

# BANK OF ALBANIA

## MONETARY POLICY REPORT ON THE FIRST SEMESTER OF 2006

JULY 2006



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### I GOVERNOR'S SPEECH

Economic stability in the country and the positive performance of the world economy have created the adequate grounds for the expansion of the economic activity in the country over the first semester of 2006. The first economic data for 2006 indicate that the Albanian economy has overtaken the consequences of the severe electricity situation and is now following a stable course of economic growth. Starting from year 2005, the economic growth has been mainly driven by the consolidation of domestic demand, which is ever-growingly being sustained by credit to economy.

World economy over the first semester of 2006 has displayed high economic growth rates. Proceeding from these positive developments, the estimates of the international financial institutions project that there will be a global economic growth of about 4 per cent over 2006. Worth mentioning is the fact that the so far problematic regions, Eurozone and Japan, have displayed a satisfactory economic growth. Eurozone has recorded a growth of 1.9 per cent. Consumer confidence and labour market show stability and optimistic expectations. The adequate economic performance and the regeneration of domestic demand have influenced on smoothing the oil price rise effect for the following period. United States economy has particularly displayed high growth rates over the first quarter of 2006, due to the high level of domestic demand and consumer expenditures.

However, the world economic environment contains several disturbing elements, not only to the global economic growth but also to the performance of growth in Albania. In particular, oil price continues to be in high historical levels, partly due to the high economic growth and the rest due to problems in the net of supply. Oil price rise in the international market has been also reflected in the domestic market over the first semester of 2006. The appreciation of the lek against the dollar in the first quarter has controlled the oil price rising pressures in the country. Meanwhile, the exchange rate smoothing effect has been weaker over the second quarter. The monetary policy pursued by the main central banks has had an evident tightening nature, in response to the increase of inflationary pressures opposite the strong economic growth. The monetary policy tightening in Albania has been reflected in the interest rates increase of financial assets in foreign currency, having significant consequences on credit terms to economy by making it more expensive.

Domestic economy has developed under satisfactory rates over the first half of 2006. Considering the available indicators, the 5.0 per cent GDP growth over 2006 is considered an achievable objective, which could be

even exceeded. The annual growth of sales to economy over the first quarter resulted in about 18 per cent. This growth has been higher than the rates recorded over the last years for this period of the year. Such a performance has been also sustained by the rapid growth of credit to economy. In relative terms, credit grew by 2.5 percentage points to the GDP over the first five months of the year, providing a strong monetary push for the expansion of the economic activity in the country. According to the estimates to date, the sector of industry, in particular processing industry, and the sector of trade, hotels and restaurants have mostly benefited from the economic growth. Despite the 6 per cent slowdown in the sales annual growth rates over the first quarter, construction sector has had a satisfactory performance. It still remains a stable source for economic growth.

Unemployment rate over the first quarter of the present year has decreased to 14.0 per cent from 14.2 per cent, due to the decrease in the number of unemployed by 4 thousand people. State administration efforts for the further formalization of economy and for a more accurate registration of unemployed have influenced greatly on such a change. The structure of employed by public and private sectors of economy has not experienced significant changes compared to the previous period.

Current account deficit deepened in the first quarter of the present year compared to the same period the previous year. Such a deepening came as a result of the deficit increase in the trade balance of goods and services. Characteristic of this quarter compared to the same period of 2005 is the more rapid increase in imports in relation to exports increase, which have covered about 28 per cent of the import volume. Workers' remittances performance continued to be stable over this period. These inflows grew by about 20 per cent compared to the first quarter of 2005.

The Government's efforts in pursuing a prudent fiscal policy have been reflected in the overall performance of budget indicators. This is mainly reflected in the growth of budget revenues, while the level of public expenditures, in particular the level of Investment item, was below the projected level for the first five-month period. Compared to the same period the previous year, revenues grew by 13 per cent, while expenditures decreased by 8 per cent. As a consequence, the first five-month period of this year recorded a continuous budget surplus. The revised budget program projected for the rest of the year sets ambitious objectives as far as the enhancement of public investment and the decrease of business tax burden are concerned. Their realization would be a welcome development for the establishment of a stable infrastructure for economic growth and the promotion of domestic and foreign investment. Moreover, we believe that more efforts should be made for a more homogeneous allocation of budget expenditures over the fiscal year.

The first semester of 2006 was characterized by low and stable annual inflation rates. Annual consumer prices rise fluctuated to 1.3-3.1 per cent over this period, while the average inflation for the period is 2 per cent. Inflationary pressures increased over the second quarter of the year, due to

the late impact of seasonal factors and the smoother appreciation of the lek against the euro, the upward trend in the prices of import as a result of inflation increase in Eurozone, and the oil price rise. Moreover, the rapid growth of credit to economy provides certain risks to macroeconomic stability in the medium and long-term period. Under these conditions, the Bank of Albania deemed as appropriate the tightening of its monetary policy and the increase of the core interest rate. It aims at keeping the demand pressures and inflationary expectations under control. According to operative data, the Bank of Albania assesses that the money markets have begun displaying the first signs of reaction toward such a movement undertaken by it.

The monetary developments have generally proceeded according to the Bank of Albania projections. Money supply growth was realized as projected in the monetary programme, to the interval of 10-12 per cent. Such a growth has served to the needs of economy for monetary assets, thus not creating inflationary pressures. As emphasized further in the report, the private sector of economy has become the main consumer of the banking system monetary resources, decreasing the so-far dominance of Government borrowing. Outstanding credit marked a growth of ALL 24.5 billion over January – May. This growth is 30 per cent higher than the growth of outstanding credit over the same period the previous year. Annual credit growth rate marked 65 per cent at the end of May. Annual credit growth has had a downward trend since December 2005. Outstanding credit to economy in relation to the GDP is estimated at about 17 per cent in the first half of the year, against the ratio of 14.6 per cent estimated at the end of 2005. Moreover, the higher private sector demand for money is reflected in the evident growth of outstanding credit weight to money supply (M3).

Money supply growth rates over the first semester of 2006 have been close to the historical trend. In May, annual growth of broad money, M3, resulted in 10.5 per cent while M2 aggregate marked a growth of 6.2 per cent in annual terms. Compared to the same period the previous year, monetary expansion rates have been lower. Money supply has recorded changes in both time structure and foreign currency one, orienting towards less liquid assets and foreign currency ones at the same time. In May, the ratio of currency outside banks to M3 was 23.5 per cent against the ratio of 24.5 per cent, recorded over the same period the previous year. At the same time, the ratio of deposits in foreign currency to M3 accounted for 27.6 per cent or 2.9 percentage points higher than the previous May.

Interest rates in the lek deposits market have by and large reflected the neutrality of the monetary policy conducted by the Bank of Albania over the last year. Under the upward tendency of the usd deposits interest rate, the difference to lek interest narrowed to about 1.4 percentage points in the first semester of 2006. In relation to the interest rate of euro deposits, the difference of lek interest fluctuates to about 2 percentage points against about 5 percentage points recorded in 2003. Despite the decrease of differences in interests, the lek has displayed appreciating tendencies against the dollar, while being relatively stable against the euro over the first semester of the present year. In annual

terms, the lek continues to be appreciated against both main currencies, the dollar and the euro, by about 4.4 and 0.4 per cent, respectively.

The Bank of Albania assesses that the second semester of 2006 will be characterized by the further consolidation of the overall macroeconomic equilibrium in the country. In its monetary programme, wherein the last weeks' decision for the increase of the repurchase agreement weekly interest rate by 0.25 percentage points has been made factual, is projected an economic growth of 5 per cent. The Bank of Albania has taken all the proper measures to respond timely to the needs of economy for money, being cautious to keep the inflationary pressures, generally generated by the growth of domestic demands, under control. In line with the economy demand for credit and with the inflation objective, the Bank of Albania has projected a money supply growth of 13.6 per cent. Similar to the end of the first quarter 2006, special attention is to be paid to the observance of quantitative restrictions deriving from the Agreement with the IMF at the end of the third quarter of 2006.

On the other hand, the Bank of Albania believes that the financial market, as observed following the last decision, shall further perceive duly the signals and decisions of the monetary policy, making a direct contribution to the improvement of the monetary policy transmission mechanism.

The Bank of Albania will continue to monitor prudently the developments in this market, by transmitting the proper signals through operations having an operational nature and through more specific monetary policy decisions, whenever deemed necessary. I avail myself of this opportunity to emphasize that the Bank of Albania will make all its efforts to be an open and communicative institution, by trying to avoid at any case surprise decisions, which only add confusion and uncertainty to the market.

## II ECONOMIC DEVELOPMENTS OVER THE FIRST SEMESTER

### II.1 WORLD ECONOMY

Over the first quarter of 2006, world economy was characterized by positive developments. This performance has consolidated the expectations for a global economic growth of over 4 per cent for 2006, for the fourth consecutive year. However, the economic growth continues to be conditioned by certain phenomena, such as the growth of oil demand, which may not always be supported by the productive capacities. This phenomenon, which the global market is evermore being faced with over the recent years, has caused shifts in the equilibrium between demand and supply for this product of primary importance, both in the short and medium term. The frequency of such an occurrence has caused the oil price to bear shocks, which influence on the further performance of global economy and of consumer prices.

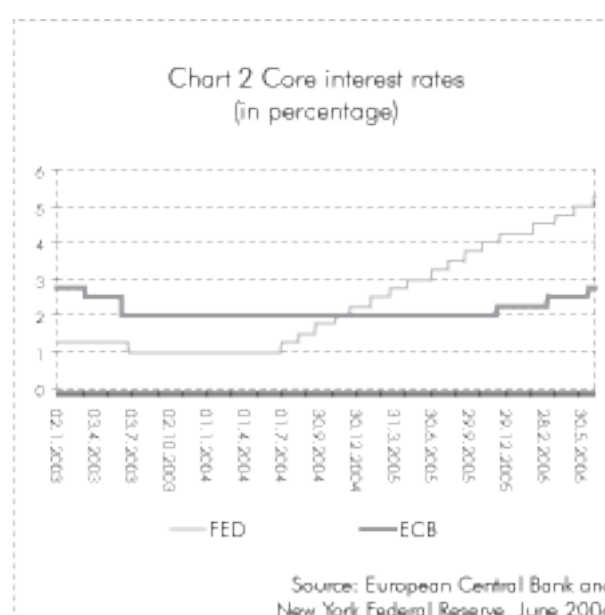
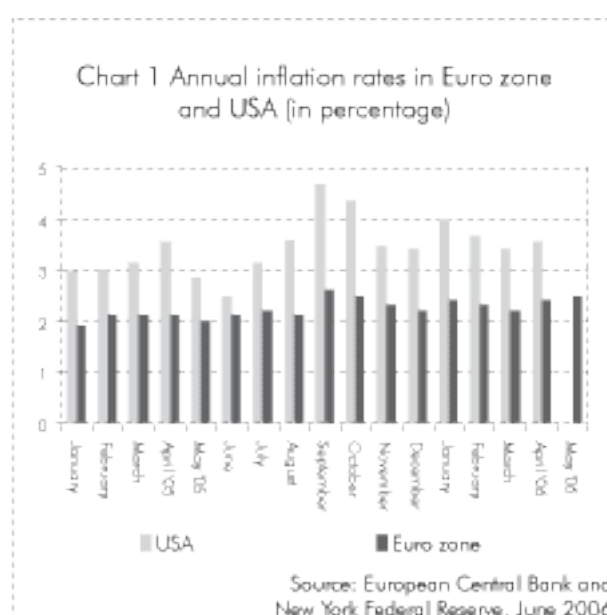
Annual inflation rate over the first quarter of the year has recorded a slight decrease in several countries, reflecting by and large the slowdown in the oil

price rise. Consumer prices annual inflation rate, excluding Foodstuffs and Energy in April 2006, was relatively low in most OECD countries, fluctuating to an average of 1.9 per cent.

	GDP-Q1	Unemployment Rate	CPI
USA	+5.6	4.6 (June)	3.6 (April)
Eurozone	+1.9	8 (April)	2.5 (May)
Germany	+1.6	10.9 (June)	2 (June)
France	+2.2	9.3 (April)	2.1 (May)
Italy	+2.4	7.7 (December)	2.2 (May)
Great Britain	+2.3	5.3 (April)	2.2 (May)
Japan	+3.1	4.1 (April)	0.4 (April)

Table 1 Some main economic indicators in annual terms (in percentage)

Source: US Department of Labor, US Department of Commerce, Eurostat, "The Economist" magazine, July 1-7, 2006.



### American Economy

In the first quarter of 2006, the economic activity in the United States of America increased by about 5.6 per cent, in annual terms. The economic growth was mostly urged by the intensification of domestic demand, particularly expressed in the increase of personal expenses in consumption and investment. At the same time, net exports continued to contribute negatively to the increase of gross domestic product. Under the effect of interest rates increase and energy price rise, in the upcoming period is expected a slowdown in the economic growth.

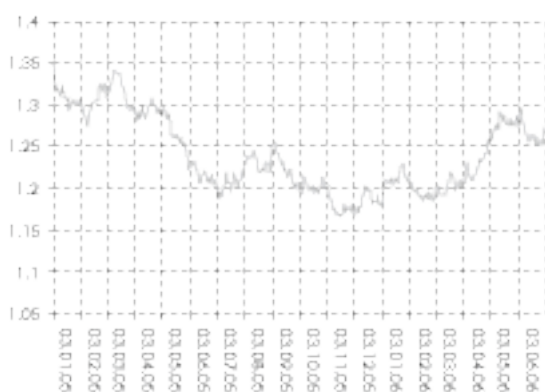
US inflation rate over the first half of the present year was considerable and mainly influenced by the energy price rise. In April it accounted for 3.6 per cent. With a view to accomplishing the main objectives, which are to maintain price stability and boost stable economic growth, the FED has continuously increased the core interest rate to the level of 5.25 per cent at the end of June, from 4.25 per cent at the end of the previous year.

### *Eurozone economy*

Real gross domestic product in the Eurozone increased by 1.9 per cent in the first quarter of 2006. The increasing domestic demand was the most critical factor influencing on the economic performance for this period. Despite the fact that the investment growth was limited due to poor climate conditions, consumer expenses intensified. This performance reflected the positive expectations of consumer confidence and the gradual labour market stabilization. The satisfactory economic performance and the regeneration of domestic demand are expected to contribute to smoothing the oil price rise effect and perhaps to a moderate appreciation of the euro for the upcoming period.

Annual harmonized index of consumer prices increased by 2.5 per cent in May, mainly reflecting the energy price developments. Aiming at maintaining price stability in the medium term, the Governing Council of the European Central Bank increased the core interest rate twice over this year. As a consequence, the core interest rate in June marked 2.75 per cent, compared to 2.25 per cent at year ended 2005. The significant growth in monetary aggregates and credit, excess liquidity situation and the economic and monetary analysis reinforce the presence of an increasing risk for attaining the objective of maintaining price stability in the level of 2 per cent over the following period.

Chart 3 Daily performance of USD/EUR exchange rate



Source: European Central Bank

### *Exchange rate*

Following a slight depreciation at the beginning of the year, the euro continued to appreciate against the usd reaching its peak at the beginning of June with 1.3 usd/euro. At the end of June, 1 euro exchanged with 1.27 usd, being about 7.7 per cent more expensive than at the end of December 2005. Such a performance in the exchange rate is backed by the improvement and positive expectations regarding the Eurozone economic situation, by the increasing attention of markets to American current account deficit, as well as by the expectations for further developments in core interest rates in the Eurozone and America.

### *Oil price*

Oil global price continued to fluctuate in high levels. Although characterized by downward tendencies in the first months of the year, oil prices in the international stock markets around mid-semester marked even higher new records. Oil price rise was mainly a consequence of continuous concerns regarding the restrictions in global effective capacities to refine the oil, interwoven with the expectations for an increasing demand in the following period. These developments were also aggravated by the geopolitical situation, speculations in the futures contracts market and by the fear of hurricanes in the Gulf of Mexico.



According to OPEC, the positive performance of the global economy over the first quarter of the year has indicated that the high oil prices have had a more restrictive effect on the economic growth, compared to year 2003<sup>1</sup>.

However, it is to be confirmed whether this phenomenon will continue to be present in the future. This shade of doubt relates to the most recent developments in the oil price curve, the aggravation of geopolitical factors in the neighbouring or even transit oil production and transportation regions, as well as to the upward tendency of demand for this product.

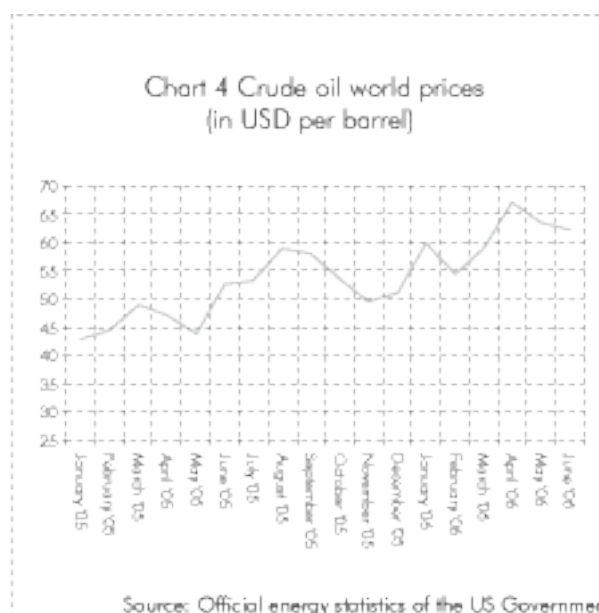


Table 2 Oil demand and supply (in million/barrel per day)

	Q1. 2005	Q2. 2005	Q3. 2005	Q4. 2005	Q1.2006	Q2.2006*
a-Oil world demand	84.02	82.32	82.79	83.95	84.74	83.50
b-Supply from countries outside OPEC	54.46	54.72	53.83	54.28	54.92	55.28
c- Supply from OPEC countries	29.46	29.90	30.19	29.92	29.68	
Balance (b+c-a)	-0.10	2.31	1.22	0.25	-0.14	

Note: \*There are no available data for the supply from countries outside OPEC over the second quarter of 2006.

Source: Organization of Petroleum Exporting Countries (OPEC)

## II.2 ALBANIAN ECONOMY OVER THE FIRST SEMESTER

Over the first months of 2006, the economic agents attempted to recover the economic activity slowdown caused by the severe electricity situation over the end 2005. The overall performance of economic activity, represented by enterprises' sales index, recorded an annual growth of about 18 per cent.

The performance of direct or indirect domestic demand indices over the first months of 2006 signals more positive developments compared to the previous year. Higher growth rates were recorded in Fuels Consumption and Vehicles Import.

Meanwhile, the performance of domestic demand, in quarterly terms, has essentially followed the yearly seasonal developments.

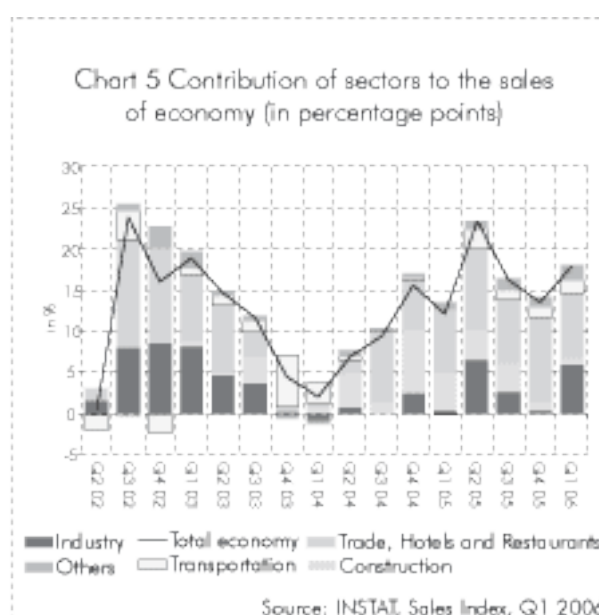


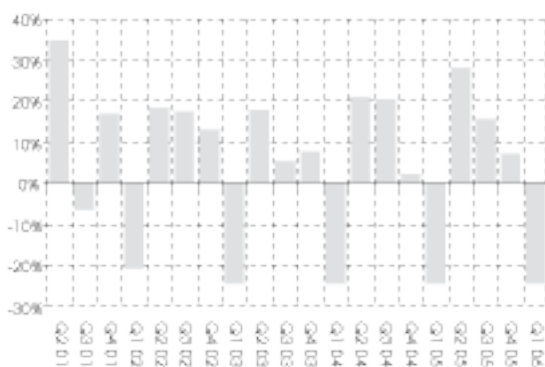
Table 3 Performance of some domestic demand indicators

Item	Annual change (in percentage)	Quarterly change (in percentage)
Fuels consumption	40.0	1.3
Total vehicles import	45.6	-6.2
TV import	-13.2	-52.6
Import of washing machines	25.6	-7.5
Import of machinery and equipment	23.2	-12.9
Cement consumption	11.8	-19.6

Source: INSTAT, Conjecture, Q1 2006.

Domestic demand growth, supported by the growth of credit stock, is reflected in the increase of imports and in the deepening of both trade and current deficit.

Chart 6 Quarterly change of sales in "Trade, hotels and restaurants" sector (in percentage)



Source: INSTAT, Conjecture, Q1 2006

## II.2.1 Performance of economy by sectors

### Sector of trade, hotels and restaurants

Service sector provided the most considerable contribution to the annual growth of sales index, by about 43 per cent of total annual growth. However, the performance of service sector, which mainly comprises the economic activity of trade, hotels and restaurants, did not seem to diverge from the quarterly seasonal developments. It implies that this sector, considering the opportunities in using substitute electricity resources alternatives, has managed to maintain the historical contribution and performance made over the first quarters in the previous years.

### Sector of agriculture

Following a period of slowdown over the past year, the agricultural production is expected to record a growth of 1.8 per cent over 2006. This growth rate is, however, lower than the average growth recorded over the last three years. Poor weather conditions, in particular over spring, have had a negative effect on the level of agricultural production. According to the most recent projections, agricultural production growth over 2006 will be mainly influenced by the higher contribution expected to be provided by Fruit-trees sub-branch. These projections are based on the expectations for the growth of productivity in this sub-branch. Agro-industry sector is expected to display stable growth rates throughout year 2006.

Table 4 Projection of agricultural production by branches (in percentage)

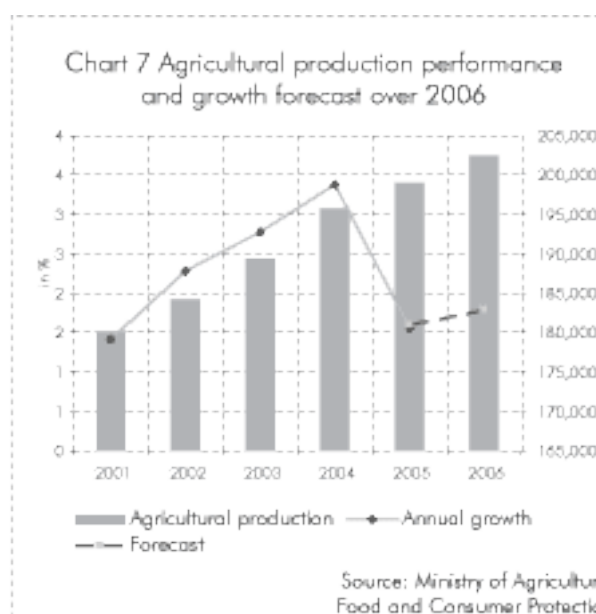
Item	Annual growth in 2005	Projection of growth for 2006
Agriculture	1.6	1.8
Animal farming	1.05	1.86
Plants	1.97	0.89
Fruit-trees	1.97	5.08
Agro-industry	5.67	6.00

Source: Ministry of Agriculture, Food and Consumer Protection.

According to estimates, agro-industrial production in quarterly terms was also influenced by the seasonal factor, which exerts downward pressure on production over the first quarters of the year. However, according to the Ministry of Agriculture, Food and Consumer Protection, investments in this sub-branch over the first quarter of 2006 marked a growth of about 35 per cent, compared to the same period the previous year, while the number of employed increased by 1 per cent. These developments signal the expansion of this sub-branch in the future.

#### *Sector of industry and electricity*

Over the first quarter 2006, the sector of industry displayed signs of revitalization after the unfavourable situation caused by the electricity crisis at the year ended 2005. At the same time, this sector recorded growth compared to the first quarter over the past years. The annual growth of industry sales for the first quarter of 2006 was 23 per cent, contributing to the annual growth of economy sales by about 33 per cent. Despite the presence of the seasonal effect, expressed in the decline of activity starting from the fourth quarter of the previous year to the first quarter of the following year, the period being analysed has been characterized by the lowest quarterly decrease observed in the last five years. This development implies the significant mitigation of the seasonal factor, as a consequence of the companies' efforts to compensate the losses recorded over the year-end, by intensifying their economic activity over the first quarter of 2006.



	Share to total	Q1 '06/Q1 '05	Contribution
Total industry	100	22.8	
Extracting industry	8	34.2	2.7
Processing industry	62	24.1	14.8
Electricity, water, gas	30	17.7	5.4

Source: INSTAT, *Conjuncture*, Q1 2006.

Table 5 Performance of industry sector for the first quarter of 2006 (in percentage)

According to the data provided by INSTAT, the annual growth of industry sales was to an extent of 65 per cent influenced by the growth in the sales of the processing industry. This sub-branch recorded the highest annual growth from 2002, by about 24 per cent. The extracting industry sub-branch also displayed a positive performance, with an annual growth of 34 per cent. This growth rate signals the revitalization of this type of industry, not very active so far.

Following the annual decline by 8 per cent over the last quarter of 2005, the sales in the electricity, water and gas sub-branch grew by 18 per cent over the first quarter of 2006. However, the data on the production of electricity for the first five months of 2006 indicate a decline in production by 2 per cent,

compared to the first five-month period in the previous year. This decline in production was followed by a decline of 5 per cent in the quantity of invoiced electricity. Electricity consumption by household consumers over the first five months of the present year has shared about 65 per cent of the overall electricity consumption.

Despite the decreasing total losses starting from February 2006, they increased by 10 per cent over the first five months of the year, compared to the same period the previous year.

Table 6 Main indicators of electricity balance sheet (in MWh)

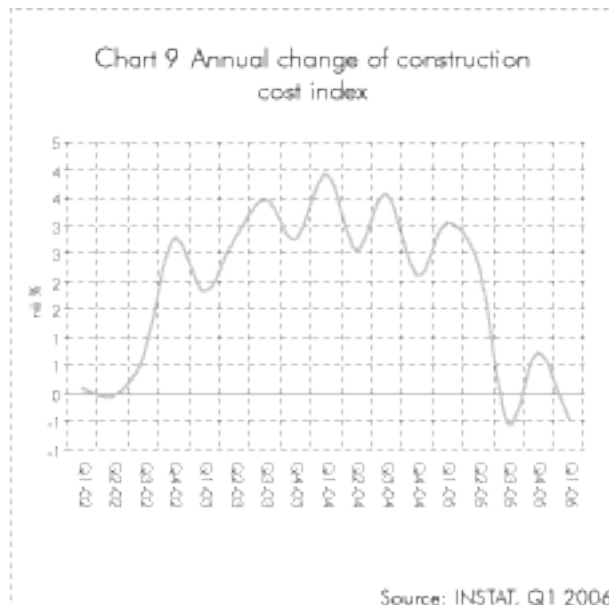
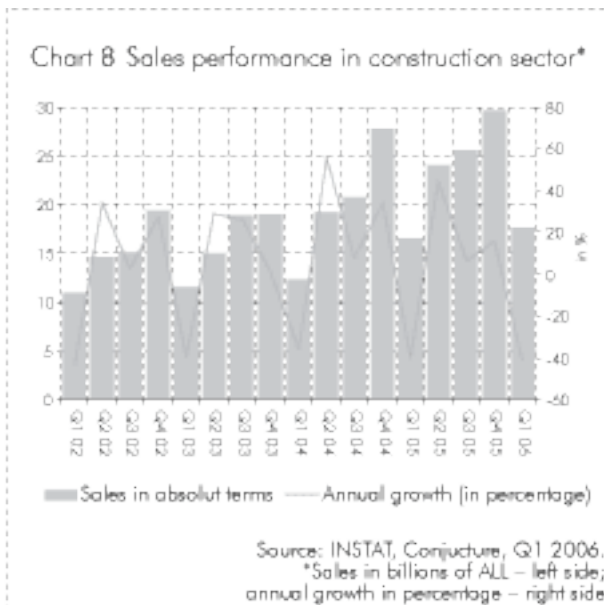
	First 5-months of 2005	First 5-months of 2006	Change
Production	2,686,921	2,632,281	-2%
Import	0	226,248	
Total loss	1,076,195	1,184,534	+10%
Invoiced consumption	1,549,503	1,473,997	
Household consumption	945,722	942,537	-0.3%

Source: Albanian Electro-Energy Corporation

Sector of construction

The decline in the contribution of the construction sector activity, observed in the last quarter of the previous year, was more significant over the first quarter of 2006. The annual growth of sales in the construction sector is the lowest compared to the growth in other sectors of economy, contributing to the growth of economy sales by only 4 percentage points. The slowdown in the economic activity of this sector, as confirmed by several surveys conducted by the Bank of Albania, was significant when compared to the same period the previous year.

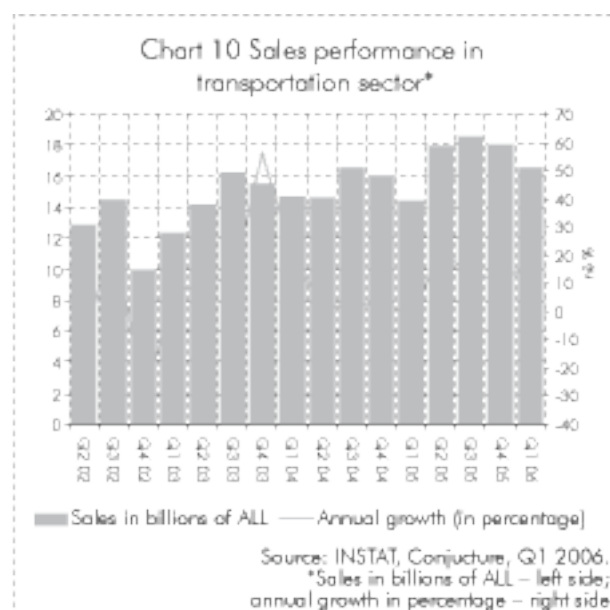
Construction cost index has displayed a downward tendency starting from the second quarter of 2005. The annual index change for the first quarter of 2006 was -0.5 per cent, signalling a decrease in the construction cost.



At the same time, "Direct expenses" sub-item has recorded an annual growth of 7.4 per cent, due to the oil price rise.

#### *Sector of Transportation*

The revitalization of the transportation sector, observed starting from the second quarter of 2005, continued over the first quarter of 2006. The annual sales of this sector grew by 15 per cent. However, oil price rise may have played a role in the performance of this sector's nominal sales. Hence, real sales growth rate may be lower than 15 per cent.



### II.3 LABOUR MARKET

The first quarter of 2006 recorded an unemployment rate of 14 per cent, which is lower when compared to the previous quarter or to the same period the previous year. The downward tendency of unemployment has been confirmed by several business surveys conducted by the Bank of Albania. In the context of further economy formalization, Government bodies have intensified the administrative measures over this period. All these elements are considered crucial factors, which influence on the decline in the number of registered unemployed. The number of employed results to be the same as over the first quarter of 2005, while the number of registered unemployed decreased by 4 thousand people. Such a development indicates that a more accurate registration of unemployed has led to a more real estimation of the working age population.

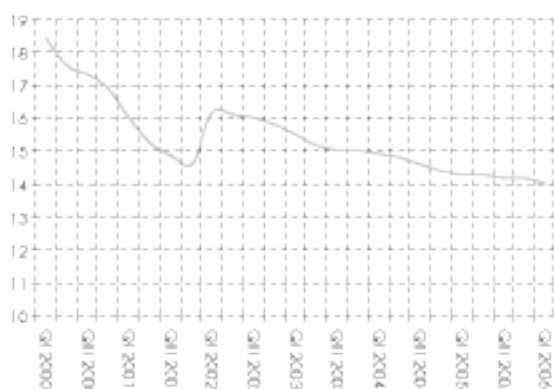
	2005			2006	
	Q1	Q2	Q3	Q4	Q5
Total labour forces	1087	1086	1086	1086	1083
A. Total of employed	931	931	931.2	932	931
i) in the public sector	176	175.6	175.6	175	174
ii) in private non-agricultural sector	213	213.4	214	215	215
iii) in private agricultural sector	542	542	542	542	542
B. Unemployment (in thousand of people)					
i) total of unemployed	156	155	154.8	154	152
ii) benefit from unemployment compensation	11.5	11.5	11.5	11.5	11.2
C. Unemployment rate (in percentage)	14.4	14.3	14.2	14.2	14.0

Source: INSTAT, Conjecture, Q1 2006.

Table 7 Labour market indicators (in thousand people)

The structure of employed by public and private sectors of economy has not experienced changes compared to the previous period. About 58 per cent of the total employed is shared by the private agricultural sector, 23 per cent by the private non-agricultural sector and the rest of employed by the public sector.

Chart 11 Unemployment rate over the last five years (in percentage)



Source: INSTAT, Conjecture, Q1 2006

Following the tendency of private sector expansion, the number of employed in the public sector has decreased. Over the first quarter of 2006, it decreased by 1.1 per cent compared to the first quarter the previous year. The employed people in the private non-agricultural sector have recorded an increase in their number by about 0.9 per cent, in annual terms. These changes have, to a large extent, balanced one another, causing the number of employed over the periods being analysed to remain unchanged.

Based on the latest estimates of the Ministry of Labour, Social Affairs and Equal Opportunities on the level of unemployment, the number of registered unemployed over May 2006 was about 150 thousand people, out of which 65 per cent is shared by long-term unemployed. The level of unemployment results

to be higher in areas of low economic activity, in particular in the north of the country, while the lowest level was recorded in Tirana. According to the same information source, the highest unemployment rate is present among the least educated part of population.

#### II.4 FISCAL SECTOR

Government's efforts in pursuing a prudent fiscal policy were reflected in the overall performance of budget indicators. The period over January – May 2006 indicates a satisfactory performance of these indicators, compared to the projected level. This performance is mainly reflected in the growth of revenues, while the level of public expenditures, in particular Investment, remained below the level projected for 2006.

According to the data provided by the Ministry of Finance, by the end of May were collected 101.7 per cent of projected revenues and realized about 87 per cent of the projected expenditures. This has caused the budget surplus to result in about ALL 10.4 billion by the end of May, from the projected deficit of ALL 2.4 billion. Compared to the same period the previous year, revenues grew by 13 per cent, while expenditures fell by 8.1 per cent, recording the highest level of contraction in total expenditures over the last 15 years. As a consequence, the period from January to May has resulted in budget surplus.

Table 8 Growth rates of main fiscal indicators (in percentage)\*

	5M 00	5M 01	5M 02	5M 03	5M 04	5M 05	5M 06	Average 98-05
Total revenues	14.6	14.8	6.5	13.8	8.5	8.2	13.0	12.2
Tax revenues	32.6	11.3	10.6	45.7	11.1	8.0	15.0	18.1
Local government revenues	48.3	69.2	16.7	247.1	18.2	7.4	(8.8)	58.5

Independent budget revenues	13.1	16.3	11.9	15.1	9.9	12.2	12.5	12.5
Non-tax revenues	(27.6)	29.2	(14.7)	(8.4)	(11.8)	(2.1)	7.8	6.1
Total expenditures	(0.8)	12.7	3.3	8.2	6.6	7.9	(8.1)	8.5
Current expenditures	(0.6)	10.2	8.3	10.0	7.7	7.2	(4.6)	8.2
Capital expenditures	(6.50)	30.6	(18.9)	(4.0)	(1.1)	14.0	(34.4)	13.5
Deficit	(38.6)	3.4	(12.9)	(26.7)	(11.9)	5.0	(266.8)	(7.8)
Domestic financing	(35.23)	(57.3)	91.9	(25.1)	(10.6)	25.2	(390.0)	19.8
Foreign financing	(42.4)	82.6	(45.0)	(28.5)	(13.5)	(18.2)	(48.9)	(12.0)

Source: Ministry of Finance, June 2006.

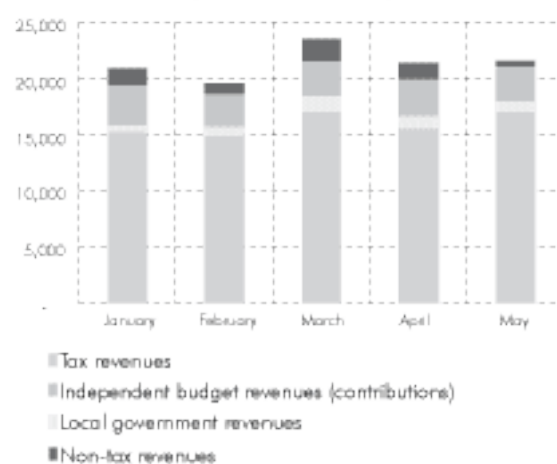
Note: \*Figures in brackets indicate decline in rates.

### Budget revenues

Budget revenues over January – May 2006 were 13 per cent higher than the same period over 2005. The level of tax revenues reached to about ALL 79.9 billion by the end of May. Customs duties amounted to about ALL 5.7 billion, as such realizing the level projected in the draft budget of the beginning of the year by 104.5 and 110.7 per cent, respectively.

Tax revenues continue to constitute the main source of budget revenues, accounting for about 89.6 per cent of total revenues. Tax on profit and excise revenues have had their best performance in revenues, exceeding the plan by 28.3 and 14.4 per cent, respectively. Among tax revenues, only tax on personal income and national tax did not reach the level projected for this period, being realized by 96.6 and 81.6 per cent, respectively. Moreover, it is observed that local government revenues have altered the upward tendency of the recent year, being realized in the level of 90 per cent.

Chart 12 Structure of budget revenues  
(in millions of ALL)



Source: Ministry of Finance, June 2006

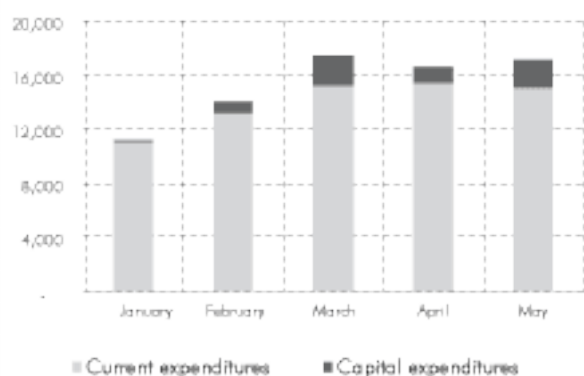
	January	February	March	April	May	Plan Jan-May	%	Annual plan
TOTAL REVENUES	16.75	32.72	51.87	69.08	86.74	85.33	101.7	39.1
Tax revenues	15.29	22.24	34.79	46.03	58.93	55.08	104.5	40.6
Value added tax	5.26	10.43	15.65	20.90	27.04	25.55	105.8	38.6
Tax on profit	1.49	3.26	6.06	7.74	9.59	7.47	128.3	52.4
Excises	1.63	3.09	4.61	6.06	8.09	7.07	114.4	40.6
Tax on personal income	0.72	1.23	1.93	2.49	3.05	3.16	96.6	36.6
National tax and other related	0.94	2.08	3.18	4.40	5.42	6.64	81.6	37.2
Customs duties	1.02	2.15	3.36	4.43	5.74	5.19	110.7	40.7

Source: Ministry of Finance, June 2006.

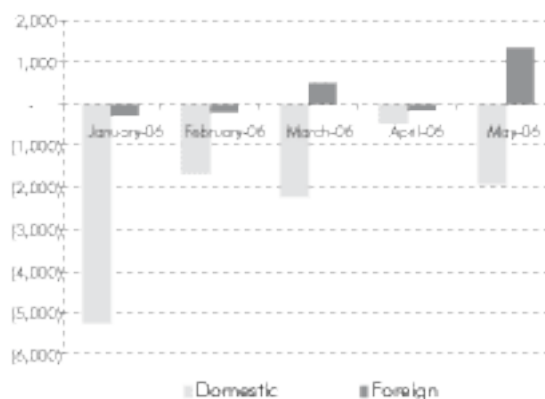
Table 9 Tax and customs revenues (in billions of ALL – progressive data)

### Budget expenditures

Budget expenditures over the first five months of the year amounted to

Chart 13 Structure of budget expenditures  
(in millions of ALL)


Source: Ministry of Finance, June 2006

 Chart 14 Budget deficit by financing resources  
(in millions of ALL)


Source: Ministry of Finance, June 2006

ALL 76.3 billion or about 86.9 per cent of the level projected for this period. Capital expenditures performance over the first months of the year did not adequately support the economic growth in the country. They continue to be realized below the projected level, accounting for 46.3 per cent. From the latter, expenditures covered by domestic financing were realized to the level of 67.8 per cent.

Table 10 Composition of current expenditures (in millions of ALL)

	January	February	March	April	May	Plan Jan-May	%	Annual plan %
Total expenditures	16.75	32.72	51.87	69.08	86.74	85.33	87.0	29.5
Current expenditures	11.19	25.25	42.66	59.22	76.32	87.76	93.8	34.1
Personnel	11.08	24.29	39.45	54.88	69.95	74.57	98.7	35.1
Interests	3.67	7.89	12.02	16.26	20.59	20.86	90.3	33.4
Domestic	2.21	3.78	6.41	8.33	10.07	11.16	94.1	35.4
Foreign	2.12	3.53	6.06	7.79	9.41	10.00	57.4	18.5
Operative maintenance expenditures	0.08	0.24	0.34	0.54	0.67	1.16	83.0	30.0
Subsidies	0.27	1.51	3.11	4.72	6.39	7.70	88.4	32.9
Social insurance expenditures	0.06	0.17	0.49	0.71	0.84	0.95	97.8	38.7
Local budget expenditures	4.19	8.74	13.39	18.04	22.86	23.39	84.2	25.1
Other expenditures	0.57	1.41	2.43	3.88	5.36	6.37	92.4	33.3

Source: Ministry of Finance, June 2006.

Current expenditures continue to represent over January – May 2006, the largest share of expenditures in the state budget. The latter share about 85 per cent of total expenditures. Personnel expenditures were realized to the level of 98.7 per cent.

#### Fiscal balance

The first five months of 2006 recorded a high level of budget surplus. However, this positive balance has had a downward trend over the months.



## II.5 EXTERNAL SECTOR OF ECONOMY

Current account deficit in the first quarter of 2006 amounted to EUR 164 million<sup>2</sup>, compared to EUR 90.2 million recorded over the first quarter of 2005. Deficit deepening in trade of goods and services provided the main contribution to current account aggravation. Meanwhile, the increase of revenues' positive balance and of current transfers has balanced the negative contribution provided by trade balance. Exchange rate performance<sup>3</sup> over January – March 2006 has maintained the tendency of the first five months of 2005, thus not having a significant impact over the developments in the balance of payments.

Trade of goods has recorded a negative balance over the first quarter of 2006, amounting to EUR 370 million, which is about 34 per cent more than the same period the previous year. Compared to the last quarter of 2005, trade deficit decreased by about 18 per cent. Trade deficit reduction in the first quarter of the year is an expected development caused by the cyclic performance of economy, which generally experiences a slowdown at the beginning of the year. The more rapid growth of imports in relation to exports and the growth of transactions' volume are the distinctive characteristic of this quarter compared to the same period the previous year. Exports managed to cover only 28 per cent of imports over this quarter, which indicates an aggravation in the trade balance. In a long-term perspective, the accumulated balance of trade deficit of goods for the last 12 months (until March 2006) amounted to EUR 1571 million from EUR 1260 million of the accumulated deficit of the last 12 months, until March 2005.

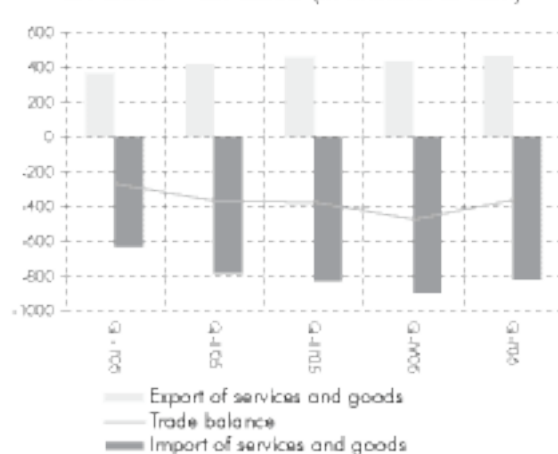
Export of goods for the period of January – March amounted to EUR 464 million or about 10 per cent more than the amount of export of goods recorded in the last quarter of 2005. This amount was 18.8 per cent higher than the same period the previous year. While, import of goods amounted to EUR 829 million. Compared to the previous year, were imported more foodstuffs, mineral products, base material and means of transportation. The growth of import in these commodity groups indicates the positive developments in the sector of production.

Chart 15 Performance of current account items, Q1 2005 – Q1 2006 (in millions of EUR)



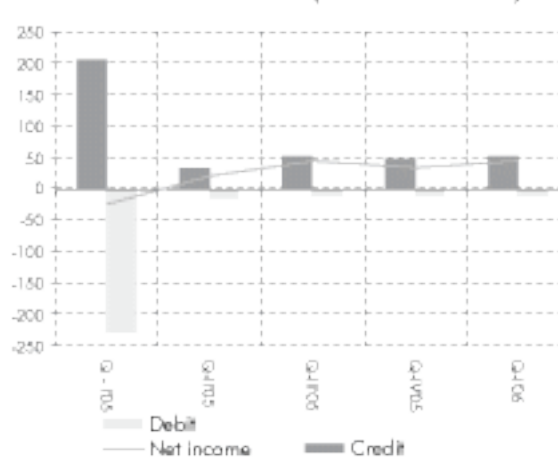
Source: Bank of Albania, Balance of Payments Division, June 2006

Chart 16 Foreign trade balance, Q1 2005 – Q1 2006 (in millions of EUR)



Source: Bank of Albania, Balance of Payments Division, June 2006

Chart 17 Performance of revenues, Q1 2005 – Q1 2006 (in millions of EUR)



Source: Bank of Albania, Balance of Payments Division, June 2006

The performance of trade of services was similar to the developments in the trade of goods. Import of services for the first quarter amounted to about EUR 304 million, marking a deficit of EUR 36.6 million. Current revenues grew compared to the year-ended and to the same period the previous year. Revenue surplus amounted to EUR 42 million, with a positive balance in both employees' compensation group and investment revenues.

Transfers from emigrants, the main item in current transfers, amounted to EUR 199.6 million by the end of the first quarter. This amount contributed to smoothing the trade deficit of goods and services by about 50 per cent. The performance of workers' remittances continued to be constant over this period. They grew by about 20 per cent compared to the first quarter of 2005, being reflected in the growth of current transfers by 10 per cent.

Capital and financial account recorded a net flow of EUR 92 million over the first quarter of 2006. These flows financed about 56 per cent of the current account deficit. Capital account amounted to EUR 36 million, while the financial account net flow amounted to EUR 56 million, over the first quarter.

Albania's financial liabilities to the rest of the world decreased by EUR 92 million by the end of the first quarter, which is about EUR 38 million less than the flow of liabilities recorded over the last quarter of the previous year. Despite the total decline of financial liabilities flow, the external debt grew by about 20 per cent over the first quarter of 2006, compared to the previous quarter, while foreign direct investment fell by about 10 per cent compared to the same period. Albania's financial claims to non-residents grew by EUR 36 million. Developments in the item of deposits and other assets have dominated in the balance of this account.

As a result of foreign assets inflows, the foreign reserve of the monetary authority grew by EUR 15.6 million over the first quarter of 2006, causing it to amount to the level of EUR 1.214 billion. The foreign reserve is sufficient to cover about 4.5 months of import of goods and services.

Table 11 Balance of payments, Q1 2005 – Q1 2006 (in millions of EUR)

	Q1' 05	Q2' 05	Q3' 05	Q4' 05	Q1' 06
Current account	-90.2	-188.5	-76.8	-238.8	-164.3
Export of goods	121.5	143.3	133.7	253.2	144.4
Import of goods	-398.1	-507.1	-516.1	-306.6	-515.2
Trade balance	-276.6	-363.8	-382.3	-53.4	-370.8
Services: Credit	203.8	237.4	270.8	253.2	267.3
Services: Debit	-227.9	239.5	-309.9	-306.6	-303.8
Services (net)	-24.1	-263.3	-39.0	-53.4	-36.6
Revenues: Credit	36.9	33.9	52.1	45.3	52.4
Revenues: Debit	-9.1	-14.0	-8.0	-11.2	-10.1
Revenues (net)	27.8	19.9	44.1	34.1	42.4
Private transfers	166.4	156.6	259.5	219.5	199.6
Government transfers	11.8	10.1	20.8	18.6	16.2
Capital account	35.5	14.6	25.0	24.1	36.0
Financial account	29.7	116.9	-15.5	193.6	55.9
Capital and financial account	65.3	131.5	9.6	217.7	91.8

Direct investment	45.3	50.3	53.0	63.9	56.7
Portfolio investment	-42.8	-5.4	40.9	5.4	4.6
Net errors and omissions	34.6	58.4	66.2	101.3	88.1
Reserve and related items:					
Reserve assets	-9.7	-1.4	-33.7	-80.1	-15.6
Use of IMF credit and loans	0.0	0.0	-4.8	0.0	0.0

Source: Bank of Albania, Balance of Payments Division, June 2006.

### III INFLATION PERFORMANCE

Average annual inflation rate for the first semester of 2006 resulted in about 2 per cent. The period of low and stable inflation until March 2006 was followed by the upward trend of this indicator. May 2006 recorded the highest annual inflation rate for the first semester of 2006. Annual inflation rate in June marked 2.4 per cent. The -1.1 per cent monthly inflation was significantly lower than the rate of -0.5 per cent marked in June 2005, due to the late impact of seasonal factors, which exert pressure over the fall of foodstuffs prices.

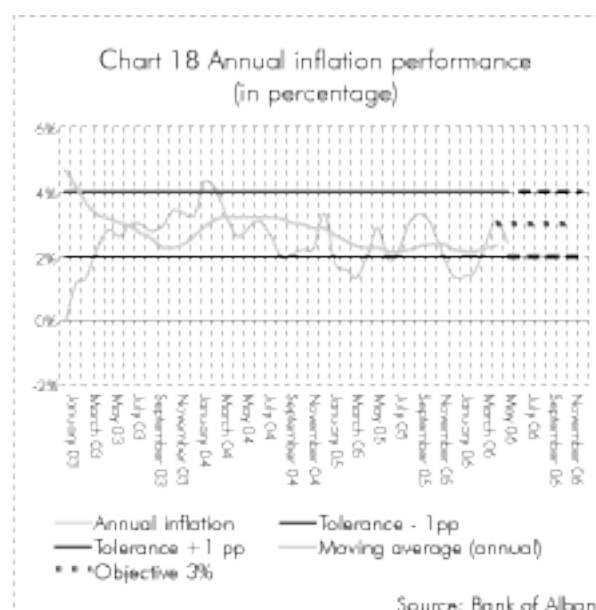
	2001	2002	2003	2004	2005	2006
January	2.2	6.5	0.0	3.3	3.3	1.4
February	1.5	7.6	1.1	4.4	1.8	1.3
March	2.9	7.5	1.3	4.0	1.6	1.5
April	3.0	6.5	2.3	3.2	1.3	2.4
May	2.5	4.6	2.8	2.6	2.0	3.1
June	4.0	3.7	2.6	2.9	2.9	2.4
July	5.6	4.2	3.0	3.1	1.8	
August	4.1	5.5	3.0	2.7	2.3	
September	3.5	5.3	2.8	2.0	3.1	
October	1.8	5.8	2.9	2.0	3.3	
November	2.8	3.7	3.4	2.2	3.0	
December	3.5	1.7	3.3	2.2	2.0	
Average	3.1	5.2	2.2	3.0	2.4	2.0

Source: CPI, INSTAT, 2006.

Table 12 Annual inflation rate (in percentage)

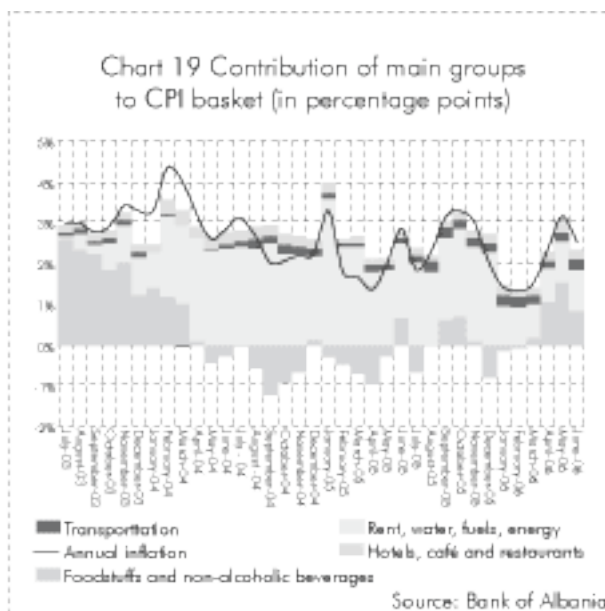
Although the deep upward tendency observed over April – May 2006 was somehow smoothed over June, the second quarter of 2006 recorded a higher annual rate than the same period the previous year (+0.6 percentage points). The increase in the annual inflation rate mostly reflected the contribution of the price rise in the agricultural products for this year. The latter is assessed to be a consequence of the reduced supply of the domestic agricultural production in the domestic market, due to poor weather conditions.

The inflationary pressures intensified over the second quarter of the year as a result of the influence of other factors, despite the seasonal ones. Smoother



appreciation of the lek against the euro, the upward tendency of import prices due to inflation increase in partner countries and the oil price rise over May and June 2006 have all further intensified the influence of pro-inflationary factors on economy.

### III.1 INFLATION PERFORMANCE BY MAIN GROUPS



The contribution of main groups to annual inflation rate displayed a different prospect over January – June 2006, compared to the previous two years.

Annual inflation of “Foodstuffs and non-alcoholic beverages” group displayed diverse performances over the first semester, in particular over the second quarter, compared to the previous years. Over April and May 2006, this group contributed to total annual inflation rate by about +50 per cent. Over the last two years, foodstuffs prices have exerted downward pressures on the annual inflation rate at the beginning of summer season. Although June partly returned this performance of Foodstuffs group,

due to the fall of prices in typical seasonal products, it continued to record a positive contribution of Foodstuffs on annual inflation. This development came as a consequence of the further rise in the prices of other foodstuffs and mainly of processed food.

Table 13 Annual inflation of “Foodstuffs and non-alcoholic beverages” group (in the country and abroad) and the contribution of this group to total inflation

	Annual inflation '05	Contribution (pp)	Annual inflation '06	Contribution (pp)	Italy <sup>4</sup> Annual inflation '06	Greece <sup>5</sup> Annual inflation '06
January	-0.7	-0.3	-0.4	-0.2	1.1	1.6
February	-1.2	-0.5	-0.3	-0.1	0.9	2.1
March	-1.7	-0.7	0.4	0.2	1.0	2.1
April	-2.2	-1	2.5	1	1.0	3.8
May	-0.7	-0.3	3.7	1.5	0.9	2.9
June	1.6	0.7	1.9	0.8	-	-

Source: Bank of Albania; General Secretariat of National Statistical Service of Greece; ISTAT-Italy.

“Transportation” group with “Service to personal vehicles” subgroup reflected the high oil price rise, which peaked in May and June 2006. Starting from May 2006, the favourable behaviour of lek exchange rate against the dollar and the euro did not manage to fully compensate the oil price rise.

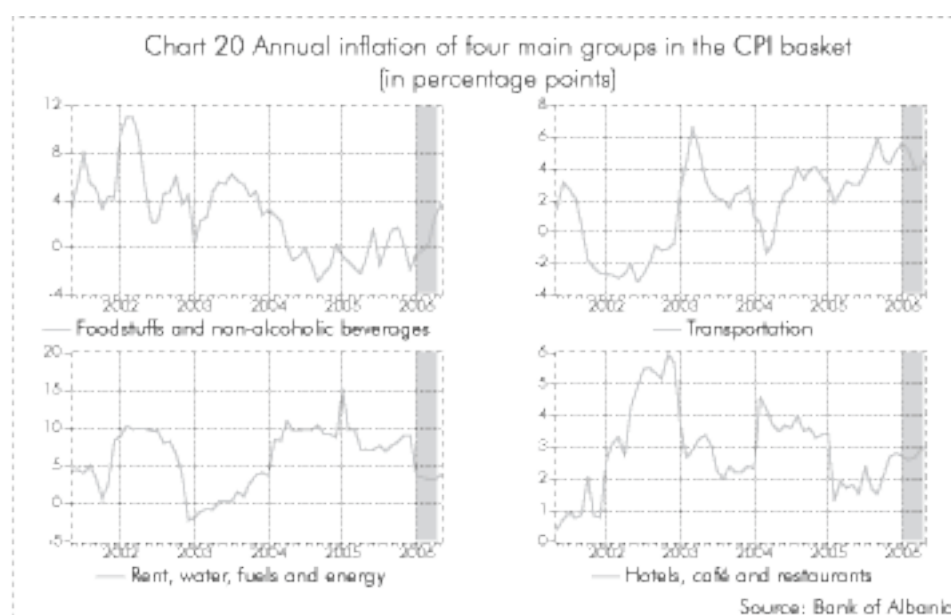
The contribution of “Rent, water, fuels and energy” price index to total annual inflation rate was positive. Moreover, this index defined the low annual inflation rate over the first quarter of 2006. As expected, the rise of energy prices in the previous year ceased to provide its effect on inflation at the beginning of 2006.

	Annual inflation '05	Contribution (pp)	Annual inflation '06	Contribution (pp)
January	15.2	3.6	3.6	0.9
February	9.8	2.4	3.5	0.9
March	9.9	2.4	3.2	0.9
April	7.2	1.8	3.2	0.8
May	7.2	1.8	3.8	1.0
June	7.1	1.8	3.9	1.0

Source: INSTAT, 2006.

Table 14 Annual inflation rate and contribution of "Rent, water, fuels, energy" group to total inflation

The contribution of other basket groups was relatively low and stable over January – June 2006, mainly manifested by "Hotels, café and restaurants" group.



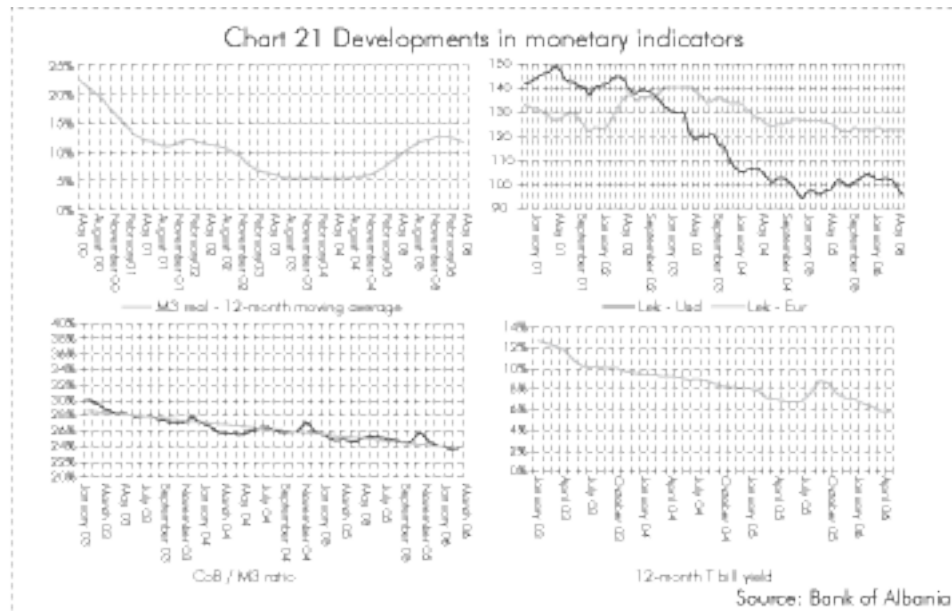
### III.2 MACROECONOMIC ENVIRONMENT AND CONSUMER PRICES

The first part of 2006 was characterized by a positive performance of monetary and fiscal indicators. These factors managed to control the further increase of inflationary pressures, which were most significant over the second quarter of 2006. External economy developments and the negative performance of some indicators related to domestic supply have caused the consumer prices to display an upward tendency. Factors, such as the high oil and import prices, the reduced supply of domestic agricultural products and the smoothing of the lek appreciation against the euro have all had an impact on the consumer price performance over January - June 2006.

#### Monetary Policy

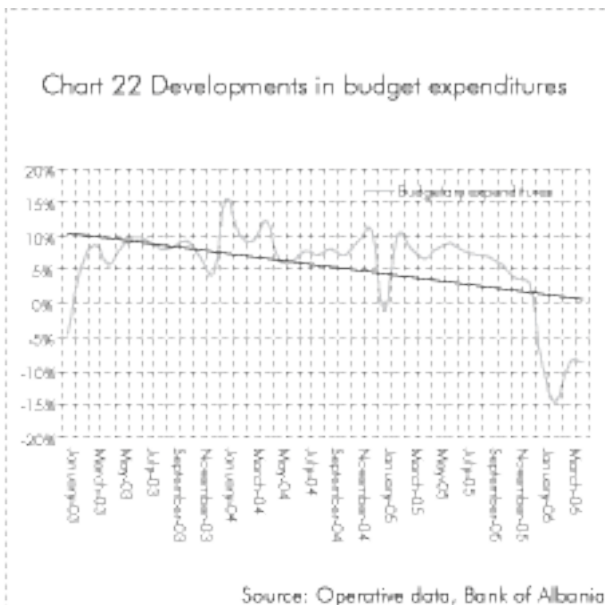
January – May 2006 was characterized by a downward tendency of M3 growth rate and of currency outside banks. While, lending rates resulted to

be high. Unlike the historical tendencies, January – May 2006 experienced a monetary expansion, pushed by the private sector demand for monetary assets. This credit is assessed to have influenced on domestic demand growth, being also reflected in the growth of sales. The growth of domestic demand may have had an impact on the increase of inflationary pressures, which are assessed to be higher than the ones experienced over the same period the previous year. This growth of demand by the private sector was somehow balanced by the modest public sector demand. This has caused the monetary developments to have a controlling role on the increase of inflation rates.



*Fiscal policy*

The fiscal policy pursued over the first half of 2006 was a prudent one. Government’s efforts in collecting revenues opposite the expenditures slowdown have resulted in the increase of budget surplus for January – May 2006. In general, it has caused the demand for money to be low, making a significant contribution to the tendency of M3 annual growth. The prudent fiscal policy has influenced on keeping the inflation rate within the Bank of Albania objective for the period being analysed. However, the expected growth of expenditures and of deficit in the second semester of 2006 shall bring the increase of inflationary pressures on economy.



*Exchange rate, imported inflation and oil prices*

The lek continued to appreciate over the first semester of 2006, both against the dollar and the euro. However, the appreciating tendency against the euro was more moderate over April - June

2006. This has caused the depreciating influence on imported products prices to be less present.

Oil price rise in the international markets was also reflected in the domestic market, reaching its peak at the end of June. This rise was more considerable than the appreciating tendencies of the lek over the last two months of the first semester. Therefore, the risk presented by "oil" factor to domestic inflation over the second quarter of 2006, is considered to be more present than before.

#### *Production and Consumer prices*

The fluctuations in production prices did not have an evident influence on the inflation rate over the first quarter of 2006. The reason behind this divergence may be the fact that the share of domestic production is not determinant in the supply of goods in the Albanian market, as such not having a direct influence on consumer prices. Moreover, a large share of production continues to be re-exported.

## IV MONETARY DEVELOPMENTS AND FINANCIAL MARKETS

### IV.1 MONETARY POLICY OF THE BANK OF ALBANIA

Monetary developments and the performance of macroeconomic indicators have generally been in line with the projected tendencies. Money supply growth was carried out according to the monetary programme. Private sector of economy was the main factor influencing on the monetary expansion, while the public sector has generally been characterized by a tightening demand for monetary assets. The net influence has resulted in the maintenance of the money supply growth rate within the interval of 10-12 per cent over the first five months of 2006. Monetary developments have reflected the constant performance of macroeconomic indicators and the growth within the targeted objective of the total level of prices in economy. The Bank of Albania has pursued a neutral monetary policy over the first semester of 2006.

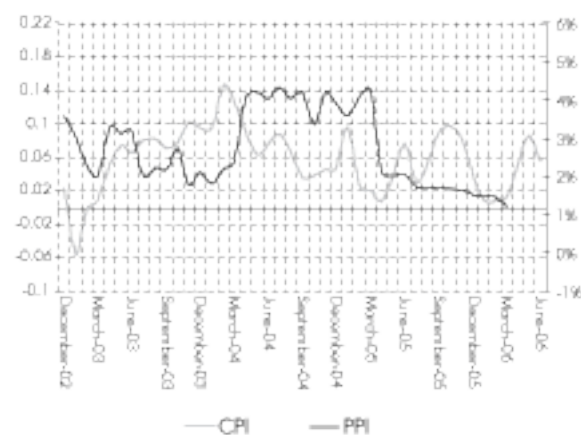
The constant maintenance of the core interest

Chart 23 Oil price annual changes and the exchange rate of Lek against the US dollar (right hand)



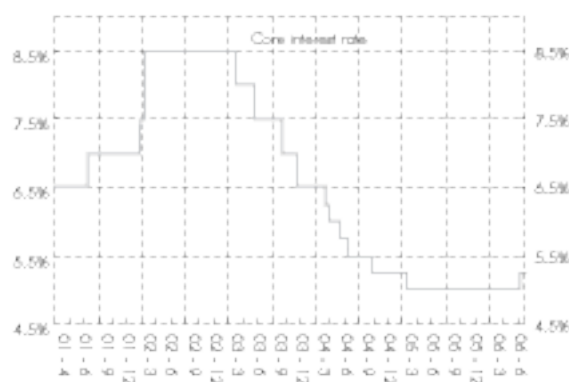
Source: INSTAT, Bloomberg

Chart 24 Performance of consumer and production prices



Source: INSTAT, 2006

Chart 25 Core interest rate performance (in percentage)



Source: Bank of Albania

rate began in March 2005, when the Bank of Albania decreased it by 0.25 percentage points. Starting from this month, the interest rate applied in repurchase agreements was 5.0 per cent. However, the interest rates in the money markets have maintained slight downward tendencies. The average weighted interest rate of deposits in the system decreased by 0.3 percentage points in May, compared to 4.46 in December. However, the Treasury bills interest rates of 3-month and 12-month maturity decreased by about 0.3 and 1.3 percentage points, respectively, over the first semester of 2006. The downward tendencies are assessed to be a result of the shift of securities portfolio to two and three-year maturity. In deposits market, the moderate downward tendency was encouraged by the enhancement of competition and the decline of market concentration among large banks.

The tendencies observed in the performance of interest rates and the developments in the real sector, reflected in the growth of domestic demand and increasing inflationary pressures expectations, have supported the reconsideration of the monetary policy stand in July. The growth of credit to the private sector constitutes a stimulating element for inflationary pressures. Given this perspective, the Bank of Albania increased the repurchase agreement interest rate by 0.25 percentage points. This policy is expected to influence on keeping the upward tendency of the aggregate demand in economy constant and on stabilizing the foreign currency structure of interest rates in credit and deposits' market.

Moreover, in the context of implementing its monetary policy, the Bank of Albania has observed its operational objectives for the first semester of 2006.

Table 15 Realization of the Bank of Albania quantitative objectives<sup>6</sup>

	December '05	March '06	April '06	May '06	June '06
Net international reserve of the Bank of Albania (in millions of USD)					
Objective	1,184	1,117	1,115	1,113	1,112
Actual	1,184	1,215	1,219	1,243	1,237
Difference	--	98	104.0	129.7	135.5
Net domestic assets of the Bank of Albania (in billions of ALL)					
Objective	82.0	85.0	86.7	88.3	90.0
Actual	76.7	61.8	65.0	62.5	66.6
Difference	-5.3	-23.2	-21.7	-25.8	-23.4
Net domestic credit to Government (in billions of ALL)					
Objective	306.7	314.6	315.9	317.2	318.7
Actual	306.7	300.5	297.1	297.3	--
Difference	--	-14.1	-18.8	-19.9	--

Source: Bank of Albania

## IV.2 PERFORMANCE OF MONETARY AGGREGATES

Money supply growth rates over the first semester of the present year have been close to the historical trend. In May, the annual growth of broad money, M3, resulted in 10.5 per cent, while M2 aggregate marked a growth of 6.2 per cent, in annual terms. Compared to the same period the previous year,



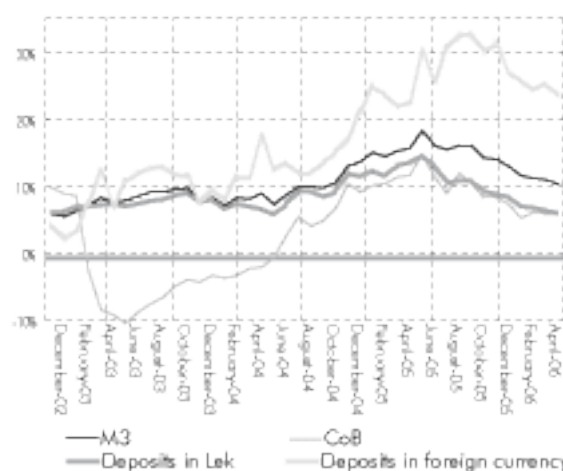
monetary expansion rates have been lower. Actually, the performance of these indicators mainly reflects the demand of the private sector of economy for money. Public sector demand for money to finance the fiscal deficit projected for 2006, is expected to be entirely realized in the second half of the year. Such a development will encourage higher money supply growth rate in the second part of the year.

Unlike the historical trends, the monetary expansion of January – May is entirely motivated by the private sector demand for monetary assets, while public sector demand has had a neutral effect on the monetary developments. Over this period, credit to the private sector has dominated the performance of monetary aggregates. Total deposits grew by ALL 21.5 billion over January – May or by about 5 per cent of deposits' stock in December 2005. Over the same period the previous year, deposits in the system grew by ALL 32.7 billion, mainly as a result of a more rapid circulation of the planned annual borrowing of the public sector. The distribution of demand for money over the year tends to influence on the concentration of deposits in quarters, with a high demand for money, and on the situation of the banking system liquidity.

Money supply has recorded changes in both time structure and foreign currency one, orienting towards less liquid assets and foreign currency ones at the same time. In May, the ratio of currency outside banks to M3 was 23.5 per cent against the ratio of 24.5 per cent, recorded over the same period the previous year. At the same time, the ratio of deposits in foreign currency to M3 accounted for 27.6 per cent or 2.9 percentage points higher than in May the previous year.

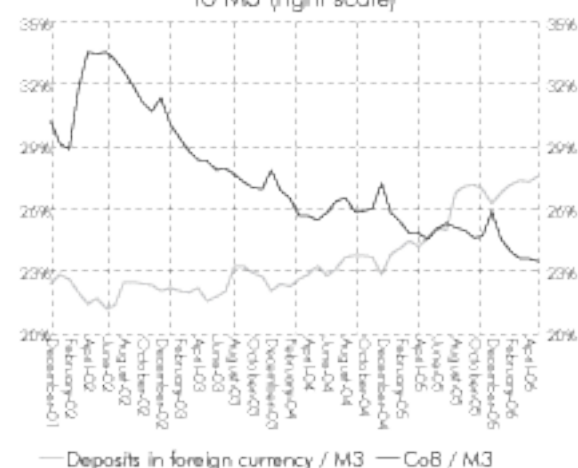
Interest rates in the lek deposits market have by and large reflected the facilitating tendency of the monetary policy conducted by the Bank of Albania over the last three years. Under the upward tendency of the used deposits interest rate, the difference to lek interest has decreased from about 7 percentage points in 2003, to about 1.4 percentage points in the first half of 2006. In relation to the interest rate of euro deposits, the difference of lek interest fluctuates to about 2 percentage points, against about 5 percentage points recorded in 2003. The difference in the lek deposits to the euro deposits is mainly due to the decrease of the lek deposits interest to the interval of 4.5 – 4.2 percentage points over this semester.

Chart 26 Annual growth of M3, M2, deposits in Lek and in foreign currency

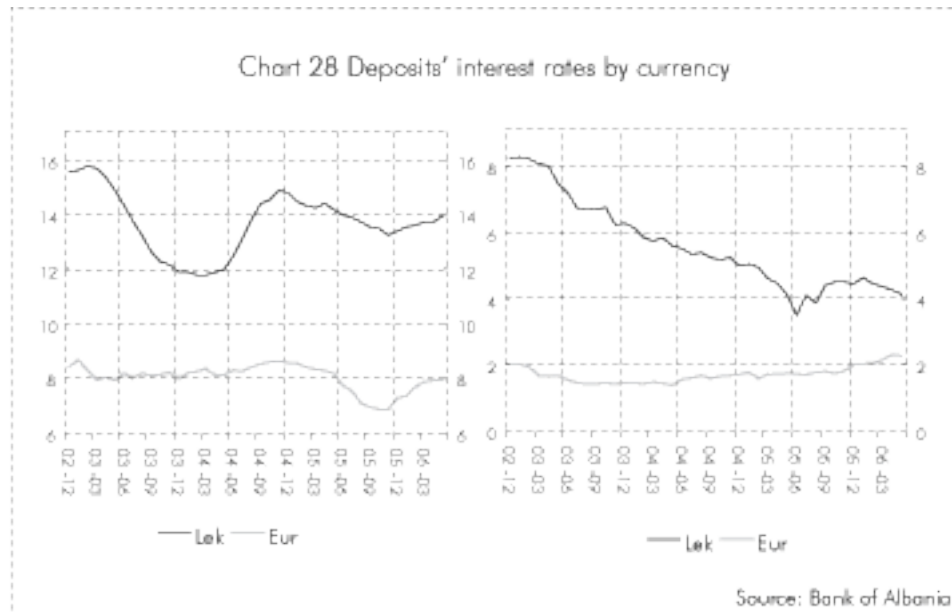


Source: Bank of Albania

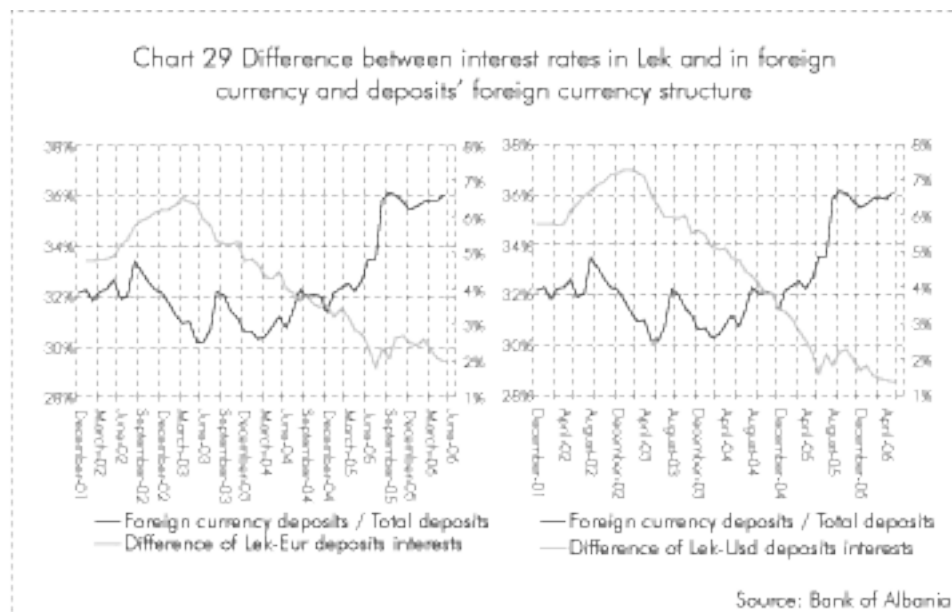
Chart 27 Ratio of currency outside banks to M3 and of deposits in foreign currency to M3 (right scale)



Source: Bank of Albania



The decrease of the lek deposits interest rates to those in foreign currency was accompanied by a shift in the foreign currency structure of deposits, in favour to deposits in foreign currency. The weighted interest rate of lek deposits in the first five months of 2006 was about 2 percentage points higher than the weighted interest rate of euro deposits. This difference was about 6.5 percentage points in 2003. The difference of lek deposits interests to those in usd has reduced from about 7 percentage points in 2003 to about 1.5 percentage point in the first semester of 2006.



The annual growth of total deposits, in absolute terms, was dominated by the growth of demand deposits in the system. The level of time deposits in the last 12 months has experienced a decline by ALL 3.2 billion, while demand deposits have recorded an annual growth of ALL 44.9 billion. As a result, the

ratio of time deposits to total deposits decreased by 7.6 percentage points from May 2005 to May 2006, decreasing from 77.8 per cent to 70.2 per cent. In December 2005, this ratio was 69.8 per cent<sup>7</sup>.

	May	Annual change		Annual change	
	2005	Absolute	Percentage	Absolute	Percentage
Currency outside banks	138.3	0.1	0.1	7.6	5.8
Total deposits	449.9	4.0	0.9	48.1	12.0
- in lek	287.7	1.5	0.5	17.2	6.3
- in foreign currency	162.2	2.5	1.5	30.9	23.6
Demand deposits	134.2	2.5	1.9	44.9	50.3
- in lek	82.6	1.8	2.2	40.0	94.2
- in foreign currency	51.6	0.7	1.4	4.9	10.4
Time deposits	315.7	1.5	0.5	3.2	1.0
- in lek	205.1	-0.3	-0.1	-22.9	-10.0
- in foreign currency	110.6	1.8	1.6	26.1	30.9
M1	220.9	1.9	0.9	47.6	27.5
M2	426.0	1.6	0.4	24.8	6.2
M3	588.2	4.1	0.7	55.7	10.5
Monetary base	190.7	0.0	0.0	16.2	9.3

Source: Bank of Albania.

Table 16 Performance of monetary indicators in May (in billions of ALL)

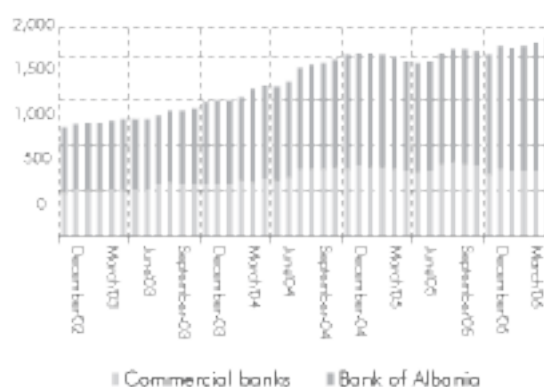
### IV.3 DOMESTIC DEMAND

#### IV.3.1 Net foreign assets

The banking system foreign assets amounted to USD 2.1 billion at the end of May 2006. Over the first five months of the year, the foreign assets grew by USD 187.9 million. The most significant contribution to this growth was provided by the growth in the net foreign reserve of the Bank of Albania by USD 144.5 million. Foreign reserve growth came as a consequence of the foreign currency purchase by the Bank of Albania, the income from the privatization of the Italian-Albanian Bank, as well as of the euro/usd exchange rate effect. The appreciation of the euro against the usd by about 8.2 per cent has caused the amount of investment in euro, expressed in usd, to grow.

Foreign currency inflows and outflows in commercial banks have resulted in the growth of net foreign assets by about USD 43.4 million, starting from the beginning of the year. This performance is due to the higher growth rate of deposits in foreign currency, compared to the growth rate of credit in foreign currency. The growth of foreign currency liabilities, expressed as credit from non-residents by about USD 36.9 million over this period, has influenced on the decrease of commercial banks' net foreign assets.

Chart 30 Net foreign assets of the banking system (in millions of USD)



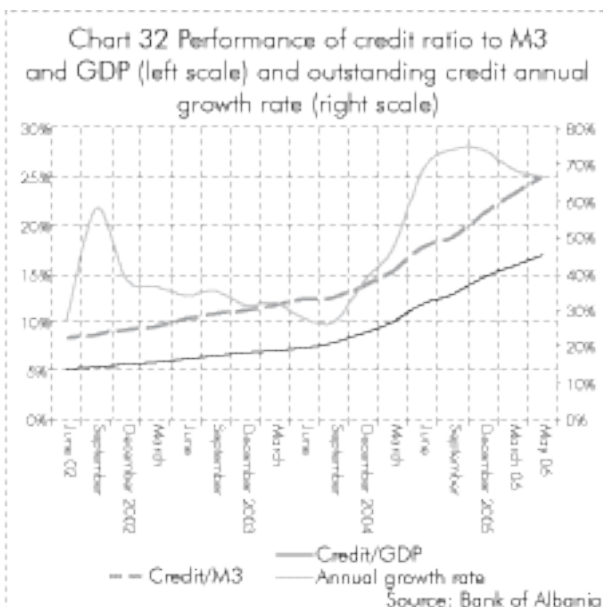
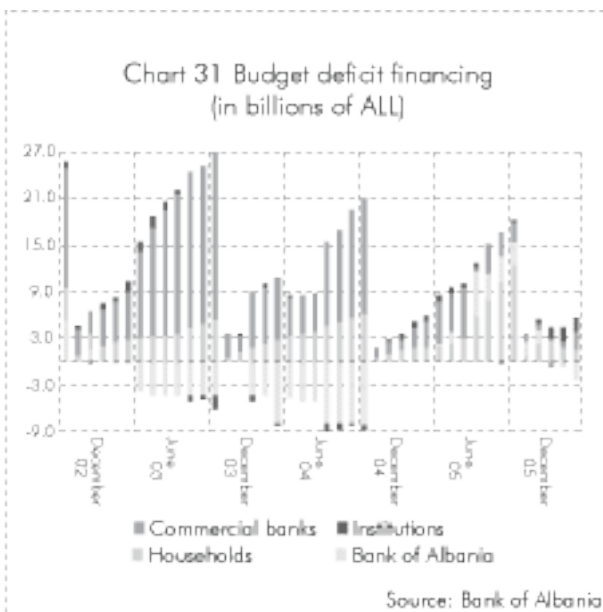
Source: Bank of Albania

### IV.3.2 Government demand for money

Budget surplus at the end of May amounted to ALL 8.9 billion. Unlike the previous year, the reduction of Government demand for money has resulted in a negative financing of deficit by the banking system. The negative level of domestic financing amounted to about ALL 2.8 billion in May, while Government deposits amounted to ALL 6.1 billion. The planned Government borrowing to be used for the 2006 budget deficit financing is expected to lead to the concentration of Government demand for money in the second semester of the year.

The decrease of the weight of domestic Government borrowing on money supply and of domestic borrowing dominating effect on the time structure of securities' interest rates continued over this year. The Government continued to issue Treasury bills of three maturities, with a view to extend the securities' maturity terms. The net effect of the Treasury bills, issued over the first semester of the year, resulted to be negative since their maturity exceeds the issued amount.

The Government issued bonds of two and three-year maturity over the first half of the year, amounting to ALL 6 billion and ALL 3.5 billion, respectively. Part of the domestic financing in May were the revenues resulting from the privatization, which amounted to ALL 2.1 billion<sup>8</sup>. Fiscal surplus of this semester was invested in commercial banks in the form of reverse repos. Their level amounted to ALL 9 billion in May.



### IV.3.3 Credit to economy

Credit to economy amounted to ALL 146.5 billion by the end of May. Over January - May, outstanding credit recorded a growth of ALL 24.5 billion. This growth is 30 per cent higher than the growth of outstanding credit over the same period the previous year. Credit in May grew by 65.1 per cent, which is lower than the annual credit growth rate of 74.3 per cent in December 2005. Credit annual growth has followed a downward tendency since December 2005.

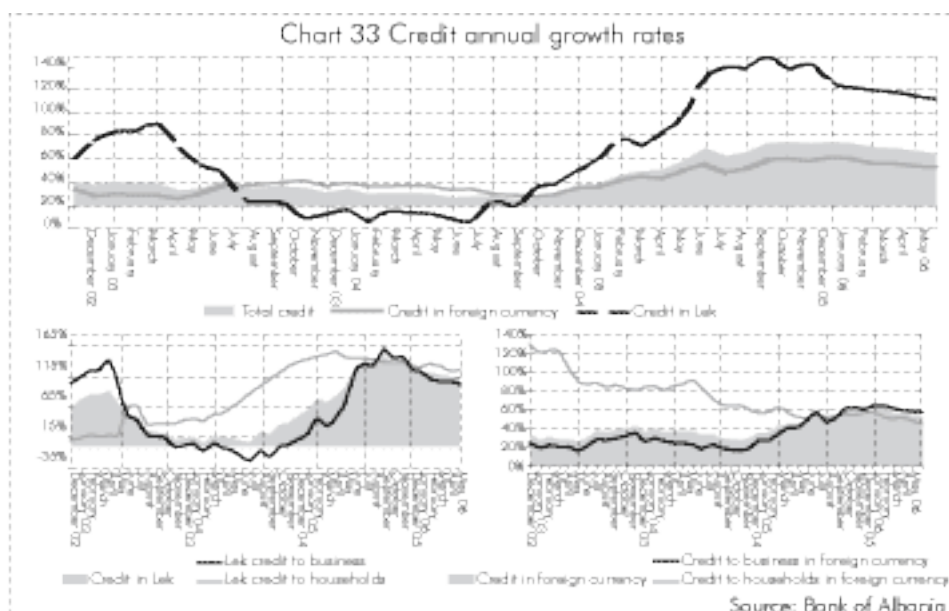
Outstanding credit to economy as a share to GDP accounted for about 17 per cent in the first semester of 2006, compared to 14.6 per cent at the year ended 2005. Moreover, the higher demand of the private sector for money is reflected in the considerable growth of outstanding credit to money supply (M3). The ratio of outstanding credit to M3

in May accounted for 24.9 per cent or 3.8 percentage points higher than in December. The same ratio was 8.2 per cent higher to May 2005.

The increasing contribution of credit to the private sector to money supply expansion is in line with the tendency projected in the medium-term. This tendency is in line with the enhancement of the banking system intermediary role in economy and is accompanied by changes in the dynamics of monetary developments. Higher credit growth rates against the historical rates are consistent with the expansion of credit base from the banking system to economy.

Over the first five months of 2006 was extended ALL 55 billion of new credit or about 33 per cent more than the previous year. In the structure of new credit is observed the tendency of banks to extend more long-term credit, credit to households and credit in local currency.

Outstanding credit in lek grew by about ALL 1.7 billion over the first five months of 2006, which is about 72 per cent higher than the average growth of the same period the previous year. The annual growth rate of credit in lek was 112 per cent in May. By the end of May, the portfolio of credit in lek accounted for 27.2 per cent of total credit to economy, against the ratio of 25.6 per cent estimated in December 2005. The increase in the share of credit in lek to total credit is a result of the tendency of crediting to households in lek, while the growth rate of credit to business in lek has maintained the downward trend.



Long-term credit displayed positive developments in the first months of 2006. The share of long-term credit to total credit portfolio accounted for 38.3 per cent by the end of May. The extension of credit maturities is one of the main reasons for the high growth rate of credit portfolio. The share of

short-term credit has had a downward tendency. Short-term credit is applied for by businesses, mainly used to cover short-term needs for liquidity.

Table 17 Outstanding credit indicators (as a share to total)

	2003	2004	2005				2006		
			Q1	Q2	Q3	Q4	March	April	May
Total credit (in billions of ALL)	50.7	69.3	79.0	95.9	106.0	121.9	134.6	140.0	146.5
Credit to households	24.5	30.6	31.0	30.8	31.4	31.6	31.9	31.7	31.9
Credit to business	75.5	69.4	69.0	69.2	68.6	68.4	68.1	68.3	68.1
Short-term credit	46.0	34.0	34.1	33.7	31.6	32.8	32.3	32.0	46.0
Medium-term credit	33.3	36.0	34.5	33.1	31.2	30.3	29.9	29.7	33.3
Long-term credit	20.7	30.0	31.4	33.1	36.9	37.0	37.8	38.3	20.7
Credit in Lek	19.6	19.5	20.1	22.9	23.7	25.5	26.0	26.3	27.1
Credit in foreign currency	80.4	80.5	79.9	77.1	76.3	74.5	74.0	73.7	72.9

Source: Bank of Albania

With regard to the sectoral distribution of credit, is observed the upward tendency of crediting the sectors which need long-term investment, as indicated by the growth of credit for real estates and construction. Consumer credit has also recorded continues growth. Credit to agriculture has remained in close levels as in December 2005. Trade continues to represent the most credited branch of economy, sharing about 19.9 per cent of total credit portfolio.

Table 18 Credit to economy by branches

	2002	2003	2004	Q1 '05	Q2 '05	Q3 '05	Q-4 '05	Q1-06	May 06
Agriculture, hunting and silviculture	0.8	1	1.5	1.5	1.5	2.4	2.7	2.2	2.29
Processing industry	17	17	17.1	16.7	15.6	13.9	16.8	14.2	13.05
Construction	8.6	10	9.8	11.2	11.2	12.8	13.8	13.0	13.21
Trade, repairing of vehicles and household equipment	0.4	34	23.3	20.6	19.1	20.0	15.9	19.0	19.90
Hotels and restaurants	6	6	8.3	5.2	4.7	4.4	13.0	4.18	4.72
Real estates	9.1	13	9.8	14.7	13.5	13.9	23.1	14.6	15.66
Other	18.1	19	30.2	30.1	34.3	32.6	33.2	32.3	31.2
Total	100	100	100	100	100	100	100	100	100

Source: Bank of Albania

Table 19 Performance of new credit over the years (as a share to total)

	2004	2005				2006	
		Q1	Q2	Q3	Q4	Q1	May
New credit (in billions of ALL)	99.7	22.1	32.8	32.1	32.9	29.5	13.6
Short-term credit	62.54	53.2	47	47.4	48.7	46	42.5
Medium-term credit	22.53	22.4	31	30.3	25.6	29	24.1
Long-term credit	14.93	24.4	22	22.2	25.7	25	33.4
In Lek	32.59	30.1	32.8	30.2	31.4	29	33.8
In foreign currency	67.41	70	67.2	69.8	68.6	71	66.2

Source: Bank of Albania

#### IV.4 FINANCIAL MARKETS, INTEREST RATES AND EXCHANGE RATE

The higher level of excess liquidity than the levels recorded in the market in the previous semester has favoured the decrease of lek interest rates over the first semester of 2006. There was a downward trend of lek interest rates, although the Bank of Albania has pursued a neutral monetary policy in the

first half of the year. The decrease of lek interest rates, in general, is in line with the trend observed in the last years. The decrease of interest rates was encountered in the primary market, Government bonds market and in the repo/reverse agreement market, repo having indefinite prices.

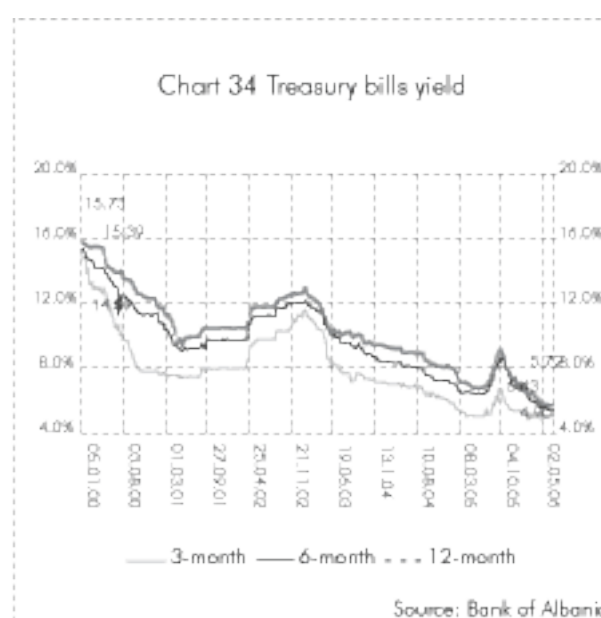
	Yield	Period
3-month Treasury bills	4.86	February 2006
6-month Treasury bills	5.43	June 2006
12-month Treasury bills	5.72	May 2006
2-year bonds	6.30	May 2006
3-year bonds	7.50	May 2006
1-month repo	5.18	June 2006
3-month repo	5.19	March 2006

Source: Bank of Albania

Table 20 The lowest historical levels of interest rates in ALL

The low nominal interest rates were accompanied by positive real interest rates, due to the low average interest rate. The decrease of interest rates was followed by the fall in the cost of financial intermediation to economy.

The banking system portfolio in Treasury bills has reduced due to the lower Government demand for this mean of financing. At the same time, the volume of investment in longer maturities – two and three-year Government bonds – has grown, resulting in a growth of ALL 0.7 billion of the banking system investment in Government securities<sup>9</sup>. Under the excess liquidity in the market, there has been a general downward tendency of the yields, except for three-month Treasury bills, the interest for which has been relatively low. The yields have fluctuated from the minimal value of 4.90 per cent in April to 5.23 per cent in June<sup>10</sup>.



Over 2005-2006, the primary market has been characterized by the narrowing of the spread between 3-month, 6-month and 12-month maturities.

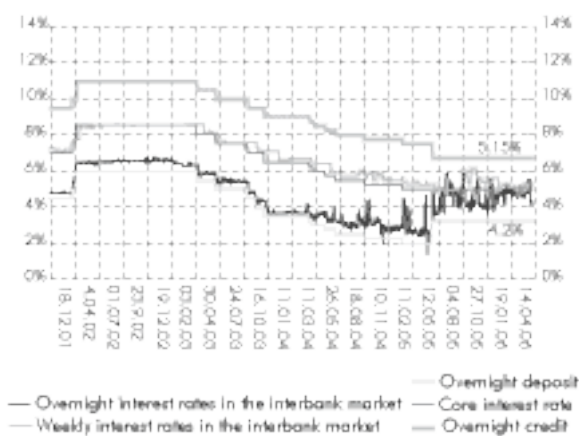
December 2004	June 2005	December 2005	June 2006
2.01%	1.73% ↓	1.50% ↓	0.51% ↓

Source: Bank of Albania

Table 21 Difference between Treasury bills interest rates of 12-month and 3-month maturity<sup>11</sup>

Unlike the other markets, the interbank market has not manifested a downward trend of interest rates, but it was characterized by their stability and very close position to the core interest rate. The borrowing activity in the interbank market has almost maintained the same intensity as in the second semester of 2005, despite the various liquidity conditions. The average daily

Chart 35 Interest rates in the interbank market and the monetary policy<sup>12</sup>



Source: Bank of Albania

level of overnight borrowing over the first semester amounted to ALL 0.7 billion, while the weekly borrowing amounted to ALL 0.9 billion. The lowest historical levels of the spread between overnight and weekly borrowing interests were attained in the interbank market over this period.

Apart from the neutral policy of the Bank of Albania and stability in the market, the change of standing facilities corridor from asymmetric to the lowest symmetrical corridor in the history of the use of these facilities has also influenced on this performance<sup>13</sup>.

Unlike the previous semester, the lek deposits market over the first semester of 2006 has been characterized by the continuous decrease of interest rates at all terms, in particular of 24-month and 12-month deposits.

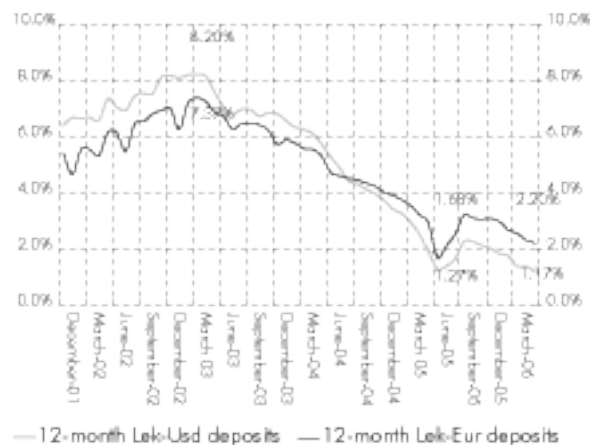
The difference between the interests of credit and deposits in lek has been stable and fluctuated close to the level of 8.0 per cent, both for 6-month and 12-month maturities. This level of the spread is yet high, since it is mainly influenced by the level of risk credit in lek bears. Over the first half of 2006, the interests of credit in lek decreased, following the decrease of lek deposits and Treasury bills interests. At the same time, the interests of credit in foreign currency increased, following the increase of libor and euribor interests and the ones of deposits in foreign currency. Another characteristic of credit market was the narrowing of the spread between the interests of credit in different terms, both of credit in lek and in foreign currency, which testifies the stability of markets and the interest rates expectations.

The interests of deposits in foreign currency in the banking market have increased over the first semester, as a result of the tightening of the monetary policy conducted by Fed and the European Central Bank.

The decrease of lek deposits interests on one hand and the increase of foreign currency deposits interests on the other, have led to the narrowing of the spread between the interests of deposits in lek and in foreign currency, which in several cases, reached the lowest historical levels.

The difference between nominal interests of deposits in lek and in usd in May 2006 reached the lowest historical levels in maturity terms of 6 and 12-month, resulting in 1.19 per cent and 1.17 per cent, respectively.

Chart 36 Lek - foreign currency deposits' interest spread, in nominal terms



Source: Bank of Albania

Exchange rate

The lek has displayed appreciating tendencies to the dollar, while being relatively stable to the euro



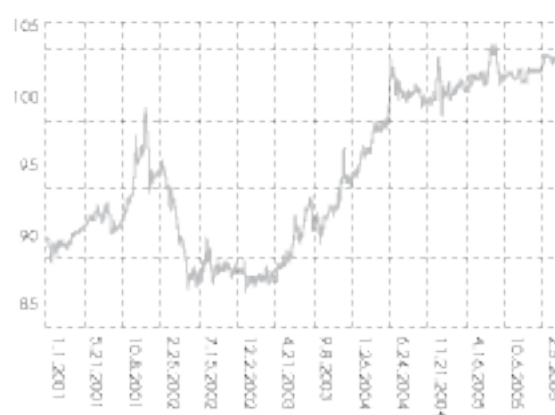
over the first semester of 2006. In annual terms, the lek continued to appreciate against both main currencies, the dollar and the euro, by about 4.4 and 0.4 per cent, respectively.

The developments in the international foreign currency market have been reflected in the lek to the US dollar exchange rate. Regarding the lek to the euro exchange rate, the developments in the international market were neutralized by the revitalization of appreciating domestic pressures of the lek against the euro. In nominal effective terms, the lek appreciated by 1.3 per cent. At the end of June, the exchange rate of the lek against the usd and the euro was 97.1 and 123.3, respectively.

## V ECONOMIC PERFORMANCE OVER 2006

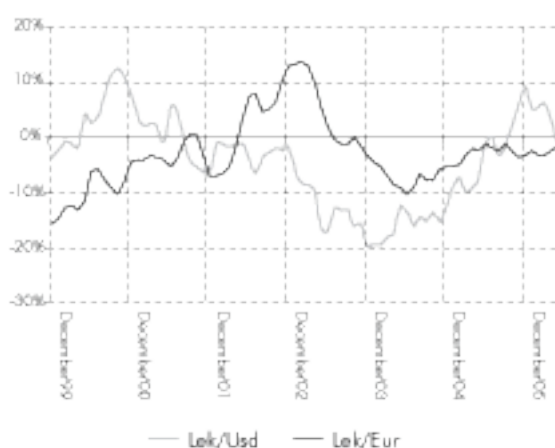
Macroeconomic stability achieved over the recent years has created the proper conditions for a stable economic growth. The Albanian economy has displayed a satisfactory resistance to the problems caused by the shortage of electricity over the end 2005 and the beginning of 2006. Economic growth for 2006 is estimated at about 5.0 per cent. This projection was based on the expected economic activity slowdown over the first quarter (due to electricity problems) and its rapid recovery in the following quarters. Meanwhile, the data on the first quarter show for a high level of economic activity, suggesting that the projection of the economic growth for 2006 may be somehow conservative.

Chart 37 Nominal effective exchange rate (NEER).



Source: Bank of Albania

Chart 38 Exchange rate annual changes



Source: Bank of Albania

	2002	2003	2004	2005	2006*
Real economy indicators (in percentage)					
GDP real growth	2.9	5.7	5.9	5.5	5.0
CPI annual growth (average)	5.4	2.4	2.7	2.4	3.0
Nominal GDP (in billions of ALL)	624.7	682.7	766.4	836.9	899.7
External sector (in percentage to GDP)					
Trade balance	-25.9	-25.1	-21.7	-24.1	-24.5
Current balance	-10.0	-8.1	-5.5	-7.8	-8.1
Fiscal indicators (in percentage to GDP)					
Fiscal deficit	-6.6	-4.5	-5.1	-3.6	-3.8
Domestic borrowing	3.3	2.9	2.3	2.7	2.3
Monetary indicators (in percentage)					
Money supply growth	5.7	8.7	13.4	13.8	13.6
Credit to economy growth	38.3	31.0	37.1	73.5	51.0
12-month Treasury bills interest rates <sup>14</sup>	12.0	9.5	8.1	6.9	--

\* Projections

Source: IMF, Ministry of Finance, Bank of Albania, INSTAT.

Table 22 Main macroeconomic indicators

Economic growth over 2006 will be mainly based on the increase of economy domestic demand. This growth will push the activity of the private sector, while the weight of the public sector will continue to decrease. Despite the enhancement of economy productive capacities, the preliminary projections and the performance of the first quarter indicate that the growth of domestic credit will be followed by the further deepening of trade balance deficit and of the current account deficit. Reflecting the expansion of imports, this fact should not be considered as disturbing in the short-term, as long as they are oriented towards the import of machinery and raw materials, which in a second period serve to the growth of domestic production. However, one of the challenges regarding Albania's economic policies over the following periods is the promotion of Albanian exports and the development of industries, which substitute imports. Such a step is crucial to boosting economic growth and enhancing the welfare under constant basis.

In a domestic context, the economic environment over 2006 will benefit from the further consolidation of public finances, reflected in the low level of budget deficit and in the further decrease of domestic borrowing. These developments will sustain the further consolidation of macroeconomic stability, fall of fiscal domination and the expansion of opportunities to support credit to the private sector. Moreover, in a more analytical plan, the revised fiscal packet provides the measures for facilitating the fiscal burden of businesses and enhancing investments in infrastructure. The successful application of this packet implies the growth of economy productive capacities. It will provide opportunities for a wider participation of labour work in production and the absorption of a higher level of investment, which will generate positive consequences to economic growth in the following period.

Through its commitment to maintain the monetary stability in economy, the Bank of Albania will further sustain economic growth framework. In response to further inflationary pressures, the last increase of core interest rate will help to manage the level of inflation, the inflationary expectations and long-term interest rates. Monetary developments, projected in the monetary programme, are expected to provide a positive impulse to the economic activity for 2006. The rapid growth of credit to economy will continue to constitute the most significant monetary development for 2006. In relative terms, outstanding credit to economy is estimated to increase by 51 per cent over 2006. This increase reflects a natural slowdown compared to the rates recorded in 2005, considering the low base this process started from in 2004. However, this process implies a considerable injection of ALL 63.4 billion banking system funds, to support business and economy consumption.

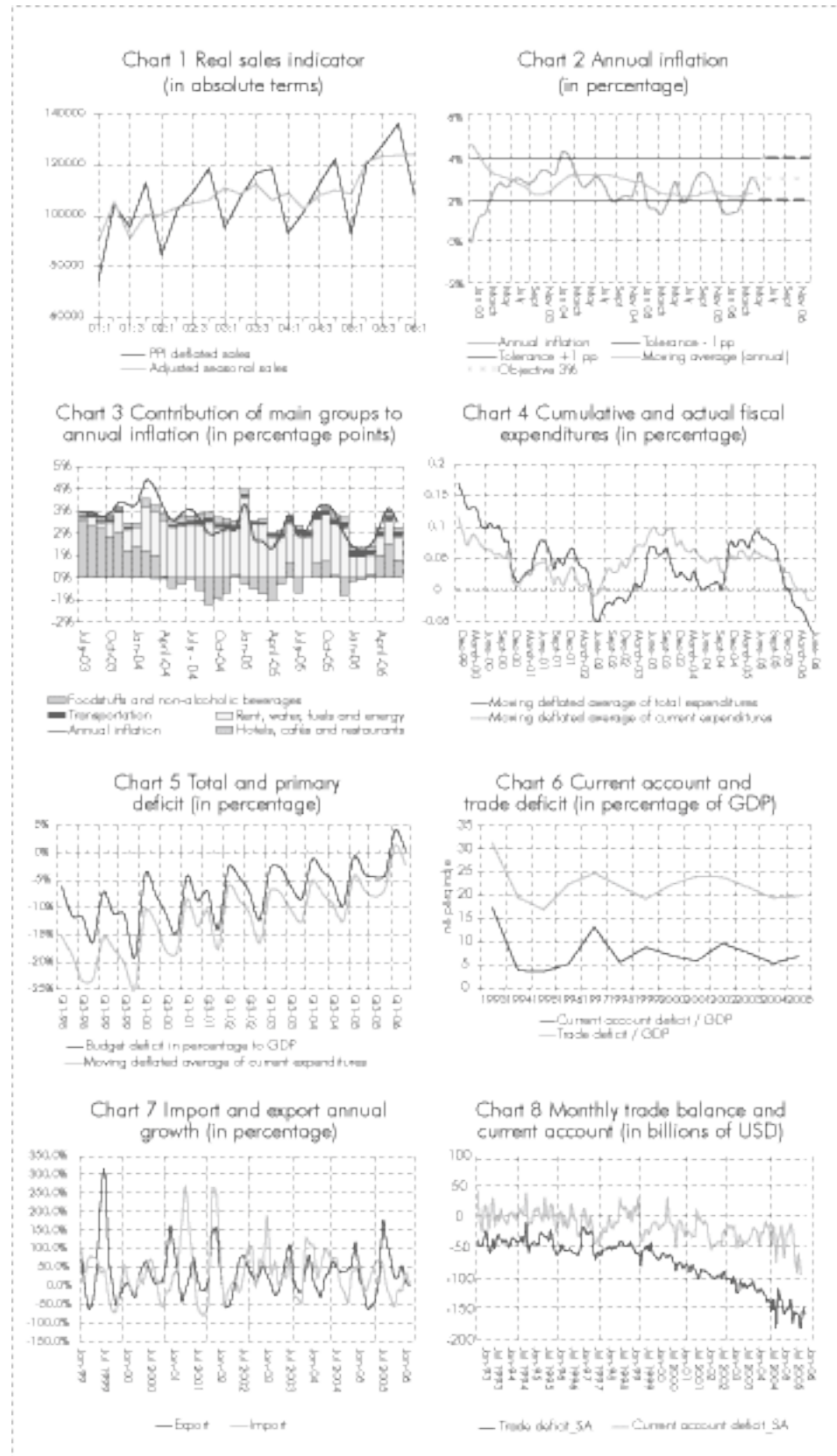
The revised monetary programme frames the impact of the Government fiscal position with the monetary developments in the private sector of economy, as such guaranteeing the accomplishment of inflation objective. According to this revision, money supply is expected to grow in higher rates. In the first half of the year, Government fiscal position has resulted in the neutralization of the expansion effect of credit growth to the private sector. In total, Government demand for budget deficit domestic financing over 2006

is projected to be almost the same as in 2005, that is, about ALL 20 billion. Public sector demand for money is expected to be fully accomplished in the second half of the year.

According to these tendencies, the revised monetary programme projects a 13.6 per cent growth of money supply. Money supply growth over 2006 is expected to further drive money velocity down. This tendency is projected in the medium-term monetary programme and is in line with the economy transitory developments. This growth is projected to be consistent with the increase of the general level of prices in economy around the objective of 3 per cent, under the conditions of maintaining macroeconomic stability and external equilibrium of economy.

The growth of M3 aggregate, broad money supply indicator, will be controlled through the control of the Bank of Albania operational objectives, Net International Reserves (NIR) and Net Domestic Assets (NDA). According to the objectives stipulated in the IMF agreement and framed in the monetary programme, the administration of these two components of reserve money will assist to the supervision of money supply growth.

STATISTICAL ANNEX



## INFLATION

Table 1 Annual inflation rate (in percentage)

	2001	2002	2003	2004	2005	2006
January	2.2	6.5	0.0	3.3	3.3	1.4
February	1.5	7.6	1.1	4.4	1.8	1.3
March	2.9	7.5	1.3	4.0	1.6	1.5
April	3.0	6.5	2.3	3.2	1.3	2.4
May	2.5	4.6	2.8	2.6	2.0	3.1
June	4.0	3.7	2.6	2.9	2.9	2.4
July	5.6	4.2	3.0	3.1	1.8	
August	4.1	5.5	3.0	2.7	2.3	
September	3.5	5.3	2.8	2.0	3.1	
October	1.8	5.8	2.9	2.0	3.3	
November	2.8	3.7	3.4	2.2	3.0	
December	3.5	1.7	3.3	2.2	2.0	
Average	3.1	5.2	2.2	3.0	2.4	1.9

Source: INSTAT

Table 2 Contribution of basket constituent groups to total inflation

	December 05	January 06	February 06	March 06	April 06	May 06	June 06
Foodstuffs and non-alcoholic beverages	-0.8	-0.16	-0.11	0.16	1.03	1.51	0.79
Rent, water, fuels and energy	2.26	0.94	0.93	0.85	0.84	1.00	1.04
Transportation	0.24	0.26	0.1	0.14	0.13	0.23	0.24
Hotels, café and restaurants	0.21	0.21	0.19	0.20	0.22	0.22	0.22
Other	0.15	0.14	0.10	0.11	0.12	0.10	0.11
Total	2.06	1.39	1.33	1.48	2.35	3.10	2.40

Source: INSTAT, Bank of Albania

## MONETARY AGGREGATES

Table 3 Performance of monetary indicators (in billions of ALL)

	May 06	Monthly change		Annual change	
		Absolute	Percentage	2006	Absolute
Currency outside banks	138.3	0.1	0.1	138.3	0.1
Total deposits	449.9	4.0	0.9	449.9	4.0
- in Lek	287.7	1.5	0.5	287.7	1.5
- in foreign currency	162.2	2.5	1.5	162.2	2.5
Demand deposits	134.2	2.5	1.9	134.2	2.5
- in Lek	82.6	1.8	2.2	82.6	1.8
- in foreign currency	51.6	0.7	1.4	51.6	0.7
Time deposits	315.7	1.5	0.5	315.7	1.5
- in Lek	205.1	-0.3	-0.1	205.1	-0.3
- in foreign currency	110.6	1.8	1.6	110.6	1.8
M1	220.9	1.9	0.9	220.9	1.9
M2	426.0	1.6	0.4	426.0	1.6
M3	588.2	4.1	0.7	588.2	4.1
Monetary base	190.7	0.0	0.0	190.7	0.0

Source: Bank of Albania

Table 4 Performance of NFA indicators by main groups (in millions of USD)

	May 06	Monthly change	Annual change
Net foreign assets	2,197.7	51.1	253.2
Foreign assets			
Bank of Albania	1,569.5	42.8	246.757
ODC	929.0	1.7	31.266
Foreign liabilities			
Bank of Albania	107.3	1.4	-2.917
ODC	193.4	-8.0	27.731

Source: Bank of Albania

Table 5 Performance of NCG indicators by main groups

	May 06	Monthly changes	Annual changes
Net claims on the Government	268.03	-2.8	-13
Bank of Albania			
ODC	50.95	-2	-5.9
Deposits with the Bank of Albania	217.08	-0.8	-7.1
Budget deficit	6.8	2.1	3.8

Source: Bank of Albania

Table 6 Outstanding credit indicators (as a percentage to total)

	2003	2004	Q1 '05	Q2 '05	Q3 '05	Q4 '05	Q1-06	May '06
Outstanding credit (in billions of ALL)	50.7	69.3	79.0	95.9	106.0	121.9	134.6	146.5
Short-term credit	46.0	34.0	34.1	33.7	31.6	32.8	31.9	32.1
Medium-term credit	33.3	36.0	34.5	33.1	31.2	30.3	30.3	29.7
Long-term term	20.7	30.0	31.4	33.1	36.9	37.0	37.8	38.2
Credit to households	24.5	30.6	31.0	30.8	31.4	31.6	31.9	31.9
Credit to private sector	75.5	69.4	69.0	69.2	68.6	68.4	68.1	68.1
In Lek	19.6	19.5	20.1	22.9	23.7	25.5	26.0	27.1
In foreign currency	80.4	80.5	79.9	77.1	76.3	74.5	74.0	146.5

Source: Bank of Albania

Table 7 Performance of credit for the main branches of economy

	2002	2003	2004	Q1 '05	Q2 '05	Q3 '05	Q4 '05	Q1-06	May '06
Agriculture, hunting and silviculture	0.8	1	1.5	1.5	1.5	2.4	2.71	2.17	2.29
Processing industry	17	17	17.1	16.7	15.6	13.9	16.8	14.22	13.05
Construction	8.6	10	9.8	11.2	11.2	12.8	13.78	13.02	13.21
Trade, repairing of vehicles and household equipment	0.4	34	23.3	20.6	19.1	20.0	15.9	18.99	19.90
Hotels and restaurants	6	6	8.3	5.2	4.7	4.4	13.02	4.78	4.72
Real estate	9.1	13	9.8	14.7	13.5	13.9	23.1	14.56	15.66
Other	18.1	19	30.2	30.1	34.3	32.6	33.2	32.27	31.2
Total	100	100	100	100	100	100	100	100	100

Source: Bank of Albania

Table 8 New credit indicators (as a share to total)

	Total 2004	Q1	Q2	Q3	2005 Q4	Q1 '06	May 06
New credit (in billions of ALL)	99.7	22.1	32.8	32.1	32.9	29.4	13.6
Short-term credit	62.54	53.2	47	47.4	48.7	44.2	42.5
Medium-term credit	22.53	22.4	31	30.3	25.6	30.1	24.1
Long-term credit	14.93	24.4	22	22.2	25.7	25.7	33.4
Credit in lek	32.59	30.1	32.8	30.2	31.4	27.7	23.8
Credit in foreign currency	67.41	70	67.2	69.8	68.6	72.3	66.2

Source: Bank of Albania

## FINANCIAL MARKETS

Table 9 Interest rates at the end of the month and their change compared to previous periods (in percentage points)

	June 06	Change June 06-December 06	Change June 06-June 05
Core interest rate	5.00%	0.00	0.00
Interbank market			
Overnight interest in the interbank market	4.21%	0.01	1.71
Weekly interest in the interbank market	5.15%	-0.31	-0.13
Primary market			
3-month Treasury bills yield	5.23%	-0.18	0.17
6-month Treasury bills yield	5.42%	-1.31	-0.98
12-month Treasury bills yield	5.74%	-1.17	-1.06
Bonds market			
2-year bonds yield	6.4%	-1.6	-1.2

Source: Bank of Albania and commercial banks

Table 10 Interest rates and their change in lek deposits and credit market (in percentage points)

	May 06	Change May 06-December 06	Change May 06-May 05
Core interest rate	5.00	0.00	0.00
Interest of deposits in lek			
3-month	3.85%	-0.22%	0.20%
6-month	4.46%	-0.31%	0.05%
12-month	5.08%	-0.49%	0.21%
24-month	5.91%	-0.91%	0.16%
Interest of credit in lek			
Up to 6-month credit	12.13%	-0.77%	-2.47%
6 month – 1 year credit	12.73%	0.57%	2.09%
1-3 years credit	16.28%	-1.79%	-2.18%
Over 3-year credit	12.01%	-0.22%	-0.22%

Source: Bank of Albania and commercial banks

Table 11 Interest rates of deposits in foreign currency (in percentage points)

	May 2006	Change May 06-December 05	Change May 06-May 05
Fed – core interest rate	5.0%	+0.75	+2.00
Interest of deposits in USD			
1-month	2.37%	0.01%	0.62%
3-month	2.92%	0.11%	0.85%
6-month	3.27%	0.28%	0.97%
12-month	3.91%	0.35%	0.95%
24-month	3.79%	-0.36%	0.41%
ECB – core interest rate	2.50%	+0.25	+0.25
Interest of deposits in EUR			
1-month	2.11%	0.29%	0.44%
3-month	2.38%	0.37%	0.61%
6-month	2.65%	0.45%	0.82%
12-month	2.88%	0.39%	0.92%
24-month	3.07%	-0.20%	-0.10%

Source: Bank of Albania and commercial banks

Table 12 Interest rate spread of deposit – credit in lek and in foreign currency

Spread of deposits interest:				
	lek-usd		lek-euro	
	May 05	May 06	May 05	May 06
3-month	1.58	0.93	1.88	1.47
6-month	2.11	1.19	2.58	1.81
12-month	1.91	1.17	2.91	2.2
Spread of credit interest:				
	lek-usd		lek-euro	
	May 05	May 06	May 05	May 06
6-month	6.66	2.64	5.48	4.21
6-month – 1 year	1.88	3.46	3.64	4.91
1-3 years	9.72	5.53	10.0	8.31
Over 3 years	3.58	2.84	4.16	3.8

Source: Bank of Albania and commercial banks



## ENDNOTES

<sup>1</sup> Organization of Petroleum Exporting Countries.

<sup>2</sup> According to the preliminary data provided by the Bank of Albania, Balance of Payments Division.

<sup>3</sup> Referring to the nominal effective exchange rate, calculated by the Bank of Albania.

<sup>4</sup> Source: ISTAT; website <http://www.istat.it>

<sup>5</sup> Source: General Secretariat of National Statistical Service of Greece; website: <http://www.statistics.gr>

<sup>6</sup> Quantitative objectives of the Bank of Albania are part of the new PRGF/ EFF 2006-2008 agreement signed between the Albanian Government, IMF and the Bank of Albania in January 2006.

<sup>7</sup> The shift to demand deposits is partly a result of Raiffeisen Bank strategy for the reclassification of some deposits in lek from time to demand deposits.

<sup>8</sup> The sale of Italian – Albanian Bank shares held by the Albanian Government.

<sup>9</sup> Average daily level of excess liquidity in the banking system over the first semester of 2006 amounted to ALL 8.9 billion or ALL 1.1 billion more than the previous year.

<sup>10</sup> The ratio of Government demand for financing the deficit with Treasury bills to the banking system supply was 1:1.2, on average.

<sup>11</sup> The difference of the spread between minimal and maximal maturities of Treasury bills yields.

<sup>12</sup> The percentages in the graph display the latest data in the interbank market and provide the interests in this market at the end of the semester.

<sup>13</sup> This corridor was changed in July 2005, from assymetrical (+250/-300 percentage points) to symmetrical (+175/-175 percentage points).

<sup>14</sup> End of period.