

QUARTERLY REVIEW OF ALBANIAN ECONOMY, FIRST QUARTER 2006

APRIL 2006

1 GOVERNOR'S SPEECH

The Albanian economy at the end of the first quarter 2006 continued to be characterized by a general macroeconomic stability, mainly reflected in keeping inflation under control, and by a considerable budget surplus, caused as a result of income realization above the projected level, while budget expenditures have resulted lower. Local currency has been stable throughout the period, while the data for January indicate that the volume of foreign trade in terms of value has undergone a significant growth compared to the same period the previous year. Like in the previous year, credit to economy marked stability in the growing rates, as such becoming the main source of money supply growth.

Annual inflation over the first quarter 2006 remained below the low limit of the objective of the Bank of Albania. Average annual inflation rate for this period was 1.4 per cent, recording a decrease of 0.8 percentage points compared to the same period the previous year. The low inflation recorded over the first quarter was determined by the low pressure exerted on consumer prices by the aggregate demand, and by the lack of excessive inflationary pressures by the supply factors. Monetary and fiscal policies have contributed to maintaining macroeconomic stability, by keeping demand inflationary tendencies under control.

The monetary policy pursued over the first quarter 2006 has maintained the monetary factor stability in the inflation rate performance. The slowdown in the growing rates of monetary indicators and the sustainability of financial indicators have been consistent with the current dynamic of inflationary pressures on economy. The growing rate of money supply slowed down over this period, meanwhile the LEK exchange rate is presented stable and money supply liquidity ratios have improved. The time structure of interest rates in economy fluctuates to minimal and stable intervals compared to the historical standards, as such reflecting the expectations for low inflation rates in the medium-term.

Fiscal policy over the first quarter, following the significant reduction of domestic financing at the year-end 2005, had a direct impact on the establishment of a non-inflationary environment. According to the data provided by the Ministry of Finance, by the end of March was collected 106 per cent of the planned income and were realized about 87.6 per cent of the projected expenditures. Fiscal balance for the first quarter resulted in about LEK 10.3 billion of surplus, compared to the forecasted amount of LEK 1.1 billion. The increase in the budget income testifies for a step forward in the enhancement of efficiency in fiscal administration.

Treasury bills yield has displayed a slight but gradual decrease throughout the first quarter, as a result of the added income and the Government's constraint in spending. However, the Government's spending policy over the second semester of 2006 should be pursued prudently, in order to correct the possible negative effects of its concentration in short time intervals. Moreover, the carrying out of capital investments calls for greater attention on behalf of the competent authorities, since these investments are utilized for the creation of the required infrastructure in order to support the economic growth in the long run.

Lek exchange rate is presented stable in nominal effective terms; however, there has been an annual appreciation of 1.0 per cent. Over the first quarter, the average exchange rate of lek to euro marked an annual appreciation of 2.9 per cent. However, the appreciating tendency of Lek to Euro has decreased compared to the previous quarter and to the same period the previous year.

The performance of oil prices in the international markets in the quarter being analyzed shows an increasing external pressure. The annual rise of fuel prices in these markets was 23 per cent. The recent rise in prices and the vague perspective characterizing this market, raise a lot of questions regarding the impact of this product price on economy. The small weight shared by this product (subgroup, wherein the oil price is included, shares a weight of 1.6 per cent in the consumer index basket) causes its direct effect on inflation to be limited. However, second round effects, which may influence on inflation in the form of increase in costs, remain a concern.

Money supply annual growth decreased to 11.6 per cent in February compared to 14.0 per cent at the year-end 2005. Over the first two months, M3 aggregate grew by only LEK 2.2 billion in absolute value. The return of cash into the system, after its seasonal growth at the end of the previous year, resulted in more rapid rates than projected. Moreover, the positive fiscal balance sheet of the public sector in the first months of the year conditioned the low Government's borrowing from the banking system. Both these factors have established the grounds for a rapid increase of liquidity in the system over the first quarter.

The banking system excess liquidity at the end of the first quarter displayed a growing tendency to the level of LEK 9.5 billion, while the quarterly average resulted in about LEK 5.8 billion. The presence of the Bank of Albania in the money markets has aimed at withdrawing the system liquidity through the use of long-term and short-term instruments of the monetary policy. Reverse repurchase agreement of one-week maturity, with fixed and very unlimited price, was the main instrument. Starting from February, the Bank of Albania withdrew liquidity through repos of three-month maturity, while the liquidity invested by banks in repos of one-month maturity was in minimal levels. The withdrawal of liquidity through three-month and one-month repos has aimed at smoothing the decreasing pressures of interest rates in the money markets. Moreover, the Bank of Albania has withdrawn the daily excess liquidity through the use of overnight deposit.

Pursuant to its strategy for the accomplishment of quantitative objectives, the Bank of Albania has also been present in the foreign currency market. Foreign exchange market interventions have resulted in the injection of about LEK 0.8 billion currency in circulation. The presence of the Bank of Albania in this market has improved the position of foreign reserve for the first quarter, thus, contributing to the increase in the level of reserve by about USD 100 million above the objective. Under the conditions of tightening the monetary basis was enabled the observance of the objective of net domestic assets, while the lack of need for fiscal deficit financing has left the level of net domestic credit to the Government unchanged.

The currency and time structure of money supply has observed the historical tendencies noticed in the recent years. The foreign currency component of money supply has continued to grow rapidly. The ratio of foreign deposits to M3 in February grew to 27.2 per cent compared to 24.1 per cent in the same period the previous year.

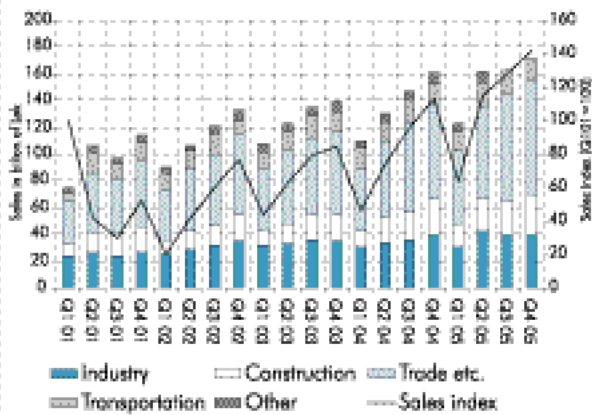
Credit performance in January – February 2006 maintained the upward tendency as noticed in 2005. Credit balance grew by LEK 7 billion or with an annual average rate of 71.4 per cent. During this period was extended a total of LEK 18 billion of new credit or 31 per cent more than the credit extended over the same period the previous year. At the end of February 2006, credit to economy shared 22.2 per cent of M3 and 15.2 per cent of the GDP projected for year 2006. On the other hand, the further increase was also reflected by the indicators of bank intermediation. The ratio of credit to total assets of the banking system reached to 25.6 per cent, while its ratio to total deposits to 29.2 per cent. The rapid credit growth may have influenced on the deepening of current account deficit, supporting the increase of demand for imported goods and machinery.

The ratio of short-term credit to total credit has maintained a downward tendency in the first two months of 2006. On the other hand, it is observed that credit of over 5 years of maturity continues with its upward trend, evidencing at the end of February a considerable growth to 38 per cent of credit portfolio. Crediting to branches of economy has generally maintained the same distribution as in the end 2005. Trade sector remains the most credited branch sharing 18.7 per cent of credit portfolio. Credit to the production sectors of economy has increased most considerably, reaching to 14.3 per cent. Credit to the construction sector has remained unchanged to the level of 13 per cent of credit portfolio.

In its perspective viewpoint, the Bank of Albania is above all underpinned by its inflation forecasting models. Pursuant to these forecasts and expected developments, both national and international, we are assessing prudently the appropriateness of the current position of the monetary policy and the 5 per cent level of the core interest rate.

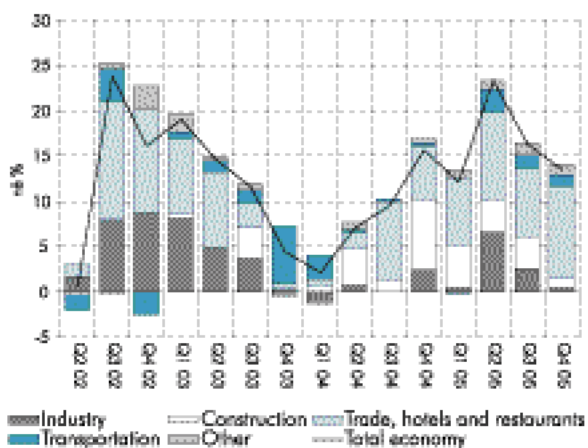
Although the short-term forecasts indicate an under-control inflation rate, we are seriously assessing a few potential risks, which for a while have

Chart 1 Performance of economy sales over Q1 '01 – Q4 '05



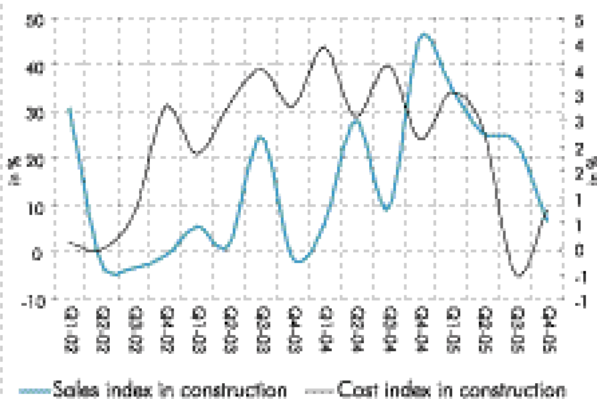
Source: INSTAT, Sales index

Chart 2 Contribution of sectors to economy sales (in percentage points)



Source: INSTAT, Sales index

Chart 3 Annual change of sales index for the construction sector (left axis) and of the cost index in construction (right axis)



Source: INSTAT, Sales index

been pending on our economy. In more concrete terms, factors such as: the performance of oil and energy prices, the rapid increase of crediting, large possible concentration of budget expenditures in the last months of the year (including a possible supplementary budget) as well as the constant decrease of the difference between the interest rates in LEK and those in foreign currency, may call for the need of a possible modification of the monetary policy target, releasing it from the relatively long status of neutrality it has been in.

2 ECONOMIC DEVELOPMENTS AND INFLATION

2.1 ECONOMIC ACTIVITY AND ECONOMIC GROWTH

The assessment of the Albanian economy performance over the first quarter 2006 becomes difficult, due to the lack of data for almost all economic indicators by different sectors. The available data enable the analysis of economy sales for the last quarter 2005 and the performance of the energy sector over the first quarter 2006.

Sales index of economy in the last quarter 2005 increased in total by 13.5 per cent in annual terms. The increase in sales by sectors has changed the dynamics over the last quarter of 2005. The contribution of "Industry" and "Construction" to the annual growth of economy sales has decreased significantly compared to the previous year. The contribution of the industry sector and the construction sector to the growth of economy sales over the last quarter of 2005 was 0.36 and 1.1 percentage points, respectively. Over the same quarter the previous year, these sectors contributed by about 2.4 and 7.9 percentage points, respectively. Meanwhile, the contribution of "Trade, hotels and restaurants" increased from 5.8 to 10.1 percentage points.

Construction

Judging from the sales performance and the performance of "Import of cement", the sector of

“Construction” has lowered the increasing rates over the fourth quarter of 2005. Sales for this period have marked an annual growth of 6.8 per cent, compared to 45.6 per cent in the previous year, while the cement imports decreased by 1 per cent. Construction costs, as indicated by the cost index in construction, increased reasonably, both compared to the previous quarter and the previous year.

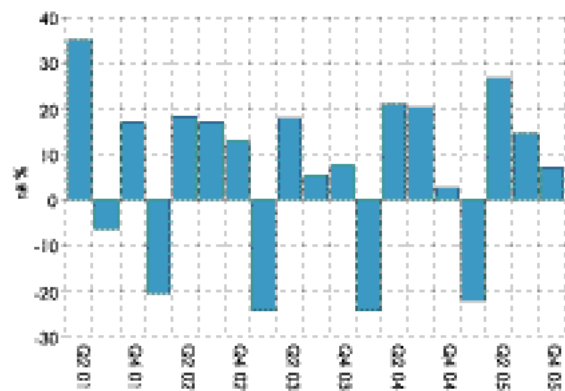
Services

Services sector continues to share a significant weight in economy sales. “Trade, hotels and restaurants” item contributed to the annual growth of the general index by 10 point percentage, as such determining almost its entire upward amplitude. The annual growth of this sector’s sales was 21.6 per cent, while compared to the previous quarter, the growth reached to 7.2 per cent. The booming in the production of this sector was accompanied by an increase in the prices’ contribution of this group to the consumer price index.

Industry

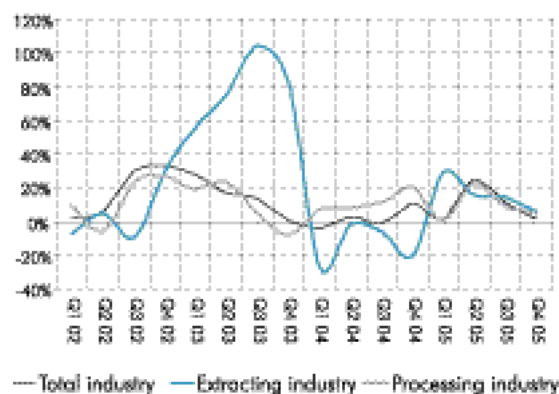
Industry sector, one of the most significant sectors of the Albanian economy, as regards its increasing weight and contribution, increased by 1.7 per cent over the fourth quarter of 2005. Extracting industry holds 7.4 per cent of this sector’s sales weight, making a contribution to its growth by 0.5 percentage points. The annual growth of the industry sector’s total sales was determined by the increase in the sales of “Processing industry” sector. The latter contributed to total growth of industry sales by 3.6 points percentage.

Chart 4 Quarterly rate of sales change in “Trade, hotels and restaurants” sector (in percentage)



Source: INSTAT, Sales index

Chart 5 Annual change of sales in “Total industry” sector and constituent branches



Source: INSTAT, Sales index

	Share to total	Sales '05/'04
Total industry	100	1.7 per cent
Extracting industry	7.4	6.1 per cent
Processing industry	67.3	5.3 per cent
Energy, water and gas	25.3	-7.8 per cent

Source: INSTAT, Sales index

Table 1 Performance of sales in the industry sector for the first semester 2005 (in percentage)

As noticed in the following chart, processing industry increased with lower rates than in the previous year. Meanwhile, extracting industry has begun to mark positive increasing annual rates, after a decrease by 20 per cent in the last quarter of 2004.

Energy

Over the first two months of the current year was recorded an annual growth in the energy supply by 8.4 per cent. The increase in supply was

mainly covered by import, considering that the domestic production of energy suffered a decrease by about 11.4 per cent compared to the production of the same period the previous year. Hydro electric power remains the greatest source of energy production in the country, covering about 98 per cent of total production. Import of energy increased significantly over this period compared to the same period the previous year. Import during January-February 2006 shared 17.9 per cent of the supply.

Losses in the system increased, recording a level of 19.6 per cent higher than the same period the previous year, while losses in equipment resulted 27.1 per cent higher. Invoiced consumption increased modestly by 0.4 percentage points, while the fact that un-invoiced consumption has increased by 139.5 per cent compared to the same period the previous year, remains an issue.

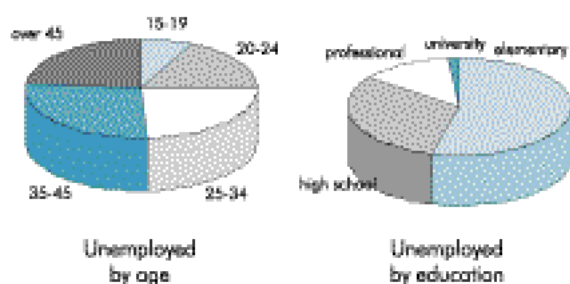
Table 2 Electricity balance
(in GWh)

	Jan-Feb 04	Jan-Feb 05	Jan-Feb 06	Jan-Feb 06/05 in percentage
Domestic production energy	1,023.4	1,110.9	983.7	-11.4
Import	176.1	13.1	209.3	1,494
Distribution	1,124.8	1,077.7	1,168.5	8.4
Losses in distribution	481.9	444.3	531.4	19.6
Technical losses	216.3	222.4	282.6	27.1
Invoiced consumption	642.9	633.4	637.0	0.6
Un-invoiced consumption	265.6	221.9	531.5	139.5
Household's invoiced consumption	405.6	398.1	399.6	0.4
Household's invoiced consumption (in percentage)	63.1	62.8	62.7	-0.2

Source: Albanian Power Corporation

2.2 LABOUR MARKET

Chart 6 Unemployment structure by age-group and education



Source: Ministry of Labour, Social Affairs and Equal Opportunities

Due to the lack of more complete statistical data¹, it may be concluded that the labour market has developed slightly over the first two months of 2006. This period was characterized by a further reduction of the number of unemployed, registered in the employment offices. This fact is underpinned by the analysis of the data on the rate of unemployment until the end February. Until this period, the number of unemployed² reduced by 1156 persons compared to the end December in the previous year, raising the number of unemployed to 152094 or 14 per cent of all labour forces³. Compared to the previous year, the employment rate has reduced by 2.5 percentage points. With regard to the unemployment structure, most of it is composed of unemployed above 35 years of age and their education does not exceed the eight-year school.

Labour force and employment over the first quarter were not characterized by an increase in figures. State administration reform, in particular reforms in large state-owned enterprises, yet unprivatized, are deemed to have led to the decrease of employment figures in the first quarter of the present year (the same was observed in the fourth quarter of 2005). Meanwhile, increase is expected in the private non-agricultural sector. In general, the increase in the employment figures over the recent years has been mainly due to the increase of employment in this sector. From the first quarter 2004 to year-ended 2005, this sector has opened 9 thousand of new work places. Another important factor in the employment of this sector is the decrease of taxes for the small business.

	2004				2005			
	Q.I	Q.II	Q.III	Q.IV	Q.I	Q.II	Q.III	Q.IV
Total of labour forces (in thousand of people)	1080	1081	1080	1074	1087	1086	1086	1086
A. Total of employed (in thousand of people)	919	921	922	917	931	931	931.2	932
i) in the public sector	179	179	177	171	176	175.6	175.6	175
ii) in private non-agricultural sector	206	208	211	212	213	213.4	214	215
iii) in private agricultural sector	534	534	534	534	542	542	542	542
B. Unemployment (in thousand of people)								
i) Total of unemployed	161	160	158	157	156	155	154.8	154
ii) Total of individuals benefiting unemployment compensation	11.7	12.3	12	11	11.5	11.5	11.5	11.2
C. Unemployment rate (in percentage)	14.9	14.8	14.6	14.4	14.3	14.3	14.2	14.2

Table 3 Labour market figures (in thousand of people)

Source: INSTAT, Conjecture, April 2006

The average salary in the public sector has risen over the recent years. Rise in salary is expected to be more considerable over 2006. The Ministry of Labour, Social Affairs and Equal Opportunities has confirmed the rise of the minimal salary, teachers' salary and of low salary categories, as well as the pension indexation.

2.3 FISCAL SECTOR

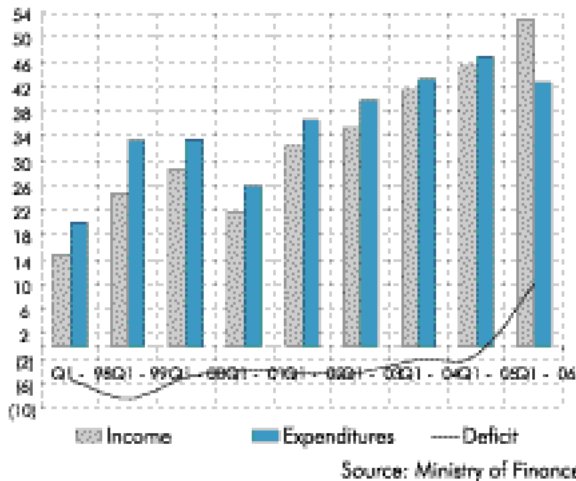
According to the data made available by the Ministry of Finance, by the end of March was collected 106 per cent of the planned income and were realized about 87.6 per cent of the projected expenditures. Fiscal balance for the first quarter 2006 resulted in about LEK 10.3 billion of surplus, compared to the projected amount of LEK 1.1 billion. The increase in the budget income testifies for a step forward in the enhancement of efficiency in fiscal administration. Over the first quarter of the year was observed a breakdown of the trend generated over the last eight years, when there has been a fiscal balance deficit.

Table 4 Growth rates of fiscal indicators (in percentage)

	Q1-01/00	Q1-02/01	Q1-03/02	Q1-04/03	Q1-05/04	Q1-06/05
Income	-24.0	48.5	9.1	16.9	9.8	16.7
Expenditure	-22.7	47.0	9.8	7.8	8.0	-6.0
- Capital expenditure	-19.9	8.0	-1.6	23.2	7.5	-33.7
Deficit	-17.4	2.0	4.7	-53.5	-30.0	-829.1

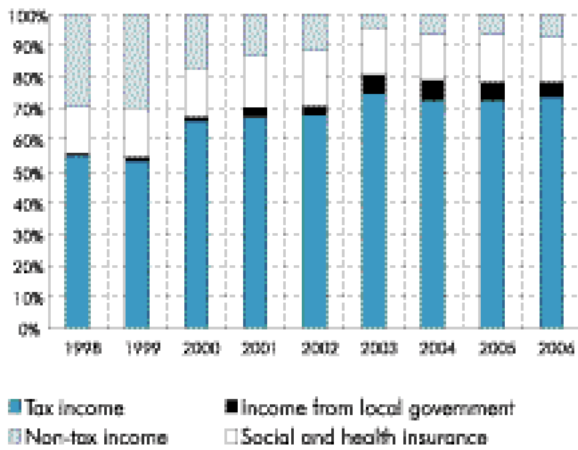
Source: Ministry of Finance

Chart 7 Main fiscal indicators, January – February 2006 (in billions of LEK)



Source: Ministry of Finance

Chart 8 Budget income structure for the first two months of the year (in millions of LEK)



Source: Ministry of Finance

Table 5 Growth rates of income over 2002-2005 (in percentage)

	Q1 - 03/02	Q1 - 04/03	Q1 - 05/04	Q1 - 06/05	Average 2002-06	Plan Realization Q1 - 06
Total income	9.1	16.9	9.8	16.7	13.1	106.3
Tax income	47.1	13.3	8.8	15.2	21.1	105.6
Value Added Tax	15.7	15.7	7.9	16.3	13.9	106.5
Tax on profit	12.7	11.4	35.1	24.4	20.9	139.4
Excises	50.6	17.8	20.4	34.1	30.7	122.1
Tax on personal income	-3.7	22.7	-2.3	23.9	10.1	108.0
Customs duties	10.7	-2.7	-4.0	18.0	5.5	112.5

2.3.1 Budget income

The first quarter of 2006 displayed a high growth of fiscal income. Total income grew to the level of 16.7 per cent compared to the same period the previous year, representing one of the highest levels of income growth over the recent years. Excise and tax income have had their best performance with regard to income.

Meanwhile, compared to the same period the previous year, income from local government decreased by 13.4 per cent.

The level of tax income at the end of the first quarter amounted to about LEK 47.3 billion, while tax collected from the customs resulted in about LEK 3.4 billion, realizing the forecasted level in the draft budget of the beginning of the year by 105.6 and 112.4 per cent, respectively.

Value Added Tax constitutes the main source of tax income. The growing rates of VAT income over the first quarter were 2.4 percentage points higher than the average growth of this indicator over the last four years. Moreover, except for income from the local government, all other fiscal income indicators have exceeded the plan forecasted for this period.

Income from local government	187.7	41.8	-0.2	-13.4	54.0	79.0
Income from independent budget (contributions)	14.8	10.1	11.7	11.5	12.0	100.6
Non-tax income	-53.1	93.0	6.1	24.6	17.6	133.8

Source: Ministry of Finance

2.3.2 Budget expenditures

Budget expenditures over the first quarter of this year reached the level of LEK 42.7 billion, constituting about 87.6 per cent of the programmed level for this period. For the first time in the last 14 years, total expenditures were lower than the same period the previous year, marking an annual decrease of 8.9 per cent. Budget plan for 2006 forecasts a reduction of 9.5 percent of Government expenditures over this year, compared to the previous year.

Current expenditures, which constitute about 92 per cent of total expenditures, marked a decrease of 6 per cent compared to the previous year. Maintenance, interest and local government operative expenditures recorded the highest decrease in this period, by 30.7, 9.0 and 18.2 per cent, respectively.

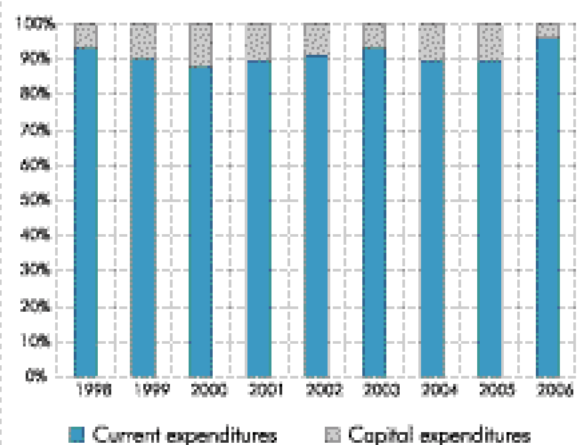
Personnel expenditure, which constitutes 30.5 per cent of current expenditures and 28.2 per cent of total expenditures, were realized to the level of 100 per cent. Capital expenditures, which underwent a considerable decrease over the first quarter, continue to be below the planned level, realizing 55.6 per cent of the plan. Expenditures covered by domestic and foreign financing were realized to the level of 75.8 and 38.7 per cent.

It is observed that expenditures for social insurance and expenditures for social insurance contributions solely increased in current expenditures.

Meanwhile, maintenance operative expenditures and capital expenditures decreased more than the other expenditure indicators, being below the planned level.

Capital expenditures were considerably reduced over this period, but their performance over years is presented as asymmetrical, suggesting that their performance is remarkably influenced by the functioning of individual projects and Government priorities. Characteristic of capital expenditures is the growing weight of domestic financing against the foreign one.

Chart 9 Structure of budget expenditures (in percentage)



Source: Ministry of Finance

Table 6 Growth rates of expenditures over 2002-2005 (in percentage)

	Q1 - 03/02	Q1 - 04/03	Q1 - 05/04	Q1 - 06/05	Average 2002-06	Plan realization Q1 - 06
Total expenditures						
Current expenditures	8.6	9.2	7.9	-8.9	4.2	87.6
Personnel	9.8	7.8	8.0	-6.0	4.9	92.5
Wages	11.1	8.9	11.7	-0.2	7.9	100.0
Social insurance contribution	12.1	9.0	11.1	-1.2	7.8	100.2
Interests	7.6	8.5	13.9	3.5	8.4	99.3
Domestic	31.1	4.8	-7.0	-9.0	5.0	93.4
Foreign	32.7	5.3	-7.0	-10.2	5.2	95.4
Maintenance operative expenditures	4.8	-6.2	-5.4	20.3	3.4	67.4
Social insurance expenditures and other transfers	37.6	-6.5	10.2	-30.7	2.7	78.1
Capital expenditures	12.8	-4.0	12.1	5.7	6.7	96.0
Domestic financing	-1.6	23.2	7.5	-33.7	-1.2	55.6
Foreign financing	21.8	28.5	-19.0	5.3	9.1	75.8

Source: Ministry of Finance

2.3.3 Fiscal deficit

Due to high income and reduction of Government expenditures over the first quarter of this year, was accumulated a fiscal surplus of LEK 10.3 billion.

Table 7 Growth rates of deficit over 2002-2005 (in percentage)

	Q1 - 03/02	Q1 - 04/03	Q1 - 05/04	Q1 - 06/05	Average 2002-06	Plan Realization Q1 - 06
Deficit						
Domestic financing	4.7	-53.5	-30.0	-829.1	-227.0	922.2
Foreign financing	46.0	-82.6	-148.5	3334.0	787.2	482.1

Source: Ministry of Finance

Government borrowing projects an evident asymmetric distribution over 2006. In the draft budget of 2006, 92.5 per cent of the deficit is projected to result in the second semester of the year, while in the three previous years this semester was projected to share on average 62.3 per cent of annual deficit weight.

Table 8 Deficit distribution by quarters in the draft budgets of 2003-'06

	Q1	Q2	Q3	Q4
2003	31.3	20.6	19.8	28.3
2004	7.3	13.9	26.3	46.4
2005	5.1	28.9	34.2	31.8
2006	-6.7	14.2	29.2	63.4

Source: Ministry of Finance

2.4 EXTERNAL SECTOR OF ECONOMY

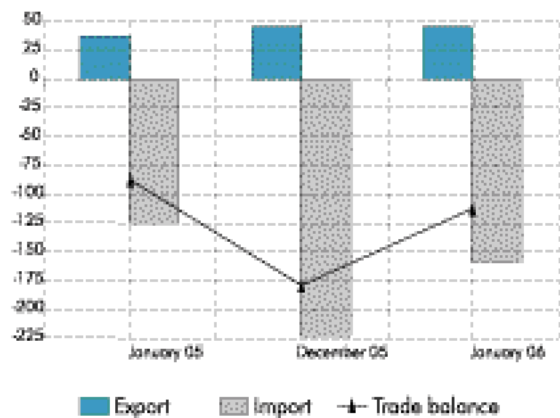
The volume of trade activity with the rest of the world over January 2006, reached to EUR 205.2 million, marking an increase by 26 per cent compared to the previous year. The increase of trade transactions for this period came as a consequence of the growth in both export and import. Exports in January amounted to about EUR 46 million or 21 per cent more than the same period the previous year. Imports amounted to EUR 159 million, increasing by about 28 per cent compared to the previous year.

Trade deficit for January marked EUR 113.3 million, deepening by 31 per cent in annual terms. The increase of imports was the main factor of trade deficit deepening. Despite the lack of information on balance of payments accounts for this period, based on the significant influence of trade balance on current account, it could be expected deepening of current account deficit for January.

2.4.1 Exports

Albanian exports over January 2006 were dominated by the commodity groups of textiles, footwear, mineral exports and base metals, which in total share 80 per cent of total exports. Export of mineral products recorded a considerable increase over this month. The weight of this commodity group to total exports for January 2006 was 13.5 per cent, compared to 0.86 per cent in the previous year. The export weight of the commodity groups of textiles, footwear and base metals to total exports marked a decrease by 12 percentage points, compared to the same period the previous year.

Chart 10 Trade balance (in millions of EUR)



Source: Bank of Albania

Table 9 Structure of exports and imports (in percentage)

		Export			Import		
		Jan '05	Dec '05	Jan '06	Jan '05	Dec '05	Jan '06
1	Live animals; animal products	0.27	0.32	0.77	3.34	2.31	3.08
2	Vegetable products	3.11	2.99	2.37	9.67	5.63	6.10
3	Animal or vegetable fats and oils	0.00	0.06	0.08	2.20	1.24	2.24
4	Prepared foodstuffs, spirits and vinegar, tobacco	3.92	2.59	3.19	6.97	7.20	7.15
5	Mineral products	0.86	3.37	13.48	10.88	14.75	19.02
6	Products of the chemical or allied industries	0.82	0.35	0.03	6.39	6.76	6.80
7	Plastics and articles thereof; rubber and articles thereof	0.43	0.66	1.14	3.43	2.63	2.50
8	Raw hides and skins, leather, fur skins and articles thereof	1.71	1.86	2.09	2.51	2.14	2.38
9	Wood and articles of wood; cork and articles of cork; manufactures of straw	1.83	1.28	1.31	1.46	1.39	1.01
10	Pulp of wood, waste of paperboard; paper and paperboard and articles thereof	1.28	1.62	2.18	1.71	1.55	1.51
11	Textiles and textile articles	33.96	27.67	27.61	11.27	9.28	9.77
12	Footwear, headgear, umbrellas, artificial flowers	29.93	29.60	27.35	2.96	2.64	2.52
13	Articles of stone, plaster, cement; ceramic products; glass and glassware	0.37	0.44	0.54	5.16	3.68	3.11
14	Pearls; precious stones and metals; jewellery; coin	0.13	0.13	0.16	0.04	0.04	0.05
15	Base metals and articles of base metal	14.52	17.40	11.79	8.54	11.01	8.73
16	Machinery and mechanical appliances, electrical equipment; parts thereof	4.24	6.58	3.90	13.79	18.63	14.99
17	Vehicles, aircraft, vessels and associated transport equipment	0.14	0.40	0.09	6.29	4.94	6.57
18	Optical instruments and apparatus; clocks and watches; musical instruments	0.37	0.07	0.11	1.53	1.48	0.96
19	Arms and ammunition; parts and accessories thereof;	2.02	0.57	0.00	0.03	0.05	0.02
20	Miscellaneous manufactured articles	1.92	2.04	1.82	1.86	2.61	1.51
21	Works of art, antique	0.00	0.02	0.00	0.0	0.01	0.00
	TOTAL	100	100	100	100	100	100

Source: Bank of Albania

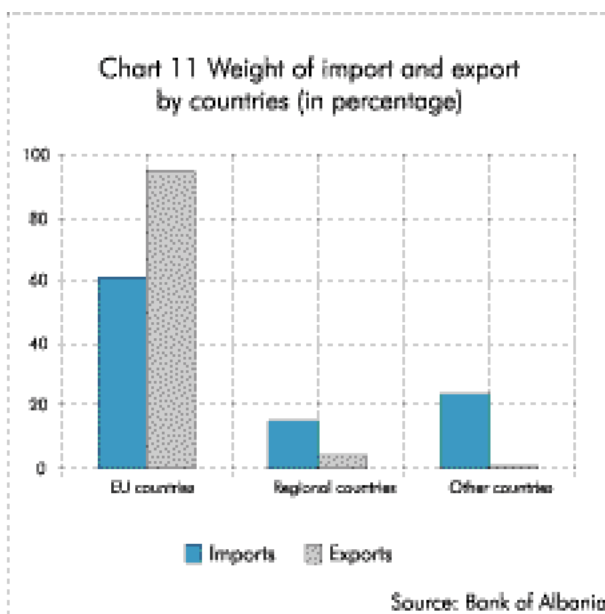
2.4.2 Imports

Import of goods is presented more diversified in items than export. The commodity groups of mineral products, machinery and mechanical appliances and textiles share the main weight in the import of goods, by 19, 14.9 and 9.7 per cent to total imports, respectively. In annual terms, the weight of agricultural products import to total imports has decreased by about 3.6 percentage points reaching to 18.6 per cent.

Geographical distribution of exports and imports

Export of Albanian goods was mainly oriented towards the European Union countries even during January 2006. Export with these countries shares 95 per cent of total exports. Albania's main trade partners with regard to export remain Italy with 81 per cent and Greece with 9 per cent. Export with regional countries⁴ for this month share 4 per cent of total exports. Main regional partners for January were Turkey, Kosovo and Macedonia.

Import of goods had a wider geographical expansion compared to export. However, European Union countries still share the main weight in import with 61 per cent of total import. Italy and Greece remain the main partners with regard to the import of goods, sharing 25 and 14 per cent of total import, respectively. Import with regional countries share 15 per cent of total import. Main partners for this month among regional countries were Turkey, Romania and Bulgaria. Main partners in imports with other countries were China, Russia and Ukraine.



2.5 INFLATION PERFORMANCE OVER THE FIRST QUARTER

Annual inflation remained below the low limit of the Bank of Albania objective over the first quarter 2006, after decreasing to the level of 2 per cent in December 2005. The average rate of annual inflation for the first quarter was 1.4 per cent, marking a decrease of 0.8 percentage points compared to the same period the previous year. Such a decrease was mainly influenced by the considerable slowdown of the rise in the prices of "Rent, water, fuels and energy" group.

Despite the positive contribution to the annual inflation rate by "Foodstuffs and non-alcoholic beverages" group for March 2006 (in contrast to its negative contribution over the same month the previous year), its pressure on total inflation was reduced by the decreasing contribution of "Rent, water, fuels and energy" group.

	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	
May	4.6	2.8	2.6	2.0	
June	3.7	2.6	2.9	2.9	
July	4.2	3.0	3.1	1.8	
August	5.5	3.0	2.7	2.3	
September	5.3	2.8	2.0	3.1	
October	5.8	2.9	2.0	3.3	
November	3.7	3.4	2.2	3	
December	1.7	3.3	2.2	2.0	
Average	5.2	2.2	3.0	2.4	1.4

Table 10 Annual inflation rate (in percentage)

Source: INSTAT

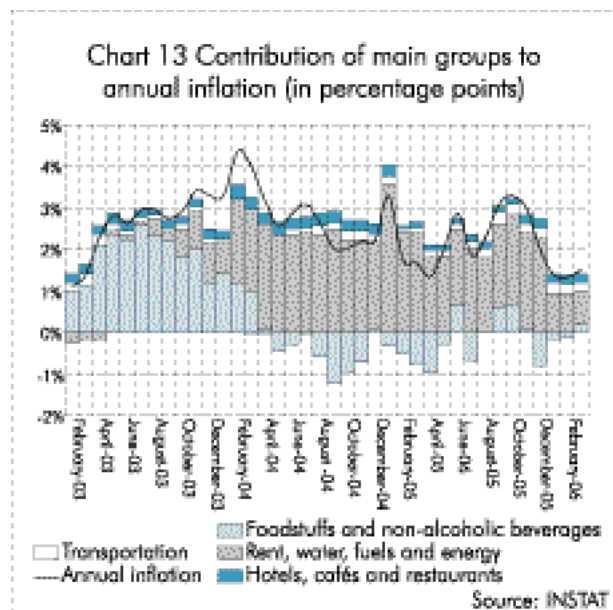
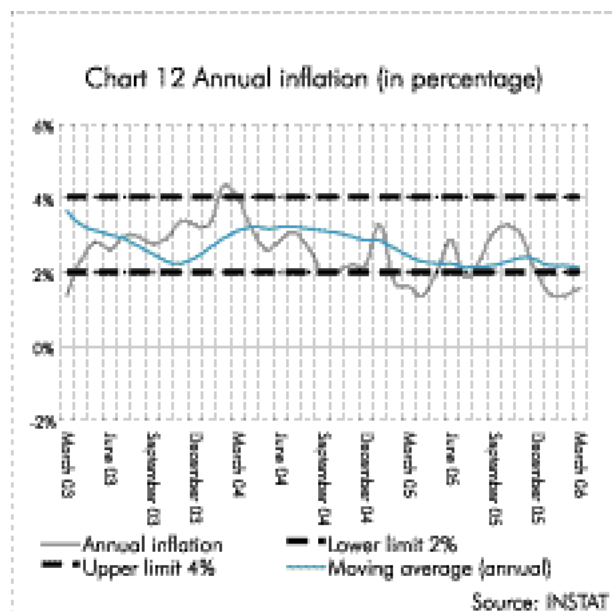
Monthly consumer price index increased gradually over the first quarter 2006, but with lower rates compared to the first quarter 2005. Average monthly inflation rate over the period being analyzed was 0.25 per cent. This rate was determined by the negative contributions of "Transportation" and "Rent, water, fuels and energy" groups and the positive contribution of "Foodstuffs and non-alcoholic beverages" group. Their contribution had an opposite track over the first quarter 2005.

Despite the smoother seasonal effect, the low inflation over this quarter also reflected the positive contribution of macroeconomic stability, the lack of shocks and the controlled inflationary pressures caused by the increase in oil prices.

2.5.1 Inflation performance by constituent groups

In general, the various groups of consumer price basket have maintained the track of their contribution to annual inflation over the first quarter 2006, but they have changed the intensity of this influence, compared to the first quarter 2005. The decreasing influence of inflation of "Rent, water, fuels and energy" group, somehow counterbalanced by a more moderate smoothing effect of "Foodstuffs and alcoholic beverages" group and the increase in the positive contribution provided by "Transportation" and "Hotels, cafés, and restaurants" groups, determined the annual inflation rate.

The prices of "Foodstuffs and non-alcoholic beverages" group, which display the most considerable unsteadiness within the consumer price



basket, recorded a decrease in the monthly rate over January and February, and an increase in March. Annual average rate of this group over the first quarter was -0.1 per cent, contributing to the average annual inflation rate by -0.04 percentage points. This contribution was -0.52 percentage points in the previous year. The positive contribution over March also reflected the rise in the prices of “Foodstuffs” in Greece and the decline of lek appreciation to the euro over March.

Table 11 Inflation of “Foodstuffs and non-alcoholic beverages” group and its weight in total inflation.

	Annual inflation '05	Contribution (pp)	Annual inflation '06	Contribution (pp)	Italy ⁵ Annual inflation '06	Greece ⁶ Annual inflation '06
January	-0.7	-0.3	-0.4	-0.2	1.1	1.6
February	-1.2	-0.5	-0.3	-0.1	0.9	2.1
March	-1.7	-0.7	0.4	0.2		

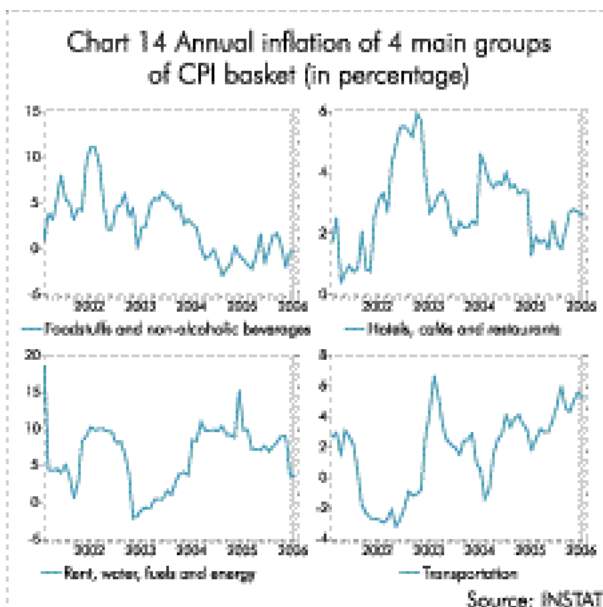
Source: INSTAT

Annual inflation of “Rent, water, fuels and energy” group fluctuated to about 3.5 per cent over the first quarter 2006. Annual inflation of 3.2 per cent in March 2006 is the lowest rate recorded since October 2003. Being the second group with regard to the weight it shares in total inflation after “Foodstuffs and non-alcoholic beverages” group, the increase in its index has influenced the positive inflation rates. The slowdown in the growing rate of this group index over the first quarter, brought the decrease of its average contribution to annual inflation rate to 0.9 percentage points. Average annual contribution in the first quarter the previous year was +2.8 percentage points. The fall in the price of rent, imputed rent and fuels influenced on the monthly decrease of this group index.

Table 12 Inflation of “Rent, water, fuels and energy” group and its weight in total inflation

	Annual inflation '05	Contribution (pp)	Annual inflation '06	Contribution (pp)
January	15.2	3.6	3.6	0.9
February	9.8	2.4	3.5	0.9
March	9.8	2.4	3.2	0.8

Source: INSTAT



Annual inflation of “Transportation” group remained in high levels over the first quarter 2006, despite the negative monthly changes of prices in this group. The annual growth by 23 per cent of oil prices in the international markets and the depreciation of the lek to the usd over the last two quarters have influenced on the increase of annual inflation of “Service to vehicles” subgroup, which increased by 9.6 per cent. Over the first quarter 2006, “Hotels, cafés and restaurants” group contributed to the average annual inflation in the same level as in the previous year. Monthly inflation over the first quarter was almost 0, with the exception of March, during which this group’s index increased by 0.6 per cent, thus reflecting the rise in the prices of “Cafés and restaurants” subgroup.

The other groups have not generally changed their influence on total inflation over the first quarter compared to the previous year. “Clothes and footwear” and “Furniture, household appliances and maintenance” contributed by -0.1 and -0.07 percentage points, while the other groups made a positive contribution.

2.5.2 Macroeconomic environment and consumer prices

The low inflation recorded over the first quarter was determined by the low pressure exerted on consumer prices by the aggregate demand and by the lack of excessive inflationary pressures by the supply factors. Monetary and fiscal policy has contributed to maintaining macroeconomic stability, transmitting neutral signals in demand inflationary tendencies.

Demand factors

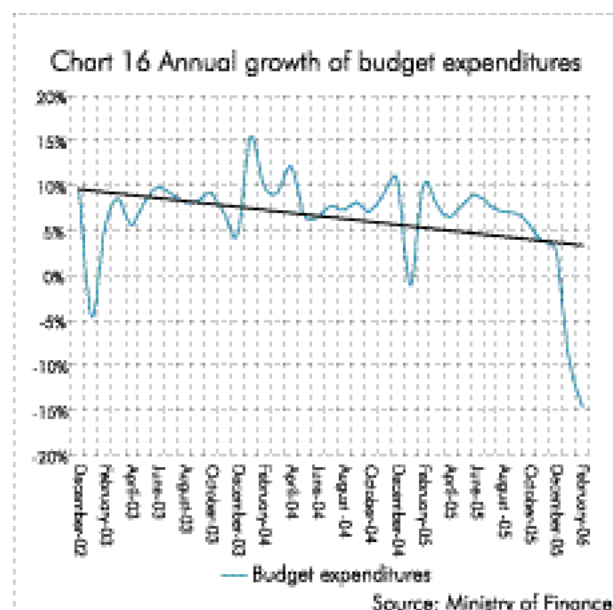
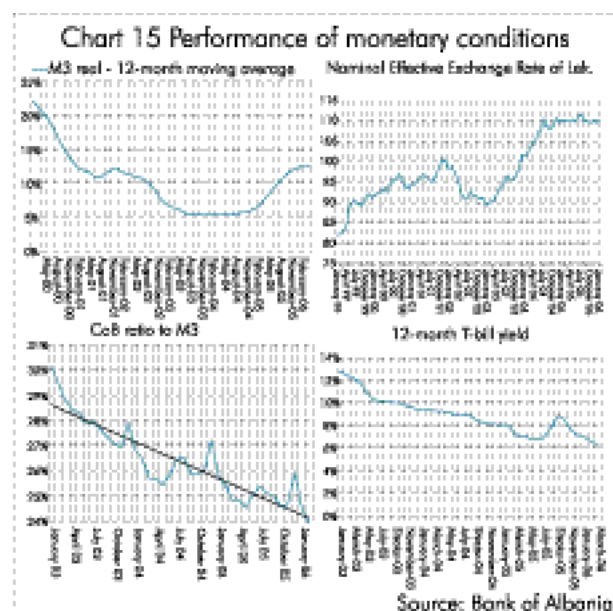
- Monetary policy and monetary indicators

The monetary policy pursued over the first quarter 2006 has maintained the monetary factor stability in the inflation rate performance. The slowdown in the growth rates of monetary indicators and the balance in financial markets have been consistent with the current dynamic of inflationary pressures on economy. Growth rate of money supply slowed down over the first quarter, while the lek exchange rate is presented stable and money supply liquidity ratios have improved. The time structure of interest rates in economy fluctuates to minimal and stable intervals compared to the historical standards, as such reflecting the expectations for low inflation rates in the medium-term.

- Fiscal policy and fiscal indicators

The prudent stance of fiscal policy over the first two months of 2006 resulted in a higher surplus than the forecast, which was reflected in a lower Government demand for money. General Government expenditures over the first two months were realized to the level of 85 per cent of the plan. On the other hand, Government income over these two months increased to the level of 104 per cent of the plan, resulting in a considerable fiscal surplus.

Fiscal policy and fiscal indicators will have a more significant contribution to inflation over the second semester of 2006, when budget expenditures and budget deficit are expected to increase.



- Other indicators of domestic demand

Sales index marked an annual growth of 13.5 per cent over the fourth quarter 2005 and a growth of 6.4 per cent compared to the previous quarter. Other indicators, such as fuels consumption and some other import indicators, which provide us with information related to the domestic demand of the Albanian economy for consumption, in general indicate a recovery compared to the previous quarter; however they display decrease in annual terms. "Consumption of energy by the population" and "Total vehicles import" decreased in the first quarter 2006 compared to the last quarter 2005, by 14.7 per cent and 35 per cent, respectively.

Supply factors

- Exchange rate and imported inflation

Lek exchange rate is presented stable in nominal effective terms; however, there has been an annual appreciation of 1.0 per cent. Over the first quarter 2006, the average exchange rate of lek to euro marked an annual appreciation of 2.9 per cent. Nevertheless, the appreciating tendency of lek against the euro has decreased, compared to the previous quarter and to the same quarter the previous year (lek appreciation for these periods was 3 per cent and 4.4 per cent, respectively). Such dynamic has enabled the transmission of inflation increase of "Foodstuffs" group in Greece over the last two months of the first quarter 2006 to the inflation of "Foodstuffs and non-alcoholic beverages".

The depreciation of lek against the dollar, which started in the last quarter of 2005, has reduced in the first quarter 2006 compared to the previous quarter, but in annual terms, lek depreciation is almost in the same levels (5.7 per cent). In quarterly terms, lek exchange rate against the dollar was estimated at 1 per cent in the first quarter, as such causing the influence of the rise in oil prices in international markets on the Albanian market oil prices to be overwhelmingly slight.

Table 13 Annual inflation of partner countries and changes in the exchange rate (in percentage) for 2005

	November	December	January	February	March
Greece ⁷	3.5	3.4	3.2	3.2	3.3
Italy ⁸	2.2	2	2.2	2.1	
Lek/Euro	-3.7	-3.2	-2.5	-3.3	-2.9
Lek/Usd	5.9	9.5	5.4	5.4	6.4

Source: INSTAT, Bank of Albania

- Production price index

Production price index has been decreasing over the last quarter of 2005, marking an increase of 0.4 per cent compared to the previous quarter and an annual change of +1.9 per cent. The annual change constitutes the lowest increasing rate of this indicator since the last quarter of 2001; however, it does not cause any problems as far as inflationary pressures are concerned, due to the rise of production costs.

- Oil prices

The performance of oil prices in international markets in the quarter being analyzed shows an increasing external pressure. The annual rise of fuel prices in these markets was 23 per cent. The small weight shared by this product (subgroup, wherein the oil price is included, shares a weight of 1.6 per cent in the consumer index basket) causes its direct effect on inflation to be limited. However, second round effects, which may influence on inflation in the form of rise in costs, remain a concern.

- Unemployment and wages

From the perspective of possible pressures on inflation, labour market is presented smoothing over the fourth quarter of 2005. The increase by 9.26 per cent of minimal wage was accompanied by an increase of public average wage by 7.9 per cent. However, this rise remains in line with the rise of wages over the same period the previous year. Employment indicators over the fourth quarter 2005 have displayed the same performance as in the first quarter the previous year; unemployment rate decreased by 0.2 percentage points compared to the previous quarter. However, this period was not characterized by the same growth rate in the number of employed. Such shifts have resulted in the decrease of capable labour force to total economy by 0.2 per cent or 2 thousand persons.

Inflation performance over the first quarter 2006 is displayed with positive figures, favoured by the controlled performance of demand factors and the moderate impact of supply factors. In general, inflation perspective remains positive for the rest of 2006. However, the continuous rise of oil prices and other risks related to supply remain factors with a possible negative impact on the performance of consumer prices.

Chart 17 Annual changes of PPI and CPI for 2002-2004

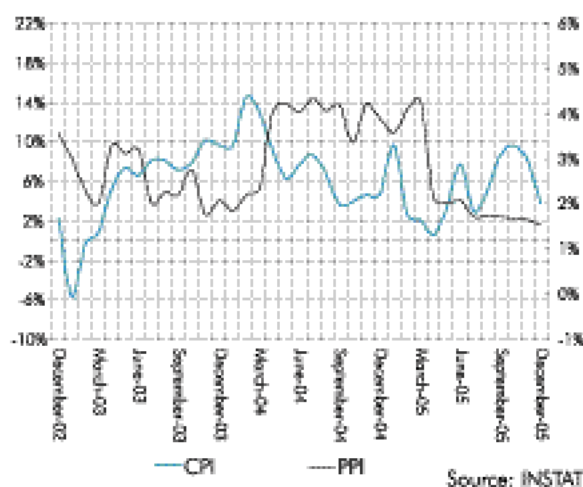
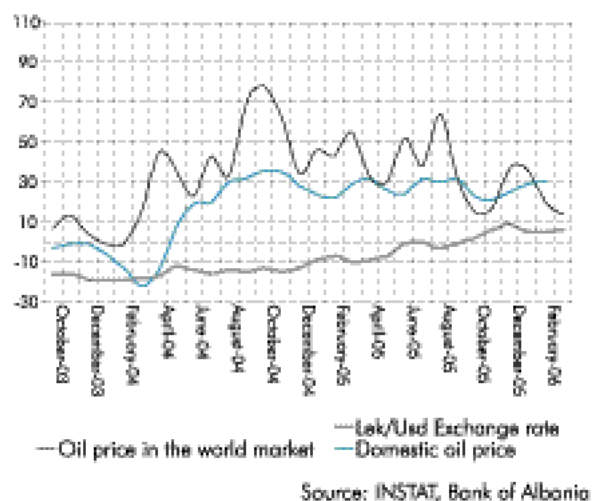


Chart 18 Annual change of oil price and exchange rate (in percentage)

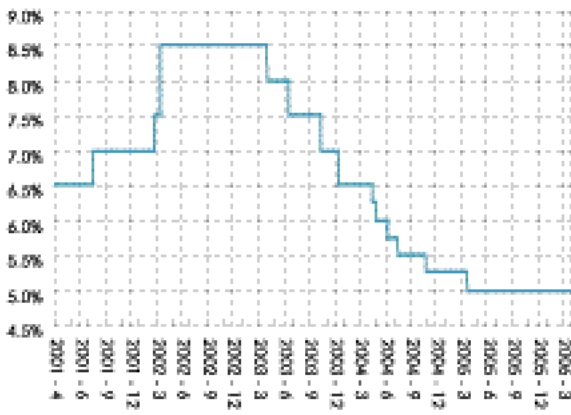


3 MONETARY DEVELOPMENTS AND FINANCIAL MARKETS

3.1 BANK OF ALBANIA MONETARY POLICY

Bank of Albania monetary policy has aimed at maintaining the monetary situation in economy stable. The neutral monetary policy stance was conditioned by the balanced influence of factors which are expected to impact the dynamic of inflationary pressures in the medium-term. Current low inflation rates indicate the lack of inflationary pressures over demand. Growth of credit

Chart 19 Performance of core interest rate



Source: Bank of Albania

to economy has been accompanied by upward tendencies of current account deficit over the last quarters, versus a limited influence on inflation. On the other hand, the increase of foreign currency interests has brought the decrease of interest rates in local currency, causing the Bank of Albania to increase its consideration with regard to possible implications of this factor on inflation.

Under this situation, the Bank of Albania monetary policy concentrated on the administration of liquidity in the system, in order to maintain the stability of monetary market stability. The return of cash into the system following its seasonal growth at the end 2005 resulted in more rapid rates than expected. Moreover, the positive fiscal balance of public sector in the first months of 2006 caused the Government borrowing from the banking system to

be low. Both these factors have prepared the grounds for the rapid increase of liquidity in the system over the first quarter.

Excess liquidity in the banking system by the end of the first quarter has displayed an upward tendency to the level of LEK 9.5 billion, while the quarterly average amounted to about LEK 5.8 billion. The presence of the Bank of Albania in the money markets has aimed at withdrawing the system liquidity through the use of long-term and short-term instruments of the monetary policy. Reverse repurchase agreement of one-week maturity, with fixed and very unlimited price, was the main instrument used. At the same time starting from February, the Bank of Albania withdrew liquidity through repos of three-month maturity, while the liquidity invested by banks in repos of one-month maturity was in minimal levels. The withdrawal of liquidity through three-month and one-month repos has aimed at smoothing the downward pressures of interest rates in the money markets. Moreover, the Bank of Albania has withdrawn the daily excess liquidity through the use of overnight deposit.

Pursuant to its strategy for the accomplishment of quantitative objectives, the Bank of Albania has also been present in the foreign exchange market.

Foreign exchange market interventions have resulted in the injection of about LEK 0.8 billion currency in circulation. At the same time, the presence of the Bank of Albania in this market has improved the position of foreign reserve for the first quarter, thus contributing to the increase in the level of reserve by about USD 100 million above the objective. Under the conditions of tightening the monetary basis was enabled the observance of the objective of net domestic assets, while the lack of need for fiscal deficit financing has left the level of net domestic credit to the Government unchanged.

	September '05	December '05	January '06	February '06	March '06*	June '06
Net International Reserve (in millions of USD)						
Objective	1,1195	1,184	1,162	1,139	1,117	1,112
Current	1,1195	1,184	1,201	1,197	1,222	--
Difference	-	-	39	58	105	--
Net Domestic Assets (in billions of LEK)						
Objective	82	82	83	84	85	90.0
Current	82	77	68	66	61	--
Difference	-	-5	-15	-18	-24	--
Net Domestic Credit to the Government (in billions of LEK)						
Objective	--	306.7	309.1	311.4	313.7	318.7
Current	--	306.7	307.1	306.6	--	--
Difference	--	-	-2.0	-4.8	--	--

* Operative data

Source: Bank of Albania

Table 14 Realization of the Bank of Albania quantitative objectives⁹

3.2 MONEY SUPPLY AND MONETARY AGGREGATES

The general trend of monetary aggregates has indicated the seasonal slowdown, which characterizes the money supply and its components at the beginning of the year. However, in contrast to the previous years, the downward tendency of annual growth rates was relatively more considerable, owing to the non-linear distribution of demand for the financing of fiscal deficit. Meanwhile, demand factors of economy for monetary assets and the external position of the banking system manifest stable growth rates. Under these conditions, the annual growth rate of money supply has reflected the trend of the Government demand for money and the magnitude of foreign assets and the economy demand rates.

Money supply annual growth rate slowed down to 11.6 per cent in February, compared to 14.0 per cent at the end 2005. In absolute terms, M3 aggregate grew by only LEK 2.2 billion over January-February. The low monthly growth rate of money supply mainly owes to the opposite effects of demand factors.

Currency and time structure of money supply has observed the historical tendencies observed in the recent years. The foreign currency component of money supply has continued to grow more rapidly than the Lek component of money supply. The level of foreign deposits amounted to LEK 157.8 billion in February. The annual growth of this indicator resulted in 25.7 per cent. The ratio of foreign deposits to M3 in February grew to 27.2 per cent compared to 24.1 per cent in the same period the previous year.

The main source of foreign deposits growth are the foreign inflows from abroad, while the financial sources created in local currency by the

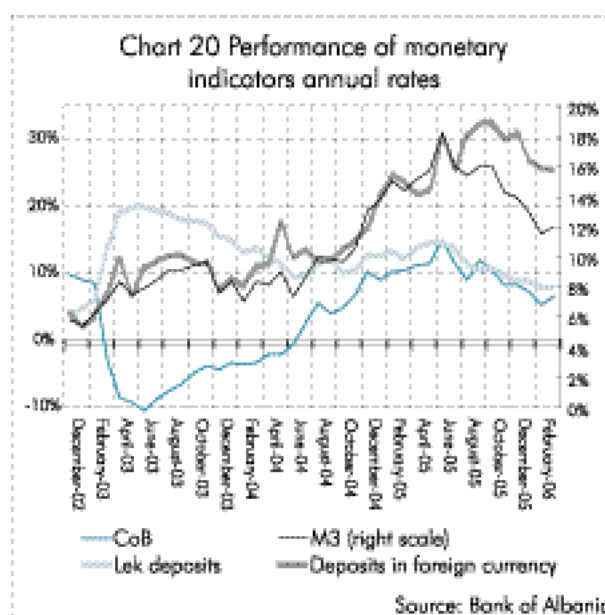
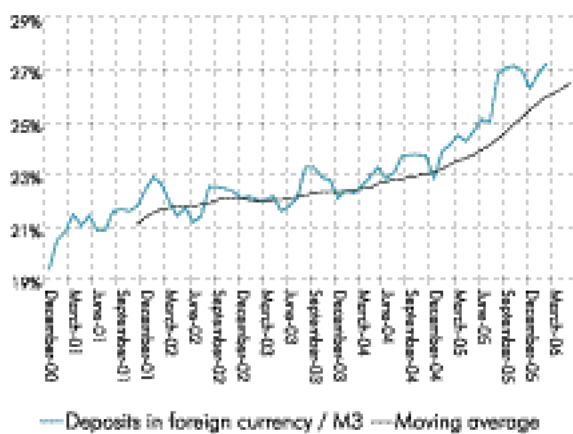
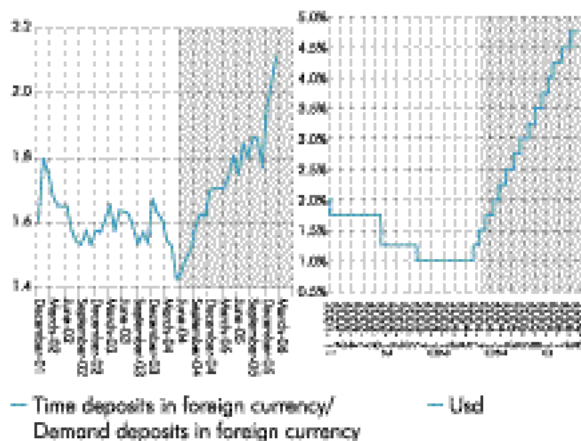


Chart 21 Performance of deposits in foreign currency ratio to M3



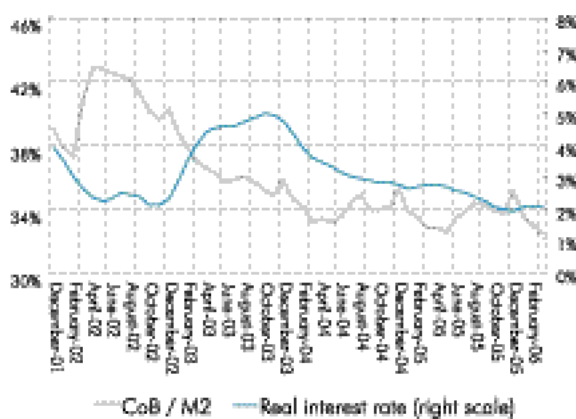
Source: Bank of Albania

Chart 22 Time structure of foreign deposits and the usd core interest rate



Source: Bank of Albania

Chart 23 Ratio of currency outside banks to M2 and average real interest rate¹¹



Source: Bank of Albania

Government and the economy demand continue to be invested in the form of Lek deposits. Moreover, the circulation of the banking system foreign assets through the financing made to the private sector constitutes an additional source for the creation of foreign deposits. Despite the foreign inflows, the high foreign currency credit rates to the economy by the banking sector increase the foreign supply in the market and lead to the investment of foreign currency balances in the banking system.

Foreign deposits time structure has been reacting to the changes in foreign currency interest rates. The ratio of time deposits in foreign currency to demand deposits in foreign currency reached to 212 per cent in February, compared to 170 per cent in the same period the previous year. Its performance was mainly in line with the tightening of Fed monetary policy through the increase of the usd core interest rate¹⁰. In June 2004, when the usd interest rate began to increase, the ratio of time deposits in foreign currency to demand deposits in foreign currency was 142 per cent or about 70 percentage points lower than the current ratio.

The shifting tendency of money supply time structure in lek to less liquid assets continued over the first quarter of the year, following the seasonal growth in December. The ratio of currency outside banks to M2 in February resulted in 32.9 per cent or 0.5 percentage points less than the same period the previous year. This performance is in line with the historical tendency of the recent years and it has a positive influence on the inflation rate perspective in economy. As a ratio to M3 aggregate, currency outside banks in February resulted in 24.0 per cent, compared to 25.4 per cent in the same period the previous year.

The time structure shifting of M2 to deposits, has enabled the monetary policy to decrease the real interest rates in economy owing to lower inflation rate. The maintenance of macroeconomic balances under lower rates of real interest rate constitutes a positive development for the economy. Time structure shifting to less liquid assets reduces the inflationary pressures. Hence, the maintenance of the downward trend of this ratio enables the economic growth without infringing the inflation objective.

	February	2-month change		Annual change	
	2005	Absolute	Percentage	Absolute	Percentage
Currency outside banks	139.1	-10.6	-7.1	7.1	5.4
Total deposits	441.1	12.8	3.0	53.2	13.7
- Lek	283.4	6.9	2.5	20.9	7.9
- Foreign currency	157.8	5.9	3.9	32.3	25.7
Demand deposits	130.7	1.2	0.9	44.9	52.4
- Lek	80.0	2.0	2.6	40.6	103.1
- Foreign currency	50.6	-0.8	-1.6	4.3	9.2
Time deposits	310.4	11.5	3.9	8.3	2.7
- Lek	203.3	4.9	2.4	-19.8	-8.9
- Foreign currency	107.1	6.7	6.7	28.0	35.4
M1	219.2	-8.5	-3.7	47.7	27.8
M2	422.5	-3.7	-0.9	27.9	7.1
M3	580.2	2.2	0.4	60.2	11.6
Monetary basis	188.9	-9.3	-4.7	14.5	8.3

Source: Bank of Albania

Table 15 Monetary indicators for January-February (in billions of LEK)

3.3 MONEY DEMAND

The performance of monetary indicators for January-February has maintained the same characteristics as in 2005. Credit to economy constitutes the main incentive of the monetary expansion, while the low Government demand for money has slowed down the growth of M3 aggregate.

Table 16 Performance of some main indicators

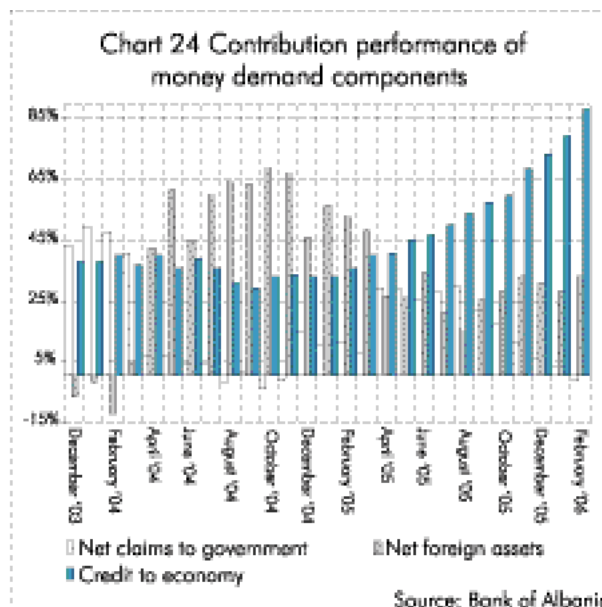
	2002	2003	2004	Q1 '05	Q2 '05	Q3 '05	Q4 '05	February '06
Money supply (in billions of LEK)	416.7	448.4	507.2	521.6	541.8	566.2	578.0	580.2
Net foreign assets (in % to M3)	38.9	35.7	36.9	37.5	36.4	37.5	36.1	37.1
Domestic credit (in % to M3)	70.8	71.5	68.9	68.7	69.9	69.1	70.0	70.4
- Credit to the Government (in % to M3)	61.5	60.2	55.1	53.4	52.2	50.3	48.9	48.1
- Credit to economy (in % to M3)	9.3	11.3	13.8	15.3	17.7	18.7	21.1	22.2
Credit to economy (in % to total assets)	11.5	13.7	16.9	17.9	20.8	22.2	25.1	25.6
Credit to economy (in % to GDP)	5.7	6.8	8.4	9.5	11.5	12.7	14.6	15.2
Total deposits (in % to GDP)	42.2	43.4	44.1	46.9	48.5	50.7	51.2	52.0
Credit/deposits ratio (in %)	13.5	15.7	19.0	20.3	23.6	25.0	28.5	29.2

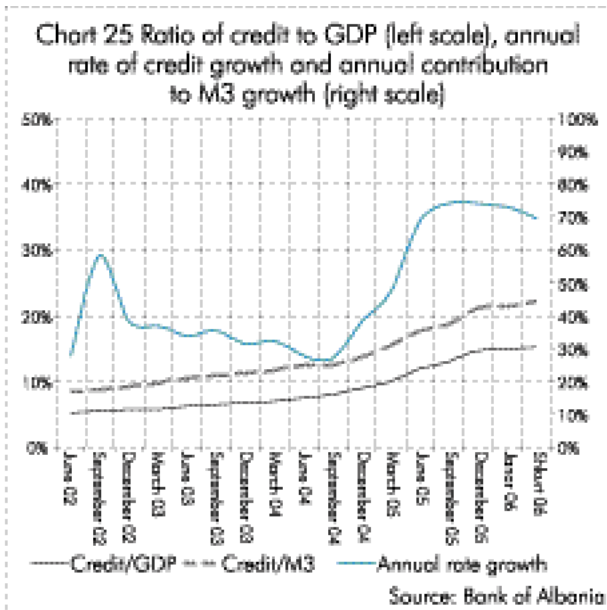
Source: Bank of Albania

In annual terms, Government's contribution at the end of February 2006 is presented negative, while the contribution of economy demand to the growth of money demand has reached to maximal levels, which is to 88 per cent. The growth of the system's foreign assets, as a source of money growth, displays a constant contribution as in year-ended 2005.

3.3.1 Credit to economy

Credit performance in January – February 2006 maintained the upward tendency of 2005. Credit balance grew by LEK 7 billion or with an average annual rate of 71.4 per cent compared to 74.3 per cent at year-ended 2005. In real terms, credit for

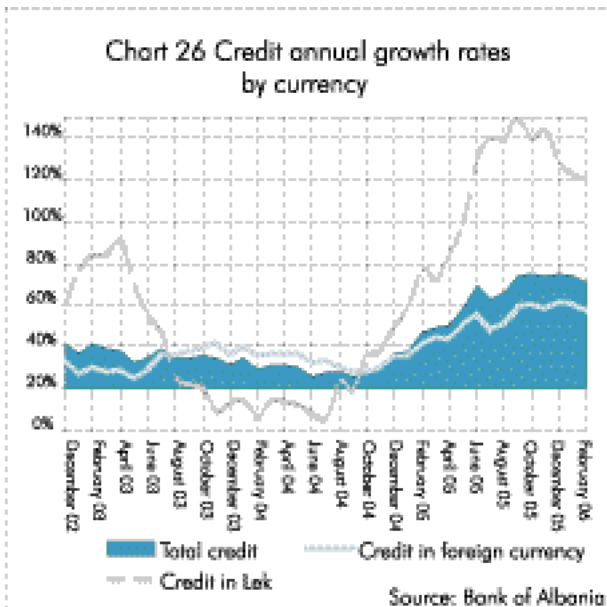




the first two months recorded an average growth of 69 per cent. Over this period was extended a total of LEK 18 billion of new credit or 31 per cent more than the credit extended over the same period the previous year. At the end of February 2006, credit to economy shared 22.2 per cent of M3 and 15.2 per cent of the GDP projected for 2006.

On the other hand, the further increase was also reflected by the bank intermediation indicators. The ratio of credit to total assets of the banking system reached to 25.6 per cent, while its ratio to total deposits to 29.2 per cent.

Characteristic of this quarter is the increasing interest of banks to crediting in lek. Credit in lek over January and February is on average 121 per cent higher than the previous year. Growth of credit in lek seems to have been influenced by both credit growth to households and to businesses.



Despite the positive developments in credit in lek, banks' portfolio is dominated by credit in foreign currency. For January-February, credit in foreign currency recorded an average annual growth rate of 59 per cent.

The ratio of short-term credit to total credit maintained a downward tendency over the first two months of 2006. The changes in the time structure of new credit (to 44.2 per cent of total credit from 53.2 per cent in the previous year) indicate a decreasing commitment on the part of banks in short-term credit. On the other hand, it is observed that credit of over 5-year maturity term continues its

upward trend, manifesting at the end of February a considerable increase to 38 per cent of credit portfolio.

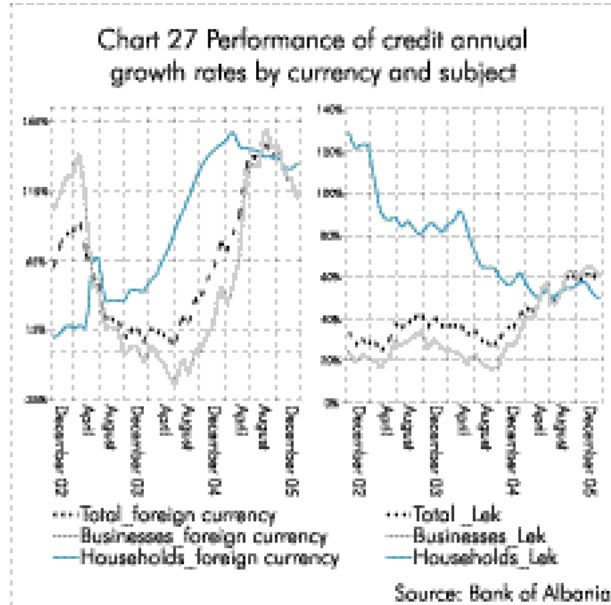
Table 17 Credit balance indicators in percentage to total

	2002	2003	2005				2006	
			Q1	Q2	Q3	December	January	February
Credit balance (in billions of LEK)	50.7	69.3	79.0	95.9	106.0	121.9	124.8	128.5
Short-term credit	46.0	34.0	34.1	33.7	31.6	32.8	32.5	31.9
Medium-term credit	33.3	36.0	34.5	33.1	31.2	30.3	30.0	30.3
Long-term credit	20.7	30.0	31.4	33.1	36.9	37.0	37.5	37.8
Credit to households	24.5	30.6	31.0	30.8	31.4	31.6	31.5	31.7
Credit to the private sector	75.5	69.4	69.0	69.2	68.6	68.4	68.5	68.3
LEK	19.6	19.5	20.1	22.9	23.7	25.5	25.4	25.7
Foreign currency	80.4	80.5	79.9	77.1	76.3	74.5	74.6	74.3

Source: Bank of Albania

Credit to economy branches has mainly maintained the same distribution as in the year-ended 2005. Trade sector remains the most credited branch with 18.7 per cent of credit portfolio, although it has displayed a moderate decrease compared to the year-ended 2005. A slight increase was also observed in agriculture and real estates portfolio.

Meanwhile, credit to manufacturing sectors of economy has increased most considerably, reaching to 14.3 per cent. Credit to construction remained in the same levels as in year-ended 2005, sharing 13 per cent of credit portfolio.



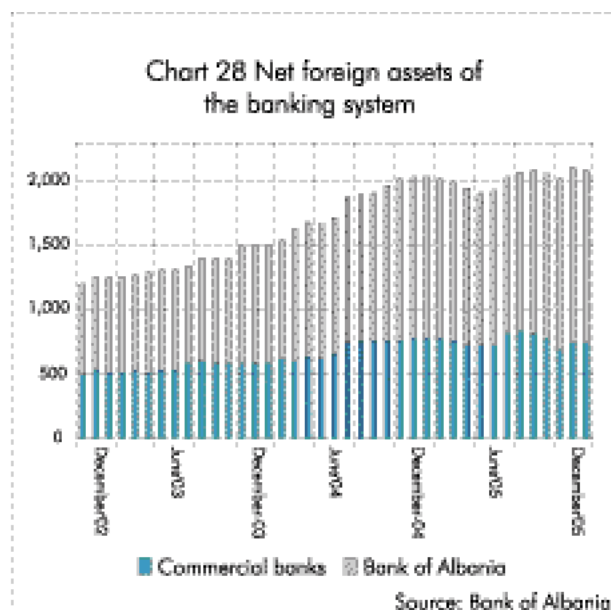
	2002	2003	2004	Q1 '05	Q2 '05	Q3 '05	Q-4 '05	February '06
Agriculture, hunting and silviculture	0.8	1	1.5	1.5	1.5	2.4	2.7	2.3
Processing industry	17	17	17.1	16.7	15.6	13.9	13.8	14.3
Construction	8.6	10	9.8	11.2	11.2	12.8	13.0	12.9
Trade, repairing of vehicles and household equipment	40.0	34	23.3	20.6	19.1	20.0	18.9	18.7
Hotels and restaurants	6.0	6	8.3	5.2	4.7	4.4	4.2	4.2
Real estates	9.1	13	9.8	14.7	13.5	13.9	14.2	13.9
Other	18.1	19	30.2	30.1	34.3	32.6	33.2	33.7
Total	100	100	100	100	100	100	100	100

Source: Bank of Albania

Table 18 Credit balance by branches of economy (in percentage)

3.3.2 Net foreign assets

The level of net foreign assets of the banking system increased over the first two months of the year. The increase of these assets for this period is estimated at USD 74.4 million, influenced positively by the Bank of Albania net foreign assets and commercial banks', by USD 25.1 million and 49.3 million, respectively. Foreign currency inflows, as a result of disbursements from foreign institutions, accompanied by the appreciation effect of euro against the dollar, have influenced on the increase of the Bank of Albania foreign reserve. Commercial banks' foreign assets were influenced by the growing rates of foreign currency deposits, which were higher than the growing rates of foreign currency credit. Moreover, over the first two months of the year was observed a decrease of commercial banks' foreign liabilities, mainly in "Non-residents' demand

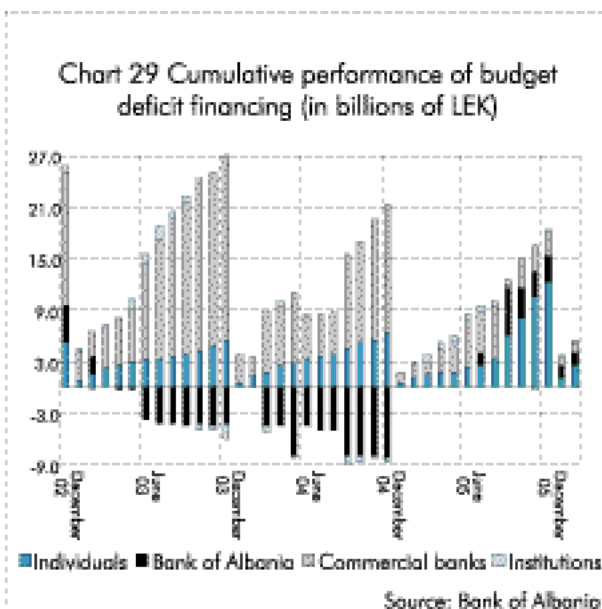


deposits”, influencing as a consequence on the increase of these banks’ net foreign assets.

3.3.3 Government demand for money

The Government has presented a positive fiscal balance for the first two months of the year. Budget surplus has been increasing, recording the level of LEK 3.7 billion in February. This position of the Government has influenced on a low demand for domestic financing. Gross domestic borrowing reached to LEK 5.7 billion in February, recording a slight increase compared to the previous month. This borrowing was covered by the issue of two and three-year Government bonds, and the issue of Treasury Bills. The level of two and three-year bonds for this period increased by LEK 3.5 billion and LEK 1.9 billion, respectively, while the level of Treasury Bills purchased in the primary market amounted to LEK 0.3 billion. The increase of households’, Bank of Albania and institutions’ portfolio by LEK 2.4, 1.7 and 0.6 billion, respectively, has compensated the decrease of commercial banks’ portfolio by LEK 4.7 billion.

In the Government accounts for February was observed that the Government has provided liquidity to commercial banks in the form of reverse repo, in the amount of LEK 1.8 billion and has transferred an amount of LEK 1.7 billion as the capitalization of National Commercial Bank. Moreover, the Government had a deposit of LEK 5.9 billion at the end of February.



Domestic financing for 2006 is projected to be in the level of LEK 26.8 billion. The low level of domestic financing at the beginning of the year implies its concentration on the second half of the year, shifting for this period the Government demand for money.

3.4 MONEY MARKET, INTEREST RATES AND EXCHANGE RATE

Over the first quarter of 2006, money market has operated under the excess liquidity increase in the banking system. In contrast to the previous quarter, when the banking system displayed cases of lack of liquidity, this indicator increased due to the return of deposits into the system and the decrease of the Government demand for the

banking system financing, a normal tendency for this period of the year. The increase of liquidity has exerted pressure for the continuous decrease of interest rates in Lek, which attempted to adjust the increase they incurred in mid-2005.

Repo auctions were the main instruments for investing excess liquidity. Besides the regular weekly auctions of defined price repos (5.00 per cent), the Bank of Albania also provided auctions of one-month and three-month repos of various prices. Their interest rate was 5.24 per cent and 5.28 per cent, respectively.

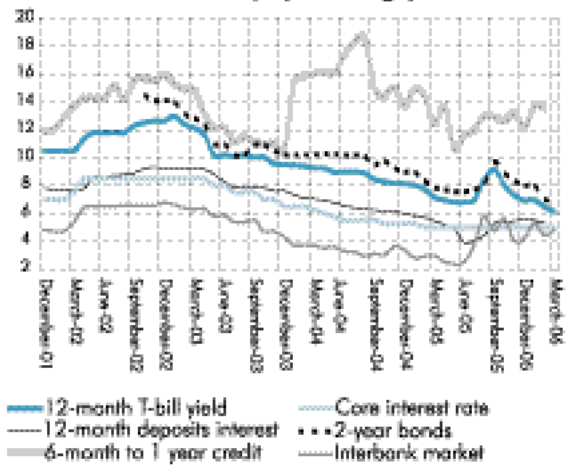
Lending activity in the interbank market has displayed a considerable growth compared to the previous year. The average daily lending level in the first quarter 2006 grew to LEK 1.85 billion, compared to LEK 1.54 billion in the previous quarter and LEK 0.98 billion in the previous year. In contrast to the previous year, most lending is composed of weekly lending, the average daily volume of which amounted to LEK 1.02 billion, compared to LEK 0.36 billion in the first quarter 2005.

Interbank market, the market which reflects the signals of monetary policy sooner, over the first quarter 2006 continued to vary to the core interest rate, depending on the change of demand/supply ratios in this market.

Interest rates increased temporarily in the periods of required reserve calculation, as a result of the increase in the lending demand in the interbank market over this period. However, the new symmetric limit of supporting facilities interests has narrowed the difference between overnight and weekly borrowing interests. Over the first quarter 2006, the interests of overnight borrowing in the interbank market varied around the level of 4.5 per cent, while weekly lending around the level of 5.4 per cent. Compared to the same period the previous year, the average interest of overnight lending increased considerably (from 2.8 per cent to 4.5 per cent), mainly due to the change of interests' spread.

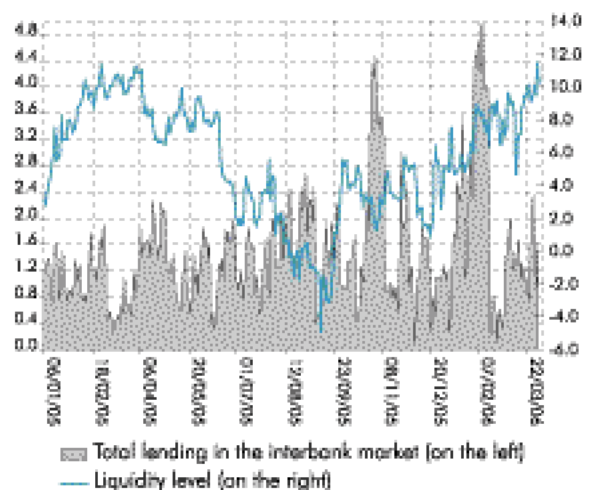
In the primary market, the liquidity provided for the purchase of the Government securities resulted at all cases higher than the issued amount (1.2:1 average ratio). This factor, along with the expectations for inflation and interest rates, have influenced on the further decrease of the yields. Over the same quarter 2006, the treasury bills yield, not only returned to the previous levels of pre-election period, but also reached to the lowest historical levels. Three-month

Chart 30 Performance of interest rates in markets (in percentage)



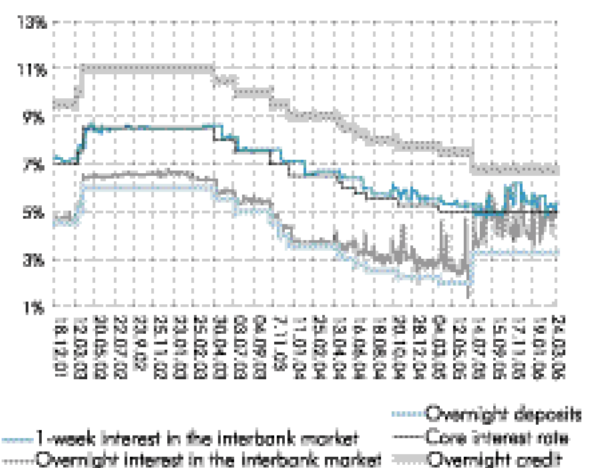
Source: Bank of Albania

Chart 31 Level of liquidity and borrowing in the interbank market (in billions of LEK)



Source: Bank of Albania

Chart 32 Interest rates performance in the interbank market



Source: Bank of Albania and commercial banks

treasury bills yield reached to the lowest historical levels in February 2006 (4.86 per cent), while the 6-month and 12-month treasury bills yield reached to these levels at the end of the first quarter 2006 (5.86 per cent and 6.11 per cent, respectively). In the two-year and three-year Government bonds market, the interest rates decreased to the lowest historical levels, to 7.0 per cent and 7.5 per cent, respectively¹². The decrease of Government securities yield reduced the cost of its domestic debt.

In the Lek deposits market, the previous upward tendency of interests has started to decrease. Such a decrease is most evident in long-term interests, while with regard to short-term interests banks were still interested in increasing the deposits.

Table 19 Interest rates and their change in LEK deposits market (in percentage)

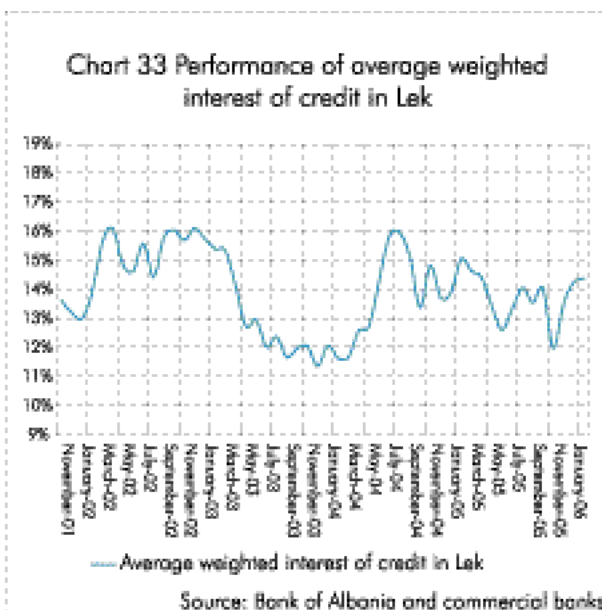
	September 05	December 05	3-month change	February 06	2-month change
3-month deposits	3.87	4.07	0.20	4.28	0.21
6-month deposits	4.55	4.77	0.22	4.71	-0.06
12-month deposits	5.28	5.57	0.29	5.34	-0.23
24-month deposits	6.62	6.82	0.20	6.37	-0.45

Source: Bank of Albania

Under low inflation, real interests increased and approached the nominal interests. According to the most recent data for February 2006, real interests of 12-month time deposits in Lek, compared to the previous year increased from 3.88 per cent to 3.99 per cent.

Credit in Lek market, in the first two months of 2006, was characterized by the approximation and fluctuation of interest rates within the relatively tight limits (12.3 – 13.8 per cent), with the exception of 1-3 year credit, which fluctuated around the level of 18.0 per cent.

Over the first two months of 2006, interest rates of credit in lek increased at all terms, with the exception of 1 to 3 year credit interests, which decreased by 0.04 percentage points.



Despite the increase of credit in Lek interests to an average level of 0.9 per cent, we observe that there have been cases of their decrease in all kinds of credit, by specific banks. Interest rates fluctuations were influenced by factors, such as, the change of banks' weight in lending and the change of banks' policies with regard to lending.

In the first two months of 2006, in the dollar deposits market were increased only 1, 3 and 6-month interests, despite the tightening monetary policy pursued by the Federal Reserve and the increase of Libor interests.

	September 05	December 05	3-month change	February 06*	2-month change
USD					
3-month deposits	2.32	2.81	0.49	2.87	0.06
6-month deposits	2.55	2.99	0.44	3.06	0.07
12-month deposits	3.02	3.56	0.54	3.35	-0.21
24-month deposits	3.18	4.15	0.97	3.93	-0.22
EUR					
3-month deposits	1.79	2.01	0.22	2.19	0.18
6-month deposits	1.91	2.20	0.29	2.30	0.10
12-month deposits	2.09	2.49	0.40	2.66	0.17
24-month deposits	3.53	3.27	-0.26	2.84	-0.43

*Latest data refer to February 2006.

Source: Bank of Albania and commercial banks

Table 20 Interest rates in foreign currency deposits market and their change (in percentage)

After a strong and continuous upward tendency which started in March 2004, long-term deposits in dollar are displaying decrease in their interest rates. Apart from other factors, the considerable increase of time deposits and the decrease of USD demand deposits have influenced greatly.

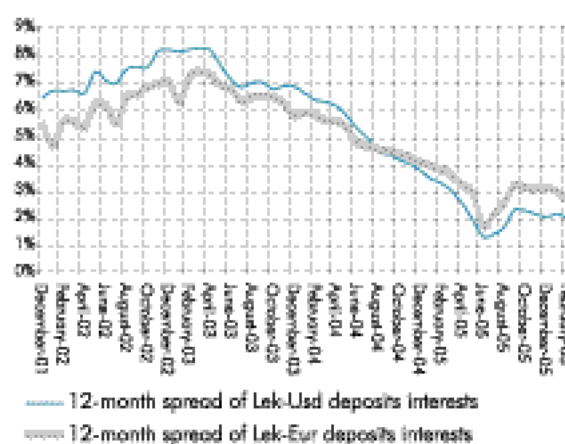
Meanwhile, time deposits interests in euro, with the exception of two-year time deposits, continued their upward trend at all terms. This trend was influenced by the tight monetary policy pursued by the European Central Bank and the increase of euribor interests in the international markets. While, the significant increase of time deposits in euro was influenced by the decrease of two-year interests.

The spread of lek-foreign currency deposits interests continued to narrow in the first two months of 2006. However, the low levels of June 2005 have not been reached yet, since in the first two months of 2006 there have been downward tendencies in both lek and dollar deposits.

In February 2006, the spread of 12-month lek-usd interests reached to 1.99 per cent, compared to 2.01 per cent at the end 2005; while that of lek-euro reached to 2.68 per cent from 3.08 per cent.

The market of credit in foreign currency over the first two months of 2006 was characterized by an upward tendency in all kinds of credit, with the exception of credit interests in euro of over three-year term, which decreased. The increase of libor and euribor interests in the international markets, the increase of foreign currency deposits interests, the change of lending structure from one month to another, the extent of lending risk, policies banks conduct in foreign currency lending, etc., have all influenced on the performance of credit in foreign currency interests. However, in this market we observe an approximation of credit interests of different terms and their fluctuation within narrower

Chart 34 Spread between Lek deposits and foreign currency deposits interests



Source: Bank of Albania and commercial banks

limits than before (7-9 per cent for credit in euro and 8.5 -10.5 per cent for credit in usd), which are indicators of stability in the market and enhancement of competition.

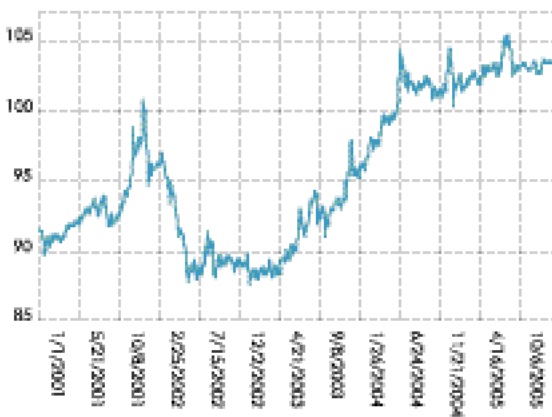
Exchange rate

Over the first quarter 2006, the lek maintained a relatively stable performance against the two main foreign currencies. The consolidation of the euro against the dollar in the international market has also been reflected in the behaviour of the lek over this period. Compared to the end 2005, the lek appreciated against the dollar by 2.0 per cent and depreciated against the euro by 0.2 per cent.

The rise of interest rates in the international market has narrowed the difference between the interest rates in lek and interest rates in foreign currency further, thus, weakening the support for the lek. However, the low inflation rates observed over the quarter being analyzed, have maintained the real interest rates in lek in positive levels, thus, keeping the demand for lek. On the other hand, the first quarter is presented with a still scenario as far as the external trade activity is concerned, by not generating strong pressures in the foreign currency market. The stable situation in the domestic foreign currency market has caused the lek exchange in the first quarter to mostly reflect the foreign currency developments of the international market.

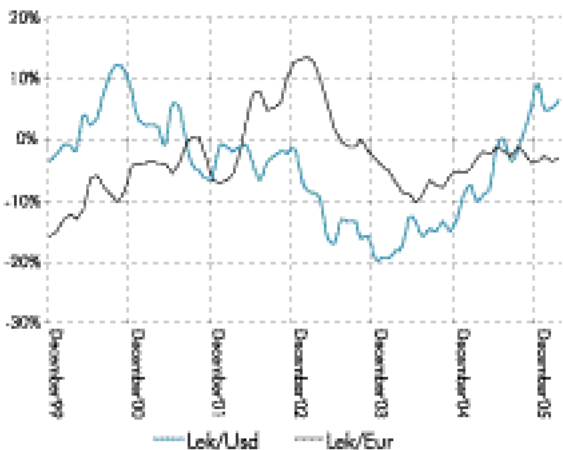
In annual terms, the lek continued to maintain the appreciating tendency against the euro, a tendency which began to be observed in mid-2003. The lek continued to appreciate against the dollar in March, maintaining the same tendency as observed from October the previous year. The annual depreciation of lek against the dollar is estimated at about 6.41 per cent for March, while the annual appreciation against the euro is estimated at about 2.94 per cent. In nominal effective terms, the lek is presented stable, but however, with an annual appreciation of 1.0 per cent. At the end of March, the exchange levels of lek were 122.95 lek/euro and 101.53 lek/usd.

Chart 35 Performance of nominal effective rate (NEER^{1,2})



Source: Bank of Albania

Chart 36 Annual change of LEK average exchange rate*



Source: Bank of Albania
* Negative change implies appreciation

NOTES

¹ No official data regarding the labour force and the level of employment in the country are available yet. Such an information would make the analysis of the labour market more complete.

² Ministry of Labour, Social Affairs and Equal Opportunities.

³ Labour force from the latest data of December 2005.

⁴ In regional countries are included: Kosovo, Serbia and Montenegro, Macedonia, Croatia, Bosnia and Herzegovina, Bulgaria, Romania and Turkey.

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

⁶ Source: General Secretariat of National Statistical Service of Greece; webpage: <http://www.statistics.gr>

⁷ Source: General Secretariat of National Statistical Service of Greece; webpage: <http://www.statistics.gr>

⁸ Source: ISTAT; webpage: <http://www.istat.it>

⁹ The table includes the new framework of quantitative objectives included in the new agreement with the IMF, signed in February 2006. Year 2005 constitutes the basis of defining the flows of quantitative objectives for the three years covered by this agreement.

¹⁰ FED: Monetary authority, which has the responsibilities and performs the functions of a central bank in the USA (Federal Reserve Bank).

¹¹ Weighted interest rate of receiving the system's deposits discounted to the inflation rate.

¹² At the beginning of April 2006, according to the latest data.

¹³ NEER – nominal effective exchange rate calculated against the two currencies, based on an approximate weight they share in trade with abroad, euro (80 per cent) and usd (20 per cent).