

Albania: 2011 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Albania

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Albania, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 22, 2011, 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 August 23, 2011. 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 Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its September 7, 2011 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Albania.

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

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ALBANIA

Staff Report for the 2011 Article IV Consultation

Prepared by the Staff Representatives for the 2011 Consultation with Albania

Approved by Juha Kähkönen and James Roaf

August 23, 2011

Executive Summary

Background: Albania weathered the global crisis well, owing to generally sound policies during the preceding boom, which provided policy space to mitigate the crisis fallout. The crisis also ushered in the needed rebalancing of the economy, and the very large external imbalance has narrowed. However, TFP growth has decelerated, the budget repeatedly slipped, and policy makers have yet to come to grips with the post-boom environment. Politics remain divisive and threaten consensus on reform, including measures needed to progress with EU candidacy. Short-term risks are elevated given Albania's large exposure to the euro-area periphery.

Challenges: The key challenge is to make the policy framework consistent with the achievement of external sustainability, thereby reversing the decline in TFP growth. In the near term, contingency planning with respect to euro-area periphery developments is essential.

Policy discussions: Fiscal consolidation is the lynchpin for a sustainable medium-term outlook. This requires more realistic budgeting, and staff recommended an expenditure-based fiscal rule tied to public debt reduction to 50 percent of GDP over the medium term. Also, it is essential to address delays in key structural reforms, notwithstanding political difficulties. Financial sector policy needs to remain nimble and quickly adapt to evolving risks.

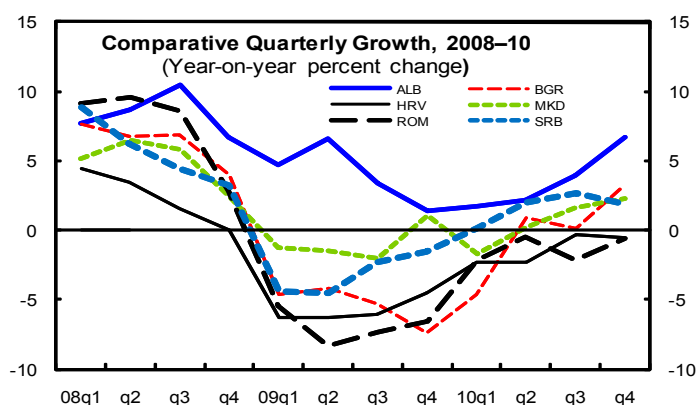
Authorities' views: There was a high degree of agreement in the discussions, especially on the short-run need for fiscal measures and on financial sector policies. The authorities had a more favorable medium term outlook, which also implied less of an adjustment need, and were not yet ready to decide on the specifics of a fiscal rule.

Discussions were held in Tirana during June 9–22. The mission comprised Mr. Bell (head), Ms. Chen, Mr. Stepanyan (all EUR), Mr. Eich (FAD), Ms. Araujo (SPR), and Ms. Spahia (Tirana-based economist). The mission met with Prime Minister Berisha, the Minister of Finance, other Ministers, the Governor of the Bank of Albania, other senior officials, and representatives of financial institutions, corporations, donors, academia, and think tanks.

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I. CONTEXT—PATCHY ADJUSTMENT TO THE POST BOOM

1. **The global crisis left Albania fairly unscathed and ushered in the needed economic rebalancing.** Recession was avoided, and the growth shock was less severe than elsewhere in Europe (Figure 1). Meanwhile, external sustainability has begun to improve, and the country was able to place a €300 million debut Eurobond in the fall of 2010. The financial system overcame heightened stress in the immediate aftermath of the crisis and avoided a credit bust, though asset quality declined. This performance owed much to the aggressive use of accumulated fiscal and monetary policy buffers which are now, however, depleted.



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

2. **The policy framework has been challenged in the post-crisis environment.** In addition to the desirable reversal of overheating pressures that had occurred in the final phase of the boom, potential growth has declined, mainly on account of lower TFP growth. The pre-crisis boom enabled the simultaneous achievement of tax cuts, large primary spending increases, and fiscal consolidation. The authorities have since struggled to align budget policies with the new environment, putting already high public debt on a rising path. This heightens financing risk and also threatens fiscal dominance for monetary policy. Albania's exposure to the euro periphery, including a large presence of euro-periphery banks, heightens near-term risks.

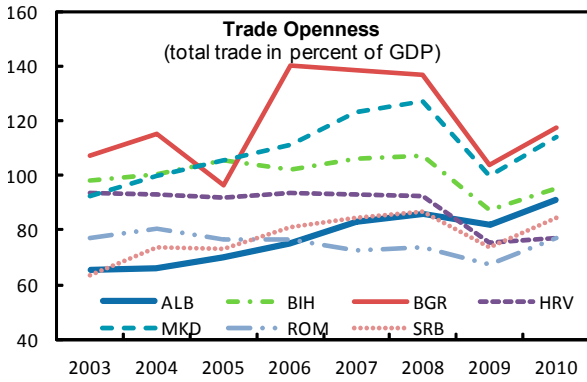
	Contributions to potential growth 1/			
	Growth	Capital	Labor	TFP
1997-2001	7.1	0.3	-1.2	8.0
2002-2007	5.6	1.6	-0.7	4.7
2008	5.4	2.0	0.1	3.3
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2010	3.9	0.8	0.3	2.7

1/ Production function with smoothed labor and TFP input (HP-filter with $\lambda=100$; $\lambda=6.25$ yields similar results)

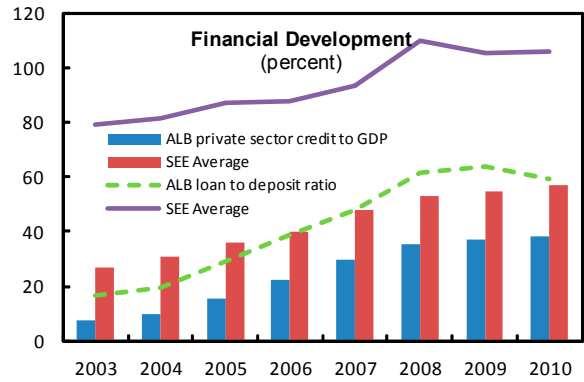
3. **Politics have been difficult.** After fatalities during protests in January against the contested 2009 election, the May 2011 local elections were keenly anticipated. The vote was close and went largely smoothly. However, the very tight race in Tirana—a narrow win for the incumbent mayor and opposition leader—was overturned in a controversial recount. Renewed controversy is thus likely ahead of the 2013 general elections, putting into question the achievement of a wide political consensus for key priorities, including those related to advancing Albania's EU candidacy.

Figure 1. Albania: Strong Performance During the Crisis

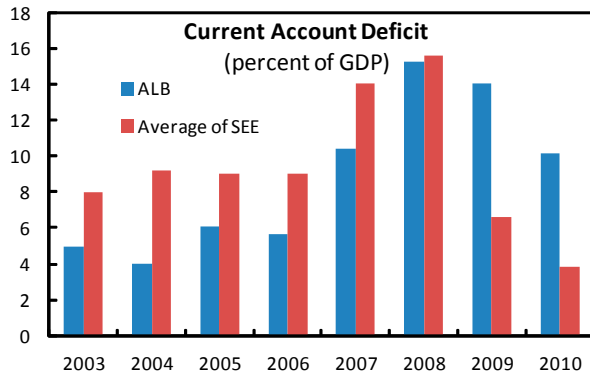
Albania is less integrated into the international market



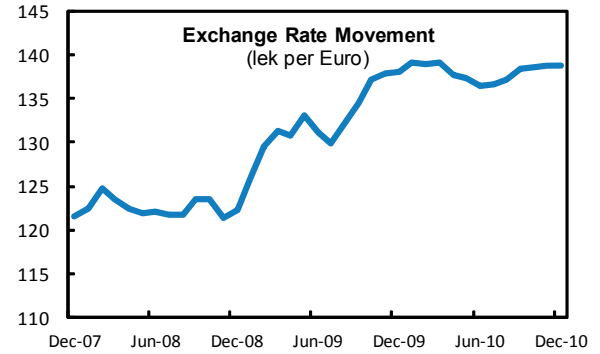
with lower financial intermediation and locally financed banks.



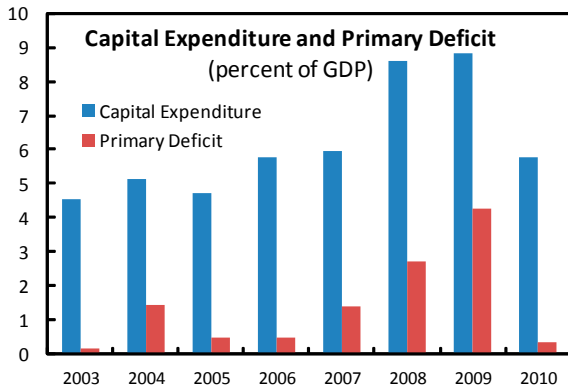
The pre-crisis external imbalance was relatively smaller,



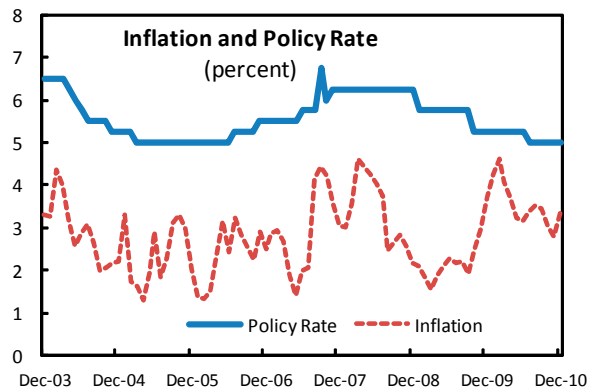
and the flexible exchange rate helped buffer the shocks,



which were also absorbed by timely fiscal stimulus in 2008-09,



as well as accommodating monetary policy actions.



Sources: World Economic Outlook; and IMF staff calculations

II. BACKGROUND

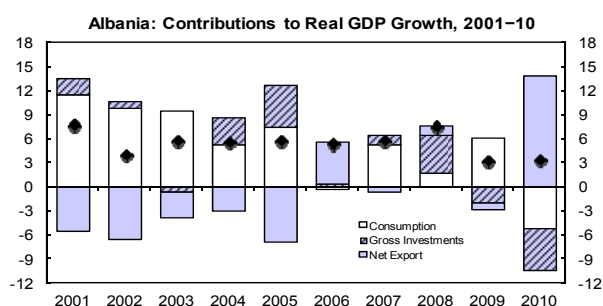
A. An Uneven Start to Rebalancing

4. **The switch from the pre-crisis domestic-demand led growth model is imparting significant headwinds.** Though imbalances never reached the stark levels observed in some other countries, Albania is no exception in the region, where the post-2000 economic boom was associated with significant increases in domestic demand. Still, balance sheets needed to adjust and the tighter financing conditions following the onset of the crisis sharply crimped growth (notwithstanding the considerable margins of data uncertainty (Annex I)).

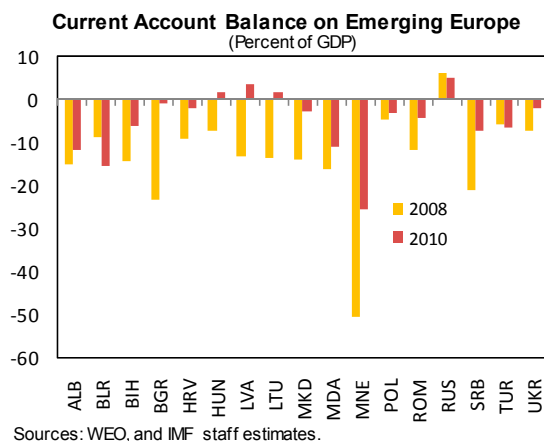
Albania: Real GDP Growth and Components, 2000-10

	Growth		Contributions	
	2000-08	2008-10	2000-08	2008-10
Real GDP growth	6.0	3.4	6.0	3.4
Domestic demand	6.3	-2.6	8.1	-3.3
<i>Consumption</i>	6.1	0.4	5.9	0.4
<i>Gross investments</i>	7.0	-11.9	2.2	-3.6
Net exports	-7.3	26.5	-2.0	6.7

Sources: IMF staff estimates



5. **Despite improvement, external imbalances remain elevated, and foreign demand could not fully offset the domestic demand drain.** In 2010, strong export growth, especially in manufactured goods, electricity, and minerals, accompanied by fiscal retrenchment, helped narrow the current account deficit to 12 percent of GDP, from above 15 percent in 2008. Still, this adjustment lags behind many neighboring countries. Moreover, export growth was to some extent one-off, in particular in electricity, where abundant rainfalls boosted production above domestic demand; buoyant commodity prices and improving terms of trade also lifted export values.

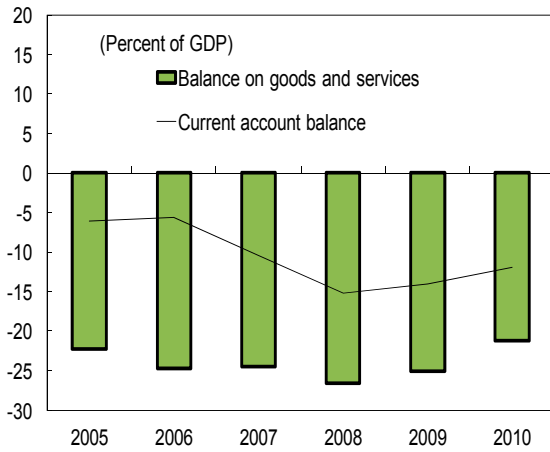


6. **The financing mix of the current account has improved, lowering the importance of remittances and boosting direct investment.**

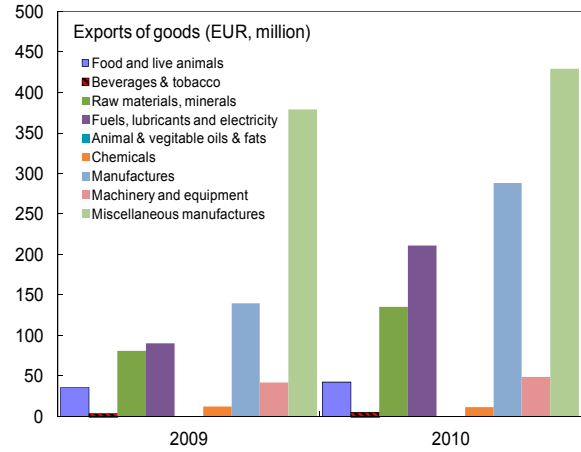
- **FDI withstood the trend decline in the region, overtaking remittances as the main financing source.** With a record €827 million in 2010, it accounted for roughly one-quarter of FDI into the entire SEE region. Major destinations were

Figure 2. Albania: External Sector Development

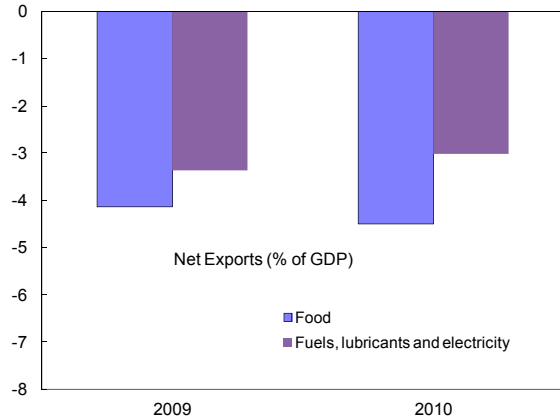
Despite the slow pace of trading partner recovery, the current account deficit improved in 2010 ...



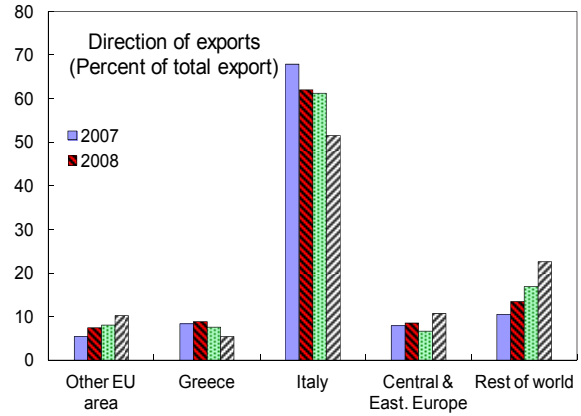
...on the back of growing exports related to manufactures, electricity and minerals ...



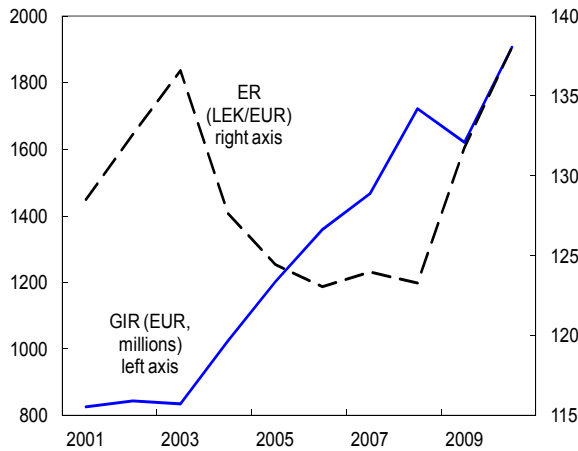
...which partly contributed to attenuate the effects of the rise in food and fuel prices,



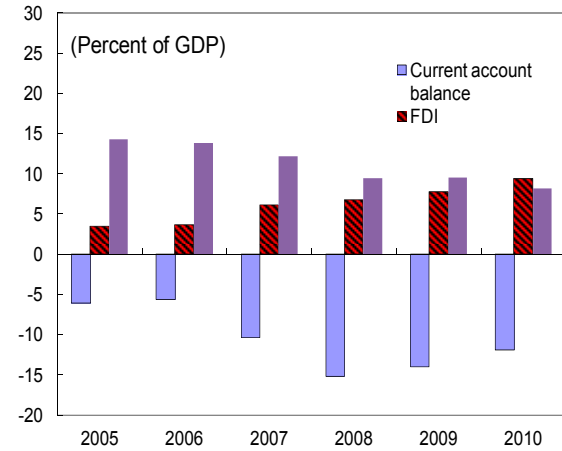
...and were associated with trade partner diversification.



A stronger trade balance was accompanied by a more depreciated currency, reserve accumulation ...



...and higher foreign direct investments.

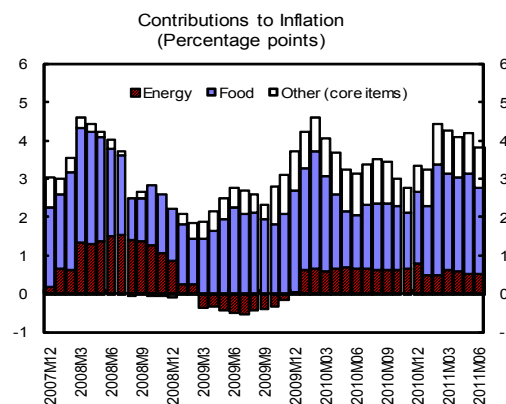


Source: World Economic Outlook; Direction of Trade; Albanian authorities; and IMF staff estimates.

telecommunication, banking, manufacturing, and increasingly hydroelectricity, oil, and gas. Reflecting the importance of large-scale privatizations and concessions, FDI has primarily been in the form of equity capital, e.g., greenfield investments and cross-border mergers and acquisitions; in the banking sector it has recently tilted toward reinvested earnings and capital injections. With the privatization program now essentially complete, FDI has slowed sharply in the first quarter of 2011.

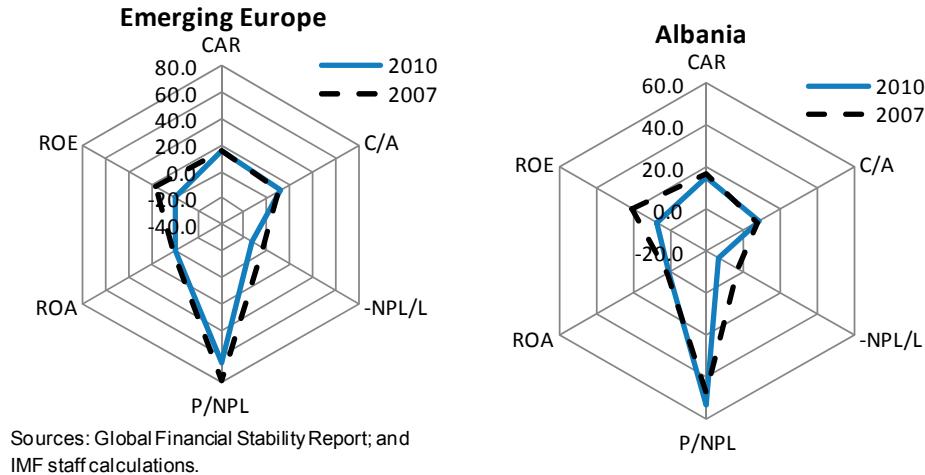
- **Donor financing remains stable** as European donors are increasingly coordinating in facilitating the integration of Albania with the European Union, and emerging donors, such as the Islamic Development Bank and the Abu Dhabi development fund, are raising their profile.
- **Remittances are only slowly recovering** due to economic uncertainties in major source countries such as Greece and Italy, but perhaps also reflecting a secular trend, though data problems make an assessment somewhat uncertain (Annex II).

7. **Inflation largely stayed in the target range of 3 ± 1 percent.** The monetary policy stance has been accommodative: in July 2010 the Bank of Albania (BOA) eased its policy rate in response to fiscal consolidation; it moved to tighten in early 2011, when headline inflation overshoot its target band as a result of rising food and fuel prices. Core inflation and inflation expectations have remained stable throughout.



Source: Albania authorities and IMF staff estimates.

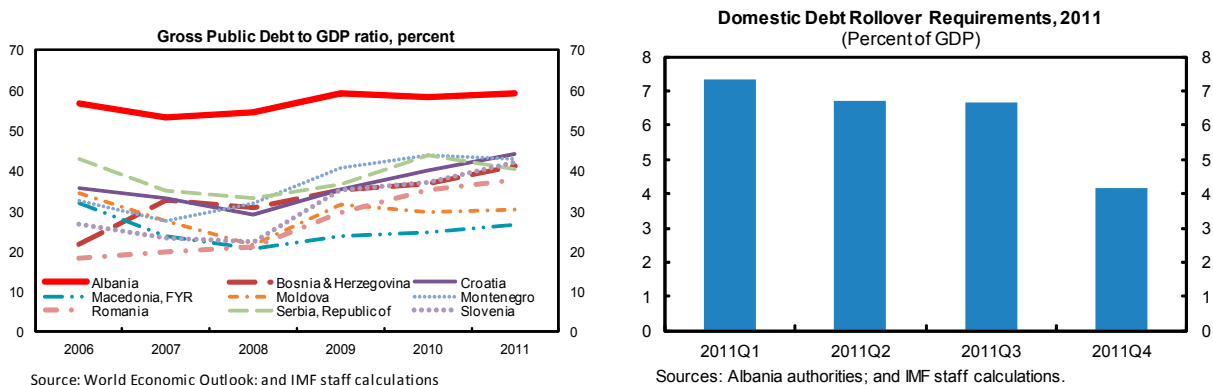
8. **The banking system has been resilient, but declining asset quality is a concern.** Notwithstanding a steep decline in deposits and increase in problem loans, banks remained generally sound throughout the crisis with adequate capital; recently profits have begun to recover as well. However, nonperforming loans rose from 3 percent pre-crisis to a record high of 15 percent in April 2011, relatively high levels even in the region, and a major concern for the banking sector. This is partly caused by institutional and judicial weaknesses that have hampered collateral execution. Strict provisioning rules do not factor in any recovery values from existing collateral, thereby building in some buffer against future adverse developments. Deposits have been steadily increasing and credit growth moderating (9 percent in 2010 and 10 percent in 2011:Q1).



B. Recent Policy Challenges

9. **The budget has been wrong-footed by slowing growth, resulting in stop-and-go fiscal policy.** Expansionary budgets for both 2010 and 2011 were predicated on over-optimistic revenue assumptions. In the event, the 2010 budget deficit was held at 3.7 percent of GDP only after significant mid-year budget cuts, about half of which were achieved through reductions in budgeted capital spending, which dropped from 8.8 percent of GDP in 2009 to 5.8 percent of GDP. Reflecting the discretionary nature of the cuts and their implementation mid-year, payment arrears of some 0.7 percent arose.

10. **Public debt has drifted up, heightening near-term rollover risk and constraining budgetary flexibility.** Debt is approaching the 60 percent of GDP statutory limit, a relatively high level compared with emerging markets (average of 47 percent) and regional peers. With an average interest of some 6 percent, and notwithstanding a still large share of concessional external debt, debt servicing cost exceeds 3 percent of GDP or 15 percent of tax revenue. Moreover, debt is set to increase further under the baseline and debt sustainability further put at risk by standard shocks. Including personnel expenditure and social insurance outlays, pre-committed spending amounts to three quarters of revenue, severely constraining budget flexibility.



11. **Financial sector policies were adjusted to safeguard financial stability and revive credit growth.** During the crisis, macroprudential policies—including higher capital requirements, tighter liquidity, and credit risk controls—were implemented. With steadily increasing deposit funding, improved liquidity conditions, and adequate capital buffers, some of the regulations were lifted. At the same time, market volatility surrounding the euro-area periphery was reflected in the domestic markets, with some signs of increased stress with local euro deposit rates edging up and banks competing for liquidity or to build net asset positions with parents. All Greek-owned banks remained in compliance with prudential ratios although their liquidity levels have been somewhat reduced. In response, the authorities have stepped up liquidity monitoring across the system and are contemplating increasing prudential liquidity ratios. There was recognition that achieving lower loan-to-deposit ratios needed to be balanced with continued parent bank exposure. In a similar vein, the remuneration of required foreign currency reserves was suspended.

III. OUTLOOK

12. **The staff's baseline scenario is for continued moderate growth, with some improvements in external sustainability, albeit subject to considerable risks.** Significant catch-up potential remains to be tapped. However, the elevated fiscal deficits and public debt under unchanged policies are not consistent with external sustainability and stand in the way of more vigorous and broader-based growth.

- **GDP growth** is projected to decelerate to some 2½ percent in 2011, reflecting a weak second quarter. Staff expect a gradual acceleration to potential of about 4 percent over the medium term, largely driven by external demand, which is in turn boosted by past investments in transport and energy infrastructure coming on line (Box 1). Private consumption and investment are likely to remain more subdued. In particular remittances, a key driver of household disposable income, could further weaken on the back of lagged effects from developments in the neighboring euro area periphery, while lending to households should remain moderate, as balance sheet repair progresses. On the other hand, lending to companies is projected to grow somewhat faster. With privatization coming to a close, greater investment and savings need policy reforms.
- **Inflation** should remain within the target band, helped by the absence of administered price increases in 2011 and projected global price trends. In the medium term, as the output gap is closing, stronger retail competition could dampen price increases.
- **The current account deficit** is expected to shrink on the back of continued buoyant exports—notwithstanding the loss of some favorable one-off effects—and moderate imports growth in 2011. In the medium term, the current account deficit would gradually decline further. However, reflecting insufficient savings under an unchanged policy scenario, it is not projected to reach sustainable levels, and (currently adequate) reserves will erode. As a result, the real exchange rate, which—after a cumulative nominal

depreciation of close to 20 percent since the peak of the crisis—is currently competitive and stable, would become overvalued over the medium term (Box 2).

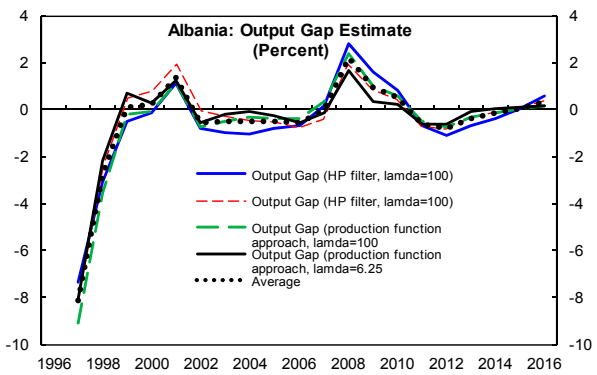
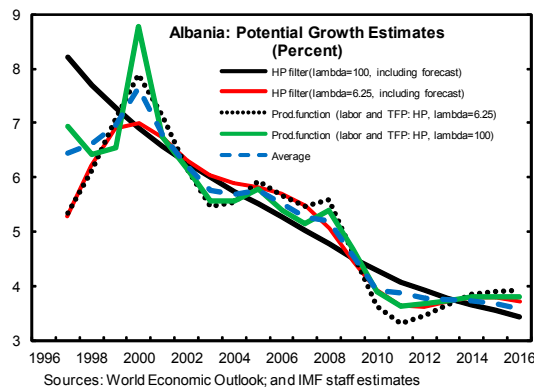
Box 1. Potential Growth Estimate

Statistical filter methods as well as the production function approach suggest that Albania’s potential growth has fallen over recent years, mainly on account of a decrease in total factor productivity (TFP) growth.^{1/} These results are in line with standard growth accounting exercises that were conducted for the new EU Member States in Central Europe and the Baltics. They also pointed to a dominant role of TFP dynamics for growth, with capital ranking second, and labor making only a small—or, as a consequence of labor shedding during economic restructuring, even negative—contribution (Schadler et al., 2006).

Contributions to potential growth 1/

	Growth	Capital	Labor	TFP
1997-2001	7.1	0.3	-1.2	8.0
2002-2007	5.6	1.6	-0.7	4.7
2008	5.4	2.0	0.1	3.3
2009	4.7	1.5	0.2	3.0
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1/ Production function with smoothed labor and TFP input (HP-filter with lambda=100; lambda=6.25 yields similar results)



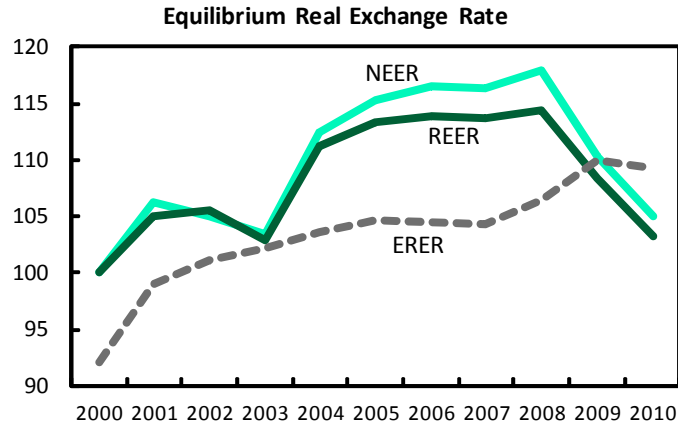
A common shortcoming of the statistical filter and production function approaches is their failure to pick up “bulky” structural supply shocks to potential growth (see, for instance, IMF WP 08/275 on the effect on potential growth of the concentrated coming-on-stream of several car factories in Slovakia in 2006–07). Thus, the recent completion of a major road corridor to Kosovo could constitute such a shock that increased potential output by more than just adding this infrastructure investment to the capital stock. However, even if this is the case, it does not change the conclusion that *ceteris paribus*, the development of total factor productivity and the associated loss of structural reform momentum weighs down on potential output.

Reform delays could prevent the recent improvements in infrastructure and Albania’s other competitive advantages (such as low wage cost, a very flexible labor market, a flat income tax regime, etc.) from coming to full fruition. Structural reforms in bottleneck areas such as the rule of law, collateral execution, education, IT infrastructure, a still unreliable electricity provision (mainly due to deficient regulatory implementation), etc. are therefore urgent—the more so since fiscal policy is severely constrained and the revival of private sector investments hinges on the improvement of the business environment.

^{1/} HP-filters were run for annual GDP data with the standard value for lambda of 100 and the Ravn and Uhlig (2002) suggested 6.25. The production function approach was Cobb-Douglas, where TFP and labor input were smoothed with an HP-filter (again lambda values of 100 and 6.25); the assumptions are: capital and labor shares of 0.3 and 0.7, respectively; a capital-to-output ratio in 1996 of 3; and depreciation of 8 percent thereafter.

Box 2. Exchange Rate Assessment

The real exchange rate has recently returned to equilibrium. After a period of appreciation, the Albanian *lek* depreciated by about 5 percent in nominal effective terms in 2010. Following a similar trajectory, the Real Effective Exchange Rate (REER) has now reverted to 2003 levels. Three CGER methodologies are used to assess the REER. The equilibrium real exchange rate (ERER) approach is based on a CEE panel-based regression model which estimates a long-run cointegrating relationship between the REER and a group of fundamentals. This approach suggests the REER reached equilibrium in 2009 and moved to a slight undervaluation (close to 5 percent) at end-2010. The set of fundamentals includes relative productivity, terms of trade, and government consumption.



Sources: International Financial Statistics; and IMF staff estimates

Underlying current account and external sustainability analysis, however, point to prospective medium-run overvaluation. The macroeconomic balance (MB) approach, which uses a panel regression of the current account on the fiscal balance, the oil balance, net foreign assets, old age dependency, FDI, population and output growth, and a remittances dummy, shows that the projected underlying current account deficit is above the norm by end-2016.^{1/} The real exchange rate adjustment that would close the gap between the projected current account and its norm would be a depreciation of 12 percent. The external sustainability (ES) approach indicates that a real depreciation of 25 percent would be required to stabilize the NFA to GDP ratio at its estimated end-2009 level.

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

Est./Proj. CA 2016	MB norm	ES norm
-6.0	-4.2	-2.3

Source: IMF staff projections and calculations.

^{1/} Incorporates new EU-member states (see WP/08/92).

Albania: Exposure to Greece, Italy and other Euro Area Countries
(percent)

	Exports 1/	Imports 1/	Bank Assets 2/
Total Euro Area	72.3	61.6	73.3
Greece	8.4	13.6	20.4
Italy	48.8	33.4	13.2
Other Euro Area	15.1	14.6	39.8
Rest of the world	27.7	38.4	26.7

1/ Data as of 2010, share of total exports and imports.

2/ Data as of May 2011, share of total assets.

Sources: Direction of Trade; Albanian authorities; and IMF staff estimates

13. **Risks to the outlook are weighted to the downside.** Uncertainty emanating from the euro-area periphery is the key near-term vulnerability. Albania has large trade, labor-market, and banking-system links with Greece and Italy. Especially the latter two links could result in substantial spillovers with banking-system contagion potentially the most severe near-term risk, while sharply lower remittances could result in a significant GDP shock. Other risks are also mostly to the downside. Exports may slow down in a less buoyant global outlook and private domestic demand could falter. High public debt, rollover risks, and interest costs also leave the country exposed to a downturn in investors' risk appetite, with knock-on effects on confidence in the financial system. On the upside, higher foreign demand and capital inflows could lead a stronger recovery of domestic demand and an improved political situation may boost confidence.

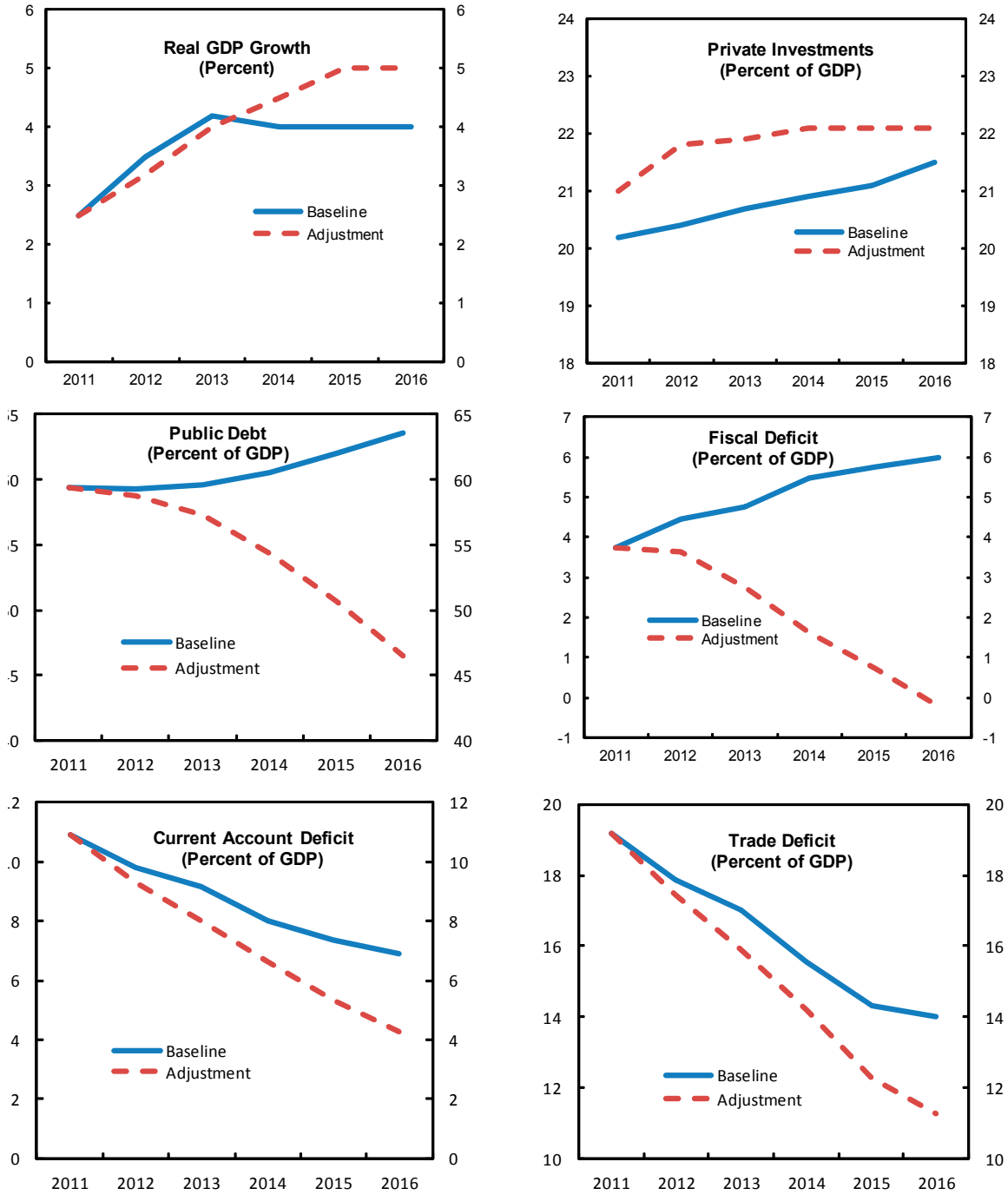
14. **The authorities viewed the outlook as more favorable,** expecting a quick return to economic growth of 5 percent or higher in the near term. They pointed to the country's strong fundamentals and private sector base, as well as large public investment in infrastructure in recent years, from which they expected higher returns than implied in the staff baseline. High current account deficits were seen as temporary and increasingly financed by FDI and concessional development lending. The authorities stressed that the potential magnitude of the shocks emanating from the euro periphery was such that no single country could offset them fully, and they expected the EU's crisis management to be effective in redressing any uncertainties. They also reported on their proactive contacts with regional and European supervisors and central banks in advancing contingency planning. They agreed that a Fund program could also help curtail contagion but so far saw no need in requesting Fund financial support.

IV. POLICY DISCUSSIONS

15. **Policy discussions focused on realigning the policy framework with the ongoing rebalancing of the economy.** In line with the generally favorable reception of past Article IV consultations, there was again a high degree of consensus in the policy discussions. Both sides agreed that the simultaneous achievement of higher growth, resilience against risks, and external sustainability is within reach, especially if progress is made on EU integration. Staff cautioned, however, that policies needed to be strengthened to

achieve these goals. In particular, a policy framework based on further fiscal consolidation, redressing critical structural reform priorities, and maintaining financial sector stability could raise growth to 5 percent while bringing the current account deficit in line with its underlying equilibrium over the medium term (Figure 3).

Figure 3. Baseline and Adjustment Scenarios Comparison



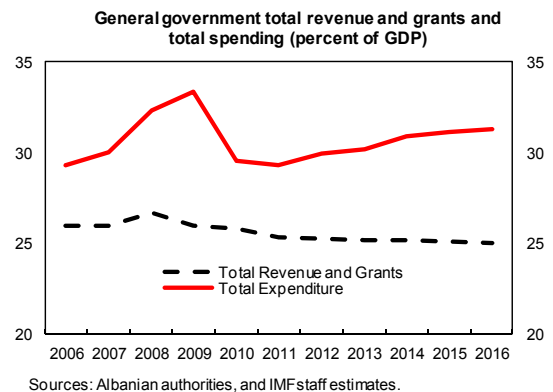
Sources: IMF staff calculations.

A. Credible Post-Boom Fiscal Consolidation

16. **The fiscal policy discussions were overshadowed by a renewed large budget slippage.** At the time of the discussions in June, a considerable underperformance of the 2011 budget had become evident, as revenue was again falling significantly short of original budget projections. Staff and authorities agreed that the deficit should be held close to the original 3.5 percent of GDP target not in the least to avoid breaching the legal limit on public debt of 60 percent of GDP. The authorities subsequently adopted the required cuts in a mid-year budget review in July. Given the limited time available to effect the correction, the cuts once more centered on one-offs, especially in capital spending, without addressing the underlying structural imbalance.

17. **Against this background, the potential need for further adjustment over the medium term became the focus of discussions.** The authorities considered that a return to higher rates of growth and their ongoing efforts to boost tax administration would boost revenues and relieve budget pressures. Staff agreed that the budget was negatively affected by lower growth, but also viewed the budget as contributing to underperforming growth, reflecting three key factors:

- **External sustainability requires tighter budgets,** as elevated fiscal deficits have been a key driver behind the high current account imbalance. In turn, the fiscal deficit is largely structural. Some of it arose from lower structural revenue, and most importantly, permanently lower import-related taxes, as the absorption gap declined.¹ Also, staff perceived a mismatch between the authorities' vision of a small government and low taxes, with past high real increases in pensions and the public wage bill.
- **With market financing increasingly important, unchecked debt will present greater risks to macroeconomic stability** even in a benign external environment. As Albania moves away from concessional borrowing to commercial debt, interest costs are likely to increase and average maturity to decline, and risk premia could rise further.
- **Stop-and-go fiscal policies have real costs.** This practice makes annual budgeting unreliable and overly political, and imperils multi-year public investment targets



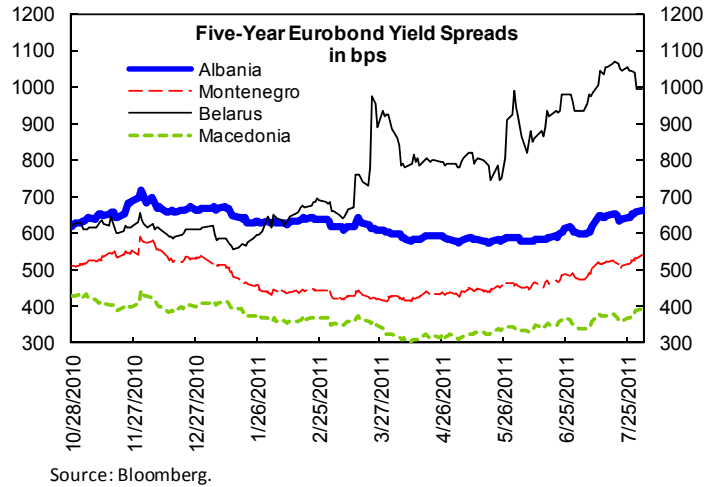
¹ Import-related taxes (VAT and Customs) fell by about one percent of GDP between 2008 and 2010.

(with potential contingent liabilities from not honoring contractual obligations) with adverse effects on private-sector confidence and investment plans, thereby potentially further dampening TFP growth. The recent ad-hoc cuts have also resulted in large payment arrears, which have the potential to trigger a non-payment chain in the private sector, with adverse implications for economic activity.

18. A strong fiscal anchor was jointly seen as desirable, though the authorities were not yet ready to settle on a specific fiscal rule.

Authorities and staff agreed that a fiscal rule could anchor expectations of a sustainable conduct of public finances, providing clear and straightforward signal to markets (where spreads have widened again). Staff recommended an expenditure-based rule anchored to the authorities' pre-crisis target of cutting debt to 50 percent of GDP over the medium term (Box 3). The authorities agreed that public debt would constitute a

desirable anchor and considered that the existing legal debt limit of 60 percent of GDP had proven its worth. They were looking at augmenting it with a mechanism to guard against procyclicality, but had not yet reached definite conclusions on a new debt target or the form of the augmentation.



19. There was agreement that future fiscal measures had to be of higher quality and lasting nature, with fast-growing current expenditure seen as the prime candidate for adjustment. Going forward, the authorities envisaged less pronounced increases in the public wage and pension bills. Staff recommended that these only be indexed to inflation. In a next step, public service reform could rationalize the wage bill and make the public sector more efficient. The authorities intend to relaunch pension reform efforts, though they cautioned that achieving the needed political consensus could be a challenge. Staff welcomed this step and stressed that in order to protect other key spending priorities, it is essential that social insurance spending increase by less than contributions over the coming years. This could be achieved, for example, by targeting old-age pension spending increases on those who need it most, or by tightening further the eligibility requirements for receiving unemployment benefits (Annex III). Moreover, past social contribution cuts should be revisited, given that the hoped-for increased compliance had proved elusive.

Box. 3. Public Finance Sustainability and Options for Fiscal Rules in Albania

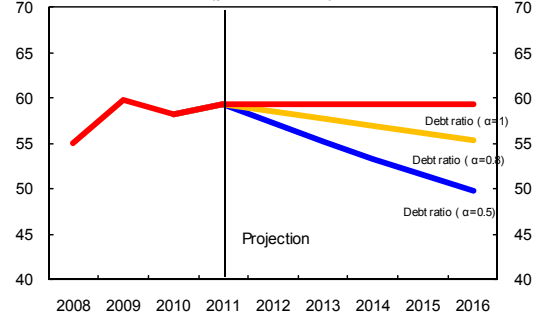
Given the high public debt, the fiscal rule should be explicitly tied to debt reduction. Public debt declined from 70 percent in 2000 to 54 percent in 2007 in the context of successive Fund-supported programs. This path was reversed with the fiscal stimulus in 2009. Under current policies public debt would rise to 64 percent of GDP by 2016. A return to the government’s pre-crisis target of cutting debt to 50 percent could be a solid medium-term objective. While leaving debt higher than in most neighboring countries, the considerable effort implied would reassure markets and investors of policy commitment.

The effectiveness of the rule will depend on its simplicity, transparency and scope for macroeconomic stabilization. A rule should be robust, not overtax the statistical base (e.g., given the lack of reliable estimates of potential output in Albania, a rule based on structural deficit targets would be problematic), and be straightforward to monitor for outside observers. A degree of cyclical flexibility would also be desirable.

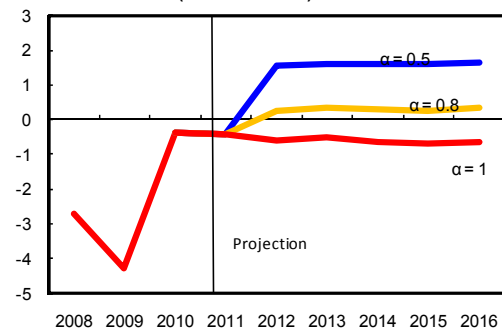
One option is to adhere to a simple debt rule. A debt rule would comprise a target debt ratio and a convergence speed when debt is above the target. The current debt level can be sustained with primary deficits of about ¼ percent of GDP. Debt reduction can be achieved by programming a factor α ($0 \leq \alpha \leq 1$) the ratio of the growth rates of the debt share and GDP, respectively. To cut debt to 50 percent in 2016 (here, $\alpha = 0.5$), a surplus of 1½ percent of GDP is necessary. Some countercyclical policy can still be accommodated, as the rule relies on forecasted GDP (rather than actual).

An expenditure rule with a debt brake offers more advantages, allowing for greater play of automatic stabilizers and keeping the size of the public sector in check. The rule would put a ceiling on real public spending growth with the debt brake forcing a review of spending growth whenever debt is above the desired target. To achieve a 50 percent debt level by 2016, real primary spending would have to be limited to 2 percent per year with unitary revenue elasticity.

Public debt ratio under the debt rule, different adjustment coefficients (percent of GDP)

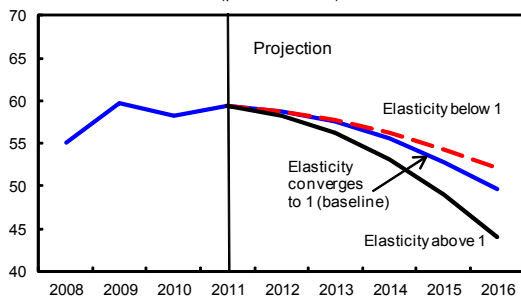


Required primary balance under debt rule different adjustment coefficients (Percent of GDP)



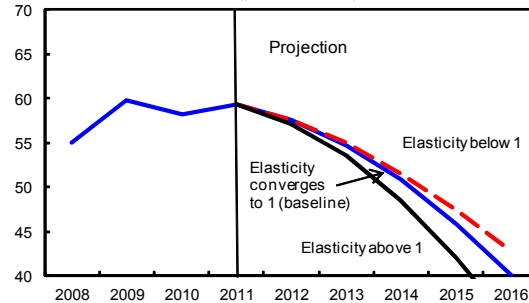
Source:IMF staff calculations.

Public debt under different revenue scenarios, with 2 percent real expenditure growth (percent of GDP)



Source:IMF staff calculations.

Public debt under different revenue scenarios, with zero real spending growth (percent of GDP)

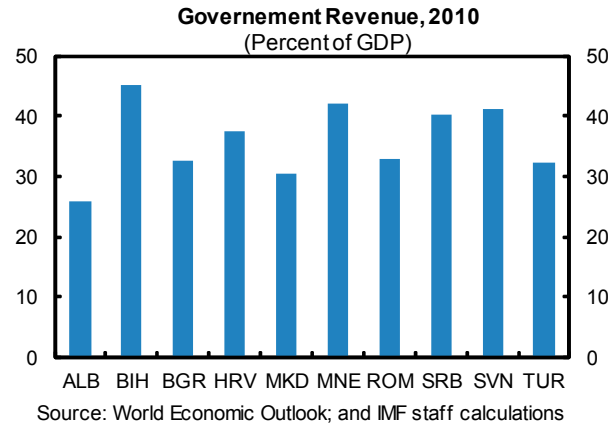


20. **The case for further cuts to public investment was not seen as strong**, especially if concessional financing is available. The authorities and staff agreed that the infrastructure can play an important role in boosting growth, leveraging Albania's potential in accessing the entire SEE region. However, project preparation and selection will need to be beefed up and made more transparent, including by rigorous cost-benefit analysis. Public-private partnerships could also be helpful in containing cost and securing private sector expertise, and their merits and risks should be carefully weighed; in any event, staff recommended that the required regulations and processes be developed.

21. **There is scope for revenue measures to offset the decline in structural revenue.**

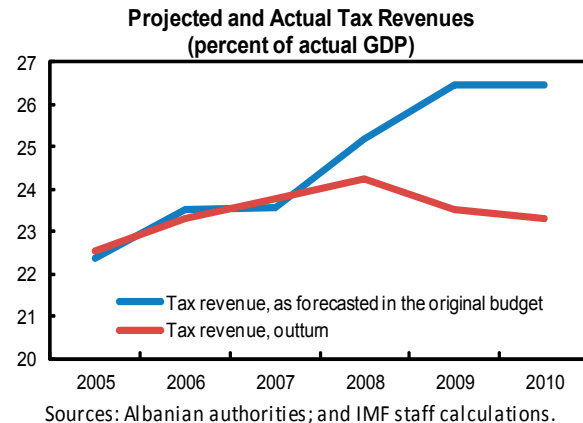
The authorities are progressing with tax administration reform but reported mixed success.

While acknowledging the considerable scope for improvement—notably in the core functions of tax payer registration and debt recovery—staff cautioned that administration gains may be difficult to achieve and could even be costly in the short run. For example, large accumulated VAT refund and credit arrears risk damaging VAT compliance and Albania's reputation as a stable harbor for FDI; their clearance will have immediate costs to the budget. Similarly, the recent tax amnesty posed risks to future compliance, if not accompanied by a comprehensive compliance strategy. Against this background, staff recommended that the authorities also consider tax policy changes such as lifting direct tax rates. Given their very low level (10 percent) even small increases could result in substantial revenue without doing critical harm to Albania's tax competitiveness. Any positive revenue surprises should be allocated to debt reduction.



22. **Staff also pointed to scope for improvements in the budget process and debt management.**

- In the first place, revenue forecasts should become more realistic. Staff suggested that relying on external forecasts, as was the case in the Fund arrangements through 2008, appeared to have resulted in fewer surprises.
- The recent accumulation of payments arrears points to the need



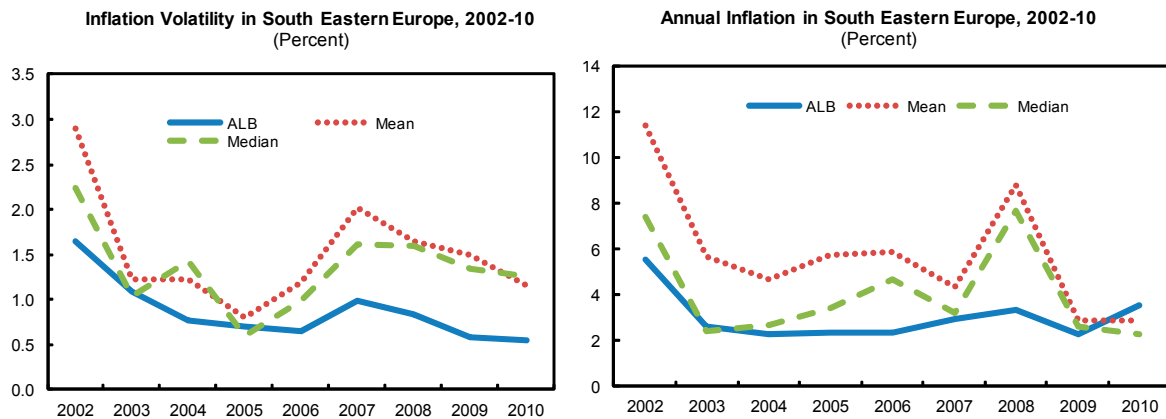
to strengthen commitments monitoring.

- Albania's successful debut in international capital markets has lowered near-term rollover risks. Further progress is needed on lengthening the maturity of domestic debt, also with a view to develop *lek* markets; fiscal consolidation will help achieve this at reasonable costs.

B. Protecting Monetary and Financial Stability Against New Risks

23. **Staff and authorities agreed that monetary policy should remain cautious, and easing would require fiscal adjustment.** The inflation targeting framework and flexible exchange rate have served Albania very well and provided resilience throughout the global crisis. Though the economy is still recovering and domestic demand remains weak, monetary stimulus would need to be conditioned on fiscal adjustment and continued anchored inflation expectations.

24. **Inflation volatility may increase in the future.** So far, margins in the uncompetitive retail sector have absorbed much of the imported price shocks, thereby smoothing inflation. As structural reform will lead to erode these margins, inflation could well become more volatile. Staff stressed the importance of updating the analytical framework and adapting communications accordingly to guide and anchor expectations.



Sources: World Economic Outlook; and IMF staff calculations.

25. **There was agreement on the near-term priority of a swift resolution of nonperforming loans and other crisis legacies.** While bank profits are recovering, asset quality has kept deteriorating. Banks have become increasingly dependent on profits from T-bills. Accelerating resolution measures for problem loans (such as seizure and sale of collateral) would help in cleaning up banks' balance sheets. Staff welcomed the introduction of the private Bailiff Officers, noting that further improvement of the court process would also be needed. Staff and the BoA also agreed on a near-term work plan which comprised stepped-up liquidity monitoring (followed up Fund TA); closer monitoring of positions

between parent banks and their subsidiaries/branches; and an improved contingency planning framework (supported by Fund TA). There was agreement that early identification of additional capital needs and assurances from parent banks to meet them—as well as maintain exposure—are essential.

26. **Macro-prudential policy needs to stay ahead of the curve.** Preventive macro-prudential measures adopted prior to the crisis have helped to contain the build-up of imbalances in the banking sector and to cope with spillovers from the recent crises. Any macro-prudential easing needs to be geared towards fast balance sheet cleaning and enhancing financial stability. The authorities intend to mandate higher-than Basel II norm, as well as recent EU proposals.

- **Local-currency market development would help build buffers.** Gradual de-euroization has come to a halt as some banks have begun aggressive competition for foreign-currency deposits. Staff and authorities agreed on the need to safeguard against attendant risks and discussed possible measures (such as higher reserve requirements, or more stringent liquidity ratios for foreign currency deposits).
- **Coordinating monetary and macro-prudential policies would be required to manage capital flows.** Notwithstanding current downside risks, returning international risk appetite could lead to quick increases in capital inflows into Albania (Annex IV) with attendant overheating risks. If the required fiscal tightening is implemented, staff and authorities agreed that the floating exchange would provide a defense against excessive inflows, but that strong appreciation and excessive volatility could hurt competitiveness. In the short term these adverse effects could be mitigated by building reserves, especially given uncertainty. Once comprehensive fiscal adjustment is firmly under way, and if excessive inflows persist that cannot be adequately addressed through exchange rate appreciation and reserve accumulation, the use of capital flow measures could be considered to complement the macro policy response.
- **The authorities are accelerating contingency planning.** The BoA is updating its stress testing framework to better capture liquidity risks. Jointly with the Fund and World Bank, they are also working to keep the framework for emergency liquidity assistance in line with changing developments and challenges. Staff welcomed these steps and further recommended that high-frequency contacts with international regulators and supervisors, importantly those of parent banks, be further deepened.

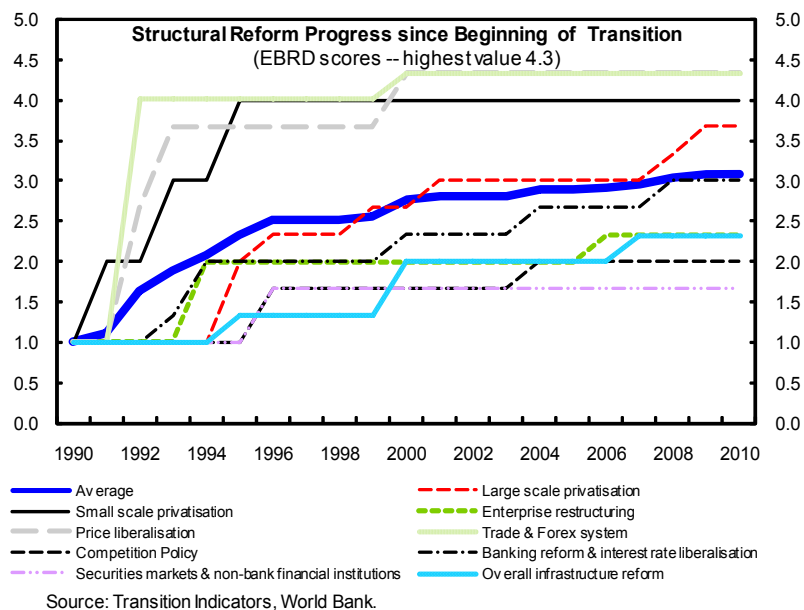
C. Upgrading the Business Climate to Raise Productivity and Speed up Convergence

27. **Authorities and staff agreed that boosting productivity by attracting foreign investment is key for higher sustainable growth.** The last decade's arrival of large-scale international investors in Albania was a critical factor in the transfer of technology and

innovation, which in turn were essential for raising productivity and providing higher-wage employment in Albania. A favorable investment environment is thus a vital condition for further progress.

28. Structural reform needs

re-invigoration. Although improvements have been made on various fronts, Albania does not compare favorably to many of its regional peers in its institutional qualities for doing business and some investors have raised concerns about an unlevel playing field. The downtrend in potential growth has coincided with the deceleration of the structural reform momentum in recent years.² Structural reform could also boost critically low domestic savings.



- Securing property rights and improving contract enforcement was jointly seen as the immediate priority.** In contrast to most of Europe, Albania is arguably under-regulated, creating idiosyncratic impediments to business. Especially land titling and contract enforcement remain insufficient. Past government actions to relieve the problem—such as the fast-tracking of large projects—have been uneven and in some instances may even have contributed to uncertainty. The post-privatization regulatory framework for key industries such as electricity, energy, and telecoms sectors is another area in need of progress. Authorities and staff agreed that improvement in these prominent areas will also promote transparency and lower the scope for corruption.
- The shift to a new growth model** could be supported by broadening the sources of growth and diversifying exports. With their boost to transport infrastructure essentially complete, the authorities saw a need to fund irrigation initiatives, given the more limited access of agriculture to credit. This would help tap the vast agricultural

² This is consistent with earlier staff analysis (see IMF Country reports 06/285 and 08/267) that found slowing growth to a large extent to reflect institutional factors—against the backdrop of a generally stable macroeconomic environment and sufficient provision of credit to the economy.

potential; agriculture employs most of the labor and yet remains largely segregated and least productive, and agricultural imports account for 17 percent of the total goods imports.

- **High-quality economic statistics are essential** to improve policy making and business environment. Priority areas for improvement include external sector statistics and national accounts. Staff noted that adequate resources needed to be provided to make effective use of the substantial technical assistance delivered by the international community.

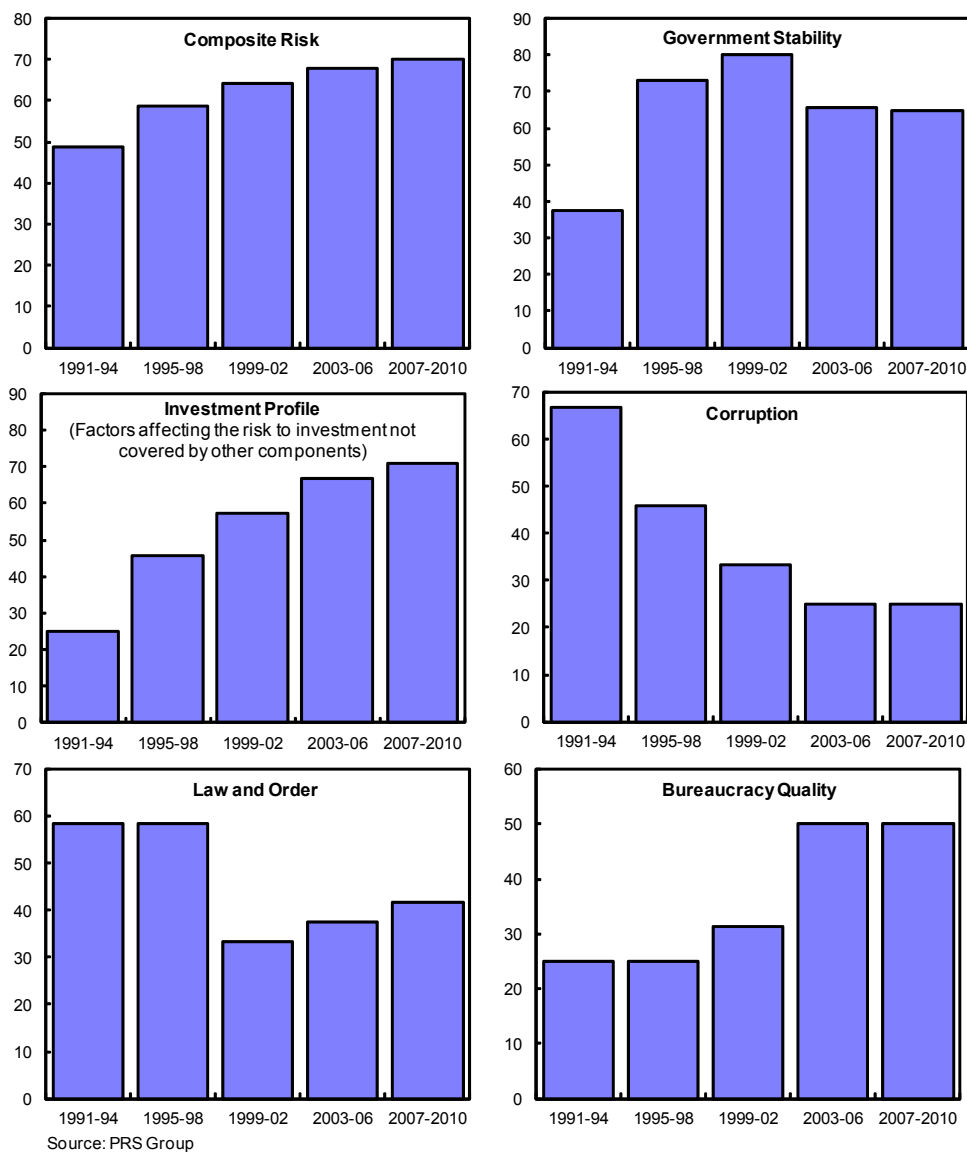
V. STAFF APPRAISAL

29. **The Albanian economy has shown admirable strength in recent years.** It weathered the global crisis well, avoided an output contraction—in contrast to most European economies—and is leading the recovery in the region. Notwithstanding a substantial deterioration in asset quality, the financial sector also proved resilient. Throughout, inflation remained well anchored. The needed rebalancing of the economy has begun, with the current account deficit narrowing.

30. **Rebalancing has dampened growth, though.** Growth is projected to decelerate further to 2½ percent in 2011. Over the medium term, it could recover to some 4 percent, with some improvements in external sustainability. These levels, though respectable, are considerably below the previous decade's average of 6 percent, and also subject to downside risks including from unaddressed external sustainability concerns.

31. **With the right policies, a return to sustained rapid growth is within reach.** The simultaneous achievement of higher growth, resilience against risks, and external sustainability is in the cards, especially if progress is made on EU integration and if policies are strengthened. Further fiscal consolidation, redressing critical structural reform priorities, and maintaining financial sector stability are key.

Figure 4. Albania: Country Risk Indicators (PRS-Group)
(higher values indicate less risk)



32. **Fiscal consolidation is the near- and medium-term policy priority.** It would reduce the risks associated with the high level of public debt and advance external sustainability. Moreover, lower deficits would boost sustainable private-sector led growth by raising the flow of credit to the economy and securing lower interest rates.

33. **Repeated budget slippages underscore the need for a more realistic macroeconomic framework.** The budget shortfalls in 2010 and 2011 mainly reflect overoptimistic forecasts. More realistic projections could be achieved by aligning them with those of independent professional forecasters. Any positive revenue surprises should be allocated to debt reduction.

34. **An expenditure-based fiscal rule could form the centerpiece of sustainable fiscal policy.** Basing budgets on tight limits for expenditure growth avoids risks of stop-and-go fiscal policy, lowers incentives for revenue overoptimism, helps dispel any investor doubts about the government's commitment to a small government, and offers an anchor for medium-term debt reduction. Lowering public debt to 50 percent of GDP over the medium term can be achieved by limiting growth in annual real primary expenditure to 2 percent.

35. **Fiscal consolidation will require credible measures and sustained efforts.** Already interest, wage, and entitlement spending claim more than three quarters of revenue. If capital spending is to be sustained at its current share in GDP, the wage and entitlement bills would have to be indexed to inflation only. If the required spending cuts are viewed as unrealistic, direct taxes or contributions will need to be raised. Especially the earlier cuts in social contributions should be rescinded, as they have not resulted in the hoped-for increased compliance. In addition, the very low flat income tax rates could be raised without imperiling Albania's competitive position.

36. **The monetary policy framework of an inflation target and flexible exchange rate is a fundamental strength of the Albanian economy.** In spite of higher imported inflation and increases in administered prices, inflation has quickly returned within the Bank of Albania's target band, thanks to its credibility and a policy of timely and determined adjustment of monetary conditions.

37. **Financial sector supervision and regulation will need to stay ahead of evolving challenges.** The limited fallout of the global financial crisis owes much to earlier proactive and forceful supervision and regulation. Still, high NPL levels and thus far incomplete balance sheet repair curtail the flow of new credit and pose risks to financial stability, if not resolved more quickly. Other risks arise from the banking system's high exposure to the euro area periphery, requiring continued supervisory vigilance and monitoring of parent institutions. Meanwhile, financial innovation is progressing, bringing with it new challenges. Priority areas for action include expediting the execution of collateral, safeguarding liquidity, enhancing the stress testing framework, and keeping contingency planning and preparedness up to date.

38. **Boosting productivity by attracting foreign investment is essential for higher sustainable growth.** Key requirements include the maintenance of a level playing field, the adoption of international best-practice regulations and their predictable enforcement by professional institutions and accelerating the structural reform agenda, especially in securing property rights, land titling and improving contract enforcement. High-quality economic statistics are essential to improve policy making and the business environment.

39. **It is proposed that the next Article IV consultation with Albania will be held on the standard 12-month cycle.**

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2008–16

	2008	2009	2010	2011	2012	2013	2014	2015	2016
		Preliminary	Est.			Projections			
	(Growth rate in percent)								
Real GDP 1/	7.5	3.3	3.5	2.5	3.5	4.2	4.0	4.0	4.0
Consumer Price Index (avg.)	3.4	2.2	3.6	3.9	3.5	2.9	3.0	3.0	3.0
Consumer Price Index (eop)	2.2	3.7	3.4	3.5	2.9	2.9	3.0	3.0	3.0
GDP deflator	4.7	2.3	3.9	4.2	4.1	3.1	3.4	3.4	3.1
	(Percent of GDP)								
Saving-investment balance									
Foreign savings	15.1	13.5	11.8	10.9	9.8	9.2	8.0	7.4	6.9
National savings	17.4	15.5	14.1	14.1	15.9	17.0	18.9	19.7	20.6
Public	3.1	1.0	1.2	0.7	0.4	0.3	0.1	-0.2	-0.4
Private	14.3	14.5	12.9	13.4	15.5	16.8	18.8	19.9	21.0
Investment	32.5	29.0	25.9	25.0	25.7	26.2	26.9	27.1	27.5
Public	8.6	8.8	5.8	4.8	5.3	5.5	6.0	6.0	6.0
Private	23.9	20.2	20.1	20.2	20.4	20.7	20.9	21.1	21.5
Fiscal sector									
Revenues and grants	26.7	26.0	25.8	25.6	25.6	25.5	25.4	25.4	25.3
Tax revenue	24.2	23.5	23.3	23.4	23.3	23.2	23.2	23.1	23.1
Expenditures	32.3	33.4	29.6	29.4	30.0	30.2	30.9	31.1	31.3
Primary	29.4	30.2	26.2	26.1	26.6	26.7	27.2	27.2	27.2
Interest	2.9	3.2	3.4	3.3	3.4	3.5	3.7	3.9	4.1
Overall balance (including grants)	-5.6	-7.4	-3.7	-3.7	-4.5	-4.8	-5.5	-5.7	-6.0
Primary balance (including grants)	-2.7	-4.3	-0.4	-0.4	-1.0	-1.2	-1.8	-1.9	-1.9
Net domestic borrowing	1.0	0.9	0.5	2.3	3.1	4.6	5.9	6.4	6.6
Privatization receipts	0.5	2.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Foreign financing	4.0	3.7	2.5	2.2	1.3	0.2	-0.4	-0.6	-0.6
Public Debt	54.7	59.3	58.3	59.4	59.2	59.6	60.6	62.0	63.6
Domestic	36.8	36.1	32.9	33.1	33.8	36.1	39.4	43.1	46.8
External (including publicly guaranteed)	17.9	23.2	25.4	26.3	25.4	23.5	21.1	19.0	16.9
Monetary indicators									
Broad money growth	7.7	6.8	12.5	10.0	11.0	12.0	12.0	12.0	12.0
Private credit growth	32.1	10.3	10.1	9.8	13.1	11.2	7.9	7.1	6.5
Velocity	1.3	1.3	1.3	1.2	1.2	1.1	1.1	1.1	1.0
Interest rate (3-mth T-bills, end-period)	6.3	6.3	5.3	...	...	...	...	...	...
	(Percent of GDP unless otherwise indicated)								
External sector									
Trade balance (goods and services)	-26.6	-24.6	-21.0	-19.2	-17.9	-17.0	-15.5	-14.3	-14.0
Current account balance (including official transfers)	-15.1	-13.5	-11.8	-10.9	-9.8	-9.2	-8.0	-7.4	-6.9
Current account balance (excluding official transfers)	-15.8	-14.2	-12.5	-11.7	-10.5	-9.8	-8.8	-8.1	-7.6
Official transfers	0.7	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.7
Gross international reserves (in millions of Euros)	1,721	1,621	1,906	1,803	1,640	1,489	1,451	1,488	1,592
(In months of imports of goods and services)	4.2	4.2	4.8	4.3	3.6	3.1	2.8	2.7	2.7
(Relative to external debt service)	12.4	10.9	4.9	7.6	6.5	4.8	3.8	2.1	3.7
(In percent of broad money)	26.1	26.0	27.0	23.7	19.5	15.8	13.8	12.6	12.0
Change in real exchange rate (eop, in percent)	-1.7	-7.8	-2.6	...	...	...	...	...	...
Memorandum items									
Nominal GDP (in billions of lek) 1/	1,089	1,151	1,238	1,322	1,423	1,529	1,644	1,768	1,896

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

1/ GDP data for 2008–09 are from the official national accounts.

Table 2a. Albania: General Government Operations, 2008–16
(Percent of GDP)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
			Est.	Projection					
Total revenue and grants	26.7	26.0	25.8	25.6	25.6	25.5	25.4	25.4	25.3
Tax revenue	24.2	23.5	23.3	23.4	23.3	23.2	23.2	23.1	23.1
VAT	9.8	9.6	9.2	9.0	9.0	9.0	8.9	8.9	8.9
Profit tax	1.7	1.5	1.4	1.6	1.6	1.6	1.6	1.6	1.6
Excise tax	3.0	2.9	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Small business tax	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Personal income tax	2.2	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Customs duties	0.8	0.7	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Other taxes	1.3	1.2	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Property and local taxes	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Social insurance contributions	4.4	4.3	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Non-tax revenue	2.1	2.1	2.1	1.9	1.8	1.8	1.8	1.8	1.8
Grants	0.4	0.4	0.4	0.4	0.5	0.5	0.4	0.4	0.4
Total expenditure	32.3	33.4	29.6	29.4	30.0	30.2	30.9	31.1	31.3
Current expenditure	23.2	24.6	24.2	24.5	24.7	24.7	24.9	25.1	25.3
Personnel cost	6.1	5.4	5.3	5.2	5.2	5.2	5.2	5.2	5.2
Interest	2.9	3.2	3.4	3.3	3.4	3.5	3.7	3.9	4.1
Of which: domestic	2.6	2.7	2.9	2.5	2.5	2.5	2.7	2.9	3.2
Operations & maintenance	2.7	2.8	2.7	2.6	2.6	2.6	2.6	2.6	2.6
Subsidies	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social insurance outlays	7.0	8.4	8.4	8.8	8.8	8.8	8.8	8.8	8.8
Local government expenditure	2.5	2.9	2.5	2.7	2.7	2.7	2.7	2.7	2.7
Social protection transfers	1.6	1.7	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Property compensation	0.0	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Capital expenditure 1/	8.6	8.8	5.8	4.8	5.3	5.5	6.0	6.0	6.0
Lending minus repayment	0.5	0.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance 3/	-5.6	-7.4	-3.7	-3.7	-4.5	-4.8	-5.5	-5.7	-6.0
Current balance including grants 4/	3.5	1.4	1.6	1.1	0.9	0.7	0.5	0.2	0.0
Financing	5.6	7.4	3.7	3.7	4.5	4.8	5.5	5.7	6.0
Domestic	2.0	3.3	0.9	2.3	3.1	4.6	5.9	6.4	6.6
Privatization receipts 5/	0.5	2.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	1.4	0.9	0.5	2.3	3.1	4.6	5.9	6.4	6.6
Foreign	3.6	3.7	2.5	2.2	1.3	0.2	-0.4	-0.6	-0.6
Accumulation of Arrears	0.0	0.5	0.3	-0.7	0.0	0.0	0.0	0.0	0.0
Memorandum Items:									
Primary balance	-2.7	-4.3	-0.4	-0.4	-1.0	-1.2	-1.8	-1.9	-1.9
Current balance excluding grants	3.1	1.0	1.2	0.7	0.4	0.3	0.1	-0.2	-0.4
Total spending contingencies 2/	0.0	0.0	0.0	0.3	0.2	0.2	0.2	0.2	0.2
Public debt	55.1	59.8	58.2	59.4	59.2	59.6	60.6	62.0	63.6
Domestic general government	36.8	36.1	32.9	33.1	33.8	36.1	39.4	43.1	46.8
External	18.3	23.7	25.3	26.3	25.4	23.5	21.1	19.0	16.9
GDP (in billions of leks)	1089	1151	1238	1322	1423	1529	1644	1768	1896

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

1/ Excludes capital transfer to KESH in 2007.

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

3/ Arrears accumulated in 2009 and 2010.

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

5/ Includes privatization of ARMO in 2008 and OSSH in 2009. Includes real estate sale in 2010.

Table 2b. Albania: General Government Operations, 2008–16
(Billions of leks)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
			Est.	Projection					
Total revenue and grants	290.9	299.0	319.6	339.0	363.7	389.6	417.8	448.2	479.7
Tax revenue	264.1	270.8	288.8	308.7	330.9	354.8	380.6	408.5	437.7
VAT	107.1	110.1	114.0	118.7	127.6	136.9	147.1	158.1	169.2
Profit tax	18.1	17.1	17.6	20.9	22.5	24.1	26.0	27.9	29.9
Excise tax	32.5	33.5	38.8	41.4	44.6	47.9	51.5	55.3	59.4
Small business tax	2.6	2.5	2.3	2.7	2.9	3.1	3.3	3.6	3.9
Personal income tax	24.4	26.8	27.1	29.1	31.3	33.6	36.1	38.9	41.7
Customs duties	8.7	7.9	7.3	8.2	7.6	7.8	8.0	8.1	8.7
Other taxes	14.4	13.4	18.4	20.4	22.0	23.6	25.4	27.3	29.2
Property and local taxes	8.7	9.7	9.6	10.5	11.3	12.2	13.1	14.1	15.1
Social insurance contributions	47.6	49.8	51.6	55.5	59.7	64.2	69.0	74.2	79.6
Non-tax revenue	22.6	23.7	26.2	24.8	25.9	27.8	29.9	32.2	34.5
Grants	4.2	4.4	4.6	5.5	6.8	6.9	7.3	7.5	7.5
Total expenditure	351.8	384.4	365.8	388.3	427.0	462.5	507.6	549.9	593.5
Current expenditure	253.0	282.9	299.9	324.3	351.0	378.3	409.0	443.8	479.8
Personnel cost	66.6	62.4	65.8	69.3	74.6	80.1	86.1	92.6	99.3
Interest	31.3	36.3	41.6	43.9	48.8	53.8	60.2	68.6	77.7
Of which: domestic	28.4	31.4	35.6	32.6	35.0	38.5	44.1	51.9	60.9
Operations & maintenance	29.0	32.1	33.3	33.9	36.5	39.2	42.2	45.3	48.6
Subsidies	2.6	2.0	3.5	3.5	3.8	4.1	4.4	4.7	5.1
Social insurance outlays	76.2	96.7	104.5	115.9	124.8	134.0	144.1	155.0	166.2
Of which: contingency				2.1	2.3	2.5	2.6	2.8	3.0
Local government expenditure	27.1	33.6	30.8	35.7	38.4	41.2	44.3	47.7	51.1
Social protection transfers	17.8	19.1	18.7	20.2	21.6	23.2	25.0	26.8	28.8
Property compensation	0.0	1.7	1.8	2.0	2.5	2.6	2.7	3.0	3.0
Capital expenditure 1/	93.8	101.4	71.6	63.9	76.0	84.1	98.6	106.0	113.7
Lending minus repayment	5.0	0.1	-5.6	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance 3/	-60.9	-85.4	-46.2	-49.3	-63.4	-72.9	-89.8	-101.6	-113.8
Current balance including grants 4/	37.9	16.1	19.7	14.6	12.7	11.2	8.7	4.4	-0.1
Financing	60.9	85.4	46.2	49.3	63.4	72.9	89.8	101.6	113.8
Domestic	21.9	37.5	11.4	29.8	44.7	70.0	97.0	113.0	125.5
Privatization receipts 5/	5.5	27.6	4.5	0.0	0.3	0.3	0.0	0.0	0.0
Net borrowing	15.4	9.9	5.7	29.8	44.4	69.7	97.0	113.0	125.5
Foreign	39.0	42.4	30.8	29.1	18.7	2.9	-7.2	-11.4	-11.7
Accumulation of Arrears		5.5	4.1	-9.6	0.0	0.0	0.0	0.0	0.0
Memorandum Items:									
Primary balance	-29.6	-49.1	-4.6	-5.4	-14.5	-19.1	-29.6	-33.0	-36.2
Current balance excluding grants	33.7	11.6	15.1	9.1	5.8	4.3	1.5	-3.1	-7.6
Total spending contingencies 2/	0.0	0.0	0.0	3.6	2.3	2.5	2.6	2.8	4.0
Public Debt	600.2	687.9	720.6	784.5	843.2	910.6	995.7	1096.4	1206.3
Domestic general government	400.5	415.0	407.4	437.2	481.5	551.2	648.2	761.2	886.7
External	199.7	272.8	313.3	347.4	361.7	359.4	347.5	335.1	319.5
Direct government external debt	168.2	232.6	273.4	301.5	310.3	302.7	285.6	267.3	246.4
Government guaranteed external debt	31.5	40.3	39.9	45.9	51.4	56.6	61.9	67.8	73.2

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

1/ Excludes capital transfer to KESH in 2007.

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

3/ Arrears accumulated in 2009.

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

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

Table 3a . Albania: Balance of Payments, 2008–16
(Percent of GDP)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
			Est.	Projections					
Current account	-15.1	-13.5	-11.8	-10.9	-9.8	-9.2	-8.0	-7.4	-7.0
Balance of goods and services	-26.6	-24.6	-21.0	-19.2	-17.9	-17.0	-15.5	-14.4	-14.1
Exports	29.3	28.7	32.1	34.8	36.2	37.1	38.6	39.8	40.3
Goods	10.3	9.0	13.1	14.4	15.0	15.7	16.4	17.2	17.4
Services	19.0	19.7	19.0	20.4	21.1	21.4	22.2	22.6	22.8
Imports	55.9	53.2	53.1	54.0	54.0	54.1	54.1	54.2	54.4
Goods	37.7	35.0	36.3	36.3	36.3	36.3	36.4	36.4	36.6
Services	18.2	18.3	16.7	17.7	17.8	17.8	17.8	17.7	17.8
Income balance	0.6	-0.6	-0.4	-0.7	-0.7	-0.7	-1.0	-1.3	-1.3
<i>Of which</i> : Interest due	0.7	0.8	0.8	1.0	1.0	1.0	1.0	0.9	0.8
Private transfers 1/	10.2	11.0	8.9	8.2	8.1	7.9	7.8	7.6	7.7
Official transfers	0.7	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.7
Financial account	16.6	11.2	12.9	8.2	6.9	6.5	6.5	6.6	6.7
Direct investment	6.7	7.7	9.2	6.9	7.3	7.9	7.8	7.8	7.8
Other capital	6.1	-0.4	1.4	-0.7	-1.4	-1.1	-0.5	-0.2	-0.2
Private loans (incl.net trade credits)	1.0	0.8	1.6	1.5	1.3	1.0	0.7	0.6	0.6
Other financial flows	5.2	-1.2	-0.2	-2.2	-2.6	-2.2	-1.2	-0.8	-0.8
<i>Of which</i> : Change in NFA of DMBs (increase = -) 2/	5.2	-1.9	-4.6	-1.8	-2.3	-2.0	-1.2	-0.7	-0.7
Medium- and long-term loans (net)	3.8	3.9	2.3	2.0	0.9	-0.2	-0.8	-1.0	-0.9
New borrowing	4.3	4.5	5.3	3.0	1.9	0.8	0.4	2.8	0.3
Multilateral loans	1.3	1.5	1.2	1.7	1.0	0.3	0.2	0.1	0.0
World Bank	0.3	0.3	0.2	0.4	0.2	0.1	0.0	0.0	0.0
EBRD	0.3	0.4	0.2	0.4	0.2	0.0	0.0	0.0	0.0
Other	0.7	0.7	0.8	0.9	0.6	0.2	0.1	0.1	0.0
Bilateral loans	0.4	0.9	0.7	1.2	0.8	0.4	0.3	0.2	0.3
Commercial debt	2.6	2.2	3.3	0.0	0.0	0.0	0.0	2.4	0.0
Amortization	-0.5	-0.6	-3.0	-1.0	-0.9	-1.0	-1.3	-3.7	-1.2
Errors and omissions 3/	0.7	1.8	2.1	1.5	1.4	1.3	1.2	1.1	1.1
Net balance	2.2	-0.5	3.3	-1.2	-1.5	-1.3	-0.3	0.3	0.8
Available financing	-2.2	0.5	-3.3	1.0	1.5	1.3	0.3	-0.3	-0.8
Change in net reserves (increase = -) 2/	-2.2	0.5	-3.3	1.0	1.5	1.3	0.3	-0.3	-0.8
Financing gap 4/	0.0	0.0	0.0	0.2	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 2008–10. In projections for 2011–16, valuation effects are assumed to be zero.

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

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

Table 3b. Albania: Balance of Payments, 2008–16

(Millions of Euros)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
			Est.	Projections					
Current account	-1,342	-1,183	-1,055	-1,023	-984	-986	-925	-913	-916
Balance of goods and services	-2,361	-2,148	-1,883	-1,795	-1,793	-1,830	-1,795	-1,775	-1,855
Exports	2,605	2,504	2,874	3,261	3,627	3,991	4,454	4,905	5,285
Goods	917	785	1,172	1,347	1,509	1,690	1,893	2,120	2,290
Services	1,688	1,718	1,702	1,914	2,118	2,301	2,561	2,785	2,996
Imports	4,967	4,652	4,756	5,057	5,420	5,821	6,249	6,680	7,141
Goods	3,349	3,054	3,255	3,396	3,638	3,908	4,199	4,493	4,807
Services	1,618	1,598	1,501	1,660	1,781	1,913	2,050	2,187	2,333
Income balance	55	-50	-32	-70	-70	-76	-121	-164	-166
Of which: Interest due	66	67	71	91	102	111	116	117	108
Private transfers 1/	905	957	798	771	812	849	905	939	1,016
Official transfers	59	58	63	71	68	71	86	88	89
Financial account	1,475	977	1,159	767	688	701	753	814	874
Direct investment, net	597	672	827	645	732	848	903	961	1,024
Other capital	545	-34	124	-65	-136	-122	-55	-26	-31
Private loans (incl.net trade credits)	86	70	144	139	129	109	81	73	74
Other financial flows	459	-105	-19	-203	-265	-231	-136	-99	-105
Of which: Change in NFA of DMBs (increase = -) 2/	461	-169	-415	-167	-235	-217	-136	-88	-92
Medium- and long-term loans (net)	334	340	207	187	92	-25	-95	-121	-118
New borrowing	379	396	474	277	186	82	51	340	43
Multilateral loans	113	127	111	162	105	35	19	10	3
World Bank	27	30	22	42	21	9	2	0	3
EBRD	25	33	14	37	25	3	0	0	0
Other	62	63	75	83	59	22	17	10	0
Bilateral loans	36	77	62	115	81	47	31	30	40
Commercial debt	230	193	300	0	0	0	0	300	0
Amortization	-45	-57	-266	-90	-94	-107	-145	-461	-161
Errors and omissions 3/	63	160	192	141	141	141	141	141	141
Net balance	197	-46	297	-115	-155	-144	-31	42	99
Available financing	-197	46	-297	98	155	144	31	-42	-99
Change in net reserves (increase = -) 2/	-197	46	-297	98	155	144	31	-42	-99
Financing gap 4/	0	0	0	17	0	0	0	0	0
Arrears Rescheduling	0	0	0	17	0	0	0	0	0
Memorandum items:									
GDP in Euros	8,878	8,737	8,964	9,366	10,031	10,762	11,547	12,328	13,123
Gross usable reserves	1,721	1,621	1,909	1,803	1,640	1,489	1,451	1,488	1,583
(months of imports of goods and services)	4.2	4.2	4.8	4.3	3.6	3.1	2.8	2.7	2.7
Balance of goods and services (percent of GDP)	-26.6	-24.6	-21.0	-19.2	-17.9	-17.0	-15.5	-14.4	-14.1
Current account (percent of GDP)	-15.1	-13.5	-11.8	-10.9	-9.8	-9.2	-8.0	-7.4	-7.0
Debt service (percent of exports of goods and services) 5/	2.7	4.0	9.9	3.4	3.2	2.4	2.2	8.1	1.1
Debt service (percent of central government revenues) 5/	3.1	4.8	13.3	5.0	4.8	3.8	3.6	13.4	1.8
Total external debt stock (percent of GDP) 6/	29.8	33.3	37.0	38.5	37.7	35.6	32.8	30.2	27.6
Volume of Exports of Goods and Services (percent change)	15.9	-6.0	24.3	9.8	10.8	10.9	11.7	10.8	5.0
Volume of Imports of Goods and Services (percent change)	6.5	0.7	-4.7	2.3	6.0	6.3	6.8	6.2	6.0
Terms of trade (percent change) 7/	-8.9	4.2	5.8	0.4	0.3	0.1	0.3	0.9	0.4

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 2008–10. In projections for 2011–16, valuation effects are assumed to be zero.

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

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

5/ Public and publicly guaranteed debt only.

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

7/ Fund Staff estimates and projections.

Table 4a. Albania: Monetary Aggregates, 2008–16
(Percent of GDP)

	Projections								
	2008	2009	2010	2011	2012	2013	2014	2015	2016
	Dec	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec	Dec
Monetary survey									
Broad money	74.9	75.7	79.2	81.6	84.1	87.7	91.3	95.1	99.3
Currency outside banks	18.0	18.2	15.8	15.4	15.9	16.6	17.3	18.0	18.8
Deposits	56.9	57.6	63.4	66.2	68.2	71.1	74.1	77.2	80.6
Domestic currency deposits	33.0	32.1	33.1	33.5	32.7	33.1	35.2	38.8	42.7
Foreign currency deposits	23.9	25.5	30.4	32.7	35.5	38.0	38.9	38.3	37.9
Net foreign assets	19.0	21.2	27.4	27.2	26.1	25.0	24.1	23.5	23.3
Bank of Albania	18.5	18.6	20.4	18.6	15.8	13.3	12.1	11.6	11.5
Commercial Banks	0.5	2.6	7.0	8.6	10.3	11.6	12.0	11.9	11.8
Net domestic assets	55.9	54.5	51.8	54.4	58.0	62.7	67.2	71.6	76.0
Claims on government (net of deposits)	29.3	29.2	27.7	28.2	29.3	31.9	35.5	39.4	43.4
BOA financing	5.6	5.8	4.5	4.2	4.2	4.3	4.3	4.2	4.2
<i>Of which</i> : gross credit	7.2	6.7	6.3	4.8	4.9	4.8	4.8	4.8	4.7
Other (including T-bills)	23.7	23.5	23.3	24.1	25.1	27.6	31.3	35.2	39.2
Claims on state enterprises and farms	1.2	1.0	0.8	0.7	0.7	0.6	0.6	0.5	0.5
Claims on the private sector	35.16	36.7	37.6	38.6	40.6	42.0	42.2	42.0	41.7
In leks	10.1	11.6	12.0	12.8	14.2	15.0	15.0	15.5	15.8
In foreign currency	25.1	25.1	25.5	25.8	26.4	27.0	27.1	26.5	25.9
Other items, net	-9.7	-12.5	-14.3	-13.2	-12.6	-11.8	-11.1	-10.3	-9.6
Memorandum items									
Reserve money	24.9	24.7	22.9	23.0	23.7	24.7	25.7	26.8	28.0
M1	26.0	24.7	22.3	15.4	15.9	16.6	17.3	18.0	18.8
M2	51.0	50.2	48.8	48.9	48.6	49.7	52.4	56.8	61.4

Sources: Bank of Albania; and IMF staff estimates.

Table 4b. Albania: Monetary Aggregates, 2008–16
(Billions of leks unless otherwise indicated; end-period)

	Projections								
	2008	2009	2010	2011	2012	2013	2014	2015	2016
	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.
Monetary survey									
Broad money	815.7	871.5	980.3	1,078.3	1,196.9	1,340.6	1,501.4	1,681.6	1,883.4
Currency outside banks	195.8	209.0	195.1	203.7	226.1	253.2	283.6	317.6	355.7
Deposits	619.9	662.4	785.2	874.6	970.8	1,087.3	1,217.8	1,364.0	1,527.6
Domestic currency deposits	359.2	369.1	409.5	442.5	465.3	505.9	578.3	686.0	809.0
Foreign currency deposits	260.7	293.3	375.8	432.1	505.6	581.4	639.6	678.0	718.6
Net foreign assets	206.7	244.4	339.4	359.3	370.9	381.6	396.4	414.9	442.6
Bank of Albania	201.2	214.5	252.8	246.3	224.4	204.0	199.0	204.6	218.6
Commercial Banks	5.5	30.0	86.6	113.0	146.6	177.6	197.4	210.2	224.0
Net domestic assets	609.0	627.0	640.9	718.9	825.8	958.7	1,104.6	1,266.2	1,440.2
Claims on government (net of deposits)	318.9	336.3	343.4	373.2	417.5	487.3	584.3	697.2	822.7
BOA financing	60.9	66.4	55.4	55.1	60.1	65.1	70.1	75.1	80.1
Of which: gross credit	78.2	77.3	78.0	64.1	69.1	74.1	79.1	84.1	89.1
Other (including T-bills)	258.0	269.9	288.0	318.1	357.4	422.2	514.2	622.2	742.6
Claims on state enterprises and farms	12.9	12.1	9.4	9.4	9.4	9.4	9.4	9.4	9.4
Claims on the private sector	383.0	422.3	465.0	510.5	577.6	642.3	693.0	742.4	790.6
In leks	110.1	133.3	149.1	169.4	202.4	229.5	247.3	274.4	299.2
In foreign currency	272.9	289.0	315.8	341.1	375.2	412.7	445.8	468.0	491.4
Other items, net	(105.7)	(143.6)	(176.9)	(174.1)	(178.7)	(180.2)	(182.0)	(182.8)	(182.5)
Memorandum items									
Reserve money (billions of Lek)	271.7	284.8	283.5	303.5	336.8	377.1	422.4	473.3	530.3
M1 (billions of Lek)	282.9	284.5	275.4	203.7	226.1	253.2	283.6	317.6	355.7
M2 (Billions of Lek)	555.0	578.2	604.5	646.2	691.3	759.1	861.8	1,003.6	1,164.8
Annual broad money growth	7.7	6.8	12.5	10.0	11.0	12.0	12.0	12.0	12.0
Annual growth in private sector credit	32.1	10.3	10.1	9.8	13.1	11.2	7.9	7.1	6.5
Private sector credit as a percent of GDP	34.8	36.4	37.6	38.6	40.6	42.0	42.2	42.0	41.7
Annual change in credit as a percent of GDP	5.5	1.6	1.1	1.1	2.0	1.4	0.2	(0.2)	(0.3)
Annual M2 growth	9.7	4.2	4.6	6.9	7.0	9.8	13.5	16.5	16.1
Velocity (annual GDP/BM)	1.3	1.3	1.3	1.2	1.2	1.1	1.1	1.1	1.0
Money multiplier (absolute values)	3.0	3.1	3.5	3.6	3.6	3.6	3.6	3.6	3.6
Currency/Broad Money ratio	24.0	24.0	19.9	18.9	18.9	18.9	18.9	18.9	18.9
Foreign currency deposits/total deposits	42.1	44.3	47.9	49.4	52.1	53.5	52.5	49.7	47.0
Gross reserves (millions of euros)	1,720.8	1,621.0	1,905.9	1,802.6	1,640.3	1,488.5	1,450.9	1,487.9	1,583.2
In percent of broad money	26.1	26.0	27.0	23.7	19.5	15.8	13.8	12.6	12.0
U.S. dollar exchange rate (end of period)	90.7	95.8	100.2	...	...	...	...	...	...
Euro exchange rate (end of period)	123.5	138.0	138.6	...	...	...	...	...	...
3-month T-bill rate (in percent)	6.3	6.3	5.3	...	...	...	...	...	...
BoA repo rate (in percent)	6.3	5.3	5.0	...	...	...	...	...	...

Sources: Bank of Albania; and IMF staff estimates.

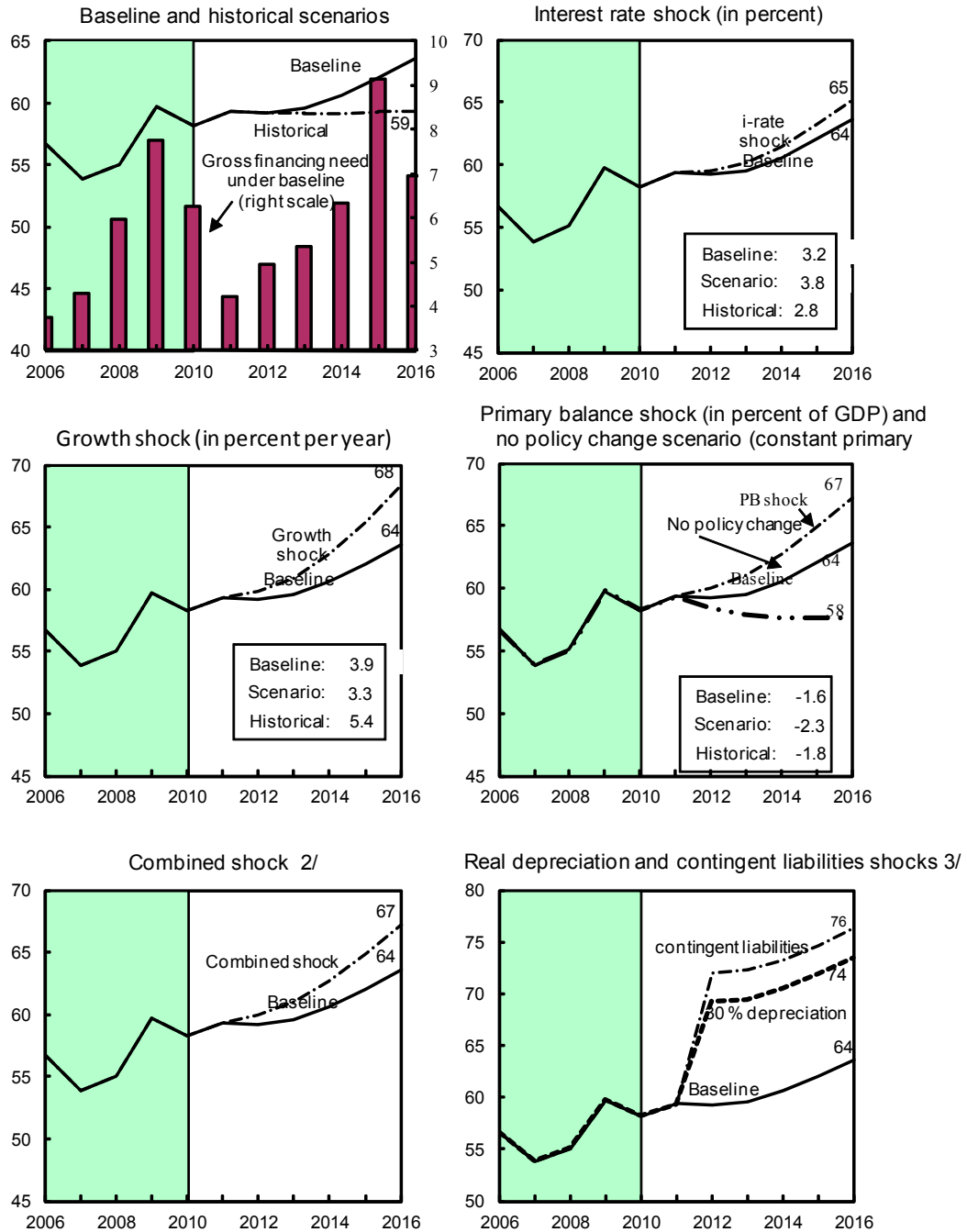
Table 5. Albania: IMF Core Indicators of Financial Soundness, December 2005–December 2010

	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10
I Capital-based						
(i) Regulatory capital as a percent of risk-weighted assets	18.6	18.1	17.1	17.2	16.2	15.4
(ii) Regulatory Tier 1 capital as a percent of risk-weighted assets	18.1	17.1	16.0	16.3	15.3	14.5
(iii) Capital as a percent of total assets						
Regulatory Tier 1 capital as a percent of total assets	5.4	5.9	5.8	6.7	8.7	8.6
Regulatory capital as a percent of total assets	5.6	6.2	6.2	7.0	9.2	9.1
Shareholders' equity as a percent of total assets	6.6	6.8	7.6	8.6	9.6	9.4
(iv) Nonperforming loans net of provisions as a percent of capital						
Nonperforming loans net of provisions as a percent of regulatory Tier 1 capital	4.4	7.2	12.0	27.2	29.9	38.1
Nonperforming loans net of provisions as a percent of regulatory capital	4.3	6.8	11.2	25.7	28.2	35.9
Nonperforming loans net of provisions as a percent of shareholders' equity	3.6	6.3	9.1	21.1	27.1	34.8
(v) Return on equity (ROE) (annual basis)	22.2	20.2	20.7	11.4	4.6	7.6
(vi) Net open position in foreign exchange as a percent of capital						
Net open position in foreign exchange as a percent of regulatory Tier 1 capital	9.5	5.5	1.8	4.5	4.1	5.3
Net open position in foreign exchange as a percent of regulatory capital	9.3	5.2	1.7	4.3	3.9	5.0
Net open position in foreign exchange as a percent of shareholders' equity	7.8	4.8	1.4	3.5	3.7	4.9
II Asset-based						
(vii) Liquid assets as a percent of total assets (Liquid-asset ratio) 1/	62.6	57.6	49.8	42.8	27.6	25.9
(viii) Liquid assets as a percent of short-term liabilities 1/	75.2	69.5	55.6	104.7	32.6	30.6
(ix) Return on assets (ROA) (net income to average total assets) (annual basis)	1.4	1.4	1.6	0.9	0.4	0.7
(x) Nonperforming loans (gross) as a percent of total loans	2.3	3.1	3.4	6.6	10.5	14.0
(xi) Sectoral distribution of loans to total loans	na	na	na	na	na	na
III Income and expense-based						
(xii) Interest margin to gross income	84.0	92.6	92.7	106.5	119.6	118.9
(xiii) Noninterest expenses to gross income	76.3	65.7	58.5	69.6	83.0	75.5
IV Memorandum items						
Other (noncore) indicators:						
Customer deposits as a percent of total (non-interbank) loans	342.5	265.5	215.5	162.6	154.3	166.4
Foreign currency-denominated loans to total loans	75.5	71.9	72.5	72.6	70.2	69.8
Foreign currency-denominated liabilities as a percent of total liabilities	41.0	44.0	46.9	48.5	48.9	51.0
Other indicators:						
Risk weighted assets as a percent of total assets	30.0	34.6	36.4	40.8	56.7	59.2
Total loans as a percent of total assets	25.7	31.7	39.4	47.6	50.8	49.6
Total loans as a percent of shareholders' equity	387.0	469.5	516.4	555.1	530.2	527.0

Source: Data provided by Bank of Albania.

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

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



Sources: International Monetary Fund, country desk data, and staff estimates.
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
 2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
 3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2011, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table A.1. Albania: Public Sector Debt Sustainability Framework, 2006-2016
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 9/ 0.1
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	
Baseline: Public sector debt 1/ o/w foreign-currency denominated	56.7	53.8	55.1	59.8	58.2	59.4	59.2	59.6	60.6	62.0	63.6	
	17.1	15.7	18.3	23.7	25.3	26.3	25.4	23.5	21.1	19.0	16.9	
Change in public sector debt	-1.5	-2.8	1.3	4.7	-1.5	1.1	-0.1	0.3	1.0	1.4	1.6	
Identified debt-creating flows (4+7+12)	-3.0	-4.4	0.0	3.1	0.8	0.8	0.2	0.7	1.3	1.5	1.8	
Primary deficit	0.5	1.4	2.7	4.3	0.4	0.4	1.0	1.2	1.8	1.9	1.9	
Revenue and grants	26.0	26.0	26.7	26.0	25.8	25.6	25.6	25.5	25.4	25.4	25.3	
Primary (noninterest) expenditure	26.5	27.4	29.4	30.2	26.2	26.1	26.6	26.7	27.2	27.2	27.2	
Automatic debt dynamics 2/	-3.1	-4.3	-2.2	1.7	1.1	-0.4	-0.8	-0.6	-0.5	-0.4	-0.1	
Contribution from interest rate/growth differential 3/	-1.6	-2.4	-3.1	0.2	-0.8	-0.4	-0.8	-0.6	-0.5	-0.4	-0.1	
Of which contribution from real interest rate	1.3	0.7	0.5	1.9	1.1	1.0	1.1	1.7	1.7	1.9	2.2	
Of which contribution from real GDP growth	-2.9	-3.0	-3.6	-1.7	-1.9	-1.4	-1.9	-2.3	-2.2	-2.3	-2.3	
Contribution from exchange rate depreciation 4/	-1.5	-1.9	0.9	1.5	1.9	...	...	...	...	...	...
Other identified debt-creating flows	-0.3	-1.6	-0.5	-2.9	-0.7	0.7	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.3	-1.6	-0.5	-2.4	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (incl. Arrears)	0.0	0.0	0.0	-0.5	-0.3	0.7	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	1.4	1.6	1.2	1.5	-2.3	0.4	-0.3	-0.3	-0.3	-0.1	-0.2	
Public sector debt-to-revenue ratio 1/	217.9	207.1	206.3	230.1	225.5	231.5	231.9	233.7	238.3	244.6	251.4	
Gross financing need 6/ in billions of U.S. dollars	3.8	4.3	6.0	7.7	6.3	4.2	4.9	5.3	6.3	9.1	6.9	
	0.3	0.5	0.8	0.9	0.7	0.6	0.7	0.8	1.0	1.6	1.3	
Scenario with key variables at their historical averages 7/						59.4	59.3	59.2	59.1	59.3	59.4	-1.4
Scenario with no policy change (constant primary balance) in 2011-2016						59.4	58.5	57.9	57.6	57.6	57.7	0.1
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.4	5.9	7.5	3.3	3.5	2.5	3.5	4.2	4.0	4.0	4.0	
Average nominal interest rate on public debt (in percent) 8/	5.3	5.1	6.0	6.0	6.0	6.1	6.2	6.4	6.6	6.9	7.1	
Average real interest rate (nominal rate minus change in GDP deflator, in p	2.6	1.5	1.3	3.8	2.2	1.9	2.2	3.3	3.2	3.5	4.0	
Nominal appreciation (increase in US dollar value of local currency, in perc	10.0	13.8	-6.2	-7.9	-7.9	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.7	3.6	4.7	2.3	3.9	4.2	4.1	3.1	3.4	3.4	3.1	
Growth of real primary spending (deflated by GDP deflator, in percent)	9.4	9.4	15.5	6.2	-10.3	1.9	5.6	4.8	5.9	4.0	4.0	
Primary deficit	0.5	1.4	2.7	4.3	0.4	0.4	1.0	1.2	1.8	1.9	1.9	

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

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

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

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

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

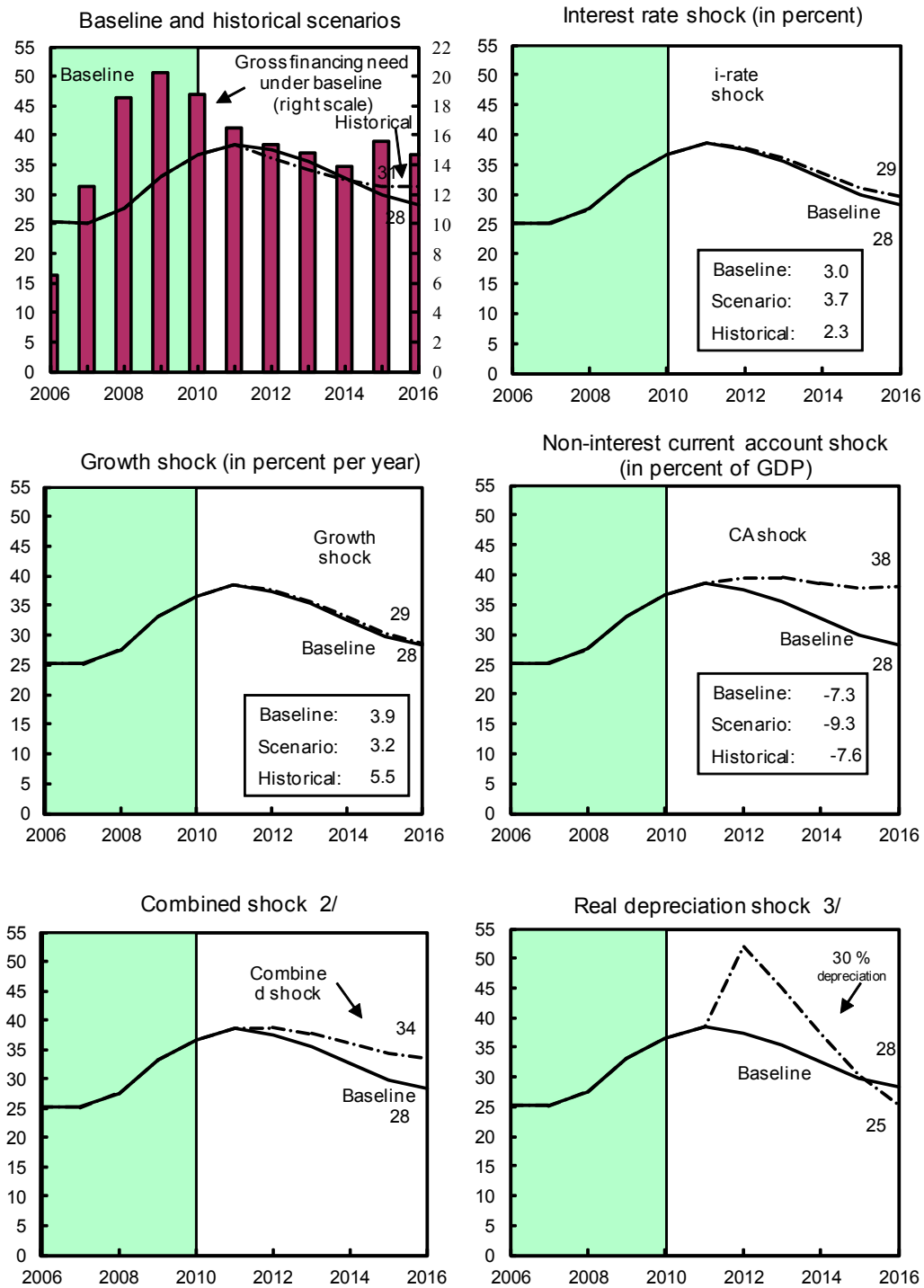
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

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

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

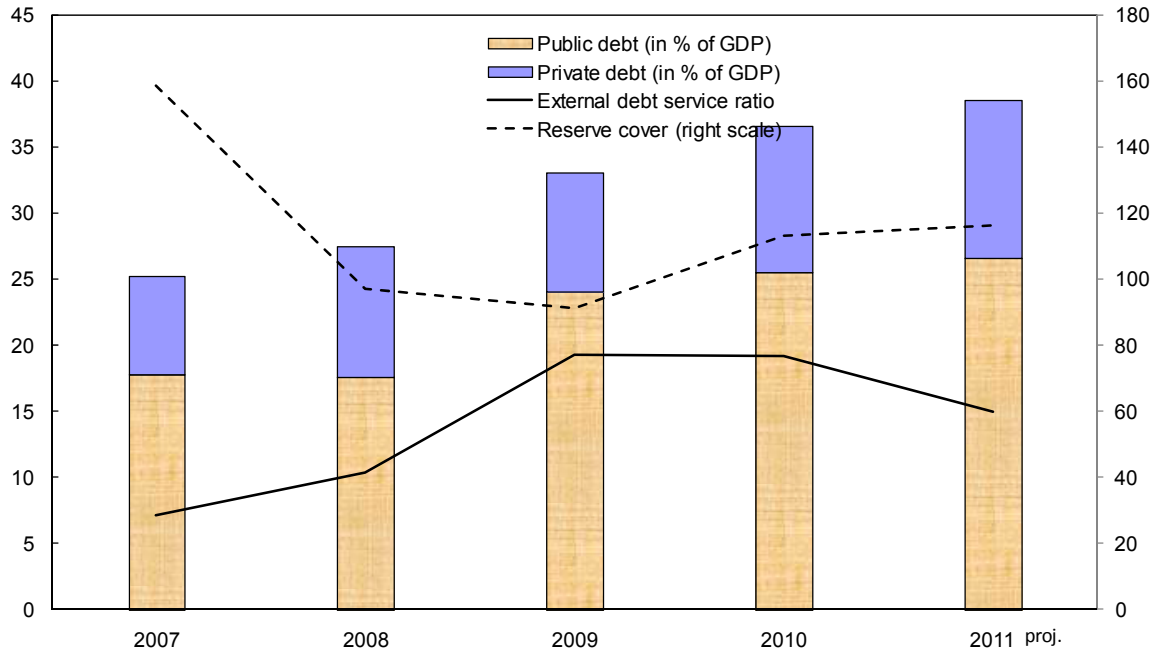
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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



Sources: International Monetary Fund, Country desk data, and staff estimates.
 1/ Shaded areas represent actual data. In individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
 2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
 3/ One-time real depreciation of 30 percent occurs in 2010.

External Debt and Liquidity Indicators 1/



Sources: BOA; and IMF staff estimates.

1/ The reserve cover is the ratio of official reserve to the sum of current account deficit and short-term external debt by remaining maturity. The external debt service ratio is the ratio of debt service to current external receipts.

Table A.2. Albania: External Debt Sustainability Framework, 2006-2016
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -8.5
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	
Baseline: External debt	25.3	25.2	27.5	33.1	36.6	38.5	37.5	35.4	32.6	29.9	28.3	
Change in external debt	4.9	0.0	2.3	5.6	3.5	1.9	-1.0	-2.1	-2.8	-2.7	-1.6	
Identified external debt-creating flows (4+8+9)	0.1	0.2	4.0	7.4	3.6	3.2	1.3	-0.2	-1.1	-1.6	-1.9	
Current account deficit, excluding interest payments	5.0	9.7	14.5	12.7	11.0	9.9	8.8	8.1	7.0	6.5	6.2	
Deficit in balance of goods and services	24.1	26.8	26.8	24.4	21.0	19.1	17.9	17.0	15.5	14.4	14.1	
Exports	25.2	28.2	29.5	28.4	32.0	34.8	36.1	37.1	38.6	39.8	40.3	
Imports	49.3	54.9	56.3	52.8	53.0	53.9	54.0	54.1	54.1	54.2	54.4	
Net non-debt creating capital inflows (negative)	-3.6	-6.1	-6.8	-7.6	-9.2	-6.9	-7.3	-7.9	-7.8	-7.8	-7.8	
Automatic debt dynamics 1/	-1.3	-3.4	-3.7	2.4	1.8	0.1	-0.2	-0.5	-0.3	-0.3	-0.3	
Contribution from nominal interest rate	0.6	0.6	0.7	0.8	0.8	1.0	1.0	1.0	1.0	0.9	0.8	
Contribution from real GDP growth	-1.0	-1.3	-1.6	-1.0	-1.2	-0.8	-1.3	-1.5	-1.3	-1.2	-1.1	
Contribution from price and exchange rate changes 2/	-0.9	-2.8	-2.8	2.6	2.2	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	4.8	-0.2	-1.7	-1.8	0.0	-1.3	-2.3	-1.9	-1.7	-1.1	0.4	
External debt-to-exports ratio (in percent)	100.4	89.6	93.2	116.5	114.3	110.8	103.8	95.6	84.6	75.2	70.3	
Gross external financing need (in billions of US dollars) 4/	598.7	1349.0	2412.6	2482.5	2237.1	2195.0	2188.2	2233.8	2230.3	2650.5	2641.6	
in percent of GDP	6.6	12.6	18.6	20.2	18.8	16.5	15.4	14.8	13.9	15.6	14.7	
Scenario with key variables at their historical averages 5/						38.5	36.3	34.2	32.5	31.4	31.4	-8.2
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.4	5.9	7.5	3.3	3.5	2.5	3.5	4.2	4.0	4.0	4.0	
GDP deflator in US dollars (change in percent)	4.6	12.4	12.7	-8.5	-6.4	9.0	3.3	2.0	2.3	1.8	1.6	
Nominal external interest rate (in percent)	3.1	3.0	3.6	2.6	2.3	2.9	2.8	2.9	3.0	3.1	2.9	
Growth of exports (US dollar terms, in percent)	22.9	31.6	27.1	-9.1	9.3	21.2	11.1	9.1	10.6	9.3	6.9	
Growth of imports (US dollar terms, in percent)	15.8	31.0	24.2	-11.4	-2.6	13.5	7.1	6.5	6.4	6.1	6.1	
Current account balance, excluding interest payments	-5.0	-9.7	-14.5	-12.7	-11.0	-9.9	-8.8	-8.1	-7.0	-6.5	-6.2	
Net non-debt creating capital inflows	3.6	6.1	6.8	7.6	9.2	6.9	7.3	7.9	7.8	7.8	7.8	

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

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

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

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

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

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

Annex I. Improving National Accounts Statistics¹

There has been notable progress in improving national accounts. The Albanian Statistics Agency (INSTAT) has received substantial technical assistance from the IMF and the European Commission during the last decade. The Fund's most recent TA has focused on the national accounts statistics. In particular, assistance has been provided on improving annual national accounts by production and expenditure approaches and developing quarterly estimates.

Still, some problems remain with respect to the reliability of the annual and quarterly national account estimates. In particular, the consistency between quarterly and annual data has not yet been secured.

- The quarterly estimates by production approach are performed at too aggregated levels and this makes the analysis and error detection in the data problematic. With more disaggregation, specific and improved deflators would be needed, especially for branches like trade, transport, financial services, and public administration. Another related issue is the quality of the deflation methods and the use of specific deflators. The use of the single deflation method often yields erratic results and one TA recommendation, yet to be implemented by INSTAT, has been to use fixed value added ratios at constant prices.
- Notable areas for improvement for annual national accounts by expenditure approach concern the estimation methodologies for household consumption and deflation of external trade, respectively.

The quality of source data also remains a major concern. More disaggregated estimates will require better quality and extended coverage of the data sources. Collection, processing and use of the data from all three main sources, namely, the annual structural business survey, the financial statements of enterprises, and VAT returns to the tax authorities, need to be improved. In the medium term, the creation of adequate statistical infrastructure, such as an automated centralized processing of administrative data, could facilitate these tasks.

The level of cooperation between units within INSTAT and between INSTAT and other government agencies that provide significant inputs needs to be improved. INSTAT units often seem to operate in silos and to lack a common vision for the development priorities for statistics. Other government agencies need to better recognize the importance of timely and accurate statistics and the Ministry of Finance should play a leading and exemplary role in improving the data processing and provision to INSTAT.

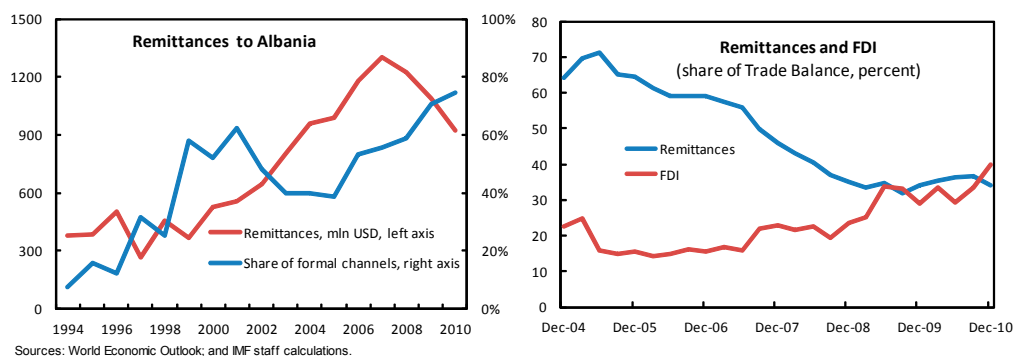
¹ Prepared by Vahram Stepanyan. This Box draws on several IMF reports on technical assistance provided to the Albanian authorities during the period of 2009–2011.

Annex II. The Shifting Pattern of Remittances in Albania¹

More than 25 percent of Albanian citizens are living abroad, making the country the fourth in the world in terms of emigrants to population ratio. Neighboring Greece and Italy attract most of the Albanian émigrés and account for 90 percent of remittances to Albania. Estimates commonly put the diaspora in Greece at 800,000 and Italy at 300,000, as high as 40 percent of Albanian labor force. Over 50 percent of the first generation of Albanian emigrants to Greece and Italy had secondary or higher education. Around 60 percent of Albanian remittances are from Greece, 30 percent from Italy, and the rest from the U.S., Germany, and other European countries.

Remittances played an important role in alleviating poverty and promoting financial development. The 2005 Albania Living Standard Measurement Survey (LSMS) estimated that remittances on average accounted for a third of disposable income of recipient families and 40 percent for rural families. Remittances were mostly used for importing consumer goods, services, and for the purchase or construction of houses. The level and particularly the severity of poverty as a result were greatly reduced among households receiving remittances. Remittances also helped promote financial development in Albania through the increasing demand of banking access and services from both senders and receivers and raising banking deposits and credit to GDP.

After peaking at \$1,305 million (€952 million) in 2007, the amount of remittances and their impact on the current account has since declined. Remittances, as a share of GDP, started declining in the early 2000s, from around 15 percent of GDP then to 9.0 percent in 2009 and an estimated 7.8 percent in 2010. Remittances traditionally covered more than 60 percent of trade deficits, but the share dropped to less than 40 percent after 2008. Rising FDI has overtaken remittances since mid-2009 as the number one source of financing for trade deficits. Notwithstanding the fall in total amount remitted, the amount transferred through official channels such as banks and monetary transfer operators (MTOs) has been on a steady rise since the early 2000s with the development of the banking system and the elimination of the black market exchange premium.



¹ Prepared by Yanliang Miao.

The waning amount and diminishing role of remittances are likely to continue because of changing demographics of emigrants and ongoing economic difficulties in host countries. Two decades after the massive emigration wave in 1991, migrant workers have either settled down in host countries with family unifications or begun to return to Albania. In either case, remittances are likely to go down. This is broadly in line with international experiences that remittances show a parabolic pattern with the prolongation of migration, reaching the peak after 10–14 years of migration and decreasing thereafter. In addition, economic difficulties in Greece and Italy are putting additional strain on remittances via reduced migrant wages and employment opportunities. On the other hand, to the extent that a new wave of workers were to leave Albania, either in response to improved labor markets in Europe or increased domestic hardships, the importance of remittances could again increase.

Emigrant earnings and savings, however, are likely to continue coming back and increasingly in forms other than remittances. For example, bank deposits in foreign currencies in Albania rose drastically in the aftermath of the 2010 Greece debt crisis possibly due to the Albanian émigré's lack of trust in Greek banks. Emigrants' savings may also enter the economy as travel receipts, real estate purchases, and other business investment as part of the broad FDI.

The shifting pattern of remittances and emigrant earnings could pose policy challenges in coping with exchange rate volatilities and protecting financial stability. The challenge on exchange rate volatility has long been associated with the seasonality of remittances to Albania: large spikes in the summer and Christmas time. The challenge is further amplified by foreign exchange inflows during the summer tourist season. The Bank of Albania has avoided large exchange rate fluctuations by a measured build-up of foreign reserves complemented with well-timed open market operations. An additional risk, however, might arise with the surge in bank deposits from emigrants, which could very well be recycled back to riskier source countries through their banking subsidiaries in Albania.

Declining remittances also present an opportunity in the long run for more robust and dynamic growth. Remittances in theory can reduce the likelihood of employment and the number of hours worked through a relaxed budget constraint and a rising reservation wage. Based on the 2005 LSMS, Trako (2008) found that remittances to Albania indeed reduced in recipient households the likelihood of participating in the labor force for adults between 22–65 years old and the likelihood of attending school for children between 12–17 years old. Financial flows from migrants in forms such as direct investment have the potential to be more productivity-enhancing than cash remittances as the latter mainly boost consumption. The shifting pattern of remittances, if properly harnessed, is thus likely to help the Albanian economy realizing its full potential.

Annex III. Albania's Pension System and Fiscal Challenges¹

The deficit in the state pension system has widened. Over the last decade spending on old age pensions increased from 3.6 percent of GDP in 2000 to 4.3 percent in 2009. That increase reflected higher spending on rural pensions, which more than doubled from 0.4 percent of GDP to 0.9 percent. Spending on urban old-age pensions, by contrast, remained more or less stable. Over the same period the share of pension contributions in GDP declined from 3.3 percent to 2.9 percent, with the fall since 2006 mainly due to the reduction in employer contribution rates from 29 percent to 20 percent that year. In 2009 the rate was lowered further to 15 percent, motivated by effort to increase compliance. Moreover, rural contributions remain heavily subsidized. The government finances the widening funding gap in the state pension scheme out of general taxation, taking financial resources away from other types of spending.

Table 1. Old Age Pensions, percent of GDP

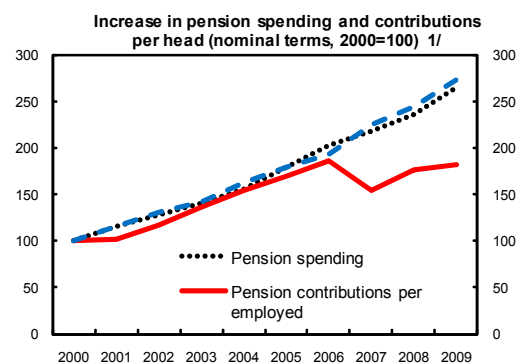
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Old-age pension	3.6	3.8	4.0	4.0	4.1	4.2	4.2	4.2	4.0	4.3	4.3
urban	3.2	3.4	3.5	3.4	3.5	3.6	3.5	3.4	3.3	3.4	3.4
rural	0.4	0.4	0.5	0.5	0.6	0.6	0.7	0.7	0.8	0.9	0.9
Pension contributions	3.3	2.6	2.7	2.9	3.1	3.1	3.2	3.0	2.9	2.9	n/a

Sources: ISSH, INSTAT, and IMF staff calculations

Despite the substantial increase in spending on rural old-age pensions, they still—on average—amounted to only 16.3 percent of the average wage or 37 percent of the official minimum wage in 2009. While this compares favorably with the situation in 2000 (when these figures were 6.8 and 14.6 percent, respectively), they are only half as generous as the urban old-age pension. The latter was on average equivalent to 29.4 percent of the average wage and 66.8 percent of the official minimum wage in 2009. Despite this continuing relatively low level, the rural pension accounted for a third of pre-transfer consumption of the poorest quintile and as such was more than twice as important as the social assistance program for this group of society as a source of income.

Per capita pension spending increased in line with the average wage over the previous decade. This is despite the fact that pensions are legally indexed to inflation only.² Up to 2006 pension contributions per person employed followed a similar trajectory. The reduction in employer contribution rates that year has resulted in diverging trends since.

The scheme's deficit is particularly worrying as the Albanian population is young. If anything, one would expect a substantial surplus based on demographic fundamentals. According to the



Source: Instat, ISSH/IMF staff calculations.

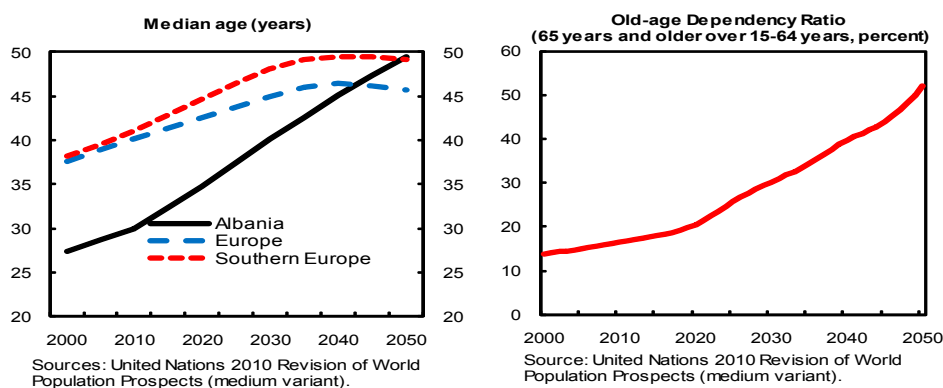
1/ Pension contributions per employed has been calculated by dividing total old-age pension contributions by the number of people in employment.

¹ Prepared by Frank Eich.

² *Pension Systems and Labor Costs in Southeastern Europe*, Anita M. Schwarz, World Bank, 2007, page 10.

United Nations 2010 revised population projections, the median age of the Albanian population was 30 years in 2010; more than a decade younger than the European and Southern European averages.

Demographic trends pose significant challenges to Albania's pension system. The Albanian population is projected to age dramatically over the coming decades, with the median age exceeding the European and Southern European averages by mid century. Similarly, Albania's old-age dependency ratio is projected to triple from around 18 percent now to just over 50 percent and thus close to the European average. On current policies the wedge between spending and contributions would continue to widen, requiring ever greater transfers from general taxation to fill the gap. This would prove to be unsustainable within a relatively short period of time.

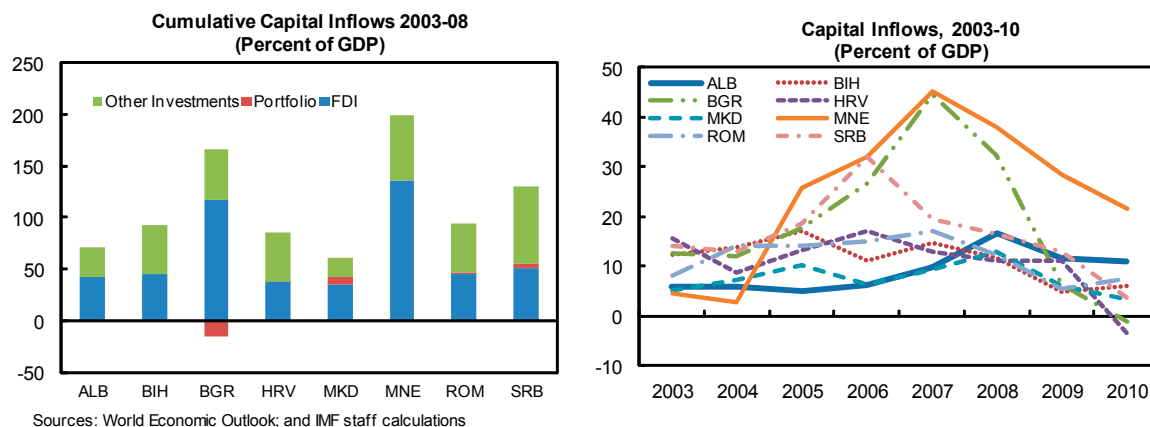


Thus, pension reform is a priority, especially addressing the imbalances in the existing pay-as-you-go system. The 2006 and 2009 reductions in contribution rates should be revisited in order to strengthen the finances of the social security system, not least as these have not led to an increase in compliance. Second, the continued need for subsidizing rural contribution should be assessed. Third, pension spending increases could be kept at bay, by raising pensions by less than earnings. Looking beyond these immediate measures to bolster the social security finances, more fundamental changes should be contemplated; such as eliminating the distinction between urban and rural pensions (which would allow for better targeting) and making the link between contributions and pensions more apparent. The high degree of redistribution within the pension system (the maximum pension is only twice the minimum pension) has often been pointed out as a major reason why higher income earners are reluctant to participate in the scheme. After the state system has been made sustainable and coverage expanded—and the regulatory environment strengthened—a move towards a multi-pillar system could be considered. Such a move would preferably lead to additional pension savings rather than merely diverting existing contributions away from the social security scheme. International evidence shows that the diversion of contributions away from the first pillar into private pensions could create substantial and sustained transition costs with a negative effect on the public finances.³

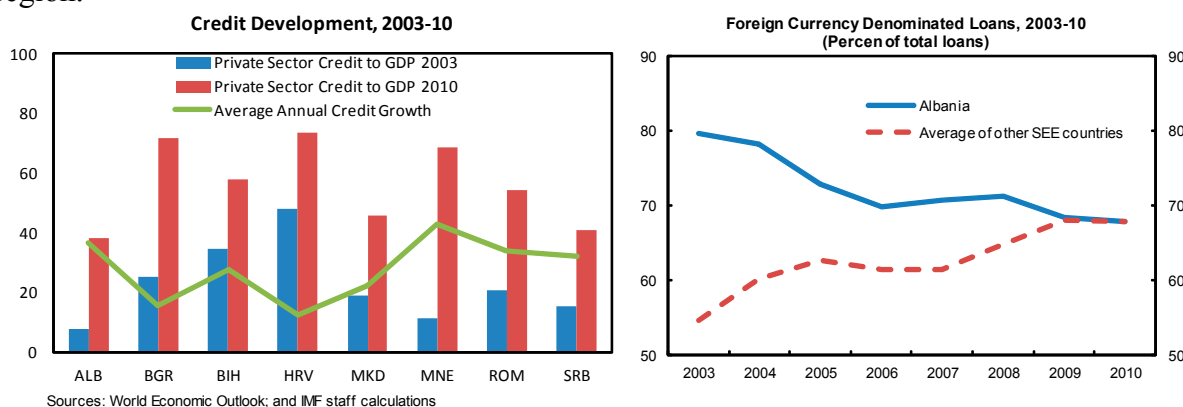
³ *A Fiscal Indicator for Assessing First and Second Pillar Pension Reforms*, Mauricio Soto, Benedict Clements, and Frank Eich, IMF, 2011.

Annex IV. Managing Capital Inflows¹

Capital flows to Albania were relatively smaller and less volatile than in other South-Eastern European (SEE) countries. From 2003 to 2010, the cumulative capital inflows (in percentage of GDP) to Albania were one of the lowest in the region. Their volatility was also lower, and in particular capital inflows into Albania withstood the global crisis better than in other countries in the region. More than half of the capital inflows are in the form of Foreign Direct Investments, which is in line with regional average.



Unlike in other SEE countries, where large capital inflows prompted rapid credit growth and rising foreign currency lending, Albania steadily reduced the foreign currency lending while maintaining high credit growth. The rapid credit growth is partly due to an initially low level of financial development, and the opening of the banking sector to foreign banks. Although timely supervisory intervention and macro-prudential measures helped contain foreign-currency lending, it is still at 68 percent, around the average of the region.



As the economy recovers and risk appetite returns to Europe, Albania could face higher capital inflows as one of the least crisis affected countries. The successful placement of

¹ Prepared by Chuling Chen.

Albania's first Eurobond in October 2010 and the modest fall of capital inflows in 2009 and 2010 showed more stable investor interest in the economy. As risk appetite returns, Albania could attract even more capital inflows. Appropriate policies would be needed to manage the capital inflows and avoid the recent boom bust cycles experienced in emerging Europe.

The recent experience in emerging European countries shows the importance of managing excessive capital inflows. Greater integration enabled emerging Europe to receive more “downhill” capital inflows than other emerging economies. However, large capital inflows, especially when associated with a domestic credit boom, could lead to real exchange rate overvaluation and overheating of the economy. A large part of the inflows were in the form of cross-border loans or parent bank financing in foreign currency, which prompted rapid credit growth and higher financial euroization. While growth picked up significantly driven mainly by aggregate demand, external vulnerabilities were building up with large current account deficits, currency mismatch in balance sheets, and increasing dependence on foreign financing which makes the economies more vulnerable to sudden stops. Fiscal policy was not used to build buffers and in some countries was pro-cyclical. Structural reforms were lagging behind. When the global financial crisis hit the advanced European countries and transmitted through the real and particularly financial channels, countries which had put into place policies to manage the excessive capital inflows withstood the crisis better than their peers that allowed the vulnerabilities to accumulate.

Experience shows that the policy response should be multidimensional and country specific. The flexible exchange rate system provides a useful policy tool to stem excessive capital inflows. Fiscal policy should be in place to respond to avoid a real exchange rate overvaluation. Composition of the capital inflows also matters. Since FDI related inflows are generally more stable and tend to contribute to productivity growth or investments, policies should be geared toward promoting FDI. On the other hand, more scrutiny should be given to inflows to the non-tradable sector which triggers fast real exchange rate appreciation and consumption based credit growth. In this respect, macro-prudential policies should be adopted to mitigate risks of rapid credit expansion and the resulting asset bubbles. In certain cases, capital controls should also be an option in the policy mix to avoid any negative impact from volatile capital inflows.

Albania should be prepared to implement multidimensional policies while anticipating higher capital inflows. The floating exchange rate has served the country well during the recent crisis, and a good record of macro-prudential policies has helped avoid disruptions in the credit market and preserve the strength of the banking sector. Faced with higher capital inflows, Albania should tighten the fiscal policy, continue to rely upon the flexible exchange rate and an adequate macro-policy mix and macro-prudential policies to manage the capital inflows. If the excessive inflows persist and cannot be adequately addressed by these policy responses, Albania should also be prepared to adopt less conventional capital flow measures.

Annex V. Transitioning to the GFSM 2001 Fiscal Presentation¹

In March 2010, the IMF Executive Board called upon member countries to present fiscal data according to the *Government Finance Statistics Manual 2001 (GFSM 2001)* framework.² The Statistics Department (STA) at the IMF assisted the Albania's team to develop a *GFSM 2001*-based reporting framework. This appendix presents the Statement of Sources and Uses of Cash in the new formats and highlights ongoing tasks that will be necessary to achieve a further alignment to *GFSM 2001*-based data. This appendix does not impact the presentation of fiscal data used elsewhere in the report.

STA found that there are adequate source data to establish a *GFSM 2001* presentation for Albania which would cover the operations of the general government (defined as the Budgetary Central Government, extra budgetary units, the Social Security Institute, districts, and municipalities). However data on financial assets need to be compiled and further disaggregation of debt instruments is necessary to report a financial balance sheet of government that reconciles stocks and flows. Reporting of fiscal data on the basis of *GFSM 2001* does not appear to substantially change the overall primary balance (including grants). For example, the attendant reclassification of some specific transactions (in particular, "net lending") would result in an increase of the overall balance deficit from -3.7 to -4.2 of GDP in 2010.

The next steps to further align the fiscal statistics are:

- To provide greater detail on some of accounts³ to ensure proper classification in the *GFSM 2001*.
- To report transactions of Albania's local governments in a separate statement instead of an item in the Statement of Sources and Uses of Cash.
- To break down the Net Acquisition of Nonfinancial assets (labeled as *Capital Expenditure* in the local presentation) into the *GFSM 2001* subcategories: fixed assets, inventories, valuables, and nonproduced assets.⁴

¹ Prepared by Frank Eich and Carlos Alberto Gutierrez Mangas.

² The mandate requires that a *GFSM 2001*-based Statement of Government Operations along with a financial balance sheet be included in staff reports as of May 2011, except for countries benefiting from Fund facilities. See decision No. 14565 outlined in *Government Finance Statistics to Strengthen Fiscal Analysis* (<http://www.imf.org/external/pp/longres.aspx?id=4431>)

³ Examples of these accounts are National Taxes, Income of Budgetary Institutions, Property Compensation, and Compensation for Electricity.

⁴ For greater detail, we refer to chapter 8 of the *GFSM 2001* (<http://www.imf.org/external/pubs/ft/gfs/manual/pdf/ch8.pdf>)

- To break down the financing section into net acquisition of financial assets and net acquisition of liabilities. These categories should be further broken down into their respective instruments.⁵

⁵ For greater detail, we refer to chapter 9 of the *GFSM 2001*
(<http://www.imf.org/external/pubs/ft/gfs/manual/pdf/ch9.pdf>)

In Millions of Leks/ Fiscal Year Ends December 31

General Government

STATEMENT OF SOURCES AND USES OF CASH

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Accounting method:	Cash	Cash	Cash	Cash	Cash	Cash	Cash	Cash	Cash	Cash	Cash	Cash
CASH FLOWS FROM OPERATING ACTIVITIES:												
C1 Cash receipts from operating activities	204,162.2	229,519.4	251,552.6	290,896.5	298,977.8	319,623.0	338,956.3	363,672.4	389,582.0	417,760.0	448,236.4	479,731.7
C11 Taxes	147,623.5	166,209.4	186,166.6	216,486.9	221,018.2	234,981.0	251,785.0	269,779.2	289,255.5	310,383.8	333,306.8	357,103.0
C12 Social contributions	36,192.0	39,308.0	41,994.0	47,593.7	49,809.6	51,645.0	55,476.6	59,744.4	64,178.3	68,995.3	74,210.4	79,580.4
C13 Grants	6,168.0	8,025.0	1,280.0	4,228.0	4,430.0	4,605.0	5,500.0	6,847.9	6,925.0	7,269.3	7,546.8	7,547.8
C14 Other receipts	14,178.7	15,977.0	22,112.0	22,588.0	23,720.0	28,392.0	26,194.6	27,301.0	29,223.2	31,116.6	33,172.4	35,500.5
C2 Cash payments for operating activities	193,965.2	207,833.0	225,616.0	250,614.3	283,904.6	299,879.0	324,335.1	351,010.5	378,349.3	409,015.0	443,830.7	479,833.4
C21 Compensation of employees	53,674.4	56,704.0	59,097.0	66,618.1	62,367.3	65,762.0	69,256.0	74,583.8	80,119.0	86,132.5	92,642.9	99,346.8
C22 Purchases of goods and services	24,515.0	25,788.0	25,231.0	28,956.2	32,058.0	33,319.0	33,896.1	36,503.7	39,212.8	42,155.9	45,342.3	48,623.4
C24 Interest	26,028.9	25,006.0	25,594.0	31,307.0	36,301.3	41,604.0	43,930.7	48,834.4	53,826.9	60,216.1	68,628.5	77,654.6
C25 Subsidies	3,653.2	3,819.0	3,536.0	2,555.0	2,004.3	3,535.0	3,518.0	3,789.3	4,075.8	4,387.2	4,729.5	5,097.7
C26 Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C27 Social benefits	66,094.7	73,803.0	84,660.0	92,949.0	113,653.2	122,145.0	134,061.4	144,271.6	154,979.2	166,603.3	179,179.8	192,127.1
C28 Other payments	19,999.0	22,713.0	27,498.0	28,229.0	37,520.5	33,514.0	38,672.8	43,027.9	46,135.7	49,520.0	53,307.6	56,983.8
C10 Net cash inflow from operating activities (1-2-AD₀₂)	10,197.0	21,686.4	25,936.6	40,282.3	15,073.2	19,744.0	14,621.2	12,661.9	11,232.7	8,745.0	4,405.7	-101.7
CASH FLOWS FROM INVESTMENTS IN NONFINANCIAL ASSETS (NFAs):												
C31.1 Purchases of nonfinancial assets	38,375.0	51,108.0	57,697.0	93,783.0	101,401.0	71,583.0	63,946.0	76,035.7	84,129.0	98,583.3	106,034.8	113,707.8
C31.1.1 Fixed assets	38,375.0	51,108.0	57,697.0	93,783.0	101,401.0	71,583.0	63,946.0	76,035.7	84,129.0	98,583.3	106,034.8	113,707.8
C31.2.1 Strategic stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C31.3.1 Valuables	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C31.4.1 Nonproduced assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C31.2 Sales of nonfinancial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C31.2.1 Fixed assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C31.2.2 Strategic stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C31.3.2 Valuables	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C31.4.2 Nonproduced assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C31 Net cash outflow: investments in NFAs (31-31.1-31.2)	38,375.0	51,108.0	57,697.0	93,783.0	101,401.0	71,583.0	63,946.0	76,035.7	84,129.0	98,583.3	106,034.8	113,707.8
CSD Cash surplus / deficit (1-2-AD₀₂-31-CSD₀₂)	-28,178.0	-29,421.6	-31,760.4	-53,500.7	-86,327.8	-51,839.0	-49,324.8	-63,373.8	-72,896.3	-89,838.4	-101,629.1	-113,809.5
CASH FLOWS FROM FINANCING ACTIVITIES:												
C32x Net acquisition of financial assets other than cash	1,000.4	-1,972.0	-9,202.0	-517.2	-27,564.9	-10,097.0	0.0	-300.0	-300.0	0.0	0.0	0.0
C32.1x Domestic	1,000.4	-1,972.0	-9,202.0	-517.2	-27,564.9	-10,097.0	0.0	-300.0	-300.0	0.0	0.0	0.0
C32.2x Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C32.3 Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C33 Net incurrence of liabilities	28,462.0	26,036.6	23,832.4	53,429.3	57,188.5	42,247.0	49,324.8	63,073.8	72,596.3	89,838.4	101,629.1	113,809.5
C33.1 Domestic	20,617.1	20,742.0	16,653.1	10,573.0	15,396.1	9,764.1	20,880.7	44,358.2	69,733.1	96,983.3	112,990.6	125,496.2
C33.2 Foreign	7,844.8	5,294.6	7,179.3	42,856.3	41,792.3	32,482.9	28,444.1	18,715.6	2,863.2	-7,150.9	-11,361.5	-11,686.7
NFB Net cash inflow from financing activities (32x-33)	27,461.6	28,008.6	33,034.4	53,946.5	84,753.4	52,344.0	49,324.8	63,373.8	72,896.3	89,838.4	101,629.1	113,809.5
NCB Net change in the stock of cash (3212-3222)	-1,695.4	-1,010.0	1,553.0	-3,794.4	-988.4	-1,200.0	0.0	0.0	0.0	0.0	0.0	0.0
Vertical check: Difference between cash surplus/deficit and total net cash inflow from financial activities (CSD-NFB-NCB=0)	979.0	-403.0	-279.0	-3,348.6	-586.0	1,705.0	0.0	0.0	0.0	0.0	0.0	0.0

af Consolidation of budgetary, extrabudgetary, and social security funds (columns 1, 2, 3).

bf Consolidation of central government, state governments, and local governments (columns 5, 6, 7).

In Millions of Leks/ Fiscal Year Ends December 31

General Government

STATEMENT OF SOURCES AND USES OF CASH

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	
Accounting method:	Cash	Cash	Cash	Cash	Cash	Cash	Cash	Cash	Cash	Cash	Cash	Cash	
CASH FLOWS FROM OPERATING ACTIVITIES:													
C1	Cash receipts from operating activities	25.1	26.0	26.0	26.7	26.0	25.8	25.6	25.6	25.5	25.4	25.4	25.3
C11	Taxes	18.1	18.8	19.2	19.9	19.2	19.0	19.1	19.0	18.9	18.9	18.9	18.8
C12	Social contributions	4.4	4.5	4.3	4.4	4.3	4.2	4.2	4.2	4.2	4.2	4.2	4.2
C13	Grants	0.8	0.9	0.1	0.4	0.4	0.4	0.4	0.5	0.5	0.4	0.4	0.4
C14	Other receipts	1.7	1.8	2.3	2.1	2.1	2.3	2.0	1.9	1.9	1.9	1.9	1.9
C2	Cash payments for operating activities	23.8	23.6	23.3	23.0	24.7	24.2	24.5	24.7	24.7	24.9	25.1	25.3
C21	Compensation of employees	6.6	6.4	6.1	6.1	5.4	5.3	5.2	5.2	5.2	5.2	5.2	5.2
C22	Purchases of goods and services	3.0	2.9	2.6	2.7	2.8	2.7	2.6	2.6	2.6	2.6	2.6	2.6
C24	Interest	3.2	2.8	2.6	2.9	3.2	3.4	3.3	3.4	3.5	3.7	3.9	4.1
C25	Subsidies	0.4	0.4	0.4	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
C26	Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C27	Social benefits	8.1	8.4	8.7	8.5	9.9	9.9	10.1	10.1	10.1	10.1	10.1	10.1
C28	Other payments	2.5	2.6	2.8	2.6	3.3	2.7	3.0	3.0	3.0	3.0	3.0	3.0
C10	Net cash inflow from operating activities (1-2-ADJz)	1.3	2.5	2.7	3.7	1.3	1.6	1.1	0.9	0.7	0.5	0.2	0.0
CASH FLOWS FROM INVESTMENTS IN NONFINANCIAL ASSETS (NFAs):													
C31.1	Purchases of nonfinancial assets	4.7	5.8	6.0	8.6	8.8	5.8	4.8	5.3	5.5	6.0	6.0	6.0
C311.1	Fixed assets	4.7	5.8	6.0	8.6	8.8	5.8	4.8	5.3	5.5	6.0	6.0	6.0
C312.1	Strategic stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C313.1	Valuables	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C314.1	Nonproduced assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C31.2	Sales of nonfinancial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C311.2	Fixed assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C312.2	Strategic stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C313.2	Valuables	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C314.2	Nonproduced assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C31	Net cash outflow: investments in NFAs (31=31.1-31.2)	4.7	5.8	6.0	8.6	8.8	5.8	4.8	5.3	5.5	6.0	6.0	6.0
CSD	Cash surplus / deficit (1-2-ADJz-31+CSDz)	-3.5	-3.3	-3.3	-4.9	-7.5	-4.2	-3.7	-4.5	-4.8	-5.5	-5.7	-6.0
CASH FLOWS FROM FINANCING ACTIVITIES:													
C32x	Net acquisition of financial assets other than cash	0.1	-0.2	-1.0	0.0	-2.4	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
C321x	Domestic	0.1	-0.2	-1.0	0.0	-2.4	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
C322x	Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
C323	Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
C33	Net incurrence of liabilities	3.5	3.0	2.5	4.9	5.0	3.4	3.7	4.4	4.7	5.5	5.7	6.0
C331	Domestic	2.5	2.4	1.7	1.0	1.3	0.8	1.5	3.1	4.6	5.9	6.4	6.6
C332	Foreign	1.0	0.6	0.7	3.9	3.6	2.6	2.2	1.3	0.2	-0.4	-0.6	-0.6
NFB	Net cash inflow from financing activities (-32x+33)	3.4	3.2	3.4	5.0	7.4	4.2	3.7	4.5	4.8	5.5	5.7	6.0
NCB	Net change in the stock of cash (3212+3222)	-0.2	-0.1	0.2	0.3	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Vertical check: Difference between cash surplus/deficit and total net cash inflow from financial activities (CSD+NFB-NCB=0)													
		0.1	0.0	0.0	-0.3	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0

INTERNATIONAL MONETARY FUND

ALBANIA

Staff Report for the 2011 Article IV Consultation

Informational Annex

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

August 23, 2011

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I. FUND RELATIONS

As of July 31, 2011

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

II. General Resources Account:	<u>SDR Million</u>	<u>Percent Quota</u>
Quota	48.70	100.00
Fund Holdings of Currency	53.57	110.00
Reserve position in Fund	3.35	6.89
III. SDR Department:	<u>SDR Million</u>	<u>Percent Allocation</u>
Net cumulative allocation	46.45	100.00
Holdings	46.72	100.57
IV. Outstanding Purchases and Loans:	<u>SDR Million</u>	<u>Percent Quota</u>
Extended Arrangement	8.22	16.88
PRGF Arrangements	25.39	52.14

V. Financial Arrangements:

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

VI. Projected Payments to the Fund (Expectation Basis)

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

	<u>Forthcoming</u>				
	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Principal	3.70	6.72	6.81	5.80	4.32
Charges/Interest	0.06	0.16	0.13	0.10	0.07
Total	3.76	6.88	6.95	5.90	4.39

VII. Safeguards Assessments:

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

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

VIII. Exchange Rate Arrangement:

On July 1, 1992 the Albanian authorities adopted a floating exchange rate system. Under the Fund's de facto exchange rate regime classification, Albania follows a floating exchange rate regime, with the monetary authorities occasionally intervening in the foreign exchange market in order to avoid excessive and short term disruptions in the functioning of the market and to accumulate reserves. Albania's exchange rate arrangement is free from exchange restrictions and multiple currency practices subject to Fund jurisdiction under Article VIII. However, the country still avails itself of the transitional arrangements under Article XIV and maintains exchange restrictions in the form of outstanding debit balances on inoperative bilateral payment agreements, which were in place before Albania became a Fund member. These relate primarily to debt in nonconvertible and formerly nonconvertible currencies. Albania has not imposed new restrictions under Article VIII. The exchange rate stood at lek 98.16 per U.S. dollar at end July, 2011.

IX. Article IV Consultation:

The conclusion of the 2010 Article IV consultation took place in May 2010 (IMF Country Report No. 10/205).

X. FSAP Participation and ROSCs:

An FSAP was carried out in early 2005. The Financial System Stability Assessment was considered by the Executive Board on August 1, 2005 concurrently with the staff report for the sixth review of the PRGF-supported program and financing assurances review. An action plan for implementing the FSAP recommendations has been prepared in consultation with the IMF. A data module ROSC was published on the Fund's website in June 2000. A fiscal ROSC was completed in June 2003. Albania participates in the General Data Dissemination System (GDDS), and a complete set of GDDS metadata for the external, financial, fiscal, and real sectors, as well as for the socio-demographic indicators is posted on the Fund's Dissemination Standards Bulletin Board (<http://dsbb.imf.org>). A data module ROSC reassessment using the Data Quality Assessment Framework was conducted in March 2006. A ROSC for assessing the Financial Action Task Force (FATF) recommendations for Anti-Money Laundering (AML) and Special Recommendations on Combating the Financing of Terrorism (CFT) was conducted in November 2010 and the report was published in July 2011.

XI. Technical Assistance:

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

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

Table 1. Albania—Technical Assistance Since FY2008

Department	Purpose	Date
FAD	Cash Management and Public Finance Strategy	May 2008
	Revenue Administration	October/November 2008
	Advice on IT Strategy and Business Process Reengineering	April 2009; March 2010
	Tax Administration	April 2009; March 2010, April 2011
LEGAL	Review of the Albanian AML/CFT law	August 2007
	TA on Repurchase Transactions Law	March 2008
	Banking Seminar for Judges and Bank Regulators	November 2008
	TA in Central Banking Law	April 2009
	TA on Payments Systems	May 2009
	ROSC on AML and CFT	Nov 2010
MCM	Monetary Policy	25 visits between June 2007 and April 2010;
	Management	June, July 2007
	Credit Registry	October 2007; January 2008
	Modeling and Forecasting	October 2007; March 2008
	Monetary Policy Strategy for Small Countries	December 2007;
	Banking Supervision	13 visits between February 2008 and March 2010;
	Delivery vs. Payment	April/May 2008
(together with LEGAL)	Central Bank Law	April 2009; February 2010
	Treasury Bill Registry	November 2009
	Modeling of Monetary Policy	December 2009; March, April, September 2010
	Stress testing, liquidity testing	April 2011, July 2011
STATISTICS	Balance of Payment Statistics	September-October 2007
	GDDS: Consultation	October 2007
	STE: Consumer Prices/Producer Price	November 2007
	LTE: Government Finance Statistics	February 2008
	STE National Accounts Statistics	5 visits between February 2008 and November 2009
	SDDS: Assessment	April, July 2010
	National Accounts Statistics	March 2011

XII. Resident Representative

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

II. IMF-WORLD BANK RELATIONS

Albania: Bank-Fund Joint Management Action Plan Matrix (As of July 2011)

Title	Product	Provisional Timing of missions	Expected Delivery date
A. Mutual information on relevant work programs			
The World Bank work program in the next 12 months	Programmatic DPL Appraisal mission Social assistance modernization project Power sector mission BERIS IPS trust fund	June 2011 June/July 2011 May, September 2011 May 2011 June, 2011	Negotiations end 2011 Ongoing Ongoing September 2011 September 2011
The Fund work program in the next 12 months	Surveillance: <ul style="list-style-type: none"> • 2011 Article IV Consultation • Staff visit for the 2012 Budget discussions Technical assistance: <p><i>Monetary and Financial sector</i></p> <ul style="list-style-type: none"> • Strengthening bank supervision • Monetary policy modeling • Government foreign exchange payments • Internal auditing • Contingency planning <p><i>Fiscal sector</i></p> <ul style="list-style-type: none"> • Modernizing revenue administration • Public financial management <p><i>Statistics</i></p> <ul style="list-style-type: none"> • National accounts statistics 	June 9–22, 2011; October 2011 [3] missions [1] missions [2] missions [1] missions [1] missions [1] mission [1] mission [1] mission	Board meeting in September 2011 Ongoing Ongoing Ongoing Ongoing Ongoing Ongoing Ongoing Ongoing

B. Requests for work program inputs (as needed)			
Fund request to Bank	<ul style="list-style-type: none"> • Growth diagnostics, assessment of competitiveness, and related structural reforms • Fiscal governance and PEM • Public expenditure reform needs (in particular pension reforms) • Nonbank financial sector development 		
Bank request to Fund	<ul style="list-style-type: none"> • Periodic macro updates • Joint approach to advisory work on institutional reform at the MoF in debt management • Debt Sustainability Analysis 		

III. ALBANIA: STATISTICAL ISSUES

August 15, 2011

A. Assessment of Data Adequacy for Surveillance

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

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

INSTAT has benefited from technical assistance from the Fund and the European Union, mainly to address weaknesses in methodology, basic data sources, and coverage of the private sector. STA continued to provide technical assistance through peripatetic missions in 2010 and 2011. The Labor Force Survey was incorporated into the estimates of the unobserved economy in the annual national accounts while attempts were made to use the Household Budget Survey to develop a new benchmark estimate of private consumption. A new methodology for gross fixed capital formation based on a commodity flow approach was developed. Quarterly national accounts were compiled during the project and are now being published and revised. Due to severe resource constraints at INSTAT, the improvement in the national accounts has been relatively slow.

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

Government finance statistics: GFS generally follow the *Government Finance Statistics Manual 1986*. External donor financed-projects that do not pass through the treasury system represent a weakness in source data. There are adequate source data to establish a *GFSM 2001* presentation for Albania, but data on financial assets need to be compiled and further disaggregation of debt instruments is necessary to report a financial balance sheet of government that reconciles stocks and flows.

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

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

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

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

B. Data Standards and Quality

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

Data ROSC published on October 2006.

ALBANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
As of August 15, 2011

	Date of latest observation	Date received	Frequency of Data ⁷	Frequency of reporting ⁷	Frequency of publication ⁷	Memo Items:	
						Data Quality – Methodological Soundness ⁸	Data Quality – Accuracy and Reliability ⁹
Exchange Rates	08/15/11	08/15/11	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	08/12/11	08/15/10	D	W	M		
Reserve/Base Money	08/12/11	08/15/11	D and M	W and M	M	O, O, O, LO	O, LO, LO, O, O
Broad Money	June 11	07/15/11	M	M	M		
Central Bank Balance Sheet	June 11	07/15/11	M	M	M		
Consolidated Balance Sheet of the Banking System	June 11	07/15/11	M	M	M		
Interest Rates ²	08/15/11	08/15/11	D	D	D		
Consumer Price Index	June 11	07/12/11	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	June 2011	7/18/11	M	M	M	LO, O, O, O	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	June 2011	7/18/11	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	May 2011	06/03/11	Q	Q	A		
External Current Account Balance	2011Q1	07/15/11	Q	I	I	O, O, O, LO	LNO, O, LO, LO, O
Exports and Imports of Goods and Services	June 2011	07/25/11	M	M	M		
GDP/GNP	2011Q1	06/11	Q	Q	Q	O, LNO, O, LO	LNO, O, LNO, LO, LO
Gross External Debt	2011Q1	7/15/11	Q	I	Q		
International Investment position ⁶	2009	7/15/11	A	A	A		

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

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

³ Foreign, domestic bank, and domestic nonbank financing.

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

⁵ Including currency and maturity composition.

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

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

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

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



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 11/129
FOR IMMEDIATE RELEASE
October 21, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with Albania

On September 7, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Albania.¹

Background

Albania has weathered the global crisis well, as sound policies implemented during the pre-crisis years provided policy space to mitigate the crisis fallout. The crisis also ushered in the needed rebalancing of the economy, and the very large external imbalance has narrowed. The financial system overcame heightened stress in the immediate aftermath of the crisis and avoided a credit bust, though asset quality declined.

The post-crisis environment has posed significant policy challenges. GDP growth is projected to be around 2.5 percent in 2011, decelerating from above 3 percent in 2009 and 2010. The budget has repeatedly underperformed, prompting large cuts in mid-year budget reviews in both 2010 and 2011, and public debt is approaching its statutory limit of 60 percent of GDP. Despite improvements, external imbalances remain elevated, and foreign demand could not fully offset the domestic demand drain. Politics remain divisive and threaten consensus on reform including measures needed to progress with

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

European Union (EU) candidacy. Short-term risks are elevated given Albania's large exposure to the euro-area periphery.

The key challenge is to make the policy framework consistent with the achievement of external sustainability, thereby reversing the decline in total factor productivity (TFP) growth. Fiscal consolidation is the near- and medium-term policy priority, and requires credible measures and sustained efforts. Contingency planning with respect to euro-area periphery developments is essential to safeguard the financial stability, while critical structural reform challenges must be addressed.

Executive Board Assessment

Executive Directors commended the authorities for pursuing sound policies, which have permitted Albania to weather the global crisis well. Looking ahead, however, the economy faces increasing challenges, particularly from high public debt, sluggish productivity growth, and significant external vulnerabilities, including from potential regional spillovers. Early and sustained actions are needed to ensure fiscal sustainability, safeguard financial stability, and improve the investment environment.

Directors emphasized that fiscal consolidation is the near- and medium-term policy priority for Albania. They advised the authorities to implement an expenditure-based fiscal rule to anchor a credible medium-term debt reduction strategy. Directors encouraged the authorities to implement further expenditure and revenue measures to achieve the required fiscal consolidation. A better macroeconomic framework built on more realistic revenue projections would help avoid the repeated budget slippages of the past.

Directors noted that Albania's flexible exchange rate and inflation targeting regime have served the economy well. Going forward, monetary policy should remain cautious, and coordinate with fiscal policy to anchor inflation expectations and safeguard growth prospects. Directors noted the staff's assessment that the exchange rate appears to be broadly in line with fundamentals, and stressed that strong fiscal consolidation efforts can help foster external sustainability.

Directors commended the resilience of Albania's banking system during the crisis, although cautioned that heightened risks, including from possible regional spillovers, called for macro-prudential policy to stay ahead of the curve. A key near-term priority is the swift resolution of the high level of non-performing loans and other crisis legacies. Directors encouraged the authorities to continue to enhance the monitoring of banks and the development of the local currency market to build buffers. They underlined the need to step up crisis preparedness, including by further development of the contingency planning framework.

Directors urged the authorities to re-invigorate structural reforms to improve the business environment and thereby boost productivity and growth, especially by securing

property rights, land titling, and improving contract enforcement. They noted that high-quality economic statistics are essential to improve policy making.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2011 Article IV Consultation with Albania is also available.

Albania: Basic Indicators and Macroeconomic Framework, 2008–11

	2008	2009	2010	2011
		Preliminary	Est.	Projections
		(Growth rate in percent)		
Real GDP 1/	7.5	3.3	3.5	2.5
Consumer Price Index (avg.)	3.4	2.2	3.6	3.9
Consumer Price Index (eop)	2.2	3.7	3.4	3.5
GDP deflator	4.7	2.3	3.9	4.2
		(Percent of GDP)		
Foreign savings	15.1	13.5	11.8	10.9
National savings	17.4	15.5	14.1	14.1
Public	3.1	1.0	1.2	0.7
Private	14.3	14.5	12.9	13.4
Investment	32.5	29.0	25.9	25.0
Public	8.6	8.8	5.8	4.8
Private	23.9	20.2	20.1	20.2
Revenues and grants	26.7	26.0	25.8	25.6
Tax revenue	24.2	23.5	23.3	23.4
Expenditures	32.3	33.4	29.6	29.4
Primary	29.4	30.2	26.2	26.1
Interest	2.9	3.2	3.4	3.3
Overall balance (including grants)	-5.6	-7.4	-3.7	-3.7
Primary balance (including grants)	-2.7	-4.3	-0.4	-0.4
Net domestic borrowing	1.0	0.9	0.5	2.3
Privatization receipts	0.5	2.4	0.4	0.0
Foreign financing	4.0	3.7	2.5	2.2
Public Debt	54.7	59.3	58.3	59.4
Domestic	36.8	36.1	32.9	33.1
External (including publicly guaranteed)	17.9	23.2	25.4	26.3
Broad money growth	7.7	6.8	12.5	10.0
Private credit growth	32.1	10.3	10.1	9.8
Velocity	1.3	1.3	1.3	1.2
Interest rate (3-mth T-bills, end-period)	6.3	6.3	5.3	...
		(Percent of GDP unless otherwise indicated)		
Trade balance (goods and services)	-26.6	-24.6	-21.0	-19.2
Current account balance (including official transfers)	-15.1	-13.5	-11.8	-10.9
Current account balance (excluding official transfers)	-15.8	-14.2	-12.5	-11.7
Official transfers	0.7	0.7	0.7	0.8
Gross international reserves (in millions of Euros)	1,721	1,621	1,906	1,803
(In months of imports of goods and services)	4.2	4.2	4.8	4.3
(Relative to external debt service)	12.4	10.9	4.9	7.6
(In percent of broad money)	26.1	26.0	27.0	23.7
Change in real exchange rate (eop, in percent)	-1.7	-7.8	-2.6	...
Nominal GDP (in billions of lek) 1/	1,089	1,151	1,238	1,322

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

1/ GDP data for 2008–09 are from the official national accounts.

**Statement by Arrigo Sadun, Executive Director for Albania,
and Francesco Spadafora, Senior Advisor to Executive Director
September 7, 2011**

On behalf of the Albanian authorities, we thank staff for the continued close and constructive cooperation, as well as for the very informative report.

Overview

Albania has weathered the global crisis better than most other regional and European economies, and is leading the recovery in the region. Generally prudent macroeconomic policies, low external debt, a sound banking system, and adequate foreign exchange reserve buffers allowed the authorities to use the available policy space accumulated in the boom years to mitigate the impact of the crisis. As a result, Albania escaped a recession, and growth continued at above 3 percent in both 2009 and 2010.

Strong export growth since the beginning of 2010 has helped narrow the large current account deficit, from above 15 percent of GDP in 2008 to 12 percent in 2010. Robust inflows of foreign direct investments have increased their importance as a source of financing of the current account deficit, overtaking remittances in this role in 2010. The country was also able to place a €300 million debut Eurobond in October 2010.

The authorities have more favorable expectations than staff on the outlook, as they currently project that growth will return to a pace of 5 percent or higher in the near term. This projection is based on the country's strong fundamentals, as well as on large public investments in infrastructure in recent years.

The authorities underscore the high degree of consensus in the policy discussions with staff, and agree that the simultaneous achievement of higher growth, resilience against risks, and external sustainability is within reach. Their policies remain focused on preserving macroeconomic stability and external sustainability, consolidating public finances, and advancing structural reforms.

Fiscal Policy

The crisis has inevitably led to deterioration in the government's fiscal position. After declining from 70 percent of GDP in 2000 to 54 percent in 2007, public debt has drifted up (driven by its external component), approaching the 60 percent of GDP statutory limit; however, the ratio declined between 2009 and 2010 (Table 1 of the report). Facing underperforming revenue, significant corrective measures adopted in mid-2010 limited the budget deficit to 3.7 percent of GDP, below the initial target of 3.9 percent set in the original 2010 budget.

The authorities concur with staff that fiscal consolidation represents the key policy challenge for the near- and medium-term, given the need to contain public debt and rollover requirements.

To this end, in July 2011 further expenditure cuts were adopted through a mid-year budget review to keep the budget close to the original target of 3.5 percent. Moreover, the revised Macroeconomic and Fiscal Framework 2012-2014, approved by the government in July 2011, targets a budget deficit of 3 percent over the medium-term and a public debt-to-GDP ratio below the statutory limit.

Going forward, the authorities expect that a return to faster growth, together with their ongoing efforts to boost tax administration, can increase revenues and relieve budget pressures.

Given the growth of current expenditures, the authorities envisaged less pronounced increases in the public wage and pension bills in the future; they also intend to re-launch pension reform efforts, while remaining mindful of the challenges to achieve the needed political consensus.

The authorities share the staff's view on the need for a strong fiscal rule to firmly anchor expectations of a sustainable conduct of public finances. The authorities agree that public debt can constitute a desirable anchor, and they consider the existing legal debt limit of 60 percent of GDP to have proven its value. They take note of the staff's preference for an expenditure-based rule, but are looking at augmenting it with a mechanism to guard against procyclicality, though they have not yet reached definite conclusions on a new debt target.

Monetary and Financial Sector Policies

The inflation targeting framework and flexible exchange rate have served Albania very well, and have provided resilience throughout the global crisis. Inflation largely stayed in the target range of 3 ± 1 percent and inflation expectations remain well-anchored.

The monetary policy stance has been accommodative but responsive to inflation risk. In July 2010 the Bank of Albania eased its policy rate in response to fiscal consolidation; as headline inflation overshot its target band because of rising food and fuel prices, the policy stance was tightened in early 2011. The authorities concur with staff that a monetary stimulus would need to be conditioned on fiscal adjustments and continued anchored inflation expectations.

The banking system has proven its resiliency through the crisis, as banks remain generally sound and well-capitalized. Deposits declined substantially but only temporarily in the midst of the crisis, and their current level is much higher than before the turmoil.

Financial sector policies were adjusted to safeguard financial stability and revive credit growth. Preventive macro-prudential measures adopted prior to the crisis have helped to contain the build-up of imbalances in the banking sector prior to the crisis. The latter led to the adoption of further macroprudential policies, including higher capital requirements, tighter liquidity, and credit risk controls; they were subsequently lifted in the face of steadily increasing deposit funding, improved liquidity conditions, and adequate capital buffers.

While bank profits are recovering, the steep increase of nonperforming loans, from 3 percent pre-crisis to 15 percent in April 2011, is a source of major concern. The authorities share the staff's view that a swift resolution of nonperforming loans (including by faster resolution measures) and other crisis legacies is a key near-term priority.

The developments in the euro area periphery have led the authorities to more closely monitor the positions between parent banks and their subsidiaries/branches, while engaging in proactive contacts with regional and European supervisors and central banks in order to advance contingency planning. While market volatility surrounding the euro-area periphery was reflected in the domestic markets, all Greek-owned banks remained in compliance with prudential ratios, although their liquidity levels have been somewhat reduced.

In response, the Bank of Albania has stepped up liquidity monitoring across the system and is updating its stress-testing framework to better capture liquidity risks. Jointly with the Fund and the World Bank, the Bank of Albania is also working to keep the framework for emergency liquidity assistance in line with changing developments and challenges. Increasing prudential liquidity ratios is being contemplated. Finally, the authorities intend to mandate higher-than Basel II norms, as well as recent EU proposals.

Structural Reforms

The authorities agree that a favorable investment environment is a vital condition for further attracting large-scale international investors and boosting productivity, which is key for higher sustainable growth. They concur with staff that securing property rights and improving contract enforcement are immediate priorities. The authorities would also like to highlight the progress in improving transport infrastructure, and they see the need for initiatives to help tap the vast agricultural potential so as to diversify exports and broaden the sources of growth.