BANK OF ALBANIA

MONETARY POLICY STATEMENT FOR THE SECOND HALF OF 2008

2008

MONETARY POLICY STATEMENT FOR THE SECOND HALF OF 2008

1. GOVERNOR'S SPEECH

World economy and the financial system in particular were severely hit in the second half of 2008. The crisis which struck the heart of the global financial system was progressively and relentlessly transmitted to the economic activity of advanced economies leading some of the latter into recession. The Albanian economy has been resilient amid this hitting wave. According to the available official data and judging upon a number of indirect indicators, the Bank of Albania notes that the economic activity throughout the year has by and large performed in line with the early 2008 projections both in terms of economic growth and preservation of macroeconomic balances. The Bank of Albania in particular has met its primary objective mandated by law, contributing to the maintenance of price stability. Average annual inflation rate marked 3.4 percent, which is close to the central bank's objective.

The recent global-scale developments attest to the further economic downturn. Despite the slackening of inflationary pressures as a result of the reduced demand and the slump in basic commodity prices, the tightening of lending standards and the fall in consumption and investment have led to uncertainties related to the duration and intensity of this troublesome situation. Against this backdrop, the facing of the economic activity contraction at a global level remains an open issue. The Euro area economy is already experiencing an economic slowdown. Euro area GDP contracted in the third quarter while the unemployment rate reached 7.8 percent in November 2008. The U.S. economy showed quite similar features. The further contraction of economic activity - owing to the deterioration of financial indicators in the U.S. corporate and household balance sheets, mirrored in lower consumption spending and reduced aggregate investment - drove the unemployment rate to reach 7.2 percent. Monetary and financial stimuli managed by central banks and the ministries of finance have helped to bolster confidence and relieve pressure on the financial institutions.

Against this backdrop, the "resilience" shown by emerging countries is displaying the first signs of weakening. In contrast to the first half of 2008, the latest data attest to the moderation of economic growth rates in the majority of these countries. The channels through which the slowdown in advanced economies has affected the emerging countries differ depending on their development characteristics. China and India have been severely hit by the slowdown in exports; Russia had hard times owing to the slump in raw material prices in the global market, while East European countries have been impacted by the tightening of funding conditions on a global level.

In contrast to many emerging countries, the Albanian economy has been sustained by domestic demand, while -although upward- foreign demand in the form of Albanian exports has provided a proportionally lower impact over the economic growth. Economic activity at home has been almost entirely sustained by domestic financial resources, while foreign financing in the form of credit lines or portfolio investment has been less considerable. Operating within all the parameters of financial soundness, the Albanian banking system has been dynamic and effective in channelling the savings towards the funding of corporate production or household consumption. This process has been also facilitated by the macroeconomic stability which enabled the fall of risk premiums in economy and helped to gradually extend the investment horizon.

These features led the economic activity at home to record adequate growth in the first three quarters of 2008, a period which is covered by statistical data. With regard to the last quarter, indirect data on economic activity - mainly financial ones - suggest a slight slowdown of economic activity, however, remaining within the projections for 2008. Manufacturing, where construction continues to share the main weight, provided the main contribution to the increase of turnover indicator in terms of volume. Investment in major road infrastructure projects and the recovery of construction permits from the prolonged constraints triggered high growth rates in construction activity during this period. In addition, the sector of services continues to provide the primary contribution to economic growth at home. The positive developments in domestic production have been also evidenced by the increase of economic tendency indicator, derived from the business and consumer opinions, and by the increased number in employed persons. In annual terms, unemployment rate fell by 1.5 percent to 12.62 percent, being mainly triggered by the increase in the average number of employed persons in the private agricultural sector.

Notwithstanding the inflationary pressures of early 2008 - mainly triggered by supply-side shocks - CPI annual inflation was brought back within the Bank of Albania's target during the second half of 2008. In the second half of the same year annual inflation rates stood close to the central bank's target - 3.0 and 2.5 percent, respectively, in both quarters. The performance of the inflation rate in the second half mirrored the global effect of the fall in basic commodity prices (mainly foodstuff and oil prices) as well as a more favourable price conjuncture of goods and services in the domestic market as a result of their demand coverage with an ever-growing supply.

The return of inflation within the targeted band was not only conditioned by the relaxation of supply-side shocks but also by the adequate monetary conditions which provided room for the balancing of demand and supply-side factors. Monetary policy stance was neutral throughout 2008 and the key interest rate was kept unchanged at 6.25 percent. In tandem with the strengthening of several banking supervision measures in terms of credit risk management, the monetary policy has led to a more balanced credit growth and has transmitted the appropriate stimuli for consumption and savings. The adequate monetary policy and the keeping of inflation under check by

the Bank of Albania have been also reflected in the anchoring of economic agents' inflationary expectations close to the 3 percent target of the central bank. In absence of unexpected shocks on financial stability, inflationary expectations or other supply-side factors, the balance of risks on inflation over the period to follow seems to be shifting downward.

In this context, worth noting is the contribution of fiscal policy which has ensured the preservation of macroeconomic balances by keeping the budget deficit at adequate levels. The carrying out of public spending in line with the budget plan has facilitated the control of domestic demand pressures and has bolstered confidence in the country's macroeconomic stability. Budget revenues collected as of end November have met the 11-month plan of the Ministry of Finance by about 96.4 percent, while expenditures met 92 percent of the plan. Following the developments in the first half of 2008, budget performance for the period July to November 2008 was characterized by a more active carrying out of expenditure. Budget deficit created after the first half of 2008 was mainly financed through foreign resources.

On the other side, the external sector of the economy continued to be characterized by the deepening of current account deficit, which in annual terms, increased by 48 percent in the third quarter of 2008 to about 252 million euros. As a share of GDP it accounted for 13.7 percent which is about 5 percentage points higher than the same period the previous year. In addition to the trade deficit widening, the deepening of current deficit was also triggered by the narrowing of the positive balance of revenues and current transfers' account. Its stability is imperative to ensure Albania's financial stability and a stable and long-term economic growth. Therefore, the dynamics in the balance of payments developments remains an area which needs constant monitoring by the Bank of Albania.

Monetary indicators had a stable performance in the second half of 2008, although the end of the period showed signs of their downward growth rates. Average annual growth rate of money supply was about 13 percent. A small part of deposits were withdrawn from the banking system in the last months of 2008 as a result of depositors' concerns following the vague situation in the global financial system. In relative terms, these withdrawals made up a small share in commercial banks' balance sheets and did not affect the banking system's soundness indicators or impair its financial intermediation role. Credit to the private sector continued to provide the main contribution to money growth. In annual terms, credit growth fell during the second half of 2008 relative to the first half the same year. Intermediation indicators increased further; the ratio of loan portfolio to deposits and total assets was 63 and 43 percent, respectively, as of end November. Following September, the structure of loan portfolio by currency displayed a higher annual growth rate of lek denominated loans. The performance of loan portfolio by customer attests to higher annual growth rates of business loans relative to household loans. In contrast to the first half of 2008, loan portfolio to construction and trade shifted downward while loans to industry increased slightly in the second half of the year.

The performance of money markets during the second half of 2008 was conditioned by the developments in monetary indicators and the real economy. As experienced by many countries, the increased vulnerability of banks to liquidity has brought about the reduction in the interbank trading volume and upward interest rates on deposits. The coverage ratio of Government demand for money has reduced and some risk premiums have increased in the last two months. This performance brought about the increase in Government securities' interest rates and in a few cases in the loan interest rates. In response to these developments, the Bank of Albania intervened in the money market by injecting liquidity at different maturity rates. In addition, the central bank changed in November the form of repo auctions to auctions with undetermined amounts in order to better satisfy the banks' needs.

Economic and financial developments have by and large been positive during 2008. Economic growth performed in line with the early year projections, while the main indicators of macroeconomic and financial stability remain solid. The negative impact of developments in global economy was marginal. However, as in other emerging countries, the Albanian economy cannot remain immune for long to the direct or indirect impact of the global economic crisis. The Bank of Albania public statements have constantly noted that the global crisis impact over the Albanian economy will largely depend on its intensity and duration. The persistence and deepening of the global economic crisis signal that the Albanian economy will go through a harder economic environment in 2009, which may call for the solution of many issues.

The slowing remittances and the tightening of financing conditions are the channels exposing the Albanian economy the most to shocks in the global economic environment. The expected impact of these factors would materialize in a slower economic growth in 2009. We note that the economic and financial programs of all economic agents need to reflect and consider this prospect. A slower economic growth does not necessarily translate into a crisis in Albania, but rather as a temporary development propelled by external factors. Hence, promoting policies need to be formulated based on this underlying premise. They should at no case be designed to the detriment of long-term macroeconomic stability, which represents one the most treasured assets the Albanian economy has achieved during the transition years.

The preservation of financial stability remains crucial for the long-term economic development and under constant consideration in the Bank of Albania decision-making process. In this context, confidence in the banking system and in its balance sheets would be the most rational behaviour of any individual, business or other agent in the Albanian economy. Global experience shows that the mutual interaction between the real economy and the banking system in terms of savings, use of payment infrastructure and expertise in the area of financial counselling and support with funds is a key feature of economies that have managed to progress and leave behind the transition countries' level.

In conclusion, I would like to assure the public that the Bank of Albania remains committed to creating the proper premises which boost economic activity at home, without infringing the objective of price stability. In addition it will keep working on firming up financial stability in the country. The Bank of Albania decisions will be a direct contribution to smoothing out the negative effects deriving from the international crisis and they will help to ensure the further maintenance of economic and financial balances at home.

2. DEVELOPMENTS IN WORLD ECONOMY

2.1 ECONOMIC GROWTH AND MACROECONOMIC BALANCES

WORLD ECONOMY

Over the second half of 2008, the world economy was characterized by the slowdown of economic activity owing to the economic contraction in the main advanced economies and to the economic downturn in emerging countries. The economic downturn has been triggered by the financial turmoil of mid-year 2008. The inflationary pressures have eased owing to the decline in food and energy prices. The heightened volatility shown in the financial markets led many institutions and organizations to review their projections for the economic growth.

Table 1 Some main macroeconomic indicators

Country	GDP Growth Q3 2008/Q3 2007	GDP Growth Q3 2008/Q2 2008	Unemployment rate November 2008	Annual inflation rate November 2008/ October 2008	Annual inflation rate November 2008/ November 2007
USA	0.7	-0.5	7.2[1]	-1.7	1.1
Euro area	0.6	-0.2	7.8	-0.5	2.1
Germany	0.8	-0.5	7.1	-0.6	1.4
Greece	3.1	0.5	7.2[2]	-0.2	3.0
Italy	-0.9	-0.5	6.7[2]	-0.2[1]	2.3[1]
Japan	-0.1	-0.1	3.9	-0.9	1.0

Source: OECD, Eurostat, Respective Statistical Institutes
[1] *Data for November.*
[2] *Data for the third quarter of 2008.*

EURO AREA ECONOMY

The economic downturn in the Euro area, triggered by the financial turmoil and the uncertainty related to the assessment of economic prospects, persisted in the third quarter of 2008. Despite an economic growth of 0.6 percent in annual terms, the Euro area economy continued to contract by 0.2 percent compared with the previous quarter. The weakening of economic activity owes mainly to the fall in investment over the third quarter of 2008 by 0.6 percent[1] and the growth of imports by 1.4 percent. Consumer spending on the other hand did not undergo significant changes.

Inflation rate marked 1.6 percent in December 2008, maintaining the downward trend starting from July 2008, when it marked 4.0 percent. The decelerating demand and the decline in energy and commodity prices

seem to have provided their contribution to the performance of inflation. In annual terms, unemployment rate marked 7.8 percent in November 2008, maintaining the upward trend of the second quarter the present year.

U.S. ECONOMY

The second half of 2008 attests to the further weakening of U.S. economic activity. In contrast to the first half of the year when the U.S. government's fiscal-stimulus package helped to maintain economic growth, the outlook for the U.S. economy deteriorated significantly owing to the aggravation of some of the largest U.S. companies' balance sheet financial indicators. This period was characterized by a weakened domestic demand as a result of lower consumption expenditure and the fall of aggregate investment, which provide the main contribution to the GDP. In November 2008 personal income and consumption expenditure dipped 0.2 and 0.6 percent, respectively, compared with the preceding month. Although the U.S. dollar appreciated in the third quarter, the current account deficit improved owing mainly to the growth of exports at more accelerated rates than imports[2]. In the second half of 2008, average unemployment rate recorded higher rates compared with the average of the preceding period[3], peaking in December when it recorded 7.2 percent. The high commodity and oil prices, which fuelled the inflationary pressures over the first half of the year, lost their effect in the second half of 2008. The period August to November 2008 was characterized by the sharp fall of the consumer price index, hence indicating possible rising deflation risks in the U.S. economy. Although the inflation rate averaged 5.3 percent in the third quarter of 2008, it has been following a downward tendency starting from September, being also followed by improved inflationary expectations[4].

MAIN EMERGING COUNTRIES' ECONOMIES

The decelerated economic activity in advanced economies over the second half of 2008 provided its impact over the economic performance of BRIC countries[5] as well. Although the economy grew at accelerated rates in the first half of the present year - which in the case of China reached a two-digit level -, the data on the third quarter of the year attest to a more moderate GDP growth rate. In China, the deceleration of industrial production led to weakened economic growth rate, notwithstanding the 4 percent growth of domestic demand in annual terms. The considerable drop of exports over October to December 2008 is expected to moderate the economic growth rates further in the last quarter of the same year. In India, the economy performed quite similarly. In annual terms, exports fell by about 4 percentage points in the third quarter and the main sectors of the economy reduced their production capacities.

In contrast, Brazil recorded more accelerated growth rates over the third quarter owing to the increase in industrial production and aggregate investment. In Russia, the turbulences in the domestic financial market provided their effect on the real economy, reflecting the weakened lending ability of commercial banks and the contracted production activity.

In the meantime, the considerable slump in the oil price – under the conditions when Russia remains one of its main exporters – led to contracted domestic demand. In November, inflation rate dropped in Russia and China while increasing in Brazil and India. In their last monetary policy meetings, the central banks of Russia, India and Brazil decided to keep the key interest rate unchanged, while the People's Bank of China decided to cut it.

Country	October 2008	November 2008	S1:2008	Q3	2009[1]
		Inflation		Real economic growth	
Brazil	6.4	6.4	6.2	6.8	3.0
China	4.0	2.4	10.4	9.0	8.5
India	9.0	10.5	8.4	7.5	6.3
Russia	14.2	13.8	8.1	6.2	3.5

Table 2 Some macroeconomic indicators for the BRICs

Source: IMF, OECD.Stat, Respective Statistical Institutes
[1] *IMF assessments.*

SOME REGIONAL COUNTRIES' ECONOMIES

According to the final National Accounts estimates, the Italian economy contracted by 0.9 percent in annual terms in the third quarter of 2008. Following the unfavourable economic conditions over the first half of the present year, the sharper contraction of the GDP growth reflected the deepening of the economic crisis Italy is going through. The downward tendency of aggregate investment shown from the first quarter, and the decreased exports for the first time the present year, were the main contributors to the economic downturn. Consumption expenditure provided a positive contribution to the GDP growth although they grew at more moderate growth rates compared with the first half of the present year. In December, the harmonized consumer price index rose by 2.3 percent relative to the same period the preceding year. The last two months attest to the relaxation of inflationary pressures which hit the Italian economy over January to September 2008.

The latest figures on the Greek economy attest to the contraction of economic activity over the last quarter of 2008 compared with the two preceding quarters. Economic growth rates were lower than the average of the first half of the year, owing mainly to the drop in aggregate investment and weakened industrial production. In the meantime, consumption expenditure has maintained a heightened upward tendency and exports to non-EU countries[6] recorded growing volumes. The economic situation seems to have deteriorated over the last months. The results obtained from the survey on Economic Tendency Indicator attest to its deterioration in September to November 2008, in contrast to the optimism which characterized the first nine months of the year. Additionally, the latest data on industry show a weakened production activity in some of the main branches of the economy, namely in manufacturing, construction and energy. In the third quarter, unemployment rate reached 7.2 percent, which is lower than in the first half of the present year. Inflation rate, as measured by the harmonized consumer price index, marked 2.2 percent in December 2008, hence maintaining the downward tendency shown in October 2008.

Turkish economy decelerated in the third quarter of 2008. Year-on-year economic growth was 0.5 percent, the lowest since 2001. Although public investment recorded an annual growth of 22.2 percent, the drop in private investment was a determining factor in the contraction of economic activity[7]. In the meantime, the growth rate of exports and consumption expenditure[8] has lowered. Annual inflation rate marked 11.7 and 10.9 percent, respectively, in the third and fourth quarter of 2008. In December, inflation marked 10.1 percent, compared with 10.8 percent the preceding month.

The Macedonian economy recorded an annual growth of 5.5 percent in the third quarter of 2008 relative to the growth of 6.5 percent the previous quarter. Construction and trade provided the main contribution to the economic growth, whereas agricultural production recorded a lower quarterly growth than the annual growth rate in this branch of the economy. From October to November 2008, industrial production contracted sharply by 9.9 and 2.9 percent, respectively. Annual inflation rate during the third and last quarter of 2008 marked 8.4 and 5.5 percent. In December, annual inflation marked 4.1 percent, while the average annual rate for the year 2008 stood at 8.3 percent.

Table 3 Economic indicators for the regional countries

Country	GDP annual growth	Annual inflation	Unemployment rate
	Q3 2008	November 2008	November 2008
Italy	-0.9	2.3	6.7[1]
Greece	3.1	3.0	7.2[1]
Macedonia	5.5[1]	4.1[2]	33.0[1]
Serbia	4.9	6.8[2]	14.0[3]
Croatia	1.6[1]	4.7	13.2
Turkey	0.5[1]	10.1[2]	10.3[4]

Source: Statistical Institutes, EuroStat, OECD.Stat, Bloomberg

[1] *Data for the third quarter of 2008.*

[2] *Data for December.*

[3] *Data for October.*

[4] *Data for September.*

2.2 MONETARY POLICY, FINANCIAL MARKETS AND THE EXCHANGE RATE

In December 2008, the European Central Bank decided to cut the key interest rate by 75 basis points to 2.5 percent[9]. This was the second time since September 2008 when the key interest rate was 4.25 percent. This decision aimed at stimulating the economy following the negative growth rates of economic activity in the Euro area over the course of the second and third quarter of 2008.

In the last quarter of 2008, the Federal Reserve cut its key interest rate for the third time to within a range of 0 to 0.25 percent from 2 percent in October 2008. The Federal Open Market Committee took this decision in order to prevent the further deterioration of the U.S. economy. The Bank of England cut the key interest rate for the fourth time to 2 percent from 5 percent it marked in October 2008. This is the lowest level since 1951. Over
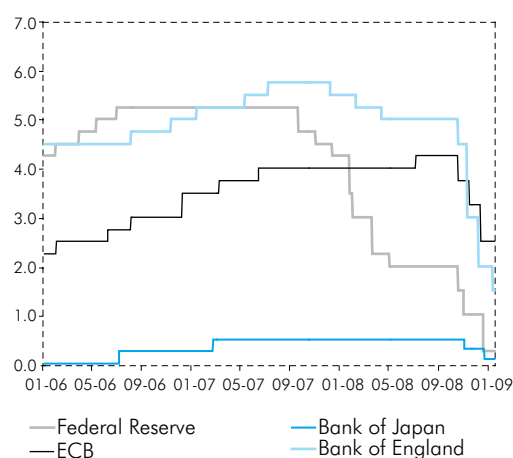
the course of the last quarter, the Bank of Japan cut the key overnight lending rate twice by 20 points basis to 0.1 percent. This decision followed after the projections for a 0 percent economic growth in the year to follow.

Over the course of the second half of 2008, there were increased tensions in the global financial markets, which affected the economic performance of the main advanced countries. The intensification of financial tensions over the last months of the year provided a negative impact over the financial and banking sector, mirroring tightened lending standards and high financing costs. In particular, the situation created over September and October when the international financial markets were faced with a wave of failures, led to heightened uncertainty

Chart 1 Changes in the key interest rate

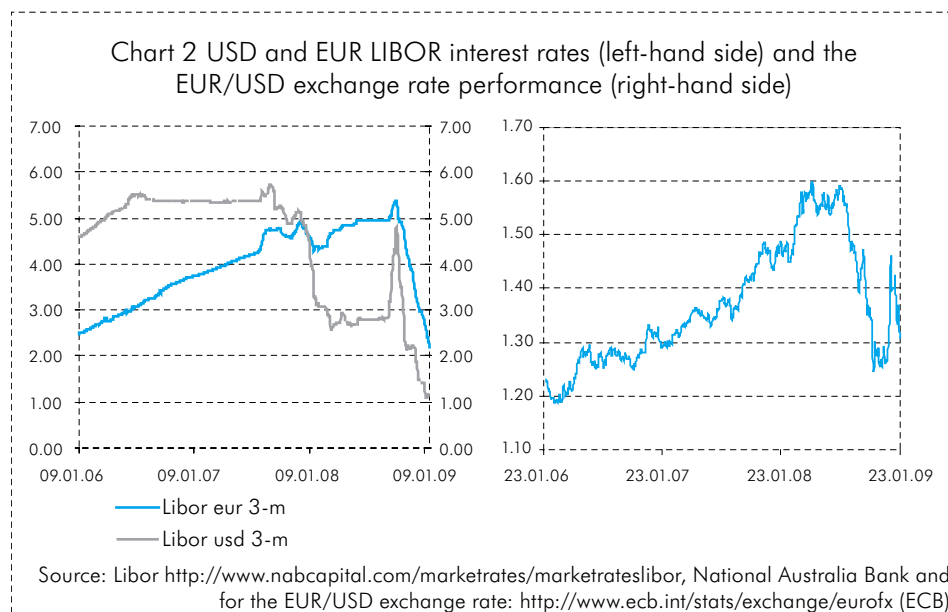Source: European Central Bank, Federal Reserve, Bank of Japan, Bank of England

and lack of confidence among the main market agents, hence hampering the exchanges in the main capital and money markets. The normalisation and relaxation of tensions in the global financial markets required a decisive and co-ordinated intervention of all central banks of advanced economies. The inflationary pressures slackened over this period following the fall in raw material prices, which helped central banks cut the key interest rate in order to reduce the financial institutions' cost of money. Over the last months of 2008 the interest rates in the international financial markets improved and decreased slightly. The interventions of central banks and governments, which sought to revigorate the financial and industrial sectors, provided their impact. In November and December 2008, the LIBOR and EURIBOR interest rates in the money market declined sharply, reflecting the reductions in key ECB and FED interest rates. In December, three-month USD and EUR LIBOR interest rates decreased by 45 and 95 basis points compared with the preceding month. Although the interest rates in the interbank markets attest to a downward performance, the tensions and the perception of risk by the market agents seem to remain high, given the high volumes of overnight deposits and the volatile interest rates applied in these markets on the swap of unsecured funds.

In the foreign currency markets, the euro recorded sizeable swings and depreciated against the U.S. dollar. Following the appreciation in July and August, the euro maintained a downward tendency and was highly unstable against the U.S. dollar. In the last months of 2008, the euro depreciated slightly vis-à-vis the main currencies, mainly as a result of the appreciation of the U.S. dollar, the Japanese yen and the Chinese yuan. In December, the euro appreciated against the pound sterling. The high demand of many financial institutions for the U.S. dollar, the weak performance of the Euro area and the latest data on some macroeconomic indicators, which stand below the market agents' expectations, have led to the appreciation of the U.S. dollar vis-à-vis the euro. The latter depreciated by an average of 7.8 percent over the course of the last six months of 2008 relative to the preceding half of the year.

Chart 2 USD and EUR LIBOR interest rates (left-hand side) and the EUR/USD exchange rate performance (right-hand side)

Libor eur 3-m
Libor usd 3-m

Source: Libor http://www.nabcapital.com/marketrates/marketrateslibor, National Australia Bank and for the EUR/USD exchange rate: http://www.ecb.int/stats/exchange/eurofx (ECB)
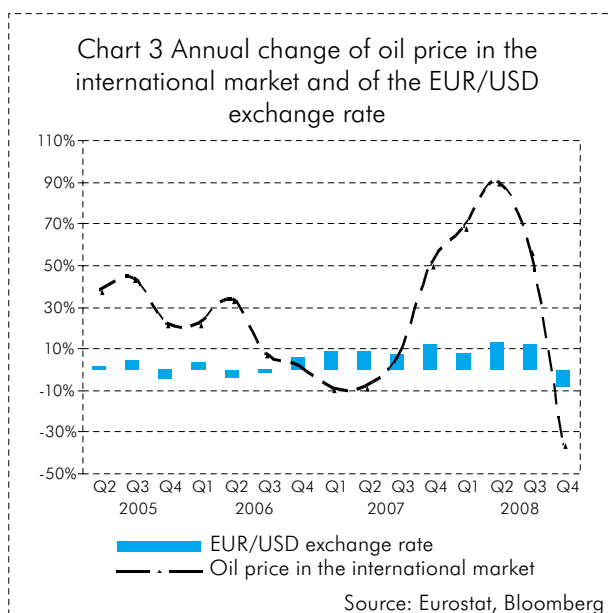
2.3 PERFORMANCE OF OIL AND RAW MATERIAL PRICES

The second half of 2008 was characterized by an accelerated decline of oil price, which began since July the present year. A closer look at the average change of the oil price over the second half of the year compared with the previous period attests to the decrease of average oil price per barrel by about 17 percent to an average of 40.88 U.S. dollar per barrel in December. The unfavourable signals on the economic environment in OECD countries and on the slowing GDP growth rate in the largest Asian countries led to the decline of oil demand at a global level in the last months of 2008. Although the demand for oil grew at moderate rates, mainly in non-OECD member economies – China, Middle East and Latin America – the consumed oil in these countries did not result sufficie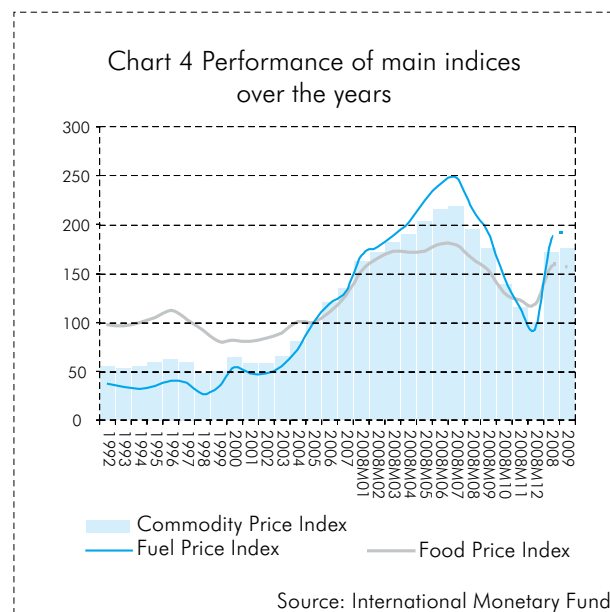nt to offset the negative effect of the weakened demand from advanced economies. The accelerated fall of the oil price was expected to lead to growing demand but the deterioration of the financial crisis in mid-September 2008 and its impact over the real economies of advanced and emerging countries did not yield positive results. Against this background, OPEC countries, in their last two meetings held in November and December, decided to slash the oil output quota by about 4.2 million barrels from the September 2008 peak.

However, the resumed refining activity by the major refining centres in the U.S., the increasing inventories in OECD countries, the rise in Russian oil export duty[10] and the persistent fall of demand are expected to keep the oil price at low levels in the months to follow. Given the expectations for the

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

EUR/USD exchange rate
Oil price in the international market

Source: Eurostat, Bloomberg

ongoing contraction of global economic activity, the forecast for the global oil demand in 2009[11] has been revised down by 0.2 percent, compared with 2008.

Over the course of the last quarter of 2008, Commodity Price Index, published by the IMF, continued to maintain its downward tendency started in mid-year. In December 2008, the index value was about 36.5 percent lower than in December 2007. The last quarter of 2008 was the first since 2002 to record negative values of this index. Food and fuel prices[12] recorded the highest fall, followed by the lower prices of main metals owing mainly to the economic downturn.

Chart 4 Performance of main indices over the years

Commodity Price Index
Fuel Price Index
Food Price Index

Source: International Monetary Fund

Box 1   Emerging countries under the global crisis

The effects of the crisis in the early 2008 did not seem to affect the emerging countries, given that their financial and economic indicators did not change substantially. The crisis evolution and its entry into a new phase, characterized by the loss of confidence among the main market agents, tensions in the money and capital markets associated with sharp losses in the stock markets altered the global economic outlook, in particular that of emerging countries, which until the early 2008 had shown stable developments. In more concrete terms, the financial crisis has lowered the demand for investment in these countries, in particular in those emerging countries which face large balance of payments deficit and imbalanced macroeconomic indicators. The tightened lending conditions have constrained the absorption of funds and at the same time, they have increased the cost of financing the domestic economies with foreign capital. The interest rates on bonds increased and the local currencies in emerging countries depreciated. In addition, the business asset prices have declined. Capital outflows have been sharper, which in turn have generated the contraction of credit supply and the tightening of liquidity conditions in the domestic markets which face high inflation and tightening monetary policies. Global demand – in particular that of industrialized countries – has reduced, causing the export of many emerging countries to shrink. These economies are largely dependent on foreign capital inflows and financing, therefore the deterioration of financial conditions in the global markets is assessed to have a considerable impact over the domestic economies.

The weakening domestic demand has provided its impact on the slowdown of economic growth in the third quarter of 2008 in Turkey, Serbia and Croatia. Macedonia as well experienced a weaker economic activity growth relative to the first half of 2008; however, it was generated by the decline in agricultural production, since domestic demand has grown. The economic issues the main trading partners of regional emerging economies are experiencing have triggered a slower export growth in Turkey, Serbia and Macedonia, while the exports of Croatia do not seem to have been affected. The liquidity shortage in the international markets was expected to provide its effect on foreign direct investment in emerging countries and on the tightening of lending terms, given the financial constraints the parent banks in advanced economies are going through. Turkey and Serbia were hit by the downturn

in foreign direct investment, which until the past year financed a large part of the current deficit. By contrast, Macedonia remained an attractive destination to foreign investors, who increased their foreign direct investment inflows over this year.

The liquidity shortages in the market have constrained the banks' lending capacity. Credit to economy and business and household loans declined in Serbia, Croatia and Turkey. Against this background, the respective central banks intervened in the market by increasing the liquidity available in the market. In addition, the central banks took other actions to halt the depreciating trend of their local currency vis-à-vis the Euro, which started in the early 2008.

Table 4 Annual changes of some macroeconomic indicators

| Country	Gross Domestic Product		Aggregate exports		Foreign Direct Investment (as a share of GDP)	
	S:1	Q:3	S:1	Q:3	S:1	Q:3
Croatia	3.9	1.6	7.0	11.6	8.1	7.0
Macedonia	6.0	5.5	12.1	16.8	6.7	8 .2
Serbia	7.3	4.9	40.3	29.8	9.0	1.5
Turkey	4.3	0.5	20.8	25.1	2.2	2.1

Source: European Commission

3 PRICE STABILITY AND THE BANK OF ALBANIA OBJECTIVE

Average annual inflation for the year 2008 marked 3.4 percent, which is about 0.4 percentage points higher than in the previous year. The increase of the average annual inflation rate owes mainly to the increase of core inflation to 3.8 percent over the course of 2008 from 1.7 percent it marked in 2007. Annual inflation fluctuated considerably over 2008, swinging between 2.2 and 4.6 percent as a result of temporary supply-side shocks.

In the second half of 2008, annual inflation marked rates close to the Bank of Albania objective - 3.0 and 2.5 percent in each quarter. The lowest rate of 2.2 percent was marked in December. This performance owes to the relieved inflationary pressures deriving from the supply-side factors and to the adequate monetary conditions to meet the needs of the economy. In addition, the carrying out of public expenditure in line with the budget plan halted the further generation of inflationary pressures. In absence of unexpected shocks on financial stability, inflationary expectations or other supply-side factors, the balance of risks on inflation is expected to shift downward over the period to follow.

In line with its strategy[13], the Bank of Albania monetary policy is oriented towards meeting its primary objective: achieve and maintain price

Chart 5 Annual inflation by quarters (in percent)

Annual inflation
Average annual inflation
Tolerance -1pp.
Tolerance +1pp.
Target
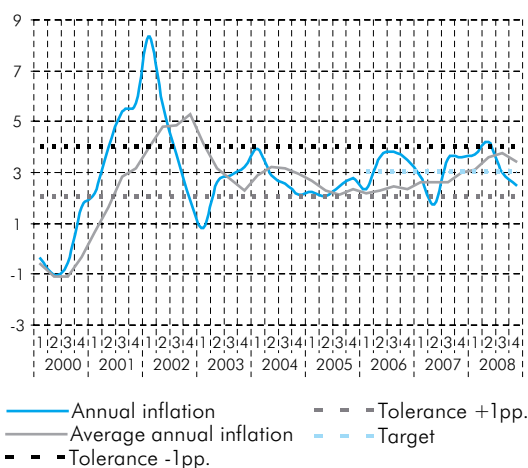
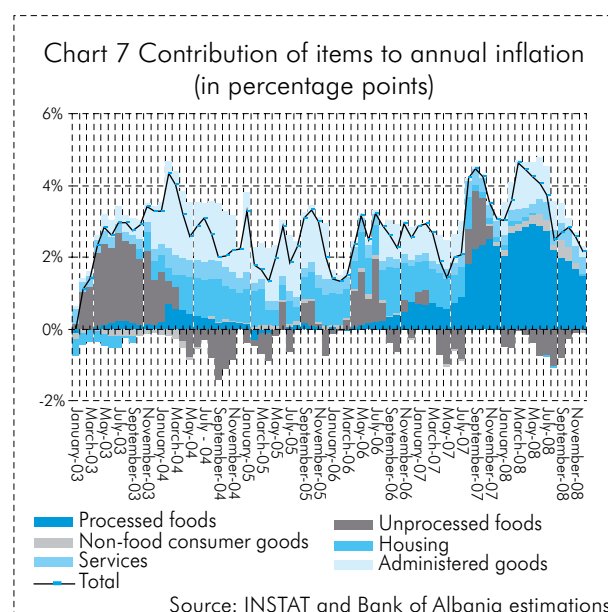Source: INSTAT and Bank of Albania estimations

stability. Monetary policy-related decisions are based on the analysis and assessment of current and expected economic developments and on the assessment of risks that may lead to the deviation of inflation from the objective, taking into account the time lag monetary policy affects the demand and the price level. In order to bring the inflation back to the target tolerance band, prevent the deterioration of inflationary expectations and the materialization of second-round effects of supply-side shocks – in the light of the ongoing growth of domestic demand[14] - the Bank of Albania increased the key interest rate three times over the course of 2007. This tightening approach proved effective in keeping the inflationary expectations under check and consequently, maintaining low inflation rates over the second half of 2008. The resetting of balances on the supply-side

Chart 6 Key interest rate of the Bank of Albania

Source: Bank of Albania

– the fall of raw material prices in the international markets and the domestic supply with agricultural products – in addition to the tightening of lending standards, attested to the fact that macroeconomic balances at home and the monetary conditions were adequate to ensure an inflation rate close to the Bank of Albania target. Monetary policy was neutral in the course of 2008 and the key interest rate was kept unchanged at 6.25 percent. Inflation forecasts suggest that it will remain stable and close to the Bank of Albania target over the following period. Economic agents' expectations are also in line with the Bank of Albania inflation forecasts, being anchored close to 3 percent.
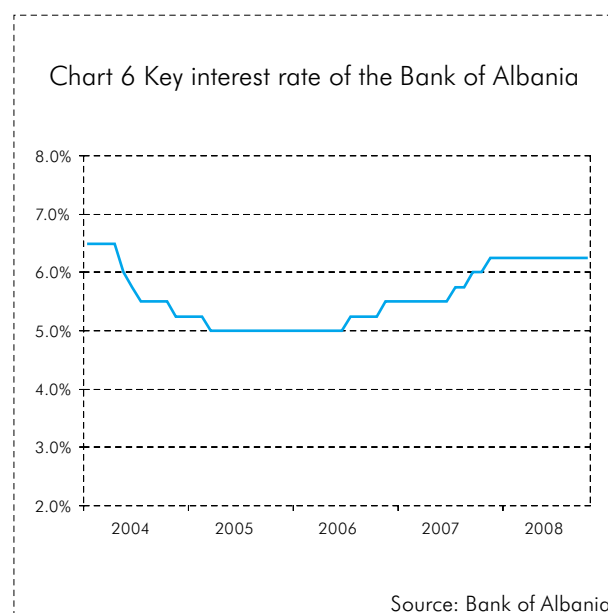
3.1 PRICE PERFORMANCE OF THE MAIN BASKET ITEMS

Inflation rate performance in the second half of 2008 reflected mainly the fall in global basic commodity prices (mainly food and fuel prices) and the favourable price conjuncture of goods and services in the domestic market, as a result of their demand coverage with an ever-growing supply. Overall, this period has been characterized by relatively lower annual inflation rates in all categories which fuelled the high rise in prices over August 2007 to July 2008.

'Processed foods' and 'Non-food consumer goods' recorded the sharpest decrease owing to the decline in fuel prices, hence preceding the overall fall of prices in the market. The low inflationary pressures deriving from the price conjuncture in the global market were also favoured by the adequate supply of domestic production. This positive performance was mostly shown in the prices of 'Unprocessed food', whose inflation marked negative rates throughout the year 2008.

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

Processed foods
Non-food consumer goods
Services
Total
Unprocessed foods
Housing
Administered goods

Source: INSTAT and Bank of Albania estimations

The contribution of some categories to headline inflation over the second half of 2008 has changed substantially the extent at which it has affected the annual inflation rate compared with the previous one-year period. Although 'Processed foods' continues to provide the main contribution to the overall inflation rate, its effect almost reduced by half as of end 2008 compared with the period from February to June, standing at the levels prior to the price crises of the last year. The decline in the prices of this category starting from August 2008 owed mainly to the relaxation of strong inflationary pressures deriving from the foreign markets these goods come from and to the abatement of effects of the bread price rise over August 2007 to February 2008.

Annual inflation of 'Unprocessed food' continued to record negative values in December (-0.3 percent). Since December 2007, its inflation has declined by an average of 2.3 percentage points. The items of this category are mainly affected by the prices of fruit and vegetables which are highly volatile and show considerable seasonality. The supply of domestic production for the year 2008 has been satisfactory (due to the good weather conditions), causing the supply in the domestic market to grow and at the same time offsetting the imported inflation transmitted from the high prices of these goods in Albania's main trading partners.

Table 5 Contribution of items to annual inflation (in percentage points)

	Q3-07	Q4-07	Q1-08	Q2-08	Q3-08	Q4-08
Processed foods (pp)	1.6	2.4	2.5	2.9	2.3	1.7
Bread and cereal (pp)	0.7	1.2	1.4	1.7	1.3	1.0
Alcohol and tobacco (pp)	0.2	0.3	0.1	0.1	0.0	0.1
Unprocessed food (pp)	0.6	0.5	-0.3	-0.4	-0.9	-0.1
Fruit (pp)	0.2	0.4	0.5	0.3	-0.1	-0.1
Vegetables (pp)	0.3	-0.1	-0.9	-0.2	-1.3	-0.7
Services (pp)	0.4	0.4	0.3	0.3	0.5	0.5
Administered prices (pp)	0.4	0.1	0.3	0.7	0.8	0.3
Fuels and energy (pp)	0.2	0.0	0.2	0.6	0.6	0.7
Housing (pp)	0.6	0.2	0.1	0.1	0.0	0.0
Non-food consumer goods	0.0	0.1	0.2	0.3	0.3	0.2
Durable consumer goods (pp)	0.0	-0.1	0.0	0.0	0.0	0.0
Consumer Price Index (y/y, %)	3.6	3.6	3.7	4.2	3.0	2.5

Source: INSTAT and Bank of Albania estimations

Annual inflation rate of 'Services' marked 5.6 percent in the second half of 2008, which is about 2 percentage points higher than the average inflation rate of the same period the preceding year. Inflation of 'Services' experienced the highest increase in June to October 2008, as a result of the accumulated price rise in hotel and restaurant services and in particular in transport services owing to the oil price crisis. Prices in hotel and restaurant services rose by an average of 2.5 percent, while starting from June 2008 transport services have recorded a high average inflation rate of 20 percent in annual terms.

'Housing' has marked very low inflation rates starting from September 2007, owing to the stable rent prices. Housing prices rose by an average of 0.5 percent, compared to the average rise by 4.3 percent in the four preceding years (2003-2007). Over the course of the second half of 2008, the prices of this category remained unchanged at an average level. Rent prices have been

constantly affected by the price changes in the housing market, reflecting the situation prevailing in this market over the past year.

Administered prices rose by an average of 3.6 percent over the course of the second half of 2008. Soon after the price rise of energy in March 2008, annual inflation of administered prices has been declining. In the second quarter it rose by an average of 6.2 percent, while in the last quarter the rise decreased to 2 percent. This decrease owes mainly to the fall of prices in 'Communication' by about 19.2 percent in the last quarter of 2008.

The prices of 'Durable consumer goods' and 'Non-food consumer goods' declined over the second half of 2008. Within the first category, 'Audio-visual equipment' continued to record negative annual inflation rates, standing at -5.5 percent in the second half of the year.

Within the second category, fuel prices declined substantially in December by 7.7 percent, which along the negative rate marked in November, represent the first decline of the inflation rate in 'Service to personal vehicles' (wherein oil is included), following a long period of high inflation which started in the middle of 2007. Although the fall in fuel prices in the domestic market did not progress as expected by consumers – albeit more evident than in the previous months – along with the satisfactory situation of prices in the food and energy supply markets, have established an environment characterized by low domestic inflation pressures.

Chart 8 Annual inflation by categories of goods and services (in percent)
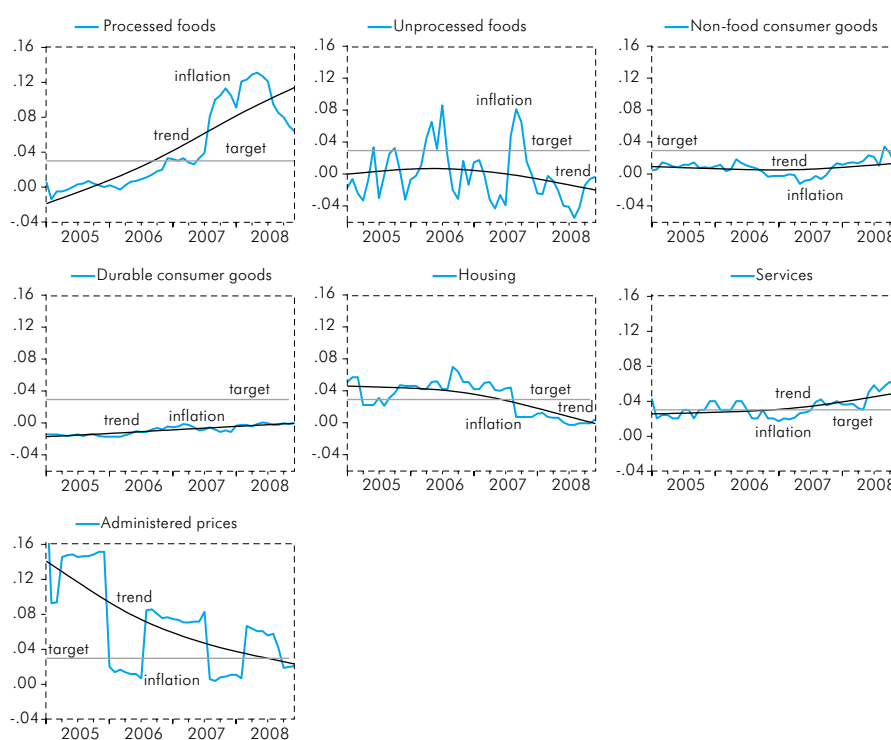
Source: INSTAT and Bank of Albania estimations

3.2 INFLATIONARY TRENDS BASED ON OTHER INFLATION MEASURES

Headline and core inflation marked higher average rates than their historical trend. However, the developments in headline inflation rates over the second half of 2008 converged to the average rates of main core inflation measures (2.5-3.0 percent) or to its long-term trend. The downward trend of annual core inflation over the second half of 2008 attests to the mitigation of inflationary pressures - mostly determined by demand-side factors - at home.
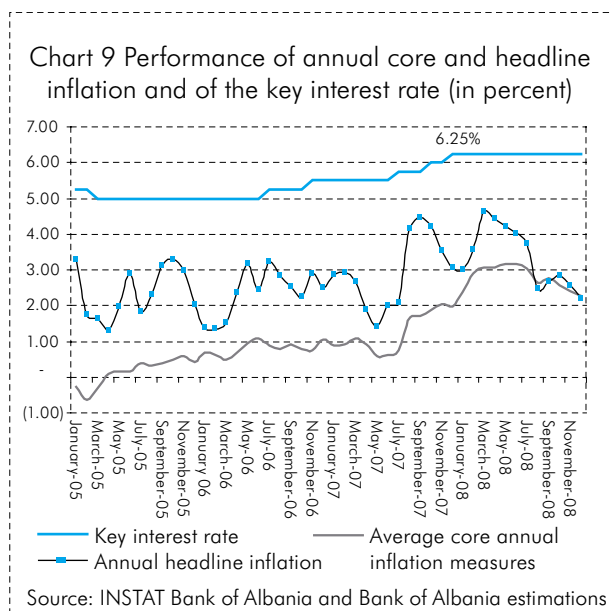
Core inflation, computed using the permanent exclusion method, marked 3.0 percent in December 2008 – the lowest rate for the year 2008. Despite the positive developments in core inflation, mainly over the last quarter, its 12-month average stood above the average rates of annual headline inflation. Global developments in the prices of consumer goods, basic commodities and production affected inevitably the performance of some primary commodity prices in the domestic consumer basket, which generally remain almost 'frozen' or are highly stable over the time. In particular, 'Bread and cereal' provided the main contribution to the high core inflation rates over the entire year 2008. If excluded, inflation would mark quite stable rates and close to 2 percent.

Chart 9 Performance of annual core and headline inflation and of the key interest rate (in percent)

Source: INSTAT Bank of Albania and Bank of Albania estimations

The downward trend in the inflation of traded goods and services is assessed to have contributed the most to the moderation of inflationary pressures in economy over the second half of 2008. In response to the more contained price rise rates in Albania's main trading partners and in the Euro area, as well as in raw materials and primary commodities, traded inflation stood at 2.1 percent[15] in the second half of 2008. In December 2008, traded inflation marked 1.3 percent, which is the lowest since fall 2007.

Table 6 Different measures of annual core inflation by price (in percent)[16]

CPI annual change	Share in the CPI basket (%)	2006	2007	2008				
				Q1	Q2	Q3	Q4	12-month average
Total (CPI)	100.0	2.4	2.9	3.7	4.2	3.0	2.5	3.4
a. Core (permanent exclusion)	77.0	1.1	1.7	3.7	4.1	3.7	3.2	3.8
- Core (permanent exclusion, excluding 'bread and cereal')	70.0	1.1	1.1	1.9	2	2.2	2.1	2.1
b. Core (trimmed mean, 30%)	Average for 2008 60.0	0.7	0.7	1.7	1.8	1.6	1.7	1.7
Average of the two measures (a and b)	68.5	0.9	1.2	2.7	2.9	2.7	2.5	2.8
By price								
Traded	62.0	1.7	2.3	3.9	4.1	2.4	1.9	3.1
Non-traded	38.0	3.7	3.9	3.4	4.4	4	3.5	3.8
- Non-traded, excluding administered prices	33.0	3	2.7	2.9	2.8	3.0	1.9	2.7

Source: INSTAT and Bank of Albania estimations

Non-traded inflation of goods and services also recorded more moderate increasing rates over the last quarter of 2008 (3.5 percent). However, its average annual rate was relatively high due to the administrative decisions taken over the year on the price rise of some goods and services 'sensitive' to consumer budget. The exclusion of the latter's effect would reduce average annual inflation by about 1 percentage point or to 2.7 percent. The downward tendency of the average core and non-traded inflation measures, excluding the administrative effects, over the last two quarters of 2008, and the rate convergence of these two measures close to 3 percent for the year 2008 attest to the mitigation of demand-side inflationary pressures and the appropriate stance of monetary policy in the decision-making process over the course of the last two years. The latter is considered to have contributed to a better balancing of supply-side factors which have been quite active in the increase of inflation rates over the first half of 2008.

4 MACROECONOMIC DEVELOPMENTS AND THEIR IMPACT ON INFLATION

4.1 AGGREGATE DEMAND AND OUTPUT

Economic activity in Albania continued to record high growth rates over the course of the third quarter of 2008. In terms of volume, turnover indicator[17] recorded an annual growth of about 19.1 percent. Manufacturing sector provided the main contribution to the growth in the volume of turnover indicator, where construction continues to share the main weight in this sector.

The positive developments in domestic production over the third quarter of 2008 are also underpinned by the increase in the Economic Tendency Indicator (ETI[18]), obtained from the business and consumer opinions as in the previous quarter.

Over the course of the third quarter of 2008, turnover indicator recorded a higher growth rate in terms of volume in the sector of manufacturing. In industry, this indicator increased by as much as five times at an annual level, compared with the previous two quarters, to 15.6 percent. Processing industry recorded an annual increase of about 18.5 percent. Turnover indicator in construction has maintained the high growth rates of the first half of 2008, reaching 51.1 percent in annual terms. Investment in major road infrastructure projects and the recovery of construction permits from the

Chart 10 Contribution of economic sectors to economic growth (in percentage points)

Industry | Services
Construction | Production and services
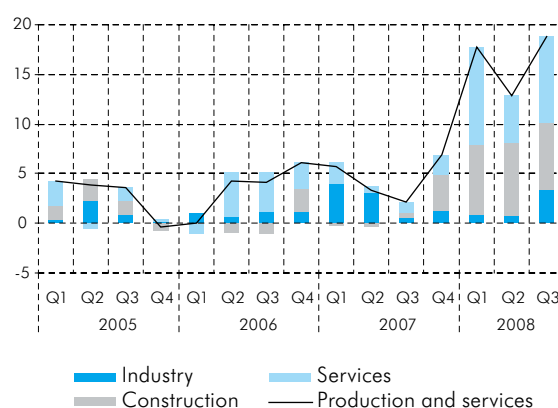
Source: INSTAT, Conjuncture: Main economic indicators: July-September 2008, Bank of Albania estimations
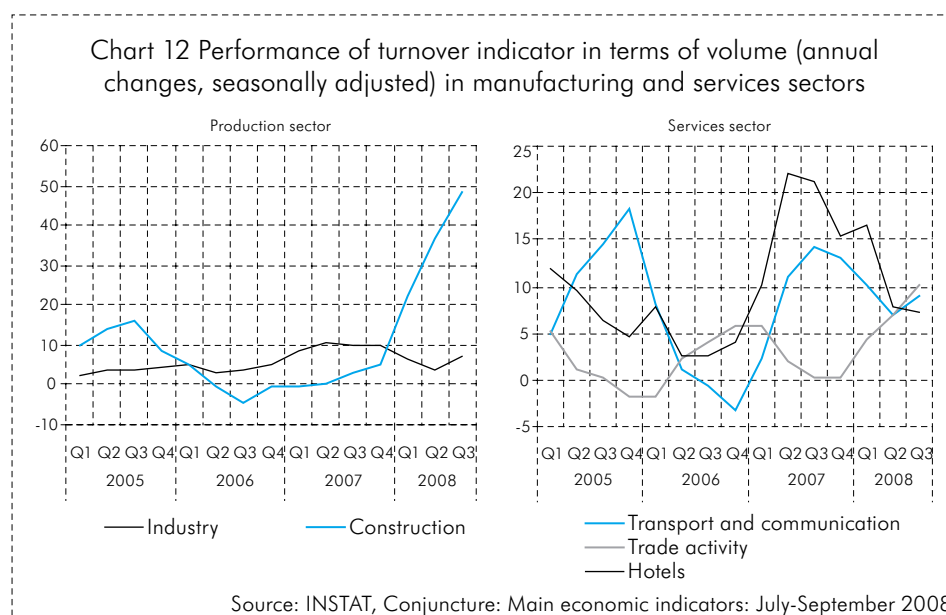
Chart 11 Economic Tendency Indicator (right-hand axis) and the annual change of turnover indicator (left-hand axis)

Production and services (turnover indicator)
ETI (right-hand axis)
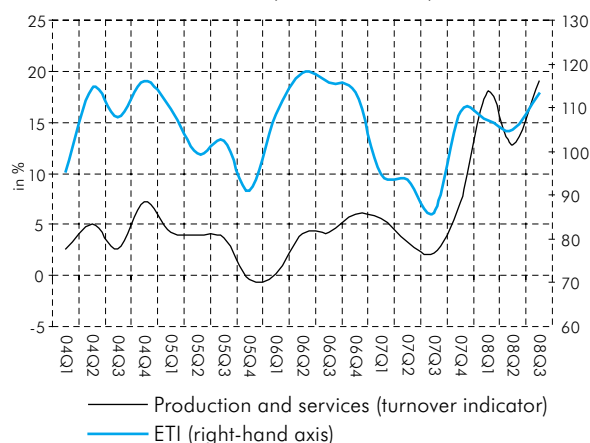
Source: INSTAT and Bank of Albania

prolonged constraints triggered high growth rates in construction activity over the first nine months of 2008.

In terms of volume, the annual increase of turnover indicator in the services sector was about 13.3 percent over the third quarter of 2008. Transport and communication services had a better performance with respect to turnover indicator. Trade activity increased by about 12.2 percent over the third quarter, while hotel services remained at almost the same levels as in the previous year.

Chart 12 Performance of turnover indicator in terms of volume (annual changes, seasonally adjusted) in manufacturing and services sectors

Source: INSTAT, Conjuncture: Main economic indicators: July-September 2008

The main indicators of energy sector attested to a positive performance over July to November 2008. The favourable hydric situation led to substantial increase of domestic production, which was followed by the fall in the import of energy.

Table 7 Annual growth rate of energy balance sheet indicators over July to November (in percent)

	2005	2006	2007	2008
Net production	3.6	8.0	-50.4	50.6
Import	-58.9	87.6	318.5	-32.8
Distribution	1.9	9.1	-15.0	15.0
Distribution losses	20.3	19.0	-33.9	8.1
Technical losses	8.5	21.1	-33.5	17.1
Non-technical losses	39.5	16.4	-34.4	-3.8
Energy supply shortages	475.3	-47.0	288.7	-18.8
Domestic demand	8.0	2.4	2.5	8.9
Consumed energy	0.2	29.1	-7.5	13.1
Invoiced consumption	-5.6	-1.1	3.5	16.2
Un-invoiced consumption	39.5	169.0	-26.1	5.8
Household consumption	-5.5	-0.8	-4.0	10.7
Non-household consumption	-5.6	-1.6	14.8	23.0

Source: KESH

Domestic demand for energy grew by about 9 percent over this period, with the private sector contributing the most. The increased collection by

10.1 percent over July to November 2008 is assessed to reflect the improved energy invoicing and the annual price rise of this product in the market.

Box 2   Importance of complete quarterly statistics on Gross Domestic Product

Uses of quarterly GDP statistics
Quarterly Gross Domestic Product (GDP) is one of the key indicators of quarterly National Accounts. It provides macroeconomic information on a quarterly basis. Hence, it provides more frequent information on the performance of economy in current periods than the annual GDP indicator. GDP quarterly data play an important role in the economic decision-making process. They provide timelier indicators than the annual data on economic activity and developments in a country or a group of countries. GDP quarterly data assist economic analysis since they manage to examine the economic activity and its level compared with the long-term trend or the business cycle, judging upon the movements and the turning points in economy in a given moment within a year. Annual GDP tends to 'hide' or 'flatten' these movements, since they are inclined to terminate over the time. Quarterly GDP data are key information which serve to the forecasting and modelling process of macroeconomic indicators in the short and medium term. In addition, they assist in the study and analytical process. Over the past 15 years, the methodologies of measuring the quarterly GDP series are being standardized, in order for their indicators to be comparable among the countries and country-groups.

On the quarterly GDP series published by the international institutions
OECD and Eurostat provide a rich database on the time series of quarterly GDP (by country/country-group as well as the total GDP of components). Among its components, the most important are as follows: GDP by type of expenditure and type of activity; gross fixed capital formation by sectors and type of production; private final consumption by type of expenditure and entity. All these series are expressed in constant and current prices. In addition, the quarterly GDP data provide the series of capital formation financing and the GDP by cost structure at current prices[19].

Some methodological aspects of quarterly GDP estimation in Albania
The first official estimation of quarterly GDP was conducted by the INSTAT. It was followed by a special publication (December 2008), which provided some methodological explanatory notes[20] in addition to the results given. The first publication of quarterly GDP covers the Q1:2004–Q3:2008 period, maintaining the consistency with the past GDP annual growth. Quarterly GDP series has been constructed based on the quarterly GDP assessment by sectors of economy in an indirect way. The indirect method has used different economic indicators (monthly and quarterly), which help to assess macroeconomic developments at home in the previous periods. The identification of economic time relationships between conjunctural indicators has helped to estimate the value added by sectors of economy. Developments in the sales index in economy (one of the most correlated indicators with production) have determined the rates in value added. This method allows the use of available conjunctural information on past periods in order to obtain quarterly GDP figures on the economy and by sectors of economy in the following periods. The estimates have been made at both current and constant prices (average prices in 2005). The published series are seasonally adjusted. Quarterly GDP is subject to future revision. GDP data are expressed as quarterly and annual rates of change in GDP figures.

One the way to using quarterly GDP

Being a user of official statistics, the Bank of Albania uses some indicators which relate to the developments in the real sector of the economy. In addition to short-term statistics (INSTAT), sales in absolute value (INSTAT), business and consumer confidence indicators (BoA), assessments and forecasts of macroeconomic indicators (BoA), the quarterly GDP (INSTAT) will be added to this set. The use of this indicator in the Bank of Albania decision-making process will be gradual for some important reasons.

First, the quarterly GDP is not a measure but an estimate that is subject to constant revision. The measuring of an indicator is more accurate than its estimate, which is more exposed to uncertainty.

Second, the Bank of Albania will estimate the quarterly GDP series after it has made the consistency analyses with a number of indicators on the real sector of economy. This step assists the past and future decision-making analysis.

Third, the availability of a longer quarterly GDP series, which is quantified by the expenditure method, would assist the central bank's experts, in particular in making the consistency analyses.

In conclusion, it is a known fact that the thorough understanding of the quarterly GDP estimation methodology by experts helps to make accurate analyses of the economy. The latter are an essential tool in the monetary policy decision-making process. The broad understanding of all methodological aspects is a crucial preliminary phase that will serve to the right use of this indicator in the future.
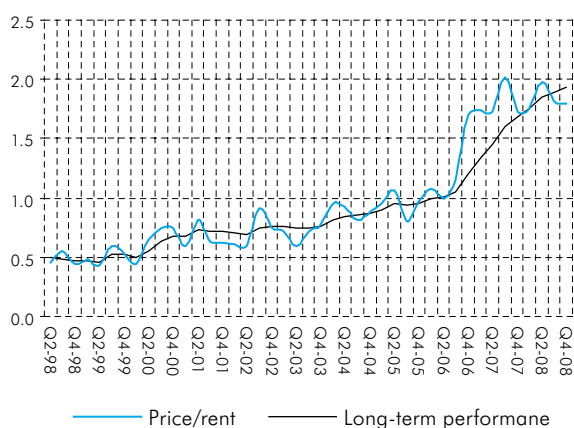
HOUSE PRICES

House prices recorded a slight annual decrease over the last quarter of 2008 (0.9 percent), which followed the more considerable decrease of the House Price Index[21] in the preceding quarter[22] (4.3 percent). Average annual change of the House Price Index for the year 2008 stood at -0.3 percent, in contrast to the two-digit growth rates over the 2005-2007 period (by an average of +16 percent). Compared with the previous quarter, the House Price Index increased by 12 percent in the last quarter of 2008. The performance of house prices starting from the first quarter of 2008 has followed the increase in the number of construction permits. As of end the third quarter, the value of residential building permits was about 10 times higher than in the same period the preceding year.

The performance of house rents over the year 2008 displays higher volatility than house prices, however showing a more apparent downward tendency. In the last quarter of 2008, the rent index fell by 4.9 percent compared with the same period the previous year. Relative to the previous quarter,

Chart 13 Price-rent ratio and its long-term performance
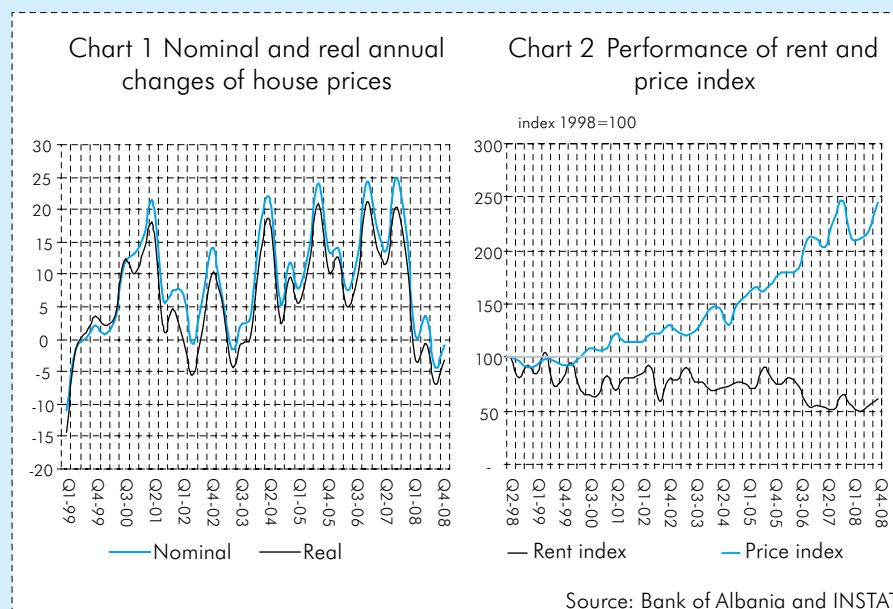
Price/rent — Long-term performane

Source: INSTAT and Bank of Albania

the rent index increased by 12 percent. The increase in the House and Rent Price Index in quarterly terms mainly relates to seasonal factors.

The price-rent ratio[23] did not undergo significant changes over the last quarter of 2008 compared with the previous quarter, maintaining its long-term tendency. The historical performance of this ratio indicates that starting from the end-2006, house prices have increased at faster rates than rent prices. This ratio recorded the highest value in the third quarter of 2007, to later show signs of downward tendency. However, the price-rent ratio is currently about twice higher than its average for the 1998-2008 period.

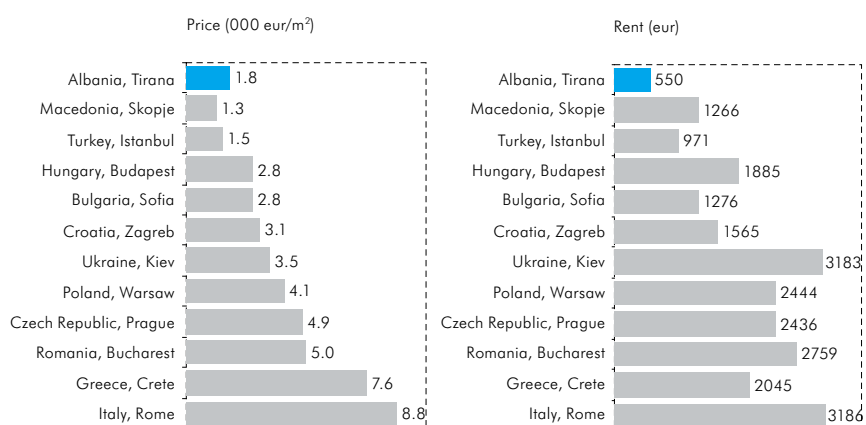*Box 3 A comparative insight on house and rent prices[24]*

House prices have risen significantly over the last decade. After having recorded only positive growth rates starting from the year 2003, the house price index – which refers only to the city of Tirana – showed signs of slowdown in 2008. By contrast, the rent index shows a general downward tendency, albeit the more volatile annual growth rates than the house price index. For the 1998-2008 period, average annual change rate of the house price index was about 9 percent. Data on the house market show that their price rise slowed down in early 2008. If we deflate the fall of prices in the last quarter, then the fall of house prices would be even higher in real terms (3 percent). The price rise in Tirana has not been uniform: the price rise in the centre is twice higher than the price rise in the suburbs. The slowdown in the house price rise was followed by the increase in the number of construction permits in the first quarter of 2008 (21 percent) after a one-year period of decrease. On the other side, the banks' lending survey shows that the lending terms banks have applied on house loans have tightened, hence leading to the relative fall of demand.

Chart 1 Nominal and real annual changes of house prices

Chart 2 Performance of rent and price index

index 1998=100

Source: Bank of Albania and INSTAT

Price/rent ratio[25] has been increasing. Although this indicator showed a downward tendency in the last quarter of 2008, its value is 1.9 times higher than its long-term average (1998-2008). This indicator suggests that house prices have risen at more accelerated rates than their rents.

The following chart shows that although the house price in Albania is relatively lower than in other countries, the cost of rent is the lowest. Based on the latest data, the ratio between the price of an average apartment to the annual price of rent for the same apartment is one of the highest among the countries taken under consideration.

Chart 3 Average price and rent for an average apartment (located in the centre of the city and with an area of 120 m²)

Price (000 eur/m²)

Location	Price
Albania, Tirana	1.8
Macedonia, Skopje	1.3
Turkey, Istanbul	1.5
Hungary, Budapest	2.8
Bulgaria, Sofia	2.8
Croatia, Zagreb	3.1
Ukraine, Kiev	3.5
Poland, Warsaw	4.1
Czech Republic, Prague	4.9
Romania, Bucharest	5.0
Greece, Crete	7.6
Italy, Rome	8.8

Rent (eur)

Location	Rent
Albania, Tirana	550
Macedonia, Skopje	1266
Turkey, Istanbul	971
Hungary, Budapest	1885
Bulgaria, Sofia	1276
Croatia, Zagreb	1565
Ukraine, Kiev	3183
Poland, Warsaw	2444
Czech Republic, Prague	2436
Romania, Bucharest	2759
Greece, Crete	2045
Italy, Rome	3186

Source: Bank of Albania, Global Property Guide and Bank of Albania estimations

* This indicator is determined by dividing the average price of an apartment in the centre of the main cities with an area of 120 m² by the cost of average rent for the same apartments multiplied by 12 months: Indicator = price/annual rent

4.1.1 External sector developments

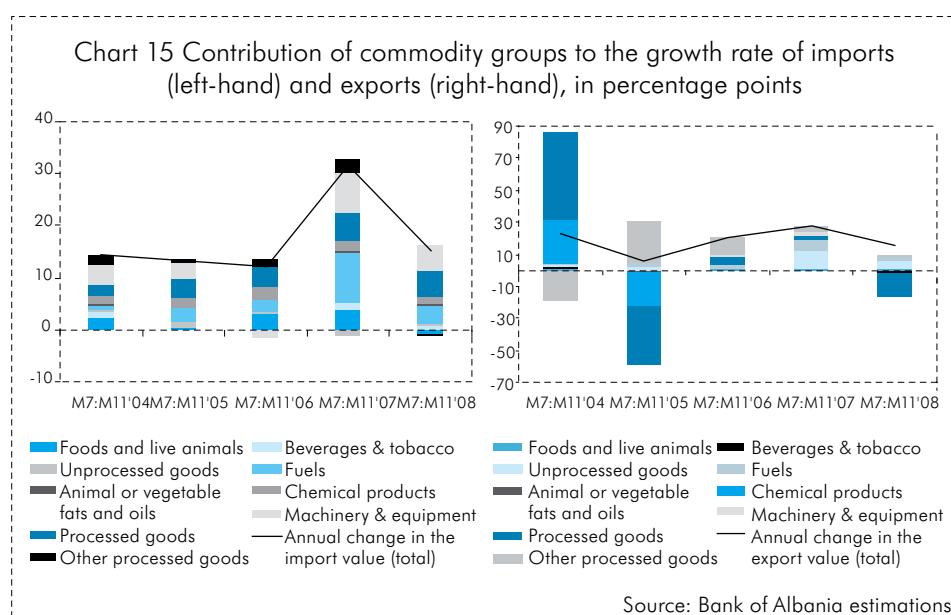*CURRENT ACCOUNT AND FOREIGN TRADE DEVELOPMENTS*

Current account deficit increased by 48 percent in annual terms to about 252 million euros over the third quarter of 2008. As a share of GDP, it accounts for about 13.7 percent, which is 5 percentage points higher than the same period the previous year[26]. In addition to the trade deficit widening, the deepening of current deficit over this period was also triggered by the narrowing of the positive balance of revenues and current transfers' account.

The volume of current transactions grew by 4.4 percent in annual terms. Current expenditures were mainly used for the purchase of goods and services (95 percent), while current inflows were principally in the form of private current transactions and travel services (56 percent)[27]. Deficit in trade in goods recorded an annual decrease of 10.5 percent over this period, accounting for about 28 percent of the GDP. Services account balance recorded a surplus of about 74 million euros, where travel services contributed by 83 and 78 percent, respectively, to the export and import of services. The net positive result of 63.2 million euros in the incomes account recorded an annual decrease of 14.6 percent, where the contraction in labour inflows[28] provided

Chart 14 Current account (left-hand side) and the balance of payments (right-hand side) as a share of GDP

Source: Bank of Albania and IMF assessments
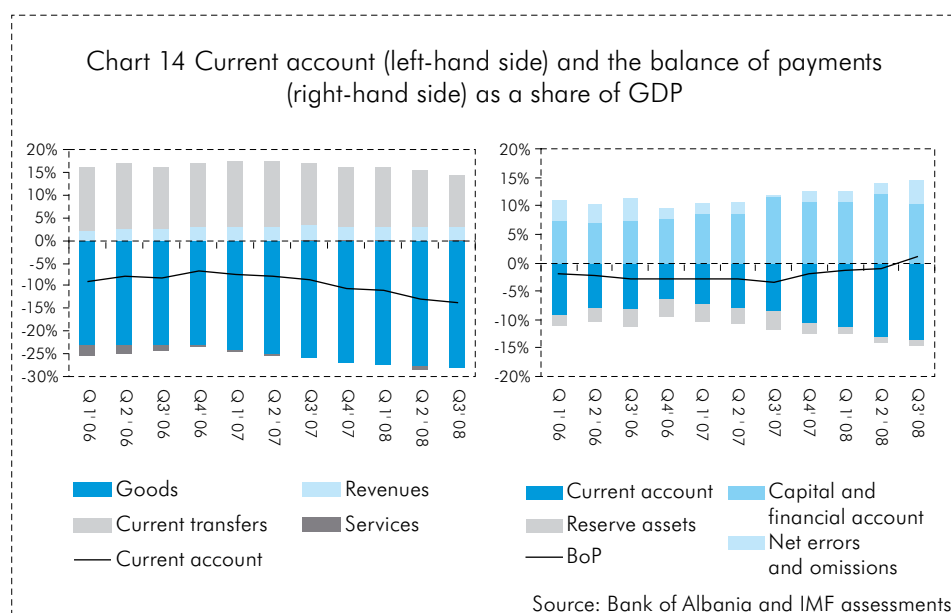
the main contribution. Investment income - mainly portfolio investment - increased by 11.4 percent. Workers' remittances recorded an annual drop by 28.2 percent over the third quarter of 2008, financing about 30 percent of the deficit in trade in goods.

Trade exchanges grew by 15.4 percent in annual terms to 1.95 billion euros over July to November 2008. Imports and exports of goods recorded an annual increase of 15.23 and 16.09 percent, respectively, while the coverage of imports by exports was 25.3 percent. Excluding the contribution of fuels, imports and exports of goods over this period would have grown by 13.8 and 15.2 percent, respectively.

Chart 15 Contribution of commodity groups to the growth rate of imports (left-hand) and exports (right-hand), in percentage points

Source: Bank of Albania estimations

In annual terms, imports and exports fell slightly in November. Maintaining the downward tendency of the preceding months, the decline in the import and export of fuels by 39 and 45 percent, respectively, provided the main

contribution. 'Unprocessed goods', 'Machinery and equipment', 'Processed goods' and 'Beverages and tobacco' recorded the highest annual growth in the import value. The favourable weather conditions in Albania are considered to have principally triggered the decline in the import of fuels.

With reference to exports, 'Animal or vegetable fats and oils', 'Fuels' and 'Beverages and tobacco' recorded the sharpest annual decline. By contrast, the export of 'Chemical products', 'Processed goods' and 'Foodstuffs and live animals' recorded growth.

Table 8 Imports and exports by commodity groups (in million euros) and annual changes

Commodity groups	Imports		Exports	
	November 2008	Change (%)	November 2008	Change (%)
Foodstuffs and live animals	34.65	-29.37%	4.24	18.23%
Beverages and tobacco	8.44	35.29%	0.10	-18.38%
Unprocessed goods	8.00	46.16%	7.54	-8.11%
Fuels	39.50	-38.71%	3.25	-44.96%
Animal or vegetable fats and oils	2.80	-28.67%	0.00	-86.76%
Chemical products	31.03	-0.08%	0.93	139.90%
Processed goods	84.30	36.05%	20.51	31.89%
Machinery and equipment	75.20	38.04%	3.89	5.67%
Other manufactured goods	30.98	-21.90%	33.52	-10.43%
Miscellaneous	-	-	-	-
Total	314.90	-0.44%	73.98	-1.21%

Source: Bank of Albania estimations

The structure of trade exchanges by partner countries attests to their high concentration with the EU member countries (about 62 percent). Italy, Greece and Germany[29] remain Albania's main trading partners in terms of total trade exchange volume with the EU member countries. China, Turkey, Macedonia and Kosovo[30] rank among the non-EU member countries.

Box 4 Unit value indices, value indices and volume in foreign trade indices

Unit value indices in foreign trade are calculated by the INSTAT based on the detailed statistics by products, in value and quantity, provided every month by the Customs General Directory. These indices capture the changes in average prices of aggregate imports and exports, assuming that the imported and exported quantities remain unchanged[31]. Thus, these are not price indices, but rather average value indices which express the ratio performance of exchanged value/quantity to the reference period[32]. Average values are initially calculated at a detailed level; then they are aggregated using the values of the surveyed quarter as a weighting coefficient. However, unit value indices as other indices in general, feature some advantages and disadvantages[33]. From the unit value index we can generate another important index, Terms of Trade Index (TTI), which results from the following formula:

*TTI = (Export unit value index/import unit value index) *100*

If the Terms of Trade Index number increases, it is described as a favourable movement as a unit of exports will buy more imports. If the Terms of Trade Index number decreases, it is described as a worsening or deterioration of the terms of trade, as a unit of exports will buy fewer imports. In the Albanian case, for instance, this index has for several quarters recorded high positive growth rates, which is a positive development, albeit the downward growth rate in the third quarter of the year 2008.

Import (Export) Value Index is as simple to calculate as it is important for the calculation of other indices. The ratio between import (export) value index and the import (export) unit value index yields the import (export) volume index. The value index is computed using the following formula:

Value index = (Vi / Vo)*100

Vi = Current value of imports or exports in the reference period;
Vo = Arithmetic average of import or export values in the base year.

From where:

Volume index = (Value index/Unit value index)*100

A major aim of economic analysis is to develop an understanding of changes taking place in an economy over time. To achieve this, it is necessary to distinguish between changes arising solely from price changes and those arising from other influences such as quantity and quality, which are referred to as changes in 'volume'. Volume indices provide a broader understanding of these changes and help us derive more accurate conclusions on the fact that the developments in one country's trade exchanges with the rest of the world owe to the developments in price performance or for instance to the performance of demand in trading partners.

Chart 1 Terms of Trade Index for Albania (left-hand axis) and its annual performance (right-hand index, in percent)

Annual change of Terms of Trade Index
Terms of Trade Index

Source: INSTAT and Bank of Albania estimations
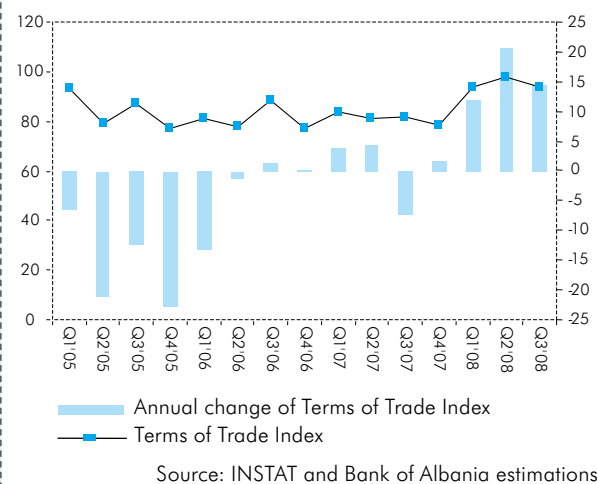
CAPITAL AND FINANCIAL ACCOUNT

Capital and financial account recorded a positive net flow of about 170 million euros in the third quarter of 2008 or 44 percent lower in annual terms. Capital transfer inflows amounted to about 27 million euros, while the financial liabilities of residents totalled 142 million euros. The net flow of this account finances about 67 percent of current deficit and accounts for 10.3 percent of the GDP. Net foreign direct investment amounted to 124 million euros over the third quarter of 2008 or about 45 percent lower than in the same period the previous year.

As of end the third quarter, 'Errors and omissions' amounted to 201 million euros, causing the overall balance of payments to record positive values that are reflected in the increase of reserve assets by 118.5 million euros. Foreign reserve totalled about 1.6 billion euros, sufficient to cover 4 months of imports of goods and services[34].

4.1.2 Fiscal indicators and fiscal policy

The fiscal policy for the year 2008 has been pursued in line with the macroeconomic and fiscal framework for the three-year period 2008-2010. The expansionary stance of fiscal policy after the first half of 2008 was reflected in the widening of budget deficit, which amounted to 22.0 billion leks as of end November 2008.

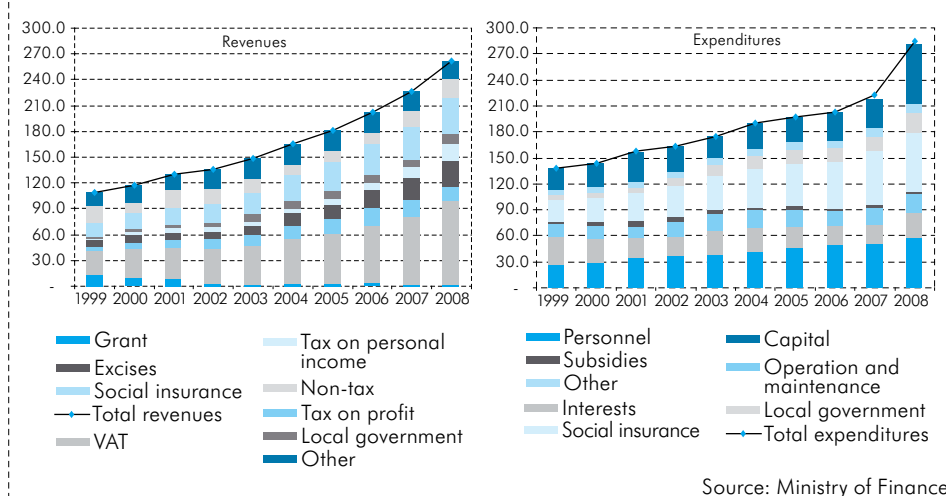*Table 9 Performance of main fiscal indicators until November, 2007-2008*

	Realization in 2008 (in billion leks)			Cumulative (in billion leks)		Realization of the 11-month plan[35] (in %)	
	Q 1	Q 2	Q 3	November 2008	November 2007	November 2008	November 2007
Total revenue	63.6	71.4	73.9	262.5	226.4	96.42	96.10
Tax and customs	46.9	49.2	53.9	185.9	160.3	97.85	98.70
- VAT	24.0	25.7	28.3	97.6	80.1	101.79	100.40
- Tax on profit	6.1	3.8	3.6	16.8	18.9	100.10	91.50
- Excise	6.5	8.4	9.9	29.9	26.1	88.71	100.90
- Tax on personal income	4.8	5.2	6.7	20.4	12.9	99.87	114.20
Local government	2.4	3.1	2.9	10.4	8.6	76.50	73.40
Social insurance contributions	11.1	11.3	11.8	43.2	36.9	94.29	95.90
Non-tax	3.1	7.4	5.1	21.6	19.3	111.61	92.60
Total expenditure	53.1	84.2	80.1	284.4	222.3	92.09	85.00
Current expenditure	48.1	59.8	61.8	212.8	189.4	94.29	91.80
- Personnel	14.2	15.8	16.4	58.1	50.9	98.14	93.00
- Interest	6.9	8.1	7.9	28.6	22.9	97.66	88.90
- Operation and maintenance	3.7	6.8	6.2	22.2	19.5	89.11	93.80
- Social insurance	16.6	18.4	20.4	68.1	62.1	96.81	97.70
- Local government	3.8	6.7	6.7	22.4	16.7	83.85	77.50
- Other expenditure	2.6	3.4	3.5	11.8	10.2	92.35	84.00
Capital expenditure	5.1	22.9	17.5	69.2	32.8	87.72	61.10
Budget balance	10.5	- 12.8	- 6.1	- 21.9	4.2	59.87	- 16.10
Domestic financing	- 10.6	11.8	- 11.5	- 11.2	- 6.8	- 179.45	- 39.50
- Privatization	0.1	0.3	0.4	1.0	13.2	35.25	109.50
- Domestic borrowing	5.5	6.1	1.9	2.7	11.8	79.50	61.40
Foreign financing	0.1	1.1	17.6	33.1	2.6	109.08	30.50

Source: Ministry of Finance

Budget revenues continued to perform satisfactorily over July to November 2008. Budget revenues collected as of end November have met the 11-month plan of the Ministry of Finance by about 96.4 percent. Excise and local government revenue recorded the main difference between the plan and the factual realization of total revenue. The non-realization of the 11-month plan for excise revenue by about 3.8 billion leks owes to the decline in the prices of goods that are subject to excise[36] in the global markets.

In nominal terms, the revenues collected over the 11-month period totalled 262.4 billion leks, recording at the same time the highest annual increase (16 percent) of the last nine years. In addition to certain items that have historically provided a positive contribution to the increase in revenues - VAT, excise and social insurance contributions -, tax on personal income has been providing an increasing contribution over the year 2008.

Chart 16 Structure of revenue and expenditure as of end November for the 1999-2008 period (in billion leks)

Revenues

Expenditures

Grant
Excises
Social insurance
Total revenues
VAT

Tax on personal income
Non-tax
Tax on profit
Local government
Other

Personnel
Subsidies
Other
Interests
Social insurance

Capital
Operation and maintenance
Local government
Total expenditures

Source: Ministry of Finance

Compared with the previous two years, the Ministry of Finance has been more active in carrying out the budget expenditure over the second half of 2008. The 11-month plan has been met by 92 percent while about 21 percent of total expenditure planned for the year 2008[37] will be carried out in December.

As of end November 2008, expenditure recorded an annual increase by about 28 percent, which as in the case of budget revenues represents the highest rate for the decade. Expenditures on wages and salaries and on social insurance continue to provide the main contribution. Investment expenditure – 50 percent of which is used for the construction of Durrës-Kukës road – have contributed to total increase of expenditure by about 6.8 percentage points[38] over the year 2008. In addition, the 11-month period recorded the highest ratio of capital expenditure (about 24 percent) to total expenditure of the last nine years[39].

Although the revenues have shown an accelerated growth rate over October and November 2008, the increase of expenditure at higher rates than revenues led to budget deficit deepening, which as of end November 2008 totalled 21.9 billion leks from the planned amount of 36.6 billion leks.

In contrast to the same period the previous two years, budget balance has recorded negative values starting from the end of the first half of 2008, standing below the level planned by the Ministry of Finance.

BUDGET DEFICIT FINANCING
Budget deficit created after the first half of 2008 was mainly financed through foreign resources.

Chart 17 Annual nominal change of revenue and expenditure as of end November for the 2000-2008 period (in percent)

Total revenues   Total expenditures

Source: Ministry of Finance
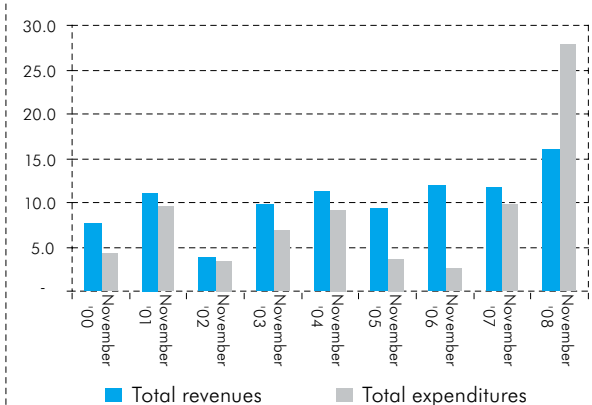
The highest amount of Government domestic borrowing was recorded in September 2008 - about 13.4 billion leks. This amount reduced in the months to follow reaching 2.7 billion leks as of end November. The reduction of domestic borrowing owes to the absence of market demand for some debt instruments issued by the Government in October and November 2008.

Table 10 Budget deficit financing for the 11-month period, 2001-2008 (in billion leks)

	November 2001	November 2002	November 2003	November 2004	November 2005	November 2006	November 2007	November 2008
Budget balance	- 27.5	- 27.9	- 25.6	- 24.8	- 16.3	0.2	4.2	- 21.9
Domestic financing	18.2	13.5	19.4	19.7	11.9	- 5.8	- 6.8	- 11.2
- Privatization	12.7	0.4	0.9	9.1	0.9	2.1	13.2	1.0
- Domestic borrowing	10.1	15.2	19.1	13.1	15.9	4.6	11.8	2.7
Foreign financing	9.2	14.4	6.2	5.1	4.3	5.6	2.6	33.1

Source: Ministry of Finance

Chart 18 Primary deficit moving sum for the preceding 12 months, December 1999-November 2008 in billion leks)[40].
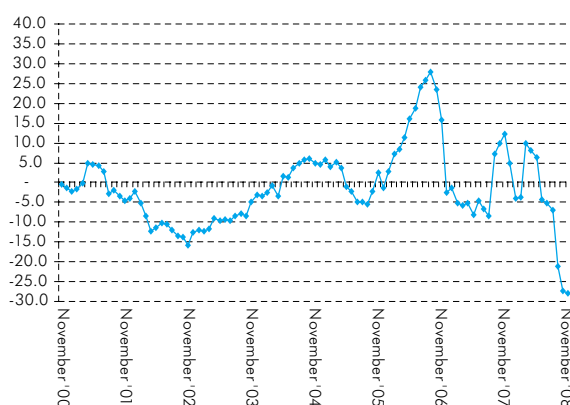
Source: Ministry of Finance, Bank of Albania estimations

Foreign financing of the Albanian deficit totalled 33.1 billion leks for the 11-month period, compared with the planned 30.3 billion leks. The loan obtained for the financing of Durrës-Kukës road shares the most considerable part. In addition, the further deepening of primary deficit, in particular over the last quarter of 2008, reflects the increase in the public debt stock, primary of the foreign one.

As of end 2008, short-term debt stock accounted for about 62 percent of total domestic debt, compared with 67 percent it accounted for as of end the previous year. The extension of the maturity term in the Government securities' portfolio represents one of the priorities in domestic borrowing policy.
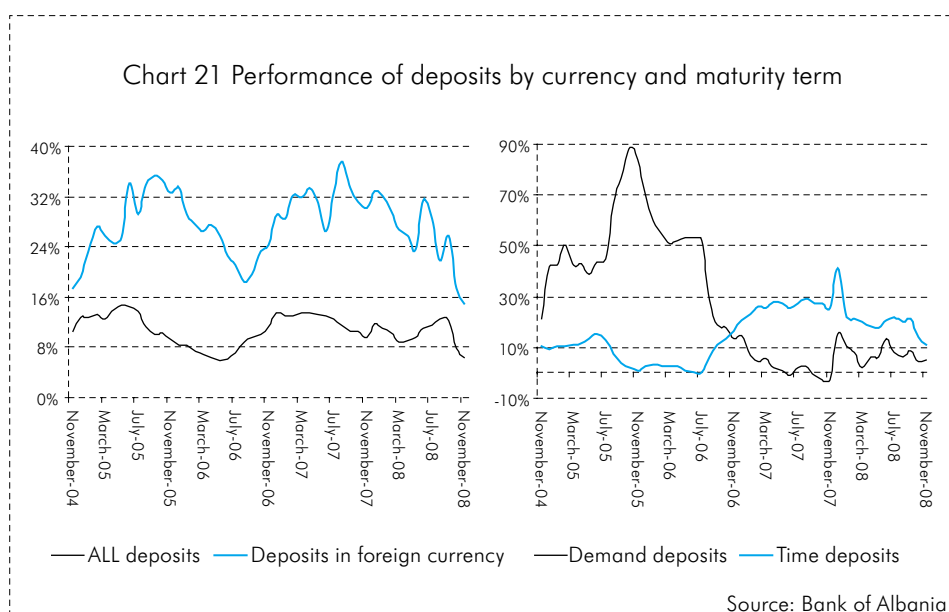
4.1.3 Monetary developments

Monetary indicators had a stable performance over the second half of 2008, although the end of the period showed signs of their downward growth rates. Average annual growth rate of M3 aggregate was about 13 percent, while M2 aggregate in lek maintained its upward trend. The performance of net domestic assets reflected the deceleration of demand for money in November, compared with the growth rates over the previous period in the year 2008.

Chart 19 Composition of domestic debt by instruments over the 2004-2008 period (nominal, in billion leks)

- T-bills
- 5-year bonds
- 2-year bonds
- 7-year bonds
- 3-year bonds

Source: Bank of Albania

The creation of monetary flows has mainly resulted from the financing of the private sector, which remains high despite the slower growth rates over the last two months. Credit to the private sector

continued to provide the main contribution to money growth by about 10 percentage points in terms of M3.

Chart 20 Annual performance of monetary indicators

Currency outside banks
Deposits in foreign currency
ALL deposits
M3 annual growth

Annual growth —M2 —Base money

Source: Bank of Albania
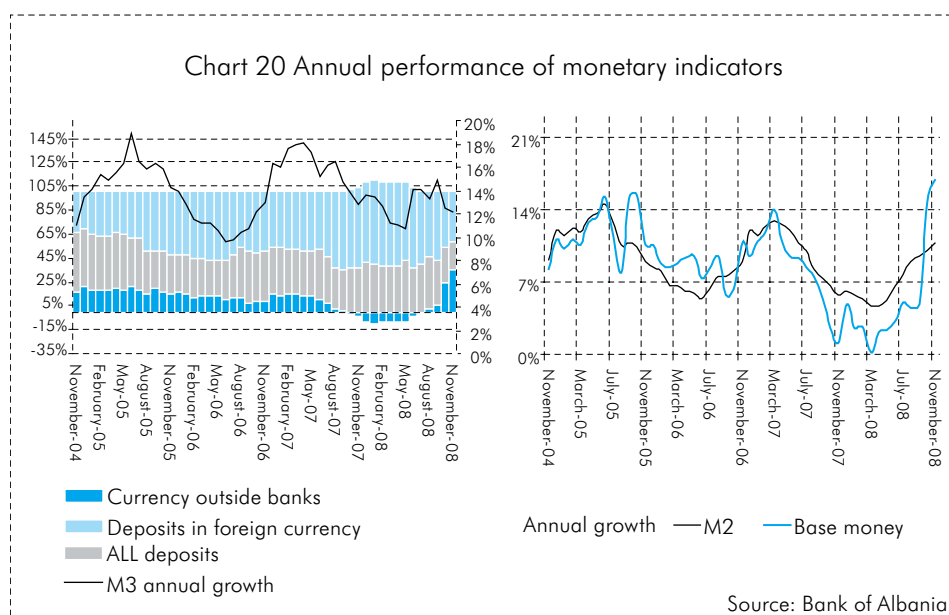
Annual growth rate of broad money increased slightly in the third quarter to above 14 percent to later stabilize at the end of the period and reach the figures recorded over the first half of the year. Slowdown in money supply over the last months of the year reflects the downward annual growth of total deposits to 10.7 percent relative to the annual average of 17.2 percent. The upward growth rate of lek denominated deposits maintained over the second half of the year shifted at the end of the period and reached 7 percent. Foreign currency denominated deposits showed a downward tendency in the second half of the year, which was mainly concentrated in the last two months of the year. Their annual growth rate was 16.2 percent compared with the average of 25.3 percent in the third quarter.

Chart 21 Performance of deposits by currency and maturity term

——ALL deposits ——Deposits in foreign currency ——Demand deposits ——Time deposits

Source: Bank of Albania

In terms of time structure, the growth rate was more weakened in household time deposits, which have the largest share in total deposits, and in business demand deposits. Household time deposits maintained their upward tendency of the first half of 2008, except for the last two months when the growth rate receded by about 15 percent. The performance of business time deposits was highly volatile. A small part of deposits were withdrawn from the banking system in the last months of 2008 as a result of depositors' concerns following the vague situation in the global financial system. Despite the fall in the growth rate of foreign currency denominated deposits, their contribution to M3 growth remains high. As of end period, their share to total deposits was 43.8 percent compared with 33.4 percent the same period the previous year.

Average annual growth rate of M2 aggregate expanded to above 10 percent over the course of the second half of 2008, concentrating mainly at the end of the period. Currency outside banks provided the main contribution to M2 growth. The downward pressures of M2, as a result of the reduced growth rate of lek denominated deposits, were moderated by the more rapid growth of currency outside banks which reached 21.2 percent. As of end November, the ratio of currency outside banks to M2 stood at 32.8 percent, which is above the average ratio for the year 2008. Subsequently, M1 aggregate grew by about 14 percent over this period. This tendency has been also reflected in the creation of high liquid money, base money. In nominal annual terms, base money grew to 9.3 percent over the second half of the year compared with 7.6 percent the same period the previous year.

Chart 22 Performance of M2 aggregate components in lek

Source: Bank of Albania
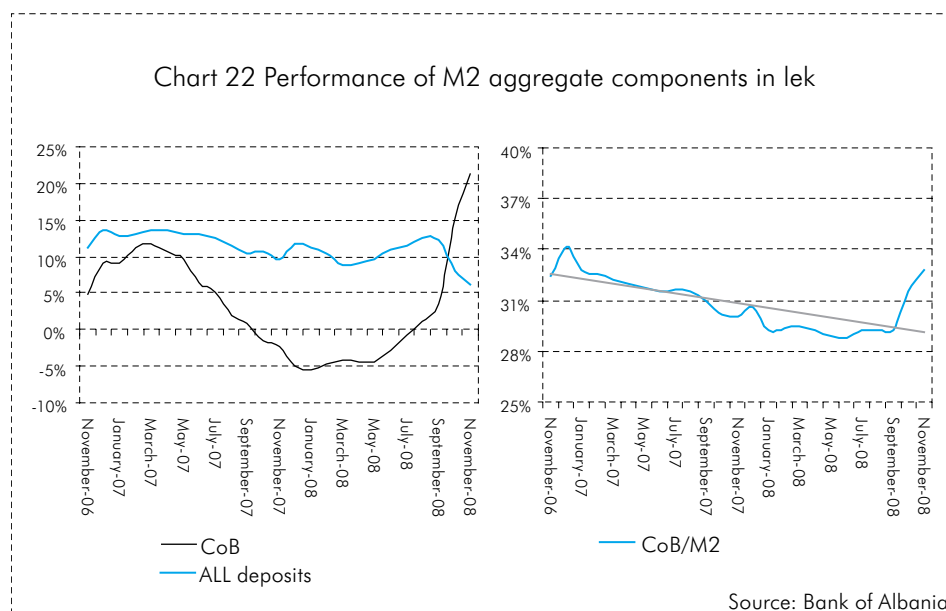
CREDIT TO THE PRIVATE SECTOR

Demand for money fell over the course of the second half of 2008, both from the private and the public sector. The annual growth of loans by an average of 44 percent reduced compared with the first half of the year when it grew by about 46 percent. The slower growth rate of loans owes to the

lower lending to households and the reduced growth of foreign currency denominated loans. In addition, as of end period, new disbursed loans recorded the lowest figures for the year 2008 and lower than the same period the previous year.


Chart 23 Performance of demand for money indicators

Net claims on the government
Credit to economy
Net foreign assets
M3 annual growth

Loans / M3   Loans / Deposits
Annual growth rate of loans
(right-hand scale)

Source: Bank of Albania
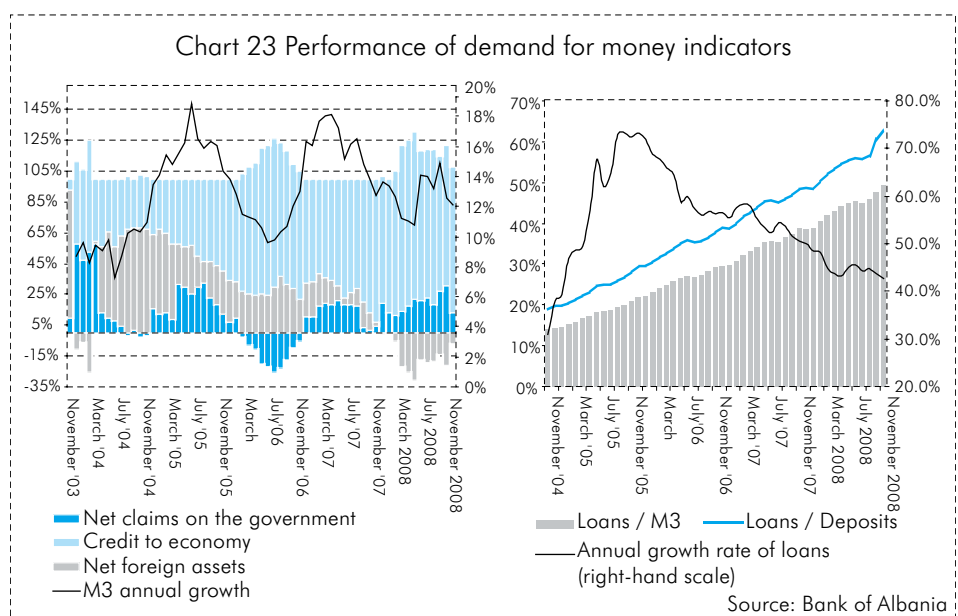
Despite the lower growth rate of loans, the banking system is ever-increasingly sustaining economic activity at home. Being also affected by the more significant decline in the growth rates of money supply and deposits, intermediation indicators increased to 50 and 63 percent, respectively, compared with 45 and 55 percent as of end June 2008.

Following September, the loan portfolio structure by currency shows an increase in the annual growth rate of lek denominated loans to 35 percent, owing mainly to the higher lending to businesses in lek. For the same period, lending in foreign currency has decreased in annual terms to 46 percent from the average of 49 percent the first half of the year 2008. The cost of loans in foreign currency did not seem to observe the easing of monetary conditions in the international markets over the last two months, hence maintaining the summer levels. The preservation of relatively high interest rates and the slackening of lending in foreign currency indicate new policies pursued by commercial banks, which sustain less lending in foreign currency in response to the strengthening of supervision regulations and the reduced liquidity in foreign currency.

The performance of loan portfolio by customer shows higher annual growth rates of business loans to 44 percent in the second half of 2008 compared with the average of 40 percent in the first half of the same year. In the meantime, household loans continued to grow at lower rates, by 39 percent compared with the average annual growth by 52 percent in early 2008. The largest share of business loans (80 percent) finances the main sectors of the economy: trade

Chart 24 Performance of loan portfolio by currency
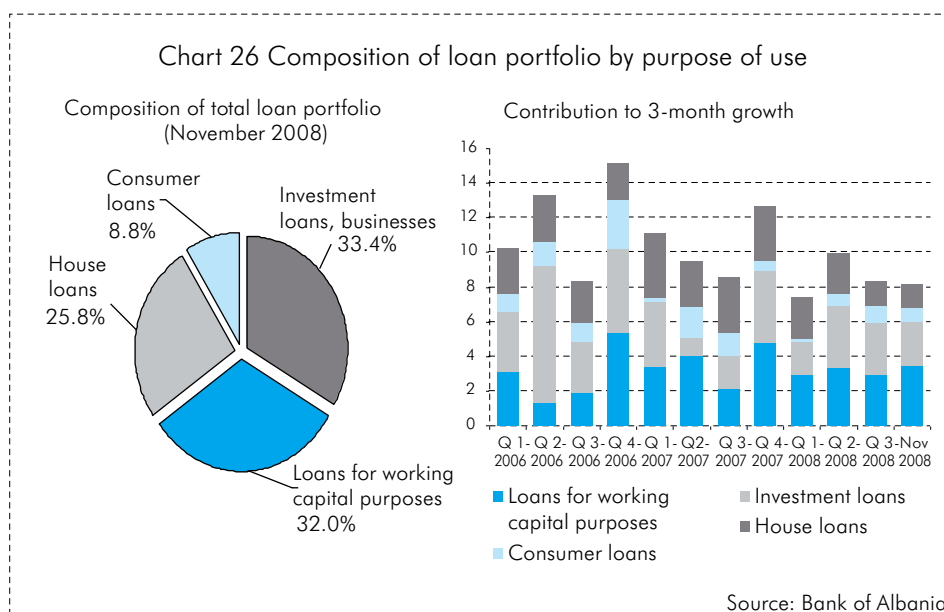
Source: Bank of Albania
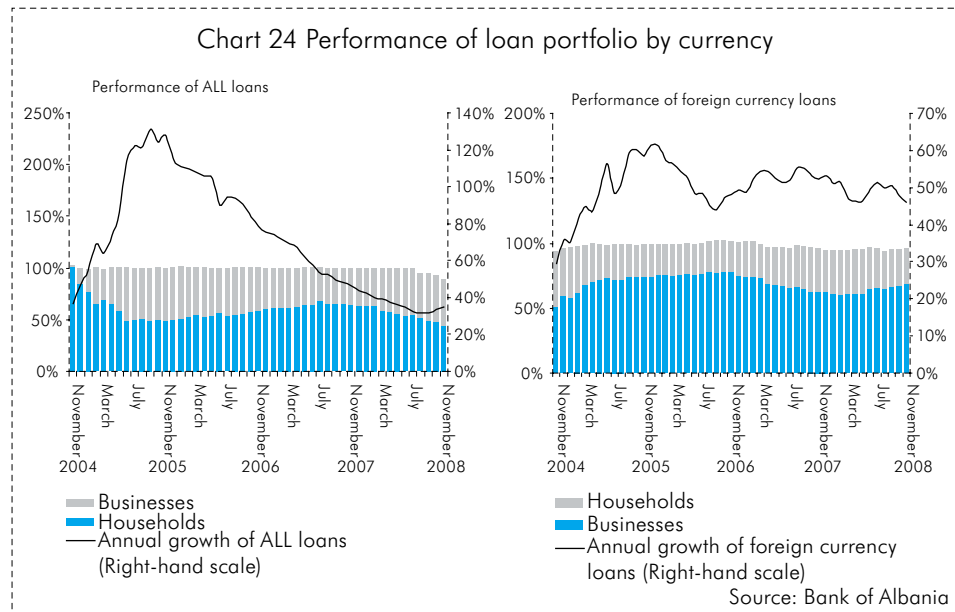
(33 percent); construction (22 percent) and industry (25 percent). In contrast to the first half of the year, the loan portfolio to construction and trade showed a declining tendency while that to industry increased slightly over the second half of 2008. The increase in the loan portfolio to industry was also triggered by the growth of lending to the public company, KESH.

Chart 25 Performance of loan portfolio by category

Source: Bank of Albania
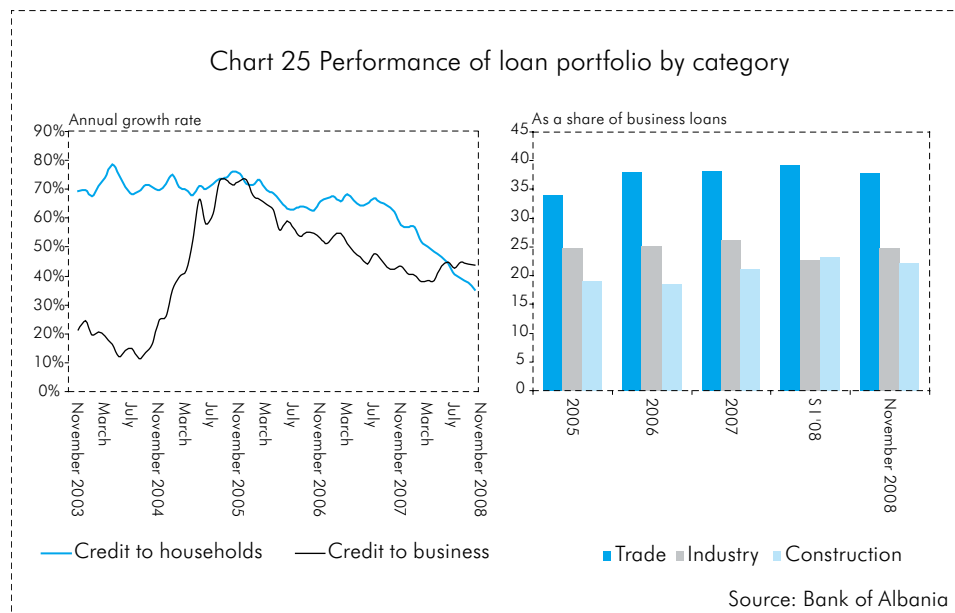
Unlike the first half of 2008, the developments in loan portfolio over the second half of the year show a declining contribution of house loans to the quarterly growth of total loans. As of end period, house loans grew by 40 percent in annual terms, compared with the average growth by 63 percent in the first quarter. Some commercial banks' inclination to tighten the conditions for this type of product may have fuelled the moderated growth of house loans' portfolio. Overall, the contribution of consumer loans to the growth of total loans reduced over the course of the year 2008. This performance was

shown since the end-2007. The annual growth of consumer loans was stable over the second half and recorded 27 percent.

Chart 26 Composition of loan portfolio by purpose of use

Composition of total loan portfolio (November 2008)

Consumer loans 8.8%

Investment loans, businesses 33.4%

House loans 25.8%

Loans for working capital purposes 32.0%

Contribution to 3-month growth

- Loans for working capital purposes
- Investment loans
- Consumer loans
- House loans

Source: Bank of Albania

CREDIT TO THE FISCAL SECTOR

In response to the higher demand for funds to cover the fiscal deficit, the net claims on the government increased in the beginning of the second half of 2008. Until September, the net claims on the government increased by 13 percent in annual terms. Despite the high government demand for funds, some commercial banks had a portion of their T-bill portfolio matured in the last month of the reference period, hence, reducing the banking system's claims on the fiscal authority. The annual growth of net claims on the government by 5 percent in November marked the lowest level for the year 2008.

As of end November, lending to the public sector accounted for only 43

Chart 27 Performance of domestic credit and Government financing

- Credit to economy/domestic credit
- Credit annual growth
- Financing to Government/domestic credit
- Annual growth of financing to Government

- Bank of Albania
- Households
- Institutions
- Cumulative financing
- T-bills-banks
- Bonds-banks

Source: Bank of Albania
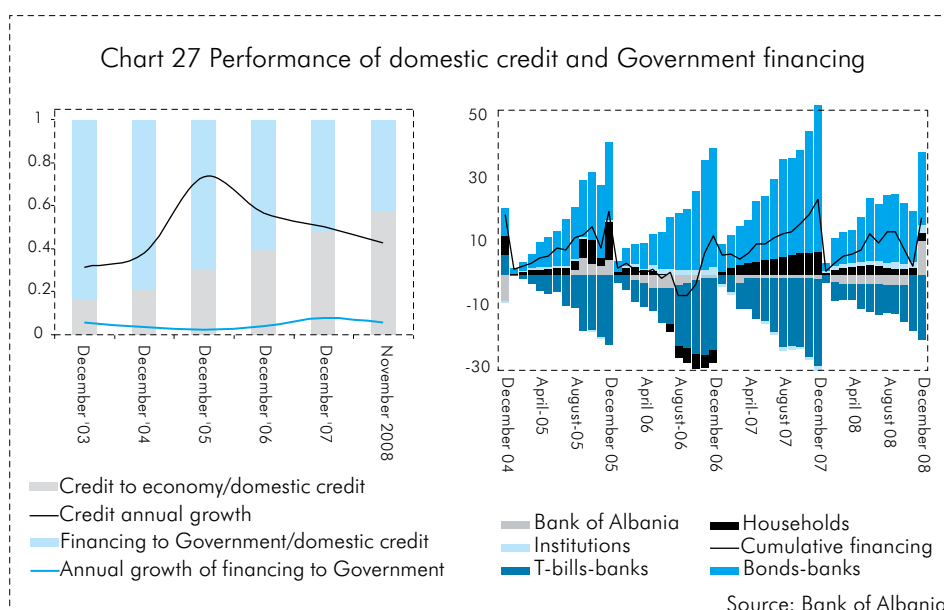
percent of domestic demand for money, recording marked decline in the last four years. Preliminary data on the primary market for December attest to the growth of the Bank of Albania T-bill portfolio and a higher participation of commercial banks in the securities' market. In December, commercial banks were noted to shift further to long-term instruments.

4.2 LABOUR MARKET AND WAGE PERFORMANCE

4.2.1 Labour market

The average number of employed persons increased over the third quarter of 2008, with the private agricultural and non-agricultural sectors providing the main contribution. The average number of unemployed persons increased slightly compared with the previous quarter. Unemployment rate has been declining, owing mainly to the increase in the average number of employed persons in the private agricultural sector. As of end the third quarter, the average number of total employed persons increased by about 3.3 percent compared with the previous quarter. The average number of employed persons in the private agricultural[41] and non-agricultural sectors increased by about 26,549 and 4,018 persons compared with the previous quarter. The increase in employment was more marked in manufacturing industry and construction, mainly owing to the high share of the number of employed persons in these sectors.

Over the course of the third quarter of 2008, the average number of total unemployed persons recorded an annual fall of 1.5 percent. Unemployment rate reached 12.62 percent, hence maintaining a downward trend.

Chart 28 Average number of total unemployed persons (left-hand axis) and unemployment rate (right-hand axis)
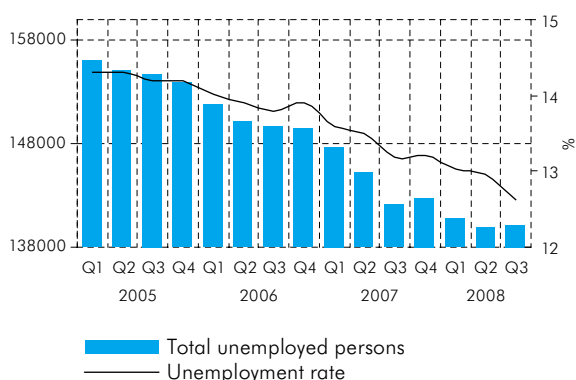
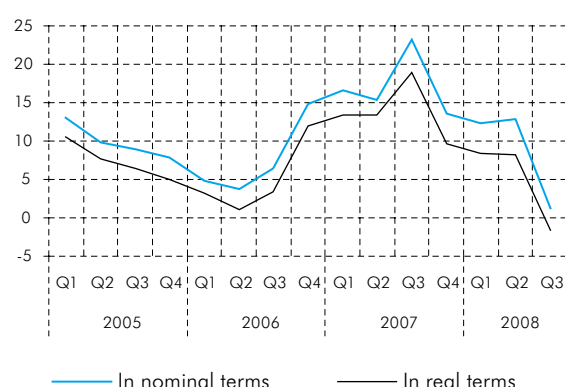Source: INSTAT, Conjuncture: Main economic indicators: July-September 2008

Chart 29 Average wage in production and services sectors (annual changes in percent)

Source: INSTAT and Bank of Albania estimations

4.2.2 Performance of wages

The annual growth rate of wages slowed down in both the public and private sectors over the third quarter of 2008. In nominal terms, average monthly wage in the public sector[42] rose by about 1.24 percent compared with the same quarter the previous year. Average wage[43] in economic enterprises rose by about 9.9 percent over the third quarter compared with the same period the previous year. However, the growth rate is about twice lower than over the first half of the present year.

In real terms, the annual growth rate of average wage was about 6.7 percent over this period. In nominal terms, the annual growth rate of average wage in the third quarter was lower for the industry and services sectors. While the nominal annual growth rates of average wage in construction and quarrying industry were higher than over the second quarter of 2008 - 16.3 and 13.9 percent, respectively. Monthly minimum base wage reached 17,000 leks in the third quarter, up by about 6.3 percent compared with the previous quarter. In quarterly terms, average full economic assistance recorded the highest growth by about 5.84 percent, while average partial economic assistance rose by about 0.52 percent.

Chart 30 Average monthly wage in the public sector (annual changes in percent)

Source: INSTAT, Conjuncture: Main economic indicators: July-September 2008

Box 6 Main signals deriving from the trends in labour productivity and labour cost per unit of output indicators

Inflationary pressures in the medium-term are to a large extent explained by the fact how and how much the changes in income from labour (wages, etc) are supported by the changes in labour productivity (LP). Labour cost per unit of output (LCUO) is the indicator which better synthesizes the main trends in the wage and labour market. It is the cost of labour required per unit of output in a sector, branch or economy. Expressed in an index, this indicator is widely used in comparative analyses between the sectors of the economy but also between different countries. As such, it identifies aspects of inter-sectoral competitive capabilities between different countries, as well.

The ongoing increase of the LCUO in an economy would provide signals for the increase of domestic supply-side inflationary pressures, materialized in the expected rise of producer prices. The upward trend of this indicator in one economy compared with that of another economy would signal 'the loss' of the competitive position of the first economy in the labour and price market area. The second economy would be a more attractive investment market, since it would provide relatively lower labour costs and consequently, lower producer prices and higher profitable opportunities for investors.

In general, a country can improve its competitive position by reducing the nominal labour cost for one employed person or by increasing the labour productivity performance. The strategies in this area are selected based on the country's economic conditions. They may consist in: moderation of wage rise rates, which would lower the producer price; growth of productivity, which would allow higher output; combination or optimization of these two strategies in order to ensure adequate LCUO development rates.

Trends of LP and LCUO in the Albanian economy
LP and LCUO indicators may be proxied using the data provided by short-term statistics. LP index is measured by the ratio of two indices: turnover indicator[44] - seasonally adjusted[45] - to the number of employed persons. LCUO index is measured by the ratio of wage index[46] per one employed person to the productivity index. The simple transformation of the formulas leads to a more direct estimation of the LCUO index: as the ratio of wage fund index to the deflated and seasonally adjusted

turnover indicator. The expected publication of value added index as part of the short-term statistics helps to better estimate the productivity. These indicators are estimated for individual sectors and the economy in general (excluding agriculture). The above-mentioned indicators are also constructed by categorizing the economy in two sectors: traded and non-traded.

In this context, the traded sector requires special attention; first, because the performance of productivity in this sector should 'tone' the upward growth rates of productivity in one economy; and second, being a competitive sector in the foreign markets, it should offer goods with 'attractive' prices and labour costs. In principle, the traded sector should embody the priorities in the country's competitive capabilities.

At an economy level, as of end 2006, these two indicators converged close to 100 percent or their ratio close to 1. Starting from the year 2007, the ratio has almost been in favour of the LCUO. The peak in the LCUO index (Q2: 2007) was reached during the implementation of the Government measures, which aimed at further formalizing the labour and wage market. The construction sector shows the most considerable divergences of the indices, where the unit labour cost index displayed the most pronounced increase.

The year 2008 marked relatively positive developments in these two indicators: LCUO downward rates and LP upward rates. The traded sector and within this sector, the industry, are the sectors showing the most pronounced converging trends of both indices. The increase in the LCUO index in the industry sector has been mostly sustained by the increase in the LP index, which has helped to maintain the stable trend of LP indicator for the entire traded sector of the economy.

Chart 1 Performance of LP and LCUO indices by main sectors of the economy
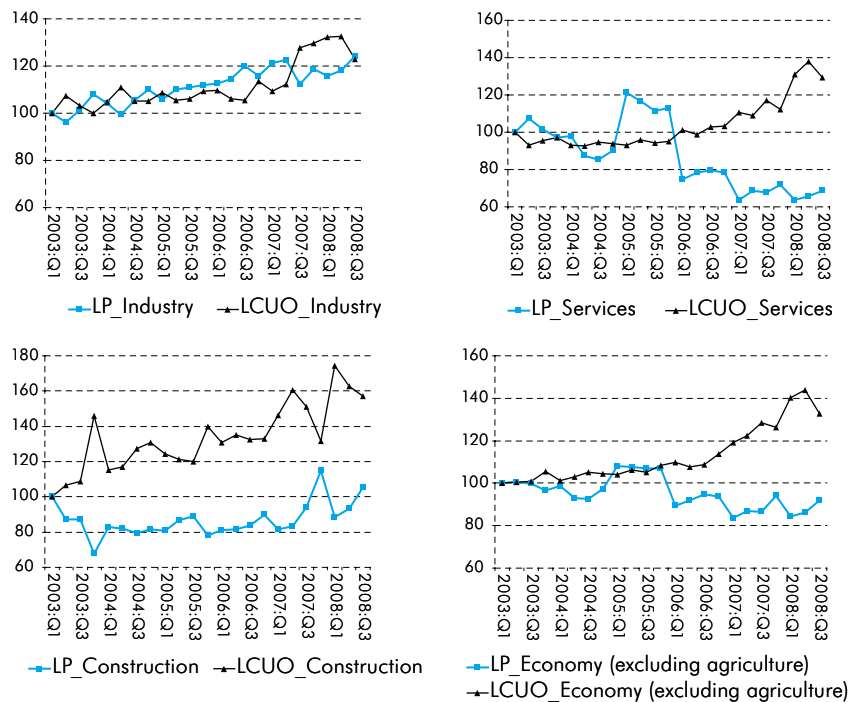
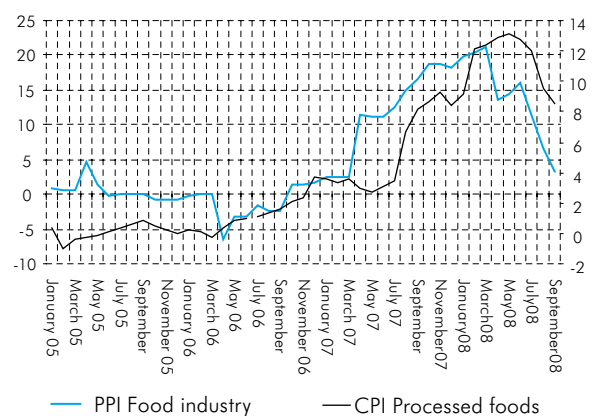Source: INSTAT and Bank of Albania estimations
Note: The economy implies only those sectors included in the short-term statistics (industry, construction and services). The indices are based on Q1:2003, in order to simplify the comparative aspect of the trends in these two indicators.

Preliminary assessments show that the maintenance of competitive capabilities of the Albanian economy in the international markets, albeit still limited, has been mostly sustained by the sector of industry, which shares a relatively considerable weight in the Albanian exports. Preliminary results on some empirical findings - under the restriction of short-time series - show that the quarterly change rates of both indicators have a relatively high negative correlation. This implies that the quarterly increase of productivity affects the average quarterly decrease of labour cost per unit of output. At the economy level, for Q2:2003-Q3:2008, the average quarterly volatility of the LCUO attributes to the labour productivity to an extent of about 32 percent.

4.3 PRODUCER AND IMPORT PRICES

Inflationary pressures generated by producer and import prices on the overall level of consumer prices have been declining in the third quarter of 2008. For both these indicators, food prices – which have a considerable share in the consumer basket - recorded the sharpest fall over this period. Compared with the same quarter the previous year, Producer Price Index (PPI) increased by 7.1 percent over the third quarter. Producer prices in quarrying industry rose by 9.7 percent in annual terms, while the average growth rate over the first half of the year was about 4.2 percent. Despite its small share to total PPI[47], it has contributed by about 1 percentage point to the PPI annual growth. The first half of the year 2008 was characterized by an accelerated rise in raw material and oil prices in the international markets. The Albanian businesses – mainly those importing the raw material – were faced with higher producer costs which were partly transmitted to the domestic market as well. The strong lek vis-à-vis the U.S. dollar helped to mitigate the complete pass-through of costs to businesses. 'Food industry' and 'Food and beverage industry', which were among the most affected categories by the high raw material prices[48], dropped their PPI by 4.0 percent in the third quarter compared with the previous quarter. This tendency does not seem to have been uniformly transmitted to the price index of 'Processed foods' in the CPI basket.

Chart 31 Annual change in the index of goods included in the PPI (right-hand axis) and CPI (left-hand axis)

— PPI Food industry   — CPI Processed foods

Source: INSTAT and Bank of Albania estimations

*Table 11 Annual change rates of some PPI components and the CPI 'Processed foods' (in percent)*

	PPI	PPI Total processing industry	PPI Food processing industry	CPI – Processed foods	PPI Extracting industry
Q4:06/Q4:05	-0.7	1.5	1.4	2.4	8.3
Q1:07/Q1:06	2.1	14.4	2.5	3.2	8.1
Q2:07/Q2:06	3.3	7.3	11.3	2.9	2.8
Q3:07/Q3:06	3.6	6.3	14.7	7.3	4.7
Q4:07/Q4:06	7.5	10.2	18.6	10.8	4.5
Q1:08/Q1:07	7.4	6.8	20.5	11.2	5.6
Q2:08/Q2:07	7.4	6.9	14.6	12.9	2.9
Q3:08/Q3:07	7.1	6.1	7.0	10.0	9.7

Source: INSTAT and Bank of Albania estimations

Import prices[49] recorded negative annual growth rates over the first nine months of 2008. The annual change in the third quarter was -7.5 percent, the lowest recorded in the last eight years. The downward tendency of import prices over the first nine months of 2008 is almost present in all categories: capital, intermediate and consumer goods.

Imported inflation has provided a positive impact over the fall of consumer prices at home, owing to the annual fall in the import prices and the appreciation of the lek vis-à-vis the U.S. dollar (8.9 percent) and the Euro (0.5 percent) in the third quarter. Developments in import prices were directly reflected in 'Processed foods' in the consumer basket and indirectly in producer prices. The prices of imported foods reached their historical peak in the second quarter of 2008, recording an annual increase of 20 percent. This increase led to the annual rise of food producer prices (14.7 percent) and to the annual rise of processed foods' prices in the consumer basket (13 percent).

Chart 32 Annual changes of import unit value index of consumer goods and processed foods' consumer prices (in percent)

CPI_Foods — — — VI_Foods
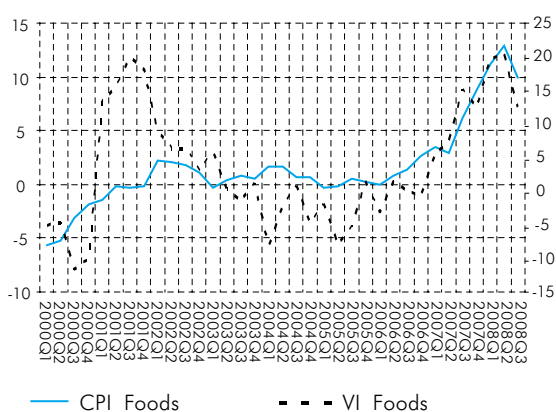
Source: INSTAT and Bank of Albania estimations

The price of imported foods fell by 7.7 percentage points in the third quarter, hence leading to the drop in the producer prices of food by 7 percentage points and to the drop in processed foods' consumer prices by 3 percentage points.

In absence of data on the last quarter of 2008, the proxy for imported inflation, measured by the consumer prices of foods[50] in Albania's main trading partners (Italy and Greece), attests to the continuous decline of imported inflation over this quarter as well. The decrease in the annual rate of imported inflation attributes mainly to the drop of food prices in these countries, while the exchange rate of the Albanian lek vis-à-vis the Euro[51] remained almost unchanged in the last quarter. In annual terms, imported food price inflation declined from 6.2 percent in the second quarter of the year to 5.1 and 4.5 percent in the following quarters. This development led the annual inflation of 'Food and non-alcoholic beverages' to decrease from 6.9 percent in the second quarter to 3.8 percent in the last two quarters.

Chart 33 Annual changes of foreign prices (right-hand axis), the exchange rate and the index of 'Food and non-alcoholic beverages' in Albania (left-hand axis)

▬ Lek/Eur
—— Foods and non-alcoholic beverages
—— Foreign prices
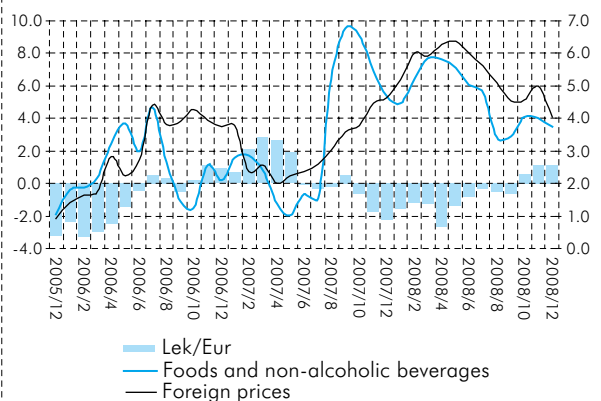
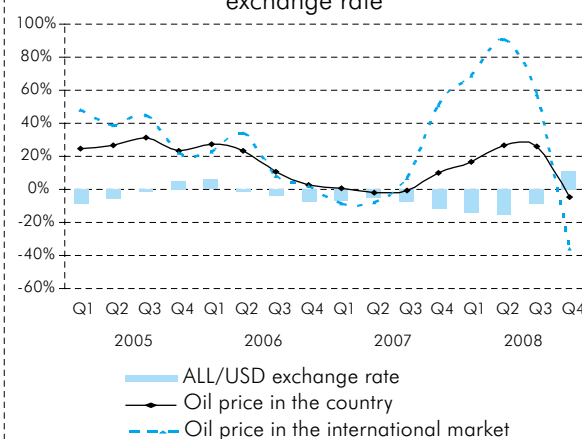Source: INSTAT and Bank of Albania estimations

Import prices continued to be affected by the oil price fluctuation in the international markets. Over the course of the second half of 2008, average price of oil in the Albanian market showed a downward tendency similar to that in the international market. However, the volatility magnitude of the average oil price in the retail market was relatively more moderate. The pass-through of the oil price change in the international market to the domestic market occurred after a lag of approximately one month.

The appreciation of the U.S. dollar to the Albanian lek both in monthly and annual terms is assessed to have curbed the fall of oil price per litre in the retail market over August to November 2008. In the meantime, the appreciation of the Albanian lek in December relative to November has provided its impact over the fall of oil price per litre. The price fall rate was the most accelerated recorded for the second half of the year[52].

4.4 EXPECTATIONS FOR THE PERFORMANCE OF PRICES IN ECONOMY

Economic agents' expectations for inflation, which are based on the results obtained from the surveys conducted by the Bank of Albania[53], have generally reflected the factual trend of this indicator. According to the latest data obtained from the banks' survey in January 2009, expectations of banks' experts for annual inflation after one year are slightly higher than the previous month. Banks expect the inflation rate after one year to increase by 3.2 percent, which is about 0.1 percentage points higher than the expected inflation in December 2008. Based on the probabilitary distribution of banks' responses – in the January 2009 survey – by intervals of expected inflation rate, the probability that inflation after 12 months will be within the band of 2-4 percent has reduced slightly by 2 percentage points, 56 percent from 58 percent in December 2008. In addition, the banks involved in the January 2009 survey assess a slight upside risk that annual inflation will deviate from the 2-4 percent target band, showing a steeper shift to lower rates. The probability that inflation will exceed the 4 percent or be lower than 2 percent stands at 44 percent, compared with 42 percent the previous month.

Chart 34 Annual change of oil price in Albania and in the international market and the ALL/USD exchange rate

Source: INSTAT, Bank of Albania, Bloomberg

Chart 35 Probability that annual inflation after one year will be within the 2-4 percent target range, lower than 2 percent and higher than 4 percent
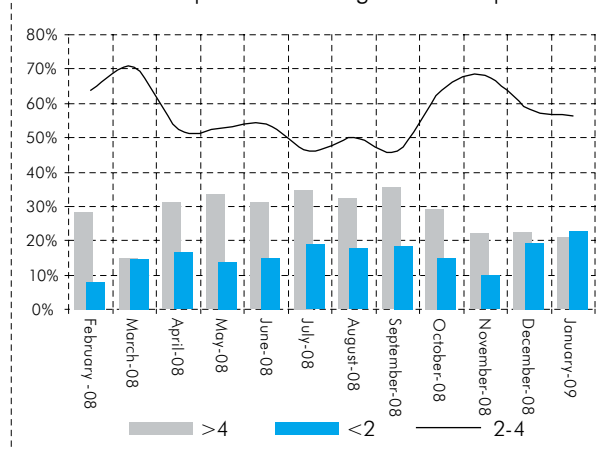
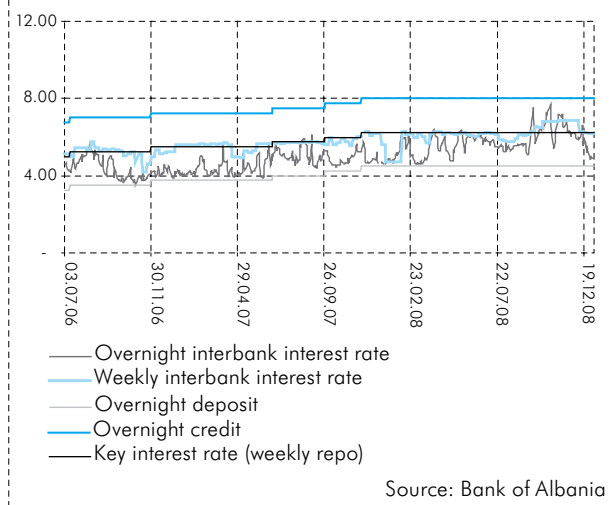Source: Monthly Banks' Survey, Bank of Albania

5 FINANCIAL MARKETS, INTEREST RATES AND THE EXCHANGE RATE

5.1 INTEREST RATES

INTERBANK MARKET

Interest rates in the interbank market shifted upward in the second half of 2008, showing sharp volatilities in particular over September to November. The banking system continued to be characterized by liquidity constraints. The

Chart 36 Interest rates in the interbank market

- Overnight interbank interest rate
- Weekly interbank interest rate
- Overnight deposit
- Overnight credit
- Key interest rate (weekly repo)

Source: Bank of Albania

Bank of Albania has injected liquidity through its open market operations, using reverse repurchase agreements of one-week maturity term. The main contributing factors are the developments in banks' depositing activity and the effects of budget actions. In order to smooth out the market and normalize the activity in the interbank market, the Bank of Albania has extended the maturity terms of reverse repo auctions and later changed the form of these auctions to a fixed price and very open auction. In addition, the Bank of Albania has made transactions for the outright purchase of securities. These measures have improved the liquidity position in the interbank market and have satisfied the commercial banks' demand.

The change of the form of the Bank of Albania auctions, in addition to the moderation of tensions in the interbank market, has also led to reduced daily trading volumes. Compared with the first half of the present year, the volume of one-week transactions has lowered by an average of 0.24 billion leks. Daily transactions volume has increased by 0.15 billion to 1.43 billion leks, mainly owing to the high volumes in the third quarter. In average terms, overnight interest rate increased to 5.99 percent in the second half of 2008 from 5.46 percent the first half. One-week interest rate increased to 6.36 percent or up by 0.49 percentage points.

PRIMARY MARKET

Unlike the performance of interest rates in the interbank market, the Government securities' yields in the primary market have been increasing starting from November. The increase of the yields at the end of the last quarter owes mainly to the tightened liquidity conditions in the market.

The upward trend of T-bill yields began in November, while the third quarter was characterized by their downward trend. The liquidity-related tensions in the banking system caused the participation in securities' auctions to be insufficient for meeting the demand. Some of the participants preferred to mature securities by reducing the portfolio in this type of instrument. The coverage ratio of demand for financing stood at 0.9 in November and December, compared with the average of 1.2 in the other months of the year 2008. The yields increased substantially reaching their peak of 8.65 percent for the 12-month maturity term, or about 60 basis points above the third quarter figure. The yields were 21 basis points higher than in the previous year, although the end-year 2007 was also characterized by sharp volatilities of this indicator owing to the growth of demand for financing. A similar performance was also present in 2008, albeit at a lower intensity.

Chart 37 Government securities' yields in the primary market

Source: Bank of Albania
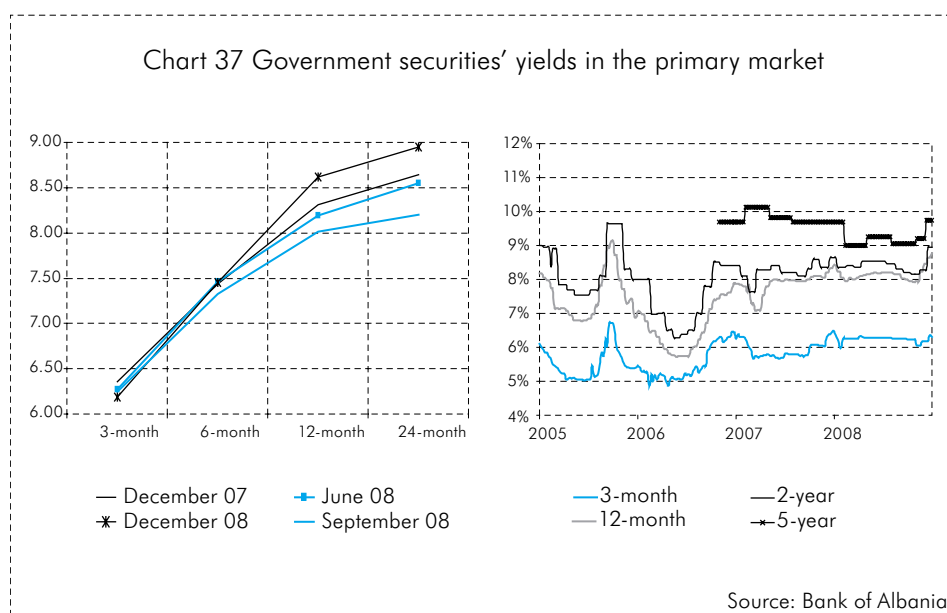
Bonds in the primary market displayed a similar trend to the T-bills. Bonds' yields have generally increased owing to the reduced supply with these securities. In December, the 2-year bonds' yield stood at 8.95 percent and the 5-year bonds' yield (of fixed interest rate) marked 9.75 percent, increasing by about 75 and 70 basis points relative to the end of the third quarter.

Yields' average interest rate			T-bills		Bonds
	3-m	6-m	12-m	2-year	5-year
2007	5.92	7.17	7.87	8.30	9.80
2008	6.26	7.39	8.15	8.40	9.25
September 2008	6.25	7.33	8.02	8.20	9.05
October 2008	6.23	7.20	7.94	8.15	
November 2008	6.05	7.42	8.10	8.29	9.20
December 2008	6.20	7.45	8.56	8.95	9.75

Table 12 Interest rates of public debt instruments

INTEREST RATES ON DEPOSITS AND LOANS

Weighted average interest rate of lek denominated deposits has by and large increased in summer following the banks' promotional strategies, peaking 6.72 percent in August. In September, the interest rates fell by 0.61 percentage points. The decline in interest rates persisted in October and November, owing to the correction of seasonal offers. Preliminary data indicate that the banking system offered relatively high interest rates in December on deposits – mainly for short-term maturity terms.
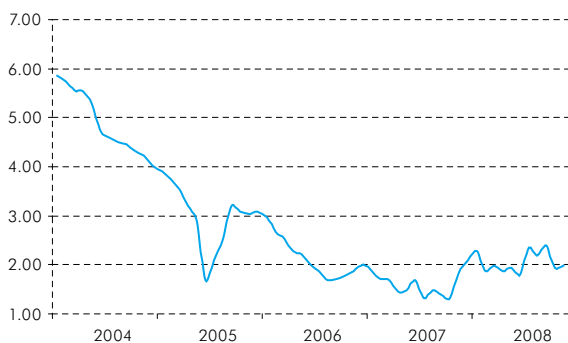
Weighted average interest rate marked 5.43 percent in November, 1.29 percentage points lower than in August. Average interest rates were 0.38 percentage points higher than in 2007 (when the repo rate increased by 0.25 percentage points). In average terms, the interest rates on deposits were 0.93

Chart 39 Interest rate on 12-month deposits in lek and in euro

Interest rate in Lek
Interest rate in Eur
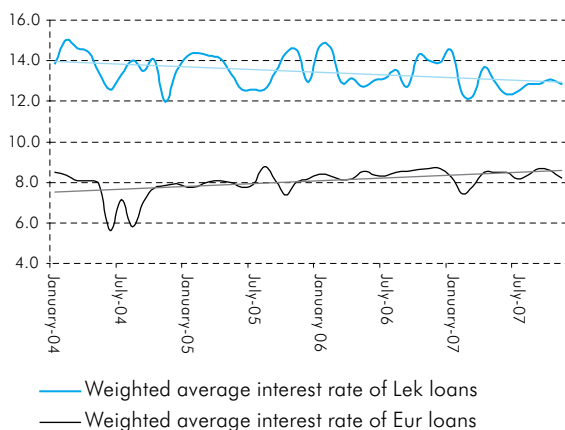12-month Eur deposits
12-month Lek deposits
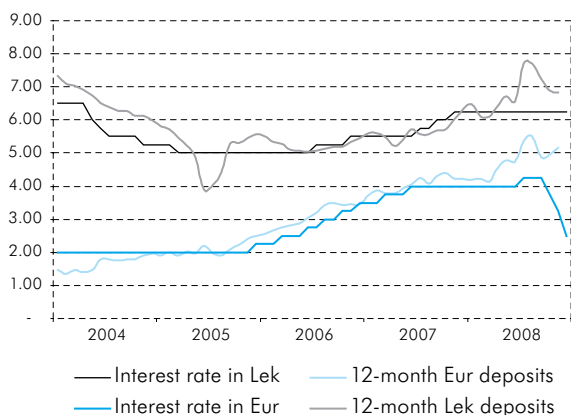
Source: Bank of Albania

Chart 40 Spread between the interest rates on 12-month lek and euro deposits

Source: Bank of Albania

Chart 41 Performance of weighted average interest rate of lek and euro loans

Weighted average interest rate of Lek loans
Weighted average interest rate of Eur loans

Source: Bank of Albania

percentage points higher in 2008 than in 2007 (the repo rate has changed by 0.75 percentage points over this period).

The interest rates on euro denominated time deposits maintained the same seasonal movements although at different margins. After the promotional increase of interest rates in the third quarter, average interest rates fell by 0.24 percentage points in the months to follow. In November they marked 3.98 percent. Weighted average interest rate on euro denominated deposits did not change in October and November. Following the cut of the key interest rate by the ECB in October, the interest rates on euro denominated deposits did not undergo any changes.

The spread between 12-month lek and euro denominated deposits was 1.98 percentage points in November, hence showing a high and ongoing competitive tendency of the banking system with regard to the euro denominated deposits.

The second half of the year has by and large showed a slight upward tendency of the interest rates in lek and in euro, being mainly affected by the short-term interest rates. Lending in euro has generally been in line with the developments in the international financial markets. In seasonal terms, the interest rates have been affected by aggressive policies pursued by some commercial banks, which have a considerable market share.

Weighted average interest rate of lek denominated loans marked 12.87 percent in November, declining by 0.20 percentage points compared with October (when the interest rate was 13.06 percent). Loans have been mainly extended for the short-term financing and overdrafts of businesses, consumers and for the purchase of real estates by households. The latter have been also promoted through the decrease of interest rates in November.

The interest rates on foreign currency denominated loans have generally performed in line with the developments in the global markets, following the changes in LIBOR and EURIBOR, although at different margins. In September, the interest rates on euro denominated loans marked 8.7 percent - 0.55 percentage points higher than the interest rate

marked in July 2008. This increase reflects mainly the tightening policies pursued by the banking system over this month. In November, the interest rate decreased to 8.23 percent. The high demand for euro denominated loans - for all purposes and mainly for real estate-purposes – persisted in the last two quarters, as well.

Following August, the spread between loans and deposits denominated in lek maintained its upward tendency. In November, the spread reached 7.43 percentage points, up by 1.32 percentage points from August. Despite the medium-term upward trend, the intermediation rate in euro reflected a slight tightening tendency in October and November, owing to the latest developments in foreign currency lending in the banking system.
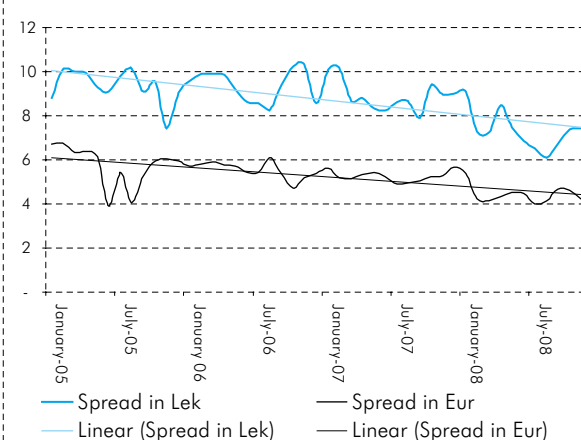
5.2 EXCHANGE RATE PERFORMANCE

The downward tendency of the lek exchange rate vis-à-vis the main currencies - the EUR and the USD - shown in the third quarter of 2008 shifted to its depreciation in the last quarter. The decrease to negative values of the change in the nominal effective exchange rate was 3.5 and 3.9 percent in annually and quarterly terms, respectively. The shift to the negative behaviour of the nominal exchange rate largely reflects the depreciation of the lek vis-à-vis the U.S. dollar, despite the small share (20 percent) this ratio has in the index. The depreciation of the lek vis-à-vis the currencies of Albania's main trading partners suggests a relative mitigation of the amortizing effect that the exchange rate has had to imported inflation.

In annual terms, the lek depreciated vis-à-vis the U.S. dollar and the Euro by 13.1 and 1.2 percent, respectively, in the last quarter. As of end period, the lek traded at USD 87.91 and at EUR 123.80.

The depreciation of the lek vis-à-vis the U.S. dollar owes to a large extent to the developments of the latter in the international markets. The correlated performance of USD/ALL and EUR/USD ratios and the high dynamics of the USD/ALL both in annual and quarterly terms, attest to the high vulnerability of this ratio to the developments in the international markets.

Chart 42 Spread between average interest rates of loans and deposits in lek and euro
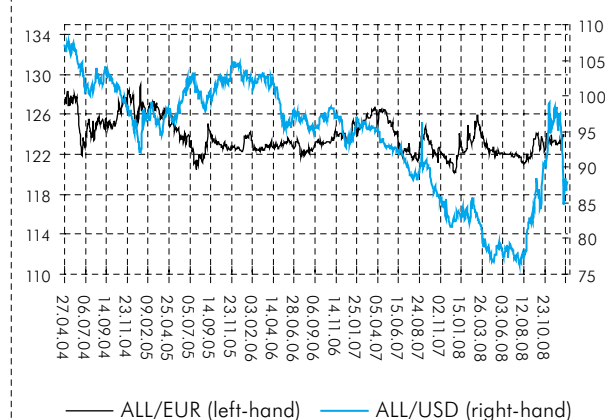
Source: Bank of Albania

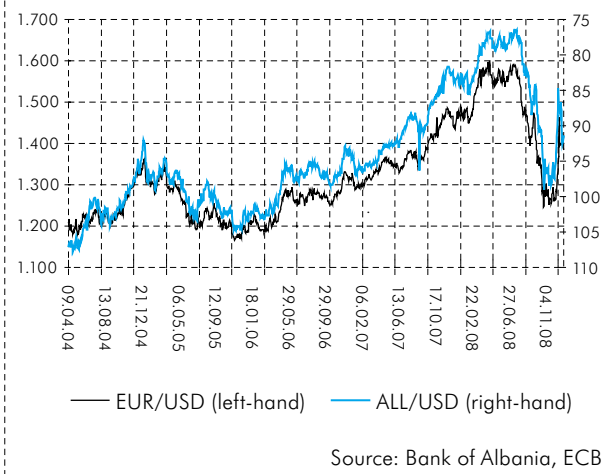**Chart 43 Lek annual changes in nominal effective exchange rates (NEER[54])**
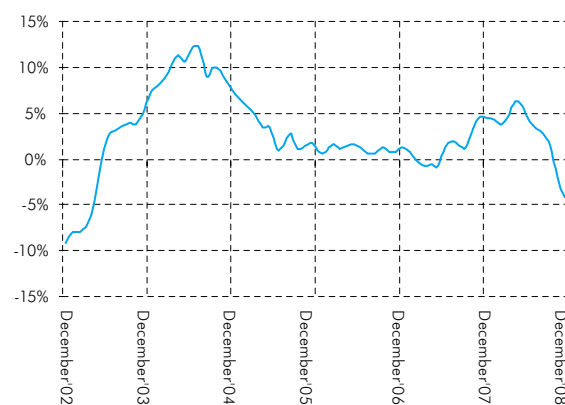
Source: Bank of Albania

**Chart 44 Daily performance of ALL/EUR and ALL/USD exchange rate**

Source: Bank of Albania

Chart 45 Daily performance of EUR/USD and ALL/USD exchange rate

EUR/USD (left-hand) —— ALL/USD (right-hand)

Source: Bank of Albania, ECB

The drop in the EUR/ALL ratio in the last months of 2008 has been mostly affected by the changes in demand-supply ratios in the internal market, rather than by the reflection of the developments in the euro in the international markets. The performance of the lek vis-à-vis the euro over the course of the last quarter has reflected the combined effect of the high demand for foreign currency, mainly outside the banking system. This effect was to some extent mitigated by the preceding behaviour of commercial banks starting from November to the seasonal supply with foreign currency, which characterizes the end-year. Accordingly, the quarterly dynamics in the behaviour of the lek to the euro is shown stable over this period, with a relatively lower volatility compared with the preceding quarter and the same period the previous year.

Chart 46 Exchange rate volatility[55] of the lek in quarters

ALL/USD

ALL/EUR

■ Q1 ■ Q2 ■ Q3 ■ Q4

Source: Bank of Albania
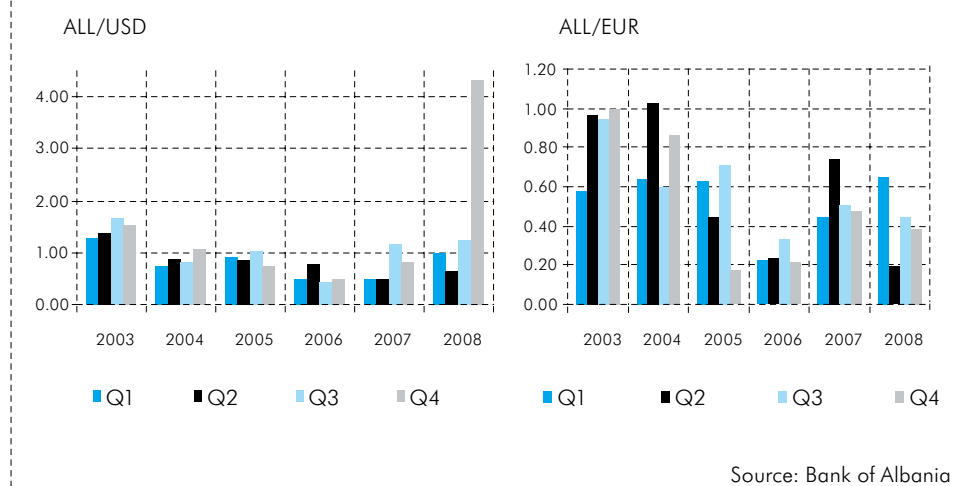
6 ECONOMIC AND MONETARY DEVELOPMENTS OVER THE COURSE OF THE YEAR 2009

The Albanian economy will perform amid a more turbulent setting of the global economy over the course of the year 2009. The chain effects of the global financial crisis are expected to affect the developments in the Albanian economy in the short-term. The global financial crisis has mainly hit the developed countries, which are Albania's main partners in trade and financial exchanges. The slowdown of economic growth in these countries will lead to the increase in unemployment and consequently to the decrease in Albanian workers' remittances, fall of foreign demand for Albanian exports and drop of foreign direct investment in Albania. The contraction of credit from foreign

banks operating in Albania, due to their buffering policies, remains a critical issue. Based on this scenario, the Bank of Albania deems that in absence of a rapid solution to the global economy issues, the economic growth over the year 2009 will to a certain extent be lower than the economic growth materialized in 2008.

However, in the analysis on the expected developments for the year 2009, the Bank of Albania considers with high priority the projections for maintaining and further bolstering macroeconomic stability. In this context, the expected reduction of budget deficit, the projections for the decrease of current deficit as a result of the more favourable conjuncture of global prices and the reduced demand for imported goods, as well as the maintenance of price stability, will help to consolidate macroeconomic stability. These factors will help to achieve a long-term economic growth, capable of responding to the challenges the Albanian economy will be confronted with as a developing economy.

The monetary programme of the Bank of Albania for the year 2009 is oriented to stabilizing the monetary stimuli of domestic demand and mitigating the pressures from the external sector and their impact on the real economy. In absence of a formal arrangement with the IMF, the quantitative restrictions with respect to the net domestic assets and the net international reserve will be constantly monitored by the Bank of Albania.

The 7.9 percent growth of broad money over the course of the year 2009 has been projected based on the assumptions for a stable fiscal performance, in line with the Bank of Albania objectives and concurrent with an average inflation rate of 3 percent. As a result of the growth of currency outside banks over the last quarter of 2008, the monitoring of this indicator aims at keeping any possible inflationary pressures under check.

The downward annual rates of foreign currency flows in the form of deposits denominated in foreign currency, owing to the expected reduced attention of commercial banks to banking intermediation in foreign currency, will stabilize the M3 component on the side of demand for deposits. The Bank of Albania's net foreign assets are projected to grow at slower rates.

The program projects a stable growth of net domestic assets. The tightening of lending conditions is projected to yield the decline of money flows. In absence of liquidity denominated in lek and in foreign currency, credit to the private sector is expected to decline. Total credit to economy is projected to amount to 54 billion leks. This growth is projected to be relatively uniform by foreign currency components. Accordingly, credit in lek and in foreign currency is projected to grow by about 27 billion leks over the course of the year 2009. Based on these assumptions, the demand for liquidity from depositing banks is projected to persist.

In the public sector, the budget deficit is projected to amount to 50 billion leks, out of which 8.5 billion will be foreign borrowing. Domestic borrowing

in foreign currency will total 30 billion leks and their channelling to projects financed in foreign currency is not projected to add the pressures over the growth of broad money. Credit in lek to the public sector - 12 billion leks - is projected to contribute to the growth of M3.

ENDNOTES

[1] Expressed in quarterly terms.

[2] In quarterly terms, the U.S. dollar appreciated by about 3.7 percent vis-à-vis the Euro.

[3] Over the first half of 2008, unemployment rate averaged 5.2 percent compared with 6.5 percent the second half of the present year.

[4] In August 2008 the inflation rate marked 5.4 percent. In September it marked 4.9 percent.

[5] BRIC countries: Brazil, Russia, India and China.

[6] The volume of exports to EU countries has reduced given the economic crisis the member countries are going through.

[7] In annual terms, private investment dropped by 10 percent.

[8] The annual growth of exports reached 1.5 percent following the sharp downward tendency shown since the first quarter of 2008. Consumer expenditure increased by only 0.3 percent in annual terms.

[9] During the meeting of its Governing Council on 15 January 2009, the ECB decided to slash its main refinancing rate from 2.5 per cent to 2.0 per cent.

[10] In order to mitigate the losses from the fall of oil price in the global markets, the Russian Government decided to increase the oil export duty.

[11] According to the forecast of the Energy Information Administration, the statistical agency of the U.S. Department of Energy.

[12] In December 2008, the Food Price Index recorded an annual rate of 18.4 percent, while the annual decrease of Fuel Price Index was 42.7 percent.

[13] Monetary Policy Document for the 2009-2011 period.

[14] The growth of credit to the private sector and the increase of employment and rise in wages, in addition to the optimistic expectations of economic agents are believed to have contributed to the growth of domestic demand.

[15] Or 2 percentage points lower compared with the first half of 2008.

[16] Due to improvements in the re-grouping of some basket items according to the measures referred to in the table, the inflation rates have reflected slight and systemic changes which have not distorted the trends shown in the analyses to date.

[17] This indicator indicates the performance of economic activity in manufacturing and services sectors at home.

[18] ETI aggregates specific indicators of the main sectors of economic activity (industry, construction and services), and of consumers. The series of indicators, which are based on the information obtained from confidence surveys conducted by the Bank of Albania, are used in the construction of the ETI and they are seasonally adjusted.

[19] www.oecd.org - Quarterly National Accounts; http://epp.eurostat.ec.europa.eu - Quarterly national accounts (including GDP)

[20] http://www.instat.gov.al

[21] House and Rent Price Index are measured by the Bank of Albania and they cover only Tirana divided in three districts.

[22] The first decrease after five consecutive years that the House Price Index recorded only growth rates.

[23] Price-rent ratio series has been constructed using the House and Rent Price Index. The increase of this indicator above a normal value, defined by its long-term average, serves as a sign for the house price appreciation.

[24] House Price Index and Rent Index are measured by the Bank of Albania and they include only the city of Tirana.

[25] Price/rent ratio is calculated by dividing the house price by their rent price. The purchase of a house is considered a financial investment, where the price of rent represents the current value of expected income from the purchase of a house. If the price/rent ratio is higher than "a normal" value, houses are considered to have appreciated. The "normal" value of the price/rent ratio is determined by the long-term average of the ratio.

[26] The values of indicators as a share of GDP, which are presented in "The External Sector Developments in the Albanian economy", are annual cumulative values.

[27] In travel services, services for personal purposes have the main share.

[28] Labour inflows are assessed to have reduced by 50.6 percent in annual terms.

[29] *The weight that trade exchanges with these countries share to total trade exchange volume is 32.43, 14.22 and 5.59 percent, respectively.*

[30] *The weight that trade exchanges with these countries share to total trade exchange volume is 6.86, 5.03, 2.73 and 1.91 percent, respectively.*

[31] *These are Paasche-type indices.*

[32] *These indices measure the average import and export prices and they do not consider the changes in quantity.*

[33] *For more information, please refer to www.instat.gov.al*

[34] *This figure refers to the period from January to September 2008.*

[35] *In comparing the plan and the realization for the year 2008, we always refer to the revised budget plan in July 2008.*

[36] *During the revision of the supplementary budget plan (July 2008), oil price in the global markets marked the highest levels for the year 2008. During this period, the Ministry of Finance reduced the annual planned level for the excises by only 1 billion leks, compared with the budget plan approved in the early 2008.*

[37] *In the previous years, there has been a higher difference between the annual plan and the 11-month realization, implying a higher concentration of previous years' budget expenditure in the last month of the year.*

[38] *Average contribution of capital expenditure to total expenditure for the 11-month period over the years 2000-2007 is about 1.0 percentage points.*

[39] *The first highest ratio over this period was recorded in 2001, which was a parliamentary election year.*

[40] *Primary deficit has been corrected for proceeds of privatizations and grants.*

[41] *According to the Labour Force Survey for the year 2007.*

[42] *Budget and non-budget (INSTAT, Conjuncture: Main economic indicators).*

[43] *According to the INSTAT methodology, average wage is measured as the ratio of wage fund to the number of employed people.*

[44] *Deflated by the effect of prices in economy.*

[45] *Among the short-term statistics indicators, the performance of turnover indicator suggests a pronounced presence of seasonal factors in the first quarters; therefore, the application of deseasonalisation techniques is econometrically justifiable.*

[46] *Measured as the ratio of wage fund index to the number of employed people index.*

[47] *About 9.6 percent to total PPI.*

[48] *Over the first half of 2008, the producer costs in the sub-items of 'Food industry' and 'Food and beverage industry' increased by 17.6 and 18.0 percent, respectively.*

[49] *Measured by the unit value index, INSTAT.*

[50] *The correlation coefficient attests to a stronger statistical relation between 'Food and non-alcoholic beverages' for Albania and these two countries than between total consumer price index. The correlation coefficient for the period 2002M1-2008M12 is 0.8 in the first case and 0.5 in the second case.*

[51] *In annual terms, the Lek depreciated slightly by 0.4 percent vis-à-vis the Euro in the last quarter.*

[52] *Compared with the previous month, in December, the Lek appreciated by about 6 percentage points vis-à-vis the U.S. dollar, while the oil price per litre dropped by 13.8 percent.*

[53] *The analysis on inflation expectations is based on the results obtained from the surveys conducted by the Bank of Albania: Business Confidence Survey, Consumer Confidence Survey and Monthly Banks' Survey.*

[54] *NEER – effective exchange rate, measured against two currencies according to an approximate share they have in trade with abroad, EUR (80 per cent) and USD (20 per cent). A positive change of the NEER implies the appreciation of the lek.*

[55] *Measured as the quarterly average of exchange rate volatility. The latter is measured as the standard deviation indicator.*