

Bank of Albania

MONETARY POLICY REPORT FOR
THE SECOND HALF OF 2009

*If you use data from this publication, you are requested to cite the source.
Published by: Bank of Albania, Sheshi "Skënderbej", Nr.1, Tirana, Albania
Tel.: 355-4-2222230; 2235568; 2235569
Fax.: 355-4-2223558
E-mail: public@bankofalbania.org*

www.bankofalbania.org

*Printed in: 650 copies
Printed by Adel PRINT*

C O N T E N T S

MONETARY POLICY REPORT FOR THE SECOND HALF OF 2009	7
I. GOVERNOR'S SPEECH	7
II. DEVELOPMENTS IN THE WORLD ECONOMY	11
II.1 Economic growth and macroeconomic balances	11
II.2 Monetary Policy, Financial Markets and the Exchange rate	14
II.3 Oil and commodity price development	15
III. PRICE STABILITY AND BANK OF ALBANIA TARGET	16
III.1 Consumer price, inflation target and monetary policy	17
III.2 Price performance of Main CPI Basket Items	19
III.3 Main inflation trends	21
IV. MACROECONOMIC DEVELOPMENTS AND THEIR EFFECTS ON INFLATION	22
IV.1 Gross Domestic Product and performance of aggregate demand	23
IV.2 Labour market and wage	49
IV.3 Imported inflation	51
IV.4 Expectations for inflation in economy	53
V. FINANCIAL MARKETS, INTERST RATES AND THE EXCHANGE RATE	53
VI. EXPECTED ECONOMIC DEVELOPMENTS DURING 2010	60
ENDNOTES	63

T A B L E S

Table 1	Some main macroeconomic indicators	11
Table 2	Some macroeconomic indicators for the BRIC countries	12
Table 3	Economic indicators for the regional economies	14
Table 4	Contribution of items to headline inflation (in percentage points)	19
Table 5	Annual indicators of the electrical energy balance (in GWh)	28
Table 6	Balance of payments indicators, in years	30
Table 7	Exports and imports (in EUR millions) and the annual change by commodity groups (in%)	30
Table 8	Data on immigrant families, their savings and remittances	33
Table 9	Accomplishment of main fiscal indicators for the 11-month period of 2009 relative to the previous years	35
Table 10	Budget deficit and its financing during the 11-month period, 2006-2009, in ALL billion	38
Table 11	Performance of labour market indicators	49

Chart 1	Performance of key interest rates	14
Chart 2	EUR/USD Exchange Rate Performance (left-hand); and USD/EUR Libor rates (right-hand)	15
Chart 3	Annual change of oil price and the international market EUR/USD exchange rate	16
Chart 4	Performance of price indices by main commodity groups	16
Chart 5	Annual inflation by quarters (in percent)	17
Chart 6	Monetary Conditions Index Performance and its components	18
Chart 7	Contribution of items to annual inflation (in percentage points)	19
Chart 8	Annual inflation by items of goods and services (in percent)	20
Chart 9	Non-core and core inflation contribution to annual inflation (in p.p)	21
Chart 10	Sectors contribution to annual inflation (in p.p)	21
Chart 11	Annual inflation of tradable and non-tradable goods	22
Chart 12	Contribution of sectors to GDP annual growth (in p.p)	23
Chart 13	Economic Sentiment Indicator and quarterly GDP	24
Chart 14	Business Confidence Surveys' results summarised at economy level	24
Chart 15	Capacities utilisation in economy and by sectors, in percentage against the complete utilisation	24
Chart 16	Tax revenues and surveys indicator on the business' financial state	24
Chart 17	Private consumption and budget expenditure indicators	25
Chart 18	Performance of house price and rent price indices	27
Chart 19	Performance of production and inventories in construction and HPI quarterly changes (left-hand); HPI/HRI ratio and its long-term trend (right-hand)	27
Chart 20	Performance of turnover index as a volume for construction and industry	28
Chart 21	Performance of turnover index as a volume for trade, transport and telecommunication and hotels	29
Chart 22	Imports, exports and trade balance (in EUR million)	31
Chart 23	Exports and imports volume and the historical trend in 1000 ton	31
Chart 24	Annual changes in the imports of capital, intermediate and consumer goods, (in percent)	32
Chart 25	Remittances, goods and services exports and FDIs (in % of GDP)	32
Chart 26	Moving sum of primary deficit, for 12 months, November 1999 – November 2009	35
Chart 27	Annual growth pace of budget revenue, VAT proceeds and excise proceeds (in %), January '99-November '09	36
Chart 28	Annual change (in %) of expenditures and current expenditures contribution for the period January 1999-November 2009	37
Chart 29	Revenue, expenditure and budget balance (in ALL billion) for the 11-month period 1998-2009	37
Chart 30	Budget deficit and main financing sources, for January-November 1999:2009, in ALL billion	37
Chart 31	Rate of world crisis impact and the change of fiscal position	39
Chart 32	Current account deficits (2008) and the effect from crisis	39
Chart 33	Change in the fiscal position 2009	39
Chart 34	Contribution of banking activity to the annual performance of M3 (in ALL billion)	40
Chart 35	Performance of monetary aggregates denominated in ALL and money multiplier	41
Chart 36	Annual growth of deposits by currency and time structure (in ALL billion and in percent)	42
Chart 37	Annual growth of deposits by currency and time structure (excluding exchange rate effect)	43
Chart 38	Performance of loan portfolio by currency	43
Chart 39	Contributions to the annual growth of lending to the private sector (left-hand); and annual growth of new loan, by borrowers (right-hand)	44
Chart 40	Contributions on the annual growth of loan to businesses (left-hand)' and annual growth of loan to liquidity and investments (right-hand)	45
Chart 41	Credit portfolio and NPL performance by sectors of the economy (in %)	45
Chart 42	Contributions to the annual growth of households' loan (left-hand); and annual growth of loans for housing and consumer (right-hand)	46

Chart 43	Changes in lending standards applied on business' loans and the impact of different factors (net balance), in percent	47
Chart 44	Changes in lending standards applied on households' (housing and consumer loans) and the impact of different factors (net balance*), in percent	48
Chart 45	Contributions of recorded employed and unemployed persons to the annual growth of the labour force, in percentage point (left-hand chart); and GDP with basic prices ⁵⁵ and the number of employed persons (annual changes in percent, right-hand chart)	49
Chart 46	Employment index performance by economic activity	50
Chart 47	Performance of average monthly wage in public sector (left-hand); and in the production and services sector (right-hand)	51
Chart 48	Performance of average wage in some branches of economy	51
Chart 49	Annual changes of imported inflation and tradable goods inflation (left-hand); and annual changes of external prices and exchange rate (right-hand)	52
Chart 50	Annual change of oil price, domestically and internationally, and ALL/USD exchange rate	53
Chart 51	Consumer and banks' experts expectations of annual inflation after 12 months and the current annual rate of inflation (in %)	53
Chart 52	Interest rates in the inter-bank market (left-hand) and daily lending volume (left-hand)	54
Chart 53	Government securities' yields in the primary market (left-hand) and yield curve (right hand)	55
Chart 54	Bonds yields in the primary market	56
Chart 55	Interest rates on 12-month deposits performance in Albania and EU with key rates	57
Chart 56	Weighted average interest rate on new ALL loans	57
Chart 57	Interest rates on new ALL-denominated loans (right hand) and on new Euro-denominated loans (left hand)	57
Chart 58	Weighted average interest rate on 12-month EUR, EURIBOR and loans	58
Chart 59	Average intermediation margin in ALL and EUR (left-hand); and the spread between average interest rate on ALL and EUR loans (right-hand)	58
Chart 60	ALL annual changes in nominal effective exchange rate (NEER) and their moving average (right-hand). Daily performance of EUR/ALL and USD/ALL ratio (left-hand)	59
Chart 61	ALL exchange rate volatility in quarters	60
Chart 62	Daily performance of EUR/USD and USD/ALL ratio	60
Chart 63	Performance of EUR /ALL ratio compared to the regional average	60

MONETARY POLICY REPORT FOR THE SECOND HALF OF 2009

I. GOVERNOR'S SPEECH

The Albanian economy has just left behind a difficult year. The deep global economic crisis was soon felt even in Albania, testing the foundations of the economy: the financial stability and the macroeconomic balances. However, the good initial state of our economy and the proper response of macroeconomic policies helped to successfully cope with this test. During the first three quarters of the year, the Albanian economy ensured a positive growth, thus preserving the financial stability and the key indicators of macroeconomic stability: price stability, public debt level and balance of payments sustainability.

The global economic and financial crisis, which was significantly intensified during the first half of the year, put in question the financial system sustainability, the macroeconomic stability and the long-term development prospects of the world economy. The determined response of public authorities, increased coordination of economic policies and keeping open the world trade channels, helped preventing any negative economic spirals. The latest data on the global economy indicate a recovery of economic activity in the third quarter onwards. The monetary and fiscal stimulus packages resulted successful in terms of stabilising the global economy. The recovery of economic growth in the main developed countries and the positive performance of the largest emerging countries are accompanied by the upsurge of the demand at world level and the reduction of uncertainty in financial markets. These positive signals, confirmed by the improvement of confidence sentiment, are reflected on more optimistic forecasts for the future.

However, the sustainability of global economic growth will remain fragile, as long as the economic activity continues to rely on significant monetary and fiscal stimuli. In particular, the public debt sustainability, which is burdened by fiscal stimulus bill to exit the crisis, is becoming a more and more aggravated problem for many countries. In this complex situation, choosing the right moment for withdrawing the economic incentive will have a decisive importance in the future economic performance.

In a more structural aspect, the recent crisis is expected to leave visible traces in the economic development. In a long-term horizon, it seems that new economic and strategic balances are being determined, thus re-dimensioning the poles of global economic growth. In a medium-term horizon, the global economic growth rate is expected to converge in a lower balance than the one that has prevailed over the last two decades. This slowdown may be accompanied by economic and social problems for those countries, which would not know how

to figure out their relevant implications. In a short-term horizon, discussions on the state's role in the economy, on economic development and growth patterns, on the philosophy and appropriate practices regulating the financial markets, will dominate the political round-table debates. In particular, the economic growth model will be a sensitive topic for economies significantly affected by the crisis, including many Eastern European countries. Promoting competitive advantage and increasing competitiveness in global markets will be the subject of discussions and intended reforms.

Turning to domestic economic developments, the analysis of available indicators shows that the Albanian economy has had a positive economic growth during the first nine months of the year. However, these indicators suggest that the growth rate was characterized by a progressive slowdown during 2009. Such performance was conditioned by reduced foreign demand and slowed domestic demand, in the presence of a tight liquidity situation, financing restriction and increased uncertainty. According to preliminary data from INSTAT, the economic growth for the first nine-month period of the year was 4.9 percent, against 7.8 percent recorded for the same period of the previous year. In sectoral terms, the sectors that benefited most from the economic growth are the services and construction one, while the industry sector underwent a more problematic performance.

The positive growth rate has been supported by the fiscal stimulus, while consumer demand and the contribution of external sector to the economy have been relatively stable. At the same time, private investments have declined. Consumer demand has been supported by a slight rise in employment and wages, while the mortgage and consumer credit contraction, as well as reduction of remittances have given the reverse effect. Private investments have been contracted, as a consequence of limited financing resources, reduced lending support by the banking system and limited access to international capital markets. Increased uncertainty, slowed progress of the final demand for their products and reduced capacity utilization rate have impacted on such performance. Effects of domestic economic slowdown and the global economic crisis have appeared even in the foreign trade. Foreign economic activity is characterized by a simultaneous decline in both, exports and imports of goods and services, thus impacting significantly on the economic growth for 2009. On the other hand, fiscal stimulus, injected mainly during the first half of the year, has contributed to rapid increase of budget spending and public debt

The economic growth below the potential has created an environment of generally reduced inflationary pressures. The annual inflation for December recorded 3.5 percent, while the average annual inflation rate was 2.2 percent. Both these indicators are in line with Bank of Albania's target on price stability. The economic activity slowdown, low main products prices in the world markets, low monetary expansion in the economy and controlled inflationary expectations offset the inflationary pressures coming from exchange rate depreciation during 2009.

The upward inflation trend during the last quarter of 2009 was expected by the Bank of Albania. It was formed mostly by transitory factors, which are not expected to generate steady inflationary pressures. In particular, this performance was influenced by rising food prices, which reflect the lagging effect of exchange rate depreciation, international markets conjunctures and structural problems of the Albanian market. These factors are expected to exert inflationary pressures during the first half of 2010, possibly added by expected reduction of agricultural products supply, as a result of the flooding that has lately occurred. However, stable core inflation trend and low inflation rate of non-traded goods confirm that inflationary pressures exerted by domestic demand are moderate. In the absence of other supply shocks, the slow progress of domestic demand, low growth of monetary supply and anchored inflationary expectations, are premises for keeping inflation within the target in the medium run.

The Bank of Albania pursued a prudent monetary policy during 2009, creating a suitable environment for a balanced development of the economy and for keeping inflationary pressures under control. In the presence of downward inflationary pressures and steady expectations, the hints for slow domestic demand in the next period have motivated the progressive growth of monetary stimulus during 2009. The Bank of Albania cut the key interest rate by one percentage point, down to 5.25 per cent during this period. It also steadily increased liquidity injection, according to banking system needs for liquidity and the economy demand for funding. Concerning liquidity injection, the Bank of Albania has made use of the entire range of monetary policy injecting instruments, facilitating at the same time the access to and easing the cost of operation of the banking system with Bank of Albania. Hence, we have also cut the overnight credit interest rate, raised the allowed level of mandatory reserve use and we have increase the accepted collateral base in our transactions.

in the presence of the exchange rate depreciation, such policy has brought about easing monetary conditions, serving the promotion of the economic activity. However, the pass-through of easing monitoring policy on interest rates of banking products has been limited, due to liquidity constraints of the banking system and weakened demand of the public sector for funds. On the other hand, the banking system itself has been reserved with regards to lending, as a result of the increased risk in the economy and performance of loan portfolio quality. The alleviation of these problems would help to more fully transmit the monetary policy and enhance its effectiveness.

The country's external position continues to be characterized by a high and upward current account deficit. During the first three quarters of the year, the deficit was fully covered by capital and financial account inflows, resulting in increased foreign exchange reserves of the Bank of Albania. However, the inflows have been significantly favoured by privatization receipts and by public sector borrowing. Both these items are limited in time and size, making necessary a steadier correction of the external position of our economy. This correction should aim at covering the trade deficit with stable funding resources, in the form of foreign direct investments and promoting export industries in branches that may constitute a competitive advantage for Albania.

However, short-term developments in foreign trade for October to November show a somewhat different performance compared with the first nine months of the year, testifying a modification of the trends observed earlier. Thus, the country's exports fell in annual average terms by about 7.4 percent, recording a slowdown in comparison with the average decline by about 19 percent during the first nine months of the year. On the other hand, imports recorded an annual average decline of 17% per cent over these two months, compared with the average annual decline of 7 percent recorded in 2009. These developments contain encouraging signs for sustainability of the balance of payments in the short run.

Fiscal policy had an expansionary nature during most of the year, being materialized in a budget deficit of 6 percent of GDP. The increase of budget deficit reflects both the action of automatic stabilizer in the form of decreased revenues, and the intended countercyclical character of fiscal policy, through increased wages and capital expenditures. The country's economic activity slowdown has dictated a slow pace in budget revenue growth, especially after the first quarter of the year. In late November, the annual growth of budget revenues was only 2 percent, almost entirely reflecting the low pace of generating the tax revenues. On the other hand, public expenditures have maintained high growth rates, accounting for 16.4 percent in November. The deficit has been mostly financed through foreign borrowing and privatization receipts, dampening the pressures in the domestic financial market.

Rapid growth of expenditure and budget deficit during 2009 has further increased the public debt level, accounting for 58 per cent of GDP at the end of November. The Bank of Albania deems that the future budget policy orientation towards fiscal consolidation, aiming at reducing the public debt, is now a prerequisite for the macroeconomic stability in the country. As we have constantly stated, the public debt reduction will mitigate the pressure of the public sector on the financial markets, creating more room for the private sector. Consolidation of public finances will also lower the risk premiums in the economy and will raise the monetary policy effectiveness.

Monetary supply slowed down further in the second half, reflecting to a great extent, the ever lower credit growth. Annual growth of private sector loan portfolio slowed down to 10 percent in November. Unlike the first six months of 2009, when credit growth curbing was more affected by the tightened supply, in the second half of the year the credit performance was dictated by decreased demand for loans. The economic activity slowdown and uncertainty about the future, in the face of still tightening lending terms by banks, have guided the economic agents' decisions to postpone the investment plans and to less finance consumption from borrowing.

However, monetary developments confirm an improved situation of deposits during the second half of 2009. The change in depositors' behaviour, in the context of measures taken to prevent the spread of global crisis effects, and the foreign currency inflows in the form of remittances during summer, have contributed to stabilizing the liquidity situation of the banking system.

Financial markets were characterized by a more relaxed situation during the second half of the year. The banking system continued to be featured by liquidity constraints, which were remedied by central bank liquidity injections. Improved liquidity situation due to increased deposits in the system and fostered certainty in the market created a suitable environment for transmitting the monetary policy signal to the interbank market. The key interest rate cut at the end of October is followed by reduced yields on government securities, after the upward trend characterizing them throughout the year. In the meantime, the Bank of Albania, in accordance with time lags that characterize the monetary policy transmission mechanism, expects and requires that the key interest rate cut be transmitted to credit markets.

II. DEVELOPMENTS IN THE WORLD ECONOMY

The positive signals transmitted from the developed and emerging economies markets, from some months now, have strengthened the opinion on the return of economic growth at positive values. The most recent data reveal that after the economic slowdown of the first half of year, economies of the main developed countries and of a number of emerging countries have recorded an economic growth in the third quarter and onwards. The improvement of economic situation owes to the successful encouraging monetary and fiscal policies undertaken since the beginning of global economic recession in the world. The core effect of high prices of the previous year imposed inflation to remain at low rates, but in the recent months, it entered into a positive territory owing to the increase of oil price.

II.1 ECONOMIC GROWTH AND MACROECONOMIC BALANCES

The economies of the main developed countries and of a part of emerging countries after the economic slowdown of the first half of year, experienced an economic growth in the third quarter and onwards. The improvement of confidence sentiments, the demand and trade growth at world level are some of signals which show the positive momentum of the world economy. However, the temporary nature of a number of stimuli staying behind this positive performance provide an advice for a more cautious and mature interpretation of many of the indicators.

Countries	GDP change		Unemployment rate November 2009	Inflation rate	
	Q3-09/Q3-08	Q3-09/Q2-09		December 2009/ December -08	
USA	-2.6	2.2	10.0 ¹		1.8 ³
Euro- Zone	-4.0	0.4	10.0		0.9
Germany	-4.8	0.7	7.6		0.8
Greece	-1.7	-0.4	9.1 ²		2.6
Italy	-4.6	0.6	8.3		1.1
Japan	-3.7	0.3	5.2		-1.9 ³

Source: Eurostat, Respective statistical institutions

¹ Data for December ². Data for September

³Data for November

Table 1 Some main macroeconomic indicators

The economic activity in the Euro-zone, during the third quarter 2009, grew by 0.4 percent relative to the previous quarter, while in annual terms it shrank by 4 percent. This increase marked the Euro-zone exit from recession and comes after five quarters of economic activity negative growth. It is mainly grounded on the upsurge of the trade activity and government expenditures mainly due to the economic incentives packages undertaken from the governments of these countries. While consumer spending and investments effected negatively¹ the economic growth rate. Surveys data reveal that the same behaviour is expected to show up even in the forth quarter of 2009 and in 2010 where the growth shall continue to remain a positive one, but at controlled rates. Unemployment rate continued its increasing trend pointing to 10 percent in November 2009. This rate shows amongst the highest of this decade. In accordance with preliminary data, annual inflation in Euro-zone pointed to 0.9 percent, in December, pursuing its climbing trend. The average rate for the forth quarter points to 0.4 percent, while in the third quarter, the latter recorded negative values. The base effect reduction of the high prices in the previous year caused that only in last months of year, inflation rate shifted to positive values.

Economic activity in United States of America has been improved progressively since the third quarter of 2009. Therefore, final estimations on GDP performance denote an economic growth of about 2.2 percent in quarterly basis. Consumer spending, aggregate investments and exports were the main economic indices which impacted the GDP growth. These indicators increased by 2.8, 5.0 and 17.8 percent, respectively in quarterly terms. Imports grew as well, thus providing a negative impact on GDP calculation. As regard the economic performance during the forth quarter of year, indicators about production industry in USA show a more accelerated upsurge trend relative to its third quarter. Annual average inflation rate, (during July-November) pointed to -2.9 percent, while the average unemployment rate pointed to 9.8 percent in the second half of year.

Economies of BRIC² countries after a weakening of the economy growth paces until to its contraction, as in case of Brazil and Russia, recorded an improvement of economic conditions during the second half of year. Economy of China, during second half of year, is supported by the accelerated expenditures of Government and the improved production indicators. While, production growth in the Indian processing industry has effected the recovery of the increasing tendency industry at the rate noted prior to the crisis. In Russia, the rise of oil price, during the second half of year, has assisted the country to exit the crisis. In Brazil, the growth of both the domestic demand and exports supported the moderate expansion of GDP during the third quarter of year compared to the previous quarter.

Table 2 Some macroeconomic indicators for the BRIC countries

Countries	Annual change of real GDP			Annual inflation
	Q3-09	2009 ¹	2010 ¹	November-09
Brazil	-1.2	-0.7	3.5	4.3 ²
Russia	-9.4	-7.5	1.5	9.1
India	7.1	5.4	6.4	12.0 ³
China	8.9	8.5	9.0	0.6

Source: IMF, OECD, Respective Statistical Institutes

¹ IMF estimations, October. ² Data for December

³ Data for October

During the first half of year, economic activity in Italy recorded the first signs of recovery. Therefore, GDP marked a positive growth pace during the third quarter of year, after fifth quarters of consecutive contraction. GDP expanded by 0.6 percent in annual terms meanwhile the consumer expenses and investments' upsurge provided the main contribution. In the meantime, the Italian Government expenditures recorded a fall. The latest economic data on the activity performance during fourth quarter of year reveal a further improvement of some of the main indicators. Unemployment rate pursued the increasing trend and in November pointed to 8.3 percent. The average annual inflation rate was 0.5 percent in the second half of year.

Economy of Greece, during second half of 2009, manifested signs of economic slowdown, after a relatively sufficient growth period, during the first half of year. Thus, third quarter of year recorded a contraction of GDP by approximately 1.7 percent relative to the same period of previous year. The fall of aggregate investments and the drop of exports provided the main contribution to this reduction. They reduced by 18.6 and 21.7 percent, respectively in annual terms. Regarding the fourth quarter of year, the latest data show a further deterioration of the economic activity. The largest risk being manifested during the last quarter of year originates from the accelerated growth of the budget deficit and public debt ratio against GDP. The latter pointed to 112 percent during 2009 and is expected to raise onwards during the next year. Unemployment rate for September was 9.1 percent, while the average annual inflation rate pointed to 1.5 percent in the second half of year.

During third quarter of 2009, the economy in Turkey recorded a negative annual economic growth of -3.3 percent, while compared to the previous quarter, it recorded a growth by 2.7 percent. Consumer expenses provided a positive impact by adding about 0.5 percentage points to the annual growth. Private investments, notwithstanding their negative impact, recorded a slowdown of the falling pace. Preliminary data denote a lower demand and restricted production, which suggest that the fourth quarter shall maintain the same rates of the third quarter. Unemployment for February remained at 13.4 percent, equal to the value of August, however it is increased by 2.7 percentage points relative to the previous year. Inflation recorded the annual rate of 5.7 percent in the fourth quarter of year 2009.

The economy of the former Yugoslavian Republic of Macedonia pursued the declining trend during the third quarter of 2009, therefore it shrank by -1.8 percent relative to the same period of previous year. This fall owes to the decline of consumer spending and the accelerated reduction of investments, whose impact is loosened somewhat by a high decline of imports and growth of public expenditures. Given the deteriorated economic situation, the increase of public expenditures caused that unemployment recorded a drop in the third quarter pointing to 31.7 percent from 33 percent in 2008. Annual inflation rate in the fourth quarter pointed to -2.1 percent, thus reducing the average annual rate of 2009 to -0.8 percent from 8.3 percent in 2008.

According to statistics of Kosovo Statistics Office, economic growth in 2009 was 6.1 percent. Consumer spending and investments grew considerably, while exports are reduced significantly. IMF forecasts reveal a growth of 4 percent in 2009. Consume Index Price continue to remain at negative values, recording the annual value of -1.3 percent in November 2009, meanwhile in the third quarter it pointed to -3.1 percent. These low rates were present since January 2009, meanwhile the lowest rate was recorded in May (-4.4 percent). These deflationary developments owed to the fall of foodstuff and transports prices, whereas the electric energy and fuels price recorded a slight increase.

Table 3 Economic indicators for the regional economies

	Change of GDP	Annual Inflation	Unemployment rate
	Q3:09	December-09	November-09
Italy	-4.6	1.1	8.3
Greece	-1.7	2.6	9.1 ²
Macedonia	-1.8	-1.6	31.7 ³
Serbia	-2.3	6.6	16.6 ⁴
Croatia	-5.7	1.9	16.1
Turkey	-3.3	6.5	13.0 ⁴
Kosovo	:	-1.3 ¹	:
Albania	4.1	3.5	12.8 ³

Source: Respective Statistical Institutes, EuroStat, EcoFin, IMF

¹ Data for November

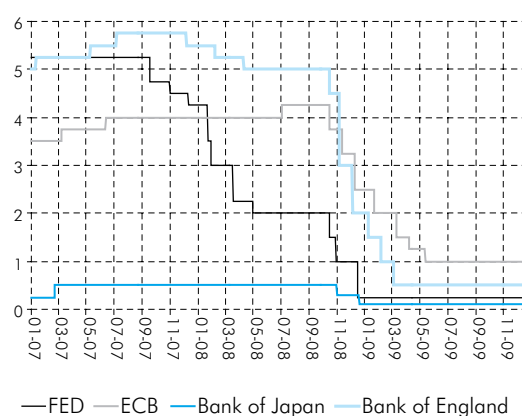
² Data for September. ³ Data for the third quarter

⁴ Data for October: Unavailable data

II.2 MONETARY POLICY, FINANCIAL MARKETS AND THE EXCHANGE RATE

During the second half of year, none of central banks change the key interest rate. These banks deemed the current rates appropriate to establish an encouraging environment for the economic growth.

Chart 1 Performance of key interest rates



Source: ECB, FED, Bank of England, Bank of Japan

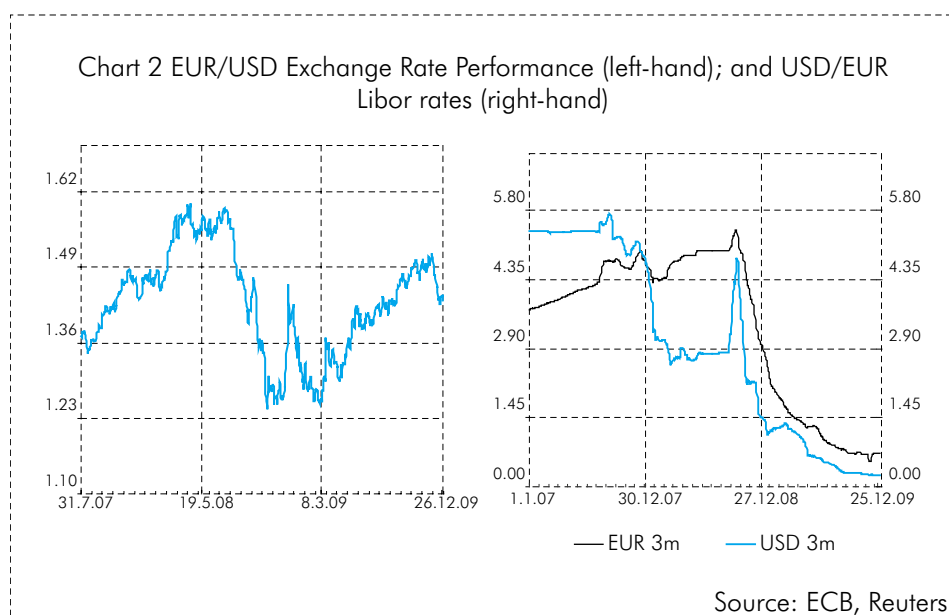
The European Central Bank has kept its rate at 1 percent, whereas it decreased the latter 4 times during the first half of year. Federal Reserve kept its interest rate at 0-0.25 percent throughout the year. Bank of England kept the key interest rate at 0.5 percent during the second half of year, whereas it cuts the latter three times in the first half of year. The Bank of Japan did not change its reference interest rate (the over-night interbank interest rate), keeping it at 0.1 percent throughout 2009.

The financial markets have manifested positive development and controlled volatility during these months. The interest rates in these markets pursued the fall started since the beginning of year, by confirming the neutralisation of tensions and the

overall improvement occurring in all segments of the market. The developed and emerging economies markets are transmitting positive signals from some months now. These positive signals have strengthened the recovery of the economic growth at positive rates. Notwithstanding the main part of this growth owes to the stimuli and encouraging policies implemented by the main central institutions of the world, the current positive performance reflects the sustained improvement in the context of controlled risks.

Since July, Libor and Eurobor interest rates continue to fall in the money market, thus transmitting the neutralisation of pressures for liquidity and the decrease of risk primes. 1-, 3- and 6-month Euribor interest rates at the end of this year fell averagely by 43, 55 and 44 basis points³ relative to the end of first half of year, whereas the 3-month Libor rate reduced by 37 basis points. The 1-, 3- and 6-month Euribor interest rates recorded 0.48, 0.68 and 0.99 percent respectively in average terms, during this month. The 3-month Libor rate diminished to 0.25 percent.

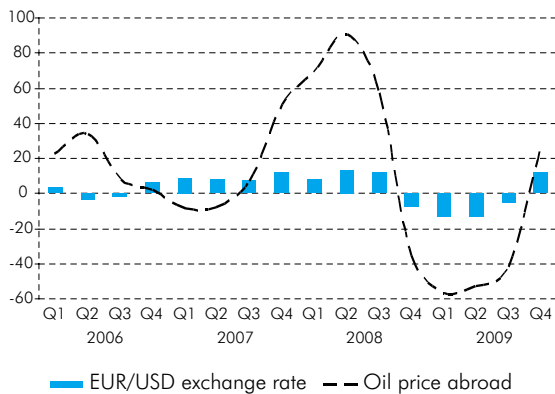
The appreciating performance of Euro against US dollar, British pound as well as against many Asian currencies related to the US currency is distinguished during this half of year in the exchange market. Euro is also appreciated against Japanese yen and other European currencies. At the end of this year EUR 1 was equal to USD 1.44, while at average terms in this half of year it was estimated 9.1 percent relative to the preceding period.



II.3 OIL AND COMMODITY PRICE DEVELOPMENT

Oil price per barrel in the international market increased during the second half of year compared to its first half, pointing to values close to those of year 2005. Thus, the average price pointed to USD 70.9 for the analysed period, approximately 40 percent higher than the average of the first half of year. The improvement of economic environment in the developed countries,

Chart 3 Annual change of oil price and the international market EUR/USD exchange rate

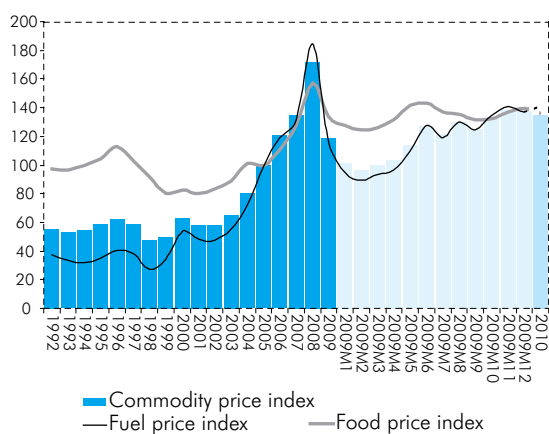


Source: Eurostat, EIA

mainly the positive performance in USA, and the high demand of the emerging countries impacted the strengthening of the oil price climbing trend.

In the meantime, during the recent months of year, the ambiguities as regards to the future economic growth paces in OECD countries, the problems in respect of the high accumulated debt in some of Persian Gulf countries and the strengthening of US dollar versus some of main international currencies affected the fall of oil price. Regarding the supply, the latter increased during the second half of year relative to the first half, mainly during October-December. This is due to the production growth in Russia and in OPEC member countries.

Chart 4 Performance of price indices by main commodity groups



Source: IMF

The main indices manifested negative changes during the second half of year relative to the same period of previous year, while they reveal positive growth when compare with the first half of year 2009. Considering that the quarterly changes manifest an upsurge tendency throughout the year for almost all indicators, the negative values of annual growth are due to the base effect of previous year high prices. Commodity Price Index showed an annual growth of 16 percent in the fourth quarter 2009, and compared to the third quarter of year increased by 8.4 percent. The increase of food, fuels and metals' prices were the main incentives of this upsurge, which show an improvement of the world economic conditions. Food Price Index in the fourth quarter of year raised by 10 percent relative to the fourth quarter of 2008, while the quarterly increase was 1.3 percent. Fuel Price Index climbed by 17.1 percent annually and by 10.2 percent quarterly.

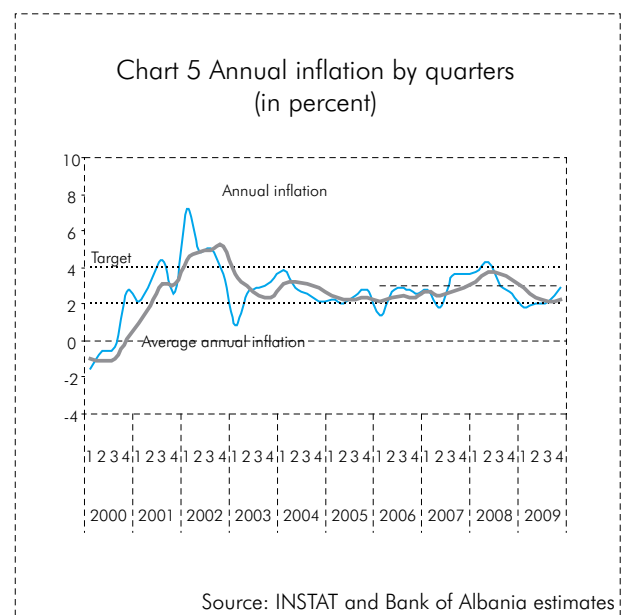
III. PRICE STABILITY AND BANK OF ALBANIA TARGET

The achievement and maintaining of price stability is the main objective of the Bank of Albania. This is the major contribution the central bank can give to stimulating savings and attracting productive investments to sustain a consistent economic growth. In line with its strategy, the Bank of Albania is committed to achieving and maintaining an annual inflation of 3.0 percent, with a +/- 1 percentage point tolerance. The publication of the qualitative objective on inflation aims at anchoring the economic agents' expectations and the decrease of inflation risk primes.

III.1 CONSUMER PRICE, INFLATION TARGET AND MONETARY POLICY

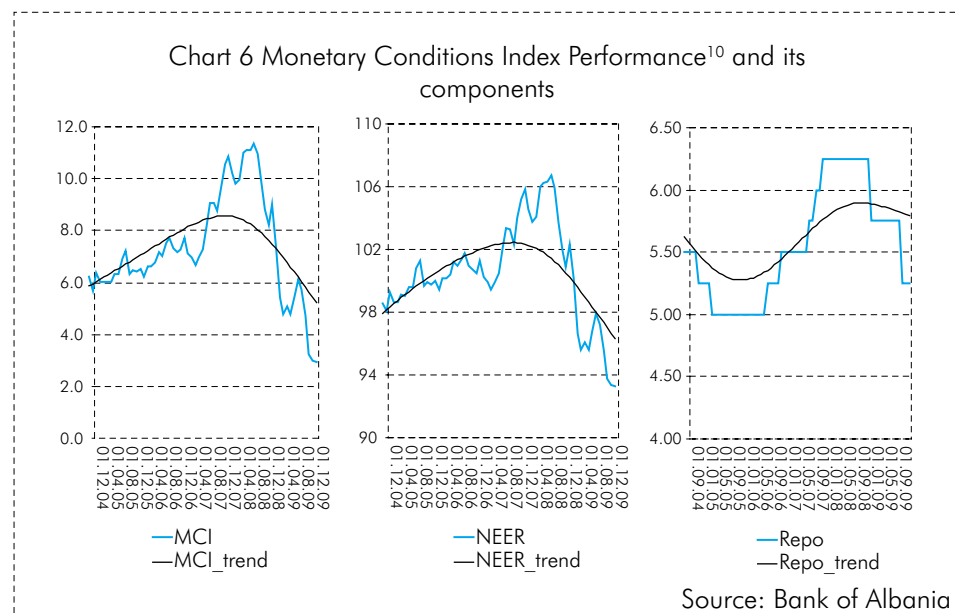
The inflation rate recorded the value 3.5 percent at the end of 2009. Average annual inflation pointed to 2.2 percent, close to the lower limit of 3.0 percent Bank of Albania's targeted band. Average annual inflation rate appears 1.2 percentage points lower relative to the previous year, displaying moderated inflationary pressures. The fall of raw materials price, the statistical effect of managed prices and the weak pressures conducted by the demand at home, provided a contribution to the low inflation rates within an environment with a depreciating tendency of the exchange rate.

Macroeconomic developments at home during 2009 were shaped in the context of the global economic downturn. These developments were characterised by a progressive slowdown of economic growth pace owing to the reduction of both external and domestic demand and under the presence of liquidity tightening conditions. They were also accompanied by reduced inflationary pressures. According to INSTAT preliminary data, economic growth for the first 9-month period of year pointed to 4.9 percent, thus slowing down from 5.4 percent in the first quarter to 4.1 percent in the third quarter. The economic growth in the previous year pointed to 7.8 percent for the same period. Private investments contracted along with the fall of the external demand⁴. The restricted external and domestic funding sources and the increased attention on the conduction of expenses, mainly for investments in an uncertain context regarding the accomplishment of future revenues- contributed to the tightening of the private investments.



Trade deficit narrowed by about 6 percent annually in the first 9-month period of year. The sustainability of consumer demand⁵ and the fiscal stimulus⁶, along with the easing monetary conditions, supported the positive rates of the domestic demand growth notwithstanding at lower paces than in the previous years. The slowdown both the demand and economic activity led to the slight raise of unemployment. Different indicators of costs in economy signal a slight declining trend in labour cost per produced item and a fall in imports and production prices⁷. The operation of demand and supply factors lead to the expansion of production negative gap⁸, that has balanced the inflationary pressures of the exchange rate depreciation. ALL depreciation during this year is transmitted considerably to the tradable consumer prices. Tradable goods inflation increased progressively since June recording the highest growth rate of 4.9 percent in December. Based on empiric studies⁹, the transmission degree of the exchange rate effect on consumer prices pointed the maximum after 9 months.

The Bank of Albania implemented a cautious monetary policy, during the year 2009, by providing adequate conditions for an equilibrated development given the considerable uncertainty situation. Given that inflation, the forecasts and economic agents' expectations remain within the tolerance band around the target of 3 percent, the signals on the slowdown of the domestic demand in the forthcoming period encouraged the upsurge of monetary stimulus. Bank of Albania decided to cut the key interest rate in two cases, in January and October 2009, pointing to 5.25 percent from 6.25 percent at the end of 2008. Along with the cut of the key interest rate, Bank of Albania has employed its entire operating framework to inject liquidity in economy. The return of exchange rate on the depreciating direction, at the end of third quarter and almost throughout the forth quarter of year, being strengthened from the easing measures of interest rate decrease, supported the dropping trend of the monetary conditions' index. The easing of monetary conditions, in the presence of slowing tendencies of the economy, has established the needed premises for the encouragement of aggregate demand and the observation of inflation target.

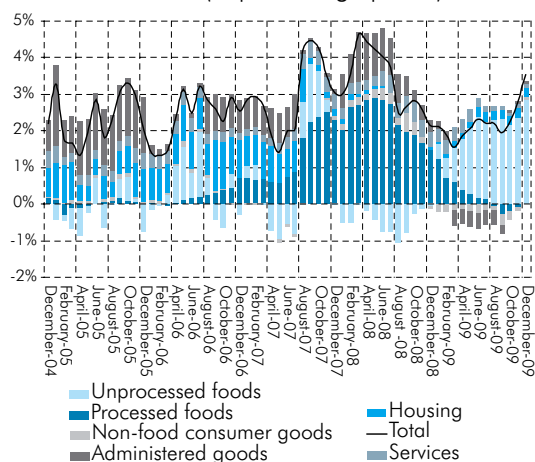


The recent data regarding the world economy signal a stabilisation of forecasts on the economic growth and raw materials prices in the international market. Risks against price stability at home for the ongoing period are estimated to be relatively balanced, in absence of unexpected shocks from the supply side. The slowdown of monetary supply, the softening of fiscal stimulus, the estimates for the slowdown of the domestic demand and economic activity paces and the low rate of producing capacities utilisation are assessed to have balance the inflationary pressures generated by the supply factors, such as the exchange rate and the projected rise of the administered energy price.

III.2 PRICE PERFORMANCE OF MAIN CPI BASKET ITEMS

The monthly inflation rate of December recorded the highest annual inflation rate of 3.5 percent for the year 2009. This rate resulted 1.3 percentage points higher relative to the average inflation rate during 2009, thus confirming the strong climbing trend during the last quarter of this year. An increase of the foodstuffs inflation rate is observed during the second half of year, especially of vegetables and fruits. This growth is more highlighted in the last months of year, which are deemed to have been characterised by the typical phenomenon of food price increase in the Albanian market during holidays.

Chart 7 Contribution of items to annual inflation (in percentage points)



Source: INSTAT and Bank of Albania estimates

Annual headline inflation, during this half of year, is almost completely shaped by the contribution of “unprocessed food” item, meanwhile the contribution of other inflation basket items has provided a low contribution to the construction of headline inflation rate.

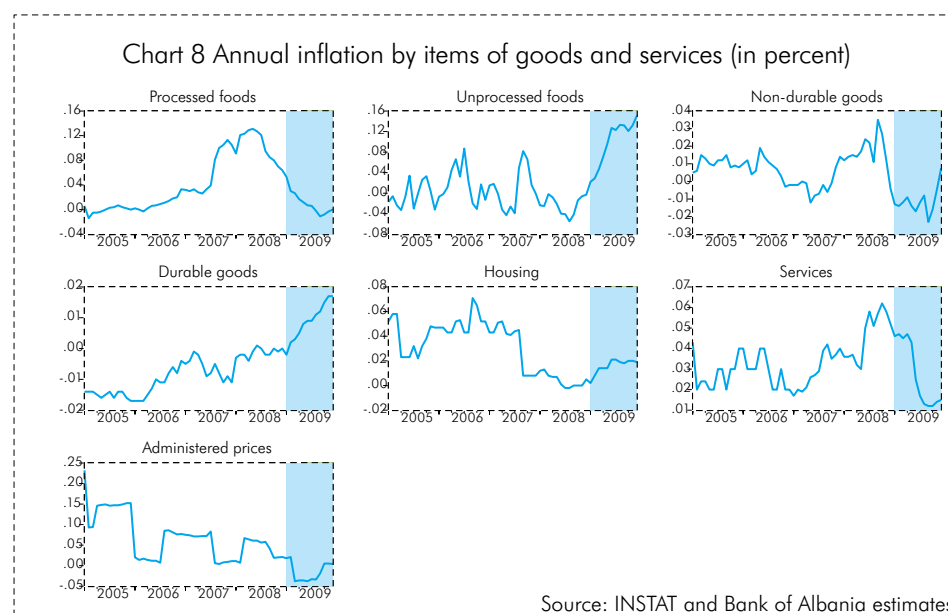
The performance of “unprocessed food” item inflation rate has a special importance in explaining and forecasting the short-term volatilities of inflation¹¹. The contribution of this item increased progressively during this year until December, peaking to 2.8 percentage points. The inflation of this item showed at a doubled value since June of this year, recording the highest rate in December of 15.1 percent. Components of this item are mainly affected by the prices of fruits and vegetables, which are considerably volatile and of seasonally nature. The inability of the domestic product to meet the demand for these goods, and the fact that the imported part of these products remains under the pressure of the exchange rate behaviour, is translated into higher prices for them. This category has also reflected the considerable growth of these goods’ prices during the last quarter, in the main trading partner countries of Albania.

	Q3-08	Q4-08	Q1-09	Q2-09	Q3-09	Q4-09
Processed foods (pp)	2.3	1.7	0.9	0.3	-0.1	-0.1
Bread and cereal (pp)	1.3	1.0	0.6	0.2	-0.1	-0.3
Alcohol and tobacco (pp)	0.0	0.1	0.1	0.1	0.1	0.2
Unprocessed foods (pp)	-0.9	-0.1	0.6	1.8	2.3	2.5
fruits* (pp)	-0.1	-0.1	0.0	0.3	0.5	0.6
vegetables*(pp)	-1.3	-0.7	-0.3	1.4	0.9	1.0
Services (pp)	0.5	0.5	0.4	0.3	0.1	0.1
Administered prices (pp)	0.8	0.3	0.1	-0.4	-0.4	0.1
Fuels and energy (pp)	0.6	0.7	0.4	0.0	0.0	-0.1
Housing (pp)	0.0	0.0	0.1	0.2	0.2	0.2
Non-food consumer goods	0.3	0.2	-0.2	-0.2	-0.2	-0.1
Durable consumer goods (pp)	0.0	0.0	0.0	0.1	0.1	0.2
Consumer Price Index (year/year, %)	3.0	2.5	1.9	2.1	2.1	2.9

Source: INSTAT and Bank of Albania estimates

Table 4 Items contribution to headline inflation (in percentage points)

The “unprocessed food” item recorded a drop of prices during year 2009, thus manifesting a completely different performance relative to the previous year. Annual inflation of this item during 2008 pointed to 2.3 percent, whereas at the end of 2009 recorded the value of 0.3 percent. In the meantime, the imported share of these products has maintained a stable period owing to the considerable fall of their prices at world market since one year ago. The descending trend of inflation appears to have set out a downward “shifting” of prices as a result of cancelling out the effect of bread price increase in February and March 2008.



“Administered prices” items recorded important developments in the performance of prices during this half of year. Annual inflation rate of this item was negative (averagely -2.2 percent) until September, owing to the statistical effect of the comparison at a higher base, as a result of energy price increase during 2008 and the drop of mobile tariffs during 2009. The annual inflation of this item marked a slight increase of 0.5 percent during this quarter, providing a positive contribution by 0.1 percent, against the negative contribution (averagely -0.4 percent) this category provided on the headline inflation rate. The inflation of this group is expected to fall considerably starting from January 2010 with the new increase of energy price.

Contribution of “Services”, “Housing” and “Durables” items to annual inflation rate, is fluctuated within the band 0.1 – 0.2 percentage points during the last months. Within these items, it is worthy to mention that the payments of taxes for education, mainly of private universities, have recorded a growth of 4.7 percent in November.

Prices of non-food consumables continued to have a negative impact on the headline inflation (-0.1 percentage point). However, the observed fall of “Transfers against personal assets” sub-item, including oil price since November of previous year, is almost cancelled out in the last quarter of year,

in addition for the first time in December, fuels prices have been increased by 4.4 percent at annual rate. During December 2008- September 2009, this item prices cut averagely by 11 percent. This factor¹², assuming that the growth paces shall pursue to be alike those of December, is thought to steam new inflationary pressures, particularly on the daily consumer goods prices.

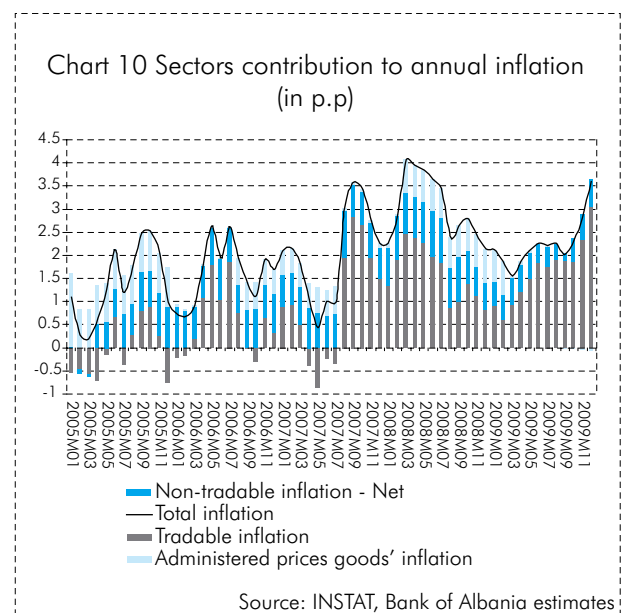
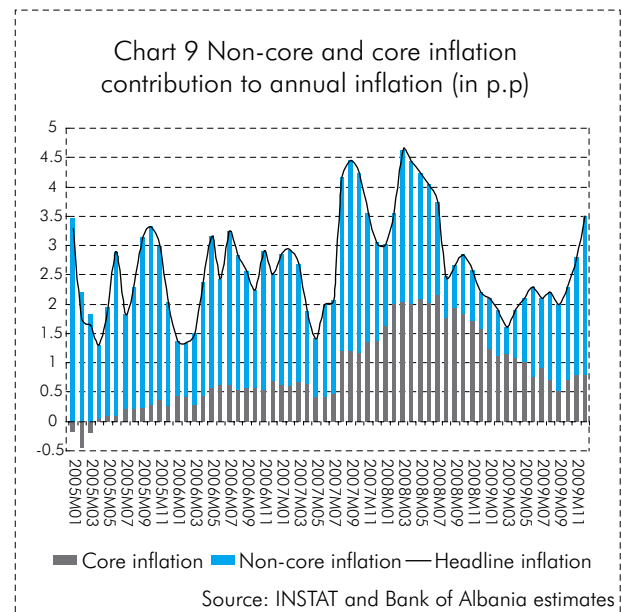
III.3 MAIN INFLATION TRENDS

The annual core inflation¹³ during the second half of 2009 fluctuated averagely around 1 percent, by observing the declining trend of its first half of year. Its values during the months of last quarter of this year, recording 0.9, 1.0 and 1.2 percent, respectively, highlighted the convergence towards the long-term average of inflation permanent component¹⁴.

Non-core inflation component, as representative of short-term volatilities in consumer price, resulted with a relatively high increasing contribution to the annual headline inflation, during June-December 2009. The relevant average contribution for the referring period pointed to about 1.7 percentage points, while in December 2009, it pointed to 2.7 percentage points. The notable rise of annual and monthly prices of unprocessed food item, mainly in November and December, are the main “responsible” factors of the high rates relevant to both non-core and headline inflation. Notwithstanding the developments of the last months of year, its second half resulted with a lower annual core inflation rate relative to the same period of previous year (1.6 percentage points lower).

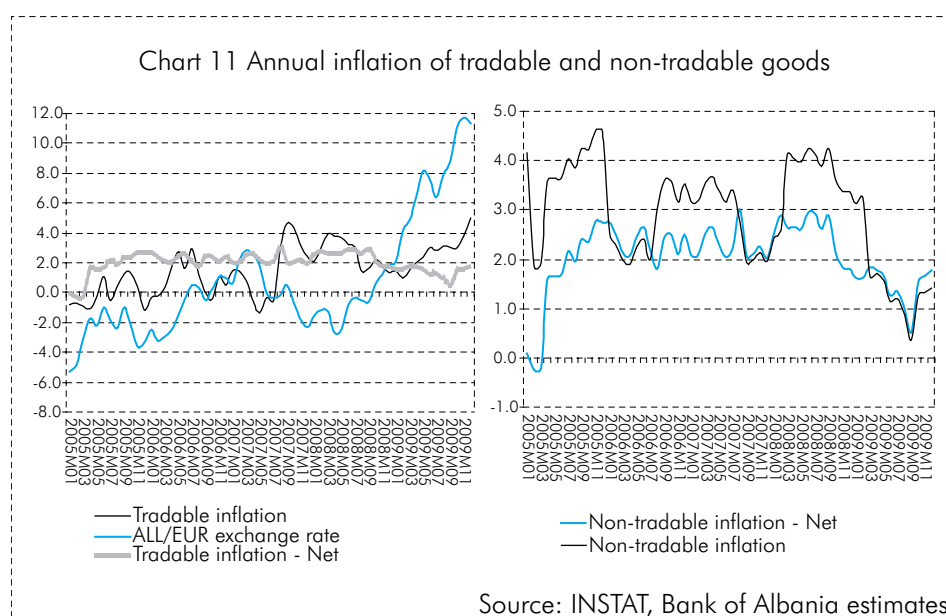
The average annual inflation rates of non-tradable goods and services of CPI basket, were 3.5 and 1.1 percent, respectively, in the second half of year 2009. The price upsurge in tradable goods sector was more evident in the last quarter of the referring year. The inflation of this sector pointed to the maximum rate of 5 percent in December 2009, contributing by about 3 percentage points to the annual headline inflation.

Net tradable inflation¹⁵ in average annual terms for the second half of 2009, resulted about 0.6 percent or 2.9 percentage points lower than the tradable inflation in the respective period. The high seasonality of unprocessed products and the added effects of prices behaviour at the end of year, were considerably amplified in the presence of the relatively depreciating long



behaviour of the exchange rate during the end of year. Estimates reveal that the relatively deep depreciating effect of ALL/EUR¹⁶ is transmitted considerably on the inflation rate of tradable goods sector, as the most exposed sector to the risk of the exchange rate volatility.

Developments in the annual inflation of non-tradable goods and services of CPI basket, helped to cancel out the rates of headline inflation close to 2.5 percent in the second half of 2009. Both, this sector's inflation and the net non-tradable one¹⁷, continue to stay at historical low rates until the last month of the referring year.



The analysed trends in consumer prices suggest that inflationary pressures from the side of domestic demand have been moderate, helping to smooth down the pro-inflationary effects caused by the depreciating exchange rate, during January – December 2009.

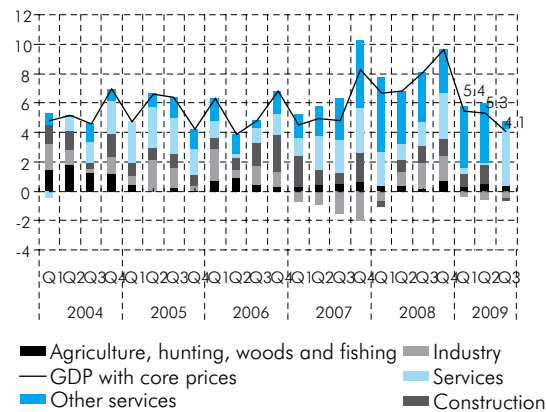
IV. MACROECONOMIC DEVELOPMENTS AND THEIR EFFECTS ON INFLATION

Developments in indirect indicators of aggregate demand in the Albanian economy show its contraction during the third quarter of 2009 and the period to follow. The indicators regarding consumption, private investments and exports continue to record lower rates than in the previous year. The expansionary fiscal policy pursued during June- November 2009 on the short-term expenses and public investment direction is assessed to have provided the main incentive to aggregate demand in economy. The contracted demand affected the slowdown of the economic activity growth paces at home, during the second half of 2009 relative to the previous year.

IV.1 GROSS DOMESTIC PRODUCT AND PERFORMANCE OF AGGREGATE DEMAND

Albanian economy recorded a positive economic growth during the first 9-month period of year, notwithstanding at increasing paces which have been slowing down. Thus, GDP recorded an annual growth rate of 4.9¹⁸ percent, or about 2.3 percentage points lower than the average annual rate of previous year. Based on preliminary data of INSTAT¹⁹, the gross domestic product in the third quarter climbed by about 4.1 percent in annual terms, while the paces recorded in the two first quarters of year were 5.4 and 5.3 percent, respectively. This indicator's dynamic, based on the quarterly paces of its growth, during January-September 2009, is in line with the annual trend. The performance of turnover figure for the economy as a total displays the same trend with GDP performance in the first three quarters of year, thus confirming the slowing down of growth rates.

Chart 12 Contribution of sectors to GDP annual growth (in p.p)



Source: INSTAT (GDP, second and third quarter 2009) and Bank of Albania estimates

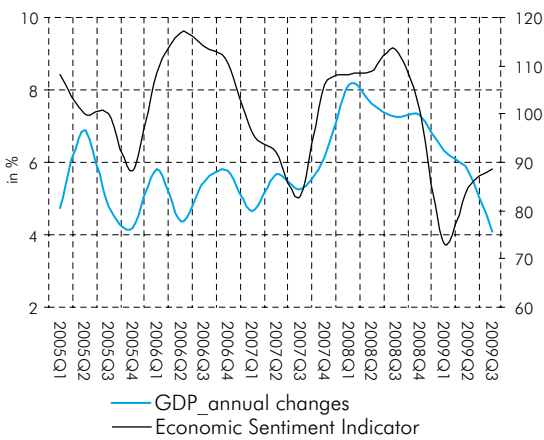
Box 1. What do confidence indicators reveal regarding the economic development at home during 2009?

Confidence indicators constructed from Bank of Albania at the end of elaborating process of business and consumer confidence survey, summarise at a sole indicator the opinions regarding different aspects for each sector and the confidence of business and consumers on the economy in general²⁰. Employment of confidence indicators in periodic analysis regarding the economic developments are based on assumptions that, the stated judgements and opinions of businesses and consumers shall be reflected on concrete operations, with economic consequences on their activity and thus on the country economy. The connection of confidence indicators to official quantitative real economy indicators depends on this level of opinions' reflection into concrete operations.

Economic Sentiment Indicator (ESI), which summarises the developments in industry, services and consumer sectors, has clearly affected the slowdown of quarterly GDP climbing paces during 2009 (chart 1). Businesses and consumer confidence indicators recorded a deep fall in the third quarter of this year, affected by the slowness of the demand and the negative expectations in face a world economic crisis. Economic Sentiment Indicator drooped by 28 percentage points in this quarter, remaining below its historical average by 27 percentage points. Notwithstanding, businesses and consumers' confidence resulted at a higher rate in the two forthcoming quarters relative to the first quarter of year, confidence indicators for all sectors of the economy remain below the long-term average rates. Production balances being aggregated for the production sectors and the balance of the perceived demand aggregated for the economy have recorded negative rates in the first three quarters of 2009 (Chart 2).

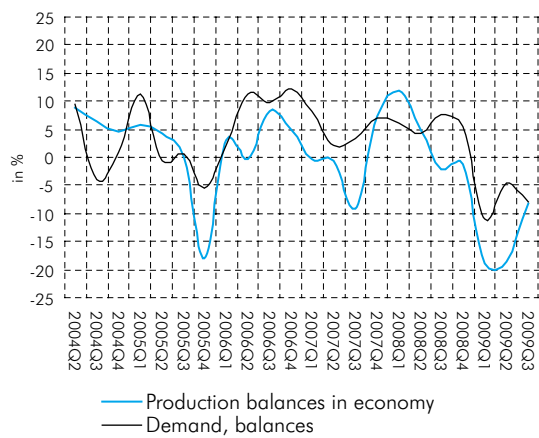
In line with the production fall and the slowdown of the demand, the utilisation of current business capacities, as an indicator of the economy situation, has declined considerably during 2009. At economy level, business have utilized averagely 69

Chart 13 Economic Sentiment Indicator and quarterly GDP



Source: Survey on business confidence, Bank of Albania

Chart 14 Business Confidence Surveys' results summarised at economy level



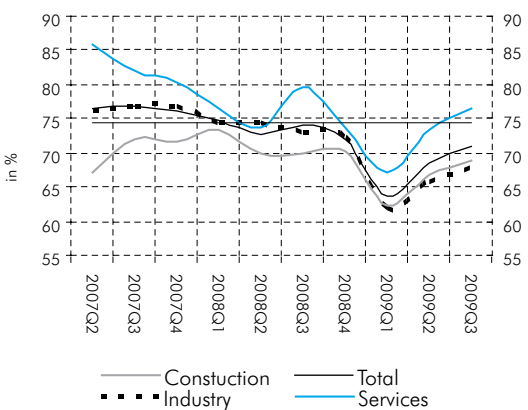
Source: Survey on business confidence, Bank of Albania

percent of their capacities during the 9-month period of this year, 10 percentage points lower than in 2008 (chart 3). The lowest capacities utilisation rate during the 9-month period of 2009 is recorded for industry sector, accounting for 65 percent at average terms. As a result of the low producing capacities utilisation, the slowdown of consumer demand and the credit tightening²¹, private investments are contracted during 2009. Investments balance, according to businesses estimations, was negative and has been dropping during 2009. This is expressed also on the annual fall by 13 of capital goods' import during January– October 2009.

Financial position of businesses at economic level, observed the declining trend during the first three quarters of 2009, owing to the shrink of the external and domestic demand, being reflected also on the fall of the growth pace of the tax income (chart 4).

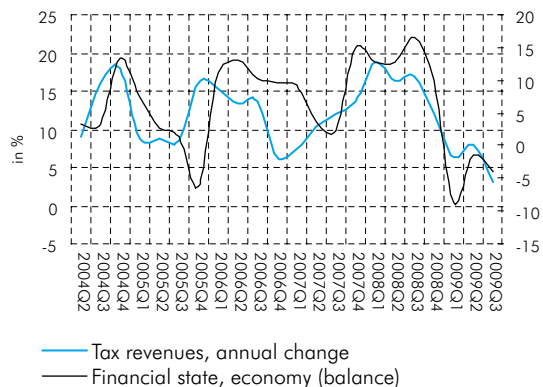
The performance of consumer confidence indicator during 2009 has reflected, on one side, their estimation on the overall economic and financial situation, and on the other side, the positive developments in the savings situation. The latter balance increased by 4.5 percentage points in the third quarter of 2009.

Chart 15 Capacities utilisation in economy and by sectors, in percentage against the complete utilisation



Source: Business confidence survey, Bank of Albania

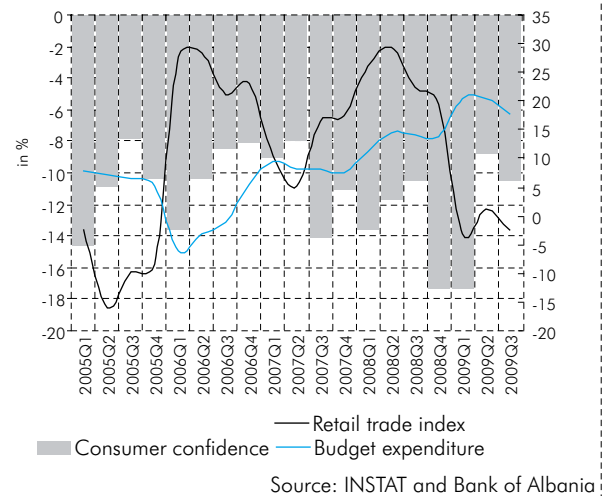
Chart 16 Tax revenues and surveys indicator on the business' financial state



Source: Business confidence survey, Bank of Albania

Private consumption, based on its measuring indirect indicators, recorded a modest increase during 2009. The moderate employment growth, the slowdown of wages rise rates in the private sector, the decrease of remittances and consumer loan, and the upsurge of uncertainty, throughout the year 2009, have affected the consumer stabilisation over the course of year. According to indirect qualitative data, retail trade indices and consumer goods import have been relatively stable during 2009. In particular, retail trade index, recorded a negative annual growth in the first quarter of year, a slight annual increase in the second quarter and fell by 2.3 percent in the third quarter. Based on the surveys' qualitative data, the consumer confidence sentiment, after a slight improvement in the second quarter, declined in the third quarter of 2009. Expectations on business and consumer surveys suggest that the growth paces of private consumption shall remain at modest rates even during the fourth quarter of 2009.

Chart 17 Private consumption and budget expenditure indicators



Indirect indicators reveal a contraction of private investments during 2009, imposed by the demand slowdown, the low rate of business confidence, the low rate of capacities utilisation and by the tightened lending standards. Capital goods import, as an approach of investments in economy, has been reduced annually by 12.8 percent during January-November 2009. The survey data about business confidence, regarding investments whose balance remained negative and decreased during the first three quarters, confirm this fall. Public investments, on the other hand, climbed by 23 percent during January – November 2009, relative to the same period of previous year. Qualitative indicators from business surveys for the second consecutive quarter show a decline of inventories in the third quarter of 2009, after a series of consecutive quarters when businesses have reported their accumulation.

Government expenditures provided a positive contribution to the aggregate demand during 2009, compared to its other components. Public expenditures recorded an annual growth of 16 percent during the 11-month period of 2009. This upsurge is reflected on the increase of budget deficit and is financed through the external borrowing and the use of proceeds from privatisation.

Net exports continued to provide a negative contribution to GDP during the first three quarters of 2009, given that imports rate exceeds considerably the exports rate. However, net exports contribution of goods and services, during this period, in the current economic rate has maintained the same share²² of the previous year.

IV.1.1 Production performance by sectors

During the fourth quarter of 2009, at sectoral rate²³, activities of services provided the highest contribution to GDP annual growth, mainly affected by the high rates of annual increase in the branches of post & telecommunication (about 34.3 percent), transport (about 15.5 percent) and trade, hotels and restaurants, (about 6.4 percent). Activities included in other services rose by about 2.3 percent in annual terms or averagely 7 times lower relative to the first and second quarter of year.

Industrial production activity pursued the contraction in the third quarter of year, notwithstanding at a lower annual rate than in the second quarter, by recording an annual fall of 4.5 percent. Construction shrank also at 0.7 percent in annual terms, differently from the increase recorded in the first half of year.

PRODUCTION SECTORS IN ECONOMY

Based on the turnover index as a volume, the industry branch recorded an annual modest rise in the third quarter by about 0.2 percent, recording the lowest annual rate since 2004. The non-household consumption indicator of electric energy reflects also this development in the industrial activity. The extracting industry, after the contraction recorded since the fourth quarter of 2008, increased in this quarter by 1.8 percent annually. During this quarter, at turnover figure terms, another branch showing a deterioration was the processing industry, declining by 5.7 percent, while "Electric energy, gas, water" item recorded a better performance, thus increasing by about 20 percent in annual terms.

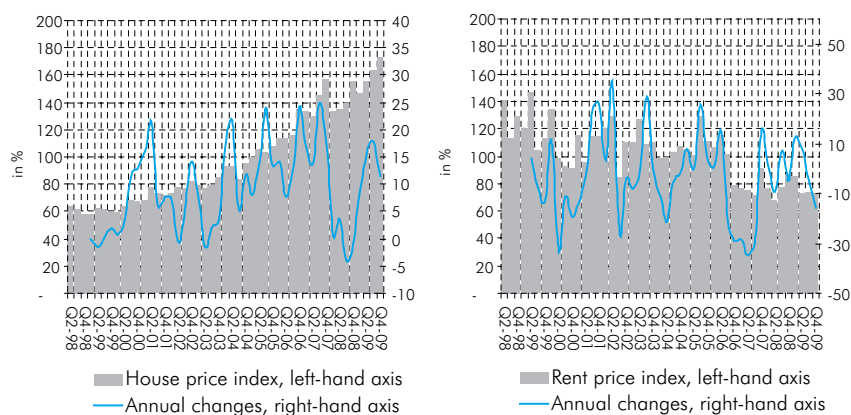
The high annual growth paces of construction sector slowed down, by generating a turnover figure as a volume of 24.5 percent higher than the third quarter of previous year, however it recorded a contraction at quarterly terms, of 8.3 percent. Construction volume, during this period has slowed down the annual increase paces, as denoted by the other indirect indices, such as the rise by lower paces of cement consumption.

Box 2. Performance of housing prices²⁴

Housing price index in Tirana recorded higher rates in the second half of 2009 relative to the first half. In the third and fourth quarter of 2009, this index pointed to 17.3 percent and 11.6 percent, respectively. The quarterly changes for these periods pointed to 5.6 and 5.8 percent, respectively. This upsurge has mainly reflected the depreciating performance of ALL during this period.

Production prices at construction sector, based on businesses estimations collected from confidence survey, increased in the third quarter 2009, after a declining trend started in the second quarter of 2008 (chart 2). As regards to these data survey, assessment of constructing businesses regarding ordering contracts is improved and the lowering of inventories continued for the second regular survey during the third quarter of 2009.

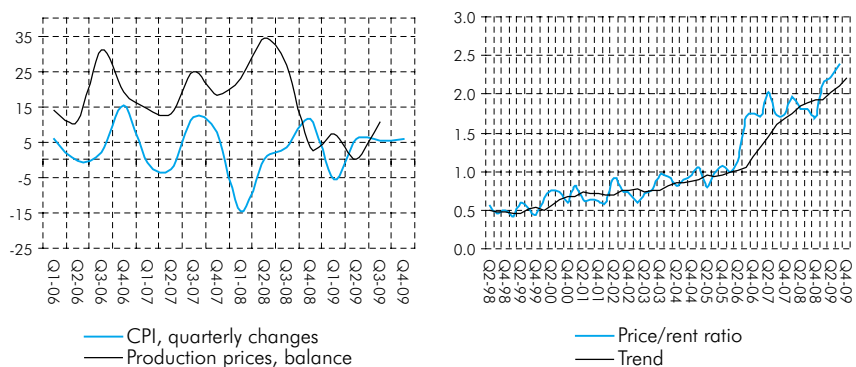
Chart 18 Performance of house price and rent price indices



Source: Bank of Albania

Rent price index, differently from house prices index, declined again during the fourth quarter of 2009, by 15.5 percent, compared to the fourth quarter of 2008. House price index is 1.2 percent lower relative to the third quarter of 2009. Price index to rent ratio²⁵ rose in the fourth quarter remaining by 0.2 percentage points upper its historic average.

Chart 19 Performance of production and inventories in construction and HPI quarterly changes (left-hand); HPI/HRI ratio and its long-term trend (right-hand)



Source: Bank of Albania

Production of electrical energy²⁶ during January – November 2009 grew by 35.2 percent relative to the same period of previous year. Available data reveal that during November 2009, electrical energy production increased 94.8 percent in annual terms and by about 5.7 percent relative to the previous month.

Chart 20 Performance of turnover index as a volume for construction and industry



Source: INSTAT, short-term statistics, third quarter 2009

Energy import and export balance was improved during January – November 2009. Thus, the energy export volume amounted to 438.5 GWh, during this 11-month period. Energy import volume, for the same period, fell by 97.2 percent compared to the same period of previous year (53.1 GWh from 2232.5 GWh in January – November 2008). The level of exported energy for the 11-month period was 385.5 GWh higher than the level of imported energy. Electrical energy consumption in January – November 2009 climbed by 5.65 percent relative to the same period of previous year. This upsurge owes mainly to the rise of electrical energy household consumption. On the other hand, electrical energy consumption by businesses increased insignificantly, by 0.04 percent, respectively.

Table 5 Annual indicators of the electrical energy balance (in GWh)

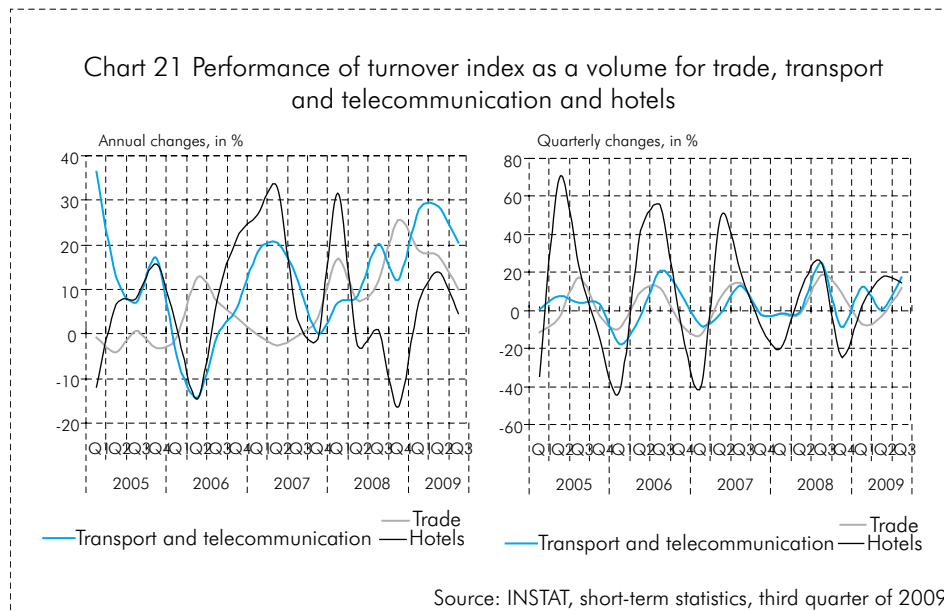
	11M '05	11M '06	11M '07	11M '08	11M '09	Annual change 11M '09/ 11M '08 (in %)
Net production	5089.0	5163.9	2591.8	3423.5	4628.8	35.21
Import (-)	149.8	507.4	2517.8	2232.5	53.1	-97.2
Export (+)	0.0	0.0	0.0	0.0	438.5	-
Losses in distribution	1793.0	2028.3	1513.7	1520.4	1881.1	23.73
Losses/ Production	35.2%	39.3%	58.4%	44.4%	40.6%	-3.8
Consumed Energy	4075.0	5151.4	4931.8	5422.4	5729.0	5.65
Billed consumption	3225.6	3123.1	3278.2	3736.1	3847.9	2.99
Unbilled consumption	849.4	2028.3	1653.5	1686.3	1881.1	11.55
Household consumption	1943.1	1939.9	1870.1	2072.8	2183.9	5.36
Non-household consumption	1282.5	1183.2	1408.1	1663.3	1664.0	0.04

Source: KESH; OSSH

SERVICES SECTOR

The volume turnover index derived from services branch has recorded a positive growth pace in annual terms, however this pace was lower relative to the first two quarters of year. According to this index, retail trade activity

rose by about 12.6 percent annually, pointing to 5.2 percentage points less than the average of the two preceding quarters. Post and telecommunication branches have also recorded positive annual rates of these indices and hotels activity as well, notwithstanding at lower paces in this quarter relative to the previous quarters.



IV.1.2 Performance of the External Sector of the Economy

The overall balance of payments denote the increase of foreign assets by about EUR 44 million for the period July- September 2009. The main developments in the external sector of the economy consisted on:

- the decline of inflow and outflow current transactions;
- the further deepening of current deficit and the modest narrowing of trade deficit;
- the contraction of net inflows in the capital and financial account;
- the growth of foreign reserves of the monetary authority.

CURRENT ACCOUNT

Current transactions carried out during July-September 2009, amounted to about EUR 2.68 billion, 7.4 percent higher than the transactions of the same period in the previous year²⁷. The deficit of current account balance amounted to EUR 330.6 million during this period, recording an annual growth of about 43 percent.

Current deficit deepening owed to the direction change of the revenues balance from surplus to deficit²⁸, and to the narrowing of *current transfers*²⁹ surplus. As a result, current deficit ratio to GDP³⁰ increased considerably in annual terms being estimated to about 17 percent. Trade exchanges in goods

and services represent the major part of current transactions of our country. More than 90 percent of the period current expenses served for the purchase of goods and services, while about 22 percent of current revenues have entered as transfers. Goods and services exports provided respectively about 17 and 57 percent of current incomes. While, goods trade deficit shrunk to EUR 591 million or about 2 percent in annual terms and its ratio against GDP is estimated to 28.4 percent.

Table 6 Balance of payments indicators, in years

	In EUR million				In percentage to GDP ³¹			
	Q3'06	Q3'07	Q3'08	Q3'09	Q3'06	Q3'07	Q3'08	Q3'09
Current account	-106.9	-170.1	-230.7	-330.6	-8.2	-8.4	-13.9	-17.3
Trade balance	-415.3	-527.4	-601.9	-590.8	-22.7	-25.1	-27.9	-28.4
-Exports	153.2	197.3	242.0	201.8	8.3	9.7	10.9	9.2
- Imports	-568.5	-724.7	-843.9	-792.6	-31.0	-34.9	-38.7	-37.6
Services (net)	-18.6	11.2	87.2	88.1	-1.3	0.2	1.0	0.5
Income (net)	50.5	74.4	54.8	-33.5	2.4	3.1	1.2	0.1
Current transfers (net)	276.4	271.7	229.2	205.7	13.4	13.6	11.7	10.5
Capital & financial account	41.0	298.8	208.1	187.1	7.4	11.5	11.5	19.8
Errors & omissions	141.9	6.4	141.1	187.4	3.6	0.2	3.3	-0.8
Balance of payments	76.1	135.1	118.5	43.9	2.8	3.3	0.9	1.7

Source: Bank of Albania and IMF estimates

FOREIGN TRADE

Data of the foreign trade for the period July-November³² 2009 denote a weakening of trading inflows and outflows. Trade exchanges for this period amounted to EUR 1.7 billion, about 11 percent lower relative to the same period of previous year. Trade deficit narrowed by about 10 percent in annual terms. Imports' coverage by exports remain at 24.6 percent and reveals a decline by about 2.4 percentage points.

Table 7 Exports and imports (in EUR millions) and the annual change by commodity groups (in %)

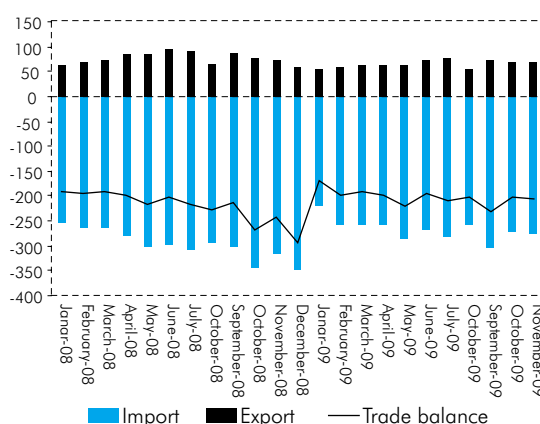
	Exports (EUR, million July-November)	Annual change (in %, July-November)	Annual change (in %, July-November)	Imports (EUR, million, July-November)	Annual change (in %, July-November)	Annual change (in %, July-November)
Foods and live animals	16.1	7.7	-8.6	170.5	1.9	-12.3
Beverages and Tobacco	0.5	-58.1	-59.9	62.4	20.4	-19.3
Raw materials	43.8	-24.0	4.5	43.2	31.6	-0.2
Fuels	39.1	-5.4	167.0	185.2	-28.5	-26.1
Vegetable and animal fats and oils	0.2	94.6	1337.1	16.6	-19.5	29.7
Chemical products	6.3	37.7	25.7	148.5	-4.7	4.1
Processed goods	61.0	-33.3	-32.7	353.9	-7.2	-11.9
Machinery and appliances	18.1	8.7	-21.0	287.5	-15.7	-23.4
Other processed goods	157.1	-5.2	-7.0	121.3	-18.9	4.6
Miscellaneous	-	-	-	-	-	-
Total	342.2	-13.1	-5.7	1,389.1	-10.9	-12.8

Source: Bank of Albania

Given that a considerable high percentage of domestic exports have as final destination the EU countries- mainly Greece and Italy, the weakening

of external demand in these countries has affected considerably the exports performance. Notwithstanding, the depreciation of the domestic currency against EUR has softened the demand decline in these countries. The fall of prices in the respective markets has exercised pressures on the reverse direction for exporters at home. Therefore, exports dropped by 13.1 percent during July-November '09 relative to the same period of previous year. Exports categories "raw materials" and "processed goods" provided the main impact by recording a decline of 24 and 33 percent, respectively in annual terms. While, the group of highest share in exports, "Other processed goods", recorded an annual fall of about 5 percent. The combined share of these three categories against total exports for this period is about 77 percent.

Chart 22 Imports, exports and trade balance (in EUR million)

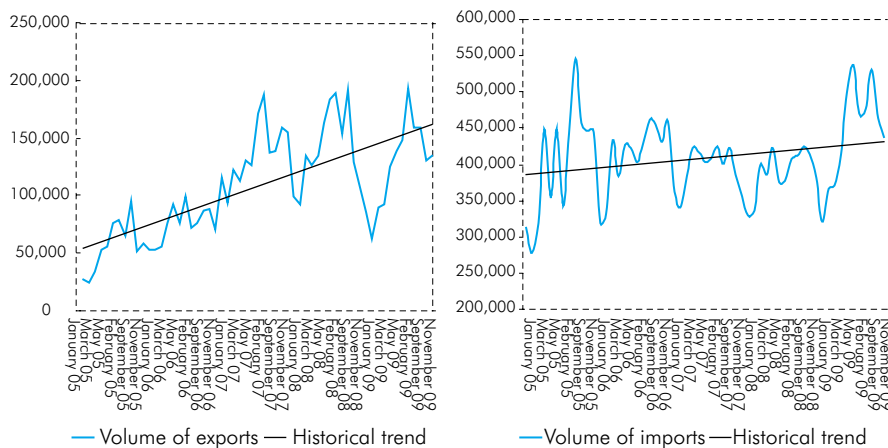


Source: Bank of Albania

Imports to our country, during July-November, reduced by approximately 11 percent in annual terms. The "machinery and appliances" and "processed goods" sub-items provided the main contribution to this drop, being reduced by 16 and 7 percent, respectively in annual terms. "Fuels" item also recorded an annual decline of imports, affected also by the high rate of prices this sector encountered in the previous year. By contrast, imports of "Foods and live animals" rose by about 2 percent in annual terms.

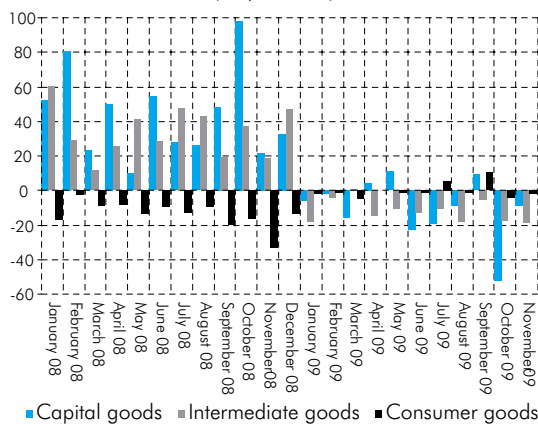
The performance of exports measured by volume (ton), attests a more moderate annual downward compared to the decline in the value. Thus, imports volume reduced by approximately 1.5 percent. Albania exports' volume to other countries recorded a fall of 9.3 percent in annual terms, during July-November'09. The analysis of imports performance in terms of their final destination, "capital goods", "intermediate goods" and "consumer

Chart 23 Exports and imports volume and the historical trend in 1000 ton



Source: General Directory of Taxes

Chart 24 Annual changes in the imports of capital, intermediate and consumer goods, (in percent)



Source: Bank of Albania

goods”, show an upward trend of the last item and a downward trend of the two first items.

Thus, in terms of the above mentioned period, imports of “capital goods” and “intermediate goods” reduced by 20 and 14 percent, respectively in annual terms. By contrast, imports of “consumer goods” recorded an increase of approximately 1.6 percent in annual terms.

The EU countries continue to remain Albania’s main trading partners. Hence, trade exchanges with these countries account for about 68 percent of total trade activity of our country. In terms of exports, Italy continues to be their main destination accounting for averagely 61 percent of total exports, during the period July-November. By contrast, geographical span of imports origin to our country is diversified.

Here it is highlighted the decline of imports from China and regional countries and the increase of imports from EU countries.

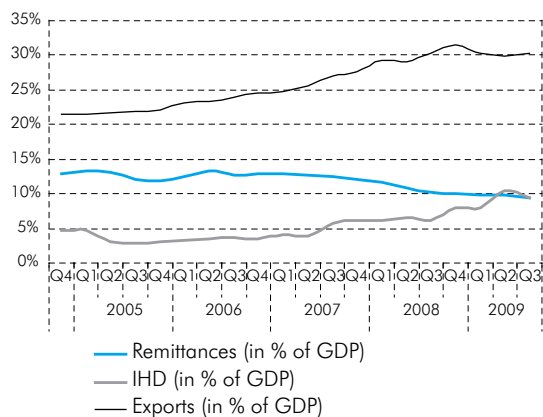
Box 3. Remittances, a developing possibility

The economic crisis’ effects and lessons, which involved the world markets during 2008-2009 should be considered in the compilation of economic policies and strategies which relate the migration to the stable economic development of a country. The expected performance of remittances and their ability to support the reduction targets of poverty and the country economic development is an important dimension of remittances. In Albania, remittances – which are estimated to about 9-10 percent of GDP, represent a quite important inflow to both households and to the entire economy.

Along with the foreign direct investments and revenues from goods and services export, they compose one of the main items for the financing of imports and the meeting of economy needs for consumption and investments. The ratio rates of remittances to GDP have been higher than those of foreign direct investments, acting as an incentive to the economic and financial development of the country.

Remittances’ effects on the economy are complex. In case of Albania, these flows compose a revenues source to meet the consumer needs of living conditions, and a potential possibility to finance investments and the creation of new work positions. On the other hand, the benefiting of remittances from emigrants families may potentially establish pressures on labour market, through the establishment of dependences and encouragement of long-term unemployment. These factors should be taken into account in dealing with remittances, in their current and expected context as well.

Chart 25 Remittances, goods and services exports and FDIs (in % of GDP)



Source: Bank of Albania

Remittances during the first 9-month period of 2009 to Albania decreased by about 6 percent against the same period of the previous year and by about 19 percent relative to the same period of 2007, by fluctuating the supply demand ratio for foreign currency and thus affecting the performance of exchange rate. The slowing down of remittances during 2009, notwithstanding was mainly a direct reflect of global crisis effects, may be considered as a primary signal of their effects in the future. The progressive reduction of their relative value and share is mainly related to the seasonal character of remittances, which as widely accepted from by different studies (Docquier, Rapoport 2005), have a long-term downward trend. Emigrants, by the time, are stabilised in the hosting country, establish their families and consequently come across with different pressures to lower the remittances level to the country of origin. The same tendency is expected to occur also for Albania, and for that reason, the attempt to find out alternative sources, which generate foreign-exchange denominated inflows, and their channelling in producing economic sectors and investments as well.

Annalists at World Bank, International Monetary Fund and World Bank for Migration have accomplished the same results: remittances currently are designated for the financing of daily consumption, for they represent a restricted capital source for investments and for the financing of the stable economic development of the countries of origin. Nowadays, when countries have a long migration history, the attention, higher than on remittances flows, should be concentrated on the development of financial instruments adequate for the attraction of immigrants' savings. Immigrants' savings are assessed to be 4.2 times higher than the remittances rate in case of Albania³³.

	Albania	Kosovo	BiH
Monthly income (familiar) – (Euro)	2300	3900	2288
Monthly expenses - (Euro)	1477	2324	1938
Value of monthly savings (Euro)	835	1578	350
Rate of monthly savings (in %)	38	41	15
Annual value of remittances per family - (Euro)	1664	3212	1752
Annual savings – Euro	10260	15724	2448
Savings in 2008 - (Euro million)	3473	2340	1175
Remittances in 2008 (Euro million)	833	479	841
Savings/Remittances	4.2	4.8	1.4
No. of migrant families	404.000	149.000	480.000

Source: IOM, IASCI and Bank of Albania

On the other hand, immigrants represent also an important channel for the transmission of new knowledge, new ways of production, work ethic, new technologies and a new culture of doing business. The intertwining of both components, savings and new knowledge, shall represent a highly considerable potential source for the development of the countries of origin in general.

PERFORMANCE OF OTHER CURRENT ACCOUNT ITEMS

Transactions rate in services amounted to ALL 1.25 billion or 31.4 percent higher in annual terms, for July-September 2009. The balance sheet of services account recorded a suffice of EUR 88.1 million, for the third quarter of 2009, remaining almost at the same level compared to the same period of previous year (EUR 87.2 million). In the meantime, the annual growth of

Table 8 Data on immigrant families, their savings and remittances

exports and imports in services pointed to 28.8 and 34.5 percent, respectively. Travel services covered the main share of both services export and import, contributing by 81.5 and 78.2 percent, respectively on the overall share of services. Net balance of travel services, during this quarter, recorded a surplus of about EUR 91 million compared to the surplus of about EUR 94 million amounted in the previous year. Foreign exchange inflows from travel services amounted to EUR 543.4 million during this period, recording an annual growth of about 40 percent, related also to the increase of visitors' number during summer season. Exchange inflows from travel services were about 2.7 times higher than goods exports' revenues. Residents' consumption outside Albania is estimated at about EUR 453 million, 54.2 percent higher compared to the same period of July – September 2008.

Transport services recorded a surplus of EUR 0.2 million, after a period of subsequent negative rates quarters. "Other services" category closed with a surplus of about EUR 12 million, being narrowed in the time span of one year³⁴. The positive signals within this category are noted for both construction and government services, while services in communication and financial sector record negative developments³⁵.

Net result of transactions in revenues is negative during this quarter and estimated to about EUR 34 million against the positive value of EUR 55 million of the same period in the previous year. Foreign currency denominated inflows of this category fell by about 49 percent, while outflows are almost doubled, relative to the third quarter of previous year. The work of seasonal and border workers and investments' proceeds, in the form of banking system deposits interests abroad, were the two main sources of revenues. Work inflows decreased by 35 percent. While, outflows from direct investments as dividend payments and re-invested profit are doubled. During the third quarter of 2009, Albania paid the amount of EUR 5 million to settle interest on its external debt.

Net current transfers balance, during July-September 2009, recorded a surplus of about EUR 206 million with a drop of EUR 24 million relative to the previous year. Remittances continue to maintain the highest share (around 90 percent) of this category incomes. These transactions amounted to EUR 187.5 million, during this period, covering about 32 percent of goods trade deficit. Relative to the same period of 2008, these transfers are assessed 6.6 percent lower. Their ratio to GDP is assessed to 9.4 percent relative to 10.2 percent in the previous year.

CAPITAL AND FINANCIAL ACCOUNT

Albania recorded a net inflow of EUR 187.1 million in the capital and financial account during the third quarter of 2009. Around EUR 32 million entered in the form of capital investment transfers, while EUR 155 in the form of net financial flows. Capital inflows financed 57 percent of the current account deficit. Albania's financial liabilities to the rest of the world grew by EUR 285 million, during the above stated period, while residents' assets

abroad raised considerably (about 19 percent). The highest shifts in this account are recorded in borrowing items. The granting of long-term and soft loans from abroad amounted to EUR162 million. Public sector borrowing amounted to about EUR 140 million, while private borrowing amounted to EUR 22 million. The increase of this type of liabilities led to higher future external debt-service payments. External-debt service for the third quarter of 2009 reduced residents' liabilities by EUR 20 million. While, the Foreign Direct Investments inflow, in the Albanian economy, for the third quarter 2009, amounted to about EUR 143 million against EUR178 million recorded in the previous year. It is worthy to mention, that for the first time, after some consecutive quarters, it is recorded an increase of residents' claims against non-residents. Foreign exchange assets invested abroad recorded a growth of EUR 130 million, mainly in the form of portfolio investments (EUR 15.8 million) and banking system reserves investments in the international market as deposits (EUR 104.3 million). Long-term lending increased as well (EUR 10.5 million).

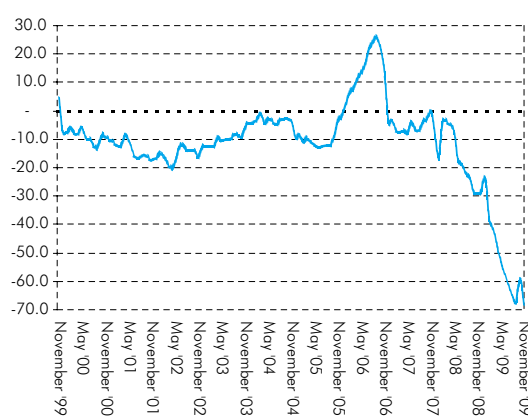
Reserve assets rose by EUR 44 million. Foreign reserves amounted to EUR 1,736 million in third quarter-end of 2009. This level is considered sufficient to cover 4.2 months of imports of goods and services.

IV.1.3 Developments in fiscal indicators and fiscal policy

Fiscal policy manifested an expansionist character during 2009, particularly in the second quarter of year. Primary deficit experienced sharp expansionary paces during this year, by reflecting the uprise of current and capital expenditure.

Primary deficit has reflected on its major part the growth of budget deficit. At the end of November, budget deficit amounted to about ALL 64.5 billion, exceeding by about 6 percent the projected level for this period. Deficit financing relied primarily on proceeds from privatisation, syndicated loan and the borrowing through the issuance of debt instruments in the Government securities market.

Chart 26 Moving sum of primary deficit, for 12 months, November 1999 – November 2009



Source: Ministry of Finance, BoA staff estimates

	Real rate (in ALL billion)	To the plan ³⁵ (in %)	Annual change (in %)		
	11-month 2009	11-month 2009	11-month 2007	11-month 2008	11-month 2009
Revenue	268.2	92.3	11.8	15.9	2.2
-Tax and customs	192.0	95.8	13.9	16.7	2.7
VAT	99.9	96.0	19.3	21.9	2.3
Tax on profit	15.8	100.1	-7.9	-11.4	-5.7

Table 9 Accomplishment of main fiscal indicators for the 11-month period of 2009 relative to the previous years

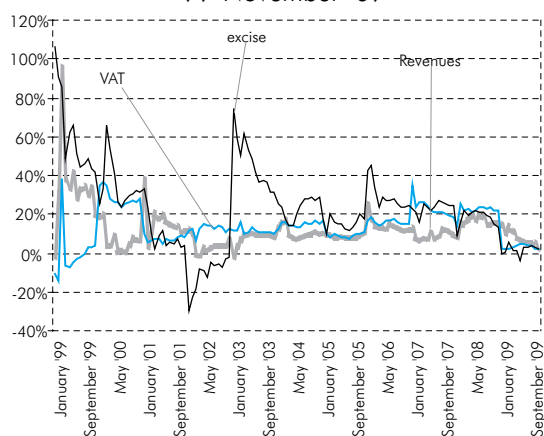
Excises	30.5	91.3	24.8	14.8	1.8
- Local government	11.1	72.8	-12.8	19.8	7.4
- Independent budget	45.5	94.4	4.2	16.8	5.5
- Non-tax income	17.1	78.1	53.4	5.9	-16.5
- Grants	2.5	51.8	-68.8	24.6	68.8
Expenditure	332.6	94.7	9.8	28.6	16.4
- Current expenditure	247.7	97.1	8.1	15.4	16.4
Personnel	55.9	102.7	4.2	14.0	-3.6
Interests	32.3	98.9	-1.2	24.5	13.1
Social insurance and pensions	86.8	99.8	17.0	9.8	27.4
Local government expenditure	29.3	90.4	-2.1	34.1	31.1
- Capital expenditure	84.9	90.5	3.4	110.7	22.8
Budget balance	-64.5	106.1	2,031.8	-664.9	175.2

Source: Ministry of Finance

BUDGET REVENUE

Budget revenue manifested a slowing trend, particularly after the first quarter of 2009. This tendency is reflected almost on all main items of tax revenues. In more concrete terms, annual increase of revenues for the 11-month period pointed to about 2 percent³⁷, against 14 percent³⁸ recorded at the end of the thirteenth quarter of 2009. This behaviour of revenues is mainly posted by VAT revenue³⁹, whose annual increase pace fluctuated within the interval 2-5 percent. The same interval constructed for 2008, has as lower and upper limits the values of 21 and 25 percent, respectively.

Chart 27 Annual growth pace of budget revenue, VAT proceeds and excise proceeds (in %), January '99-November '09



Source: Ministry of Finance, BoA staff estimates

Budget revenue during the first half of year, along with the slowdown trend, have manifested differences to the projected level. Their performance during first half of year imposed as indispensable the review of budget for the year 2009⁴⁰. As revealed from the reviewed budget of 2009, revenue dropped by ALL 8.7 billion, while expenditure rose by ALL 16.1 billion, relative to the rates being projected at the beginning of year. Consequently, budget deficit grew by ALL 24.8 billion from the initial projected rate⁴¹.

At the end of 11-month period, total revenue were realised by about 92.3 percent of the projection⁴² for the same period. Almost all revenue items have manifested differences to the projection, excluding revenues from profit tax, customs and national tax.

BUDGET EXPENDITURE

Fiscal policy has manifested signs of fiscal expansion, being led at the same time by short- and long-term expenditures, throughout the 11-month period. The realised budget expenditure, in annual terms, during the 11-month period, recorded a growth by about 16 percent, where capital expenses contribution is about 4 percentage points. Contribution of capital expenditure to the total

of expenditure growth has been highlighted in the two last years, mainly owing to the expenditures for the construction of Durrës-Kukës⁴³ way.

There are realised a total of 332.6 billion expenditures, until the end of November, which represent about 95 percent of the projection compiled for this period. Short-term expenditure cover about 74 percent of total expenditure. After the first quarter of year, almost all components of this item have been increased considerably, where there are highlighted local government expenditure and operative expenditure of maintenance⁴⁴.

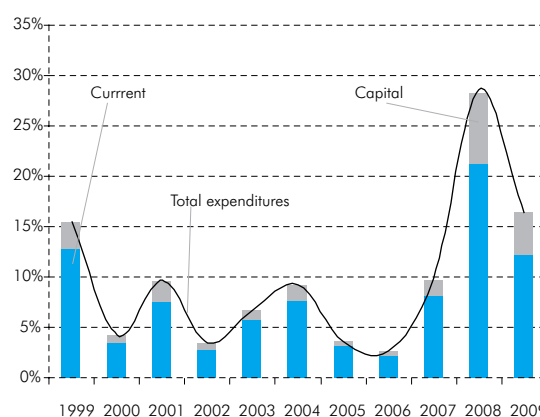
BUDGET DEFICIT AND ITS FINANCING

Budget deficit has pursued an uprising trajectory starting from February of this year due to a more active fiscal policy on the expenditure side. The performance of budget revenue and expenditure, in terms of growth rates and meeting of projection provided the expansion of budget deficit, which at the end of November is estimated around 6.2 percent of GDP⁴⁵.

Budget deficit at the end of November 2009, is 2 times higher than the rate recorded in the same period of the previous year. At the same time, the face value recorded for the 11-month period amounted to ALL 65 billion, represents the higher rate recorded during the last 10-year period. Budget deficit experienced considerable growing paces during the last two years, by being deviated somewhat from the trajectory of fiscal consolidation followed during 2005-2007.

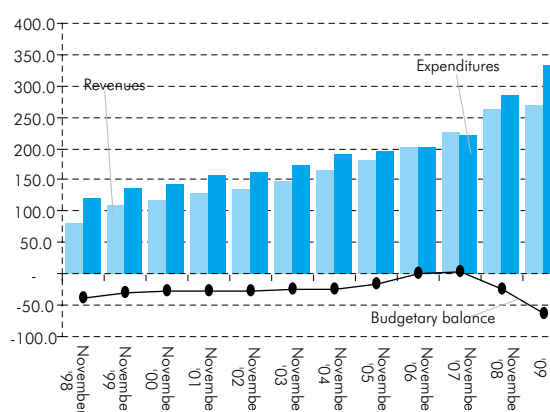
A higher rate of budget deficit is accompanied by higher needs for (external and domestic) borrowing, relative to the previous years. As a result, along with the widely employed instruments in the financing of budget deficit, the syndicated loan has been used throughout the previous years, in 2009⁴⁶. This new instrument (amounting to ALL 24.6 billion) has financed about 38 percent of the 11-month budget deficit. About 75 percent of syndicated loan was provided by non-resident banks and the rest by resident banks and institutions operating in Albania.

Chart 28 Annual change (in %) of expenditures and current expenditures contribution for the period January 1999-November 2009



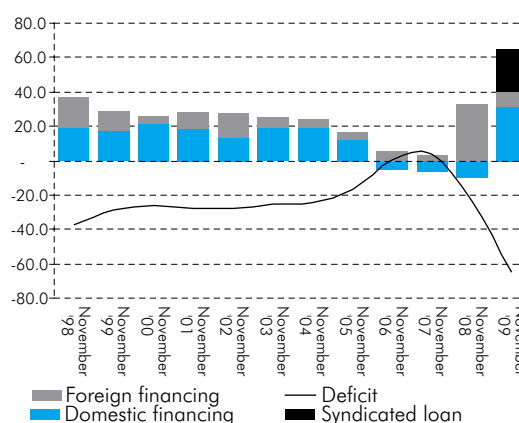
Source: Ministry of Finance, BoA staff estimates

Chart 29 Revenue, expenditure and budget balance (in ALL billion) for the 11-month period 1998-2009



Source: Ministry of Finance

Chart 30 Budget deficit and main financing sources, for January-November 1999:2009, in ALL billion



Source: Ministry of Finance

Privatisation receipts provided considerable contribution to the financing of budget deficit for the 11-month period (by about 43 percent)⁴⁷. Government borrowing policy until the end of September was considerably oriented towards long-term instruments of debt. 5-year bonds covered a considerable part of total debt being issued during 2009. The focus of the Ministry of Finance shifted towards shorter-term instruments of debt in the third quarter, mainly towards 12-month T-bills. The borrowing shift was mainly based on the main actors' preferences in securities market of government, who have showed a trend to shorten the lending span, relative to the previous years⁴⁸. Consequently, until the end of this year, the percentage of long-term debt to total debt is expected to reduce at moderated terms relative to 2008. Total of public debt until the end of third quarter of 2009, is estimated to about 58.3 percent of GDP against 56 percent of GDP at the end of 2008.

Table 10 Budget deficit and its financing during the 11-month period, 2006-2009, in ALL billion

	11-month 2006	11-month 2007	11-month 2008	11-month 2009
Revenues	202.5	226.4	262.4	268.2
Expenditures	202.3	222.3	285.9	332.6
Budget balance	0.2	4.1	-23.4	-64.5
Financing	-0.2	-4.1	23.4	64.4
Domestic financing	-5.8	-6.8	-9.7	37.5
Domestic borrowing	4.6	11.8	2.7	14.3
Treasury bills	-29.7	-20.9	-13.2	8.9
Bonds	34.3	38.4	15.9	8.4
Eurobond	0.0	-5.8	0.0	0.0
Direct Loans	0.0	0.0	0.0	-3.0
Privatisation receipts	2.1	13.2	1.0	27.6
Others	-12.5	-31.8	-13.3	-10.6
Syndicated loan	0.0	0.0	0.0	24.6
Foreign financing	5.6	2.6	33.1	26.9
Projections with foreign sources	5.6	2.6	33.1	8.5

Source: Ministry of Finance and Bank of Albania

Box 4. World crisis and its financial costs to Eastern European countries

The economic and financial global crisis extended its effects also on Eastern European countries. Notwithstanding at different dimensions, the crisis impact on these countries was shown on the reduction of economic activity, the increase of unemployment rate, financial sectors problems as well as in the deterioration of both fiscal positions and the balance of payments.

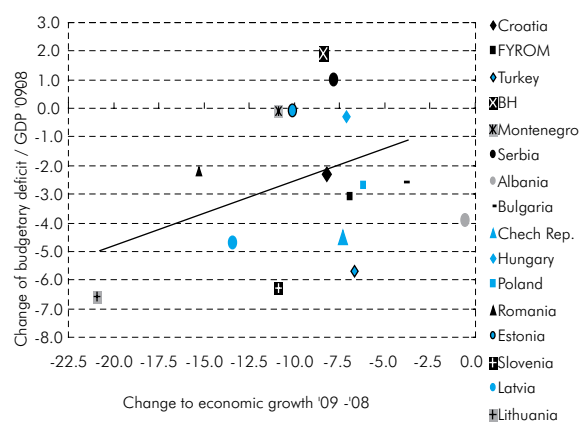
The encountering of crisis imposed the commitment of a range of measures mainly focused on the recovery of financial system and the encouragement of aggregate demand. The reaction of fiscal policy against the crisis consists on the fiscal simulation of economy to encourage aggregate demand and to provide explicit guarantees to the financial stability. The free movement of automatic stabilisers and the different discretionary programs of fiscal stimuli were accompanied by the considerable growth of budget deficit and of the public debt.⁴⁹ Countercyclical fiscal policies increased the borrowing needs, making many countries apply for the assistance of international institutions, as IMF and EU, to cut their cost.

Chart 1 illustrates the fact that countries which were affected mostly by the economic crisis, reacted more considerably through the transmission fiscal stimuli. The experience acquired during this period identifies two important lessons.

Firstly, countries enjoying a good macroeconomic and financial stability prior to the crisis encountered the latter with lower consequences. Chart 2 illustrates the fact that the countries with macroeconomic misbalances, approximated by high deficits of current account, were affected to a greater extent from the world crisis.

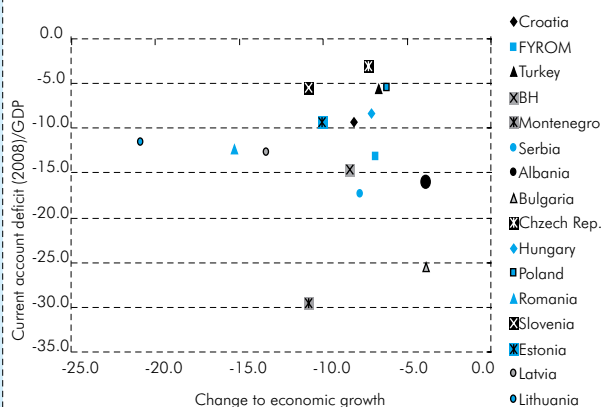
Secondly, countries with better fiscal position, expressed at low rates of public debts and budget deficit, had possibilities to provide a stronger reaction. The anti-crisis measures have been directly related to the available fiscal spaces of each country; those countries with more controlled rates of public debt, have had possibilities to implement broader projections of fiscal stimuli, as denoted in chart 3.

Chart 31 Rate of world crisis impact and the change of fiscal position⁵⁰



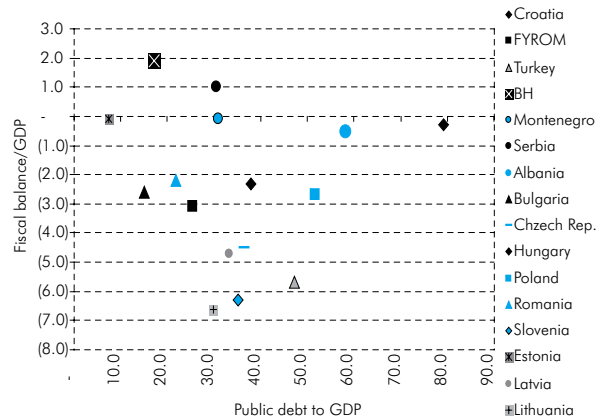
Source: European Commission, Directorate General ECFIN Economic and Financial Affairs

Chart 32 Current account deficits (2008) and the effect from crisis



Source: European Commission, DG ECFin and World Economic Outlook, FMN, October 2009

Chart 33 Change in the fiscal position 2009⁵¹



Source: European Commission, Directorate General ECFIN Economic and Financial Affairs

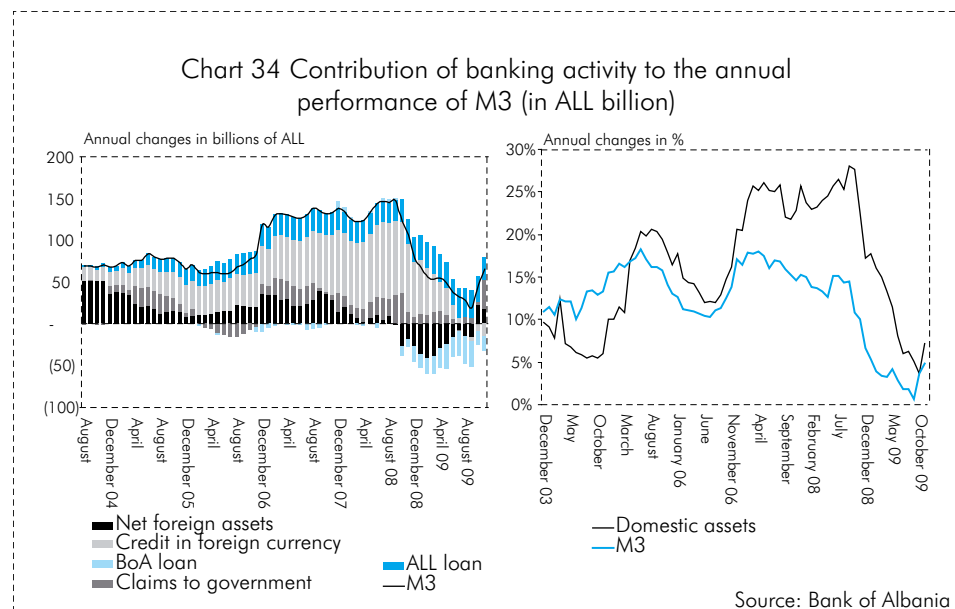
In light of these lessons, these countries made more considerably highlighted attempts for fiscal consolidation and the strengthening of macroeconomic stability. The meeting of these targets cuts the risk primes and promotes the attraction of foreign investments, softens the macroeconomic shock risks and increases the possibility against contingencies. Regarding the Western Balkan countries, Albania owns a relatively comparative rate of the public debt. As a ratio to GDP, this indicator pointed to about 56 percent in 2008, thus increasing to about 58.3 percent in the third quarter of 2009. In this view, the recent initiatives for the decrease of budget deficit and the control of public debt rate in Albania sustain the stable and long-term growth of the country.

IV.1.4 Monetary developments

Monetary developments were characterised by a further slowdown of monetary supply until September 2009. In the meantime, in October it is noted a considerable increase of M3 growth paces, mainly as a consequence of the cancellation of the deposits withdrawal effect. However, the slowdown of monetary expansion mostly expresses the interruption of the sharp growth of the credit portfolio. Notwithstanding the liquidity improvement of banking system, economy lending is restricted by the deterioration of portfolio quality, the uncertainties in terms of the future of the economic activity at home and by the decrease of the demand. Money creation in economy is mainly realised through the component of ALL-denominated-monetary stock. While, the improved situation of deposits and lack of lending in foreign currency led to the improvement of foreign exchange –denominated component of money demand, by increasing its positive contribution to monetary expansion in economy.

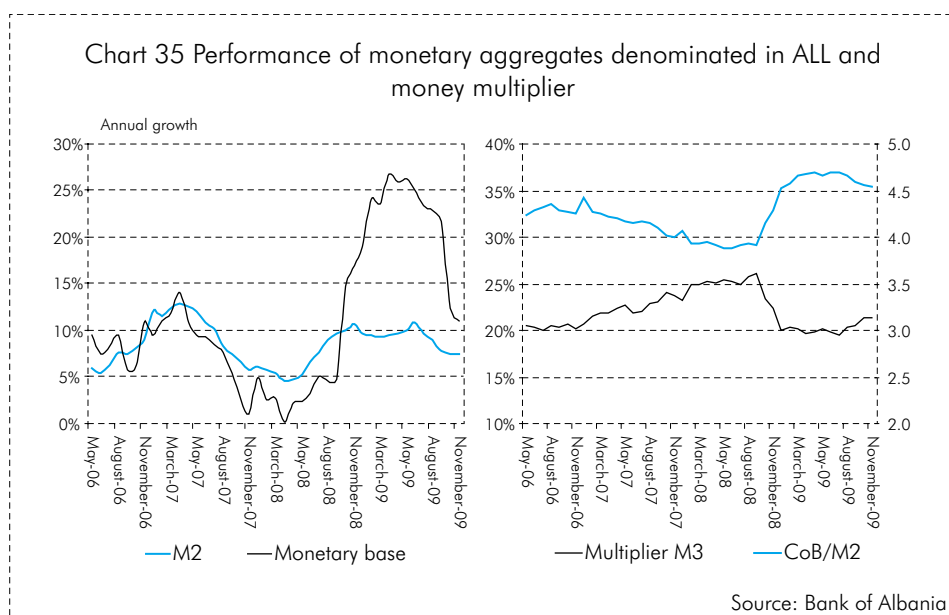
PERFORMANCE OF MONETARY AGGREGATES

Performance of monetary indicators, excluding the exchange rate effects, has reaffirmed the slowdown trend of the lending activity. M3 broad aggregate recorded a growth of about 2 percent in average annual terms in the second part of year, relative to 4 percent in the second half of year. The neutralisation of statistical effect of deposits outflow from the banking system is reflected on the higher paces of monetary supply of averagely 3.7 percent in November-October against 1 percent in the third quarter of year.



In the meantime, ALL denominated money indicators, M2 and reserve money, have persisted to manifest slowdown signs in annual terms. Annual average rate of M2 aggregate pointed to about 8 percent in the end of half of year relative to the rate of 10 percent in the first half of year. Monetary base

pursued also the downward trend, climbing to only 11 percent in November relative to the annual average pace of 25 percent in the first half of year. Performance of these indicators has mainly reflected currency reduction outside banks during this period and the slowdown of ALL denominated lending. The uprising participation of households in financing budget deficit has imposed the use of currency outside banks to meet the demand of fiscal agent for financing. High demand for T-bills instruments from households, which in statistical terms is excluded from the calculation of ALL M2 aggregate, has affected the reduction of M2 growth paces for the second part.

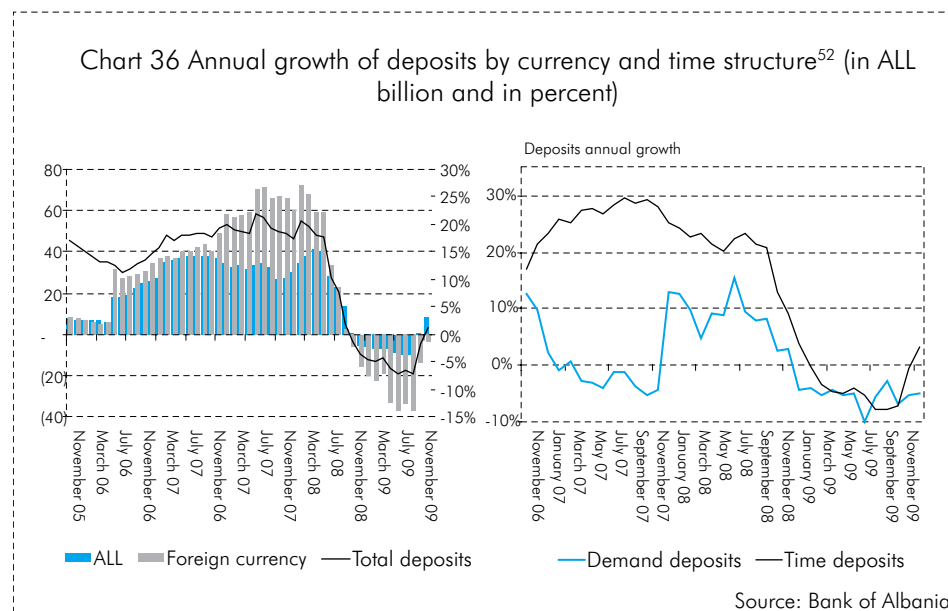


The slowed paces of foreign lending have created spaces for foreign exchange reserve accumulation of banking system. This latter is more emphasised in the last quarter of year. Net foreign assets of commercial banks, during October-November, resulted 3.5 percent against broad money, relative to about 0.1 percent this ratio composed in the first half of year. While, to meet banking system need for liquidity in ALL, Bank of Albania, through reverse Repo agreements have increased the amount of liquidity being injected into the market. In the second part of year, the injected liquidity from Bank of Albania composed about 6 percent of M2 aggregate, thus supporting the intermediation in ALL from banking system.

PERFORMANCE OF DEPOSITS

The dynamic of recent developments in the monetary supply affirms an improvement of deposits situation during the second half of 2009, mainly concentrated at the end of the period. Statistical effect of deposits withdrawal at the end of 2008 has impacted the negative annual pace of deposits growth in the third quarter. The neutralisation of this effect in October is reflected on the expansion of total deposits in annual terms where in November recorded an annual growth of 5 percent. The change of depositors' behaviour in the

framework of the measures taken for the prevention of global crisis effects allocation as well as the foreign exchange flows in the form of remittances during the summer months, are thought to have effected mostly the recovery and growth of ALL -and foreign currency-denominated deposits in the second half of year.

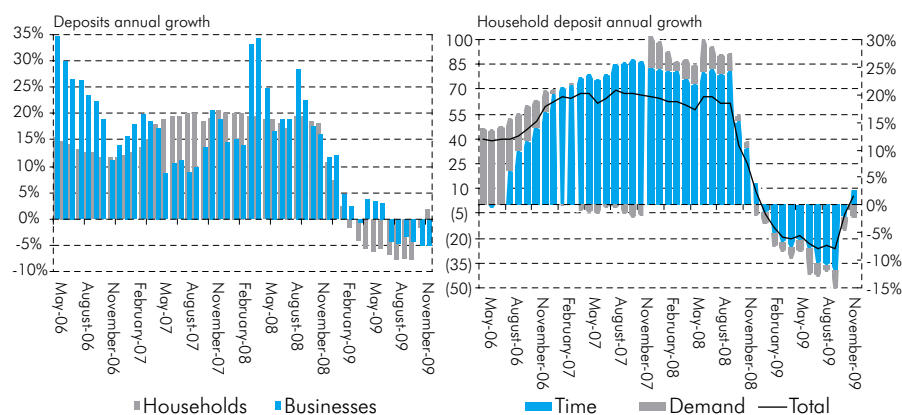


Developments in deposits stock excluding exchange rate effects displays a continued improvement of the system deposits' situation, which in November resulted 1.2 percent higher in annual terms, relative to the reduction of this stock of higher 6 percent at the end of first half year. ALL-denominated deposits provided the highest contribution to its broadening, which have continued to return to the system more quickly than deposits. ALL denominated-deposits, during the last quarter, increased gradually, by 1 percent and 3.5 percent in annual terms, in October and November, respectively. Foreign currency-denominated deposits stock, excluding exchange rate effect, at the end of the period resulted around 1.6 percent lower than in the previous year, recording however an improvement against a higher drop in the first half of year.

A gradual trend of demand deposits shift to time deposits is noted in the second half of year. This fact is reflected on the increase of time deposits share to total stock by 78 percent at the end of the period. Demand deposits experienced an annual average fall by 5 percent during October-November, while time deposits rose by 1.2 percent, thus transmitting positive signals about the restore of confidence in banking system.

Developments of deposits, according to economic agents, affirm a higher growth of households' deposits, mainly in ALL denominated time accounts. Households' stock of foreign currency-denominated deposits continues to remain lower than in the previous year, owing also to the higher outflow of this category from the banking system. Monthly developments in business' deposits

Chart 37 Annual growth of deposits by currency and time structure (excluding exchange rate effect)



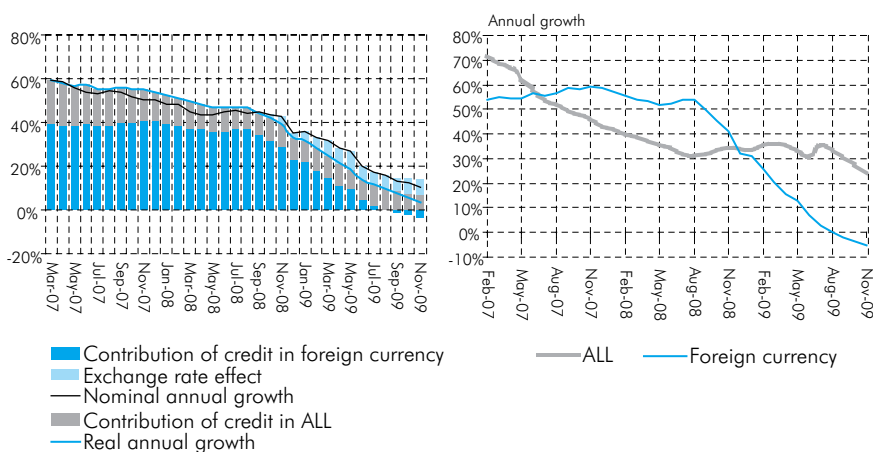
Source: Bank of Albania

resulted more unstable, incurring fluctuation according to their activity. While in annual terms, business' deposits have been cut during the second half of year, owing to the reduction of time deposits, starting since September and a considerable shift is noted regarding business' foreign currency demand deposits to time deposits. During this period, demand deposits of business reduced averagely by about 14 percent in annual terms, while time deposits incurred a rise by about 12 percent. Developments in the performance of businesses' deposits signal their expectations for a possible slowdown of the economic activity at home, a fact which is supported also by all available data of the real sector.

PRIVATE SECTOR LENDING

Developments in lending to the private sector during the second half of 2009, reveal a further slowdown of loan increase. Annual growth of loan

Chart 38 Performance of loan portfolio by currency

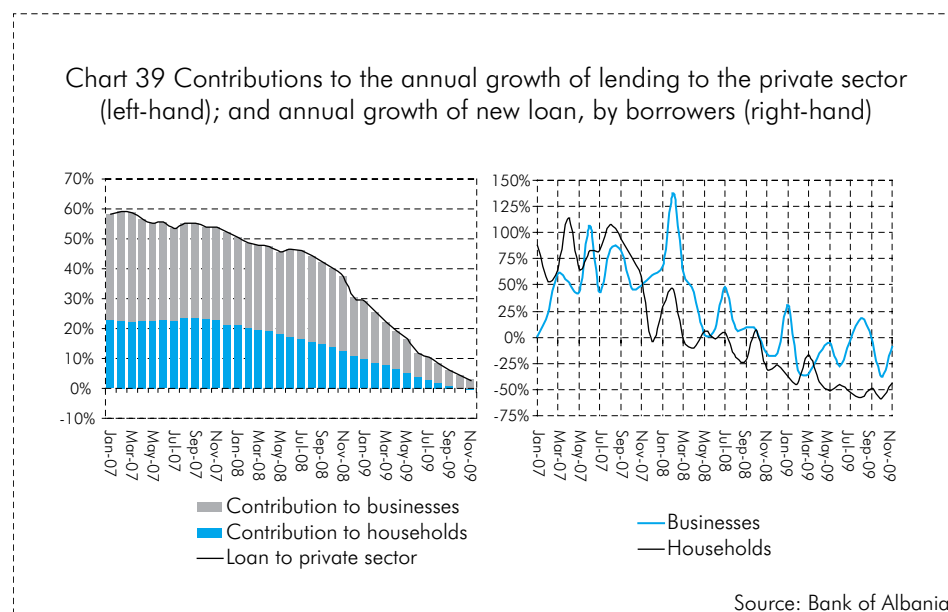


Source: Bank of Albania

portfolio to the private sector slowed to 10 percent in November. This rise, excluding the exchange rate effect⁵³, was only 3 percent, 4 times lower than the one of June 2009. Unlike the first half of 2009⁵⁴, in its second half the decline of the demand for credit is reflected on the ever-increasing lower paces of lending to the private sector. The slowdown of economic activity and uncertainty for the future in the light of relatively tightened lending standards, have imposed the decisions of economic agents to postpone the investments plans and to lower the financing of their activity through borrowing.

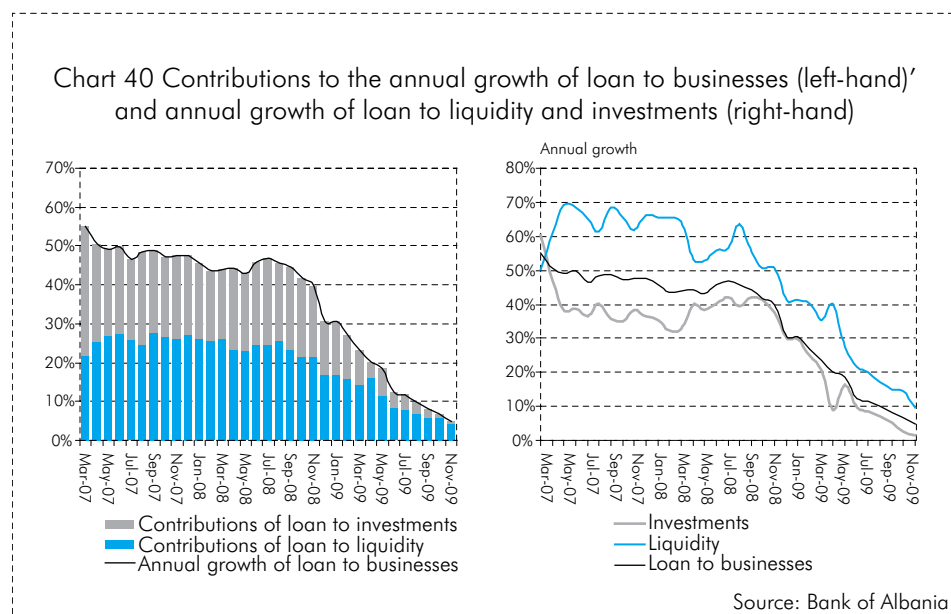
The highlighted deceleration of credit, like in the first half of year, is considerably imposed by the slowdown and later on by the tightening of foreign exchange loan. After the deceleration at sharp paces throughout the year 2009, foreign denominated credit portfolio during September-October, started to reduce, being contracted averagely by 3.5 percent in annual terms. The ever-decreasing foreign currency lending has reflected a more cautious behaviour of banks, which factorise more the indirect risk of exchange rate in the non-payment of loan. Moreover, customers should become more aware regarding the risk they undertake while attaining a loan denominated in a currency different from the currency they generate incomes.

ALL -denominated loan continues to maintain relatively high growth paces. However, in the last three months there are noted signs of its deceleration. ALL-denominated loan portfolio is broadened by about 28 percent during September – November, against the relative average pace of the annual growth at 34 percent, maintained during the preceding months of year.

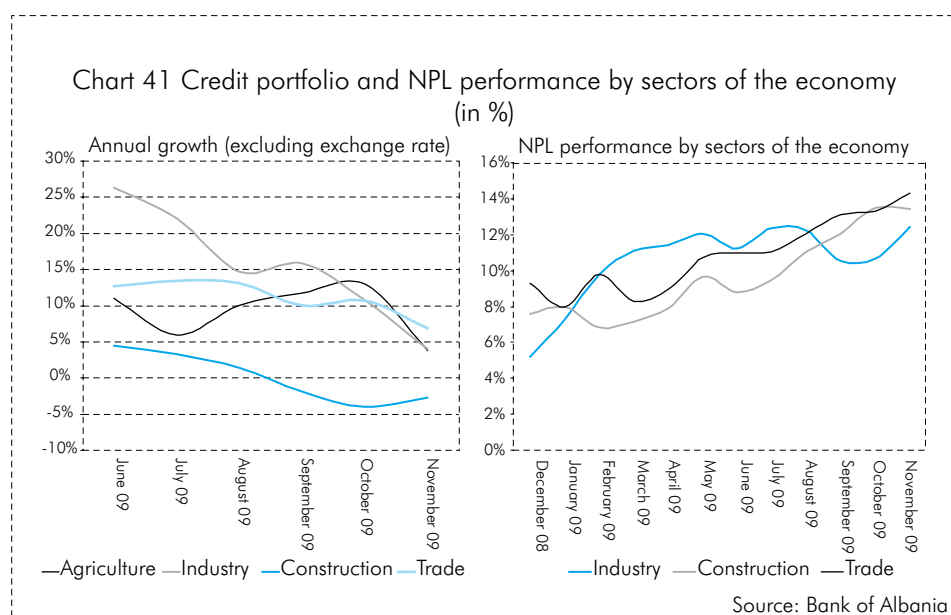


Annual growth of credit to businesses during the second half of year has pursued the uniform fall during the second half of 2009, pointing to 5 percent in November. Credit for liquidity continues to increase at higher paces relative to the loan for investments. Both have maintained the same downward

trend, and their annual growth remains at 10 and 2 percent, respectively in November. New credit for liquidity purposes has maintained high rates throughout year 2009, comparable to those of 2008. In the meantime, the loan for investing purposes has been declining continuously, particularly in the last three months of year.

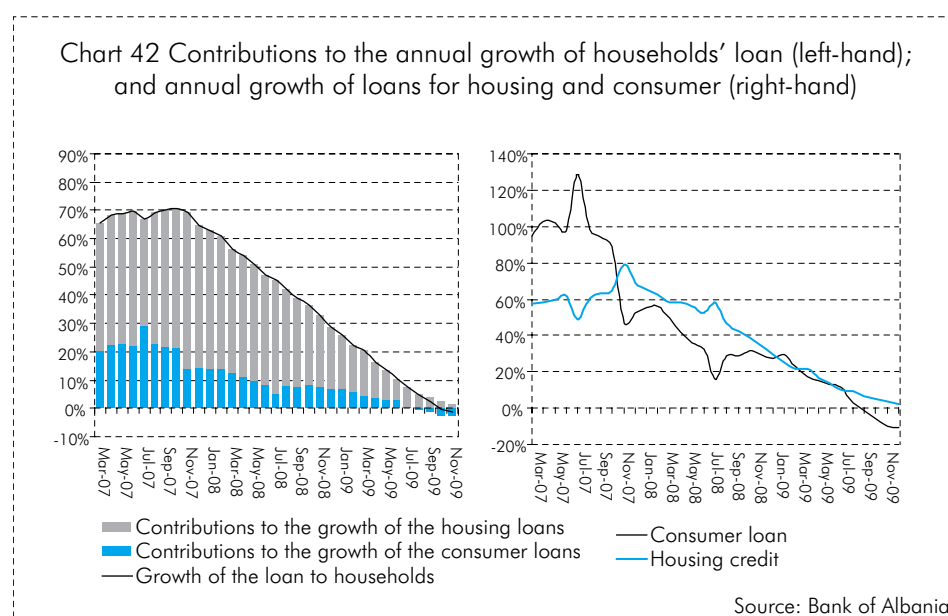


According to surveys with bank's specialists, the ever-decreasing demand of economic agents led to the highest slowdown for investments, as well as of more conservative policies of banks itself, particularly in terms of this type of loan. Trade remains the most important sector in lending, although it has manifested a slowdown of growth paces, the latter continues to maintain relatively high rates of credit surplus expansion by about 11 percent. Lending activity contraction is more considerable for the construction sector. Credit portfolio to this sector, in the second half of year, shrank by 1% relative to year



2008, compared to the annual average increase of 24 percent, it manifested during the first half of 2009. The considerable deterioration of this sector portfolio quality, the perception on surplus investments in this sector, and the uncertainty on the performance of real estate market in future, have made banks more conservative to finance this sector. While, industry sector has manifested a deceleration of growth paces averagely at 14%, compared to the average of 24% in the first half of year.

Unlike the loan to businesses, the slowdown of the loan to households has appeared since two years already. Following a modest expansion during the first half of 2009, the portfolio of this loan has started to tighten during the last month, remaining at about 1 percent lower in November than in the previous year. These developments of the loan to households reflects both the drop of consumer loan and the slowdown of housing market, as well as the continuing tightened conditions kept from banks.



Consumer loan, whose performance was weak over the year 2009, is contracted in annual terms, recording in the two last months a negative annual change of 10 percent. Households have manifested an ever-increasing conservative conduct against the consumption and particularly regarding its financing with loans, as shown by the climbing rate of payments in the portfolio of this loan.

Housing credit, accounts for about 77 percent of loan to households, has been slowed down uniformly during the second half of year. In November, its portfolio increased at annual terms only by 2 percent, 8 percentage points lower than in June. The average rate of new loans, granted from banks for housing purchase purposes, during the last 5-month period, is about 30 percent lower than in the first half of 2009.

Box 5. Summary of lending activity surveys' results

Surveys' results of lending activity support the concluded performance of this indicator and provide some available indices regarding its future.

Survey aggregate results suggest that standards applied on lending are tightened further during the forth quarter. The major part of banks (7 out of 10 banks) have not changed these standards during this period, whereas other banks have conducted this change mainly on the tightening direction. In secotral terms, the standards applied on loans granted to businesses are strengthened at a lower rate than in the third quarter. Standards applied on loans granted to households are tightened at a higher rate. Standards applied on small-and –medium sized enterprises continue to be more tightened relative to corporations (the respective balances are -7.9 and -6.6 percent). According to the purpose of loan use, the tightening degree of standards reveals higher for the loan for investments purposes than for the loan for working capital purposes.

All the considered factors have affected the tightening of lending standards in the third quarter of 2009, regarding both businesses and individual loans, but at a lower rate. Banks tightened the lending standards mainly through the terms regarding the borrowing cost; banks increased the average margin of credits, the margin for loans with higher risk and the loan commissions.

According to bank experts' estimations, the demand for loans from businesses and households, is decreased, however at a lower rate in comparison to the third quarter of previous year.

Expectations for the first quarter of 2010 reveal optimistic, in terms of easing the lending standards for both categories, business and households as well as on their expected increasing demand.

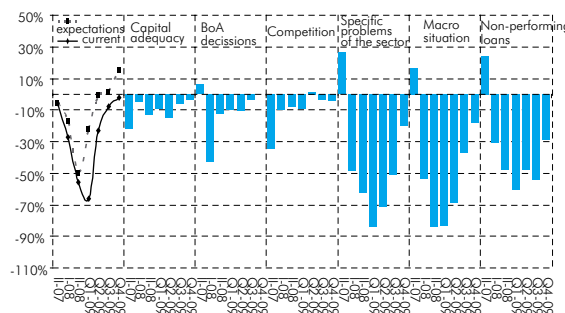
Business Loans

During the forth quarter of 2009, the tightening of business loan standards continued to decrease, maintaining the trend started in the second quarter of 2009. Thus, the net percentage of banks reporting a lower rate of loan standards tightening increased in comparison to the previous quarter: net balance of loans standards to business increased to -2.3 percent from -7.6 percent in the third quarter of 2009.

The softening of tightening degree of loan standards during forth quarter of 2009 is reflected on the standards applied to small-and-medium-sized enterprises: net balance increased to -7.9 percent from -12.2 percent in the third quarter of this year. Net balance of loan standards to corporations was about 2 percentage points higher than that of third quarter. According to the purpose of the loan use, the tightening of lending standards was higher for the loan for working capital than for investments loan. All factors considered in the survey of the forth quarter of 2009 have impacted the reduction of the tightening standards degree for the loan to business.

In the forth quarter 2009, banks have strengthened lending standards through the terms regarding borrowing

Chart 43 Changes in lending standards applied on business' loans and the impact of different factors (net balance¹), in percent



Source: Bank Albania
 Note 1. The positive balance indicates easing of lending standards or that the factor has impacted the easing of lending standards; whereas the negative balance indicates tightening of lending standard or that the factor has impacted on the tightening of lending standards

cost; banks increased average margin of loans, the margin on loans with higher risk and raised the commissions. Unlikely, terms which are not related to loan cost have affected the implementation of a more easing lending policy; banks grew averagely the amount of loan and its maximum maturity term.

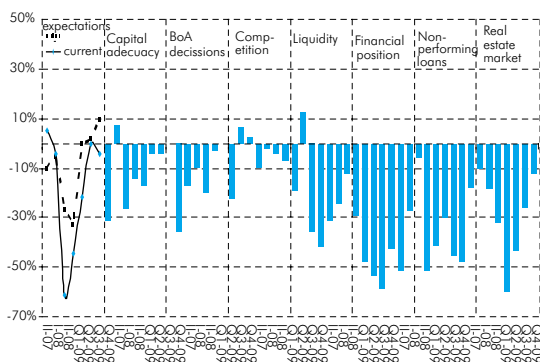
Demand for loan. Net demand for loan is assessed to decline as revealed by the survey of lending activity for the fourth quarter of 2009, however at a lower rate than in the third quarter of this year. The main factors affecting the fall of the demand are the reduction of need for the financing of fix investments as well as the current and expected macroeconomic situation. Net balances of these indicators are -30.4 and -27.7 percent, respectively.

Expectations. Banks' experts expect an easing of the loan standards in the first quarter of 2010. Net balance of expectations is +15.2 percent. The easing of loan standards granted to businesses is expected in terms of the loan granted to small-and-medium sized enterprises as well as for the loan accorded to corporations (net balance 20.0 percent and 12.2 percent, respectively).

Households loans

Lending standards applied on individual loans are tightened further in the fourth quarter of year, relative to the previous quarter (net balance point to -4.0 percent from the balance of 0.0 percent in the previous quarter). Standards on consumer loans are tightened more than for the housing loans; the net balance of consumer loans pointed to -8.7 percent relative to the net balance for housing loan -1.7 percent. Banks have tightened the lending standards during the fourth quarter of year through the increase of higher risk loan margin, whose balance grew to -7.8 percent relative to -3.8 percent in the previous quarter.

Chart 44 Changes in lending standards applied on households' (housing and consumer loans) and the impact of different factors (net balance*), in percent



Source: Bank of Albania
*) See note 1.

These developments in consumer loan are mainly impacted by the individual financial situation, which was the factor with the highest impact on the strengthening of loan standards during the fourth quarter of 2009.

Loan demand. The households' demand for loan, according to banks experts' opinion, is estimated to have been decreased during the fourth quarter of 2009, but at a lower rate than in the previous quarter (net balance of banks stating for an increase of the demand points to -18.7 percent, relative to -21.2 percent in the previous quarter). Households' demand for housing loans is assessed to be lower than their demand for consumer loans. In real terms, households' need to finance consumption is ranked as the most important factor encouraging the households' demand, whose balance climbed to 25.0 percent, relative to 17.0 percent in the previous quarter.

Expectations. Banks expect a slight easing of lending standards to individuals in the first quarter of 2010 compared to those applied in the fourth quarter of 2009.

This easing will reveal higher for housing loans than for consumer loans (net balances points to +13.7 percent and +4.4 percent, respectively). In the meantime, banks' experts expect a growth of the demand for loans during the first quarter of 2010 (balance +14.8 percent).

IV.2 LABOUR MARKET AND WAGE

During the third quarter of 2009, labour force grew by about 0.3 percent, whereas the number of unemployed persons recorded an uprise about 0.2 percent in annual terms. Average number of recorded unemployed persons increased slightly during the year, where the highest annual rate is recorded in the third quarter, about 1.4 percent. Thus, given these developments, unemployment rate in this period pointed to 12.76 percent, fluctuating close to the average rate of 2008.



Employment by non-agricultural private and public sector has not recorded considerable changes during the third quarter of year. In more concrete terms, employed persons in non-agricultural private sector increased their number to 0.7 percent compared to the same period of previous year recording the lowest rate since 2004.

Table 11 Performance of labour market indicators

Some indicators of labour market	Q1 2009	Q2 2009	Q3 2009	Difference (*)
Labour force	1,114,161	1,114,166	1,113,580	0.33
Total number of employed persons	972,851	972,831	971,518	0.17
Number of employed persons in public sector	166,563	166,453	166,453	-0.06
Number of employed persons in non-agricultural private sector	230,739	237,829	236,516	0.73
Number of employed persons in agricultural private sector	568,549	568,549	568,549	0.00
Registered number of unemployed persons	141,310	141,335	142,062	1.42
Unemployment rate (in %)	12.68	12.70	12.76	0.14

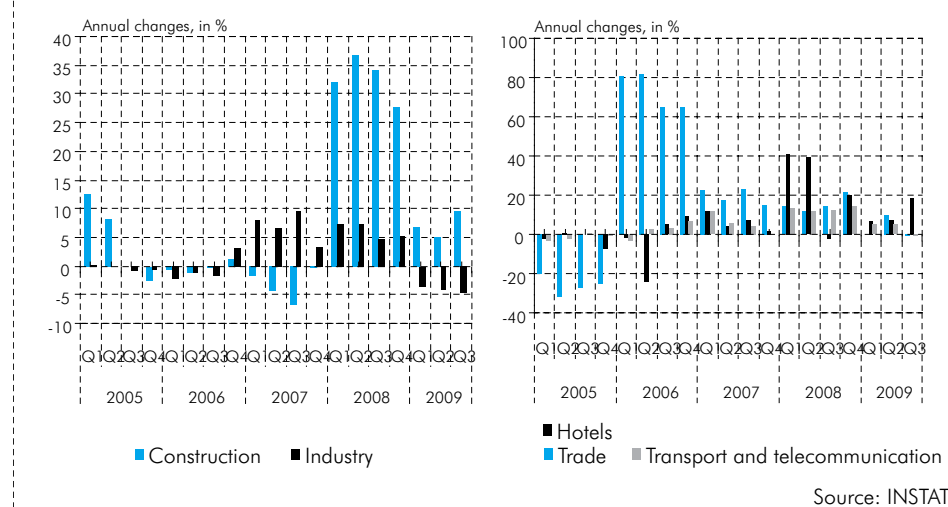
Source: INSTAT *Conjuncture Main Economic Indicators*, July-September 2009

(*) Annual change of Q3:2009 to Q3:2008 in percent, for the unemployment rate is in pp

Performance of employed persons⁵⁶ in non-agricultural economic enterprises displayed different dynamics compared to sectors level during the third quarter of 2009, whereas as aggregate indicator, it did not record

any growth. In more concrete terms, the highest growth of employed persons was recorded from hotels activity, about 18.3 percent. On the other hand, other activities of services experienced a slowdown of growth annual paces of employment indicator, recording the rates of 9.6 percent in the retail trade branch, 3.2 percent in “post”, -8.7 percent in “telecommunication”. As regards to production sector, employed persons’ number in industry continued to decline at annual rate, by about 4.6 percent. Unlike, construction recorded the highest rate of annual growth of this indicator during 2009, about 9.5 percent, however it remains at lower rate than in the previous year.

Chart 46 Employment index performance by economic activity

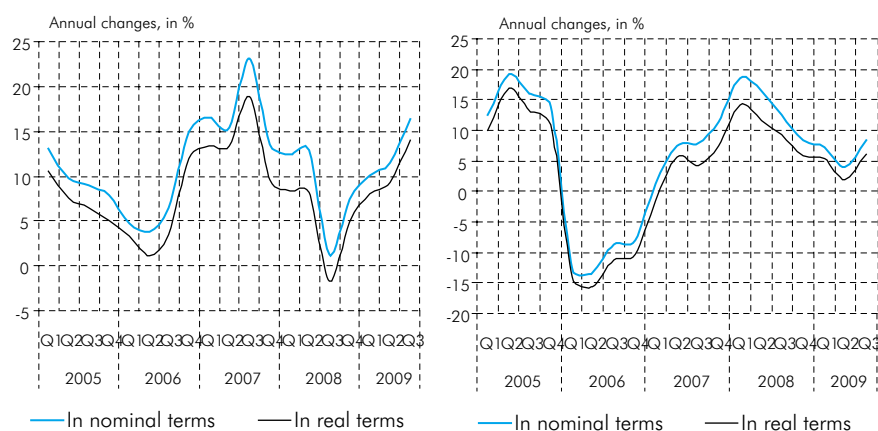


WAGES IN ECONOMY

Performance of wages⁵⁷ in economy, during the third quarter of year, continued to record a climbing trend in public sector and accelerated the growth pace in production and services sector. The monthly average wage in public sector during the first three quarters of 2009 increased averagely by 12.7 percent, about 3.8 percentage points higher, compared to the same period of previous year. This performance of wage has reflected the decisions taken from Government regarding the increase of wage in public sector for some categories of profession. In the third quarter, this indicator recorded the highest annual growth rate for the year 2009; 16.4 percent in nominal terms or about 13.9 percent in real terms.

The nominal average wage⁵⁸ in production and services sector recorded the highest annual growth rate in the third quarter of 2009, about 8.4 percent, 5.5 percentage points lower than the average annual growth of 2008. In real terms, the average wage of production sector increased by 6.2 percent in the third quarter of previous year.

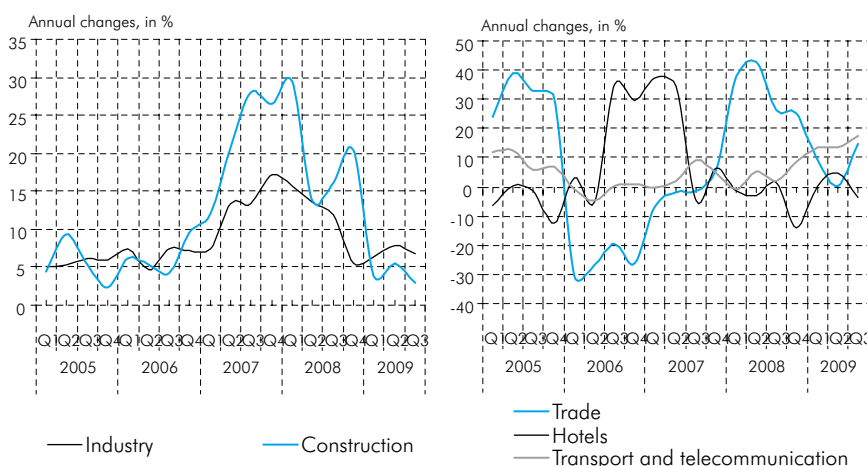
Chart 47 Performance of average monthly wage in public sector (left-hand); and in the production and services sector (right-hand)



Source: INSTAT, Bank of Albania estimates

The performance of average wage by economic activities accelerated its climbing pace in services sector, while it increased at lower rates in production sector, in the third quarter of 2009. Thus, the average wage continued to record the highest pace of annual growth in transport and telecommunication, about 17.2 percent, to be followed by the trade activity where this indicator raised by 14.7 percent. In production sector activities, the average wage slowed the raise, by recording an annual growth of about 6.9 percent in industry and 2.9 percent in construction.

Chart 48 Performance of average wage in some branches of economy



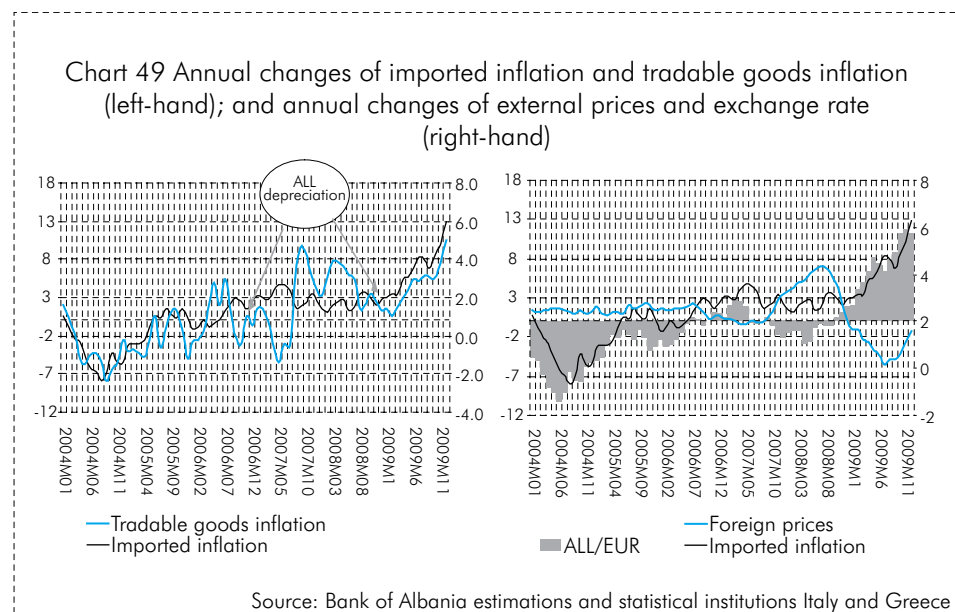
Source: INSTAT

IV.3 IMPORTED INFLATION

Inflationary pressures from the economy outside Albania on the overall price rate of consumption showed weak during the year 2009. The global

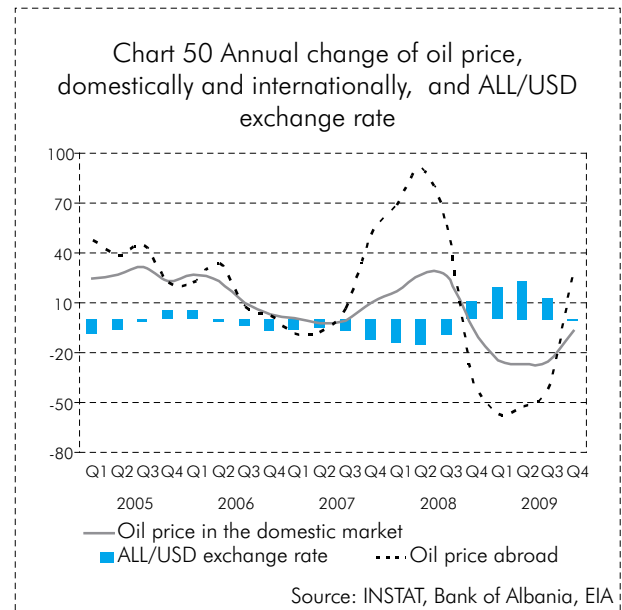
economic fall along with the drop of raw materials costs compared to the high rates of 2008, provided the conditions for a decline of inflation in the world. In line with the global trend, the average annual inflation at home (2.2 percent) dropped by 1.2 percentage points relative to the previous year. This drop was lower than the one noted abroad, as attested by the positive spread of inflation at home to the inflation average of Italy and Greece. This measuring has manifested a highlighted increasing trend since the beginning of year. In average terms, for this year, this indicator pointed to 1.3 percentage points, while one year ago pointed to -0.3 percentage points. The broadening of this gap, particularly in the second half of year (averagely by 1.8 percentage points), mainly reflects the transmission at a higher degree of the exchange rate depreciation inflationary effect.

Domestic currency is depreciated in the same period averagely by 7.6 percent against the European currency and by 13.8 percent against USD, leading to an increase of imported inflation. The latter performance is of a high importance in shaping the inflation rate at home, particularly of tradable goods component. This component shares about 60 percent of consumer goods basket and represents that part of consumer goods which derive mainly from imports. While for a period of some years, ALL strong position against European currency has softened the inflationary pressures coming from abroad. In the last year this factor provided an inflationary effect. Imported inflation was 6.9 averagely in 2009. This figure reveals 3 times higher than its historic average (2.4 percent). The action of this factor became more sensible in the fourth quarter. The transmission share of exchange rate, based on empirical studies as well, points to its maximum rate (99%) after three consecutive quarters.



In the meantime, ALL exchange rate against US dollar has not imposed increasing pressures on oil price during the second half of year. ALL is appreciated by 5.2 percent compared to the first half of year.

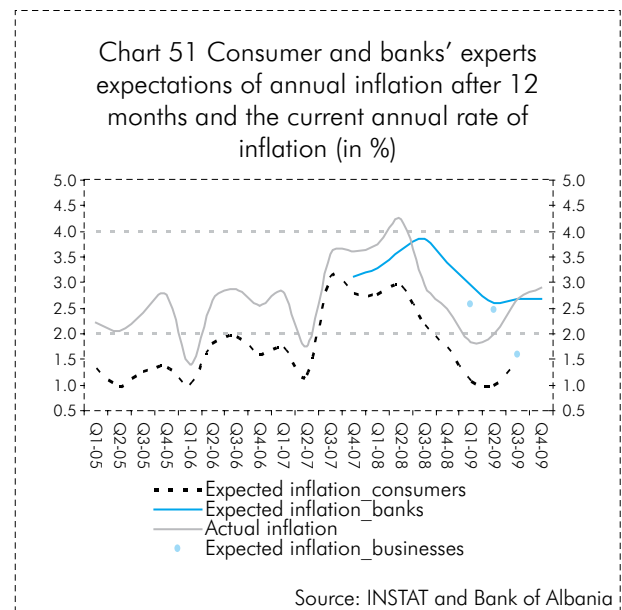
The international conjunctural developments are estimated to have completely triggered oil price performance in the domestic market. Oil price in the domestic market, after recording a fall in the two first quarters, showed a climbing trend until the end of year. Average price of a litre of oil in the retail market amounted to ALL 114.8 in the second half of year increasing by about 10 percent against the average recorded during the first half of year. However, this price continues to be lower (about 20 percent) than in the previous year, time when the price of this product experiences a sharp growth. Developments at this market are mirrored on the sub-item index "Services to personal transport vehicles" in CPI goods basket. Annual inflation of this index recorded 5.5 percent relative to the first half of year. While sub-item index "transport services", which relates indirectly to the domestic oil market, remained unchanged in average terms.



IV.4 EXPECTATIONS FOR INFLATION IN ECONOMY

The expectations of different economic agents⁵⁹ regarding inflation remained at low rates during 2009. Expected inflation of consumers pursued the fall during the two first quarters of year, started since the last quarter of 2008. In the third quarter, these expectations displayed an upraising turn, but however remaining too close to the lower limit of the Bank of Albania's target band.

Unlike, business' expectations for inflation after one year perused the fall even in the third quarter of 2009. The survey organised with banks' experts reveal that the rate of expected inflation after one year in the forth quarter of year of 2009 remains unchanged since the previous quarter, respectively 2.7 percent.



V. FINANCIAL MARKETS, INTERST RATES AND THE EXCHANGE RATE

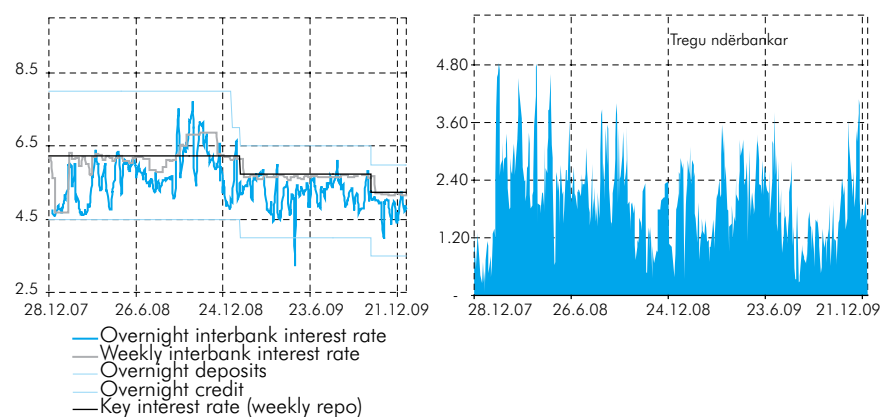
Bank of Albania cut the key interest rate by 50 percentage points in October, thus transmitting a signal on the easing of monetary conditions. A declining trend of interest rates in the money market observed this direction

in addition to the improvement of liquidity situation and the strengthening of security in the market. The cut of key interest rate is transmitted in the primary market of the Government securities, along with the reaction of interests in interbank market, where yields raised on ongoing basis since the beginning of year. These positive signals are still not reflected on the lending activity of the economy. ALL denominated- loans interest rates remain at relatively high and volatile levels, thus reflecting high risks rates, giving rise to uncertainty about the economy performance at home.

INTERBANK MARKET

The second half of year is characterised by a declining performance of interest rates in interbank market and an improvement of banks' liquidity situation. On the other side, the exchanged volume among banks recorded lower values during this period and has manifested a climbing trend only in the last quarter. Interest rates during these months have manifested a falling trend and more controlled volatility than in the previous half of year⁶⁰. Banking system continued to lack liquidity during this period, and the Bank of Albania injected liquidity by employing its transactions in the open market, through the reverse repurchase agreements of one week maturity term. Bank of Albania, in addition to this instrument, employed the longer –term maturity REPO agreements, particularly in the last months there are employed the 1- and 3-month REPO agreements. The supplied liquidity was high, while deposits level at commercial banks recorded the values of the period prior to November 2008, thus confirming the signals of their improvement. Bank of Albania continued to employ the reverse repurchase auction at fixed price and unlimited amount. The average volume of one-week reverse repurchase auctions, during this half of year, amounted

Chart 52 Interest rates in the inter-bank market (left-hand) and daily lending volume (left-hand)



	Daily interest rate	1-week interest rate	Daily volume	Weekly volume
Q 2- 09	5.08	5.65	1,620	712
Q 3- 09	5.30	5.67	1,319	228
Q 4- 09	4.93	5.35	1,214	649
October-09	5.10	5.68	905	325
November-09	4.90	5.19	1,281	817
December-09	4.78	5.17	1,472	650

Source: Bank of Albania

to averagely ALL 21 billion from ALL 14 billion in the previous period, by meeting the demand of participating banks. The allocation of liquidity has been uniform, leading to lower interest rates volatility.

At the end of October, Bank of Albania by estimating inflation performance within the target band, with the purpose to promote economic activity and the reduction of credit cost, decided to cut the ALL key rate by 50 basis points to 5.25 percent. Trade volume in interbank market, after the lower values of September and October, recorded a growth during the last months of year. The improvement of liquidity conditions should have been reflected on a cut of interest rates in interbank market, whereas banks financing in money market has manifested a more efficient behaviour. The interest rates in interbank market have transmitted the cut of key rate and the neutralisation of pressures for liquidity. Daily lending decreased slightly, amounting to ALL 1.21 billion relative to the previous quarter, while the total volume of interbank transactions increased by 0.27 billion amounting to ALL 1.76 billion, notwithstanding it is lower than first half of year, in half of year terms. Banks continue to prefer daily transactions while weekly transactions have been climbing during the last months affecting positively the growth of total transactions volume. In average terms, the daily interest rate fell to 4.93 percent from 5.30 percent, it was in the previous quarter, while the one-week is reduced to 5.35 percent, or 32 percentage points lower. In December, the exchanged volume in interbank market recorded an increase and interest rates have pursued the dropping trends affected mainly by the supply and demand factors.

PRIMARY MARKET

Primary market yields maintained the upward trend in the major part of this half of year, to change direction onwards, during November and December, as a reaction against the monetary policy easing. Yields increase is attested for all maturities and has been present since the beginning of year, being highlighted at definite periods. The cut of key interest rate at the end of October has been transmitted at yields in the primary market, in meantime the

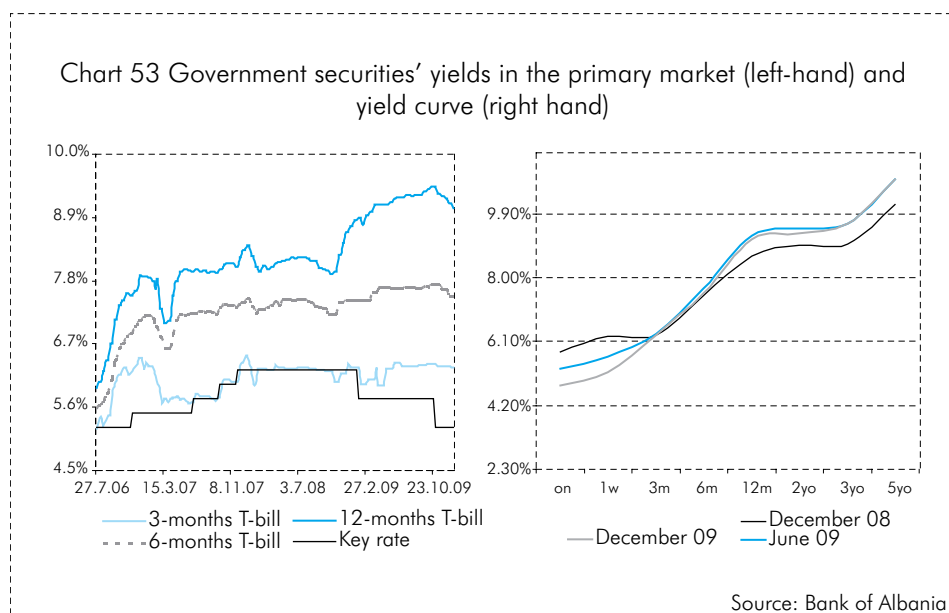
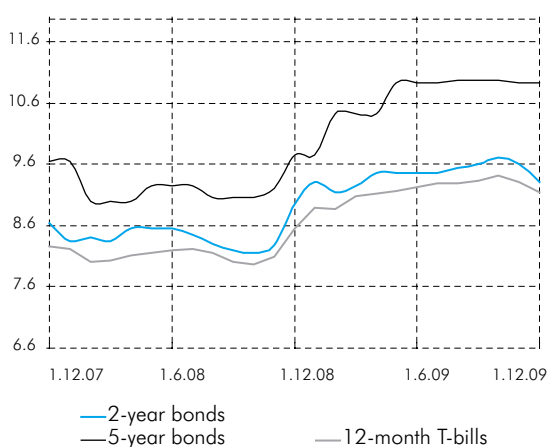


Chart 54 Bonds yields in the primary market



Source: Bank of Albania

high participation of banks in this market but also the previously cuts of the rate⁶¹, seems to have not provided a considerable impact on this direction. The banks participation in the Government securities auction has been high, during this period, however it is has not affected the smoothing of the uprising pressures, thus denoting an increase of their assessment about the risk. The growth of issuances during this period is an other factor which has not helped the hampering of climbing trends. The more highlighted growth of T-bills yields are observed for the longer maturity, being then transmitted to the bonds yields, as measured by this indicator. At the end of October, the 12-month T-bills interest pointed to 9.43 percent declining afterwards at 9.06 percent or at a rate equal to the average of first half quarter. Notwithstanding yields performance has manifested

a downward trend, They remain at higher rates relative to the preceding period in average terms. At an average rate the one-year T-bills yield is 0.22 percentage points higher than in the first half of year.

Other 6 and 3-month maturities yields attested the same performance, but at a more controlled rate. The 6-month yield, after pointing to 7.73 percent in October, continued to drop, thus recording the rate of 7.52 percent at the end of December or 0.15 percentage points lower than the end of June. 3-months T-bills yield displayed a more controlled volatility and has approximately remained at the same level.

Bonds in primary market manifested similar trends to T-bills. Bonds yields increased mainly during the third quarter of year affected by the increase of risk assessment from banks while banks' participation in auctions appears plausible⁶². 2-years bonds yield, at actions held in November and onwards, dropped by observing the overall fall displayed by the T-bills. At the end of this quarter, 2-year bond yield was assessed at 9.30 percent or 0.05 percentage point less than the average of the first half of year. Yield of 3-and 5-year bonds have observed the same performance (at flexible interest rate). Thus at the end of this year, it points to 9.60 and 10.93 percent, respectively. It is worthy to underscore that the yield raise of flexible interest rate bonds was mainly affected by the performance of instruments, by which it is pre-measured, as the accepted margin has always followed a downward trend during this period. Yields rates among different maturities denote a growth mainly for the short and medium-term rate, therefore making the slope of curve be more emphasised in its first part.

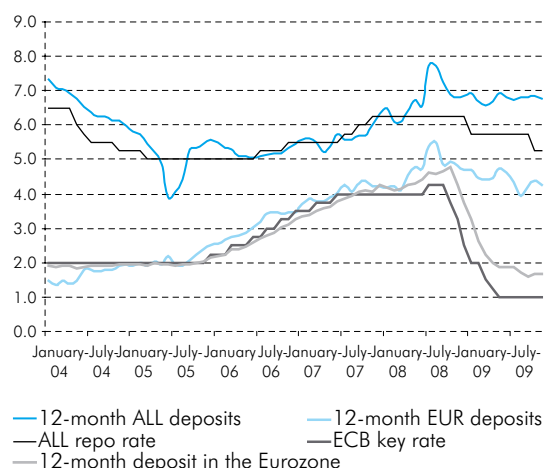
INTEREST RATES ON NEW DEPOSITS

In the second half of 2009, interest rates for both main currencies, ALL and EUR, continued to maintain higher rates relative to the key rates. Data reveal that the cut of key interest rate by 0.50 percentage points from the Bank of Albania is not implemented from all banks of the system, owing to the high competition to maintain the market shares.

Average interest rate on ALL-denominated deposits was approximately 5.56 percent in the second half of 2009, by 0.18 percentage points higher relative to the first half of this year. The 1-and 12-month term recorded an increase of the average weighted interest rate. After the end of summer season, banks proceeded to complete at high margins (even after the cut of the key interest rate) through the prior implementation of end-year supplies. However, the average trend of ALL deposits after August 2009 has been declining, pointing to 5.28 percent in November. This rate is 0.15 percentage points lower than November 2008 (ALL core rate is cut by 1.00 percent in this period).

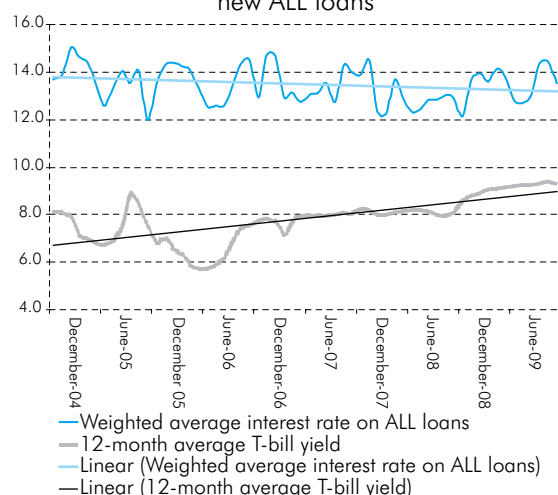
The interest rate of Euro-denominated time deposits maintained in general a reverse shifting trend with that of the domestic currency. They recorded a fall by 0.28 percentage points in the second half of year. Reductions of interests rate are recorded for all the usage terms. However, the interest rates of Euro-denominated deposits continued to maintain high values⁶³ relative to ECB key rate, which pointed to 1.00 percent throughout the second half of 2009, being conditioned by the liquidity situation and the individual orientation of banks policies regarding the interest rates. Banks continue to employ deposits interest rates as reference rates for Euro-denominated time deposits. The weighted average interest rate of Euro-denominated deposits was cut considerably in November (2.00 percent). Since October, this rate reflected high values, affected by the reduction of

Chart 55 Interest rates on 12-month deposits performance in Albania and EU with key rates



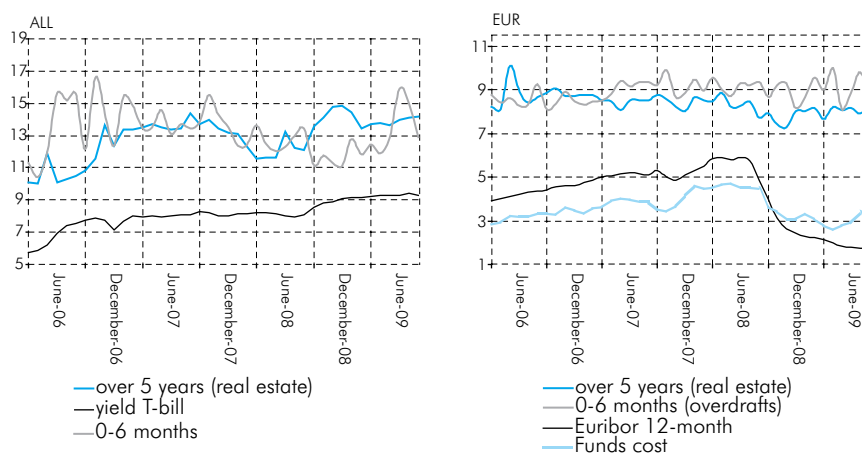
Source: Bank of Albania

Chart 56 Weighted average interest rate on new ALL loans



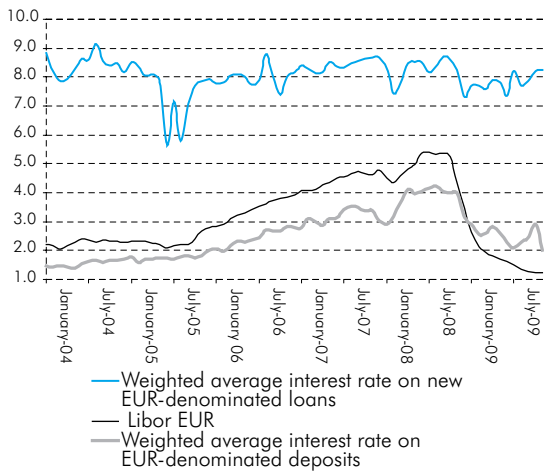
Source: Bank of Albania

Chart 57 Interest rates on new ALL-denominated loans (right hand) and on new Euro-denominated loans (left hand)



Source: Bank of Albania

Chart 58 Weighted average interest rate on 12-month EUR, EURIBOR and loans



Source: Bank of Albania

lowest interest rate deposits' share to total deposits (as a result of weighting).

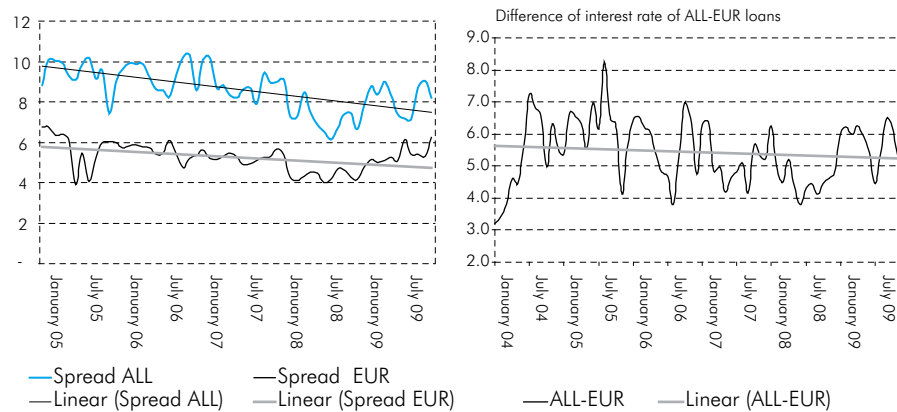
INTEREST RATES ON NEW LOANS

The average interest rates are characterised by a high volatility during July – November. The business seasonal effect for working capital to increase inventories was one of the main factors. Their effect continued until October, while November recorded a decline of interest rates on new ALL –denominated loans. The tightening trend on lending is emphasised in European currency, which has expanded the spreads with the benchmark rates (as euribor, libor euro and funds cost).

The weighted average interest rate on new ALL-denominated loans decreased 0.04 percentage points, in average terms, during July-November of 2009. This performance reflects the observation of the tightened lending conditions during this period.

According to maturity terms, it is noted the trend to tighten more both the long-term and investments loans as a reaction to banks perception on the increased uncertainty, regarding the economy development at home. Interest rates on short-term (0-6 month) displayed increasing trend until October, owing to the high seasonal demand for the growth of inventories for business, and decreased onwards, returning to normality in November. Average interest rate on new Euro-denominated loans revealed an increase in this period compared to the benchmark rates. It resulted averagely 8.05 percent or 0.37 percentage points higher than the previous half of year. The overall perception on uncertainty, the close monitoring of foreign–denominated lending and the factorization of exchange rate volatility, imposed an increase of prices from banks. Euribor rate in international markets is cut during this period, Euro-

Chart 59 Average intermediation margin in ALL and EUR (left-hand); and the spread between average interest rate on ALL and EUR loans (right-hand)



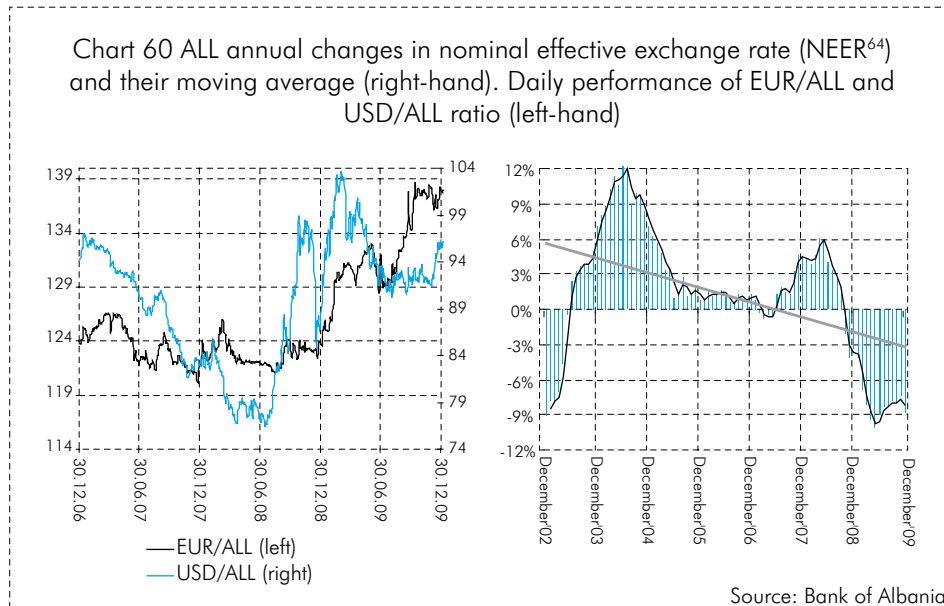
Source: Bank of Albania

denominated credit increased for all terms. The interest rates (working capital to businesses) observed the same behaviour with the domestic currency, in the short-run, highlighting the tightening trend of banking system to provide seasonal liquidity denominated in foreign currency.

Intermediation cost (loan/deposit spread) maintained a high rate during July – November 2009. This spread observed opposite directions, being increased in terms of ALL by 0.22 percentage points and in terms of EUR by 0.66 percentage points. This indicator pointed to 8.23 percent for ALL and 6.25 percent for EUR. The interest rates spread of ALL loans to EUR changed direction in November. It recorded a drop of 0.98 percentage points pointing to 5.27 percent.

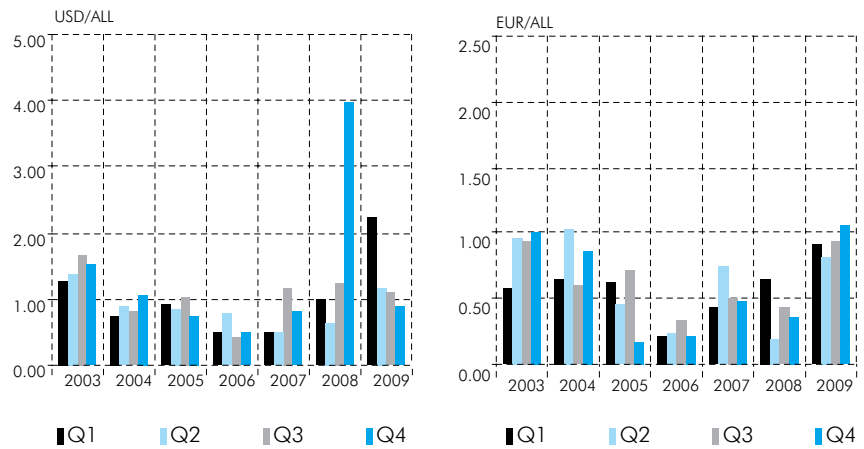
EXCHANGE RATE

The second half of 2009 experienced a depreciation of ALL at effectively nominal terms, by relatively stable paces. In annual terms, the changes in the NEER during this period, fluctuated within a narrow band (from 7.42 percent to 8.78 percent) comparable to the one of the first half of year (-4.2 percent to -10.2 percent). The performance of ALL during this half of year in the domestic exchange market has resulted on the depreciating direction. In average terms, the domestic currency depreciated against both currencies, EUR and USD, by 9.57 and 2.36 percent respectively, relative to the same period of the previous year.



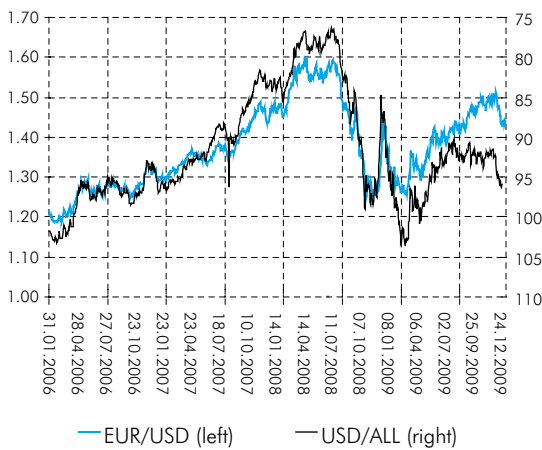
Developments in EUR/ALL ratio, beyond the already known factors which impacted the misbalance of supply demand, reflected at a considerable rate the effects of seasonal nature. Therefore, at the beginning of the second half, the domestic currency was strengthened owing to the remittances which characterise this period. This effect seems to have posted a preliminary neutralisation, leading to a shift of the preceding behaviour against the end of the seasonal supply since August. In the succeeding months, ALL positions

Chart 61 ALL exchange rate volatility in quarters⁶⁵



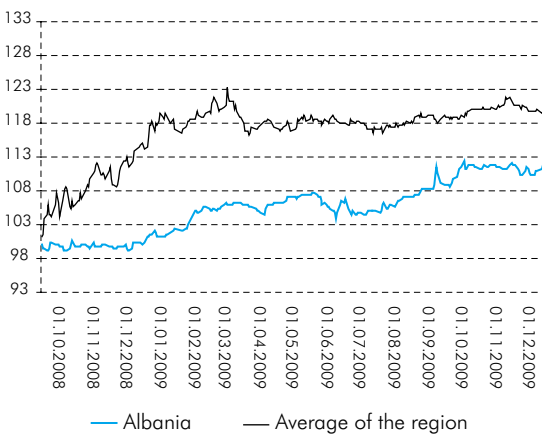
Source: Bank of Albania

Chart 62 Daily performance of EUR/USD and USD/ALL ratio



Source: Bank of Albania

Chart 63 Performance of EUR /ALL ratio compared to the regional average



Source: Bank of Albania

against foreign currency continued to fluctuate at depreciating direction. This performance owes to the volatile supply demand ratios, which are also accompanied by an uncertainty of market agents, which was reflected at a historic volatility in the last quarter of year. The confidence growth to the domestic currency combined with the seasonal effect of the end –year have supported the gradual reduction of ALL depreciating positions.

ALL performance as a ratio to USD, resulted on the declining side relative to the same period of 2008. However, at half of year terms, USD/ALL ratio displayed an appreciation of 5.17 percent. This ratio performance, during this half of year, partially resulted in line with EUR/USD ratio developments in the international market, for the transmission of USD weak positions against EUR (a depreciation of 9.17 % in 6-month terms) was not a completed one.

EUR/ALL ratio after the accelerated rise in favour of European currency during the third quarter, seems to have been stabilised and has pursued almost the same performance with that of the other countries.

VI. EXPECTED ECONOMIC DEVELOPMENTS DURING 2010

Economic activity during 2009 took place in face of unfavourable demanding and financing conditions. Overall, macroeconomic indicators

are affected, by the contraction of regional and world economies, as well as by the developments in the domestic market. The slowing down of the world economy is transmitted to Albanian economy in the form of the external demand reduction for goods and services and a contraction of other financial capital inflows. The trend of monetary aggregates and credit to economy confirms also the slowdown of the domestic demand.

Developments in the external sector of economy reflect the intertwined of financial and capital foreign inflows and of competitiveness of the Albanian economy. The trade opening during the two last years was encouraged by the financial inflows in the form of foreign direct investments and external borrowing. Along with the sustained economic growth and high pace of investments, their injection into the economy provided a higher consumption and an increase of trade and current deficit of the country. The gradual tightening of the external financing during 2009, accompanied by a strong slowdown of lending activity in the financial market, hampered the maintaining of investments pace in economy, while consumption rate manifests an inertia trend. The reduction of domestic and external investments' sources has affected the economic growth throughout this period.

Indirect data of last quarters denote a contraction of domestic demand relative to the previous years owing also to the slowdown of the lending activity. Economy lending by banking system in annual terms is slowed by one figure rate against the average pace of higher than 40 percent in the two previous years. Lending to economy, in its major part, is financed by foreign assets stock at commercial banks balance-sheet. In presence of this stock reduction after the withdrawal of a part of deposits at the end of 2008, the funding of economic growth through financial intermediation is becoming more difficult. For 2010, lending credit growth extended to private sector of economy from banking system is forecasted to be about 1/3 of the one injected in 2008. The performance of credit portfolio quality and the higher risk prim, in presence of other factors, shall make difficult the recovery of banking system lending to the economy private sector, to be characterised by the previous paces.

External financing sources of the economic growth for the current year are also lower relative to the two previous years. External financing through capital and financial inflows has contributed on the continuance of aggregate demand expansion during 2008-2009. Financial flows in 2009 are expected to be at about 11-12 percent of GDP, while 2008 financing from external financial flows accounted for about 17 percent of GDP⁶⁶. In general, these flows consist on foreign direct investments, partially as privatisations of state-owned companies, as well as the external borrowing mainly of public sector. Further lowering of these flows during the current year, as a consequence of the reduction of foreign direct investment and the tightening of financial borrowing standards in international markets, is expected to impose an increasing impact on the country economy during this year.

Along with the developments in the financial markets, long-term factors that have contributed on the economic growth reveal more reduced during 2010.

Macroeconomic development and economic growth during the last years is enhanced by the high rate of remittances which shall remain low during 2010, as a result of the difficult situation in our trading partners. In terms of GDP, remittances foreign-denominated inflows fluctuate at 12-15 percent, while during 2008 and 2009, their rate dropped by 8 percent each year pointing to lower than 10 percent of GDP. The further drop of remittances during the forthcoming year shall have a negative effect on the economy aggregate demand. The decreasing trend observed during the last two years, is neutralised by high financial flows of foreign investments and external borrowing. Their ongoing contraction tends to be transmitted at consumer rate and on the climbing opportune costs of investments in economy being reflected on the fall of the economic strengthening in the medium-term period.

In presence of these developments, during 2010, the economy is expected to encounter reduced financing possibilities of aggregate demand and a moderated performance of consumer and investments. Real economy is expected to remain under its long-term potentiality in presence of restrictions in terms of consumption financing sources. This shall transmit reduced inflationary pressures generated from the domestic economy. On the other side, the lowering of the domestic demand shall be reflected on a gradual improvement of the economy external balance.

ENDNOTES

¹ Consumer spending and investments dropped by 0.1 and 0.8 percent, respectively in the third quarter 2009 relative to the previous quarter.

² Brazil, Russia, India and China

³ Calculated from the spread of the monthly average of these indicators in June with December.

⁴ Exports during January –November 2009 fell by 17% in annual level.

⁵ Retail trade dropped by 1.4% in the first 9-month period of 2009, consumer loan recorded lower increasing rates since the beginning of year, import of consumer goods maintained the rates of the previous year. Wages in economy have recorded a slight increase while remittances dropped by 6.6%.

⁶ Current and capital expenses during January-November increased by 16 and 23% respectively in annual terms.

⁷ See the analyse in Chapter IV.3 for more details

⁸ Production gap is measured as the spread between current production of economy with the production it would potentially generate under the complete exploitation conditions, with maximum efficiency.

⁹ Istrefi K., Semi V., (2007). "Transmission of exchange rate in Albania: evidence from autoregressive vectors ". Working paper of the Bank of Albania.

¹⁰ In case of Albania, Monetary Conditions Index (MCI) is a weighted average of the key interest rate changes and the Nominal Effective Exchange Rate, against their respective values in a basic period. Since the second quarter of 2009, the basic period is December 2005. MCI ratio in case of Albania points to 1.82:1, implying that the effect of an appreciation 1.82 percent of NEER on aggregate demand, would be neutralised by a cut of the key interest rate by 1.0 percentage points. Index is monitored to see the monetary conditions direction and not as an operational target.

¹¹ The share of this item on total shares in calculating consumer price index is approximately 19 percent.

¹² Oil price in the domestic market is almost affected by the oil price in the world market, which have been increasing recently.

¹³ Average of measuring (with permanent exclusion and by reduced average). For more detailed information see: Çeliku and Hoxholli (2008), "Other measuring of core inflation: their employment in forecasting and analysing", Working Paper, No. 1(24) 2008, Bank of Albania.

¹⁴ Average of core inflation in annual terms for the last decade points to about 0.8 percent.

¹⁵ CPI tradable sector basket, are excluded the process effects of "Fruits" and "Vegetables and potatoes" items' prices.

¹⁶ The estimate takes into account the tradable sector share (0.62%), average annual inflation for the ALL/EUR Exchange rate for 2009 (+7.5%), average inflation of tradable sector during July-December 2009 (3.5%) and historic average (0.8%).

¹⁷ Which are excluded from CPI non-tradable sector, sub-items by administered process.

¹⁸ GDP growth rate of Q3:2009, INSTAT published rate "The Quarterly Gross Domestic Product", Publication of third quarter for the year 2009, December 2009. GDP growth rate for Q1:2009 and Q2:2009, might be subject of review from INSTAT.

¹⁹ INSTAT, "Quarterly Gross Domestic Demand " third quarter 2009, December 2009

²⁰ The confidence indicators for the industry, construction, services and consumers sectors, which summarise in a sole indicator the judgements expressed from all the above mentioned groups, based on the confidence survey results.

²¹ According to the data from lending activity survey at banks, lending standards are contracted at a higher rate in terms of the loan for investments purposes, relative to the loan for inventory and working capital purposes.

²² Annual fall of exports and imports during this period provided an impact on an expansion by 0.12 percent of net exports.

²³ Analysis at sectoral rate referring to publications " Quarterly Gross Domestic Product", September 2009 and December 2009, INSTAT.

²⁴ Housing price index is calculated based on the hedonic way of indices calculation, which provides an index cleaned from the effect of quality change, based on the process of announcements for housing sale in "Çelësi" newspaper. The major part of announced process are issued in the European currency. The major part of notices relate to the re-sail from owners and sales for the

first time. Index also might not trigger in time the change of selling price as an effect of its change from housing constructors.

²⁵ Selling price ratio to house rent is a simple indicator that shows if housing price is appreciated, from the comparison of ratio current values with its historical rates.

²⁶ Data of electrical energy balance are available until November.

²⁷ Both current revenues and expenses recorded an annual growth of 3.7 and 10.4 percent, respectively during July – September '09.

²⁸ Deficit of revenues amounted to about EUR 34 million relative to the surplus of EUR 55 million recorded in the previous year.

²⁹ The latter amounted to about EUR 206 million relative to the amount of about EUR 229 million, it recorded during the Q3'08.

³⁰ The calculations of nominal GDP for the year 2009 are based on IMF estimates for nominal GDP: ALL 1,129,000 million (6th review of PRGF agreement, February 2009, <http://www.imf.org/external/pubs/>). The rates of different indicators expressed as a percentage of GDP refer to cumulative data for Q4'08- Q3'09.

³¹ The values of the following ratios refer to cumulative data, which include the period from Q4 of the previous year to Q3 of the referring year.

³² Due to the shortfall of data for December, foreign trade shall be considered on the above-mentioned period.

³³ Source: Bank of Albania relevant data and "Maximising the development impact of migration related Financial Flows and Investment from Austria to BiH ", IOM (International Organization for Migration), IASCI (International Agency for Source Country Information).

³⁴ This balance recorded a surplus of about EUR 34.5 million during July-September '08.

³⁵ Communication services sector recorded a narrowing of this category surplus from EUR 19.3 million during Q3'08 to EUR 6.6 million during Q3'09; while the financial ones record a further expansion of the above mentioned account deficit: from EUR 2.0 million during Q3'08 to EUR 6.4 million in Q3'09.

³⁶ According to the reviewed 2009 projection, approved on September 2009

³⁷ This rate represents the lowest increase of the decade for the 11-month period.

³⁸ The rate of 14 percent represents the highest annual growth recorded for the year 2009.

³⁹ VAT contribution to the growth of total revenues throughout this year appeared at modest levels (lower than percentage point), meanwhile in the previous years, given that this item has the main share on revenue (35%), this item contributed averagely with about 5 percentage points on the increase of total revenue.

⁴⁰ The review and approval of the 2009 budget, is carried out in September of this year.

⁴¹ The initial rate projected by the Ministry of Finance amounted to 74.8 billion.

⁴² According to the reviewed projection

⁴³ Increasing contribution during the last two years of capital expenses is clear from the chart.

⁴⁴ Growth of this items, for the 11-month period was 27, 31 and 18 percent, respectively.

⁴⁵ Referring to the 11-month budget deficit ratio against 11-month (IMF) GDP

⁴⁶ Syndicated loan is a form of loan provided from a group of resident and non-resident banks in the territory of the Republic of Albania to the Albanian Government by, to finance budget deficit. The maturity of this loan does not take too long.

⁴⁷ These proceeds refer to privatisation of ARMO (a portion of which were transferred to the 2009 account), OSSH, a part of AMC and of the United Bank of Albania stocks, and the licence granted to the forth mobile telephony.

⁴⁸ In the meantime, Government borrowing policy aimed the increase of Bonds issuance of all maturities, against T-bills.

⁴⁹ Almost all Western Balkan countries, manifested a deepening of budget deficit owing to the realisation of budgeted revenue lower to the estimated rate, as well as a high rate of expenses as a reaction to the last economic and financial crisis.

⁵⁰ The change of GDP real growth at horizontal axe and of budget deficit against 2009 GDP in vertical axle.

⁵¹ Horizontal axel shows public debt stock against GDP for the year 2009, while vertical axle shows the difference of fiscal balance to GDP for the year 2009 with 2008. Data for Albania refer to Q3 2009.

⁵² Excluding the Exchange Rate

⁵³ The displayed figures in the lending analysis are excluded from the foreign exchange rate.

⁵⁴ During the first half of year, lending growth hampering was mostly affected by the supply tightening, lending standards from banks, and the difficult liquidity situation.

⁵⁵ GDP value for Q3:2009, referred to INSTAT publication for Q3:2009, "Quarterly Gross Domestic Demand".

⁵⁶ Based on short-term statistics (INSTAT), indicator of employed persons with wage.

⁵⁷ Referred data from "Short-term statistics", INSTAT, excluding agriculture and "The main Economic indicators Conjecture, July-September 2009", INSTAT.

⁵⁸ Average payment index is calculated as a index of payments funds ratio to employed persons' number index.

⁵⁹ Expectations of economic agents for inflation are measured based on business survey data, consumers confidence survey and the monthly survey of banks' experts for the forecast of some macroeconomic indicators.

⁶⁰ Standard deviation of interest rates in interbank market during this half of year was 0.36 relative to 0.46 in the first half of year.

⁶¹ At the end of January 2009 the key rate reduced at base rate cut by 50 basis points

⁶² Bid/cover ratio in bonds auctions was averagely higher than 1.

⁶³ The weighted average interest rate on Euro-denominated deposits was 2.35 percent

⁶⁴ NEER – Nominal Effective Exchange Rate measured against to currencies according to an approximate share they have in trade with abroad, EUR (80 percent) and USD (20 percent). An increase of the NEER implies the appreciation of ALL.

⁶⁵ Measured as the quarterly average of exchange rate volatility. The latter is measured as the standard deviation indicator.

⁶⁶ The complete data for the year 2009 are still unavailable.

