

BANK OF ALBANIA

**MONETARY POLICY REPORT
MAY 2005**

JUNE 2005

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I. MAIN HIGHLIGHTS

- Annual inflation rate was 2.0 per cent in May, from 1.3 per cent in April, thus coinciding with the lower limit of the targeted band of Bank of Albania. Annual average inflation rate reached the level of 2.2 per cent.
- Annual inflation was influenced mainly by the administered prices in “Rent, water, fuels and energy” group, whose growth in January will follow even in the coming months of the year. Monthly inflation marked the level of –1.1 per cent, influenced mainly by the fall of prices in “Foodstuffs and non-alcoholic beverages”.
- In general, macroeconomic and monetary conditions have sustained the easing of inflationary pressures. During the first five months of the year, fiscal policy resulted to be in accordance with projections. Also, the easing of monetary conditions led to the demand rise, but without infringing the liquidity control in the system and without causing upward pressures on inflation.
- Annual growth rate of M3 aggregate in April reached the level of 15.2 per cent. Money supply composition is characterized by the tendency towards domestic currency, while liquidity structure of money supply has been stable.
- Credit balance amounted to ALL 84 billion, marking an annual growth of 50 per cent. In April new credit to the economy increased to ALL 10.4 billion or 23 per cent higher than in March. Lending activity in April is characterized by the tendency to raise the weight of Lek credit and to increase credit to individuals and production sectors.
- In April Lek interest rates decreased in all markets, including credit market. In the interbank market, government securities primary market and Lek deposits market, interest rates continued to reduce considerably even during May.
- Exchange rate developments showed signs of expected seasonal effects. During these months, foreign exchange market knew a further appreciation of Lek versus Euro and its depreciation versus US dollar.

II. INFLATION IN MAY

During the first months of 2005, annual inflation was characterized by a downward trend, reaching the lowest level in April. In May, annual inflation highlighted a slight increase, reaching the level of 2.0 per cent, the lower limit of the targeted band of the Bank of Albania. As from February 2004, the annual average inflation rate has followed a downward trajectory. In May 2005, this rate marked the level of 2.25 per cent.

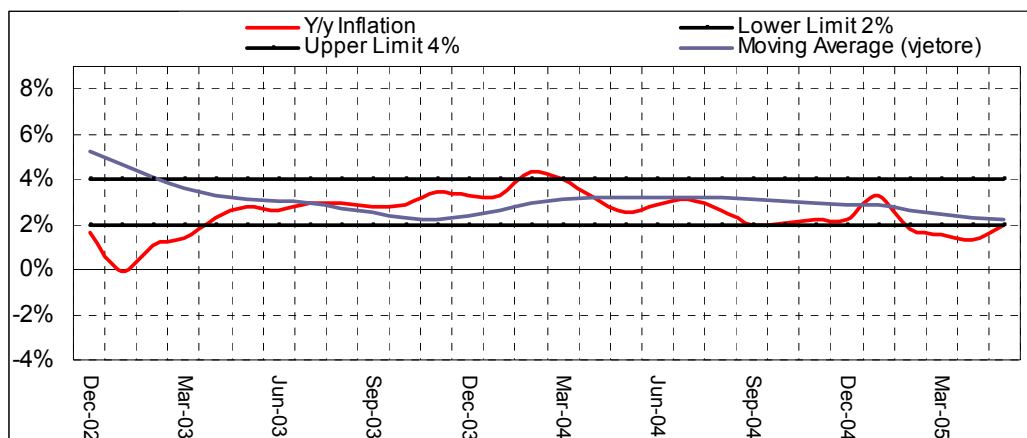
Table 1 Annual inflation rate (in percentage)

	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	
July	5.6	4.2	3.0	3.1	
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	2.3

Source: Institute of Statistics

Demand factors, budget expenditures, budget deficit, monetary indicators and exchange rate, as well as supply factors, agricultural production and imported inflation, have created a favorable environment for controlling inflationary pressures during this period. Fiscal policy has been cautious and within the projected parameters, whereas monetary policy has been prudential, constantly sustained by the expected inflation developments.

Chart 1 Annual inflation (in percentage)

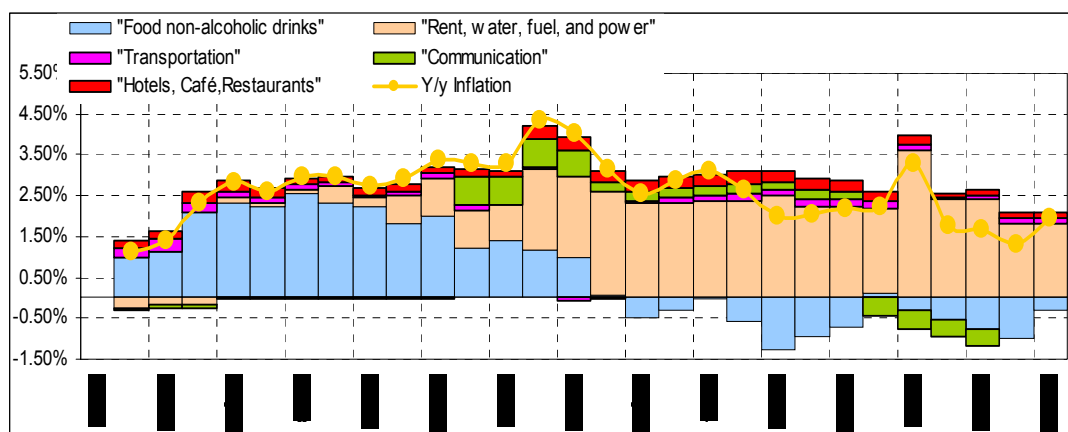


II.1 INFLATION AND CONSTITUENT GROUPS

In May 2005, monthly inflation was -1.1 per cent, while annual inflation 2.0 per cent. Based on the analyses of the contributions that constituent groups of consumer basket give to annual inflation, it is noted that annual inflation rate of May is mainly influenced by "Foodstuffs and non-alcoholic beverages", "Rent, water, fuels and energy", "Transport" and "Health" groups (Chart 2). "Health", "Transport" and "Hotels, cafés and restaurants" groups marked positive low annual inflation rates, while "Rent, water, fuels and energy" continues to considerably affect the annual inflation rate, contributing by about 1.8 percentage points in May.

"Clothes and footwear" group and especially "Foodstuffs and non-alcoholic beverages" group marked negative inflation rates. Except for the month of December of the last year, "Foodstuffs and non-alcoholic beverages" group recorded negative annual inflation rates during the 12-month period. The contribution of price fall in this group to overall annual inflation rate is lower than the one recorded in the first four months of the year, due to the deepest fall in May of the previous year. Monthly inflation of this group (-2.7 per cent) gave a contribution of -1.1 percentage points to the monthly inflation of May. The annual decline in prices of foodstuffs is still attributed to the effect of the factors influencing over the last 12-month period. The meeting of the domestic market needs from domestic agricultural supply, as well as lower import prices, due to favorable exchange rate developments, have influenced the decline in prices of these goods.

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



After a considerable growth during the first quarter of 2005, the contribution of "Rent, water, fuels and energy" recorded a slight decrease over the last two months. This group has contributed by an average of 1.8 percentage points to the inflation of April – May 2005, compared to the contribution of 2.8 percentage points given to the inflation of the first quarter. The sub-groups that marked the most significant decrease have been "Rent" and "Imputed rent", with an annual inflation rate of 2.3 per cent.

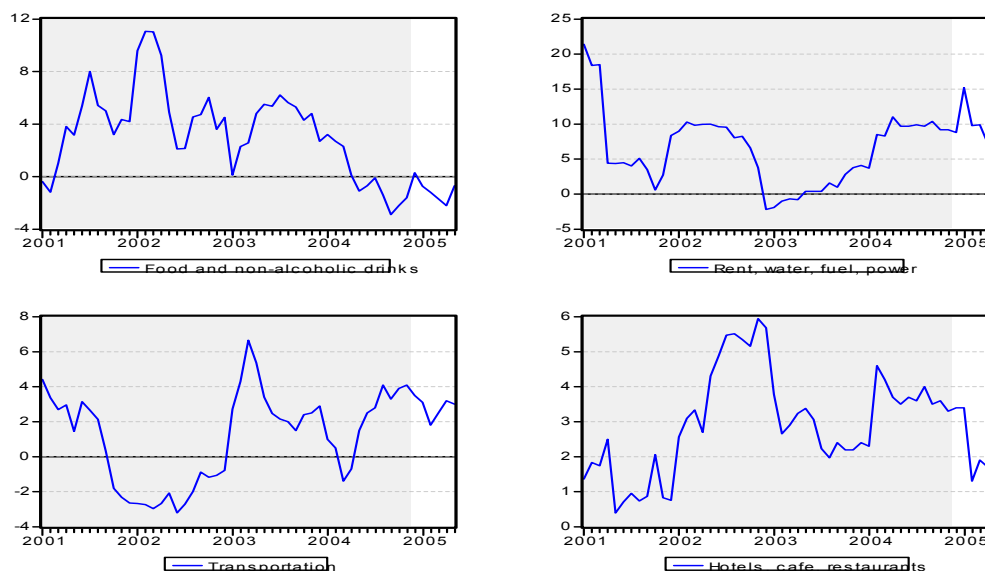
Table 2 Annual and monthly inflation and contribution of main groups to inflation in May

	Inflation in (%)		Contribution in (pp)	
	Annual	Monthly	Annual	Monthly
Foodstuffs and non-alcoholic beverages	-2.7	-0.7	-1.1	-0.3
Rent, water, fuels and energy	0.0	7.2	0.0	1.8
Communication	0.0	-0.2	0.0	0.0
Other			0.04	0.4
Transport	0.1	3.0	0.04	0.14
Hotels, cafés and restaurants	0.1	1.8	0.00	0.14
Health	1.6	5.3	0.04	0.12
Total	-1.1	2.0	-1.1	2.0

During April – May 2005, “Communication” group has not exerted any impact on inflation figure. During the four-month period (December 2004 – March 2005), this group contributed to the reduction of annual inflation rate by 0.5 percentage points. With the cease of the effect produced from the changes of fixed telephony prices in April 2005, “Communication” group is not expected to have a significant impact on the performance of consumer basket prices.

The other groups of the basket have contributed by 0.4 percentage points to annual inflation of May (Table 2). We may specify among them the increased prices of “Health” group (5.3 per cent) and “Transport” group (3.0 per cent). During the last two months, oil price rise brought about the inflation increase of “Services to personal vehicles”¹ sub-group.

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

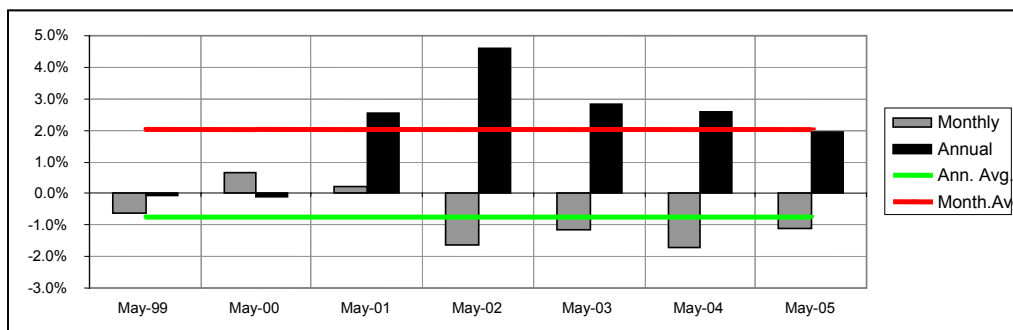


¹ Annual inflation of this sub-group for April and May 2005 is 8.6 per cent and 6.7 per cent, respectively.

II.2 MACROECONOMIC ENVIRONMENT AND CONSUMER PRICES

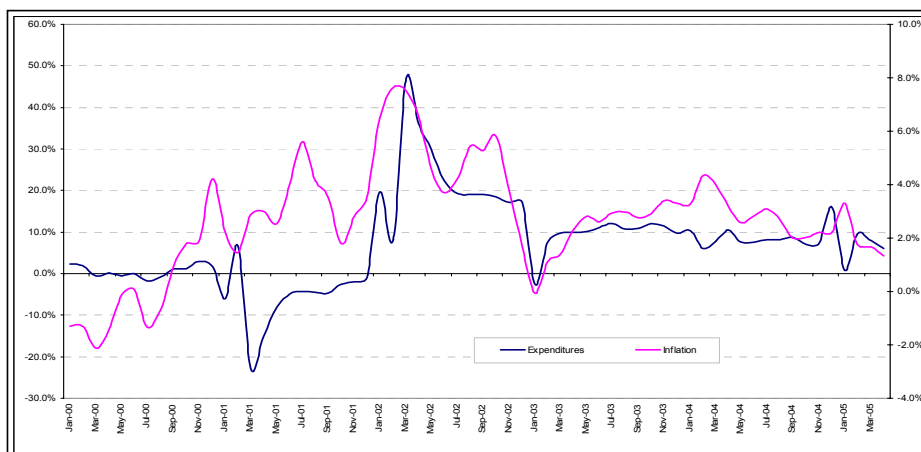
In general, during the first five months of the year inflation developments were quiet and no shocks were noted from the supply or the demand. The annual inflation of 2 per cent recorded in May was higher than the inflation of the previous three months, highlighting a return to the two-to-four per cent targeted range. During the first five-month period of the year, the month of May marked the deepest downward monthly rate of -1.1 per cent. The fact that either annual inflation rate or monthly inflation rate in May are much closer to the averages of the last seven years, indicates that this month was characterized by a normal performance, within the expected parameters.

Chart 4 Monthly and annual inflation rates and their respective averages for the months of May during 1999-2005



The fiscal policy followed during the first months of the year has been a prudential policy. The annual growth rate of budget expenditures has been almost the same as the tendency observed during the most part of the previous year. The low annual growth rate in January is compensated by the growth observed in the subsequent three months. As it is already confirmed by the developments that have come over last two years, a period in which the correlation between budget expenditures and annual inflation is being strengthened, a growth of budget expenditures to 5-10 per cent is followed by inflation rates not higher than 3 per cent. Budget expenditures increased based on cautious steps over this period, without generating inflationary pressures.

Chart 5 Annual growth of budget expenditures (left axis) and annual inflation rate (right axis)



At the end of March, for the first time during this year, Bank of Albania cut the core interest rate by 0.25 percentage points, leading it to the lowest historical level of 5 per cent. The further easing of monetary policy is applied based on the need to comply the current monetary conditions with inflation target in an environment of positive monetary indicators performance. Annual growth of M1 and M3 aggregates followed their slight upward trends in April, reflecting mainly higher credit growth rates. Meanwhile, government borrowing performance being below projections in the first four months of the year made the annual growth rates of monetary aggregates remain below the projected levels. Also, the stable time structure of money supply resulted in a gradual growth of liquidity in the economy, without being accompanied by inflationary pressures.

Even in May, exchange rate of Lek against Euro and US dollar maintained the potential inflationary pressures under control from the external environment. The Lek was appreciated by about 3 percentage points against Euro and by 8.5 percentage points against US dollar, over the first months of the year. This development made the inflationary pressures of partner countries become further smoothed due to Lek strengthening.

Table 3 Annual changes in the inflation of partner countries and in exchange rate

	January	February	March	April	May
Greece ²	4.0%	3.1%	2.9%	3.4%	3.2%
Italy ³	1.9%	1.9%	1.9%	1.9%	
ALL/EUR	-5.3%	-4.8%	-3.1%	-1.6%	-2.3%
ALL/USD	-8.8%	-7.4%	-9.8%	-8.9%	-7.4%

Factors such as agricultural production and administered price fluctuations continue to determine the annual inflation rate profile. The electricity price rise in January continues to impact on the annual inflation rate, though to a lower extent than in the first three months of the year. This impact is expected to continue even for the rest of year 2005.

² Source: General Secretariat of National Statistical Service of Greece; website: <http://www.statistics.gr>

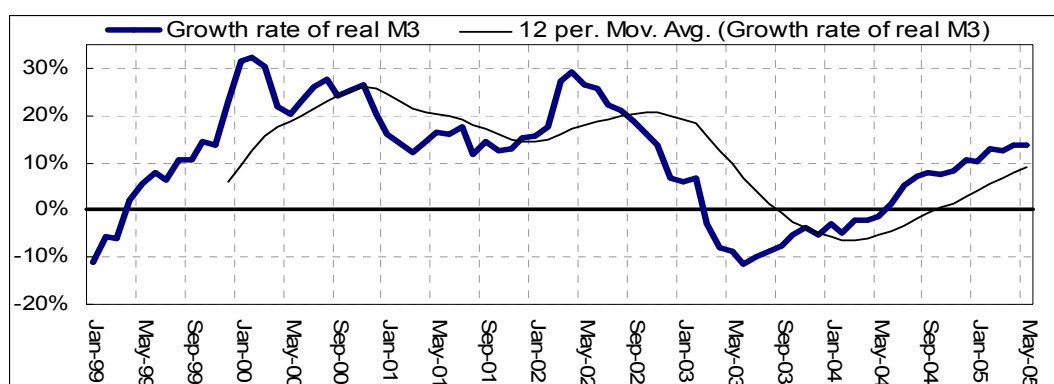
³ Source: Institute of Statistics; website: <http://www.istat.it> .

III. MONETARY DEVELOPMENTS AND FINANCIAL MARKETS

III.1 MONETARY POLICY AND QUANTITATIVE OBJECTIVES

During 2005 the Bank of Albania monetary policy aimed at easing the monetary conditions in the economy, cutting the core interest rate by 0.25 percentage points at the end of March. This stance is conditioned by the absence of inflationary pressures from the demand, over 2005. Monetary policy measures are accompanied by interest rate reductions in the banking market and, through them, by the rising of the demand for domestic monetary assets.

Chart 6 Annual growth rate of real M3



Annual growth rates of monetary aggregates were ranging at the maximum levels of the last three years. Annual growth rate of real M3 aggregate is floating at 15.0 per cent over the last three years. Despite the money supply growth at high annual levels, currency outside banks is floating within a relatively narrow band. The ratio of currency outside banks to money supply is at historical minimum level, while annual growth rate of real M1 aggregate preserved the upward rates of the last months. This performance of monetary indicators is in compliance with the exchange rate developments in the banking market. During April-May interest rates of deposits and Treasury bills have been decreasing.

Table 4 Interest rate reaction in the banking market (March 30 – May 31)*

	Interest rates of time deposits	Government security yield
3-month	(0.60)	(0.24)
6-month	(0.66)	(0.03)
12-month	(0.97)	(0.34)
24-month	(1.29)	(0.30)

* Operative data.

In deposits market, the fall of interest rates has been sharper in long-term deposits, levelling so the curve of interest rates. The fall of interest rates and high

rates of money supply are expected to have a positive impact on the demand rise and inflationary pressures stability, over the second half of the year. Bank of Albania has succeeded, through the monetary policy, in meeting its quantitative objectives.

Table 5 Meeting of quantitative objectives of the Bank of Albania

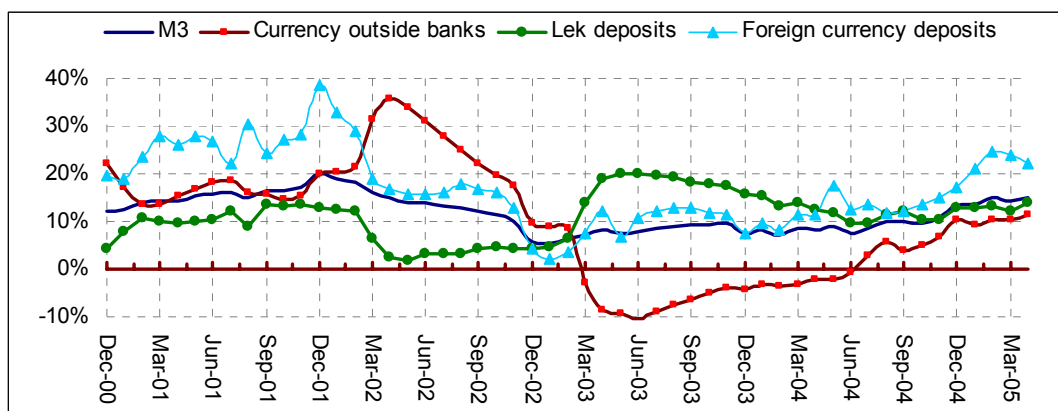
	Dec. '04	January '05	Feb. '05	March '05	April '05	May '05*
Net international reserves of the Bank of Albania (in millions of USD)						
Objective	941.7	985.3	1,029.0	1,072.7	1,077.3	1,082.0
Current	1,105.2	1,108.8	1,108.7	1,107.4	1,109.0	1,104.6
Difference	163.5	123.5	79.7	34.8	31.7	22.6
Net domestic assets of the Bank of Albania (in billions of ALL)						
Objective	79.0	73.1	67.2	61.3	61.6	61.9
Current	61.0	56.3	56.5	53.3	56.1	57.0
Difference	-18.0	-16.7	-10.7	-7.9	-5.5	-4.9
Net domestic credit to government (in billions of ALL)						
Objective	286.4	288.2	289.9	291.7	293.7	--
Current	285.7	286.9	288.9	287.8	290.4	--
Difference	-0.7	-1.3	-1.0	-3.9	-3.3	--

* Operative data.

III.2 MONETARY AGGREGATES

The month of April marked a higher growth rate of money supply compared to the previous month. Annual growth rate of M3 aggregate reached 15.2 per cent in April from 14.4 per cent in March. This performance has reflected a higher demand of government and economy for money, which brought about a quick growth of money supply in domestic currency. On the other side, foreign deposits indicator has contributed negatively to the monthly growth of money supply, leading to the fall of foreign currency component weight in money supply. Liquidity structure of money supply has been stable, this being reflected in the unchanged ratio of currency outside banks to M3.

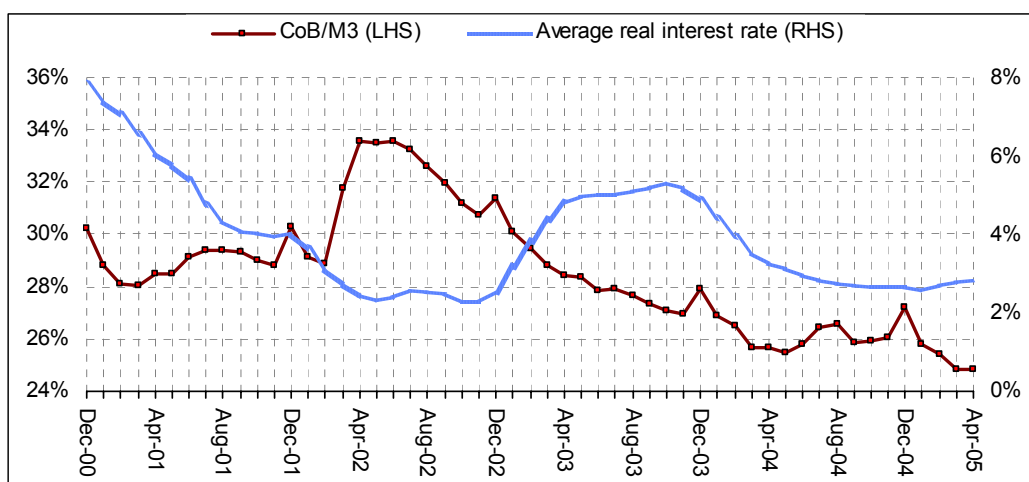
Chart 7 Annual monetary aggregate rates



Currency outside banks has interrupted its downward trend, marking a monthly growth of ALL 1.2 billion or about 0.9 per cent. Such a performance complies with the seasonal trend of this indicator in April, a period which coincides with the return of currency into the banking system. Annual rate of currency outside banks has been increasing, reflecting the highest growth rate of M2 aggregate in April. Annual growth rate of currency outside banks reached the level of 11.3 per cent in April, from 10.4 per cent recorded in the previous year.

The ratio of currency outside banks to M3 was 24.8 per cent in April, remaining at the same level as in March. This ratio decreased by 0.9 percentage points compared to April of the previous year. The positive developments of banking payment means encouraged the return of currency into the system in the form of demand deposits, while maintenance of real interest rates at stable levels supported the investments in time deposits in Lek.

Chart 8 Ratio of CoB to M3 and average real interest rate of time deposits in Lek (right scale)



Lek deposits have constituted the monetary indicator having the highest growth rate, marking a monthly growth of ALL 3.5 billion. The annual growth rate of Lek deposits reached the level of 14.1 percent, from 12.2 per cent recorded in March. This growth has reflected mainly the positive performance of time deposits in Lek from households, which count for 85 per cent of total deposits in Lek.

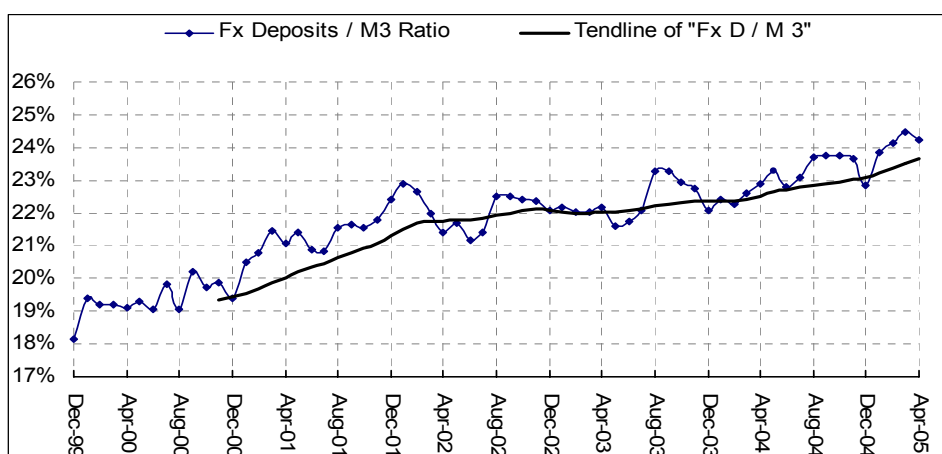
Another source of Lek deposits growth was also the significant growth of demand deposits in Lek from households and the private sector. The demand deposits growth is assessed as having been stimulated by the measures taken within the framework of the Bank of Albania program on enhancing the use of banking payment instruments. Demand deposits growth in Lek contributed by about 35 per cent to the monthly growth of total deposits in Lek in April. The upward performance of demand deposits in Lek as well as a higher annual growth rate of currency outside banks is accompanied by a faster growth of M1 aggregate. The annual rate of this indicator increased to 23.6 per cent in April, from 20.8 per cent recorded in March.

Deposits in foreign currency had a negative contribution to the monthly growth of money supply in April. Their level decreased by ALL 0.2 billion compared to the previous month. This decrease has reflected the negative effect of Lek

appreciation on a monthly basis (about ALL 0.9 billion), as well as the slowdown of foreign deposits growth in real terms.

The annual growth rate of foreign deposits lowered to 22.0 per cent in April, from 23.9 per cent recorded in March. The main impact was given by the decline of the annual rate of demand deposits in foreign currency, while the annual rate of time deposits showed stability trends.

Chart 9 Foreign currency deposits ratio to M3



The negative monthly change of foreign deposits and the acceleration of the M2 aggregate growth rate have contributed to the orientation of money supply towards the Lek. The ratio of foreign deposits to M3 reached the level of 24.2 per cent in April, marking a decrease of 0.3 percentage points compared to the previous month.

Table 6 Performance of monetary indicators in April (in billions of ALL)

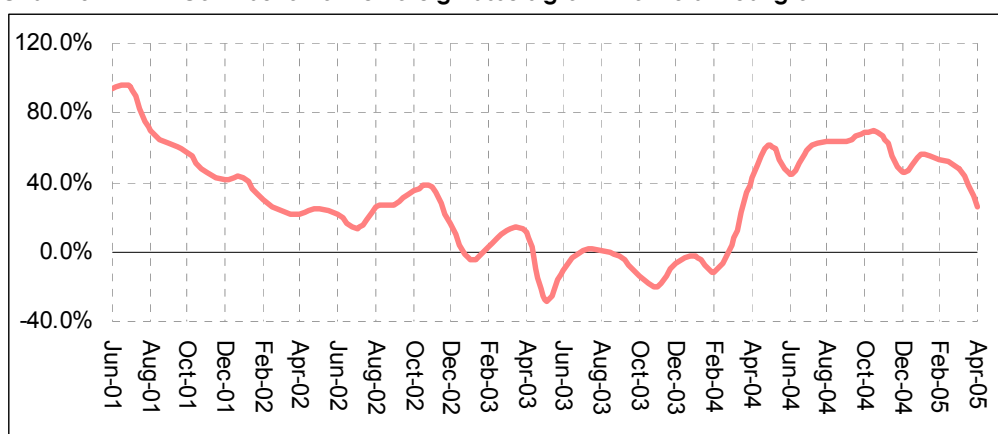
	April		Monthly change		Annual change	
Currency outside banks	130.6	1.2	0.9	13.2	11.3	
Total deposits	395.4	3.2	0.8	56.1	16.5	
- in Lek	268.0	3.5	1.3	33.1	14.1	
- in foreign currency	127.4	-0.2	-0.2	23.0	22.0	
Demand deposits	88.4	0.4	0.4	24.8	39.0	
- in Lek	42.0	1.2	2.9	19.8	88.6	
- in foreign currency	46.3	-0.8	-1.7	5.0	12.2	
Time deposits	307.0	2.8	0.9	31.3	11.3	
- in Lek	225.9	2.3	1.0	13.3	6.3	
- in foreign currency	81.1	0.6	0.7	18.0	28.4	
M1	172.6	2.4	1.4	33.0	23.6	
M2	398.6	4.7	1.2	46.3	13.1	
M3	526.0	4.4	0.8	69.3	15.2	
Monetary base	174.1	3.0	1.7	20.2	13.1	

III.3 ECONOMY DEMAND FOR MONEY

III.3.1 Net foreign assets

The contribution of the annual growth of net foreign assets to the annual growth of money supply continued decreasing even in April. This contribution reached the level of 26.4 per cent in April, from 48.1 per cent recorded in March. The growth rates of net foreign assets were interrupted during the first part of the year, resulting in a decrease. In April the banking system resulted in a decrease of USD 10 million in net foreign assets compared to the previous month.

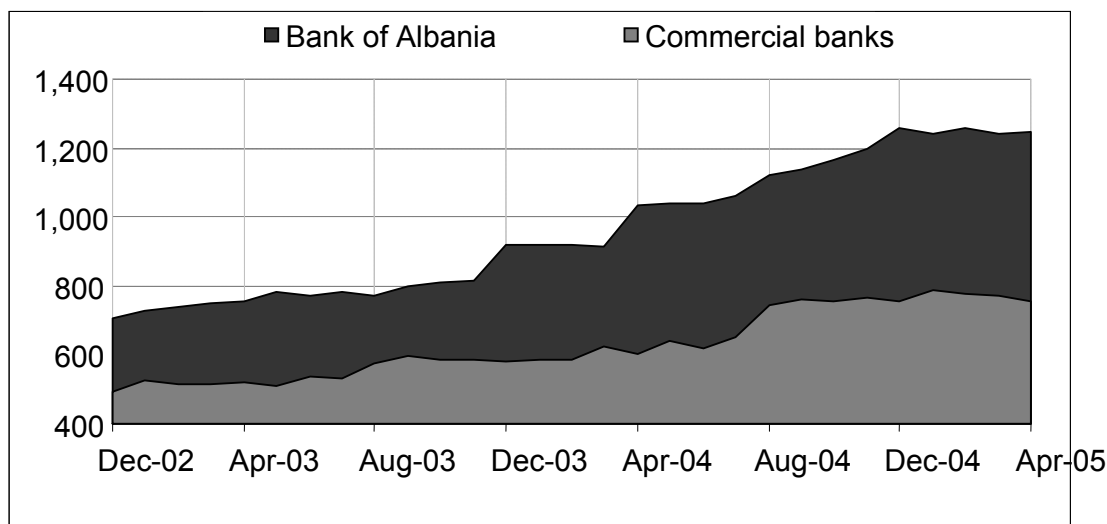
Chart 10 Contribution of net foreign assets growth to M3 annual growth



In April net foreign reserve of the Bank of Albania marked an increase of USD 6 million. On the other side, net foreign assets of commercial banks decreased by USD 16 million. The inflows to the account of the Ministry of Finance and the rise of the interest rates of foreign security investments have contributed to increasing the foreign reserve of the Bank of Albania. Foreign deposits grew throughout the month, but crediting level in foreign currency was much higher, reducing the level of net foreign assets of commercial banks.

The decrease of net foreign assets of the banking system is about USD 12.6 million if these assets are calculated at fixed rate. Bank of Albania resulted in an increase of its foreign reserve by USD 3.6 million, while commercial banks resulted in a decrease of net foreign assets by USD 16.2 million.

Chart 11 Net foreign assets level of the banking system



III.3.2 Domestic credit

Domestic credit contribution to the demand for money has been increasing, representing about 70 per cent of the total at the end of April. Domestic credit increased by about ALL 48 billion or 15.4 per cent compared to the previous year. Almost 58 per cent of this increase was due to the growth of crediting to the economy. The quick growth of crediting to the economy has reduced the part of funds that are allocated to government, which represented 77 per cent of the domestic demand for money at the end of the month, from 82 per cent recorded in the previous year.

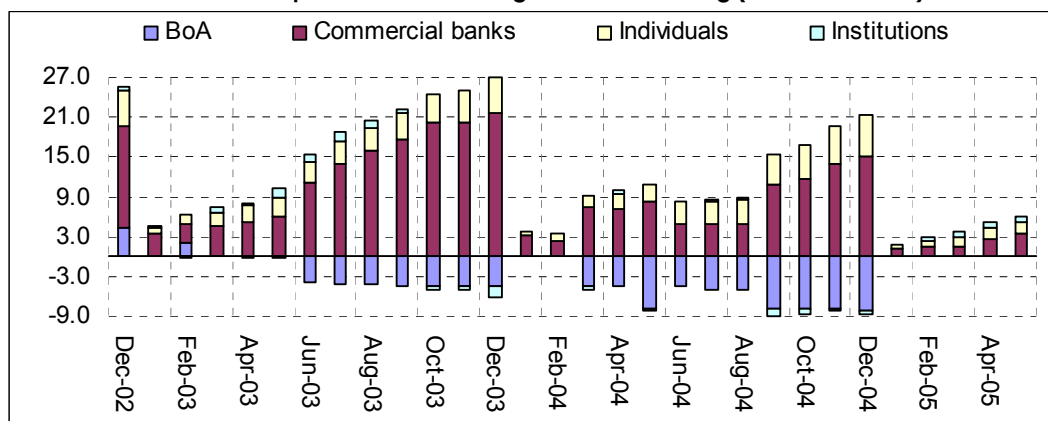
III.3.3 Government demand for money

The month of April experienced a growth of government demand for monetary assets. The budget deficit amounted to ALL 2.98 billion during this month, being about ALL 1.2 billion higher than the previous month. The financing of this deficit totalled to ALL 6.6 billion⁴.

The government demand for monetary assets during April is almost totally covered by means of government bonds issue, at the amount of ALL 3.5 billion. For the first time in April, three-year maturity bonds, of about ALL 2 billion, were issued. Treasury bills portfolio decreased by ALL 1.9 billion, due to the decrease of commercial banks portfolio by ALL 2.2 billion. Households, institutions and Bank of Albania slightly increased their Treasury bills portfolio.

⁴ The difference between the budget deficit and the domestic financing of budget deficit, represents government's statement of account with Bank of Albania.

Chart 12 Cumulative performance of budget deficit financing (in billions of ALL)



III.3.4 Banking system credit to economy

Credit balance to economy increased by ALL 4.3 billion in April, totalling to ALL 84 billion. Credit balance is about 50 per cent higher than in the previous year. Unlike the previous year, there was noted an upward commitment of banks towards crediting in Lek, which reflected an annual growth of about ALL 7.8 billion. Foreign currency credit continued maintaining a growth rate close to the historical average, of 43 per cent. The time structure of credit balance remained unchanged compared to the previous month.

About one third of credit to economy is extended to individuals, where credit in Lek for this group marked a significant growth. Expressed in annual terms, it increased at about 1.5 times.

Table 7 Indicators of credit balance to the total (in percentage)

	2004		2005			
Credit balance (in billions of ALL)	56.0	70.0	72.0	76.0	79.0	84.0
Short-term credit	40.8	34.0	32.0	34.0	34.1	34.6
Mid-term credit	35.9	36.0	35.0	35.0	34.5	34.5
Long-term credit	23.4	30.0	33.0	31.0	31.4	30.8
ALL	17	20.0	20.0	20.0	20.0	21.0
Foreign currency	83	80.0	80.0	80.0	80.0	79.0

Sectoral credit distribution in April maintained in general the same composition as the one noted in the first months of the year. Trade sector continues to show downward trends, representing at the end of the month about 19 per cent of credit portfolio. Meanwhile, during the first months of this year, credit to construction sector highlighted a slight increase, which represents about 11.3 per cent of total credit to economy.

Table 8 Credit balance by economy branches (in percentage)

		2003	2004	2005			
				Jan.	Feb.	Mar.	April
1	Agriculture, hunting and	1	1.5	1.4	1.5	1.5	

	silviculture						1.4
2	Fishery	0	0.1	0.1	0.2	0.1	0.1
3	Extracting industry	1	0.3	0.2	0.8	0.7	0.7
4	Processing industry	17	17.1	15.5	16.1	16.7	16.5
5	Electricity, gas and water production and distribution	3	2.8	4.1	3.2	2.3	3.0
6	Construction	10	9.8	9.6	11.3	11.2	11.3
7	Trade, automobile and house items repairing	34	23.3	21.3	19.9	20.6	18.9
8	Hotels and restaurants	6	8.3	7.5	5.3	5.2	5.0
9	Transport and telecommunication	1	2.0	1.9	1.8	1.8	2.0
10	Financial activities	0	0.2	0.4	1.1	1.0	0.8
11	Real estate	13	9.8	16.7	14.8	14.7	13.0
12	Health and social activities	0	0.5	0.4	0.4	0.8	0.8
13	Social, personal and collective services	8	4.8	6.4	6.7	6.5	7.1
14	Other	4	19.3	14.4	17.1	16.7	19.2
	Total	100	100.0	100.0	100.0	100.0	100.0

During April about ALL 10.4 billion of new credit is extended. However, new credit extended remained almost at the same levels compared to the previous year. Unlike the previous year, the credit extended in April highlighted once again the commitment of banks to long-term crediting and production sectors, being adapted to the demand of the market. About 23 per cent of new credit is extended for processing industry, while credit to trade business continues reducing its weight, representing only 16 per cent of the total new credit extended during the month.

Table 9 New credit indicators to the total (in percentage)

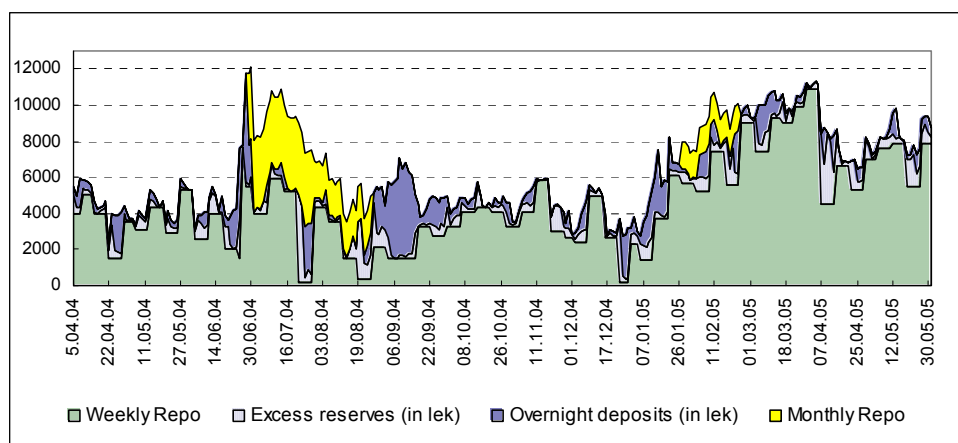
	2004			2005			
New credit (in billions of ALL)	13.0	10.6	11.0	6.1	7.5	8.5	10.4
Short-term credit	67.5	65.4	56.4	56.0	53.2	51.3	50.3
Mid-term credit	20.9	22.0	23.4	17.0	24.6	24.3	28.0
Long-term credit	11.6	12.6	20.2	27.0	22.2	24.4	21.7
ALL	30.8	22.6	26.7	37.8	25.6	28.7	26.2
Foreign currency	69.2	77.4	73.3	62.2	74.0	71.3	73.8

III.4 MARKETS AND INTEREST RATE PERFORMANCE

III.4.1 Liquidity performance

Daily liquidity level during May was ALL 8.26 billion, marking almost the same value as the one of April (ALL 8.16 billion).

Chart 13 Banking system daily liquidity level (in millions of ALL)



In May, weekly repos at fixed price were employed for withdrawal of liquidity. The average repo investment increased by ALL 0.51 billion compared to April, totalling to ALL 7.16 billion. Overnight deposit facility is used by an average of ALL 0.46 billion or ALL 0.11 billion more than in the previous month. Overnight credit is not used at all in May and liquidity needs are met through the interbank market.

Interbank market activity is focused on overnight loan. The average level of overnight transactions remained almost the same as in the previous month, ALL 0.74 billion, while weekly loan decreased by an average of ALL 0.36 billion, from ALL 0.89 billion in April.

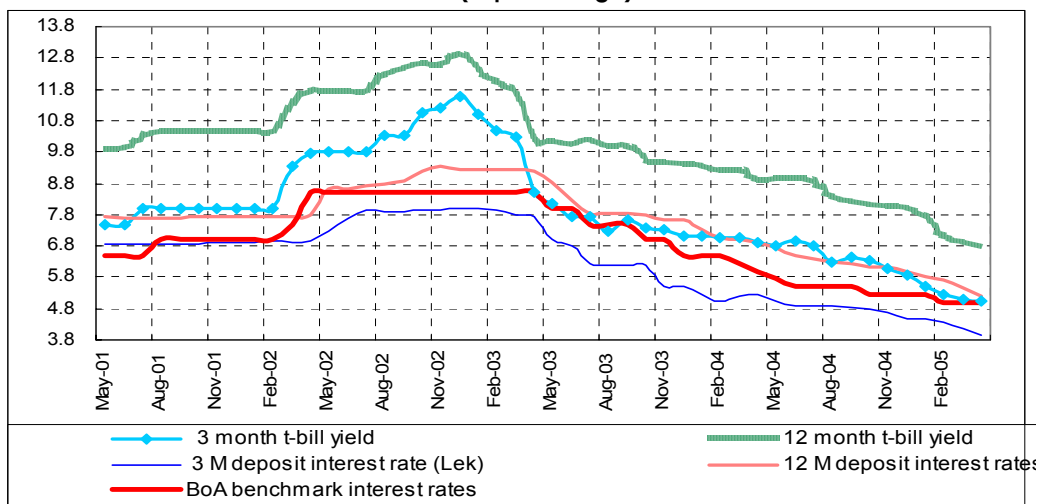
The activity in government security primary market was characterized by the same intensity as in the previous months. The demand to invest in government securities has been higher than the accepted amount in auctions even during this month, thus impacting the further decrease of interest rates in the primary Treasury bills market. Calculated in net value⁵, the liquidity investment in government securities in May resulted 1.1 billion higher than in the previous month.

III.4.2 Interest rates

After the cut of core interest rate by the Bank of Albania at 0.25 percentage points at the end of March, interest rates in interbank market, in government securities market and Lek deposits market continued to decrease during the subsequent months (April-May). In Lek credit market, April highlighted a fall of interest rates compared to the previous month.

⁵ Includes the new investment as well as investment maturity in government securities.

Chart 14 Interest rates (in percentage)



* Data on May 2005 are operative ones.

The cut of core interest rate is immediately reflected in the interbank market, where at the end of May the lowest historical levels of interest rates on interbank transactions were recorded. For overnight transactions, interest rate lowered to 2.14 per cent from 2.58 percent at the end of April and 2.95 per cent at the end of March, whereas for weekly transactions it lowered to 5.23 per cent from 5.30 per cent and 5.40 percent it was respectively one and two months ago.

Apart from the monetary policy signals, the yield reduction in the primary market is stimulated by the competition in this market, as disclosed by the ratio above 1.00 between the banking system demand for Treasury bills and government supply. At the end of May, Treasury bills yield reached the lowest levels of 5.04 per cent, 6.44 per cent and 6.8 per cent, respectively in 3-month, 6-month and 12-month terms. The lowest historical levels were also reached in 2-year government bonds market. In May's auction, the yield lowered to 7.55 per cent from 7.70 per cent in the previous month and 10.25 per cent in the previous year. The downward trend of T-bills and 2-year bonds yield has contributed to the reduction of domestic government debt cost.

Under eased monetary conditions, the banking system found more spaces for further reduction of interest rates of Lek deposits, which came down to the their lowest levels in the last thirteen years. They lowered for all the terms, especially for 6-month and 12-month terms. Based on preliminary data, interest rates of Lek deposits decreased further even in May.

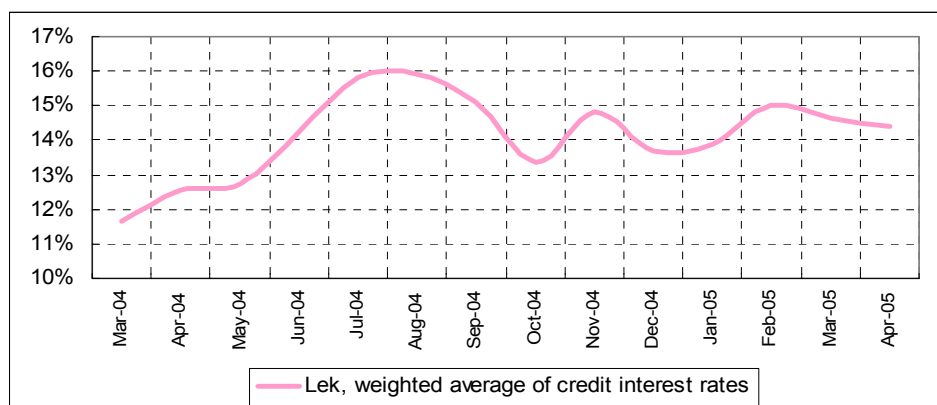
Table 10 Weighted average interest on the new flow of time deposits in Lek and their change

	April-05 (in percentage)	Monthly change (in percentage points)	Annual change (in percentage points)
1-month deposits	3.56	-0.01	-0.99
3-month deposits	3.95	-0.21	-1.29
6-month deposits	4.70	-0.15	-1.93
12-month deposits	5.22	-0.22	-1.71

In real terms, the interest rate of Lek deposits dropped compared to the previous month. In April real interest rate of 12-month deposits lowered to 3.2 per cent, from 4.1 per cent in March and 3.6 per cent in the previous year.

During April interest rate of credits in Lek decreased for all the terms, except for the credits from 6 months to 1 year, which increased by 1.27 percentage points.

Chart 15 Weighted average interest performance of credit extended in Lek



The difference between the minimum and maximum (weighted average) interest of credits extended in Lek continues to be considerable. In April this difference resulted about 17 percentage points, from 16 percentage points in March.

Table 11. Weighted average interests of credit extended in Lek and monthly change

	April'05 (in percentage)	Monthly change (in percentage points)	Annual change (in percentage points)
0 to 6-month credit	13.5	-0.50	3.31
6 to 12-month credit	13.7	1.27	-2.43
1 to 3-year credit	16.9	-1.67	-3.02
Over 3-year credit	12.4	-0.03	-2.52
Weighted average	14.4	-0.21	1.85

Interest rates of foreign deposits have followed the fluctuations in the international markets. The weighted average rate of deposits in USD increased in April and May,⁶ due to Fed's tightening policy and to the continuous growth of LIBOR interests, while that in Euro remained almost at the same level, as a result of the unchanged policy of European Central Bank.

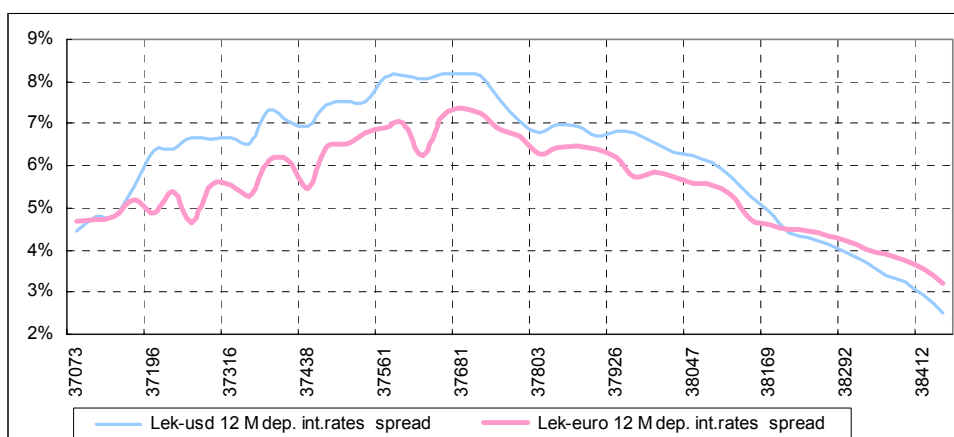
⁶ Based on preliminary data.

Table 12 Weighted average interests on the new flow in foreign currency

	USD		EUR	
	April-05	Monthly change	April-05	Monthly change
3-month deposit	2.04%	0.09	1.72%	-0.03
6-month deposit	2.23%	0.13	1.76%	-0.06
12-month deposit	2.72%	0.23	2.02%	0.12
24-month deposit	3.23%	0.21	2.95%	-0.11
Weighted average	1.94%	0.10	1.72%	0.01

The fall of interest rates of deposits in Lek and the increase of interest rates in USD have narrowed ever more the differences between them. Spread of deposits ALL-USD interests, of 3-month term, is narrowed from 6.6 percentage points in April 2003 to 4.3 percentage points in April 2004 and to 1.9 percentage points in April 2005. Meanwhile, spread of deposits ALL-USD interests, of 12-month term, reached 2.5 percentage points in April 2005, from 6.1 percentage points in the previous year.

Chart 16 Spread of 12-month deposit interests (ALL-USD and ALL-EUR)



In the foreign currency credit market, a stability and approximation between interests of credit in USD and those in Euro was observed. In April interests of credit in Euro reached 8.10 per cent from 8.06 per cent they were in the previous month and interests of credit in USD reached 8.19 per cent from 7.18 per cent they were in March.

III.4.3 Exchange rate

Although in the first months of the year there was noted a certain silence in the foreign exchange market, in April and May signs of expected seasonal effects were felt. During these months, the foreign exchange market knew a further appreciation of Lek against Euro and its depreciation against US dollar. From the beginning of the year till the end of May, Lek is appreciated by about 1.2 per cent versus Euro. Meanwhile, the developments in the international market where the US currency gained ground against the Euro were also reflected in the exchange rate between Lek and US dollar in the domestic market. From the beginning of the year to May, Lek is depreciated by about 8 per cent versus US

dollar. At the end of May, the Albanian lek is exchanged at 124.32 ALL/EUR and 99.34 ALL/USD.

Chart 17 Lek exchange rate performance

