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### INTRODUCTION

The primary objective of the Bank of Albania’s monetary policy is to achieve and maintain price stability. This target implies reaching low rates with positive inflation, and maintaining these for a relatively long period. In qualitative terms, the Bank of Albania has defined price stability as maintaining a 3.0% annual inflation rate of consumer prices in the medium term. By preserving price stability, the Bank of Albania helps establish an environment with few unexpected events and assists Albanian households and enterprises in planning their own consumption and investments.

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

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

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


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1 Monetary Policy Document delineates the monetary policy framework at the Bank of Albania. This Document is available at: https://www.bankofalbania.org/Monetary_Policy/Objective_and_strategy/Monetary_Policy_Document.html
FOREWORD BY THE GOVERNOR

Economic activity, in Albania and globally, has been and continues to be experiencing the negative effects of the Covid-19 pandemic. The measures taken to contain it and an overall increase in uncertainty has driven a fall in both domestic and foreign demand, as well as restriction in production over the second half of the year. Thus, the Albanian economy experienced a marked recession, the unemployment rate trended upward, enterprises and households experienced financial difficulties, and the premises for an increase in wages and the return of inflation to target faded.

Addressing this situation triggered a coordinated easing of fiscal, monetary and financial policies. These measures helped mitigate the impact of the pandemic on the Albanian economy.

Analysis of available information suggests economic activity in Albania has shown recovery trends during the second half of 2020. Economic activity in the third quarter was almost 10% higher than in the second quarter, although remaining 3.5% lower than the same period in the previous year. Also, the Albanian economy produced nearly 34 000 jobs in the third quarter, recovering around 2/3 of losses recorded in the previous quarter. Available data show a further improvement in economic activity in the fourth quarter. Exports of Albanian goods have been increasing, lending to the private sector jumped to 7.7% at the end of December, while the situation of enterprises has been improving.

Demand for goods and services, although improving has not provided for a sufficient increase in employment, wages and profit margins, which would enable the return of inflation to target. This performance has been reflected, as well, in the low and fluctuated values of inflation during the last quarter of year.

Looking ahead, the Bank of Albania expects economic activity to continue recovering over the next two years. Growth in demand for goods and services will back an increase in demand for both jobs and employment, leading to an increase in wages and a gradual return of inflation to target within 2022.

These projections are based on the assumption that there will be a progressive reduction in the spread of the pandemic in 2021. In addition, they take into account current economic development trends in Albania, and a more positive outlook for the global economy. These projections also propose maintaining a simulating monetary and fiscal environment over the next two years.
Based on the above, after reviewing this Report, the Supervisory Council has decided to maintain the accommodative stance of the monetary policy, by keeping the policy rate unchanged, at 0.5%, and to signal our willingness to continue simulating monetary conditions over the next two years.

Low interest rates and provision of sufficient liquidity to the market will boost economic growth and establish the premises for a return of inflation to our 3.0% target, in line with our forecasts.
1. INFLATION AND MONETARY POLICY STANCE

The Supervisory Council of the Bank of Albania has assessed that the following are essential: tackling the pandemic shock; bolstering stable economic growth; and a return of inflation to target; to trigger actions towards stimulating economic policies. After reviewing the Monetary Policy Report, the Supervisory Council decided to keep the key interest rate unchanged, at 0.50%, and to affirm its willingness to maintain an accommodative policy stance in the medium term. The Supervisory Council has assessed that current monetary conditions are adequate for a stable convergence of inflation to 3.0% target, within the medium-term horizon.

The pandemic continues to be a serious challenge to the Albanian as well as global economies. In many countries, the reintroduction of restrictions, at the end of 2020, decelerated the economic recovery started in summer. The Euro area economy, our main trading partner, is expected to contract in the last quarter of the year. The situation in the labour market remains difficult, in spite of supportive programmes initiated by European governments, and employment continues to be lower than in the pre-pandemic period. Inflation remains in negative territory, reflecting weak demand. Forecasts for the European economy remain on hold in the short term, but the start of vaccination campaigns at the end of 2020, has increased confidence in a gradual rebound in the medium term. Implementation of stimulating fiscal policies is expected to underpin economic recovery and the return of inflation to target.

Regarding the Albanian economy, the shift towards normalisation of some sectors of the economy, over the summer, drove a swift recovery of economic activity in the third quarter of 2020. The volume of economic activity grew by 9.8% compared with the second quarter, though this is 3.5% lower than the same quarter in the previous year. Partial improvement of private consumption and expansion of investments supported economic recovery, reflected in a better performance of the services sector and an increase in construction activity. Also, the labour market improved in the third quarter. Employment grew by 34,224 persons in this quarter, partially recovering the losses of the second quarter, while the unemployment rate fell to 11.6%. As well, wages continued to rise, albeit at a slower pace than in previous years.

In 2020, inflation averaged 1.6%. Although with fluctuating performance, mostly affected by the performance of food prices, inflation has undershot the target, while inflationary pressures remain insufficient for the return of inflation to target.
Economic dynamics remain fragile in the short run. Available indicators suggest a slowdown in the pace of rebound in economic activity in the last quarter of the year, due to the enhanced spread of pandemic in Albania and abroad. Nevertheless, the Bank of Albania expects economic activity to return to positive growth rates in 2021 and following. A considerable fiscal and monetary stimulus, continuation of the reconstruction programme following damages from the earthquake, and the rebound of global economic activity are all expected to bolster economic growth in Albania. These factors are expected to boost the growth of consumption, exports and investments, and to gradually increase income across all sectors of the economy.

Improvement in economic activity and demand will be accompanied by an increase in employment, wages and production costs. Inflation is projected to hover around 1.8% on average in 2021 and return to the Bank of Albania’s target in the second half of 2022. This expectation takes into account the expected increase of inflation in partner economies.

The expected recovery of the economy and the return of inflation to target need to be supported by stimulating macroeconomic policies. The Supervisory Council assesses that the measures taken by the Bank of Albania since the onset of the crisis have contributed to maintaining accommodative monetary conditions, by reducing the servicing costs of existing debts and bolstering lending to the economy.

Financial markets are calm and the banking system has preserved indicators of financial soundness, by enabling better transmission of the monetary stimulus to the economy. Financing costs to banks, enterprises, households and the public sector stand at low historical levels and the exchange rate is stable. The eased monetary and regulatory measures implemented by the Bank of Albania, enabled a 6.7% increase of credit to the private sector over 2020. Lending in lek continues to be the main contributor to the growth of credit. The share of this portfolio in relation to the total has been growing over the last four years, hitting 50%, up from 46% in 2017. This development establishes the premises for enhancing monetary policy effectiveness and strengthening the financial stability of Albania in the future.

The monetary policy stance will remain accommodative in the medium-term horizon. For this reason, in the meeting of 3 February 2021, the Supervisory Council decided to reaffirm the key interest rate at 0.50%, and the overnight deposit and overnight lending rates at 0.1% and 0.9%, respectively. At the same time, the Bank of Albania will supply unlimited liquidity to the banking system, at least during the first half of 2021.

Coming developments in the economy continue to be surrounded by downside risks, but these risks are more mitigated. The development of several vaccines and the start of the vaccination process are expected to enhance confidence in a faster end to the health crisis. Nevertheless, the achievement of complete
immunity will need time and repeated waves of viral spread or new variations are still factors of risk to financial and economic conditions. In addition, other risk factors include (i) an increasing trend in households towards savings, given a prolonged crisis situation; (ii) a slower realisation of the reconstruction programme; and (iii) potential structural changes that the pandemic may cause to both Albanian and global economies.

Considering these risks, the Bank of Albania will assess on an ongoing basis the effectiveness of the monetary policy measures to respond in a timely and adequate manner to changes in the economic situation. Our monetary policy will always aim at establishing adequate monetary conditions to support both the economy and inflation converging towards a 3% target.
2. EXTERNAL ENVIRONMENT

The external economic environment improved in 2020 Q3, due to the reopening of economies, though the new restrictions, implemented at the end of year, fed a slowing of this pace. Risks to economic growth are on the downside, but are expected to ease following the start of the vaccination process. Inflationary pressures across foreign countries are expected to remain low, providing minimum support to the increase of prices in Albania. Interest rates in financial markets remain at minimum and stable levels, and the sentiment of investors has improved, supporting financing in foreign economies.

2.1. ECONOMIC GROWTH

Global economic activity improved in 2020 Q3, broadly affected by the lift of containment measures across the majority of countries. An economic rebound in advanced countries was supported by an increase in consumer spending, which was fuelled by government aid packages. Developing countries have benefited from the return of trade activity and private investments.

Indirect data from more frequent indicators suggest that economic activity has continued to improve in the fourth quarter, while the services and production sectors have performed positively. In developing countries in the Far East, particularly in China, where Covid-19 spread is reported as contained, private investments have been rising. The increase in the number of infections in the advanced western countries, in addition to the containment measures for preventing the spread of the pandemic, have decelerated the pace of economic growth in these countries.

Economic activity in large and developing economies is expected to shrink in 2020 and grow positively in 2021. In line with slow economic recovery, inflation rates are expected to remain low. Risks to forecasts remain on the downside, but appear somewhat lower than in the previous period, due to the start of the vaccination process across many countries. Commodities prices in global markets trended upwards in 2020 H2. Expectations on commodities

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Chart 1
Global economic activity improved in the fourth quarter, but still remains below pre-pandemic levels

![Global Economic Activity Chart](chart1.png)

Note: Annual GDP growth. Source: Respective statistical institutes.
prices in the short run are characterised by uncertainty, which derives from the evolution of the pandemic and the measures in place to contain it.

**EURO AREA ECONOMY**

The Euro area economy grew at a fast quarterly pace in the third quarter, following the lifting of restrictive measures across many countries. Consumer spending, investments and exports supported this positive performance. Nevertheless, economic activity contracted compared with a year earlier. Governments of member states and the European Commission undertook a set of fiscal measures, which helped in mitigating the impact of the pandemic on the economy. Preliminary estimates for the fourth quarter suggest another slowdown in the economy in the fourth quarter, due to the reinstatement of containment measures, though these are easier than those undertaken in the second quarter.

Inflation in the Euro area stood at -0.3% in the three months of the fourth quarter, reflecting low pricing of commodities and weak consumption. Core inflation also stood unchanged, and at low rates close to zero.

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

**REGIONAL ECONOMIES**

Regional countries also suffered the effects of the pandemic and restrictive measures. All countries in the Western Balkans have recorded a contraction of economic activity in the third quarter, reflected in all components of demand.

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2 Main trading partners outside the European Union (Kosovo, North Macedonia, Serbia, Turkey).
Indirect data show a slight improvement in the fourth quarter, but below pre-pandemic levels.

Table 1 Economic indicator for countries in the region

<table>
<thead>
<tr>
<th>Country</th>
<th>Annual change of GDP 2020 Q3</th>
<th>Annual change of GDP 2020 Q4</th>
<th>Annual inflation 2020 Q3</th>
<th>Annual inflation 2020 Q4</th>
<th>Unemployment 2020 Q3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Italy</td>
<td>-18.0</td>
<td>-0.2</td>
<td>-0.4</td>
<td>8.9*</td>
<td></td>
</tr>
<tr>
<td>Greece</td>
<td>-14.2</td>
<td>-11.7</td>
<td>-2.2</td>
<td>16.7**</td>
<td></td>
</tr>
<tr>
<td>North Macedonia</td>
<td>-14.9</td>
<td>-3.3</td>
<td>1.6</td>
<td>22.2</td>
<td></td>
</tr>
<tr>
<td>Serbia</td>
<td>-6.3</td>
<td>-1.4</td>
<td>1.9</td>
<td>1.6</td>
<td></td>
</tr>
<tr>
<td>Kosovo</td>
<td>-9.3</td>
<td>-7.3</td>
<td>-0.3</td>
<td>-0.3</td>
<td></td>
</tr>
<tr>
<td>Albania</td>
<td>-10.2</td>
<td>-3.5</td>
<td>1.4</td>
<td>1.6</td>
<td></td>
</tr>
</tbody>
</table>


Inflation rates increased at the end of the year, reflected in a rise in food prices. Financial institutions forecast an economic contraction in 2020 and improvement in 2021 across the Western Balkans3.

2.2. COMMODITY PRICES IN GLOBAL MARKETS

With the spread of the pandemic, a fall in demand drove a fall in commodity prices in global markets. The sharp drop recorded in oil prices in the first quarter dictated its performance throughout the year. The price of Brent crude oil reached $50 a barrel in December 2020. Although jumping in quarterly terms, this level settles around 25.7% below the same period in the previous year. The effect of weak oil demand, due to reduced economic activity, has exceeded the decline in global supply. The reduction of supply and improvement of demand for investments, in the following period, are expected to drive an increase in oil prices in 20214.

The fall in oil prices was reflected only marginally in the domestic market, showing a low pass through and a lag in time.

Chart 3

Main indices have pursued an upward path in the second half of the year

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

Notes: Commodity prices index, 2015 = 100.

Notes: Domestic oil price calculated from CPI basket.
Source: INSTAT, staff estimates.

3 Consensus Forecast, December 2020.
4 US Energy Information Administration, Short term energy Outlook, January 2021.
Price indices of other groups have pursued a downward trajectory in the second half of 2020, reaching a double-digit increase in annual terms, in the last months of year. Normalisation of the situation and the reactivation of production in China were reflected in an increase in industrial metal prices. The increase in metal prices may trigger positive effects in the export of domestic metal.

2.3. GLOBAL FINANCIAL MARKETS

Financial conditions in international markets remain eased and favour the growth of lending and support to economies. The simulating policies implemented by central banks continue to be the main supportive factor for controlling risks in financial markets.

In addition to cutting policy rates, central banks have undertaken programmes to supply long-term liquidity to banking systems, liquidity to primary markets, and foreign currency through swap agreements. In some cases they have established programmes for supporting companies with liquidity. In December, the European Central Bank decided to further recalibrate the use of these instruments aiming at increasing the monetary stimulus to the economy. The monetary policy stance in the Euro area will continue to remain accommodative for a long time.\(^5\) The position of small European central banks remains on the accommodative side, where some of them have implemented non-conventional instruments in addition to the policy rate.

Expectations for support with liquidity from central banks have maintained interest rates in the Euro area at low levels. Yields on government bonds decreased further in 2020 Q4. Conditions for providing financing to the private sector

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\(^5\) ECB press conference, January 2021
improved, as evidenced in the narrowing of spreads in securities issued by private companies. Nevertheless, these spreads remain higher than in the pre-pandemic period. Indexes of stocks increased at the end of the year, showing an improvement in both companies’ income and investors’ sentiment.
3. FINANCIAL MARKETS AND LENDING CONDITIONS

Financial markets were calm in the fourth quarter. Trading volumes and risk premia in financial markets appeared within normal parameters, while the exchange rate was stable. Although yields on government securities trended upwards, reflecting public borrowing, interest rates on loans to the private sector remain low. This has enabled a stable growth of credit to Albanian enterprises and households, helping them to face the shock and establishing the premises for economic growth in the future.

3.1. DOMESTIC FINANCIAL MARKET

Interest rates in the interbank market remained stable in 2020 Q4, reflecting both the Bank of Albania’s operational strategy of liquidity injection, and the stable position of the banking sector’s balance sheet. Deviations from the policy rate and their fluctuation have maintained minimum values, meeting the operational target of the monetary policy and supporting the monetary policy transmission mechanism. Also, trading volumes remained at average levels following the previous quarter. The Bank of Albania has continued its policy on supplying unlimited quantities of liquidity, through one-week repo. The injected liquidity has been decreasing since October, but the ratio of weekly injections to long-term injections (up to three months) has remained almost unchanged.

The foreign exchange market appeared relatively calm during the last quarter of 2020. This market is characterised by trading within the normal parameters.

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**Chart 5**

- **Liquidity situation of banks improved during the fourth quarter**
- **Interest rates in the interbank market remain anchored close to the policy rate**

Note: Daily performance of liquidity supplied by the Bank of Albania through one-week and 1-3 month repo and traded volume by banks in the money market. Source: Bank of Albania

Note: Data show the daily performance of interest rates in the interbank market. Source: Bank of Albania
of foreign currencies, a slight seasonal appreciation of lek against euro, and a strong appreciation of the lek against the US dollar. The euro/lek exchange rate was 124.6 lek/euro in October, standing close to its average since May. In November and December, it dropped to 123.8 lek/euro and 123.5 lek/euro, respectively. This performance was in line with seasonal behaviour, but the seasonality appeared weaker than in the previous years. Trading parameters for European currency in the domestic market appear stable, the volatility indicator and the quotation spread have ended close to their normal values. At the same time, daily volatilities of the exchange rate were almost two-sided, showing a balancing of agents’ positions for purchase and sale in the market. In December, Lek appreciated strongly against the US dollar, reflecting US dollar depreciation against the Euro in the international market. The usd/lek exchange rate averaged ALL 101.6 during this month, from ALL 105.0 in the period August - November. The exchange rate has not experienced considerable changes in the first weeks of January.

Yields on Government debt securities have been increasing since November 2020, reflecting a higher demand from Government for financing. The growth was more present in short-term and medium-term segments - 12-month to 2-year maturities - and more contained in other maturities. In the last auction of January, the 12-month yield increased to 1.99% from 1.73% in October. In the same time horizon, the 2-year yield increased to 2.63% from 2.44%. Meanwhile, the increase in 3.5-, 7-year maturities was lower, 0.13 percentage point on average. The 10-year yield remains stable over almost two years.6

* 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 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 the auction of January, it stood at 5.38%, equal to its last two-year average.
The bid/ask ratio on government securities has been fluctuating throughout the last year, driving a volatility of yields as well. In January, the noted increase in 12-month and 2-year yields reflects a fall in demand/supply ratio for funds in the conducted auctions. The 10-year bond is an exception to this behaviour. In its auction, the demand of inventors was systematically high, maintaining the yield at minimum levels over the last few years. The dynamic in the last months has shifted the yields curve upward, pronouncing its convex shape on medium-term maturities compared with the previous year.

3.2. LENDING CONDITIONS

The lending activity of banks has improved during 2020 Q4, despite the mitigated effect of stimulating measures. The average annual growth rate of 6.8% in 2020 Q4 is close to the average of 2020 and that of the previous year. The expansion by ALL 14 billion of loans to the private sector, in December, has provided a particular impact on this performance. This value was also affected by a specific loan. However, even excluding this loan, the growth in 2020 Q4 is the highest in recent years, showing the active role of banks in supporting the economy.

The good credit performance in 2020 Q4 was supported by loans to enterprises, whose portfolio grew on average by 7.2% in annual terms. This expansion reflected improvement of the growth rates of loans for investments (at 10.7%) and the slowdown of loans for liquidity (at 2.8%)7.

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7 The expansion of loans for investments is particularly affected by a specific loan in December. The granting of this loan in foreign currency has affected the rebound of loans denominated in foreign currency. Loans denominated in lek maintained the same growth rate as in the third quarter, at 10.8%.
Loans to households have also improved. The annual growth rate of 5.8% is slightly higher than in the previous quarter. Loans for house purchase continue to provide the main contribution in this expansion, with an average annual growth rate of 7.3%. This growth stands at similar levels to growth rates throughout the year. Consumer loans continued to increase at 2.2% on average, but their growth rates remain significantly lower than in the beginning of the year, in response to both weak consumption and heightened uncertainty from the pandemic.

Despite the slight increase in the enterprises segment, interest rates of loans in lek supported growth in lending. The average interest rate for new loans to enterprises was 5.6% in 2020 Q4, up from 5.1% and 5.3%, respectively, in 2020 Q2 and 2020 Q3. The increase in interest rates was registered for all types of credit by size and was also observed in most banks in the system, reflecting as well the gradual completion of the impact of sovereign

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**Chart 8**

The growth of credit to the private sector in 2020 Q4 is driven by the expansion of loans to enterprises

![Chart showing the growth of credit to the private sector in 2020 Q4](image)

**Notes:** The data represent annual changes in % of credit to the private sector according to economic agents. This data are adjusted for written off loans and exchange rate fluctuations.

*Source: Bank of Albania.*

**Chart 9**

The interest rate on loans in lek increased for enterprises and remained stable for households

![Chart showing the interest rate on loans in lek](image)

**Notes:** The data indicate the monthly interest rates of new loans in lek in %, 6-months moving average.

*Source: Bank of Albania.*

2020 Q4 is characterized by higher interest rates for loans to enterprises in euro

![Chart showing interest rates for loans to enterprises in euro](image)

**Notes:** The data indicate the monthly interest rates of new loans in euro in %, 6-months moving average.

*Source: Bank of Albania.*
guarantee schemes. However, in reflection of the accommodative monetary policy, interest rates remain lower than the level of 2019. Interest rates for loans to households continued to be favourable during 2020 Q4 as well. Interest rates on mortgage loans decreased to 4.2% from 4.5% in the previous three quarters. The interest rate for consumer loans ended at 8.3%, confirming its stability throughout the year.

Interest rates on loans to enterprises in euro increased in 2020 Q4. They registered 5.7% in this quarter, up from 5.1% in the 2020 Q3, and 5.4% in 2020 H1. For households, they remained stable at 4.1% as in the previous quarters of the year. The interest rate differential between new loans in lek and those in euro has remained minimal for loans to enterprises and mortgage loans.

**BOX: CREDIT STANDARDS AND DEMAND FOR LOANS 2020 Q4**

Banks tightened credit standards, terms and conditions on loans to enterprises in 2020 Q4. The prolongation of the global pandemic and the uncertainties it poses for economic recovery have heightened banks’ concerns about the solvency or current state of enterprises and their future prospects. These developments have made banks more prudent in terms of risk tolerance and for granting new loans to enterprises. These factors have led to the highest negative balance value for credit standards to enterprises since 2009 Q1, and further easing of lending terms and conditions. The tightening of terms and conditions on loans for enterprises was reached due to the granting of loans with smaller size than enterprises’ demand, as well as through the application of higher margins on loans for this segment.

The exception is April, when the interest rate on consumer credit was considerably lower (5.3%), affected by loans granted by a bank in the system.
For households, supply conditions eased in 2020 Q4, both for credit standards, terms and conditions for their granting. This approach of banks to lending to households, for two quarters now, is determined by the indicators related to the perceived risk to households and banks’ tolerance to this risk. Banks have eased lending conditions on loans to households by providing them a longer maturity for the required loan. On the other hand, loan demand continues to be perceived as low, by both enterprises and households.

The decline in loan demand for five consecutive quarters, from the point of view of banks, is driven by the higher perceived risk for the macro-economic situation in Albania and its prospects.

Total stock of deposit recorded a stable annual growth, at around 7%, on average, similar to the 6.8% rate of the previous quarter. The expansion was driven by the growth of deposits in lek. Their stock registered an average annual increase of around 8.7%, reflecting the expansion of credit to the private sector in lek, as well as enhanced activity of the government during this period. Deposits in foreign currency also increased, at around 5.3% y.o.y, close to the average of 2020 Q3. The total stock of deposits increased by around ALL 36 billion in the last quarter, concentrated mostly in December. The performance of deposits, during this period, evidences the high growth of deposits by enterprises in lek, in reflection of a seasonal increase in their activity at the end of the year, as well as payments related to the government’s activity in this period. Households’ deposits also recorded significant growth, supported, among other things, by seasonal foreign currency flows.

Notes: The data represent annual changes in % of monetary deposits and time deposits with over two years maturity. Source: Bank of Albania.

Notes: The data represent the annual contribution in % of deposits by currency and economic agents. Source: Bank of Albania.
The time structure of deposits continues to reflect the preference for keeping monetary assets in liquid form. Demand deposits accounted for around 51.8% of the total stock of deposits in the banking system, or around 1.6 percentage points higher than at the end of the previous quarter. Meanwhile, time deposits with maturity over two years recorded a contraction of their share of the total by around 0.3 percentage points in the same period, accounting for around 13.1% of the total stock. This performance was driven by a decrease in interest rates for this category and increased uncertainty. Interest rates on deposits’ in lek declined further, at an average of 0.54% in 2020 Q4, due to lower interest rates for long-term deposits.
4. ECONOMIC GROWTH

Economic activity recorded a slight contraction in 2020 Q3. GDP decreased by 3.5%, recording a gradual recovery after the alleviation of anti-Covid measures. The slight decline of uncertainty and the relative improvement in confidence curbed the downward dynamic of private consumption and helped an increase of investments. Also, the performance of exports slightly improved, although their dynamic is conditioned by the weakness of foreign demand. Available quantitative and qualitative indicators are in line with our assessments for a continuation of economic recovery in 2020 Q4. However, the rebound in economic activity remains fragile in the short run.

4.1. GROSS DOMESTIC PRODUCT

GDP decreased by 3.5% in 2020 Q3, improving against the contraction of 10.2% in the previous quarter. Mitigation of the impact of the pandemic was reflected both in the activity of the production sector and in halting of the decline of the services sector. Their contributions to the annual performance of economic activity resulted at +0.8 and -3.2 percentage points, respectively (Chart 11, left).

An increase of 2.2% of value added to the production sector in 2020 Q3 was driven mainly by the expansion of construction activity, whose contribution to GDP
was 0.7 percentage points. The positive performance of construction is estimated to be supported by a higher volume of new construction and engineering works. The activities of industry, energy and water also stopped their downward trend, although the positive impact on GDP was low (around 0.1 percentage points). Their developments reflected reactivation of the manufacturing industry, under the impact of the respective exports\(^9\), the increase of value added by electrical energy. Their contributions to GDP were 0.1 and 0.6 percentage points, respectively. Meanwhile, the value added of agriculture, forestry and fishing was almost equal to the level recorded in the previous year.

The services sector mitigated significantly the downward pace of value added in 2020 Q3, at 6.3% from 15.1% in the previous quarter. The branch “Trade, transportation, accommodation and food services”, although with a negative contribution of 2.4 percentage points to GDP, was the main contributor to the slowdown of the economic fall. Its performance was affected by the improvement of trade activity. Among service activities, “Real estate” and “Public administration, education and healthcare” were the branches that supported GDP upwards by 0.5 and 0.3 percentage points, respectively. The other services branches curbed the downward performance, but continued to generate negative contributions to overall GDP performance.

The economy is expected to continue the trend towards recovery in 2020 Q4. The increase in both economic sentiment indicators and the production capacity utilisation rate provides the first signal of a gradual normalisation of economic activity (Chart 11, right). However, these indicators remain below their respective historical averages and below pre-pandemic levels, confirming our expectations for a continuation of weak economic performance in 2020 Q4. Also, indirect quantitative indicators - movement of foreign citizens and transport of passengers, in October and November, as well as exports of products related to industry - are in line with these expectations. Meanwhile, positive developments in the construction sector are expected to be supported by the utilisation rate of production capacities in construction which are higher than the historical average, an upward trend in construction permits, as well as continuation of the implementation of the re-construction programme.

4.2. AGGREGATE DEMAND

Aggregate demand contracted in annual terms in 2020 Q3, with negative contributions from both the domestic and the foreign component. This negative impact was driven mainly by foreign demand (-8.9 percentage points). Domestic demand also had a negative impact, but considerably lower compared to the previous quarter. Domestic demand recovered faster than foreign demand compared to 2020 Q2 (Chart 12).

\(^9\) The improvement of the performance was also affected by the increase of exports related to the output of metal products, rubber, plastic, as well as the slowdown of the decline in exports of textiles, clothing, leather and footwear.
Domestic demand declined by 2.1%, in annual terms, in 2020 Q3, a more mitigated fall compared to the previous quarter (-7.9%). This development was driven mainly by a decline of 3.9% in population consumption. Meanwhile, investments expanded by 4.1%, in annual terms, reflecting the growth of public investments (Chart 13).

Private consumption slowed down the decline in 2020 Q3 at -3.9%, after a sharp fall of 8% in 2020 Q2. Easing of restrictive measures and a decrease in uncertainty affected the recovery of long-term goods and services consumption 10 (Chart 14, right). The impact of the pandemic had a mitigating effect on short-term spending. The retail trade index of food commodities continued towards an annual increase in 2020 Q3 as well.

Continuation of high uncertainty and a decline in disposable income are the main factors that impeded the complete recovery of private consumption in 2020 Q3 (Chart 14, left). On the other hand, the growth of remittances and consumer loans supported financing sources of consumption in this quarter.

Various indirect indicators suggest that recovery of private consumption has continued in 2020 Q4, but remains below the pre-pandemic level (Chart 15, left). Automobile imports, which returned upward in 2020 Q2, accelerated its annual growth in October and November. Import of goods for consumption

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10 Analysis of the performance of the component categories of private consumption is based on retail trade indirect indicators, value added by sectors, and survey indicators.
increased by 6.1%, on average, during October and November, compared with the same period in the previous year.

Monthly data from households’ card purchases suggest that the recovery of consumer spending will continue in 2020 Q4, but at a slower pace (Chart 15, right). In line with these quantitative indicators, qualitative indicators from surveys indicate a strengthening of confidence in the services and trade sectors (Chart 15, left).

Total investments grew to 4.1% in 2020 Q3, for the first time after four quarters of trending downward (Chart 16). This component had a positive contribution of 0.9 percentage points to aggregate demand. The return of investments to positive territory reflected the growth of capital public expenditure, while private investments are expected to move downward for 2020 Q3. The growth
of total investments is driven by an increase in the investments for both construction and for machinery and equipment. The annual growth of value added in construction and imports of capital goods were 8.7% and 12.3%, respectively, in 2020 Q3.

Preliminary quantitative indicators and results from surveys suggest that the component of investments will continue to contribute positively to economic growth in 2020 Q4. Growth of the capacity utilisation rate, particularly in the production sector, was the driving factor in the decision-making of enterprises for new investments (Chart 17, left). Import of capital goods and materials used in construction recorded an increase, suggesting an expansion of investment in both these categories (Chart 17, right). Also, the value of granted construction permits, as a preliminary indicator of construction investments, increased gradually during the first 9-months.

Fiscal policy has been stimulating throughout 2020. In line with global experience, fiscal deficit and public debt of Albania have increased significantly throughout 2020, to mitigate the shock suffered by the Albanian economy from the global pandemic Covid-19 as well as the earthquake in the previous year. The budget deficit increased to 5% of GDP by the end of November and public debt to 79.3% by the end of the 9-month period. In terms of GDP, debt increased by 13.1 percentage points from the end of 2019, reflecting an expansion of the deficit, the issuing of sovereign guarantees as well as the impact of the contraction of the Gross Domestic Product.
The reaction of fiscal policy in mitigating the negative impacts caused by the pandemic, appeared in two forms: (i) direct, through transfers to households, exemptions and deferrals of tax obligations for enterprises, as well as in the form of increasing expenditure to cover the immediate needs of healthcare to face the pandemic; (ii) indirect, through the issuing of sovereign guarantees in support of a partial addressing of enterprises’ worsening balance sheets. These supportive measures, together with the action of automatic stabilizers\(^{11}\), as well as the continuation of the re-construction programme brought an annual expansion of 3.6 percentage points of the primary deficit to GDP by the end of November 2020. This value represents the highest level of fiscal impulse estimated over years.

Budget expenditure expanded by around 3.4% in annual terms in October and November, an increase significantly below the level of the previous quarter (13.2%). However, the structure of the increase of expenditure in 2020 Q3 and Q4 remained the same, based mainly in the expansion of public investments. The support of the fiscal authority to the economy in 2020 H2, differently from H1, was manifested in an increase in public investments, among other things destined to the re-construction of houses and infrastructure damaged by the earthquake. In 2020 H1 the increase of expenditure was driven entirely by direct transfers of the government to households, which are assessed at 1% of GDP up to the end of November.

In view of information available, the fiscal sector is expected to continue to support domestic demand in the form of increasing fixed capital.

\(^{11}\) Automatic stabilizers in this case mean the expansion of the deficit from the decline of income, due to the worsening of economic activity, and the increase of public expenditure due to the increase of unemployment.
Revenues continued to contract in October and November as well, by 3.3% in annual terms. For the first 11-months of the year revenue contraction declined at 9.1%, from the maximum of 14.8% at the end of the first 5-months of the year.

Revenues performance improved in 2020 Q4, based on signals transmitted by the performance of VAT and excise revenues. However, their positive contribution has not been sufficient to mitigate the negative impact from the non-tax component and items related to profit tax and personal income tax. The last two items have continuously contributed negatively to total revenues for 2020, reflecting the government’s easing measures to defer and exempt tax obligations. Also they reflect the basis impact of the previous year for personal income, due to the fiscal measure related to the allocation of dis carried on throughout the years.
The budget deficit for the 11-months was ALL 72.7 billion, the highest in several years in absolute terms. Just in October and November the deficit expanded by ALL 13.3 billion. Part of this was financed by the issuing of securities in the primary market. A rapid increase in borrowing in the previous quarter created pressures for the increase of interest rates in the primary market. The main buyers of domestic public debt remain commercial banks.

On the other hand, foreign currency liquidity surpluses created during 2020 H1, from the issuing of the Eurobond and funds in the form of budget support from international organisations, was used to pay interests and settle the foreign debt.\(^\text{12}\)

\textbf{Net exports had a negative impact on economic growth during 2020 Q3.} The trade deficit in goods and services expanded by 8.9% in real annual terms (Chart 22). The defining factor has been the decline of exports by 31.7%, with the main impact coming from a fall in the exports of services by 36.1%. Also, the export of goods decreased by 9.8%. On the other hand, the annual decline of imports was 23.9% with the main impact coming from a decrease in the imports of services by 52.5%. At the same time, the decline in the import of goods resulted at 5.5%\(^\text{13}\).

Data on foreign trade of goods in 2020 Q4 show a growth, in annual terms, in both exports and imports.
These increases reflect a continued recovery in trade activity compared to the previous quarters of 2020. The values of increased exports and imports have been similar in absolute terms, but the higher share of imports in the trade balance has driven the latter to expand by 5.2%.

Exports of goods grew by 4.9% in annual terms (Chart 23, left). This growth was mainly dictated by the category “Construction materials and metals”. The increase of export in this category reflects the recovery of the demand and international industrial metal prices, during the fourth quarter. The categories “Machinery, equipment and spare parts” and “Food, beverages, tobacco” also made considerable positive contributions. The main negative contribution came from the category “Minerals, fuels, electricity,” which has continued to reflect a sluggish recovery in the international trade of fuels. The main positive contributions come from the category of “Minerals, construction and metals,” reflecting primarily developments in construction activity in Albania and signalling its continued regeneration.

Imports of goods grew by 5.1% in annual terms (Chart 23, right). The main positive contributions came from the categories “Machinery, equipment and spare parts” and “Construction materials and metals”, mainly reflecting developments in construction activity in Albania and signalling its continuing revitalisation. Like imports, the main negative contribution came from the sub-category related to fuels, reflecting primarily a weak recovery in the activities of transport.

In terms of main trading partners, exports to Kosovo, Germany and Turkey grew during this quarter. Negative contributions to exports have come from Spain and Switzerland. In the case of imports, Kosovo, Italy and Serbia have made the main positive contributions, while imports from Turkey have decreased.
5. INFLATION, PRICES AND COSTS IN THE ECONOMY

Average inflation resulted at 1.6% in the fourth quarter, up by 0.2 percentage points compared with the previous quarter. The increase in inflation was due to higher average contributions from the “unprocessed foods” category. In 2021, inflation is expected to trend upwards as a result of expectations for increased domestic and external inflationary pressures. However, during 2021, inflation is expected to remain below target, returning towards target during the second half of 2022.

5.1. CONSUMER PRICES

Annual inflation averaged 1.6%, in 2020 Q4, up by 0.2 percentage points compared with the previous quarter. During this quarter, prices have shown high volatility and unusual seasonal behaviour. The inflation gap remains negative\(^\text{14}\), and has deepened further during the last month of the year (Chart 24, left). The higher inflation reflects the temporary effects of demand-side shocks caused by the pandemic, appearing in the form of upward base effects. Also, foreign inflation has continued to fluctuate in low and negative values (Chart 24, right), by keeping weak foreign inflationary pressures on the economy.

\(^{14}\) The inflation gap is calculated as the difference between factual and target annual inflation of BoA (around 3%). The gap is negative when inflation is below the target.
Food prices, which are mostly part of tradable goods inflation, experienced high fluctuations during the fourth quarter (Chart 25 and Table 2). Food categories contributed 90% to the total inflation, with “unprocessed foods” playing a primary role. The difference in contributions was due primarily to inflation development in the sub-categories of “fruits” and “vegetables”, which increased unusually in October\(^{15}\). During November-December 2020 the replacement of restrictive measures on bar and restaurant services affected a fall in demand for unprocessed foods, from a supply oriented towards a typical higher demand at the end of the year. This drove to a disequilibrium between demand and supply for these goods, reflecting a deflationary development which peaked with low inflation in December (1.1%). Seasonal increase of intensity in terms of prices for this category was quite weak\(^{16}\). Meanwhile, the category of “unprocessed foods” maintained a steady positive contribution in the last quarters of the year. In contrast, the sharp drop in oil prices continues to affect inflation (Chart 25, Table 2).

Prices of other more stable components of inflation, such as: services, housing and consumer durable goods made an increased contribution from the previous quarter. This increase in contribution was caused by prices in the category of services—part of non-tradeable inflation—particularly due to the effect of the low comparative base in air transport services of the previous year\(^{17}\). Meanwhile, the contribution of the category “regulated prices” has remained negligible.

\(^{15}\) During October months the difference recorded negative values, while in October of this year the moving trend is positive (+1.5%).

\(^{16}\) Monthly inflation of “Unprocessed foods” in the month of December was 1.6%, relative to 5.0% from last year. This movement in prices for this category lowered the contribution of this category by 0.5 percentage points.

\(^{17}\) In October an increasing base effect was verified, due to an obvious fall in the prices of air transport services. Thus, the monthly inflation of services of this transport was -14.4%, while in October of this year it resulted around -4.5%. This effect extended throughout the next two months of the quarter.
Table 2: Contribution of main categories to annual inflation (in percentage points)*

<table>
<thead>
<tr>
<th>Category</th>
<th>Q1'18</th>
<th>Q2'18</th>
<th>Q3'18</th>
<th>Q4'18</th>
<th>Q1'19</th>
<th>Q2'19</th>
<th>Q3'19</th>
<th>Q4'19</th>
<th>Q1'20</th>
<th>Q2'20</th>
<th>Q3'20</th>
<th>Q4'20</th>
<th>Inf Q4 '20 (%)</th>
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<tbody>
<tr>
<td>Processed foods</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.3</td>
<td>0.3</td>
<td>0.4</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>1.9</td>
</tr>
<tr>
<td>Bread and corn</td>
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<td>0.0</td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.1</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>2.0</td>
</tr>
<tr>
<td>Unprocessed foods</td>
<td>0.9</td>
<td>1.1</td>
<td>1.0</td>
<td>0.9</td>
<td>1.3</td>
<td>0.8</td>
<td>0.7</td>
<td>0.8</td>
<td>1.2</td>
<td>0.8</td>
<td>1.0</td>
<td>5.8</td>
<td></td>
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<tr>
<td>Fruits</td>
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<td>0.1</td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.3</td>
<td>0.0</td>
<td>0.1</td>
<td>0.4</td>
<td>0.7</td>
<td>0.7</td>
<td>0.5</td>
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<td></td>
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<tr>
<td>Vegetables</td>
<td>0.2</td>
<td>0.9</td>
<td>0.9</td>
<td>1.5</td>
<td>0.8</td>
<td>0.6</td>
<td>0.4</td>
<td>0.2</td>
<td>0.4</td>
<td>0.2</td>
<td>0.6</td>
<td>11.6</td>
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</tr>
<tr>
<td>Services</td>
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<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.0</td>
<td>0.1</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Regulated prices</td>
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<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
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<tr>
<td>Housing (rent)</td>
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<td>0.4</td>
<td>0.4</td>
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<td>0.1</td>
<td>0.2</td>
<td>0.1</td>
<td>0.0</td>
<td>0.2</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>Non-food consumer goods</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.0</td>
<td>0.2</td>
<td>0.0</td>
<td>0.1</td>
<td>1.9</td>
<td></td>
</tr>
<tr>
<td>Fuel</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.0</td>
<td>-0.1</td>
<td>0.0</td>
<td>-0.3</td>
<td>-0.3</td>
<td>-0.4</td>
<td></td>
</tr>
<tr>
<td>Durable consumer goods</td>
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<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>1.2</td>
<td></td>
</tr>
<tr>
<td>Inflation (%)</td>
<td>1.9</td>
<td>2.2</td>
<td>2.2</td>
<td>1.8</td>
<td>1.6</td>
<td>1.4</td>
<td>1.4</td>
<td>1.3</td>
<td>1.6</td>
<td>1.9</td>
<td>1.4</td>
<td>1.6</td>
<td></td>
</tr>
</tbody>
</table>

Source: INSTAT and calculations of the BoA. *The table shows some of the main groups and goods of the categories.

5.2. DETERMINANTS OF INFLATION

Medium-term inflationary pressures, evaluated according to the calculations of domestic and core inflation, remained relatively steady during 2020 Q4. They continued to dominate the formation of headline inflation, although at a slightly lower degree than in the previous quarter (Chart 26, left). This development shows the consequences of weak demand due to high insecurities, in Albania and abroad. Both core inflation and domestic inflation have behaved in the same manner, converging towards 1.3%, with a contribution of 59% to the formation of inflation during the last quarter of 2020. Short-term components showed...
clear fluctuations during the months of the same quarter. These fluctuations determined the slight increase of headline inflation from the previous quarter. The added contributions of non-core and imported inflations by 14 percentage points compared to the previous quarter (Chart 26, right), did not succeed in overcoming internal inflationary pressures, which still remain weak.

The following analyses the main economic determinants of inflation.

Cyclical position. Mitigation of the falling dynamic of aggregate demand contributed to a partial improvement in the cyclical position of the economy, during the third quarter. However, the cyclical situation of the economy remains weak. The scale unemployment rate is at a higher level compared with last year, and the capacity utilization rate is still below the historical average. The latter illustrates the presence of spare capacities in the economy, which curtail the build-up of domestic inflationary pressures (Chart 27).

The capacity utilization rate in the economy was 71.3% in 2020 Q4, or 1.9 percentage points higher than the previous quarter. Enterprises increased the utilization of their capacities in both production and services sectors. Despite the upward trend of the indicator for the second successive quarter, its level remains 2.8 percentage points below the rate recorded in the fourth quarter of 2019, and 2.1 percentage points below the historical average.

Preliminary signals of a gradual continuation of the recovery phase of the cyclical situation of the economy can be seen in an increase in the capacity utilization rate in the economy and improved expectations of enterprises and consumers in relation to employment and unemployment during 2020 Q4. Nonetheless, as recovery of the economy and aggregate demand remain closely connected to the evolution of the pandemic, the build-up of inflationary pressures in the short-term period remains fragile. The fading out of the pandemic effects will drive to a reduction of uncertainty and strengthening of confidence, over the medium-term horizon.

Employment and unemployment. The conditions of the labour market improved during the third quarter, but its recovery remains incomplete. Alleviation of containment measures, the recovery of service activities related to the summer season, and the positive effect of the support of employment programmes, have mitigated the shock to the labour market.

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18 For persons unemployed from 10 March to 23 June, approved in July (Decision of CM no 608 dated 29/07/2020).
Employment in the economy increased by 34,224 persons in Q3, reflecting a rise in employment in services and industry. Nevertheless, the number of employed persons is lower than one year earlier, as 50,035 persons lost their jobs during the first half of 2020.

The increase in employment in the third quarter was accompanied by a decrease of 11.6% in the unemployment rate, from 11.9% in the second quarter. However, this indicator has remained 0.2 percentage points higher than in the same period in the previous year. The economic recovery during Q3 is reflected in a more active labour market, as shown by an increase in the participation indicator in the labour force at 69.8%, up from 68.1% in Q2 (Chart 28).

Gross average monthly wage continued to slow its increase in the third quarter. The indicator rose by 1.8% (0.4% in real terms), after a 2.9% increase (0.9% in real terms) in the previous quarter. The average wage has continued to remain below last year’s level, since the contraction of employment from the pandemic has hit service and industry activities which offer jobs with lower wages than the average wage in the economy. The average wage in the private sector also mitigated the annual growth pace, at 2.2% in nominal terms and 0.8% in real terms. Meanwhile, the average wage in the government sector was around 0.7% higher than one year earlier, in nominal terms, but 0.7% lower in real terms (Chart 29, left).

The unit labour costs slowed down the upward trend in Q3, at 1.1% from 2.4% recorded in the previous quarter. The performance of the indicator
is primarily attributed to the slowdown of the downward trend of labour productivity, following the alleviation of restrictions during 2020 H2 (Chart 29, right). The increase in unit labour cost has been relatively lower in the services sector\textsuperscript{25}, which remains closely related to consumer spending, being transmitted in the weakness of domestic inflationary pressures.

**Other output costs** during 2020 Q3 continued to show a performance comparable to Q2. Industrial production prices fell by 4.1\% in annual terms. The contraction of industrial production prices for exports continued at a faster pace (-5.3\%) compared to the decrease of domestic industrial producer prices (-2.7\%). Production costs in the construction sector\textsuperscript{26} were close to the previous year (+0.2\%).

**Imported inflation.** The Imported Inflationary Pressure Index (IIPI)\textsuperscript{27} expanded by 3.7\% in annual terms, during October-November of 2020. This rate accelerated compared to Q3 2020 (1.7\%). This development was dictated by a 7.6\% expansion in the Import Price Index, from 3.6\% in the second quarter of the year. Meanwhile, a higher appreciation of the Nominal Effective Exchange Rate (NEER) at -3.9\% mitigated the increasing effect of foreign prices.

The developments above have resulted in a slight increase of imported inflation during Q4 2022, compared to the previous quarter (Chart 26, right). The additional costs and delays in the transportation of goods across countries, imposed by the restrictions, may continue to affect the increase in import goods

\textsuperscript{25} For those activities covered by short-term statistics.

\textsuperscript{26} Construction cost index for houses includes the prices of construction materials, workforce and other capital expenditures used in the construction of a house with 8-10 floors.

\textsuperscript{27} IIPI is calculated as the annual growth of the imported prices index and the NEER index for the respective month. Correlative analysis of relevant indicators with various time lags shows that IIPI affects inflation component imported from 3-5 months.
prices. The effects of the second round in prices will depend on the performance of restrictive measures at a global level.

The expectations of consumers and financial agents for inflation fell in the fourth quarter. Expectations of enterprises for inflation recorded a slight increase (Chart 31).

After one year, consumers expect inflation to be at 3.4%. Their expectations regarding inflation have been decreasing since Q2 2020. Next year, enterprises expect inflation to be 2.8%, around 0.2 percentage points higher than the previous quarter. In contrast to consumers’ expectations, which are more volatile, enterprises’ expectations are stable. The slight fall in the inflation expectations of financial agents was registered for three reported time horizons. Hence, their expectation for inflation after one, two and three years stands at 2%, 2.2% and 2.5%, respectively, around 0.1 percentage points lower than the expectations reported in Q3.

28 The analysis of inflation expectations is based on the results of the business and consumer confidence survey, as well as on the financial agents’ expectations survey.