INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/142

ALBANIA

June 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION, SEVENTH REVIEW UNDER THE EXTENDED ARRANGEMENT, AND REQUEST FOR WAIVER OF APPLICABILITY AND MODIFICATION OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ALBANIA

In the context of the Staff Report for the 2016 Article IV Consultation, Seventh Review under the Extended Arrangement, And Request for Waiver of Applicability and Modification of performance criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its May 27, 2016 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 27, 2016, following discussions that ended on March 22, 2016, with the officials of Albania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 12, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Albania.

The documents listed below 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*
Selected Issues
*Also included in Staff Report

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

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 16/269
FOR IMMEDIATE RELEASE
June 9, 2016

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

IMF Executive Board Concludes 2016 Article IV Consultation with Albania

On May 27, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the 2016 Article IV Consultation with Albania.[1]

Albania continues on a path of a gradual economic recovery despite difficult external conditions. GDP grew by 2.6 percent in 2015. Inflation remains low, reflecting the negative output gap and weak import prices. Large current account imbalances are financed mostly by foreign direct investment (FDI), while official foreign reserves have been rising.

Reforms are progressing well. In the past two years, Albania has made good progress with strengthening public finances and implementing structural reforms in the power sector. A sizable fiscal consolidation is underway and public debt is projected to start decreasing in 2016. However, other reforms critical for improving the business environment—including those related to property rights, resolution of nonperforming loans, the judiciary, and governance—are lagging.

The medium-term outlook remains favorable. GDP growth is projected to reach 3.4 percent in 2016, and around 4 percent over the medium term, reflecting a recovery in private sector credit, continued FDI, and structural reforms, as Albania advances through the European Union accession process. Headline inflation is likely to remain subdued. The current account deficit is expected to widen and remain elevated as import-intensive investment picks up.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors welcomed the increased strength of Albania's economic recovery and emphasized that the medium-term outlook remains favorable, provided the reform momentum is maintained. Directors commended the authorities for their strong program ownership and for the implementation of an ambitious structural and fiscal reform agenda. Going forward, Directors encouraged the authorities to address fiscal vulnerabilities, strengthen efforts to reduce non-performing loans (NPLs) which will boost private sector credit, and press ahead with reforms to improve the business environment to strengthen competitiveness and support growth.

Directors welcomed the authorities' commitment to fiscal consolidation and gradual debt reduction. They underscored that continued fiscal adjustment will be crucial to lower fiscal vulnerabilities and ensure debt sustainability. Directors encouraged the authorities to consider adopting a fiscal rule to anchor long-term expectations and strengthen credibility.

Directors supported the authorities' plans to focus fiscal adjustment efforts on the revenue side, given the relatively low level of public spending. They emphasized that the consolidation strategy should aim to broaden the tax base, limit exemptions, and strengthen compliance and revenue administration. Directors encouraged the authorities to expedite steps to introduce a valuation-based property tax. They welcomed the authorities' efforts to address tax evasion and informality by targeting high-risk, high-value segments and harnessing modern compliance risk management tools.

Directors emphasized the need for persistence in implementing structural fiscal reforms to reduce fiscal risks. In this regard, they urged the authorities to strengthen efforts toward improving public investment management, preventing new arrears, and conducting risk analysis of public-private partnership proposals in line with international norms.

Directors shared the view that the current accommodative monetary policy stance under the inflation targeting framework remains appropriate. They encouraged the authorities to consider measures to reduce euroization in the banking system in order to enhance the monetary transmission mechanism. Greater exchange rate flexibility would support the monetary policy framework, but it is also important to pay attention to financial stability risks emanating from unhedged exposures.

Directors noted that the Albanian banking system remains well capitalized and liquid. They welcomed the progress made in reducing NPLs but underscored the need to speed up implementation of the comprehensive NPL strategy, which will help revive credit growth. In

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

particular, Directors supported simplifying the legal framework for insolvency and facilitating out-of-court restructuring. They also encouraged the authorities to continue strengthening financial supervision and regulation, and to boost the non-bank financial regulator's supervisory capacity.

Directors emphasized that further structural reforms to improve the business environment are critical for strengthening Albania's competitiveness. They noted the importance of implementing judicial reform, strengthening property rights, improving infrastructure, and diversifying the export base. Directors commended the authorities for their continued progress on power sector reforms, and urged steadfast implementation of the reform agenda in the sector.

Albania: Basic Indicators and Macroeconomic Framework, 2011–15

	2011	2012	2013	2014	2015 (est.)
Real sector	(Growth rate in percent)				
Real GDP	2.5	1.4	1.1	2.0	2.6
Consumer Price Index (avg.)	3.4	2.0	1.9	1.6	1.9
Consumer Price Index (eop)	1.7	2.4	1.9	0.7	2.0
GDP deflator	2.3	1.0	0.2	1.6	1.1
Saving-investment balance	(Percent of GDP)				
Foreign savings	13.2	10.1	10.8	12.9	11.1
National savings	20.6	20.0	18.3	15.5	17.3
Public	1.6	0.8	-0.8	0.6	0.8
Private	19.0	19.2	19.1	14.9	16.5
Investment	33.8	30.2	29.1	28.4	28.4
Public	6.1	5.2	5.1	4.8	4.8
Private	27.7	25.0	24.0	23.6	23.5
Fiscal sector	(Percent of GDP)				
Revenues and grants	25.4	24.8	24.0	26.2	26.0
Tax revenue	23.4	22.6	21.9	24.0	23.5
Expenditures	28.9	28.2	29.2	32.0	30.5
Primary	25.8	25.1	26.0	29.2	27.9
Interest	3.2	3.1	3.2	2.9	2.7
Overall balance (excluding arrears payment)	-3.5	-3.4	-5.2	-5.9	-4.5
Primary balance (excluding arrears payment)	-0.4	-0.3	-2.0	-3.0	-1.8
Net domestic financing	2.0	2.0	4.4	3.4	-0.4
of which: Privatization receipts	0.0	0.1	1.2	0.0	0.1
Foreign financing	1.5	1.5	0.8	2.4	4.8
Public Debt	59.4	62.1	70.4	71.7	71.9
Domestic	33.7	35.3	43.4	42.3	38.2
of which: Unpaid bills and arrears			4.8	1.9	0.2
External (including publicly guaranteed)	25.7	26.8	26.9	29.4	33.8
Monetary indicators	(Growth rate in percent)				
Broad money growth	9.2	5.0	2.3	4.0	1.9
Private credit growth	10.4	1.4	-1.4	2.0	-2.9
Velocity	1.2	1.2	1.2	1.2	1.2
Interest rate (3-mth T-bills, end-period)	5.3	5.0	3.4	3.1	2.6
BoA repo rate (in percent)	4.8	4.0	3.0	2.3	1.6
External sector	(Percent of GDP, unless otherwise indicated)				
Trade balance (goods and services)	-22.7	-18.6	-18.0	-18.9	-17.1
Current account balance	-13.2	-10.1	-10.8	-12.9	-11.1
Gross international reserves (in billions of euros)	1.9	2.0	2.0	2.2	2.9
(In months of imports of goods and services)	4.6	4.6	4.5	5.0	6.2
(Relative to external debt service)	7.8	6.6	6.7	6.8	4.4
(In percent of broad money)	24.8	24.5	24.6	25.7	32.5
Change in real exchange rate (eop, in percent)	-0.9	-0.2	1.0	2.4	1.3
Memorandum items					
Nominal GDP (in billions of lek)	1,301	1,333	1,351	1,401	1,454
Output gap (percent, - = gap)	0.8	0.1	-0.7	-1.1	-1.3

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

INTERNATIONAL MONETARY FUND

ALBANIA

May 12, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION, SEVENTH REVIEW UNDER THE EXTENDED ARRANGEMENT, AND REQUEST FOR WAIVER OF APPLICABILITY AND MODIFICATION OF PERFORMANCE CRITERIA

KEY ISSUES

Context: Over the past few years, Albania has successfully maintained macroeconomic stability amidst a turbulent external environment. However, growth remains sluggish due to a weak Euro Area recovery and risk-averse banks. The current account deficit is expected to remain elevated as import-intensive FDI picks up. Headline inflation will likely remain subdued, due to imported disinflation and domestic slack. The medium-term outlook remains favorable, provided the reform momentum is maintained.

Policies: The policy mix focuses on fiscal adjustment, while supporting growth through gradual monetary easing. Fiscal consolidation is underway and public debt is projected to have peaked in 2015. The authorities have implemented ambitious and difficult reforms, including in pensions, the electricity sector, and public financial management. However, other reforms critical for improving the business environment are lagging. The key policy priorities are to lower fiscal vulnerabilities through continued consolidation, revive private sector credit by cleaning up bank balance sheets, and continue implementing growth-friendly structural reforms.

Program Background and Performance: In February 2014, the Executive Board approved a three-year Extended Arrangement with access equivalent to SDR 295.42 million (212.1 percent of current quota). So far, five purchases totaling the equivalent of SDR 180.84 million have been made, and another one equivalent to SDR 28.65 million will be made available upon completion of the seventh review. The program remains broadly on track. All performance criteria (PCs) were met, as were most indicative targets. Most structural benchmarks were also implemented, albeit one with a delay (as a prior action). The authorities request, and staff supports, a waiver of applicability for two end-April 2016 PCs and a modification of PCs for August and November 2016.

Risks: Risks to the program remain high. With the next general election due by mid-2017, political tensions could test the authorities' perseverance with reforms and commitment to fiscal adjustment and debt reduction.

Approved By
Masato Miyazaki and James Gordon

Discussions were held in Tirana during March 9–22, 2016. Staff team: Ms. Tuladhar (head), Messrs. Cabezon and Slavov (all EUR), Messrs. End and Thackray (FAD), and Mr. Ismail (SPR). Mr. Reinke (Resident Representative) and Ms. Spahia (local economist) assisted the mission. Messrs. Gordon (EUR) and Di Lorenzo (OED) joined some of the meetings. The mission met with Deputy Prime Minister Peleshi, Minister of Finance Ahmetaj, Minister of Economy Ekonomi, Minister of Energy Gjiknuri, Minister of Justice Manjani, Bank of Albania Governor Sejko, other senior officials, parliamentarians, and representatives of banks and the private sector. Support was provided by Mr. Song, Ms. Mendoza (both EUR), and Ms. Kadeli (Tirana office).

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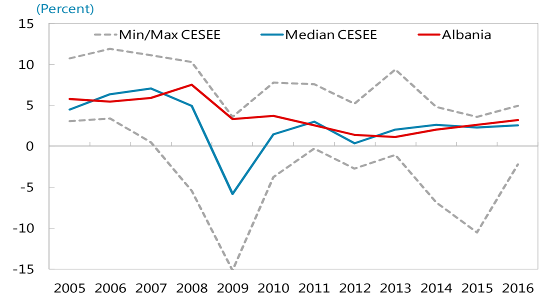
CONTEXT

1. **Albania is gradually recovering from a protracted growth slowdown.** The country weathered the global financial crisis well, but economic difficulties in key Euro Area trading partners (Italy and Greece) and stagnant bank lending have weighed on economic activity in the post-crisis period. A gradual recovery is now underway, supported by prudent policies and a gradual restoration of confidence.

CESEE: Real GDP Growth
(Percent)



Source: IMF, World Economic Outlook database.

2. **Reforms are progressing, backed by the ruling coalition's strong legislative majority.** Since the approval of the Extended Arrangement in early 2014, the authorities have implemented ambitious and difficult structural reforms, including in pensions and the electricity sector. A substantial stock of central government arrears was cleared. An ambitious fiscal consolidation is underway and public debt is projected to have peaked at 72 percent of GDP in 2015. These achievements have allowed a successful Eurobond issuance and a recent credit rating upgrade. However, other reforms critical for improving the business environment—including those related to property rights, NPL resolution, the judiciary, and governance—are lagging (text table and Box 1).

Implementation of the Recommendations from the 2014 Article IV Consultation

Recommendation	Progress
Fiscal sustainability	
Implement sizable fiscal adjustment in order to reduce public debt.	Moderate
Clear large stock of arrears and prevent the accumulation of new ones.	Good
Strengthen tax administration.	Moderate
Implement pension reform.	Good
Reform the disability benefit system.	Moderate
Implement local government reform.	Moderate
Improve public debt management.	Good
Monetary policy and financial stability	
Gradually ease monetary policy.	Good
Remove exchange restrictions and accept the obligations of Article VIII.	Good
Implement FSAP recommendations to strengthen financial stability.	Good
Tackle comprehensively and forcefully the large stock of NPLs.	Insufficient
Ensure that risks associated with euroization are internalized.	Moderate
Take steps to strengthen nonbank supervision.	Moderate
Structural reform	
Improve the investment climate.	Insufficient
Implement comprehensive electricity sector reform.	Good
Implement public administration reform.	Moderate
Improve quality of statistics and strengthen INSTAT's independence.	Moderate

3. **The main policy priority is to continue lowering fiscal vulnerabilities while advancing structural reforms to achieve sustainable growth.** Given prospects of lower commodity prices for the foreseeable future and a slow recovery in Europe, Albania will need to reorient towards a more diversified and open growth model. Faster implementation of structural reforms will be critical to strengthen competitiveness, improve the investment climate, and catalyze stronger growth. The ongoing Extended Arrangement and prospective negotiations for EU accession provide a strong impetus to advance these reforms.

RECENT DEVELOPMENTS

4. **Economic growth is gradually strengthening while inflationary pressures are subdued (Figure 1)**. GDP growth accelerated to 2.6 percent in 2015, from 2.0 percent in 2014, driven by higher electricity production due to exceptional rainfall, a pickup in tourism, and a recovery in construction. Nevertheless, growth remains below potential. Headline inflation is very low (0.3 percent in March 2016), reflecting low food and fuel prices as well as fading base effects from the impact of the floods last year, while core inflation remains negative reflecting imported disinflation and domestic slack.

5. **The current account deficit narrowed temporarily in 2015 but remains large (Figure 2).** Despite reduced oil exports, a one-off reduction in electricity imports (due to improved hydropower conditions) and strong tourism receipts helped narrow the trade deficit. Remittances, accounting for 5.7 percent of GDP, have remained broadly stable despite weak growth in the main source countries (Greece and Italy). Consequently, the current account deficit declined from 12.9 percent of GDP in 2014 to 11.1 percent of GDP in 2015. However, risks from the large external deficit are limited, as more than three quarters of the current account deficit are financed by foreign direct investment.

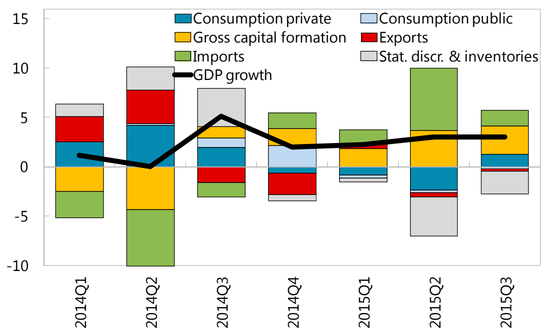
6. **External financing remains ample, primarily due to FDI inflows but also increased external borrowing by the public sector.** FDI is mainly concentrated in the oil sector and has slowed down recently with falling crude prices. However, FDI remains strong at around 8–9 percent of GDP on the back of large energy projects, such as the Trans Adriatic Pipeline and the Statkraft/Devoll hydropower project. With a Eurobond issuance in November 2015, gross FX reserves climbed to over six months of imports at end-2015.

7. **Fiscal performance is broadly on track.** The 2015 fiscal deficit target was met with a comfortable margin (Tables 2a–2b and Figure 3), despite persistent tax revenue shortfalls. Fiscal revenues underperformed by 0.6 percentage point of GDP, due to lower-than-projected imports of fuel and tobacco products in Q4. However, an across-the-board underexecution of recurrent expenditure (0.8 percent of GDP), including further savings on public support to the electricity sector, allowed the authorities to meet their overall budget target comfortably. In the first two months of 2016, the fiscal deficit has been lower than projected: fiscal revenues came in as expected, but the authorities underexecuted their budget, by nearly 0.5 percent of GDP.

Figure 1. Albania: Background and Outlook

The economic recovery continues...

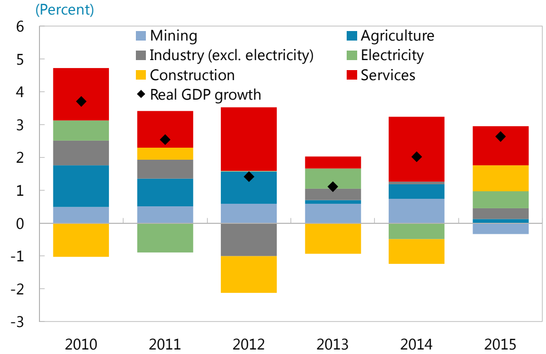
Real GDP: Expenditures
(Percent)



Sources: INSTAT; and IMF staff calculations.

...led by electricity, construction, and services, whose strength offset the contraction in the oil sector.

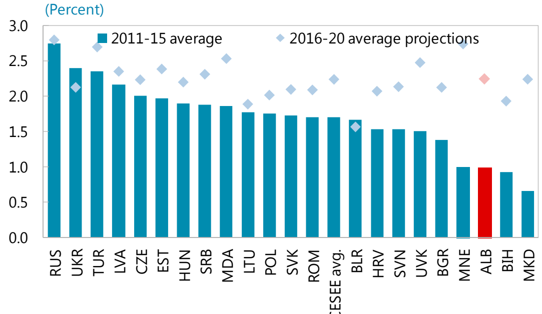
Albania: Contributions to Growth
(Percent)



Sources: INSTAT; and IMF staff estimates.

External growth drivers have been weak in the past few years...

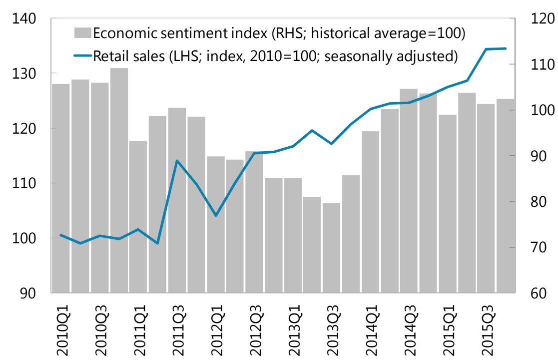
CESEE: Trading Partners' Growth[1]
(Percent)



1/ Weighted by imports. Albania's main trading partners are: Italy (55%), Kosovo (7%), Greece (6%), Turkey (5%), China (4%), Spain (3%), and Germany (3%).
Source: IMF staff estimates.

...while domestic demand is picking up, albeit gradually.

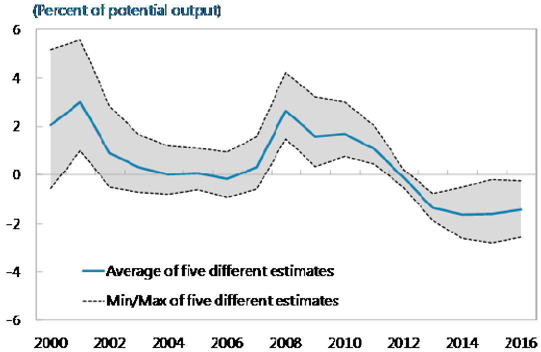
Albania: Retail Sales Volume and Economic Sentiment



Sources: INSTAT; and IMF staff calculations.

The output gap is still negative...

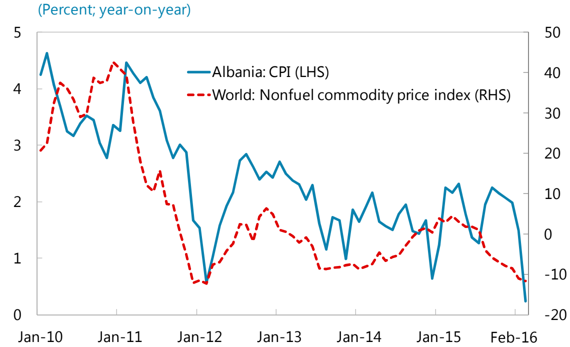
Albania: Output Gap
(Percent of potential output)



Source: IMF staff estimates.

...adding to deflationary pressures from overseas.

Albania: Inflation
(Percent; year-on-year)

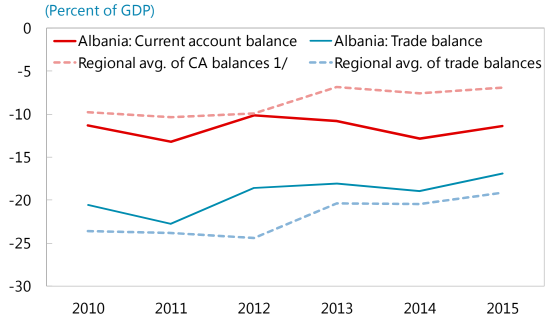


Sources: Haver Analytics; IMF, Direction of Trade Database; and INSTAT.

Figure 2. Albania: External Sector Developments

The current account deficit narrowed in 2015 but remains high.

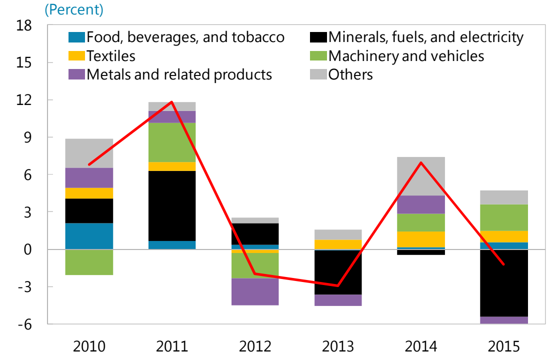
External Balance
(Percent of GDP)



1/ The regional average covers Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, and Serbia.
Sources: Albanian authorities; WEO database; and IMF staff calculations.

The improvement reflected strong tourism receipts and a lower energy import bill…

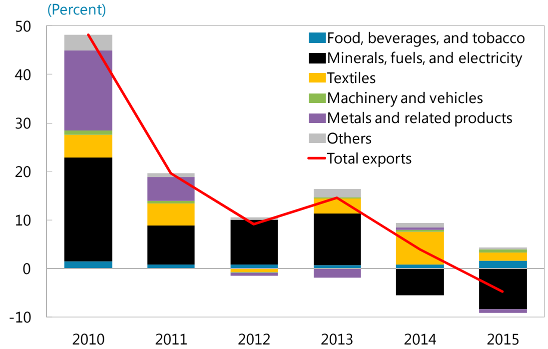
Import Growth
(Percent)



Sources: INSTAT; and IMF staff calculations.

…which offset the decline in exports, mainly in the oil sector.

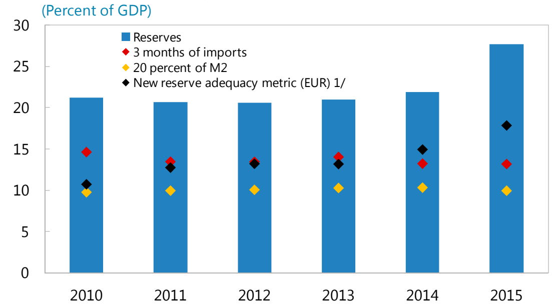
Export Growth
(Percent)



Sources: INSTAT; and IMF staff calculations.

International reserves are ample.

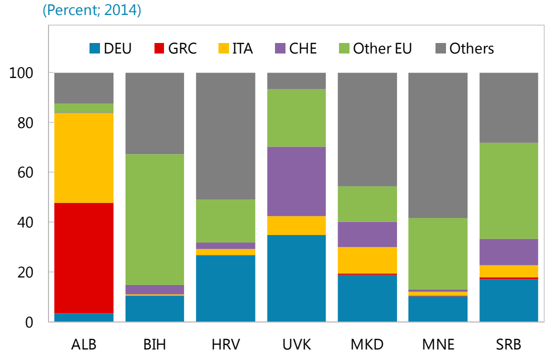
Reserve Adequacy
(Percent of GDP)



1/ Composed of 30% of short-term external debt, 10% of other portfolio liabilities, 5% of M2, and 5% of exports. Short-term debt excludes deposits due to data limitations.
Sources: Albanian authorities; and IMF staff calculations.

Greece and Italy remain the major source countries for remittances.

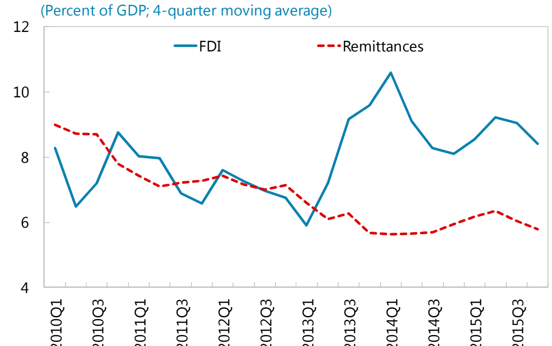
Decomposition of Remittances by Source Country
(Percent; 2014)



Sources: World Bank, Migration and Remittances data; and IMF staff calculations.

Despite the turmoil in Greece, remittances remained stable, while FDI inflows have surged since late 2013.

FDI and Remittances
(Percent of GDP; 4-quarter moving average)



Sources: Haver Analytics; and IMF staff estimates.

PROGRAM PERFORMANCE

8. **The program is on track (MEFP ¶5-6 and MEFP Tables 1, 3a, and 3b):**

- **All performance criteria and most indicative targets were met.** The authorities are seeking a waiver of applicability for the end-April ceilings on the general government's primary fiscal balance and primary expenditure, for which data are not yet available. Staff expects these PCs to have been met. The December 2015 indicative target on contracting non-energy guarantees was missed by a very small margin (0.03 percent of GDP). Going forward, the authorities are proposing to remove this IT, as non-energy guarantees are now fully captured in their fiscal framework. The IT on the accumulation of new central government domestic arrears was missed by a small margin (0.09 percent of GDP) in December 2015. However, the authorities will repay all accumulated arrears by mid-2016, except for those on court decisions regarding layoffs and expropriations which will be settled in accordance with a special Council of Ministers (CoM) decision. As a remedial measure, the authorities are improving public investment management and seeking rapid implementation of multi-year commitment limits.

- **Most structural benchmarks (SBs) were implemented, albeit one with a delay.** Of the six SBs, three were met on time. Of the remaining three, one was implemented with a delay (as a prior action), and one is proposed to be rescheduled. The need to build support and allow sufficient time for consultations with stakeholders delayed amendments to the Budget Law, but these were submitted to Parliament in early May 2016, as a prior action. The roll-out of the new treasury IT system (AGFIS) to 15 budget institutions has been delayed to end-May 2016, to allow time to train new users of the system. The need to fine-tune the implementation plan to restructure the tax agency's headquarters delayed its adoption to May.

OUTLOOK AND RISKS

9. **The near-term outlook remains broadly unchanged from the combined 5th and 6th reviews under the Extended Arrangement:**

- **2016 GDP growth is projected at 3.4 percent, up from 2.6 percent in 2015.** A reduction in oil production due to the declining global price will be mostly offset by a recovery in construction as the moratorium on construction permits was recently removed. Furthermore, favorable weather conditions are projected to boost electricity generation, while increased disposable incomes from the drop in fuel retail prices will shore up consumption.

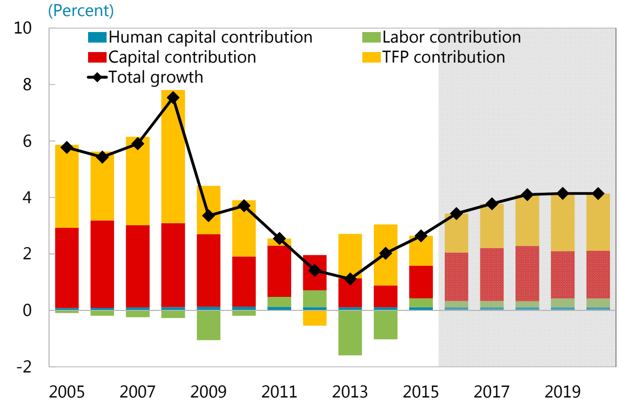
- **Inflation will remain subdued due to a persistent negative output gap and supply shocks to food and fuel prices.** The headline inflation projection in 2016 has been downgraded from 2.5 percent in the last staff report to 2.2 percent. Nevertheless inflation is projected to gradually rise, based on strengthening domestic demand.

- **The current account deficit is projected to increase to around 13 percent of GDP in both 2016 and 2017 (Tables 3a–3b).**[1] Imports are expected to pick up with increased foreign direct investment in large energy-related projects. Export growth will continue to decline given the terms of trade shock and slowing global demand.

10. **The medium-term outlook remains favorable, supported by ongoing FDI, a recovery in the euro area, and continued reforms towards EU accession:**

- **Growth** is expected to rise to around 4 percent over the medium term, down by about half a percentage point from the medium term growth projected in the 2014 Article IV Consultation, but in line with peers in the region and the projected recovery in major trading partners. The revision also reflects lower investment in the oil sector and slower-than-expected implementation of some growth-enhancing reforms, including those related to governance, property rights, and the judiciary.[2] The main growth drivers would be physical capital accumulation and productivity improvements, due to continued high FDI and structural reforms to improve the investment climate as Albania advances through the EU accession process (text chart). Ongoing FDI in the hydropower sector will boost energy supply, a major bottleneck for business growth. Relatively favorable demographics, a flexible labor market, and declining emigration will also support an increased growth contribution from labor (Figure 8).

Growth Accounting
(Percent)



Source: IMF Staff estimates.

- **Inflation** will pick up gradually as domestic demand recovers and the output gap narrows, reaching Bank of Albania's inflation target of 3 percent in 2018.

- The **current account deficit** will narrow over the medium term, as FDI in large import-intensive energy-related projects tails off, and exports in the energy and services sectors pick up and offset gradually declining remittances. External financing will continue to be dominated by FDI and official financing. Reserve cover is expected to stabilize at around 4-4½ months of imports.

11. **The balance of risks to the outlook is on the downside (Annex I).** Political tensions ahead of the 2017 general election could hinder the implementation of structural reforms. A further drop in oil prices could damage fiscal revenues and growth, by forcing a scale-back in investment and production in the domestic oil sector. While direct spillover channels from emerging economies

[1] The recorded current account deficit overstates external imbalances because of sizable errors and omissions (around 2–3 percent of GDP). Most of these are probably unrecorded private remittances.
[2] See *Selected Issues Paper*, "Potential Growth and Output In Albania."

are limited, renewed turbulence in Greece or weak growth in Italy could spill over to Albania and test the banking sector or the authorities' perseverance with fiscal adjustment and structural reforms. Erratic rainfall could affect electricity generation as in the past, with power shortages damaging growth and expensive electricity imports posing quasi-fiscal risks.

Authorities' views

12. **The authorities broadly shared staff's outlook and assessment of risks (MEFP ¶3–4).** However, they emphasized that the governing coalition remains stable and is fully determined to continue implementing reforms. While acknowledging the negative impact of lower energy prices, they noted that risks may be mitigated by the recent acquisition of the main domestic oil producer by a larger foreign company which would allow it to expand operations. Regarding risks to the financial sector, they noted that significant contingency planning has already taken place and banks are insulated from shocks by their substantial capital and liquidity buffers.

POLICY DISCUSSIONS

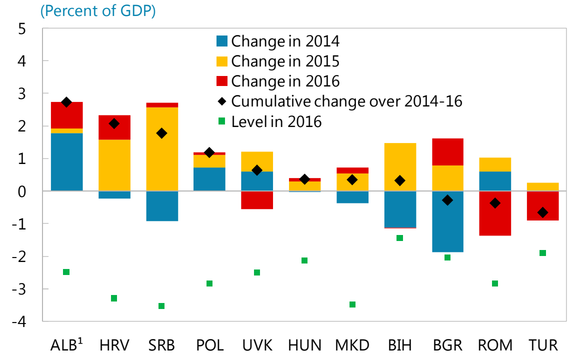
A. Ensuring Fiscal Sustainability and Implementing Structural Fiscal Reforms

Background

13. **The high level of public debt poses a key macroeconomic risk (Figure 3 and Annex II).** Public debt stood at around 72 percent of GDP in 2015, among the highest in the region. Although the recent issuance of a five-year Eurobond and the increase in donor financing have alleviated somewhat rollover risks in the near term, financing needs of 23 percent of GDP are still sizable, with an average maturity of the public debt stock below two years and substantial reliance on domestic banks with significant sovereign exposure. Moreover, high debt constrains fiscal policy and is a potential drag on medium-term growth.

14. **To address this risk, a sizable fiscal consolidation is underway (text table).** Under the program, the structural primary balance is expected to improve by 2.4 percent of potential GDP in 2014–16. The overall deficit (excluding arrears clearance) is expected to improve from 5.2 percent of GDP in 2013 to 2.5 percent of GDP in 2016, bringing the primary balance into a small surplus (0.3 percent of GDP). The authorities are firmly committed to lowering public debt. However, a fiscal framework to anchor the fiscal target and operationalize the fiscal consolidation path is yet to be finalized.

Change in Overall Balance
(Percent of GDP)

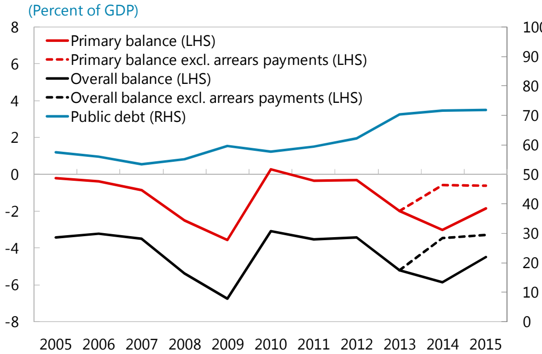


1/ Arrears clearance in 2014-2015.
Sources: IMF, WEO database; and IMF staff projections for Albania.

Figure 3. Albania: Fiscal Developments

Fiscal imbalances have stopped deteriorating…

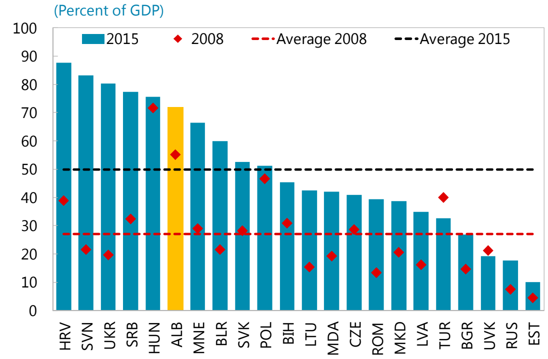
Fiscal Outcomes
(Percent of GDP)



Source: Albanian Ministry of Finance.

…but debt levels are still high relative to other CESEE countries.

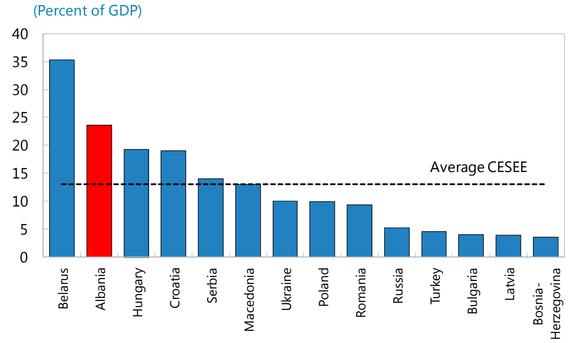
CESEE Public Debt
(Percent of GDP)



Source: IMF, WEO database.

High gross financing needs are a key vulnerability.

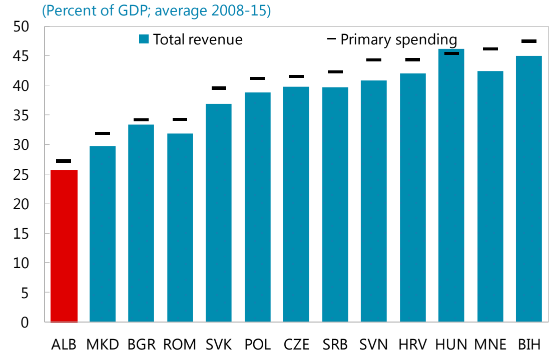
Gross Financing Needs
(Percent of GDP)



Source: IMF staff estimates.

The public sector is relatively small.

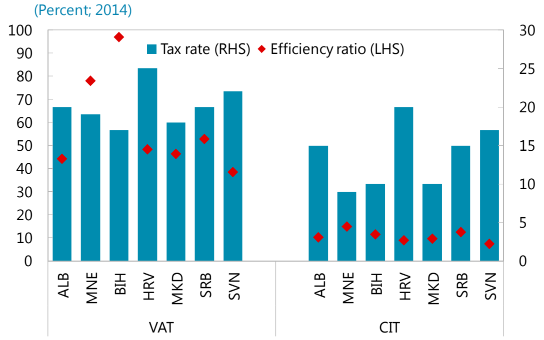
CESEE: Total Revenue and Primary Spending
(Percent of GDP; average 2008-15)



Sources: IMF, WEO database; and IMF staff calculations.

Tax efficiency is low due to numerous exemptions and problems with tax compliance…

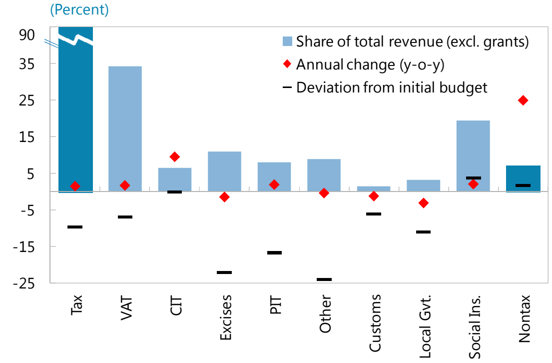
Western Balkans: Tax Rate and Efficiency Ratios[1]
(Percent; 2014)



1/ Tax efficiency is the ratio of tax revenue (in percent of GDP) over the tax rate.
Source: IMF staff estimates.

…which, together with lower than expected oil prices and nominal growth, led to revenue shortfalls in 2015.

Performance of Revenues During 2015
(Percent)



Source: Albanian Ministry of Finance.

Fiscal Consolidation, 2013-2019
(Percent of GDP, unless otherwise specified)

	2013	2014	2015		2016		2017		2018		2019	
	Act.	Act.	EBS/ 16/6	Act.	EBS/ 16/6	Proj.	EBS/ 16/6	Proj.	EBS/ 16/6	Proj.	EBS/ 16/6	Proj.
Revenues	24.0	26.2	26.7	26.0	27.1	26.8	27.3	26.4	27.3	26.2	27.3	26.1
Tax revenue	21.9	24.0	24.0	23.5	24.6	24.3	24.8	24.0	24.8	23.9	24.9	23.8
Non-tax revenue	1.6	1.5	2.0	1.8	1.6	1.6	1.6	1.5	1.6	1.5	1.6	1.5
Grants	0.4	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Expenditures	29.2	32.0	31.2	30.5	29.6	29.2	29.5	29.1	29.6	29.3	29.5	29.2
Current expenditure (incl. net lending)	24.3	25.3	25.7	25.0	25.7	25.4	25.6	25.2	25.5	25.2	25.2	24.9
of which : Energy sector spending 1/		0.9	1.2	0.8	0.5	0.3	0.4	0.4	0.3	0.3	0.0	0.0
Capital expenditure	4.8	4.3	4.1	4.3	3.7	3.7	3.7	3.7	3.9	3.9	4.1	4.1
Other spending	0.0	2.4	1.4	1.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Unidentified measures					0.0	0.0	1.1	1.1	1.0	1.0	1.0	1.0
Unidentified measures (cumulative)					0.0	0.0	1.1	1.1	2.1	2.1	3.1	3.1
Overall balance	-5.2	-5.9	-4.5	-4.5	-2.5	-2.5	-1.1	-1.6	-0.2	-0.9	0.9	0.0
Overall balance excl. arrears clearance		-3.4	-3.2	-3.3	-2.5	-2.5	-1.1	-1.6	-0.2	-0.9	0.9	0.0
Primary balance	-2.0	-3.0	-1.8	-1.8	0.3	0.3	1.6	0.9	2.4	1.6	3.4	2.5
Primary balance excl. arrears clearance	-2.0	-0.6	-0.5	-0.6	0.3	0.3	1.6	0.9	2.4	1.6	3.4	2.5
Change in the structural primary balance	-1.4	1.6	0.2	-0.4	0.9	1.2	1.2	0.5	0.6	0.6	0.8	0.8
Public debt	70.4	71.7	72.2	71.9	70.6	70.4	67.1	67.7	62.6	64.1	57.3	59.7
Domestic debt	43.4	42.3	38.7	38.2	36.0	34.6	33.4	32.7	30.6	30.6	26.9	28.2
Foreign debt	26.9	29.4	33.5	33.8	34.6	35.8	33.7	35.0	32.1	33.5	30.4	31.5
Memo items:												
Nominal GDP (in billions of leks)	1,351	1,401	1,445	1,454	1,530	1,532	1,637	1,632	1,760	1,749	1,891	1,879
Public debt (in billions of leks)	950	1,005	1,043	1,045	1,080	1,079	1,098	1,105	1,102	1,121	1,084	1,122

Sources: Albanian authorities; IMF staff estimates and projections.
1/ Energy spending includes energy sector subsidies, compensation for the poor, and policy net lending. Prior to 2014, energy subsidies were not recorded in the fiscal accounts, but handled through extra-budgetary guarantees and debt-financed policy net lending.

15. **The revenue-based fiscal consolidation is made difficult by poor tax design and weaknesses in revenue administration and compliance.**[3] While tax rates are in line with neighboring countries, fiscal revenues are low in Albania relative to the region, reflecting low efficiency of the country's tax system. Policies such as the 2014 switch to a progressive personal income tax with a high exemption and the 2016 exemption of all small businesses from income tax are eroding tax efficiency. Furthermore, tax compliance is costly and burdensome (Figure 7) contributing to low tax yields and a difficult business environment. For example, a preliminary estimate of the compliance gap for VAT suggests that Albania loses between 34 and 39 percent of potential VAT revenues on account of low compliance, compared to an average estimate of 15 percent of potential VAT revenues for the EU countries. Recognizing these challenges, the government launched a large-scale effort to tackle tax evasion, non-compliance, and informality which has yielded substantial increases in the number of registered employees and small businesses. More recently, the campaign has changed focus to target high-risk, high-value segments and harness modern compliance risk management tools.

[3] See *Selected Issues Paper*, "Tax Policy, Evasion, and Informality in Albania."

Policy advice

16. **Continued fiscal consolidation is crucial to reduce the risks to debt sustainability and foster Albania's growth potential.** Staff projections show that lowering public debt below 60 percent of GDP by 2019 would require measures of around 1 percent of GDP each year. To provide a fiscal anchor, the authorities need to adopt a quantitative fiscal rule with an embedded automatic correction mechanism. The credibility of the medium-term budget would be strengthened by using independent macroeconomic forecasts and assessments, which could be provided by an independent fiscal council. In addition, debt management should further lengthen the maturity of public debt and diversify the investor base, thereby lowering the risks arising from elevated financing needs.

17. **The fiscal adjustment should continue to target mainly the revenue side to make room for more productive spending**. The level of public spending is low by regional standards (30.5 percent of GDP in 2015), and areas such as health, education, and infrastructure demand more resources. In addition, the authorities are already implementing ambitious reforms of the pension and social assistance systems. The consolidation strategy therefore has to focus on broadening the tax base and on strengthening compliance and revenue administration. Furthermore, to address compliance and evasion issues, policies need to focus on strengthening the cooperation between the tax and customs departments, enhancing performance monitoring of tax administration, and improving policy design to boost tax compliance.

18. **Revenue measures to broaden the tax base and strengthen efficiency are crucial.** The main headline tax rates in Albania are above the Balkan average, but the tax thresholds are also comparatively higher. There is scope to lower the zero-tax threshold for personal income tax. The authorities should accelerate work on a fiscal cadastre (SB), in order to support the goal of introducing a valuation-based property tax by end-2017. Towards this end, they will start developing a valuation formula and methodology (SB). Eliminating import tax exemptions would also reduce the risks of misreporting and facilitate proper monitoring of the VAT supply chain. The authorities need to refrain from granting any further tax exemptions or preferential tax treatments, and should strive to remove existing ones. To support this effort, an annual survey of tax expenditures is being prepared (SB).

19. **Budgetary discipline and persistence with structural fiscal reforms is needed to reduce fiscal risks.**

- **2016 budget (MEFP ¶8-9):** To protect the 2016 primary surplus target from a renewed slide in global oil prices, the authorities are committed to maintaining strict budgetary discipline, ensuring savings in current expenditure, and strengthening the revenue base and tax compliance. They have also committed to taking additional measures, if needed, to meet the target. The authorities remain prudent in projecting the revenue gains from the campaign against tax evasion, non-compliance, and informality. Large unbudgeted windfalls due to disputed tax payments will not be counted as revenue under the program until the tax dispute is resolved. On the expenditure side, the authorities intend to restrain the central government's wage bill and reap further dividends from the electricity sector reform.

- **Electricity sector (MEFP ¶10):** Fiscal support to the power sector (in the form of public guarantees, policy net lending, and targeted transfers to the poor) continues to weigh on public finances, while weather-related risks remain high. The authorities are committed to gradually unwind public support for the sector by 2020, while addressing its infrastructure gap. To cement the gains from the power sector reform (see ¶45 and ¶47 below), further steadfast implementation would be critical, as will be strict monitoring of the investment plans of the electricity SOEs.

- **Revenue administration (MEFP ¶12–15):** Timely implementation of the tax administration's corporate strategy is needed. The plan includes a function-based restructuring of the General Directorate of Taxes (GDT) headquarters as well as the adoption of modern compliance risk management tools (SBs). The tax and customs administrations have to improve information-sharing, coordinate more closely on risk assessment, and maintain the momentum of the campaign against informality.

- **Public financial management (MEFP ¶11 and 16–17):** Strengthening public investment management and boosting the credibility of the authorities' Medium-Term Budget Framework (MTBF) are crucial in order to reduce the risk of unfunded commitments and arrears. Unbudgeted commitments on existing infrastructure projects continue to exceed the MTBF envelope. The appraisal, selection, management, and evaluation of public investment projects have been fragmented across the government, although efforts are underway to streamline them under the MoF. In line with the recommendations from the recent Public Investment Management Assessment, the public investment management process needs to be further strengthened. This includes operationalizing the public investment unit at the MOF to strengthen the appraisal process for large projects, integrating various public investment projects into the budget cycle, and reviewing and streamlining project classification to reduce fragmentation. Specifically, the authorities should develop transparent criteria based on which they should review all outstanding unbudgeted investment projects and identify low-priority projects that will be cancelled.

- **Public Private Partnerships (MEFP ¶11):** The authorities are keen to pursue new PPP projects which pose quasi-fiscal risks. All PPP proposals would need to be subject to a detailed feasibility study and cost-benefit analysis and be evaluated by the Ministry of Finance before approval. The impact of any new PPPs on the fiscal accounts and debt statistics should be reflected transparently and in line with international norms. Efforts are underway to launch a public register of all active PPP projects and to publish summaries of all PPP contracts.

- **Fiscal decentralization and arrears clearance and prevention (MEFP ¶11):** Fiscal decentralization has been relatively limited in Albania, with local government spending currently accounting for only 11 percent of total general government spending. Tight controls on local government borrowing have limited debt to 0.1 percent of GDP. However, the authorities are pursuing a fiscal decentralization strategy which involves devolution of certain functions and new financing sources for local governments. In this context, the review of the local public finance law should be expedited to improve reporting and monitoring and mitigate fiscal risks. A recent survey of local government finances uncovered potential arrears of around 0.6 percent of GDP as of mid-2015. Once audited and verified, these claims should be promptly resolved, with external auditors ensuring the integrity of the process. To prevent recurrence of new central government arrears, multi-year commitment limits and the rollout of the new treasury IT system (to 15 budget institutions accounting for 84 percent of the budget and one local government) should be implemented urgently (SB) and subsequently expanded to cover other local government units as well. The authorities will also continue to publish the regular survey of new central government arrears (SB), and gradually expand its coverage.

Authorities' views

20. **The authorities reaffirmed their commitment to gradually reduce the public debt (MEFP ¶7).** While cognizant of the risks that excessive consolidation may have on the nascent recovery and the political difficulties of maintaining the pace of consolidation, the authorities remain committed to lowering the public debt-to-GDP ratio below 60 percent by 2019, in line with the program. They support a consolidation strategy based on broadening the tax base, improving revenue compliance and administration, and implementing structural reforms that yield fiscal savings over time. There is a strong political consensus on maintaining a small government with a low tax burden. The authorities are thus wary of raising tax rates which they believe would be counterproductive and further undermine compliance. They are cautious about adopting a stringent fiscal rule that limits flexibility to respond to shocks and are also skeptical about the value added of a fiscal council given a limited pool of available expertise.

21. **The authorities are addressing potential risks by strengthening the fiscal framework and institutional capacity**. The authorities have recently submitted to Parliament amendments to the Organic Budget Law in order to strengthen the MTBF and allow for multi-year commitment limits. The amendments also seek to strengthen the MoF's role in the assessment of PPP proposals and to better integrate PPPs into the budgetary process. The authorities nevertheless noted that the key challenge arises from implementation risks. They highlighted that clearance of central government arrears has been completed ahead of schedule. Regarding the emerging legacy stock of local government arrears, the authorities argued that early estimates of the stock are unverified. To mitigate moral hazard risks, they emphasized that they will ensure that local governments deal with arrears using their own resources. The local government unit at MoF will also start preparing quarterly surveys of local government arrears (SB).

B. Fine-Tuning Monetary Policy to Support the Economic Recovery

Background

22. **The Bank of Albania (BoA) has been maintaining an accommodative monetary policy stance in line with its inflation-targeting framework (Figure 4).** Headline inflation has, however, been running below the 3 percent target against the backdrop of declining food and fuel prices, imported disinflation, and a negative output gap. The exchange rate against the euro has been stable. Core inflation has hovered around zero since 2013 and has turned negative in recent months, partly reflecting the recent pass-through of imported inflation and a decline in retail fuel prices. The BoA has lowered its policy rate by a cumulative 400 basis points since mid-2011 to the current historic low of 1¼ percent. With increased reliance of public borrowing on external sources since late 2015, market liquidity has also increased significantly, creating further downward pressures on domestic T-bill yields.

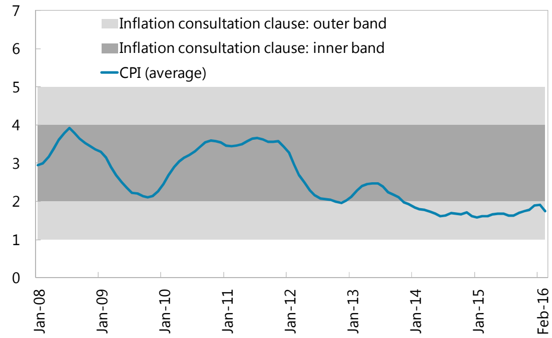
23. **Structural constraints in the financial sector continue to hinder monetary policy.** The monetary transmission mechanism is limited by heavy euroization, with foreign currency loans accounting for two thirds of all loans, of which around half remain unhedged. While deposit rates continue to decline steadily, lending rates are falling at a slower pace, reflecting continued risk-aversion by banks still plagued by high NPLs (18 percent of total loans at end-December 2015). Credit growth remains very weak (¶31), although this also reflects weak demand (especially for corporate loans), deleveraging pressures on foreign subsidiaries, and continued difficulties with collateral execution. The BoA plans to maintain its easing bias, and at some stage could consider the use of unconventional policy tools for monetary easing.

24. **The authorities are implementing an ambitious agenda to improve governance at the central bank, rebuild its credibility, and strengthen its safeguards and independence.** Over the last 18 months, the authorities have taken steps to fill all vacancies in BoA's top management lineup, resumed normal operations at the Internal Audit Department, and constituted an Audit Committee. The BoA has also prepared its 2015 financial statements in accordance with IFRS, and discussions are underway to align the BoA Law with modern central banking legislation.

Figure 4. Albania: Inflation and Monetary Developments

Inflation has underperformed since 2014…

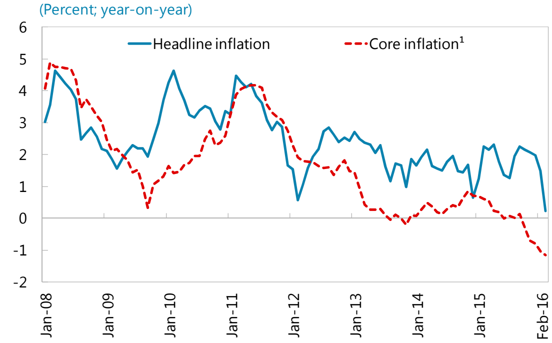
Average Inflation
(Percent)



Sources: INSTAT; and IMF staff calculations.

…with core inflation falling below zero in recent months.

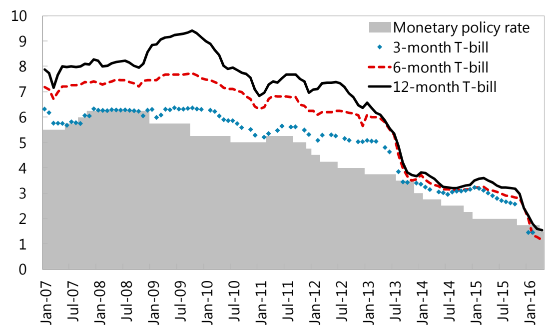
Inflation
(Percent; year-on-year)



1/ BoA's permanent exclusion measure.
Sources: Bank of Albania; Haver Analytics; and INSTAT.

Treasury bill rates have declined significantly, particularly in recent months…

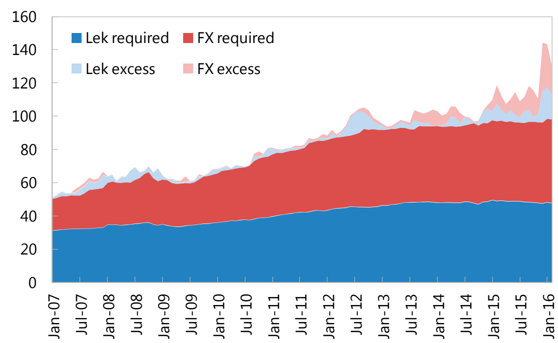
Reference Interest Rates
(Percent)



Sources: Bank of Albania; and IMF staff estimates.

…reflecting increased liquidity in the system.

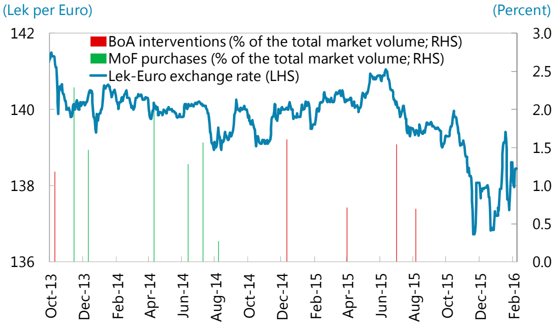
Commercial Banks: Reserves at the Central Bank
(Billion lek)



Sources: Bank of Albania and IMF staff estimates.

Central bank interventions in the FX market were minimal…

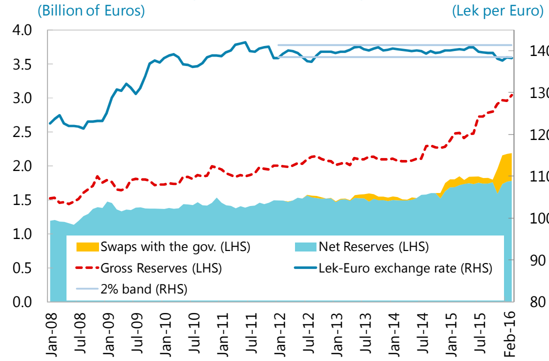
Official Interventions in the Foreign Exchange Rate Market
(Lek per Euro) (Percent)



Note: BoA auctions for foreign exchange are based on a pre-announced schedule.
Sources: Bank of Albania; and Haver Analytics.

…but the exchange rate with the euro has been very stable since late 2009.

Nominal Exchange Rate and Foreign Reserves
(Billion of Euros) (Lek per Euro)

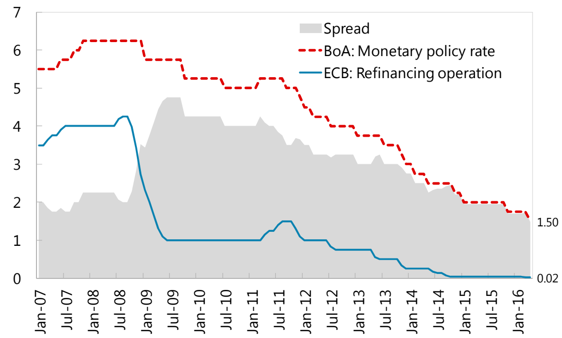


Sources: Bank of Albania; and IMF staff calculations.

Figure 4. Albania: Inflation and Monetary Developments (concluded)

Monetary policy has been accommodative.

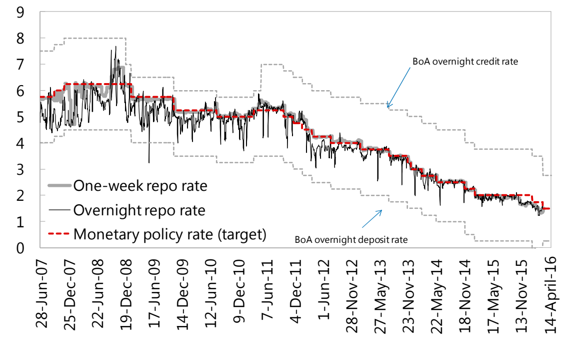
Monetary Policy Rates
(Percent)



Sources: Bank of Albania; and IMF staff estimates.

While interbank rates have closely tracked the policy rate in recent years…

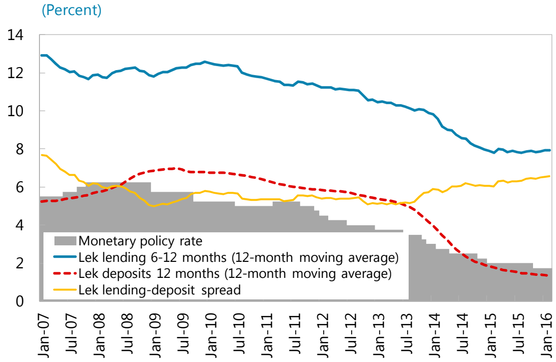
Monetary Policy Rate and Interbank Rates
(In percent)



Sources: Bank of Albania; and IMF staff estimates.

…lending rates have declined less than deposit rates…

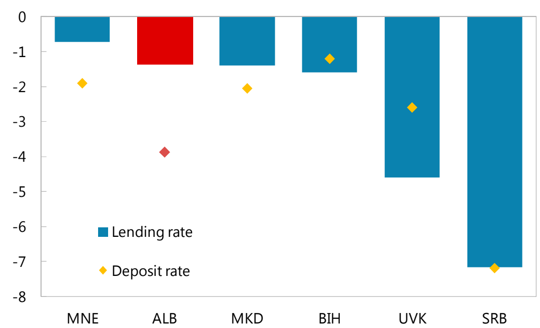
New Lending and New Deposit Rates
(Percent)



Sources: Bank of Albania; and IMF staff estimates.

… reflecting the high risk aversion of banks, even compared to the region.

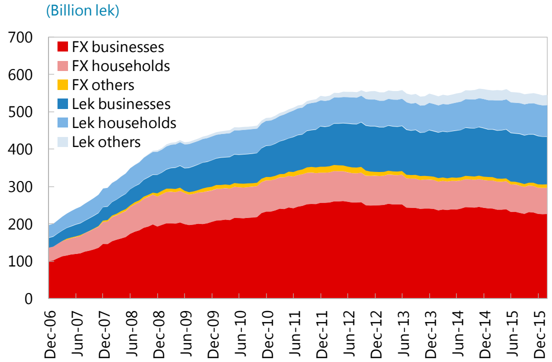
Western Balkans: Changes in Lending and Deposit Rates
(Percentage points; 2015Q4 relative to 2013Q1)



Sources: IMF, Internation Financial Statistics; and IMF Staff estimates.

Monetary policy transmission is hindered by high euroization.

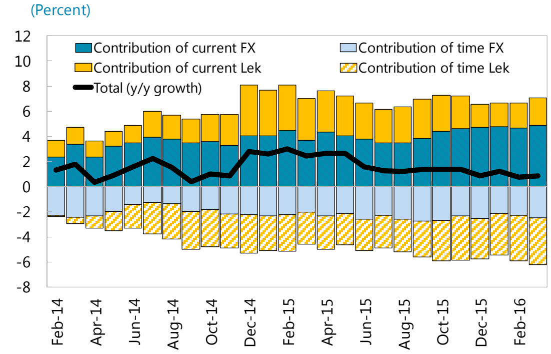
Commercial Banks: Loans
(Billion lek)



Sources: Bank of Albania; and IMF staff estimates.

There is an increasing tendency towards short-term funding.

Deposits by Maturity and Currency
(Percent)



Sources: Bank of Albania; and IMF staff estimates.

25. **Staff assesses the external position as moderately weaker than implied by fundamentals (Annex III).** The lek-euro exchange rate has remained very stable over the past six years, despite limited interventions by the central bank. The REER has been broadly stable, appreciating by 3.7 percent in 2015 compared to 2013. International reserves, which rose in 2015 owing to strong donor flows and Eurobond issuance, are deemed adequate based on metrics for floating regimes. Nevertheless, the current account deficit is sizable and the net international investment position (-47 percent of GDP in 2015) has declined rapidly reflecting the high FDI and increasing external public borrowing. The new EBA-Lite and external sustainability models that take into account Albania's high remittances and FDI suggest a moderate exchange rate overvaluation of around 10 percent.

External Sector Assessment Summary Table

(in percent, except for elasticity)

	CA Norm	Adjusted Actual CA	CA Gap	REER Gap
EBA-Lite (CA Approach)	-3.9	-6.2	-2.3	11.6
External Sustainability Approach	-6.0	-8.6	-2.6	12.2
REER Approach	n.a.	n.a.	n.a.	3.0
REER elasticity	0.2			

26. **Exchange restrictions.** Albania maintained an unapproved exchange restriction under Article XIV of the IMF Articles of Agreement in the form of outstanding balances under inoperative bilateral payment agreements, which were in place before Albania became a Fund member in 1991. These balances relate primarily to debt in nonconvertible and formerly nonconvertible currencies. On February 21, 2015, the Republic of Albania removed two other exchange restrictions and accepted the obligations of Article VIII, Sections 2(a), 3, and 4 of the Articles of Agreement. The authorities continue their efforts to resolve inoperative balances on bilateral payment agreements, maintained subject to Article VIII, Section 2(a), through regular attempts to contact their counterparts.

Policy advice

27. **Given the continued disinflationary pressures, persisting with further monetary easing is appropriate.** There still remains space under the conventional monetary policy framework for further loosening. Strengthening the credit channel will require structural reforms to improve collateral recovery and lower commercial banks' risk aversion (MEFP ¶24) such as through amendments in the Bankruptcy Law and Bailiff's Law as well as improvements in the credit registry. Greater exchange rate flexibility would support the inflation-targeting monetary policy framework, but should be weighed against financial stability risks emanating from unhedged exposures.[4] The

[4] The 2014 FSAP estimated that the direct impact of exchange rate devaluation on bank balance sheets would be limited as banks hold a net long position in foreign currency. However, the indirect impact on credit quality, due to

(continued)

BoA should take further steps to rebuild its credibility, safeguard its independence, and improve its operations and governance, including through amendments to the central bank law to strengthen protections for staff and increase operational autonomy.

Authorities' views

28. **With inflation significantly below the BoA's target of 3 percent, monetary easing is expected to continue in the near term (MEFP ¶18-19 and 26).** The authorities agree that there is still space for conventional monetary easing through lowering the policy rate, and underscored that any decisions on additional measures will be taken in consultation with Fund staff. The authorities remain concerned that lowering the lek-euro interest rate differential below a certain level could lead to heightened exchange rate volatility, thereby aggravating financial stability risks given the significant unhedged exposures. They agree on the importance of amending the central bank law and have already launched the process, but cautioned that more time might be needed to consult stakeholders and build support.

29. **The authorities agreed that there may be some overvaluation in the exchange rate, but stressed that the exchange rate is floating freely and is driven entirely by market forces (MEFP ¶20).** They emphasized that interventions in the FX market are small, infrequent, and typically announced months in advance. They consider structural factors and balanced financial flows and entrenched expectations to be the driving factors behind exchange rate stability.

C. Unlocking Private Sector Credit and Safeguarding Financial Stability

Background

30. **The banking system remains stable, well capitalized and liquid.** The system-wide capital adequacy ratio is around 16 percent and the liquidity ratio is around 33 percent, well above statutory requirements. Although the Albanian banking system is dominated by foreign banks (with a market share of 86 percent), it is mostly funded by domestic deposits, mitigating the effects of deleveraging compared to regional peers. The level of bank intermediation remains low, with private sector credit at around 35 percent of GDP, compared to 45 percent of GDP in the Western Balkans region. Profitability has been low, but has been recovering since the crisis. Key vulnerabilities stem from high euroization, large exposure to illiquid central government securities, and persistently high NPLs.

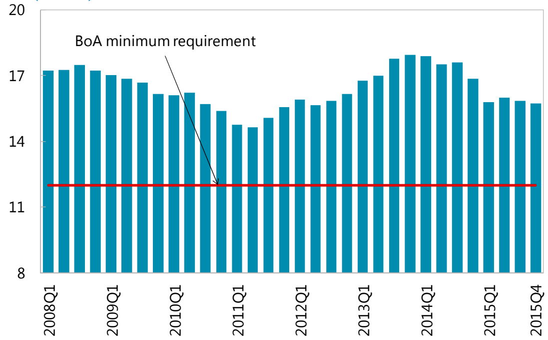
31. **Credit growth to the private sector is subdued, as banks remain risk-averse given the significant NPL overhang (Figure 5, and Tables 4a and 5).** The 2.9 percent decline in private sector credit in 2015 is explained by a 2015 regulation mandating write-offs of loans that have spent more than three years in the "loss" category. However, even after removing the effects of NPL

foreign currency lending to unhedged borrowers, would be more significant—a 30 percent depreciation of the lek would lead to an increase in the NPL ratio of the banking system of over 5 percentage points.

Figure 5. Albania: Financial Sector Developments

Banks are well capitalized…

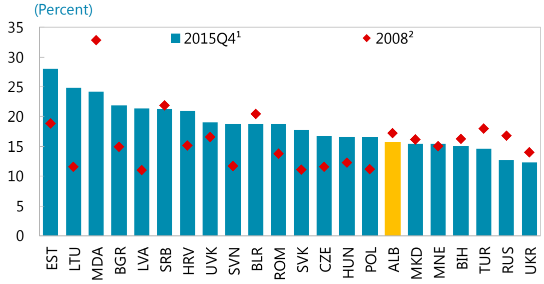
Capital Adequacy Ratio
(Percent)



Source: Bank of Albania.

…and capital buffers are close to their pre-crisis levels.

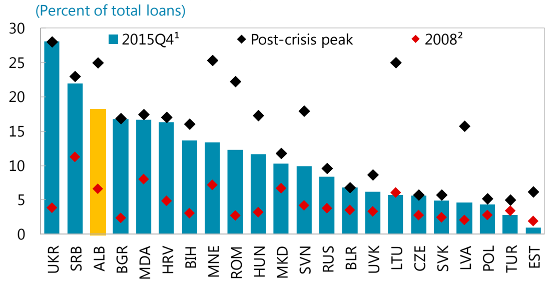
CESEE: Regulatory Capital to Risk Weighted Assets
(Percent)



1/ Except for Bulgaria (2014), Czech Republic (2015Q3), Moldova (2015Q3), Romania (2015Q3), and Turkey (2015Q3).
2/ Except for Belarus (2010Q4) and Moldova (2009Q1).
Sources: National authorities; IMF Financial Soundness Indicators; and IMF staff estimates.

NPLs are elevated but have started falling…

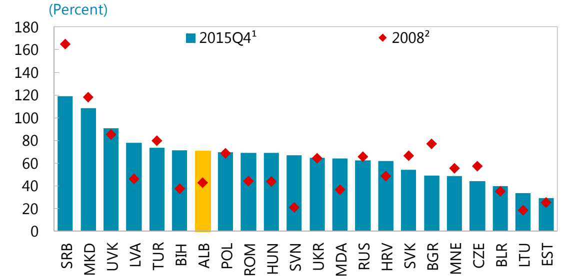
CESEE: Non-Performing Loans
(Percent of total loans)



1/ Except for Bulgaria (2014), Czech Republic (2015Q3), Moldova (2015Q3), Romania (2015Q3), and Turkey (2015Q3).
2/ Except for Belarus (2010Q4) and Moldova (2009Q1).
Sources: National authorities; IMF Financial Soundness Indicators; and IMF staff estimates.

…and they are adequately provisioned.

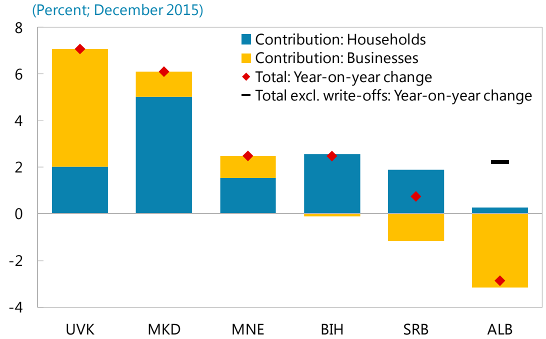
CESEE: Provisions to Gross NPLs
(Percent)



1/ Except for Bulgaria (2014), Czech Republic (2015Q3), Moldova (2015Q3), Romania (2015Q3), and Turkey (2015Q3).
2/ Except for Belarus (2010Q4) and Moldova (2009Q1).
Sources: National authorities; IMF Financial Soundness Indicators; and IMF staff estimates.

However, bank lending remains cautious…

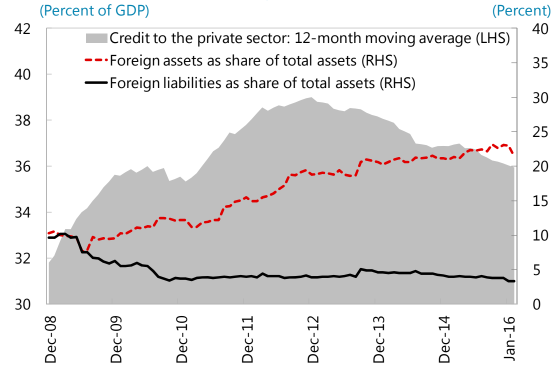
Western Balkans: Credit to Domestic Private Sector
(Percent; December 2015)



Sources: Haver Analytics; IMF, International Financial Statistics; and IMF staff estimates.

…as banks have increased overseas placements.

Private Credit and Foreign Assets and Liabilities
(Percent of GDP) (Percent)



Sources: IMF International Financial Statistics; and IMF staff calculations.

write-offs, credit to the private sector grew by only 2.3 percent in 2015. While demand for credit is weak, difficulties with contract enforcement and collateral execution in the court system also deter new lending. NPLs have declined substantially from their peak of 25 percent in September 2014 but still remain high at 18 percent of all loans in December 2015. Provisions cover 71 percent of gross NPLs.

32. **The authorities are implementing a comprehensive strategy to reduce NPLs.** The plan integrates and sequences reforms in the areas of supervision, regulatory enforcement, debt restructuring, and insolvency. The authorities have already submitted legal changes to Parliament to better protect financial collateral and to strengthen property rights over real estate, amended regulations to facilitate write-offs and collateral management, and formulated an action plan for handling the 35 largest holders of NPLs (that account for around 50 percent of the NPLs). Going forward, the NPL strategy envisions simplifying and clarifying the bankruptcy law, as well as amending several other pieces of legislation such as the Civil Procedure Code and the Private Bailiff's Law in order to increase the efficiency of the NPL resolution process (SBs).

33. **The BoA has made significant strides in improving its supervisory vigilance.** Although Greek banks account for around 13 percent of total assets, the banking system weathered the financial turmoil in Greece last summer with minimal spillovers. The authorities adopted the Basel II framework in 2015 strengthening the banks' risk management practices. With about 70 percent of assets concentrated in the four largest banks, the authorities have been monitoring closely systemic institutions. The crisis management framework has been improved, including by preparing a new bank resolution law. The BoA also joined the European Banking Authority College in 2015, which will enable better coordination with foreign supervisors.

34. **Nonbank supervision has been substantially strengthened.** The non-banking sector in Albania is relatively small at around 10 percent of GDP, but has seen rapid growth over the past few years.[5] Investment funds in particular have expanded rapidly, currently accounting for about half of this sector. The low interest rate environment is leading to increased appetite for savings instruments in the non-banking sector. In June 2015, the authorities approved new regulations on liquidity requirements and asset valuation for investment funds. All vacancies on the executive board of the Albanian Financial Supervisory Authority (AFSA) have now been filled, after substantial delays. The presence of only a single investment fund custodian, a small bank, is raising concerns about systemic vulnerabilities, especially given plans to start new investment funds.

[5] The non-banking sector consists of investment funds, insurance companies, savings and credit associations, pension funds, and other non-bank financial institutions.

Policy advice

35. **The key to reviving credit is to strengthen banks' balance sheets and restore their confidence by improving NPL resolution.** Speedy and forceful implementation of the authorities' comprehensive NPL strategy would be critical, in particular in simplifying the legal framework for insolvency and facilitating collateral execution and out-of-court restructuring.

36. **The authorities need to continue efforts to strengthen financial supervision and regulation**. BoA's microprudential tools should continue to focus on the fastest-growing and systemically important segments of the banking system, and seek to reduce euroization and the share of unhedged borrowers in foreign currency in the banking system. It should also maintain consistency with international standards and ensure healthy capitalization levels in the banking system by unwinding reduced risk weights designed to encourage moderate credit growth. The central bank has also committed to gradually unwind the recently introduced lower risk weights on Albanian government securities issued in foreign currency to contain euroization risks and align its framework with Basel II.

37. **Given the growing presence of investment funds and non-bank financial institutions, there is an urgent need to strengthen AFSA's capacity and its ability to attract and retain skilled staff**. To protect financial stability, AFSA should assess carefully all license applications for new investment funds, and should encourage more competition among investment fund custodians.

Authorities' views

38. **The BoA is committed to maintaining its supervisory vigilance to preserve financial stability (MEFP ¶22–23).** The central bank will continue to monitor closely individual banks' resilience to risks, as well as capital and liquidity positions, and will continue to target fast-growing or systemically important banks. The authorities noted the adverse domestic impact of international regulatory reform initiatives which have led to very tight credit standards. They agreed that the changes to capital requirements designed to encourage moderate credit growth are temporary and explained that they plan to repeal them by end-2016. Similarly, the central bank will gradually roll back the lower risk weights on Albanian government securities issued in foreign currency by 2021.

39. **The authorities agree on the importance of a speedy implementation of their action plan to reduce NPLs (MEFP ¶24–25).** The BoA will continue to actively facilitate out-of-court restructuring of NPLs. The authorities are also committed to strengthening AFSA's capacity and its ability to attract and retain skilled staff. AFSA will also conduct stress tests and a crisis preparedness exercise for investment fund custodians.

D. Advancing Structural Reforms to Achieve Sustainable High Growth

Background

40. **Structural reforms to improve the business environment are critical for strengthening Albania's competitiveness (Figures 6–7).**[6] Albania's rankings in the Doing Business survey are lagging behind regional peers. As key challenges to competitiveness, cross-country surveys point to (i) critical infrastructure gaps that constrain trade and raise the cost of business, (ii) widespread informality that leads to low investment and productivity, (iii) complex tax procedures that increase the burden on businesses, (iv) financial underdevelopment with extremely limited access to equity financing constraining growth, and (v) an inefficient judiciary system that does not protect property rights adequately and hampers the rule of law. More broadly, weak institutions and poor governance are significant constraints to improving the investment climate.

41. **Despite relatively favorable demographics, skills shortages remain a key structural challenge (Figure 8).** Albania's population is relatively young compared to European peers. Furthermore, labor supply has been increasing with decelerating emigration, increased migration from rural to urban areas, and a gradual increase in labor force participation rates. However, youth unemployment has been climbing up reaching 33 percent at end-2014, with the difference between the youth and the headline unemployment rate increasing from 6 percentage points in 2007 to 15 percentage points in 2014. This reflects gaps in the education system which have contributed to shortages of skilled labor. The lack of skilled workers is more severe in the tradable sectors—manufacturing and tourism— than in nontradable sectors, such as construction and retail trade.

42. **Indicators of external competitiveness also suggest underlying weaknesses (Figure 9).** Flexible labor markets have helped maintain low unit labor costs. However, labor productivity gains have virtually stalled as investment remains constrained by shortages of skilled labor and a weak business environment. The export base remains very narrow and commodity exports (mostly oil) are exposed to volatile global prices. The market share of non-oil exports has seen little growth. These are concentrated in low value-added sectors (such as textiles and footwear), which are exposed to competition from textile hubs in low-income countries with cheaper labor. The exchange rate is estimated to be moderately overvalued, thus undermining competitiveness (¶25).

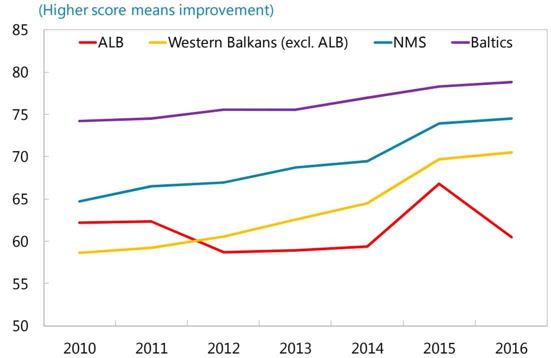
43. **Persistence with electricity sector reform has started to yield impressive results.** These include sustained increases in bill collections, reductions in distribution losses, and stronger finances of the state-owned electricity companies. Arrears to the private sector by electricity SOEs have been cleared. Despite these achievements, service interruptions are still a frequent occurrence.

[6] See *Selected Issues Paper*, "External Competitiveness."

Figure 6. Albania: Business Environment

Business environment indicators lag behind the region…

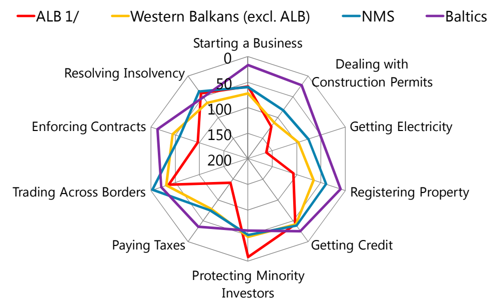
Doing Business Indicator
(Higher score means improvement)



Sources: Doing Business (2016); and IMF staff calculations.

…particularly in enforcing contracts, registering property, getting electricity, and paying taxes.

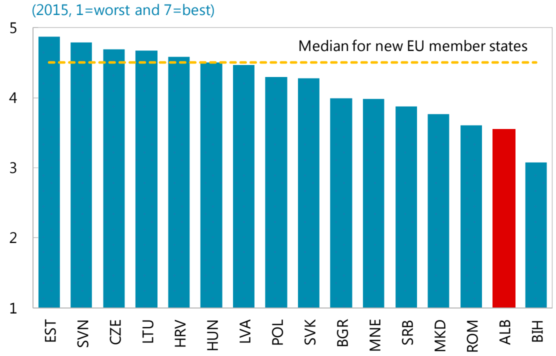
Business Environment, Ranking



1/ 2016 data for "Dealing with Construction Permits" for Albania are not available. 2015 data are used instead.
Sources: Doing Business (2016); and IMF staff calculations.

Infrastructure gaps increase the cost of business…

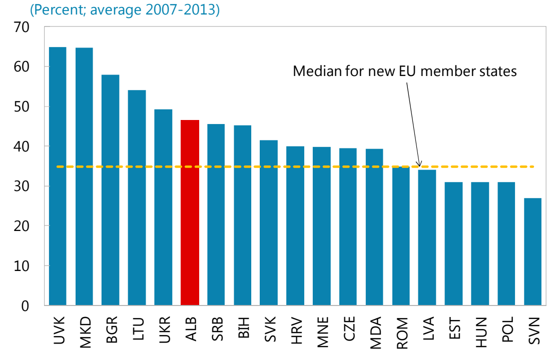
Infrastructure Quality
(2015, 1=worst and 7=best)



Source: Global Competitiveness Report (2015-16).

…and informality is also a challenge.

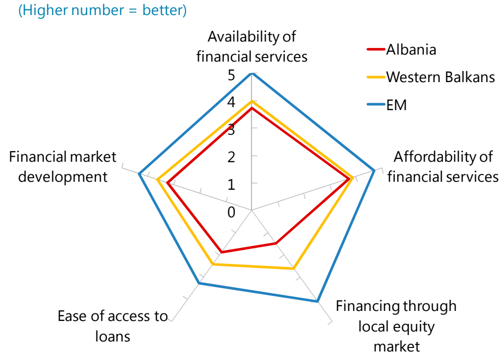
Informality: Firms Competing Against Unregistered Firms
(Percent; average 2007-2013)



Sources: World Bank, Business Enterprise Survey; and IMF staff calculations.

Financial underdevelopment constrains growth.

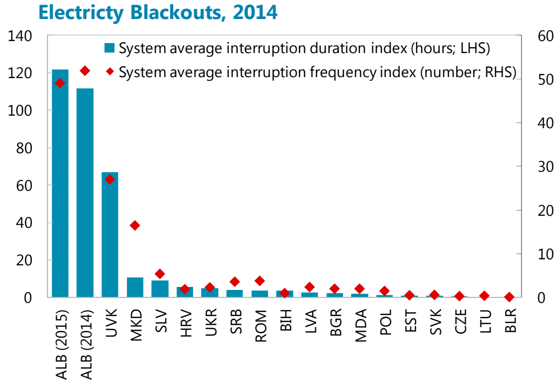
Financial Market Development Indicators
(Higher number = better)



Sources: Global Competitiveness Report (2015-16); and IMF staff calculations.

The authorities are pursuing an ambitious reform in the electricity sector, but service interruptions remain high.

Electricty Blackouts, 2014

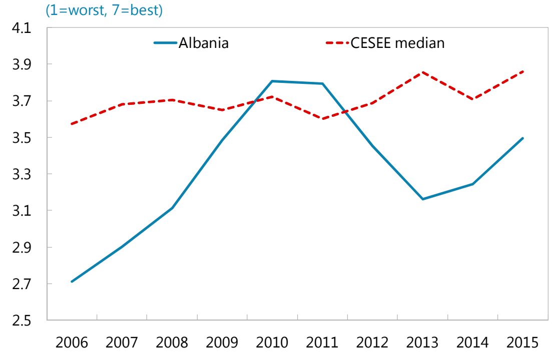


Sources: OShEE; and World Bank, Doing Business Indicators.

Figure 7. Albania: Governance and Public Financial Management

Institutional quality remains low…

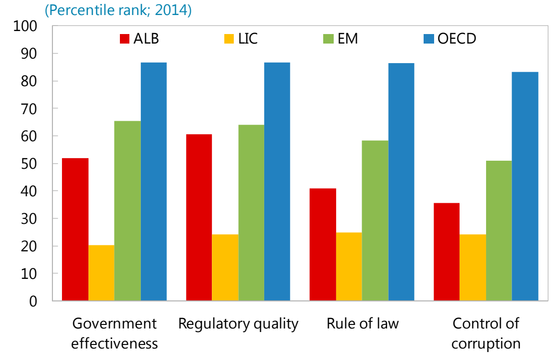
Institutional Quality Scores
(1=worst, 7=best)



Source: Global Competitiveness Report (2015-16).

…with the rule of law and control of corruption being the two areas where the governance gap is the widest.

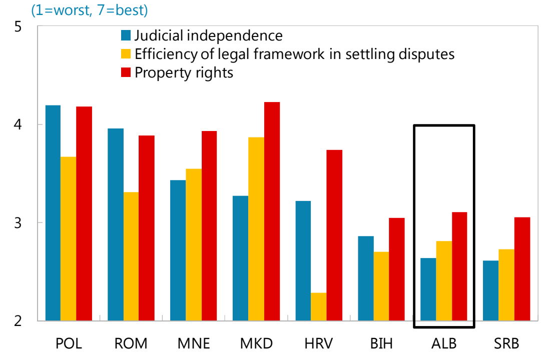
Governance Indicators
(Percentile rank; 2014)



Sources: Worldwide Governance Indicators; and IMF staff calculations.

The judicial system lacks independence and efficiency, and does not protect property rights adequately.

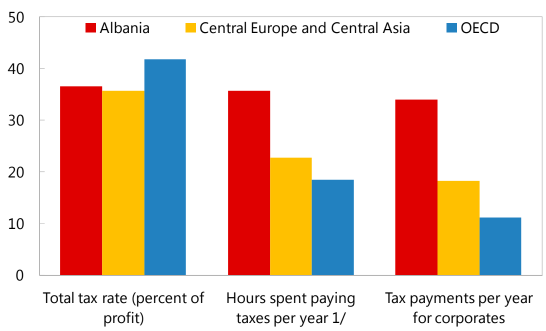
Judicial System and Property Rights Protection
(1=worst, 7=best)



Source: Global Competitiveness Report (2015-16).

Tax administration is in need of major improvement…

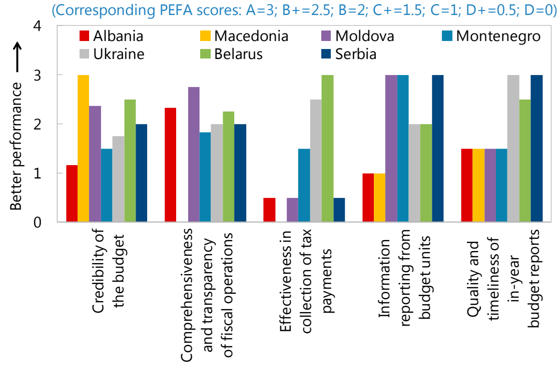
Administrative Efficiency in Paying Taxes



1/ Each unit in the chart corresponds to 10 hours.
Sources: Doing Business (2016); and IMF staff calculations.

…as are other areas of public fiscal management, including the budgetary framework…

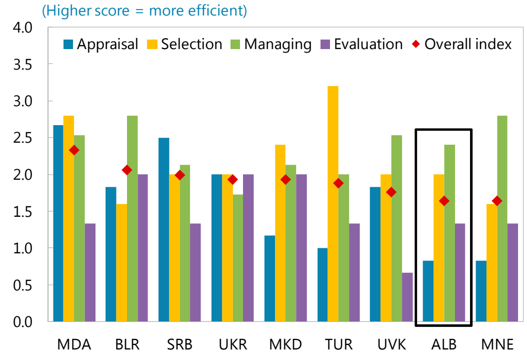
Public Expenditure and Financial Accountability
(Corresponding PEFA scores: A=3; B+=2.5; B=2; C+=1.5; C=1; D+=0.5; D=0)



Sources: PEFA program reports and staff calculations.

…and public investment management.

Public Investment Efficiency Index
(Higher score = more efficient)



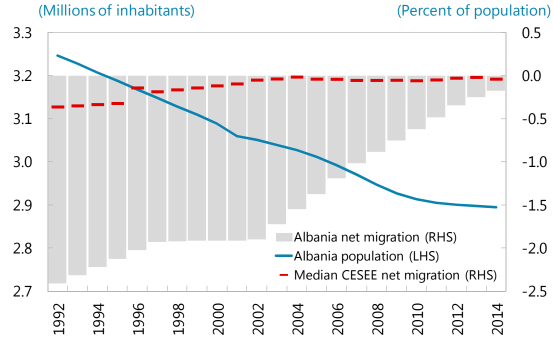
Source: IMF Working Paper WP/11/37.

Figure 8. Demography and the Labor Market

The population has been shrinking due to emigration, but the pace has decelerated in recent years.

Population and Net Migration

(Millions of inhabitants) (Percent of population)

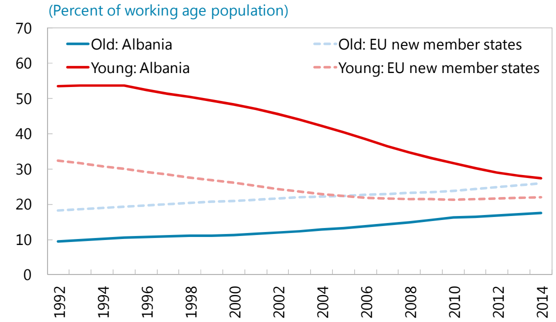


Sources: World Bank, World Development Indicators; and IMF staff estimates.

As in the rest of CESEE, the population is aging, while still being younger than in most other CESEE countries.

Dependency Ratios

(Percent of working age population)

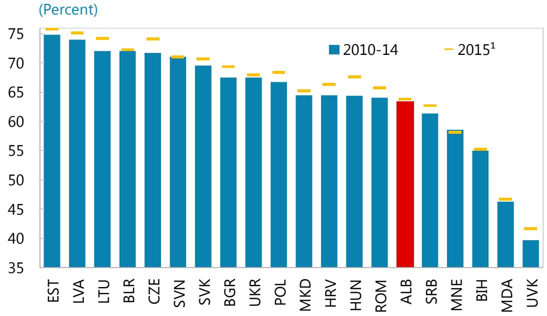


1/ Old dependency ratio = population 65+ years / population 15-65 years.
2/ Young dependency ratio = population 0-15 years / population 15-65 years.
Source: World Bank, World Development Indicators.

The labor force participation rate is low, partly due to high remittances, but has been gradually rising.

Labor Force Participation Rate

(Percent)

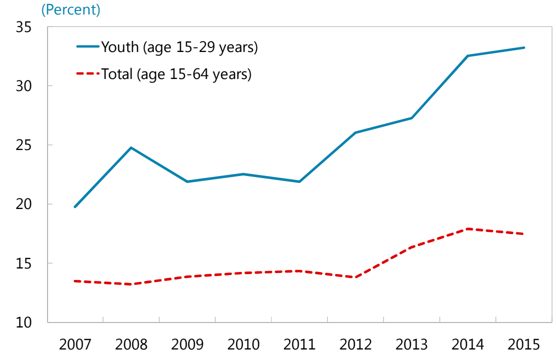


1/ 2015 or latest available.
Sources: INSTAT; International Labour Organization database; and IMF staff estimates.

Unemployment remains high and has risen rapidly since 2011, especially among the young…

Unemployment Rate

(Percent)

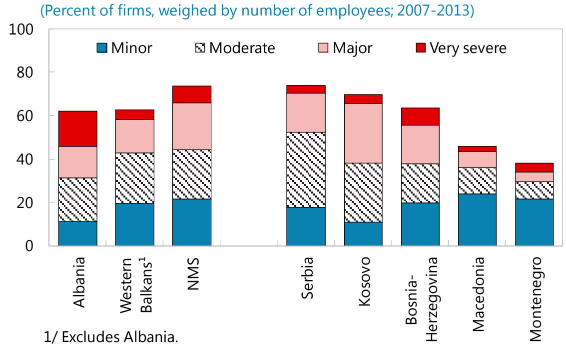


Source: INSTAT.

…which reflects gaps in the educational system contributing to skill shortages.

How Much of an Obstacle is an Inadequately Educated Wokforce?

(Percent of firms, weighed by number of employees; 2007-2013)

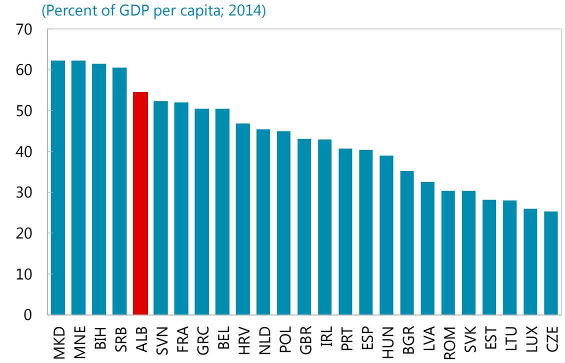


1/ Excludes Albania.
Sources: World Bank, Enterprise Surveys; and IMF staff estimates.

The minimum wage is relatively high and likely to be binding for a significant share of young workers.

Minimum Wage

(Percent of GDP per capita; 2014)

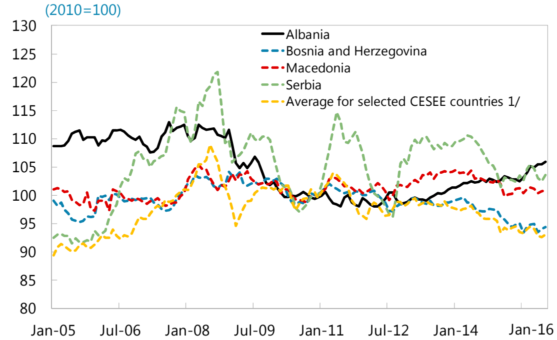


Sources: Haver Analytics; OECD; IMF, WEO database; and IMF staff estimates.

Figure 9. Albania: Export Competitiveness

The real exchange rate has been appreciating recently, mostly due to higher inflation relative to trading partners.

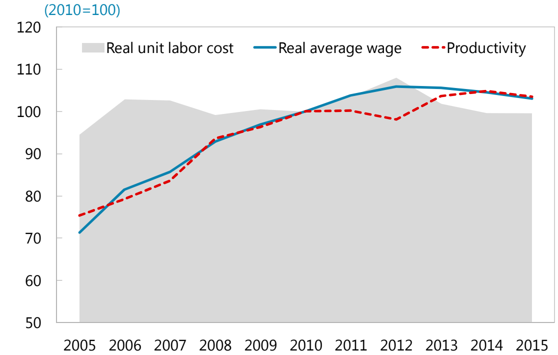
REER
(2010=100)



1/ Bulgaria, Croatia, Czech Republic, Hungary, Poland, and Romania.
Source: IMF, Information Notice System.

Despite a slowdown in labor productivity growth, real unit labor costs have fallen, as wages have declined…

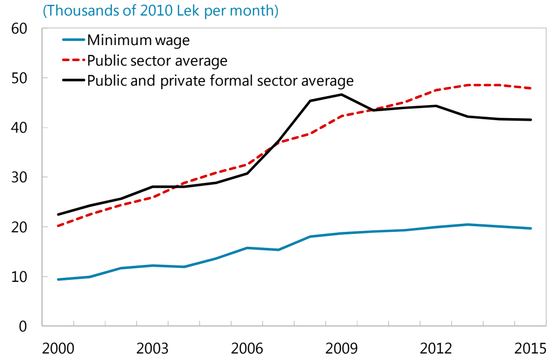
Real Unit Labor Cost, Real Wages, and Productivity
(2010=100)



Sources: Haver Analytics; OECD; IMF, WEO database; and IMF staff estimates.

…particularly in the private sector, while minimum wages have grown steadily.

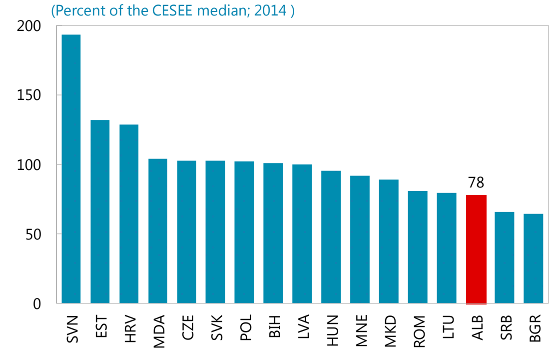
Real Wages
(Thousands of 2010 Lek per month)



Sources: INSTAT; and IMF staff estimates.

Albania has thus maintained its cost competitiveness, with unit labor costs among the lowest in CESEE.

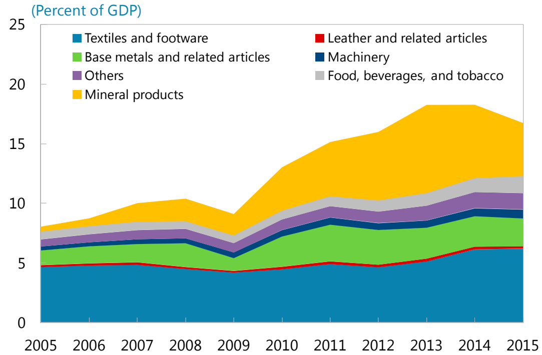
Unit Labor Cost
(Percent of the CESEE median; 2014)



Sources: Haver Analytics; INSTAT; OECD; and IMF staff estimates.

Exports are mainly concentrated in oil, metals, and textiles and footwear.

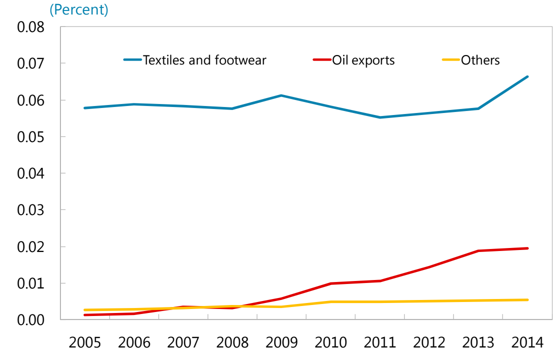
Albania: Exports of Goods
(Percent of GDP)



Sources: INSTAT; and IMF staff estimates.

The world market share of oil exports has been growing, while that of non-oil exports has been more stable.

Albania's Share in the World Market
(Percent)



Sources: INSTAT; World Bank, WITS; and IMF staff estimates.

Policy advice

44. **Further structural reforms to improve the business environment would be critical for strengthening Albania's competitiveness and catalyzing stronger growth.** The focus needs to be on reforms crucial for improving the business climate, including property rights and the judiciary. Efforts to establish the legal cadastre for property registration should be expedited, in order to strengthen property rights, a key impediment to investment. Progress in judicial reform should be guided by the recommendations of the Venice Commission.[7] Albania also needs to sustain the fight against informality, simplify tax collection procedures, and improve governance. Finally, diversification of exports beyond commodities and low value-added textiles will be important for sustainable growth, and would require additional investment in education and infrastructure.

45. **Electricity sector reforms focusing on further deregulation and improved corporate governance would improve energy supply and lower the cost of doing business.** In advancing reforms, the focus should be on further liberalizing the electricity market, investing prudently in meters and grid infrastructure, and strengthening corporate governance in the sector, including through greater financial transparency.

Authorities' views

46. **While the authorities acknowledge the importance of further structural reforms, they also pointed to the accomplishments of the past few years.** Reforms in higher education and vocational training have started tackling the education gap. The new Strategic Investment Law is introducing fast-track procedures for businesses, including a one-stop shop to help attract FDI by streamlining the entry process. VAT refunds have been simplified and accelerated, and the ongoing campaign against tax evasion, non-compliance, and informality is trying to level the playing field for law-abiding businesses.

47. **The authorities are determined to sustain the momentum of the electricity sector reform (MEFP ¶27-28).** The 2015 power sector law sets in place a schedule for moving all medium-voltage customers out of the regulated tariff structure by end-2017, beginning with 35kV customers by July 2016 and 20 kV customers by end-2016 (SBs). On completion, the share of deregulated consumption would increase from 13 to 33 percent of the total energy consumed. The authorities are also developing a power exchange and pursuing integration with the electricity markets of neighboring countries. The authorities will continue to prepare a quarterly survey of the arrears of the electricity sector to the private sector (SB), and will monitor the SOEs' operations on a monthly basis to ensure financial discipline. Finally, they will target improvements in corporate governance in the sector, including by moving forward with an advisory services contract for the distribution company and by publishing quarterly financial statements for the generation, transmission, and distribution SOEs (SB).

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[7] The Venice Commission is an advisory body of the Council of Europe composed of independent experts in the field of constitutional law.

PROGRAM DESIGN AND RISKS

48. **The authorities request, and staff supports, a waiver of applicability for the end-April PCs on the general government's primary balance and primary expenditure.** Data for assessing these PCs are unavailable. Staff expects these PCs to be met. All PCs for end-December 2015 were met.

49. **The authorities propose, and staff supports, the following modifications to program conditionality (MEFP Tables 1 and 3b):**

- Adjust marginally the PCs and ITs for August and November 2016 in line with the updated economic outlook. In particular, the lower world price of oil justifies a modest downward revision in the NIR floors for August and November 2016.
- Remove the indicative target on contracting non-energy guarantees. The amounts are now fully captured in the authorities' fiscal framework, including the program targets on the primary deficit and primary expenditure.
- To allow time to train users of the new treasury IT system (AGFIS), reschedule its roll-out to 15 budget institutions to end-May 2016.
- Introduce new structural benchmarks aimed at improving public financial management and tax administration.

50. **The program remains fully financed**. In 2016, the World Bank is providing a development policy loan of $175 million, and the EBRD is expected to provide a loan of €100 million to finance a restructuring of electricity sector debt. In addition, the EU is providing €20 million annually over 2016-18, in the form of a grant for balance of payments support linked to the implementation of Albania's PFM reform strategy.

51. **Albania is expected to meet repayment obligations to the Fund (Table 7).** By the end of the Extended Arrangement, Fund credit outstanding is projected to be 3.2 percent of GDP, or 13.3 percent of gross reserves. Debt service to the Fund is expected to peak in 2022 at around 0.5 percent of GDP and less than 3 percent of international reserves. After peaking at 43.3 percent of GDP in 2017, external debt will decline to 37.2 percent of GDP by 2021, with external public debt falling from 35.0 to 28.6 percent of GDP. Risks to repayment capacity are mitigated by Albania's strong record of repaying the Fund and by the authorities' robust performance during the first two years of the program, including their willingness to move ahead with difficult structural reforms.

52. **Risks to the program remain elevated.** With the next general election due by mid-2017, political and social tensions could test the authorities' perseverance with reforms and commitment to fiscal adjustment and debt reduction. The revenue gains from the tax compliance efforts remain uncertain in the near term. Revenue mobilization requires sustained political will and is vulnerable to constraints on administrative and technical capacity. Despite an impressive start, electricity sector

reforms are subject to implementation and weather-related risks, and will require unbending political commitment over the medium term. These risks are mitigated by the prospect for EU accession, which provides a catalyst for reform. Extensive TA by the Fund and other donors will continue to build up capacity to manage macroeconomic risks. Finally, border closures elsewhere in the Balkans could lead to a surge of refugees transiting through Albania and could strain the country's infrastructure and public finances. Fiscal targets could be adjusted to accommodate such a temporary shock.

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53. **Albania's economic recovery is slowly gathering pace, supported by prudent policies and a gradual restoration of consumer confidence.** The current account deficit is expected to widen as import-intensive FDI picks up. Headline inflation is low and will likely remain so in the near future, due to imported disinflation and domestic slack. The medium-term outlook remains favorable, provided the reform momentum is maintained.

54. **Program ownership has been strong, with the authorities implementing some ambitious and difficult reforms.** Program targets were broadly met, with comfortable margins. Fiscal consolidation is underway and public debt is projected to have peaked in 2015. Pension and power sector reforms and arrears clearance are important milestones. However, other reforms critical for improving the business environment—including those related to property rights, NPL resolution, the judiciary, and governance—are lagging.

55. **Fiscal consolidation should continue to lower fiscal vulnerabilities and ensure debt sustainability.** The authorities need to persist with their target of lowering public debt below 60 percent of GDP by 2019, which requires measures of around 1 percent of GDP each year. To anchor long-term expectations, the authorities should adopt a fiscal rule, particularly in view of the EFF-supported program ending next year.

56. **Given the relatively low level of public spending, the fiscal adjustment will need to focus mainly on the revenue side**. The space for further tax rate increases is limited, so the consolidation strategy should instead broaden the tax base and strengthen compliance and revenue administration. The authorities should refrain from granting any further tax exemptions or preferential tax treatments, and strive to remove existing ones. Steps to introduce a valuation-based property tax should be expedited.

57. **Strengthening tax compliance to address the low and declining efficiency of the tax system is a key priority.** The refocusing of the authorities' campaign against tax evasion, non-compliance, and informality to target high-risk, high-value segments and harness modern compliance risk management tools is welcome. The tax administration should focus on the timely implementation of its corporate strategy. The tax and customs administrations should share information and coordinate more closely on risk assessment.

58. **Persistence with structural fiscal reforms is needed to reduce fiscal risks.** Strengthening public investment management and boosting the credibility of the authorities' MTBF are crucial in order to reduce the risk of unfunded commitments and arrears. The recent transfer of the public investment portfolio from the Ministry of the Economy back to the Ministry of Finance is a significant step in the right direction. All PPP proposals should be subject to a detailed feasibility study and cost-benefit analysis, which should be evaluated by the Ministry of Finance before approval. The impact of any new PPPs on the fiscal accounts should be reflected transparently and in line with international norms.

59. **Progress with arrears clearance and prevention should be sustained.** To prevent recurrence of new arrears, multi-year commitment limits and the rollout of a new treasury IT system should be implemented urgently. The emerging stock of legacy arrears at the local level should be audited and swiftly addressed without introducing moral hazard risk. To mitigate fiscal risks from the ongoing fiscal decentralization and improve reporting and monitoring, the review of the local public finance law should be expedited.

60. **Continued progress on power sector reforms would also mitigate fiscal risks.** The early results from these reforms are impressive. To cement these gains, steadfast implementation of the reform agenda would be critical. In advancing reforms, the focus should be on further liberalizing the electricity market, investing prudently in meters and grid infrastructure, and strengthening corporate governance in the sector.

61. **The authorities should persist with monetary easing.** There remains space under the conventional monetary policy framework for further easing. Greater exchange rate flexibility would support the inflation-targeting monetary policy framework, but should be weighed against financial stability risks emanating from unhedged exposures. The BoA should take further steps to rebuild its credibility, safeguard its independence, and improve its operations and governance.

62. **High risk aversion by banks due to difficulties in NPL resolution continues to thwart credit recovery.** Speedy implementation of the authorities' comprehensive NPL strategy is critical, in particular in clarifying and simplifying the legal framework for insolvency, as well as facilitating collateral execution and out-of-court restructuring.

63. **The authorities continued efforts to strengthen financial supervision and regulation are welcome**. The banking system remains well-capitalized and liquid. BoA's microprudential tools should focus on the fastest-growing and systemically important segments of the banking system. The BoA should seek to reduce euroization in the banking system, including by appropriate macroprudential measures to reduce the share of unhedged borrowers in foreign currency. It should also maintain consistency with international standards and ensure healthy capitalization levels in the banking system. Given the growing presence of investment funds and non-bank financial institutions, the authorities should urgently strengthen the non-bank financial regulator's capacity and its ability to attract and retain skilled staff.

64. **Further structural reforms to improve the business environment would be critical for strengthening Albania's competitiveness.** Policies should seek to address structural bottlenecks to investment. Higher investments would potentially foster greater technology transfer and enable the export base to diversify into higher value-added sectors. Faster growth in labor productivity would require further reforms in higher education and vocational training. Additional improvement in the country's infrastructure could ease the cost of doing business. In order to bolster its competitiveness, Albania also needs to sustain the fight against informality, simplify tax collection procedures, and improve governance. Efforts to address corruption and organized crime could be enhanced, in line with key priorities in the EU accession negotiations and recommendations by the Council of Europe's Group of States against Corruption, including by mobilizing the AML framework. To strengthen property rights, efforts to establish the legal cadastre for property registration should be expedited. Progress in judicial reform should be guided by the recommendations of the Venice Commission.

65. **In light of the progress so far and the authorities' policy commitments going forward, staff supports the completion of the Seventh Review under the Extended Arrangement.** Staff also supports the authorities' requests for waivers of applicability and modification of performance criteria.

66. **It is recommended that the next Article IV consultation with Albania be held on the 24-month cycle, subject to Decision No. 14747, as amended.**

Box 1. Implementation of the Recommendations from the 2014 Article IV Consultation

Advice: Implement sizable revenue-based fiscal adjustment in order to reduce public debt to about 60 percent of GDP over the medium term and to 40 percent of GDP over the longer term. Pass a fiscal rule law and adopt a binding MTBF.

Status: The authorities have adopted three annual budgets with significant revenue measures. However, due to revenue shortfalls, the ex post fiscal adjustment has had a significant expenditure component, particularly in public investment. Public debt peaked at 72 percent of GDP in 2015, partly due to exogenous factors and after incorporating subsidies to the electricity sector. The authorities have drafted a fiscal rule law that targets a debt level of 45 percent of GDP over the longer term. Making the MTBF more credible and binding continues to be a challenge.

Advice: Clear central government arrears in a comprehensive and transparent fashion and prevent the accumulation of new arrears.

Status: The authorities have implemented a public strategy for clearance and prevention. The bulk of arrears clearance is projected to have been completed at end-2015. Amounts cleared have been made public on a regular basis. External auditors were employed to ensure the integrity of the process. However, measures to prevent future arrears, such as introducing multi-year commitment limits and rolling out a new treasury IT system, have been delayed. As a result, small amounts of new arrears have recurred.

Advice: Strengthen tax administration.

Status: GDT has adopted a new IT system and developed a corporate strategy to guide medium- and long-term reforms, including the adoption of modern compliance management principles. VAT refunds have been streamlined and are now audited on a risk basis. However, staffing and capacity issues persist, and the tax administration is distracted by multiple reform initiatives.

Advice: Implement pension reform. Reform the existing disability benefit system.

Status: A pension reform was passed in mid-2014. It gradually raises the retirement age, separates social assistance from social insurance, aligns benefit and contribution ceilings, and indexes pensions to inflation. The authorities are also reforming disability benefits, with help from the World Bank.

Advice: Implement a reform of local government to address fiscal risks and improve transparency and accountability.

Status: The authorities are pursuing a fiscal decentralization strategy which involves devolution of certain functions, transfer of related personnel, and new financing sources for local governments. Following local elections in mid-2015, a large number of communes and municipalities have been consolidated into 61 units. The authorities are reviewing the legal framework on local public finance, with help from USAID and the World Bank.

Advice: Improve public debt management.

Status: The authorities have lengthened the maturity structure of public debt, shifted greater weight toward IFI funding, and successfully rolled over a maturing Eurobond in November 2015.

Advice: Gradually ease monetary policy, while considering risks from unhedged foreign currency exposures and high NPLs. Remove exchange restrictions and accept the obligations of Article VIII.

Status: The BoA lowered its main policy rate by 175 basis points over 2014–16, to a historical low of 1.25 percent. The exchange rate with the euro has remained very stable. The authorities recently removed two exchange restrictions and accepted the obligations of Article VIII, Sections 2(a), 3, and 4. Albania maintains an unapproved exchange restriction in the form of outstanding balances on inoperative bilateral payment agreements. These were in place before Albania became a Fund member in 1991.

Advice: Implement FSAP recommendations to strengthen financial stability.

Box 1. Implementation of the Recommendations from the 2014 Article IV Consultation (Concluded)

Status: The authorities intensified supervision of systemic banks and now require them to maintain emergency recovery plans. They also expanded the collateral eligible for ELA to all government securities and enhanced coordination with overseas supervisors. Banking supervision was strengthened with an updated supervision manual introducing a new risk assessment system which prioritizes governance and risk management. However, an asset quality review for the banking system has been delayed.

Advice: Tackle comprehensively and forcefully the large stock of NPLs.

Status: The authorities have adopted a comprehensive strategy which integrates and sequences reforms in the areas of supervision, enforcement, debt restructuring, and insolvency. However, its implementation is in its early stages. The NPL ratio has declined from a peak of 25 percent in September 2014 to 18 percent in December 2015, mostly due to a new regulation requiring mandatory write-offs of loans that have spent more than three years in the "loss" category.

Advice: Ensure that risks associated with euroization are internalized.

Status: The authorities have introduced higher liquidity requirements for foreign currency deposits. There is room for further prudential measures as well as improvements in the definition of hedged borrowers.

Advice: Take steps to strengthen nonbank supervision.

Status: The authorities have introduced new regulations on liquidity requirements and asset valuation for investment funds. Several laws have been amended to strengthen AFSA's financial and operational independence. However, the agency is still short of capacity and struggling to attract and retain skilled staff.

Advice: Improve the investment climate, with a particular focus on the legal framework and judicial effectiveness related to land titling and property rights.

Status: Albania has not made substantial progress in the Doing Business rankings recently. The government set up a National Investment Council to facilitate dialogue among government and business on how to improve the business climate. The judicial system continues to lack independence and does not protect property rights adequately.

Advice: Implement comprehensive electricity sector reform.

Status: The authorities have replaced subsidized prices to low-income consumers with targeted assistance. They have aggressively lowered distribution losses, repaid arrears to the private sector, increased bill collections, and strengthened the finances of the state-owned electricity companies. A new power sector law passed in May 2015 will reform the market structure and will gradually remove commercial users from the regulated tariff system. The authorities are restructuring the balance sheets of the SOEs in the sector. Further reforms are needed to improve corporate governance.

Advice: Implement public administration reform.

Status: The authorities passed a new civil service law which provides for merit-based recruitment, promotion, and dismissal. However, the new law does not cover certain institutions and positions. In addition, recent amendments have made recruitment and dismissal decisions more vulnerable to considerations other than merit. The quality of recruitment procedures needs to be significantly improved, especially in independent institutions. Implementation of the new law at the local level remains a challenge.

Advice: Improve quality of statistics and strengthen INSTAT's independence.

Status: INSTAT has improved the quality of national accounts and BOP statistics, with help from Fund TA. However, amendments to the Law on Statistics and an MoU setting up an inter-government data-exchange scheme have been delayed and are now expected in 2016. High-frequency and labor market indicators need to be strengthened.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2013–21

	2013	2014	2015		2016		2017	2018	2019	2020	2021
			Prog.	Prel.	Prog.	Rev. Prog.			Projections		
Real sector					(Growth rate in percent)						
Real GDP 1/	1.1	2.0	2.6	2.6	3.4	3.4	3.8	4.1	4.1	4.1	4.1
Consumer Price Index (avg.)	1.9	1.6	1.8	1.9	2.3	1.9	2.4	2.8	3.0	3.0	3.0
Consumer Price Index (eop)	1.9	0.7	1.9	2.0	2.5	2.2	2.7	3.0	3.0	3.0	3.0
GDP deflator	0.2	1.6	1.0	1.1	2.5	1.9	2.6	3.0	3.2	3.1	3.1
Saving-investment balance					(Percent of GDP)						
Foreign savings	10.8	12.9	11.4	11.1	13.1	12.5	13.0	12.3	11.3	10.6	10.4
National savings	18.3	15.5	15.2	17.3	16.6	17.5	18.2	18.6	18.8	18.8	18.7
Public	-0.8	0.6	0.7	0.8	0.5	0.6	1.2	2.0	2.6	2.5	2.4
Private	19.1	14.9	14.5	16.5	16.1	16.9	16.9	16.6	16.2	16.3	16.3
Investment	29.1	28.4	26.6	28.4	29.7	30.1	31.1	30.9	30.1	29.5	29.1
Public	5.1	4.8	4.1	4.8	3.7	4.2	4.1	4.1	4.3	4.3	4.3
Private	24.0	23.6	22.5	23.5	26.1	25.8	27.0	26.8	25.8	25.2	24.8
Fiscal sector											
Total revenue and grants	24.0	26.2	26.7	26.0	27.1	26.8	26.4	26.2	26.1	26.0	25.9
Tax revenue	21.9	24.0	24.0	23.5	24.6	24.3	24.0	23.9	23.8	23.7	23.5
Total expenditure	29.2	32.0	31.2	30.5	29.6	29.2	29.1	29.3	29.2	29.3	29.3
Of which: Repayment of end-2013 stock of unpaid bills and arrears		2.4	1.3	1.2	0.0	0.0					
Primary	26.0	29.2	28.4	27.9	26.8	26.5	26.6	26.7	26.7	26.8	26.9
Interest	3.2	2.9	2.7	2.7	2.8	2.8	2.5	2.5	2.5	2.5	2.4
Unidentified measures (cumulative)		0.0	0.0	0.0	0.0	0.0	1.1	2.1	3.1	3.1	3.1
Overall balance	-5.2	-5.9	-4.5	-4.5	-2.5	-2.5	-1.6	-0.9	0.0	-0.2	-0.3
Primary balance	-2.0	-3.0	-1.8	-1.8	0.3	0.3	0.9	1.6	2.5	2.3	2.1
Financing	5.2	5.9	4.5	4.5	2.5	2.5	1.6	0.9	0.0	0.2	0.3
Of which: Domestic	4.4	3.4	-0.5	-0.4	-0.5	-1.3	0.2	0.1	-0.3	-0.1	-0.6
Of which: Foreign	0.8	2.4	5.0	4.8	2.9	3.7	1.4	0.8	0.3	0.3	1.0
Public Debt	70.4	71.7	72.2	71.9	70.6	70.4	67.7	64.1	59.7	55.8	52.3
Domestic	43.4	42.3	38.7	38.2	36.0	34.6	32.7	30.6	28.2	26.1	23.7
Of which: Unpaid bills and arrears	4.8	1.9	0.1	0.2	0.0	0.0					
External	26.9	29.4	33.5	33.8	34.6	35.8	35.0	33.5	31.5	29.6	28.6
Monetary indicators					(Growth rate in percent, unless otherwise indicated)						
Broad money growth	2.3	4.0	4.3	1.9	4.1	3.8	5.9	6.5	6.6	6.7	7.4
Private credit growth	-1.4	2.0	-0.8	-2.9	4.2	4.2	6.9	9.0	11.3	12.1	12.6
Velocity (nominal GDP/broad money)	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)	3.4	3.1	…	2.6	…	…	…	…	…	…	…
BoA repo rate (in percent)	3.0	2.3	…	1.8	…	…	…	…	…	…	…
External sector					(Percent of GDP, unless otherwise indicated)						
Trade balance (goods and services)	-18.0	-18.9	-16.9	-17.1	-18.2	-18.0	-18.0	-17.1	-15.8	-15.0	-14.7
Current account balance	-10.8	-12.9	-11.4	-11.1	-13.1	-12.5	-13.0	-12.3	-11.3	-10.6	-10.4
Gross international reserves (in billions of Euros)	2.0	2.2	2.5	2.9	2.5	2.8	2.8	2.7	2.6	2.5	2.4
(In months of imports of goods and services)	4.5	5.0	5.2	6.2	5.0	5.8	5.5	5.2	4.7	4.2	4.2
(Relative to external debt service)	6.7	6.8	3.8	4.4	6.1	6.8	5.6	5.0	4.3	2.3	3.6
(In percent of broad money)	24.6	25.7	27.8	32.5	27.3	31.0	29.4	27.2	24.4	22.0	19.9
Change in REER (eop, in percent; +=appreciation)	1.0	2.4	…	1.3	…	…	…	…	…	…	…
Memorandum items											
Nominal GDP (in billions of lek) 1/	1351	1401	1445	1454	1530	1532	1632	1749	1879	2019	2167
Output gap (percent)	-0.7	-1.1	-1.5	-1.3	-1.6	-1.0	-0.8	-0.3	-0.1	0.0	0.0

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

1/ In December 2015, INSTAT made small revisions to the real and nominal GDP estimates for 2014.

Table 2a. Albania: General Government Operations, 2013–21

(Percent of GDP)

	2013	2014	2015		2016		2017	2018	2019	2020	2021
			Prog.	Prel.	Prog.	Rev. Prog.	Projections				
Total revenue and grants	24.0	26.2	26.7	26.0	27.1	26.8	26.4	26.2	26.1	26.0	25.9
Tax revenue	21.9	24.0	24.0	23.5	24.6	24.3	24.0	23.9	23.8	23.7	23.5
VAT	8.0	8.8	8.8	8.6	8.8	8.7	8.6	8.6	8.6	8.6	8.6
Profit tax	1.1	1.5	1.6	1.7	1.6	1.7	1.7	1.7	1.7	1.7	1.7
Excise tax	2.8	2.9	3.0	2.7	2.9	2.8	2.7	2.6	2.5	2.4	2.3
Personal income tax	2.2	2.1	2.1	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Customs duties	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other taxes	2.1	2.3	2.4	2.3	2.5	2.4	2.4	2.4	2.4	2.4	2.4
Local government revenue 1/	0.8	0.9	0.8	0.8	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Social insurance contributions	4.4	5.0	5.0	5.0	5.3	5.2	5.2	5.2	5.1	5.1	5.1
Non-tax revenue	1.6	1.5	2.0	1.8	1.6	1.6	1.5	1.5	1.5	1.5	1.5
Grants	0.4	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Total expenditure	29.2	32.0	31.2	30.5	29.6	29.2	29.1	29.3	29.2	29.3	29.3
Current expenditure	24.3	24.9	25.3	24.5	25.5	25.3	25.0	24.9	24.9	25.0	25.0
Personnel cost 2/	5.2	5.1	5.1	5.0	4.7	4.6	4.6	4.6	4.6	4.6	4.6
Interest	3.2	2.9	2.7	2.7	2.8	2.8	2.5	2.5	2.5	2.5	2.4
Operations & maintenance	2.4	2.2	2.7	2.9	2.9	2.8	2.8	2.8	2.8	2.8	2.8
Subsidies	0.1	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.5	0.5	0.7
Energy guarantees		0.5	0.4	0.3	0.3	0.2	0.2	0.0	0.0	0.0	0.0
Nonenergy guarantees		0.0	0.1	0.0	0.1	0.1	0.1	0.2	0.3	0.4	0.5
Other		0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social insurance outlays	9.5	9.9	9.8	9.7	10.0	10.0	9.9	9.9	9.8	9.8	9.8
Local government expenditure 2/	2.2	2.3	2.5	2.3	3.2	3.3	3.3	3.3	3.3	3.3	3.3
Social protection transfers	1.7	1.8	1.9	1.4	1.5	1.4	1.4	1.4	1.4	1.4	1.4
Capital expenditure	4.8	4.3	4.1	4.3	3.7	3.7	3.7	3.9	4.1	4.1	4.1
Domestically financed	2.7	2.4	2.4	2.6	1.4	1.6	1.4	1.7	1.9	2.1	2.4
Foreign financed	2.1	1.9	1.7	1.7	2.2	2.0	2.3	2.1	2.1	1.9	1.7
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lending minus repayment	0.0	0.4	0.4	0.5	0.2	0.1	0.2	0.3	0.0	0.0	0.0
Reserve and contingency funds 3/	0.0	0.0	0.1	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Repayment of end-2013 stock of unpaid bills and arrears		2.4	1.3	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified measures (cumulative)		0.0	0.0	0.0	0.0	0.0	1.1	2.1	3.1	3.1	3.1
Overall balance	-5.2	-5.9	-4.5	-4.5	-2.5	-2.5	-1.6	-0.9	0.0	-0.2	-0.3
Financing	5.2	5.9	4.5	4.5	2.5	2.5	1.6	0.9	0.0	0.2	0.3
Domestic	4.4	3.4	-0.5	-0.4	-0.5	-1.3	0.2	0.1	-0.3	-0.1	-0.6
Privatization receipts	1.2	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Net borrowing	3.4	3.2	-0.5	-0.9	-0.5	-1.4	0.2	0.1	-0.3	-0.1	-0.6
Other	-0.3	0.2	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.8	2.4	5.0	4.8	2.9	3.7	1.4	0.8	0.3	0.3	1.0
Accumulation of arrears 4/	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (+=gap) 5/			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
World Bank			0.0	0.0	0.0	0.0					
Residual financing (e.g., EU)			0.0	0.0	0.0	0.0					
IMF			0.0	0.0	0.0	0.0					
Memorandum Items:											
Primary balance	-2.0	-3.0	-1.8	-1.8	0.3	0.3	0.9	1.6	2.5	2.3	2.1
Primary balance (excl. repayment of end-2013 stock of unpaid bills and arrears)	-2.0	-0.6	-0.5	-0.6	0.3	0.3	0.9	1.6	2.5	2.3	2.1
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears		-3.4	-3.2	-3.3	-2.5	-2.5	-1.6	-0.9	0.0	-0.2	-0.3
Public Debt	70.4	71.7	72.2	71.9	70.6	70.4	67.7	64.1	59.7	55.8	52.3
Of which: Short-term public debt	19.7	20.5	15.4	17.5	10.1	11.7	9.8	9.0	7.9	7.8	7.1
Domestic	43.4	42.3	38.7	38.2	36.0	34.6	32.7	30.6	28.2	26.1	23.7
Of which: Unpaid bills and arrears	4.8	1.9	0.1	0.2	0.0	0.0					
External	26.9	29.4	33.5	33.8	34.6	35.8	35.0	33.5	31.5	29.6	28.6
Direct government external debt	24.6	27.4	31.6	32.0	32.8	34.1	33.5	31.9	29.5	27.1	25.6
Government guaranteed external debt	2.3	2.0	1.9	1.8	1.8	1.7	1.6	1.6	2.0	2.5	3.0
GDP (in billions of leks)	1351	1401	1445	1454	1530	1532	1632	1749	1879	2019	2167

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

1/ Includes the property tax, the simplified profit tax for small businesses, and other local taxes.
2/ There is a structural break in 2016, reflecting the transfer of central government employees to local governments, as part of fiscal decentralization.
3/ Spending contingencies are reported according to their economic classification at outturn.
4/ As reflected in official data and not accounting for arrears accumulated outside of the budget prior to 2014.
5/ Following the approval of the program, Fund purchases are reported under foreign financing. Similarly, secured funding by the World Bank is reported under foreign financing.

Table 2b. Albania: General Government Operations, 2013–21

(Billions of leks)

	2013	2014	2015		2016		2017	2018	2019	2020	2021
			Prog.	Act.	Prog.	Rev. Prog.	Projections				
Total revenue and grants	323.7	366.6	385.3	378.6	414.4	410.0	430.3	459.1	490.7	524.4	560.3
Tax revenue	296.4	335.8	346.3	341.6	376.8	372.7	392.4	418.4	447.0	477.4	509.9
VAT	108.5	123.7	126.7	124.8	134.6	133.0	139.6	149.7	160.8	172.7	185.4
Profit tax	15.1	21.5	23.0	24.2	24.4	25.5	27.2	29.1	31.3	33.6	36.1
Excise tax	38.2	40.9	42.9	39.0	45.1	42.5	43.6	44.8	46.1	47.4	48.8
Personal income tax	29.6	28.9	30.0	29.5	31.7	32.1	34.1	36.6	39.3	42.2	45.3
Customs duties	5.8	5.9	5.7	5.9	6.0	6.2	6.6	7.1	7.6	8.2	8.8
Other taxes	28.5	32.6	34.1	33.5	38.5	37.4	39.5	42.5	45.9	49.4	53.1
Local government revenue 1/	10.8	12.4	12.1	11.7	16.0	15.9	16.9	18.1	19.5	20.9	22.4
Social insurance contributions	60.0	69.9	71.7	72.9	80.4	80.1	84.8	90.5	96.5	103.0	110.0
Non-tax revenue	21.6	20.7	29.0	25.8	24.7	24.5	24.3	26.0	28.0	30.0	32.2
Grants	5.7	10.1	10.0	11.2	13.0	12.8	13.7	14.6	15.7	16.9	18.1
Total expenditure	394.1	448.6	450.3	444.0	452.4	447.9	474.9	511.7	549.0	590.5	633.9
Current expenditure	328.6	348.1	365.6	356.3	390.8	387.3	407.6	435.0	468.8	504.6	542.0
Personnel cost 2/	70.7	71.4	73.2	72.5	71.3	70.4	75.0	80.4	86.3	92.7	99.5
Interest	43.3	40.1	39.6	38.6	43.0	42.3	40.8	44.0	47.1	50.4	51.7
Operations & maintenance	32.4	31.3	39.2	42.4	43.6	42.6	45.4	48.7	52.3	56.2	60.3
Subsidies	1.6	8.4	8.7	6.8	7.7	6.7	7.0	6.3	8.8	11.0	14.7
Energy guarantees		6.7	6.0	4.6	4.4	3.4	2.8	0.7	0.7	0.7	0.7
Nonenergy guarantees		0.1	0.9	0.5	1.6	1.6	2.4	3.6	6.0	8.0	11.5
Other		1.6	1.8	1.7	1.8	1.8	1.9	2.0	2.1	2.3	2.5
Social insurance outlays	127.6	138.5	141.0	141.2	152.6	152.6	161.9	172.7	185.0	198.5	212.9
Local government expenditure 2/	29.8	32.9	36.1	33.8	49.1	50.7	54.0	57.9	62.2	66.8	71.7
Social protection transfers	23.2	25.5	27.9	20.9	23.5	22.0	23.4	25.1	27.0	29.0	31.1
Capital expenditure	65.5	60.5	59.2	62.1	56.0	56.0	59.6	67.4	76.2	81.8	87.9
Domestically financed	36.7	33.8	34.0	37.7	21.9	24.7	22.4	30.4	35.9	42.9	51.9
Foreign financed	28.8	26.8	25.2	24.4	34.0	31.2	37.2	37.0	40.3	39.0	35.9
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lending minus repayment	0.0	5.9	5.9	7.3	2.6	1.6	3.7	5.3	0.0	0.0	0.0
Reserve and contingency funds 3/	0.0	0.0	1.2	0.0	3.0	3.0	4.0	4.0	4.0	4.0	4.0
Repayment of end-2013 stock of unpaid bills and arrears		33.8	18.4	17.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified measures (cumulative)		0.0	0.0	0.0	0.0	0.0	18.0	36.8	57.7	62.0	66.6
Overall balance	-70.4	-82.1	-65.0	-65.4	-38.0	-37.9	-26.6	-15.8	-0.5	-4.1	-7.0
Financing	70.4	82.1	65.0	65.4	38.0	37.9	26.6	15.8	0.5	4.1	7.0
Domestic	59.6	47.5	-6.8	-6.0	-7.2	-19.3	3.3	1.8	-5.6	-3.0	-13.9
Privatization receipts	16.7	0.0	0.8	0.9	0.0	2.2	0.0	0.0	0.0	0.0	0.0
Net borrowing	46.3	45.0	-7.6	-12.6	-7.2	-21.5	3.3	1.8	-5.6	-3.0	-13.9
Other	-3.4	2.5	0.0	5.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	10.8	34.3	71.8	70.3	45.1	57.2	23.3	14.0	6.1	7.0	20.8
Accumulation of arrears 4/	0.0	0.3	0.0	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (+=gap) 5/			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
World Bank			0.0	0.0	0.0	0.0					
Residual financing (e.g., EU)			0.0	0.0	0.0	0.0					
IMF			0.0	0.0	0.0	0.0					
Memorandum Items:											
Primary balance	-27.1	-42.0	-25.4	-26.8	5.0	4.3	14.2	28.2	46.7	46.3	44.8
Primary balance (excl. repayment of end-2013 stock of unpaid bills and arrears)	-27.1	-8.2	-7.1	-9.2	5.0	4.3	14.2	28.2	46.7	46.3	44.8
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears		-48.3	-46.7	-47.8	-38.0	-37.9	-26.6	-15.8	-0.5	-4.1	-7.0
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears, and new guarantees		-41.5	-39.7	-42.7	-32.0	-32.9	-21.5	-11.5	6.2	4.7	5.3
Public Debt	950.3	1004.5	1043.1	1045.4	1080.2	1078.8	1105.4	1121.3	1121.8	1125.8	1132.8
Of which: Short-term public debt	265.7	286.6	222.4	254.3	154.1	179.3	159.8	158.0	148.5	157.9	152.8
Domestic	586.4	592.1	558.9	554.6	550.9	530.8	534.1	535.9	530.4	527.4	513.5
Of which: Unpaid bills and arrears	65.2	26.6	0.9	2.3	0.0	0.0					
External	363.9	412.4	484.2	490.8	529.4	548.0	571.3	585.3	591.4	598.4	619.2
Direct government external debt	332.5	383.9	456.9	465.2	502.3	522.7	545.9	557.7	553.5	547.4	555.0
Government guaranteed external debt	31.4	28.5	27.3	25.6	27.0	25.3	25.4	27.7	37.9	51.0	64.3

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

1/ Includes the property tax, the simplified profit tax for small businesses, and other local taxes.
2/ There is a structural break in 2016, reflecting the transfer of central government employees to local governments, as part of fiscal decentralization.
3/ Spending contingencies are reported according to their economic classification at outturn.
4/ As reflected in official data and not accounting for arrears accumulated outside of the budget prior to 2014.
5/ Following the approval of the program, Fund purchases are reported under foreign financing. Similarly, secured funding by the World Bank is reported under foreign financing.

Table 3a. Albania: Balance of Payments, 2013–21[1]

(Percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
			Prel.	Projections					
Current account	-10.8	-12.9	-11.1	-12.5	-13.0	-12.3	-11.3	-10.6	-10.4
Balance of goods and services	-18.0	-18.9	-17.1	-18.0	-18.0	-17.1	-15.8	-15.0	-14.7
Trade Balance (goods)	-17.9	-22.1	-22.1	-21.7	-21.6	-20.6	-19.5	-18.8	-18.5
Exports	18.2	9.3	7.4	6.0	5.9	6.0	6.1	6.0	6.0
Of which: Energy	5.7	4.6	3.1	2.0	1.9	2.0	2.0	2.0	2.0
Imports	36.1	31.5	29.5	27.7	27.5	26.7	25.6	24.8	24.5
Of which: Energy	6.6	6.1	3.9	3.3	4.0	4.2	4.3	4.1	3.9
Services (net)	-0.2	3.2	5.0	3.7	3.6	3.6	3.7	3.8	3.8
Income balance	0.2	-1.2	-1.4	-1.6	-1.8	-1.8	-1.8	-1.7	-1.6
Of which: Interest due	0.5	0.9	1.1	1.2	1.3	1.3	1.3	1.2	1.1
Current transfers	7.1	7.2	7.4	7.0	6.8	6.6	6.3	6.1	5.9
Capital and Financial account	8.7	9.0	6.6	5.8	9.1	8.9	7.8	7.4	7.3
Capital transfers	0.5	0.9	1.2	0.8	0.7	0.7	0.6	0.6	0.6
Direct investment, net	9.6	8.1	8.4	8.4	8.1	6.6	5.1	4.6	4.5
Government Medium- and long-term loans, net	1.1	0.5	-2.5	0.1	0.2	0.1	-0.2	-0.3	0.3
Project loans	1.9	1.6	1.6	1.6	2.0	1.9	1.6	1.4	1.1
Other loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.2	1.0
Amortization (includes Eurobond bullet payment)	-0.8	-1.1	-4.2	-1.5	-1.8	-1.8	-1.8	-4.9	-1.8
Government Guaranteed Borrowing, net	-0.2	-0.2	-0.2	0.0	0.0	0.1	0.5	0.7	0.6
Disbursement	0.1	0.0	0.0	0.2	0.2	0.4	0.7	0.8	0.7
Amortization	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.1	0.1
Other flows	-2.1	-1.0	-1.0	-4.2	-0.9	0.4	0.7	0.8	0.2
Errors and omissions [2/]	3.1	2.7	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Net balance	1.1	-1.2	-2.0	-4.2	-1.3	-0.9	-0.9	-0.7	-0.6
Available financing	-1.1	1.2	1.9	4.2	1.3	0.9	0.9	0.7	0.6
Change in net reserves (increase = -) [3/]	-1.1	-1.0	-5.8	0.5	0.2	0.3	0.9	0.7	0.6
IMF (budget support)	…	0.5	0.9	1.3	0.6	0.0	0.0	0.0	0.0
World Bank (DPL)	…	1.7	0.0	1.4	0.6	0.5	0.0	0.0	0.0
Other budget loans	…	…	…	0.9	0.0	0.0	0.0		
Commercial borrowing	0.0	0.0	6.7	0.0	0.0	0.0	0.0	0.0	0.0
o/w WB PBG			2.4						
o/w Eurobond			4.3						
Memorandum items:									
Exports of Goods and Services (percent of GDP)	35.4	35.1	33.9	32.1	32.1	32.1	32.1	31.9	31.9
Imports of Goods and Services (percent of GDP)	53.5	54.0	50.9	50.1	50.1	49.2	47.9	47.0	46.5
Current Account (percent of GDP)									
excluding TAP, Statkraft related imports	-10.8	-12.9	-9.2	-9.0	-10.4	-10.9	-10.9	-10.6	-10.4
Balance of goods and services									
excluding TAP, Statkraft related imports	-18.0	-18.9	-15.2	-14.5	-15.5	-15.6	-15.5	-15.0	-14.7

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

1/ Historical data for 2013 reflect old BPM5 estimates which record insourcing services as goods. The data from 2014 onwards reflect BPM6 treatment of textile insourced manufacturing, which is recorded as services.

2/ Includes unidentified flows of private transfers, which are projected to decline gradually over the medium term with the decline in remittances as a share of GDP.

3/ Net of valuation changes in 2013–14. In projections for 2015–21, valuation effects are assumed to be zero.

Table 3b. Albania: Balance of Payments, 2013–21[1]

(Millions of euros)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
			Prel.			Projections			
Current account	-1,036	-1,287	-1,154	-1,385	-1,505	-1,523	-1,492	-1,514	-1,584
Balance of goods and services	-1,737	-1,892	-1,774	-1,985	-2,088	-2,110	-2,097	-2,139	-2,234
Trade Balance (goods)	-1,719	-2,216	-2,299	-2,397	-2,506	-2,552	-2,585	-2,675	-2,819
Exports	1,757	932	771	659	680	745	804	858	921
Of which: Energy	545	463	323	219	215	247	269	282	302
Imports	3,476	3,147	3,070	3,056	3,186	3,297	3,389	3,533	3,740
Of which: Energy	631	611	405	366	465	515	564	586	596
Services (net)	-18	323	525	412	418	442	488	536	585
Income balance	21	-119	-149	-175	-204	-225	-233	-240	-242
Of which: Interest due	51	90	111	129	145	161	166	171	175
Current transfers	680	725	768	775	787	812	838	865	893
Capital and Financial account	838	899	686	645	1,054	1,100	1,036	1,054	1,113
Capital transfers	48	87	126	85	85	85	85	85	85
Direct investment, net	923	812	871	925	945	821	675	656	680
Government Medium- and long-term loans, net	105	51	-262	13	27	16	-30	-43	53
Project loans	180	165	170	179	231	234	215	200	173
Other loans	0	0	0	0	0	0	0	450	150
Amortization (includes Eurobond bullet payment)	-74	-114	-432	-166	-204	-218	-245	-693	-270
Government Guaranteed Borrowing, net	-17	-22	-20	-2	1	16	72	93	93
Disbursement	5	0	3	21	26	55	98	113	113
Amortization	22	23	23	24	25	40	26	20	19
Other flows	-206	-97	-102	-464	-105	44	98	108	25
Errors and omissions 2/	301	266	264	281	295	314	337	361	387
Net balance	103	-122	-204	-460	-156	-110	-119	-98	-84
Available financing	-104	122	195	460	156	110	119	98	84
Change in net reserves (increase = -) 3/	-104	-97	-600	58	18	43	119	98	84
IMF (budget support)	…	54	96	144	72	0	0	0	0
World Bank (DPL)	…	166	0	158	67	67	0	0	0
Other budget loans	…	…	…	100	0	0	0	0	0
Commercial borrowing	0	0	700	0	0	0	0	0	0
o/w WB PBG			250						
o/w Eurobond			450						
Memorandum items:									
Nominal GDP	9,629	10,006	10,403	11,047	11,600	12,364	13,254	14,223	15,244
Gross international reserves	2,015	2,192	2,880	2,800	2,780	2,735	2,610	2,510	2,427
(months of imports of goods and services)	4.5	5.0	6.2	5.8	5.5	5.2	4.7	4.2	4.2
Balance of goods and services (percent of GDP)	-18.0	-18.9	-17.1	-18.0	-18.0	-17.1	-15.8	-15.0	-14.7
Current account (percent of GDP)	-10.8	-12.9	-11.1	-12.5	-13.0	-12.3	-11.3	-10.6	-10.4
Debt service (percent of exports of goods and services) 4/	-0.1	3.0	13.1	5.6	6.1	6.5	5.6	14.3	4.4
Debt service (percent of central government revenues) 4/	-0.1	4.3	17.7	7.4	8.0	8.6	7.3	18.6	5.7
Total external debt stock (percent of GDP) 5/	34.7	36.9	40.7	43.2	43.3	42.1	40.3	38.5	37.2
Exports of Goods and Services (millions of Euros)	3,412	3,507	3,524	3,551	3,727	3,974	4,252	4,544	4,861
Imports of Goods and Services (millions of Euros)	5,149	5,400	5,298	5,537	5,815	6,083	6,349	6,682	7,096
Volume of Exports of Goods and Services (percent change)	5.6	10.1	1.8	0.4	3.6	4.3	4.4	4.2	4.4
Volume of Imports of Goods and Services (percent change)	4.2	7.6	0.6	7.0	3.6	3.2	2.8	3.6	4.5
Terms of trade (percent change)	-0.2	-2.0	-5.7	-4.7	2.9	0.9	0.2	-0.4	-0.5

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

1/ Historical data for 2013 reflect old BPM5 estimates which record insourcing services as goods. The data from 2014 onwards reflect BPM6 treatment of textile insourced manufacturing, which is recorded as services.
2/ Includes unidentified flows of private transfers, which are projected to decline gradually over the medium term with the decline in remittances as a share of GDP.
3/ Net of valuation changes in 2013–14. In projections for 2015–21, valuation effects are assumed to be zero.
4/ Public and publicly guaranteed debt only.
5/ Public and private external debt, including arrears. Debt stock converted into Lek at the e-o-p exchange rate.

Table 4a. Albania: Monetary Survey, 2013–17
(Billions of leks, unless otherwise indicated; end-period)

	2013	2014	2015	2016	2017
Net foreign assets	479	525	617	662	704
Bank of Albania	274	292	366	352	347
Commercial banks	205	233	251	311	357
Net domestic assets	670	670	601	601	634
Claims on central government, net	363	378	332	326	328
Bank of Albania	43	47	27	33	33
Commercial banks	320	331	305	293	295
Claims on public enterprises	25	27	27	13	5
Claims on the private sector	513	524	509	530	567
In leks	195	207	212	221	236
In foreign currency	318	317	296	309	330
Other items, net	-231	-259	-267	-268	-266
Broad money	1,149	1,195	1,218	1,264	1,338
Currency outside banks	199	218	231	239	252
Deposits	950	977	987	1,025	1,086
Domestic currency	494	505	493	512	542
Foreign currency	456	473	494	513	543
Memorandum items:					
Broad money growth (% change)	2.3	4.0	1.9	3.8	5.9
Reserve money growth (% change)	3.5	8.1	15.3	0.6	3.7
Private sector credit growth (% change)	-1.4	2.0	-2.9	4.2	6.9
Broad money (as percent of GDP)	85.1	85.3	83.8	82.5	82.0
Private sector credit (as percent of GDP)	38.0	37.4	35.0	34.6	34.7
Velocity (nominal GDP/broad money)	1.2	1.2	1.2	1.2	1.2
Money multiplier (absolute values)	3.7	3.6	3.2	3.3	3.3
Currency (as share of broad money)	17.3	18.2	18.9	18.9	18.8
Foreign currency deposits/total deposits	48.0	48.4	50.0	50.0	50.0
Gross reserves (millions of euros)	2,015	2,192	2,880	2,800	2,780

Sources: Bank of Albania; and IMF staff estimates.

Table 4b. Albania: Summary of Accounts of the Central Bank, 2013–17

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

	2013	2014	2015	2016	2017
Net foreign assets	274	292	366	352	347
Assets	294	319	408	405	405
Liabilities	20	27	42	53	58
Net domestic assets	34	41	18	35	54
Domestic credit	66	75	42	52	66
Net claims on central government	43	47	27	33	33
Assets	65	64	53	64	64
Liabilities	22	17	26	31	31
Other credit	23	27	15	19	33
Private sector	2	2	2	2	2
Commercial banks	22	26	13	17	32
Other items, net (assets = +)	-32	-34	-23	-17	-12
Reserve money	308	333	384	386	400
Currency in circulation	199	218	231	239	252
Bank reserves	109	115	152	147	149
Other nonbank deposits	0	0	2	0	0

Sources: Bank of Albania; and IMF staff estimates.

Table 5. Albania: IMF Core Indicators of Financial Soundness, 2007–15

		Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
I	Capital-based															
(i)	Regulatory capital as a percent of risk-weighted assets	17.1	17.2	16.17	15.4	15.6	16.2	18.0	17.9	17.5	17.6	16.8	15.8	16.0	15.8	15.7
(ii)	Regulatory Tier 1 capital as a percent of risk-weighted assets	16.0	16.3	15.3	14.5	14.3	14.6	14.9	14.8	14.5	14.5	13.8	13.1	13.6	13.2	13.5
(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	7.9	7.7	7.6	7.5	7.6	7.4	8.0	8.3	8.4	8.3
	Regulatory capital as a percent of total assets	6.2	7.0	9.2	9.1	8.8	8.8	9.3	9.2	9.0	9.2	9.0	9.7	9.7	9.7	9.7
	Shareholders' equity as a percent of total assets	7.6	8.6	9.6	9.4	8.7	8.6	8.4	8.4	8.3	8.5	8.6	9.0	9.1	9.2	9.5
(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	61.8	48.5	50.7	49.0	53.0	46.7	42.3	36.1	33.9	28.4
	As a percent of regulatory capital	11.2	25.7	28.2	35.9	52.0	55.6	40.2	41.8	40.5	43.8	38.3	35.2	30.8	29.2	24.3
	As a percent of shareholders' equity	9.1	21.1	27.1	34.8	52.6	56.9	44.8	45.8	44.2	47.3	40.2	37.6	32.8	30.8	24.8
(v)	Return on equity (ROE) (annual basis)	20.7	11.4	4.6	7.6	0.8	3.8	6.4	17.2	10.4	11.0	10.5	20.3	14.2	13.1	13.2
(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	4.1	4.9	7.8	5.9	8.3	10.4	5.1	8.5	9.3	9.0
	As a percent of regulatory capital	1.7	4.3	3.9	5.0	3.9	3.7	4.1	6.5	4.9	6.8	8.5	4.2	7.2	8.0	7.7
	As a percent of shareholders' equity	1.4	3.5	3.7	4.9	4.0	3.8	4.5	7.1	5.3	7.4	8.9	4.5	7.7	8.4	7.8
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	29.4	27.6	30.9	32.7	32.4	31.9	33.2	32.6	33.2	32.3
(viii)	Liquid assets as a percent of short-term liabilities 1/	55.6	104.7	32.6	30.6	33.1	34.9	34.7	39.1	41.4	41.2	40.4	42.3	42.0	43.3	41.4
(ix)	Return on assets (ROA) (net income to average total assets, annual)	1.6	0.9	0.4	0.7	0.1	0.3	0.5	1.5	0.9	0.9	0.9	1.8	1.3	1.2	1.2
(x)	Nonperforming loans (gross) as a percent of total loans	3.4	6.6	10.5	14.0	18.8	22.5	23.5	24.0	24.1	25.0	22.8	22.8	20.9	20.6	18.2
III	Income and expense-based															
(xii)	Interest margin to gross income	92.7	106.5	119.6	118.9	147.7	130.4	112.6	95.4	106.0	109.6	113.1	127.1	108.9	109.8	109.0
(xiii)	Noninterest expenses to gross income	58.5	69.6	83.0	75.5	91.3	85.0	74.7	54.7	66.0	95.7	68.4	81.4	61.2	62.6	63.4
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	171.6	180.8	183.0	183.3	181.9	180.2	180.7	180.5	184.2	187.8
	Foreign currency-denominated loans to total loans	72.5	72.6	70.2	69.8	67.9	64.5	63.0	62.6	62.1	62.1	62.4	62.2	61.7	61.2	60.8
	Foreign currency-denominated liabilities as a percent of total liabilities	46.9	48.5	48.9	51.0	51.9	52.6	52.8	52.5	52.4	52.7	52.4	52.5	52.8	53.0	53.5
	Other indicators:															
	Risk weighted assets as a percent of total assets	36.4	40.8	56.7	59.2	56.5	54.2	52.1	51.5	51.6	52.5	53.6	61.3	60.5	61.3	62.0
	Total loans as a percent of total assets	39.4	47.6	50.8	49.6	50.5	48.6	45.9	45.2	45.2	45.4	46.0	45.6	45.5	44.7	44.5
	Total loans as a percent of shareholders' equity	516.4	555.1	530.2	527.0	581.9	567.4	548.8	536.2	544.9	531.1	536.3	504.1	501.2	485.8	466.8

Source: Bank of Albania.

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

Table 6. Albania: Schedule of Reviews and Purchases[1]

Availability Date	Millions of SDR	In Percent of Quota	Conditions
February 28, 2014	23.55	16.9	Board approval of arrangement
June 28, 2014	23.55	16.9	Observance of end-March 2014 and continuous performance criteria and completion of first review
September 15, 2014	23.55	16.9	Observance of end-June 2014 and continuous performance criteria and completion of second review
December 15, 2014	23.55	16.9	Observance of end-September 2014 and continuous performance criteria and completion of third review
April 15, 2015	28.88	20.7	Observance of end-December 2014 and continuous performance criteria and completion of fourth review
July 15, 2015	28.88	20.7	Observance of end-April 2015 and continuous performance criteria and completion of fifth review
November 15, 2015	28.88	20.7	Observance of end-August 2015 and continuous performance criteria and completion of sixth review
March 15, 2016	28.65	20.6	Observance of end-December 2015 and continuous performance criteria and completion of seventh review
July 15, 2016	28.65	20.6	Observance of end-April 2016 and continuous performance criteria and completion of eighth review
November 15, 2016	28.65	20.6	Observance of end-August 2016 and continuous performance criteria and completion of ninth review
February 15, 2017	28.63	20.6	Observance of end-November 2016 and continuous performance criteria and completion of tenth review
Total	**295.42**	**212.1**	

[1] Albania's IMF quota is SDR 139.3 million.

Table 7. Albania: Indicators of Capacity to Repay the Fund, 2015–21[1,2]

(Under Obligated Repurchase Schedule; in millions of SDRs)

	2015	2016	2017	2018	2019	2020	2021
Fund repurchases and charges							
In millions of SDRs	5.3	5.1	5.7	8.8	18.0	30.8	46.9
In millions of euro	6.8	6.4	7.2	11.0	22.4	38.2	58.4
In percent of gross international reserves	0.2	0.2	0.3	0.4	0.9	1.5	2.4
In percent of exports of goods and services	0.2	0.2	0.2	0.3	0.5	0.8	1.2
In percent of GDP	0.1	0.1	0.1	0.1	0.2	0.3	0.4
In percent of external public debt	0.2	0.2	0.2	0.3	0.6	0.9	1.4
In percent of quota	8.9	3.7	4.1	6.3	12.9	22.1	33.7
Fund credit outstanding (end of period)							
In millions of SDRs	187.1	241.5	296.8	291.7	277.3	249.6	205.1
In millions of euro	238.3	302.5	371.1	364.3	345.1	310.3	255.3
In percent of gross international reserves	8.3	10.8	13.3	13.3	13.2	12.4	10.5
In percent of exports of goods and services	6.8	8.5	10.0	9.2	8.1	6.8	5.3
In percent of GDP	2.3	2.7	3.2	2.9	2.6	2.2	1.7
In percent of external public debt	7.0	8.1	9.5	9.1	8.5	7.6	6.1
In percent of quota	311.8	173.4	213.0	209.4	199.1	179.2	147.3
Memorandum items:							
Gross international reserves	2261	2235	2223	2190	2097	2019	1954
Exports of goods and services	2767	2835	2980	3182	3417	3655	3907
GDP	8166	8819	9275	9902	10650	11441	12250
External public debt	2683	2978	3118	3205	3253	3296	3336
Quota	60.0	139.3	139.3	139.3	139.3	139.3	139.3

Source: Fund staff estimates.

1/ Projections are based on current interest rates for PRGF and the EFF.
2/ End-of-year value.

Annex I. Risk Assessment Matrix[1]

Source of Risk	Relative Likelihood	Impact if Realized	Policy Advice
Persistently lower energy prices, including due to a slowdown in China and other large EMs	**High**	**Medium** A further drop in oil prices could hurt fiscal revenues from oil-related royalties and VAT. The main domestic oil producer is engaged in a tax dispute with the government and might scale back investment and production further. On the upside, since Albania is a net oil importer, low prices could boost domestic consumption and investment.	Implement additional fiscal measures, as needed, to meet the end-year primary balance target for 2016.
Surge in the US dollar	**High**	**Low** Gradual monetary tightening by the Fed could lead to further appreciation of the dollar against the euro. That could push up Albania's public-debt-to-GDP ratio.	Target improvements in public debt management which would make the debt stock less sensitive to fluctuations in the euro-dollar exchange rate.
Exit of a foreign bank from the market	**High**	**Low** An abrupt and disorderly pull-out could lead to stress in the domestic banking system and a stagnant supply of credit to the private sector.	The authorities should continue sharing information with parent banks and their regulators. They should also continue strengthening contingency plans and closely monitor capital and liquidity positions. In the event of a change of ownership, the authorities should ensure that fit-and-proper rules are enforced.
Border closures elsewhere in the Balkans	**High**	**Low** A surge of refugees transiting through Albania could strain the country's infrastructure and public finances.	Fiscal targets could be adjusted to accommodate such a temporary shock.
Structurally weak growth in key advanced and emerging economies	**High/ Medium**	**High** Weak growth (particularly in Greece and Italy, the main sources of remittances) might spill over to Albania. In turn, stagnant domestic growth could test the authorities' perseverance with reforms and commitment to fiscal adjustment and debt reduction.	Continue to diversify export markets. Improve the domestic policy environment to support growth in domestic consumption and investment.
Domestic political instability	**Medium**	**High** With strains in the ruling coalition and rumors about an early general election, political and social tensions could hinder the implementation of the authorities' ambitious structural reform agenda. In particular, deteriorating revenue administration and compliance could lead to further revenue shortfalls that could crowd out capital spending and cause the accumulation of new arrears.	Reforms improving the business environment are key to medium-term growth prospects, particularly in regards to NPL resolution, the judiciary, governance, anti-corruption, and property rights. Failure to advance in these areas would undermine medium-term debt sustainability. On the fiscal front, the authorities should reduce tax expenditures, improve revenue administration, and

			implement modern compliance risk management approaches at the GDT. They should implement additional fiscal measures, as needed, to meet the end-year primary balance target for 2016.
Adverse weather conditions	**Medium**	**Medium** Erratic rainfall has affected agriculture and electricity generation in the past. Power shortages could damage growth. Expensive electricity imports could pose quasi-fiscal risks to the budget.	Continue with the steadfast implementation of the electricity sector reform. Diversify domestic sources of electricity.
Renewed financial turmoil in Greece	**Medium**	**Low** Renewed financial turmoil in Greece could weigh on investor confidence. It could also lead to stress in the domestic banking system.	The authorities should continue strengthening their contingency plans and be proactive in seeking information from banks, closely monitoring capital and liquidity positions, and requiring banks to respond promptly.
Rollover of public debt	**Low**	**Medium** Uncertainty about economic conditions and concerns about debt sustainability may make banks reluctant to roll over government debt, a significant part of which is short-term.	Persist with fiscal adjustment and debt reduction. Further lengthen the maturity of public debt and diversify the holder base.

[1] The RAM shows events that could materially alter the baseline scenario (the scenario most likely to materialize in staff's view). The relative likelihood of risks listed is staff's subjective assessment of the risks surrounding the baseline.

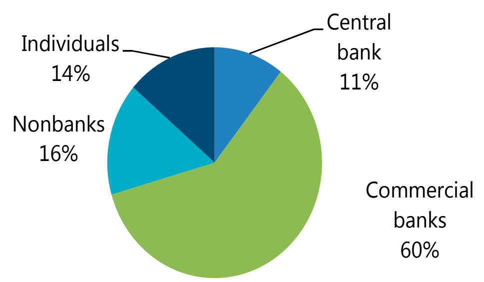
Annex II. Debt Sustainability Analysis (DSA)

Albania's public debt is sustainable but vulnerabilities remain due to the high levels of debt and rollover risks. Rollover needs remain sizable but the recent issuance of a five-year Eurobond and the increase in donor financing have mitigated rollover risks in the near term. The fiscal adjustment underway since 2014 has helped slow down the pace of debt accumulation, with the public debt-to-GDP ratio projected to start declining in 2016. Over the medium term, continued fiscal consolidation and steadfast implementation of reforms will be crucial to reduce the risks to debt sustainability and achieve the target of lowering public debt below 60 percent of GDP by 2019. The authorities broadly agreed with this assessment.

A. Background

1. **Albania's public debt stood at 71.9 percent of GDP at the end of 2015.** Public debt, defined as general government gross financial liabilities, includes public guarantees, both domestic and external. At end-2015, public debt was mostly domestic (53 percent of the total stock), medium-to-long term (76 percent), and denominated in domestic currency (51 percent). Public debt includes guaranteed debt (5 percent at end-2015). The share of local government debt is negligible (0.1 percent). After three years of clearing domestic arrears and unpaid bills, the share of the outstanding stock of central government arrears is now small (0.2 percent). Commercial banks hold most domestic debt, although nonbanks have quintupled their exposure since 2010 (text figure). The Bank of Albania also holds a substantial share. Regarding external debt, the share of holdings by private creditors has decreased in 2015 (reaching about 26 percent at end-December), at the expense of a rising share held by multilateral borrowers (55 percent), with official bilateral creditors maintaining a constant share in the portfolio (20 percent).

Domestic Public Debt By Holder
(2015, share of total excl. arrears and guarantees)



2. **Following a period of rapid growth, the debt accumulation slowed considerably in 2015.** High primary deficits and slowing macroeconomic growth led to a rapid increase in public debt by around 9 percent of GDP between 2007 and 2012. The authorities subsequently abandoned the debt ceiling of 60 percent of GDP in 2012. In 2013, a widening fiscal deficit and the recognition of a substantial stock of domestic arrears and unpaid bills (about 5 percent of GDP) led to an increase of the debt-to-GDP ratio by another 8 percentage points. In 2014, the authorities embarked on a fiscal adjustment strategy and an ambitious reform of the electricity sector, which included incorporating public support to the sector into public debt statistics. As a result, the pace of debt accumulation slowed down in 2014–15.

3. The macroeconomic assumptions underpinning the DSA are in line with the updated macroeconomic adjustment program. The medium term will see a gradual recovery of real growth to about 4 percent, supported by a solid implementation of structural reforms, a rebound in confidence, and higher private investment flows in key sectors (energy and road infrastructure). Inflation expectations will remain anchored by the central bank's 3 percent target. After achieving a consolidation of about 2 percent of GDP in 2014–15,[1] fiscal adjustment is expected to continue under the program. The authorities are targeting a primary surplus beginning in 2016 and an annual consolidation of around one percentage point of GDP per year over 2016–2019.

4. The share of external financing is increasing, while average maturity is lengthening. This reflects mainly efforts to shift from short-term domestic to long-term external sources, including through increased financing from the IMF and the World Bank.[2] Furthermore, the authorities successfully issued a €450 million Eurobond in November 2015, which rolled over a maturing €300 million Eurobond. Thus, average weighted maturity has increased slightly and is now close to two years.

B. Public DSA Results

Baseline

5. Under the baseline scenario, Albania's public debt will decline gradually over the medium term, albeit remaining at elevated levels. The authorities are committed to lowering the public debt, with the aim of bringing it below 60 percent of GDP by end-2019.[3] Even at this level, debt would continue to pose significant risks because of high rollover needs and a vulnerability to macroeconomic shocks arising from slow growth, low inflation, and volatility in interest rates and the terms of trade. In addition, the heavy reliance on the domestic financial sector poses risks given the systemic link between banks and the sovereign.

6. Public debt under the baseline scenario is susceptible to a range of risks arising from the composition of the financing profile. Although the authorities have started lengthening the maturity profile by increasing long-term external public debt and undertaking debt buybacks, ***rollover risks*** remain high as more than two fifths of central government domestic direct debt was short-term at the end of 2015 and is expected to decline only gradually over time. Despite a substantial decline from 2016 onwards, public gross financing needs are projected to remain above the early warning levels associated with past debt crises. ***Interest rate risk*** is expected to increase with the lengthening of maturities. However, the lack of a liquid secondary market limits somewhat this effect on valuations. Another mitigating factor includes the increasing share of multilateral

[1] As measured by the overall balance excluding arrear clearance. The headline deficit figure for 2014 includes 2.4 percent of GDP in arrears clearance, which is not a debt-creating flow.

[2] The IMF program will continue to provide financing until 2017. The World Bank helped the authorities secure a commercial bank loan of €250 million in August 2015 through a Policy Based Guarantee (PBG).

[3] Under the proposed fiscal rule, the authorities aim for a medium-term debt target of 45 percent of GDP.

donor financing which lowers the effective interest rate. Finally, ***exchange rate risk*** will rise with the expansion of foreign currency debt, but Albania's comfortable level of international reserves should alleviate the risk of a large disorderly devaluation.

7. The alternative scenarios underscore the risks to the baseline if reforms falter. Key risks arise from a slower-than-projected fiscal adjustment and growth recovery. Indeed, by 2021, public debt would still be close to 70 percent of GDP under the scenario based on historical performance and 60 percent under the constant primary balance scenario.[4] In both scenarios, gross financing needs would exceed 20 percent of GDP in 2021, higher than current levels.

8. The baseline scenario nevertheless remains realistic. It represents a central forecast reflecting recent policy performance, the government's commitments under the program, the planned reintroduction of a fiscal rule, and realistic assumptions about the medium-term:

- *Limited validity of the historical and constant primary balance scenarios.* The historical performance of the past 10 years is not representative of the current policy environment. The current government, which took office in 2013, has engineered a clear break with past policies. In the past, high growth and easy financing conditions led to a procyclical fiscal stance, which in turn fueled the accumulation of public debt and domestic arrears. Since 2014, the new government has successfully embarked on fiscal consolidation and accompanying reforms, including of fiscal institutions. Given significant risks for macroeconomic stability and uncertain market access, the authorities remain committed to reducing the public debt (by improving the primary balance over the medium term) and accelerating growth (by implementing further structural reforms).

- *Relatively realistic assumptions.* Forecasts for growth, the primary balance, and inflation do not suffer from a large systematic bias, with forecast errors broadly within the inter-quartile range of the forecast errors of other countries. The planned fiscal effort is somewhat bigger than what is typical of other countries' adjustment experiences, but this also reflects the substantial arrear clearance, which worsens the overall fiscal balance in 2014–2015.[5]

- *GDP forecasts in line with the planned fiscal effort.* Medium-term growth projections seem realistic, given (i) Albania's relatively low per capita income by regional standards and its potential for convergence; (ii) high inflows of FDI throughout the period; (iii) the country's status as EU accession candidate, which fosters growth-friendly structural reforms; and (iv) the authorities' strong record of implementing difficult reforms. The fiscal multiplier assumption is

[4] Under the historical scenario, real GDP growth, the primary balance, and real interest rates are set at their historical average of the past 10 years while other variables are the same as in the baseline. Under the constant primary balance scenario, the primary balance remains at the 2016 projected level (in percent of GDP), while all other variables are the same as in the baseline.

[5] Consequently, the adjustment of the cyclically adjusted primary balance over the forecasting period looks larger than it really is.

consistent with empirical estimates for CESEE countries. The fiscal adjustment is expected to be largely revenue-based, and empirical estimates of revenue multipliers are typically low. Albania's trade openness and high levels of public debt are also consistent with lower fiscal multipliers.

Stress tests

9. **Macroeconomic and fiscal shocks can significantly increase public debt and gross financing needs relative to the baseline throughout the projection period.** Among all stress test scenarios, Albania shows the highest vulnerability to a combined macro-fiscal shock.[6] Under this scenario, the debt-to-GDP ratio increases to 74 percent in 2017–2018, before gradually declining to around 64 percent by 2021. Gross financing needs would be permanently higher relative to the baseline (by 5 percentage points of GDP in 2021). The second worst-case scenario would be a growth shock. A negative shock in real GDP growth by one standard deviation in 2017–2018 would delay reaching the 60 percent of GDP target for public debt by a year.

10. **Fan charts further illustrate the possible evolution of debt over the medium term, through simulating a large number of shocks to macroeconomic variables.[7]** These simulations suggest that under a symmetric distribution, an 80 percent confidence interval for the debt stock in 2021 ranges between 45 and 60 percent of GDP. However, under a restricted distribution (which precludes a positive shock to the primary balance), debt could be above 60 percent of GDP by 2021 with a probability of more than 20 percent, relative to the baseline scenario of 52 percent of GDP.

C. External Debt Sustainability

11. **The bulk of external debt is public and held by multilateral creditors and development agencies.** External debt in 2015 is estimated to have reached around 40 percent of GDP, out of which 34 percent of GDP was public debt. Multilateral institutions held slightly more than half of public external debt, with around half of that being held by the World Bank. The remainder of public debt is split among bilateral development agencies and governments (about 7 percent of GDP) and private creditors (about 9 percent of GDP, including the recent Eurobond issuance of €450 million). External debt service is estimated to have spiked to about 6 percent of GDP in 2015 due to the amortization of the €300 million Eurobond that matured in November. External public debt is primarily denominated in either Euros (60 percent) or SDRs (25 percent).

12. **External debt is projected to rise gradually over the medium term, as the public debt composition shifts from short-term domestic to long-term external sources.** External public borrowing will drive total external debt to peak around 43 percent of GDP in 2017 (with 35 percent

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[6] Stress tests include shocks to macro variables (real interest rate, real GDP growth, real exchange rate), fiscal variables (primary balance), and a combination of macro and fiscal variables which incorporates the largest effect of individual shocks on all variables.

[7] Fan charts show a spectrum of possible outcomes for the level of debt based on a probabilistic view of uncertainty around the baseline.

of GDP as public external debt) before gradually declining to 37 percent by 2021. During this period, external private borrowing is expected to remain contained at 1½ percent of GDP, with the bulk of private foreign financing coming through foreign direct investment, including for large projects such as the Trans Adriatic Pipeline and the Statkraft/Devoll hydropower project.

13. Stress tests show that external debt dynamics can significantly worsen in the event of shocks to the real exchange rate and the current account. Under a 30 percent depreciation shock, external debt would peak at 63 percent of GDP in 2017 before declining to 54 percent by 2021. However, the real effective exchange rate has been relatively stable over the last several years and ample reserve buffers mitigate the risk of a steep depreciation. Following a shock to the current account of half a standard deviation (around 1.5 percent of GDP), external debt would peak at 45 percent of GDP by 2018 and remain near that level.

D. Conclusion

14. Despite the significant fiscal adjustment since 2014, Albania's debt remains high and poses significant risks. As highlighted in red in the standardized heat map, shocks related to growth, the primary balance, interest rates, and the exchange rate push Albania's debt and gross financing needs above relevant benchmarks, providing early warning signs of emerging risks. Specifically, both under the baseline and various shock scenarios, Albania's debt exceeds the 70 percent of GDP benchmark and its gross financing needs exceed the 15 percent of GDP benchmark. The debt profile poses moderate risks (yellow in the heat map), with the exception of external financing requirements, which raise more concerns (red in the heat map).[8] The risks are mitigated somewhat by the fact that donors hold a significant share of multilateral and bilateral debt and that the bulk of foreign financing comes through foreign direct investment.

15. Addressing the risks associated with high debt remains critical for Albania's macroeconomic stability. High debt is associated with lower growth and may thwart the weak economic recovery. High debt also means higher vulnerability to shocks. Finally, high debt is associated with high rollover requirements, and thus increased vulnerability to sudden shifts in market perception. To address these risks, the authorities should continue to strengthen debt management capacity and lengthen debt maturity. Furthermore, continued fiscal consolidation and steadfast implementation of structural reforms will be crucial to ensure debt sustainability.

[8] Following the issuance of the Eurobond, the government reduced short-term public debt in late 2015 by repaying (rather than rolling over) maturing securities and buying back securities maturing in early 2016. This led to a net reduction in the share of short-term debt and a green flag in the heat map.

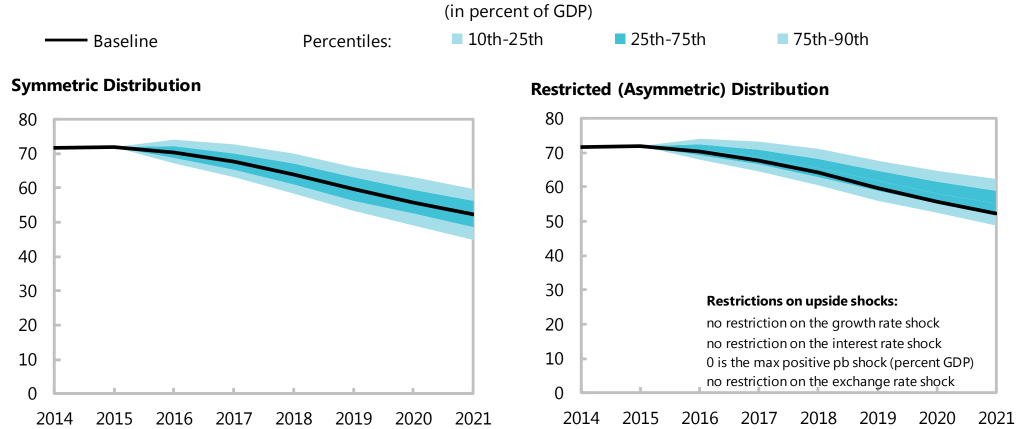
Albania: Public DSA Risk Assessment

Heat Map

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

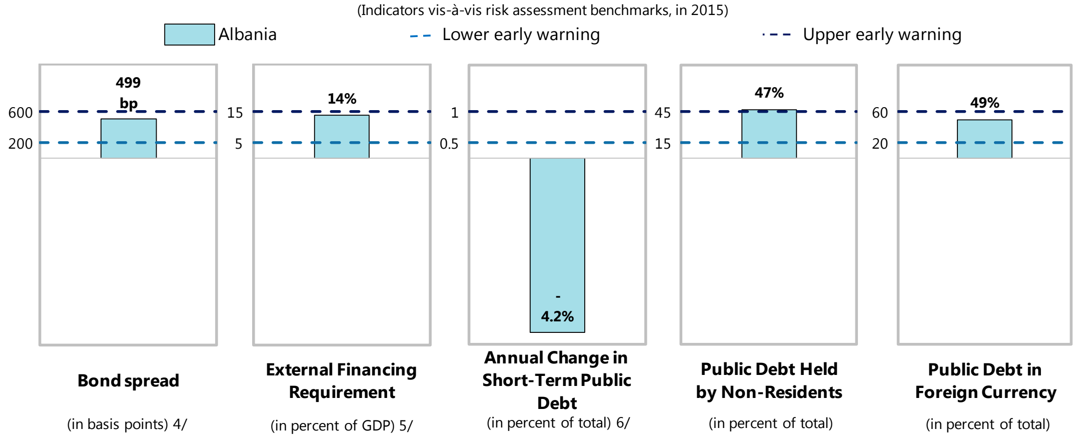
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



Source: IMF staff.

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

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

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Bond Spread over German Bonds, an average over the last 2 weeks, 22-Dec-15 through 21-Mar-16 (the new Eurobond was issued on November 5, 2015).

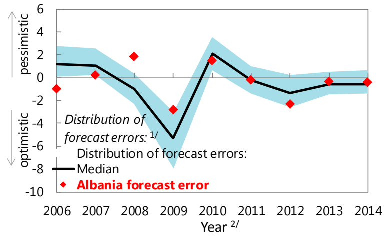
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

6/ Following the Eurobond isuance in November, 2015, the governemnt reduced short-term debts by a rollover reduction and a buyback of bonds maturing in early 2016.

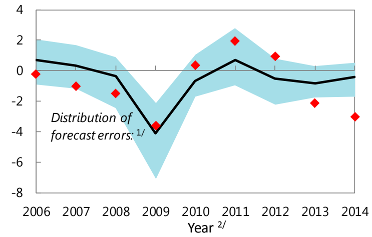
Albania: Public DSA - Realism of Baseline Assumptions

Forecast Track Record, versus all countries

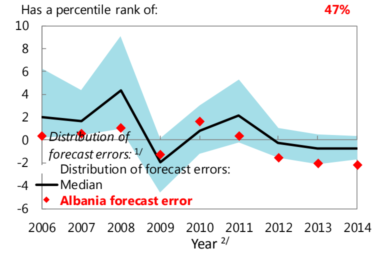
Real GDP Growth
(in percent, actual-projection)
Albania median forecast error, 2006-2014: **-0.31**
Has a percentile rank of: **49%**



Primary Balance
(in percent of GDP, actual-projection)
Albania median forecast error, 2006-2014: **-1.01**
Has a percentile rank of: **29%**

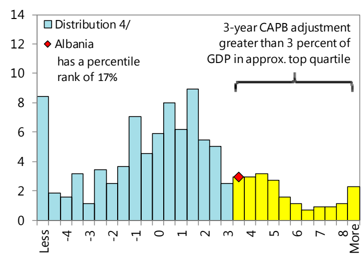


Inflation (Deflator)
(in percent, actual-projection)
Albania median forecast error, 2006-2014: **0.35**
Has a percentile rank of: **47%**

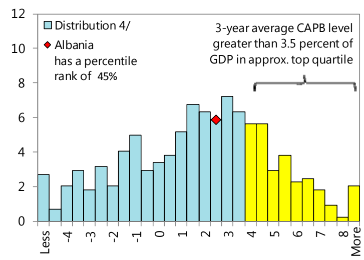


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB) 5/
(Percent of GDP)

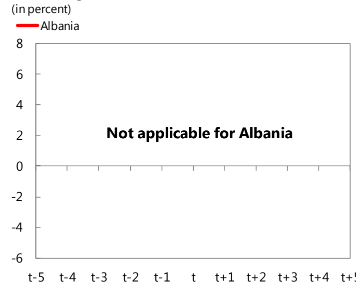


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB) 5/
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Albania, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.
5/ CAPB in Albania includes substantial arrear clearnce in 2014-2015, so that Albania's ranking is overestimated.

Albania: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

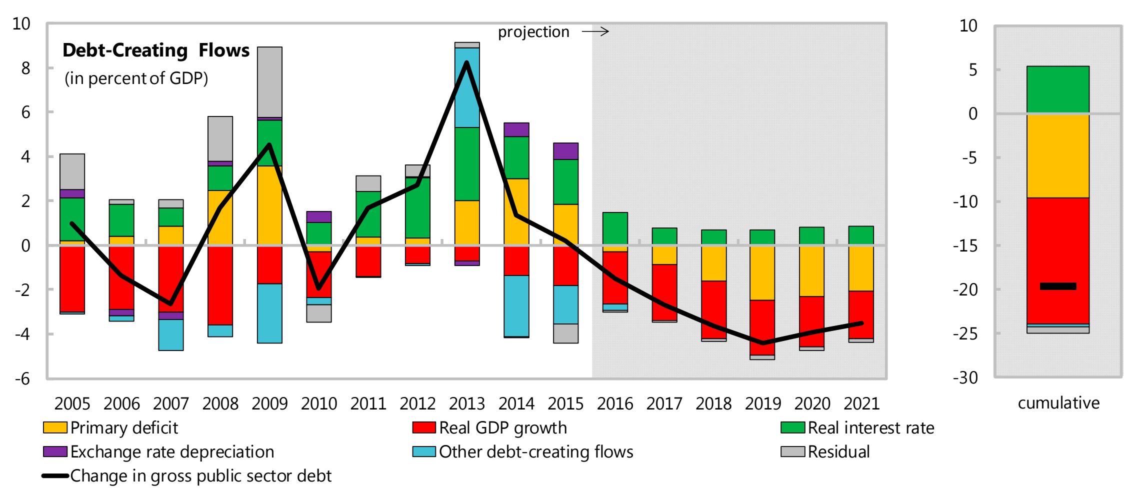
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of Mar 21, 2016		
	2005-2013 [2]	2014	2015	2016	2017	2018	2019	2020	2021			
Nominal gross public debt	59.0	71.7	71.9	70.4	67.7	64.1	59.7	55.8	52.3	Sovereign Spreads		
Of which: guarantees	3.4	3.9	3.9	3.7	3.4	3.2	3.0	2.8	2.6	Spread (bp) 3/		472
Public gross financing needs	43.1	37.0	32.1	23.1	18.9	18.0	16.4	20.1	16.9	5Y CDS (bp)		n.a.
Real GDP growth (in percent)	4.1	2.0	2.6	3.4	3.8	4.1	4.1	4.1	4.1	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	2.6	1.6	1.1	1.9	2.6	3.0	3.2	3.1	3.1	Moody's	B1	B1
Nominal GDP growth (in percent)	6.8	3.7	3.8	5.4	6.5	7.2	7.4	7.4	7.4	S&Ps 11/	B+	B+
Effective interest rate (in percent) [4]	6.0	4.5	4.1	4.2	3.9	4.2	4.5	4.8	4.9	Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [10]
Change in gross public sector debt	1.5	1.4	0.2	-1.5	-2.7	-3.6	-4.4	-3.9	-3.5	-19.6	
Identified debt-creating flows	0.6	1.4	1.1	-1.4	-2.6	-3.5	-4.2	-3.8	-3.4	-18.9	
Primary deficit [5]	1.1	3.0	1.8	-0.3	-0.9	-1.6	-2.5	-2.3	-2.1	-9.6	-1.3
Primary revenue and grants [5]	25.5	26.2	26.0	26.8	27.2	27.8	28.4	28.3	28.2	166.6	
Primary expenditure [5]	26.6	29.2	27.9	26.5	26.3	26.2	25.9	26.0	26.1	157.0	
Automatic debt dynamics [6]	-0.3	1.2	1.0	-0.8	-1.7	-1.9	-1.8	-1.5	-1.3	-9.0	
Interest rate/growth differential [7]	-0.3	0.5	0.2	-0.8	-1.7	-1.9	-1.8	-1.5	-1.3	-9.0	
Of which: real interest rate	1.8	1.9	2.0	1.5	0.8	0.7	0.7	0.8	0.9	5.4	
Of which: real GDP growth	-2.1	-1.4	-1.8	-2.3	-2.5	-2.6	-2.5	-2.3	-2.1	-14.4	
Exchange rate depreciation [8]	0.0	0.6	0.8	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.2	-2.8	-1.7	-0.3	0.0	0.0	0.0	0.0	0.0	-0.3	
Net privatization proceeds (negative)	-0.7	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Creation/clearance of end-2013 stock of arrears	0.5	-2.8	-1.7	-0.2	0.0	0.0	0.0	0.0	0.0	-0.2	
Residual [9]	0.9	0.0	-0.9	-0.1	-0.1	-0.1	-0.2	-0.2	-0.1	-0.8	



Source: IMF staff.

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

2/ Based on available data.

3/ Bond Spread over German Bonds, based on the 5-year eurobond issued in November 2015.

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

5/ The DSA includes unallocated measures in revenues and expenditures.

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

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

8/ The exchange rate contribution is derived from the numerator in footnote 6 as ae(1+r).

9/ Includes guarantees, asset changes, and interest revenues (if any). It includes also exchange rate changes during the projection period.

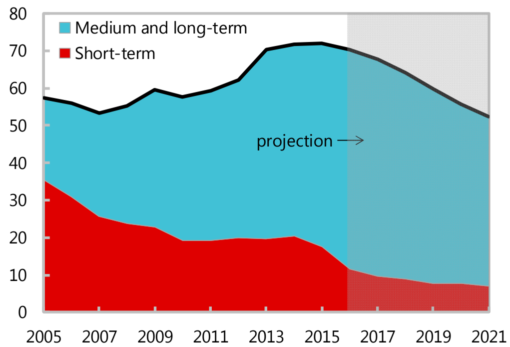
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

11/ Credit ratings for short-term foreign and local currency sovereign is maintained at "B."

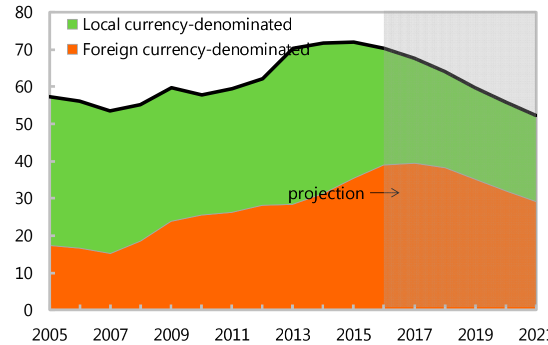
Albania: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



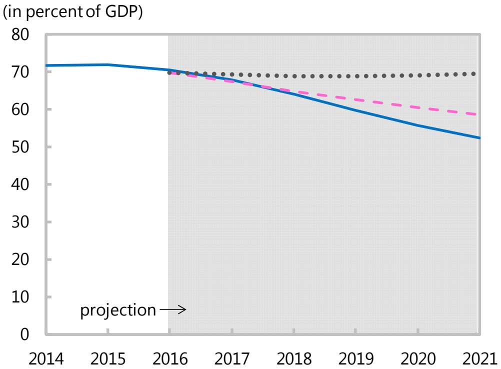
By Currency
(in percent of GDP)



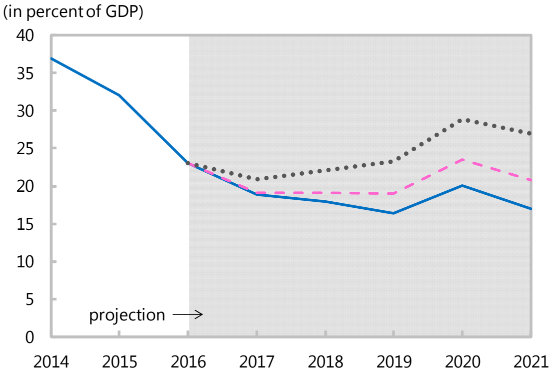
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

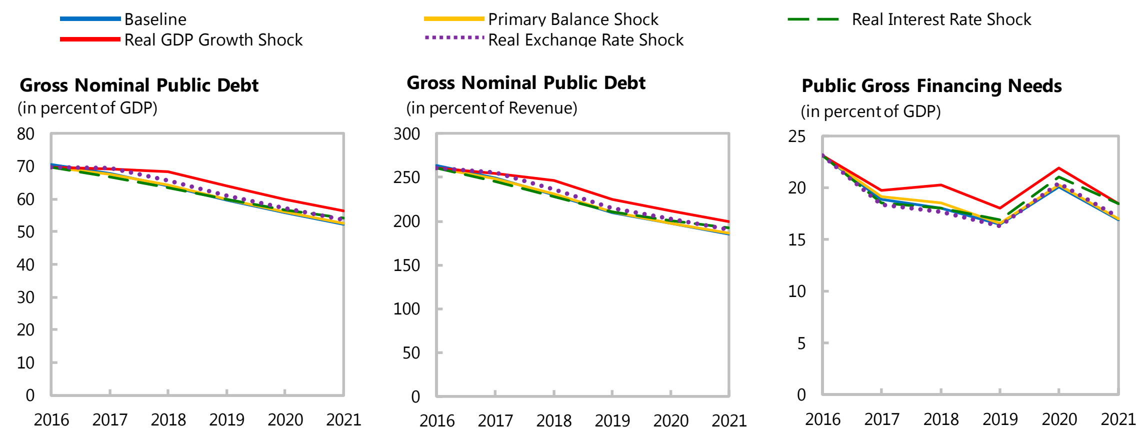
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	3.4	3.8	4.1	4.1	4.1	4.1
Inflation	1.9	2.6	3.0	3.2	3.1	3.1
Primary Balance	0.3	0.9	1.6	2.5	2.3	2.1
Effective interest rate	4.2	3.9	4.2	4.5	4.8	4.9
Constant Primary Balance Scenario						
Real GDP growth	3.4	3.8	4.1	4.1	4.1	4.1
Inflation	1.9	2.6	3.0	3.2	3.1	3.1
Primary Balance	0.3	0.3	0.3	0.3	0.3	0.3
Effective interest rate	4.2	3.9	4.2	4.5	4.7	4.8

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	3.4	3.6	3.6	3.6	3.6	3.6
Inflation	1.9	2.6	3.0	3.2	3.1	3.1
Primary Balance	0.3	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	4.2	3.9	4.6	5.1	5.5	5.9

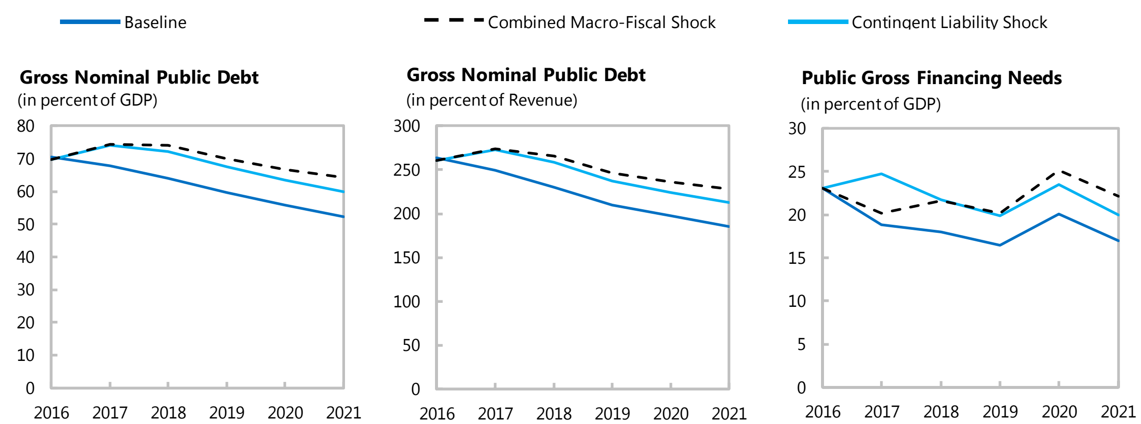
Source: IMF staff.

Albania: Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	3.4	3.8	4.1	4.1	4.1	4.1
Inflation	1.9	2.6	3.0	3.2	3.1	3.1
Primary balance	0.3	0.2	1.0	2.5	2.3	2.1
Effective interest rate	4.2	3.9	4.2	4.6	4.8	4.9
Real Interest Rate Shock						
Real GDP growth	3.4	3.8	4.1	4.1	4.1	4.1
Inflation	1.9	2.6	3.0	3.2	3.1	3.1
Primary balance	0.3	0.9	1.6	2.5	2.3	2.1
Effective interest rate	4.2	3.9	5.0	5.8	6.4	7.0
Combined Shock						
Real GDP growth	3.4	1.7	2.0	4.1	4.1	4.1
Inflation	1.9	2.1	2.4	3.2	3.1	3.1
Primary balance	0.3	0.2	0.2	2.5	2.3	2.1
Effective interest rate	4.2	4.1	4.9	5.7	6.3	6.9

Real GDP Growth Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	3.4	1.7	2.0	4.1	4.1	4.1
Inflation	1.9	2.1	2.4	3.2	3.1	3.1
Primary balance	0.3	0.2	0.2	2.5	2.3	2.1
Effective interest rate	4.2	3.9	4.2	4.6	4.8	4.9
Real Exchange Rate Shock						
Real GDP growth	3.4	3.8	4.1	4.1	4.1	4.1
Inflation	1.9	6.0	3.0	3.2	3.1	3.1
Primary balance	0.3	0.9	1.6	2.5	2.3	2.1
Effective interest rate	4.2	4.1	4.1	4.4	4.7	4.8
Contingent Liability Shock						
Real GDP growth	3.4	1.7	2.0	4.1	4.1	4.1
Inflation	1.9	2.1	2.4	3.2	3.1	3.1
Primary balance	0.3	-4.7	1.6	2.5	2.3	2.1
Effective interest rate	4.2	4.2	4.5	4.7	4.9	5.0

Source: IMF staff.

Albania: External Debt Sustainability Framework, 2011-2021
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2011	2012	2013	2014	2015			2016	2017	2018	2019	2020	2021	Debt-stabilizing non-interest current account 6/
Baseline: External debt	33.3	36.2	35.8	34.2	40.6			**43.0**	**43.1**	**42.1**	**40.4**	**38.5**	**37.0**	**-5.8**
Change in external debt	0.0	2.9	-0.4	-1.7	6.4			2.4	0.1	-1.0	-1.7	-1.9	-1.5	
Identified external debt-creating flows (4+8+9)	4.2	4.9	-0.1	3.4	9.0			4.0	3.9	4.4	5.0	5.0	5.1	
Current account deficit, excluding interest payments	12.2	9.4	10.4	12.2	10.4			11.6	11.4	11.4	10.4	10.0	9.9	
Deficit in balance of goods and services	22.7	18.6	18.0	18.9	16.9			17.5	17.0	16.8	15.6	15.0	14.8	
Exports	34.0	33.4	35.4	35.1	34.0			32.0	32.3	32.3	32.1	32.0	32.0	
Imports	56.7	52.0	53.5	54.0	50.8			49.6	49.3	49.1	47.8	47.0	46.7	
Net non-debt creating capital inflows (negative)	-6.6	-6.8	-9.6	-8.1	-7.5			-7.3	-7.1	-6.5	-4.9	-4.5	-4.3	
Automatic debt dynamics 1/	-1.5	2.3	-0.9	-0.7	6.2			-0.3	-0.4	-0.5	-0.5	-0.5	-0.5	
Contribution from nominal interest rate	1.0	0.8	0.4	0.7	1.0			1.1	1.1	1.2	1.1	1.1	1.0	
Contribution from real GDP growth	-0.8	-0.5	-0.4	-0.7	-1.0			-1.3	-1.5	-1.7	-1.6	-1.6	-1.5	
Contribution from price and exchange rate changes 2/	-1.7	2.0	-0.9	-0.7	6.2			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-4.1	-2.0	-0.3	-5.0	-2.6			-1.7	-3.8	-5.4	-6.7	-6.9	-6.6	
External debt-to-exports ratio (in percent)	97.8	108.4	101.1	97.5	119.5			134.1	133.5	130.5	125.8	120.3	115.9	
Gross external financing need (in billions of US dollars) 4/	1.9	1.5	1.7	2.0	1.9			1.9	2.0	2.2	2.2	2.8	2.4	
in percent of GDP	14.9	12.3	13.3	15.2	16.5	10-Year	10-Year	15.3	15.5	15.7	14.8	17.4	14.2	
Scenario with key variables at their historical averages 5/								**43.0**	**43.2**	**41.9**	**39.5**	**36.7**	**33.6**	**-7.7**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.5	1.4	1.1	2.0	2.6	3.6	2.1	3.4	3.8	4.1	4.1	4.1	4.1	
GDP deflator in US dollars (change in percent)	5.3	-5.8	2.6	1.9	-15.4	0.4	9.0	2.8	1.9	2.5	3.4	3.7	2.9	
Nominal external interest rate (in percent)	3.2	2.2	1.1	2.0	2.5	2.2	0.7	2.8	2.8	2.9	2.9	2.9	2.9	
Growth of exports (US dollar terms, in percent)	13.1	-6.1	10.0	2.9	-15.9	8.8	16.1	0.3	6.6	6.6	7.2	7.7	6.9	
Growth of imports (US dollar terms, in percent)	15.5	-12.4	6.7	4.9	-18.2	5.4	17.0	3.7	5.2	6.2	4.8	6.3	6.5	
Current account balance, excluding interest payments	-12.2	-9.4	-10.4	-12.2	-10.4	-11.2	2.9	-11.6	-11.4	-11.4	-10.4	-10.0	-9.9	
Net non-debt creating capital inflows	6.6	6.8	9.6	8.1	7.5	7.2	1.7	7.3	7.1	6.5	4.9	4.5	4.3	

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

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

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

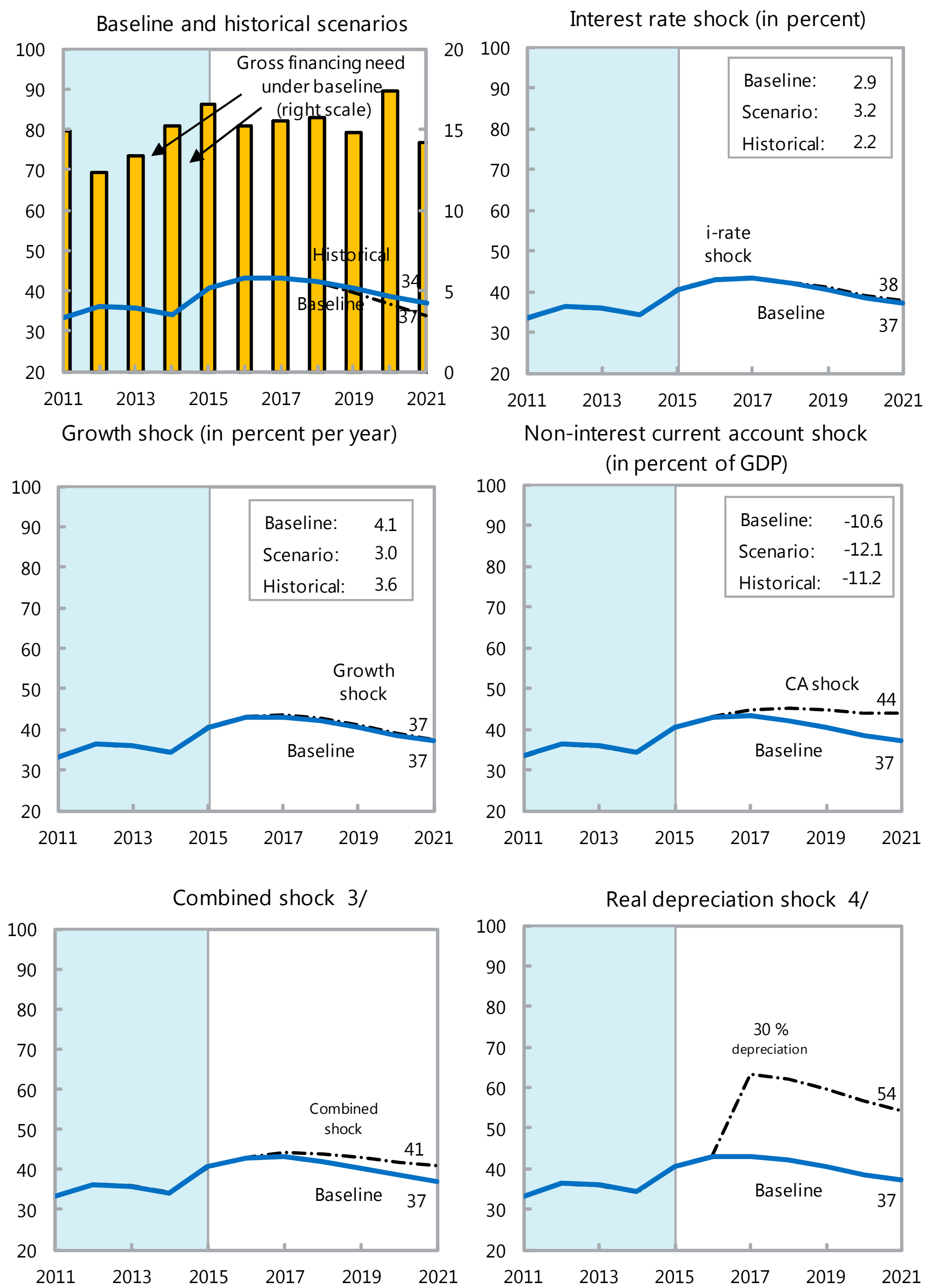
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Albania: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



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

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

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

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

4/ One-time real depreciation of 30 percent occurs in 2017.

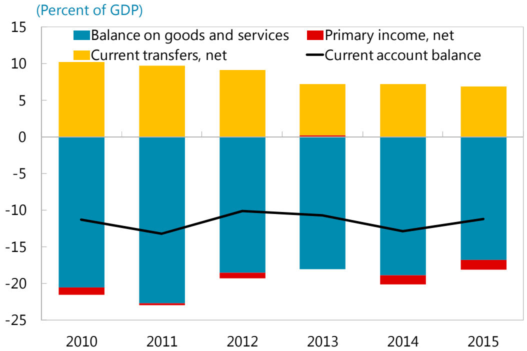
Annex III. External Sector Assessment

Albania's exchange rate regime is floating de jure, but the lek/euro rate has remained very stable over the past 6 years despite limited interventions by the central bank. The external position is moderately weaker than implied by fundamentals, with a real exchange rate overvaluation estimated at around 10 percent. Reserves are adequate based on metrics for floating regimes.

A. Background

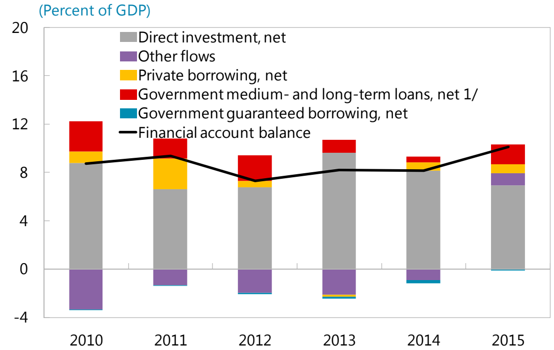
1. Albania receives large external inflows which have raised foreign liabilities and reduced its net international investment position (NIIP). The inflows are mainly foreign direct investment (FDI), remittances, and public external borrowing. These inflows have been persistent over the last six years and have outpaced the growth in foreign assets. As a result, the NIIP has been on a downward trajectory and is estimated to have reached -47 percent of GDP in 2015, with 109 percent of GDP in foreign liabilities and 62 percent of GDP in foreign assets, of which around 28 percent of GDP were gross reserves. Foreign liabilities are evenly divided between investment liabilities and external debt, most of which is public.

Current Account Balance
(Percent of GDP)



Source: IMF staff calculations.

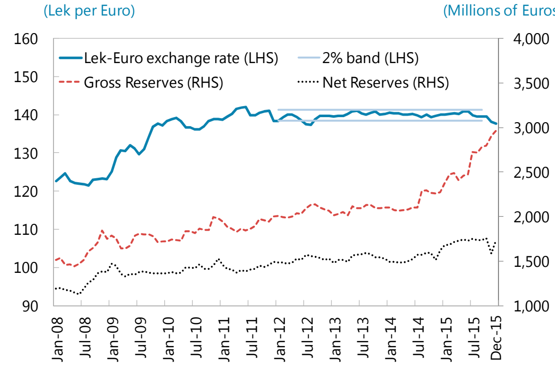
Financial Account Balance
(Percent of GDP)



Source: IMF staff calculations.
1/ Includes 2015 eurobond.

2. The current account (CA) deficit has been large and primarily funded by FDI, although more recently, public external borrowing has also played a large role. The CA deficit was estimated at about 11 percent of GDP in 2015, the ninth year in a row in double digits. The CA deficit has been largely funded by FDI of around 8–9 percent of GDP. In 2015, the government was able to tap international markets with public net external borrowing of 5 percent of GDP. Reserves have been on a rising trend, mainly due to a lower energy import bill and rising inflows from public external borrowing.

Albania: Nominal Exchange Rate and Foreign Reserves
(Lek per Euro) (Millions of Euros)

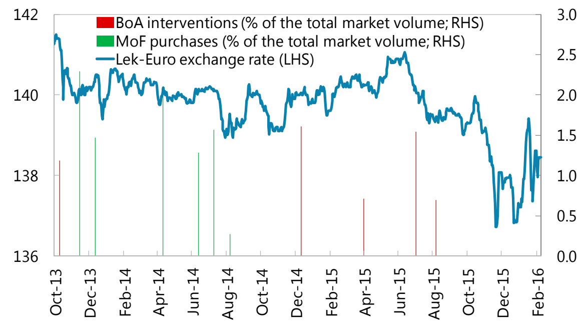


Sources: Bank of Albania; and IMF staff calculations.

3. The exchange rate against the euro has been very stable over the past six years despite a wide array of external and domestic shocks. The exchange rate has remained mostly within a 2 percent band around 140 lek/euro over the past 6 years. Prior to a devaluation of 13 percent in 2009, the exchange rate was similarly stable over 2004–2009. This is in part due to high euroization and a thin foreign exchange market, as most large parties satisfy their FX needs outside of the market. This includes the government which has relied on central bank swaps. While the BoA has refrained from active intervention to stabilize the exchange rate, monetary policy seems to have been constrained by concerns about movements in the exchange rate, as the large exposure of unhedged borrowers in FX (around 30 percent of private sector credit) raises financial stability risks in the event of significant adjustment in the exchange rate. Monetary policy has thus sought to maintain yield differentials with euro policy rates.

Official Interventions in the Foreign Exchange Rate Market

(Lek per Euro) (Percent)

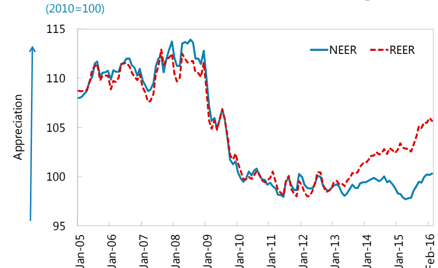


Note: BoA auctions for foreign exchange are based on a pre-announced schedule.
Sources: Bank of Albania; and Haver Analytics.

4. Albania's REER has appreciated marginally over the last six years while the NEER has been very stable. The small REER appreciation reflects the positive inflation differential vis-à-vis trading partners, even though domestic inflation remains low in Albania due to weak import prices and the output gap.

Albania: Nominal and Real Effective Exchange Rates

(2010=100)



Source: IMF staff estimates.

B. Methodology

5. This assessment relies on three available tools to assess the exchange rate: i) an EBA-Lite model that estimates the current account norm from a sample of emerging markets; ii) a REER model that estimates the equilibrium real exchange rate based on the same sample; and iii) an external sustainability approach that assess the deviation from the current account norm needed to stabilize the NIIP.

6. The analytical tools used here are adapted to Albania's specifics. They take into account large unrecorded inflows in the balance of payments and the sizable FDI inflows. Thus, they differ from those used in the 2014 Article IV Consultation. In particular, in the EBA-Lite model, the underlying current account is adjusted to include the rather sizable inflows from errors and omissions. At around 2-3 percent of GDP, these inflows are associated mainly with unrecorded remittances. The underlying current account also excludes imports financed by FDI inflows over and above the sample average. Albania's FDI inflows are around 8–9 percent of GDP, higher than the sample average of 4 percent.[16] In addition, the CA is adjusted for the one-off positive impact in 2015 (0.5 percent of GDP) from strong rainfall leading to improvements in the electricity trade balance, due to hydropower.[17]

7. **In the external sustainability approach, the underlying current account is adjusted for errors and omissions only.** The REER approach is the least adapted to Albania as none of the adjustments above are feasible under that approach. As a result, the EBA-Lite model provides a much better fit for changes in Albania's current account balance over time than the REER model.

C. Results

8. **The analysis below, taken together with the assessment of reserve adequacy in section D, point to the external position being moderately weaker than implied by fundamentals.**

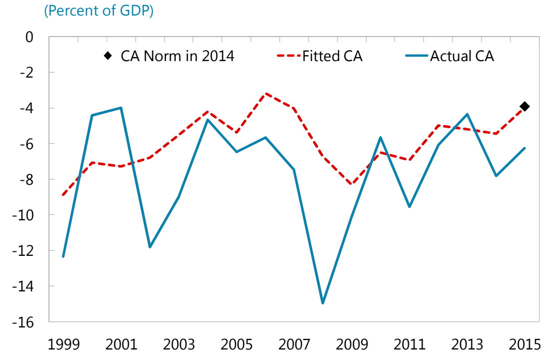
External Sector Assessment Summary Table

(in percent, except for elasticity)

	CA Norm	Adjusted Actual CA	CA Gap	REER Gap
EBA-Lite (CA Approach)	-3.9	-6.2	-2.3	11.6
External Sustainability Approach	-6.0	-8.6	-2.6	12.2
REER Approach	n.a.	n.a.	n.a.	3.0
REER elasticity	0.2			

- The CA norm under **the EBA-Lite approach** is estimated at -3.9 percent of GDP (a fitted value of -4 percent of GDP plus an additional 0.1 percent of GDP to account for policy factors), compared to an underlying CA balance of around -6.2 percent of GDP in 2015. Albania's CA fitted value is mainly driven by downward contributions from inflows of aid and remittances and the expected economic recovery, offsetting positive contributions from a relatively young demographic. Policy factors are estimated to have a marginal contribution due to tight credit conditions offsetting the cyclically loose fiscal position. Thus, the current account gap is estimated at -2.3 percent of GDP. Based on

Current Account: Actual, Fitted, and Norm
(Percent of GDP)



Source: IMF staff calculations.

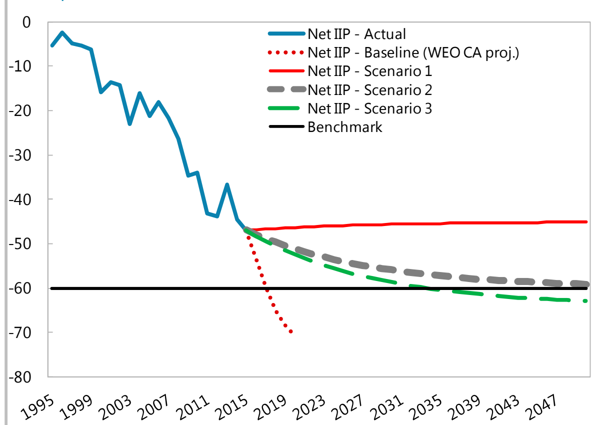
[16] Half of recent FDI has been concentrated in oil drilling which has a sizable import component.

[17] Staff also adjusted the current account balance in 2014 upward by 0.3 percent of GDP due to the one-off negative impact of weak rainfall and increased electricity imports.

a REER elasticity with respect to the CA of -0.2, the REER is assessed to be overvalued by about 11.6 percent.[18]

- **The external sustainability approach** estimates three CA norms depending on NIIP stabilization objectives, all of which point to an overvalued exchange rate. NIIP was estimated at around -47 percent of GDP in 2015. The CA norm needed to stabilize NIIP at 2015 levels is -4.6 percent of GDP compared to an underlying CA of -8.6. Given that Albania is likely to continue receiving substantial FDI inflows as it nears EU accession, a more realistic benchmark would be to stabilize NIIP around -60 percent of GDP, slightly above Bulgaria (around -75 percent of GDP) and Serbia (around -80 percent of GDP). Stabilizing the NIIP at -60 percent of GDP by 2035 implies a CA norm of -6.0 percent of GDP and a real exchange rate overvaluation of 12.2 percent.

Net IIP: Actual & Projected
(In percent of GDP, based on IIP data from EWN database)



Source: Lane and Milesi-Ferretti's External Wealth of Nations Dataset; IMF WEO

			CA norm (% of GDP)	Underlying CA (% of GDP)	CA gap	REER gap
Scenario 1: Stabilizing net IIP at	-45.0 % of GDP		-4.6	-8.6	-4.0	19.0
Scenario 2: Stabilizing net IIP at	-60.0 % of GDP		-5.7	-8.6	-2.9	13.7
Scenario 3: Reaching net IIP at	-60.0 % of GDP in	2035	-6.0	-8.6	-2.6	12.2

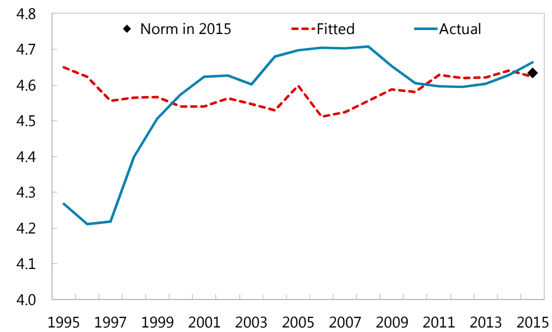
- **The REER approach points to the exchange rate being broadly in line with fundamentals, but the model has weak predictive power for Albania.** The estimate overvaluation is small at about 3 percent. However, the model misses all historical turning points in the REER. Also, the approach cannot be adapted to Albania-specific factors such as the significant and persistent inflows associated with unrecorded remittances and the substantial FDI over and above the sample average.

[18] The REER-CA elasticity parameter assumption is suggested by IMF Occasional Paper 167 and is identical to the one used for the External Sector Assessment in the 2014 Article IV Consultation.

D. Reserve Adequacy

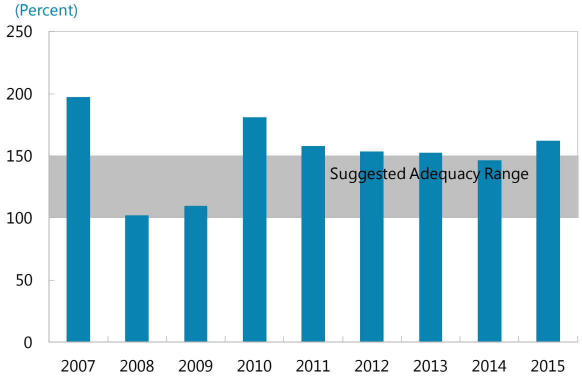
9. For a floating regime, reserve coverage is adequate. The composite metric for reserve adequacy for floating regimes is the sum of 30 percent of short-term debt at remaining maturity, 15 percent of other liabilities, 5 percent of broad money, and 5 percent of exports of goods and services. The recommended adequacy range is 100–150 percent of this metric.

Natural Log of REER: Actual, Fitted, and Norm



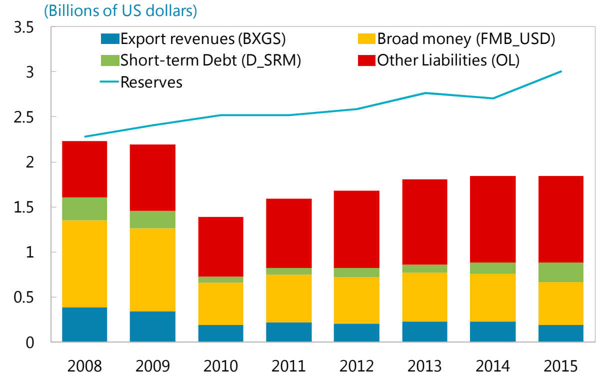
Source: IMF staff calculations.

Albania: Reserves as Percent of Metric (Floating Regime)
(Percent)



Source: IMF staff calculations.

Albania: ARA Metric Decomposition (Floating Regime)
(Billions of US dollars)



Source: IMF staff calculations.

Appendix I. Letter of Intent

May 10, 2016

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

Dear Ms. Lagarde:

1. The Extended Arrangement approved by the Executive Board of the International Monetary Fund (IMF) in February 2014 remains the 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 (BoA) will pursue over the next twelve months.

2. Performance under the program has been strong. All end-December, available end-April, and continuous performance criteria were met, as were most indicative targets. The indicative targets on contracting non-energy guarantees and the accumulation of new arrears were missed by small margins. The government is implementing remedial measures and most of the newly accumulated arrears will be settled by mid-2016. We are currently awaiting data to assess two end-April performance criteria on general government primary modified cash balance and primary expenditure, and we expect them to be met based on available data.

3. Most structural benchmarks were implemented, though one was implemented with a delay as a prior action, and one more is proposed to be rescheduled. Amendments to the Budget Law incorporating multi-year commitment limits were submitted to Parliament in early May 2016, as a prior action. The roll-out of the new treasury IT system (AGFIS) to 15 budget institutions was delayed to end-May 2016, to allow time to train new users of the system. The adoption of an implementation plan to restructure the tax agency's headquarters was delayed to May, to allow sufficient time for fine-tuning the plan.

4. Our policy priorities over the next twelve months are to continue pursuing fiscal consolidation, safeguard financial sector stability, revive credit growth, and implement growth-enhancing reforms. In particular, we will persist with ambitious reforms in revenue administration, public financial management, and the electricity sector.

5. Implementation of our program will be monitored by the Fund through reviews, quantitative performance criteria, indicative targets, and structural benchmarks, as described in the attached

MEFP and Technical Memorandum of Understanding (TMU). 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. We will consult with the Fund on the adoption of such measures, as well as in advance of any revisions to the policies contained in this letter and the MEFP. The government of Albania will provide the IMF with such information as it may request to monitor progress in economic and financial policy implementation.

6. In view of the strong program performance to date and the strength of policy commitments for the period ahead, we request that the Executive Board of the IMF complete the seventh review under the Extended Arrangement. We further request the purchase of SDR 28.65 million. We request a waiver of applicability for the two end-April performance criteria on general government primary modified cash balance and primary expenditure, given the unavailability of data for assessing these. We also request the modification of performance criteria, as described in Table 1 of the MEFP and in the TMU.

7. We wish to make this letter available to the public, along with the attached MEFP and TMU, as well as the IMF staff report on the seventh review under the Extended Fund Facility. 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/	/s/
Arben Ahmetaj	Gent Sejko
Minister of Finance	Governor, Bank of Albania

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

Attachment I. Memorandum of Economic and Financial Policies

1. This Memorandum lays out the Government of Albania's policy priorities for the period ahead, supported by the IMF's Extended Fund Facility. Our policies seek to generate higher living standards and better employment opportunities for Albanians. Achieving these goals will require sustained efforts to reduce debt-related vulnerabilities, revive credit growth, and unlock structural constraints to medium-term growth.

Recent Economic Developments

2. Economic growth picked up in 2015, despite significant headwinds. Weak demand in the Euro Area as well as low international commodity prices reduced export growth, while economic uncertainties arising from financial turmoil in Greece also weighed on domestic demand. The resulting broad-based weakness in mining and services was, however, offset by strong hydropower generation, a pickup in construction and manufacturing, continued arrears clearance, higher tourism receipts, and stronger domestic and foreign private investment. As a result, real GDP growth reached 2.6 percent in 2015. However, the economy continues to operate below its potential. Domestic slack and declining international commodity prices have resulted in very low headline inflation. CPI inflation fell to 0.3 percent in March 2016, due mostly to one-off supply shocks such as decreases in food and fuel prices. The current account deficit is expected to have narrowed to around 11 percent of GDP, given improvements in tourism receipts and higher net electricity exports that offset the decline in commodity exports.

Outlook

3. The economic recovery is expected to gather further momentum in 2016, driven by rising domestic demand. GDP growth is projected to increase to 3.4 percent in 2016, benefiting from continued strength in hydropower generation and FDI inflows, the lifting of the moratorium on construction permits, improved consumer confidence, and continued low interest rates. These effects are expected to offset the drop in domestic oil production and related investment, as well as the fiscal drag from the end of the central government's arrears clearance program. Given the persistent negative output gap and the deflationary impulse from global commodity prices, average headline inflation for 2016 has been revised downwards from 2.3 to 1.9 percent. However, medium-term inflation expectations remain anchored by the BoA's target of 3 percent.

4. The current account deficit is likely to remain elevated throughout 2016–17. The current account deficit is projected to widen to around 12½ percent of GDP this year. Imports are projected to remain high on the back of large infrastructure projects (such as the Trans Adriatic Pipeline and the Statkraft/Devoll hydropower plant), while low commodity prices are expected to continue weighing down on exports. After several years of decline, remittances have picked up but are expected to remain below their pre-crisis peak, given economic uncertainties in Greece and Italy, the main source countries. The current account will continue to be financed largely by FDI. Over the medium term, the current account deficit is expected to narrow because of improvements in export

capacity and falling import needs of the major FDI projects. Gross official reserves are expected to cover around 5½ months of imports of goods and services in 2016–17.

Program Implementation

5. All December, available end-April, and continuous performance criteria were met, as were most indicative targets (Table 1). The ceilings on the government's cash deficit and expenditure were met with large margins, due to expenditure savings and a non-tax revenue windfall, both of which offset broad-based weakness in tax revenues. The December ceiling on contracting non-energy guarantees was missed by a very small margin (0.03 percent of GDP). Going forward, we are proposing to remove this IT, as non-energy guarantees are now fully captured in our fiscal framework. The zero ceiling on the accumulation of central government domestic arrears was also not met. Results from the triannual survey of ten key ministries and the General Directorate of Taxation (GDT) show a stock of 1.3 billion lek of new arrears at end-December 2015 (0.09 percent of GDP). The bulk of new arrears was due to road construction projects and court decisions. All accumulated arrears will be repaid by mid-2016, except for those on court decisions, which will be settled in accordance with a special Council of Ministers decision. We will also seek rapid implementation of multi-year commitment limits, and have expedited related amendments to the Budget Law.

6. Most structural benchmarks were implemented, though one was implemented with a delay as a prior action, and one more is proposed to be rescheduled (Table 3a):

- In the area of public financial management, the regular report on the accumulation of new arrears was published on time. The roll-out of the new treasury IT system (AGFIS) to 15 budget institutions is proposed to be rescheduled to end-May 2016, to allow time to train new users. Amendments to the Budget Law incorporating multi-year commitment limits were submitted to Parliament in early May 2016, as a prior action.

- In the area of tax administration, the adoption of an implementation plan to restructure the GDT's headquarters was delayed to May, to allow sufficient time for fine-tuning the plan.

- In the electricity sector, we prepared the regular quarterly survey of the consolidated arrears of state-owned enterprises in the electricity sector to the private sector. We also published for the first time the quarterly financial statements of KESh and OShEE, the state-owned generation and distribution companies.

Economic Policies for 2016

A. Fiscal Policy

7. We commit to continuing with fiscal consolidation in order to reduce debt-related vulnerabilities which hamper growth and cause macroeconomic instability. We intend to pursue a steady pace of fiscal consolidation based on a strategy of broadening the tax base and strengthening tax administration and compliance, with the goal of lowering the public debt-to-GDP

ratio below 60 percent by 2019, from around 72 percent at end-2015. This path will be consistent with undertaking measures of at least 1 percent of GDP annually. The recent credit rating upgrade is a vote of confidence for our fiscal consolidation strategy. To improve debt management, we will also increase staffing levels and strengthen capacity at MoF's debt management unit.

8. We remain committed to achieving our target of a primary surplus of 0.3 percent of GDP in 2016. The renewed slide in global oil prices is posing a risk to oil-related royalties, VAT, and customs collections. To minimize the potential implications of this risk, we have committed to maintaining strict budgetary discipline, ensuring savings in current expenditure, and strengthening the revenue base and tax compliance. We commit to taking additional measures, if needed, to meet the 2016 target.

9. To address the structural roots of revenue underperformance in 2015, we have undertaken several additional reform measures:

- In early September 2015, we launched a large-scale reform effort against tax evasion, non-compliance, and informality. Our reform effort has already yielded a large increase in the number of registered small businesses and employees. We are refocusing our effort on high-risk segments, in line with our compliance risk management strategy. We remain prudent in projecting the revenue gains from our reform effort in 2016. Although we expect them to be higher, we have limited them in our budget projections to 4 billion lek (0.3 percent of GDP), from social contributions by newly registered workers. We have also frozen 4 billion lek in capital expenditure and have made it contingent on additional revenues from our reform effort.

- We are addressing weaknesses in revenue forecasting and monitoring. We are enhancing the coordination among the Ministry of Finance (MoF) and the General Directorates of Taxes and Customs (GDT and GDC). In September 2015, a dedicated revenue unit was established and commenced operations at MoF. The unit prepared its first survey of tax expenditures for the 2016 budget and will update this survey annually. With help from Fund TA, we will expand the survey to incorporate exemptions administered by the GDT, and we will broaden the definition of tax expenditures to include preferential tax rates. The survey will also include a rationale and, eventually, an efficiency assessment for each tax expenditure.

- We commit not to grant any further tax exemptions or preferential tax rates, without consulting with the IMF. This complements the efforts aimed at broadening the tax base by closing tax loopholes, simplifying tax administration, and creating a more level playing field.

- We have planned sufficient buffers in the budget to cope with the outcome of pending tax disputes, in order to protect the end-year primary balance target for 2016. In particular, large unbudgeted windfalls due to disputed tax payments will be adjusted under the program until the tax dispute is resolved.

10. We are making good progress in reducing the heavy burden the electricity sector places on public finances, while addressing the infrastructure gap. The financial gap in the sector reflected

mostly low collection levels and large network losses. We have implemented an ambitious set of reforms in the sector (see ¶27) that have started to reduce the structural imbalances. Therefore, we aim to limit public guarantees and policy net lending to the sector to 7 billion lek in 2016 and 6.5 billion lek in 2017, with the aim of completely eliminating power sector subsidies by 2020. Subsidies to the electricity sector are transparently reflected in the fiscal accounts under the program and in our budget. If government support to the electricity sector exceeds the annual programmed amount, we commit to taking offsetting fiscal measures to meet the program's fiscal targets.

11. We are addressing other emerging and potential risks to the baseline fiscal framework:

- *Local government reform*: Following local elections in mid-2015, 61 local government units replaced the previous 373 communes and municipalities. We are pursuing an ambitious fiscal decentralization strategy, by devolving certain functions, transferring personnel, and providing new financing sources for local governments. A recent survey commissioned by the Ministry of State for Local Government took stock of the finances of the new consolidated units as of mid-2015, and revealed a potentially significant stock of local government arrears. However, these arrears remain to be audited. We will require that local governments promptly conduct audits and prepare action plans by end-September 2015, which will provide for the clearance of the legacy stock of arrears, out of their own resources, in a comprehensive and transparent way, with external auditors ensuring the integrity of the process. The dedicated unit at MoF which continuously monitors the finances of local governments is adequately staffed and will start preparing quarterly surveys of local government arrears, starting with end-March 2016. With help from USAID and the World Bank, we are reviewing the legal framework on local public finance, in order to improve reporting requirements and tighten monitoring.

- *Capital expenditure:* Outstanding unbudgeted investment projects continue to exceed the government's ability to absorb them in its Medium-Term Budget Framework (MTBF). We have now made public the total cost and sunk cost of each outstanding project. The Ministry of Economy (MoE) has published a list of all projects that the 2016 budget will support, including an indicative budget for each project for all three years of the MTBF, in order to signal our intention to implement only projects included in the list. Going forward, our National Investment Committee will review all outstanding unbudgeted investment projects. Based on transparent criteria, which we will prepare by end-May, we will compile a priority ranking for all such projects and identify projects that will be cancelled by end-September, conditional on a legal review.

- *Arrears prevention:* The process of clearing the pre-2014 stock of central government arrears is now complete, and our focus is shifting toward prevention. The small amounts of outstanding pre-2014 arrears will be paid directly by budgetary institutions out of their allocations. We are reinforcing public financial management to prevent the accumulation of new arrears at all levels of government. By end-May 2016, we will extend our new treasury IT system (AGFIS) to 15 budget institutions (accounting for 84 percent of the budget) and one local government. We are also implementing revenue administration reforms and streamlining public investment management to prevent the recurrence of new arrears (see ¶12 and ¶17).

- *Public Private Partnerships (PPPs):* We are in the process of amending the Budget Law to strengthen MoF's role in the *ex ante* assessment of PPP proposals and their subsequent monitoring, to integrate PPPs into the budgetary process, and to limit the total stock of PPPs. We also plan to review our PPP law to strengthen MoF oversight, integrate PPPs into the broader public investment monitoring framework, and ensure consistency with the amendments to the Budget Law. To limit fiscal risks from PPPs, we will ensure that they follow international best practice and that their related fiscal costs and contingent liabilities are transparently accounted for in the fiscal accounts and debt statistics. Toward that objective, we will empower INSTAT to review PPP contracts in accordance with ESA and eventually IPSAS. By mid-2016, we will launch a public register of all active PPP projects and will also publish summaries of all PPP contracts as well as the contracts themselves (excluding confidential or protected information), to ensure transparency for the commitments made by the government. All future PPPs will be subject to a proper feasibility study and value-for-money analysis by the newly established fiscal risks unit at the MoF. The unit will be fully staffed by end-June 2016. By end-2016, the unit will start evaluating fiscal risks (including those stemming from all active PPPs and concession contracts and from local government arrears), propose measures to mitigate them, and provide risks assessments to be included in budget document submissions to Parliament. Technical assistance from the Fund and other international partners will continue to help assess our current legal and regulatory framework and suggest recommendations for improvement.

B. Medium-term Fiscal Structural Reforms

12. Advancing tax administration reforms is a key policy priority that underpins our fiscal consolidation strategy. We remain fully committed to implementing the GDT reforms laid out in its corporate strategy. By end-June 2016, the Large Taxpayer Office will be restructured, with specialization according to business sectors, and the Risk Management Unit will be fully staffed to enable it to identify major compliance risks and develop mitigating strategies. The GDT has started phasing in a modern compliance risk management approach for one major risk cluster, and will commence another one by end-September 2016, with help from Fund TA. By end-2016, the GDT will streamline its regional and local office structure, in order to match business needs. The taxpayer service function will also be upgraded to deliver easy-to-understand and accessible guidance to taxpayers based on their needs and compliance risks, using a variety of communication channels. Finally, by end-2017, the GDT will conduct a comprehensive review of its audit function.

13. We are moving forward with reforms in customs administration. The GDC is working on a restructuring proposal, which benefited from the recommendations provided by the external consultant on customs administration. The GDC will accelerate discussions with customs authorities in neighboring countries to develop real-time intelligence sharing on smuggling risks. It will upgrade the fiscal stamps system to conform to international "track and trace" standards set out in the Framework Convention for Tobacco Control. The GDC will put in place more effective measures to supervise and monitor fuel movements, including through the use of remote GPS-based surveillance in high-risk areas. To reduce subjectivity in customs assessments, GDC will create a

national customs assessment online portal. Finally, GDC will introduce online monitoring of customs warehouses.

14. Closer cooperation and information sharing between the GDT and GDC will enhance revenue administration reform efforts. In particular, the risk management units of the two revenue agencies have started sharing data and performing joint risk analysis and monitoring. Nevertheless, the merger of the two departments remains a medium-term objective which will be guided by Fund TA. Any related decisions will be taken in consultation with IMF staff.

15. We commit to accelerating the work on a fiscal cadastre, with the goal of introducing a valuation-based property tax by end-2017. The reform will be undertaken in consultation with Fund TA. As a first step, we plan to introduce a fiscal cadastre to assess tax for each property by end-2016. In parallel, we will develop a valuation formula and methodology, and draft the related legislation by end-September 2016.

16. In consultation with IMF TA, we are taking steps to shore up the credibility of our MTBF. MoF will continue to align its budget projections and macro framework with independent external forecasts, such as those produced by the BoA and international financial institutions. Starting with the 2016 budget, the MTBF now contains the total approved cost, the sunk cost so far, and remaining cost beyond the three-year window of the MTBF for all projects. In 2016, MoF will develop a methodology for distinguishing core allocations from new policy initiatives in the MTBF, in order to focus attention on the costing of new policies and prevent them from squeezing existing ones for resources. Starting with the 2017 budget, the MTBF will begin to make that distinction at the sectoral and program level. We are also working on a fiscal responsibility law, which will provide for a fiscal rule and a fiscal council.

17. We are seeking to improve the process for evaluating, selecting, executing, and monitoring public investment projects. Our top priority is to improve coordination among the various government bodies sharing responsibility over public investment management. As a first step, we recently transferred the public investment portfolio from the Ministry of the Economy back to MoF. To strengthen coordination, we have been training experts in line ministries on the public investment cycle. We have also compiled a manual that spells out the public investment process, in order to provide a handy reference to the laws and regulations guiding the process. We will seek to strengthen the process further, in line with the recommendations from the recent Public Investment Management Assessment. In particular, we will integrate SOEs and Regional Development Fund (RDF) projects into our MTBF, the budget cycle, and the public investment monitoring framework. We will review and streamline project classification to reduce fragmentation. We will fully staff and operationalize the public investment management unit in MoF, as well as strengthen the appraisal process for major projects. Finally, we will establish a unique project pipeline for large projects, based on clear criteria linked to national priorities.

C. Monetary and Exchange Rate Policy

18. The BoA remains committed to achieving an average annual CPI inflation of 3 percent over the medium term under an inflation-targeting framework. Monetary policy will also strive to smooth out the macroeconomic cycle and to avoid excessive volatility in the financial sector. Inflation performance will continue to be monitored under the program through an Inflation Consultation Clause.

19. Monetary policy is likely to remain accommodative for the foreseeable future given weak underlying inflationary pressures. Furthermore, the overall balance of risks is skewed to the downside due to continued domestic slack and external disinflationary pressures. The monetary policy transmission mechanism is hampered by high risk aversion in the banking system. We expect inflation to gradually converge to 3 percent over the medium term, as improved bank balance sheets and the crowding-in effect from lower domestic public debt strengthen credit flows to the private sector. There is still space for conventional easing and any decisions on additional measures will be taken in consultation with IMF staff.

20. Exchange rate flexibility complements our price stability objective and supports our operational framework for monetary policy. The exchange rate is determined entirely by market forces, and the BoA undertakes only small pre-announced interventions in the foreign exchange market. The BoA will aim to maintain adequate reserve coverage over the medium term. For the duration of the program, we will not impose or intensify restrictions on the making of payments and transfers for current international transactions, nor impose or modify any multiple currency practices, nor conclude any bilateral payments agreements that would violate our obligations under Article VIII of the IMF's Articles of Agreement. Also, we will not impose or intensify import restrictions for balance of payments reasons. Finally, we will continue with our efforts to resolve the outstanding balances on inoperative bilateral payment agreements.

21. We will strengthen coordination and information sharing between the BoA and the MoF on liquidity and debt management. MoF will discuss with BoA in advance any external or domestic debt operations to ensure orderly market conditions and avoid excessive financial volatility.

D. Safeguarding Financial Sector Stability

22. The BoA is maintaining its supervisory vigilance, with a focus on the fastest-growing and systemically important segments of the banking system. Systemically important banks are now required to develop and maintain recovery and resolution plans, which are currently being assessed by the BoA with assistance from the World Bank. Measures adopted earlier to counteract the slowdown in credit growth, including changes to capital requirements designed to encourage moderate credit growth and discourage outflows to non-resident entities, have been extended temporarily. To maintain consistency with international standards and ensure healthy capitalization in the banking system, we will unwind these measures by the end of 2016, while retaining measures discouraging bank outflows to non-resident entities, as appropriate. We will work with banks to ensure a smooth transition during this process The BoA will raise capital requirements on systemic

banks that expand into non-banking activities. The central bank will also strengthen its monitoring of loans to unhedged borrowers, with the aim of reducing their share in total outstanding credit from its current elevated levels. If necessary, the BoA will take appropriate macroprudential actions to further constrain borrowing in foreign currency by unhedged borrowers.

23. Given delays in external debt issuance caused by financial turmoil in Greece in 2015, the BoA undertook temporary measures to avoid disruption in the government debt market. In particular, the central bank reduced the risk weights on Albanian government securities issued in foreign currency from 100 to 50 percent. The BoA will gradually roll back this measure by 2021 and ensure that any additional investments by banks in such securities, compared to the levels in December 2015, will be risk-weighted at 100 percent.

24. We are committed to implement further regulatory and legal reforms to reduce NPLs and promote sound credit growth. Following the implementation of a regulatory requirement for mandatory NPL write-offs, NPLs have declined to 18 percent at end-December 2015 from a peak of 25 percent in September 2014. The 2015 strategy to address the NPL issue is now coordinated by the Ministry of Finance. The strategy integrates and sequences the following reforms in the areas of supervision, enforcement, debt restructuring, and insolvency:

- The BoA has revised the terminology on write-offs, changed the time limit for holding repossessed collateral on banks' books, and improved the regulatory framework for NPL sales.

- We have prepared an action plan for handling the 35 largest holders of NPLs. In addition, we submitted to Parliament amendments to the Law on the Registration of Immovable Properties and we are working on amendments to the Law on Securing Charges, in order to better protect financial collateral and to increase the legal certainty of security rights over real estate.

- By end-June 2016, the BoA will adopt measures to accelerate the reduction of NPLs through the use of out-of-court debt restructuring, and will also amend regulations to require banks to grant loans based on companies' fiscal declarations, starting in January 2018.

- Also by end-June 2016, we will set up coordination mechanisms between BoA and GDT to integrate the tax authority into the collateral execution process. To further facilitate this process, the BoA will coordinate with the MoF to streamline the tax treatment of NPLs, NPL sales, and collateral recovered in judicial procedures.

- With technical assistance from the World Bank and the IMF, the Ministry of Justice will submit a new bankruptcy law to Parliament by end-June 2016. It will incorporate best international practices, simplify the existing framework, allow for expedited approval of reorganization plans, and protect the economic and governance rights of secured and unsecured creditors.

- By end-September 2016, we will submit to Parliament amendments to the Civil Procedure Code and the Private Bailiffs Law to increase the efficiency of litigation, foreclosure procedures, and debt collection.

- Finally, by end-December 2016, we will upgrade the Credit Register (for example, by adding ongoing legal cases).

25. AFSA is strengthening its toolbox and capacity to monitor non-bank financial institutions. The final vacancy on AFSA's executive board was filled in January 2016 and the full board is now operational. To build up capacity, AFSA will adopt policies and procedures which will allow it to attract and retain skilled staff. AFSA is monitoring closely the transition of investment funds to the new regulatory framework on asset valuation and liquidity adopted in mid-2015. AFSA will assess carefully all license applications for new investment funds to protect financial stability. Finally, AFSA will encourage competition among investment fund custodians, and will conduct stress tests and a crisis preparedness exercise in this market segment.

26. The BoA is making progress on implementing the recommendations of the 2015 safeguards monitoring report. The Internal Audit Department will continue to update the Supervisory Council's Audit Committee on a semiannual basis on the implementation status of external and internal auditors' recommendations, including those related to improving controls over currency operations. The BoA has prepared its 2015 financial statements in accordance with the IFRS. We have launched the process of amending the BoA Law, taking into account recommendations from IMF staff, in order to strengthen the central bank's institutional and operational independence and improve its governance and operations.

E. Structural Reforms

27. We are encouraged by the early results from our efforts to reduce losses and improve collections in the electricity sector. Distribution losses—unbilled power as a share of total power entering the distribution system—fell from 45 percent in 2013 to 31 percent in 2015. We are committed to reducing distribution losses to 14 percent by 2019. We will ensure that budgetary, non-budgetary, and local government institutions make timely and full payments on their electricity bills. Further reforms will focus on improving corporate governance, which is key for the sustainability of the electricity sector. We are moving forward with contracting an advisory services consultant for the distribution company, and expect the new team to be in place by end-2016. We have started publishing quarterly financial statements for the generation and distribution companies, KESh and OShEE, and we will start publishing these for the transmission company OST as well. The Ministry of Energy and Industry and MoF will strictly monitor KESh and OShEE's investment plans and economic performance on a monthly basis to ensure financial discipline and value for money. Finally, in order to reduce financial risks, we will restructure the overdraft borrowing by electricity SOEs.

28. The new power sector law was approved by Parliament in May 2015. It restructures the relationship among the three public power companies responsible for generation, transmission, and distribution (KESh, OST, and OShEE) and moves toward further market liberalization, in line with the EU's 2009 Electricity Directive. The law sets in place a schedule for moving all medium-voltage customers out of the regulated tariff structure by end-2017, beginning with 35kV customers by

mid-2016 and 20kV customers by end-2016. On completion, the share of deregulated consumption would increase from 13 to 33 percent of the total energy consumed. Furthermore, we plan to undertake a review of our current tariff methodology in cooperation with the World Bank, in order to make tariff adjustments more frequent and automatic. We are also developing a power exchange and pursuing integration with the electricity markets of neighboring countries.

F. Statistics

29. INSTAT will continue with its efforts to improve the quality of macroeconomic statistics. By end-June 2016, we will submit a revised Law on Statistics to Parliament, in order to strengthen INSTAT's institutional independence and provide adequate legal support for more effective cooperation and coordination among INSTAT, MoF, and BoA. By end-2016, the three institutions will establish a Memorandum of Understanding detailing processes and responsibilities for data sharing, source data collection, and statistical compilation.

Program Monitoring

30. We anticipate that the eighth, ninth, and tenth program reviews will take place on or after July 15, 2016, November 15, 2016, and February 15, 2017, respectively. Each review will require observance of conditionality for the most recent test date.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets for 2014–16

(In billions of leks, unless otherwise indicated)

	2014				2015									2016					
	Mar	Jun	Sep	Dec	Apr			Aug			Dec			Apr		Aug		Nov	
	Act.	Act.	Act.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Act.	Prog.	Rev. Prog.	Prog.	Rev. Prog.
I. Quantitative Performance Criteria																			
1. Floor on net international reserves of the BoA (EUR million)	1463	1495	1525	1539	1507	1389	1587	1509		1624	1510		1601	1535	1677	1454	1402	1476	1425
2a. Ceiling on general government overall cash deficit (cumulative) 2/ 3/	1.2	6.0	8.0	41.5	16.9	17.2	3.3	22.2	20.4	11.1	52.1	52.5	48.0						
2b. Floor on general government primary modified cash balance (cumulative)														9.0		13.1	13.0	6.3	5.2
3a. Ceiling on general government expenditure (cumulative) 2/ 3/		181.2	274.7	408.0	141.6	144.9	124.5	280.0	281.2	259.0	457.5	462.2	426.6						
3b. Ceiling on general government primary expenditure (cumulative)														120.9		253.7	252.0	370.2	367.5
4. Ceiling on the increase of Bank of Albania credit to the general government (cumulative) 2/ 4/	-0.1	-0.2	0.0	0.0	0.0		-0.8	0.0		-0.2	0.0		-10.7	0.0	-12.8	0.0	0.0	0.0	0.0
II. Continuous Performance Criteria																			
5. Accumulation of new external payment arrears by the general government (EUR million)	0.0	0.04	0.0	0.0	0.0		0.0	0.0		0.0	0.0		0.0	0.0		0.0	0.0	0.0	0.0
III. Inflation Consultation																			
6. 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
Center point	1.9	1.6	1.7	1.3	3.0		2.0	3.0		1.6	3.0		2.1	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																			
7. Ceiling on subsidies to the energy sector					4.4		4.6	8.7		4.6	13.1		4.6	1.7		3.1	2.4	4.2	3.2
8. Ceiling on average distribution losses by energy distribution company (OSHEE) (percent, cumulative from beginning of year)					37.0		33.2	34.5		31.7	34.0		31.3	28.6		25.3	25.3	25.2	25.2
9. Ceiling on contracting nonenergy guarantees					0.0		0.0	0.0		0.0	0.0		0.5	0.6		1.1		1.5	
10. Ceiling on accumulation of central government domestic arrears (as reported by MoF's survey on arrears accumulation)	0.4	1.1	0.4	0.3	0.0		1.1	0.0		1.1	0.0		1.3	0.0		0.0	0.0	0.0	0.0
11. Floor on clearance of central government domestic arrears 5/	1.0	19.1	25.9	33.8	5.0		7.6	10.0		14.5	15.0		17.6						
Memorandum Items																			
New energy guarantees (excluding rollover)					4.4		4.6	6.7		4.6	10.1		4.6	1.7		3.1	2.4	4.2	3.2
Privatization receipts	0.001	0.010	0.026	0.035	0.0		0.1	0.0		0.6	0.0		0.9	0.0		0.0	0.0	0.0	0.0
One-off revenues					0.0		4.3	0.0		6.1	0.0		6.1						
Total non-grant revenues														126.8		260.5	258.8	365.4	361.8
Project grants					4.7		2.6	5.9		5.5	10.0		11.2	3.2		6.5	6.2	7.8	7.8

Source: Albanian authorities; and Fund staff estimates and projections.

1/ All adjustors are described in the Technical Memorandum of Understanding (TMU).

2/ Data revisions have led to minor adjustments of the outturn for the cash deficit and government expenditure in April and August 2015, and for BoA credit to government in June 2014, April 2015, and August 2015.

3/ Excluding arrears payments under the APCS. The assessment of performance in 2014 also excluded new energy and nonenergy guarantees, which were not part of the original PC but are now included in the fiscal framework.

4/ Indicative target through December 2014.

5/ General government for March 2014.

Table 2. Albania: Prior Actions for Completing the Seventh Review under the Extended Arrangement

Prior Actions	Status
I. Public Financial Management	
1. Submit to Parliament amendments to the Budget Law to incorporate multi-year commitment limits.	Met.

Table 3a. Albania: Structural Benchmarks for the Seventh Review under the Extended Arrangement

	Structural Benchmarks	Test Date	Status	Remarks
	I. Public Financial Management			
1.	Publish a triannual report on new arrears accumulation in ten key ministries and the GDT on MoF's website.	Continuous	Met.	
2.	Roll out the AGFIS to 15 budget institutions (see TMU).	End-Mar. 2016	Not met.	Delayed to end-May 2016.
3.	Amend the Budget Law to incorporate multi-year commitment limits.	End-Mar. 2016	Implemented with a delay.	
	II. Tax Policy and Administration			
4.	Adopt an implementation plan for a function-based headquarters structure for GDT.	End-Mar. 2016	Not met.	
	III. Electricity Sector			
5.	Prepare a quarterly survey of the gross consolidated arrears of the electricity sector (KESH, OST, OSHEE) to the private sector.	Continuous	Met.	
6.	Publish quarterly financial statements for KESh and OShEE.	Continuous	Met.	

Table 3b. Albania: Structural Benchmarks for the Remainder of 2016 under the Extended Arrangement

	Structural Benchmarks	Test Date	Status	Remarks
	I. Public Financial Management			
1.	Publish a triannual report on new arrears accumulation in fourteen key ministries, the Regional Development Fund, and GDT on MoF's website.	Continuous		
2.	Publish a quarterly survey of local government arrears on MoF's website, starting with end-March 2016.	Continuous		
3.	Roll out the AGFIS to 15 budget institutions.	End-May 2016		
4.	Fully staff the fiscal risks unit at MoF.	End-June 2016		
5.	Formulate comprehensive action plans to deal with local government arrears.	End-Sep. 2016		
	II. Tax Policy and Administration			
6.	List and quantify tax expenditures in the annual budget documentation submitted to Parliament.	Continuous		
7.	Restructure GDT's Large Taxpayer Office with specialization according to business sectors.	End-June 2016		
8.	Commence phasing in a modern compliance risk management approach at GDT, starting with two major risk clusters.	End-Sep. 2016		
9.	Design a valuation formula and methodology, and draft the legislation for a valuation-based property tax.	End-Sep. 2016		
10.	Create a fiscal cadastre to assess tax for each property.	End-Dec. 2016		
	III. Financial Sector			
11.	Submit to Parliament a new Bankruptcy Law, incorporating best international practices and simplifying existing procedures.	End-June 2016		
12.	Submit to Parliament amendments to Civil Procedure Code and Private Bailiffs Law to increase the efficiency of litigation, foreclosure procedures, and debt collection.	End-Sep. 2016		
	IV. Electricity Sector			
13.	Prepare a quarterly survey of the gross consolidated arrears of the electricity sector (KESh, OST, OShEE) to the private sector.	Continuous		
14.	Publish quarterly financial statements for KESh, OST, and OShEE.	Continuous		
15.	Remove 35kV medium-voltage consumers from the regulated tariff system.	End-July 2016		
16.	Remove 20kV medium-voltage consumers from the regulated tariff system.	End-Dec. 2016		

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) defines the indicators used to monitor the program, and reflects the understandings between the Albanian authorities and the IMF. The TMU also defines the associated reporting requirements.

2. The exchange rates for the purposes of the program are set at lek 140.25 = €1, lek 103.17 = $1, and lek 158.05 = SDR 1. The gold price is set at €920.18 = 1 oz. These were the rates shown on the Bank of Albania's website as of November 30, 2013.

3. For the purpose of the program, the central government includes extra-budgetary funds. The general government includes the central government, 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.

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 (BoA). Reserve assets are readily available claims of the BoA on nonresidents denominated in foreign convertible currencies, and held for the purpose of meeting balance of payments financing needs, intervening in exchange markets, and other purposes. They include BoA holdings of monetary gold, SDRs, Albania's reserve position with 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 BoA, irrespective of their maturity. They include: foreign currency reserves of commercial banks held at the BoA; foreign currency deposits of the government held at the BoA; all credit outstanding from the IMF that is a liability of the BoA; 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.

Reporting

7. Data will be provided by the BoA to the Fund with a lag of no more than 45 days after the test date for December test dates. For all other test dates, data should be provided with a lag of no more than 15 days after the test date.

B. Cumulative Floor on General Government Primary Modified Cash Balance

Definition

8. The primary modified cash balance of the general government will be measured from the financing side (below the line) at current exchange rates, based on the template below:

PRIMARY MODIFIED CASH BALANCE = (A) + (B) + (C)
Interest payments (A)
Domestic financing (B)
Privatization receipts (gross)
Domestic net borrowing (using residency criterion)
Central government net direct debt
Central government guarantees (drawings minus repayments)
Local government net direct debt
Other
Change in the balance of government accounts at BoA
TSA bank account
SSI & HII's bank accounts
Trust accounts
On-loan principal
Change in the balance of government accounts outside BoA
Reconstruction Fund
Other government accounts outside TSA (in commercial banks)
Transitory accounts – guarantees on custom duties
Cash in transit
Accounting items
Variance accrual-cash
Float
Liability to SSI (receipts minus payments)
Others
Foreign financing (C)
Drawings
Long-term loans (all direct debt drawings included in Albania's official debt statistics, including loans for the energy sector, even if on-lent)
Budget support loans (drawings)
Guarantees (drawings)
Change of statistical account
Repayments (of direct and guaranteed debt)

9. In determining the primary modified cash balance, the following considerations will apply:[1]

- Domestic borrowing is reported on a net basis and using the residency criterion. It covers bank loans, securities issued, overdraft accounts, and other debt instruments, less government deposits.
- Principal repayments include only principal paid by the government and not that by the actual borrower. In case a borrower repays the Ministry of Finance (MoF) at a later point in time, principal is recorded under "on-loan principal."
- Foreign borrowing is reported on a gross basis and using the residency criterion. It covers disbursements by international financial institutions, bank loans, securities issued, overdraft accounts, and other debt instruments.
- "Change of statistical account" covers funds disbursed but not yet withdrawn and held by nonresidents in financial institutions for project-related spending.
- "Repayments" refers to all payments to nonresidents related to disbursements or guarantees by international financial institutions, bank loans, securities, overdraft accounts, and other debt instruments.

10. The primary modified cash balance will also include all new issuances of general government guarantees (excluding rollover) for the energy and non-energy sectors, as well as net policy lending.

11. Excluded from the calculation of the primary modified cash balance of the general government are any preliminary payments made to the Albanian Government by Bankers Petroleum Ltd. in the context of the December 2015 agreement between the two sides regarding a $57 million tax dispute. These payments will only be considered as revenue, in whole or in part, upon the conclusion of the dispute resolution process and the domestic legal process.

12. Included in the calculation of the primary modified cash balance of the general government are the outstanding amounts on letters of credit and local governments' savings and carryover.

Reporting

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

Adjustors

14. The floor on the primary modified cash balance of the general government will be adjusted upward (downward):

[1] Cash balance data come from the Treasury, the Debt Office, and the BoA.

- the shortfall (excess) of new energy guarantees, excluding rollover, issued during the course of the year, up to a maximum of the annual budgeted allocation. The adjustor will not apply to December targets. Energy guarantees are defined as guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE.

15. The floor on the primary modified cash balance of the general government will be adjusted downward by:

- 50 percent of privatization receipts, up to total privatization receipts of lek 15 billion in a given year.

C. Cumulative Ceiling on General Government Primary Expenditure

Definition

16. General government primary expenditure covers spending on personnel, operations and maintenance, subsidies, social insurance outlays, local government expenditures, other current expenditures (social protection transfers), capital expenditure, reserve and contingency funds, and net lending, as reported in the government's monthly budget outturns. It is measured on a cash basis and excludes interest payments.

17. Included in the calculation of general government primary expenditure are the outstanding amounts on letters of credit and local governments' savings and carryover.

Reporting

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

Adjustors

19. The ceiling on primary expenditure of the general government will be adjusted upward (downward) by:

- the excess (shortfall) of new energy guarantees, excluding rollover, issued during the course of the year, up to a maximum of the annual budgeted allocation. The adjustor will not apply to December targets. Energy guarantees are defined as guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE.

20. The ceiling on primary expenditure of the general government will be adjusted upward by:

- 50 percent of privatization receipts, up to total privatization receipts of lek 15 billion in a given year.

- the excess of total non-grant revenues (both tax and non-tax) over programmed amounts, up to a maximum of lek 4 billion in 2016. Excluded from the calculation of total non-grant revenues are any preliminary payments made to the Albanian Government by Bankers Petroleum Ltd. in the context of the December 2015 agreement between the two sides regarding a $57 million tax dispute. These payments will only be considered as revenue, in whole or in part, upon the conclusion of the dispute resolution process and the domestic legal process.

- the excess of project grants over the programmed amount.

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

Definition

21. Credit of the central bank to the general government is defined as outstanding claims of the BoA on the general government, including overdrafts, direct credit, and holdings of government securities (excluding repo operations), advance distribution of profits, and other technical receivables. For the purpose of this target, government securities will be valued at their original purchase price. The stock of central bank credit to the government amounted to lek 63.965 billion at the end of December 2013. The cumulative ceiling will be computed relative to that amount.

Reporting

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

Continuous Performance Criteria

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

Definition

23. External debt is determined according to the residency criterion. The term "debt"[2] 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

[2] As defined in point 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688.

liabilities incurred under the contract. Debt can take a number of forms, the primary ones being as follows:

- loans, defined as 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, defined as 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

- leases, defined as arrangements under which property is provided which the lessee has the right to use for one or more specified periods 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.

24. 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.

25. Under the 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 a rescheduling agreement is being sought are excluded from this definition.

26. 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.

27. This performance criterion does not cover arrears on trade credits and will apply on a continuous basis.

Reporting

28. The MoF will provide the final data on the external arrears of the general government to the Fund, with a lag of no more than two weeks after the end of each month.

Inflation Consultation

29. The triannual 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 (4-month 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 (4-month average) fall outside the inner bands specified for each trimester.

Indicative Targets

F. Ceiling on Subsidies to the Energy Sector

Definition

30. Subsidies to the energy sector are defined as new guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE, excluding rollover.

Reporting

31. Data will be provided to the Fund by the MoF on a monthly basis with a lag of no more than thirty days.

G. Ceiling on Average Distribution Losses by OSHEE

Definition

32. Average distribution losses are defined as the difference between total electricity entering the distribution system and the amount of electricity billed to consumers by OSHEE, the energy distribution company, as a share of the total amount of electricity entering the distribution system. These are measured on a cumulative basis for each calendar year.

Reporting

33. Data will be provided to the Fund by the Ministry of Energy on a monthly basis with a lag of no more than thirty days.

H. Ceiling on Accumulation of Central Government Domestic Arrears

Definition

34. 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 30 days after the due date specified by the contract, or, in the absence of a contractual definition, as determined by law.

35. Domestic tax refund arrears are defined as obligations on any valid tax refund claims, in accordance with tax legislation, that remain unpaid 60 days after the claim is submitted.

36. For the purpose of this target, the accumulation of domestic arrears will be monitored through MoF's triannual survey on arrears accumulation (see paragraph 38 below). The recording of invoices and tax refund claims should be cumulative, that is, the recording in each trimester should include all invoices/refund claims that have not been paid from the previous trimesters, starting from the beginning of 2014. MoF should verify that the invoices/refund claims reported in the survey are not already included in the arrears clearance database under the Arrears Prevention and Clearance Strategy (APCS).

Reporting

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

Structural Benchmarks

38. MoF to publish a triannual survey on new arrears accumulation in fourteen key ministries, the Regional Development Fund, and GDT. The ministries covered are Transportation, Health, Education, Defense, Justice, Interior, Agriculture, Finance, Economy, Social Welfare, Urban Development, Culture, Environment, European Integration. The survey should be published within 75 days from the end of each trimester.

39. Publish a quarterly survey of local government arrears on MoF's website, starting with end-March 2016. The survey should be published within 90 days from the end of each quarter.

40. Roll out the AGFIS to 15 budget institutions. The 15 budget institutions are as follows: Council of Ministers, Ministry of Transport and Infrastructure, Road Authority, Ministry of Finance, National Agency of Information Society, Municipality of Tirana, Ministry of Welfare, Ministry of Education, Ministry of Agriculture, Agricultural and Rural Development Agency, Ministry of Health, Ministry of Interior, Ministry of Justice, Ministry of Defense, and Ministry of Energy.

41. Fully staff the fiscal risks unit at MoF. This benchmark is met when the unit is staffed with one director and 3 staff.

42. Formulate comprehensive action plans to deal with local government arrears. This benchmark is met when the 61 local government units submit their action plans to MoF, and MoF shares them with Fund staff.

43. List and quantify tax expenditures in the annual budget documentation submitted to Parliament. The survey of tax expenditures should be submitted to Parliament by end-November of each year.

44. Restructure GDT's Large Taxpayer Office with specialization according to business sectors. This benchmark is met when a chart of the current organization of the LTO shows that it is organized according to business sectors.

45. Commence phasing in a modern compliance risk management approach at GDT, starting with two major risk clusters. This benchmark is met when: (1) strategies have been adopted for the mitigation of two major identified compliance risk clusters; (2) operational plans reflecting the strategies are in place; and (3) substantial operational implementation activities have commenced.

46. Design a valuation formula and methodology, and draft the legislation for a valuation-based property tax. This benchmark is met when the three documents are shared with Fund staff.

47. Prepare a quarterly survey of the gross consolidated arrears of the electricity sector to the private sector. The survey should be prepared within 15 days from the end of each quarter.

48. Publish quarterly financial statements for KESh, OST, and OShEE. The statements will be published within 30 days from the end of March, June, and September, and within 120 days from the end of December.

Monitoring and Reporting Requirements

49. 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 BoA;
ii) the separate consolidated accounts of commercial banks and Savings and Loan Institutions;
(iii) the monetary survey;
(iv) banking sector prudential indicators;
(v) the net foreign assets of the BoA and their components;
(vi) comprehensive information on reserve assets that are pledged, collateralized, or otherwise encumbered;
(vii) the foreign exchange cash flow of the BoA, including the level of NIR;
(viii) daily data on average exchange rates, FX interventions, and FX swaps;
(ix) quarterly balance of payments data and updates of balance of payments estimates;
(x) quarterly inflation forecasts;
(xi) data on government deposits and net domestic financing; and
(xii) quarterly data on the stock of foreign currency credit to unhedged borrowers, by bank and economic activity.

The Ministry of Finance will supply to the Fund:

(i) the monthly fiscal tables, 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, disbursement, and amortization of public debt;
(v) detailed information on interest expenses for domestic and external debt;
(vi) information on the stock of short-, medium-, and long-term debt;
(vii) information on official grants for projects or budget support purposes;
(viii) information on the stock of expenditure arrears identified in the APCS, and progress in arrears repayment;
(ix) information on energy and non-energy guarantees issued by the general government, including on new issuance, drawings, repayments (called and non-called), interest (called and non-called), late returned principal and interest, separately for domestic versus external as well as energy versus non-energy guarantees; and
(x) data on local government spending, by type of expenditure.

The General Directorate of Customs will supply to the Fund:
(i) detailed data on customs revenues collected.

The General Directorate of Taxation will supply to the Fund:
(i) detailed data on tax revenues collected;
(ii) information on progress in implementing business restructuring and IT reforms;
(iii) data on the stock of VAT refunds claimed, refund arrears, and refunds paid out; and
(iv) quarterly performance metrics, including rate of on-time filing (per major tax type), stock of tax arrears (per major tax type), percentage of refund claims processed on time, number and total value of approved-but-not-yet-paid refund claims, number and total value of in-process-but-not-yet-approved refund claims, share of VAT refunds released without audit, additional tax assessed through audits (all types of audits), and additional tax paid that relates to audit assessments.

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

(i) the consumer price index (CPI) at the aggregate level and for each individual item;

(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 "Conjuncture"; and

(v) preliminary estimates for quarterly GDP and preliminary estimates for annual GDP disaggregated by 35 sectors and distinguishing between the observed and unobserved economy.

INTERNATIONAL MONETARY FUND

ALBANIA

May 12, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION, SEVENTH REVIEW UNDER THE EXTENDED ARRANGEMENT, AND REQUEST FOR WAIVER OF APPLICABILITY AND MODIFICATION OF PERFORMANCE CRITERIA—INFORMATIONAL ANNEX

Prepared By | EUR Department

CONTENTS

FUND RELATIONS

(As of March 31, 2016)

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

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	139.30	100.00
IMF's Holdings of Currency	296.37	212.76
Reserve Tranche Position	26.00	18.67

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	46.45	100.00
Holdings	114.65	246.81

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
Extended Arrangement	183.07	131.42
ECF Arrangements	2.68	1.92

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	Feb. 28, 2014	Feb. 27, 2017	295.42	180.84
ECF[1]	Feb. 1, 2006	Jan. 31, 2009	8.52	8.52
EFF	Feb. 1, 2006	Jan. 31, 2009	8.52	8.52

Projected Payments to Fund:

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

	Forthcoming				
	2016	2017	2018	2019	2020
Principal	1.56	2.01	5.04	14.40	25.33
Charges/Interest	1.41	1.91	1.90	1.84	1.64
Total	2.97	3.92	6.94	16.24	26.96

[1] Formerly PRGF.

Safeguards Assessments. A safeguards assessment update of the Bank of Albania (BoA) was completed in June 2014. It noted that while the bank had strengthened its external and internal audit and financial reporting functions, the absence of an effective Audit Committee to oversee these functions and exercise control posed risks. Such risks were further exacerbated following the dismissal of the Governor and the Inspector General in the fall of 2014 for dereliction of duty in the wake of a vault theft scandal. Since then, the BoA has taken measures to implement safeguards recommendations, including establishing an Audit Committee governed by a charter aligned with international best practice, as well as engaging an external expert to assist it. In addition, the internal audit function resumed operations with the appointment of a new Inspector General, and the 2015 financial statements were prepared in accordance with International Financial Reporting Standards (IFRS). The authorities are also taking preliminary steps to align the BoA Law with modern central banking legislation.

Exchange Rate Arrangement: On July 1, 1992 the Albanian authorities adopted a floating exchange rate system. The *de jure* exchange rate system is classified as free floating, but the *de facto* exchange rate arrangement is floating, with the monetary authorities occasionally intervening in the foreign exchange market in order to accumulate reserves and avoid excessive disruptions in the functioning of the market. On February 21, 2015, the authorities removed two exchange restrictions and accepted the obligations of Article VIII, Sections 2(a), 3, and 4. Albania maintains an unapproved exchange restriction in the form of outstanding debit balances on inoperative bilateral payment agreements. These were in place before Albania became a Fund member in 1991, and relate primarily to debt in nonconvertible and formerly nonconvertible currencies. The exchange rate stood at lek 126.59 per U.S. dollar on February 29, 2016.

Article IV Consultation: The 2014 Article IV consultation was concluded on February 28, 2014 (IMF Country Report No. 14/78).

FSAP Participation and ROSCs: The most recent FSAP was carried out in November 2013 (with a Board date of February 28, 2014). A data module ROSC was published on the Fund's website in June 2000. A fiscal ROSC was completed in June 2003. Albania participates in the General Data Dissemination System (GDDS), and a complete set of GDDS metadata for the external, financial, fiscal, and real sectors, as well as for the socio-demographic indicators is posted on the Fund's Dissemination Standards Bulletin Board (http://dsbb.imf.org). A data module ROSC reassessment using the Data Quality Assessment Framework was conducted in March 2006. A ROSC for assessing the Financial Action Task Force (FATF) recommendations for Anti-Money Laundering (AML) and Special Recommendations on Combating the Financing of Terrorism (CFT) was conducted in November 2010 and the report was published in July 2011.

Technical Assistance: The Fund, other multilateral organizations, and donors have provided extensive technical assistance for institutional development in Albania. The Fund has sent multiple technical assistance missions to Albania every year since 1991. The extent and focus of Fund TA since FY 2011 is briefly summarized below.

Table 1. Albania—Technical Assistance Since FY2011		
Department	**Purpose**	**Date**
FAD	Tax Administration (including IT Redesign, Corporate Strategy, Compliance Improvement Plan, and VAT Refund Management)	Multiple visits.
	Cash and Debt Management	October 2011, October 2012
	Tax Policy	November 2013, March 2014
	Public Financial Management	November 2013, April 2014, July 2014, September 2014, November 2014
	Property Tax	September 2014
	Fiscal Rules, Fiscal Risks, and the MTBP	March 2015
	Fiscal Transparency Evaluation	June 2015
	Tax Revenue Underperformance: Causes and Corrective Options	June 2015
	Public Investment Management Assessment	March 2016
LEG	Jurisdictional Review of Exchange System (joint with MCM)	July 2010
	Banking Law	February 2012
	Deposit Insurance Law	February 2014
	Tax Law	March 2015, May 2015
	NPL Resolution	April 2015
MCM	Monetary Policy Design and Implementation	September 2010, January 2011, January 2016
	Banking Supervision and Regulation	April 2011, July 2015
	Stress Testing	July 2011, September 2011, September 2013
	Contingency Planning and Crisis Management	September 2011
	Inflation Modeling and Forecasting	October 2011
	IFRS Implementation	May 2013
	Basel II Implementation	June 2013
	Regulatory Framework for Investment Funds	March 2014, October 2014
	NPL Resolution	September 2014, November 2015
	Central Bank Accounting and Official Foreign Exchange Transactions	January 2015

Department	Purpose	Date
STA	SDDS Assessment	July 2010
	National Accounts Statistics	March 2011, November 2014, May 2015
	Price Statistics	September 2013
	External Sector Statistics	April 2014, January 2016
	Government Finance Statistics	October 2014, May 2015

Resident Representative: Mr. Jens Reinke has filled the position since July 2014.

WORLD BANK GROUP RELATIONS

1. **The Republic of Albania has been a member of the World Bank Group (WBG) since 1991.** Since then, the WBG has provided strong support to Albania, including 87 IDA, IBRD, and GEF projects in different sectors totaling US$2.06 billion; IFC investments totaling US$406 million; and MIGA guarantees totaling US$8.6 million. The quality of the active portfolio has continued to improve, with an increasing focus on long-term capacity development and implementation through government structures.

2. **The National Strategy for Development and Integration (NSDI) for 2007-2013 outlined the Government's economic and social development program.** The strategic goals of the NSDI were: (i) integration into the European Union (EU); (ii) strengthening democratic institutions and the rule of law; and (iii) achieving rapid and sustainable economic and social development. The authorities have made progress towards their NSDI goals. First, Albania gained EU candidate status in 2014. Second, Albania maintained GDP growth throughout the global financial crisis, while poverty continued to decline. However, the business climate still faces important challenges: Albania's overall ranking in the World Bank's 2016 Doing Business Indicators declined to the 97th position.

3. **The authorities are in the process of finalizing the National Strategy for Development and Integration (NSDI) for 2014–2020.** The current draft, which is undergoing a consultative process, has three main pillars: (i) to prepare Albania to become a full member of the EU; (ii) to foster strong and sustained economic growth; and (iii) to transform growth into improved well-being for all citizens in a fair and cohesive society. These broad goals are to be advanced through measures in four key areas: (i) governance, democracy, and the rule of law; (ii) fiscal discipline and increased competitiveness; (iii) sustainable growth through efficient use of resources; and (iv) investing in people and social cohesion.

4. **The current WBG Country Partnership Framework (CPF) for 2015–19 supports the Government's National Strategy for Development and Integration** by focusing on three main areas: (i) restoring macroeconomic balance; (ii) creating conditions for accelerated private sector growth; and (iii) strengthening public sector management and service delivery. The CPF activities under each of the three focus areas will be underpinned by two cross cutting themes: gender equity and the EU accession process as a long-term policy anchor. The CPF focuses on accelerating the implementation of the ongoing program while selectively introducing new IBRD lending in strategic areas, increasing IFC financing for the private sector to US$150–250 million, strengthening partnerships with other IFIs and donors, and expanding its knowledge program through regional and national activities. IBRD indicative financing up to US$1.2 billion is proposed in support of the FY2015–FY2019 CPF program, with significant frontloading.

5. **The current portfolio of US$544 million includes nine projects.** It is a young portfolio, with six projects approved in the past two years. Implementation is affected by chronic public sector weaknesses, including procurement issues. This has led to a slowdown in project implementation,

with a very low disbursement ratio of 9 percent in FY2015 and about 7 percent during FY2016. There have been high-level portfolio reviews during FY2016; the last one took place at the end of February 2016 and was chaired by the Prime Minister. An acceleration in project implementation is anticipated given recent progress in completing procurement actions for large projects.

Albania: Bank-Fund Joint Management Action Plan Matrix (As of March 2016)			
Title	Product	Provisional Timing of Missions	Expected Delivery Date
A. Mutual information on relevant work programs			
The World Bank's work program in the next 12 months	Financial Sector Modernization DPL II Competitiveness and Jobs DPL	May 2016	July 2016
	Project for Integrated Urban Economic Development	May 2016	July 2016
	Analytical and Technical Assistance: Public Finance Functional Review	n.a.	October 2016
	Pension Supervision and Coverage	March 2016	June 2016
	Energy PSIA	April 2016	June 2016
	Assessment of Switching Medium Voltage Customers and Independent Power Producers to the Deregulated Power Market	April 2016	June 2016
	Insurance Market Reform	May 2016	August 2016
	Subnational Public Finance Review	May 2016	September 2016
	Public Debt Management & Government Bond Market	April 2016	October 2016
	Country Fiduciary and Project Implementation (CFPI) Review	May 2016	December 2016
The Fund's work program in the next 12 months	7th Review Under the Extended Arrangement	March 2016	Board Meeting in May 2016
	8th Review Under the Extended Arrangement	June 2016	Board Meeting in September 2016
	9th Review Under the Extended Arrangement	October 2016	Board Meeting in January 2017

	10th Review Under the Extended Arrangement	January 2017	Board Meeting in February 2017
B. Requests for work program inputs			
Fund request to Bank	Growth diagnostics; assessment of competitiveness and related structural reforms (e.g., electricity sector); fiscal governance and PFM; public expenditure reform needs (in particular civil service, pensions, disability, social assistance); nonbank financial sector development		
Bank request to Fund	Periodic macro updates; joint approach to advisory work on institutional reform at the MoF in debt management; debt sustainability analysis		

STATISTICAL ISSUES

ALBANIA—STATISTICAL ISSUES APPENDIX (As of February 29, 2016)
I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. The main obstacles are in real sector statistics.
National accounts: The weaknesses in national accounts are mainly due to poor source data. While technical assistance has been provided on methodological procedures and basic data sources, source data still do not provide sufficient information to compile reliable estimates. High dependence on administrative and tax data undermines the estimates. The long lag in handling certain source data (e.g., the Structural Business Survey) also hampers the timeliness of annual GDP publication, which currently takes place around 13 months after year-end. National accounts have been harmonized with ESA 2010. An important enhancement has been the publication of quarterly GDP—including on the demand side—since July 2015. Quarterly GDP is published with a lag of over 90 days, using the so-called indirect method based on selected indicators and statistical assumptions. Due to differences in compilation methods, there are discrepancies between the aggregated quarterly estimates and the annual ones. In addition, frequent methodological changes combined with limited backcasting constrain the reliability of national account time series. Due to severe resource constraints at INSTAT, improvement in the national accounts has been relatively slow. **Labor statistics:** The Labor Force Survey (LFS) is of insufficient quality. Remote areas are undersurveyed, due to resource constraints. The treatment of agricultural employment needs to improve, as currently all individuals that own agricultural land are considered self-employed by the survey. Various short-comings in the LFS lead to unreliable measures of employment and wages. Poverty data are available with a substantial lag compared to other CESEE countries. **Price statistics:** Compilation generally follows international standards, and the estimation of imputed rent within the CPI was improved in 2003. In December 2015, INSTAT updated the CPI weights using the results of a new national Household Budget Survey conducted during 2014. The PPI and construction price indexes are published on a quarterly basis due to resource constraints.
Government finance statistics: Fiscal source data are adequate to allow a broad presentation of the Albanian general government's fiscal operations in line with the Government Finance Statistics Manual (GFSM) 2001. Transitioning to the GFSM 2001 fiscal presentation does not appear to substantially change the overall picture (Table 1). However, the transition also requires further improvements in fiscal statistics. In particular, Albania would need to: (i) provide greater details on some items (such as National Taxes, Income of Budgetary Institutions, Property Compensation, and Compensation for Electricity); (ii) report transactions of Albania's local governments in a separate statement; (iii) break down Net Acquisition of Nonfinancial Assets (labeled as Capital Expenditure in the local presentation) into the GFSM 2001 subcategories (i.e., fixed assets, inventories, valuables, and nonproduced assets); and (iv) split the financing section into net acquisition of financial assets and net acquisition of liabilities (and their respective instruments).

Monetary statistics: The monetary data compilation framework conforms to the methodology recommended in the *Monetary and Financial Statistics Manual (MFSM) 2000*. The survey of depository corporations covers the Bank of Albania (BoA) and all the other deposit-taking institutions (commercial banks and savings and loans associations, or SLAs). The accounts of the SLAs, with the exception of loans, are produced on a cash basis, which contrasts with the *MFSM*'s recommendation of accrual accounting. Another deviation from the *MFSM*'s methodology is that the BoA's and commercial banks' holdings of nontradable long-term securities are recorded at book value.
External sector statistics: Balance of Payments data are compiled by the BoA with a time lag of less than 90 days and is methodologically sound, though some of the estimates (particularly for international transactions outside the banking system) need to be refined. Problems remain in the areas of service transactions and remittances, and in the monitoring of financial account transactions, private external debt, and foreign assistance (data on grants from abroad not channeled through the central government are fragmented and require consolidation). The estimation methods for transactions outside the banking system (mostly remittances, investment transactions by nonresident Albanians, and travel exports and imports) require further improvement. These are considered the primary drivers of persistently high errors and omissions. The external debt database ensures timely and accurate reporting of external public debt (including commitments of state-owned enterprises). The collection of data on external grants is not timely and only covers the central government. Improving grant coverage requires closer collaboration between the Donor Coordination Unit in the Office of the Prime Minister, the Ministry of Finance, and the Bank of Albania. The International Investment Position (IIP) data are compiled annually by the BoA and published nine months after year-end.

II. Data Standards and Quality	
Albania participates in the General Data Dissemination System (GDDS).	Data ROSC published in October 2006.

Table 1. Albania: Statement of Operations—General Government, 2011–21

(Billions of leks)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Est.			Projection			
Revenue	330.4	330.4	323.7	366.6	378.6	410.0	430.3	459.1	490.7	524.4	560.3
Taxes	247.3	243.5	236.4	265.9	268.7	292.6	307.6	328.0	350.5	374.5	400.0
Social contributions	56.6	57.4	60.0	69.9	72.9	80.1	84.8	90.5	96.5	103.0	110.0
Grants	3.8	5.6	5.7	10.1	11.2	12.8	13.7	14.6	15.7	16.9	18.1
Other revenue	22.7	24.0	21.6	20.7	25.8	24.5	24.3	26.0	28.0	30.0	32.2
Expenditure	376.2	376.2	394.1	408.7	418.4	446.3	471.2	506.4	549.0	590.5	633.9
Expense	305.6	314.6	328.6	348.1	356.3	390.3	411.6	439.0	472.8	508.6	546.0
Compensation of employees	67.4	69.4	70.7	71.4	72.5	70.4	75.0	80.4	86.3	92.7	99.5
Use of goods and services	33.0	33.5	32.4	31.3	42.4	42.6	45.4	48.7	52.3	56.2	60.3
Interest	41.1	41.5	43.3	40.1	38.6	42.3	40.8	44.0	47.1	50.4	51.7
Subsidies	3.3	1.9	1.6	8.4	6.8	6.7	7.0	6.3	8.8	11.0	14.7
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	132.6	141.0	150.8	164.1	162.1	174.6	185.4	197.8	212.0	227.5	244.0
Other expense	28.1	27.3	29.8	32.9	33.8	53.7	58.0	61.9	66.2	70.8	75.7
Net acquisition of nonfinancial assets	70.6	61.7	65.5	60.5	62.1	56.0	59.6	67.4	76.2	81.8	87.9
Domestically financed	42.7	27.4	36.7	33.8	37.7	24.7	22.4	30.4	35.9	42.9	51.9
Foreign financed	27.9	34.3	28.8	26.8	24.4	31.2	37.2	37.0	40.3	39.0	35.9
Unidentified measures (cumulative)				0.0	0.0	0.0	18.0	36.8	57.7	62.0	66.6
Gross Operating Balance	24.8	15.8	-4.9								
Net lending/borrowing	-45.7	-45.9	-70.4	-42.1	-39.8	-36.3	-22.9	-10.5	-0.5	-4.1	-7.0
Transaction in financial assets and liabilities	-45.7	-45.9	-70.4	-42.3	-40.0	-33.3	-19.2	-2.7	13.4	11.9	9.1
Net acquisition of financial assets	-0.4	-1.2	-16.7	5.9	6.5	-0.6	3.7	5.3	0.0	0.0	0.0
Domestic	-0.4	-1.2	-16.7	5.9	6.5	-0.6	3.7	5.3	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	45.3	44.6	53.7	48.2	46.5	32.7	23.0	8.0	-13.4	-11.9	-9.0
Domestic	25.6	25.3	42.9	14.0	-23.3	-21.5	3.3	1.8	-5.6	-3.0	-13.9
Foreign	19.7	19.4	10.8	34.2	69.8	54.2	19.7	6.2	-7.9	-8.9	4.8

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

Albania: Table of Common Indicators Required for Surveillance

As of February 29, 2016

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological Soundness[8]	Memo Items: Data Quality – Accuracy and Reliability[9]
Exchange Rates	2/29/16	2/29/16	D	D	D		
International Reserve Assets and Liabilities of the Monetary Authorities[1]	2/26/16	2/29/16	D	W	M		
Reserve/Base Money	1/16	2/15/16	M	M	M	O, O, O, LO	O, LO, LO, O, O
Broad Money	1/16	2/15/16	M	M	M		
Central Bank Balance Sheet	1/16	2/15/16	M	M	M		
Consolidated Balance Sheet of the Banking System	1/16	2/29/16	M	M	M		
Interest Rates[2]	1/16	2/29/16	D	D	D		
Consumer Price Index	1/16	2/10/16	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3] – General Government[4]	1/2015	2/29/16	M	M	M	LO, O, O, O	LO, O, O, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3] – Central Government	1/2015	2/29/16	M	M	M		

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological Soundness[8]	Memo Items: Data Quality – Accuracy and Reliability[9]
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/2015	2/29/16	Q	Q	Q		
External Current Account Balance	2015:Q3	12/10/15	Q	Q	Q	O, O, O, LO	LNO, O, LO, LO, O
Exports and Imports of Goods and Services	1/16	2/29/16	M	M	M		
GDP/GNP	2015:Q3	1/11/16	Q	Q	Q	O, LNO, O, LO	LNO, O, LNO, LO, LO
Gross External Debt	2015:Q3	12/10/15	Q	Q	Q		
International Investment position[6]	2014	9/30/15	A	A	A		

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

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

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. It also includes the explicit guarantees granted by the central government.

[5] Includes currency and maturity composition.

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

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annual (A), Irregular (I), Not Available (NA).

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

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

ALBANIA

May 24, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION, SEVENTH REVIEW UNDER THE EXTENDED ARRANGEMENT, AND REQUEST FOR WAIVER OF APPLICABILITY AND MODIFICATION OF PERFORMANCE CRITERIA—SUPPLEMENTARY INFORMATION

Prepared By European Department

This supplement provides information that has become available since the Staff Report was circulated to the Executive Board on May 13, 2016. The information does not alter the thrust of the staff appraisal.

Recent macroeconomic data point to robust economic growth, consistent with projections in the staff report. GDP growth in 2015 came in at 2.6 percent, as expected, driven by a gradual improvement in domestic demand. High-frequency indicators such as credit to private sector, non-oil imports, and tax revenues suggest continued recovery in 2016:Q1. However, goods exports have been falling, dragged by sluggish performance in the oil and mining sector as a consequence of weak global commodity prices. The NPL ratio increased from 18.2 percent at end-2015 to 19.3 percent in 2016:Q1, due to one-off factors related to two large bankruptcies.

Average headline inflation for the first four months was 0.6 percent, below the lower outer band of the Inflation Consultation Clause (1 percent). The unexpectedly low inflation is the result primarily of supply shocks stemming from imported food and fuel prices which are affecting domestic prices with a lag. Core inflation also declined, reflecting predominantly the negative contribution of processed foods. The disinflationary pressure appears to be at least partly transitory, as global commodity prices have started to recover. Furthermore, the base effect due to floods that led to high domestic food price inflation in 2015:Q1 is also expected to gradually dissipate in the near future. In line with the Inflation Consultation Clause, the Bank of Albania has provided a letter (attached) explaining the reasons behind the drop in inflation, the corrective measures that the BoA is undertaking (two interest rate cuts of a cumulative 50 basis points in April and May), and their projected impact. The policy rate cuts aim to anchor inflation expectations, in order to preempt any second-round effects on prices, while also supporting the recovery in domestic demand. An updated table is also attached.

On the basis of the authorities' letter and related policy discussions, staff supports the completion of the inflation consultation and the Seventh Review under the Extended Arrangement.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets for 2014–16

(In billions of leks, unless otherwise indicated)

	2014				2015									2016					
	Mar	Jun	Sep	Dec	Apr			Aug			Dec			Apr		Aug		Nov	
	Act.	Act.	Act.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Act.	Prog.	Rev. Prog.	Prog.	Rev. Prog.
I. Quantitative Performance Criteria																			
1. Floor on net international reserves of the BoA (EUR million)	1463	1495	1525	1539	1507	1389	1587	1509		1624	1510		1601	1535	1677	1454	1402	1476	1425
2a. Ceiling on general government overall cash deficit (cumulative) 2/ 3/	1.2	6.0	8.0	41.5	16.9	17.2	3.3	22.2	20.4	11.1	52.1	52.5	48.0						
2b. Floor on general government primary modified cash balance (cumulative)														9.0		13.1	13.0	6.3	5.2
3a. Ceiling on general government expenditure (cumulative) 2/ 3/		181.2	274.7	408.0	141.6	144.9	124.5	280.0	281.2	259.0	457.5	462.2	426.6						
3b. Ceiling on general government primary expenditure (cumulative)														120.9		253.7	252.0	370.2	367.5
4. Ceiling on the increase of Bank of Albania credit to the general government (cumulative) 2/ 4/	-0.1	-0.2	0.0	0.0	0.0		-0.8	0.0		-0.2	0.0		-10.7	0.0	-12.8	0.0	0.0	0.0	0.0
II. Continuous Performance Criteria																			
5. Accumulation of new external payment arrears by the general government (EUR million)	0.0	0.04	0.0	0.0	0.0		0.0	0.0		0.0	0.0		0.0	0.0		0.0	0.0	0.0	0.0
III. Inflation Consultation																			
6. 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
Center point	1.9	1.6	1.7	1.3	3.0		2.0	3.0		1.6	3.0		2.1	3.0	0.6	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																			
7. Ceiling on subsidies to the energy sector					4.4		4.6	8.7		4.6	13.1		4.6	1.7		3.1	2.4	4.2	3.2
8. Ceiling on average distribution losses by energy distribution company (OSHEE) (percent, cumulative from beginning of year)					37.0		33.2	34.5		31.7	34.0		31.3	28.6		25.3	25.3	25.2	25.2
9. Ceiling on contracting nonenergy guarantees					0.0		0.0	0.0		0.0	0.0		0.5	0.6		1.1		1.5	
10. Ceiling on accumulation of central government domestic arrears (as reported by MoF's survey on arrears accumulation)	0.4	1.1	0.4	0.3	0.0		1.1	0.0		1.1	0.0		1.3	0.0		0.0	0.0	0.0	0.0
11. Floor on clearance of central government domestic arrears 5/	1.0	19.1	25.9	33.8	5.0		7.6	10.0		14.5	15.0		17.6						
Memorandum Items																			
New energy guarantees (excluding rollover)					4.4		4.6	6.7		4.6	10.1		4.6	1.7		3.1	2.4	4.2	3.2
Privatization receipts	0.001	0.010	0.026	0.035	0.0		0.1	0.0		0.6	0.0		0.9	0.0		0.0	0.0	0.0	0.0
One-off revenues					0.0		4.3	0.0		6.1	0.0		6.1						
Total non-grant revenues														126.8		260.5	258.8	365.4	361.8
Project grants					4.7		2.6	5.9		5.5	10.0		11.2	3.2		6.5	6.2	7.8	7.8

Source: Albanian authorities; and Fund staff estimates and projections.

1/ All adjustors are described in the Technical Memorandum of Understanding (TMU).

2/ Data revisions have led to minor adjustments of the outturn for the cash deficit and government expenditure in April and August 2015, and for BoA credit to government in June 2014, April 2015, and August 2015.

3/ Excluding arrears payments under the APCS. The assessment of performance in 2014 also excluded new energy and nonenergy guarantees, which were not part of the original PC but are now included in the fiscal framework.

4/ Indicative target through December 2014.

5/ General government for March 2014.

Inflation Consultation Letter

May 13, 2016

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

Dear Ms. Lagarde:

Annual CPI inflation in Albania declined to an average rate of 0.6 percent during the first four months of 2016. This decline brings our CPI inflation below the lower outer band of the Inflation Consultation Clause which is part of the conditionality agreed to monitor Albania's performance under the IMF Extended Arrangement.

As the Governor of the Bank of Albania, I am writing to brief you about the reasons behind the unexpected drop in inflation, the corrective measures that the Bank of Albania is undertaking, as well as their expected impact over the short to medium term.

1. Reasons behind the recent inflation performance

CPI inflation has been undershooting our 3 percent target for some time now. This performance reflects prevailing slack in the economy and disinflationary pressures from external markets. In order to deliver on its price stability mandate, the Bank of Albania has been engaged in an aggressive course of monetary easing over the past few years. This monetary stimulus is delivered through policy rate cuts, liquidity injections, and conditional forward guidance on the future path of monetary policy. Its effects are being gradually transmitted to the broader economy, though risk aversion in the private sector remains high and the international environment remains challenging.

The rapid drop in inflation during the first four months of 2016 appears to be driven by supply-side shocks. The disinflationary pressure comes from the drop in global food and oil prices, which are transmitted with a lag and account for more than ¾ of the decline in inflation. The rest is explained by base effects, stemming from the high domestic food price inflation prevailing over the same period of last year, on account of flooding.

By and large, the decline in food and oil prices in Albania appears to reflect developments in international markets. Similar declines in inflation are taking place both globally and regionally. Annual CPI inflation in the Euro Area was near zero during the first quarter of 2016. Inflation in other Western Balkan countries averaged 0.1 percent (on an annual basis) during the same period.

We expect these supply-side shocks to be transitory and their impact on inflation in Albania and the deviation below the lower outer band under the Inflation Consultation Clause to be temporary. Both forecasts and market-based indicators point to a gradual stabilization of both food and oil prices in international markets. Therefore, the adverse effect on inflation is expected to be confined to early 2016.

2. Corrective measures taken by the Bank of Albania

The Bank of Albania reacted promptly to the emergence of these downside risks to our price stability objective, via a further easing of the monetary policy stance. The Supervisory Council lowered the policy rate by a combined 50 basis points during its meetings in April and May. The policy rate now stands at a record low of 1.25 percent. We also signaled our strong commitment to price stability and expressed our expansionary bias for monetary policy.

While the recent drop in inflation has left our medium-term projections largely unchanged, the Bank of Albania reacted decisively to these downside risks to price stability. By increasing monetary policy stimulus, we aim to create better financing conditions in order to support domestic demand and aid economic recovery. A stronger domestic environment will help counteract disinflationary pressures from external markets. At the same time, our determined action aims to anchor medium-term inflation expectations, thus preempting the emergence of second-round effects on wages and prices.

3. Expected impact and medium-term projections

The pass-through of the lower policy rates to government bond yields and to banking rates has been effective. Our banking system remains profitable, well capitalized, and highly liquid. Determined action to tackle high NPLs in the banking system – undertaken as part of a joint project between the Bank of Albania and the Albanian Government – is expected to yield further improvements in lending standards. Overall, we expect financing conditions in the economy to improve materially throughout the 2016-2018 period.

Based on our forecasts, we expect a pick-up in inflation in the second half of 2016 and a gradual convergence towards our 3 percent target by the second half of 2018. Improved financing conditions, coupled with ongoing structural reforms and a higher risk appetite among real and financial market agents, will contribute to a sustained recovery in domestic demand. At the same time, we expect the external environment to improve during the second half of the forecast horizon, while inflation expectations will remain anchored to our target.

Overall, we remain confident the recent monetary policy stimulus will be sufficient to reach the 3 percent inflation target over the medium term. However, we are aware that risks to price stability remain skewed on the downside, given uncertainties regarding the strength of the domestic recovery and persistent headwinds from the Euro Area.

For these reasons, the Bank of Albania stands ready to act further with the policy tools at its disposal, if needed, for the pursuit of its price stability objective.

Sincerely,

/s/
Gent Sejko
Governor, Bank of Albania

Statement by Carlo Cottarelli, Executive Director for Albania and Paolo Di Lorenzo, Advisor to Executive Director May 27, 2016

On behalf of our Albanian authorities, we wish to thank the mission team for the constructive discussions and the valuable and tailored advice in the Report and Selected Issues Paper. As a result of strong program ownership, all performance criteria were met and the structural reform agenda remains on track. The authorities broadly concur with staff's analysis and policy recommendations and their views have been duly reported. Some specific comments are offered for emphasis.

The Albanian economy is proving its resilience in a challenging context.

Economy growth has accelerated from 2 percent to 2.6 percent in 2015. Sustained performance reflects high investment activity, including in the construction sector, as well as an improved trade balance, outweighing the large drop in government consumption and the consequences of low oil prices on exports. Leading indicators of domestic demand point to a steady pace of recovery also in the first quarter of 2016. The authorities project economic growth to reach 3.4 percent in 2016 and to accelerate gradually in subsequent years, supported by higher domestic demand, an expected improvement of the external financial and economic environment, and the impact of business-friendly structural reforms.

Regarding the composition of demand, private consumption is set to recover thanks to lower precautionary saving by households, lower fuel prices, and a projected steady increase in employment and wages. This said, unemployment remains high especially among the young and women, contributing to depressing long term growth. Private investment is also rising, both in absolute terms and as a share of GDP. On the external side, continued FDI inflows as well as tapping of the international markets to finance the budget deficit resulted in a 27.4% annual increase of the FX reserves of the Bank of Albania. As a result, the reserves cover over seven months of imports, which is well above the minimum of four months of import floor requested by the central bank.

In the fiscal area, tax collection gathered momentum in the first quarter of 2016.

Tax collection increased by over 13 percent in the first four months of the year compared to the same period in 2015. As a result, and together with the effect of tight expenditure control across all levels of government, the primary balance in cash terms turned positive, with an improvement of around 1.3 percentage points of GDP. This trend is providing buffers large enough to cope with any negative outcome of pending tax disputes. Regarding debt dynamics, after rising by 16.5 percentage points of GDP from 2008 to 2014 (below average of the SEE countries), in 2015 the debt-to-GDP ratio has basically stabilized. 2.2 billion (around 0.15 percent of GDP) of additional revenue generated by the recent privatization of the insurance company INSIG will contribute to lowering public debt. Lowering the debt ratio below 60 percent is one of the government's key economic policy goals.

Remaining vulnerabilities require adequate action in line with program conditionality. Sustained action in broadening tax basis and reducing informality in the economy is yielding positive results in terms of business and employees registration, and the newly merged tax/customs risk unit is working well. The organizational reform of the tax administration (postponed to end-June in order to ensure an effective implementation) will be adopted along the lines suggested by the Fund’s TA missions, including the restructuring of the Large Taxpayer Office and the adoption of a modern risk management approach, paving the way to targeted audits on high value firms and sectors with higher non compliance risks.

A strong fiscal framework is critical for sound fiscal accounts. Key steps have been undertaken in strengthening the medium term budgetary framework. Amendments to the Budget Law to incorporate multi-year commitment limits have been submitted to Parliament as required by program conditionality. Building on the achievements in reducing liabilities from the energy sector and in clearing central governments arrears, the focus is now on mitigating fiscal risks stemming from PPPs or poor investment management. This should also benefit from a number of TA missions from FAD. The authorities consider PPPs an important policy tool for specific policy goals. However, several initiatives have been recently put in place with the aim of monitoring and limiting PPP related fiscal risks; an evaluation unit at the MoF will be shortly operational and entitled in evaluating new PPP proposals, recommending measures to mitigate risks and to ensure the delivering of adequate value-for-money. Finally, the authorities are committed to strengthen the information on the amount of local governments' arrears and to address this issue in a comprehensive and transparent approach.

Monetary conditions are supporting the economic cycle.

The Bank of Albania is acting to fulfill its price stability mandate. The key interest rate has been lowered by 50 basis points in 2016. Moreover, the rate corridor has been narrowed to 2 percentage points. These decisions will support the ongoing economic recovery and the effectiveness of the transmission mechanisms. With the economy gradually returning to equilibrium during 2017, CPI inflation is expected to reach its target around the end of 2018. Bank of Albania has clearly communicated via its forward guidance that monetary conditions will remain accommodative throughout 2016 and any future tightening in 2017 will be conditional on the strength of the economic recovery. Lower government should also help improve the pass-through of monetary policy.

Credit recovery should benefit from favorable financial conditions and forthcoming legislative initiatives. Targeted macroprudential measures are facilitating a system-wide reduction in NPLs. The provision rate is in line with regional peers. Despite a resilient banking system, underpinned by adequate capitalization and ample liquidity, risk aversion has so far prevented translating accommodative monetary conditions in steady credit growth. However, excluding the effect of the loan write off from banks balance sheets, credit to the private sector has given some signals of recovery in the first quarter, with a yearly growth of 2.6 percentage points. The success of the road map agreed with the Fund for the reduction in non-performing loans will contribute to lowering perceived credit risk. By end-June, the reform of the bankruptcy law will be submitted to Parliament and measures to accelerate the reduction of NPLs through out-of-court procedures of debt restructuring will be adopted.

Finally, the absence of financial contagion from last summer's events shows to what extent the supervision framework has strongly benefited from policies and practices deployed also in response to the FSAP recommendations. This framework will be further strengthened by the rise in capital requirements on systemic banks that expand into non-banking activities. The central bank will also devote increasing efforts to monitoring loans to unhedged borrowers. Temporary measures adopted earlier to counteract the slowdown in credit growth will be unwind by the end of 2016.

Structural reforms aimed at building a competitive and modern economic system are advancing well.

Despite recent successful reform efforts, structural vulnerabilities have slowed down economic convergence. Well aware of this, the Albanian authorities will continue to concentrate on all-encompassing structural reforms, consistently with the achievements of the fiscal targets. Judicial reform, integration of the young and women into the labor market and a more efficient and diversified energy sector are the key drivers of the country's economic and social development.

The long awaited judicial reform is in the final stages of Parliamentary negotiation. The authorities are boosting efforts to win resistances from vested interests and have approved by the summer the constitutional amendments necessary for the reform. Once finalized, it will address the request from international stakeholders (included the Fund and the EU) to grant independence to the Courts, and ensure adequate property rights' protection. A new law on higher education and scientific research was adopted in 2015 and the accompanying implementing laws are to follow in 2016. It establishes two agencies for scientific research and higher education funding. Albania plans to address skills-mismatches and to improve the VET system through the introduction of a dual education model.

The construction of the major gas pipeline TAP has just been launched some days ago. The feasibility study for the project of gasification system connected with TAP is expected to be presented by October. Fiscal risks linked to the energy sector have considerably declined. In 2015 the SOE energy producer KESH has been able to pay its current and outstanding tax obligations and to cover energy imports with its own resources. Defaults hours have been reduced by two thirds between 2013 and 2015; further improvements in efficiency in generation are expected from self-financed investments amounting to 1.3 billion. The removal of 35kV medium-voltage consumers from regulated tariff system is within reach and the collection rate from budgetary institutions is close to 100 percent. Investments in the core transport network has been prioritized by the creation of a Single Sector Project Pipeline which includes national priority projects aimed at improving connectivity within the country and with neighboring countries. The lifting of the moratorium on construction will eliminate the main factor explaining the huge drop in 2015 World Bank Doing Business index. A National Business Centre has been established to streamline business registration and licensing through a single stop shop.

Concluding remarks

The Albanian authorities confirm their commitment to sound macroeconomic policies in line with their Fund-supported program which remains key to long-term sustainable growth and reform agenda.