



# The Effectiveness of the Albanian Monetary Policy

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**Abstract:** *This article aims to assess the efficiency of the Bank of Albania's monetary policy in attaining its goals of price stability and economic expansion. Price stability is essential for ensuring a favorable business environment, preserving the purchasing power of the currency, and reducing uncertainty in the economy. The analysis takes into account the unique characteristics and challenges faced by the Albanian economy. This article offers insights into the effectiveness of the monetary policy framework in Albania by assessing the primary instruments and tactics used by the BoA, including interest rates, reserve requirements, and open market operations. It also investigates how external influences affect the efficacy of monetary policy and makes suggestions for improvement.*

*This paper concludes with suggestions for boosting the Albanian monetary policy's efficacy. It recommends actions to strengthen the transmission mechanism, improve data quality and availability, enhance coordination between monetary and fiscal policies, and boost the institutional capability of the central bank. It also stresses how crucial it is to have a consistent and well-defined policy framework.*

*In the end, this article provides recommendations for enhancing the effectiveness of the Albanian monetary policy. It suggests measures to strengthen the transmission mechanism, improve data quality and availability, enhance coordination between monetary and fiscal policies, and increase the central bank's institutional capacity. Additionally, it emphasizes the importance of maintaining a stable and predictable policy framework.*

## 1. THE GLOBAL FINANCIAL CRISIS AND ALBANIAN ECONOMIC OVERVIEW

The difficult economic conditions and the internal imbalances of the most powerful countries were among the main causes of today's economic crisis and financial catastrophe. Since Italy and Greece, two Eurozone members experiencing severe financial and internal debt crises, are Albania's two most significant trading partners, the consequences of the global financial crisis are indirectly felt in the country's economy.

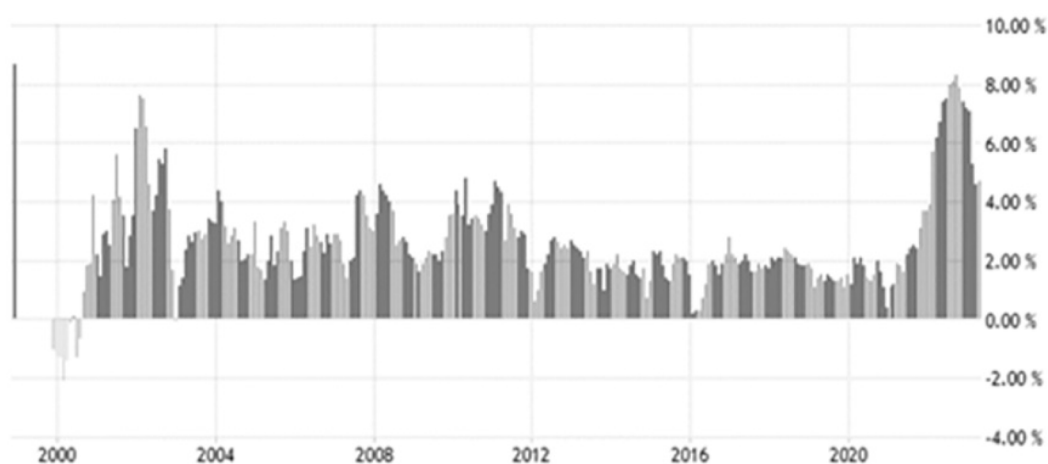
The financial crisis had an impact on the Albanian economy in 2009. Albania's economic development outpaced that of several other Balkan and European nations between 2009 and 2011 as a result of the balanced economy. Due to the rising debt, the fiscal measures adopted by the Albanian government in this situation were unable to achieve their objectives. The Bank of Albania concentrated on prudential policy with the main objective of raising the competitiveness of Albanian goods and services in foreign markets to guarantee economic stability (Shijaku, 2016).

With a growth of 4.8 percent in 2022, the Albanian economy has surpassed forecasts because of robust consumer demand, tourism inflows, and building activity. Along with a rise in the local currency Lek, the fiscal and current account deficits also significantly decreased. Due to sluggish trading partner growth, the removal of policy assistance, and also the tighter financial

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conditions, the GDP will go toward a falling trend. Although it has been slowly falling, inflation is still beyond the central bank's objective (IMF, 2023).

The latest data indicates that economic growth has recovered rather quickly over the previous year, inflation has kept a cap on its rise, and the major financial and economic balances have remained healthy. One of the lowest inflation rates in the area and Europe, the consumer price index (CPI) inflation dropped in March, marking the lowest level in a year. Due to stabilized prices on the global market and a robust Lek/Euro exchange rate, inflation declined in the first quarter of the year. Inflation was down from the previous quarter's average of 7.9% to an average of 6.5% in the first quarter. Particularly in March, when inflation hit 5.3%, this drop quickened. In terms of the consumer basket, the decline in inflation was a result of lower costs for food and energy, especially for oil. It represented the reduction in imported inflation from a macroeconomic standpoint (Instat, 2023).



**Figure 1.** Inflation rate during the period 2000-2023

Source: Instat, 2023

The rise in household spending, building activity, and the dynamism of the tourist industry all contributed to the 4.8% economic growth for 2022. This success was backed up by the private sector's strong financial position, the labor market's strong performance, and the growth in consumer and business confidence. At the beginning of 2023, indirect data also predicts a rise in demand and output.

The labor market indicates a strong need for workers and pressure to raise pay in the future. This progress may be seen in the unemployment rate dropping to its lowest levels in history, 10.8% at the end of 2022, as well as the quick rise in private sector salaries.

The monetary policy stance has become more normalized as a result of the rise in inflation. The Bank of Albania raised the benchmark interest rate six times since the start of 2022, reaching a high of 3% in March 2023. The domestic financial markets are being affected by the normalization of the monetary policy stance.

The normalization of the monetary policy stance, undertaken through the gradual increases in the key interest rate, has played a decisive role in this positive performance. By setting up the ideal conditions for inflation to return to the goal, prompt monetary policy action was crucial for stabilizing the domestic financial markets and achieving a better balance between the demand and

supply for goods and services. Additionally, the right monetary policy response had no negative effects on the upward tendencies in economic growth. The Albanian economy is still expanding and creating more employment, higher pay, and stable business financial balance sheets. According to this perspective, our monetary policy has contributed to Albania's sustainable and long-term development, which has in turn increased social welfare (Bank of Albania, 2023).



**Figure 2.** Economic growth during period 1991-2022

Source: World Bank Group, 2019

## 2. THE OBJECTIVE OF THE MONETARY POLICY OF THE BANK OF ALBANIA

Annual inflation has been on a downward trend since reaching a peak of 8.3% in October 2022, and it is anticipated to reach 4.6% by the end of 2023 (European Commission, 2023). In order to combat inflationary pressures, the Bank of Albania has increased the key policy interest rate by 250 basis points to 3%. It plans to continue normalizing its monetary policy stance.

Inflation is predicted to attain the 3% objective in 2024 as import costs slow down and local price pressures ease.

The following techniques are used to implement monetary policy: Open market operations, accessible facilities, and operating under the constraints of minimal reserve requirements and freely fluctuating currency rates are all prerequisites.

The M3 monetary aggregate, which is used by the Bank of Albania as a proxy for widespread money, is used to assess the impact of monetary policy on economic inflation. Similar actions are used by the European Central Bank to accomplish the main objective of monetary policy. According to this approach, rising inflation outside of the economy is both a precursor to and an indicator of an increase in the money supply. According to the Bank of Albania, as inflation is a long-term monetary phenomenon, the increase in the amount of money in circulation within the economy has the most effect on it. The fall in mutual funds, the steady long-term expansion of the economy and welfare, as well as the promotion of the financial system's stability all contribute to maintaining price stability, which directly affects maintaining macroeconomic equilibrium in Albania.

From this perspective, the Bank of Albania must keep prices steady at all times, and the best method to achieve this is through utilizing comprehensive economic and financial data. These indicators allow for the early identification of inflationary pressures and the appropriate adjustments to monetary policy.

The examination of economic indicators should be related to indicators of output and the country's financial status and should place a strong emphasis on the short- and long-term inflation processes. This element considers how the interplay between supply and demand in the markets for goods and services affects inflationary pressure.

### **3. FACTORS INFLUENCING MONETARY POLICY EFFECTIVENESS IN ALBANIA**

This section examines many variables, such as inflation rates, the high degree of use of the euro, the timing of political transmission of monetary policy, and the high degree of non-performing loans, to judge the success of the Albanian monetary policy. It looks at how these indicators have performed historically and how they relate to the BoA's policy decisions.

Monetary stability served as one of the main pillars of the Albanian economy's historical economic growth record. It was fairly successful in reducing the minimal volatility of currency rates as shown by inflation. Consumer price inflation decreased from 40% to barely 3% after 1997. The value of the Albanian Lek concerning the euro grew while the exchange rate remained stable. A stable inflation rate and reliable inflation expectations were produced by the soundness of the banking system and the confidence in the monetary policy.

The effectiveness of the monetary policy is directly impacted by the high economic adoption of the euro. Because businesses are more sensitive to exchange rate fluctuations, free exchange rates do not stabilize the economy. Fiscal policy is impacted by the potential price increase in the stock of outstanding debt that is denominated in foreign currencies. In order to limit the frequent use of the euro as a currency and promote the use of local currencies, a deal was made that the Bank of Albania must abide by (Novosz ath, 2023).

The monetary policy will constantly look to the future by estimating the anticipated inflation rate. The transmission mechanism of monetary policy may fluctuate from one year to up to three years depending on important economic operators' expectations regarding interest rates and liquidity. Financial markets, however, do not always respond instantly. This indicates that it may take some time for the impacts of monetary policy operations to be seen inside the economy.

Due to the high percentage of non-performing loans, the banking industry follows a very cautious lending strategy that is based on issues that exist in many economic sectors as well as the practices of other central banks (Balla, 2019).

### **4. FUTURE RESEARCH DIRECTIONS**

There may be other efforts made to tighten inflation targeting. In order to do this, more changes must be made, with a particular emphasis on the following areas:

1. reduce the extent of dollarization;
2. increase financial intermediation levels while taking care to prevent an unsustainable loaning boom;

3. convert the cash-based economy into a bank-based economy;
4. improve the quality of financial institutions (Bolle & Meyer, 2004).

According to empirical evaluations, monetary aggregates should take the lead since they might offer helpful data regarding the long-term impacts of inflation for cross-checking reasons. As a result, there would be considerable changes in how the Bank of Albania approached inflation and the growth of the economy. The biggest challenge will be figuring out how to implement a comprehensive strategy where new and pertinent information is not lost during the decision-making process and where data can be organized so that data necessary for adhering to legal requirements and maintaining price stability can be identified in due time and regularly (Shijaku, 2016).

## 5. CONCLUSION

This paper concludes by summarizing the key findings regarding the effectiveness of the Albanian monetary policy. It highlights the achievements made in maintaining price stability and promoting economic growth. However, it also acknowledges the challenges faced by the BoA and the need for continuous improvement in policy implementation. By adopting the recommended measures, the BoA can further enhance the effectiveness of its monetary policy and contribute to the long-term stability and prosperity of the Albanian economy.

Albania, which had to deal with the bad effects of the earthquake in November 2019 in addition to the epidemic, has found the previous several years to be difficult. Over the past five years, the shock has severely impacted Albanian society and presented difficulties for the country's capacity to maintain its sources of development as well as its economic, monetary, and financial stability. It has demonstrated that preserving economic and financial stability mostly depends on the efforts made by monetary institutions as well as society's capacity to respond to the epidemic promptly and efficiently.

The nation's economic and financial balances have remained sound, economic growth appears stable, and inflation has been falling recently. This development has been positively impacted by the monetary policy normalization thus far, which has contributed to stable financial markets and inflation management. With the way the economy is now operating, inflation is likely to reach its objective by 2024. The normalization of the monetary policy stance may, however, be required to continue in the future due to high aggregate demand and swift wage rise.

Overall, due to persistently strong inflationary pressures, tightening financial conditions, and a slowdown in economic development, the external economic environment for the Albanian economy continues to be a challenge.

Because the issue of crediting domestic firms, particularly SMEs, has not been resolved, there are several dangers associated with financial markets dependent on international banks and foreign currencies. As a result, the country is highly exposed to external hazards and vulnerable to them.

The extent to which Albania's economic and monetary policy will be able to address the ever-evolving issues in the global economy, such as the energy crisis and the price hikes brought on by the Russian-Ukrainian war, is not yet obvious. The major issue is that it is even less clear how Albania will be able to speed up growth, catch up with other EU member states, and close its huge GDP per capita deficit.

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