

Bank of Albania

QUARTERLY MONETARY POLICY REPORT

2022/I

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INTRODUCTION¹

The main objective of the BoA's monetary policy is to achieve and maintain price stability. Price stability 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 a sustainable monetary environment 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. Following, these changes drive to the increase or decrease of the demand for goods and services through a chain known as "transmission mechanism". Changes in the demand for goods and services bring about increases or decreases in the prices of these goods and services.

Transmission mechanism encompasses various channels through which prices may change, for example: the exchange rate channel; the inflationary expectations channel; and the foreign assets channel. The Bank of Albania has constructed models to forecast changes in all elements which affect prices and to forecast inflation 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. The monetary policy decision-making considers the reasons that cause the deviation of inflation from target and the time needed to economy to react against the changes in the 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 public.

The Monetary Policy Report is published on a quarterly basis. This Report is compiled by the Monetary Policy Department at the Bank of Albania and it is adopted by the Supervisory Council. The current report contains data as at 21 January 2022.

The Supervisory Council reviewed and adopted this Report at its meeting of 2 February 2022.

¹ 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/Monetary_Policy_Document.html



FOREWORD BY THE GOVERNOR

The Albanian economy continues to recover at a rapid pace, supported by a broad gamma of factors. Projections about the future remain positive, but the increase in prices in international markets drove to a swift upswing of inflation in Albania and heightened uncertainty about the future.

The economic activity in Albania grew by 10.4% in the first three quarters of year, fuelled by: the relaxation of restrictions taken for curbing the pandemic; enhancement of foreign demand; improved business and households' confidence, increase of public expenditure; and the favourable financing conditions. Our assessments suggest economy has continued to grow in the fourth quarter as well.

The increase in the demand for goods and services is reflected in the expansion of activity across all sectors of economy. Since 2021 Q3, both the entire economy and its individual sectors have exceeded the production and revenues levels of the pre-pandemic period.

Economic growth is accompanied by increase of employment, which now is close to the pre-shock levels and of wages, which rose across all sectors of economy. The rise in wages has driven to the increase of Albanian households' income and has allocated the recovery fruits on a broader base.

Against this positive dynamic, inflation rose sharply in the fourth quarter, to 3.7% in December.

Our analyses suggest this increase is dictated by two factors. First, the progressive growth in the demand for goods and services, which drives to the rise in employment, wages, production costs and profit margins of enterprises. This factor has been present throughout 2021. Second, the sharp upswing in the prices of food, energy, transportation and goods costs in global markets. The second factor was particularly present over the last quarter, and has considerably pushed up inflation.

Our forecasts for the outlook remain positive. The Bank of Albania expects economic growth to continue in the next years. Nevertheless, this growth is expected to return closer to the historical average rates of the last decade. In parallel, we expect inflation rate continue to remain slightly above our 3% target in the course of 2022, owing to the developments in international markets. Inflation is expected to return to target in 2023, once surpassing these shocks.

In reflection of them, in the meeting of 2 February 2022, we decided to maintain the stimulating monetary policy stance. This policy used to be and will remain a supportive factor to economic rebound. Nevertheless, we expect this stimulus to gradually reduce in the future. This return of monetary policy to normality will aim at establishing the premises towards the observation of our inflation target, for a sustained economic growth over the medium term and long term, and for a good balancing of risks.



1 INFLATION AND MONETARY POLICY STANCE

In the meeting of 2 February 2022, the Supervisory Council of the Bank of Albania kept the policy rate unchanged, at 0.50%. The Supervisory Council deems that the current monetary policy stance is adequate to meet inflation target, over the medium term, and the needs of economic rebound.

The Supervisory Council assesses that economy is on a recovery phase, while inflationary pressures are building on both demand and supply sides. Projections under baseline scenario remain positive, although inflation is expected to remain above the target in the course of 2022, due to supply-side shocks. The confirmation of our expectations and the achievement of inflation target will require the reduction of monetary stimulus in the following quarters. However, the Bank of Albania will be attentive to the next developments, particularly to the materialisation of risk scenarios for assessing the monetary policy stance.

Global economy is experiencing a sharp increase of inflation, while growth momentum is slowing down, partially owed to the base effect, and partially owed to uncertainties dictated by the spread of Omicron variation. After the opening of economies, companies were faced with an increasing demand, while dealing with shortages in inventories and labour force. This unbalance drove to the increase in prices of commodities, inputs and consumption across many countries. Inflation in euro area jumped to 5.0% in December 2021, the highest level in the last two decades, led by the increased prices of energy. These prices are expected to keep inflation at high levels for some quarters in the euro area. The European Central Bank has continued to maintain the accommodative monetary policy stance, by assessing the supply-side shocks as transitory. On the other hand, some central banks in Europe have raised the policy rate, to address the swift increase in domestic inflationary pressures.²

The economic activity in Albanian has continued to expand swiftly and sustainably, but inflation increased rapidly at the end of year. The latter jumped from 2.4% in October, to 3.1% and 3.7%, respectively in November and December. The upward trend of inflation over 2021 has reflected the recovery in the pressures of demand, employment and wages. On the other hand, the high inflation rates across global markets drove to its swift upsurge in the last quarter. This phenomenon was reflected in the prices of processed foods, oil and energetic items in Albania. Foreign supply-side shocks are expected to maintain inflation above our target in the next months.

² Some central banks in the European Union: the National Bank of Poland, the Czech National Bank, the Hungarian National Bank and the National Bank of Romania.



The economic activity in Albania has recovered at a fast pace over 2021, bolstered by the relatively swift normalisation of consumption and investments, improved partner economies and the continuous support with stimulating policies.

Gross Domestic Product grew by 7.0% in the third quarter, after the 5.6% and 18.4% growth, respectively in the first and second quarter of 2021. Available information suggests positive growth rates of consumption during the fourth quarter as well. Economic growth has mainly reflected the increase in consumption and investment, also in the exports of goods and services. This growth has affected the entire economy sectors, with a strong recovery in the sectors of services and industry. Thus, the Albanian economy has fully recovered the losses suffered in 2020, both in sectoral and aggregate levels.

The expansion of economic activity was accompanied by the further improvement of labour market. Employment rose by 0.7%, unemployment rate dropped at 11.3% and the wages accelerated the increase rate at 6.9%, in the third quarter. Improving trends in labour market indicators and the increased job demand reported from enterprises signal that pressures on the growth of wages will continue strengthening in the future.

The new information of recent months was, overall, in line with our expectations, by not showing significant changes in our macroeconomic forecasts.

The Albanian economy is expected to progress along an upward trajectory in the course of 2022 and in the next years. Economic growth is expected to be broadly-based, underpinned by the further expansion in: private consumption; investments; and in the export of goods and services. The favourable financing conditions, the improved confidence and private sector's balance sheets, and the improved economic activity in partner countries are expected to support the economic growth. On the other hand, public sector is expected to reduce the direct impact on economic growth, in line with the Government's objectives for the consolidation of fiscal policy over the medium term. After the strong growth in 2021, the economic growth rates are expected to be in line with the economy potential to generate additional goods and services.

Inflation is expected to remain above the central bank's target in the short run, and further reduce towards it. This forecast is based on the conclusions in our analyses and the consensus with international institutions, which expect the re-establishment of the demand and supply balance in international markets, the solution of logistic problems and the stabilisation of energy price. This performance will elevate inflationary pressures and reduce the effect of foreign prices on inflation in Albania.

Inflation is foreseen to return sustainably to 3% target within 2023. The reduction of supply-side shocks, the increase of employment and wages in line with productivity, as well as the stability of profit margins will support the



inflation to converge to target. Nevertheless, the revision of our projections suggests a later stability of prices in international markets, which also extends the return of inflation to target.

The balance of risks appears tilted upside in the short run and balanced in the medium term. In one hand, a faster or prolonged increase of prices in international markets and a slower consolidation pace constitute upside risks to inflation. On the other hand, a slower recovery of both global and Albanian economies, due to the pandemic or a faster tightening than expectations of financing conditions, poses downside risks.

The continuation of the accommodative monetary policy stance is needed for the sustainable return of inflation to target and the consolidation of economic recovery. Hence, the Supervisory Council decided to keep the policy rate unchanged, at 0.5%.

The Supervisory Council assesses that the accommodative monetary policy stance has yielded positive effect on the economy. Interest rates on loans to both households and enterprises have remained at low levels, coupled with the stable exchange rate of lek against main foreign currencies. Bank credit grew at high rates throughout 2021. Its growth has financed investments and expenditure, of both enterprises and households, while its foreign exchange structure has appeared more balanced. Supportive factors of credit growth - high demand, eased lending conditions and sound balance sheets of banking sector - are relatively solid, suggesting an ongoing good performance of credit in the future.

Monetary stimulus will continue to support the economic growth in the medium term. Nevertheless, the consolidation of economic rebound will require a gradual normalisation of monetary policy during 2022. This consolidation will aim at better balancing the risks to both economic recovery and inflation increase. Also, during the normalisation process, the policy rate - and consequently the interest rates of financing to private sector - will remain below the historical level, by preserving a stimulating financial environment to the economy.

On the other hand, the Supervisory Council remains attentive to the transmission of foreign supply-side shocks on the Albanian economy, and ready to react if the latter jeopardise the objective of price stability in the medium term.



2 EXTERNAL ENVIRONMENT

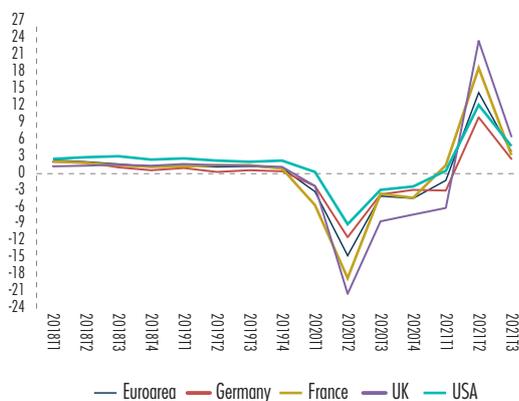
External economic environment worsened in the last quarter of 2021, due to the increased uncertainty induced from the spread of new Covid-19 variation and the supply-side shocks on prices. Global consumption was contained; trade worsened, while developing countries showed problems in the production chain. Inflation rates have shown an upward trend, by recording the highest values in the last decade. Their performance was mostly affected by the upswing in energy prices and the bottlenecks in global supply chains. While central banks have started to tighten their monetary policies, financing conditions remain favourable. Factors affecting the rise in prices are considered to have a temporary nature, but their prolongation may induce sustained inflationary pressures.

2.1. ECONOMIC GROWTH

Global economy has continues to grow in the final quarter of 2021, although the growth rate has been slowing. The spread of the Omicron variant of the coronavirus (COVID-19) has heightened the uncertainties of economic agents, driving to a fall in consumption. Supply chain disruptions, higher transport costs and long delivery times have weighed on trade and put upward pressure on prices. Preliminary data show that industry sector has continued to suffer the supply-side shocks, while the sector of services has benefited from the relaxation of restrictions on mobility taken by some countries in December.

Chart 1

The global economic activity has slowed the growth rate in the third quarter



Note: Annual GDP growth.
Source: OECD.

Advanced countries have experienced a fall in consumer's confidence, observed also in the slow increase of consumption. The relaxation of restrictive measures in the last month has affected the improvement in services sector, while output sector suffers the supply-chain bottlenecks. Most developing countries and exporter countries of goods have tightened the restrictive measures, driving to intensify difficulties in production. In China, the energy shortage and its increased prices, coupled with the resurged problems in construction, have negatively affected the economic recovery pace.

Projections on economic outlook show that economic activity will continue to grow in the next year, but at lower rates from 2021, by reflecting the lack of low

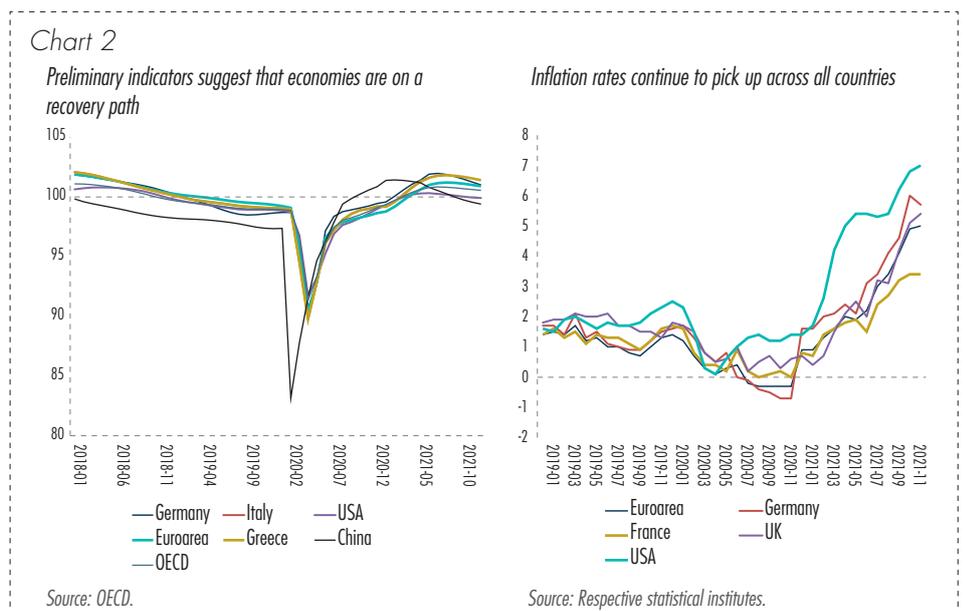


comparative base observed a year earlier. The further performance remains related to the increased uncertainties about the spread of the pandemic and the prolongation of the high inflation rates observed across all countries. The tightening of monetary policy is also a phenomenon that induces downside risks to forecasts.

EURO AREA ECONOMY

The euro area economy continued to grow in the third quarter of 2021, but at a lesser momentum than in the previous quarter, when the effect of low comparative base was present. Economic growth in the third quarter reflected the increase in consumer spending, which benefited from the reduction of restrictions during the summer. Production sector has suffered the disruptions in global supply chain and the shortages they have generated to the market. Preliminary data of the fourth quarter suggests that impairments in the sectors of production and services, stemming from increased energy prices, supply chain disruptions and the new containment measures have driven consumer confidence worsening. The unemployment rate has continued to be on a downward trajectory to stand at 7.2% in November. Inflation rate, showing an upward trend throughout the year, stood at 5.0% in December. This value, the highest rate for more than one decade, stands above the European Central Bank’s target. Almost half of inflation was driven by the increased energy prices, while the rest by inflation in services, industrial products and foods. Although the upswing in consumer prices is bolstered by temporary factors, their continuation may feed inflationary expectations and generate longer-term pressures on prices.

The European Central Bank envisages economic growth be moderate in the course of 2022, absence of the low comparative base that provided its impact in the previous year³. The economic activity is expected to hit the pre-pandemic



³ Eurosystem staff macroeconomic projections, December 2021.



levels in the first half of 2022. Inflation is expected to record high increasing rates in the short run, stay above the target over 2022, by pursuing a converging trajectory towards the ECB's 2% target in the next year.

REGIONAL ECONOMIES⁴

The economic activity has continued to grow across regional countries in 2021 Q3, but at a more moderate growth rates in response to the reduced base effect. Both consumer and government expenditure has supported the economic growth in all countries. Investments have stepped back, excluding Serbia where investments recorded a double-digit annual growth. Indirect data show that the regional positive performance has continued in the next period. Forecasts suggest economic growth will record high rates for 2021, to somewhat moderate in the current year.

Inflation rates have picked up in recent months, by recording the highest values in the last decade. This upswing in inflation reflects the rise in prices for energy, transport and food.

Table 1 Economic indicators for countries in the region

	Annual change of GDP		Annual inflation	Unemployment
	2020 Q2	2021 Q3	December 2021	2021 Q3
Italy	17.1	3.9	4.2	9.2*
Greece	16.6	13.4	4.4	13.4*
North Macedonia	13.4	3.0	4.9	15.7
Serbia	13.7	7.7	7.9	10.5
Kosovo	16.3	14.5	6.7	25.8†
Albania	18.4	7.0	3.1	11.3

Source: Respective statistical institutes.

*November 2021, †2021 Q1.

2.2. COMMODITY PRICES IN GLOBAL MARKETS

Commodity prices in global markets continued to pick up at high rates in the last months, but at a lesser momentum. The price of crude oil reached 74.2 USD a barrel in December, or around 48% higher than the same period in the previous year. Nevertheless, in monthly terms, the price contracted around 9%. Worries in the market about the spread of the pandemic, which increased the uncertainty in oil demand for the future, drove to this performance. In the future, it is expected an increases of price in the first quarter, and a downward trajectory in the next months⁵. In the domestic market, the rise has started to be reflected with a time lag, while prices are tracing an upward trend from some months.

⁴ Main trading partners outside the European Union (Kosovo, North Macedonia, Serbia, Turkey).

⁵ US Energy Information Administration, Short term energy Outlook, January 2022.

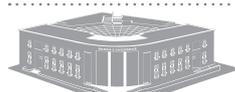
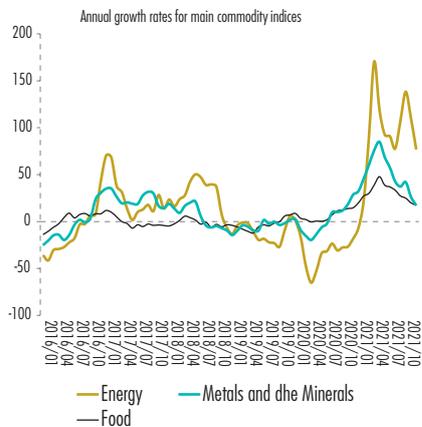


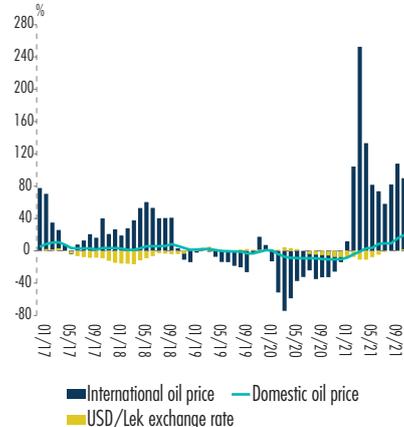
Chart 3

Main indices has halted the climbing trend, but remain at high levels



Source: World Bank.

Oil price in Albania has started to react against the external price pressures



Source: INSTAT, staff estimates.

Also, indices of other prices have showed similar behaviour. Food prices have continued to record double-digit increasing rates while the upward trend appears to have started to mitigate. The favourable climate conditions have helped the growth in agricultural production, thus mitigating the growing pressures on price. In addition, metal prices have also shown a softened double-digit increase in December. Recovery of economic activity in developing countries, which mostly use metals, impacts on the increase of the demand for metals, be exerting upward pressure on the prices of commodities in this index. High prices of metals have positively affected the export of domestic metals.

Price of electrical energy pushed up swiftly in the fourth quarter. Price of electricity in the Hungarian Power Exchange was up by 400% in annual terms. In January 2022, the price has been reduced from the previous month, though it continues to remain above the double value of January 2021. According to futures, prices of electricity are expected to slightly decline in the second quarter.

2.3. GLOBAL FINANCIAL MARKETS

Financing conditions continue to be eased and real interest rates are negative, but the monetary policy outlook is towards normalization. Financial markets showed higher volatility in the fourth quarter, driven by increased inflation rates, the swift spread of Omicron and expectations for a reduction in monetary stimulus. Major central banks (Fed, ECB, and Bank of England) have started to react, driven by the uncertainty that prices increase may last longer than initially estimated. Some of the central banks increased the interest rates, shifting thus the capital flow and tightening financing conditions, especially for some developing countries.

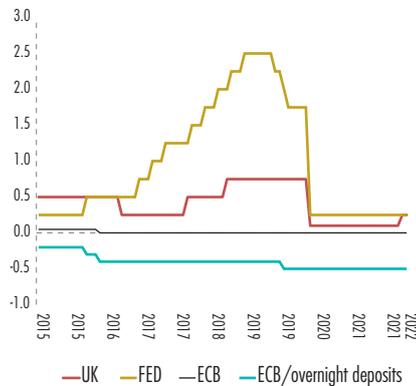


The Bank of England increased the policy rate by 15 basis points to 0.25% in December. The BoE based this decision on expectations for higher inflation rates. The Fed did not change the interest rate, but it did scale back total purchases under the terms of quantitative easing. Its projections also show an increase in the interest rates in 2022. The ECB maintained a flexible stance being conditional from the economic data. It has communicated the judgement that the factors that influenced the rise in inflation are transitory, while showing that it is concerned by the timely extension of its high rates and the uncertainties that surround it. The ECB has assured the market that it will continue to maintain low interest rates for some more periods. However, it took a step towards normalization in December, deciding that purchases under the PEPP⁶ programme would be completed in March 2022.

Interest rates rose by the end of 2021 and early in 2022, reflecting investors' uncertainty regarding inflation and the pandemic. The growth has been pronounced in the short-term segment, which reflects the expectations for tightening monetary conditions by central banks. Long-term yields have remained relatively more stable.

Chart 4

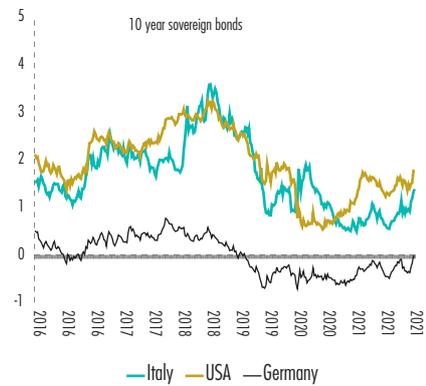
Central banks are expected to reduce monetary stimulus by lowering quantitative easing programs and / or raising interest rates



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

Source: Central banks.

Rise of inflation and assumptions that monetary policy may be tightened have led to the increase of short-term yields



Notes: 10-Year yields on government bonds.

Source: Bloomberg.

⁶ The pandemic emergency purchase programme (PEPP) is a quantitative easing program created by the ECB when the pandemic began, in order to maintain favourable financing conditions and address low inflationary pressures during this period.



BOX 1 WHY HAS INFLATION PICKED UP GLOBALLY?

Global economy is suffering a swift upswing in inflation in the last quarter, partially due to the recovered demand and mainly due to supply-side shocks. These shocks, overall, are of global nature, in reflection of the quick rise in the prices for oil, energy and commodities, coupled with the supply chain disruptions and fast increase in prices of transport services.

This Box aims at shedding more light on their nature and impact. The first part briefly describes the global factors after the rise in inflation, while the second part analyses inflation across different regions, by identifying the similarities and differences amid them.

1. Global factors backed inflation increase^I

A. Prices of energy items

Year 2021 was characterised by a sharp rise in prices for oil, gas and electricity. Oil price rose by around 20 USD (35%) since the beginning of 2021, standing at 75 USD/per barrel in December 2021 (Chart 3). The mismatch between the fast increase of the demand and the constrained supply pushed up its price^{II}. According to forecasts, crude oil price is expected to increase in 2022 Q1, and go along a downward trend in the next period.^{III} At the beginning of December 2021, OPEC+ decided to increase oil production in January 2022, in line with the plan for gradually setting off the output cuts which emerged in 2020. In addition, the USA and other countries have declared the higher use of strategic oil reserves.

Gas and electricity prices rose considerably in the last year. Oil prices increased driven by the cold winter, the very lower supplies from Russia and lower gas storage levels in European countries. European prices of gas futures show a pronounced fall of gas in the summer of 2022, in reflection of the expectations on increased imports of gas from Russia and the decrease of its consumption. On the other hand, based on the same sources, gas prices are expected to remain the highest in the current years.

The increase in gas price led to the rise in the price of electricity, as one to five of electricity production in Europe is based on natural gas. Market price of electricity in Italy and Germany soared by around 500% since the beginning of 2019. According to the futures, electricity price in Italy is expected to follow a downward trajectory in 2022 Q1, and further remain stable in the next part of year, to fall again in the beginning of 2023. Nevertheless, the prices are expected to reach the double of the pre-pandemic level, even after the falling trajectory.^{IV}

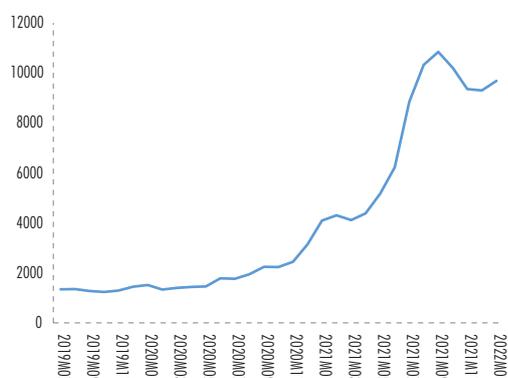
B. Supply bottlenecks, high prices for commodities and input shortages

The pandemic and social distancing measures caused high fluctuations in the global economic activity. Since the beginning of the Covid-19 pandemic, many transporting companies shut down their ships for reducing shipping costs, while goods orders were down. When the demand recovered, the supply did not succeed to adapt to the same pace. In parallel, goods traffic was disrupted due to some incidents in the summer of 2021^V. The Global Container Index - which reflects the median price of containers taken for an usual number of shipping routes - shows that shipping costs of goods have increased sharply since



Chart 1 HI 1

Shipping container prices have more than quadrupled since the start of the pandemic



Source: Freightos, the Global Container Index.

summer 2020. Notwithstanding the recent significant improvements, the situation still remains problematic and prices continue to spike (following Chart).

Frequent fluctuations in the demand and various interruptions of productions drove to the fast upsurge in commodity prices, like food items (corn, coffee, sugar, oil, etc.), coupled with other impediments in global supply chains, by augmenting the shortages in goods and inputs^{VI}. According to futures, prices of foods are expected to rise in 2022 Q1, but by mitigating their inflationary trend^{VII}. Geopolitical tensions in Ukraine, one of the main corn-producing countries, may drive these expectations shift to the upside.

C. Rise in services prices

The pandemic has led to considerable fluctuations in services prices. When social distancing restrictions were introduced in 2020, they halted the increase of prices in services, as: hotels, restaurants, entertainment,

travels, etc. The alleviation of restrictions drove demand for these services jumping, by finding companies unprepared and with staff's shortages. This situation led recently to the fast using in prices of services.

2. Inflation and monetary policy decision across different regions

Inflation in the United States remains high since 1982. In December, consumer prices inflation reached 7%, following a progressive increase recorded during 2021. Energy prices continue to be the main contributors, accompanied by the increase of car prices - mainly used ones - housing and food. Core inflation increased rapidly over a short period of time - at 5.5% in December - reflecting the heightened job market pressures and inflationary expectations. The central bank of the USA (Fed) has reduced the size of the monthly purchases of assets, by diminishing the monetary stimulus in the economy, but has not yet increased the policy rate.

Inflation in the Euro area remains at the highest levels since 1999

In the euro area, consumer prices inflation increased by 5% in December, but the differences across Member States are considerable. For example, Malta (2.6%) and Portugal (2.8%) have relatively low inflations, whereas Lithuania (10.7%) and Estonia (12%) have reached double-digit inflation rates. Most price hikes since the beginning of last year, are explained by the increases of energy prices. Core inflation, which excludes these prices and unprocessed food prices from the calculation, was around 2.6% at the end of the year. Despite the increasing trend, its difference from total inflation is noticeable.

The European Central Bank (ECB) deems that the increase of inflation will be transitory, although the effects of the above mentioned factors have been stronger and longer in time from initial expectations. The ECB expects that these effects will lessen over 2022 and has not reacted by contracting the monetary policy.

Inflation in Central European countries^{VIII} is the highest in a decade.



Inflation followed a climbing trajectory in in Poland, Czech Republic, Hungary and Romania by hitting the highest values for at least from decade, and being above the respective targets of the central banks. The increasing trend of inflation across all countries is bolstered by the high prices in energy, transport (including fuels) and foods. Also, higher prices in energy and gas have affected the increased contribution of the category “Rent, water, fuels and energy”.

Central Banks has intervened by increasing the policy rate. Poland increased the policy rate, from 0.1% to 2.25%, through four interventions since September 2021. Romania increases the policy rate from 1.25% to 2%. The central bank of Hungary and the Czech National Bank have started to tight the measures in the third quarter, by intervening 6 times and 5 times, respectively. ¹Currently the policy rate in Hungary And Czech Republic stands at 2.4% and 3.75%, respectively.

ⁱ Box 1. Commodity prices in Global markets, Monetary Policy Report 2021/IV

ⁱⁱ At the end of 2019, OPEC+ and its allies agreed to cut oil production in member states. The increased demand from main countries, after the removal of quarantine measures, drove up oil prices in international markets. In addition, the geopolitical tensions in oil producing countries have served as upside shocks on this price.

ⁱⁱⁱ US Energy Information Administration, Short term energy Outlook, January 2022.

^{iv} Futures prices of January, NYMEX exchange

^v In March, the Ever Given, one of the world’s largest container ship got stuck in the Suez Canal, causing a huge traffic. In addition, China has shut down some major container ports due to the outbreak of COVID-19 at different periods.

^{vi} Such examples include: steel; wood; plastic; and some textiles.

^{vii} Staff’ assessment, based on futures of Chicago Mercantile Exchange.

^{viii} Inflation in Poland, Czech Republic, Hungary and Romania, is in the interval 6%-8%.



3 FINANCIAL MARKETS AND LENDING CONDITIONS

Positive developments characterised the financial market also during the fourth quarter of the preceding year. The accommodative stance of the monetary policy continues to induce low liquidity risk premia and a positive approach of banks towards funding both the private and public sector.

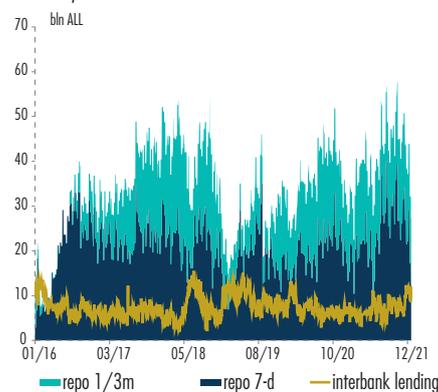
The improved pace of credit in the fourth quarter reflected mainly the expansion of loans to enterprises, particularly those designated to fund liquidity needs. The household segment also showed stable growth rates, supported mainly by the expansion in mortgage loans. Interest rates in all its segments have fluctuated at low levels and the foreign exchange market was calm.

3.1 DOMESTIC FINANCIAL MARKET⁷

The interbank market continues to be characterised by stable interest rates and a calm liquidity situation. The banks' interest rates of interbank fund trading have remained almost unchanged from the previous quarters. Their minimum differences from the policy rate are in line with the operational target of the monetary policy, and they have reflected a calm environment without added pressures for liquidity. The Bank of Albania continued to supply liquidity through its main instrument of one-week repo, as well as through the three-month maturity injections. The injected amount in this quarter was equal to the third quarter⁸.

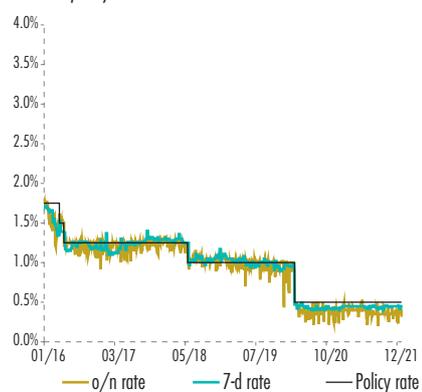
Chart 5

The liquidity situation of banks has remained calm in the last quarter



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 the money market.
Source: Bank of Albania

Interest rates in interbank market remain anchored close to the policy rate



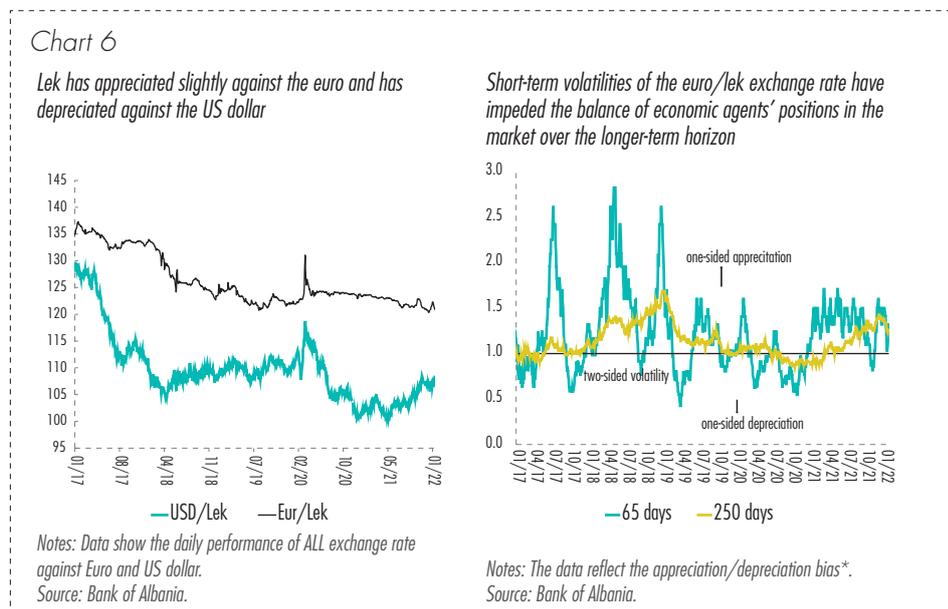
Notes: Data show the daily performance of interest rates in the interbank market.
Source: Bank of Albania

⁷ The following analysis is based on the data available up to 21 January.

⁸ The average liquidity injected in 2021 Q4 was ALL 45 billion, equal to the third quarter but higher than the first half of the year (ALL 35 billion).



The fourth quarter of 2021 was characterised by a slight appreciation of lek against euro, and a continuing depreciation of the lek against the US dollar. The euro/lek exchange rate averaged 121.5 lek/euro in this quarter, from 121.8 lek/euro in 2021 Q3. Fluctuations in the euro/lek exchange rate were balanced during this period, reflecting the ratio between market demand and supply. Both the euro/lek exchange rate volatility and the quotation spreads have remained close to their average levels. In particular, volatilities on the appreciating side of the euro/lek exchange rate, which characterised both the second and third quarter, have declined in the fourth quarter and the positions of economic agents in the markets remain balanced. In the first three weeks of January, lek depreciated against the euro, which was a typical performance during this month. The euro/lek exchange rate averaged 121.7 lek/euro, appreciating by 1.5% compared to the average level of January last year.



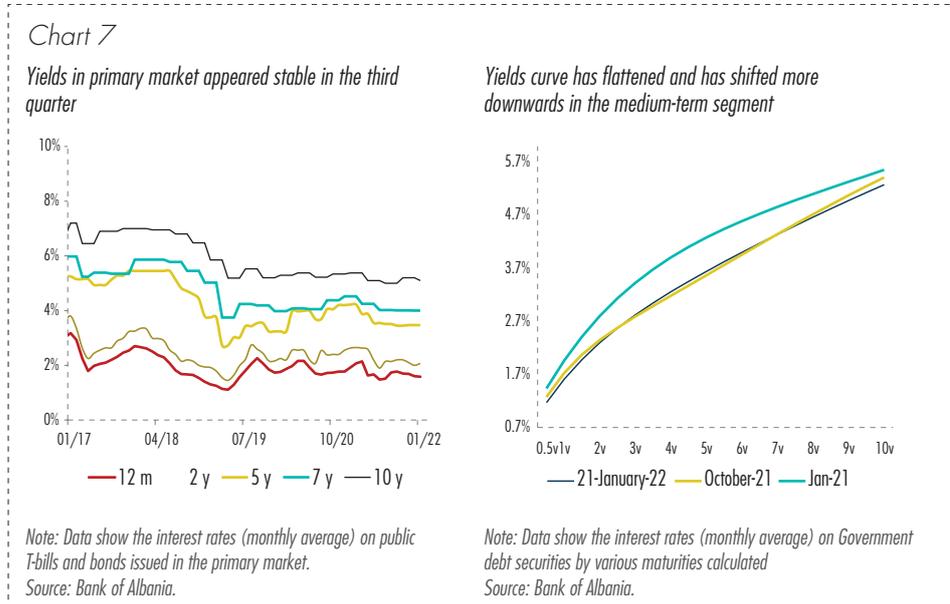
Lek depreciated against the US dollar also during the fourth quarter, in line with the strengthening of the latter against the euro in the international market. The USD/ALL exchange rate averaged 106.2 lek/usd in this quarter, from a value of 103.3 lek/usd in the third quarter. The depreciation of lek against the US dollar has continued also during January, when the usd/lek exchange rate averaged 107.1 lek/usd, with an annual depreciation of 5.4%.

The performance of yields on T-bills and bonds in the last quarter of the year has reflected the congruence between demand and supply in the primary market; differences in them have been at minimum level and in the downside.

* 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).



Government's demand for funding has been entirely absorbed by the market, confirming its positive approach towards risk taking. The coverage ratio of government debt securities auctions, for both T-bills and bonds, has remained high during this month⁹. Their monthly dynamic shows that yields have fluctuated, particularly regarding the short-term maturities. Starting from October, yield on 12-month T-bills has followed a falling trajectory, closing the year at 1.6%, or down by 0.2 p.p. compared to September and the previous year. The behaviour of yields on bonds has been stable, with a minimum decline on long-term maturities. At the latest auction organised in January, the 10-year yield on bonds was 5.10%, or down by 0.1 p.p. from October, and by 0.3 p.p. from last year. Beyond the temporary dynamics, the overall level of yields remains below the quarterly values of 2021. The yield curve has reflected these developments, shifting downwards, mainly on the medium-term maturity, compared to the previous year.



In November 2021, the Ministry of Finance and Economy issued bonds with 15 years maturity for the first time. The high demand for these bonds and 5.9% yields confirm the contained risk premia in the domestic market. At the same time, the government realised the issuance of 10-year Eurobond in the international market. The use of funds created from this Eurobond is expected to provide yield stability in the domestic market, while banks' demand for investments in the primary market is stable.

3.2 LENDING CONDITIONS

The sound situation of the banking system and the low credit risk premia are manifested in a positive approach of banks towards lending, materialised in low interest rates on granted loans and further easing of the lending standards. The average interest rate on new loans to enterprises in lek stood at 5.7% in

⁹ The bid/cover indicator for government securities auctions in the primary market was 1.3 in the last quarter, equal to 2021 Q3.



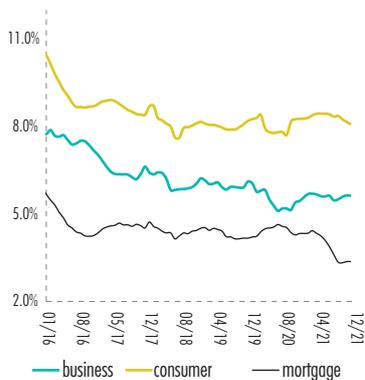
2021 Q4, close to the average level of 5.6% recorded in first three quarters of 2021. Looking beyond the high volatility that characterises them, the stable performance of interest rates in this quarters is noted on both small loans (up to ALL 35 million) as well as on large ones (over ALL 140 million), whereas interest rates on medium-sized loans have slightly increased.

Banks continued to provide low interest rates on **loans to households** in the fourth quarter of the year as well. The average interest rate on mortgage loans was 3.6%. Although rising against the 3.3% average of 2021 Q2 and Q3, it remains lower than the 4.4% level of the previous year. In consumer credit segment, the interest rate has recorded a decline in the fourth quarter, dropping to 7.9%, from the 8.3% long-term average.

In the last quarter, interest rates on **new loans in euro** were 4.6%, remaining close to the average of year's previous quarters. They remain at low levels also when compared to the 5.4% average of the previous year. By intervals, interest increased slightly on both loans up to EUR 250 000 and loans over EUR 1 million. Similar to enterprises, interest rates on loans to households in euro remained close to the annual average, and below the levels of the previous year. Interest rates increased on loans for house purchases, while they registered a decline for consumption financing.

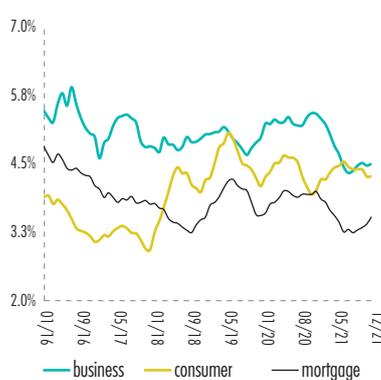
Chart 8

Interest rates remained stable for loans in lek to enterprises and households



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

Interest rates for loans in euro have remained stable, on average, for enterprises and mortgage loans



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

Interest rates on new deposits have continued to fluctuate at low levels during these months, registering marginal changes. The financing cost to banks remains at minimum levels. Average interest rate on **new time deposits in lek** was 0.70% in the fourth quarter, from 0.75% in the previous quarter, and equal to the annual average. Interest rates on deposits registered a minimum decline with up to 1 year maturity, in this quarter. Average interest rate on **new time deposits in euro** was 0.20% in in this quarter, equal to the previous quarter, but slightly higher than the first half of the year (0.15%).



BOX 2 SUPPLY CONDITIONS AND DEMAND FOR LOANS IN 2021 Q4¹

Indicators of loan supply and demand continued to improve in the fourth quarter, for the third quarter in raw. Positive developments in loan supply and demand reflect the economic recovery in Albania and the improved risk indicators on loans, assessed in lending policies of commercial banks.

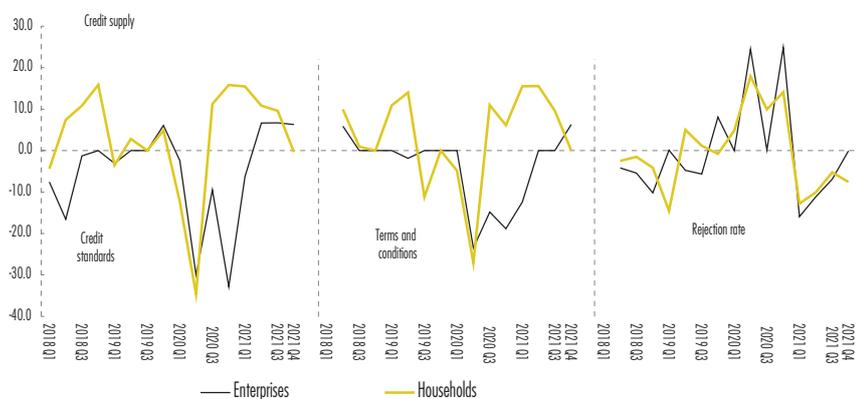
Banks have further relaxed their lending policies to enterprises in 2021 Q4, in particular for the segment of large enterprises. The business-plans submitted from this segment, coupled with the improved credit risk indicators - the borrowers' creditworthiness, credit history and collateral, etc. - drove banks to further ease credit standards on loans to enterprises, and for both loan's purpose of use, investment loans and loans for meeting liquidity needs. Alongside the standards, banks also eased the terms and conditions on loans for the first time in the last three years, by offering to clients more favourable margins as well lower commissions. In the fourth quarter banks reported a similar rejected loan ratio with the previous quarter.

Supply conditions of loans to households were also improved in the fourth quarter, though their easing was focused only on loans granted for house purchases. The loan rejection rate was reported downwards in the last quarter of 2021, reflecting mainly the perception of banks related to both the improved credit history and the borrowers' creditworthiness.

Loan demand from enterprises remained high in the fourth, mostly concentrated on large enterprises. The expansion of loan demand from enterprises reflected the higher needs for financing investments and liquidity and the improved financing conditions.

Chart 1 HI 2

Supply conditions for loans improved to both enterprises and households



Values in chart represent net balances. Positive values indicate easing of terms and conditions and vice versa. Positive values indicate increase of the scale of application refusal and vice-versa.

Source: Bank of Albania.



Higher loan demand was observed also from households, in the fourth quarter, but it was concentrated on house purchase loans. In addition to the higher needs for house purchase financing, the increased demand for loans from households was supported by the improved confidence indicators in economy and the current level of interest rates.

For the first quarter of 2022, the year, banks' expectations are the same for both the supply conditions and demand for loans.

¹ The analysis is based on Bank Lending Survey and conducted on quarterly bases and is published at: www.bankofalbania.org.

Chart 2 H1 2

Loan demand from both households and enterprises was perceived upwards



Values in chart represent net balances. Positive values show increase of credit demand, while negative values show its decrease.

Source: Bank of Albania.

3.3 CREDIT TO THE PRIVATE SECTOR¹⁰

Credit to the private sector continued to increase in the fourth quarter of 2021.

Also, banks offered a higher support to the increased demand from enterprises and households. The annual growth rate of credit to the private sector was 9.9% in 2021 Q4, from 8.6% in 2021 Q3, and 7.6% in 2021 H1. The economic recovery, the positive expectations on its performance in the future, and the contained risk premia, has continued to dictate an active commitment of banks towards financing to the economy.

The higher increase in **credit to enterprises** has led the improved growth of loans in the fourth quarter. In 2021 Q4, credit to enterprises marked 9.1%, on average, from 7.6%, on average, in the first three quarters of 2021. The acceleration of loans for meeting liquidity needs mainly drove to the growth of loans to enterprises, different from the previous quarter, where loans for investment purposes were the main drivers. These loans grew averagely 9.0% in annual terms, or around 4.6 p.p higher from the third quarter of 2021. On the other hand, credit for investment purposes recorded an annual growth of 9.2%, continuing the deceleration started in the first half of year. Notwithstanding the deceleration, credit for investments remains the main bank financing to enterprises, in line with the increasing demand for this kind of loans.

Credit to households has continued the climbing trajectory observed since the beginning of year. Its annual growth stood at 11.6% in this quarter, or 0.7 p.p. higher than in the previous quarter. Mortgage loans, annually up by 14.3%

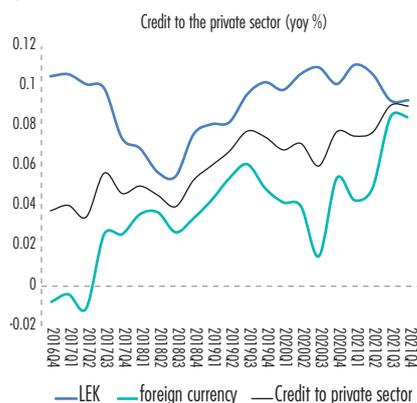
¹⁰ Credit analysis refers to the monetary data adjusted to account for the effect of exchange rates. Credit data are adjusted also for written off loans.



dictated the good performance of credit to households in this quarter. The specifically eased condition on these loans, since from more than one year, coupled with the supportive housing schemes, have driven to an increased demand for purchases in the real estate market. On the other hand, consumer credit grew at a similar pace with the third quarter, 8.6%, by maintaining the improvement against the first half of 2021.

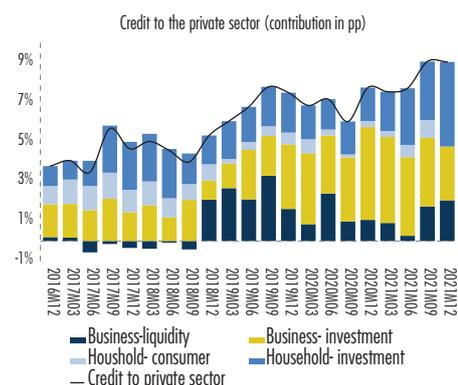
Chart 9

Credit to private sector recorded a high growth in the fourth quarter



Notes: The data indicate the annual changes (%) of lending by currency.
Source: Bank of Albania.

Both lending to enterprises and households have supported the growth of credit in the fourth quarter



Notes: The data indicate the annual changes of lending by purpose of use to the private sector.
Source: Bank of Albania.

Credit in lek continues to provide the main contribution in the expansion of credit, though at a lower extent than in the first half of 2021. Its annual growth slightly slowed down to 9.7% in the fourth quarter. In parallel, credit in foreign currency recovered swiftly. Its annual growth rate was 10.2% in the fourth quarter, or around 3.0 p.p higher than in the previous quarter. Higher lending in the course of 2021, particularly high demand from enterprises, and the considerable growth of deposits in foreign currency, drove to a larger engagement of banks in foreign currency funds lending.

Bank deposits continued to expand with high rates. In 2021 Q4, deposits expanded averagely around 10.3%, from 9.8% in the previous quarter. Households' savings, forming around 2/3 of growth of total deposits in the system, in the last quarter, continues to support the expansion of deposits. In terms of currency, foreign currency-denominated deposits, mainly those of households, have generated most of total deposits growth. This trend turned more evident after the first quarter of year. Data from the economy supports this increase in foreign currency savings, when the growth in tourism incomes was more pronounced¹¹. Enterprises' deposits also experienced a persistent growth over 2021, providing an average contribution of 3.2 p.p. in the total growth

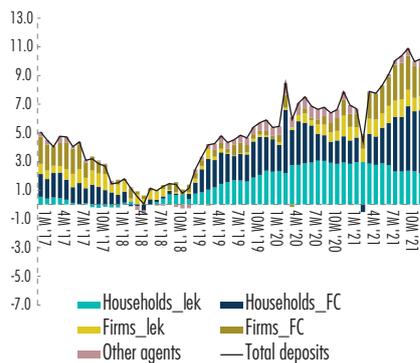
¹¹ The balance of travelling services was positive at EUR 673 million, in the first 9 months of 2021, compared to EUR 412 million in the same period in 2019 (2020 is not considered due to the high restrictions posed on mobility to contain the pandemic). On the other hand, remittances were around EUR 540 million, around EUR 70 million higher than in 2020.



of deposits in the fourth quarter, similar to 2021 Q3, but somewhat higher from the first half of year. Enterprises' deposits recorded a considerable part of growth in December 2021. This is a seasonal phenomenon related to the high concentration of public spending at the end of year.

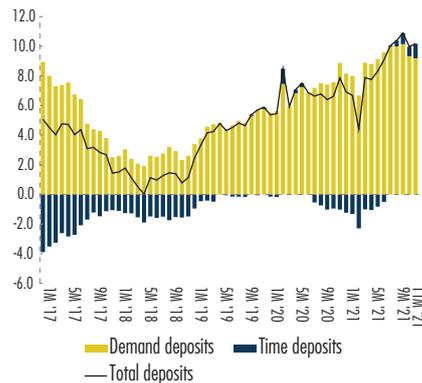
Chart 10

Deposits continued to grow being based at a broad extent in the foreign currency component



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

Households also have preferred time deposits



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

Demand deposits dominate the structure of deposits. Economic agents continued the preferred trend to hold their savings in demand deposits, which accounted for around 55% of total deposits at the end of 2021. This ratio is 3.6 p.p. higher than in the previous year. Nevertheless, developments in the last quarter, showed the households' preference to deposit their savings in 2-year maturity deposits. Time deposits contributed by averagely 0.8 percentage point in the 10.3% growth of deposits in the fourth quarter of year.



4 ECONOMIC GROWTH

Gross Domestic Product in Albania grew 7.0% in the third quarter of 2021, showing a slowdown in the annual growth pace from the second quarter of 2021, in line with our expectations. Economic growth was broadly based, by reflecting the expansion in all aggregate demand components and being present across all sectors of the economy.

The increased external demand, the improved confidence and the stimulating monetary and fiscal policies have fuelled the expansion of the economic activity. These factors are expected to contribute in the expansion of economic activity in the course of 2022 as well.

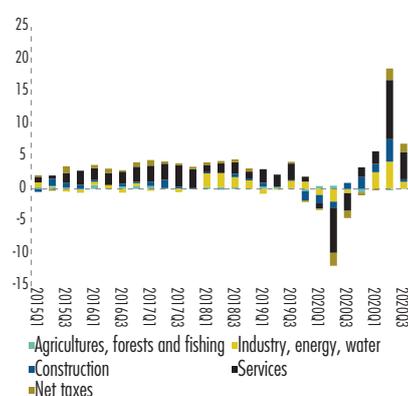
Indirect data suggest a slowdown of economic growth, in the fourth quarter, in reflection of the further reduced base effect, and bringing it in line with the economic growth potential.

4.1 GROSS DOMESTIC PRODUCT

GDP expanded by 7.0% in annual terms in 2021 Q3. As expected, annual growth slowed down in reflection of a more mitigated base effect from the previous year¹². Economic growth was broadly-based. Production sector provided a 1.5 percentage points contribution in this growth, while services sector contributed by 4.2 percentage points (Chart 11, left). This dynamic

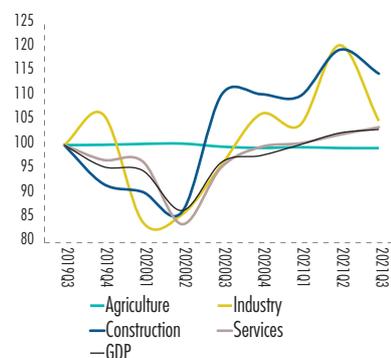
Chart 11

Economic growth slowed down compared to the previous quarter, affected by the more mitigated base effect



Source: INSTAT and Bank of Albania.

All sectors have surpassed the value added levels of the pre-pandemic



Note: The value added of the economic sectors adjusted seasonally and turned into an index based on the 2019 Q3.

Source: Bank of Albania.

¹² The annual contraction of GDP was -3.5% in 2020 Q3.



implies that the volume of economic activity has surpassed the pre-pandemic levels across all sectors (Chart 12, right).

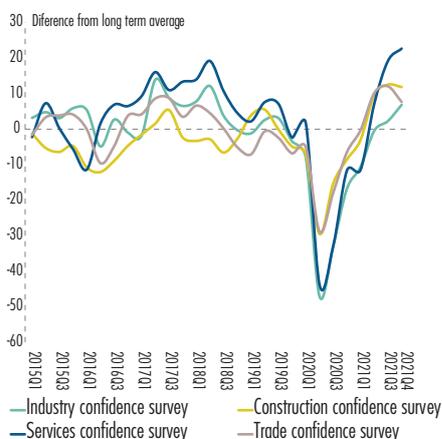
The production sector expanded by around 4.2% in 2021 Q3, from 18.4% in 2021 Q2. Industry provided the main contribution in this regard (1.1 percentage points), and more concretely the mining industry (0.7 percentage point). Mining industry provided almost equal contributions with the second quarter. On the other hand, the manufacturing industry reduced its contribution (0.5 percentage point from 1.8 percentage points in the second quarter). Construction activity showed similar developments, with a contribution of 0.4 percentage point in the third quarter, from 3.5 percentage points in the previous quarter. Construction is characterised by an earlier recovery, with double-digit growth rates since 2020 Q3, by suggesting a more complete normalisation of its activity. The branch of electrical energy is being characterised by reduced contributions, reflecting the less favourable hydrous situation compared with the previous quarters. Whereas, activities in agriculture, forests and fishing expanded only by 0.3%.

Value added in **services sector** grew by 9.1% in 2021 Q3, a slowed performance compared to the previous quarter. "Trade transport, accommodation and food services" provided the main contributions in this growth. Likewise in the previous quarter, the branch of "Accommodation" closely related with the swift growth in the export of tourism services has provided significant positive contributions¹³. Meanwhile the other branches of services have also provided positive contributions, although with lower magnitudes compared with the second quarter.

Economic growth is expected to be slower in the fourth quarter of year, but remaining at comparable levels with the historical high growth rates¹⁴. Also,

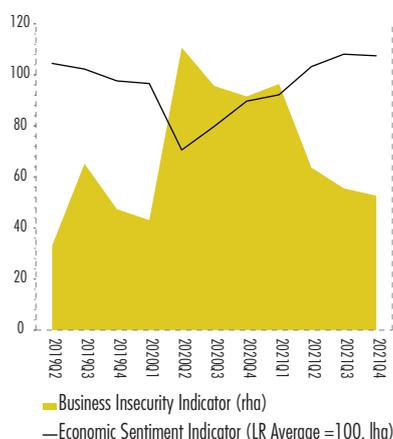
Chart 12

Improving trend of confidence indicators has reflected a certain maturity in during 2021 Q4



Source: Bank of Albania.

... similar view is observed in the Economic sentiment and uncertainty indicators of enterprises



Source: Bank of Albania.

¹³ Based on the data in the Balance of Payments for 2021 Q3.

¹⁴ In 2020 Q4, economic growth shifted to positive territory by 2.4%, by signalling a fading of the comparative base effect of the first year of the pandemic.

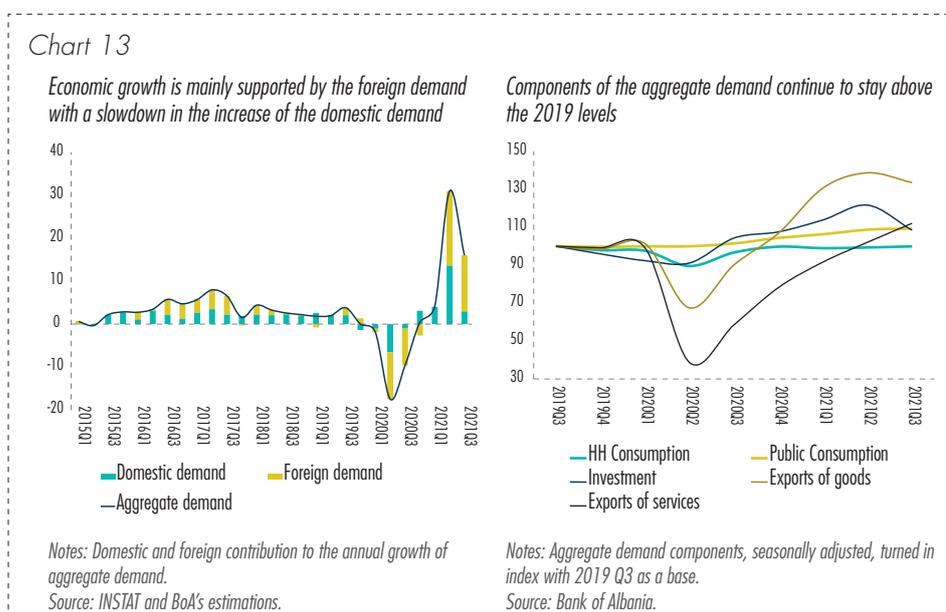


the qualitative data of confidence surveys support this assessment (Chart 12, left). Internal measures to contain Covid-19 spread were tightened somewhat in the fourth quarter, while international restrictions were intensified on travellers' mobility in the framework of curbing Omicron variation. These restrictions are expected to be particularly reflected in the performance of tourism sector and the related services.

4.2 AGGREGATE DEMAND

Aggregate demand continued to expand in the third quarter. Foreign demand driven by the high increase in the export of tourism services provided the main contribution in this growth. On the other hand, domestic contributions were reduced, given that the domestic demand started the recovery earlier (Chart 13, left). The recovery of external demand was delayed, as the restrictions on international mobility of travellers were relaxed later, compared with the measures taken in Albania.

Domestic demand expanded by 3.8% in annual terms, in 2021 Q3. Both consumption and investments show slowed annual growth, in reflection of the base effect (Chart 13, right). Population consumption recorded 3.3% annual growth in 2021 Q3, investments grew 3.8%, while public consumption grew 7.6%.



Private consumption continued to recover in the third quarter, but at a slow pace. Its growth was mainly driven by expenses in services¹⁵. Also, non-food and food consumer goods grew (Chart 14, right and expenses for durable consumer goods). The upward trend in consumption, throughout 2021, was

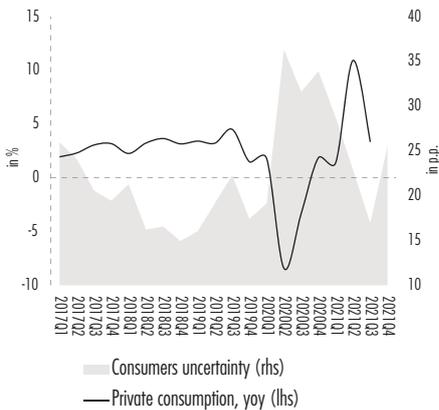
¹⁵ Judged from indirect data. The analysis of family spending by various categories of consumption is based on the indicators of Retail Trade Index and GDP measurements by output.



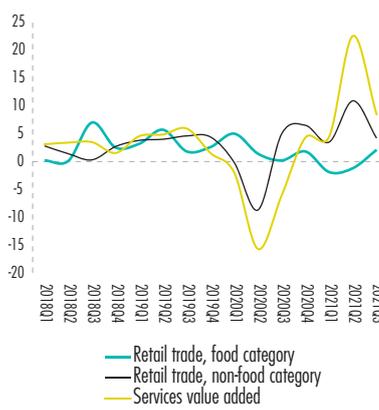
supported by the reduction of restrictions, the improved consumer confidence and the reduced uncertainty, the increased income due to the raise in employment and wages, and the increased lending from banks.

Chart 14

Private consumption continued to grow in the third quarter



Growth of consumer spending for goods and services



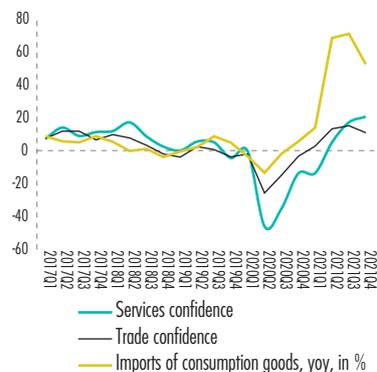
Notes: Indicator of consumer uncertainty is measured from Consumer Confidence Survey and expressed as net balance in percentage points. Source: INSTAT and Bank of Albania.

Notes: All indicators are stated in annual changes. Source: INSTAT and Bank of Albania.

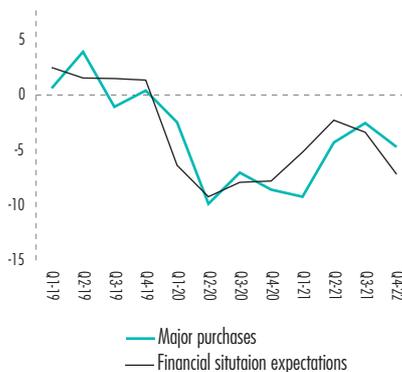
Private consumption is expected to continue the increasing rates in the last quarter of year, at a similar pace with the third quarter. Quantitative data from the import of consumption goods and the import of automobiles suggest an increase of consumption. Confidence indicator in services continued to increase in the fourth quarter, but confidence indicator in trade and consumer confidence recorded a reduction compared to the third quarter (Chart 15, left). Consumers' assessments about the financial situation in the future fell in the fourth quarter, while the balance of major purchases recorded a lower value from the third quarter (Chart 15, right).

Chart 15

Growth of import of consumer goods and improved confidence in trade and service sectors provide positive signals for private consumption in the fourth quarter



Indicators from consumer confidence survey suggest a prudential behaviour of consumers in the fourth quarter.



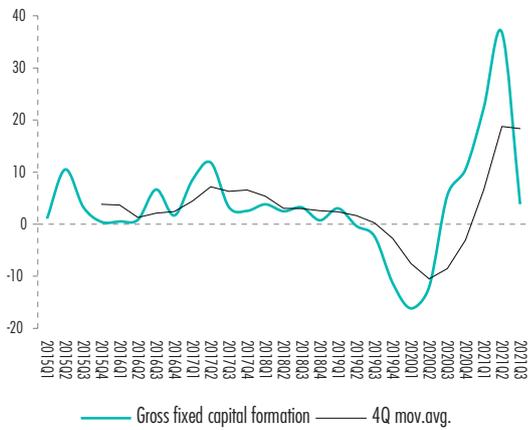
Notes: Import of goods for consumption is annual change and confidence indicators are balances average in percentage points. Source: INSTAT and Bank of Albania.

Notes: Indicators are based on consumer confidence survey and are expressed in percentage points. Source: INSTAT and Bank of Albania.



Chart 16

Total investments in economy decelerated the growth in 2021 Q3



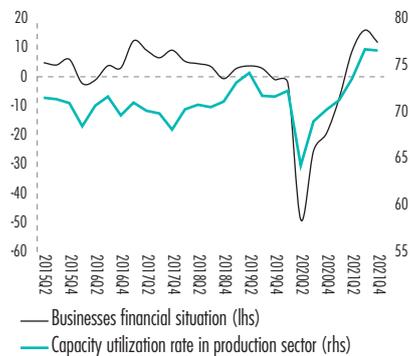
Source: INSTAT and Bank of Albania.

Growth of investments in economy slowed down at 3.8% in the third quarter, after the strong doubled-digit increase in the first two quarters of year (Chart 16). Both the fall of investments from private sector¹⁶, and the considerable deceleration of public investments drove to this slowdown. Based on indirect indicators (GDP data by production and import data), the slowdown in enterprises' investments was recorded in both categories: investments in construction and investments in machinery and equipment.

Quantitative data and those from surveys suggest a slow growth of investments in the 2021 Q4 as well. Thus, the increase in the import of machineries and equipment decelerated in this period (Chart 17, right), while businesses reported a slight worsening of their financial situation in the fourth quarter of year (Chart 17, left).

Chart 17

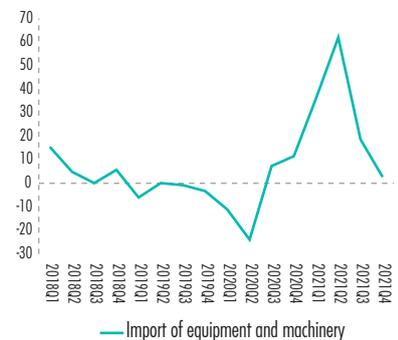
Financial situation of enterprises worsened somewhat in the fourth quarter



Notes: Financial situation of enterprises is an average of balances from confidence surveys. Capacity utilisation rate is in percent of total capacity.

Source: INSTAT and Bank of Albania.

Import of machineries and equipment fell in the fourth quarter



Notes: Indicators are annual changes in percentage points. 2021 Q4 is approximated to the values in October and November.

Source: INSTAT and Bank of Albania.

Public expenditure supported the expansion of economic activity in Albania in the course of 2021. Growth in both investments and public consumption is translated into positive contributions in the expansion of the aggregate demand. Nevertheless, fiscal stimulus has been diminishing in the fourth quarter. Also, the composition of this stimulus had a different shape from the previous year. Thus, the direct transfers to households - one of the key components driving to the growth of total spending in 2020 - were replaced by higher spending for investments and public consumption.

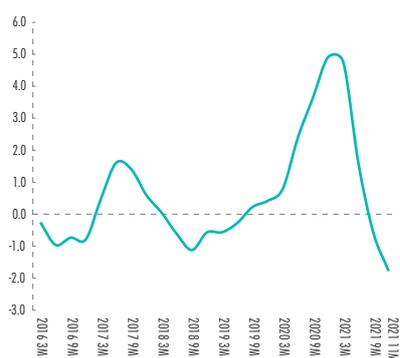
¹⁶ The performance of public and private investments is analysed based on the indirect assessments, as INSTAT does not publish such a break up of total investments in economy.



Fiscal impulse was assessed at around -1.8% p.p of GDP at the end of November. The negative values of the impulse have reflected the slowdown in spending, particularly after the first half of year and the fast growth in budget revenues. Unlike a year earlier, when deficit had a somewhat more linear allocation throughout the year, most part of the planned budget deficit was realised in December.¹⁷

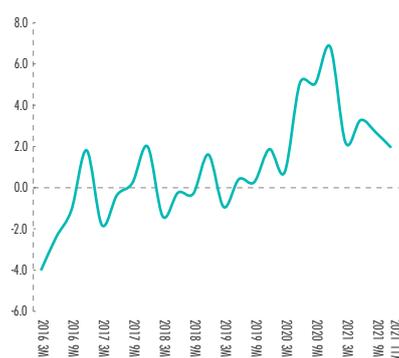
Chart 18

Fiscal impulse remained in negative territory...



Notes: Change in primary deficit ratio to GDP for 12 months, from the previous year. Positive values of this indicator show that fiscal policy has generated increased impulse into the economy
Source: Ministry of Finance and Economy, Bank of Albania.

... due to a lower deficit compared with the previous year



Notes: Budget deficit to GDP. Calculations based on quarterly flows. Positive values show deficit, negative values show budget surplus.
Source: Ministry of Finance and Economy

Budget deficit in the first 11 months of year amounted to ALL 32.2 billion, narrowing by ALL 3.8 billion from the level recorded at the end of September. At the same time, this value stands considerably below the one recorded in the same period in the previous year (ALL 72.2 billion). Eurobond amounting EUR 650 million was issued in November, driving the current stock of this instrument to EUR 1.8 billion. The issue of Eurobond increased excess liquidity in foreign currency of the Government, most of which are transferred to be used during 2022.

In 2021 Q4, an amount of Government securities were issued in line with the domestic borrowing policy, around ALL 2.5 billion higher than the maturity of this period¹⁸. Borrowing in the domestic market increase in long-term securities - bonds with maturity: 3, 10 and 15 years - while it reduced in securities with maturity up to 2 years, by around ALL 6.6 billion. 15-year bond was issued for the first time in November 2021. This bond was added to the gamma of the other existing instrument, whose maturity varies from 3 months up to 10 years.

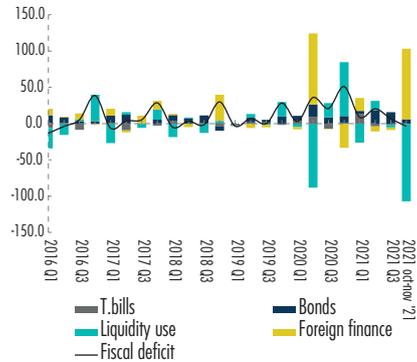
¹⁷ Published data on fiscal indicators of December 2021 are not available so far to the date of MPR publication. The lack of data for December 2021 drives the deficit created in 2020 - which is assessed to be lower than the one in December 2021 - be considered in the calculation of fiscal impulse.

¹⁸ Data on the domestic borrowing, by instruments and actors, are deduced by auctions held till 31 December 2021.



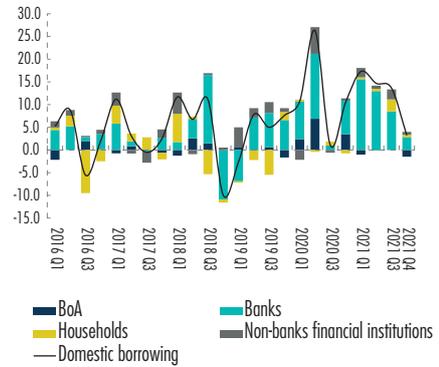
Chart 19

The issue of Eurobond drove to the creation of a considerable excess liquidity at the end of year



Notes: Budget deficit by quarters and its financing, in ALL billion.
Source: Ministry of Finance and Economy.

Commercial banks continue to dominate the structure of domestic debt holding



Notes: Government's' borrowing in debt securities, by buyers, in ALL billion, quarterly flows.
Source: Ministry of Finance and Economy, Bank of Albania.

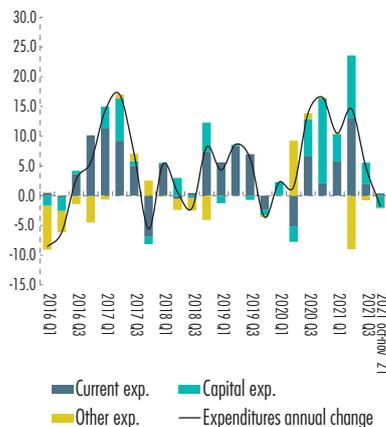
Commercial banks remain the main buyers of domestic public debt. Commercial banks increased by ALL 2.8 billion their securities portfolio in the last quarter. The increase of other market agents' portfolio, both household and other non-financial institutions, was marginal.

In October and November, expenditure fell by 1.8% in annual terms. The fall in expenditure in both months was attributable to the lower levels recorded on: capital expenditure; existing debt interests; and on local government. Nevertheless, these developments bear also the comparative base effect, where the allocation of expenditure a year earlier was somewhat more even compared with 2021.

Expenditure amounted around ALL 490 billion, or 7.6% higher in annual terms, till November 2021. The growth of expenditure during this period was driven

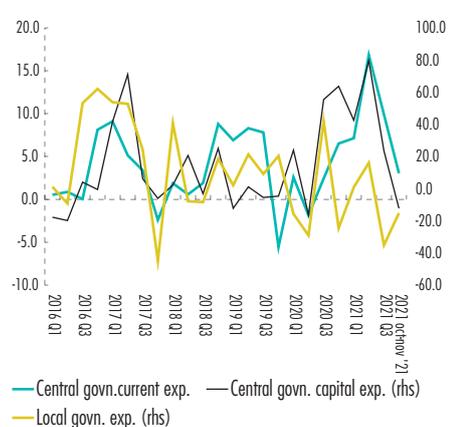
Chart 20

Expenditure fell in October and November



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

... due to the temporary restriction of investments



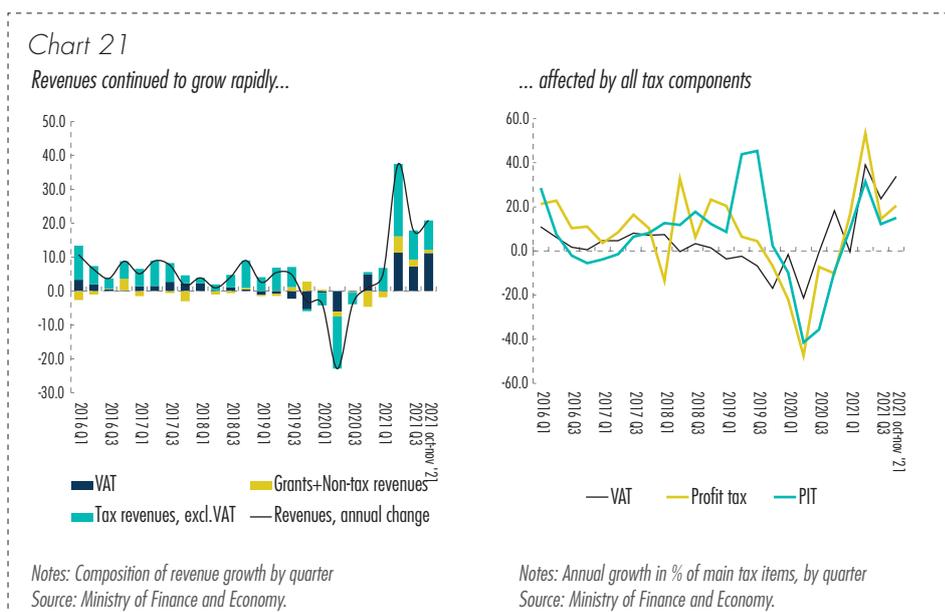
Notes: Annual growth in % of main expenditure items, by quarters.
Source: Ministry of Finance and Economy.



by expenditure for: investments; social insurances (pensions, health insurances); personnel and operating expenses. These items also compensated the 2.5 p.p. negative effect of direct transfers a year earlier.

Notwithstanding the growth profile in October and November, the intensity of expenditure in December is assessed to go beyond the seasonality characterising both months. For this reason, public sector is assessed to continue to support the domestic demand in the fourth quarter, both in the form of fixed capital and public consumption increase.

Revenues continued the fast growth in October and November, by around 20.8% in annual terms. VAT on the import of goods accounted for almost half of revenues growth. Also other tax items, VAT on the production of goods and services in Albania, profit tax, personal income tax, and social insurance contributions - provided positive contribution to the growth of revenues, but at a moderate degree than VAT on imports. The growth on tax income is in line with the economic recovery and the upsurge in prices of main commodities in international markets.



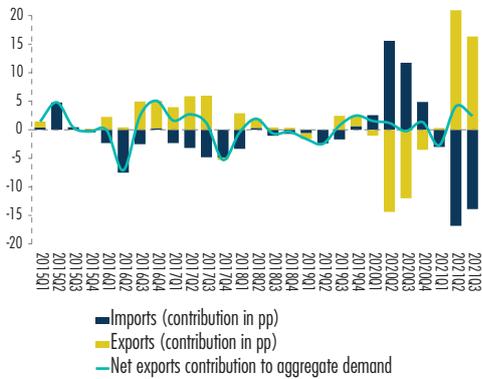
In the first 11 months of year, revenues reached around ALL 458 billion, around 20% higher from the same period in the previous year. The growth profile of revenues was equal throughout the year, where VAT on imports in the total growth provided a more pronounced role, by marking the highest contribution in years. Revenues dynamic in the course of 2021, partially bears the effect of fiscal easing measures of the previous year, where part of tax liabilities of enterprises in financial difficulties were either granted or extended.

Net exports provided a high contribution in the economic growth in 2021 Q3. Trade deficit in goods and services narrowed by 14.3%, in response to



Chart 22

In 2021 Q3, net exports continued to provide a considerable positive contribution in the growth, driven by the export of services



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

the rapid growth in exports (62.7%). Services, with an annual increase of 66.6% affected by the rise in tourism income, and provided the main impact on the growth of exports. Exports of goods, up by 49.2%, also supported total exports.

Also, imports recorded a high annual growth rate (35.9%), mainly driven by the import of goods. Import of services recorded a high growth pace (66.1%), also driven by the tourism expenditures. Recovery of this flow continues to remain slower than exports, owing to the asymmetry in the elimination of restrictions on travellers: mobility in Albania to foreigners and in world to Albanians.

Developments in the trade of goods, during 2021 Q4, reflected the upsurge effect in the prices of commodities in international markets. The rise of prices in markets drove to an acceleration of growth rates in value compared with the third quarter of year, for both exports and imports. Annual growth rate of imports was higher than the growth rate of exports. This coupled with the highest share that imports have in trade exchanges, drove their deficit deepening by 43.1% in annual terms.

In 2021 Q4, exports of goods grew by 33.4% in annual terms (Chart 23, left). Categories "Construction materials and metals" and "Minerals, fuels and electrical energy" provided the main contributions in this growth. The sharp rise in international prices of industrial metals, fuels and energy, considerably determined this dynamic. In 2021 Q4, the category "Textiles and footwear" also experienced, for the first time, a growth above the pre-pandemic levels.

In 2021 Q4, the imports of goods grew by 38.8% in annual terms (Chart 23, right). In this case, the category "Minerals, fuel and electricity" due to the increase in prices of these products, led the positive contributions. In addition, the category "Construction materials and metals" increased considerably, mainly related to the development in construction sector in Albania. Categories related to foods and pharmaceuticals products have continued to provide positive contribution in the import of goods.

Exports to Italy, followed by those to Kosovo and Spain, notably led the exports, in terms of trading partners. In case of imports, the countries mostly affecting the annual growth in imports were Italy and Turkey, followed by Greece and Saudi Arabia (in the latter case due to the increased import of fuels).

Foreign trade of goods has experienced significant growth throughout 2021. The recovery of both domestic demand and foreign demand, coupled with

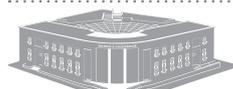
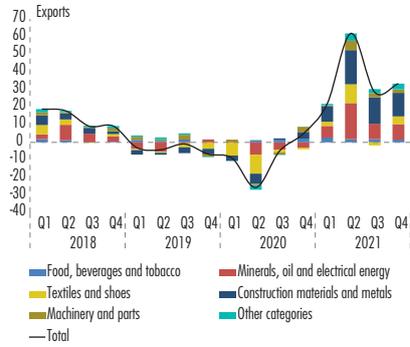


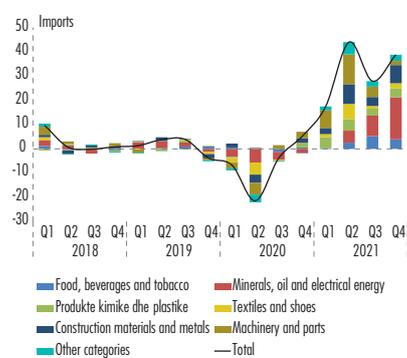
Chart 23

The annual upsurge in international prices of commodities was the primary determinant in the growth of the exports of goods



Note: Contribute of main categories in the goods market, in percentage points.
Source: INSTAT and Bank of Albania calculations.

The growth in imports was affected by the surge in international oil prices and the developments in the domestic market of construction



Note: Contribute of main categories in the goods market, in percentage points.
Source: INSTAT and Bank of Albania calculations.

the considerable upswing of prices in international markets, particularly in the second half of year, has affected this growth. Exports grew by 35.6% over this year, while imports by 32.3%. Due to imports' higher share, trade deficit in goods expanded by 29.6% throughout 2021, by inverting the dynamic of the previous year (when trade deficit narrowed by 4.9% during 2020, due to lower imports). Overall, trading flows have surpassed the pre-pandemic levels. Export in the category of "Textile and footwear" is an important exclusion.



5 INFLATION, PRICES AND COSTS IN THE ECONOMY

Annual inflation averaged to 3.1% in 2021 Q4, from 2.4% in the previous quarter. The average inflation of the year was 2%, following an upward trend during the quarters.

The inflations' upward trend reflected the gradual strengthening of domestic inflationary pressures, in response to the demand recovery, improvements in the labour market and wages increase. On the other hand, the acceleration of inflation in the fourth quarter was influenced, to a large extent, by the intensification of imported inflationary pressures, as a result of high prices of commodities and food in foreign markets, higher costs of transport, and difficulties in the production chain. Short-term inflation expectations increased, while in the medium term they are close to the 3% target.

5.1 CONSUMPTION PRICES

Annual inflation averaged 3.1% in 2021 Q4, standing 0.7 percentage point higher compared to the previous quarter. (Chart 24, left) This increase was caused by the relatively high inflation in November and December, at 3.1% and 3.7%, respectively.

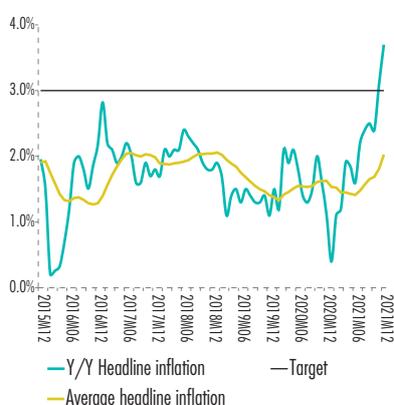
The food and energy commodities group, including oil, increased their contributions by 0.3 percentage points (Table 2). In total, these categories formed about 80% of headline inflation in this quarter (Chart 24, right). At a more disaggregated level, within the food group, the contribution to the formation of headline inflation came almost entirely from processed food goods (0.3 percentage point). This trend has reflected the global developments in rising commodity prices. The other category, non-processed foods, fluctuated within the quarter. In October, its inflation slowed down significantly, while in the following months it accelerated due to the increase in the prices of fruits in November and prices of vegetables in December. Despite the above developments, in average terms of the quarter, this category recorded the same contributions as those of the third quarter.

The category of "Non-food goods" was influenced by the increase in prices of oil and gas products in the world market. From May 2021, their direct contribution returned to positive values and, as expected, boosted prices in the fourth quarter. The contribution of this category to headline inflation was around 0.3 percentage point higher than in the previous quarter. The most



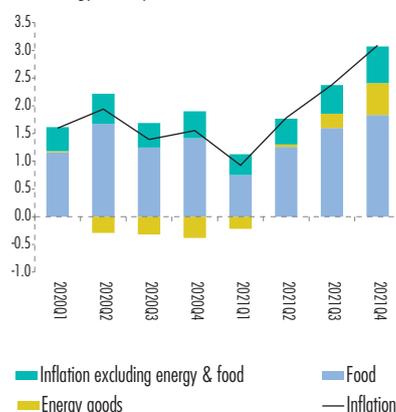
Chart 24

The inflation rate exceeded the Bank of Albania's target in the fourth quarter



Source: INSTAT and Bank of Albania's calculations.

Its performance reflected the increased inflation of food and energy items prices



Source: INSTAT and Bank of Albania's calculations.

stable components of inflation, including *services, housing and long-term consumer goods*, has also recorded an upward trend during the last months, increasing by 0.1 percentage point the contribution in the inflation of the fourth quarter (Table 2). The recovery of consumer demand is reflected in the gradual increase in the price of services, especially in December. In this category, the main factor for this development was the increase of prices of hotel, tourist packages and communication.

Table 2 Decomposing effects on annual inflation by category (in percentage points)*

	Q4'19	Q1'20	Q2'20	Q3'20	Q4'20	Q1'21	Q2'21	Q3'21	Q4'21	Inf. Q4 '21 (%)
Processed foods	0.3	0.4	0.5	0.5	0.5	0.6	0.4	0.6	0.9	4.5
Bread and corn	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	6.2
Unprocessed foods	0.8	0.8	1.2	0.8	1.0	0.3	0.9	1.0	1.0	5.4
Fruits	0.4	0.7	0.7	0.5	0.2	0.2	0.1	0.1	0.4	10.7
Vegetables	0.4	0.2	0.4	0.2	0.6	0.0	0.6	0.8	0.4	6.8
Services	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.2	0.3	1.5
Regulated prices	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4
Housing (rent)	0.0	0.2	0.3	0.3	0.2	0.0	0.1	0.2	0.2	1.2
Non-food consumer goods	0.0	0.0	-0.2	-0.2	-0.4	-0.3	0.1	0.3	0.6	4.1
Fuel	-0.1	0.0	-0.3	-0.3	-0.4	-0.3	0.0	0.2	0.4	18.3
Durable consumer goods	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.9
Inflation (%)	1.3	1.6	1.9	1.4	1.6	0.9	1.8	2.4	3.1	3.1

Source: INSTAT and Bank of Albania's calculations

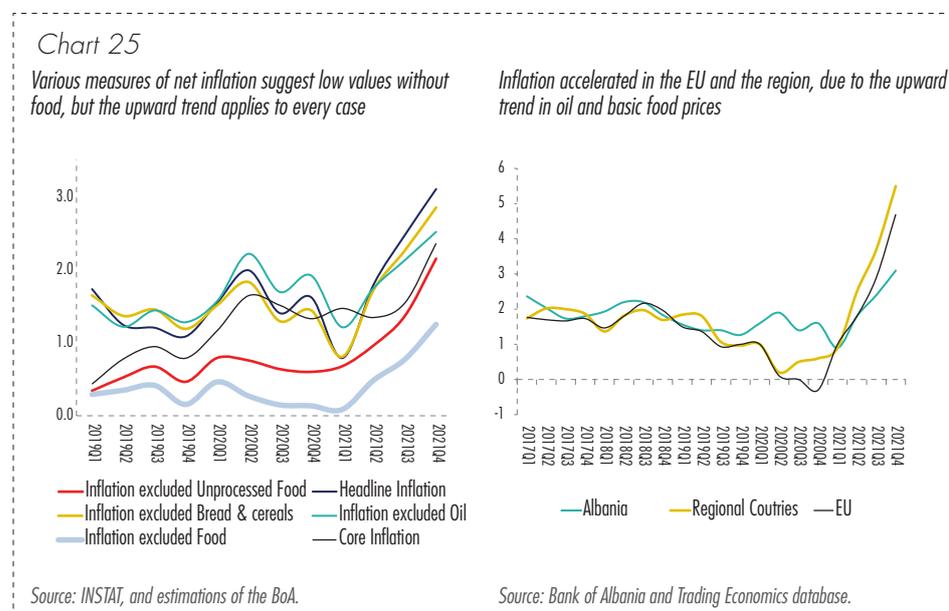
* The table presents the contributions to inflation by constituent categories and some of their main items. The table also shows the average value of inflation in 2021 Q4.

In macroeconomic terms, the upward trend in inflation reflected both the action of domestic demand factors and the effect of shocks - mainly of foreign origin - on supply.

From the demand point of view, the gradual improvement of the cyclical position of the economy, reflecting in the progressive growth of the demand for goods



and services, was accompanied by an increase in employment and wages. This performance was also reflected in the upward trend of core inflation, or various measures of inflation which exclude the effect of more price-volatility goods (Chart 25, left).

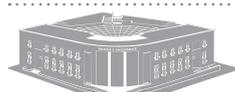


In terms of supply, the acceleration of inflation in 2021 Q4 reflected the combination of several factors of domestic and foreign origin. Thus, the upswing in inflation reflected to a large extent the upward trend of prices in the EU and regional countries (Chart 25, right); increases in energy commodity prices, beyond the effect of the low comparative base of oil prices during 2020; increase of commodity prices in the international market and other additional effects on the production and transport cost chain. It also reflected the fluctuations of raw food prices in the domestic market, which affected inflation in the upside direction. Finally, inflation in the fourth quarter carried the statistical effect of the low comparative base of December of the last year.¹⁹

5.2 DETERMINANTS OF INFLATION

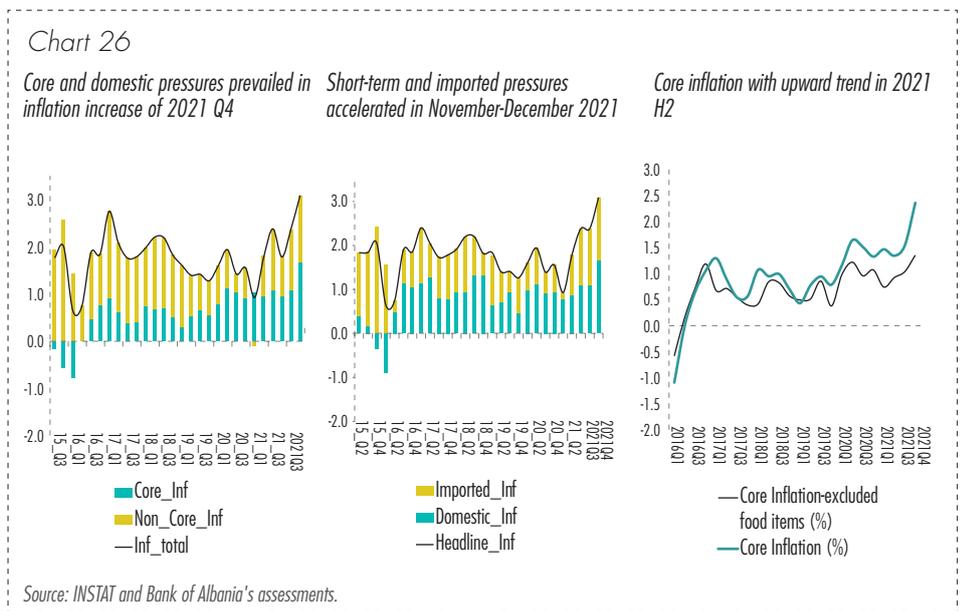
The increase in inflation in 2021 Q4 was influenced by the additional contributions of all its components (Chart 26, left and centre). Core inflation was 2.4% and domestic inflation was 2.1%, with a contribution of about 1.7 percentage points to the formation of headline inflation. Their gradual upward trend during 2021 has reflected the positive dynamics of demand. Meanwhile, their rapid growth during the period September-October 2021 showed that these indicators were also affected by the increasing pressures exerted by global imbalances in the production and supply chain as a result

¹⁹ The statistical effect is estimated to have increased the inflation of December and of 2021 Q4, by 0.6 and 0.2 percentage points, respectively.



of the pandemic. Excluding the accelerating impact of prices of some food items from core inflation, it is evident that its upward trend has been present, mainly during the last two quarters of the year²⁰ (Chart 26, right). Average core inflation stood at 1.7% in 2021, compared to 1.4% in the previous year.

Non-core and imported components showed high volatility, with weaker effects in October and increasing impacts on headline inflation for the other two months of the quarter (by about 0.5 percentage points). Non-core and imported inflation increased compared to the previous quarter, reaching 4.9% and 6.7%, respectively, with a contribution of 1.4 percentage points to the headline inflation.



Inflation is expected to remain above the target in the short term, reflecting pressures from the chain of increased operating costs on the prices of domestic and imported products and services. Meanwhile, in the longer term, inflation is expected to gradually decline towards the target, reflecting the mitigation of supply shocks and the gradual closing of the output gap.

The main economic determinants of inflation are analysed below.

Cyclical position. Our assessments suggest that cyclical position of the economy has been improving as a result of the economic recovery during this period. The data also show further improvement in the labour market, characterized by rising employment and declining unemployment. These developments are reflected in high annual wage growth rates, especially in the private sector. The above developments increased the domestic inflationary pressures, reflected in the increase of core and domestic inflation during 2021 (Chart 27).

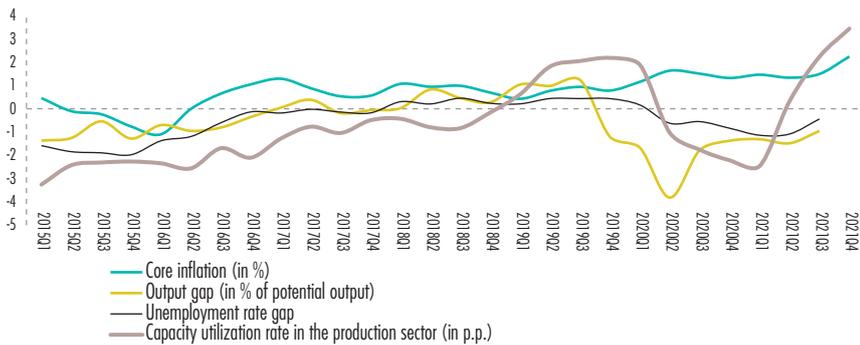
²⁰ The core inflation sub-basket includes some of the processed foods that have historically shown price stability, but that have a significant weight in the CPI basket. Other items, mainly services and goods with long-term usage, account for about 66% of the core inflation sub-basket.



The capacity utilization rate in the economy stood at around 78.9% in 2021 Q4, slightly higher compared to the previous quarter (Chart 27). This development has reflected the increase in the utilization rate of operating capacities in the services sector, while in other sectors this indicator decreased.

Chart 27

The cyclical position of the economy continued to improve in the third quarter, being reflected in the rising rates of domestic (core) inflation during the fourth quarter

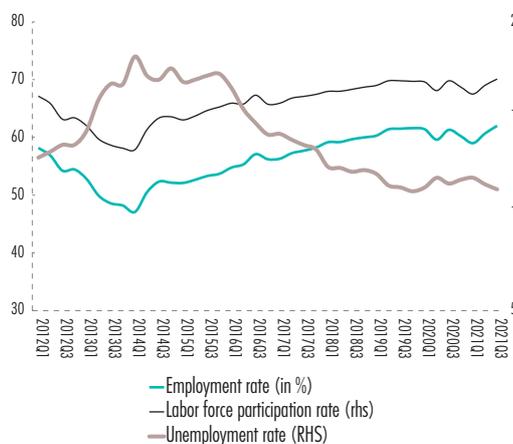


Notes: The output gap is the average of several measurements on which the method of moving average is applied. The capacity utilisation rate gap is estimated as a deviation of the current value from the relevant historical average, and then the moving average method is applied. The unemployment rate gap is assessed as an average of unemployment gaps according to three methods, which assess the equilibrium or structural level of unemployment. It is stated as the difference of equilibrium unemployment rate to actual unemployment rate and then the method of moving average is applied. The Chart shows the results of the most recent general reassessment conducted in 2021 on the output and unemployment gap. Source: INSTAT and estimations of the Bank of Albania.

Employment and unemployment. Employment increased by 0.7% in the third quarter, but at a more contained annual rate compared to the previous quarter (Chart 28). The industry and services sectors continue to show high growth rates in employment. Despite the positive dynamics of employment in the aforementioned sectors, its decline in agriculture has slowed down the growth rates of general employment in the economy.

Chart 28

The improving trend in the labour market continued during 2021 Q3



Source: INSTAT and estimations of the Bank of Albania.

The growth of employment in the economy affected the decline in the unemployment rate to 11.3%, from 11.6% in 2021 Q2. This has been accompanied by an increase in the participation rate in labour force and a decrease in the inactivity level (Chart 28). This performance which started during the previous quarter indicates the improvement of labour market indicators and its gradual return to the equilibrium.

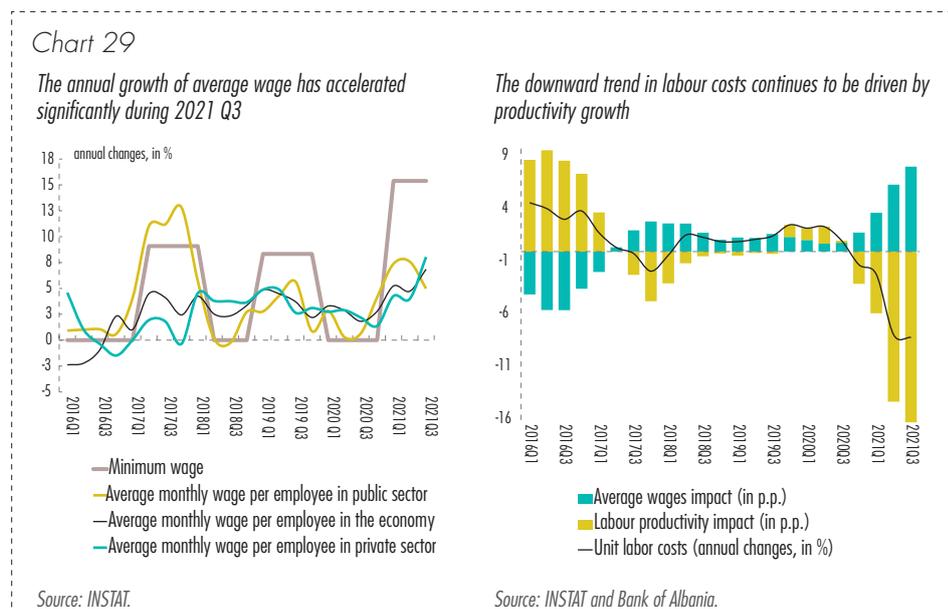
Wages, productivity and labour costs. In 2021 Q3, the gross average monthly wage per employee²¹ expanded by 6.9% (4.5% in real terms, (Chart 29, left). This rate is significantly accelerated compared to the second quarter of the year (4.7%), mainly influenced by wage increases in the private sector.

²¹ This indicator refers to the gross monthly average wage received per employee and is based on the payroll data declared at the General Directorate of Taxation (INSTAT 2021 Q3).



The increase has resulted in a broad base according to economic sectors and with more visible contributions from the wage increase in the activities of "Trade, transport, accommodation and food service", "Information and communication", "Real estate" and "Public administration and defence".

Labour costs per unit²² continued to be characterized by a downward trend. The annual decline of the indicator resulted 8.2%, from 7.9% in the second quarter. The performance of the indicator was defined by the faster increase of labour productivity against the increase of the wages²³ (Chart 29, right).



Other output costs are characterized by the acceleration of growth rates. The industrial production prices increased by 4.3% from 1.6% in the second quarter of the year. The acceleration came from both producer prices for the domestic market and the export market. The increase in producer prices for the domestic market was 3.3% in the third quarter, from 1.4% a quarter earlier.

Imported inflation. The imported inflationary pressure index (IIPi)²⁴ expanded by 10.9% in annual terms during 2021 Q4 (Chart 30), an accelerated rate compared to the previous quarter (9.3%). This performance reflects the strong expansion of foreign prices (about 15.8% in annual terms). Their acceleration started in the third quarter of the year, but significantly intensified during the fourth quarter. On the other hand, the appreciation dynamics of the nominal effective exchange rate (NEER) has continued to act in the downward direction of IIPi, mitigating the upward effects of foreign prices. NEER appreciation in

²² Proxy indicators of labour productivity and 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, 2021 Q3).

²³ In terms of contributions, labour productivity exceeds (with the opposite effect), the contribution from wage increases.

²⁴ IIPi is calculated as the annual growth of foreign price index and the NEER index for the respective month.

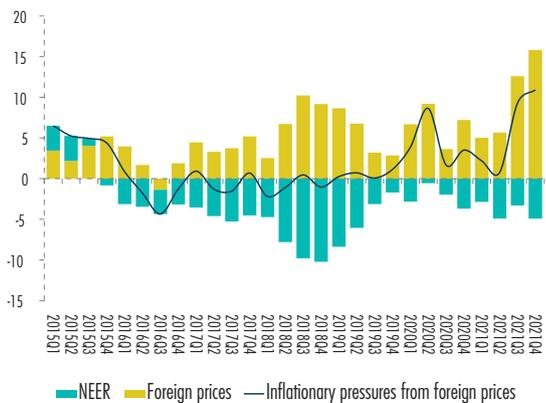


annual terms was 4.9% in the fourth quarter of 2021, accelerated compared to the previous quarter (3.3%).

The above dynamics are also transmitted in the upward trend of headline inflation through the channel of its imported component. The contribution of the latter marked an increase in 2021 Q4 (46%) compared to the same period of the previous year (40%) (Chart 26, centre). Foreign inflationary pressures will continue to exert upward pressure on inflation throughout 2022.

Chart 30

The rapid rise in foreign prices also affected the rapid expansion of the Foreign Inflationary Pressure Index during the fourth quarter



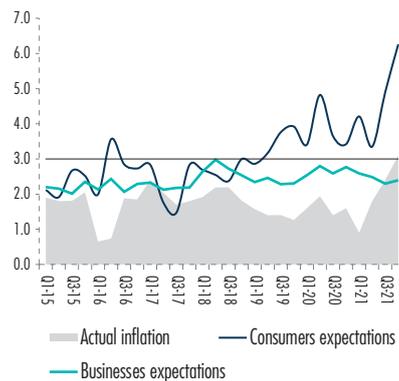
Source: INSTAT and estimations of the Bank of Albania.

Inflation expectations²⁵ increased in the fourth quarter. Based on surveys conducted by various agents of the economy, the growth is more visible for consumers (by 1.4 percentage points) and very little for businesses (by 0.1 percentage point) (Chart 31, left).

Financial agents have also revised upwards expected future inflation (Chart 31, right). They expect inflation after a year to be 2.7%, or 0.5 percentage point higher than the expectations of the previous quarter. Expected inflation after two and three years is 2.8% and 3.0%, respectively, an increase of 0.4 and 0.3 percentage point, respectively, compared with the expectations of the previous quarter.

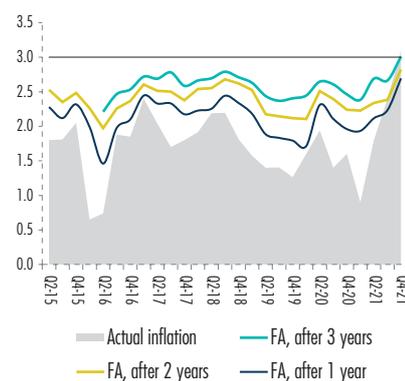
Chart 31

Consumers' inflation expectations after one year increase significantly compared to those of businesses



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

Inflation expectations from financial agents are rising, although the medium-term expectations are close to the target



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

²⁵ 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.



BOX 3 RISING INFLATION IN ALBANIA, TRANSITORY OR SUSTAINABLE?

The pandemic has caused strong fluctuations in demand and supply for goods and services. The introduction of social distancing measures in March 2020 initially led to a decline in demand, and subsequently negatively affected the activity of a significant part of the economy. The faster decline in demand contributed to a strong contraction of the output gap in 2020, which reached its minimum in the second quarter of the year and gradually began to recover. The recovery of the economy was rapid and the impact on the labour market was restrained, which reflects, among other things, the significant support provided by stimulating fiscal and monetary policies.

The increase in demand, employment and wages has increased the inflationary pressures from the domestic economy, the contribution of which has been stable and has been increasing (Chart 26, left). Core and services inflation has shown an upward trend since the beginning of the year (Chart 25, left).

The acceleration of inflation during the recent months, both in Albania and in other countries, has been affected by the rising prices of commodities and inputs in the world markets.¹ In the economic literature, such shocks are called supply shocks, which can produce three types of effects on inflation.

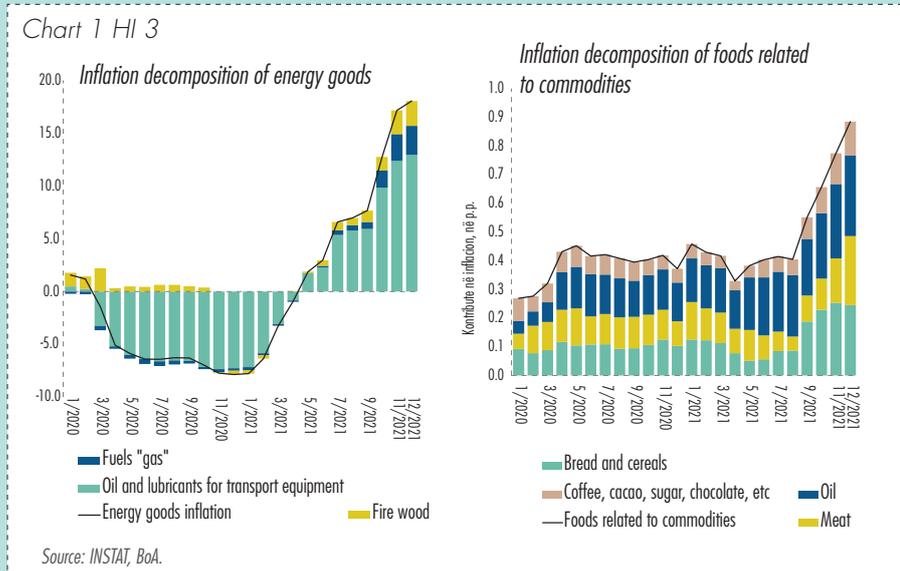
First, the increase in commodity and input prices have a direct effect on inflation, as some of them are included in the measurement of the consumer goods basket. Thus, the inflation of energy goods in the country has gradually increased during 2021, reaching 16% in the last quarter of the year. The increase in the oil price has contributed the most to this increase. The increase in the international price of energy has not yet given its full impact on costs and consumer prices in the country, although it is reflected in the price of imported energy. This is because the price of energy in the country is administered, and there have been no legislative decisions to increase the price of energy for consumers and businesses in general. Also, the increase in prices of food items has led to an increase in inflation of processed food to 4.3%, during 2021 Q4. The contributions of individual items to the inflation of the respective groups are shown in the charts below, while, in aggregate, the contribution of commodity-related prices in world markets has increased from an average of 12% in 2017-2020, to 32% in 2021, and 43% in the last quarter (Chart 25, left).

The direct effects of supply on inflation are temporary; with the stabilization or adjustments of prices their contributions to inflation come to an end. But, on the other hand, they cause volatility in the short run.

Currently, market's analyses and expectations converge on the interpretation that the rise in commodity prices is temporary. Restoring the balance between supply and demand, solving supply problems and reducing the price of energy goods is expected to stabilize these prices. This is what we consider the baseline scenario.

Second, the rise in prices of commodities and inputs may have indirect effects on value formation chains. An example of this effect is the increase in transportation costs, and consequently the price of final products and services, as a result of the increase of fuel price. Indirect effects are difficult to calculate, as the transmission to consumer prices can change over time and is dependent on demand elasticity, competition by market segments, and the ability of private companies to absorb the shock through the adjustments of profit margins.





Third, supply shocks can cause second-round effects. Such effects arise when high inflation affects households 'and businesses' expectations for future price developments, and their behaviour regarding consumption and savings. Higher inflation expectations could push businesses to raise prices at a faster pace than what was expected and wage-earners to demand higher wages to maintain purchasing power. This creates an inflationary cycle, as businesses are forced to raise prices even further in order to offset rising costs.

In contrast to the direct effects, the indirect and second-round effects have a longer-term impact on inflation. They require a response by the monetary policy.

As in many other countries, inflation expectations in Albania have gradually increased during 2021 (Chart 31). Our analysis show that inflation expectations have become more adaptive in the post-global financial crisis¹ – following closely the low inflation values of this period, which increases the resurgence risk of second-round effects. This risk requires careful monitoring of the price performance, to identify in time the occurrence of these effects and to enable an appropriate monetary policy response.

¹ The reasons for the increase in commodities prices are analysed in more detail in Box 1 of this report.

² A more in-depth analysis can be found in the study material, 'Factors behind low inflation in Albania', 2019 <https://www.bankofalbania.org/?crd=0,15,7,3,0,26042>

