

RESEARCH DEPARTMENT

(CONFIDENTIAL)

MONETARY POLICY MONTHLY REPORT

OCTOBER 2001

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1. GENERAL CONSIDERATIONS

The raised developments of this end of year seem to follow the same line with the early warnings of the Bank of Albania on a possible worsening of the energy crisis in the country. This situation is coinciding with a global slowdown of the world economy, situation that was considerably accelerated, after the terrorist attack of September 11. Although it is early yet to assess a short – term impact of these factors on the financial – economic development of the country, it is sure that, their effects will be soon notable, especially on the performance of those sensible macroeconomic indicators such as production and inflation. Independently of this situation, taking into account the proved developments till the end of October and knowing the insufficient opening of Albania toward the global trade, it could be concluded that, the important targets of the financial – economic development of the country are previewed to be achieved in accordance with the programmed figures.

In more concrete terms, it is thought the economic growth for the entire year 2001 could reach the level of 7.3 per cent. The further invigoration of private sector will play the main role in this possible increase. Nevertheless, it should be emphasized that, agriculture, one of the major branches of the global production, has started to manifest signs of deceleration. This fact should really be taken into consideration, as in the future it might become a real cramp for the insurance of a stable increase in long terms.

The demonstrated developments of the end of October, 2001, denote that the annual rate of inflation has further decelerated at the level of 1.8 per cent. In concrete terms, the developments of October were “ a surprise”, when the monthly rate resulted - 0.5 per cent, differently from the developments of the previous Octobers. Throughout the history of transition this rate has resulted to be positive. Nevertheless, Bank of Albania, earlier has expressed its preview, that the year 2001 will record an annual rate of inflation in accordance with the decided target, at the level of 2 – 3 per cent. Bank of Albania is taking such a decision based on the fact that the core inflation or the measured one by a reduced weight of the “ foodstuff, beverages and tobacco” group, have continuously been in low levels.

Among the momentary concerns, is the inflation rate performance in longer terms. For it is known the fact that the expected impacts of the raise of electric energy price, those of the worsening of deteriorated energetic situation and economy of world deceleration, firstly will have impact on the general level of consume prices.

In general, the developments of fiscal policy, have resulted to be within the target limits by non exercising strong pressures on the banking system for the

liquidates. However it previewed for the rest of year, budget demands for liquidity to be increased and, like the previous years, will reach their climax on December. It is expected budget deficit by the end of year to reach the level of 9.4 per cent of GDP, of which 2.1 per cent will be financed by privatization revenues and 2.8 per cent by the banking system.

Bank of Albania monetary policy during the last two months (September – October 2001) has been characterized by the continuance, both in its position toward the inflationary pressures and of interest rates, and toward the operational framework used by Bank of Albania to achieve the targets.

Bank of Albania has continued to maintain a careful position toward the developments of inflation, reflecting it in its position toward the interest rates, aiming the end of their decreasing tendency throughout the group of financial instruments of economy. For this reason, the level of interest rate of repo auctions was kept unchangeable, at the level of 7 per cent. The instrument of repurchase agreement continued to be the main instrument used by the Bank of Albania.

This implemented policy is reflected in the markets performance in general. Where from September, has started the stoppage of the further decrease of interest percentages and to a certain point there are signs of inverted movement. More concretely: the average interest deposits rate in Lek as a system has remained stable; interest rate for the given credits in Lek has shown a light increase and the t-bills yield as well. Although inflation of October decreased under the target band of the Bank of Albania, there are some reasons which indicate us to continue carefully toward the inflation performance. Nevertheless the expectations for the real inflation denote that it will be closer to the upper limit. At the same time, it is expected for the next year inflation to increase in comparison with that of this year.

The experience of the last year, the increase of budgeted expenditures and the speculative prices movements that caused the excelling of the annual target inflation, will be present this year as well. Furthermore, this year the Albanian business and consumers will also face the increase of electric energy price. Nevertheless the increase of these prices will have a small direct impact on CPI because of the small weight that has the group of “ Energy, fuel, rent” in the CPI basket. The inflationary pressures of prices increase will continue to be present for a long period because of their impact on merchandise costs without excluding the clear speculative motives that will follow this increase. For these reasons, Bank of Albania assesses as reasonable the present phase of monetary policy, maintaining fixed the weekly repo rate. This position of the Bank of Albania should be judged as a continuance of a neutral policy followed during the last two months, September – October 2001. Independently of this fact, Bank of Albania in order to insure a longer term stability, will continue to follow carefully the performance of the domestic market and those of international markets.

2. THE DEVELOPMENTS OF THE DOMESTIC ECONOMY

2.1. Briefly on the General Macroeconomic Environment

By the end of this year it appears like that the Albanian economy has entered a development phase where it is notable a continuance of the further invigoration of private sector of economy. Such performance of private sector of economy could be sufficient for the probable insurance of programmed increase, of 7.3 per cent in real terms by the beginning of 2001. On the other hand, the believe that inflation by the end of year 2001 will be within the target limit, is on the up and up. More concretely, at the end of December 2001, it is expected its annual rate to fluctuate within the interval of 2 – 3 per cent.

The developments of the last days, nevertheless, where the worsening of energy crisis is specifically notable, the announcement of electric energy price increase and the deepening of global economy deceleration, are factors that could cause “surprise” developments. Unfortunately the control on them is impossible and have a clear nature of influence from the strike. The first signs of a inflation acceleration have appeared since the first week of November, where from the statistical dates of Agriculture and Food Ministry, it is notable a general increase throughout the food productions range. And according to our assessments it is a weekly increase of the above mentioned productions at a range of 5 – 6 per cent. As it will be seen during the material treatment, the based served arguments, belong to different periods basing on the supposition that: the definition of expectances for the remaining period of 2001, is based on the use of the last data for any indicators category taken up for consideration. Judging from the available data, its notable the re-invigoration of the trade activity of Albania with the rest of the world. It should be particularly emphasized the export increase in absolute value in September differently from the months of July and August.

Table 1: Data on the Foreign trade

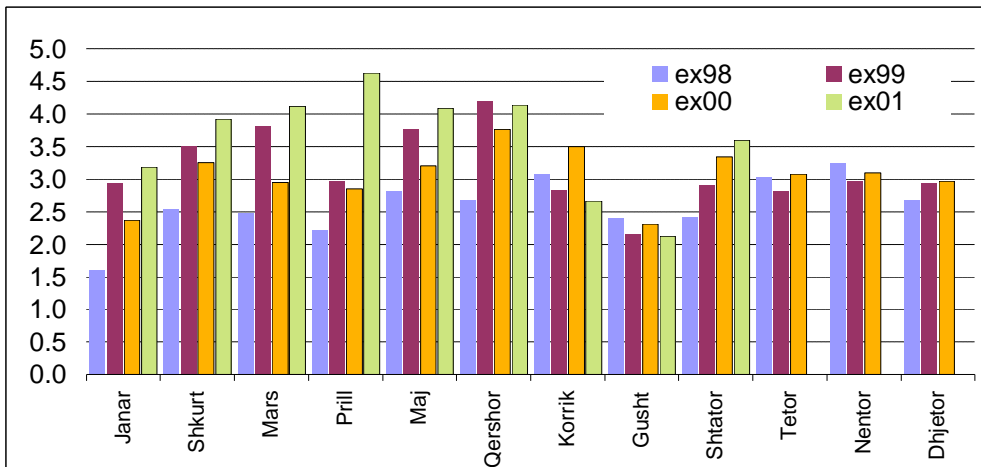
In Lek billion ¹	September '00	August '01	September '01
Total imports	13.4	12.9	16.9
Of which:			
Machinery and equipment	1.8	1.9	3.4
-Mach. and electrical equipment of tv sounds and image.	0.9	1.2	2.3
Exports	3.3	2.1	3.7
Of which:			
Textile	1.3	0.8	1.5
Footwear	0.7	0.5	1
Trade deficit	10.1	11.1	13.2
Covering coefficient: export/import (%)	25	16.4	21.7
Trade volume (absolute value, in billions of Lek)	16.7	15	20.6

¹ Source: Bank of Albania, Statistical Report

The exports continue to be dominated by the re-exports of active elaborating merchandise, while by the imports side, the item “ machinery and equipment” continues to have the main weight. The same thing could be affirmed for the partner countries, which as in the past, continue to be identified with Italy and Greece.

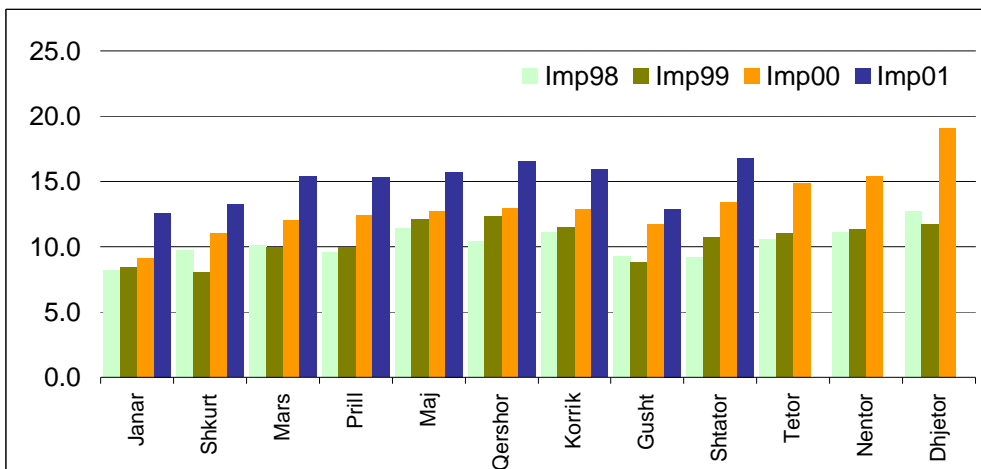
Although the increase of exports in September, trade deficit compared with that of August, during this month, had a further increase, achieving more or less the same levels of July 2001 (see chart 3). This development is a significant one and bring in evidence once more the fact that exports level is rather low and whatever relative increase of exports is not able to absorb the most relative increases that are registered in the side of imports.

Chart 1: The performance of total exports (in billion of Lek)



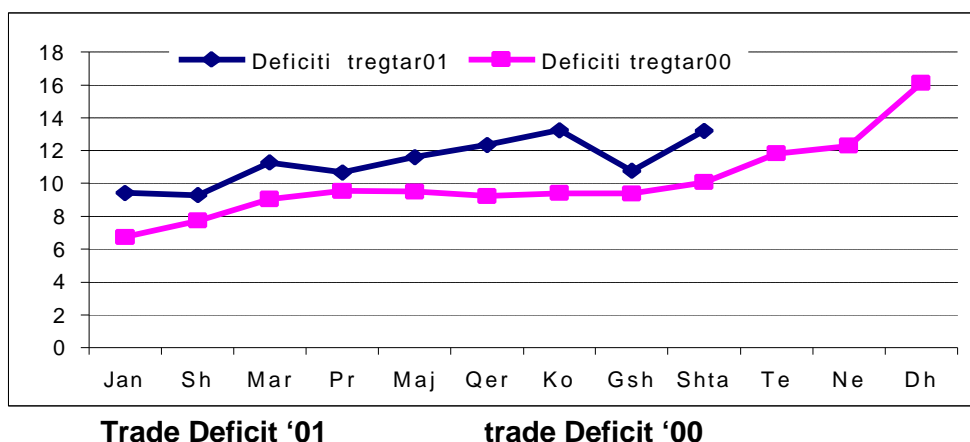
January, February, March, April, May, June, July, August, September, October, November, December

Chart 2: Total imports performance (billion of Lek)



Jan. Feb. March. April. May. June. July. Aug. Sep. Oct. Nov. Dec.

Chart 3: Trade deficit during the period 2000 – 2001 9 (in billion of Lek)



Jan. Feb. March. April. May. June. July. Aug. Sep. Oct. Nov. Dec.

The developments in the domestic economy and especially those in the foreign sector of economy could not be considered detached by the developments that are characterizing the world economy. The world economy, during September continued to demonstrate signs of deceleration and even of defacing of increase rhythms. These signs were noted both at the most developed European economies and in the American one. Nevertheless, although Albania is not considered a country of a high degree of openness (foreign trade/GDP ratio), it might not remain out of the developments that take place in the international area.

Table 2: Some data on the American economy – third quarter 2001.

Indicator	Annual Change in %
GDP	-0.4
-Consume Expenditures	1.2
- Government Expenditures	4.6
Of which – Defense expenditures	5.0
- Non-residential fixed investment	-11.9
- Merchandise and services real exports	-16.6
- Goods and services real imports	-15.2
Other indicators	
Unemployment	5.4% (September)
CPI (September y/y)	2.6%

The large decreases of the American exports (indicator of the decreasing foreign demand), and of the nonresidents investments (indicator of the increasing uncertainty of investors) are balanced by the expenses for private consume (69 per cent of GDP) and by the government expenditures (18 per cent of GDP) as well.

The further deceleration of American economy during September was added to the bad news that for a long time were coming from European economy and especially from the German one. Ifo institute data of September for the business in Germany, was at the level of 85.0 toward the expected level of 88.1. In this way it recorded the most negative situation of the German business for 27 past years. The strong decrease of the expectancies element suggests that, the events of September 11 had a larger impact than the previewed one and surpassed the positive impact of interest rates decrease by ECB (Central European Bank). At the same time, Italy and France demonstrate signs of production decrease and of unemployment increase.

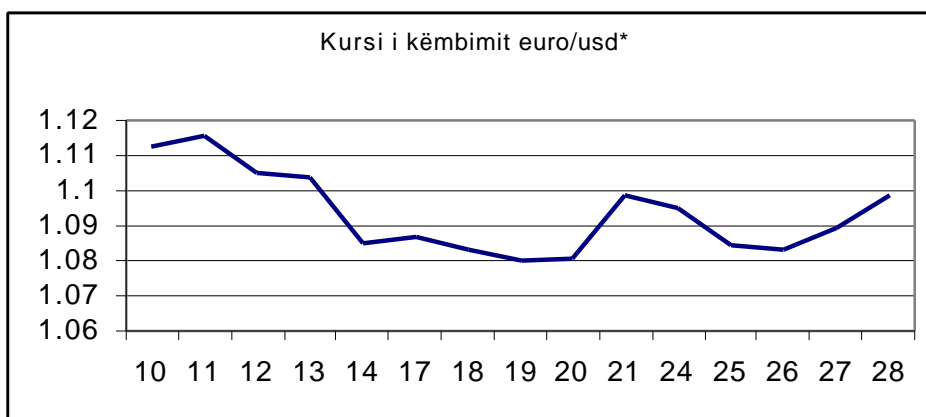
In order to encourage the investments and to help the recovery of the proper economies, a great number of central banks are following an expansionist policy, which is further deepening after September 11.

Table 3: Re-financing rates and their change dates of some central banks² (in percent)

Central Banks	16 Sept	17 Sept	18 Sept	2 Oct	4 Oct	6 Nov.	8 Nov	9 Nov.
Federal Reserve	3.5	3	3	2.5	2.5	2	2	2
Central European Bank	4.25	4.25	3.75	3.75	3.75	3.75	3.75	3.25
Bank of England	5	5	4.75	4.75	4.5	4.5	4	4

The events in USA have had impact on the exchange rate eur/dollar, which has recorded the low point for the dollar on September 19, 2001. However, the last events have brought into evidence a week performance of both currencies increasing the unclerness on their future.

Chart 4: Exchange rate usd/eur during September



The direct reflection of the above performances is appeared in the continuing instability of participants prices, of security and of the basic merchandises.

² The data are taken from the correspondent pages of central banks websites

The largest fluctuations are observed for the oil price. According to the latest data are noted the following developments for the prices, since September 11, 2001:

Table 4: The fluctuations in the prices of the basic merchandises.³

Product	Difference in price
Oil	-4.5 USD
Agricultural Products	- (6-8) %
Metals	-4 %

Apart of the present oil price an other indicator to base on for previewing the economy performance is the oil price included in the purchase contracts for the future. The last one has decreased by USD 2.2 since September 11 demonstrating that the expectance for the recovery of the world economy remains within low levels. The prices decrease of the other trade produces, while reflecting an advantage for the imported countries of these produces, creates an unstable situation for the countries which export and especially for those economies whose trade is strongly based on the export of agricultural produces or of the elaborated materials of textile origin. These countries being non big importers and consumers of oil, do not profit from the decrease of oil price while paying their “tax” for the part of exports. In Albania oil and energy produces compose 9 per cent of the total of imports or about USD 97 million⁴.

This figure is rather higher from that of this product export (USD 5million) or of the exports of textile merchandise, on which can be seen the impacts of world prices decrease. While the Albanian trade balance can take advantage from the decrease of these prices, it should be taken into consideration the fact that, in Albania the prices do not decrease immediately as a result of cost decrease (the prices are sticky). A further deepening of the budget deficit can cause Albania to become more vulnerable toward the developments of exchange rates and of the inflation in the partner countries. On the other hand, prices decrease, mainly in the agricultural produces of the world market might be also reflected in the prices decrease of the Albanian domestic market within a definite short term period. Previewing this fact, it should be taken in consideration the prices increase in December which is likely to become weaker because of the prices increase in the international market. In the context of world economy, it should be also stressed that Albania, having close economic relations with the neighbor countries, Italy and Greece, quickly and faithfully reflects the economic developments of both countries. The point here is about for both: the developments of their demand for import merchandises; and for the developments in the labor market which are related to the Albanian emigrants as well in these countries. If during the following moths European economic deceleration will influence the employment in both countries, Albanian emigrants risk to suffer the consequences, remaining

³ taken from the report of the World Bank on “ The impact of the last events on the countries of medium and low development”, November 2001.

⁴ Bank of Albania: Statistical Report, data of the year 2000.

unemployed and in some cases turning home in Albania. Anyway it is difficult to relay on these forecasts taking into consideration that people movement of such nature are reflected on statistics after a certain period of time.

2.2. October inflation and the expectances for it.

Month of October was characterized by a decreasing inflation in comparison with the previous month at the level of – 0.45 per cent. This figure was firstly meet in the series of monthly inflation of the past Octobers. It achieved the value of 1.8 per cent, as an annual level. Index consume prices decrease in October results to have reflected, in a larger degree, the prices decrease of the “ foodstuff – beverages – tobacco” group. The climate that favored this inflation value is related with the stability manifested by the country currency (appreciation); with the presence in the market of fall seasonal products; with the general reduction of merchandise prices in the world markets; with the “ tranquilization” of the intensity of budget expenditures performance, which gives a delayed effect of three months. The ultimate values of inflation are promising to achieve the target until the end of year.

Table 5: Inflation of October for the period of 1994 – 2001.

Period	Inflation (in %)
October 1994	1.00
October 1995	0.66
October 1996	1.60
October 1997	5.00
October 1998	0.28
October 1999	0.38
October 2000	1.26
October 2001	-0.45

1. The present performance of inflation, certifies a future that to a certain point will not effect the target achievement till the end of year.
2. The history of inflation monthly series, shows that in general the months of November and December of the past years, are characterized by an increasing tendency of it. So, basing on the average performance of the past Novembers and Decembers, it is previewed inflation to be respectively in a monthly level about: 1 and 2 per cent. It is important to be emphasized that the increasing tendency of inflation is not previewed to pass the limit of 4 per cent by the end of December.
3. The preview on inflation increase at the beginning of November 2001, is certified by the reports of the Ministry of Agriculture and Food, where the prices of the first week of November, shows the beginning of an increasing tendency, almost for the prices of alimentary articles.

4. The impact of the previewed increase of the electric energy price in December 2001, will also cause the increase of inflation figure, that will be a direct and indirect one. But, the energy crisis will continue to worsen, its costs, will effect both the production contraction and the increase of consume goods cost, by effecting the increase of their prices and in higher levels that of inflation. The inflationary pressures caused by the increase of electric energy price and by the bad energetic situation that the Albanian economy is facing, it thought to have a larger impact at the beginning of the next year.

3. THE ANALYSIS OF MONETARY DEVELOPMENTS

3.1 Survey on Monetary Policy

Monetary policy of the Bank of Albania has been characterized by continuation expressed both in its position against inflationary pressures and interest rates and against the interests framework used to achieve its targets as well.

Bank of Albania has maintained a careful position against the inflation developments, reflecting it in its position against interest rates, aiming the completion of their decreasing tendency throughout their financial instruments range of the economy. For that reason, interest rate levels of repo auctions was kept unchangeable, at the level of 7 per cent. Repurchase agreements instrument continued to be the main instrument used by the Bank of Albania.

In September inflation fell at 3.6 per cent, while in October fell at 1.8 per cent. At the same time, the other categories of inflation, the inflation calculated by the new basket and the core one are at low levels. Bank of Albania decision for interest rates increase has demonstrated some positive signals; the average rate of deposits in Lek interest as a system is stabilized during the two next months after the decision. The movement of the Bank of Albania to soften the inflationary pressures and expectations in economy, can be considered a successful one.

Although inflation in October fell under the target band of the Bank of Albania, there are some reasons which denote to be careful toward inflation performance. The experience of the last year, the increase of budget expenditure and of the speculative prices movements that caused the surpass of the inflation annual target, will be present this year as well. Furthermore, the Albanian business and consumers will face the increase of electric energy price. Although the increase of these prices will have an immediate and direct impact relatively low on CPI, because of the small weight that the " Energy, fuel, rent" group has in the basket of CPI, the inflationary pressures of prices increase will continue to be present for a long time because of their impact on merchandise costs.

For that reason, Bank of Albania sees to be right in its careful position against both the inflation and the present level of repo rate. On the other hand, Bank of Albania will work on the elaborating of the instruments used for the implementing

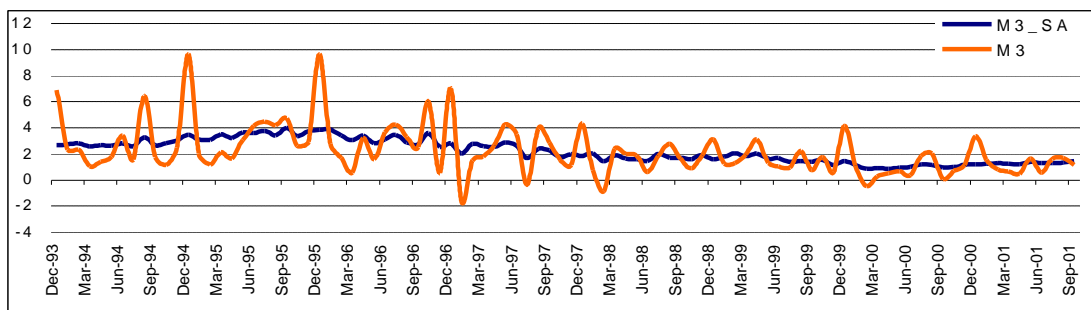
of the monetary policy, in the function of its final target, that is the maintenance of prices stability.

3.2. The developments of money supply⁵

September has demonstrated money supply developments to be closer to the average values of the year. In comparison with the last month the aggregate M3 increased at 1.13 per cent, projecting an annual rate increase of 15.4 per cent. This increasing rate is close to its monthly increase, 1.11 per cent, for the period of January - August 2001.

In annual terms, M3 is increased at the level 16.3 per cent, reaching the highest annual increase since the year beginning.

Chart 10. Monthly rates performance of M3 increase



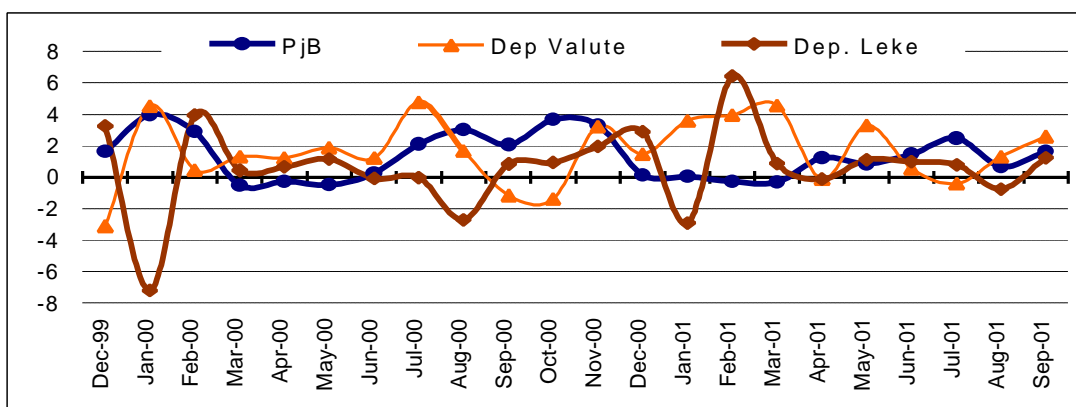
As its is shown on the chart, M3 performance is considerably influenced by the seasonal impact. The frequent movements of M3 appear because of the seasonal impact that have its elements especially, currency outside banks.

Currency outside banks

Monthly increase of the currency outside banks was lower in comparison with the average increase of the three previous months. In relative terms, currency outside banks is increased at 0.8 per cent or at Lek 0.8 billion for this month, by decreasing its weight on M3 from 29.4 per cent to 29.3 per cent. In annual terms, Currency Outside Banks increase has been 15.5 per cent, under the annual increase average during this year and during the 2000 as well.

⁵ See the attached table 1 for the values on the main indicators of monetary supply

Chart 11: Monthly increase rates of the monetary elements seasonally adjusted



CoB(Currency Outside Banks) was characterized by high increase rhythms during the period of June-August as a result of Government expenditure increase and because of the seasonal impact of currency outside banks increase during the holidays season. This was one of the factors that caused the inflation increase during this period. Meanwhile, judging from CoB position during the previous periods, its increase for this month should have been higher. But, as the requirement for domestic finance has been relatively lower this month, CoB increase has been within relative low levels.

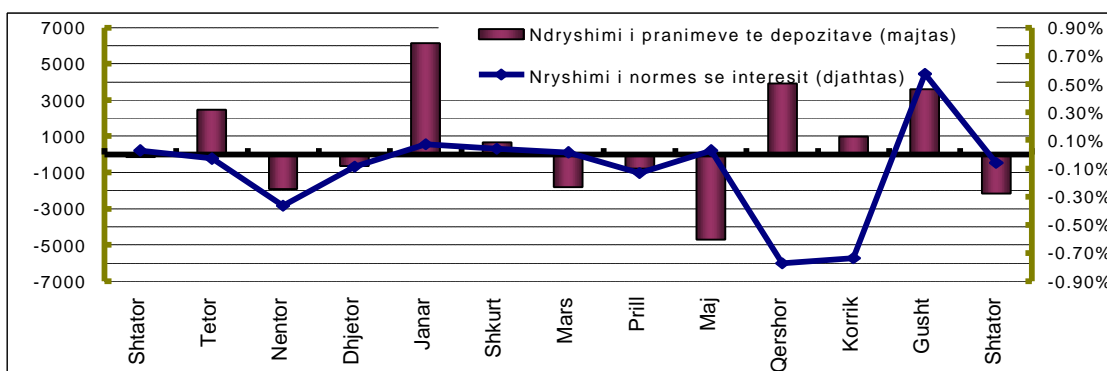
Real values deviation from the seasonal adjusted ones are rather regular and as a result it is easier to perform a more precise preview on the further performance of CoB judging only from the time series. Basing on the position of this element during the previous periods, CoB is expected to increase during the last quarter of year at about Lek 6 billion increasing their weights to M3 at 29.7 per cent. This for the reason that it is expected Government expenditures to increase at about 14.8 billion during the last quarter of the year (for more details sees section 3.7. The previews about the end of year 2001).

Lek Deposits

Lek deposits are increased by 1.2 per cent or by Lek 2.1 billion in September, compared with the last month. September has achieved a higher rate of the annual Lek deposits increase since the beginning of year, 13.5 per cent. Nevertheless this is highly effected by the fact that this deposits have considerably fell during September 2000, showing in that way a tendency different from that of the last year. Th return of a part of the CoB increase during summer months, into the banking system in September, is one of the reasons that could explain this deposits position

On their side, banks being unable to invest the funds generated from deposits increase, have decrease the interest rate of their acceptance, although at a small degree, During September interest rate for the new deposits is decreased by 6 b.p .

Chart: 12. The acceptance of the new deposits and their interest rates.



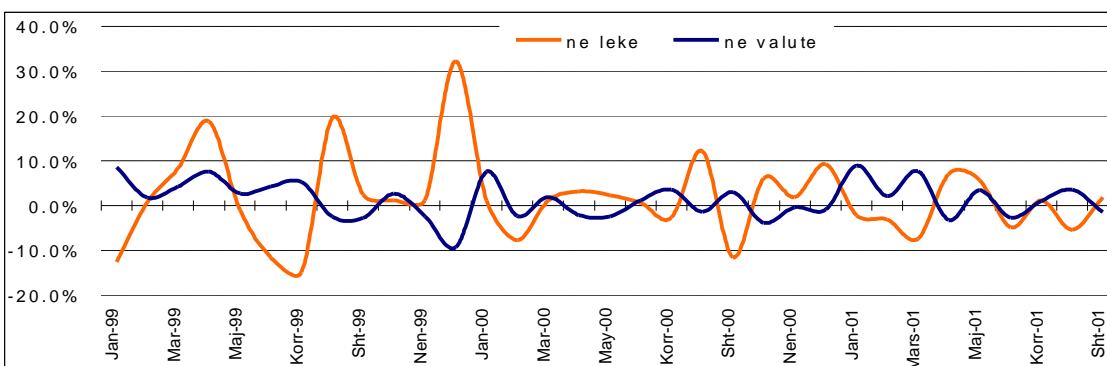
September, October, November, December, January, February, March, April, May, June, July, August, September.

The difference of deposits acceptances (on the left)
The difference of interest rate (on the right)

Lek deposits weight to M3 has been decreasing during the period of February - August, while it is observed a light decrease of them in September, from 49 per cent to 49.1 per cent compared with August.

Unlike August, when the demand deposits fell by 5.7 per cent compared with the previos month, in September they have increased by 1.8 per cent.

Chart: 13. The Monthly rates increase of the demand deposits



In Lek

In foreign currency

Jan.99, Mar.99, May 99, Jul.99, Sep. 99, Nov.99, Jan.00, Mar.00, May 00, Jul.00, Sep.00, Nov.99, Jan.01, Mar.01, May 01, Jul.01, Sep. 01, Nov.01.

As it is shown from the chart, the increase rates of demand deposits are quite fluctuated, and in addition they demonstrate a negative relation among them. This relation, can be explained by the fact that the private sector, that possess the major part of these deposits, prefer to have them in the foreign currency, depending on their expectations for the inflation and for the interests rates. Thus, demand deposits in Lek increase is followed by the increase of the demand

deposits in foreign currency, with a time delay at an average of one month. Demand deposits in Lek are expected to increase with the government and consumers expenditure increase.

Time deposits are increase at about Lek 1.7 billion or 1.1 per cent compared with the last month. Time deposits in Lek decrease during the first period of year, was a result of the continuing decrease of their interest rates, increasing the possibility of the tendency of having their savings in foreign currency.

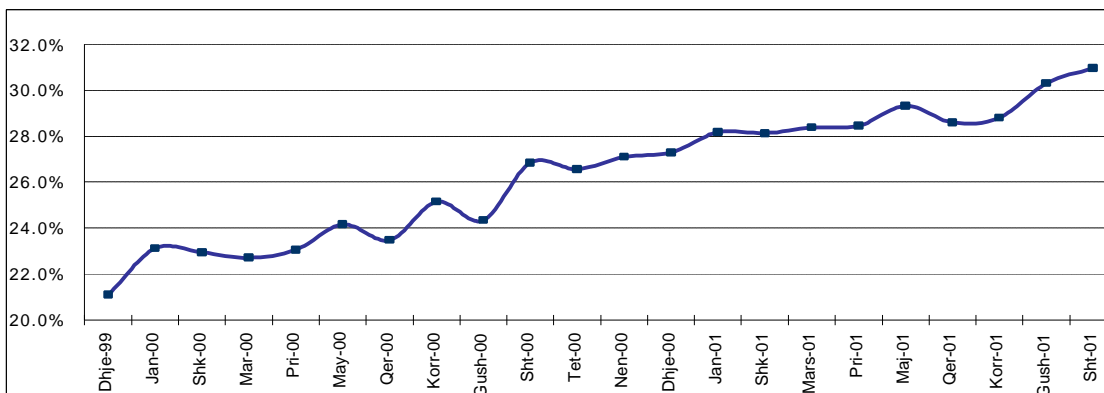
Bank of Albania decision to increase repo interest rates in August, was followed by the interest rates increase of Lek deposits in August, while in September their level was the same with that of July. Taking into account the stability of interest rates and the preview of lending demand increase from the economy during the last quarter, it is expected the increase of these deposits for this period to be at the degree of Lek 8.1 billion.

Foreign Currency Deposits

Foreign currency deposits after a high rate of annual increase, which was 30.3 per cent in August, decelerated their rhythm of increase in September at 24.3 per cent, being closer to their average for the period of January - July 2001. In comparison with August, foreign currency deposits increased at about Lek 1 billion or 1,4 per cent.

It is observed that demand deposits are decreased at 1,4 per cent, while time deposits in foreign currency are increased at 3.3 per cent. The following chart denotes that the ratio of time deposits in foreign currency to those in Lek is always increasing. This increasing ratio demonstrates an increasing preference of households to have deposits in foreign currency. The ratio of time deposits in foreign currency to those in Lek is increased from 27.3 in December 200 to 30.9 during this month. The increase of these deposits has caused the increase of their weight to M3. In September they compose 21.6 per cent of it.

Chart 14. The ratio of time deposits (in foreign currency/in Lek).



Dec.99; Jan.00; Feb.00; Mar.00; Apr.00; May 00; June00; July00; Aug.00; Sep.00; Oct.00; Nov.00; Dec.00; Jan.01; Feb.01; Mar.01; Apr.01; May 01; June01; July01; Aug.01; Sep.01.

The Introduction of Euro in the world financial markets, could also have an impact on the foreign currency deposits. As the commercial banks have offered the service of the physic foreign currency exchange into euro toward a commission, its expected this to cause an increase of foreign currency deposits. Nevertheless, this impact might be reduced or might not result within the expected levels, if we consider the fact that, the interest of foreign currency deposits are decreasing and the reliability degree of Albanians for the Euro might fluctuate.

3.3. Monetary Base⁶

The level of the monetary base has been relatively stable during the third quarter of this year. Its performance is effected by both the currency outside banks movements and those of the excess reserve as well. In September, both these factors have moved toward different directions causing a monthly increase of Lek 0.2 billion in comparison with August. An other factor that has contributed on the stability of monetary base was the low government demand for the finance of the budged deficit from the Bank of Albania.

The decrease of excess reserves, during the third quarter, was a result of the change of repo auction type, from an auction of variable interest to an of fixed interest one, without limits on the amount that banks can invest on them. This makes banks able to more effectively administrate their excess liquidity, investing into repo auctions the major part of it.

Net foreign currency assets of the Bank of Albania denote a decrease of Lek 0.28 billion, for the month of September. This was caused from the appreciation of exchange rate during this month, while the net foreign currency of the authority are increased at USD 5 million.

Bank of Albania claims on the Central Government are decreased mainly as a result of the outright T-Bills sale at the value of Lek 4 billion. The aim of this operation, was the decrease of the excess structural liquidity of the banking system, whose high level had a negative impact on the monetary policy transmission into the financial markets and on these markets effect as well. This has caused the decrease of the excess liquidity in the system, and that of repo level, and also the increase of Bank of Albania claims on the commercial banks.

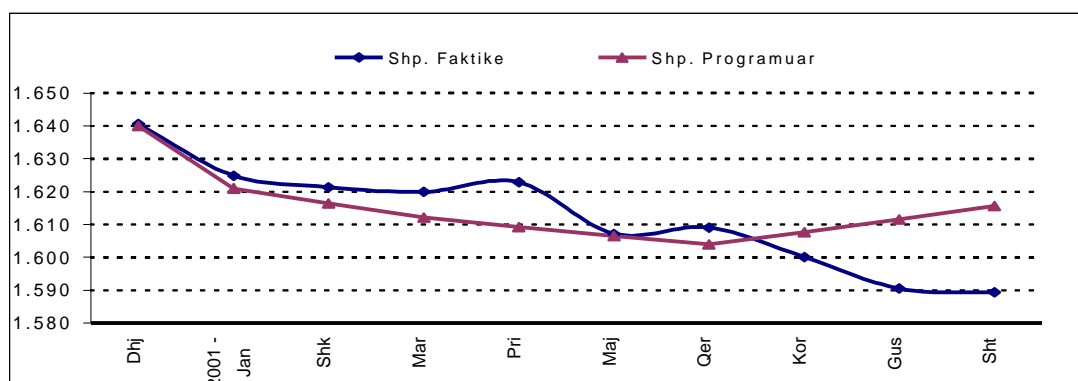
⁶ See the attached table 2 about the values of this indicator

3.4. The comparison with the existing monetary program

The level of M3, in September, was Lek 5.8 billion beyond the preview of the monetary policy. Money increase beyond the preview without being followed by an increase of inflation beyond the programmed limits, demonstrates that the demand for real money in Albania has had a higher increase than the forecast.

An other indicator of the real money demand increase is the continuing decrease of currency in circulation acceleration during this year, as it is also shown on the following chart.

Chart 15. Money velocity change rate



----- the real velocity

----- the projected velocity

Judging from M3 element, currency outside banks is increased at about lek 2.8 billion against the forecast in the program, while the deposits by about Lek 3 billion. Nevertheless, within the deposits there are observed individual deviations at a different direction from the forecast. Lek deposits are Lek 2.3 billion lower than the forecast. Since March 2001 these deposits have been under the previewed level, while foreign currency deposits are Lek 5.3 billion higher. Both foreign currency deposits and their ratio to monetary supply, have continuously been higher than the previewed values of the monetary program.

3.5. The developments of asset indicator

Like August, September was followed by **a real increase** of money demand. In fact according to the data, it appears like money demand is decreased at 1.2 per cent in comparison with August, for its two elements are decreased in value. 0.07 per cent of this decrease is caused from the net foreign assets decrease while and 0.95 per cent of it from the decrease of net domestic assets.

3.5.1. The developments of Net foreign assets item

September showed a decrease of about Lek 280 billion (0.18 per cent) for the level of net foreign assets in comparison with August. Referring to the net foreign

assets of this month, given in American dollars, we observe that in concrete terms this item has had an increase at the value of 7.8 million USD (0.75 per cent). This incompatibility is explained by the appreciation of 1 per cent of the domestic currency against the American dollar (from 142.9 to 141.6 Lek/USD). In annual terms, net foreign currency demonstrate an increase of 26 per cent.

Table 8: Foreign assets performance for the month of September 2001 (in Lek million)

August	September	The difference	in %
Net foreign assets	153,913	153,634	-0.18
Foreign assets MA	84,792	84,679	-0.13
Foreign assets DMB	69,121	68,955	-0.24

Table 9: Foreign assets performance for the month of September 2001 (in Lek million)

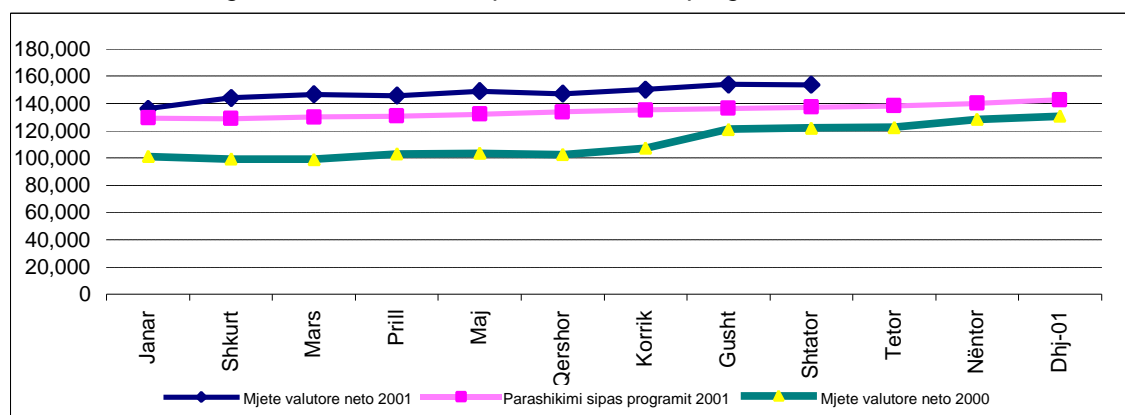
June	September	The difference	in %
Net foreign assets	147,185	153,634	4.38
Foreign assets MA	82,312	84,679	2.87
Foreign assets DMB	64,873	68,955	6.29

In general, the developments of net foreign assets of September has reflected the international developments occurred during this month. As a result of these developments there are observed more important movements from the side of the active net foreign assets in comparison with August:

- A decrease of demand deposits in Lek in the foreign banks at 43 per cent and an increase in investments of time deposits in Lek 4.7 per cent and in securities of nonresidents at 19.4 per cent. This shift is performed for a more effective administration of the foreign reserve.
- An increase from the Bank of Albania of both foreign currencies and banknotes from Lek 69 million to Lek 408 million or 488 per cent in comparison with August. This was as a result of the preliminary measures taken from the Bank of Albania to avoid the possible lack of the foreign currency in the banking market.

Basing on the performance of the present net foreign assets and on their performance during the last year we can expect to have the same increasing tendency during the coming months as well.

Chart 16: Net foreign assets and the comparison with the program



January, February, March, April, May, June, July, August, September, October, November, December 01

---- Net foreign assets 2001-----The preview according to the program 2001 -----
Net foreign assets 2000.

3.5.2. Net domestic Assets

Domestic money demand like the previous months, during September, continues to keep the same structure, where, the claims on the Central Government compose 91 per cent of the total of the domestic demand and the lending to the economy composes only 9 per cent.

1. Claims on the Central Government

In September there was a light increase of this item as a result of Government lending from the commercial banks. In particular, during September was performed an outright sale auction. In this auction, Bank of Albania decreased its T-Bills portfolio by an amount of Lek 4 billion. These T-Bills were called by the Savings Bank, increasing in that way the commercial banks portfolio.

2. The economy lending

We would emphasize that during September the economy lending continues to manifest the same dominant characteristics like the previous periods:

- short - term loans composes the major part of outstanding credit;
- the increasing rhythm of the credit in foreign currency is rather higher than the one in Lek;
- the lending of the private sector is dominant.

As a particular event of this month we would mention:

- Savings Bank, in September, transferred to the Loan Collection Agency about 85 per cent of the outstanding credit. This was followed with the reduction

of outstanding credit as a system, of Lek 5,3 billion, as a result of: the transfer to LCA of 6.1 billion of the savings Bank credits; of the Lek 4,8 billion increase of the new accorded credits; the credits liquidation of Lek 4 billion.

Non performed lending	Lek 6,052,842 billion
Crude interests	Lek 4,115,719 billion
Provisions (interests + loans)	Lek (9,843,4380) billion

- Only during September the disbursed credit are almost equal with those of the first quarter of 2001.
- The new credit accorded only by Alpha Bank is lek 2.5 billion or composes 53 per cent of the new credit accorded during this month.

Table 10. The performance of the domestic money demand

Indicators	August	September	real difference	difference according to the program
NDA	253,548.20	255,741.30	2,193.10	1,446
Claims on Central Government	223132.2	224,579.30	1,447.10	771
Monetary Authority	69,680.00	64,605.00	-5,075.00	
Commercial Banks	153,452.20	159,974.30	6,522.10	
Claims on economy	30,416.00	31,162.00	746.00	675
Public Sec.	1,761.00	1,721.00	-40.00	68
Private Sec.	28,655.00	29,441.00	786.00	608

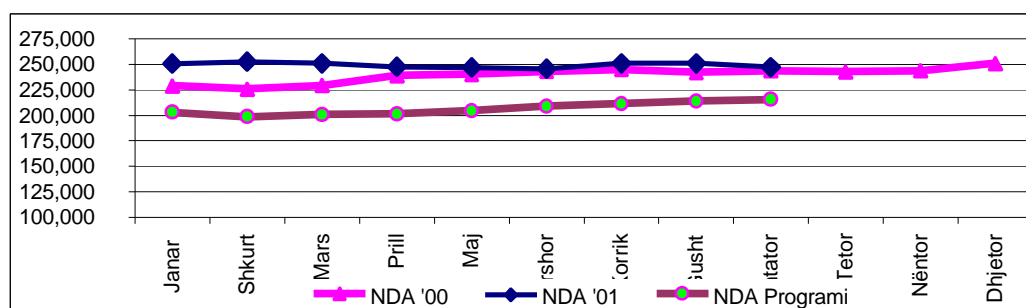
If it is excluded the impact of problem credits transfer to the Loan Collection Agency, credit outstanding by the end of September 2001 was increased at Lek 2.5 billion against the end of June 2001. This change was an impact of the new credit increase, whose level reached at Lek 11.4 billion, and that of liquidations at the degree of Lek 8.9 billion. During the last three years, the new accorded credit for the first time achieved the double level within one quarter. Table 10 shows the outstanding credit situation including ATK in order to give more clearly the performance of credit outstanding, excluding the structural movements that could happen in the system.

Table 10. The performance of the domestic money demand

Indicators	June	September	the change in %
NDA	248,052.50	255,741.30	3.10
Claims on			
the Central Government	219,431.50	224,579.30	2.35
Monetary Authority	70,876.00	64,605.00	-8.85
Commercial Banks	148,555.50	159,974.30	7.69
Claims on			
The economy	28,621.00	31,162.00	8.88
Public Sec.	1,153.00	1,721.00	49.26
Private Sec.	27,468.00	29,441.00	7.18

Seeing closely the performance of the net domestic assets during the last year and the present developments of 2001 it is thought that, during the following months there will be an increase of the item "claims on the Central Government". The same performance is expected for the lending of the economy in comparison to the previous periods.

Chart 17: The performance of NDA compared with the program



3.6 Markets

October and the starting of November did not mark changes of the Bank of Albania operational framework, either regarding its main instruments, that is repo interest rates that remained at 7 per cent, or regarding the facility corridor applied by the Bank of Albania, which remained unchanged at 2.5% overnight facility and 6 % Lombard facility.

The banking system liquidity continues to be characterized by the prevailing of reserve requirements, on the one hand, and repo portfolio on the other hand. During September-November period, under conditions of lacking the demands for liquidity by the Government, the Bank of Albania is obliged to apply, besides weekly repo auctions, even the outright sales to withdraw excess liquidity more permanently. At end of October, the excess reserve level reached to 7.5 billion Leke as compared to 10 billion Leke it was at end of August. Currently, the sharpest issue rests upon the forecasting of liquidity level for the remaining

period, due to the expectation that the banking system budgetary deficit financing, especially for December, will be excessively increased. In this light, the attending of the level of excess liquidity in the system each day, takes special importance, with the purpose to harmonize at maximum, the effective management of free funds with the more effective functioning of the inter-banking market and with the government demands for liquidity.

3.6.1 Money Market

The total repo transactions in October resulted in 3.9 billion Leke lower than the previous month. However, at end of October, due to the decrease of participation of the Savings Bank, the cumulative amount of excess (not remunerated) reserve was increased by 7.1 billion Leke. The putting of excess liquidity of the Savings Bank (of about 2 billion Leke) for a week in succession with the Bank of Albania, in the form of overnight deposits and later on in the account of non-remunerated reserve, shows that the bank have not succeeded in making an accurate forecasting of this liquidity.

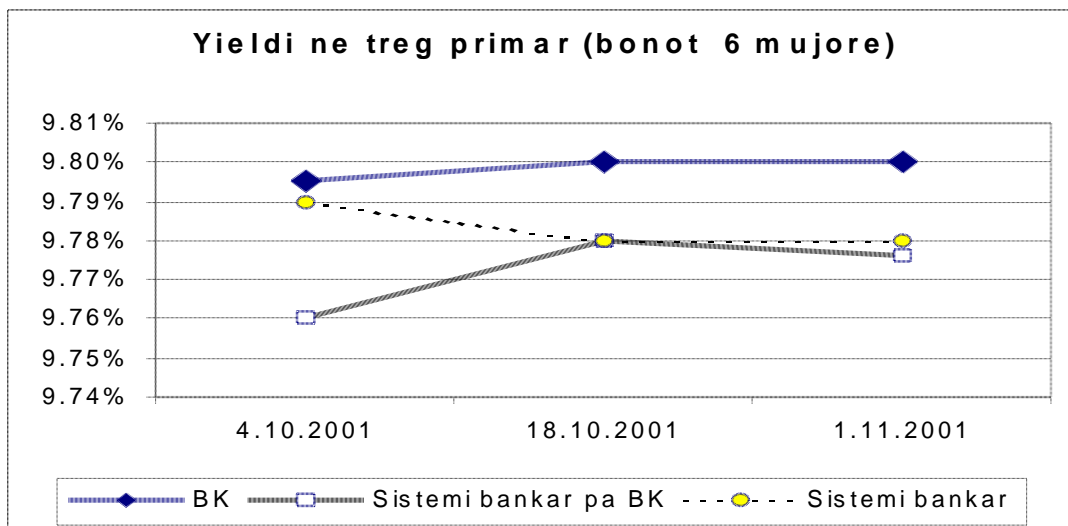
Nevertheless, we think that one factor, which makes the accurate forecasting of liquidity needs difficult is even the acquiring of information on the results of primary market in delay, that is information that is posted to the banks after the Ministry of Finances approves the primary market auction results. This makes possible that the banks might have not received the information on the primary market auction results before the closure of acceptances in repo.

Aiming at improving the liquidity management by banks and taking into account that there does not exist any space for accelerating the moment of approving the auction results by the Ministry of Finances, and starting from the experience that so-far no disapproval is provided by the Ministry of Finances on the auction results, we propose that the Bank of Albania sends to the banks the preliminary notice on the auction results, as soon as the auction results come out. It may be stated in that notice that the confirmation by the Ministry of Finances is being expected. Probably, this would assist the banks to make a more accurate forecasting of their liquidity.

3.6.2. Primary Market

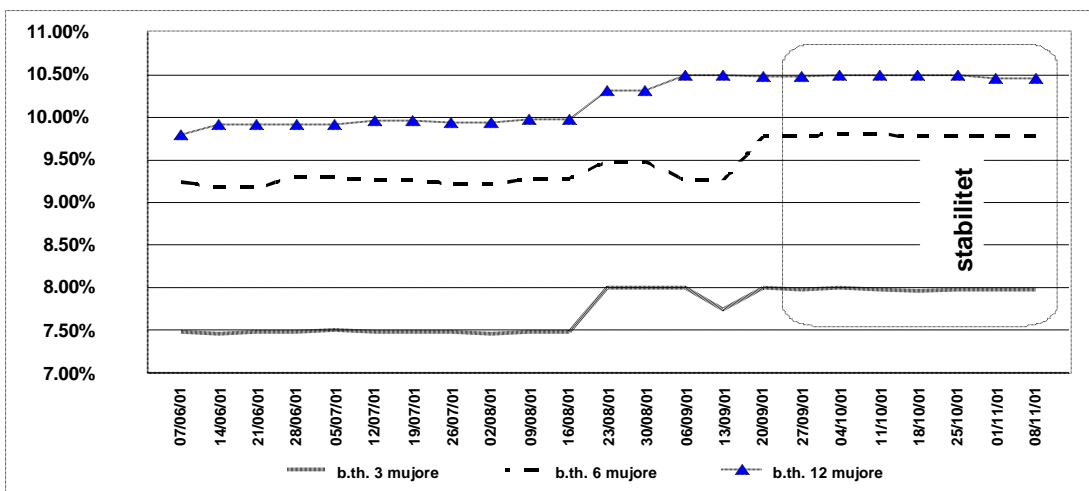
The treasury bill amount, issued in the primary market during October, was increased by 1.6 billion Leke against the previous month. The primary market, during October and the beginning of November, is generally characterized by a stability in the level of interests, having in November a slight downward tendency in twelve-month treasury bills.

Graph 18. Treasury bills yield



The Savings Bank has played an important role in determining the primary market interest rates, due to the weight this Bank occupies in the primary market. The Savings Bank continues to offer the highest interests rates in the primary market against the interests offered by other participants in this market. This bank has offered the same level of interest rates in the primary market during the whole period starting from the moment of the change of repo interests. The level of interests calculated by excluding the effect of the Savings Bank, results to be lower than the treasury bills average weighed yield.

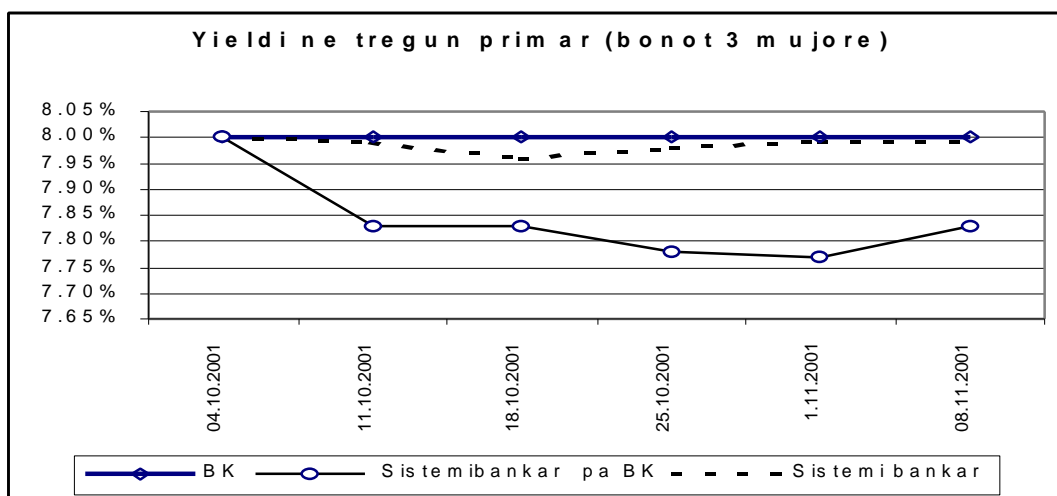
Graph 19. The treasury bills yield without the Savings Bank



SB Banking system w/o SB Banking system

Specially, a relatively low level of Savings Bank participation in purchasing twelve-month treasury bills in November is reflected in the reduction of the average weighed yield by 0.03 percentage points against the last auction of the month.

Graph 20. The treasury bills yield without the Savings Bank



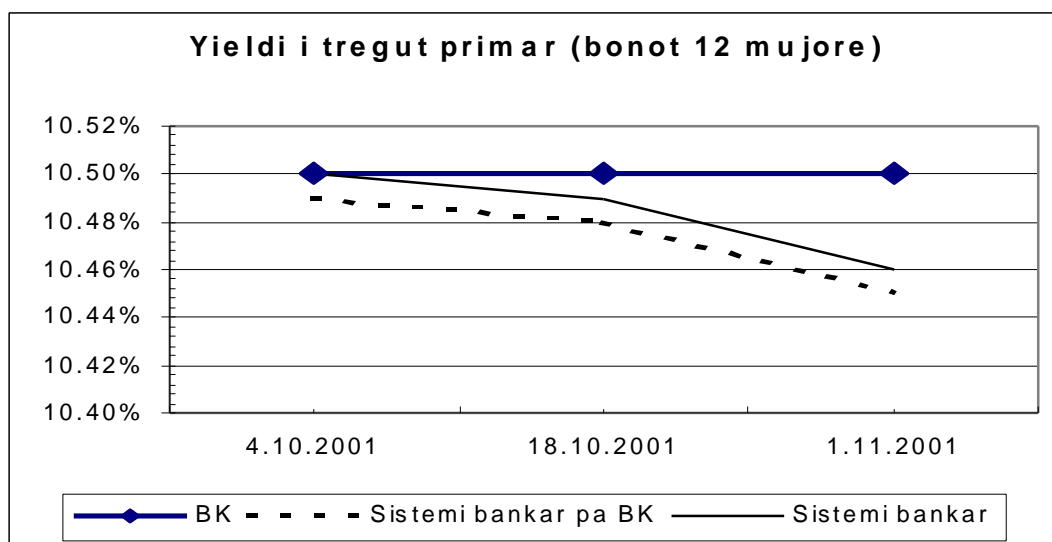
SB Banking system w/o SB Banking system

The volume of treasury bills, purchased in the primary market during October reached to 43.4 billion Leke. During October, the Savings Bank has purchased about 46 % of three-month treasury bills, 50 % of six-month treasury bills and about 80 % of twelve-month treasury bills.

3.6.3. Interbank Market

During October, the volume of transactions in interbank market reached the level of 4.6 billion Leke; hence, it is almost doubled as compared to the previous month. The number of transactions performed in interbank market was increased from 35 transactions in September to 45. The main loan-taker during October has been Alpha Bank, by around 53 % of the volume of transactions, and Tirana Bank by around 28 % of the volume of transactions performed during October. Meanwhile, the American Bank, Italian-Albanian Bank and Greek Commercial Bank have been other loan-takers in interbank market. The interests in interbank market have varied from 4,7 % to 7,5 % and the terms from 1 day to 29 days. During October, the level of overnight (cumulative) deposits was almost halved against September resulting to an amount of 16.6 billion Leke.

Graph 21. The treasury bills yield without the Savings Bank



SB Banking system w/o SB Banking system

About 57 per cent of such deposits belong to the Savings Bank and about 22 per cent belong to the National Commercial Bank.

High liquidity established in the fourth week of October, (which belonged mainly to the Savings Bank), being for a two-day term, was placed as overnight deposit with the Bank of Albania.

3.6.4. Deposits Market

In September, the average weighed level of three-month deposit interests marked an increase of 0.03 per cent in the deposits market as compared to the previous month, reaching the highest point in these four recent months. The average twelve-month deposit interest did not change against the previous month, and, furthermore, this is the highest level of interests for these four recent months. Only the average interest of six-month deposits has dropped, affected mainly by Greek National Bank, which has dropped the interests from 7.16 per cent to 6.95 per cent while other banks such as the Savings Bank, Alpha Bank, Tirana Bank, FEFAD Bank, and the First Investment Bank have increased such interests.

Table 11. Deposits interests

	3-month deposits	6-month deposits	12-month deposits
June-01	6.87 %	7.23 %	7.68 %
July-01	6.87 %	7.24 %	7.69 %
August-01	6.85 %	7.33 %	7.71 %
September-01	6.88 %	7.26 %	7.71 %

A series of Banks have increased the interest rates in 12-month deposits such as Alpha Bank, BISH, Tirana Bank, First Investment Bank, etc. Meanwhile, the interests of Savings Bank have dropped by 0.01 per cent and of Greece (Albania) Commercial Bank by 0.06 per cent making possible that the average weighed interest does not change against August.

3.6.5. CREDIT MARKET

In September we notice a reduction of **average weighed interest** of all kinds of terms in the credit market, (excluding those of 1-3 year term). This has been affected by the change of the structure of lending banks, and by the reduction of interests in FEFAD Bank for the terms from 6 months to one year.

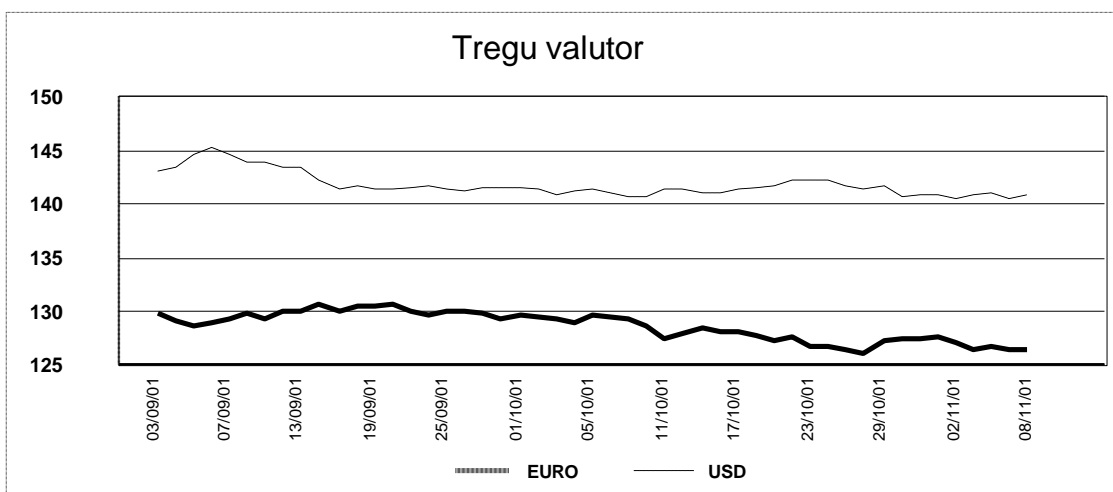
We may state that in September, signs of deposit interests increase and new credit interests reduction are noticed. This reaction, being not in the expected direction of the banking system, has to do more with the deforming of Albanian lending market, where exists, especially regarding the new credit in Leke, a close market dominated by few banks. As a consequence, their weight to the new credit of a certain month affects significantly on the average rate of the system for the new credit.

More concretely, in September, the reduction of interest rate of the new credit finds its explanation in the reduction of interest rate for the new credit by FEFAD Bank.

3.6.6 Foreign Exchange Market

We notice a gradual stability of Leke exchange rate against USD in the domestic foreign exchange market, around a level of 141 Leke/USD, whereas, Leke has had an appreciation tendency against EURO, reaching to the level of 126,43 Leke/Euro in November 8th, from 129,7 Leke/Euro it was at the beginning of October.

Graph 22. Leke exchange rate



The effects that may be effected by the converting of EU Member Countries (DEM, ITL, GRD, etc) banknotes to the new Euro banknote:

- Besides the expected flow of their increase due to the coming back of refugees in year-end period, we may expect an increase of deposits in foreign currency (DEM, ITL, and GRD) with the banks.

We also think that the changeover process to Euro banknote would make possible a further increase of deposits in foreign currency, and especially of deposits in Euro. Nevertheless, there exists the possibility that the depositors deposit part of their cash in USD deposits or in Leke, leading to the existence of pressures for depreciation of Euro during this period.

- The process of converting the foreign currency into deposits will assist in making a more accurate measurement of the level of foreign currency that circulates in domestic foreign currency market, since it will effect the recording of a part of foreign currency that circulates off the banking system.

3.7. Monetary Program for the year-end 2001

The monetary supply is increased at a higher pace than the one forecasted in the monetary program. The macroeconomic stability achieved and consolidated during the three recent years, has positively affected the expectations of economic agents, the strengthening of their confidence to the banking system and the increase of their demand for real monetary assets. The summarized indicators below present the main macroeconomic data of these recent years. The data of all sectors of economy mark significant improvements compared to 1997 and a relative stability during the following years. Hence, economy has marked a growth in real terms while the annual inflation has been low. The fiscal deficit has had a downward tendency, measured in terms of the weight to GDP and, the domestic public debt has been controlled over, influencing on the

reduction of treasury bills interest rates. Meanwhile, the increase of trade deficit, which indicates the consumption increase in economy, is covered by foreign currency inflow, making possible even the increase of Bank of Albania gross foreign currency reserves.

Table 12. Main macroeconomic indicators

	1997	1998	1999	2000	2001
Real economy indicators (in percentage points)					
GDP growth	-7	8	7.3	7.8	7.3
Annual (average)					
CPI	32.1	20.9	0.4	0	2.5
Fiscal indicators (in percentage to GDP)					
Fiscal deficit	-12.9	-10.4	-11.5	-9.3	-9.4
Domestic public debt	35.8	32.8	36.3	41.9	41.5
External sector (in USD million)					
Trade deficit	- 535	-604	-663	-814	-950
Gross foreign currency reserves	306	384	485	608	687
Monetary indicators (in percentage points)					
M3 Growth	28.5	20.7	22.3	12	15.4
Treasury bills interest rate	26	20.7	14.8	7.8	...

This is reflected in an increase of monetary supply beyond the expectations, without being accompanied by an inflation increase, which indicates that the scale of using and demanding monetary assets is being increased in Albanian economy.

Observing that monetary developments have had deviation from the forecasts made in the program, demonstrating at the same time even some tendencies not included in the assumptions of this program, the review of this program is made also for the remaining period of the year.

The main assumptions of this program, which have to do with the developments in real economy, have not changed. First, it is considered that the annual target for realizing GDP pursuant to the program forecasts will be achieved, so, this target has remained to the level of 7.3 per cent. Second, it is forecasted that the inflation rate will not move away of its average level and that is why it is computed to the level of 3 per cent. Third, noticing that the increase of monetary aggregates is not accompanied by the inflation increase, indicating clearly an increase of the demand for monetary assets of economy and a reduction of money velocity, it is assumed that this tendency will continue even for the remaining period of the year. Hence, it is assumed in the program review that the velocity of money circulation will keep on falling even during the last quarter of the year, reaching the value of 1.57 at year-end against 1.58 it was at end of September.

All this framework of assumptions leads to the forecasting of an annual increase of monetary supply to the limits of 15.4 per cent against 11.26 per cent it was in the initial forecasting. This forecasting, which comprises even the intermediate objective of the Bank of Albania monetary policy, complies with the developments in the real economy and with the Bank of Albania objective for the annual inflation level.

The reviewed composition of monetary supply included two primary inclinations, evidenced during this year and mentioned even earlier: the increase of relative weight of currency off banks and foreign currency deposits within monetary supply. Hence, the currency off banks is forecasted to reach 29.7 per cent of M3 at year-end, given even the seasonality of its increase, and especially the large increase in December. Meanwhile, starting from the continuous decrease of foreign currency deposits interest rates and the stability of such rates for deposits in Leke, the ratio of foreign currency deposits to M3 is forecasted to drop by 0.4 percentage points during the last quarter,.

The budgetary deficit financing by the banking system is forecasted to be 16.8 billion leke or 2.8 per cent of GDP. This figure is lower than the previous value of monetary program, which was 18.5 billion Leke, and it takes into account the increase of budgetary deficit domestic financing by other non-bank financial institutions and the satisfying realization of other budgetary indicators. The fiscal indicators' history encourage us to expect a significant focussing of budgetary deficit financing by the domestic resources and especially by the banking system in December.

This is because it is expected that the government expenditure be increased again in this period, as it was noticed in the previous year. In June, the increase of such expenditure was financed by the income on privatization, whereas the expenses expected to be incurred in the last quarter, which lack other income on privatization and foreign financing, will be financed by the banking system. This seems as the most possible scenario if we take into account even the Ministry of Finances demand for transferring a part of its income on the profit of the Bank of Albania for the year 2001 to the coming year. The domestic financing of the deficit, which will be effected through the treasury bills issue, may lead to the increase of treasury bills yield, affecting even the increase of interest rates of deposits in Leke, considering the orienting role that the treasury bills interest rates play in Albanian banking market.

The other component of domestic credit, credit to the private sector of economy is forecasted to increase by 1.4 billion Leke during the last quarter. In this way, the annual increase of credit to economy is forecasted to be 6.7 billion leke. It should be pointed out that the effect of transferring the Savings Bank's bad credit is excluded from the computation of such changes in the balance sheet of the Agency of Treating the Loans, something that causes even non-compliance.

During the fourth quarter, the increase of the currency off banks to M3, will be accompanied by the reduction of the value of multiplier and a lower relative increase of monetary base against the increase of monetary supply during the fourth quarter. The annual increase of monetary base is forecasted to be 11.4 per cent at year-end.

In view of the Bank of Albania balance sheet asset, during the last quarter, the level of Bank of Albania gross foreign currency reserves is expected to have a slight decrease, whereas the Bank of Albania interventions are expected to depend largely on the presence of speculative elements that may accompany the introduction of Euro in Albanian market.

Pursuant to the current framework of monetary policy, the budgetary deficit financing by the Bank of Albania is in the function of operational objectives of Bank of Albania net domestic assets level (monetary base) and budgetary deficit domestic financing. Due to this reason, it may be an important instrument in manipulating and determining the general conditions of the banking system liquidity. However, given the current levels of monetary indicators, especially the banking system excess reserves and the Bank of Albania efforts for their reduction, we deem that the Bank of Albania may keep a withdrawn position in the treasury bills primary auctions to create more possibilities to commercial banks to invest their funds. In relative terms, this would be expressed in a net financing of budgetary deficit lower than the limit of 5 per cent permitted by law. (5.4 billion leke).

The forecasts of monetary indicators for the year-end 2001 are also established depending on these assumptions. The following table presents such indicators in a summarized manner.⁷

Monetary Indicators (in billions of Lekë)	September 2001	December 2001	Annual growth	Annual growth in %
M3	362.5	378.6	50.5	15.4
CoB	106.2	112.5	13.3	13.4
Lek deposits	177.8	185.9	20.6	12.5
Foreign currency deposits	78.4	80.3	16.7	26.1
M1	129.1	136.1	12.7	10.2
M2	284.1	298.4	33.9	12.8
NFA	153.6	154.5	23.7	18.1
Bank of Albania	84.7	85.0	13.2	18.3
Commercial Banks	69.0	69.5	10.5	17.9
NDA	208.8	224.2	26.9	13.6
Claims of government	217.2	232.1	16.8	7.8
Credit to economy ⁸	22.5	23.9	0.6	5.0

⁷ The whole table of the Bank of Albania Monetary Program for 2001 will be attached to this material.

⁸ This figure includes the transfer of 6.1 billion Lek to BART. In case this transfer would not have happened, the annual growth of credit would be 28.4 per cent.

Responding to new monetary developments and new forecasts for their indicators, even in agreement with IMF mission, the Bank of Albania quantitative has also reviewed the objectives within the framework of the new agreement signed with the international financial bodies.

	September 2001 (current)	December 2001 (objective)	December 2001 (growth – objective)
1. The ceiling for the Bank of Albania net domestic assets (billion leke)	61.6	72.2	8
2. The ceiling for net credit to Government (billion leke)	217.2	239.7	19
3. Floor for the Bank of Albania net international reserves (USD million)	498.8	483.9	7

Starting from the forecasts made for the performance of monetary indicators during year-end 2001, it is deemed that these objectives are achievable.