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ALBANIA

December 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ALBANIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Albania, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its December 6, 2021 consideration of the staff report that concluded the Article IV consultation with Albania.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 6, 2021, following discussions that ended on October 11, 2021, 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 November 17, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Albania.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2021 Article IV Consultation with Albania

FOR IMMEDIATE RELEASE

WASHINGTON, DC – **December 6, 2021** the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Albania.

Albania was severely affected by the November 2019 earthquake and the COVID-19 pandemic, but the economic contraction in 2020 was smaller than originally expected. Real GDP is rebounding strongly by a projected 7.8 percent in 2021, spurred by continued monetary and fiscal policy support, reconstruction, reduction in movement restrictions, strong electricity production due to favorable weather conditions in the first few months, and a relatively good tourism season. Headline inflation has risen on account of higher food and energy prices, but core inflation has increased only modestly, and broader inflationary pressures are subdued. The fiscal deficit widened sharply to 6.8 percent of GDP in 2020 and is expected to remain at that level in 2021. Public debt increased to 77.2 percent of GDP at end-2020 and is expected to increase further in 2021. The financial system has been stable and liquid and credit flows have continued to support the economy.

From 2022 onwards, economic activity is expected to remain strong as the impact of the pandemic wanes and international tourism continues to recover, but growth will be tempered by the phasing out of fiscal support and reconstruction and the maturing of the recovery cycle. In the medium-term, growth is projected to converge to its potential of 3.4 percent, a level held back by adverse demographic factors. After the temporary increases in inflation recede by mid-2022, inflation is expected to settle at the Bank of Albania's 3 percent target in the medium run. Albania's general government debt is projected to decline gradually from a peak of about 81 percent of GDP in 2021 to 74 percent of GDP in 2026, absent new shocks. Uncertainty over the outlook remains high. The emergence of vaccine-resistant variants at the global level or localized outbreaks in Albania as well as potentially tighter global financial conditions and higher global energy prices pose important downside risks to the outlook. A faster normalization from the pandemic presents an upside risk.

Executive Board Assessment[2]

Executive Directors commended the resilience of the Albanian economy after the 2019 earthquake and COVID-19 pandemic, underpinned by strong domestic policies and external support. They welcomed the strong rebound underway, while noting the uncertainty around the outlook with risks tilted to the downside, including from the pandemic trajectory, low vaccination rates, and energy prices. Directors called for efforts to rebuild policy buffers,

[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.

[2] 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.

safeguard financial stability, and address structural bottlenecks to unlock the country's growth and development potential.

Directors emphasized the need to embark on a credible revenue-based fiscal consolidation, underpinned by a sound Medium-Term Revenue Strategy in line with staff recommendations. They stressed that low efficiency spending should be reduced and fiscal support should better target those most in need. Directors further stressed the importance of strengthening the quality and transparency of public spending. It will be critical to address shortcomings in managing public investment, including public-private partnerships, and bolster the credibility of the budget and fiscal framework. More concerted efforts are also needed to monitor and manage rising fiscal risks. Directors urged the authorities to implement promptly transparency and accountability measures for emergency spending and subject reconstruction funds to adequate public financial management controls.

Directors supported maintaining monetary accommodation and stressed that any shift towards tightening should be based on clear indications of broadening and persistent inflationary pressures. They welcomed the authorities' commitment to let the exchange rate act as a shock absorber.

Directors noted that the financial sector remains stable and liquid. However, as the full impact of the shock on banks' balance sheets is yet to be fully observed, they called for continued vigilance in monitoring and supervision. Directors recommended close monitoring of banks' loan portfolio quality, preserving capital buffers, and strengthening the NPL resolution frameworks. Close attention to a potential buildup of vulnerabilities from the real estate sector and virtual assets is also needed.

Directors saw the need for steadfast efforts to address structural impediments to growth. They called for completion of judicial reforms and continued efforts to strengthen Albania's AML/CFT framework and exit from FATF's grey list. Directors welcomed the work underway to update the anticorruption strategy and action plan.

Directors agreed that Albania's capacity to repay the Fund is adequate and risks remain contained and manageable.

Albania: Selected Economic Indicators, 2017–2022

	2017	2018	2019	2020	2021	2022
					Proj.	
			(Percent change)			
Real sector						
Real GDP	3.8	4.0	2.1	-4.0	7.8	3.8
Domestic demand contribution	3.6	3.9	2.2	-4.6	7.7	3.5
Consumption	2.3	2.4	2.7	-1.5	6.5	3.3
Investment (Incl. inventories and stat. disc)	1.3	1.5	-0.5	-3.1	1.2	0.2
External demand contribution	0.2	0.2	-0.1	0.7	0.1	0.3
Consumer Price Index (eop)	1.8	1.8	1.1	1.1	2.8	2.0
Consumer Price Index (avg.)	2.0	2.0	1.4	1.6	2.0	2.4
GDP deflator	1.5	1.5	1.2	-0.4	1.5	1.7
			(Percent change)			
Saving-investment balance						
Foreign savings	7.5	6.8	7.6	8.8	8.4	8.0
National savings	17.1	17.1	14.7	14.2	14.5	14.2
Public	2.4	3.0	2.0	-0.2	0.3	0.3
Private	14.7	14.1	12.7	14.4	14.2	13.9
Investment (incl. Inventories and stat. disc.)	24.6	23.9	22.3	23.0	22.9	22.3
Public	5.5	5.6	5.3	6.9	7.9	6.7
Private	19.1	18.3	17.0	16.1	15.0	15.6
Fiscal sector						
Total revenue and grants	27.8	27.5	27.2	26.3	27.4	27.6
Tax revenue	25.7	25.6	25.2	24.6	25.6	25.8
Total expenditure	29.7	28.8	29.2	33.2	34.2	33.0
Primary	27.7	26.6	27.2	31.0	31.9	30.8
Interest	2.1	2.2	2.1	2.1	2.2	2.2
Overall balance 1/	-2.0	-1.3	-2.0	-6.8	-6.8	-5.4
Primary balance	0.1	0.9	0.1	-4.7	-4.5	-3.2
Financing	2.0	1.3	2.0	6.8	6.8	5.4
Of which: Domestic	0.1	-1.6	2.5	3.0	0.4	5.5
Of which: Foreign	1.9	2.9	-0.5	3.8	6.3	-0.1
General Government Debt 2/3/	71.9	69.5	67.3	77.2	80.6	79.0
Domestic	39.0	37.3	36.9	41.3	40.8	41.0
External	32.9	32.2	30.4	35.9	39.8	38.0
			(Percent change)			
Monetary indicators						
Broad money growth	0.3	-0.2	4.3	10.5	9.1	4.2
Private credit growth	-0.8	-0.9	6.1	8.9	7.5	3.0
			(Percent of GDP, unless indicated otherwise)			
External sector						
Trade balance (goods and services)	-15.1	-13.7	-13.6	-14.8	-14.3	-13.6
Current account balance	-7.5	-6.8	-7.6	-8.8	-8.4	-8.0
Gross international reserves (billions of Euros)	3.0	3.4	3.4	3.9	4.3	4.1
(In months of imports of goods and services)	6.2	6.6	8.1	8.2	8.1	6.9
(In percent of ARA metric)	156	182	174	188	176	164
Gross reserves excl. banks' FX reserves (billions of Euros)	2.5	2.9	2.8	3.3	3.6	3.4
Memorandum items						
Output gap	-0.9	-0.1	-1.0	-3.3	-0.4	-0.1
Real GDP (growth per capita)	3.5	4.1	2.2	-3.9	8.0	4.0
Exchange rate Lek/Euro (avg.)	134.2	127.6	123.0	123.8	…	…
Exchange rate Lek/Euro (eop, annual growth)	-1.7	-7.2	-1.3	1.6	…	…

Sources: Albanian authorities; and IMF staff estimates and calculations.
1/ The fiscal balance includes guarantees for new loans to the energy sector through 2019 and from 2021, and potential calls of COVID-19 related guarantees from 2021.
2/ The stock of general government debt includes public guarantees (domestic and external) and arrears from central and local government and VAT refund arrears.
3/ The 2021 SDR allocation of $190 million is recorded with the government, increasing both the TSA balance and government external debt.

INTERNATIONAL MONETARY FUND

ALBANIA

STAFF REPORT FOR THE 2021 ARTICLE IVCONSULTATION[1]

November 17, 2021

KEY ISSUES

Context. Albania's economy has shown considerable resilience in the face of the 2019 earthquake and the pandemic. After the hardship endured in 2020, real GDP is rebounding strongly by a projected 7.8 percent in 2021. Policies have played a critical role in preserving lives and livelihoods and thereby paving the way for the recovery. The key challenges now are to invest efficiently in people and the economy to support the continued development of the country and to rebuild room for fiscal policy maneuver by lowering the very high fiscal deficit and public debt.

Policy Discussions

- A credible and ambitious medium-term fiscal adjustment plan should be adopted now and implemented from 2022. The lynchpin of such a plan should be a sound Medium-Term Revenue Strategy to boost tax revenues. At the same time, the quality and transparency of public spending should be increased and non-priority, low efficiency spending as well as non-targeted support pared back. Fiscal support needs to better target those most in need to ensure an inclusive recovery. The credibility of the budget and fiscal framework should be bolstered and rising fiscal risks be better monitored and managed, with their root causes addressed.

- Monetary policy should remain accommodative. Tightening will only be warranted if there are clear indications of broadening and persistent inflationary pressures. As the full impact of the shocks on the banking system may only become visible after some time, continued vigilance will be key to safeguarding financial stability.

- Albania needs to step up efforts to improve the rule of law, reduce vulnerabilities to corruption, strengthen the AML/CFT framework, and boost competitiveness to realize its long-term development goals.

Post Financing Assessment. Albania's capacity to repay the Fund remains adequate under the baseline, and risks are contained and manageable.

[1] On May 7, 2021 the IMF Board approved renaming Post-Program Monitoring (PPM) to Post Financing Assessment (PFA) and adopted combined Article IV and PFA consultations (IMF Policy Paper No. 2021/026).

Approved By
Jörg Decressin (EUR) and Martin Sommer (SPR)

Discussions were held remotely from Washington DC during September 28 – October 11, 2021. The team comprised Y. Sun (head), F. Jamaludin, A. Khachatryan, M. Pinat (all EUR), H. Selim (FAD), D. Milkov (SPR), S. Eble (Regional Resident Representative), and L. Spahia and A. Edwards (both local economists). R. Kadeli (IMF local office) assisted the mission. A. Madaraszova and Z. Zhu (both EUR) assisted in the preparation of the report. D. Fanizza and L. Cerami (both OED) attended part of the meetings. The mission met remotely with Deputy Prime Minister Ahmetaj, Minister of Finance and Economy Ibrahimaj, Bank of Albania Governor Sejko, senior officials, parliamentarians and other representatives of political parties, development partners, and representatives of businesses and financial institutions.

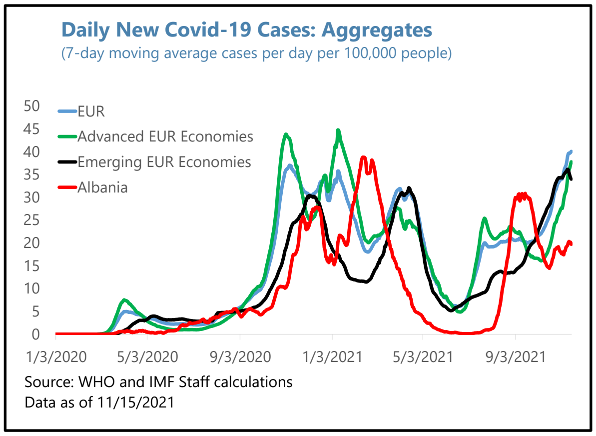
CONTENTS

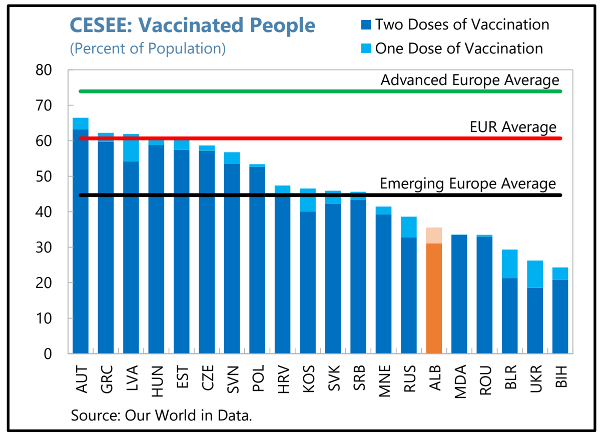
TABLES

ANNEXES

CONTEXT

1. Albania was hit by the COVID-19 pandemic after enduring its strongest earthquake in decades. Following a strict lockdown at the onset of the pandemic, successive waves of infections were managed with light-touch restrictions. Mass vaccination started on April 2021, but to date only one-third of the population is fully vaccinated, one of the lowest in the region, with about 80 percent of the available 2.5 million doses administered. Due to the spread of the Delta variant, case incidence increased at the peak of the tourism season and moderated before edging up recently.





2. The Socialist Party was confirmed for a third consecutive mandate in this year's elections, with its focus on recovery and reconstruction. Albania continues to lag its peers in converging to EU living standards. While the EU Council decision on starting accession talks is being put on hold, EU accession and related reforms—including ongoing judicial reforms—remain a priority for the country. With a renewed mandate, the government is well positioned to address many challenges faced by Albania.

3. The implementation of past Fund advice has been uneven (Annex V). The authorities are interested in developing a Medium-Term Revenue Strategy (MTRS), but the shocks have delayed progress in tax policy reform, even though some progress has continued on revenue administration. Efforts to strengthen public finance and investment management, including notably Public-Private Partnerships (PPPs), have fallen short. Progress in implementing structural reforms has been limited, including State-Owned Enterprise (SOE), governance and anti-corruption, and institutional reforms. Advances have been made in aligning banking supervision and regulation with Basel standards, but shortcomings in the NPL resolution frameworks persist due to delays in judicial reforms.

RECENT DEVELOPMENTS

4. Albania was severely affected by two major shocks, but the economic contraction in 2020 was smaller than originally expected.

- Real GDP contracted by 4 percent in 2020, driven by a large drop in services. The downturn was softened by strong domestic and regional tourism, the absence of a second lockdown, as well as policy support and earthquake reconstruction. Almost 45,000 jobs were lost, but the drop in labor force participation and the increase in the inactivity rate were limited (Figure 1).

- The fiscal deficit widened sharply to 6.8 percent of GDP as a result of a large drop in revenue and spending increases to cushion the impact of the shocks (Text Table 1). Public debt increased to 77.2 percent of GDP (Figure 4).

- The current account deficit widened considerably in 2020, reflecting lower tourism receipts and goods exports, with the decline in imports limited by relatively resilient domestic demand (Figure 3). The exchange rate remained broadly stable during the year, except for a short-lived episode of depreciation in late March that was quickly reversed following interventions by the Bank of Albania (BoA). Reserves increased to €3.9 billion at year-end (188 percent of ARA metric), thanks to the Rapid Financing Instrument (RFI) and a Eurobond issuance, and the BoA suspended its pre-announced purchases of FX reserves. Staff assesses Albania's external position in 2020 to be moderately weaker (Annex III).

Text Table 1. Albania's Economic Performance During 2020 Relative to Peers

(Percent of GDP)

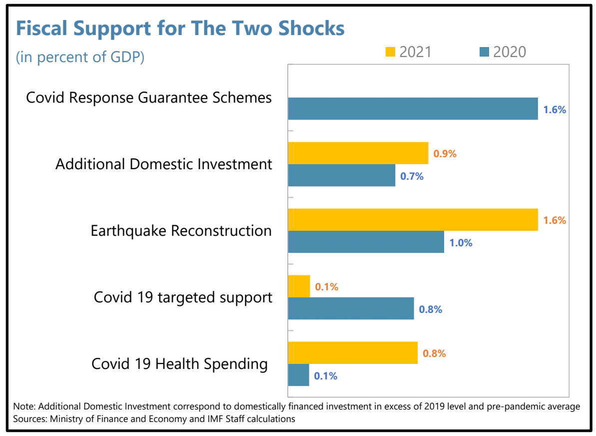
	Real GDP Growth		Primary Fiscal Balance		Current Account		Gross Public Debt		Total Reserves		Fiscal Policy
	2019	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**	**2020**	**Support**
ALB	2.1	-4.0	0.1	-4.7	-7.6	-8.8	67.3	77.2	24.4	30.2	3.4
BIH	2.8	-4.3	2.3	-3.6	-3.1	-3.2	32.5	36.7	35.7	40.8	2.5
KOS	4.9	-5.3	-2.5	-7.4	-5.6	-7.1	17.6	24.1	10.9	10.9	12.7
MNE	4.1	-15.2	0.7	-9.4	-14.3	-26.0	78.8	107.2			2.5
MKD	3.2	-4.5	-0.8	-6.9	-3.3	-3.5	40.6	51.2	28.9	33.3	3.8
SRB	4.2	-1.0	1.8	-6.1	-6.9	-4.3	52.8	58.4	29.0	26.9	5.6

Note: Fiscal Policy Support includes above and below the line measures adopted in both 2020 and 2021 as a share of 2020 GDP, based on the IMF Fiscal Monitor of April 2021. For Albania, it does not include higher-than-normal level of domestically financed public investment.
Sources: Country Authorities and IMF Staff estimations and projections

5. **The economy is rebounding strongly in 2021 while inflationary pressures have remained subdued.** The recovery is broad-based with all sectors but agriculture registering positive growth in 2021H1. Electricity production doubled in 2021Q1 compared to 2020Q1 due to favorable weather conditions. January–September tourist arrivals reached 89 percent of the 2019 level, although the sources of tourist flows have shifted to more regional and emerging market countries (Annex VI). Labor market indicators have improved in the first half of 2021, but labor force participation and employment rates remained one percentage point below the pre-pandemic levels while unemployment was 0.7 percentage point higher. Headline inflation has risen on account of higher food and energy prices, but core inflation has increased only modestly, and broader inflationary pressures are contained. Average wages have grown by more than inflation in 2021Q2, following a year of muted increase, partly due to an increase in the minimum wage in January 2021. The monetary policy rate has been maintained at a historical low

of 0.5 percent since March 2020 (Figure 2), and the BoA's provision of unlimited liquidity to banks was extended through end-2021 and is expected to be discontinued in 2022Q1.

6. While the sizeable increase in the 2020 deficit was necessary to cushion the impact of the shocks, fiscal policy in 2021 is more expansionary than warranted. Despite weak public investment management, the government has ramped up domestically financed (non-earthquake) public investment since 2020, more than the COVID-19 targeted support (Text Table 2). The fourth budget revision in July increased the 2021 deficit by 0.7 percent of GDP to accommodate higher (non-earthquake) capital expenditure. While supporting channeling the 2021 SDR allocation to the budget, staff has advised against the deficit increase. Revenue collections so far have rebounded to above pre-crisis levels. Execution of spending accelerated in the lead-up to the parliamentary elections in April. It has slowed down since but is expected to pick up toward the end of the year. Accordingly, despite a strong rebound in revenue, the primary deficit is projected at 4½ percent of GDP in 2021, similar to that in 2020. General government debt is projected to rise to slightly above 80 percent of GDP at end-2021, among the highest in the region. A €700 million Eurobond issuance is currently planned before end-2021 to help meet budget financing needs in 2021 and 2022.



7. The current account deficit is expected to decline marginally in 2021. Tourism arrivals have sprung back strongly, increasing service exports, while service imports have remained subdued as COVID-19 restrictions for Albanians travelling abroad have remained largely in place. This improvement in net services exports has been offset somewhat by a strong growth of goods imports, driven by the rebound in domestic demand, while exports of goods have rebounded more moderately. The exchange rate has appreciated somewhat so far, as a result of the improvement in the current account and the continued capital inflows. The BoA has resumed its pre-announced purchases of FX reserves and the expected issuance of a Eurobond is projected to raise FX reserves towards €4.3 billion (176 percent of ARA metric) at year end.

OUTLOOK AND RISKS

8. Staff's baseline projects a strong recovery. Real GDP growth is projected at 7.8 percent in 2021, spurred by continued fiscal and monetary policy support, reconstruction, reduction in movement restrictions, strong electricity production due to favorable weather conditions in H1, and a good tourism season. From 2022 onwards, economic activity is expected to remain strong as the impact of the pandemic wanes and international tourism continues to recover (Annex VI), but growth will be tempered by the phasing out of fiscal support including reconstruction and the maturing of the recovery cycle. The current account deficit is expected to continue to decline, underpinned by continued increase in tourist arrivals and slower growth of imports of goods as public investment and reconstruction slow down. Growth is projected to converge to its potential of 3.4 percent, a level held back by adverse demographic factors. Inflation is projected to settle at the BoA's 3 percent target over the medium run.

Text Table 2. Main COVID-19 Fiscal Support Measures

In 2020

Non-Health Measures *(Budgeted: Lek 15.5 billion; Used: Lek 13.3 billion) of which:*

Wage Support

- At minimum wage level for small businesses and the self-employed throughout the 3-month lockdown period
- One-off transfer (at 1.5 times the minimum wage) for other affected employees, included those laid off during the pandemic.

Social Assistance

- Doubling of the social assistance and unemployment benefits for the duration of the lockdown (3 months)

Health Measures *(Budgeted: Lek 3.5 billion; Used: Lek 2.2 billion)*

- Additional funds to deal with the Covid 19 pandemic

Below-the-Line Measures *(Announced: Lek 26 billion; Used: Lek 9.1 billion)*

- Two sovereign guarantee schemes: one to provide wage support for large companies, the second to provide loans for working capital and investment for all companies.

In 2021

Health Measures *(Budgeted: Lek 15 billion)*

- Increase funds for the health sector to cover the purchase of Covid-19 vaccines and Covid-19-related treatments
- Increased salaries for the health sector workers

Non-Health Measures *(Budgeted: Lek 2.5 billion)*

- Doubling of the unemployment benefits for six months (up to end-June)

9. Uncertainty over the outlook remains high (Annex I). Considerable uncertainty over the future trajectory of the pandemic presents a major downside risk, either through the emergence of vaccine-resistant variants or localized outbreaks in Albania due to slower-than-expected vaccination. Higher global energy prices present another downside risk to the recovery. Tighter global financial conditions stemming from a potential de-anchoring of inflationary expectations in major advanced economies could also make financing more challenging for Albania, a scenario that could be further exacerbated by any significant deterioration in the country's fiscal position. Balance sheets are exposed to exchange rate variations, with sizeable external debt and unhedged FX loans. The large reserve coverage would be a mitigating factor. A faster normalization from the pandemic presents an upside risk.

Authorities' Views

10. The authorities broadly share the staff's views on the outlook and risks. They highlighted the role of policy responses in steering the economy towards a strong rebound in the face of two major shocks. They expressed concerns about the adverse impact of rising energy prices on the recovery in the short run but see the risks to the outlook as more balanced in the medium to long run. The BoA expects inflation to converge to the 3 percent target within 2022, as the broad-based recovery continues, driving up capacity utilization, employment, and wages.

POLICY DISCUSSIONS

Discussions focused on the appropriate policy mix to secure an inclusive recovery and meet Albania's development needs while preserving fiscal sustainability and financial stability. With the recovery firming up and given Albania's high fiscal deficit, fiscal policy should pivot towards rebuilding the firepower to withstand future shocks and reduce debt while meeting Albania's development needs—all these will hinge on raising revenue. Fiscal support should also better target those most in need. As fiscal policy support is pared back, monetary policy should remain accommodative as long as inflationary pressures are contained. Financial sector risks should be closely monitored as the impact of the shocks works its way through the system. The authorities should also redouble efforts to address long-standing structural challenges.

A. Fiscal Policy

11. The fiscal position is expected to strengthen as the economy recovers, but the consolidation path under the baseline envisages very limited adjustment in 2022 and will not go far enough to replenish policy buffers and rein in public debt.

- The 2022 Budget submitted to the Parliament indicates that elevated spending pressures will persist, backed by overly optimistic revenue projections. The government's spending plans include: domestically financed infrastructure projects and reconstruction; support for the state-owned utility sector to keep electricity tariffs unchanged for households and most businesses despite rising energy prices; new subsidies to farmers; further wage increases for health and education sector workers and regularization of end-year bonuses for pensioners; and higher health spending, including for vaccination. Using realistic revenue projections and assuming some under-spending based on past experience, staff's baseline projects a primary deficit of about 3.2 percent of GDP in 2022, higher than the 2.7 percent of GDP forecast in the Budget. This means that there would only be a 0.2 percentage point of GDP decline in the structural primary deficit in 2022.

- Beyond 2022, staff's baseline projects the primary deficit to decline gradually to a zero balance by 2024 per the requirement of the Organic Budget Law (OBL), as support measures, infrastructure spending, and reconstruction wind down. This implies a heavily backloaded consolidation of about 2⅓ percent of GDP over three years. Furthermore, without additional adjustment efforts, public debt will still hover above 70 percent of GDP in the medium term, considerably higher than the pre-pandemic level. The government's gross financing needs will also remain substantial at about 21 percent of GDP annually. Visibility over the government's implicit liabilities—arising from PPPs and other schemes deployed to support investment and growth—also remains limited (¶17).

12. With the recovery firming up, fiscal policy should make a greater, revenue-based effort to rebuild room for policy maneuver, which is essential to withstand future shocks. The authorities' track record of keeping the fiscal deficit under control and reducing debt prior to the shocks earned them some policy credibility and space, enabling a swift response to cushion Albania from the worst effects of the shocks. Staff recommends a revenue-based medium-term adjustment to achieve a primary deficit of about 2.4 percent of GDP in 2022 and reach a primary surplus of 1½ percent of GDP in 2024. This implies a total structural adjustment of about 3.8 percent of GDP over three years, with meaningful consolidation starting in 2022 (about 1 percent of GDP) to help strengthen the credibility of the adjustment. The proposed additional adjustment in 2022 (relative to the authorities' budget) should be based on measures to remove tax loopholes and exemptions (¶13) and reduce non-priority, low-efficiency spending as well as non-targeted support (¶14), which should have a limited impact on growth. With such a strategy, general government debt could be brought back to below the pre-pandemic level by 2026, assuming no new shocks hit the economy. Even staff's proposed adjustment path would be slightly backloaded to provide room for better targeted measures to deal with near-term risks to the recovery, including rising energy prices. Windfall revenues should be saved for faster deficit and debt reduction. If the recovery suffers setbacks, higher targeted support should be deployed, assuming financing is available.

13. The lynchpin of a credible fiscal adjustment must be a sound MTRS to broaden the tax base and remove loopholes. If fully operationalized, a sound MTRS in line with Fund recommendations can be expected to help boost revenues by 2.3 percent of GDP over four years,[2] thus bearing the brunt of the additional adjustment needed for faster debt reduction (Text Table 3). Recommendations from the recent Fund CD mission on review of tax policy components of the authorities' draft MTRS and the 2022 Fiscal Package should be addressed (Box 1). Strong political leadership and broad stakeholder support are crucial to making the MTRS a success and a dedicated tax policy unit with adequate resourcing and staffing in the Ministry of Finance and Economy (MOFE) will need to be created. Staff continues to advise against tax amnesty and ad hoc tax cuts, exemptions, and incentives, which go against the government's longer-term revenue-enhancing strategy.

14. At the same time, it is important to reduce non-priority spending, including broad subsidies and overly ambitious domestically financed (non-earthquake) public investment given weak capacity and low efficiency. The fiscal room created in this way should be partly used for higher targeted support to the most vulnerable (such as low-income households) to ensure an inclusive recovery, particularly given the country's relatively high poverty rate (Box 2). Looking beyond 2024, after the governance and efficiency of public spending have been strengthened and fiscal risks are brought under control (¶15-18), a lower primary surplus of

[2] Staff assumes a revenue gain of 0.3 percent of GDP in the baseline based on measures already taken to improve revenue administration (e.g., fiscalization).

about 1 percent of GDP could be considered for 2026. This should serve, first and foremost, to support spending on human development needs and second, to address infrastructure needs.

Text Table 3. Medium-Term Fiscal Paths

Percent of GDP

	2018	2019	2020	2021	2022	2023	2024	2025	2026
						Proj.			
Tax revenues									
IMF staff baseline	25.6	25.2	24.6	25.6	25.8	25.8	25.8	25.8	25.8
IMF staff preferred path	25.6	25.2	24.6	25.6	26.2	27.0	27.5	27.8	27.8
MTBF*	25.6	25.2	24.6	25.9	26.8	27.1	27.3	27.5	27.7
Primary expenditure (excluding interest)									
IMF staff baseline	26.6	27.2	31.0	31.9	30.8	29.0	27.6	27.6	27.5
IMF staff preferred path	26.6	27.2	31.0	31.9	30.4	28.7	27.8	28.2	28.5
MTBF*	26.6	27.2	31.0	32.8	31.4	29.0	28.7	28.7	28.2
Overall balance									
IMF staff baseline	-1.3	-2.0	-6.8	-6.8	-5.4	-3.7	-2.3	-2.3	-2.4
IMF staff preferred path	-1.3	-2.0	-6.8	-6.8	-4.6	-2.2	-0.8	-0.9	-1.4
MTBF*	-1.3	-2.0	-6.8	-6.8	-5.4	-2.9	-2.8	-2.8	-2.3
Primary balance									
IMF staff baseline	0.9	0.1	-4.7	-4.5	-3.2	-1.5	0.0	0.0	0.0
IMF staff preferred path	0.9	0.1	-4.7	-4.5	-2.4	0.0	1.5	1.4	1.0
MTBF*	0.9	0.1	-4.7	-4.6	-2.7	0.0	0.3	0.4	1.1
Structural primary balance									
IMF staff baseline	0.9	0.6	-2.8	-2.3	-2.1	-1.5	0.0	0.0	0.0
IMF staff preferred path	0.9	0.6	-2.8	-2.3	-1.3	0.0	1.5	1.4	1.0
Public debt									
IMF staff baseline	69.5	67.3	77.2	80.6	79.0	78.6	77.6	75.5	74.1
IMF staff preferred path	69.5	67.3	77.2	80.6	78.0	76.1	73.4	69.3	66.2
MTBF* 1/	67.7	66.3	76.1	80.6	79.4	78.3	76.6	75.4	74.2
Memorandum items									
Revenue gains under IMF staff preferred path					0.4	1.2	1.7	2.0	2.0
Expenditure changes under IMF staff preferred path					-0.4	-0.3	0.2	0.6	1.0
Change in structural primary balance (+ means consolidation)									
IMF staff baseline		-0.4	-3.4	0.5	0.2	0.7	1.5	0.0	0.0
IMF staff preferred path		-0.4	-3.4	0.5	1.0	1.4	1.5	-0.1	-0.4
Real GDP growth, baseline (percent)	4.0	2.1	-4.0	7.8	3.8	3.6	3.5	3.5	3.4
Real GDP growth, reform path (percent)	4.0	2.1	-4.0	7.8	3.6	3.2	3.5	4.2	4.5

Sources: IMF Staff estimates and projections.

* MTBF as of October 2021

1/ The MTBF's public debt ratios in 2018-20 do not inlcude arrears; The projected debt in 2021-22 reflects the authorities' ceiling in the budgets.

15. **Bolstering the credibility of the budget and fiscal framework will be crucial to maintaining market confidence and keeping borrowing costs down.** All supplementary budgets since 2011 have been normative acts, which are designed to be used only under emergency circumstances. The OBL was also amended in July through a normative act to postpone the attainment of a zero primary balance from 2023 to 2024 and to suspend the application of the fiscal rules in 2021.[3] Changes related to the design and application of the OBL should only occur through normal parliamentary procedures, and the use of normative acts to amend the budget in-year, except for emergency circumstances (such as 2020), should be discontinued.

[3] The escape clause was applied in 2020.

Box 1. Review of Tax Policy Proposals of the Albanian Draft MTRS[1]

Strengthening revenue mobilization has been at the forefront of Albania's policy agenda over the last decade. To support its revenue augmentation needs, Albania initiated work on designing and implementing an MTRS. In 2019, two IMF missions—on tax policy and revenue administration—supported the authorities in developing revenue options to lay the groundwork for the MTRS. The earthquake and the pandemic delayed the completion of the strategy, but with the first draft of the MTRS ready in 2021, the authorities requested IMF's help with its review and finalization.

Some measures taken since 2019 to mitigate the impact of the shocks are warranted, but others increase distortions and undermine the tax system's robustness. Following the pandemic, Albania adopted tax deferrals that provided timely and temporary relief for the most affected businesses without eroding the tax base. However, measures such as increasing the non-taxable corporate income tax (CIT) threshold to exclude businesses with an annual turnover of up to Lek 14 million—coupled with a reduced dividend withholding tax—create a loophole for high-income individuals that can now avoid taxes through incorporation, thereby significantly weakening the personal income tax (PIT) system. The larger tax rate differential between businesses below and above the threshold deepens the incentive to underreport and/or split companies, leading to the erosion of the corporate tax base. Albania should reduce the turnover threshold and establish an appropriate regime for small- and medium-sized enterprises (SMEs). A single registration threshold for the VAT and the income tax should be established, with SMEs defined as those with turnover below this threshold, regardless of their corporate structure.

The MTRS should be designed and seen as the blueprint of Albania's tax reforms in the medium term. It should replace the hitherto piecemeal approach to tax policy changes and avoid rushed policy design and/or multiple small, ad hoc adjustments to the tax system. Beyond the revenue gains, the stability and predictability of the tax system will make revenue administration easier. Furthermore, there should be no discrepancy between the MTRS and the yearly implementation of tax policy reforms, including the measures in the 2022 Fiscal Package currently under consideration.

The MTRS should have a clear point target for revenue gains, as opposed to a wide range. It should also have yearly revenue targets, showing distribution of the overall MTRS revenue goal over the life-cycle of the MTRS. Each of the tax policy reform measures in the MTRS should clearly indicate its objective, justification, timing, and expected revenue impact. The MTRS should be accompanied by an Action Plan to show sequential steps leading to the achievement of desired revenue targets.

The current MTRS draft is estimated to leave a gap of ¾ percent of GDP to meet the lower bound of the authorities' revenue objective of 1 percent of GDP from tax policy reforms. This revenue gap needs to be filled and additional revenue-augmenting tax policy measures should be included. If IMF's 2019 MTRS tax policy recommendations were considered in full, revenue gains could be at least 1.3 percent of GDP. As a further revenue measure, consideration could be given to improving Albania's taxation options in the digital age.

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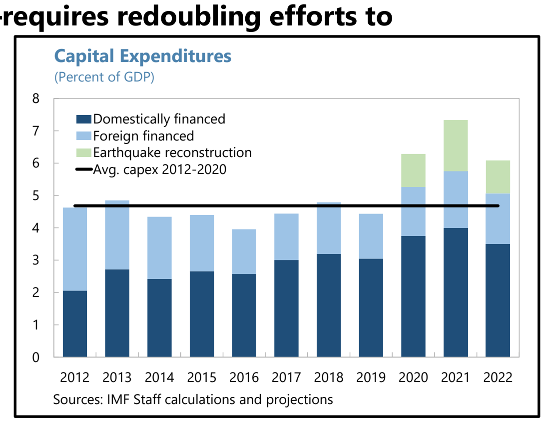
[1] This box summarizes the main findings of an IMF TA mission on the tax policy component of the authorities' draft MTRS held in October 2021. A mission to review the revenue administration side of the MTRS is expected to conclude in mid-December.

Box 1. Review of Tax Policy Proposals of the Albanian Draft MTRS (concluded)

The proposed 2022 Fiscal Package includes some measures that are recommended by the 2019 IMF MTRS mission while others are not or go in the opposite direction. Removing some exemptions (for fuel supplied in free-zones) and preferential CIT rates (for software businesses), indexing excises with inflation, and partially reducing the differentials between excises for beer and wine are steps in the right directions. However, some measures, such as introducing a second reduced VAT rate and the proposed structure of the PIT regime that creates two marginal effective rate spikes, are likely to further undermine the robustness of the tax system and should be reconsidered.

Recommendations	Timing
• Structure MTRS as the blueprint of Albanian tax reforms in the medium term	ST
• Set a single overall revenue target. Set yearly revenue targets, showing the distribution of the overall MTRS revenue goal over the life-cycle of the MTRS	ST
• Estimate the revenue impact of each tax policy reform and include and explain it in the MTRS	ST
• Ensure that all tax-related measures in the 2022 Fiscal Package are in the MTRS. Going forward, ensure no discrepancy between the MTRS and the yearly implementation of tax policy reforms	ST
• Include aspirational tax policy reforms in the MTRS, together with their projected revenue impact. Do not count them towards the achievement of the MTRS total revenue goal	ST
• Establish a single registration threshold for VAT and the income tax, with small enterprises defined as those with turnover below this threshold, regardless of their corporate structure	ST-MT
• Design a simplified tax regime to treat equivalently taxpayers of the simplified and normal regime	ST-MT
• Reconsider the design of personal income tax brackets—currently in the 2022 Fiscal Package—to avoid marginal effective tax rates spikes	ST
• Close the current gap between the stated MTRS revenue goal and the sum of revenue impacts of individual reforms, by including additional revenue-augmenting reforms into the MTRS.	ST

16. The rapidly rising stock of public-private partnerships (PPPs)—expected to reach 50 percent of GDP in 2021, up from 33 percent in 2018—requires redoubling efforts to strengthen public investment management (PIM). Domestically financed (non-earthquake) public investment has also grown markedly since 2020, but shortcomings in PIM remain unaddressed and a few major recommendations from the 2016 Public Investment Management Assessment (PIMA) remain outstanding. Key challenges include the lack of transparency on cost and schedule overruns and noncompliance with established selection and approval



processes, including when PPPs are used to circumvent medium-term budgetary ceilings. Before scaling up public investment, it is important to address outstanding PIMA recommendations and strengthen the capacity of the MOFE to pro-actively act as gatekeeper in project selection and to engage actively in evaluation and monitoring. The processes for PPPs and budget-funded projects need to be aligned.

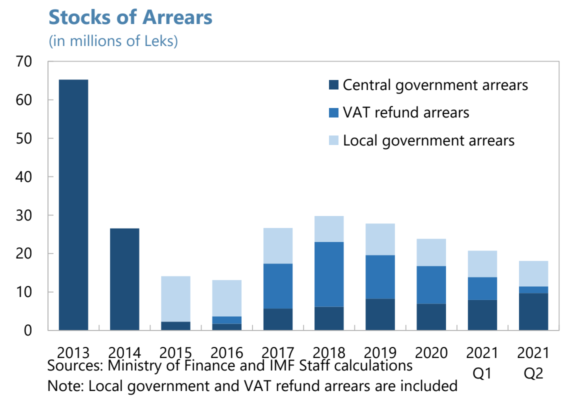
17. Albania needs to make concerted efforts to better monitor and manage rising fiscal risks. Fiscal risks have risen and the lack of clear data on government exposure makes it difficult to effectively assess and manage them. Limited information on the government's true exposure to PPPs is a key challenge. The government guarantee schemes to the private sector currently under discussion and the increasing reliance of state-owned enterprises—especially in the utility sector—on sovereign guarantees and intermittent budget support also add to fiscal risks.[4] In this context, it is important to reinvigorate electricity and related water sector reforms that have been delayed in recent years to help reduce fiscal risks and climate-related vulnerabilities (Figure 6). Furthermore, court decisions can have large fiscal costs and should be identified and monitored properly as contingent liabilities.

18. Steadfast commitment to transparency and accountability, underpinned by robust Public Financial Management (PFM) systems, is a priority. Transparency and accountability measures for spending carried out under emergency procedures in response to shocks should be implemented as soon as possible and the use of earthquake reconstruction funds, given their size and multi-year duration, be integrated to the budget process and subject to adequate PFM controls. Staff welcomes the ongoing progress to implement a public registry of beneficial owners as well as the recent publication of the Supreme Audit Institution's (SAI) audit of earthquake and pandemic-related spending, which identified shortcomings in the coordination, monitoring, and transparency of the use of COVID and reconstruction funds. The authorities are urged to publish public procurement contracts pertaining to pandemic and earthquake recovery related spending, the names of awarded companies, and their beneficial owners. They should also address deficiencies identified in the SAI's audit.

19. Staff stresses the need to continue strengthening cash and debt management, particularly given the government's plans to regularly access international financial markets. Albania has large refinancing needs, shallow domestic markets, a sizeable share of external commercial debt with large bullet repayments, and sizeable domestic arrears. A robust debt management strategy is needed to guide the government's decisions on external commercial borrowing, which is subject to rollover and exchange rate risks. The MOFE has improved its cash forecasting capacities and made progress in minimizing forecasting errors. There has been limited progress in agreeing on a framework with the BoA on how to expand cash management toolbox for dealing with foreign currencies. An improved arrears reporting

[4] A fifth budget revision adopted through a normative act in October increased the ceiling for sovereign guarantees by Lek 10 billion (0.6 percent of GDP), which will be used for the state-owned utility sector.

system has been introduced and operationalized, and the stock of VAT refund arrears has been reduced further and is expected to be cleared by end-2021.



Sources: Ministry of Finance and IMF Staff calculations
Note: Local government and VAT refund arrears are included in central government arrears before 2015.

Authorities' Views

20. The authorities reaffirmed their commitment to fiscal consolidation as a priority to rebuild policy buffers for future shocks but are considering more gradual adjustment than recommended by staff. They noted that the pace of consolidation will have to start slow, given the elevated spending pressures in 2022 stemming from the government's economic program and the need to deal with the challenges posed by rising energy prices. They reiterated their strong commitment to abiding by the fiscal rules from 2022 and to achieving a primary balance of at least zero from 2024 onwards. They will stop the use of normative acts for in-year budget revisions from 2022 and ensure that any changes to the design and application of the OBL will be subjected to normal parliamentary approval. The authorities stressed the role of revenue reforms as the key pillar of fiscal consolidation and envisaged timely implementation of a sound MTRS, aiming to raise additional revenue of 2.3-3 percent of GDP over four years. They also agreed on the need to scale back overly ambitious domestically financed (non-earthquake) capital expenditure but signaled plans to continue pursuing infrastructure projects already underway. They further committed to strengthening public investment management (including PPPs) and to closer monitoring and management of rising fiscal risks. In this context, they noted that an annual PPP monitoring report has been published since 2019 and the MOFE also reports periodically on budget payments to PPPs and whether the overall support in the medium term is below the 5 percent of tax revenue legal limit. The authorities plan to pass a law to channel the 2021 SDR allocation to the budget and hold it for contingency. The SAI has signaled its intention to continue its work on auditing crisis-related spending in 2021.

B. Monetary and Exchange Rate Policy

21. The BoA's accommodative monetary policy stance remains appropriate. Despite a strong economic recovery and rising global commodity prices, inflation has remained below the BoA's target and expectations are still well anchored. Any shift towards monetary policy tightening should be data-driven, based on clear indications of inflationary pressures broadening and becoming persistent.

Box 2. Social Protection in Albania[1]

Albania's poverty rate is one of the highest in the Western Balkans, while its social protection coverage is among the lowest. The country's poverty headcount is estimated to have increased by 0.8 percentage point in the aftermath of the earthquake and pandemic, partially reversing a declining trend started in 2014. Thanks to the strong economic rebound in 2021 and the government's support measures, the World Bank estimates a decline in the poverty rate to below pre-pandemic levels in 2021. Given the high level of informality, relatively low labor participation rates, and limited government resources, social protection coverage is among the lowest in the region.

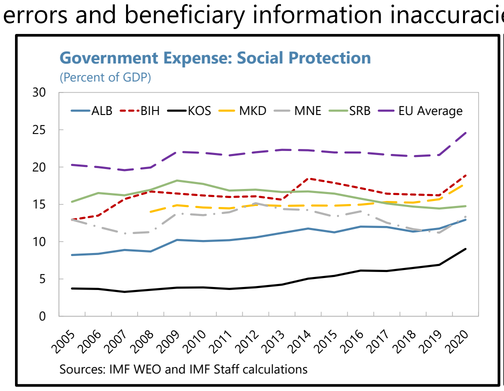
Albania Poverty Headcount Compared to Peers, 2019-2021
(in percent of population)

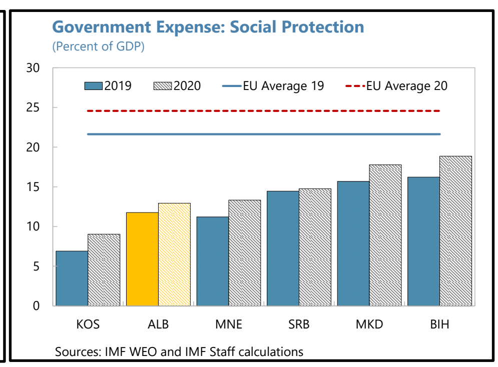
	2019	2020	2021
Albania	31.8	32.6	30.8
Kosovo	20.9	23.4	20.9
North Macedonia	16.9	18.0	16.9
Montenegro	14.5	20.0	17.7
Serbia	17.3	17.4	17.1

Notes: Poverty is defined as living on less than $5.5/day per person in revised 2011 PPPs. Calculations based on ECAPOV harmonization using SILC-C data for ALB, MKD, MNE, and SRB, and HBS data for KOS. BIH is excluded due to a lack of comparable data. The figures for 2019-21 are estimates/forecasts.
Source: World Bank Western Balkans Regional Economic Report Autumn 2021.

In response to the pandemic, the authorities swiftly and temporarily expanded existing social protection programs by about 1 percent of GDP in 2020-21, among the lowest in the Western Balkans. High informality and low social protection coverage imply weak automatic stabilizers, strengthening the case for discretionary support to the affected population. The government introduced temporarily higher social assistance benefits, extended unemployment insurance, and provided wage subsidies for formal workers, unpaid members of family businesses, and workers in the informal sector if they formalize.

With the support of the World Bank, the authorities are working on updated assessments of the effectiveness of Albania's social protection system and on strengthening it to reach those most in need in a timely fashion. Increasing the coverage of social protection programs will require raising tax revenues and increasing social insurance contributions by raising labor force participation and reducing informality. Furthermore, it will be important to enhance the design of the social protection system, including better targeted and higher coverage of social protection to help those most in need, and reducing exclusion errors and beneficiary information inaccuracies.





Notes: Please note caveats due to cross-country reporting differences and differences in social protection systems. Eg: BIH and KOS government expenses include relatively large amounts of 'war veteran benefits'. KOS data excludes mandatory pillar 2 pensions in KOS (around 0.7 percent of GDP), and transfers for health care. The EU weighted average does not include Austria, Latvia and Romania due to data availability.

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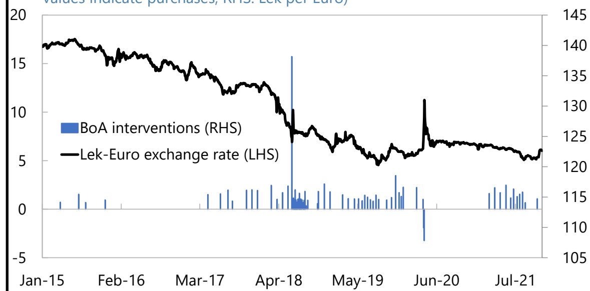
[1]Prepared by Amanda Edwards and Armine Khachatryan.

22. Exchange rate flexibility has served Albania well and should continue to perform its role as a shock absorber. The use of foreign exchange interventions should continue to be reserved for disorderly market conditions and mitigating the adverse effects of large depreciations on balance sheets, as well as for modest pre-announced foreign exchange purchases. In case of heightened balance of payments (BoP) pressures and financial stability concerns—including in the context of tighter global financial conditions—the authorities should stand ready to take further measures as needed to preserve stability.

Interventions in the Foreign Exchange Market

(LHS: Percent of the total market volume, positive values indicate purchases; RHS: Lek per Euro)



Sources: Bank of Albania and Haver Analytics

Note: Bank of Albania foreign exchange purchases were based on a pre-announced schedule.

23. Continued progress in de-euroization will remain key to improving the effectiveness of monetary policy. The growth in local currency deposits and loans in 2021 has, on average, outpaced those in foreign currency. The level of euroization in the banking system however remains relatively high, with foreign currency-denominated credit and deposits accounting for around half of the total. Continued macroeconomic stability will remain key to further progress in de-euroization.

Authorities' Views

24. The BoA agrees that monetary policy should remain accommodative to provide the necessary support to the economic rebound and facilitate fiscal consolidation. They expect the current rise in the headline inflation, driven by global commodity prices, to subside by the second half of 2022 and consider inflationary pressures well contained. The BoA indicated that they would continue to monitor inflation developments closely and adjust policy stance in line with its objective to maintain price stability. They also see the strong growth in local currency credit relative to foreign currency loans as a testament to the effectiveness of their de-euroization measures in recent years.

C. Financial Sector

25. The financial system has so far shown its resilience and credit flows have continued to support the economy. The banking system has remained stable and liquid, with continued growth of deposits and credit to the private sector driven by household mortgages and the construction sector (Figure 5). The banking system's average capital adequacy ratio declined marginally in 2021H1 but remains well above regulatory requirements,

Selected Financial Stability Indicators

(Percent)

	Dec.-2018	Dec.-2019	Dec.-2020	Sept.-2021
Capital Ratios				
Regulatory capital to risk-weighted assets	18.3	18.3	18.3	18.3
Tier 1 capital to risk-weighted assets	17.0	17.1	17.2	17.2
Shareholders' equity as a percent of total assets	10.1	10.5	10.4	10.0
Assets Quality				
Net NPLs to regulatory capital	15.5	13.6	11.3	7.8
Gross NPLs to total loans	11.1	8.4	8.1	6.5
Profitability				
ROE (annual basis)	13.0	13.5	10.7	12.8
ROA (annual basis)	1.3	1.4	1.1	1.3
Net open FX positions to capital				
Net open FX position to regulatory capital	7.8	7.4	8.4	7.7
Net open FX position to Tier 1 capital	8.4	8.0	9.0	8.2
Asset ratios				
Liquid assets to total assets	34.2	35.7	34.8	33.4
Liquid assets to short-term liabilities (<1Y)	46.2	49.4	47.4	45.9
Loans and Deposits				
Private sector credit growth	-0.9	6.1	8.9	8.3
Bank deposits growth	-1.3	3.9	8.3	9.9

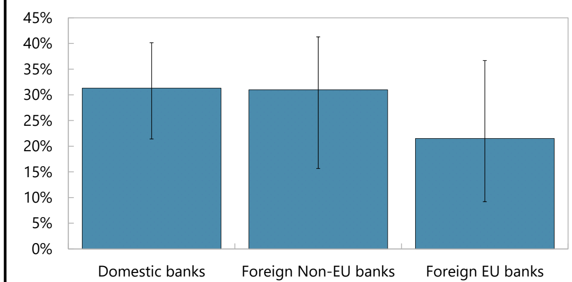
Sources: Bank of Albania and IMF Staff calculations

Note: the latest available data of credit and deposit growth is from August 2021.

although a few banks' ratios are only marginally above the requirements. The NPL ratio reached its lowest level in 13 years in September but remains above the level of regional peers.

26. Continued vigilance is key to the early detection of any buildup of vulnerabilities. Loan moratoria and temporary relaxation of loan classification and provisioning rules have ended without discernible adverse effects on bank credit flows and performance so far. Nevertheless, about 30 percent of total bank loans have been restructured in March–December 2020, with 7 percent of these restructured loans already non-performing prior to the pandemic. As the full impact of the shocks on banks' balance sheets may only become visible after some time, close monitoring of loan portfolio quality and timely identification and management of problem assets are crucial. More vulnerable banks should be subject to enhanced on-site and off-site supervision. Where capital shortfalls emerge, a credible capital restoration plan should be adopted while capital could be allowed to temporarily fall below prudential limits.

Loans Restructured Because of The Pandemic
(Percent of Total Loans)

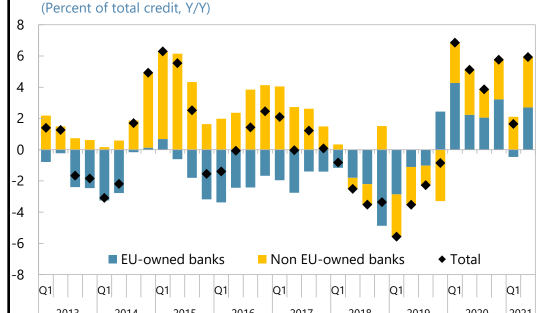


Note: Bars show the average share of loans restructured by banks in each ownership category. Whisker lines indicate the minimum and maximum shares of restructured loans.
Source: Bank of Albania.

27. Banks' capital buffers need to be preserved until the pandemic's full impact on asset quality is known. The suspension of bank dividend distribution lapsed at end-2020 and the BoA rightly adopted a new decision in January to restrict banks from distributing the profit of 2020-21 until end-2021. If the restriction for the 2020 profit is not extended beyond 2021, the BoA should engage in supervisory dialogues with banks and allow distribution on a case-by-case basis, subject to rigorous assessment and stress testing. Banks that have not met the increased macroprudential capital buffer requirement should retain their profits to build buffers.

28. The risk of an increase in NPLs adds to the importance of strengthened resolution frameworks. Staff analysis suggests that the NPL ratio could peak at 15 percent due to the impact of the pandemic (Annex VII). The regulatory framework for dealing with large borrowers with NPLs with more than one bank (i.e., Tirana approach) should be more extensively implemented. Beyond the BoA's remit, the insolvency and resolution frameworks already in force should be swiftly implemented, including out-of-court loan restructuring. The long-standing impasse between the Bailiff Chamber and banks on regular asset recovery and tariff structure should also be resolved. If NPLs remain

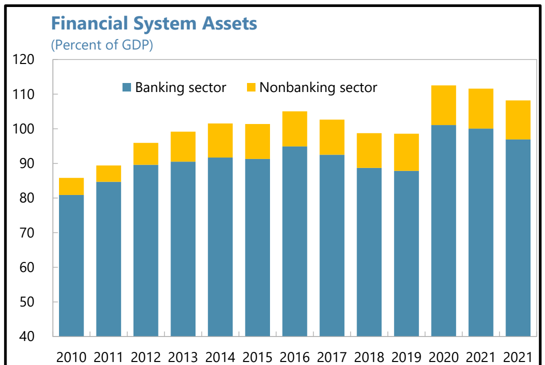
Credit Growth
(Percent of total credit, Y/Y)



Sources: Bank of Albania and IMF Staff calculations contained next year, a focused asset quality review by the BoA could be considered to accurately assess the pandemic's impact on banks' asset quality and capital position.

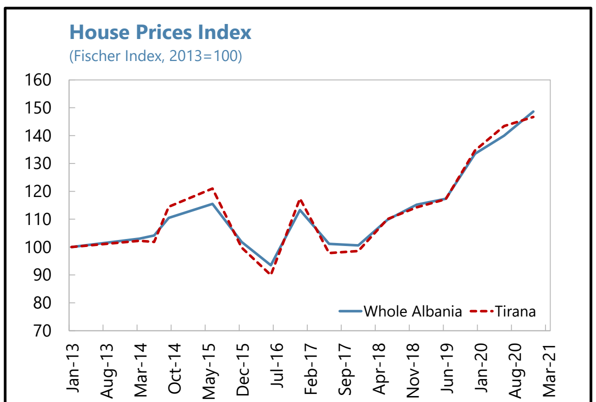
29. The changing landscape of the banking system calls for enhanced vigilance in regulation and supervision. The presence of more banks with significant shareholding by individuals and non-financial groups raises the risk of capital shortfalls, related-party transactions, and a growing share of large exposures. The authorities should continue to improve and implement the licensing and supervisory frameworks, including to ensure the fit and proper status of significant shareholders and controllers, beneficial owners, and senior managers. Furthermore, the BoA should continue its efforts to align the banking regulatory framework with international standards.

30. Although relatively small, the non-bank financial sector has been growing. Investment funds, with asset under management equivalent to 4 percent of GDP, represent the largest share of the non-bank activities. Albania recently enacted legislation on virtual assets and related activities. While virtual asset activity remains limited in the country at present, the recent adoption of a regulatory framework might create greater demand on this front. This could lead to risks, including for AML/CFT, in instances where the Albanian Financial Supervisory Authority (AFSA) does not have sufficient resources, expertise or capacity to enforce the regulation. AFSA should strengthen monitoring of the virtual asset ecosystem and communication with investors, as well as the enforcement of the framework within its purview. At the same time, the lack of international regulatory frameworks on virtual asset activity, except for the related FATF standard for AML/CFT regulation and supervision, makes this even more challenging for AFSA, and collaboration with international regulatory authorities will be important for effective oversight.



Sources: Bank of Albania, INSTAT, and IMF Staff estimates

31. Enhanced surveillance of the fast-growing real estate market is needed. Housing price growth has averaged 11 percent annually since 2018, driven by prices in Tirana and coastal areas. Mortgages account for 64 percent of household loans and construction loans account for 13 percent of total loans to enterprises. Staff encouraged the authorities to address data gaps in the real estate market and develop indicators to closely monitor the potential impact of the sector on financial stability.



Source: Bank of Albania

Authorities' Views

32. The BoA highlights the stability and resilience of the banking system. It is committed to continuing to carefully monitor the pandemic's effects on the banking sector's balance sheets; identify potential problems in advance; and take corrective measures in a timely manner. It is also actively pursuing the equivalence of the supervisory and regulatory framework with EU standards. The BoA is developing a taxonomy of risk indicators for bank lending related to the real estate sector and expects to publish a guideline for banks in 2022. It pointed out that the real estate sector does not currently pose a threat to financial stability given the small size of bank financing to the sector. AFSA noted that according to the law on virtual assets, only licensed entities in Albania will be subject to their supervision.

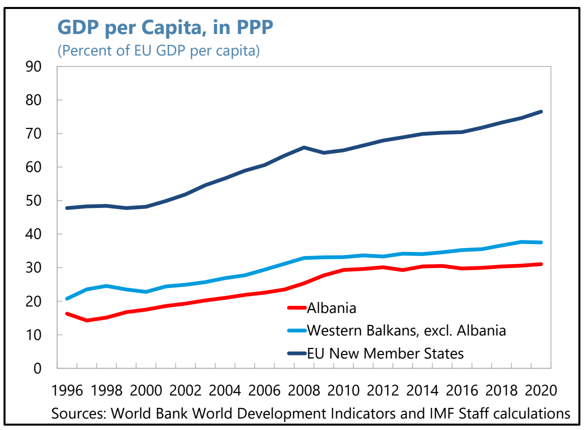
D. Governance, Institutions, and Competitiveness

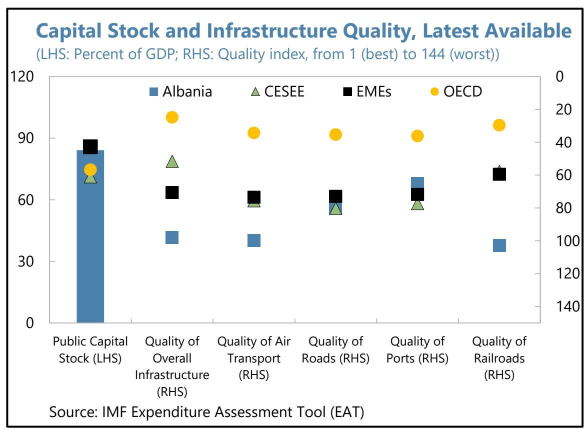
33. The implementation of the comprehensive judicial reform launched in 2016 with EU support is progressing. The vetting of judges has progressed further with more than half of the judges having been vetted. With an increasing number of vetted judges, the High Court and the Constitutional Court now have sufficient quorum to convene. The Specialized Structure for Anti-Corruption and Organized Crime (SPAK), comprising the Special Prosecution Office (SPO) and the National Bureau of Investigation (NBI), is now also operational with improved capacity and notable prosecution actions have been taken against some high officials and corrupt officers of the court. Going forward, key priorities include the need to ensure sufficient numbers of trained judges and prosecutors, as well as to streamline the court system in order to improve the independence, professionalism, and efficiency of the justice system.

34. Despite progress in recent years, corruption remains a key impediment to growth. Implementation of the authorities' anti-corruption strategy has continued, albeit slowly. The completion of the broader judicial reform will be key to maintaining the momentum of past efforts. A mid-term review of the national anticorruption and intersectoral strategy has been completed under the auspices of the Ministry of Justice and work is underway to draft an updated strategy and action plan. Enforcement capacity has been bolstered with the vetting, appointment, and training of new prosecutors and investigators. The authorities should continue to work closely with development partners to increase transparency and accountability of public spending as part of the broader anticorruption agenda.

35. Albania has made progress in improving its AML/CFT framework and should continue efforts to address remaining concerns. In February 2021, the FATF put Albania under increased monitoring ("grey-list") owing to concerns about its AML/CFT framework and its effectiveness, and an action plan was agreed. While the recent MONEYVAL enhanced follow-up report noted some progress, more work is needed to attain full technical compliance. Efforts are underway to exit the grey-list, including by aligning the national AML/CFT legislative framework with EU AML/CFT Directives and revisiting the law related to virtual assets and virtual asset service providers in light of updated FATF standards. A beneficial ownership register is being put in place and work is progressing, however, beneficial owners of dormant companies have yet to be identified. The authorities should also improve supervision of real estate agents, given the high ML/TF risks in this sector.

36. Albania's structural competitiveness gaps vis-à-vis regional peers persist. The business and investment environment suffers from a weak institutional framework, vulnerabilities to corruption, shortages of skilled labor, and infrastructure gaps. The resulting productivity gap is reflected, among others, in lagging GDP per capita levels and comparatively low wages. A further increase in the minimum wage should be accompanied by measures to reduce informality and increase productivity (Box 3). Despite above-average public investment levels, persistent shortfalls in the quality of infrastructure vis-à-vis regional comparators also weigh down efforts to foster a conducive business environment, which further underscores the urgency of strengthening the efficiency and quality of public investment (¶16). While Albania's greenhouse gas emissions per capita are well below those of regional peers, reforms in the energy and related water sectors are crucial to mitigating climate-related vulnerabilities as hydropower is the sole source of electricity and heat production (Figure 7).



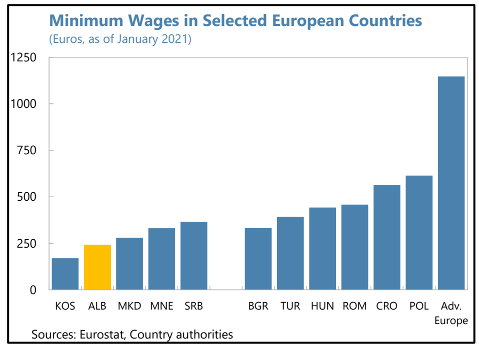


Authorities' Views

37. The authorities broadly concur with staff on the need to persevere with efforts to address structural impediments to growth. They reaffirmed the government's commitment to judicial reform and the anticorruption agenda and highlighted the steady progress in these areas. In particular, they indicated that the asset declaration platform is in the final stages for operationalization and plans are in place to make the information publicly available. With regard to plans to exit FATF's grey-list, the authorities pointed out that existing laws already address some of the concerns raised in the MONEYVAL enhanced follow-up report pertaining to virtual assets. They also drew attention to ongoing initiatives and existing institutions, including the Albania Investment Development Agency which has been active in fostering a business-friendly environment for investors through increased transparency in investment processes and procedures.

Box 3. The Minimum Wage in Albania[1]

The minimum wage in Albania is one of the lowest in Europe. Albania has a unified statutory minimum wage, with no differentiation by region, activities, or type of workers. To support the most vulnerable workers during the pandemic, the government increased the minimum wage from 26,000 lek to 30,000 lek on January 1st, 2021 and announced its intention to raise it further to 40,000 lek over the next four years. Despite the recent increase by 15.4 percent, Albania's absolute value of the minimum wage remains one of the lowest in Europe. In Albania, the current minimum wage is equivalent to 64 percent of the median gross earnings, but large informality in the workforce suggests the need for caution in interpreting this ratio.



Setting the level of minimum wage should balance the need to alleviate in-work poverty and reduce income inequality[2] and economic factors. The appropriate level of minimum wage should provide a "decent wage floor" without adversely affecting firm productivity, competitiveness, and employment.

- *Productivity*. Minimum wage increases should be in line with the evolution of productivity to compensate workers in line with their contribution to production while avoiding economic distortion. Productivity in Albania is low compared to the EU and neighboring countries and has been declining in recent years.
- *Competitiveness*. By increasing costs to firms, an increase in minimum wage can lower export and formal sector competitiveness. In a survey of business owners in the Western Balkans,[3] less than 0.1 percent of managers consider labor regulation as one of the biggest obstacles for business in Albania. Unfair competition from the informal sector stands out as a serious impediment to businesses in the region.
- *Monopsony power*. Market concentration reduces workers' wage bargaining power and can contribute to increasing poverty and inequality across the workforce. There can be a role for minimum wage to address market failures and promote economic efficiency. In Albania, large firms (50+ employees) represent only 1.4 percent of the total number of firms but employ 41.4 percent of formal workers and contribute the most to net employment growth, which suggests the existence of monopsonic power in some sectors.

High informality limits the impact of a minimum wage increase on most vulnerable workers, and past minimum wage hikes have coincided with a rise in informality. About 110,000 individuals benefited from the recent increase of the minimum wage, corresponding to 4.6 percent of population older than15 years. At the same time, informal workers represent 30.3 percent of the labor force,[4] the highest in Europe, and will only benefit to a small extent from the increase in minimum wage even though their employment is more fragile and lower paid than formal workers.[5] Moreover, past increases in the minimum wage have coincided with an increase in informality, which could put further pressure on the most vulnerable workers.

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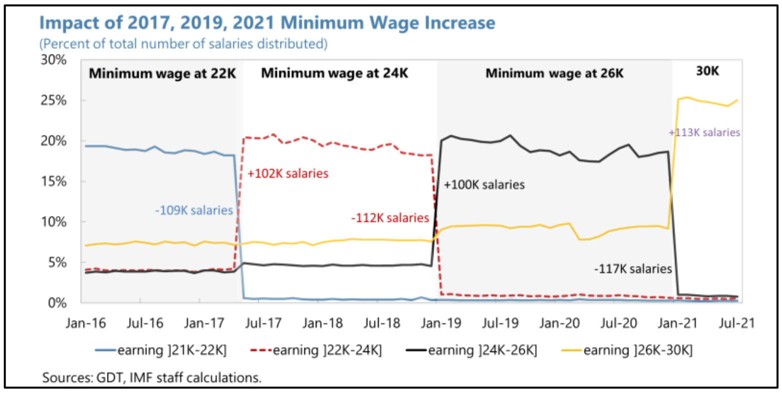
[1] Prepared by Magali Pinat.
[2] For further details. see Duval, R. and P. Loungani, 2019. "Designing Labor Market Institutions in Emerging Market and Developing Economies: Evidence and Policy Options" IMF Staff Discussion Note 19/04.
[3] For further details, see EBRD's 2018 BEEPS survey.
[4] Based on ILO estimates, informal workers represent 57.6 percent of the labor force. Discrepancies are due to the difference of treatment of agricultural workers.
[5] While the minimum wage directly affects only formal workers, it is also known to have a "lighthouse effect" on informal wages, possibly because it sets norms for low-skilled jobs across the economy (Cunningham, 2007). Nevertheless, the higher the minimum wage, the smaller the ability of the informal sector to pay at the minimum wage.

Box 3. The Minimum Wage in Albania (concluded)



Note: Lines stand for the share of the total number of salaries distributed for different wage brackets. For each increase in minimum wage, the number of salaries paid in the bracket incorporating the former minimum wage drops at the benefit of the bracket including the new minimum wage. In the three increases of minimum wage reported in this chart, the number of salaries paid at the minimum wage before the introduction of a new minimum wage is found to be lower than after, that could be attributed to an increase in informality.

An increase in the minimum wage must be complemented by effective measures to reduce informality and improve productivity. Albania's minimum wage is low and a further increase to 40,000 lek is likely to affect competitiveness only marginally. But a further increase in the minimum wage must be accompanied by decisive measures to reduce informality, as high informality limits the benefits of the minimum wage on the most vulnerable workers. It is also crucial for the minimum wage increase to be in line with productivity growth to avoid economic distortions.

POST FINANCING ASSESSMENT[5]

38. Albania's capacity to repay the Fund is adequate. Fund credit outstanding was 279.2 percent of quota (3.5 percent of GDP or 11.7 percent of gross international reserves) at end-2020 and will amount to 247.3 percent of quota at end-2021. It is expected to remain above 200 percent of quota—the threshold for a PFA—until February 2023. Debt service to the Fund is projected to peak in 2024 at 0.8 percent of GDP and 3.1 percent of reserves, well within Albania's capacity to repay.

39. Public finances remain the main source of vulnerabilities. Albania's public debt is sustainable, but the level is high and GFNs remain large (Annex II). The public debt ratio is expected to decline gradually starting in 2022 but will remain considerably above pre-pandemic levels in 2026, and GFNs are projected to average 21 percent of GDP annually. The large GFNs reflect the short maturity of domestic public debt (half of the total debt). Key vulnerabilities stem from rollover risks and exchange rate risks, given the increase in foreign currency-denominated debt. The debt burden is also sensitive to shocks in fiscal stance, growth, and interest rates.

[5] See footnote 1. This section reports on discussions under the Post Financing Assessment policy. For a description of the PFA policy see IMF Policy Paper No. 2021/026.

40. Risks from the banking system remain contained, although a potentially delayed impact of the pandemic should be carefully monitored. Risks are partly mitigated by the improvement in banks' asset quality and capital buffers before the pandemic and the predominance of foreign ownership of systemically important banks. The BoA also made progress in aligning the regulatory framework with international standards and adopted more intensive supervision. Nevertheless, the risk of an increase in NPLs amid persistent weaknesses in the resolution frameworks could exert pressure on the banking system.

41. Albania's net international investment position (NIIP) was -57 percent of GDP at end-2020. Foreign liabilities amounted to 121 percent of GDP, but over half of these consisted of less volatile FDI liabilities and a quarter comprised long-term public debt, which help mitigate balance of payments risks. Albania's foreign reserves are projected to remain adequate in the medium term.

42. Risks to Albania's capacity to repay remain contained and manageable. Albania's sizeable reserve coverage and flexible exchange rate remain important shock absorbers. Rollover risks are mitigated by Albania's access to development partners' longer-term financing and captive domestic financial market. In February 2021, the BoA's repo line of €400 million with the ECB has been extended to March 2022. With a strong repayment track record, relative macroeconomic stability, high international reserves, long external debt maturity, continued ease of market access (sovereign spread has shrunk over the last year), and access to liquidity, Albania should be able to manage a range of risks (Annex I) to its capacity to repay.[6] If downside risks were to materialize, Albania's twin deficits are expected to rise, implying larger financing needs, and further policy adjustment and additional official support, including from the Fund, could be needed (Annex IV).

43. In sum, policies to reduce fiscal vulnerabilities and rebuild room for fiscal policy maneuver are critical to risk mitigation. Fiscal discipline, clear communication of policy priorities, and fiscal credibility and transparency should make government borrowing easier. In particular, a credible, revenue-based medium-term fiscal consolidation would help limit external vulnerabilities, preserve market confidence, and reduce financial sector risks as a quarter of bank assets are held in government securities.

Authorities' Views

44. The authorities agree with the assessment and expressed confidence in their ability to fully repay the Fund. They highlighted their strong repayment track record and full commitment to preserving fiscal and external sustainability and rebuilding buffers.

[6] An update safeguards assessment in connection with the 2020 RFI is underway in November. Most recommendations from the 2015 safeguards monitoring report have been implemented. This assessment will follow up on the outstanding recommendation on proposed draft amendments to the central bank law.

STAFF APPRAISAL

45. The Albanian economy has shown considerable resilience in the face of the 2019 earthquake and the COVID-19 pandemic. Following a contraction of 4 percent in 2020, the economy is rebounding strongly by a projected 7.8 percent in 2021. Staff projects economic growth to normalize to 3.8 percent in 2022, reflecting less policy support and the maturing of the recovery cycle. Headline inflation has risen on account of higher food and energy prices, but core inflation has increased only modestly, and broader inflationary pressures are subdued. Uncertainty around the outlook remains considerable. The emergence of vaccine-resistant variants or localized outbreaks in Albania as well as potentially tighter global financial conditions and higher energy prices represent major downside risks. A faster normalization from the pandemic presents an upside risk.

46. With the recovery consolidating, fiscal policy should pivot towards rebuilding the firepower to withstand future shocks while still meeting Albania's development needs. Policies have played a critical role in preserving lives and livelihoods and thereby paving the way for the recovery. Now it is crucial to make use of the recovery to rebuild policy buffers, underpinned by a sound MTRS in line with Fund recommendations to broaden the tax base, remove loopholes, and raise revenue. A credible revenue-based medium-term adjustment plan—best formulated now and implemented starting next year—should aim to achieve a meaningful fiscal adjustment in 2022 that would place Albania on a strong footing to reach a primary surplus of 1½ percent of GDP in 2024. Non-priority spending needs to be reduced, particularly overly ambitious domestically financed (non-earthquake) public investment given weak capacity and low efficiency. To secure an inclusive recovery, fiscal support should better target those most in need, while broad subsidies should be avoided.

47. The effectiveness of the fiscal adjustment will also hinge on strengthening the quality and transparency of public spending. Bolstering the credibility of the budget and fiscal framework will be crucial to maintaining market confidence and keeping borrowing costs down. Shortcomings in public investment management should be addressed before scaling up investment, and the rapidly rising stock of PPPs will require redoubling efforts to strengthen PIM standards and capacity. In particular, the MOFE should build capacity to proactively play its gatekeeper role and the processes for PPPs and budget-financed projects should be aligned. More concerted efforts are needed to better monitor and manage rising fiscal risks, including those originating from the government's exposure to PPPs and contingent liabilities related to state-owned enterprises (especially the utility sector) and court decisions. Transparency and accountability measures for spending carried out under emergency procedures should be implemented as soon as possible and the use of earthquake reconstruction funds should be integrated into the budget process and subject to adequate PFM controls.

48. As fiscal policy support is pared back, monetary policy should remain accommodative. Despite a strong economic recovery and rising global commodity prices, inflation has remained below the BoA's target and expectations remain well anchored. Any shift towards monetary policy tightening should be based on clear indications of broadening and persistent inflationary pressures. Exchange rate flexibility should continue to perform its role as a shock absorber.

49. The banking system has remained stable and liquid, and continued vigilance will be required to safeguard financial stability. As the impact of the shocks continues to work its way through the banking system, close monitoring of loan portfolio quality and timely identification and management of problem assets are needed, as well as subjecting more vulnerable banks to enhanced on-site and off-site supervision. Banks' capital buffers should be preserved until the pandemic's full impact on asset quality is known. The risk of an increase in NPLs underlines the importance of strengthening resolution frameworks. The changing landscape of the banking system warrants heightened vigilance in regulation and supervision, particularly to ensure the fit-and proper status of significant shareholders and controllers, beneficial owners, and senior managers. The BoA's ongoing efforts to align its bank regulatory and supervisory framework with international standards should continue. The fast-growing real estate market will require enhanced surveillance of its potential impact on financial stability.

50. Steadfast efforts to address structural impediments to growth remain crucial to realizing Albania's long-term development aspirations. In particular, efforts should continue towards completing the comprehensive judicial reform launched in 2016, building on the good progress made thus far. Work currently underway to update the anticorruption strategy and action plan presents an opportunity to strengthen the authorities' commitment to the anticorruption agenda. Efforts to strengthen Albania's AML/CFT framework should continue and the action plan to exit from FATF's grey-list be implemented swiftly. The authorities should also persevere in efforts to improve the business environment and productivity to close the competitiveness gap vis-à-vis regional peers.

51. Albania's capacity to repay the Fund is adequate and risks to it remain contained and manageable. Albania's external position in 2020 is moderately weaker than the level implied by fundamentals. Public finances remain the key source of vulnerabilities. Policies to reduce fiscal vulnerabilities and rebuild room for fiscal policy maneuver are critical to risk mitigation.

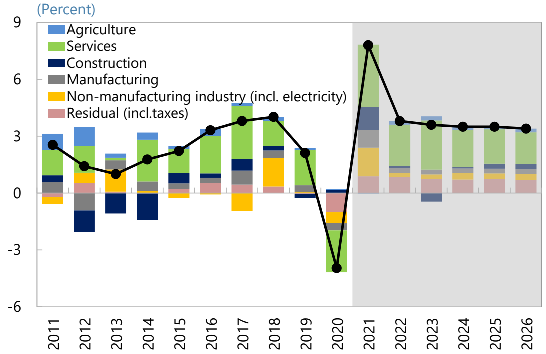
52. It is recommended that the next Article IV consultation be held on the standard 12-months consultation cycle.

Figure 1. Albania: Real Sector Developments

The COVID-19 pandemic and earthquake severely affected 2020 growth, especially through their impact on services.

Real GDP Growth: Production Side

(Percent)

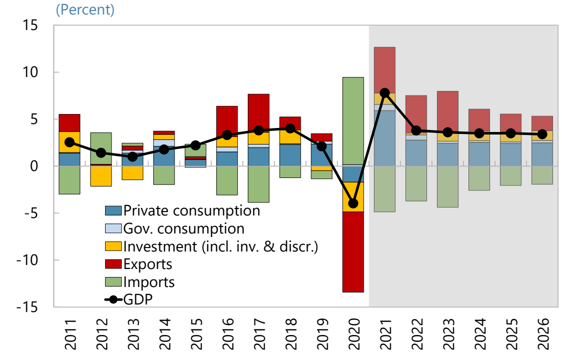


Source: IMF Staff calculations

The economy is projected to rebound strongly in 2021.

Real GDP Growth: Expenditure Side

(Percent)

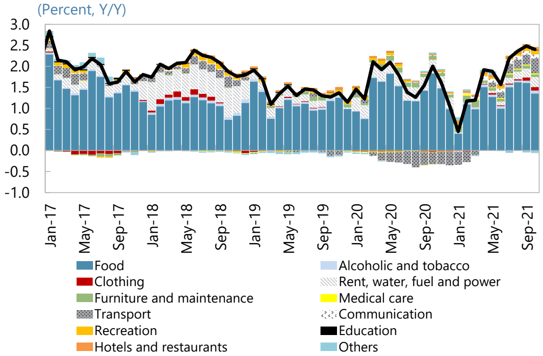


Source: IMF Staff estimates

Headline inflation picked up on higher international commodity prices and reached 2.4 percent in October…

Inflation

(Percent, Y/Y)

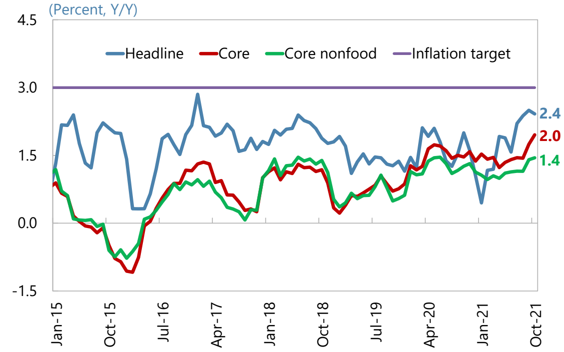


Sources: INSTAT and IMF Staff calculations

…but remains below the BoA's target, with core inflation increasing only modestly.

Headline and Core Inflation

(Percent, Y/Y)

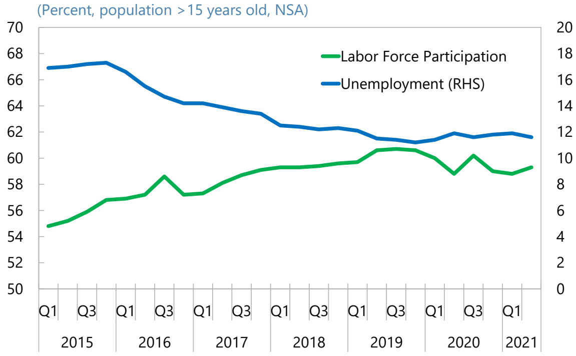


Sources: INSTAT and IMF Staff calculations

Gains in labor force participation and employment were partially reversed due to the pandemic.

Employment Statistics

(Percent, population >15 years old, NSA)

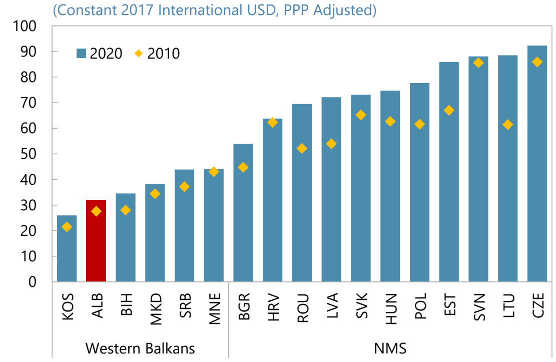


Source: Haver Analytics

Albania remains one of the poorest countries in Europe.

GDP per Capita, as a Share of the EU Average

(Constant 2017 International USD, PPP Adjusted)

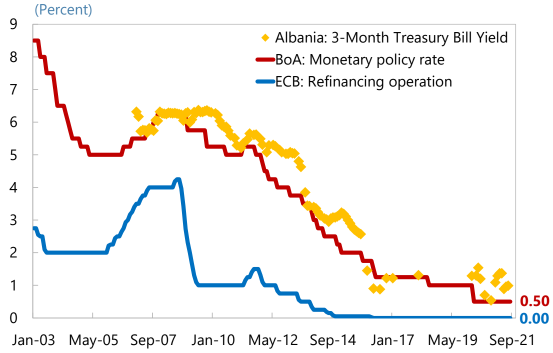


Sources: World Bank World Development Indicators and IMF Staff calculations

Figure 2. Albania: Monetary Sector Developments

The policy interest rate has remained at a historical low since the start of the pandemic…

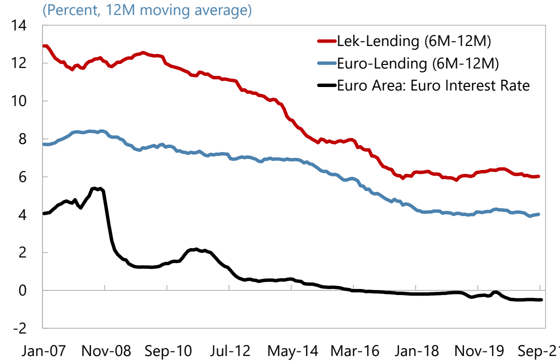
Monetary Policy Rates
(Percent)



Sources: Haver Analytics and IMF Staff estimates

…mirroring accommodative monetary conditions in the region.

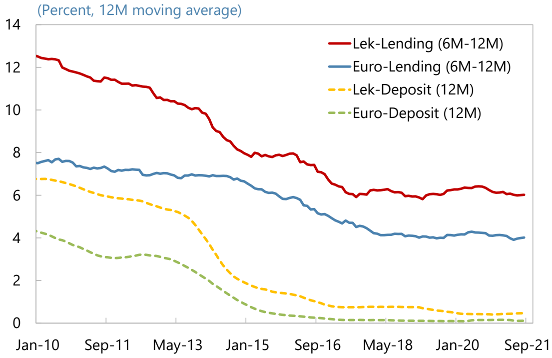
Interest Rates, 12-Month
(Percent, 12M moving average)



Sources: Haver Analytics and IMF Staff calculations

Accommodative financial conditions are reflected in the interest rates on local and foreign currency loans and deposits…

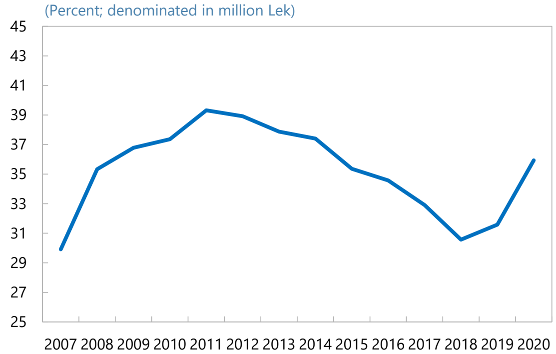
Lending and Deposit Interest Rates
(Percent, 12M moving average)



Sources: Haver Analytics and IMF Staff calculations

…and the rising ratio of private credit relative to the size of the economy.

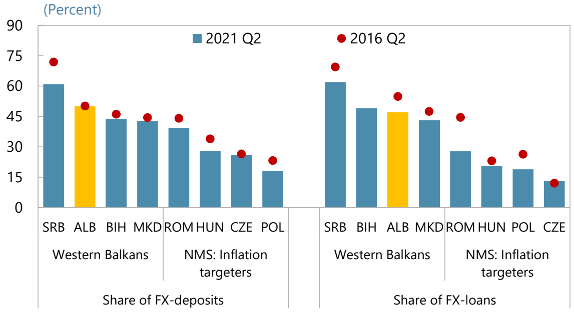
Total Private Credit to Nominal GDP
(Percent; denominated in million Lek)



Sources: Bank of Albania and IMF Staff calculations

Albania remains one of the most euroized country in the region…

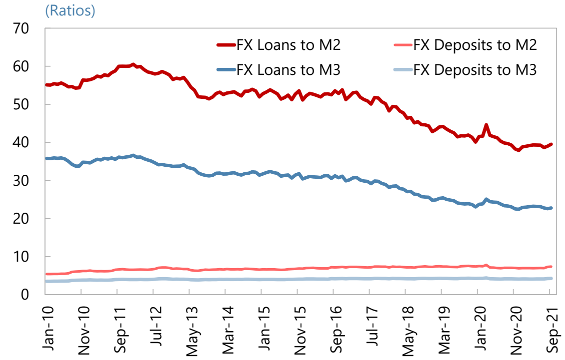
Euroization
(Percent)



Sources: IMF, MFS database and IMF Staff calculations
Note: Non-residence FX deposits and FX loans are excluded.

…although the size of foreign currency loans has declined in relative terms in recent years.

Loans and Deposits to Money Supply
(Ratios)

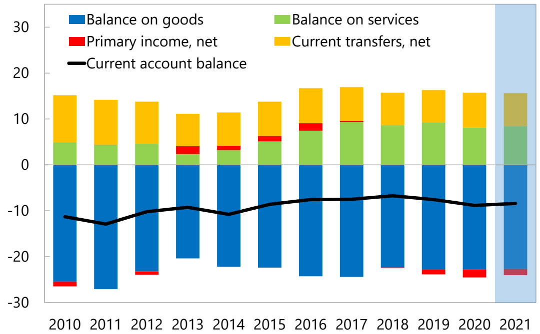


Sources: IMF, MFS database and IMF Staff calculations

Figure 3. Albania: External Sector Developments

After widening in 2020, the current account deficit is expected to narrow in 2021…

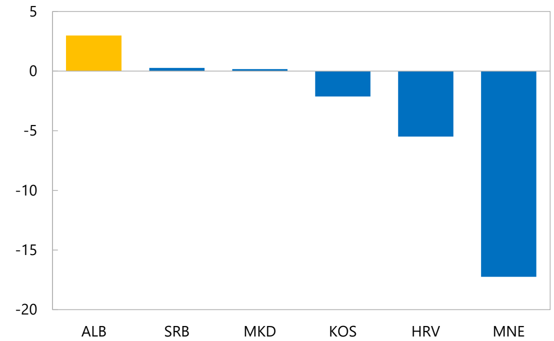
Current Account Balance
(Percent of GDP)



Sources: Bank of Albania and IMF Staff calculations

…resuming the past trend of tourism-led improvement in services balance.

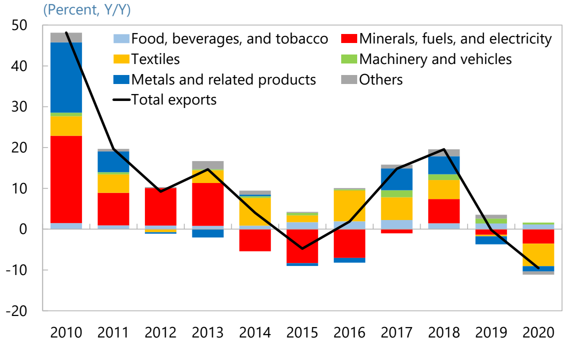
Change in Services Balance Relative to GDP, 2015-2020
(Percent of GDP)



Sources: Bank of Albania and IMF Staff calculations

Goods exports declined in 2020 due to lower textile and energy exports…

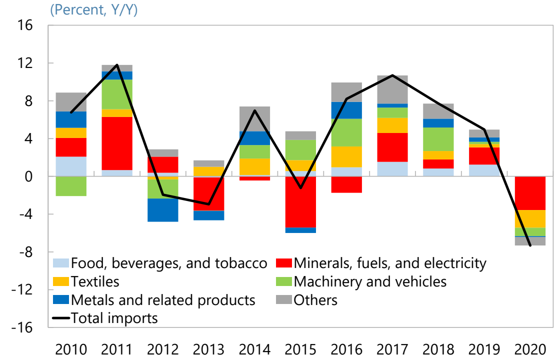
Contribution to Export Goods Growth
(Percent, Y/Y)



Sources: Haver Analytics and IMF Staff calculations

…and import growth turned negative.

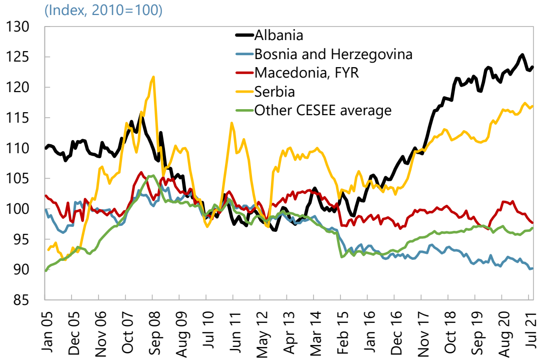
Contribution to Import Goods Growth
(Percent, Y/Y)



Sources: Haver Analytics and IMF Staff calculations

Albania's real effective exchange rate has appreciated slightly in 2021…

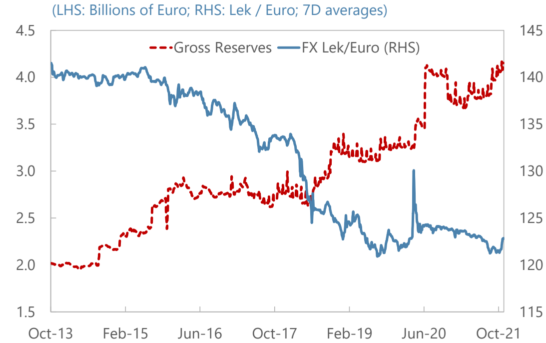
CESEE: Real Effective Exchange Rate
(Index, 2010=100)



Sources: IMF, INS database and IMF Staff calculations

…while the BoA has continued to accumulate FX reserves.

Gross Reserves and Foreign Exchange Rate
(LHS: Billions of Euro; RHS: Lek / Euro; 7D averages)

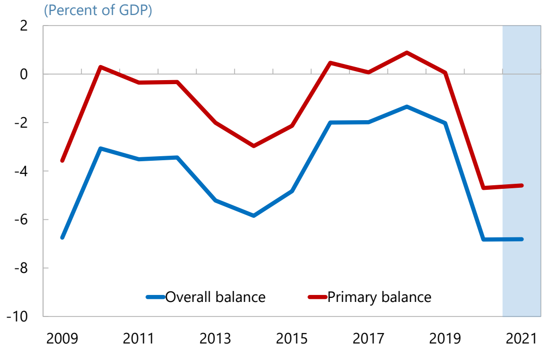


Sources: Bank of Albania and Haver Analytics

Figure 4. Albania: Fiscal Sector Developments

Fiscal policy was relaxed in 2020 to accommodate the shocks and is expected to remain expansionary in 2021…

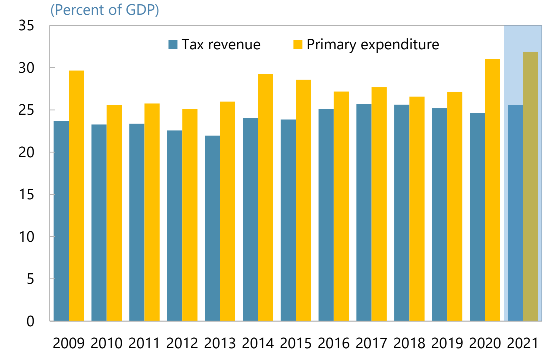
Overall Fiscal and Primary Balance
(Percent of GDP)



Sources: INSTAT, Ministry of Finance and Economy and IMF Staff calculations

…driven by lower revenues and larger spending.

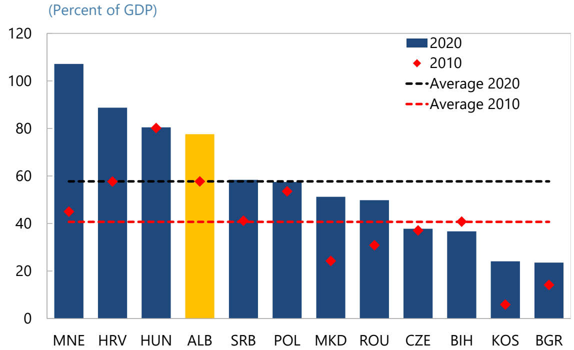
Tax Revenue and Primary Expenditure
(Percent of GDP)



Sources: INSTAT, Ministry of Finance and Economy, and IMF Staff calculations

The stock of public debt remains high…

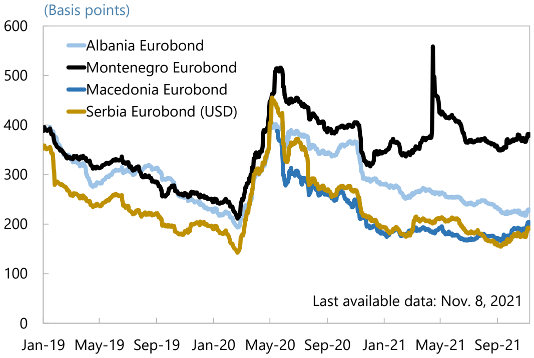
CESEE: Public Debt
(Percent of GDP)



Source: IMF, WEO database

…though sovereign spreads have been declining since September 2020.

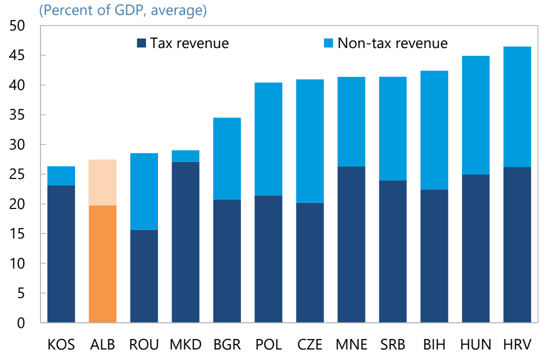
Selected Western Balkans: Sovereign Spreads
(Basis points)



Source: Bloomberg Finance L.P.

Higher revenues are needed to improve debt-servicing capacity…

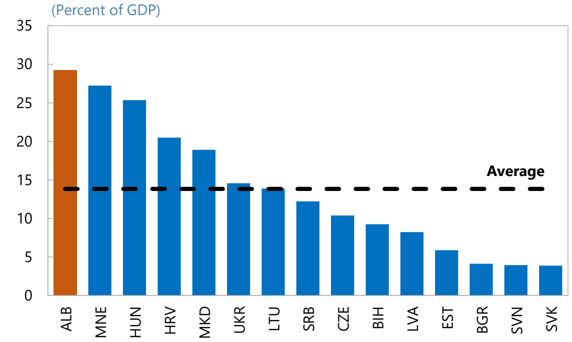
CESEE: Total Revenue, 2015-2020
(Percent of GDP, average)



Sources: IMF, WEO database, Haver Analytics, and IMF Staff calculations

…given large gross financing needs.

Gross Financing Needs, 2020
(Percent of GDP)

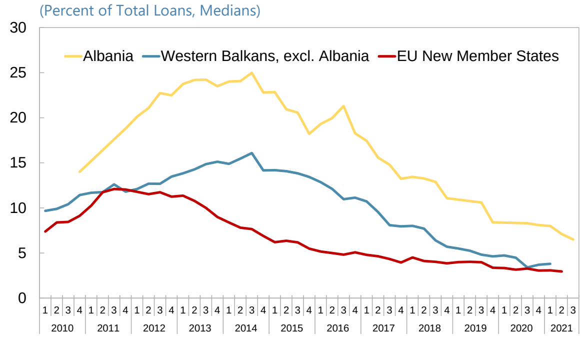


Sources: IMF Vulnerability Exercise database, IMF WEO databse and IMF Staff calculations

Figure 5. Albania: Banking Sector Developments

NPLs have reached a historically low level in September but the ratio remains higher than that of regional peers.

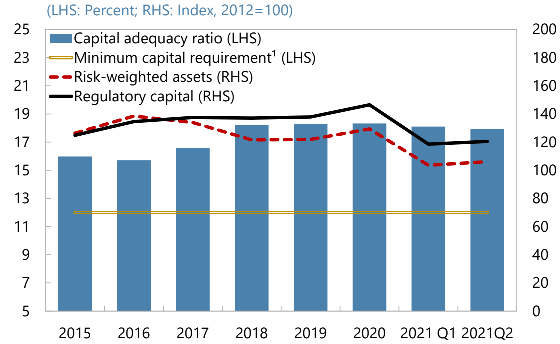
Non-Performing Loans
(Percent of Total Loans, Medians)



Sources: National authorities, IMF Financial Soundness Indicators, and IMF Staff calculations

Capital ratios of the banking system are above regulatory requirements, although buffers are declining.

Capital Adequacy Ratio
(LHS: Percent; RHS: Index, 2012=100)

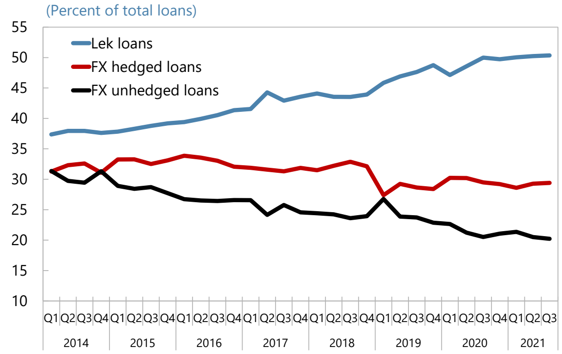


Source: IMF FSI database

1/ Some banks have higher regulatory capital minimum.

A large share of the FX loans remains unhedged.

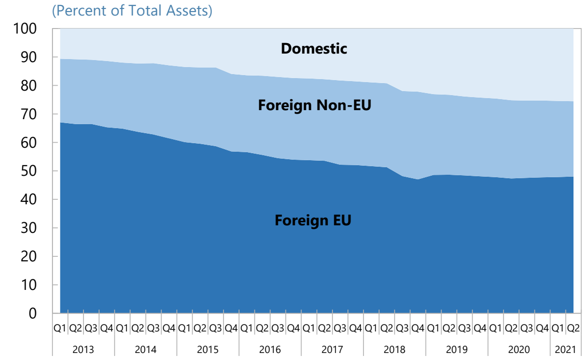
Unhedged FX Borrowing
(Percent of total loans)



Sources: Bank of Albania and IMF Staff calculations

Foreign-owned banks have been deleveraging.

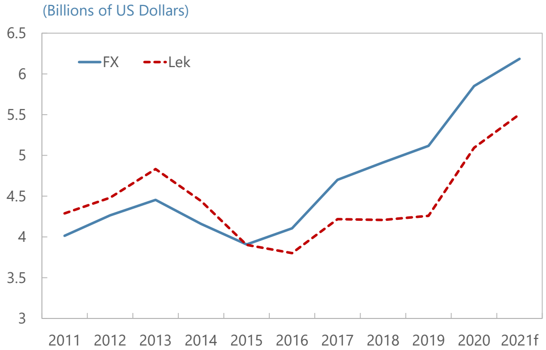
Banking System Ownership Structure
(Percent of Total Assets)



Sources: Bank of Albania and IMF Staff calculations

The banking system has remained liquid.

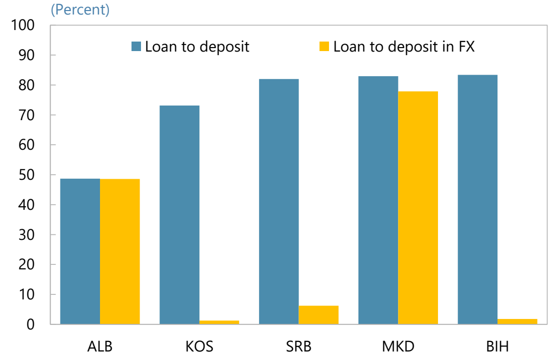
Total Deposits
(Billions of US Dollars)



Source: Bank of Albania and IMF Staff estimates

Financial intermediation is low in Albania

Loan to Deposits Ratio, 2020
(Percent)



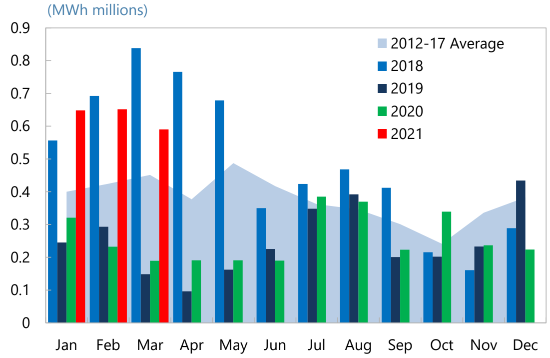
Sources: IFS, MFS database and IMF Staff calculations

Figure 6. Albania: Electricity

Electricity generation has been high in the first few months of 2021, following a pattern similar to the 2018 record year.

Net Electricity Generation by KESH

(MWh millions)

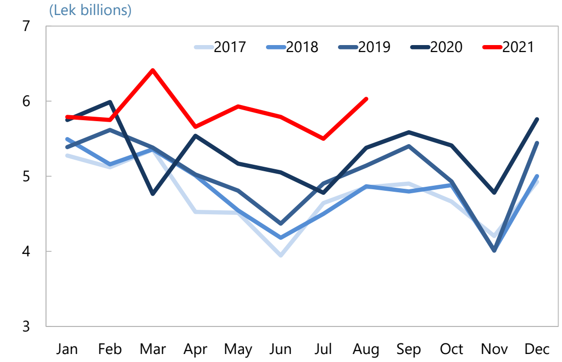


Sources: KESH and IMF Staff calculations

The collection of bills in the first months of 2021 are high.

Current Bill Collections by OSHEE

(Lek billions)

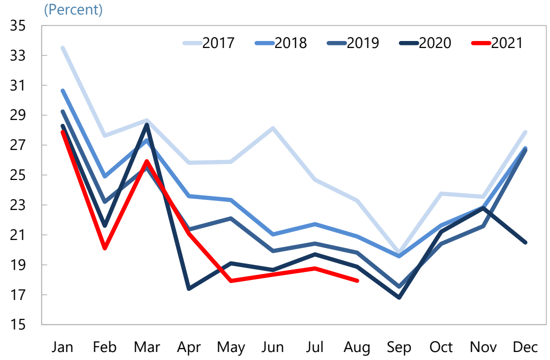


Source: OSHEE

Distribution cost are on the decline from the highs in 2014-2016.

Electricity Distribution Losses

(Percent)

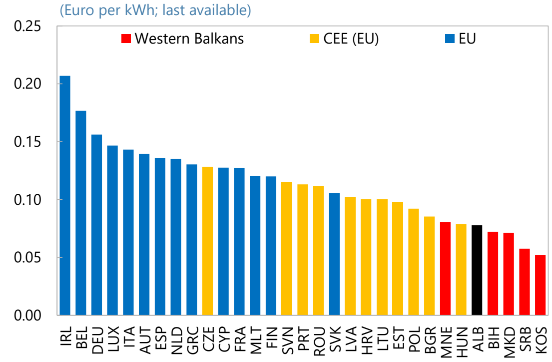


Sources: OSHEE and IMF Staff calculations

Owing to reliance on low-cost hydropower and despite the sector's persistent financial problems, tariffs for household are among the lowest in Europe.

Electricity Prices for Household Consumers

(Euro per kWh; last available)



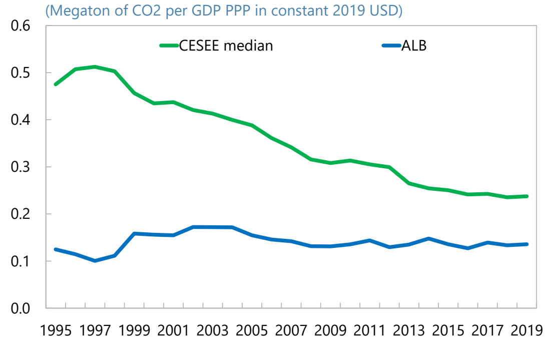
Source: Eurostat

Figure 7. Albania: Climate Change

Albania's emissions per capita are well below the CESEE median.

Greenhouse Gas Emissions

(Megaton of CO2 per GDP PPP in constant 2019 USD)

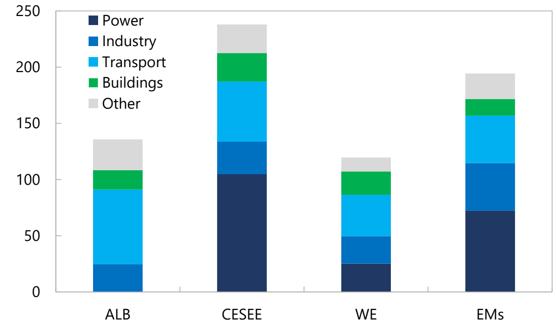


Sources: Emission Database for Global Atmospheric Research (EDGAR), IMF WEO Database, and Global Carbon Project

The transportation sector accounts for the largest share of greenhouse gas emissions.

Greenhouse Gas Emission by Activity, 2019

(Kilo tonnes of CO2 per GDP PPP USD)

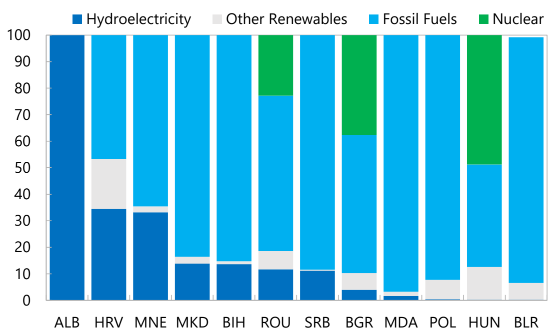


Sources: Emission Database for Global Atmospheric Research (EDGAR) and IMF WEO Database

Hydropower is the sole source of electricity and heat production, making Albania vulnerable to weather conditions.

Electricity and Heat Production by Source, 2018

(Percent share)

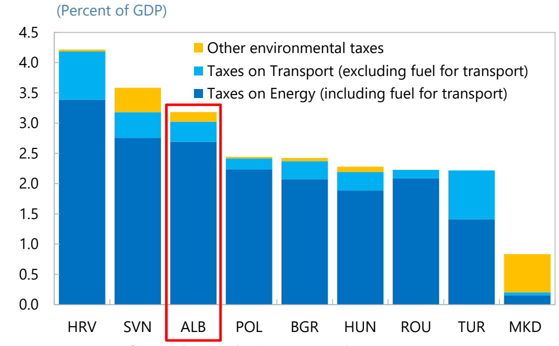


Source: International Energy Agency

Environmental taxes are an important contributor to government revenues.

Environmental Taxes, 2019

(Percent of GDP)



Note: Data for North Macedonia corresponds to 2018

Source: OECD

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2017–26

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
					Proj.					
					(Percent change)					
Real sector										
Real GDP	3.8	4.0	2.1	-4.0	7.8	3.8	3.6	3.5	3.5	3.4
Domestic demand contribution	3.6	3.9	2.2	-4.6	7.7	3.5	3.7	3.7	3.7	3.8
Consumption	2.3	2.4	2.7	-1.5	6.5	3.3	2.7	2.7	2.6	2.7
Investment (Incl. inventories and stat. disc)	1.3	1.5	-0.5	-3.1	1.2	0.2	1.1	1.0	1.1	1.0
External demand contribution	0.2	0.2	-0.1	0.7	0.1	0.3	-0.1	-0.2	-0.2	-0.4
Consumer Price Index (eop)	1.8	1.8	1.1	1.1	2.8	2.0	2.2	2.6	2.8	3.0
Consumer Price Index (avg.)	2.0	2.0	1.4	1.6	2.0	2.4	2.5	2.7	2.9	3.0
GDP deflator	1.5	1.5	1.2	-0.4	1.5	1.7	1.6	1.8	1.9	1.9
					(Percent of GDP)					
Saving-investment balance										
Foreign savings	7.5	6.8	7.6	8.8	8.4	8.0	7.8	7.6	7.5	7.4
National savings	17.1	17.1	14.7	14.2	14.5	14.2	14.9	15.4	16.0	16.5
Public	2.4	3.0	2.0	-0.2	0.3	0.3	0.8	1.9	1.8	1.8
Private	14.7	14.1	12.7	14.4	14.2	13.9	14.0	13.5	14.2	14.7
Investment (incl. Inventories and stat. disc.)	24.6	23.9	22.3	23.0	22.9	22.3	22.7	23.0	23.5	23.9
Public	5.5	5.6	5.3	6.9	7.9	6.7	5.5	5.2	5.2	5.1
Private	19.1	18.3	17.0	16.1	15.0	15.6	17.2	17.9	18.3	18.8
Fiscal sector										
Total revenue and grants	27.8	27.5	27.2	26.3	27.4	27.6	27.5	27.6	27.6	27.5
Tax revenue	25.7	25.6	25.2	24.6	25.6	25.8	25.8	25.8	25.8	25.8
Total expenditure	29.7	28.8	29.2	33.2	34.2	33.0	31.3	29.9	29.9	29.9
Primary	27.7	26.6	27.2	31.0	31.9	30.8	29.0	27.6	27.6	27.5
Interest	2.1	2.2	2.1	2.1	2.2	2.2	2.3	2.3	2.3	2.4
Overall balance 1/	-2.0	-1.3	-2.0	-6.8	-6.8	-5.4	-3.7	-2.3	-2.3	-2.4
Primary balance	0.1	0.9	0.1	-4.7	-4.5	-3.2	-1.5	0.0	0.0	0.0
Financing	2.0	1.3	2.0	6.8	6.8	5.4	3.7	2.3	2.3	2.4
Of which: Domestic	0.1	-1.6	2.5	3.0	0.4	5.5	2.8	1.8	3.9	2.3
Of which: Foreign	1.9	2.9	-0.5	3.8	6.3	-0.1	0.9	0.5	-1.6	0.1
General Government Debt 2/3/	71.9	69.5	67.3	77.2	80.6	79.0	78.6	77.6	75.5	74.1
Domestic	39.0	37.3	36.9	41.3	40.8	41.0	41.3	41.5	42.7	42.8
External	32.9	32.2	30.4	35.9	39.8	38.0	37.3	36.1	32.8	31.4
					(Percent change)					
Monetary indicators										
Broad money growth	0.3	-0.2	4.3	10.5	9.1	4.2	4.1	5.0	5.4	5.3
Private credit growth	-0.8	-0.9	6.1	8.9	7.5	3.0	5.4	5.3	5.3	5.2
					(Percent of GDP, unless indicated otherwise)					
External sector										
Trade balance (goods and services)	-15.1	-13.7	-13.6	-14.8	-14.3	-13.6	-13.4	-13.3	-13.1	-13.1
Current account balance	-7.5	-6.8	-7.6	-8.8	-8.4	-8.0	-7.8	-7.6	-7.5	-7.4
Gross international reserves (billions of Euros)	3.0	3.4	3.4	3.9	4.3	4.1	4.2	4.4	4.3	4.6
(In months of imports of goods and services)	6.2	6.6	8.1	8.2	8.1	6.9	6.6	6.5	6.1	6.4
(In percent of ARA metric)	156	182	174	188	176	164	161	161	157	160
Gross reserves excl. banks' FX reserves (billions of Euros)	2.5	2.9	2.8	3.3	3.6	3.4	3.5	3.7	3.6	3.5
Memorandum items										
Output gap	-0.9	-0.1	-1.0	-3.3	-0.4	-0.1	0.0	0.0	0.0	0.0
Real GDP (growth per capita)	3.5	4.1	2.2	-3.9	8.0	4.0	3.9	3.8	3.8	3.8
Exchange rate Lek/Euro (avg.)	134	128	123	124	...	...	...	...	...	...
Exchange rate Lek/Euro (eop, annual growth)	-1.7	-7.2	-1.3	1.6	...	...	...	...	...	...

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

1/ The fiscal balance includes guarantees for new loans to the energy sector through 2019 and from 2021, and potential calls of COVID-19 related guarantees from 2021.

2/ The stock of general government debt includes public guarantees (domestic and external) and arrears from central and local government and VAT refund arrears.

3/ The 2021 SDR allocation of $190 million is recorded with the government, increasing both the TSA balance and government external debt.

Table 2a. Albania: General Government Operations, 2017–26

(Percent of GDP)

	2017	2018	2019	2020	2021	2022		2023	2024	2025	2026
							Budget				
								Proj.			
Total revenue and grants	27.8	27.5	27.2	26.3	27.4	27.6	28.7	27.5	27.6	27.6	27.5
Tax revenue	25.7	25.6	25.2	24.6	25.6	25.8	26.8	25.8	25.8	25.8	25.8
VAT	9.0	8.8	7.8	8.1	8.5	8.6	8.9	8.6	8.7	8.7	8.7
Profit tax	2.0	2.1	2.2	1.8	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Excise tax	2.9	2.7	2.8	2.8	2.9	2.9	3.0	2.8	2.7	2.6	2.5
Customs duties	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Personal income tax	2.1	2.2	2.7	2.1	2.3	2.4	2.4	2.4	2.4	2.4	2.4
National taxes	2.5	2.4	2.2	2.2	2.3	2.3	2.7	2.3	2.3	2.3	2.3
Local government revenue 1/	1.2	1.3	1.4	1.4	1.4	1.4	1.5	1.4	1.4	1.4	1.4
Social insurance contributions	5.6	5.7	5.8	6.0	5.9	5.9	6.0	5.8	5.9	6.0	6.0
Non-tax revenue	1.3	1.4	1.5	1.2	1.2	1.2	1.2	1.1	1.2	1.2	1.2
Grants	0.7	0.5	0.5	0.5	0.6	0.6	0.7	0.6	0.6	0.6	0.6
Total expenditure	29.7	28.8	29.2	33.2	34.2	33.0	34.1	31.3	29.9	29.9	29.9
Current expenditure	24.7	24.0	24.7	26.0	26.5	26.7	27.5	26.1	25.1	25.2	25.2
Personnel cost 2/	4.7	4.5	4.5	4.8	4.8	4.8	4.8	4.8	4.6	4.6	4.6
Interest	2.1	2.2	2.1	2.1	2.2	2.2	2.7	2.3	2.3	2.3	2.4
Operations & maintenance	2.8	2.8	2.8	3.0	3.3	3.4	3.4	3.1	2.9	3.0	3.0
Subsidies	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social insurance outlays	10.5	10.3	10.4	11.1	11.2	11.2	11.4	11.3	10.8	10.7	10.8
Local government expenditure 2/	3.0	3.0	3.3	3.2	3.3	3.1	3.2	3.1	3.1	3.1	3.1
Social protection transfers	1.5	1.1	1.3	1.8	1.6	1.5	1.5	1.5	1.4	1.4	1.4
Other current transfers						0.4	0.4				
Capital expenditure 3/	4.4	4.8	4.4	6.3	7.3	6.1	6.4	4.9	4.6	4.6	4.6
Domestically financed	3.0	3.2	3.0	3.7	4.0	3.5	3.5	3.3	3.0	3.0	3.0
Foreign financed	1.4	1.6	1.4	1.5	1.8	1.6	1.9	1.6	1.5	1.5	1.5
Earthquake spending	0.0	0.0	0.0	1.0	1.6	1.0	1.1	0.0	0.0	0.0	0.0
Lending minus repayment	0.6	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds	0.0	0.0	3.1	0.7	0.3	0.2	0.2	0.3	0.2	0.2	0.2
Overall balance 3/	-2.0	-1.3	-2.0	-6.8	-6.8	-5.4	-5.4	-3.7	-2.3	-2.3	-2.4
Financing	2.0	1.3	2.0	6.8	6.8	5.4	-5.4	3.7	2.3	2.3	2.4
Domestic	0.1	-1.6	2.5	3.0	0.4	5.5	5.4	2.8	1.8	3.9	2.3
Privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	0.5	0.8	1.5	3.0	2.8	2.7	2.7	2.5	2.4	3.4	2.2
Change in general gov. deposits	-0.3	-2.1	1.0	0.9	-2.4	2.8	2.7	0.3	-0.6	0.5	0.1
Other	-0.1	-0.3	0.0	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	1.9	2.9	-0.5	3.8	6.3	-0.1	0.0	0.9	0.5	-1.6	0.1
Gross borrowing	3.5	6.0	1.3	7.5	8.6	2.0	2.3	4.4	4.3	4.1	4.0
Amortization	1.7	3.2	1.9	3.8	2.3	2.1	2.3	3.5	3.8	5.7	3.9
Memorandum Items:											
Primary balance	0.1	0.9	0.1	-4.7	-4.5	-3.2	-2.7	-1.5	0.0	0.0	0.0
Structural primary balance	0.3	0.9	0.6	-2.8	-2.3	-2.1	...	-1.5	0.0	0.0	0.0
Government TSA 5/	1.4	3.0	1.9	1.1	4.6	1.5	...	1.1	1.7	1.1	1.0
General government debt 4/5/	71.9	69.5	67.3	77.2	80.6	79.0	...	78.6	77.6	75.5	74.1
Direct general government external debt	31.6	30.4	28.8	33.7	37.9	35.9	...	35.2	34.1	31.0	29.7
Government guaranteed external debt	1.3	1.8	1.6	2.2	1.9	2.1	...	2.1	1.9	1.8	1.6
Nominal GDP (billions of leks)	1551	1637	1692	1618	1769	1868	1867	1965	2072	2184	2301

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

1/ Includes the property tax, the simplified profit tax for small businesses, and other local taxes.
2/ There is a structural break in 2017, reflecting the transfer of the Regional Development Fund to the Ministry of Urban Development.
3/ The fiscal balance includes guarantees for new loans to the energy sector through 2019 and from 2021, and potential calls of COVID-19 related guarantees from 2021.
4/ The stock of general government debt includes public guarantees (domestic and external) and arrears from central and local government and VAT refund arrears.
5/ The 2021 SDR allocation of $190 million is recorded with the government, increasing both the TSA balance and government external debt.

Table 2b. Albania: General Government Operations, 2017–26

(Billions of Leks)

	2017	2018	2019	2020	2021	2022		2023	2024	2025	2026
							Budget				
								Proj.			
Total revenue and grants	430.4	449.9	460.3	425.9	484.8	515.4	536.8	540.6	572.4	602.5	633.4
Tax revenue	398.6	419.3	426.3	398.7	453.5	481.8	500.2	506.9	535.4	564.2	593.0
VAT	139.5	143.5	132.4	130.4	150.7	161.4	166.1	169.8	179.9	189.7	199.8
Profit tax	31.6	34.5	36.6	28.4	33.2	35.3	35.6	37.7	40.0	42.0	44.2
Excise tax	45.1	45.0	46.7	44.5	51.0	53.8	56.5	54.6	55.9	57.2	58.2
Customs duties	6.5	6.2	6.5	6.2	6.9	7.3	7.5	7.7	8.4	8.9	9.4
Personal income tax	32.1	36.5	46.1	33.7	41.5	44.9	45.2	48.0	50.6	53.3	55.9
National taxes	38.5	38.6	36.4	35.8	40.8	42.8	49.7	46.0	48.5	50.6	53.4
Local government revenue 1/	18.4	21.9	23.1	22.0	24.9	26.9	27.6	28.3	29.8	31.4	33.0
Social insurance contributions	86.8	93.2	98.4	97.7	104.5	109.4	112.0	114.7	122.4	131.2	139.2
Non-tax revenue	20.7	22.4	25.3	19.0	20.4	22.7	22.7	22.3	24.7	25.5	27.6
Grants	11.1	8.2	8.8	8.3	10.9	10.9	14.0	11.5	12.2	12.9	12.8
Total expenditure	461.2	471.4	494.6	536.3	604.3	616.0	637.7	614.3	619.4	653.3	687.6
Current expenditure	382.6	392.6	418.2	421.4	468.5	498.2	513.9	512.5	520.7	549.5	578.9
Personnel cost 2/	72.6	73.6	77.0	76.9	85.8	89.6	90.4	93.7	94.4	99.4	104.7
Interest	31.9	36.5	35.1	34.4	39.3	40.9	50.8	44.6	47.0	50.8	54.1
Operations & maintenance	43.4	45.3	47.2	48.9	58.2	62.7	62.9	60.9	60.7	65.0	68.5
Subsidies	2.6	1.9	2.8	1.5	1.6	1.5	1.5	1.5	1.6	1.6	1.6
Social insurance outlays	162.1	168.3	175.6	179.4	197.4	209.1	212.8	222.1	224.5	234.4	247.9
Local government expenditure 2/	46.5	49.6	56.2	51.6	57.6	58.8	59.7	61.0	64.4	68.0	70.4
Social protection transfers	23.4	17.5	21.9	28.7	28.7	27.5	27.7	28.7	28.0	30.2	31.6
Other current transfers						8.2	8.2				
Capital expenditure 3/	68.8	78.8	75.0	101.7	129.7	113.6	120.4	95.8	95.0	100.1	105.0
Domestically financed	46.6	52.2	51.5	60.6	70.6	65.4	64.4	65.2	62.9	66.6	69.7
Foreign financed	22.3	26.2	23.5	24.5	31.1	29.1	36.0	30.6	32.1	33.5	35.3
Earthquake spending	0.0	0.4	0.0	16.6	28.0	19.0	20.0	0.0	0.0	0.0	0.0
Lending minus repayment	9.2	0.0	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds	0.0	0.0	53.1	12.1	6.1	4.2	3.4	6.1	3.7	3.7	3.7
Overall balance 3/	-30.8	-21.5	-34.2	-110.4	-119.5	-100.6	-100.9	-73.7	-47.0	-50.8	-54.1
Financing	30.9	21.5	34.2	110.4	119.5	100.6	-100.9	73.7	47.0	50.8	54.1
Domestic	1.5	-25.5	42.9	49.0	7.4	101.8	100.3	56.0	37.2	86.1	52.2
Privatization receipts	0.4	0.1	0.0	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	7.3	13.0	25.6	48.4	50.0	50.0	50.0	50.0	49.9	75.0	50.8
Change in general gov. deposits	-5.2	-33.6	17.2	14.7	-42.7	51.8	50.3	6.0	-12.7	11.1	1.4
Other	-1.1	-5.1	0.0	-14.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	29.4	47.0	-8.7	61.4	112.1	-1.2	0.6	17.7	9.8	-35.3	1.9
Gross borrowing	55.0	98.8	22.8	121.3	152.2	37.9	42.4	85.8	88.9	89.8	91.1
Amortization	25.8	51.7	31.4	61.3	40.1	39.2	42.5	68.1	79.1	125.2	89.1
Memorandum Items:											
Primary balance	1.1	15.0	0.9	-76.0	-80.3	-59.7	-50.1	-29.1	0.0	0.0	0.0
Structural primary balance	4.5	15.5	9.6	-45.8	-40.7	-40.0		-29.1	0.1	0.0	0.0
Government TSA balance 5/	22.0	49.7	32.9	18.1	80.6	28.5		22.5	35.3	24.2	22.8
General government debt 4/5/	1,115	1,137	1,138	1,248	1,427	1,475		1,545	1,607	1,650	1,706
Direct general government external debt	490.5	496.8	488.1	544.4	670.3	669.7		692.5	706.9	677.2	684.4
Government guaranteed external debt	19.8	29.5	26.7	35.5	33.8	39.4		40.6	40.3	39.0	37.7

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

1/ Includes the property tax, the simplified profit tax for small businesses, and other local taxes.

2/ There is a structural break in 2017, reflecting the transfer of the Regional Development Fund to the Ministry of Urban Development.

3/ The fiscal balance includes guarantees for new loans to the energy sector through 2019 and from 2021, and potential calls of COVID-19 related guarantees from 2021.

4/ The stock of general government debt includes public guarantees (domestic and external) and arrears from central and local government and VAT refund arrears.

5/ The 2021 SDR allocation of $190 million is recorded with the government, increasing both the TSA balance and government external debt.

Table 3a. Albania: Balance of Payments, 2017–26

(Percent of GDP)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Current account	-7.5	-6.8	-7.6	-8.8	-8.4	-8.0	-7.8	-7.6	-7.5	-7.4
Goods and services (fob)	-15.1	-13.7	-13.6	-14.8	-14.3	-13.6	-13.4	-13.3	-13.1	-13.1
Goods (fob)	-24.4	-22.4	-22.9	-22.8	-22.7	-22.6	-22.9	-22.8	-22.7	-22.6
Exports	6.9	7.7	6.6	6.1	7.0	7.2	7.4	7.5	7.4	7.5
Imports	31.3	30.1	29.5	28.9	29.7	29.8	30.3	30.3	30.1	30.1
Services	9.4	8.7	9.3	8.0	8.4	9.0	9.4	9.5	9.6	9.5
Exports	24.7	24.0	24.7	17.0	18.9	20.7	23.1	23.8	24.3	24.5
Imports	15.4	15.3	15.4	9.0	10.5	11.7	13.7	14.4	14.8	15.0
Primary Income	0.2	-0.1	-1.0	-1.7	-1.3	-1.4	-1.3	-1.3	-1.3	-1.3
Compensation of employees (net)	2.3	2.2	2.2	1.7	2.0	2.0	2.1	2.2	2.2	2.2
Investment income (net)	-2.0	-2.3	-3.2	-3.4	-3.4	-3.5	-3.4	-3.5	-3.5	-3.5
Other (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Secondary Income	7.3	7.1	7.0	7.6	7.2	7.0	7.0	7.0	7.0	7.0
General Government (net)	0.6	0.5	0.5	0.4	0.2	0.2	0.2	0.2	0.2	0.2
Workers' Remittances (net)	5.5	5.2	5.1	5.2	5.0	5.2	5.2	5.2	5.2	5.2
Other private transfers (net)	1.2	1.3	1.4	2.0	2.0	1.6	1.6	1.6	1.6	1.6
Capital account	1.1	0.8	0.5	1.1	0.5	0.5	0.5	0.5	0.5	0.5
Financial account	-9.6	-8.9	-6.0	-11.5	-10.4	-6.3	-8.0	-8.1	-6.6	-8.2
Direct investment, net	-8.6	-8.0	-7.5	-6.8	-6.5	-7.1	-7.3	-7.3	-7.3	-7.3
Portfolio investment	-0.9	-0.6	1.0	-0.5	-3.8	1.7	-0.3	-0.5	0.9	-0.6
Other investment	-0.2	-0.3	0.5	-4.2	-0.1	-0.8	-0.4	-0.3	-0.3	-0.4
Errors and omissions	-1.6	-0.1	0.4	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Net balance	3.2	3.0	-1.0	3.8	2.5	-1.3	0.7	1.0	-0.3	1.3
Reserve assets (reserve loss = +)	-1.6	-2.9	0.6	-5.0	-2.5	1.3	-0.7	-1.0	0.3	-1.3
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
				(Percent change, unless otherwise noted)						
Memorandum items:										
Goods and Services										
Export value (fob)	17.5	11.1	6.1	-29.8	23.8	15.5	14.9	8.2	6.9	5.9
Import value (fob)	9.8	7.8	6.1	-19.8	17.1	10.7	11.5	7.1	6.0	5.8
Export volume	10.1	3.5	1.7	-27.6	18.9	14.0	13.2	6.6	5.2	4.2
Import volume	6.0	5.8	4.7	-19.4	12.9	9.7	10.5	5.7	4.5	4.1
Terms of trade	8.5	6.1	-1.0	-8.8	2.6	-0.3	-0.4	-0.3	-0.3	-0.2
Gross reserves (millions of euros)	2,996	3,399	3,360	3,942	4,306	4,116	4,236	4,403	4,348	4,597
(in months of imports of goods and services)	6.2	6.6	8.1	8.2	8.1	6.9	6.6	6.5	6.1	6.4
(in percent of ARA metric)	156	182	174	188	176	164	161	161	157	160
Gross reserves excl. banks' FX reserves (millions of euros)	2,498	2,887	2,817	3,350	3,638	3,418	3,513	3,651	3,564	3,780
(in months of imports of goods and services)	5.2	5.6	6.8	6.9	6.8	5.7	5.5	5.4	5.0	5.3
(in percent of ARA metric)	130	155	146	160	149	136	133	133	128	131
Gross external debt (millions of euros)	7,949	8,353	8,246	8,555	9,927	9,921	10,254	10,536	10,397	10,628
Gross external debt (percent of GDP)	68.8	65.1	60.0	65.5	68.8	64.3	62.9	61.4	57.5	55.8

Sources: Albanian authorities; and IMF staff estimates.

Table 3b. Albania: Balance of Payments, 2017–26

(Millions of Euros)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
							Proj.			
Current account	-866	-866	-1,041	-1,153	-1,211	-1,242	-1,267	-1,312	-1,351	-1,413
Goods and services (fob)	-1,742	-1,760	-1,870	-1,931	-2,058	-2,097	-2,190	-2,287	-2,372	-2,500
Goods (fob)	-2,824	-2,871	-3,144	-2,983	-3,278	-3,485	-3,726	-3,914	-4,103	-4,311
Exports	797	986	907	794	1,007	1,117	1,206	1,281	1,345	1,422
Imports	3,621	3,857	4,050	3,776	4,285	4,602	4,932	5,195	5,448	5,733
Services	1,082	1,111	1,274	1,052	1,219	1,389	1,536	1,628	1,731	1,811
Exports	2,856	3,073	3,398	2,226	2,733	3,203	3,760	4,093	4,401	4,665
Imports	1,774	1,962	2,124	1,174	1,513	1,814	2,224	2,465	2,670	2,854
Primary Income	29	-14	-140	-219	-190	-220	-210	-222	-240	-242
Compensation of employees (net)	263	285	299	221	294	315	350	371	392	415
Investment income (net)	-234	-300	-439	-443	-484	-537	-561	-595	-633	-658
Other (net)	0	1	0	2	1	1	1	1	1	1
Secondary Income	848	908	968	997	1,037	1,075	1,134	1,197	1,262	1,329
General Government (net)	70	67	67	58	31	25	26	30	31	33
Workers' Remittances (net)	636	670	702	673	717	803	847	892	941	991
Other private transfers (net)	142	171	199	266	289	247	261	275	289	305
Capital account	122	104	76	143	72	81	85	88	93	92
Financial account	-1,115	-1,143	-827	-1,504	-1,504	-971	-1,301	-1,391	-1,203	-1,569
Direct investment, net	-994	-1,022	-1,036	-894	-944	-1,100	-1,189	-1,245	-1,316	-1,386
Portfolio investment	-100	-76	141	-66	-552	255	-48	-90	159	-114
Other investment	-22	-44	69	-545	-8	-125	-65	-56	-46	-69
Errors and omissions	-186	-9	60	160	0	0	0	0	0	0
Net balance	372	380	-138	495	364	-191	120	167	-55	249
Reserve assets (reserve loss = +)	-185	-371	78	-655	-364	191	-120	-167	55	-249
Financing Gap	0	0	0	0	0	0	0	0	0	0
					(Percent change, unless otherwise noted)					
Memorandum items:										
Goods and Services										
Export value (fob)	17.5	11.1	6.1	-29.8	23.8	15.5	14.9	8.2	6.9	5.9
Import value (fob)	9.8	7.8	6.1	-19.8	17.1	10.7	11.5	7.1	6.0	5.8
Export volume	10.1	3.5	1.7	-27.6	18.9	14.0	13.2	6.6	5.2	4.2
Import volume	6.0	5.8	4.7	-19.4	12.9	9.7	10.5	5.7	4.5	4.1
Terms of trade	8.5	6.1	-1.0	-8.8	2.6	-0.3	-0.4	-0.3	-0.3	-0.2
Gross reserves (millions of euros)	2,996	3,399	3,360	3,942	4,306	4,116	4,236	4,403	4,348	4,597
(in months of imports of goods and services)	6.2	6.6	8.1	8.2	8.1	6.9	6.6	6.5	6.1	6.4
(in percent of ARA metric)	156	182	174	188	176	164	161	161	157	160
Gross reserves excl. banks' FX reserves (millions of euros)	2,498	2,887	2,817	3,350	3,638	3,418	3,513	3,651	3,564	3,780
(in months of imports of goods and services)	5.2	5.6	6.8	6.9	6.8	5.7	5.5	5.4	5.0	5.3
(in percent of ARA metric)	130	155	146	160	149	136	133	133	128	131
Gross external debt (millions of euros)	7,949	8,353	8,246	8,555	9,927	9,921	10,254	10,536	10,397	10,628
Gross external debt (percent of GDP)	68.8	65.1	60.0	65.5	68.8	64.3	62.9	61.4	57.5	55.8

Sources: Albanian authorities; and IMF staff estimates.

Table 4a. Albania: Monetary Survey, 2017–26

(Billions of leks, unless otherwise indicated; end-period)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
					Proj.					
Net foreign assets	700.5	724.4	729.0	808.2	838.3	827.4	859.5	891.4	882.2	938.0
Bank of Albania	390.7	412.5	402.0	480.4	515.8	489.8	504.6	524.9	518.4	547.9
Commercial banks	309.8	311.9	327.0	327.8	322.5	337.7	354.8	366.5	363.8	390.1
Net domestic assets	566.6	539.7	589.6	648.7	751.1	829.2	864.5	918.8	1,026.5	1,072.6
Claims on central government, net	351.0	340.7	378.5	435.4	430.2	519.5	563.0	587.7	649.9	689.4
Claims on public enterprises	34.9	20.3	24.2	15.2	19.7	17.4	18.5	18.0	18.3	18.1
Claims on the private sector	506.6	501.9	532.5	579.9	623.3	642.2	676.9	712.8	750.6	789.6
In leks	239.1	247.0	271.7	300.8	329.1	340.8	358.9	377.8	397.7	418.7
In foreign currency	267.5	254.9	260.8	279.1	294.2	301.4	318.0	335.0	352.9	370.9
Other items, net	-326.0	-323.2	-345.5	-381.7	-322.1	-350.0	-394.0	-399.7	-392.2	-424.4
Broad money	1,267.0	1,264.1	1,318.7	1,456.9	1,589.4	1,656.6	1,724.0	1,810.2	1,908.7	2,010.6
Currency outside banks	265.3	275.3	291.4	344.6	398.6	415.5	429.5	448.9	473.3	498.6
Deposits	1,001.8	988.8	1,027.3	1,112.3	1,190.8	1,241.1	1,294.5	1,361.3	1,435.4	1,512.0
Domestic currency	473.8	456.2	466.6	517.7	560.7	591.3	623.8	663.5	707.5	753.6
Foreign currency	528.0	532.6	560.6	594.7	630.0	649.8	670.7	697.8	727.9	758.4
Memorandum items:										
Broad money growth (% change)	0.3	-0.2	4.3	10.5	9.1	4.2	4.1	5.0	5.4	5.3
Reserve money growth (% change)	2.6	-0.4	2.5	23.1	7.4	3.9	3.1	4.1	4.8	5.4
Private sector credit growth (% change)	-0.8	-0.9	6.1	8.9	7.5	3.0	5.4	5.3	5.3	5.2
Broad money (as percent of GDP)	81.7	77.2	77.9	90.1	89.8	88.7	87.7	87.4	87.4	87.4
Private sector credit (as percent of GDP)	32.7	30.7	31.5	35.9	35.2	34.4	34.4	34.4	34.4	34.3
Velocity (nominal GDP/broad money)	1.2	1.3	1.3	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Other current transfers										
Money multiplier (absolute values)	3.0	3.0	3.0	2.7	2.8	2.8	2.8	2.8	2.8	2.8
Currency (as share of broad money)	20.9	21.8	22.1	23.6	25.1	25.1	24.9	24.8	24.8	24.8
Foreign currency deposits/total deposits	52.7	53.9	54.6	53.5	52.9	52.4	51.8	51.3	50.7	50.2
Gross reserves (millions of euros)	2,995.9	3,399.0	3,359.6	3,942.4	4,306.4	4,115.9	4,235.9	4,402.9	4,347.9	4,596.9

Sources: Bank of Albania; and IMF staff estimates.

Note: Foreign exchange denominated items are converted at exchange rates for that period.

Table 4b. Albania: Summary of Accounts of the Central Bank, 2017–26

(Billions of leks, unless otherwise indicated; end-period)

	2017	2018	2019	2020	2021	2022	2024	2025	2026
					Proj.				
Net foreign assets	390.7	412.5	402.0	480.4	515.8	489.8	524.9	518.4	547.9
Assets	417.6	436.5	427.0	504.2	539.1	513.0	548.1	541.6	571.1
Liabilities	26.9	24.0	25.0	23.8	23.3	23.2	23.2	23.2	23.2
Net domestic assets	34.6	11.0	31.9	54.0	58.0	106.3	114.8	151.9	158.8
Domestic credit	59.9	21.7	44.5	66.5	70.6	118.9	127.3	164.4	171.4
Net claims on central government	18.3	-12.4	8.4	31.8	-10.9	40.9	34.2	45.3	46.7
Other credit	41.6	34.1	36.1	34.7	81.5	77.9	93.1	119.1	124.7
Private sector	1.7	1.8	2.1	2.0	2.1	2.1	2.1	2.1	2.1
Commercial banks	39.9	32.3	34.0	32.7	79.4	75.8	91.0	117.1	122.6
Other items, net (assets = +)	-25.3	-10.8	-12.6	-12.5	-12.6	-12.6	-12.6	-12.6	-12.6
Reserve money	425.2	423.4	434.0	534.3	573.8	596.1	639.6	670.3	706.7
Currency in circulation	265.3	275.3	291.4	344.6	398.6	415.5	448.9	473.3	498.6
Bank reserves	156.1	148.1	142.4	189.7	175.2	180.6	190.7	196.9	208.1
Other nonbank deposits	3.9	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0

Sources: Bank of Albania; and IMF staff estimates.

Note: Foreign exchange denominated items are converted at exchange rates for that period.

Table 5. Albania: IMF Core Indicators of Financial Soundness, 2012–2021

		Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Sep-21
I	Capital-based										
(i)	Regulatory capital as a percent of risk-weighted assets	16.2	18.0	16.8	15.7	15.7	16.6	18.3	18.3	18.3	18.3
(ii)	Regulatory Tier 1 capital as a percent of risk-weighted assets	14.6	14.9	13.8	13.5	13.8	15.1	17.0	17.1	17.2	17.2
(iii)	Capital as a percent of total assets										
	Regulatory Tier 1 capital as a percent of total assets	7.9	7.7	7.4	8.3	8.7	9.0	9.2	9.1	9.1	9.0
	Regulatory capital as a percent of total assets	8.8	9.3	9.0	9.7	10.0	9.9	9.8	9.7	9.6	9.6
	Shareholders' equity as a percent of total assets	8.6	8.4	8.6	9.5	9.7	10.2	10.1	10.5	10.4	10.0
(iv)	Nonperforming loans net of provisions as a percent of capital										
	As a percent of regulatory Tier 1 capital	61.8	48.5	46.7	28.4	26.3	17.3	16.6	14.6	12.0	8.3
	As a percent of regulatory capital	55.6	40.2	38.3	24.3	23.1	15.7	15.5	13.6	11.3	7.8
	As a percent of shareholders' equity	56.9	44.8	40.2	24.8	23.6	15.3	15.0	12.7	10.5	7.5
(v)	Return on equity (ROE) (annual basis)	3.8	6.4	14.2	13.2	7.2	15.7	13.0	13.5	10.7	12.8
(vi)	Net open position in foreign exchange as a percent of capital										
	As a percent of regulatory Tier 1 capital	4.1	4.9	10.4	9.0	8.0	7.3	8.4	8.0	9.0	8.2
	As a percent of regulatory capital	3.7	4.1	8.5	7.7	7.0	6.7	7.8	7.4	8.4	7.7
	As a percent of shareholders' equity	3.8	4.5	8.9	7.8	7.2	6.5	7.5	6.9	7.8	7.4
II	Asset-based										
(vii)	Liquid assets as a percent of total assets (Liquid-asset ratio)	29.4	27.6	31.9	32.3	31.3	30.2	34.2	35.7	34.8	33.4
(viii)	Liquid assets as a percent of short-term liabilities	34.9	34.7	40.4	41.4	40.6	40.8	46.2	49.4	47.4	45.9
(ix)	Return on assets (ROA) (net income to average total assets, annual)	0.3	0.5	0.9	1.2	0.7	1.5	1.3	1.4	1.1	1.3
(x)	Nonperforming loans (gross) as a percent of total loans	22.5	23.5	22.8	18.2	18.3	13.2	11.1	8.4	8.1	6.5
ansfers											
III	Income and expense-based										
(xii)	Interest margin to gross income	101.1	87.9	102.2	98.0	81.6	95.6	100.8	75.7	74.1	73.9
(xiii)	Noninterest expenses to gross income	65.9	58.3	61.8	57.0	50.4	71.9	77.6	61.2	58.7	58.0
IV	Memorandum items										
	Other (noncore) indicators:										
	Customer deposits as a percent of total (non-interbank) loans	171.6	180.8	180.2	187.8	192.8	194.0	203.2	207.2	211.3	216.3
	Foreign currency-denominated loans to total loans	64.5	63.0	62.4	60.8	58.6	56.4	56.1	51.2	50.3	49.6
	Foreign currency-denominated liabilities as a percent of total liabilities	52.6	52.8	52.4	53.5	54.6	60.4	59.1	56.8	55.7	56.5
	Other indicators:										
	Risk weighted assets as a percent of total assets	54.2	52.1	53.6	62.0	63.4	59.7	53.9	53.2	52.6	52.4
	Total loans as a percent of total assets	48.6	45.9	46.0	44.5	42.7	41.6	40.0	39.0	38.5	37.3
	Total loans as a percent of shareholders' equity	567.4	548.8	536.3	466.8	438.6	408.9	393.8	373.3	370.5	373.1

Sources: Bank of Albania; and IMF staff estimates.

Table 6. Albania: Indicators of Capacity to Repay the Fund, 2021–26 (Under Obligated Repurchase Schedule) 1/

(Millions of SDRs)

	2021	2022	2023	2024	2025	2026
Fund repurchases and charges based on the existing and prospective drawings						
In millions of SDRs	8.4	54.7	87.4	116.7	70.5	21.7
In millions of euro	10.1	65.2	103.9	138.2	83.2	25.6
In percent of gross international reserves	0.2	1.6	2.5	3.1	1.9	0.6
In percent of exports of goods and services	0.3	1.5	2.1	2.6	1.4	0.4
In percent of GDP	0.1	0.4	0.6	0.8	0.5	0.1
In percent of external public debt	0.2	1.1	1.6	2.1	1.3	0.4
In percent of quota	6.0	39.2	62.8	83.8	50.6	15.6
Fund credit outstanding (end of period)						
In millions of SDRs	344.4	295.2	211.1	96.2	26.3	4.8
In millions of euro	414.0	352.3	250.9	113.9	31.1	5.6
In percent of gross international reserves	9.6	8.6	5.9	2.6	0.7	0.1
In percent of exports of goods and services	11.1	8.2	5.1	2.1	0.5	0.1
In percent of GDP	2.9	2.3	1.5	0.7	0.2	0.0
In percent of external public debt	7.0	5.8	4.0	1.7	0.5	0.1
In percent of quota	247.3	211.9	151.6	69.0	18.9	3.4
Memorandum items:						
Gross international reserves	3582	3449	3565	3719	3682	3900
Exports of goods and services	3111	3620	4179	4539	4866	5164
GDP	12005	12938	13708	14496	15322	16168
External public debt	4913	5118	5315	5518	5314	5365
Quota	139.3	139.3	139.3	139.3	139.3	139.3

Source: IMF staff estimates.

1/ End-year value.

Table 7. Albania: External Financing Requirement and Sources, 2017–2026

(Millions of Euros)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Total financing requirement	1,124	1,546	1,123	2,016	1,775	1,233	1,804	1,989	2,198	2,282
Current account (incl. official transfers)	744	762	965	1,009	1,140	1,161	1,181	1,224	1,258	1,320
Amortization	195	412	236	353	271	262	503	599	995	713
Of which: IMF	0	5	17	34	53	59	59	54	41	25
Change in gross reserves (increase = +)	185	371	-78	655	364	-191	120	167	-55	249
Total financing sources	1,311	1,555	1,064	1,856	1,775	1,233	1,804	1,989	2,198	2,282
Foreign direct investment, net	994	1022	1036	894	944	1100	1189	1245	1316	1386
Official medium- and long-term project loans	203	154	159	137	197	175	185	195	203	219
Official guaranteed loans	2	118	11	75	29	86	48	34	34	34
Official budget support loans	255	0	14	192	341	138	26	41	41	35
Of which: IMF	70	0	0	170	0	0	0	0	0	0
SDR Allocation	0	0	0	0	161	0	0	0	0	0
Commercial borrowing (Eurobond and PBG)	0	498	1	650	703	0	500	500	500	500
Commercial Banks, net	160	7	70	-328	-9	-144	-138	-130	-138	-157
Of which:										
Portfolio investment, net	104	-176	-77	-256	-106	-206	-168	-203	-200	-218
Other investment, net	56	183	147	-72	96	62	30	73	62	62
Other	-303	-245	-228	236	-591	-123	-5	104	242	264
Errors and omissions	-186	-9	60	160	0	0	0	0	0	0
Total financing needs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

Annex I. Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
External Risks				
Global resurgence of the Covid-19 pandemic. (possibly due to vaccine-resistant variants, leading to costly containment efforts and persistent behavioral changes).	Medium	ST	**High.** Reduced cross-border movements would adversely affect the tourism sector. Growth deterioration in Albania's main export destinations and sources of remittances might spill over to Albania through lower demand for exports and a decline in remittances. All these would weigh on Albania's economic activity, fiscal performance, and financial stability.	Adjust composition of fiscal spending to better target policies to support health care, the most vulnerable, and the economy. Adopt a credible revenue-based fiscal consolidation plan and seek additional financing. Closely monitor and manage fiscal and financial sector risks.
De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia (earlier-than expected Fed tightening; front-loaded tightening of financial conditions).	Medium	ST	**High.** Tighter global financial conditions would reduce capital inflows, create depreciation pressures, and worsen debt dynamics Negative impact in the near term will partly be mitigated by Albania's high level of foreign reserves.	Adjust fiscal spending to better target support and strengthen debt and liquidity management. Adopt a credible revenue-based fiscal consolidation plan and seek additional financing. Be prepared to tighten monetary policy. Closely monitor and manage fiscal and financial sector risks.
Rising commodity prices amid bouts of volatility. Commodity prices increase by more than expected against a weaker U.S. dollar, post-pandemic pent-up demand and supply disruptions, and for some materials, accelerated plans for renewable energy adoption. Uncertainty surrounding each of these factors leads to bouts of volatility, especially in oil prices.	Medium	ST	**Medium.** Volatility in energy prices could result in large swings in the current account, increase budget deficit and fiscal risks through increased support to the energy sector, de-anchor inflation expectations, and endanger economic recovery.	Clear communication of the BoA on the temporary nature of the energy price increase. Better target budget support to those most in needs and avoid broad subsides. Closely monitor and manage fiscal risks and address their root causes. Reinvigorate electricity and related water sector reforms.
Domestic Risks				
Uncontrolled Covid-19 local outbreaks and subpar/volatile growth (in the event of slower-than-expected pace of vaccination, forcing new lockdowns).	Medium	ST	**High.** Reduced cross-border movements would adversely affect the tourism sector. A full lockdown would also negatively weigh down other sectors, derailing recovery. Should market access be reduced, fiscal space to support the economy would also be affected.	Be prepared to adjust composition of fiscal spending to better target policies to support health care, the most vulnerable, and the economy. Adopt a credible revenue-based fiscal consolidation plan and seek additional financing. Closely monitor and manage fiscal and financial sector risks.

[1] The Risk Assessment Matrix (RAM) shows events that could alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability <10 percent, "medium" a probability 10–30 percent, and "high" a probability 30–50 percent).

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
Poorly designed PIM projects and PPPs & increased contingent liabilities	**High**	**MT**	**Medium.** Engaging in poorly designed PIM and PPP contracts for infrastructure investment could impede the efficiency of public investment, and create large contingent liabilities, the realization of which could undermine fiscal and debt sustainability	Strengthen public investment management and governance and transparency of PPPs. Upgrade the capacity of the Ministry of Finance to undertake financial analysis of new PPP contracts and their direct or contingent impact on fiscal for the lifetime of the project.
Intensification of financial sector vulnerabilities	**Medium**	**ST, MT**	**Medium**. A surge in non-performing loans could lower capital adequacy levels, affecting banking sector stability and the ability to extend credit to the private sector	Closely monitor the financial sector and continue to improve NPL resolution framework. Continue to strengthen and implement the capital and liquidity regulatory framework and remain vigilant through onsite and off-site supervision.
Rollover of public debt	**Medium**	**ST, MT**	**Medium.** Elevated levels of net domestic borrowing could raise concerns about the ability of foreign-owned banks with limits on exposure to the sovereign to absorb additional borrowing and/or crowding out credit to private sector.	Diversify the debtholder base and lengthen maturity. Improve market communication and coordination with the central bank. Promptly resume revenue-based fiscal adjustment and debt reduction once the pandemic recedes.
Social discontent and political instability	**Low**	**ST, MT**	**High**. Social tensions erupt as lingering impact of the pandemic and inadequate policy responses (including to the effects of "scarring") cause persistent economic hardship and exacerbate preexisting socioeconomic inequities.	Reforms, including those to strengthen the rule of law, are key for medium-term growth and prospects for EU accession talks. Ensure that reforms are grounded in careful policy analysis and a consultative preparation process.
Adverse weather conditions	**Medium**	**ST, MT**	**Medium.** Drought could affect electricity generation. Power shortages could damage growth. Electricity imports could pose quasi-fiscal risks for the budget.	Reinvigorate the implementation of the electricity sector reform. Finalize financial restructuring plans to restore the financial viability of public electricity companies. Prepare a backup power supply plan.

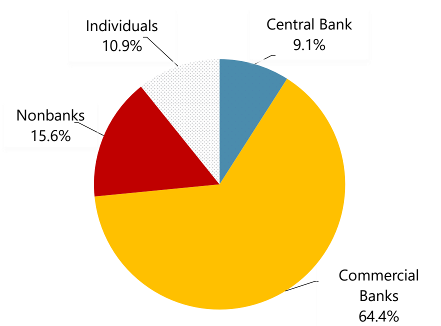
Annex II. Debt Sustainability Analysis[1]

The economic contraction and expenditure pressures resulting from two large consecutive shocks have led to a rapid increase of borrowing needs, reversing the declining trend of debt in recent years and raising debt from 67.3 percent of GDP in 2019 to an expected 79.4 percent of GDP in 2021. As the effects of the shocks subside and the economy recovers, Albania's public debt is projected to resume a downward path from 2022 and decline to about 73 percent by 2026, still above the pre-shock level. The debt path under the baseline is subject to significant risks. Gross financing requirements also remain large at an annual average of about 21 percent of GDP, reflecting sizable rollover needs including maturing Eurobonds in 2025. With the recovery firming up, it would be critical to embark on revenue-based consolidation to rebuild space for fiscal policy maneuver and put debt on a solid downward path.

A. Public Debt Sustainability

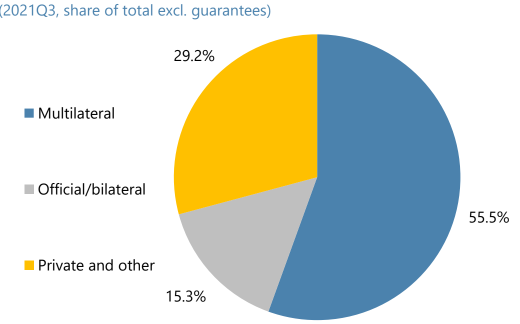
1. Debt Profile[2]. Albania's debt profile has gone through several changes over the past decade or so. First, the share of external debt in total public debt went up from about 33 percent in 2008 to about 45 percent in September 2021. Second, this trend reflects a rising share of commercial debt from about 17 percent of total external debt in 2008 to 30 percent in September 2021 following several issuances of Eurobonds. Second, the maturity profile of domestic debt has also changed with the share of long-term paper increasing from about half of the total domestic debt in 2011 to more than 69 percent in September 2021. The average weighted maturity of domestic public debt increased from less than one year in 2011 to about 2.2 years at the same time. The lengthening of maturity, together with ample liquidity in the banking system, reduced rollover risks and improved cost efficiency. Nonetheless, further lengthening of maturities is still needed to help reduce the still very high annual financing requirements, combined with the preparation of mitigation strategies to address possible

Domestic Debt Holders, 2021 Q3
(Percentage share of total debt excl. arrears and guarantees)



Source: Ministry of Finance.

Public External Debt by Holder
(2021Q3, share of total excl. guarantees)



Source: Ministry of Finance.

[1] The authorities intend to keep the 2021 SDR allocation as a line of credit for the budget. Therefore, the SDR allocation to Albania (about EUR 161 million,19.5 billion LEK and about 1% of GDP) is excluded from the stock of government external debt and hence debt figures differ from those in the macroframework.
[2] Public debt refers to the general government and includes all public guarantees for energy and non-energy sector debt and stock of central and local government arrears. It does not include PPPs.

tightening of financing conditions. In this context, the development of the market maker program for longer-term benchmark bond issuances and seeking foreign official financing should help. At the same time, the MOFE is encouraged to continue the issuance of short-term debt (specifically for 3–6 months maturity), to support liquidity management and market development. About 90 percent of domestic debt was denominated in domestic currency, whereas 60 percent of external debt was denominated in euros.

2. **Fiscal risks have risen in recent years.** In 2020, Albania adopted two sovereign guarantee schemes in local currency (1.6 percent of GDP) as part of COVID-19 support packages to support businesses, with new ones currently under discussion. Contingent liabilities from PPPs and utility SOEs (energy and water) with persistent financial vulnerabilities that create sustained dependence on fiscal support constitute additional long-standing risks. Public guarantees to SOEs are accounted for in the stock of debt at the date of issuance. Contingent liabilities related to PPPs are not measured in a comprehensive manner and as such are neither properly assessed nor adequately monitored. Under the Organic Budget Law, only direct payments to PPPs and concessions from the budget should not exceed 5 percent of tax revenue of the preceding year. This ceiling could be breached if contingent liabilities materialize or revenues underperform. Moreover, an unexpected growth slowdown leading to the materialization of these contingent liabilities may trigger additional jumps in the government debt stock.

Baseline Scenario

3. **Macroeconomic assumptions.** In 2020 the economy contracted by 4 percent. Higher spending and reduced revenue collection drove up the fiscal deficit and gross financing needs considerably. Under the baseline, GDP growth is expected to rebound to almost 8 percent in 2021, on the back of a strong recovery of pandemic-affected sectors and continued fiscal support including earthquake reconstruction. Debt is still expected to increase slightly to almost 79.4 percent of GDP by end-2021. Medium-term growth is forecasted at an average of 3.6 percent between 2022 and 2026. The baseline assumes a Eurobond issuance of €700 million in late 2021 and further tapping of international capital markets each year between 2023 and 2026.

4. **Debt level under the baseline and alternative scenarios.** Under the baseline scenario, Albania's gross debt is projected to decline gradually from a peak of 79.4 percent in 2021 to 73.3 percent of GDP in 2026. Gross financing needs over the same period are projected to remain elevated, averaging about 21 percent annually, reflecting rollover needs and new debt issuances. Under the constant-primary-balance scenario (assuming the primary deficit remains at the 2021 level of 4.5 percent of GDP), the debt ratio would continue to increase over the projection horizon, breaching 90 percent in 2026. The historical scenario (assuming real GDP growth, the primary balance and real interest rates at the historical average of the past ten years) projects debt at about 82 percent of GDP by 2026.

5. **Heat map and debt profile vulnerabilities.** Risks related to the level of debt remain elevated. Gross financing needs breach the 15 percent threshold over the projection period. The debt profile shows moderate risks related to the declining share of short-term debt (green in the

heatmap). However, the debt profile remains vulnerable to high external financing needs, interest rates risks, the sizeable share of foreign currency debt, and debt held by non-residents. Exchange rate risks will remain important given the projected sizeable debt denominated in foreign currency.

Stress Test and Stochastic Simulations

6. The debt ratio remains above 70 percent of GDP under the baseline and all stress scenarios, and it is particularly sensitive to the fiscal stance, interest rate and real GDP growth shocks. Under those stress scenarios, debt peaks to about 79.5 percent GDP in 2021-22 before declining to about 77.6 percent of GDP in 2026. Sensitivity to exchange rate shocks is also notable, as under this scenario public debt reaches about 75.7 percent of GDP in 2026. A large debt stock in Albania means high rollover requirements, which increases its vulnerability to market risk and magnifies the impact of an interest rate shock on the debt-to-GDP ratio. It also increases vulnerability to growth shocks and reduces the scope for countercyclical policy. Against this background and given the uncertainty over the outlook including a possible tightening in global financial conditions, a stress test showing dual shocks to real GDP growth and interest rate is carried out.[3] Another stress test including a combined macro-fiscal shock of the largest effect of individual shocks on all relevant variables (real GDP growth, inflation, primary balance, exchange rate and interest rate) also show an increasing debt path. Under this scenario the debt to-GDP ratio will reach about 92 percent of GDP in 2026. The fan charts illustrate the possible evolution of public debt over the medium term and are based on both symmetric and asymmetric distributions of risks. Under an asymmetric distribution of risks, there is a high level of probability that the debt stock will be in the range of 79 to 92 percent of GDP.

B. External Debt Sustainability

7. The external debt-to-GDP ratio remains elevated. Most external debt continues to be held by multilateral creditors and bilateral development agencies, though the share of commercial debt is expected to increase over the medium-term. Most foreign public debt is denominated in euros (inter-government loans and Eurobonds), followed by SDRs.

8. The external debt ratio is expected to decline gradually over the medium-term supported by GDP growth and declining multilateral borrowing.

- **External debt** rose to 65½ percent of GDP in 2020 and is projected to increase to around 68 percent of GDP in 2021 before declining gradually to around 55 percent by 2026. Over the same period, the external private debt stock is expected to fall from about 31 to 26 percent of GDP. Although the accumulation of FDI-related debt liabilities will slow as investment in large energy projects (such as the Trans Adriatic Pipeline) tapers off, such liabilities will likely

[3] Assumptions underpinning this test over the period 2022-2026 include: (i) a decline in growth by about 1.6 percent every year relative to the baseline, (ii) a corresponding decline in fiscal revenues, and (iii) an increase in interest rate by 25 basis points relative to the baseline. This interest rate growth shock could increase the debt-to-GDP ratio to above 90 percent.

remain the largest component of the private external debt stock. Deposits held by Albanians living abroad were the second largest component of private external debt.

- Regarding **public external debt,** a €700 million Eurobond issuance is planned for late 2021 (after having issued €650 million in June 2020) and a €500 million Eurobond issuance with buyback is assumed annually starting from 2023. Total public and private external debt service, as a percentage of total external debt, is expected to decrease to 11 percent in 2021 before increasing again to 17 percent due to large amortization payments in 2025. In line with the expected succession of new Eurobond issuances, external commercial debt as a percentage of total external public sector debt is expected to increase steadily from 38 percent at end-2021 to around 49 percent in 2026.

9. **Stress test results.** Under a 30 percent exchange rate depreciation shock, external debt would peak at 95 percent of GDP in 2022 before declining to 82 percent by 2026. Depreciation shocks are likely to have added significance for debt dynamics in view of increased external commercial borrowing. Following a shock to the current account of half a standard deviation (around 1 percent of GDP), external debt would peak at 68 percent of GDP in 2021 and gradually decline to 59 percent by 2026.

Annex II. Figure 1. Albania: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

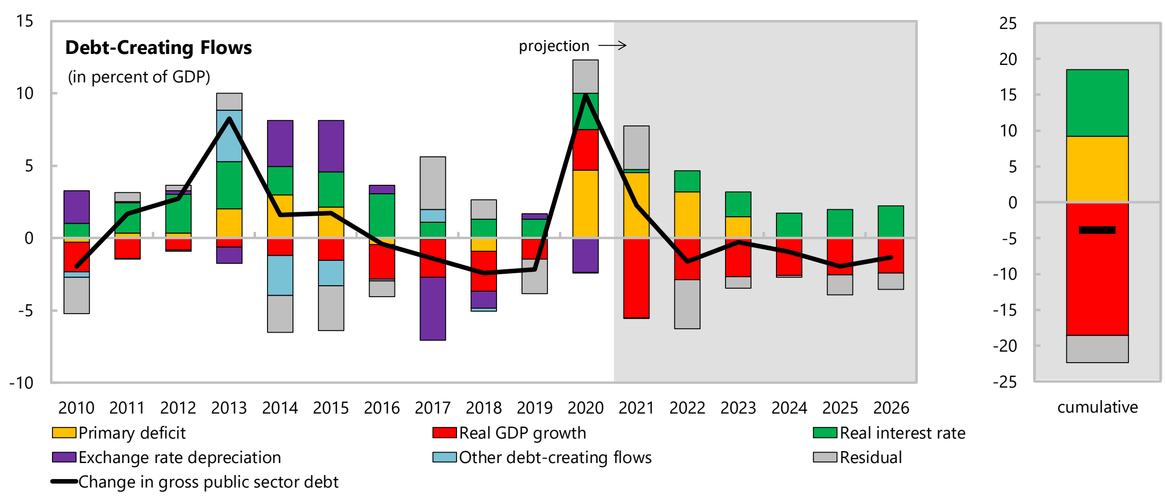
	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	67.8	67.3	77.2	79.4	77.8	77.5	76.6	74.6	73.3
Of which: guarantees	3.6	2.5	3.0	3.2	3.1	2.9	2.8	2.6	2.5
Public gross financing needs	32.4	20.6	29.2	16.9	21.2	19.3	22.9	18.6	27.4
Real GDP growth (in percent)	2.6	2.1	-4.0	7.8	3.8	3.6	3.5	3.5	3.4
Inflation (GDP deflator, in percent)	1.4	1.2	-0.4	1.5	1.7	1.6	1.8	1.9	1.9
Nominal GDP growth (in percent)	4.1	3.4	-4.4	9.4	5.6	5.2	5.4	5.4	5.3
Effective interest rate (in percent) [4/]	4.7	3.2	3.1	1.9	3.7	3.9	4.3	4.7	5.1

As of October 22, 2021

Sovereign Spreads		
EMBIG (bp) 3/		245
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	B1	B1
S&Ps	B+	B+
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.1	-2.2	9.9	2.3	-1.6	-0.3	-1.0	-2.0	-1.3	-3.9	
Identified debt-creating flows	1.3	0.2	7.6	-0.8	1.8	0.5	-0.8	-0.6	-0.2	-0.1	
Primary deficit	0.7	-0.1	4.7	4.5	3.2	1.5	0.0	0.0	0.0	9.2	-0.2
Primary (noninterest) revenue and grants	26.2	27.2	26.3	27.4	27.6	27.5	27.6	27.6	27.5	165.2	
Primary (noninterest) expenditure	26.9	27.2	31.0	31.9	30.8	29.0	27.6	27.6	27.5	174.5	
Automatic debt dynamics [5/]	0.8	0.3	2.9	-5.3	-1.4	-1.0	-0.8	-0.6	-0.2	-9.3	
Interest rate/growth differential [6/]	0.4	-0.1	5.3	-5.3	-1.4	-1.0	-0.8	-0.6	-0.2	-9.3	
Of which: real interest rate	2.1	1.3	2.5	0.2	1.4	1.7	1.7	2.0	2.2	9.3	
Of which: real GDP growth	-1.7	-1.4	2.8	-5.5	-2.9	-2.7	-2.6	-2.5	-2.4	-18.5	
Exchange rate depreciation [7/]	0.4	0.4	-2.4	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net privatization proceeds (negative)	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Creation/clearance of end-2013 stock of arrears	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.2	-2.4	2.3	3.0	-3.4	-0.8	-0.1	-1.4	-1.1	-3.8	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as domestic and external guarantees for the energy and non-energy sector.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

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

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

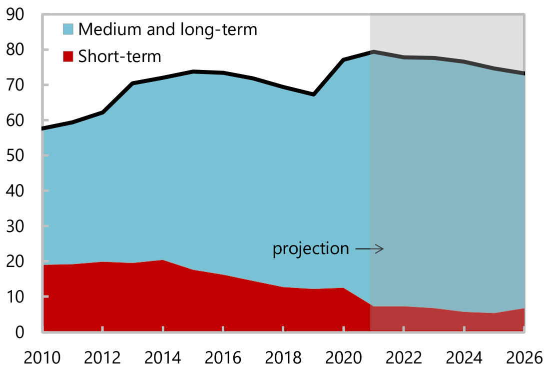
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Annex II. Figure 2. Albania: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

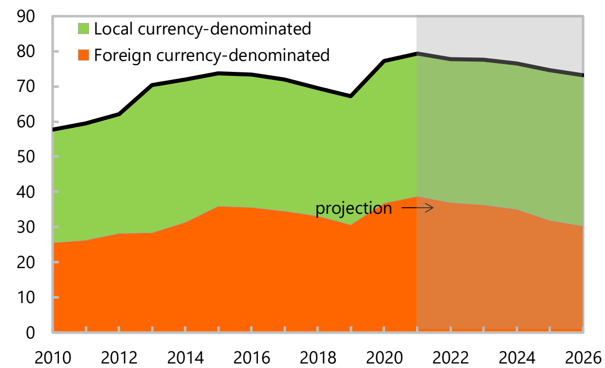
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

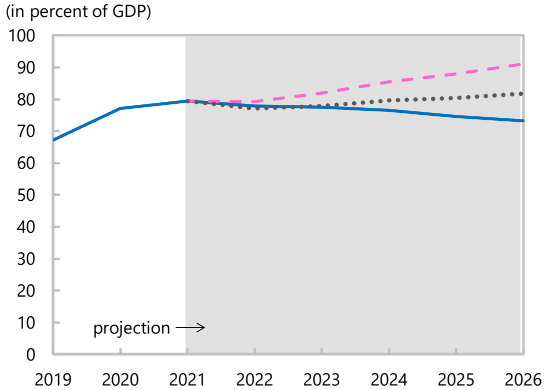


Alternative Scenarios

Baseline — Historical — Constant Primary Balance

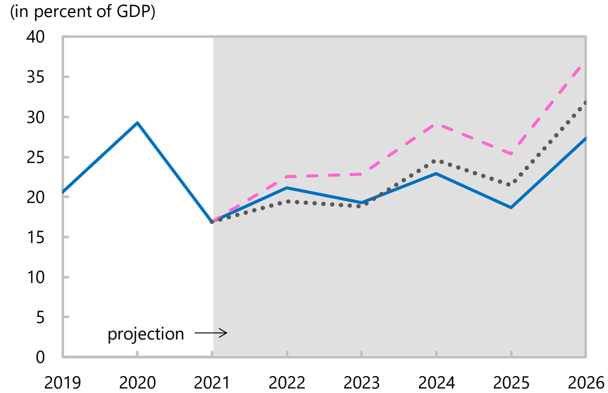
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

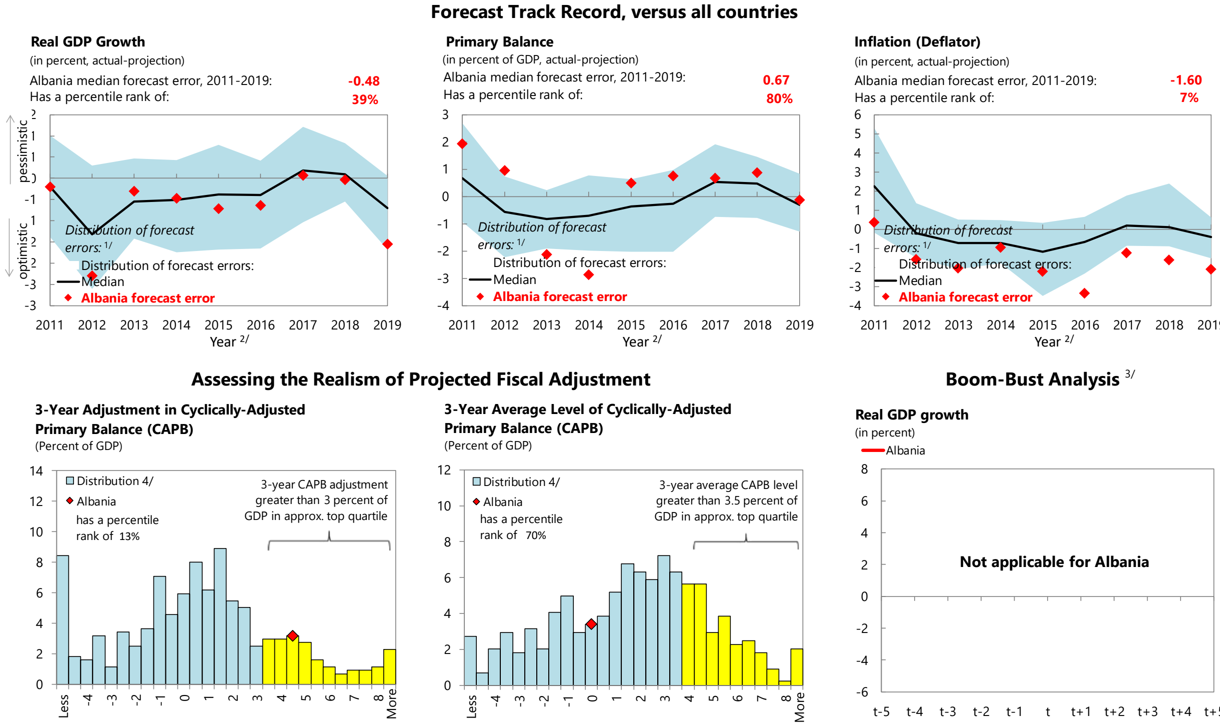
(in percent)

Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	7.8	3.8	3.6	3.5	3.5	3.4
Inflation	1.5	1.7	1.6	1.8	1.9	1.9
Primary Balance	-4.5	-3.2	-1.5	0.0	0.0	0.0
Effective interest rate	1.9	3.7	3.9	4.3	4.7	5.1
Constant Primary Balance Scenario						
Real GDP growth	7.8	3.8	3.6	3.5	3.5	3.4
Inflation	1.5	1.7	1.6	1.8	1.9	1.9
Primary Balance	-4.5	-4.5	-4.5	-4.5	-4.5	-4.5
Effective interest rate	1.9	3.7	3.9	4.3	4.7	5.1

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	7.8	1.8	1.8	1.8	1.8	1.8
Inflation	1.5	1.7	1.6	1.8	1.9	1.9
Primary Balance	-4.5	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	1.9	3.7	4.1	4.6	5.2	5.8

Source: IMF staff.

Annex II. Figure 3. Albania: Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

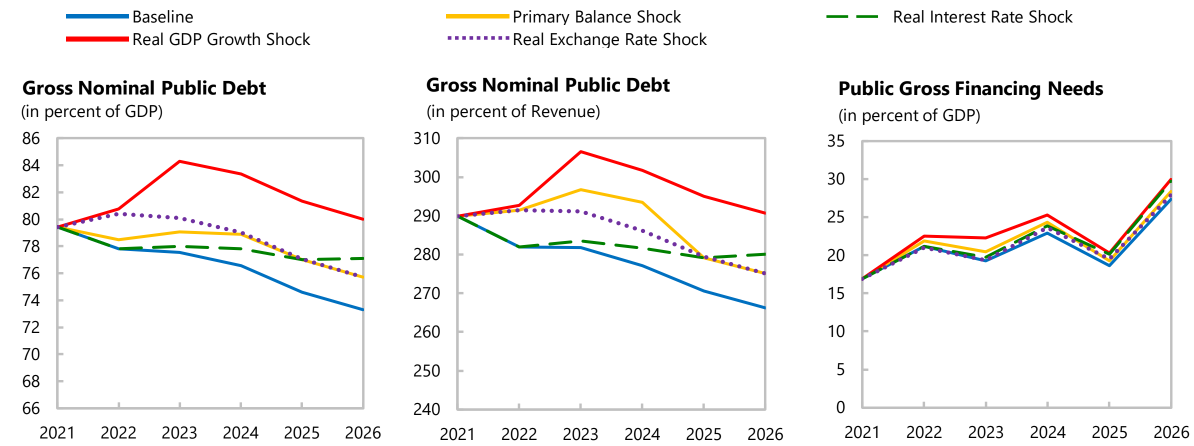
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Albania, as it meets neither the positive output gap criterion nor the private credit growth criterion.

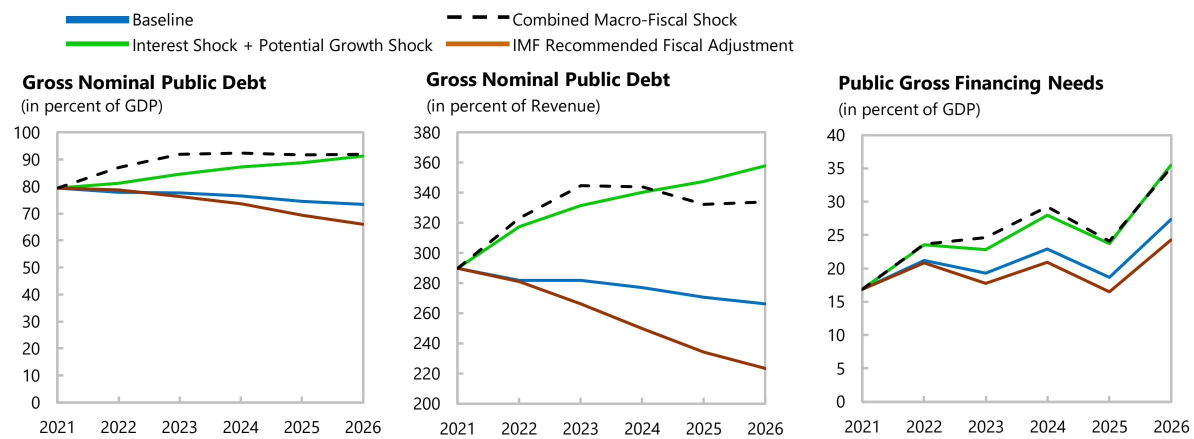
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex II. Figure 4. Albania: Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	7.8	3.8	3.6	3.5	3.5	3.4
Inflation	1.5	1.7	1.6	1.8	1.9	1.9
Primary balance	-4.5	-3.9	-2.3	-0.7	0.0	0.0
Effective interest rate	1.9	3.7	3.9	4.4	4.8	5.2
Real Interest Rate Shock						
Real GDP growth	7.8	3.8	3.6	3.5	3.5	3.4
Inflation	1.5	1.7	1.6	1.8	1.9	1.9
Primary balance	-4.5	-3.2	-1.5	0.0	0.0	0.0
Effective interest rate	1.9	3.7	4.5	5.4	6.3	7.1
Combined Shock						
Real GDP growth	7.8	1.5	1.3	3.5	3.5	3.4
Inflation	1.5	1.1	1.0	1.8	1.9	1.9
Primary balance	-4.5	-4.7	-4.0	-0.7	0.0	0.0
Effective interest rate	1.9	3.9	4.5	5.4	6.3	7.1

	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock						
Real GDP growth	7.8	1.5	1.3	3.5	3.5	3.4
Inflation	1.5	1.1	1.0	1.8	1.9	1.9
Primary balance	-4.5	-4.1	-3.1	0.0	0.0	0.0
Effective interest rate	1.9	3.7	4.0	4.4	4.8	5.2
Real Exchange Rate Shock						
Real GDP growth	7.8	3.8	3.6	3.5	3.5	3.4
Inflation	1.5	5.4	1.6	1.8	1.9	1.9
Primary balance	-4.5	-3.2	-1.5	0.0	0.0	0.0
Effective interest rate	1.9	3.9	3.85	4.2	4.6	5.0
IMF Recommended Fiscal Adjustment						
Real GDP growth	7.8	3.6	3.2	3.5	4.2	4.5
Inflation	1.5	1.7	1.6	1.8	1.9	1.9
Primary balance	-4.5	-2.4	0.0	1.5	1.4	1.0
Effective interest rate	1.9	3.7	3.907	4.2	4.5	4.9

Source: IMF staff.

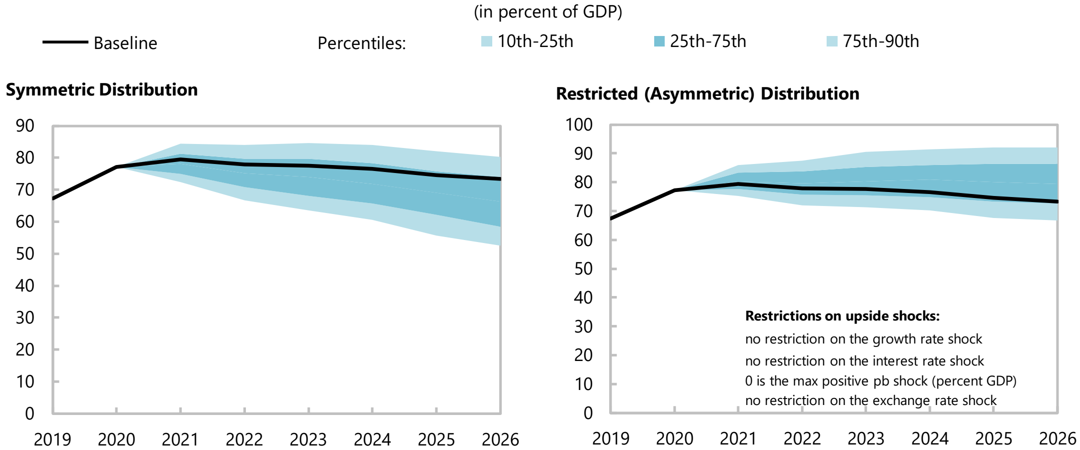
Annex II. Figure 5. Albania: Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

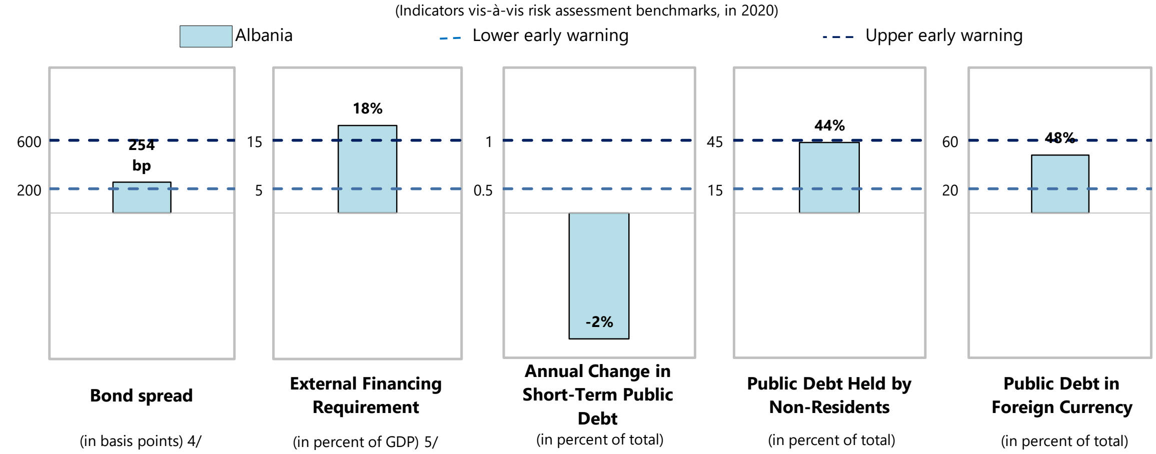
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment benchmarks are: 200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 24-Jul-21 through 22-Oct-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex II. Table 1. Albania: External Debt Sustainability Framework, 2016–2026
(Percent of GDP, unless stated otherwise)

	Actual							Projections						
	2016	2017	2018	2019	2020			2021	2022	2023	2024	2025	2026	
Baseline: External debt	73.5	68.8	65.1	60.0	65.5			**67.7**	**63.3**	**62.0**	**60.5**	**56.6**	**55.0**	
Change in external debt	0.6	-4.8	-3.7	-5.2	5.5			2.3	-4.5	-1.3	-1.5	-3.9	-1.7	
Identified external debt-creating flows (4+8+9)	-3.2	-6.8	-9.5	-0.2	4.8			1.4	-2.9	-0.3	-0.2	-2.6	-0.1	
Current account deficit, excluding interest payments	6.8	6.7	5.9	6.8	7.9			7.5	7.4	7.3	7.3	7.3	7.3	
Deficit in balance of goods and services	16.8	15.1	13.7	13.6	14.7			14.6	13.4	13.4	13.5	13.6	13.8	
Exports	29.0	31.6	31.6	31.3	23.1			25.6	28.2	31.2	32.3	33.0	33.4	
Imports	45.9	46.7	45.4	44.9	37.9			40.2	41.6	44.6	45.9	46.6	47.2	
Net non-debt creating capital inflows (negative)	-7.9	-7.6	-6.7	-6.7	-6.0			-2.6	-8.6	-6.1	-6.0	-8.3	-6.0	
Automatic debt dynamics 1/	-2.1	-6.0	-8.7	-0.2	2.8			-3.6	-1.8	-1.6	-1.5	-1.5	-1.4	
Contribution from nominal interest rate	0.8	0.7	0.9	0.8	0.9			0.9	0.6	0.6	0.5	0.5	0.4	
Contribution from real GDP growth	-2.3	-2.5	-2.4	-1.4	2.4			-4.4	-2.4	-2.2	-2.1	-2.0	-1.8	
Contribution from price and exchange rate changes 2/	-0.6	-4.2	-7.2	0.3	-0.5			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.8	2.1	5.9	-5.0	0.7			0.9	-1.5	-0.9	-1.3	-1.3	-1.6	
External debt-to-exports ratio (in percent)	253.5	217.6	205.8	191.6	282.8			264.5	224.0	198.7	187.0	171.4	164.6	
Gross external financing need (in billions of US dollars) 4/	2.8	3.0	3.6	2.3	2.7			2.7	2.8	3.1	3.3	3.9	3.6	
in percent of GDP	23.8	23.0	23.8	14.9	18.0	10-Year	10-Year	15.8	14.8	15.9	16.1	17.8	15.8	
Scenario with key variables at their historical averages 5/						Historical	Standard	**67.7**	**69.8**	**70.9**	**71.6**	**72.2**	**72.5**	For debt
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							stabilization
Real GDP growth (in percent)	3.3	3.8	4.0	2.1	-4.0	1.8	2.3	7.8	3.8	3.6	3.5	3.5	3.4	
GDP deflator in US dollars (change in percent)	0.8	6.0	11.6	-0.5	0.9	0.7	7.4	7.2	4.1	1.8	1.8	1.9	1.9	
Nominal external interest rate (in percent)	1.1	1.1	1.5	1.3	1.5	1.7	0.8	1.5	1.0	1.0	0.9	0.8	0.8	
Growth of exports (US dollar terms, in percent)	10.8	19.9	16.2	0.5	-28.4	1.4	15.1	27.8	19.2	16.6	9.2	7.6	6.5	
Growth of imports (US dollar terms, in percent)	7.2	12.0	12.8	0.5	-18.3	0.5	12.8	22.6	11.9	13.1	8.4	7.1	6.6	
Current account balance, excluding interest payments	-6.8	-6.7	-5.9	-6.8	-7.9	-8.0	1.7	-7.5	-7.4	-7.3	-7.3	-7.3	-7.3	
Net non-debt creating capital inflows	7.9	7.6	6.7	6.7	6.0	6.5	1.0	2.6	8.6	6.1	6.0	8.3	6.0	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

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

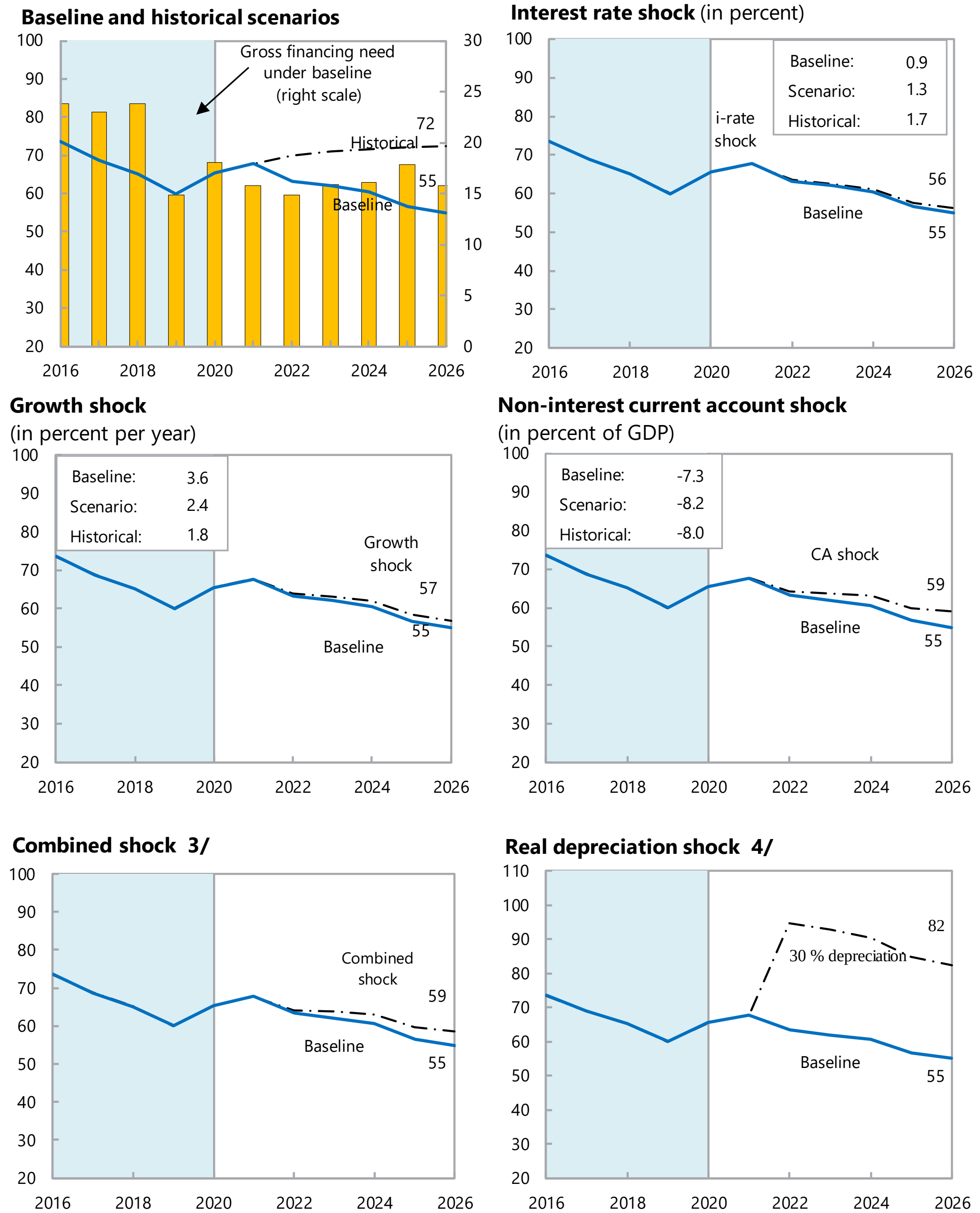
3/ For projection, line includes the impact of price and exchange rate changes.

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.

Annex II. Figure 6. Albania: External Debt Sustainability: Bound Tests 1/ 2/

(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/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

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

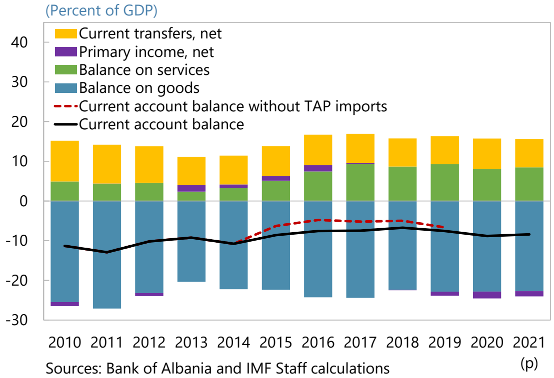
4/ One-time real depreciation of 30 percent occurs in 2021.

Annex III. External Sector Assessment

The external position of Albania in 2020 was moderately weaker than the level implied by medium-term fundamentals and desirable policies. The EBA-Lite CA-model results indicate a current account gap of -1.2 percent of GDP, implying a REER overvaluation of 4.9 percent. The current account deficit widened in 2020 compared to 2019, mainly due to lower exports and foreign tourism receipts, while imports declined marginally. Significant external financing needs, increasing share of commercial financing in the overall external debt, and a large negative NIIP pose risks, which are mitigated by the predominance of FDI flows and still large share of official financing. The reduction of external imbalances will hinge on efforts to increase domestic saving, particularly fiscal consolidation. Furthermore, Albania's investment climate remains burdened by structural weaknesses, including governance concerns, infrastructure gaps, and skills shortages that hamper a transition to export-led growth.

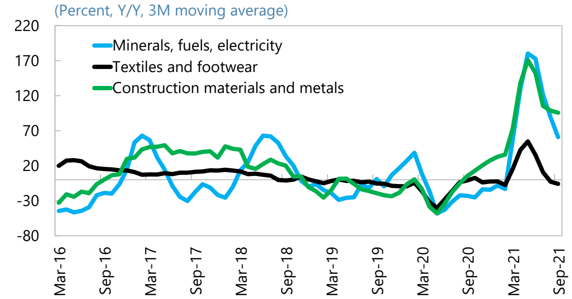
1. **Albania's current account position worsened in 2020.** The current account deficit increased to 8.8 percent of GDP, as the pandemic caused a large drop in exports of goods, while the slowdown in imports was smaller, due to a smaller drop in private demand and a boost from earthquake reconstruction and public investment. On the services side, the large drop in exports of services, consisting mostly of tourism, were offset to a large degree by the lower level of imports of services, as Albanians largely vacationed domestically due to travel restrictions. In addition, a drop in remittances in nominal terms was more than offset by the strong growth in net private transfers, which tempered the widening of the CA deficit,[1] while FDI remained resilient and provided continued capital inflows. In the first half of 2021, the CA deficit was only marginally lower than 2020H1, as strong growth in foreign tourism receipts was mostly offset by imports growth, driven by the recovery in domestic demand. The current account deficit is expected to improve gradually over time, as (i) imports generated from FDI in large energy projects, especially the Trans-Adriatic Pipeline (TAP), decline; and (ii) imports generated by spending on earthquake reconstruction and public investment decline as projects are completed; and (iii) in the medium term, net tourism

Current Account Balance
(Percent of GDP)



Sources: Bank of Albania and IMF Staff calculations

Growth of 3 Largest Export Goods
(Percent, Y/Y, 3M moving average)

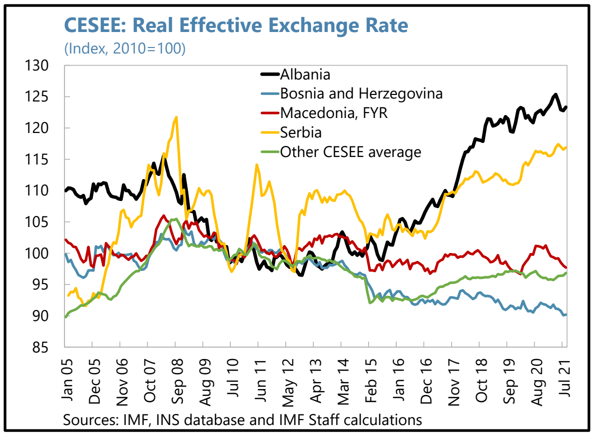


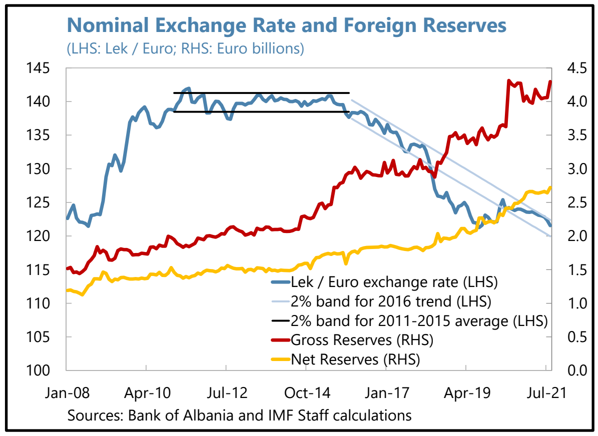
Sources: INSTAT and IMF Staff calculations
Note: in the IMF tables and consistent with BPM6, most textiles exports are classified as manufacturing services on physical inputs owned by foreigners rather than goods exports.

[1] Remittances dropped by around 4 percent in nominal terms compared to 2019. Net private transfers increased by 34 percent in nominal terms compared to 2019, mostly due to private transfers related to earthquake reconstruction as well as other real estate purchases.

inflows and an expansion of domestic energy production are expected to lead to increased exports. However, Albania's reliance on hydropower and dependence on tourism, remittances, and Italy and Greece as export destinations make the current account vulnerable to external shocks, including weather-related shocks.

2. The REER appreciation, which had leveled off in 2020 after a period of strong appreciation, has resumed since the beginning of 2021. Since the beginning of 2017, the CPI-based REER had appreciated by about 15 percent, reflecting price differentials vis-à-vis trading partners and a pronounced appreciation of the nominal exchange rate. The latter has been supported by long-term factors, such as robust FDI flows. Towards the end of 2019 and during 2020, this appreciation had leveled off, reflecting the impact of the two successive shocks. Since the beginning of 2021, the REER has started to appreciate as the effects of the pandemic subside, and due to continued strength in remittances[2] and capital inflows.





3. The net international investment position (NIIP) has deteriorated somewhat, but the large stock of FDI and official lending mitigate sustainability concerns. The NIIP has decreased to about -57 percent of GDP at end-2020 from -52 percent of GDP at the end 2019, driven by FDI inflows and external borrowing, including the Eurobond issuance. Foreign liabilities were about 121 percent of GDP, although over half of this stock comprised stable direct investment liabilities and a large part of the other liabilities were long-term public debt. The profile of liabilities may become less favorable over the medium term, however, as FDI inflows related to large energy projects taper off and the authorities increase commercial borrowing.

4. The external position in 2020 is assessed to be moderately weaker than the level implied by medium-term fundamentals and desirable policy settings. Under the EBA-Lite Current Account approach, the multilaterally consistent cyclically adjusted CA norm in 2020 is estimated at -6.3 percent of GDP. The cyclically adjusted CA balance is -7.5 percent, which includes

[2] In the first half of 2021, remittances grew by 1.4 percent in nominal terms relative to the first half of 2019, and by 24.5 percent in nominal terms relative to the first half of 2020, as the economies of the source countries improved.

Albania: Model Estimates for 2020 (in percent of GDP)		
	CA model	REER model
CA-Actual	**-8.8**	
Cyclical contributions (from model) (-)	-0.3	
COVID-19 adjustor (+) 1/	1.4	
Additional temporary/statistical factors (+)	0.0	
Natural disasters and conflicts (-)	0.4	
Adjusted CA	**-7.5**	
CA Norm (from model) 2/	**-6.3**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**-6.3**	
CA Gap	**-1.2**	**-4.9**
o/w Relative policy gap	7.2	
Elasticity	-0.25	
REER Gap (in percent)	**4.6**	**19.5**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on oil trade balances (0.1 percent of GDP) and on tourism (1.3 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

1.4 percent adjustment for COVID-19 factors, including oil trade and tourism balances. These adjustments take into account the temporary effects of the pandemic and are important in the case of Albania in order to assess the external position. The estimated CA gap of -1.2 percent of GDP suggests a REER that is overvalued by 4.9 percent. The results of the REER model suggests a REER overvaluation of 19½ percent. The overvaluation is expected to resolve over time, with fiscal adjustment and productivity growth supported by structural reforms.

5. **Albania has large external financing needs, though robust FX coverage and access to long-term financing help to mitigate risks.** Albania's external financing needs are large at 21 percent of GDP in 2020, of which almost 75 percent are banks' currency and deposits liabilities. Gross FX reserves were 30 percent of GDP and 188 percent of the ARA metric at end-2020. However, gross FX reserves include large FX deposits held at the BoA by commercial banks, which cannot be used for other balance of payments purposes. Excluding commercial banks' FX reserves, gross reserves stood at 26 percent of GDP and 160 percent of the ARA metric at end-2020. While this level is above the 150 percent upper threshold for floating regimes, the higher level is appropriate, given Albania's vulnerability to shocks, the sensitivity of public debt and private balance sheets (with sizable unhedged FX loans) to depreciations, risks of euroization, and the structurally high fiscal financing needs. As the large import-intensive energy projects are completed, Albania's ability to attract new FDI flows and roll over commercial external debt will be increasingly important for external sustainability and growth. Steadfast reforms to improve Albania's competitiveness and resilience of the economy have become of even greater importance in light of the pandemic.

6. **Authorities' Views:** The authorities concur with staff's assessment of the external position of Albania in 2020 as well as assessment of the exchange rate. They agree with the outlook for a gradual reduction of the current account deficit over the medium term and the need for fiscal consolidation and continued structural reforms to strengthen Albania's competitiveness.

Annex IV. An Illustrative Adverse Scenario

1. Given the significant outlook uncertainty, this illustrative adverse scenario considers the impact of COVID-19-related downside risks, should they materialize. The baseline scenario projects a strong economic rebound in 2021 and continued recovery in 2022–23. The adverse scenario assumes a substantial resurgence of infections in 2022 for EMDCs. The persistence of the pandemic is accompanied by tighter global financial conditions and a more challenging market access environment for emerging markets.

2. Under the adverse scenario, public debt is expected to increase further, reserves would decline, pressures for exchange rate depreciation would mount, and Albania would be faced with fiscal and external financing gaps from 2022 onwards.

Albania: Adverse Scenario, 2021-2023

(Percent of GDP, unless otherwise specified)

	Baseline			Adverse scenario		
	2021	2022	2023	2021	2022	2023
Real Sector						
GDP growth (percent)	7.8	3.8	3.6	7.8	0.5	1.5
Balance of Payments						
Current Account Balance	-8.4	-8.0	-7.8	-8.4	-8.6	-8.4
Capital Account Balance	0.5	0.5	0.5	0.5	0.5	0.5
Financial Account Balance (- = inflow)	-10.4	-6.3	-8.0	-10.4	-2.6	-3.5
BOP Financing Gap (+ = gap)	0.0	0.0	0.0	0.0	0.5	1.0
Reserves (million Euro)	4,306	4,116	4,236	4306	3,576	3,096
In months of imports	8.1	6.9	6.6	8.4	6.4	5.3
In percent of ARA EM Metric	176	164	161	176	148	127
Reserves excluding banks' FX reserves (million Euro)	3,638	3,418	3,513	3638	2,878	2,373
In months of imports	6.8	5.7	5.5	7.1	5.2	4.0
In percent of ARA EM Metric	149	136	133	149	119	97
Fiscal Sector						
Tax Revenue	25.6	25.8	25.8	25.6	25.2	25.0
Expenditure	34.2	33.0	31.3	34.2	33.8	32.3
Fiscal balance	-6.8	-5.4	-3.7	-6.8	-6.9	-5.7
Primary balance	-4.5	-3.2	-1.5	-4.5	-4.7	-3.2
Fiscal Financing Gap	0.0	0.0	0.0	0.0	0.5	1.4
Public debt	80.6	79.0	78.6	80.6	85.0	89.1
Eurobond	4.9	0.0	3.1	4.9	0.0	0.0

Source: IMF Staff calculations.

- **Growth**. Enhanced containment efforts and prolonged behavioral changes would weigh down on tourism. The recovery in 2022–23 would be significantly weaker. Pressures generated by lower exports and tighter global financial conditions could be expected to result in a considerable nominal exchange rate depreciation.

- **External.** The current account would deteriorate amid lower tourism receipts and exports. The adverse scenario assumes pressures on the financial account, including significantly reduced access to international financial markets, lower FDI, and capital outflows. Reserves are expected to decline to finance deteriorating balance of payments. External financing gaps are expected to emerge unless additional IMF or other external financing is mobilized.

- **Fiscal.** With weaker growth, the overall fiscal balance would worsen significantly as revenues decline and spending remains elevated to support the economy. Amid a more challenging market environment, the adverse scenario assumes no further Eurobond issuances after 2021 as well as a larger drawdown of liquidity buffers. Consequently, in the absence of additional IMF or other external financing, Albania could face a fiscal financing gap for 2022–23. Lower growth, higher deficits, and nominal exchange rate depreciation would raise the public debt to almost 90 percent of GDP in 2023.

3. Policy options. With the expected deterioration of Albania's twin deficits in the event of a pandemic resurgence and tighter global financial conditions, contingent policy options could include:

- Continuing monetary accommodation and keeping the domestic financial market liquid;

- Targeting additional fiscal support to ensure adequate healthcare provision and protect the most vulnerable. Where needed, budgetary resources should be reallocated. Additional official financing should be considered if financing gaps were to emerge;

- Retaining a flexible exchange rate as a shock absorber. Foreign exchange interventions should be used only in the face of disorderly market conditions and to mitigate the impact of large depreciations on balance sheets; and

- Strengthening the monitoring and management of financial risks to ensure early detection of vulnerabilities. In case of heightened balance of payments pressures and financial stability concerns, the authorities need to stand ready to take further actions to preserve macro-economic and financial stability.

Annex V. Summary of Capacity Development Strategy

1. **Albania is a heavy capacity development (CD) user, with activities spanning a wide range of areas.** The authorities value Fund CD, especially its timeliness in delivering high-quality tailored assistance and responding to evolving needs. CD engagement with the authorities has continued in a virtual environment to help them manage the impact of the shocks. The BoA has a broadly satisfactory track record in not only implementing CD advice, but also driving a forward-looking agenda on future needs. Progress in the fiscal area has been mixed, hindered by limited absorptive capacity, staffing shortages, and possible political and social concerns. While progress has been made in some areas (such as establishing a fiscal risk unit, arrears monitoring and clearance, and cash forecasting and management), ownership is weak and progress lags behind in other areas (such as PIM and active monitoring of risks related to PPPs and SOEs).

2. **CD will continue to have a critical role in supporting Albania's efforts to maintain macroeconomic stability and achieve higher growth.** The authorities' demand for CD in FY 2022 remains strong, particularly given that the pace of reforms may pick up with the government's renewed mandate. The mission had meetings with CD experts and with the authorities to reflect on priorities, summarized as follows:

- **MTRS:** updating and implementing the MTRS prepared in 2019, which will be crucial to raise tax revenue necessary to rebuild buffers once the recovery is entrenched and to meet Albania's development needs.

- **PIM:** improvement is key to ensure a cost-efficient way to close Albania's infrastructure gap with its peers, while replenishing fiscal buffers to weather future shocks. The authorities need to show stronger ownership and leadership, including by implementing past CD advice for the Fund to meaningfully continue engagement.

- **Fiscal risks:** continuing TA support in fiscal risks and contingent liabilities, including PPPs, SOEs, the newly established standardized credit guarantee schemes, and arrears prevention.

- **Cash and debt management:** elevated debt, high gross financing requirements, sizable arrears, and increasing reliance on external commercial financing underscore the need for strengthening cash and debt management.

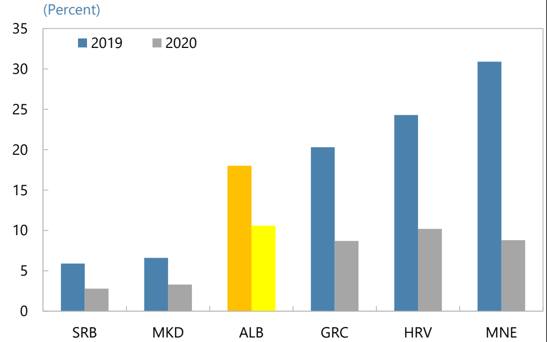
- **Banking supervision:** TA remains critical, particularly given the impact of the pandemic may take some time to materialize. The likely increase in NPLs and weakened capital position of relatively vulnerable banks will require continued CD support on supervision and regulation.

- **AML/CFT:** CD needs remain as Albania continues to have strategic deficiencies.

Annex VI. Tourism in Albania—The Impact of the Pandemic and the Road to Recovery[1]

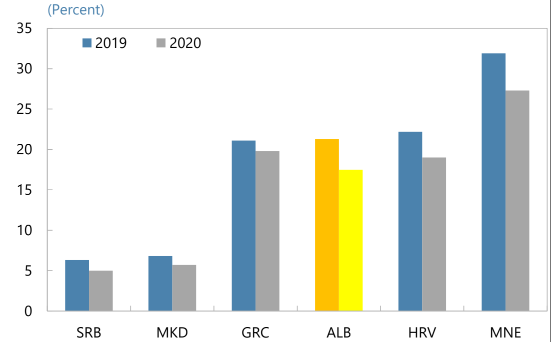
1. **The Albanian economy has a high dependence on tourism,[2] which exacerbates the impact of the shocks caused by Covid-19 and the 2019 earthquake.** The total contribution of the tourism sector and related activities peaked at 18 percent of GDP in 2019 according to staff calculations[3] with direct contribution at 7.6 percent. Official statistics indicate more than one in ten formal jobs were generated by tourism and related sectors, possibly an underestimate due to high informality and the seasonal nature of work.[4] The World Tourism and Travel Council estimates that one in five jobs in Albania is linked to tourism, travel, and related activities. Tourism also plays an important role in the balance of payments, generating a large share of export revenue (representing half of total export receipts in 2019), although the net impact is mitigated by Albanians' outbound travel spending. On average, tourism inflows in the decade prior to the pandemic were above 13 percent of GDP, while net flows are just 2 percent of GDP.

Travel and Tourism Share of GDP
(Percent)



Sources: World Travel and Tourism Council, Instat, and IMF Staff calculations

Tourism Share of Employment
(Percent)

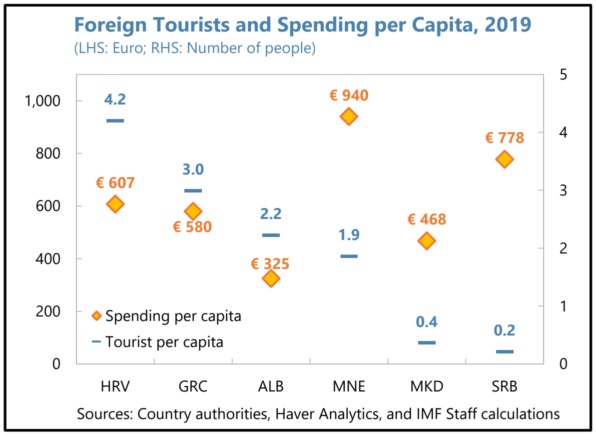


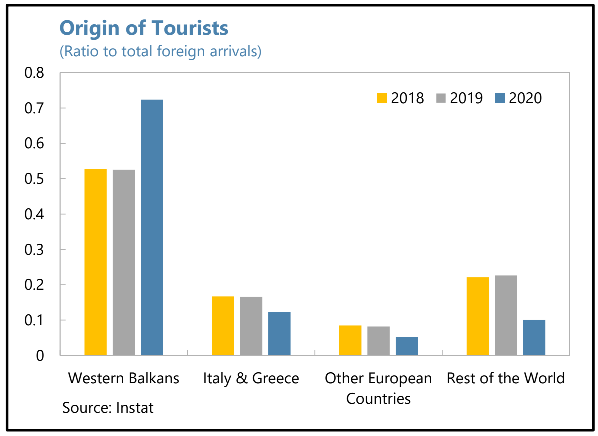
Sources: World Travel and Tourism Council, Instat, and IMF Staff calculations

2. **Prior to the pandemic, the tourism sector was experiencing a boom in Albania. In the decade to 2019, foreign tourist arrivals more than tripled to 6.4 million.[5]** In a competitive region, Albania is attracting a growing number of tourists per capita. But compared to more established tourist destinations, Albania attracts lower-spending tourists. More than half of the tourists come from neighboring Western Balkan countries (especially landlocked Kosovo and North Macedonia). The second largest group of tourists (17 percent of the total) come from Albania's EU

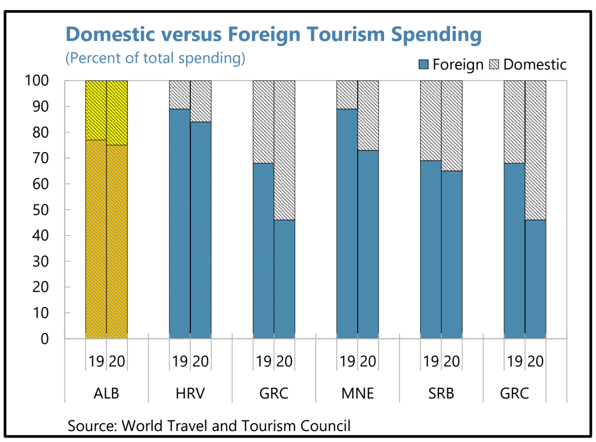
[1] Prepared by Linda Spahia with inputs from Magali Pinat.
[2] The Fund considers tourism-dependent economies, those countries, where the direct and indirect tourism contribution is 10 percent of GDP or above. "Direct contribution" refers to total spending on travel and tourism by residents and nonresidents and government spending on travel and tourism. "Indirect and induced contributions" include investment spending, collective government spending (for example, administration, marketing), and domestic supply chain purchases by sectors dealing with tourists.
[3] The total contribution of tourism to GDP for 2019 has been calculated by using the Input and Output tables applying the same approach of the World Travel and Tourism Council and Oxford Economics to allow for cross-country comparisons.
[4] INSTAT reports that in Q3 2019 some 75,800 jobs were registered in accommodation and food services (or 6 percent of the total jobs). By adding other related sectors (transportation and 1/3 of administrative services jobs as a proxy for travel agencies and other tourism support services, there are 127,000 jobs linked to tourism or 10 percent of total.
[5] This does not include arrivals of Albanian citizens residing abroad, mostly immigrants returning home for holidays, which in the past exceeded foreign tourists.

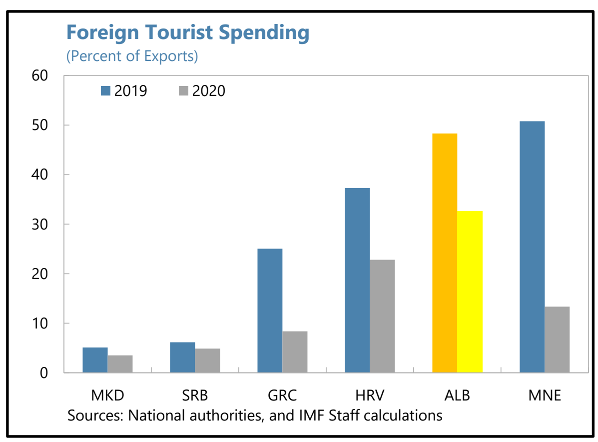
neighboring countries, Greece and Italy. Both countries are also home to a large Albanian diaspora that regularly come to Albania to visit relatives. However, in the last decade, Albania has started to attract foreign tourists beyond its vacationing emigrants and from those host countries, especially from Central and Eastern Europe (i.e., Poland, Ukraine, Belarus), mainly for beach package holidays. Environmental and cultural tourism have also started to take off.





3. Global tourism had the worst year on record in 2020 due to the pandemic and the severe travel restrictions imposed worldwide in its wake. International arrivals globally dropped by 74 percent year on year in 2020 according to UNWTO. In Albania, international arrivals dropped by 59 percent, a less severe drop, thanks to regional tourism and the removal of restrictions to inbound visitors. The total tourism contribution to GDP shrank to 10.4 percent, while the share of receipts from tourism to exports declined from half to one-third in 2020. The government provided one-off cash transfers to tourism sector employees in 2020, to mitigate job losses during the lockdown, but the support was not extended to informal or part-time workers. However, job losses in tourism and related sectors were twice higher than for the overall economy[6]. Other measures included tax deferrals, loan moratoria, loan guarantees, and temporary increases in social and wage support for small businesses/self-employed workers to ease the impact on households and firms.



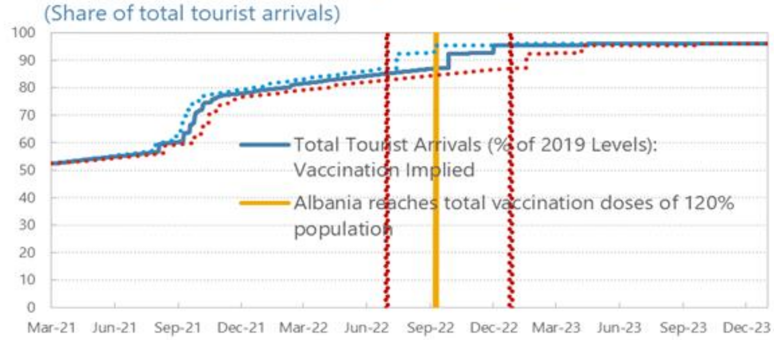


[6] INSTAT reports that between Q2 2019 and Q2 2021 jobs shrank by 2.5 percent overall vs 5.6 percent of jobs lost for travel and tourism sectors

4. Recovery in 2021 is led by regional tourism. Apart from 2020Q2, Albania has not instituted a full lockdown and has maintained open borders without quarantine requirements, with only light-touch restrictions during the summer season. As a result of the improvement in its epidemiological situation, the EU placed Albania on the green list on June 18th (thus recommending the removal of travel restrictions imposed since March 2020). Furthermore, to mitigate the loss of EU tourists, Albania is targeting non-EU eastern European market for package tourism (i.e., Ukraine, Belarus), and has temporarily removed visa requirements for others (Egypt, Russia, United Arab Emirates), and established direct flights. However, after a period of steady decline, there has been an uptick in Covid-19 cases in August due to the spread of the Delta variant, although capacity remains adequate to handle the number of hospitalizations. Albania started rolling out vaccinations in April 2021, and since then it has managed to fully vaccinate about one-third of the population, among the lowest rates in Europe.

5. The full recovery of the tourism sector will depend on the speed of vaccination in both Albania and its main tourist source countries. Although arrivals from the region have in part mitigated the decline in Western tourists numbers, they tend to spend fewer nights and less per capita. An uptick in cases in the region and lower vaccination rates compared to the EU average could also impact regional arrivals for the remainder of the year. Albania expects to have fully vaccinated its adult population by September 2022, while the pace of vaccination in its main source countries varies widely. Under the baseline assumptions, Albania is expected to return to the 2019 level of tourist flows by 2023, while in 2021 tourist arrivals are projected to vary between 70 percent (baseline) and 80 percent (fastest vaccination scenario).[7] The forecast is more pessimistic compared to the data for international tourist arrivals up to September 2021 thanks to a strong pick up of regional and emerging countries tourism (total arrivals were at 89 percent of the January-September 2019 level). Nevertheless, tourists from higher-spending Western European countries between January and September was at 59 percent of their 2019 value.

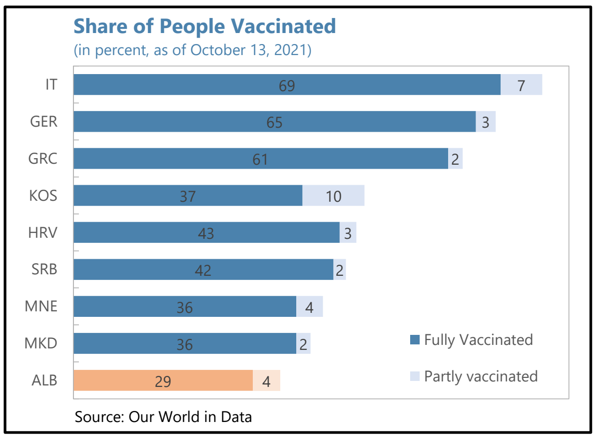
Albania:Timeline for the Recovery of Tourism, Three Scenarios
(Share of total tourist arrivals)

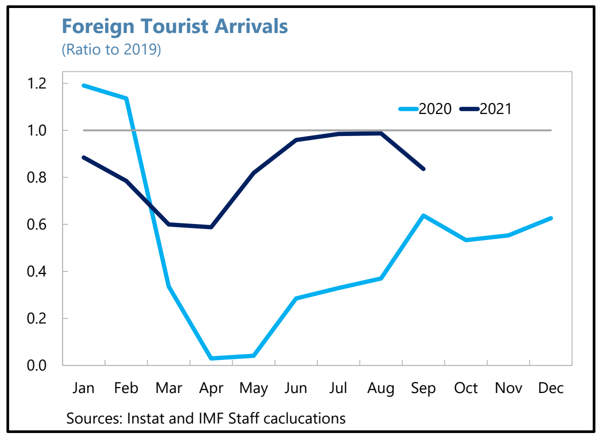


Sources: Our World in Data; UNWTO; and IMF staff calculations.
* This projection is based on the share of tourist source countries that have injected vaccine doses at 120% of the population.

[7] An in-house tool developed by staff tries to predict the return to the pre-pandemic levels based on the speed of vaccination (as well as other restriction measures) in both host and home countries, with the assumption that a country reaches immunity after having administered doses at 120% of population (covering all adults with two shots).

6. To support the long-term growth of the sector, the government is investing in infrastructure. It plans to add two new low-cost airports (one in the north, already inaugurated, and one in the south), convert its main trading port to one that caters to tourists, and upgrade road infrastructure in the coastal areas. Some of these investments are ongoing while others are expected to be financed directly by the budget or through PPPs. Albania has yet to find a balance between mass tourism and nature and heritage tourism, and currently lacks a clear target market. Fiscal incentives for the tourism sector introduced prior to the pandemic include a reduced VAT rate (to 6 percent from the standard 20 percent) for accommodation; additional tax breaks for luxury hotels (reduced VAT rate for all services); and 10-year exemptions from the Corporate Income Tax. An additional standardized guarantee scheme to support the sector with loans is currently under discussion.





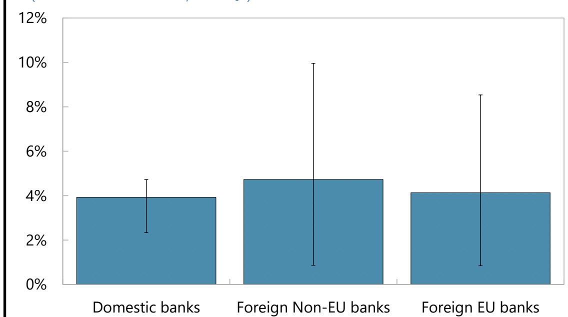
7. In the short term, support measures for tourism are warranted given the unprecedented challenges faced by the sector. These support measures should be temporary, well-targeted, and be increasingly subject to strict checks on business viability. Broad tax incentives for the tourism sector should be revisited in the context of the adoption of an MTRS to ensure that they are better targeted. International experience shows that benefits of these incentives are rarely passed onto the consumer and provide limited competitive advantage. Policy design should take into account the fact that tourism sector workers constitute one of the most vulnerable segments of society and seek to enhance social protection and support for training and job reallocation.

8. The long-term challenge is to transform the tourism sector in Albania from seasonal, mass tourism to year-round, sustainable tourism. Large-scale tourism places a strain on Albania's infrastructure and investments to upgrade it should account for environmental sustainability. Albania can take advantage of its diverse natural landscapes and rich cultural heritage to promote year-round tourism and reach for diverse markets, aiming at quality rather than quantity. A more diverse source of tourism flows and operators that do not compete only on price could better position the sector to withstand future shocks.

Annex VII. The Dynamics of NPLs and the Pandemic's Effects[1]

1. **The COVID-19 pandemic has exerted considerable pressure on banks' balance sheets, but a sizeable increase in NPLs has yet to materialize.** Banks are exposed to the sectors most impacted by the pandemic through their business loan portfolios, such as the accommodation and food service sectors. Banks are also increasingly exposed to households (from 29.5 percent end-2015 to almost 35 percent in August 2021), with mortgages representing 23 percent of total loans. Despite the scale of the pandemic's impact on the economy, the NPL ratio has continued on a declining trend and reached 6.5 percent in September. Timely support from the authorities, notably the loan moratoria and government guarantees, have mitigated the initial impact of the pandemic on borrowers. The relaxation of loan classification and provision rules until March 2021 might have also delayed the proper recognition of NPLs.

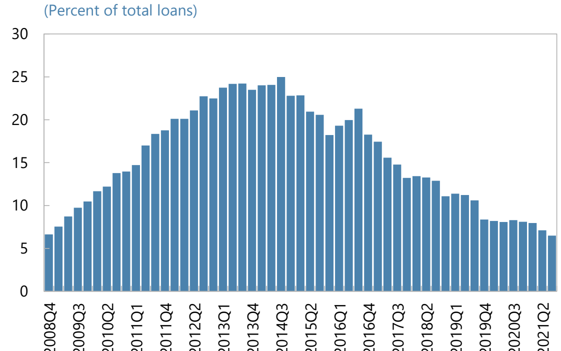
Loans in Accomodation and Food services
(Percent of Total Loans, 2020Q3)



Sources: Bank of Albania
Note: Bars show the weighted average share of loans in accomodation and food services sector by banks in each ownership category. Whisker lines indicate the minimum and maximum shares of loans.

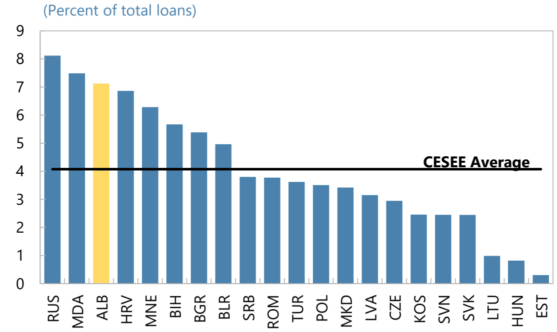
2. **Persistently high levels of NPLs have been a major vulnerability in Albania's financial sector.** It took several years for the impact of the global financial crisis and the Greek financial crisis on bank asset quality to fully materialize. In 2014Q3, NPLs of the banking system reached 25 percent of total loans, with some banks registering NPL ratios larger than 50 percent. High levels of NPLs were driven by shortcomings in bank risk management, exposures to the price bubble in the construction sector, and gaps in supervision and regulation. In addition to the deterioration of bank asset quality, a significant NPL overhang may lead to heightened risk aversion among banks and subdued growth in credit to the private sector. Since 2015, the progressive implementation of the action plan on NPLs spearheaded by the BoA has resulted in a significant drop in the NPL ratio, principally through write-offs. The BoA has also improved regulation and supervision, with continued alignment with Basel standards. Banks have made substantial improvement in risk

Non-Performing Loans
(Percent of total loans)



Sources: IMF Financial Soundeness Indicators

Non-Performing Loans, 2021 Q2
(Percent of total loans)



Note: LTU uses data in 2020 Q2; KOS, POL, SER, and TUR uses data in 2021 Q1
Sources: IMF Financial Soundness Indicators and IMF Staff caculations

[1] Prepared by Magali Pinat and Bo Zhao. Based on a forthcoming IMF Working Paper.

management. However, despite several years on a downward trend, NPLs remain high compared to regional peers.

3. Staff analysis suggests that both macroeconomic and bank-level factors have affected the quality of banks' assets. Based on an unbalanced panel regression model including up to 16 banks from 2005Q1 to 2020Q1,[2] a decrease in Albania's GDP growth is associated with increases in NPL ratios, validating the strong link between the business cycle and the banking sector's performance. Depending on the model specification, an increase in inflation or in short-term lending rates is also found to be associated with higher NPL ratios, as higher funding costs reduce borrowers' capacity to repay their loans. The regional global economic and financial environments have played important roles in determining the quality of bank assets. Lower growth in the EU and higher global risk aversion are associated with an increase in NPLs in Albania, as the previous spike in NPLs has shown. Furthermore, several bank-level factors are identified to be closely associated with bank asset quality. NPLs were found to have a high autocorrelation, suggesting that an increase in NPLs have prolonged effects on bank asset quality. Lower equity to total assets positively correlates with the NPL ratio. This may reflect that banks with relatively low capital tend to increase the riskiness of their portfolios, which in turn results in higher NPLs[3]. Higher profitability, a proxy for good management, is found to be associated with lower NPLs.

Text Table 1. NPLs in Albania: Macroeconomic and Bank-Level Determinants, 2005q1-2020q1

	(1)	(2)	(3)	(4)	(5)	(6)
NPL $_{(t-4)}$	0.704***	0.675***	0.625***	0.763***	0.640***	0.709***
	(0.036)	(0.039)	(0.031)	(0.052)	(0.082)	(0.060)
Macroeconomic regressors						
Δyoy rGDP $_{(t-4)}$	-2.488***	-2.598***	-2.659***	-1.481***	-2.360***	-1.752***
	(0.565)	(0.665)	(0.505)	(0.494)	(0.594)	(0.488)
Inflation $_{(t-4)}$	0.116*	0.115*	0.115***	0.043	0.021	0.020
	(0.055)	(0.054)	(0.039)	(0.025)	(0.024)	(0.023)
6m Lending rate $_{(t-4)}$	0.017	0.014	-0.006	0.042**	0.038**	0.047***
	(0.022)	(0.021)	(0.018)	(0.016)	(0.017)	(0.012)
Δyoy EU rGDP $_{(t-4)}$	-2.493**	-2.730**	-2.590***	-0.283	-0.132	-0.733
	(1.093)	(1.133)	(0.705)	(1.111)	(1.086)	(0.984)
VIX $_{(t-4)}$	0.006*	0.006	0.004**	0.004	0.001	0.003
	(0.003)	(0.003)	(0.002)	(0.003)	(0.003)	(0.003)
Δyoy EUR/LEK $_{(t-4)}$	-0.126	-0.171	0.537	0.171	0.103	0.246
	(0.845)	(0.799)	(0.652)	(0.841)	(0.796)	(0.661)
Bank specific regressors						
Equity/Total Assets $_{(t-1)}$				-1.399***	-3.068**	-1.410**
				(0.255)	(1.270)	(0.526)
ROA $_{(t-1)}$				-0.086***	-0.096***	-0.085***
				(0.011)	(0.012)	(0.010)
Type of regression	Pooled	FE	S-GMM	Pooled	FE	S-GMM
Observations	778	778	778	649	649	649
Number of banks	16	16	16	15	15	15
R^2	0.750	0.730		0.762	0.704	
Adjusted R^2	0.747	0.727		0.759	0.699	
Full Hansen			0.764			0.340
Diff Hansen			0.435			0.401
AR2			0.555			0.597

Notes: Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1. Sample covers observations from 2005q1 to 2020q1. Dependant variable corresponds to the logit transformation of the NPL ratio per bank. NPL is defined as NPL on banks' balance sheet plus write-offs to mitigate the regulatory impact on the panel regression estimation. T corresponds to quarters. Constant included but not reported.

4. Historically, NPL ratios have been sensitive to exchange rate movements. About 50 percent of total loans are in foreign currency, and 42 percent of the loans in FX are unhedged. Staff analysis suggests that depreciations against the euro have resulted in higher NPL ratios, including higher foreign currency NPLs, while appreciations have reduced NPLs, both in lek and in FX.

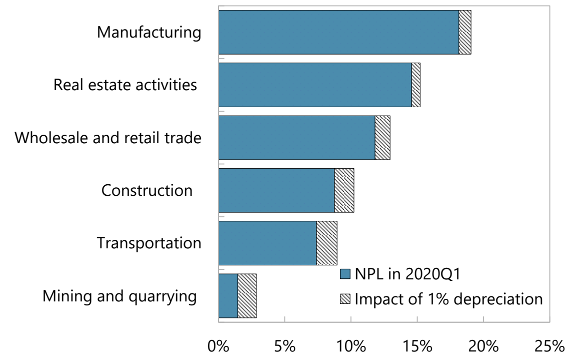
[2] Available information after 2020Q1 was not included in the sample as the COVID-19 pandemic impact may have not fully materialized on the level of NPLs.
[3] The "moral hazard" hypothesis was first described by Keeton and Morris (1987).

Text Table 2. NPLs in Albania : Uncovering the exchange rate impact

	Depreciation	Appreciation
Overall	6.113**	-3.163
	(2.311)	(1.869)
NPL in FX	5.842*	-4.822**
	(2.965)	(1.703)
NPL in Lek	11.856**	-11.524**
	(4.841)	(4.029)

Notes: The table present the coefficient associated to the absolute change in exchange rate y-o-y growth. Dependant variable corresponds alternatively to the logit transformation of the per bank overall NPL ratio, NPL ratio in foreign currency or NPL ratio in lek. Columns refers to the coverage of the sample: column (1) includes only the observations corresponding to a depreciation period of more than 1% and column (2) only the observation corresponding to an appreciation period of more than 1%. All baseline variables from Table 1 column (5) are included to this regression but not reported. Table 2 shows that depreciation leads to higher NPL ratio while appreciation leads to lower NPL ratio. In lek depreciation periods, 1% change of exchange rate leads to 5.8% increase of NPL in FX and 11.9% increase of NPL in lek. In lek appreciation periods, 1% change in exchange rate leads to 4.8% decrease of NPL in FX and 11.5% decrease of NPL in lek.

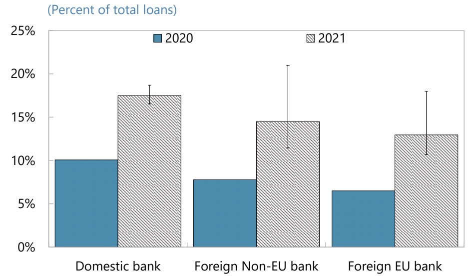
Impact of A Depreciation on Selected Sectorial NPL Ratio
(Percent)



Source: IMF Staff calculations

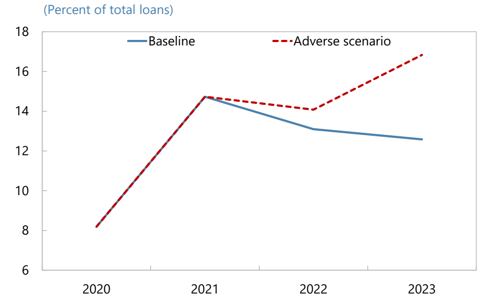
5. The COVID-19 pandemic could result in a significant increase of the NPLs to 15 percent of total loans in Albania. Forecast models[4] suggest the NPLs in the banking sector could double on average, reaching 21 percent of total loans for some banks depending on their initial level of NPLs. CET1 ratio is estimated to decline significantly but for most of the banks it would remain above regulatory standards. Should the adverse scenario materialize (Annex IV), the average NPL ratio in the banking system could reach 17 percent by 2023.

Forecasted Impact of The Pandemic on NPL Ratio
(Percent of total loans)



Note: Bars show the weighted average value for 2020 (in blue) and 2021 forecast (in grey) of non-performing loans to toal loans by banks in each ownership category. Whisker lines indicate the minimum and maximum shares of loans.
Source: IMF Staff calculations

Non-performing Loans Ratio
(Percent of total loans)



Note: The adverse scenario corresponds to the scenario described in Annex IV
Source: IMF Staff calculations

Some mitigating factors might lower the probability of a significant increase in NPLs, but risks remain elevated and warrant close monitoring. Improvement in bank management and performance in recent years and the authorities' timely response to contain the impact of the pandemic on banks' balance sheets could help limit the expected rise of NPLs.[5] Nevertheless, a prolonged pandemic could weigh on borrowers' capacity to repay loans and the full impact of the pandemic on banks' balance sheets may only become visible after more time than historically observed and econometric models suggest, as policy support measures are expected to delay NPL recognition.

[4] Due to the lack of availability of reliable bank-level quarterly forecast, the regression models used for forecasting are at the bank year level.

[5] Staff regressions are based on historical data and do not capture the impact of policy changes implemented since the pandemic nor improvement in bank risk management, and thereby may over-estimate the impact of the pandemic on NPLs.

INTERNATIONAL MONETARY FUND

ALBANIA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

November 17, 2021

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of September 30, 2021)

Membership Status: Joined October 15, 1991; Article VIII.

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	139.30	100.00
IMF's Holdings of Currency	466.45	334.86
Reserve Tranche Position	26.00	18.67

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	179.96	100.00
Holdings	261.02	145.04

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
Extended Arrangement	213.86	153.52
Rapid Financing Instrument	139.3	100.0

Latest Financial Commitments:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Outright Loans				
RFI	Apr. 10, 2021	N/A	139.3	139.3
Arrangements				
EFF	Feb. 28, 2014	Feb. 24, 2017	295.42	295.42
ECF[1]	Feb. 1, 2006	Jan. 31, 2009	8.52	8.52
EFF	Feb. 1, 2006	Jan. 31, 2009	8.52	8.52

Projected Payments to Fund:

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

	Forthcoming					
	2021	2022	2023	2024	2025	2026
Principal	6.76	49.24	84.06	114.96	69.88	21.52
Charges/Interest	1.67	5.41	3.36	1.73	0.61	0.17
Total	8.43	54.7	87.4	116.7	70.5	21.7

[1] Formerly PRGF.

Safeguards Assessments. An update safeguards assessment mission in connection with the Rapid Financing Instrument approved in April 2020 is conducted remotely during November 8-19. The last safeguards assessment of the Bank of Albania (BoA) was completed in June 2014 and a monitoring report was completed in August 2015. Except for proposed legal reforms to align the BoA law with leading practices, all safeguards recommendations from the 2014 and 2015 reports have been implemented. In particular, the audit and control oversight were strengthened through the establishment of an Audit Committee in 2015, and internal audit resumed operations. The BoA's financial statements are prepared and audited under international standards and the results are published.

Exchange Rate Arrangement: On July 1, 1992 the Albanian authorities adopted a floating exchange rate system. The *de jure* exchange rate system is classified as free floating, while the *de facto* exchange rate arrangement is floating, with the monetary authorities occasionally intervening in the foreign exchange market to accumulate reserves and avoid excessive disruptions in the functioning of the market. On February 21, 2015, Albania accepted the obligations under Article VIII, Sections 2(a), 3, and 4, but continues to maintain an exchange restriction in the form of outstanding debit balances on inoperative bilateral payment agreements with two IMF member countries. Those debit balances were in place before Albania became a Fund member in 1991 and relate to debt in nonconvertible and formerly nonconvertible currencies. Unfortunately, no agreement has been reached with the counterparties. The exchange rate stood at lek 122.30 per U.S. dollar on October 27, 2021.

Article IV Consultation: The 2018 Article IV consultation was concluded on January 23, 2019 (IMF Country Report No. 19/29).

FSAP Participation, ROSCs: The most recent FSAP was carried out in November 2013 (with a Board date of February 28, 2014). 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 enhanced General Data Dissemination System (e-GDDS), and a complete set of e-GDDS data with accompanying metadata for the external, financial, fiscal, and real sectors, as well as for the socio-demographic indicators, is posted on Albania's National Summary Data Page, which can be found 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.

AML/CFT assessment:
Two enhanced follow-up reports have been conducted after the Mutual Evaluation Report by the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval) was adopted in July 2018, which assessed Albania's AML/CFT framework against the 2012 Financial Action Task Force (FATF) standards. The latest enhanced follow-up report was completed in April 2021 and maintained Albania under enhanced monitoring (FATF's "grey list") owing to continuing concerns about its AML/CFT framework and its effectiveness. An action plan has been agreed with the Albanian authorities to attain full technical compliance and exit the grey list, including by aligning the national AML/CFT legislative framework with EU AML/CFT Directives

and revisiting the law related to virtual assets and virtual asset service providers in light of updated FATF standards.

Technical Assistance: The Fund, other multilateral organizations, and donors have provided extensive technical assistance for institutional development in Albania. The Fund has sent multiple technical assistance missions to Albania every year since 1991. The extent and focus of Fund TA since FY 2016 are briefly summarized below in Table 1.

Resident Representative: Ms. Eble from the regional office for the Western Balkans took her post on June 14, 2019 and oversees Albania's local office.

Table 1. Albania: Technical Assistance Since FY2016		
Department	**Purpose (V=Virtual)**	**Date**
FAD	Tax Administration	Multiple (nearly monthly) visits in 2018
	Revenue Administration	May 2021 (V), November 2021 (V)
	Public Financial Management	March-April 2016, July 2016, September 2016, October 2016, March 2017, September 2017, October-November 2017 December 2018, April 2019, May 2019, June 2019, November 2019, May 2020 (V), June 2020 (V), December 2020 (V), May 2021 (V), September 2021 (V), October 2021 (V), November 2021 (V)
	Tax Policy	June 2015, September 2016, September 2017; October 2017, June 2018, September 2018, January 2021 (V), October 2021 (V)
	Fiscal Transparency Evaluation	June 2015
LEG	Tax Law	March 2015, May 2015, June 2018, November-December 2018
	AML/CFT Measures Related to VA and VASPs	March 2021 (V), June 2021 (V)
	NPL Resolution	April 2015
MCM	IFRS 9 Implementation and capital structure review	February 2017 January 2018, November 2018
	Regulatory Framework for Investment Funds	
	NPL Resolution	November 2015
	Central Bank Accounting and Official Foreign Exchange Transactions	October 2018
	Banking Supervision and Regulation	July 2015, May 2018
	Long-Term Resident Advisor on Monetary Policy	September 2015-August 2018
	Financial Stability, systemic risk analysis	April 2018, November 2018

Table 1. Albania: Technical Assistance Since FY2016 (concluded)		
Department	**Purpose (V=Virtual)**	**Date**
	Financial management and accounting policy framework	September 2018
	Monetary Policy Design and Implementation	January 2016, September 2016, December 2016, February 2017, September 2017, September 2018
	Long-Term Resident Advisor on Banking Supervision and Financial Stability	September 2017- July 2020
	Foreign Exchange Market Development	December 2019
	Crypto Asset Regulatory Framework	May 2021 (V)
STA	Price Statistics	
	External Sector Statistics	January 2016, April-May 2017
	Government Finance Statistics	May 2015, May-June 2016, November 2016, May 2017, June 2017, September 2017, April 2018, May 2018, November 2018, April 2019, May 2019, June 2019, July 2020 (V), June 2021 (V), Sept-Oct 2021 (V)
	National Accounts Statistics	May 2015, April 2017, September 2017, March 2018, November 2019
	Enhanced General Data Dissemination System	April 2017
	Monetary and Financial Statistics	July 2017, April 2019

STATISTICAL ISSUES

(As of October 30, 2021)

I. 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 and weak inter-institutional cooperation between government agencies.
National accounts: National accounts compilation has been improving in the last few years and is now generally compliant with the System of National Accounts 2008 and the European System of Accounts 2010. However, there is still room for further improving methodologies and compilation techniques, especially regarding GDP estimates by the expenditure approach. Better source data would significantly enhance national accounts estimates. Although formal agreements for sharing data among government agencies have been signed, in some cases the cooperation needs to be more effective. Very ambitious objectives combined with severe resource constraints at INSTAT complicate improvements in basic indicators. Currently, quarterly GDP estimates are released with a lag of 90 days and the first annual estimates are published around 15 months after year-end. Data are subject to large revisions and there are significant discrepancies between the aggregated quarterly estimates and the annual national accounts results, due to differences in compilation methods, and between the GDP compilation by the expenditure and by the production approach. In May 2018, INSTAT published the first two non-financial institutional sector accounts for the years 2013–2015. **Labor statistics:** The Labor Force Survey (LFS) is of insufficient quality. The treatment of agricultural employment needs to improve, as currently all individuals that own agricultural land are considered self-employed by the survey. Various shortcomings in the LFS lead to lack of reliable income and wage indicators. Poverty data are available with a substantial lag, compared to other CESEE countries. **Price statistics:** Compilation generally follows international standards. Since December 2015, INSTAT updates annually the CPI weights using the results of a new national Household Budget Survey. The PPI and construction cost indexes are published on a quarterly basis, due to resource constraints.
Government finance statistics: Fiscal source data are adequate to allow a broad presentation of the Albanian fiscal operations in line with the Government Finance Statistics Manual (GFSM2014), but still does not cover the entire general government. The authorities are working with the assistance of the IMF to improve the coverage of fiscal statistics by adding more extrabudgetary units. The net impact of extra-budgetary units not currently covered in the fiscal statistics is expected to be small. Accounts payable data continue to have some issues, with amounts used for Fund surveillance not being reconciled to values in the financial accounting records or in the STA GFS database. In the meantime, there has been good progress over the last 3 years, including a 6-year time series of comprehensive GFS data and a full balance sheet. Consistency across fiscal surveillance, GFS Yearbook, and other macroeconomic reporting is improving and from October 2021 onwards, INSTAT will produce reports from the same compilation system.
Monetary statistics: The monetary data compilation framework conforms to the methodology recommended in the *Monetary and Financial Statistics Manual (MFSM)*. Data on the central bank, other depository corporations (ODCs), and other financial corporations (OFCs) are comprehensive and provided to STA on a monthly basis (quarterly for OFCs) using the standardized reporting forms.

Financial sector statistics: Albania reports to STA for publication on the IMF's website all core financial soundness indicators (FSIs) and twelve encouraged FSIs on a monthly basis. Coverage of FSIs for nonfinancial corporations sector, and households sector need to be improved as FSIs for these sectors are not reported to STA.
External sector statistics (ESS): Balance of Payments and International Investment Position (IIP) data are compiled by the BoA with a time lag of less than 90 days and are methodologically sound. Compilation is based on the *Balance of Payments Manual, sixth edition (BPM6)* and the *European System of National and Regional Accounts (ESA 2010)* methodological framework. The implementation of IMF's technical assistance recommendations on ESS have improved the measurement of compensation of employees and remittances, facilitated compilation of the quarterly international investment position statistics (IIP), supplementary IIP data (currency composition of debt assets and liabilities), and the Reserves Data Template. Albania also participates in the IMF's Coordinated Portfolio Investment Survey (CPIS) and Coordinated Direct Investment Survey (CDIS). Challenges remain in the measurement of remittances, some financial account transactions outside the banking system, and foreign assistance (data on grants from abroad not channeled through the central government are fragmented and require consolidation). The external debt database ensures timely and accurate reporting of external public debt data (including commitments of state-owned enterprises) to the Quarterly External Debt Statistics (QEDS) database.

II. Data Standards and Quality	
Albania participates in the Enhanced General Data Dissemination System (e-GDDS). The country published a National Summary Data Page in June 2017: http://instat.gov.al:8080/NSDPAlbania/.	Data ROSC published in October 2006: https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Albania-Report-on-the-Observance-of-Standards-and-Codes-Data-Module-Response-by-the-20059.

Table 1. Albania: Table of Common Indicators Required for Surveillance
(As of November 4, 2021)

	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]	Memo Items: Data Quality – Accuracy and Reliability[9]
Exchange Rates	11/04/2021	11/04/2021	D	D	D		
International Reserve Assets and Liabilities of the Monetary Authorities[1]	09/30/2021	10/16/2021	M	M	M		
Reserve/Base Money	09/30/2021	10/16/2021	M	M	M	O, O, O, LO	O, LO, LO, O, O
Broad Money	09/30/2021	11/04/2021	M	M	M		
Central Bank Balance Sheet	09/30/2021	11/04/2021	M	M	M		
Consolidated Balance Sheet of the Banking System	09/30/2021	11/04/2021	M	M	M		
Interest Rates[2]	09/30/2021	11/04/2021	M	M	M		
Consumer Price Index	09/21	11/10/2021	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3] – General Government[4]	2020	09/29/2021	A	A	A	LO, O, O, O	LO, O, O, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3] – Central Government	2020	09/29/2021	A	A	A		

Table 1. Albania: Table of Common Indicators Required for Surveillance (concluded)
(As of November 4, 2021)

	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]	Memo Items: Data Quality – Accuracy and Reliability[9]
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2020	09/29/2021	A	A	A		
External Current Account Balance	2021 Q2	09/14/2021	Q	Q	Q	O, O, O, LO	LNO, O, LO, LO, O
Exports and Imports of Goods and Services	2021 Q2	09/14/2021	Q	Q	Q		
GDP/GNP	2021 Q2	05/15/2021	Q	Q	Q	O, LNO, O, LO	LNO, O, LNO, LO, LO
Gross External Debt	2021 Q3	12/10/2021	Q	Q	Q		
International Investment position[6]	2021 Q2	09/27/2021	Q	Q	Q		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should include 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, and 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. It also includes the explicit guarantees granted by the central government.

[5] Includes currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annual (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.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL ORGANIZATIONS

As of October 30, 2021, Albania collaborates with the World Bank Group, the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the Council of Europe Development Bank. Further information can be obtained from the following hyperlinks.

https://www.worldbank.org/en/country/albania

https://www.ebrd.com/cs/Satellite?c=Page&cid=1395236446640&d=Mobile&pagename=EBRD%2FPage%2FCountry

http://www.eib.org/en/projects/regions/enlargement/the-western-balkans/albania/index.htm

https://coebank.org/en/about/member-countries/albania/

Statement by Mr. Domenico Fanizza, Executive Director for Albania and Ms. Laura Cerami, Advisor to the Executive Director
December 6, 2021

On behalf of our Albanian authorities, we thank staff for their continued engagement throughout the pandemic and for the open and constructive dialogue during this year's Article IV Consultation discussions. The authorities continue to appreciate and greatly value staff's insightful analysis, technical assistance, and policy advice and are keen to implement Fund's recommendations to strengthen Albania's macroeconomic resilience and accelerate convergence to European living standards.

I. Economic Developments During the Pandemic and the Outlook

The Albanian economy has been remarkably resilient in the face of the twin and consecutive shocks of the November 2019 earthquake followed by the outbreak of the COVID pandemic. A prompt, comprehensive, and flexible policy response to the health emergency along with external financial assistance, including by the Fund through the Rapid Financing Instrument (RFI), have helped mitigate the impact on the population and the economy and prepare the ground for a swift and robust recovery.

After contracting by only 4 per cent in 2020, the economy is projected to rebound by around 8 per cent this year. The recession resulted much milder than both anticipated by staff and experienced by most regional peers; **the ongoing recovery has gained strength and broadened** beyond the service sector, that was hit hardest by the pandemic-related containment measures. The rebound has been driven by the post-earthquake reconstruction, strong energy production, and a better-than-expected tourism season. Rising service exports and continued capital inflows have contributed to improving the external position and to a moderate exchange rate appreciation. **The labor market has fared well**, with employment and participation gradually returning to pre-pandemic levels and wages edging up. **Inflationary pressures have remained contained** despite recent increases in food and energy prices and continued monetary accommodation.

The authorities are fully aware of the high uncertainty hovering around the near-term outlook, mainly because of new waves of the pandemic and higher energy prices; they stand ready to adjust their policy response to preserve the strong momentum and rebuild policy buffers as soon as conditions allow. Furthermore, after securing a new mandate, the government is well positioned and determined to advance high-priority reforms, which will steer the economy to a more sustained, sustainable, and inclusive growth path over the medium-to-long term.

II. Fiscal Policy

The recession together with the cost of dealing with the health and economic emergencies had an adverse impact on public finances in 2020. The overall deficit widened to 6.8 per cent (from 2.0%) and the public debt to GDP ratio increased by 10 percentage points to 77.2 per cent. Amidst high uncertainty over the course of the pandemic and rising energy prices, the government has maintained an expansionary stance, through repeated budget revisions in response to growing social and capital expenditure needs, leaving the projected deficit almost unchanged for 2021.

The authorities concur with staff that the use of normative acts to revise the budget in the course of the fiscal year should be reserved exclusively to emergency circumstances and reaffirm their commitment to the ordinary parliamentary process going forward. **They are also committed to bringing the primary balance into equilibrium by 2024 and keeping it unchanged thereafter, as established by the Organic Budget Law; as a result, the public debt to GDP ratio would decline steadily over time.** To this end, the 2022 budget foresees a reduction of the primary deficit to 2.7 per cent, supported by both rising revenues as the economy firms up and a gradual tapering of economic support measures and capital expenditure.

The authorities strongly believe that a more front-loaded fiscal adjustment, as recommended by staff, might weaken the robust but highly uncertain economic momentum, and unduly restrict their ability to support the vulnerable population, strengthen social protection, and close the still large infrastructure gaps. They believe that the envisaged **Eurobond issuance for 700 million euro** by the end of the year will provide ample fiscal buffers for next year. Thet also intend to use the **2021 SDR allocation** for contingent spending.

At the same time, the authorities agree with staff on the need to continue strengthening revenue mobilization and improving the efficiency of spending; they are keen to advance the necessary fiscal reforms swiftly and decisively by leveraging on past and ongoing Fund's technical assistance. They highlight the recent progress in cash debt management, most notably the operationalization of an **improved reporting system for arrears and the clearance of those related to VAT refunds** by the end of 2021, as testament to their determination to advancing fiscal reforms notwithstanding limited resources and challenging conditions.

A comprehensive **Medium Term Revenue Strategy (MTRS)** is being developed with Fund's assistance with the aim of raising additional revenue of up to 3 per cent of GDP over four years. The MTRS will strive to remove current loopholes and distortions, while creating a tax system more conducive to business and, in particular, SMEs development. The authorities are equally committed to: a) strengthening public investment management by implementing the outstanding recommendations from the 2016 **Public Investment Management Assessment (PIMA)**; and b) managing the fiscal risks from Public Private Partnerships (PPP), which have been covered by an annual **PPP monitoring report** since 2019. Finally, further reforms would improve **fiscal transparency and accountability**, following the establishment of the public registry of beneficial ownership and the publication of the Supreme Audit Institution's (SAI) audit of earthquake and pandemic-related spending.

III. Monetary and Financial Sector Policies

The Bank of Albania (BOA) has maintained a highly **accommodative monetary stance** since the outbreak of the pandemic, keeping the policy interest rate at the historical low level of 0.5 per cent and providing unlimited liquidity to banks. While the unlimited liquidity provision is envisaged to end in the first quarter of 2022, reflecting lower banks refinancing needs, the BOA intends to pursue its accommodative monetary policy stance **as long as inflationary pressures remain subdued and inflation expectations well anchored**.

The BOA strongly supports the **flexibility of the lek and adequate foreign reserves** as key shock absorbers. The BOA will intervene in the foreign exchange market only to contain excessive volatility and build the needed reserves. It will also continue to promote the de-euroization of the credits and deposits to further improve the effectiveness of its monetary policy.

The **banking system** is supporting the economic recovery by supplying credit both to businesses and households, while remaining **adequately capitalized and liquid**, and with no discernible impact on non-performing loans (NPLs). As financial vulnerabilities might materialize only after the emergency regulatory measures expire, the BOA will closely monitor banks' asset quality; it stands ready to conduct thorough asset quality reviews on a case-by-case basis and take remedial action to restore adequate capital buffers, if needed.

IV. Post Financing Assessment and the Way Ahead

The authorities welcome and fully share staff's assessment that Albania's capacity to repay the Fund remains adequate and that risks are contained and manageable. They are determined to build on the favorable economic and political momentum to advance their structural reform agenda focused on completing the judicial reform, strengthening the anticorruption and the AML/CFT frameworks, and improving business conditions, thereby fostering confidence and trust among official partners and investors and meeting Albania's development needs.

The financial authorities are fully aware that **exiting the FATF's grey list is of utmost importance** to safeguard financial stability and integrity within and beyond the banking sector, including the nascent virtual assets industry. To this end, they are making significant progress in strengthening and enforcing the AML/CFT framework, as also acknowledged by the latest MONEYVAL report.

The authorities wish to thank Fund's staff for the constructive engagement during the safeguard assessment of the BOA's institutional set-up and practices, conducted in November 2021.