

Albania: 2010 Article IV Consultation—Staff Report; Staff Statement; Public Information on the Executive Board Discussion; and Statement by the Executive Director for Albania

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on **March 9, 2010**, with the officials of Albania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on **April 23, 2010**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement by the IMF Representative on Albania.
- A statement by the Executive Director for Albania.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 10, 2010 discussion of the staff report that concluded the Article IV Consultation

The document(s) listed below will be separately released

Selected Issues

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

ALBANIA

Staff Report for the 2010 Article IV Consultation

Prepared by European Department

Approved by Adam Bennett and Dominique Desruelle

April 23, 2010

Executive Summary

Context: The impact of the global crisis was buffered through the use of previously accumulated fiscal and monetary policy space. This policy space is now depleted and needs to be rebuilt urgently to mitigate risks to macroeconomic stability. The task is to recalibrate policies following the authorities' counter-cyclical response to the crisis in a setting where domestic vulnerabilities and regional risks remain substantial.

Outlook: The baseline is for a V-shaped recovery, albeit to a lower potential growth than before the crisis, with low inflation and external imbalances narrowing. However, downside risks are significant and elevated budget financing requirements under unchanged policies will crowd out private investment, thereby undermining potential growth over the medium term.

Policy Discussions: A tighter fiscal stance with improvements in productivity and competitiveness is a superior adjustment strategy, and consolidation could serve to enhance, rather than damage, growth prospects. The authorities' fiscal adjustment strategy is based on over-optimistic revenue and growth expectations. There was agreement of the benefits of a clear, credible, and monitorable fiscal rule to safeguard fiscal sustainability. Monetary policy should remain cautious and supervisors remain vigilant, given heightened regional uncertainty. Improvements in the business environment are critical to harvest the benefits from closer EU integration.

Albania follows (de facto) a floating exchange rate regime with occasional interventions. Albania maintains exchange rate restrictions under the transitional arrangements of Article XIV, but maintains no restrictions subject to Fund jurisdiction under Article VIII.

Team: Mr. Bell (head), Ms. Chen, Mr. Steinlein (all EUR), Mr. Christofides (SPR), and Ms. Pereira (FAD) visited Tirana from February 25 to March 9, 2010 and met with the Prime Minister, the Ministers of Finance and of Economy, the Governor of the Central Bank, senior officials of the administration, parliamentarians, the private sector, and academics. An outreach conference was held on March 4, 2010 with staff presentations on fiscal rules, euroization, market access conditions, and competitiveness.

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GLOSSARY

ARMO	State-Owned Oil Company
BoA	Bank of Albania
CEE	Central and Eastern Europe
INSTAT	The State Statistical Agency
NMS	New Member States
PPP	Purchasing Power Parity
PRG	Partial Risk Guarantee

Main Sources of Economic Data for Albania

Data in the staff report reflect information received by April 9, 2010 from the following organizations:

Ministry of Finance

http://www.minfin.gov.al/index.php?lang=en&option=com_frontpage&Itemid=1

Bank of Albania

<http://www.bankofalbania.org/>

Ministry of Economy, Trade, and Energy

<http://www.mete.gov.al/index.php?l=e>

Albanian Institute of Statistics (INSTAT)

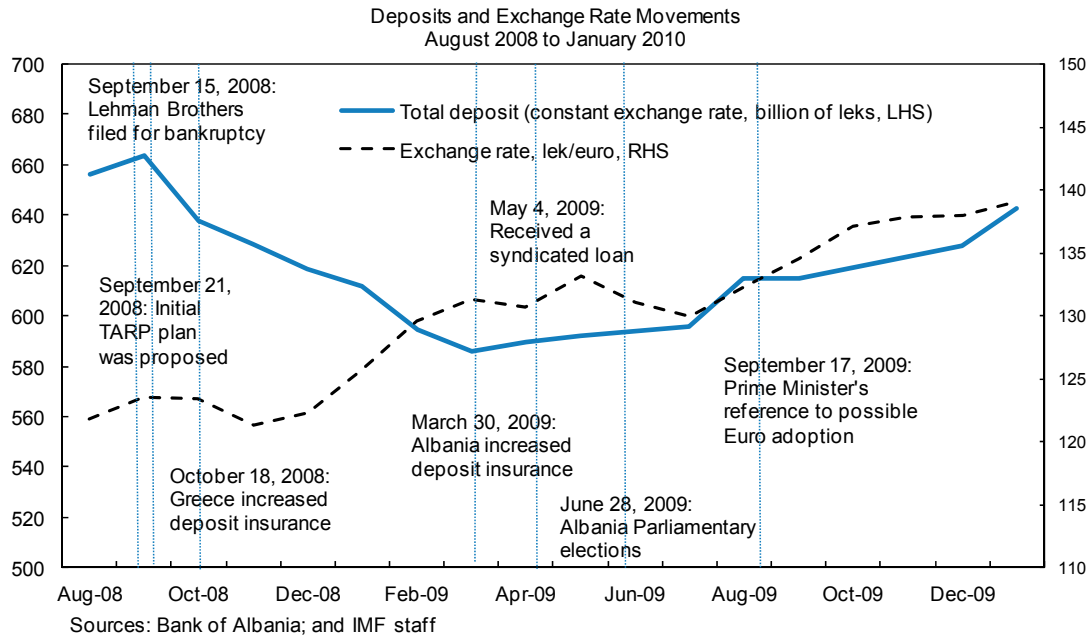
<http://www.instat.gov.al/>



I. CONTEXT AND RECENT DEVELOPMENTS

A. Albania's Strengths and Weaknesses at the Onset of the Global Crisis

- 1. Before the crisis, Albania enjoyed strong growth with comparatively benign external vulnerabilities** (Figure 1, Table 1). Sustained macroeconomic stability, a simplification of the tax system, and structural reforms—in the context of subsequent Fund-supported programs and generally good implementation of past Fund advice—helped boost investment and productivity. As a result, growth averaged some 6¼ percent during 2005–08, largely based on advancements in total factor productivity, while inflation was kept in check. Although current account deficits had crept up over time, they mainly reflected an ambitious public investment program and transition-driven productivity gains.
- 2. At the onset of the crisis, Albania benefited from a flexible monetary policy framework, sound banks, and substantial foreign exchange reserve buffers, while its weaknesses were mainly structural and elevated public debt.** Inflation expectations were low, the exchange rate stable, and the financial system entered the crisis well capitalized and relatively solvent, liquid, and profitable (Figure 2). To a large extent this was due to the Bank of Albania's (BoA) early and successful adoption of macroprudential measures that, inter alia, slowed credit growth and limited the balance sheet effects of unhedged foreign currency lending (Box 1). External debt was low (17 percent of GDP) and reserves coverage stood above six months of imports. In addition, the impact of the crisis was mitigated through the limited importance of the export channel in Albania and its smaller reliance on market financing. However, total public debt levels were sizable. Other weaknesses were concentrated in the structural area, especially a comparatively underdeveloped business environment.
- 3. Despite Albania's limited integration into global financial markets, the crisis was transmitted to its economy via a number of channels.** As elsewhere in the region, Albanian banks witnessed substantial panic deposit withdrawals on the heels of the dislocation in US financial markets and amplified concerns about the health of the Greek banking system in the fall of 2008 (text chart). Deposits did not start to recover until the second half of 2009. In February 2009, pressures mounted on the *lek*, and only subsided after intervention from the BoA and substantial new inflows through privatization receipts and a syndicated loan. The recession in trading partners—particularly Greece and Italy—led to falling exports. Finally, remittances and nonclassified inflows, while imprecisely measured—are estimated to have fallen drastically.



B. The Crisis Response—Use of Built-Up Policy Buffers

4. **Building on these strengths, the authorities were able to use accumulated policy space to soften the immediate blow from the crisis, and Albania has performed better than most other regional and European economies.**

- **Ample liquidity buffers** were utilized to meet deposit withdrawals. Throughout, foreign banks increased exposure, *inter alia* complying with a BoA ban on distributing dividends, and continued to extend credit. To further boost confidence, deposit insurance limits were raised fivefold.
- **Monetary loosening**, initially by quantitative easing in late 2008 via BoA direct liquidity injections, was followed by interest rate cuts by 50 bps each in January and October 2009. Meanwhile the *lek* depreciated by a cumulative 14 percent.
- **Considerable fiscal stimulus** was also provided, in part financed from the privatization of the electricity distribution system. In the first place, automatic stabilizers on the revenue side were given full play (1 percent of GDP). In addition, social security contributions were cut and a large infrastructure project was in train. Moreover, there was a strong fiscal relaxation prior to the mid-2009 elections. Together these created another 1 percent of GDP fiscal impulse.
- **Growth continued** at an estimated 2.8 percent, in contrast to most of Europe that witnessed declines. Inflation has mostly been in line with the target of 3 ± 1 percent, though depreciation pass through and higher electricity prices have recently lifted inflation above 4 percent.

Box 1. Albania: A Case of Effective Macro-Prudential Measures

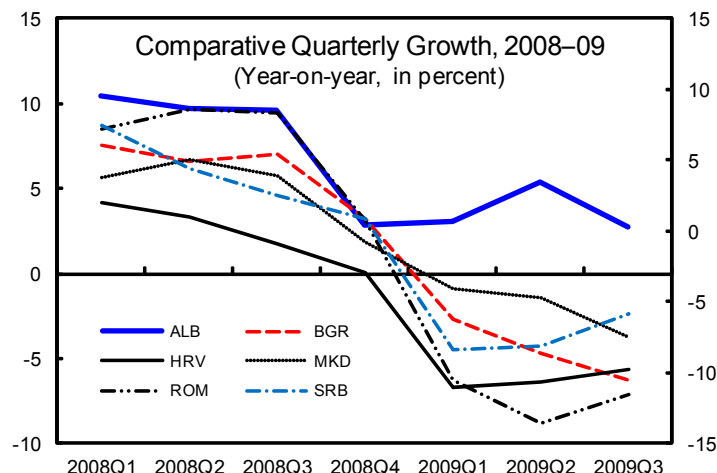
Using powers under the new Banking Act of 2006, the BoA undertook decisive measures to restrain high credit growth.

To improve credit risk management, stricter requirements were placed on individual banks based on their: (i) rate of credit growth, and (ii) levels of nonperforming loans. For example,

- the BoA imposed higher capital adequacy ratios (12½–13 percent) on two banks than the minimum of 12 percent;
- non-euro denominated foreign currency lending was banned;
- the maximum risk weights were raised to 150 percent and banks were required to slow their credit growth by reducing acceptable levels of customers' debt service to income ratios to below 25 percent;
- maintenance of foreign bank exposure was helped by strong moral suasion, and if needed, by suspending dividends distribution;
- in few cases, managers of banks were also removed or banks were asked to suspend expansion of branch networks.

The BoA took a proactive approach to increase awareness on loan quality through open forums, meetings and official letters. This approach included:

- requiring prudent loan-to-value ratios;
- encouraging tighter internal loan classification rules;
- promoting prudence in foreign currency lending; and,
- establishing a credit registry (banks submit daily (i) detailed information on the borrower and terms of all new loans; (ii) information on related persons; and (iii) information on collateral (banks report the status and internal classification for each loan quarterly). Banks are required to obtain a credit report from the registry for each new credit. During on-site examinations, BoA inspectors check the files to assure adherence to this requirement.



Sources: WEO; Haver; Albanian authorities; and IMF staff estimates.

C. The Post-Crisis Context—A Depleted Arsenal

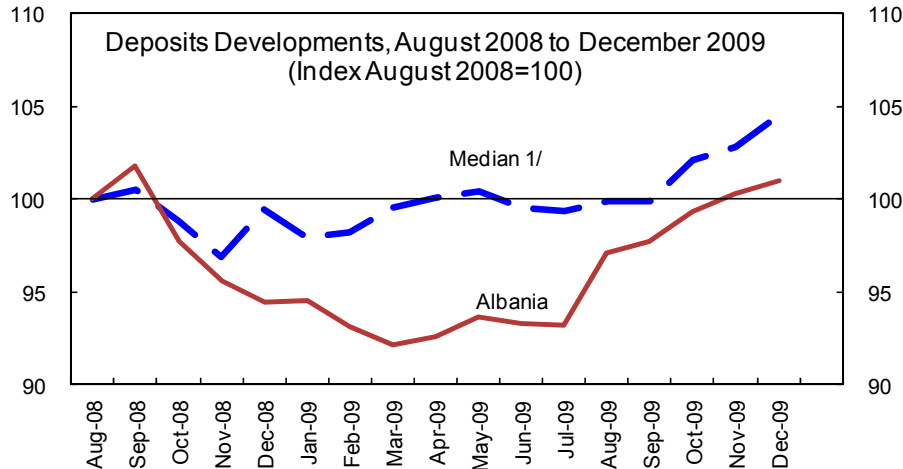
5. **Policy space is now exhausted with vulnerabilities up sharply, especially given a more challenging regional and political environment.**

- **The fiscal position deteriorated significantly and reestablishing control over expenditure has proved a challenge.** In 2009, the fiscal deficit increased to 7.4 percent of GDP (Table 2). Consequently, public debt shot to close to 60 percent of GDP, 40 percent of it short-term with substantial rollover risks. Moreover, a late-year attempt at pulling back was not successful and resulted in arrears of 0.5 percent of GDP.
- **The banking system is only slowly recovering.** Slow remonetization, rising NPLs and only creeping credit growth have lowered profitability significantly (Tables 3 and 4). Meanwhile, there has been some concern about the financial health of some parent banks.

Financial Soundness Indicators, 2008: Q3 and 2009: Q3

Country	Regulatory Capital to Risk-weighted Assets		NPL to total loans		Return on Equity	
	2008: Q3	2009: Q3	2008: Q3	2009: Q3	2008: Q3	2009: Q3
Albania	17.5	16.4	4.1	8.6	16.3	4.3
SEE average	17.2	17.4	4.6	7.9	12.8	5.1
NMS average	13.3	14.2	3.0	9.0	20.6	-5.4

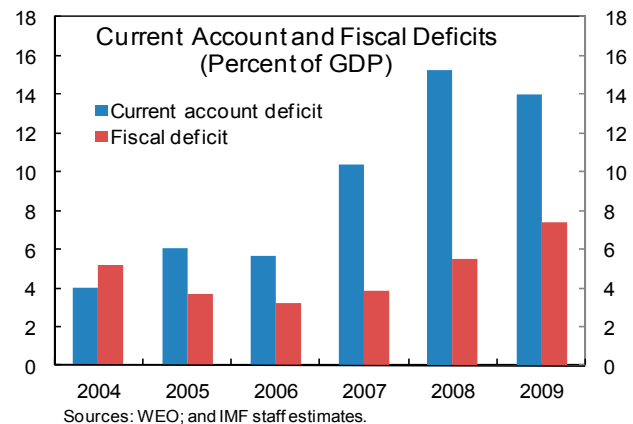
Sources: IMF, Global Financial Stability Report April 2010.



Sources: International Financial Statistics; and IMF staff estimates.

1/ The countries include Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech, Estonia, Hungary, Kosovo, Latvia, Lithuania, FYR Macedonia, Montenegro, Poland, Romania, and Serbia.

- External imbalances rose.** In contrast to the region, imports declined only modestly, leaving the current account deficit at some 15 percent of GDP (Figure 3, Table 5). In the past, private sector imbalances were the key factor. While they have begun to adjust—in line with the drought of available financing—more recently the runaway fiscal deficit has driven the current account.



Sources: WEO; and IMF staff estimates.

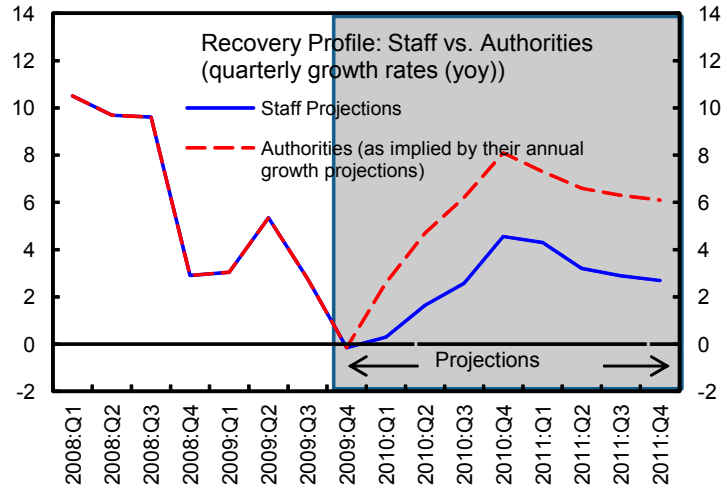
Regional and political developments add to these challenges.

While the country made important progress on EU integration, submitting its membership application in 2009, Albania is exposed to the Mediterranean euro-periphery via significant trade, remittances, and financial sector links to Greece and Italy. Greek bank subsidiaries and branches account for one quarter of the banking system and have the lowest capital and liquidity buffers in the system. Meanwhile, political uncertainty continues as the opposition has not accepted the outcome of the mid-2009 elections.¹

¹ International observers endorsed the election result.

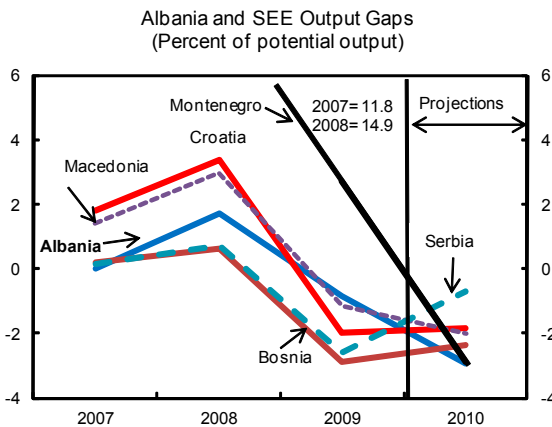
II. OUTLOOK: IMPROVING, BUT WEIGHED DOWN BY REGIONAL RISK AND FISCAL IMBALANCES

6. While there was agreement that the recovery would likely be v-shaped, staff saw it as considerably more gradual than the authorities. In the near term, domestic demand continued to be weighed down by weakened confidence on the back of the fiscal deterioration, political uncertainty, sluggish remittances, and more selective credit extension. These drags are only partly compensated by improving export performance that has been observed in the first months of 2010 and is expected to continue. Growth is therefore projected to resume in the first quarter of 2010, after an estimated GDP contraction in the fourth quarter of 2009, and then gradually gain strength, with annual GDP growth in the range of 2–2½ percent in 2010. The authorities were more optimistic, expecting activity to bounce back more quickly.

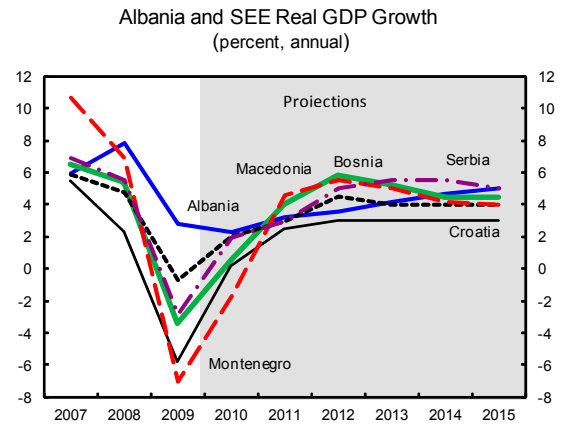


Sources: Albanian authorities and IMF staff estimates.

7. Substantial differences of view emerged over medium-term growth prospects. In contrast to some other regional economies, Albania experienced only mild capital-inflow-supported overheating, thereby limiting the buildup of output gaps. This background comforted the authorities in their view that pre-crisis growth rates would quickly re-emerge as Albania, compared to other countries, would see less of a need to recalibrate its growth model. Staff, on the other hand, saw future potential growth increasingly pulled down by high fiscal financing requirements.



Source: IMF desk estimates.

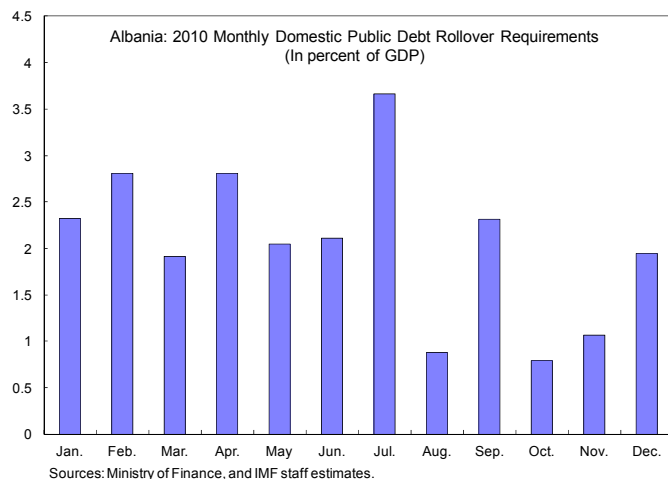
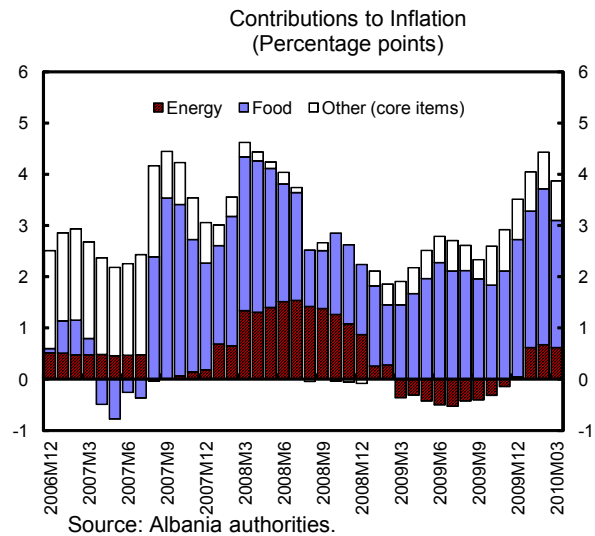


Sources: WEO; and IMF staff estimates.

8. **The baseline inflation outlook remains benign.** Administrative price increases may drive headline inflation temporarily above the 3 ± 1 percent target band in the near term. However, underlying inflation is expected to remain under control, and annual inflation is projected at 3.5 percent in 2010 and 3 percent in the medium term, benefitting from the well entrenched credibility of the monetary policy framework (see background paper).

9. **External imbalances are expected to significantly narrow, though partly through an undesirable compression of investment.** Helped by the recent depreciation of the real exchange rate, which eliminated the overvaluation depicted in GGER-type analysis, the current account deficit can narrow from 14 to 13 percent this year, and should decline further over the medium term to reach a sustainable level. The real exchange rate appears competitive and not to pose a risk to external stability (Box 2). However, high budget deficits are severely crowding out the private sector. Owing to the projected increased interest rates from high levels of government borrowing, private savings are projected to pick up sharply. While companies will partially compensate for reduced bank financing by own-funding capital expenditure, private investment will not be able to recover to past levels, thus undermining potential growth. A tighter fiscal stance with improvements in productivity and competitiveness would be a superior adjustment strategy, a topic that framed the policy discussions.

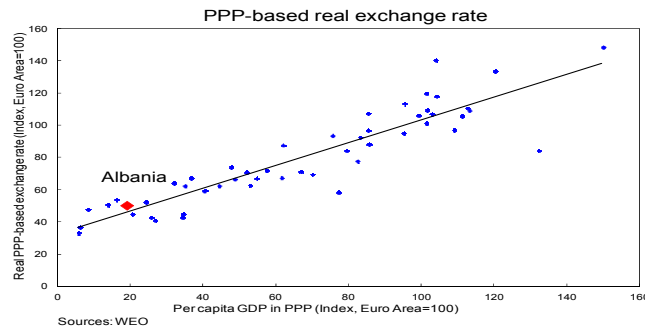
10. **Downward risks to the baseline are significant.** Both staff and the authorities agreed that, apart from risks stemming from the external environment, domestic vulnerabilities remain. The relatively high presence of Greek banks amplifies trade-related contagion risk. Rollover risks have increased—as a large part of domestic public debt matures every month—while the remaining privatization program is unlikely to generate significant proceeds. Banks will also need to keep pace with the new outlook given weaker credit demand, worsening loan portfolios, and resulting lower profitability. Faltering confidence of households and enterprises may decrease consumption and investment more than anticipated.



Box 2. Exchange Rate Assessment

The exchange rate does not appear to pose a risk to external stability. While various measures point to some overvaluation at the end of 2008, the real effective exchange rate (REER) has since moved towards equilibrium with depreciation of about 10 percent over 2009. However, a large deviation of the current account from its medium-term norm remains to be corrected. On current policies, the latter correction is projected to be driven by a substantial crowding out of the private sector.

A long-run PPP-based assessment of the exchange rate does not suggest disequilibrium. Under this approach the equilibrium real exchange rate is expected to reflect productivity differentials between countries. When comparing productivities (approximated by GDP per capita in PPP prices) with their real exchange rates per PPP dollar, Albania appears in line with other countries—within one standard deviation from the trend line.



CGER-type analysis suggests the REER moving towards equilibrium in 2009.

- *The equilibrium real exchange rate (ERER)* approach, which links the equilibrium exchange rate to a set of fundamentals, suggests neither under- nor over-valuation at end-2009. This result is obtained using CEE panel-based regression models estimating a long-run co-integrating relationship between the REER and fundamentals, such as relative productivity, terms of trade, and government consumption.
- An assessment based on the *macroeconomic balance (MB)* approach using panel estimates which incorporate new EU-member states (see WP/08/92) shows that the underlying current account balance, i.e., stripped of temporary factors, is below the norm at end-2008. However, the gap is narrowing in the medium term, albeit with the exchange rate remaining somewhat overvalued (by about 8 percent). Explanatory variables for the current account norm include the fiscal balance, the oil balance, net foreign assets, old age dependency, FDI, population and output growth, and a remittances dummy.
- *The external sustainability (ES)* approach indicates that a real depreciation of about 20 percent would be required to stabilize the NFA to GDP ratio at its estimated end-2008 level.

Current Account: Estimated/Projected vs. Norms
(In percent of GDP)

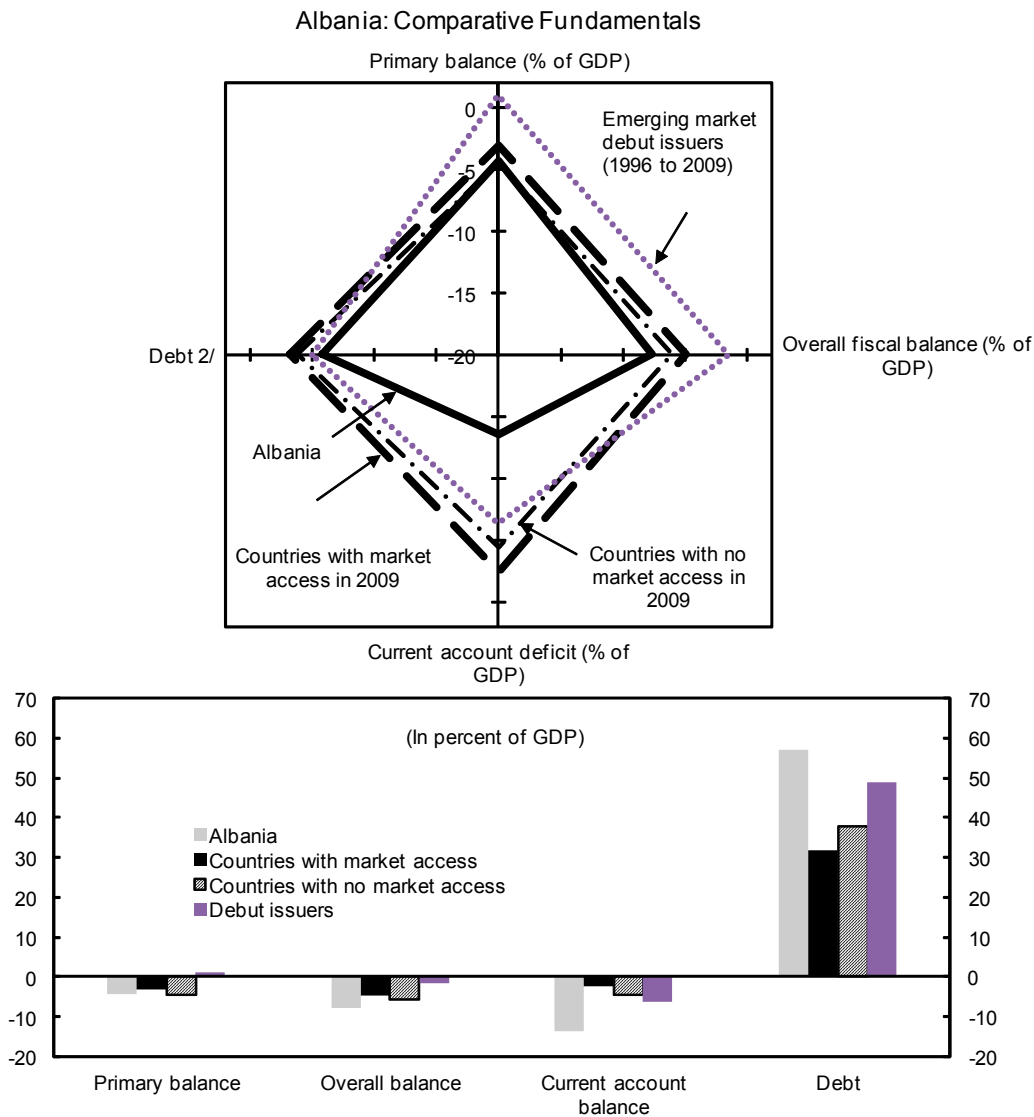
	Est. underlying CA	MB norm	ES norm
2008	-12.1	-4.9	-1.5
2015	-5.2	-4.3	-1.7

Source: IMF staff projections and calculations.

III. POLICY DISCUSSIONS

A. Rebuilding Fiscal Space and Aligning the Budget with Sustainable Financing

11. **Fiscal consolidation was jointly seen as the key near- and medium-term policy challenge.** There was agreement that after the large fiscal stimulus in 2009, there was no further scope for countercyclical policy and that the budget now needed to adjust.



Source: IMF.

1/For the top chart, improvements in fundamentals are indicated by a move away from the axis.

2/ In percent of GDP multiplied by -1/10.

Notwithstanding a still fragile economic recovery, fiscal consolidation is a priority. The government's large financing requirement and rollover needs threaten not only its chances to access markets but macroeconomic stability in general. Moreover, the fiscal deficit has begun to

crowd out investment and fiscal consolidation could therefore serve to enhance, rather than damage, growth prospects.

12. Staff cautioned against using optimistic revenue forecasts as a basis for the authorities' strategy. The government has targeted a reduction in the deficit to 3 percent of GDP over the medium term. However, much of this derives from revenue growth which is not consistent with staff's macroeconomic projections. Little progress has been made in adapting the 2010 budget to a more challenging economic environment, and a deficit of 5.2 percent of GDP is expected.² Under current policies, this would be followed by deficits in excess of 6 percent throughout the medium term, pushing debt to close to 70 percent of GDP. The authorities proposed to link certain expenditures to revenue performance, although they acknowledged that this tactic had not worked in 2009 (when their attempts to cut contingent expenditures were not successful despite significant revenue shortfalls).³

Staff Baseline 2010–13 and Authorities' Views

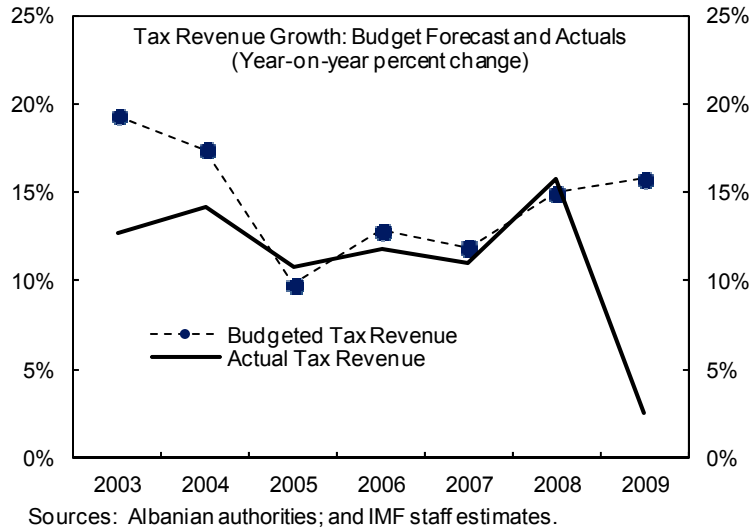
	2010		2011		2012		2013	
	Projections							
	Staff	Auth.	Staff	Auth.	Staff	Auth.	Staff	Auth.
	(Growth rate in percent)							
Real GDP	2.3	5.5	3.2	6.5	3.6	7.1	4.2	6.7
Retail prices (avg.)	3.5	3.0	2.9	3.0	3.0	3.0	2.9	3.0
	(Percent of GDP, unless otherwise indicated)							
Fiscal sector 1/								
Revenues and grants	25.2	26.6	25.0	26.8	25.4	26.9	25.7	27.1
Expenditures	30.3	30.6	31.1	29.9	31.6	29.9	31.9	30.0
Overall balance (including grants)	-5.2	-4.0	-6.1	-3.2	-6.1	-3.0	-6.1	-3.0
Public Debt	62.8	59.5	65.1	58.2	66.9	55.7	68.1	54.0
Monetary indicators								
Private credit (change in percent)	8.6		8.1		7.6		6.9	
External sector								
Trade balance (goods and services)	-22.7		-22.4		-20.9		-19.2	
Current account balance (including official tran:	-12.6		-11.3		-9.4		-7.5	
Memorandum items								
Nominal GDP (in billions of lek)	1,216.8	1,242.8	1,295.0	1,363.5	1,383.6	1,503.4	1,486.8	1,654.6

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ Defined in accrual basis

² This assumes planned significant one-off cuts to the 2010 budget of some 30 billion *lek* or 2.5 percent of GDP.

³ In December 2009, attempts to withhold the usual year-end bonus payment to civil servants and pensioners were not successful, though payments were reduced from the levels in previous years and customary pre-payments of January salaries were not implemented.



13. **A clear, credible, and monitorable fiscal rule could help safeguard medium-term fiscal sustainability.** Such a rule could put an end to the recent upward drift in deficits. Moreover, a successful rule could give financial markets greater confidence into the government's efforts to cut debt over time, thereby boosting chances for market access. For the rule to work, it would need to be binding on the authorities. Staff recommended anchoring the rule to the objective of cutting public debt below 50 percent of GDP by the end of the current government's mandate in 2013 (Background paper). Two particular options were discussed.

- **Expenditure rule:** this would be consistent with the authorities' stated preference for a small government. Keeping real expenditure constant, or limiting its increases to 2 percent could achieve debt reduction to 50 or 54 percent of GDP, respectively, by 2013. This rule would preferably be augmented by a mechanism that would trigger lower spending growth in the event of an unexpected revenue shortfall, while, in contrast, positive surprises should translate into fiscal savings, reducing the risk of ever exceeding the debt ceiling. In this way, the rule would allow for substantial play of automatic stabilizers.
- **Deficit rule:** this rule was favored by the authorities, as it places greater emphasis on protecting recent gains in tax administration and the overall fiscal balance. However, staff stressed that these gains notwithstanding, lower post-boom revenue would call into question the current system of low income tax rates—flat at 10 percent—if the authorities' goal was to accommodate higher expenditure growth under a deficit rule.

14. **Staff pressed for upfront progress on fiscal consolidation.** Targeting a cut in the 2010 deficit to around 3 percent of GDP, would lower the financing requirement, and mark a first step toward credible public debt reduction. This should allow more credit to go toward private investment, support the current account adjustment, and possibly improve the terms (and availability) of market borrowing. To achieve such a target in 2010 requires a considerable share of one-off measures that would need to be followed up by more structural measures over the following years. Throughout, such adjustments can take place while protecting the most vulnerable sections of the population.

Albania: Impact of Consolidation Measures on the 2010–13 Budget Accounts
(percent of GDP)

	2010		2011		2012		2013	
	Baseline	Adjust.	Baseline	Adjust.	Baseline	Adjust.	Baseline	Adjust.
Revenue & Grants	25.2	25.7	25.0	25.8	25.4	26.8	25.7	27.1
Total expenditure	30.3	28.5	31.1	27.8	31.5	27.1	31.8	26.2
Primary	27.0	25.2	27.3	24.5	27.7	23.9	28.0	23.4
Current	21.9	20.2	22.1	19.6	22.5	19.0	22.8	18.4
Capital	5.1	5.0	5.2	5.0	5.2	5.0	5.2	5.0
Interest	3.3	3.3	3.8	3.3	3.8	3.1	3.8	2.9
Contingencies	0.4	0.0	0.6	0.0	0.6	0.0	0.6	0.0
Overall balance	-5.2	-2.8	-6.1	-2.0	-6.1	-0.3	-6.1	0.9
Primary balance	-1.8	0.5	-2.3	1.3	-2.3	2.9	-2.3	3.8
Public debt	62.3	60.4	64.6	58.8	66.4	55.2	67.7	50.1
Policy-adjusted variables:								
Social Security Contributions	4.2	4.7	4.2	5.1	4.3	5.7	4.5	5.9
Wage and Personnel Costs 1/	6.3	6.0	6.3	5.6	6.3	5.3	6.3	4.9
Social Insurance Outlays 2/	8.5	7.9	8.5	7.7	8.5	7.5	8.5	7.2
Operations and Maintenance	2.3	2.0	2.2	2.0	2.4	2.0	2.6	2.0
Local Government Expenditure	2.4	2.4	2.5	2.4	2.7	2.4	2.7	2.4
Public Investment	5.1	5.0	5.2	5.0	5.2	5.0	5.2	5.0
Contingencies 3/	0.4	0.0	0.6	0.0	0.6	0.0	0.6	0.0

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ Nominal freeze in 2010, followed by public employment rationalization.

2/ Nominal freeze in 2010, followed by CPI indexation.

3/ In the adjustment scenario, contingencies would not be spent.

- **Past tax and contribution cuts should be reconsidered.** Staff saw little evidence that last year's cut in social security contributions was delivering the expected improved compliance; on the contrary, it aggravated the pension deficit to 2.5 percent of GDP, which is high in view of Albania's fairly young population. Staff advised against a planned tax amnesty, as it could undermine future tax compliance.
- **Significant expenditure adjustments could be effected in 2010.** The remaining contingency allowance (0.4 percent of GDP) in the 2010 budget could be reduced. Public investment should be scaled back from still historically high levels to more financeable and administratively manageable levels after the completion of the Reshen-Kalimash

road. Looking forward, civil service employment levels should be rationalized, while keeping wages and pensions in check. This could be helped by indexing the latter to only inflation.

15. Staff and the authorities agreed on the need to continue structural fiscal reforms.

Capital expenditure execution remains a challenge. In past years, before the large road project, spending lagged well behind budgeted amounts (see table) and was only boosted through late-year reallocations. A fall-back to past implementation problems is likely unless planning and implementation capacities are significantly enhanced. Regarding tax administration, an effective compliance strategy is especially urgent, including by addressing the under-reporting of taxable income by high-wealth individuals and by capturing a greater share of informal economic activity.

Albania: Comparison of Budget and Outcome, 2005–09
(In percent of actual GDP)

	2005		2006		2007		2008		2009	
	Budget	Actual	Budget*	Actual	Budget	Actual	Budget	Actual	Budget	Actual
Total Expenditure	30.4	28.6	27.5	28.6	30.1	29.6	33.9	32.3	33.4	33.4
Current Expenditure	23.8	23.7	23.3	22.9	23.7	23.3	23.3	23.2	24.6	24.5
Capital Expenditure	6.2	4.7	4.3	5.6	6.2	5.9	9.7	8.6	7.8	8.8
of which: RK road	...	...	1.0	1.0	1.5	1.8	3.1	3.6	2.3	3.6
of which: other	6.2	4.7	3.3	4.6	4.7	4.1	6.6	5.0	5.6	5.2
Overall Balance	-5.2	-3.7	-1.6	-3.2	-3.8	-3.9	-7.9	-5.5	-4.3	-7.4

Sources: Albanian Ministry of Finance.

* Includes supplementary budget.

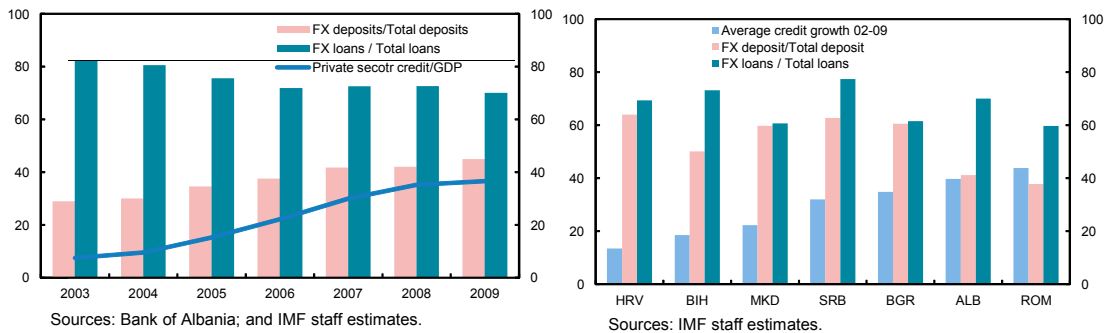
16. The authorities are seeking to place a Eurobond, to lessen the heavy reliance on short-term domestic financing, reduce near-term rollover risk and lower crowding out. However, heightened uncertainty in international markets may have an impact on the size and pricing of the issue, and the authorities are keeping other options on the table, including a Fund-supported program.

B. Conducting Effective Monetary Policy and Preserving Financial Stability

17. All agreed that the prevailing monetary policy framework—an inflation target range combined with a flexible exchange rate—is an asset in the current uncertain environment. It has endowed the economy with considerable resilience, as evidenced by the limited impact of the energy and food price shock on Albania in 2007–08. Recently the moderate depreciation eased the adjustment to the global crisis while keeping inflation expectations well anchored. This is an important achievement especially within the context of still significant euroization, and its attendant limits on monetary policy (Box 3).

Box 3. Euroization and Banking Sector Risks

Euroization increases banking sector risks and requires high capital and reserves buffer. Currency mismatches could increase solvency risks of the banking sector directly through unfavorable exchange rate movements or indirectly through credit risks of nonhedged portfolios. The central bank's lender-of-last-resort facilities may only have limited funding in foreign currencies in case of bank runs, which could aggravate creditors' fears and trigger a run. Without any implications on the direction of causality, empirical analysis on data in some South and Eastern European countries shows that a higher degree of Euroization is associated with higher default probabilities and higher nonperforming loan levels. These higher risks reduce the banking sector's capacity to provide credit by requiring higher capital or reserves.



Euroization and Banking Sector Risks

Dependent Variable	Proxy of Default Probabilities				Non-performing Loans			
	Constant	1.59***	4.38***	1.91***	6.27***	-0.28	5.68*	-2.18***	0.85
Euroization	0.02***	0.03***	0.02***	0.02***	0.04***	0.05***	0.06***	0.06***
GDP per capita		-0.21***		-0.20***		-0.36		-0.42**
Inflation		0.00		-0.01		0.02		0.04
REER		-0.27		-0.55**		-0.74		-0.10
Market concentration			-0.40	-0.84***			2.19***	2.82***
Net Interest Margin to ROA			0.011	-0.001			-0.03	-0.02
R square	0.42	0.63	0.46	0.71	0.33	0.42	0.48	0.61
NOB	35	35	35	35	35	35	35	35

Sources: IMF staff estimates.

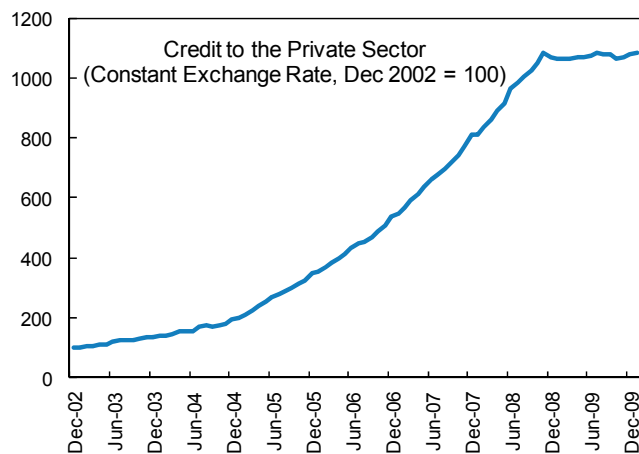
Notes: (1)*, ** and *** indicates significance at 10, 5 and 1 percent respectively.

(2) Sample includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania and Serbia from 2003 to 2007.

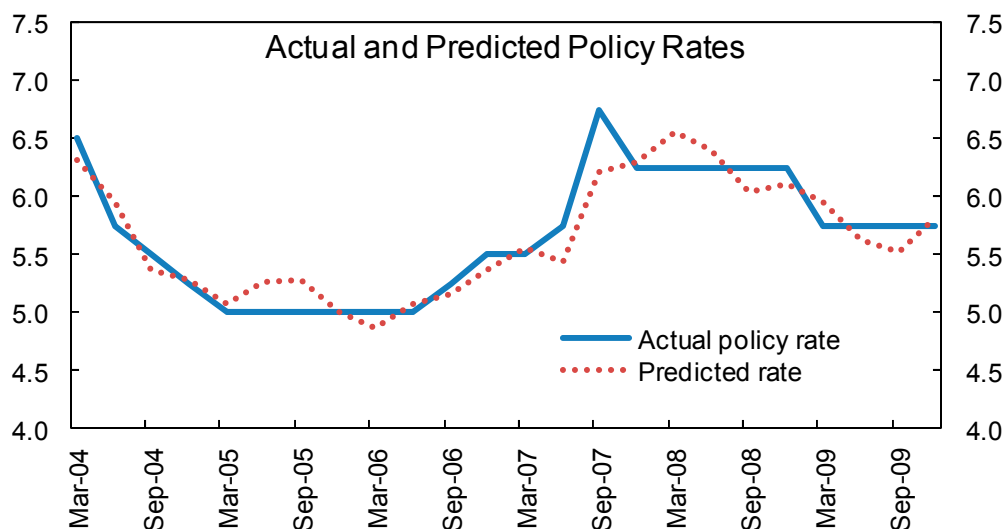
While lower Euroization would facilitate monetary policy, it cannot be forced and prudential measures should be adopted to contain the risks. De-euroization policies could involve both market-based and administrative measures, but should stick to the principle of first maintaining macroeconomic stability, and in particular low inflation. However, a certain degree of Euroization appears inevitable as Albania becomes more integrated into the European market, and indeed reflects confidence in the country's transition process. To effectively contain the risks, banking supervisors should enhance risk-based supervision by setting high standards for risk management and ensure that banks have adequate buffers to handle large shocks.

18. **Monetary policy should remain cautious.** Compared to many regional central banks and a simple Taylor rule, the BoA has adopted a relatively tight stance (Text table and chart).

Staff encouraged the Bank of Albania to continue with this cautious stance, with the emphasis on anchoring inflation expectations. However, while interest rate decisions should be guided by the inflation target, policy makers must keep an eye on financial stability considerations and macroprudential needs. Staff advised against administrative measures to boost credit to the private sector, pointing out that a viable resumption of credit flows will depend upon fiscal consolidation.



Sources: Bank of Albania; and IMF staff estimates.



Sources: Bank of Albania; and IMF staff estimates.

Monetary Policy Actions by Central Banks in the Region

Country	De Facto Exchange rate	Interest Rates	Required Reserves
Albania	Floating	Policy rate was lowered from 6.25 to 5.75 in January 2009 and further to 5.25 in October 2009.	No change in required reserve ratios.
Bosnia and Herzegovina	Currency board		In October 2008, the required reserves ratio on short-term deposit and loans was reduced from 18 to 14 percent. In May 2009, the required reserves ratio on long term deposit and loans was reduced from 10 to 7 percent.
Bulgaria	Currency board	Base interest rates have declined from 5.77 percent in December 2008 to 1.46 percent in October 2009.	In December 2008, the minimum required reserves ratio was reduced from 12 to 10 for lev, from 10 to 5 on deposits from abroad, and 0 on state and local government budget funds.
Croatia	Other managed float	The repo rate was reduced from around 8-9 percent to a fixed 6 percent in November 2008.	In January 2009, the required reserve ratio was reduced from 17 to 14 percent.
Macedonia, FYR	Stabilized arrangement	The policy rate was raised from 7 to 9 percent in April 2009, and lowered to 8.5 percent in December 2009.	In May 2009, the required reserve ratio was increased from 10 to 13 percent for foreign currency liabilities, and from 10 to 20 percent for domestic currency liabilities with forex clause.
Romania, Rep	Floating	The policy rate was reduced from 10.25 to 10 percent in February 2009, 9.5 in May 2009, 9 in July 2009, 8.5 in August 2009, and 8 in September 2009.	The reserves requirement ratio was reduced from 20 to 18 percent in November 2008 and to 15 percent in July 2009 for lei denominated liabilities with residual maturities up to two years. The ratio was reduced from 40 percent to zero for foreign currency liabilities with residual maturity of over two years in May 2009. The ratio was reduced from 40 to 35 percent in July, 30 percent in August, and 25 percent in November 2009 for foreign currency liabilities with residual maturity of up to two years.
Serbia, Rep.	Floating	The repo rate was cut from 15.75 to 16.5 in January, 15 in April, 13 in June, 12 in July, 11 in October and 10 in November 2009.	In October 2008, the minimum required reserve ratio for foreign assets was reduced to zero and the allocation of dinars in the required reserves was increased from 10 to 20 percent. This ratio was further increased to 40 percent in January 2009.

Sources: Central banks, and IMF

19. **Stress tests suggest that the banking system has sufficient buffers to weather the expected downturn.** The tests assessed key banking system risks:

- *Credit risk.* The regulatory capital of the banking sector would remain above the minimum required level, with two banks modestly undercapitalized according to Tier 1 leverage.
- *Liquidity risk.* Some banks are vulnerable to reduced credit lines from parents. Reliance on short-term BoA repo funding has increased to some €270 million in 2009.
- *Exchange rate risk.* The banking sector would remain adequately capitalized with shocks to the exchange rate due to its small positive foreign exchange positions, and the associated indirect credit risks are fairly contained.
- *Interest rate risk.* A few banks would become modestly undercapitalized with interest rate hikes of 5 percent, but the banking sector would remain adequately capitalized.

The stress tests suggest that capital cushions, profits and increased provisioning should provide enough resources to absorb foreseen loan losses. Assuming simultaneous shocks, some institutions may require new capital, and the relevant banks have agreed to increase capital accordingly.

20. **The near-term banking sector outlook is stable, but uncertainties loom large.** Banks have been aided by their reliance on funding through their domestic deposit base, which is now recovering. Many foreign parents have boosted the capital of their subsidiaries. At the same time, Albanian firms and households are only moderately leveraged compared to South Eastern European (SEE) peers. Staff noted that strong supervision in the past had enabled banks to draw on large liquidity and capital buffers to weather the crisis. However, a drawn-out recovery could further worsen the quality of domestic credit. Moreover, other risks are emerging, and supervisors need to stay ahead of evolving challenges and risks. Notably, contingency plans that deal with new tail risks need to be elaborated. The macroprudential toolkit should be accordingly adapted to address any developing risks to financial stability early on, and thereby lay the foundation for a sustainable resumption of credit growth. Noting that all banks are again permitted to distribute profits, it was now also time for banks to move to address non-performing loans. In particular, they should begin aggressively seizing collateral of nonperforming loans or seek viable loan restructuring. This would also promote the correction of the real estate market and facilitate the rebalancing of the economy.

21. **Further development of the nonbank financial sector was seen as essential.** The authorities continue to work with the World Bank to develop the insurance and pension sectors, which have potential to provide longer-term funds for investment; and staff advised that relevant legal and regulatory problems in these two sectors should be resolved expeditiously.

C. Enhancing Competitiveness for Better European Integration

22. **An improved business environment is key to harnessing the advantages from prospective EU integration.** There was agreement that the Albanian economy needed to broaden its sources of growth and strengthen competitiveness by raising productivity and helping Albania's exports to climb up the value-added ladder. Albania's light regulation already provides the economy with welcome flexibility, especially in labor markets, and wage levels are among the lowest in the region. The needed productivity gains should be secured by greater investment. This calls for further rapid improvements to the business environment and investor protection along the following lines:

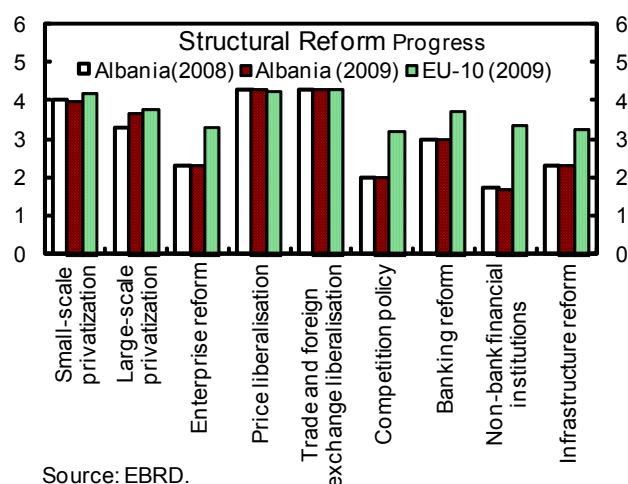


Sources: Haver and Albania authorities.

- **Obstacles to the effective operation of privatized industries need to be addressed.** Staff encouraged the quick resolution of the regulatory issues regarding the privatized

electricity distributor OSSH that could potentially trigger a World Bank Partial Risk Guarantee (PRG), with adverse effects for the country's reputation. Furthermore, increasing payment arrears from the privatized refinery complex (ARMO) threaten the successful privatization of Albpetrol—and thereby the conclusion of the strategic privatization program. Staff thus recommended the initiation of legal recovery proceedings against ARMO.

- **Establishing a clear property rights system**—particularly for land tenure—needs to be sped up. To bypass this bottleneck, the authorities are planning a number of industrial zones to attract additional investment, including from abroad.
- **Enforcing rules.** Considerable implementation and enforcement gaps for formal rules as well as the sizeable informal economy are key—and mutually reinforcing—weaknesses.



23. **Sound macroeconomic statistics are essential for competent policy making and investor confidence.** The national statistical agency INSTAT has made formidable progress over recent years, for example, by starting to publish quarterly national accounts and continuously upgrading their quality. However, considerable scope for further improvement remains. Staff recommended a significant increase of resources and administrative support for INSTAT and welcomed the intention to subscribe to the IMF Special Data Dissemination Standard.

IV. STAFF APPRAISAL

24. **In the face of strong headwinds, the Albanian economy has weathered the global crisis fairly well so far, in part reflecting policy stimulus.** In the budget, the full play of automatic stabilizers was supplemented by major expenditure increases. Monetary policy provided timely support, and the exchange rate functioned as a shock absorber. GDP is estimated to have registered positive growth of 2.8 percent in 2009. Moreover, confidence in the financial sector has returned, as evidenced by the resumption of deposit growth, while inflation

expectations have remained well-contained. Both remittances and exports have begun to recover. The baseline scenario is for a V-shaped recovery, albeit to a lower post-boom level of potential growth, with growth in 2010 projected at 2–2½ percent. Underlying inflation is expected to remain well contained.

25. **However, policy buffers are now exhausted and must be rebuilt.** Especially given the significant downward risks from the challenging external environment and sizeable domestic vulnerabilities, quick progress must be made to redress internal and external imbalances. With private sector adjustment already under way, the budget must achieve a significant turnaround to bring down the current account deficit and make space for credit extension to the private sector.

26. **Fiscal tightening has to be quickly effected.** The 2010 fiscal deficit should be cut to around 3 percent of GDP (from 5.2 percent on unchanged policies) by a combination of one-time and structural measures on both the revenue and expenditure side. Past tax and contributions cuts should be reconsidered and a tax amnesty eschewed. All remaining contingency reserves in the 2010 budget should be saved. More fundamentally, and with more lasting impact, public investment should be scaled back to more financeable and administratively manageable levels after the completion of the Reshen-Kalimash road. Current spending needs to be revisited with a view to rightsizing the civil service, and keeping wages and pensions in check, indexing them only to inflation.

27. **Medium-term fiscal policy should be governed by a credible and monitorable fiscal rule.** Limiting real expenditure increases to below 2 percent could go some way toward achieving the government's goal of debt reduction to 50 percent by 2013. This rule would preferably be augmented by a mechanism that would trigger lower spending growth in the event of an unexpected revenue shortfall. In contrast, positive surprises should translate into fiscal savings, reducing the risk of ever exceeding the debt ceiling.

28. **In addition to consolidation, there is also a role for debt management in lowering fiscal risks.** The authorities are appropriately seeking to place a Eurobond. However, heightened uncertainty in international markets may have an impact on the size and pricing of the issue, and the authorities are well advised to keep other options on the table, including a Fund-supported arrangement, if a balance of payments need emerges.

29. **Financial sector supervisors need to continue to stay ahead of evolving challenges and risks.** Past strong supervision has proven its worth in helping banks weather the storm. However, supervisors need to monitor developments closely and continuously elaborate contingency plans that deal with tail risks. Banks should help the needed economy-wide rebalancing and real-estate price correction by executing collateral of nonperforming loans or seeking viable loan restructurings.

30. **The monetary policy framework and the flexible exchange rate have served the economy well.** Hence, the Bank of Albania should continue with its cautious stance, with a

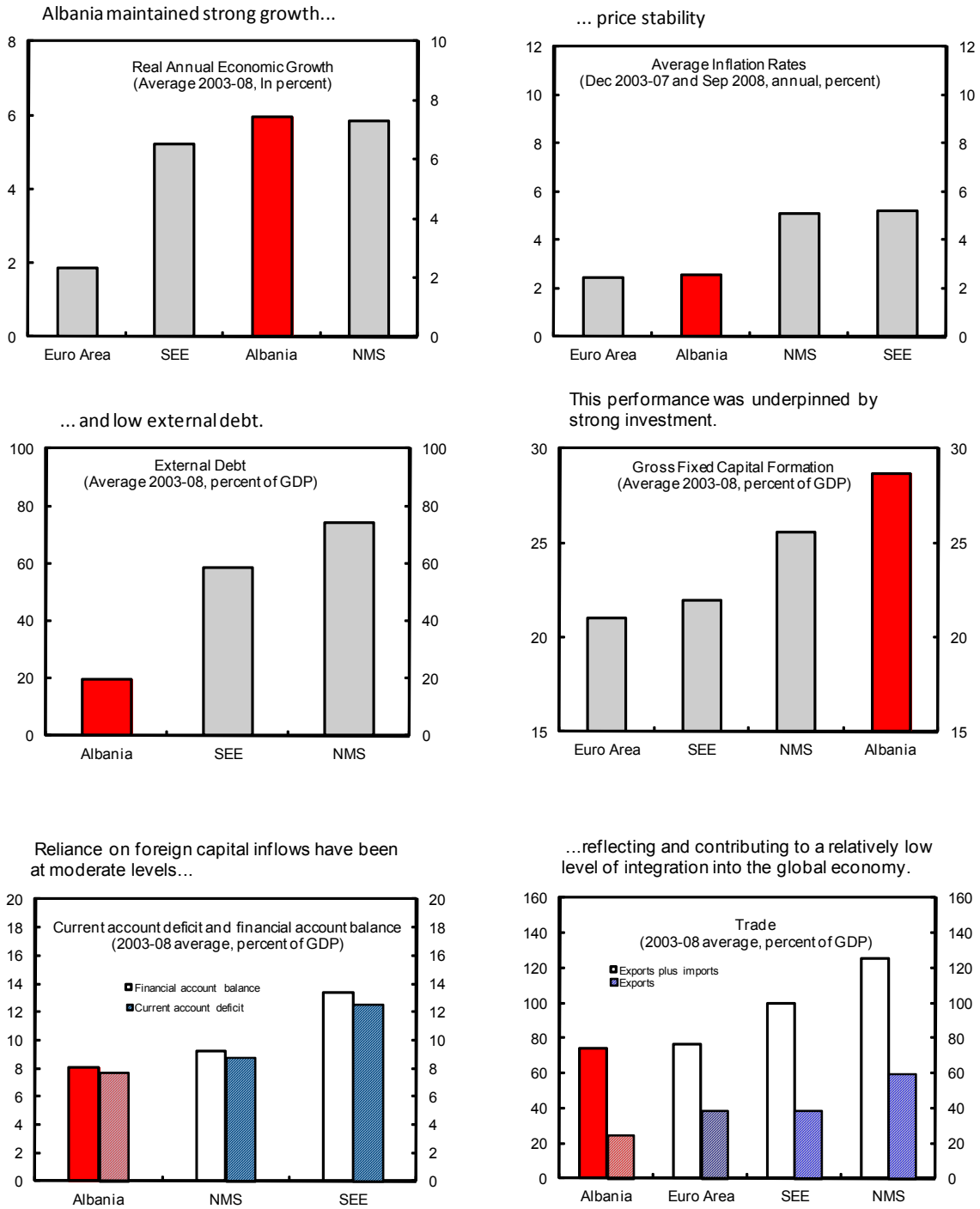
strong focus on anchoring inflation expectations. While interest rate decisions should be governed by actual and projected inflation developments with respect to the inflation target, monetary policy makers should remain mindful of financial stability considerations and macroprudential needs.

31. **Going forward, the Albanian economy needs to broaden its sources of growth and strengthen competitiveness.** This calls for further improvements in the business environment and in investor protection. Priorities for action include the implementation and enforcement of formal rules; improving the security of property rights (including for land tenure); and reducing regulatory uncertainties associated with some past privatizations. Funding sources for new investment could be boosted by finding new institutional investors, for instance, via accelerated pension reforms.

32. **Sound macroeconomic statistics are essential for competent policy making and investor confidence.** The national statistical agency INSTAT has made formidable progress over recent years but will need a significant increase in funding and administrative support. The intention to subscribe to the IMF Special Data Dissemination Standard is commendable.

33. **It is proposed that the next Article IV consultation be held on the standard 12-month cycle.**

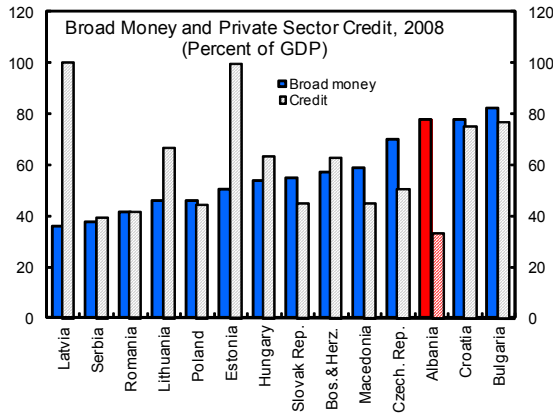
Figure 1. Comparative Economic Performance Before the Onset of the Global Crisis



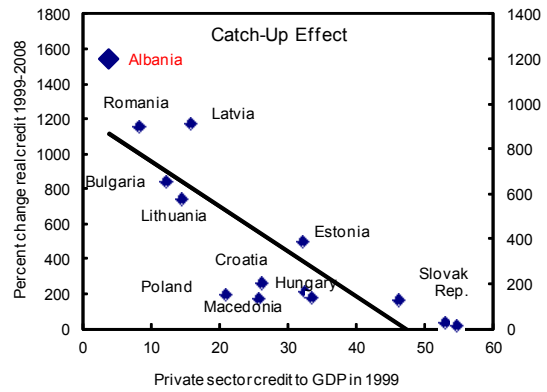
Sources: IFS and WEO data.

Figure 2. Albania: Characteristics of Albanian Banking Sector Prior to the Crisis

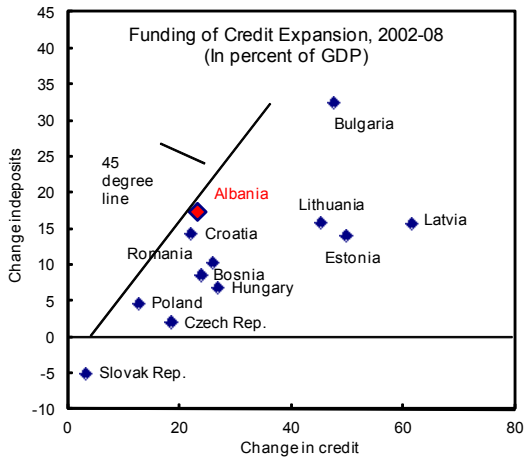
Given the high degree of monetization, financial intermediation in Albania remains well below potential...



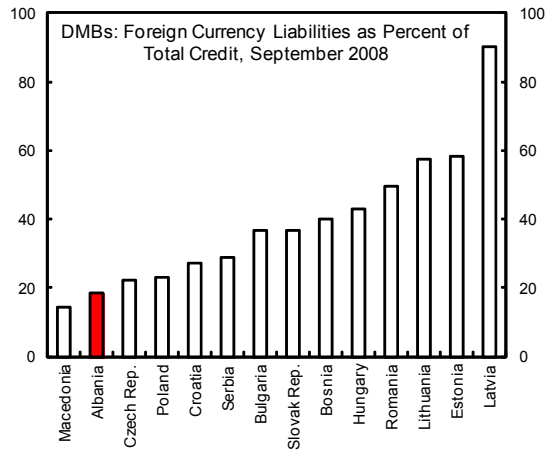
...despite an ongoing catch-up effect.



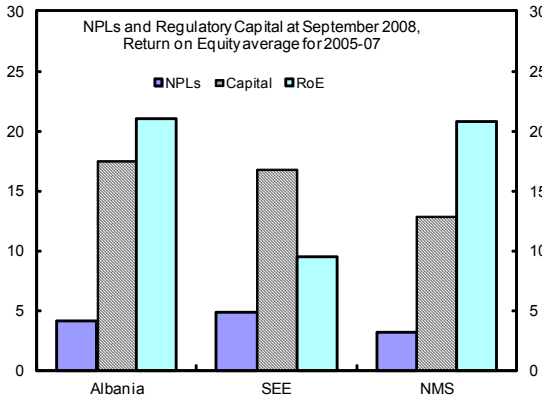
A large proportion of lent funds have been generated through deposits...



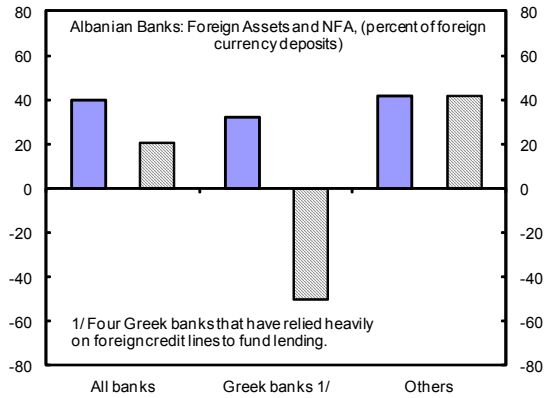
...while the use of foreign borrowing is correspondingly low.



Core indicators point to a banking system that was solvent and profitable before the crisis...

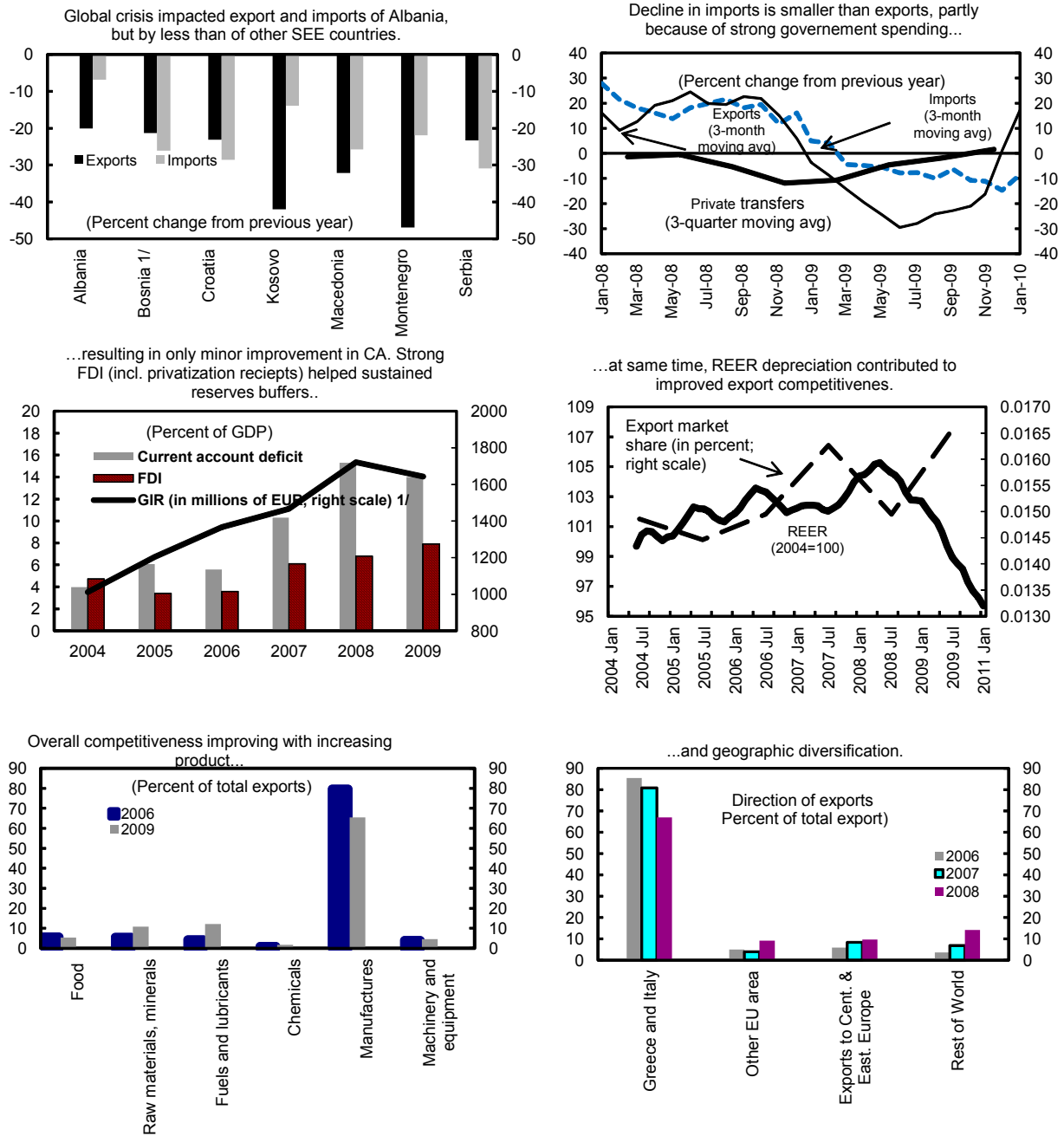


...particularly significant NFA buffers in September 2008



Sources: International Financial Statistics (IFS); and IMF staff estimates.

Figure 3. External Sector Developments, 2009



Sources: Albanian authorities; and IMF staff estimates.
1/ Includes SDR allocation.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2007–15

	2007	2008	2009 Est.	2010	2011	2012	2013	2014	2015
						Projections			
	(Growth rate in percent)								
Real GDP 1/	6.0	7.8	2.8	2.3	3.2	3.6	4.2	4.7	5.0
Retail prices (avg.)	2.9	3.4	2.2	3.5	2.9	3.0	2.9	3.0	3.0
Retail prices (end-period)	3.1	2.2	3.5	2.9	2.9	2.9	2.9	3.0	3.0
	(Percent of GDP)								
Saving-investment balance									
Foreign savings	10.3	15.3	14.0	12.6	11.3	9.4	7.5	6.2	5.2
National savings	19.1	17.3	15.0	13.3	14.8	16.9	19.0	20.3	21.5
Public	2.2	3.2	1.1	-0.4	-1.1	-1.1	-1.1	-1.1	-1.1
Private	16.8	14.1	13.9	13.6	15.9	18.0	20.1	21.5	22.6
Investment	29.4	32.5	29.0	25.9	26.1	26.2	26.5	26.5	26.7
Public	5.9	8.6	8.8	5.1	5.2	5.2	5.2	5.2	5.2
Private	23.5	23.9	20.2	20.8	20.9	21.0	21.3	21.3	21.5
Fiscal sector									
Revenues and grants	25.7	26.8	26.0	25.2	25.0	25.4	25.7	25.9	26.0
Tax revenue	23.6	24.3	23.5	22.9	22.9	23.3	23.7	23.9	24.0
Expenditures	29.6	32.3	33.4	30.3	31.1	31.6	31.9	32.1	32.2
Primary	26.9	29.4	30.2	27.0	27.3	27.7	28.0	28.1	28.1
Interest	2.6	2.9	3.1	3.3	3.8	3.8	3.9	4.0	4.1
Overall balance (including grants)	-3.9	-5.5	-7.4	-5.2	-6.1	-6.1	-6.1	-6.2	-6.2
Primary balance (including grants)	-1.2	-2.7	-4.3	-1.8	-2.3	-2.3	-2.3	-2.2	-2.1
Net domestic borrowing	1.8	1.7	0.9	2.5	3.8	4.4	5.7	6.2	6.7
Privatization receipts	1.6	0.5	2.4	0.0	0.0	0.0	0.0	0.0	0.0
Foreign financing	0.5	3.2	3.7	3.1	2.3	1.7	0.4	0.0	-0.5
Public Debt	53.9	55.2	59.7	62.8	65.1	66.9	68.1	69.1	69.9
Domestic	38.2	36.8	36.0	36.6	38.2	40.1	43.0	46.1	49.3
External (including publicly guaranteed)	15.7	18.4	23.7	26.2	26.9	26.8	25.1	23.0	20.6
Monetary indicators									
Broad money growth	13.7	7.7	6.8	7.0	9.0	11.5	13.0	13.5	13.5
Private credit growth	48.2	32.1	10.3	8.6	8.1	7.6	6.9	5.9	5.7
Velocity	1.3	1.3	1.3	1.3	1.3	1.2	1.2	1.1	1.1
Interest rate (3-mth T-bills, end-period)	6.3	6.3	6.3	...	...	...	...	...	...
	(Percent of GDP unless otherwise indicated)								
External sector									
Trade balance (goods and services)	-26.7	-26.8	-25.0	-22.7	-22.4	-20.9	-19.2	-18.0	-16.8
Current account balance (including official transfers)	-10.3	-15.3	-14.0	-12.6	-11.3	-9.4	-7.5	-6.2	-5.2
Current account balance (excluding official transfers)	-11.3	-15.9	-14.7	-13.3	-12.1	-10.1	-8.2	-6.8	-5.7
Official transfers	1.0	0.7	0.7	0.7	0.8	0.7	0.7	0.6	0.5
Gross international reserves (in millions of Euros)	1,467	1,721	1,621	1,586	1,580	1,725	1,924	2,226	2,571
(In months of imports of goods and services)	4.1	4.2	4.2	4.2	4.0	4.2	4.4	4.7	5.1
(Relative to external debt service)	12.1	12.4	9.5	3.7	6.3	6.9	7.2	6.8	4.0
(In percent of broad money)	23.3	26.1	26.0	23.9	21.9	21.5	21.3	21.7	22.1
Change in real exchange rate (e.o.p., in percent)	0.5	-0.6	...	...	...	...	...	...	...
Memorandum items									
Nominal GDP (in billions of lek) 1/	967	1,088	1,153	1,217	1,295	1,384	1,487	1,604	1,735

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ GDP data for 2007–08 are from the official national accounts.

Table 2a. Albania: General Government Operations, 2007–15
(Percent of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Projection								
Total revenue and grants	25.7	26.8	26.0	25.2	25.0	25.4	25.7	25.9	26.0
Tax revenue	23.6	24.3	23.5	22.9	22.9	23.3	23.7	23.9	24.0
VAT	9.1	9.8	9.5	9.3	9.2	9.5	9.6	9.7	9.7
Profit tax	2.2	1.7	1.5	1.5	1.5	1.5	1.6	1.6	1.6
Excise tax	3.0	3.0	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Small business tax	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Personal income tax	1.5	2.3	2.3	2.1	2.1	2.2	2.2	2.3	2.3
Customs duties	1.0	0.8	0.7	0.7	0.6	0.6	0.6	0.6	0.6
Other taxes	1.5	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Property and local taxes	0.7	0.8	0.8	0.9	0.9	0.9	0.9	0.9	0.9
Social insurance contributions	4.3	4.4	4.3	4.2	4.2	4.3	4.5	4.5	4.6
Non-tax revenue	1.9	2.1	2.1	1.7	1.6	1.6	1.5	1.5	1.5
Grants	0.1	0.4	0.3	0.5	0.5	0.5	0.5	0.4	0.4
Total expenditure	29.6	32.3	33.4	30.3	31.1	31.6	31.9	32.1	32.2
Current expenditure	23.3	23.2	24.5	24.8	25.3	25.7	26.0	26.3	26.3
Personnel cost	6.1	6.1	6.3	6.3	6.3	6.3	6.3	6.3	6.3
Interest	2.6	2.9	3.1	3.3	3.8	3.8	3.9	4.0	4.1
<i>Of which: domestic</i>	2.4	2.6	2.7	2.7	2.8	2.9	3.0	3.2	3.4
Operations & maintenance	2.6	2.6	2.4	2.3	2.2	2.4	2.6	2.8	2.8
Subsidies	0.4	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Social insurance outlays	7.2	7.0	8.4	8.5	8.5	8.5	8.5	8.5	8.5
Local government expenditure	2.2	2.5	2.8	2.4	2.5	2.7	2.7	2.7	2.7
Social protection transfers	1.5	1.6	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Capital expenditure 1/	5.9	8.6	8.8	5.1	5.2	5.2	5.2	5.2	5.2
Lending minus repayment	0.3	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 2/	0.0	0.0	0.0	0.4	0.6	0.6	0.6	0.6	0.6
Overall balance	-3.9	-5.5	-7.4	-5.2	-6.1	-6.1	-6.1	-6.2	-6.2
Current balance including grants 3/	2.3	3.5	1.4	0.1	-0.6	-0.6	-0.6	-0.7	-0.6
Financing	3.9	5.4	7.4	5.2	6.1	6.1	6.1	6.2	6.2
Domestic 4/	3.3	2.2	3.7	2.0	3.8	4.4	5.7	6.2	6.7
Privatization receipts 5/	1.6	0.5	2.4	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	1.8	1.7	0.9	2.5	3.8	4.4	5.7	6.2	6.7
Foreign	0.5	3.2	3.7	3.1	2.3	1.7	0.4	0.0	-0.5
Memorandum Items:									
Primary balance	-1.2	-2.7	-4.3	-1.8	-2.3	-2.3	-2.3	-2.2	-2.1
Current balance excluding grants	2.2	3.2	1.1	-0.4	-1.1	-1.1	-1.1	-1.1	-1.1
Total spending contingencies	0.0	0.0	0.4	1.0	1.0	1.0	1.0	1.0	1.0
Expenditures in priority sectors 6/	9.5	9.5	9.7	9.7	9.7	9.7	9.9	9.9	9.9
Public debt	53.9	55.2	59.7	62.8	65.1	66.9	68.1	69.1	69.9
Domestic general government	38.2	36.8	36.0	36.6	38.2	40.1	43.0	46.1	49.3
External	15.7	18.4	23.7	26.2	26.9	26.8	25.1	23.0	20.6
GDP (in billions of leks)	967	1,088	1,153	1,217	1,295	1,384	1,487	1,604	1,735

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ Excludes capital transfer to KESH in 2007.

2/ Spending contingencies are reported according to their economic classification at outturn.

3/ Revenue including grants minus current expenditure (including the capital transfer to KESH in 2007).

4/ Includes arrears in 2009

5/ Includes privatization of ARMO in 2008 and OSSH in 2009.

6/ Education, health, and road sectors.

Table 2b. Albania: General Government Operations, 2007–15
(Billions of leks)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Projection								
Total revenue and grants	248.3	291.2	299.2	306.3	323.7	351.5	382.5	415.2	451.4
Tax revenue	228.2	264.2	270.8	278.8	296.4	322.6	352.5	383.2	417.1
VAT	87.8	107.1	110.1	113.1	119.7	130.8	143.2	155.1	167.9
Profit tax	21.1	18.1	17.1	18.1	19.3	21.1	23.1	25.2	27.5
Excise tax	28.7	32.5	33.5	35.4	37.6	40.2	43.2	46.6	50.4
Small business tax	2.2	2.6	2.5	2.6	2.8	3.1	3.4	3.7	4.0
Personal income tax	14.8	24.5	26.8	25.5	27.4	30.0	33.2	36.5	40.3
Customs duties	9.8	8.7	7.9	7.9	7.5	8.0	8.6	9.3	10.1
Other taxes	14.5	14.4	13.4	14.3	15.2	16.3	17.5	18.8	20.4
Property and local taxes	7.1	8.7	9.7	10.7	11.9	13.1	14.1	15.2	16.5
Social insurance contributions	42.0	47.6	49.8	51.2	55.0	60.0	66.2	72.7	80.0
Non-tax revenue	18.8	22.8	24.3	21.3	21.0	22.0	23.0	24.8	26.8
Grants	1.3	4.2	4.0	6.3	6.4	6.8	6.9	7.2	7.4
Total expenditure	285.7	351.5	384.7	369.2	402.5	436.5	473.8	515.1	558.5
Current expenditure	225.6	252.7	282.9	302.0	327.4	355.8	387.0	421.5	457.2
Personnel cost	59.1	66.6	72.7	76.7	81.7	87.2	93.8	101.2	109.4
Interest	25.6	31.3	36.3	40.6	49.3	53.1	57.8	63.9	71.0
<i>Of which: domestic</i>	23.5	28.4	31.4	33.2	35.6	39.5	44.4	51.2	59.2
Operations & maintenance	25.2	28.8	27.9	27.8	28.6	33.1	38.7	44.6	48.2
Subsidies	3.5	2.6	2.0	1.9	2.0	2.0	2.0	2.2	2.3
Social insurance outlays	69.9	76.2	96.7	103.7	110.3	117.9	126.7	136.7	147.8
Local government expenditure	21.3	27.1	32.8	29.3	32.2	37.1	40.8	44.0	47.6
Social protection transfers	14.8	17.8	19.1	20.5	21.8	23.9	26.0	27.6	29.3
Property compensation	0.5	0.0	1.7	1.4	1.4	1.4	1.4	1.4	1.4
Capital expenditure 1/	57.0	93.8	101.6	61.9	67.6	72.2	77.6	83.7	90.5
Lending minus repayment	3.0	5.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 2/	0.0	0.0	0.0	5.2	7.6	8.6	9.2	10.0	10.8
Overall balance 3/	-37.4	-60.2	-85.5	-62.8	-78.8	-85.1	-91.3	-99.9	-107.1
Current balance including grants 4/	22.7	38.6	16.3	1.7	-7.4	-8.6	-9.1	-11.2	-11.2
Financing	37.4	59.1	79.9	68.3	78.8	85.1	91.3	99.9	107.1
Domestic	32.1	24.4	37.4	30.4	48.9	61.4	84.9	100.2	116.0
Privatization receipts 5/	15.1	5.5	27.6	0.3	0.3	0.3	0.3	0.0	0.0
Net borrowing	17.0	18.9	9.8	30.1	48.6	61.1	84.6	100.2	116.0
Foreign	5.3	34.7	42.5	37.9	29.9	23.7	6.4	-0.2	-8.9
Memorandum Items:									
Primary balance	-11.8	-28.9	-49.2	-22.2	-29.5	-31.9	-33.6	-36.0	-36.1
Current balance excluding grants	21.4	34.3	12.2	-4.6	-13.8	-15.4	-16.1	-18.4	-18.6
Total spending contingencies	0.0	0.0	5.0	12.9	17.4	19.8	21.1	22.0	24.1
Expenditures in priority sectors 6/	91.5	102.9	112.0	118.2	125.8	134.4	146.5	158.1	171.0
Public Debt	521.1	600.2	688.1	764.0	842.8	925.7	1013.0	1109.2	1212.6
Domestic general government	369.5	400.5	415.4	445.5	494.1	555.2	639.8	739.9	855.9
External	151.5	199.7	272.8	318.5	348.7	370.6	373.2	369.3	356.7
Direct government external debt	123.5	167.8	238.1	280.3	305.3	321.7	319.3	310.3	292.6
Government guaranteed external debt	28.0	32.0	34.7	38.2	43.4	48.9	53.9	59.0	64.1

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ Excludes capital transfer to KESH in 2007.

2/ Spending contingencies are reported according to their economic classification at outturn.

3/ Arrears accumulated in 2009.

4/ Revenue including grants minus current expenditure (including the capital transfer to KESH in 2007).

5/ Includes privatization of ARMO in 2008 and OSSH in 2009.

6/ Education, health, and road sectors.

Table 3. Albania: IMF Core Indicators of Financial Soundness, 2005–2009

	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09
I Capital-based					
(i) Regulatory capital as a percent of risk-weighted assets	18.6	18.1	17.1	17.2	16.2
(ii) Regulatory Tier 1 capital as a percent of risk-weighted assets	18.1	17.1	16.0	16.3	15.3
(iii) Capital as a percent of total assets					
Regulatory Tier 1 capital as a percent of total assets	5.4	5.9	5.8	6.7	8.7
Regulatory capital as a percent of total assets	5.6	6.2	6.2	7.0	9.2
Shareholders' equity as a percent of total assets	6.6	6.8	7.6	8.6	9.6
(iv) Nonperforming loans net of provisions as a percent of capital					
Nonperforming loans net of provisions as a percent of regulatory Tier 1 capital	4.4	7.2	12.0	27.2	29.9
Nonperforming loans net of provisions as a percent of regulatory capital	4.3	6.8	11.2	25.7	28.2
Nonperforming loans net of provisions as a percent of shareholders' equity	3.6	6.3	9.1	21.1	27.1
(v) Return on equity (ROE) (annual basis)	22.2	20.2	20.7	11.4	4.6
(vi) Net open position in foreign exchange as a percent of capital					
Net open position in foreign exchange as a percent of regulatory Tier 1 capital	9.5	5.5	1.8	4.5	4.1
Net open position in foreign exchange as a percent of regulatory capital	9.3	5.2	1.7	4.3	3.9
Net open position in foreign exchange as a percent of shareholders' equity	7.8	4.8	1.4	3.5	3.7
II Asset-based					
(vii) Liquid assets as a percent of total assets (Liquid-asset ratio) 1/	62.6	57.6	49.8	42.8	27.6
(viii) Liquid assets as a percent of short-term liabilities 1/	75.2	69.5	55.6	104.7	32.6
(ix) Return on assets (ROA) (net income to average total assets) (annual basis)	1.4	1.4	1.6	0.9	0.4
(x) Nonperforming loans (gross) as a percent of total loans	2.3	3.1	3.4	6.6	10.5
(xi) Sectoral distribution of loans to total loans	na	na	na	na	na
III Income and expense-based					
(xii) Interest margin to gross income	84.0	92.6	92.7	106.5	119.6
(xiii) Noninterest expenses to gross income	76.3	65.7	58.5	69.6	83.0
IV Memorandum items					
Other (noncore) indicators:					
Customer deposits as a percent of total (non-interbank) loans	342.5	265.5	215.5	162.6	154.3
Foreign currency-denominated loans to total loans	75.5	71.9	72.5	72.6	70.2
Foreign currency-denominated liabilities as a percent of total liabilities	41.0	44.0	46.9	48.5	48.9
Other indicators:					
Risk weighted assets as a percent of total assets	30.0	34.6	36.4	40.8	56.7
Total loans as a percent of total assets	25.7	31.7	39.4	47.6	50.8
Total loans as a percent of shareholders' equity	387.0	469.5	516.4	555.1	530.2

Source: Data provided by Bank of Albania.

1/ Definition of liquid assets and short term liabilities were changed in October 2009.

Table 4a. Albania: Monetary Aggregates, 2007–15

(in percent of GDP)

	Projections											
	2007	2008	2009				2010	2011	2012	2013	2014	2015
	Dec	Dec	Mar.	Jun.	Sep.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	
Monetary survey												
Broad money	78.4	75.0	69.9	71.1	73.2	75.6	76.6	78.5	81.9	86.1	90.6	95.1
Currency outside banks	16.0	18.0	17.4	18.0	17.6	18.1	18.4	18.8	19.7	20.7	21.7	22.8
Deposits	62.3	57.0	52.4	53.1	55.6	57.5	58.2	59.7	62.3	65.5	68.8	72.3
Domestic currency deposits	36.3	33.0	29.9	30.8	31.3	32.0	32.0	33.0	35.4	38.7	42.4	46.1
Foreign currency deposits	26.0	24.0	22.6	22.3	24.3	25.4	26.3	26.7	26.8	26.7	26.5	26.2
Net foreign assets	24.0	19.0	17.1	18.7	21.1	21.2	20.5	19.3	19.4	19.8	20.8	21.8
Bank of Albania	17.7	18.5	17.4	18.7	19.0	18.6	17.5	16.5	17.1	17.9	19.2	20.6
Commercial Banks	6.3	0.5	-0.3	0.1	2.1	2.6	3.0	2.7	2.3	1.9	1.6	1.2
Net domestic assets	54.4	56.0	52.8	52.3	52.1	54.4	56.1	59.2	62.5	66.3	69.8	73.3
Claims on government (net of deposits)	32.0	29.3	27.5	27.1	27.0	29.2	30.1	32.1	34.4	37.7	41.2	44.8
BOA financing	5.4	5.6	6.2	4.4	4.1	5.8	5.9	5.9	5.9	5.8	5.7	5.6
<i>Of which</i> : gross credit	7.5	7.2	7.1	6.5	6.2	6.7	6.8	6.7	6.7	6.5	6.4	6.2
Other (including T-bills)	26.6	23.7	21.3	22.7	23.0	23.4	24.2	26.2	28.5	31.9	35.5	39.2
Claims on state enterprises and farms	0.4	1.2	1.2	1.1	1.1	1.0	1.0	0.9	0.9	0.8	0.8	0.7
Claims on the private sector	30.0	35.21	34.9	35.1	36.0	36.6	37.7	38.3	38.6	38.4	37.7	36.8
In leks	8.8	10.1	10.1	10.7	11.4	11.6	12.5	12.7	12.7	12.5	11.9	11.3
In foreign currency	21.2	25.1	24.8	24.5	24.6	25.1	25.2	25.5	25.8	25.8	25.7	25.6
Other items, net	-8.0	-9.7	-10.8	-11.0	-12.0	-12.5	-12.7	-12.1	-11.4	-10.6	-9.9	-9.1
Memorandum items												
Reserve money	23.6	25.0	23.5	23.8	24.0	24.7	25.1	25.7	26.8	28.2	29.6	31.1
M1	25.1	26.0	23.6	24.5	24.1	24.7	22.2	18.8	19.7	20.7	21.7	22.8
M2	52.4	51.0	47.3	48.8	48.9	50.2	50.4	51.8	55.1	59.4	64.1	68.9

Sources: Bank of Albania; and IMF staff estimates.

Table 4b. Albania: Monetary Aggregates, 2007–15
(In billions of leks unless otherwise indicated; end-period)

	Projections											
	2007	2008	2009				2010	2011	2012	2013	2014	2015
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	
Monetary survey												
Broad money	757.6	815.7	805.4	819.4	843.6	871.5	932.5	1,016.4	1,133.3	1,280.6	1,453.5	1,649.7
Currency outside banks	155.0	195.8	201.0	207.6	202.4	209.0	223.8	243.9	272.0	307.3	348.8	395.9
Deposits	602.7	619.9	604.4	611.8	641.2	662.4	708.7	772.5	861.3	973.3	1,104.7	1,253.8
Domestic currency deposits	351.2	359.2	344.3	354.5	361.1	369.1	389.0	427.2	490.1	576.1	679.7	799.1
Foreign currency deposits	251.5	260.7	260.1	257.3	280.2	293.3	319.7	345.3	371.2	397.1	424.9	454.7
Net foreign assets	232.1	206.7	197.3	216.1	242.7	244.4	249.7	249.5	268.9	294.7	333.7	378.5
Bank of Albania	171.0	201.2	200.2	215.3	218.8	214.5	213.3	214.3	236.5	265.8	308.5	357.4
Commercial Banks	61.1	5.5	(2.9)	0.8	23.9	30.0	36.4	35.2	32.4	29.0	25.2	21.1
Net domestic assets	525.5	609.0	608.1	603.3	600.9	627.0	682.8	766.9	864.4	985.9	1,119.8	1,271.2
Claims on government (net of deposits)	308.9	318.9	317.0	312.4	311.6	336.3	366.4	415.0	476.1	560.7	660.9	776.9
BOA financing	52.1	60.9	71.5	50.6	46.9	66.4	71.4	76.4	81.4	86.4	91.4	96.4
Of which: gross credit	72.9	78.2	82.1	75.0	71.3	77.3	82.3	87.3	92.3	97.3	102.3	107.3
Other (including T-bills)	256.8	258.0	245.6	261.8	264.8	269.9	295.0	338.7	394.7	474.3	569.5	680.5
Claims on state enterprises and farms	3.9	12.9	14.2	12.6	12.8	12.1	12.2	12.3	12.4	12.5	12.7	12.8
Claims on the private sector	289.8	383.0	401.8	405.0	414.4	422.3	458.8	495.7	533.5	570.5	604.4	639.1
In leks	84.8	110.1	116.3	122.8	130.9	133.3	152.5	164.9	176.2	186.4	191.5	195.2
In foreign currency	205.1	272.9	285.5	282.2	283.5	289.0	306.3	330.8	357.3	384.1	412.9	443.8
Other items, net	(77.2)	(105.7)	(125.0)	(126.6)	(137.9)	(143.6)	(154.6)	(156.2)	(157.6)	(157.9)	(158.2)	(157.5)
Memorandum items												
Reserve money (billions of Lek)	228.2	271.7	270.9	274.9	276.1	284.8	304.8	332.3	370.6	418.9	475.6	539.9
M1 (billions of Lek)	242.7	282.9	272.0	282.6	277.6	284.5	270.7	243.9	272.0	307.3	348.8	395.9
Annual broad money growth	13.7	7.7	6.7	5.9	2.8	6.8	7.0	9.0	11.5	13.0	13.5	13.5
Annual growth in private sector credit	48.2	32.1	28.9	17.9	11.9	10.3	8.6	8.1	7.6	6.9	5.9	5.7
Private sector credit as a percent of GDP	29.6	35.0	36.0	36.0	36.7	36.8	37.7	38.3	38.6	38.4	37.7	36.8
Annual change in credit as a percent of GDP	7.7	5.4	5.3	3.0	1.9	1.8	0.9	0.6	0.3	(0.2)	(0.7)	(0.8)
Annual M2 growth	6.0	9.7	9.4	10.8	7.8	4.2	6.0	9.5	13.6	15.9	16.4	16.2
Velocity (annual GDP/BM)	1.3	1.3	1.4	1.4	1.3	1.3	1.3	1.3	1.2	1.2	1.1	1.1
Money multiplier (absolute values)	3.3	3.0	3.0	3.0	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Currency/Broad Money ratio	20.5	24.0	25.0	25.3	24.0	24.0	24.0	24.0	24.0	24.0	24.0	24.0
Foreign currency deposits/total deposits	41.7	42.1	43.0	42.1	43.7	44.3	45.1	44.7	43.1	40.8	38.5	36.3
Gross reserves (millions of euros)	1,466.8	1,720.8	1,597.2	1,695.7	1,724.5	1,621.0	1,585.5	1,579.6	1,725.4	1,924.0	2,225.5	2,570.6
In percent of broad money	23.3	26.1	25.5	26.9	27.4	26.0	23.9	21.9	21.5	21.3	21.7	22.1
U.S. dollar exchange rate (end of period)	82.7	90.7	98.6	92.6	91.9	95.8	...	...	...	...	...	...
Euro exchange rate (end of period)	121.6	123.5	131.0	130.8	134.5	138.0	...	...	...	...	...	...
3-month T-bill rate (in percent)	6.3	6.3	6.1	6.4	6.3	6.3	...	...	...	...	...	...
BoA repo rate (in percent)	6.3	6.3	5.8	5.8	5.8	5.3	...	...	...	...	...	...

Sources: Bank of Albania; and IMF staff estimates.

Table 5a . Albania: Balance of Payments, 2007–15
(In percent of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
			Est.	Projections					
Current account	-10.3	-15.3	-14.0	-12.6	-11.3	-9.4	-7.5	-6.2	-5.2
Balance of goods and services	-26.7	-26.8	-25.0	-22.7	-22.4	-20.9	-19.2	-17.9	-16.7
Exports	28.1	29.6	28.2	28.9	28.9	29.9	31.1	32.0	32.9
Goods	10.1	10.4	8.6	9.1	9.3	9.5	9.6	9.8	10.0
Services	18.1	19.2	19.6	19.8	19.6	20.4	21.5	22.2	22.9
Imports	54.9	56.5	53.2	51.6	51.3	50.7	50.3	49.9	49.6
Goods	37.0	38.1	34.9	33.4	33.0	32.4	31.9	31.4	31.3
Services	17.9	18.4	18.3	18.2	18.3	18.4	18.4	18.5	18.3
Income balance	2.8	0.6	-0.7	-1.1	-0.9	-0.6	-0.4	-0.3	-0.3
<i>Of which</i> : Interest due	0.6	0.7	0.9	1.1	1.1	1.0	0.9	0.9	0.8
Private transfers 1/	12.6	10.3	10.9	10.4	11.2	11.4	11.4	11.4	11.4
Official transfers	1.0	0.7	0.7	0.7	0.8	0.7	0.7	0.6	0.5
Financial account	9.8	16.7	11.4	10.2	9.3	9.1	7.7	7.3	6.6
Direct investment	6.1	6.8	7.7	6.8	6.3	6.3	6.3	6.3	6.3
Other capital	2.6	6.2	-0.4	0.2	0.9	1.3	1.3	1.3	1.0
Private loans (incl.net trade credits)	0.1	1.0	0.8	0.7	0.8	1.1	0.9	0.8	0.6
Other financial flows	2.5	5.2	-1.2	-0.5	0.0	0.2	0.4	0.5	0.4
<i>Of which</i> : Change in NFA of DMBs (increase = -) 2/	0.9	5.2	-1.9	-0.5	0.1	0.2	0.2	0.2	0.2
Medium- and long-term loans (net)	1.1	3.8	4.1	3.3	2.2	1.5	0.1	-0.3	-0.8
New borrowing	1.6	4.3	4.8	6.4	3.2	2.4	1.1	1.0	2.9
Multilateral loans	1.2	1.3	1.7	1.8	1.6	0.7	0.1	0.1	0.0
World Bank	0.5	0.3	0.3	0.5	0.4	0.2	0.1	0.1	0.0
EBRD	0.2	0.3	0.4	0.4	0.4	0.0	0.0	0.0	0.0
Other	0.5	0.7	1.0	0.8	0.8	0.5	0.0	0.0	0.0
Bilateral loans	0.4	0.4	0.9	1.2	1.0	1.2	0.5	0.5	0.3
Commercial debt	0.0	2.6	2.2	3.4	0.5	0.5	0.5	0.4	2.6
Amortization	-0.5	-0.5	-0.7	-3.2	-1.0	-1.0	-1.0	-1.3	-3.6
Errors and omissions 3/	1.3	0.8	2.1	2.1	2.0	1.9	1.7	1.6	1.5
Net balance	0.7	2.2	-0.5	-0.3	0.0	1.6	2.0	2.7	2.9
Available financing	-1.9	-2.2	0.5	0.3	0.0	-1.6	-2.0	-2.7	-2.9
Change in net reserves (increase = -) 2/	-1.9	-2.2	0.5	0.3	0.0	-1.6	-2.0	-2.7	-2.9
BOP support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Changes in arrears (increase = +) 4/	0.0	-0.1	-0.1	-0.2	0.0	0.0	0.0	0.0	0.0
Overdue debt forgiveness	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling 4/	0.0	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0
Identified Financing	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Of which</i> : World Bank including DPL	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Ministry of Finance; Bank of Albania; donors; and Fund staff estimates and projections.

1/ Bank of Albania data plus IMF estimate (to capture some unrecorded inflows not captured in the BOA estimate).

2/ Net of valuation changes in 2007–09. In projections for 2010–15, valuation effects are assumed to be zero.

3/ Net errors and omissions include unidentified flows of private transfers.

4/ In 2006–2007 assumes rescheduling of stock of outstanding arrears, both with official and private creditors.

Table 5b. Albania: Balance of Payments, 2007–15

(In millions of Euros)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
			Est.	Projections					
Current account	-809	-1,342	-1,227	-1,101	-1,040	-918	-787	-703	-638
Balance of goods and services	-2,092	-2,361	-2,183	-1,981	-2,063	-2,046	-2,023	-2,035	-2,054
Exports	2,202	2,605	2,469	2,529	2,661	2,931	3,274	3,633	4,035
Goods	786	917	751	796	859	928	1,012	1,113	1,224
Services	1,415	1,688	1,718	1,733	1,802	2,003	2,262	2,520	2,811
Imports	4,293	4,967	4,652	4,510	4,724	4,977	5,297	5,668	6,090
Goods	2,891	3,349	3,054	2,920	3,038	3,176	3,355	3,567	3,845
Services	1,402	1,618	1,598	1,590	1,686	1,800	1,942	2,101	2,244
Income balance	221	55	-59	-96	-81	-58	-39	-29	-39
Of which: Interest due	51	66	83	100	102	99	93	97	102
Private transfers 1/	983	905	957	913	1,032	1,119	1,204	1,295	1,399
Official transfers	78	59	58	62	71	68	71	66	58
Financial account	765	1,472	997	892	860	888	811	828	805
Direct investment, net	477	597	672	591	580	618	663	710	774
Other capital	206	545	-34	14	79	127	134	153	125
Private loans (incl.net trade credits)	11	86	70	61	76	106	95	96	77
Other financial flows	195	459	-105	-47	3	21	39	57	48
Of which: Change in NFA of DMBs (increase = -) 2/	73	461	-169	-45	9	21	24	27	29
Medium- and long-term loans (net)	83	331	359	286	201	143	13	-35	-94
New borrowing	124	376	422	564	294	239	116	108	351
Multilateral loans	94	110	153	159	150	70	14	6	0
World Bank	39	27	30	45	39	22	11	6	0
EBRD	14	25	33	39	37	0	0	0	0
Other	41	59	89	74	73	48	3	0	0
Bilateral loans	29	36	77	105	95	120	53	52	31
Commercial debt	0	230	193	300	50	50	50	50	320
Amortization	-41	-45	-63	-277	-93	-96	-103	-143	-445
Errors and omissions 3/	102	66	183	183	183	183	183	183	183
Net balance	58	197	-47	-26	3	154	206	308	350
Available financing	-142	-197	47	26	-3	-154	-206	-308	-350
Change in net reserves (increase = -) 2/	-149	-197	47	26	-3	-154	-206	-308	-350
Of which: Change in gross reserves, (increase = -) 2/	-144	-192	100	35	6	-146	-199	-302	-345
Use of Fund Resources (net)	-5	-5	-7	-9	-9	-8	-8	-7	-5
Budget support	0	0	0	0	0	0	0	0	0
Changes in arrears (increase = +) 4/	-3	-10	-11	-20	0	0	0	0	0
Overdue debt forgiveness	0	0	0	0	0	0	0	0	0
Rescheduling 4/	3	10	11	0	0	0	0	0	0
Identified Financing	7	0	0	0	0	0	0	0	0
Of which: World Bank including DPL	7	0	0	0	0	0	0	0	0
Financing gap 5/	0	0	0	20	0	0	0	0	0
Arrears Rescheduling	0	0	0	20	0	0	0	0	0
Memorandum items:									
GDP in Euros	7,823	8,796	8,749	8,742	9,208	9,810	10,528	11,358	12,281
Gross usable reserves	1,467	1,721	1,621	1,586	1,580	1,725	1,924	2,226	2,571
(months of imports of goods and services)	4.1	4.2	4.2	4.2	4.0	4.2	4.4	4.7	5.1
Balance of goods and services (percent of GDP)	-26.7	-26.8	-25.0	-22.7	-22.4	-20.9	-19.2	-17.9	-16.7
Current account (percent of GDP)	-10.3	-15.3	-14.0	-12.6	-11.3	-9.4	-7.5	-6.2	-5.2
Debt service (percent of exports of goods and services) 6/	2.6	2.7	5.0	12.8	5.0	4.3	3.3	3.5	10.3
Debt service (percent of central government revenues) 6/	2.9	3.1	5.8	15.9	6.2	5.4	4.4	4.7	14.4
Total external debt stock (percent of GDP) 7/	23.8	29.9	34.1	36.6	37.2	37.2	35.3	33.0	30.2
Volume of Exports of Goods and Services (percent change)	21.7	14.9	-8.0	-2.5	5.0	7.3	8.1	8.7	8.9
Volume of Imports of Goods and Services (percent change)	10.4	6.0	1.2	-7.9	2.9	3.8	4.5	5.1	5.8

Sources: Ministry of Finance; Bank of Albania; donors; and IMF staff estimates and projections.

1/ Bank of Albania data plus IMF estimate (to capture some unrecorded inflows not captured in the BOA estimate).

2/ Net of valuation changes in 2007–09. In projections for 2010–15, valuation effects are assumed to be zero.

3/ Net errors and omissions include unidentified flows of private transfers.

4/ In 2010 assumes rescheduling of stock of outstanding arrears, both with official and private creditors.

5/ The financing gap, if any, is expected to be fully covered by arrears rescheduling.

6/ Public and publicly guaranteed debt only.

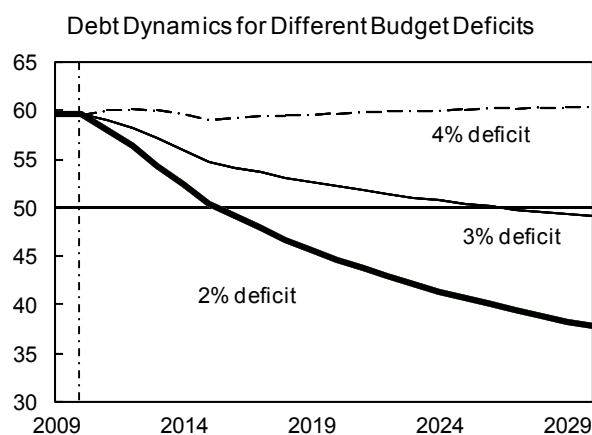
7/ Public and private external debt, including arrears. Debt stock converted into Lek at the e-o-p exchange rate.

Appendix I. Public¹ and External Debt Sustainability Analysis (DSA)

In the absence of further policy adjustment, public debt levels may turn unsustainable.

Total public debt has picked up since 2007, practically reaching the Albanian legal limit of 60 percent of GDP in 2009². Taking into account the authorities' current medium-term spending plan, staff projects that debt ratios will continue to grow and reach 70 percent of GDP in 2015 (Table A.1). With such a debt path, financing the deficit will be increasingly hard. The average maturity of domestic debt is still relatively low (as of the beginning of 2010 the duration of the domestic portfolio was 0.8 years) and the share of concessional lending should decrease in the coming years as Albania seeks financing in international capital markets.

The medium term target of a debt-to-GDP ratio below 50 percent is only attainable after substantial fiscal consolidation. This target—elucidated in the government's program—will not be met in the baseline scenario. The following chart illustrates the need for a drastic reduction of budget deficits in the short run if debt is to converge swiftly to this level.



Sources: Albanian authorities; and IMF staff estimates.

Stress tests indicate important vulnerabilities (Figure A.1). Public debt dynamics are particularly vulnerable to a sharp depreciation of the lek and to a lower than projected growth path (half standard deviation drop). Furthermore, persistently higher primary deficits (by 0.6 percent) due, for example, to a protracted burden of the current social security system, would bring debt up to almost 74 percent by 2015. In all instances, the prospects of meeting debt targets would be severely undermined. Finally, following unchanged policies would push up debt above 100 percent of GDP by 2015 as privatization proceeds are now mostly exhausted.

¹ This section covers General Government Public Debt. Stress tests were performed using IMF's Debt Sustainability Assessment Framework for Market Access Countries: <http://imf.org/external/np/pp/eng/2005/070105.htm>

² Foreseen in the 2008 Organic Budget Law.

External debt has been on the rise since 2005 but remains sustainable based on current staff projections. Policies, however, should be mindful of vulnerabilities, particularly given the risks associated with current account and other shocks. Under the assumptions that (i) growth will gradually return to its potential level with stabilizing global conditions, and (ii) borrowing will moderate with FDI inflows strengthening and current account improving, external debt is projected to peak at 37 percent of GDP in 2012 and then decline to 30 percent of GDP by 2015 (Table A.2). Stress tests highlight vulnerabilities to the current account, and combined shocks including real interest, growth and current account balance shocks (Figure A.2). Under these two shocks external debt is projected to increase to 42 and 37 percent of GDP by 2015, respectively

Table A.1. Country: Public Sector Debt Sustainability Framework, 2005–2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 9/
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Baseline: Public sector debt 1/ o/w foreign-currency denominated	58.0	56.0	53.9	55.2	59.7	62.8	65.1	66.9	68.1	69.1	69.9	-0.9
Change in public sector debt	0.3	-2.0	-2.1	1.3	4.5	3.1	2.3	1.8	1.2	1.0	0.7	
Identified debt-creating flows (4+7+12)	0.1	-5.9	-17.4	-5.1	-23.8	2.2	2.0	1.7	1.2	1.2	1.0	
Primary deficit	0.5	0.4	1.2	2.7	3.8	2.3	2.3	2.3	2.3	2.2	2.1	
Revenue and grants	25.0	25.3	25.7	26.8	26.0	25.2	25.0	25.4	25.7	25.9	26.0	
Primary (noninterest) expenditure	25.5	25.8	26.9	29.4	29.7	27.5	27.3	27.7	28.0	28.1	28.1	
Automatic debt dynamics 2/	0.5	-3.6	-3.5	-2.2	0.0	0.2	0.0	-0.3	-0.8	-1.0	-1.1	
Contribution from interest rate/growth differential 3/	-1.5	-2.1	-1.6	-3.1	0.0	0.2	0.0	-0.3	-0.8	-1.0	-1.1	
Of which contribution from real interest rate	1.5	0.8	1.5	0.6	1.5	1.5	1.9	1.9	1.9	2.0	2.1	
Of which contribution from real GDP growth	-3.1	-2.9	-3.1	-3.8	-1.5	-1.3	-1.9	-2.2	-2.6	-3.0	-3.2	
Contribution from exchange rate depreciation 4/	2.0	-1.5	-1.9	0.9	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.9	-2.8	-15.1	-5.5	-27.6	-0.3	-0.3	-0.3	-0.3	0.0	0.0	
Privatization receipts (negative)	-0.9	-2.8	-15.1	-5.5	-27.6	-0.3	-0.3	-0.3	-0.3	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	0.3	3.9	15.3	6.3	28.3	0.9	0.3	0.1	0.0	-0.2	-0.2	
Public sector debt-to-revenue ratio 1/	232.4	221.0	209.9	206.1	230.0	249.4	260.3	263.4	264.9	267.1	268.6	
Gross financing need 6/ in billions of U.S. dollars	4.1	3.7	4.3	5.9	7.5	8.4	6.7	6.8	6.8	7.2	9.5	
in billions of U.S. dollars	0.3	0.3	0.5	0.8	0.9	1.1	0.9	1.0	1.0	1.2	1.7	
Scenario with key variables at their historical averages 7/					59.7	60.6	60.9	61.1	61.1	61.2	61.3	-1.5
Scenario with no policy change (constant primary balance) in 2009-2014					59.7	90.9	95.2	98.7	101.3	103.4	105.3	-1.6
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.8	5.5	6.0	7.8	2.8	2.3	3.2	3.6	4.2	4.7	5.0	
Average nominal interest rate on public debt (in percent) 8/	6.0	5.3	5.1	6.0	6.0	5.9	6.5	6.3	6.2	6.3	6.4	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	3.1	1.7	3.0	1.7	3.0	2.7	3.3	3.2	3.1	3.2	3.4	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-10.4	10.0	13.8	-6.2	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.9	3.5	2.1	4.3	3.1	3.2	3.1	3.1	3.1	3.1	3.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	3.5	6.8	10.6	18.0	3.9	-5.6	2.5	5.3	5.2	5.2	4.9	
Primary deficit	0.5	0.4	1.2	2.7	3.8	2.3	2.3	2.3	2.3	2.2	2.1	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+\tau)] / (1+g+\pi+g\pi)$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+\tau)$.

5/ For projections, this line includes exchange rate changes.

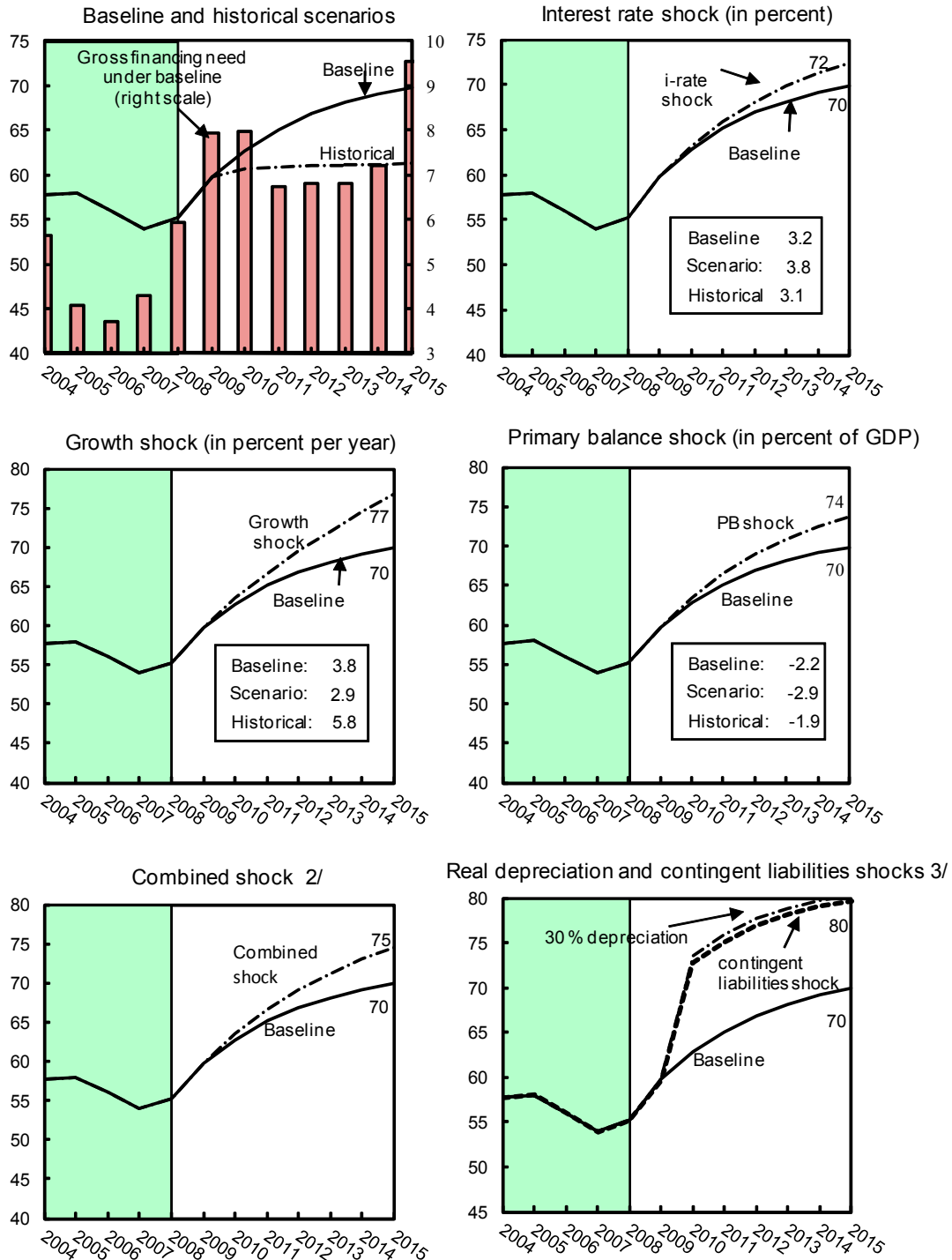
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A.1. Albania: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
 2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
 3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table A.2. Country: External Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -7.7
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Baseline: External debt	20.4	25.3	25.8	27.6	34.1	35.9	37.0	37.0	35.3	32.9	30.2	
Change in external debt	-3.9	4.9	0.6	1.8	6.5	1.8	1.2	0.0	-1.7	-2.4	-2.7	
Identified external debt-creating flows (4+8+9)	-4.7	-0.1	0.5	3.9	8.2	5.0	3.8	1.7	-0.4	-1.8	-3.0	
Current account deficit, excluding interest payments	5.7	5.0	9.7	14.5	13.3	11.4	10.1	8.2	6.5	5.2	4.1	
Deficit in balance of goods and services	24.6	24.1	26.8	26.8	25.0	22.6	22.4	20.9	19.2	17.9	16.8	
Exports	22.8	25.2	28.2	29.5	28.2	28.9	28.9	29.9	31.1	31.9	33.0	
Imports	47.4	49.3	55.1	56.3	53.2	51.5	51.3	50.8	50.4	49.8	49.8	
Net non-debt creating capital inflows (negative)	-3.4	-3.6	-6.1	-6.8	-7.9	-6.7	-6.3	-6.3	-6.3	-6.2	-6.3	
Automatic debt dynamics 1/	-7.0	-1.5	-3.1	-3.8	2.8	0.3	0.0	-0.3	-0.6	-0.7	-0.7	
Contribution from nominal interest rate	0.4	0.6	0.6	0.7	0.9	1.1	1.1	1.0	0.9	0.9	0.8	
Contribution from real GDP growth	-2.0	-1.0	-1.3	-1.7	-0.8	-0.8	-1.1	-1.3	-1.5	-1.5	-1.5	
Contribution from price and exchange rate changes 2/	-5.4	-1.1	-2.4	-2.9	2.6	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	0.8	4.9	0.0	-2.1	-1.6	-3.2	-2.6	-1.7	-1.3	-0.6	0.3	
External debt-to-exports ratio (in percent)	89.4	100.4	91.5	93.4	120.8	124.4	128.1	123.9	113.3	103.0	91.6	
Gross external financing need (in billions of US dollars) 4/ in percent of GDP	551.0 6.7	598.7 6.6	1349.0 12.6	2413.2 18.6	2584.2 21.2	2459.6 20.6	2066.5 16.6	1891.0 14.4	1731.6 12.3	1677.2 11.2	1971.3 12.2	
Scenario with key variables at their historical averages 5/						35.9	31.2	28.5	26.5	25.2	24.6	-7.5
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	11.8	5.5	6.0	7.8	2.8	2.3	3.2	3.6	4.2	4.7	5.0	
GDP deflator in US dollars (change in percent)	28.6	5.5	10.6	12.7	-8.7	-4.1	0.7	2.3	2.3	2.4	2.4	
Nominal external interest rate (in percent)	2.2	3.1	3.0	3.5	3.2	3.3	3.2	2.9	2.5	2.6	2.7	
Growth of exports (US dollar terms, in percent)	60.0	22.9	31.6	27.1	-10.3	0.3	4.1	9.5	11.1	9.8	11.1	
Growth of imports (US dollar terms, in percent)	50.5	15.8	31.0	24.2	-11.4	-5.1	3.7	4.8	5.8	5.9	7.4	
Current account balance, excluding interest payments	-5.7	-5.0	-9.7	-14.5	-13.3	-11.4	-10.1	-8.2	-6.5	-5.2	-4.1	
Net non-debt creating capital inflows	3.4	3.6	6.1	6.8	7.9	6.7	6.3	6.3	6.3	6.2	6.3	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)] / (1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)] / (1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

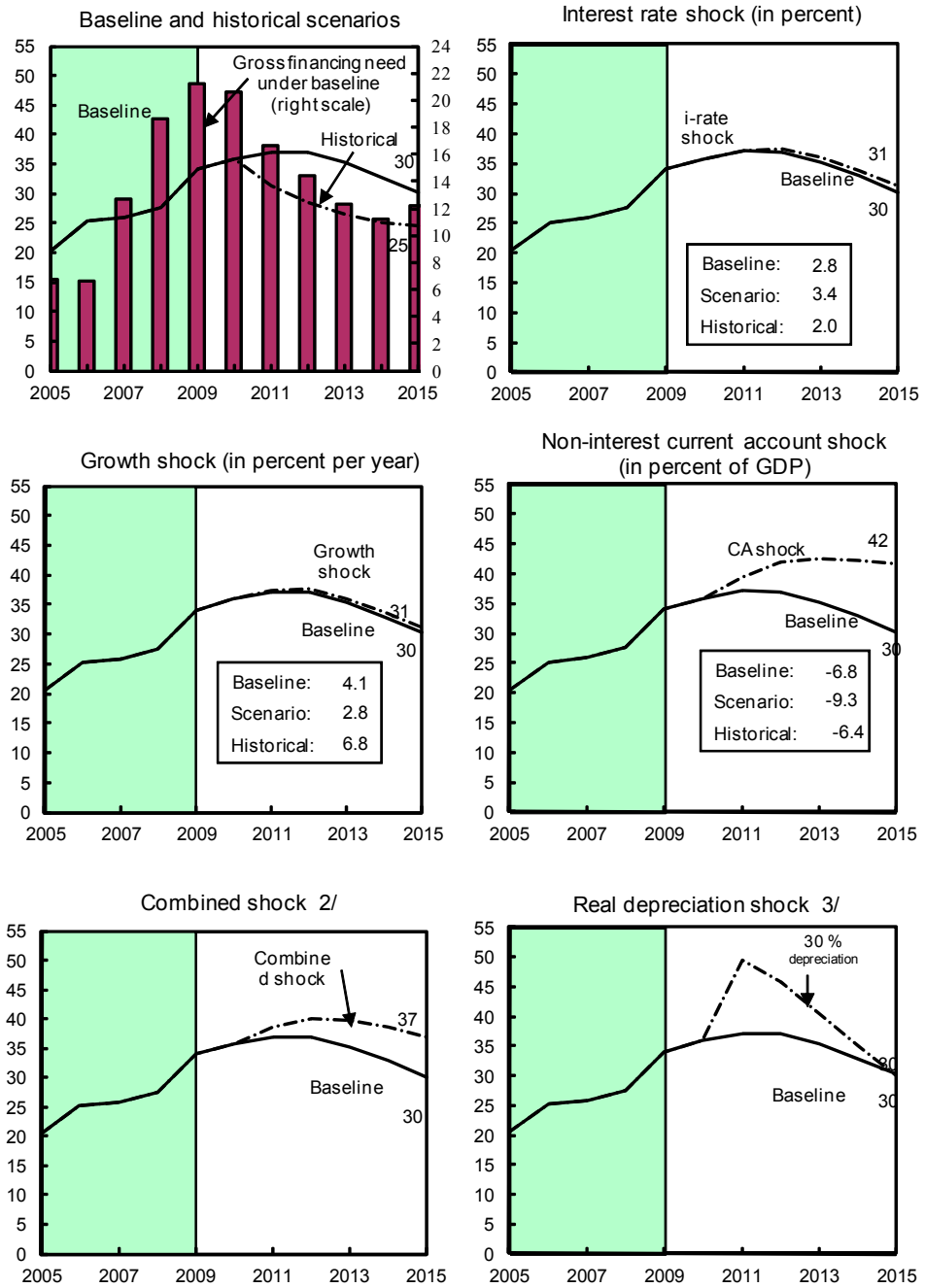
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure A.2. Albania: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2009.

INTERNATIONAL MONETARY FUND

ALBANIA

Staff Report for the 2010 Article IV Consultation

Informational Annex

Prepared by the European Department
(In consultation with other departments and the World Bank)

April 23, 2010

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I. FUND RELATIONS

As of March 31, 2010

I. **Membership Status:** Joined: 10/15/1991; Article XIV

II. General Resources Account:	<u>SDR Million</u>	<u>Percent Quota</u>
Quota	48.70	100.00
Fund Holdings of Currency	53.87	110.62
Reserve position in Fund	3.35	6.89
III. SDR Department:	<u>SDR Million</u>	<u>Percent Allocation</u>
Net cumulative allocation	46.45	100.00
Holdings	46.65	100.42
IV. Outstanding Purchases and Loans:	<u>SDR Million</u>	<u>Percent Quota</u>
Extended Arrangement	8.52	17.50
PRGF Arrangements	33.35	68.47

V. **Financial Arrangements:**

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
EFF	2/01/2006	1/31/2009	8.52	8.52
PRGF	2/01/2006	1/31/2009	8.52	8.52
PRGF	6/21/2002	11/20/2005	28.00	28.00

VI. **Projected Payments to the Fund (Expectation Basis)**

(SDR Million; based on existing use of resources and present holdings of SDRs):

	<u>Forthcoming</u>				
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Principal	4.31	7.64	6.72	6.81	5.80
Charges/Interest	0.09	0.11	0.14	0.11	0.09
Total	4.40	7.75	6.86	6.93	5.89

VII. **Safeguards Assessments:**

The Bank of Albania (BoA) was subject to a safeguards assessment with respect to current arrangements. The most recent assessment was completed on July 14, 2006 and found that some weaknesses exist in the central bank's safeguards framework. The main vulnerabilities identified by the assessment concern the quality of the external audit, oversight of the external and internal audit functions and the system of internal controls,

and certain weaknesses in the controls over the Fund data reporting process. The assessment recommended measures to alleviate these weaknesses. The authorities have taken steps to improve the external audit process and staff will monitor the implementation of the remaining recommendations.

VIII. Exchange Rate Arrangement:

On July 1, 1992 the Albanian authorities adopted a floating exchange rate system. Under the Fund's de facto exchange rate regime classification, Albania follows a floating exchange rate regime, with the monetary authorities occasionally intervening in the foreign exchange market in order to avoid excessive and short term disruptions in the functioning of the market and to accumulate reserves. Albania's exchange rate arrangement is free from exchange restrictions and multiple currency practices subject to Fund jurisdiction under Article VIII. However, the country still avails itself of the transitional arrangements under Article XIV and maintains exchange restrictions in the form of outstanding debit balances on inoperative bilateral payment agreements, which were in place before Albania became a Fund member. These relate primarily to debt in nonconvertible and formerly nonconvertible currencies. Albania has not imposed new restrictions under Article VIII. The exchange rate stood at lek 103.31 per U.S. dollar at end-March 2010.

IX. Article IV Consultation:

The conclusion of the 2008 Article IV consultation and the fifth review under the PRGF/EFF-supported program took place in July 2008 (IMF Country Report No. 08/267).

X. FSAP Participation and ROSCs:

An FSAP was carried out in early 2005. The Financial System Stability Assessment was considered by the Executive Board on August 1, 2005 concurrently with the staff report for the sixth review of the PRGF-supported program and financing assurances review. An action plan for implementing the FSAP recommendations has been prepared in consultation with the IMF. A data module ROSC was published on the Fund's website in June 2000. A fiscal ROSC was completed in June 2003. Albania participates in the General Data Dissemination System (GDDS), and a complete set of GDDS metadata for the external, financial, fiscal, and real sectors, as well as for the socio-demographic indicators is posted on the Fund's Dissemination Standards Bulletin Board (<http://dsbb.imf.org>). A data module ROSC reassessment using the Data Quality Assessment Framework was conducted in March 2006.

XI. Technical Assistance:

The Fund, other multilateral organizations and donors have provided extensive assistance for institutional development in Albania. The Fund has sent several technical assistance

missions to Albania every year since 1991. The extent and focus of Fund TA since FY 2008 is briefly listed below.

Table 1. Albania—Technical Assistance Since FY2008

Department	Purpose	Date
FAD	Cash Management and Public Finance Strategy	May 2008
	Revenue Administration	October/November 2008
	Advice on IT Strategy and Business Process Reengineering	April 2009; March 2010
	Tax Administration	April 2009; March 2010
LEGAL	Review of the Albanian AML/CFT law	August 2007
	TA on Repurchase Transactions Law	March 2008
	Banking Seminar for Judges and Bank Regulators	November 2008
	TA in Central Banking Law	April 2009
	TA on Payments Systems	May 2009
MCM	Monetary Policy	25 visits between June 2007 and April 2010;
	Management	June, July 2007
	Credit Registry	October 2007; January 2008
	Modeling and Forecasting	October 2007; March 2008
	Monetary Policy Strategy for Small Countries	December 2007;
	Banking Supervision	13 visits between February 2008 and March 2010;
	Delivery vs. Payment	April/May 2008
(together with LEGAL)	Central Bank Law	April 2009; February 2010
	Treasury Bill Registry	November 2009
	Modeling of Monetary Policy	December 2009; March, April 2010
STATISTICS	Balance of Payment Statistics	September-October 2007
	GDDS: Consultation	October 2007
	STE: Consumer Prices/Producer Price	November 2007
	LTE: Government Finance Statistics	February 2008
	STE National Accounts Statistics	5 visits between February 2008 and November 2009
	SDDS: Assessment	April 2010

IX. Resident Representative:

A Fund resident representative was posted in Tirana from April 1993 to August 2009. Ms. Ann-Margret Westin filled the position from August 2005 to August 2009.

II. IMF-WORLD BANK RELATIONS

Albania: Bank-Fund Joint Management Action Plan Matrix (As of April 2010)

Title	Product	Provisional Timing of missions	Expected Delivery date
A. Mutual information on relevant work programs			
The World Bank work program in the next 12 months	<u>Budget support:</u> Social Sector Reform DPL (\$25 million) <u>Analytical work:</u> Country Economic Memorandum Institutional and Governance Review Country Partnership Strategy <u>Technical Assistance:</u> Program of Accounting Reform and Institutional Strengthening (REPARIS) (Technical Assistance - \$7.5 million) Multi-donor Trust Fund: Capacity Building & Support to Implement the Integrated Planning System (support for Public Finance reform) Social Protection TA	February 2010 March 2010 March 2010 Ongoing starting Jan 2010 February 2010 February, May, September 2010 [2?] missions	May 25, 2010 April 2010 April 2010 May 25, 2010 April 2010 Ongoing June 2010
The Fund work program in the next 12 months	<u>Surveillance:</u> <ul style="list-style-type: none"> • 2010 Article IV Consultation [including a fiscal rules note and debt sustainability update] • Staff visit for the 2011 Budget discussions <u>Technical assistance:</u> <i>Monetary and Financial sector</i> <ul style="list-style-type: none"> • Strengthening bank supervision • Monetary policy infrastructure • Payments system (jointly with LEG) • Government securities market 	February 24-March 10, 2010; September 2010 [3] missions [2] missions [1] mission [1] mission	Board meeting in May 2010 Ongoing Ongoing Ongoing Ongoing

	<p><i>Fiscal sector</i></p> <ul style="list-style-type: none"> • Modernizing revenue administration • Public financial management <p><i>Statistics</i></p> <ul style="list-style-type: none"> • National accounts statistics • Move towards SDDS 	<p>[1] mission</p> <p>[1] mission</p> <p>[1] mission</p> <p>[1] mission</p>	<p>Ongoing</p> <p>Ongoing</p> <p>Ongoing</p> <p>April–May 2010</p>
B. Requests for work program inputs (as needed)			
Fund request to Bank	<ul style="list-style-type: none"> • Growth diagnostics, assessment of competitiveness, and related structural reforms • Fiscal governance and PEM • Public expenditure reform needs (in particular pension reforms) • Non-bank financial sector development 		
Bank request to Fund	<ul style="list-style-type: none"> • Periodic macro updates • Joint approach to advisory work on institutional reform at the MoF in debt management • Debt Sustainability Analysis 		
C. Agreements on joint products and missions			
Joint products in next 12 months	Bank staff to participate in the 2010 Article IV consultation mission.	February-March 2010	

III. ALBANIA: STATISTICAL ISSUES

April 6, 2010

A. Assessment of Data Adequacy for Surveillance

General: Data provision has some shortcomings, but is broadly adequate for surveillance. The main obstacles are in real sector statistics.

National Accounts: National accounts are compiled from insufficient and poor quality sources. While technical assistance has been provided on methodological procedures, source data still do not provide sufficient information to compile reliable estimates on the unobserved economy. In November 2005, the Institute of Statistics (INSTAT) released major revisions of the national accounts estimates for 1996–2003 and updates for 2004, reflecting methodological improvements.

INSTAT has benefited from technical assistance from the Fund and the European Union, mainly to address weaknesses in methodology, basic data sources, and coverage of the private sector. STA provided technical assistance through peripatetic missions in 2008 and 2009. The Labor Force Survey was incorporated into the estimates of the unobserved economy in the annual national accounts while attempts were made to use the Household Budget Survey to develop a new benchmark estimate of private consumption. A new methodology for gross fixed capital formation based on a commodity flow approach was developed. Quarterly national accounts were compiled during the project and are now being published. Due to severe resource constraints at INSTAT, the improvement in the national accounts has been relatively slow.

Price statistics: Compilation generally follows international standards, and the estimation of imputed rent within the CPI was improved in 2003. In December 2007, INSTAT has updated the CPI weights using the results of a new national-level HBS conducted during the period October 2006–September 2007. PPI has been published only quarterly due to financial constraints. The weights were derived from the 1998 annual Structural Business Survey.

Government finance statistics: GFS generally follow the *Government Finance Statistics Manual 1986*. External donor financed-projects that do not pass through the treasury system represent a weakness in source data.

Monetary statistics: The monetary data compilation framework conforms to the methodology recommended in the *Monetary and Financial Statistics Manual (MFSM) 2000*. The depository corporations survey covers the Bank of Albania (BoA) and all the other deposit-taking institutions (commercial banks and savings and loans associations (SLAs)). The accounts of the SLAs, with the exception of loans, are produced on a cash basis, which contrasts with the *MFSM*'s recommendations of accrual accounting. Another deviation from the *MFSM*'s methodology is that the BoA's and commercial banks' holdings of nontradable long-term securities are recorded at book value.

External sector statistics: The Balance of payments data compiled by the BoA are methodologically sound, although some of the estimates, particularly for international transactions outside the banking system need to be refined. Problems remain in the areas of service transactions and remittances, and in the monitoring of financial account transactions, foreign assistance (grants from abroad to regional and local governments are underreported), and external debt.

A September–October 2007 mission noted strong progress in adopting earlier recommendations but advised that estimation methods for transactions outside the banking system (mostly remittances and investment transactions by nonresident Albanians) require further improvement.

The external debt database ensures timely and accurate reporting of external government debt (including commitments of state-owned enterprises). However, there have been some irregularities in the recording and presentation of external arrears. The collection of data on external grants is not timely, with lags of several months frequently encountered.

B. Data Standards and Quality

Albania participates in the General Data Dissemination System (GDDS).

Data ROSC published on October 2006.

ALBANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
As of April 5, 2010

	Date of latest observation	Date received	Frequency of Data ⁷	Frequency of reporting ⁷	Frequency of publication ⁷	Memo Items:	
						Data Quality – Methodological Soundness ⁸	Data Quality – Accuracy and Reliability ⁹
Exchange Rates	04/05/10	04/05/10	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	04/02/10	04/05/10	D	W	M		
Reserve/Base Money	04/02/10	04/05/10	D and M	W and M	M		
Broad Money	February 10	03/30/10	M	M	M	O, O, O, LO	O, LO, LO, O, O
Central Bank Balance Sheet	February 10	03/30/10	M	M	M		
Consolidated Balance Sheet of the Banking System	February 10	03/30/10	M	M	M		
Interest Rates ²	04/05/10	04/05/10	D	D	D		
Consumer Price Index	February 09	03/08/10	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	December 2009	2/18/10	M	M	M	LO, O, O, O	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	December 2009	2/18/10	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	December 2009	02/18/10	Q	Q	A		
External Current Account Balance	2009Q4	03/10/10	Q	I	I	O, O, O, LO	LNO, O, LO, LO, O
Exports and Imports of Goods and Services	January 2010	02/25/10	M	Q	Q		
GDP/GNP	2008	11/09	A	A	A	O, LNO, O, LO	LNO, O, LNO, LO, LO
Gross External Debt	2009Q3	2/26/10	Q	I	NA		
International Investment position ⁶	2008	2/25/10	A	A	NA		

¹ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

² Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Includes external gross financial asset and liability positions vis a vis nonresidents. The IIP is currently being developed by the Albanian authorities and is not yet published. The authorities will publish the data once quality checks have been completed.

⁷ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

⁸ Reflects the assessment provided in the data ROSC published on October 31, 2006, and based on the findings of the mission that took place March 8-22, 2006, for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

⁹ Same as footnote 8, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies



INTERNATIONAL MONETARY FUND

Public Information Notice

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Public Information Notice (PIN) No. 10/81
FOR IMMEDIATE RELEASE
July 12, 2010

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2010 Article IV Consultation with Albania

On May 24, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Albania.¹

Background

Despite Albania's limited integration into global markets, the global financial crisis was transmitted through several channels. As elsewhere in the region, Albanian banks witnessed substantial deposit withdrawals in the fall of 2008. The recession in trading partners—particularly Greece and Italy—led to falling exports. Finally, remittances and nonclassified inflows, while imprecisely measured, are estimated to have fallen drastically.

The authorities were able to use accumulated policy space to soften the immediate blow from the crisis, and Albania has performed better than other regional and European economies. In particular, (i) ample liquidity buffers were utilized to meet deposit withdrawals; (ii) monetary conditions were loosened, initially by quantitative easing via BoA direct liquidity injections, followed by interest rate cuts; and (iii) considerable fiscal stimulus was also provided. Growth continued at an estimated 2.8 percent in 2009 and inflation has mostly been in line with the

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

target of 3±1 percent, though depreciation pass through and higher electricity prices recently lifted inflation above 4 percent.

However, policy buffers are now exhausted and need rebuilding. Especially given the significant risks emanating from the challenging external environment and sizeable domestic vulnerabilities, quick progress is essential to redress internal and external imbalances. With private sector adjustment already under way, the budget must achieve a significant turnaround to bring down the current account deficit and make space for credit extension to the private sector.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They observed that Albania's previously accumulated fiscal and monetary policy space provided buffers that have helped soften the impact of the global crisis. Directors noted that the authorities' decisive actions had supported the economy and prevented a surge in financial risks. However, policy buffers now have been depleted and must be rebuilt to safeguard macroeconomic stability, given significant downside risks from the external environment and domestic vulnerabilities.

Directors generally called for timely and decisive fiscal tightening in 2010 to reduce financing risks and crowding out of private investment, and help contain external imbalances. They recommended both one-off and structural revenue and expenditure measures, and advised saving the remaining contingency reserves in the 2010 budget. They also encouraged the authorities to pursue civil service reform, keep wages and pensions in check, and strengthen public investment execution.

Directors emphasized the importance of lowering public debt to sustainable levels in the medium term and welcomed the authorities' commitment to cut public debt levels significantly. In support of this goal, they saw merit in a sound medium-term fiscal policy framework governed by a credible and monitorable fiscal rule. Directors endorsed the authorities' efforts to diversify financing sources, while recommending that the authorities keep all options on the table, especially in light of current heightened uncertainty in international markets.

Directors commended the authorities' early and successful adoption of macroprudential measures. They stressed the need for continued vigilant supervision in face of worsening domestic credit quality and rising external risks, in particular potential spillover risks related to recent developments in Greece. Directors also recommended the development of contingency plans to deal with tail risks, as well as the supervisory and macroprudential toolkit to address emerging challenges.

Directors considered that the monetary policy framework and the flexible exchange rate have served Albania well by keeping inflation in check and helping the economy weather external shocks. They encouraged the authorities to continue the cautious monetary stance and focus on anchoring inflation expectations, while remaining mindful of financial stability considerations and macroprudential needs.

Directors welcomed progress on structural reforms, while emphasizing the importance of further improvements in the business environment and investor protection to improve competitiveness and broaden sources of growth. They recommended tackling obstacles to the effective operation of privatized industries, establishing a clear property rights system, strengthening rule enforcement, and addressing weaknesses in economic statistics.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2010 Article IV Consultation with Albania is also available.

Albania: Basic Indicators and Macroeconomic Framework, 2007–10

	2007	2008	2009	2010
			Est.	Proj.
	(Growth rate in percent)			
Real GDP 1/	6.0	7.8	2.8	2.3
Retail prices (avg.)	2.9	3.4	2.2	3.5
Retail prices (end-period)	3.1	2.2	3.5	2.9
	(Percent of GDP)			
Saving-investment balance				
Foreign savings	10.3	15.3	14.0	12.6
National savings	19.1	17.3	15.0	13.3
Public	2.2	3.2	1.1	-0.4
Private	16.8	14.1	13.9	13.6
Investment	29.4	32.5	29.0	25.9
Public	5.9	8.6	8.8	5.1
Private	23.5	23.9	20.2	20.8
Fiscal sector				
Revenues and grants	25.7	26.8	26.0	25.2
Tax revenue	23.6	24.3	23.5	22.9
Expenditures	29.6	32.3	33.4	30.3
Primary	26.9	29.4	30.2	27.0
Interest	2.6	2.9	3.1	3.3
Overall balance (including grants)	-3.9	-5.5	-7.4	-5.2
Primary balance (including grants)	-1.2	-2.7	-4.3	-1.8
Net domestic borrowing	1.8	1.7	0.9	2.5
Privatization receipts	1.6	0.5	2.4	0.0
Foreign financing	0.5	3.2	3.7	3.1
Public Debt	53.9	55.2	59.7	62.8
Domestic	38.2	36.8	36.0	36.6
External (including publicly guaranteed)	15.7	18.4	23.7	26.2
Monetary indicators				
Broad money growth	13.7	7.7	6.8	7.0
Private credit growth	48.2	32.1	10.3	8.6
Velocity	1.3	1.3	1.3	1.3
Interest rate (3-mth T-bills, end-period)	6.3	6.3	6.3	...
	(Percent of GDP unless otherwise indicated)			
External sector				
Trade balance (goods and services)	-26.7	-26.8	-25.0	-22.7
Current account balance (including official transfers)	-10.3	-15.3	-14.0	-12.6
Current account balance (excluding official transfers)	-11.3	-15.9	-14.7	-13.3
Official transfers	1.0	0.7	0.7	0.7
Gross international reserves (in millions of Euros)	1,467	1,721	1,621	1,586
(In months of imports of goods and services)	4.1	4.2	4.2	4.2
(Relative to external debt service)	12.1	12.4	9.5	3.7
(In percent of broad money)	23.3	26.1	26.0	23.9
Change in real exchange rate (e.o.p., in percent)	0.5	-0.6	...	...
Memorandum items				
Nominal GDP (in billions of lek) 1/	967	1,088	1,153	1,217

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ GDP data for 2007–08 are from the official national accounts.

Statement by the Staff Representative on Albania
May 24, 2010

1. This paper briefly summarizes recent developments since the issuance of SM/10/100. The additional information does not change the thrust of the staff appraisal.
2. **Official figures suggest a sharper than expected fall in GDP in the fourth quarter of last year.** However, the figures also indicate that GDP in earlier quarters could have been higher than assumed. On balance, staff believe that the growth estimate in SM/10/100 of 2.8 percent for 2009 remains valid. Nevertheless, if confirmed, the sharp downturn in the fourth quarter could imply a more significant negative carry-over effect into 2010, so that the growth projection of 2.3 percent could be revised down.
3. **Consumer price inflation has fallen back into the 3±1 percent target range.** Inflation was 3.9 percent in March, and 3.5 percent in April 2010. The decline was mainly owing to dropping food price inflation. These developments are broadly in line with the profile underlying the staff forecast for average and end-period inflation in 2010.
4. **The first quarter budget deficit was somewhat higher than expected, but staff believe that the full year projection remains valid.** Revenue developments were fully in line with staff's projections. Meanwhile expenditure came in some 10 percent higher than forecast, owing to significant growth in current spending—especially on social insurance outlays and operations and maintenance—that is expected to be offset by lower capital spending going forward.
5. **Liquidity in the banking system has continued to improve, driven by deposit inflows.** Following the IMF-EU program with Greece, Greek-owned banks (which had earlier seen some deposit withdrawals) are now also part of the system-wide deposit growth.
6. **In recent discussions with staff, the authorities have indicated their intention to effect a mid-year budget tightening.** They intend to use the budget review exercise to keep public debt within the 60 percent of GDP legal ceiling. The authorities also reported their intention to make progress in introducing a fiscal rule that would be operationalized through deficit ceilings.

Statement by Mr. Sadun and Mr. Spadafora on Albania
May 24, 2010

On behalf of the Albanian authorities, we thank staff for the well-written and informative reports, and for the continued close and constructive cooperation with the authorities.

Overview

The global crisis impacted the Albanian economy through lower exports and remittances, reduced capital inflows, heightened risks in the financial sector, and a moderation of domestic demand due to higher precautionary saving.

However, Albania has weathered the global crisis better than most other regional and European economies. Building on a flexible monetary policy framework, low external debt, a sound banking system, and substantial foreign exchange reserve buffers, the authorities were able to use the policy space accumulated during years of strong growth (over 6 percent on average during 2005–08) to mitigate the consequences of a deteriorating external environment. Monetary conditions were repeatedly eased and a considerable fiscal stimulus was provided by acting on both the revenues and expenditure side.

The depreciation of the *lek* (by a cumulative 14 percent) helped mitigate the fall in exports triggered by the recession in the country's main trading partners; export performance has improved significantly since the beginning of 2010. Current account deficits are mainly a reflection of an ambitious public investment program and transition-driven productivity gains. About half of these deficits have been financed by net inflows of foreign direct investments. External debt is low and reserves coverage remains high.

Against this background, growth continued at 3.3 percent in 2009, as recently estimated by the Albanian Institute of Statistics (INSTAT), and a V-shaped recovery now constitutes the baseline scenario. The authorities expect activity to bounce back more quickly than staff's projections, on account of gains from the large investments and structural reforms undertaken in the past. Their policies for 2010 aim at preserving macroeconomic stability, consolidating public finances and advancing structural reforms.

Fiscal Policy

On account of the crisis-induced deterioration in the fiscal position, the authorities concur with staff that fiscal consolidation represents the key near- and medium-term policy challenge, given the need to address a sizable public debt and large financing and rollover requirements. To this end, in the Macroeconomic and Fiscal Framework 2011–2013 approved by the Council of Ministers on January 2010, the government has targeted a

reduction in the overall deficit from 7.4 percent of GDP in 2009¹ to 3 percent over the medium term.

In particular, this will be achieved by targeting an overall deficit not exceeding 4 percent of GDP in 2010, and of 3 percent during 2011-2013. In line with staff's view, public investment has been scaled back from 8.8 percent of GDP in 2009 to 5.2 percent. Given the more challenging environment, the 2010 budget has been strengthened through one-off expenditure cuts of about 30 billion *lek* (2.5 percent of GDP). Moreover, in order to preserve the deficit and debt targets, the budget allows for contingency funds should revenues fall below projections.

The forthcoming mid-term budget review in the summer will provide an opportunity to verify that the current fiscal stance is in line with the fiscal objectives, and to ascertain the need for corrective measures.

To support fiscal consolidation, the authorities intend to adopt a fiscal rule, and currently favor a deficit rule over an expenditure one. The former places greater emphasis on protecting recent gains in tax administration and the overall fiscal balance, and is considered more effective in achieving fiscal consolidation. The authorities are also aware of the need to continue structural fiscal reforms in order to improve capital expenditure execution and tax administration.

The authorities are seeking to place a Eurobond to lessen the reliance on short-term domestic financing, although current conditions in international markets may have an impact on the timing, size and pricing of the issuance.

While the authorities greatly appreciate the dialogue with the Fund, they considered that current economic perspectives do not call for a Fund-supported program.

Monetary Policy and the Financial Sector

The prevailing monetary policy framework, an inflation target range combined with a flexible exchange rate, is serving the country well; it has increased the resilience of the economy while keeping inflation expectations well anchored. The exchange rate worked as a shock absorber, both by limiting the impact of the energy and food price shocks of 2007-08, and subsequently by easing the adjustment to the global crisis.

The financial system entered the crisis well capitalized, relying on a funding model based on domestic deposits; it is relatively solvent, liquid, and profitable. To a large extent, this is due to the Bank of Albania's (BoA) strong supervision, which has enabled banks to build large liquidity and capital buffers. The BoA also proactively adopted macroprudential measures that, *inter alia*, slowed credit growth and limited the balance sheet effects of unhedged foreign currency lending.

¹ On a cash basis, the deficit was 6.9 percent, of which 2.4 percent was financed through privatization receipts.

As elsewhere in the region, Albanian banks witnessed substantial panic deposit withdrawals in the face of spillovers from instability of global financial markets, which were compounded by concerns about the health of the Greek banking system in the fall of 2008. Ample liquidity buffers were utilized to meet deposit withdrawals. To boost confidence, deposit insurance limits were raised fivefold, and deposits started to recover from the second half of 2009. Stress tests assessing key risks suggest that the banking system has sufficient buffers to weather the expected downturn. Moreover, Albanian firms and households are only moderately leveraged compared to South Eastern European peers.

These strengths notwithstanding, the authorities remain vigilant. While foreign banks continued to extend credit during the crisis, the financial health of some parent banks is under close scrutiny. Given the preponderance of foreign-owned banks, the BoA has long stepped up cross-border coordination efforts with regional supervisors and parent-bank supervisors.

Structural Reforms

Albania's light regulation already provides the economy with flexibility, especially in labor markets, and wage levels are among the lowest in the region. Improving the business environment is paramount to exploiting in full the benefits associated with the prospective EU integration. Greater investment is needed to raise productivity and ultimately strengthen competitiveness and broaden the country's sources of growth. The authorities are planning a number of industrial zones to attract additional investment, including from abroad. They continue to work with the World Bank to develop the insurance and pension sectors, which have potential to provide longer-term funds for investment.