Bank of Albania

QUARTERLY MONETARY POLICY REPORT

2021/II
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Bank of Albania
**INTRODUCTION**

The primary objective of the Bank of Albania’s monetary policy is to achieve and maintain price stability. This target implies reaching low rates with positive inflation, and maintaining these for a relatively long period. In qualitative terms, the Bank of Albania has defined price stability as maintaining a 3% annual inflation rate of consumer prices in the medium term. By preserving price stability, the Bank of Albania helps establish an environment with few unexpected events and assists Albanian households and enterprises in planning their own consumption and investments.

The Supervisory Council of the Bank of Albania holds 8 meetings each year to decide on monetary policy, aimed at achieving the price stability objective. The Supervisory Council sets the key interest rate. Changes in the key interest rate affect, with a time lag, other interest rates in the financial market, for example, yields on government’s securities and the interest rates on loans. These changes drive increase or decrease in the demand for goods and services through a chain known as the “transmission mechanism”. Changes in the demand for goods and services bring about increases or decreases in the prices of these goods and services.

The concept of transmission mechanism is rather broad and complex, encompassing various channels through which prices may change, for example: the exchange rate channel; the inflationary expectations channel; and the foreign prices channel. The Bank of Albania has constructed models to forecast changes in all elements which affect prices and to forecast inflation for up to three years. When forecasts show a dominance of low inflationary pressures, which may drive inflation below the 3.0% target, this is a signal that the monetary policy should be accommodative - interest rates should stay at low levels. The opposite also is valuable. However, drafting a monetary policy is not a mechanical process. Monetary policy decision-making considers the reasons for deviations in inflation from target and the time needed for the economy to react against changes in interest rates.

The Supervisory Council makes decisions on the monetary policy based on a variety of information, including estimations regarding economic developments, forecasts in relation to inflation, the performance of financial markets, risks and uncertainties surrounding forecasts. The Monetary Policy Report - which is the main component of the monetary policy - includes these considerations and assessments on this information. With the aim of communicating its monetary policy in a transparent manner, the Bank of Albania regularly publishes this Report and makes it available to citizens.


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FOREWORD BY THE GOVERNOR

The Albanian economy is showing recovery signs, although the pandemic effects on the economic activity still remain present. The available data indicate that economic growth has jumped into positive territory, in 2020 Q4 and during the first quarter of 2021, fuelled by the expansion in consumption, investments and exports. Their growth has benefited from: the improved business and consumer’s confidence; the stimulating monetary and financial environment; expansion of public investments; and ultimately, from the relaxation of containment measures undertaken to control the pandemic.

Although the aggregate demand volume is trending upwards, it still remains insufficient to ensure an employment level which would enable the rise of wages and profit margins, in line with our inflation target of 3%. This indicator continued to undershoot the target during the first quarter of year, by showing increased fluctuations, due to the performance of food prices.

In face of a recession and the weak inflationary pressures, the Bank of Albania further eased the monetary policy during the previous year. This accommodation took the shape of cutting the policy rate at 0.5% and increasing the liquidity injections in the banking sector. The strong monetary stimulus has continued to be present during the first quarter of 2021 as well. In coordination with our regulatory measures - which enabled the moratorium and urged the restructuring of loans - it aims at supporting the increase of consumption and investments of the private sector, through the reduction of borrowing costs and growth of lending to economy.

The analysis of financial market suggests that the Bank of Albania has succeeded in this regard. Financial markets appear calm and are characterised by low interest rates, stable exchange rate and normal circulation of liquidity. In parallel, lending to private sector has continued to record a relatively fast growth, by supporting the needs for funds to Albanian enterprises and households, while banking sector shows strong and sound balance sheets.

Our projections for the outlook remain positive. The continuation of vaccination process in Albania and globally, the monetary and fiscal stimuli, and the return of confidence at historical levels, will pave the way to the progressive expansion of economic activity in the next years. In their response, both employment and wages are expected to trend upwards, thus enabling the return of inflation to target within 2022.
Against this backdrop, the Supervisory Council assessed that the current monetary policy stance is adequate for underpinning both the further economic recovery and inflation converge to target. In this view, the Supervisory Council decided to keep the policy rate unchanged, and confirmed maintaining the current form of unlimited liquidity injections at fixed price to the banking sector, at least during the third quarter of the current year.

Deeming that the factors of economic growth still do not appear consolidated - something that would result in negative consequences in meeting our inflation target - the Supervisory Council assessed that the monetary policy stance will continue to remain accommodative throughout the medium-term horizon, and the eventual normalisation of monetary policy will be a gradual and careful process.
1. INFLATION AND MONETARY POLICY STANCE

After reviewing the Monetary Policy Report, the Supervisory Council decided to keep the policy rate unchanged, at 0.50%, and to affirm its willingness to maintain the accommodative policy stance in the medium term. The Supervisory Council has assessed that the current monetary conditions are adequate for supporting the economy and a stable convergence of inflation to 3.0% target, within the medium-term horizon.

Global economic outlook has been improving. Monetary and fiscal stimuli, and the continuation of the broad vaccination programmes, are underpinning the recovery of economic activity globally, although divergences across countries continue to be considerable. The increase of infections and the tightening of containment measures in some European countries drove to the interruption of economic recovery in Euro area at the end of 2020, and triggered expectations for a weak performance at the beginning of this year. Inflationary pressures are assessed to be low and the current inflation increase is expected to be temporary. In this context and in presence of high uncertainties, the stimulating policies undertaken by the European governments and central banks are expected to be active for a long period of time, to boosting the growth of production at pre-pandemic levels and enabling inflation increases towards the target.

Economic recovery in Albania is continuing at a higher pace than expected, by showing a higher resilience of our economy to the shock and a better reaction to stimulating measures. Improvement of economic activity picked up in the last quarter of 2020, alongside with the growth of GDP by 3% from the previous year. All components of aggregate demand increased, but public investments provided the most positive contribution. Indirect data show a continuation of economic recovery in the first quarter of 2021.

Despite the noted improvement, the effects of pandemic on the economy still are evident, as shown by the low levels of the demand, production and employment, as a ratio to 2019. Thus, economy generated 3.3% less production and income during 2020, and 3.4% less employment, while unemployment rate increased to 11.8%. These factors were reflected in the weak rise of wages and other production costs, decrease of profit margins to enterprises, and last, in the slow increase in consumer prices.

Inflation continues to undershoot the 3% target of the central bank. Annual inflation dropped to 0.9% in 2021 Q1. This fall was almost completely attributable to food prices, which recorded a sharp reduction in January.
Further, their increase drove headline inflation to upswing at 1.1% and 1.2%, respectively, in February and March. On the other hand, core inflation, which avoids these fluctuations, was stable, around 1.5%. Other goods and services prices in the consumer basket did not experience significant changes. Inflation is expected to rise slowly, by following with one time lag the improvement of demand and the increase of prices in partner countries.

**Economic outlook for Albania has been improving.** This improvement does factorise the so far flexibility of economy to adapt to the new conditions, the continuous support with stimulating economic policies, and the strengthening of population’s immunity, in line with the continuation of vaccination programmes.

**Forecasts of the Bank of Albania show the uninterrupted growth of economic activity during 2021-2023.** The gradual end of the pandemic effect will drive to the normalisation of economic activities, which will continue to benefit from the favourable financing conditions and the recovery of both domestic demand and foreign demand. Economic growth is expected to be broadly-based, underpinned by the increase in consumption, investments and exports. On one side, the increase in sales and income of economy sectors, the rise of their finances, and the upsurge of employment and wages on the other side, will accompany the economic recovery. The combination of these factors will build up inflationary pressures on the increase of consumer prices towards our target. Inflation is projected to hover around 1.5% in 2021 and upsurge to 3.0% within 2022.

**The Supervisory Council assesses that bolstering a firm economic rebound and the return of inflation to target require the maintaining of the accommodative monetary policy stance.** This will be realised by maintaining the policy rate below the equilibrium level in the medium-term horizon. For this reason, in the meeting of 5 May 2021, the Supervisory Council decided to maintain the policy rate unchanged, at 0.50%, and the overnight deposit and overnight lending rates at 0.1% and 0.9%, respectively. At the same time, the Bank of Albania will supply unlimited liquidity to the banking system, at least during the third quarter of 2021, too.

**The Supervisory Council deems that the stimulating monetary policy has been effective in guaranteeing the smooth functioning of financial markets and ensuring the lending flows to economy.** Financial markets have been characterised by ample liquidity and contained risk premia. Their good state has enabled the continuous pass-through of the monetary stimulus, which has maintained the interest rates on loans to private sector, at low levels. Currently, the interest rates applied on loans to enterprises are lower than their levels before the cut of the policy rate in March 2020. Bank credit has been trending upwards and has continued to be a stable financing source to Albanian households and enterprises. In 2021 Q1, banks have increased the volume of
credit to the private sector by around 7.5%.\(^2\) compared with the previous year. Credit growth has been mostly channelled to enterprises and has served mainly for financing investments. Financing in ALL has increased at a high pace, by pursuing the improving trend of the last years and by establishing the premises for the further enhancement of monetary policy’s effectiveness.

Although positive, the economic and financial outlook remains surrounded by downside risks, particularly in the short run. Economic developments, in 2021, will mainly be determined by the implementation speed and effectiveness of vaccination programmes, and the prolongation of restrictions. Meanwhile, downside risks arise from: (i) the extension of restrictions beyond the first half of 2021; (ii) a slower recovery of consumption and investments, due to a more prudential behaviour of the Albanian households and enterprises; (iii) a possible worsening of external economic and financial environment; and (iv) a slower transmission of monetary, due to a more prudential approach of banks to lending.

The Bank of Albania will cautiously monitor the economic developments and will continuously maintain adequate monetary conditions to supporting the economy and inflation converging towards our 3% target.

\(^2\) This rate is calculated for the credit being adjusted for the foreign exchange rate and loan write-offs.
2. External Environment

External environment has somewhat curtailed the improvement pace during the last quarter of 2020, due to the replacement of containment measures in large economies. Developments in the first quarter - along with the progress of vaccination roll out, the alleviation of containment measures and the undertaken fiscal stimulus - have affected the improvement of economic activity. Risks to economic growth are on the downside, but remain easier. Inflationary pressures across foreign countries are expected to remain less, providing low support to the increase of prices in Albania.

2.1. Economic Growth

Global economy has shown an improving trend, after the shock suffered from the pandemic. Data of the last quarter of 2020 indicate that the majority of advanced countries have succeeded in maintaining positive growth rates, although at a lower intensity. While the overall economic situation is expected to improve during 2021, economic outlook, in the short run, still remains clouded and is particularly related to the dynamics of COVID-19 pandemic and the speed of vaccination campaigns. Meanwhile, the increase of global demand and the additional fiscal measures have supported the economic activity globally and in the Euro area.

Indirect data from preliminary and more frequent indicators of growth suggest that economic activity has continued to expand in the first quarter of this year. This growth was supported by the sectors of production and industry, while services have reflected the return of containment measures across the majority of advanced countries.

Updated forecasts show that large and developing economies are expected to record a positive economic growth during this year. Although inflation picked up in the first months of 2021, its rates are expected to remain low. Risks to forecasts remain on the downside and are related to the evolution of the pandemic, and the vaccination roll out in many countries. Commodities prices in global markets have continued the upward trajectory, by reaching the pre-
pandemic levels. Expectations on commodities prices suggest a continuous increase of prices over the course of the current year and their stabilisation in the next year.

**EURO AREA ECONOMY**

The Euro area economy slowed down in the last quarter of 2020, after the placement of new containment measures to prevent the pandemic spread. Economic activity continues to remain below the pre-pandemic levels. Notwithstanding the increased fiscal stimulus that supported the budget of consumers and firms, the economic agents seem to have reduced their consumption, due to uncertainties on the economic prospects in the future. On the other hand, investments have accelerated, with private investments as a support to economic growth. Preliminary data suggest that the economic activity has continued to be weak in the first quarter of year, with similar characteristics to the previous quarter. The progress of vaccination roll out seems to lead to the relaxation of containment measures. This situation, in turn, will affect positively the economic development in the remaining part of year.

Inflation in the Euro area picked up to 1.3% in March, by recording positive values in all months of the quarter. This increase was attributable to the contribution of higher prices of energy, along with the core inflation set on a downward trajectory in the months of the quarter.

The European Central Bank forecasts that economic growth will settle on an upward trajectory in 2021, underpinned by expansionary fiscal measures, employment protection measures, and favourable lending conditions. The inflation rate is expected to return to positive values in 2021, but undershooting the ECB’s target.
Regional economies

Regional countries, as well continue to suffer the consequences of the containment measures taken for the prevention of the pandemic spread. In 2020 Q4, the economic performance has improved across all regional countries, but the economic activity remains below the pre-pandemic levels. Overall, components of the domestic demand have affected negatively the economic growth, while those of external demand have contributed to its support. Indirect data show a similar performance in the first quarter of 2021.

Overall, inflation rates have increased in the first months, by reflecting the rise in the prices of transport, which include the oil price. Financial institutions forecast positive growth rates in 2021 across the Western Balkans.

Table 1 Economic figures for countries in the region

<table>
<thead>
<tr>
<th>Country</th>
<th>Annual change of GDP</th>
<th>Annual inflation</th>
<th>Unemployment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2020 Q3</td>
<td>2020 Q4</td>
<td>2020 Q4</td>
</tr>
<tr>
<td>Italy</td>
<td>-5.2</td>
<td>-6.6</td>
<td>-0.4</td>
</tr>
<tr>
<td>Greece</td>
<td>-10.5</td>
<td>-7.9</td>
<td>-2.2</td>
</tr>
<tr>
<td>North Macedonia</td>
<td>-3.3</td>
<td>0.7</td>
<td>2.2</td>
</tr>
<tr>
<td>Serbia</td>
<td>-1.4</td>
<td>1.1</td>
<td>1.6</td>
</tr>
<tr>
<td>Kosovo</td>
<td>-7.3</td>
<td>0.7</td>
<td>-0.1</td>
</tr>
<tr>
<td>Albania</td>
<td>-2.8</td>
<td>3.0</td>
<td>1.6</td>
</tr>
</tbody>
</table>

Source: Respective statistical institutes. *2020 Q3

2.2. Commodity prices in global markets

The uprising trend in commodities prices, started at the end of previous year, has continued in the first quarter of this year. Levels of prices have reached those of pre-pandemic period. Oil price has recorded a sharp increase, reaching at 65.4 USD a barrel at the end of March, or around 109% higher than the same month in the previous year. The augmented demand coupled with the reduction

Chart 3.

Main indices have pursued the upward path in the first quarter of the year

Oil prices in Albania have reacted at a lower level to fluctuations in prices in global markets

Note: Domestic oil price calculated from CPI basket. Source: World Bank

Note: Commodity prices index. Source: INSTAT, BoA’s staff calculations.

Main trading partners outside the European Union (Kosovo, North Macedonia, Serbia, Turkey).
of produced quantity has triggered this upward pressure in international markets. The rising trend is expected to continue during the first half of year⁴.

Price indices of other groups have also pursued an upward trajectory. The increased demand has yielded higher prices of agriculture products. Also, the increase of investments in advanced countries and developing economies has generated upward pressures in metal prices, globally. The increase in metal prices may trigger positive effects in the export of the domestic metal.

2.3. GLOBAL FINANCIAL MARKETS

Overall, financial conditions in international markets remain eased, thus favouring access to lending and support to economies. Central banks have continued to implement accommodative policies, by contributing to the maintaining of premia and controlling risks in financial markets.

The main central banks have affirmed the respective accommodative monetary policy stance. Related to short- and medium-term expectations about the interest rates of future contracts financial instruments, central banks confirm a contained performance of premia during the first half of year. Monetary policy in Euro area will continue to be accommodative, while the European Central Bank has increased, since March, the volume of its purchasing programme in the securities market. The central banks in non-euro area countries have shown similar performance, by combining the accommodative monetary policies with non-conventional instruments.

The support with liquidity from central banks has maintained interest rates in the Euro area at low levels. In the Unites States, the improvement of the overall

Chart 4.

Interest rates implemented by main central banks are expected to remain at low levels in 2021 as well

<table>
<thead>
<tr>
<th>Year</th>
<th>UK</th>
<th>FED</th>
<th>ECB</th>
<th>ECB/overnight deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td></td>
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<tr>
<td>2019</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td>-2</td>
<td>-1.4</td>
<td>-1.25</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>-0.5</td>
<td>-0.3</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes: Key interest rates for large central banks with impact on international markets. Source: Central banks.

All central banks reacted against the pandemic by cutting the key interest rate

<table>
<thead>
<tr>
<th>Country</th>
<th>Key Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>0.75%</td>
</tr>
<tr>
<td>FED</td>
<td>-1.25%</td>
</tr>
<tr>
<td>ECB</td>
<td>-0.5%</td>
</tr>
<tr>
<td>ECB/overnight deposits</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

Notes: Changes in key interest rates in the period February 2020 - April 2021, in some European banks targeting inflation. Source: Central banks.

⁴ US Energy Information Administration, Short term energy Outlook, April 2021.
global framework and the approval of budget stimuli have driven to an increase in long-term yields. Then, this effect has been partially extended on long terms yields, in other advanced countries. Hence, yields on government bonds in the Euro area have slightly increased in the first months of year, by reflecting the improvement of forecasts. Also, indexes of stocks have risen in 2021 Q1, showing an improvement in the perspective of both companies’ income and investors’ sentiment.
3. FINANCIAL MARKETS AND LENDING CONDITIONS

Albanian financial market remains calm, being characterised by low risk premia of liquidity dictated by the sound balance sheets of the banking sector. Also, performance of yields reflects contained risk premia in this market. Nonetheless, in certain segments of credit, increasing pressures on interest rates are noted, due to the reduction of the effect of sovereign guarantee schemes. Lending maintained the upward trajectory, supported by the financing to both enterprises and households. In parallel, deposits - despite the low interest rates - have increased at a high pace, in response to the propensity for savings.

3.1. DOMESTIC FINANCIAL MARKET

Interest rates in the interbank market have continued to be anchored close to the policy rate\(^5\), by reflecting low risk premia of liquidity and being in line with the operational target of monetary policy. Trading volumes in this market have fluctuated close to the average levels of the last quarters. The Bank of Albania has continued the operations of liquidity injections, through its main instrument of one-week repo. In addition, three-month repo has been also used. The injected amount in this quarter was lower than in the last quarter of 2020\(^6\).

\[^5\] In 2021 Q1, the standard deviations of the overnight and weekly interbank rates were 0.03 and 0.006, respectively, from 0.6 and 0.03 in the previous quarter.

\[^6\] The injected amount of liquidity averaged ALL 33 billion in 2021 Q1, from ALL 39 billion in 2020 Q4, down for both weekly repo and for those with one month and three-month maturities.
but, the ratio of weekly injections to long-term injections (up to three months) has remained almost unchanged. One-week repo auctions continue to take place at fixed price and unlimited amount, by contributing to the maintaining of low risk premia of liquidity in the banking system.

The foreign exchange market appeared calm during the first months of 2021. This market is characterised by trading within the normal parameters of foreign currencies - a slight appreciation of lek against euro since March, and a depreciation of the lek against the US dollar.

The euro/lek exchange rate averaged 123.6 lek/euro in the first two months of 2021, standing close to the average level of 2020 Q4. During March and first half of April, it dropped to 123.3 lek/euro and 123.1 lek/euro, respectively. This performance is in line with the seasonal behaviour of the last years7. Although the short-term volatilities of the exchange rate were mainly on the appreciating side of lek in the last two months, the appreciation/depreciation bias, in a medium-term horizon, remains close to the equilibrium value, by showing balanced positions of economic agents in the market. Trading parameters of European currency in the domestic market appear stable; volatility indicator and quotation spread have resulted close to their normal values.

* Since 2015, March and April are characterised by a monthly appreciation of lek against euro, averagely 0.2% and 0.4%. Year 2020 is an exemption from this behaviour as the foreign exchange market suffered a short-term uncertainty shock caused by the pandemic spread in Albania.

* The exchange rate appreciation/depreciation ratio is calculated as the ratio of the number of days when the exchange rate is appreciated against the number of days when the exchange rate is depreciated, over a moving time horizon that may vary, e.g. 22 days (one calendar month) up to of 250 days (one calendar year). The value of this indicator near 1 indicates an equal number of cases of appreciation and depreciation and it shows that there are no one-sided pressures for appreciation or depreciation. If the value of this indicator is above 1 (below 1), then in the market there are signals for one-sided expectations for exchange rate appreciation (depreciation).
Lek appreciated in March and April, by 1.3% on average, compared with the previous year.

In the first months of year, lek depreciated slightly against the US dollar, in line with the performance of US dollar against euro in the international market. One US dollar was quoted on average at 103.5 lek in March and in the first half of April, from 101.6 lek in December 2020 and January 2021. This level is around 10.5% lower than a year earlier.

**Yields on Government debt securities**, after starting the year with a slight upward performance, have turned direction in March and have recorded a decrease in the last auctions. Volatilities were more present in the short term segment (up to 12-month maturities) and more moderated in the medium-term segment (2-5-year maturities). In details, yield of 12-month T-bills increased to 2.2% at the beginning of March, from 1.8% at the end of last year, and dropped to 1.6% in the last auction in April. Yields on bonds have shown similar performance, although with small changes in terms of side and amplitude. The behaviour of yields was mainly determined by the increase of banks’ preference to invest in long-term maturities, given that the government’s demand seems unchanged.

Overall, fluctuations of interests in the primary market have initially reflected a mismatch between the Government’s demand for short-term funds and the preference of banks for long-term maturities, which seem to have been reduced in the last months, thus mitigating the pressures on yields. Such behaviour is confirmed by the coverage ratio of government’s demand for funds from the banking system. The bid/ask ratio on government securities has been increasing month after month, by supporting the downward trend of yields that was evidenced in the last auctions. As a consequence, the yields curve has lost the convex noted in 2020 Q4, up to the first two months of 2021, and is slightly more flattened compared with the previous year.

**Chart 7.**

<table>
<thead>
<tr>
<th>Yields in primary market have shown a downward trend since March</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yields curve has slightly flattened and has mitigated the convex in the medium-term segment</td>
</tr>
</tbody>
</table>

**Note:** Data show the interest rates (monthly average) on public T-bills and bonds issued in the primary market. Source: Bank of Albania.

**Note:** Data show the interest rates (monthly average) on Government debt securities by various maturities calculated. Source: Bank of Albania.
3.2. LENDING CONDITIONS

The lending activity of banks has improved in the first quarter of 2021. The annual growth rate of credit to the private sector pursed a positive trajectory, averaging 7.5%, from 6.7% in the previous quarter. The portfolio expanded on a broad base. It has reflected both the recovery of demand for financing from private sector, in line with the better performance of the economic activity, and the more positive approach of banks to meet this demand. In absolute value, the quarterly growth of ALL 6 billion is a return close to the historic seasonal behaviour.

The good credit performance in 2020 Q4 was supported by loans to enterprises, whose portfolio grew on average by 7.2% in annual terms. This expansion reflected improvement of the growth rates of loans for investments (at 10.7%) and the slowdown of loans for liquidity (at 2.8%).

The expansion of lending activity was mostly affected by the better performance of credit in lek, with a contribution of 5.2 pp to total growth of portfolio. This contribution is slightly higher than at the end of 2020, and was supported by the increase of lending in lek for investment purposes, to both enterprises and households. The stable growth rates of loans for investments (by 11.8% on average) continue to be the main supporter to the expansion of loans.

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8 Analysis of credit and deposits refers to monetary data adjusted for the movements of the foreign exchange rate. Credit data are adjusted also for written off loans.
9 The expansion of loans for investments is particularly affected by a specific loan in December. The granting of this loan in foreign currency has affected the rebound of loans denominated in foreign currency. Loans denominated in lek maintained the same growth rate as in the third quarter, at 10.8%.
10 A detailed analysis on lending and interest rates is provided at: “Trends in lending - April 2020” at: https://www.bankofalbania.org/Monetary_Policy/Analyses/Trends_in_lendings/
to enterprises by 8.2% in the first quarter. In contrary, loans for liquidity remain volatile and with low growth rates (of 3.5%, on average). Loans to households have also improved. The annual growth rate of 6.1% is slightly higher than in the previous quarter. Loans for house purchase continue to provide the main contribution in this expansion, with an annual growth rate of 8.4%. Consumer loans continued to increase at moderate rates of 2.1%, affected by the sluggish demand of households for financing and hesitation of banks to expand the segment of loans with no collateral.

Interest rates on loans in lek have recorded a segmented increase in 2021 Q1, in reflecting a more mitigated effect of sovereign guarantee schemes and the increase of pressures from credit risk to certain segments. The latter relates to the concern of banks regarding the stability of both enterprises and households’ financial situation being affected by the pandemic consequences from more than one year. The average interest rate for new loans to enterprises was 5.8% in 2021 Q1, from 5.6% 2020 Q4. Interest rates increased only for small loans (up to ALL 35 million) mainly related to the small enterprises, while interest rates applied on medium and large loans have remained unchanged. Interest rates on mortgage loans to households were up to 4.7%, from 4.2% in 2020 Q4. The interest rate for consumer loans at 8.4% in this quarter remains stable, close to the average level of the previous year. However, in reflection of the accommodative monetary policy, interest rates on new loans in lek remain lower than the level of 2019.

Interest rates on loans in euro decreased in 2021 Q1, mainly affected by one bank of the system. Interest rates on loans to enterprises were 4.4%, from the 5.4% average in the previous year. This fall was noted across the three intervals of loans’ amounts granted to enterprises in euro. For households, interest rates

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11 The exception is April, when the consumer credit interest rate resulted considerably lower (5.3%), affected by loans granted by a bank of the system.
on mortgage loans in euro decreased (3.3% from 4.0%) and on consumer
loans increased.

**BOX 1**

**SUPPLY CONDITIONS AND DEMAND FOR LOANS IN 2021 Q1**

Banks continue to appear prudential in assessing the approval of loans to
enterprises. Credit standards on loans to enterprises remained tightened in 2021
Q1, too. The unclear situation about the duration and developments of the
pandemic has triggered banks’ concern regarding the economic situation and
its prospects, as well as the borrowers’ creditworthiness, to be still present in the
first quarter of year, although at a moderate degree. Also, terms and conditions
on loans to enterprises remain tightened, mainly due to higher margins applied
on riskier loans and the approval of loans with smaller size.

Differently from enterprises, banks continued to ease credit standards, terms and
conditions on loans to households in 2021 Q1. This approach was driven by the
higher competition in the banking system and the perception of banks related to
the improved borrowers’ creditworthiness, turning them more tolerant to this risk.

Balance of loan demand from enterprises was slightly negative, due to the
somewhat low demand on loans from small and medium-sized enterprises.
Uncertainties about the macroeconomic situation in Albania, and higher use
of internal financing resources seem to have made small and medium-sized
enterprises somewhat reluctant to apply for a loan. On the other side, large
enterprises have increased the loan demand for the second consecutive quarter.
In terms of loans’ purpose of use, loan demand was higher for both types of
loan financing: investment and working capital.
Loan demand from households was perceived higher, after the fall for five consecutive quarters. Higher financing needs for consumption and house purchase and a more improved consumer confidence drove to the increased loan demand from households.

The analysis is based on Bank Lending Survey, conducted on quarterly bases and is published at: www.bankofalbania.org/

Nevertheless, net balances were more moderate than in the previous quarter, as they were mainly determined by solely one bank.

The balance showing the demand for investment financing was positive for the first time after eight quarters.

Bank deposits have continued to record a stable growth in 2021 Q1. Absolute changes in the stock of deposits show an expansion of around ALL 12 billion since December 2020, or around 7% on average, in annual terms. The expansion of deposits was broadly driven by the good performance of deposits in lek, providing a contribution of around 4 percentage points to this growth. The expansion of lending in the national currency and the high government expenditures continued to support the creation of money in lek. In annual terms, the stock of deposits in lek recorded a growth by around 8.3%, by mainly reflecting the upsurge of households’ deposits. Deposits in foreign currency also expanded at a stable pace, around 5.6% in annual average terms, in 2021 Q1. Their contribution to the growth of total deposits in the banking system was
around 3 percentage points. Alongside with households, which have the main contribution, also enterprises have continued to affect the expansion of deposits in foreign currency during the first quarter.

The time structure of deposits confirms the further shift towards the liquid component. The preference for liquid assets is noted in both the partial replacement of time deposits with demand deposits and in the increase of cash balances. At the end of the period, demand deposits accounted for around 52.2% of the total stock of deposits, or around 0.4 percentage points higher than in December. Currency outside banks ratio to the aggregate in lek, M2, also has increased by 0.1 percentage point for the same period, standing at 29.7% at the end of March.
4. ECONOMIC GROWTH

The growth by 3.0% of GDP in 2020 Q4 showed a more dynamic recovery of economy compared to our expectations. However, GDP level in the first half of 2021 remains below the pre-pandemic level. The improved confidence and the lower uncertainty favoured the domestic demand in the form of a higher consumption and increased investments. Exports, despite the mitigation of the downward performance, continue to reflect the weak foreign demand. Indirect data suggest that economy performance is expected to remain on the upward trend in the first quarter of this year.

Nevertheless, the stability of this trend remains conditioned by the pandemic-related developments. Economic prospect depends on the progress of population vaccination. This process is expected to affect positively the improvement of confidence, the further decrease of uncertainty and the growth of economy over the course of 2021 and further.

4.1. GROSS DOMESTIC PRODUCT

GDP accelerated its recovery pace in 2020 Q4, by standing above the level of the previous year. Economic growth was 3.0%, underpinned by both production sector and services sector, with a contribution of 1.8 and 1.5 percentage points, respectively (Chart 11, left).
Value added of the production sector accelerated its upward pace to around 5.0%, from 2.6% in the first quarter. Construction activity continued to have the highest impact on the expansion of the sector. Its contribution to GDP increased to 1.8 percentage points. Expansion in construction has reflected a higher volume in the three main categories: new constructions, reconstructions and engineering works. Also, the activities of industry, energy and water increased their contribution to the growth of GDP to 0.5, from 0.1 percentage points in the previous quarter. This was attributable to the increase in the branches of manufacturing industry\(^\text{12}\) and electrical energy, with contributions of 0.3 and 0.7 percentage point, respectively, to GDP, while mining continued to contribute to the downside by -0.5 percentage point, equal to the previous quarter. Activity in agriculture generated an added value lower than in the previous year, with a negative contribution to GDP growth (-0.5 percentage points).

The value added in the services sector increased by 2.9% in the fourth quarter, after three quarters performing downwards. All branches of the sector showed improved dynamics, except for “Trade, transport, accommodation and food services” which continued to remain on the downward trend. Nevertheless, the contribution of this branch to GDP, where the negative impact of the pandemic has affected mostly the activities related to accommodation and food services, resulted more mitigated from the previous quarter (-0.1, from -2.3 percentage points). Meanwhile, the branch of “Public administration, education and health” increased its impact on economic growth to 1.0 percentage point. “Real estate” continued to contribute by 0.5 percentage points to GDP, equal to the previous quarter, while the other branches of services provided a positive contribution at a lower degree.

Economic activity is assessed to have continued to improve in 2021 Q1.\(^\text{13}\) The increase in both confidence and capacity utilisation rate in economy provide supporting signals in this regard (Chart 11, right). However, these indicators remain below their respective historical averages, by suggesting that the positive developments in economy remain below pre-pandemic levels and strongly conditioned by its outlook. Also, indirect quantitative indicators - movement of foreign citizens, transport of passengers, and exports of some products related to industry, in January and February, - confirm the expected performance. In addition, the increase in the number of construction permits and the positive contribution of the re-construction programme from the earthquake suggest the continuation of the positive developments in the construction sector.

\(^{12}\) The more improved performance of manufacturing industry is assessed to have been supported mainly by the growth of exports related to the output of metal products, and the deceleration of the fall in the exports of textiles, clothing, leather and footwear.

\(^{13}\) The effect of lower comparative base than in the previous year is expected to also affect the performance of economic activity, in this quarter. In 2020 Q1, GDP fell by 2.3%.
4.2. AGGREGATE DEMAND

Aggregate demand expanded in annual terms in 2020 Q4, with positive contributions from the domestic demand. This performance was contrary compared to the two previous quarters. On the other side, contributions from foreign demand remain negative, but with a more mitigated impact. Overall, domestic demand recovered faster than foreign demand. The latter was considerably affected by the negative performance of services export.

Domestic demand expanded by 3.8% in annual terms, in 2020 Q4. The annual growth of investments by 10.9% provided the main contribution in this regard. Population consumption and public consumption grew by 1.6% and 3.9%, respectively.

Private consumption increased by 1.6% in 2020 Q4, after the pronounced fall in the two previous quarters (Chart 13, left), by providing a positive contribution of 1.2 percentage points to the expansion of aggregate demand. Consumer spending showed a faster recovery in the category of non-food consumer goods and services. Both items recorded growth rates comparable to the pre-pandemic period (Chart 13, right). The recovery in consumer confidence, the increase of credit to households, and growth of remittances, were the factors that have supported the private consumption in the fourth quarter. Nonetheless the positive return in this quarter, the growth rate of private consumption was...
lower than the increase of the disposable income and given the still high uncertainty (Chart 13, left).

Based on indirect data, the private consumption is assessed to have continued the positive trend in 2021 Q1, as well. Quantitative indicators, as the 3.6% increase in the import of goods for consumption and the 3.8% increase in automobile import, support this assessment. Meanwhile, the confidence indicator in trade has been improved considerably, jumping above the long-term average in the first quarter (Chart 14, left).

Data from consumer survey suggest that consumers’ behaviour is expected to be cautious over the course of this year and the increase of consumption will remain below the pre-pandemic level. Assessments of consumers about the financial situation, after a slight recovery in 2020 H2, have remained almost unchanged, while their trend for saving has been upwards (Chart 14, right).

Growth of investments had an important role to the positive return of economic activity in the fourth quarter. Total investments have accelerated to 10.9% the growth rate, after the 5.8% expansion in the previous quarter (Chart 15). They provided the main contribution to the improvement of aggregate demand. In terms of developments in the third quarter, the growth of total investments in economy reflected the high positive contribution from public component. On the other hand, private investments are assessed to have continued to be downwards in this quarter too.
Other supporting data show that the acceleration of total investments was driven by the increase in the investments for both construction and for machinery and equipment. Value added in construction increased 18.5% in the fourth quarter, the highest growth since the start of measuring the series, while the import of capital goods grew by 9.6%.

Investments are expected to contribute positively to the economic growth in the first quarter as well. Public projects for reconstruction, the growth of lending activity, and the low interest rate will support investments. Import of capital goods increased by 25% in the first two months of 2021, suggesting a growth of investments in this category (Chart 16, right). The capacity utilisation rate of enterprises continued to increase in 2021 Q1, approaching to its historical levels (Chart 16, left). However, it should be emphasised that uncertainty about the future remains high and may influence enterprises’ decisions to invest, making them more volatile over time.

Fiscal policy has been easing in 2021 Q1, maintaining almost the same profile as the previous year. In the current year, fiscal policy is projected to be accommodative, in support of the healthcare system, oriented towards the reconstruction of infrastructure and houses damaged from the earthquake of 2019, as well as for increasing public investments. The deficit in 2021 is planned at around 6.5% of GDP, or around 0.4 percentage point lower than the level realised for 2020.

Maintaining the easing features of fiscal policy, even in 2021 Q1, is estimated to have created an additional fiscal impulse, at around 4.7 percentage points of GDP (Chart 17, left).
Budget deficit was ALL 7.2 billion, or 1.8% of GDP (Chart 17, right) in 2021 Q1.

In terms of GDP the deficit expanded by around 1 percentage point against the previous year, defined by the performance of budget expenditure.

The budget deficit was financed by both foreign and domestic sources (Chart 18, left). Foreign financing sources were formed mainly by the budget support of the European Bank for Reconstruction and Development (EBRD) and the European Commission (EC), at around ALL 19.4 billion. On the other hand, in 2021 Q1 the borrowing in government securities increased by around ALL 17.3 billion, where around 74% was composed by securities with up to 1 year maturity. The main purchasers of government securities remain commercial banks (Chart 18, right). Also, non-bank financial institutions had a role in...
financing the budget during 2021 Q1, mainly through T-Bills with up to 6 months maturity. The uncomplete utilization of foreign and domestic borrowing has created government liquidity surpluses, by around ALL 26.6 billion.

**Budget expenditure** amounted to around ALL 115.8 billion in the first quarter, or 8.2% higher than in the previous year. Expenses for special funds, expenses for reconstruction, and personnel expenses provided the main share in the growth of expenditure, in 2021 Q1 (Chart 19, left).

Capital expenditure, including that for reconstruction, amounted to around ALL 14.2 billion, or around 24% higher than in the previous year. Personnel expenditure registered a high increase in this quarter, by around 8% (Chart 19, right).

The profile of growth and the structure of budget expenditure suggest that the fiscal component will support economic growth, in the form of both public consumption and public investments during 2021 Q1.

Budget revenues were ALL 108.6 billion in 2021 Q1, or 4.3% higher than in the previous year (Chart 20, left). The growth of revenues was entirely driven by the tax component, compensating at the same time the negative impact from grants and non-tax revenues. VAT revenues on the import of goods, social insurances and revenues from tax on profit provided the highest contribution to the total growth. In addition to the base effect (in March 2020 there was a strong contraction of all components of tax revenues), the growth of revenues, in this quarter, also reflects the effect of fiscal measures taken this year, such as the increase of minimum wages in the country. Also, the performance of tax revenues reflects the performance of imports, which experienced a quite significant annual upsurge in 2021 Q1 (Chart 20, right).

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16 The rise of minimum wage also increases automatically the maximum limit on which social security contributions are calculated.
Developments in terms of budget revenues provide indirect signals on the improvement of consumption, economic activity and of the labour market indicators, during 2021 Q1.

Net exports contributed positively to the growth in 2020 Q4 (Chart 21). The trade deficit in goods and services reduced by 5.6%, mainly reflecting the fall in “imports”, by 9.9%. “Import of services” has been decisive in this regard, as it decreased by 41.2%, as a result of the continuous decline in travel services or tourism activity. On the other hand, “Import of goods” expanded by 5.1%, returning to upwards rates in response to higher aggregate demand.

Exports decreased by 12.8% in annual terms. The defining factor has been the fall in the export of services by 18.9% driven by the decline in travel services (tourism). The export flows of services reflect a more rapid recovery compared with imports. On the other hand, export of goods expanded by 8.5%, reflecting, as in the case of imports, a more rapid recovery in the flows of goods compared with services.

Data on foreign trade of goods in 2021 Q1 show a significant growth, in both exports and imports. These increases reflect the continuation of the recovery in trade activity registered in 2020 H2, in addition to the statistical effect of the low comparative base. The growth rate of exports has been higher than imports, but the higher share of imports in the trade balance has driven the deficit to expand by 13.5%.
Exports of goods grew by 21.9% in annual terms, during 2021 Q1 (Chart 22, left). This growth was mostly dictated by the category “Construction materials and metals”, mainly due to the increase in the export of industrial metals, whose prices and demand in international markets have continued to recover. The categories “Minerals, fuels, electricity” and “Food, beverages, tobacco” also have given significant positive contributions. The category “Textiles and footwear” has also shown an increase in annual terms, but it is the only category that continues to remain below the pre-pandemic levels 17.

Imports of goods grew by 17.5% in annual terms during 2021 Q1 (Chart 22, right). The categories “Machinery, equipment and spare parts” and “Construction materials and metals” provided positive contributions. The latter have reflected the positive continuation of the construction sector. The category “Chemical products and plastic” also provided significant positive contributions, generated mainly by pharmaceutical products. The category “Textile and footwear” also experienced a growth, but in the case of imports as well, it continues to remain below the pre-pandemic levels.

Regarding the main trade partners, Italy, Kosovo and Greece contributed the most in the increase of exports. In the case of imports, Italy, Turkey and China have driven their increase in annual terms.

17 Exports volume is lower compared with 2019 Q1.
5. INFLATION, PRICES AND COSTS IN THE ECONOMY

Average inflation resulted 0.9% in the first quarter of 2021, down by 0.7 percentage points compared with the previous quarter. This development was driven by the lower contribution of the food category, due to the downward impact of the supply-side factors, particularly in January. Imported inflationary pressures, although higher, remained weak.

The inflation trend throughout 2021 is expected to be upwards, but insufficient to reach the target. This development will be driven mainly by the increase of domestic inflationary pressures. In parallel, imported inflationary pressures will strengthen, due to upward trend forecasted for commodities prices. The recovery of the economy, supported also by the continuation of the vaccination of the population, will affect the strengthening of demand and the improvement of conditions in the labour market and wages in the economy.

5.1. CONSUMER PRICES

Annual inflation resulted 0.9% in 2021 Q1. Its average rate in this quarter was around 0.7 percentage points lower compared with 2020 Q4 (Chart 23, left). Inflation showed high volatility throughout the months, where the value in January (0.4%) defined the average value of it. The prices of “unprocessed foods” showed a contraction, by completely deforming the seasonal behaviour in this month of year. In the next two months, particularly in March, inflation re-settled on the values of the end of the previous year (1.2%), as result of the recovery in the inflation “unprocessed foods” contribution. The increasing base effect from fuel prices also played a role. Overall, pressures from domestic supply-side factors showed downwards. Pressures from demand, although weak, are assessed as more stable. Inflation in both regional the EU countries, returned trending upwards (Chart 23, right), affected mainly by oil prices in international markets. However, foreign inflationary pressures are assessed as contained, also due to the appreciation behaviour, but slowing down, of the exchange rate in the domestic foreign exchange market.

Categories of foods contributed almost completely to the formation of headline inflation. The category “Unprocessed foods” has the main role in this regard (Chart 24 and Table 2). By category of the CPI basket, unprocessed food prices drove the fluctuations of the inflation. This category contributed negatively by 0.1 percentage point to headline inflation, in January, while in February
and March its contribution returned to positive values by 0.6 and 0.5 percentage points, respectively. The performance of this category defined almost completely the difference of this quarter compared with the previous one. In terms of “Processed food” category, the latter showed an upward contribution compared with the previous quarter. Although with a slow negative contribution, the behaviour of fuel prices continues to affect inflation negatively (Table 2)\(^{18}\).

**Table 2. Contribution of key categories to annual inflation (p.p.)*\(^{18}\)**

<table>
<thead>
<tr>
<th>Category</th>
<th>Q.1’19</th>
<th>Q.2’19</th>
<th>Q.3’19</th>
<th>Q.4’19</th>
<th>Q.1’20</th>
<th>Q.2’20</th>
<th>Q.3’20</th>
<th>Q.4’20</th>
<th>Q.1’21</th>
<th>Inf. Q1’21 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Processed foods</td>
<td>0.1</td>
<td>0.2</td>
<td>0.3</td>
<td>0.3</td>
<td>0.4</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.6</td>
<td>2.7</td>
</tr>
<tr>
<td>Bread and corn</td>
<td>-0.1</td>
<td>0</td>
<td>0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Unprocessed foods</td>
<td>1.3</td>
<td>0.8</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
<td>1.2</td>
<td>0.8</td>
<td>1.0</td>
<td>0.3</td>
<td>1.1</td>
</tr>
<tr>
<td>Fruits</td>
<td>-0.3</td>
<td>0</td>
<td>0.1</td>
<td>0.4</td>
<td>0.7</td>
<td>0.7</td>
<td>0.5</td>
<td>0.2</td>
<td>0.2</td>
<td>5.1</td>
</tr>
<tr>
<td>Vegetables</td>
<td>1.5</td>
<td>0.8</td>
<td>0.6</td>
<td>0.4</td>
<td>0.2</td>
<td>0.4</td>
<td>0.2</td>
<td>0.6</td>
<td>0.0</td>
<td>-3.3</td>
</tr>
<tr>
<td>Services</td>
<td>0</td>
<td>0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.0</td>
<td>0.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Regulated prices</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Housing (rent)</td>
<td>0.1</td>
<td>0.2</td>
<td>0.1</td>
<td>0.0</td>
<td>0.2</td>
<td>0.3</td>
<td>0.3</td>
<td>0.2</td>
<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Non-food consumer goods</td>
<td>0.1</td>
<td>0.2</td>
<td>0.1</td>
<td>0.0</td>
<td>0.0</td>
<td>-0.2</td>
<td>-0.2</td>
<td>-0.4</td>
<td>-0.3</td>
<td>-1.1</td>
</tr>
<tr>
<td>Fuel</td>
<td>0.1</td>
<td>0.1</td>
<td>0</td>
<td>0.1</td>
<td>0.0</td>
<td>-0.3</td>
<td>-0.3</td>
<td>-0.4</td>
<td>-0.3</td>
<td>-4.2</td>
</tr>
<tr>
<td>Durable consumer goods</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>1.6</td>
</tr>
<tr>
<td>Inflation (%)</td>
<td>1.6</td>
<td>1.4</td>
<td>1.4</td>
<td>1.3</td>
<td>1.6</td>
<td>1.9</td>
<td>1.4</td>
<td>1.6</td>
<td>0.9</td>
<td>0.9</td>
</tr>
</tbody>
</table>

Source: INSTAT and Bank of Albania’s calculations. *The table shows some of the main groups and items of the categories.

In March, the negative contribution of the fuel sub-group to inflation resulted more mitigated (-0.2, from -0.4 percentage point in February).
5.2. Determinants of Inflation

Medium-term domestic inflationary pressures continued to be dominant in the formation of inflation in 2021 Q1 (Chart 25). The slowdown of inflation was caused by its non-core and imported components. Despite the stability of core inflation and domestic inflation, their values remain low, by reflecting a still weak demand. Core inflation resulted around 1.5%, by overcoming the negative impact of the non-core-component (Chart 25, left). In parallel with this, the imported component of inflation contributed significantly less than the average of the last four years (Chart 25, right).

The following analyses the main economic determinants of inflation.

Cyclical position. The faster recovery of the economy is assessed to have contributed to the improvement of the cyclical position, which however continues to remain in negative territory. Unemployment, at higher than pre-pandemic levels, and the capacity utilisation rate, still under its historical average, confirm our assessment on the weakness of the cyclical situation (Chart 26).

The capacity utilisation rate in the economy remained near the average of 71.7% in 2021 Q1. Enterprises in both production and services sectors reported an increase in the utilisation of production capacities by 0.4 percentage points during this quarter. However, the indicator continues to be below the pre-pandemic levels.
by 2.4 percentage points, and below the historical average of 1.7 percentage points.

The trend of the capacity utilisation rate and the assessed performance of employment by enterprises suggest an increase of the use of production factors and a gradual tightening of the negative gap of output in the first quarter too. However, the economy is expected to operate in the conditions of a partial utilisation of potential capacities during 2021 as well. Further correction of demand in the medium-term, with the gradual removal of national and international constraints, is expected to contribute in building-up inflationary pressures, by ensuring a stable inflation trend.

Employment and unemployment. The improvement shown in the labour market in 2020 Q3 resulted temporary. The number of employed persons decreased by 27,595 individuals during 2020 Q4, mainly reflecting the decline of employment in the services sector. The fading out of the positive impact of the summer season in the branches of services and the tightening of the restrictive measures are assessed to have affected employment. Compared with the previous year, the number of individuals that have lost their job resulted at around 43,405.

The contraction of employment drove unemployment rate increases to 11.8%, from 11.6% in the previous quarter. This indicator is 0.6 percentage points higher than the level registered in the same period in the previous year. Alike the first three quarters of 2020, the decline of employment, during the last quarter, was largely accompanied by the exit from the labour market. This movement is reflected in the decline of participation indicator in the labour market participation rate in the fourth quarter (68.7%), compared to the value of the indicator in the third quarter (69.8%) (Chart 27).

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19 The analysis of employment and unemployment is based on the “Quarterly Labour Force Survey”, and refers to indicators for those 15 years and older. Participation in the labour force represents the group 15 – 64 years old, to prevent the impact from retired persons. By administrative data as well, employment resulted lower than in the previous year. According to them, employment in the private non-agricultural sector decline by 0.9% in annual terms and by 0.7% in quarterly terms.

20 Employment in services contracted by 6.4% in quarterly terms and by 5.3% in annual terms. Meanwhile, the number of employed in the agricultural sector and in industry (including construction), despite the quarterly growth by 1.0% and 1.4%, respectively, continued to remain below the level of the previous year, of 2.8% and 0.5%, respectively.

21 The increase in the unemployment rate is attributed mainly to the decline in employment. Examination of the factors influencing the unemployment rate suggests that the increase in the indicator was largely determined by developments in labour demand (employment performance, analysed in terms of labour demand, and labour force participation rate in the population in working age, on the supply side).
WAGES, PRODUCTIVITY AND LABOUR COSTS

Gross average monthly wage per employee, in 2020 Q4, continued to remain above the level of the previous year, since the negative impact of the pandemic affected mostly those with lower wages than those with average wages in the economy. The nominal average wage increased by 2.8%, while the real one by 1.2%. This trend is attributable to the increase of average wage in the public sector. The average wage in public sector accelerated its rise to 4.2% in nominal terms and to 2.6% in real terms, after the pace of 0.7% and -0.7%, respectively, in the previous quarter. Meanwhile, the upward trend of the average wage in the private sector slowed down (1.4% against 2.2% in 2020 Q3). The average wage in the private sector, deflated for inflation, resulted around 0.2% lower than in the previous year (Chart 28, left). The unit labour costs deepened the downward trend in 2020 Q4, resulting around -1.0% in annual terms. The performance of the indicator was defined mainly by the faster increase of labour productivity against the increase of the real average wage (Chart 28, right). The decline of unit labour cost resulted stronger in the services activities, suggesting that the domestic inflationary pressures in the economy continue to remain weak on the side of labour costs.

Other output costs in 2020 Q4 continued to be lower than in the previous year. Industrial production prices fell by 3.4%, following the 4.1% contraction in the previous quarter. These prices continue to show stronger contraction in the mining and quarrying industry. Here, the downward trend remained faster for the prices of the industrial output for export, against the decline of prices.

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22 This indicator refers to the gross monthly average wage received per employee and is based on the payroll data declared at the General Directorate of Taxation (INSTAT 2020 Q4).

23 Proxies of labour productivity, unit labour costs and average wage in accordance with short-term statistics are calculated by the Bank of Albania using the total series of Short-Term Statistics (SHTS, INSTAT, 2020 Q4).

24 For those activities covered by short-term statistics.
of the industrial output for the products in the domestic market. Meanwhile, production costs in the construction sector\(^{25}\) remained at the same level of the previous year (-0.1%).

**Imported inflation.** During January-February 2021, the Imported Inflation Pressure Indicator (IIPI)\(^{26}\) expanded by 3.2% in annual terms, slowing down the pace compared with 2020 Q4 [Chart 29]. Determinant in this regard was the increase of foreign prices (5.6% compared with the previous year), providing a stronger impact compared with the one from the foreign exchange rate. In the case of the latter, the appreciating performance has continued, but at lower rates compared with 2020 Q4 (2.4% against 3.7%). These signals have been transmitted into a lower contribution of imported inflation to headline inflation during 2021 Q1, where other short-term impacts have curbed down even further this contribution [Chart 25, left].

**Expectations for inflation**\(^{27}\) continued to be higher than the official inflation in 2021 Q1, based on all the measurements from surveys with various economic agents [Chart 30]. **Enterprises** and **financial agents’ expectations** for inflation have slightly decreased in this quarter compared with 2020 Q4. Meanwhile, expectations of **consumers** for inflation have registered an increase.

Next year, enterprises expect inflation to be 2.6%, around 0.2 percentage point lower from 2020 Q4. Consumers’ expectations for inflation one-year-ahead have increased at 4.2%, from 3.4% in 2020 Q4. The slight fall in expectations of financial agents was registered for all the three time horizons. They expect that inflation after one, two and three years stands at 1.9%, 2.2% and 2.4%, respectively, around 0.1 percentage points lower than the expectations resulted in the survey of the previous quarter.

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\(^{25}\) Construction cost index for apartments includes prices of building materials, labour force and other capital expenditures used for the construction of a typical building of 8-10 floors.

\(^{26}\) IIPI is calculated as the annual growth of the imported prices index and the NEER index for the respective month. From the correlation analysis of the relevant indicators with different time delays, IIPI anticipates the developments in the imported inflation component by about 3-5 months.

\(^{27}\) The analysis on inflation expectations is based on the results of the Business and Consumer Confidence Survey, as well as on the Financial Agents’ Expectations Survey.
Chart 30.
Expectations on inflation one-year-ahead of enterprises and consumers

Expectations on inflation of financial agents by three time horizons

Source: INSTAT and Bank of Albania.