

# **MONETARY POLICY MONTHLY REPORT**

**MAY 2003**

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## **1 MAIN HIGHLIGHTS OF THE MONTH.**

Annual inflation rate for April 2003 resulted 2.8 percent. "Foodstuffs and non-alcoholic" group prices provided an important impact on rising prices in this month, while transport prices were reduced as a result of the oil price decline. Inflation annual average rate resulted 3.5 percent, indicating a declining trend throughout 2003.

Reported data on March and operating data on April indicate a further improving performance of monetary aggregates, liquidity condition, a fast return of currency outside banks in the system, an increase of Lek deposits, etc. Lek deposit growth is supported by high interest rates (real) in Lek and the more favorable position in ratio to the foreign currency interests. Inflation in the country continues to record low rates, mainly reflecting the maintenance of monetary aggregates under control.

Lek has been stable to Euro and appreciated to USD. Lek has followed EUR/USD ratio, international market performance. Exchange rate performance did not affect extension of inflationary pressures.

Budget expenditures and government net borrowing by the domestic market have been under the plan. These have lowered inflationary pressures in April. Budget expenditures performance and financing the deficit, on the other hand, adds up the concerns on a possible concentration of them for the remainder of the year.

In rising inflation, as previously mentioned are expected on operation, such factors as, the local government elections or the increase of the power price, and the intensity with which these events will influence the consumer prices.

Assessing the above factors, in view of the immediate and almost total reaction of commercial banks to the Bank of Albania decision on cutting the core rate by 0.5 percentage points has led to the conclusion, that maintaining the current interest rates, remains appropriate.

## 2 INFLATION AND EXCHANGE RATE PERFORMANCE AS OF APRIL

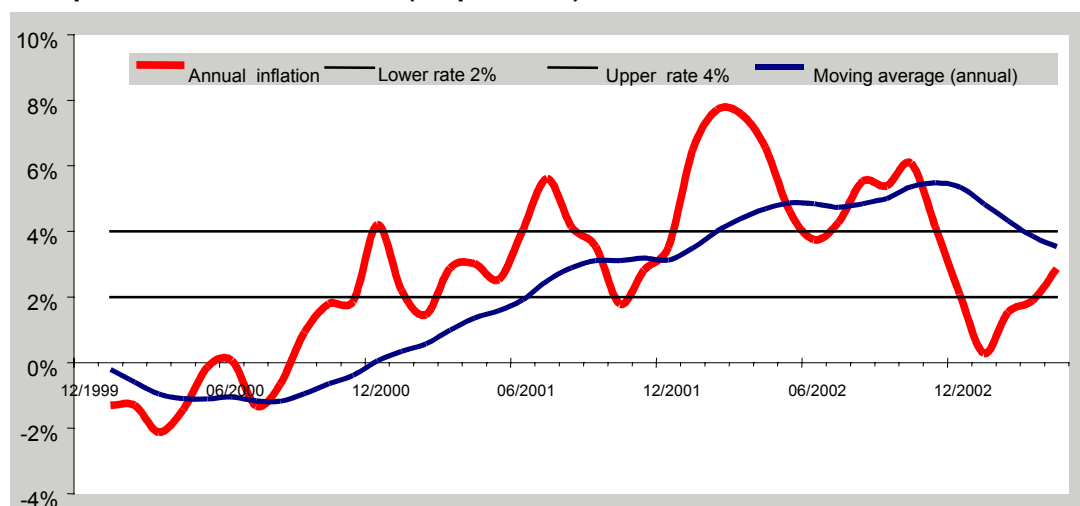
### 2.1 INFLATION DETERMINANTS

April 2002 recorded an annual inflation rate of 2,8 percent or the highest from the initial year. Annual average inflation kept a reducing rate, reaching 3.5 percent.

**Table 1: Annual inflation rate (in percent).**

	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	
June	-0.6	0.1	4.0	3.8	
July	0.1	-1.3	5.6	4.3	
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	

**Graph1: Annual inflation (in percent).**



In April, annual inflation rate increased a bit more than the Bank of Albania forecasts. Inflation was mainly as a result of the significant rise of annual inflation of "food and non-alcoholic drinks", reaching 4.8 percent, or 1.9 percent, on monthly basis. "Vegetables" and "fruits" recognized the highest increase of the group, by respectively 10 and 16.7 percent, on annual basis. The rising price of agricultural products, this month, is assessed to have been as result of:

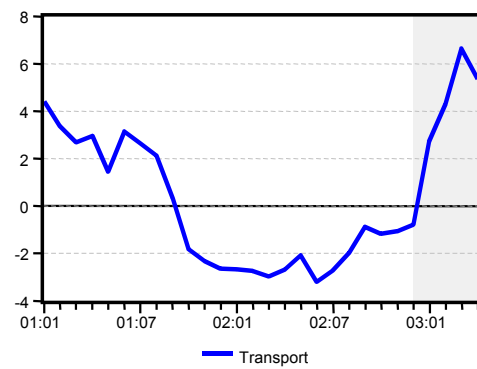
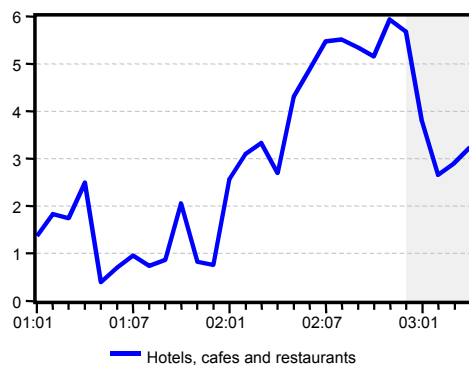
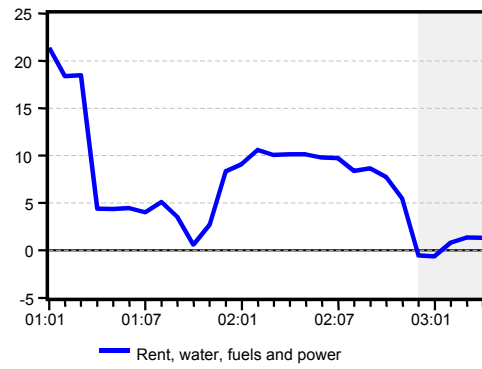
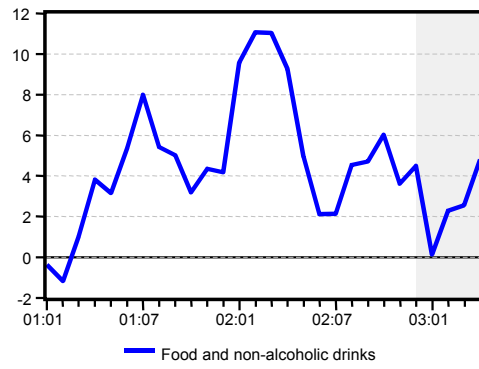
- **Relatively more expensive imports** of March affected by a higher inflation rate, recorded by main partners countries to Albania. For example, inflation in Greece reached to 4.1 percent from 3.3 percent target, at year-end. In Italy, this rate reached 2.7 percent from 2.4 percent, set as target rate.
- **The speculative increase of prices**, as already frequent by the Albanian market, during holiday periods, was concentrated in the second half of the year.

Inflation would be higher, if fuels did not record a falling price. Fuel price, as at the end of April, reached the rate of 72 Lek/liter. This price is last time registered in October 2002. The constant falling of oil price is a result of two reasons:

- Oil price decline by international markets, after the OPEC decision to increase the maximum production, allowed. Such a fall has led to reduction of the wholesale purchase price on the behalf of oil suppliers to Albania.
- Reference price reductions used for clearing oil through customs.

The fall in oil price is also reflected by transport price performance domestically. "Transportation" had a monthly decline of 1 percent, moving from 6.6 to 5.4 percent, on annual basis.

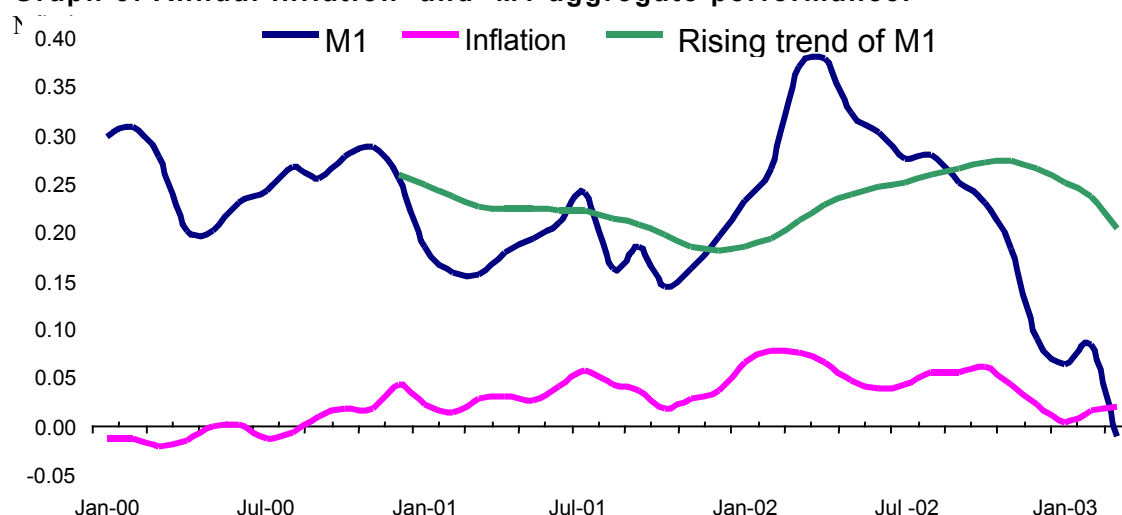
**Grafik 2: Annual inflation of 4 main groups of the CPI basket (in%).**



Permanent determinants affecting inflation rate, even in this month, continued to remain stable:

- **Monetary aggregates** continue to be kept under control for an already long time from now. So, the declining values of M1 aggregate in the last quarter of 2002 have caused the reduction of inflationary pressures, this month.
- **Exchange rate** movements have kept the same side with the previous month. Exchange rate movements, in average terms, as of March 2003, have been Lek appreciated to USD by 0.39 percentage points and EUR depreciated by 0.1 percentage points. Such a movement continues to keep low exchange rate pressures on inflation.
- **Budget expenditures** have under the planned rates. These are assessed to operate with 6 months lag on inflation rate. So, the previous year operation of September and October did not add the inflationary pressures in this period of the year.

**Graph 3: Annual inflation and M1 aggregate performance.**

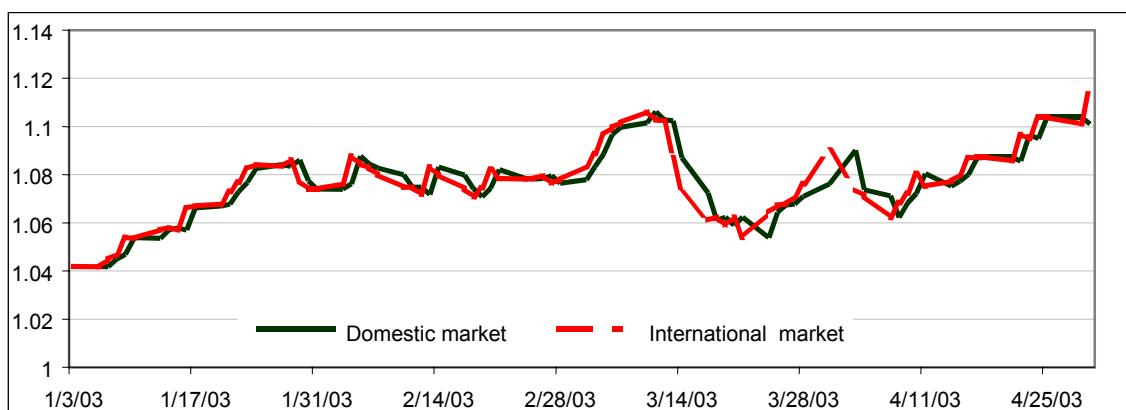


In conclusion, it might be said that, in the conditions, when other factors did not exercise pressures on rising inflation, the speculative increase of consumer prices and higher prices of imported agricultural products, caused an unexpected rise of inflation figure for this month.

## 2.2 EXCHANGE RATE PERFORMANCE

In April, USD depreciated to EUR, internationally, by about 4 percent and 7 percent from 2003 outset. Albanian foreign exchange market has closely followed the international market performance of USD/EUR exchange rate, albeit USD has been at more favorable rates to EUR.

**Graph 4: USD/EUR exchange rate during 2003.**

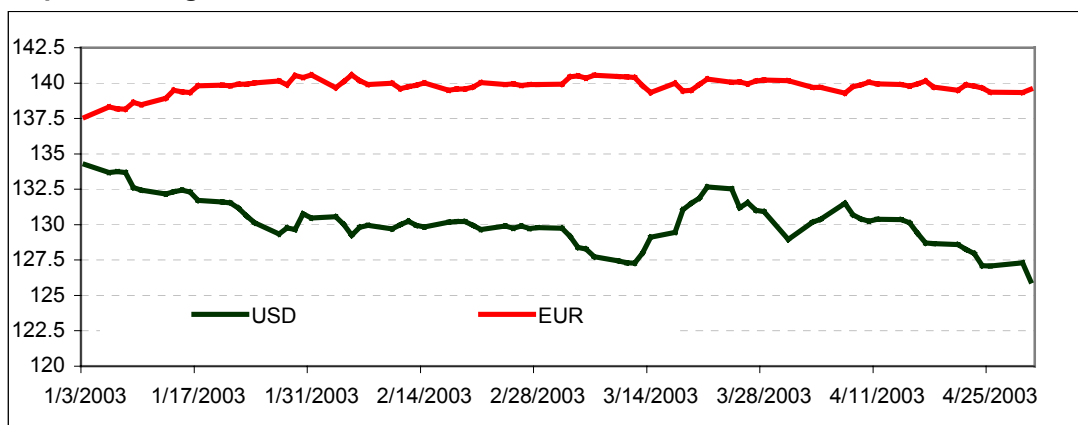


Lek has been stable in exchange to EUR and gained points in exchange to USD. USD depreciated to Lek by about 3 percent in April and about 6 percent, compared to the first days of 2003.

Compared to the previous year, Lek has been average appreciated to USD, by about 10.3 percent and average depreciated to EUR, by about 9.7 percent.

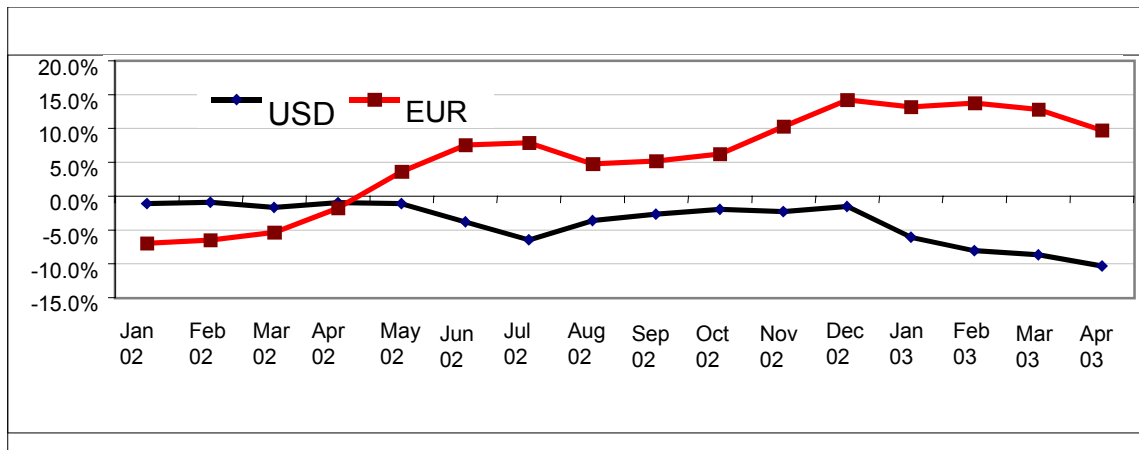
Lek/USD and USD/EUR are evidenced on a strong negative correlation between (-0.95) whereas Lek/EUR and USD/EUR did not indicate such a strong correlation between them (0.55). A constant appreciation of EUR to USD, internationally, is expected to bear a greater effect on USD depreciation to Lek and a less on Lek/EUR exchange rate, in the next month.

**Graph 5: Lek against EUR and USD in 2003.**



**Graph 6: Annual change of average exchange rate of Lek to EUR and USD (in percent).**





## 3 MONETARY INDICATORS

### 3.1 MONETARY POLICY

Monetary developments in April and in the first two weeks of May have tracked the evidenced trend in the first quarter of the year. Currency outside banks has been tracking return in the banking system, bringing a significant rise of Lek deposits and a further decrease of M1 aggregate.

Improving monetary indicators is one of the main factors, affecting the maintenance of low inflation rates, in 2003. M1 aggregate is at its lowest range, after March 2002, during which deposit retractions from two largest banks of the system began, whereas banking system liquidity statement, expressed by the high rate of excessive reserves, presents, as stable. This has permitted gradual loosening of monetary policy, expressed by the 0.5 percentage points' reduction of Repo rate, on April 23.

Our banking system has rapidly reacted and to the expected manner to monetary policy alleviation. Monetary developments indicate that the Bank of Albania movement did not ruin monetary balances or break the disclosed trend in the first four months of the year. According to the operating data, currency outside banks has been stable in the first two weeks of May. Also, Lek deposit growth seems to have kept its pace even in this period. As an indicator of this fact is that the excessive liquidity, invested in Repo agreements by banks, as at May 9, was Lek 7,8 billion or Lek 3,2 billion more, than at the beginning of the month.

The Bank of Albania change of its monetary policy stance did not bear a negative impact on the observance of its quantitative targets, set. The Bank of Albania increase of its net foreign assets and the decrease of base money have apparently extended the differences between quantitative indicators from their targets, set. Also, the low government demand for financing deficit in March enabled the Bank of Albania respect its target set on net domestic credit to government, this month.

**Table 2: Meeting quantitative targets of the Bank of Albania.**

	Dec'02	Jan'03	Feb '03	Mar'03	Apr'03*
Meeting the target on NIR (in millions of USD).					
Target	558.6	559.3	559.9	560.6	560.6
Current	562.2	571.1	586.2	596.2	603.7
<b>Difference</b>	<b>3.6</b>	<b>11.8</b>	<b>26.2</b>	<b>35.6</b>	<b>43.1</b>
Meeting the target on NFA (in billions of Lek).					
Target	95.1	95.8	95.9	97.1	97.4
Current	87.1	80.1	81.2	77.1	70.1
<b>Difference</b>	<b>-8.0</b>	<b>-15.7</b>	<b>-14.7</b>	<b>-20.0</b>	<b>-27.3</b>
Meeting the target on the net domestic credit to government (in billions of Lek).					
Target	257.0	261.2	262.9	264.6	265.9
Current	259.6	262.8	264.4	263.1	--
<b>Difference</b>	<b>2.6</b>	<b>1.6</b>	<b>1.5</b>	<b>-1.4</b>	<b>--</b>

\*Operating data.

## 3.2 MONETARY AGGREGATES

Monetary developments during March–April have been in line with monetary program.

- The currency outside banks has kept returning in the banking system, causing an extension of Lek deposits.
- Deposit growth is the main growth resource of M3 aggregate. As the increase of monetary assets in economy takes the shape of less liquid assets, it is not expected to comprise a resource of inflationary pressures.
- Monetary aggregates' growth rates continue to be low. According to the operating data on April, monetary developments confirm a low growth expectation for M2 aggregate as a result of the low government and economy demand for monetary assets, in Lek.

**Table 3: Monetary indicators as of March 2003, (in billions of Lek).**

	March 2003	Monthly change		Annual change	
		Absolut	Percent	Absolut	Percent
Currency outside banks	121.3	-3.1	-2.5	-3.4	-2.7
Total deposits	299.3	1.7	0.6	31.6	11.8
- in Lek	206.8	2.1	1.0	25.2	13.9
- In foreign currency	92.6	-0.4	-0.4	6.4	7.4
Required deposits	57.6	-1.4	-2.3	1.7	3.0
- in Lek	22.7	-0.6	-2.4	-1.1	-4.4
- In foreign currency	34.8	-0.8	-2.3	2.7	8.5
Time deposits	241.8	3.1	0.0	29.9	14.1
- in Lek	184.0	2.7	1.5	26.2	16.6
- In foreign currency	57.8	0.4	0.7	3.7	6.8
M1	144.0	-3.6	-2.5	-4.4	-3.0
M2	328.0	-1.0	-0.3	21.8	7.1
M3	420.6	-1.4	-0.3	28.2	7.2
Base money	157.9	-3.4	-2.1	-1.7	-1.1

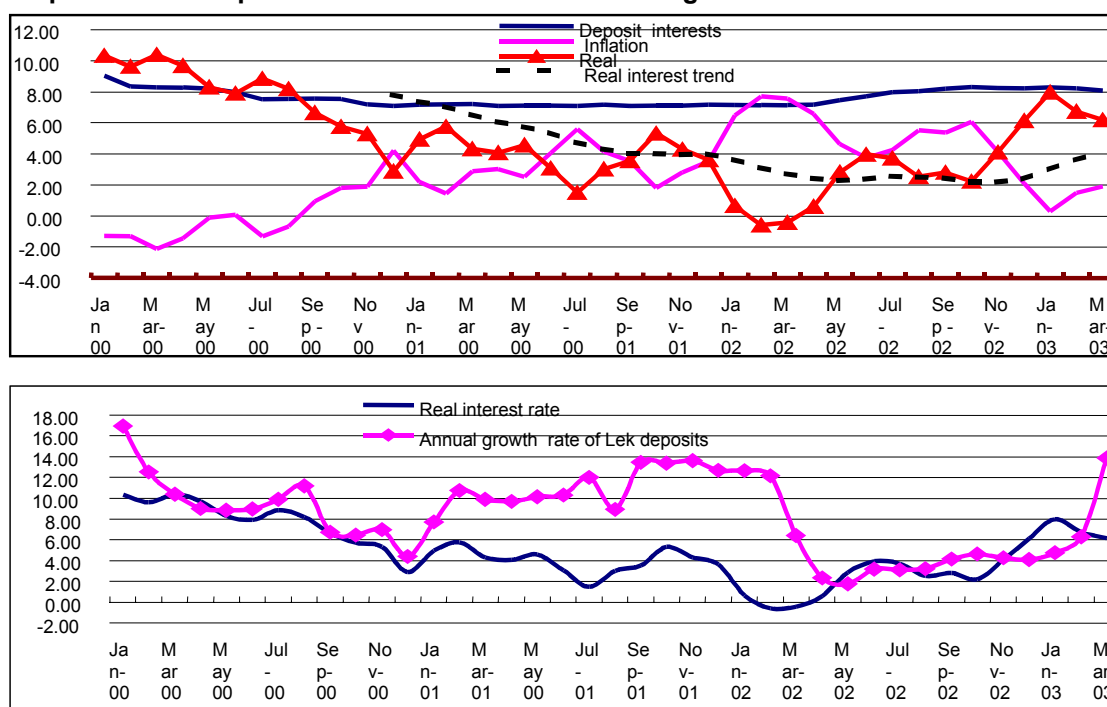
**Table 4: Comparing monetary aggregates to the program, (in billions of Lek).**

	December		March		April*	
	Program	Current	Program	Current	Program	Current
Currency outside banks	130.5	130.8	134.3	121.4	122.9	120.3
Lek deposits	197.9	193.9	201.9	206.3	207.7	209.2
Foreign currency deposits	92.6	92.0	96.9	93.1	94.2	93.7
M1	154.3	152.7	158.0	144.2	146.2	143.7
M2	328.5	324.6	336.2	327.7	330.7	329.5
M3	421.1	416.6	433.1	420.8	424.8	423.2

\*According to operating data.

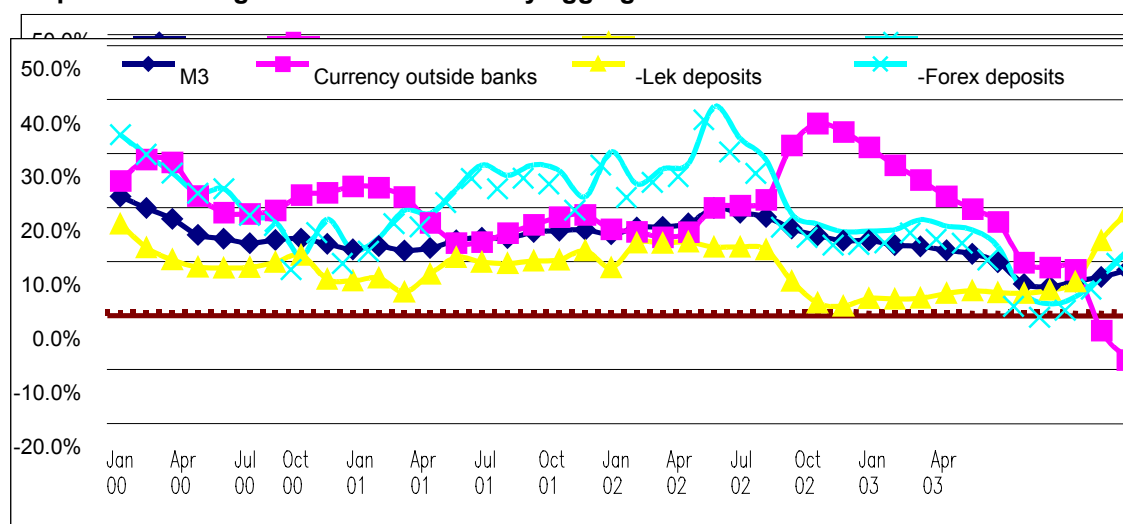
Lek deposits are grown in March, notwithstanding the slight interest rates decline.

**Graph 7: Lek deposit rates and their annual growth rate.**



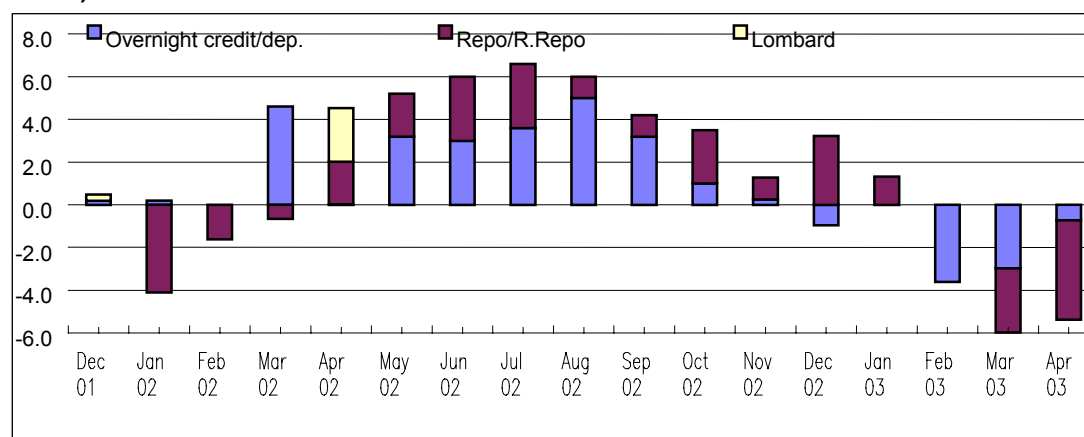
According to the operating data, the annual growth rate of money supply reached 8.5 percent in April. Money supply growth is totally as an outcome of the deposit rise, while the annual growth rate of currency outside banks remains negative. In April, money supply recorded growth by both foreign currency components, M2 aggregate and foreign currency deposits. This comprises a different behavior compared to March, when foreign currency deposits and M2 aggregate recorded decline.

**Graph 8: Annual growth rate of monetary aggregates.**



Notwithstanding Lek deposit rise, commercial banks' excessive reserves recorded a slight reduction by Lek 0,6 billion in April, reaching Lek 5,4 billion at the end of the month.

**Graph 9: Interbank relations of the banking system to the Bank of Albania<sup>1</sup> (in billions of Lek)**



### 3.3 ECONOMY DEMAND FOR MONETARY ASSETS

#### 3.2.1 BANKING SYSTEM NET INTERNATIONAL RESERVE

Banking system net foreign assets have been Lek 0,3 billion less, in March. The contribution of banking system net foreign assets in the rise of the money supply in March accounts for 8.3 percent, only. The continuous appreciation of Lek to USD has caused the reduction of net foreign assets, expressed in Lek. USD has been average depreciated to Lek by about 4 percent, in 2003.

Lek appreciation to USD has disguised the real growth of banking system's net foreign assets. These assets expressed in USD have been increased by USD 10,7 million, in March. Banking system increase of its net foreign assets, expressed in USD, has been mainly as an aftermath of the Bank of Albania interventions by the foreign exchange market, while the reduction of foreign currency deposits influenced its negative side. The Bank of Albania increased the level of its net international reserves by USD 12,1 million, whereas, the commercial banks' net international reserve accounts for USD 1,4 billion less. The Bank of Albania's interventions by the foreign exchange market have been at the amount of USD 9,6 million, in March.

#### 3.2.2 GOVERNMENT DEMAND FOR MONETARY ASSETS

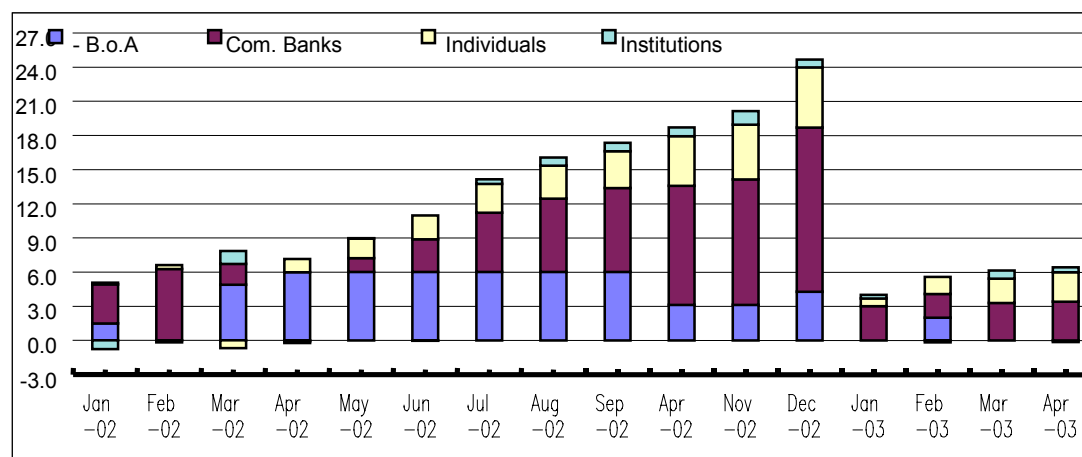
Deficit financed through domestic borrowing has been low during the first half of the year. Government demand for monetary assets did not comprise an important resource for the provision of monetary assets. Deficit financed from treasury bills during January–April period has been Lek 6,3 billion, compared to Lek 6,7 billion of the same period, previous year. Banking system has covered Lek 3,3 billion of this financing in 2003, from Lek 5,9 billion in 2002.

Deficit financed through treasury bills in April 2003 was only Lek 0,1 billion. This has been due to the fact that accomplishing incomes for April resulted 12 percent higher,

<sup>1</sup> The positive sign indicates banks net borrowing by the Bank of Albania. The negative sign indicates investment of excessive reserves in the Bank of Albania.

than the plan. Exceeding incomes plan is dedicated to the Bank of Albania flowing the profit amount of Lek 2,85 billion from 0,83 billion, planned. On the other hand, budget expenditures in April were 13.5 percent lower, than those planned. However, budget expenditures have been higher, as previous month compared.

**Graph 10: Cumulative performance of deficit financed over the year (in billions of Lek).**



### 3.2.3 CREDIT TO ECONOMY

Net outstanding credit to economy increased by Lek 0,7 billion in March, reaching Lek<sup>2</sup> 49 billion at the end of it. Net outstanding credit increased by Lek 1,7 billion in 2003, being at the same rate with that in the first quarter, 2002. Its rise in this period comprises only 53 percent from the projected growth by the monetary program.

A positive aspect of credit to economy during 2003 is the constant displacement of net outstanding credit in favor of the medium- and long-term credit. In 2003, even March did not conduct changes in the structure of the net outstanding credit by foreign currency. Credit to economy continues to be mostly developed in foreign currency.

**Table 5: The structure of net outstanding credit (in percent).**

	Dec '02	Jan '03	Feb '03	Mar '03
Short-term credit	49	48	49	48
Mid-term credit	28	29	29	29
Long-term credit	23	23	22	23
Credit to the public sector	2	2	2	2
Credit to the private sector	98	98	98	98
Lek credits	34	34	34	33
Foreign currency credits	66	66	66	66
Net outstanding credit (in bln of Lek)	<b>47.3</b>	<b>47.04</b>	<b>48.4</b>	<b>49</b>

<sup>2</sup> The value of net outstanding credit includes credits transferred by BART.

New credit indicators present a positive performance of credit to economy. New credit disbursement, as of March 2003, reached Lek 8 billion, or 1.2 times more, than the same period, previous year. New credits in Lek were only Lek 3,7 billion, or 76 percent more, than those accorded for the first quarter of 2002. New credits accorded in March were accompanied by these characteristics:

- 61 percent from the total of new accorded credits were short-term credits,
- 54 percent of them were foreign currency credits.

**Table 6: New credit (in Billions of Lek).**

Indicators	Year 2002			Year 2003		
	January	February	March	January	February	March
Short-term credit	2.6	1.7	5.2	3.2	3.6	4.8
Mid –term credit	0.4	0.8	1.1	0.9	1.0	2.4
Long-term credit	0.1	0.1	0.4	0.4	0.4	0.7
Credit to the public sector	0.004	0.004	0.01	0.0	0.0	0.045
Credi to the private sector	3.2	2.6	6.7	4.5	5.0	7.9
In Lek	0.8	0.5	0.8	1.7	1.7	3.7
In foreign currency	2.4	2.1	5.9	2.8	3.3	4.2
Total	<b>3.2</b>	<b>2.6</b>	<b>6.7</b>	<b>4.5</b>	<b>5.00</b>	<b>7.9</b>

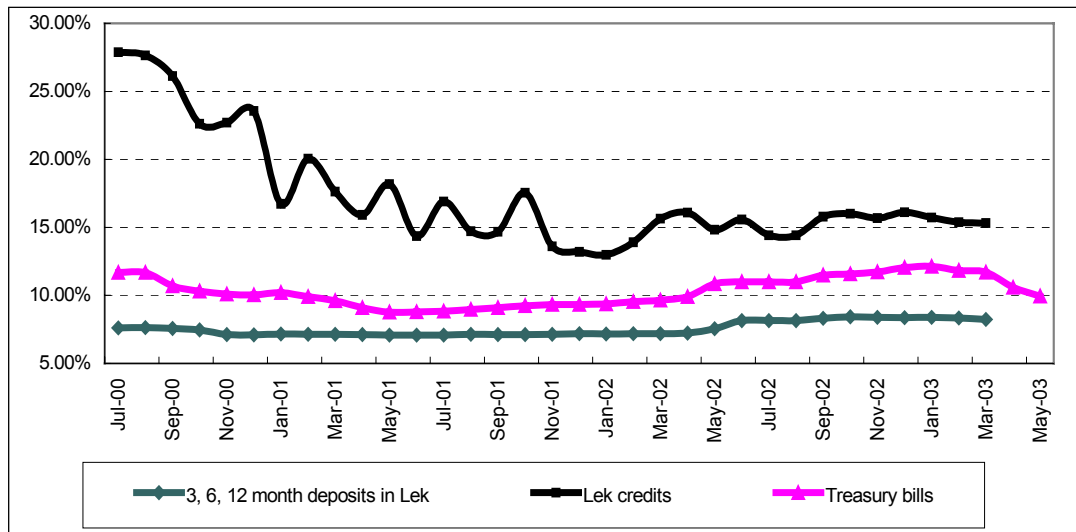
## 4 INTEREST RATES IN ECONOMY

Interest reduction by low rates kept moving by all markets in March 2003. These trends accentuated apparently after the Bank of Albania decision on cutting Repo rates by 0.5 percentage points. The first changes were evidenced with interbank market transactions, where the 0.5 percentage points' reduction was entirely reflected.

**Table 7: Change of interest rates (in percentage points).**

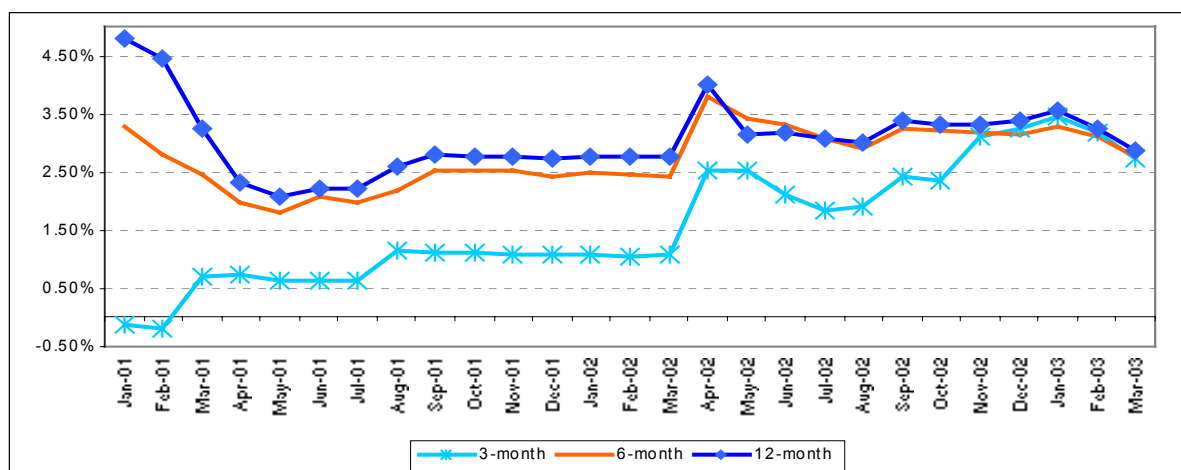
	Of deposits	Of treasury bills		Of credits
	January – March 2003	January – Mars 2003	January – May 15, 2003	January – March 2003
3-month	-0.22	-0.97	- 2.70	
6-month	-0.04	-0.54	- 1.58	-1.09
12-month	-0.02	-0.70	- 2.21	-0.47
1-3 years				+0.93
Over 3-years				-2.13
Average-weighted	-0.20	-0.43	- 2.16	-0.42

**Graph 11: Average weighted market rates, in percent.**



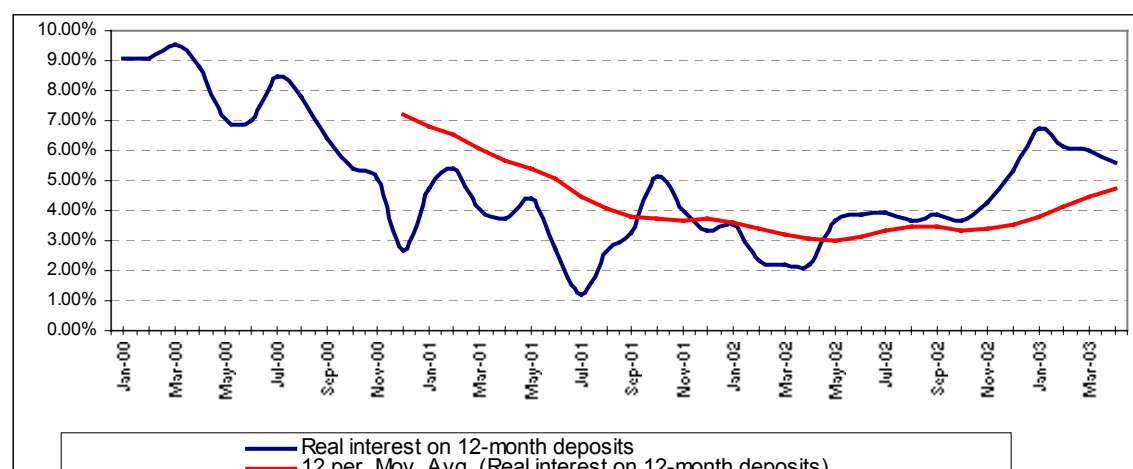


**Graph 12: The spread between time deposit rates and the treasury bills yields by maturity term in percentage points.**



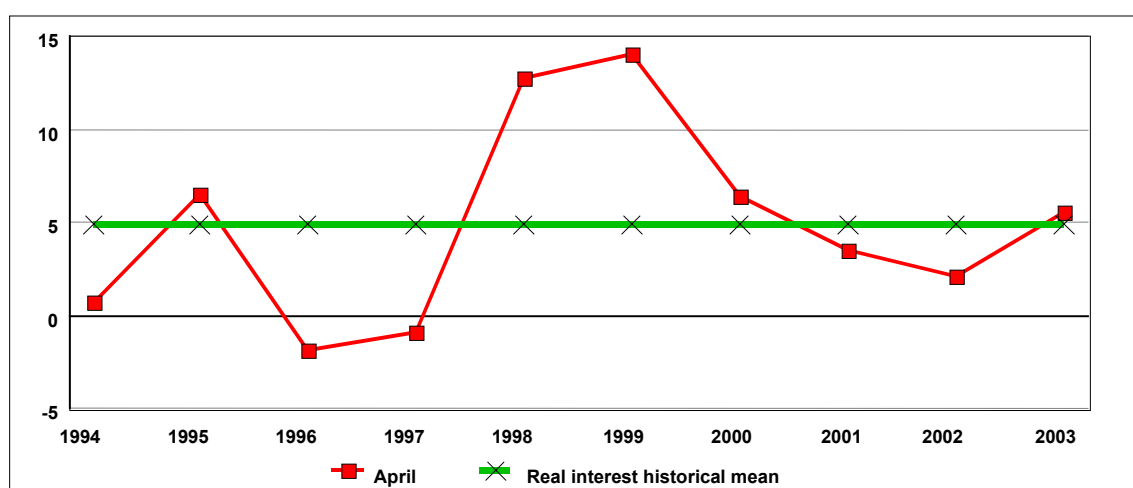
Real interest incomes on 12-month deposits in Lek after tax for April 2003 reached at 5.5 percent, marking the lowest rate for 2003. Decisive in this change was cutting interest rates on time deposits in Lek against the rising trend of annual inflation to the first months of 2003.

**Graph 13: Real average rate on 12-month deposits in Lek, in percent.**



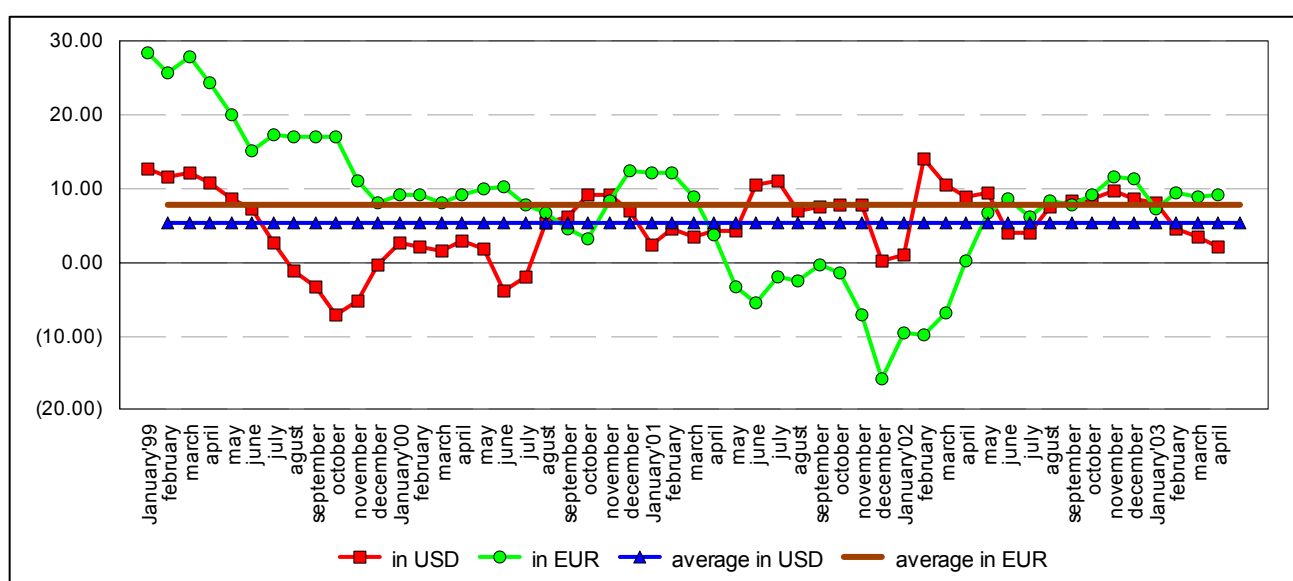
Notwithstanding the slight reduction of this indicator along January–April 2003, it results that compared to historical average in April, depositors have gained the highest level of income from deposits placed since 2001.

**Graph 14: Real average rate performance and historical mean as of April (in percent).**



So, applicable interests on 12-month deposits in Lek remain more favorable than the foreign currency interests.

**Graph 15: The spread between 12-month deposit rates in Lek and 12-month deposits in USD and Euro converted<sup>3</sup> in Lek and the historical average, in percent.**



<sup>3</sup> Exchange rate expected monthly rate and historical average, in percent.

