

MONETARY POLICY MONTHLY REPORT



JULY 2003

CONTENT

I.	The main developments in July 2003.	2
II.	Inflation and foreign exchange trend in July	3
II.1	Factors influencing on inflation trend.....	3
II.2	Exchange rate trend.....	6
III.	Monetary developments and financial markets.....	7
III.1	Monetary policy of Bank of Albania	7
III.2	Monetary aggregates trend.	8
III.3	Economy's demand for money.....	11
III.3.1	Net foreign assets of the banking system.....	11
III.3.2	Government's demand for monetary assets.....	12
III.3.3	Credit to economy.....	13
III.4	Financial markets and interest rate.....	13
III.4.1	Financial markets.....	13
III.4.2	Interest rate trend.....	15

I. THE MAIN DEVELOPMENTS IN JULY 2003

- Consumer price index in July exceeded the objective set by Bank of Albania by 0,16 percentage points. This month, inflation decreased by a monthly value of 0,36%, while its annual rate marked 4,16%. However, the average inflation in the first seven months of 2003 remains 3,5% within the objective's limits.
- Exchange rate in July showed a symmetrical trend of the two main currencies, Euro and dollar against Albanian Lek. Lek was depreciated on the average, by 1,1% against USD and was appreciated by 1,6% against EURO.
- Money supply in June underwent the greatest monthly growth at Lek 4,3 billion since the year onset, as a result of time Lek and foreign currency deposits increase. These deposits constitute 30% of total deposits increase.
- In June, the highest level of the monthly credit to economy granted by the banking system for the first six months of the year was reached at. The credit extended in this month was Lek 8,9 billion, or nearly twice more than the same period a year ago.
- Budget deficit marked a growth in July. During 2003, the budget deficit was completely covered by the domestic financing resources. In July, the deficit was generally covered by commercial banks, whereas Bank of Albania does not continue to participate in financing it.
- The banking system during July-August period continues to have liquidity deficiency. According to the operative data, the system's liquidity in July is assessed to have fallen at Lek 4-5 billion level.
- The general tendency has been Lek interest rate decrease, influenced by the inflation's downward tendency, treasury-bill yield decrease in the primary market, Lek deposits interest decline by Savings Bank, foreign currency deposits (mainly Euro deposits) interest decline, etc.

I. INFLATION AND EXCHANGE RATE TREND IN JULY.

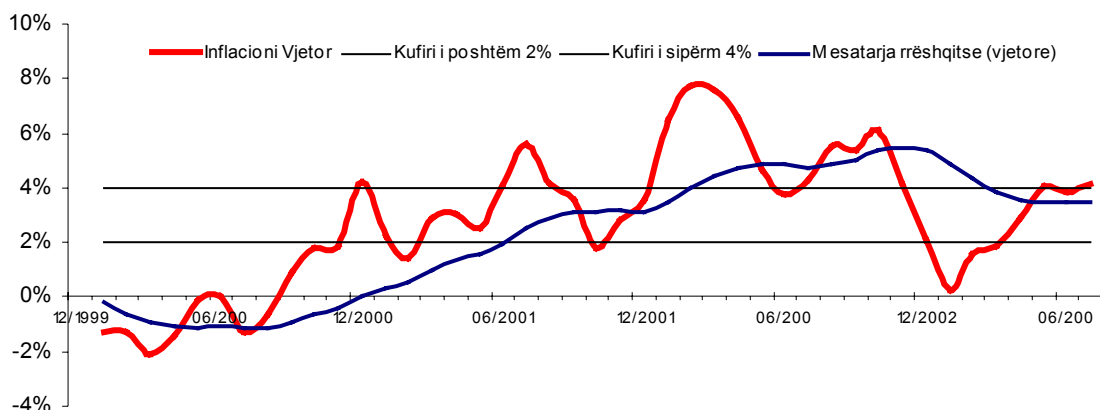
I.1 FACTORS INFLUENCING ON INFLATION TREND.

July 2003 marked an annual inflation of 4,16%, the highest value noticed at the year onset. This was the first time for this year that the annual inflation rate passes the objective interval's ceiling. However, the annual average inflation rate continued to remain at 3.5% value.

Table1: The annual inflation rate (in %).

	1999	2000	2001	2002	2003
January	6.0	-1.3	2.2	6.5	0.3
February	3.5	-1.3	1.5	7.7	1.5
March	2.0	-2.1	2.9	7.6	1.9
April	0.4	-1.4	3.0	6.6	2.8
May	-0.1	-0.1	2.5	4.6	4.0
June	-0.6	0.1	4.0	3.8	3.8
July	0.1	-1.3	5.6	4.3	4.2
August	-0.6	-0.7	4.1	5.5	
September	-1.9	0.9	3.5	5.4	
October	-1.8	1.8	1.8	6.1	
November	-1.2	1.9	2.8	4.1	
December	-1.0	4.2	3.5	2.1	

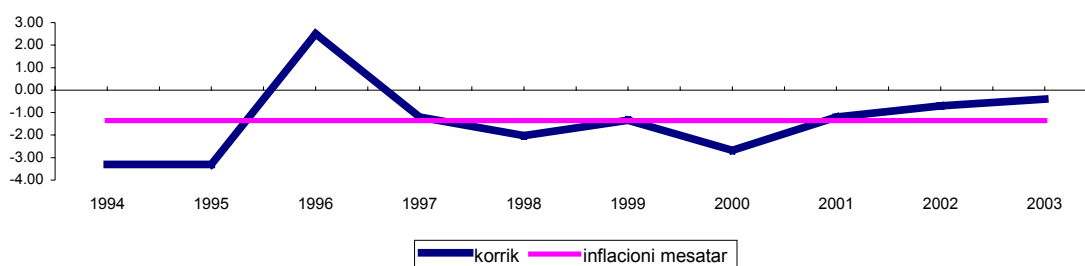
Chart 1: Annual inflation (in percentage).



In July, the annual inflation rate increased a little more than Bank of Albania forecasts. Inflation stemmed mainly as a result of the operation of a smoother seasonal effect compared to other years. The seasonal behavior for this year

marked a noticeable lower interest compared to July of previous years (with the exception of July 1996).

Chart 2: The monthly inflation rate trend in July months.



The main contribution to high inflation rate during this month was given by the group “Food and soft drink” and it has contributed by 62% to the inflation increase of 4,16% in this month. This group’s trend is determined by its two main sub-group, “fruits” and “vegetables including potatoes”. These two sub-groups have marked in July, high values of annual inflation, respectively 19,2% and 30,1%, values that were not assessed since 1998, even in the prices general level. As to other groups (with the exception of “Tobacco and alcoholic drink” group that had 2,8% annual rate growth), they marked the same values or underwent slight annual inflation decline compared to the previous month.

	Group “Food and soft drink”		Sub-group “Fruits”		Sub-group “Vegetables”	
	Monthly	Annual	Monthly	Annual	Monthly	Annual
August '03	-1.0	6.2	-3.9	19.2	-11.3	30.1
August '02	-1.8	2.1	-2.2	-3.6	-3.9	-2.6

Table 2: The basket’s main groups contribution to the annual total inflation (%)

	January	February	March	April	May	June	July
1. Food and soft drink	0.05	0.99	1.11	2.09	2.34	2.23	2.56
2. Rent, water, fuel and electrical power.	-0.15	0.19	0.33	0.32	1.31	1.31	1.33
3. Hotels, cafeterias and restaurants	0.28	0.20	0.21	0.24	0.26	0.24	0.17
4. Transport	0.13	0.20	0.31	0.25	0.16	0.12	0.10
5. Other groups	-0.04	-0.04	-0.08	-0.07	-0.04	-0.90	0.00
The total	0.28	1.54	1.89	2.82	4.03	3.81	4.16

As a result, this month, inflation reduced less than it had to under this period’s seasonal effect. The reasons of the seasonal effect weak intensity over foodstuff prices in the summer months are:

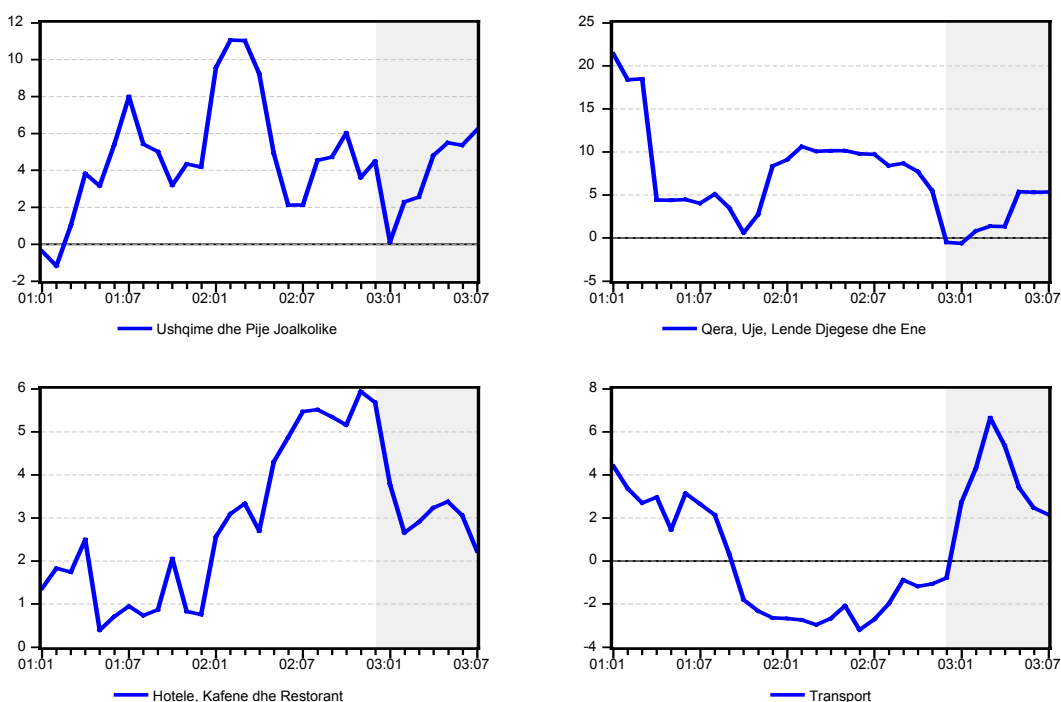
- It is assessed that the increase of such products demand, as the outcome of tourism expansion (about which the data are still contradictory) has restrained the falling prices effect provided by the domestic agricultural products entry and has fostered/stimulated these products import, in order to meet market’s needs. Particularly, the high prices of the main countries where Albania imports these kinds of products from, high temperatures and droughts/dryness in the whole region, EURO appreciation during the whole first period of the year have

influenced on the foodstuff relatively high prices this summer. In the six-month period, according to the data provided by the Ministry of Agriculture, agricultural goods import has recognized a substantial increase, at nearly Lek 1,3 billion more. Imports for the agriculture and agro-industry sectors have increased correspondingly by 99% and 86%.

On the other hand, the speculative setting in adopting import prices and for domestic products (which mark the product top level in this period) has favored the maintenance of prices at high levels. Free trade agreements, now signed with the majority of the region's countries, have influenced on unifying foreign prices to domestic ones, in cases when the Albanian exports of agricultural goods have recognized a considerable increase during the last months.

- A growing impact on the annual inflation rate of this month has been given by "Alcoholic drink and tobacco" group, which turns out to have an annual inflation of 3,2%. The sub-group that has suffered a higher increase is "Tobacco" sub-group at 4,1% annual rate. Excises increase in July, started to be noticed at this group price level, bringing about their increase. It is thought that this increase has not burdened on this group's commodity prices, but part of it is reflected on the goods of "Food and alcoholic drink" group.

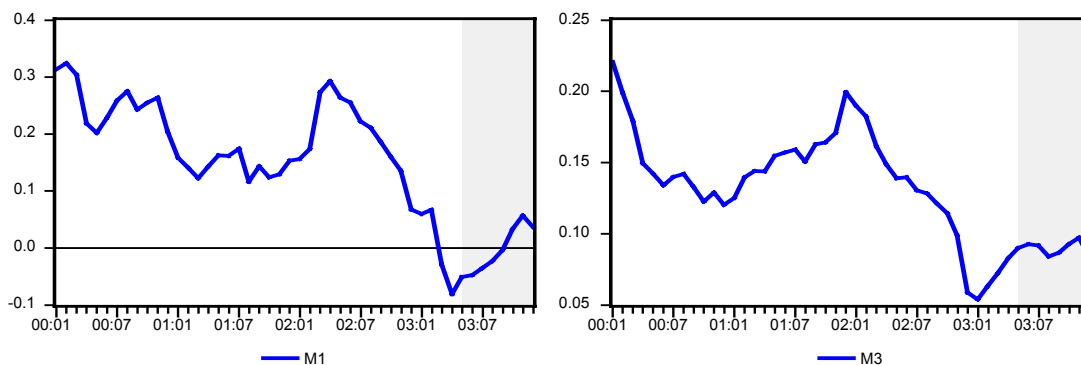
Chart 3: Annual Inflation of the 4 main groups of the basket of ICP (in %).



In the meantime, the growing pressures on inflation are compensated by the tightened monetary policy of Bank of Albania, tracked during 2002. Also in 2003, especially after April, the monetary policy has taken a smoothing trend. Other important factors such as budgetary expenditures at low and controllable levels, have positively influenced on the inflation trend.

In conclusion, it could be said that in circumstances where the other factors have exerted no growing pressure on inflation rate, agricultural goods high prices caused the unexpected growth of inflation figure for this month, as well.

Chart 4: The annual changes of monetary aggregates M1 and M3 (%).

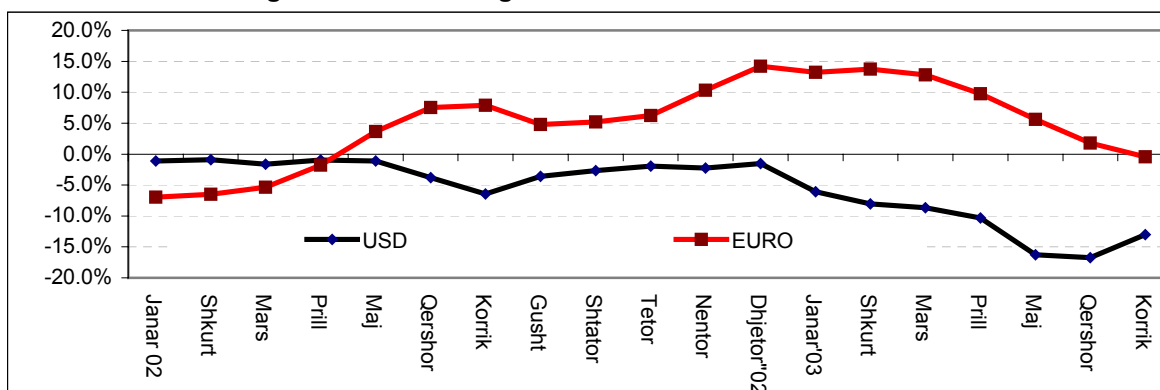


Notice: The shadowed part shows the forecast.

I.1 EXCHANGE RATE TREND.

During July, Lek has changed the direction followed in the previous months. It is depreciated against dollar by 1,1% on the average, and is appreciated against Euro by 1,6% on the average. In annual terms, Lek is appreciated against the two currencies. Historically, Lek has been appreciated against dollar in July while compared to Euro, it is noticed no accurate direction of Lek.

Chart 5: Annual changes of Lek exchange rate.



The latest developments in the international market, in Euro and dollar currencies exchange, have given their impact even in the domestic foreign exchange market. Lek/USD exchange rate shows a negative correlation (-0,98) with USD/EURO exchange rate in the international market, evidencing that even the slightest movement in the international exchange rate influences substantially on Lek exchanging against USD. The negative correlation occurs between Lek/EURO and USD/EURO exchange rate, but at a lower level, at about 0,45.

III. MONETARY DEVELOPMENTS AND FINANCIAL MARKETS.

III.1 MONETARY POLICY OF BANK OF ALBANIA.

The developments in monetary indicators during June have followed the tendency noticed during the first five months of the year. In this month, a moderate growth of money supply is noticed and this was influenced by the economy demand for monetary assets. Lek and foreign currency deposits have marked a growth in monthly and annual terms as well, whereas the further decline of money outside banks level and its ratio versus M3 has continued. This ratio fell below the 28% level, the lowest ratio noticed since January 2000. The downward tendency of M1, during the last three months sets up premises for maintaining low inflationary pressures that stem from the developments in the monetary indicators.

According to the monetary indicators positive developments, associated with real interest high rates, low inflationary pressures, and in the forecasts on respecting the inflation's objective till year-end, Bank of Albania reduced REPO's interest rate by 0,5 percentage points at the beginning of July. The banking system responded immediately by reducing deposits interest rate¹. The immediate impact of REPO's rate reduction is observed in money outside banks level.

The quantitative objectives have remained within the determined limits. The increase of net foreign assets of Bank of Albania and the further monetary base² reduction have made net international reserves and net domestic assets rate be maintained within the objectives set forth. Net domestic credit to government, as well, shows the respecting of the objective.

Table 4: The fulfillment of the quantitative objectives of Bank of Albania.

	December '02	January '03	April '03	June '03	July '03**
The fulfillment of NIR objective (million USD)					
Objective	558.6	559.3	560.6	582.2	579.0
Actual	562.2	571.1	597.5	606.5	614.7
Difference	3.6	11.8	36.9	24.3	35.7
The fulfillment of NDA objective (billion Lek)					
Objective	95.1	95.8	97.5	98.1	97.8
Actual	87.1	80.1	71.3	68.9	70.7
Difference	-8.0	-15.7	-26.2	-29.3	-27.1
The fulfillment of net domestic credit to government's objective (billion Lek)					
Objective	258.7	260.4	265.0	267.7	-
Actual	258.7	262.8	261.9	263.1	-
Difference	0.0	2.5	-3.1	-4.6	-

**The data about July are operative.

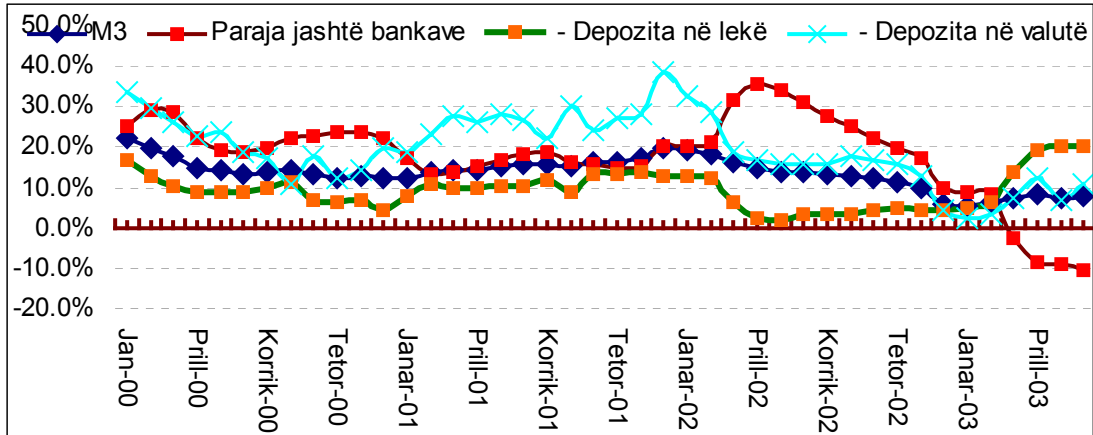
¹ Within one-month period, commercial banks responded by reducing deposit acceptance interest rate from 0,16 percentage points into 0,26 percentage points. 3- and 12-month treasury bills yield has fallen respectively by 0,44 and 0,13 percentage points.

² According to the operative data, the monetary base for July and August show signs of growth.

III.2 MONETARY AGGREGATES TREND

The monetary indicators have generally proceeded according to the monetary program forecasts. In June, money supply has undergone the greatest monthly change since January of this year, by rising up at Lek 4,3 billion, compared to the previous month.

Chart 6: The trend of monetary aggregates annual rate.

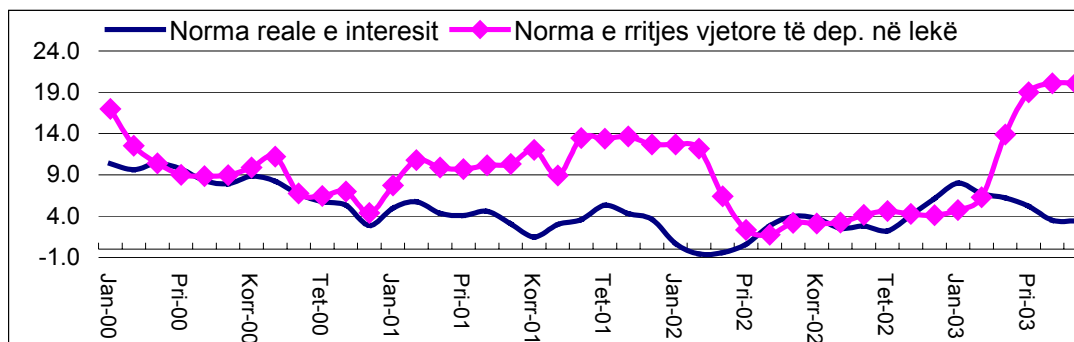


However, the pace of monetary supply and foreign currency deposits annual growth is positively and slightly increasing, although beyond their historical trend. Money supply increase is the aftermath of Lek and foreign currency time deposits increase, as well. Lek deposits annual growth in June has reached the maximum levels, at about 20%. Currency deposit rate as well, marks a positive step for this month, that reverse from May, is increased by Lek 1,6 billion. This constitutes 30% of the total deposit increase. The high level of Lek interest real rate and foreign currency inflows have caused the increase of the corresponding deposits during June.

The downward trend of Lek interest real rate³ and the maintenance of Lek deposits increase high pace during the last months evidence that the preference to deposit in the domestic currency is urged by other factors. These can be Lek's appreciation against the two main currencies, Euro and USD, the households preference rise-up to invest their savings in the banking system, etc.

³ After REPO's rate decrease in April, followed by the deposit acceptance interests decline and inflation rate increase during May and June, real interest rate has undergone a decline.

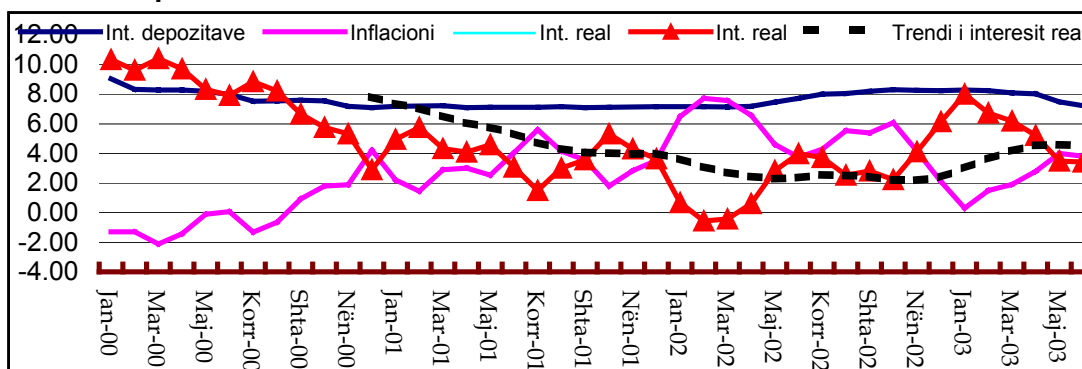
Chart 7: Interest real rate and Lek deposits annual growth.



Lek deposit growth continues to be associated with banks liquidity high rate. As a consequence of deposits growth and the government's low demand for funds, a high liquidity in the banking system, at about Lek 7,1 billion is noticed during June. The high liquidity rate has assisted in giving rise to pressures over the market, in further reducing interest rate.

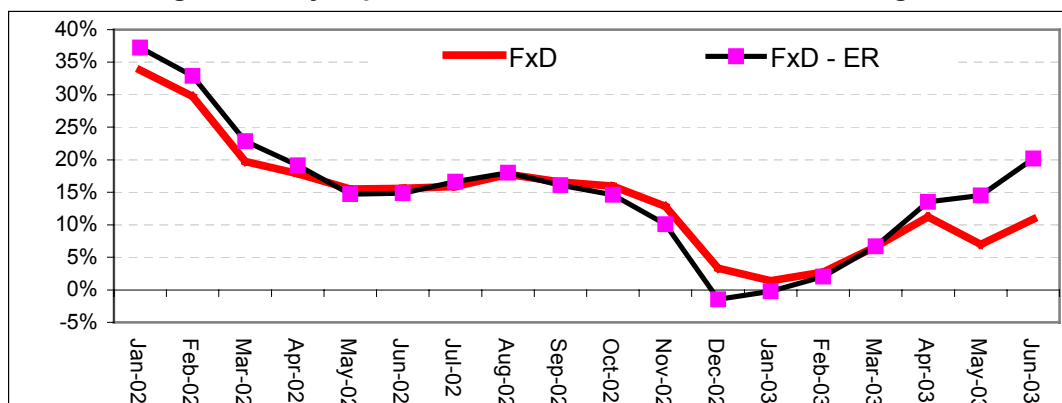
Bank of Albania intervened during June by withdrawing Lek 3,4 billion liquidity through outright sales. At the end of June, the banking system had Lek 2 billion liquidity less than the previous month. According to the operative data, the system's liquidity is assessed to have decreased at Lek 4-5 billion level, during July.

Chart 8: Deposits interest and real interest.



Meanwhile, currency deposit interest rate and Lek's appreciation during June must not have negatively influenced on foreign currency deposit rate.

Chart 9: Foreign currency deposit annual trend with or without exchange rate effect.



The money outside banks level was slightly reduced in June. The reduction pace was slowed down after REPO's rate fall in April. In June, the ratio of money outside banks versus M3 has reached the lowest rate in the last three years, 27,9%.

Table 5. Monetary indicators trend in June (in million Lek).

	June 2003	Monthly change		Annual change	
		Absolute	Percentage	Absolute	Percentage
Money outside banks	118,889	-816	-0.7	-13,831	-10.4
Total deposits	307,768	5,146	1.7	45,103	17.2
- Deposits in Lek	214,974	3,558	1.7	36,041	20.1
- Deposits in currency	92,794	1,588	1.7	9,061	10.8
Demand deposits	55,109	-1,654	-2.9	-188	-0.3
- in Lek	19,898	-2,314	-10.4	-3,851	-16.2
-- in currency	35,211	660	1.9	3,663	11.6
Time deposits	252,660	6,800	2.8	45,291	21.8
- in Lek	195,076	5,873	3.1	39,893	25.7
- in currency	57,583	928	1.6	5,398	10.3
M1	138,787	-3,130	-2.2	-17,682	-11.3
M2	333,863	2,743	0.8	22,210	7.1
M3	426,657	4,331	1.0	31,272	7.9
Monetary base	151,669	-777	-0.5	-11,119	-6.8

Meanwhile, the money outside banks level marked a growth in July-August period, as it followed the historical trend. Consumer expenditures growth in this period influenced on cash outside banks level increase. According to the operative data, money outside banks level is slightly increased in July, whereas in August money outside banks level increase is expected to be even higher (based on this indicators trend during the the first half of August). Money outside banks level increase is expected to influence on the money outside banks ratio approach to M3 at the level that the forecasts sets forth in the program for August.

Table 6. The comparison of the aggregates with the program (in billion Lek).

	April-03		May-03		June-03	
	Actual	Program	Actual	Program	Actual	Program
Money outside banks	122.9	120.0	124.1	119.7	125.3	118.9
Deposits in Lek	207.7	208.8	209.1	211.4	209.1	215.0
Deposits in currency	94.2	93.7	95.2	91.2	97.6	92.8
M1	146.2	142.6	147.6	141.9	149.0	138.8
M2	330.7	328.8	333.2	331.1	334.4	333.9
M3	424.8	422.5	428.4	422.3	432.1	426.7

Money outside banks low level and demand Lek deposits monthly decline at about Lek 2,3 billion, have influenced on M1aggregate fall deepening the

difference of its actual value with the value as forecasted by the program. The aggregates M2 and M3 have tracked the directions forecasted by the program.

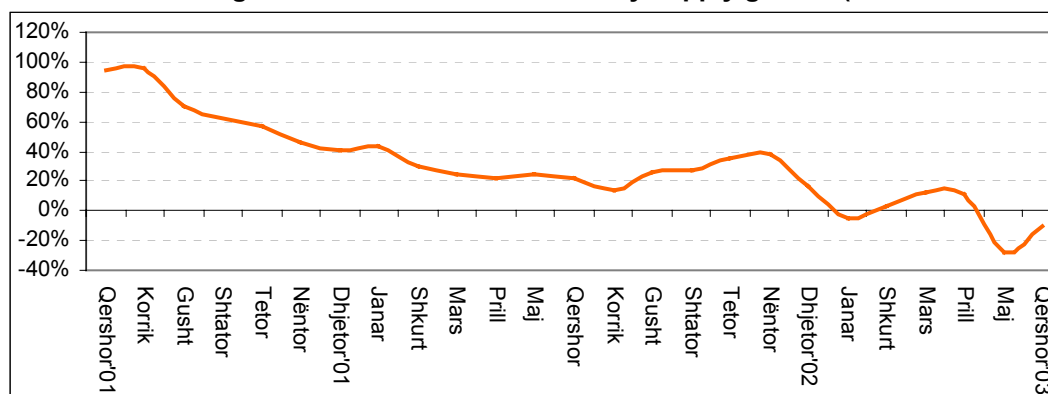
III.3 ECONOMY'S DEMAND FOR MONEY

III.3.1 NET FOREIGN ASSETS OF THE BANKING SYSTEM.

Net foreign assets of the banking system, during June, have marked a monthly growth of Lek 1,6 billion (USD 12,9 million). In annual terms, these assets have marked a monthly growth at USD 161,28 million⁴, whereas if expressed in Lek, a decline is noticed. This decline in Lek comes out as a result of Lek appreciation against USD by 15,3% in annual terms.

Net foreign assets trend in annual terms, continues to render a negative contribution to money supply growth for June, as well.

Chart 10: Net foreign assets contribution to money supply growth (the annual base).



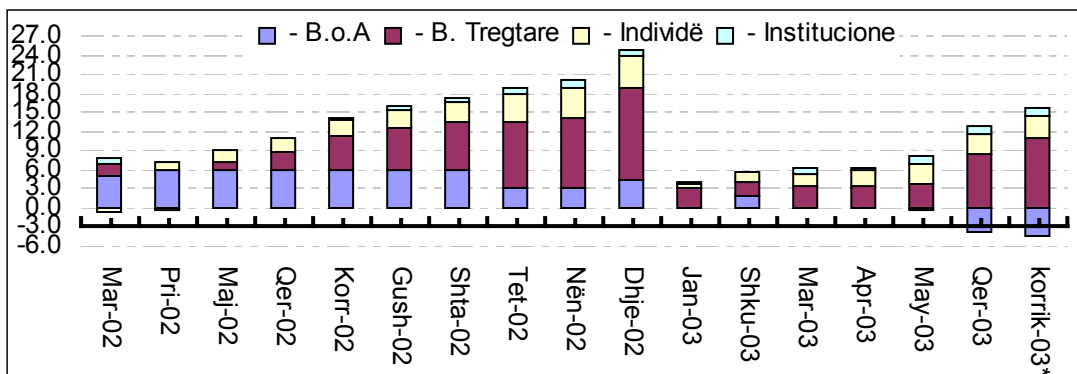
Foreign exchange assets growth of the banking system in June was due to foreign exchange assets growth of commercial banks at USD 23 million. These assets level is influenced by foreign currency deposits growth during this month. In the meantime, it is noticed a decline at USD 10 million of Bank of Albania net foreign reserves. Euro depreciation against dollar has caused Euro investments value decrease expressed in dollars. Compared to May, Euro has lost nearly 3,6% of its value against dollar in the exchange.

⁴ EURO appreciation versus USD during this period has influenced on the increase at USD 35 million of the banking system net foreign assets.

III. 3.2. GOVERNMENT'S DEMAND FOR MONETARY ASSETS.

During June, the government's needs for monetary assets continue to reflect low levels. Incomes realization at 8% lower than the level forecasted about June and the fulfillment of expenditures predictions, brought about the budget deficit increase at about Lek 2 billion. In January-June period, budget deficit financing by treasury bills was Lek 8,9 billion from Lek 11 billion of the same period a year ago. From this financing, the banking system has covered Lek 4,5 billion in 2003, about the half of the amount covered in 2002. During June, it is noticed that the financing of the budget deficit by the banking system and households has risen up compared to the previous month. Meanwhile, the financial institutions portfolio shows no change. As a consequence of the intervention in the money market, the treasury bills portfolio of Bank of Albania was considerably reduced at about Lek 3,4 billion.

Chart 11: The cumulative trend of budget deficit financing during the year (in billion Lek).



According to the operative date of July, it is noticed that incomes and expenditures realization has been higher than the level predicted, meantime the expenditures increase has been more considerable. This has caused further budget deficit increase, which continues to be financed only by domestic resources. Financing in July is increased at Lek 2,5 billion and was covered by more or less commercial banks. Households and institutions portfolio show a slight increase. Even during July, it is noticed a slight reduction of Bank of Albania portfolio because of its intervention in the market.

III.3.3 CREDIT TO ECONOMY

During June, credit outstanding to economy increased by Lek 1,8 billion, reaching at Lek 44,5% billion ⁵. This growth is the highest for the whole year 2003. The high level of the credit extended during this month and also the tendency in lending at long maturity terms are thought to be the major factors in bringing about this growth. Credit outstanding structure for the first six-month period of 2003 is characterized by short-term credit (53,5%) expressed in currency (79%) and this is mainly for the agriculture sector. Nevertheless, banks' tendency of lending to the private sector by medium-term credits, not only in foreign currency but in domestic currency, as well, is noticed. In June these credits' ratio compared to the total credit, have remained unchanged.

Table 7: The trend of domestic demand indicators for monetary assets.

Indicators	T-1 '02	T-2 '02	T-3 '02	T-4 '02	T1-03	T2-03
Credit outstanding (in billion Lek)	29.5	33.3	35.6	37.8	40.4	44.5
New extended credit (in billion Lek)	12.5	15.5	16.2	18.5	17.5	24.6
Credit/deposit ratio (in %)	11.0	12.7	12.9	13.2	13.5	14.5
Credit to government (in % versus M3)	64.6	65.7	66.5	66.3	67.4	67.1
Credit to economy (in % versus M3)	7.4	8.4	8.8	9.07	9.6	10.4

During June, Lek 8,9 billion were extended, nearly twice more than the credit extended at the same period the previous year. The short-term credit (68,9%) continues to be the major characteristic of the new extended credit. It is noticed that during June, less short-term credits were extended compared to the previous second three-month period. For the same period, the medium-term credit has mostly increased reflecting the changes of banks' tendencies to grant credit to the economy with mid-run terms. Whereas during June, Lek credit constitutes 1/3 of the extended credit, so reflecting the downward tendency of the foreign currency credit. More than half of the new credit is extended to the trade sector.

III.4 FINANCIAL MARKETS AND INTEREST RATE TREND

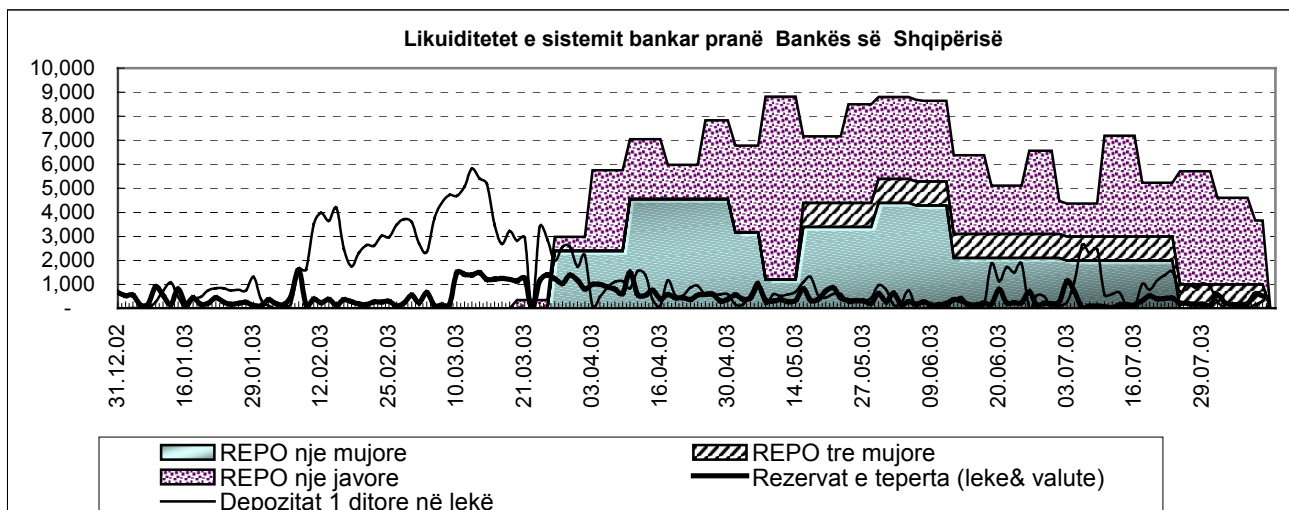
III.4 1 FINANCIAL MARKETS

Till the onset of June, the financial system is characterized by excess liquidity at about Lek 10 billion. The deposits increase at banks, the decline of government's demand for liquidity, and also the restrictions on credits to economy that Savings Bank experienced, have mainly influenced on liquidity increase.

In the conditions of excess liquidity, Bank of Albania tracked a sterilizing policy, utilizing the instruments of liquidity long-term withdrawal such as one-month REPOs, three-month REPOs and outright sale transactions. In addition to that, on 10 July, Bank of Albania signalled again core interest rate fall, at 0,5% (after that in April), a policy that would serve in inflation maintenance within the determined limits.

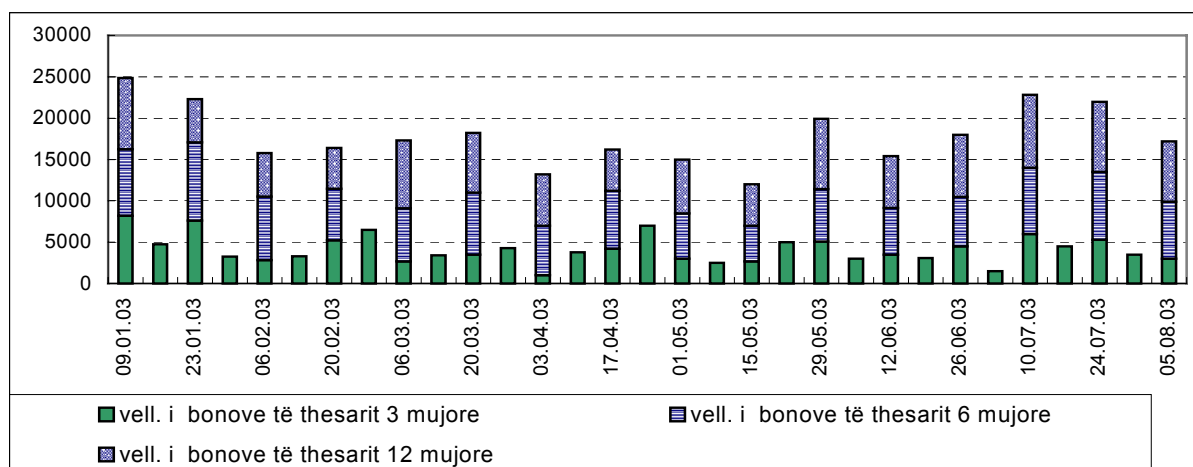
⁵ The credit outstanding value does not include that part of credit transferred near BART.

Chart 12: Banking system liquidity at Bank of Albania.



The primary market: In July, there has been tendencies toward the government's demand increase in the primary market, which has forced banks reduce their participation in REPO agreements auctions.

Chart 13: Primary market.



Interbank market: the borrowing volume in the interbank market remained at low levels. Over-night transactions have dominated in this market, since the liquidity needs have been short-term.

Table 8: The monthly average borrowing change in the interbank market (in million Lek).

	June-May '03	July-May '03	August-July '03
Borrowing volume change	50	-293	317

In comparison with the previous year when the system was under deficiency conditions, a borrowing volume decrease in the interbanking system is noticed, as it is presented in the following table. Therefore, banks' needs to turn to this market have been less during 2003.

Chart 14: Borrowing volume in the interbank market.

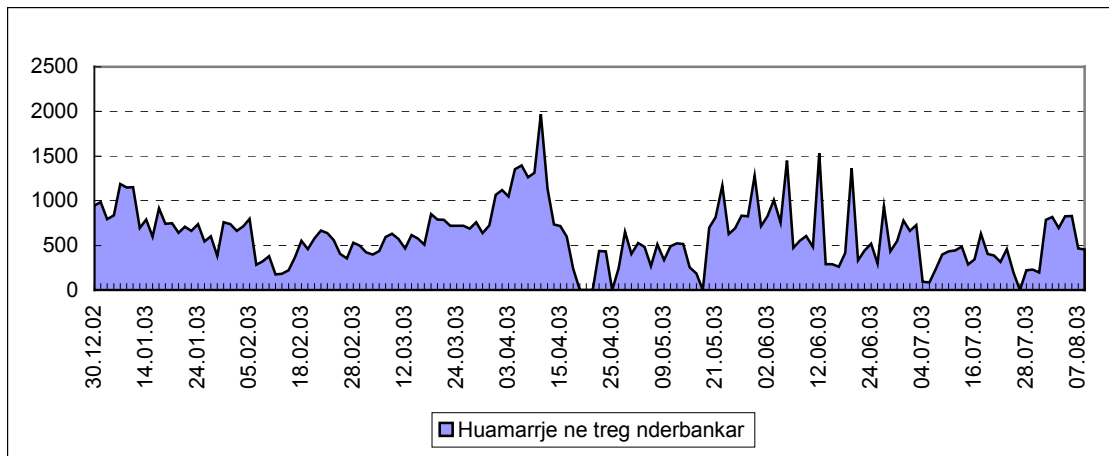


Table 9: The comparison of the monthly average borrowing in the interbanking system to the same period a year ago (in million Lek).

	June	July
Monthly borrowing average volume in 2002	979	1064
Monthly borrowing average volume in 2003	608	365
The change of the borrowing volume 2003-2002	-371	-699

III.4.2 INTEREST RATE TREND

Banks' reaction to core interest rate decline in July has been greater in the interbank market and slighter in Lek deposit market and primary⁶ market. Compared to banks' reaction in July, after the core interest decline in April, the reaction has been slight. This was because the reaction after Bank of Albania signals in April, was caused by a tightened and latter neutral period, when banks were interested in reducing the mediator cost as soon as possible.

The following table reflects credit interest change, calculated by the simple arithmetic average, to see that interests, in fact, have fallen less than the decrease signaled by Bank of Albania, notwithstanding this, it turned out to have increased in May and June.

Table 10: The monthly change of the simple average Lek credit interest.

	April '03	May '03	June '03
Till 6 months	1.44	-0.85	-0.16
6 months till to 1 year	-1.68	0.58	0.62
1-3 years	2.07	-3.26	0.76
Over 3 years	-1.65	-0.96	0.24
Total credit	-0.48	0.22	0.18

Banks' reaction after the signals in July is expected to be slighter, because:

- Banks liquidity at Bank of Albania have had a downward tendency (especially in the first week of August);

⁶ There is no information on the credit market for July 2003.

- Consumer price index in July turned out to be above the objective at 0,2 percentage points higher;
- In the conditions of local election, government's demand in the primary market is expected to increase, and this makes competition in this market easier, so it creates the possibility for yield increase in this market.

Table 11: The weighted average interest of Lek time deposits (in %).

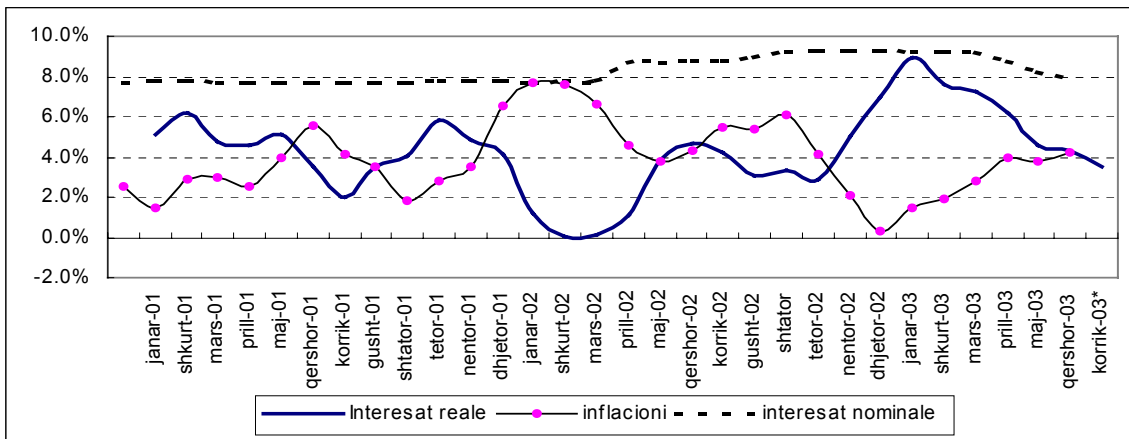
	3 months	6 months	12 months
July * 2003	6.42	7.72	7.83
June 2003	6.81	7.79	8.25
The change (July* - June '03)	-0.39	-0.07	-0.42
May 2003	7.01	8.30	8.80
The change (July* - May 2003)	-0.59	-0.58	-0.97
April 2003	7.74	8.75	9.17
The change (July* - April 2003)	-1.32	-1.03	-1.34

*According to the operative data.

Real interests.

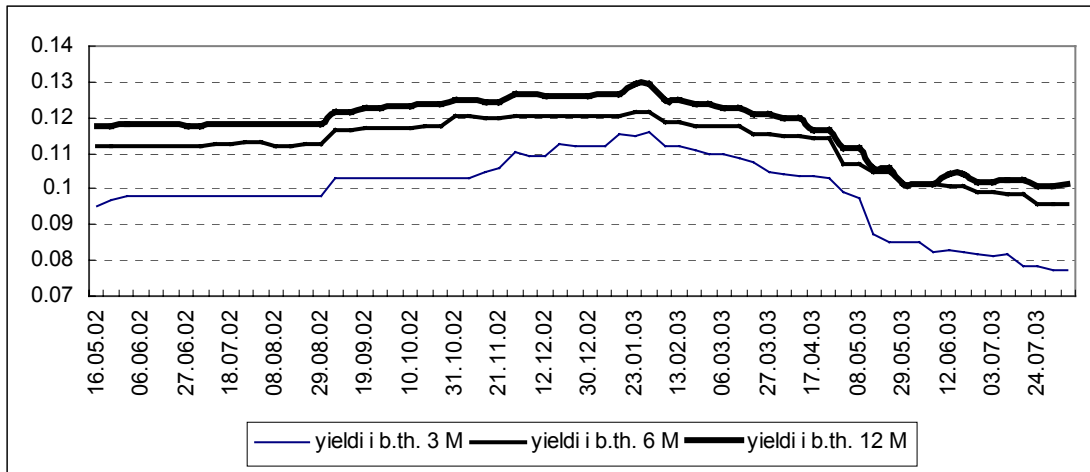
The changes in consumer price index have influenced on the real value of Lek deposits interests.

Chart 15: The real and nominal interests of Lek 12 month-time deposits.



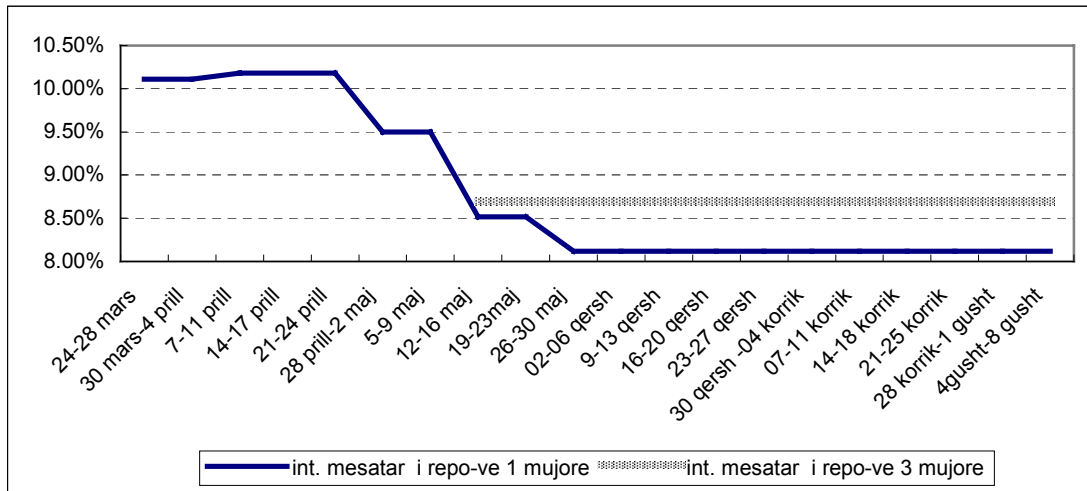
In the primary market, treasury bills yield in June-August period, has had a downward tendency resulting in lower rates than the same period of the previous year. The fulfillment of the government's need at 100% level in the last months auctions and the high competition in this market have influenced on the weighted average yield decrease.

Chart 16: Treasury bill yield trend.



1 and 3-month REPO agreements auctions have also had weighted average interest fall, as it is noticed in the following chart.

Chart 17: The weighted average interest rate in 1 and 3-month REPO agreements auctions.



Interest rate decrease has occurred even in the market of foreign currency deposits, mainly of Euro deposits. This was influenced by the core interest rate fall provided by European Central Bank and Fed in June, and by money supply increase, mainly by immigration and tourism.