



ALBANIA

July 2014

FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—STAFF REPORT; AND PRESS RELEASE

In the context of the first review under the Extended Arrangement and request for modification of performance criteria, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on May 13, 2014, with the officials of Albania on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on June 13, 2014.
- A **Press Release** summarizing the staff report.

The following documents have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Albania*
Memorandum of Economic and Financial Policies by the authorities of Albania*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

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ALBANIA

June 13, 2014

FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

KEY ISSUES

Background: On February 28, the Executive Board approved a three-year Extended Arrangement with access of SDR 295.42 million (492.4 percent of quota). A purchase of SDR 23.55 million (about EUR 26.4 million) was made in April 2014, and another will be made in the same amount upon completion of the first review.

Recent Economic Developments: Growth in 2013 was the lowest in more than 15 years. The economy is showing tentative signs of recovery, but remains below potential. Successive monetary easing has not prevented credit contraction. The banking system remains stable, but asset quality is a concern.

Program Performance and Risks: The program is on track. All end-March quantitative performance criteria and structural benchmarks were met, except for the structural benchmark on contracting an external auditor to conduct risk-based audits of arrears payments, which was not met but the government expects to complete in the coming weeks. An indicative target on accumulation of new arrears was not met although by a small margin and inflation has been slightly below the inner band prescribed under the inflation consultation clause. Program risks emanate from the complexity of reforms, particularly in electricity sector, and the need for sustained political commitment over the medium term.

Policy Recommendations: No new fiscal measures will be needed in 2014, but the authorities should tackle emerging fiscal risks. Arrears clearance can be accelerated once external audits have progressed sufficiently. Addressing high NPLs will require continued efforts to clean bank and private sector balance sheets. Preparatory work related to the 2015 budget and structural reforms should start soon.

Approved By
European Department

Discussions were held in Tirana on April 30–May 13, 2014. The staff team comprised Mr. Ilahi (head), Ms. Che, Mr. Gaertner, Mr. Ioannou (all EUR), Ms. Unsal (SPR), and Ms. Gerling (FAD), and was assisted by Ms. Spahia (local office). Mr. Husain (EUR), Mr. Montanino, and Mr. Senatore (both OED) attended some of the meetings. Mr. Reinke, the Resident Representative designate also joined the mission. The mission met with the Prime Minister, Finance Minister, Minister of Economy, Bank of Albania Governor, other senior officials, banks, private sector representatives, and parliamentarians.

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BACKGROUND

1. The economic slowdown of the recent past has coincided with a buildup of macroeconomic imbalances. In 2013, the economy was at its weakest in 15 years; growth dipped to 0.4 percent, while unemployment rose to 15.6 percent, public debt increased, nonperforming loans (NPLs) continued to rise, and credit began to shrink for the first time in a decade. Despite the negative developments at home and in Europe, the banking sector remained stable thanks to adequate capital and liquidity.

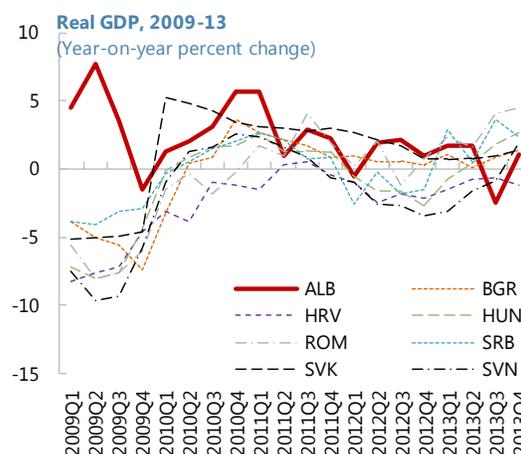
2. The economic reforms launched in late 2013 seek to promote sustained growth while addressing the macroeconomic imbalances. The new government, which took power in September 2013, remains committed to reducing public debt and tackling structural impediments to growth. The broad national consensus on joining the EU remains a key anchor for difficult reforms. However, acrimonious politics could test the government's ability to deliver on policy commitments.

RECENT ECONOMIC DEVELOPMENTS

There are tentative signs that the economy may have bottomed out in 2013:Q3 (MEFP ¶12). The external current account balance deteriorated in 2013, despite lower energy imports and a modest pickup in external demand. Fiscal revenue performance appears on track (MEFP ¶15). Credit continues to shrink notwithstanding successive monetary easing (MEFP ¶123). The banking system is stable, but asset quality is a concern.

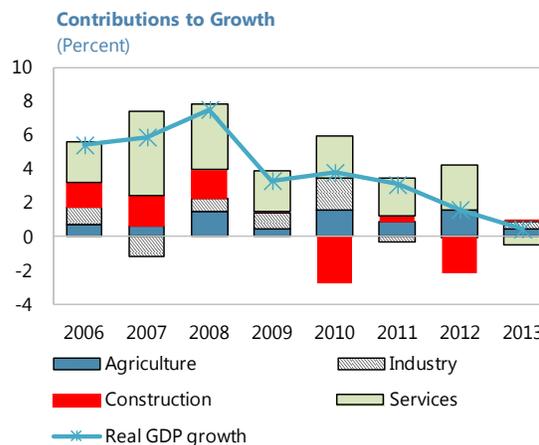
A. Output and Growth

- Growth has been slowing since 2011.
- It was negative in 2013:Q3 (yoy basis), the lowest since 2005.
- Annual growth in 2013 was 0.4 percent, lower than the 1.1 percent recorded in 2012.



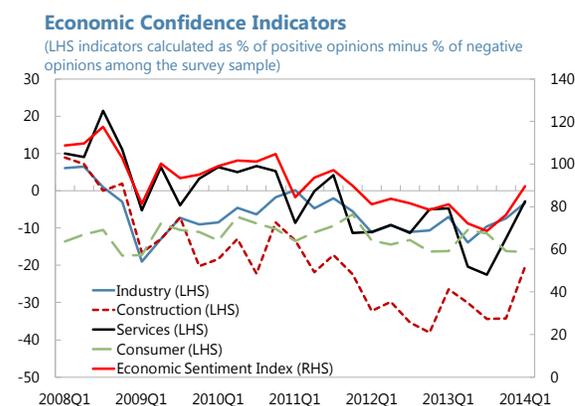
Source: WEO

- The slowdown in 2013 was mainly driven by weak services and agriculture, the main growth drivers in the past.
- Industry fared relatively well on the back of positive export growth.
- The recent contraction in construction appears to have eased.



Source: INSTAT

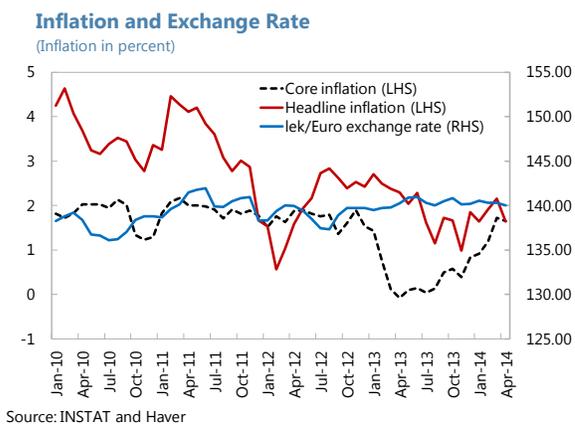
- Economic confidence is beginning to show signs of recovery in 2014Q1...
- ...but consumer confidence remains down.



Source: BoA

B. Price Developments

- Inflation has remained low and has recently fallen below the BoA's target range.
- The recent decline in inflation has been driven by lower food prices...
- ...the recent increase in core inflation is partly because of tax measures adopted in 2013 and one-off factors such as adjustments in car insurance premium.

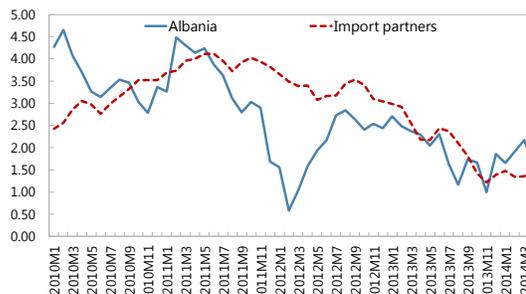


Source: INSTAT and Haver

- *Low inflation in major trade partners—Italy and Greece, in particular—appears to have contributed to inflation developments in Albania.*

Inflation: Albania and Trade Partners

(yoy percentage change of CPI index)



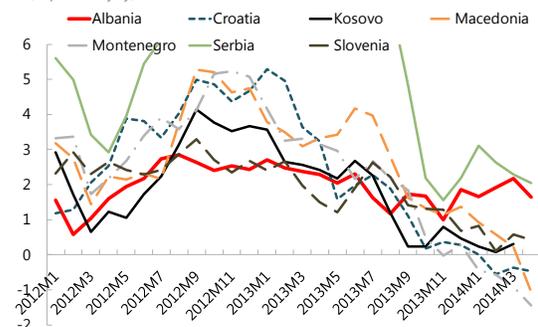
*Inflation of trade partners is calculated as weighted average inflation of 10 largest import sources: Italy, Greece, China, Germany, Turkey, Serbia, Switzerland, Russia, US, Spain.
Sources: IFS and staff calculation

Source: IFS

- *Nonetheless, the decline in inflation is smaller in magnitude in Albania than in the neighbors.*

Inflation in the Balkans

(in percent; yoy)



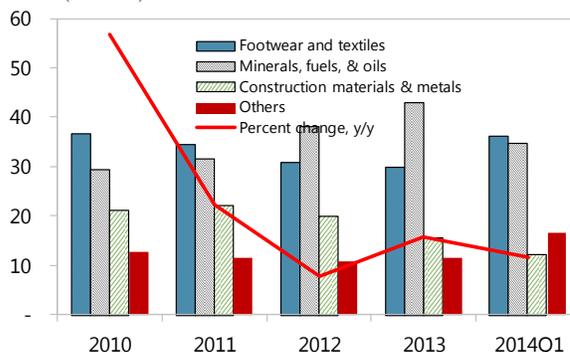
Source: IFS

C. External Sector

- *Export growth has been positive recently, averaging around 10 percent over the past two years.*
- *Mineral and oil exports have been growing strongly...*
- *As have labor-intensive industries—mainly footwear and textiles.*

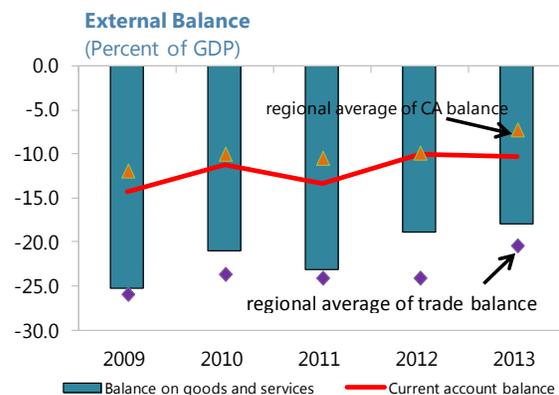
Export Growth and Composition

(Percent)



Source: BoA

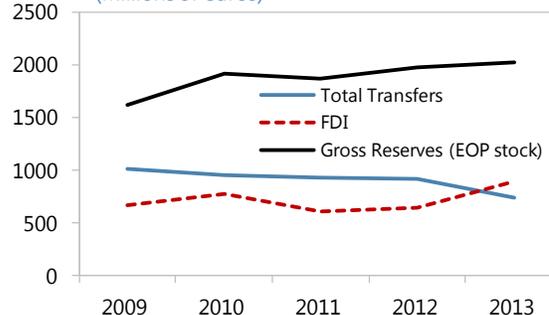
- Nevertheless, the current account deficit has not shrunk...



Source: BoA

- ...primarily because of a decline in remittances...
- ...which have been largely affected by return migration and weak economic performance and prospects in Greece and Italy.
- Export-oriented FDI has become the largest source of external financing.

Trade Balance Financing Sources
(Millions of euros)

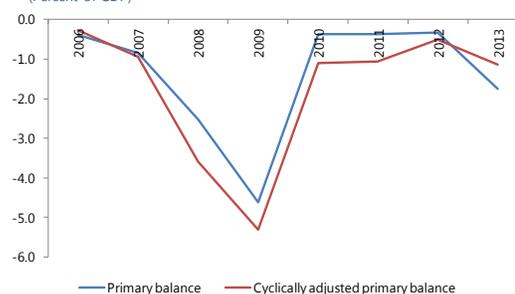


Source: BoA

D. Fiscal

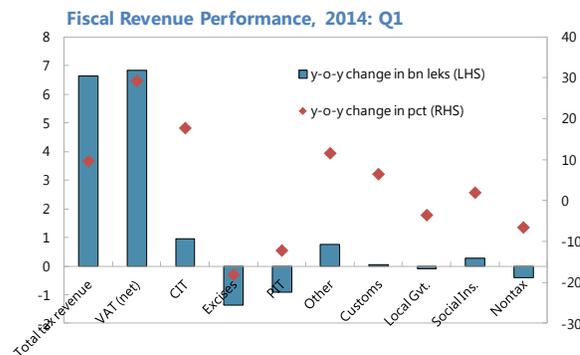
- The fiscal position deteriorated in 2013, because of election-related slippages and a weak economy.

Fiscal Indicators, 2005-13
(Percent of GDP)



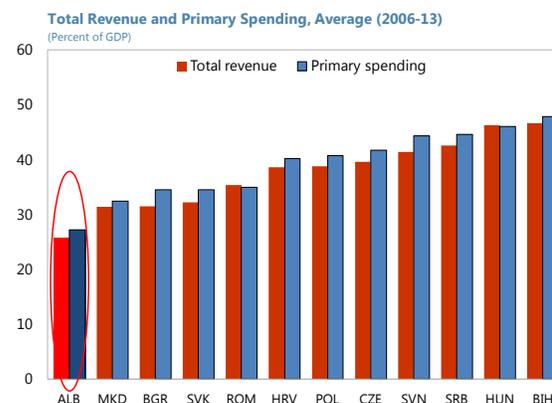
Source: MoF

- Recent fiscal policy and administration reforms appear to be yielding a good performance in 2014:Q1.
- VAT and CIT are showing an improvement...
- ...but other tax categories show mixed performance, and tax refunds are an issue.



Source: MoF and staff calculation

- Albania's revenue- and spending- to-GDP ratios are low...
- ...leaving little scope for expenditure cuts and justifying revenue-based adjustment.

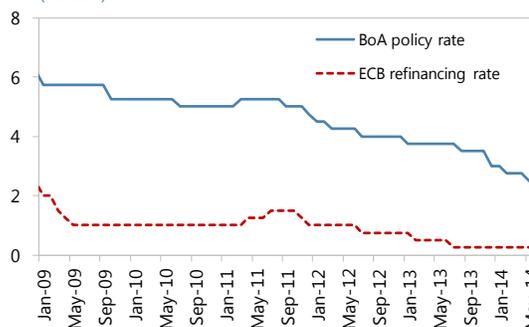


Source: MoF

E. Monetary and Financial Sector

- Low inflation has provided space for monetary easing...
- ...allowing BoA to lower the policy rate by 150 bps since 2012 (most recently on May 30, 2014 by 0.25 bps)...
- ...which helped lower lek market interest rates...

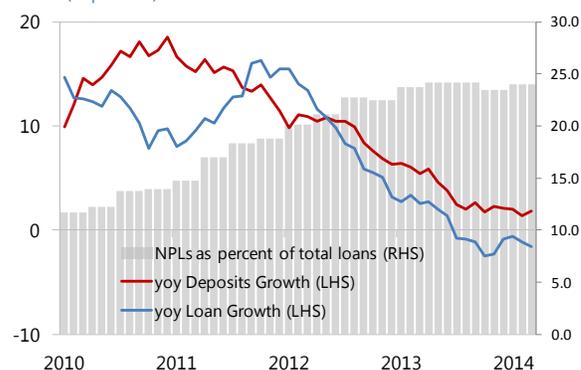
Interest Rates



Source: BoA and Haver

- ...but high NPLs (mainly in trade, construction and manufacturing) and weak private balance sheets have affected monetary transmission by increasing risk aversion...
- ...so credit has continued to shrink; it fell by 2.1 percent in 2014:Q1 (yoy)...
- ...though excluding NPL cleanup, it has been broadly flat.

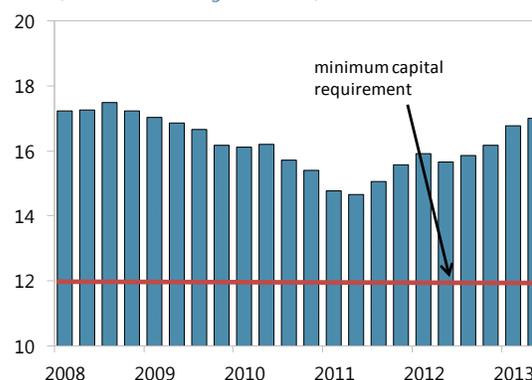
Deposits, Loans, and NPLs
(in percent)



Source: BoA

- The banking sector is well-capitalized.
- Pressures on profitability have eased recently as slowdown in NPL growth has led to reduction in provisioning.

Regulatory Capital
(Percent of risk weighted assets)



Source: BoA

PROGRAM PERFORMANCE

3. **The program is on track** (MEFP Tables 1–2).
 - **Quantitative targets.** All end-March and continuous performance criteria (PCs) as well as indicative targets (ITs) have been met (MEFP, Table 1), with the exception of the IT on domestic arrears accumulation, which was missed by a small margin.
 - **Fiscal performance was better than programmed** (MEFP ¶15). The overall cash deficit, excluding arrears repayment, was lek 2.0 billion, against a programmed deficit of lek 16.0 billion. Revenues exceeded program targets, in part because of better tax administration, but also lower refunds. Capital spending undershot by a wide margin.

- **Repayment of the 2013 stock of arrears began in March 2014.** The authorities paid a total of lek 1.0 billion in March and published a report on arrears paid on the MoF website.¹
- **A quarterly survey of five ministries revealed three had accumulated small amounts of arrears (0.03 percent of GDP) in 2014:Q1.** The main cause was delays in registering bills and invoices. The authorities are reinforcing internal controls—by enhancing procedures to register bills and invoices at the treasury more promptly—and ensuring that the accumulated arrears are paid promptly. The survey results were posted on the MoF website.
- **Inflation was slightly below the inner band prescribed under the inflation consultation clause.** Average inflation in 2014:Q1 was 1.9 percent, compared to the 2.0 percent inner band (MEFP, ¶4). Staff and the authorities discussed the factors behind these developments, which could be broadly ascribed to lower-than-projected imported food prices earlier in the year. Inflation in March was 2.2 percent (yoy), slightly higher than the 1.9 percent outturn in December (yoy). They expect inflation to converge to their medium term target as the output gap begins to close and the recently-implemented measures to help clear NPLs improve balance sheets and lower risk premia, and thus enhance the effectiveness of policy interest rates as a policy tool. In the meantime, the authorities expect to continue to proceed with monetary easing cautiously—cognizant of the risk posed by exchange rate volatility on financial stability—and keeping in mind the easing stance adopted by the ECB. They are also expanding the use of forward guidance to align expectations to their monetary policy objective more forcefully. It was agreed that there was no need for other policy action for now.
- **Structural benchmarks.** Progress on meeting the structural conditions was satisfactory (MEFP, Table 2). The structural benchmark on contracting an external auditor to conduct risk-based audits of arrears payments was not met by the end May test date, but is in process, and the government expects to complete it in the coming weeks.

¹ In addition, the authorities cleared energy arrears totaling lek 4.4 billion, by netting off claims among government, the energy supplier, and the distributor (MEFP ¶33).

POLICY DISCUSSIONS

A. Outlook and Risks

4. The macro framework discussed at the time of program approval remains broadly suitable (Table 1):

- **Growth is expected to rebound to 2 percent in 2014.** Real growth is expected to accelerate in H2, fuelled by external drivers and a modest recovery in domestic demand. The latter will be underpinned by a revival in domestic confidence, better anchoring of policies under the program, a modest credit expansion, and arrears clearance.
- **Inflation will remain modest.** With the output gap persisting, inflation pressures will remain muted, despite the tax rate hikes earlier in 2014. The inflation targeting framework will continue to anchor inflation expectations.
- **The external current account deficit will deteriorate slightly.** A modest release of import compression will keep the trade balance broadly unchanged from 2013, despite a recovery in exports; the external current account will worsen with continued weakness in remittances. Gross international reserves cover is expected to remain adequate, thanks to FDI flows and borrowing.

5. The medium-term outlook is generally favorable (Table 1). Economic growth is expected to gradually rebound to 4½ percent over the medium term on the back of: (i) critical structural reforms that improve the business climate and raise potential growth, (ii) a gradual recovery in European partners, and (iii) large energy-related investments. EU accession-related reforms would also improve Albania's prospects as an investment destination.

6. The balance of risks to the 2014 growth outlook is tilted to the downside.

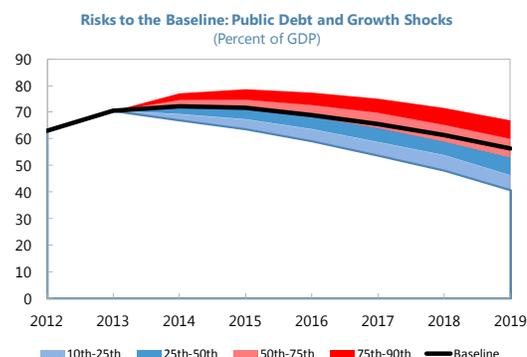
Insufficient fiscal consolidation could undermine fragile investor confidence, affect the domestic and external rollover of public debt and impact bank holdings of government paper. Incomplete structural reforms could prevent a revival in investment. A weaker-than-expected outlook in the main trading partners—Italy and Greece—could affect the prospects for an export led recovery. Potential regulatory and compliance risks at parent banks pose deleveraging spillover.

B. Fiscal Consolidation in an Environment of Emerging Fiscal Risks

Fiscal consolidation is proceeding as planned and no new measures are needed in 2014. Arrears clearance is expected to accelerate once external audits have progressed sufficiently. Ambitious fiscal reforms would be needed to underpin fiscal consolidation in the near term. Pension reform has advanced. Electricity and property restitution claims pose serious fiscal risks.

7. Fiscal consolidation is on track with no additional revenue or expenditure measures needed in 2014.

The public debt target envisaged under the program appears attainable. While some types of tax revenue are so far performing better than envisaged, the performance is quite varied across categories, and also is temporarily boosted by a buildup in unpaid refunds. Revenue and expenditure projections for 2014 remain broadly unchanged from the level envisaged in the original program (IMF Country Report No. 14/78), except for a 0.3 percent of GDP adjustment to revenue, associated with removal of some VAT and excise tax exemptions proposed in the 2014 budget that have since gone into effect, and budgeted expenditure that has now been incorporated into program targets so that the overall budget deficit target remains unchanged in relation to GDP. On balance, annual revenue and deficit targets remain appropriate (in percent of GDP), and broadly on track. In addition, the authorities agreed to a ceiling on expenditures, which will ensure that any revenue overperformance, if it were to materialize, would be saved. Capital spending has slowed since late 2013 because of reassessment of needs and reprioritization, and human resource capacity problems associated with the government transition. Execution remains below budgeted levels this year. Staff encouraged the authorities to accelerate the execution of budgeted capital spending to avoid a drag on growth; the authorities expect execution to speed up over the course of the year now that the review of capital spending has been completed.



Fiscal Consolidation, 2012-19
(Percent of GDP, unless otherwise specified)

	2012	2013		2014		2015	2016	2017	2018	2019
		EBS/14/19	Act.	Prog.	Rev. Prog.					
Revenues	25.1	24.0	24.1	25.4	26.1	26.1	26.2	26.2	26.2	26.2
Tax revenue	22.9	21.6	22.0	23.3	24.0	24.0	24.0	24.0	24.0	24.0
Non-tax revenue	1.8	1.8	1.6	1.5	1.5	1.5	1.6	1.6	1.6	1.6
Grants	0.4	0.6	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Expenditures	28.6	30.1	29.3	32.1	32.8	32.0	31.7	30.6	30.5	30.3
Additional unidentified measures						1.2	1.1	0.8	1.0	0.6
Additional unidentified measures (cumulative)						1.2	2.2	3.1	4.1	4.7
Overall balance	-3.5	-6.2	-5.2	-6.7	-6.7	-4.7	-3.2	-1.3	-0.2	0.6
excl. repayment of end-2013 stock of unpaid bills and arrears				-4.2	-4.2	-3.4	-2.2	-1.3	-0.2	0.6
Primary balance	-0.3	-2.9	-2.0	-3.4	-3.4	-0.6	0.9	2.7	3.7	4.3
Structural primary balance	-0.5	-2.4	-1.4	-0.5	-0.3	1.1	1.9	2.3	3.0	3.4
Change in SPB	0.6	-1.9	-0.9	1.9	1.1	1.4	0.8	0.4	0.7	0.4
Public debt	62.9	70.5	70.5	71.7	72.1	71.6	69.0	65.6	61.3	56.4
Domestic debt	35.8	43.7	43.5	42.3	41.8	40.0	36.7	35.6	34.4	32.7
Foreign debt	27.2	26.8	27.1	29.3	30.4	31.5	32.3	30.0	26.9	23.7
Memo										
Public debt (in bn leks)	828	957	948	1,016	1,007	1,056	1,091	1,113	1,117	1,106

Sources: IMF staff estimates and projections.

8. Arrears prevention is being strengthened. The authorities have taken significant steps in preventing arrears, as laid out in the Arrears Prevention and Clearance Strategy (APCS), including through measures to improve reporting and approval procedures for multi-year commitments, asking line ministries and central institutions to submit planned commitments in line with medium term budget envelope and strengthening local government reporting. While arrears prevention is being improved through these measures, there are capacity limitations that

will take time to improve. In that context, the recent discovery for modest level of new arrears while disappointing can be ascribed largely to technical factors which staff believe the authorities are taking adequate remedial action to correct.

9. Arrears clearance can be accelerated once oversight and audit mechanisms are in place (MEFP ¶16–17). To support private sector liquidity, the authorities are inclined to accelerate arrears payment in 2014, beyond the budgeted allocation. Staff agreed in principle, but argued that in order to ensure fairness, transparency, and a high degree of integrity, the clearance process outlined in the government’s APCS depended importantly on how fast claims could be verified and audited. It was agreed that the pace of arrears clearance should be aligned with the need for ensuring the audit and oversight checks envisaged in the APCS are in place—the government expects to contract an external auditor in the coming weeks (the structural benchmark was not met by the end May test date)—to conduct ex post audit of clearance of nontax arrears, and the auditor is now expected to complete audits of 20 percent of outstanding nontax claims paid between January and June 2014 by end September, a new structural benchmark). Contracting an external auditor to conduct verification of arrears payments on tax refunds is to be added as an additional structural benchmark for end-September. The MoF auditors and the High State Audit are to play an active role in monitoring arrears payment.

10. The authorities are committed to undertaking the required fiscal consolidation in 2015. Achieving the program objectives of lowering debt over the medium term will require additional fiscal measures in 2015 (MEFP ¶6). Implementation of a valuation-based property tax—originally thought to be an important part of the 2015 adjustment—will likely take longer than expected because of land registration and valuation problems. The authorities are committed to finding other measures that meet the consolidation objectives, largely from the revenue side, but also through increasing the efficiency of some spending through better targeting. They are also preparing a revised VAT law which seeks to streamline exemptions and is consistent with the EU directive (MEFP ¶9).

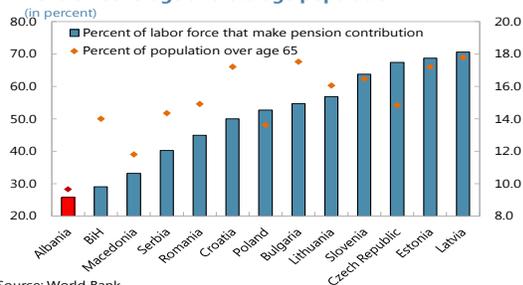
11. Pension reform is moving ahead, but progress on improving the social assistance system has been mixed. The authorities published a draft pension reform strategy in April in consultation with the World Bank, and plan to submit it to Parliament for approval in July (Box 1 and MEFP ¶11), significantly ahead of schedule to allow time for consultation. If approved by Parliament, the new law could become effective in 2015. They are also making progress with reforming the means-tested social assistance program (*Ndihma Ekonomike, NE*), though clean up of the heavily abused disability scheme, which has ballooned in recent years and crowded out the NE program, has lagged (MEFP ¶10).

Box 1. Albania: Proposed Pension Reform Strategy

The recently-released draft reform strategy aims to make the system sustainable by strengthening the link between contributions and benefits and separating the social assistance function. Fiscal benefits of the proposed reform (under the pessimistic scenario) are likely to be pronounced in the long term, and would depend on increase in participation.

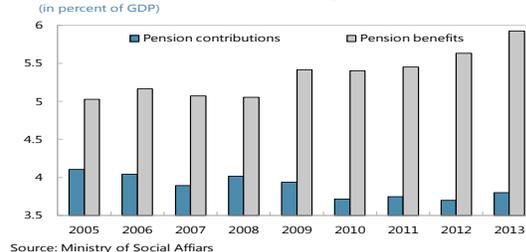
The current pension system is unsustainable. Although Albania's population is relatively young, the number of beneficiaries is large, and the scheme mixes pension and social assistance functions. Participation, on the other hand, is weak in part because the scheme limits the benefits to only twice the minimum benefits, while allowing contributions up to five times minimum contribution. The excess of benefits over contributions is particularly severe in rural Albania. These factors, together with significant benefit increases in recent years, have led to a rapid worsening of the pension deficit.

Pension coverage and old age population



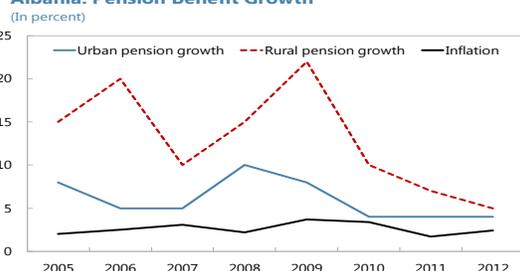
Source: World Bank

Albania: Pension revenue and expenditure



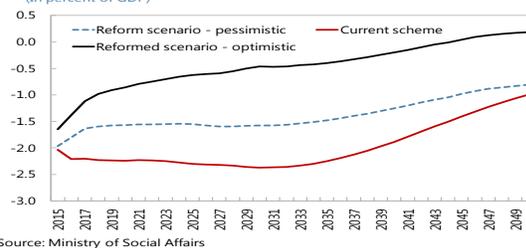
Source: Ministry of Social Affairs

Albania: Pension Benefit Growth



Source: Ministry of Social Affairs

Albania: Pension deficit under the reformed scheme



Source: Ministry of Social Affairs

The draft reform strategy aims to improve system sustainability by strengthening the link between contributions and benefits. Key features likely to be adopted include:

- Replacing the basic pension (under the current system) with a social pension for residents over the age of 70 (means tested, and to be covered directly by the budget);
- Increasing the minimum contributory wage to the official minimum wage—currently 22,000 lek per month (about 160 euros)—and indexing maximum contributory wage with average wage growth;
- Increasing contribution requirement from 35 to 40 years by 2025;
- Gradually increasing rural contribution rates to urban levels by 2017;
- Increasing farmers' service time requirement;
- Removing the benefit ceiling;
- Gradually raising the retirement age to 67 by 2056 for both men and women (from 65 for men and 60 for women at present);
- Introducing strict indexation of pensions to inflation

Fiscal benefits of the proposed reform (under the pessimistic scenario) are likely to be pronounced in the long term, and would depend on increase in participation. In the optimistic scenario where the improved benefit structure is expected to attract greater numbers of contributors over time, the projected average pension deficit in 2015–2024 is 1 percent of GDP, compared with 2.2 percent under the current scheme. Under the pessimistic scenario, where the number of contributors does not increase, the new scheme will generate little saving in 2015, and run an average deficit of 1.6 percent of GDP during the first 10 years, with the improvement coming mainly from the higher contributory wage.

12. Other fiscal reforms are also advancing (MEFP ¶17–8, 18). The authorities are progressing with the implementation of the new IT system in tax administration which should help automate procedures and reduce fraud. In PFM, the treasury system is being reconfigured to allow better control of multi-year commitments for all budget users and there is a plan to introduce commitment limits for every line item of the 2015 budget. MoF has issued instructions to all local governments to report all new procurement orders to MoF starting September (an end-March structural benchmark). The purchase of a new IT server for the treasury has been added as a structural benchmark for end September. Finally, the authorities intend to review committed capital projects (as much as 4–5 percent of GDP) with the aim of canceling low priority ones and renegotiating some of the others to stretch them over time (MEFP ¶13).

13. Fiscal risks have increased since the approval of the program, however. Weaker than normal rains could necessitate government guaranteed electricity imports in 2014 to the tune of 0.3–0.6 percent of GDP. Property compensation is becoming a growing fiscal concern, besides posing a major risk to investment climate and growth as the number of claimants whose properties were expropriated under Communism has recently received favorable rulings on their claims from European Court of Human Rights (ECHR). Potential claims for restitution at full current value could far exceed the government’s capacity to pay.² There is heightened urgency because of European Court of Human Rights’ (ECHR) recent rulings in favor of previous owners and the prospect of potential fines being imposed on the Albanian government. To mitigate the risk and develop a strategy, the authorities will be asking for an extension of moratorium on new judgments, and are exploring revisions to existing legislation (MEFP ¶12). The government is negotiating energy sector reforms with the World Bank under a prospective energy sector reform loan, which, if implemented, could help mitigate electricity sector risks.

C. Safeguarding Financial Stability and Reviving Credit Growth

Financial sector vulnerabilities stem from high NPLs and potential deleveraging in a system dominated by subsidiaries of foreign banks.

14. Tackling NPLs is necessary but not sufficient for sustained credit growth. The recent FSAP delved into this area and suggested actions. The authorities have implemented legal and administrative measures to address high NPLs (MEFP ¶25)—such as changes in the civil code to ease collateral execution, passage of tax law amendments to ease NPL write offs by banks, and requiring banks to write off loans that have been held in the “loss” category for longer than three years from the beginning of 2015. However, progress to date in cleaning up these troubled loans has been limited. An economic recovery, clearance of arrears and reforms of bankruptcy and competition laws would help facilitate private balance sheet restructuring and revive loan demand.

² Other countries in the region have opted for compensation based on proportion of current market value, or at the original expropriation value.

15. Financial sector risks warrant caution in further monetary easing (MEFP ¶121–24). Widespread euroization, weak demand, and bank risk aversion have hampered the transmission of monetary policy. The BoA has continued to refine and extend its communication framework by adopting forward guidance with regard to future monetary policy to improve monetary transmission. As corporate balance sheets begin to improve with the clearance of government arrears, and banks are better able to clear NPLs also following the recent regulatory changes, monetary transmission could begin to improve, increasing the effectiveness of interest-rate based monetary policy.

16. Continued vigilance is needed to preserve financial stability (MEFP ¶126–30). The authorities have begun to implement key FSAP recommendations, as agreed under the program (MEFP, ¶126–29, and Table 2). They are strengthening nonbank regulation and supervision (MEFP ¶128). An MOU covering operations of the inter-agency Financial Sector Advisory Group (FSAG) was amended to increase the frequency of meetings and to exclude financial development from the mandate of the Group (end-March structural benchmark). The Albanian Financial Supervisory Authority (AFSA), in consultation with BoA, is to amend the regulatory framework for investment funds on asset valuation, liquidity and capital adequacy (end-September structural benchmark). In addition, an amended Financial Supervisory Authority (AFSA) law, a new insurance law and amendments to the law on salaries of independent institutions, which are intended to improve AFSA's supervisory and operational independence, have been passed by Parliament.

17. Deleveraging risk persists. While bank profitability has improved beginning in 2013:Q4—largely because of reduced need for provisions as NPL growth has slowed—the authorities are concerned that developments in the euro area at the level of parent groups in Austria, Greece and Italy (asset quality review and stress tests) may force local subsidiaries to shed loans and or shrink balance sheets. A further tightening of credit supply would put the economic recovery at risk. In March 2014 the authorities hosted, jointly with IMF staff, under the auspices of Vienna Initiative, a follow up home-host, cross-border banking forum to discuss, among other things, spillover financial risks emanating from abroad.

D. Preparing the Groundwork for Growth-Enhancing Reforms

Preparatory work for ambitious structural reforms is underway. If implemented properly, these reforms could unlock Albania's medium term growth potential and enhance prospects for EU integration.

18. The authorities are taking measures to improve the business environment (MEFP ¶131). They have established a structured high-level dialogue with the business community—through regular meetings of the National Economic Council, a consultative body led by the Prime Minister—and are undertaking a comprehensive review of the business environment to tackle potential deficiencies. Some businesses reported signs of improvement in tax administration.

19. Energy reform is critical for reducing fiscal and growth risks (MEFP ¶132–33). The authorities are preparing an energy reform strategy, in consultation with the World Bank, which envisages improvements in liquidity of the producer and distributor over the near term by taking administrative measures to curb theft and losses and deregulating prices for commercial consumers. Medium-term measures include additional investments in the grid to reduce losses, changes to the market model (e.g., role of generation company as supplier of last resort), and adjustment of energy tariffs closer to cost recovery. The authorities plan to expand the net of bill payers by asking for proof of multiple years of paid utility bills before registering illegally constructed buildings. The authorities expect to wean the electricity sector away from implicit or explicit budget support by end 2016.

20. Public administration and local government reforms are also making headway (MEFP ¶114). The recently adopted new civil service law which was prepared in consultation with the EU is expected to help depoliticize public administration and improve its professionalism. A fiscal decentralization strategy and a new local government law are expected to increase local governments' financial autonomy, while addressing concerns over weak revenue collection, financial control, human resource management, corruption, and transparency. The EU and bilateral donors are supporting the creation of larger and more efficient local government units.

PROGRAM MODALITIES AND RISKS

21. Updated program conditionality is being proposed (MEFP Tables 1–2).

Quantitative PCs

- Staff proposes a modest increase in the overall nominal cash deficit (excluding arrears payment) at end-2014 by lek 2.0 billion to keep the fiscal deficit in percent of GDP unchanged relative to program, reflect the effect of revisions to nominal GDP in 2013 and earlier, and to rectify the inconsistency between the projected overall balance and the end-2014 PC (IMF Country Report No. 14/78). Targets for 2014:Q2–Q3 have been revised to reflect the significant underperformance in 2014:Q1. The floor on international reserves of the BoA has been revised up 2014:Q2–Q4 to account for higher projected imports of goods and services, in order to keep the floor at three months' import coverage.
- A new PC on government expenditure, excluding arrears payment, has been added (with end-June 2014 as the first test date) to ensure that potential revenue over performance is saved.
- The floor on clearance of domestic arrears has been increased in 2014:Q2–Q4 to reflect the 2014:Q1 outcome.
- New PCs and ITs have been proposed for 2015:Q1 in the same areas as in 2014 (see Table 1).

- To avoid possible misinterpretation, staff proposes removing the arrears clearance adjustor for the performance criterion on the general government overall cash deficit because the definition of the deficit already excludes arrears payment. All adjustors are laid out in the TMU.

Structural benchmarks

- The end-June structural benchmark on amendment of the regulatory framework for investment funds on asset valuation, liquidity requirement, and capital adequacy requirement has been extended to September 2014 to allow more time for consultation (an initial joint IMF-World Bank technical assistance mission took place in 2014:Q2, with a follow-up mission planned to assist with an impact assessment and help finalize the required regulatory changes).
- New proposed structural benchmarks for 2014:
 - Contract an external auditor to conduct verification of arrears payments on tax refunds.
 - Completion of ex post audit of 20 percent of outstanding non-tax claims paid during January–June, 2014.
 - Purchase an IT server for the treasury system to enhance capabilities and security, given the critical importance of having a well functioning and modern treasury system.
 - Structural conditionality in 2015 would focus on operationalizing a risk management unit in tax administration, and on arrears clearance and prevention (continuous).

22. The 2014 program is fully financed. The World Bank has approved two Development Policy Loans (DPLs) in May 2014, in the areas of public finance and financial sector modernization, totaling US\$220 million.

23. BoA has strengthened its safeguards framework since 2006, but there is need for further improvement. The update safeguards assessment, completed on June 5, 2014, found that the BoA has strengthened its safeguards framework in a number of areas in line with international standards (including in its external and internal audit and financial reporting functions). However, its governance structure lacks effective oversight of audit, financial reporting, and control matters, and the assessment recommended the establishment of an audit committee. Staff recommended that the BoA should adopt a formal auditor selection and rotation policy and undertake a quality assessment of the internal audit function. Compilation procedures for the reporting of net international reserves and credit to government should be reviewed by its internal audit department at each test date.

24. Albania is expected to meet repayment obligations to the Fund. By the end of the proposed extended arrangement, Fund credit outstanding is projected to be 3.0 percent of GDP, or 14.8 percent of gross reserves (Table 7). After peaking at 41.9 percent of GDP in 2016, external debt will decline to 33.2 percent of GDP by 2019, with external public debt falling from 32.3 to 23.7 percent of GDP. Albania has a strong record of repaying the Fund.

25. Risks to the program remain. The main risks arise because of the complexity of reforms and weaknesses in administrative capacity. A weaker than expected economic recovery could also test the authorities' resolve to implement policies under the program. Factors mitigating these risks include the prospect for EU accession which serves as an anchor for reform; and extensive technical assistance by the Fund and other donors. The program also envisages an easing of program targets if economic conditions weaken, and vice versa.

STAFF APPRAISAL

26. The economy is showing tentative signs of recovery. Even if the 2014 growth forecast materializes as projected, however, the economy would remain below potential. Albania will need stronger sustained growth over the medium term, aided by structural reforms that increase the economy's potential, to tackle rising unemployment, correct domestic imbalances and solidify financial stability.

27. The program is off to a good start. All end-March performance criteria were met with comfortable margins. Program targets for the next review should be within reach, provided the authorities adhere to program commitments, and risks emanating from growth or fiscal shocks do not materialize. The authorities' commitments in this regard are welcome.

28. Urgent action is needed to tackle fiscal risks. The electricity reform agenda is complex but needs to be addressed promptly to mitigate fiscal risks and support growth. Even then, it will take time to eliminate implicit and explicit budget support to the energy sector. Property restitution claims should be dealt with urgently, while safeguarding fiscal sustainability. Staff supports the authorities' decision to prioritize existing capital spending commitments, which far exceed the government's available resources, to minimize the risk of further arrears accumulation.

29. High fiscal risks and the heavy fiscal consolidation needs in 2015 and beyond suggest that any revenue overperformance in 2014, were it to materialize, should be saved. If revenues over perform on a sustained basis in 2014, the authorities should rebuild buffers to protect against fiscal risks and lessen the burden of fiscal adjustment in 2015 and beyond. Meanwhile, they should also accelerate capital spending in line with the budget in the remainder of 2014 and implement timely VAT refunds practices to avoid a fiscal drag on growth. Of course, if growth were to be weaker than envisaged, then the pace of fiscal consolidation in 2014 would need to be adjusted.

30. Acceleration of arrears clearance will be appropriate once safeguards are in place to guard the credibility of the process. Given the significant arrears payments made so far, there is a need for the external auditor to catch up with ex post audits of cleared amounts, to provide assurance to the public and stakeholders of the integrity of the process.

31. There has been good progress to date in implementing critical program reforms but challenges remain. The authorities' determined effort to initiate pension reform ahead of schedule is welcome. They are also making good progress in tax administration and PFM reforms, supported by technical assistance by the IMF. Preventing new arrears accumulation will hinge on greater discipline in line ministries and further improvements in the treasury system, including through its rollout to all budget users. Signs of improvement in business environment are encouraging, yet more needs to be done. Staff urges the authorities to take more decisive actions in difficult reform areas including tax administration and property right protection.

32. Continued vigilance is needed to preserve financial stability. While bank profitability has improved recently because of lower provisioning expense associated with slowdown of NPL buildup, NPLs remain high and should be closely monitored. Continued vigilance is needed regarding parent bank developments to address deleveraging risks. The authorities have made good progress in initiating FSAP reforms.

33. Bank of Albania should build on good progress to date and further strengthen its safeguards framework. Good progress in external and internal audit and financial reporting functions should be complemented with the establishment of an audit committee and the adoption of a formal auditor selection and rotation policy and undertaking a quality assessment of the internal audit function.

34. Staff supports the authorities' request for the completion of the first review under the Extended Arrangement and modification of performance criteria (see para. 21), in light of the progress achieved so far and policy commitments going forward.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2009–19

	2009	2010	2011	2012	2013	2014		2015	2016	2017	2018	2019
					Est.	Prog.	Rev. Prog.	Projections				
Real sector												
(Growth rate in percent)												
Real GDP	3.4	3.5	2.3	1.1	0.4	2.1	2.1	3.3	4.2	4.5	4.5	4.7
Consumer Price Index (avg.)	2.3	3.5	3.4	2.0	1.9	2.7	2.2	2.7	3.0	3.0	3.0	3.0
Consumer Price Index (eop)	3.7	3.4	1.7	2.4	1.9	2.6	2.3	3.0	3.0	3.0	3.0	3.0
GDP deflator	2.2	4.7	3.5	2.1	1.7	2.3	1.7	2.4	2.8	2.8	2.8	2.8
Saving-investment balance												
(Percent of GDP)												
Foreign savings	14.3	11.2	13.3	10.0	10.4	10.3	11.0	12.6	13.8	12.4	10.1	8.1
National savings	16.2	15.7	12.5	14.3	12.5	15.0	13.9	13.0	13.8	16.0	16.7	18.6
Public	1.0	1.2	1.6	0.8	-0.8	0.2	0.2	1.0	2.2	3.1	4.1	4.9
Private	15.3	14.4	10.9	13.5	13.3	14.8	13.7	11.9	11.6	13.0	12.5	13.7
Investment	30.5	26.9	25.8	24.3	22.9	25.3	24.9	25.6	27.6	28.5	26.8	26.8
Public	10.3	6.8	6.2	5.2	4.9	5.2	4.8	5.0	5.0	5.0	5.0	5.0
Private	20.2	20.1	19.6	19.1	18.0	20.1	20.1	20.6	22.6	23.5	21.8	21.8
Fiscal sector												
(Percent of GDP)												
Total revenue and grants	26.6	26.4	25.8	25.1	24.1	25.4	26.1	26.1	26.2	26.2	26.2	26.2
Tax revenue	24.1	23.7	23.8	22.9	22.0	23.3	24.0	24.0	24.0	24.0	24.0	24.0
Total expenditure	34.5	30.2	29.4	28.6	29.3	32.1	32.8	32.0	31.7	30.6	30.5	30.3
Of which: Repayment of end-2013 stock of unpaid bills and arrears						2.5	2.5	1.4	1.0			
Primary	31.2	26.7	26.2	25.4	26.1	28.9	29.5	27.9	27.6	26.5	26.6	26.6
Interest	3.2	3.4	3.2	3.2	3.2	3.2	3.3	4.1	4.1	4.0	3.9	3.7
Unidentified measures (cumulative)						0.0	0.0	1.2	2.2	3.1	4.1	4.7
Overall balance	-7.9	-3.8	-3.6	-3.5	-5.2	-6.7	-6.7	-4.7	-3.2	-1.3	-0.2	0.6
Primary balance	-4.6	-0.4	-0.4	-0.3	-2.0	-3.4	-3.4	-0.6	0.9	2.7	3.7	4.3
Financing	7.9	3.8	3.6	3.5	5.2	4.2	6.7	3.6	2.1	1.3	0.2	-0.6
Of which: Domestic	3.5	-2.0	1.9	2.3	4.1	3.0	2.4	1.9	0.4	1.4	1.2	0.8
Of which: Foreign	3.8	5.5	1.6	1.2	1.1	1.2	4.3	1.7	1.8	-0.1	-1.0	-1.3
Public Debt	60.8	58.8	60.4	62.9	70.5	71.7	72.1	71.6	69.0	65.6	61.3	56.4
Domestic	37.0	33.5	34.3	35.8	43.5	42.3	41.8	40.0	36.7	35.6	34.4	32.7
Of which: Unpaid bills and arrears					5.3	2.6	2.6	1.1	0.0			
External	23.8	25.3	26.1	27.2	27.1	29.3	30.4	31.5	32.3	30.0	26.9	23.7
Monetary indicators												
(Growth rate in percent)												
Broad money growth	6.8	12.5	9.1	5.0	2.3	4.6	4.1	5.5	7.1	7.4	7.4	7.6
Private credit growth	10.3	10.1	10.4	1.4	-1.4	2.6	2.6	4.6	5.9	5.9	6.6	6.7
Velocity	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Interest rate (3-mth T-bills, end-period)	6.3	5.3	5.3	5.0	3.4	...	...	...	...	...	...	...
BoA repo rate (in percent)	5.3	5.0	4.8	4.0	3.0	...	...	...	...	...	...	...
External sector												
(Percent of GDP, unless otherwise indicated)												
Trade balance (goods and services)	-25.2	-21.0	-23.1	-18.9	-17.9	-17.0	-17.5	-18.5	-19.7	-18.7	-16.3	-14.0
Current account balance (including official transfers)	-14.3	-11.2	-13.3	-10.0	-10.4	-10.3	-11.0	-12.6	-13.8	-12.4	-10.1	-8.1
Current account balance (excluding official transfers)	-15.0	-12.1	-13.9	-10.7	-10.9	-11.3	-11.7	-13.5	-14.6	-13.4	-11.0	-8.9
Official transfers	0.7	0.9	0.6	0.7	0.6	1.0	0.7	0.9	0.8	0.9	0.9	0.8
Gross international reserves (in billions of Euros)	1.6	1.9	1.9	2.0	2.0	2.1	2.1	2.1	2.2	2.3	2.4	2.5
(In months of imports of goods and services)	4.1	4.4	4.5	4.7	4.6	4.5	4.4	4.0	4.0	4.1	4.0	3.9
(Relative to external debt service)	2.5	3.6	7.8	6.6	6.7	4.7	5.4	2.8	4.6	4.0	3.6	3.3
(In percent of broad money)	26.1	27.0	24.8	24.5	24.6	24.2	24.7	23.7	23.4	22.8	21.9	21.0
Change in real exchange rate (eop, in percent)	-5.3	-4.7	8.7	-0.1	1.0	...	...	...	...	...	...	...
Memorandum items												
Nominal GDP (in billions of lek)	1122	1217	1279	1316	1345	1418	1396	1476	1580	1697	1823	1961
Output gap (percent, - = gap)	1.8	1.9	1.9	0.5	-1.7	-2.2	-2.4	-2.2	-1.5	-0.8	-0.4	0.1

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

Table 2a. Albania: General Government Operations, 2009–19
(Percent of GDP)

	2009	2010	2011	2012	2013	2014		2015	2016	2017	2018	2019
						Prog.	Rev. Prog.		Projection			
Total revenue and grants	26.6	26.4	25.8	25.1	24.1	25.4	26.1	26.1	26.2	26.2	26.2	26.2
Tax revenue	24.1	23.7	23.8	22.9	22.0	23.3	24.0	24.0	24.0	24.0	24.0	24.0
VAT	9.8	9.4	9.3	8.9	8.1	8.3	8.5	8.5	8.5	8.5	8.5	8.5
Profit tax	1.5	1.4	1.5	1.3	1.1	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Excise tax	3.0	3.2	3.2	2.8	2.8	3.2	3.5	3.5	3.5	3.5	3.5	3.5
Small business tax	0.2	0.2	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Personal income tax	2.4	2.2	2.2	2.1	2.2	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Customs duties	0.7	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other taxes	1.2	1.5	1.7	2.2	2.1	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Property and local taxes	0.9	0.8	0.7	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Social insurance contributions	4.4	4.4	4.4	4.4	4.5	4.5	4.6	4.6	4.6	4.6	4.6	4.6
Non-tax revenue	2.1	2.3	1.8	1.8	1.6	1.5	1.5	1.5	1.6	1.6	1.6	1.6
Grants	0.4	0.4	0.3	0.4	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Total expenditure	34.5	30.2	29.4	28.6	29.3	32.1	32.8	32.0	31.7	30.6	30.5	30.3
Current expenditure	25.3	24.7	23.9	23.9	24.4	24.4	25.0	25.6	25.6	25.6	25.5	25.3
Personnel cost	5.6	5.4	5.3	5.3	5.3	5.2	5.3	5.1	5.1	5.1	5.1	5.1
Interest	3.2	3.4	3.2	3.2	3.2	3.2	3.3	4.1	4.1	4.0	3.9	3.7
Of which: domestic	2.8	2.9	2.7	2.6	2.7	2.6	2.6	2.8	2.7	2.6	2.5	2.4
Operations & maintenance	2.9	2.8	2.6	2.5	2.4	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Subsidies	0.2	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social insurance outlays	8.6	8.7	8.9	9.1	9.5	9.6	9.8	9.8	9.8	9.8	9.8	9.8
Local government expenditure	3.0	2.5	2.2	2.1	2.2	2.1	2.4	2.4	2.4	2.4	2.4	2.4
Social protection transfers	1.8	1.5	1.5	1.6	1.7	1.6	1.6	1.6	1.6	1.6	1.7	1.7
Capital expenditure	9.0	5.9	5.5	4.7	4.9	4.7	4.8	5.0	5.0	5.0	5.0	5.0
Lending minus repayment	0.2	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 1/	0.0	0.0	0.0	0.0	0.0	0.6	0.5	0.0	0.0	0.0	0.0	0.0
Repayment of end-2013 stock of unpaid bills and arrears						2.5	2.5	1.4	1.0	0.0	0.0	0.0
Unidentified measures (cumulative)						0.0	0.0	1.2	2.2	3.1	4.1	4.7
Overall balance	-7.9	-3.8	-3.6	-3.5	-5.2	-6.7	-6.7	-4.7	-3.2	-1.3	-0.2	0.6
Financing	7.9	3.8	3.6	3.5	5.2	4.2	6.7	3.6	2.1	1.3	0.2	-0.6
Domestic	3.5	-2.0	1.9	2.3	4.1	3.0	2.4	1.9	0.4	1.4	1.2	0.8
Privatization receipts	2.2	0.4	0.0	0.1	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	1.1	-2.5	2.1	2.2	3.1	2.9	2.4	1.9	0.4	1.4	1.2	0.8
Of which: banks						1.3	1.2	0.9	0.2	0.7	0.6	0.4
Other	0.2	0.1	-0.2	0.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	3.8	5.5	1.6	1.2	1.1	1.2	4.3	1.7	1.8	-0.1	-1.0	-1.3
Accumulation of arrears 2/	0.5	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (+gap) 3/						2.5	0.0	1.2	1.1	0.0	0.0	0.0
World Bank						1.4	0.0	0.7	0.6			
Residual financing (e.g., EU)						0.0	0.0	0.5	0.4			
IMF						1.0	0.0	0.0	0.0			
Memorandum Items:												
Primary balance	-4.6	-0.4	-0.4	-0.3	-2.0	-3.4	-3.4	-0.6	0.9	2.7	3.7	4.3
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears						-4.2	-4.2	-3.4	-2.2	-1.3	-0.2	0.6
Public Debt	60.8	58.8	60.4	62.9	70.5	71.7	72.1	71.6	69.0	65.6	61.3	56.4
Domestic	37.0	33.5	34.3	35.8	43.5	42.3	41.8	40.0	36.7	35.6	34.4	32.7
Of which: Unpaid bills and arrears					5.3	2.6	2.6	1.1	0.0			
External	23.8	25.3	26.1	27.2	27.1	29.3	30.4	31.5	32.3	30.0	26.9	23.7
GDP (in billions of leks)	1122	1217	1279	1316	1345	1418	1396	1476	1580	1697	1823	1961

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

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

2/ As reflected in official data and not accounting for arrears accumulated outside of the budget prior to 2014.

3/ Following the approval of the program, Fund purchases are reported under foreign financing. Similarly, funding by the World Bank for 2014 has been secured and is reported in foreign financing.

Table 2b. Albania: General Government Operations, 2009–19
(Billions of leks)

	2009	2010	2011	2012	2013	2014		2015	2016	2017	2018	2019
						Prog.	Rev. Prog.		Projection			
Total revenue and grants	298.5	320.7	330.4	330.4	323.7	360.8	364.7	385.2	414.0	444.6	477.6	513.8
Tax revenue	270.8	288.6	303.9	300.9	296.4	331.1	335.0	353.9	378.9	407.0	437.1	470.3
VAT	110.1	114.0	119.2	116.5	108.5	117.9	118.4	125.2	134.0	143.9	154.6	166.3
Profit tax	17.1	17.6	19.7	16.9	15.1	23.0	23.0	24.3	26.0	28.0	30.0	32.3
Excise tax	33.5	38.8	40.4	36.4	38.2	44.9	48.4	51.1	54.8	58.8	63.2	67.9
Small business tax	2.5	2.3	2.6	2.1	2.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Personal income tax	26.8	27.1	28.0	28.0	29.6	28.5	28.5	30.1	32.3	34.7	37.2	40.0
Customs duties	7.9	7.3	6.9	6.1	5.8	5.9	5.9	6.2	6.7	7.2	7.7	8.3
Other taxes	13.4	18.3	21.4	28.7	28.5	36.4	36.4	38.4	41.2	44.2	47.5	51.1
Property and local taxes	9.7	9.6	9.2	8.7	8.9	10.7	10.4	11.0	11.7	12.6	13.5	14.6
Social insurance contributions	49.8	53.6	56.6	57.4	60.0	63.8	63.8	67.5	72.3	77.6	83.4	89.7
Non-tax revenue	23.2	27.5	22.7	24.0	21.6	21.2	21.2	22.3	25.5	27.4	29.4	31.6
Grants	4.4	4.6	3.8	5.6	5.7	8.5	8.5	9.0	9.6	10.3	11.1	11.9
Total expenditure	386.7	366.8	376.2	376.2	394.1	455.2	458.5	472.1	500.4	519.2	555.9	594.3
Current expenditure	283.4	300.9	305.6	314.6	328.6	345.5	349.6	378.6	405.2	434.6	465.1	496.6
Personnel cost	62.4	65.8	67.4	69.4	70.7	74.0	74.0	75.3	80.7	86.6	93.1	100.1
Interest	36.3	41.6	41.1	41.5	43.3	46.0	46.4	60.5	64.4	68.6	71.6	73.3
Of which: domestic	31.4	35.6	34.3	34.0	35.9	36.5	36.6	41.0	43.1	43.5	45.3	47.0
Operations & maintenance	32.1	34.3	33.0	33.5	32.4	35.3	35.3	37.3	39.9	42.9	46.1	49.6
Subsidies	2.0	3.5	3.3	1.9	1.6	1.6	1.6	1.7	1.9	2.1	2.1	2.2
Social insurance outlays	96.7	106.2	113.9	120.3	127.6	136.3	136.3	144.2	154.4	165.9	178.4	191.9
Local government expenditure	33.6	30.8	28.1	27.3	29.8	29.4	33.1	35.3	37.8	40.6	43.6	46.9
Social protection transfers	20.4	18.7	18.7	20.7	23.2	22.9	22.9	24.2	26.0	27.9	30.2	32.7
Capital expenditure	101.5	71.6	70.6	61.7	65.5	66.7	67.3	73.5	78.7	84.5	90.8	97.7
Domestically financed	75.7	46.6	41.1	27.4	36.7	28.1	28.7	32.7	35.0	37.6	40.4	43.5
Foreign financed	20.3	20.9	27.9	34.3	28.8	38.6	38.6	40.8	43.7	46.9	50.4	54.2
Other	5.5	4.1	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lending minus repayment	1.8	-5.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 1/	0.0	0.0	0.0	0.0	0.0	8.0	6.6	0.0	0.0	0.0	0.0	0.0
Repayment of end-2013 stock of unpaid bills and arrears						35.0	35.0	20.0	16.5	0.0	0.0	0.0
Unidentified measures (cumulative)						0.0	0.0	17.2	35.5	52.1	74.0	91.5
Overall balance	-88.2	-46.2	-45.7	-45.9	-70.4	-94.4	-93.8	-69.7	-50.9	-22.4	-4.4	11.0
Financing	88.2	46.2	45.7	45.9	70.4	59.1	93.8	52.5	33.8	22.4	4.4	-11.0
Domestic	39.6	-24.8	24.7	30.2	55.6	42.2	33.8	27.9	5.6	24.1	22.2	15.2
Privatization receipts	25.1	4.5	0.4	1.2	16.7	0.4	0.4	0.0	0.0	0.0	0.0	0.0
Net borrowing	12.3	-30.7	26.8	28.5	42.3	41.8	33.4	27.9	5.6	24.1	22.2	15.2
Of which: banks						17.9	16.7	14.0	2.8	12.0	11.1	7.6
Other	2.2	1.5	-2.5	0.5	-3.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	43.1	66.9	21.0	15.7	14.8	16.9	60.0	24.6	28.2	-1.7	-17.9	-26.2
Accumulation of arrears 2/	5.5	4.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (+=gap) 3/						35.3	0.0	17.1	17.1	0.0	0.0	0.0
World Bank						20.5	0.0	10.1	10.0			
Residual financing (e.g., EU)						0.0	0.0	7.0	7.1			
IMF						14.9	0.0	0.0	0.0			
Memorandum Items:												
Primary balance	-51.9	-4.6	-4.6	-4.4	-27.1	-48.4	-47.4	-9.2	13.5	46.3	67.3	84.3
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears						-59.4	-58.8	-49.7	-34.4	-22.4	-4.4	11.0
Current balance excl. grants	10.7	15.2	21.0	10.2	-10.7	2.8	3.3	14.9	34.7	51.8	75.4	96.8
Public Debt	682.5	715.5	772.7	828.3	948.3	1016.3	1006.7	1056.3	1090.7	1113.1	1117.4	1106.4
Domestic	415.0	407.5	438.8	470.6	584.5	600.5	582.9	590.8	580.0	604.0	626.2	641.4
Of which: Unpaid bills and arrears						71.5	37.5	36.5	0.0			
External	267.5	308.0	333.9	357.6	363.7	415.8	423.7	465.5	510.7	509.0	491.2	465.0
Direct government external debt	227.3	268.1	294.3	319.8	332.3	369.0	388.1	425.7	466.9	461.2	441.6	413.8
Government guaranteed external debt	40.2	39.9	39.7	37.8	31.4	46.7	35.6	39.7	43.8	47.9	49.6	51.2

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

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

2/ As reflected in official data and not accounting for arrears accumulated outside of the budget prior to 2014.

3/ Following the approval of the program, Fund purchases are reported under foreign financing. Similarly, funding by the World Bank for 2014 has been secured and is reported in foreign financing.

Table 3a. Albania: Balance of Payments, 2009–19
(Percent of GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Est.	Projection					
Current account	-14.3	-11.2	-13.3	-10.0	-10.4	-11.0	-12.6	-13.8	-12.4	-10.1	-8.1
Balance of goods and services	-25.2	-21.0	-23.1	-18.9	-17.9	-17.5	-18.5	-19.7	-18.7	-16.3	-14.0
Exports	29.4	33.2	34.6	33.9	35.3	36.0	36.1	36.5	37.0	37.4	37.2
Goods	9.2	13.3	15.4	16.2	18.1	18.7	19.2	19.8	20.4	20.9	21.1
Of which: Energy	1.1	2.4	3.3	4.3	5.6	5.8	5.9	6.2	6.5	6.8	7.0
Services	20.2	19.9	19.2	17.7	17.3	17.3	17.0	16.7	16.6	16.4	16.2
Imports	54.6	54.2	57.8	52.8	53.3	53.5	54.7	56.2	55.7	53.6	51.3
Goods	35.9	36.9	40.0	37.4	36.1	36.6	37.7	39.4	39.1	37.2	34.8
Of which: Energy	4.2	5.1	7.1	7.4	6.2	6.3	6.5	6.8	6.7	6.4	6.1
Services	18.8	17.2	17.7	15.5	17.2	16.9	17.0	16.8	16.6	16.4	16.4
Income balance	-1.0	-1.0	-0.4	-0.8	-0.1	-0.6	-1.1	-1.0	-0.8	-0.7	-0.5
Of which: Interest due	0.5	0.6	1.0	1.0	0.5	1.2	1.6	1.6	1.8	1.7	1.6
Private transfers 1/	11.2	10.0	9.6	9.0	7.1	6.4	6.2	6.1	6.1	6.0	5.8
Official transfers	0.7	0.9	0.6	0.7	0.6	0.7	0.9	0.8	0.9	0.9	0.8
Financial account	11.9	9.2	10.0	8.0	10.4	9.1	7.9	12.6	13.4	10.7	8.4
Direct investment	7.9	8.7	6.7	6.9	9.3	9.7	11.1	11.7	10.3	7.6	6.7
Other capital	-0.4	1.4	1.6	-0.4	0.0	-2.2	-1.0	0.3	3.2	4.1	3.1
Medium- and long-term loans (net)	4.4	-0.9	1.7	1.5	1.1	1.6	-2.1	0.6	-0.1	-1.0	-1.3
Project loans	4.7	2.0	2.4	2.5	2.4	3.3	2.6	2.5	1.9	1.5	1.3
Amortization	-0.2	-2.9	-0.7	-0.9	-1.3	-1.7	-4.7	-1.8	-2.0	-2.5	-2.6
Errors and omissions 3/	2.3	2.1	2.9	3.2	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Net balance	-0.5	0.1	-0.4	1.2	0.5	-1.9	-4.7	-1.2	0.9	0.6	0.3
Available financing	0.5	-0.1	0.4	-1.2	-0.5	1.9	3.5	0.1	-0.9	-0.6	-0.3
Change in net reserves (increase = -) 2/	0.5	-3.5	0.4	-1.2	-0.5	-0.8	-0.2	-1.0	-0.9	-0.6	-0.3
IMF (budget support)						1.1	0.9	1.1	0.0	0.0	0.0
World Bank						1.6	0.0	0.0	0.0	0.0	0.0
Commercial loans (eurobond)						0.0	2.9	0.0	0.0	0.0	0.0
Prospective financing 4/	0.0	0.0	0.0	0.0	0.0	0.0	1.2	1.1	0.0	0.0	0.0
IFIs (World Bank, EU)						0.0	1.2	1.1			
Other						0.0	0.0	0.0			

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 2009–13. In projections for 2014–19, valuation effects are assumed to be zero.

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

4/ Following the approval of the program, Fund purchases are reported under available financing. Similarly, funding by the World Bank for 2014 has been secured and is reported in available financing.

Table 3b. Albania: Balance of Payments, 2009–19

(Millions of euros)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Est.			Projection			
Current account	-1,218	-988	-1,213	-945	-993	-1,095	-1,325	-1,545	-1,496	-1,307	-1,131
Balance of goods and services	-2,148	-1,851	-2,107	-1,786	-1,720	-1,740	-1,946	-2,210	-2,248	-2,101	-1,976
Exports	2,504	2,922	3,153	3,199	3,386	3,579	3,793	4,088	4,449	4,822	5,249
Goods	785	1,172	1,406	1,526	1,731	1,861	2,010	2,221	2,455	2,700	2,970
Of which: Energy	91	211	298	406	537	578	624	689	777	872	978
Services	1,718	1,751	1,747	1,673	1,655	1,718	1,783	1,867	1,995	2,122	2,279
Imports	4,652	4,773	5,260	4,985	5,106	5,319	5,739	6,298	6,697	6,923	7,224
Goods	3,054	3,254	3,647	3,525	3,460	3,640	3,958	4,412	4,701	4,806	4,907
Of which: Energy	361	449	642	702	594	625	680	758	808	826	843
Services	1,598	1,519	1,613	1,460	1,646	1,680	1,781	1,886	1,996	2,117	2,317
Income balance	-84	-90	-39	-73	-8	-61	-116	-107	-95	-85	-69
Of which: Interest due	45	50	92	94	51	115	167	182	212	224	229
Private transfers 1/	957	877	878	847	681	637	647	686	737	769	803
Official transfers	58	75	55	67	54	70	90	85	110	110	110
Financial account	1,016	811	912	758	995	909	832	1,412	1,608	1,380	1,173
Direct investment, net	672	769	609	648	893	962	1,162	1,309	1,234	983	929
Other capital	-34	125	145	-36	-2	-214	-108	32	386	523	430
Medium- and long-term loans (net)	378	-83	159	146	105	161	-222	72	-12	-126	-186
Project loans	396	174	221	233	233	331	276	276	228	195	174
Amortization	-18	-256	-62	-87	-129	-169	-498	-204	-240	-321	-360
Errors and omissions 3/	194	188	261	303	46	0	0	0	0	0	0
Net balance	-46	11	-39	116	49	-185	-493	-133	112	73	41
Available financing	47	-311	39	-116	-49	185	372	12	-112	-73	-41
Change in net reserves (increase = -) 2/	47	-311	39	-116	-49	-81	-26	-116	-112	-73	-41
IMF (budget support)						106	97	128	0	0	0
World Bank						161	0	0	0	0	0
Commercial loans (eurobond)						0	300	0	0	0	0
Prospective financing 4/	0	0	0	0	0	0	122	121	0	0	0
IFIs (World Bank, EU)						0	122	121			
Other						0	0	0	0		
Memorandum items:											
GDP in Euros	8,518	8,811	9,108	9,436	9,583	9,948	10,495	11,202	12,015	12,905	13,899
Gross usable reserves	1,621	1,922	1,875	1,983	2,024	2,102	2,123	2,235	2,345	2,417	2,457
(months of imports of goods and services)	4.1	4.4	4.5	4.7	4.6	4.4	4.0	4.0	4.1	4.0	3.9
Balance of goods and services (percent of GDP)	-25.2	13.3	15.4	16.2	18.1	18.7	19.2	19.8	20.4	20.9	21.1
Current account (percent of GDP)	-14.3	-11.2	-13.3	-10.0	-10.4	-11.0	-12.6	-13.8	-12.4	-10.1	-8.1
Underlying current account (percent of GDP) 8/	-14.0	-11.2	-13.3	-10.0	-10.4	-10.1	-10.0	-10.0	-9.7	-9.4	-8.1
Underlying current account (millions of euros) 8/	-1,190	-983	-1,214	-946	-994	-1,001	-1,050	-1,120	-1,160	-1,216	-1,131
Debt service (percent of exports of goods and services) 5/	2.1	9.7	1.9	1.1	1.3	4.7	14.9	6.6	6.9	8.0	7.4
Debt service (percent of central government revenues) 5/	2.5	12.9	2.5	1.4	1.8	6.8	21.6	9.7	10.3	12.0	11.3
Total external debt stock (percent of GDP) 6/	34.4	34.3	35.4	35.9	35.1	38.9	40.7	41.9	39.3	36.4	33.2
Volume of Exports of Goods and Services (percent change)	-6.0	23.7	11.3	2.5	15.3	10.3	10.1	10.7	10.7	9.8	10.0
Volume of Imports of Goods and Services (percent change)	1.1	-4.8	5.1	-9.0	4.4	5.5	9.1	9.9	6.2	3.2	4.3
Terms of trade (percent change) 7/	4.7	6.1	0.2	-0.1	-1.1	-1.0	-0.6	-0.3	-0.2	-0.1	-0.1

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 2009–13. In projections for 2014–19, valuation effects are assumed to be zero.

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

4/ Following the approval of the program, Fund purchases are reported under available financing. Similarly, funding by the World Bank for 2014 has been secured and is reported in available financing.

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.

8/ Excluding large investment projects (TAP, Statkraft).

Table 4a. Albania: Monetary Survey, 2009–14
(In billions of leks, unless otherwise indicated; end-period)

	2009	2010	2011	2012	2013	2014	
						Prog.	Rev. Prog.
Net foreign assets	244	339	389	451	479	503	511
Bank of Albania	214	253	256	267	274	289	288
Commercial banks	30	2	133	185	205	214	222
Net domestic assets	627	641	681	672	670	707	686
Claims on central government, net	336	341	359	351	363	394	380
Bank of Albania	66	55	54	52	43	52	43
Commercial banks	270	285	305	299	320	343	337
Claims on public enterprises	12	9	19	24	25	25	25
Claims on the private sector	422	465	513	521	513	518	527
In leks	133	149	177	192	195	191	200
In foreign currency	289	316	336	328	318	327	326
Other items, net	-144	-174	-209	-223	-231	-231	-246
Broad money	871	981	1,070	1,124	1,149	1,210	1,196
Currency outside banks	209	195	195	193	199	208	207
Deposits	662	785	875	931	950	1,003	989
Domestic currency	369	410	452	477	495	514	515
Foreign currency	293	376	423	454	456	489	474
Memorandum items:							
Broad money growth (% change)	6.8	12.5	9.1	5.0	2.3	4.6	4.1
Reserve money growth (% change)	4.8	-0.5	2.2	2.7	3.5	4.1	3.8
Private sector credit growth (% change)	10.3	10.1	10.4	1.4	-1.4	2.6	2.6
Broad money (as percent of GDP)	77.7	80.6	83.7	85.4	85.5	85.4	85.7
Private sector credit (as percent of GDP)	37.6	38.2	40.1	39.6	38.2	36.5	37.7
Velocity (nominal GDP/broad money)	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Money multiplier (absolute values)	3.1	3.5	3.7	3.8	3.7	3.7	3.7
Currency (as share of broad money)	24.0	19.9	18.2	17.2	17.3	17.2	17.3
Foreign currency deposits/total deposits	44.3	47.8	48.3	48.8	48.0	48.8	48.0
Gross reserves (millions of euros)	1,645	1,904	1,913	1,972	2,015	2,075	2,102

Sources: Bank of Albania; and IMF staff estimates.

Table 4b. Albania: Summary of Accounts of the Central Bank, 2009–14

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

	2009	2010	2011	2012	2013	2014	
						Prog.	Rev. Prog.
Net foreign assets	214	253	256	267	274	289	288
Assets	236	275	276	288	294	309	308
Liabilities	22	22	21	22	20	20	19
		2					
Net domestic assets	70	31	34	31	34	34	31
Domestic credit	100	70	81	75	66	70	64
Net claims on central government	66	55	54	52	43	52	43
Assets	77	64	64	65	65	65	65
Liabilities	11	9	10	13	22	13	22
Other credit	34	14	27	24	23	18	21
Private sector	2	2	2	2	2	2	2
Commercial banks	32	13	25	22	22	16	19
Other items, net (assets = +)	-30	-39	-47	-44	-32	-36	-32
Reserve money	285	283	290	298	308	323	320
Currency in circulation	209	195	195	193	199	208	207
Bank reserves	76	88	95	105	109	114	113
Other nonbank deposits	0	0	0	0	0	2	0

Sources: Bank of Albania; and IMF staff estimates.

Table 5. Albania: IMF Core Indicators of Financial Soundness, December 2007–March 2014

	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
I Capital-based														
(i) Regulatory capital as a percent of risk-weighted assets	17.1	17.2	16.2	15.4	15.6	15.9	15.7	15.9	16.2	16.8	17.0	17.8	18.0	17.9
(ii) Regulatory Tier 1 capital as a percent of risk-weighted assets	16.0	16.3	15.3	14.5	14.3	14.7	14.5	14.5	14.6	15.2	15.4	14.8	14.8	14.8
(iii) Capital as a percent of total assets														
Regulatory Tier 1 capital as a percent of total assets	5.8	6.7	8.7	8.6	8.1	8.3	8.0	7.9	7.9	8.2	7.9	7.7	7.7	7.6
Regulatory capital as a percent of total assets	6.2	7.0	9.2	9.1	8.8	9.0	8.6	8.6	8.8	9.0	8.8	9.2	9.3	9.2
Shareholders' equity as a percent of total assets	7.6	8.6	9.6	9.4	8.7	8.7	8.6	8.5	8.6	8.6	8.5	8.3	8.4	8.4
(iv) Nonperforming loans net of provisions as a percent of capital														
As a percent of regulatory Tier 1 capital	12.0	27.2	29.9	38.1	56.6	58.8	60.5	64.9	61.8	62.8	62.5	54.7	48.5	50.7
As a percent of regulatory capital	11.2	25.7	28.2	35.9	52.0	54.2	55.8	59.5	55.6	57.0	56.4	45.4	40.2	41.8
As a percent of shareholders' equity	9.1	21.1	27.1	34.8	52.6	56.0	56.3	60.8	56.9	59.4	58.4	50.7	44.8	45.8
(v) Return on equity (ROE) (annual basis)	20.7	11.4	4.6	7.6	0.8	8.0	4.8	4.2	3.8	5.2	2.9	-1.7	6.4	17.2
(vi) Net open position in foreign exchange as a percent of capital														
As a percent of regulatory Tier 1 capital	1.8	4.5	4.1	5.3	4.3	4.3	6.5	4.5	4.1	4.0	4.5	5.2	4.9	7.8
As a percent of regulatory capital	1.7	4.3	3.9	5.0	3.9	4.0	6.0	4.1	3.7	3.6	4.0	4.3	4.1	6.5
As a percent of shareholders' equity	1.4	3.5	3.7	4.9	4.0	4.1	6.1	4.2	3.8	3.8	4.2	4.8	4.5	7.1
II Asset-based														
(vii) Liquid assets as a percent of total assets (Liquid-asset ratio) 1/	49.8	42.8	27.6	25.9	26.5	29.0	35.9	29.0	41.9	41.9	43.3	43.6	42.7	49.3
(viii) Liquid assets as a percent of short-term liabilities 1/	55.6	104.7	32.6	30.6	33.1	36.1	36.0	35.8	34.9	34.9	33.8	36.5	34.7	39.1
(ix) Return on assets (ROA) (net income to average total assets, annual)	1.6	0.9	0.4	0.7	0.1	0.7	0.4	0.4	0.3	0.4	0.3	-0.1	0.5	1.5
(x) Nonperforming loans (gross) as a percent of total loans	3.4	6.6	10.5	14.0	18.8	20.1	21.1	22.7	22.5	23.7	24.2	24.2	23.5	24.0
III Income and expense-based														
(xii) Interest margin to gross income	92.7	106.5	119.6	118.9	147.7	119.7	129.5	130.6	130.4	123.6	131.2	148.3	112.6	95.4
(xiii) Noninterest expenses to gross income	58.5	69.6	83.0	75.5	91.3	71.7	80.4	82.2	85.0	78.7	87.5	98.3	74.7	89.4
IV Memorandum items														
Other (noncore) indicators:														
Customer deposits as a percent of total (non-interbank) loans	215.5	162.6	154.3	166.4	163.2	164.0	168.1	172.3	171.6	171.9	173.9	180.9	180.8	183.0
Foreign currency-denominated loans to total loans	72.5	72.6	70.2	69.8	67.9	68.2	67.1	66.5	64.5	64.8	64.5	63.7	63.0	62.6
Foreign currency-denominated liabilities as a percent of total liabilities	46.9	48.5	48.9	51.0	51.9	52.1	52.3	53.7	52.6	52.4	51.8	52.9	52.8	52.5
Other indicators:														
Risk weighted assets as a percent of total assets	36.4	40.8	56.7	59.2	56.5	56.3	55.2	54.5	54.2	53.7	51.7	52.0	52.1	51.5
Total loans as a percent of total assets	39.4	47.6	50.8	49.6	50.5	50.2	49.4	48.5	48.6	48.6	48.1	46.0	45.9	45.2
Total loans as a percent of shareholders' equity	516.4	555.1	530.2	527.0	581.9	578.8	575.5	573.6	567.4	562.4	566.7	555.0	548.8	536.2

Source: Data provided by Bank of Albania.

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

Table 6. Albania: Schedule of Review and Purchases 1/

Date	Amount (millions of SDR)	In Percent of Quota	Conditions
February 28, 2014	23.55	39.3	Board approval of arrangement
June 27, 2014	23.55	39.3	Observance of end-March 2014 and continuous performance criteria and completion of first review
September 15, 2014 2/	23.55	39.3	Observance of end-June 2014 and continuous performance criteria and completion of second review
December 15, 2014	23.55	39.3	Observance of end-September 2014 and continuous performance criteria and completion of third review
March 27, 2015	28.88	48.1	Observance of end-December 2014 and continuous performance criteria and completion of fourth review
June 28, 2015	28.88	48.1	Observance of end-March 2015 and continuous performance criteria and completion of fifth review
December 10, 2015	28.88	48.1	Observance of end-September 2015 and continuous performance criteria and completion of sixth review
June 28, 2016	57.29	95.5	Observance of end-March 2016 and continuous performance criteria and completion of seventh review
December 15, 2016	57.29	95.5	Observance of end-September 2016 and continuous performance criteria and completion of eighth review
Total	295.42	492.4	

1/ Albania's IMF quota: 60 million SDR.
2/ Planned Board date for the Second Review is October 17, 2014.

Table 7. Albania: Indicators to Capacity to Repay to the Fund, 2012–19 1/ 2/
(under Obligated Repurchase Schedule)
(In millions of SDRs)

	2012	2013	2014	2015	2016	2017	2018	2019
			Projections					
Fund repurchases and charges								
In millions of SDRs	6.8	6.8	3.4	6.1	6.1	7.4	10.6	27.0
In millions of euro	8.0	7.6	3.8	6.8	6.8	8.1	11.6	29.4
In percent of gross international reserves	0.4	0.4	0.2	0.3	0.3	0.3	0.5	1.2
In percent of exports of goods and services	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.6
In percent of GDP	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.3
In percent of external public debt	0.3	0.3	0.1	0.2	0.2	0.2	0.3	0.9
In percent of quota	11.3	11.3	5.6	10.2	10.2	12.3	17.7	45.1
Fund credit outstanding (end of period)								
In millions of SDRs	23.2	16.4	104.8	187.1	298.8	296.8	291.7	271.0
In millions of euro	27.2	18.4	117.6	208.5	331.1	326.8	319.3	294.8
In percent of gross international reserves	1.4	0.9	5.6	9.8	14.8	13.9	13.2	12.0
In percent of exports of goods and services	0.9	0.5	3.3	5.5	8.1	7.3	6.6	5.6
In percent of GDP	0.3	0.2	1.2	2.0	3.0	2.7	2.5	2.6
In percent of external public debt	1.0	0.7	3.8	6.2	8.9	9.0	9.1	8.9
In percent of quota	38.7	27.3	174.6	311.8	498.0	494.6	486.2	451.6
Memorandum items:								
Gross international reserves	1691	1803	1872	1905	2017	2130	2209	2259
Exports of goods and services	2727	3017	3188	3403	3688	4040	4406	4824
GDP	8045	8537	8861	9416	10107	10911	11791	10297
External public debt	2234	2350	2753	3040	3348	3283	3195	3051
Quota	60.0	60.0	60.0	60.0	60.0	60.0	60.0	60.0

Source: Fund staff estimates.

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

2/ End of year value.

Appendix I. Letter of Intent

Tirana, June 6, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C., 20431

Dear Ms. Lagarde:

1. The Extended Arrangement approved on February 28, 2014 by the Executive Board of the International Monetary Fund (IMF) is the main anchor of our economic policies. The attached Memorandum of Economic and Financial policies (MEFP) reviews progress in implementing the program, and outlines the policies that the government and the Bank of Albania will pursue during the rest of 2014 and first quarter of 2015.
2. Performance under the program has been satisfactory so far. All end-March quantitative performance criteria and structural benchmarks were met, except for the end May structural benchmark on contracting an external auditor to conduct risk-based audits of arrears payments, which was not met (but on which we are proceeding rapidly and expect to meet in the coming weeks). The indicative target on accumulation of new arrears was missed by a small margin, and inflation was slightly below the inner band prescribed under the inflation consultation clause. We are reinforcing internal controls to ensure that the government meets its payment obligations on a timely basis. Moreover, the Bank of Albania and Fund staff agreed that given the policy of cautious monetary easing and forward guidance, there was no need for other policy action regarding inflation. The Bank of Albania expects inflation to converge to the medium term target and is expanding the use of forward guidance to align expectations to its monetary policy objective.
3. Policy priorities for the remainder of 2014 and early part of 2015 focus on pursuing fiscal consolidation while advancing the payment of arrears, safeguarding financial sector stability and reviving credit growth, and preparing the groundwork for growth-enhancing reforms. In this context, we are committed to pursuing, among other things, pension and energy sector reforms, as well as fiscal reforms in the areas of public financial management, tax administration, and expenditure policy.
4. Implementation of our program will be monitored by the Fund through reviews, quantitative performance criteria and indicative targets, as well as structural benchmarks, as described in the attached MEFP and Technical Memorandum of Understanding (TMU). The reviews will assess progress in implementing the program and reach understandings on any additional measures that

may be needed to achieve its objectives.

5. While we are confident that the policies described in the MEFP are adequate to achieve program objectives, we stand ready to take additional measures that may be required for this purpose. In accordance with the Fund's policies, we will consult with the Fund on the adoption of such measures in advance of revisions to the policies contained in this letter and the MEFP.

6. The government of Albania will provide the IMF with such information as it may request to monitor progress in economic and financial policy implementation.

7. In view of the strong program performance to date and the strength of policy commitments in the period ahead, we request that the Executive Board of the IMF complete the first review under the Extended Arrangement and modification of performance criteria, as described in Table 1 of the MEFP. The Albanian authorities also request: 1) removal of the arrears clearance adjustor for the performance criterion on the general government overall cash deficit because the definition of the deficit already excludes arrears payment, and 2) the purchase of SDR 23.55 million, following completion of the first review by the IMF's Executive Board.

8. The Albanian authorities wish to make this letter available to the public, along with the attached MEFP and Technical Memorandum of Understanding (TMU), as well as the IMF staff report on the first review under the EFF. We therefore authorize their publication and posting on the IMF website, subject to Executive Board approval. These documents will also be posted on the official websites of the Albanian government.

Sincerely,

/s/

Shkelqim Cani
Minister of Finance

/s/

Ardian Fullani
Governor, Bank of Albania

/s/

Arben Ahmetaj
Minister of Economic
Development

Attachments: Memorandum on Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

1. This Memorandum lays out the economic program of the government of Albania, highlighting the key policy and structural reforms that we will be undertaking in the period ahead, supported by the IMF. Our economic policies are aimed at putting the Albanian economy on a path of sustained medium term growth that results in tangible gains, including employment generation and improvement in the standard of living of the Albanian population. We will undertake broad-ranging economic reforms that improve the business environment and remove the constraints that hamper economic development. We are committed to pursuing our growth objectives while enhancing macroeconomic stability and, in this regard, will strive to lower the debt related vulnerabilities that the country faces today by putting public finances on a sustainable footing.

I. RECENT ECONOMIC DEVELOPMENTS

2. **Real GDP growth continued to slow in 2013, falling to 0.4 percent from 1.2 percent in 2012 and 3.1 percent in 2011.** The fall in output growth reflected a further weakening in domestic demand, which was only partially offset by a modest improvement in net exports. From the production side, weaker growth reflected a sharp contraction in services output, despite modest growth in agriculture and industry and a rebound in construction activity that reflected the rise in public investment spending in the first half of the year. In line with the sharp slowdown in economic activity, the unemployment rate (as measured by the Labor Force Survey) jumped to 15.6 percent in 2013 from 13.4 percent a year before.

3. **The current account deficit increased to 10.4 percent of GDP in 2013, and remains a source of vulnerability.** The wider current account deficit partly reflected the rise in the fiscal deficit, but also included a temporary pull forward of imports during the fourth quarter in anticipation of increases in excise taxes. Remittances also dropped considerably in 2013, as Albanians working abroad continued to return home due to the weak economic outlook in the most popular destinations, Italy and Greece. This offset continued growth in exports from textiles and petroleum, as well as a rise in agricultural exports. The deficit was primarily financed through FDI inflows, which rose by 37 percent in 2013, partly due to the privatization of two hydroelectric plants. These nondebt creating sources of financing limited the increase in external debt, which amounted to 35 percent of GDP at year-end.

4. Consumer prices have been relatively stable, in an overall economic environment conducive to low inflation. Average CPI inflation rose to 1.9 percent (year-on-year) in the first quarter of 2014, up from 1.5 percent during the last quarter of 2013. The underlying trends point to a lack of both demand and supply side pressures, with weak aggregate demand and a negative output gap. In addition, low inflation in Albania's main trading partners together with a stable exchange rate and well-anchored inflation expectations have helped limit inflationary pressures.

II. FISCAL CONSOLIDATION

5. In 2014, the first quarter fiscal outturn was well within the program target. Total revenues increased by 10.1 percent (year-on-year), boosted by a rebound in VAT receipts. Despite the first quarter revenue improvement, prevailing uncertainty over the economic outlook and the durability of the rebound in tax collection warrants caution in revising our projection for the full-year. Expenditures were well below the planned level in the first quarter, as a review of the investment budget resulted in a significant under-execution of capital spending. With this review process completed, capital spending is expected to accelerate in the second quarter in order to catch up with the full-year plan. As a result, we maintain the original full-year fiscal deficit target under the program; for program monitoring purposes, we will add a quarterly ceiling on public expenditure as a performance criterion. We will consult with Fund staff before revising the budget.

6. We will implement further fiscal consolidation in 2015 in order to begin to bring down public debt. Over the medium-term, we aim to lower public debt from 72 percent of GDP at the end of this year to 69 percent by the end of the program with the IMF in 2016 and to well below 60 percent by 2019. We have already begun to identify possible measures to achieve the fiscal savings that will be needed next year, in order to ensure that the budget is prepared well in advance of the required timeline for submission to Parliament. We will work closely with our international partners, including the IMF, to strengthen our medium-term fiscal framework.

7. An external consultant has been hired to support customs administration, and began work in February. The first phase of the work has focused on a comprehensive review of existing procedures, and identified several key target areas where it will be working with customs staff to strengthen processes and ensure that regulations are consistently and properly applied. Over the medium-term, a key priority will be to move away from reference pricing and introduce transaction value as a basis of assessing customs duties, in line with international best practice in this area. We

will also be moving forward with several initiatives to rein in corruption, including the introduction of a code of ethics for staff, with criminal penalties for those in violation, as well as electronic monitoring and reporting systems to limit scope for corruption during inspection procedures.

8. We are in the process of implementing a series of measures to increase tax compliance and reduce fraud. We will launch a public awareness campaign beginning in June 2014 through media on the importance of paying taxes. We also plan to implement lotteries on sales receipts in the second half of the year to give consumers more incentives to request receipts in market transactions. To reduce fraud in VAT and CIT refunds, we have started to carry out more thorough verifications of refund claims, and in 2015, will change the verification process to link it directly to businesses' online tax payment records, so as to reduce the risk of corruption. Undertaking the verifications electronically will also help in expediting the refund process. The successful rollout of the new IT system remains a top priority in improving the efficiency of tax administration. Finally, we have also introduced a number of steps to simplify tax procedures and lower administrative costs for taxpayers, based on recommendations from a joint project with the IFC.

9. We are preparing an updated VAT law, which we expect will be approved by Parliament to take effect at the beginning of 2015. The revised law has been prepared in cooperation with the European Commission, and is intended to harmonize the VAT regime in Albania with EU directives and comply with accession requirements under the *acquis communautaire*. VAT receipts remain our primary source of fiscal revenue, and we are committed to a broad-based and simple VAT system with few exemptions, in line with the EU directive.

10. We are implementing measures to curb abuse of social assistance and disability benefits. The rapid expansion in claims for these benefits in recent years has become a growing fiscal burden, with insufficient means-testing and verification procedures in place to ensure that the benefits are limited to those who qualify. In order to reduce abuse of the system, we are in the process of introducing an electronic database that allows us to cross-check claims for social benefits against public filings, including tax records, in order to verify eligibility. In addition, we have introduced the penalty of criminal prosecution for fraud in order to deter false claims, and intend to prosecute those who have abused the system at the expense of those truly in need. We are already seeing a decline in claims for social benefits as a result of these measures to curb fraud, and expect to achieve a reduction of 10 percent for 2014 as a whole. There has also been a small decline in

disability claims in 2014, although so far it appears likely to be less than the large decrease envisaged in preparing this year's budget.

11. We have accelerated our work on pension reform in order to ensure that the plan can be introduced from the beginning of 2015. The pension reform strategy was presented for public consultation in April; we intend to draft a new law on social insurance following consultation with key stakeholders, and submit to Parliament for approval by July, to ensure that the new scheme will be able to go into effect at the beginning of 2015. The proposal, developed in cooperation with the World Bank, envisages a number of key changes in order to close the large financing gap in the current scheme:

- Replacing the current basic pension plus 1 percent of own earnings base, subject to a relatively low ceiling on the maximum pension, with a smaller social pension plus 1 percent of own earnings base, with no maximum ceiling. This will provide a living minimum pension for those without sufficient years of contributions to qualify for a regular pension, but remove the ceiling on benefits that currently serves as a disincentive for higher income earners to declare their full salary.
- Indexing increases in the level of pensions strictly to inflation, and eliminating the scope for discretionary changes by the government.
- Increasing the minimum contributory wage to the official minimum wage for all contributors and indexing the ceiling for contributions to average wage growth.
- Gradually increasing the retirement age for both men and women to 67 by 2056;
- Equalizing the contribution in rural areas with that of urban areas by 2017.
- Replacing the supplemental schemes currently attached to pensions with targeted social assistance.

12. We recognize that the cost to pay compensation owed for expropriated land is not fiscally sustainable under the current scheme. This issue needs to be addressed quickly in order to resolve the growing uncertainty over the fiscal implications. We are seeking an extension of the current moratorium at the European Court of Human Rights on qualifying cases pertaining to the pilot judgment until June 2015. This would provide a sufficient window to allow us to review the law and the existing scheme, undertake a comprehensive review of the claims that have been filed, and complete ongoing work on the cadastre update that is essential in order to fairly assess the claims that have been brought forward. An inter-agency working group headed by the Deputy Prime Minister is working to identify available land for compensation in-kind. We are committed to finding

an equitable solution that provides a fair settlement to those owed compensation, within the scope of Albania's fiscal capacity to meet these obligations.

13. The large stock of project commitments outstrips our capital spending envelope and raises the prospect of a recurrence of arrears in the future. A particularly large stock of projects has accumulated in the transport sector. We intend to carry out a review of these outstanding commitments and establish a clear prioritization by the end of 2014, with lower priority projects to be legally postponed or cancelled in order to align existing commitments with our medium-term expenditure envelope. Until this process has been completed, there is very little, if any, scope for new investment projects to be undertaken.

14. We are also moving forward with local government reform to consolidate the large number of small local units into a more efficient structure. Weakness in local government administration adds to fiscal risks and hampers the effective delivery of services. The reform will be based on an analysis of the optimal size and functions of local government units, with a goal to have the required legislative changes passed through parliament by mid 2015, so that next year's local government election can be organized according to the new local government structure.

15. We have initiated the preparatory work to move toward a valuation-based property tax reform. We are working with our international partners to conduct an assessment of the technical work required in advance. The key challenge is the establishment of the fiscal cadastre, which will assign a unique number to every property, as well as the appraised value, which will be used as the basis for assessing property tax. The establishment of the fiscal cadastre will be facilitated by the digitization of property records by the office of immovable properties, a process which is ongoing with the support of the World Bank.

III. PREVENTION AND CLEARANCE OF GOVERNMENT ARREARS

16. We have begun to clear arrears, adhering closely to the arrears prevention and clearance strategy (APCS) approved in January. Although there was some delay early in the year, the oversight function of the High State Audit has been established as envisaged under the strategy. In addition, we intend to engage the internal auditor of the Ministry of Finance to verify the arrears payments. Through May 2, 13.1 billion lek have been approved for payment, of which 8.7 billion lek have so far been paid. Roughly 2/3 of these relate to unpaid VAT refunds, with the remainder

pertaining to capital investment projects. The breakdown of individually cleared arrears, by amount, and result of the external auditor's findings will be published quarterly on the Ministry of Finance website (continuous structural benchmark).

17. We are working with the EU to contract an external auditor (structural benchmark, end May, 2014) and to perform ex-post risk-based audit of randomly chosen cases. The tender for an auditor to review contractor arrears is already in process, and we expect the auditor to be in place and in a position to complete its first audit by July 15 (structural benchmark, July 2014). The tender for an auditor to review tax arrears will be launched soon; we expect this to be finalized by the end of September (structural benchmark, September 2014). We intend to move as quickly as we can with arrears clearance once these auditors are in place, while fully respecting the due diligence and verification process specified in the APCS. We will align the pace of arrears clearance with the work of the external auditor in the interim, in order to ensure that they are able to perform their intended function in verifying that the repayment process adheres to the APCS. As a result, we will limit the amount of arrears cleared to 25 billion lek by the end of August 2014 to ensure that arrears clearance proceeds in accordance with the APCS, and to safeguard the integrity of the process; we will consult with Fund staff should arrears clearance exceed this amount. Any VAT refund claims submitted after 2013 for VAT paid before December 31, 2013 will be subject to full ex-ante audits.

18. We have introduced several measures to improve reporting and approval procedures for multi-year commitments, as required under the program. An instruction issued in February obliges all local government units to report new procurement orders with three-year ceilings (structural benchmark, March 2014). We will also begin introducing multi-year commitment limits with the 2015 budget (structural benchmark, December 2014). The MoF issued an instruction in March requiring line ministries and central institutions to submit their planned commitments for 2015 in line with the 2015–17 medium-term budget ceilings. The terms of reference for the changes to the Treasury system to include multi-year commitments (spending unit levels) are to be finalized and effective by September 2014 and operational starting from the beginning of 2015 (in full compliance with the 2015 budget implementation). We will also amend the relevant laws in 2014 to legally enforce the commitment limits.

19. We have also introduced measures to avoid delays in payment of VAT refund claims. In February, the Ministry of Finance issued the instruction on the new system for payment of VAT refund claims through the Treasury. According to this instruction the Tax Administration Department

(TAD) within 5 days of receiving the VAT refund claim, sends the notification and the respective information to the Treasury. Based on this information, the Treasury insures that the necessary funds to make the payment are available. After the Tax Administration assessment, within 25/55 days, the VAT refund payment order is send by TAD to Treasury for payment. All VAT refund payments are regularly published on the MoF website upon execution.

20. We will continue to strengthen financial data reporting of government agencies. The quarterly survey of arrears accumulation, conducted for the first time in April 2014 to collect information on all unpaid obligations of five central government ministries will continue in August, and be expanded to include the GDT (continuous structural benchmark). We will continue to provide a consolidated survey of the report to the IMF, within 75 days after the end of each quarter. The survey will be expanded further in October to cover an additional 5 ministries (continuous structural benchmark, beginning in October). The results of the survey for March showed 360 million lek (about 0.03 percent of GDP) of new arrears during this period; these largely reflected delays on the part of these institutions in registering the bills with the Treasury in sufficient time to receive payment. Instructions have been issued that should avoid these delays in the future, and we expect that any arrears discovered through this process will be cleared promptly. There were no new government external arrears outstanding at the end of March, in line with the continuous performance criteria under the program.

IV. MONETARY AND EXCHANGE RATE POLICY

21. The BoA remains committed to preserving price stability under an inflation-targeting framework. As defined in our medium-term strategy, the BoA aims to achieve average CPI inflation of 3 percent over the medium term, with a tolerance band of +/-1 percentage point to account for supply side shocks and inflation inertia. The monetary policy decision-making process will be guided by the deviation of forecasted inflation from this objective, while striving to avoid excessive volatility in the real and financial sector. While the target applies to headline inflation, we will also monitor core inflation as a measure of underlying inflationary pressures. The inflation performance will continue to be monitored under the program through an inflation consultation clause (see TMU).

22. The exchange rate remains fully flexible and determined entirely by market forces. The BoA relies on indirect instruments to steer financial market interest rates and conducts its monetary policy through open market operations. This regime complements our price stability objective and

supports our operational framework of monetary policy. The BoA will also aim to maintain adequate reserve coverage over the program. Net international reserves were higher than the floor specified under the program for March, with reserve coverage comfortably above the level prescribed by most standard reserve metrics. For the duration of the program we will not, without Fund approval, introduce or intensify restrictions on the making of payments and transfers for current international transactions, nor introduce or modify any multiple currency practices or conclude any bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement. Moreover, we will not introduce or intensify import restrictions for balance of payments reasons.

23. The lack of inflationary pressure expected over the medium-term has provided scope for further monetary easing. Since October 2013, we have reduced the main policy rate by a cumulative 1 percent, to a new historical low of 2.5 percent. The easing of monetary policy aims to support domestic demand, in line with our commitment to price stability and to maintain inflation expectations anchored to our CPI inflation target of 3 percent. However, the transmission to long term interest rates and to credit growth remains hampered by uncertainty over the economic outlook and banks' risk aversion. Credit to the private sector contracted by 2.1 percent in the twelve months through March. (Excluding several transactions where a package of loans was sold to nonbanks, the level of credit was unchanged). In order to improve the transmission of monetary policy, we have refined and extended our communication framework, by adopting a forward guidance with regard to the future of monetary policy. The BoA will continue to exercise caution on further monetary easing, and remain cognizant of possible exchange market pressures and financial market stability.

24. The inflation-targeting framework continues to successfully anchor inflation expectations. In spite of large disinflationary shocks to the economy, inflation has remained just outside the inner band of our inflation consultation performance criteria, and we expect a gradual convergence of inflation to its 3 percent target rate in the medium term.

V. SAFEGUARDING FINANCIAL SECTOR STABILITY

25. Several measures have been introduced to accelerate collateral execution procedures and encourage the write-off of nonperforming loans. The early results from the changes in the Civil Procedures Code that were introduced in September 2013 have been encouraging, with increase of 8.9 percent (year-on-year) in recovered amounts realized through the collateral execution

process. In addition, on February 27, the BoA approved a change in the regulation on credit risk management, specifying when a loan should be classified as “loss,” and requiring banks to write-off all the loans that have been in the ‘loss’ category for more than 3 years. These changes will enter into force on January 1, 2015. These measures are expected to facilitate more proactive management of NPLs by banks and encourage them to clean their balance sheets. In addition, a project with the World Bank to facilitate the restructuring of problem loans continues to move forward.

26. The MoU on operations of the FSAG was revised in line with the recommendations

from the recent FSAP (structural benchmark, March 2014). The MoU was adjusted: to remove ‘development of the financial market’ as an objective of the FSAG (and focus FSAG in ‘systemic risk management’); to introduce a requirement for organizing regular meetings of the FSAG every three months; to introduce the Technical Supporting Group (along with its functioning procedures, as an Annex of the MoU) which will meet monthly; to include as an Annex to the MoU the functioning procedures of the FSAG’s Secretariat; and to streamline the content of the document (compared to the previous one).

27. The regulatory framework on collateral eligibility for monetary operations was also revised in line with recommendations from the FSAP (structural benchmark, March 2014). The

purpose of the changes was to expand collateral eligibility for monetary operations to include government securities of all maturities, as opposed to only those with a maturity of one year or less under the previous regulation. To this end, the relevant regulations were amended to change the definition and establish the eligibility of government bonds to be used as underlying securities in repo and reverse repo transactions and determine appropriate haircuts for these securities.

28. Changes to strengthen the supervisory framework for the nonbank financial sector are moving forward, as recommended by the FSAP.

Legislation to improve the supervisory and operational independence of the Albania Financial Supervisory Authority (AFSA) has been submitted to Parliament (structural benchmark, March 2014). We firmly support the importance of an independent and capable AFSA as essential to ensure proper oversight of the fast-growing nonbank sector in Albania, and will work to ensure that the full package of laws (the amended AFSA law, new insurance law, and amendments to the Civil Servant Law and the Law on Salaries of Independent Institutions) are approved by Parliament with no substantial changes from what was originally submitted. In addition, work has begun on changes to the regulatory framework for investment funds to introduce liquidity and capital requirements and mark to market calculations for net asset

value, with the new regulations expected to be in place by mid-year (structural benchmark, September 2014).

29. In line with the latest recommendation of the FSAP, the BoA has adopted a number of changes to strengthen their stress-testing toolkit. These include more stringent assumptions in the adverse scenarios used in top-down stress-testing, and more elaborate simulations for credit and market risk in the bottom-up stress tests. In addition, where banks appear to have persistently underestimated NPL performance in their own stress testing exercise, the BoA will provide stricter guidelines on the required assumptions. Finally, a new stress-testing methodology to be applied for liquidity risk has been developed by the BoA in cooperation with the FSAP team.

30. We will strengthen audit, financial internal control and other procedures in line with recommendations of the recent IMF safeguards mission. The BoA will take steps to harmonize the bank's internal audit procedures with leading international governance practice, as recommended by the safeguards mission. Also in line with the advice of the safeguards mission, the BoA will discontinue the practice of advanced distributions of monthly profits to the MoF, in order to align with international best practice.

VI. STRUCTURAL REFORMS

A. Business Climate

31. The government is moving forward with several initiatives to improve the business climate and streamline registration procedures in Albania. A MoU has been signed with the EBRD to create an Investment Council, under the National Economic Council, which will work with foreign investors to improve communication with the government and ensure timely resolution of problem issues. The IFC is also currently conducting a thorough analysis of the Doing Business Report on Albania, which will identify the key problems of the respondents. As a second stage, in June, a cross-institutional working group will be established to address the specific issues and suggest any necessary legal and procedural changes. In addition, we are also moving forward with the creation of a "virtual service window" at the National Registration Center that will allow businesses to register online, which should result in a significant reduction in the time needed to register. The private sector has responded favorably to our initiatives to improve the business environment. The upgrade of the cadastre and formalization of land registration is also essential to

attract foreign investors, who are often deterred by the uncertainty over property rights and land ownership in the current system.

B. Energy Sector

32. The failure to resolve longstanding problems in Albania's electricity sector has resulted in growing risks to both the budget and growth. Albania's electricity generation is almost entirely dependent (98 percent) on hydropower. Variations in rainfall cause enormous variation from year to year in the costs of meeting electricity demand and pose a major risk to electricity supply. Beyond weather, the energy sector's problems have been compounded by several other factors: high distribution losses; a lack of adequate and timely tariff adjustment; and an ongoing law suit between the former private owner of the distribution company and the government. The very low rate of collection from consumers has resulted in a liquidity shortfall throughout the sector, with reliance on either government guarantees or direct financing from the budget to finance import needs.

33. Our goal is to secure Albania's energy supply and security over the medium term. This will require increased domestic power generation, reduced distribution losses, and improved integration with regional and European energy systems. Under the arrears clearance strategy approved in early April, the government has netted off 4.4 billion lek in inter-company debts that have accumulated between the government and the generation and distribution companies and retained external, independent auditors to audit disputed energy sector arrears. We have established a Task Force for energy sector reform, which is not only taking immediate actions to reduce energy losses, but also developing a strategy in cooperation with the World Bank to phase out explicit and implicit fiscal support of the electricity sector by the end of 2016.

- *Short-term measures:* (i) The Task Force in collaboration with other law enforcement agencies is identifying the consumers who are receiving illegal electrical services and cutting them off the grid until there is a request to re-connect legally. (ii) As a stop-gap measure to contain the financial losses in the sector, the energy regulator has introduced a flat tariff for non-metered consumers. (iii) The authorities will issue a regulation to move high voltage commercial customers to the open market subject to technical and economic assessment by June 2014. Through these measures, we intend to achieve an improvement in collections by the distribution company (CEZ) of 10–15 percent this year, with a reduction in electricity

losses to 35 percent of total production, from 50 percent in 2013. This would also mitigate the need for budgetary financing for imports in 2014.

- *Medium-term measures:* The short-term measures will be followed by specific investments to reduce losses (e.g., installation of smart meters and grid), and amendments to the Power Law and the Renewable Energy Law. These amendments will change the market model, update the regulatory tariff framework to bring energy tariffs closer to cost recovery in the sector and revise the prices for feed-in energy produced by small private hydro-electric companies. This will be supported by an ongoing study by the government to clearly identify the types of customers that require subsidies for electricity. The Task Force will recommend changes in all laws relating to the power sector, including all the necessary supporting regulations, in order to have a revised market model ready by December 31, 2014.
- *Longer-term measures:* Several new important generation projects, such as the Devolli HEC and Skavica HEC, are beginning to move forward, while several others are almost finished and are soon expected to be fully operational, such as Ashta 1 HEC and Ashta 2 HEC. We will undertake an analysis on the feasibility of the Interconnection project with Italy and also the Master Plan for the gasification of the country, given the possibilities presented by the TAP Project. We intend to closely collaborate with the World Bank on the medium and long-term reform measures through an investment operation in coordination with other IFIs.

C. Statistics

34. INSTAT is working to strengthen data sources and dissemination procedures. In line with the European Statistics Code of Practice, INSTAT has started to implement the system of country-wide administrative data exchange for statistical purposes. The Joint Directive for inter-agency data sharing, which provides a framework for data exchange and collaboration among government bodies, has been drafted with support from IMF technical assistance, and initial bilateral technical discussions have been conducted. The next step is for INSTAT to submit the Directive to the Council of Ministers to launch the procedure to establish inter-government data sharing protocols. We are working to shorten the production cycle of national accounts statistics, and plan to disseminate a monthly industrial production index.

35. We will take steps to improve the quality of fiscal data. The MoF will introduce internal controls before releasing fiscal data, and will align the definition of external and domestic public debt across all departments within the MoF. In addition, the MoF and the BoA will strengthen interagency cooperation in compiling external debt statistics.

VII. PROGRAM MONITORING

36. We anticipate that the second, third, fourth, and fifth reviews will take place on or after September 15, 2014; December 15, 2014; March 27, 2015 and June 28, 2015, respectively. These reviews will require observance of the conditionality for end-June 2014, end-September 2014, end-December 2014 and end-March 2015, respectively.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets for 2014–15 1/
(In billions of leks, unless otherwise indicated)

	2013		2014								2015
			Mar		Jun		Sep		Dec		Mar.
	Act.	Prog.	Prog. Adj.	Act.	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Prog.
I. Quantitative Performance Criteria											
1. Floor on net international reserves of the BoA (EUR million)	...	1289		1463	1289	1330	1289	1330	1289	1330	1435
2. Ceiling on general government overall cash deficit excluding arrears payment (cumulative)	...	16.0	15.9	2.0	26.6	20.3	33.4	31.6	56.8	58.8	8.4
3. Ceiling on general government expenditure, excluding arrears payment (cumulative)	...	...	...	...	...	194.9	...	300.9	...	423.5	103.9
II. Continuous Performance Criteria											
4. Accumulation of new external payment arrears by the general government (EUR million)	...	0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
III. Inflation Consultation											
5. 12-month percent change in consumer prices											
Upper outer band		5.0			5.0	5.0	5.0	5.0	5.0	5.0	5.0
Upper inner band		4.0			4.0	4.0	4.0	4.0	4.0	4.0	4.0
Actual/center point	1.9	3.0		1.9	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Lower inner band		2.0			2.0	2.0	2.0	2.0	2.0	2.0	2.0
Lower outer band		1.0			1.0	1.0	1.0	1.0	1.0	1.0	1.0
IV. Indicative Targets											
6. Ceiling on the increase of Bank of Albania credit to the general government (cumulative)	...	0.0		-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
7. Ceiling on accumulation of central government domestic arrears (as reported by MoF's quarterly survey on arrears accumulation)	...	0.0		0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
8. Floor on clearance of central government domestic arrears 2/	...	0.0		1.0	0.0	1.0	0.0	1.0	14.2	14.2	4.0
Source: Albanian authorities; and Fund staff estimates and projections.											
1/ All adjustors are described in the Technical Memorandum of Understanding (TMU).											
2/ General government for March, 2014.											

Table 2. Albania: Structural Benchmarks for 2014–15 under the Extended Arrangement under the EFF

Conditionality	Test Date	Status	Remarks
Structural Benchmarks			
I. Public Financial Management			
<i>Arrears Clearance</i>			
1. Contract an external auditor with a mandate to conduct risk-based audits of arrears payments.	End-May 2014	Not met	In process. Government expects to complete in the coming weeks.
2. Publish a report on arrears paid (on a quarterly basis) on the MoF website (starting in June, 2014).	Continuous		
3. The external auditor to complete first audit of arrears payment.	July 15, 2014		
4. The external auditor to complete auditing of 20 percent of outstanding non-tax claims paid during January–June, 2014.	End-Sept. 2014		
5. Contract an external auditor to conduct verification of arrears payments on tax refunds (see TMU).	End-Sept. 2014		
6. MoF to purchase a new IT server for the treasury system.	End-Sept. 2014		
<i>Arrears Prevention</i>			
1. MoF to issue instructions to all local governments to report all new procurement orders to MoF starting September, 2014.	End-March 2014	Met	
2. MoF to report quarterly survey results on new arrears accumulation (starting with the period from January-March, 2014) among five key ministries (Ministries of Transportation, Health, Education, Defense, and Justice), and GDT (starting with the period from April-June, 2014).	Continuous	Met	
3. MoF to expand the reporting of quarterly survey on arrears accumulation to five additional ministries (Ministries of Interior, Agriculture, Finance, Economy, and Social Welfare) (starting with the period from October-December, 2014).	Continuous		
4. Introduce multi-year commitment limits (the limits on commitments made in the current year for both the current year and each outer-year) in the 2015 budget, and change the Procurement Law, the Financial Management and Control Law, and the Budget Law accordingly.	End-December 2014		

Table 2. Albania: Structural Benchmarks for 2014–15 under the Extended Arrangement under the EFF (Concluded)

Conditionality	Test Date	Status	Remarks
II. Tax Administration			
1. The GDT to develop a corporate strategy for medium to long term capacity building.	End-Dec. 2014		
2. Establish and commence operations of a permanent Risk Management Unit (RMU) in GDT (see TMU).	End-March 2015		
III. Expenditure Policy			
1. Establish a Pension Reform Commission to devise a reform strategy of the pension system.	End-March 2014	Met	
2. Council of Ministers to approve a pension reform strategy.	End-Dec. 2014		
IV. Financial Sector			
1. Amend the MOU covering operations of the inter-agency Financial Sector Advisory Group (FSAG) to: (i) require technical-level meetings every month (in addition to the existing three-monthly high-level meetings); and (ii) exclude financial development from the mandate of the FSAG.	End-Mar. 2014	Met	
2. In agreement with BoA and Albanian Financial Supervisory Authority (AFSA), amend the regulatory frame work for investment funds on asset valuation, liquidity requirement, and capital adequacy requirement.	End-Sept. 2014		
3. BoA to amend the regulatory framework that applies the same collateral standards to all monetary operations of the BOA (including repurchase and reverse repurchase agreements) and expands collateral eligibility to all negotiable securities issued by the government of Albania.	End-Mar. 2014	Met	
4. Present to parliament an amended AFSA law, a new insurance law, and amendments to the Civil Servant Law and the Law on Salaries of Independent Institutions, to improve AFSA supervisory and operational independence, in line with FSAP recommendations (see TMU).	End-Mar. 2014	Met	

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) defines the indicators used to monitor developments under the program, according to the understandings between Albanian authorities and IMF. The TMU also defines the associated reporting requirements.
2. The exchange rates for the purposes of the program of the lek to the euro is set at lek 140.25 = €1, to the U.S. dollar at lek 103.17 = \$1, and to the SDR at lek 158.05 = SDR 1. The gold price in euro is set at 920.18 oz = €1. These are the rates shown on the Bank of Albania's website as of November 30, 2013.¹
3. For the purpose of the program, the central government includes the central government and extra-budgetary funds. The general government includes the central government, the local governments, the Social Security Institute (SSI), and the Health Insurance Institute (HII).
4. The fiscal year starts on January 1 and ends on December 31.

I. QUANTITATIVE PERFORMANCE CRITERIA

A. Floor on Net International Reserves of the BoA

Definition

5. Net international reserves (NIR) are defined as reserve assets minus reserve liabilities of the Bank of Albania. **Reserve assets** are readily available claims of the Bank of Albania on nonresidents denominated in foreign convertible currencies, and held for the purpose of meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include Bank of Albania holdings of monetary gold, SDRs, Albania's reserve position in the IMF, foreign currency cash, securities, and deposits abroad. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).
6. **Reserve liabilities** are defined as foreign exchange liabilities to residents and nonresidents of the Bank of Albania, irrespective of their maturity. They include: foreign currency reserves of commercial banks held at the Bank of Albania; foreign currency deposits of the government held at the Bank of Albania; all credit outstanding from the IMF that is a liability of the Bank of Albania; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies. Reserve assets and reserve liabilities will both be expressed in euros, at the program exchange rate.

¹http://www.bankofalbania.org/web/Time_series_22_2.php?evn=agregate_detaje&evb=agregate&cregtab_id=644&periudha_id=1

Reporting

7. Data will be provided by the BoA to the Fund with a lag of no more than five days past the test date.

Adjustor

8. **The floor on net international reserves** of the BoA will be adjusted downward by any shortfall in external budget support relative to the programmed amount. Budget support is defined as non-project financial assistance that is provided to the central government. The programmed amount of budget support in 2014 is lek 60 billion.

B. Cumulative Ceiling on General Government Overall Cash Deficit Excluding Arrears Payments

Definitions

9. **The overall cash deficit of the general government** will be measured from the financing side (below the line) at current exchange rates, based on the template below:

CASH BALANCE	Code
Financing (Cash)	
Domestic	
Privatization receipts	B/1160000-116ZZZZ
Domestic borrowing	
Central	000-009/1600000-169ZZZZ
Local	010-999/1600000-169ZZZZ
Other	
Change in balance of TSA bank account	001/010-ZZZ/5120100/TH000; 001/5120100/TH008; 001/5120100/TH009; 001/5120100/TH010; 5120100/TH011
Change in balance of S&HII's bank account	5000000-54ZZZZZ/5800000-58ZZZZZ
Trust accounts (3020)	4660000-466ZZZZ
On-Loan's Principal (3030)	2500200
Liability to SSI (3015) (receipts (3016) minus payments (3017))	4351291; 4351298-4351299
Variance Accrual-Cash [4030=4019 (4011->4018)-4029(4021->4028)]	More detailed codes submitted to staff
Float (3060)	001/5200000/B0000-52ZZZZZ/BZZZZ
Transitory accounts - Guaranties on Custom Duties (3021)	4701100
Others-Float (mean time)	
Foreign	
Long-term Loan(Drawings) (1010=2600(00/1700000-99/174ZZZZ)/1030/1040)	
Change of statistical account (1040)	More detailed codes submitted to staff
Repayments 1030= (2081->2082)	More detailed codes submitted to staff
Memo: arrears clearance	

- 10.** In determining the overall cash balance, the following considerations will apply²:
- Privatizations: Privatization receipts should be reported on a gross basis.
 - Domestic borrowing: Domestic borrowing is reported on a net basis and is determined on the basis of the residency criterion. It covers bank loans, securities issued, overdraft accounts, and other debt instruments, less government deposits.
 - Other: “Other” refers to the change in the Single Treasury Account, the accounts of Special Funds, and other transitory accounts.
 - Foreign borrowing: Foreign borrowing is reported on a gross basis and is determined on the basis of the residency criterion. It covers disbursements by international financial institutions, bank loans, securities issued, overdraft accounts, and other debt instruments.
 - Change of Statistical Account: This item covers balances held by nonresidents in financial institutions for project-related spending.
 - Repayments: This item refers to all payments to nonresidents related to disbursements by international financial institutions, bank loans, securities, overdraft accounts, and other debt instruments.
- 11.** Excluded from the calculation of the overall cash deficit of the general government are the arrears payments to be made in the context of the Arrears Prevention and Clearance Strategy (APCS). The amount of arrears paid will be identified using the verified arrears list and matching the list with the Treasury payment records. A summary of the total amount of arrears paid under the clearance strategy, as defined above, will be provided on a monthly basis.

Reporting

12. Data, including the amount of arrears payments under the APCS, will be provided to the Fund using current exchange rates with a lag of no more than 30 days after the test date for March, June, and September test dates. For December test dates, data should be provided no more than 60 days after the test date.

Adjustor

13. The ceiling on the overall cash deficit of the general government will be adjusted upward (downward)—that is, the deficit target will be increased (reduced)—by 50 percent of the privatization receipts, up to total privatization receipts of lek 14 billion in a given year. The programmed amount of privatization receipts in 2014 is lek 400 million.

² All cash balance data come from Treasury.

C. Cumulative Ceiling on General Government Expenditure Excluding Arrears Payment

Definitions

14. General government expenditure is defined as general government spending on personnel, interest, operations and maintenance, subsidies, social insurance outlays, local government expenditures, other expenditures (social protection transfers), capital expenditure, reserve and contingency funds, and net lending, as reported in the government's monthly fiscal indicators table. For the purpose of this target, arrears payments are excluded from the calculation. The amount of arrears payment is identical to the number used in the calculation of the performance criterion on cash deficit (Section B).

Reporting

15. Data will be provided to the Fund using current exchange rates with a lag of no more than 30 days after the test date for March, June, and September test dates. For December test dates, data should be provided no more than 60 days after the test date.

II. CONTINUOUS PERFORMANCE CRITERIA

A. Accumulation of New External Payment Arrears by the General Government

Definitions

16. External debt is determined according to the residency criterion. The term "debt"³ will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

- Loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);
- Suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

³ As defined in Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, Decision No. 6230-(79/140), as amended.

- Leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property. For the purpose of the program, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

17. Under this definition of debt set out above, external payments arrears consist of arrears of external debt obligations (principal and interest) falling due after the due date and grace period, as specified in the contract, has passed. Arrears resulting from nonpayment of debt service for which a clearance framework has been agreed or rescheduling agreement is being sought are excluded from this definition.

18. The external arrears of the general government will be calculated based on the schedule of external payments obligations reported by the MoF. Data on external arrears will be reconciled with the relevant creditors, and any necessary adjustments will be incorporated in these targets as they occur.

19. This performance criterion does not cover arrears on trade credits.

20. The performance criterion will apply on a continuous basis.

Reporting

21. The MoF will provide the final data on the external arrears of the general government to the Fund, with a lag of not more than two weeks after each month.

Adjustor

22. The performance criterion on the accumulation of new external payment arrears by the general government will exclude any arrears relating to obligations prior to 2014 and which existed prior to the program but are now recognized.

III. INFLATION CONSULTATION

23. **The quarterly consultation bands apply to the 12-month rate of inflation** in consumer prices (as measured by the headline consumer price index (CPI) published by the INSTAT). Should the observed year-on-year rate of CPI inflation (quarterly average) fall outside the outer bands, the authorities will complete a consultation with the IMF on their proposed policy response before requesting further purchases under the program. In addition, the BoA will

conduct discussions with IMF staff should the observed year-on-year rate of CPI inflation (quarterly average) fall outside the inner bands specified for the end of each quarter.

IV. INDICATIVE TARGETS

A. Ceiling on Accumulation of Central Government Domestic Arrears

Definition

24. Central government domestic arrears consist of domestic expenditure arrears of the central government and domestic tax refund arrears. Domestic expenditure arrears are defined as payments to residents determined by contractual agreements that remain unpaid 60 days after the due date specified by the contract, or, in the absence of a contractual definition, as determined by the law.

25. Domestic tax refund arrears are defined as obligations on any valid tax refund claims in accordance with tax legislation that remain unpaid 90 days after the claim is submitted.

26. For the purpose of this target, the accumulation of domestic arrears will be monitored through MoF's quarterly survey on arrears accumulation. The first survey, to cover the period from January-March 2014, will include the following part of the central government: Ministries of Transportation, Health, Education, Defense, and Justice. The next survey, to cover April-June 2014, will be extended to cover the General Directorate of Taxation. The Ministries of Interior, Agriculture, Finance, Economy, and Social Welfare will also be added in the survey for October-December 2014. These surveys will continue to be conducted quarterly on a continuous basis, with all Ministries to be included in the survey, beginning with April-June 2015. Table 1 and 2 contain templates for the survey form sent to the ministries and the GDT respectively, to be filled out on a quarterly basis. The recording of invoices and tax refund claims should be cumulative—the recording in each quarter should include all invoices/refund claims that have not been paid from the previous quarters, starting 2014:Q1. The MoF should verify that the invoices/refunded claims reported in the survey is not already included in the arrears clearance database.

Table 1. Template for Quarterly Survey on Expenditures Arrears Accumulation

(1) Economic Code	(2) Name of Supplier/ creditor	(3) Commitment number from Treasury System	(4) Commitment amount	(5) Invoice/claim details			(6) Age of Invoice (Due date) Enter Amount			(7) Reason for delayed payment
				Number (from Treasury System)	Date	Amount	30- 59 days	60- 90 days	+90 days	
Invoices recorder in the Treasury System										
Invoices not in the Treasury System										
Totals										

Table 2. Template for Quarterly Survey on VAT Tax Arrears Accumulation

(1) Name of company	(2) Tax identification number	(3) Date of Assessment	(4) Refund details			(5) Age of claim Enter Amount:			(6) Reason for delayed payment
			Number	Date	Amount	30- 59 days	60- 90 days	+90 days	
Totals									

Reporting

27. The MoF should send to the Fund the consolidated data from the survey with a lag of no more than 75 days after each quarter.

B. Clearance of Central Government Domestic Arrears

Definitions

28. Central government domestic arrears consist of domestic expenditure arrears of the central government and domestic tax refund arrears. Domestic expenditure arrears are defined as payments to residents determined by contractual agreements that remain unpaid 60 days after the due date specified by the contract, or, in the absence of a contractual definition, as determined by the law. Domestic tax refund arrears are defined as obligations on any valid tax refund claims in accordance with tax legislation that remain unpaid 90 days after the claim is submitted. For the purpose of this target, domestic arrears consist of arrears submitted before December 31st, 2013 that fall into the following categories:

- Central government contracts
- Central government utility bills
- Disability benefits from social assistance program
- Special funds, including payments for ex-persecuted prisoners and expropriations related to public construction work, and other special payments approved by the Council of Ministers
- Court orders, excluding cases in land restitution and compensation
- Local government contracts financed by central government
- Child registration subsidies
- Civil emergency
- VAT refunds
- CIT returns

29. The limit on clearance of central government domestic arrears consists of a floor for the amount of arrears payment.

30. Data will be collected through payments identified as made through the Treasury system under the arrears clearance strategy.

Reporting

31. Data will be provided by the MoF to the Fund with a lag of no more than four weeks after the test date.

C. Cumulative Ceiling on the Increase of Bank of Albania Credit to the General Government

Definitions

32. Credit of the central bank to the general government is defined as outstanding claims of the Bank of Albania on the general government, including overdrafts, direct credit, and holdings of government securities excluding repo operations, advance distribution of profits, other technical receivables, and holdings of the Bank of Albania pension fund. For the purpose of this target, government securities will be valued at their original purchase price.

Reporting

33. Data will be provided by the BoA to the Fund on a quarterly basis with a lag of no more than fifteen days.

V. STRUCTURAL BENCHMARKS

The structural benchmarks shall include those listed in Table 2 of the MEFP. The below provides additional details on selected measures.

34. Contract an external auditor with a mandate to conduct ex-post risk-based audits of expenditure arrears payments. The MoF should submit the Terms of Reference for the external auditor to the IMF for review before starting the tendering process.

35. Contract an external auditor to conduct verification of arrears payments on tax refunds. The MoF should submit the Terms of Reference for the external auditor to the IMF for review before starting the tendering process.

36. Introduce multi-year commitment limits in the 2015 budget, and change the Procurement Law, the Financial Management and Control Law, and the Budget Law accordingly. Commitment is an obligation to make a future payment subject to the fulfillment of certain conditions (contractual or otherwise). Commitment limits specify the amounts that can be committed in the current year for both the current year and each outer-year per line item of the budget. The sum of the commitment limits for an outer-year should be lower than the cash spending ceiling for that year, to leave sufficient room for the amounts that can be committed within that year.

37. The GDT to develop a corporate strategy for medium to long term capacity building. The strategy should be developed in consultation with IMF TA.

38. Establish and commence operations of a permanent Risk Management Unit (RMU) in GDT. The RMU should be tasked with leading the tax administration's day-to-day work in two major areas: (I) identifying, analyzing, and prioritizing major taxpayer compliance risks that need mitigation through compliance efforts; (II) developing integrated compliance strategies for compliance efforts that are designed specifically to mitigate the major risks prioritized under (I).

39. In agreement with BoA and Albanian Financial Supervisory Authority (AFSA), amend the regulatory frame work for investment funds on asset valuation, liquidity requirement, and capital adequacy requirement. The amended regulations should:

- a) Require that the calculation of the unit value represent the proportionate share of the aggregate market value of the underlying assets of the fund;
- b) Introduce capital adequacy requirements aligned with relevant E.U. regulations;
- c) Introduce liquidity requirements consistent with recent E.U. regulatory developments and the current level of development of the Albanian market.

VI. MONITORING AND REPORTING REQUIREMENTS

40. To facilitate the monitoring of program performance, the authorities will provide the following information on a monthly basis (except where noted).

The Bank of Albania will supply to the Fund:

- (i) The balance sheets of the Bank of Albania;
- (ii) The consolidated accounts of, separately, the commercial banks, and the Savings and Loan Institutions (SLIs);
- (iii) The monetary survey;
- (iv) Banking sector prudential indicators;
- (v) The net foreign assets of the Bank of Albania and their components;
- (vi) Comprehensive information on reserve assets that are pledged, collateralized, or otherwise encumbered;
- (vii) The foreign exchange cash flow of the Bank of Albania, including the level of NIR;
- (viii) Daily average exchange rates;
- (ix) Quarterly balance of payments data and updates of balance of payments estimates;
- (x) Inflation forecast on a monthly basis.

The Ministry of Finance will supply to the Fund:

- (i) The summary fiscal table, including the overall budget deficit, on a modified cash basis;
- (ii) Issuance of treasury bills and bonds by the MOF, including gross value and cash received;
- (iii) Privatization receipts;
- (iv) Information on the contracting and guaranteeing of new debt;
- (v) Information on the stock of short-, medium- and long-term debt;
- (vi) Information on official grants for projects or budget support purposes;
- (vii) Information on the stock of expenditure arrears identified in the Arrears Prevention and Clearance Strategy and progress in arrears repayment;
- (viii) Information on the accumulation of new arrears in central government ministries;
- (ix) Information on the implementation of stronger procurement and commitment controls.

The General Directorate of Customs will supply to the Fund:

- (i) Detailed monthly data on customs revenues collected.

The General Directorate of Taxation will supply to the Fund:

- (i) Detailed monthly data on tax revenues collected;
- (ii) Information on progress in implementing business restructuring and IT reforms;
- (iii) Information on the stock of VAT refunds claimed, refund arrears, and refunds paid out every month will be supplied within one month of the end of the reporting period.

The Albanian Statistical Agency (INSTAT) will supply the Fund:

- (i) The consumer price index (CPI index) at the aggregated level and at the level of each individual item making up the basket;
- (ii) The producer price index;
- (iii) The construction cost index;
- (iv) All short term indicators as they become available as defined in INSTAT's quarterly publication "Conjoncture";
- (v) In addition, INSTAT will communicate to the Fund on a regular basis the preliminary estimates for Quarterly GDP. It will also communicate as early as possible the preliminary estimates for annual GDP disaggregated by 22 sectors and distinguishing between the observed and nonobserved economy.



INTERNATIONAL MONETARY FUND



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IMF Executive Board Completes First Review under Extended Fund Facility Arrangement for Albania; Approves €26.7 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Albania's economic performance under a program supported by an arrangement under the Extended-Fund Facility (EFF). The completion of the review enables the authorities to draw an additional amount equivalent to SDR 23.55 million (about €26.7 million), bringing the total resources made available to Albania under the arrangement to SDR 47.1 million (about €53.3 million). The decision¹ was taken without a formal meeting.

All end-March 2014 performance criteria were met, and good progress has been made with respect to the applicable structural benchmarks. The economy is showing tentative signs of recovery in 2014, boosted by a pickup in exports, but output remains below potential.

The Executive Board approved a 36-month arrangement under the EFF for Albania on February 28, 2014 (see [Press Release No. 14/81](#)) in an amount equivalent to SDR 295.42 million (about €334.4 million, 492.4 percent of the country's quota in the Fund).

¹ The Executive Board takes decisions under its lapse-of-time procedures when it is agreed by the Board that a proposal can be considered without convening formal discussions.