

Monetary Policy in Albania 2006-2015

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Summary:

The current paper presents a review which aims at recognizing the positive developments in the monetary policy in Albania for the period 2006 - 2015. The focus is on exploring the monetary policy in Albania - the way it is designed, approved and implemented, accomplishing the main objective of the Central Bank - Bank of Albania - to achieve and maintain price stability. Attention is paid to three main aspects: 1) a theoretical framework that guides the design of monetary policy in terms of the legal framework and decision-making body, the intermediate and operational objectives, the monetary variables of economy – the money supply, interest rates and exchange rates, framework of instruments employed to implement the monetary policy; 2) an amendment to the theoretical framework and approaches adopted for the selected period; 3) performance of the targeted variables.

Research is divided into three main pillars. The first one is focused on short representation of the country and its macroeconomic framework. The second part aims at examining Albanian monetary policy in terms of the theoretical framework for the period of 2006 - 2015. The purpose of the third part is to follow up the amendment to the theoretical framework and approaches for the selected period and the performance of targeted variables.

The research showed, in terms of the monetary variables in the economy, that

the Bank of Albania has implemented and maintained a free-floating exchange rate regime and price stability inflation rate at 3 per cent with fluctuations of ± 1 per cent for the observed period.

Fundamental change is seen in intermediate and operational objectives where the Bank of Albania targets the adoption of more advanced forms. The choice of intermediate and operational objectives depends on the monetary policy regime and the level of economic and financial market development. For the period 2006 - 2008, the Bank of Albania has approved the annual growth of money supply (M3); net domestic assets; and net international reserves. After year 2009 the bank's priority has been to steer short-term interbank rates close to the Bank of Albania's key interest rate. A significant step is made in this regard - instruments such as repurchase agreements, outright transactions, foreign exchange market operations, overnight deposit, overnight loan are employed to achieve the objective.

Key words: Western Balkans, Albania, macroeconomic, monetary policy, monetary supply, interest rates, exchange rate, key interest rate, interbank market interest rate

JEL Classification: E5, E4, E51, E52, E58, E6

1. Introduction

The Bank of Albania is the monetary authority of the Republic of Albania. Pursuant to the legal framework in force, it has the exclusive right to design, approve and

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implement the monetary policy in Albania. The monetary policy is designed, approved and implemented with a view to accomplishing the mandated objective of the Bank of Albania: achieve and maintain price stability.

Global theory and practice suggest that price stability is the greatest contribution that the central bank can make to sustain the long-term economic growth of the country. This quantitative of price stability reflects the level of development of the Albanian economy as a small, open and emerging economy.

The Supervisory Council of the Bank of Albania is the supreme decision-making body of the central bank. It is responsible for the design of the monetary policy and the approval of guidelines for its implementation. Monetary policy decisions are to be taken every month according to a pre announced schedule.

The aim of the current paper is to review evolving monetary policy in Albania, as a post-communist country, and its upgrade within the last decade. The period of observation is chosen based on documentation availability, as the preparation of structured monetary policy documents by the Bank of Albania started after year 2005.

2. Country profile and macroeconomic framework

2.1. Why Albania?

Albania, officially known as the Republic of Albania (Albanian: *Republika e Shqipërisë*), is a country in Southeastern Europe. It is bordered by Montenegro to the northwest, Kosovo to the northeast, the Republic of Macedonia to the east, and Greece to the south and southeast. It has a coast on the Adriatic Sea to the west and on the Ionian Sea to the southwest. It is less than 72 km (45 mi) from Italy, across the Strait of Otranto which links the Adriatic

Sea to the Ionian Sea.

Albania declared independence in 1912 and was recognized the following year.

After the liberation of Albania from Nazi occupation¹, the country became a Communist state, the People's Republic of Albania (renamed "the People's Socialist Republic of Albania" in 1976), which was led by Enver Hoxha and the Labour Party of Albania.

The socialist reconstruction of Albania was launched immediately after the annulling of the monarchy and the establishment of a „People's Republic“.

Religious freedoms were severely curtailed during the Communist period, with all forms of worship being outlawed. In August 1945, the Agrarian Reform Law meant that large plots of land owned by religious groups were nationalized, along with the estates of monasteries and dioceses.

After protests began in 1989 and reforms were made by the communist government in 1990, the People's Republic was dissolved in 1991-92 and the Republic of Albania was founded. Albania is a parliamentary republic.

Albania is a member of the United Nations, NATO, the Organization for Security and Co-operation in Europe, the Council of Europe and the World Trade Organization. It is one of the founding members of the Energy Community and the Union for the Mediterranean. It is also an official candidate for membership in the European Union.

Albania is an interesting case in Eastern Europe not only for its size and location but also for its legacy in the economic development and many other specific characteristics as well. Similar to some other ex-communist countries, Albania has pursued its economic transformation toward a market economy (Qarri *et al*, 2012).

Very little has been published about Albania. Generally speaking, studies could be divided into two parts: 1) Albania has been

¹ The occupation of Poland by Nazi Germany and the Soviet Union during the Second World War (1939–1945) began with the invasion of Poland in September 1939, and formally ended with the defeat of Nazism by the Allies in May 1945

examined separately or 2) in the context of Western Balkans. Albania as part of post-communist country has been investigated in term of monetary regimes in different papers (Nenovsky and Borisova, 2015; Koczan, 2015). Some works aimed to assess Albanian lek in terms of measurement of Value at Risk for the EUR/ALL exchange rate (Cera, Cera and Lito, 2013); the effectiveness of monetary policy in Albania and the need for further reforms have been examined during the transition period from communist to democratic country (Muço, Sanfey and Taci, 2004; Bolle & Meyer, 2005).

Albania monetary policy is closely observed and influenced by external actors such as the World bank, IMF, etc., including a number of IMF programs that have affected Albania's macroeconomic policies throughout the past quarter century.

2.2. Macroeconomic framework

Albania is a middle-income country that has made enormous strides in establishing a credible, multi-party democracy and market economy over the last two decades. Following graduation from the International Development Association (IDA) to the International Bank for Reconstruction and Development (IBRD) in 2008, Albania has generally been able to maintain positive growth rates and financial stability, despite the ongoing economic crisis.

Before the global financial crisis, Albania was one of the fastest-growing economies in Europe, enjoying average annual real growth rates of 6%, accompanied by rapid reductions in poverty. However, after 2008 average growth halved and macroeconomic imbalances in the public and external sectors emerged. The effects of the reduced growth rate were observed in poverty and unemployment rates: between 2002 and 2008, poverty in the country fell by half (to about 12.4%) but in 2012 it increased again

to 14.3%. Unemployment increased from 12.5% in 2008 to 16.9% in 2013, with youth unemployment reaching 26.9%.

The growth recovery to above 3% in 2011 levelled off in 2012 and 2013, reflecting the deteriorating situation in the Euro zone and the difficult situation in the energy sector. Real Gross Domestic Product (GDP) dipped to a low of -2.3% in the third quarter of 2013. A rebound was expected in 2014, but growth is expected to stay below the country's potential over the medium term.

Albania weathered the 2008 global financial crisis relatively well, but the economy is weak and macroeconomic imbalances are huge.

Albania is focused on supporting economic recovery and growth in a difficult external environment, enhancing and sustaining the country's social gains, and reducing vulnerability to climate change – particularly through improved water resource management. Key challenges Albania faces include early recovery of fiscal consolidation and more prudent public spending management, regulatory and institutional reform, reduction of infrastructure deficits, and improvement in the effectiveness of social security systems and key health services.

3. Albania's monetary policy - theoretical framework and approaches

3.1. Central bank

The Bank of Albania is the monetary authority of the Republic of Albania. Pursuant to the legal framework in force, it has the exclusive right to design, approve and implement the monetary policy in Albania. The monetary policy is designed, approved and implemented with a view to accomplishing the main objective of the Bank of Albania: achieving and maintaining price stability.

According to the Law "On Bank of Albania", the primary objective of the Bank of Albania's monetary policy is to achieve and maintain price stability.

Albania established its first central bank institution in 1913. It was founded under the agreement concluded between Ismail Qemali's Government and Mr. Karol Pitner and Mr. Oskar Pollak, representatives of the Wiener Bank Verein, acting on behalf of the Austrian-Hungarian banking group, and Mr. Pietro Fenolio and Mr. Guido Ansbahe, representatives of the Banca Commerciale Italiana, acting on behalf of the Italian banking group. The banking institution was short-lived due to the political climate during the period and the outbreak of the First World War.

The Supervisory Council of the Bank of Albania is the supreme decision-making body of the central bank, composed of 9 members, appointed by the Assembly of the Republic of Albania for a term of seven years, eligible for reappointment. It is responsible for the design of the monetary policy and the approval of guidelines for implementing it. Monetary policy decisions are taken every month following a previously announced schedule.

3.2. Background

Communism in Albania collapsed in late-1990 and early-1991. It was followed by a year of economic slump, social disorder and widespread emigration. The turnaround began in 1992 when stabilization measures were introduced through a one-year reform program.

Under this program, annual inflation was to be reduced to below 20 per cent.

Money growth was to be the principal nominal anchor of the program. This would be supported by a fiscal policy which eliminated monetary deficit financing by mid-1993 and by a tight lending policy. A two-tier banking system was established in April 1992.

Under this stabilization program, which was supported by the International Monetary Fund (IMF) and other international institutions, monetary policy was based on the implementation of direct instruments of monetary control. This decision was driven by the poor state of the banking system, the external debt situation and the need to finance the large budget deficit. During the first half of the 1990s, the banking system was dominated by three state-owned banks which quickly accumulated substantial debt problems. Eventually, one of these banks (the Rural Commercial Bank) was liquidated in January 1998 and a second one (the National Commercial Bank) was privatized by foreign investors in 2000. Furthermore, the last and largest state-owned bank, the Savings Bank, was bought by the Austrian Raiffeisen Bank in late 2003. This development was expected to provide a major boost to lending activities and financial intermediation, as the Savings Bank, the only bank in Albania with extensive national coverage, was not allowed to lend to the private sector during the process of privatization.

Meanwhile, non-bank financial institutions gained a limited, though growing, influence in Albania. Micro-credits were increasingly being provided by savings and credit agencies (SCAs) and by end-2002 there were 109 SCAs operating throughout the country while at the end 2000 there were only 36. The insurance market was still dominated by the state but the largest insurance company, INSIG, was undergoing privatization procedure, with the support of the EBRD and the International Finance Corporation (IFC).

At the beginning of 1996, some private banking activity licenses were issued to several foreign banks, paving the way for a real market in that field. Nevertheless, the Bank of Albania continued to impose ceilings on deposit rates offered by state-owned banks. Only recently has the consolidation of the banking system allowed the implementation of indirect instruments of

monetary control, including the establishment of required reserves, a refinancing window and a liquidity requirement, to replace direct instruments. New private banks have played a key role in encouraging the use of indirect instruments of monetary control and inter-bank competition. For example, in July 2000 the Bank of Albania adopted multiple-price one-week repos of T-bills, followed by fixed-rate repos in April 2001. The T-bill market has expanded considerably since then.

The control of interest rates was an important part of Albanian stabilization policy during the transition period. Real interest rates became positive in the third-quarter of 1994 (see Chart 1) when inflation declined, however these rates remained under the control of the Central Bank until the banking system began consolidating and monetary policy moved gradually towards the use of indirect instruments. The Bank of Albania started to eliminate direct control over interest rates at the beginning of 2000. Within a year, the capped interest rates on 3-month, 6-month and 12-month deposits were removed and replaced with indirect instruments of monetary policy.

3.3. Legal framework and decision making body

3.3.1. Legal framework

To design its monetary policy Bank of Albania relies on two main documents: The Constitution of the Republic of Albania and the Law "On the Bank of Albania":

Pursuant to Article 161 of the Constitution of the Republic of Albania, the Bank of Albania *"... is granted the exclusive right to independently implement the monetary policy"*.

Pursuant to Article 3, paragraph 4a of the Law No. 8269, dated 23 December 1997, "On the Bank of Albania", the basic task of this institution is *"to independently formulate, adopt and implement the monetary policy of the Republic of Albania, consistent with its main objective"*.

Pursuant to Article 3, paragraph 1 of the Law No. 8269, dated 23 December 1997, "On the Bank of Albania", the primary objective of the Bank of Albania is *"to achieve and maintain price stability"*.

Pursuant to Article 43, paragraph a of the Law No. 8269, dated 23 December 1997, "On the Bank of Albania", the Supervisory Council of the Bank of Albania has the following competences:

"To approve the monetary policy of the Republic of Albania, defining the limits of the Bank of Albania's operations in the open market, the interest rates on deposits held with the Bank of Albania and on the discounts and loans of the Bank of Albania, and the reserves and level of reserves that commercial banks are required to hold with the Bank of Albania".

Pursuant to Article 161, paragraph 1 of the Constitution of the Republic of Albania, the Bank of Albania *"... holds and manages the official foreign reserves of the Republic of Albania"*.

Pursuant to Article 3, paragraph 4 of the Law No. 8269, dated 23 December 1997, "On the Bank of Albania", the basic task of this institution is to *"...formulate, adopt and execute the exchange arrangement and the exchange rate policy in the Republic of Albania"*.

3.3.2. Decision making body

The Supervisory Council of the Bank of Albania is the supreme decision-making body of the central bank. It is responsible for the design of monetary policy and the approval of guidelines to implement it.

In formulating and implementing its monetary policy, the Bank of Albania is guided by the following principles:

- Monetary policy guarantees price stability in the economy.
- *Monetary policy is forward looking.*
- *Monetary policy is balanced.*
- *Monetary policy is robust.*
- *Monetary policy is transparent.*

3.4. Theoretical framework of monetary policy

Monetary policy is transferred to the real economy with time lags. These time lags are preconditioned, firstly, by the response of financial markets to the instruments employed for monetary policy implementation, and secondly, by the response of households and businesses to interest rates and liquidity conditions in financial markets. This chain of effects is known as *the monetary policy transmission mechanism*. Generally, it covers a medium term horizon of one to three years, forming the monetary policy relevant horizon.

Therefore, monetary policy is guided by forecasts about the expected inflation rates in the future. In practice, central banks set up a comprehensive framework of analysis and forecasting, which enables the timely identification of possible deviations of inflation from the target and affects monetary policy decision-making accordingly.

The Bank of Albania bases its monetary policy decision-making on a thorough analysis of economic, monetary and financial indicators. The main indicator of the balance of inflationary pressures in the economy is the deviation of the medium term forecast inflation from the targeted one. This monetary policy analysis and assessment regime is known as the inflation targeting regime. Monetary policy plays an important role in medium-term forecasts. The actual and expected key interest rate during the forecast horizon determines the performance of other macroeconomic indicators. Under these circumstances, the task of monetary policy is to determine the trajectory of the key interest rate that achieves the primary objective most effectively.

3.4.1. Monetary Policy Objective of Bank of Albania

According to the Law "On the Bank of Albania", the primary objective of the Bank of Albania is to achieve and maintain price

stability. By ensuring price stability, the Bank of Albania provides a direct contribution to sustaining macroeconomic balances in the country, promoting economic growth and improving the standard of living, as well as safeguarding the financial stability of the system.

In addition to measuring inflation as the annual change in the Consumer Price Index, the Bank of Albania uses other instruments – namely core inflation, tradable and non-tradable inflation, and the inflationary expectations of economic agents - in order to improve the monetary policy decision making process. These measures provide a more comprehensive basis for more pragmatic decisions. Core inflation represents the stable and long-term part of headline inflation.

In quantitative terms, the Bank of Albania has translated the price stability objective into keeping inflation rate at 3 per cent, with a fluctuation band of ± 1 per cent. Furthermore, the Bank of Albania maintains a free floating exchange rate regime. The value of the Albanian Lek (ALL) against foreign currencies is freely determined in the foreign exchange market by demand and supply.

3.4.2. Operational objectives & Monetary policy instruments

Operational objectives

Operational objectives establish the link between monetary policy operations and its primary objective, i.e. achieving and maintaining price stability. The setting of these operational objectives depends on the monetary policy regime and the level of economic and financial market development.

The operational objective of the Bank of Albania's monetary policy, after 2009, is to steer short-term interbank rates close to the Bank of Albania's key interest rate, set by the Supervisory Council, and to minimize their volatility.

Steering short-term interbank rates close to the Bank of Albania's key interest rate enhances the effectiveness and transparency of the monetary policy, thus contributing to a better control of long term interest rates in the economy.

Experience shows that this operational approach mitigates the volatility of interest rates in the financial markets. By controlling the short-term interbank rate and facilitating the predictability of its changes through a clear monetary policy strategy, the medium and long-term interest rates predictably respond to the changes in short-term interest rates.

Monetary policy instruments

In order to achieve its objectives, the Bank of Albania employs open market instruments. Monetary policy instruments are targeted towards the achievement of the Bank of Albania's operational objective. Consistent with the monetary policy framework principles, the Bank of Albania does not have any commitments with regard to interventions in the foreign exchange market and the exchange rate.

The interest rate on repurchase agreements with seven-day maturity, applied in the regular weekly auctions of the Bank of Albania is the key rate used to send out monetary policy signals.

This interest rate is set by the Supervisory Council of the Bank of Albania and determines the central bank's monetary policy. It also serves as a reference system for other interest rates of the Bank of Albania.

The following provides a brief description of the *instruments*² employed to implement the monetary policy.

- Open market operations

Open market operations include the purchase or sale of market securities by the

Bank of Albania.

Operations of repurchase and reverse repurchase agreements are respectively known as repo and reverse repo.

Open market operations also include foreign currency operations. However, in contrast to domestic currency operations, they do not seek to regulate interest rates or liquidity in the system and define the monetary policy. The main purpose of foreign currency operations is to change the level of the international reserves and level out high and risky fluctuations in the exchange rate.

Open market operations include:

- (reverse) repurchase agreements; and
- outright transactions.

- Standing facilities

The main purpose of standing facilities is to adjust the level of liquidity in the banking system and steer short-term interest rates in the money market. They are always and exclusively initiated by commercial banks. The latter are the sole counterparties to the Bank of Albania in these operations.

The Bank of Albania provides the following standing facilities:

- overnight deposit; and
- overnight loan.

- Required reserve

Through the required reserve instrument, the Bank of Albania aims to adjust money supply and the level of liquidity in the banking system, as well as to steer interbank rates. The Bank of Albania requires commercial banks to hold a certain amount of reserve in ALL and in foreign currency with the central bank.

The Bank of Albania continuously revise its monetary policy instruments depending on the conditions on the Albanian financial market and monetary policy course. These revisions aim at

enhancing their effectiveness.

- Other instruments

² For more detailed information on the types and use of monetary policy instruments implemented by the Bank of Albania, please refer to "Bank of Albania's Monetary Policy Instruments and Procedures for their Execution" (www.bankofalbania.org)

The above instruments are conventional monetary policy instruments. In particular circumstances, the Bank of Albania may consider employing other instruments, in order to enhance the effectiveness of the above instruments or to complement their effectiveness. These instruments are in compliance with the legal framework of the Bank of Albania. They can only be used occasionally, as deemed necessary by the Bank of Albania.

Forward guidance is one such monetary policy instrument. Bank of Albania's public commitment to pursue a certain monetary policy path in the future helps to reduce the uncertainties in the financial markets and to increase the effectiveness of its conventional instruments.

4. Theoretical framework amendment and performance of targeted variables

4.1. The amendment to the theoretical framework

According to the Law "On the Bank of Albania", the primary objective of the Bank of Albania's monetary policy is to achieve and maintain price stability. For this reason Bank of Albania has implemented and maintained a free-floating exchange rate regime for the period under consideration. The value of the ALL against the other foreign currencies is freely determined in the foreign exchange market by its supply and demand. The free-floating exchange rate regime allows the Bank of Albania's monetary policy maximum flexibility in achieving the inflation target. The Bank of Albania has defined price stability as the keeping of the consumer price inflation rate at 3.0%, with a tolerance band of ± 1 percentage point around this central numerical figure for the observed period.

The research showed change in *intermediate and operational objectives* where Bank of Albania targets the adoption

of more advanced forms. The choice of intermediate and operational objectives depends on the monetary policy regime and the level of economic and financial market development. For the period 2006 - 2008, Bank of Albania adopted the following:

- The annual growth of money supply (M3) is an interim objective.

The definition of M3 annual growth as an interim objective is based on the argument that inflation, being a monetary phenomenon, is influenced by the money supply growth.

- Net domestic assets.

Net domestic assets of the Bank of Albania represent the amount of the Bank of Albania claims, excluding its foreign currency claims on nonresidents.

- Net international reserves.

Net international reserves of the Bank of Albania represent the Bank of Albania net foreign assets minus all foreign currency assets of commercial banks held with the Bank of Albania (required reserve in foreign currency plus excess reserve in foreign currency).

After year 2009 a major step has been taken in terms of the institutional development of the interbank rates, through the establishment and maintenance of TRIBOR and TRIBID reference rates.

The Monetary Policy Document for the 2009-2011 period was a significant move in this direction - the instruments are employed to achieve the objective, namely:

- (Reverse) repurchase agreements.

In compliance with its operational objective, the Bank of Albania employs (reverse) repurchase agreements to steer short-term interest rates in the interbank market, and to temporarily withdraw or inject liquidity into the banking system. Repurchase agreements are used to temporarily reduce the liquidity in the banking system. Reverse repurchase agreements are used to temporarily increase the liquidity in the banking system or banks' capacity to

increase lending or currency in circulation. (Reverse) repurchase agreements of one-week maturity are executed through standard auctions, while agreements of one-day, one-month and three-month maturity are executed through quick auctions.

➤ **Outright transactions.**

The Bank of Albania reduces the liquidity in the market through outright sale transactions and increases it through outright purchase transactions. These transactions are executed through the purchase or sale of Treasury bills of up to one-year maturity or highly credible debt securities.

➤ **Foreign exchange market operations.**

Foreign exchange market operations are carried out by the Bank of Albania through the purchase or sale of foreign currency in the market when the central bank intends to intervene in the market.

➤ **Overnight deposit.**

The overnight deposit assists commercial banks in operating with excess liquidity, by placing it for only one day with the Bank of Albania. Overnight deposit also helps withdraw the excess liquidity from the banking system and level out large fluctuations in short-term interest rates in the interbank market. The interest rate on overnight deposit is the lowest interest rate offered by the

Bank of Albania in the market.

➤ **Overnight loan.**

The overnight loan is a fully collateralized loan provided to assist commercial banks in solving their overnight liquidity problems. It also helps to smooth fluctuations in short-term interest rates in the interbank market. The interest rate on overnight loan is higher than the key interest rate.

Next steps considered to boost the development of the interbank market in Republic of Albania are as follows³: first,

setting the prime rates for commercial banks. These rates can and should serve as a guide to setting prices on banking products, both on assets and liabilities. Second, the functioning of the collateralized market through repo or reverse repo contracts. Although in its classical concept the interbank market is an uncollateralized market, its enhancement with the above mentioned instruments would open the way to its thorough development, ensuring a more efficient distribution of liquidity among the market operators. Third, banks can and should be active in quoting the liquidity in ALL, keeping the same position as in the foreign exchange market.

4.2. Performance of the targeted variables

Consumer price inflation rate

"Achieving and maintaining price stability" implies pursuing low but positive inflation rates and maintaining them for relatively long periods of time. In quantitative terms, the Bank of Albania defines price stability as the keeping of the consumer price inflation rate at 3.0%, with a tolerance band of ± 1 percentage point around this central numerical figure. The inflation target is measured by the annual rate of change in the Consumer Price Index, which is calculated and published by INSTAT.

This quantitative definition of price stability reflects the performance of the Albanian economy as a small, open and emerging economy. As such, it is characterized by a high relative price volatility, towards finding stable structural balances of the market economy. In addition, the quantitative inflation target of 3.0% supports the EU integration process, enabling a reasonable time span for the real and nominal convergence of the Albanian

³ For more details see: www.bankofalbania.org, Speech of the Governor of the Bank of Albania, Ardian Fullani, at the Forum "Interbank Market Development and Improvement of Operational Policy at the Bank of Albania", 21 June 2010

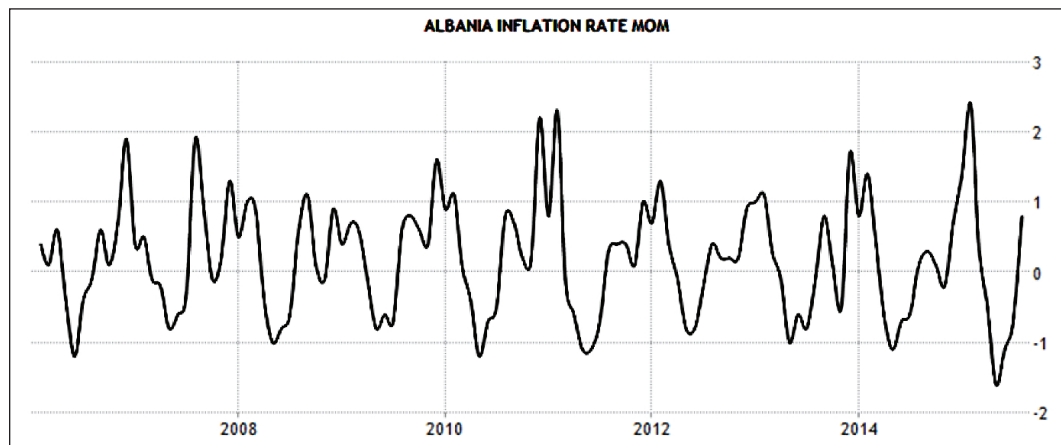
economy with the EU. Lastly, keeping the inflation target at the same numerical figure as in the previous years will contribute positively to better anchoring the public's inflation expectations around the Bank of Albania's announced target.

Measuring inflation as the annual change in the Consumer Price Index, the Bank of Albania uses other measures – namely core inflation, tradable and non-tradable inflation, and the inflationary expectations of economic agents - in order to improve the monetary policy decision-making process.

These measures provide a more comprehensive basis for more pragmatic decisions.

value of the ALL against the other foreign currencies is freely determined in the foreign exchange market by its supply and demand. The free-floating exchange rate regime allows the Bank of Albania's monetary policy for maximum flexibility in achieving the inflation target. In addition, the implementation of this regime reflects and enables the free movement of goods and capital in Albania's commercial and financial exchanges with its trading partners.

Consistent with its monetary policy, as a guarantee for coping with the severe shocks on the real sector of the economy, and in order to safeguard the country's financial stability, the Bank of Albania is committed



source: <http://www.tradingeconomics.com> / INSTITUTI / STATISTIKAVE (INSTAT)

The Consumer Price Index in Albania increased by 0.8 percent in August 2015 relative to the previous month. Inflation Rate MoM in Albania averaged 0.19 percent from 2006 until 2015, reaching an all time high of 2.4 percent in February 2015 and a record low of -1.6 percent in May 2015. The analysis shows that the targeted value was achieved during the observed period. Inflation Rate MoM in Albania is reported by the Instituti i Statistikave (INSTAT).

Exchange rate regime

The Bank of Albania has implemented a free-floating exchange rate regime. The

to holding a sufficient level of foreign reserve. In line with the best international practices, the Bank of Albania determines the sufficient level of foreign reserve based on the concurrent observance of these two quantitative criteria:

- the maintenance, in the med-term, of foreign reserve levels sufficient to cover at least 4 months of imports of goods and services; and
- the maintenance, in the med-term, of foreign reserve levels sufficient to cover the short-term foreign debt of the Albanian economy.

Articles

In order to increase the level of foreign reserve and contribute to the stabilization and development of the domestic financial markets, the Bank of Albania may intervene in the domestic foreign exchange market.

The annual growth rate of M3 aggregate and its confrontation with the real demand of the economy for money will serve as an indicator of monetary inflationary pressures. The quantitative adequacy levels of money



source: <http://www.tradingeconomics.com> / OTK INTERBANK

These interventions, however, will not reflect the monetary policy; they will neither affect nor prejudice the achievement of the primary objective of the Bank of Albania.

The Bank of Albania intervenes in the foreign exchange market in accordance with the relevant internal regulations. The latter are made transparent to the public.

The Albanian ALL averaged 111.98 between 1998 and 2015, reaching an all time high of 151.87 in October 2000 and a record low of 76.38 in July 2008.

Annual growth of money supply (M3)

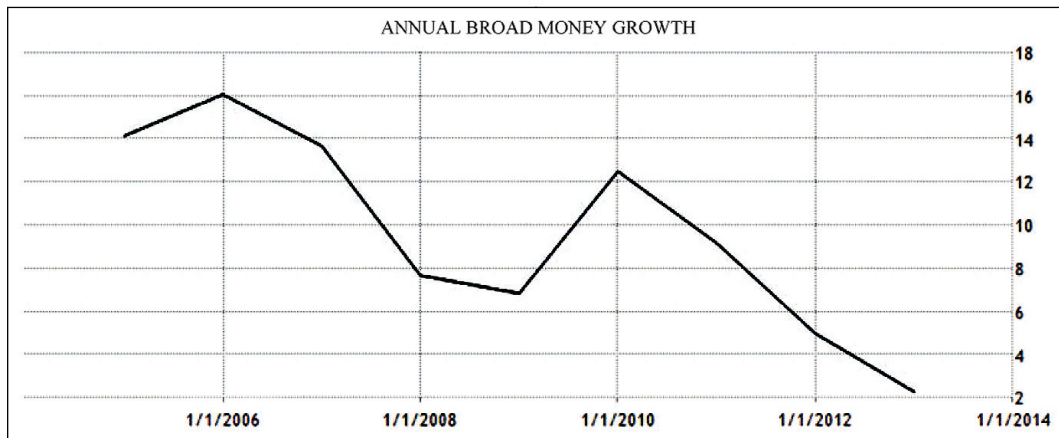
The Bank of Albania uses the broad money aggregate (M3) as an indicator of inflationary pressures in the economy. The informative role of broad money is substantiated by the argument that inflation is a monetary phenomenon over long time periods, and consequently, it is affected by the growth of money supply in the economy. Accordingly, the growth of broad money beyond the demand of the economy signals and provides room for mounting inflationary pressures.

growth are revised over the course of the year, consistent with the performance of monetary developments and the corrective measures proposed by the Bank of Albania in the monetary program.

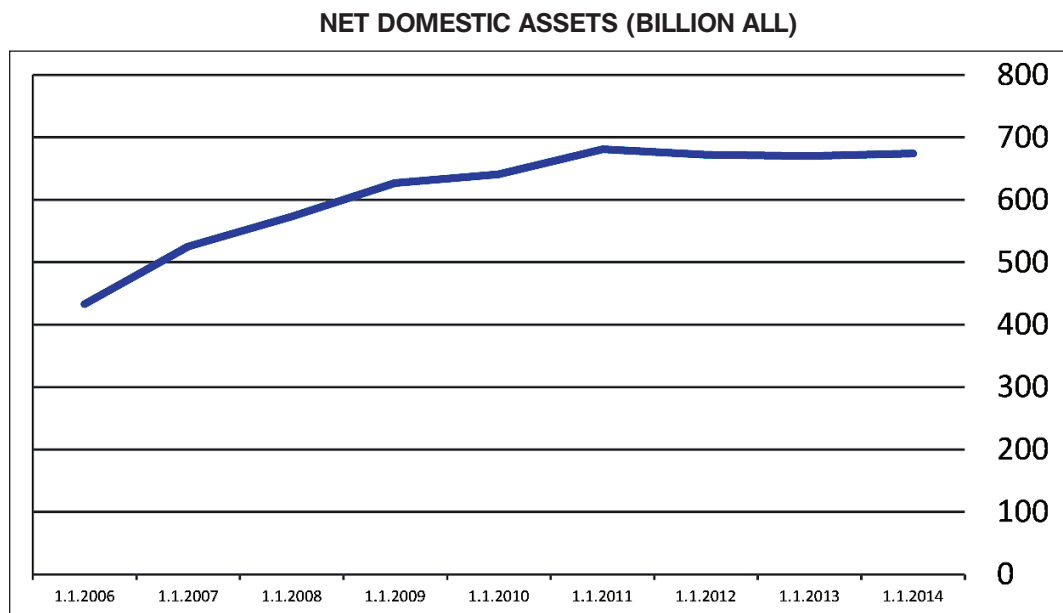
Annual Broad money growth (%) in Albania was last measured at 4.8% for Q2 in 2015, according to the Bank of Albania. Negative trend was recorded as per annual broad money growth with highest level for 2006 of 16.3%. Private sector demand for financing continued to appear sluggish, providing low contribution to the creation of money in the economy.

Net domestic assets

Net domestic assets of the Bank of Albania represent the amount of the Bank of Albania claims, excluding its foreign currency claims on nonresidents. More specifically these include the Bank of Albania (net) claims on the Government, and its claims on commercial banks. An upper limit is set on these claims, which implies that the Bank of Albania cannot increase the position of net domestic assets beyond the set limit.



source: <http://www.tradingeconomics.com> / BANK OF ALBANIA



source: www.imf.org

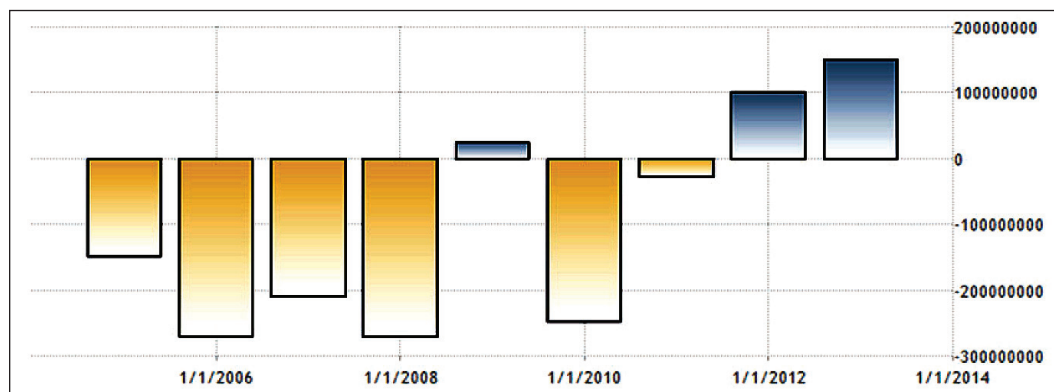
Net domestic assets were last measured at ALL 670 billion in 2013, according to the Bank of Albania and forecasted at ALL 682 billion for 2015. They mark an increasing trend compared to 2006 when they were measured at ALL 433 billion. Increase is generally triggered by claims on commercial banks and on the private sector.

Net international reserves

Net international reserves of the Bank of Albania represent the Bank of Albania net foreign assets, minus all foreign currency assets of commercial banks held with the Bank of Albania (required reserve in foreign currency plus excess reserve in foreign currency).

NET INTERNATIONAL RESERVES

5. Conclusion



source: <http://www.tradingeconomics.com> / BANK OF ALBANIA

Changes in net reserves (US dollar) in Albania was last measured at USD 150,50 million in 2013, according to the World Bank. Changes in net reserves is the net change in a country's holdings of international reserves resulting from transactions on the current, capital, and financial accounts.

Interbank rate

The Supervisory Council deemed that the monetary conditions are appropriate for achieving the price stability objective and decided to keep the key interest rate unchanged at 2.0%. Albania's interest rate was cut several times until brought down to its new historic low of 2%.

Albania Interbank transactions consist in short-term ones, mainly one and seven days. Since the last interest rate cut in January, interbank interest rates have remained mainly below the key rate. The overnight rate averaged 1.92% for Q2 2015 and the seven-day rate fell to 1.97%

The borrowing volume in the interbank market is estimated to be around 1.0% of total banking system assets. The market is segmented and, due to exposure restrictions, liquidity management is often inefficient.

Fundamental change is seen in intermediate and operational objectives where Bank of Albania targets the adoption of more advanced forms. The choice of intermediate and operational objectives depends on the monetary policy regime and the level of economic and financial market development. For the period 2006 - 2008, Bank of Albania approved the annual growth of money supply (M3); net domestic assets; and net international reserves. After 2009 the priority was to steer short-term interbank rates close to the Bank of Albania's key interest rate and the instruments which were employed to achieve the objective.

With respect to the monetary variables of the economy, the Bank of Albania has implemented and maintained a free-floating exchange rate regime. In quantitative terms, the Bank of Albania defines price stability as the keeping and maintaining of the consumer price inflation rate at 3.0%. Targeting the interbank market interest rates seems a practical option for Albania but currently there is plenty of room for improvement in this philosophy and practice. Albania's financial markets required continuous upgrade in the policy framework and instruments.

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