26%	0.84%	3.19%	1.71%
Spread of credit interest				
	ALL-USD		ALL-EUR	
	September '05	September '06	September '05	September '06
6-month	4.33%	6.16%	4.58%	7.85%
6-month – 1 year	2.71%	3.64%	6.90%	5.50%
1-3 years	7.28%	5.48%	9.47%	7.94%
Over 3 years	3.60%	1.80%	4.57%	3.14%

Source: Bank of Albania and commercial banks