

BANK OF ALBANIA

**MONETARY POLICY
MONTHLY REPORT**

NOVEMBER 2003

TABLE OF CONTENTS

1. Main Highlights of November 2003
2. Inflation Performance in November 2003
 - 2.1 Performance of Inflation and component groups
 - 2.2 Factors impacting on inflation performance in November
3. Monetary Developments
 - 3.1 Bank of Albania Monetary Policy
 - 3.2 Monetary Aggregates Performance
 - 3.3 Economy Demand for Money
 - 3.3.1 Banking system net foreign assets
 - 3.3.2 Government demand for monetary assets
 - 3.3.3 Credit to economy
 - 3.4 Exchange Rate
 - 3.5 Financial Markets and Interest Rate Performance
 - 3.5.1 Financial Markets
 - 3.5.2 Interest Rate Performance

I. MAIN HIGHLIGHTS OF NOVEMBER 2003

- Annual inflation rate in November reached to 3.4 per cent. Monthly inflation rate was 0.4 per cent, whereas the average annual inflation rate was slightly lowered to 2.24 per cent. Actual inflation rate was close to the BoA forecasting.
- “Foodstuff and non-alcoholic beverages” group has rendered the largest contribution to annual inflation. Annual inflation rate of this group is 4.8 per cent. In this month, the largest reduction is manifested by “Clothes and shoes” group, with an annual inflation of –2.9 per cent.
- Generally, November 2003 has observed the historical trend of positive monthly inflation rates in this month. However, the monthly rate of 0.4 per cent in November 2003 remains below the average.
- Impact of demand factors on inflation performance continues to be a positive contributing factor in inflationary developments. On the other hand, the supply factors are assessed as having been stable during November, without exerting pressure on price level. Growth of annual inflation in this month is due to raising agricultural product price on the threshold of celebrations at end of November.
- October is featured by a slow growth of monetary indicators, enabling the money supply to pursue the rhythm of the previous month. The increase of the latter one is due to lek deposit growth, while the level of foreign currency deposits denominated in lek is reduced.
- Slow increase of monetary indicators and the maintaining of inflation rate within the target have created space for easing the monetary conditions by the BoA. At end of October, it reduced repo interest rate by 0.5 percentage point, leading the base interest rate to 7 per cent.
- In October the government has increased significantly the monthly demand for monetary assets. Budget deficit of this month was increased by Lek 2.8 billion, reaching the level of Lek 16.6 billion. Commercial banks have increased the monthly deficit financing about Lek 2 billion, while the households finance the rest. According to operative data, in November, budget deficit is increased by Lek 1.5 billion.
- Balance of credit to economy at end of October reached to Lek 48.8 billion, marking a monthly growth of lek 0.8 billion. New credit extended in October was Lek 6.9 billion or 50 per cent higher than in October of 2002. Totally, credit extended for January-October marked the figure of Lek 70.6 billion or 13 per cent more than the credit extended during 2002.
- At end of November, exchange rate of lek against dollar resulted to 113.7 lek/usd, while against euro it resulted to 135.3 lek/euro. During November, lek is depreciated by 0.6 per cent against euro and is appreciated by 2.2 per cent against dollar.

II. INFLATION PERFORMANCE IN NOVEMBER 2003

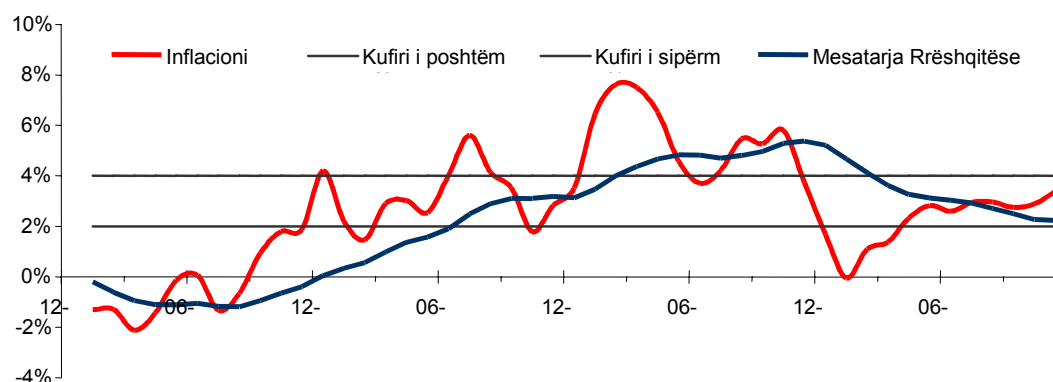
II.1 PERFORMANCE OF INFLATION AND COMPONENT GROUPS

November 2003 recorded an annual inflation of 3.4 per cent, marking the highest annual rate of annual inflation of this year. Monthly inflation rate was 0.4 per cent, whereas average annual inflation rate was reduced slightly to 2.24 per cent.

Table 1. ANNUAL INFLATION RATE (IN PER CENTAGE)

	1999	2000	2001	2002*	2003*
January	6.0	-1.3	2.2	6.5	0.0
February	3.5	-1.3	1.5	7.6	1.1
March	2.0	-2.1	2.9	7.5	1.3
April	0.4	-1.4	3.0	6.5	2.3
May	-0.1	-0.1	2.5	4.6	2.8
June	-0.6	0.1	4.0	3.7	2.6
July	0.1	-1.3	5.6	4.2	3.0
August	-0.6	-0.7	4.1	5.5	3.0
September	-1.9	0.9	3.5	5.3	2.8
October	-1.8	1.8	1.8	5.8	2.9
November	-1.2	1.9	2.8	3.7	3.4
December	-1.0	4.2	3.5	1.7	

Chart 1. Annual inflation (in per cent)



* Annual inflation rates for 2002-2003, are calculated by INSTAT according to the new approach.
 Inflation Lower limit Upper limit Moving average

Monthly and annual inflation rates of November were within the BoA inflation forecasted band. In monthly and annual terms, it approached the upper limit of the forecasted band.

“Foodstuff and non-alcoholic beverages” group has rendered the largest contribution to annual inflation. So, in November 2003, “Foodstuff and non-alcoholic beverages” group contributed to annual inflation by 2.01 per cent points, while in November of 2002, this contribution was lower, 1.52 per cent points.

Table 2: Contribution of main basket groups to total annual inflation (in percentage points)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov
Foodstuff and non-alcoholic beverages	0.05	0.99	1.11	2.09	2.34	2.23	2.56	2.33	2.21	1.82	2.01
Rent, water, fuels and power	-0.45	-0.24	-0.18	-0.18	0.10	0.11	0.10	0.39	0.23	0.68	0.91
Hotels, café and restaurants	0.28	0.20	0.21	0.24	0.26	0.24	0.17	0.15	0.19	0.18	0.17
Transport	0.13	0.20	0.31	0.25	0.16	0.12	0.10	0.10	0.07	0.12	0.12
Others	-0.01	-0.05	-0.15	-0.10	-0.06	-0.10	0.07	0.03	0.10	0.10	0.19
Total	0.0	1.1	1.3	2.3	2.8	2.6	3.0	3.0	2.8	2.9	3.4

Annual inflation rate of this group is 4.8 per cent. The subgroups “Fruits” and “Vegetables including potatoes” have had a more obvious growth, with annual inflation rates of 25.1 per cent and 19.2 per cent respectively. Along the whole year 2003 the annual inflation of these subgroups has marked high rates. After the extinguishing of seasonal effect, which was smoothing this year, the domestic demand is fulfilled by goods of import. As we have already mentioned, the highest inflation rates in partner countries, and the adopting of import prices for country’s goods results in raising the prices of these goods, and this raising is transmitted from one month to the other. Monthly inflation of “Foodstuff and non-alcoholic beverages” group is raised as compared to previous month or previous year. Annual and monthly inflation of “Foodstuff and non-alcoholic beverages” group and its main subgroups are shown in the following table for November 2003 and November 2002:

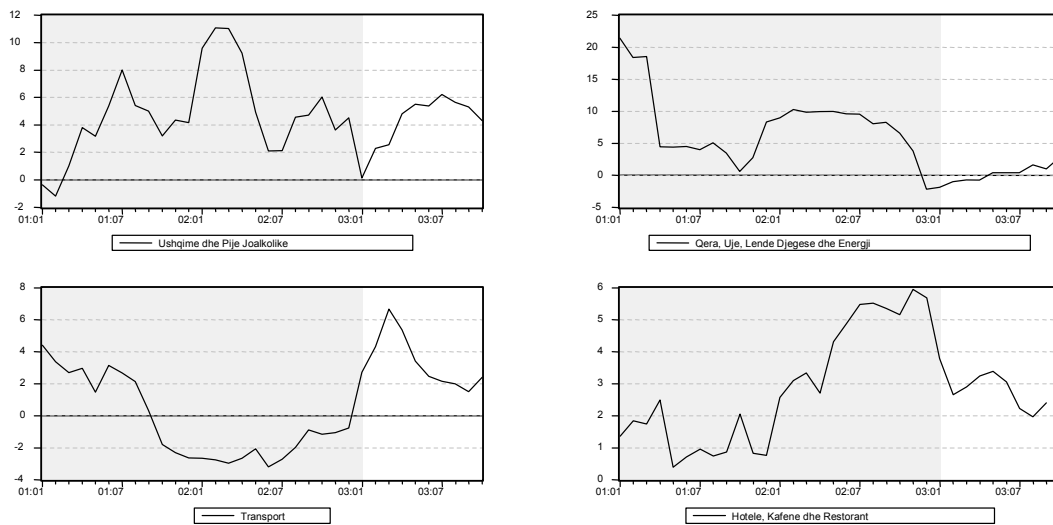
Table 3. Monthly and annual rate of “Foodstuff and nonalcoholic beverages”

	“Foodstuff and non-alcoholic beverages” group		“Fruits” Subgroup		“Vegetables” Subgroup	
	Monthly	Annual	Monthly	Annual	Monthly	Annual
November ‘03	0.4	4.8	-5.0	25.1	8.1	19.2
November ‘02	-0.1	3.6	-5.3	5.6	3.9	-3.3

Even the “Education services” group is highlighted for high annual inflation rate of 8.3 per cent. The increase by 6.6 per cent of fees for teaching foreign languages has brought about the monthly inflation increase of this group by 4.6 per cent. However, the contribution of this group to annual inflation is small, due to its insignificant value in consumer price index.

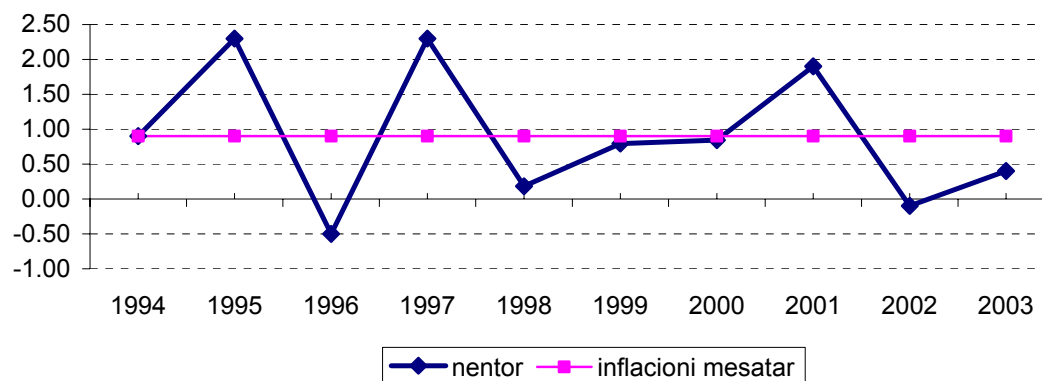
The largest reduction in this month was manifested by “Clothes and shoes” group, with an annual inflation of –2.9 per cent. However, its monthly inflation rate is increased by 1.5 per cent, observing its seasonal behaviour.¹

Chart 2: Annual inflation of 4 main CPI basket groups (in per cent)



Generally, November 2003 has observed the historical tendency of positive monthly inflation rates in this month. However, the monthly rate of 0.4 per cent in November 2003 remains below the average.

Chart 3: Monthly inflation rate performance in November



II.2 FACTORS IMPACTING ON INFLATION PERFORMANCE IN NOVEMBER

During November, the supply factors are estimated to have been stable, without exerting pressures on price level. Exception to this is imported inflation, which has been a continuous source of inflationary pressures during 2003.

Albania, as an importing country, is sensitive to price rise of partner countries. Main partners of trading exchanges with our country, Italy and Greece, continue to have a high inflation rate compared to 2 per cent ECB target.

Table 4. Annual inflation of main partner countries (in per cent)

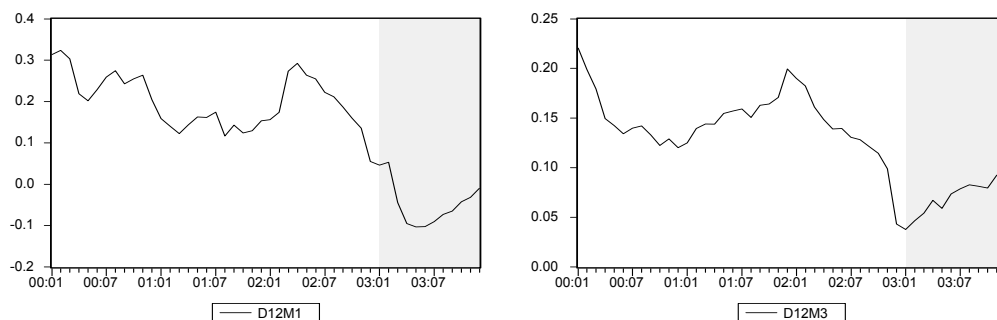
	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct
Greece	3.9	3.3	3.5	3.6	3.5	3.3	3.3*	--
Italy	2.9	3.0	2.9	2.9	2.9	2.7	3.0	2.8
Germany	1.2	1.0	0.6	0.9	0.8	1.1	1.1	1.1

* Non-official data. Source: Imerisia, date 15.12.2003.

Impact of demand factors on inflation performance continues to be a factor with positive contribution to inflationary developments.

- **Stable liquidity situation**, keeping of monetary aggregates under control, maintaining of domestic financing within the permitted limit and its uniform spreading along the year have established an appropriate monetary environment for controlling inflation.

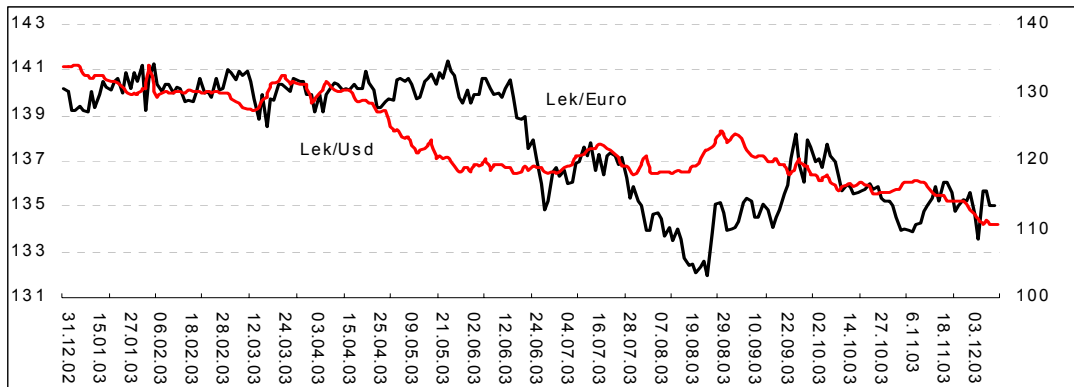
Chart 4. Annual changes of M1 and M3 monetary aggregates (in percentage)



¹ Generally, the coming of a new season marks the “entry” phase of products into the market and is associated with price rise in clothes and shoes.

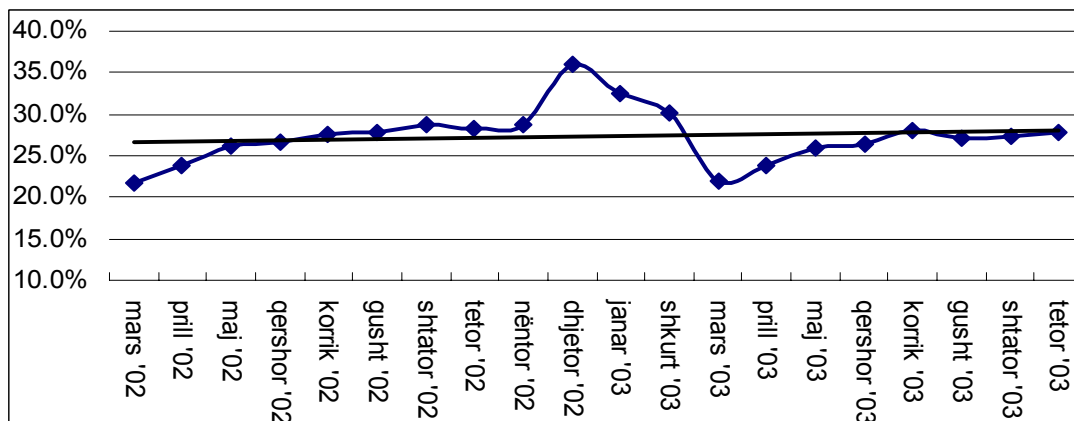
- **Exchange rate movements**, which are featured by lek appreciation against two main currencies in the second half of the year, have influenced on smoothing the imported inflation impact on total inflation.

Chart 5. Lek exchange rate performance in months.



- **Moderate increase of budget spending has impacted on maintaining a stable economy demand.** Risk of focusing budget spending in December, causing pressures on raising the inflation rate, is presented as lower during this year.

Chart 6. Monthly budget spending performance (in percentage to GDP).



Price rise of agricultural products on the threshold of celebrations at end of November caused inflation rise for this month. The other factors have not exerted pressure on increasing the inflation rate.

III. MONETARY DEVELOPMENTS

III.1 BANK OF ALBANIA MONETARY POLICY

October is featured by a slow increase, but within the forecasting of monetary indicators, enabling the money supply follow up the previous month rhythm. The money supply components have had reverse performances during October, thus slowing down the pace of M3 growth. The increase of the latter one is due to the result of lek deposit growth, while the foreign currency deposit level denominated in lek has declined.

Inflation rate in September - October has resulted below the level of 3 per cent, maintaining the real interest rates in satisfactory levels for depositors. The high real interest rates and the low economy demands for monetary assets during the recent months have led to continuous liquidity growth during August - October.

The slow growth of monetary indicators and the maintaining of inflation rate within the target have established space for easing the Bank of Albania monetary conditions. At end of October, it reduced the repo interest rate by 0.5 percentage point, leading the base interest rate to 7 per cent. Commercial banks have reacted to repo rate reduction, by reducing the rates of accepting time deposits. The weighted lek deposit interest has marked a reduction of 0.48 percentage point along November and the first week of December.

Responding to monetary developments, the BoA has been present, both in foreign exchange market and in money market, managing to withdraw excess liquidity of the banking system, mainly by weekly repo.

During this period, the BoA quantitative targets are met to satisfactory levels.

Table 5. Meeting the Bank of Albania quantitative targets.

	December'02	March'03	June '03	October '03	November '03*
Meeting the Net International Reserve target (in million dollars).					
Target	558.6	560.6	582.2	578.5	580.8
Actual	562.2	596.2	607.3	619.9	620.1
Difference	3.6	35.6	25.2	41.4	39.2
Meeting net domestic asset target (in billion leks).					
Target	95.1	97.1	98.1	90.5	91.8
Actual	87.1	76.5	68.8	72.0	71.5
Difference	-8.0	-20.7	-29.4	-18.4	-20.3
Meeting net domestic credit to government target (in billion leks).					
Target	258.7	264.6	267.7	276.4	278.0

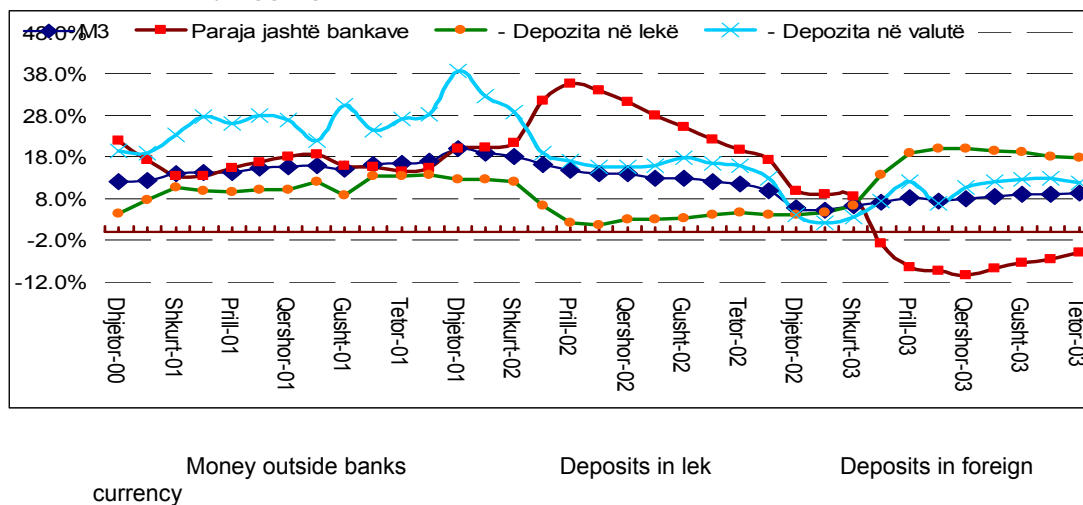
Actual	259.6	263.1	263.1	274.0	-
Difference	0.9	-1.4	-4.6	-2.3	-

****Data on November are operative.**

III.2 MONETARY AGGREGATE PERFORMANCE

Main monetary indicators in October have generally pursued the tendencies observed in the third quarter of the year. Money supply has had an annual growth of 9.5 per cent during October, which is supported mainly by the annual growth of 18.0 per cent of deposits in lek.

Chart 7. Monetary aggregate annual rate performance



During this month money supply has marked a monthly growth of 0.5 per cent or about Lek 2.1 billion. This is so due to increase by 1.8 per cent (or Lek 3.9 billion) of deposits in lek. Monthly growth of two other money supply components: money outside banks and foreign currency deposits, have been negative. The level of money outside banks has declined by lek 0.6 billion, remaining in the interval of Lek 119- 122 billion, within which it has fluctuated since March of this year. The level of money outside banks has reached the values of lek 118.9 and 122.1 billion respectively in June and August. In other months of March – October period, money outside banks has fluctuated within these values.

The level of foreign currency deposits has declined after the successive monthly increases in four recent months. This decline is due to appreciation of lek against two main currencies, euro and dollar, during October. The combined effect of exchange rate is estimated at lek - 2.0 billion. In absence of this effect, the level of foreign currency deposits would grow by about lek 0.8 billion.

Table 6. Monetary indicator performance in October (in billion leks).

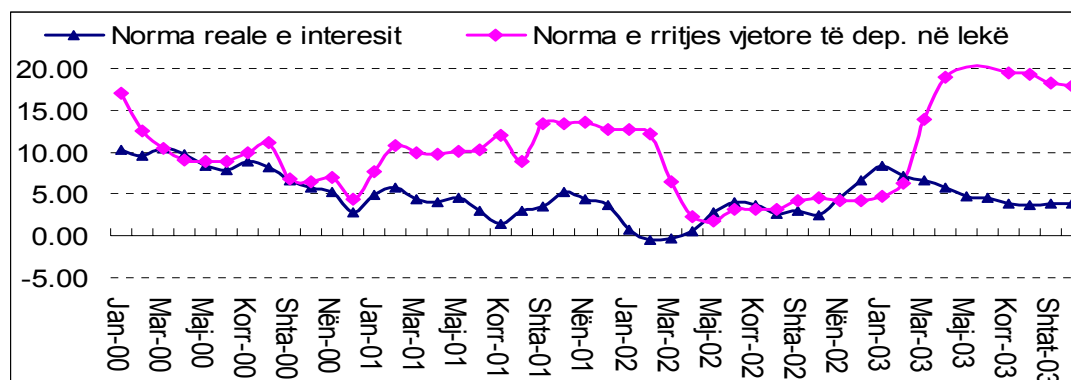
	Level	Monthly change		Annual change	
		Absolute	Percentage	Absolute	Percentage
Money outside banks	120.7	-0.6	-0.5	-6.2	-4.9
Total deposits	325.1	2.7	0.8	44.8	16.0
- Deposits in lek	223.0	3.9	1.8	34.0	18.0
- Deposits in foreign currency	102.1	-1.2	-1.1	10.8	11.8
Demand deposits	60.6	-0.4	-0.6	2.5	4.3
- in lek	20.9	0.7	3.3	-1.8	-7.7
-- in foreign currency	39.7	-1.0	-2.5	4.3	12.0
Time deposits	264.5	3.1	1.2	42.3	19.0
- in lek	202.0	3.2	1.6	35.7	21.5
- in foreign currency	62.4	-0.1	-0.2	6.5	11.7
M1	141.6	0.0	0.0	-8.0	-5.3
M2	343.6	3.3	1.0	27.7	8.8
M3	445.8	2.1	0.5	38.5	9.5
Money base	156.7	-0.5	-0.3	-1.9	-1.2

Lek deposit annual rate is almost at the levels of its historical trend, whereas the annual rate of money outside banks, though upward, is much lower than its trend. Constancy of the level of money outside banks during two last quarters has made M2 aggregate growth be based totally on the growth of lek deposit level.

The increase of these latter ones has been higher than economy demand for monetary assets, impacting on the increase of excess liquidity in the system. The liquidity level is increased from lek 4.1 billion at end of September, to lek 5.5 billion at end of October. According to operative data, excess reserves of the system reached to lek 6.3 billion at end of November.

Lek deposit growth is favoured even by the positive performance of real interest rate, which in October resulted in 3.9 per cent.

Chart 8. Deposit interest and real interest rate



Real interest rate

Annual growth rate of deposits in lek

Monetary developments in October have generally taken place according to lines defined in the monetary program. Deviations of monetary aggregates from the forecasted values are at minimum.

Table 7. Comparison of aggregates to the program (in billion leks)

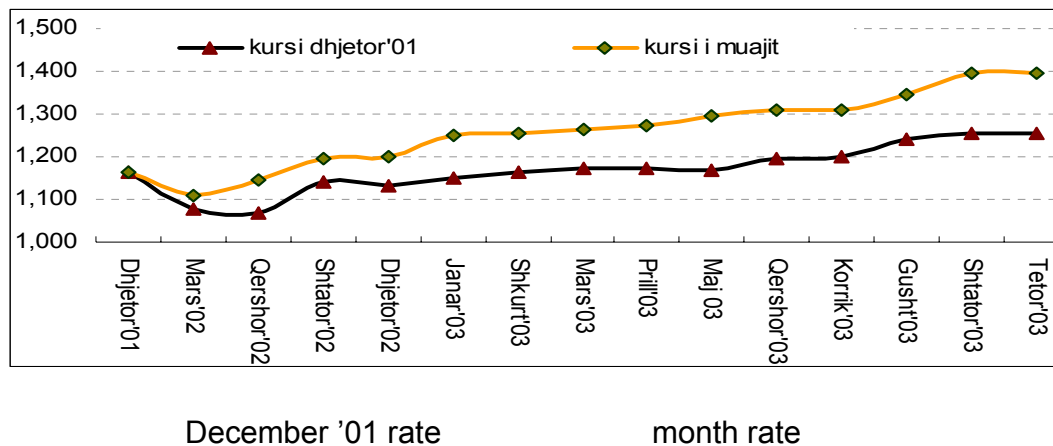
	Program	Actual
Money outside banks	121.1	120.7
Deposits in lek	223.2	224.1
Deposits in foreign currency	96.0	94.6
M3	440.3	439.4

III.3 ECONOMY DEMAND FOR MONEY

III.3.1 BANKING SYSTEM NET FOREIGN ASSETS

Banking system net foreign assets were decreased by 3.9 million dollars during November. BoA foreign reserves are increased by 7 million dollars, due to purchases of foreign currency in the market and increase of the dollar value of investments in euro. Meantime, net foreign assets of commercial banks are decreased by about 10.9 million dollars.

Chart 9. Banking system net foreign assets (in million dollars).



December '01 rate

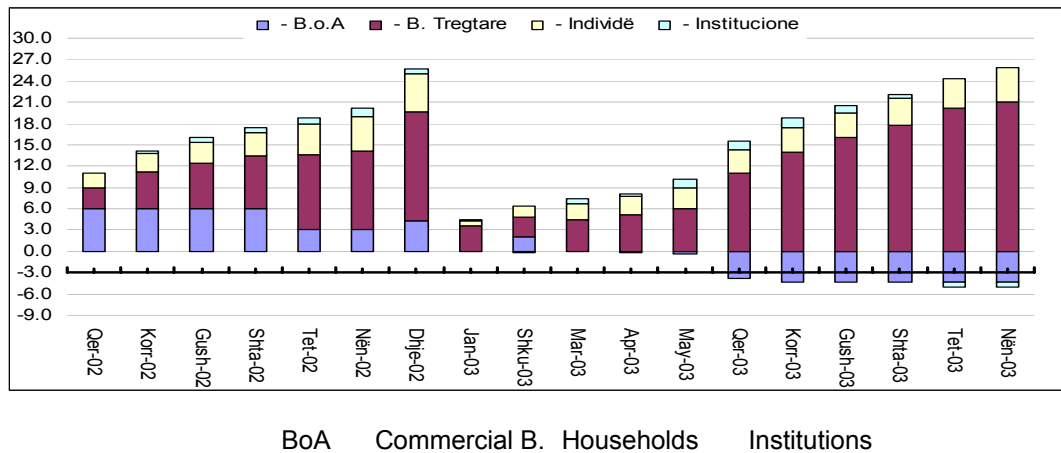
month rate

III.3.2 GOVERNMENT DEMAND FOR MONETARY ASSETS

In October the government increased significantly the monthly demand for monetary assets. Budget deficit of this month was increased by lek 2.8 billion, reaching the level of lek 16.6 billion. Commercial banks have increased the

monthly deficit financing by about lek 2 billion, whereas the households finance the rest.

Chart 10. Cumulative performance of the gross budget deficit financing along the year (in billion leks).



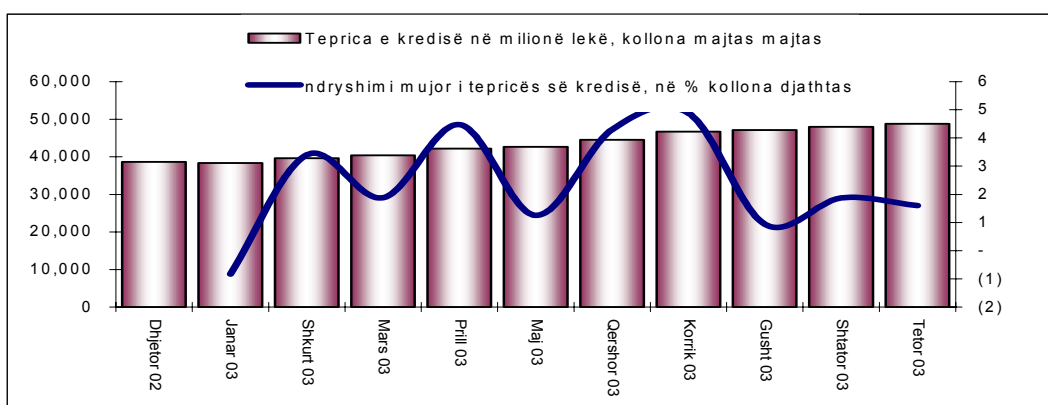
According to operative data, in November, the budget deficit is increased by lek 1.5 billion. In this month, a non-realization of the plan is noticed, either on income or expenditure. Monthly income is realized at 79.4 per cent of the planned level, whereas the expenditure is realized at about 80.7 per cent of the forecasted level.

Gross domestic financing for 2003 reached the level of Lek 19.1 billion. It is withdrawn in the form of treasury bills and two-year bonds (these are at Lek 0.3 billion).

III.3.3 CREDIT TO ECONOMY

Balance of credit to economy, at end of October, reached to lek 48.8 billion, marking a monthly growth of Lek 0.8 billion. During October, short-term credit balance was presented as falling for the first time by about lek 1.1 billion. Mid-term and long-term credit, altogether, comprise 52 per cent of the banking system credit portfolio structure. In October they were increased by lek 1.8 billion.

Chart 11. Monthly performance of the balance of credit to economy in 2003



Balance of credit in million lek, left column
Monthly change of the balance of credit, in %, right column

During three last years, short-term credit has dominated in the credit market, but developments in October have reversed the credit balance structure in favour of mid-term and long-term credit.

Credit balance structure according to currencies went on maintaining same ratios to those of the previous month, where 19 per cent of it is in lek and the rest is in foreign currency. However, the new credit extended in lek reached to 34 per cent of the new credit in October.

New credit extended in October was lek 6.9 billion or 50 per cent higher than in October of 2002. The largest part of this credit, 70 per cent of it, was provided in short-terms. About 58 per cent of the new credits were extended to businesses for trading reasons, whereas the processing industry branch and the purchase of real estate have benefited respectively 9 and 8 per cent of them.

In total, the credit extended for January-October marked the figure of lek 70.6 billion or 13 per cent more than the credit extended during the whole year of 2002. Compared to forecasting according to monetary program of 2003, until end of October 2003 it is realized to 78 per cent of the forecasted level of credit to economy by the banking system.

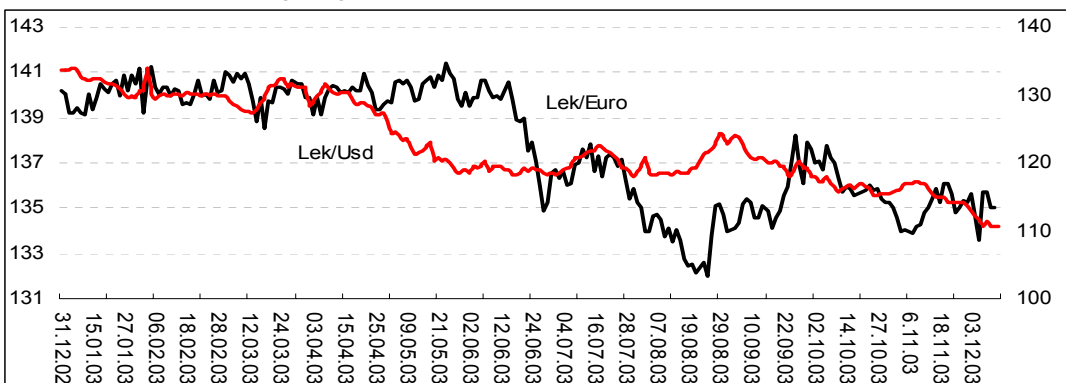
III.4 EXCHANGE RATE.

At end of November, exchange rate of dollar resulted to 113.7 lek/usd, being depreciated by 2.2 per cent against lek as compared to the level of the month start. Whereas euro against dollar jumped to higher levels ever reached in the history of its use as a currency, the exchange against lek has fluctuated in narrow intervals. At end of November lek is exchanged at the level of 135.3 lek/euro, where the depreciated amount is estimated at 0.6 per cent.

In December dollar has undergone further depreciation against lek. Only in the first ten days the depreciation against lek is deepened further by about 2 per cent.

Mostly the movements in international market influence lek exchange rate performance even in November. However, the historical data indicate that generally lek is appreciated against both currencies in November. Such factors as seasonality and low inflation rate in the country, have favoured lek strongly.

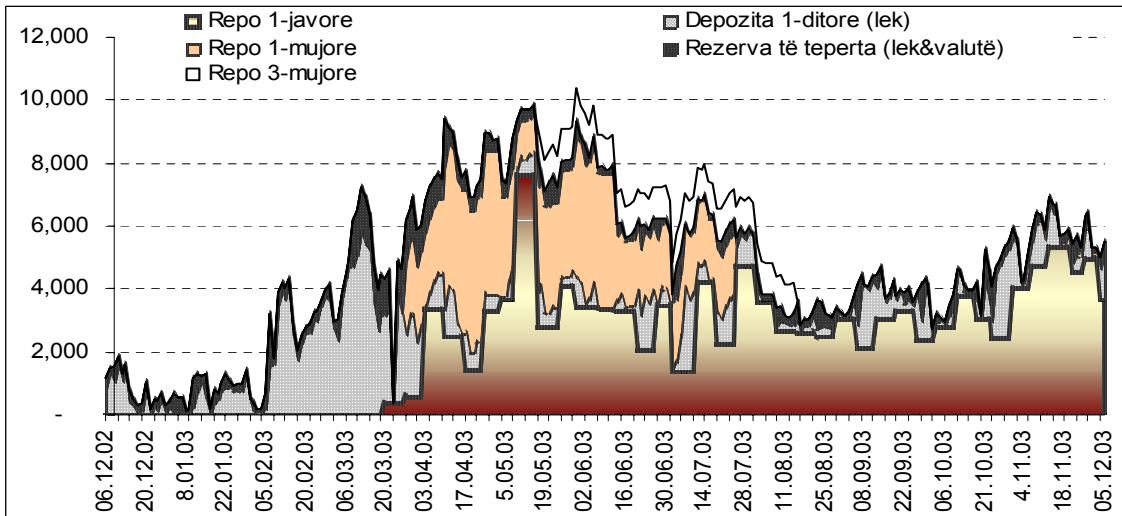
Chart 12. Lek exchange against dollar and euro in 2003.



III.5 FINANCIAL MARKETS AND INTEREST RATE PERFORMANCE

Money market continued to be featured by liquidity excess even during November. At end of this month, the level of excess liquidity in the banking system resulted to lek 6.3 billion from lek 5.5 billion it was at end of October. Data on the first week of December indicate that liquidity excess has been falling.

Chart 13. Excess liquidity of the banking system (in billion leks).

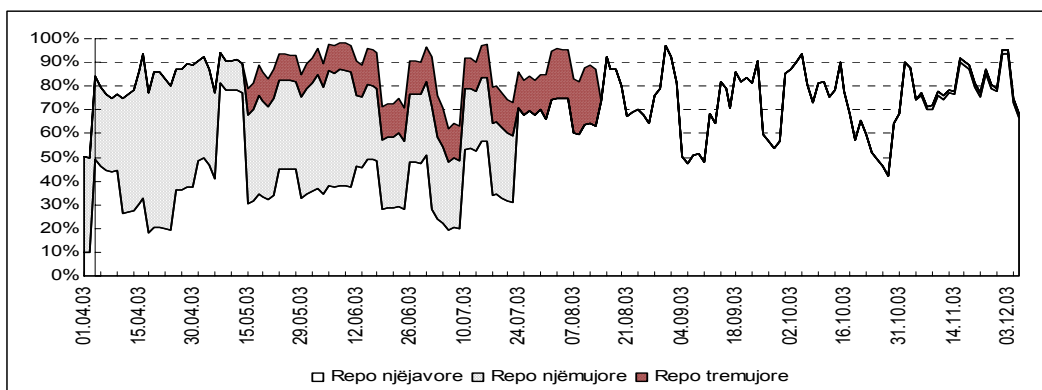


Weekly repo
 Monthly repo
 &forex)
 Quarterly repo

Overnight deposits (in lek)
 Excess reserves (in lek)

To withdraw the liquidity, in November, the Bank of Albania intervened in the market mainly by means of weekly repo, whereas the commercial banks have not presented interest in repo auctions with longer term.

Chart 14. Specific Repo weight in total liquidity of commercial banks at the Bank of Albania.



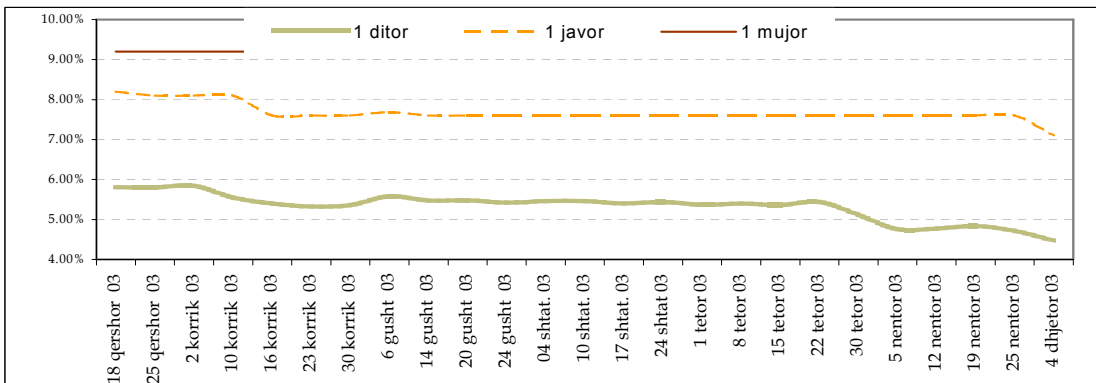
Weekly Repo Monthly Repo Quarterly Repo

Besides repo, banks have also used overnight deposit facility and almost the same liquidity spread structure is maintained even in the first weeks of December. In this month banks have also used the facility established by the Bank of Albania, on using the reserve requirement up to 20 per cent.

Excess liquidity level has made banks in November not be vary active in the interbank market. Transactions' volume in this market recorded lek 4.8 billion or about lek 0.2 billion less than in October. Borrowing was performed on overnight term, while in the first week of December banks recorded a one-week transaction, for the first time after a five-month period.

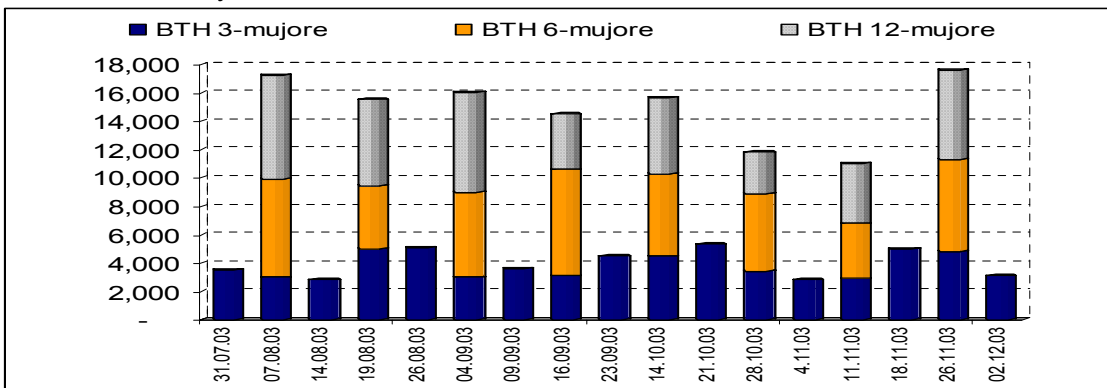
Responding to Bank of Albania signals at end of October, and under the conditions of excess liquidity, interbank market has reacted on interest rate reduction in November. Compared to October, the rate applied on overnight transactions is reduced by 0.4 percentage point. In December, reduction of overnight deposit interest has impacted on further reduction of interbank interest rate, leading it to 4.4 per cent at beginning of the month. This change was reflected even in interest rate applied for weekly transaction (7.1 per cent).

Chart 15. Reaction of banks in interbank market to monetary policy signals



In the **primary market**, government demands for monetary assets are fulfilled wholly by commercial banks. It is noted that the amount requested by government has been lower than in the previous year, thus impacting on liquidity growth and yield rate reduction.

Chart 16. Primary market transactions volume



3-month TBs

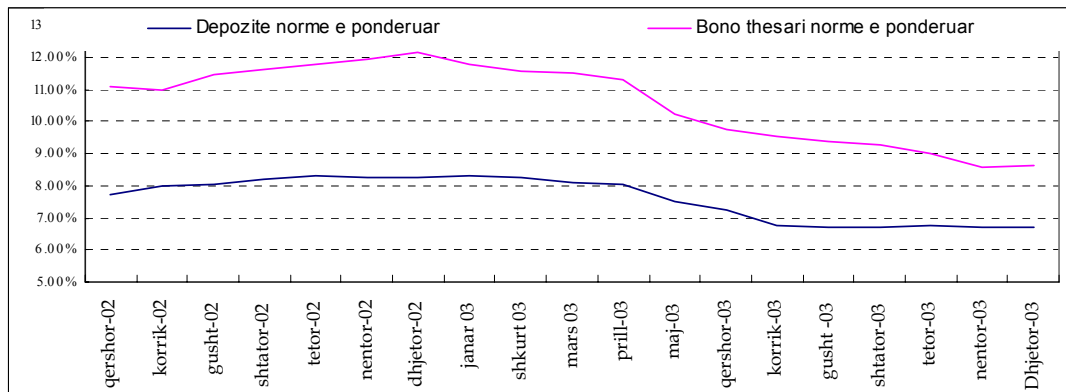
6-month TBs

12-month TBs

Treasury bill interest rates with longer than three-month maturity have had a more obvious reduction. This is influenced not only by the Bank of Albania signals, but also the high demand and competition for 6- and 12- month treasury bills.

Interest rate of collecting funds in November has been reduced, dictated more by the three-month deposit interest rates (by 0.67 percentage), than by the 6- and 12-month deposit rates (respectively by 0.39 and 0.22). Reaction with regards to interest reduction in November resulted lower than the one after the first interest reduction (in April), though the signals on reducing the base interest have been at the same degree, 0.5 percentage point. This is due to excess liquidity at higher levels during April compared to October, and due to higher real interest rate levels, which left space for reducing nominal interest rate.

Chart 17. Banks' reaction in primary market and deposit market.



Weighted rate deposit

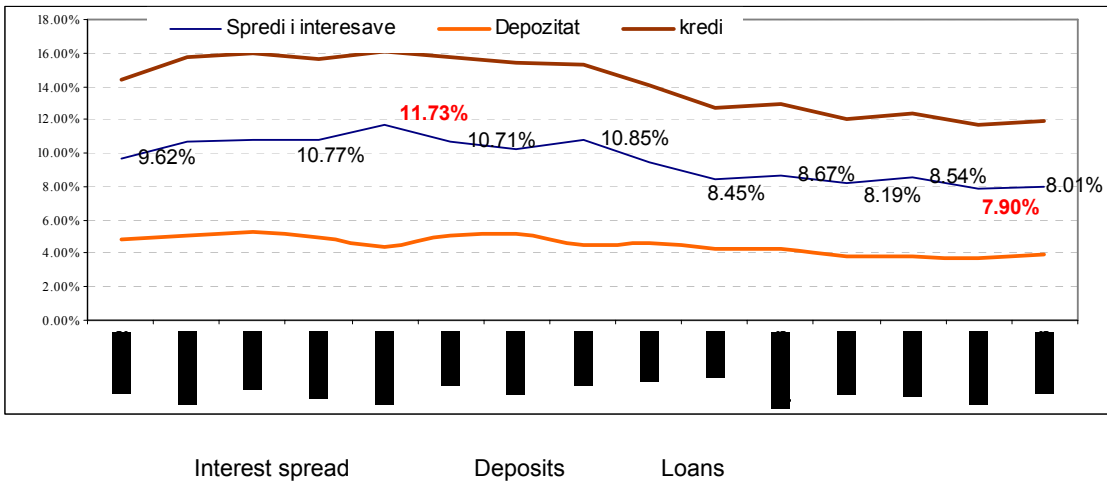
Weighted rate Treasury bill

Table 8. Change of average weighted interests in lek time deposits after the BoA signals in 2003.

January-March	April-June	July-October	November-December
-0.14%	-0.87%	-0.55%	-0.48%

Interest spread for October has remained around lowest levels, almost same levels with the previous months.

Chart 18. Lek deposit, loan interest rate and their spread.



Foreign currency interest rate performance

Tendencies of raising libor and euribor interests are observed in the international markets in November, which are also reflected even in our foreign currency deposit market.

However, during this period, interest reduction cases have not lacked, thus impacting on average foreign currency deposit levels.

Table 9. Weighted average interest of foreign currency deposits (in total).

	August-03	September-03	October -03	November-03
In usd	0.52	0.50	0.50	0.49
In euro	0.81	0.77	0.71	0.74

We notice in the market of foreign currency loans the narrowing of interest rate fluctuations, especially in USD loans, which indicates stability of these rates.