

Bank of Albania

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MONETARY POLICY DEPARTMENT

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## INTRODUCTION<sup>1</sup>

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 quantitative 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 transmission mechanism encompasses 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 is also 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.

The Monetary Policy Report is published on a quarterly basis. The Monetary Policy Department at the Bank of Albania compiles this Report and the Supervisory Council approves it. The current report contains data, as of 21 October 2022. The Supervisory Council reviewed and adopted this Report at its meeting on 2 November 2022.

<sup>1</sup> Monetary Policy Documents delineates the monetary policy framework at the Bank of Albania. This Document is available at [https://www.bankofalbania.org/Monetary\\_Policy/Objective\\_and\\_Strategy/](https://www.bankofalbania.org/Monetary_Policy/Objective_and_Strategy/)



## FOREWORD BY THE GOVERNOR

The overall economic environment, domestic and external one, continues to be challenging.

Russia's aggression to Ukraine triggered supply-side shocks - manifested in the form of soaring food, energy and commodity prices, heightened uncertainty and tightened financing conditions – which have driven up inflation and economic activity slowdown globally.

The Albanian economy is increasingly experiencing the effect of these shocks. Despite economic growth remains in positive territory, it has started to exhibit slowdown signs after the first quarter. On the other hand, inflation has progressively picked up during 2022, reaching at 8.1% in September. The increase in international prices pushed up inflation, which has started to be transmitted in the rise of production costs and in inflationary expectations in Albania. For that reason, the surge in prices in Albania seems to be of a broad base and relatively stable.

Against this backdrop, we have embarked on a gradual normalisation process of monetary policy stance, by increasing the policy rate. This process took place also in the meeting of 2 November 2022. The Supervisory Council, after reviewing this Quarterly Monetary Policy Report, decided to raise the policy rate by 0.5 percentage point, to 2.75%.

This normalisation is indispensable to curb the rapid increase of prices, control inflationary pressures and for inflation to return to target. It serves to the concordance with our legal mandate of price stability. In this light, this normalisation aims to: safeguard the overall economic and financial equilibriums in Albania; preserve the value of savings and wages; maintain the purchasing power of households and enterprises; and further grow the social welfare.

Our projections for the future suggest that inflation will return to the target within the first half of 2024. In parallel, the Albanian economy is foreseen to continue to record a positive growth pace, notwithstanding the expected slowdown in the short run. The soundness of private sector's balance sheets, the preservation of a stable banking and financial environment, the continuous lending, and the increase in income from exports will continue to underpin the economic growth. On the other hand, the economic growth will continue to be reflected in further increase of wages and employment in the Albanian economy, thus supporting the Albanian families to dampen shocks from prices.



The Bank of Albania will continue to carefully monitor the economic, monetary and financial developments in both domestic and external environments. Our commitment has been and remains the undertaking of any measure, in a timely manner, necessary to safeguard the economic and monetary stability, as a precondition for a sustainable and long-term growth in Albania.



## 1. INFLATION AND MONETARY POLICY STANCE

*In the third quarter, supply-side shock had a stronger effect in the Albanian economy. In particular, inflationary pressures were strong, broadly-based and persistent, while Albanian economy reflected deceleration signs. The Supervisory Council deemed that the long-term negative consequences of inflation in the economic growth, finances of enterprises and households, and in the uncertainty of economic agents for the future, remain the main concern for the economic and monetary stability of the country and its sustained and long-term growth. For this reason, and based on the conclusions in the Quarterly Monetary Policy Report, as well as on the expectations for the future, the Supervisory Council of the Bank of Albania decided to continue the normalising cycle of monetary policy. The Council deems that this normalisation is necessary to ensure the adequate monetary conditions for controlling inflation and provide a better balance of risks in the economy.*

Global economy growth is decelerating while inflationary pressures continue to be high. War in Ukraine and the continuous production chains and global trade bottlenecks - shocks which push up the costs and curb the output - are being transmitted in high inflation and synchronised slowdown across advanced and emerging economies. Though the increase in prices of certain commodities seems to have exceeded the peak, inflationary pressures remain high and have started to be transmitted in second-wave effects. The build-up inflationary pressures have made central banks raise the policy rate in an aggressive manner, driving to an overall tightening of financing conditions globally. Projections for the future remain subject of uncertainty. In baseline scenario, global inflation is expected to gradually reduce in 2023, while economic growth is expected to remain in positive territory. Nevertheless, the risks to the inflation outlook are on the upside, and to the economic growth outlook are on the downside.

**Supply-side shocks in foreign markets and high uncertainty in them are driving up inflation and pulling down the economic growth in Albania.** Inflation hiked 7.9% in 2022 Q3, from the average 6.7% in the previous quarter. High prices in food and oil continue to provide the main contribution in inflation. In addition, an increasingly broader gamma of products and services are manifesting a rise in prices as well. The stable consumer demand, increased employment and wages and the expectations on high inflation are driving to an expansion of the inflationary pressures base.

**After the considerable growth of economic activity in 2022 Q1, the growth pace slowed down in the second quarter.** The rapid increase in costs and uncertainty in the wake of the war in Ukraine induced a slowdown in exports



and private investments, contraction in public investments and more expensive imports bills. As a result, the economy reduced at 2.2% in 2022 Q2, from 6.5% in 2022 Q1.

**On the other hand, consumer demand was relatively resilient to shocks.** It grew at stable rates in the second quarter as well, supported by the dynamic increase in employment and wages, high levels of savings and the social resistance package. In particular, labour market improved at a rapid pace since the beginning of 2021, recording an increase in employment, fall in unemployment and a rise of wages in the private sector. These improvements support the budget of Albanian households, but they also created premises for more persistent inflationary pressures onward.

**Financing conditions have started to reflect the monetary policy normalisation in response to inflationary pressures build-up.** Financial markets were liquid, with contained risk premia, while the raise of policy rate is being gradually transmitted across market segments. Nevertheless, financial conditions still support the economy. Financing conditions coupled with the increased demand drove to a stable growth of credit to private sector, which in turn has financed consumption and investments of households and enterprises. In the future, the good soundness of banking sector and its willingness for lending establish the premises for continuously funding the economy. In parallel, the positive performance of the lek is absorbing a part of external shocks.

**Economic activity in Albania is expected to expand for the rest of 2022 and in the next year, but at a slower growth momentum.** The high inflation, the weak economy across European partners and the reduced fiscal stimulus are expected to weigh on the aggregate demand. Nevertheless, certain factors will continue to underpin the economic growth. The sound financial balance sheets and the growth of credit are expected to underpin the expansion of consumption and investments. Also, the dynamic labour market is expected to support the budgets of both households in countering the cost-of-living. The tourism, free of pandemic-related containment measures, is expected to maintain the positive trend, in turn supporting the interconnected sectors and the economic growth.

**Inflation is expected to remain high till the beginning of 2023, but it is forecasted to gradually reduce onwards, towards our 3% target.** High inflation rates in the short run will reflect both the impact from global factors - the soaring energy and food prices in global markets - as well as the impact from domestic factors - the increased demand, employment and wages and the high inflationary expectations. On the other hand, the reduction in inflation over 2023, factorises the expected fall in food and oil inflation in global markets, as well as the consequences of the base effect and the stability of commodity prices. At the same time the monetary policy normalisation in Albania will create more accommodative conditions for inflation return to the target in the first half of 2024.



**Assessments on the balance of risks show that risks to the inflation outlook are on the upside, while to the economic growth outlook are on the downside.** A long-lasting war in Ukraine remains a significant risk, with the potential to further push up commodity prices and global inflation, and to drive both European and global economies into a recession. In particular, the escalation in energy prices in Europe heightens the possibilities for higher inflation rates and a slower economic growth in Albania.

**In compliance with the analysis and forecasts introduced in this Report, the Supervisory Council decided to continue the normalisation of monetary policy.** *In the meeting of November 2022, the Supervisory Council decided to raise the key interest rate to 2.75% from 2.25%.* This decision serves to safeguard price stability, which is the main precondition for the monetary and financial stability as well as for a sustained and long-term economic growth of Albania.

**The raise of key interest rate ensures the return of inflation to the target in the medium-term, without jeopardising the perspective of positive economic growth in this horizon.** This movement is consistent with the forecasts in baseline scenario, which show that the economy will continue to grow in the course of the medium-term horizon, and inflation will return to target within a reasonable time framework. In this light, the movement towards monetary policy normalisation provides the best equilibrium between costs and profits in both medium term and long term.

**The Bank of Albania will continue to carefully monitor the situation** to assess the implications to inflation performance and identify the necessary measures, in a timely manner for its effective management. In any case, the Bank of Albania stands ready to take all the necessary measures to guarantee the price stability in Albania.



## 2. EXTERNAL ECONOMIC ENVIRONMENT

*The economic situation in the external market has continued to show signs of a slowdown, reflecting the rising prices of energy, transportation and food, which, in turn, have engendered high inflation rates, heightened uncertainty, and tighter financial conditions in most of the countries.*

*The persistent and high inflationary pressures have forced central banks to tighten the monetary conditions by rising the interest rates and withdrawing the monetary stimuli. The economic performance is expected to remain weak and affected by the repercussion of war and developments impacting the production chains. The contraction of financial conditions is expected to curtail the demand and reduce the inflation rate.*

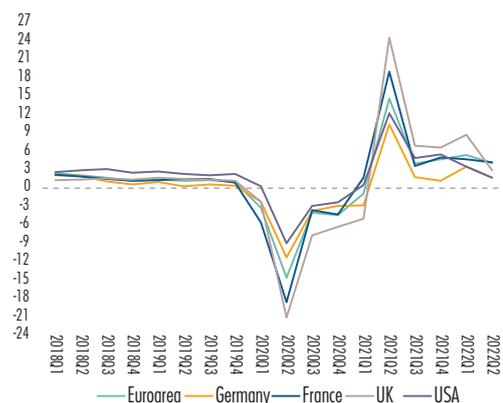
### 2.1. ECONOMIC GROWTH AND INFLATION

The world economy grew at a more moderate pace in 2022 Q3. The economic activity has felt the rising prices, distribution chain bottlenecks, and the tightening of financial conditions. These factors coupled with the heightened uncertainties due to the duration of the war in Ukraine, have caused a fall in consumption and investments. Furthermore, the restriction measures imposed to prevent COVID-19 spread in China, have obstructed the chains of production and trade globally. Thus, highly industrial countries have suffered a sharper economic slowdown. Inflation rates have recorded the highest values in the last decade, lowering purchasing power as a result.

The developments of the war in Ukraine continue to be a telling factor on the performance of economic activity in the short run. Future forecasts show that economic growth will continue to suffer the consequences of the war. Global economic growth will continue to be moderate, remaining below its potential level and appearing as a recession in some countries. Inflation is expected to rise during the current year, as it will also approach its peak. In the succeeding year, it is expected to follow a downward trajectory due to the monetary tightening undertaken by central banks.

Chart 1

*The growth pace of global economic activity has continued to be weak in the second quarter*



Notes: Annual GDP growth.  
Source: Respective statistical institutes.

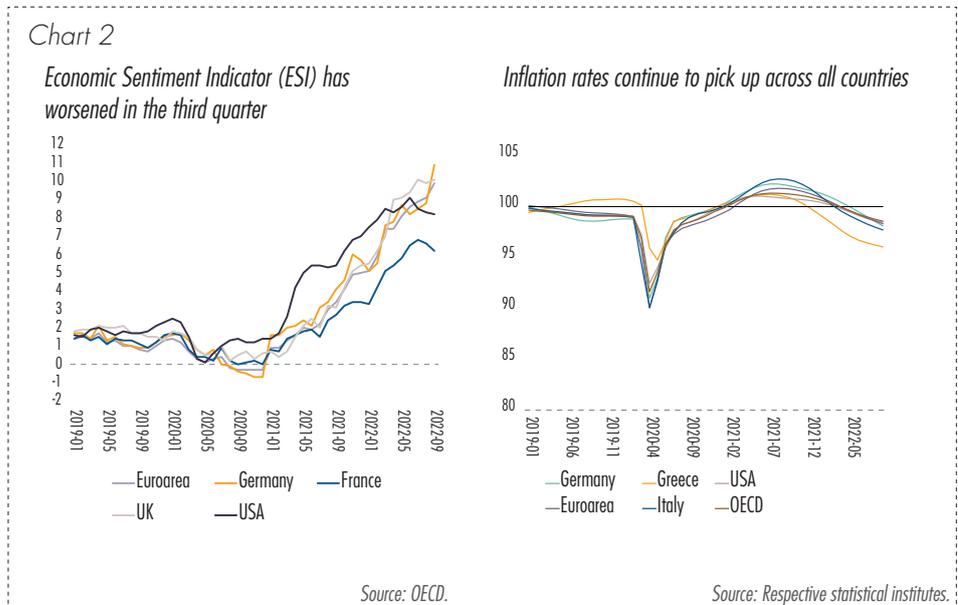


### EURO AREA ECONOMY

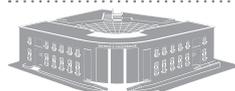
The Euro Area economy decelerated in the second quarter, recording an annual growth of 4.1%, from 5.4% in the previous quarter. Economic growth was underpinned mainly by domestic demand. The expansion of the economic activity reflected the sharp growth in the services sector, which has benefited from the lifting of movement restriction in all Member States. The industrial production sector has been affected by soaring prices of commodities and energy, and production chain issues. Preliminary data for the third quarter suggests that economic activity has decelerated even further.

Unemployment rate continues to be low, recording 6.6% in September. It has remained unchanged compared to the previous month. Inflationary pressures have been present throughout the third quarter. In September, annual inflation recorded 9.9%, impacted in the main by rising prices of energy and food. The joint contribution of these two categories constitutes more than half of total inflation.

Based on the European Central Bank's forecasts<sup>2</sup> economic growth will slow down considerably for the remaining part of 2022, as a result of the war in Ukraine and high energy and commodity prices. Economic growth will decelerate even further in the upcoming year, and will remain low in the medium term. Inflation rate is expected to rise in the first months of 2023, and follow a downward trajectory over the year, remaining, nonetheless, over the 2.0% target of the ECB.



<sup>2</sup> Euro system staff macroeconomic projections, September 2022.



### REGIONAL ECONOMIES<sup>3</sup>

Economic activity in the region has grown at a positive rate in the second quarter of the year. The growth pace has slowed down in all countries, except North Macedonia. Across countries, consumer spending has slowed down; investment performance has varied across countries; whereas government spending have declined, due to the suspension of the COVID-19 support package. In North Macedonia, the reduction in government consumption and spending has been balanced by a strong investment growth.

Inflation rates have recorded double-digit values, the highest during one decade. The region continues to be affected by the war in Ukraine, which has engendered an upsurge in the prices of energy, food, and transportation. Also, core inflation has been upward, demonstrating that inflationary pressures are more persistent in these countries. Inflation rates in the region are expected to continue recording high values until the end of the year, and follow a downward trajectory onwards. Economic performance in the region is expected to continue slowing down even further, due to soaring inflation rates and central banks' monetary policy tightening.

Table 1 Economic indicators for countries in the region

	Annual change of GDP		Annual inflation	Unemployment
	2022 Q1	2022 Q2	September 2022	2022 Q2
Italy	6.3	4.7	9.4	7.8*
Greece	8.0	7.7	12.1	12.0*
North Macedonia	2.4	2.8	18.7	14.5
Serbia, Republic of	4.4	3.9	14.0	8.9
Kosovo	4.9	2.1	12.7	20.5
Albania	6.5	2.2	8.1	11.1

Source: Respective statistical institutes.

\* August 2022.

## 2.2. COMMODITY PRICES IN GLOBAL MARKETS

In 2022 Q3, the increase of commodity prices in global markets have moderated, but they continue to generate high inflationary pressures. This moderation is attributed to a lower demand, but also the stabilisation of supply in some markets. Therefore, the price of Brent oil followed a downward trajectory in the last quarter, reaching around \$90/barrel in September, from \$122.7/barrel in June. It still remains around 20.5% higher than the one recorded in the same month of the previous year. The increase of exports from producing countries and the decrease in demand in developing countries contributed to the downward trend of oil prices. The price is expected to remain close to this level in the short run,<sup>4</sup> but forecasts are sensitive to the latest OPEC+ decision on reducing production.

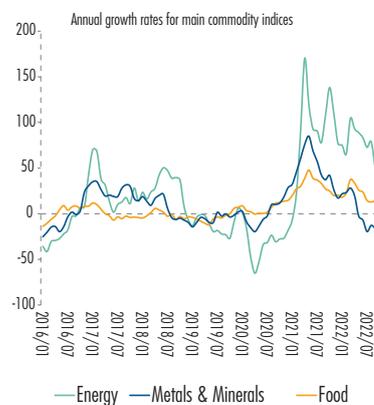
<sup>3</sup> Main trading partners outside the European Union (Kosovo, North Macedonia, Serbia).

<sup>4</sup> US Energy Information Administration, Short term energy Outlook, October 2022.



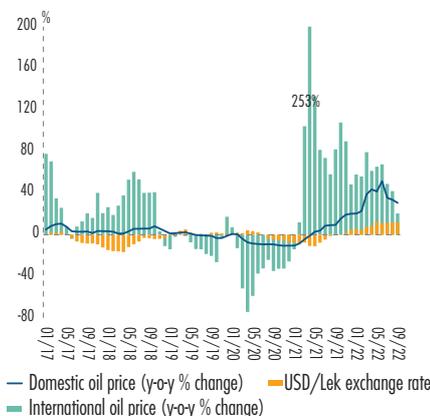
Chart 3

The main indices have embarked on a slower growth rate trajectory



Source: World Bank.

In 2022 Q4, oil price in Albania are rising at a slower pace



Source: INSTAT, staff estimates.

The prices of other commodities have shown a similar behaviour. The food price index has slowed down in the third quarter, but it has recorded an annual double-digit growth. The slower growth rate came as a result of the agreement reached to allow the produced grain to pass through the area that is under conflict in Ukraine. The metal price index shrank in the past five months in annual terms, reflecting the decrease in demand in China, and expectations of a lower demand in the future. The price of electricity has continued to rise, reaching around 390.3 Euro/MWh in the Hungarian Stock Exchange in September, with an annual growth rate of 190%.

### 2.3. GLOBAL FINANCIAL MARKETS

The financial conditions in international markets have tightened significantly, given the heightened economic and geopolitical uncertainties. Central banks will continue the monetary policy normalisation at a faster pace due to the rising inflation and the uncertain perspective regarding prices. Markets have experienced volatility, reduced liquidity, rising interest rates, and higher risk premia.

In congruence to their mandates, central banks have shown determination in putting breaks on the rising inflation, despite the economic costs in the short run. The large central banks have increased interest rates successively, and they have also reduced the monetary stimulus injected through market purchases. The upward trajectory of interest rates has been stronger than initial market expectations and varying between banks. As a result interest rates and exchange rates have experienced increased volatility. Since July, the European Central

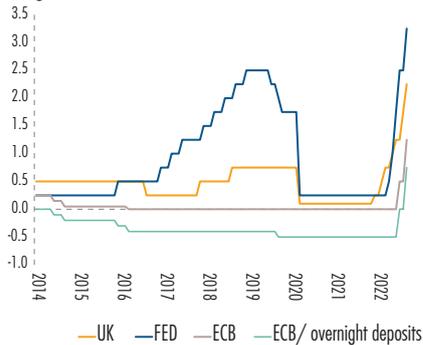


Bank increased the key interest rate by 0.75 percentage point, to 1.25%<sup>5</sup>; the Fed also increased it by 0.75 percentage point, to 3.25%; the Bank of England has raised the key interest rate twice by 0.5 percentage point each time, bringing it to 2.25%. Central banks' communication has emphasized the high uncertainties regarding the expected performance of inflation and economic activity, and the monetary policy pertinent to this performance. These uncertainties have been transmitted in additional financial market volatility.

Yields on sovereign securities have increased significantly, reflecting both the tightened monetary conditions as well as the risk premia related to a higher public debt burden. The financing cost of the private sector have contracted, factoring both the rising key interest rate of central banks as well as the weak prospect on the economic activity.

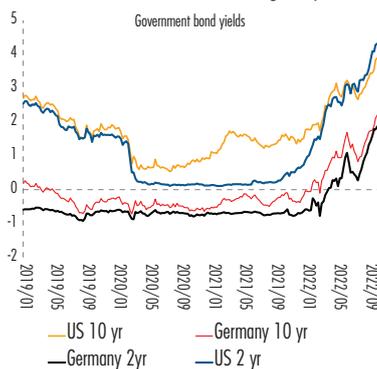
Chart 4

*The high and continuous inflation rates have led central banks to increase the interest rates in a persistent and non-gradual manner*



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

*The contraction of the monetary policy has engendered higher yields. Expectations for the slowdown of the economy in the future were reflected in flattening the yield curve*



Notes: 2- and 10-Year yields on government bonds.  
Source: Investment.

<sup>5</sup> The ECB will convene in 27 October, where the key interest rate is expected to increase. The report will be updated in accordance with the new decision.



### 3. FINANCIAL MARKETS AND LENDING CONDITIONS

The domestic financial market is characterised by rising interest rates, following the monetary policy normalisation cycle in Albania and across the world. Reflecting market expectations on future monetary policy reactions, the increase of interest rates have surpassed the increase of policy rate in the primary market of government securities. In the foreign exchange market, the lek has appreciated against the euro and has depreciated against the US dollar. However, it has remained within normal parameters.

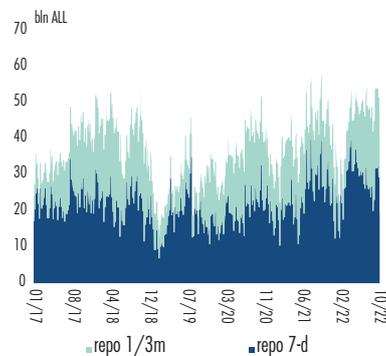
Overall, the market risk premia remain contained, whereas the current interest rate level is still stimulating to credit growth. Credit has continued to grow across all categories. Banks' balance sheets show that liquidity performance and credit soundness are satisfactory.

#### 3.1. DOMESTIC FINANCIAL MARKET<sup>6</sup>

Interest rates in the interbank market have increased in the third quarter of the year, in the same vein with changes experienced by the policy rate. In addition to these developments, the interest rates for this segment appear stable, and their differences with the policy rate are at minimum level. The market has not experienced additional liquidity pressures, allowing the operational objective of the monetary policy to be fulfilled. The Bank of Albania continued to supply liquidity through its main one-week repo instrument, as well as by three-month

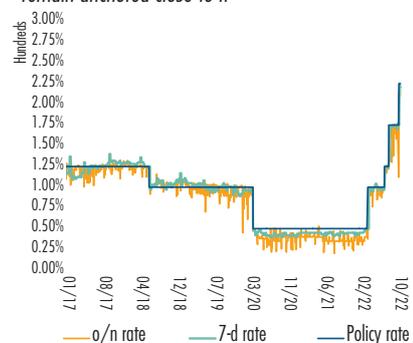
Chart 5

*The liquidity situation of the banks remains favourable for a good monitoring of the monetary policy*



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

*Interest rates in the interbank market immediately followed the recent increase in the policy rate and remain anchored close to it*



Notes: The data shows the daily performance of interbank market interest rates, alongside the policy rate and overnight-deposit-and-loan rates. Source: Bank of Albania.

<sup>6</sup> The following analysis is based on data available up to 21 October.



maturity injections. The amount injected in this quarter was almost similar to the one of the second quarter<sup>7</sup>. The current liquidity levels are adequate in conveying the monetary policy signals to the interbank market, and, furthermore, to the other financial market segments.

During the third quarter of the year, lek has continued to appreciate against the euro, in contrast to the implications of its seasonal behaviour, but has remained within the normal trading parameters. The appreciation of the lek against the euro, which started since the end of April, peaked in the third quarter; whereas the EUR/ALL exchange rate recorded an average of 117.1 ALL/EUR, from 120.4 ALL/EUR in the second quarter, and 121.9 ALL/EUR in the first quarter of the year. In the first three weeks of October, the EUR/ALL exchange rate has fluctuated close to the average level recorded in September and August, with an annual lek appreciation of 3.9%.

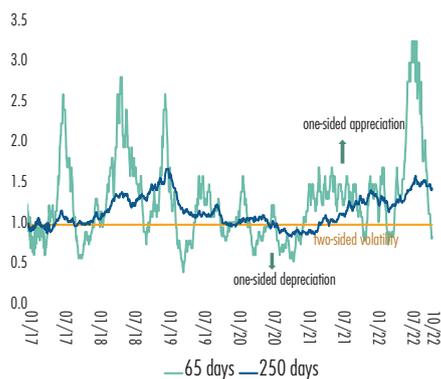
Chart 6

*The lek has appreciated against the euro and has continued to depreciate against the US dollar*



Note: Data show the daily performance of ALL exchange rate against Euro and US dollar.  
Source: Bank of Albania.

*The appreciative pressures on the eur/lek exchange rate have intensified in the third quarter*



Note: The data present the indicator of bias for appreciation/depreciation. For more, see note 8.  
Source: Bank of Albania.

Overall, the performance of lek against the euro was driven by movements of demand and supply within normal trading conditions. Both the euro/lek currency volatility as well as the spread between the quotations of the purchasing price and the selling price, have fluctuated close to their normal values. The intensification of appreciation pressures, as evidenced by the performance of the bias indicator<sup>8</sup>, reflects the higher currency inflows during this year. During the year, foreign currency supply grew mainly due to the improvement of the

<sup>7</sup> In 2022 Q3, the average liquidity injected amounted ALL 49 billion, from ALL 48 billion in the second quarter.

<sup>8</sup> The appreciation/depreciation bias 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. from 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).



trade deficit, which was affected in the main by a high surplus of services and the acceleration of net foreign direct investments<sup>9</sup>.

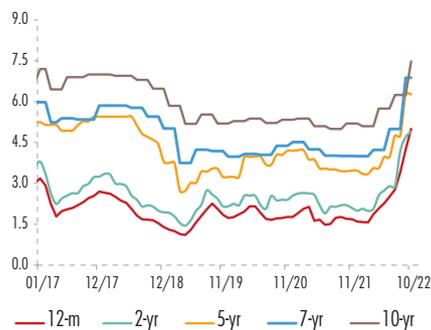
Lek has depreciated considerably against the US dollar, reflecting the strong appreciation of the latter against the euro in international markets. The US dollar was quoted at an average of 116.3 ALL in the third quarter and by 119.4 ALL in the first three weeks of October, from 113.0 ALL in the second quarter. The depreciation of the euro against the US dollar has accelerated by 18.7% in annual terms in September and October, because the Fed, in comparison to the ECB, enacted a faster monetary policy normalisation, and the Euro area's economic performance is increasingly disconcerting. This performance engendered an annual depreciation of lek against the US dollar by around 14.0%, during this period.

The yields on Government securities have further increased in 2022 Q3. Their performance has reflected the rising policy rate and the market agents' expectations regarding the strength and pace of the monetary policy normalisation in the near future. Banks were induced to seek high yields given the latest changes to the policy rate, the current high-inflation context, and the market expectations on the monetary policy response. These developments were reflected in banks' bid in auctions, which has been cautious, preferring short maturity terms.

Since the start of monetary policy normalisation yield spreads between government securities and the policy rate have been expanding. The yield on 12-month T-bills, used widely as a parameter in pricing long-term securities, recorded 5.26% in the latest October auction, from 2.84% in July. The yield on bonds recorded a similar growth. Their average levels are up by 1.6 pp. and

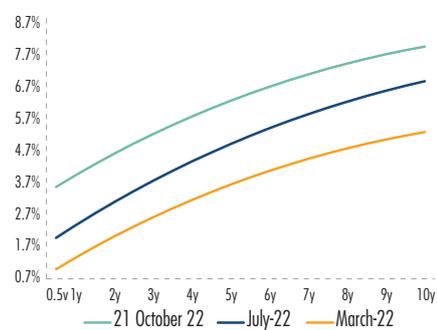
Chart 7

*Yields have continued the growth exceeding the policy rate changes during these months*



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

*The yield curve has shifted higher, but its slope has remained unchanged*



Notes: Data show the interest rates on Government debt securities by various maturities calculated according to the Nelson Siegel model. Source: Bank of Albania.

<sup>9</sup> In 2022 Q1, net inflows from tourism were up by 49% compared to the 2021 Q1, whereas net foreign direct investments were up by 28%. Indirect data, such as citizens' mobility, suggest that these trends were carried over in the third quarter as well.



2.9 pp. compared to July and the beginning of the year, respectively.<sup>10</sup> The increase has been consistent on all maturities. Therefore, the yield curve has shifted to a higher level, without any significant changes in its slope.

### 3.2. LENDING CONDITIONS

The interest rates on loans to enterprises and households have increased in the third quarter, while banks continue to gradually pass through the new financial conditions in the economy. In spite of this, the current loan interest rates remain accommodative to credit growth.

The average **interest rate on new loans to enterprises in lek** recorded 6.2% in 2022 Q3, from 5.7% in 2022 H1. The spike in interest rates has continued in the segment of small loans (up to ALL 35 million), strengthening further in September. Meanwhile, the interest rate of large loans remains volatile and the upward trend is still weak. The interest rate on **new loans to households** recorded the highest increase. In 2022 Q3, their average interest rate was 7.6%, with a 1.0 pp. cumulative difference compared to 2022 Q1. A similar spike was recorded in both the average interest on house purchase loans and on consumer loans, reaching 4.5% and 10.1%, respectively.

The interest rate on loans in euro continue to fluctuate at low levels, comparable to the previous year. The average interest rate on **new loans in euro to enterprises** fluctuated during this year. After falling in 2022 Q2, it rose in 2022 Q3, to 4.8%, returning close to the level of the first quarter. The average interest of loans to **households**, of 3.6% in this quarter, remained almost unchanged from the average of the first half of the year and the previous year. The interest gap has widened due to the higher interest rate on loans in lek and the continuing low rates on loans in the euro. It has increased gradually since May, reaching 3.0% in September, from the 1.8 pp. average in the previous year.

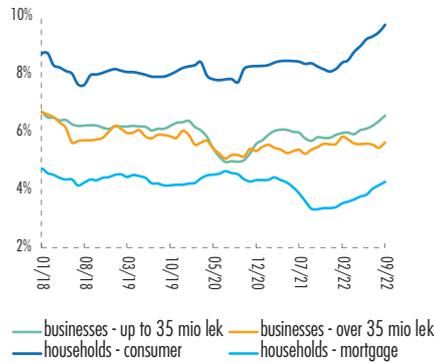
Following the start of the monetary policy normalisation, banks have started to gradually raise interest rates on deposits. The average interest on **time deposits in lek** was 1.3% in September, from the stable average of 0.6% - 0.7% in the last three years. The same trend was noticeable in interest rates on **deposits in euro**, which reached 0.7% in September, from below 0.2% recorded in the previous four years. The interest rates of deposits in lek and euro rose at the same speed, which resulted in a spread between the two, close to the average of 0.5 pp. of the past three years.

<sup>10</sup> March 2022, before the first change of the policy rate was enacted in this year.



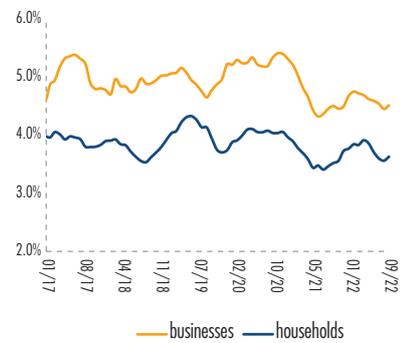
Chart 8

*Interest rates for loans in lek to households and small loans to enterprises continue to rise*



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

*The interest rates of loans in euro continue to fluctuate at low levels, for both enterprises and households*



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

**BOX 1 SUPPLY CONDITIONS AND DEMAND FOR LOANS IN 2022 Q3<sup>1</sup>**

Lending to economic agents reflected a more conservative approach by banks in the third quarter. Banks tightened lending standards on new loans to households and enterprises, for any purpose of use. In the same vein, lending terms and conditions also tightened, reflected in higher loan margins, as well as less favourable non-price elements<sup>11</sup> compared to last quarter.

Banks' prudent approach was also reflected in a lower number of loans approved to all agents. The main risks that drove banks' behaviour toward lending in this quarter were: the slower domestic demand, the additional costs to enterprises, heightened economic uncertainties, and the rising interest rates. Therefore, banks adopted a tighter risk tolerance range in order to potentially prevent the spillover of these risks in their balance sheets.

Enterprises' demand for loans continued to remain high in the third quarter. Enterprises increased their demand for loans to cover inventory and

Chart 1 Box 1

*Credit supply conditions tightened for all economic agents*



Source: Bank of Albania.  
Values on the chart are calculated as net percentage. Positive values indicate easing of terms and conditions and vice versa. Positive values indicate increase of the scale of application refusal and vice-versa.



working capital financing needs, due to the higher costs engendered by rising prices. The high cost environment, particularly the energy sector, has pushed enterprises to seek new investment alternatives in order to tackle these costs.

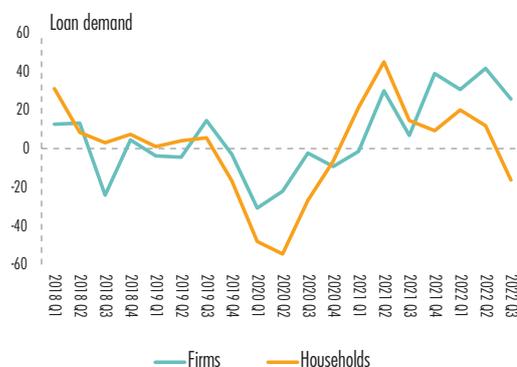
On the other hand, households' loan demand to cover their consumption and mortgages, contracted for the first time after six quarters. In addition to the latest development in the housing market, the rising interest-rate environment seems to have discouraged households' demand for loans during this quarter.

<sup>1</sup> The analysis is based on Bank Lending Survey, conducted on a quarterly basis and is published at: [www.bankofalbania.org/](http://www.bankofalbania.org/)

<sup>11</sup> Non-price elements consist of: commissions, loan size and maturity, loan agreement conditions, and collateral requirements.

Chart 2 Box 1

Loan demand was fragmented in the third quarter



Source: Bank of Albania.  
Values on the chart are calculated as net percentage. Positive values show increase of credit demand, while negative values show its decrease.

### 3.3. CREDIT TO THE PRIVATE SECTOR<sup>11</sup>

Loans to the private sector expanded at a high rate in the third quarter. The 13.9% annual growth of portfolio was around 1.1 pp. higher than in the second quarter. Also, the ALL 26 billion expansion of this quarter is comparable to the second quarter, despite the weak seasonal trend of credit, currently. The expansion of credit reflects, first and foremost, the higher demand of enterprises to cover the rising costs and prices, as well as banks' continuing accommodative approach. Meanwhile, banks have started to cautiously tighten lending standards, given the increasing cost of credit. The non-performing loans ratio to the total remains low, at 5%, signalling that solvency has not deteriorated.

In the third quarter, credit-portfolio developments show that foreign-currency loans grew at a higher rate (19% y-o-y), and loans in lek at a more contained one (9.5%). The expansion of foreign-currency loans reflected a higher support for enterprises to cover liquidity needs. Overall, loans to enterprises grew annually by 12.8%, or 1.5 pp. higher than in June. Therefore, lending to enterprises used to cover liquidity, grew by 15.5% (4 pp. higher than in the second quarter), besides the stable performance of loans for investment purposes<sup>12</sup>.

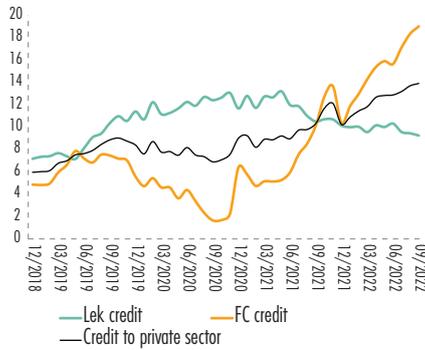
<sup>11</sup> The credit analysis is based on the new set of information prepared by the Department of Statistics in line with the ECB's methodology for "real" credit flows - cleaned of both exchange rate movements and off-balance sheet loans. As a result of methodological changes, the current values are higher than the growth rates analysed until 2021. Despite the differences, both series show the same trend in lending in time. In September, the Department of Statistics reviewed these series for the period 2018-September 2022.

<sup>12</sup> Loan demand from enterprises was concentrated on investing for financing alternative energy production projects, aimed at reducing energy costs, which have already soared this year.



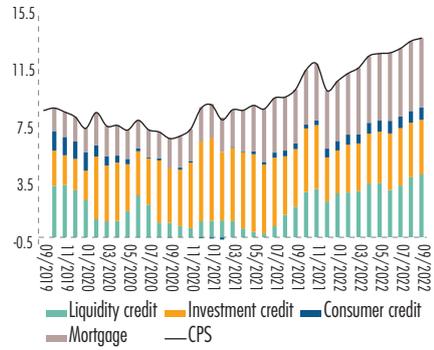
Chart 9

Credit to the private sector recorded high growth rates; the improvement in the growth rate of foreign-currency loans was offset by the deceleration in domestic-currency loans



Notes: The data represent annual changes (%) of the loan net of exchange rate cleared by the movements and off-balance sheets.  
Source: Bank of Albania.

Rapid credit growth has been supported by the expansion of loans to enterprises to cover liquidity needs



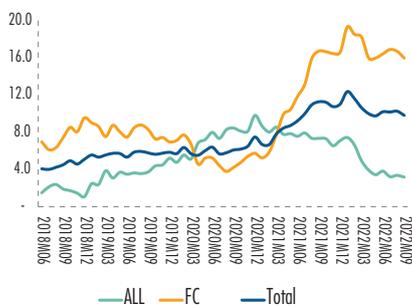
Notes: The data represent annual changes of CPS and credit contribution by purpose of use.  
Source: Bank of Albania.

In September, the annual growth rate of loans to households, of 15.8%, was close to the one recorded in the previous quarter. Nonetheless, the decline in the number of granted loans and the growth of net portfolio, signal a deceleration of financing to households, affected mostly by the lower demand<sup>13</sup>. The rapid increase in the cost of credit in response to the rising interest rates and heightened uncertainties, were the main factors affecting this performance. Also, banks have paid additional attention to loan applications, particularly for households that pose higher risk to solvency.

Developments on the liability side of the banks' balance sheet indicate a stable increase in the accumulation of funds. **Total deposits** grew by 10%, as much

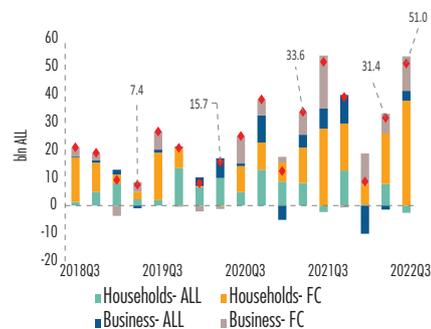
Chart 10

Deposits grew at a stable rate, where foreign-currency deposits recorded the highest growth which compensated the slowdown in lek deposits



Notes: Growth of total deposits by currency, including over 2-year deposits.  
Source: Bank of Albania.

In 2022 Q3, households' deposits in foreign currency grew sharply



Notes: Growth of total deposits by agents, including over 2-year deposits, decomposed by currency.  
Source: Bank of Albania.

<sup>13</sup> For more information see [https://www.bankofalbania.org/Monetary\\_Policy/Surveys\\_11282/Bank\\_Lending\\_Survey/Bank\\_Lending\\_Survey\\_2022\\_Q3\\_1.html](https://www.bankofalbania.org/Monetary_Policy/Surveys_11282/Bank_Lending_Survey/Bank_Lending_Survey_2022_Q3_1.html)



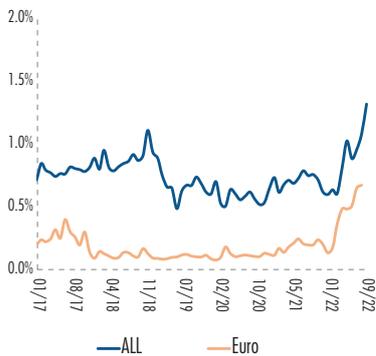
as in the second quarter. The slowdown in the growth rate of lek deposits was balanced by the stronger growth recorded by foreign-currency deposits. Thus, lek deposits contracted slightly during the quarter, recording an annual growth rate of 3.2%, whereas the foreign-currency annual growth rate was 16.5%. The quarterly flow in these deposits - particularly in August - was strong, underpinned mostly by the increase in households' foreign-currency deposits. This growth is in line with their seasonal behaviour for this period of the year, and is characterised by high foreign-currency inflows, as well as a placement of households' savings into bank deposits.

Meanwhile, for more than two years now, households are increasingly placing their savings in over 2-year time deposits in order to extract higher returns. Data shows that the increased contribution of time deposits to total growth is making up for the lower contribution of demand deposits. The rising interest rates, domestically and abroad, seems to support this preference shift to hold savings in long-term maturity deposits instead of liquid ones.

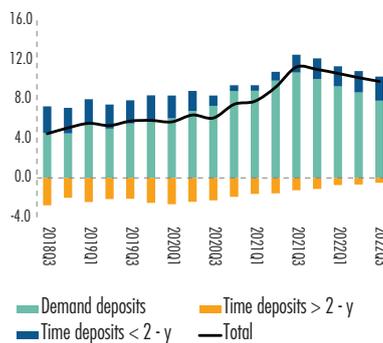
Chart 11

Interest rates on new deposits in lek and euro rose, albeit maintaining a stable difference between them...

...increasing the contribution of time deposits - particularly those with over 2 years maturity - to total growth.



Notes: The data show the interest rate applied on new Lek deposits in %.  
Source: Bank of Albania.



Notes: Total deposits growth by maturity.  
Source: Bank of Albania.



## 4. ECONOMIC GROWTH

The economic activity in Albania slowed down in the second quarter. The economic growth rate dropped to 2.2%, lower than our expectations, and the 6.5% rate recorded in the previous quarter. The war in Ukraine and sanctions imposed on Russia, engendered a new wave of soaring commodity prices in foreign markets, heightened global uncertainties, and major obstructions of production and supply chains in partner economies. Given these developments, investments in Albania fell and the construction activity recorded negative rates. Public consumption and net exports also experienced a negative performance, whereas personal consumption continued to record a high and stable growth.

Based on the available data, the economic activity is assessed as improved in the third quarter, given the positive impact of the tourist season. Investments have resumed their positive growth rates. The balance of risks is tilted downwards, despite the improved expectations on economic growth. The energy crisis and rising inflation will weaken investments and corrode short-term consumption, but the gradual return of inflation to target and the waning uncertainties are expected to have a positive contribution to growth in the medium term.

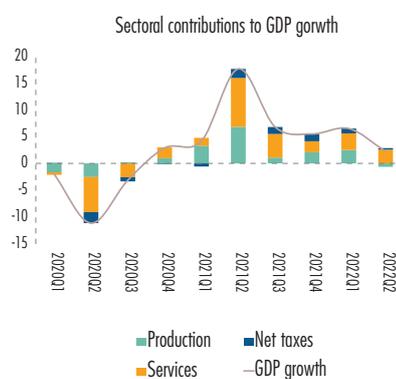
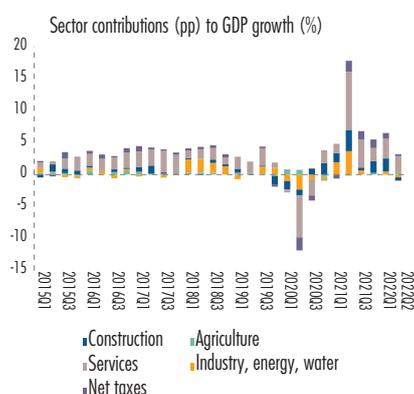
### 4.1. GROSS DOMESTIC PRODUCT

GDP expanded by 2.2% in annual terms during 2022 Q2. The growth rate decelerated considerably compared to the previous quarter (6.5%). This deceleration was engendered from supply-side shocks of a global origin that were in turn caused by rising prices of energy, oil, metals and key production

Chart 12

*Economic activity slowed down significantly in 2022 Q2*

*The slowdown of growth is related mainly to the annual contraction of the production activity contribution*



Source: INSTAT and Bank of Albania.

Source: Bank of Albania.



inputs, as well as by uncertainties and hindrances in production and supply chains. These factors affected the economic activity beyond the comparatively low base effect of the previous year<sup>14</sup>. The production sector contributed negatively by 0.6 pp., compared to the positive impact of 2.5 pp. recorded in the previous quarter. The value added growth of the services sector decelerated to 2.6 percentage points, from 3.1 percentage points in the first quarter (Chart 12, left).

**The production sector** contracted by 1.6% in the second quarter, from the expansion of 6.3% recorded in the first quarter. This performance was driven by the contraction of the construction activity by 5.3%, contributing by -0.5 pp. to economic growth. This development came after two years of significant growth for the sector, exceeding even the strong base effect of the previous year<sup>15</sup>. "Industry" had a negative contribution by -0.4 pp. due to the non-too-satisfactory performance of both the "Energy" production and "extracting industry" branches. On the other hand, a positive contribution stemmed from the "refining industry" and "agriculture".

The value added growth in **the services sector** is calculated at 5.9%, down from the previous quarter (6.8%). The main contribution come from the "Trade, transport, accommodation and food service" branch, where the sub-branch "accommodation" stands out for the positive performance in the sector of tourism during the second quarter of the year. The contribution appear stable compared to the previous quarter. The "real estate" branch continues to be a supporting factor for economic growth, similar to the previous quarter.

Economic growth is assessed to have improved in 2022 Q3<sup>16</sup>. Foreign demand is expected to have an added contribution due to the positive developments in tourism and the sectors related to it. Activities, overall, not least "construction" and "industry" are experiencing a new price reality, forcing them to act more cautiously in an environment impregnated with high uncertainties and tighter financing conditions. "Construction" is expected to return to its positive growth rates. "Industry" will continue to reflect its high dependency on electrical energy produced domestically, foreign demand for metals and minerals, and the conjuncture of input prices.

## 4.2. AGGREGATE DEMAND

**The growth of aggregate demand slowed down in 2022 Q2.** The performance of "investment" was a determining factor since its dynamic shifted to the negative territory. This performance reflected the contraction of the "construction" activity. Public consumption had a negative contribution as well. On the other hand,

<sup>14</sup> Economic growth was 17.6% in 2021 Q2.

<sup>15</sup> "Construction" grew by 40.8% in 2021 Q2.

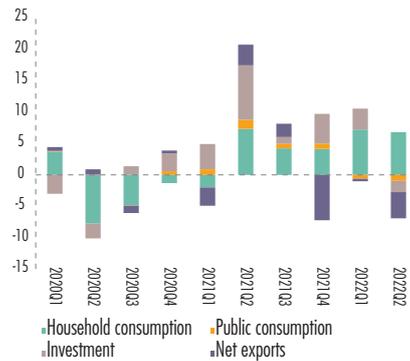
<sup>16</sup> Economic growth in the third quarter will reflect a very weak comparative base effect than the previous year (6.8%).



private consumption grew at a high and stable pace. Lastly, net exports had a negative impact as well, since imports had a stronger effect than exports.

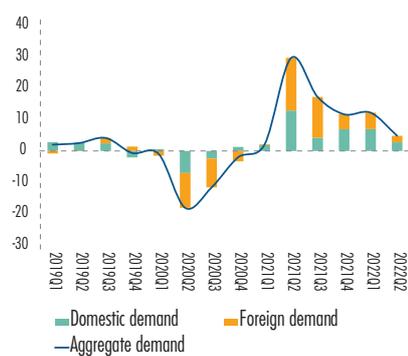
Chart 13

Private consumption supported economic growth, while the impact from aggregate demand had a negative contribution



Notes: Contribution of demand components to economic growth.  
Source: INSTAT and Bank of Albania.

Domestic and foreign contributions were lower compared to the previous quarter, beyond the comparative base effect



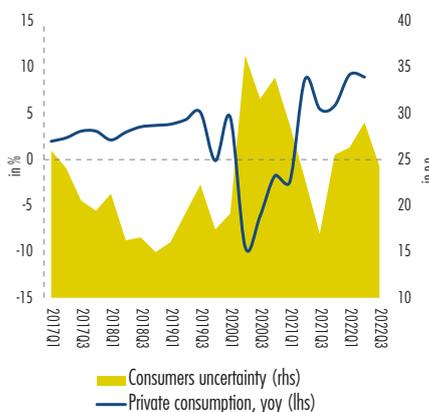
Notes: Domestic and foreign contribution to the annual growth of aggregate demand.  
Source: INSTAT and Bank of Albania.

**Domestic demand** grew by 3.6% in annual terms in 2022 Q2, from 8.8% in the previous quarter. The slowdown is related to the annual contraction of investments. The negative contribution was mostly driven by both public and private investments, which grew at a slower pace. In parallel, public consumption fell by 8.5% during the quarter under review, a sharper slump compared to the previous quarter (5.0%).

**Private consumption** grew by 8.9% in the second quarter of the year, a similar rate to the previous quarter of the year. Based on indirect indicators, the growth of private consumption had a broad base across its main categories: consumer

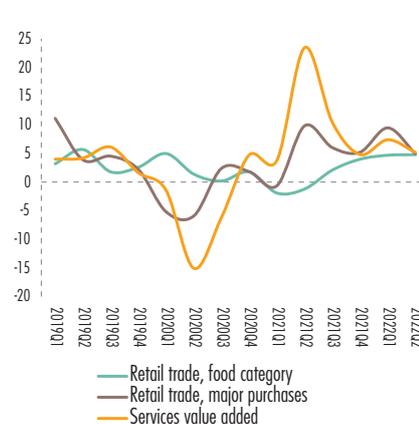
Chart 14

Private consumption continued to grow in the second quarter



Notes: The consumer uncertainty indicators is measured from Consumer Confidence Survey and expressed as net balance in percentage points.  
Source: INSTAT and Bank of Albania.

Consumer spending recorded slightly slower growth rates



Notes: Indicators are stated in annual changes, in %.  
Source: INSTAT and Bank of Albania.

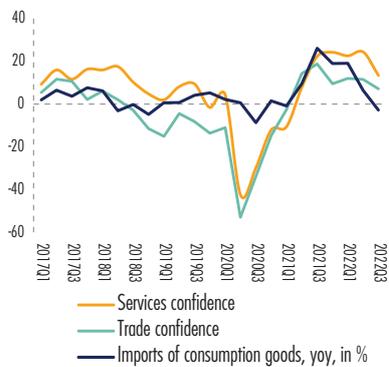


goods, large purchases and services<sup>17</sup>, albeit at a slower pace than the previous quarter (Chart 14, right). Consumer demand for goods and services was underpinned by positive developments in the labour market and financing sources stemming from an increase of wages, remittances and consumer loans.

Indirect data for the third quarter suggest that private consumption will grow at a slower pace compared to the first half of the year. Demand from the sector of services and trade has shrunk in the third quarter, based on the enterprise confidence survey (Chart 15, left). Data from consumer confidence survey show that expectations on the financial situation and the balance of large purchases, have remained below the long-term average in the third quarter (Chart 15, right).

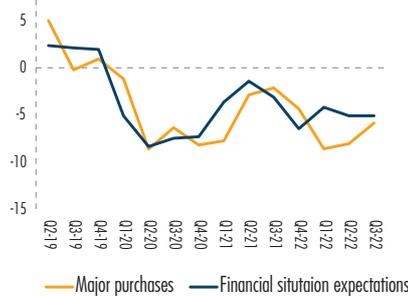
Chart 15

Data from the import of consumer goods and confidence level in trade and service sectors signal a slowdown of consumption in the second quarter



Notes: Import of goods for consumption is annual change and demand indicators are based on the enterprise confidence survey. Source: INSTAT and Bank of Albania.

Large purchases and expectations on the financial situation are still below the long-term average in the third quarter

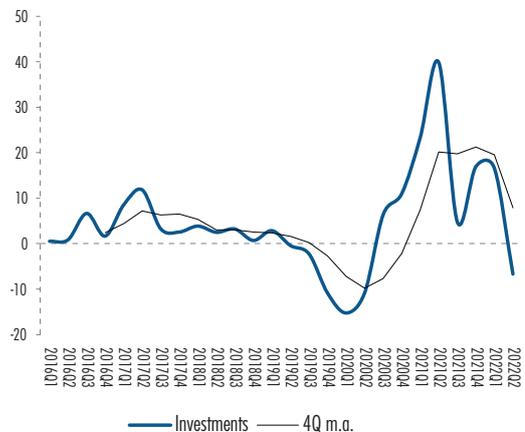


Notes: Indicators are based on surveys and are expressed as the differences from the long-term average, in percentage points. Source: INSTAT and Bank of Albania.

**Total investments** contracted by 6.7% in the second quarter, shifting to negative territory for the first time since 2020 Q2. The outbreak of the war in Ukraine arose an upsurge in commodities prices, new supply-chain bottlenecks and uncertainty for their performance in the future. This shock drove to a decreased willingness of businesses to invest. The strengthened clarity on drafting a fiscal support for companies operating in construction sector<sup>18</sup>, and the adaptation to the new reality contributed to the reduction in uncertainty.

Chart 16

Total investments in economy shrunk in the second quarter



Source: INSTAT and Bank of Albania.

<sup>17</sup> Disaggregated data of retail trade index and GDP data measured under the production method.

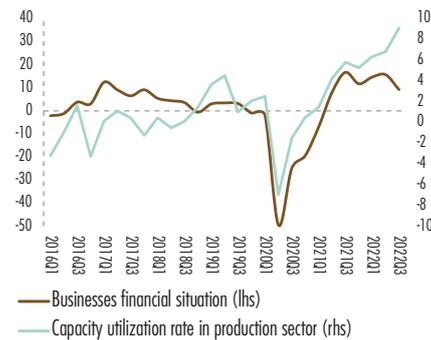
<sup>18</sup> The Council of Ministers adopted the Normative Act No. 10, dated 18.5.2022 "On financial compensation of price for some construction materials, pursuant to the definitions in public contracts for work, due to the specific situation in the market during 2022".



Indirect indicators give, in balance, positive signals on the performance of investments in the third quarter. Survey data show business confidence stands above the historical average and the capacity utilisation rate has further edged up in his quarter (Chart 17, left). Also, imports of construction materials and metals returned to the increasing rates, by signalling the recovery of construction sector.

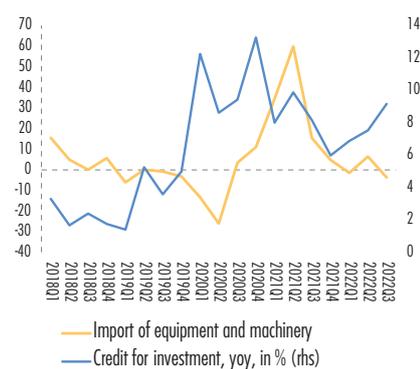
Chart 17

Capacity utilisation rate and financial situation of businesses stand above the long-term average



Notes: Financial situation of enterprises is an average of balances from confidence surveys. Capacity utilisation rate is in percent of total capacity. Indicators are a difference from the long-term average. Source: INSTAT and Bank of Albania.

Indicators of imports for machineries and equipment suggest a weak performance of investments in this category

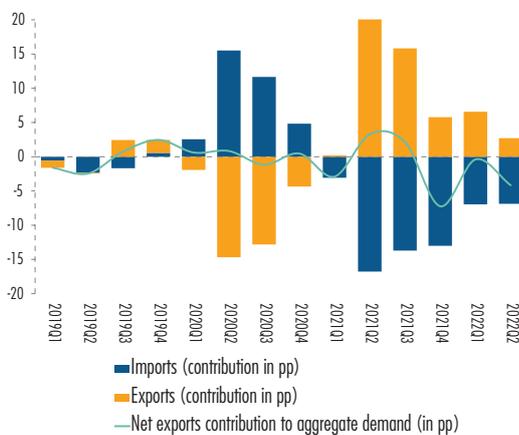


Notes: Import indicator is annual changes in percentage points. BLS - Bank Lending Survey. Source: INSTAT and Bank of Albania.

**Negative contribution of net exports** increased in 2022 Q2 (Chart 18). Trade deficit in goods and services expanded by 41.3% due to the sharp growth in imports by 17.6%, mainly driven by the increased import of services by 35.9%, while the import of goods expanded by 11.5%. In 2022 Q2, growth in exports slowed down (9.1% from 25.6% in the first quarter.), affected by both the increase in the export of services (6.9%) and of goods (14.5%).

Chart 18

Negative impact of net exports increased in 2022 Q2



Notes: Contribution of imports and exports in economic growth. Source: INSTAT and estimations of the Bank of Albania.

The trade deficit in real terms is different from that in real terms. Data from the balance of payments and the nominal GDP show a tightening of trade deficit. The different rates of deflators, where those of exports are quite high and edging up compared to the first quarter of year, led to this difference.

In 2022 Q3, trade in goods continues to reflect the impacts from the increased prices in both exports and imports. The import of electrical power was intensified during this period, driving to an accelerated expansion of trade deficit. These developments also coincide with a slowdown in the growth of exports. Trade deficit in goods was up by 20.3% in annual terms, while the increase in the second quarter recorded 10.5%.



In 2022 Q3, the exports of goods increased by 27.2% in annual terms, from 38.0% in the previous quarter (Chart 19, left). The categories “Minerals, fuel and electricity” and “textile and footwear” provided the main contribution in this growth. Meanwhile, the declining contribution from the category “Construction materials and metals” dictated the slowdown in the growth of exports. The effect of prices continues to dominate the annual growth of exports, but at and assessed slowed intensity in the third quarter. On the other hand, the effect of the exported volume is assessed as stable.

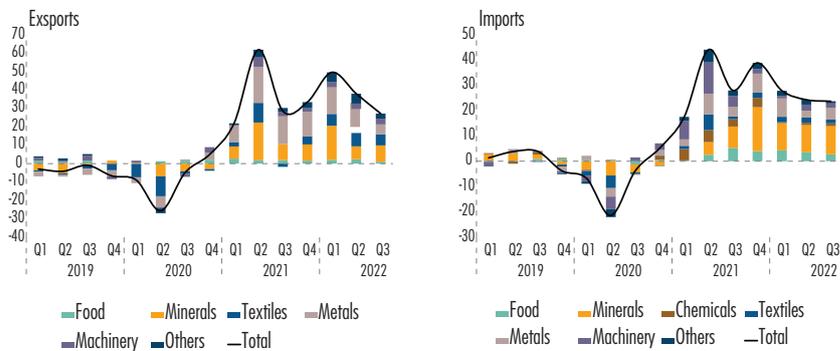
In 2022, the imports of goods increased by 23.7%, a similar rate with the second quarter of 2022 (24.3%), (Chart 19, right). The categories “Minerals, fuel and electricity” and “Construction materials and metals” provided the main impacts in this regard. Both categories increased their contributions compared to the previous quarter, particularly “Construction materials and metals”. The above -stated developments have offset the lower contributions from categories “Machinery, equipment and spare parts”. On the other hand, the effect stemming from prices on the increased imports remains dominant, like in case of exports, it appears mitigated. On the other hand, the effect from the increased volume of imports is assessed as higher compared to the second quarter of year.

In terms of trading partners, members of the European Union, mainly Italy, Germany and Spain, dictated the growth in exports. While, neighbour countries stemmed negative impacts. In terms of exports, European Union members, mainly Greece, expanded their contributions compared with the previous quarter. At the same time, other partners, like Turkey, China and Serbia, increased their contributions. Saudi Arabia continues to provide high contributions due to the effect of fuels import.

Chart 19

Annual growth in exports slowed down in 2022 Q3, driven by the fall in the category “Construction materials and metals”

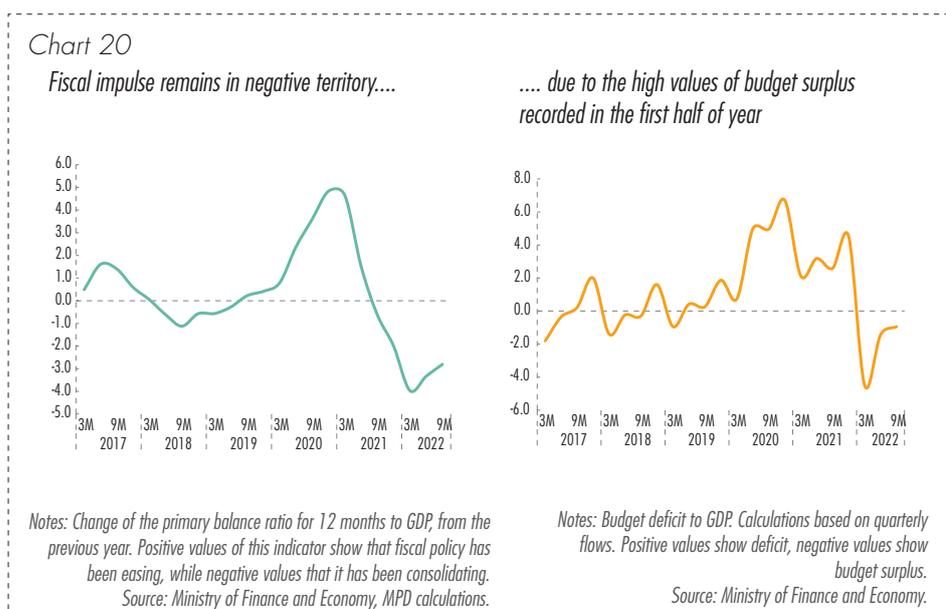
Growth in imports was stable driven by the categories “Minerals, fuel and electricity” and “Construction materials and metals”



Note: Contributions of main categories in the trade of goods, in percentage points.  
Source: INSTAT and Bank of Albania's calculations.



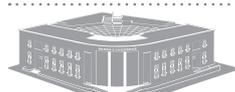
**Fiscal policy** continued to maintain the consolidating position in the third quarter, being reflected in negative values for fiscal stimulus. As at end of September 2022, fiscal impulse was assessed at -2.8 pp of GDP, from -3.3 pp in the previous quarter. Negative values for fiscal impulse are attributable to the rapid increase in revenues, combined with contained expenses. These developments are materialised in higher values of primary surplus, suggesting a low impact from public component on the expansion of aggregate demand during this year.



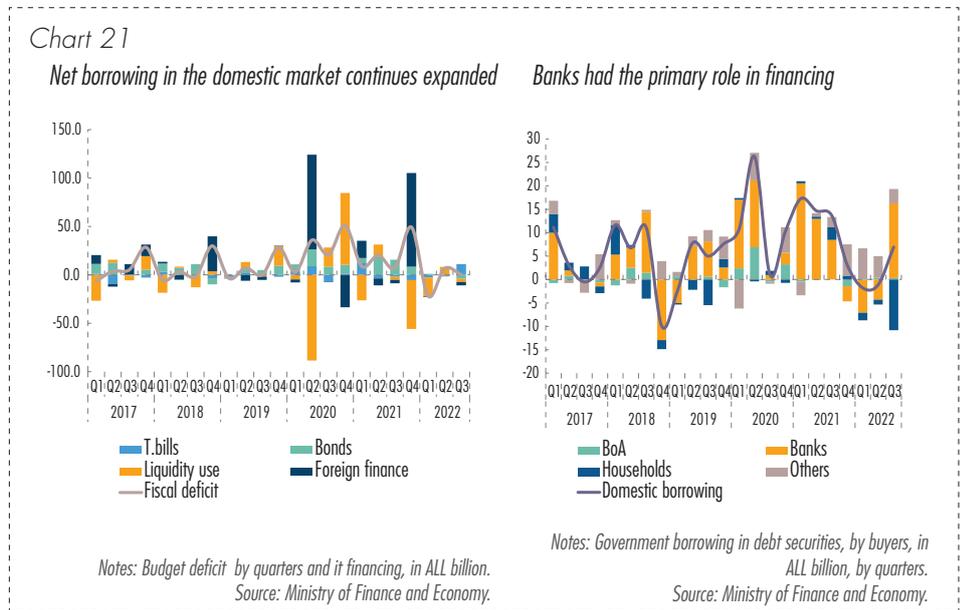
**The budget balance** maintained the positive values in the third quarter. As at end of September 2022, it amounted around ALL 1.5 billion, similar to the second quarter, assessed at 1% of GDP. In the fourth quarter, the accelerated realisation of most part of public investment is expected to turn this trend.

Net **borrowing** in the domestic market of securities grew by around ALL 7 billion in 2022 Q3. The issue of instruments with maturity up to one year, which in turn compensated the reduction by ALL 4 billion in the long-term securities portfolio, formed this growth. As at end of September 2022, net borrowing in the domestic market was around ALL 4 billion, from ALL 33 billion planned in total for the year 2022. The failure to meet the announced amounts for issue mainly in the first half of year, has shifted a relatively high domestic financing amount of the deficit in the second part.

In the third quarter, banks have increased participation in the auctions of government securities, by around ALL 13 billion, after appearing reluctant at the end of the first quarter and partially in the second one. Investment policies of government securities have been oriented towards short-term instruments, driving government to adapt the borrowing strategy with the preferences of commercial banks. On the other hand, households have been withdrawn from the investments in government securities in this quarter, by partially channelling



their savings toward deposits in the banking system. Other non-bank financial institutions continue to find investment in government securities as attractive, thus further increasing their exposure to government securities.



Net borrowing in foreign market reduced by ALL 3.5 billion in the third quarter, due to the debt servicing at a higher value than disbursements of funds from abroad. In 2022 Q3, flows from abroad consisted mainly in the form of budget support. The liquidity of the government continues to be quite high, as a result of the foreign currency funds transferred from 2021, combined with the considerable growth of surpluses, due to the increase in revenues and not being realized at the same speed of budget expenditure.

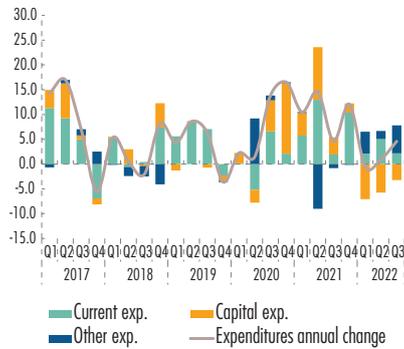
**Budget expenditure** expanded by around 4.4% in annual terms, in 2022 Q3. The fund, of ALL 8 billion, granted to OSHEE (Electricity Power Distribution System Operator) by the Government, fully supported the growth in expenditures. At the end of the nine-month period, the support for the energy sector reached ALL 16 billion, from ALL 28 billion planned for 2022. The destination of this fund is to support the financial balance of OSHEE, which is suffering the costs of non-transmitting the high energy prices to family consumer and small enterprises.

In 2022 Q3, capital expenditure continued trending downward, by around 18%. Current expenditure showed a decelerated growth, by around 2.7% in annual terms. The performance of expenditure approximating consumption and public investments in the third quarter, suggest that public sector will continue to provide a negative contribution in the expansion of aggregate demand, as in the two previous quarters.



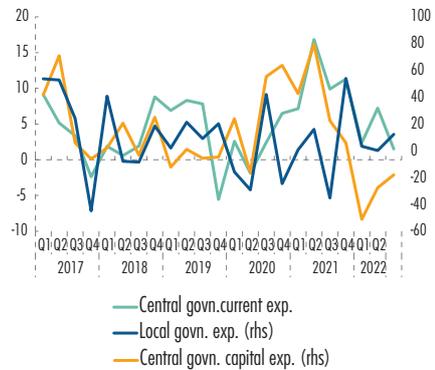
Chart 22

Realisation of expenditure was somewhat higher than in the first half of year



Notes: Composition of expenditure growth by quarter.  
Source: Ministry of Finance and Economy.

Investment continue to remain lower from a year earlier



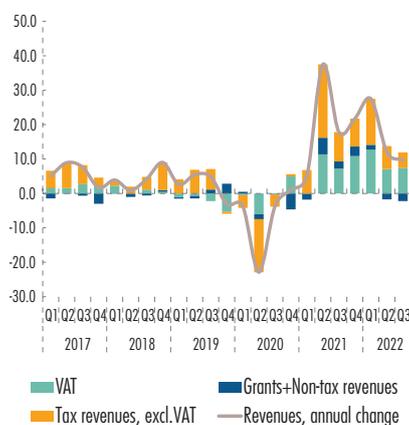
Notes: Annual growth in % of main expenditure items, by quarters.  
Source: Ministry of Finance and Economy.

For the first 9 months of the year, expenditure were about ALL 410.7 billion, or around 1.7% higher than the same period a year earlier. The weak performance of public investment, with a negative contribution of 5.3p.p in total expenditure, continues to remain the main factor curbing the expansion in expenditure.

**Budget revenues**, in 2022 Q3, grew by around 10% in annual terms. In 2022 Q3, the growth pace of budget revenues slowed down, from averagely 19% in the first half of year. Nevertheless, the profile of growth remained equal to the first half of year, where the expanded VAT revenues formed most part of it. The latter contributed by 7.4 percentage points to the increase of the total. The other items mostly contributing to the growth of revenues in this quarter were profit tax, by around 4.4 pp and contribution for social insurances, by around 2.3 pp.

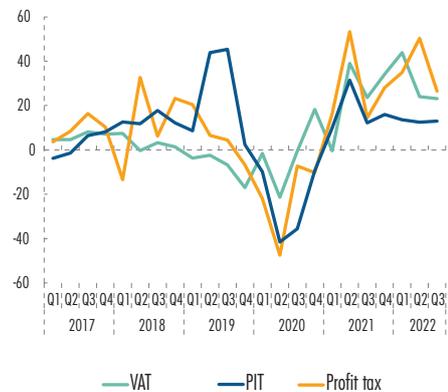
Chart 23

Revenues continued to grow.....



Notes: Composition of revenue growth by quarter.  
Source: Ministry of Finance and Economy.

...with VAT income provided the main contribution



Notes: Annual growth in % of main tax items, by quarter.  
Source: Ministry of Finance and Economy.



In the first nine months of year, revenues amounted ALL 425.7 billion, around 15.8% higher than the same period in the previous year. VAT revenues, by around 9 pp, profit tax by 2.5 pp, and social insurance by 2.2 pp, provided the highest contribution in the growth of total. The rapid expansion of revenues during this year reflects, at a considerable degree, the increase in main good prices in international markets. In addition, a part of the growth in budget revenue on the imports of goods, in this year, was affected by the depreciation of the national currency against the US dollar, averagely by 9.8%<sup>19</sup>.

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<sup>19</sup> The group of import goods which are quoted in the US dollar, like fuels, metals, etc., have a considerable share in the total of imports in value.

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## 5. INFLATION, PRICES AND COSTS IN THE ECONOMY

*In 2022 Q3, inflation accelerated to 7.9% in 2021 Q3, from 6.7% in the previous quarter. The high historical values in this quarter reflected both the soaring prices in commodities and services. The conjuncture of high prices in international markets and their rapid spill over in the domestic inflation, have shifted up both inflation factual rates and expectations. These developments materialised in further expansion of both core and domestic inflation.*

*Inflation is expected to remain high for the remainder of the year, and gradually reduce in the next period. Risks surrounding this assessment, relate to the uncertain long-lasting war in Ukraine, the expectations on elevated inflation and the reflection degree of increased labour and production costs in consumer prices.*

### 5.1. CONSUMER PRICES

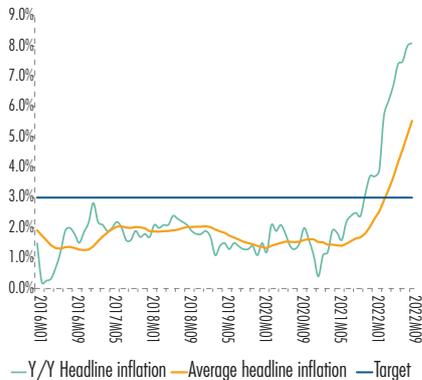
Annual inflation averaged 7.9% in the third quarter of year, standing 1.2 percentage points higher from the previous quarter. Inflation has been trending upwards, hitting at 8.1% in September. The continuous increase of inflation has shifted the later 4.6 percentage points above the January-September average in the previous year. The escalated crises in Ukraine intensified the increase in energy, food and commodity prices in international markets, being directly and indirectly passed-through to consumer prices by the stronger costs. The recovered demand and labour market eased the transmission of soaring prices at a broad base across CPI categories. The increased expectations of economic agents on inflation have driven to high pressures on wages. The above-stated developments have been reflected in high historical rates of both core inflation and domestic inflation.

Inflationary profile in Albania is similar to the one in both regional economies and the EU members. Its lower trajectory in our economy, in the second half of previous year (Chart 24, right), is mainly due to the structural differences in consumption among countries and maintaining the electrical energy price for families unchanged. In addition, the heightened supply of domestic production for unprocessed food and the appreciation of the exchange rate are assessed to have slightly dampened the external inflationary pressures.



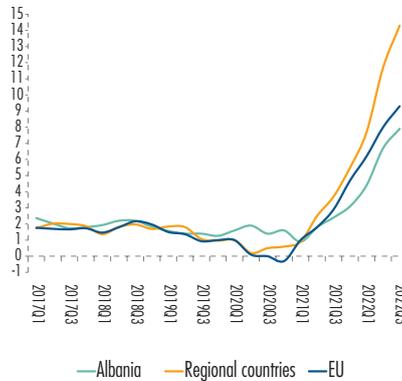
Chart 24

Annual inflation in Albania continues to hit records due to the strong pressures stemming from global supply factors



Source: INSTAT and Bank of Albania's calculations.

The geopolitical situation is driving inflation to pick up sharply globally



Source: INSTAT and Bank of Albania's calculations.

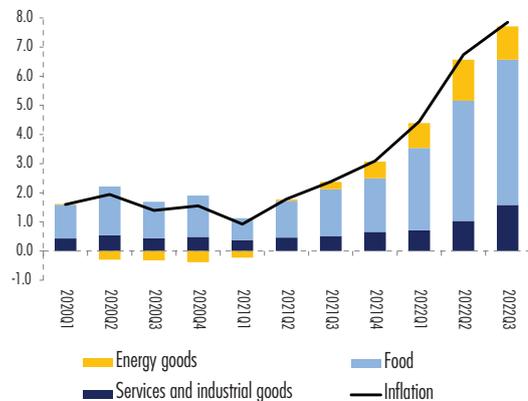
“Processed foods” continued to mainly determine the annual inflation (around 45%, Table 2). Increased prices in this category expanded their contribution by around 0.5 percentage point compared with the second quarter. In addition, the category “Unprocessed foods” provided a higher contribution in the formation of headline inflation than in the previous quarter. Sub-groups “meat” and “fruit” provided a more significant contribution in the increase, while the sub-group “vegetables” showed a downward trend, by lessening the strong pressures arising from imported goods in this category. The category “Non-food items”, which include energy items, as oil, its sub-products and gas, continue to maintain a high positive contribution in the headline inflation. Nevertheless, this contribution decelerated compared to the previous quarter, due to the more contained increase in commodity prices of energy in international markets.

The other more stable components of inflation - housing, services, and durable consumer goods - also experienced increased contribution in the formation of inflation. In particular, services, mainly related to the increased tourism activity in Albania - recorded a rise of contributions, like prices of tourism packages, transport services, hotels, restaurants and bars.

The increased contributions of foods, services and durable goods drove to the accelerated inflation (Chart 25).

Chart 25

Services recorded increase in prices at a broad base by respective sub-groups



Source: INSTAT and Bank of Albania's estimations.



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

	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	Inf. 2022 Q3
Processed food	0.6	0.4	0.6	0.9	1.4	3.0	3.5	15.8
Bread and grains	0.1	0.1	0.1	0.2	0.4	0.7	0.8	19.2
Milk, cheese and eggs	0.2	0.1	0.1	0.2	0.3	0.9	1.0	21.5
Unprocessed foods	0.3	0.9	1.0	1.0	1.5	1.2	1.6	9.1
Fruits	0.2	0.1	0.1	0.4	0.2	-0.1	0.1	4.5
Vegetables	0.0	0.6	0.8	0.4	0.9	0.5	0.5	8.9
Meat	0.1	0.1	0.1	0.2	0.4	0.7	0.9	10.8
Services	0.1	0.2	0.2	0.3	0.4	0.5	0.7	3.7
Goods with regulated prices	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.6
Housing lease	0.0	0.1	0.2	0.2	0.1	0.2	0.3	2.9
Non-food consumer goods	-0.3	0.1	0.3	0.6	1.0	1.6	1.5	11.0
Fuel	-0.3	0.0	0.2	0.4	0.7	1.4	1.3	33.3
Durable consumer goods	0.1	0.1	0.1	0.1	0.0	0.2	0.3	0.3
Inflation (%)	0.9	1.8	2.4	3.1	4.4	6.7	7.9	7.9

Source: INSTAT and Bank of Albania's calculations.

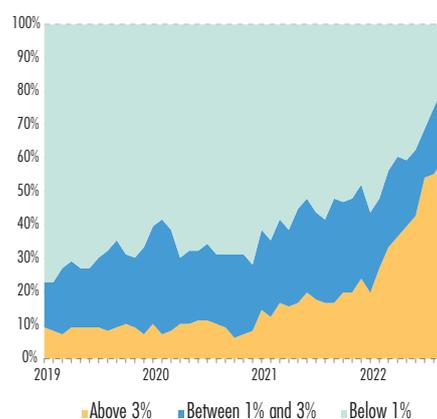
\*The Table shows the contributions in inflation by composing categories and some of their main items. Also, the Table shows the average inflation rate in 2022 Q3.

The share of goods and services with an inflation above 3% to the total of CPI basket, has been climbing in 2022, resulting 3.5 times higher than the average in the period 2019-2021 (Chart 26, left).<sup>20</sup> In parallel, the share of items with inflation within the range 1%-3% continued to remain stable, while the share of items with inflation below 1% contracted considerably.

The effects of increased prices in international markets are spilled over and are broadly persisting on the final prices in the domestic market. This transmission materialised in a high intensity in the third quarter, is being reflected in a considerable increase across all measurements of net inflation<sup>21</sup> (Chart 26, right).

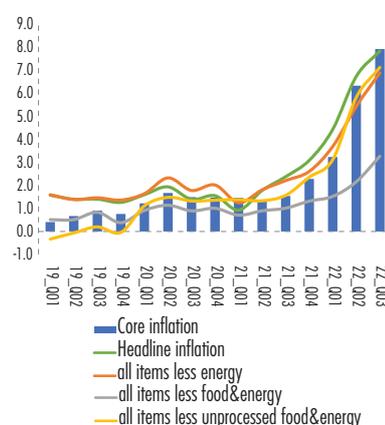
Chart 26

The share of items with inflation above 3% dominated in the third quarter



Source: INSTAT and Bank of Albania's estimations.

Shocks on prices are materialised in the increase across all measurements of net inflation



Source: Bank of Albania.

<sup>20</sup> The assessment is based on the annual inflation data for a detailing at a 2-digit level pursuant to COICOP classification of CPI basket items. This detailing included a total number of 96 goods and services.

<sup>21</sup> These measurements include the effects of prices with more volatile prices and are assessed as different alternatives of core inflation.



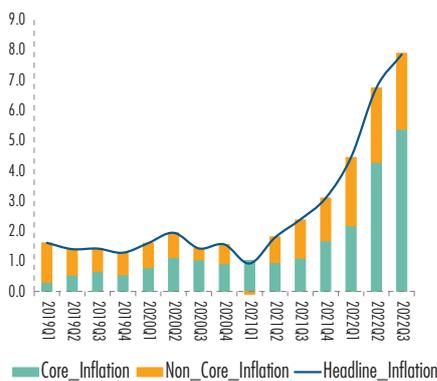
## 5.2. INFLATION DETERMINANTS

The soaring international prices have induced the overall inflationary pressures in Albania. At the same time, the cyclical position appears positive, notwithstanding the slow pace of economic growth in the second quarter. Employment rose at more rapid pace and at a broad base of sectoral contributions. Capacity utilisation rate continues to settle above the historical average. The increase of wages in private sector stands on two-digit figures. Values of core inflation have accelerated in the second and third quarters, recording high rates.

The further sharpened domestic demand drove to the persistent high inflation rates in 2022 Q3. In addition, imported and short-term inflationary pressures remain high and similar to those in the previous quarter (Chart 27). Core inflation and domestic inflation marked the highest historical rates, at 7.9% and 5.6%, respectively. The expanded core inflation mainly owed to the accelerated prices in services and durable goods. The progressive hike of net core inflation, reaching at 3.7% (Chart 28) in September<sup>22</sup>, shows this development. The above-stated developments drove to the expanded contributions from core and domestic components, by 68.4% and 55.2%, respectively, by driving almost entirely up the headline inflation in the third quarter.

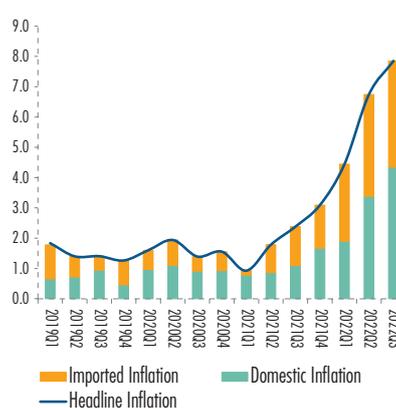
Chart 27

*The increased contribution of core inflation pushed up the headline inflation*



Source: INSTAT and Bank of Albania's estimations.

*Imported inflation provided positive contribution in the formation of headline inflation*



Source: INSTAT and Bank of Albania's estimations.

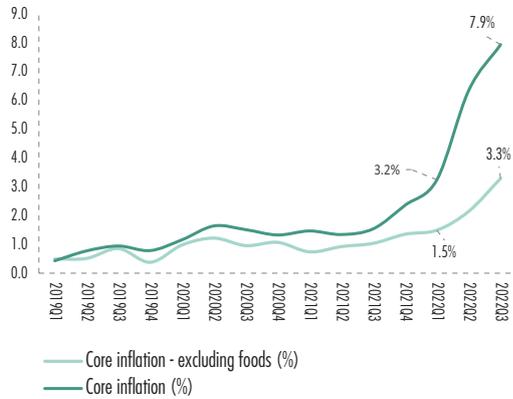
Non-core and imported components pursued a high increasing pace, but slightly slower than those at the end of the second quarter, recording an average inflation rate of 7.8% and 15.4%, respectively. This performance mainly reflects the more contained surging pace of fuel prices in international markets.

<sup>22</sup> Net core inflation excludes the sub-groups of processed foods (including bread and grains" from the measurement of the core inflation. Net core inflation considers 44.1% of the current CPI basket. In the months of the third quarter, it increased at: 2.9; 3.3 and 3.7%, respectively (around the 3.3% average), standing above the inflation target.



Chart 28

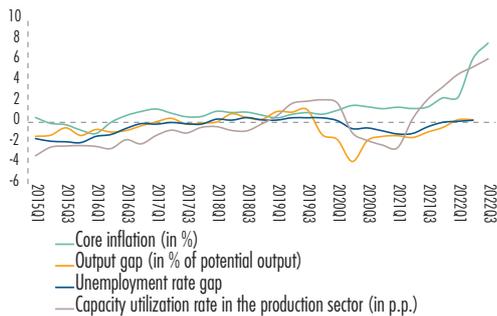
The accelerated core inflation mainly owed to the surge in services and durable goods prices.



Source: INSTAT and Bank of Albania's estimations.

Chart 29

Cyclical position of economy remained at positive levels in the second and third quarters reflecting high rates of core inflation



Notes: The output gap is the average of several measurements on which the method of moving average is applied. The capacity utilisation rate gap is estimated as a deviation of the current value from the relevant historical average, and then the moving average method 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 the equilibrium unemployment rate to the actual unemployment rate and then the moving average method is applied.

Source: INSTAT and Bank of Albania's estimations.

Chart 30

Employment accelerated the growth rate while unemployment dropped at the lowest recorded level



Source: INSTAT and Bank of Albania's estimations.

**Cyclical position.** Our assessments suggest a positive situation of cyclical position in the second quarter of year, despite the decelerated economic growth. The increase in employment, has settled on the lowest level recorded, while wages in private sector continue to pursue a double-digit rise. These developments are reflected in the hiking core inflation rates.

**The capacity utilisation rate** was around 77.3% in 2022 Q3, similar to the rate in the previous quarter. The capacity utilisation rate in economy remains above the long-term average, suggesting for inflationary pressures build-up from the producing markets.

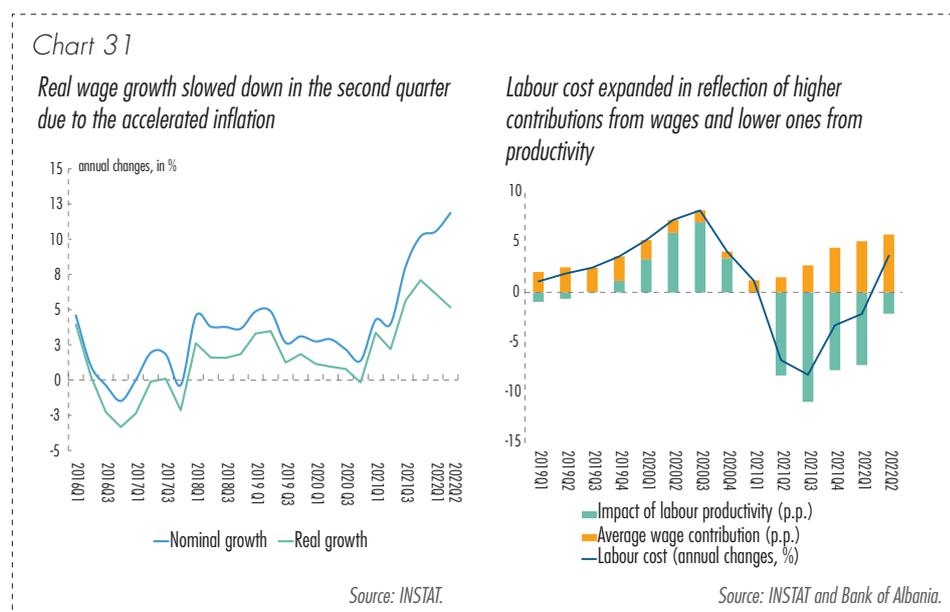
**Employment and unemployment.** The employment growth rate accelerated in the second quarter, reaching at 4.1%, from 3.4% in the previous quarter. All sectors of economy provided positive contributions in this regard. For the first time, employment level (number of employed persons) exceeded the pre-pandemic level. As noted previously, labour market has a slower reaction in post-pandemic period compared to the market output. Despite the time lag, the indicator of this market may be considered already as fully recovered.

Improved employment indicators are reflected in the decreased unemployment rate. Unemployment recorded the lowest rate, 11.1% from 11.3% in the previous quarter.

**Wages, productivity and labour costs.** Average wage in private sector continued expanding at a double-digit pace in the second quarter. Annual increase recorded 11.9%, from 10.5% in the previous quarter (Chart 31, left). Among the sectoral contributions, the branches "Trade, transport, accommodation and food services", "Information and communication" and "Industry" have provided pronounced contributions in this regard. On the other hand, the hiking inflation rates have decelerated the growth pace of real wage at 5.2% in the second quarter, from 6.1% a quarter earlier.



The unit labour cost<sup>23</sup> shifted trend in the second quarter. The unit labour cost - for the first time since 2020 - expanded in annual terms at 3.7% (Chart 31, right). The performance of real wage provided a stable impact on the expansion of this indicator. Productivity decelerated the negative impact, driven by the slower economic activity growth coupled with the accelerated employment expansion.



**Other output costs** have continued the accelerated trend in 2022 Q2 at double-digit annual growth rates. The industrial producer prices increased by 20.5% and those in domestic market by 16.5%. The export producer prices were up by 31.7%. Last, output costs in the sector of construction edged up by 6.2%. Higher labour and output costs have driven to the build-up of domestic inflationary pressures, which are materialised in high inflation rates of domestic inflation.

**Imported inflation.** The imported inflationary pressure remains high in 2022 Q3, but at a slower intensity compared with the second quarter of year. The annual increase of the imported inflationary pressure index (IIPI)<sup>24</sup> was 20.6%, from 25.5% in the previous quarter. The slight increasing moderation in international prices (31.1%) drove to this slowdown. The stronger appreciation of the nominal effective exchange rate (10.5% compared to 7.8% in 2022 Q2) contributed to dampening the imported inflationary pressures.

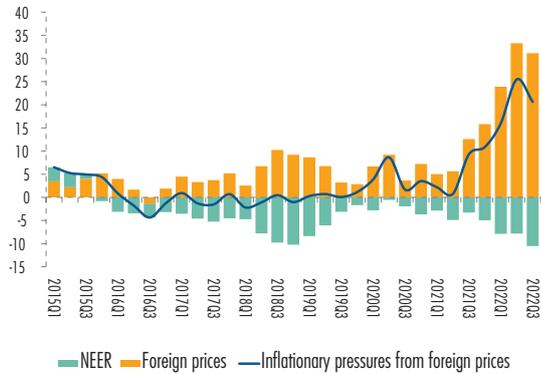
<sup>23</sup> Proxy indicators of labour productivity, unit labour costs and average wage by short-term statistics are calculated by the Bank of Albania using the total series of Short-Term Statistics (SHTS, INSTAT, 2022 Q2).

<sup>24</sup> IIPI is calculated as the annual growth of IPI and NEER for the respective month. From the correlation analysis of the relevant indicators with different time delays, IIPI anticipates the developments in the imported inflation component by about 3-5 months.



Chart 32

The imported inflationary pressure increased at a high rate in 2022 Q3, but slower compared to the previous quarter.



Source: INSTAT and Bank of Albania's estimations.

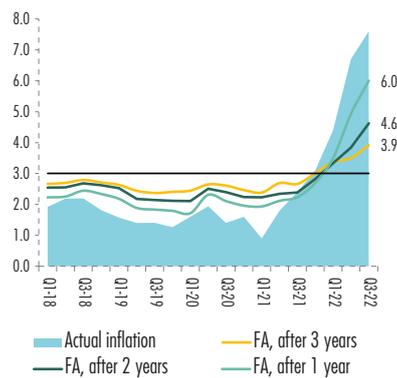
In line with the performance of IIP, imported inflation measured based on the CPI data have showed a slightly decelerated behaviour, but fluctuating close to the high historical rates. It formed around 45% of headline inflation (Chart 27, right). Imported inflation is expected to remain high and significantly affect the headline inflation in the rest of year, due to high prices of raw materials, energy and processed and commodity foods.

Inflation expectations of enterprises and financial agents have continued the upward trend in 2022 Q3, while consumers decreased their expectations in this quarter<sup>25</sup>. Businesses' expectations are higher compared to the expectations of the other agents of the economy. Thus, they expect inflation to be 12.7% one year ahead. Consumer expect inflation to be 9.1% one year ahead, around 0.5 percentage point lower than their expectations in the second quarter.

Financial agents' expectations on inflation have been revised up, for three time horizons, but remaining below the factual inflation rates of the third quarter of 2022. They expect inflation after one, two and three years to be 6.0%, 4.6% and 3.9%, respectively, approaching the target (Chart 33, right).

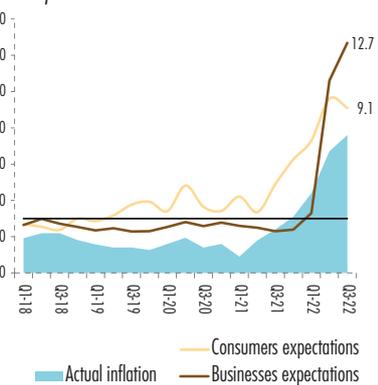
Chart 33

Expectations on inflation one-year-ahead of enterprises and consumers remain high



Notes: Annual changes in %.  
Source: INSTAT and Bank of Albania.

Expectations on inflation of financial agents by three time horizons are high, but below the factual value of the third quarter



Notes: Annual changes in %.  
Source: INSTAT and Bank of Albania.

<sup>25</sup> 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.

