

BANK OF ALBANIA

MONETARY POLICY REPORT JULY 2005

AUGUST 2005

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MAIN HIGHLIGHTS

- Annual inflation rate in July decreased to 1.8 percent, from 2.9 percent in June, being very close to the lower limit of the targeted band of the Bank of Albania. Annual average inflation rate marked a level of 2.1 percent, while monthly inflation was -1.2 percent.
- Annual inflation rate was highly influenced by a negative foodstuffs inflation rate and an increase in the energy price; bore from the beginning of the year. Fiscal and monetary policies have created a favourable environment for consumer price stability. In addition, annual appreciation of the exchange rate has smoothed the inflationary pressures caused by an increase in oil prices.
- Macroeconomic developments conditioned the maintenance of a neutral stance of the monetary policy from the Bank of Albania. The annual inflation rate fluctuated in relatively low levels, while the performance of main monetary indicators reflected a downward tendency of the monetary policy.
- In June, the annual increase of money supply accelerated to 18.3 percent from 15.8 percent in May. The main contribution was due to the annual growth of deposits in foreign currency. In addition, the pace of M2 aggregate increased, reflecting a growth in government and economy demand for money in June.
- In June, the annual growth of currency outside banks, mainly influenced by temporary factors, reached a level of 14.9 percent from 11.6 percent in May. This growth has increased the banking system needs, which were met by decreasing the excessive bank liquidity level. Consequently, the objective for net domestic assets of the Bank of Albania was beaten in June.
- In June, credit to economy reached a level of ALL 95.9 billion, thus, increasing by ALL 7.1 billion per month. During June, new credit to economy was about ALL 12.7 billion. This level is the highest new credit level ever provided to in a month.
- In June, interest rates for deposits and credits in lek decreased; while in July, interest rates showed a slight increase in the interbank market and government securities primary market.
- In July, Lek has been stable against the main foreign currencies, though being under the seasonal effect pressures. At the end of July, Lek exchange rates levels were 121.3 lek/euro and 100.4 lek/usd, against respectively 123.9 lek/euro and 102.8 lek/usd, at the end of June.

I. INFLATION IN JULY

Similar to the first six months of 2005, July was characterized by a low inflation rate. Annual and monthly inflation rates were respectively 1.8 and -1.2 percent. The annual average inflation rate¹ was 2.1 percent, almost meeting the lowest limit of the targeted band (2 – 4 percent).

Table 1. Annual inflation rate (in percentage).

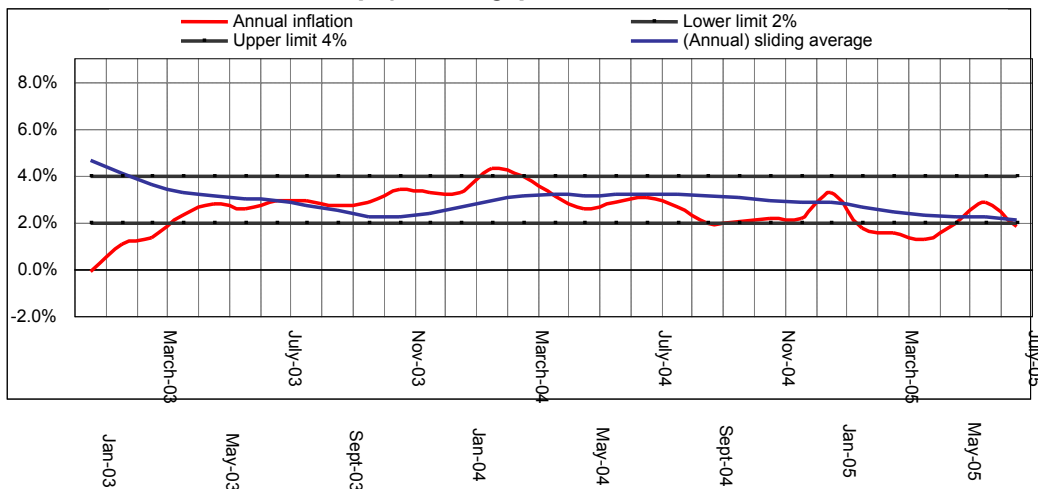
	2001	2002	2003	2004	2005
January	2.2	6.5	0.0	3.3	3.3
February	1.5	7.6	1.1	4.4	1.8
March	2.9	7.5	1.3	4.0	1.6
April	3.0	6.5	2.3	3.2	1.3
May	2.5	4.6	2.8	2.6	2.0
June	4.0	3.7	2.6	2.9	2.9
July	5.6	4.2	3.0	3.1	1.8
August	4.1	5.5	3.0	2.7	
September	3.5	5.3	2.8	2.0	
October	1.8	5.8	2.9	2.0	
November	2.8	3.7	3.4	2.2	
December	3.5	1.7	3.3	2.2	
Average	3.1	5.2	2.2	3.0	2.1

Source: INSTAT

Favourable macroeconomic developments created the necessary conditions for keeping inflation rate under control. The prudential fiscal policy stopped inflationary pressures, while the monetary policy aimed at accommodating actual and expected developments of inflation, without putting at risk the inflation target. The continuous appreciation of exchange rate and the significant decrease of agricultural products prices continued to serve as a shield against inflationary pressures injected to the economy through administered and oil prices in the international market.

¹ Annual average inflation is the average value of annual inflation for the last 12 months including the year being analyzed.

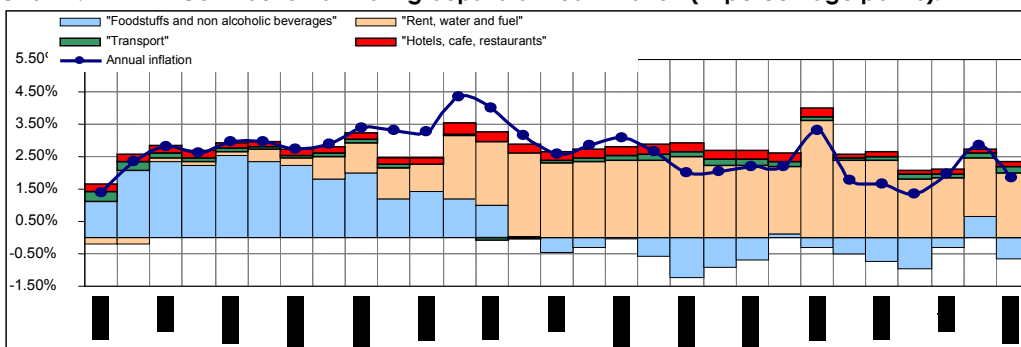
Chart 1. Annual inflation (in percentage).



1.1 INFLATION AND CONSTITUENT GROUPS.

In July, the annual inflation was 1.3 percentage points lower compared to the month of July in the previous year (3.1%). Similar to the last two years, during this month the annual inflation profile continued to be influenced by developments in “Foodstuffs and non-alcoholic beverages” and “Rent, water, fuels and energy” prices. The joint contribution of these two groups to the annual inflation rate was of 1.3 percentage points in July, while other groups of the consumer basket contributed with 0.5 percentage points.

Chart 2. Contribution of main groups to annual inflation (in percentage points).



After a temporary increase marked in June, the annual inflation of “Foodstuffs and non-alcoholic beverages” group turned to the negative rates recorded in the beginning of this year. In July, “Foodstuffs and non-alcoholic beverages” group reduced the total annual inflation rate by -0.7 percentage points. The price level of this group was conditioned by the performance of agricultural production prices². On the other hand, the appreciation of lek against the euro, associated with a

² Fruit prices decreased by 10.7 percent, while vegetable prices decreased by 2.9 percent.

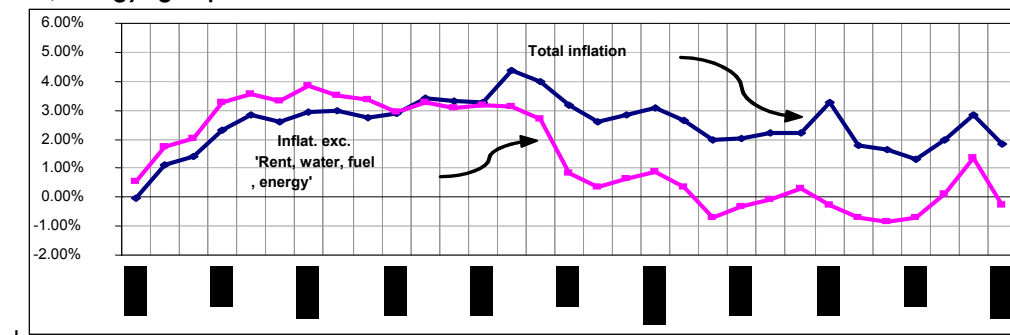
decrease of foodstuff prices in partner countries, such as Italy and Greece, helped smooth or even eliminate the external inflationary pressures.

Table 2. Annual inflation rate of “Foodstuffs and non-alcoholic beverages” group (in the country and outside) and the contribution of inflation in this group to total inflation.

	Annual inflation'04	Contribution (pp)	Annual inflation'05	Contribution (pp)	Italy ³ Annual inflation'05	Greece ⁴ Annual inflation'05
January	3.2	1.4	-0.7	-0.3	-0.7	0.6
February	2.7	1.2	-1.2	-0.5	-0.4	-0.9
March	2.3	1.0	-1.7	-0.7	-0.2	-1.4
April	0.1	0.1	-2.3	-1.0	-0.2	-0.1
May	-1.1	-0.5	-0.7	-0.3	-0.2	-0.4
June	-0.7	-0.3	1.6	0.7	-0.2	-0.5
July	-0.1	-0.05	-1.6	-0.7		

While inflation rate dynamics was determined by the inflation performance of “Foodstuffs and non-alcoholic beverages” group, the amplitude of the inflation rate was influenced by the inflation of “Rent, water, fuel, energy” group. In the absence of this group contribution, domestic inflation would have been lower. (Chart 3). In July, the annual inflation of “Rent, water, fuel, energy” group marked a growth of 7.7 percent and contributed to the annual inflation rate by 2.0 points of percentage. While the administered energy price remained invariable from February, rent and imputed prices fluctuated significantly. Thus, average inflation of “Rent” and “Imputed rent” subgroups decreased from 5.7 percent over the first quarter to 2.3 percent over the second quarter, to increase later to 3.3 percent in July. The rise of rent price over this month is due to growth in domestic demand, caused by the beginning of tourist season.

Chart 3. Total annual inflation performance and inflation performance without “Rent, water, fuel, energy” group.



Along with energy prices⁵, the other administered prices, such as health and education tariffs exerted inflationary pressures, by increasing consumer costs. During January – July '05, “Health” and “Education service” groups marked high inflation

³ Source: ISTAT; website <http://www.istat.it>

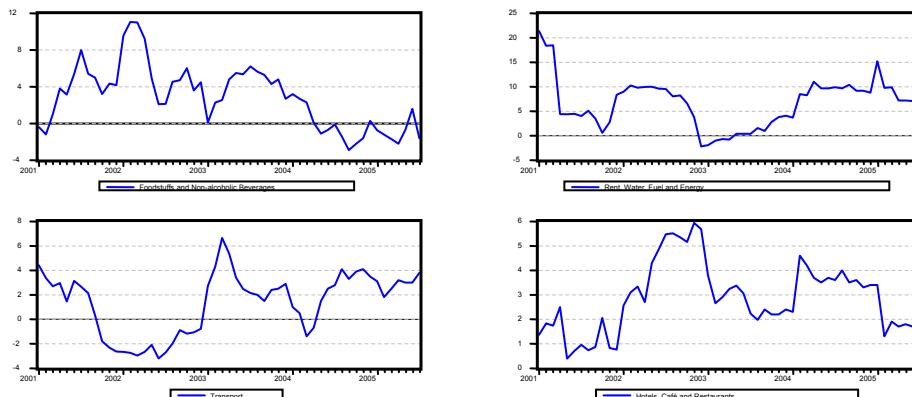
⁴ Source: General Secretariat of National Statistical Service of Greece; website: <http://www.statistics.gr>

⁵ Increased by 25.7 percent, in January 2005.

rates, but due to the low weight⁶ they have in the consumer basket, their average contribution to the inflation over this period was marginal.

The oil price rise in the international market was reflected in a slight inflation increase of "Transport" group. The month of July marked an increase in the inflation rate of this group to 3.8 percent, after the period May – June '05, over which "Transport" group inflation remained invariable to a level of 3.0 percent. This rise was basically caused by the increase in "Service to personal vehicles"⁷ subgroup inflation, influenced even by the price of oil used by the Albanian consumer.

Chart 4. Annual inflation of the four main groups of CPI basket (in percentage).



The inflation of other basket groups varied according to their seasonal tendencies. Inflation of "Clothes and footwear" decreased to -2.6 percent, while that of "Alcoholic drinks and tobacco" increased to 2.9 percent. "Hotels, café, restaurants" group marked a more significant increase with an annual inflation of 2.4 percent, reflecting a demand increase for these services, due to the tourist season.

1.2 MACROECONOMIC ENVIRONMENT AND CONSUMER PRICES

During 2005, the annual inflation increased gradually, contributing to the maintenance of macroeconomic equilibriums. For more than two years, low positive inflation rates resulted from the sound coordination of economic policies and lack of shocks caused by demand and supply factors. Inflationary pressures injected by costs, such as the rise of administered prices, production prices; oil prices and salaries are almost totally balanced by the exchange rate appreciation, the agricultural supply and the lack of external pressures.

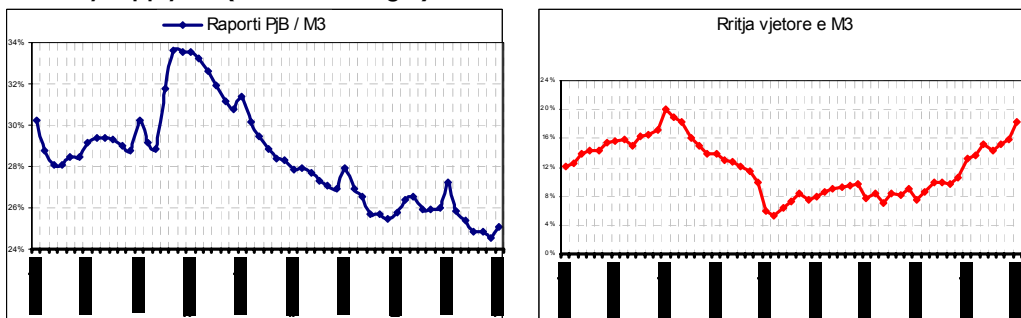
- Monetary policy

The easing of monetary policy by the Bank of Albania has not created inflationary pressures. The lowering of the core interest rate, through lending enhancement, brought about a growth in money supply. However, low inflation rates provided positive real interest rates by channelling the free funds of economy in the banking system.

⁶ Groups have a weight of 2.1 and 1.0 percent respectively in the consumer basket.

⁷ Annual inflation of this subgroup for June-July '05 is 6.2 and 8.8 percent respectively.

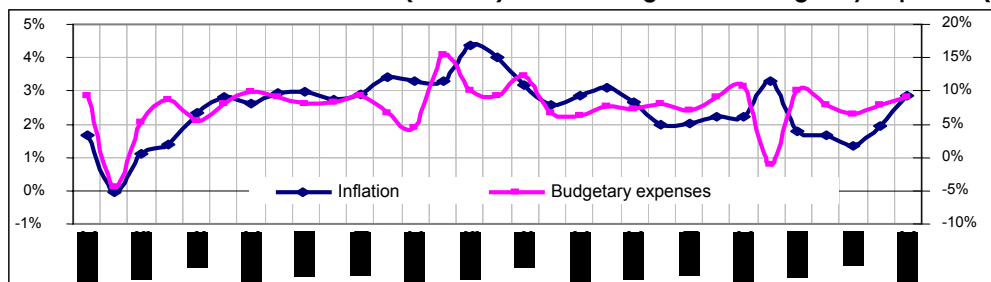
Chart 5. Annual change of currency outside banks to M3 (chart on the left) and annual change of money supply M3 (chart on the right).



- Fiscal policy

The prudential implementation of fiscal policy and the realization of expenses according to the budget program, created the conditions for inflation rate control. Over the first six months of 2005, current and capital budgetary expenses increased by accelerating paces. However, until the month of June, total expenses were within the targeted band, by not exerting inflationary pressures to economy.

Chart 6. Annual inflation rate (left axis) and annual growth of budgetary expenses (right axis).



- Exchange rate and imported inflation

Even in the month of July, exchange rate of lek against euro and dollar was the main factor which controlled inflationary pressures of the external environment. Over this month, lek appreciated against euro by around 1.8 percent in annual terms, while dollar remained almost invariable. For a long time, this factor has served as a barrier to the import of trading partner countries inflation.

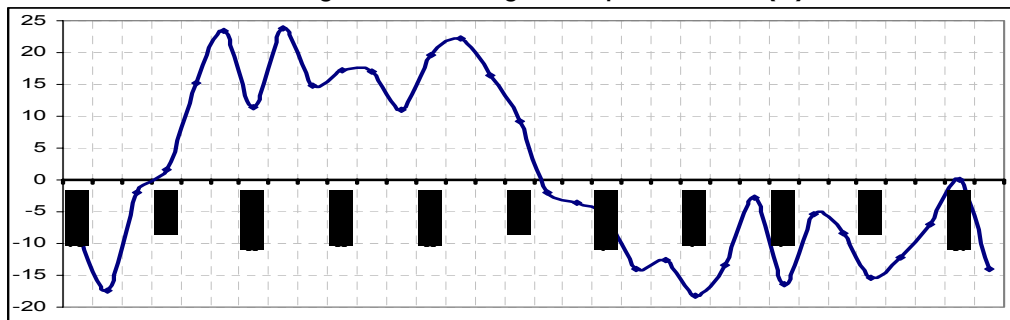
Table 3. Annual changes in partner countries inflation and exchange rate (in percentage).

	January	February	March	April	May	June	July
Greece ⁸	4.0	3.1	2.9	3.4	3.2	3.3	3.9
Italy ⁹	1.9	1.9	1.9	1.9	1.9	1.8	
Lek/Euro	-5.3	-4.8	-3.1	-1.6	-2.3	-1.0	-1.8
Lek/Usd	-8.8	-7.4	-9.8	-8.9	-7.4	-1.2	0.0

- Agricultural production.

Agricultural production supply influenced the lowering of domestic inflation rate. Agricultural production and greenhouse production met the domestic demand. Lower fruit and vegetable prices led to the lowering of annual inflation rates for the “Foodstuffs and non-alcoholic beverages” group in the consumer basket. Owing to the considerable weight of this group in the consumer basket, the annual inflation rate was significantly influenced by the price performance in these production prices.

Chart 7. Annual change of fruit and vegetables price index 10 (%)



- Oil prices.

Oil price performance remains a potential risk for inflation increase in oil importing countries (incl. our country). The direct impact on the consumer prices emerged in the form of increased inflation for “Transport” group. This increase has had and it is expected to have a modest effect on the total level of prices. A more significant effect, not being directly perceived in the consumer prices, might be the increase in the production cost. Last developments, especially the oil quotation over the level of 70 dollars per barrel, increased the risks for both inflation and economic growth.

⁸ Source: General Secretariat of National Statistical Service of Greece; website: <http://www.statistics.gr>

⁹ Source: ISTAT; website <http://www.istat.it>

¹⁰ Compiled according to the weekly data taken from the Ministry of Agriculture and Food.

II. MONETARY DEVELOPMENTS AND FINANCIAL MARKETS

II.1 MONETARY POLICY AND QUANTITATIVE OBJECTIVES

Macroeconomic developments conditioned the invariable maintenance of the monetary policy stance by the Bank of Albania during June and July. Inflationary pressures to economy reflected the seasonal developments in the domestic production performance. Inflation rate performance was considerably influenced by the lowering of agricultural production prices, as a result of the growth in domestic production supply over summer time. Inflation rate fluctuated to relatively low levels, while the performance of main monetary indicators reflected a downward tendency of the monetary policy.

Chart 8. Annual growth rate of real M3



The use of supporting instruments by the Bank of Albania enabled the meeting of needs for liquidity and the short-term surplus absorption of the banking system, while aiming at smoothing interest rate volatility in the market. In June, the weighted interest rate of new deposits flow in lek, marked 3.5 percent by recording a further decline of 0.6 percentage points compared to May. Monetary operations focused mainly on withdrawing the excessive liquidity of the system through one-week repo and the use of overnight deposits. The excessive liquidity level in the system fluctuated between ALL 7.0 billion in the beginning of June and the minimum of ALL 0.8 billion at the end of this month. Under the conditions of a temporary need for liquidity in the system, the Bank of Albania injected liquidity by using reverse repos.

The stability of the exchange rate during the past months did not make the intervention of the Bank of Albania in the domestic market necessary. Net Domestic Assets Index (NDAI) of the Bank of Albania marked a deviation of ALL 3.6 billion from the target established in the monetary program for June. The cause of that deviation was the non-forecasted increase of currency outside banks in June, which faced the injection of liquidity through the money market. This injection was performed by using the excessive liquidity of commercial banks in repo at the Bank

of Albania. This has been associated with a relevant increase in the NDAI of the Bank of Albania. The growth in cash money demand in June exceeded the

forecasts, by reflecting the impact of some factors that were not considered when establishing the NDAI target, such as, the allocation of funds to creditors of pyramid schemes and the concentration of the government demand increase and credit in Lek during June.

Table 4. Meeting of quantitative objectives of the Bank of Albania.

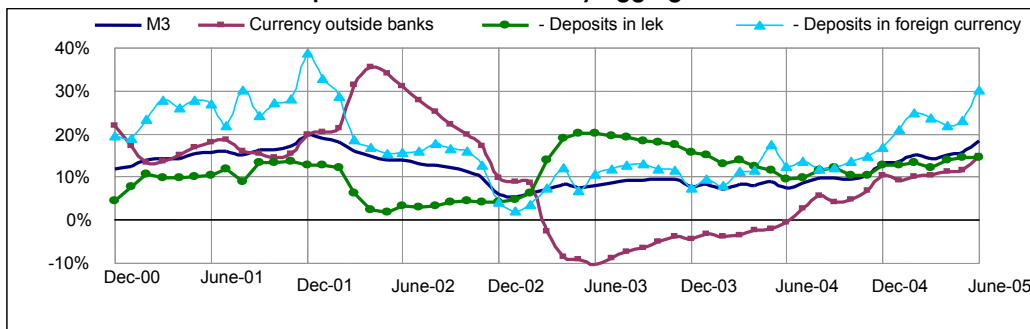
	December '04	January '05	February '05	March '05	April '05	May '05	June '05
Net International Reserves of the Bank of Albania (in millions of usd)							
Objective	942	985	1,029	1,073	1,077	1,082	1,087
Current	1,105	1,108	1,109	1,107	1,109	1,104	1,098
Difference	163	123	80	35	32	23	11
Net Domestic Assets of the Bank of Albania (in billions of lek)							
Objective	79	73	67	61	61	60	60
Current	61	56	56	53	56	57	64
Difference	-18	-16	-11	-8	-5	-3	4
Net Domestic Credit to government (in billions of lek)							
Objective	286	288	289	292	294	296	298
Current	285	286	288	288	290	291	294
Difference	-1	-2	-1	-4	-4	-5	-4

II.2 MONETARY AGGREGATES

According to the easing of monetary conditions in economy, money indicators continued increasing at accelerating paces. Annual growth rate of money supply marked a considerable increase in June, reaching a value of 18.3 percent, versus 15.8 percent in May. The main contribution to this performance was the annual increase of currency deposits which was reflected in the considerable increase of the exchange rate¹¹ annual effect. In addition, the rhythm of money supply growth in Lek, aggregate M2, has increased, reflecting a growth in the money demand of government and economy in June. The time structure of money supply experienced an evident increase of the liquid monetary asset weight, resulting from a considerable increase of currency outside banks. The structure according to currency maintained the tendency of shifting to its currency constituents, being reflected in a rise of the ratio of foreign currency deposits to money supply.

¹¹ In June, the annual change effect of the exchange rate of lek against euro and dollar (according to their weights in currency deposits) raised to 1 percent, against -3.5 percent in May.

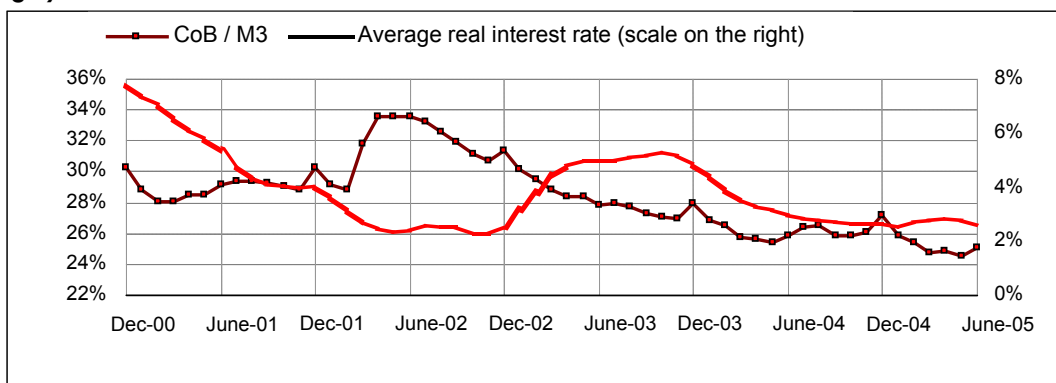
Chart 9. Annual rate performance of monetary aggregates.



Currency outside banks constituted the monetary indicator with the most rapid monthly growth. In June, its level marked an increase of ALL 5.1 billion or 3.9 percent. Annual money growth rate outside banks increased considerably to 14.9 percent from 11.6 percent in the previous month. The unusual acceleration of currency outside banks during June was mostly influenced by factors having temporary impacts, such as, the reimbursement of pyramid scheme creditors, the strength of money demand of government during elections and the high increase of credit to economy in Lek. Preliminary data for July and August indicate the decline of the abovementioned factors effects and the growth of currency outside banks according to its seasonal performance, proved over the past years.

The immediate outflow of currency outside banks was associated with an increase of its ratio to money supply. In June, the ratio of currency outside banks to M3 reached to 25.1 percent, marking a rise of 0.6 percentage point from the previous month.

Chart 10. Ratio of CoB to M3 and average real interest rate of time deposits in lek (scale on the right).



Deposits in Lek contributed negatively to money supply growth in June, marking a decline of ALL 0.5 billions. This performance was a consequence of the decline of ALL 1.5 billion in demand deposits, while time deposits increased by ALL 1 billion. Annual growth rate of deposits in Lek resulted in the same level of the previous month, about 14.7 percent, reflecting an increased contribution of individual time deposits. The fall of interest rates in Lek and the reduction of their difference with

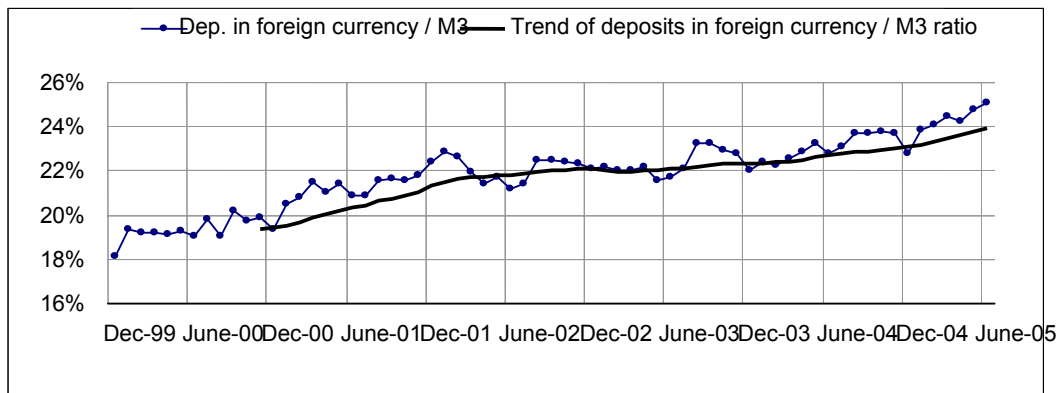
interests in foreign currency do not seem to have influenced negatively on the preference of deposits in lek.

Contribution of demand deposits to the annual growth of total deposits in Lek, though high, dropped in June, mostly influenced by a decline in deposits of public enterprises¹². The slowing rhythm of demand deposits in Lek has smoothed the effect of growth in currency outside banks to annual growth of M1 aggregate. In June, the annual rate of this indicator increased to 25.8 percent from 24.0 percent in May.

Foreign currency deposits continued their increasing trend also in June, marking a level of ALL 4 billion. Their growth has been positively influenced by the monthly depreciation of the exchange rate, which is estimated to be about ALL 1.7 billion. Under the impact of an increase in the annual exchange rate effect, the annual growth rate of deposits in foreign currency marked a significant increase, from 23.3 percent in May to 30.2 percent in June. In absence of the exchange rate effect, the annual growth of deposits in foreign currency in real terms would be respectively 27.6 and 29 percent.

The structure of deposits in foreign currency according to terms experienced an increased contribution of demand deposits, ALL 2.7 billion versus a time deposits growth of ALL 1.3 billion. This growth is largely due to a considerable increase in demand deposits in foreign currency of the private sector, which constituted about 84 percent of the monthly growth of demand deposits in foreign currency¹³.

Chart 11. Performance of ratio of deposits in foreign currency to M3.



The relatively more accelerating rhythm of the growth of money supply foreign currency component compared to its component in lek, is associated with an increase of weight of deposits in foreign currency to M3. According to the trend presented in the beginning of the year, June marked a further rise of this ratio to a level of 25.1 percent, from 24.8 percent in May.

¹² The distribution of pyramid scheme funds has caused the reduction of deposits in the public sector by about ALL 1.5 billion up to June.

¹³ This rise was influenced by an increase of ALL 2.1 billion of demand deposits of private companies to “Alpha Bank”.

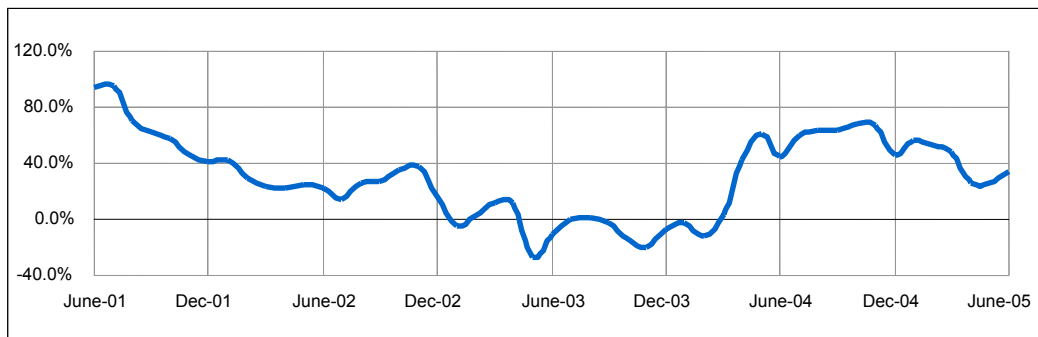
Table 5. Performance of monetary indicators in June (in billion lek).

	June	Monthly change		Annual change	
	2005	Absolute	Percentage	Absolute	Percentage
Currency outside banks	135.8	5.1	3.9	17.6	14.9
Total deposits	406.0	3.5	0.9	66.1	19.4
- in lek	270.0	-0.5	-0.2	34.5	14.7
- in foreign currency	136.0	4.0	3.0	31.6	30.2
Demand deposits	90.5	1.2	1.4	25.5	39.3
- in lek	41.0	-1.5	-3.6	18.7	83.7
- in foreign currency	49.5	2.7	5.8	6.9	16.1
Time deposits	315.5	2.3	0.7	40.6	14.7
- in lek	229.0	1.0	0.4	15.9	7.4
- in foreign currency	86.5	1.3	1.5	24.7	39.9
M1	176.8	3.6	2.1	36.3	25.8
M2	405.8	4.6	1.1	52.1	14.7
M3	541.8	8.6	1.6	83.7	18.3
Monetary base	180.4	5.9	3.4	23.4	14.9

II.3 ECONOMY DEMAND FOR MONEY

II.3.1 Net foreign assets

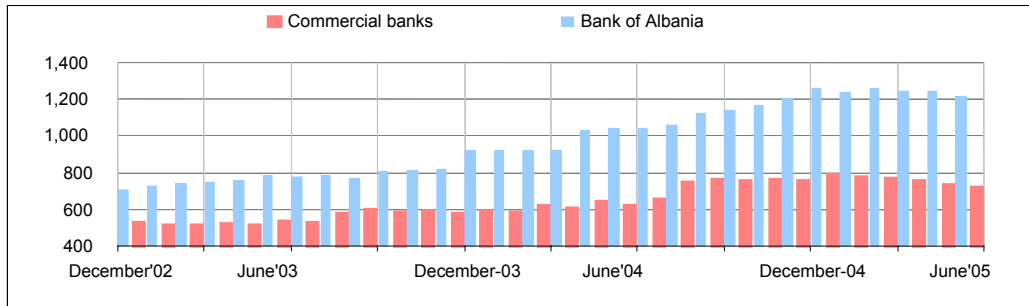
In June, the banking system marked a further decline in the net foreign assets' level. The euro depreciation against the American dollar by 2 percent in comparison with the previous month seemed to be the main factor influencing on the net foreign assets decline in the banking system. These assets dropped by USD 29 million, while calculated at a fixed exchange rate, this decline was only USD 6.7 million. However, net foreign assets' contribution to annual money supply growth marked a slight increase in June, reaching a level of 34.2 percent from 26.3 percent in the previous month.

Chart 12. Annual contribution of NFA growth to M3 growth.

Euro depreciation against the dollar influenced mostly the net foreign assets of the Bank of Albania. These assets marked a decline of USD 17.7 million compared to the previous month. Accounted for a fixed exchange rate, this decline was only USD 2.7 million. Also in June it was noticed a higher increase in foreign currency lending than

in foreign currency deposits. Associated with a depreciation of the euro against the dollar, it influenced on the drop of net foreign assets of commercial banks at a level of USD 11.3 million.

Chart 13. Performance of net foreign assets of the banking system (in million dollars).



II.3.2 Domestic credit

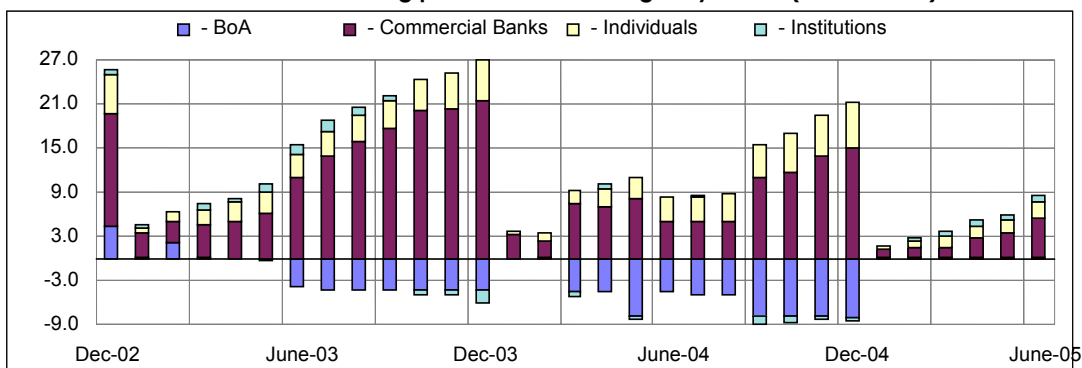
Contribution of domestic credit to money demand remained in the same levels of the previous month, about 70 percent. However, domestic credit in June reflected an annual growth of 18.9 percent or about 3 percentage points higher than in May. This growth was canalized mainly on lending to economy, which contributed by 65 percent to the annual domestic credit growth.

II.3.3 Government demand for money

Up to June, government fiscal accounts marked a budgetary deficit of ALL 6.8 billion, with a monthly growth of ALL 2.1 billion. The financing of this deficit was covered by domestic sources by ALL 10.5 billion, while the government deposits with the Bank of Albania were ALL 3.7 billion.

The issuing of two-year bonds was the main form of domestic financing. In June, the issued level of these bonds increased by ALL 1.5 billion, reaching a total of ALL 8.8 billion. Moreover, government demand for this month was covered by purchasing treasury bills. Commercial banks increased the treasury bills portfolio by ALL 0.68 billion. Individuals took part in the treasury bills purchasing, increasing their portfolio by ALL 0.34 billion. A slight increase was also perceived in treasury bills portfolios of institutions and the Bank of Albania.

Chart 14. Cumulative financing performance of budgetary deficit (in billion lek).



II.3.4 Credit to economy from the banking system

In June, credit to economy reached to ALL 95.9 billion, increasing by ALL 7.1 billion within a month or about twice as high as the monthly growth of May. Credit to economy was about 70 percent higher than in the previous year. In June, credit in lek increased by ALL 3.3 billion or 18 percent higher than in May. This growth constituted 46 percent of the monthly total credit growth¹⁴, witnessing a higher commitment of banks to credit in lek¹⁵. The credit in lek is about 2.3 times higher than in the previous year. Foreign currency credit in June maintained its normal pace, with an annual growth of 56 percent and a monthly growth of 6 percent in June.

Time structure of credit to economy has somewhat changed in favour to the short-term credit, marking an almost equal division to the credit, according to settlement terms.

Credit to individuals continues to maintain high growth rhythms even during June, constituting about one-third of the credit to economy. In comparison with the previous year, credit to individuals increased by 76 percent. However, the monthly contribution of this group to credit growth reflected a decline in total, which was considered to be consequent to a higher temporary commitment of banks to private sector.

Table 6. Outstanding credit indicators to the total (in percentage).

	2003	Q-1 '04	Q-2 '04	Q-3 '04	Q-4 '04	Q-1	April '05	May '05	June '05
Outstanding credit (in billion lek)	50.7	53.4	56.8	61.0	69.3	79.0	83.3	87.9	96.0
Short-term credit	46.0	41.6	35.4	33.9	34.0	34.1	34.6	32.2	33.7
Mid-term credit	33.3	35.4	37.8	37.2	36.0	34.5	34.5	34.5	33.1
Long-term credit	20.7	23.0	26.8	28.9	30.0	31.4	30.8	33.2	33.1
Credit to individuals	24.5	26.0	29.3	30.8	30.6	31.0	30.9	31.1	30.8
Credit to private sector	75.5	74.0	70.7	69.2	69.4	69.0	69.1	68.9	69.2
Lek	19.6	17	17	17	19.5	20.1	20.8	21.0	22.9
Foreign currency	80.4	83	83	83	80.5	79.9	79.2	79.0	77.1

Section distribution of credit in June, generally remained equal to that in May. Trade sector continues to constitute the primary sector of attracting the lion share of credit, even though it presented downward tendencies during 2005, being at the end of the month, about 19.5 percent of the credit portfolio. Meanwhile, credit to construction sector presented a slight increase, which is about 11.5 percent of the total credit to economy.

¹⁴ In May, the monthly contribution of credit in lek to total was about 33 percent.

¹⁵ During June, the Greek National Bank extended ALL 1.2 billion one-month credit in lek, to a private company. This credit was settled during July.

In June it was extended ALL 12.7 billion of new credit, or 1.3 times higher than in the previous month. This level represents the highest level of new credit extended in a month over a period longer than one year, when the lending activity is experiencing an accelerating growth. In comparison with the same period of the previous year, we noticed that new extended credit is shifting to longer maturity terms, while the most preferable is credit in lek.

Table 7. New credit indicators to the total (in percentage).

	2004		2005			
	June	December	March	April	May	June
New credit (in billion lek)	7.6	11.0	8.5	10.4	9.5	12.6
Short-term credit	61.1	56.4	51.3	50.3	39.8	49.9
Mid-term credit	26.0	23.4	24.3	28.0	37.8	28.3
Long-term credit	12.9	20.2	24.4	21.7	22.4	21.8
Lek	33.8	26.7	28.7	26.2	33.4	37.9
Foreign currency	66.3	73.3	71.3	73.8	66.6	62.1

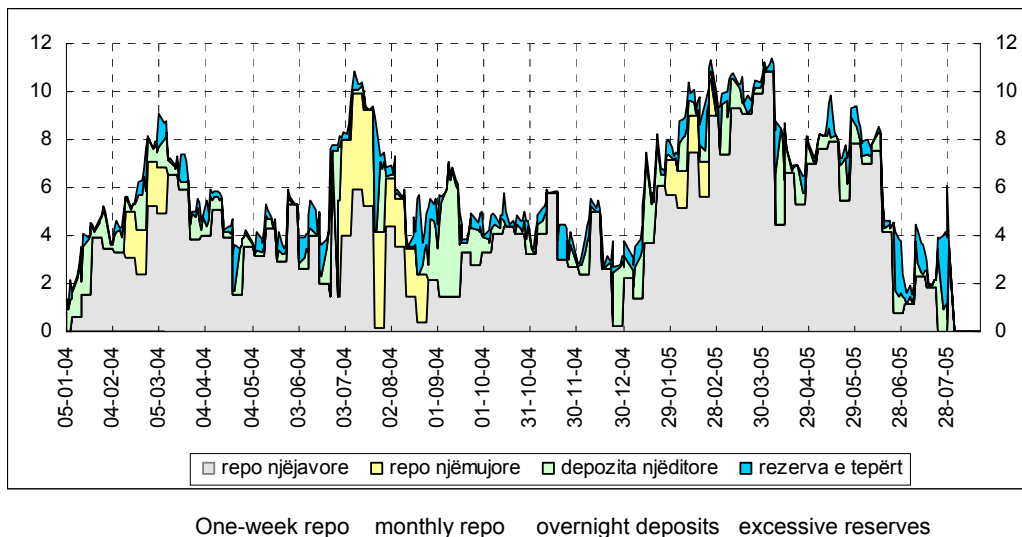
II.4

II.5 MARKETS AND PERFORMANCE OF INTEREST RATES

II.5.1 Liquidity performance

July marked a considerable decrease in the banking system liquidity level, compared to that in the previous month. Average daily liquidity dropped to ALL 3.0 billion from ALL 6.0 billion in June and ALL 8.9 billion in the previous year.

Chart 15. Daily liquidity level in the banking system (in billion lek).



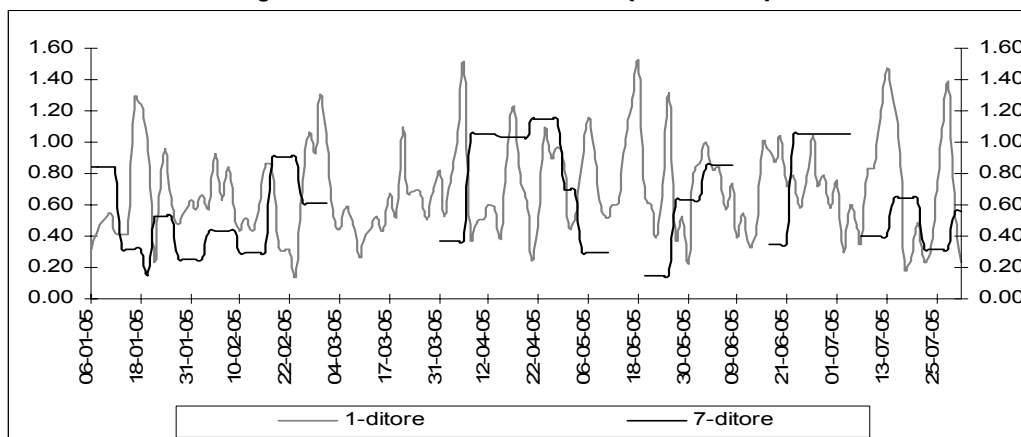
One-week repo monthly repo overnight deposits excessive reserves

During the first part of July, the excessive liquidity was regularly withdrawn through weekly repo auctions at a fixed price. Average investment in repo decreased by ALL 2.9 billion compared to June, resulting in a value of ALL 2.0 billion. At the end of July, the meeting of the required reserve made the banking system result in a need for liquidity, injected by weekly reverse repo auctions. This instrument was used for the first time this year, at an average sum of ALL 0.45 billion.

Overnight deposit facility is widely used by banks, especially over the second part of the month. In average, overnight deposit level marked a value of ALL 1.1 billion or ALL 0.5 billion higher than in the previous year. Overnight credit was rarely used and the need for liquidity was met in the interbank market.

Lending volume in the interbank market recorded a decline of ALL 0.42 billion, compared to June. Average daily level of lending in July resulted in ALL 1.16 billion, out of which 41 percent is occupied by the one-week maturity lending. In June, one-week lending occupied 53 percent of the total in the interbank market.

Chart 16. Lending volume in the interbank market (in billion lek).



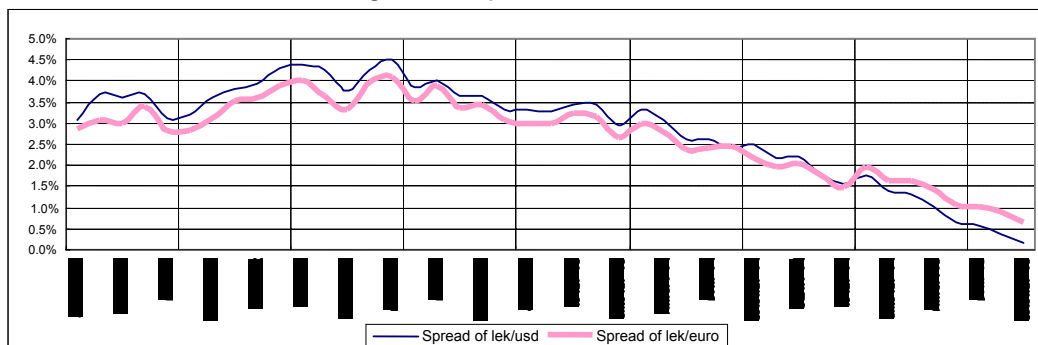
In July, it was noticed a reduction of the banking system participation in the primary market, which led to an increase of treasury bills yields. Investment offer in treasury bills did not always succeed in meeting government demand. Bank portfolio in treasury bills accounts for ALL 4.3 billion lower than in June, while two-year bonds increased by ALL 1.7 billion.

II.5.2 Performance of interest rates

During June, interest rates in market deposits in lek¹⁶ continued decreasing, by reducing even more their difference with interest rate of deposits in foreign currency.

¹⁶ The interest rate reduction of deposits in lek was applied in all terms.

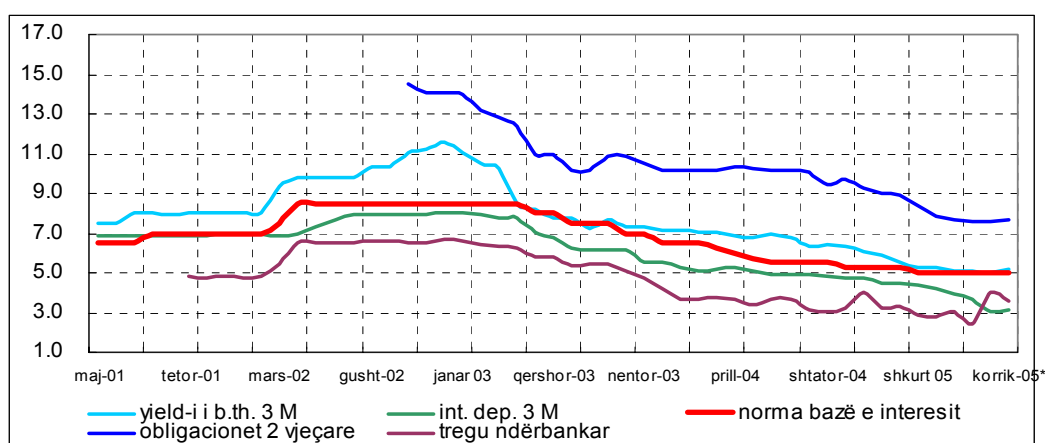
Chart 17. Spread between weighted average interests of time deposits in lek (less than a year) and those in foreign currency.



In June, the real interest of 12-month deposits in lek fell to a level of 0.96 percent, from 2.86 percent in the previous month and 3.56 percent in the previous year. This was influenced by the cutting of nominal interest rates of 12-month deposits in lek and the slight increase of inflation in June.

In July it was noticed an increase of interest rates in the interbank market, the primary market and the 2-year government bonds.

Chart 18. Performance of interest rates



*interest rates of 3-month deposits in lek for July, according to operative data.

This behaviour of interest rates was influenced by a reduction of excessive commercial banks liquidities in the Bank of Albania, a change of demand/supply ratios in the interbank market, a narrowing of the low corridor of supporting facilities interests¹⁷, a growth of demand for liquidities in the period of required reserve fulfilling, etc.

¹⁷ On 13 July 2005, the Bank of Albania decided to tighten the corridor of supporting facilities, at the level of ± 1.75 percent, to the core interest rate (the system passed to a symmetric corridor).

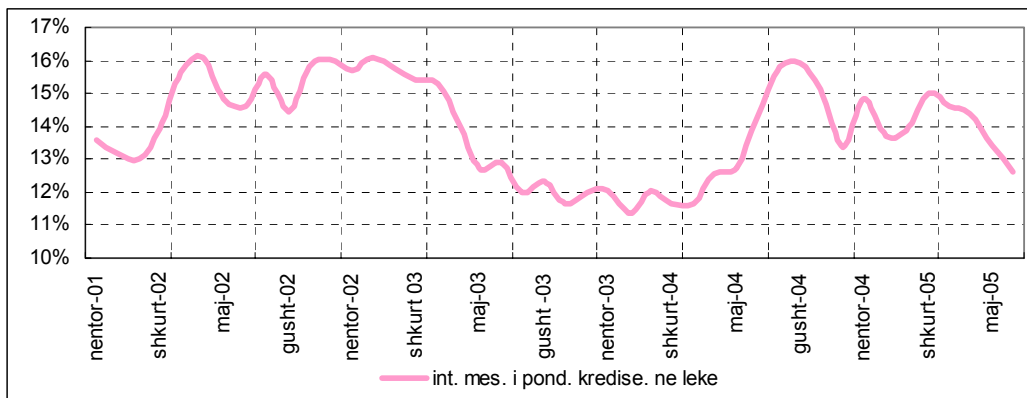
Table 8. Markets presenting tendencies of increased interest rates in lek.

in %)	June 05	July 05	int. change July-June
3-month Treasury bills yield	5.03	5.16	+0.13
6-month Treasury bills yield	6.42	6.58	+0.16
12-month Treasury bills yield	6.81	6.97	+0.16
Overnight interbank market interest rates	2.50	4.50	+2.00
2-year government bond yield	7.55	7.70	+0.15

*data for July are operative

In the lek credit market, weighted average credit interests (in total) in June reduced to a level of 12.6 percent from 13.4 percent in the previous month.

Chart 19. Weighted average interest rates of credit in lek (in total).



Unlike the previous tendency, interest rates of deposits in dollars in June were reduced in all terms. In this period, it is believed that this was mostly influenced by internal seasonal factors, such as the foreign currency increase and the dollar depreciation in the internal foreign exchange market, rather than by the international market performance. Weighted average rate of time deposits in dollar was reduced to a level of 1.91 percent or 0.08 percentage points below the previous month.

Interest rates of deposits in euro remained almost constant in June. Weighted average rate of deposits in euro resulted in a level of 1.73 percent, equivalent to that of May.

At the end of June, weighted average interest rate for credits in dollar was 8.1 percent, while for euro it was 5.6 percent, showing a decline compared to the previous month, similar to interest rates of credits in lek.

II.5.3 Exchange rate

Over the summer, the lek had an evident appreciation tendency against the euro, being previously depreciated against the dollar and ultimately appreciated against the latter. In June it was noticed the highest appreciation rate of the dollar against the lek, influenced by the performance of the American dollar against the euro in international markets. Although in June there were foreign currency inflows from the tourist season, mostly in euro, the appreciation of the lek versus the euro again showed resistance. In monthly terms, lek depreciated by 2.7 percent against the American dollar, while it has not presented volatility against the euro.

In July, the American dollar lost some points in the international market, which was reflected as Lek`s appreciation by 2.3 percent in our foreign currency market, compared to June. Over this month, the euro lost resistance and depreciated by about 2.3 percent against the Lek. In nominal effective terms, lek appreciated by 2 percent during July. Lek exchange rate levels were 121.3 lek/euro and 100.4 lek/usd at the end of July, against respectively 126.4 lek/euro and 92.6 lek/usd in the beginning of the year.

Chart 20. Lek exchange rate performance

