

QUARTERLY REVIEW OF THE ALBANIAN ECONOMY OVER THE THIRD QUARTER OF 2006

I GOVERNOR'S SPEECH

The development of the Albanian economy has generally been consistent with the projections of the first semester over 2006. The sales performance over the first semester, the realization of the budget revenues plan and the rapid growth rates of credit absorption from the private sector supported the projection for an economic growth of 5 per cent over 2006.

The economic activity has been sustained by the macroeconomic stability and by the favourable monetary conditions. Consumer prices inflation has remained under controlled levels, fluctuating around the Bank of Albania objective of 3 per cent. Against the lags in carrying out the expenditures, the fiscal activity was characterized by a stable growth of budget revenues, in particular of capital ones, providing a budget surplus over this period. Trade transactions with abroad extended further. The exports and imports of goods maintained the growth rates of the previous years, resulting in trade deficit deepening. Monetary developments were characterized by a relative stability of indicators, interest rates fluctuations around the minimal historical levels, stable exchange rates and by a rapid crediting to the economy. Outstanding credit grew by ALL 38 billion over the first eight months of the year, supporting the growth of consumption and of investments in economy. The exchange rate of the domestic currency, the Lek, has remained almost unchanged over the whole period.

The annual growth of sales over the first semester accounted for 11 per cent, which is close to the average recorded over the last years. The growth of sales was mainly backed by the developments over the first quarter, while the second quarter has recorded slower sales' growth. Such a development may be explained by the attempts of the private sector to recover the lack of activity over the electricity crisis of the first quarter the previous year. On the other hand, the sectoral developments of the economy, do not present an even economic growth between the sectors of production. The sector of trade, which bears the main share in the total volume of sales, has recorded the highest growth rates, providing as such the most significant contribution to the growth of sales. A positive tendency was also observed in the performance of other services' sales, among which, the financial services and real estates transactions have provided their best performance. Meanwhile, the sales in the sector of construction and of transport have been displaying signs of slowdown for several quarters, causing one of the main historical incentives of economic growth to reduce significantly. Considering the importance of these sectors in the Albanian economy, their performance requires a special attention, since they will condition the economic growth rates in the medium-term.

As far as the fiscal policy is concerned, the long presence of budget surplus stands out. Budget balance by the end of August resulted in a positive balance of ALL 10.9 billion. However, under the conditions when the Government aims to realize all the projected domestic financing (about ALL 22 billion), the following period bears concerns regarding the performance of Treasury bills yields and of the liquidity in the system. The recent growth demonstrates best this concern. Nonetheless, the Bank of Albania stance in observing rigorously all the legal obligations and the ones deriving from the multilateral and bilateral agreements with the IMF and the Ministry of Finance remain unchanged.

According to the preliminary data of the trade balance for the first semester of 2006, the trade of goods' balance deficit amounted to around EUR 830 million or about 22 per cent more than the same period the previous year. The growth of consumer loans, the increase of technological needs' financing and the stable workers' remittances constitute the core factors, which influence on a high demand for the import of goods.

Annual inflation fluctuated around the Bank of Albania objective over the third quarter of the year. After reaching 3.2 per cent in July 2006, the annual change of consumer prices followed a downward trend in the following two months. However, the Bank of Albania states that the inflationary pressures have increased over 2006. The inflationary pressures, which influenced on the consumer price rise over the first semester of 2006, were also perceived over the third quarter. Average inflation rate over the third quarter was about 0.5 percentage points higher than the same period the previous year.

The pressures are assessed to have been stronger than the same period the previous year. The average annual inflation for the third quarter of 2006 resulted to be 2.9 per cent, compared to 2.4 per cent the previous year. Among the events conditioning the inflation developments, it is assessed that the ones related to the supply were transmitted more frequently and more directly to the level of prices. The prior notice on the electricity price rise, applied in August, as well as the price rise in some of excise goods, had a direct impact over the general level of consumer prices.

Meanwhile, almost throughout the nine-month period, pro-inflationary pressures have also been present in the group of fuels prices, conditioned by the tense situation in the international oil market. Annual inflation rates for foodstuffs in the Euro zone and in Albania's main trade partners, have testified its upward trend over this period of the year. While the lending activity in the private sector of economy continued to record high growth rates, the low level of budget expenditures over the first eight months influenced on keeping the aggregate demand and the inflationary pressures under control.

The increased inflationary pressures in the first semester of 2006 led to the reconsideration of the Bank of Albania monetary policy stance. In July, the Bank of Albania raised the cost of money, by increasing the core

interest rate by 0.25 percentage points. This increase aimed at bringing the monetary conditions in line with the inflation medium-term objective. The raise of the core interest rate, among others, took notice of the rapid expansion of credit to economy, the narrowing of the interest rates spread between the lek and the foreign currency, as well as of the expectations regarding the concentration of budget expenditure on the rest of the year.

The tightening monetary policy stance was also reflected in the monetary operations of the Bank of Albania. The change in the core rate was applied in the interest rate of one-week repos for the withdrawal of the system liquidity and in the standing facilities interests. The banking system reacted by increasing the interest rates, being quicker in the percentages of the interbank market and in the Treasury bills yield.

Worth emphasizing is the fact that the whole situation has corresponded with an increasing aggressiveness for domestic financing by the Government, while the high rates of credit to economy did not leave too much ground in this respect. Under these circumstances, the system liquidity has been decreasing, reflecting the high liquidity of the Government account throughout the period.

As a consequence, there has been an increase of about 1.0 percentage points in the Treasury bills yield. The Bank of Albania injected liquidity in the system, aiming at reducing its fluctuations and balancing the demand, as well as amortizing the pressures over the Treasury bills yield. Along with the money market operations, the interventions in the foreign market met the economy seasonal demand for liquid assets by about ALL 4.5 billion. The presence of the Bank of Albania over the third quarter in the money markets through monetary operations caused the maintenance of its indicators to be within the objectives.

The banking system stability, in particular, and that of the financial system, in general, constitutes a permanent priority of the Bank of Albania. Our commitment bears a major importance in the context of credit market developments, which has continued to record growth. As underlined in the supervision report on the second quarter, the banking system presents in a sound financial position, being in line with all the parameters established by the banking supervision norms. The banking system continues to be profitable and capitalized according to the international norms and constantly records expansion of its activity.

In conclusion, I would like to emphasize that the Bank of Albania is determined to continue pursuing prudently the performance of the economy and of the financial market, concentrating on those developments which may influence negatively on the macroeconomic and the financial stability. The Bank of Albania is assessing these developments cautiously, being committed to keep the proper stance and aiming to encourage a more progressive performance of the economy.

II WORLD ECONOMY

World economy has recorded rapid growth rates over 2006. The economic growth has been present in all the geographic regions, while being displayed stronger in the Asian countries and in the USA. Year 2006 seems to mark a positive year for the economies in the Euro zone, which is assessed to have recorded one of the highest growth rates over the last six years. Following the favourable environment the world economy experienced over the first semester of 2006, the IMF reconsidered the world economic growth rate, assessing that the global economic activity for 2006 will be 5.1 per cent, instead of 4.9 per cent projected in April.

The high economic growth pushed the price rise of electricity and of other goods. Oil prices over the last months have fluctuated around the level of USD 75, marking a rise of USD 10 compared to the level of the beginning of the year. The price rise of electricity and of other goods was reflected in the increase of consumer price inflation, causing the concerns for second round effects to grow bigger. However, global inflation has been in lower levels than what the historical experience suggests under such circumstances. The continuous growth of productivity and the better anchoring of inflation expectations are the two main reasons which have kept the inflationary pressures under control. However, the increasing inflationary pressures have constrained many central banks to pursue a tightening monetary policy.

Table 1 Some main economic indicators in annual terms (in percentage)

	GDP annual growth	Unemployment rate	CPI
USA	+2.6	4.7 (August)	3.8 (August)
Euro zone	+2.6	7.9 (August)	1.8 (September)
Germany	+3.6	10.6 (September)	1.0 (September)
France	+4.9	9 (August)	1.9 (August)
Italy	+1.9	7 (June)	2.2 (September)
Japan	+1.0	4.1 (August)	0.9 (August)

Source: US Department of Commerce, ECB, "The Economist" magazine, 7-13 October 2006

EURO ZONE ECONOMY

The most recent estimations of Eurostat confirm that the economic activity in the Euro zone has had high growth rates in the first semester of 2006. The annual real growth rate of the GDP for the second quarter was 2.6 per cent from 2.1 per cent in the past period. Domestic demand, in particular investment, and the improvement of labour market conditions, were the engine of the positive developments in the economic activity. On the other hand, foreign demand developments have not followed the same path, and caused the growth rate to slow down. The estimations of the European Central Bank (ECB) on the economic growth over the second semester of the year favour the continuity of the economic growth, but with a lower rate that that recorded over the first semester of 2006.

The inflationary pressures over this period have been quite moderate and did not put the economic developments under risk. The ECB Governing

Council, in its meeting on 5 October 2006, decided to increase the core interest rate by 0.25 percentage points, causing this rate to reach the level of 3.25 per cent.

USA ECONOMY

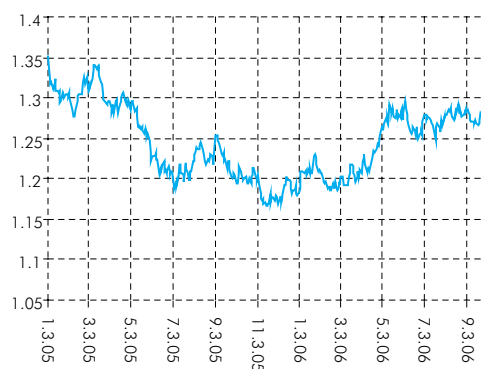
After a long period of economic growth above the historical average, the rates of economic activity developments in the United States of America slowed down by the end of the first semester 2006. The annual real growth rate of the GDP fell to the level of 2.6 per cent in the second quarter, from 5.6 per cent in the first quarter. Meanwhile, the trade deficit deepened further to 6.6 per cent of the GDP. The decrease of domestic demand for goods, due to the continuous increase of interests and to the high oil price, is considered to be the main factor influencing on the slowdown of demand.

The inflationary pressures in the American economy were considered to be moderate over this period. In the last meeting of the FOMC¹, on 20 September 2006, it was decided to leave the core interest rate, currently standing at 5.25 per cent, unchanged. The slowdown of the economy in the following period is assessed to present moderate inflationary pressures in economy. However, the expected labour cost growth is a risk that may influence on inflation.

EXCHANGE RATE

The exchange rate between the USD and the European currency fluctuated around the level of 1.25 - 1.3 USD/EUR over the last months. The exchange rate fluctuations were in line with the change of interest rates between the USA and the Euro area. Moreover, the current and expected developments in the respective economies have influenced on the extent of exchange rate change. The positive signals received from the Euro area economy have by and large effected the favouring of the European currency over the last months.

Chart 1 Exchange rate performance, USD/EUR, 2005-2006



Source: European Central Bank

OIL PRICE

The increase of global demand for oil, deriving from the positive developments of the global economy and the geopolitical uncertainty in its main productive regions were all reflected in the oil price rise over 2006. Official statistics indicate that the global oil consumption has increased by 0.5 million barrels per day, which is about 0.6 per cent more than the consumption over the same period the previous year. The increase of demand from China and the Middle East has affected the growth of consumption. The average oil price rose by 16 per cent over the first eight months of 2006. In August, the oil price hit a new record, by reaching USD 76 per barrel.

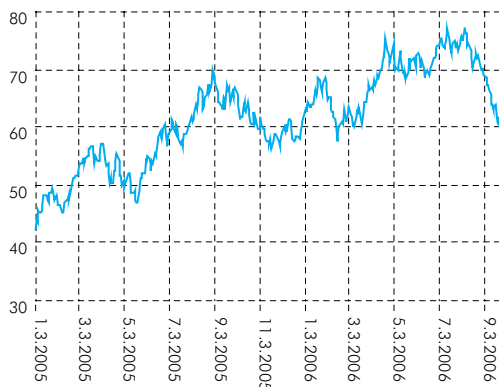
Table 2 Oil demand and supply (in million/barrel per day)

	Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006
a-Oil world demand	82.32	82.79	83.95	84.66	83.02	84.21
b-Supply from countries outside OPEC	54.72	53.83	54.28	50.57	50.45	51.19
c- Supply from OPEC countries	29.90	30.19	29.92	29.68	29.57	29.79
Balance (b+c-a)	2.3	1.23	0.25	-4.41	-3	

Note: *The figure of supply from OPEC countries relates to August 2006.

Source: Organization of Petroleum Exporting Countries (OPEC)

Chart 2 Crude oil world prices (in USD per barrel)



Source: Bloomberg

As far as the future is concerned, the International Energy Agency has projected a decrease in the demand for oil at the level of 1.2 million barrels/day, from 1.8 million barrel/day, at present. Meanwhile, it is expected growth in the production of countries outside the OPEC in the level of 0.6 to 1.1 million barrel/day and a growth of 1 million barrel/day in the production of OPEC countries. Based on these projections, the oil price over the rest of 2006 and 2007 is believed to fluctuate around the level of USD 70-75 per barrel. The international political developments may bring about short-term fluctuations beyond this interval.

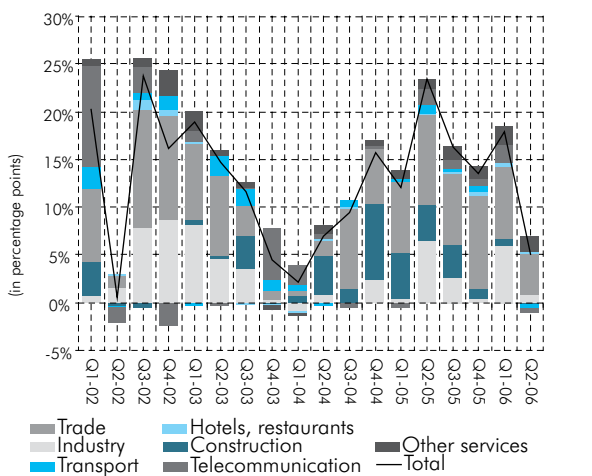
III ECONOMIC DEVELOPMENTS AND INFLATION

III.1 ECONOMIC ACTIVITY AND ECONOMIC GROWTH

The economic activity in the country continued to record growth over the second quarter of 2006, although under more moderate rates compared to the first quarter.

The annual change of the sales to economy index for the second quarter was 5 per cent, while the first quarter had an extraordinary growth for this period, recording the highest level in the last three years, that is, 18 per cent. In total, the annual growth of sales for the first semester was about 11 per cent. The sector of trade continues to bear the main share in the total volume of sales, contributing to their overall growth by about 5.7 percentage points, while the sectors of construction and of transport have been displaying signs of slowdown for several quarters. A positive tendency was observed in the performance of other services' sales, among which the financial services and real estates transactions have provided their best performance. Altogether, these activities have recorded a six months growth of 8 per cent.

Chart 3 Contribution of sectors to the annual growth of the sales of economy (in percentage points)



Source: INSTAT,

Economy sales index and Bank of Albania estimations

According to the preliminary estimations made at the beginning and in the middle of the year, the Albanian economy is expected to record an annual growth of 5.0 per cent. These estimations set the sector of construction and that of industry at the basis of the economic growth, while the sectors of agriculture, transport and services are expected to record more moderate growth rates.

The performance of sales by the end of the first semester suggests for a satisfactory performance of economy, sustaining the projection for an annual growth of 5 per cent. However, the Bank of Albania considers that the performance of economy over the second semester of 2006 will provide a more complete assessment on the economic growth for 2006. Meanwhile, the current share of the sectors' contribution to the general growth will not be similar to the projected structure. More concretely, the sector of services, part of which is trade, seems to be recording high growth rates, and contributing considerably to the total growth of sales. On the other hand, the slowdown evidenced in the sector of construction and the lack of a significant growth in industry, cast doubt on the accomplishment of expectations for these sectors.

	Q1-06	Q2-06	S1-06	Share	Contribution
Industry	22.9	3.4	11.6	25.9	3.0
Extracting industry	34.2	5.8	17.1	2.1	0.4
Processing industry	24.3	7.2	14.0	17.1	2.4
Electricity, water, gas	17.7	-7.5	4.5	6.8	0.3
Construction	5.8	-1.3	1.6	13.1	0.2
Trade	17.4	9.5	13.0	43.8	5.7
Hotels, restaurants	48.0	33.4	39.4	0.9	0.3
Transport	-2.3	-16.9	-11.1	2.7	-0.3
Telecommunication	21.4	-7.2	6.2	7.7	0.5
Other services	31.7	26.3	28.7	6.0	1.7
Total economy	17.9	5.1	10.6	100.0	10.6

Table 3 Annual growth of sales in some sectors of economy (in percentage)

Source: INSTAT, Economy sales index and Bank of Albania estimations

SECTOR OF INDUSTRY

According to the sales index, the sector of industry recorded a satisfactory growth of about 12 per cent over the first semester. It is evident that the endeavours made over the first quarter to recover the economic activity after the difficult electricity situation of the year ended 2005 provided the expected outcome, being reflected in a considerable annual growth of 23 per cent over this quarter. On the other hand, the second quarter presented slower, and marked an annual growth lower than the historical average. The contribution of the sector of industry to the total volume of sales accounted for 26 per cent, which is close to the contribution provided through the years. The processing industry continues to share most of sales from the sector of industry, recording over the first semester an annual growth of 14 per cent.

“Electricity, water and gas” continue to remain problematic for the Albanian economy. The production of electricity has recorded a slight decrease, while the increase of its import by 18 per cent caused the usable sources to be at

the same level as in the previous year. The invoiced consumption of energy has almost maintained the same levels, while the net losses have grown slightly. As far as the consumption of energy is concerned, worth mentioning is the fact that the household energy consumption is most considerable, while the consumption from other economic units is lower. This finding may be considered as a structural peculiarity of the Albanian economy.

Table 4 Main indicators of electricity balance (in GWH)

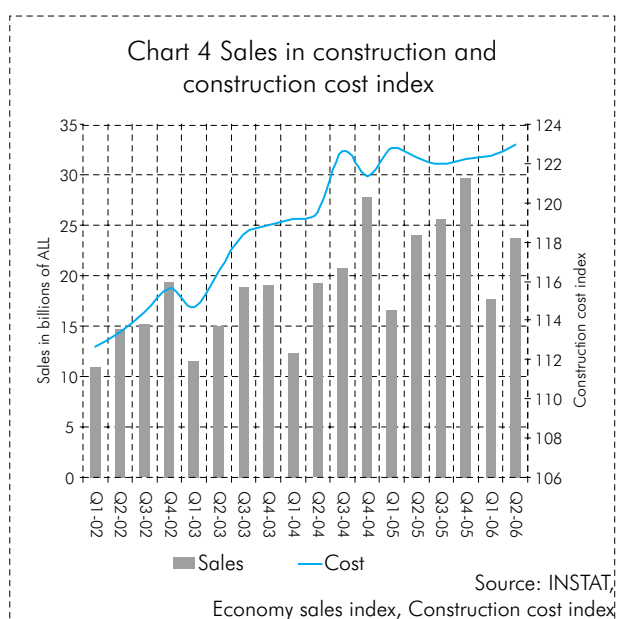
	S1 2005	S1 2006	Change (in percentage)
Resources	3,670,371	3,698,660	0.8
Production	3,258,293	3,212,509	-1.4
Import (including exchanges)	412,078	486,151	18
Uses	3,670,371	3,698,660	0.8
Export (including exchanges)	511,926	473,924	-7.4
Consumer use	1,829,360	1,833,753	0.2
- Families	1,107,349	1,110,884	0.3
- Other unspecified	722,010	722,869	0.1
Net losses	1,271,561	1,334,441	4.9
- In distribution	1,110,562	1,216,088	9.5

Source: INSTAT, Electricity Balance, first semester of 2006

SECTOR OF CONSTRUCTION

The sector of construction displayed signs of slowdown over the first semester of 2006. There was an annual growth of sales by 1.6 per cent, while the second quarter recorded fewer sales than over the same period the previous year. The picture presented by the sales index is also supported by indicators of the production activity over this period. Operative data indicate that the consumption of the cement, steel and bricks has decreased compared to the first semester the previous year.

The slowdown in this sector's activity over the second quarter of 2006 was also forewarned by the relevant businesses through the surveys conducted by the Bank of Albania. The businesses attribute this performance to the slowdown of demand for resident and non-resident constructions. Referring to the factors of supply, it is stated that the cost of construction has remained almost unchanged over the second quarter of the year. As a consequence, the rise in the prices of apartments, observed by the Bank of Albania while monitoring this market, requires alternative explanations, which may be related to the restrictions in granting the construction permits.



The growth of this sector for 2006 is expected to be about 10 per cent or lower than the growth by 15 per cent recorded in 2005. The accomplishment of the projection will require the recurrence of the high growth rates over the second semester of 2006.

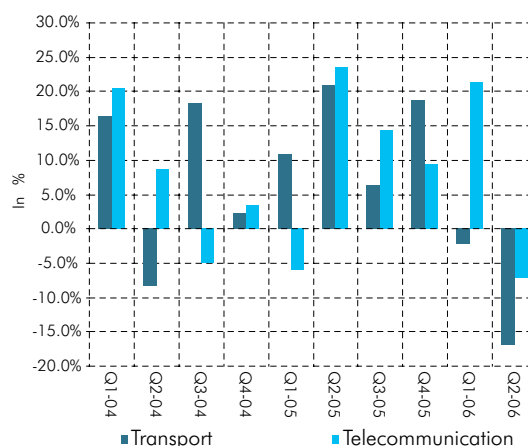
OTHER SERVICES

Both wholesale and retail trade activity continues to mark positive developments, recording the highest rate and contribution as opposed to other production activities. Compared to the same period the previous year, the sales of this activity were 13 per cent higher over the first semester of 2006. The contribution of this sector continues to remain high, both due to the high growth rates and to its considerable share in the total volume of sales. The projection regarding the annual growth of the services activity by 2.1 per cent does not seem to have taken into consideration the positive performance of trade over the recent years.

The sales volume of hotel and restaurants services was considerably higher than that of 2005, for both quarters. The first semester recorded an annual growth of about 40 per cent. The performance of nominal sales in this sector should not be taken for granted, due to the services group price effect. CPI for this group recorded continuous growth throughout 2006. An adjustment of the annual sales rates with the annual change of services group prices, presents a lower real activity of the services sector compared to the same period the previous year.

According to the data provided by INSTAT, the sales index for the sector of transport decreased over the first semester. Meanwhile, the sector of telecommunication displays a better performance. The first semester recorded an annual growth of about 6 per cent, which is comparable to the growth recorded over the same period in 2005. In absence of other data, it is assessed that the performance of this branch of economy is similar to its performance over the past years. Other services, which stand moderately in the sector of services, recorded the highest growth ever in the sales index.

Chart 5 Annual growth of sales in transport and telecommunication



Source: INSTAT, Economy sales index

SECTOR OF AGRICULTURE

The developments in the sector of agriculture for the first semester of 2006 sustain the projection for a 3.0 per cent growth in the agricultural production for the present year. So, the agro-industrial production has grown by 13 per cent compared to the previous year. In the second quarter, this production grew by 34 per cent, as opposed to the first quarter. Such a considerable growth may be explained by the processing of the seasonal agricultural productions.

The considerable increase of investment in the sub-sector of agro industry, as opposed to the previous year, has provided its effect on the multiple increase of the quantity of processed agricultural items in all main groups. The processing and preservation of meat and fish, as well as the production of oil, flour and beverages provided most of the contribution to the annual growth of the agro-industrial production. These developments have been

Chart 6 Performance of agricultural production (in millions of ALL) and its annual growth (in percentage)

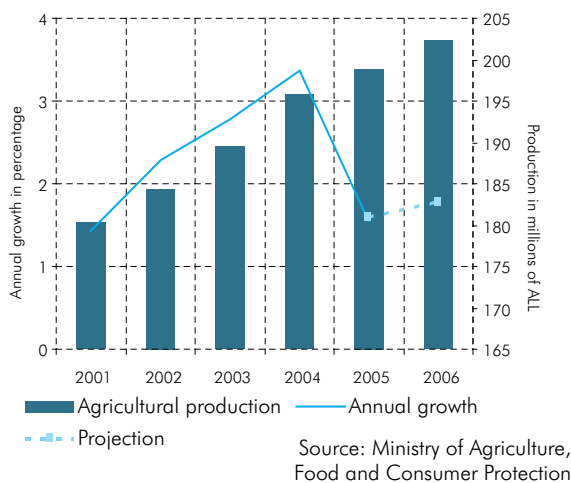


Chart 7 Monthly change of agricultural production prices index

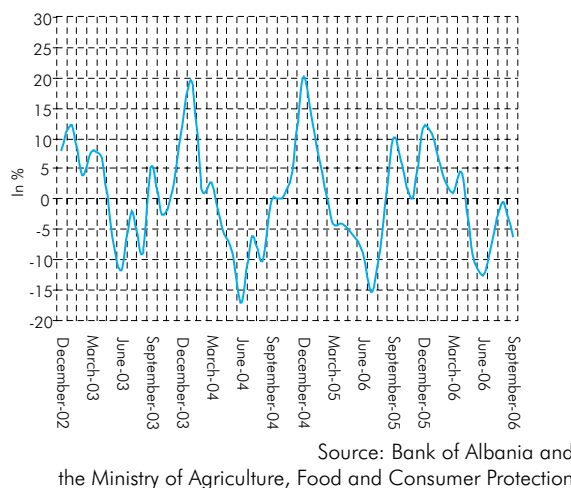
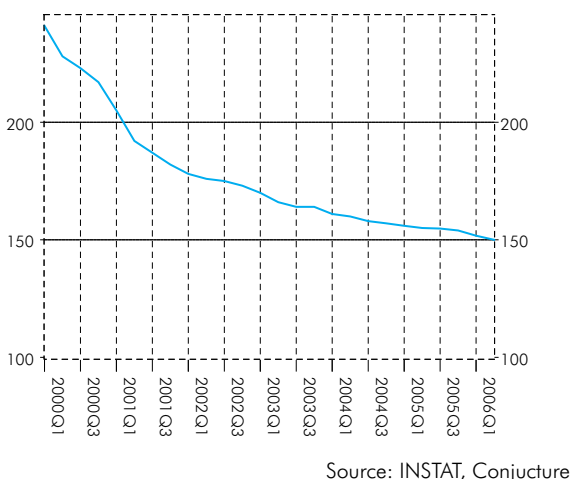


Chart 8 Number of unemployed over the last five years (in percentage)



a consequence of the increase of investment in the sector of agriculture, of the enhancement of efficiency in the sub-sector of farming, as well as of the enlargement of greenhouse areas. The growth of domestic production was reflected in the decrease of the agricultural prices index over September, both in monthly and annual terms.

The developments in the sector of agriculture provided their effect on the performance of prices of agricultural products and foodstuffs. The emerging of domestic agricultural production in the market and the growth of production, mainly over April - August, is reflected in a continuous fall of agricultural production prices, in particular over summer. Due to the great share of foodstuffs in the consumer basket and to the almost instant influence of the produced quantity on the level of prices, the agricultural production is one of the main domestic factors conditioning the consumer price developments.

III.2 LABOUR MARKET

The number of unemployed fell by about 4000 people over the first eight months of the year, causing the rate of unemployment to decrease to 13.9 per cent. Employment over the second quarter recorded a slight increase compared to the previous quarter. The decrease in the number of employed in the public sector was balanced by the increase of employment in the private non-agricultural sector. In general, the increase of the employment index over the recent years has been a consequence of the increase of employment in this sector. As opposed to the same quarter the previous year, this sector employed nearly four thousand people more.

The structure of unemployment is dominated by that part of the population, above 35 years of age, whose education does not exceed the eight-grade school.

The average wage in the public sector rose again after some period of stillness in the first quarter. The average wage in the second quarter rose by 3.7 per cent compared to the same quarter the previous year. This quarter also recorded a rise in the unemployment compensation.

Table 5 Labour market indicators (in thousand people)

	2004				2005				2006	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Total labour forces	1080	1081	1080	1074	1087	1086	1086	1086	1083	1081
A. Total of employed	919	921	922	917	931	931	931.2	932	931	931
i) in the public sector	179	179	177	171	176	175.6	175.6	175	174	172
ii) in private non-agricultural sector	206	208	211	212	213	213.4	214	215	215	217
iii) in private agricultural sector	534	534	534	534	542	542	542	542	542	542
B. Unemployment										
i) total of unemployed	161	160	158	157	156	155	154.8	154	152	150
ii) benefit from unemployment compensation	11.7	12.3	12	11	11.5	11.5	11.5	11.2	11.2	11.2
C. Unemployment rate (in percentage)	14.9	14.8	14.6	14.4	14.3	14.3	14.2	14.2	14.0	13.9

Source: INSTAT, September 2006

III.3 FISCAL SECTOR

According to the data provided by the Ministry of Finance, by the end of August were collected 99.2 per cent of planned revenues and realized about 97.1 per cent of the programmed expenditure². This caused the budget surplus to result in about ALL 10.9 billion by the end of August, from the projected ALL 8.1 billion. Budget revenues recorded high growth rates over the first eight months of the year, while the budget expenditure, in particular capital expenditure reduced over this period. This situation was followed by a considerable budget surplus, which may be considered as a new situation for the Albanian economy.

Table 6 Growth rates of fiscal indicators over January–August 1999–2006 (in percentage)

	1999	2000	2001	2002	2003	2004	2005	2006	Average 99-05	Dev. '06 from Average
Total revenues	13.0	12.0	3.8	18.3	12.8	9.1	7.9	14.5	11.0	3.6
Total expenditure	14.8	2.0	2.5	9.4	8.1	7.2	7.1	(5.8)	7.3	(13.1)
Current expenditure	9.5	(0.8)	(4.4)	19.1	10.8	8.2	6.5	(0.5)	7.0	(7.5)
Capital expenditure	53.7	16.6	33.7	(18.9)	(6.3)	1.0	11.1	(39.7)	13.0	(52.7)
Deficit	19.1	(20.4)	(1.7)	(20.1)	(15.3)	(5.6)	1.0	(170.5)	(6.1)	(164.4)

Source: Ministry of Finance

III.3.1 Budget revenues

Budget revenues recorded an annual growth of 14.5 per cent over the first eight months of 2006, shifting from the downward tendency of this indicator's growth rates in the last three years. The level of tax income amounted to about ALL 131.2 billion by the end of August. Customs revenue resulted in about ALL 9.3 billion, growing by 14.6 per cent compared to the same period the previous year.

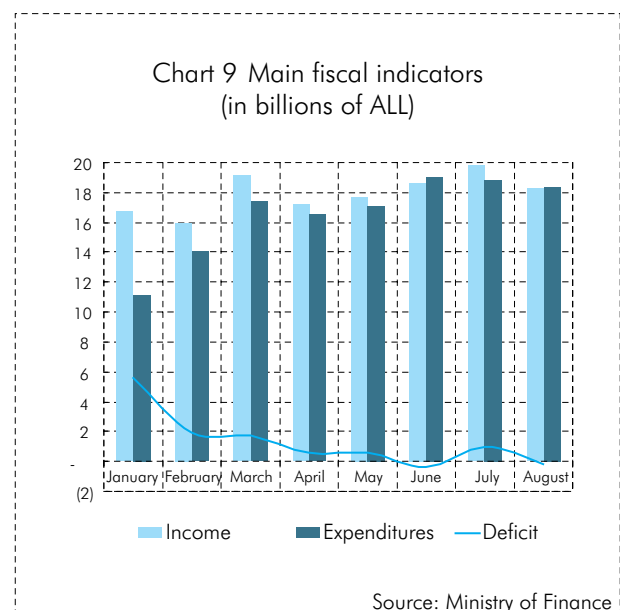
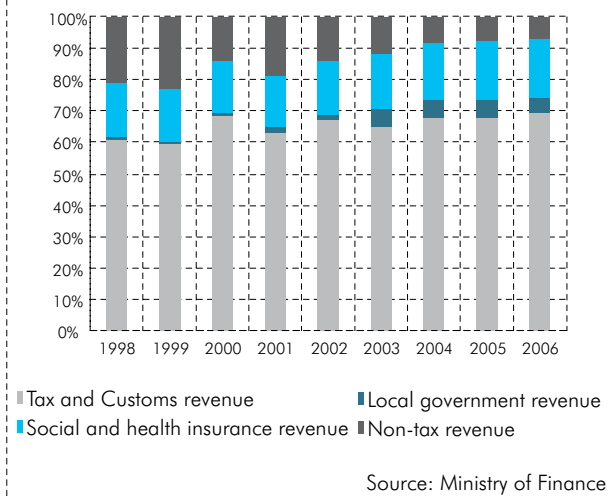


Chart 10 Structure of budget revenues over January-August 1998 – 2006 (in percentage)



Value added tax is the main source of tax revenues. Over the first eight months of 2006, the VAT revenues growth rate was 6.1 percentage points higher than the average growth of this indicator in the last eight years.

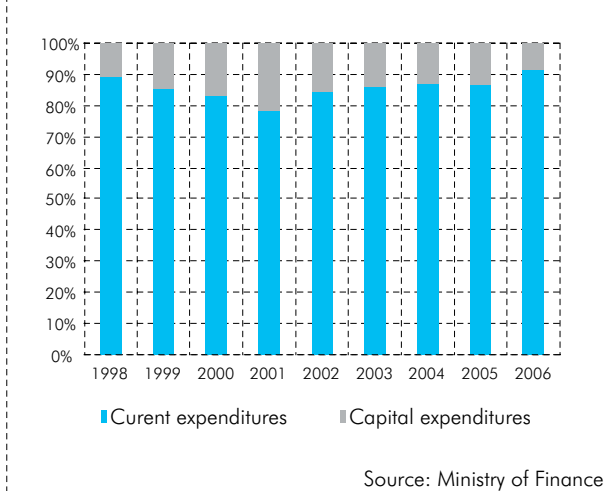
With regard to the period covering July-August 2006, it may be concluded that the total revenues have grown by 19.4 per cent, compared to the same period the previous year. Tax on personal income and excises had their best performance in the total revenues, recording a considerable growth by 34.2 per cent and 29.6 per cent, respectively.

Table 7 Growth rates of revenues over January-August 1999-2006 (in percentage)

	1999	2000	2001	2002	2003	2004	2005	2006	Average 1999-05
Total revenues	13.0	12.0	3.8	18.3	12.8	9.1	7.9	14.5	11.0
Tax revenues	10.4	28.7	(2.6)	25.1	43.5	13.2	8.4	14.6	18.1
Tax and customs	10.4	28.5	(3.5)	25.0	8.5	13.8	7.1	17.3	12.8
Values added tax	(2.4)	25.4	(4.1)	25.6	10.7	16.0	7.4	17.3	11.2
Tax on profit	27.0	39.2	20.8	36.2	5.3	20.2	15.4	22.6	23.4
Excises	44.7	27.5	(4.5)	3.8	36.8	28.3	12.0	27.6	21.2
Personal income	176.9	63.1	8.9	15.0	4.6	5.1	8.0	17.9	40.2
Customs duties	(10.3)	11.1	(15.0)	17.6	5.5	(0.2)	(5.5)	14.6	0.5
Local government	9.8	46.7	48.7	29.9	246.2	11.1	17.5	(7.7)	58.6
Independent budget	9.2	14.3	0.1	26.5	13.8	11.8	10.6	12.6	12.3
Non-tax revenues	23.2	(32.8)	40.8	(12.8)	(7.2)	(19.6)	(3.8)	9.6	-1.7

Source: Ministry of Finance

Chart 11 Structure of budget expenditure over January-August (in percentage)



III.3.2 Budget expenditure

Budget expenditure totalled ALL 132.6 billion over the first eight months of 2006, or about 97.1 per cent of the level projected for this period. For the first time in the last eight years, budget expenditure for this period decreased, being 5.8 per cent lower than the previous year. Personnel expenditure, which account for about 29 per cent of current expenditure and 26 per cent of total expenditure, were realized at 99.2 per cent. Capital expenditure over January-August 2006 had a low level of realization, decreasing by 39.7 per cent compared to the same period the previous year. From the latter, the expenditure covered by domestic and foreign financing was realized at 80.5 and 69.9 per cent, respectively.

Over July-August 2005, total expenditure fell by 1.6 per cent compared to the same period the previous year. It is observed that interest expenditure and

social insurance expenditure had the highest growth in current expenditure over these two months, increasing by 11.6 and 11.0 per cent, respectively. Meanwhile, operative maintenance and subsidies' expenditure decreased. As far as capital expenditure is concerned, it may be concluded that domestic financing is growing more significantly than the foreign one.

Table 8 Growth rates of expenditure over January-August 1999-2006 (in percentage)

	1999	2000	2001	2002	2003	2004	2005	2006	Average 1999-05
Total expenditure	14.8	2.0	2.5	9.4	8.1	7.2	7.1	(5.8)	7.3
Current expenditure	9.5	(0.8)	(4.4)	19.1	10.8	8.2	6.5	(0.5)	7.0
Personnel	8.4	5.2	11.4	10.4	8.7	10.4	10.7	3.4	9.3
Wages	8.2	5.5	14.4	9.7	(3.0)	24.1	10.7	2.7	9.9
Social insurance contribution	8.9	4.2	1.3	13.3	7.6	10.6	10.8	6.2	8.1
Interests	(0.7)	(14.1)	(34.1)	9.4	24.3	(0.5)	(11.4)	(2.6)	(3.9)
Domestic	(0.8)	(14.2)	(35.5)	1.8	12.2	16.7	(12.1)	(3.3)	(4.6)
Foreign	5.3	(7.4)	42.4	187.6	(36.7)	0.8	0.6	7.6	27.5
Operative maintenance	1.9	(3.4)	(12.2)	32.3	12.0	6.7	2.8	(18.0)	5.7
Social insurance	37.7	6.8	4.7	30.1	16.8	(12.6)	11.5	7.1	13.6
Capital expenditure	53.7	16.6	33.7	(18.9)	(6.3)	1.0	11.1	(39.7)	13.0
Domestic financing	30.1	72.7	34.6	(27.8)	10.6	10.2	16.3	(37.3)	20.9
Foreign financing	72.5	(16.9)	32.6	(7.8)	(22.9)	(11.9)	1.9	(44.6)	6.8

Source: Ministry of Finance

Box 1. 2006 Supplementary Budget

Year 2006 had the characteristic of the supplementary budget approval, which replaced the budget projected for August-December 2006. The above situation resulted from the accumulation of a high level of revenues over the first months of the present year. This situation prompted the public administration to review the expenditure projections for the following months of the year, by planning an increase in budget expenditure, in particular in primary sectors, such as in the health system, education and in capital investment. So, until July was applied the original budget for this year, but starting from August the analyses comparing the plan with the fact, need to take into account the new supplementary budget. The revenues, expenditure and fiscal balance in total for January-July 2006 are considered from the Ministry of Finance as realized at 100 per cent. (Their realization to the original budget was 102.9, 87.2 and -119.5 per cent of the plan, respectively.)

III.3.3 Fiscal balance

August ended up with a cumulative budget surplus of ALL 10.9 billion. Unlike the past 15 years, year 2006 resulted in a positive balance for the first eight months, shifting overwhelmingly from the average tendency of the past years. Despite the positive fiscal balance over this period, the Government is expected to realize its borrowing plan in the last four months of 2006, reaching a deficit of ALL 33.8 billion by the end of the year.

Table 9 Deficit growth rates over January-August 1999-2006 (in percentage)

	1999	2000	2001	2002	2003	2004	2005	2006	Average 99-06	Dev. 06 from Average
Deficit	19.1	(20.4)	(1.7)	(20.1)	(15.3)	(5.6)	1.0	(170.5)	(6.1)	(164.4)
Domestic financing	(8.8)	37.2	(24.8)	(14.1)	12.6	(1.0)	7.7	(183.0)	1.2	(184.2)
Foreign financing	47.7	(56.8)	44.6	(26.2)	(49.3)	(17.7)	(20.8)	(115.4)	(11.2)	(104.1)

Source: Ministry of Finance

III.4 EXTERNAL SECTOR OF ECONOMY

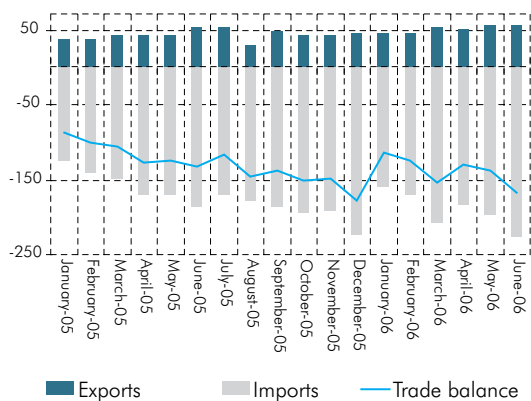
According to the preliminary data on the trade balance for the first semester of 2006, the trade of goods' balance deficit amounted to about EUR 830 million or 22 per cent more than over the same period the previous year. The more rapid increase in imports as opposed to exports continues to represent the main characteristic of the developments in the foreign trade in goods. The backing of consumer and investment demand with the imported goods and the continuous growth of the level of credit to economy over the recent years are two of the main factors influencing on the growth of imports. Lek maintained the same tendency compared to our partner countries' currencies, meaning that it did not represent a significant factor in determining the competitive status of domestic demand as opposed to partner countries' economies³.

Table 10 Trade balance items for the first quarter of 2006, in millions of EUR

	Q2 2006			April-June 05	April-June 06	Jan-June 05	Jan-June 06
	April	May	June				
Trade balance	-130.2	-138.9	-168.5	-384.6	-437.6	-677.5	-829.0
Exports	52.6	56.9	56.2	143.3	165.7	265	310
Imports	182.8	195.8	224.7	527.9	603.3	942	1,139

Source: Bank of Albania

Chart 12 Trade balance performance for 2005-2006, in millions of EUR



Source: Bank of Albania

Over the first semester of 2006, exports totalled EUR 310 million or 17 per cent more than total exports over the same period the previous year. The increase of exports was present in almost all export groups, although agricultural products, mineral products and the processing of wood were exported at a higher rate than the average. Meanwhile, textiles and footwear, which have most of the share, increased by slower rates than the total exports.

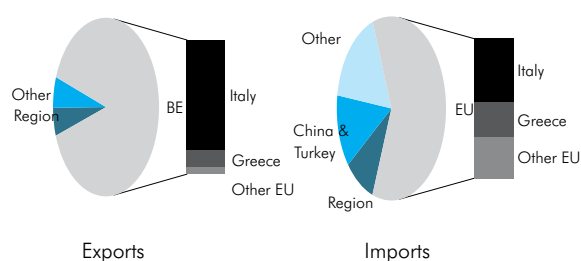
The import of goods over January-June grew by about 21 per cent compared to the same period the previous year, amounting to EUR 1139 million. As in exports, the increase of imports was present in all import groups, while mineral products, precious metals, products of chemical industry and foodstuffs grew above the average growth rate of imports.

Apart from trade deficit deepening, the higher growth of imports than exports leads to the aggravation of the imports' coverage ratio. The ratio of imports' coverage for the first semester of 2006 was 27 per cent from the ratio of 28 the previous year.

The volume of transactions totalled about EUR 1500 million over the first semester of the year. The regional countries and some of the European Union countries have the largest share in the geographical distribution of Albania's trade partners. These transactions amounted to nearly EUR 926 million or 67 per cent of the total. Meanwhile, the volume of transactions with the regional countries was about EUR 212 million or 14 per cent of the total.

The geographical distribution of transactions by source and by destination is not equal. In general, imports have a wider and a more diversified distribution as opposed to exports. Italy is the main destination country of the Albanian products, in specific of goods for re-export with the orderer's raw material. Italy, Greece, Turkey and China are the main import countries.

Chart 13 Geographical distribution of exports and imports over January-June 2006



Source: Bank of Albania

Note. In the exports chart, Turkey is part of the region countries group, while it is not included in the imports chart.

III.5 INFLATION PERFORMANCE OVER THE THIRD QUARTER

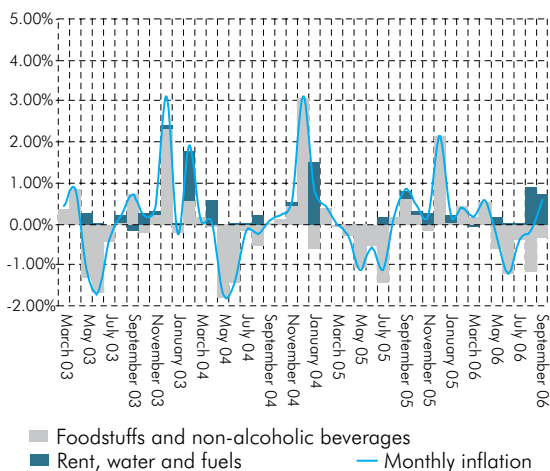
Annual inflation fluctuated around the objective of the Bank of Albania over the third quarter of 2006. After reaching 3.2 per cent in July 2006, the consumer prices' annual change followed a downward trend in the other two months of the quarter. However, the Bank of Albania states that the inflationary pressures have increased over 2006. The inflationary pressures, which affected the rise of consumer prices during the first semester, were also present in the third quarter. Average inflation rate was about 0.5 percentage points higher than over the same period the previous year.

	2002	2003	2004	2005	2006
January	6.5	0.0	3.3	3.3	1.4
February	7.6	1.1	4.4	1.8	1.3
March	7.5	1.3	4.0	1.6	1.5
April	6.5	2.3	3.2	1.3	2.3
May	4.6	2.8	2.6	2.0	3.2
June	3.7	2.6	2.9	2.9	2.5
July	4.2	3.0	3.1	1.8	3.2
August	5.5	3.0	2.7	2.3	2.8
September	5.3	2.8	2.0	3.1	2.6
October	5.8	2.9	2.0	3.3	
November	3.7	3.4	2.2	3.0	
December	1.7	3.3	2.2	2.0	
Average	5.2	2.2	3.0	2.4	2.3

Source: INSTAT

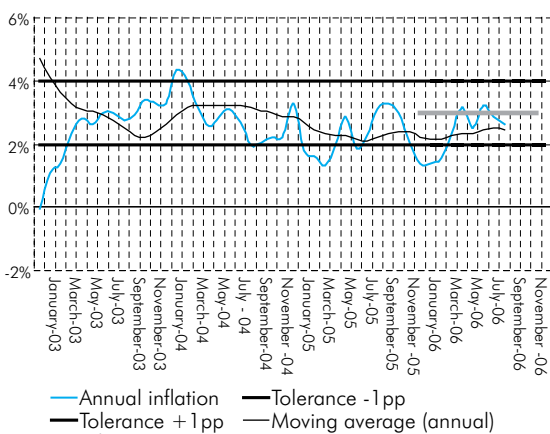
Table 11 Annual inflation rate (in percentage)⁴

Chart 14 Contribution of the two main groups to monthly inflation (in percentage points)



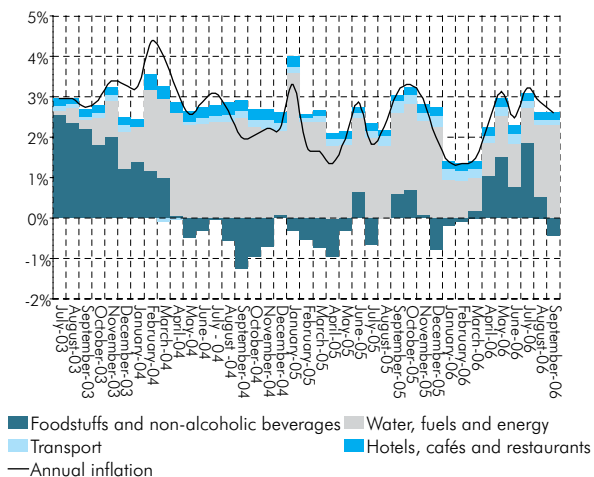
Source: Bank of Albania

Chart 15 Annual inflation (in percentage)



Source: Bank of Albania

Chart 16 Contribution of main groups to annual inflation (in percentage points)



Source: Bank of Albania

The historical behaviour of inflation gives evidence that the third quarter is characterized by a gradual rise of the general level of consumer prices. This tendency was also confirmed over 2006, being displayed in the increase of the monthly inflation rate. "Transport", "Rent, water, energy and fuels" and "Beverages and tobacco" had high monthly inflation rates. However, these tendencies were compensated by the low non-typical monthly inflation rates of "Foodstuffs and alcoholic beverages", mainly in August and September.

The decision on rising the energy price, the rise in the excise on alcoholic beverages and tobacco, as well as the further oil price rise were the factors, which exerted pressure on the level of consumer prices over this period. On the other hand, the late seasonal effect within this quarter caused the above mentioned factors to reduce their impact in August and September. The observance of the main objectives with regard to the development of the country has created the proper grounds for the performance of prices over this quarter.

III.5.1 Performance of inflation and of constituent groups

The contribution of various groups to total inflation over the third quarter of 2006 has changed both the direction and the extent of their impact on the annual inflation rate compared to the third quarter of 2005. While in 2005, "Foodstuffs and alcoholic beverages" was a determinant for the low inflation rates at the beginning of the quarter, this year it had its effect at the end of the period. Starting from August, the second largest group in the consumer basket - "Rent, water, energy and fuels" - increased its positive contribution with the energy price rise. Among other groups, "Alcoholic beverages and tobacco" recorded high positive contribution rates.

The performance of "Foodstuffs and non-alcoholic beverages" is very determining for the performance of the general price index. The level of prices for this group has been falling each month over this quarter. The average monthly inflation rate of this group recorded -1.6 per cent over the third quarter, compared to -0.5 per cent in the previous year. The

contribution of this group to the annual inflation rates was positive over the first two months of the third quarter and negative in September. After the bad weather over the second quarter, domestic agricultural production in the domestic market grew. Domestic production supply resulted sufficient to meet the market demand. As a consequence, the price rise of foodstuffs in the European markets is assessed to not have affected the final prices of domestic foodstuffs production.

Table 12 Annual inflation of "Foodstuffs and non-alcoholic beverages" (in the country and abroad) and the contribution of this group to total inflation

	Annual inflation '05	Contribution* (pp)	Annual inflation '06	Contribution* (pp)	Italy ⁵ Annual inflation '06	Greece ⁶ Annual inflation '06	Euro zone ⁷ (12 countries)
January	-0.7	-0.3	-0.4	-0.2	0.9	1.8	1.7
February	-1.2	-0.5	-0.3	-0.1	0.9	2.6	1.6
March	-1.7	-0.7	0.4	0.2	1.0	2.8	1.3
April	-2.2	-1	2.5	1.0	0.9	3.5	1.6
May	-0.7	-0.3	3.7	1.5	1.1	2.4	1.7
June	1.6	0.7	1.9	0.8	1.3	3.0	2.0
July	-1.6	-0.7	4.7	1.9	1.8	5.4	2.6
August	0.0	0.0	1.3	0.5	2.2	4.6	2.9*
September	1.5	0.6	-1.1	-0.5	2.5* ⁸	4.6*	--

Source: INSTAT, Bank of Albania

(*) Preliminary values

Annual inflation rate would have been lower in August and September, in absence of the energy price rise effect. The energy price rise by 13.7 per cent was reflected in the consumer price index for these two months, providing an additional contribution to annual inflation by 0.5 percentage points. The average contribution of this group to annual inflation rate for this quarter was 1.7 percentage points. Although the energy price rise took place in January last year, it had a greater impact on the increase of the inflation rate in the third quarter by 1.9 percentage points. The rise of rent prices and of imputed rent in September, due to the increase of demand with the beginning of the school year, also influenced on the monthly increase of this group's index.

Table 13 Inflation of "Rent, water, fuels and energy" and its share in inflation

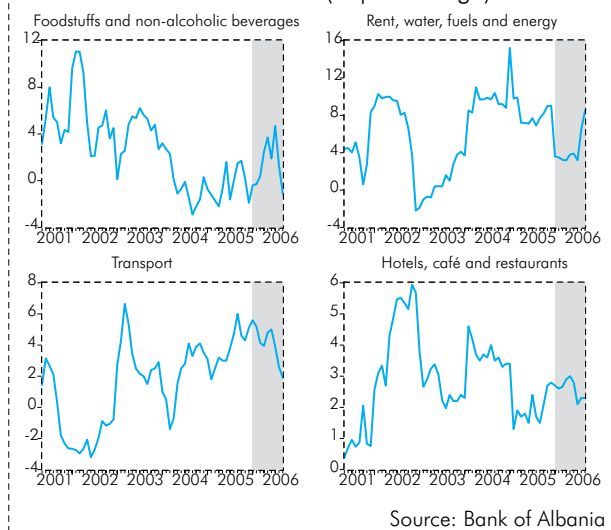
	Annual inflation '05	Contribution (pp)	Annual inflation '06	Contribution (pp)
July	7.7	2.0	3.2	0.9
August	6.9	1.8	6.5	1.8
September	7.7	2.0	8.5	2.3

Source: INSTAT

The annual index rates of "Transport" decreased over this quarter, mainly due to the inflation decrease of "Service to vehicles" sub-group. The oil price in the world markets fluctuated less over this quarter compared to the previous months, while falling significantly in September. This was partly manifested in the domestic market price starting from the end September.

The other groups sharing less weight, in general, provided a lower contribution to the annual inflation. "Clothes and footwear", "Furniture, household and maintenance equipment" and "Health service" recorded a fall

Chart 17 Annual inflation of four main groups in the CPI basket (in percentage)



in prices, contributing as such to the decrease of the cost-of-living.

III.5.2 Macroeconomic environment and inflation

The developments in the level of consumer prices over the third quarter of 2006 were influenced by a quite balanced macroeconomic environment, despite the presence of inflationary pressures. These pressures are assessed to have been stronger than those of the same period the previous year. The complexity of the external factors influence on economy, both from demand and supply, caused the average level of annual inflation for the third quarter of 2006 to result in 2.9 per cent, against 2.4 per cent the previous year. Among the events conditioning the inflation developments, it is assessed

that those related to supply were transmitted more rapidly and directly to the level of prices. The prior notice on the energy price rise, applied in August, as well as the price rise in some of the excise goods, had a direct impact over the general level of consumer prices. Meanwhile, almost throughout the nine-month period, pro-inflationary pressures have also been present in the Fuels prices, conditioned by the tense situation in the international oil market. Annual inflation rates for Foodstuffs in the Euro zone and in Albania's main trade partners, have testified its upward trend over this period of the year. While the lending activity in the private sector of economy continued to record high growth rates, the low level of budget expenditure over the first eight months influenced on keeping the aggregate demand and the inflationary pressures under control.

Opposite the interaction of the abovementioned factors, the contribution of the prudent monetary policy pursued over the previous period, finalized on the tightening side in mid-July 2006, is assessed to have infringed the intensification of the inflationary pressures on economy.

FACTORS OF DEMAND

Domestic demand indices

The sales index for the first semester of 2006 recorded an annual growth of about 11 per cent, evidencing positive developments on demand. However, an increasing demand is assessed to have exerted pressure on maintaining the downward trend of annual inflation transmitted over the third quarter of the year. The indicators of the external trade activity evidence a higher volume of imports and exports for the second quarter compared to the same period the previous year, by 14 and 16 per cent, respectively. In particular, the imports growth of foodstuffs, construction, machineries and equipment, back the expansion trend of consumption and investment in the short- and medium-term. Domestic demand was also influenced by the rapid growth

of credit to economy, which resulted to be present throughout the eight-month period. Furthermore, credit structure suggests further increase of consumer and real estate loans. The tendencies of the first semester in the above indices, make up a considerable potential to deem that besides the positive effects the expansion of domestic demand has both in terms of consumption and investment, they support the presence of inflationary pressures in the following periods.

Fiscal policy

The inflationary pressures were infringed by the pursuance of a very reserved fiscal policy to demand for money. This stand was on one hand favoured by the active position of tax and customs institutions with regard to the collection of income for January – August 2006, and on the other hand, by the delay in carrying out capital expenditure. The latter presented downward annual rates, even under the revised budget figures (for the eight-month period, they were realized at 77 per cent). It is assessed that the intensification of the economic activity, as a result of the possible shift of non-carried budget expenditure over the rest of the year, would increase the inflationary pressures on economy, in both short- and medium terms, due to the over concentration of demand for money.

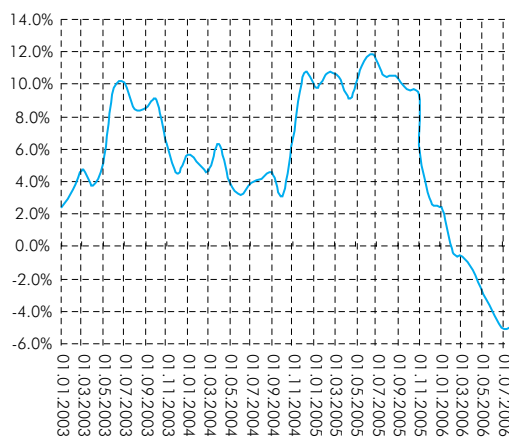
Monetary policy

The tightening of monetary conditions in economy and the signalling for a more prudent monetary policy in the following period, through the increase of the core interest rate in July 2006, brought about the increase of the cost of money in the securities' market. The transmission of this change to the interest rates of deposits in the systems has been intensifying, causing the control of demand for money to increase. The annual growth of the monetary aggregate M3 reached about 10 per cent by the end of August, more or less remaining within the monetary programme projections.

FACTORS OF SUPPLY

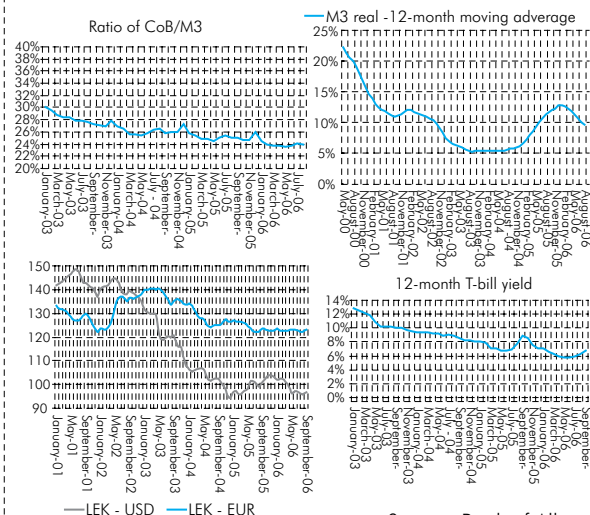
The analysis of supply factors deriving from the external environment may be summarized in these main developments: the exchange rate performance in the international markets and its stability in the domestic foreign market; the tense situation in the international oil market; the upward trend of Foodstuffs prices in the Euro zone and in Albania's main trade partners.

Chart 18 Annual change trends of budget expenditure (in percentage)



Source: Ministry of Finance

Chart 19 Main monetary indicators



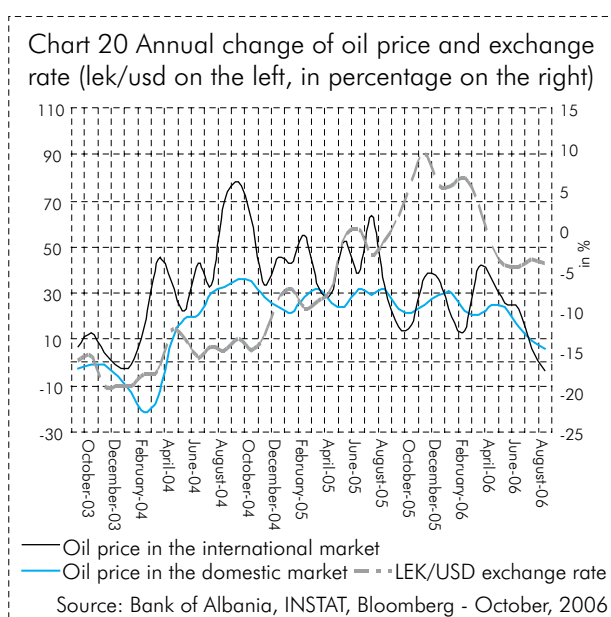
Source: Bank of Albania

Exchange rate and imported inflation

The behaviour of the exchange rate over the third quarter of 2006 reduced the inflationary pressures on the side of supply. More concretely, in annual terms, the lek appreciated against the US dollar, presented as stable against the euro and displayed a smoother seasonal effect over summer than the previous year.

Oil price

The considerable upward trend of oil price in the international market, in particular over June-August 2006, was also reflected in the domestic market, by exerting pressure on the rise of the general level of prices. However, the consecutive appreciation of the lek against the dollar over the period being analyzed, favoured the relaxation the inflationary pressures caused by the influence of this factor. September 2006 recorded the first annual fall of oil price in the international stock-market, since February 2004. Despite the downward trend, the price of fuels in the domestic market continues to be higher than the one recorded at the end of the first nine-month period over the previous year. The expectations for a re-rise of the oil price in the international market keep the pressure regarding the further performance of the oil prices high.



Imported inflation

Total inflation rates for the first nine-months of the year resulted as being stable in Albania's main trade partner countries and in the Euro zone. However, the annual price rise of "Foodstuffs and non-alcoholic beverages" group over the third quarter, both for the Euro zone and for Albania's main trade partner countries (Italy and Greece), indicates that the pressures exerted through the imported inflation for this group were present. Despite these developments, the inflation of domestic agricultural production over August-September 2006, has contributed to the considerable decrease of foodstuffs total inflation rates.

Table 14 Annual inflation of partner countries and the exchange rate annual change (in percentage)

	January	February	March	April	May	June	July	August	September
Greece ⁹	3.2	3.2	3.3	3.3	3.1	3.2	3.8	3.5	2.9
Italy ¹⁰	2.2	2.1	2.1	2.2	2.2	2.3	2.2	2.2	2.2
Euro zone -12 countries ¹¹	2.4	2.4	2.2	2.4	2.5	2.4	2.5	2.3*	--
Lek/Euro	-2.5	-3.3	-2.9	-2.5	-1.4	-0.4	0.5	0.3	-0.5
Lek/Usd	5.4	5.4	6.4	3.0	-2.1	-4.3	-4.5	-3.7	-4.2

Source: CPI, INSTAT

Note: (*) Preliminary value

Energy, foodstuffs and rent prices

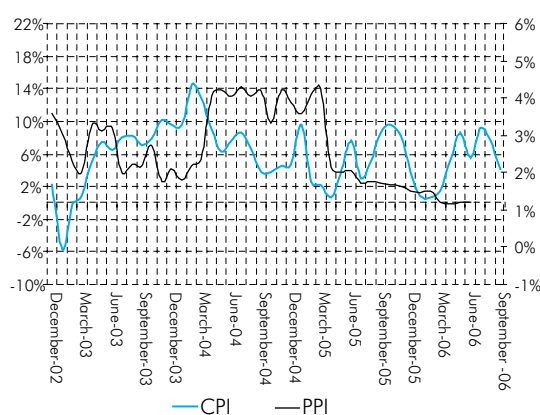
The rise of energy price in August 2006 caused the annual inflation rate to increase by about 0.5 percentage points. The fluctuations in the prices of other basket goods and services are assessed to have influenced on keeping

the annual inflation rate within the Bank of Albania objective. Foodstuffs prices manifested the most favourable behaviour, providing a considerable contribution to decreasing total inflation rates. The increase in the quantity of agricultural production in the market, which shifted in time by the end of the third quarter, is considered as one of the supply factors having a high impact over the balancing of inflationary pressures, caused by the rise of energy and rent price in August and September.

Production and consumer prices

The volatility in the Production Price Index (PPI) is expected to provide its influence on the consumer prices performance. According to the available date, there is no statistical relation between the production and consumer prices, yet. One reason may be the concentration of the PPI in the industry manufacturing sector. Furthermore, it is assessed that the share of domestic production is not a determining constituent of goods supply in the domestic market, yet. However, the behaviour of the CPI annual rate against the PPI annual rate suggests that it would take no longer than six months to transmit the volatility from the production to consumer prices. It seems that the downward trend of the PPI annual rate, observed since April 2006, has started to provide its impact on the annual inflation rate over August-September 2006.

Chart 21 Annual change of production and consumer price index (in percentage)



Source: INSTAT, October 2006

Unemployment rate and inflation

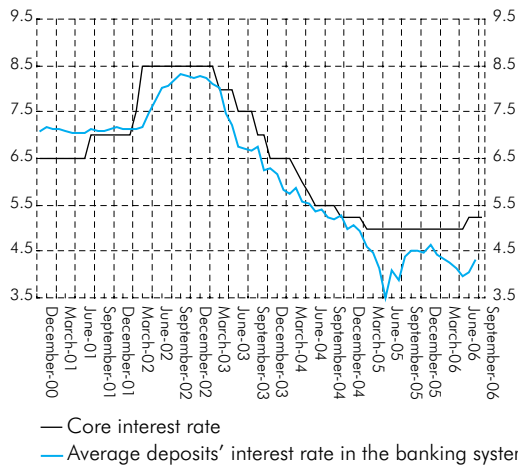
The expansion of the economic activity is underpinned by the improved labour market indicators, among which, the unemployment rate indicator is the most representative. For more than two years, the latter has had a gradual downward trend. In medium terms, such a trend would affect inflation through the pressures of the wage market, that is, from the growth of consumption supply in economy.

IV MONETARY DEVELOPMENTS AND FINANCIAL MARKETS

IV.1 BANK OF ALBANIA MONETARY POLICY

The upward trend of inflationary pressures, reflected in the performance of inflation over the first semester of the year, led to the reconsideration of the Bank of Albania monetary policy stand. Following the public statements related to the performance of factors influencing on the level of prices and their expected performance, in July the Bank of Albania raised the cost of money through the increase of the core interest rate by 0.25 percentage points. This increase aimed at bringing the monetary conditions in line with the inflation medium-term objective. The increase of the core interest rate, among others, took notice of the rapid expansion of credit to economy, the narrowing of the

Chart 22 Performance of core interest rate
(in percentage)



Source: Bank of Albania

interest rates spread between the lek and the foreign currency, as well as the expectations regarding the concentration of budget expenditure on the rest of the year. Through this increase, it is aimed at better controlling the demand pressures, accommodating supply shocks, maintaining the attraction for financial assets in lek, as well as keeping the inflationary expectations under control.

The tightening monetary policy stand was also reflected in the Bank of Albania operations in the money market. The change in the core rate was applied in the interest rate of one-week repos for the withdrawal of the system liquidity and in the standing facilities interests. The banking system reacted by increasing the interest rates. As expected, this reaction was quicker in the interbank market and in the Treasury bills yield. The interest rate of

one-week transactions increased by 0.17 percentage points in the interbank market.

On the other hand, the increase of Government borrowing and the maintenance of high crediting in lek rates caused the lack of liquidity in the system. This situation was reflected in the increase of Treasury bills yield by 1.0 percentage points. Under these conditions, the Bank of Albania injected liquidity in the system, aiming at reducing its volatility and balancing the demand. It influenced on reducing the pressures on the Treasury bills yield. Along with the money market operations, the interventions in the foreign currency market met the seasonal demand of the economy for liquid assets with about ALL 4.5 billion over July-August. The increase of interests was also observed in the rates of deposits in lek, which in August increased by 0.31 percentage points¹⁵. Further increase of deposits in lek interest rates was also experienced in September. The Bank of Albania presence over the third quarter in the money markets through monetary operations maintained its indicators within the set objectives.

Table 15 Realization of the Bank of Albania quantitative objectives¹⁶

	December '05	March '06	June '06	July '06	August '06	September* '06
Net international reserve of the Bank of Albania (in millions of USD)						
Objective	1,184	1,117	1,112	1,163	1,213	1,264
Current	1,184	1,215	1,237	1,283	1,306	1,314
Difference (2-1)	--	98	125	120	93	50
Net domestic assets of the Bank of Albania (in billions of ALL)						
Objective	82.0	85.0	90.0	87.6	85.2	82.7
Current	76.7	61.8	67.7	66.6	67.4	70.6
Difference (2-1)	-5.3	-23.2	-22.3	-20.9	-17.8	-12.1
Net domestic credit to the Government (in billions of ALL)						
Objective	306.7	314.6	329.8	331.8	333.9	335.8
Current	306.7	300.5	306.6	308.2	307.9	--
Difference (2-1)	--	-14.1	-23.2	-23.6	-26.0	--

* Operational figures for September

Source: Bank of Albania

Box 2. Monitoring

The global economic growth was accompanied by the increase of inflationary pressures. Central banks worldwide have interpreted this tendency as a non-transitory one, considering the macroeconomic factors, among which the growth of demand stands out. Besides the specific factors, the high energy and oil price effect was a common factor for these countries, causing the risk of inflation to reach high levels. In response to these developments, many central banks have pursued tightening monetary policies over the third quarter of 2006. In some of them, this policy had begun earlier, such as the case of the Federal Reserve and the European Central Bank. In others, the increase of the core interest rate was a shift in the pursued monetary policy, such as the Bank of Japan and the Bank of England. The Reserve Bank of Australia, the Bank of Sweden, the Czech National Bank, the National Bank of Hungary and the National Bank of Slovakia also pursued a tightening monetary policy over this quarter. Among the region countries, the Central Bank of the Republic of Turkey and the National Bank of Serbia followed the same trend.

Table 1, Box 2 Inflation and interest rates (in percentage)

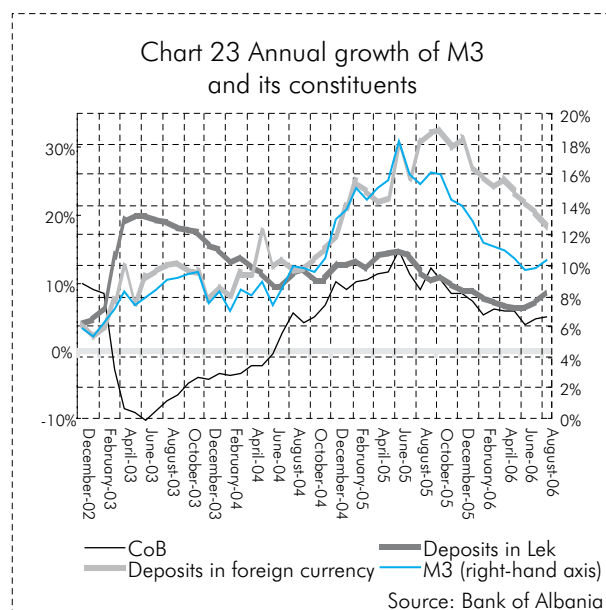
	Inflation objective	Inflation September '06	Core interest rate	Real interest rate
Bank of Albania	3.0	2.6	5.25	2.65
Federal Reserve	n/a	2.45	5.25	2.80
European Central Bank	<2.0	1.8	3.25	1.45
Bank of England	2.0	2.5	4.75	2.25
Central Bank of the Republic of Turkey	5.0*	10.3	17.4	7.10
Czech National Bank	3.0	2.7	2.50	-0.20

*Target for end year 2006.

The tightening of the monetary policy is expected to be a characteristic of the following months, in particular for the European Central Bank, the Bank of England, the National Bank of Switzerland, the Bank of Sweden, the Bank of Japan, etc.

IV.2 PERFORMANCE OF MONETARY AGGREGATES

M1 and M2 aggregates grew over the third quarter in line with the economy demand for monetary assets. On the other hand, M3 broad money grew extensively, due to the seasonal incoming workers' remittances, in the form of deposits in foreign currency, in the form of deposits in foreign currency. The time composition of M2 aggregate oriented towards the liquid component, currency outside banks, as a result of the higher demand for money in circulation over the summer. The annual growth rate of broad money accounted for 10.4 per cent. Money supply growth was supported by the private sector demand for monetary assets, expressed in the growth of the banking system crediting to the private sector. However, money



supply over August was considerably influenced by the seasonal growth of deposits in foreign currency.

The monetary data for August provide evidence for the growing demand of the economy for liquidity through the increase of the ratio of currency outside banks to M2 aggregate to 33.5 per cent, which is 1.0 percentage point higher than in May. Moreover, the expected growth of deposits in foreign currency, as a result of workers' remittances, was entirely concentrated in August, raising the ratio to M3 to 28.7 per cent or by 1.1 percentage point over summer.

The influence of workers' remittance on inflation remains insignificant in the short-term. The growth of net foreign assets constitutes an external factor of monetary developments, thus not reflecting directly the impact of the growth of demand for monetary assets. As such, it does not transmit inflationary pressures on economy directly. However, in the medium-term, the growth of deposits in foreign currency exerts its influence through the financing of credit to the private sector. The distinct growth of deposits in foreign currency over summer makes up a financing source for the creation of foreign currency assets in general, and for the crediting of the system in foreign currency in the following quarters.

In annual terms, total system deposits in August grew by 12.2 per cent. Demand deposits recorded the highest rate for deposits in lek and in foreign currency, accounting for 34.2 per cent and 19.5 per cent, respectively. The ratio of time deposits to demand deposits resulted in 2.26 against 2.33 at the end of the second quarter. However, the latest interest rates, both in lek and in foreign currency, have increased the cost of keeping cash and demand deposits. On the other hand, the narrowing of the lek-foreign currency interests has become quite evident, affecting as such the ratios of savings in economy.

Table 16 Performance of monetary indicators in August (in billions of ALL)

	August	Two-month change		Annual change	
	2006	Absolute	Percentage	Absolute	Percentage
Currency outside banks	147.7	6.7	4.7	7.2	5.1
Total deposits	470.2	16.7	3.7	51.1	12.2
- in lek	292.8	5.2	1.8	23.8	8.8
- in foreign currency	177.4	11.6	7.0	27.3	18.2
M1	228.0	3.1	1.4	27.7	13.8
M2	440.5	11.9	2.8	31.0	7.6
M3	617.9	23.4	3.9	58.3	10.4
Money base	201.4	3.2	3.5	17.5	9.5

Source: Bank of Albania

IV.3 DEVELOPMENTS IN DEMAND FOR MONEY

The developments in demand for money have confirmed the expanding trend of the monetary factor over the third quarter. Although broad money has grown by average rates, compared to its historical performance, the

concentration of the private sector demand for money is a dynamic factor in the development of inflationary pressures in economy. The contribution of credit to the monetary expansion continues to be high, accounting for about 100 per cent in August. The foreign currency component has also increased its contribution, while the public sector demand has not yet started to be demonstrated in the performance of monetary indicators.

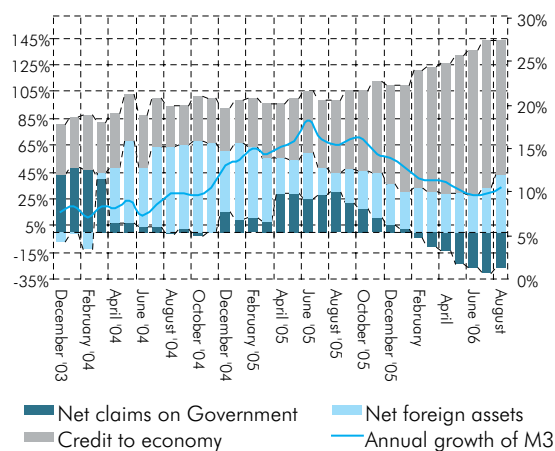
CREDIT TO ECONOMY

Credit to economy continued to grow rapidly over the third quarter of 2006, mainly pushed by the credit in lek to households. Over July and August, it grew by ALL 6.8 billion, which is 31 per cent higher compared to the same period the previous year. However, in annual terms, credit over this period grew by about 60.2 per cent, marking a decline compared to 64.2 per cent over the previous quarter. Meanwhile, the extension of new credit in summer continued to record high rates. Only for July-August, it was extended a total of ALL 24 billion of new credit, which is about 20 per cent more than the previous year. As far as the structure of new credit is concerned, there is an ever-increasing orientation of banks towards crediting in lek. In August, the share of credit to the GDP accounted for 18.1 per cent from 14.6 per cent in December 2005. The high credit rates have increased the share of credit portfolio compared to other banking system assets to 29.2 per cent, from 25.1 per cent at the end year 2005.

Credit in lek, for July-August, has had an average annual growth rate of about 100 per cent, which is higher than that of the second quarter of 2006. Over these two months, the contribution of credit in lek to the annual growth of credit to economy increased further, also encouraged by the increase of credit in lek to businesses. However, the largest share of credit in lek is extended to households. Meanwhile, credit in foreign currency continued to display downward annual rates.

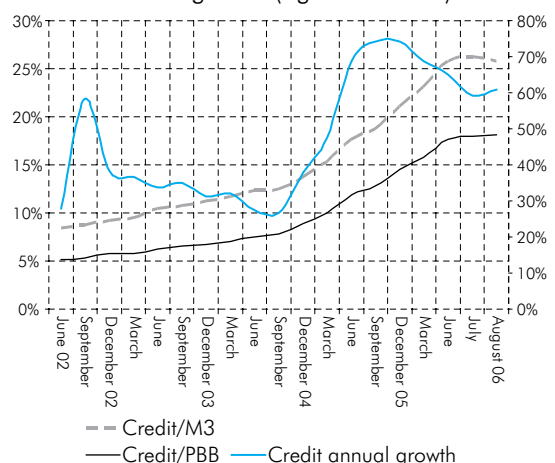
Credit to households shares 33 per cent of credit portfolio, most of which is extended to finance the purchase of real estates. Credit for this purpose shared about 64 per cent of credit to households

Chart 24 Contribution of demand for money constituents to M3



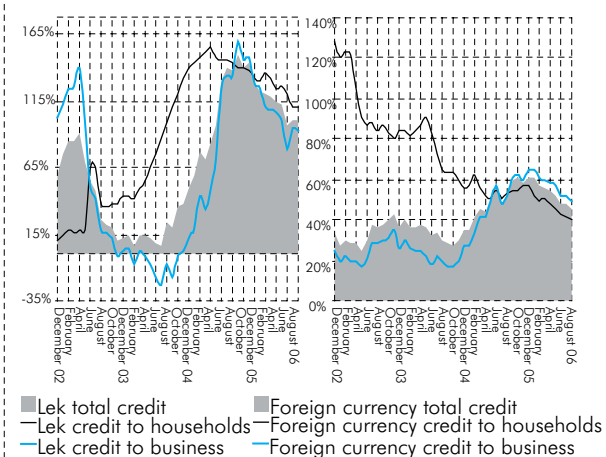
Source: Bank of Albania

Chart 25 Performance of outstanding credit to economy (left-hand axis) and its annual growth (right-hand axis)



Source: Bank of Albania

Chart 26 Credit growth rate by currency and borrowing entity

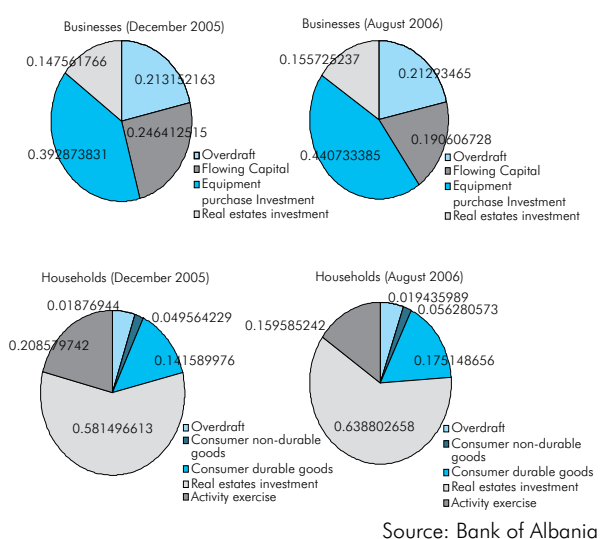


Source: Bank of Albania

in August¹⁷. Compared to the year ended 2005, credit for the purchase of real estates has grown by 46.2 per cent. Consumer loan¹⁸, for the same period, has shared 26 per cent of credit to households and, compared to December 2005, it has grown by 59 per cent. Consumer loan, which has a more direct impact on inflation, is dominated by the financing of durable consumer goods' purchase¹⁹ (70 per cent of consumer loan). Although the consumer loan has had an upward trend, it currently shares only 9.0 per cent of total credit.

The growth of credit to businesses has provided the highest contribution to the expansion of credit, with an annual rate of 56 per cent. It has mainly financed the purchase of new equipment and machinery, accounting in August for 44 per cent of total credit. Compared to the end year 2005, this credit is 48 per cent higher, recording a monthly growth of 5 per cent per month.

Chart 27 Distribution of credit by use

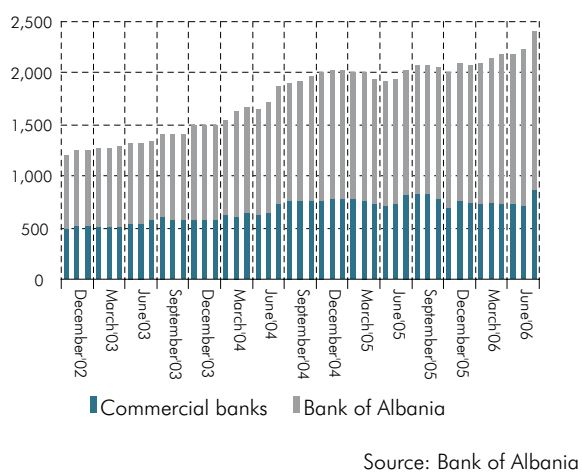


As far as the sectoral distribution of credit is concerned, trade holds most of the share, accounting for 23.2 per cent in August, marking a moderate increase compared to June. Meanwhile, the sector of construction seems to have reflected the highest growth over summer in its share to total credit, accounting for 13.5 per cent in August, from 12.2 per cent in June. Credit to agriculture and processing industry decreased over July and August. The reduction of the share of credit to the sector of agriculture was due to the redistribution of one of the main banks' portfolio in the system according to a new criterion.

NET FOREIGN ASSETS

The level of net foreign assets of the banking system totalled USD 2.4 billion in August, influenced by the growth of deposits in foreign currency held with the commercial banks and by the Bank of Albania foreign currency interventions. The Bank of Albania net foreign assets grew by USD 88 million over July-August. Apart from the foreign currency purchase in the market, these assets were also affected by the appreciation of the euro against the dollar, which increased the amount of investment in euro expressed in dollar. Commercial banks grew their net foreign assets by USD 131.5 million. The developments in these assets confirm the idea of seasonality, also observed in the previous years, that is, the attainment of the highest net foreign currency level over the third quarter. Such a development is in line with the performance of deposits in foreign currency held with the commercial banks. Meanwhile, credit in foreign currency suffered a slowdown over this period.

Chart 28 Net foreign assets of the banking system (in millions of usd)



GOVERNMENT DEMAND FOR MONEY

Fiscal balance resulted in a surplus for the third quarter in row, totalling ALL 8.3 million in August. Compared to the previous quarters, there were downward growth rates of the budget surplus over July and August. This development kept the Government demand for money low. Meanwhile, domestic financing continued to record negative levels, amounting to ALL - 5.5 billion. Over July and August, it was issued long-term debt in the form of 2 and 3-year bonds, to the amount of ALL 3.6 billion and ALL 2.8 billion, respectively. On the other hand, the net level of Treasury bills issued in the primary market reduced by ALL 10.6 billion. Commercial banks, households and institutions decreased the Treasury bills' level in their portfolio by ALL 7.8, 1.7 and 0.2 billion, respectively. In contrast, the Bank of Albania increased its portfolio by ALL 1 billion. The produced surplus was invested in the form of reverse repos to commercial banks. Their level decreased to ALL 5 billion over August, which is about ALL 6 billion less than in June. The level of the Government's deposit did not experience significant shifts over this period recording ALL 2.8 billion at the end August.

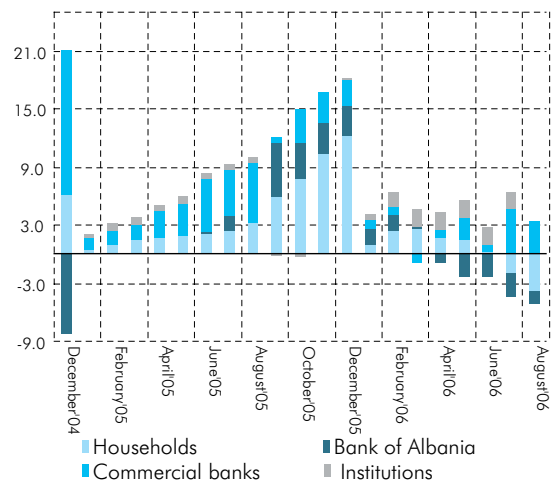
According to the Government fiscal data, the level of domestic financing for 2006 is projected to amount to ALL 22.8 billion, while recording negative levels by the end of the third quarter. Provided that the Government sticks to its budget plan, the whole domestic financing projected for 2006 will concentrate on the rest of the year.

IV.4 FINANCIAL MARKETS AND INTEREST RATES

The money market reaction to the tightening monetary policy signal over the third quarter, was originally experienced in the interbank market, in the securities market, and afterwards, in the deposits and credit market in lek. However, the actual level of the banking system interests results to be lower than that of the end third quarter the previous year.

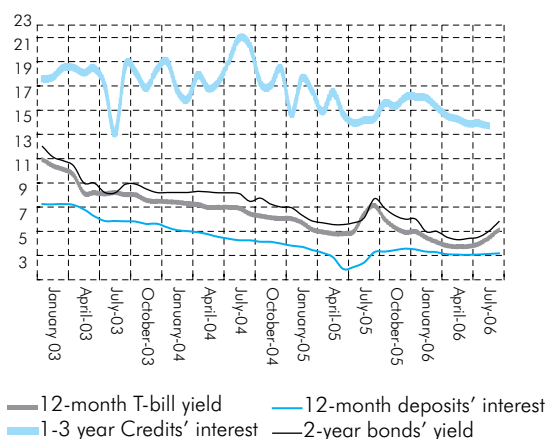
The interest rates in the interbank market fluctuated within the new corridor of the standing

Chart 29 Developments in the gross financing of budget deficit (in billions of ALL)



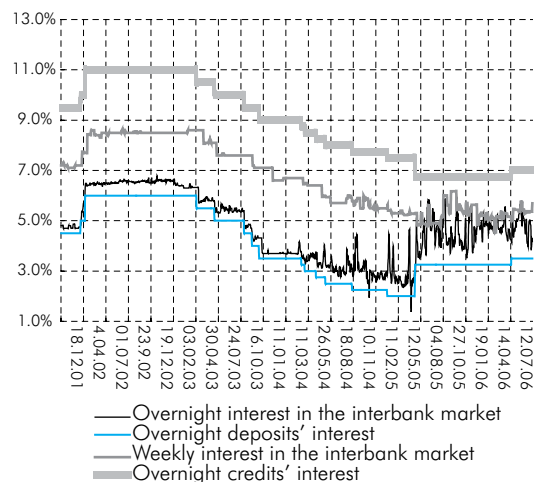
Source: Bank of Albania

Chart 30 Interest rates performance in the markets



Source: Bank of Albania and commercial banks

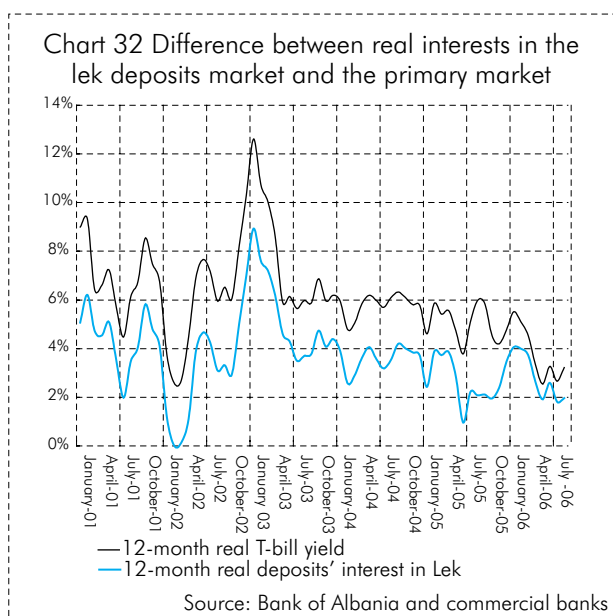
Chart 31 Interests in the interbank market and the Bank of Albania monetary policy



Source: Bank of Albania and commercial banks

facilities interests, near the core interest rate. The volatility over the third quarter owes mainly to the readjustment with the monetary policy signal and to the volatility in demand-supply ratio in this market. Lending in this market increased, totalling the average daily amount of ALL 1.4 billion, from ALL 1.1 billion in the previous quarter.

The increase of interest rates in the primary market of Treasury bills and of 2-year Government bonds was higher than the increase signalled by the Bank of Albania²⁰. This fact owes to the increase of the Government borrowing and the maintenance of high credit in lek rates, which have created lack of liquidity in the system. This situation was reflected in the rise of Treasury bills yield by 1.0 percentage point. As opposed to the previous year, the current level of Treasury bills and of 2-year bonds yields remains lower. By the end of the third quarter, the level of Treasury bills yields of 3, 6 and 12-month maturity, accounted for 5.96 per cent, 6.43 per cent and 7.13 per cent, respectively.



The tightening of the monetary policy provided its effect in the interest rates of deposits in lek. The timely rearrangement of deposits market was in line with the order this market shares in the monetary policy transmission mechanism. According to the preliminary data, by the end of the third quarter 2006, the level of deposits' interests of 6, 12 and 24-month maturity resulted in 4.3 per cent, 5.2 per cent and 5.7 per cent, respectively²¹.

Credit in lek market, influenced by competition, the structure of lending, the scale of credit risk and by the expectations related to the performance of interest rates etc, is subject to a slower adaptation to the monetary policy signals. However, the credit interests of up to six months maturity and of over three years maturity increased over the third quarter.

The intermediation cost, expressed as a difference between the interests of credit and deposits in lek, experienced a downward tendency compared to the previous year. However, as opposed to the previous quarter, this cost increased, reflecting the reaction of markets to the monetary policy tightening at different extent.

Table 17 Intermediation cost
(in percentage points)

	August - 05	June - 06	August - 06
6-month term	10.6	6.9	7.7
1-year term	8.6	6.8	6.8

Source: Bank of Albania and commercial banks

Real interest rates became more stable over the third quarter of 2006. The downward pressure of real interest rates reduced, providing a positive shift over August. This behaviour was influenced by the rise of nominal interest rates,

despite the opposite effect provided by the level of inflation in this period. The difference between the real interests of deposits and 12-month Treasury bills in July 2006 began to extend, owing to the various reactions of these markets to the monetary policy.

The difference between the interest rates in foreign currency and in lek grew deeper in the third quarter of 2006. The tightening of the monetary policy by the Federal Reserve and the European Central Bank for an extended period of time, influenced on the continuous rise of deposits interests in the euro and in the dollar, causing them to get close to the nominal interests of deposits in lek. The latest developments in the lek deposits interests are expected to improve the difference between the lek-foreign currency interest rates.

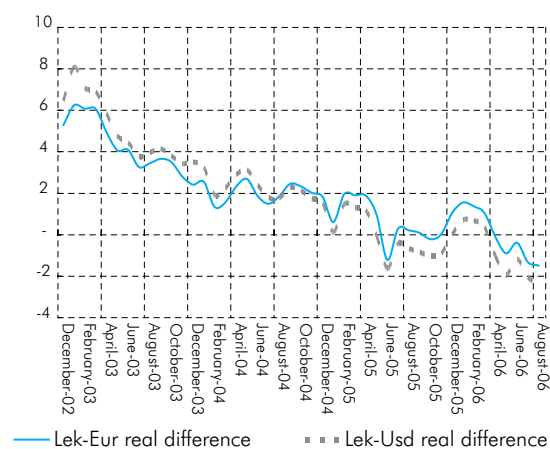
The tightening policy pursued by the Federal Reserve and the European Central Bank was also reflected in the foreign currency credit interests. Despite the volatility characterizing this market, these interests had a rising tendency compared to the third quarter the previous year. Meanwhile, the difference between lek-foreign currency credit interests have in general, had a downward tendency.

IV.5 EXCHANGE RATE PERFORMANCE

The lek appreciated slightly against both currencies, the euro and the dollar, over the third quarter. At the end of September, the lek to euro returned to the levels recorded in June, while remaining appreciated against the dollar by 0.6 per cent. The lek is presented strong against the dollar even in annual terms, with an average appreciation of 4.2 per cent, while being more stable against the euro, with an average depreciation of 0.1 per cent. In nominal effective terms, the lek appreciated by 0.1 per cent over the third quarter.

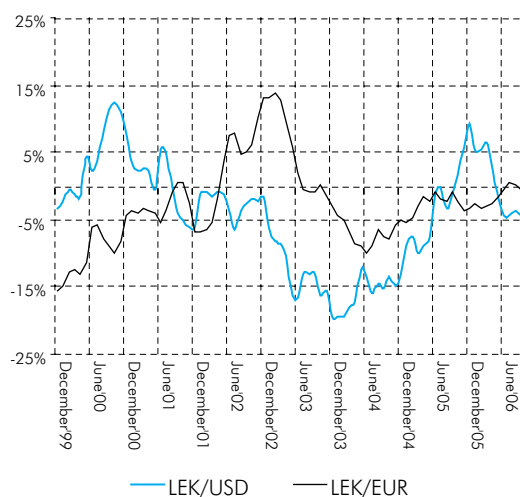
The seasonal effect of summer on the lek appreciation has been more moderate in this quarter compared to the previous year. Despite the higher volatility in the lek exchange over the third quarter compared to the previous quarters, it followed the downward trend observed over the years. Through time, the lek gained stability, in particular to the euro.

Chart 33 Difference of (real) lek – foreign currency interest for 12-month deposit



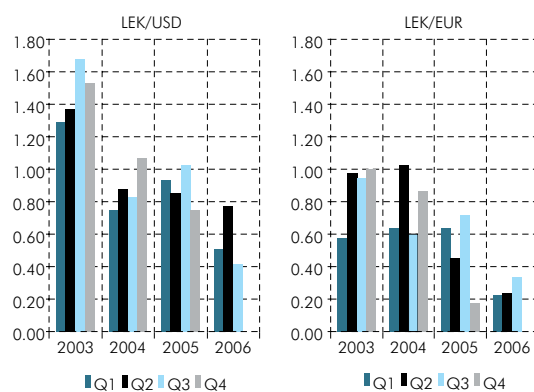
Source: Bank of Albania and commercial banks

Chart 34 Annual changes in the exchange of lek



Source: Bank of Albania

Chart 35 Volatility²² in the exchange of lek over quarters



Source: Bank of Albania

Macroeconomic factors, such as the stable economic growth, the low inflation, the transparency and the reduced uncertainty regarding the performance of these indicators in the future, combined with the improvements in the foreign exchange market functioning, are considered as positive influences on the lek stability.

NOTES

¹ FOMC – Federal Open Market Committee – the decision-making body of the Federal Reserve monetary policy, the central bank of the USA.

² See Box 1 for more detailed information.

³ Referring to the nominal effective exchange rate, measured by the Bank of Albania.

⁴ INSTAT corrected the CPI figure for August 2006, from 109.3 to 108.6 per cent, resulting in a lower annual inflation rate, from 3.1 to 2.8 per cent.

⁵ Source: ISTAT; web page <http://www.istat.it>

⁶ Source: National Statistical Service of Greece; web page: <http://www.statistics.gr>

⁷ Source: Eurostat, web page <http://epp.eurostat.cec.eu.int>

⁸ (*) Preliminary values.

⁹ Source: National Statistical Service of Greece; web page: <http://www.statistics.gr>

¹⁰ Source: Italian National Statistics Institute; web page: <http://www.istat.it>

¹¹ Source: EUROSTAT; web page <http://epp.eurostat.cec.eu.int>

¹⁵ Average weighted interest for time deposits in lek.

¹⁶ The Bank of Albania quantitative objectives are part of the new PRGF/ EFF 2006 -2008 arrangement.

¹⁷ Aiming at a detailed analysis of the rapid lending developments, in June 2006 the Bank of Albania introduced 3 new credit forms to the commercial banks. The reporting methodology in these forms is believed to be subject to changes in the future.

¹⁸ Consumer loan includes household overdraft, as well.

¹⁹ “Durable consumer goods” implies that category of consumer goods, which may be used for a long time without being consumed (finished).

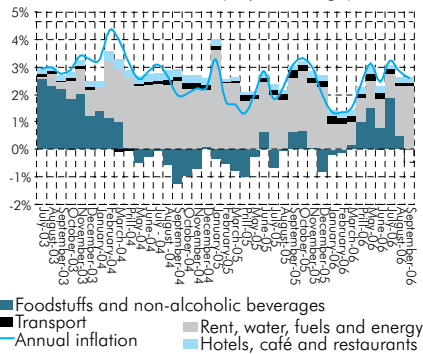
²⁰ See the data on the table “Statistical Annex – Financial Markets”.

²¹ Operative data.

²² Calculated as the quarterly average of the exchange rate volatility. Exchange rate volatility is measured as the standard deviation $\sqrt{\frac{\sum (x_i - \bar{x})^2}{n-1}}$, x_i – exchange rate in period i , \bar{x} – period average of i (for example, the exchange rate in a day of a certain month in year i minus the average rate of the month in year i).

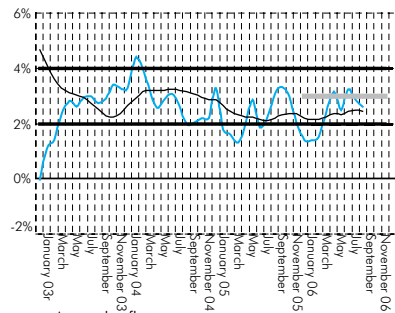
STATISTICAL ANNEX

Chart 1 Contribution of main groups to annual inflation (in percentage)



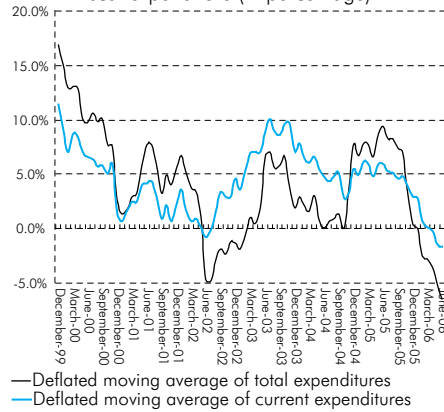
Source: INSTAT

Chart 2 Annual inflation (in percentage)



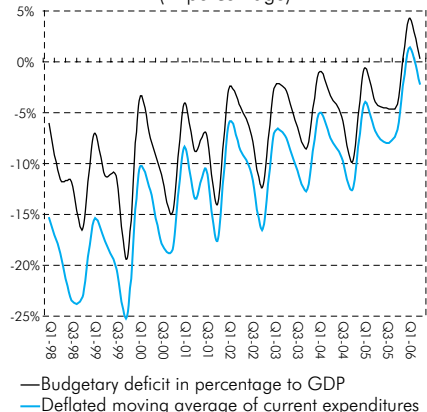
Source: Bank of Albania, INSTAT

Chart 3 Cumulative and actual fiscal expenditure (in percentage)



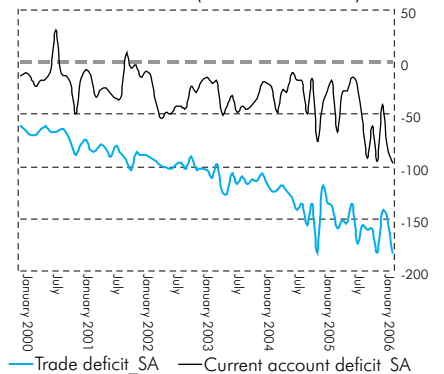
Source: Ministry of Finance

Chart 4 Total and primary deficit (in percentage)



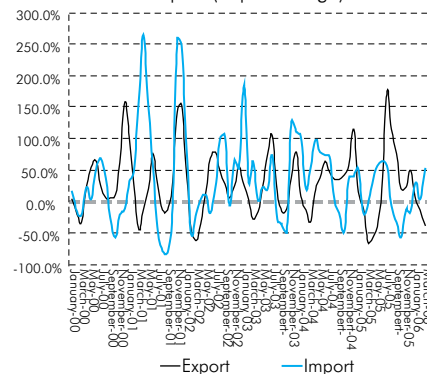
Source: Ministry of Finance

Chart 5 Monthly trade balance and current account (in billions of USD)



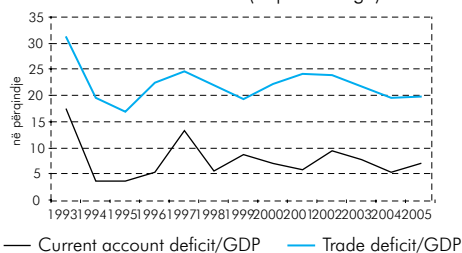
Source: Bank of Albania

Chart 6 Annual growth of import and export (in percentage)



Source: Bank of Albania

Chart 7 Current account and trade deficit to the GDP (in percentage)



Source: Bank of Albania

INFLATION

Table 1 Annual inflation rate (in percentage)

	2001	2002	2003	2004	2005	2006
January	2.2	6.5	0.0	3.3	3.3	1.4
February	1.5	7.6	1.1	4.4	1.8	1.3
March	2.9	7.5	1.3	4.0	1.6	1.5
April	3.0	6.5	2.3	3.2	1.3	2.4
May	2.5	4.6	2.8	2.6	2.0	3.1
June	4.0	3.7	2.6	2.9	2.9	2.4
July	5.6	4.2	3.0	3.1	1.8	3.2
August	4.1	5.5	3.0	2.7	2.3	2.8
September	3.5	5.3	2.8	2.0	3.1	2.6
October	1.8	5.8	2.9	2.0	3.3	
November	2.8	3.7	3.4	2.2	3.0	
December	3.5	1.7	3.3	2.2	2.0	
Average	3.1	5.2	2.2	3.0	2.4	2.3

Source: INSTAT

Table 2 Contribution of basket constituent groups to total inflation

	February – 06	March – 06	April – 06	May – 06	June – 06	July – 06	August – 06	September – 06
Foodstuffs and non-alcoholic beverages	-0.11	0.16	1.03	1.51	0.80	1.86	0.51	-0.45
Rent, water, fuels and energy	0.93	0.85	0.84	1.00	1.04	0.88	1.78	2.32
Transport	0.1	0.14	0.13	0.23	0.24	0.19	0.13	0.10
Hotels, café and restaurants	0.19	0.20	0.22	0.22	0.22	0.16	0.18	0.18
Other	0.10	0.11	0.12	0.10	0.15	0.15	0.24	0.40
Total	1.33	1.48	2.35	3.1	2.45	3.24	2.84	2.55

Source: INSTAT, Bank of Albania

MONETARY AGGREGATES

Table 3 Performance of monetary indicators (in billions of ALL)

	August - 06	Monthly change		Annual change	
		Absolute	Percentage	Absolute	Absolute
Currency outside banks	147.7	3.1	2.1	7.2	5.1
Total deposits	470.2	15.6	3.4	51.1	12.2
- in lek	292.8	2.7	0.9	23.8	8.8
- in foreign currency	177.4	12.9	7.8	27.3	18.2
Demand deposits	144.4	4.1	2.9	30.9	27.2
- in lek	80.3	-4.6	-5.5	20.4	34.2
- in foreign currency	64.0	8.8	15.9	10.5	19.5
Time deposits	325.8	11.5	3.7	20.2	6.6
- in lek	212.5	7.4	3.6	3.3	1.6
- in foreign currency	113.4	4.1	3.8	16.8	17.5
M1	228.0	-1.6	-0.7	27.7	13.8
M2	440.5	5.8	1.3	31.0	7.6
M3	617.9	18.7	3.1	58.3	10.4
Money base	201.4	3.2	1.6	17.5	9.5

Source: Bank of Albania

Table 4 Performance of NFA indicators by main groups (in millions of USD)

	August - 06	Monthly change	Annual change
Net foreign assets	2,400.2	176.5	371.9
Foreign assets			
Bank of Albania	1,644.1	39.6	325.1
ODC	1,089.7	142.1	147.2
Foreign currency liabilities			
Bank of Albania	111.4	8.4	1.8
ODC	222.2	- 3.3	98.6

Source: Bank of Albania

Table 5 Performance of Net Claims on the Government indicators by main groups

	August - 06	Monthly change	Annual change
Net Claims on the Government	270,427.6	1,161.1	-15,698.1
Bank of Albania	53,348.7	1,250.8	-5,291.1
ODC	217,078.9	-90.1	-10,407.0
Deposits with the Bank of Albania	3,649.0	-683.9	2,475.4
Budget deficit	8,313.9	5.6	19,836.1

Source: Bank of Albania

Table 6 Performance of some main indicators

	2003	2004	2005		2006	
			S 1	S 2	S 1	August
M3 (in billions of ALL)	448.4	507.2	541.8	578.04	594.5	617.9
Domestic credit (in percentage to M3)	71.5	68.9	69.9	70.03	71.0	69.6
Credit to the Government (in percentage to M3)	60.2	55.1	52.2	48.94	45.3	43.8
Credit to economy (in percentage to M3)	11.3	13.8	17.7	21.10	25.71	25.81
Credit to economy (in percentage to total assets)	13.7	16.9	20.8	25.11	28.7	29.2
Credit to economy (in percentage to GDP)	6.8	9.0	11.2	14.57	17.6	18.1
Credit/deposits ratio (in percentage)	15.7	19.0	23.6	28.47	33.7	33.9

Source: Bank of Albania

Table 7 Outstanding credit indicators as a percentage to total

	2003	2004	September '05	Q1-06	Q2-06	July '06	August '06
Outstanding credit (in billions of ALL)	50.7	69.3	106.0	134.6	152.8	157.0	159.5
Credit to households	24.5	30.6	31.4	31.9	32.3	32.4	33.3
Credit to private sector	75.5	69.4	68.6	68.1	67.6	67.6	66.7
Short-term credit	46.0	34.0	33.7	32.5	31.1	31.2	30.2
Medium-term credit	33.3	36.0	33.1	30	31.2	31.2	32.6
Long-term credit	20.7	30.0	33.1	37.5	37.7	37.6	37.2
In lek	19.6	19.5	23.7	26.0	28.2	28.8	29.6
In foreign currency	80.4	80.5	76.3	74.0	71.8	71.2	70.4

Source: Bank of Albania

Table 8 New credit indicators as a percentage to total

	Total 2004	2005				2006			
		Q1	Q2	Q3	Q4	Q1	Q2	July	August
New credit (in billions of ALL)	99.7	22.1	32.8	32.1	32.9	29.4	35.7	12.7	11.3
Short-term credit	62.54	53.2	47	47.4	48.7	44.2	42	48	46
Medium-term credit	22.53	22.4	31	30.3	25.6	30.1	33	30	33
Long-term credit	14.93	24.4	22	22.2	25.7	25.7	26	21	21
Credit in lek	32.59	30.1	32.8	30.2	31.4	27.7	35	35	37
Credit in foreign currency	67.41	70	67.2	69.8	68.6	72.3	65	65	63

Source: Bank of Albania

Table 9 Distribution of credit by sectors of economy

	2004	Q3 '05	Q4 '05	Q1 '06	Q2 '06	August '06
Agriculture, Hunting and Silviculture	1.5	2.4	2.7	2.2	0.9	0.7
Fishing	0.1	0.1	0.1	0.1	0.1	0.1
Extracting industry	0.3	0.5	0.5	1.4	2.3	1.0
Processing industry	17.1	13.9	13.8	14.2	15.3	14.1
Production, distribution of energy, gas and water	2.8	2.9	2.6	2.4	1.1	2.0
Construction	9.8	12.8	13	13.0	12.2	13.5
Trade, repairing of vehicles and household equipment	23.3	20	18.9	19.0	22.5	23.2
Hotels and restaurants	8.3	4.4	4.3	4.8	4.1	3.8
Transport and telecommunication	2	1.7	1.5	1.3	1.6	1.6
Financial activities	0.2	0.7	0.8	0.7	1.3	0.7
Health and social activities	0.5	0.6	0.7	0.6	0.6	0.6
Collective, social and personal services	4.8	5.9	5.8	4.6	1.7	1.8
Other*	29.1	34.1	35.4	35.7	36.2	36.8
Total	100	100	100	100.0	100.0	100.0

Source: Bank of Albania

*"Other" includes credit extended to some sectors sharing a small weight in the country's economic activity and credit to households. Upon the introduction of new credit forms, was required a review of the credit distribution by sectors, where the new classification was introduced.

FINANCIAL MARKETS

Table 10 Interest rates in September and their change compared to previous periods (in percentage points)

	September-06	Change September '06-June '06	Change September '06-September '05
Core interest rate	5.25%	25	25
Interbank market			
Overnight transactions	4.17%	-0.04	-0.55
Weekly transactions	5.32%	0.17	0.42
Primary market			
3-month Treasury bills yield	5.96%	0.73	-0.77
6-month Treasury bills yield	6.43%	1.01	-2.21
12-month Treasury bills yield	7.13%	1.39	-2.00
Bonds market			
2-year bonds yield	7.8%	1.4	-1.9

Source: Bank of Albania and commercial banks

Table 11 Deposits and credit interest rates (in percentage points)

	August - 06	Change August '06 - June '06	Change August '06- August '05
Core interest rate	5.25%	25	25
Interest of deposits in ALL			
3-month	3.66%	-0.08	0.53
6-month	4.26%	-0.09	0.36
12-month	5.12%	0.07	0.70
24-month	5.84%	-0.06	-1.07
Interest of credit in ALL			
Up to 6-month credit	11.96%	0.68	-2.53
6-month - 1 year credit	11.95%	0.15	-1.07
1 - 3 years credit	15.70%	-0.19	-0.45
Over 3-year credit	11.89%	0.47	-0.18

Source: Bank of Albania and commercial banks

Table 12 Interest rates of deposits in foreign currency (in percentage points)

	August - 06	Change August '06 – June '06	Change August '06 – August '05
Fed - Core interest rate	5.25%	0.25	2.00
Interest of deposits in USD			
1-month	2.98%	0.64	1.15
3-month	3.41%	-0.12	1.28
6-month	3.57%	0.16	1.26
12-month	4.37%	0.55	1.58
24-month	4.92%	0.54	1.77
ECB – Core interest rate	3.00%	0.25	1.00
Interest of deposits in EUR			
1-month	2.35%	0.22	0.68
3-month	2.75%	0.32	0.93
6-month	3.02%	0.11	1.19
12-month	3.44%	0.40	1.53
24-month	3.80%	0.17	0.74

Source: Bank of Albania and commercial banks

Table 13 Interest rate spread of deposit-credit in lek and in foreign currency

Spread of deposits interest:				
	ALL-USD		ALL-EUR	
	August '05	August '06	August '05	August '06
3-month	1.00%	0.25%	1.31%	0.91%
6-month	1.59%	0.69%	2.07%	1.24%
12-month	1.63%	0.75%	2.51%	1.68%
Spread of credit interest:				
	ALL-USD		ALL-EUR	
	August '05	August '06	August '05	August '06
6-month	7.32%	2.33%	6.75%	3.84%
6-month – 1 year	0.53%	1.14%	8.04%	3.52%
1-3 years	10.58%	5.75%	8.91%	7.51%
Over 3 years	3.51%	3.02%	6.17%	2.68%

Source: Bank of Albania and commercial banks