

**BANK OF ALBANIA**

**MONETARY POLICY REPORT  
OCTOBER 2004**

**NOVEMBER 2004**

## Table of contents

<b>I.</b>	<b>Main highlights of the month</b>	<b>3</b>
<b>II.</b>	<b>Inflation performance in October</b>	<b>4</b>
II.1	Inflation and constituent groups performance	4
II.2	Macroeconomic environment and consumer prices	6
<b>III.</b>	<b>Monetary developments and demand for money</b>	<b>8</b>
III.1	Bank of Albania monetary policy	8
III.2	Monetary aggregates performance	9
III.3	Economy demand for money	11
III.3.1	Net foreign assets	11
III.3.2	Government demand for money	11
III.3.3	Banking system credit to economy	12
<b>IV.</b>	<b>Money market and interest rates</b>	<b>14</b>
IV.1	Liquidity performance	14
IV.2	Interest rate performance	14
IV.3	Exchange Rate	17

## I. MAIN HIGHLIGHTS OF THE MONTH

Annual inflation marked 2.0 per cent in October, thus being within the Bank of Albania target. The average annual inflation marked 3.1 per cent. The monthly inflation of October was 0.23 per cent.

The demand factors did not exert inflationary pressures during October. The effect of seasonal foodstuff price cut continued to be present, balancing the annual inflation caused by the price rise of electrical power at the beginning of this year.

The international oil price rise did not impact significantly on inflation, mainly because of the lek appreciation against the American dollar and the euro.

The Bank of Albania, pursuant to its monetary policy, cut the base interest rate by 0.25 percentage points in November 11<sup>th</sup>. The easing policy pursued by the Bank of Albania has brought about further reduction of lek deposits interest rates, primary and interbank market. Generally, during 2004, a rapid response of banks to monetary policy signals is noticed.

The annual growth of money supply was stabilized at the level of 9.9 per cent in September, after the acceleration marked during the summer months. During September lek deposits gave the main contribution to money supply growth.

Foreign exchange position of the banking system was improved during September, when an increase by 31.5 million dollars was marked in net foreign assets.

Budget deficit was totally covered by domestic financing during September. The banking system continued to finance the government by purchasing treasury bills and government bonds.

Credit to economy has marked satisfactory rise along the year, while a shifting of the portfolio is noticed towards longer maturity terms. However, the rise of credit balance to economy marked a slowdown in September, partly influenced even by the exchange rate effect.

Meanwhile, the exchange rate of the lek against the euro during September-October has been generally stable, on average 125.4 lek/euro. The lek has been appreciating against the American dollar, reflecting the depreciation of the American dollar in international markets.

## II. INFLATION PERFORMANCE IN OCTOBER

### II.1 INFLATION AND CONSTITUENT GROUPS PERFORMANCE

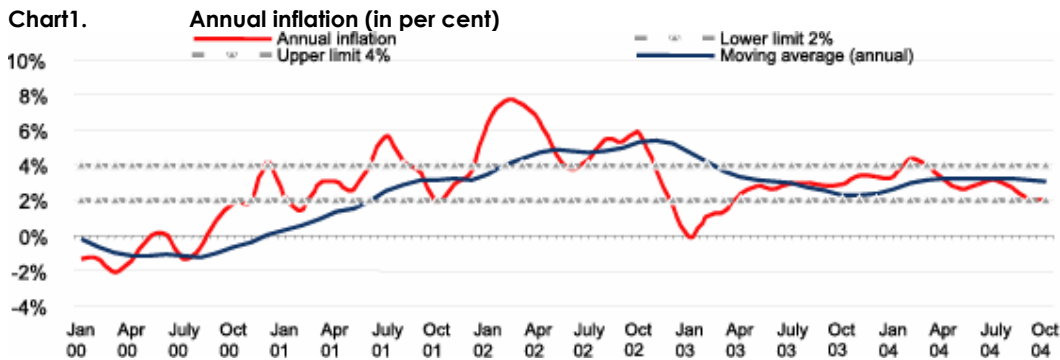
Annual inflation rate of October 2004 resulted to 2.0 per cent, being within the targeted band of 2 - 4 per cent. Meanwhile, the average annual inflation remained at the same level with the previous month, 3.1 per cent. Positive developments in consumer prices continued to be supported by favourable macroeconomic situation and prudential monetary and fiscal policy.

**Table 1. Annual inflation rate (in per cent).**

	2000	2001	2002	2003	2004
January	-1.3	2.2	6.5	0.0	3.3
February	-1.3	1.5	7.6	1.1	4.4
March	-2.1	2.9	7.5	1.3	4.0
April	-1.4	3.0	6.5	2.3	3.2
May	-0.1	2.5	4.6	2.8	2.6
June	0.1	4.0	3.7	2.6	2.9
July	-1.3	5.6	4.2	3.0	3.1
August	-0.7	4.1	5.5	3.0	2.7
September	0.9	3.5	5.3	2.8	2.0
October	1.8	1.8	5.8	2.9	2.0
November	1.9	2.8	3.7	3.4	
December	4.2	3.5	1.7	3.3	
Average	0.1	3.1	5.2	2.2	3.1

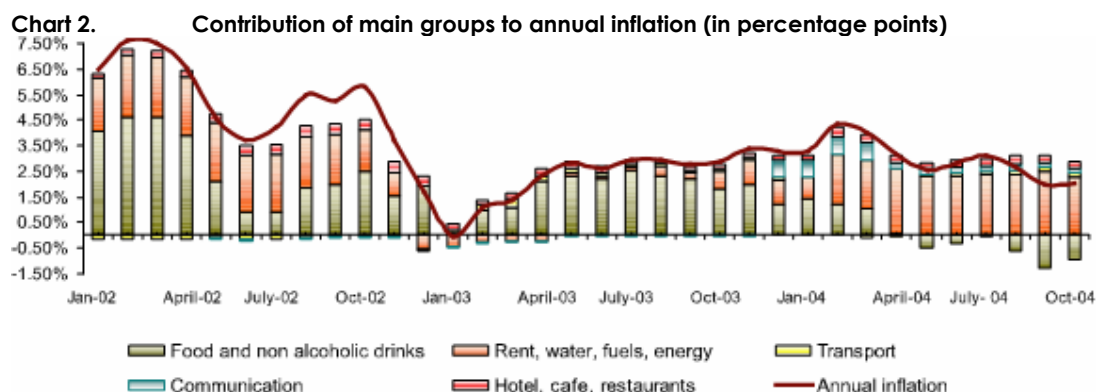
Source: INSTAT.

The large agricultural production of this year has brought foodstuff price cut and has determined, to a certain extent, even the falling annual inflation performance, since May 2004. In accordance with the seasonal performance, the monthly inflation marked a positive rate of 0.23 per cent in October, but it was lower than the 2.8 per cent monthly inflation rate of October 2003.



During October, an annual growth was recorded in the prices of almost all the consumer basket groups, with the exception of "Food and non-alcoholic drinks" group. The largest growth and contribution to annual inflation rate is given by "Rent, water, fuels and energy", which appeared as the group of highest annual inflation since February of this year, immediately after the managed price rise of energy. This group contributed by 2.24

percentage points to annual inflation rate during October. The effect of electrical energy price rise is expected to be significant, at least until first quarter of 2005.



The significant contribution of the inflation of “Rent, water, fuels and energy” group to annual inflation is balanced by the price cut of the group “Food and non-alcoholic drinks”. The foodstuff group has reflected significant price cut since May of this year. The price cut of agricultural goods, which is also felt during October, is an indicator of a large agricultural production. The negative annual inflation rate of “Food and non-alcoholic drinks” group by – 2.2 per cent has reduced the annual inflation rate by about 1 percentage point. The monthly growth of foodstuff prices has been rather slight (0.3 per cent). The annual inflation of this group has marked a turning point in the trend in comparison to October of the previous year when annual inflation marked 4.3 per cent. The reason behind this decline is mainly the price cut of seasonal products, such as fruits and vegetables.

**Table 2. Monthly and annual rate of “Food and alcoholic drinks”.**

	"Food and non-alcoholic drinks"		"Fruits" subgroup		"Vegetables" subgroup	
	Monthly	Annual	Monthly	Annual	Monthly	Annual
October '04	0.3	-2.2	-1.3	-1.2	3.4	-18.1
October '03	-0.5	4.3	3.1	24.8	-6.1	14.6

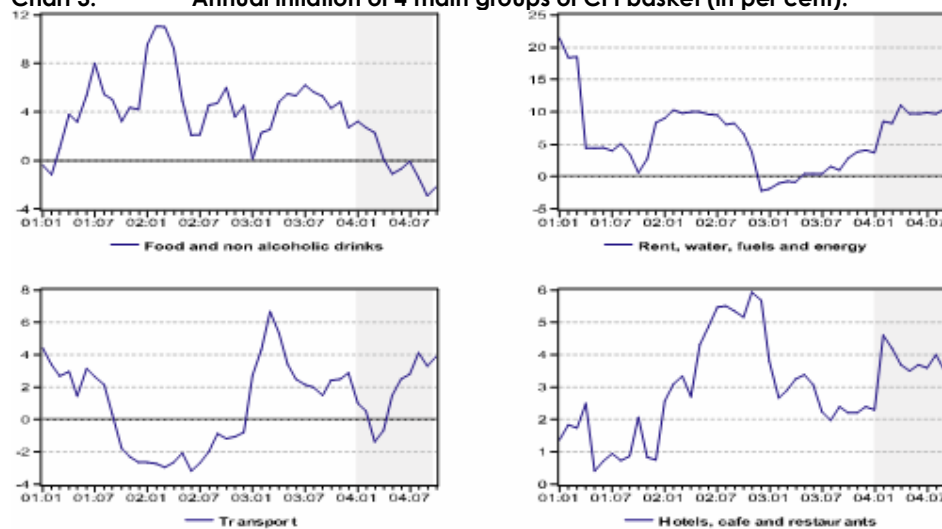
The risk of oil price rise in the country and the conveying of such rise to the cost of other goods were not evidenced even in the developments of this month. The rise of inflation of “Transport” group to 3.9 per cent provided a modest contribution by only 0.2 percentage point to annual inflation. The impact of this group remains weak, not only because of the small weight if this group in the CPI basket, but also because of the appreciation of our currency against the dollar<sup>1</sup> (currency in which oil is imported). This has made possible that oil price rise in dollars be transmitted only partially to the price expressed in lek.

Other groups such as “Educational service” (11.4%)<sup>2</sup>, “Hotels, cafe, restaurants” (3.6%), “Communication” (15.5%)<sup>2</sup> and “Clothes and shoes” (-2.0%)<sup>2</sup> provided a contribution of 0.5 percentage points to annual inflation rate of October.

<sup>1</sup> In October our currency was appreciated against the dollar by 1.8 per cent compared to September and by 13.5 per cent compared to October of the previous year.

<sup>2</sup> Figures in brackets show the annual inflation of the relevant group for October.

**Chart 3. Annual inflation of 4 main groups of CPI basket (in per cent).**



## II.2 MACROECONOMIC ENVIRONMENT AND CONSUMER PRICES

The annual inflation has rested within the 2 – 4 per cent targeted band by the Bank of Albania for the sixth month in succession. The satisfying of needs for foodstuffs from domestic supply was associated by reduction of imports<sup>3</sup> of these products (expressed in lek), reducing the impact of the imported inflation to country's inflation. Furthermore, the main partner countries in foreign trade have marked moderate inflation rates.

**Table 3. Annual inflation of main partner countries (in percentage)**

	February	March	April	May	June	July	August	September
Greece	2.6	2.9	3.1	3.1	3.0	3.1	2.8	2.9
Italy	2.4	2.3	2.3	2.3	2.4	2.2	2.4	2.1

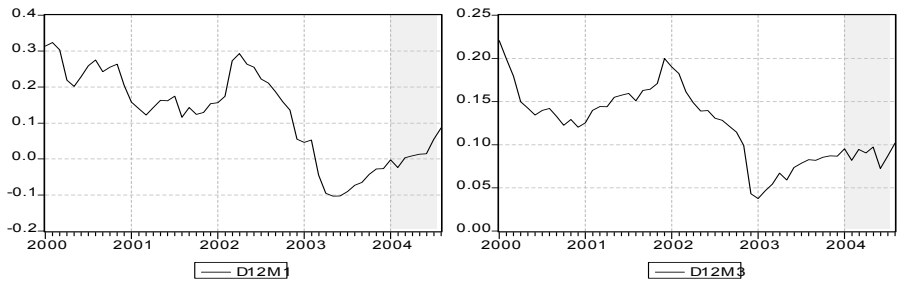
Source: Eurostat News Release.

On the other hand, the lek has gained points against the euro and dollar at the beginning of the fourth quarter. During September - October, the lek appreciated against the euro and dollar respectively by 8.0 and 14.0 per cent. The appreciating tendency of the lek has served as a smoothing of inflationary pressures that come from imported inflation of consumer goods (including oil).

The Bank of Albania has created a suitable monetary environment for controlling inflation. Though the monetary policy has maintained its smoothing trend, the continuous decreases of interest rates do not seem to have impacted on macroeconomic equilibrium. The satisfactory liquidity situation, annual growth rate of M1 below historical levels, return of money outside banks to the system and in consequence, growth of deposits in lek are positive indicators of a favourable monetary policy for maintaining inflation rate within the targeted band.

<sup>3</sup> During the first half of 2004.

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



Fiscal indicators have observed the programmed levels. Until end of September, the government has shown care towards budget expenditures, realising 90.5 per cent of the planned expenditures for the nine-month period of 2004. The care shown in this direction has led to lack of inflationary pressures over the third quarter and over the current month.

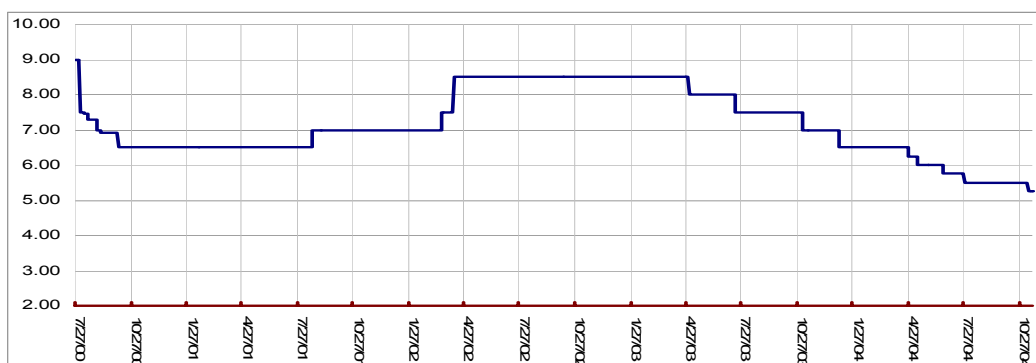
### III. MONETARY DEVELOPMENTS AND DEMAND FOR MONEY

#### III.1 BANK OF ALBANIA MONETARY POLICY

The constant improvements of macroeconomic stability and stable monetary conditions have enabled the pursuing of an easing monetary policy during two recent years. The economic growth has followed the projected performance, while inflation has been moderate, maintaining positive real interest rates. The level of real interest rates has contributed to maintaining monetary equilibrium and to ensuring a stable liquidity position in the system. Under such conditions, the easing monetary policy has intended further encouragement of economic activity through reducing the borrowing cost and through smoothing the appreciating pressures of the lek exchange rate. The continuous base interest rate cut is associated with interest rate reduction of deposits, loans and treasury bills in lek.

The third quarter of the year was featured by low inflationary pressures and a relatively quiet liquidity situation in interbank market. In compliance with seasonal expectations, the agricultural production and foreign currency inflows marked significant rise during this period. These factors impacted on further reduction of inflationary pressures over this quarter. Therefore, the inflation declined during three last months, reaching the lower limit of the Bank of Albania target. On the other hand, the rise of foreign currency supply in the market and the reduction of demand for it due to decline of imports increased the pressures for the lek appreciation. Continuously following the performance of inflation and monetary conditions, the Bank of Albania undertook another base interest rate cut on November 11<sup>th</sup>. This reduction, being the fifth during 2004, has descended the base interest rate, from 8.5 per cent during the second half of 2002 to 5.25 per cent.

**Chart 5. Performance of base interest rate**



The Bank of Albania has been present in the foreign exchange market during August, in the direction of purchasing foreign currency, by injecting liquidity and by compensating the low demand for foreign currency. The smoothing of appreciating pressures in the coming month has not made necessary the presence of the Bank of Albania in this market.

The Bank of Albania has continued to withdraw liquidity from the system, by using the instrument of repurchase agreements during this period. Also, it has observed its quantitative objectives in the framework of PRGF agreement.

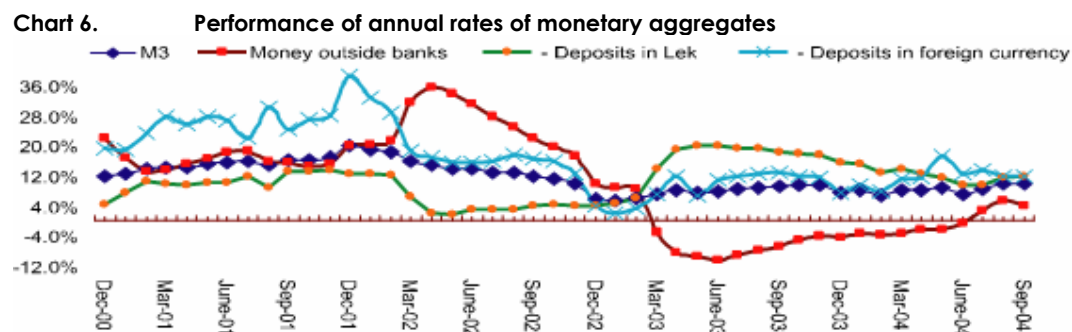


**Table 4. Realisation of quantitative objectives of the Bank of Albania**

	December '03	March 04	June 04	August '04	September '04
<b>Net international reserve (in million dollars)</b>					
Objective	715.8	751.8	765.8	871.1	923.7
Actual	832.7	827.6	961.5	1041.9	1043.6
Difference	116.8	75.8	195.7	170.9	119.9
<b>Net domestic assets (in billion lek)</b>					
Objective	96.0	83.0	85.0	75.0	70.0
Actual	72.0	66.4	54.7	59.5	55.4
Difference	-24.0	-16.6	-30.3	-15.5	-14.5
<b>Net domestic credit to government (in billion lek)</b>					
Objective	280.9	272.8	270.1	276.1	279.1
Actual	266.8	272.6	263.6	268.3	272.0
Difference	0.0	-0.2	-6.5	-7.8	-7.1

### III.2 MONETARY AGGREGATES PERFORMANCE

Acceleration of money supply growth during summer is followed by its stabilisation in September. The annual rate of the growth of M3 aggregate resulted in 9.9 per cent, remaining almost unchanged from the level of the previous year. This performance has reflected the stable demand of government and of economy for money and the non-intervention of the Bank of Albania in the foreign exchange market, while the lek appreciation has impacted negatively on the growth of deposits in foreign currency. Money outside banks has continued its return into the system at satisfactory paces, assisting in the growth of deposits in lek and the shifting of the time structure of money supply towards less liquid assets.

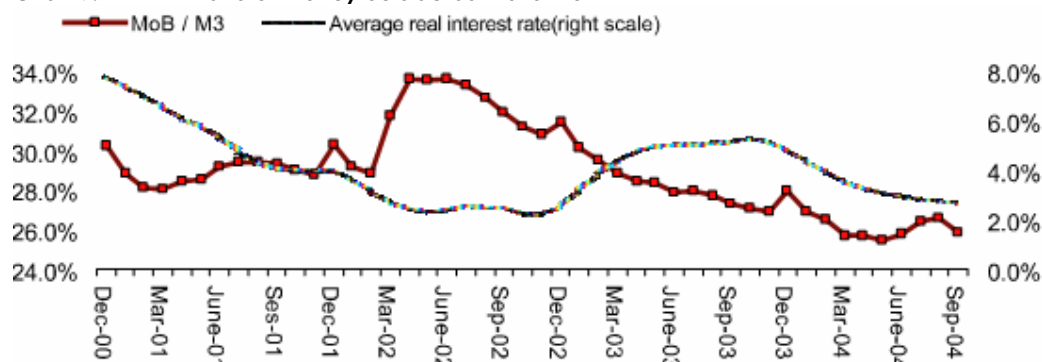


Money supply during September marked a growth of 2.5 billion lek or about 0.5 per cent. The main contribution to this growth was given by deposits in lek, which have undergone a monthly growth of 4.3 billion lek, while the level of money outside banks has been reduced by 2.6 billion lek. Deposits in foreign currency are presented by a growth of 0.8 billion lek.

Reduction of the demand for cash once the summer ended is associated with its fast return into the system. This return is supported by satisfactory levels of real interest rates for deposits in lek, due to inflation rate decline. The ratio of money outside banks to money supply in September dropped to 25.9 per cent, marking a reduction of 0.7 percentage points compared to the previous month. After the upward performance of money outside banks during the recent months, the annual growth rate of this indicator in September marked a reduction, dropping to 4.1 per cent, from 5.5 per cent it was in August. This performance of it

has determined even the slow-down of the growth of annual rate of M1 aggregate, which resulted unchanged at the level of 8.8 per cent, remaining under historical levels.

**Chart 7. Ratio of money outside banks to M3**



Annual rate of the growth of deposits in lek reached to 12.1 per cent, from 11.5 it was a month ago, being in compliance with the growing tendency of recent months. Their growth has been mainly in the form of demand deposits in lek, which in September marked a rise of 2.7 billion lek. Annual rates of the growth of time deposits in lek are presented as stable and at satisfactory levels. Though the spread between interest rates in lek and those in foreign currency has been slightly downward, the rise of confidence in domestic currency has continued to favour lek investment instruments. The presence of this factor is noticed even in the rise of interest to invest in treasury bills by individuals, whose portfolio was increased by 0.8 billion lek only in September.

The annual growth rate of deposits in foreign currency in September resulted to 12.1 per cent, being in line with annual rates of this indicator that appeared in the recent months. Appreciation of the lek against the American dollar during September has impacted negatively on the growth of deposits in foreign currency, by about 1.8 billion lek. In absence of the negative effect of annual appreciation of the exchange rate, whose effect is estimated at about 13.9 billion lek, the annual rate of the growth of deposits in foreign currency would be stable, at 25.5 per cent. The performance of the time frame of deposits in foreign currency presents a shifting towards time deposits, reflecting the gradual growth of interests for time deposits in US\$ during recent months. In September, the ratio of deposits in foreign currency to money supply reached to 23.7 per cent. This level marks a slight growth against the previous month and complies with the long-term upward trend of this indicator.

**Table 5. Performance of monetary indicators in September (in billions of Lek).**

	September 2004	Monthly change		Annual change	
		Absolute	Percentage	Absolute	Percentage
Money outside banks	126.2	-2.6	-2.0	4.9	4.1
Total deposits	361.3	5.1	1.4	39.0	12.1
- in lek	245.6	4.3	1.8	26.5	12.1
- in foreign currency	115.8	0.8	0.7	12.5	12.1
Demand deposits	72.4	1.6	2.3	11.4	18.7
- in lek	27.8	2.7	10.8	7.5	37.1
- in foreign currency	44.6	-1.1	-2.4	3.9	9.6
Time deposits	288.9	3.5	1.2	27.6	10.5
- in lek	217.8	1.6	0.7	19.0	9.5
- in foreign currency	71.2	1.9	2.7	8.6	13.7

M1	154.0	0.1	0.1	12.4	8.8
M2	371.8	1.7	0.5	31.4	9.2
M3	487.6	2.5	0.5	43.9	9.9
Base money	166.5	-3.9	-2.3	9.3	5.9

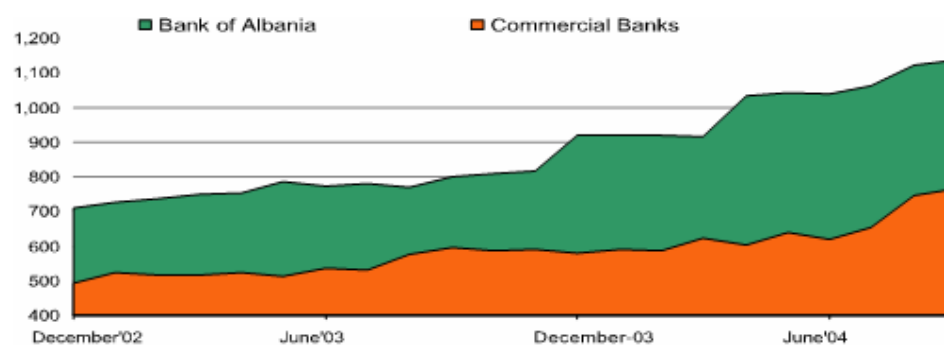
### III.3 MONEY DEMAND OF THE ECONOMY

#### III.3.1 Net foreign assets

September was characterized by an improved foreign position of the banking system. During this month net foreign assets grew by USD 31.5 million. The growth of net foreign assets would be USD 14 million if excluding the exchange rate impact. Net foreign assets growth has contributed by 63.3 per cent to the increase of M3 aggregate in September.

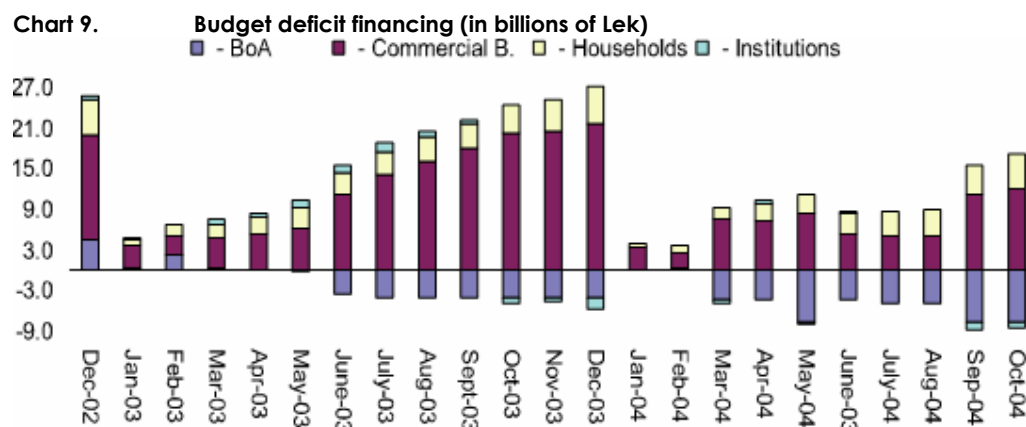
The major contribution to the net foreign assets growth of the banking system has been given by commercial banks. The growth of foreign currency deposits was higher than the demand of the economy for loans in foreign currency during September. Hence, net foreign assets of the commercial banks grew by USD 17 million. The Bank of Albania continued to further increase the net foreign reserve level. The net foreign reserve increased by USD 14.4 million in September, mainly due to Euro appreciation by 1.9 per cent against US dollar in the international market. Hence, this appreciation raised the investments value in Euro denominated in US dollar. The growth of net foreign assets of the Bank of Albania is estimated at USD 3.5 million, if excluding the exchange rate impact. The presence of the Bank of Albania in the foreign market regarding foreign currency purchase has impacted as well the foreign reserve increase.

**Chart 8. Banking system foreign assets (in millions of USD)**



#### III.3.2 Money demand of the government

Government demand for monetary assets raised in September. Budget deficit grew by Lek 2 billion compared to the previous year, reaching the amount of Lek 13.7 billion.



The domestic financing, about LEK 2.9 billion, has completely covered the Government demand for this month. The banking system continued to finance the Government through purchasing T-bills and government bonds. Unlike the previous quarter, the commercial banks have grown their T-bills portfolio, which is estimated at Lek 4.6 billion. Institutions continued to reduce their T-bills portfolio (1 billion Lek), while Bank of Albania and households have slightly increased their portfolio. LEK 1 billion government bonds were issued in September. Even during this month, part of the Savings Bank privatization revenues, about 0.1 billion Lek, are deposited to the Government account.

### III.3.3 Credit to the economy by the banking system

Positive developments were marked in respect of lending activity during 2004. Credit to the economy was characterized by a satisfactory growth, while a displacement of the portfolio towards longer maturity terms was noted throughout the year. However, credit balance growth for the economy was characterized by slowness in September, partially due to the exchange rate impact. Credit balance remained in September at the same level with the previous month, Lek 60.9 billion. The growth of credit balance remained Lek 10.2 billion, representing about 87 per cent of the growth projected according to the monetary program. The monthly credit balance growth would be Lek 0.75 billion, if excluding Lek appreciation against foreign currencies. This appreciation provides a negative impact of Lek 3.1 billion on the credit growth during 2004.

**Table 6. Main indicators performance <sup>4</sup>**

	2002	2003	2004				
			Q-1	Q-2	July	August	Sept.
Money supply (in billions of Lek)	416.7	448.4	456.0	458.2	469.9	485.1	487.6
Domestic credit (as % of M3)	70.8	71.5	71.6	69.5	69.1	66.9	67.4
- Loans to the Government (as % of M3)	61.5	60.2	59.9	57.1	56.3	54.3	54.8
- Credit to economy (as % of M3)	9.3	11.3	11.7	12.4	12.8	12.6	12.6
Credit to economy (as % of total assets)	11.5	13.7	13.7	14.6	15.1	15.0	14.7
Credit to economy (as % of GDP)	5.7	6.8	7.0	7.4	7.2	7.3	7.3
Total deposits (in % to GDP)	42.2	43.4	44.1	44.1	41.3	42.6	44.4
Ratio of loans/deposits Credit/deposits ratio (in %)	13.5	15.7	15.8	16.7	17.4	17.1	16.9

<sup>4</sup> This ratio is established against GDP on an annual basis for 2004.

Referring to maturity terms, the credit structure suggests a further increase of the mid-term and long-term credit weight regarding the total credit during September. This growth should be considered as a positive development, since it better supplies the country's needs for performing and enhancing productive capacities. On the other hand, Lek credit also has known a growth against the total credit, though remaining at modest rates.

**Table 7. Credit balance indicators (in percentage)**

	2002	2003	Q-1 '04	Q-2' 04	July '04	August '04	September'04
<b>Credit balance (in billions of Lek )</b>	<b>38.7</b>	<b>50.7</b>	<b>53.4</b>	<b>56.8</b>	<b>60.0</b>	<b>60.9</b>	<b>60.9</b>
Short-term loans	53.8	46.0	41.6	35.4	35.6	35.0	34.0
Medium-term loans	30.1	33.3	35.4	37.8	37.4	38.0	37.0
Long-term credit	16.1	20.7	23.0	26.8	27.0	27.0	29.0
LEK	21.3	19.6	17.0	17.0	16.0	16.0	17.0
Foreign currency	73.7	80.4	83.0	83.0	84.0	84.0	83.0

During September new loans of Lek 5.7 billion, or about 25 per cent more than the last month, were extended. The new credit extended over the first 9-month period of the year was Lek 74.3 billion, being 17 per cent higher than the same period of the previous year. In general, the extension of the new credit is characterized by upward tendencies from a month to another, either on a monthly basis or in a cumulative form, compared to the preceding year.

Medium-term and long-term loans represent 42 per cent of the new extended credit during September. This month was characterized by a positive progress regarding the foreign currency structure of the new extended loan. The new loan in Lek covered 39 per cent of the new total credit, resulting 6 percentage points higher than the last month and much higher compared to the historical rates of 25 per cent.

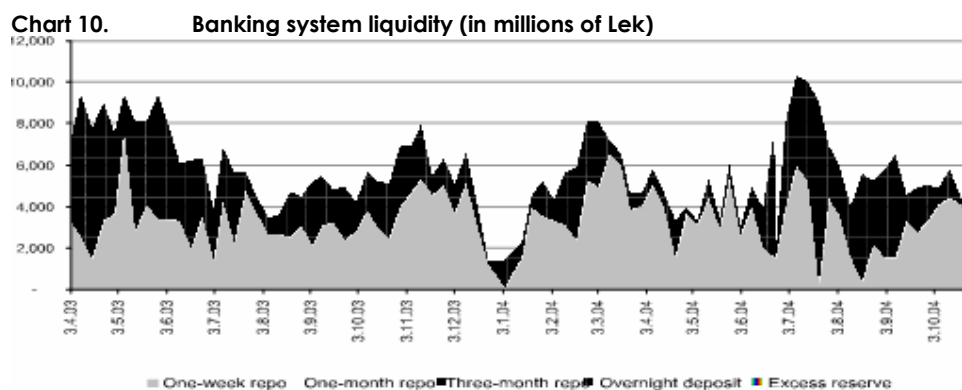
**Table 8. New credit over the years (in billions of Lek)**

	2002	2003	Q1 '04	Q-2'04	Q-3 '04
New loans (in billions of Lek)	62.6	92.6	27.9	28.5	18.0
Short-term loans	44.7	63.1	18.7	18.1	10.9
Medium-term loans	13.0	22.2	5.7	6.8	3.9
Long-term loans	4.8	7.4	3.5	3.6	3.1
LEK	20.8	30.8	8.80	8.9	6.0
Foreign currency	41.8	61.8	19.10	19.6	12.0

## IV. MONEY MARKET AND INTEREST RATES

### IV.1 LIQUIDITY

October was characterized by excess liquidity at a stable rate for the banking system. The average liquidity level marked Lek 4.3 billion, resulting Lek 1 billion under the average level of September. Banking system liquidity performance was mainly influenced by Government rising demand for the financing of the budget deficit in October.



The Bank of Albania employed the instrument of one-week Repo at a fixed price to withdraw the excess liquidity. The invested Repo amount resulted on the average Lek 3.9 billion in October, or Lek 1.4 billion more than the previous month. The highest liquidity level marked in September was reflected in the overnight deposits growth due to the Repo auctions performance at limited amount.

The withdrawn liquidity through overnight deposit resulted to be at lower levels in October compared to the previous month. In overnight deposits, on the average Lek 0.4 billion were invested, or Lek 1.5 billion less than the previous month. The overnight credit is granted at an average of Lek 0.66 billion. Liquidity demand resulted from specific banks' behaviour, while inter-bank market activity expanded. The average daily volume of transactions in October recorded Lek 0.3 billion more than in September.

Government demand for financing is afforded by banks and households. Banks' supply to invest in T-bills was higher than the Government demand, being mainly concentrated on 6-month and 12-month T-bills. This led to the increase of competitiveness and the reduction of respective yields.

### IV.2 INTEREST RATES PERFORMANCE

The easing policy followed by the Bank of Albania brought about the further reduction of Lek deposit interests, either in the primary or inter-bank market. Interest rates are expected to further fall, following the key interest rate cut in the beginning of November. The weighted average interests of 3, 6 and 12-month Lek deposits resulted 4.83 per cent, 5.79 per cent and 6.26 per cent, respectively.

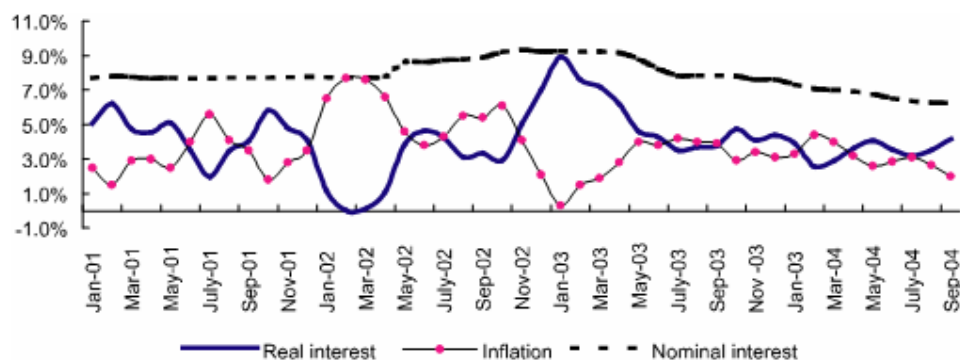
**Table 9. Banking system reaction on the monetary policy over 2004 (in percentage points)**

	30/12-28/04	28/4-25/06	25/06-28/07	28/07-29/10	29/10-11/11	Total
<b>Base interest rate cut</b>	<b>-0.25</b>	<b>-0.25</b>	<b>-0.25</b>	<b>-0.25</b>	<b>-0.25</b>	<b>-1.25</b>
<b>Lek deposits</b>						
3-month	-0.43	-0.31	-0.02	-0.20	-0.09	<b>-1.05</b>
6-month	-0.53	-0.51	-0.02	-0.51	-0.04	<b>-1.61</b>
12-month	-0.50	-0.58	0.00	-0.49	-0.04	<b>-1.61</b>
<b>T-bills yield</b>						
3-month	-0.30	-0.26	0.02	-0.47	-0.16	<b>-1.17</b>
6-month	-0.4	-0.17	-0.08	-0.78	-0.03	<b>-1.46</b>
12-month	-0.3	-0.22	-0.1	-0.63	-0.13	<b>-1.38</b>

According to the operating data.

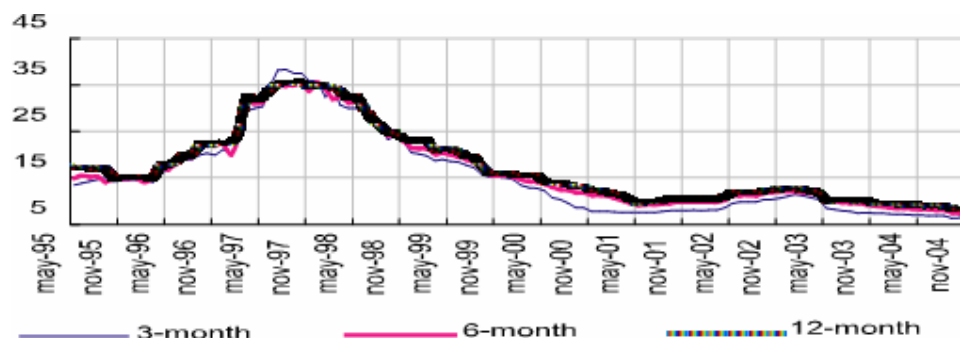
Following the cut of the base interest rate, the first reactions of banks on Lek deposit interests reduction emerged, and this is expected to be reflected in the following days. The most significant reduction of interest rates is noted for the 6-month and 12-month deposits, reflecting to some extent the market expectations for further reductions. Independently of this trend, the real interest rate of Lek deposits increased due to the low inflation rate, thus raising the value of depositors' savings.

**Chart 11. Real and nominal interest rates of 12-month time deposits in Lek**



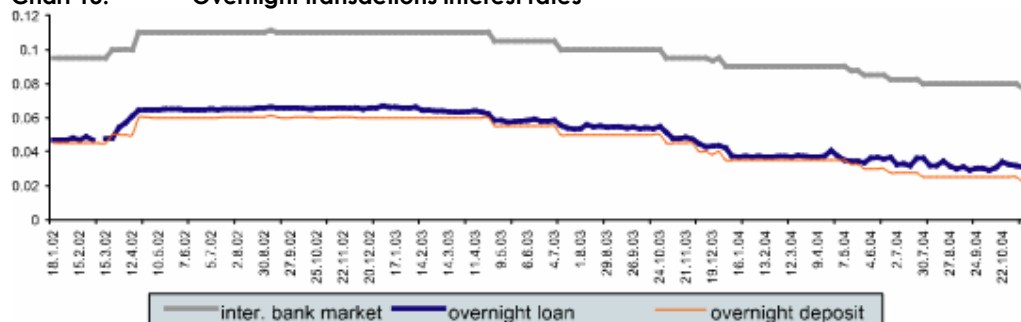
The low T-bills yield rates have impacted the reduction of Government domestic debt cost. In the primary market, the weighted average yield of 3, 6 and 12-month T-bills dropped to 6.21 per cent, 7.28 per cent and 8.14 per cent, respectively. Independently of the different reaction in time and magnitude, a stability of the spread between the T-bills yield and Lek deposits interest rate was noted, especially following the first quarter of 2003.

**Chart 12. Performance of T-bills yield**



The inter-bank market is characterized by interest rate fluctuations, but the general trend was a falling one at the end of October. The transactions interest rates, as for overnight and one-week transactions, reached 2.96 per cent and 5.78 per cent, respectively, in the first week of November.

**Chart 13. Overnight transactions interest rates**



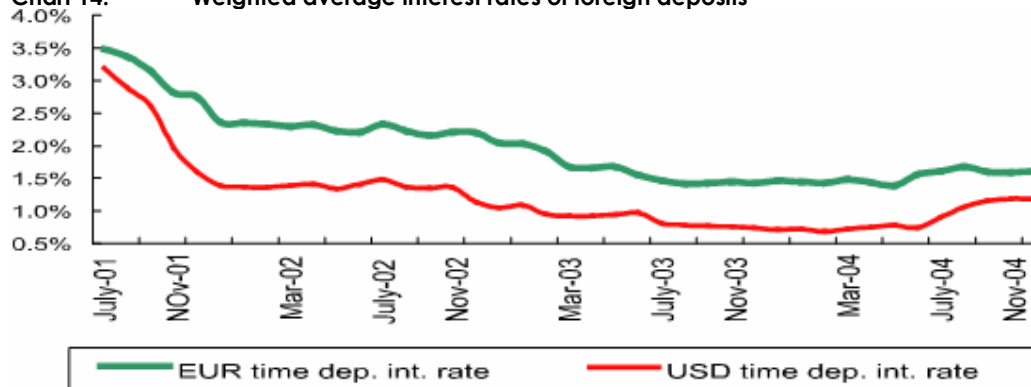
Lek credit interest rates declined for all the maturity terms in September compared to the previous month, reacting on the same target with the monetary policy expectations.

**Table 10. Lek credit interest rates (in percentage)**

Credit	August-04	September-04	Difference
0 – 6-month	11.27	11.20	-0.07
6-month – 1 year	18.57	15.02	-3.55
1-3 years	22.97	22.29	-0.68
Over 3 years	14.94	14.56	-0.38

Foreign deposits market marked a growth of the USD interest rates, reaching the highest levels throughout 2004. Lek and USD deposits interests spread has dropped to 4.0 per cent, while Lek and Euro deposit interests' spread to 3.6 per cent.

**Chart 14. Weighted average interest rates of foreign deposits**



LIBOR interests growth in the international markets at the highest levels of the year has affected the change of USD interest rate due to the tight monetary policy followed by Fed. While Euro deposits have slightly decreased due to the decline of EURIBOR interests. The weighted average interests of both USD and Euro time deposits resulted 1.15 per cent and 1.6 per cent, respectively, in September.

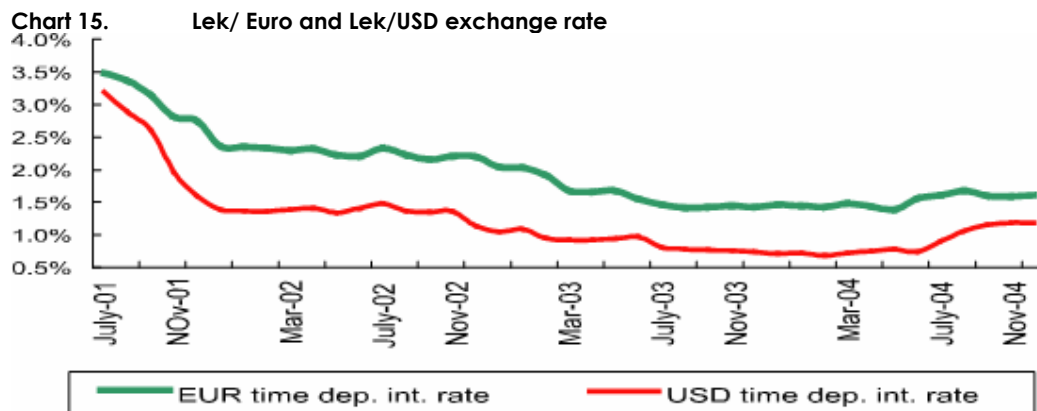


In response to the foreign deposit interests change and to LIBOR and EURIBOR interest rates in the international markets, banks rose the USD credit interests at an average of 0.67 percentage points and reduced the Euro credit interests by 0.57 percentage points. In September, the average interest rate of USD credits reached 8.48 per cent and the one of Euro credits, 8.56 per cent.

### IV.3 EXCHANGE RATE

Lek continued being appreciating against US dollar over the last months. Lek exchange rate against US dollar reached Lek/USD 98.4 in the first ten days of November. Meanwhile, Lek exchange rate against Euro has been generally stable, over the period September-October – on the average Lek/Euro 125.4 –, followed by a slight depreciation trend of Lek at the end of October. This trend became more evident in the beginning of November when Lek fluctuated around the level of 127.2 Lek/Euro.

The external factor has had the major impact on the exchange rate performance of US dollar. The Euro exchange against US dollar reached the highest historical levels, USD/Euro 1.299, in the international markets, and this was reflected in our foreign market as well.



The Lek strengthening against the foreign currencies, over the last months, was attributed to the Albanian economy factors as well. The growth of the domestic agricultural products has led to the reduction of imports for these products, thus decreasing the foreign currency demand. The low inflation rate has maintained the real interest rate of Lek on a favorable level, making it the most favorite currency compared to the other currencies. Furthermore, the satisfactory positive difference between the Lek interest rate and that in foreign currency still has maintained high the demand for domestic currency.