

## FOREWORD BY THE GOVERNOR

*The information analysed in this quarterly monetary policy report has resulted overall in line with the expectations of the Bank of Albania. New economic and financial data show economic growth accelerated and main macroeconomic balances improved during the end of 2016 and beginning of 2017.*

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Inflation has been upward in the first quarter of 2017, averaging 2.4%. This performance was determined by the rise of foods and oil prices. The prices of other basket items did not change significantly, and continued to provide low positive contribution.

From the macroeconomic perspective, inflation's uptrend is underpinned by the improvement of economic activity and more complete utilisation of production capacities, the upward prices in global markets, and the better anchoring of inflation expectations.

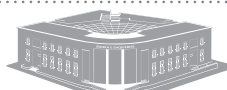
The effect of these factors is expected to persist in the periods ahead. Inflation is forecasted to average around 2.3% for 2017 and to rise further toward the target - during the next year.

According to INSTAT data, the pace of economic growth improved in the last quarter of the previous year. The Gross Domestic Product increased by 4.0% in this quarter, taking economic growth annual rate for 2016 at 3.5%. The services and construction sectors made the largest contribution to economic activity; meanwhile, industry and agriculture grew at positive, but lower, rates.

In terms of aggregate demand, economic growth reflected the expansion of domestic and external demand for goods and services. Private consumption and investments increased, driven by the low interest rates, expansion of employment, improvement of confidence, and high FDI inflows. In parallel, economic growth in the fourth quarter benefited from the increased activity in tourism and the recovery of growth rates in the exports of goods.

Indirect available data suggest that these trends continued in the first quarter of 2017.

Fiscal data for the first quarter point to fiscal consolidation slowing down materialised in budget surplus 33.2% lower than in the same period in the previous year. Budget expenditure for this quarter increased 10.3% in annual terms, against the 4.3% increase in income. The budget plan for 2017 suggest added contribution by the fiscal policy to aggregate demand growth, but the



Bank of Albania continues to draw the attention on the need for a more even distribution of expenditure and budget deficit throughout the year.

The analysis of the available information reveals the positive role of our monetary policy. Financial markets continue to be characterised by low interest rates on both deposits and loans. The rise in yields on government securities at the end of the year resulted to be a temporary development and was not transmitted to other segments of the financial market. The stimulating monetary conditions have favoured the growth of credit and reduction of debt servicing costs; they have, therefore, supported the recovery of private consumption and investments, and have established the preconditions for the return of inflation to target.

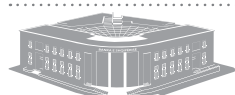
The monetary policy has supported in particular the growth of credit in the domestic currency, albeit the total credit growth remains sluggish. As at end-March, credit to the private sector was 3.3% higher than a year earlier. During the last twelve months, lek credit expanded by 10.2%, whereas foreign currency credit reduced by 1.5%. By sector, credit expansion was concentrated in the segment of loans to households, whereas loans to enterprises appears sluggish, driven both by the weak demand from enterprises and the tight supply by the banking sector.

Judging on the current economic and financial trends, as well as the relevant underlying factors, the Bank of Albania deems that the cyclical improvement of the economy will continue in the medium-term horizon. According to the baseline scenario, in this time horizon, we expect economic activity to grow further, driven by the recovery of domestic demand and improvement of the external environment. The growth in economic activity is expected to be accompanied by the absorption of spare production capacities, both in the labour and capital markets. The return of the economy to equilibrium will establish adequate preconditions for the stable return of inflation to target within 2018.

The Bank of Albania deems that the realisation of these projections requires maintaining the actual macroeconomic policy mix and continuing with structural reforms.

Fiscal policy is expected and should continue to maintain a consolidation stance in the medium term. This policy stance lowers risk premiums, increases space for credit to the private sector and fosters the country's capacities for withstanding shocks in the future.

Based on the available information, the monetary policy will remain accommodative during the medium-term period. This policy stance ensures the necessary stimulus for boosting economic activity and for the return of inflation to target.



In the medium-term horizon the Bank of Albania expects a progressive improvement of credit demand. The increasing demand should be matched by increased credit supply. In this context, the reduction down to 17.4% of non-performing loans ratio in March is an encouraging development, but it should be accompanied by continuation of the implementation of initiatives for improving the credit environment and more active lending policies by banks. In this context, it is necessary to continue the structural reforms with regard to improving the business climate, enhancing the efficiency and expanding the production potential of Albania.

