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I. CONSUMER PRICE DEVELOPMENTS.

Bank of Albania's main target, as defined in the central bank law is achieving and maintaining the stability of consumer prices. Such target is embodied in the intention to reach low inflation rates, annually. For year 2000, such target was fixed at 2-4 percent. Fixing the inflation target through an interval provides the authorities with more flexibility in reaching it, especially, in unstable economies.

Inflation performance interim 1998, 1999 as well as that of January - November 2000, created the conviction that even for 2000, it will be observed the inflation target. It did not happen so, in fact. Beyond any forecast, December developments produced an annual inflation rate at 4,6 percent bringing in a total capsize of inflation rate from -0,4 percent as 11- month term (November against December 2000) at 4,2 percent at year-end. Such rate is 0,2 percentage points over the upper limit of inflation target.

The unexpected development in consumer prices is mainly as a result of two-factor effect; the intensity of speculation in December and the power crisis that gripped the country in the last three months of the year.

Taking a closer look at December, it may be quite said that speculation with the consumer price developments because of the year-end holidays is ever more becoming a determinant on inflation rate. With the passing of years, this speculation is ever growing.

Although, that high growth partly bears as the extension of the money demand for consumer goods as outcome of year-end celebrations, the speculative motive is estimated as strong, and comprises the main cause for the unusual growth of consumer prices.

However, it must be admitted that the environment of just closing year was more favorable to the addition of speculation in economy compared with both years previously, based on the deterioration of the power crisis in December. The desire to speculate is as so strong as in the case of removing fiscal duties on liquid gas the prices remained the same, to not say they had a slight growth. Although oil prices internationally have declined, the oil price in the domestic market remained stuck by the same levels of the top crisis.

In fact similar phenomenon as those that might be called seasonal effect, speculative or enforced increases of consumer prices by shock factors (domestic or foreign) etc, are recognized and taken into account by the central banks which on their side try to set up a similar indicator to succeed in "undressing" the inflation rate from other effects even those casual, which are not as an outcome of applied policy. The indicator that comes out from undressed inflation from the external factors is usually recognized as core of basic inflation.

The Bank of Albania's computations on core inflation consists in the elimination of the unstable items of the basket, special food articles or the entire group as well as the so-called seasonal foodstuffs. On the other hand, based on the assumptions for a change in the consume behavior in Albania, it has been computed a new method of measuring inflation where the share of "foodstuffs, beverage and tobacco" falls in 50 percent from 73 actually.

Normally, stopping at various computed measurements (see the chart), it results that in all the cases, current inflation at the end of December is higher than all other measurements.

As already observed, core inflation is much below the fact. Whereas, from the comparison of current inflation with the

corrected one, reducing the share of foodstuffs to 50 percent of the total, it is noted that, this measurement during the whole year has resulted over the current inflation. To be excluded is the last month when the percentage of corrected inflation, descended below the current one (see table1).

In practice all those countries that have as direct monetary policy target the maintaining stability of consumer prices, it's a long ago they have set up the indicator of core inflation. What changes from one bank to another is that the performed suppositions and exceptions and the applied methodology varies with each country peculiarities. It is the same fact that the success of a central bank policy is measured with judging on the performance of this indicator. Under the current circumstance, the Bank of Albania is of the opinion to make this new concept on inflation official, making clear at the same time its opinion. It can not be tolerated the speculation with the consumer prices of fruit and vegetables (which went up to 23 percent on monthly base) in the last 15-days of the year, to compromise the monetary policy efficiency and lead to strong upsurges of consumer prices at year-end periods, generally.

To illustrate the fact, enough to stress that core inflation monthly rate for December has resulted 0.4 percent whereas, on annual template, this rate has been negative per 0.9 percent. This means that inflation is not a derivative of monetary policy operations but is under the pressure of seasonal effects of the growing intensity of speculation and the unsafe environment created by the power crisis.

II. DEPOSIT DEVELOPMENTS IN MONETARY MARKET AND CREDITS.

II.1. Deposit performance.

Total deposits of the banking system during January- December interval increased by Lek 13,3 billion against 40,3 billion of 1999. Foreign exchange deposits had the main share in this growth by Lek 9,9 billion to November against 12,5 billion in 1999. Meantime foreign currency deposits increased by only Lek 3,4 billion against 21,1 billion in 1999.

Household deposits of the banking system increased by Lek 11,1 billion. From these 8,8 billion are time deposits in foreign currency and 2,3 billion are time deposits in domestic currency. January- December 2000 is characterised by stable growing trends of foreign currency deposits.

Deposit behaviour in the system during January-November reflects the several factors' effect. They are partly hard to identify or measure in effect, even for the fact that we lack statistics on the real indicators of economy or the available ones are very poor.
The public preference against household deposits in foreign currency is conditioned by the falling trend of time deposit rates in Lek (as an aftereffect of Bank of Albania followed policy on interest rates); from the slight growing trend of time deposit rates in US$, DEM, Euro and the exchange rate performance in the domestic market as well as from the high level of 6 and 12-month T-bills.

The deposit performance in the system interim January-December is affected by other factors that continue to remain out of the Bank of Albania control.

So at the beginning of year, the propaganda and in press and media on the deposit safety in the Savings Bank had a psychological effect on the public. Individuals in part withdrew their household deposits from this bank.

The second-tier bank contribution in extending bank deposits of the system has acknowledged change for January-November 2000.

Private and joint venture commercial banks have increased the share of total deposits against the total deposits of the system.

So the share of total deposits of private and joint stock commercial banks against the total deposits of the system has reached in 19,1 percent in November 2000 from 13,5 percent at the end of 2000.

The same tendency is also maintained for either for the share of domestic or foreign currency deposits.

More precisely, the share of domestic currency deposits with the private or joint-venture commercial banks against the total domestic currency deposits of the banking system increased from 3.7 percent at the end of 1999 to 8.06 percent at November 2000. The share of foreign currency deposits of these banks against the total foreign currency deposits of the banking system has reached in 44.5 percent from 39.6 percent at the end of 1999.

The figures indicate that, compared to the previous years, mainly, private and joint venture banks have done a good work with respect of attracting deposits especially those in Lek. On the individual side, the commercial banks additionally to the Savings Banks, which is traditional for holding household deposits from public, are considered as one of the potential alternatives to invest their savings.

The public audiences are attracted from the high level of time deposit rates compared to the Savings Bank. In the first months of 2000, the level of applied interests from commercial banks stood almost by the 2 percent average over the level of the Savings Bank.

This level narrowed gradually reaching below the average rate of 1.5 percent.

II.2. Monetary market developments.

Organising repurchase auctions started in July of the previous year. To the end of December there have been performed 22 auctions where the total bidding amount has been Lek 77,6 billion. These auctions have been of diversified -price- type. Based on the level of excessive reserves and the short-term forecasts on banking system liquidity, the object of organised has been to affect short-term rates in the money market. At the same time, through advertising the maximum auction rate, the Bank of Albania transmits clear market signals related to its monetary policy on intrest rates.

The market interference of the Bank of Albania through Repo auctions has served the its rising pressure for the reduction of money market rates. It is worth mentioning that interest rates in the primary market of T-bills had a significant decrease during 2000. Hence, at the end of 2000, these rates were at 7.83, 11.34 and 12.32 percent each on 3-, 6- and 12-month terms compared to the respective rates of 14.86, 15.39 and 15.73 percent at year-onset.

We affirm that through its market presence and operations, the Bank of Albania has managed to transmit market signals understood by market agents and affect their behaviour, reaching its intentions. In reaching its final target of reducing money market rates other factors such as, the stability of macroeconomic indicators, the improvement of fiscal indicators, the rising collaboration between the Bank of Albania and the Ministry of Finance concerning the management of internal debt, the improvement of bank supervision and the better administration of liquidity from second-tier banks, have been of effect.

As most expensive credits applied by the Bank of Albania, Lombard and refinancing credits were never launched even during 2000.

In December 2000, the Bank of Albania's Supervisory Council approved the framework of monetary policy instruments of Bank of Albania. The new framework of Bank of Albania's instruments includes the reformation of current instruments, to serve the rising efficiency and flexibility in their use.

There have been also prepared respective draft-regulations, to specify the applying conditions and the working mode of Bank of Albania's instruments. These draft-regulations are envisaged to enter in effect in the first half of 2001. The three major groups of Bank of Albania instruments consist of:

- the required reserve;
- open market operations;
- Repo auctions where the weekly auctions is the Bank of Albania's major instrument, while daily auctions will be used for small settlements;
- selling and buying transactions with full entitlements on securities and foreign currencies
- Bank of Albania's facilities;
- Lombard credit
- daily credits
- Daily deposits.

The reliance on these instruments proposes increase of flexibility in drafting and applying monetary policy, to help markets' extension and development, to raise the competition, to affect the improving efficiency of financial sector Intermediation, to improve the efficiency of investments as well as to instigate the increase of savings channelling them to the banking system.

II.3. Credit developments.

Year 2000, (to November '00) indicated growth in the lending activity on all banks generally. The credit stock as of November '00 reached in Lek 26 billion.

Credit to economy in relative terms for January -November '00 increased significantly compared to the previous year.

Meanwhile, the newly accorded credit during 1999 was only Lek 8 billion, only for the 11 -month term of 2000, the level of the

newly accorded credits reached the extent of Lek 21,2 billion. However, it must be admitted that in absolute terms credit to economy continues to be still low and for more it still continues to be practised only in foreign currency.

During December 1999- November 2000, the credit supply to economy increased by Lek 6,2 billion from which 5,8 billion in foreign currency and 0,4 billion in domestic currency.

As to their issuing terms, short- and mid-term credits increased by Lek 3 and 2,7 billion, respectively, while the long-term credit by Lek 0,5 billion. Referring to the figure of Lek 21,2 billion (newly accorded credits), the situation since at the beginning of the year is as follows:
- Lek 17,5 billion are newly accorded credits in foreign currency and;
- Lek 11, 2 billion is short- term credits.

Up to now, private banks preference have been to issued more credits in foreign exchange and very few in Lek as:

- they grant more credits for trade and construction,
- the rate of receiving foreign currency deposits in the banking system is high,
- the risk from oscillating exchange rate reduced as result of non-providing open positions in foreign exchange at a considerable extent.

Table 2: The performance of credit indicators (in billions of Lek).

Indicators	October '00	November '00
Total outstanding credit of the banking sector[11]	25.8	26
From these : Public sector	1.6	1.6
Private sector	24.2	24.4
- In Lek	9.6	9.7
- In foreign exchange	14.6	14.7
Share (in %) of credit in forex	57.0	60
New banking credits	1.8	2.3
New banking credit in Lek	0.4	0.6
New banking credits in forex	1.3	1.7
Share (in%) of credit extensions in foreign exchange	75.0	74

From the data reported on business credited through the banking sector, construction activities occupy 26 percent of the newly accorded credits, trade nearly 26 percent, processing industry about 16 percent, hotels and restaurants 5 percent, real estates 6 percent and the rest are accorded credits to agriculture, fishing, transport and services, etc.

The economy has absorbed the average of Lek 1,9 billion of newly accorded credits from the banking system, per month as, the credit portfolio of banks increased to the average of Lek 0,56 billion per month.

Credit to economy to the end of November 1999 is as much as 83 percent of the forecast made in monetary program.

Although the credit forecast in the monetary program will not realise to 2000-end, it is still expected to attain at a very satisfactory rate compared to 1999, when its realisation was 31 percent.

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[1] In the credit at end-November 2000, it is included the NBC credit of Lek 1,5 billion.

Box 1. A credit survey with second-tier bank specialists of December 2000.

Based on the importance of lending to domestic economy as well as the several arguments related to the credit level to it, Bank of Albania undertook a survey with second-tier bank specialists to learn their opinions on this issue.

In their opinions, they clearly delineate their preferences for:
• Short-term credits (68 percent of the interviewees). They also confirm that the long-term credits accorded by banks are at a higher rate than banks would like to provide.
• Foreign exchange credits (100 percent of interviewees) whereas 71 percent of interviewees issue credits in US$ and 53 percent in DEM;
• Credits to construction, trade and industry.
• Credit specialists identify as major reason for the current credit structure, the level of risk accompanying this activity. The risk is assessed to oscillate from average to high rates.
• Granting short-term credits enables a more operating and continuos pursuit, while granting credits in foreign exchange is totally dependent on the customer preferences and the provision with liabilities (deposits and equity) in foreign currency.

Credit specialists express that banks have attained their credit plans.
• The share of banks on no credit accounts, compared to 1999, declined from 33 to 26 percent in 2000.
• The bank's share to accomplish and exceed their credit plans increased from 50 percent compared to 1999 to 67 percent in 2000.
• In some cases, the non-fulfilment of credit plans is frequently justified with the lack of electric power, especially, by localities. .

On the other hand, credit specialists also rank problems (or deficiencies) presented by businesses in the process requiring credits from banks, deficiencies that mostly lead to a low credit rate. As to their significance, these deficiencies rank as below:
- Lack of tradition in bank relations;
- Presentation of unreal balances,
- Insufficient argumentation of business plans
- Total unawareness on bank requirements;
- Unfamiliarity with legislation;
- Business deficiency in managing skills.

Credit specialists are relatively optimistic for the future of lending process. They believe that more credits will be directed to industry and construction, reducing the credit engagement against trade. However, the rural and transport sectors still remain outside attention.

III. FOREIGN EXCHANGE DEVELOPMENTS.

III.1. Exchange rate.

As sign of reaction of exchange rate developments of domestic market with the international markets, the exchange rate of domestic currency apart the changes in the domestic demand and supply for foreign currency during 2000, has broadly reflected the exchange rate developments internationally.

Lek appreciated against Euro. The nominal value of Euro/ Lek opened at 137. 3 (DEM/Lek = 70.2) at year onset and closed at 131. 2 (DEM/LEK= 67.1) at the end of December. Expressed in relative terms, Lek appreciation was at 4.6 percent. As may be realised, Lek appreciated to the same extent against all other Euro components.

With Greece membership in the European Monetary Union Lek depreciated against GDR by 7.1 percent, as it was changed into

an Euro component stating from January 1, 2001. Lek depreciated against US$. The nominal value of the ratio US$/ LEK at the beginning of the year was at 135. 2 whereas at the end of December this ratio indicated the value of 143.5. In relative terms depreciated in conversion with US$ by 6.1 percent.

Lek appreciation against Euro and its simultaneous depreciation against US$ have reflected the exchange rate performance of both currencies internationally during 2000. To the end of December, the European currency is estimated to have lost about 10.6 par cent of its value in conversion with US$.

Exchange rate movements of domestic currency during 2000 have been gradual and offset. To ensure a similar thing, the Bank of Albania has undertaken market interventions especially in JULY-October when the seasonal effects with appreciating impacts of exchange rate of domestic currency were expectant. During this period, the banking system purchased about US$ 35,36 million or nearly 97 percent of the entire amount of 36.48 million purchased during 2000.

The exchange rate of domestic currency for 2001 is expected to be stable and with balanced movements to be slightly absorbed by the economy.

III. 2. International reserves.

At the end of December 2000, the value of the gross international reserve amounted to US$ 607,8 million whereas the value of the net international reserve in US$ 455,2 million. The growing value of the gross international reserve reached the figure of US$ 126,8 million or 26.4 percent more since at the beginning of the year.

Foreign exchange inflows during the term amounted to US$ 310.3 million where to specify are US$ 57,3 million in the form of grants (EU and others), US$ 91,4 million in the form of credit funds (IMF, IDA, EU and others), 113, 3 million in the type of net purchasing (from banks, Government and others), 24.9 million in the form of income from investments, etc.

Foreign exchange outflows of the term amounted to Lek 159,6 million where to specify are: the US$ 20.2 million in the form of payments for external debt services (of the Bank of Albania and the Republic of Albania's Government); 123,4 million in the form of transfers (Government, banks and others); 15, 8 million in the form of sales (for banks and government) etc.

I.   Banking system performance

At the end of October 2000, banking system activity increased by 2.4 percent against 1999. This indicator is 57.3 percent for the private banks and 17.6 percent[2] for joint-venture banks. It is ever more underlying the tendency for the reducing share of state-owned banks and the drive for competition. The Albanian banking system continues to operate on proceeds. From Lek 2,7 billion at the end of September 2000, this indicator went up to 2,9 and 3,5 billion for October and November respectively. The rising profit month over month has also improved the return on own assets and equity (ROA, ROE).

Table 3. Return (in %).

Months	Return (in %)	
	Assets	Capital
Sept. 2000	1.1	23.5
Oct. 2000	1.16	24.6
Nov. 2000	1.39	28.65

The performed inspections during 2000 demonstrated that banks are improving the quality of management and have a satisfactory financial condition. Core elements of income as net interest margins the quality of assets and efficiency are strengthened. The Bank of Albania's performed inspections have been 11 full and 2 partial inspections of banks, enabling the achievement of its target for undertaking once in a year inspection for each bank during 2001, within 2000.

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[2] At the end of September 2000, these indicators were 45.6 and 6.5 percent respectively.

For more, banks managing boards and executive directors had a positive reaction against the Bank of Albania's left duties and recommendations with respect of:

* proper improvements in lending policies and procedures, the foreign exchange activity, risk management etc.
* the rising independence of banks' internal control;
* the application of bank accounting manual;
* bank strategic developments;
* the insurance of necessary domestic assets for new operations etc.

Bank of Albania has established in some cases direct contacts with banks supervisory boards, aiming the increase of responsibility of executive direction to the application of legal framework.

Notwithstanding the positive data, Bank of Albania with its inspection program drafted 2001, wants to ensure on the stability of bank profits. This means that the analysis will be focused in that whether these bank proceeds are as results of their improving management or the favourable macroeconomic environment and, particularly, of the overall climate of reducing interests. However, the realised profit promise for more credits in 2001.

IV. 1. The privatisation of the Savings Bank.

The Bank of Albania has devoted much attention to the Savings Bank privatisation.

This bank holds a dominant position in the Albanian banking system and its necessary to be very careful in the steps to undertake to not infringe the banking system stability. For this reason, Bank of Albania insisted in its demand to re-capitalise the Savings Bank within 2001. The Council of Ministers by decision no. 37, dated 28. 12. 2000 defined the terms and conditions of T-bills under the state liability and the re-

capitalisation of the Savings Bank AE to the amount of Lek 17,2 billion. Thus this bank capitalisation was carried through issuing T-bills of Republic of Albania Government. These T-bills have been issued on 6-month term with renovation entitlement. The intrest payable for these T-bills will be equal to the average yield of T-bills on the same maturity term resulted from the first auctions after December 29, 2000. The issued amount covers the old state liability against the Savings Bank to Lek 7,6 billion and the bank's cumulative loss per Lek 9,6 billion.

It must be stressed that these computations are based on the certified results from the external independent auditor of the Savings Bank that is KPMG for accounting balances of years 1998-1999. That amount is sufficient to cover the negative value of regulatory capital as well as to reach the rate of capital adequacy thus to obey the standard of 12 percent. However, the capitalisation amount can not meet the liability of paid-up capital to Lek 700 million. According to the preliminary computations as the final computations will be made with the appointment of results at the end of 2000, the Ministry of Finance will realise its duty to meet the liability of subscribed capital to the amount of Lek 269 million.

However it must be clear that the savings Bank re-capitalisation is not everything to ensure the privatisation success. The care and attention for the privatisation process must be continuos and extremely high. I stress; the ruling position of the Savings bank in the system demands a serious treatment. The problem of privatisation must be considered in complex. One of the targets of this privatisation process must be the elimination of current disfigurements in the Albanian bank market. Whether privatisation realises the change of ownership and shifts from ruling positions of state into ruling positions private persons, we can not say that we will have the expected developments in the Albanian banking system.