Bank of Albania

QUARTERLY MONETARY POLICY REPORT

2020/IV

Data from this publication may be used, provided the source is acknowledged.
Published by: Bank of Albania
Sheshi "Skënderbej", Nr.1, Tirana, Albania
Tel.: + 355 4 2419301/2/3; + 355 4 2419401/2/3
Fax: + 355 4 2419408
E-mail: public@bankofalbania.org

www.bankofalbania.org

C O N T E N T S

BOXES

TABLES

CHARTS

INTRODUCTION

The primary objective of monetary policy of the Bank of Albania is to achieve and maintain price stability. In quantitative terms, it is defined as maintaining inflation close to the 3% target in the medium-term horizon.

In achieving this objective, the monetary policy sustains the stable and long-term growth of the Albanian economy, promotes financial stability and supports improvement in the overall welfare of society.

In accordance with the principles set out in the Monetary policy document, the Bank of Albania implements a forward-looking, consistent, balanced, prudent, and transparent monetary policy.

The economic and monetary analysis in this report is based on the latest statistical and qualitative data available as at 23 October 2020.

The monetary policy report was approved at the SC meeting, on 4th November 2020.

FOREWORD BY THE GOVERNOR

The new information analysed in this Report shows the economic activity improved during summer, after the sharp drop in the second quarter. This recovery reflected the relaxing of social distancing measures and the support provided by the comprehensive fiscal, monetary and macro prudential stimulus. Notwithstanding the positive trends, the recovery outlook of economy in the future still remains fragile. The new wave of infections and the implementation of restrictive measures in many countries, potentially in Albania as well, introduce serious challenges to both public health and performance of economy during the continuing period.

In this context, the Supervisory Council judges that the current monetary policy stance remains adequate. The monetary conditions and the low interest rates provide the necessary stimulus for fuelling economic growth and for inflation to converge to target within 2022.

The Pandemic provided a strong negative impact on the Albanian economy. Its consequences were clearly materialised in the main indicators; social distancing measures and the heightened uncertainty drove to the sharp contraction of economic activity, reduction of employment and fall of inflation.

Inflation of consumption prices averaged 1.4% in the third quarter, slowing down from the previous quarter. Its reduction was mainly attributable to the drop in the prices of some food items and in the prices of some services category. From the macroeconomic perspective, the fall of inflation reflected the fading out of supply-side shocks, the low pressures from the weak aggregate demand and the disinflationary tendencies in our partner economies.

According to INSTAT data, the Gross Domestic Product fell by 10.2% in the second quarter of 2020, recording the strongest contraction in the last two decades of the Albanian history. This contraction resulted at a broad base in the sectoral allocation and the structure of aggregate demand, but it mostly reflected the contraction of private consumption and of the activity in services sector. In the same quarter, the Albanian economy suffered around 50 000 job losses and the unemployment rate jumped to 11.9%. Nevertheless, fiscal supporting packages have somewhat mitigated the difficult situation in the labour market. Hence, both the fall of employment and increase of unemployment have been slower than the performance of the other indicators of the economic activity.

The available indicators on the economic activity and labour market signal a gradual recovery during the third quarter. The lifting of restrictions on the

movement of people and goods, in Albania and abroad, the maintaining of monetary and financial stability of Albania, and the slight improvement of confidence indicators, have established the necessary premises for the growth of economy growth in the future. However, this recovery remains fragile while risks are expected to remain tilted to the down side.

Our baseline scenario of the expected developments rests upon the assumption for avoidance of extreme measures to contain the spread of a second wave of pandemic and the gradual reduction of its consequences. In this scenario, the Albanian economy is expected to record a sharply drop in 2020 and further relatively fast and stable growth rates. In accordance with this scenario, inflation is expected to stay close to the current rates in the current year. Further, the return of economic activity close to the potential will provide the conditions for inflation to converge to target within 2022.

The coordinated fiscal, monetary and financial stimulus has been a crucial element in mitigating the negative consequences of the crisis.

The monetary and financial measures undertaken by the Bank of Albania aimed at fully supplying financial markets with liquidity; the reduction of credit cost and debt servicing; and a rather adequate allocation of financial burden of the crisis among the Albanian banking sector, enterprises and households. On the other hand, fiscal measures have aimed at: dealing with the health emergency; increasing the financial support to the families in need; easing the fiscal pressure on enterprises; and improving their access to credit.

Financial markets have reacted positively to the implemented measures and the monetary stimulus pass-through to economy has been complete. Credit interest rate stands at low levels, pressures on liquidity are contained and the exchange rate is stable.

Banking sector has accommodated the needs of borrowers, by providing the temporary extension for credit payment and its entire restructuring. In addition, the banking sector has undertaken a part of this crisis financial burden. Also, banks have continued to credit the economy by responding to the needs of private sector for financing. Credit to private sector increased by 6.3% in the third quarter, mainly supported by credit to enterprises and the credit in lek. In addition to the monetary stimulus, the performance of both portfolios is positively affected by the regulatory measures taken by the Bank of Albania and the schemes of sovereign guarantees. Maintaining the banking sector's positive approach towards lending will be a necessary precondition for the rebound of economy.

At the same time, simulating economic policies should continue to support the normalisation of the economic situation.

Based on these considerations about the projections of baseline scenario and the balance of risks surrounding it, the Supervisory Council deems that the current monetary policy stance is adequate. The policy rate remains unchanged, at 0.50%.

The monetary policy stance will continue to remain accommodative throughout the forecast horizon, to provide the favourable financing conditions for the growth of economy and for the return of inflation to target.

However, the expected macroeconomic developments are surrounded by many uncertainties and exposed to the downside risks. In particular, the downside risks arise from:

- The worsening epidemiological situation and its deeper impact on economy;
- The size of the damage of production capacities and the possibility for a slower recovery of both domestic and foreign demand;
- Problems arising in the monetary policy transmission mechanism, in the form of: increased interest rates and financing costs to private sector; slower credit supply growth; strong fluctuations of the other indicators of the financial market.

The materialization of these risks would require further easing of monetary policy stance.

1. PRICE STABILITY AND BANK OF ALBANIA'S MONETARY POLICY

Spread of pandemic provided a strong negative impact on both Albanian and global economies. Although the economic fall was lower than expected, the contraction in the second quarter was the strongest in the two last decades of Albanian history. With the easing of restrictive measures in May, the economic activity started to gradually recover. Effects of pandemic were felt in labour market and performance of prices. Inflation reduced driven by the weak demand and disinflationary pressures from foreign economies.

The economic policies implemented by the Albanian Government and the Bank of Albania have contributed in the mitigation of pandemic impact and in the establishment of premises for economy to rebound. In particular, the undertaken measures helped the well-functioning of financial markets, by providing for the transmission of monetary stimulus in low interest rates to households and enterprises. Also, banks have continued to credit the economy by responding to the needs of private sector for financing.

These are positive premises for a recovery of economy and increase of inflation towards the target. The economic activity, after the contraction in the current year, is foreseen to grow in the next two years, supported by the macroeconomic stimuli, the improved external environment and the reduced uncertainty. The return of economic activity close to the potential will provide the conditions for inflation to converge to target within 2022.

This scenario of expected macroeconomic developments requires the maintaining of the monetary stimulus in the form of the current levels of the policy rate. It is surrounded by many uncertainties and it exposed to the risks on the down side, both the short run and medium term. The adequacy of monetary policy stance will be continuously assessed, by adopting it to the economic developments.

Global economy started to recover the economic activity after the easing of restrictive measures in the third quarter, but the improvement pace is slow and its continuation is conditioned by the containment of the virus spread. In the last weeks, many countries, including Western Europe, are suffering a second infection wave, which is being tackled with targeted containment measures.

After the historical economic shrinkage recorded in the second quarter, the available indicators on the economic activity and labour market for the European economy signal the gradual recovery in the third quarter. But, the improvement pace is slow and heterogeneous, implying a longer time with spare capacities

in the economy. Against this backdrop, the inflationary pressures are expected to remain low. The European Central Bank has maintained the monetary stimulus unchanged, deeming the financing conditions as accommodative and supportive the economy recovery.

In 2020 Q2, the Albanian economy recorded the sharpest contraction in the last two decades. The Gross Domestic Product (GDP) dropped by 10.2% in this quarter due to the containment measures to halt virus transmission. Although it was a broad-base fall, private consumption and the activity on services sector provided the largest shock.

Data on the labour market showed the fall in employment and increase of unemployment rate in the second quarter of year. The Albanian economy has suffered a loss of around 50 000 jobs compared with the end of 2019.

The contraction of economy and increase of unemployment, in the second quarter, were lower than our expectations. The earlier relaxing of restrictive measures, in addition to the better performance than expected of some of economic activities - real estate, textile industry and construction - were the reasons standing behind this performance. Also, the growth in unemployment, so far, is contained by the financial packages provided by the Government and the increase in the number of persons registered as inactive.

The available indicators on the economic activity and labour market signal a gradual recovery during the third quarter. In particular, indicators on the consumer and businesses confidence have been trending upwards, after falling to the lowest historical levels in the second quarter.

Nevertheless, the analysed indicators remain notably below the levels recorded prior to pandemic outbreak and show that the recovery of the economic activity is still at early stages.

Inflation has been slowing down in 2020 Q3, standing at 1.4%, from 1.9% in the previous quarter. Its reduction was mainly driven by the fall in prices of unprocessed foods and transport services, while oil prices continue to provide a negative contribution. On the other hand, core inflation has resulted relatively stable, at 1.5% - 1.6%. Inflationary pressures are expected to remain low by reflecting the week demand and the disinflationary pressures from external economy, in the following period.

The economic policies implemented by the Albanian Government and the Bank of Albania have contributed in mitigating the pandemic impact and establishing the premises for economy to rebound. The measures undertaken by the Bank of Albania have ensured the necessary monetary stimulus for the smooth functioning of financial markets and have provided for lending flows to the economy. Currently, the policy rate stands at 0.5% and the Bank of Albania has met the increasing demand of banking sector for funds.

The monetary conditions are favourable and show the good pass- through of the monetary policy. The interest rates on loans to households and enterprises stand at low levels and pressures for liquidity are contained. The exchange rate is stable and relatively depreciated from the previous year.

The bank credit has continued to finance the private sector, supported by the favourable monetary conditions and the supportive schemes on lending. Credit to private sector increased by around 6.3% in the third quarter, mainly supported by credit to enterprises and in lek. The temporary deferral of loan instalments and the implementation of sovereign guarantee schemes have continued to positively affect the performance of both portfolios. In the last months, their positive impact reduced driving to the slowdown of credit growth pace. Also, banks report tightening of non-price terms and conditions, mainly due to the macroeconomic situation. On the other hand, developments of credit are expected to be characterised by the restructuring process of credit portfolio to enterprises, which appears to be oriented towards lek currency and longer-term maturities.

The banking sector has entered the crisis with strong both capital and liquidity positions and able to intermediate funds to economy. The regulatory measures undertaken by the Bank of Albania and the sovereign guarantee schemes have served as a cushion, by considerably minimising the transmission risk of crisis from real sector to financial one and its further amplification.

The monetary policy should maintain the accommodative stance to support the economy and the increase of inflation to target. For 2020, the economy is expected to shrink, driven by the drop in both domestic and external demand. The fall in consumption and private investments is expected to reflect the weak perspectives for employment and business as well as the high uncertainty, while the weakness in external economy is expected to penalise the demand for Albanian goods and services. On the other hand, the increase in public spending, including the expenditures for the reconstruction of buildings, which were damaged from the earthquake, is expected to generate a positive contribution.

In the next years, the Albanian economy is expected to grow, underpinned by the macroeconomic stimuli, the reduction of uncertainty and the recovery of external economy. The return of economic activity close to the potential will provide the conditions for inflation to converge to target within 2022. Inflation is expected to fluctuate around 1.6%, in the current year.

Future developments are surrounded by uncertainties and are exposed to the risks on the down side, in the short run and medium term. In the short run, risks are mostly related to the evolution of pandemic, the severity and the duration of measures and protocols of health care, and to the hesitation for consumption and private investments due to the heightened uncertainty. In the long term, risks are mostly related to the size of the long-term damage of

production capacities of economy, the domestic demand and the economic transformations in economy due to the change in the behaviour of the economic agents after the pandemic.

In the presence of the high uncertainty and the downside risks, the adequacy of the monetary policy will be assessed on ongoing basis, being adapted to the economic developments.

2. EXTERNAL ECONOMIC ENVIRONMENT

The global economy has showed positive signs in the third quarter of year, although remaining below pre-pandemic levels. The lifting of containment measures drove to the recovery of consumption and productivity. Some of Asian developing economies, which are an important link to the global production chain, were opened earlier, hence giving a positive impulse to the global trade activity. The simulating measures undertaken by governments have mitigated the consequences of pandemic and have established the adequate financing conditions for the increase of consumption and investments.

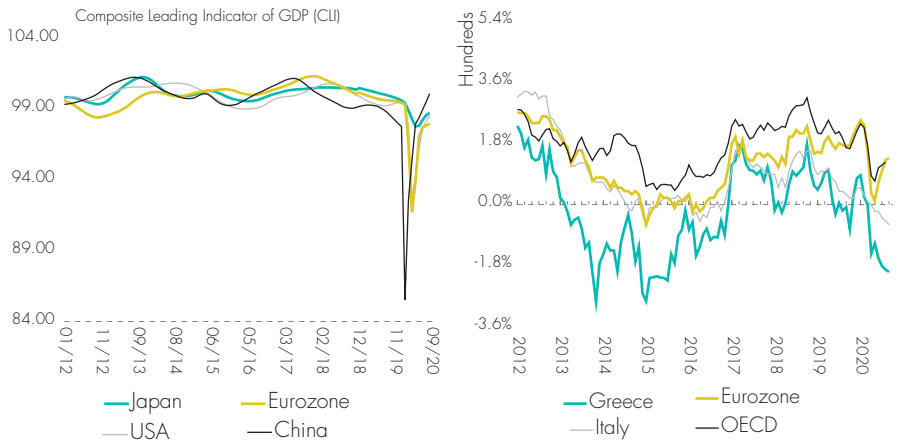
The commodity prices increased in the third quarter, reflecting an overcome of the short-term shock, except for energy prices, which suffered a sharp contraction. Financial markets have shown low volatile, with short-term yields in negative territory and bonds spread of corporates contracting, by reflecting the confidence of markets to the guarantees of sovereign institutions.

The situation for the future is surrounded by downside uncertainties, which are related to the evolution of pandemic, the growth in the number of global infections and the possible need for other restrictive measures.

2.1 GLOBAL ECONOMY

After a sharp contraction in 2020 H1, global economy has shown improvement signs in the third quarter, attributable to the lifting of containment measures undertaken by many countries to restrain the spread of pandemic. The gradual opening of various countries drove to a recovery of consumption, trade and industrial production. Also, the aid packages provided by governments in addition to the monetary easing implemented by central banks have mitigated the negative consequences arisen from the restriction of free movement, the disruption of production chain and the halt of trade activity.

Chart 1 Composite Leading Indicator (left) and inflation (right) in major countries

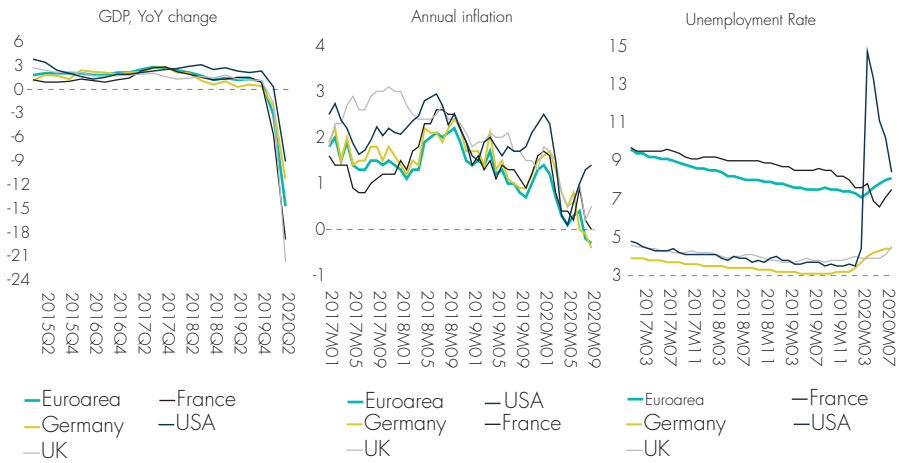


Source: OECD, Organisation for Economic Co-operation and Development.

The spread of pandemic and the related-containment measures across countries were different, thus, the economic performance of countries is uneven. Countries that were first affected from pandemic, as China, recorded a positive growth in the second quarter. In the USA and Euro area, preliminary data show that economic activity improved in the third quarter of year, benefiting from the simulating monetary and fiscal packages, which supported the consumption and industrial production after a historical contracting quarter.

The situation for the future remains surrounded by uncertainty, which is titled on the downside. These uncertainties are related to pandemic spread, the increasing number of infections, and the restrictive measures being considered by public authorities on people's movement.

Chart 2 Selected macroeconomic indicators.



Source: Eurostat, BEA, BLS.

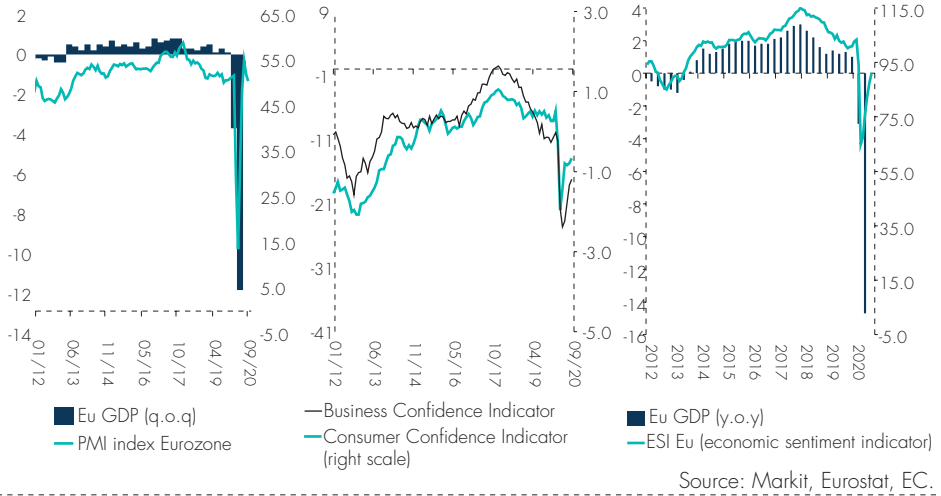
EURO AREA ECONOMY

The euro area economy contracted by 15% in the second quarter of 2020, which is the lowest historical rate. The strong negative performance across all sectors of economy is attributable to the pandemic and the containment measures to restrain its spread. The economic activity of countries with higher rate of infections suffered the sharpest shock. In addition to the domestic demand, the foreign trade also suffered the shock. The unemployment rate increased by around one percentage point. This figure does not entirely reflect the difficulties in the labour market. The measures undertaken by governments to maintain the jobs, the agreements on the cut of work hours mitigated the effect in this market, compared with the real economy.

Preliminary data for the third quarter, have shown positive signals, and provide for a strong economic growth, although below the pre-pandemic levels. The lifting of containment measures drove to a boost of consumption and industrial production. Services sector showed an immediate improvement after the first months of the opening, but it has reflected slowdown signs recently. Annual inflation pursued a downward trajectory, reaching negative values in the third quarter. It has mainly reflected the strong contraction of energy prices. Core inflation traced a downward trajectory in August and September.

Forecasts on the economic activity suggest a positive growth in 2021, after the strong contraction in the current year. Uncertainties surrounding these forecasts remain on the downside, related to the performance of pandemic spread and the continuation of discussions on Brexit process.

Chart 3 Euro area, composite output index (PMI) and quarterly GDP (left), confidence survey indicators (middle) and the economic sentiment indicator (ESI) and annual GDP (right)



Source: Markit, Eurostat, EC.

The main trading partner of Albanian in the euro area, Italy and Greece, which were amongst the most hardly affected countries by the pandemic, recorded a two-digit contraction of the economic activity, affected by the negative

performance across all sectors of the economy. Preliminary data suggest an improvement of the situation in the third quarter, with the increase of consumption and industrial production. Annual inflation rates recorded negative values in the third quarter.

REGIONAL ECONOMIES[1]

Regional countries also suffered the effects of pandemic and restrictive measures. All countries in Western Balkans have recorded strong values of economic activity contraction in the second quarter, reflected in all components of the demand. Indirect data show an improvement in the third quarter, with the recovery of consumption and production.

In the second quarter, the economy of Serbia recorded a strong contraction, affected by the negative performance in all components of the demand. The Economy of North Macedonia recorded the strongest contraction, of 12.7% in annual terms, mostly driven by the slowdown in consumer spending. The economy of Kosovo shrunk at a strong pace, by reflecting the slowdown of trade activity and investments, with consumer spending which recorded a slight slowdown.

In North Macedonia, Serbia and Kosovo, the annual inflation rate recorded a marginal increase in September. In Kosovo it recorded a negative value for the second consecutive month. Prices of foods and energy mainly determined this dynamic.

Table1 Economic indicators for countries in the region

	Annual change of GDP		Annual inflation	Unemployment rate
	2020 Q1	2020 Q2	September-2020	2020 Q2
Italy	-5.6	-17.7	-1.0	9.7*
Greece	-0.5	-15.2	-2.3	16.8**
North Macedonia	0.2	-12.7	1.9	16.7
Serbia	5.1	-6.4	1.8	7.3
Kosovo	1.3	-9.3	-0.4	25.0†
Albania	-2.5	-10.2	1.5	11.9

Source: Respective statistical institutes.
**August 2020; **July 2020 †2020 Q1.*

2.2 COMMODITY PRICES IN GLOBAL MARKETS

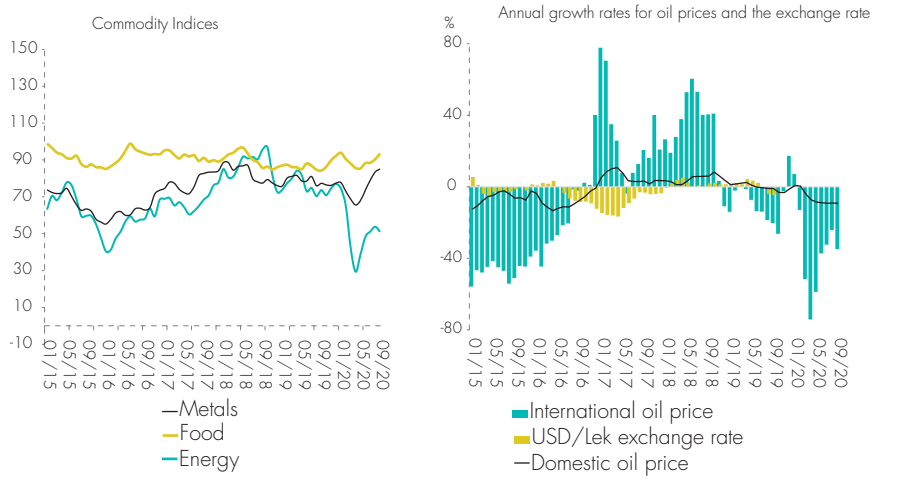
Pandemic provided a twofold effect in goods markets, by affecting both supply and demand. The lifting of restrictive measures drove to a mitigation of the shock effects, while commodity indices have pursued an upward trajectory.

The positive performance of investments in emerging economies, which have a high demand for metals, affected the increase of prices. The metal price

[1] *The main trading partners outside the European Union (Kosovo, North Macedonia, Serbia).*

index recorded a positive annual increase in August and September, 9.8% and 10.1%, respectively. The food price index has showed a gradual upward trajectory since May, by recording an increase of 11.1% in September.

Chart 4 Commodities Price Index; Oil price in international and domestic markets



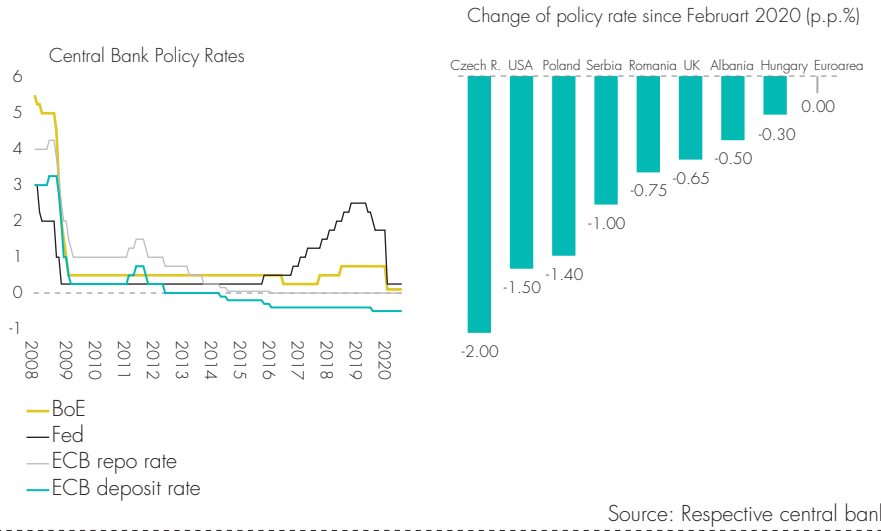
Source: WB indices; INSTAT, staff's calculations.

Energy prices continued to record a negative increase rate. In September, the energy price index shrunk by around 30.7% in annual terms. The Brent oil price in international markets registered USD 40.9/barrel in December, or around 34.9% lower than the same month a year earlier. This performance has reflected the fall in both demand and expectations for the future, which has exceeded the effect of supply contraction from OPEC countries.

2.3 GLOBAL FINANCIAL MARKETS

Financial conditions in international markets continued to be accommodative, attributable to the simulating monetary and fiscal policies. Central banks have maintained the accommodative monetary stance through low policy rates and the asset purchase programmes, which provide for ample liquidity in markets. This policy was necessary to support the growth of the domestic demand given the pandemic circumstances. The third quarter has recorded no changes in the implementation of these instruments. Large central banks (ECB, Fed and Bank of England) as well as small central banks in Europe have maintained the policy rates unchanged. Also, central banks continued to implement the asset purchase programmes of various categories. Central banks have stated that the monetary policy will continue to be accommodative for a long time.

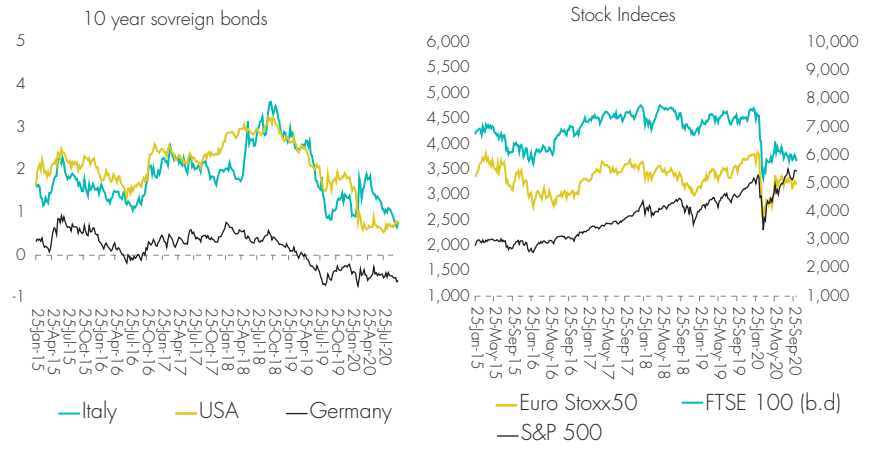
Chart 5 Policy rates of major central banks



Source: Respective central banks.

The alleviation of financial condition has helped the monetary flows and improved the investors' sentiment. The interest rate in the interbank market of the euro area remains in negative territory. Yields on sovereign bonds (government bonds) were reduced further in the third quarter, after the launching of the aid packages by the European Commission. At the same time, the spreads of corporate bonds against low risk bonds have narrowed, by reflecting the confidence for the continuation of the asset purchase programme from the central bank. The low interest rates have helped the enterprises to easily ensure the needed liquidity for the continuation of the economic activity. This drove to the increase in the confidence on the economic improvement and has contributed to the rise in the shares prices.

Chart 6 Capital markets



Source: Eurostat, Reuters.

Notwithstanding the positive rates in financial markets, their performance remains still fragile and sensitive to the change in the economic outlook and the pace of responsive measures by the authorities.

3. FINANCIAL MARKETS AND MONETARY DEVELOPMENTS

The third quarter was characterized by a stable exchange rate, interest rates that fluctuated close to the minimum levels and by an improvement of lending in lek. Meanwhile, the demand for new government borrowing in the primary market has been low, which has been translated into interest rate levels of securities almost similar to those of the second quarter.

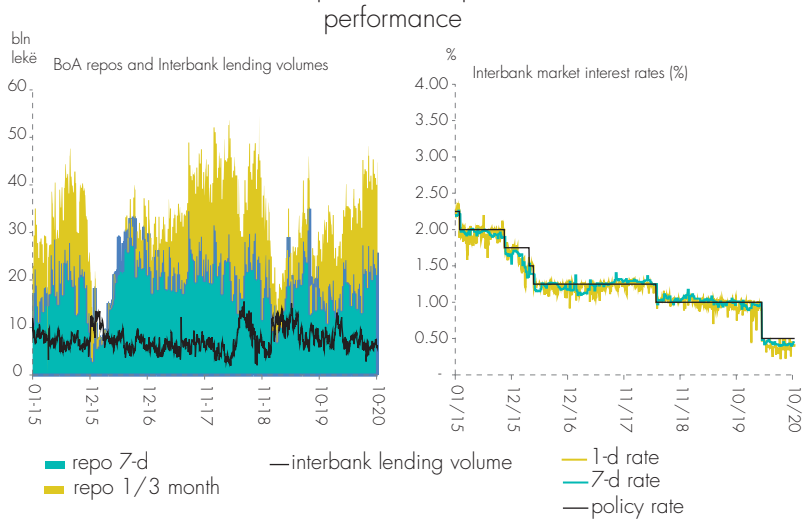
Banks expanded their lending activity, especially in the domestic currency. However, the pace of credit expansion has been downward compared to the previous quarter. This performance reflects both the resumption of instalment payments for a part of the portfolio and the lesser impact of guarantee schemes.

In 2020 Q3, the monetary and financial conditions remain easing and favourable to boost bank lending in support of economic recovery.

3.1 FINANCIAL MARKET DEVELOPMENTS

The interbank market continued to be characterised by low interest rates and minimum spread vis-à-vis the policy rate. The banks' interest rates in the funding trade amongst them have fluctuated below the policy rate and volatility indicators registered low levels. The market has not shown increased liquidity pressures and the average traded volume has been shrinking since the end of the first quarter. Overnight and one-week maturities remain the most used ones in this market.

Chart 7 Bank of Albania open market operations and interbank rates performance



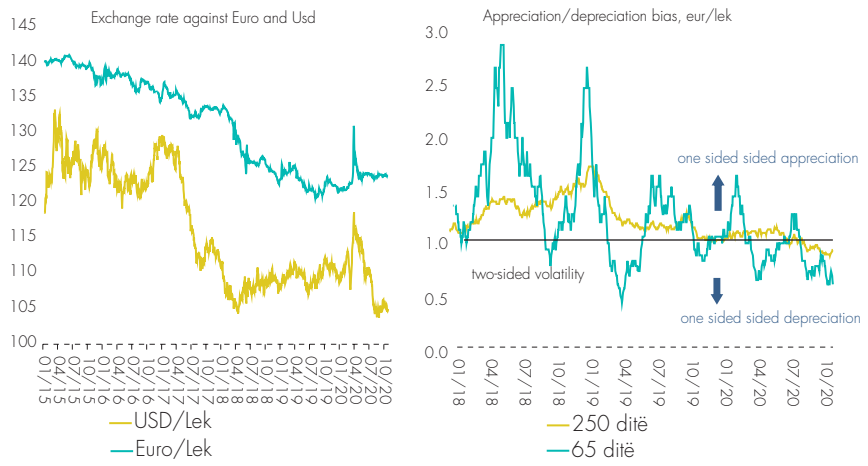
Source: Bank of Albania.

The Bank of Albania has increased liquidity injections in the banking system during 2020 Q3, in response to its greater need for financing. The increase of funding is realized both through 7-day and 3-month repo. Conducting 7-day auctions with unlimited amount from the end of March this year helped maintain low liquidity premiums in the banking system.

DOMESTIC FOREIGN EXCHANGE MARKET

The situation in the foreign exchange market was calm in 2020 Q3, characterized by the relatively stable performance of the exchange rate against the euro. Foreign exchange market stress indicators - volatility and quotation spreads - were close to their normal values. Also, the appreciation/depreciation bias[2] fluctuated close to the equilibrium value, indicating a balance of demand and supply in foreign currency. Overall, this situation reflected the cancelling out of market uncertainty with the gradual removal of restrictions imposed to control the spread of the pandemic. Meanwhile, the widening of the current account deficit, mainly due to the contraction of tourism activity, has dictated the slight weakening of the lek against the euro compared to the previous year.

Chart 8 Exchange rate in the domestic market and the exchange rate appreciation/depreciation ratio of eur/lek.



Source: Bank of Albania.

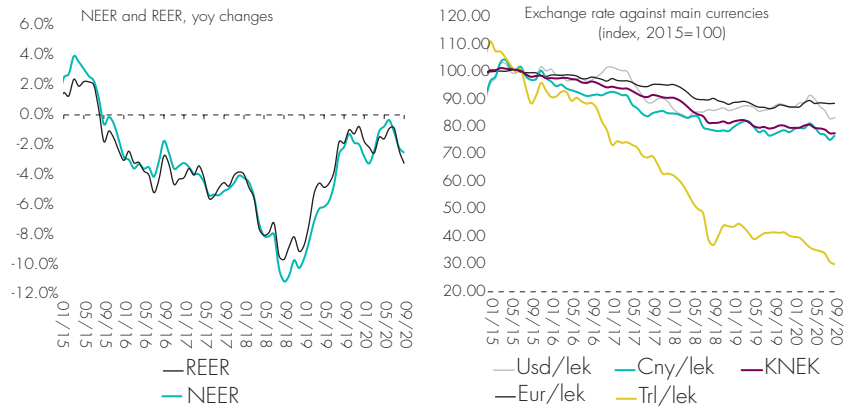
The euro/lek exchange rate fluctuated closely around 124.0 lek/euro. In August, a slight appreciation of the lek against the euro was recorded; the euro / lek exchange rate dropped to an average of 123.8 lek / euro, reflecting the modest revival of tourism this month. This appreciation was completely reversed

[2] *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).*

in September, where the euro / lek exchange rate fluctuated again around 124.0 lek / euro. This level is maintained in the first weeks of October as well. The annual depreciation of the lek against the euro rose to 1.9% in 2020 Q3, from 1.1% in 2020 Q2.

The exchange rate of the lek against the US dollar has reflected the performance of the US dollar in international markets, where the latter continued to depreciate against the euro until the end of August, to appear more stable in the following months. The usd / lek exchange rate averaged 105.0 lek / usd in August and September, from 108.5 lek / usd in July and 113.2 lek / usd in 2020 Q2. Lek strengthened by about 2.9% against the US dollar during the third quarter, compared to the previous year[3]. The developments so far for October show a stable performance of the lek / usd exchange rate, at average levels close to those of September.

Chart 9 The performance of effective exchange rate* and currencies of the basket.



The nominal effective exchange rate (NEER) is calculated against the currencies of Albania's five major trading partners (Italy, Greece, Germany, Turkey and China), using the relevant market weights. For the purpose of calculating lira/lek and yuan/lek rates, the official reference rates remain those of the Turkish lira and the Chinese yuan against the US dollar. The real effective exchange rate (REER) is calculated similarly to the nominal, but it considers the domestic inflation and those in the trading partners, as well.

Source: Bank of Albania.

The effective exchange rate strengthened in the third quarter, reflecting the strong appreciation of the lek against the Turkish lira[4]. The effective annual appreciation averaged 2.0% in this quarter, from 0.7% in the previous quarter. The real effective exchange rate has shown similar performance; real annual appreciation increased to 2.2% in the third quarter, compared to 1.3% in the second quarter of the year.

PRIMARY MARKET

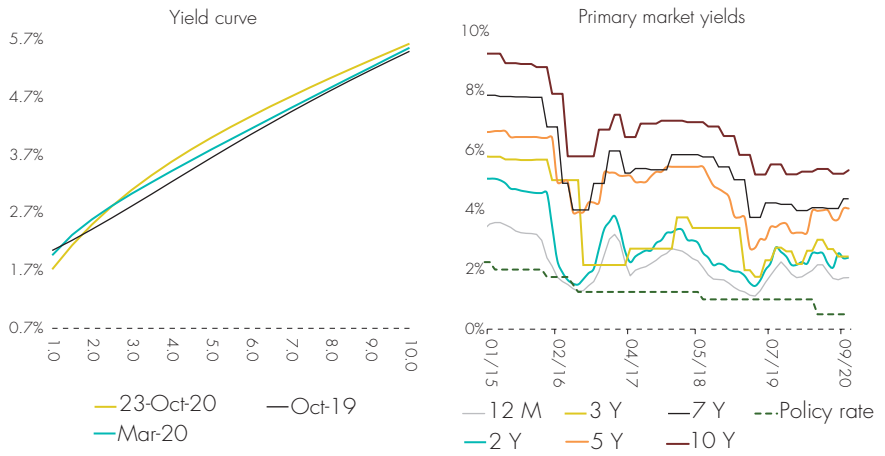
T-bills and bonds yields in the primary market showed a volatile performance in the third quarter. Until the beginning of August, premiums demanded by banks for government debt securities have been on the downside, reflecting

[3] *For this period, the US dollar has lost about 4.8% y-o-y against the euro.*

[4] *The annual appreciation of the lek against the Turkish lira is estimated at an average of about 24% in the third quarter of the year, compared to 11% in the first half of the year.*

a competitive demand for them. Starting at the end of this month, bond yields turned around and recorded slight increase in the majority of auctions. The dynamics of yields is determined both by the developments in the government supply and by the behaviour of banks and their preference for certain maturities. Over the last 12 months, as a result of banks' preference for long-term securities, the pressures for increasing yields in the medium-term segment have increased and the yield curve has become more convex, at a time when its slope and level have slightly changed. The bit-to-cover ratio in medium-term debt securities auctions these months, was downward[5], being an increasing factor for yields in this segment.

Chart 10 Yields in the primary market*



*The chart includes auctions conducted as at 23 October 2020.
Source: Bank of Albania.

The increase in the demand of banks in the last auctions, in October 2020, has resulted in a slowdown in the growth of yields[6]. Thus, the yield of the 12-month T-bills and that of the 2-year bonds were 1.7% and 2.4%, same as in September. Beyond the volatility of these months, yields are approximately at the same levels as in the previous quarter and the previous year.

3.2 DEPOSIT AND CREDIT INTEREST RATES AND FINANCING CONDITIONS

The average interest rate on ***new loans in lek*** was 5.7% in Q3, registering a slight increase from the average in Q2. This performance seems to have been influenced by the weakening of the positive effect of the first sovereign

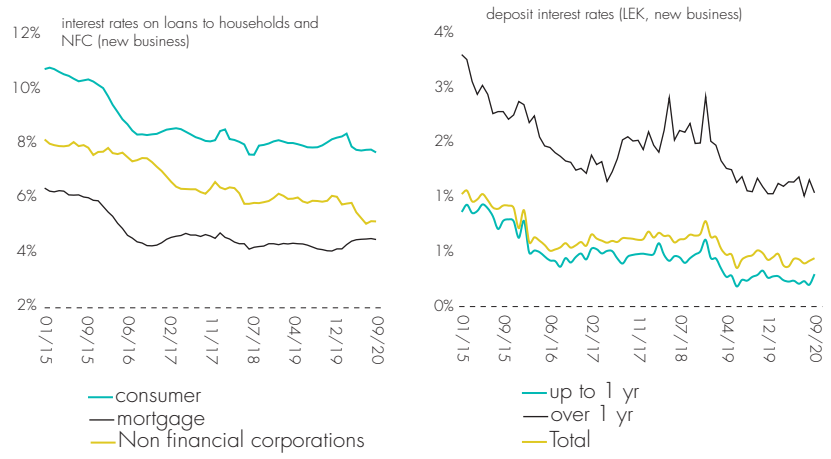
[5] *The bid / cover indicators in the auctions of 12-month T-bills, 2- to 7-year bonds and 10-year bonds for the August-September interval resulted 1.2, 1.2 and 1.3 respectively from 1.3, 1.5 and 1.4 for the January-July interval, this year.*

[6] *The bid-to-cover ratio of t-bills and bonds auctions conducted during this period was 1.5.*

guarantee scheme on lending[7]. The level of interest rates of loans in lek in the third quarter remains below their average level before the reduction of the policy interest rate in March.

The upward interest rates has been present for both enterprises and households credit. The interest rates on loans to enterprises stood at 5.3% in the quarter, up from 5.1% in the second quarter. The analysis according to the categories of disbursed amounts (up to ALL 35 million, ALL 35-140 million and over ALL 140 million) shows a stronger increase in the first interval (up to ALL 35 million), which corresponds mainly to small and medium-sized enterprises. The interest rates on loans to households increased to 6.4% in this period, from 5.9% in the previous quarter. The increase mainly reflected the higher interest rates on consumer loans, while the average interest rate on mortgage loans did not change.

Chart 11 Interest rate on new loans (left) and deposits (right) in lek

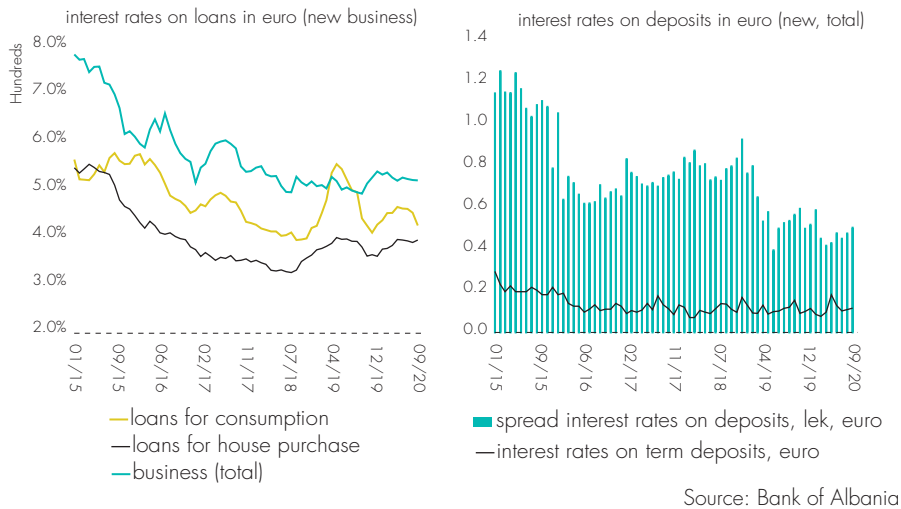


Source: Bank of Albania.

Interest rates on new loans in euro to enterprises fell this quarter to 5.1%, from an average of 5.3% in the first half of the year. The monthly dynamics show that the loan interest rates decreased mainly in August, in the segment of large loans (over 250 thousand euro). Interest rates on loans for amounts up to 250 thousand euro, which mainly approximate the financing of small and medium-sized enterprises slightly increased during the recent months. The interest rates on loans to households have not changed this quarter and since the beginning of the year, they fluctuated at similar levels. This volatility was dictated by the interest rates on consumer credit, while interest rates on loans for house purchase did not change.

[7] *In the third quarter, loans granted under sovereign guarantee schemes had a smaller share than in the previous quarter. Moreover, during this quarter, more loans were granted under the second sovereign guarantee lending scheme, which is characterized by higher interest rates than the first scheme.*

Chart 12 Interest rate on new loans in euro (left) and deposits (right)



Source: Bank of Albania.

The average interest rate on ***new time deposits in lek*** was 0.58% in the third quarter, same as in the second quarter and slightly below of that in the first quarter (0.61%). Interest rates on deposits continued to fluctuate around minimum values these months, being more dynamic mainly in deposits with over 1-year maturity. The average interest rate on ***new time deposits in euro*** was 0.12% these months, at the same levels as in the first half of the year.

NON-PRICE TERMS AND CONDITIONS OF LOANS TO ENTERPRISES AND HOUSEHOLDS[8]

Increased uncertainties with the continuation of the pandemic have driven banks to perceive increased risk in certain sectors of the economy during this quarter. For this reason, banks have tightened the terms and conditions of loans to enterprises in the third quarter. The tightening of lending terms and conditions was mainly reflected in the reduction of the size of loans to enterprises, to some extent also in higher collateral requirements, as well as higher conditionality in loan agreements. On the other hand, banks have extended the maximum maturity of loans granted in the third quarter.

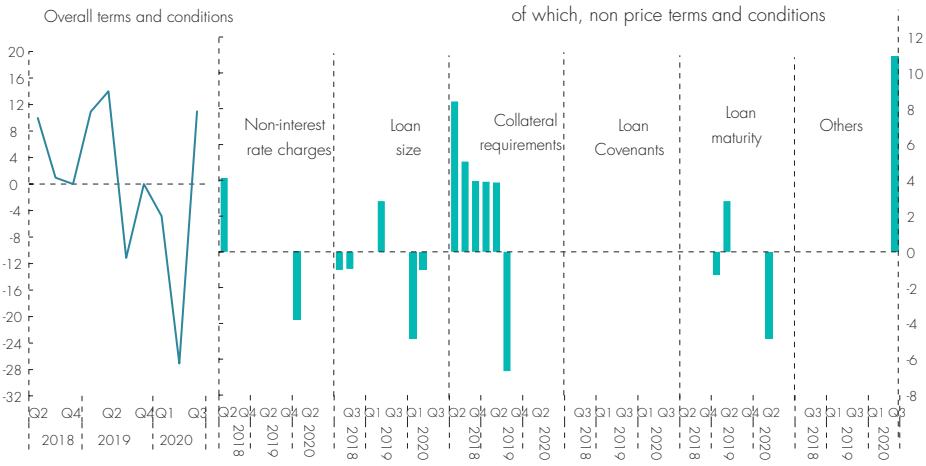
[8] *The analysis is based on the Bank Lending Survey, which is conducted regularly every quarter https://www.bankofalbania.org/Monetary_Policy/Surveys_11282/Bank_Lending_Survey/*

Chart 13 Non-price terms and conditions for loans to enterprises

Source: Bank of Albania and staff estimates.

Lending policies to households in the third quarter were different from those to enterprises. Thus, overall terms and conditions of loans to households were eased in response to improved risk analysis for existing customers[9]. Other conventional factors that make up the non-price component of overall terms and conditions of loans did not change during this quarter.

Chart 14 Non-price terms and conditions for loans to households



Source: Bank of Albania and staff estimates.

3.3 CREDIT TO THE PRIVATE SECTOR[10]

The bank's loan portfolio to the private sector increased by ALL 7.6 billion in the third quarter, or 6.3% year on year. Credit expansion was widely supported

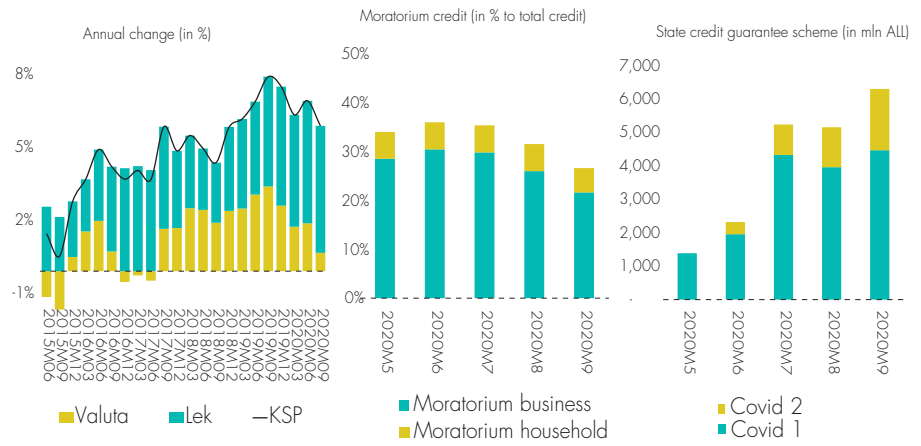
9 *This factor is illustrated by the "Other" category in Chart 14.*

10 *In order to analyse the real developments of ongoing loans, credit data have excluded the effect of exchange rates and write-off loans of balance sheet.*

by sovereign guarantee schemes as well as by measures taken by the Bank of Albania, which have facilitated the financing of customers in difficulty. However, the quarterly portfolio expansion is lower than in the previous quarter, reflecting the low seasonality of this period, the weakness of credit demand and the resumption of instalment payments by some customers. With the end of the the six-month loan moratorium (March - August 2020), some of the enterprises that benefited from it have resumed the instalment payments. In parallel, new disbursed loans recorded positive growth rates in almost all categories, illustrating the support that banks are providing to the economy.

Lek-denominated loan portfolio on average, increased by 10.8% in the third quarter, or 0.6 percentage point higher than in the second quarter. For the same period, lending in foreign currency almost halved its growth rates averagely at 2.1%. These developments are reflected in the increase in the share of loans in lek in 49.7% of the total loan portfolio to the private sector.

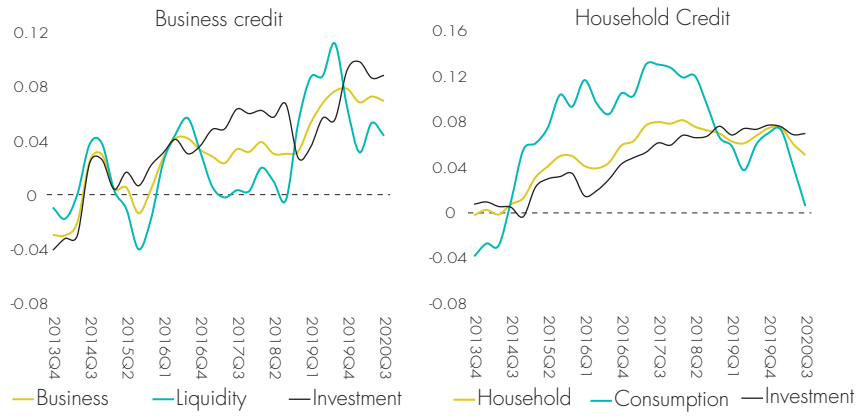
Chart 15 Credit to the private sector



Source: Bank of Albania.

Banks have provided higher financing to enterprises and less to households. Credit to enterprises increased by 6.9% compared to the previous year, down by 0.4 percentage points compared to the previous quarter. This slowdown reflected the curtailment for liquidity credit and illustrates the improvement in the income and financial flows of enterprises during this period. Meanwhile, credit for investment showed the best performance, increasing by 8.8%. In parallel, loans to households continued to show lower growth rates throughout the year, recording an annual increase of 5.1% in the third quarter (1 pp lower than in 2020 Q2). The favourable monetary conditions and the advantages offered by the schemes introduced by the government have helped lending to enterprises and households. The latter, during this quarter, have also benefited from the easing of non-price terms and conditions for obtaining loans, mainly for financing of house purchase. Credit for house purchase maintained a steady growth rate, around 7.3% throughout 2020.

Chart 16 Lending to the private sector by economic agents and purpose of use



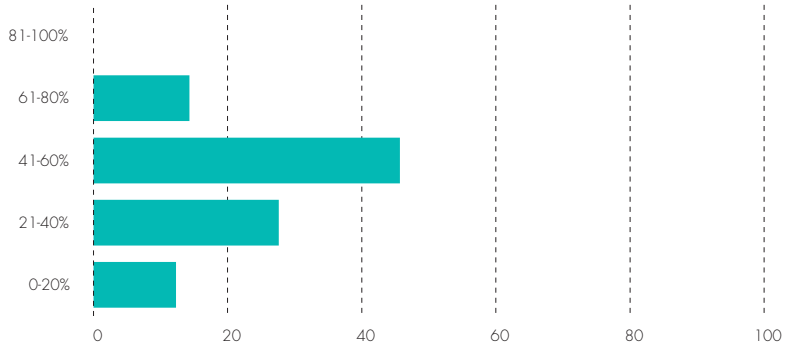
Source: Bank of Albania.

*BOX 1 THE RESULTS FROM THE SPECIAL SECTION OF BANK LENDING SURVEY**

Covid-19 pandemic had a strong negative impact on the Albanian economy. The contraction of aggregate demand reduced the revenues of enterprises and has aggravated their balance sheets. To supplement our information, the Bank of Albania presented a special section in the bank lending survey of the third quarter of the year. Its purpose was to gather the opinion of the banking sector regarding the impact of the pandemic on the finances of borrowing enterprises, as well as on the expected effectiveness of various instruments for the promotion of lending.

The processing of the opinion of the surveyed banks, converges towards the conclusion that the pandemic had a negative impact on the revenues of about 40 to 60% of borrowing enterprises. A small number of banks think that this negative impact is limited to about 21-40% of enterprises, while the 0-20% and 61-80% intervals are chosen by one bank each, respectively.

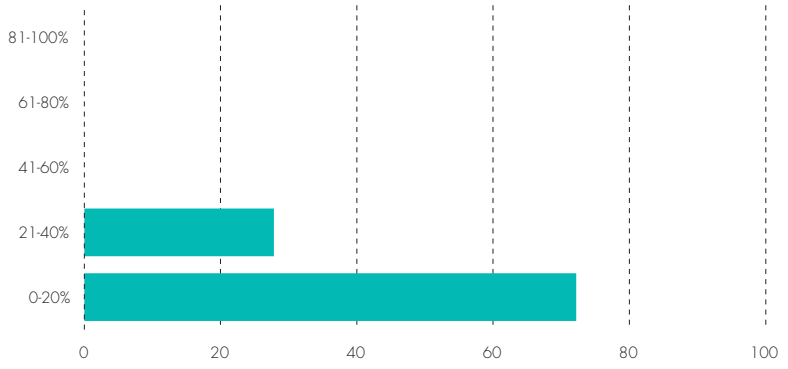
Chart 17 Distribution of Opinions on borrowing enterprises that were negatively affected by the Covid-19 Pandemic*



*Percentages are calculated based on the opinion of banks, the selection frequency of predefined intervals and the weight of selective banks in the total loan portfolio.
Source: Bank of Albania's estimates.

Deteriorating of enterprises revenues naturally lead to temporary difficulties in the flows and financial condition of enterprises. At the same time, it can potentially damage the medium and long-term perspective of the enterprise itself. Under these circumstances, enterprises that finance a part of their activity with borrowed funds, including bank loans, may need temporary financial easing from lenders. In this context, banks were asked what percentage of their clients' enterprises needed to restructure current loans. The results of the answers are presented in Chart 18.

Chart 18 Distribution of opinions on borrowing enterprises that need to restructure current loans.

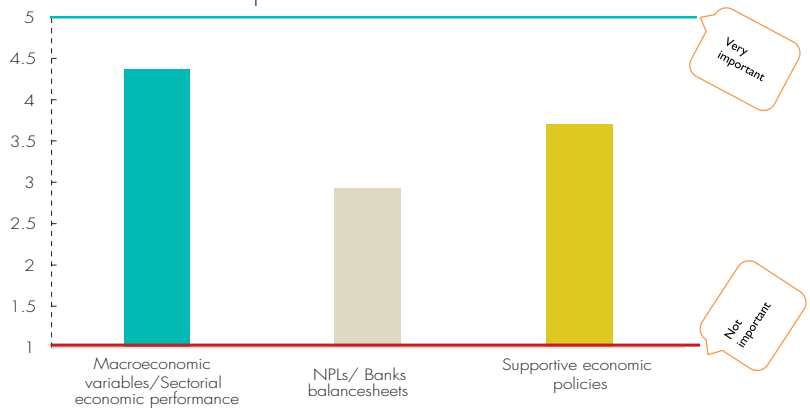


* Percentages are calculated based on the opinion of banks, the selection frequency of predefined intervals and the weight of selective banks in the total loan portfolio.
Source: MPD calculations.

Eight of the nine banks surveyed, which own about 72% of total loans granted to enterprises, reported that the proportion of their customers who needed restructuring, or had restructured their current loans, ranged between 0-20%. Meanwhile, one bank stated that its customers who needed to restructure their current loans ranged between the 21-40%. The measures taken so far by the Bank of Albania and the public authorities have aimed at mitigating the negative effects of the pandemic on the economy, as well as curbing the transmission of the shock from the real economy to the financial market and vice versa. Many factors remain important for the desired trajectory of economic activity in the future, including the performance of credit. However, the latter is expected to be a derivative of developments related to domestic demand, the soundness of the balance sheet of the banking system, as well as the continuation of supportive policies for the proper functioning of the financial system.

In this context, banks were asked about the importance of the above factors in the performance of lending in the future, where values closer to 5 represented the highest importance. Responses are shown in Chart 19. According to the banks' opinion, the most important factor that is expected to determine the performance of credit in the future is the performance of macroeconomic indicators mainly related to the performance of specific sectors of the economy. The significance of this factor is assessed at 4.4 from the maximum of 5. Also, supportive economic policies were assessed as an important factor for developments in the credit market. The banks deemed that the least important factor among them was that related to the performance of NPLs or the soundness of the banks' balance sheet. On average, this factor was estimated to be of a 2.9 importance, suggesting that banks do not see their balance sheet as a deterrent to lending.

Chart 19 The importance of the factors that will determine the credit performance in the future. *



* Percentages are calculated based on the opinion of banks, the selection frequency of predefined intervals and the weight of selective banks in the total loan portfolio.
Source: MPD calculations.

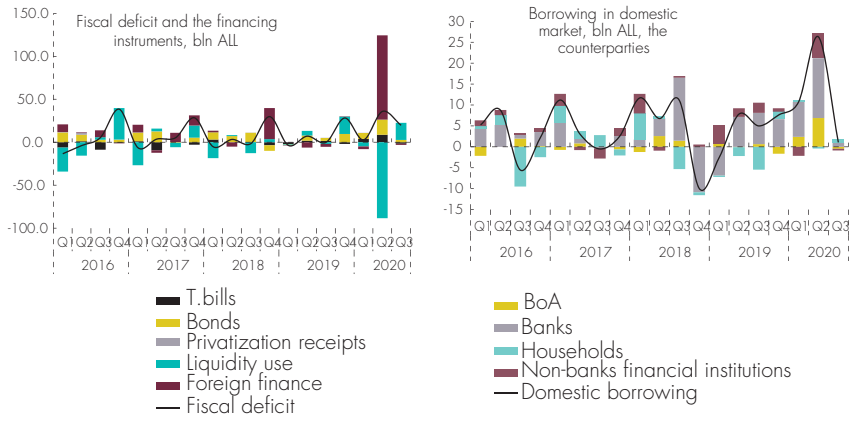
The future remains surrounded by a high uncertanity, mainly related to the degree of restrictions needed to curb the spread of the virus and their prolongation over time. However, the supportive measures taken so far, in addition to the positive effect they had, can serve as a valuable experience in creating the right conditions in coping with possible shocks in the future.

* *The lending survey is conducted on a regular quarterly basis and is based on the responses of the 10 banks of the system that account for about 95% of the loan portfolio to the private sector. 9 out of 10 banks that regularly participate in the bank lending survey responded for the special section.*

3.4 FINANCING TO PUBLIC SECTOR

The budget deficit expanded by ALL 19.8 billion in 2020 Q3, reaching ALL 58.4 billion at the end of September. The financing in the third quarter was realized mainly through the use of the excess liquidity accumulated in the first half of the year (ALL 20 billion), as a result of the Eurobond issuance and acquisition of the budget support from the IMF, in the form of the Rapid Financing Instrument.

Chart 20 Deficit, instruments for financing it (left) financing instruments in the domestic market (right)*



**Values above the horizontal axis in the chart imply a fiscal deficit, below zero they indicate fiscal surplus.*

Source: Ministry of Finance and Economy, Bank of Albania.

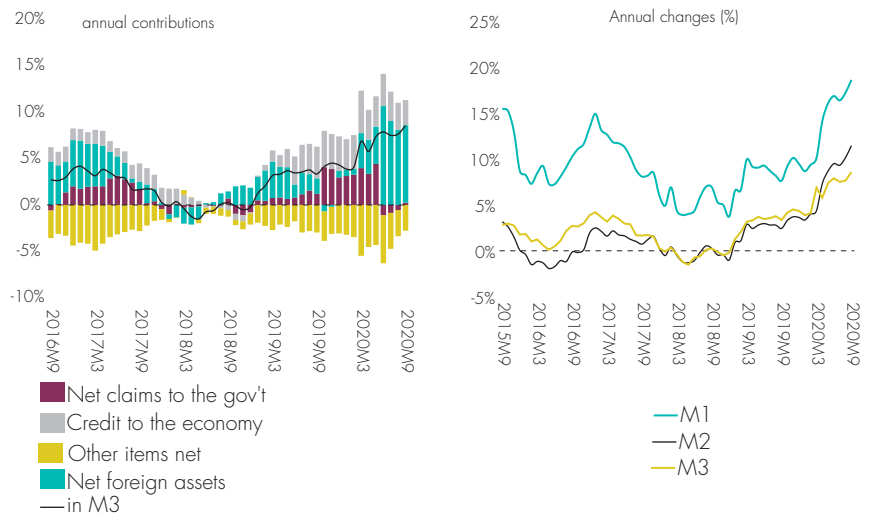
Borrowing in the market of government securities increased by ALL 1 billion in the third quarter, to ALL 38 billion in the first nine months of the year. The increase in domestic borrowing was a result of the partial maturity of short-term securities, by ALL 1.7 billion, compared to the increase in issues by 2.7 billion in long-term securities.

3.5 MONEY AND DEPOSITS IN THE ECONOMY

Money supply continued to expand. The increase in the monetary mass was supported by the government high flows in foreign currency, in addition to the support undertaken by the Government and the Bank of Albania to stimulate lending, in the context of coping with the consequences of Covid-19. The growth rate of broad money, aggregate M3, accelerated to about 7.9% in the third quarter of the year. The money holding structure continues to reflect the shift towards the liquid component, both in currency outside banks and in demand deposits. Money creation in the economy is faster for the domestic currency, supported by increased government activity and lending in domestic currency. This performance is reflected in the increase by 10.3% of the aggregate in Lek, M2.

The increased preference of economic agents for liquid monetary assets during the pandemic, combined with the seasonal increase of demand during summer, have affected the rapid annual expansion of the liquid aggregate, M1, by about 17.4%.

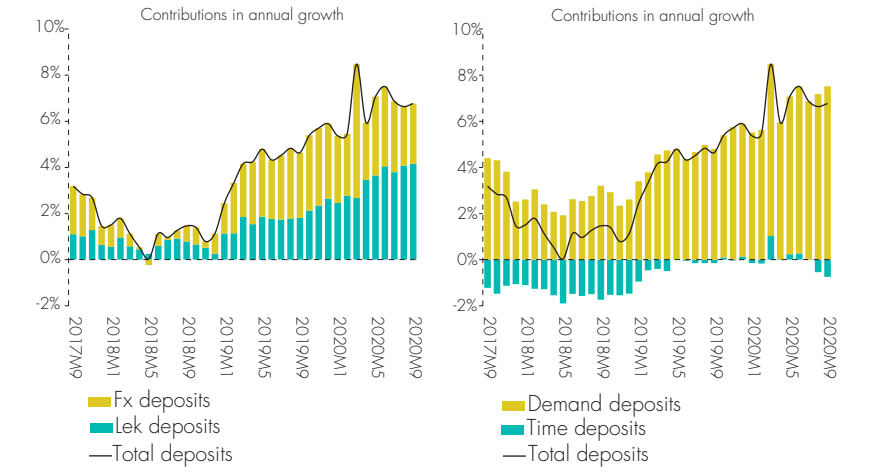
Chart 21 Monetary indicators



Source: Bank of Albania.

The total stock of deposits in the banking system recorded stable growth rates, by 6.8% in 2020 Q3. This performance reflects the good performance of deposits in lek, supported by developments in the banking system assets. Lek deposits marked an annual increase of about 8.2% in the third quarter. Deposits in foreign currency also increased, by 5.4% on average during this period. In absolute terms, the stock of deposits in the third quarter increased by about ALL 23 billion, being concentrated in August 2020.

Chart 22 Deposits in the banking system



Source: Bank of Albania.

The time structure of deposits continued to shift towards the liquid component. At the end of September, demand deposits accounted for around 50.1% of the total stock of deposits in the banking system. Their performance is in line with the reduction of interest rates to historically low levels, the uncertainty, and the

growing preference for liquid instruments from economic agents. Meanwhile, the share of deposits with over 2-year maturity slightly reduced to 13.4% at the end of the period.

4. INFLATION AND ECONOMIC GROWTH

In 2020 Q3, the average inflation of 2020 Q3 resulted at 1.4%, decreasing by 0.5 percentage point compared with the previous quarter. This performance reflects the gradual mitigation of the shock to prices during the period of anti-Covid restrictive measures, while demand pressures continue to remain weak.

Economic activity shrank by 10.2% in the second quarter, reflecting the negative impact of the pandemic. The decline has significantly affected the consumption, investments and exports of goods and services.

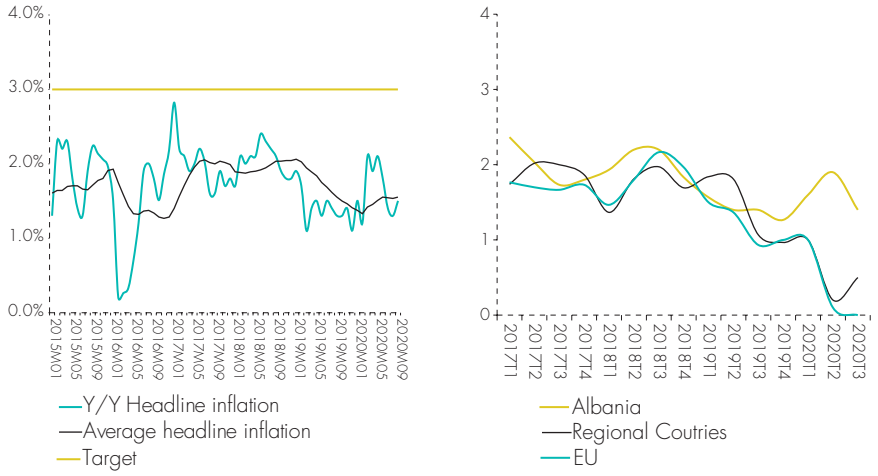
The annual change of economic activity is expected to remain in a negative territory during 2020 H2, but declining at a more mitigated pace than in 2020 H1. The gradual elimination of restrictive measures, together with stimulating monetary and fiscal policies, is expected to boost the gradual recovery of the economy. The expected recovery of partner countries and the facilitation of the movement of travellers will have a positive impact on the re-establishment of exports of goods and services.

4.1 INFLATION

Inflation in 2020 Q3 was 1.4%, standing 0.5 percentage point lower compared to the previous quarter. Despite the fluctuations during the quarters, in the first nine months of 2020, inflation was about 1.6%, slightly higher compared to the same period in the previous year.

The slowdown of inflation was mainly due to falling prices in some of "food" sub-groups. Food prices were significantly exposed to supply-side shocks during the closing period (March-May), while in the third quarter they determined 80% of the inflation slowdown. The decline was also attributed to the lower contribution from some transport services and the negative contribution of oil prices in Albania. The latter conveyed the weak inflationary pressures from abroad.

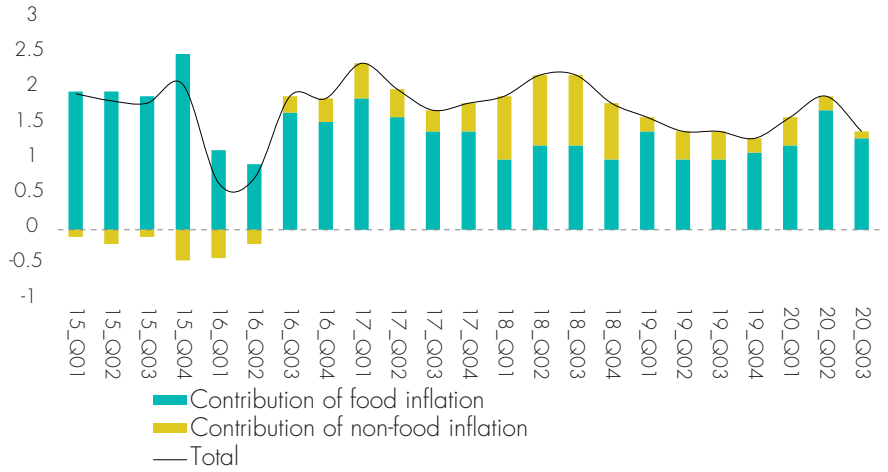
Chart 23 Headline inflation and target (left) Inflation in regional and EU countries (right)



Source: INSTAT, Trading Economics database and calculations of the Bank of Albania.

The annual contribution of the category of "Unprocessed food" decreased by around 0.4 percentage point compared to the second quarter. The decrease of inflation in this category was mainly caused by the decrease in inflation of the sub-groups "fruits" and "vegetables". Their prices fluctuated in line with the seasonal behaviour of the period, following the unusual increase they experienced in the preceding months. The category of "processed food" was characterized by almost same annual inflation rates. Both of these categories continued to form the largest share in of headline inflation (around 90%).

Chart 24 Contributions by food and non-food categories to headline annual inflation



Source: INSTAT and Bank of Albania calculations.

The contribution of non-food categories to the formation of inflation reduced as well. The category "Non-food consumer goods" continued to contribute negatively, where low oil prices in foreign markets were reflected in fuel prices in the domestic market during the third quarter. The prices of other more stable

components of inflation, such as services, housing and consumer durable goods, had a lower contribution (-0.1 percentage point) than in the previous quarter. This decline was caused by prices in the category of services, in particular, those of air and sea freight services[11].

*Table 2 Contribution of main categories to annual inflation (p.p.)**

	Q3-'19	Q4-'19	Q1-'20	Q2-'20	Q3-'20	July'20	Aug'20	Sep'20	Inf. Q3'20 (%)
Processed food	0.3	0.3	0.4	0.5	0.5	0.5	0.5	0.5	2.1
Bread and cereals	0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	1.7
Unprocessed foods	0.7	0.8	0.8	1.2	0.8	0.7	0.7	0.9	4.5
Fruits	0.1	0.4	0.7	0.7	0.5	0.6	0.5	0.5	14.6
Vegetables	0.6	0.4	0.2	0.4	0.2	0	0.1	0.4	2.1
Services	0.1	0.1	0.1	0.1	0.0	0	-0.1	0	0.2
Goods with regulated prices	0	0.0	0.0	0.0	0.0	0	0	0	0.1
Accommodation (rent)	0.1	0.0	0.2	0.3	0.3	0.3	0.3	0.3	2.0
Non-food consumer goods	0.1	0.0	0.0	-0.2	-0.2	-0.2	-0.2	-0.3	-2.8
Fuel	0	-0.1	0.0	-0.3	-0.3	-0.3	-0.3	-0.3	-9.3
Consumer durable goods	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	1.8
Inflation (%)	1.4	1.3	1.6	1.9	1.4	1.4	1.3	1.5	1.4

*Source: INSTAT. *The table shows some of the main groups of items.*

4.2 GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

The economy contracted by 10.2% in the second quarter, by reflecting the negative impact of pandemic. The undertaken measures for containing the spread of Covid-19 mostly have exposed services and processing industry as sectors which are intensively based on labour factor. Meanwhile, construction showed a more mitigated fall. Negative impact of pandemic broadly spread on the components of aggregate demand, among which, consumption and investments suffered the most pronounced contraction.

The easing of restrictions has urged the reactivation of economy in the third quarter. Nevertheless, this recovery is expected to be gradual and the Albanian economy is expected to return to the positive growth rates in 2021.

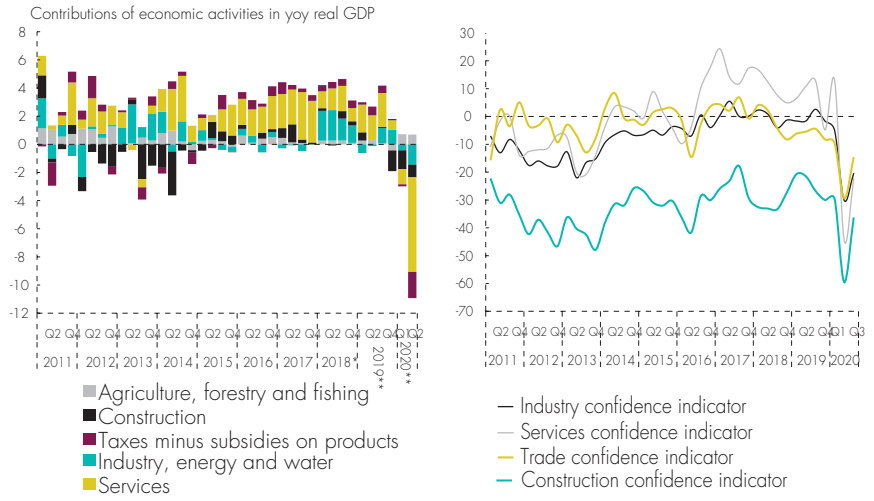
In balance, the risks to economy performance, in the second half of year, are tilted on the downside. The economic growth will continue to be affected by the restrictions on international movements, the lower demand from trading partners and the uncertainty on the performance of both domestic and foreign economy in the future.

[11] *In July and August a strong downward base effect was verified, due to the significant increase that the prices of these services had in the previous year. Monthly inflation of transport services (aircraft and sea) for the respective months were about 25% and 10%, while in the same months of the current year were, around 5%.*

4.2.1 GROSS DOMESTIC PRODUCT BY SECTOR[12]

GDP deepened the fall in the second quarter of year, reflecting the shock from pandemic. The 10.2% contraction of the economic activity was mainly attributable to the negative developments in services sector, and at a lower degree to the contraction of production sector. Their contributions to the annual performance of GDP resulted at -6.7 and -1.6 percentage points, respectively. Also, net taxes affected GDP on the downside, by 1.9 percentage points.

Chart 25 Gross domestic product by output and confidence indicators



Source: INSTAT and Bank of Albania. *Semi-final data. ** A preliminary estimate.

Services sector shrunk by 15.0% of the value added in the second quarter. Although the broad-base impact of pandemic, the contraction of services, mainly reflected the shrinkage of the branch "Trade, transport, accommodation and food service". The contribution of this branch accounts for -4.1percentage points. In addition to the negative impact of the activities of hotels, bar-restaurants and transport, which are the branches mostly exposed to the social distancing and travel restrictive measures, trade also contributed to the falling side[13]. Branch of "Professional activities and administrative services" also accelerated the fall, contributing by -1.2 percentage points to the drop of GDP, in reflection of the reduction in the activity of travel agencies, and the architectural and engineering services.[14] Also, "Public administration, education and health", contributed by 0.6 percentage point to the falling side, mainly reflecting the developments in education as a result of the closure of educational institutions, in the framework of the undertaken measures to contain the spread of Covid-19. Services included in "Financial and insurance activities" and "Arts, entertainment, relax and other activities of services" also affected negatively on GDP (each by -0.4 percentage point). In the meantime

[12] *Gross Domestic Product and Gross Value Added by sector are treated in terms of real annual changes. The differences between the sectors' growth rates of this publication and those analysed in the Monetary Policy Report 2020/III are the result of the series' review.*

[13] *Referred to the net sales volume from short-term statistics (2020 Q2).*

[14] *Referred to the net sales volume from short-term statistics (2020 Q2).*

the negative effect of "Information and communication" resulted relatively low. The branch of "Real estate" recorded growth rates standing around its average, by providing a modest contribution (0.3 percentage point).

Value added of production activities continued to fall in the second quarter, resulting 3.8%; lower in annual terms. Its dynamics mainly reflected the contraction of industry, energy and water sector, and at a lower degree, the fall in construction sector. The negative impact of 1.4 percentage points of industry, energy and water on the economic drop in this quarter, is attributable to the deepening of the downward trend of both processing and extractive industries (with contributions to GDP, -1.1 and -0.5 percentage points, respectively). Their negative performance was affected by the weak foreign demand and is reflected in the fall of respective exports, as these branches are oriented towards foreign markets.[15] Developments in construction also resulted negative, although this sector reduced the annual falling pace. Construction activity contributed by -0.9 percentage point to the fall of GDP in the second quarter. Despite of the growth in the production volume of reconstructions and engineering works categories, the performance of the sector was dictated by the low level of new constructions[16]. Meanwhile, the sector of agriculture, forestry and fishery and the branch of electrical energy grew, contributing by 0.7 and 0.3 percentage point, respectively to GDP.

Available data signal a gradual recovery of the economy in the third quarter, although the performance is expected to remain on the downside and below pre-crisis levels. The improvement in business and consumer confidence, and the increase in the capacity utilisation rate, suggest for a starting point of the economic recovery in the third quarter. Nevertheless, these survey indicators remain below the respective historical averages. The indirect quantitative indicators signal for the mitigation of the downward trend of economy in the third quarter - movement of foreign citizens, exports of products related to extracting and processing industries, transport in volume of goods and passengers. The enterprises' expectations, for the last quarter, signal the recovery of services sector related to the performance of the demand and employment. The dynamic of construction sector is expected to be supported by the implementation of the construction programme for the damages of the earthquake.

4.2.2 AGGREGATE DEMAND

Domestic demand contracted by 7.7% in annual terms in 2020 Q2. The annual decline is significantly higher compared with the previous quarter, fully reflecting the impact of the pandemic Covid-19. The main impact in this regard

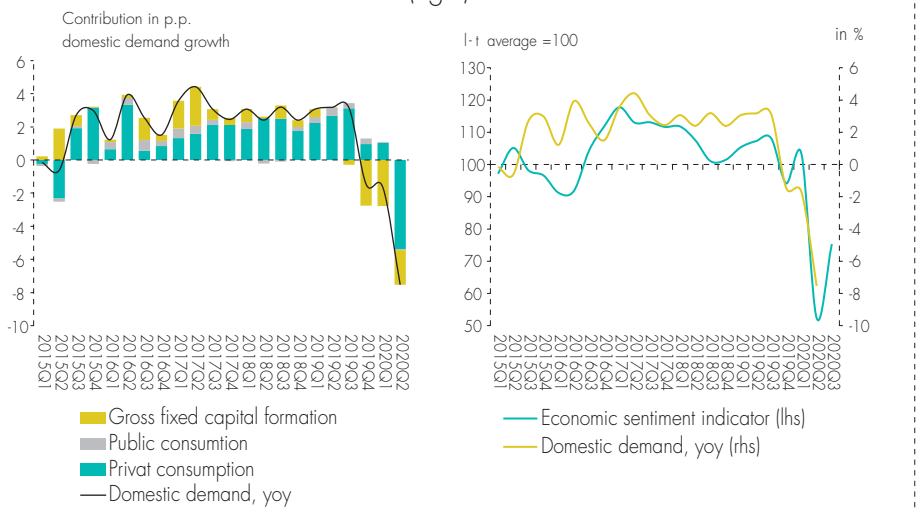
[15] *The sharp contraction of processing industry was driven by the deterioration in the industries related to the production of textiles, clothing, leather and footwear, and the continuation of the downward trend of metal products industry. Meanwhile, the deepening in the contraction of extractive industry mainly reflects the annual fall in the exports of the respective groups.*

[16] *Notwithstanding the increase in the number of construction permits in the second quarter (209), their level is lower than previously for constructions in total.*

was given by private consumption, which decreased by 7.6% compared to the previous year. Investments continued the double digits contraction, by 11.1%. The decline of investments is assessed as mainly driven by the public component.

Preliminary and indirect indicators suggest a relative revival of domestic demand during 2020 Q3, as the reaction of economy to the easing of anti-Covid measures. However, its performance remains under the pre-pandemic levels and the normalisation of domestic demand still requires time.

Chart 26 Structure of domestic demand (left) Economic sentiment indicator (right)



Source: INSTAT and Bank of Albania.

PRIVATE CONSUMPTION

In the presence of measures to curtail the spread of Covid-19, private consumption registered an annual decline of 7.6% in 2020 Q2, the lowest decline in the last ten years. The most severely hit consumption categories are expenditures on long-term goods and services[17]. The latter, in addition to increasing uncertainty, have also been affected by the forced closure of activities. Disaggregate data of retail trade show an annual decline of 8.7% for non-food goods. Retail trade of food goods, although slowing down, registered an annual growth of 1.4% in 2020 Q2. The decline in expenditures for services is evidenced in the decline by 38.7% of value added in the branch of hotels, restaurants, bars, transport and telecommunication.

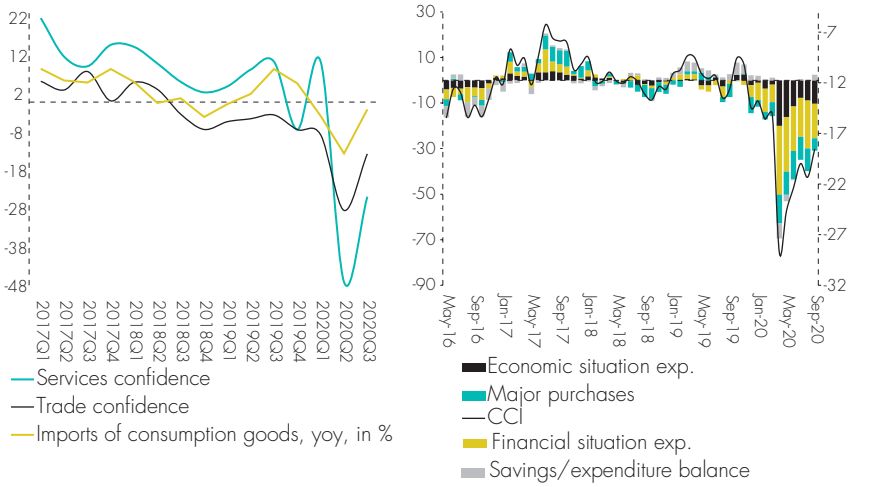
[17] *Our analyses and assessments on the performance of private consumption and its categories are based in indirect indicators of: retail market; value added by sectors; confidence survey indicators.*

Chart 27 Private consumption (left); Approximate consumption indicators by categories (right)

Source: INSTAT and estimations of the Bank of Albania.

Factors that have affected the performance of private consumption during this year are related with the pandemic and peaked in 2020 Q2, when uncertainty also increased significantly. This was reflected in the decline in consumer confidence during this quarter to its historical low. The deterioration of household income and liquidity situation was partially offset by state - aiding schemes implemented by the Government.

Chart 28 Short-term indicators on private consumption in 2020 Q2 (survey indicators are changes from the historical average, in p.p.)



Source: INSTAT and Bank of Albania.

High frequency data suggest a turning point of consumption in 2020 Q3. This performance is signalled by the decrease of the indicator of consumer insecurity and the improvement of large purchases balance from the Consumer Confidence Survey, the improvement of confidence in the services sector and the slight increase of vehicle imports for the period July-August[18].

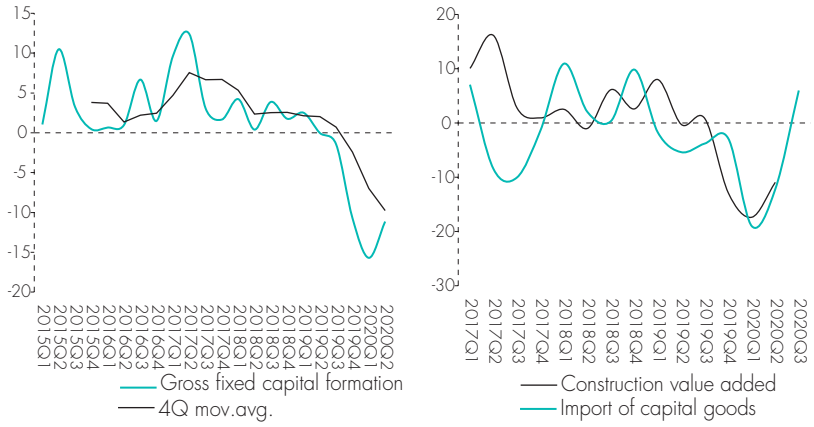
[18] *After the double-digit decline of 2020 Q2 of -37%, in the period July-August there was an increase of 0.2%.*

INVESTMENTS

Total investments declined by 11.1% in 2020 Q2, a more mitigated rate compared with the decline of 15.7% in 2020 Q1. Our assessments indicate that the main contribution to the decline of total investments came from the decline of public investments. Private investments, which are still in negative territory for a year, mitigated the decline in 2020 Q2. Information from indirect data indicates a decline of investments in the two main categories: construction and machinery and equipment. Thus, value added in construction decreased by 10.9% and the import of capital goods by 12.2% in 2020 Q2[19].

The main deterrent factor in the decision-making of enterprises to invest in Q2 is related with the pandemic, the forced closure of some activities, as well as increased insecurity. The latter is expected to have a longer-term impact on investments than the other two. Also, foreign direct investments decreased in 2020 Q2, as well as in the previous quarter.

Chart 29 Fixed gross capital formation (left) and approximate indicators for investments by category (right) in annual change (in %)



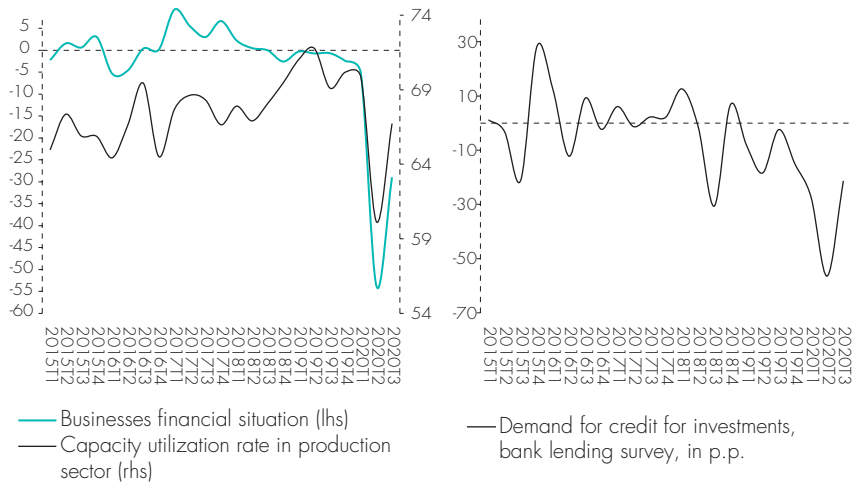
*Source: INSTAT.

*) Import of capital goods in 2020 Q3 is approximated by the average annual growth of July and August 2020.

The recovery of private investment is expected to continue in 2020 Q3. Preliminary short-term indicators from foreign trade give positive signals of increased investment in machinery and equipment. Imports of capital goods shifted into positive territory in July-August 2020, after a negative dynamics of a year and a half. Indicators from surveys of enterprises and banks support the signals from preliminary quantitative indicators. Confidence indicators have turned towards improvement, especially for the construction sector. Public investment is expected to contribute positively this quarter.

[19] *In national accounts (INSTAT), investments are not published disaggregated by composing categories. The analyses on the performance of investments' composing categories are based on GDP's indirect indicators by output and various imports items.*

Chart 30 Indicators from confidence surveys (left) and banks' lending activity (right)



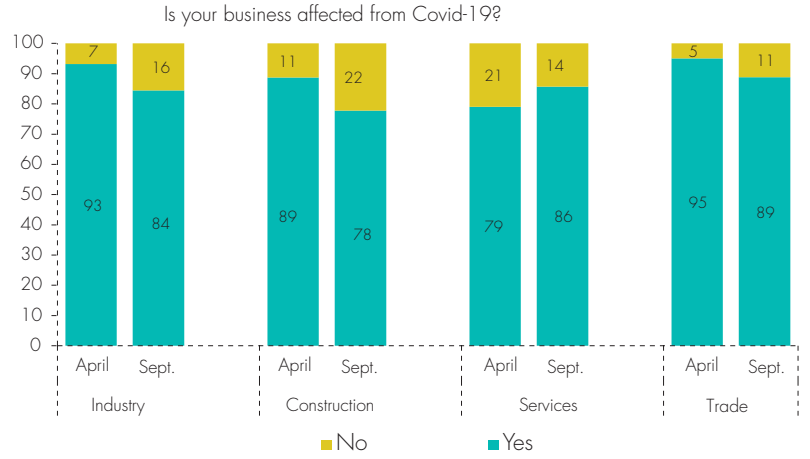
Source: Bank of Albania.

*BOX 2 RESULTS FROM THE SPECIAL SECTION ON CONFIDENCE SURVEYS "IMPACT OF BUSINESSES FROM THE COVID-19 PANDEMIC"**

During the confidence survey conducted in late April, enterprises were asked some specific questions in order to understand the extent of the impact of the Covid-19 pandemic, the measures they have taken, and when they expect to return to normal. The response rate was 72%. The same questions were repeated in the September survey. The response rate in this month was 87%.

In April, about 90% of responding enterprises reported that their activity was affected by the Covid-19 pandemic. In September, this ratio decreased slightly, 84% respectively, mainly affected by the industry and construction sectors. In contrast, the number of enterprises in the service sector that expressed to have been affected has increased in September (Chart 31).

Chart 31 Degree of impact from the pandemic (in % of total responses)

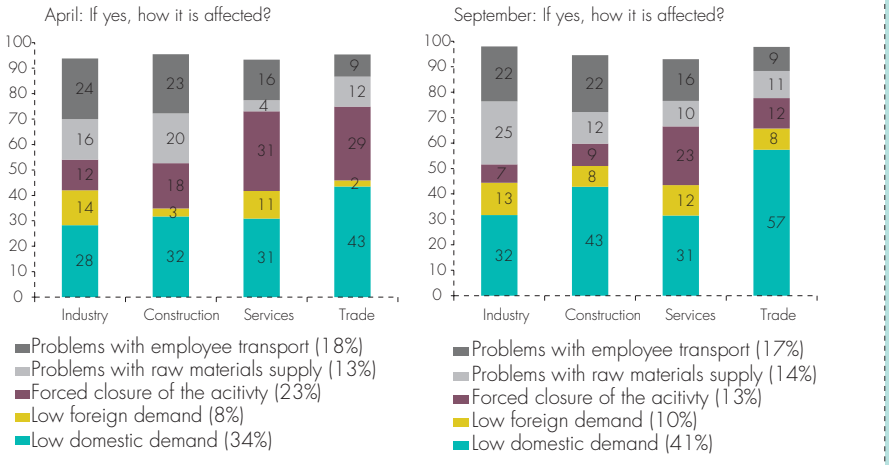


Source: Business Confidence Survey, Bank of Albania.

*Meanwhile, by size of the enterprises** included in the survey, the decline in the share of enterprises that responded their activity was affected by the Covid - 19 pandemic in September was largely influenced by small enterprises.*

On the question of how they have been affected, by a number of choice alternatives, enterprises continue to assess as the most important the reduction in demand from domestic customers. The importance of this factor increased compared with the beginning of the pandemic: around 42% of responses from enterprises in September compared with 34% in April. In line with the easing of measures undertaken, "forced closure of activity", which affected at 23% in April decreased at 13% in September. Other alternatives were assessed almost equally by enterprises in both surveys (Chart 32).

Chart 32 How enterprises have been affected by the Covid-19 pandemic

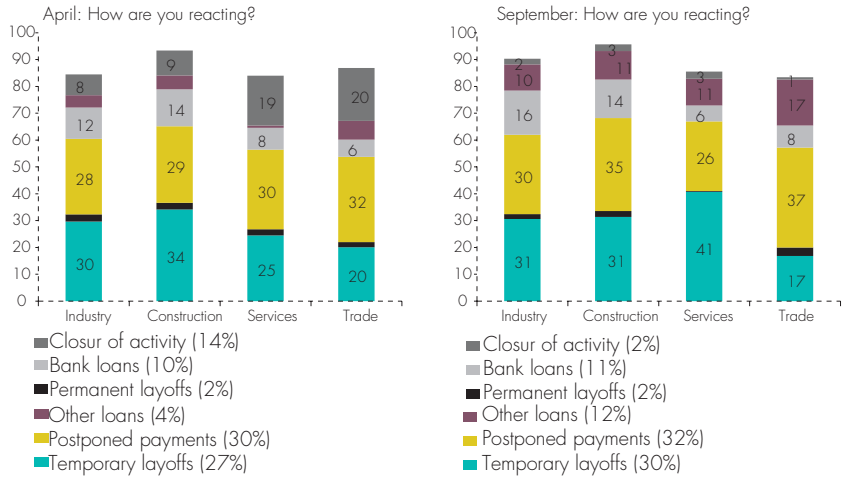


Source: Business Confidence Survey, Bank of Albania.

"Decrease in demand from domestic customers" is identified as the factor with the greatest impact on the categorization of enterprises by size, with a particularly greater share for micro-enterprises. Meanwhile, medium-sized and large enterprises have chosen "Problems in employee transport" as the alternative with relatively greater impact from the situation created by Covid-19.

Enterprises have chosen as the main alternatives to cope with the situation: "deferral of payments" (30% of cases) and "temporary reduction of the number of employees" (27% of cases), to a similar extent in both surveys. The main change is noted in the alternative "closure activity" which was considered in April (14% of total responses), but not in September (only 2% of enterprises responses). The alternative which is considered to be upwards by enterprises in September is "other loans" (12% from 4% in April). The alternative of "permanent layoffs" is still not considered in both surveys.

Chart 33 How they are reacting to the Covid-19 pandemic (in April and September)

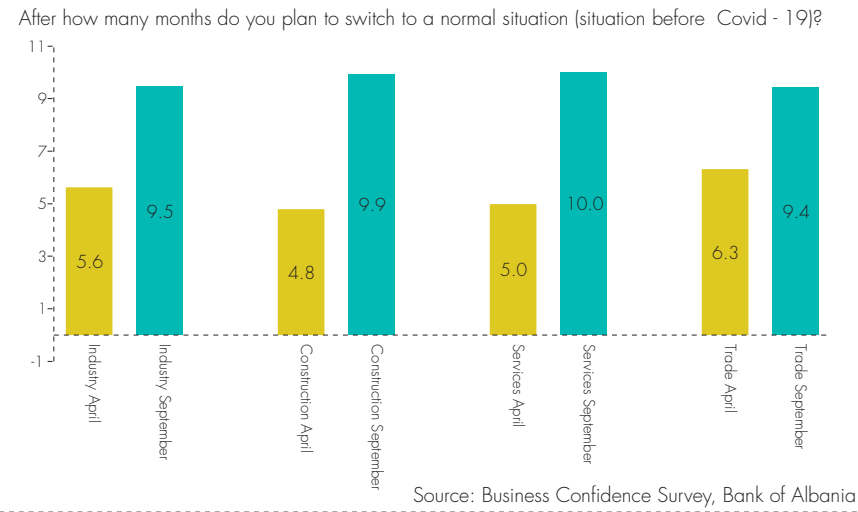


Source: Business Confidence Survey, Bank of Albania.

By size the main alternatives to cope with the situation result as above. In September, there is an increase in the share of the alternative "Other loans" for micro and small enterprises. Meanwhile, "Bank loans" alternative results at a higher share in September for medium-sized and large enterprises.

Overall, enterprises expect to return to normal (the situation before Covid-19) after approximately 10 months. Compared to April, where the crisis was expected to be more temporary, this period has doubled (Chart 4). By size, the return time to the normal situation results higher for small businesses.

Chart 34 Expectations to return to normal



Source: Business Confidence Survey, Bank of Albania.

* *The interview period is 21-30 April and 1 - 12 September 2020.*

** *According to INSTAT, micro-enterprises include 1 - 9 employees, small enterprises 10 - 49 employees, medium enterprises 50 - 249 employees and large enterprises 250 and more employees.*

PUBLIC SECTOR DEMAND AND FISCAL POLICY

Fiscal policy has taken on easing features during 2020, to offset to some extent the negative and unprecedented effect caused by the pandemic. Fiscal easing in 2020 Q3, in addition to the supportive role of the government, appeared mostly in the form of increased investments in the reconstruction of infrastructure and housing damaged by the earthquake.

The budget deficit and public debt have grown rapidly during 2020. Public debt was estimated at 79% of GDP at the end of 2020 H1, up by 12.7 percentage points from the end of 2019. The primary cumulative deficit widened by about 3.6 percentage points of GDP from the previous year, reflecting: i) fiscal policy response to the pandemic (1.4 p.p.) - in the form of increased spending and deferral of tax liabilities, as a supportive measure to avoid liquidity problems for enterprises; (ii) expanding investment spending and performing core government functions (1.7 p.p.); (iii) as well as the cyclical weakness of the economy (0.7 p.p.).

Chart 35 Orientation of fiscal policy*

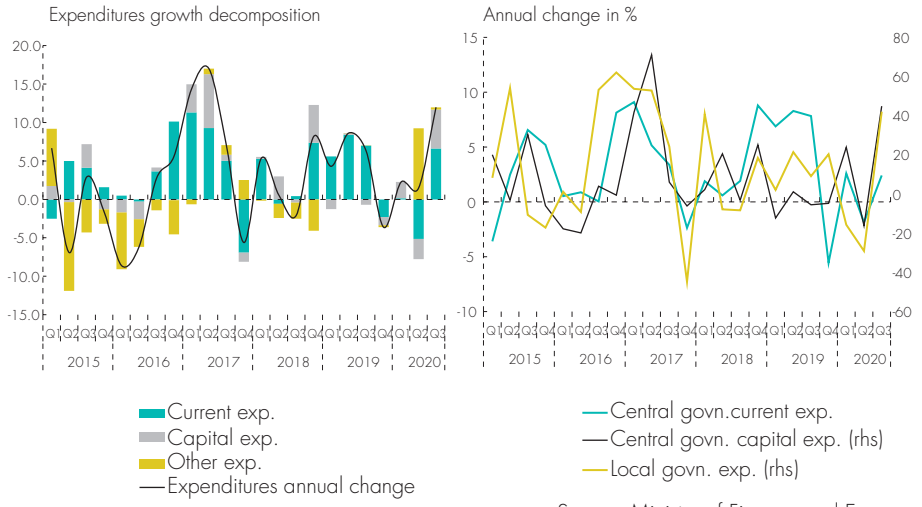
The orientation of fiscal policy is proxied by changes in the ratio of primary cumulative deficit for a 12-month period to the GDP, compared to a year earlier. Negative changes, i.e. the values of these indicators under zero show that the fiscal position has improved, which indirectly indicates negative values of fiscal impulse in the economy.
Source: Ministry of Finance and Economy, INSTAT, and Bank of Albania staff calculations.

The budget deficit at the end of September reached ALL 58.4 billion, or 5% of GDP, from 0.3% estimated in the same period a year ago.

Budget expenditures in 2020 Q3 grew more rapidly in annual terms, 12.7%, compared to 2020 H1 (1.9%). The expenditure growth profile in this quarter was different from the first half of the year. Thus, the expansion of capital and local government expenditures accounted for about 82% of total expenditure growth. In the previous quarter, the government partially cut spending on its core functions, to make room for the ALL 11.6 billion fund, which was used in the form of transfers to the marginalized groups, and to partially address labour market weaknesses, as a result of the pandemic in Albania.

Developments in the area of budget expenditures suggest that the public component will positively support aggregate demand in 2020 Q3, mainly in the form of fixed gross capital formation.

Chart 36 Budget expenditures



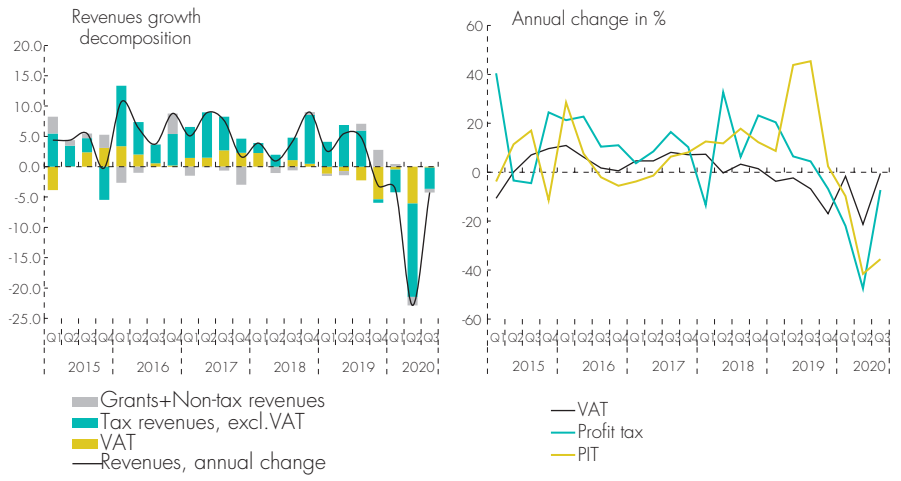
Source: Ministry of Finance and Economy.

In cumulative terms, for the first 9 months of the year, expenditures were realised around ALL 366.3 billion, around 5.5% higher than in the previous year. The shock of the earthquake in 26 November and the Covid-19 pandemic have also changed the composition of expenditures from other years, basing their growth solely on addressing these two issues.

Budget revenues contracted by around 4.2% in annual terms, in 2020 Q3. Although negative, these rates were much more mitigated than those recorded for 2020 Q2 (-23%). The highest negative contribution to revenues (-4.6 p.p.) was given by the item of revenues from personal income tax, which this quarter as well has the effect of high comparative base[20]. Also, negative contributions were registered from excises revenues (-1.1 p.p.) and from VAT revenues on imports (-1.3 p.p.), reflecting the decline of imports. Positive contributions, but not enough to compensate for the negative effect of the above items, have provided VAT revenues on the domestic production of goods and services (1.1 p.p.), national taxes (1.5 p.p.) and local taxes (0.8 p.p.).

[20] *The high comparative base is derived from the fiscal amnesty of the previous year for the allocation of enterprises dividends accumulated over the years.*

Chart 37 Performance of budget revenues



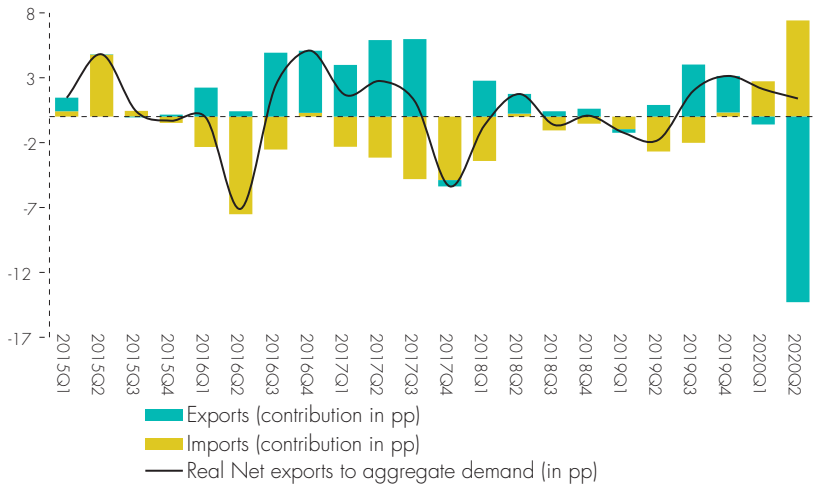
Source: Ministry of Finance and Economy.

The performance of revenues in 2020 Q3 indicates a more positive trend of the economy compared with 2020 H1.

EXTERNAL DEMAND AND FOREIGN TRADE

Available data in 2020 Q2 evidence the deep impact of the Covid-19 pandemic on trade flows. Both exports and imports decreased significantly. In the case of exports, the annual decline registered 49.9%. The main impact came from the deep decline in the export of services (57.7%) caused by the significant contraction of "travel" flows. In parallel, the decline in global demand has caused a contraction of 23.3% in the export of goods. At the same time, import of goods and services decreased by 36.0% compared to the previous year. In this case as well it was the decline in the flow of services (67.9%) that gave the main impact on the contraction of imports. The decline of domestic demand was reflected in a decrease by 18.7% of the import of goods and a contraction by 9.9% in annual terms of the trade deficit. These developments underline the presence of a positive impact from the overall component of net exports to economic growth.

Chart 38 Contribution of net exports to aggregate demand (in p.p.)e)



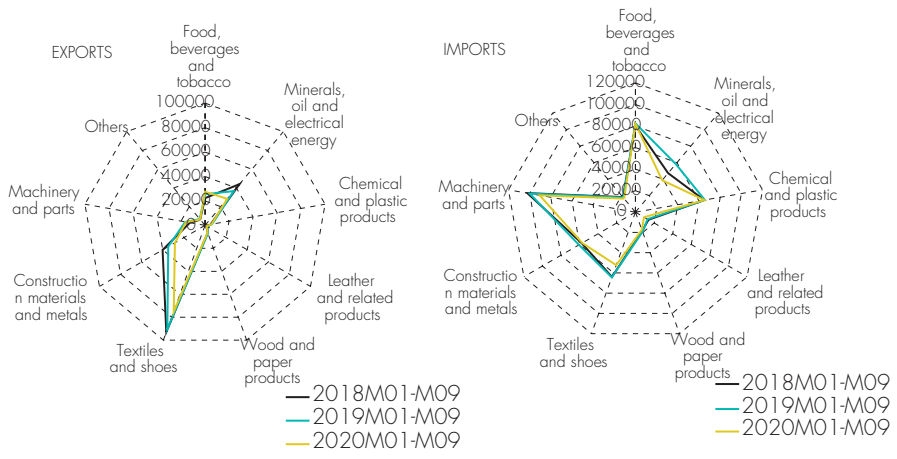
Source: INSTAT and Bank of Albania.

Data on trade of goods in 2020 Q3 indicate that both exports and imports remain below the levels of the previous year. However, they show signs of recovery compared with 2020 Q2, reflecting the easing of the restrictive measures due to the pandemic. The annual decline of exports was higher than that of imports, but the greater share that imports have in trade balance, caused the deficit during this quarter to contract by around 3.5% in annual terms.

Exports of goods declined at a more mitigated pace (5.0%) during 2020 Q3. The category that led the decline was "Minerals, fuels, electricity", mainly reflecting the weak recovery of demand and international oil prices. On the other hand, the positive contributions came from the categories "Food, beverages, tobacco" and "Construction materials and metals".

Like exports, the annual decline of imports of goods in 2020 Q3 (4.1%), resulted more mitigated than in 2020 Q2. The decline was broad-based, reflecting the weak domestic demand. The categories "Minerals, fuels, electricity" and "Food, beverages, tobacco" have given the deepest negative contributions. The category "Machinery, equipment and spare parts" has provided a positive contribution, suggesting a possible recovery of investment activities.

Chart 39 Import and export by category (in ALL million)



Source: INSTAT.

In terms of major trading partners, exports to Italy continued to decline during this quarter (-4.5%). Negative contributions to exports have also come from partners such as Spain, China and Kosovo. On the other hand, exports to Greece and Turkey registered an increase compared to the previous year. In the case of imports, Italy, Greece and Serbia continued to affect their contraction, whereas imports from Turkey have contributed positively during this quarter.

BOX 3 BALANCE OF PAYMENTS 2020 Q2

The developments in the balance of payments reflected the impact of the Covid-19 pandemic with a strong decline of trade exchanges and of income flows. Current deficit expanded by 27.7% compared to the previous year, and is assessed at 12.2% of GDP, up by 4.0 percentage points compared with the previous year. The main impact came from the sub-account of services. The services account surplus contracted by 46.1% driven by the 61.2% decline of exports. In parallel, imports of services also declined by 68.1% compared with the previous year. In both cases, the definers were the travel services flows. On the other hand, the deficit in goods declined by 16.0% due to the decline of imports by 19.2%. As a result of to the higher impact from goods, the trade deficit in goods and services contracted by 1.1% in annual terms.

The deficit of "primary income" account expanded by around EUR 40.6 million. The main cause of this has been a significant decline of labour income inflows. At the same time, secondary income has reflected a contraction by 19.1% of the positive surplus cause by the decline of net remittances by 34.7%.

The financial account was characterized by a contraction of 26.6% in annual terms of net liabilities. Direct investments inflows decreased by 10.2%. On the other hand, liabilities in the form of debt for portfolio investments and other investments expanded. The balance of payments was characterized by an increase in reserve assets by about EUR 848.2 million. The reserve in June 2020 is sufficient to cover 9 months of imports of goods and services or 194% of short-term external debt.

The balance of payments reports an inflow of "errors and omissions" at EUR 92.4 million.

Table 3 Indicators of Balance of payments

	2018 Q4	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2
Current account (in EUR million)	-372.2	-270.4	-296.0	-176.5	-345.8	-233.8	-378.1
y-o-y (%)	20.1	51.6	74.7	20.6	-7.1	-13.5	27.7
/GDP (%)	-11.0	-8.8	-8.2	-5.0	-10.1	-7.7	-12.2
Goods and services	-614.8	-407.7	-523.0	-379.8	-569.3	-384.3	-517.0
y-o-y (%)	7.8	13.8	22.4	5.6	-7.4	-5.7	-1.1
Exports, f.o.b.	952.8	886.8	1059.2	1346.0	1019.1	847.4	488.0
y-o-y (%)	8.8	5.3	3.4	8.5	7.0	-4.4	-53.9
Imports, f.o.b.	1567.6	1294.5	1582.2	1725.8	1588.5	1231.7	1005.1
y-o-y (%)	8.4	7.9	9.0	7.9	1.3	-4.9	-36.5
Net Travel	72.1	75.9	81.5	254.9	88.2	93.0	-1.9
Primary income	6.3	-54.9	-22.2	-53.4	-49.6	-53.7	-62.8
Credit	105.0	76.0	129.7	106.0	108.5	74.0	77.7
Debit	98.7	130.9	151.9	159.4	158.1	127.8	140.4
Net income from Direct Investments	-48.1	-96.4	-123.4	-123.1	-104.5	-84.1	-101.6
Secondary income	236.4	192.1	249.3	256.7	273.1	204.2	201.7
Credit	265.2	225.6	281.0	288.4	310.4	244.1	241.9
Debit	28.8	33.5	31.7	31.7	37.3	39.9	40.2
Net Remittances	169.2	150.2	185.2	184.6	181.9	152.4	120.9
y-o-y (%)	-1.7	1.0	1.9	8.6	7.5	1.5	-34.7
Capital account	41.6	17.9	12.3	19.7	26.2	25.4	23.5
Net borrowing/net lending	-330.6	-252.6	-283.6	-156.8	-319.6	-208.4	-354.6
Financial account	-271.0	-390.8	-357.1	-6.3	-150.5	-266.6	-262.2
y-o-y (%)	32.0	37.0	80.4	-62.5	-44.5	-31.8	-26.6
/GDP (%)	-8.0	-12.7	-9.8	-0.2	-4.4	-8.8	-8.4
Direct investments	-244.9	-302.3	-231.9	-253.6	-248.5	-220.7	-222.5
y-o-y (%)	10.7	4.1	6.3	-5.6	1.4	-27.0	-4.1
Portfolio investments	-203.0	-0.2	-82.4	93.4	129.8	20.1	-240.5
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Other investments	-96.9	-17.6	0.8	44.2	41.2	-14.8	-647.4
Reserve assets	273.9	-70.7	-43.6	109.7	-73.0	-51.1	848.2
Errors and omissions	59.7	-138.2	-73.5	150.5	169.1	-58.2	92.4

Source: Bank of Albania, INSTAT and staff's estimates.

4.3 CYCLICAL SITUATION OF THE ECONOMY AND INFLATIONARY PRESSURES

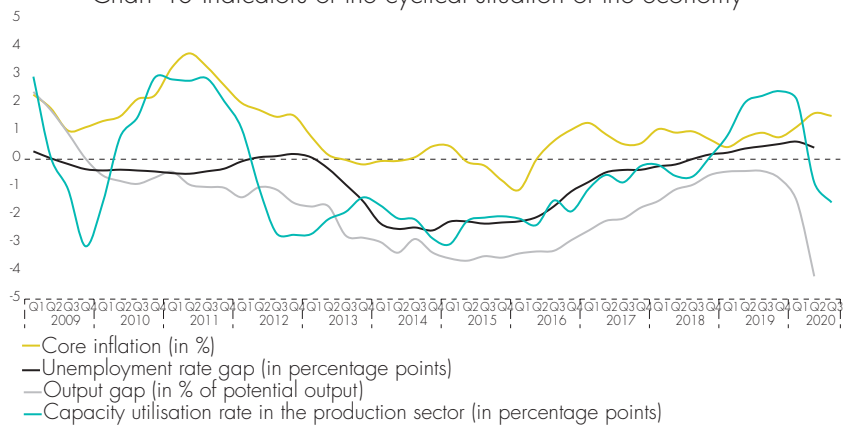
The negative impact of the pandemic has worsened the cyclical situation of the economy, by halting the strengthening of inflationary pressures in the short-term period. The economy has suspended its convergence toward potential, reflecting an increase of spare capacities in labour and capital markets, and a significant expansion of the negative output gap.

In the conditions of the continuation of the pandemic, the uncertainty surrounding the assessment of the cyclical position and the inflationary pressures in Albania

remain high. However, the gradual entry of the economy into a phase of normalization is expected to gradually increase the inflationary pressures. The gradual improvement of the cyclical situation of the economy and the expected growth of imported inflation are expected to return inflation to target in the medium-term.

The deterioration of the cyclical state of the economy is illustrated by the indirect indicator of the capacity utilization rate gap and by the increase of the unemployment rate. Although being contained by rising inactivity rates[21] and government support schemes, the unemployment rate signals an increase in spare capacities in the labour market as well. Meanwhile, the first signals of entering into of gradual recovery are taken from the increase in the utilization rate of production capacities in 2020 Q3, as well as the improvement of enterprises and consumers' expectations on labour market dynamics. However, these indicators remain below the pre-crisis levels of Covid-19, being in line with our estimates for weak inflationary pressures from the real economy.

Chart 40 Indicators of the cyclical situation of the economy*



**The output gap is the average of several measurements on which the method of moving average is applied. The capacity utilisation rate gap is assessed as a deviation of the current value from the relevant historical average, and then the method of the four terms moving average is applied. The unemployment rate gap is assessed as an average of unemployment gaps according to three methods, which assess the equilibrium or structural level of unemployment (NAIRU or NAWRU). The unemployment rate gap is stated as the difference of equilibrium unemployment rate to actual unemployment rate and then the method of the four terms moving average is applied.*

Source: INSTAT and estimations of the Bank of Albania.

The ***capacity utilisation rate*** in the economy increased by 3.0 percentage points in the 2020 Q3, standing at around 69.3%. Both production sector and service sector enterprises increased the use of production capacity. After the historical low level recorded in the previous quarter, the improved performance of the indicator was insufficient to shift the capacity utilization rate above the level of the previous year and above its long-term average. More specifically, enterprises have utilized their capacity at a rate which is 4.2 percentage points below the historical average.

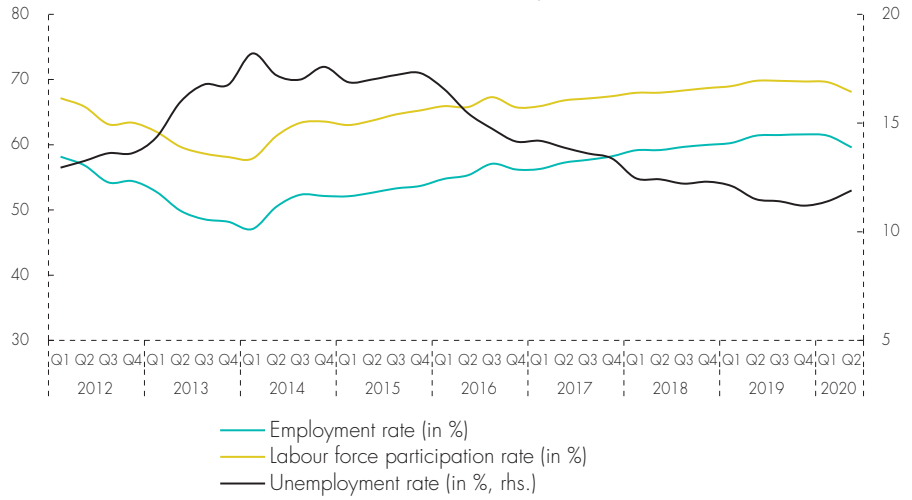
The Covid-19 pandemic affected the ***labour market*** more significantly in 2020 Q2, reflected by some of the main indicators like, employment, unemployment

[21] *Under the influence of the restrictions adopted to control the pandemic.*

and the participation rate in the labour force.[22] Employment in the economy decreased by 3.6% in annual terms, resulting less 45.183 employees than in the same period the previous year. The indicator registered a quarterly decline of 2.6%, 33.235 persons, after the decrease of 16.800 persons in 2020 Q1. The decline of employment by sector was broad-based, affected in annual terms by the contraction of employed in "services", "agriculture" and "industry and construction" by -1.5, -1.4 and -0.7, respectively.

The contraction of employment was accompanied with an increase of unemployment in 2020 Q2.[23] The unemployment rate resulted at 11.9%, a level higher in both quarterly terms (by 0.5 percentage point) and in annual terms (by 0.4 percentage point). However, the decline in employment has been channelled to a lesser extent to rising unemployment and mostly to an increase in persons leaving the labour market, under the status of inactive.[24] As a result, labour forces registered a decline by 3.1% in annual terms (43.760 persons) and by 2.1% in quarterly terms (29.149 persons). Reflecting these developments, the participation rate in labour forces continued to decrease, at 68.1% from 69.6% in 2020 Q1.

Chart 41 Participation in labour force, employment level and unemployment level in economy



Source: INSTAT.

[22] *The analysis of employment and unemployment is based on the "Quarterly Labour Force Survey" (QLFS), and refers to indicators for those 15 years and older. In 2020 Q2, the administrative data also present developments in the labour market in line with the data from the survey. Employment in the economy also shrank according to administrative data, driven mainly by the decline of employment in the non-agricultural private sector.*

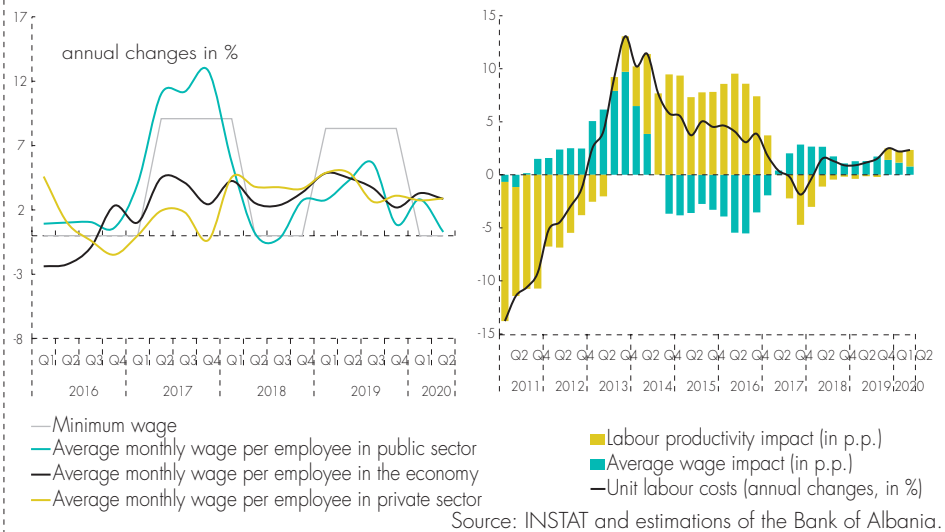
[23] *The quarterly increase in the unemployment rate continues to be attributed to the decline in employment. The assessment of the factors influencing the unemployment rate suggests that the increase in the indicator was driven by developments in labour demand (employment - by demand; labour force participation rate - by supply).*

[24] *It should be kept in mind that the collection of statistical data was influenced by anti-Covid measures, reflected in a lower response rate in the QLFS, reporting delays, and the time required to obtain unemployment status.*

In the remaining part of the year and following, the Covid-19 shock is expected to mitigate the negative impact on the labour market, due to the alleviation of containment measures, the support from the recovery of service activities related to the summer season. This is signal also from the improvement of enterprises' expectations for the employment and consumers for unemployment and the number of individuals that have lost their jobs, and have benefited financial aid from the Government's schemes[25].

The contraction in the number of contributing employees, during the second quarter, was mostly concentrated across employees receiving a wage that is lower than the average wage in the economy.[26] As a result, the average monthly wage per employee [27] has remained at higher levels than in the same period in the previous year, but it has slowed its increasing dynamic to 2.9%. In real terms, the increase of average wage resulted 0.9% the average wage in public sector stood almost at the same level of the previous year 0.3% (around -1.6% in real terms). Meanwhile, the average wage in the private sector increased by 2.9% (1.0% in real terms).

Chart 42 Wage indicators in Albania (left) and labour costs and their decomposition (right)



Source: INSTAT and estimations of the Bank of Albania.

The ***unit labour cost*** slightly accelerated the upward trend in the second quarter (2.4%). This performance was mainly dictated by the deepening of

[25] *Referring to the up to date information of the Ministry of Finance and Economy on the performance of Anti-Covid Financial Packages, till 19 October 2020, around 65,656 individuals who have lost their job have benefited financial aid. In these data were fully reflected in the fall of employment and simultaneously in the increase of unemployment, and by taking into account the contraction of employment with 50,035 individuals, till first half of year, the unemployment rate may jump further during the second half of year. Nevertheless, this assessment is surrounded by uncertainties as it does not consider the expected positive effects in employment, as mentioned above, and the fact that the fall in employment may not be fully reflected in the increase of unemployment, and that part of individuals may shift to inactive status.*

[26] *Based on the distribution of contributing employees by intervals of the average gross monthly wage (INSTAT, Wage Statistics, Q2 - 2020).*

[27] *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 Q2-2020.*

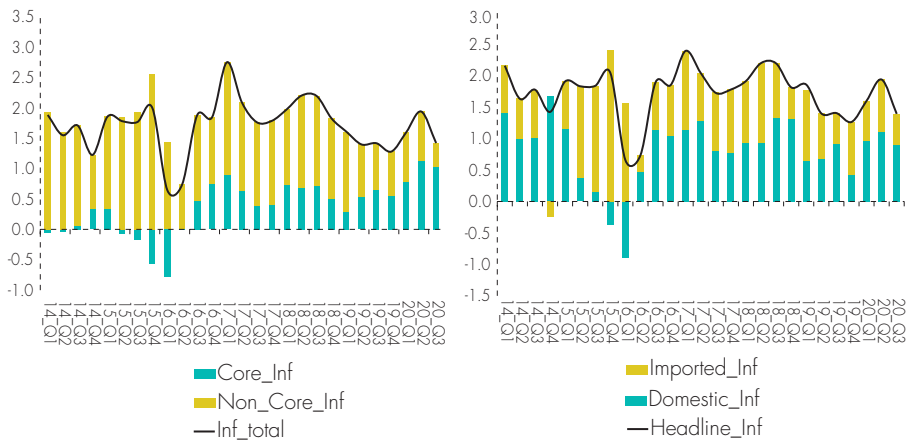
the downward trajectory of labour productivity, whereas real wage slowed down[28]. The faster fall of labour productivity was attributable to the temporary disruption of a group of activities in the framework of containment measures against Covid-19 spread and the drop of the demand in certain sectors of economy.

Whereas, ***other output*** costs deepened the fall in the second quarter of year. The industrial producer prices fell by 4.1% in annual terms. This performance reflected both the faster contraction of export prices, by 7.0%, and of domestic industrial producer prices, by 3.1%. The production costs in construction sector[29], recorded a slight annual increase comparable with the previous quarter (around 0.4%).

The deepening of negative output gap, increase of unemployment rate and of spare capacities in the economy are reflected in the performance of long-term components of inflation. Both core inflation and domestic inflation affirmed the gradual envisaged slowdown for the third quarter of year. ***Core inflation*** and non-tradable inflation were 1.5% and 1.2%, respectively.

The reduction of the supply-side effects, due to the easing of anti-Covid-19 measures, was reflecting in the slowdown of the short-term components of inflation in July and August and their acceleration in September. In average annual terms, non-core and tradable inflation of the CPI basket items registered 1.2% and around 1.7%, respectively.

Chart 43 Structure of inflation by components: core and non-core (left); domestic and imported (right)



Source: INSTAT and estimations of the Bank of Albania.

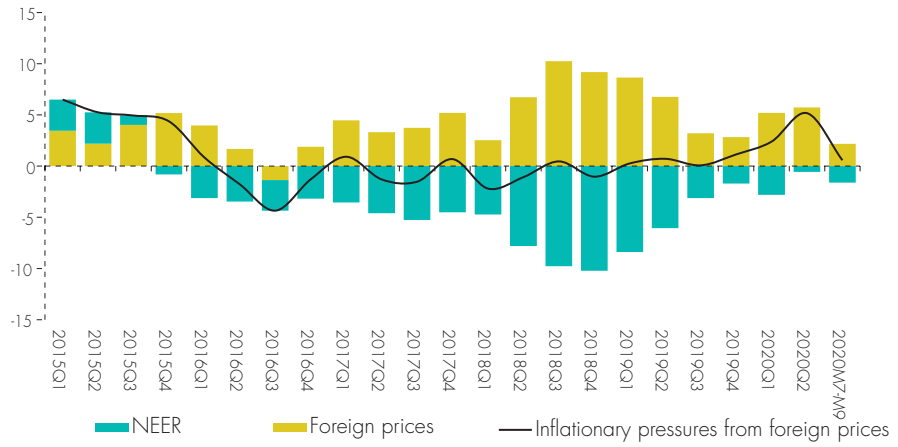
[28] *Proxies of labour productivity, unit labour costs and average wage in accordance with short-term statistics are calculated by the Bank of Albania using the total series of Short-Term Statistics (SHTS, INSTAT, Q2 - 2020). The reported growth rates are in real terms and refer to the four-terms moving average of the annual changes of the indicator.*

[29] *According to the Construction Cost Index (INSTAT, Q2-2020).*

Although slowing down, long-term and domestic inflations have remained relatively steady, by maintaining higher contribution in the formation of headline inflation (70%), compared with complementary short-term components. The reduced pressures from foreign prices and the exchange rate appreciation, during the third quarter, are translated into lower contributions of the imported inflation to headline inflation, compared with the previous quarter.

Signal on the continuation of the weak intensity from imported inflation, during the remaining months of the year; also come from the ***Imported Inflationary Pressure Index (IIPI)***[30]. Its performance slowed own (0.6%) compared with the second quarter of year. This development was mostly dictated by the sharp slowdown in the Import Price Index (2.2%) and the slight appreciating effect of the Nominal Effective Exchange Rate (NEER).

Chart 44 IIPI and contributions of its components



Source: INSTAT and estimations of the Bank of Albania.

INFLATION EXPECTATIONS[31]

The expectations of businesses, consumers and financial agents on inflation, after one year, fell in the third quarter. Inflation expectations in the medium term of financial agents have remained unchanged from the previous quarter.

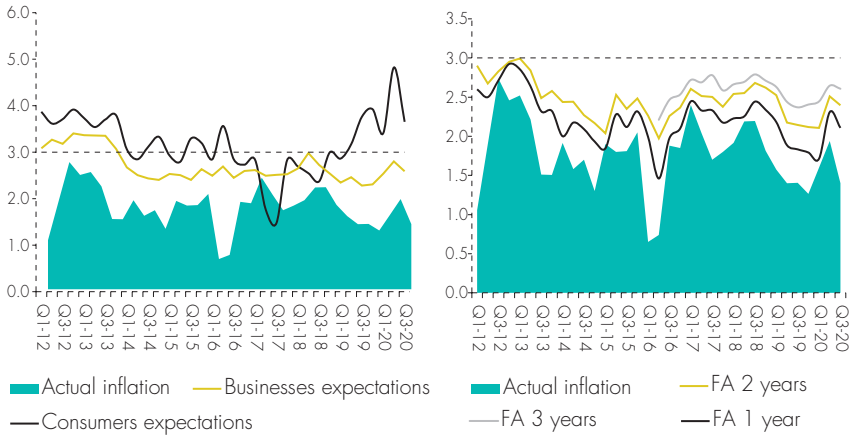
The fall of short-term expectations is more pronounced for consumers, whose expectations recorded the highest levels in the second quarter. Consumers expect inflation to be 3.7% after one year, from 4.8% in the previous quarter. The expectations of other agents have been revised slightly downward from the second quarter. Hence, the expectations of businesses and financial agents are reduced by 0.2 percentage point. In the third quarter, their expectations

[30] *IIPI is calculated as the annual growth of the imported prices index and the NEER index for the respective month. IIPI is assessed to affect the imported inflation after a 5 months' time lag, calculated from CPI of the country.*

[31] *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.*

for inflation after one year stand at 2.6% and 2.1%, respectively. The expected inflation from financial agents after two and three years is 2.4% and 2.6%, respectively.

Chart 45 One-year-ahead inflation expectations, businesses and consumers (left) and financial agents, according to three horizons (right), annual change in %



Source: INSTAT and Bank of Albania.