

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.

