Bank of Albania

MONETARY POLICY REPORT

2025/I

MONETARY POLICY DEPARTMENT

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of the Supervisory Council of the Bank of Albania

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C O N T E N T S

INTRODUCTION[1]

The primary objective of the Bank of Albania's monetary policy is to achieve and maintain price stability. This target implies reaching low but positive inflation rates 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 an 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.

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 various elements which affect prices and to forecast inflation for 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 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 decision taking on 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 at 29 January 2025.

The Supervisory Council reviewed and adopted this Report at its meeting on 5 February 2025.

FOREWORD BY THE GOVERNOR

2024 was a positive year for the Albanian economy.

The volume of economic activity, employment, and wages have been edging up. This increase has: fuelled the expansion of consumption and improved the well-being of Albanian households, supported the financial health of businesses, and bolstered investment growth in the economy.

In parallel, the indicators of monetary and financial soundness have improved. The consumer price inflation dropped to an average of 2.2% over the past year, marking a rapid reduction from the average rate of 4.8% recorded in 2023. The return of inflation under control, after the high values recorded during the 2022-2023, preserves the purchasing power of Albanian households, cushions the value of their savings, and establishes a more transparent economic environment for businesses and their development plans. At the same time, the public debt and foreign debt of Albania have reduced, while banking sector remains sound and solid.

This panorama of positive developments reflects, among other things, the positive contribution of the monetary policy of the Bank of Albania. This policy has been and remains oriented towards maintaining price stability, implying an inflation rate around 3%, ensuring - at the same time - both the support for a sustainable growth of the economic activity and the financial stability of Albania.

In line with these objectives, the cautious increase in the policy rate that we undertook during the 2022-2023 period, in response to the rapid surge in prices in global markets and in Albania, was followed by an easing of monetary conditions in the second half of 2024. This easing, as inflation declined and the exchange rate strengthened, led to a relatively fast and stable growth in credit, thus supporting the expansion of consumption and investments in Albania.

Overall, our monetary policy has proven successful in containing inflation without undermining the positive trend of economic growth and the soundness of the financial balance sheets of the economy.

Our expectations for the future, despite the external environment is characterized by many uncertainties, remain positive. The Albanian economy is expected to grow at a stable pace in the coming years, driven by the expansion in consumption, investments, and service exports. The creation of new jobs and further rise in wages will accompany the increase in the demand for goods and services. In addition, inflation is expected to return to target in the coming quarters, suggesting a balanced and sustainable development of economic activity.

In line with these projections, we decided to maintain the current stance of monetary policy, unchanged, in this decision-making round, aiming to stabilize lending and financing conditions in the economy.

Our monetary policy, in the future as well, will continue to remain prudential and fully dedicated to guaranteeing price stability in Albania, as a necessary precondition for rapid and sustainable growth.

1. INFLATION AND MONETARY POLICY STANCE

The Albanian economy closed 2024 with improved economic and financial indicators. Inflation remained at low levels, while economic growth continued at a stable pace, as employment and wages increased. The financial environment was characterized by low interest rates, contained risk premiums, while credit growth provided a significant support to the economy.

The economic outlook is positive. Economic activity is expected to grow in line with its potential over the next two years, while inflation is projected to return to the 3% target in 2025.

[Based on current information and expectations for the future, the Supervisory Council, at the meeting of 5 February 2025, decided to keep the policy rate unchanged at 2.75%. This decision aims at maintaining the right monetary premises for ensuring that inflation returns to the 3% target.]

The international environment was characterized by a reduction in inflationary pressures, modest economic growth, and key interest rates cuts by central banks. However, monetary policy globally remains tight, unlike the situation in Albania. Financial markets expect a deceleration in interest rate cuts in the United States and a faster pace in the euro area, reflecting the divergence in economic outlooks in these two regions.

The euro area is experiencing a slow economic growth, which is expected to improve only gradually over the next two years. On the other hand, inflation increased in recent months, standing at 2.4% in December 2024, mainly due to the surge in energy prices. Though, the disinflationary process is advancing, thus enabling the European Central Bank (ECB) to cut the key interest rate. Forecasts suggest that inflation will return to the 2% target in 2025.

Uncertainty on the global outlook has increased, particularly affected by potential changes in trade and economic policies by the new U.S. government. These changes could have significant impact on global economic growth and inflation.

The Albanian economy was characterized by low inflation rates and a stable growth in economic activity, employment, and wages.

Inflation in the fourth quarter was 2.0%, bringing the annual average inflation rate to 2.2% for 2024. Volatilities in food and oil prices in the international market have directly impacted the inflation trend in Albania. The rise in these prices in recent months led inflation going up to 2.1% in December. Meanwhile, other categories showed low and balanced fluctuations throughout the months.

The decline in inflation over 2024 reflected the decrease in inflation in the external environment, the lek strengthening, and the reduction of inflationary pressures in the domestic economy. Monetary policy played an important role in this process, contributing to a better balance between demand and supply in the economy and keeping inflation expectations anchored. As a result of this contribution, core inflation has decreased, approaching its historical averages.

Economic activity grew by 4.1% in the third quarter, following a similar dynamic to the first half of the year. The increase in domestic demand and tourism exports continued to be the main factors influencing this development. This demand profile was reflected in increased activity in the services and construction sectors. On the other hand, the rise in imports and the contraction of activity in the agricultural and industrial sectors contributed negatively. Available data signals positive trends for economic activity in the last quarter of the previous year.

The growth in economic activity has been accompanied by an increase in employment and wages. Indirect data for the third quarter show an increase in employment by 1.9%[2], while the average wage has risen by 8.6%. This trend, in the presence of low inflation levels, has supported the purchasing power of Albanian households.

The financial environment has been characterized by favourable financing conditions, and bank credit has supported the growth of consumption and investment. Financing conditions have improved due to the easing of monetary policy, the willingness of banks to lend to households and businesses, as well as the deceleration of exchange rate appreciation. As a result of these favourable conditions and increased demand, credit to the private sector grew by 15.8% in 2024 Q4. This increase in credit has financed the needs of households and businesses for consumption and investments, by maintaining a balanced currency composition and ensuring good portfolio quality. These characteristics suggest that credit growth will continue to be sound and aligned with the needs of the economy.

Positive developments in both the real and financial sectors of the economy create the right foundations for the sustainable economic growth in the medium term.

Economic activity is expected to grow in line with its potential over the next two years, while inflation is projected to return to the 3% target in 2025. Economic growth, supported by the strong financial position of the private sector, favourable financing conditions, credit growth, and the strong confidence

2 *Official data from the labour market survey remains unavailable, and the analysis is based on administrative data for the third quarter.*

of economic agents, is expected to reflect the expansion of consumption, investments, and tourism. Furthermore, foreign demand for Albanian services, especially in tourism, is expected to continue contributing to economic growth. In parallel, inflation return to the target will underpin the purchasing power of households and create a more stable environment for businesses.

The return of inflation to the target is expected to be supported by: (i) the normalization of imported inflation, which is expected to be affected by the stabilization of commodity prices in international markets – mainly food and oil – and the more moderate appreciation of the exchange rate; and (ii) the alignment of the economy with its production potential and the anchoring of inflation expectations, which are expected to keep domestic economic pressures at stable levels. In 2025, inflation is expected to decrease as a result of the government's decision to lower electricity prices for households with consumption below 700 kWh. In the absence of repeats, the effect of this decision will be present throughout the year.

The global factor remains a source of uncertainty for the future, particularly in the presence of ongoing geopolitical tensions and heightened uncertainty regarding trade and economic policies.

In line with the above analysis and forecasts, the Supervisory Council decided to keep the policy rate unchanged at 2.75%. In its judgement, the financial conditions in the economy are adequate to support the return of inflation to the target during 2025.

Future monetary policy decisions will always be in fulfilment of the main objective: achieving price stability. They will be new data-guided, aiming to react in timely manner and on the right side, both to the overall balance of inflationary pressures and to possible domestic and external shocks.

2. EXTERNAL ENVIRONMENT

The global economic activity picked up speed over the third quarter of 2024, although its upward trend remains low and differences between regions have increased. High-frequency data in the euro area suggest that economic growth is slow in the fourth quarter as well.

Meanwhile, global inflation rose slightly over the fourth quarter, following very low figures in September. Besides specific factors, a common element that affected the rise of global inflation was the increase in energy prices. However, the disinflation process is moving forward shifting central banks' attention to the weaker economic growth and its implications on future inflation. Against this backdrop, central banks in advanced economies continued to reduce the policy rate in the last quarter of 2024.

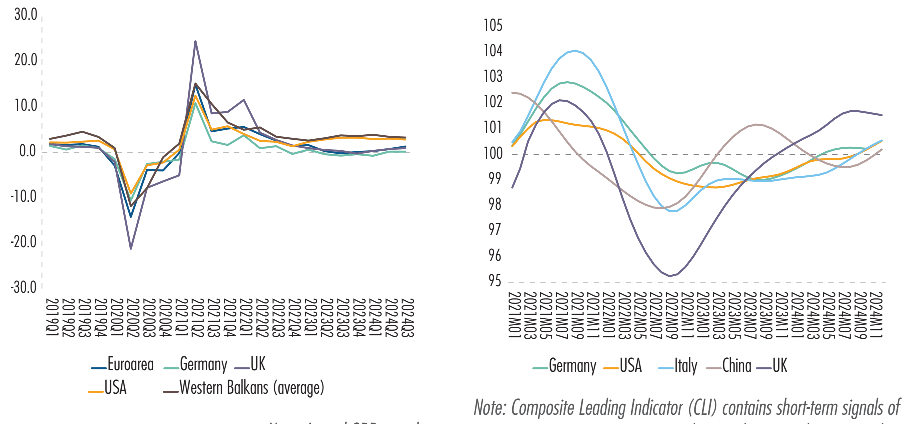
2.1. ECONOMIC ENVIRONMENT

During the third quarter of 2024, the global economic activity accelerated slightly. The euro area economy expanded by 1.25%, marking a noticeable improvement compared to the 0.7% growth recorded in the second quarter and the forecasts. However, this growth is considered a temporary positive development, as expectations point to a potential slowdown over the fourth quarter. Also, the United Kingdom continues to face a sluggish economic growth (0.9%), lagging behind the pace of other main advanced economies. Whereas, the economy of United States maintained a sustained growth rate, expanding at 2.8% in Q3, slightly below the 3.0% recorded in Q2. With this sustainable economic growth, the US has surpassed its European counterparts.

Chart 1

Economic activity has slightly improved over 2024 Q3...

...preceding indicators show that the euro area performance is slower, and that of US higher



Note: Annual GDP growth.
Source: Respective statistical institutes.

Note: Composite Leading Indicator (CLI) contains short-term signals of qualitative changes in business cycles.
Source: OECD.

Inflation rates have experienced an upward trend over the fourth quarter, following very low levels recorded in September. The expansion of inflationary pressures in the euro area reflected an acceleration of unprocessed food price inflation and the rise in energy prices. In the United Kingdom, inflation expansion is related to food and specific core-inflation components (mainly services). Meanwhile, the rise of inflation in the US has been primarily affected by the rise in energy prices.

Short-term inflation fluctuations have not changed central banks' forecasts regarding its return to their target. Therefore, central banks of advanced economies have continued to ease monetary policy. This easing have also taken into consideration the slow economic recovery, which becomes a premise for weak inflationary pressures in the future. In this framework, the ECB, the Federal Reserve and the Bank of England reduced their key rates following their fourth-quarter meetings. Regardless, the monetary policy in these economies remains restricted.

The global economic activity is expected to maintain a positive growth pace in the medium term. According to the latest evaluations conducted in December 2024[3], the global economic activity is expected to expand by 2.6% in 2024, 2025 and by 2.5% in 2026. The growth pace is expected to accelerate in the EU, Asia and the Pacific and in advanced economies in Africa and the Middle East. On the other hand, a slower growth is expected in North America and Eastern Europe.

Inflation is expected to follow a downward trajectory in the upcoming two years. Global inflation rates are expected to be 2.9% in 2025; 2.6% in 2026; downward compared to the 3.8% recorded in 2024. This decelerating trend is noticeable in all countries around the world, albeit being more pronounced in the areas of east Europe, Latin America and other major economies in Asia and Africa.

EURO AREA ECONOMY

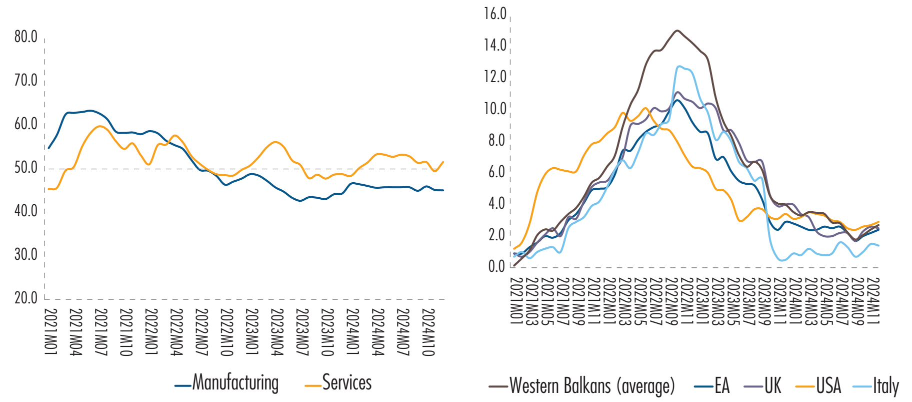
The euro area economy expanded by 1.25% in annual terms in 2024 Q3, accelerating from the previous quarter and exceeding expectations. The acceleration is related to higher consumption driven by tourism during the summer and the accumulation of inventories. On the other hand, preceding indicators point to a deceleration of growth in the fourth quarter, due to the contraction of industry and the slower increase of services. Firms are reluctant to invest because demand is sluggish and uncertainty for the future has increased.

The labour market has maintained its stability as unemployment rates remain low (recording 6.3% in November) and wages continue to grow. However, demand for labour has grown at a slower pace, and expectations for new job vacancies are lower in the fourth quarter.

[3] *Referring to evaluation published in the monthly "Consensus Forecast," January 2025.*

Chart 2

Economic activity has slowed down in 2024 Q4... *...whereas inflation has had an increasing tendency*



Note: Survey indicators on enterprises which signal the progress of economic activity in the short-term.
Source: PMI indices.

Source: Eurostat, national statistics institutes.

Inflation in the euro area has accelerated to 2.4% in December 2024, following the low value of 1.7% recorded in September. The upward trend of the past months is related mainly to the high price inflation of unprocessed food items and the slower decrease of energy prices, particularly oil.

In the latest macroeconomic forecasts of the ECB[4], economic growth has been revised slightly downward for 2024 and 2025, whereas inflation expectations have remained unchanged. Inflation is expected to return to the target by 2025.

REGIONAL ECONOMIES[5]

Growth in the regional economies have been relatively high and stable over 2024 Q3. Kosovo's economy grew by 4.1%, supported mainly by the strong growth of investments and exports, and a slowdown in private consumption. In North Macedonia, economic growth registered 3.0%, similar to the figure of the previous quarter, with positive contributions from private and public consumption. On the other hand, investments seem to have been sluggish, whereas exports' contribution was missing. In Serbia, growth rates have slowed down from 4.2% in Q2 to 3.1% in Q3. The slower economic growth is related to the performance of public and private consumption, as well as exports, whereas investment growth remained high and stable.

The inflation rate trends in Q4 reflected the various dynamics among regional countries. In Albania and Serbia inflation has remained stable, whereas it has slowed down in Kosovo, reflecting mainly the negative contribution from the energy products. In North Macedonia, on the contrary, inflation has picked up, mainly as a result of the increase of food prices.

4 *The ECB staff projections expect the economy to grow 0.7% in 2024 and 1.1% in 2025. The average inflation for 2025 and 2026 is expected to be 2.1% and 1.9% (Source: ECB staff macroeconomic projections, December 2024).*

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

The 2025 forecasts show that inflation trend in the regional countries is on the decline, whereas economic growth is expected to be more stable and sustainable compared to 2024.

Table 1 Economic indicators for main trading partner countries

	Annual change of GDP p.p.		Annual inflation (%)		Unemployment, in %
	2024 Q2	2024 Q3	2024 Q3	2024 Q4	Latest publication
Italy	0.9	0.8	1.2	1.3	5.7
Greece	2.6	2.5	3.1	3.0	9.6
Kosovo	4.3	4.1	1.3	0.7	10.7
North Macedonia	2.8	3.0	2.6	4.1	12.3
Serbia	4.2	3.1	4.3	4.4	8.1
Albania	4.0	4.1	2.0	2.0	10.7

Source: Respective statistical institutes.

2.2. COMMODITY PRICES IN GLOBAL MARKETS

Commodity price index[6] has decreased during the last quarter of 2024, dropping by 4.4% in annual terms. This performance was mainly a reflection of the fall in the prices of energy and food, as supply was high and global demand was low. Throughout 2024, commodity prices in global markets have declined by 2.7%. Their future performance will be affected by geopolitical tensions in the Middle East and Ukraine, as well as the higher level of uncertainty of trade and economic policies.

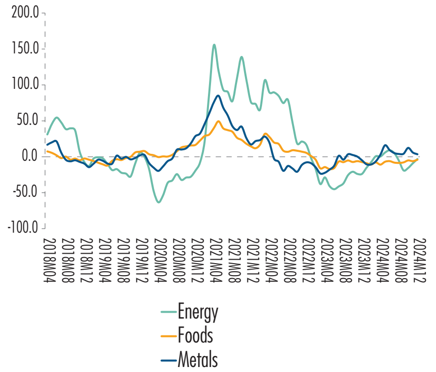
Brent crude oil stood at $74.6 per barrel in the last quarter of the year. After reaching its lowest level in September, this price rose over the last quarters. However, the annual rate of decline for this quarter has accelerated, reaching 11.2%, whereas over the course of 2024, this decline was 2.3%. The fall in oil prices over the year stemmed from a weak global demand, particularly that of China, as well as the continuing increase of supply from producing non-OPEC countries. This trend is expected to continue over 2025 as well[7].

Food Price Index has contracted in annual terms by 5.1% in the last quarter, a slower decline compared to the previous quarter. The falling dynamics in the price of food continues to reflect the faster expansion of supply against demand for food items globally. However, specific products such as cacao or coffee have recorded higher prices as a result of the weather conditions.

[6] *Monthly frequency indices published by the World Bank.*
[7] *US Energy Information Administration, Short term Energy Outlook, January 2025.*

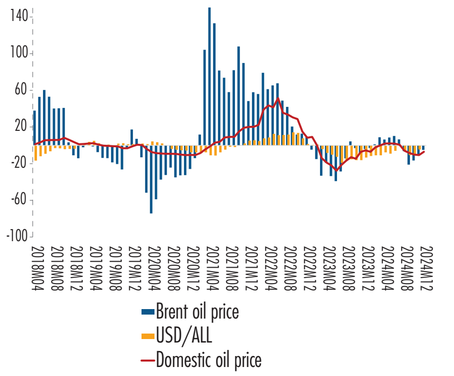
Chart 3

A faster expansion of supply has brought a declining trend in commodity prices globally



Note: Main commodity price indices, annual change (%)
Source: World Bank

The fall of oil prices abroad has been reflected in lower oil prices domestically



Note: Indicators annual changes Oil price in Albania is approximated to the oil price in consumer basket.
Source: INSTAT, staff estimates

2.3. INTEREST RATES

The central banks of large economies have continued to ease their monetary policy. The ECB lowered the key interest rate[8] twice (at a total of 50 basis points) in 2024 Q4, down to 3.0%. Monetary policy continued to ease in the euro area because inflation is expected to return to its 2% target and the economy is deemed to be fragile. The Federal Reserve has lowered the key rate twice (from 5% to 4.50%) in November and December, whereas Bank of England lowered its key rate in November (from 5% to 4.75%), reflecting the downward inflationary trend in the economy.

Despite the continued easing of the monetary policy, financing conditions in the economy remained restrictive. From a historical perspective, the cost of new loans in the euro area remained particularly high, while lending standards from banks operating in this region are still considerably restrictive.

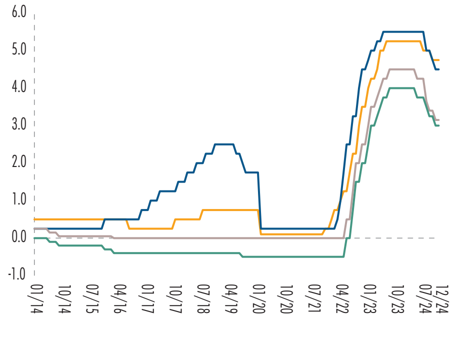
By the end of last year, markets expected a gradual reduction of key interest rates from the main central banks, which increased the yields on government securities of the most prominent economies. Yields on 2-year and 10-year government securities in the euro area and the US have increased over the past months.

The higher level of uncertainty regarding trade and economic policies, following the US elections, and divergences on growth expectations between the euro area and the US will have an impact on financial markets in the future. However, until now, the higher macroeconomic uncertainty has not translated in higher financial market volatility.

[8] *In March 2024, the Governing Council of the ECB decided to steer the monetary policy stance through the deposit facility rate.*

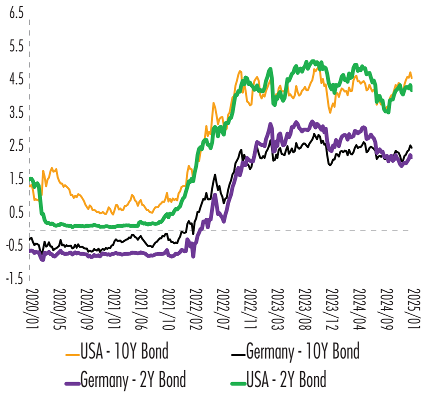
Chart 4

ECB reduced the key rate twice in September and October



Notes: Policy rates for main large central banks with impact on international markets
Source: Respective central banks.

Yields have gone up slightly in December



Notes: 2 and 10-Year yields on government securities
Source: Respective central banks.

3. FINANCIAL MARKETS AND CREDIT CONDITIONS

In 2024 Q4, monetary policy stance eased, which was also reflected by interest rate cuts across all financial market segments. Risk premia have remained low, as shown by the low spreads between interest rates and policy rate and each other. The appreciating pressures on domestic currency have been more moderate, whereas trading conditions in the foreign currency market have been mild and volumes have continued to grow.

In the same line with the eased financing conditions, credit to the private sector has continued to expand at a high pace. The expansion of credit remains closely related to financing investment, and it is supported by the growth of loans in lek.

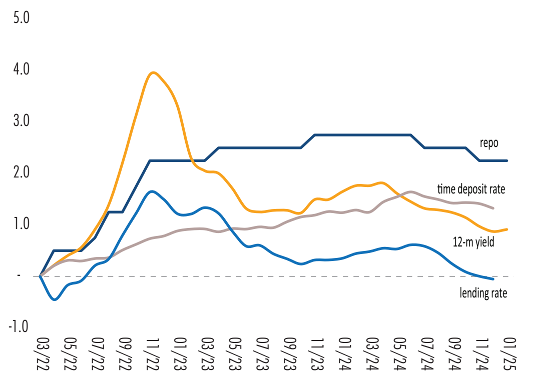
3.1. DOMESTIC FINANCIAL MARKET[9]

Monetary policy easing has been broadly reflected in the financial market over the course of the fourth quarter of 2024. Interest rates, first in the interbank and primary government securities market and later in the segment of credit and deposits, have been declining. Low liquidity and credit risk premiums continue to dominate the market, reflected in the narrow spread between yields and other interest rates compared to the policy rate and between each other.

The lowering of policy rate at the beginning of November has been fully transmitted to the interbank market rate. They remained anchored close to the policy rate and have experienced minimum volatility[10]. The narrow spread from this rate reflected a calm environment, free of additional liquidity pressures. The liquidity deficit in the banking system is adequate, allowing for a satisfactory transmission of the monetary policy. The Bank of Albania continued to supply the system with liquidity through its main instrument the one-week repo, as well as the three-month repos, where the injected amount this quarter was lower than the third quarter of the year[11].

Chart 5

Interest rates drop have been broadly based, reflecting the lower policy rate

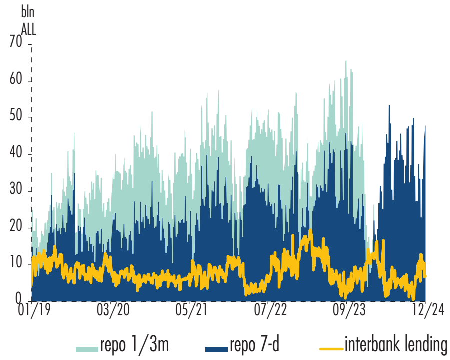


Note: cumulative changes since March 2022 in interest rates in lek: Repo, 12-month bonds, time deposits and loans.
Source: Bank of Albania.

9 The following analysis is based on the data available up to 30 October 2024.
10 Standard deviation of overnight and one-week interbank market rate in Q4 was 0.12, from 0.09 in Q3.
11 Liquidity injected in Q4 through 7-day and one- to three-month repos were ALL 50 bln, dropping from ALL 59 bln in Q3.

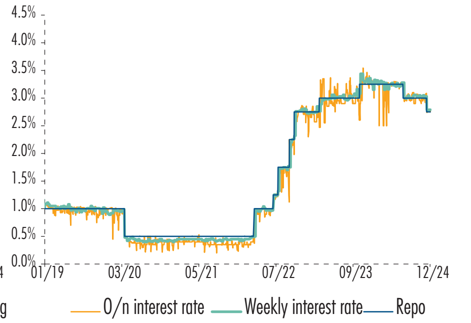
Chart 6

The liquid situation of banks in the past quarter remains stable



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.

Interbank market rates have reflected changes to the policy rate



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

Lek performance in the fourth quarter of the year is still driven by appreciating pressures. Lek appreciation against the Euro was present during October and November, where the EUR/ALL exchange rate dropped at ALL/EUR 98.7 and ALL/EUR 98.2, respectively, from ALL/EUR 99.4 in September. Pressures appear more contained since the end of November, which is reflected in the stability of the exchange rate over the month of December and the first weeks of January. In annual terms, the appreciation of lek has been more moderate, dropping to 4.4% in December, from 7.0% in September.

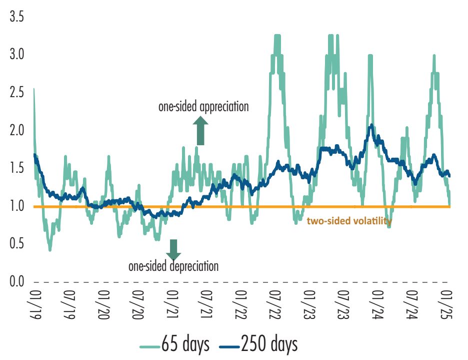
** The appreciation/depreciation bias is calculated as the ratio of the number of days when the exchange rate is appreciated against the number of days when the exchange rate is depreciated, over a moving time horizon that may vary, e.g. from 22 days (one calendar month) up to 250 days (one calendar year). The value of this indicator near 1 indicates an equal number of cases of appreciation and depreciation and it shows that there are no one-sided pressures for appreciation or depreciation. If the value of this indicator is above 1 (below 1), then in the market there are signals for one-sided expectations for exchange rate appreciation (depreciation).*

Chart 7

Lek has appreciated against the euro and has depreciated against US dollar

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

Appreciating pressures are still present, albeit at more moderate levels compared to last year



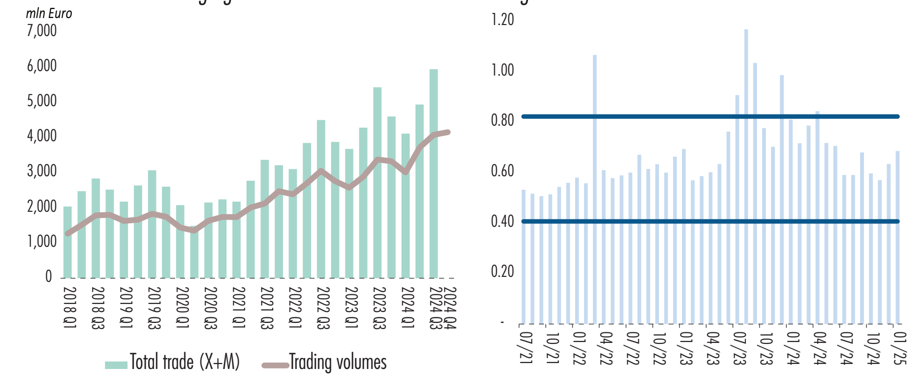
Notes: The data reflect the appreciation/depreciation bias.*
Source: Bank of Albania.

Volumes in the foreign exchange market have increased, in line with the growth in international trade exchanges in goods and services, as well as by normal trading conditions. Thus, trade volumes grew by 25.0% year-on-year in Q4, maintaining the high double-digit figures that were present in 2024. At the same time, volatility and spreads between the selling and buying quotes for the euro have resulted within their normal range.

Chart 8

Trading volumes in the foreign exchange market have continued their double-digit growth

Quotation spreads have resulted within their normal range



Notes: The data presents the quarterly trading volumes in the foreign exchange market and the value of trade in goods and services (imports + exports), in EUR mln.
Source: Bank of Albania.

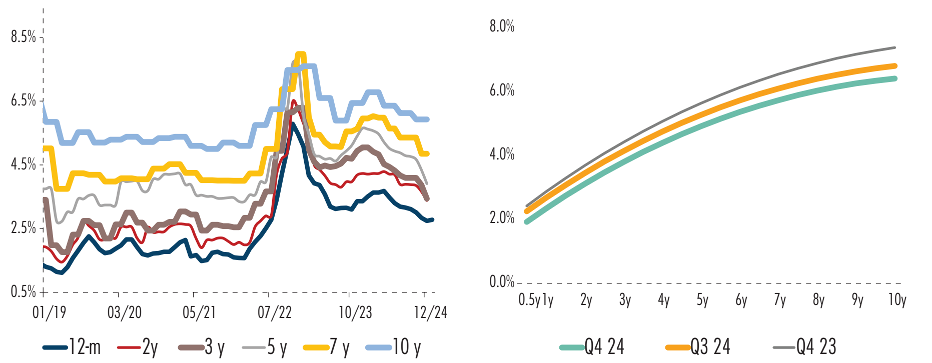
Notes: The chart shows the spread between the quotations of the bid/ask price of euro, monthly average. The interval is calculated as an average +/- standard deviation.
Source: Bank of Albania.

Lek has depreciated against the **US dollar** in Q4 owing to the appreciation of the latter in the international market. The USD/ALL exchange rate climbed to 93.9 ALL/USD in December, from 89.4 ALL/USD in September. The annual appreciation of lek against the US dollar has dropped significantly over the course of three months, approaching zero in December. The depreciation of lek against the USD has continued in the first month of January, where USD/ALL exchange rate has fluctuated around an average of 94.9 ALL/USD, a level slightly below that of the same period last year.

Chart 9

Yield performance reflects the lower policy rate and minimal pressures in this segment

The yield curve has shifted downwards and flattened compared to the previous year



Note: The data show the interest rates (monthly averages) of both T-bills and bonds issued in the primary market.
Source: Bank of Albania.

Note: The data show the interest rates (monthly averages) of government debt securities according to different maturities, calculated using the Nelson-Siegel model.
Source: Bank of Albania.

Yields on T-bills and bonds in the primary market continued to follow the downward trajectory in the last quarter of the past year as well. Beyond reflecting the monetary policy decisions, the yield trend during this period also indicates minimal liquidity pressures in the market. Yields performance was determined by a lack of financial pressures from government as well as a high demand[12] from banks in the primary market. Meanwhile, as yield margins continue to contract above the policy rate, as well as in between maturities, there is an overall improvement in risk perception. Yield on 12-month T-bills during this quarter was on average 2.8%, from 3.2% in the previous quarter. Yields on bonds have also dropped down over this month. Yields on 3-, 5-, 7-, 10-, and 15-year bonds were 3.4%, 3.9%, 4.8%, 5.9% and 6.4%, each, dropping on average by 0.6 p.p. from Q3 (September 2024). The yield curve has reflected the abovementioned developments by moving downwards, in line with the decrease of policy rate, and appearing less slanted compared to last year.

3.2. CREDIT CONDITIONS

Interest rates on new loans and deposits dropped in 2024 Q4, further reflecting the latest policy rate cut in November. As the cost of financing sources for banks (i.e., borrowing from Bank of Albania and deposits) became cheaper, the low interest rates on loans reflect the tight risk premia as well. The difference between the interest rate and the 12-month bond fluctuated around its minimal level of 3.3% in the past two years. Households are a driving factor behind the higher competitiveness between banks and their propensity to provide more flexible credit conditions to them. This has been reflected in a faster decline of their interest rates compared to enterprises.

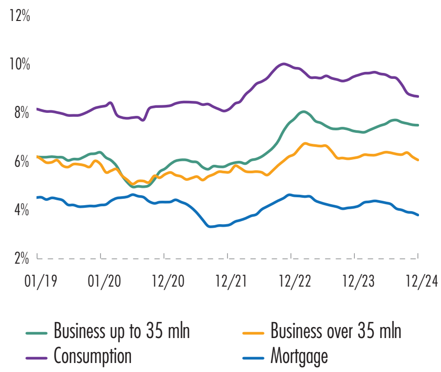
The average interest rate on new loans in lek to enterprises in Q4 was 6.4%, from 6.5% and 6.8% in Q3 and Q2, respectively, this year. The analysis of loan interest rates based on the loan amount shows that both categories have recorded lower interests. Interest rates on loans above ALL 35 million stood at 7.4%, or down by 0.2 p.p. than the previous quarter. The average interest rate on loans of a larger amount have dropped by the same degree, recording 5.9%.

The drop in the loan rates is more noticeable in the segment of households, as the interest rate has started to fall since the second quarter of last year. Interest rate on mortgage loans for households recorded 3.7% in Q4, falling by 0.2 p.p. for the second consecutive quarter. Interest rate on consumer laons fell by 0.3 p.p. during this quarter, dropping to 8.5%.

[12] *The bid/cover indicator for T-bills and bond auctions was 1.7 in the fourth quarter, compared to 1.3 in the third quarter.*

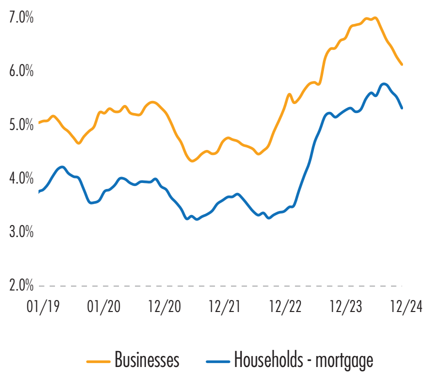
Chart 10

Interest rates on loans in lek decreased in the fourth quarter, reflecting the change in the policy rate



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

Interest rates on loans in euro have been declining since the second half of last year

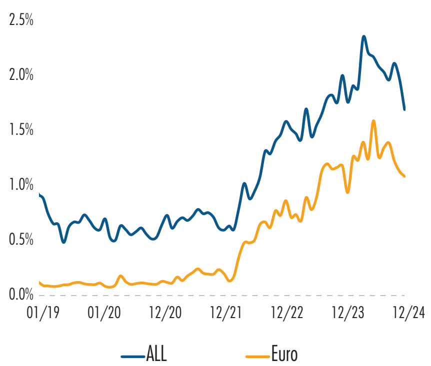


Note: Interest rates of new loans in euro as 6-months moving average.
Source: Bank of Albania.

The interest rates on loans in euro have continued to fall during the fourth quarter of last year. The monetary policy easing from the ECB has been reflected upon the reference rates of euro in the international market, driving down the interest rates on loans in euro in Albania from August onward. The average interest rate on new loans in euro to enterprises stood at 6.1% in Q4, from 6.2% and 7.0%, respectively during Q3 and first half of the year. Meanwhile, the average interest rate on mortgage loans in euro to households, after a marginal reduction in the preceding quarter, has dropped to 4.9% in Q4. The interest rate spread for enterprises has shifted into positive territory over the last two quarters of the year, leading to the growth of loans in euro over this period. This spread remains negative for financing house purchases, but it has contracted to 1.2 percentage points in the fourth quarter.

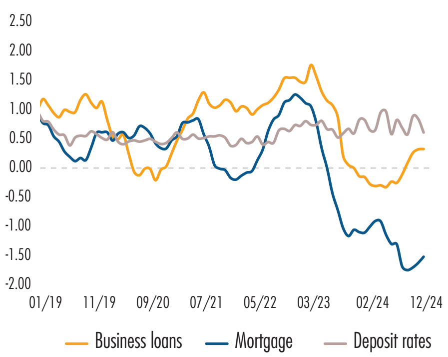
Chart 11

Interest rates on time deposits have decreased, both for lek and for euro, reflecting signals from the monetary policies of central banks



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

The lek/euro interest rate spread for mortgages has narrowed down, and remained stable 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.

Interest rates on deposits in both lek and euro also decreased in the fourth quarter of the year. The average interest rates on deposits in lek was 1.9%, from 2.0% and 2.2% which was respectively in the third and second quarter of the year. The fall of deposit rates during this quarter was more pronounced on maturities up to one year. In a similar fashion, the average rate on deposits in euro has dropped to 1.1% in Q4, down from an average of 1.4% in the two preceding quarters. The spread between interest rates on deposits in lek and euro remains positive and stable.

BOX 1:

CREDIT SUPPLY CONDITIONS AND DEMAND FOR LOANS IN Q4[13]

The credit supply conditions in the last quarter of 2024 did not experience essential changes from the previous quarter. However, banks approved a high number of loan applications from both households and enterprises, due to the heightened competition in the banking sector and banks' perception on current and expected developments in some specific sectors of the economy. Demand for loans to finance investments, working capital, and house purchases as well as consumer loans, remained high.

For the seven quarter in a row, banks did not change credit criteria on loans to enterprises over the last quarter of 2024 either. The lending policy framework indicates that credit standards remained unchanged, by business size and purpose of use. Credit terms and conditions did not change either from the previous quarter. Banks adopted lower margins on loans granted to enterprises over this quarter, driven by the low risk premia and a low-interest rate environment in both the domestic and foreign market. The lower margins were counterbalanced by higher loan covenants. Banks financed a higher number of loans to enterprises compared to the previous quarter, after conducting assessments on the financial situation of enterprises and the risk perception on current and expected developments in specific sectors of the economy.

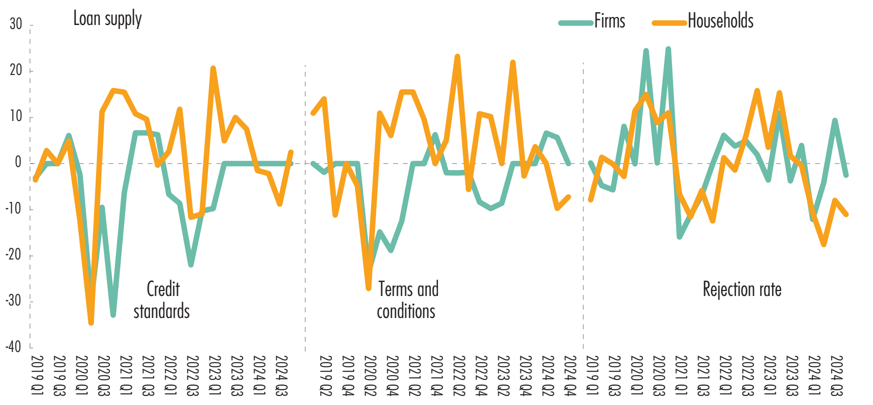
The approach of banks regarding lending to households in the last quarter was somewhat easier than the previous quarter, as credit standards on consumer loans specifically, were eased. Only one bank tightened its credit terms and conditions during this quarter as in the previous quarter, due to additional monitoring on some types of loans to households. However, banks reported declining margins on loans, mainly on consumer loans, due to the competitive environment in the banking sector. The loan rejection rate reduced in the fourth quarter, as a result of the banks' assessments on the borrowers' quality.

Loan demand from enterprises was high for all categories of businesses and all types of purpose of use. The balance of demand for loans was particularly high from the segment of small and medium-sized enterprises, for loans granted for the purpose of financing investments and covering liquidity

[13] *The analysis is based on Bank Lending Survey, conducted on quarterly bases and is published at Bank Lending Survey*

Chart 1 Box 1

Loan supply conditions remained almost unchanged compared to the previous quarter



Source: Bank of Albania.

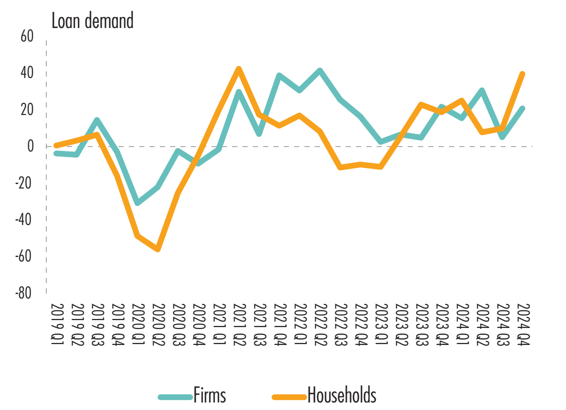
Values on the chart represent net balances. Positive values indicate easing of terms and conditions and vice versa. Positive values indicate increase of the scale of application refusal and vice-versa.

needs. Enterprises' demand for financing from the banking sector, despite the increased need for financing during the quarter, was also affected by the perception on the macroeconomic outlook in the domestic market[14] and the favourable interest rates. Additionally, the continuation of an expanding cycle of production capacities in Albania, driven in part by the improvement in business confidence, continues to generate high demand for loans.

Banks reported an increasing loan demand from households, recording the highest net balance of the past years. The higher financing needs for house purchases and consumption, were supported by a low-interest rate environment in both domestic currency and the euro.

Chart 2 Box 1

The demand for loans was on the rise across all segments



Source: Bank of Albania.

Values on the chart are calculated as net percentage. Positive values show increase of loan demand, while negative values show its decrease.

[14] *This indicator recorded the highest net balance of the past eight years.*

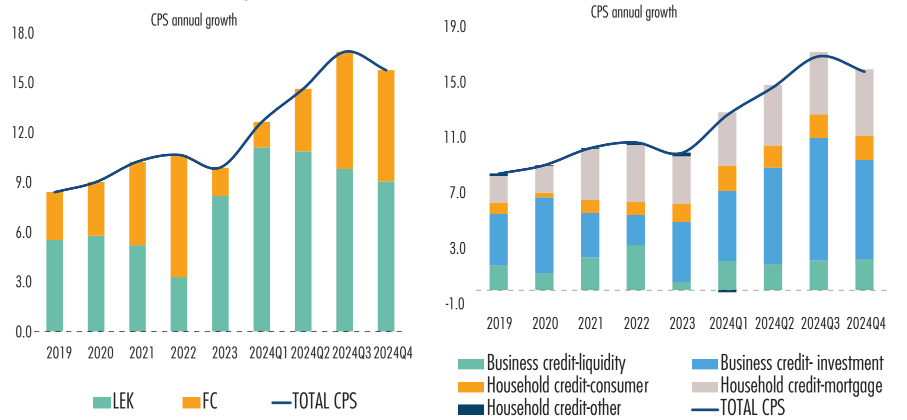
1.2. CREDIT TO THE PRIVATE SECTOR[15]

Credit to the private sector has continued to grow at a high rate in the fourth quarter of the year as well. Its annual growth rate of 15.8% was close to the level recorded in the previous quarter of 16.3%. The positive performance of the lending activity of banks has increased the credit-to-GDP ratio to 31.5%, up by around 1.5 percentage points than last year. The easier financing conditions,

[15] *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.*

economic activity expansion from economic agents, and banks' willingness to provide funding have supported the increase in financial intermediation.

Chart 12
Credit to the private sector continues to expand at a high pace, supported by all the categories, particularly from credit for investment and lending in lek



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.

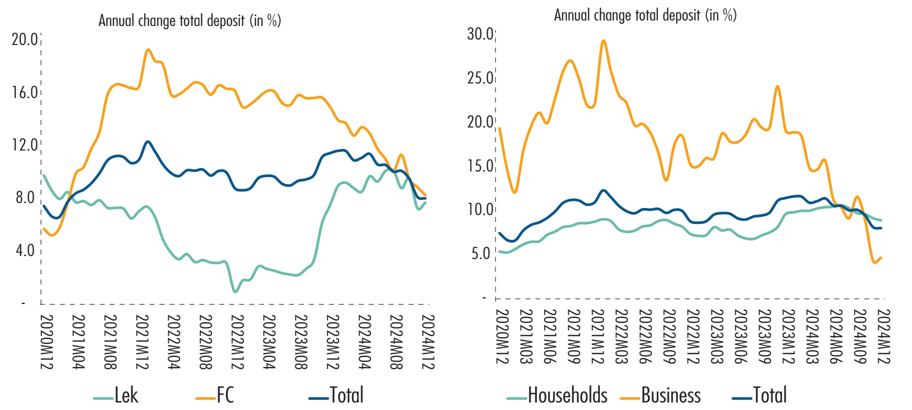
The expansion of credit was supported by all sectors which continue to register high growth rates. However, the growth rate of credit to enterprises was slightly down compared to last quarter, at 16.1%, whereas credit to households was slightly up at 15.3%. Overall, credit for investments remains the main contributor to the expansion of lending activity throughout the year, although in the last quarter it has provided a somewhat lower contribution. More specifically, loans to enterprises for investments have grown by 22.2% on average. Meanwhile, the annual growth rate of loans granted to households for house purchases improved up to 18%. Whilst, both loans for liquidity (with an annual growth rate of 7.5%) and consumption to enterprises (with a 16.2% annual growth) have maintained the same level of contribution as in the third quarter.

The composition of credit portfolio by currency confirms the highest share of loans in lek, at 57.3% of the total. Meanwhile, the dynamic of lending indicates the increase of loans in foreign currency by 15.5% in the last quarter, a slightly higher rate than in the previous quarter. The rapid expansion of euro-denominated loans during the second half of 2024 reflected both the declining cost of these loans, the demand from large businesses, and their use in financing large project investments.

On the liability side of banks' balance sheets, there has been a slower increase in deposits, which has returned to the average annual growth rate of the past five year. Total deposits in the private sector increased by around 8.6%, or 1.7 percentage points lower than in the third quarter. This slowdown reflects, on one hand, the lower amount of foreign currency flows deposited with banks, as well as the statistical effect of the increase in lek-denominated deposits. Thus, foreign currency deposits experirnced the lowest growth of the year at 9%, driven by a slower rise in households' foreign currency deposits and liquidity withdrawals by enterprises throughout the quarter[16]. The growth rates of this segment have shown a significant slowdown, reaching the lowest historical value of 2.8% year-on-year in December. Meanwhile, deposits in lek increased by around ALL 37 billion during the last quarter, in line with seasonal behaviour. Their annual growth rate of 8.2%, although lower than the growth recorded during the first quarters of the year, remains significantly higher than it was a year ago.

Chart 13

Deposits have shown a slowdown in growth rates, reflecting slower performance across all categories. This slowdown has been more pronounced in foreign currency deposits and for enterprises



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

According to economic agents, households deposits grew at slightly lower rates than previously, by 9%. Meanwhile, there has been a sharp slowdown in the deposits of enterprises, which grew by 6% from 14% in the first half of the year. Despite this, the liquidity level of enterprises deposits with banks remains high, accounting for about 20.2% of the total. The maturity structure of deposits has shifted towards demand deposits, which now account for about 55.7% of the total, or 0.2 percentage points more than the previous quarter. This trend reflects the decline in return rates on deposits both in lek and in the euro, leading to a return of the tendency to place them in highly liquid deposits. Meanwhile, the performance of deposits with maturities of up to two years has remained more stable, with a growth rate of 6%, closely aligned with the average of recent years.

[16] *In contrast to their previous behaviour, enterprises withdrew around ALL 17 billion from their foreign currency deposits with banks in the fourth quarter.*

4. ECONOMIC GROWTH

In 2024 Q3, the Albanian economy recorded an annual growth of 4.1%, a similar rate with that in the previous quarter. Economic growth was driven by domestic demand, supported in particular by public investments and private consumption. Net foreign demand contributed negatively, mainly due to the increase in the import of goods. On the other hand, overall exports have expanded, influenced by the growth in the export of services, while goods exports have declined.

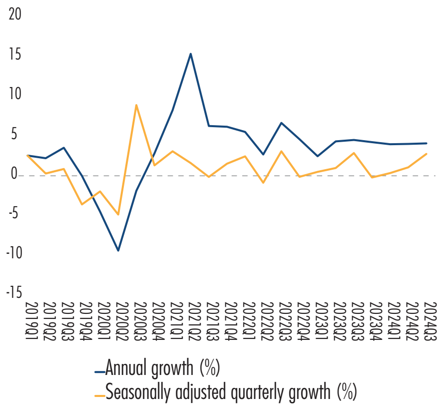
Available data suggest a similar economic performance in the last quarter of the year.

4.1. GROSS DOMESTIC PRODUCT

Gross Domestic Product (GDP) grew by 4.1% in 2024 Q3, at a similar rate recorded in the previous quarter (Chart 14, left). The main drivers of economic growth were "Public administration, Education, Health", "Trade, Transportation, Accommodation, and Food Services," and "Professional and Technical activities" and "Construction" (Chart 14, right). The rest of the sub-sectors of services have contributed positively as well. On the other hand, the "Agriculture" and "Industry" sectors had a negative contribution to economic growth. Negative contributions were observed from both "Mining" and "Processing" branches.

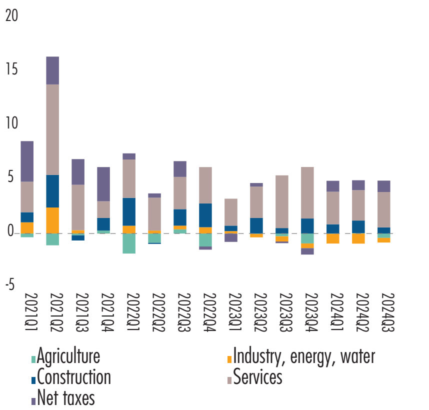
Chart 14

Economic growth in the third quarter has been similar to that of previous quarter



Source: INSTAT and Bank of Albania.

The positive contributions of "Services" and "Construction" underpinned the economic growth



Source: INSTAT and Bank of Albania.

The contribution of production sector to economic growth in 2024 Q3 was negative, marking -0.3 percentage points. This result was driven by the contraction of the "Agriculture" and "Industry" sectors (Chart 14, right). "Agriculture" declined by 2.5% during this quarter, while "Industry" shrank by 4.0%. On the other hand, the "Construction" sector contributed positively, marking a growth of 5.3%, which translates into a 0.6 percentage point contribution to the total economic growth. However, both the growth and contribution of "Construction" slowed compared to the previous quarter.

The services sector contributed by 3.3 percentage points to economic growth during the third quarter, showing an improvement compared to the previous quarter. The main contributing sub-sectors were "Trade, transportation, accommodation, and food services," "Public administration, defence, education, and health," and "Professional and technical activities." Meanwhile, other service branches provided lower albeit positive contributions.

Additionally, "net taxes" played a significant role in economic growth, adding 1.1 percentage points to the total increase.

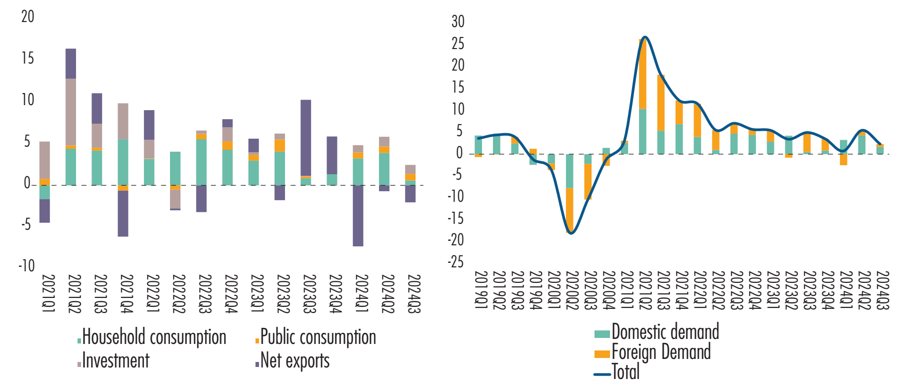
4.2. AGGREGATE DEMAND

Economic growth was mainly supported by domestic demand, primarily driven by investments (Chart 15, left). Public investments were mainly the main contributors to investments growth. Regarding private consumption, growth was lower compared to 2024 H1. On the other hand, public consumption growth remains high and stable.

Foreign demand contributed positively, but to a lesser extent compared to the second quarter of the year (Chart 15, right). Export growth has slowed down due to a more moderate increase in the export of services and a decline in the export of goods.

Chart 15

Domestic demand, mainly underpinned the economic growth | *Contributions from foreign demand have slowed compared to the previous quarter*



Source: INSTAT and Bank of Albania.
Notes: Contribution of demand components to economic growth.

Source: INSTAT and Bank of Albania.
Notes: Domestic and foreign contribution to the annual growth of aggregate demand.

Domestic demand grew by 2.35% in in 2024 Q3, slightly down compared to the previous quarter (5.65%). The slowdown in domestic demand growth rates has been driven by weak private consumption growth. On the other hand, investment and public consumption growth rates have remained more stable.

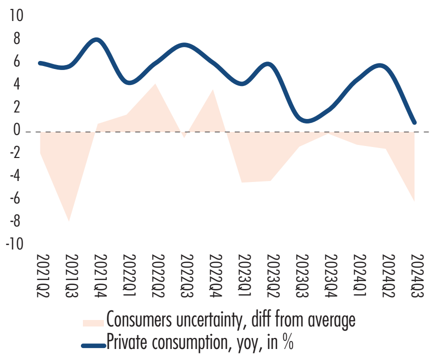
Private Consumption's growth rate slowed to 0.8% in the third quarter, following the sharp growth by 5.1% in the first half of the year (Chart 16, left). Available indirect data suggest that this slowdown is temporary and the growth rate will recover in the fourth quarter (Chart 16, right).

Private consumption growth was supported by an increase in disposable income and credit expansion, while uncertainty has been declining throughout 2024. This growth was recorded across all its components: food products, durable consumer goods, and services[17].

Indirect data indicate an increase in private consumption in the fourth quarter. Based on the consumer confidence survey, the indicator for major purchases of households has expanded, and their financial situation has improved. Additionally, businesses assess consumer demand as being high during this quarter.

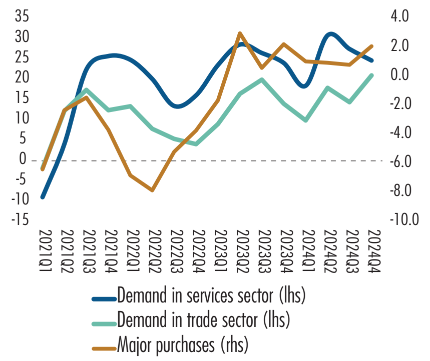
Chart 16

Private consumption slowed in the third quarter



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

Survey indicators suggest increased consumption in Q4



Notes: The indicators are net balances, in percentage points, and are based on business and consumer confidence surveys. The indicators are presented as changes from the relevant long-term averages.
Source: Bank of Albania.

Investments grew by 4.5% in the third quarter, maintaining a similar growth pace to that of the first half of the year (Chart 16, right). In line with developments in the previous quarter, investment growth in the economy was primarily driven by

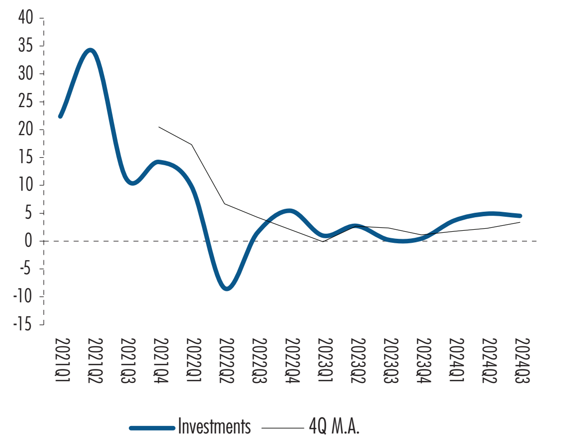
[17] *The analysis of service consumption is based on the indirect indicator of value-added growth in the services sector, as measured by GDP using the production method. The analysis of consumption in both consumer goods and durable goods is based on data from the retail trade index.*

public investments[18]. Investments in construction are estimated to have increased, but at a slower pace than in the first half of the year. The value-added growth in construction rose by 5.3%, compared to 8.5% and 10.5% in the first two quarters of the year. Investments in machinery and equipment have also contributed positively to the overall investment growth. Import of machinery and equipment increased by 11.6%, up from 5.2% in the second quarter.

Survey data indicate high levels of capacity utilization rate by enterprises (Chart 18, left) and a declining perceived uncertainty. At the same time, investment growth has been supported by an increase in loans for investment purposes.

Chart 17

Total investments increased in the second quarter

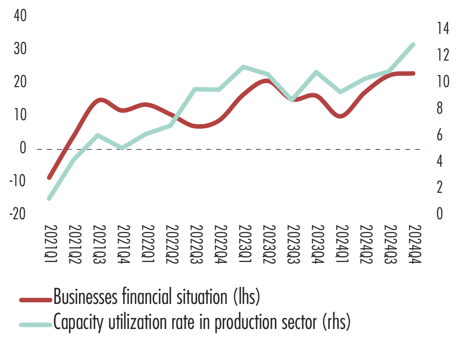


Source: INSTAT and Bank of Albania.

Indirect quantitative data and survey data suggest that investment growth will maintain a similar pace in the fourth quarter. Imports of machinery and equipment recorded an average annual growth of 14.3% during the last quarter of 2024 (Chart 18, right). High utilization of production capacities in this quarter continued to be a driving factor for investments. Additionally, enterprises' financial situation and the growth of loans for investments reached high levels this quarter.

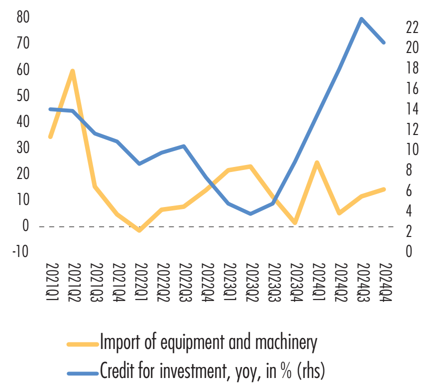
Chart 18

The capacity utilization rate and the enterprises' financial situation improved in the second half of the year



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 support the positive growth rates



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

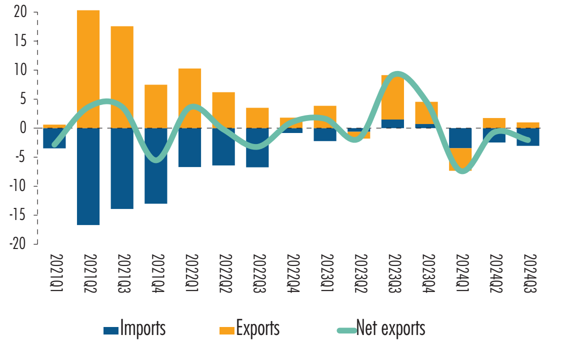
Real net exports of goods and services contributed negatively to the growth (Chart 19). The trade balance in real terms resulted in a deficit, while marking

[18] *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.*

a high surplus in the previous year. The deterioration of the trade balance was caused by the expansion in imports, while export growth slowed down compared to the previous quarter.

Chart 19

Net exports provided a negative contribution to economic growth in 2024 Q3 as well, with a higher magnitude than in the previous quarter



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

Exports of goods and services grew by 2.3% in real terms. This growth was mainly driven by the expansion in the export of services, up by 3.9%. On the other hand, export of goods decreased by 4.4% compared to the same period in the previous year.

Import of goods and services expanded by 6.8% in 2024 Q3, meaning its growth pace accelerated compared to that of the previous quarter. This growth was mainly driven by the expansion in the import of goods, which rose by 9.8%. Meanwhile, import of services showed a modest increase of 1.5%.

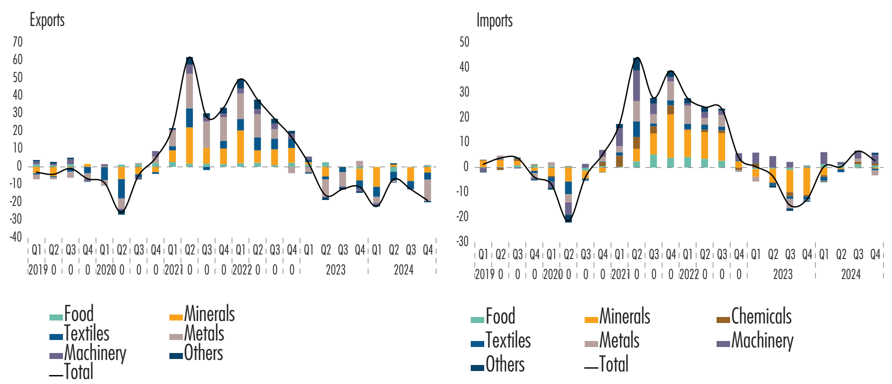
International trade data in nominal terms in lek show a contrasting trend between exports and imports, resulting in the expansion of the trade deficit by 23% in the last quarter of 2024.

Exports of goods shrank by 18.9% during this quarter (Chart 20, left). The decline was primarily driven by the categories "Construction materials and metal" and "textile and footwear", which were affected by the specific characteristics of the sectors, falling prices, and exchange rate effect. On the other hand, after several quarters with decline, export of food started to increase again, supported by a significant expansion in trade volumes. However, throughout 2024, export of goods decreased by 15.4%.

Chart 20

Export declined sharply, mainly due to the: "Construction materials and metals" category

The slight increase in imports was driven by imports of "Machinery, equipment and spare parts"



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

Import of goods increased by 2.8% during the fourth quarter of the year (Chart 20, right). The positive contributions to the growth of import stemmed mainly from the category" Machinery, equipment and spare parts''. On the other hand, the categories, "Construction and metal materials" and "Textile and footwear'', contributed negatively. During 2024, imports increased by 2.5%, impacted by the falling prices and the exchange rate effect. However, most group of goods showed a noticeable increase in imported quantities, reflecting the growth in domestic demand.

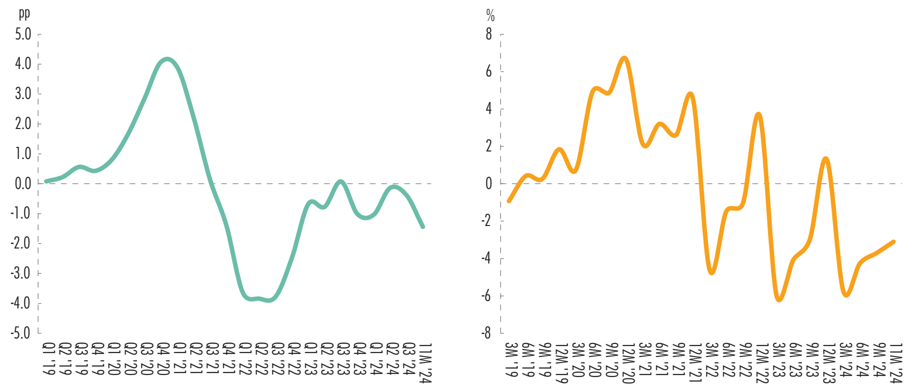
FISCAL POLICY AND DEMAND OF PUBLIC SECTOR[19]

Fiscal policy showed stronger fiscal consolidation in October and November, driven by the slowdown in public investments.

The fiscal impulse[20] decreased at -1.4 percentage points of GDP as at end of November, suggesting a restrictive contribution of fiscal policy to aggregate demand expansion during the first 11 months of the year. The negative values of the fiscal impulse, particularly in the first and last quarters of the year, are mainly linked to low expenditures during these periods. As a result, the budget balance was relatively positive, estimated at around 3.1% of GDP by the end of November, the highest value recorded during this period.

Chart 21

Fiscal impulse was negative | *...due to fiscal surpluses created during the year*



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

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

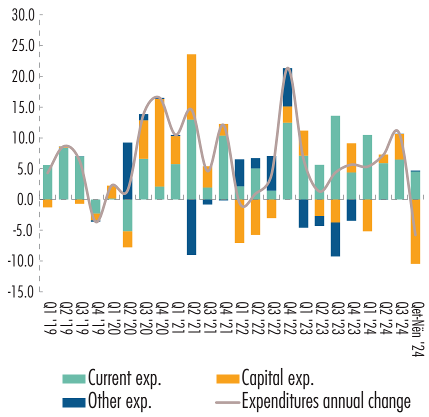
[19] *The latest data published for the public sector up to the report preparation date pertain to November. The fourth quarter of 2024 mirrors the trend of each of the indicators during October and November.*

[20] *The measurement of the fiscal impulse excludes temporary measures on the budget deficit, which can stem from both revenues and expenditures. For 2024, these measures amounted to ALL 16 billion in revenues due to the transfer of one-off funds totalling ALL 16 billion.*

Government expenditures in October and November amounted to around ALL 115.7 billion, representing a 5.8% decrease compared to the same period last year. This decrease was mainly due to the performance of capital expenditures, which contributed by -10.5 percentage points to the annual change in total expenditures. Similarly, expenditures on interest payments for domestic and foreign debt contributed negatively by around 2.3 percentage points. On the other hand, expenditures on personnel costs increased significantly by 18.7%, reflecting recent policies aimed at raising wages in the public sector.

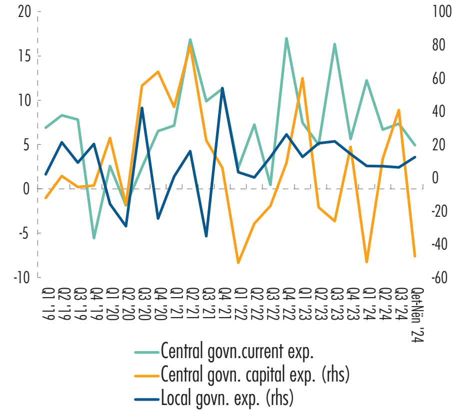
Chart 22

Expenditures decreased in annual terms...



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

... due to the contraction of public investments in the last two months



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

In the first 11 months of the year, expenditures amounted to approximately ALL 575.3 billion, or 4.8% higher in annual terms, compared to 7.9% at the end of the first nine months. The profile of rising expenses throughout the year was similar in terms of current expenditures, whereas capital expenditures concentrated in the second and third quarters of the year. Personnel costs had a positive impact on the total expenditure growth, contributing around 2.2 percentage points in the first 11 months of the year. The contribution of this item to the expansion of expenditures was similar to the previous year but higher compared to the historical average of 0.5 percentage points over the past 10 years.

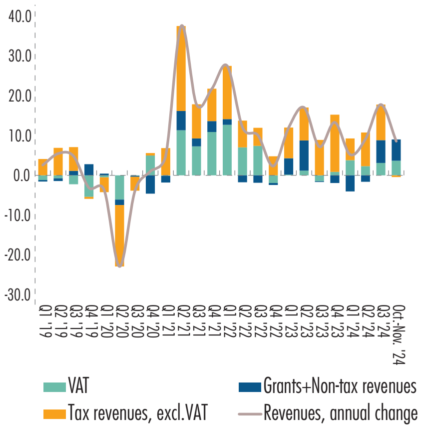
In October and November, revenues amounted to approximately ALL 118.6 billion, expanding by around 8.6% compared to the same period in the previous year. The growth rate of revenues in the last two months slowed down compared to the second and third quarters of the year, which grew averagely by 13.5%. The value added tax was responsible for performance of revenue growth in the past months, due to the special profit budgeted from private companies of the energy sector[21]. The highest contribution to revenue growth

[21] *In 2023, private companies involved in the sale of electricity paid special profit taxes in two instalments (March and November) due to high profits from the rapid increase in electricity prices in 2022.*

in the last two months came from VAT revenues on the production of goods and services in the domestic market, by around about 4.1 percentage points.

Chart 23

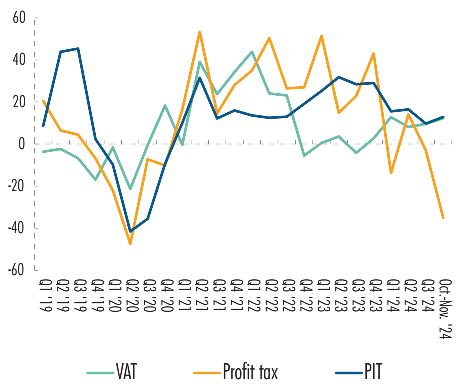
Revenues grew at slower rates



Source: Ministry of Finance.

Notes: Composition of revenue growth by quarter

reflecting the base effect of corporate income tax



Source: Ministry of Finance.

Notes: Annual growth in % of main tax items, by quarters.

For the first 11 months of the year, revenues reached approximately 647 billion lek, marking a 10.3% increase compared to the previous year. The highest contribution to revenue growth, by around 3.5 percentage points, came from non-tax revenues due to funds collected from the Social Insurance Institute (SII)[22] and transferring of the unspent balance of the expropriation fund to the state budget[23]. Other items that contributed positively to revenue growth during 2024 were: (i) revenues from social security, by 2.6 percentage points, due to their high share in total revenues; (ii) revenues from domestic VAT and VAT on imported goods, by 2 and 1.2 percentage points, respectively; (iii) revenues from personal income tax, due to wage increases in both the public and private sectors; and (iv) local taxes, by 1.4 percentage points. VAT revenues for the first 11 months of the year expanded by about 10.5% in annual terms. The rapid expansion of VAT revenues, along with the increase in imports, is also attributed to domestic production of goods and services.

The budget surplus at the end of November was around ALL 71.7 billion, or 3.1% of GDP, reaching the highest historical level. Meanwhile, the planned deficit for 2024 was ALL 57.3 billion, indicating that the realization of the plan requires a significant concentration of budgetary expenditures during December.

22 The amount transferred to the budget was ALL 7.9 billion, reflecting the improved financial result of this entity for the fiscal year 2023.

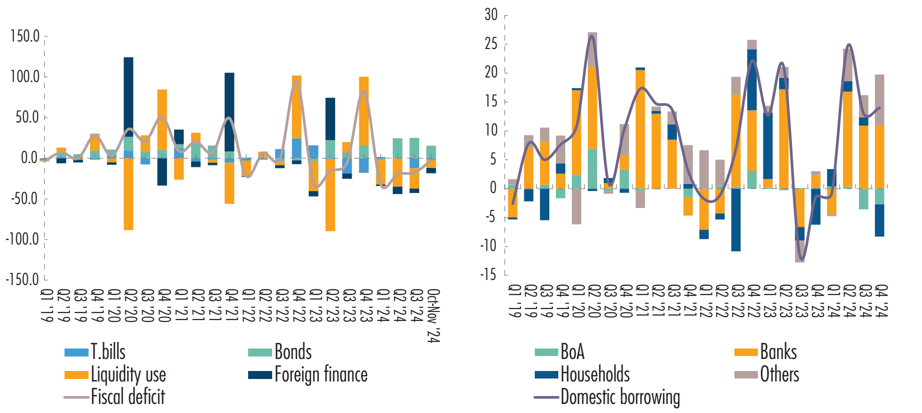
23 This transferred fund was ALL 8 billion in September.

Net borrowing in the domestic market[24] amounted to around ALL 50 billion, matching the planned level for 2024. The increase in borrowing in the securities market, similar to last year, was realized solely in long-term instruments, which offset the reduction of around ALL 20.5 of net borrowing in treasury bills. About 68% of the new borrowing increase was absorbed by the banking sector, which is also the main holder of the government's long-term securities portfolio. After a rapid increase in households' investments in government securities during the first nine months of the year, households' participation in the securities auctions dropped by ALL 5.6 billion in the last quarter. Throughout 2024, the households' portfolio in government securities increased by only ALL 0.7 billion. This was mainly influenced by the government's focus on long-term borrowing, which encouraged households to put their savings into bank deposits, especially in the last months of the year.

Unlike previous years, in 2024, non-residents participated actively in the government markets. During 2024, non-residents purchased about ALL 14.4 billion in government securities, covering for about 29% of the increase in domestic borrowing.

Chart 24

Domestic borrowing increased only in bonds... *...where the main share in financing was held by banks*



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

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

Net foreign borrowing was around ALL -22.6 billion in the first eleven months of the year. The negative values of net foreign borrowing are related to the higher levels of debt servicing compared to the government's inflows in foreign currency in the form of grants, projects, or budgetary support. Funds in foreign currency from 2023 were used for foreign debt servicing.

[24] *Data published by the Monetary Policy Department, which include the securities auctions held in December, was used for borrowing in the domestic market.*

5. INFLATION, PRICES AND COSTS IN THE ECONOMY

Inflation fluctuated around 2.0% over the fourth quarter, almost identical to the values recorded in the third quarter. Inflation stabilization was mainly influenced by the sustainability of core inflation. Meanwhile, its slight increase in the last two months was driven by the rise in imported inflation, which, however, remains near historically low levels.

The sustainable return of inflation to our 3% target is expected to be supported by the stability of domestic inflationary pressures, the anchoring of inflation expectations, and the increase in imported inflation.

5.1. CONSUMER PRICES

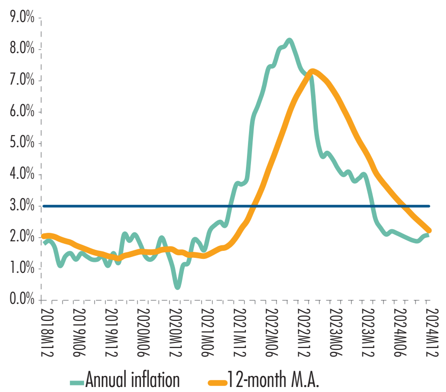
Inflation remained stable in the fourth quarter, averaging around 2.0% (Chart 25). The surge in food prices was offset, on a quarterly level, by the decline in the prices of fuel and rent. Meanwhile, the monthly performance showed an increase in the last two months of the year, mainly due to rising food and oil prices.

In macroeconomic terms, inflation stability reflects a slight moderation of domestic inflationary pressures, which nevertheless remain dominant. At the same time, external pressures were upward, influenced by rising inflation in trade partners and the slowdown of the exchange rate appreciation pace.

Inflation profile in Albania is similar to the one in both regional and EU economies (Chart 25, right).

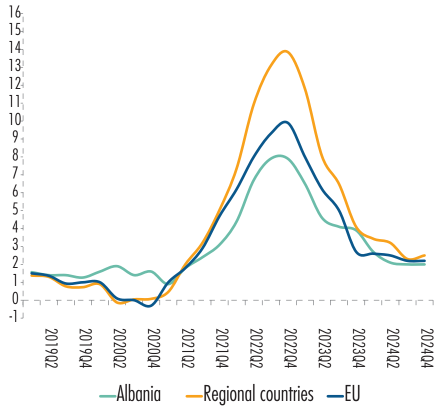
Chart 25

Inflation slowed down in the fourth quarter, remaining close to the 2.0% average



Source: INSTAT and Bank of Albania's calculations.
Note: The inflation target is the annual change in the Consumer Price Index (published by INSTAT)

The country's inflation profile is similar to that the region and the EU economies



Source: INSTAT and Bank of Albania's calculations.
Note: Inflation rates are annual changes, in percent.

Inflation decomposition by key categories of the consumer basket shows an increase in the contribution of the food group to inflation in the fourth-quarter (Table 2). The contribution of the **"Unprocessed Food"** category expanded by an average of 0.3 percentage points compared to the previous quarter. This increase was particularly pronounced in October and November, mainly in the "Vegetables" subcategory. **"Processed food"** contribution rose by 0.1 percentage point compared to the previous quarter. This expansion is mainly attributed to the "Oils and Fats" subcategory, the contributions of which shifted from low negative values in previous quarters to slightly positive ones by the end of 2024.

The **"Non-food goods"** category shrank averagely by 0.2 percentage points in the contributions during the fourth quarter. This development was driven by a reduction in the contribution of the fuel subcategory (-0.4 percentage points), reflecting fluctuations in the prices of energy raw materials in both foreign and domestic markets. The prices of some components including **services, housing, and durable consumer goods** had a lower contribution to inflation formation. This came as a result of rent and some durable consumer goods price contributions falling by 0.1 percentage point.

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

	2023 Q1	2023 Q2	2023 Q3	2024 Q4	2024 Q1	2024 Q2	2024 Q3	2024 Q4	Annual inflation 2024 Q4 (%)
Processed food	**2.8**	**1.3**	**0.8**	**0.6**	**0.5**	**0.4**	**0.5**	**0.6**	**2.3**
Bread and grains	0.6	0.2	0.1	0.1	0.1	0.1	0.1	0.1	1.5
Milk, cheese and eggs	1.3	0.8	0.6	0.5	0.3	0.2	0.3	0.3	3.2
Unprocessed foods	**1.9**	**2.5**	**2.3**	**2.1**	**0.9**	**0.3**	**0.4**	**0.7**	**4.5**
Fruits	0.1	0.4	0.3	0.3	0.1	-0.2	-0.1	0.0	-0.9
Vegetables	0.7	1.1	1.3	1.3	0.5	0.3	0.3	0.5	6.8
Meat	1.0	0.9	0.7	0.4	0.2	0.1	0.2	0.2	4.0
Services	**0.5**	**0.5**	**0.5**	**0.4**	**0.4**	**0.4**	**0.3**	**0.3**	**2.1**
Goods with regulated prices	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**	**0.1**	**0.1**	**0.1**	**1.3**
Housing lease	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.3**	**0.2**	**1.4**
Non-food consumer goods	**0.4**	**-0.6**	**-0.4**	**-0.1**	**0.1**	**0.3**	**0.1**	**-0.1**	**-0.3**
Fuel	0.0	-0.9	-0.6	-0.2	-0.1	0.1	-0.2	-0.4	-9.2
Durable consumer goods	**0.5**	**0.5**	**0.4**	**0.4**	**0.3**	**0.3**	**0.3**	**0.2**	**3.4**
Inflation (%)	**6.5**	**4.6**	**4.1**	**3.9**	**2.7**	**2.1**	**2.0**	**2.0**	**2.0**

Source: INSTAT and Bank of Albania's estimations.

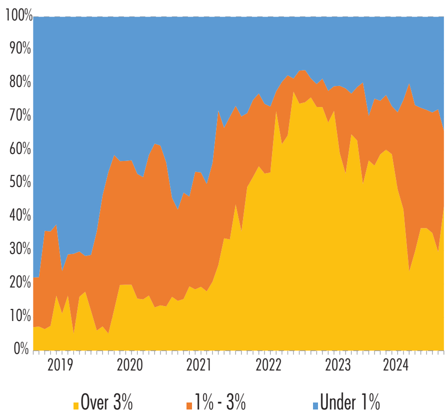
The distribution of CPI basket items by inflation rate in the fourth quarter narrowed within the 1%-3% inflation range and expanded at both ends of the central zone[25]. These effects have offset each other, keeping inflation values in the third and fourth quarters nearly unchanged. The share of items in categories with inflation above 3% and below 1% increased by 1.7 and 3 percentage points, respectively, accounting for 36% and 32% of the basket. Items share

[25] *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.*

within the 1%-3% range was 33.8%, or 4.6 percentage points lower than in the third quarter (Chart 26, left).

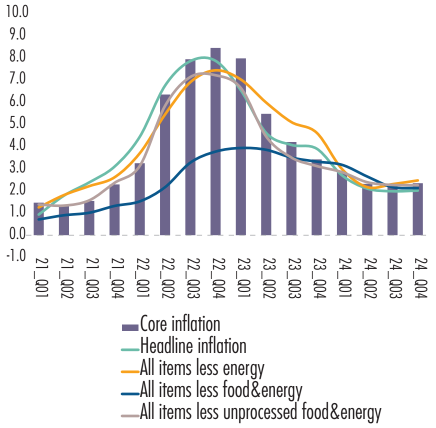
Chart 26

Distribution of items by inflation categories expanded in the fourth quarter



Source: INSTAT and Bank of Albania's calculations.

Inflation slowdown has also been confirmed in net inflation measurements



Source: Bank of Albania.

The slowdown in disinflation has also been verified in net inflation measurements, confirming the presence of stable domestic inflationary pressures that remain relatively isolated from short-term developments (Chart 26, right). Specifically, net inflation, which excludes food and energy[26], remained nearly unchanged in October and November and increased slightly in December.

5.2. INFLATION DETERMINANTS

The cyclical position of the economy remained positive in 2024 H2, whilst the economic growth exceeded its potential. Indirect indicators suggest that growth of employment, and tight labour market conditions continue to persist. Enterprises continue to face difficulties in filling vacancies. Wages in the private sector continued to grow, albeit at a slower pace, in turn mitigating the pressure on labour costs per unit.

Headline inflation remained primarily affected by core and domestic components at the end of 2024. While core inflation tended to remain stable, domestic inflation slightly declined, while external inflationary pressures increased, but remaining at historically low levels.

The intensity of core and domestic inflation components continued to dominate the formation of total inflation throughout the last quarter of 2024.

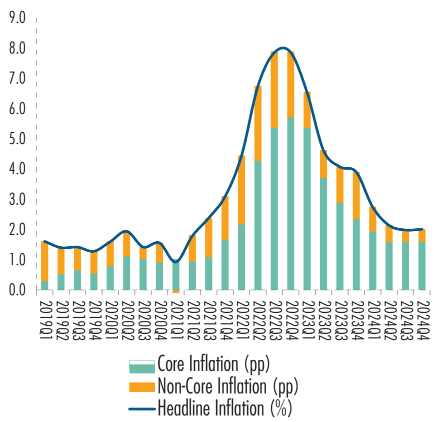
[26] *This includes in large part durable services and consumer goods.*

Inflation in the fourth quarter remained nearly unchanged from the previous quarter, mainly influenced by stable core inflation values. Core inflation averaged 2.3% in the last quarter, a similar value to the previous quarter and higher than total inflation. Throughout the quarter, core inflation gradually increased, reaching 2.5% in December. Net core inflation[27] averaged 2.1%, slightly more moderate than in the previous quarter. On the other hand, non-core inflation was around 1.3%, a rate similar to that of the previous quarter. Measurements show that core inflation contributed 80% to total inflation during this period (Chart 27, left).

Domestic inflation slowed down during the last quarter, while imported inflation increased. Domestic inflation averaged at 1.8%, slower by 0.3 percentage point compared to the previous period. However, it accounted for around 70% of total inflation during this period. On the other hand, imported inflation rose significantly, from 1.7% to 3.1%, in 2024 Q4. Its increase was a result of the performance of oil prices and some processed foods, as well as the stabilization of the exchange rate. This has led to the expansion of imported inflation contributions, despite the indicator remaining at historically low levels. Meanwhile, domestic inflationary pressures remained relatively stable (Chart 27, right).

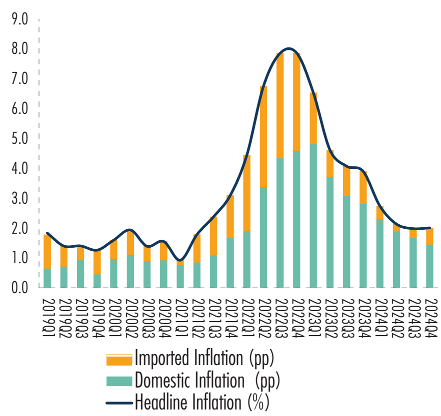
Chart 27

The average contribution of core inflation in Q4 remained nearly unchanged



Source: INSTAT and Bank of Albania's calculations.

Imported inflation increased but remained at historically low levels, while domestic inflation prevailed



Source: INSTAT and Bank of Albania's calculations.

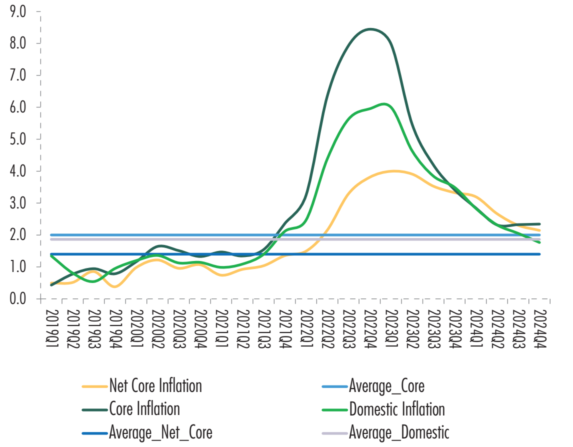
The domination of headline inflation, driven by its more persistent components, has been primarily supported by the strong persistence of inflation in services and industrial goods. As a result, the trajectories of core inflation measurements have remained close to their respective averages of the latest decade, while domestic inflation stands slightly below its respective average (Chart 28).

[27] The sub-basket which measures core inflation accounts for 69% of total CPI; net core inflation, excludes the sub-groups of some processed foods with stable inflation. It is measured based on over 46% of the CPI basket.

The cyclical position of the economy remained positive in 2024 Q4. Economic growth remained above potential levels, and the capacity utilization rate remained above its historical average. These developments have been reflected in stable core inflation rates (Chart 29), which have exceeded overall inflation rates during this quarter.

Chart 28

Core inflation levels remain above their respective historical averages

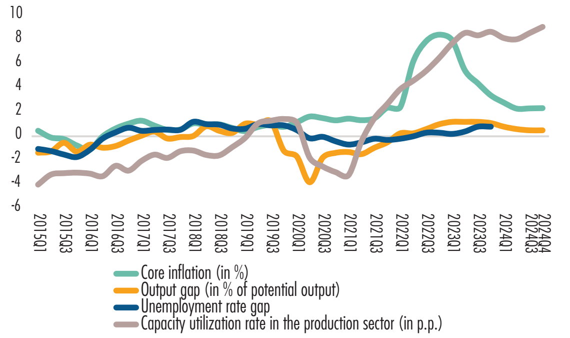


Source: INSTAT and Bank of Albania's calculations.

Employment and unemployment. Data on employment for the third quarter of 2024 is still unavailable. To highlight key trends in the labour market, data from administrative labour market indicators and indirect sources from confidence surveys have been used. The slow employment growth during 2024 Q3, according to administrative data, was accompanied by high levels of the "labour force shortage" throughout the year[28] (Chart 30, left). These developments indicate the presence of continued tight conditions of the labour market. Additionally, survey indicators show lower business expectations for employment and higher unemployment expectations from consumers during the fourth quarter (Chart 30, right).

Chart 29

Economy's cyclical position appears positive in 2024 Q3



Source: INSTAT and Bank of Albania's estimations.

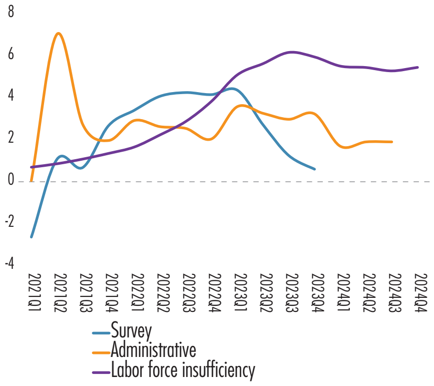
Notes: The output gap is the average of several measurements on which the method of moving average is applied. The capacity utilisation rate gap is estimated as a deviation of the current value from the relevant historical average, upon which the moving average method is then applied. The unemployment 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 measured as the difference of the equilibrium unemployment rate to the actual unemployment rate, upon which the moving average method is then applied.

Wages, productivity and labour costs. The wages growth in the private sector further slowed during the third quarter, affected by the high comparative base from last year due to the effects of the minimum wage increase (Chart 31, left). Nominal wage growth recorded was 5.4%, down from 6.9% in the second quarter. The slowdown in growth rates is more pronounced in high-paying sectors such as "Information and Communication", "Financial and Insurance Activities," and "Real Estate." Real wage growth also slowed to 3.4%, compared to 4.8% in the second quarter.

[28] *Indicator estimated by the Bank of Albania based on the results of the Business Confidence Survey in industry, construction and services. One of the limiting factors for business' activity is the "labour force shortage," listed alongside other factors. Its aggregate calculation represents the approximate importance level of the "labour force shortage" factor for the non-agricultural private sector, using respective shares in GDP. The base year used is 2019. Finally, a four-term moving average has been applied to highlight its trend.*

Chart 30

Employment continued to grow at contained rates in the third quarter, while the importance of the "labour force shortage" has increased



Source: INSTAT, BoA, and BoA's calculations.
Note: "Survey" refers to the Quarterly Labour Force Survey, INSTAT.

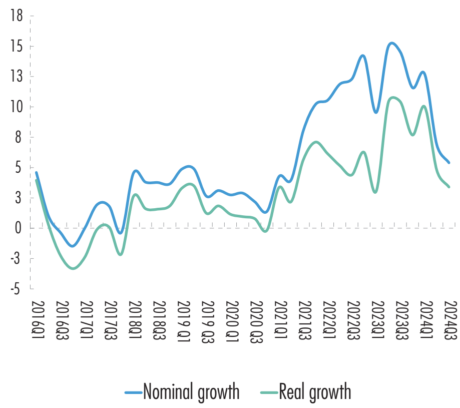
Businesses' expectations for employment have slowed alongside higher consumer expectations for unemployment in the last quarter of 2024

Source: INSTAT, BoA (Confidence Surveys).

Unit labour cost[29] expanded at a slower pace during 2024 Q3, increasing by 1.0%, compared to by 2.2% in the second quarter of last year. This slowdown is mainly driven by the more contained growth of real wages, while labour productivity has shown a growth rate similar to that of the second quarter (Chart 31, right).

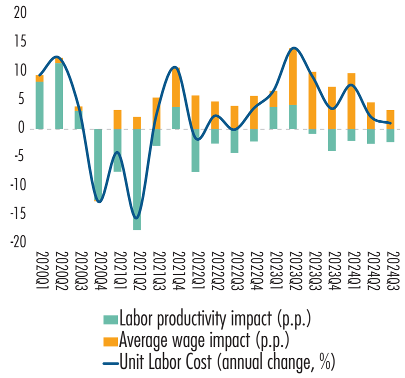
Chart 31

Private sector wage growth slowed during the third quarter...



Source: INSTAT and Bank of Albania.

... easing pressures on unit labour costs



Source: INSTAT and Bank of Albania.
Note: The positive contribution of labour productivity in the calculation of annual changes of the unit labour cost indicator shows that the labour productivity index has resulted in negative annual rate.

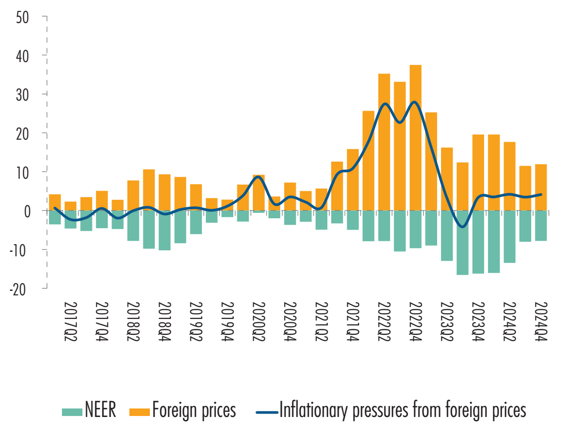
The rise in other output costs continued to slow down in 2024 Q3. Production prices increased by 1.1%, compared to 1.7% in the previous quarter. In the domestic market, production prices grew by 1.6%, compared to 2.3% in the

[29] *The indicators of labour costs per unit and labour productivity are estimations of the Bank of Albania. They pertain to the non-agricultural private sector and are calculated based on INSTAT data from the quarterly National Accounts statistics, administrative labour market data, and wage statistics.*

previous quarter. Meanwhile, Construction Cost Index (CCI) increased by 1.6%, down from 2.5% in the second quarter. In contrast, only the producer price index for exports showed a slight acceleration, rising by 0.7%, compared to 0.2% in the second quarter of the same year.

Chart 32

Foreign Inflationary Pressures Accelerated in 2024 Q4



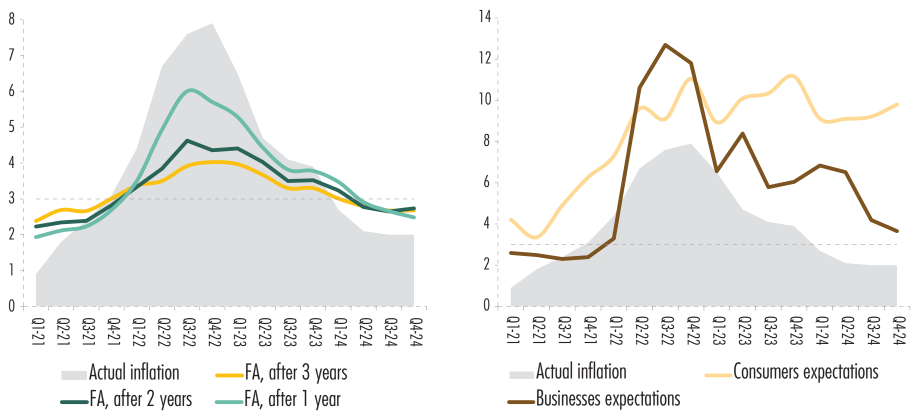
Source: INSTAT, Eurostat and estimations of the Bank of Albania.

Imported Inflationary Pressures. The Imported Inflationary Pressure Index (IIPI) expanded in the fourth quarter, reflecting the increase in inflationary pressures from the external environment. During this period, IIPI grew by 4.1%, compared to 3.5% in the third quarter (Chart 32). The main contributing factors to this acceleration include the increase in foreign prices, which accelerated to 11.9%, up from 11.5% in the third quarter. Furthermore, the slowdown in the appreciation of the exchange rate was another influencing factor, with the appreciation rate at standing 7.8%, down from 8.0% in the previous quarter[30].

Inflation expectations. Short-term inflation expectations of businesses and financial agents have been revised down in the fourth quarter, based on survey data[31]. Thus, inflation is expected to be 2.5% and 3.7 % next year, respectively, compared to the previous values of 2.7% and 4.2% (Chart 33, left). The medium-term inflation expectations of financial agents (for the next two and three years) have remained very close to the value recorded in the previous

Chart 33

Business expectations for inflation have been revised downward, while consumer expectations remain high. *The inflation expectations of financial agents have not changed, staying close to the 3% target.*



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

[30] *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*

[31] *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.*

quarter, at 2.7%, being close to the 3% target (Chart 33, right). On the other hand, the perceived and expected inflation by consumers continues to register high values even in the fourth quarter. Based on the consumer confidence survey, the expected inflation after one year is 9.8%.