

MONETARY POLICY MONTHLY REPORT

APRIL 2003

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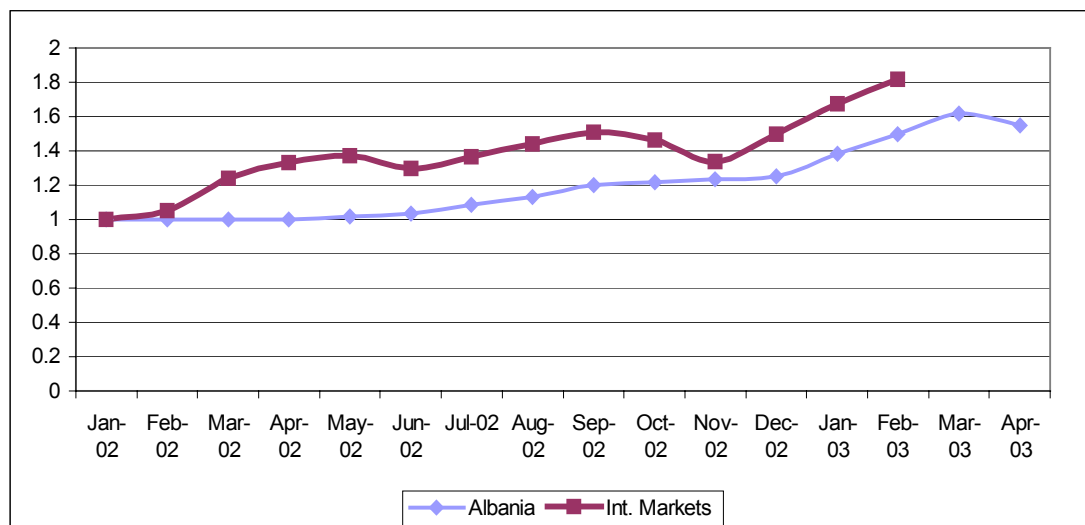
1 THE MAIN EVENTS OF THE MONTH.

- The annual inflation rate for March 2003 was 1.9 percent. In the first quarter of 2003 the annual inflation rate has had a slightly upward tendency nearing the bottom limit of the objective that is 2 percent. The increase in the price of oil has raised the prices for the transportation sector, which in turn has influenced the increase of the prices in general for the month of March.
- The average annual inflation rate was 3.85 percent remaining at the below the upper limit of the 4 percent objective. Since November 2002, there has been a low national inflation reflecting the sustained monetary aggregates.
- Data for the month of February and the operative data for March and April show the continuous improvement of monetary aggregates, liquidity conditions, a quick return of the outside money into the banking system, and an increase in the Lek deposits. The increase in the Lek deposits has come as a result of their high real interest rates of being more competitive than those of exchange deposits. The monetary developments indicate low inflationary pressure.
- It is expected that the next quarter will see a lower inflation. Based on the recent developments, Bank of Albania believes that by the year-end the inflation will be within the target objective of 2-4 percent. The lowering of the oil prices in the international markets has reinforced the expectancy of lower inflation. However, the upcoming local elections and the increase in energy prices could cause concern for the last quarter of the year.
- **The evaluation of the above factors has made us reach the conclusion that it is appropriate to lower the interest rate base by 0.5 percentage points. The rate that will be offered in the weekly auction of repos will be 8 percent, down from 8.5 percent, which is the current rate.**

2 DEVELOPMENTS OF INTERNATIONAL TRADE AND OIL PRICES.

International trade for January 2003¹ has been generally positive. Exports in this month have been 33 percent higher than those in December, while the imports have decreased by 14.7 percent. These developments have lowered the trade deficit by 25.6 percent compared with December. The textile and shoes exports have grown considerably (by 38 percent), wood and paper production (close to 4 times as much), as well as those of food and of minerals and of flammable products. As for imports, it is noticed the doubling of minerals, flammable products and energy compared with January of last year. This increase has come mostly due to the higher international oil prices that went from USD 19.7 per barrel in January 2002 to USD 33.00 per barrel in January 2003. Oil prices in international markets have risen continuously in 2002, while in the first quarter of 2003 the oil prices have been quite volatile because of the war in Iraq.

Graph 1: Changes in oil prices in international markets and in Albania for the period January 2002 – April 2003 (keeping as base January 2002).



The domestic market in 2002 has generally followed the trend of oil prices in international markets. However, domestic oil prices have been influenced by the changes in custom's reference prices of imported oil. Although the fear of war in Iraq would lead to significant increases of oil prices in international markets, purchase contracts for oil in June decreased to 262 USD per ton. This means that oil prices could not go higher than the current level even if the reference prices remain unchanged for the next two-three months, unless they decrease even further.

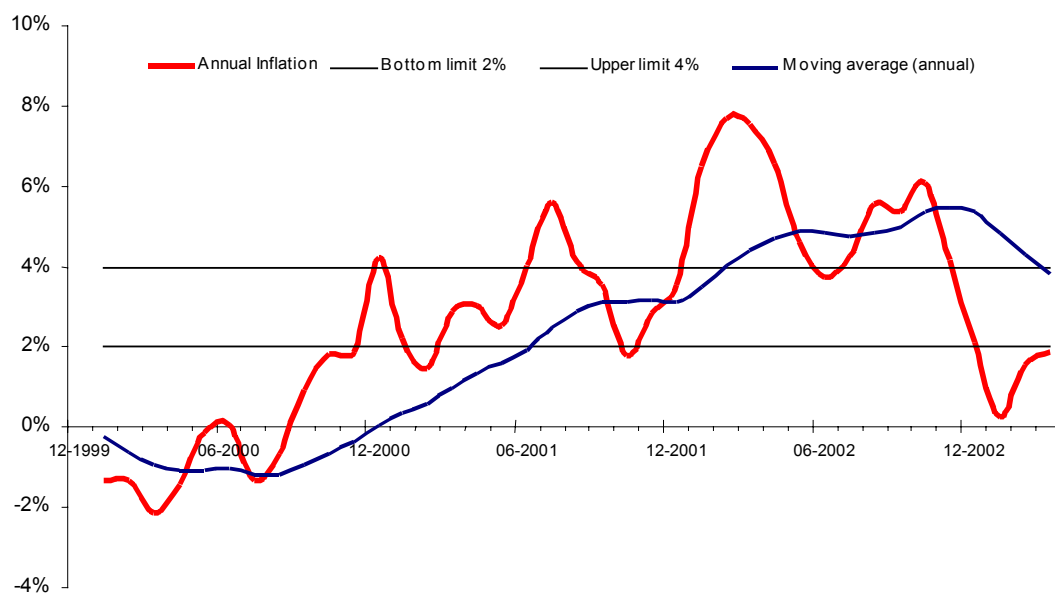
¹ These are the latest available foreign trade data.

3 DEVELOPMENTS IN INFLATION AND EXCHANGE RATES IN MARCH.

3.1 FACTORS INFLUENCING THE RATE OF INFLATION.

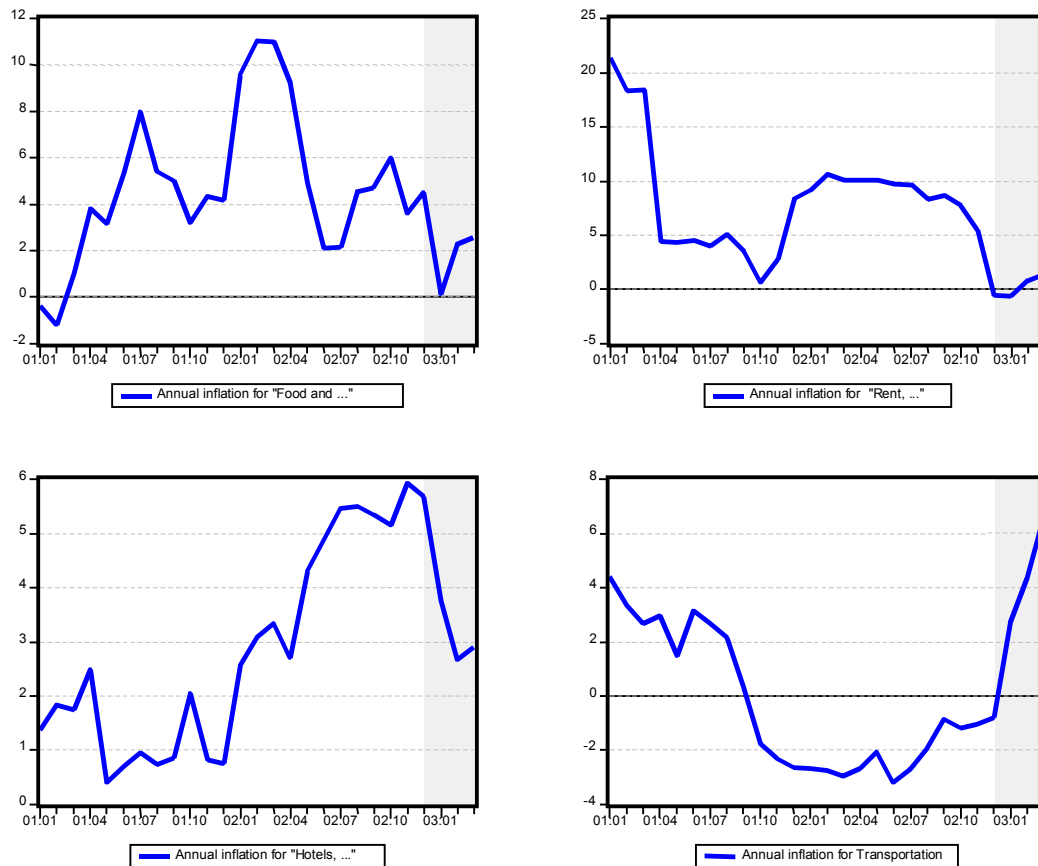
In March 2002 the annual inflation rate was 1.9 percent. For the first time the average annual interest rate of 3.85 percent, fell below the upper limit of the central bank's target of 4 percent.

Graph 2: Annual inflation (in percentage).



In March the Transportation sector had a significant increase in annual inflation that reached 6.6 percent. The rise of prices in the transportation sector, in February and March, seems to have been passed to other goods and services prices'. However, this price increase does not seem to have been associated with other speculative price increases as it has happened before in similar situations in the Albanian market. Annual inflation of two main basket groups "Food and non-alcoholic beverages" and "Rent, flammable products and energy" in March, has demonstrated to be in some low and positive levels.

Graph 3: Annual inflation for 4 main basket groups of CPI (in percentage).

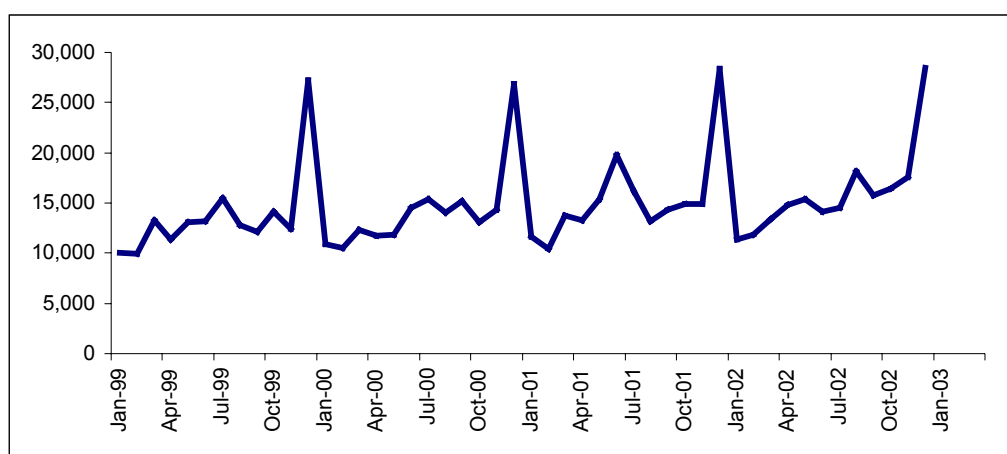


These are some of the factors that remain influencing the low inflation rate for this month:

- ◆ Keeping in control the **M1 monetary aggregate** for a long period of time.
- ◆ It is believed that the movements in the **exchange rates** have softened the inflation pressures in the first quarter of the year. In February, the average exchange rates have shown a 1.12 percentage point appreciation of Lek against the dollar and a 0.04 percentage point depreciation of Lek against Euro.
- ◆ The fiscal budget expenditures have continued to go as planned.

Inflation for the countries of the Eurozone has been low, even though it was higher than forecasted. Annual inflation rate for Eurozone in March was 2.3 percent from the 1.8 forecasted level. In Greece inflation rose to 4.1 percent from the forecasted 3.3 percent, while in Italy it was 2.7 percent from 2.4 percent that was forecasted earlier.

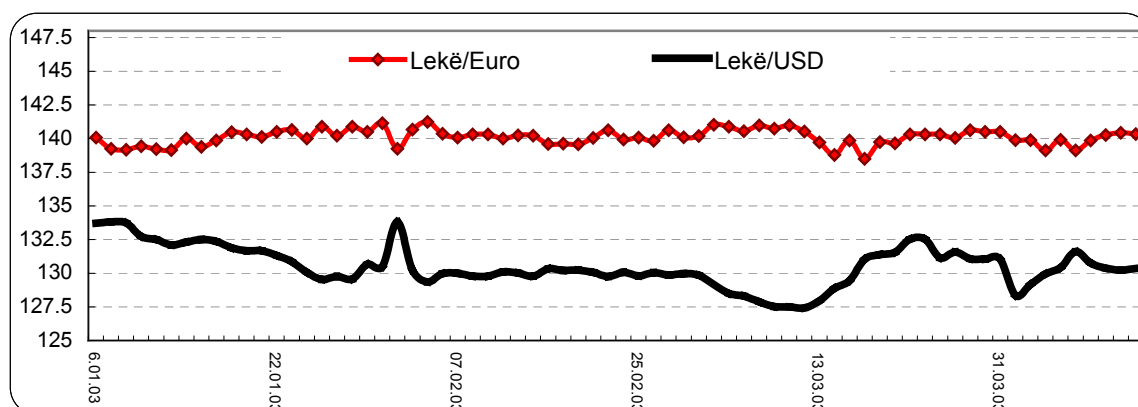
Graph 4: Fiscal budget expenditures (in million Lek).



3.2 DEVELOPMENTS IN THE FOREIGN EXCHANGE MARKET, MARCH 2003.

In March Lek was relatively stable against Euro while it was unstable against the dollar. Compared with the last month, Lek depreciated near 0.4 percent against Euro and appreciated close to 0.06 percent against the dollar. In annual terms Lek appreciated in average about 8.7 percent against the dollar and depreciated 12.8 percent against Euro.

Graph 5: Developments in the exchange rate of Lek in 2003.

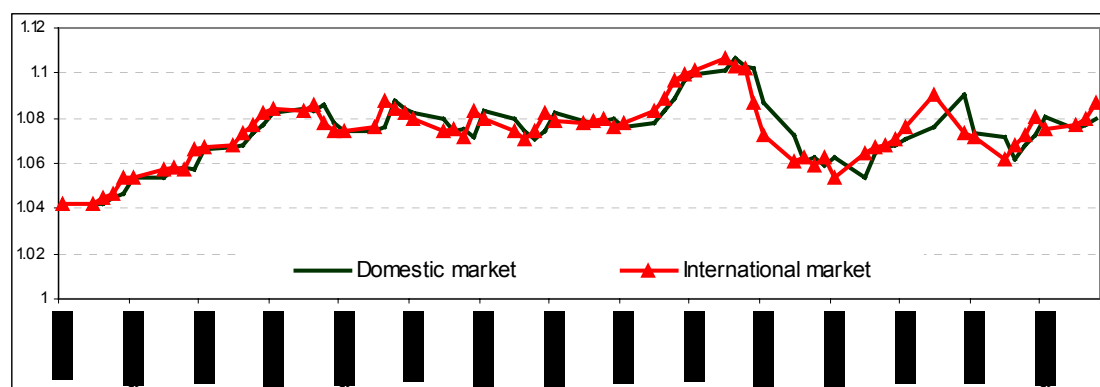


The domestic exchange market has generally followed the developments in international markets. We notice that there are differences between the exchange rates of USD vs. Euro in both markets. This is more visible in the differences that were recorded for the dates prior and after the beginning of the war in Iraq. In average the dollar in the domestic market has been valued higher against Euro than in the international markets.

In international markets, in March, rates of USD vs. Euro have been more volatile than a month ago. Just like in February, in March this exchange rate

has remained in stable levels. The peak of 1.106 USD/Euro was reached in 10th of March, two days before the war in Iraq. Soon after the war began the value of Euro fell showing that the previous levels were associated with psychological expectations relating to the start of the war.

Graph 6. Developments in USD/Euro rate in international and domestic market.



4 DEVELOPMENTS IN MONETARY VARIABLES.

4.1 MONETARY AGGREGATES.

Monetary variables have behaved in line with expectations of the monetary program. The first quarter of 2003 has been characterised a slow growth of monetary supply, a quick return of the money outside banks into the system and a growth of the time Lek deposits thus lowering the M1 aggregate. Stability in the interest rates for deposits and a low inflation rate has created higher real interest rates for Lek deposits that wash a strong attraction for new deposits in the system. The significant difference of real interest rates between Lek and FX deposits has also been a factor in the stability of Lek. These developments given low inflation pressures.

The monetary policy of Bank of Albania for the first quarter has continued to be a neutral one. Bank of Albania changed the form of the Repo auction on 19th of March in order to improve the liquidity of the system. The change in the form of auctions and helped drain the inflated liquidity and lowered the cost of excessive bank reserves. This event lowered the yield for treasury bonds in the primary market.

Bank of Albania has kept in check its quantity objectives. The increase in the monetary assets of Bank of Albania and the decrease of the monetary base has enlarged the discrepancy between the quantity variables and its objectives. The net domestic credit to the government has not been as projected for the months January-February. However, the decreased government's borrowing has lowered the difference from its target.

Table 1. The achievement of the quantity targets for Bank of Albania.

	December '02	January '03	February '03	March '03
Achieving the RNN targets (in million dollars).				
Target	558.6	559.3	559.9	560.6
Actual	562.2	571.1	586.2	590.1
Difference	3.6	11.82	26.23	29.46
Achieving the MBN Target (in billion Lek).				
Target	95.1	95.8	95.9	97.1
Actual	87.1	80.1	81.2	77.6
Difference	-8.0	-15.7	-14.8	-19.5
Achieving the government's net domestic credit (in billion Lek).				
Target	257.0	261.2	262.9	264.6
Actual	259.6	262.8	264.4	--
Difference	2.6	1.6	1.5	--

4.2 THE LATEST DEVELOPMENTS IN THE MONETARY VARIABLES.

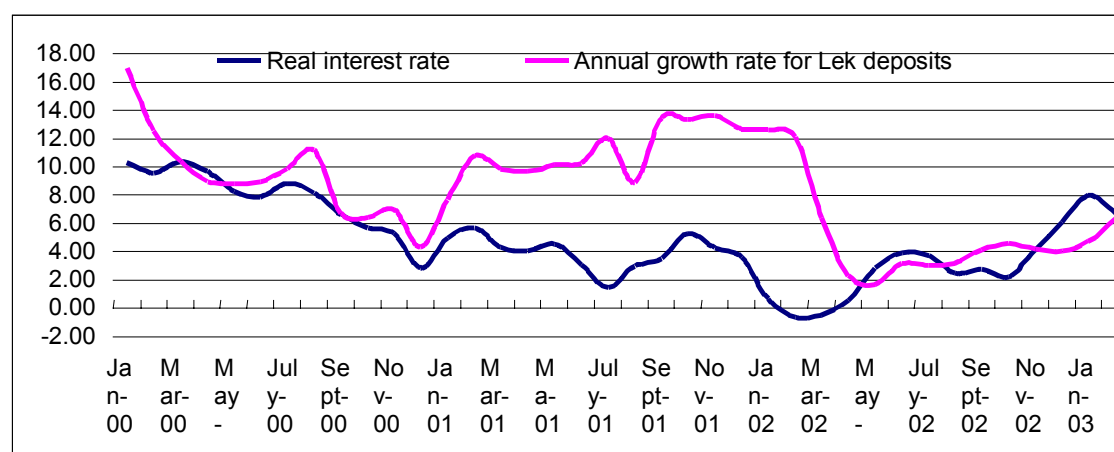
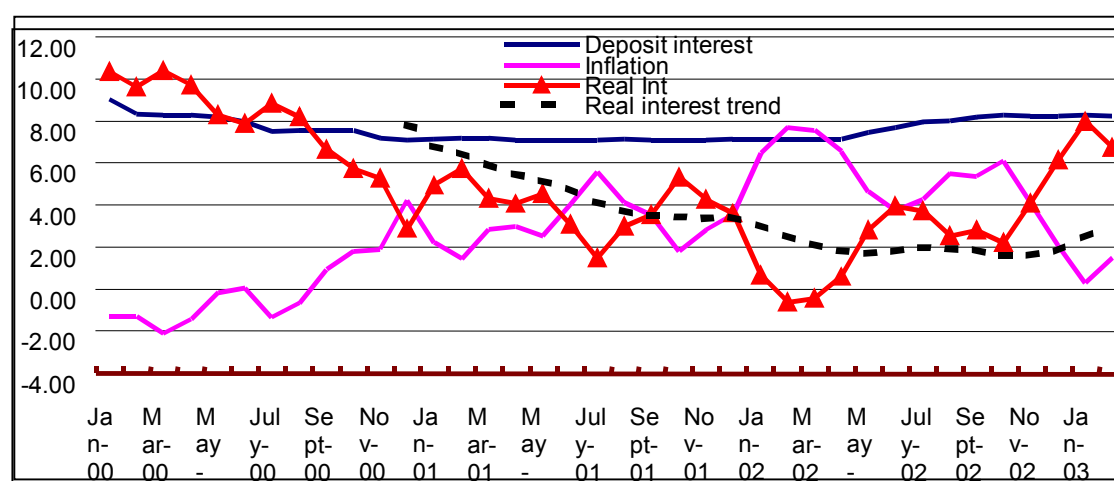
The monetary developments have followed the projected trend set by the monetary program. The main deviations from the program have been:

- The M2 aggregate has had a slower growth as a result of a lower demand than forecasted from the economy and from the government for monetary assets in Lek.
- FX deposits have grown slower than forecasted. This could be as a result of a large discrepancy between Lek and FX deposits and/or a higher demand for imports.
- The return of the money into the system has been quicker than anticipated. This phenomenon lowered the level of money outside banks and increased Lek deposits. The return of the money in the system has been induced by high real interest rates for Lek deposits.

Table 2. Comparing the aggregates with the program (in billion Lek).

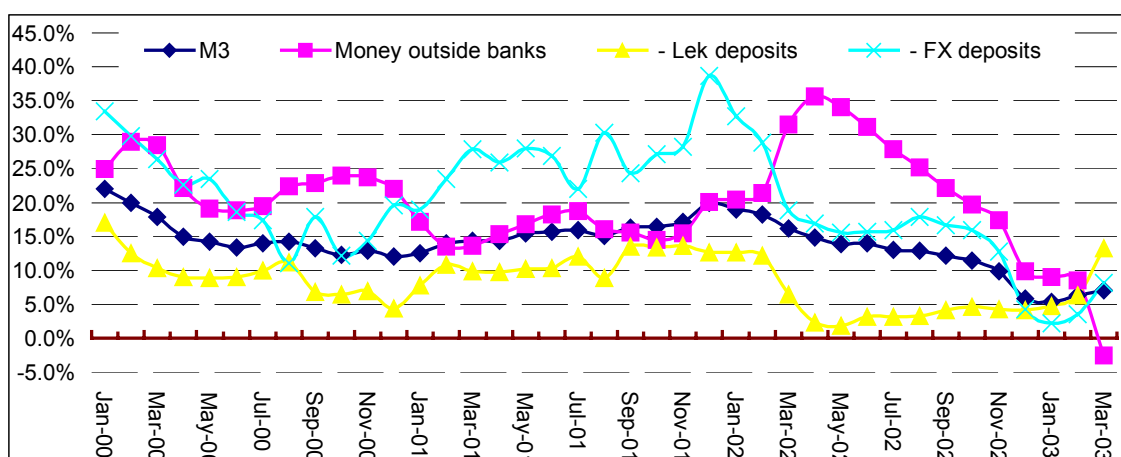
	December		January		March	
	Program	Actual	Program	Actual	Program	Actual
Money outside banks	130.5	130.8	131.8	125.9	134.3	121.4
Lek Deposits	197.9	193.9	199.3	199.2	201.9	206.3
FX Deposits	92.6	92.0	94.1	92.7	96.9	93.1
M1	154.3	152.7	155.5	147.3	158.0	144.2
M2	328.5	324.6	331.0	325.1	336.2	327.7
M3	421.1	416.6	425.1	417.7	433.1	420.8

Graph 7. Interest rates and the annual growth of Lek deposits.



The annual rates of growth of monetary aggregates for the months February-March have continued to be in the three-year lows.

Graph 8. Annual rate of growth for monetary aggregates.



The most noticeable event is the decrease of the absolute size of the money outside banks compared with a year ago. In March the annual growth of money outside banks was –2.6 percent. After the annual growth of FX deposits and M3, reached a multi-year low in January, they had a slightly upward tendency in February and March.

Table 3. Monetary variables in February (in billion Lek).

	February	Monthly change		Annual change	
	2003	Absolute	Percent	Absolute	Percent
Money outside banks	124.4	-1.5	-1.2	9.8	8.5
Total deposits	297.7	5.7	2.0	15.3	5.4
- Lek deposits	204.7	5.4	2.7	12.1	6.3
- FX deposits	93.0	0.3	0.4	3.1	3.5
Demand deposits	58.9	1.5	2.5	2.5	4.4
- Lek deposits	23.3	1.8	8.6	-0.5	-2.2
- FX deposits	35.6	-0.4	-1.1	3.0	9.3
Time deposits	238.7	4.3	0.0	12.8	5.7
- Lek deposits	181.4	3.5	2.0	12.7	7.5
- FX deposits	57.4	0.7	1.3	0.1	0.2
M1	147.7	0.4	0.2	9.2	6.7
M2	329.0	3.9	1.2	21.9	7.1
M3	422.0	4.2	1.0	25.1	6.3
Monetary base	161.3	3.2	2.0	13.4	9.0

The return of the money into the system and the increase in Lek deposits has continued in March and the first two weeks of April according to operative data.

Table 4. Monthly change of monetary aggregates (in billion Lek).

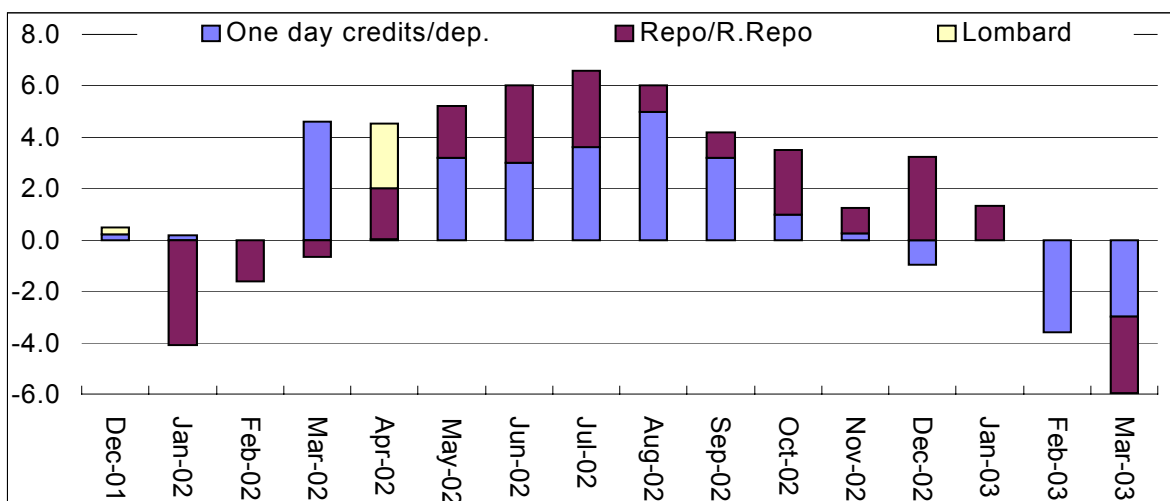
	Monthly absolute change		
	January '03	February 2003	March 2003*
Money outside banks	-4.9	-1.5	-2.9
Total deposits	6.1	5.7	1.8
-in Lek	5.4	5.4	1.7
-in FX	0.7	0.3	0.1
Demand deposits	-0.1	1.5	-1.0
-in Lek	-0.4	1.8	-0.5
-in FX	0.4	-0.4	-0.2

Time deposits	6.2	4.3	2.1
-in Lek	5.8	3.5	2.2
-in FX	0.3	0.7	0.4

* Operative data.

The increase in Lek deposits has improved the liquidity of banks. Banks have gone from being borrowers of 2.3 billion Lek in December to being lenders of 3.6 billion in February. Their liquidates have continued to improve in March as well. By the end of March, excessive reserves in commercial banks were close to 6 billion Lek.

Graph 9. Excessive reserves in the banking system (in billion Lek).



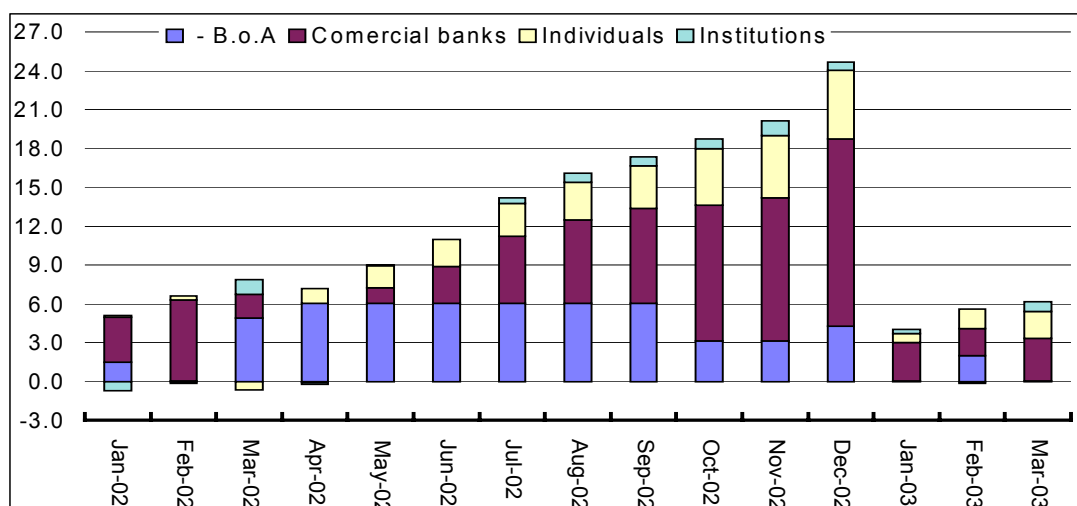
4.3 MONEY DEMAND VARIABLES.

From the beginning of 2003 until February the banking system had an increase of close to 1 billion Lek or 55.2 million dollars of FX monetary assets compared with December 2002. The contribution of the increase in FX monetary assets to the money supply is calculated to be near 19 percent. This increase of FX currencies is due to the transactions of Bank of Albania in the foreign exchange market and of an increase in FX deposits in the banking system. Bank of Albania has increased its net reserves level by 30.4 million dollars, of which close to 20.4 million consist of purchases in the foreign exchange market.

Government's demand in the first quarter of the year has been 6.2 billion Lek compared with 6.7 billion Lek of the same period a year ago. From this amount, the banking system covered 3.3 billion Lek in 2003 against 6.7 billion Lek in 2002. Meanwhile, the monetary program had forecasted to be financed 5.2 billion Lek of the fiscal budget. This has been yet another factor

influencing the increase in excessive reserves of the banks. Bank of Albania has financed the fiscal deficit in February by direct crediting in order to lower the *yield* of treasury bonds. This credit has matured in March and for the moment the balance of financing the fiscal deficit by Bank of Albania is 0.

Graph 10. Cumulative financing of the fiscal deficit (in billion Lek).



The excessive credits for the economy by the end of February reached 48.4 billion Lek up 1.4 billion Lek from a month ago. This monthly increase of excessive credits in February is twice as high as the same month a year ago. This level also exceeds the forecast of monetary program, which was near 1 billion Lek.

Table 5. Structure of excessive credits (in percentage).

	2002				2003	
	Q-1	Q-2	Q-3	Q-4	Jan.	Feb.
Short-term loans	52	50.5	48.4	49	48	49
Medium-term loans	26	28.1	29.0	28	29	29
Long-term loans	22	21.4	22.6	23	23	22
Public sector	4	3	2.7	2	2	2
Private sector	96	97	97.4	98	98	98
Lek	32.5	32	33.1	34	34	34
Foreign currency	67.5	68	66.9	66	66	66
Excessive loans (in bill. Lek)	38.2	42	44.3	47.4	47.04	48.4

New loans issued in February reached 5 billion Lek or near twice as much as a year ago in the same month. This tendency demonstrates an improving crediting activity.

Table 6. New credits (in billion Lek).

Variables	Year 2001	New credits for 2002				2002	2003	
		Q-1	Q-2	Q-3	Q-4		Jan.	Feb.
Short-term loans	27.6	9.5	10.7	11.4	13.2	44.8	3.2	3.6
Medium-term loans	10.4	2.4	3.1	3.5	4.0	13.0	0.9	1.0
Long-term loans	2.6	0.6	1.6	1.3	1.3	4.8	0.4	0.4
Public sector	0.5	0.02	0.03	-	0.00	0.05	0.0	0.0
Private sector	40.1	12.5	15.4	16.2	18.50	62.59	4.5	5.0
Lek	10.0	2.1	4.3	6.6	7.9	20.9	1.7	1.7
Foreign currency	30.6	10.4	11.1	9.6	10.6	41.7	2.8	3.3
New credits (in billion Lek)	40.6	12.5	15.4	16.2	18.5	62.6	4.5	5.00

5 INTEREST RATES IN THE ECONOMY.

In February 2003 interest rates have shown a slightly downward tendency. Decreased Lek interest rates have been influenced by such factors as the growth of Lek liquidity in the banking system, especially by the Savings Bank and of a steady supply of government treasury bonds in the market.

Graph 11. Weighted average market interests, in percentage.

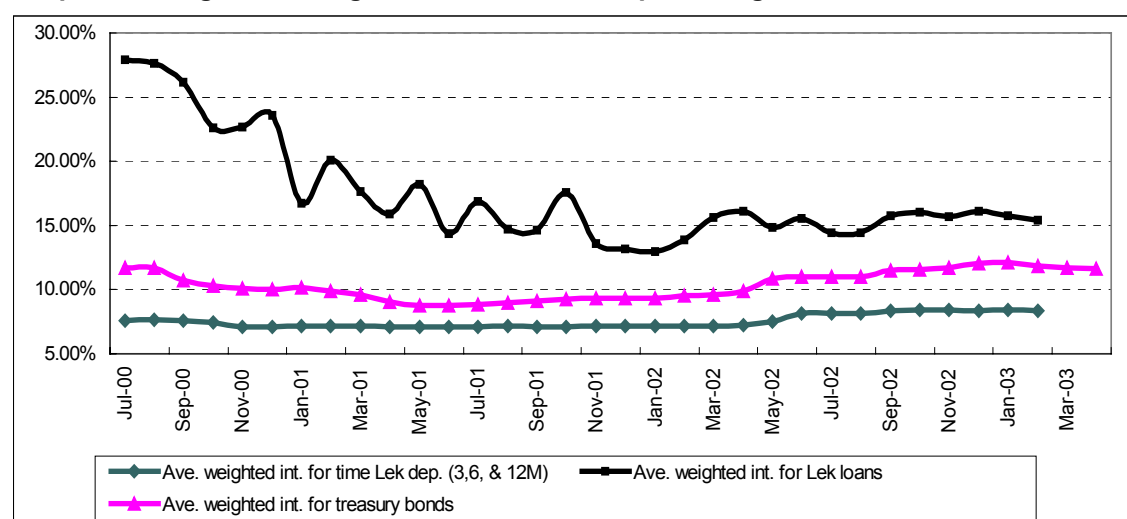
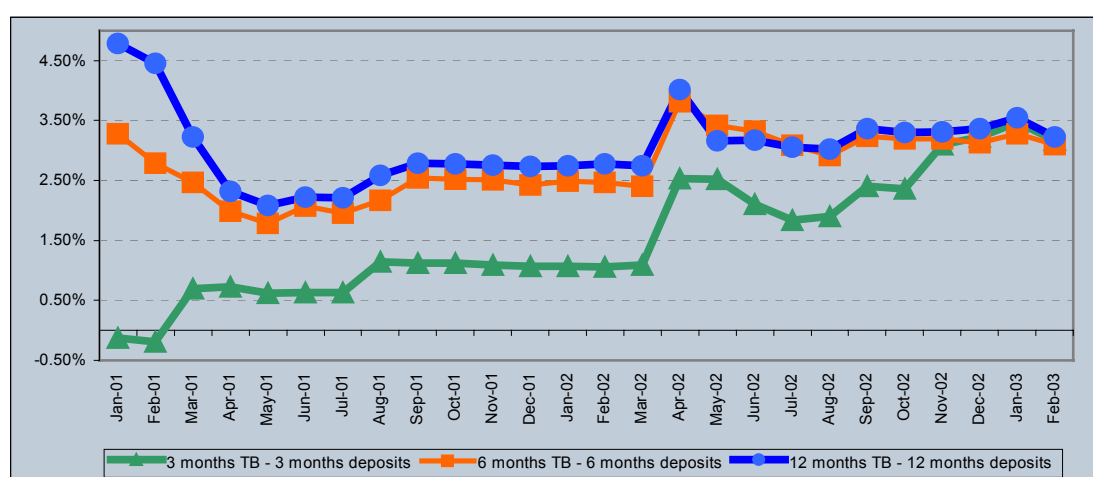


Table 7. Change in interest rates (by percentage point).

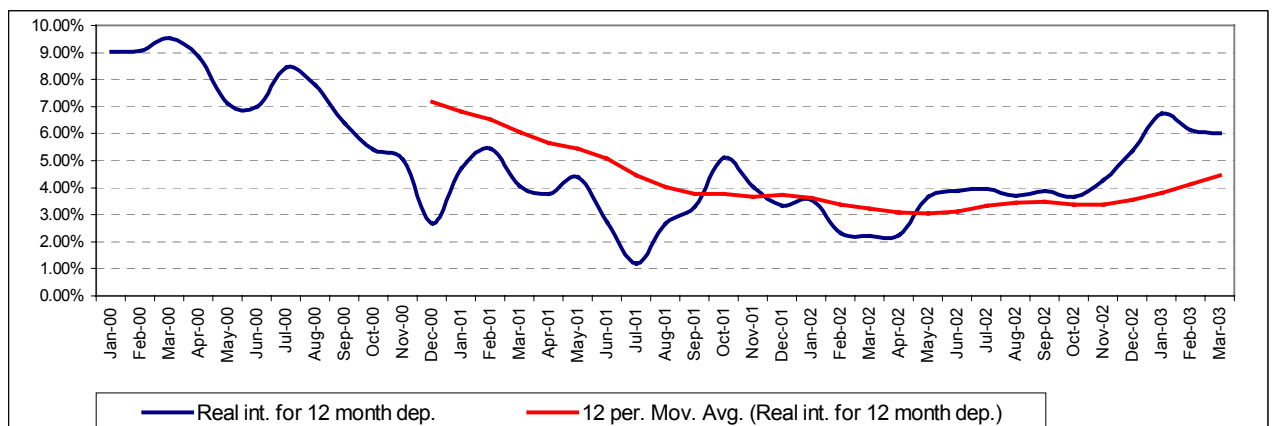
	Change in Deposit interests	Change in treasury bonds <i>yields</i>		Change in credit interests
	Period January – February 2003	Period January – February 2003	Period January – April 15 th 2003	Period January – February 2003
3-month	-0.04	-0.34	-0.77	
6-month	-0.06	-0.24	-0.47	
12-month	-0.04	-0.36	-0.65	-0.43
1-3 years				+0.15
Over 3 years				-0.54
Weighted	-0.06	-0.31	-0.63	-0.35

Graph 12. Difference between treasury bills and deposit interests by maturity, in percentage points.



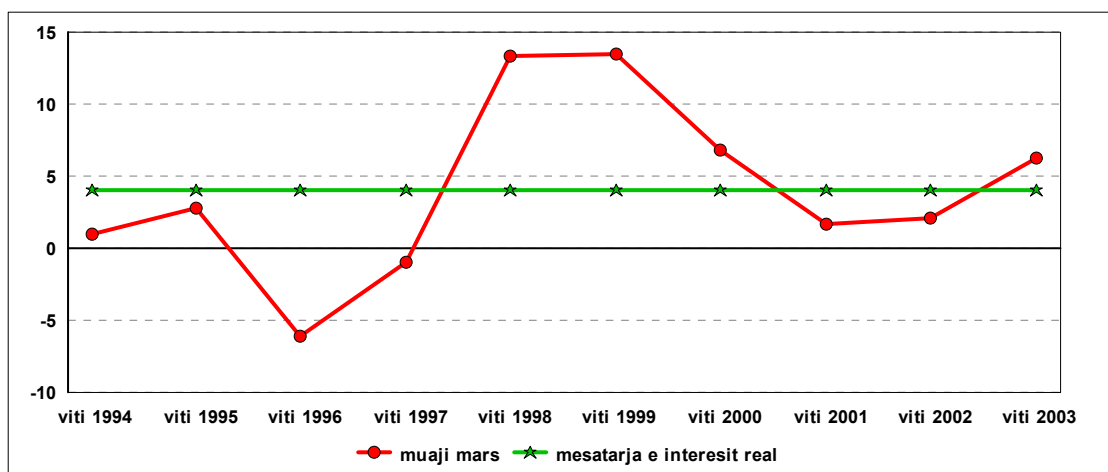
By the end of March the average real interest rates for one-year time deposits, after income tax, was 6.3 percent. This level came as a result of a small reduction in interest rates for time deposits in Lek as well as a slight annual inflation growth compared with the previous two months.

Graph 13. Average real interest rate for one-year Lek deposits, in percentage.



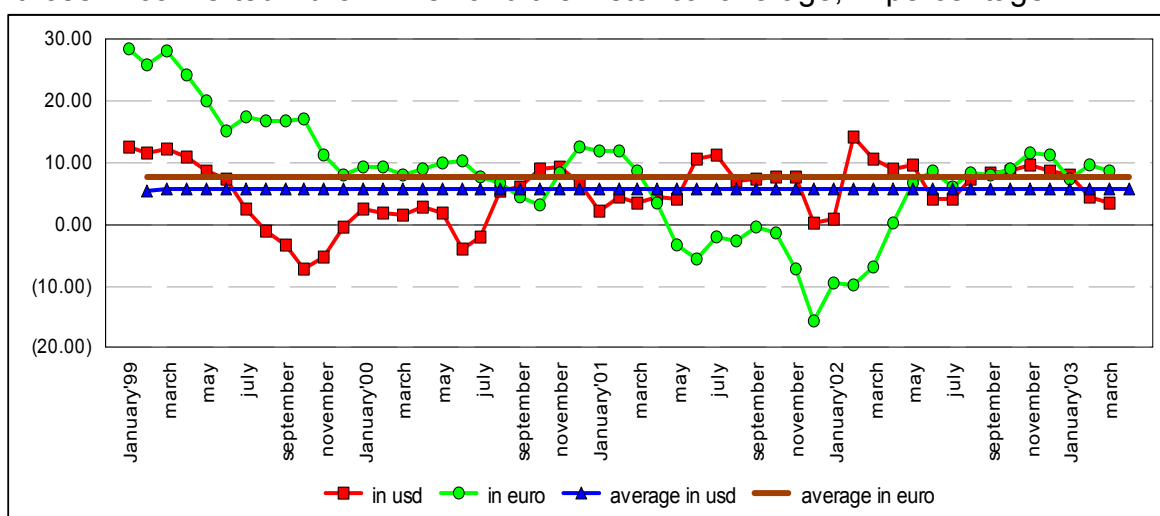
If compared with the historical average for the month of March we see that investors have earned the highest income from such an investment since 2001.

Graph 14. Average real interest rates for March and the historical average (in percentage).



Interest rates for one-year time deposits in Lek continue to be more competitive than the interest of foreign exchange deposits.

Graph 15. The difference between interest rates of one-year Lek deposits and those in converted Euro² in Lek and the historical average, in percentage.



² Expected monthly exchange is calculated as a historical average