

## FOREWORD BY THE GOVERNOR

The new economic and monetary information suggests that the Albanian economy continues on a positive development trend. Aggregate demand continued to grow in the second half of the previous year, resulting in an increase in production, employment growth and improvement of main economic and financial balances.

Our monetary policy continues to support growth, by providing a financial environment with low interest rates, and decelerating appreciating pressures on the exchange rate.

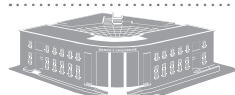
The Bank of Albania deems that the new information is broadly in line with our expectations.

Inflation registered a slight decline in the last quarter of 2018. Average inflation declined to 1.8% in the fourth quarter, from 2.2% in the previous quarter. The decline reflected temporary supply-side shocks and a fuller transmission of the decelerating effect arising from the exchange rate appreciation on inflation. This effect will remain present over the first half of 2019; it is, however, expected to wear off in the following period.

The Bank of Albania deems that the domestic medium-term and long-term inflationary pressures are gaining strength, as illustrated by the core inflation. Irrespective of the fluctuations, this indicator shows a gradual trend of convergence toward the equilibrium. Such performance is dictated by the further improvement of the cyclical position of the country, as reflected in both the downward trend in the unemployment rate, and the improvement of the capacity utilisation rate.

According to INSTAT data, the Albanian economy grew by 4.45% in the third quarter of the previous year. Growth was fuelled by the further expansion of private consumption, investments and exports, as well as the annual growth of electricity production. It was reflected in the expansion of activity in industry, services and construction. Available data suggest that the economy continued to grow in the fourth quarter as well, although at a slower pace than in the previous quarters. Our analyses suggest that this slowdown reflects a lower contribution from electricity production, while it is expected to be temporary.

Our medium-term projections have not changed significantly. The current trends of economic development and their underlying economic and financial factors hint that the economy will trend upward and inflationary pressures will build up in the period ahead.



While uncertainties and risks persist, the external environment appears overall favourable for economic growth at home. The upward demand from the global economy continues to favour growth for Albanian exports, and financing costs remain relatively low.

In parallel, the domestic policy mix remains stimulating.

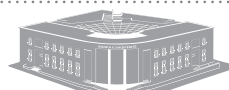
As a result of the accommodative monetary policy stance, interest rates on deposits, credits and government securities remain at historical low levels. Similarly, the situation of liquidity in financial markets has been improving and risk premiums have been trending down. The exchange rate appeared stable in January, due to a better balancing of demand and supply for foreign currency, and to the response of the Bank of Albania. Additionally, the banking sector continues to be characterised by good liquidity, capital and profitability levels, while the balance sheets continue to improve. In particular, the ratio of non-performing loans dropped to 11.1% at the end of 2018, illustrating the sustainable progress marked in this regard.

In response, credit to the private sector showed signs of recovery, although the reported downward stock continues to reflect the effects arising from the cleaning of balance sheets from both non-performing loans and the effect of the exchange rate. Excluding these two effects, credit to the private sector recorded 5.9% annual growth at the end of 2018. Credit growth continues to be faster for credit denominated in lek and that for consumer loans. Meanwhile, loans to enterprises grew rapidly in December, regardless of the conservative policies that banks apply to this segment.

Fiscal policy continued the consolidation trend. Fiscal data suggest that budget deficit decreased to 1.6% of the GDP at the end of 2018, standing 0.4 percentage point lower than planned. In line with it, the direct fiscal stimulus to the economy was lower than previously anticipated. On the other hand, the reduction of total public sector borrowing and the reliance on foreign markets for financing a major part of it, over the past year, have broadened the space for crediting to the private sector.

In accordance with these trends, the Bank of Albania deems that the Albanian economy will continue to grow in the next three years. The expansion in aggregate demand will contribute to further employment growth, creating the premises for rising wages and domestic inflation. In parallel, the slowdown in the exchange rate appreciation will subdue disinflationary pressures arising from it. In accordance with this scenario of developments, inflation is expected to converge to our target in the second half of 2020.

In parallel to the expected positive developments according to the baseline scenario, the Supervisory Council finds that the balance of risks remains tilted to the down side. In particular, the external environment, the exchange rate and the pace of credit growth may tilt inflation to the down side of our expectations.



Judging on these factors, the Bank of Albania considers the current accommodative path of the monetary policy as adequate. The monetary policy will remain accommodative in the medium-term horizon, although the intensity of the stimulus will be adjusted to the speed and the sustainability of the economic activity improvement.

The Bank of Albania emphasises that structural reforms need to continue, as the best instrument for boosting sustainable and long-term growth in Albania.

