

Bank of Albania

MONETARY
POLICY REPORT

2024/III

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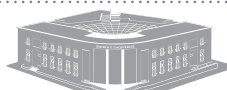
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INTRODUCTION¹

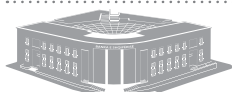
The primary objective of the Bank of Albania's monetary policy is to achieve and maintain price stability. This target implies reaching low rates with positive inflation and maintaining these for a relatively long period of time. In quantitative terms, the Bank of Albania has defined price stability as maintaining a 3.0% annual inflation rate of consumer prices in the medium term. By safeguarding price stability, the Bank of Albania contributes to the establishment of a sustainable monetary environment and assists Albanian households and enterprises in planning their own consumption and investments.

The Supervisory Council of the Bank of Albania holds 8 meetings each year to decide on monetary policy, aimed at achieving the price stability objective. The Supervisory Council sets the key interest rate. Changes in the key interest rate affect, with a time lag, other interest rates in the financial market, for example, yields on government's securities and interest rates on loans. These changes drive increase or decrease in the demand for goods and services through a chain known as the "transmission mechanism". Changes in the demand for goods and services bring about increases or decreases in the prices of these goods and services.

The transmission mechanism encompasses various channels through which prices may change, for example: the exchange rate channel; the inflationary expectations channel; and the foreign assets channel. The Bank of Albania has constructed models to forecast changes in all elements which affect prices and to forecast inflation up to three years. When forecasts show a dominance of low inflationary pressures, which may drive inflation below the 3.0% target, this is a signal that the monetary policy should be accommodative interest rates should stay at low levels. The reverse is also possible. However, drafting a monetary policy is not a mechanical process. Monetary policy decision-making considers the reasons for deviations in inflation from target, and the time needed for the economy to react to changes in interest rates. The opposite is also valuable.

The Supervisory Council makes decisions on the monetary policy based on a variety of information, including estimations regarding economic developments, forecasts in relation to inflation, the performance of financial markets, risks and uncertainties surrounding forecasts. The Monetary Policy Report - which is the main component of the monetary policy - includes these considerations and assessments on this information. With the aim of communicating its monetary policy in a transparent manner, the Bank of Albania regularly publishes this Report and makes it available to citizens.

¹ *Monetary Policy Document delineates the monetary policy framework at the Bank of Albania. This Document is available at https://www.bankofalbania.org/Monetary_Policy/Objectivei_and_strategy/*



The Monetary Policy Report is published on a quarterly basis. This Report is compiled by the Monetary Policy Department at the Bank of Albania and it is adopted by the Supervisory Council. The current report contains data, as 29 July 2024. The Supervisory Council reviewed and adopted this Report at its meeting on 7 August 2024.



FOREWORD BY THE GOVERNOR

The Albanian economy continues to settle on a positive development trend.

Economic activity, employment and wages have been growing, in turn generating more income for Albanian businesses and households. The increase in both family spending and businesses' investments bolstered the economic activity in the first half of year, as reflected in the growth in services and construction sectors.

In parallel with these developments, inflation has come down swiftly, by recording a complete recovery of the shock we experienced from the surge in prices across international markets. The fall in inflation has been broadly based, but it was faster in food items prices. The return of price stability in Albania, after a two-year period of elevated inflation, facilitates the cost of living of households and establishes a more transparent environment for businesses' long-term investments.

We have expected this panorama of developments. As we have continuously highlighted, it first reflects the sound bases of country development, as well as the resilience and high flexibility that private sector has showed over the recent years. In addition, the positive development trend also reflect the prudential monetary policy implemented by the Bank of Albania.

In the meeting of July, the Supervisory Council decided to ease the monetary policy stance, aimed at better accommodating the liquidity level and financing costs in Albania with the performance of both inflation and economic activity, as well as with the developments across international financial markets.

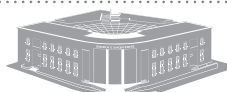
The low financing costs in the Albanian economy has supported a fast and broadly-based growth of lending. Now, bank credit has been transferred into an important and reliable financing source for the Albanian economy, reflecting positive signals on the stability of growth in the future.

In this context of developments, our expectations for the future remain positive. Despite challenges to development are still present, we expect a further and stable growth of economic activity over the next years, as well as inflation to stabilise around our 3% target in 2025. In these circumstances, we decided to keep our monetary policy stance unchanged, judging that - for the moment - this stance is adequate, for meeting our price stability objective.

As always, I would like to conclude this communication by assuring you that even in the future we will continue to be attentive, with a view to a timely reaction



and at the adequate degree against economic and financial developments. In any case, our commitment remains constant: the establishment of an economic environment with stable prices, as an instrument to preserve savings' value of citizens and to boost the stable and long-term development of Albania.



1. INFLATION AND MONETARY POLICY STANCE

The new information in this Report is overall positive and close to our expectations. Economic activity, employment and wages have continued to grow over the course of two first quarters of year, inflation has been declining and financial markets have been relatively calm, while lending has picked up progressively. However, the fall in inflation was faster than expected due to supply-side shocks. This development, as well as its potential impact on economic agents' expectations for inflation in the future, drove the Supervisory Council to lower the policy rate in July.

Our forecasts for the future are positive. They suggest a continued growth of the economic activity and a return of inflation to the 3% target in 2025 H1. Current monetary conditions are consistent with these forecasts and enable price stability in the medium term. Against this backdrop, the Supervisory Council decided to keep the policy rate unchanged, at 3.00%.

The international environment has been characterized by an improvement in the pace of economic growth and a further, albeit slower, decline in inflation. After several quarters of stagnation, the euro area economy returned to positive growth rates (0.4%) in the first quarter of 2024. On the other hand, after a rapid decline in the first months of the year, inflation fell by only 0.1 percentage point in the second quarter, down to 2.5%. The persistence of inflation reflects the steady rise in service prices, fuelled by continued wage growth. In the meeting in June 2024, the European Central Bank (ECB) decreased the policy rate at 4.25%, motivated by the progress achieved with inflation and its return to the 2% target in 2025. At the meeting in July, it kept the policy rate unchanged and reiterated the importance of decision-making guided by new data.

The Albanian economy is characterized by the continuation of the positive progress of economic activity in the first half of the year, while the fall in inflation accelerated in the second quarter of the year. Inflation fell to an average level of 2.1%, from 2.7% in the first quarter. Similar to the beginning of the year, its decline was dictated by the fall in inflation of food items, which reflected the similar performance of these prices in regional markets. Despite being dominated by this category, the fall in inflation in the second quarter was observed on a broader price base, among them the prices of some services.

Overall inflationary pressures have been reduced, underpinned by the decrease of inflation in trading partners, exchange rate appreciation and the normalization of monetary policy stance over the past two years. This



normalization has mitigated the domestic inflationary pressures by anchoring inflation expectations, avoiding second-round effects, and better balancing of the demand and supply in the economy.

Albanian economy grew by 3.6% in the first quarter of the year. Economic growth was driven by increased private consumption and investment, while net exports and public investments contributed negatively. In sectoral terms, the growth was mainly generated by the increased activity in the construction and services sectors.

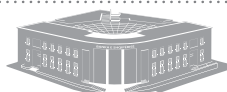
The increase in the demand for goods and services is reflected in tight conditions in the labour market. This market is characterized by rapid wage growth and labour shortage. Available data suggest an increase in employment and wages in the first quarter of this year as well². In particular, wages in the private sector accelerated the growth rate to 12.7%, while enterprises continue to report labour shortages as a limiting factor for the expansion of their activity. Inflationary pressures from this market are present. So far, wage growth has been partly reflected in consumer prices, suggesting that rising costs have been partly absorbed by increased productivity and partly by declining profit margins per unit of enterprises. The dynamics between these two factors in the future will be determinant for the progress of the domestic inflationary pressures.

Available information signals the positive performance of the economy in the second quarter as well. This assessment is based on the positive performance of monetary and fiscal indicators, on the improvement of the financial situation of the private sector, as well as on confidence levels which stand above historical averages.

In particular, the financial environment is characterized by ample liquidity, relatively low and stable interest rates and contained risk premiums. In parallel, the exchange rate has maintained an appreciating trend, fuelled by the increased flows of tourism, remittances and foreign direct investments. However, the annual appreciation rate has been declining in recent months.

Overall, financing conditions remain accommodative and have supported credit growth to the private sector. The latter has trended upward since the beginning of the year, with a growth rate of 14.6% in June. Credit distribution continues to be diversified, with beneficiaries such as enterprises and households, for consumption and investments. In particular, a positive development is the continuous growth of loans for investments, which signals the expansion and modernization of the country's production capacities. In parallel, the rapid growth of loans in lek and maintaining a good quality of the portfolio are prerequisites for a sound loan growth in the future.

² The release of Labour Force Survey data for the first quarter has been postponed to an unspecified date.



Economic forecasts for the future signal the return of the economy to equilibrium and of inflation to target in 2025 H1. Economic growth is expected to be supported by increased consumption and investments, coupled with the heightened exports in services. A number of factors are expected to fuel domestic and foreign demand growth, including solid balance sheets of the private sector, favourable financing conditions, credit growth and positive tourism performance. On the other hand, inflation is expected to be under the influence of supply shocks in food item prices until the end of the year and, thereafter, to increase towards the 3% target.

The balance of risks to the inflation forecast has shifted downward in the short term and appears more neutral in the medium term. This shift reflects uncertainties about the intensity and duration of supply-side shocks on prices of food items.

In the previous meeting, the Council reduced the policy rate by 0.25 percentage points, to 3.00%. This decision was motivated by the rapid decline in inflation and the risk that this trend would affect the expectations of economic agents for inflation in the future. The reduction in the policy rate was immediately transmitted to the government securities market, which is also the first step for the transmission of monetary policy. Meanwhile, transmission to other segments of the financial market is expected to continue in line with the specifics of each segment.

According to the above-mentioned analyses and forecasts, the Supervisory Council decided to keep the policy rate unchanged, at 3.00%. The Council deems that the current monetary and financial conditions are adequate to return inflation to target by 2025. Future decisions of the monetary policy will be guided by new data, aiming to react in the right time and direction, both to the overall balance of inflationary pressures and to possible domestic or external shocks. They will always aim to achieve price stability, as a nominal anchor necessary for sustainable economic growth.



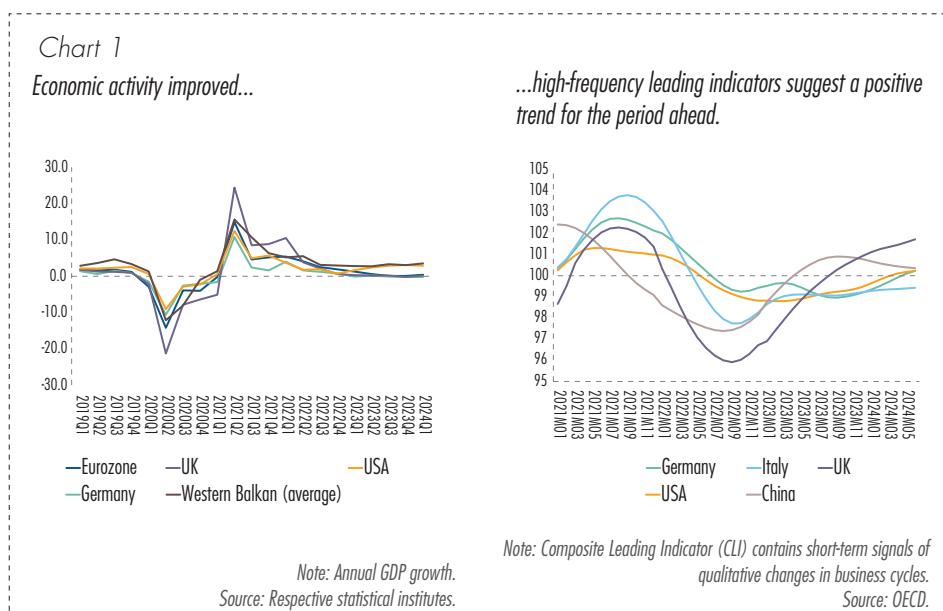
2. EXTERNAL ENVIRONMENT

Global economic activity accelerated over the first half of 2024. Decreasing inflation rates and low levels of unemployment have affected the preservation of consumers' purchasing power. High-frequency data and forecasts related to the market suggest a continuous growth of the economic activity in the coming quarters.

Monetary conditions continue to remain tight across advanced economies and developing countries. However, in reflection of falling inflation rates, some central banks have started lowering the policy rate. Among them, the most important is the ECB, which lowered the policy rate by 0.25 p.p in the meeting in June 2024.

2.1. ECONOMIC ENVIRONMENT

Global economic activity accelerated during 2024 Q1, but growth rates in some advanced economies still remain relatively low in the historical context. The euro area economy expanded by 0.4% during the year and by 0.3% compared to the previous quarter. Preliminary data of the euro area economy suggest a continuation of economic growth in 2024 Q2. The economic activity in the USA continued to expand at accelerated pace during 2024 Q1. The annual growth pace accelerated at 2.9% from 3.1% in the first quarter. The preliminary data indicate that the positive economic situation will continue even in 2024 Q2.



Inflation rates have stopped the decelerating trend during the second quarter of the year 2024, and have generally remained at levels similar to the values recorded a quarter ago. This performance is dictated by the decrease in commodity prices in the international market, the increase in energy prices and the stabilization at relatively high levels of inflation of services.



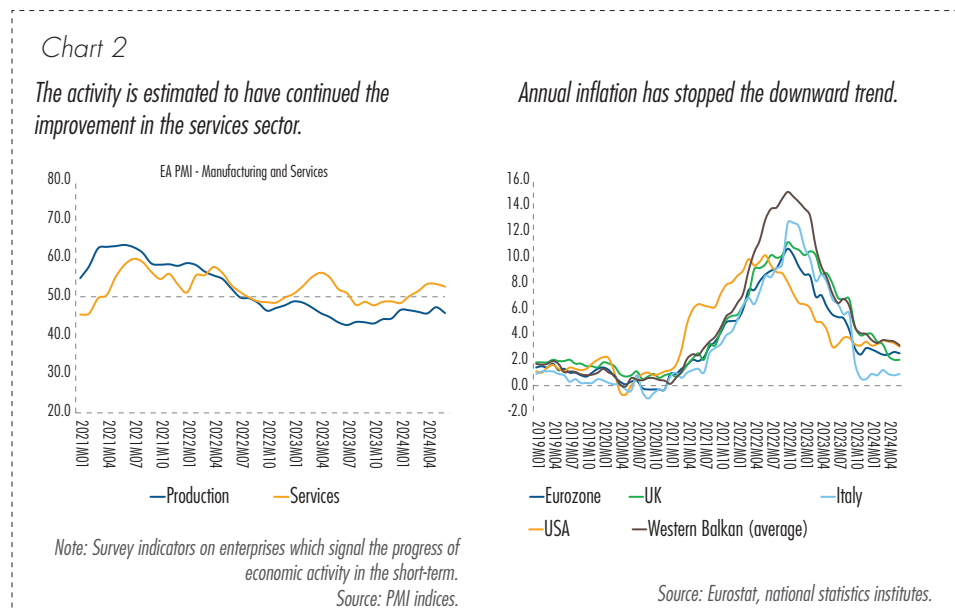
The ECB cut its policy rate by 25 base points at its last meeting in June to 4.25%, and kept it unchanged in July. According to the ECB, and based on the updated macroeconomic forecasts, the performance of the core inflation and the intensity of the monitoring of the monetary policy impulse until now, provide for a further easing of the monetary policy stance in the future. The Bank of England and the Federal Reserve kept interest rates unchanged at their last meetings in May and June.

Global economic activity is expected to maintain a positive growth pace in the medium term. According to the latest July 2024 estimates from the Consensus Forecast publication³, global economic activity is projected to expand by 2.5% and 2.6% in 2024 and 2025. Developing economies are expected to expand at a faster pace than that across advanced economies. Inflation rates are expected to decline gradually in 2024 and 2025.

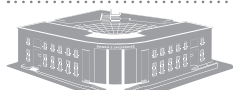
EURO AREA ECONOMY

The euro area economy expanded by 0.4% in annual terms in Q1. Economic activity across euro area countries was heterogeneous; it contracted in Germany, increased minimally in Italy and was relatively faster in Greece and Spain. Leading economic indicators of the euro area suggest a slightly better performance in 2024 Q2.

The business surveys for 2024 Q3 indicate a continuation of the improvement of activity in the services sector. The latter is expected to lead the expansion of economic activity in the euro area. In contrast, activity in the manufacturing sector is estimated to have been weak during the second quarter of the year. The labour market in euro area countries remains strong. In 2024 Q1, employment grew by 1.0% and average wages by about 5.1% annually.



³ The monthly publication of Consensus Forecast aggregates forecasts made by several banking and financial institutions separated geographically by continent.



Inflation in the euro area was 2.5% in 2024 Q2, similar to the previous quarter. Core inflation slowed slightly to 2.8%, from 3.1% recorded in the previous quarter. The speed and intensity of the slowdown observed when measuring core inflation are deemed sufficient by the ECB to initiate the reduction of the key interest rate in June.

In the ECB's latest macroeconomic forecasts, economic growth has been revised upwards for the next two years⁴. On the other hand, inflation is expected to fall, but remain above the target level of 2.0% during 2024 as well and return to the target in mid-2025.

REGIONAL ECONOMIES⁵

Regional economies have experienced acceleration in their economic growth rates in recent reports. In 2024 Q1, economic activity in Kosovo expanded by 5.6% from 4.0% in the previous quarter. Data on economic activity in North Macedonia indicate a slight acceleration of the growth rate of the economy to 1.2% from 0.9% in the previous quarter. For both of these countries, the main impact has been given by the rapid growth of consumption expenditures and investments. The latest GDP data in Serbia also shows for a significant acceleration of the growth rate of economic activity in 2024 Q1. The main impact has been given by the higher public expenditures and investments as well as the increase in the consumption of the population.

The performance of annual inflation has been different in each of the countries of the region. Thus, the inflation rate accelerated in Kosovo and North Macedonia, and slowed down in Serbia during the second quarter. The central bank of the latter, in the meetings of June and July, decided to lower the policy rate twice by 25 base points, lowering it to 6.0%.

The latest forecasts for the countries of the region indicate a slowdown in the inflation rate and acceleration of economic growth in 2024 and 2025.

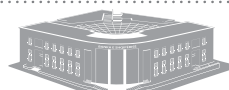
Table 1 Economic indicators for main trading partner countries

	Annual change of GDP p.p		Annual inflation (%)		Unemployment, in %
	2023Q4	2024Q1	2024Q1	2024T2	Latest publication
Italy	0.7	0.6	3.2	2.6	6.8
Greece	1.1	1.9	1.0	0.9	10.6
Kosovo	4.0	5.6	2.1	2.4	10.6
North Macedonia	0.9	1.2	3.4	3.9	12.9
Serbia	3.8	4.7	5.7	4.4	9.4
Albania	3.8	3.6	2.8	2.1	10.7

Source: Respective statistical institutes.

⁴ The ECB staff projections show economic growth is expected to be 0.9% in 2024, and to 1.4% in 2025. Average inflation for 2024 and 2025 is expected to be at 2.5% and 2.2%, revised upwards from 2.3% and 2.0% respectively in previous forecasts (Source: ECB staff macroeconomic projections, June 2024).

⁵ The main trading partners outside the European Union (Kosovo, North Macedonia, Serbia).

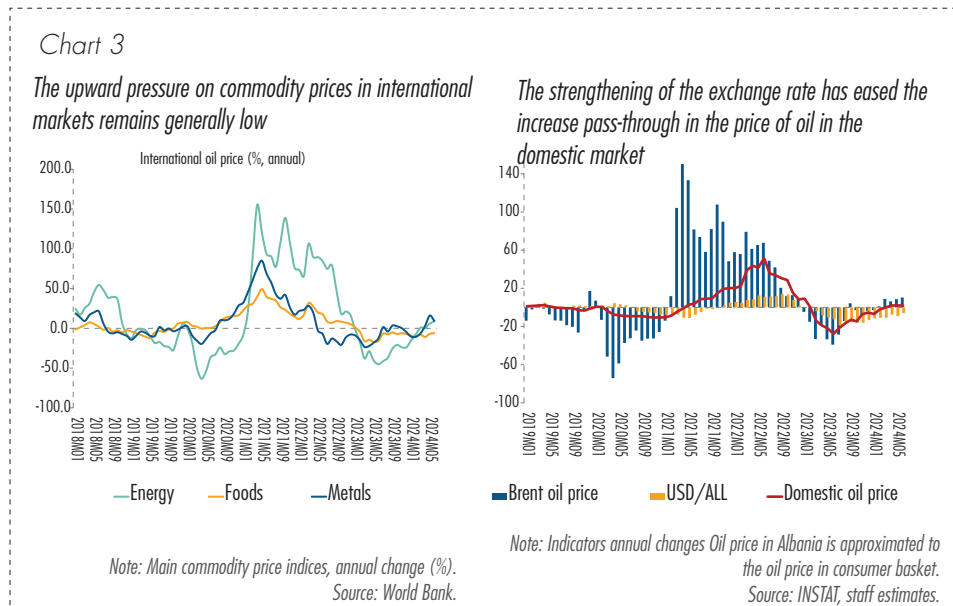


2.2. COMMODITY PRICES IN GLOBAL MARKETS

The index of commodity prices,⁶ after a continuous decline of 5 quarters, has expanded by 4.6% during 2024 Q2. The annual increase in the prices of metals and energy materials have the main impact to this performance. The increased demand of some of the largest developing economies, as well as from the USA, have influenced the growth of the metal price index⁷. The higher energy materials prices in annual terms have been influenced by higher oil prices, while the liquid gas price has continued to decrease.

The Brent oil price was quoted around the average level USD 84.7\$/barrel during this quarter, with an annual increase of 8.6%. However, broken down by months within the quarter, the average price recorded in May and June was significantly lower compared to the average price in April. This performance has reflected a combination of the extension in time of reduced production quotas from OPEC countries with low demand from advanced economies⁸.

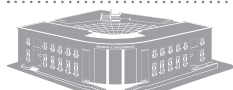
The food price index decreased by about 8.0% on an annual level, which shows for a slight slowing down of the annual decline rate of food price. In 2024 Q1, this index contracted by 9.2% annually. Uncertainties about the performance of commodity prices remain heightened. The still low demand from developed countries is expected to continue to exert a downward influence on the annual performance of the commodities prices during 2024 H2. On the other hand, supply-side factors, such as climate change and the intensification of geopolitical tensions, may exert upward pressure.



⁶ Monthly frequency indices published by the World Bank.

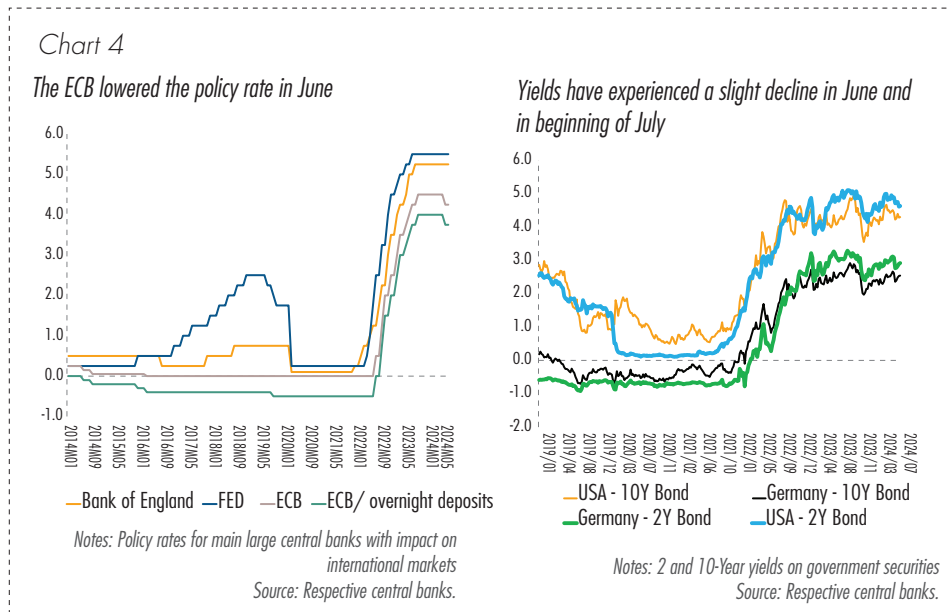
⁷ Commodity Markets Outlook, 2024, published by the World Bank.

⁸ US Energy Information Administration, Short term energy Outlook, July 2024.

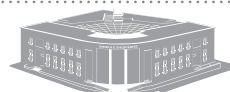


2.3. INTEREST RATES

Financing conditions in international markets continue to remain tight, reflecting the still high level of policy rates. However, the slowdown of inflation rates has incited some banks, of which the most important, the ECB to start lowering interest rates. The Federal Reserve and the Bank of England have kept the policy rates unchanged in the last meetings in June, at 5.25%-5.50% and 5.25%, respectively.



The yields on 2-year public securities decreased somewhat during the month of June and the beginning of July, reflecting the reduction of the policy rate by the ECB and the expectation of the financial market to follow the same path from the Federal Reserve.



3. FINANCIAL MARKETS AND LENDING CONDITIONS

The financial market showed low levels of interest rates and contained risk premiums in the second quarter. The reduction of the policy rate at the beginning of July was immediately followed by the interest rates of the interbank market and by the yields on government securities, creating the right premises for its reflection in other segments of the market as well. Loan interest rates continue to fluctuate at low levels, maintaining their stimulating nature for credit growth. The foreign exchange market has functioned normally and the lek has maintained its appreciation, albeit at slower annual rates.

The lending activity of banks continued to grow, reflecting on the one hand the eased financial conditions and on the other hand a high demand for financing from the private sector. Demand increased in all categories for the second consecutive quarter, but it is more evident in lek and from enterprises. On the other hand, deposits grew at a steadily pace, driven by the upward trend of interest rates.

3.1. DOMESTIC FINANCIAL MARKET⁹

The reduction in the policy rate has been transmitted to the money market and that of government securities, at a time when the financial market continues to be characterized by contained risk premiums. Interest rates in interbank market fluctuated close to the policy rate. They have promptly reflected the decrease of the latter at the beginning of July, at 3.00%. The reduction in the policy rate has also been reflected in yields on government securities. These yields continue to maintain narrow historic spreads from the policy rate due to high demand, a situation marked by declining inflationary pressures. This yield performance also keeps loan interest loans low, especially for households, where the connection between the two indicators becomes more pronounced.

Interest rates in the interbank market promptly reflected the monetary policy signals and remain anchored closed to it. In the second quarter, interbank market interest rates were approximately the same as in the previous quarter. The policy rate change in the first week of July was immediately reflected in interbank interest rates and their spread from policy rate remains minimal. The market has not experienced additional liquidity pressures. Meanwhile, the Bank of Albania continued to supply liquidity through its main one - and three - week repo instruments, as well as by three-month liquidity injections. The injected amount during this quarter was equal to that of the third quarter.

⁹ The following analysis is based on available data until 29 July 2024.

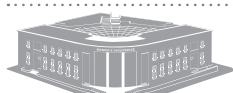
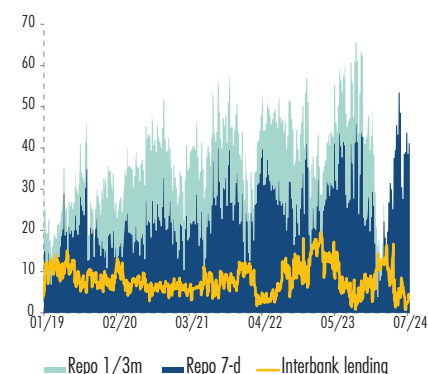


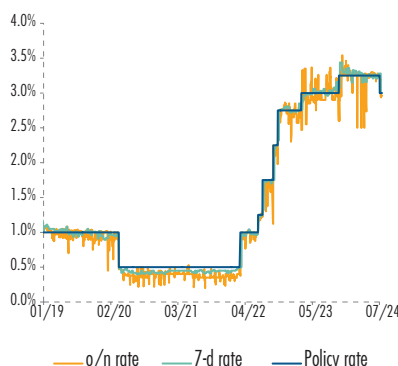
Chart 5

Bank borrowing from the Bank of Albania increased, but this has not affected the liquidity premiums



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

Interest rates in interbank marked a decline of policy rate and remain anchored close to it

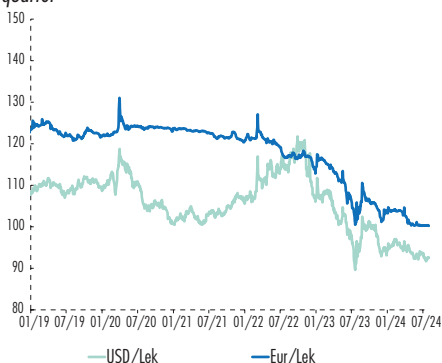


Note: Data show the daily performance of interest rates in the interbank market. Source: Bank of Albania.

The exchange rate has appreciated in the second quarter of the year, following the stable performance in the first quarter. The EUR/ALL exchange rate averaged 101.5 in April and 100.4 in May and June, from 104.0 in the previous two quarters. In July, it remained stable near the average of the previous two months. Compared to a year ago, the rate and extend of appreciation observed so far this year are significantly lower¹⁰. As a result, the annual appreciation of the EUR/LEK rate has decreased in the second quarter, falling to 6.4% in June and further to 2.8% in July, from 9.4% at the end of the first quarter of the year.

Chart 6

The lek has appreciated slightly in the second quarter of this year, though below the rate observed in the previous quarter



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

Annual inflation moderated significantly during the second quarter and in July

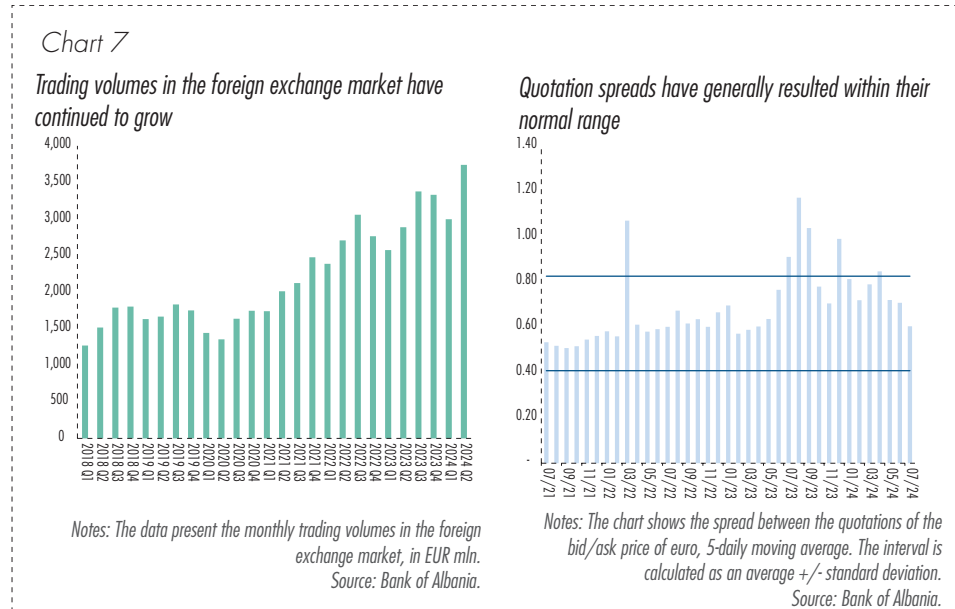


Notes: Average monthly exchange rate EUR/ALL, in %. Source: Bank of Albania.

¹⁰ The appreciation of lek in July 2024, compared to December 2023, stands at 2.4%. During the same period in the year earlier it was 10.2%.



The foreign exchange market has been characterized by high trading volumes and normal trading conditions. Annual growth in trading volumes accelerated to 30% in the second quarter, up from 16% in the first quarter and 11.5% in the previous quarter. At the same time, the volatility and spreads between the selling and buying quotes for the euro have resulted within their normal range.



The lek has also appreciated against the **US Dollar** during the second quarter. The USD /ALL exchange rate declined to 94.6 ALL/USD in April, from ALL 95.7 in the first quarter, to fluctuate around the average of ALL 93.1 in May and June. In July, the depreciation of the US dollar against the Euro in the international market has also led to its weakening in our market. The annual appreciation of the lek against the US Dollar has continued to decline, standing at 5.9% in June and 0.9% in July, from 7.6% at the end of the first quarter.

In the second quarter, the yields on government securities continued the downward trend experienced at the end of the first quarter, reflecting the further reduction of policy rate in July. The performance of the yields has mainly reflected the investors' dynamics in the primary market, as government's demand for funds increased during this quarter. Banks' demand remained high¹¹, being the main driver in the downward trend of yields.

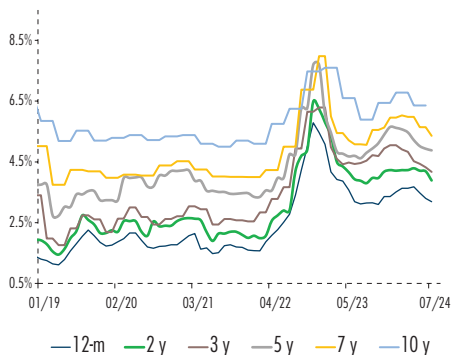
The overall performance of yields during this period has confirmed the presence of contained risk premiums. The spread of the 12-month yield with the policy rate as well as with long-term bond yields narrowed month after month. In detail, the yield of 12-month T-bills fell to 3.3% in June, from 3.6% in March. Other long-term debt instruments have shown a similar trend. Bond yields with a maturity of 3-15 years decreased by an average of 0.4 p.p. in the second

¹¹ The bid/cover indicator for T-bills and bond auctions held in the April/July interval was 1.5, the same as in the first quarter.



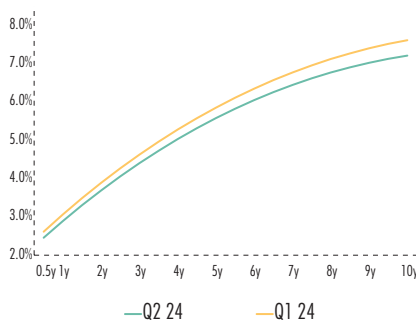
Chart 8

Yields in the primary market have reflected the reduction of the policy rate, maintaining small spreads against it



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

The yield curve has shifted downward, while its slope has decreased compared to the first quarter of the year



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

quarter compared to their values in the first quarter. The yield curve has reflected these developments, mitigating the slope and level slightly compared to the previous quarter. In the July auctions, further declines were recorded, following the reduction of the policy rate.

3.4. LENDING CONDITIONS

Interest rates on new loans in lek continued to fluctuate at low levels in the second quarter of the year, maintaining their stimulating nature on loan demand. This quarter was characterized by a slight increase in interest rates on loans to enterprises, while rates for consumer and mortgage loans to households decreased. Over a longer time frame, current levels of interest rates on loans are close to the averages observed over the past two years. Conversely, interest rates on deposits have increased, resulting in a slight narrowing of the interest margin.

The average interest rate on **new loans in lek to enterprises**, showed a marginal but stable increase since the end of last year. It was 6.8% in the second quarter, from 6.6% in the first quarter. This trend was present across all loan sizes. In a longer-term perspective, current interest rates on loans to enterprises stand close to the average recorded during 2023.

Interest rates on **loans to households** exhibited the opposite trend. They have decreased, after the increase recorded in the first quarter, returning to the average of the second half of last year. Interest rate on mortgage loan rates averaged 4.1% this quarter, from 4.5% in the first quarter, while interest rate on consumer loan decreased to 9.5% from an average of 9.7% in the previous quarter. Looking back, interest rates on loans to households have hovered near these average levels since 2022.

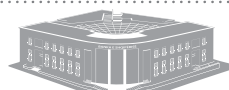
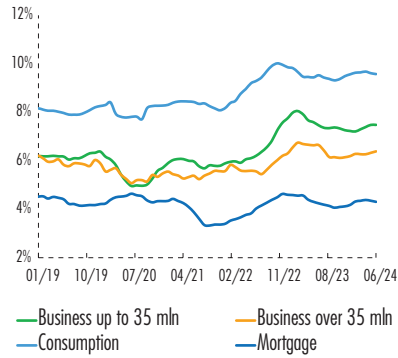


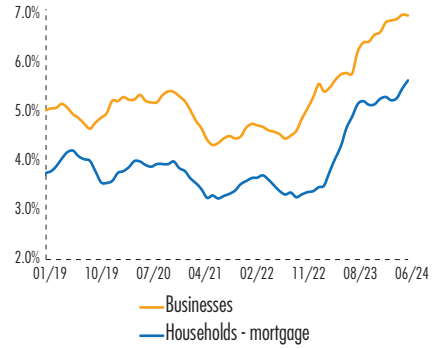
Chart 9

Interest rates for loans in lek have increased for enterprises, while they have decreased for households



Note: Interest rates on new loans in lek as 6-month moving average. Source: Bank of Albania.

Interest rates for loans in lek have increased for enterprises, while they have decreased for households

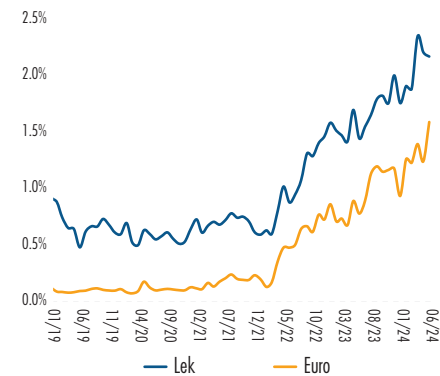


Note: Interest rates of new loans in euro as 6-months moving average. Source: Bank of Albania.

Interest rates on loans in euro have continued to grow for households, while for enterprises they have stabilized at high levels. The average interest rate on new loans in euro to enterprises remained at 7.0 % similar to the previous quarter. Within this category, a light decrease in interest rates on small and medium-sized loans (up to EUR 1 mln) offset the increases in the large loans. Meanwhile, interest rates on mortgage loans in euro to households continued to increase. It stood at 5.8% in the second quarter, from 5.5% averagely in the first quarter of the year. The interest spreads of ALL/EUR loans continue to be in negative territory, influencing loan demand toward the domestic currency, particularly for mortgage loans.

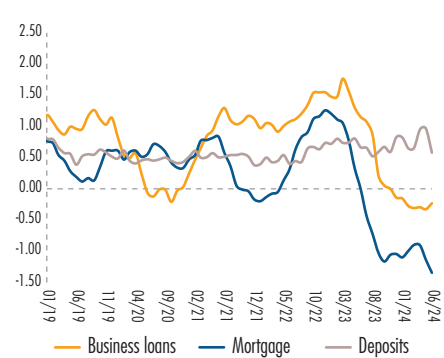
Chart 10

The interest rate for time deposits continues to increase, albeit at minimum values



Note: The data show the interest rate applied on new time deposits in lek and euro, in % Source: Bank of Albania.

Lek/euro interest rates spread is in negative territory for loans and remains at low levels for deposits



Note: The data show the spread between the interest rates in lek and loans in euro, in percentage points, for: business loans, mortgage loans and deposits. Source: Bank of Albania.



The interest rates on time deposits in lek have increased in the second quarter, after the stagnation that appeared in the previous two quarters. They averaged 2.2% this quarter, up from 1.9% in the previous six months. Interest rates on deposit have increased to almost the same extent for maturities up to one year and for longer ones. Even the interest rates on time deposits in euro have increased this quarter, reaching 1.3% from 1.1% in the previous three quarters. The spread of the interest rates on lek deposits to euro deposits remained stable close to the average levels of last year noted in the previous quarters of 2024.

BOX 1: SUPPLY CONDITIONS AND DEMAND FOR LOANS IN 2024 Q2¹²

The credit policy framework for the private sector did not experience significant changes in the second quarter. Banks continued to finance a higher number of loan applications from both enterprises and households. However, in terms of economic agents, loan supply conditions were reported to be eased for enterprises driven by perception of banks on the improvement of the macroeconomic situation and its outlook. Demand for loans remained high even in the second quarter, reflecting increased financing needs across all the economic agents.

Banks kept credit standards to enterprises unchanged during the second quarter, whether for short-term liquidity needs or for financing investments. However, operating in an environment of lower balance sheet costs and constraints, bank have offered lower margins on loans to enterprises. This reduction in margins, particularly for large enterprises, contributed to the easing of credit terms and conditions for this segment. The loan rejection rate - in relation to the total number of loan applications - was reported to be lower, as a result of the banks' perception on the outlook of some of the economy's sectors.

Credit standards for consumer loans and those for house purchasing were tightened in the second quarter, determined only by one bank of the system. The risk perception by this bank on the solvency of borrowers seems to have fostered a more cautious approach to lending to households during this quarter. On the other hand, credit terms and conditions remained largely unchanged, despite a reported easing for consumer loans. The higher margins applied on consumer loans and on those for house purchase were balanced by an increase in the size of loans granted to households during this quarter. The competitive environment in which banks operate remained the key element that continues to positively support the framework of banks' lending policies in this segment. The loan rejection rate reduced further in the second quarter, dictated mainly by banks' assessments of the quality of borrowers.

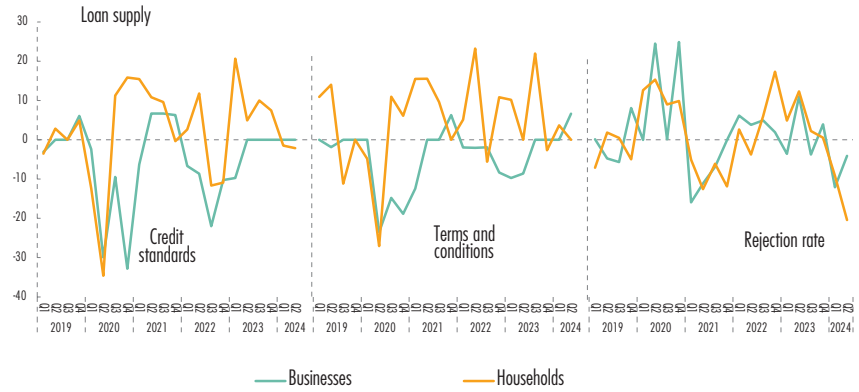
Supply conditions for loans to households were fragmented in this quarter, expressed in eased conditions for consumer loans and tightened conditions for house purchase loans. The current and expected developments in the housing market are considered by some banks as a key factor for the tightening of terms of conditions on loans to households in this quarter. Banks somewhat tightened

¹² The analysis is based on Bank Lending Survey, conducted on quarterly bases and is published at https://www.bankofalbania.org/Politika_Monetare/Vrojtimet/Vrojtimi_i_aktivitetit_kreditues/



Chart 1 Box 1

Loan supply conditions remained almost unchanged compared to the previous quarter.

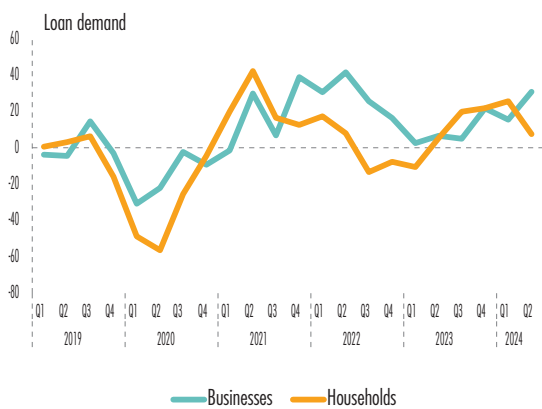


Notes: Values on the chart represent net balances. Positive values indicate easing of terms and conditions and vice versa. Positive values indicate increase of the scale of application refusal and vice-versa. Source: Bank of Albania.

the price elements, through the application of higher margins, especially on loans to households for the purpose of house purchase. On the other hand, they have accommodated the loan demand of households in financing consumption, by increasing the loan size, applying lower margins and reducing commissions. The approved loans ratio to total loan applications was higher in this quarter, driven by banks' perception of households' solvency and credit history.

Chart 2 Box 1

Loan demand was high in all segments.



Notes: Values on the chart are calculated as net percentage. Positive values indicate increase of loan demand and vice versa. Source: Bank of Albania.

Loan demand was high across all sizes of enterprises and for all types of loans by purpose of use, in line with banks' expectations. Financing conditions positively influenced loan demand by enterprises, for the first time in seven quarters. Thus, the interest rate environment, the expected economic situation, as well as the further improvement of business confidence encouraged enterprises to apply for higher amounts of loans to meet their increased financing needs. The use of available liquidity by enterprises did not curb the high demand for loan, both for financing working capital inventories and planned investment. Loan demand from enterprises continues to be high, after more than two years, supported by both, loans to cover short-term liquidity needs, and loans for investments financing.

Increased demand for loans was also reported in the households segment in line with expectations, for the fifth consecutive quarter. The rise in loan demand stemmed from increased needs for loans to finance consumption and for house purchase.



3.5. CREDIT TO THE PRIVATE SECTOR¹³

Private sector lending accelerated the growth rates in the second quarter of the year, reflecting high demand and eased financial conditions. In parallel, the good financial health of the banking sector, both in terms of credit quality, capital size and fund raising, has supported the expansion of credit supply and enabled a better response to the climbing demand.

The annual rate of credit growth for the private sector averaged 14.2%, or 3 p.p. more than in the first quarter, reflecting growth in all categories. At the same time, the quarterly flow of ALL 38 billion marked a new historical record, confirming the positive momentum of private sector lending. Outstanding credit ratio to GDP reached 31.5%, or 1 p.p. higher than at the end of 2023.

Developments by currency show the increase in loans denominated both in lek and foreign currency in the second quarter. As in the previous quarters, credit growth in lek continued to be more dynamic, driven by low interest rates on loans denominated in the domestic currency and the preference of economic agents for it. Credit to the private sector increased 21% in the first quarter, or 2 p.p. higher compared with the end of the previous quarter. Loans in foreign currency also appear to be increasing, recording an annual rate of 6.6%. The increase of financing in foreign currency went mainly for private investments financing of. The dynamics between the two portfolios – in lek and in foreign currency – drove lek loans to total loans ratio at 57.3% at the end of the second quarter.

Developments by customer confirm the rapid expansion of loans to enterprises in the second quarter as well. Thus, the annual growth of 14% of this segment was about 4 p.p. higher than that recorded on average in the first quarter. Meanwhile, the quarterly flow, despite the seasonal improvement it has historically shown, appears significantly above the quarterly growth of previous years. The expansion by ALL 26 billion of this segment was about twice as high as last year's in the same period.

The growth of loans to enterprises continued to be influenced by the strong growth of loans for investments. Loans for investments is showing high double-digit growth, also influenced by the financing of large projects. The average growth of investment loans was 18% in the second quarter, about 5 p.p. higher than in the first quarter. On the other hand, the increase in liquidity loans was 8.3% from about 6.0% in the first quarter. Also, businesses have used the accumulated liquidity, as shown by the performance of their deposits with banks.

¹³ Credit analysis is based on the new set of statistics, in line with the ECB methodology on "real" credit flows, which excludes both the effect of exchange rate and loans written off of balance sheets.

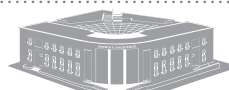
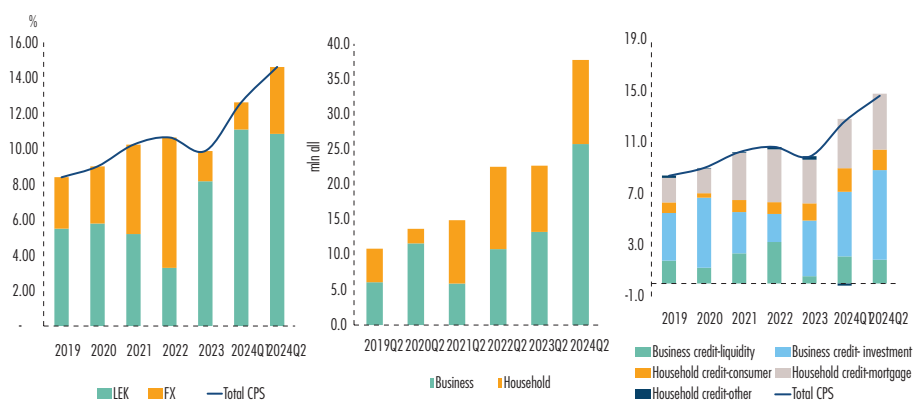


Chart 11

The expansion of credit for the private sector has accelerated, affected by all categories, but it has been stronger for loans in lek and loans to enterprises.



Notes: The data show the annual changes (in %) of credit adjusted for exchange rate effects and written-off loans from the balance sheets. Source: Bank of Albania.

The expansion of the loan portfolio to households continued in the second quarter, supported by both house purchase and consumer loans. The annual growth of this portfolio averaging at 14.8% was 1.2 p.p. higher than in the first quarter, while the quarterly flow was comparable to that observed in the first quarter and in line with the seasonal behaviour observed over the years. By sub-segments, a faster pace of growth is observed in the loan segment for house purchase - which increased by 16.4% from 14.8% in the first quarter - and a more moderate expansion in the consumer loan segment - which increased by 15.2%, around 0.4 pp more than in the first quarter.

Developments in bank liabilities show the stable growth of deposits in the second quarter of the year. In total, deposits grew averagely by 11.1%. This rate is similar to the first quarter (about 0.3 p.p. lower). Deposits account for around 65% of GDP.

The growth in deposits was driven by the increase in the deposits of households, while deposits of enterprises slowed the growth rates in the second quarter. The increase in interest rates seems to have stimulated the surge in deposits of households, both in lek and in foreign currency. Thus, households' deposits rose by 10.4%, or 0.4 p.p. higher than in the first quarter. The increase appears to be balanced both in terms of currency and maturities. On the other hand, enterprises' deposits recorded a slowdown in the growth rate for the second consecutive quarter, at 14%. This slowdown is observed in both funds in lek and foreign currency. The stock of enterprises' deposits stood at around 12.9% of GDP at the end of the second quarter.

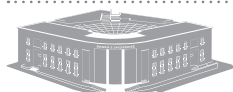
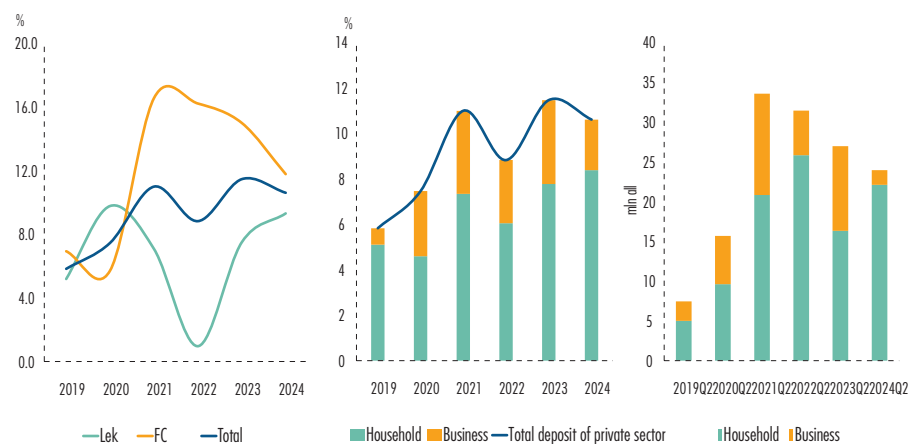


Chart 12

Deposits have shown stable growth rates supported by the good performance of deposits to households.



Notes: Increase in total deposits by currency, in % adjusted for exchange rate fluctuations.
Source: Bank of Albania.

Developments by currency show a slight improvement in the growth rates of deposits in lek to 9.2%, which has partially offset the slowdown of those in foreign currency to 12.7%. The performance of deposits in lek has reflected the behaviour of the government and the low budget expenditures, which have restrained the monetary expansion in the domestic currency.



4. ECONOMIC GROWTH

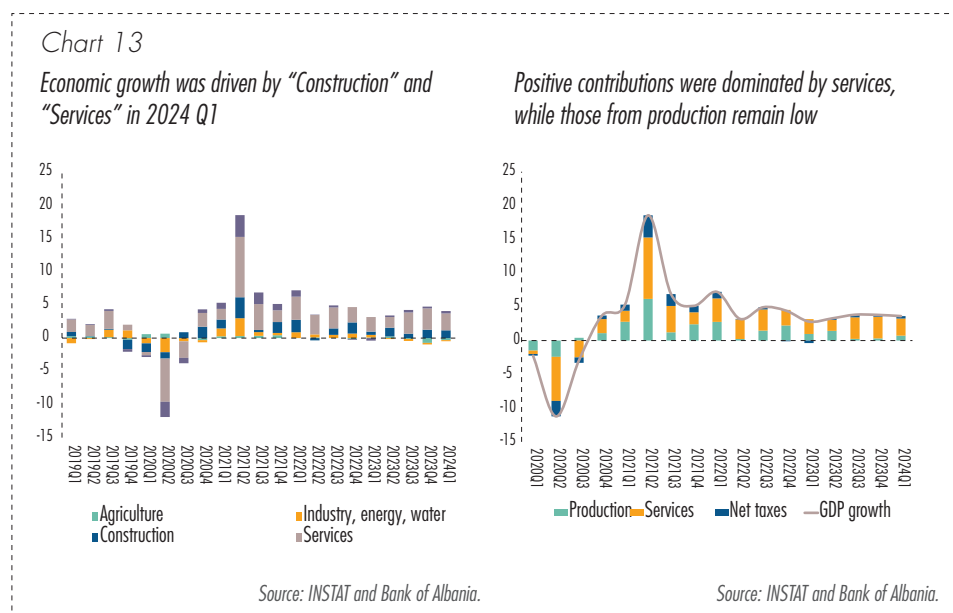
Economy recorded an annual growth of 3.6% in 2024 Q1, a slightly lower rate compared to the previous quarter. In sectorial terms, economic growth was underpinned by “Construction,” “Public administration, education, and health,” and “Trade, transportation, accommodation and food services”.

In terms of aggregate demand, increasing contributions came entirely from domestic demand which was driven by the accelerated expansion in consumption and private investments. Public consumption had a positive albeit slower contribution, whereas public investments have shrank in annual terms. The contribution of external demand shifted to negative territory during the first quarter of the year. Both goods and services fed the fall in exports. On the other hand, imports expanded significantly, with positive contributions made from both goods and services.

Economic growth was fuelled by stimulating financing conditions, the increase in disposable income and the intensified inflows of foreign direct investments.

4.1. GROSS DOMESTIC PRODUCT

According to INSTAT data, in 2024 Q1, GDP grew by 3.6%, a slightly lower rate than the previous quarter¹⁴. This growth was supported by “Construction,” “Public administration, education and health,” as well as “Trade, transportation, accommodation and food services” (Chart 13, right). The rest of the sub-branches of services have made positive contributions as well. On the other hand, “Agriculture” and “Industry” have continued to contribute negatively



¹⁴ The economic growth in 2023 Q4 was 3.8%.



(Chart 13, right). In the sector of “Industry”, the sub-branches of the “Processing industry” has had a negative contribution.

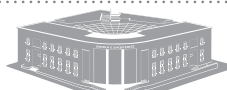
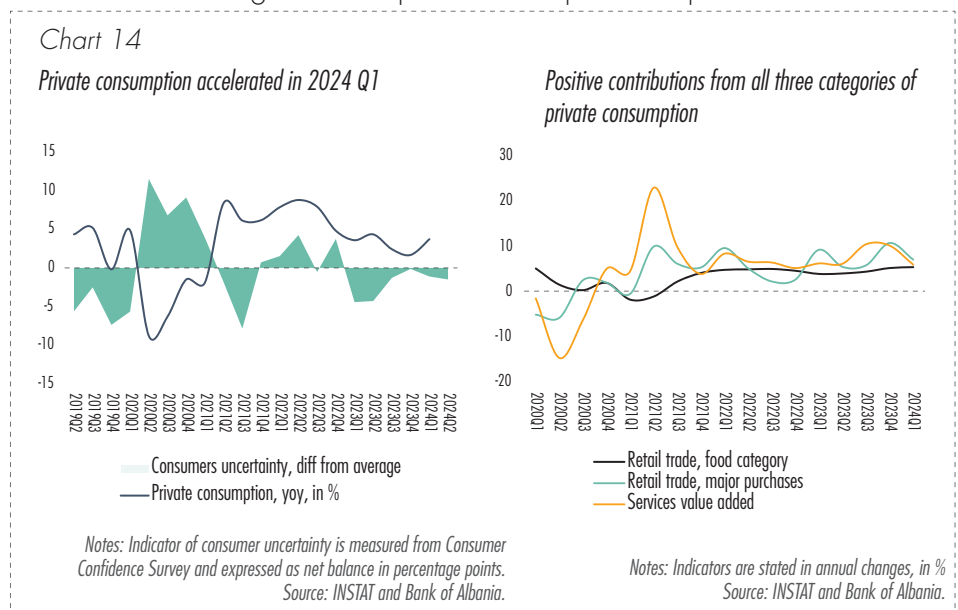
The contribution of the production sector to economic growth was 0.7 percentage points during the first quarter of 2024 (Chart 13, right). Positive contributions were made by “Construction,” which recorded an accelerated growth compared to the first quarter, climbing to 14%, with a 1.2 p.p. contribution to the expansion of economic activity. On the other hand, “Agriculture” and “Industry” shrank by 1.7% and 1.0%, respectively; rates with a magnitude lower than the previous quarter. The negative contributions of “Industry” are related to “Processing,” whereas the “Extracting industry” and “Energy” contributed positively.

The contribution of services was upward by 2.5 percentage point. The main sub-branches were “Public administration, defence, education and health” and “Trade, transportation, accommodation and food services.” Relatively lower positive contributions were made by the other branches of services.

4.2. AGGREGATE DEMAND

Economic growth was driven by domestic demand, with added positive contributions from consumption and investments (Chart 14). Both private consumption and investments recorded higher growth rates. In the case of investments, private contributions were positive, whereas public contributions were negative. Lastly, public consumption expanded, but at a lower magnitude compared to the previous quarters.

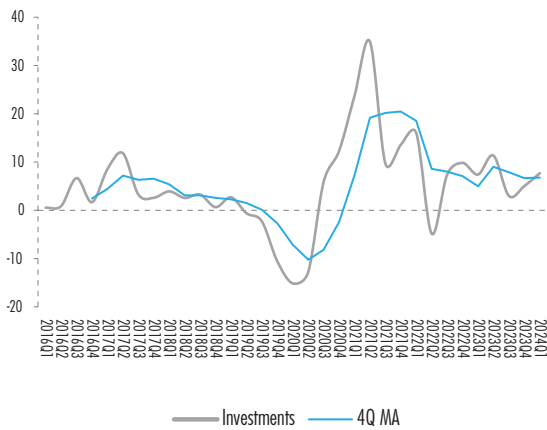
Domestic demand grew by 4.4% in in 2024 Q1, slightly up compared to the previous quarter (4.1%). Accelerated positive contributions were made by private consumption and investments. On the other hand, public consumption recorded a slower growth compared to the previous quarter. In the case of



investments, growth was determined by private investments, whereas public ones, had a lessening impact.

Chart 15

Total investment grew in 2024 Q1



Source: INSTAT and Bank of Albania.

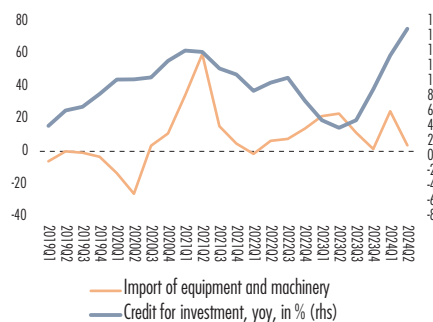
Private consumption grew by 3.7% in 2024 Q1, providing the main contribution in the expansion of aggregate demand. Its growth was broadly based according to all consumption categories for non-durable and durable goods and services. The main factors supporting the enlargement of private consumption were: the rise of employment¹⁵, the accelerated expansion of wages, the growth of consumer credit and the increase in remittances. Indirect indicators available for Q2 suggest a continuation of consumption growth.

Total investments grew 7.7% in the first quarter of this year, led by their private component (Chart 15). Public investments are assessed to have provided a negative contribution during this quarter¹⁶. Indirect data show that investments in construction are still an important component to the expansion of total

investments. Also, the increase in the import of machinery and equipment suggest a higher level of investments in this category as well. The increase of private investments was underpinned by higher utilization rates of productive capacities of enterprises, their positive financial performance and the higher demand for goods and services.

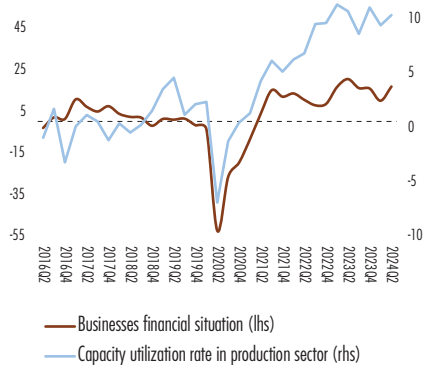
Chart 16

The capacity utilisation rate and the enterprises' financial situation improved in the second quarter



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

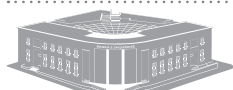
Quantitative indicators from imports and bank credit signal an increase in investments



Notes: Indicators are annual changes in percentage. Source: INSTAT and Bank of Albania.

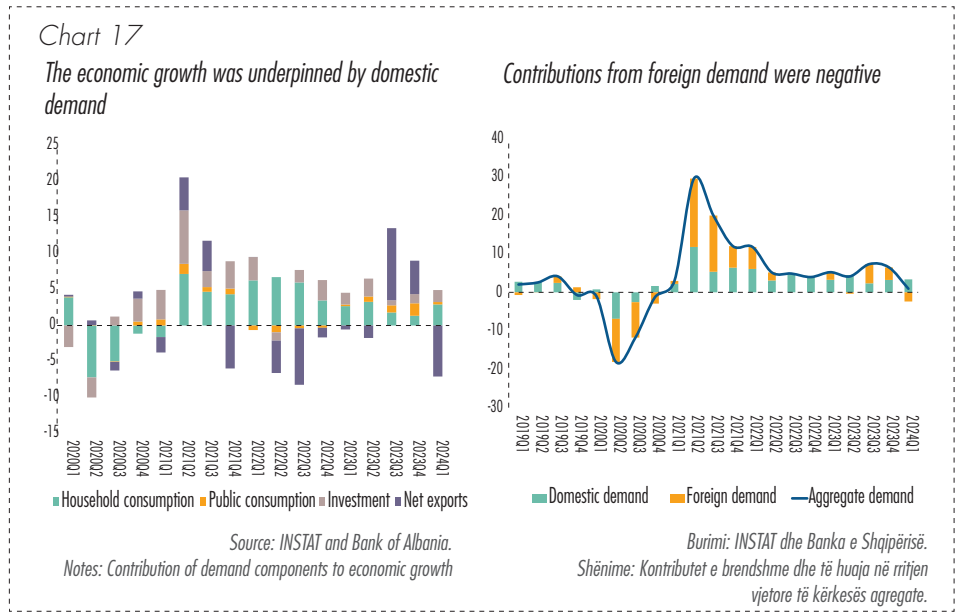
¹⁵ As official data on the labour market for 2024 Q1 are not published as yet, they are approximated with indirect indicators from short-term statistical data and assessments.

¹⁶ INSTAT does not publish disaggregated investments by type. The analysis on the performance of private and public investments and investments by category is based on internal assessments, which are conducted using the indirect indicators available.



The partial information available for the second quarters suggest that investments will continue to grow. The latter continues to be supported by the increase in lending during this quarter as well (Chart 16, right).

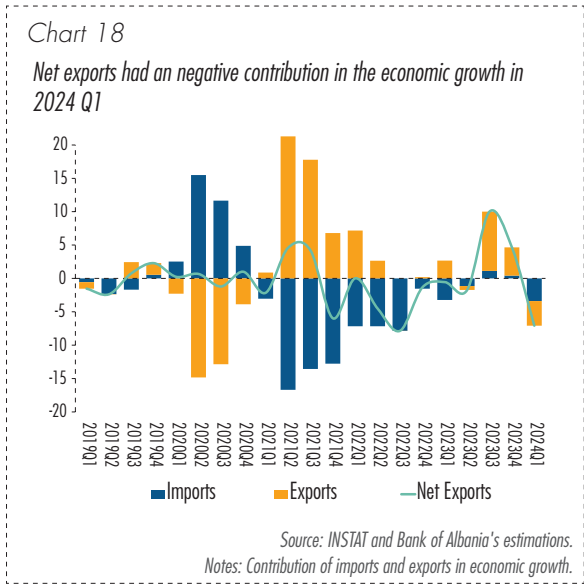
Foreign demand provided an on-the-rise negative contribution (Chart 17, right). Exports contracted compared to the previous year, mainly due to the fall in the exports of goods, but with low negative effects springing from the export of services as well.



Real net exports of goods and services had an increasing negative contribution (Chart 18) to real trade deficit, which expanded by 114.9%. Negative contributions came from both the fall of exports and the rise of imports. Export of goods and services reduced by 9.9%, due to the fall in the export of goods by 30.8% and that of services by 1.4%.

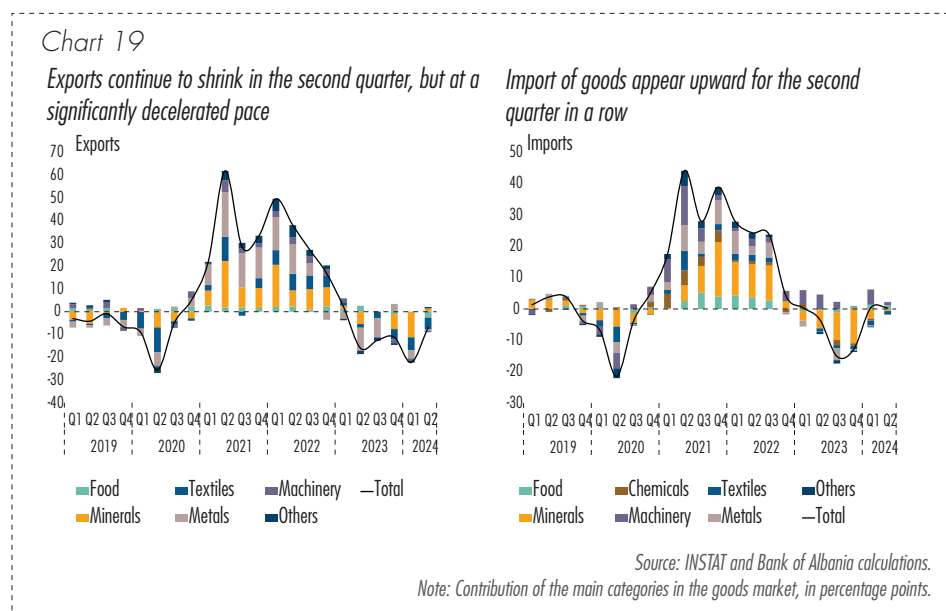
Imports of goods and services expanded by 7.6% in 2024 Q1. This was mainly due to the growth in the import of goods by 8.2%, coupled with the increase in the import of services by 6.4%.

The data on the trade of goods in value for 2024 Q2 indicate a deceleration in the fall of exports, as well as a slight increase of imports. This performance was reflected in the expansion of trade deficit by 7.1%. The impact from the falling prices in combination with the exchange rate appreciation, continue to support this performance, whereas the impact from the quantity side is more pronounced in the case of imports and at a tight base in the case of exports.



Exports of goods shrank by 6.9% in 2024 Q2 (chart 19, left). “Textiles and footwear” and “Food, beverages and tobacco” provided the main impacts in this regard. Other branches, also provided slightly negative contributions. The decline of exports reflects the impact of prices and the appreciated exchange rate, but also the lower volume for certain categories of goods.

Imports of goods grew by 0.3% during 2024 Q2, continuing the upward trend of the past quarter (Chart 19, right). Higher quantities have spurred an increase of imports, whilst the impact of prices and the appreciated exchange rate was reflected in its deceleration. Positive contributions were recorded by the categories of “Food, beverages and tobacco” and “Machinery, equipment and spare parts.” Negative contributions are at moderated levels and across several categories.



The fiscal policy is expected to remain consolidating over the year 2024, supporting the improvement of fiscal position. The primary balance is planned to be positive, at 0.4% of GDP, from 0.7% in 2023.

The fiscal impulse at the end of the first half of the year, remained in the negative territory, although it shrank to 0.8% of GDP, from 1.4% it recorded at the end of the first quarter. The negative values of the fiscal impulse factorise the higher revenues, combined with lower ratios of expenses in terms of GDP as compared to the same period last year. The fiscal surplus at the end of the first half of the year amounted ALL 51.4 billion, assessed at 4.3% of GDP, reaching record levels for this period of the year.

Expenditure in the second quarter amounted ALL 159.5 bln, up by 7.3% in annual terms. The rate of the expenses realisation accelerated in the second quarter, driven by expenses for public investments. Public investments had a

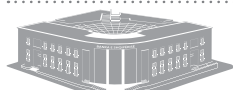
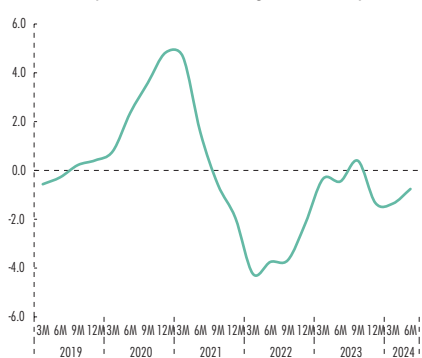


Chart 20

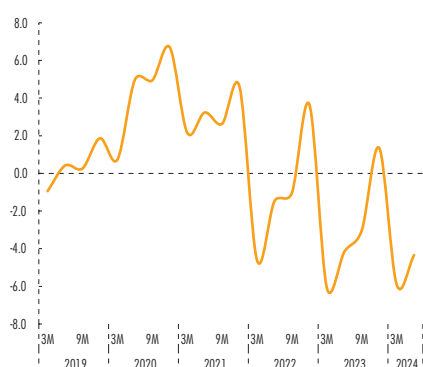
Fiscal impulse remained in negative territory



Notes: Change in primary deficit ratio to GDP for 12 months, from the previous year. Positive values of this indicator indicate an accommodative fiscal policy, while negative values indicate a consolidating one.

Source: Ministry of Finance and Economy, MPD calculations.

The fiscal surplus was relatively high



Notes: Budget deficit to GDP. Calculations are based on quarterly flows. Positive values show deficit, negative values show budget surplus.

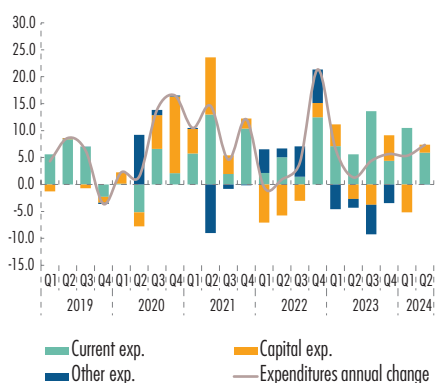
Source: Ministry of Finance.

positive contribution in this quarter, expanding total expenses by 1.5 percentage points, from -5.1 percentage points in the first quarter. However, the item with the most significant contribution to the expansion of expenses in Q2, were payments of interest on foreign debt, by 2.3 percentage points, reflecting the increase in the debt portfolio with Eurobond¹⁷ and the seasonal behaviour of this item. Personnel costs and pension spending had also a positive impact to the expansion of total expenses, albeit at a lower degree than in the previous quarter.

In the first half of the year, expenditure amounted around ALL 291.4 bln, or around 6.4% higher than in the same period last year. Despite the increase in the second quarter, the level of public investments for the first half of the year

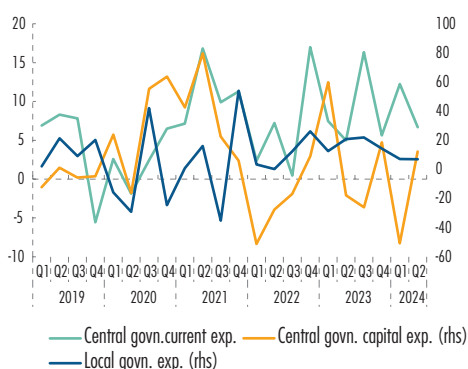
Chart 21

The realisation rate of expenses accelerated somewhat...



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

...reflecting the higher level of investments in Q2

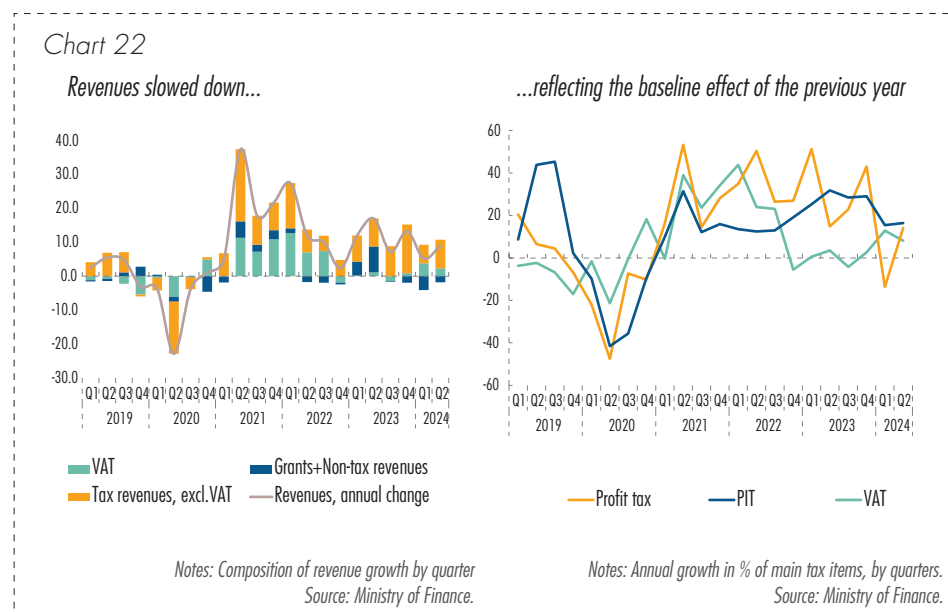


Notes: Annual growth in % of main expenditure items, by quarters.
Source: Ministry of Finance.

¹⁷ Distribution of interest payments on foreign debt has not been the same throughout the year. They tend to have the largest share in the second and the fourth quarter of each fiscal year.



was around 13.8% lower in annual terms, reflecting their contraction beyond the seasonality over the course of first quarter.

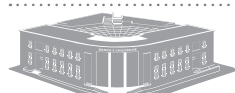


In 2024 Q2, **budget revenues** were around ALL 178.5 billion, accelerating the annual growth rate to 9%, from 5.2% recorded at the end of Q1.

The growth of revenues was fuelled mainly from non-tax revenues, with a contribution of around 5.2 percentage points, due to the transfer of funds from the Institute of Social Insurance Institute to the state's budget, reflecting the improved financial results of this institution during the 2023 fiscal year. A positive contribution by around 2.2 percentage points came from VAT on imports of goods, which reflected the rise of commodity prices (except food) in international markets. Revenues from Personal Income Tax, local taxes and social insurance contributions had a positive contribution to the expansion of revenues during this quarter as well, at range of 1.5-2.2 percentage points. The only item that had a negative contribution by around 7.1 percentage points to the expansion of total revenue, was grants, reflecting the base effect of the previous year, when large sums were disbursed by the European Commission to energy-related projects.

At the end of the first half of the year, revenues reached ALL 342.8 bln, or around 7.1% higher than in the same period last year. All tax-related items had a positive contribution to the higher total, except the Profit Tax. The latter's contribution was negative by 0.4 percentage points in the first half of the year, as a result of the base effect of the previous year, from the temporary special taxation imposed on electrical energy-trading companies.

Budget balance was positive in Q2, as well, at around ALL 19 bln. Fiscal surplus, as at the end of the first half of the year, amounted ALL 51.4 billion, estimated at around 4.3% of GDP. Net new borrowing in the domestic market

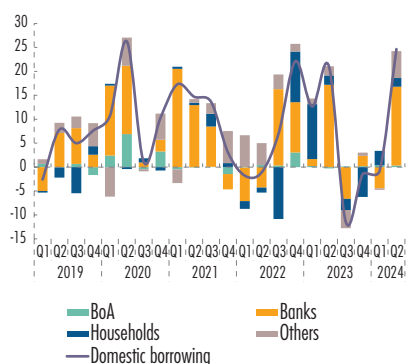


grew by ALL 24.7 bln during the second quarter¹⁸, which consisted almost entirely (97%) of bonds with 2-15 years of maturity. In the second quarter, the last 2-year Eurobond of EUR 70 million, matured as well. Most of the debt instruments were purchased by banks in the second quarter, financing around 68% of the additional government borrowing. Households, on the other hand, increased their participation in the government securities' auctions, covering almost 8% of the domestic market's net borrowing. A new occurrence noticed during this year were non-resident investors purchasing government securities. Their portfolio, at the end of the first half of year, amounted ALL 6 bln, or 0.8% of the total domestic debt. However, their participation during the second quarter covered around 18% of the additional government borrowing.

Net borrowing in foreign market in Q2 reduced by ALL 8.8 bln. In the first half of the year, net borrowing in the foreign market was ALL -10.6 bln. The liquidity surplus in foreign currency inherited from the previous year, due to the issuance of the Eurobond, was used for foreign debt servicing throughout 2024. The performance of both government borrowing and fiscal surpluses over the course of this period, have been factored into liquidity surpluses available to be used to be spend in the upcoming months.

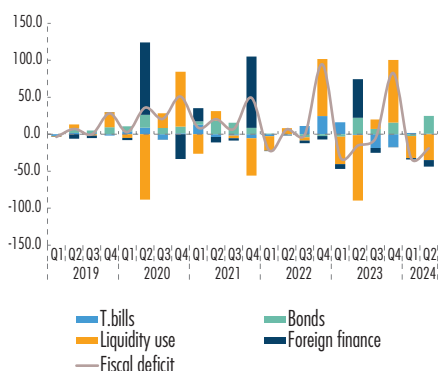
Chart 23

Net borrowing in the domestic market contracted...



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

...followed by the decrease of the banking market exposure to public debt.



Notes: Government borrowing in debt securities, by buyers, in ALL billion, by quarters.
Source: Ministry of Finance.

Public debt was estimated at around 56.8% of GDP at the end of the first half of 2024, dropping by around 2.1 percentage points from the one recorded at the end of 2023¹⁹. This ratio continued to decrease due to: (i) the appreciation of domestic currency; (ii) economic growth; and (iii) the improved fiscal position during the first half of the year. The domestic debt ratio to total debt reached

¹⁸ Borrowing in lek in Q2 was ALL 31.7 bln. As the 2-year Eurobond matured at ALL 7 bln - the counter-value of EUR 69 million - the net borrowing in the domestic market during the second quarter was ALL 24.7 bln.

¹⁹ The ratio of debt stock to cumulative GDP at the end of Q2 for the same time period.



56.3% at the end of the second quarter of 2024, from 54.4% in 2023. It increased due to the higher level of borrowing in the domestic market, whereas foreign debt payments were more intense compared to foreign-currency debt disbursement over this period.



5. INFLATION, PRICES AND COSTS IN THE ECONOMY

Inflation fluctuated close to 2.1% in Q2, slowing down faster than expected. The downward trajectory became more pronounced as the contribution of unprocessed foods to headline inflation fell. The decrease in prices of these items, despite seasonal developments, is related to the similar performance of these prices in foreign markets. The impacts of the monetary normalisation continued to be reflected in the gradual deceleration of core inflation and domestic inflation. However, they remain above headline inflation in Q2.

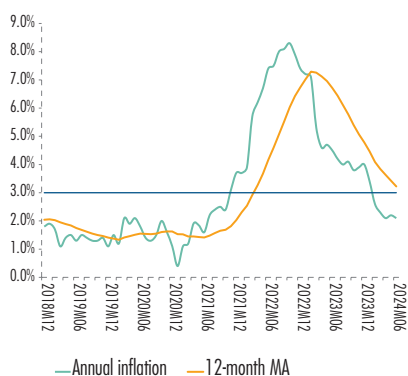
The performance of inflation in the upcoming months will reflect the positive impact of supply springing from food prices, which is expected to be present in the short term. As they flatten out, inflation is expected to return to target, reflecting a more balanced performance of demand and supply of goods, services and labour, as well as a more stable anchoring of medium-term inflation expectations towards the target.

5.1. CONSUMER PRICES

Inflation continued to decline in Q2, remaining on average close to 2.1% (Chart 24, left). Inflation continued to slow down throughout the quarter, reaching 2.1% in June, the lowest value recorded since July 2021. As a result, inflation dropped by 0.6 and 2.5 percentage points below the respective values of the previous quarter and the same period of last year. Inflation profile in Albania is similar to the one in both regional and the EU economies (Chart 24, right). The downward trajectory of inflation in Albania was influenced by the high-paced deceleration of food prices in foreign markets, the appreciation

Chart 24

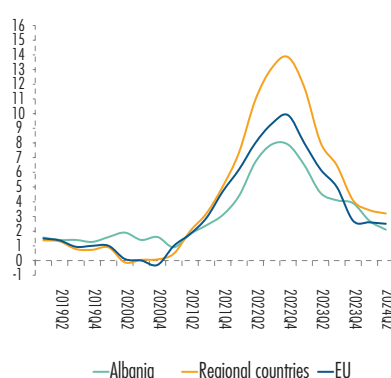
The slowdown in inflation continued at a higher pace compared to the previous year



Source: INSTAT, BoA's calculations.

Note: The inflation target is the annual change in the Consumer Price Index (published by INSTAT).

Food prices reduced the inflation rate in the country and in the region



Source: INSTAT, BoA's calculations.

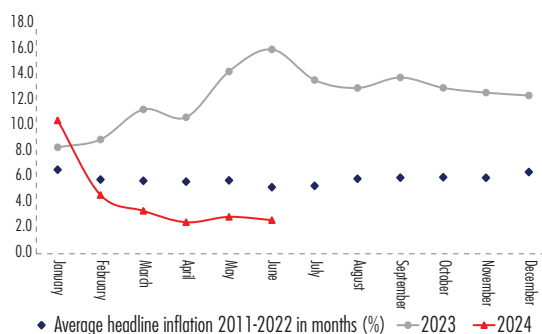
Note: Inflation rate are annual changes, in percentage.



of the exchange rate, and the high comparative base. The strong drop of inflation in our economy reflects also the impact of consumption's structural differences, where the weight of food is considerably higher than in the EU markets²⁰. Although pressures of a domestic origin have gradually mitigated, they have maintained the high intensity in the formation of headline inflation nonetheless.

Chart 25

Inflation of "Unprocessed foods" recorded the lowest historical values during February-June 2024, having a strong reductive impact on headline inflation



Source: INSTAT, BoA's calculations.

Note: For the category of unprocessed foods, the annual average rates for each month of the 2011-2022 period were compared to the annual rates of every month of 2023 and 2024.

The fall of inflation was mainly driven by the sharp fall in the contribution of "Unprocessed foods" which reduced by 0.6 percentage points compared to the previous quarter. Therefore, the contribution of this category dropped to 14%, from 33% in the previous quarter. The fall in the contributions from these goods over the course of this year, were quite pronounced²¹ compared to the increase in 2023, resulting in a strong reductive impact on headline inflation (Chart 25).

"Processed foods" had a lower contribution than in the previous quarter, reducing headline inflation by 0.1 percentage points. The inflation for this category was more stable throughout the year, as compared to the one-by-one reductions of 2023.

"Non-food consumer goods" have increased their contribution to the formation of headline inflation, particularly in the first two months of the quarter, due to the rising trend of fuel prices in foreign markets. The prices of other more stable components of inflation - **housing, services, and durable consumer goods** - had a lower contribution to inflation formation than in the previous quarter. Particularly in this quarter, there is a fall in the sub-group of "Furnishing and house maintenance." The prices of services continue to remain high, due to the increased demand in the tourism sector and the higher labour cost, the weight of which is relatively more in services.

²⁰ The group of "Foods and non-alcoholic beverages" account for 34.6% of the CPI basket in Albania, and the same group accounts for 16.9% of the CPI basket in EU.

²¹ The inflation of this category over the months of this year recorded one of the lowest historical values, dropping to 2.7%.

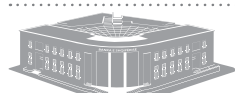


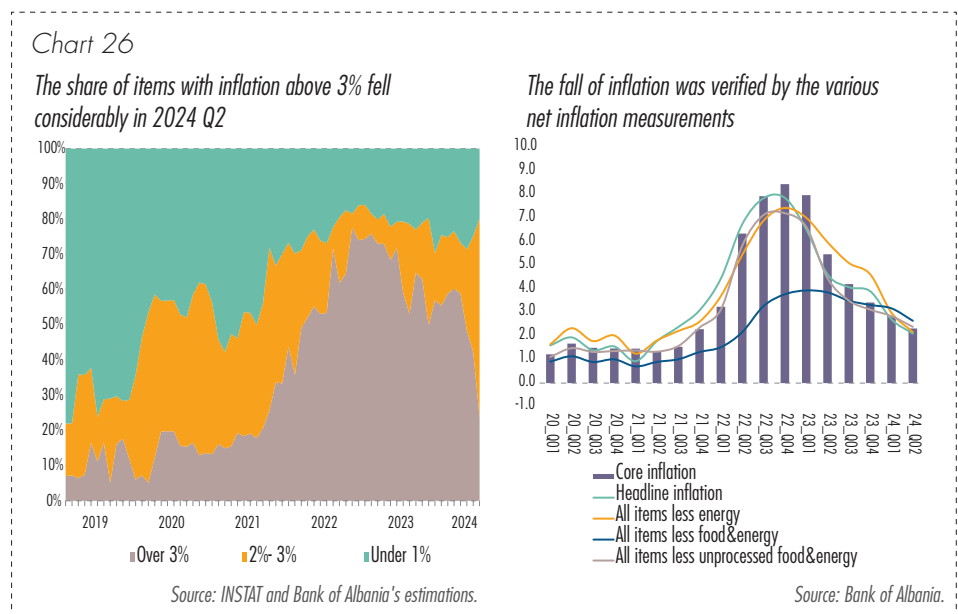
Table 2 Contribution of the main categories in the annual inflation market, in percentage points.

	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2024 Q4	2024 Q1	2024 Q1	Annual inflation 2024 Q2 (%)
Processed food	3.4	2.8	1.3	0.8	0.6	0.5	0.4	1.4
Bread and grains	0.6	0.6	0.2	0.1	0.1	0.1	0.1	1.1
Milk, cheese and eggs	1.2	1.3	0.8	0.6	0.5	0.3	0.2	3.5
Unprocessed foods	1.9	1.9	2.5	2.3	2.1	0.9	0.3	2.7
Fruits	0.1	0.1	0.4	0.3	0.3	0.1	-0.2	-2.2
Vegetables	0.8	0.7	1.1	1.3	1.3	0.5	0.3	4.3
Meat	1.0	1.0	0.9	0.7	0.4	0.2	0.1	2.4
Services	0.5	0.5	0.5	0.5	0.4	0.4	0.4	2.2
Goods with regulated prices	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.7
Housing lease	0.4	0.4	0.4	0.4	0.4	0.4	0.4	3.2
Non-food consumer goods	1.2	0.4	-0.6	-0.4	-0.1	0.1	0.3	2.7
Fuel	0.9	0.0	-0.9	-0.6	-0.2	-0.1	0.1	2.4
Durable consumer goods	0.4	0.5	0.5	0.4	0.4	0.4	0.3	3.3
Inflation (%)	7.9	6.5	4.6	4.1	3.9	2.7	2.1	2.1

Source: INSTAT and Bank of Albania's estimations.

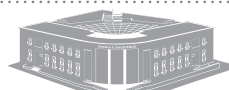
The fall in the rate of inflation during 2024 Q2, reflects the reduction in the share of CPI basket's items with inflation over 3%²². This share has fallen to around 38%, dropping for the first time below 50% since the beginning of 2022. As compared to 2024 Q1, this share reduced by around 21 percentage points. On the other hand, the share of items with inflation below 1% shrank slightly by 1 percentage point, and the share of items with inflation between 1% and 3%, increased by 22 percentage points (Chart 26, left).

Net inflation which excludes food and energy²³ registered 2.3% in Q2, with a downward trend compared to the first quarter of the year, although remaining above the level of headline inflation and the other net measurements. This



²² The assessment is based on the annual inflation data for a 2-digit level detailing pursuant to COICOP classification of CPI basket items, which includes a total number of 96 goods and services.

²³ This mainly includes durable services and consumer goods.



confirms the presence of stable domestic inflationary pressures, and relatively isolated short-term developments (Chart 26, right).

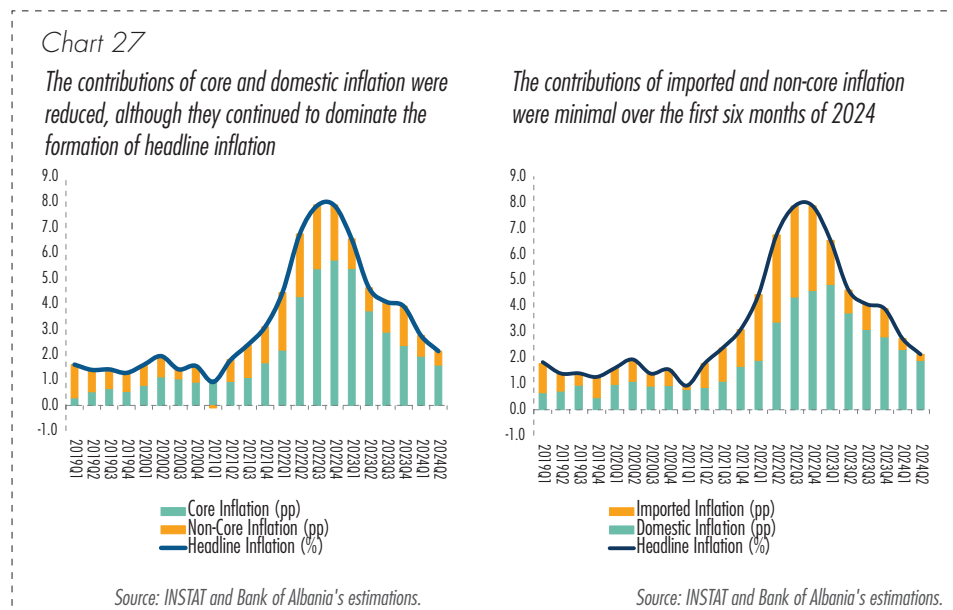
5.2. INFLATION DETERMINANTS

Economic activity continues to be in a positive stage of business cycle in the first quarter of 2024. Economic growth remains above the potential level, and the capacity utilisation rate in the economy is above the historical average. Indirect indicators suggest that employment has grown, albeit at a slower rate than in 2023. However, labour market conditions remain tight, pushing up the growth rates of nominal and real wages in the economy.

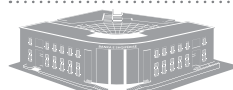
The domestic inflationary pressures have moved gradually downward. However, core and domestic inflation continue to dominate the formation of total inflation. The imported component of inflation have had considerably less contributions in the formation of total inflation in the second quarter of the year.

Inflation deceleration in 2024 Q2 was broadly based. The strongest decline were recorded by the short-term and imported components of inflation. Core and domestic inflation, gradually moved down as well, maintaining their dominant role in the formation of headline inflation (Chart 27).

Core inflation, net core inflation²⁴ and domestic inflation recorded 2.3%, 2.7% and 2.3%, respectively, during this quarter, falling by almost the same degree (0.5 percentage points) from the respective values recorded in the previous quarter. Core and domestic inflation maintained their convergence, whereas



²⁴ Core inflation is calculated by taking into account about 69.03% of the CPI basket; net core inflation that excludes processed food subgroups (including bread and grains) takes into account around 46.03% of this basket.

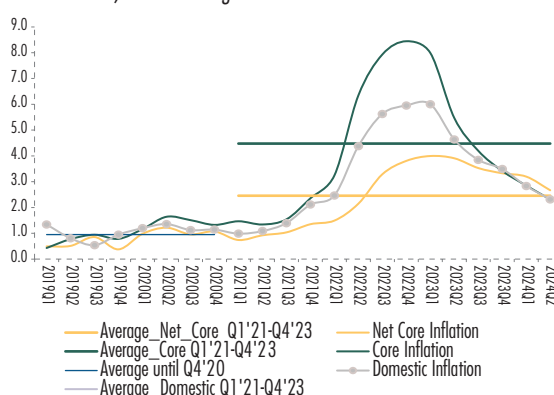


net core inflation remained above the latter ones. Although downwards, the more stable components of inflation registered higher values than headline inflation in this quarter. Furthermore, net core inflation remained slightly above the average of the past three years, reflecting the higher stability of inflation of services and other durable goods (Chart 28).

The short-term and foreign components of inflation decelerated considerably, fluctuating close to the lowest historical values. Non-core inflation and imported inflation recorded 1.7% and 1.3%, respectively, in the second quarter, dropping by 0.8 p.p. and 1 p.p. from the respective values of the previous quarter. The fall of inflation in food prices across foreign markets, and the impact of the appreciation of the exchange rate were reflected in the slowdown of inflation of these components.

Chart 28

Net core inflation slowed down and approached the average of 2021-2023*, but remaining above this value nonetheless



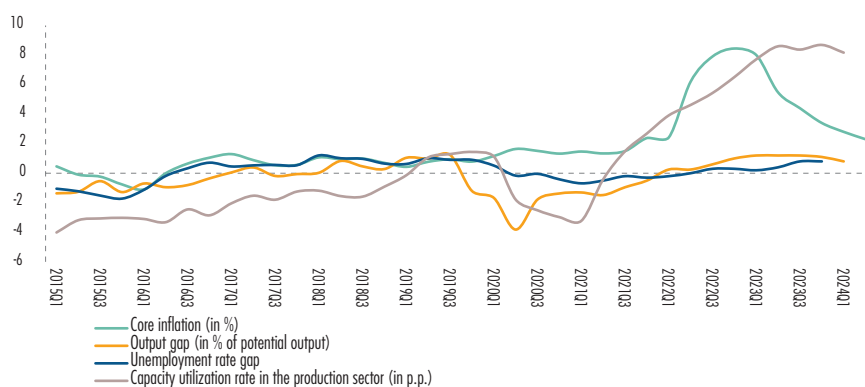
Source: INSTAT and Bank of Albania's estimations.
Note: *The sub-period 2021-2023 is taken as the later comparative reference (benchmark) with high inflation.

Although slowing down, domestic and core contributions dominated the formation of headline inflation (by 1.9 and 1.6 p.p., respectively). The domestic inflationary pressures maintained their stability, reflecting the high demand for goods and services and the increase in labour costs per unit.

The cyclical position remained at positive levels in the first quarter of 2024, as well, as it is indicated by the positive output and unemployment gaps, as well as the high levels of capacity utilisation rate (Chart 29). Domestic and long-term pressures continued to influence the formation of total inflation, a behaviour which has been present in the past two years.

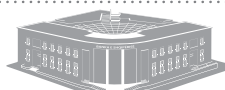
Chart 29

The cyclical position of the economy appears positive for 2023 Q4 as well for the future



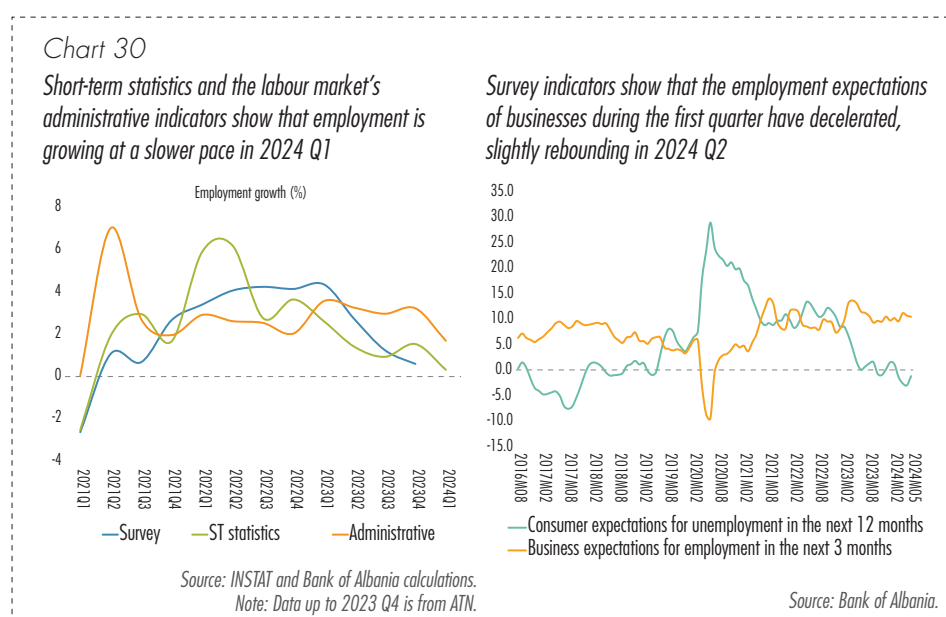
Source: INSTAT and Bank of Albania's estimations.

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



EMPLOYMENT AND UNEMPLOYMENT²⁵

The latest data available for the fourth quarter of 2023 show that employment grew by 0.6% and the unemployment rate stood at 10.7%. As the data from the Labour Force Survey are not yet available, alternative data have been used to estimate the performance of the labour market through the first half of 2024²⁶. Short-term statistics and the labour market's administrative indicators show that employment has grown at a slower pace, continuing the trend identified over 2023. In line with these trends, survey indicators show that businesses' expectations on employment have been reduced during the quarter, while the situation is assessed to have improved during the second quarter of the current year. Consumers expect lower unemployment rates over the first half of 2024.



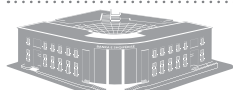
WAGES, PRODUCTIVITY AND LABOUR COSTS²⁷

The growth of wages in the private sector has accelerated again during 2024 Q1, reaching 12.7%, from 11.6% in 2023 Q4. The growth of wages continues to be broadly based across sectors. The acceleration has affected the real wages as well (Chart 31, left), as they were up by 10.0% in Q1, from 7.7% of the previous quarter.

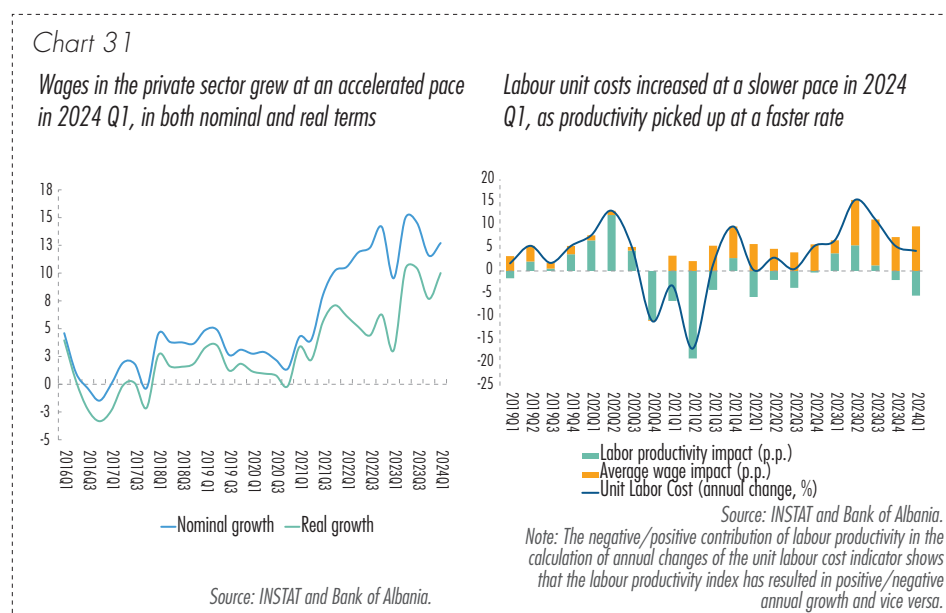
²⁵ Labour market data in 2024 Q1, which are based on the Labour Market Survey, are yet to be published by INSTAT, due to methodological changes.

²⁶ Short-term statistics and the administrative indicators of the labour market (INSTAT, 2024 Q1); Confidence Surveys (Bank of Albania, 2024 Q1 and Q2).

²⁷ Indicators of labour unit cost and of labour productivity are estimated by the Bank of Albania. They refer to the non-agricultural private sector and are calculated based on INSTAT data on the National Accounts statistics, of employment and wages. In 2024 Q1, to calculate the above indicators, short-term statistics on employment have been used instead of employment data from the Labour Force Survey, since they are not available yet. The latter expose a dynamic which is more similar to employment from the Labour Force Survey data rather than the employment dynamic according to administrative sources.



The unit labour costs expanded by 4.4%, from 5.4% in the preceding quarter. The slowdown of the growth rates was due to a more accelerated growth of labour productivity, which has offset the faster growth of real wages in the private sector (Chart 31, right).



Other production costs have continued to inch up at a decelerated pace. Producer prices rose by 2.8% during Q1, from 3.1% of the preceding quarter. For the same periods under comparison, producer prices in the domestic market expanded by 3.5%, from 4.2%, and the export ones to 0.5%, from 1.1%. Lastly, the construction cost index rose by 3.4%, from 4.1% in the previous quarter.

Imported inflationary pressures have continued to trend downward in 2024 Q2. The Imported Inflationary Pressures Index (IIPI) expanded by 3.0% during this quarter, from 3.5% in the previous quarter (Chart 32), mainly influenced by the slower rise of foreign price by 18.1%, from 19.6% in the previous quarter. On the other hand, the continuous appreciation of the nominal exchange rate has slowed down. The nominal effective appreciation was 15.1% in Q2, from 16.1% recorded last quarter²⁸.

In the same vein with the deceleration of IIPI indicators, were the contributions of imported inflation components on the formation of total inflation, which also lost their strength in the second quarter of the year. On average terms, imported inflation contributed by around 1% to the formation of headline inflation, from 14% in the previous quarter. The domestic inflationary pressures, although mitigating, remain dominant in the formation of headline inflation.

²⁸ IIPI is calculated as the annual growth of IPI and NEER for the respective month. From the correlation analysis of the relevant indicators with different time delays, IIPI anticipates the short-term developments in the imported inflation component by about 1-2 months.

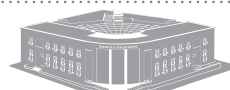
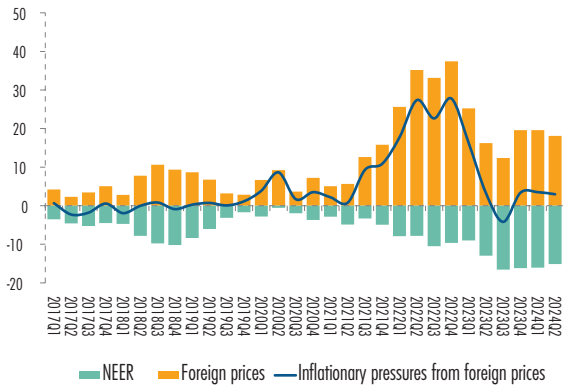


Chart 32

Imported inflationary pressures have become weaker over the first half of 2024

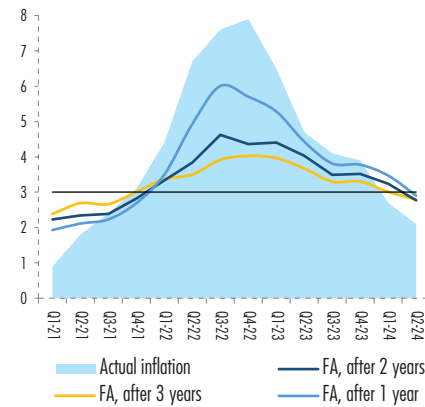


Source: INSTAT, Eurostat and estimations of the Bank of Albania.

Inflation expectations of financial agents and businesses have been revised down, while consumers' expectations have remained unchanged in the second quarter²⁹. Short-term expectations of businesses have dropped to 6.5%, against the 6.8% recorded in the previous quarter. Short-term inflation expected from consumers remains high, at 9.1% in both first two quarters of current year. This consists a 2. percentage points drop in comparison to the higher value registered in the fourth quarter of 2023 (Chart 23, left). Financial agents' expectations have been revised down and they converge to inflation target over all three time frames (Chart 33, right).

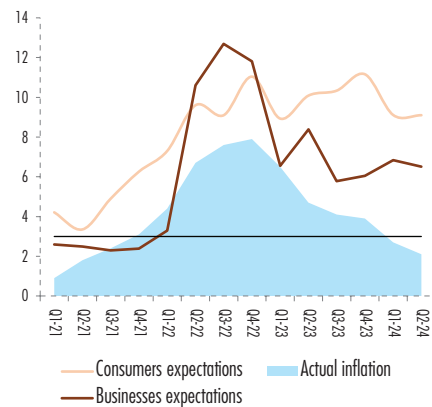
Chart 33

Businesses' expectations on inflation have fallen, while consumers have not changed their expectations



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

Financial agents' expectations on inflation over all three time horizons lean toward the 3% target



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

²⁹ The analysis on inflation expectations is based on the results of the Business and Consumer Confidence Survey, as well as on the financial agents' Expectations Survey.

