

BANK OF ALBANIA

QUARTERLY REVIEW
OF THE ALBANIAN
ECONOMY OVER THE
FIRST QUARTER OF 2007

MAY 2007

QUARTERLY REVIEW OF THE ALBANIAN ECONOMY OVER THE FIRST QUARTER OF 2007

1 GOVERNOR'S SPEECH

The performance of the Albanian economy over the last years has been characterized by the maintenance of relatively high growth rates, remaining within a stable macroeconomic framework. The private sector of economy was supported by the expansion of financial intermediation and by the gradual progress in the structural environment of economy. Monetary conditions have favoured the economic growth, by providing low interest rates, exchange rate stability and financial sources to the economy. Meanwhile, the public sector development has been oriented by the need for continuous fiscal consolidation, aiming at the same time, the enhancement of service quality. The same tendencies have been also confirmed over the first quarter of 2007.

Domestic demand was the main driver of economic growth over the end of 2006 and the first quarter of 2007. The indicators of production activity for the last quarter of 2006 indicate a higher growth compared to the previous quarters. The annual real growth of about 5 per cent is now supported by reliable statistics and by consistent background developments in all sectors of economy. Starting from November 2006, the Bank of Albania has been pursuing a neutral monetary policy, while the inflationary pressures, both from the internal and external environment, have been prudently monitored and kept under control over the first quarter.

Consumer prices over the last quarter of 2006 and the first quarter of 2007 were relatively stable. Annual inflation rate in March marked 2.7 per cent, while the first quarter of the present year recorded an average annual rate of 2.8 per cent, being close to the Bank of Albania target. The main factors to have influenced on the consumer prices performance over this period were the import prices and the developments in the international oil market in particular, administered prices-side pressures and the depreciation trend of domestic currency to the euro.

Preliminary data for the first quarter of the present year suggest that the economic growth rate remains high. The improved employment indicators, the increase of exports and imports and the substantial growth of credit provide evidence for a high domestic demand, despite the problems deriving from the difficult situation in the production and use of energy.

Economic enterprises output over the last quarter of 2006 is assessed to have been high. The annual growth rate of sales recorded 23 per cent over the last quarter, while in annual terms, the sales to economy were about

16 per cent higher than in 2005. The sales' performance suggests that the sectors of construction, trade and industry have been the main driving force of economic growth. Sales in construction, over the last quarter of 2006, were about 50 per cent higher than the same period the previous year. However, the annual growth of construction enterprises' sales was somehow lower than the three previous years'. Trade and other services continue to record considerable sales' growth rates, providing evidence for a sound domestic demand and for an ever-increasing quality. The limited supply of domestic energy over the last quarter of 2006 and the first quarter of 2007, was offset by the substantial increase of import over the period. The unfavourable weather conditions, and the regional energy restraints were assessed to have led to this critical situation, adding to the difficulties in the KESH management.

Fiscal indicators' trend over the first quarter of 2007 was dissimilar to the trend observed over the last quarter the previous year. While over the last quarter of 2006 there was considerable concentration of spending, the first quarter of the present year ended in a surplus of about ALL 5 billion. The recurrence of a similar scenario to that of 2006, reflected in the concentration of spending in the second half or the last quarter of the year, may result in added inflationary pressures in the short and medium run.

External sector developments over the first two months of 2007 provided evidence for both current and trade deficit deepening, while the imports and exports of goods have recorded an annual growth of 24 and 26 per cent, respectively. The structure of imports and exports, by use of commodity groups, has provided positive signals. Over the first two months, there has been an increase in the imports of raw materials used in production, while the share of re-exports to the total volume of exports has dropped compared to the previous years.

Monetary conditions over the first quarter of the present year were characterized by the further growth of money supply in economy, being in line with the real demand of economy for monetary assets. The projection within the objective and the overall assessment of the expected inflation performance by consumers were reflected in the maintenance of the core inflation rate unchanged at 5.5 per cent.

The Bank of Albania monetary policy, over the first quarter of the present year, was oriented towards the management of liquidity conditions through its operations in the open market. In January, the relatively high liquidity level in the interbank market exerted pressure on the deposits' and securities' market interest rates. There was an increase of liquidity as a result of the return of currency outside banks to the system. Under these conditions, the monetary operations consisted in the withdrawal of about ALL 6 billion, through the maturity of reverse repos of one- and three-month maturity term. These operations aimed at maintaining the interbank liquidity interest rate close to the core rate and at transmitting monetary policy signals to the rates of longer maturity term in the deposits' and loans' market.

In conclusion, the most recent economic and monetary developments suggest that the overall environment remains favourable for the economic growth in the long run. However, the yet subtle perspective of energy, the rapid growth of credit and its impact on domestic demand and trade balance deficit, as well as the implications of the tightening monetary policy cycle in the Euro area to the domestic financial conditions, remain potential risk factors for the macroeconomic stability in the country. The Bank of Albania, a committed institution to maintaining macroeconomic and financial stability in the country, is monitoring these indicators prudently, in order to take necessary preventive measures timely.

2 WORLD ECONOMY

The world economy development rate continued to be considerably high over the first months of 2007. The US housing market negative developments have affected the slowdown in the economic growth rate, while the oil price fall and the propitious financial conditions have limited the second round effects and have eased the inflationary pressures. The first months of 2007 confirmed stable economic growth in the Euro area, though this growth may not reach to the levels recorded in 2006. The economies of China and India continue to be outstanding among developing economies, recording high expansion rates.

According to estimates, the world economic growth for 2007 is expected to be about 4.9 per cent or 0.5 percentage points less than the previous year. The main factors, which may potentially pose risk to the development of world economy, relate to the US housing market situation, with supply-side pressures on inflation rate and with the prospective developments in the oil market. Global imbalances may also impede the economic growth in many countries. US current deficit continues to be high, while oil exporting countries and many Asian ones record considerable trade surpluses. The slowdown of the US economic growth has affected the lessening of these balances, though the differences remain considerably high.

	GDP annual growth, Q4	Unemployment rate	CPI, February
USA	+3.1	4.4 (March)	2.4
Euro area	+3.3	7.3 (February)	1.8
Germany	+3.7	7.1 (February)	1.9
France	+2.5	8.8 (February)	1.2
Italy	+2.8	6.5 (December)	2.1
Japan	+1.7 (Q2-2006)	4.0 (February)	- 0.2

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

Source: Eurostat; Bureau of Economic Research; Bureau of Labour Statistics; ECB, Report for December

ECONOMIC DEVELOPMENTS IN THE EURO AREA

The positive developments in the Euro area economic activity over 2006 are assessed to be present in 2007, as well. The increase in the value added tax rate in Germany on January 1, 2007 and the tightening fiscal and monetary

policy being pursued throughout the Euro area are expected to provide their effects on the growth rate reduction by about 0.3 percentage points. However, as a result of the constant progress in the labour market conditions, of the favourable financing conditions and the enhancement in businesses efficiency, domestic demand, which is the driver of the Euro area economic growth, will remain at high levels. The oil price fall has been affecting the fluctuation in the inflation rates around the target set by the European Central Bank since the last months of 2006. Over the recent months, the core inflation rate has risen, reflecting at large the increase of the VAT in Germany. Under the conditions when the Euro area economy is assessed to have reached close to its potential, and in the presence of inflationary pressures, the European Central Bank has started to gradually tighten its monetary policy. In its meeting in March, the European Central Bank raised interest rates by 0.25 percentage points with the headline rate at 3.75 per cent.

On 1 January 2007, Bulgaria and Romania joined the European Union and Slovenia became part of the Euro area, by adopting the common currency. The European Union currently has 27 member states and the Euro area consists of 13 member states. Given that the economic share of the new member states is less than the old EU members', the macroeconomic statistical features in both the European Union and the Euro area, are not expected to change considerably.

ECONOMIC DEVELOPMENTS IN THE UNITED STATES OF AMERICA

The growth rate of the American economy has considerably slowed down following the end of the first quarter of 2006. Last year economic growth was significantly affected by the difficulties encountered in the housing market and by the fall in residents and businesses' investments. The improvement of rentability indicators and of business financial situation in the following months is expected to bring about the growth of private investment. The fall in investments was offset by the high level of consumer spending and trade, supported by the positive performance of the labour market and the oil price fall. The latter has also impacted the decrease of inflationary pressures. However, the core inflation remains beyond the band set by the central bank (Federal Reserve). FOMC¹ maintained the core interest rate unchanged since June last year. Meanwhile, the pursue of monetary policy has been headed by the concerns related to inflation developments and by the consideration to stop the economic growth slowdown.

OIL PRICE PERFORMANCE

Following August 2006, when it peaked the trading price, oil price fluctuated around USD 60 per barrel. However, since the beginning of February 2007, oil price performance is displaying an upward trend, which is a result of the change in the balance between oil supply and demand. The decrease of temperatures in the Northern Hemisphere over the last months, the positive assessments for the world economic performance and the oil price fall over the second half of 2006 have affected the global growth

demand for oil. On the other hand, oil production has fallen following the entry into force of decisions on the decrease of production in OPEC member countries, while production in non-member countries was lower than projected. According to some statements made by many OPEC member countries, the organization will attempt to keep the oil price above 50 USD per barrel and possibly, close to USD 60.

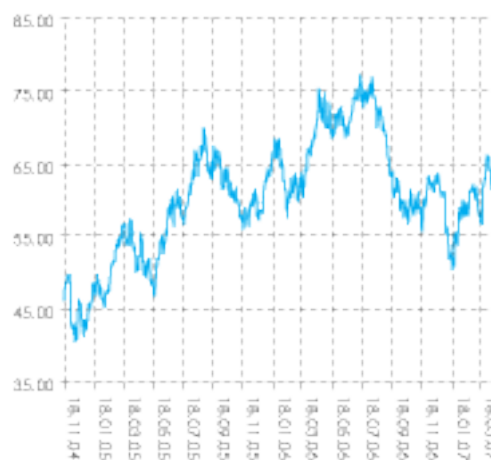
3 ALBANIAN ECONOMY

3.1 PRODUCTION BY SECTORS

The last quarter of 2006 is assessed to have recorded considerable economic growth, comparable with the highest annual growth rates marked over the last four years. The sales' annual growth rate in the last quarter was 23 per cent, while in annual terms, the sales to economy were about 16 per cent higher than those of 2005. The sales' performance suggests that the sectors of construction, trade and industry have been the main driving force of economic growth.

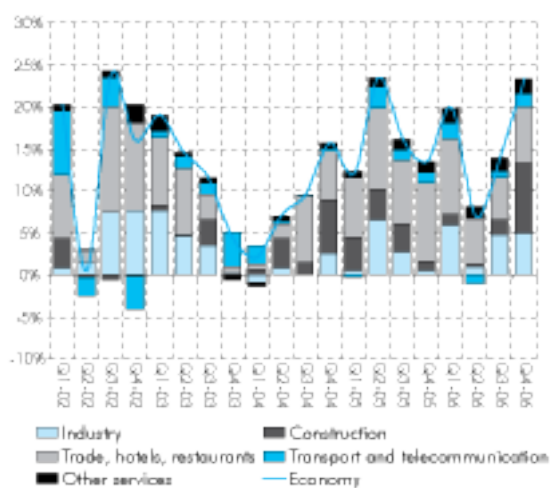
According to the sales index, the sectors of economy have recorded different annual growth rates over the last five years. Services have been characterized by a higher average growth rate than other sectors', while the growth of sales in transportation and telecommunication has been considered more moderate.

Chart 1 Price performance of one crude oil barrel (in USD)



Source: Bloomberg, April 2007

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



Source: INSTAT and Bank of Albania estimates, March 2007

	2002	2003	2004	2005	2006	Average
Industry	18	14	3	10	17	12
Construction	3	7	24	20	21	15
Trade, hotels and restaurants	19	10	10	19	14	14
Transportation and telecommunication	4	19	6	11	7	9
Other services	21	10	5	23	33	19
Sales to economy	15	12	9	16	16	14

Source: INSTAT and Bank of Albania estimates, March 2007

Table 2 Annual growth of sales by sectors (in percentage)

Throughout 2006, there was an upward trend in the annual rates of sales volume in industry. In the last quarter of 2006, sales grew by about 22.8 per cent, compared with the same period the previous year. This figure makes up the highest rate of sales recorded in the last six years. Sales in the sub-sector of extracting industry doubled compared with the previous year. The

same performance was present in sub-branches of heavy industry, such as in refining, metallurgy and metal manufacturing, which are closely related to extracting industry. These sub-branches recorded high growth rates compared with the previous year. Processing industry grew stable by about 28.5 per cent. A positive contribution to this performance was also provided by the high growth rates in the sub-branches of light industry. Meanwhile, the sub-sector of energy, water and gas recorded almost the same sale rate as in the previous year.

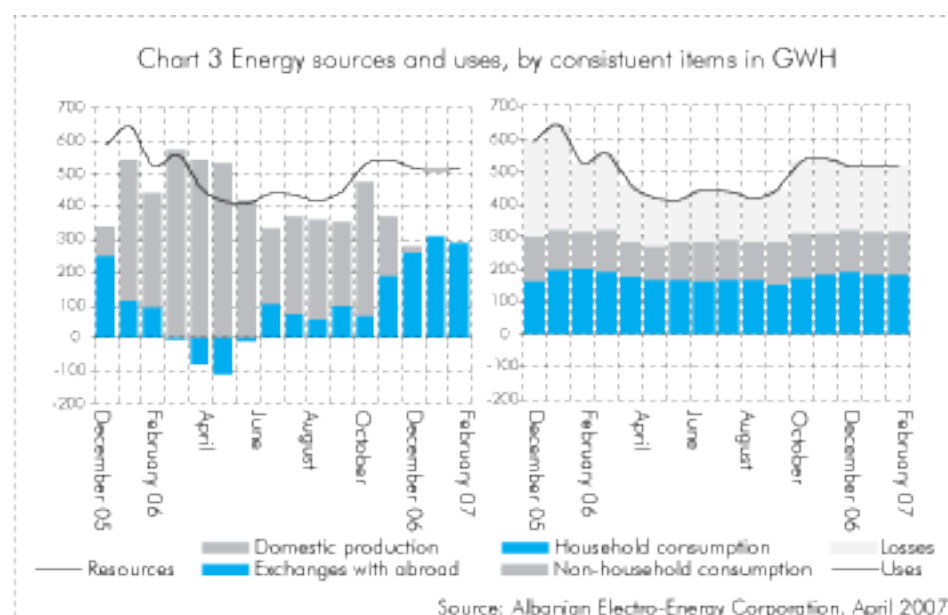
Table 3 Performance of industry for Q4 2006 (in percentage)

	Share to total (in percentage)	Sales '06/Sales '05 (in percentage)	Sales Q4 '06/Q3 '06 (in percentage)
Total industry	100	22.8	1.9
Extracting industry	9.0	48.5	8.0
Processing industry	70.4	28.5	0.2
Energy, water and gas	20.6	0.1	5.6

Source: INSTAT, Sales index, March 2007

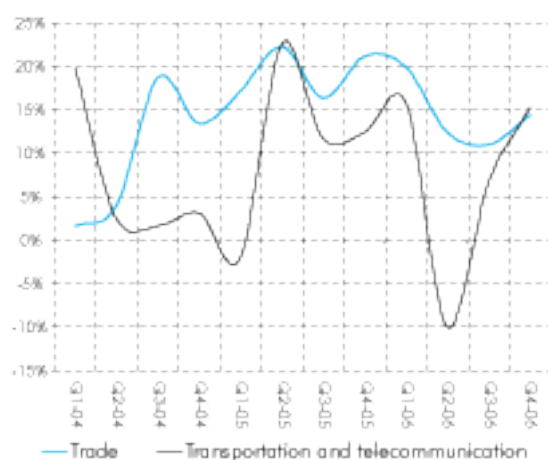
Domestic production of energy fell considerably in the first quarter of 2007. Compared with the first quarter of the previous year, energy production halved, causing various operators in economy to be faced with shortages in energy supply. The overwhelming decrease in the production of energy was offset by the increase of its import over this quarter, which quadruplicated compared with the previous year and quarter. In total, the import of energy surpassed domestic production. The unfavourable weather conditions and the energy restraints in the region were assessed to be the main causes of this situation, adding to the difficulties in the KESH administration.

The losses continued to be high over the first quarter of 2007. The ratio of losses to the supplied energy resulted in about 40 per cent. There has been an increase in losses over this quarter, as a result of the invoiced consumption, adding to the aggravation of KESH's financial situation.



Sales in construction over the last quarter of 2006 were about 50 per cent higher than the same period the previous year, and about 60 per cent higher than the previous quarter. The annual growth of construction nominal sales was about 15 per cent, being somewhat lower than the annual growth of the previous three years. This figure provides evidence that the real growth rate of construction remains comparable with that of the previous years. Cement production over 2006 was almost the same as in 2005, while the quantity of cement used in construction over the last quarter was higher than over the last quarters of the two previous years. The performance of construction permits indicators on the approved permits for new constructions over 2006 provides evidence that demand in construction remains in similar levels with the previous years.

Chart 4 Annual growth of sales in trade, transportation and telecommunication (in percentage)



Source: INSTAT and Bank of Albania estimates

According to the sales index, retail and wholesale trade recorded an annual growth of about 14 per cent. Over the last two years, the sales' annual growth rates have been stable fluctuating around 10 and 20 per cent. The contribution of trade sales to the annual growth rate of total sales to the economy was about 50 per cent for the entire period. The sales of transportation and telecommunication enterprises share about 10 per cent of total sales. The sales performance in this sector over the last two quarters of 2006 provides evidence for their revitalization following the slowdown in the second quarter. Railway transportation of goods and oil recorded the lowest growth rate over the last quarter. However, the volume of loading and unloading operations in the country's harbours and the railway and automotive transportation of passengers reached over the same quarter the highest level of the year, providing positive signals for an increase of domestic demand in economy. This phenomenon has been generally present in the fourth quarters of the last years.

Table 4 Indicators of rail, sea and road transportation

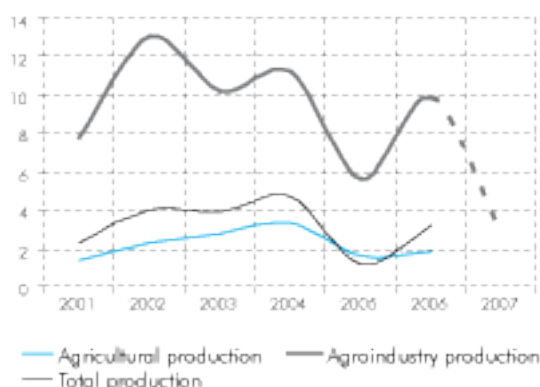
Activity	Unit	Q4-05	Q1-06	Q2-06	Q3-06	Q4-06
Rail transportation of goods	Thousand tones	101	115	129	127	79
Oil transportation	Thousand tones	66	86	86	88	74
Loading and unloading volume	Thousand tones	1,178	921	1,139	1,201	1,206
Passengers transportation -Rail	Thousand passengers	364	370	442	491	356
--Automotive (urban –public sector)		5,519	5,021	5,442	4,740	6,096

Source: INSTAT, Quarterly Statistical Bulletin, No. 4, 2006

Other services' sales continued to record high growth rates in the last quarter of 2006. Financial intermediation, real estates, scientific research and other professional activities services generated about 80 per cent of total sales of other services.

The very limited statistical information on agriculture for the first quarter of 2007 does not allow the analysis of its contribution to the performance of

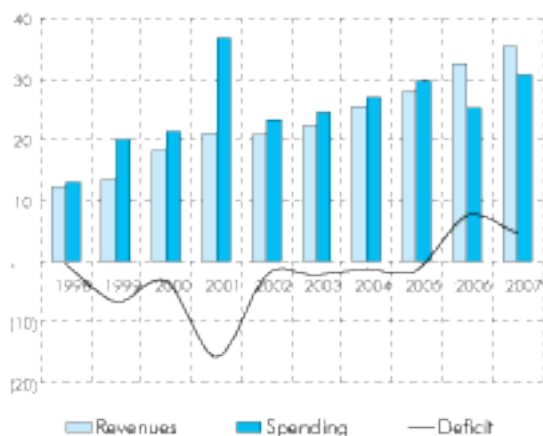
Chart 5 Annual change of total agricultural production by sectors, in percentage*



Source: Ministry of Agriculture, Food and Consumer Protection, April 2007

Note: The data on agro industry for 2007 refer to the projections of the Ministry of Agriculture, Food and Consumer Protection.

Chart 6 Main fiscal indicators for January 1998 – February 2007 (in billions of ALL)



Source: Ministry of Finance, March 2007

economy. According to the most recent estimates, there have been no developments in the planted area with agricultural products over the first quarter of 2007, compared with the same period the previous year. The projected increase in the production of plants is expected to be pursued through a higher agricultural output. As far as farming is concerned, the output growth by the end of 2007 is projected to be achieved through the enlargement of farms and the increase of the output. Agricultural experts assess that the low mechanism level of agricultural processes and the considerable fragmentation of farming areas are the main causes to impede the development in agriculture.

The sub-branch of agro industry is expected to have a lower growth rate over 2007, compared with the previous year. The projections for lower investments in agro industry over the present year are assessed to mostly condition the performance of this sub-branch.

3.2 FISCAL SECTOR

There have been positive developments in the performance of public finances main indicators over January and February 2007. The data of the Ministry of Finance suggest for satisfactory performance in collecting income and carrying out spending within the projected levels. As a result, the fiscal balance for the first two months of the present year resulted in about ALL 4.7 billion of surplus.

Budget revenue over the first two months of 2007 provided evidence for the constant active efforts of tax administration in collecting income. As a result, their level compared with the same period the previous year resulted in about 8.1 per cent. Among all income categories, value added tax and tax on personal income recorded the highest annual growth rates by 23.8 and 27.4 per cent, respectively. Customs administration activity has been assessed as very effective, considering that more revenues than projected were allocated in the state budget. The fall by about 15.8 per cent of income from local government may be associated with the downward performance rate of local administration, which for this reference period may have been engaged in the election process.

Budget spending totalled ALL 30.7 billion, accounting for about 10 per cent of total spending projected for 2007. Despite this fact, budget spending were higher than the same period the previous year, recording a positive growth rate of about 21.5 per cent. The annual growth of both current and capital spending

contributed to attaining these positive rates. Current spending were about 10.8 per cent higher than the previous year, while capital spending almost tripled.

Domestic financing is ever-increasingly playing a crucial role in covering capital spending. Although the latter has grown satisfactorily over the last months, it is yet too soon to assess their distribution over time, since the structure of their carrying out is to a large extent, established by the implementation of individual projects and the priorities set by the Government. The Bank of Albania has been repeatedly supporting the idea that a more harmonized structure of budget spending at the beginning of the year would reduce their possible concentration at end-year. Their uniform distribution would consequently, control the inflationary pressures in economy in the medium run.

Fiscal deficit, for January to February 2007 had the same performance observed over the last years, being lower than the projected level. As a result, fiscal balance for this period resulted with ALL 4.7 billion of surplus, being the second year in succession, where the budget financial outcome ends in a surplus. It is assessed that the surplus is a positive signal for further reducing the cost of public debt.

3.3 LABOUR AND WAGES MARKET

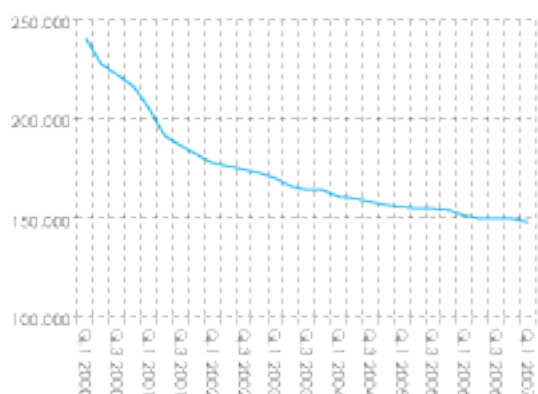
The last quarter of 2006 recorded improved labour indicators. On one hand, reform in the public sector continued to drop the number of employed, while there is evidence that the private non-agricultural sector has drawn part of the unused labour capacity. The implementation of the Government's policy, which aims to reduce small-business taxes and to strengthen the controls undertaken by public administration, has pressed the process of employed registration, tightening the circle of the informal labour market. Starting from the second semester of 2006, the number of employed, along with the jobseekers registration process in the employment offices, has increased. As of end 2006, the number of employed increased by about 4000 people compared with the previous quarter, while last year it was recorded an increase of 1000 people. Labour forces over 2006 increased by more than 1600 people, shifting from the last years' tendency when this indicator underwent constant decrease. As a result of the above dynamics of labour market indicators, unemployment rate recorded a relatively stable rate of about 13.9 per cent.

Table 5 Labour market indicators (in thousands of people)

	2004				2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Total labour force	1,087.0	1,086.0	1,086.0	1,086.0	1,082.9	1,081.3	1,084.1	1,084.5
A. Total employed	931.0	931.0	931.2	932.0	931.0	931.3	934.4	935.1
i) in the public sector	176	175.6	175.6	175.0	174.0	172.1	170.5	169.0
ii) in private non-agricultural sector	213.0	213.4	213.6	215.0	215.0	217.1	221.9	224.1
iii) in private agricultural sector	542.0	542.0	542.0	542.0	542.0	542.0	542.0	542.0
B. Unemployment								
i) Total unemployed	156.0	155.0	154.8	154.0	151.8	150.1	149.7	149.5
ii) Unemployment rate (in percentage)	14.3	14.3	14.2	14.2	14.0	13.9	13.8	13.9

Source: INSTAT, *Conjuncture*, October-December 2006

Chart 7 Number of unemployed over the last years (in thousands of people)



Source: INSTAT and the Ministry of Labour, Social Affairs and Equal Opportunities, April 2007

January and February 2007 continued to record positive trends of labour market indicators. The number of unemployed fell and the number of jobseekers registered in the employment offices increased considerably. Compared with December 2006, as of end February this year, the number of unemployed fell by about 1860 people. According to the most recent data provided by the Ministry of Labour, Social Affairs and Equal Opportunities, at end February, the number of people recorded in the employment offices as unemployed was 147.930 people. Assuming an unchanged labour force, since the end of December last year, this figure may be translated into a potential decrease of the unemployment rate by 0.2 per cent.

The average salary in the public sector rose by 7.5 per cent on average over 2006, compared with the previous year. The most significant salary rise was evidenced in the last quarter of 2006. It is assessed that the annual rise of salaries for 2006, though higher than the annual rise of the previous year, has not caused added supply-side inflationary pressures in economy, being within the Government's programme.

3.4 EXTERNAL SECTOR OF ECONOMY

According to the balance of payments preliminary data, the deficit on trade in goods services for the first two months of 2007 was about EUR 290 million or about 23 per cent higher than the same period the previous year. Compared with December 2006, the 12-month accumulated balance² was higher for both January and February. The higher growth of imports than exports has affected the continuous deepening of trade deficit. The inflows generated by exports over the first two months of the year covered about 28 per cent of spending for the purchase of foreign goods.

Table 6 Balance of trade in goods for December 2006 – February 2007 (in millions of EUR)

	2006	2007		2007	December	January	February
	December	January	February	Jan-Feb			
Monthly flow							Annual change
Balance	-189	-140	-152	-292	0.06	0.23	0.23
Exports	55	54	62	116	0.20	0.17	0.35
Imports	244	194	213	407	0.09	0.22	0.26
12-month accumulated balance							
Balance	-1,780	-1,807	-1,835				
Exports	631	582	655				
Imports	2,411	2,201	2,490				

Source: Bank of Albania, March 2007

Over the first two months of the year, the annual growth rate of imports and exports of goods was considerably high. Exports grew by 26 per cent and imports by 24 per cent.

Compared with the first two months of 2006 were exported more industrial goods used as raw material in the production process. The exports of this item over these two months totalled about EUR 40 million, while the highest growth was recorded in copper, aluminium and ores. Re-exports continue to be concentrated in textiles and footwear items. For the first two months of the present year, these two groups generated above 50 per cent of total income from the export of goods.

The structure of imports by groups of use is more balanced than that of exports. Except for industrial commodity groups' category, which has provided a considerable contribution to the annual growth of imports, the other categories provided a moderate and even contribution. The business demand for raw material and other products required in the production process, has shared the largest part of demand for import goods. Over the first two months of the present year were imported more fuels, live animals, cast-iron, aluminium and various types of industrial products compared with the same period the previous year.

Chart 8 Trade balance performance for January 2005 – February 2007 (in millions of EUR)



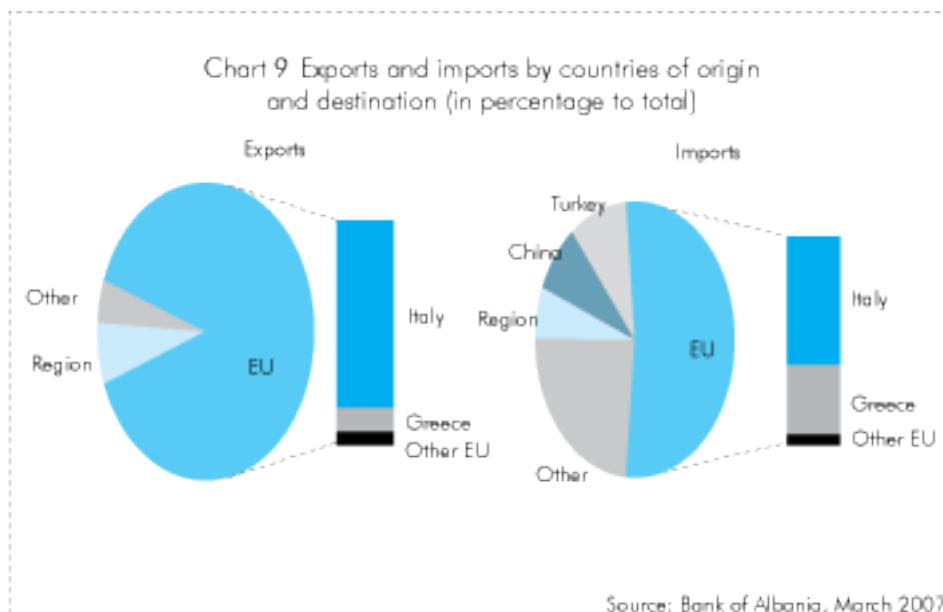
Source: Bank of Albania, March 2007

	2007 January-February	2006 January-February	Contribution to total value growth
Exports			
Foodstuffs and beverages	4.6	3.4	1.4%
Industrial goods	37.9	24.6	17.5%
Means of transportation	0.2	0.1	0.2%
Capital goods	4.3	3.8	0.5%
(Non-food) consumer goods	63.0	55.1	7.8%
Imports			
Foodstuffs and beverages	41.5	37.5	1.1%
Industrial goods	206.7	160.0	14.8%
Means of transportation	26.8	20.6	2.0%
Capital goods	61.4	54.2	2.0%
(Non-food) consumer goods	50.6	43.5	2.0%

Source: Bank of Albania, March 2007

Table 7 Groups of exports and imports by final consumption (in millions of EUR)

The geographical structure of foreign trade did not undergo significant changes over the first months of 2007. European Union countries remain Albania's main trade partners, while the largest share of transactions are carried out with Italy and Greece. Over the last years, the trade relations with other regional countries, with Turkey and China have further intensified.

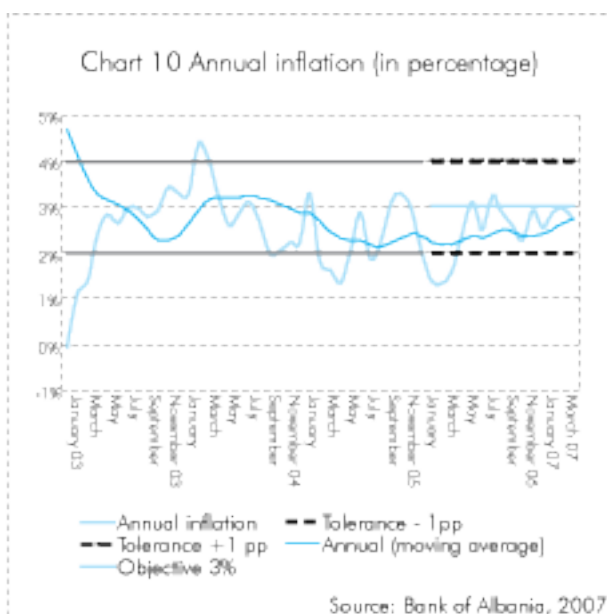


4 DEVELOPMENTS IN CONSUMER PRICES

4.1 INFLATION AND MACROECONOMIC ENVIRONMENT

Annual inflation rate in March 2007 marked 2.7 per cent, while the first quarter of the present year resulted in an average annual rate of 2.8 per cent. Over the first quarter of 2007, annual inflation displayed a stable trend and close to the projected target of the Bank of Albania.

The monetary policy decision-making process has prudently considered the influence of both supply- and demand-side factors, aiming at maintaining their balances. Despite the low inflation figures, the inflationary pressures in economy have displayed signs of increase over the first quarter of 2007. This was a result of the added supply-side pressures, originating outside the Albanian economy. In more concrete terms, the presence of the upward import prices trend, the intensified depreciating rates of domestic currency to the European one and the high volatility in the international market oil price have all increased the share of these factors' influence on inflation.

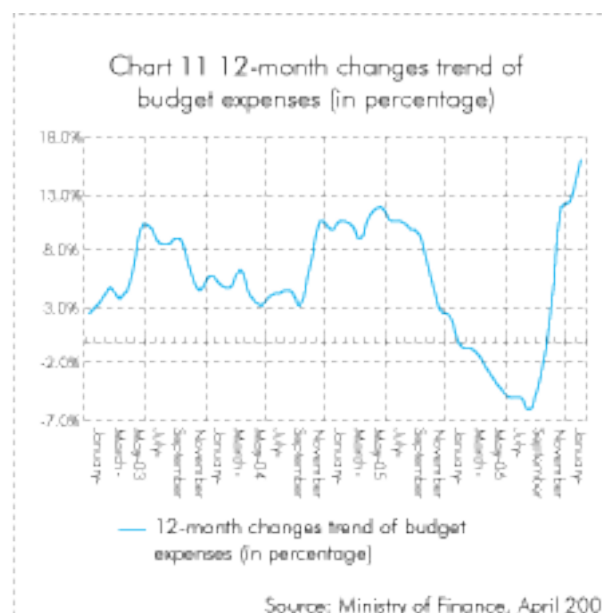


Nonetheless, the controlled developments in both monetary and fiscal policy and the satisfactory rates of domestic demand indicators are assessed to have mitigated the inflationary pressures in economy.

Monetary conditions and monetary policy, over the first quarter of 2007, have sustained the efforts to put the supply-side inflationary pressures under control. Over December 2006 – March 2007, the monetary policy stance was a neutral one. The stable trend, over the first quarter of 2007, of 12-month real interest rates provides evidence for a more complete transmission of monetary policy decisions to the bank and interbank market operators. As a result, the level of liquidity in the market has been duly managed. In response to the expectations for an increasing demand for money by both private and public sector, in the first months of 2007 there were higher annual growth rates of money supply than the previous year. Credit rates continued to be high, but stable. Opposite to the abovementioned trends, the downward annual rates of currency outside banks ratio to money supply to 22.6 per cent, provide evidence for the ever-increasing presence of the banking system in the country’s economic activity. The monetary conditions framework and the presence of Government’s moderate demand for liquidity provided safe settings for keeping the inflationary pressures over the first quarter of 2006 under control.

Fiscal conditions, over the first quarter of 2007, contributed to the control of inflationary pressures, caused by the concentration of budget spending at end year. The satisfactory performance in collecting income and the restrained budget spending caused the public finances to result in a surplus of about ALL 4.7 billion for January and February 2007. However, over the reference period, were carried out only 10 per cent of spending projected in the state budget for the coming year. Though it is yet too soon to make assessments, the above figure suggests that it is quite probable to have a recurrent last year’s structural profile in spending. Through this signal, the Bank of Albania draws attention for a more even distribution of budget spending over the rest of the year. Such a development would mitigate the supply-side inflationary pressures.

Domestic demand, over the last quarter of 2006 and the first months of 2007 has displayed positive developments in some of its most key indicators. The considerable annual growth of the volume of sales to economy (23 per cent), of imports and exports (24 and 26 per cent), of fuels consumption and vehicles import have sustained the stable inflation developments. According to the Bank of Albania periodical analyses, the available capacities operating in economy have, with no constraints, coped with the growth rates of domestic demand over the last quarter of the previous year. In view of the abovementioned assessments, the production costs of goods and services have not risen, being reflected in the constant performance of the respective prices. This analysis further supports the data of production price index. Its upward annual rates trend was quite moderate at end 2006.



The performance of import price index, oil price and the exchange rate have added to the presence of supply-side inflationary pressures at the beginning of the present year. The annual rate of Import Price Index (IPI) displayed an evident upward trend over the first quarter of 2007. Although the annual rates of Harmonized Consumer Price Index (HCPI) in Albania’s main trading partners were stable over the first months of the year, particular HCPI aggregates have recorded high growth rates, especially in the Euro area and Greece. Moreover, the inflationary pressures originating from outside our economy were further influenced by the unfavourable performance of ALL/EUR exchange rate.

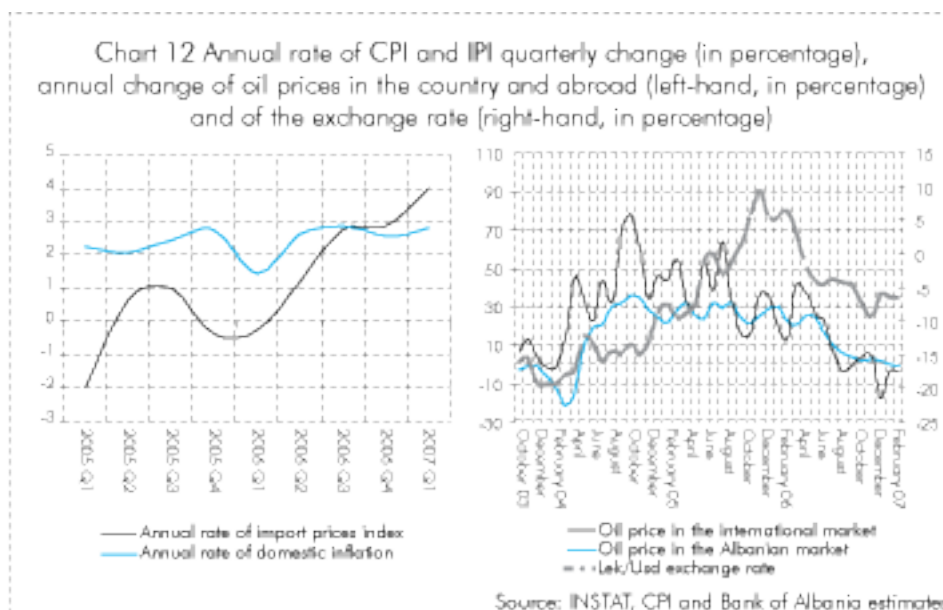


Table 8 Inflation annual rates in Italy, Greece and the Euro area (in percentage)

	Q4-06*	January-07*	February-07*	March -07*	Q1-07*
Greece**	3.2	3	3	2.8	2.9
Italy**	2.0	1.9	2.1	2.1	2.0
Euro area (25 countries)**	2.0	2.1	2.1	2.2	2.1

Source: CPI - INSTAT, March 2007; <http://epp.eurostat.ec.europa.eu> Notes: (*) The quarterly figures are the average of monthly figures; (**) The data refer to the inflation measured by the Harmonized Consumer Prices Index (HCPI).

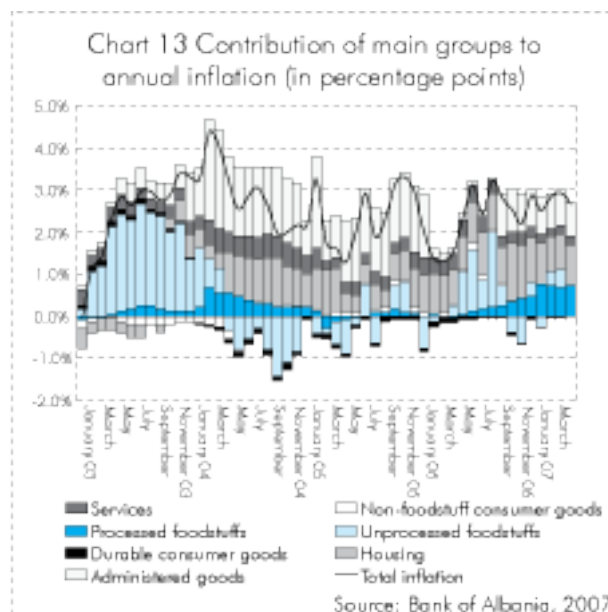
The depreciating annual rates of the lek against the euro intensified over December 2006 – March 2007, causing the imports to increase their cost further. The rising oil price in the international market was modestly transmitted to the domestic market, which was favoured by the constant appreciation of domestic currency to the US dollar. As a result, the volatilities in the annual oil prices changes in the domestic market were more smoothed out than in the international one. For that reason, they did not trigger volatilities in this category prices.

4.2 INFLATION BY CATEGORIES AND FACTORS’ INFLUENCE

The impact of various macroeconomic environment factors on inflation rates will be more specifically evidenced in a more detailed analysis of

consumer prices performance by categories based on their economic function. Under the pressure of both domestic and external factors, almost all basket groups recorded positive growth rates. The annual price changes in “Processed foodstuffs”, “Housing” and “Administered goods”, constituted above 86 per cent of average annual rate of total inflation for this quarter.

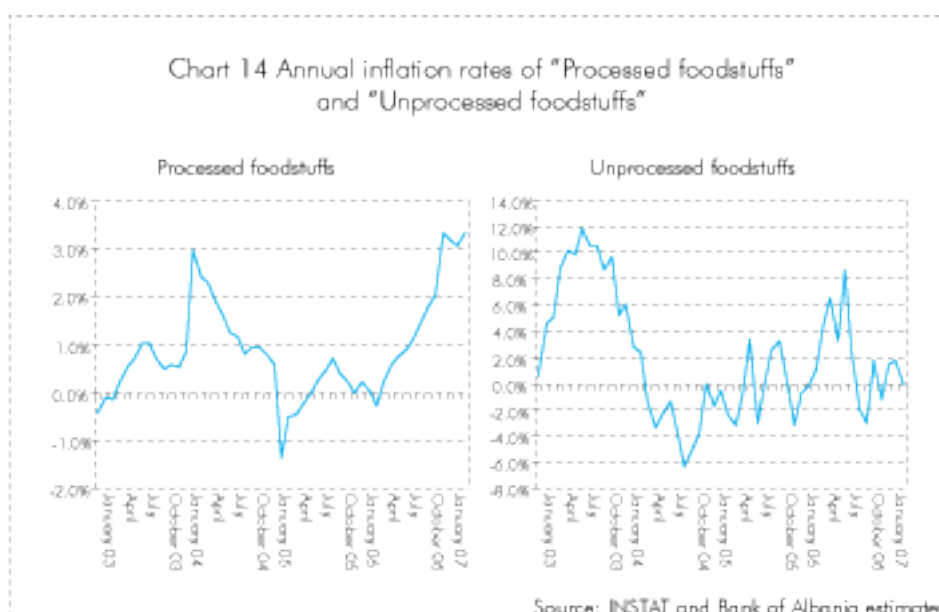
Annual inflation of “Processed foodstuffs”, recorded the highest rate in March 2007, reaching about 3.3 per cent. For the first quarter of 2007, this rate fluctuated around 3 per cent. Starting from May 2006, this item’s annual inflation rate had an upward trend. The high inflation stemmed from administrative factors, such as the rise of excise duty on tobacco in September 2006. In addition, the high prices of tobacco and alcoholic beverages abroad³, combined with the depreciation of the lek to the euro⁴, transmitted increased inflationary pressures on the country’s inflation.



	Alcoholic beverages and Tobacco annual inflation (%)			Foodstuffs and non-alcoholic beverages annual inflation (%)		
	Albania	Italy	Greece	Albania	Italy	Greece
March '06	1.8	6.7	3.3	0.2	1.0	2.1
June '06	1.6	6.6	4.9	0.8	1.3	3.5
September '06	11.4	6.4	6.7	1.9	2.5	4.7
December '06	12.0	6.4	10.7	0.5	2.7	4.3
March '07	12.2	5.7	10.8	-0.5	2.4	2.7

Table 9 Inflation annual rates by main groups

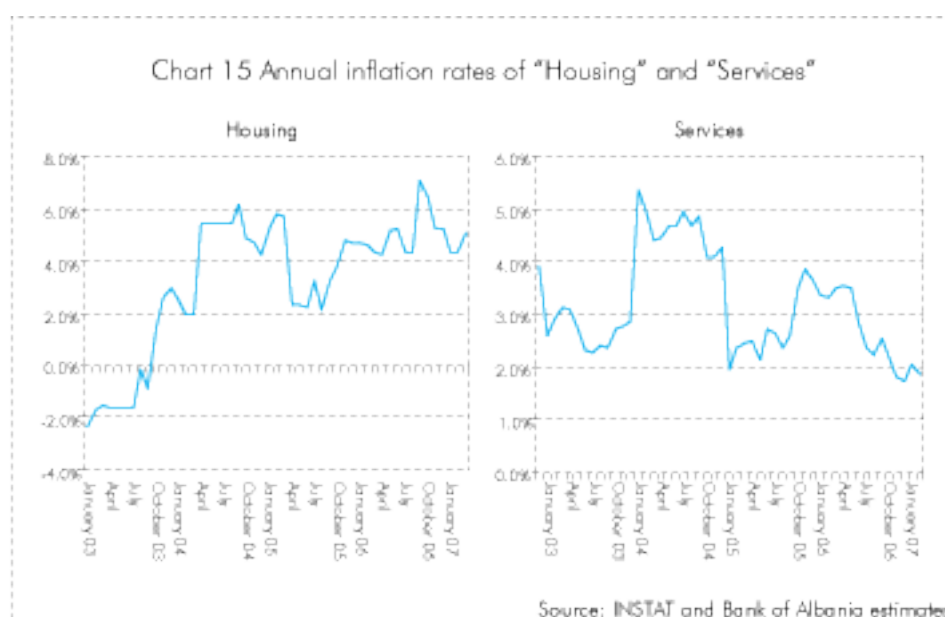
Source: ISTAT; website <http://www.istat.it>; National Statistical Service of Greece; website: <http://www.statistics.gr>; INSTAT, CPI, March 2007



Annual inflation rate of “Unprocessed foodstuffs” increased over the first two months (1.5 and 1.8 per cent), while in March it did not undergo any changes. This item is mainly characterized by the high fluctuation in fruit and vegetables prices.

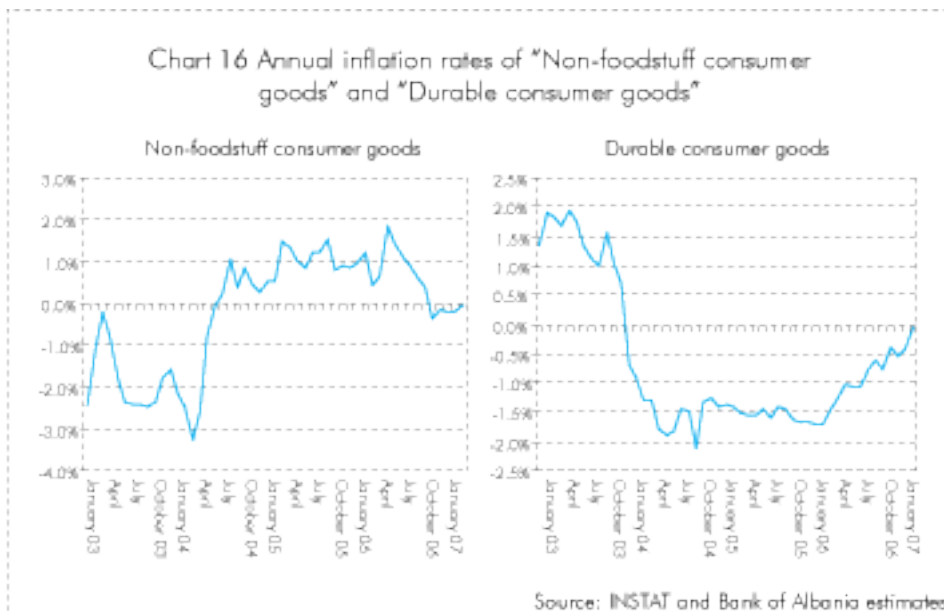
Annual inflation rate of “Housing”, remained unchanged in the last two months of 2007 at 4.3 per cent, and increased to 5.1 per cent in March 2007. This item’s annual inflation has been recording high rates since the beginning of 2004, reflecting the fluctuations in rent and imputed rent prices. The price of rent has manifested the growth of domestic demand resulting from the domestic migration of people to urban areas and the energy price change. The increase of this item’s inflation in March 2007 may have derived from the information for a rise in real estates tax.

Annual inflation rate of “Services” recorded a moderate annual increase over the first quarter of 2007. At end quarter, this item’s annual inflation stood at 1.9 per cent. Over the last two months, transportation prices have risen, determining this item’s prices trend. Meanwhile, the prices of hotel and restaurants services have been rising by about 2 per cent a year. The increasing domestic demand for higher services quality in hotels and restaurants and the use of import goods as crucial components in these services have had an impact on maintaining a non-falling trend of this item’s prices at about 2 per cent.

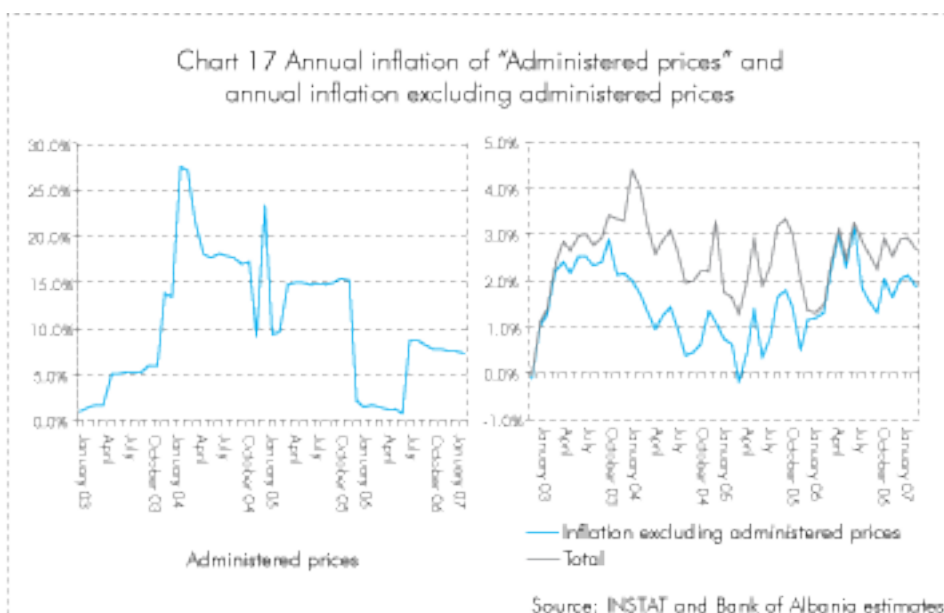


“Non-foodstuff consumer goods” and “Durable consumer goods” have recorded negative annual inflation rates over the period. This phenomenon has been present for several years in durable consumer goods prices, which is assessed to have been influenced by a number of factors. The exchanging nature of these goods in the international market makes them subjects of international competition and globalization. The favourable exchange rate

developments of the lek to the usd caused the lek import prices of these goods to drop. On the other hand, the prices of “Non-foodstuff consumer goods” almost made no contribution to the annual inflation rate over the first quarter of 2007.



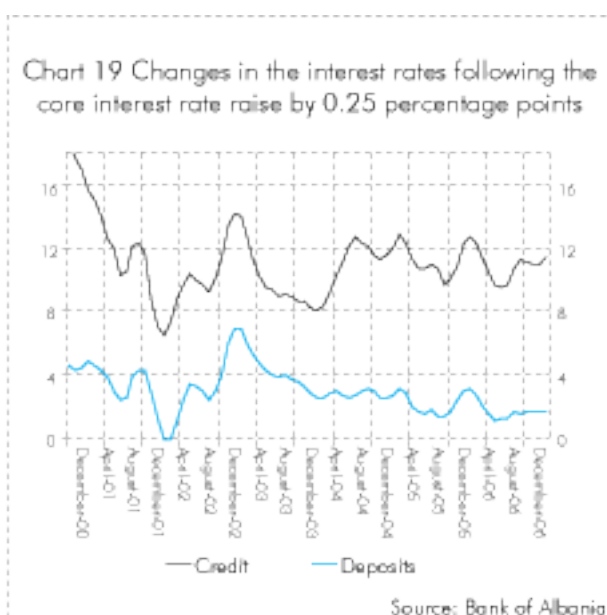
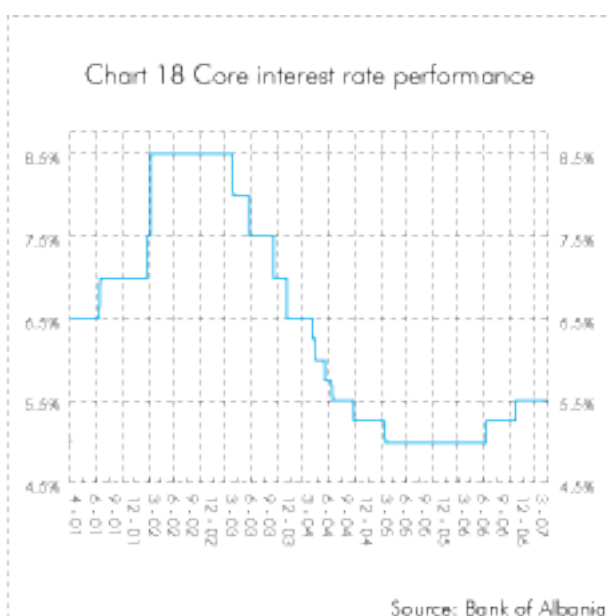
Annual inflation of “Administered prices” continued to record high rates, sharing one third of average inflation for the period. Administered prices fluctuated around 7-8 per cent over August 2006 and March 2007, following the last rise of energy price by 14 per cent. The annual rate increase by 0.5 percentage points relative to the previous quarter came as a result of the drop in health services tariffs. The reforms in medicaments reimbursement have been also assessed to have had an impact. Meanwhile, since October 2006, telecommunication prices have continued to fall by about 2.5 per cent in annual terms.



5 MONETARY DEVELOPMENTS AND FINANCIAL MARKETS

5.1 MONETARY POLICY OF THE BANK OF ALBANIA

Monetary conditions over the first quarter of the present year were characterized by the further growth of money supply in economy, being in line with the real demand of economy for monetary assets. The inflation rate for the first quarter of 2006 averaged 2.8 per cent, while the financial markets interest rates have reflected the rise of the core rate in November. The projection within the objective and the overall assessment of the expected inflation performance by consumers were reflected in the maintenance of the core interest rate unchanged at 5.5 per cent. However, the Bank of Albania observes that the current and expected rates of money growth in economy poses risks to the inflation rate performance in the medium run.



The Bank of Albania monetary policy, over the first quarter of the present year, was oriented towards the management of liquidity conditions through its operations in the open market. In January, the relatively high liquidity level in the interbank market exerted pressure on the deposits' and securities' market interest rates. There was an increase of liquidity as a result of the return of currency outside banks to the system. Under these conditions, the monetary operations consisted in the withdrawal of about ALL 6 billion, through the maturity of reverse repos of one and three-month maturity term.

In March, the Bank of Albania withdrew about ALL 2.5 billion of liquidity through the Treasury bills outright purchase. In the short run, the level of liquidity was managed through one-week repos. These operations aimed at maintaining the interbank liquidity interest rate close to the core rate and at transmitting monetary policy signals to the rates of longer maturity term in the deposits' and loans' market.

The interest rates' equilibrium in the Government securities' market was quite responsive to the lower Government demand relative to December and to the high level of liquidity in the system over the first quarter. The management of liquidity in February and March 2007 aimed to reduce the securities interest rates fluctuations. Meanwhile, the Bank of Albania was not present in the exchange market over the first quarter of 2007. The developments in this market provide evidence for depreciating trends of the lek to the main currencies basket of trade.

The Bank of Albania monetary operations allowed the realization of its quantitative objective, the net foreign assets, within the parameters aiming monetary stability. The net foreign reserve level of the Bank of Albania was about USD 129 million above the objective.

	March '06	September '06	December '06	January '07	February '07	March '07*
Net International Reserve of the Bank of Albania (in millions of USD)						
Objective	1,117	1,252	1,268	1,259	1,251	1,243
Current	1,202	1,296	1,394	1,397	1,398	1,372
Difference (C-Obj)	85	44	126.8	137.5	146.6	129.0
Net Domestic Assets of the Bank of Albania (in billions of ALL)						
Objective	85.0	82.9	86.9	87.4	87.9	88.4
Current	61.9	71.2	73.2	67.0	67.2	71.2
Difference (C-Obj)	-23.1	-11.7	-13.7	-20.4	-20.6	-17.2
Net Domestic Credit to the Government (in billions of ALL)						
Objective	325.8	335.8	342.4	334.7	335.9	338.5
Current	311.8	307.4	330.5	334.4	335.2	--
Difference (C-Obj)	-14.0	-28.5	-11.9	-0.3	-0.7	--

*Operative data

Source: Bank of Albania

Table 10 Realization of the Bank of Albania quantitative objectives⁵

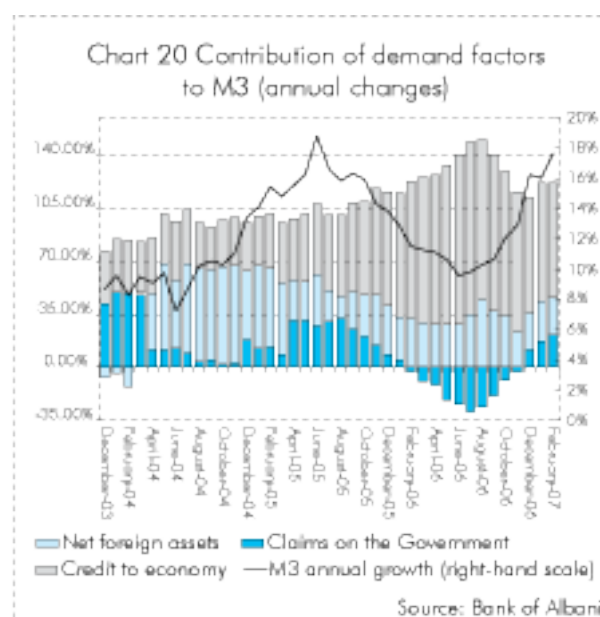
5.2 MONEY SUPPLY

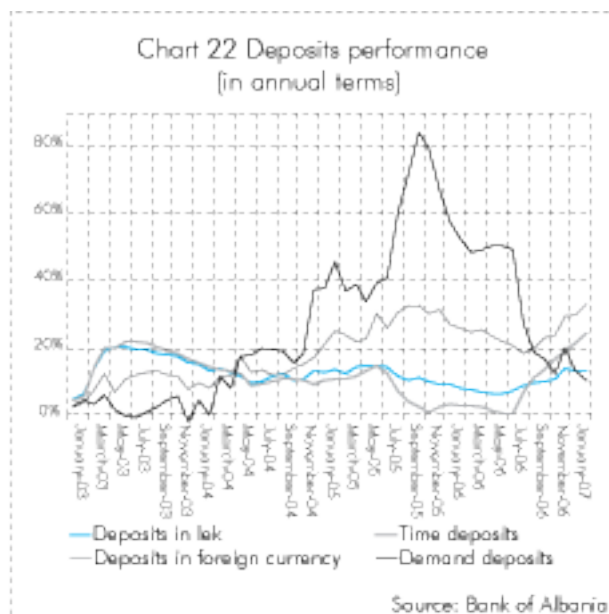
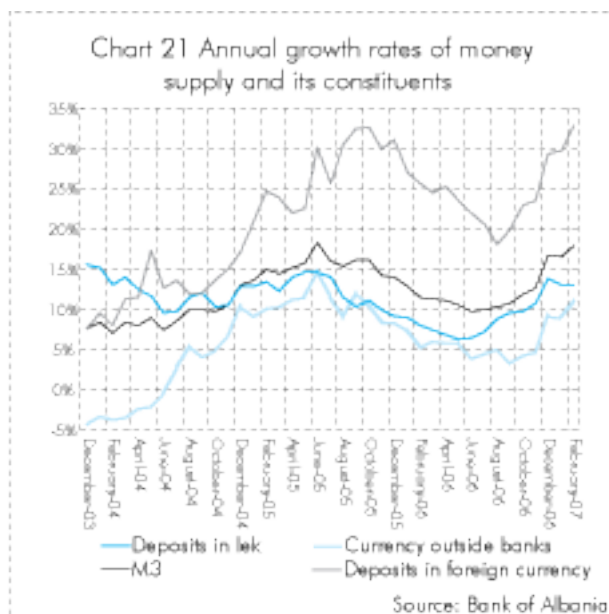
Money supply, over December to February, maintained the upward trend displayed since mid-2006, reaching an annual growth of 17.9 per cent at end February. Supply-side developments in broad money were supported by the increase of time deposits level by ALL 29.8 billion.

From the demand viewpoint, money supply growth was mainly urged by the increase of net domestic assets of the banking system. Credit to economy was among the main components of this monetary indicator, providing the main influence on monetary expansion. The annual change of credit to economy in February accounts for 76 per cent of money supply annual change.

Currency outside banks reduced by 5.3 per cent in February, compared with December, reflecting as such the historical tendency of the return of currency to the banking system after the end-year. In addition to the seasonal factor, this development provides evidence for the reduction of cash in our domestic economy and for the enhancement of public trust in the banking system.

The return of currency outside banks to the banking system was reflected in the increase of ALL deposits by 1.9 per cent, at end 2006. In terms of time structure, ALL time deposits grew by 6 per cent, while demand deposits reduced by 9.8 per cent.





As a result of the reduction of currency outside banks and ALL demand deposits, M1 monetary aggregate reduced by 6.9 per cent compared with December 2006. Being the most liquid component of money supply, this aggregate is assessed to bring about changes in consumer demand. Its performance over the first two months of the year is considered to have mitigated the inflationary pressures.

Deposits in foreign currency had the most rapid growth rate among the monetary aggregates. By time structure, time deposits in foreign currency increased by 12.5 per cent, while demand ones reduced by 4 per cent compared to the end-year 2006. Remittances and the reduction of the interest spread between ALL and foreign currency time deposits are the main factors to have influenced on the increase of time deposits in foreign currency.

Table 11 Monetary indicators (in billions of ALL)

	February 2007	2-month change		Annual change	
		Absolute	Percentage	Absolute	Percentage
Currency outside banks	154.5	-8.7	-5.3%	15.4	11.1
Total deposits	529.8	18.8	3.7%	88.7	20.1
- ALL deposits	320.3	5.8	1.9%	37.0	13.0
- Foreign currency deposits	209.5	12.9	6.6%	51.7	32.8
M1	230.5	-17.0	-6.9%	11.4	5.2
M2	474.9	-2.9	-0.6%	52.4	12.4
M3	684.3	10.0	1.5%	104.1	17.9
Monetary base	212.0	-5.6	-2.6%	23.1	12.2

Source: Bank of Albania

5.3 MONEY DEMAND

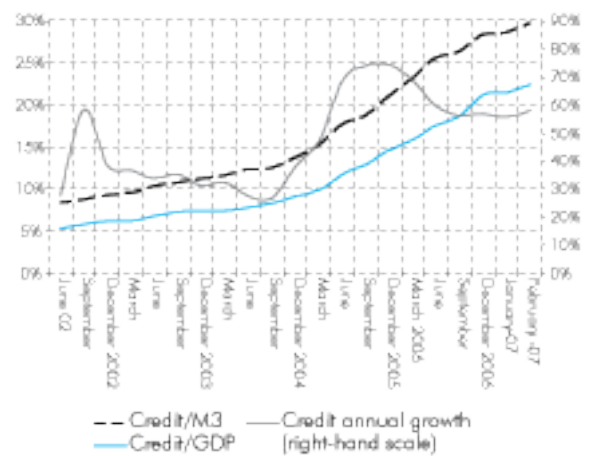
5.3.1 Credit to economy

Credit to economy grew under stable rates over the first two months of 2007, amounting to ALL 203.5 billion at end February and accounting for 22.4 per cent

of the GDP. Following the successive drops over most of 2006, the first months of 2007 provide evidence for a stable annual growth rate, with a slight growth trend to 57.9 per cent, in February. This was mostly a consequence of the increasing contribution of short-term loans, foreign currency loans and of business loans. In relation to broad money, outstanding credit accounted for 29.7 per cent, increasing sharply by 1.3 percentage points compared with December 2006. The rapid growth of credit remains a source of inflationary pressures in the medium term.

The positive credit performance affected its substantial share growth to the banking system assets and deposits to 32.1 per cent and 38.4 per cent, respectively. For the first two months of 2007, outstanding credit to economy grew by ALL 12.3 billion or twice as much than over the same period the previous year. The high monthly growth in August by ALL 9.3 billion holds the main share, providing evidence for a shifted performance for this period of the year. New credit extended over these two months was ALL 22.6 billion or 30 per cent more than the previous year. Credit structure in the first quarter of the year shifted to credit in foreign currency and credit to business. As of end February, credit in foreign currency and credit to business shared 71.7 per cent and 66.2 per cent of credit portfolio. Their annual growth rates display upward tendency.

Chart 23 Outstanding credit performance as a share to M3 and GDP (in percentage)

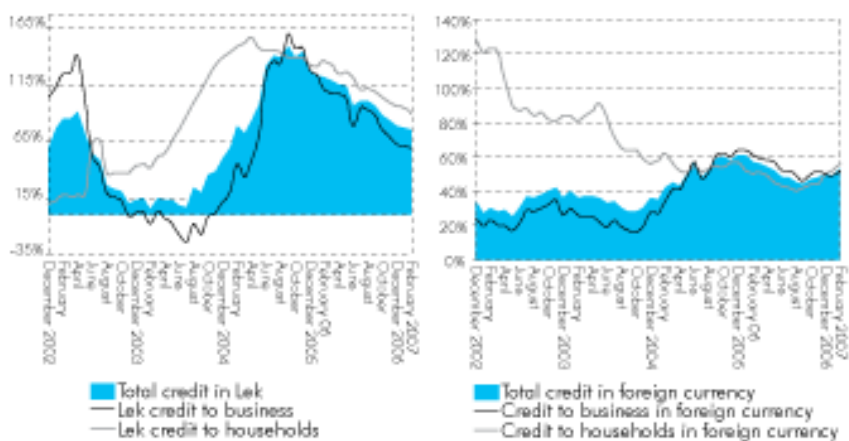


Source: Bank of Albania

Box: Performance of credit indicators

Credit in lek grew by 2.3 billion. Meanwhile, annual growth slowed down, reaching 74.2 per cent in February. Annual contribution of ALL credit to total has been dropping since last summer, bringing about the slight decrease in the share of ALL credit portfolio to total to 28.3 per cent. The growth of ALL outstanding credit in lek has been similarly bolstered by households and businesses.

Chart 1 Annual growth rate performance of credit by currency

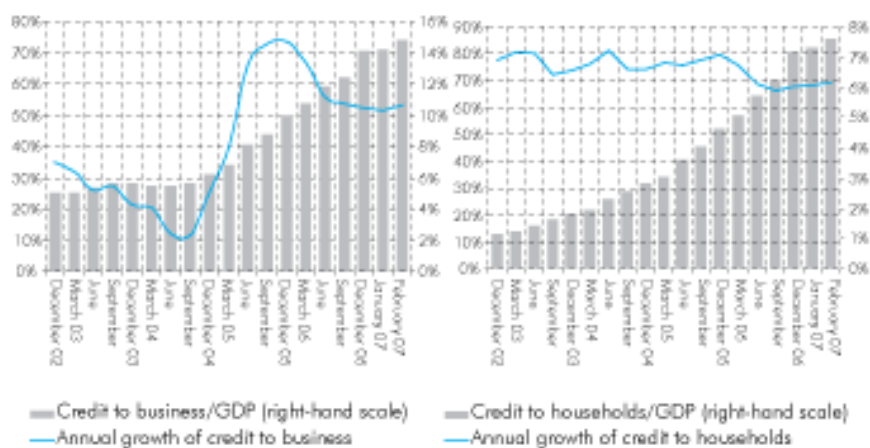


Source: Bank of Albania

Credit in foreign currency dominated outstanding credit performance, contributing by more than 67.4 per cent to credit portfolio annual growth. Following the moderate drop in January, the annual growth rate of credit in foreign currency returned to the upward trend and reached 52.9 per cent from 49.5 in December 2006. The increase of credit extended to business shored credit portfolio in foreign currency further up.

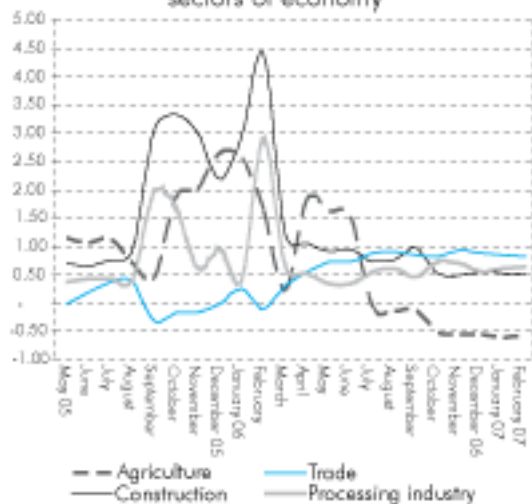
In annual terms, credit to households had the same growth rates over the first months of 2007 as in December 2006, growing by 69 per cent and sharing 33.8 per cent of credit portfolio. As a share to GDP, in February it accounted for 8 per cent. The portfolio of credit to households is dominated by the constant growth of credit extended for real estates purchase purposes. Over the recent years, the higher demand for apartments has led to the sharp growth of real estates loans, which in February accounted for 62 per cent of households' portfolio. The share of consumer loan to total loan portfolio remained unchanged at 8.3 per cent over the first two months of 2007, dropping compared to December last year when it shared 9.1 per cent.

Chart 2 Performance of outstanding credit by type of consumer



Source: Bank of Albania

Chart 3 Loan index growth rate by sectors of economy



Source: Bank of Albania

Business loans as of end February accounted for 15 per cent of the GDP. Its annual growth rates reached to 53.3 per cent in February, reflecting growth compared with December. Loans for covering businesses' short-term needs for liquidity and investment in machinery and equipment made the main contribution to the growth of this type of loan. Loans for investment in machinery and equipment share 35.1 per cent of business loans. Business loans for the purchase of real estates also have a considerable share in business loans portfolio, accounting for 23 per cent. The continuous price rise in business environments and business demands for expanding their activities or reconstructing their existing buildings are the main factors to have led to such a performance.

The analysis of sectoral distribution of business loans portfolio points out that trade sector is extended most of the banking system loans. This sector's loan growth

rates remained almost unchanged over the first two months of 2007, at 83 per cent. As in December, financial intermediation loan's portfolio grew in February. It mainly comprises loans banks extend to their leasing companies. Construction and processing industry maintained the same share in loans portfolio by 12.6 and 14.2 per cent, respectively. The difficult situation agriculture is going through still keeps it away from the banking system attention and interest. Agriculture loans account for less than 1 per cent of loans portfolio.

5.3.2 Government financing

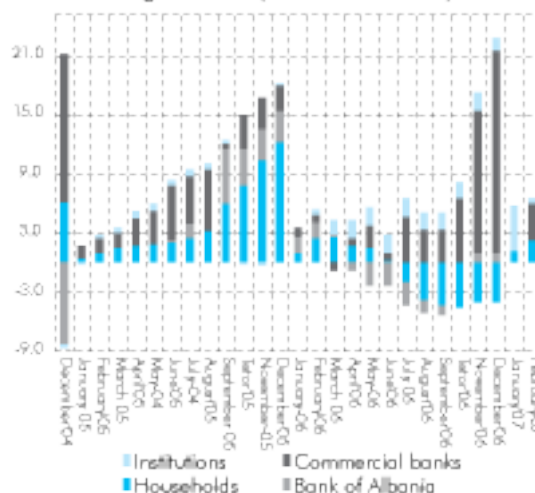
As commonly occurs, Government demand for money was moderate in January and February, as a result of the positive fiscal balance. Government demand for the period was covered by domestic financing, which amounted to ALL 4.6 billion. The issue of Government bonds of 2, 3 and 5-year maturity share most of the financing, by ALL 3.4, 2.9 and 4.0 billion, respectively. The issue of Treasury bills was also part of domestic financing. The matured amount exceeded the issued amount, bringing about the dropping of Treasury bills portfolio by ALL 3.8 billion. Over the first quarter of 2007, households and institutions increased their Treasury bills portfolio by ALL 2.2 and 0.6 billion, while commercial banks dropped it by ALL 6.7 billion. In this way, commercial banks responded to the shift in Government debt structure to the long one (Government bonds). At end 2004, Treasury bills accounted for 97.2 per cent of total domestic debt, while at end 2006, this share dropped to 87.9 per cent.

In February, the Government invested the excess liquidity provided by the long-term debt to commercial banks, in the form of reverse repos amounting to ALL 2 billion. At end February, the Government's deposit held with the Bank of Albania levelled ALL 6 billion. The performance of the Government's demand for monetary assets is in line with the developments observed over 2006.

5.3.3 Net foreign assets

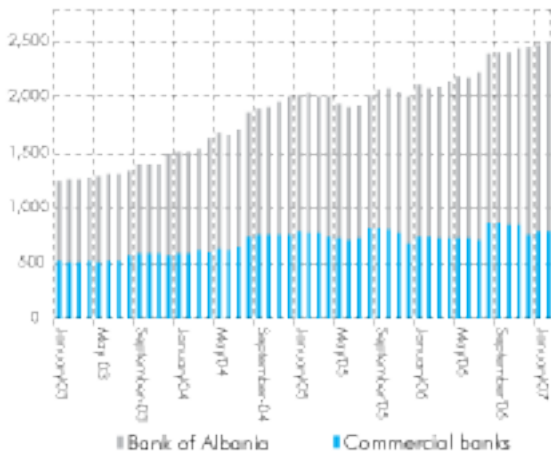
The foreign currency component of demand for money grew over the first two months of the present year. Commercial banks increased their net foreign assets by USD 32 million in January and February, pushed by the higher foreign deposits than foreign loans. The developments in the Bank of Albania net foreign reserve have increased the banking system net foreign assets. The Bank of Albania net foreign reserve grew by USD 17.7 million, as a result of foreign disbursements and the purchases with the Ministry of Finance. In total, the banking

Chart 24 Developments in gross financing of budget deficit (in billions of ALL)



Source: Bank of Albania

Chart 25 Net foreign assets of the banking system (in millions of USD)



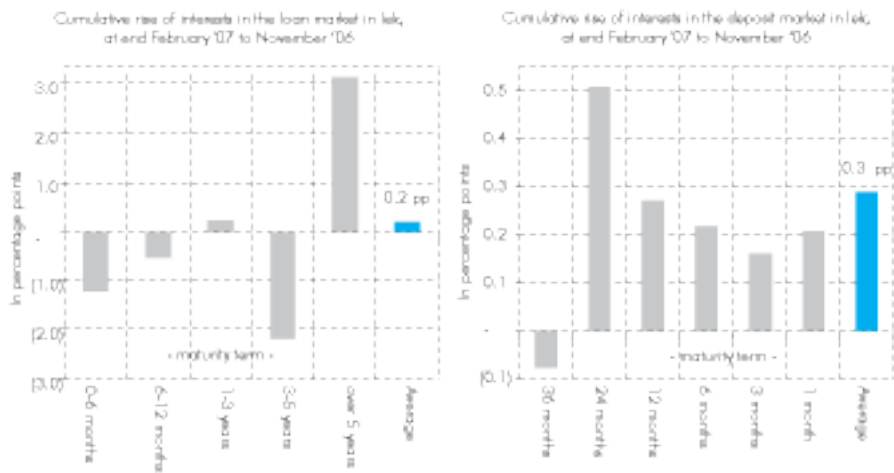
Source: Bank of Albania

system net foreign assets have grown by USD 49.8 million, amounting to USD 2.5 billion. The changes in the exchange rate of the euro to the usd had a moderate impact on the performance of these assets. Excluding the exchange rate effect, they grew by USD 48.6 million.

5.4 DEVELOPMENTS IN FINANCIAL MARKETS

After the tightening monetary conditions in July and November the previous year, the Bank of Albania has been pursuing a neutral monetary policy in the first quarter of 2007. Being affected by the increase of excess liquidity, the money market interest rates decreased compared with the previous quarter, while remaining in higher rates than the previous year. Meanwhile, the interest rates in the ALL deposits and loans market reflected the monetary policy signal in November further.

Chart 26 Interest rates performance in deposits and loans' market



Source: Bank of Albania

5.4.1 Money market

The banking system excess liquidity grew substantially in the first quarter, as a result of the money inflow in the system and the positive effect of the Government's operations. The daily average level of liquidity amounted to ALL 4.2 billion compared with ALL 1.9 billion in the fourth quarter and ALL 6.1 billion in the first quarter of 2006⁶.

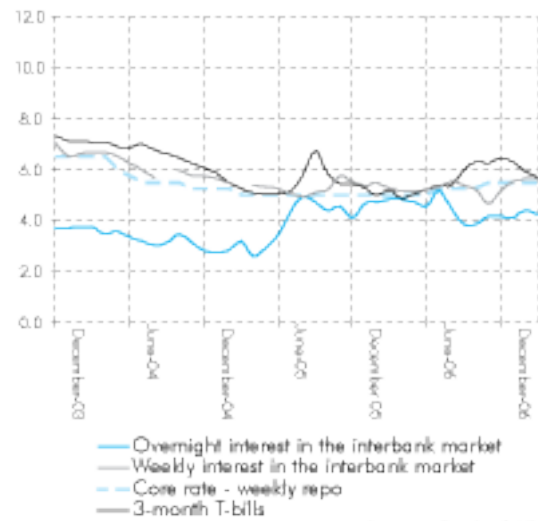
The asymmetric distribution of liquidity causes the interbank market to be used as a source for meeting short-term needs for funds. All transactions in the interbank market were of weekly or shorter maturity (overnight mainly). The daily volume of lending averaged ALL 1.78 billion⁷, compared with ALL 1.75 billion in the previous quarter and ALL 1.83 billion the previous year. The average interest for weekly transactions increased to 5.60 per cent from 5.00 per cent the previous quarter and 5.38 per cent the previous year, being quite close to the core interest rate.

Banks' short-term investment in Treasury bills had a positive effect on the increase of liquidity, part of which shifted to the purchase of bonds. The effect of liquidity formation was followed by the decrease of Treasury bills yields of three maturities (3-month, 6-month and 12-month). At end March, the 3-month yield dropped to 5.69 per cent from 6.45 per cent at end December, while the 12-month yield dropped to 7.10 per cent from 7.89 per cent.

5.4.2 Capital market

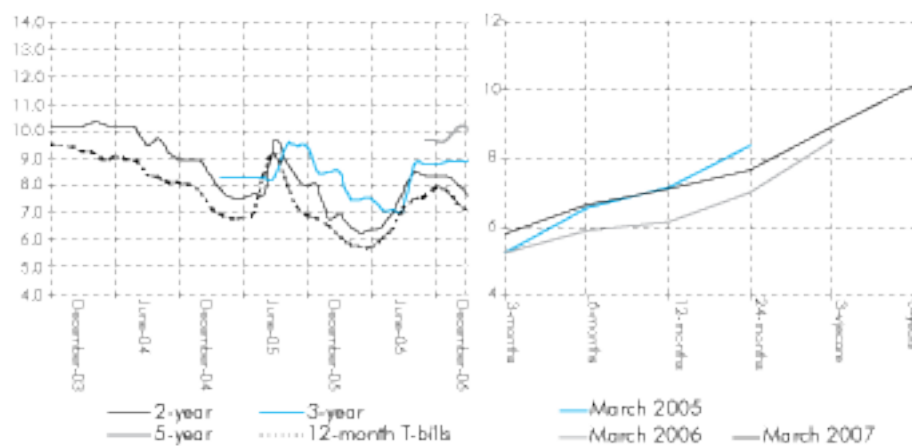
Banks remain the sole active participants to have met the demand for financing in the auctions of 2-, 3- and 5-year Government bonds⁸. Their portfolio in these securities grew by ALL 12.1 billion in the first quarter, shifting slowly the time structure of investment to longer terms. 2-year bonds yield had the same downward performance of 12-month yields, as a result of competition enhancement and high excess of liquidity. It dropped to 7.65 per cent in March or 0.75 percentage points below the yield of December. 3- and

Chart 27 Interest rates in the money market



Source: Bank of Albania

Chart 28 Yields performance in the Government's bonds market and interest rates curve



Source: Bank of Albania

5-year bonds yield, which are issued only once in three months had quite an opposite performance. In March, 3-year yield recorded 8.90 per cent, while the 5-year one 10.14 per cent, increasing by 0.10 and 0.46 percentage points, respectively.

The difference between long-term and short-term yields continues to be positive. Except for 3- and 5-year maturity terms, the yields dropped similarly in the first quarter, pushed by a neutral policy and the increase of excess liquidity in the market. Nonetheless, at the beginning of April, there has been a reduction of liquidity in the market, which has brought about the increase of Treasury bills yields for all maturity terms⁹.

5.4.3 Deposits and credit interests

According to the most recent data¹⁰, the lek deposits interests¹¹, in particular of 1 and 24-month deposits, increased in the first two months of 2007. However, signs of interests decrease were being displayed in February, such as in current accounts, 1-month and 24-month deposits, reflecting as such the increase of liquidity in the system over the period.

The intermediation cost continues to fluctuate around the same level, as a result of the high level of lek credit. Credit demand continued to grow and it did not seem to exert any pressures for the decrease of credit rates.

In February 2007, the average weighted interest of ALL credit increased to 14.7 per cent, from 12.9 per cent in December. ALL credit interest increased for all terms, except for 1-3 years credit, which in contrast, dropped.

In the first two months of 2007, the dollar and euro deposits interests increased in all terms, except for 24-month euro deposits and 36-month dollar deposits. Compared with the same period the previous year, the euro and dollar deposits interests have also been increasing. The tightening monetary policy pursued by the European Central Bank and the Federal Reserve at the early 2007 has had its influence on this increase.

The following chart displays the spread of real 12-month deposits interests in lek to those in foreign currency, which in February 2007 dropped to lower levels compared with December 2006. Furthermore,

Chart 29 Difference between 1-3 years ALL credit interests and 12-month deposits interests

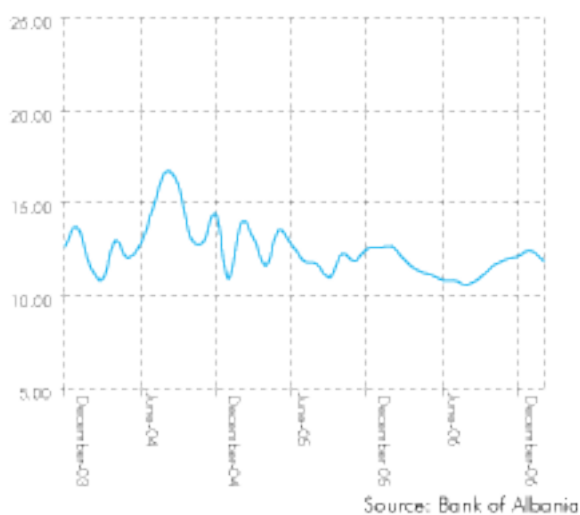
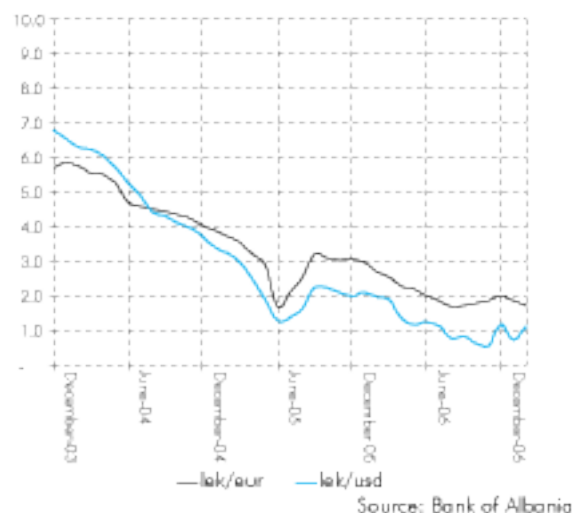


Chart 30 Spread of real 12-month deposits interests in lek to those in foreign currency (in percentage)



credit in foreign currency was mostly concentrated in the euro, pushing banks to become more aggressive in accepting euro funds.

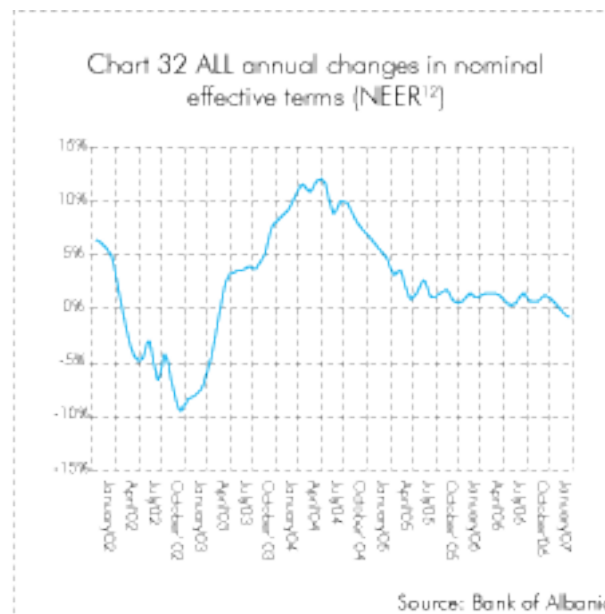
In February, there has been a decrease in USD deposits interest in all terms, except for interests of current accounts, demand deposits and 6-month deposits. This performance was pushed by the expectations for the dropping of the core interest rate by the Federal Reserve at the beginning of 2007.

In the first two months of 2007, the USD credit interests decreased almost in all terms, except for over 3-year credit interests, which increased. In February, the average weighted interest of USD credit reached 8.97 per cent from 9.4 per cent as of end December. EUR credit interests decreased only for 6-month - 1 year and 1-3 years credit. The dropping of interests in foreign currency credit affects the decrease of the intermediation cost in foreign currency. At an average level, the weighted interest of EUR credit has increased slightly, reaching to 8.3 per cent in February, from 8.2 per cent as of end 2006.

5.4.4 Exchange rate

The lek performance over the first quarter of 2007 provided evidence for its depreciating trend to the euro and the appreciating one to the dollar. The depreciating tendency of the lek to the euro is a relatively new one (since the end 2006), while the appreciation of the lek to the dollar dates earlier (since the end 2005). The annual dynamics of the lek exchange rate presents the same performance. Over the first quarter of the present year, the exchange rate of the lek to the euro depreciated by 1.8 per cent, while that of the lek to the usd appreciated by 6.4 per cent, on average.

Except for end-year and Easter holidays, it may be concluded that the appreciating rates of the euro to the lek in the domestic foreign currency market were higher than the appreciating rates of the euro to the dollar in the international market. The appreciation of the euro to the dollar in the international market for the first quarter of the present year was 0.9 per cent, while the appreciation of the euro to the lek was 2.1 per cent. Other domestic factors exerted depreciating pressures on the lek, among them the increase of foreign currency spending to afford to the import of energy, the reduction of the ALL-foreign currency interest rates spread and the growth of demand for our domestic currency over the last quarter of 2006.



In nominal effective annual terms, the lek depreciated by an average of 0.1 per cent over the first quarter of 2007. This is the first time in the last four years to observe a depreciation of the NEER. At end March, the lek exchanged at 94.98 to the usd and 126.47 to the euro.

ENDNOTES

¹ FOMC - Federal Open Market Committee

² 12-month accumulated balance is measured as the sum of the preceding 12 months at any point/month of the year.

³ Average annual inflation of this commodity group in the Euro area (27) was 4.4 per cent.

⁴ Lek depreciated considerably to the euro over the first quarter of 2007. Average annual rate of the depreciation for the period was 1.9 per cent.

⁵ The Bank of Albania quantitative objectives are part of the new PRGF/EFF 2006-2008 arrangement, signed between the Albanian Government, the IMF and the Bank of Albania in January 2006.

⁶ The excess liquidity in the first quarter was withdrawn by the Bank of Albania through one-week and three-month repos.

⁷ Out of which, ALL 0.68 billion were overnight loans.

⁸ 5-year bonds were issued for the first time in November 2006.

⁹ On 11 April, the 12-month yield increased to 7.54 per cent.

¹⁰ The most recent data refer to February.

¹¹ See: Statistical Annex, Financial Markets: Table "Interest rates and their change in the lek deposits and credit market".

¹² NEER – nominal effective exchange rate measured against two currencies according to an approximate share they have in trade with abroad, EUR (80 per cent) and USD (20 per cent). Since April 2004, the NEER is above 100. An increase of the NEER implies an appreciation of the lek.

STATISTICAL ANNEX

INFLATION

Table 1 Annual inflation rate (in percentage)

	2001	2002	2003	2004	2005	2006	2007
January	2.2	6.5	0.0	3.3	3.3	1.4	2.9
February	1.5	7.6	1.1	4.4	1.8	1.3	2.9
March	2.9	7.5	1.3	4.0	1.6	1.5	2.7
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	2.9	
September	3.5	5.3	2.8	2.0	3.1	2.6	
October	1.8	5.8	2.9	2.0	3.3	2.3	
November	2.8	3.7	3.4	2.2	3.0	2.9	
December	3.5	1.7	3.3	2.2	2.0	2.5	
Average	3.1	5.2	2.2	3.0	2.4	2.4	

Source: INSTAT

Table 2 Contribution of basket constituent groups to total inflation

	April - 06	May - 06	June - 06	July - 06	August - 06	September - 06	October - 06	November - 06	December - 06	January - 07	February - 07	March - 07
Foodstuffs and non-alcoholic beverages	1.03	1.51	0.80	1.86	0.51	-0.45	-0.59	0.45	0.09	0.66	0.70	0.32
Rent, water, fuels and energy	0.84	1.00	1.04	0.88	1.78	2.32	2.19	1.91	1.87	1.70	1.70	1.84
Transportation	0.13	0.23	0.24	0.19	0.13	0.10	0.09	0.08	0.05	0.02	0.01	0.04
Hotels, café and restaurant	0.22	0.22	0.22	0.16	0.18	0.18	0.15	0.15	0.14	0.14	0.17	0.14
Other	0.12	0.10	0.15	0.15	0.24	0.40	0.40	0.32	0.40	0.34	0.35	0.35
Total	2.35	3.1	2.45	3.24	2.84	2.55	2.24	2.91	2.55	2.86	2.93	2.69

Source: INSTAT, Bank of Albania

MONETARY INDICATORS

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

	February - 07	Monthly change		Annual change	
		Absolute	Percentage	Absolute	Percentage
Currency outside banks	154.5	-0.9	-0.6	15.4	11.1
Total deposits	529.8	7.6	1.5	88.7	20.1
- In lek	320.3	0.9	0.3	37.0	13.0
- In foreign currency	209.5	6.7	3.3	51.7	32.8
Demand deposits	144.0	-2.9	-2.0	13.3	10.2
- In lek	76.0	-4.2	-5.2	-4.1	-5.1
- In foreign currency	68.0	1.2	1.8	17.4	34.3
Time deposits	385.8	10.6	2.8	75.3	24.3
- In lek	244.3	5.0	2.1	41.0	20.2
- In foreign currency	141.4	5.5	4.1	34.3	32.0
M1	230.5	-5.1	-2.2	11.4	5.2
M2	474.9	0.0	0.0	52.4	12.4
M3	684.3	6.7	1.0	104.1	17.9
Monetary base	212.0	0.3	0.1	23.1	12.2

Source: Bank of Albania

Table 4 Performance of NFA indicators by main groups, January 2007 (in millions of USD)

	In absolute terms	Monthly change	Annual change
Net foreign assets	2,500.6	29.6	416.3
Foreign assets			
Bank of Albania	1,811.2	26.5	364.5
ODC	1,193.1	51.3	301.5
Foreign liabilities			
Bank of Albania	104.7	- 0.9	0.9
ODC	399.0	49.1	248.8

Source: Bank of Albania

Table 5 Performance of Net Credit to the Government indicators by main groups

	February - 07	Monthly changes	Annual changes
Net claims on the Government	297,019.5	1,398.0	17,722.9
Bank of Albania	50,820.7	- 31.8	- 4,768.5
ODC	246,198.8	1,429.8	22,491.4
Deposits held with the Bank of Albania	7,017.0	22.2	1,018.9
Budget deficit	14,2934	11,060.5	10,544.4

Source: Bank of Albania

Table 6 Performance of some main indicators

	2003	2004	June - 05	December - 05	June - 06	December - 06	January - 07	February - 07
Money supply (in billions of ALL)	448.4	507.2	541.8	578.04	594.5	674.3	677.6	684.3
Domestic credit (in percentage to M3)	71.5	68.9	69.9	70.03	71.0	71.8	72.3	73.1
Credit to the Government (in percentage to M3)	60.2	55.1	52.2	48.94	45.3	43.4	43.6	43.4
Credit to economy (in percentage to M3)	11.3	13.8	17.7	21.10	25.71	28.4	28.7	29.7
Credit to economy (in percentage to total assets)	13.7	16.9	20.8	25.11	28.7	31.3	31.5	32.1
Credit to economy (in percentage to GDP)	6.8	9.0	11.2	14.57	17.6	21.3	21.5	22.4
Credit/deposits ratio (in percentage)	15.7	19.0	23.6	28.47	33.7	37.4	37.2	38.4

Source: Bank of Albania

Table 7 Outstanding credit indicators as a share to total

	2003	2004	2005	Q1-06	Q2-06	Q3-06	Q4-06	January- 07	February - 07
Outstanding credit (in billions of ALL)	50.7	69.3	121.6	134.6	152.8	165.3	191.2	194.4	203.5
Credit to households	24.5	30.6	32.3	31.9	32.3	33.3	33.4	34.2	33.8
Credit to private sector	75.5	69.4	67.7	68.1	67.6	66.7	66.5	65.7	66.2
Short-term credit	46.0	34.0	32.3	32.5	31.1	30.0	29.6	29.5	29.8
Medium-term credit	33.3	36.0	29.7	30.0	31.2	32.6	31.6	31.1	31.0
Long-term credit	20.7	30.0	37.9	37.5	37.7	37.4	38.8	39.4	39.2
Lek	19.6	19.5	26.6	26.0	28.2	29.8	28.9	28.9	28.3
Foreign currency	80.4	80.5	73.4	74.0	71.8	70.2	71.1	71.1	71.7

Source: Bank of Albania

Table 8 New credit indicators as a share to total

	Total 2004	2005				2006				January - 07	February- 07
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
New credit (in billions of ALL)	99.7	22.1	32.8	32.1	32.9	29.4	35.7	35.8	53.9	9.6	13.1
Short-term credit	62.54	53.2	47	47.4	48.7	44.2	42	45.8	46.7	38.8	40.2
Medium-term credit	22.53	22.4	31	30.3	25.6	30.1	33	31.2	27.4	28.0	31.6
Long-term credit	14.93	24.4	22	22.2	25.7	25.7	26	23.0	25.9	33.2	28.2
Credit in lek	32.59	30.1	32.8	30.2	31.4	27.7	35	39.6	26.2	32.7	26.9
Credit in foreign currency	67.41	70	67.2	69.8	68.6	72.3	65	61.4	73.8	67.3	73.1

Source: Bank of Albania

Table 9 Distribution of credit by sectors of economy (as a share to total)

	Q1 -'05	Q2 -'05	Q3 -'05	Q4 -'05	Q1 -'06	Q2 -'06	Q3 -'06	Q4 -'06	January - '07	February - '07
Agriculture, Hunting and Silviculture	1.3	1.5	2.4	2.7	2.2	0.9	0.7	0.7	0.7	0.7
Fishing	0.01	0.1	0.1	0.1	0.1	0.1	0.11	0.1	0.1	0.1
Extracting industry	2.35	0.6	0.5	0.5	1.4	2.3	1.0	1.0	1.1	1.4
Processing industry	15.8	15.6	13.9	13.8	14.2	15.3	15.5	14.3	14.5	14.2
Production, distribution of energy, gas and water	6.27	2.9	2.9	2.6	2.4	1.1	1.2	1.5	1.1	1.3
Construction	10.6	11.2	12.8	13	13.0	12.2	12.6	12.6	12.5	12.6
Trade, repair of vehicles and household appliances	20.5	19.1	20	18.9	19.0	22.5	23.1	22.4	22.2	21.9
Hotels and restaurants	2.5	4.7	4.4	4.3	4.8	4.1	3.9	3.5	3.5	3.5
Transportation and telecommunication	2.5	1.7	1.7	1.5	1.3	1.6	1.6	2.0	2.0	1.9
Financial activities	0.2	1.1	0.7	0.8	0.7	1.3	0.7	2.1	1.5	2.1
Health and social activities	0.1	0.4	0.6	0.7	0.6	0.6	0.3	0.0	0.2	0.3
Collective, social and personal services	8.3	7.4	5.9	5.8	4.6	1.7	2.0	0.6	1.9	2.1
Other*	29.6	33.7	34.1	35.4	35.7	36.2	35.1	39.2	38.7	37.9
Total	100	100	100	100	100	100	100	100	100	100

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, it was required to review the credit distribution by sectors, where the new classification was introduced.

FINANCIAL MARKETS

Table 10 End-month interest rates and their change compared with the previous periods (in percentage points)

	March '07	Change March '07– December '06	Change March '07 – '06
Core interest rate	5.50%	0.00	+0.50
Interbank market			
Overnight interest	4.51%	-0.01	-0.27
Weekly interest	5.68%	0.44	+0.48
Primary market			
3-month Treasury bills yield	5.75%	-0.75	+0.47
6-month Treasury bills yield	6.64%	-0.47	+0.78
12-month Treasury bills yield	7.07%	-0.64	+0.99
Bonds market			
2-year bonds yield	7.65%	-0.75	+0.65
3-year bonds yield	8.90%	+0.10	+0.40
5-year bonds yield	10.14%	+0.46	-
9-month Eurobond	5.02%	-	-

Source: Bank of Albania and commercial banks

Table 11 Interest rates and their change in the lek deposits and credit market (in percentage points)

	February '07	Change February '07 – December '06	Change February '07- February '06
Core interest rate	5.50	0.00	+0.50
Interest of ALL deposits			
1-month	3.56%	+0.21	+0.15
3-month	4.02%	+0.08	-0.26
6-month	4.73%	+0.09	+0.02
12-month	5.60%	+0.14	+0.26

24-month	6.10%	+0.22	-0.27
36-month	6.48%	+0.06	+0.28
Interest of ALL credit			
Up to 6-month credit	14.38%	+2.20	+1.37
6-month to 1-year credit	13.46%	+2.30	-0.06
1-3 years credit	17.51%	-0.19	-0.52
Over 3-year credit	13.41%	+1.20	+1.06

Source: Bank of Albania and commercial banks

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

	February '07	Change February '07- December '06	Change February '07- February '06
Fed – Core interest rate	5.25%	0.00	+0.75
Interest of USD deposits			
1-month	3.16%	+0.13	+0.74
3-month	3.64%	+0.20	+0.77
6-month	4.16%	+0.29	+1.10
12-month	4.49%	+0.20	+0.89
24-month	4.93%	+0.07	+1.00
ECB – Core interest rate	3.50%	0.00	+1.25
Interest of EUR deposits			
1-month	2.76%	+0.22	+0.92
3-month	3.39%	+0.48	+1.15
6-month	3.45%	+0.16	+1.14
12-month	3.88%	+0.43	+1.20
24-month	3.77%	-0.39	+0.93

Source: Bank of Albania and commercial banks