

BANK OF ALBANIA

MONETARY POLICY  
MONTHLY REPORT

JANUARY 2006

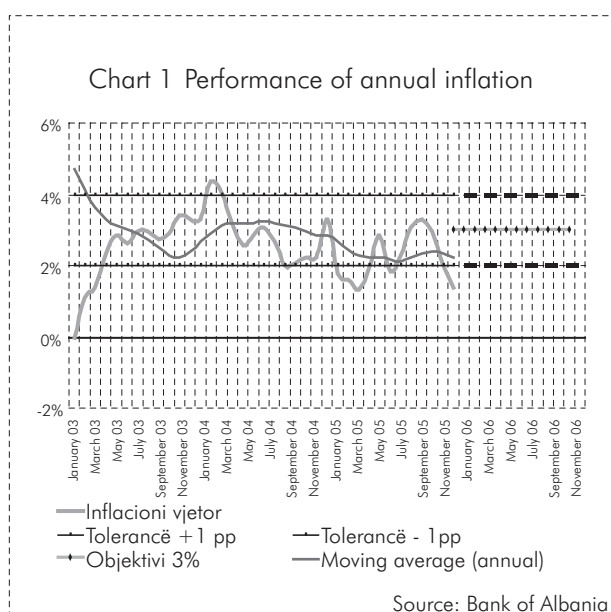


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## I SUMMARY OF MAIN HIGHLIGHTS

- Annual inflation in January marked 1.4 per cent. The average annual inflation rate decreased to 2.2 per cent, compared to 2.3 per cent in December.
- Demand and supply factors did not cause inflationary pressures over the general price level. The decrease of annual inflation in January came as a consequence of the inflation decrease in the “Rent, water, fuels and energy” group. However, this group continues to provide the main contribution to the increase of consumer prices. On the other hand, “Foodstuffs and non-alcoholic beverages” group continues to be characterized by negative annual inflation rates.
- According to operational data, the growth pace of money supply continued to decrease even during January. In January, the annual growth of currency outside banks marked 7.6 per cent, as such confirming the decreasing seasonal tendency during this period of the year.
- December was characterized by a high money demand influenced by the crediting to the economy and the demand for budget deficit financing. The concentration of budget deficit financing in December caused liquidity problems to the banking system. Meanwhile, January presented a normal liquidity situation, as a consequence of the return of money to the system and the low borrowing demand by the Government.
- Despite the long period of interventions in the foreign currency market, Lek continued to be characterized by appreciating tendencies. In annual terms, the nominal effective rate of lek in January appreciated by 0.8 per cent.
- January was characterized by a stable liquidity level. Liquidity was mainly withdrawn through fixed price one-week repos. Short-term liquidity needs were met in the interbank market without having the need to use the overnight credit.
- Interest rates in lek displayed a slight decreasing tendency during January. However, the low inflation rate maintained high real interests in lek. The difference between lek deposits interest rates and treasury bills yield tightened during January. Operational data display increasing foreign currency interest rates.



The difference between lek deposits interest rates and treasury bills yield tightened during January. Operational data display increasing foreign currency interest rates.

## II INFLATION IN JANUARY 2006

Annual inflation in January marked 1.4 per cent, decreasing by 0.6 percentage points compared to the previous month. The average rate of annual inflation decreased to 2.2 per cent compared to 2.3 per cent in December. The monthly inflation rate was 0.2 per cent, which is rather higher than the average rate of the last three years.

## II.1 INFLATION BY CONSTITUENT GROUPS

Inflation in January 2006 displayed a different behaviour compared to the same month the last year, when the annual inflation rate marked 3.3 per cent. Such a decrease came as a consequence of the influence of the structural factors. Demand and supply factors did not exercise inflationary pressures over the general price level.

The annual change of consumer price index did not pursue the same structure as during 2005. The annual inflation rate during January was created by a decreasing contribution of the “Rent, water, fuels and energy” group and by the negative contribution of “Foodstuffs and non-alcoholic beverages” group. The decrease in the prices of these groups was (somehow) counterbalanced by the increase in the service prices (transportation and hotels, café and restaurants). The other basket groups have maintained the tendencies observed during the last year.

The decreasing contribution of “Rent, water, fuels and energy” group led the decrease of inflation rate during this month. For a period of almost two years (February '04 – December '05), this group has practically determined the whole annual inflation rate. In January, “Rent, water, fuels and energy” group contributed by 0.9 percentage points to total inflation, compared to the contribution by 3.6 percentage points in January '05. The decrease of contribution provided by this group came as a consequence of the reduction in the energy price increase effect during this month. On the other hand, the monthly change of inflation in January by 0.2 per cent was entirely influenced by the increase of prices by 0.9 per cent of rent and imputed rent. The group's contribution to the monthly inflation rate was 0.2 percentage points.

“Foodstuffs and non-alcoholic beverages” group marked a negative annual change by -0.4 per cent, as such smoothing the annual inflation decrease of this month. This group's contribution to annual inflation maintained the same direction as during January in the previous year. In January 06, this group caused the decrease of annual inflation rate by -0.2 percentage points. On the other hand, the monthly developments in the performance of these goods' prices indicate the maintenance of prices in the same levels as in December. The monthly inflation rate of this group resulted in 0.0 per cent.

“Transportation” and “Hotels, café and restaurants” groups have marked an increase in the prices during January. “Transportation” group has contributed by 0.26 percentage points to annual inflation rate. The contribution to annual inflation rate provided by this group during this month has almost been twice the contribution provided to annual inflation during January 2005 (0.14 percentage points). The source

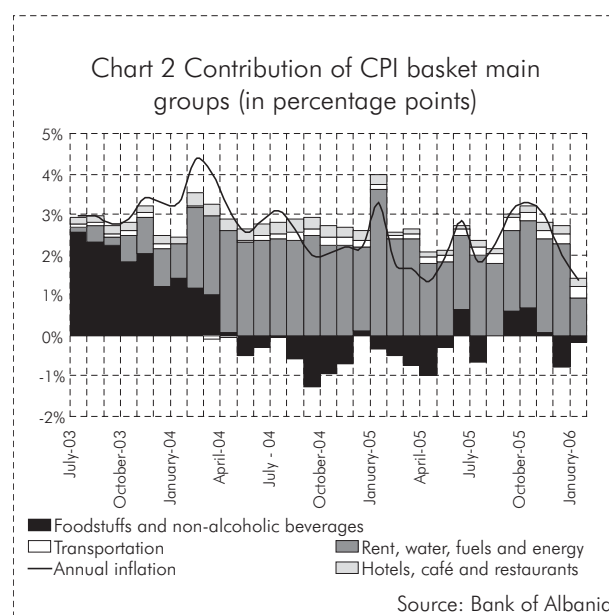
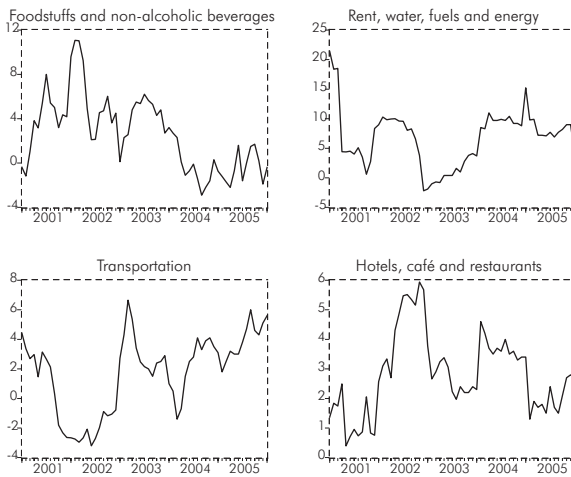
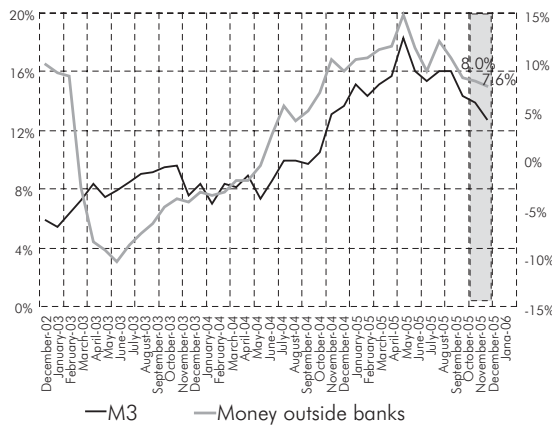


Chart 3 Annual inflation of 4 main groups in the CPI basket (in percentage points)



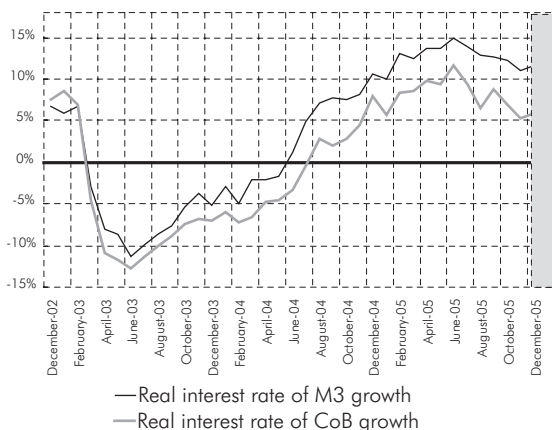
Source: Bank of Albania

Chart 4 Annual growths of M3 and currency outside banks



Source: Bank of Albania

Chart 5 Annual growths of M3 and currency outside banks in real terms



Source: Bank of Albania

of this increase is the increase in the oil prices. Thus, "Service to personal vehicles" subgroup has marked an annual increase of 11.3 per cent, compared to 6.2 per cent in January 2005.

"Hotels, café and restaurants" group has continued to influence over the increase of annual inflation rate by 0.21 percentage points. This contribution has remained unchanged during the last three months.

The items prices of "Alcoholic beverages and tobacco", "Education service" and "Health service" groups have marked positive increasing rates, contributing to the inflation rate by 0.3 percentage points. Meanwhile, the other groups, such as "Clothes and footwear" and "Furniture, household equipment etc", have recorded negative annual change rates, making a negative contribution of -0.2 percentage points.

### III. MONETARY DEVELOPMENTS AND FINANCIAL MARKETS

During the last two months, our economy has been characterized by stable monetary conditions. The slowdown of monetary expansion observed during the second semester of the previous year continued even during January, while the monetary aggregates ratios have known improvements. Moreover, the interest rates and the exchange rate are presented as stable.

According to preliminary data, the growth paces of the main indicators have fluctuated to the rates observed in the last quarter of 2005. After the peak marked in June, the growth pace of the monetary supply has been under continuous decrease. Such a tendency continued even during January. The annual growth of currency outside banks in January marked 7.6 per cent, confirming the decreasing seasonal tendency during this period of the year.

In real terms, the trend of these two indicators is presented more stable. The annual growth of currency outside banks and M3, in real terms, has not incurred significant changes during the last two months, generally performing as planned in the programme.

The ratio of currency outside banks to M2 aggregate has undergone decrease, mainly due to the characteristic reduction of currency outside banks in January. During the last two years, the ratio of currency outside banks to M2 and the real interest have had a decreasing tendency as a consequence of the macroeconomic stability and the enhancement of confidence in the banking system. However, this tendency is expected to be slighter in the upcoming months.

The decrease of inflation rates in the last two months has enabled high real interest rates in the reception of deposits by the banking system, which was around the level of 4 per cent. According to preliminary data, the real interest rates reach close to the maximal levels observed in the last two years, mainly due to low inflation rates. The nominal factor of this indicator is stable, while the oscillation of the real component reflects the inflation rate fluctuation.

### CREDIT TO ECONOMY

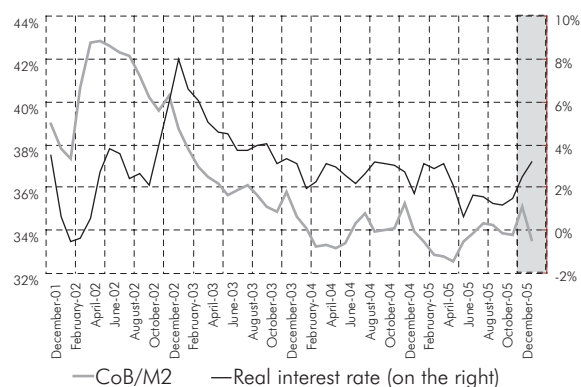
December was characterized by a substantial crediting to the economy. According to operational data for December, credit to economy had a monthly increase by ALL 7 billion. The annual growth pace of credit at the end of December reached to 74 per cent.

At the end of the year, the credit balance reached to ALL 121 billion, which is equal to 14.6 per cent of the GDP. The increase of credit has constituted 73.4 per cent of the monetary expansion for 2005.

The increase of credit balance came as a consequence of the enhancing commitment of banks to credit the economy. The new credit extended by the banking system during 2005 was ALL 120 billion. This credit is generally of a short-term kind and it reflows more than once within a year, if we will consider that the annual growth of credit balance was ALL 52 billion.

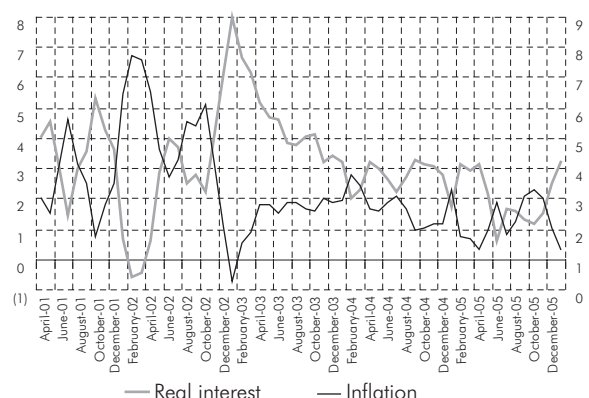
However, during 2005, it was observed an increase in the average credit maturity, influencing even over its portfolio growth. About

Chart 6 Ratio of currency outside banks to M2 and the real interest rate



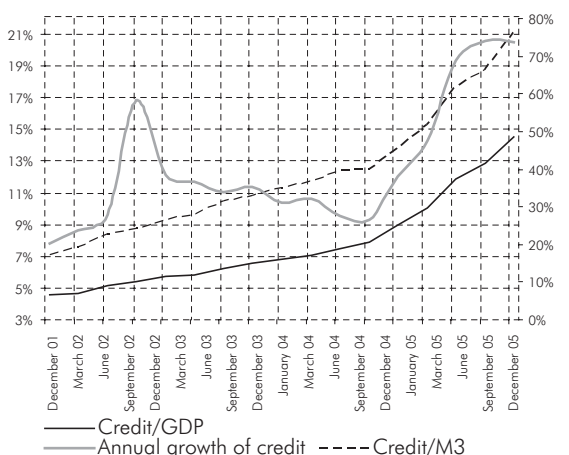
Source: Bank of Albania

Chart 7 Inflation and real interest performance



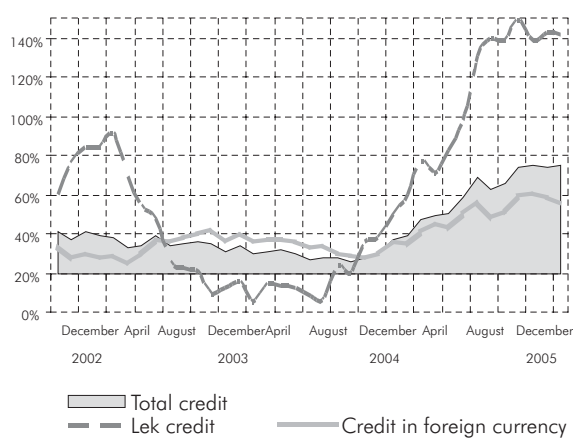
Source: Bank of Albania

Chart 8 Ratio of credit to M3 and GDP (left scale) and the annual growth credit rate (right scale)



Source: Bank of Albania

Chart 9 Annual rates of credit growth



Source: Bank of Albania

50 per cent of the new extended loans have had a maturity of over 1 year. At the end of December, the long-term (over 3 years) credit constituted 37 per cent of credit portfolio, compared to 30 per cent in the previous year.

During 2005, the contribution of credit in lek to the total credit growth increased, reaching to 34 per cent at the end of the year. At the end of 2005, credit in lek constituted 25.5 per cent of the banking system credit portfolio. The main contributors of credit in lek were the households, although it was observed a big demand by businesses, as well.

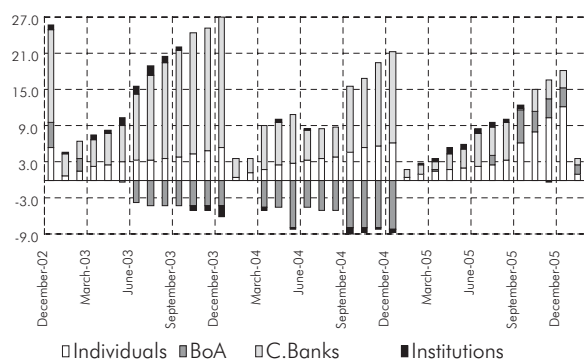
Table 1 Indicators of credit balance to total (in percentage)

	2003	2004	Q-1 '05	Q-2 '05	Q3 '05	November	December
Credit balance (in billions of ALL)	50.7	69.3	79.0	95.9	106.0	114.6	121.6
Short-term credit	46.0	34.0	34.1	33.7	31.6	32.0	32.8
Medium-term credit	33.3	36.0	34.5	33.1	31.2	31.2	30.3
Long-term credit	20.7	30.0	31.4	33.1	36.9	36.8	37.0
Credit to households	24.5	30.6	31.0	30.8	31.4	32.0	31.6
Credit to private sector	75.5	69.4	69.0	69.2	68.6	68.0	68.4
Lek	19.6	19.5	20.1	22.9	23.7	25.2	25.5
Foreign currency	80.4	80.5	79.9	77.1	76.3	74.8	74.5

## BUDGET DEFICIT FINANCING

Government demand for money has been moderate during 2005. Deficit financing by the banking system was in its lowest level in the recent years, as a consequence of the households' interest enhancement to invest in treasury bills. Budget deficit domestic financing was mainly carried out through 2 and 3-year bonds. After the concentration of budget deficit financing in December, bringing liquidity problems to the banking system, January displayed a more normal situation.

Chart 10 Deficit domestic financing through treasury bills



Source: Bank of Albania

## EXCHANGE RATE

Despite the long period of interventions in the foreign currency market, lek continued to be characterized by appreciating tendencies. In January, the nominal effective rate of lek<sup>2</sup> appreciated by 0.8 per cent in annual terms.



This tendency is explained by the maintenance of the demand for lek, as a consequence of the favourable difference of interest rates, and the seasonal decrease of imports during this period. Lek appreciated by 5.4 per cent to the usd and depreciated by 2.5 per cent to the euro.

### LIQUIDITY AND INTEREST RATES IN THE MONEY MARKET

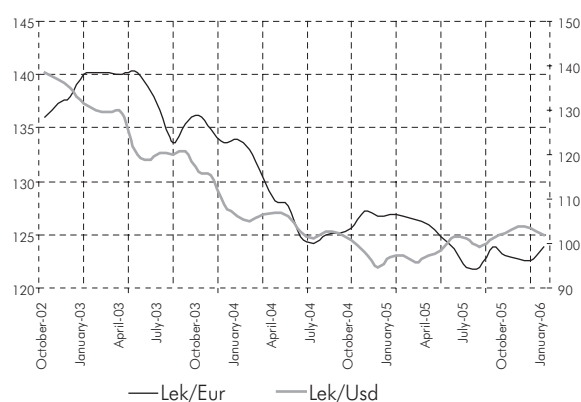
January was characterized by a stable level of liquidity. The daily average level of liquidity in January increased to ALL 5.3 billion, compared to ALL 3.5 billion marked in December. The growth of liquidity was mainly caused by the return of money to the banking system and the low demand of the Government for monetary assets.

Liquidity was mainly withdrawn through fixed price one-week repos. Their daily average level during January was ALL 2.5 billion. The rest of liquidity was kept in the form of overnight deposits and excess reserves (ALL 2.6 billion). Short-term liquidity needs were met in the interbank market, as such not requiring the need of using overnight credit.

Compared to December, the average volume of overnight transactions increased to ALL 0.68 billion compared to ALL 0.65 billion, while the average volume of weekly transactions increased to ALL 1.19 billion compared to ALL 0.98 billion in December. The interest rates in this market fluctuated to the band 3.51 – 5.29 per cent for overnight lending and 5.23 – 5.70 per cent for weekly lending, as such marking a decrease compared to the previous month.

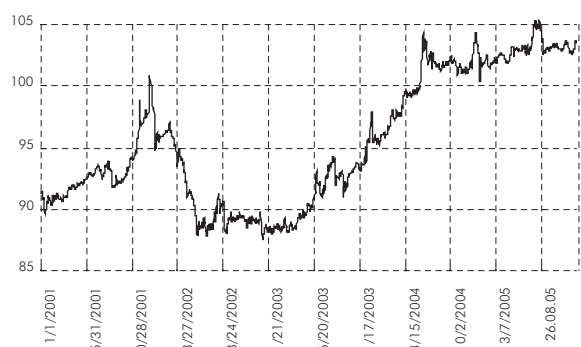
The growth of excess liquidity influenced over the ratio increase between the amount provided by the banking system and the amount demanded by the Government. In January this ratio was in the level of 1:1.2. In a few cases, the matured amount of treasury bills was above the amount notified to be issued, as such influencing over the augmentation of liquidity in the system. Treasury bills yields incurred a decrease, compared to December, by 0.17 percentage points, 0.26 percentage points and 0.13 percentage points, for 3-month, 6-month and 12-month treasury

Chart 11 Monthly average of lek exchange



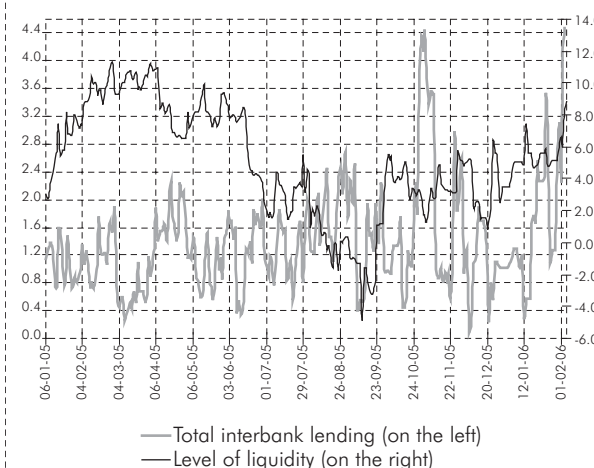
Source: Bank of Albania

Chart 12 Nominal effective rate of lek exchange



Source: Bank of Albania

Chart 13 Level of liquidity and borrowing in the interbank market (in billions of ALL)



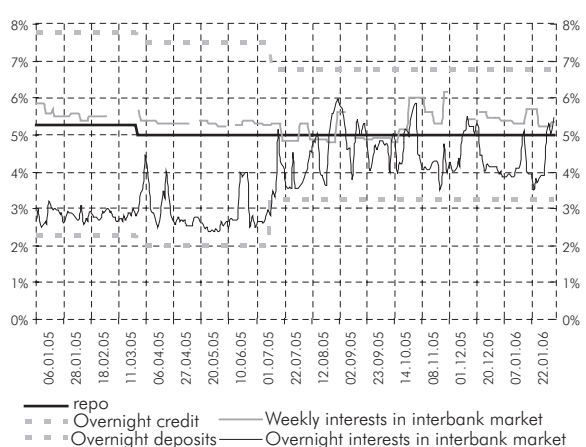
Source: Bank of Albania

bills, respectively. Treasury bills yields are reaching the levels of June, when they recorded their historical minimum.

Table 2 Treasury bills yields (in percentage)

	3-month	6-month	12-month
January 05	5.84	7.05	7.97
March 05	5.24	6.51	7.14
June 05	5.06	6.37	6.78
September 05	6.73	8.64	9.14
December 05	5.42	6.73	6.91
January 06	5.25	6.47	6.78

Chart 14 Interest rates in the interbank market and the Bank of Albania interest rates



Source: Bank of Albania

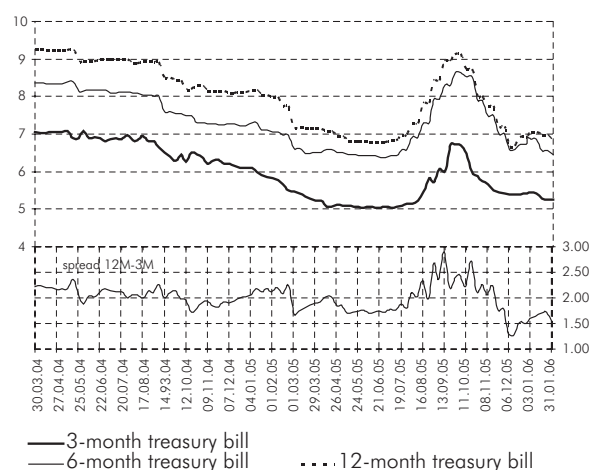
According to operational data<sup>3</sup>, the interest rates of lek deposits were presented as relatively stable, with a slight decreasing tendency during the last two months.

At the end of January, the average risk-weighted rate of lek deposits for the 12-month period was 5.28 per cent, which is 0.04 percentage points lower than in December and 0.13 percentage points lower than in November.

Table 3 Risk-weighted<sup>4</sup> rates of lek deposits (in percentage)

	3-month	6-month	12-month	24-month
November '05	4.17	4.89	5.45	6.54
December '05	4.08	4.69	5.32	5.96
January '06	4.12	4.72	5.28	5.69

Chart 15 Treasury bills yields and the spread for 12-month and 3-month terms (in percentage)



Source: Bank of Albania

Although the official data for the foreign currency interest rates for December and January are missing, the considerable increase of the real lek rate is deemed to have led to an increase in the interests' difference between lek and the foreign currency.

The difference between the interest rates of lek deposits and the treasury bills yield tightened in January. For the 12-month term, this difference reached to 1.50 percentage points, compared to 1.75 percentage points in November. However, these rates should not be taken for granted, since the data on the deposits' rates are operational.

Chart 16 Real rate of lek and its difference with the foreign currency rates (in percentage points)

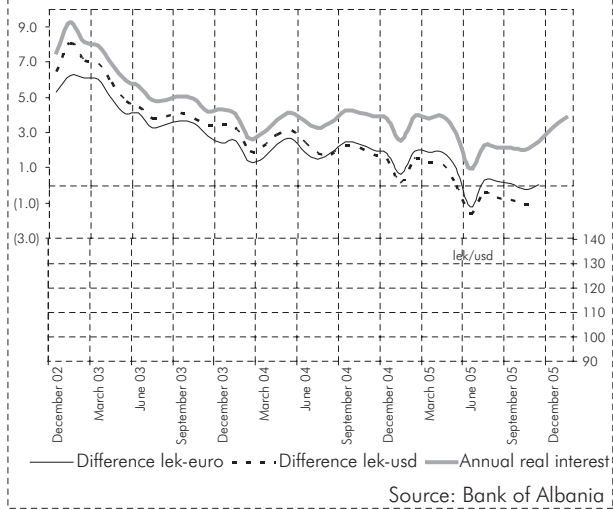
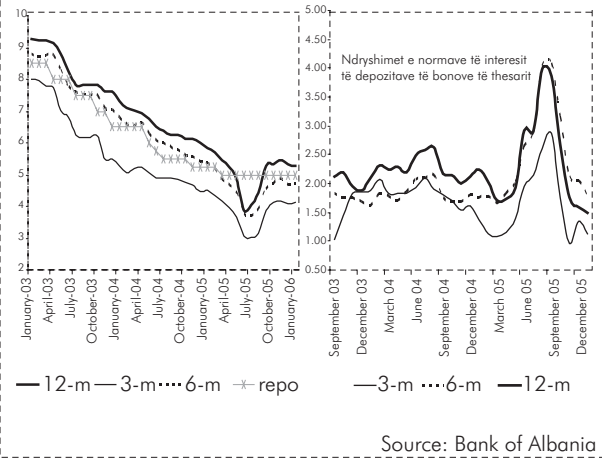


Chart 17 Rates of lek deposits and the spread with the treasury bills yields (in percentage)



Endnotes

<sup>1</sup> Preliminary data

<sup>2</sup> The nominal effective rate is set up based on a basket composed of 80 per cent of its weight in euro and 20 per cent in usd.

<sup>3</sup> The official data on the rates of deposits and credit are available until November 2005.

<sup>4</sup> Risk-weighted deposits according to November 2005 data.

## STATISTICAL ANNEX

## INFLATION

Table 1 Annual inflation rate  
(in percentage)

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

Source: INSTAT

Table 2 Contribution to  
total inflation of the basket  
constituent groups

	Dec-03	Dec-04	March-05	June-05	Sep-05	Oct-05	Nov-05	Dec-05	Jan-06
Foodstuffs and non-alcoholic beverages	1.20	0.12	-0.74	0.65	0.61	0.71	0.09	-0.8	-0.16
Rent, water, fuels, energy	0.95	2.08	2.40	1.83	2.00	2.13	2.30	2.26	0.94
Transportation	0.14	0.16	0.11	0.14	0.29	0.23	0.22	0.24	0.26
Hotels, café and restaurants	0.18	0.25	0.14	0.12	0.12	0.17	0.21	0.21	0.21
Other	0.84	-0.42	-0.27	0.15	0.11	0.07	0.13	0.15	0.14
Total	3.31	2.19	1.64	2.89	3.14	3.32	2.94	2.06	1.39

Source: INSTAT, Bank of Albania

## MONETARY AGGREGATES

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

	November 2005	Monthly change		Annual change	
		Absolute	Percentage	Absolute	Percentage
Currency outside banks	139.7	3.8	2.8	10.8	8.4
Total deposits	426.3	20.3	5.0	60.1	16.4
- Deposits in Lek	273.9	3.9	1.4	24.8	10.0
- Deposits in foreign currency	152.4	16.4	12.1	35.2	30.0
Demand deposits	130.9	40.4	44.7	57.9	79.2
- in Lek	76.0	35.0	85.3	47.6	168.1
- in foreign currency	55.0	5.5	11.1	10.3	22.9
Time deposits	295.4	-20.1	-6.4	2.2	0.7
- in Lek	197.9	-31.1	-13.6	-22.8	-10.3
- Deposits in foreign currency	97.5	10.9	12.6	25.0	34.4
M1	215.6	38.8	21.9	58.4	37.2
M2	413.6	7.8	1.9	35.6	9.4
M3	566.0	24.2	4.5	70.9	14.3
Monetary base	188.9	8.4	4.7	19.2	11.3

Source: Bank of Albania

	In absolute value	Monthly change	Annual change
Net foreign assets			
Foreign assets			
Bank of Albania	1425.5	58	(54.8)
ODC			
Foreign liabilities			
Bank of Albania	194	(1.5)	(7.4)
ODC			

Source: Bank of Albania

Table 4 Performance of NFA indicators by main groups, December 2005 (in millions of USD)

	In absolute value	Monthly change	Annual change
Net claims to the Government	281,682	(3,230.6)	13,729.7
Bank of Albania	57,031.0	(6,288.7)	5,904.8
ODC	224,651.0	3,058.1	7,824.8
Deposits with the Bank of Albania	12,149.2	4,288.7	(2,586.6)
Budget deficit	(11,270.4)	2,190.4	3,994.0

Source: Bank of Albania

Table 5 Performance of NCG indicators by main groups, November 2005

## FINANCIAL MARKETS

	Interest rates January 2006	Change January 2006- December 2005	Change January 2006-January 2005
Core interest rate	5.00%	0.00	-0.25
Interbank market			
Overnight interest	3.9%	-0.3	+1.15
Weekly interest	5.2%	-2.23	-0.27
Primary market			
3-month treasury bills yield	5.26%	-0.15	-1.87
6-month treasury bills yield	6.57%	-0.16	-1.93
12-month treasury bills yield	6.97%	0.06	-2.48
Bonds market			
2-year bonds yield	8%	0.0	-0.95

Source: Bank of Albania and commercial banks

Table 6 Interest rates at the end of January and their change compared to previous periods (in percentage points)

	Interest rates November 2005	Change November- October 2005	Change November '05 -November '04
Core interest rate	5.00%	0.00	-0.50
Deposits interests in Lek			
3-month	4.17%	0.06	-0.52
6-month	4.89%	0.15	-0.69
12-month	5.45%	0.13	-0.68
Credit interests in Lek			
Up to 6-month credit	13.36%	-0.02	1.38
6-month – 1-year credit	13.29%	0.67	-1.76
1-3 years credit	17.34%	-0.27	-1.68
Over 3 years credit	8.54%	-3.61	-4.18

Source: Bank of Albania and commercial banks

Table 7 Interest rates and their change in Lek deposits and credit market (in percentage points)

Table 8 Currency deposits interest rates (in percentage points)

	Interest rates November 2005	Change November- October '05	Change November '05- November '04
Fed-core interest rate	4.0%	+0.25	+2.00
Deposits interests in USD			
1-month	2.28%	+0.31%	+0.99%
3-month	2.53%	+0.18%	+0.98%
6-month	2.80%	+0.17%	+0.95%
12-month	3.34%	+0.26%	+1.16%
24-month	3.76%	-0.07%	+1.24%
ECB-core interest rate	2%	0.00	0.00
Deposits interests in EUR			
1-month	1.71%	+0.01%	+0.07%
3-month	1.98%	+0.29%	+0.30%
6-month	2.07%	+0.07%	+0.25%
12-month	2.40%	+0.17%	+0.50%
24-month	2.74%	-0.92%	+0.72%

Source: Bank of Albania and commercial banks