

**Albania: Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under the Extended Arrangement, and Financing Assurances Review—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Albania**

In the context of the sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility, review under the extended arrangement, and financing assurances review for Albania, the following documents have been released and are included in this package:

- The staff report for the Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under the Extended Arrangement, and Financing Assurances Review, prepared by a staff team of the IMF, following discussions that ended on November 12, 2008, 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 January 8, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of January 28, 2009, updating information on recent developments.
- A Press Release summarizing the views of the Executive Board as expressed during its January 28, 2009 discussion of the staff report that completed the review.
- A statement by the Executive Director for Albania.

The document listed below has been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Albania\*

\*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

ALBANIA

**Sixth Review Under the Three Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, and Financing Assurances Review**

Prepared by the European Department

(In consultation with other departments)

Approved by Poul M. Thomsen and Patricia Alonso-Gamo

January 8, 2009

**Executive Summary**

**Albania has recorded a strong track record under the program and is joining the middle-income group.** Over the program period, the economy has achieved robust non-inflationary growth, albeit with increasing external imbalances, and has begun to tackle longstanding problems in the business environment.

**The end of the PRGF-EFF program falls in challenging times.** The external environment is deteriorating sharply and previously high inflows into the banking system have slumped. Remaining structural problems in the utility sector, and elevated public debt aggravate vulnerabilities. Meanwhile, the upcoming elections risk diverting policy makers' attention from stability-oriented policies.

**Policy discussions focused on strengthening fundamentals in the short run.** While the medium-term outlook remains broadly favorable, the 2009 budget must buttress the economy's defenses by lowering the deficit to 3.9 percent of GDP, inter alia, through delaying planned social security contribution cuts and bringing wholesale electricity tariffs to cost-recovery levels. Despite significant buffers and inbuilt strengths of the financial sector, continued diligent supervision, high-frequency monitoring, and enhanced cooperation with foreign supervisors of resident banks will be needed to underpin prompt, proactive responses to changing circumstances. Over the medium term, a clear fiscal rule should be adopted and informality combated through greater reliance on self-enforcement incentives.

**Based on the satisfactory performance and the authorities' commitments, staff recommends completion of the sixth and final review.**

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## I. INTRODUCTION

1. **Albania registered considerable progress under the PRGF-EFF arrangement** (Box 1). Based on generally sound economic policies, Albania has over the last three years capitalized on strong global growth and buoyant capital flows, recording robust growth along with low inflation, and joining the middle-income country group (Figure 1). Efforts to tackle governance issues also advanced and international assessments of the business environment have improved (Figure 2).

### Box 1. Albania's Third PRGF/EFF-Supported Program: Objectives and Achievements

**The program aimed at further advancing Albania's transition** by maintaining low and stable inflation, while containing external and financial stability risks; enhancing government solvency through improved revenues and lower public debt; and increasing growth potential, strengthening economic institutions, and boosting private sector activities through financial development, electricity sector reform and privatization in strategic sectors.

**To a large extent, many of these objectives were achieved.** Growth and inflation especially have been in line with the program (table). Revenue administration and public debt management were strengthened—tax revenue increased by over 2 percentage point of GDP notwithstanding a lowering of corporate and personal income tax rates—and the average maturity of public debt rose from 224 to 445 days. In the financial sector, the supervisory and regulatory regimes were considerably enhanced. Most strategic privatizations have been completed.

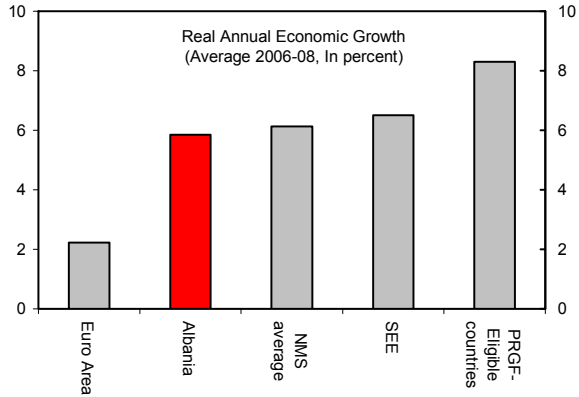
**But external imbalances grew, and electricity reform fell short.** Both the private and public sectors tapped into buoyant external conditions to smooth consumption and boost investment. Repeated attempts to tackle electricity sector problems have been frustrated, reflecting deeply entrenched structural and political impediments.

Albania: Original Program and Outturn, 2006–08

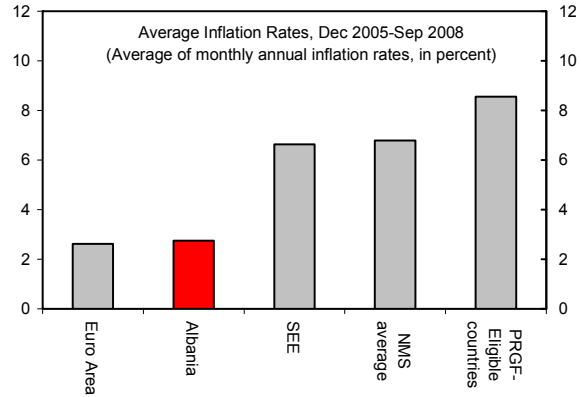
	Original program projections			Outcomes		
	2006	2007	2008	2006	2007	2008
	Proj.	Proj.	Proj.			Est.
	(Percent of GDP unless otherwise indicated)					
Real GDP growth (percent)	5.0	6.0	6.0	5.5	6.0	6.0
CPI inflation (end-period)	3.0	3.0	3.0	2.5	3.1	2.9
Overall balance (including grants)	-4.1	-3.5	-3.4	-3.2	-3.8	-5.2
Fiscal revenues and grants	24.6	24.7	24.7	25.3	25.3	27.5
Expenditures	28.7	28.2	28.0	28.6	29.2	32.7
Net domestic borrowing	2.6	2.5	2.4	2.3	1.7	0.0
Current account balance (including official transfers)	-6.7	-5.9	-5.7	-7.3	-10.1	-11.8
Public Debt	55.0	54.5	53.6	56.0	52.8	52.6
Domestic	38.1	37.4	36.6	39.1	37.4	34.4
External (including publicly guaranteed)	17.0	17.0	17.0	16.9	15.5	18.2
Broad money growth (percent)	12.0	12.0	12.7	16.3	13.7	6.3
Private credit growth (percent)	43.2	35.3	29.6	57.2	48.2	25.1
Gross international reserves (in millions of Euros)	1,225	1,329	1,483	1,359	1,467	1,666
(in months of imports of goods and services)	4.1	4.1	4.1	3.8	3.7	4.3

Figure 1. Comparative Economic Performance Over the Program Period, 2006-08

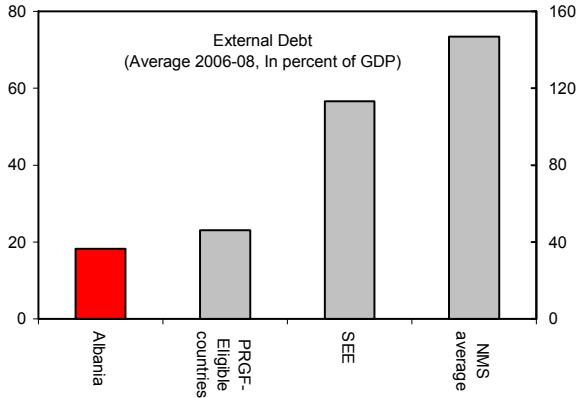
Over the program period, Albania maintained strong growth...



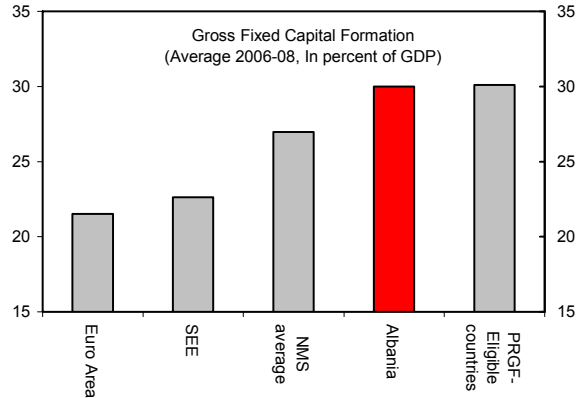
...price stability...



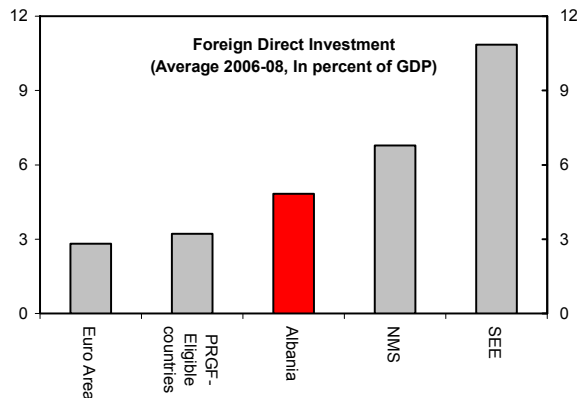
...and low external debt.



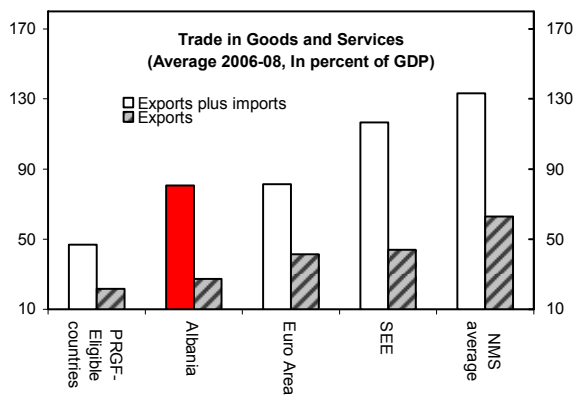
This performance was underpinned by strong investment.



Foreign investment has been at moderate levels.

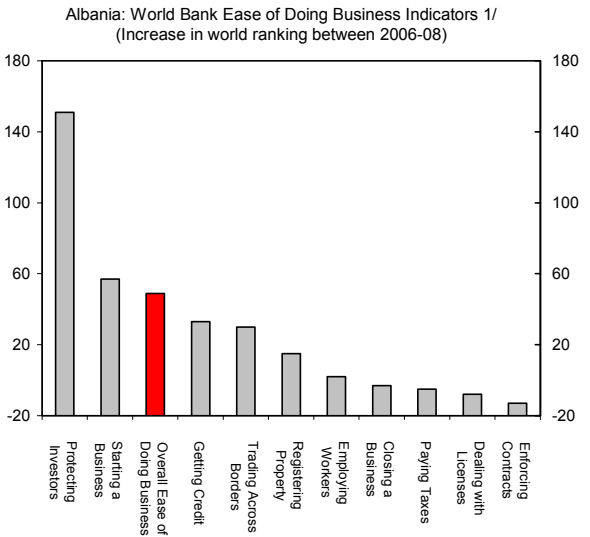
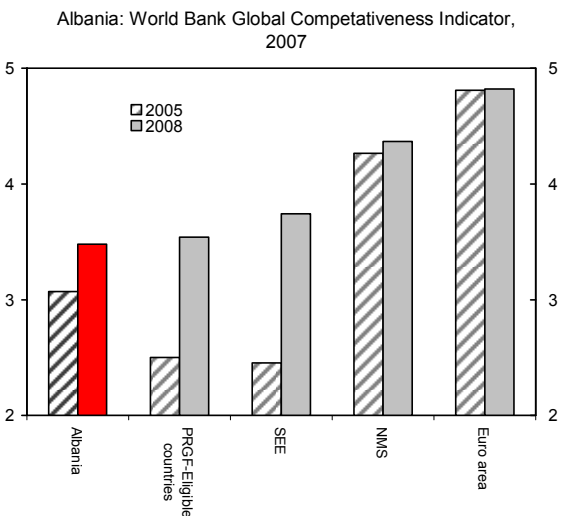
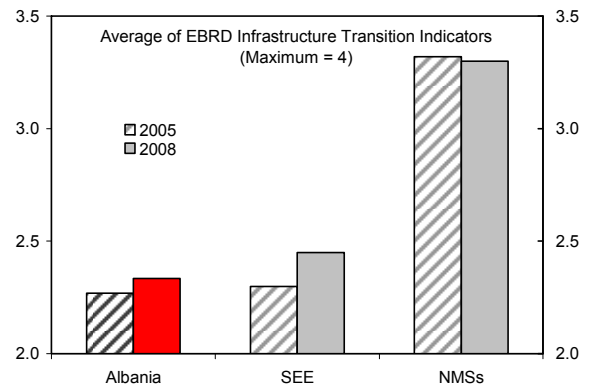
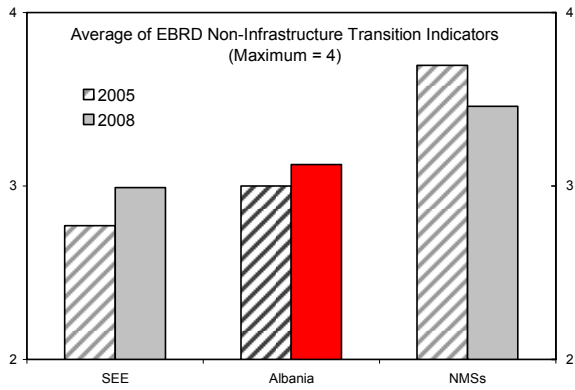
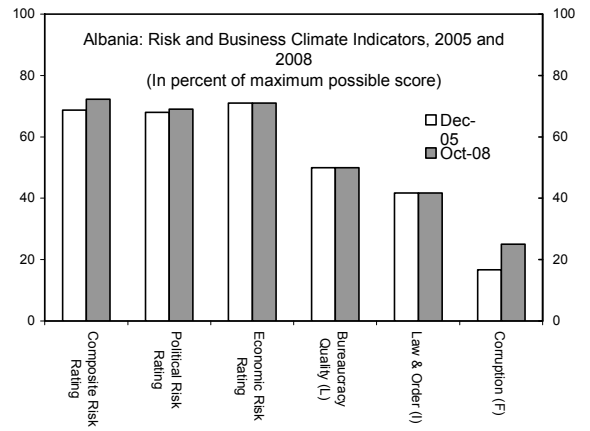
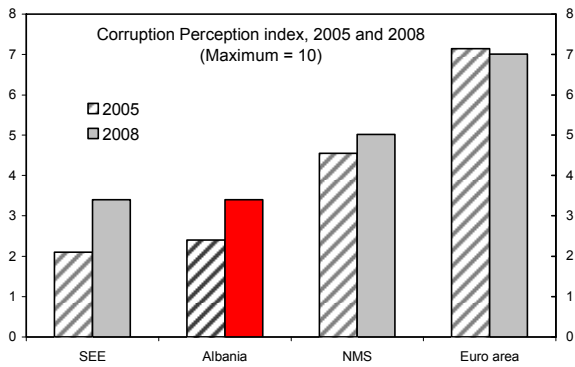


...reflecting and contributing to a relatively low level of integration into the global economy.



Sources: IFS and WEO data.

Figure 2. Albania: Business Climate Indicators, December 2005-October 2008  
(Higher values indicate improvement)



Source: Transparency International, the World Bank Group, the PRS Group, and EBRD.  
1/ Higher values indicate improvement.

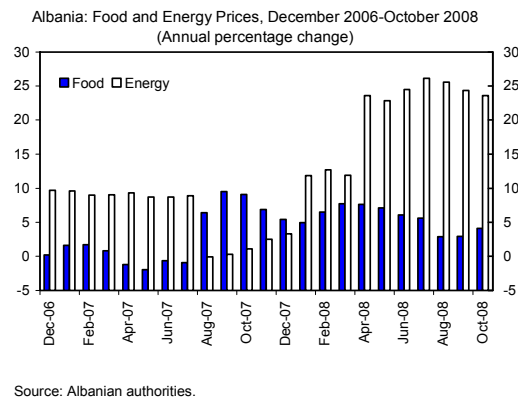
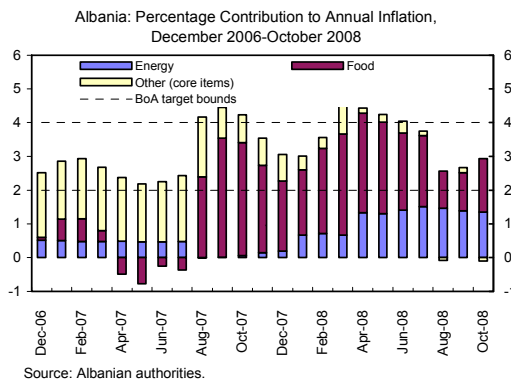
2. **However vulnerabilities built up and Fund program support is ending amid unfavorable domestic and international conditions.** Chronic and longstanding power sector problems have not yet been sufficiently tackled. The current account deficit has risen sharply and public debt remains at elevated levels, while the global outlook has severely deteriorated and the economy is beginning to register the fallout from international financial tremors. In this more challenging setting, the mid-2009 elections are already claiming policy makers' attention.

3. **Policy discussions thus focused on ways to sustain, extend, and build on past policy success in more challenging conditions.**

## II. BACKGROUND AND RECENT DEVELOPMENTS

4. **Macroeconomic trends in 2008 were in line with the program:**

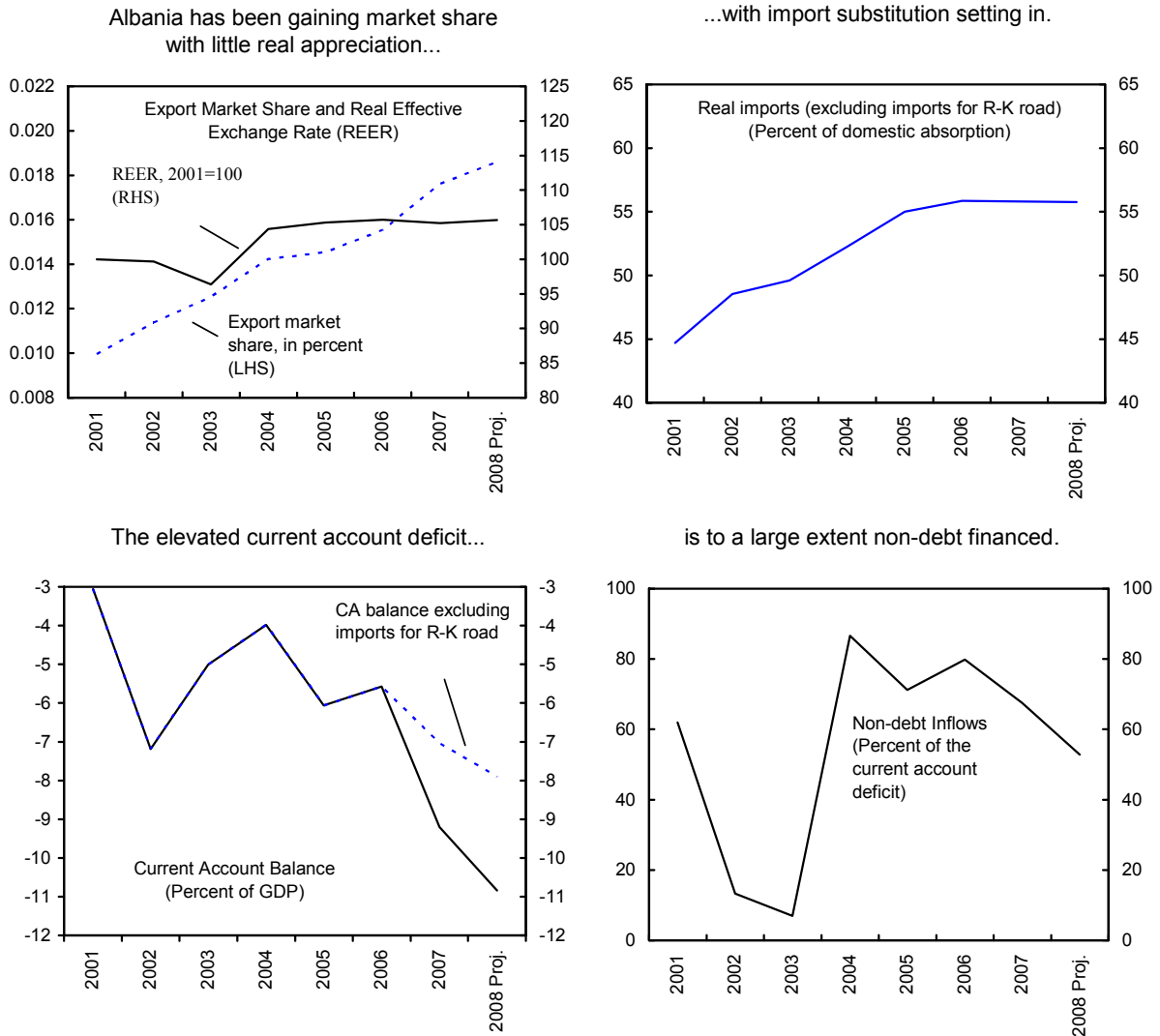
- **Growth was buoyant, while inflation returned to target.** High-frequency indicators consistently pegged growth stronger than 6 percent through the first half of the year. After being pushed slightly above the BoA's  $3\pm 1$  target range during March-June 2008, inflation returned to the target band in July 2008, as food prices eased (Table 1). Throughout, inflationary expectations were contained.



- **The current account deficit has deteriorated, though by less than indicated by the headline figure.** The almost 2 percentage points increase to 10.8 percent of GDP primarily reflects higher food and fuel import prices through the early part of the year and the scaling up of the import-intensive Rreshen-Kalimash (RK) road (Tables 2 and 3). However, underlying trends are sounder (Figure 3) and the temporary increase is fully financed by privatization revenue and RK-related loan disbursements.

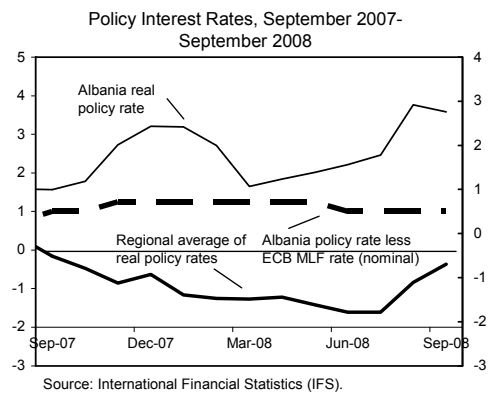


Figure 3. Albania: External Sector Indicators, 2001-08



## 5. Policy implementation has generally proceeded in line with program undertakings.

- Macroeconomic policies were kept tight.** Strong revenue growth and slow execution of some investment spending have held the budget in surplus for much of the year. Meanwhile real policy interest rates were significantly positive (chart). Together with a tightening of



prudential and supervisory regulations—importantly pertaining to foreign-currency denominated lending—this has helped to strengthen liquidity buffers in the banking system (Tables 4 and 5).

- **Conditionality was mostly observed.** All quantitative performance criteria for end-September and the indicative revenue target were met (Table 6). Similarly, all structural conditionality was observed, except for the end-October effective electricity collection rate, though the slippage from the target was small—60 percent (excluding payment arrears by water companies that have since been cleared by the budget) compared to the target of 62 percent (Table 7).
- **Broader structural reform progressed.** Since the last review, World Bank, EBRD, and Transparency International assessments depict long-awaited improvements in Albania’s business environment. With the privatizations of the oil company ARMO and the insurance company INSIG, along with the successful tender for the electricity distribution company (OSSH), the strategic privatization program is approaching a successful conclusion.
- **Progress with settling arrears to non-Paris Club and private creditors has continued.** Arrears to Greek and Swiss companies have been cleared and an agreement for clearance of official arrears to Greece is being finalized. Negotiations on arrears clearance and reconciliation are ongoing with the remaining private and official creditors. Arrears with Korea, Russia, Serbia, and Cuba are expected to be regularized in the near term.

6. **Meanwhile, the impact from global financial turmoil is beginning to be felt in Albania.** Reduced investor appetite for emerging market debt has resulted in the delay of the planned debut eurobond. Moreover, bank deposits began to be withdrawn in the wake of the October 2008 global financial turmoil and concerns about the health of regional banking systems that triggered increases in deposit insurance levels elsewhere. Between end-September and mid-December 2008, 8 percent of banking system deposits were withdrawn and are only gradually returning. While prudent past supervisory policies endowed banks with large liquidity buffers that helped meet withdrawal requests without systemic strain, banks’ foreign exchange liquidity has been draining, while financial conditions tightened and several subsequent government debt auctions were significantly undersubscribed. The BoA reacted quickly in boosting banking system liquidity.

### III. REPORT ON THE DISCUSSIONS

7. **Discussions centered on outstanding policy commitments and short-term actions needed to boost fundamentals and anchor policy following the expiration of the PRGF-EFF arrangement.** While the authorities saw potential merit in a precautionary Stand-By

Arrangement, on balance, they considered that the baseline scenario did not call for this approach.

### A. Macroeconomic Outlook

8. **Within a broadly still favorable medium-term outlook, there was disagreement about the extent to which the worse-than-previously-projected international outlook would affect Albania in 2009.**

- All agreed on a benign inflation outlook and an underlying **baseline scenario** where an improved business environment and prudent macroeconomic policies resulted in rapid productivity growth, which in turn permitted an orderly unwinding of imbalances and a soft landing over the medium term. In addition to improvements in competitiveness, the reversal of temporary factors was expected to quickly lower the current account deficit by some 3 and 1 percentage points of GDP in 2009 and 2010, respectively.
- For **2009**, the authorities considered that growth was unlikely to slow much from last year's 6 percent pace, noting evidence of strong underlying domestic activity and Albania's still limited integration into global markets. Staff allowed for these factors, but still projected growth to slow to 3.7 percent due to adverse spillovers in remittances, exports, and tighter domestic financial conditions. While at the time of the discussions, the projection risks were considered broadly balanced, they have since clearly tilted to the downside.

### B. Fiscal Policy

9. **Fiscal policy discussions centered on the need to trim near-term budgetary financing needs** (Tables 8 and 9). The financing environment was seen to be tighter going forward, posing rollover risk and raising the possibility of significant crowding out of the private sector. Accordingly, it was agreed to fortify the budget in the near term:

- **The 2008 budget would meet new spending requirements through another reallocation.** Cost overruns on the RK road and renewed arrears of the water companies would be met from shortfalls in other areas of the capital budget within the programmed deficit of 5.2 percent of GDP.
- **For 2009, the budget deficit should not exceed 3.9 percent of GDP.** While sharply lower than the projected 2008 deficit, and implying a tighter fiscal stance, this was seen as providing sufficient room for public investment—including the finalization of the RK road. Even so, this would require government to raise almost 2½ percent of GDP in domestic financing (up from essentially zero in 2008) in a very challenging market environment. Against this background and given heightened uncertainty, the authorities also included contingency reserves of 1.9 percent of GDP.

Adjustment of the fiscal balance for the effect of the large road project  
In percent of GDP

	2006	2007	2008	2009
Overall fiscal balance	-3.2	-3.8	-5.2	-3.9
Spending on R-K road	1.0	1.8	2.9	3.2
import content (80%)	0.8	1.4	2.3	2.6
Adjusted fiscal balance 1/	-2.4	-2.4	-2.9	-1.3
Capital expenditure	5.6	5.8	8.1	5.9
Non-road capital expenditure	4.6	4.1	5.2	2.8

Source: Albanian authorities; and IMF staff estimates.

1/ Adjusted to exclude external domestic demand component from road spending.

- **The budget needed to be shored up in early 2009, when financing pressures would be most acute.** Measures include an increase in the wholesale electricity tariff to prevent power sector quasi-fiscal losses, and a delay from January to May in the planned cut in the employer social security contribution rate, for which the authorities saw some room given the large growth in contributions over 2008 resulting from their efforts to raise the number of payers. Especially the latter measure was contentious (Box 2), and only agreed after no other measures to offset the implied loss in revenue could be identified.

10. **Looking ahead, staff's advocacy for a clear and credible fiscal rule to help maintain fiscal discipline and anchor expectations was accepted, but plans remain at a preliminary stage.** The existing fiscal rules—mandating current balance and limiting debt to 60 percent of GDP—are not binding. The authorities have yet to decide between an expenditure- or deficit-based rule. They saw the former as more likely to preserve small government—a feature of Albania's past success—and give greater play for automatic stabilizers, while a deficit-based rule would place greater emphasis on maintaining advances in revenue administration and promoting fiscal consolidation. On balance, staff expressed a preference for an expenditure rule, but urged that any eventual rule contain a “debt-brake” mechanism that would require slippages to be recovered in subsequent periods.

### C. Monetary Policy and Financial Stability

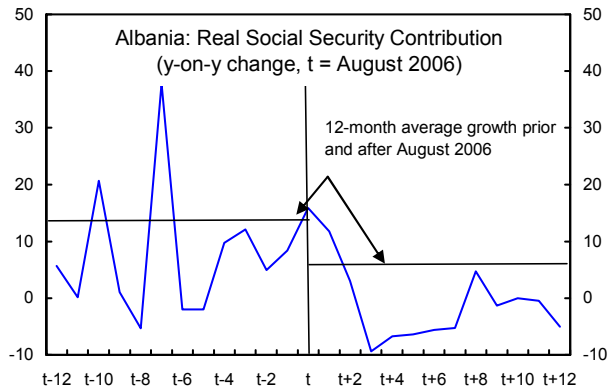
11. **It was agreed that the monetary policy framework—an inflation target range combined with a flexible exchange rate—was an asset in current conditions.** It has endowed the economy with considerable resilience, as evidenced recently by the global

## Box 2: Pension Reform and Combating Informality

**Recent attempts to lower tax evasion have heavily relied on complex presumptive assessments.** Tax authorities have introduced sectorally differentiated wage and employment reference values at which companies' minimum tax obligations are assessed. Staff has advised against these, noting their complex nature, wide scope for discretion, and potential to harm economic efficiency.

**To promote more self-compliance, the authorities plan to cut employer pension contributions.** They considered that eliminating the differential between the contribution rate and the 10 percent company income tax (CIT) rate would reduce the incentive for firms to hide their operations from taxes, as all social security payments could be offset by lower profit tax (CIT) liability. (With contribution rates in excess of CIT rates, payments on the former exceed the permissible CIT deduction). With employer contributions at 15.95 percent and the CIT rate at 10 percent, the plan was thus to cut contributions by 5 percentage points.

**Staff were skeptical on both theoretical and empirical grounds.** While cutting employers' contribution rates could mitigate evasion, it would be unlikely to remove the incentive to evade, but would risk substantial revenue loss. Registering workers would not only allow employers to deduct labor costs from profits, but would also force them to begin withholding wage and social security taxes from workers—resulting in an immediate reduction of take-home wages. Under the reasonable assumption that labor supply is not perfectly inelastic, workers would then demand compensatory wage increases, thus negating the incentive for compliance from a lower social security rate. In support of its analysis, staff pointed to a previous cut in employer contributions in 2006 (from 23.5 to 15.95 percent) that resulted in significant revenue losses in real terms.



Source: Albanian authorities.

**A meaningful pension reform could, however, significantly improve incentives for self compliance.** Staff suggested that from a worker's perspective, pension contributions are currently viewed as a tax rather than savings, because of the weak link between contributions and benefits. Comprehensive and credible pension reform that succeeded in changing this perception would make participation in the pension scheme more advantageous than remaining in the informal sector. Substantial incentives for self enforcement could thus be secured, simultaneously enhancing long-term fiscal stability. While the reform could be fairly inexpensive, given Albania's still young population, it would imply fiscal costs, and staff urged the authorities to forego social contribution cuts at the current juncture to preserve the needed fiscal space.

energy and food price shock that Albania was able to weather well, despite being a net importer of both. Inflation expectations remained well anchored. The authorities indicated that they valued the shock absorbing capacity of the flexible exchange rate system.

12. **While current unsettled financial market conditions warranted caution, some room for monetary easing could emerge over 2009.** As interest rate policy also affects the confidence channel and may need to adjust accordingly, predicting the future of interest rates was difficult. However, staff argued that once conditions normalize, scope might exist to cut the policy rate over the course of 2009.<sup>1</sup>

13. **A track record of pro-active supervision and regulation, and still comparatively low integration into global markets provide important buffers for the financial sector** (Figure 4). Albania's financial system compares well within the region and September 2008 core indicators depict a well

capitalized and relatively solvent, liquid, and profitable banking system (Table 10).

Banks have reportedly little or no direct exposure to known international troubled assets or counterparts. The BoA is set up to act as an effective lender of last resort in domestic currency and has established regulations to ensure banks properly hedge foreign currency liabilities.

While the banking system is predominantly foreign owned, contagion risks are mitigated by

a large domestic deposit base which is the main funding source, and less concentration than elsewhere—the largest bank holds just one third of deposits. The potential transmission of financial sector shocks would also be slowed by Albanian businesses' lower reliance on loan financing and the absence of a stock market.

14. **The global financial crisis shifted the balance of risk from slow, but steadily building disequilibria to a sudden loss-of-confidence driven event.** Albania's vulnerabilities stem mainly from its rapid transition gains, as—in response to attendant

Financial Sector Indicators, 2008 1/

	Regulatory Capital to Risk-weighted Assets	Nonperforming Loans to Total Loans	Return on Equity
Moldova	28.7	3.7 2/	24.5
Serbia	27.4	4.8	15.3
<b>Albania</b>	17.3	4.3	16.6
Macedonia, FYR	17.2 2/	9.1 2/	15.8 2/
Montenegro	17.2	3.0	2.6
Turkey	16.9	3.1	19.5
Bosnia and Herzegovina	16.5	3.1	2.0
Croatia	15.9	4.8	10.0
Russia	15.3	2.4	4.8
Estonia	14.8 2/	0.5 2/	30.0 2/
Bulgaria	14.5	2.1	28.6
Ukraine	13.3	13.1	11.4
Romania	13.0	9.7	15.4
Latvia	12.6	0.5	19.5
Slovak Republic	12.4 2/	2.5 2/	16.6 2/
Czech Republic	12.3	2.8	26.0
Poland	11.8 2/	3.1 2/	23.7 2/
Lithuania 3/	10.9 2/	1.0 2/	27.2 2/
Hungary	10.8 2/	2.4 2/	18.1 2/
Albania, percent of median	118	141	96

Sources: National authorities; and IMF staff estimates.

1/ Latest available data available for each country in 2008.

2/ 2007 value.

3/ Data exclude foreign bank branches.

<sup>1</sup> Staff research indicates that the BoA's inflation targeting regime has matured, and can now be well described by an estimated Taylor rule, similar to the one fitting other inflation targeters. Applying the estimated rule to the staff's macroeconomic projections would indicate 50-75 basis points easing potential.

opportunities for consumption smoothing and investment—banks rapidly built up a loan portfolios whose quality is untested. While credit is lower than elsewhere, nonperforming loans have risen. Up until recently, therefore, rapid credit expansion was seen as the most relevant risk to financial sector instability. However, after the deposit drop, and with credit growth set to decelerate sharply, the balance of risk now tilts towards a sudden stop scenario that could be triggered by external contagion or a sharp reassessment of investor sentiment vis-à-vis Albania.

**15. Against this background, discussions centered on how to improve preparedness on several fronts.**

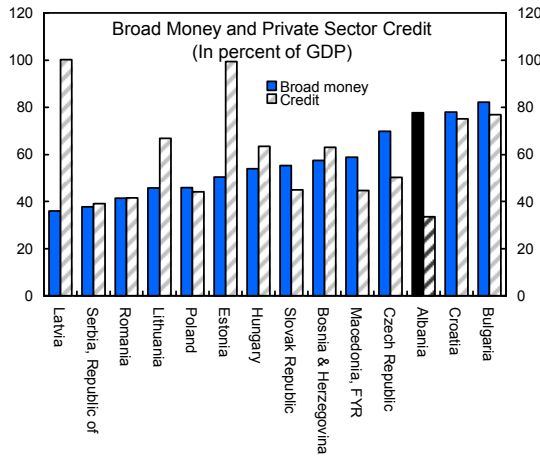
- **Reaching out to and coordinating with foreign supervisors:** Given the preponderance of foreign-owned banks, problems in parents or other regional banking systems could spill over, if only for reputational concerns among depositors. The BoA has stepped up cross-border coordination efforts with regional supervisors and renewed a push to sign MoUs with parent-bank supervisors.
- **Redressing key institutional weaknesses:** The mission pressed for fast adoption of bankruptcy and collateral execution legislation, currently stalled in parliament. It was agreed to secure BoA's solvency by henceforth endowing it with interest paying securities for valuation losses from lek appreciation.
- **Improving supervision and liquidity management tools:** The BoA has significantly improved its ability to gather high frequency data on developments in the banking sector, and has increased the maturity and volumes of liquidity it provides banks through the repurchase market. Broadening eligible collateral for liquidity provision is under consideration. In case of a further worsening of financial conditions, the mission recommended that beyond financing and liquidity provision to address temporary bottlenecks, responses should draw from the full policy arsenal of adjusting interest rates; tightening the budget; and using the flexible exchange rate as a shock absorber.

#### **D. Structural Policies**

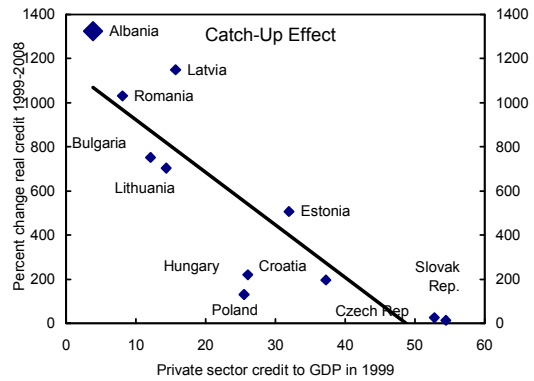
**16. While the privatization of strategic public enterprises is winding down, wider public utility reform is emerging as a sore point.** After the ARMO and INSIG privatizations, the government is seeking to divest its remaining share in a telecom company. However, the expected progress in water utilities under the World Bank reform program has failed to materialize.

Figure 4. Albania: Characteristics of Albanian Banking Sector

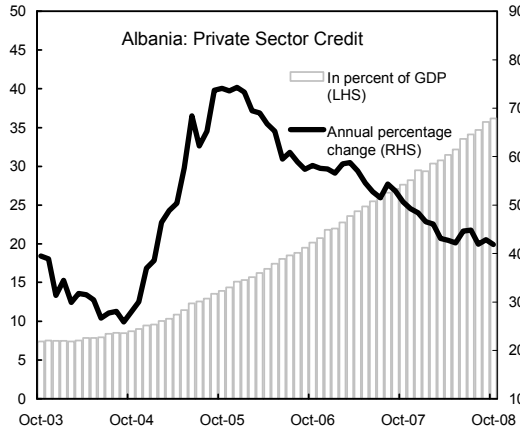
Given the high degree of monetization, financial intermediation in Albania remains well below potential...



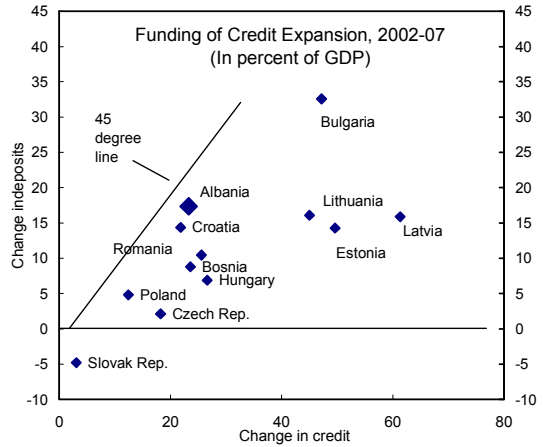
...despite an ongoing catch-up effect.



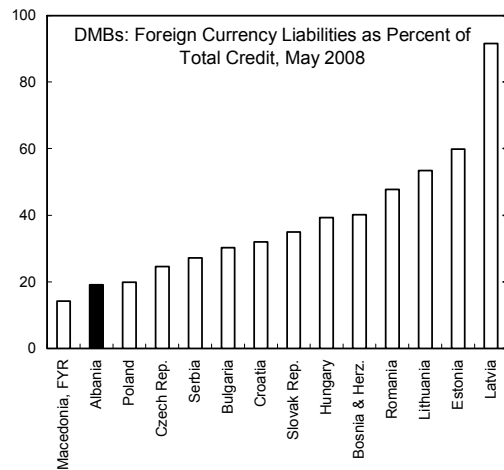
...and rapid credit growth over the last four years.



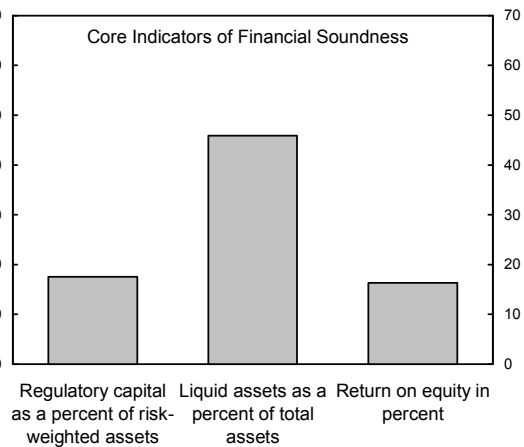
A large proportion of lent funds are generated through deposits...



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



Core indicators pointing to a system that remains solvent, liquid, and profitable.



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



17. **Power sector reform is at a critical point.** Final negotiations with the winning bidder for OSSH are underway, but there was a tacit acceptance of a nontransparent subsidization of the privatization through non-cost covering wholesale supply prices. These would imply financial shortfalls of some 0.7 percent of GDP for KESH—which will remain responsible for power generation and wholesale supply—that the budget would have to cover. The staff insisted on cost-covering wholesale prices, and suggested that the final deal allow instead for lower privatization proceeds and/or a pass-through of higher wholesale prices to consumers.

### **Box 3. Privatization in the Power Sector**

**Unbilled electricity is at the core of KESH's financial problems.** Despite some progress in raising the effective collection rate in 2008, it averaged about 52 percent over the last 7 years, notwithstanding repeated power sector action plans.

**The government decided to privatize the distribution arm of KESH in order to reduce losses and improve service quality.** The distribution arm was unbundled from KESH and incorporated as a separate power distribution system operator (OSSH) in June 2007.

**The winning bidder was a Czech utility—one of the four reputed foreign companies prequalified in June 2008.** It offered €102 million for a 76 percent stake in OSSH, agreed to take over servicing of the company's debt (about €125 million), and plans to invest €200 million over 5 years for upgrading the distribution network. Final negotiations started in November 2008, covering issues such as the compensation for unrealized revenues, the path to target losses of 15 percent in 2014, and the allowance for uncollected bills. The bidder also asked the government for a Partial Risk Guarantee from the World Bank for an amount of €50 million.

18. **Progress has been made on national accounts statistics.** Besides improvements in the annual accounts, quarterly accounts are being prepared—a key requirement for subscribing to the Special Data Dissemination Standard. The authorities appreciated Fund TA and committed to boost resources to implement the recommendations in this area.

## **IV. STAFF APPRAISAL**

19. **Albania is joining the middle-income country group but the envisaged exit from Fund program support is occurring in a challenging setting.** With sound economic policies, Albania was able to capitalize on a buoyant global environment over the last three years, but, as elsewhere in the region, recent global financial turmoil has raised external, fiscal, and financial sector vulnerabilities. Without Fund program support—which has served as a policy anchor since the early 1990s—added prudence of policy makers is called for when, at the same time, upcoming elections may tilt political instincts in the opposite direction. Pressures are likely to emerge from less buoyant remittances, lower exports, and tightened external and domestic financing conditions.

20. **Under current external circumstances, policy slippages or a lack of crisis preparedness could exact a high price.** Continued steadfast implementation of sound economic policies and unwavering commitment to reform are necessary to navigate stormy waters. While the Albanian economy has exhibited resilience to recent commodity price shocks, the global economic environment is worse than at any time since Albania's transition and places a premium on preparedness. Policy makers should accept the need to err on the side of caution.

21. **In the financial sector, additional efforts are needed to mitigate risks despite significant buffers and inbuilt strengths.** Continued diligent supervision and high frequency monitoring will be needed to underpin prompt proactive responses to changing circumstances, as will be enhanced cooperation with foreign supervisors of resident banks. The enactment of new bankruptcy and collateral laws should be a priority, and mechanisms for liquidity provision should be updated as needed. In case financial conditions deteriorate further, the authorities should draw from the full policy arsenal of adjusting interest rates; tightening the budget; and using the flexible exchange rate as shock absorber.

22. **The 2009 budget must help buttress the economy's resilience.** More constrained external and domestic financing calls for a tighter fiscal stance to avoid crowding out private sector investment. Limiting the annual budget deficit to 3.9 percent of GDP will be essential and will require eliminating losses in the electricity sector by raising wholesale electricity tariffs to cost recovery levels and delaying—or preferably eschewing—social security contribution cuts. Contingency reserves of 1.9 percent should be maintained.

23. **In the medium term, fiscal policy must be better anchored and the informal economy formalized.** Three actions are important. First, a commitment to a fiscal rule could help strengthen fiscal discipline and reduce public debt. While Albania can choose from several alternative fiscal rules, an expenditure-based approach would seem to best fit the country's circumstances. Second, efforts to combat informality must put greater reliance on incentives for self enforcement instead of administratively complex rules. Finally, a pension reform—aside from its benefits for long-term fiscal sustainability—could introduce such incentives by establishing a stronger link between contributions and benefits.

24. **A decisive push should be made to broadly improve public utilities.** The authorities have all but completed their privatization program with the planned sale of the electricity distribution company. They should push to overcome any obstacles to finalizing the sale which offers the chance to tackle the key problem of electricity theft. In this context, stepped up efforts to improve the financial performance of water utilities will also be needed.

25. On the basis of Albania's strong performance under the PRGF-EFF arrangements and their policy commitments going forward, staff supports the authorities' request to complete the sixth and final review.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2006–13

	2006	2007	2008	2009	2010	2011	2012	2013
			Est.	Proj.	Proj.	Proj.	Proj.	Proj.
			(Growth rate in percent)					
Real GDP 1/	5.5	6.0	6.0	3.7	6.2	6.2	6.2	6.1
Retail prices (avg.)	2.4	2.9	3.6	2.3	3.0	2.7	2.8	2.9
Retail prices (end-period)	2.5	3.1	2.9	2.5	2.8	2.9	2.9	3.1
			(Percent of GDP)					
Saving-investment balance 2/								
Foreign savings 3/	5.6	9.1	10.8	8.0	6.9	5.9	5.6	5.0
National savings	23.6	20.8	21.2	21.0	21.7	21.6	20.9	21.1
Public 4/	1.9	2.2	3.1	2.0	3.1	3.5	4.3	5.0
Private	21.7	18.6	18.2	19.0	18.6	18.1	16.6	16.1
Investment	29.1	29.9	32.0	29.0	28.6	27.5	26.5	26.1
Public	5.6	5.8	8.1	5.9	6.3	6.2	5.7	5.5
Private	23.5	24.1	23.9	23.1	22.3	21.3	20.8	20.6
Fiscal sector								
Revenues and grants	25.3	25.3	27.5	28.0	27.8	28.1	28.5	28.9
Tax revenue	23.0	23.3	25.0	25.7	26.0	26.5	27.0	27.5
Expenditures	28.6	29.2	32.7	31.9	31.1	30.9	30.0	29.6
Primary	25.8	26.5	29.5	28.5	28.1	28.0	27.2	26.9
Interest	2.8	2.6	3.2	3.3	3.0	2.9	2.8	2.6
Overall balance (including grants)	-3.2	-3.8	-5.2	-3.9	-3.3	-2.8	-1.5	-0.7
Primary balance (including grants)	-0.4	-1.2	-2.0	-0.6	-0.3	0.1	1.3	2.0
Net domestic borrowing	2.3	1.7	0.0	2.4	1.6	1.6	0.6	0.2
Privatization receipts	0.3	1.5	1.8	1.1	0.3	0.3	0.3	0.1
Foreign financing	0.6	0.5	3.4	0.4	1.4	0.9	0.6	0.4
Public Debt	56.0	52.8	52.6	52.5	50.8	48.7	45.7	42.5
Domestic	39.1	37.4	34.4	34.8	33.5	32.3	30.3	28.0
External (including publicly guaranteed) 5/	16.9	15.5	18.2	17.7	17.3	16.4	15.5	14.5
Monetary indicators								
Broad money growth	16.3	13.7	6.3	6.7	10.0	10.0	10.1	10.0
Private credit growth	57.2	48.2	25.1	13.4	16.0	13.4	15.1	13.5
Velocity	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Interest rate (3-mth T-bills, end-period)	6.4	6.3	...	...	...	...	...	...
			(Percent of GDP unless otherwise indicated)					
External sector								
Trade balance (goods and services)	-24.1	-26.4	-26.5	-22.0	-20.5	-19.6	-19.0	-18.1
Current account balance (including official transfers)	-5.6	-9.1	-10.8	-8.0	-6.9	-5.9	-5.6	-5.0
Current account balance (excluding official transfers)	-7.3	-10.1	-11.8	-9.0	-7.7	-6.6	-6.2	-5.6
Official transfers	1.7	1.0	1.0	1.0	0.8	0.6	0.6	0.5
Gross international reserves (in millions of Euros)	1,359	1,467	1,666	1,540	1,556	1,669	1,816	2,075
(In months of imports of goods and services)	3.8	3.7	4.3	3.7	3.4	3.4	3.4	3.5
(Relative to external debt service)	11.9	12.1	11.3	8.8	8.2	8.3	9.3	10.2
(In percent of broad money)	25.3	23.3	25.6	22.0	20.2	19.6	19.4	20.1
Change in real exchange rate (e.o.p., in percent)	-0.1	1.2	...	...	...	...	...	...
Memorandum items								
Nominal GDP (in billions of lek) 1/	893	980	1,064	1,129	1,235	1,348	1,470	1,599
<b>Social Indicators:</b> GNI per capita, World Bank Atlas Method, US\$ (2007): \$3,290; life expectancy at birth (2007): 76 years; infant mortality rate (2007, per thousand births): 15; population 3.2 million (2007); population living below the poverty line (2005): 18.5 percent; population without running water inside their dwellings (2003): 40 percent.								

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

1/ GDP data for 2004–06 are from the official national accounts; GDP data for 2007 are staff estimates.

2/ The statistical discrepancy contained in the national accounts was allocated to private consumption and investment according to the ratio observed in the national accounts excluding the discrepancy. Unexplained oscillations in this discrepancy introduced additional statistical uncertainty into the historical data.

3/ Negative of current account including official transfers.

4/ Revenue excluding grants less wages, local government expenditure, and operations and maintenance.

5/ Includes arrears, with the exception of pre-1978 arrears to China, and excludes IMF repurchase obligations.

Table 2. Albania: Balance of Payments, 2003–13

(Percent of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
					Est.	Projections					
Current account	-5.0	-4.0	-6.1	-5.6	-9.1	-10.8	-8.0	-6.9	-5.9	-5.6	-5.0
Balance of goods and services	-24.7	-22.2	-24.5	-24.1	-26.4	-26.5	-22.0	-20.5	-19.6	-19.0	-18.1
Exports	20.4	21.9	22.7	25.1	27.8	28.5	28.3	28.8	29.7	30.4	31.3
Goods	7.8	8.2	8.0	8.7	9.9	11.2	10.7	11.0	11.4	12.0	12.7
Services	12.6	13.7	14.7	16.5	17.8	17.3	17.5	17.8	18.3	18.4	18.6
Imports	45.1	44.1	47.2	49.3	54.1	55.1	50.3	49.3	49.3	49.4	49.4
Goods	31.1	29.7	30.4	31.9	36.5	37.8	34.8	34.1	33.9	33.9	34.0
Services	14.0	14.4	16.8	17.4	17.7	17.3	15.4	15.2	15.3	15.5	15.5
Income balance	3.0	2.4	2.0	2.8	2.8	3.1	2.8	2.8	2.9	2.8	2.8
Of which: Interest due	0.4	0.3	0.4	0.6	0.6	0.5	0.6	0.6	0.6	0.5	0.5
Private transfers 1/	14.1	14.0	14.7	14.1	13.5	11.6	10.2	10.0	10.1	10.0	9.7
Official transfers	2.6	1.8	1.8	1.7	1.0	1.0	1.0	0.8	0.6	0.6	0.5
Capital account	5.4	5.6	5.0	5.8	9.6	11.9	5.5	6.0	6.1	6.0	6.2
Direct investment	3.1	4.7	3.4	3.6	6.0	5.0	4.6	4.3	4.8	5.0	5.4
Other capital	0.8	-0.2	0.6	1.5	2.8	3.6	0.8	0.9	1.1	0.8	0.7
Private loans (incl.net trade credits)	0.4	1.3	1.0	0.5	0.4	0.6	0.6	0.8	0.8	0.8	0.7
Other financial flows	0.4	-1.5	-0.3	0.9	2.5	2.9	0.2	0.2	0.3	0.1	0.0
Of which: Change in NFA of DMBs (incr = -) 2/	0.4	-1.5	-0.3	0.1	0.9	2.9	0.2	0.2	0.3	0.1	0.0
Official medium- and long-term loans (net)	1.5	1.1	1.0	0.7	0.8	3.3	0.1	0.7	0.2	0.1	0.0
New borrowing	2.0	1.7	1.5	1.6	1.6	4.4	1.3	1.9	1.4	1.2	1.0
Multilateral loans	1.5	1.2	1.1	1.1	1.2	1.4	1.0	1.4	0.9	0.4	0.1
World Bank	0.7	0.6	0.5	0.5	0.5	0.2	0.2	0.3	0.3	0.2	0.1
EBRD	0.3	0.2	0.2	0.3	0.2	0.4	0.4	0.6	0.1	0.0	0.0
Other	0.5	0.4	0.4	0.4	0.5	0.7	0.5	0.6	0.5	0.3	0.0
Bilateral loans	0.5	0.5	0.4	0.5	0.4	0.3	0.2	0.4	0.3	0.3	0.3
Commercial debt					0.0	2.7	0.0	0.1	0.2	0.4	0.6
Amortization	-0.5	-0.6	-0.5	-0.9	-0.8	-1.1	-1.2	-1.2	-1.2	-1.0	-1.0
Errors and omissions 3/	0.1	1.4	2.1	2.3	1.3	1.3	1.2	1.1	1.0	0.9	0.9
Net balance	0.5	3.0	1.1	2.5	1.8	2.4	-1.3	0.2	1.1	1.3	2.0
Available financing	-0.5	-3.0	-1.1	-2.7	-1.8	-2.6	1.5	-0.2	-1.1	-1.3	-2.0
Change in net reserves (increase = -) 2/	-0.9	-3.3	-1.1	-2.8	-1.9	-2.4	1.3	-0.2	-1.1	-1.3	-2.0
BOP support	0.3	0.3	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Changes in arrears (increase = +) 4/	0.1	-0.2	-0.3	-0.1	0.0	-0.3	-0.2	0.0	0.0	0.0	0.0
Overdue debt forgiveness	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling 4/	0.0	0.2	0.3	0.1	0.0	0.0	0.2	0.0	0.0	0.0	0.0
Identified Financing	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Of which: World Bank including DPL	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap 5/	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0
Expected EU Macro-Financial Assistance	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Arrears Rescheduling	...	...	0.0	0.0	0.0	0.3	0.2	0.0	0.0	0.0	0.0
Other	...	...	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; donors; and Fund staff estimates and projections.

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

2/ Net of valuation changes in 2005–07. In projections for 2008–13, valuation effects are assumed to be zero.

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

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

5/ The financing gap is expected to be fully covered by arrears rescheduling and prospective privatization receipts.

Table 3. Albania: Balance of Payments, 2003–13

(Millions of Euros)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
					Est.			Projections			
Current account	-252	-235	-399	-405	-725	-933	-734	-695	-653	-677	-661
Balance of goods and services	-1,248	-1,307	-1,617	-1,752	-2,092	-2,293	-2,012	-2,057	-2,154	-2,286	-2,372
Exports	1,031	1,293	1,497	1,825	2,202	2,465	2,586	2,893	3,263	3,651	4,098
Goods	396	486	530	631	786	968	982	1,100	1,254	1,442	1,666
Services	635	808	967	1,195	1,415	1,497	1,604	1,793	2,009	2,209	2,432
Imports	2,279	2,600	3,115	3,578	4,293	4,757	4,598	4,949	5,417	5,937	6,470
Goods	1,572	1,752	2,007	2,316	2,891	3,264	3,186	3,425	3,729	4,077	4,446
Services	708	848	1,108	1,261	1,402	1,493	1,412	1,524	1,687	1,860	2,023
Income balance	152	143	132	201	220	265	259	279	321	341	370
Of which: Interest due	21	18	25	42	51	46	57	61	65	66	64
Private transfers 1/	714	826	969	1,024	1,068	1,005	930	1,006	1,109	1,200	1,270
Official transfers	129	103	117	123	78	90	89	77	71	68	71
Capital account	275	332	328	420	765	1,025	505	603	666	721	811
Direct investment	158	277	224	259	477	432	424	436	524	603	711
Other capital	42	-13	41	109	225	308	72	95	119	101	96
Private loans (incl.net trade credits, net)	22	78	63	40	30	53	55	75	90	95	96
Other financial flows	21	-91	-22	69	195	254	17	19	29	6	0
Of which: Change in NFA of DMBs (incr = -) 2/	21	-91	-22	7	73	254	17	19	29	6	0
Medium- and long-term loans (net)	75	68	63	53	64	285	9	73	23	18	5
New borrowing	101	100	98	116	124	376	117	192	151	140	137
Multilateral loans	75	72	73	82	94	117	96	146	94	51	17
World Bank	36	37	32	36	39	21	19	27	29	20	15
EBRD	13	13	15	19	14	37	34	57	12	0	0
Other	25	23	25	27	41	59	43	61	52	30	1
Bilateral loans	26	28	26	35	29	29	21	36	37	40	43
Commercial debt					0	230	0	10	20	50	77
Amortization	-25	-33	-35	-63	-60	-91	-108	-119	-128	-123	-132
Errors and omissions 3/	5	80	141	166	102	113	111	112	105	111	116
Net balance	27	177	69	181.3	142.3	204.0	-117.9	21.2	117.6	155.2	266.3
Available financing	-27	-177	-69	-181.3	-142.3	-204.0	117.9	-21.2	-117.6	-155.2	-266.3
Change in net reserves (increase = -) 2/	-46	-193	-75	-203	-149	-204	118	-25	-121	-155	-266
Of which: Change in gross reserves, (increase = -)	10	-191	-77	-200	-144	-199	125	-16	-113	-148	-259
Use of Fund Resources (net)	2	2	2	-3	-5	-5	-8	-9	-9	-8	-8
Budget support	17	15	3	9	0	0	0	0	0	0	0
Changes in arrears (increase = +) 4/	3	-12	-17	-7	-3	-22	-20	0	0	0	0
Overdue debt forgiveness	0	0	0	0	0	0	0	0	0	0	0
Rescheduling 4/	0	12	17	7	3	22	0	0	0	0	0
Identified Financing	0	0	0	13	7	0	0	4	4	0	0
Of which: World Bank including DPL	0	0	0	0	7	0	0	4	4	0	0
Financing gap 5/	0	0	0	0	0	0	20	0	0	0	0
Expected EU Macro-Financial Assistance	...	...	0	0	0	0	0	0	0	0	0
Arrears Rescheduling	...	...	0	0	0	0	20	0	0	0	0
Other	...	...	0	0	0	0	0	0	0	0	0
<i>Memorandum items:</i>											
Gross usable reserves	834	1,025	1,202	1,359	1,467	1,666	1,540	1,556	1,669	1,816	2,075
(months of imports of goods and services)	3.9	3.9	4.0	3.8	3.7	4.3	3.7	3.4	3.4	3.4	3.5
Balance of goods and services (percent of GDP)	-24.7	-22.2	-24.5	-24.1	-26.4	-26.5	-22.0	-20.5	-19.6	-19.0	-18.1
Current account (percent of GDP)	-5.0	-4.0	-6.1	-5.6	-9.1	-10.8	-8.0	-6.9	-5.9	-5.6	-5.0
Debt service (percent of exports of goods and service)	5.0	4.1	3.9	4.7	3.4	4.2	4.6	4.6	4.6	4.1	3.7
Debt service (percent of central government revenue)	4.5	3.9	3.9	5.0	3.8	4.5	4.8	4.8	5.0	4.5	4.2
Total external debt stock (percent of GDP) 7/	21.9	20.8	21.1	19.9	18.0	20.4	19.5	19.0	18.1	17.3	16.3
Volume of Exports of Goods and Services (percent of GDP)	9.5	20.6	5.4	9.8	21.7	14.4	0.0	9.9	12.2	13.2	13.8
Volume of Imports of Goods and Services (percent of GDP)	8.4	10.7	8.4	-3.3	10.4	-0.1	0.1	6.0	7.9	8.3	7.8

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

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

2/ Net of valuation changes in 2005–07. In projections for 2008–13, valuation effects are assumed to be zero.

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

4/ In 2006–2008 assumes rescheduling of stock of outstanding arrears, both with official and private creditors.

5/ The financing gap is expected to be fully covered by arrears rescheduling and prospective privatization receipts.

6/ Public and publicly guaranteed debt only.

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

Table 4. Albania: Monetary Aggregates, 2004–13  
(Percent of GDP)

	Actuals				IMF Forecast					
	2004 Dec.	2005 Dec.	2006 Dec.	2007 Dec.	2008 Dec.	2009 Dec.	2010 Dec.	2011 Dec.	2012 Dec.	2013 Dec.
Monetary survey										
Broad money	67.0	70.1	74.6	77.3	75.7	76.1	76.4	77.0	77.8	78.7
Currency outside banks	18.4	18.3	18.3	15.8	16.5	14.3	12.6	10.8	9.1	7.7
Deposits	48.6	51.8	56.3	61.5	59.2	61.7	63.8	66.2	68.6	71.0
Domestic currency deposits	34.0	33.8	35.2	35.8	33.4	35.3	36.7	38.4	40.9	43.0
Foreign currency deposits	14.6	17.9	21.2	25.7	25.8	26.4	27.1	27.8	27.8	28.0
Net foreign assets	25.1	25.8	26.1	23.7	21.8	18.9	17.2	16.6	16.4	17.2
Bank of Albania	15.8	17.0	18.1	17.5	18.8	16.3	15.1	14.9	14.9	15.8
Commercial Banks	9.3	8.8	8.1	6.2	2.9	2.6	2.2	1.7	1.5	1.4
Net domestic assets	41.9	44.3	48.5	53.6	53.9	57.2	59.2	60.4	61.3	61.5
Claims on government (net of deposits)	36.1	33.9	32.2	31.5	28.8	29.3	28.3	27.3	25.4	23.2
BOA financing	7.6	7.2	5.2	5.3	4.2	3.6	3.1	2.6	2.2	1.9
<i>Of which</i> : gross credit	8.7	8.4	7.6	7.4	6.0	5.6	4.9	4.2	3.7	3.3
Other (including T-bills)	28.5	26.7	27.0	26.2	24.6	25.8	25.2	24.8	23.2	21.2
Claims on state enterprises and farms	0.0	0.0	0.0	0.4	0.7	0.6	0.6	0.5	0.5	0.5
Claims on the private sector 1/	9.5	15.2	21.9	29.6	34.1	36.4	38.6	40.1	42.3	44.2
In Leks	2.1	4.1	6.6	8.7	9.6	11.2	12.8	13.5	15.9	17.7
In foreign currency	7.5	11.1	15.3	20.9	24.5	25.2	25.8	26.5	26.4	26.5
Other items, net	-3.8	-4.8	-5.6	-7.9	-9.7	-9.2	-8.3	-7.5	-6.8	-6.3
Memorandum items:										
Reserve money (billions of Lek)	23.8	24.2	24.4	23.3	23.3	21.5	20.0	18.4	17.0	15.8
M1 (billions of Lek)	22.6	27.3	27.1	24.8	23.7	21.5	19.7	17.9	16.3	15.0
M2 (Billions of Lek)	52.4	52.1	53.5	51.7	49.9	49.6	49.4	49.2	50.0	50.7

Sources: Bank of Albania; and IMF staff estimates.

1/ Excluding credit transferred to the Bank Asset Resolution Trust (BART).

Table 5. Albania: Monetary Aggregates, 2004–13  
(Billions of leks unless otherwise indicated; end-period)

	Actuals							Projections					
	2004	2005	2006	2007	2008			2009	2010	2011	2012	2013	
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Dec.	Dec.	Dec.	Dec.	
Monetary survey													
Broad money	503.2	573.0	666.5	757.6	754.5	773.7	820.3	805.1	858.7	944.2	1038.7	1143.2	1257.9
Currency outside banks	138.1	149.7	163.3	155.0	146.8	145.8	152.7	175.5	161.9	156.0	145.4	134.2	122.3
Deposits	365.1	423.3	503.2	602.7	607.7	627.9	667.6	629.6	696.8	788.3	893.3	1009.0	1135.6
Domestic currency deposits	255.2	276.8	314.1	351.2	351.4	361.3	369.9	355.4	398.3	453.7	518.4	600.6	687.7
Foreign currency deposits	110.0	146.6	189.1	251.5	256.3	266.6	297.6	274.2	298.5	334.6	374.9	408.4	447.8
Net foreign assets	188.8	210.8	233.2	232.1	215.8	198.2	236.5	231.8	212.9	213.0	223.8	241.5	274.8
Bank of Albania	118.6	138.8	161.2	171.0	166.7	165.2	188.5	200.5	183.9	186.4	200.8	219.3	252.7
Commercial Banks	70.2	72.0	72.0	61.1	49.2	33.0	47.9	31.3	29.0	26.6	23.0	22.2	22.1
Net domestic assets	314.4	362.2	433.2	525.5	538.7	575.5	583.8	573.3	645.8	731.2	814.9	901.7	983.1
Claims on government (net of deposits)	271.0	277.0	287.9	308.9	302.2	305.9	305.0	306.8	331.4	349.9	368.7	372.9	370.1
BOA financing	57.2	58.6	46.8	52.1	46.5	40.3	39.3	45.0	40.4	38.4	34.4	32.4	30.4
Of which : gross credit	65.7	68.8	67.9	72.9	64.4	64.5	64.3	63.8	62.7	60.7	56.7	54.7	52.7
Other (including T-bills)	213.7	218.4	241.0	256.8	255.7	265.6	265.7	261.9	291.0	311.5	334.3	340.5	339.7
Claims on state enterprises and farms	0.1	0.1	0.2	3.9	4.5	4.6	7.2	7.2	7.2	7.2	7.2	7.2	7.2
Claims on the private sector 1/	71.6	124.4	195.5	289.8	311.7	343.5	370.2	362.5	411.2	476.8	540.6	622.1	706.0
In Leks	15.6	33.7	59.2	84.8	88.8	98.2	103.1	102.2	127.0	158.3	182.7	233.7	282.4
In foreign currency	56.0	90.6	136.4	205.1	222.8	245.3	267.0	260.3	284.2	318.5	357.9	388.4	423.7
Other items, net	-28.3	-39.2	-50.3	-77.2	-79.7	-78.4	-98.5	-103.3	-103.9	-102.7	-101.6	-100.5	-100.3
Memorandum items:													
Reserve money (billions of Lek)	178.6	198.3	217.6	228.2	213.6	219.7	226.9	248.2	242.3	247.0	248.5	250.6	253.4
M1 (billions of Lek)	170.1	223.7	242.4	242.7	215.2	219.4	228.0	252.0	242.6	243.8	241.1	240.1	239.1
M2 (Billions of Lek)	393.3	426.4	477.4	506.1	498.2	507.1	522.7	530.8	560.2	609.7	663.8	734.8	810.0
Annual broad money growth	13.5	13.9	16.3	13.7	11.2	14.0	14.9	6.3	6.7	10.0	10.0	10.1	10.0
Annual reserve money growth	11.2	11.0	9.8	4.9	0.1	3.2	4.8	8.7	-2.4	1.9	0.6	0.9	1.1
Annual growth in private sector credit	36.9	73.6	57.2	48.2	43.0	44.5	42.8	25.1	13.4	16.0	13.4	15.1	13.5
Private sector credit as a percent of GDP	9.5	15.2	21.9	29.6	30.9	33.6	35.8	34.1	36.4	38.6	40.1	42.3	44.2
Annual change in credit as a percent of GDP	2.0	5.7	6.7	7.7	7.2	8.1	8.7	4.5	2.3	2.2	1.5	2.2	1.8
Annual M2 growth	11.9	8.4	11.9	6.0	4.6	6.6	9.6	4.9	5.5	8.8	8.9	10.7	10.2
Velocity (annual GDP/BM)	1.5	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Money multiplier (absolute values)	2.8	2.9	3.1	3.3	3.5	3.5	3.6	3.2	3.5	3.8	4.2	4.6	5.0
Currency/Broad Money ratio	27.4	26.1	24.5	20.5	19.5	18.8	18.6	21.8	18.9	16.5	14.0	11.7	9.7
Currency/M2 ratio	35.1	35.1	34.2	30.6	29.5	28.8	29.2	33.1	28.9	25.6	21.9	18.3	15.1
Foreign currency deposits/total deposits	30.1	34.6	37.6	41.7	42.2	42.5	44.6	43.6	42.8	42.4	42.0	40.5	39.4
Gross reserves (millions of euros)	1,025	1,202	1,359	1,467	1,421	1,401	1,570	1,666	1,540	1,556	1,669	1,816	2,075
Gross reserves (millions of U.S. dollars)	1,374	1,425	1,796	2,138	2,207	2,212	2,252	2,284	2,122	2,153	2,319	2,535	2,910
In percent of broad money	25.3	25.7	25.3	23.3	22.9	22.1	23.7	25.6	22.1	20.2	19.7	19.4	20.1
US Dollar Exchange Rate (end of period)	92.7	103.4	94.0	82.7	78.3	77.3	86.4	...	...	...	...	...	...
Euro Exchange Rate (end of period)	125.9	122.4	123.6	121.6	123.6	122.1	123.9	...	...	...	...	...	...
3-month T-bill rate (in percent)	6.2	5.4	6.4	6.3	6.3	6.3	0.0	...	...	...	...	...	...
BoA repo rate (in percent)	5.3	5.0	5.5	6.3	6.3	6.3	0.0	...	...	...	...	...	...

Sources: Bank of Albania; and IMF staff estimates.

1/ Excluding credit transferred to the Bank Asset Resolution Trust (BART).

Table 6. Albania: Quantitative Performance Criteria and Indicative Targets, June 2008-December 2008 1/

	Actual	End-June 2008	Prog. (Adj.)	Actual	End-September 2008	Prog. (Adj.)	End-December 2008
		Prog.			Prog.		Prog.
(In billions of lek)							
Ceiling on net domestic credit to the government 2/	13.3	12.6	30.1	7.1	14.3	33.0	19.0
Ceiling on accumulation of net domestic assets of the BOA 3/	-7.2	10.1	10.1	0.5	18.8	20.4	13.0
Indicative total tax revenue target 4/	119.9	108.6	108.6	186.2	185.8	185.8	261.7
(In millions of US dollars for June 2008; in millions of euros thereafter)							
Floor on accumulation of net international reserves of the BOA 3/	-15.5	-25.2	-25.2	103.9	15.8	2.8	57.4
(In millions of euros)							
Ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt with original maturities of more than one year 5/	494.1	515.0	515.0	494.1	650.0	650.0	680.0
Ceiling on public and publicly-guaranteed external debt with original maturities up to and including 1 year 6/	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ceiling on accumulation of new external payments arrears, excluding interest on pre-existing arrears 6/	0.0	0.0	0.0	0.0	0.0	0.0	0.0

1/ The performance criteria and indicative targets outlined in this table, and their adjustors, are defined in the Technical Memorandum of Understanding (TMU) of IMF Country Report No. 08/267. Data for end-September 2008 are performance criteria except where marked. Data for end-June 2008 and end-December 2008 are indicative targets.

2/ Cumulative change within the calendar year.

3/ For end-March 2008 and end-June 2008, cumulative change from end-December 2007. For end-September 2008 and end-December 2008, cumulative change from end-March 2008.

4/ Indicative target. Defined as all revenues collected by the GDT, GDC, and SSI. Aggregate revenue so defined includes all revenues collected on behalf of local governments, but excludes revenues collected by local governments directly. From September 2007 includes small business tax. Targets defined as cumulative changes within the calendar year.

5/ Over the program period.

6/ Applies on a continuous basis.



Table 7. Structural Benchmarks under the PRGF and EFF Arrangements

	Status
<b>I. Prior Action</b>	
Clear all unpaid bills that budgetary institutions and public water companies owe to the electricity distribution company.	...
<b>II. Structural Benchmarks</b>	
<b>A. Reduce fiscal vulnerabilities</b>	
1. Raise the effective collection rate on electricity consumption to 62 percent.	Not Met
2. Improve VAT administration by preparing and providing to the Fund quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected (within one month of the end of each quarter).	Met
3. Prepare and issue quarterly reports on progress made in the actual use of the risk assessment module of the ASYCUDA system to perform inspections in the customs.	Met
4. Prepare semi-annual reports (within one month of the end of each semester) on the stock of external arrears.	Met
5. Increase the number of taxpayers paying social security contributions (excluding agricultural workers and voluntary contributors) to 410,000.	Met
<b>B. Improve public expenditure management</b>	
6. Safeguard the efficient use of nonconcessional foreign project loans:	
(i) Conduct an independent feasibility study for any large project (as defined in the TMU) financed through non-concessional commercial borrowing;	Met
(ii) Provide a semestrial listing and status report on all projects being considered for nonconcessional foreign financing.	Met
<b>C. Strengthen the financial system</b>	
7. Complete the delivery vs. payments system for government securities.	Met

Table 8. Albania: General Government Operations, 2006–13

(Percent of GDP)

	2006	2007	2008	2009	2010	2011	2012	2013
			Projection					
Total revenue and grants	25.3	25.3	27.5	28.0	27.8	28.1	28.5	28.9
Tax revenue	23.0	23.3	25.0	25.7	26.0	26.5	27.0	27.5
VAT	8.3	9.0	10.0	10.5	10.8	11.1	11.4	11.6
Profit tax 1/	2.5	2.2	1.7	1.7	1.7	1.7	1.7	1.7
Excise tax	2.6	2.9	3.2	3.3	3.4	3.5	3.6	3.7
Small business tax	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Personal income tax	1.0	1.5	2.1	2.3	2.3	2.3	2.3	2.3
Customs duties	1.6	1.0	0.8	0.5	0.5	0.5	0.4	0.4
Other taxes	1.5	1.5	1.4	1.2	1.2	1.2	1.2	1.2
Property and local taxes	1.0	0.7	0.8	0.9	1.0	1.2	1.3	1.5
Social insurance contributions	4.4	4.3	4.6	4.8	4.8	4.8	4.8	4.8
Non-tax revenue	1.8	1.9	2.1	2.0	1.5	1.5	1.4	1.3
Grants	0.5	0.1	0.3	0.4	0.2	0.2	0.1	0.1
Of which: budget support	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	28.6	29.2	32.7	31.9	31.1	30.9	30.0	29.6
Current expenditure	22.9	23.0	23.9	24.9	24.2	24.3	23.9	23.6
Personnel cost	6.3	6.0	6.4	6.5	6.3	6.3	6.3	6.2
Of which: contingency	...	...	0.0	...	0.3	0.3	0.2	0.2
Interest	2.8	2.6	3.2	3.3	3.0	2.9	2.8	2.6
Of which: domestic	2.6	2.4	2.8	2.9	2.5	2.4	2.2	2.1
Operations & maintenance	2.9	2.6	2.7	3.1	3.0	3.2	3.2	3.1
Subsidies	0.4	0.4	0.2	0.2	0.2	0.2	0.2	0.2
Social insurance outlays	6.7	7.1	7.3	7.4	7.3	7.1	6.9	6.7
Of which: contingency	...	...	...	...	...	...	...	...
Local government expenditure	2.5	2.2	2.6	2.8	2.7	2.8	3.0	3.1
Social protection transfers	1.2	1.5	1.5	1.5	1.6	1.6	1.5	1.5
Other 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure 3/	5.6	5.8	8.1	5.9	6.3	6.2	5.7	5.5
Domestically financed	4.3	4.9	3.4	4.6	4.3	4.7	4.5	4.4
Of which: contingency	...	0.0	0.3	0.4	0.5	0.6	0.6	0.6
Foreign financed projects	1.4	0.9	3.5	1.3	2.0	1.5	1.2	1.1
Capital transfer to KESH	...	0.6	0.0	...	...	...	...	...
Additional capital spending	...	...	1.2	...	...	...	...	...
Lending minus repayment	0.0	0.3	0.2	-0.4	0.0	0.0	0.0	0.0
Reserve and contingency funds 4/	0.0	0.0	0.6	1.4	0.5	0.5	0.5	0.5
Cash balance	-3.2	-3.8	-5.2	-3.9	-3.3	-2.8	-1.5	-0.7
Current balance including grants 5/	2.4	2.3	3.4	2.3	3.3	3.6	4.4	5.1
Financing	3.2	3.8	5.2	3.9	3.3	2.8	1.5	0.7
Domestic	2.6	3.3	1.8	3.5	1.9	1.9	0.9	0.2
Privatization receipts 6/	0.3	1.5	1.8	1.1	0.3	0.3	0.3	0.1
Net borrowing	2.3	1.7	0.0	2.4	1.6	1.6	0.6	0.2
Foreign	0.6	0.5	3.4	0.4	1.4	0.9	0.6	0.4
Memorandum Items:			0.0					
Primary balance	-0.4	-1.2	-2.0	-0.6	-0.3	0.1	1.3	2.0
Current balance excluding grants	1.9	2.2	3.1	2.0	3.1	3.5	4.2	5.0
Total spending contingencies 4/	...	0.0	0.8	1.9	1.3	1.3	1.3	1.3
Expenditures in priority sectors 7/	9.2	9.3	9.7	10.5	10.5	10.5	10.5	10.5
Public Debt 8/	56.0	52.8	52.6	52.5	50.8	48.7	45.7	42.5
Domestic general government	39.1	37.4	34.4	34.8	33.5	32.3	30.3	28.0
External	16.9	15.5	18.2	17.7	17.3	16.4	15.5	14.5
GDP (in billions of leks)	893	980	1064	1129	1235	1348	1470	1599

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

1/ Includes reduction of CIT rate to 10 percent from 2008.

2/ Includes statistical discrepancy.

3/ Excludes capital transfer to KESH in 2007.

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

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

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

7/ Education, health, and road sectors.

8/ Includes securities issued to the Bank of Albania in 2005 to compensate for its foreign exchange valuation losses.

Table 9. Albania: General Government Operations, 2006–13

(Billions of leks)

	2006	2007	2008	2009	2010	2011	2012	2013
	Projection							
Total revenue and grants	226.3	248.3	292.9	315.9	342.8	379.4	419.1	461.8
Tax revenue	205.5	228.2	266.5	289.7	321.4	357.2	397.1	439.8
VAT	74.3	87.8	106.9	118.8	133.0	149.0	166.9	185.2
Profit tax 1/	22.3	21.1	18.4	19.5	21.4	23.3	25.5	27.7
Excise tax	23.0	28.7	34.4	37.2	41.6	46.6	52.2	58.5
Small business tax	2.6	2.2	3.0	3.1	3.4	3.8	4.1	4.4
Personal income tax	8.6	14.8	22.7	25.7	28.1	30.7	33.5	36.5
Customs duties	14.0	9.8	8.6	6.1	5.8	6.1	6.4	6.7
Other taxes	13.0	14.5	14.6	14.0	15.3	16.7	18.2	19.8
Property and local taxes	8.5	7.1	8.7	10.6	12.9	15.8	19.2	23.4
Social insurance contributions	39.3	42.0	49.2	54.6	59.8	65.2	71.1	77.5
Non-tax revenue	16.0	18.8	22.8	22.2	19.0	20.0	20.0	20.5
Grants	4.8	1.3	3.7	4.0	2.4	2.2	2.0	1.6
Of which: budget support	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	255.2	285.7	348.3	359.9	383.6	417.3	441.3	472.7
Current expenditure	204.9	225.6	253.8	281.4	299.2	327.3	350.9	376.8
Personnel cost	56.7	59.1	68.0	72.9	77.8	85.0	92.6	99.9
Of which: contingency	...	...	0.0	0.0	3.5	3.5	3.5	3.5
Interest	25.0	25.6	34.1	37.6	37.0	39.2	40.8	42.2
Of which: domestic	23.0	23.5	30.2	33.0	30.5	32.0	33.0	34.0
Operations & maintenance	25.8	25.2	28.6	35.2	37.4	43.7	46.7	49.8
Subsidies	3.8	3.5	2.0	2.0	2.9	2.9	3.2	3.4
Social insurance outlays	60.0	69.9	77.5	84.0	90.7	95.9	101.2	106.8
Of which: contingency	...	...	...	0.0	...	...	...	...
Local government expenditure	22.7	21.3	27.7	32.2	33.2	37.9	43.4	49.7
Social protection transfers	10.8	14.8	15.4	16.9	19.6	21.9	22.2	24.2
Property compensation	0.0	0.5	0.5	0.6	0.7	0.8	0.8	0.8
Other 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure 3/	50.4	57.0	86.6	67.2	77.9	83.5	83.9	88.3
Domestically financed	38.2	48.2	36.6	52.0	53.2	63.0	66.0	70.0
Of which: contingency	...	0.0	3.0	5.0	6.3	7.5	8.7	9.0
Foreign financed projects	12.1	8.8	36.9	15.2	24.8	20.5	17.9	18.3
Capital transfer to KESH	...	5.7	...	...	...	...	...	...
Additional capital spending	...	...	13.1	...	...	...	...	...
Lending minus repayment	0.0	3.0	2.0	-5.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 4/	...	0.0	5.9	16.3	6.5	6.5	7.5	7.5
Cash balance	-28.9	-37.4	-55.3	-44.0	-40.8	-37.9	-22.2	-10.8
Current balance including grants 5/	21.4	22.7	36.2	26.3	40.4	48.9	64.4	81.2
Financing	28.9	37.4	55.3	44.0	40.8	37.9	22.2	10.8
Domestic	23.5	32.1	19.7	40.0	23.5	25.7	13.9	3.8
Privatization receipts 6/	2.8	15.1	19.4	12.8	3.2	3.9	4.4	1.0
Net borrowing	20.7	17.0	0.2	27.1	20.2	21.8	9.5	2.8
Foreign	5.4	5.3	35.7	4.1	17.3	12.2	8.3	7.0
<i>Memorandum Items:</i>								
Primary balance	-3.9	-11.8	-21.3	-6.4	-3.8	1.3	18.6	31.4
Current balance excluding grants	16.6	21.4	32.5	22.3	37.9	46.7	62.4	79.7
Total spending contingencies 4/	...	0.0	8.9	21.3	16.3	17.5	19.7	20.0
Expenditures in priority sectors 7/	81.9	91.5	102.9	118.8	130.0	141.9	154.7	168.2
Public Debt 8/	500.1	517.5	560.0	592.7	627.7	657.0	672.2	679.9
Domestic general government	348.9	366.0	366.2	393.3	413.6	435.4	444.9	447.7
External	151.1	151.5	193.8	199.4	214.2	221.6	227.3	232.2
Direct government external debt	125.7	123.5	158.7	161.4	170.8	174.0	175.2	175.8
Government guaranteed external debt	25.4	28.0	35.1	38.0	43.3	47.6	52.1	56.4

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

1/ Includes reduction of CIT rate to 10 percent from 2008.

2/ Includes statistical discrepancy.

3/ Excludes capital transfer to KESH in 2007.

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

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

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

7/ Education, health, and road sectors.

8/ Includes securities issued to the Bank of Albania in 2005 to compensate for its foreign exchange valuation losses.

Table 10. Albania: IMF Core Indicators of Financial Soundness, December 2003–September 2008

	Dec-03	Dec-04	Dec-05	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08
<b>I Capital-based</b>											
(i) Regulatory capital as a percent of risk-weighted assets	28.5	21.6	18.6	18.1	16.9	16.4	17.5	17.1	17.2	17.3	17.5
(ii) Regulatory Tier 1 capital as a percent of risk-weighted assets	29.0	21.5	18.1	17.1	15.9	15.4	16.7	16.0	16.3	16.5	16.6
(iii) Capital as a percent of total assets											
Regulatory Tier 1 capital as a percent of total assets	4.8	4.8	5.4	5.9	6.4	6.2	6.9	5.8	6.1	6.2	6.5
Regulatory capital as a percent of total assets	4.7	4.8	5.6	6.2	6.8	6.6	7.3	6.2	6.4	6.5	6.8
Shareholders' equity as a percent of total assets	5.9	6.1	6.6	6.8	7.0	7.1	7.6	7.6	7.9	7.9	8.0
(iv) Nonperforming loans net of provisions as a percent of capital											
Nonperforming loans net of provisions as a percent of regulatory Tier 1 capital	4.8	4.8	4.4	7.2	7.8	8.5	9.0	12.0	13.7	16.7	14.2
Nonperforming loans net of provisions as a percent of regulatory capital	4.9	4.8	4.3	6.8	7.4	7.9	8.5	11.2	13.0	15.9	13.5
Nonperforming loans net of provisions as a percent of shareholders' equity	3.9	3.8	3.6	6.3	7.1	7.4	8.2	9.1	10.6	12.9	11.5
(v) Return on equity (ROE) (annual basis)	19.5	21.1	22.2	20.2	20.8	20.0	21.0	20.7	16.3	16.6	16.3
(vi) Net open position in foreign exchange as a percent of capital											
Net open position in foreign exchange as a percent of regulatory Tier 1 capital	7.2	7.5	9.5	5.5	6.9	0.8	7.1	1.8	9.9	-0.6	5.7
Net open position in foreign exchange as a percent of regulatory capital	7.3	7.4	9.3	5.2	6.5	0.8	6.7	1.7	9.4	-0.6	5.4
Net open position in foreign exchange as a percent of shareholders' equity	5.9	5.9	7.8	4.8	6.3	0.7	6.4	1.4	7.6	-0.4	4.6
<b>II Asset-based</b>											
(vii) Liquid assets as a percent of total assets (Liquid-asset ratio)	73.6	71.1	62.6	57.6	55.8	53.6	52.4	49.8	48.9	47.0	45.9
(viii) Liquid assets as a percent of short-term liabilities	na	na	75.2	69.5	73.2	69.2	71.4	55.6	54.4	52.3	50.8
(ix) Return on assets (ROA) (net income to average total assets) (annual basis)	1.2	1.3	1.4	1.4	1.4	1.5	1.6	1.6	1.3	1.3	1.3
(x) Nonperforming loans (gross) as a percent of total loans	4.6	4.2	2.3	3.1	3.2	3.1	3.4	3.4	3.9	4.3	4.1
(xi) Sectoral distribution of loans to total loans	na	na	na	na	na	na	na	na	na	na	na
<b>III Income and expense-based</b>											
(xii) Interest margin to gross income	89.6	80.3	84.0	92.6	93.0	93.1	94.3	92.7	100.0	99.2	97.7
(xiii) Noninterest expenses to gross income	57.4	66.2	76.3	65.7	61.1	59.4	58.0	58.5	73.3	72.1	62.9
<b>IV Memorandum items</b>											
Other (noncore) indicators:											
Customer deposits as a percent of total (non-interbank) loans	652.1	535.8	342.5	265.5	251.2	230.7	227.0	215.5	201.9	187.7	183.9
Foreign currency-denominated loans to total loans	82.1	80.5	75.5	71.9	72.4	71.1	71.1	72.5	73.1	73.1	73.7
Foreign currency-denominated liabilities as a percent of total liabilities	35.9	37.0	41.0	44.0	45.2	45.7	46.5	46.9	47.8	48.1	50.2
Other indicators:											
Risk weighted assets as a percent of total assets	16.7	22.2	30.0	34.6	40.3	40.4	41.6	36.4	37.2	37.4	38.9
Total loans as a percent of total assets	13.6	16.4	25.7	31.7	33.7	35.9	37.1	39.4	40.7	43.0	44.1
Total loans as a percent of shareholders' equity	231.2	270.3	387.0	469.5	478.4	504.4	485.7	516.4	517.4	541.4	550.9

Source: Data provided by Bank of Albania.

Table 11. Albania: External Financing Requirement and Sources, 2003–13

(Millions of Euros)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
			Est.	Projections					
Total financing requirement	536	684	943	1256	746	838	902	955	1059
Current account (incl. official transfers)	399	405	725	933	734	695	653	677	661
Amortization	43	72	71	102	118	128	137	130	140
<i>Of which</i> : IMF	7	9	11	10	10	9	9	8	8
Change in gross reserves (increase = +)1/	77	200	144	199	-125	16	113	148	259
Reduction in arrears	17	7	3	22	20	0	0	0	0
Total sources	536	684	943	1256	727	838	902	955	1059
Foreign direct investment	224	259	477	432	424	436	524	603	711
Other capital	41	109	225	308	72	95	119	101	96
Official medium- and long-term loans	98	116	124	376	117	192	151	140	137
Multilateral (excluding IMF)	73	82	94	117	96	146	94	51	17
Bilateral	26	35	29	29	21	36	37	40	43
Commercial	0	0	0	230	0	10	20	50	77
IMF disbursements	9	6	6	5	3	0	0	0	0
Other 2/	143	166	102	113	111	112	105	111	116
Debt rescheduling	17	7	3	22	0	0	0	0	0
Budget support	3	9	0	0	0	0	0	0	0
Identified financing	0	13	7	0	0	4	4	0	0
<i>Of which</i> : WB FSAC/PRSC/EU	0	13	7	0	0	4	4	0	0
Financing gap	0	0	0	0	20	0	0	0	0
Expected EU macro-financial assistance	0	0	0	0	0	0	0	0	0
Debt rescheduling (mostly clearance of bilateral arrear	0	0	0	0	20	0	0	0	0
Other	0	0	0	0	0	0	0	0	0

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

1/ The change in gross reserves is net of valuation changes for 2005–07. In projections for 2008–13, valuation effects are assumed to be zero.

2/ Includes errors and omissions.

Table 12. Albania: Actual and Projected Payments to the Fund, 2003–13  
(Millions of SDRs)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
	Projections										
<b>Obligations from existing drawings</b>											
1. Principal											
PRGF repayments	6.80	6.39	6.17	7.60	9.41	9.62	9.08	7.95	7.13	5.81	5.50
GRA repurchases	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.10	0.51	0.91	1.22
2. Charges and Interest 1/											
PRGF Interest	0.31	0.32	0.32	0.31	0.28	0.24	0.20	0.15	0.12	0.09	0.06
GRA	0.01	0.00	0.00	0.06	0.20	0.24	0.27	0.26	0.25	0.23	0.19
Total obligations	7.12	6.71	6.49	7.97	9.89	10.11	9.55	8.10	7.25	5.90	5.56
(percent of quota)	14.61	13.79	13.33	16.36	20.31	20.76	19.61	16.63	14.89	12.11	11.42
<b>Obligations from prospective drawings</b>											
1. Principal											
PRGF repayments	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
GRA repurchases	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.10
2. Charges and Interest											
PRGF Interest	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.01	0.01	0.01	0.01
GRA	0.00	0.00	0.00	0.00	0.00	0.00	0.04	0.04	0.04	0.04	0.04
Total obligations	0.00	0.00	0.00	0.00	0.00	0.00	0.05	0.05	0.05	0.05	0.15
(Percent of quota)	0.00	0.00	0.00	0.00	0.00	0.00	0.10	0.10	0.10	0.10	0.31
<b>Obligations from existing and prospective drawings</b>											
1. Principal											
PRGF + EFF repayments	6.80	6.39	6.17	7.60	9.41	9.62	9.08	8.05	7.64	6.72	6.82
2. Charges and Interest 1/											
PRGF Interest	0.31	0.32	0.32	0.31	0.28	0.24	0.21	0.16	0.13	0.10	0.07
GRA	0.01	0.00	0.00	0.06	0.20	0.24	0.31	0.30	0.29	0.27	0.23
Total obligations	7.12	6.71	6.49	7.97	9.89	10.11	9.60	8.51	8.06	7.09	7.12
(Percent of quota)	15	14	13	16	20	21	20	17	17	15	15
Outstanding Fund credit 2/	60.8	62.4	64.3	61.5	57.0	52.3	45.6	37.6	29.9	23.2	16.4
Extended Arrangements	...	...	...	2.4	4.9	7.3	8.5	8.4	7.9	7.0	5.7
PRGF Arrangements	60.8	62.4	64.3	59.1	52.1	45.0	37.1	29.1	22.0	16.2	10.7
<b>Memorandum items:</b>											
<b>Outstanding Fund credit</b>											
<i>In percent of:</i>											
Exports of goods & services	7.0	5.5	5.2	3.8	2.8	2.3	1.9	1.4	1.0	0.7	0.4
GDP	1.4	1.2	1.2	1.0	0.8	0.7	0.5	0.4	0.3	0.2	0.1
Quota	125	128	132	126	117	107	94	77	61	48	34
<b>Total obligations</b>											
<i>In percent of:</i>											
Exports of goods & services	0.9	0.6	0.5	0.5	0.5	0.4	0.4	0.3	0.3	0.2	0.2
GDP	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Source: IMF staff estimates.

1/ Projections are based on current interest rates for PRGF and the EFF.

2/ End of year value.

**Annex I: Fund Relations**

As of November 30, 2008

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

<b>II. General Resources Account:</b>	<u>SDR Million</u>	<u>Percent Quota</u>
Quota	48.70	100.00
Fund Holdings of Currency	52.66	108.12
Reserve position in Fund	3.35	6.89
<b>III. SDR Department:</b>	<u>SDR Million</u>	<u>Percent Allocation</u>
Holdings	6.41	N/A
<b>IV. Outstanding Purchases and Loans:</b>	<u>SDR Million</u>	<u>Percent Quota</u>
Extended Arrangement	7.31	15.00
PRGF Arrangements	46.54	95.56

**V. Financial Arrangements:**

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
EFF	2/01/2006	1/31/2009	8.52	7.31
PRGF	2/01/2006	1/31/2009	8.52	7.31
PRGF	6/21/2002	11/20/2005	28.00	28.00

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

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

	<u>2008</u>	<u>2009</u>	<u>Forthcoming</u>	<u>2011</u>	<u>2012</u>
Principal	1.59	9.08	8.15	8.15	7.64
Charges/Interest	0.12	0.35	0.31	0.26	0.20
Total	1.71	9.44	8.46	8.41	7.83

**VII. Safeguards Assessments:**

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

assessment recommended measures to alleviate these weaknesses. The authorities have already taken steps to improve the external audit process, and staff will monitor their implementation of the remaining recommendations.

#### **VIII. Exchange Rate Arrangement:**

On July 1, 1992 the Albanian authorities adopted a floating exchange rate system (an independent float). Under the Fund's de facto exchange rate regime classification, Albania follows an independently floating exchange rate regime—although the monetary authorities occasionally intervene in the foreign exchange market with the objective of smoothing temporary fluctuations and accumulating reserves. Albania's exchange rate arrangement is free from exchange restrictions and multiple currency practices subject to Fund jurisdiction under Article VIII. However, the country still avails itself of the transitional arrangements under Article XIV and maintains exchange restrictions in the form of outstanding debit balances on inoperative bilateral payment agreements, which were in place before Albania became a Fund member. These relate primarily to debt in nonconvertible and formerly nonconvertible currencies. Albania has not imposed new restrictions under Article VIII. The exchange rate stood at lek 95.46 per U.S. dollar at end-November, 2008.

#### **IX. Article IV Consultation:**

The conclusion of the 2008 Article IV consultation and the fifth review under the PRGF/EFF-supported program took place in July 2008 (IMF Country Report No. 08/267). Albania moved from a 12-month cycle to a 24-month cycle, in line with the decision on consultation cycles approved on July 15, 2002. The last Article XIV Consultation was concluded in December 2005.

#### **X. FSAP Participation and ROSCs:**

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



## **XI. Technical Assistance:**

The Fund, other multilateral organizations and donors have provided extensive assistance for institutional development in Albania. The Fund alone has sent several technical assistance missions to Albania every year since 1991. The extent and focus of Fund TA over the past two years is briefly reviewed below.

**Technical assistance from MCM** has focused on two main areas: monetary policy and banking supervision. In the monetary policy area, a resident advisor assisted the Bank of Albania during the initial transition to an implicit inflation targeting regime. This was followed by short expert visits that focused on monetary policy decision processes, as well as more technical background work such as modeling and forecasting. The results of the TA have been favorable, with a significant boost in quality of the monetary policy decision-making process, as evidenced, inter alia, by inflation performance as well as research output. In the banking supervision area, following assistance in the implementation of a Supervisory Development Plan through 2005, TA missions have helped the authorities focus on stress testing, rapid credit growth and other emerging issues. A mission in February 2008 focused on assisting the authorities to draw up an action plan for the further development of their banking supervisory practices. Ongoing assistance with the implementation of a credit registry contributed to the successful inauguration of the registry at end-2007. Assistance was provided to assist in the creation of a delivery-versus-payments system for secondary market sales of government securities.

**Recent technical assistance from FAD** has concentrated in two main areas: tax administration and debt management. In strengthening tax administration, Fund TA covered improving large taxpayer operations, review of the computerization program, and the transfer of responsibility for the collection of social insurance contributions from the Social Insurance Institute to the General Department of Taxation. FAD also provided assistance on the reform and development of public debt management, including the strategic, legal and institutional framework, the development of a domestic securities market, and the integration of debt and cash management.

**Recent technical assistance from LEG** included help in drafting legislation and supervisory guidance for AML/CFT and banking supervision, and for amendments to the Central Bank Law and related agency agreements between the Bank of Albania and the Ministry of Finance.

**Technical assistance from STA** covered national income accounts, balance of payments, consumer price index, and data dissemination. While a previous resident technical expert financed by the Fund helped the official statistical agency improve national accounts coverage of the informal sector, a new peripatetic technical assistance project started in February 2008 to increase the frequency and enhance the accuracy of these accounts. In

strengthening balance of payments statistics, Fund TA supported the rapid progress with regard to the accuracy and frequency of data. However, poor source data constitutes a problem in making further progress especially in analyzing current transfers. A data ROSC mission visited Albania in March 2006. While Albania successfully subscribes to GDDS, the authorities have expressed their intention of subscribing to the SDDS. A TA mission has evaluated the requirements for the SDDS and concluded that the main obstacle is the lack of quarterly national accounts data. A mission also assisted the authorities in updating and rebasing the consumer price index.

Generally, the authorities welcomed the technical assistance from the Fund and made extensive efforts to adopt the TA recommendations. However, further institutional development is required in virtually every sector.

#### **IX. Resident Representative:**

A Fund resident representative has been posted in Tirana since April 1993. Ms. Ann-Margret Westin has filled this position since August 2005.

## **Annex II: IMF-World Bank Relations**

### **Partnership in Albania's Development Strategy**

The Republic of Albania has been a member of the World Bank since 1991. Since then, the WBG has provided strong support to Albania, including 73 loans mostly in IDA commitments totaling about US\$1021 million, IFC commitments of US\$125 million, and MIGA guarantees totaling US\$8.6 million. The quality of the active portfolio has continued to improve, with an increasing focus on long-term capacity development and implementation through Government structures.

The World Bank's Board approved the Country Assistance Strategy (CAS) for Albania for FY06-FY09 in January 2006. The CAS builds on the experience of the World Bank Group (WBG) since the early 1990s (through three CASs).<sup>2</sup> The CAS presents a program of support which seeks to build on the improved macro-economic management and progress in structural reforms that has occurred since 2002. It aims to support Albania's National Strategy for Social and Economic Development (NSSD) and the European Union (EU) Stabilization and Association process (SAP) with the ultimate objective of EU integration and the attainment of the Millennium Development Goals (MDGs).

The government has prepared the first annual progress report for the National Strategy for Development and Integration and is committed to better address the link between the strategic planning process, the Medium Term Budget Program (MTBP) and the annual budget in the context of newly established Integrated Planning System (IPS). The IPS aims to allow the Government of Albania (GoA) to prioritize its expenditures based on a national strategy that focuses on the European Integration agenda. A government executed multi-donor trust fund (MDTF) has been established with financing from various donors in order to ensure increased and transparent linkage between NSDI objectives and government policy and budget allocations and expenditures

### **Bank Group Strategy**

Reflecting Government priorities, the CAS (2006–09) program seeks to support Albania's efforts in strengthening governance, sustaining a private sector-led growth and improving service delivery. The CAS recognizes that more coherent efforts need to be made to address the challenge of poor governance in Albania, and introduces a 'Governance Filter' comprising of four core principles which will be used to ensure that governance

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<sup>2</sup> The 'Bank' refers to the IBRD and IDA and the 'World Bank Group' generally refer to the Bank, IFC, FIAS and MIGA.

considerations are mainstreamed into all of the Bank's interventions. The CAS program is also more selective, focused on two pillars:

**I. *Continued Economic Growth through Support to Private Sector Development***, with expected outcomes including (a) macroeconomic stability; (b) improved business climate through better quality of business regulations and improved public-private sector dialogue; (c) improved public infrastructure; (d) increased operational efficiency of financial institutions; (e) improved functioning of the land market; (f) improved corporate governance; (g) increased transparency and efficiency in the management of public spending and stronger institutions for planning, tendering and providing infrastructure and services; (h) better accountability in public administration; and (i) better management and planning for Albanian coastal resources.

**II. *Improving Public Service Delivery, particularly in the Social Sectors***, with expected outcomes including: (a) improved educational attainment and quality of basic education; (b) improved efficiency and equity of health financing; (c) better quality of health care; (d) improved fiscal sustainability of the social insurance system and increased access to well-targeted, sustainable, and effective assistance; and (e) improved access to safe rural water supply and sanitation.

The 2006–09 CAS proposed a lending range of US\$ 75–US\$ 196 million, with actual lending to be determined by the pace of reform in key sectors. The active World Bank portfolio includes 18 investment projects with a total commitment of \$295.5 million, of which about \$218.6 million remain to be disbursed. Four new projects totaling US\$ 70 million were approved by the Bank Board in the last month of the FY 2008. These projects focus on improving the secondary and local roads, safety of dams, disaster risk mitigation and adaptation, and ecosystem management. The first Development Policy Operation (DPO) was approved on March 29, 2007 and a CAS Progress Report (CAS PR) was presented to the Board in June 2008. A second Development Policy Operation (DPO) is expected to go to the Board in the first half of 2009.

### **Bank-Fund Collaboration in Specific Areas**

As in previous periods, the World Bank assistance for structural reform in Albania will continue supporting the IMF's lead role on support for macro-economic policies aimed at facilitating sustainable growth. Continuing collaboration is likely to become even more critical given that most of the outstanding areas for reform remain on the structural side. In areas of direct interest to the IMF, the Bank is engaging in policy dialogue and providing financial and technical assistance to support (i) improved public expenditure management; (ii) public sector reform; (iii) pension, health and social assistance reform; (iv) financial sector reform and development; and (v) an improved policy environment for business.

**Public expenditure management:** Albania's systems of Public Financial Management (PFM) and related fiscal institutions constitute a main risk for macroeconomic stability and high quality fiscal adjustment. Over the past years, the Bank has complemented IMF policy conditionality and technical assistance with a multi-pronged assistance program including lending operations and fiduciary and diagnostic work. Under the new CAS, the Bank will continue its support to the GoA through the ongoing Programmatic Public Expenditure and Institutional Review (PEIR) and the Country Fiduciary Assessment Update (CFAU-FY06). These have identified key weaknesses in the PFM system and provide the underlying analysis for defining policy reform conditionality in the Development Policy Operation (DPO) that focus on public investment management.

To increase the effectiveness of public expenditure and public financial management system, the World Bank will support a number of measures to further improve the strategic allocation of resources mainly through the support to the implementation of the Integrated Planning System (IPS); improving the linkages between recurrent and investment spending and strengthening the rigorous review of public investment projects based on economic and financial criteria.

**Public sector reform:** The civil service and broader public sector employment structures require continued engagement and support. The Bank and IMF are working closely to ensure that an appropriate framework remains in place to allow the Government to move ahead with efforts to (a) strengthen accountability mechanisms for public entities, both Ministries and subordinated agencies, rendering them more efficient; (b) increase competitiveness of the salary structure and the ability of the civil service to attract skilled and competent professionals; and (c) consolidate and deepen the measures aimed at the depoliticization of the civil service, both through improved adherence to the requirements of the Civil Service Law, as well as through a cautious, measured expansion of the Civil Service Law in a manner that is fiscally responsible. As deeper reform of public administration is currently anticipated through the CAS period, the Bank through the DPO continues to engage on civil service reform.

**Power sector reform:** While the Bank has taken the lead in developing the policy agenda, the sector's fiscal impact has also motivated conditionality in IMF-supported PRGF/EFF arrangements. Since mid-2006, KESH's financial situation has deteriorated significantly as a result of the following factors: (a) severe shortage in electricity supply in the region which led to a significant rise in electricity import prices; (b) unfavorable hydrology since late 2006; (c) a suboptimal management of hydro resources in the last quarter of 2006; and (d) poor performance of the utility as indicated by low collection rates and large losses. The hydrology and reservoirs management have improved in 2008. The tariff increase effected in March 2008 was insufficient to cover fully cost of electricity. This and large unpaid electricity consumption continue to hamper KESH's financial situation, which puts the company's investments as well as operational performance at risk.

Conditionality related to improving sector performance, sector restructuring, and strengthening the regulatory and legislative framework is included in successive Bank-financed projects. On-going projects include the Power Sector Generation and Restructuring Project (2004) that will provide new thermal generation capacity (expected to be operation in 2009) and is co-financed by EBRD and EIB; and the ECSEE APL2–Albania Project (2005) that is co-financed by EBRD and will finance the upgrading of the high-voltage transmission substations, thereby facilitating Albania's participation in the Energy Community of South East Europe (ECSEE), and newly approved ECSEE APL5 for Albania dam safety.

Final negotiations with the winning bidder for the distribution arm of KESH—which is working as a separate distribution system operator (OSSH) since July 2008—are underway. The IFC is advising the authorities on the privatization of OSSH and the Bank is negotiating a Partial Risk Guarantee for this operation.

**Social insurance reforms:** The financial stability of the social insurance system and the coverage and targeting of the social assistance system are key components of medium term fiscal consolidation. Both the Bank and the IMF have focused on pension reform under the PRSC and PRGF programs, including the increase of the retirement age for men and women. The short-term agenda will focus on strengthening the financial sustainability of the existing pension scheme while aiming for a reduction of the overall payroll tax burden in the medium term so as to help improve competitiveness of Albanian labor. The Bank is supporting SII in developing its capacity to model medium- and long-term impacts of policy changes on the fiscal sustainability of the social insurance system and to identify a sustainable path for future reforms to the social insurance system. The Bank and the IMF are supporting such reforms in a coordinated fashion. They will also work closely to ensure that essential pre-conditions for future structural reforms to the pension system will be put in place, including strengthening of the financial markets.

**Financial sector reform and development.** Albania has made significant progress towards the adoption of a market-based economy with the support of the World Bank and the IMF. The Financial Sector Adjustment Credit (FSAC), approved by the Board in June 2002, has helped to advance reforms in the banking sector, including the privatization of the Savings Bank, the development of a deposit insurance system, improvement of the bankruptcy framework and collateral enforcement, strengthening of bank regulation and supervision, and the development of a Real Time Gross Settlement (RTGS) system.

The WBG in conjunction with the IMF are assisting the Government in the completion of the financial sector reform agenda and support the implementation of the recommendations of the 2005 Joint IMF-World Bank Financial Sector Assessment Program (FSAP). The DPO is providing support for policy measures aimed at the (i) adoption of a legal, institutional and supervisory framework enabling sound development of the non-banking financial sector, including the insurance sector; (ii) strengthening insurance supervision and regulation; and

(iii) adoption and implementation of an ED—compatible legal and institutional framework for accounting and auditing.

This reform agenda is being coordinated with European Commission institutions, especially in those elements of the reform agenda, such as accounting and auditing, for which the *acquis communautaire* is relevant.

**Improving the business environment.** Improving the business environment will be crucial to overcome high levels of unemployment, attract the badly needed investment flows, and boost exports. Complementing the IMF dialogue on macro-economic stability and its technical and advisory assistance to strengthening tax administration, the Bank is using a combination of instruments. These include the Business Environment Reform and Institutional Strengthening and the Land Management and Urban Development projects in conjunction with the DPO to support improvements in the business climate, through (i) the adoption and implementation of regulatory governance tools aimed at improving the quality of business-sector related regulations; (ii) establishment and operations of a Secretariat for Regulatory Reforms for the removal of administrative barriers to investment; and (iii) adoption and implementation of a transparent land registration system.

Prepared by World Bank staff. Questions may be addressed to Mr. Roland Clarke at 202-458-4820.
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### **Annex III: Statistical Issues**

Data provision has some shortcomings, but is broadly adequate for surveillance. Albania was a pilot country for the data module of the Report on the Observance of Standards and Codes (ROSC); data ROSCs have been published in May 2000 and October 2006. Albania participates in the General Data Dissemination System (GDDS).

A March 2006 data ROSC reassessment mission assessed data quality based on the Data Quality Assessment Framework. In addition, at the request of the authorities, the mission conducted an assessment of dissemination practices against the Special Data Dissemination Standard (SDDS) and prepared a work program and timetable for meeting the requirements for SDDS subscription.

The ROSC reassessment mission found significant progress in adopting international statistical standards despite acute resource constraints. Official statistical agencies demonstrate strong and sustained commitment to plans and programs to further upgrade statistics in response to greater challenges posed by: (i) a rapidly evolving economy; (ii) the adoption of an inflation targeting regime; and (iii) growing national interest in joining the European Union. However, due to severe resource constraints at the Institute of Statistics (INSTAT), the improvement in the national accounts has been slower relative to other datasets.

The *Law on Official Statistics* (2004) strengthened the legal framework for INSTAT as an independent agency under the Council of Ministers, and articulated the role of the Statistics Council as INSTAT's governing body. In addition, planned Memoranda of Understandings between INSTAT, the Ministry of Finance (MoF) and the Bank of Albania (BoA) should facilitate data sharing and coordination among these agencies.

A further review of progress towards SDDS subscription was carried out in October 2007. The mission found that the BoA has started disseminating draft versions of the Advance Release Calendar and the National Summary Data Page, covering data from INSTAT, the MoF and the BoA. The mission concluded that Albania would be ready for SDDS subscription within 12 to 18 months, assuming that the current momentum in improving data can be maintained. The main obstacles are in real sector statistics, which are being addressed through the peripatetic technical assistance project.

#### **A. Real Sector Statistics**

##### **National accounts**

National accounts are compiled from insufficient and poor quality sources. While technical assistance has been provided on methodological procedures, source data still do not provide sufficient information to compile reliable estimates on the nonobserved economy. In



November 2005, INSTAT released major revisions of the national accounts estimates for 1996–2003 and updates for 2004, reflecting methodological improvements.

The ROSC reassessment mission recommended (i) improvement of source data to adequately capture the nonobserved economy; (ii) expansion of the scope of annual national accounts to include the income account, the capital account, and the rest of the world accounts; and (iii) improvement of the timeliness of GDP data (currently 12 months) so as to meet the 9-month recommendation of the GDDS. INSTAT needs additional staff and financial resources to fully carry out its statistical work program.

INSTAT has benefited from technical assistance from the Fund and the European Union (EU), mainly to address weaknesses in methodology, basic data sources, and coverage of the private sector. STA provided technical assistance through peripatetic missions during 2008 to (a) improve the accuracy of the data sources and statistical techniques used in compiling annual GDP by activity and by expenditure approach; (b) to establish a compilation system for quarterly national accounts (QNA); and (c) to improve the dissemination of national accounts data and metadata. New data from the most recent Household Budget Survey (HBS) and Labour Force Survey (LFS) were incorporated into the compilation of the national accounts. The LFS was incorporated into the estimates of the nonobserved economy in the annual national accounts while attempts were made to use the HBS to develop a new benchmark estimate of private consumption. A new methodology for gross fixed capital formation based on a commodity flow approach was developed. QNA were compiled during the project; official dissemination will follow with a short delay.

### **Price statistics**

The CPI is reported regularly for publication in the *International Financial Statistics (IFS)*. Compilation generally follows international standards, and the estimation of imputed rent within the CPI was improved in 2003. The recent ROSC mission recommended (i) introduction of checks on the prices reported by enumerators; (ii) replacement of nonrespondents to the HBS with similar households; and (iii) inclusion of new items in the CPI as they become significant. In December 2007, INSTAT has updated the CPI weights using the results of a new national-level HBS conducted during the period October 2006-September 2007.

A monthly PPI has been published quarterly since March 2002. Prices are not collected each month, but only once a quarter, due to financial constraints. The weights were derived from the 1998 annual Structural Business Survey. The ROSC mission recommended (i) monthly publication of the PPI; (ii) replacement of enterprises that go out of business; and (iii) validation of the PPI results against other available price data.

## B. Government Finance Statistics (GFS)

GFS generally follow internationally accepted standards and guidelines on concepts and definitions, scope, classification and sectorization, and basis for recording vis-à-vis the *Government Finance Statistics Manual 1986 (GFSM 1986)*. The scope of the general government sector encompasses budgetary central government, local government, and two extrabudgetary funds, the social security fund and the health insurance fund.

The *Organic Budget Law* and the *Guidelines on State Budget Performance* clearly provide the MoF with a mandate to compile and disseminate GFS. The main data sources, which are timely, are reports of (i) District Treasury Offices; (ii) the Debt Management and Financial Analysis System; (iii) project implementation units for foreign financed projects; and iv) the extrabudgetary funds. External donor financed-projects that do not pass through the treasury system, represent a weakness in source data. Following the ROSC mission's recommendation that MoF accelerate work aimed at formally adopting *GFSM 2001*-based reporting format and improve source data coverage for external donor-financed projects, the authorities have begun reporting high frequency fiscal data for publication in the *IFS* using the *GFSM 2001*-based monthly Statement of Sources and Uses of Cash. Albania has submitted annual *GFSM 2001*-based fiscal data to the Fund for publication in the *Government Finance Statistics Yearbook* for 2001–07.

## C. Monetary and Financial Statistics

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

In January 2005, the BoA began reporting its monetary data to STA using Standardized Report Forms (SRFs). The monetary data in the SRFs format have been published in the quarterly *IFS Supplement* since September 2006. The reporting of monetary data in the SRFs format facilitated the implementation of an integrated monetary database to be used for both publication in *IFS* and for operational needs of EUR.

To further improve the compilation and dissemination of statistics, the ROSC reassessment mission recommended that BoA (i) apply fully the *MFSM*'s recommendations on market valuation and accrual accounting; (ii) implement measures to improve the accuracy of the banks' reporting; (iii) implement an electronic (online) reporting system for banks and other financial institutions; and (iv) introduce a database driven compilation system for monetary

statistics. The authorities have informed STA of good progress towards implementing the ROSC mission's recommendations, particularly those related to the use of market valuation and improvement of the accuracy of the commercial banks' reporting.

#### **D. External Sector Statistics**

##### **Balance of payments**

The data compiled by the BoA are methodologically sound, although some of the estimates, particularly for international transactions outside the banking system need to be refined. The BoA has established data compilation procedures based on the classification system of the fifth edition of the *Balance of Payments Manual*. The BoA reports quarterly data to STA on a regular and timely basis. It has revised the methodology for the measurement of tourism services, principally through surveys of travelers. Problems remain in the areas of service transactions and remittances, and in the monitoring of financial account transactions, foreign assistance (grants from abroad to regional and local governments are underreported), and external debt. These problems could be addressed by strengthening existing data sources and improving estimation methods.

A November 2004 mission noted that the coverage and accuracy of the data should be improved through the strengthening of the legal framework and the use of the bank reporting system to verify the data from enterprise surveys. It also recommended incorporating the results of the direct investment survey as well as investigating the net errors and omissions observed at the level of individual reporting banks. The February 2006 follow-up mission focused on remittances, goods for processing, services (particularly travel services), official transfers, and direct investment.

To further improve compilation and dissemination of statistics, the ROSC reassessment mission recommended that BoA (i) improve source data to adequately capture remittances; (ii) strengthen its law to: provide for the sanctions—including fines—needed to mandate response to surveys by nonbank reporters, inspect the financial accounts of firms, and prohibit the provision of individual reporter's data to tax authorities; (iii) require quarterly reporting by significant firms of transactions in direct investment equity, debt, and reinvested earnings, in portfolio equity and debt, and in trade credit; and (iv) introduce a database driven compilation system.

A September–October 2007 mission reviewed the remittances and travel service estimates and reconciled the financial account and International Investment Position. The mission noted strong progress in adopting earlier recommendations but advised that estimation methods for transactions outside the banking system (mostly remittances and investment transactions by nonresident Albanians) require further improvement.

**External trade**

The compilation and dissemination of foreign trade data has improved in recent years, following disruptions in the late 1990s. One important contributing factor has been the implementation of the Automated System of Customs Data (ASYCUDA) software system, supported by the EU. Further progress is expected in the area of trade in services as a result of the implementation of surveys.

**External debt and grant statistics**

Good quality external debt statistics for public and publicly-guaranteed debt are compiled by the MoF. The external debt database ensures timely and accurate reporting of external government debt (including commitments of state-owned enterprises). However, there have been some irregularities in the recording and presentation of external arrears. The External Debt Committee would need to improve inter-agency coordination to ensure the timely and accurate reporting of the stock of external arrears and changes resulting from rescheduling agreements. The collection of data on external grants is not timely, with lags of several months frequently encountered. In consultation with donors, the authorities are preparing a new framework to improve data collection and reporting, to be led by the MoF.

**ALBANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE**  
**As of December 17, 2008**

	Date of latest observation	Date received	Frequency of Data <sup>7</sup>	Frequency of reporting <sup>7</sup>	Frequency of publication <sup>7</sup>	Memo Items:	
						Data Quality – Methodological Soundness <sup>8</sup>	Data Quality – Accuracy and Reliability <sup>9</sup>
Exchange Rates	12/17/08	12/17/08	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	10/31/08	11/2008	M	M	M		
Reserve/Base Money	October 08	12/02/08	D and M	D and M	M and M	O, O, O, LO	O, LO, LO, O, O
Broad Money	October 08	12/05/08	M	M	M		
Central Bank Balance Sheet	October 08	12/02/08	D and M	D and M	M and M		
Consolidated Balance Sheet of the Banking System	October 08	12/05/08	M	M	M		
Interest Rates <sup>2</sup>	12/17/08	12/17/08	D	D	D		
Consumer Price Index	October 2008	11/17/08	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	November 2008	12/12/08	M	M	M	LO, O, O, O	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	November 2008	12/12/08	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	06/2008	10/16/08	Q	Q	A		
External Current Account Balance	9/2008	12/10/08	Q	I	I	O, O, O, LO	LNO, O, LO, LO, O
Exports and Imports of Goods and Services	6/2008	10/06/08	M	Q	Q		
GDP/GNP	2006	12/2007	A	A	A	O, LNO, O, LO	LNO, O, LNO, LO, LO
Gross External Debt	12/2007	5/2008	Q	I	NA		
International Investment position <sup>6</sup>	2007	5/2008	A	A	NA		

<sup>1</sup> Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

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

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

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

<sup>5</sup> Including currency and maturity composition.

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

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

<sup>8</sup> 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).

<sup>9</sup> 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

**Attachment: Letter of Intent**

Tirana, January 8, 2009

Mr. Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

The current Fund-supported program, approved in January 2006, is coming to a close. During the three years of the program, Albania has maintained macroeconomic stability, improved its debt sustainability outlook, and made substantial progress with structural reforms. In 2008, inflation remained low, and growth buoyant at about 6 percent. The budget deficit was about 5.2 percent of GDP, in line with the program target. Our monetary policy stance is at an appropriate level, and the banking system remains solvent, liquid, and profitable.

Our policies in 2009 will be guided by the goal to preserve macroeconomic stability, sustain growth and advance our structural policies agenda. We expect some deterioration in the external environment with export demand and remittances declining, and external financing tightening.

Given the current challenging environment, our principal goal this year is to strengthen economic fundamentals and further reduce vulnerabilities. We therefore remain committed to a prudent fiscal policy: the 2009 budget foresees a deficit of 4.2 percent of GDP, which—given the usual mobilization delays for foreign-financed projects—is expected to keep the end-year deficit below 4 percent of GDP. We are postponing planned reductions of social security contribution rates to May 1 and will adjust wholesale electricity tariffs to cost-recovery levels; as a first step, we have asked the energy regulator to calculate the required level. Moreover, we are increasing the contingencies in the 2009 budget to some 2 percent of GDP to offset any revenue shortfalls or other developments that would threaten budget targets. The lower budget deficit, combined with expected privatization proceeds, will contain net domestic borrowing within acceptable bounds and minimize crowding out of private investment.

We are committed to the floating exchange rate regime. Monetary policy will continue to be guided by our inflation targeting framework and we will work to further improve its legal and institutional framework. With respect to the financial sector, we will remain vigilant and

enhance our already considerably improved capacity for high-frequency monitoring of financial conditions, and further strengthen our supervisory and regulatory regimes. All quantitative performance criteria and structural benchmarks set under the program for the sixth review have been observed with the exception of the end–October benchmark for the effective collection rate on electricity consumption. Whereas substantial progress was made in raising the effective collection rate, the target of 62 percent at end of October was missed by 2 percentage points—if arrears by the budgetary institutions and public water companies that have now been cleared are excluded from the calculation. The company is expected to have achieved the end–year effective collection target.

We are progressing towards the privatization of the electricity distribution company and are committed to ensure complete cost recovery tariffs for KESH. We are aiming to conclude a final contract for a 76 percent share in the distribution company OSSH. We expect the private distributor to enhance efficiency and raise effective collection rate to 82 percent by 2014. The privatization process for public insurance company INSIG is also by now quite advanced. Half of the proceeds from these privatizations will be used to reduce public debt and the other half expended on priority road projects.

On this basis, we request completion of the financing assurances review, and completion of both the sixth review under the three–year PRGF arrangement and the sixth review under the three–year EFF arrangement. We also request the seventh disbursement under these arrangements in an aggregate amount of SDR 2.435 million.

Following this arrangement, and as long as Albania has outstanding financial obligations to the IMF arising from loan disbursements under the present arrangement, Albania will consult with the IMF on economic and financial policies, at the initiative of the government or the Bank of Albania, or if the Managing Director of the IMF request such consultation. These consultations may include correspondence and visits of officials of the IMF to Albania or of representatives of Albania to the IMF.

In continuing with our policy of transparency, we consent to the publication of this letter, and the accompanying Executive Board documents on the IMF’s website.

Sincerely yours,

/s/

Sali Berisha  
Prime Minister

/s/

Ridvan Bode  
Minister of Finance

/s/

Ardian Fullani  
Governor, Bank of Albania

**Statement by the IMF Staff Representative  
January 28, 2009**

1. This statement reports on developments since the issuance of the staff report (EBS/09/5). The additional information does not change the thrust of the staff appraisal.

2. **Deposit withdrawals started to reverse in late December and deposits have so far recovered by about ½ percentage points of GDP.** However, the loss was somewhat larger than anticipated in the staff report—despite the turnaround, total deposits were down by about 7 percent at end-2008 compared to end-September. Still, confidence in the domestic currency does not appear to have diminished, as the exchange rate remains relatively stable despite the absence of intervention.

Albania: Projections of Monetary Aggregates, Sept-Dec 2008  
(Annual percentage change)

	Actual	EBS/09/5
	Sept 2008	Dec 2008
Broad money	14.9	6.3
Currency outside banks	3.5	13.2
Deposits	17.9	4.5
In domestic currency	12.3	1.2
In foreign currency	25.7	9.1
Credit	42.9	25.1
In domestic currency	30.5	20.7
In foreign currency	48.3	26.9
Net foreign assets	-7.2	-0.1
BoA	6.2	17.2
Commercial banks	-37.9	-48.8
Assets	2.9	2.1
Liabilities	90.7	72.6

Source: Albanian authorities and IMF staff estimates.

3. **For the first time, Albania has published quarterly national accounts.** Quarterly GDP growth came in at 9.9 percent y-o-y basis through September 2008. Staff considers this to be broadly consistent with its projections (6 percent in 2008 and 3.7 percent in 2009). First, the quarterly data tend to be volatile and significant revisions are likely—especially in the construction sector where there are inconsistencies between production and use data. Second, quarterly GDP data only cover the formal sector’s activities and, with the ongoing formalization of the economy, are likely to overestimate growth. Third, the global economic turmoil, which has spilled over to Albania in the final months of 2008, will cut growth in the final quarter of the last year because of weakened remittances, exports and investment.





Press Release No.09/16  
FOR IMMEDIATE RELEASE  
January 28, 2009

International Monetary Fund  
Washington, D.C. 20431 USA

**IMF Executive Board Completes the Sixth and Final Review Under the PRGF and EFF Arrangements with Albania and Approves US\$3.6 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) today completed the sixth and final review of Albania's economic performance and financing assurances under the three-year Poverty Reduction and Growth Facility (PRGF) arrangement and the Extended Fund Facility (EFF) arrangement. The completion of the reviews enables the release of an amount equivalent to SDR 2.435 million (about US\$3.6 million), which will disburse the total amount available under both arrangements.

The concurrent three-year arrangements under the PRGF and EFF, amounting to the equivalent of SDR 17.045 million (about US\$25.4 million), were approved on February 1, 2006 (see [Press Release No. 06/17](#)).

Following the Executive Board's discussion of Albania, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, stated:

“The Albanian authorities are to be commended for their strong performance under the Fund-supported program. Their adherence to sound economic policies and the progress made in structural reforms have allowed Albania to sustain high growth and maintain low inflation. The strengthening of revenue administration, near completion of the privatization agenda, and improvement of the business environment are particularly welcome.

“However, the global economic downturn and financial turmoil have increased vulnerabilities, as pressures are emerging from slowing remittances and exports, and tightening financing conditions. Continued steadfast implementation of sound economic policies and unwavering commitment to reform are necessary to navigate the current environment.

“Further fiscal consolidation will be key to reinforcing the economy’s resilience. The tighter fiscal stance, to which the authorities have committed for 2009, will help to lower budgetary financing needs in a challenging environment. Controlling expenditure, delaying planned cuts in social security contributions, and raising wholesale electricity tariffs to cost-recovery levels will support the appropriate fiscal stance.

“Over the medium term, further fiscal reforms will create room for development spending, while maintaining macroeconomic stability. A fiscal rule would be an important tool to better anchor fiscal policy, strengthen fiscal discipline, and reduce public debt. In addition, increasing incentives for workers to participate in the pension system would help combat tax evasion.

“The existing monetary policy framework, including an independent central bank and a floating exchange rate, has served the economy well and remains appropriate. Significant buffers and inherent strengths are underpinning the stability of Albania’s financial sector. Continuing diligent supervision, high-frequency monitoring, and close coordination with foreign supervisors of resident banks will be important to mitigate emerging risks. The recent enhancement of the mechanisms for liquidity provision is welcome. Early enactment of new bankruptcy and collateral laws will further strengthen crisis preparedness.

“Decisive progress on improving the performance of public utilities, particularly the electricity companies, is a key reform priority. The successful launch of the privatization process for the electricity distribution company was a step forward, and finalizing the sale of the distribution company would offer a chance to reduce electricity theft and to assure a reliable supply over the medium term,” Mr. Portugal said.

**Statement by Arrigo Sadun, Executive Director for Albania  
and Francesco Spadafora, Senior Advisor to Executive Director  
January 28, 2009**

On behalf of the Albanian authorities, we thank staff for the well-written and informative report and for the remarkably close and constructive cooperation with the authorities maintained throughout the program.

**Overview**

In the context of favorable external conditions, the 2006-08 PRGF-EFF arrangement has underpinned Albania's strong non-inflationary growth, which has allowed the country to join the rank of the middle-income countries.

Growth remained above 6 percent through the first half of 2008, while inflation returned within the Bank of Albania's  $3\pm 1$  target band and inflation expectations are well anchored.

Public finances have improved markedly. Significant progress was made in strengthening the revenue administration, as the tax revenues-to-GDP ratio increased by over 2 percentage points despite a reduction in corporate and personal income taxes. Improvements in public debt management have led to a reduction in the debt-to-GDP ratio from 56 percent in 2006 to 52.6 percent in 2008, and to the doubling of the average maturity of public debt.

The deterioration in the current account balance (excluding official transfers) over the program years (from -7.3 percent in 2006 to -11.8 in 2008) partly reflected temporary factors, namely the spike in food and fuel import prices that occurred in the first half of 2008 and the scaling up of a major import-intensive road project. As underscored by staff, the temporary increase in the current account deficit has been fully financed, and the underlying trends remain sound. The reversal of those temporary factors should lower the current account deficit to 7.7 percent in 2010.

Policy implementation in 2008 has been broadly in line with the program, as the authorities have maintained tight macroeconomic policies. All quantitative performance criteria and structural benchmarks set under the program for the sixth review have been met, with the only exception of the end-October effective electricity collection rate for the electricity company KESH. However, the target of 62 percent was missed by only 2 percentage points, and the company is expected to achieve the end-year target.

Albania is now facing the adverse consequences associated with the severe downturn of the global economy. While the medium-term outlook appears relatively favorable, sustained by prudent macroeconomic policies and improved business environment, the global financial crisis has increased external, fiscal and financial sector vulnerabilities.

The authorities expect a decline in exports and remittances, as well as less favorable external and domestic financial conditions. However, their current outlook for growth is somewhat more optimistic than staff's. Against this background, the authorities' policies for 2009 aim at preserving macroeconomic stability and further reducing vulnerabilities, while sustaining growth and advancing structural reforms.

### **Policy commitments for 2009**

The authorities remain committed to a prudent fiscal policy. In the face of less favorable financing conditions and heightened rollover risk, they have tightened the 2008 budget by allowing new spending requirements to be met through reallocations. This should preserve the 2008 deficit target of 5.2 percent of GDP.

The 2009 budget envisages a deficit of below 4 percent of GDP. This target strikes a balance between the need to finance key public investment and a tighter fiscal stance made necessary by the increase in borrowing requirement (2.5 percent of GDP, up from essentially zero in 2008). Against a background of intensified financing pressures and uncertainty in early 2009, the authorities agreed to further strengthen the budget by increasing wholesale electricity tariffs, as well as by postponing the planned reductions in the employer social security contribution rate from January to May. Moreover, the 2009 budget includes contingency reserves of about 2 percent of GDP.

In the longer term, fiscal discipline will be further pursued by the adoption of a credible fiscal rule, possibly an expenditure-based one, which would be instrumental in containing the size of the public sector while allowing automatic stabilizers to play a greater role.

On the monetary front, the authorities are committed to the current policy framework, which combines an inflation target range with a flexible exchange rate regime, and has proved to work well as a shock-absorber in the face of the recent commodity price shock.

### **Impact of the global financial turmoil on the financial system**

Supervisory and regulatory regimes were considerably enhanced during the program. Facing the sharp deterioration in the external environment and less favorable financial conditions, the authorities have reacted swiftly to preserve financial stability. They remain vigilant and ready to tackle any potential problems.

In October 2008 the banking system started experiencing some withdrawals of bank deposits, triggered by concerns about the soundness of the banking systems in the whole region, which in turn led to increases in deposit insurance levels outside Albania. Besides, less favorable financing conditions were evidenced by several subsequent government debt auctions that were significantly undersubscribed.

Large liquidity buffers, built up through pro-active regulatory and supervisory measures adopted in the past, have allowed banks to meet withdrawals without experiencing systemic strains. Furthermore, bank deposits are gradually returning. In any event, the Bank of Albania is ready to act as a lender of last resort in domestic currency. Regulatory provisions are also in place to ensure that banks properly hedge foreign currency liabilities.

As noted in the staff report, Albania's financial system compares favorably within the region. September 2008 core indicators depict a well capitalized, solvent, liquid and profitable banking system; banks have reportedly little or no direct exposure to international troubled assets or counterparts. While the banking system is predominantly foreign owned, contagion risks are mitigated by a large domestic deposit base, which is the main funding source.

Despite those strengths, the authorities have intensified efforts to improve crisis management in case of a further worsening of financial conditions. Given the preponderance of foreign-owned banks, the Bank of Albania (BoA) has stepped up cross-border coordination efforts with regional supervisors and moved forward to sign MoUs with parent-bank supervisors. To underpin prompt proactive responses to changing circumstances, the BoA has significantly improved its ability to gather high frequency data on developments in the banking sector, and has increased the maturity and volumes of liquidity it provides to banks through the repurchase market. Broadening eligible collateral for liquidity provision is under consideration.

### **Structural reforms**

Further progress has been made in structural reform. Since the last review, assessments carried out by the World Bank, EBRD and Transparency International have acknowledged improvements in Albania's business environment. The privatization program has approached the end with the sale of the oil company ARMO and the insurance company INSIG. The proceeds from privatizations will be evenly allocated between public debt reduction and capital expenditure on priority road projects. Power sector reform is at a critical juncture. Following the unbundling from the electricity company KESH in June 2007, a 76 percent stake in the power distribution system operator OSSH was successfully tendered, and final negotiations with the winning bidder started in November 2008. It is expected that efficiency gains on the part of the new private owner will raise the electricity effective collection rate to 82 percent by 2014. The authorities remain committed to ensure complete cost recovery tariffs for KESH.

### **Relationship with the Fund**

Fund-supported programs have served as a policy anchor since the early 1990s. The current arrangement expires under challenging external circumstances. While the authorities see potential merit in a precautionary Stand-by Arrangement, they considered that current expectations for growth do not call for a successor arrangement at this time.