INTERNATIONAL MONETARY FUND

Staff Country Reports

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

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

- The staff report for the Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, and Financing Assurances Review, prepared by a staff team of the IMF, following discussions that ended on May 8, 2007, 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 June 21, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of July 9, 2007 updating information on recent developments.
- A Press Release summarizing the views of the Executive Board as expressed during its July 9, 2007 discussion of the staff report that completed the review.
- 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*

*Also be included in Staff Report

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

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INTERNATIONAL MONETARY FUND

ALBANIA

Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, and Financing Assurances Review

Prepared by the European Department

(In consultation with other departments)

Approved by Juha Kähkönen and Scott Brown

June 21, 2007

Executive Summary

All quantitative program targets and structural conditionality for the third review have been met.

Albania has reached a pivotal stage in its economic development. Increasing FDI and rapid financial sector development point to a faster convergence toward emerging market income levels.

While the macroeconomic environment remains generally favorable, energy sector problems and strong credit growth create new challenges. Policy actions are required to safeguard the 2007 budget given the need to support the ailing state-owned electricity company (KESH), and to keep inflation expectations well anchored.

With measures agreed with the IBRD and some rationing of electricity, budget support for KESH can be limited to ½ percent of GDP in 2007. However, to achieve a lasting solution, KESH's distribution arm needs to be privatized expeditiously. To facilitate this and eliminate reliance on public support, domestic electricity prices should be raised to cost-recovery levels.

The authorities will take revenue measures and use expenditure savings to fully cover the cost of stabilizing KESH's financial position in 2007. These measures should ensure that priority expenditure is protected and budgetary safeguards remain adequate.

There was agreement that monetary tightening should continue to firmly anchor inflation expectations in the face of rapid credit growth. Additional prudential and regulatory measures might also become necessary to safeguard financial stability.

On the basis of the strong program performance and the authorities' commitments, staff recommends completion of the Third Review.

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List of Acronyms

ARMO	The state-owned oil company
BoA	Bank of Albania
CIT	Corporate income tax
FSA	Financial Supervisory Authority
GDDM	General Directorate for Debt Management
INSIG	The state-owned insurance company
INSTAT	The state statistical agency
KESH	The state-owned electricity company
LTO	Large taxpayer office
MEFP	Memorandum of Economic and Financial Policies
PC	Performance criterion
PIT	Personal income tax
PPP	Public Private Partnerships
PRSP	Poverty Reduction Strategy Paper (denoted as the National Strategy ` for Development and Integration in Albania)
SB	Structural benchmark

I. INTRODUCTION

1. **While the economic environment remains generally favorable, problems in the energy sector have resurfaced and credit growth has been faster than expected.**

Accordingly, the main policy challenges for this review were:

- to safeguard the 2007 budget and medium-term fiscal framework despite large demand for support from the ailing state-owned electricity company (KESH);
- to address problems in KESH on a sustainable basis; and
- to keep inflation expectations well anchored in the face of rapid credit growth and increased risks to the budget.

II. PERFORMANCE UNDER THE PROGRAM

2. **Economic developments have been mostly as anticipated at the time of the last review (Table 1):**

- A broad-based export recovery has gained strength.
- Inflation has remained within the 3 ± 1 percent target range (Figure 1).
- Revenue performance has been as expected and budget implementation has improved.
- Although the current account deficit is widening because of higher electricity imports, the strength of the export recovery indicates adequate competitiveness (Table 2).

3. **All quantitative program targets and structural conditionality for this review have been met** (MEFP Table 1 and Table 4).

4. **However, KESH's performance has deteriorated.** The effective collection rate dropped below 50 percent of the potential for most of 2006. In addition, due to unfavorable weather conditions and poor water reserve management in 2006, domestic electricity production (mostly hydropower based) is projected to decline by 30 percent this year, while imports will triple. In addition, import prices are expected to increase by 50 percent this year due to tight regional supply conditions. Altogether, electricity import costs are projected to increase by $1\frac{1}{4}$ percent of GDP in 2007—without additional measures, KESH's financial position would worsen by $1\frac{3}{4}$ percent of GDP.

5. **Moreover, credit growth is leveling off at a higher level than projected by staff.** Nonetheless, the level of private sector (mostly corporate) credit is still low by European standards (Figure 2, Table 3).

III. PROGRAM DISCUSSIONS

A. Economic Outlook

6. **A strong export recovery is likely to counterbalance the negative effects of a sharp drop in domestic energy production.** Growth is thus expected to reach 6 percent in 2007 as assumed in the budget, while the external current account deficit should be limited to below 7½ percent of GDP. Risks to these projections are on the downside because of energy sector difficulties.

B. Electricity Sector

7. **An IBRD-supported Action Plan for KESH has been adopted.** Accordingly, steps to increase collection rates and reduce losses, combined with appropriate power rationing, should limit budget support to KESH to ½ percent of GDP in 2007 (MEFP, ¶10). The mission emphasized that tariffs should be raised if necessary to eliminate subsidies by end-2007, but the authorities felt this could be achieved without tariff increases this year (MEFP, ¶11). In this context, the fourth review will need to take importantly into account performance against the action plan, aimed at eliminating the need for budget support for KESH in 2008 and setting it on a more sustainable path. Preparations continue to privatize KESH's distribution arm, including by preparation of an opening balance sheet. Staff reiterated the need for a firm sale timetable.

Figure 1. Albania: Price Developments, December 2005-April 2007

From very low levels in early 2006, headline inflation returned to the midpoint of the 2-4 percent target range...

...as the increase in nontraded goods inflation moderated by end year...

...and traded goods prices increased somewhat.

Traded goods prices were driven by rising food prices through July 2006...

...and then by the electricity tariff adjustment of August 2006...

...and by a slight increase in prices of other traded goods resulting from higher excises on tobacco.

Source: Data provided by INSTAT.

Figure 2. Evolution of Private Sector Credit, December 2003-April 2007

The stock of credit has been rising at a sustained and rapid pace...

...although the level of financial intermediation remains low relative to regional standards.

Transition Countries: Stock of Credit, 2000 and 2006		
(In percent of GDP)		
	2000	2006 1/
Albania	4	24
Romania	9	28
Poland	27	27
Macedonia, FYR	18	31
Russia	14	32
Moldova	14	32
Lithuania	13	41
Czech Republic	49	42
Bulgaria	13	49
Ukraine	12	50
Slovenia	36	53
Hungary	31	55
Bosnia & Herzegovina	43	58
Croatia	39	74
Estonia	36	85
Latvia	19	89
AVERAGE	24	48

Source: WEO and IFS.

1/ 2005 value for Poland, Lithuania, and Slovenia. March 2007 value for Albania.

The overwhelming majority of borrowing is for productive purposes....

...and appears to be stabilizing in terms of currency composition.

Source: Data provided by Bank of Albania.

C. Fiscal Issues

8. **The authorities were confident that the budget can absorb the costs of supporting KESH.** In line with the program's fiscal framework—which keeps a balance between lowering public debt and supporting development priorities—net credit to government in 2007 is capped at 2½ percent of GDP (2 percent if Albtelcom is sold as planned) (Table 5). The authorities agreed to take 0.3 percent of GDP of revenue measures—including a higher environmental tax on cars—and to achieve (primarily current) expenditure savings of 0.2 percent of GDP to cover the cost of stabilizing KESH's financial position (MEFP, ¶12). They indicated that budget contingencies (0.9 percent of GDP)—introduced to ensure safe implementation of large road projects—would not be used for this purpose. Staff concurred that the new measures kept the 2007 budget on track. The authorities plan to submit a supplementary budget to incorporate these changes and to reallocate already-budgeted investment funds between projects in a mid-year review (MEFP, ¶14).

Albania: Medium-Term Fiscal Path
(In percent of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012
Overall balance	-5.1	-3.6	-3.2	-3.9	-3.9	-3.6	-3.4	-3.2	-3.0
Total revenue	24.1	24.4	25.2	25.9	26.4	26.7	27.0	26.9	26.9
Total revenue (excluding grants)	23.8	23.7	24.7	25.5	26.1	26.4	26.7	26.7	26.7
Current expenditure	24.0	23.2	22.9	23.8	23.4	23.4	23.2	23.0	22.8
Capital expenditure	5.0	4.6	5.6	5.9	6.5	6.7	7.1	7.0	7.0
Current balance 1/	-0.2	0.5	1.9	1.6	2.4	2.9	3.5	3.7	3.8
Domestic financing	4.2	2.8	2.6	3.2	2.8	2.5	2.5	2.5	2.4
Privatization receipts	1.9	0.1	0.2	1.1	0.4	0.2	0.2	0.2	0.1
Domestic net borrowing 2/	2.3	2.7	2.3	2.0	2.3	2.3	2.3	2.3	2.3
Foreign financing	1.0	0.8	0.6	0.8	1.1	1.1	0.9	0.7	0.6
Public debt	56.6	56.7	55.7	54.4	53.4	52.3	51.1	49.8	48.4
Domestic 3/	38.5	39.1	38.9	37.5	36.5	35.6	34.7	33.9	33.1
External 4/	18.0	17.6	16.8	16.9	16.8	16.7	16.4	15.9	15.3

1/ Revenue excluding grants minus current expenditure.

2/ Assumes privatization of Albtelcom in 2007.

3/ Overwhelmingly lek-denominated and held by banks. Includes securities (1.4 percent of GDP) issued to the Bank of Albania to compensate for its exchange valuation losses.

4/ Overwhelmingly official and concessional.

9. **Tax reforms continue** (MEFP, ¶14). The authorities aim to create room to reduce tax rates by broadening the tax base and to improve compliance by simplifying the tax system. In mid-2007, the authorities plan to reduce the number of the personal income tax (PIT) brackets from five (1 to 20 percent) to two (0 and 10 percent)—this will be broadly neutral to the budget, while the zero-rate bracket will protect low-income people. The Council of Ministers already approved a draft law to reduce the CIT rate beginning in 2008 to match the new 10-percent PIT rate. Staff welcomed simplification, but urged greater focus on reducing the tax wedge on wages to promote employment. As halving the CIT rate is expected to

result in sizable revenue losses (1–1¼ percent of GDP), the authorities committed to agree offsetting measures with staff during the next mission to preserve the program’s medium-term fiscal framework. Noting the controversy surrounding recent attempts to limit the right of taxpayers to appeal, staff urged greater consultation with business on detailed design of tax policy to improve the quality of tax legislation and enhance compliance.

10. The maturity of domestic public debt has been lengthened and debt management has strengthened. Based on IBRD recommendations, a new General Directorate for Debt

Management (GDDM) will be created in the MoF. Functions (front-, middle-, and back-office) will be separated, and the GDDM will be properly staffed (MEFP, ¶16). To promote wider holding of longer-term government securities, access to primary Treasury Bond auctions will be broadened to include nonbank foreign and domestic institutional investors (structural benchmark (SB), end-September 2007). This, together with the introduction of a delivery-versus-payment system by early 2008, should improve government securities markets significantly. Welcoming these efforts, staff underscored the need for appropriate training.

11. Following FAD advice, collection of social security contributions and the large taxpayer office (LTO) will be strengthened (MEFP, ¶15). To improve efficiency, inactive taxpayers will be removed from the taxpayer register (Performance Criterion, December 15, 2007), and the LTO will become a full-service office also for large taxpayers outside Tirana (SB, end-October 2007). In addition, measures will be taken to increase the number of contributors to the social security system (SB, end-July 2008), including the development of a cross-agency campaign (SB; end-2006). Staff observed that this latter measure would help mitigate the tendency for tax collection to decline during elections.

D. Monetary Policy and Financial Stability

12. There was agreement that the tightening cycle should continue to firmly anchor inflation expectations. Last year’s increases in the policy interest rate were well timed, and a strengthening of banking regulation and supervision has helped maintain financial stability. Nonetheless, the confluence of rapid credit expansion and budgetary risks makes a policy rate increase prudent at this stage to prevent an erosion of confidence. As the interest rate differential vis-à-vis the euro has declined, the real exchange rate has remained stable, and exports are strong, the authorities and staff agreed that further tightening would not pose significant risks to the economy.

13. **The authorities continued to consider the dominantly foreign-owned domestic banking sector well functioning and robust.** Following a small rise in mid-2006, NPLs are again declining as a share of total loans (Table 6). Though rapid credit growth continues to lower capital adequacy and liquidity ratios, banks on the whole remain well capitalized, liquid, and profitable. Stress tests regularly performed by the authorities indicate that the banking sector is resilient to standard exchange rate, interest rate, and credit quality shocks, with strong profitability (average RoE of 20 percent) providing a considerable buffer. Recently announced plans for bank mergers and acquisitions indicate the success of the BoA's strategy to promote consolidation in the banking system. Welcoming these positive

developments, staff agreed that continued consolidation would strengthen the industry and increase competition by creating a more balanced market structure.

14. **With MCM technical assistance, prudential regulation, bank supervision and the financial infrastructure have strengthened** (MEFP, ¶21). The most important measure introduced in January 2007 was to mandate higher capital requirements for banks that expand credit rapidly (Table 7). So far, this has strengthened the capital base rather than slowed credit expansion. There was agreement that additional prudential and regulatory tightening—particularly for banks with weak risk management practices—would be needed to safeguard stability if credit growth does not soon moderate. This would include measures to reduce the indirect credit risk arising from unhedged foreign currency borrowing (MEFP, ¶21). The BoA selected a company to develop the IT system for the planned credit bureau and was confident that the bureau will be established by end-2007 (SB).

15. **With IBRD support, the recently-created Financial Supervisory Authority (FSA) is improving insurance supervision** (MEFP, ¶15).¹ Staff welcomed this, noting that issuance of new pension licenses should be avoided until supervisory capacity is raised and an appropriate legal framework is introduced. Progress in insurance supervision is urgent not least because several acquisitions by foreign companies are being negotiated. Given FSA's limited capacities and close ownership links between banks and leasing companies, there was agreement that supervision of the leasing industry—and of factoring—should be assigned to the BoA, and that the necessary legislation would be submitted to Parliament by end-October 2007 (SB).

E. Other Structural Reforms

16. **The authorities prioritize completion of privatization and promotion of FDI.** The renegotiation of the contract for Albtelecom with the originally selected foreign investor is close to conclusion. Sale preparations in insurance (INSIG) and energy (ARMO) continue and foreign investor interest is strong in tourism and energy, with some favoring PPPs. Staff welcomed the strong political commitment to privatization. But they called for renewed efforts to complete some long-delayed transactions and cautioned against PPPs, certainly until the necessary institutional capacity to handle them has been created.

17. **A weak statistical system continues to hinder policymaking.** Yet another change in the management of the Statistical Office (INSTAT) slowed progress. There was agreement that successful completion of the ongoing household budget and labor force surveys is critical to improving the national accounts and labor statistics (MEFP, ¶29).

¹ FSA supervises insurance companies, pension funds, and securities markets

18. **The authorities appreciate the close collaboration between the IBRD and the Fund in key areas.** This has been an important factor promoting financial reforms in Albania, with the Fund concentrating on banking and the IBRD on the nonbank sector. With an IBRD program in debt management, this collaboration now extends to another key area.

F. Program Issues

19. **The authorities are preparing a new PRSP (National Strategy for Development and Integration) for 2007–13.** They will soon start discussions with stakeholders and plan to complete the process by end-October, 2007. Staff was encouraged by the authorities' determination to strengthen national ownership through a broad consultation process.

20. **The proposed conditionality for the Fourth Review (MEFP Tables 1–2) is consistent with program goals, and the program is fully financed over 2007–08 (Tables 8 and 9).** The 2007 financing gap is expected to be closed by arrears rescheduling and Fund financing. External debt remains sustainable (Table 10), and projected future debt service to the Fund is minimal (Table 11).

21. **Progress has been made in clearing remaining external arrears,** estimated at €65.6 million at end-2006. These largely reflect inoperative bilateral payment agreements in place before Albania joined the Fund. Arrears to Bulgaria and Poland were cleared on schedule, and the authorities aim to eliminate remaining arrears to official and private creditors by end-2007 (MEFP, ¶28).

IV. STAFF APPRAISAL

22. **Albania has reached a pivotal stage in its economic development.** Increasing foreign direct investment and rapid financial sector development, supported by macroeconomic stability, herald faster convergence toward emerging market income levels. However—to seize these opportunities effectively—significant risks must be successfully managed and wide-ranging reform efforts need to be sustained.

23. **Pursuing sound macroeconomic policies remains key to the authorities' development strategy.** Despite difficulties in the electricity sector, growth is returning to potential, inflation has remained low, and robust exports mitigate the impact of large electricity imports on the external balance. Looking ahead, the BoA should stay vigilant to keep inflation expectations well anchored in the face of still-rapid credit expansion and uncertainties about the fiscal implications of KESH's financial difficulties. Additional tightening of the prudential and regulatory environments might also become necessary to safeguard financial stability.

24. **The fiscal framework of the program continues to provide a sound foundation for rapid development and macroeconomic stability.** It appropriately balances public debt reduction with support for development, and enjoys welcome political and public support.

25. **Despite sizable costs of stabilizing the financial position of KESH, fiscal targets are expected to be met this year and in 2008.** Revenue measures and expenditure savings will ensure that priority expenditure is protected and budgetary safeguards remain adequate. The mid-year review of public investment projects should help strengthen budget execution and create additional budget safeguards.

26. **However, serious deterioration of KESH's financial position must be corrected on a sustained basis.** Implementation of the authorities' donor-supported interim package, should stabilize the company's financial position and contain the budget impact for 2007. Progress against the action plan will be a key element in the fourth review and policies should aim to fully eliminate budget support for KESH in 2008, thereby setting it on a more sustainable path. Moreover, to achieve a lasting solution, KESH's distribution arm needs to be privatized expeditiously. Unanimous support across the political spectrum provides a unique opportunity to achieve this. To facilitate privatization and eliminate reliance on public support, domestic electricity prices should be raised to cost-recovery levels, including through a rate increase this year.

27. **Further progress has been made in improving public institutions, and planned measures would help strengthen this reform momentum.** The creation of a general directorate for debt management in the MoF will help enhance debt management. Future fiscal reforms will focus on the most critical steps to strengthen revenue administration and further lengthen the average maturity of domestic public debt. Regarding financial infrastructure, the completion of a credit information bureau will be a landmark improvement that will help keep safe the rapidly-growing credit portfolio of the banking system.

28. **The authorities have made commendable efforts to preserve the health of the banking system.** Allocating financial leasing supervision to the BoA will eliminate a dangerous gap in the supervisory framework. Promoting consolidation in the banking sector by bringing in foreign banks with the necessary capital strength is an appropriate strategy at this stage of development.

29. **Important steps have been taken to strengthen the FSA's supervisory capacities.** Increased interest in the Albanian insurance industry by reputable foreign investors is an encouraging development that may soon bring about major improvements. It is important, however, that supervisory capacities keep pace with these developments. Regulatory capacity in the nascent pension industry also needs significant improvements and—until an appropriate legal framework and supervisory capacity can be developed—it would be advisable for the authorities to refrain from issuing new pension fund licenses.

30. **Increased private sector involvement in key sectors is essential to enhance Albania's growth potential.** The success of the banking sector in attracting major European banks could be emulated in other financial industries and more broadly by improving public institutions, such as nonbank supervision. The authorities, however, lack the capacity to limit and manage risks involved in large PPP projects with sophisticated financing structures—they should therefore avoid direct involvement at this stage.
31. **Further efforts are needed to improve official statistics, including the timely completion of the household budget and the labor force surveys.**
32. **On the basis of the strong program performance and the authorities' commitments, staff recommends completion of the Third Review under the PRGF/EFF-supported program and the financing assurances review.**

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2003–12

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
				Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(Growth rate in percent)										
Real GDP 1/	5.7	5.9	5.5	5.0	6.0	6.0	6.1	6.1	6.2	6.3
Retail prices (avg.)	2.3	2.9	2.4	2.4	2.5	3.4	3.0	3.0	3.0	3.0
Retail prices (end-period)	3.3	2.2	2.0	2.5	3.1	3.1	3.0	3.0	3.0	3.0
(In percent of GDP)										
Saving-investment balance 2/										
Foreign savings 3/	5.3	3.9	6.5	5.8	7.4	6.5	6.0	5.5	5.3	5.0
Domestic savings	18.2	19.9	17.1	19.2	18.3	20.3	21.7	23.1	23.5	23.8
Public 4/	-0.1	0.1	1.2	2.4	2.0	2.8	3.2	3.8	3.9	4.0
Private	18.3	19.8	15.9	16.8	16.3	17.5	18.5	19.3	19.6	19.7
Investment	23.4	23.8	23.6	25.0	25.7	26.9	27.7	28.6	28.8	28.8
Public	4.6	5.0	4.6	5.6	5.9	6.5	6.7	7.1	7.0	7.0
Private	18.8	18.8	19.0	19.4	19.8	20.4	21.0	21.5	21.8	21.8
Fiscal sector										
Revenues and grants	24.5	24.1	24.4	25.2	25.9	26.4	26.7	27.0	26.9	26.9
Tax revenue	21.3	21.7	22.0	22.9	23.7	24.3	24.8	25.2	25.2	25.2
Expenditures	29.0	29.2	28.0	28.5	29.8	30.3	30.3	30.4	30.1	30.0
Primary	24.6	25.5	24.9	25.7	26.9	27.3	27.4	27.5	27.3	27.1
Interest	4.4	3.7	3.1	2.8	3.0	3.0	3.0	2.9	2.9	2.9
Overall balance (including grants)	-4.5	-5.1	-3.6	-3.2	-3.9	-3.9	-3.6	-3.4	-3.2	-3.0
Primary balance (including grants)	-0.2	-1.4	-0.5	-0.4	-1.0	-0.9	-0.6	-0.6	-0.3	-0.2
Net domestic borrowing	2.9	2.3	2.7	2.3	2.0	2.3	2.3	2.3	2.3	2.3
Privatization receipts	0.1	1.9	0.1	0.2	1.1	0.4	0.2	0.2	0.2	0.1
Foreign financing	1.5	1.0	0.8	0.6	0.8	1.1	1.1	0.9	0.7	0.6
Public Debt	61.7	56.6	56.7	55.7	54.4	53.4	52.3	51.1	49.8	48.4
Domestic	41.1	38.5	39.1	38.9	37.5	36.5	35.6	34.7	33.9	33.1
External (including publicly guaranteed) 5/	20.6	18.0	17.6	16.8	16.9	16.8	16.7	16.4	15.9	15.3
Monetary indicators										
Broad money growth	8.7	13.5	13.9	16.3	16.3	15.6	14.6	14.1	12.3	11.8
Private credit growth	31.1	36.9	73.6	57.2	43.4	33.9	28.5	23.2	18.7	16.7
Velocity	1.5	1.5	1.5	1.3	1.3	1.2	1.1	1.1	1.1	1.1
Interest rate (3-mth T-bills, end-period)	7.3	6.2	5.4	6.4	...	...	...	...	...	...
(In percent of GDP unless otherwise indicated)										
External sector										
Trade balance (goods and services)	-25.1	-21.7	-24.0	-24.0	-25.1	-23.5	-22.6	-21.6	-20.9	-20.2
Current account balance (including official transfers)	-5.3	-3.9	-6.5	-5.8	-7.4	-6.5	-6.0	-5.5	-5.3	-5.0
Current account balance (excluding official transfers)	-7.9	-5.6	-7.7	-7.2	-8.6	-7.6	-7.0	-6.4	-6.1	-5.7
Official transfers	2.6	1.7	1.2	1.4	1.2	1.1	1.0	0.9	0.8	0.7
Gross international reserves (in millions of Euros)	834	1,025	1,202	1,359	1,488	1,610	1,705	1,848	1,977	2,126
(In months of imports of goods and services)	3.9	3.9	4.0	4.0	4.1	4.2	4.1	4.1	4.0	4.0
(Relative to external debt service)	15.2	17.6	17.8	12.2	11.8	9.5	8.8	8.1	8.0	8.2
(In percent of broad money)	24.6	25.3	25.7	25.3	23.8	22.5	20.9	20.0	19.2	18.6
Change in real effective exchange rate (e.o.p., in percent)	1.2	5.1	2.8	-0.1	...	...	...	...	...	...
Memorandum items										
Nominal GDP (in billions of lek) 1/	683	766	837	896	980	1,075	1,181	1,296	1,425	1,568

Social Indicators: GNI per capita, World Bank Atlas Method, US\$ (2005): \$2,570; **life expectancy at birth** (2005): 75 years; infant mortality rate (2005, per thousand births): 16; population 3.1 million (2005); population living below the poverty line (2005): 18.5; population without running water inside their dwellings (2003): 40 percent.

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

1/ GDP data for 2002-03 are from the official national accounts; GDP data for 2004-10 are staff estimates.

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

3/ Negative of current account including official transfers.

4/ Revenue including grants less current expenditure and net lending.

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

Table 2a . Albania: Balance of Payments, 2003–12
(In percent of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Projections									
Current account	-5.3	-3.9	-6.5	-5.8	-7.4	-6.5	-6.0	-5.5	-5.3	-5.0
Balance of goods and services	-25.1	-21.7	-24.0	-24.0	-25.1	-23.5	-22.6	-21.6	-20.9	-20.2
Exports	20.8	21.5	22.2	25.0	26.2	26.6	26.7	27.1	27.4	27.8
Goods	8.0	8.1	7.9	8.7	9.8	10.2	10.5	10.9	11.4	11.8
Services	12.8	13.4	14.3	16.4	16.4	16.4	16.2	16.1	16.1	16.0
Imports	45.9	43.2	46.2	49.1	51.3	50.1	49.3	48.6	48.3	48.0
Goods	31.6	29.1	29.8	31.8	33.3	32.5	31.8	31.3	31.0	30.9
Services	14.2	14.1	16.4	17.3	18.0	17.7	17.5	17.3	17.3	17.1
Income balance	3.1	2.4	2.0	2.8	2.6	2.2	2.1	2.0	1.9	1.9
Of which: Interest due	0.4	0.3	0.4	0.5	0.7	0.7	0.8	0.8	0.8	0.8
Private transfers 1/	14.2	13.7	14.4	14.1	13.8	13.6	13.4	13.2	12.9	12.6
Official transfers	2.6	1.7	1.2	1.4	1.2	1.1	1.0	0.9	0.8	0.7
Capital account	5.5	5.5	4.9	5.8	8.3	7.4	7.0	7.0	6.5	6.3
Direct investment	3.2	4.6	3.3	3.5	5.2	4.9	4.9	5.0	5.1	5.2
Other capital	0.8	-0.2	0.6	1.5	2.0	1.7	1.4	1.4	1.1	0.8
Private loans (incl.net trade credits, net)	0.4	1.3	0.9	0.5	0.8	0.9	0.9	0.8	0.8	0.7
Other financial flows	0.4	-1.5	-0.3	0.9	1.2	0.8	0.5	0.6	0.3	0.1
Of which: Change in NFA of DMBs (incr = -) 2/	0.4	-1.5	-0.3	0.1	0.6	0.2	0.2	0.2	0.2	0.1
Official medium- and long-term loans (net)	1.5	1.1	0.9	0.7	1.1	0.8	0.7	0.5	0.4	0.3
New borrowing	2.0	1.7	1.5	1.6	1.9	1.9	1.9	1.8	1.7	1.5
Multilateral loans	1.5	1.2	1.1	1.1	1.1	0.9	1.0	1.1	1.0	0.9
World Bank	0.7	0.6	0.5	0.5	0.5	0.4	0.3	0.4	0.3	0.2
EBRD	0.3	0.2	0.2	0.3	0.3	0.2	0.3	0.3	0.3	0.3
Other	0.5	0.4	0.4	0.4	0.4	0.3	0.4	0.4	0.4	0.4
Bilateral loans	0.5	0.5	0.4	0.5	0.8	0.9	0.9	0.8	0.7	0.6
Amortization	-0.5	-0.5	-0.5	-0.9	-0.8	-1.1	-1.2	-1.3	-1.3	-1.3
Errors and omissions 3/	0.3	1.3	2.7	2.5	0.7	0.5	0.0	0.0	0.0	0.0
Net balance	0.5	3.0	1.1	2.4	1.6	1.3	1.0	1.4	1.2	1.3
Financing requirement	-0.5	-3.0	-1.1	-2.4	-1.6	-1.3	-1.0	-1.4	-1.2	-1.3
Available financing	-0.5	-3.0	-1.0	-2.6	-1.6	-1.3	-1.0	-1.4	-1.2	-1.3
Change in net reserves (increase = -) 2/	-0.9	-3.2	-1.1	-2.7	-1.7	-1.5	-1.1	-1.5	-1.2	-1.3
BOP support	0.3	0.3	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Changes in arrears (increase = +) 4/	0.1	-0.2	-0.2	-0.1	-0.8	0.0	0.0	0.0	0.0	0.0
Overdue debt forgiveness	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling 4/	0.0	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Identified Financing	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0
of which: World Bank including DPL	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0
Financing gap 5/	0.0	0.0	0.0	0.0	0.8	0.0	0.0	0.0	0.0	0.0
Expected EU Macro-Financial Assistance	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Arrears Rescheduling	...	...	0.0	0.0	0.8	0.0	0.0	0.0	0.0	0.0
Other	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

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

2/ Net of valuation changes in 2005-2006. In projections for 2007-2010, valuation effects are assumed to be zero.

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

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

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

Table 2b. Albania: Balance of Payments, 2003–12
(In millions of Euros)

	2003	2004	2005	2006					2007	2008	2009	2010	2011	2012
				Q1	Q2	Q3	Q4	2006			Projections			
				Est.	Est.	Est.	Est.	Est.						
Current account	-261	-235	-437	-124	-146	-41	-115	-426	-585	-561	-568	-568	-595	-616
Balance of goods and services	-1,248	-1,307	-1,617	-406	-423	-434	-489	-1,752	-1,985	-2,031	-2,123	-2,213	-2,337	-2,464
Exports	1,031	1,293	1,498	422	448	490	466	1,825	2,072	2,298	2,515	2,776	3,072	3,402
Goods	396	486	530	144	166	153	167	631	773	885	991	1,119	1,271	1,442
Services	635	808	967	278	282	337	298	1,195	1,299	1,413	1,525	1,657	1,801	1,959
Imports	2,279	2,600	3,115	827	871	924	954	3,577	4,057	4,329	4,638	4,989	5,409	5,865
Goods	1,572	1,752	2,007	515	580	568	653	2,316	2,633	2,802	2,989	3,209	3,475	3,774
Services	708	848	1,108	312	292	356	302	1,261	1,424	1,527	1,649	1,779	1,934	2,092
Income balance	152	143	132	50	39	48	66	203	209	194	198	206	216	228
Of which : Interest due	21	18	25	5	13	8	14	40	52	65	75	84	91	97
Private transfers 1/	706	826	969	210	216	320	279	1,024	1,095	1,177	1,262	1,351	1,440	1,535
Official transfers	129	103	79	22	23	25	29	99	97	99	95	88	87	85
Capital account	274	332	328	74	154	7	186	420	656	637	660	716	729	775
Direct investment	158	277	224	57	69	76	58	259	408	422	462	515	567	640
Other capital	42	-13	41	5	66	-88	125	109	160	149	129	148	121	99
Private loans (incl.net trade credits, net)	21	78	63	7	18	0	15	40	66	79	86	87	87	91
Other financial flows	21	-91	-22	-2	48	-88	110	69	94	70	43	61	35	8
Of which: Change in NFA of DMBs (incr = -) 2/	21	-91	-22	-21	26	-101	104	7	49	21	21	21	18	14
Medium- and long-term loans (net)	75	68	63	12	19	19	3	53	88	67	68	53	41	35
New borrowing	101	100	98	24	35	36	23	116	152	161	177	189	188	188
Multilateral loans	75	72	73	18	16	31	16	82	88	79	90	109	115	114
World Bank	36	37	32	5	9	13	9	36	39	35	25	36	37	29
EBRD	13	13	15	5	4	5	4	19	20	18	30	35	37	40
Other	25	23	25	8	3	13	3	27	29	26	35	37	41	45
Bilateral loans	26	28	26	5	18	5	6	35	64	82	87	80	73	75
Amortization	-25	-33	-35	-12	-16	-17	-19	-63	-64	-94	-108	-136	-147	-153
Errors and omissions 3/	14	80	182	58	18	88	20	184	55	40	0	0	0	0
Net balance	27	177	72	8	26	54	91	178	127	116	92	148	134	159
Financing requirement	-27	-177	-72	-8	-26	-54	-91	-178	-127	-116	-92	-148	-134	-159
Available financing	-27	-177	-69	-7	-26	-54	-90	-178	-127	-116	-91	-148	-134	-158
Change in net reserves (increase = -) 2/	-46	-193	-72	-16	-26	-67	-90	-200	-134	-127	-103	-152	-138	-158
Of which: Change in gross reserves, (increase = -) 2/	10	-191	-77	-17	-24	-67	-88	-197	-129	-122	-95	-142	-129	-150
Use of Fund Resources (net)	1	2	2	1	-2	0	-2	-3	-5	-5	-8	-9	-9	-9
Budget support	17	15	3	9	0	0	0	9	0	0	0	0	0	0
Changes in arrears (increase = +) 4/	3	-12	-17	0	-4	0	-3	-7	-64	0	0	0	0	0
Overdue debt forgiveness	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Rescheduling 4/	0	12	17	0	4	0	0	7	0	0	0	0	0	0
Identified Financing	0	0	0	0	0	13	0	13	8	11	11	4	4	0
Of which : World Bank including DPL	0	0	0	0	0	0	0	0	8	11	11	4	4	0
Financing gap 5/	0	0	0	0	0	0	3	0	64	0	0	0	0	0
Expected EU Macro-Financial Assistance	...	...	0	0	0	0	0	0	0	0	0	0	0	0
Arrears Rescheduling	...	...	0	0	0	0	3	0	64	0	0	0	0	0
Other	...	...	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:														
Gross usable reserves	834	1,025	1,202	1,219	1,223	1,291	1,359	1,359	1,488	1,610	1,705	1,848	1,977	2,126
(months of imports of goods and services)	3.9	3.9	4.0	...	...	...	...	4.0	4.1	4.2	4.1	4.1	4.0	4.0
Balance of goods and services (percent of GDP)	-25.1	-21.7	-24.0	...	...	...	...	-24.0	-25.1	-23.5	-22.6	-21.6	-20.9	-20.2
Current account (percent of GDP)	-5.3	-3.9	-6.5	...	...	...	...	-5.8	-7.4	-6.5	-6.0	-5.5	-5.3	-5.0
Debt service (percent of exports of goods and services) 6/	5.0	4.1	3.9	...	...	...	...	4.7	4.5	5.2	5.3	5.7	5.8	5.5
Debt service (percent of central government revenues) 6/	4.5	3.9	3.9	...	...	...	...	5.0	4.9	5.7	5.8	6.3	6.5	6.2
Total external debt stock (percent of GDP) 7/	22.2	20.4	20.5	...	...	...	...	19.8	19.9	19.8	19.6	19.0	18.3	17.5
Volume of Exports of Goods and Services (percent change)	9.5	20.6	6.1	...	...	...	...	11.8	19.1	14.0	12.0	12.5	12.1	11.9
Volume of Imports of Goods and Services (percent change)	8.4	10.7	8.4	...	...	...	...	6.3	8.5	6.5	7.2	7.2	7.3	7.2

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

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

2/ Net of valuation changes in 2005-2006. In projections for 2007-2010, valuation effects are assumed to be zero.

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

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

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

6/ Public and publicly guaranteed debt only.

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

Table 3a. Albania: Monetary Aggregates, 2003–12

(In percent of GDP: end-period)

	Actuals								IMF projections							
	2003	2004	2005	2006				2007				2008	2009	2010	2011	2012
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.
Monetary survey																
Broad money	65.0	65.7	68.5	67.9	68.2	70.4	74.4	74.6	76.2	77.4	79.1	83.3	87.0	90.4	92.4	93.9
Currency outside banks	18.3	18.0	17.9	16.2	16.3	16.6	18.2	16.8	16.3	16.5	18.4	18.0	17.4	17.0	16.6	16.4
Deposits	46.6	47.7	50.6	51.7	51.9	53.9	56.1	57.7	60.0	60.9	60.7	65.3	69.6	73.4	75.8	77.4
Domestic currency deposits	33.1	33.3	33.1	33.6	33.4	33.7	35.0	35.5	37.0	36.4	35.8	37.4	39.8	42.1	44.2	46.3
Foreign currency deposits	13.5	14.4	17.5	18.1	18.5	20.1	21.1	22.2	22.9	24.5	24.9	27.9	29.8	31.3	31.6	31.2
Net foreign assets	23.7	24.6	25.2	25.3	24.7	26.7	26.0	25.8	25.4	24.8	24.7	23.9	22.8	22.1	21.3	20.6
Bank of Albania	14.6	15.5	16.6	16.5	16.4	17.1	18.0	18.2	17.9	17.6	18.0	18.0	17.6	17.6	17.3	17.1
Commercial Banks	9.1	9.2	8.6	8.8	8.3	9.6	8.0	7.6	7.5	7.2	6.6	5.9	5.1	4.5	4.0	3.5
Net domestic assets	41.3	41.0	43.3	42.6	43.5	43.7	48.3	48.7	50.9	52.6	54.4	59.4	64.2	68.3	71.1	73.3
Claims on government (net of deposits)	38.1	35.4	33.1	31.3	30.5	30.2	32.1	31.7	31.5	31.0	31.1	29.5	28.0	26.8	25.5	24.4
BOA financing	9.5	7.5	7.0	6.2	6.4	6.1	5.2	5.3	5.0	4.9	5.6	4.9	4.3	3.7	3.1	2.7
Of which: gross credit	10.8	8.6	8.2	7.9	7.5	7.5	7.6	7.2	7.3	7.1	6.8	6.0	5.3	4.7	4.0	3.5
Other (including T-bills)	28.6	27.9	26.1	25.1	24.2	24.1	26.9	26.5	26.5	26.1	25.5	24.6	23.8	23.0	22.4	21.7
Claims on state enterprises and farms	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on the private sector 1/	7.7	9.4	14.9	16.2	18.0	19.2	21.8	23.9	25.6	27.2	28.6	34.9	40.8	45.8	49.5	52.5
In Leks	1.6	2.0	4.0	4.5	5.3	6.0	6.6	7.0	8.7	8.7	8.9	12.0	15.8	19.0	22.1	25.3
In foreign currency	6.1	7.3	10.8	11.7	12.7	13.2	15.2	16.9	16.9	18.5	19.7	22.9	25.0	26.8	27.4	27.2
Other items, net	-4.5	-3.7	-4.7	-4.9	-5.1	-5.7	-5.6	-7.0	-6.3	-5.7	-5.3	-5.0	-4.6	-4.3	-4.0	-3.6
Memorandum items:																
Reserve money	23.5	23.3	23.7	22.0	22.5	23.3	24.3	23.4	23.5	24.3	24.9	25.0	24.8	24.8	24.8	24.8
M1	20.8	22.2	26.7	25.2	25.6	25.3	27.0	24.7	22.7	22.5	25.8	25.6	25.3	25.1	25.0	25.1
M2	51.5	51.3	51.0	49.8	49.7	50.3	53.3	52.3	53.3	52.9	54.2	55.4	57.2	59.1	60.8	62.7

Sources: Bank of Albania; and Fund staff estimates.

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

Table 3b. Albania: Monetary Aggregates, 2003–12

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

	Actuals								IMF projections							
	2003	2004	2005	2006				2007				2008	2009	2010	2011	2012
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar	Jun.	Sep.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.
Monetary survey																
Broad money	443.5	503.2	573.0	575.2	589.3	621.8	666.5	678.5	709.7	738.8	774.9	895.9	1026.9	1172.0	1316.4	1471.7
Currency outside banks	125.2	138.1	149.7	137.2	141.0	146.2	163.3	153.3	151.5	157.8	179.9	193.5	205.4	220.1	237.0	257.5
Deposits	318.3	365.1	423.3	437.9	448.3	475.6	503.2	525.1	558.2	580.9	594.9	702.4	821.5	951.9	1079.5	1214.2
Domestic currency deposits	226.1	255.2	276.8	284.4	288.1	298.0	314.1	322.8	344.6	347.1	350.9	402.2	470.0	546.0	629.3	725.3
Foreign currency deposits	92.2	110.0	146.6	153.5	160.2	177.6	189.1	202.4	213.6	233.8	244.1	300.2	351.5	405.9	450.2	488.9
Net foreign assets	161.8	188.8	210.8	214.2	213.6	235.9	233.2	234.9	236.2	237.1	241.7	256.8	268.6	287.1	303.5	323.1
Bank of Albania	99.8	118.6	138.8	140.1	142.1	151.5	161.2	165.9	166.4	168.0	176.6	193.8	207.9	228.6	246.8	267.8
Commercial Banks	62.0	70.2	72.0	74.2	71.6	84.5	72.0	69.0	69.8	69.1	65.1	63.0	60.7	58.5	56.7	55.3
Net domestic assets	281.7	314.4	362.2	360.9	375.7	385.9	433.2	443.6	473.5	501.7	533.2	639.1	758.3	884.9	1012.9	1148.6
Claims on government (net of deposits)	260.1	271.0	277.0	264.7	263.7	266.4	287.9	288.8	293.4	296.1	304.9	317.1	330.9	347.0	364.1	382.4
BOA financing	64.6	57.2	58.6	52.4	54.8	53.6	46.8	48.0	46.8	46.8	54.6	52.4	50.4	48.4	44.4	42.4
Of which: gross credit	73.4	65.7	68.8	67.3	64.9	66.2	67.9	65.5	67.9	67.9	66.9	64.7	62.7	60.7	56.7	54.7
Other (including T-bills)	195.5	213.7	218.4	212.3	208.9	212.8	241.0	240.7	246.5	249.3	250.2	264.7	280.5	298.6	319.7	340.0
Claims on state enterprises and farms	0.0	0.1	0.1	0.1	0.2	0.1	0.2	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on the private sector 1/	52.3	71.6	124.4	137.4	155.7	169.8	195.5	217.8	238.4	259.7	280.3	375.4	482.2	594.0	705.2	822.7
In Leks	10.6	15.6	33.7	37.9	46.2	52.9	59.2	63.9	81.1	83.5	87.1	128.8	186.5	246.5	315.4	396.2
In foreign currency	41.7	56.0	90.6	99.5	109.6	116.8	136.4	153.9	157.3	176.2	193.2	246.6	295.7	347.6	389.8	426.5
Other items, net	-30.8	-28.3	-39.2	-41.3	-44.0	-50.3	-50.3	-63.6	-58.2	-54.1	-52.0	-53.3	-54.8	-56.1	-56.4	-56.6
Memorandum items:																
Reserve money (billions of Lek)	160.6	178.6	198.3	186.3	194.6	205.4	217.6	213.3	218.6	231.9	243.8	268.7	293.4	322.1	352.8	388.1
M1 (billions of Lek)	142.0	170.1	223.7	213.3	221.2	223.1	242.4	225.2	211.7	215.1	253.0	275.6	298.4	325.6	356.3	392.9
M2 (Billions of Lek)	351.3	393.3	426.4	421.6	429.2	444.2	477.4	476.1	496.1	504.9	530.8	595.7	675.4	766.1	866.2	982.8
Annual broad money growth	8.7	13.5	13.9	11.3	9.6	10.7	16.3	18.0	20.4	18.8	16.3	15.6	14.6	14.1	12.3	11.8
Annual reserve money growth	-2.0	11.2	11.0	8.9	7.8	5.8	9.8	14.5	12.3	12.9	12.0	10.2	9.2	9.8	9.5	10.0
Annual growth in private sector credit	31.1	36.9	73.6	68.6	59.2	57.1	57.2	58.5	53.1	53.0	43.4	33.9	28.5	23.2	18.7	16.7
Private sector credit as a percent of GDP	7.7	9.4	14.9	16.2	18.0	19.2	21.8	23.9	25.6	27.2	28.6	34.9	40.8	45.8	49.5	52.5
Annual change in credit as a percent of GDP	1.3	1.7	5.5				6.9		7.6	8.0	6.8	6.3	5.9	5.0	3.7	3.0
Annual M2 growth	9.2	11.9	8.4	6.6	5.4	7.4	11.9	12.9	15.6	13.1	11.2	12.2	13.4	13.4	13.1	13.5
Velocity (annual GDP/BM)	1.5	1.5	1.5	1.5	1.5	1.4	1.3	1.3	1.3	1.3	1.3	1.2	1.1	1.1	1.1	1.1
Money multiplier (absolute values)	2.8	2.8	2.9	3.1	3.0	3.0	3.1	3.2	3.2	3.2	3.2	3.3	3.5	3.6	3.7	3.8
Currency/Broad Money ratio	28.2	27.4	26.1	23.9	23.9	23.5	24.5	22.6	21.4	21.4	23.2	21.6	20.0	18.8	18.0	17.5
Currency/M2 ratio	35.6	35.1	35.1	32.5	32.9	32.9	34.2	32.2	30.5	31.3	33.9	32.5	30.4	28.7	27.4	26.2
Foreign currency deposits/total deposits	29.0	30.1	34.6	35.1	35.7	37.3	37.6	38.5	38.3	40.2	41.0	42.7	42.8	42.6	41.7	40.3
Gross reserves (millions of euros)	834	1,025	1,202	1,219	1,223	1,291	1,359	1,405	1,406	1,415	1,488	1,610	1,705	1,848	1,977	2,126
Gross reserves (millions of U.S. dollars)	1,026	1,374	1,425	1,465	1,548	1,643	1,796	1,827	1,827	1,839	1,939	2,107	2,242	2,446	2,639	2,864
In percent of broad money	24.6	25.3	25.7	25.8	25.5	25.7	25.3	25.6	24.5	23.7	23.8	22.5	20.9	20.0	19.2	18.6
US Dollar Exchange Rate (end of period)	106.4	92.7	103.4	101.5	97.2	97.1	94.0	94.9	...	...	...	...	...	...	...	...
Euro Exchange Rate (end of period)	133.8	125.9	122.4	122.8	123.2	123.0	123.6	126.4	...	...	...	...	...	...	...	...
3-month T-bill rate (in percent)	7.32	6.15	5.40	5.13	5.12	5.69	6.4	5.6	...	...	...	...	...	...	...	...
BoA repo rate (in percent)	6.50	5.25	5.00	5.00	5.00	5.25	5.5	5.5	...	...	...	...	...	...	...	...

Sources: Bank of Albania; and Fund staff estimates.

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

Table 4. Status of Performance Criteria and Structural Benchmarks under the PRGF and EFF Arrangements

	Test Date	Status as of May 20, 2007
I. Performance Criteria		
1. <i>Prepare and approve by the Minister of Finance an action plan to review the role of the Tax Police, including a description of the measures that will be taken to implement IMF technical assistance recommendations in this area (as specified in the FAD report "Albania-Challenges to Reforming Tax Administration" of June 2005, page. 63)".</i>	End-March 2007	Met
II. Structural Benchmarks		
A. Improve public expenditure management		
2. Safeguard the efficient use of nonconcessional		
(i) Conduct an independent feasibility study for any large project (as defined in the TMU) financed through non-concessional commercial borrowing;	Ongoing	Met
(ii) Provide a semestrial listing and status report on all projects being considered for nonconcessional foreign financing.	Ongoing	Met
B. Reduce fiscal vulnerabilities		
Strengthen tax administration		
3. Improve VAT administration by preparing and providing to the Fund quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected (within one month of the end of each quarter).	Ongoing	Met
4. Prepare and issue quarterly reports on progress made in the actual use of the risk assessment module of the ASYCUDA system to perform inspections in the customs.	Ongoing	Met
Improve debt management capacity		
5. <i>Conduct an independent review of staffing requirements in the debt management unit of the Treasury and Public Debt Management Directorate, including a review of the conditions (e.g., competitive salary) necessary to recruit people with the</i>	End-June 2007	Met
6. Prepare semi-annual reports (within one month of the end of each semester) on the stock of external arrears.	Ongoing	Met
C. Strengthen the financial system and improve economic monitoring capability		
7. Establish a credit bureau within the Bank of Albania.	End-December 2007	On track

Table 5a. Albania: General Government Operations, 2003–12
(In percent of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
				Prel.	Projections					
Total revenue and grants	24.5	24.1	24.4	25.2	25.9	26.4	26.7	27.0	26.9	26.9
Tax revenue	21.3	21.7	22.0	22.9	23.7	24.3	24.8	25.2	25.2	25.2
VAT	7.4	7.6	7.7	8.3	8.8	8.9	9.0	9.0	8.9	8.9
Profit tax	1.9	2.1	2.3	2.5	2.3	2.5	2.5	2.7	2.7	2.7
Excise tax 1/	1.8	2.1	2.2	2.6	3.1	3.5	3.6	3.8	3.9	3.9
Small business tax	0.4	0.5	0.5	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Personal income tax 2/	0.9	0.9	0.9	1.0	1.3	1.3	1.4	1.4	1.5	1.5
Customs duties	2.0	1.8	1.6	1.6	1.2	0.7	0.5	0.4	0.3	0.2
Other taxes	1.8	1.6	1.5	1.5	1.6	1.7	1.7	1.8	1.8	1.8
Property and local taxes	0.7	0.7	0.9	1.0	1.1	1.1	1.1	1.1	1.1	1.2
Social insurance contributions	4.2	4.3	4.3	4.4	4.1	4.5	4.7	4.7	4.7	4.8
Non-tax revenue	2.8	2.1	1.7	1.8	1.8	1.7	1.6	1.5	1.5	1.5
Grants	0.4	0.3	0.7	0.5	0.4	0.4	0.3	0.2	0.2	0.2
Of which: budget support	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	29.0	29.2	28.0	28.5	29.8	30.3	30.3	30.4	30.1	30.0
Current expenditure	24.6	24.0	23.2	22.9	23.8	23.4	23.4	23.2	23.0	22.8
Personnel cost 2/	6.6	6.4	6.4	6.3	6.5	6.3	6.3	6.1	6.1	6.1
Of which: contingency	...	...	...	...	0.4	...	...	...	...	...
Interest	4.4	3.7	3.1	2.8	3.0	3.0	3.0	2.9	2.9	2.9
Of which: Domestic	4.1	3.5	2.9	2.6	2.5	2.5	2.4	2.3	2.3	2.3
Operations & maintenance	3.2	3.1	2.9	2.9	2.4	2.6	2.7	2.9	2.9	2.8
Subsidies	0.7	0.7	0.4	0.4	0.3	0.3	0.2	0.2	0.2	0.2
Social insurance outlays	6.6	6.6	6.7	6.7	7.2	7.1	7.1	6.9	6.9	6.9
Of which: contingency	...	...	...	...	0.1	...	...	...	...	...
Local government expenditure	2.1	2.1	2.4	2.5	2.5	2.6	2.6	2.6	2.6	2.6
Social protection transfers	1.3	1.5	1.2	1.2	1.4	1.5	1.5	1.5	1.4	1.3
Other 3/	-0.3	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure 4/	4.6	5.0	4.6	5.6	5.9	6.5	6.7	7.1	7.0	7.0
Domestically financed	2.7	3.6	2.9	4.3	4.4	4.7	4.7	5.2	5.1	5.3
Of which: contingency	...	...	...	...	0.3	0.6	0.7	0.8	0.7	0.6
Foreign financed projects	1.9	1.4	1.7	1.4	1.5	1.8	2.0	1.9	1.9	1.7
Capital transfer to KESH	...	...	...	...	0.5	...	...	...	...	...
Lending minus repayment	-0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 5/	...	...	...	0.0	0.2	0.5	0.2	0.2	0.1	0.1
Cash balance	-4.5	-5.1	-3.6	-3.2	-3.9	-3.9	-3.6	-3.4	-3.2	-3.0
Current balance including grants 6/	-0.1	0.1	1.2	2.4	2.0	2.8	3.2	3.8	3.9	4.0
Financing	4.5	5.1	3.6	3.2	3.9	3.9	3.6	3.4	3.2	3.0
Domestic	3.1	4.2	2.8	2.6	3.2	2.8	2.5	2.5	2.5	2.4
Privatization receipts 7/	0.1	1.9	0.1	0.2	1.1	0.4	0.2	0.2	0.2	0.1
Net borrowing	2.9	2.3	2.7	2.3	2.0	2.3	2.3	2.3	2.3	2.3
Foreign	1.5	1.0	0.8	0.6	0.8	1.1	1.1	0.9	0.7	0.6
Memorandum Items:										
Primary balance	-0.2	-1.4	-0.5	-0.4	-1.0	-0.9	-0.6	-0.6	-0.3	-0.2
Current balance excluding grants	-0.5	-0.2	0.5	1.9	1.6	2.4	2.9	3.5	3.7	3.8
Total spending contingencies 5/	...	...	...	...	0.9	1.1	0.8	0.9	0.8	0.8
Expenditures in priority sectors 8	7.3	8.2	8.0	9.1	9.3	9.6	10.1	10.1	10.1	10.1
Public Debt 9/	61.7	56.6	56.7	55.7	54.4	53.4	52.3	51.1	49.8	48.4
Domestic general government	41.1	38.5	39.1	38.9	37.5	36.5	35.6	34.7	33.9	33.1
External	20.6	18.0	17.6	16.8	16.9	16.8	16.7	16.4	15.9	15.3
GDP (in billions of leks)	683	766	837	896	980	1075	1181	1296	1425	1568

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

1/ Includes the impact of 2 billion increase in excises in 2007

2/ Includes the impact of introducing a 10 percent flat PIT rate from July 1, 2007, and compensating low income public employees.

3/ Includes statistical discrepancy.

4/ Excludes capital transfer to KESH in 2007.

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

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

7/ Includes privatization of Italian-Albanian Bank in 2006 and projected privatizations of Albtelekom in 2007 and INSIG in 2008.

8/ Education, health, and road sectors.

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

Table 5b. Albania: General Government Operations, 2003–12
(In billions of leks)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
				Prel.	Projections					
Total revenue and grants	167.2	184.6	204.2	226.3	253.8	284.1	315.6	349.8	384.0	422.3
Tax revenue	145.3	166.0	183.8	205.5	232.7	261.7	292.7	326.6	358.6	394.8
VAT	50.6	58.2	64.5	74.3	86.5	96.2	106.2	116.7	126.4	139.6
Profit tax	13.1	16.3	19.2	22.3	22.9	26.6	30.1	34.4	37.8	41.7
Excise tax 1/	12.3	15.8	18.5	23.0	30.7	37.4	43.0	49.5	56.1	61.4
Small business tax	2.9	4.1	3.8	2.6	1.6	1.8	2.1	2.4	2.7	2.9
Personal income tax 2/	6.4	6.9	7.4	8.6	12.7	14.3	16.3	18.8	21.7	24.0
Customs duties	13.9	13.9	13.6	14.0	11.4	7.8	6.1	5.7	4.9	3.7
Other taxes	12.5	12.1	12.7	13.0	16.0	18.0	19.9	22.9	25.2	28.7
Property and local taxes	4.5	5.0	7.5	9.3	10.4	11.7	13.1	14.8	16.2	18.1
Social insurance contributions	28.6	33.3	36.2	39.3	40.7	47.8	56.0	61.5	67.6	74.7
Non-tax revenue	19.2	16.0	14.2	16.0	17.4	18.5	19.2	20.0	22.0	24.2
Grants	2.6	2.6	6.2	4.8	3.7	3.9	3.7	3.2	3.4	3.4
Of which: budget support	0.2	0.2	0.4	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	198.1	223.8	234.2	255.2	292.4	326.1	358.0	394.2	429.6	469.6
Current expenditure	167.7	183.8	194.0	204.9	233.2	251.2	276.7	300.2	327.6	357.9
Personnel cost 2/	44.7	49.0	53.7	56.7	63.6	67.8	74.1	79.6	87.2	95.1
Of which: contingency	...	...	...	...	3.5	...	...	...	...	...
Interest	29.8	28.4	26.0	25.0	29.0	32.4	35.0	37.2	40.8	44.9
Of which: domestic	28.2	26.7	24.2	23.0	24.9	27.4	28.5	29.4	32.3	35.6
Operations & maintenance	22.2	24.0	24.5	25.8	23.3	27.5	32.1	37.4	41.1	44.2
Subsidies	5.1	5.1	3.7	3.8	2.6	2.7	2.8	2.9	3.2	3.5
Social insurance outlays	44.8	50.2	55.9	60.0	70.4	76.8	83.9	89.4	98.0	107.5
Of which: contingency	...	...	...	...	0.6	...	...	...	...	...
Local government expenditure	14.2	15.9	20.0	22.7	24.6	27.5	30.5	34.0	37.4	41.3
Social protection transfers	8.8	11.5	10.2	10.8	14.2	16.1	17.9	19.3	19.3	20.8
Property compensation	...	...	...	0.0	0.5	0.5	0.5	0.5	0.5	0.6
Other 3/	-2.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure 4/	31.5	38.6	38.4	50.4	57.5	69.4	79.2	92.0	100.0	109.7
Domestically financed	18.3	27.6	24.3	38.2	42.7	50.1	55.7	66.8	72.8	83.0
Of which: contingency	...	...	...	...	3.0	6.0	8.0	10.0	10.0	10.0
Foreign financed projects	13.2	11.0	14.1	12.1	14.8	19.3	23.5	25.1	27.2	26.7
Capital transfer to KESH	...	...	...	...	5.0	...	...	...	...	...
Lending minus repayment	-1.1	1.4	1.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 5/	...	...	...	...	1.7	5.6	2.0	2.0	2.0	2.0
Cash balance	-30.9	-39.2	-30.1	-28.9	-38.6	-42.0	-42.4	-44.3	-45.6	-47.3
Current balance including grants 6/	-0.6	0.7	10.2	21.4	19.8	30.1	37.9	48.6	55.4	63.4
Financing	30.9	39.2	30.1	28.9	38.6	42.0	42.4	44.3	45.6	47.3
Domestic	20.9	31.9	23.3	23.5	31.0	29.8	30.0	32.1	35.1	38.4
Privatization receipts 7/	0.9	14.4	0.9	2.0	10.9	4.6	2.4	2.3	2.3	2.3
Net borrowing	20.0	17.6	22.4	20.7	20.1	25.2	27.6	29.8	32.8	36.1
Foreign	10.0	7.3	6.8	5.4	7.6	12.2	12.4	12.2	10.5	9.0
Memorandum Items:										
Primary balance	-1.1	-10.8	-4.0	-3.9	-9.6	-9.6	-7.4	-7.2	-4.8	-2.4
Current balance excluding grants	-3.2	-1.9	4.0	16.6	16.1	26.2	34.2	45.4	52.0	60.0
Total spending contingencies 5/	...	...	...	...	8.8	11.6	10.0	12.0	12.0	12.0
Expenditures in priority sectors 8/	50.1	62.6	66.7	81.9	91.5	102.9	118.8	130.5	143.4	157.8
Public Debt 9/	421.4	433.4	474.4	499.7	533.2	573.6	618.0	663.0	709.5	758.4
Domestic general government	280.8	295.2	327.4	348.9	367.7	392.9	420.5	450.3	483.0	519.1
External	140.6	138.2	147.1	150.7	165.5	180.8	197.5	212.8	226.4	239.3

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

1/ Includes 2 billion increase in excises in 2007.

2/ Includes the impact of introducing a 10 percent flat PIT rate from July 1, 2007, and compensating low income public employees.

3/ Includes statistical discrepancy.

4/ Excludes capital transfer to KESH in 2007.

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

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

7/ Includes privatization of Italian-Albanian Bank in 2006 and projected privatizations of Albtelekom in 2007 and INSIG in 2008.

8/ Education, health, and road sectors.

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

Table 6. Albania: IMF Core Indicators of Financial Soundness, December 2003-February 2007

	Dec-03	Dec-04	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Feb-07
I Capital-based											
(i) Regulatory capital as a percent of risk-weighted assets	28.5	21.6	21.0	19.8	18.3	18.6	19.3	18.4	18.3	18.1	na
(ii) Regulatory Tier 1 capital as a percent of risk-weighted assets	29.0	21.5	20.4	19.3	17.9	18.1	18.9	17.4	17.2	17.1	na
(iii) Capital as a percent of total assets											
Regulatory Tier 1 capital as a percent of total assets	4.8	4.8	5.0	5.2	5.1	5.4	5.8	5.7	5.9	5.9	6.3
Regulatory capital as a percent of total assets	4.7	4.8	5.1	5.3	5.3	5.6	5.9	6.0	6.3	6.2	6.7
Shareholders' equity as a percent of total assets	5.9	6.1	5.8	6.4	6.6	6.6	6.5	6.7	7.0	6.8	7.0
(iv) Nonperforming loans net of provisions as a percent of capital											
Nonperforming loans net of provisions as a percent of regulatory Tier 1 capital	4.8	4.8	4.5	3.0	4.1	4.4	6.2	9.5	7.7	7.2	6.7
Nonperforming loans net of provisions as a percent of regulatory capital	4.9	4.8	4.4	2.9	4.0	4.3	6.1	8.9	7.2	6.8	6.3
Nonperforming loans net of provisions as a percent of shareholders' equity	3.9	3.8	3.9	2.4	3.2	3.6	5.6	8.1	6.5	6.3	6.1
(v) Return on equity (ROE) (annual basis)	19.5	21.1	22.1	24.3	24.5	22.2	21.4	18.8	19.2	20.2	20.5
(vi) Net open position in foreign exchange as a percent of capital											
Net open position in foreign exchange as a percent of regulatory Tier 1 capital	7.2	7.5	3.6	8.7	7.3	9.5	6.7	0.1	6.4	5.5	3.7
Net open position in foreign exchange as a percent of regulatory capital	7.3	7.4	3.5	8.5	7.1	9.3	6.6	0.1	6.0	5.2	3.5
Net open position in foreign exchange as a percent of shareholders' equity	5.9	5.9	3.1	7.0	5.7	7.8	6.0	0.1	5.4	4.8	3.4
II Asset-based											
(vii) Liquid assets as a percent of total assets (Liquid-asset ratio)	73.6	71.1	70.3	67.1	65.3	62.6	62.1	60.0	58.7	57.6	57.3
(viii) Liquid assets as a percent of short-term liabilities	na	na	83.2	109.9	73.5	75.2	75.5	75.6	74.5	69.5	75.7
(ix) Return on assets (ROA) (net income to average total assets) (annual basis)	1.2	1.3	1.3	1.5	1.5	1.4	1.4	1.2	1.3	1.4	1.4
(x) Nonperforming loans (gross) as a percent of total loans	4.6	4.2	3.5	2.4	2.4	2.3	3.0	3.8	3.3	3.1	3.1
(xi) Sectoral distribution of loans to total loans	na	na	na	na	na	na	na	na	na	na	na
III Income and expense-based											
(xii) Interest margin to gross income	89.6	80.3	83.2	80.5	82.0	84.0	93.4	98.5	95.6	92.6	92.1
(xiii) Noninterest expenses to gross income	57.4	66.2	81.5	75.3	76.7	76.3	71.4	72.9	68.5	65.7	60.1
IV Memorandum items											
Other (noncore) indicators:											
Customer deposits as a percent of total (non-interbank) loans	652.1	535.8	498.3	417.8	384.8	342.5	326.6	296.6	286.7	265.5	261.5
Foreign currency-denominated loans to total loans	82.1	80.5	79.9	77.7	77.6	75.5	74.5	72.5	71.1	71.9	72.1
Foreign currency-denominated liabilities as a percent of total liabilities	35.9	37.0	38.2	39.9	41.5	41.0	41.0	41.6	43.1	44.0	45.0
Other indicators:											
Risk weighted assets as a percent of total assets	16.7	22.2	24.4	26.8	28.7	30.0	30.8	32.8	34.4	34.6	na
Total loans as a percent of total assets	13.6	16.4	17.6	20.8	22.8	25.7	26.5	28.9	30.4	31.7	32.3
Total loans as a percent of shareholders' equity	231.2	270.3	302.6	326.5	348.7	387.0	408.7	434.4	432.5	469.5	464.1

Source: Data provided by Bank of Albania.

1/ Risk-weighted assets are calculated for banks only on a quarterly basis. Consequently, the value of item I (i) Regulatory capital as a percent of risk-weighted assets; and item I (ii) Regulatory Tier 1 capital as a percent of risk-weighted assets are not available for February 2007.

**Table 7. Albania: Measures to Strengthen the Banking System
Supervisory/Regulatory Regime**

I. To improve credit risk management

1. Stricter requirements are placed on individual banks based on their (i) rate of credit growth; and (ii) non performing loan level. The individual bank bears the responsibility of monitoring continuously these indicators and reporting them to the BoA. As soon as problems are identified in maintaining these figures within certain levels, banks, according to the gravity of the situation and in a need-based approach, will be required on their own to:

(a) Strengthen monitoring processes. Additional monthly reporting to the BoA will be required to identify problem loans according to their characteristics (nature, maturity, currency, sector, geography).

(b) Slow their rate of credit provision by (i) adjusting interest rates and revising credit growth objectives; (ii) reducing internal guidelines for acceptable levels of customers' debt service to available income ratios to below 25 percent—especially for consumer loans; (iii) reduce internal guidelines for credit to collateral value ratios; and (iv) suspend promotional advertisements in the media.

(c) Weight with a 150 percent risk factor, the greater of (i) the value of credit that exceeds the prudential requirements for single exposures, individually or in total; (ii) the value of nonperforming loans that exceeds the new ceiling level set by BoA; or (iii) the value of the loan portfolio that has increased above the limit set up by the BoA (either in absolute terms or as a ratio of loans to deposit).

(d) Increase their capital, or take other measures to achieve a higher minimum level of capital adequacy ratio.

(e) Initiate cost-cutting measures, including by suspending dividends and further expansion of branch networks.

(f) Set up an additional reserve fund from profit within the following six months.

2. The Supervision Department will have the authority to impose any of the measures mentioned above when they judge that the bank has delayed the required action or implemented them with insufficient rigor. If this is necessary, penalty measures will be automatic. If the BoA judges that such measures are not working, they will then have the authority to suspend all or part of the credit operations of the bank; or introduce credit ceilings for individual banks.

II. To improve transparency

3. The new regulations also contain requirements concerning the transparency the bank should have with its clients, particularly as regards the contracting of credit (e.g. warn the borrower about the risks entailed in foreign currency-denominated lending, calculate and indicate the effective interest rate of the loan etc).

III. To strengthen regulations governing lending to related persons

4. The aggregate prudential limit on lending by individual banks to related persons will be reduced if the bank is found to have insufficient systems in place to monitor related

Source: Bank of Albania.

Table 8. Albania: External Financing Requirement and Sources, 2003–2012
(In millions of Euros)

	2003	2004	2005	2006 Est.	2007	2008	2009	2010	2011	2012
	Projections									
Current account (incl. official transfers)	261	235	437	426	585	561	568	568	595	616
Amortization	34	40	43	72	75	105	119	145	156	162
Of which : IMF	8	8	7	9	11	11	10	9	9	9
Change in gross reserves (increase = +)1/	-10	191	77	197	129	122	95	142	129	150
Reduction in arrears	-3	12	17	7	64	0	0	0	0	0
Total financing requirement	282	477	574	702	853	788	782	857	880	928
Available financing	282	478	577	703	788	788	783	856	880	928
Foreign direct investment	158	277	224	259	408	422	462	515	567	640
Other capital	42	-13	41	109	160	149	129	148	121	99
Official medium- and long-term loans	101	100	98	116	152	161	177	189	188	188
Multilateral (excluding IMF)	75	72	73	82	88	79	90	109	115	114
Bilateral	26	28	26	35	64	82	87	80	73	75
IMF disbursements	10	10	9	6	6	6	3	0	0	0
Other 2/	-44	76	185	184	55	40	0	0	0	0
Debt rescheduling	0	12	17	7	0	0	0	0	0	0
Budget support	17	15	3	9	0	0	0	0	0	0
Identified financing	0	0	0	13	8	11	11	4	4	0
Of which : WB FSAC/PRSC/EU	...	...	0	13	8	11	11	4	4	0
Financing gap	0	0	0	0	64	0	0	0	0	0
Expected EU macro-financial assistance	...	...	0	0	0	0	0	0		
Debt rescheduling (mostly clearance of bilateral arr	...	...	0	0	64	0	0	0	0	0
Other	...	...	0	0	0	0	0	0	0	0

Sources: Ministry of Finance, Bank of Albania, donors, and Fund staff estimates.

1/ The change in gross reserves is net of valuation changes for 2005–2006. In projections for 2007–2010, valuation effects are assumed to be zero.

2/ Includes errors and omissions.

Table 9. Albania: Schedule of Remaining Disbursements Under PRGF/EFF Arrangement

Date	Amounts in millions of SDRs	In percent of quota 1/	Conditions
July 2007	2.435	5.0	Observance of end-March 2007 quantitative performance criteria, structural performance criteria, and completion of third review.
January 2008	2.435	5.0	Observance of end-September 2007 quantitative performance criteria, structural performance criteria and completion of fourth review.
July 2008	2.435	5.0	Observance of end-March 2008 quantitative performance criteria, structural performance criteria and completion of fifth review.
January 2009	2.435	5.0	Observance of end-September 2008 quantitative performance criteria, structural performance criteria and completion of sixth review.
Total	9.740	20.0	

1/ Albania's quota is SDR 48.7 million.

Table 10. Albania: External Debt Sustainability Framework, Baseline Scenario, 1996-2026 1/
(In percent of GDP, unless otherwise indicated)

	Actual										Projections							
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2015	2020	2026
External debt (nominal) 1/	28.6	40.1	34.3	31.2	31.7	28.5	25.3	22.2	20.4	20.5	19.8	19.9	19.8	19.7	19.1	16.5	16.5	17.6
Of which: public and publicly guaranteed (PPG) 2/	28.6	40.1	34.3	31.2	31.6	28.4	25.2	22.0	19.2	18.7	18.1	17.9	17.9	17.6	17.0	14.1	12.3	12.0
Of which: private	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.3	1.2	1.8	1.6	2.0	1.9	2.1	2.1	2.4	4.2	5.6
Change in external debt	-0.9	11.4	-5.7	-3.1	0.5	-3.1	-3.2	-3.1	-1.9	0.1	-0.7	0.1	-0.1	-0.2	-0.5	-0.1	0.1	0.3
Identified net debt-creating flows	-1.3	14.5	-6.6	-12.0	-6.5	-5.5	3.5	0.7	-2.9	2.1	2.1	1.9	1.1	0.5	-0.3	-0.9	-1.6	-1.3
Non-interest current account deficit	7.8	12.8	6.0	1.4	6.3	6.2	9.5	7.4	5.3	7.3	6.7	8.0	6.9	6.2	5.6	4.5	3.2	3.1
Deficit in balance of goods and services	24.1	26.6	24.6	18.6	21.6	22.8	25.9	25.1	21.7	24.0	24.0	25.1	23.5	22.6	21.6	18.9	16.8	15.8
Exports	10.7	10.0	10.6	17.3	19.0	18.4	20.5	20.8	21.5	22.2	25.0	26.2	26.6	26.7	27.1	29.4	31.1	31.4
Imports	34.8	36.6	35.2	35.8	40.6	41.2	46.3	45.9	43.2	46.2	49.1	51.3	50.1	49.3	48.6	48.3	48.0	47.2
Net current transfers (negative = inflow)	-14.1	-11.4	-16.1	-9.5	-12.1	-13.2	-13.0	-14.2	-13.7	-14.4	-14.1	-13.8	-13.6	-13.4	-13.2	-12.0	-11.2	-10.3
Other current account flows (negative = net inflow)	-2.2	-2.3	-2.5	-7.6	-3.2	-3.4	-3.3	-3.5	-2.7	-2.3	-3.3	-3.3	-3.0	-2.9	-2.8	-2.3	-2.4	-2.4
Net FDI (negative = inflow)	-3.2	-1.9	-1.6	-1.5	-3.9	-5.0	-3.0	-3.2	-4.6	-3.3	-3.5	-5.2	-4.9	-4.9	-5.0	-5.0	-4.6	-4.2
Official transfers (negative = inflow)	-2.6	-3.5	-3.3	-4.1	-3.0	-3.0	-2.8	-2.6	-1.7	-1.2	-1.4	-1.2	-1.1	-1.0	-0.9	-0.4	-0.2	-0.2
Endogenous debt dynamics 3/	-3.3	7.1	-7.7	-7.9	-5.9	-3.8	-0.2	-1.0	-3.6	-1.9	-1.0	-0.9	-0.9	-0.8	-0.9	-0.5	-0.3	-0.3
Contribution from nominal interest rate	0.4	0.6	0.6	0.4	0.3	0.3	0.4	0.4	0.3	0.4	0.5	0.7	0.7	0.8	0.8	0.8	0.9	1.1
Contribution from real GDP growth	-2.3	3.6	-4.0	-2.6	-1.8	-2.0	-0.9	-1.4	-1.1	-1.0	-0.9	-1.1	-1.1	-1.1	-1.1	-1.0	-1.0	-1.0
Contribution from price and exchange rate changes	-1.4	2.9	-4.2	-5.6	-4.3	-2.1	0.3	0.0	-2.8	-1.2	-0.6	-0.5	-0.5	-0.5	-0.6	-0.3	-0.3	-0.3
Residual 4/	0.4	-3.0	0.8	8.9	6.9	2.4	-6.7	-3.8	2.7	-0.8	-1.5	-0.5	0.0	0.4	0.7	1.2	1.9	1.8
Of which: exceptional financing	-0.2	-0.2	-0.2	-0.3	-0.1	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external debt 5/	7.8	13.7	8.8	4.9	2.4	-2.4	-6.7	-5.8	-7.6	-7.7	-8.9	-6.6	-5.9	-5.1	-6.2	-7.5	-9.1	-9.9
Of which: public sector	19.3	25.8	21.0	17.2	14.9	11.5	6.5	5.6	2.4	1.1	0.5	0.7	0.4	0.1	-0.8	-3.1	-6.0	-7.5
Of which: private sector	-11.5	-12.1	-12.2	-12.3	-12.5	-14.0	-13.2	-11.5	-10.0	-8.8	-9.0	-7.0	-5.9	-5.0	-5.2	-4.4	-2.9	-2.0
NPV of external debt 6/	...	...	...	...	...	...	...	...	...	16.4	16.2	16.3	16.1	16.2	16.2	16.0	16.0	17.0
In percent of exports	...	...	...	...	...	...	...	...	...	75.1	64.1	62.6	61.5	61.7	60.4	51.8	50.9	52.5
NPV of PPG external debt	...	...	...	...	...	...	...	...	...	14.7	14.2	14.3	14.2	14.3	14.2	12.7	11.3	10.6
In percent of exports	...	...	...	...	...	...	...	...	...	67.0	56.4	54.4	53.1	53.2	52.2	42.9	36.1	33.4
Debt service-to-exports ratio (in percent)	8.1	12.8	8.9	4.2	4.1	4.4	6.8	5.3	4.5	4.5	6.1	6.1	7.4	7.7	8.3	7.4	8.0	8.9
PPG debt service-to-exports ratio (in percent)	8.1	12.8	8.9	4.2	4.0	4.0	6.0	4.9	4.1	4.1	5.1	5.5	5.8	5.9	6.1	5.6	4.9	4.6
Total gross financing need (billions of Euros)	0.1	0.2	0.1	0.0	0.2	0.1	0.3	0.1	0.2	0.4	0.3	0.4	0.5	0.5	0.5	0.6	0.9	1.5
Non-interest current account deficit that stabilizes debt ratio	8.7	1.4	11.7	4.5	5.9	9.4	12.7	10.5	7.2	7.2	7.4	7.8	7.0	6.4	6.1	4.7	3.2	2.8
Key macroeconomic assumptions																		
Real GDP growth (in percent)	9.1	-10.3	12.7	10.1	7.3	7.2	3.4	6.0	5.9	5.5	5.0	6.0	6.0	6.1	6.1	6.3	6.3	6.3
GDP deflator in terms of Euros (change in percent)	4.9	-9.1	11.6	19.7	16.1	7.2	-1.2	-0.2	14.3	6.3	3.2	2.6	2.8	2.7	3.2	1.9	1.9	1.9
Effective interest rate (percent) 6/	1.7	1.7	1.7	1.5	1.2	1.2	1.6	1.8	1.6	2.0	2.9	3.8	4.1	4.3	4.5	5.3	6.1	6.6
Growth of exports of G&S (in terms of Euros, in percent)	10.3	-23.7	32.8	114.7	37.0	11.4	13.8	7.2	25.4	15.8	21.9	13.5	10.9	9.5	10.4	9.7	8.7	8.2
Growth of imports of G&S (in terms of Euros, in percent)	29.3	-14.2	20.9	34.1	41.1	16.8	14.8	4.7	14.1	19.8	14.8	13.4	6.7	7.1	7.6	8.2	7.7	7.8
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	...	...	22.3	19.8	21.0	10.2	10.2	7.1	5.8	5.9	6.1
Memorandum item:																		
Nominal GDP (billions of Euros)	2.4	1.9	2.4	3.2	4.0	4.6	4.7	5.0	6.0	6.7	7.3	7.9	8.6	9.4	10.3	15.4	22.6	35.9
Averages and Standard Deviations																		
	Historical								Standard				Average				Average	
	Average								Deviation				2006-11				2012-26	
Real GDP growth (in percent)	5.7								6.2				5.9				6.3	
GDP deflator in terms of Euros (change in percent)	7.0								8.8				2.7				1.9	
Effective interest rate (percent) 7/	1.6								0.2				4.1				5.9	
Growth of exports of G&S (in terms of Euros, in percent)	24.5								35.8				12.8				9.1	
Growth of imports of G&S (in terms of Euros, in percent)	18.2								15.5				9.7				7.9	
Grant element of new public sector borrowing (in percent)	...								...				12.3				5.9	
Non-interest current account deficit	7.0								2.9				6.4				3.8	
Net current transfers (negative = inflow)	-13.2								1.8				-13.5				-11.4	
Net FDI (negative = inflow)	-3.1								1.2				-4.8				-4.7	

Source: Staff simulations.

1/ Includes both public and private sector external debt.

2/ Includes IMF.

3/ Derived as $[r - g - r(1+g)] / (1+g+r+gr)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in terms of Euros.

4/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

5/ Defined as the stock of debt less international reserves of the banking system. Net debt of the public sector is defined as PPG external debt minus GIR of the Bank of Albania, and net debt of the private sector is estimated as private external debt minus foreign assets of commercial banks.

6/ Assumes that NPV of private sector debt is equivalent to its face value.

7/ Current-year interest payments divided by previous period debt stock.

Table 11. Albania: Actual and Projected Payments to the Fund, 2003–10
(in millions of SDRs)

	2003	2004	2005	2006	2007	2008	2009	2010
	Projections							
Obligations from existing drawings								
1. Principal								
PRGF repayments	6.8	6.4	6.2	7.6	6.7	9.6	9.1	8.0
GRA repurchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2
2. Charges and Interest 1/								
PRGF Interest	0.3	0.3	0.3	0.4	0.28	0.23	0.18	0.14
GRA and SDR Net Charges	0.0	0.0	0.0	0.00	0.15	0.20	0.20	0.20
Total obligations	7.1	6.7	6.5	8.0	7.1	10.1	9.5	8.5
(percent of quota)	15	14	13	16	15	21	19	17.4
Cumulative obligations (existing and prospective)								
1. Principal								
PRGF +EFF repayments	6.8	6.4	6.2	7.6	6.7	9.6	9.1	8.2
2. Charges and Interest 1/								
PRGF Interest	0.3	0.3	0.3	0.4	0.3	0.2	0.2	0.2
GRA and SDR net charges	0.0	0.0	0.0	0.0	0.2	0.4	0.5	0.5
Total obligations	7.1	6.7	6.5	8.0	7.2	10.2	9.7	8.8
(Percent of quota)	15	14	13	16	15	21	20	18
Outstanding Fund credit 2/	60.8	62.4	64.3	61.5	57.0	52.3	45.6	37.5
o/w projected under the current arrangements	...	...	...	...	4.9	4.9	2.4	...
Breakdown of Fund credit								
Extended Arrangements	...	...	...	2.4	4.9	7.3	8.5	8.4
PRGF Arrangements	60.8	62.4	64.3	59.1	52.1	45.0	37.1	29.1
Memorandum items:								
Outstanding Fund credit								
<i>In percent of:</i>								
Exports of goods & services	7.0	5.5	5.2	3.8	3.2	2.6	2.1	1.5
GDP	1.5	1.2	1.2	1.0	0.8	0.7	0.6	0.4
Quota	125	128	132	126	117	107	94	77
Total obligations								
<i>In percent of:</i>								
Exports of goods & services	0.9	0.6	0.5	0.5	0.4	0.5	0.4	0.4
GDP	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1

1/ Projections are based on current interest rates for PRGF and the EFF. The current SDR interest rate is assumed for net use of SDRs.

2/ End of year value.

ANNEX I: FUND RELATIONS

As of April 30, 2007

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

II. General Resources Account:	<u>SDR Million</u>	<u>Percent Quota</u>
Quota	48.70	100.00
Fund Holdings of Currency	49.00	100.62
Reserve position in Fund	3.35	6.89
III. SDR Department:	<u>SDR Million</u>	<u>Percent Allocation</u>
Holdings	5.74	N/A
IV. Outstanding Purchases and Loans:	<u>SDR Million</u>	<u>Percent Quota</u>
Extended Arrangement	3.65	7.50
PRGF arrangements	57.60	118.27

V. Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
EFF	2/01/2006	1/31/2009	8.52	3.65
PRGF	2/01/2006	1/31/2009	8.52	3.65
PRGF	6/21/2002	11/20/2005	28.00	28.00

VI. Projected Payments to the Fund (Expectation Basis)

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

	<u>Forthcoming</u>				
	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Principal	6.69	9.62	9.08	8.05	7.64
Charges/Interest	0.43	0.43	0.38	0.34	0.28
Total	7.11	10.05	9.46	8.38	7.92

VII. Safeguards Assessments:

The Bank of Albania (BoA) was subject to a safeguards assessment with respect to current arrangements. The most recent assessment was completed on July 14, 2006 and found that some weaknesses exist in the central bank's safeguards framework. The main vulnerabilities identified by the assessment concern the quality of the external audit, oversight of the external and internal audit functions and the system of internal controls, and certain weaknesses in the controls over the Fund data reporting process. The assessment recommended measures to alleviate these weaknesses. The authorities have already taken steps to improve the external audit process, and staff will monitor their implementation of the remaining recommendations.

VIII. Exchange Rate Arrangement:

On July 1, 1992 the Albanian authorities adopted a floating exchange rate system (an independent float). Under the Fund's de facto exchange rate regime classification, Albania follows an independently floating exchange rate regime—although the monetary authorities occasionally intervene in the foreign exchange market with the objective of smoothing temporary fluctuations. Albania's exchange rate arrangement is free from exchange restrictions and multiple currency practices subject to Fund jurisdiction under Article VIII. However, the country still avails itself of the transitional arrangements under Article XIV and maintains exchange restrictions in the form of outstanding debit balances on inoperative bilateral payment agreements, which were in place before Albania became a Fund member. These relate primarily to debt in nonconvertible and formerly nonconvertible currencies, which the authorities expect to resolve by end-2007. Albania has not imposed new restrictions under Article VIII. The exchange rate stood at 92.91 lek per U.S. dollar at end-April 30, 2007.

IX. Article IV Consultation:

The conclusion of the 2006 Article IV consultation and the first review under the PRGF/EFF-supported program took place in July 2006 (IMF Country Report No. 06/286). Albania moved from a 12-month cycle to a 24-month cycle, in line with the decision on consultation cycles approved on July 15, 2002. The last Article XIV Consultation was concluded in December 2005.

X. FSAP Participation and ROSCs:

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

XI. Technical Assistance:

The Fund, other multilateral organizations and donors have provided extensive assistance for institutional development in Albania. The Fund alone has sent several technical assistance missions to Albania every year since 1991. However, further institutional development is required in virtually every sector.

IX. RESIDENT REPRESENTATIVE:

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

ANNEX II: IMF-WORLD BANK RELATIONS

Partnership in Albania's development strategy

1. The Republic of Albania has been a member of the World Bank since 1991. Since then, the WBG has provided strong support to Albania, including 63 loans mostly in IDA commitments totaling US\$924.1 million, IFC commitments of US\$125 million, and MIGA guarantees totaling US\$8.6 million. The quality of the active portfolio has continued to improve, with an increasing focus on long-term capacity development and implementation through Government structures.

2. The World Bank's Board approved the Country Assistance Strategy (CAS) for Albania for FY06–FY09 in January 2006. The CAS builds on the experience of the World Bank Group (WBG) since the early 1990s (through three CASs).¹ The CAS presents a program of support which seeks to build on the improved macro-economic management and progress in structural reforms that has occurred since 2002. It aims to support Albania's National Strategy for Social and Economic Development (NSSD) and the European Union (EU) Stabilization and Association process (SAP) with the ultimate objective of EU integration and the attainment of the Millennium Development Goals (MDGs).

3. The government is currently finalizing the new National Strategy for Development and Integration (expected for October 2007) and is committed to better address the link between the strategic planning process, the Medium Term Budget Program (MTBP) and the annual budget in the context of newly established Integrated Planning System (IPS). The IPS aims to allow the Government of Albania (GoA) to prioritize its expenditures based on a national strategy that focuses on the European Integration agenda. A government executed multi-donor trust fund (MDTF) has been established with financing from various donors in order to ensure increased and transparent linkage between NSDI objectives and government policy and budget allocations and expenditures

Bank Group strategy

4. Reflecting Government priorities, the CAS (2006–09) program seeks to support Albania's efforts in strengthening governance, sustaining a private sector-led growth and improving service delivery. The new CAS recognizes that more coherent efforts need to be made to address the challenge of poor governance in Albania, and introduces a 'Governance Filter' comprising of four core principles which will be used to ensure that governance considerations are mainstreamed into all of the Bank's interventions. The CAS program is also more selective, focused on two pillars:

¹ The 'Bank' refers to the IBRD and IDA and the 'World Bank Group' generally refer to the Bank, IFC, FIAS, and MIGA.

- (I) ***Continued Economic Growth through Support to Private Sector Development***, with expected outcomes including (a) macroeconomic stability; (b) improved business climate through better quality of business regulations and improved public-private sector dialogue; (c) improved public infrastructure; (d) increased operational efficiency of financial institutions; (e) improved functioning of the land market; (f) improved corporate governance; (g) increased transparency and efficiency in the management of public spending and stronger institutions for planning, tendering and providing infrastructure and services; (h) better accountability in public administration; and (i) better management and planning for Albanian coastal resources.
- (II) ***Improving Public Service Delivery, particularly in the Social Sectors***, with expected outcomes including: (a) improved educational attainment and quality of basic education; (b) improved efficiency and equity of health financing; (c) better quality of health care; (d) improved fiscal sustainability of the social insurance system and increased access to well-targeted, sustainable, and effective assistance; and (e) improved access to safe rural water supply and sanitation.

5. The CAS proposes a lending range of US\$ 75–\$196 million, with actual lending to be determined by the pace of reform in key sectors. The proposed lending program is financed by a blend of IDA and IBRD resources, with gradual transition from IDA to IBRD beginning in FY06. Up to 11 new IDA/IBRD lending operations are proposed in FY06–FY09, of which three would be a series of programmatic Development Policy Operations (DPO) building on the success of the PRSC series in the previous CAS. The CAS employs also targeted program of WBG Analytical and Advisory Activities (AAA) support.

6. The active World Bank portfolio includes 18 investment projects with a total commitment of \$291.5 million, of which about \$255.3 million remain to be disbursed. The investment side of the Bank's portfolio has performed well. Three projects were approved by the Board in 2006: (i) Albania Avian Flu (June, 27); (ii) BERIS (October, 26); (iii) Education Excellence and Equity Project (June 1). Two new projects have been approved in February 2007, the Transport Project and the Land Administration and Management Project. The first Development Policy Operation (DPO1) is expected to be approved on March 29, 2007.

Bank-Fund collaboration in specific areas

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

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

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

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

Power sector reform: While the Bank has taken the lead in developing the policy agenda, the sector's fiscal impact has also motivated conditionality in previous IMF-PRGF arrangements. Since mid-2006, KESH's financial situation has deteriorated significantly as a result of the following factors: (a) severe shortage in electricity supply in the region which led to a significant rise in import electricity prices, (b) unfavorable hydrology since late 2006; (c) a sub-optimal management of hydro resources in the last quarter of 2006; and (d) poor performance of the utility as indicated by declining collection ratios and increased losses. The Bank and the Fund confirmed their support to the Government's efforts to overcome the ongoing crisis and are working with the authorities to prepare, and agree on, a set of measures to improve the performance in the power sector to avoid potential negative implications on growth and macroeconomic stability.

11. Conditionality related to improving sector performance, sector restructuring, and strengthening the regulatory and legislative framework is included in successive Bank-financed projects. On-going projects include the Power Sector Rehabilitation and Restructuring Project (2002) that covers rehabilitation of the distribution network in three regions; the Power Sector Generation and Restructuring Project (2004) that will provide new thermal generation capacity and is co-financed by EBRD and EIB; and the ECSEE APL2-Albania Project (2005) that is co-financed by EBRD and will finance the upgrading of the high-voltage transmission substations, thereby facilitating Albania's participation in the Energy Community of South East Europe (ECSEE). The authorities have recently completed a long-delayed tender for a new thermal power station.

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

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

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

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

16. **Improving the business environment.** A weak business environment plagued with considerable administrative barriers, weak governance, corruption, ambiguities in property and land rights, poor quality and high cost of infrastructure and utilities, is undermining future growth prospects and job creation. Improving the business environment will be crucial to overcome high levels of unemployment, attract the badly needed investment flows, and boost exports. Complementing the IMF dialogue on macro-economic stability and its technical and advisory assistance to strengthening tax administration, the Bank is using a combination of instruments, namely the Business Environment Reform and Institutional Strengthening Project (approved in October 2006) and the Land Management and Urban Development project (approved in February 2007) in conjunction with the DPO to support improvements in the business climate, through (i) the adoption and implementation of regulatory governance rules and tools aimed at improving the quality of business-sector related regulations, (ii) establishment and operations of a Secretariat for Regulatory Reforms for the removal of administrative barriers to investment; and, (iii) adoption and implementation of a transparent land registration system.

Prepared by World Bank staff. Questions may be addressed to Ms. Alia Moubayed at 473-0250.
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ANNEX III: STATISTICAL ISSUES

Data provision is adequate overall for surveillance, although further improvements in some areas are needed. Albania was a pilot country for the data dissemination module of the Report on the Observance of Standards and Codes (ROSC), and a data ROSC was published on the IMF's external website in May 2000.¹ Albania participates in the General Data Dissemination System (GDDS) and metadata for the external, financial, fiscal, and real sectors, as well as socio-demographic indicators were initially posted on the Fund's Dissemination Standards Bulletin Board (DSBB) in May 2000 and last updated in January 2007. Plans for improving data compilation and dissemination across all statistical sectors are also posted on the DSBB.

A data ROSC reassessment mission took place during March 8–22, 2006. The mission assessed data quality in six areas of macroeconomic statistics (national accounts, consumer price index, producer price index, government finance, monetary, and balance of payments statistics) based on the DQAF (July 2003), and reassessed data dissemination practices against the GDDS. At the request of the authorities, the mission also conducted an assessment of dissemination practices against the SDDS and prepared a work program and timetable for meeting the requirements for SDDS subscription. The data ROSC report was published on the IMF's external website in October 2006.

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

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

A. Real Sector

Price statistics

STA has provided considerable technical assistance on price statistics. The consumer price index (CPI) is reported regularly for publication in the *International Financial Statistics (IFS)*. In 2001, a revision of CPI weights was initiated by INSTAT based on a new household budget survey; the

¹ This data ROSC was completed before the formal adoption of the Data Quality Assessment Framework.

revised index was finalized in February 2002. The compilation of the CPI generally follows international standards, and the estimation of imputed rent within the CPI was improved in 2003. However, given the limited coverage of the 2000 household budget survey (HBS) (only urban areas combined with a rapid change of the structure of the economy and consumption pattern), new CPI weights should be compiled. The recent ROSC mission recommended (i) introduction of checks on the prices reported by enumerators; (ii) replacement of nonrespondents to the HBS with similar households; and (iii) inclusion of new items in the CPI as they become significant.

A monthly producer price index (PPI) has been published quarterly since March 2002. Prices are collected for each month, but only once a quarter, due to financial constraints. The weights were derived from the 1998 annual Structural Business Survey. The ROSC mission recommended (i) monthly publication of the PPI; (ii) replacement of enterprises that go out of business; and (iii) validation of the PPI results against other available price data.

National accounts

National accounts are compiled from numerous but insufficient source data that are hampered by poor questionnaire design (e.g., Structural Business Survey), limited area coverage (e.g., HBS), and insufficient frequency of surveys. While technical assistance has been provided on methodological procedures, source data still do not provide sufficient information to compile reliable estimates on the nonobserved economy. In November 2005, INSTAT released major revisions of the GDP estimates (for 1996–2003) and updates for 2004, reflecting methodological improvements.

The ROSC reassessment mission recommended (i) improvement of source data to adequately capture the nonobserved economy; (ii) expansion of the scope of annual national accounts to include the income account, the capital account, and the rest of the world accounts; and (iii) improvement of the timeliness of GDP data (currently 11 months) so as to meet the 9-month recommendation of the GDDS. INSTAT needs additional staff and financial resources to fully carry out its statistical work program.

STA missions visited Albania in November 2004 and March 2005 to assist the authorities in improving the timeliness of the annual estimates and in developing quarterly national accounts. INSTAT has benefited from technical assistance from the Fund and the European Union (EU), mainly to address weaknesses in methodology, basic data sources, and incomplete coverage of the private sector. STA concluded a technical assistance project in March 2006 for which the Italian government agreed to commit \$500,000 from its sub-account with the IMF over a period of two years. The project was aimed at further improving the national accounts estimates and basic source data. The Italian National Institute of Statistics (Istat) and the National Statistics Office of Finland (Statistics Finland) provided technical assistance to INSTAT following the project contract. In addition, STA will post shortly an advisor that will provide further technical assistance to Albania and Macedonia through peripatetic missions during 2007–2008.

External trade

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

B. Government Finance

Government finance statistics (GFS) generally follow internationally accepted standards and guidelines on concepts and definitions, scope, classification and sectorization, and basis for recording vis-à-vis the *Government Finance Statistics Manual 1986 (GFSM 1986)*. A formal “migration path” to the *GFSM 2001* has not been articulated, but a series of coordinated technical actions at the MoF—including the design and implementation of an accrual-compatible database infrastructure—are well advanced. The scope of the general government sector is in line with the *GFSM 1986* and encompasses budgetary central government, (about 1520 individual budget institutions), local government (about 2160 units), and two extrabudgetary funds (the social security fund and the health insurance fund).

The *Organic Budget Law* and the *Guidelines on State Budget Performance* clearly provide the MoF with a mandate to compile and disseminate government finance statistics. The main data sources, which are timely, are reports of (i) District Treasury Offices; (ii) the Debt Management and Financial Analysis System; (iii) project implementation units for foreign financed projects; and (iv) the extrabudgetary funds. External donor financed-projects that do not pass through the treasury system, represent a weakness in source data. Since 2005, Albania has submitted fiscal data to the Fund for publication in the *Government Finance Statistics Yearbook*. Following the ROSC mission’s recommendation that MoF accelerate work aimed at formally adopting the *GFSM 2001*-based reporting format and improve source data coverage for external donor-financed projects, the authorities have recently begun reporting quarterly fiscal data for publication in the *International Financial Statistics* using the *GFSM 2001*-based monthly Statement of Sources and Uses of Cash.

C. Monetary Accounts

The monetary data compilation framework conforms to the methodology recommended in the *Monetary and Financial Statistics Manual (MFSM)*, and data are compiled and disseminated on a timely basis. The depository corporations’ survey covers the BoA and all the other deposit-taking institutions (17 commercial banks and 130 savings and loans associations (SLAs)). The accounts of the SLAs, with the exception of loans, are produced on a cash basis, which contrasts with the *MFSM*’s recommendations of accrual accounting. The accounts of the BoA and of the commercial banks are produced on an accrual basis. An exception is that their holdings of nontradable long-term securities are recorded at book value.

In January 2005, the BoA reported its monetary data to STA using Standardized Report Forms (SRFs). The monetary data in the SRFs format have been published in the quarterly *IFS*

Supplement since September 2006. The reporting of monetary data in the SRFs format will facilitate the implementation of an integrated monetary database to be used for both publication in *IFS* and for operational needs of EUR.

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

D. Balance of Payments

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

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

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

The mission also discussed SDDS-related issues, including data requirements of the Data Template on International Reserves and Foreign Currency Liquidity (Template), and determined that data on official reserve assets is, in principle, consistent with that of the Template, although adequate data on other foreign currency assets and currency drains are not yet included.

E. External Debt and Grant Statistics

Good quality external debt statistics for public and publicly-guaranteed debt are compiled by the MoF. The external debt database, developed with technical assistance from UNCTAD, became fully operational in mid-2000. The external debt database ensures timely and accurate reporting of external government debt (including commitments of state-owned enterprises). However, there have been some irregularities in the recording and presentation of old external arrears. The External Debt Committee would need to improve inter-agency coordination to ensure the timely and accurate reporting of the stock of external arrears and changes resulting from rescheduling agreements. The collection of data on external grants is not timely, with lags of several months frequently encountered. In consultation with donors, the authorities are preparing a new framework to improve data collection and reporting, to be led by the MoF.

ALBANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
AS OF MAY 31, 2007

	Date of latest observation	Date received	Frequency of data ⁶	Frequency of reporting ⁶	Frequency of publication ⁶	Memo Items:	
						Data Quality – Methodological Soundness ⁷	Data Quality – Accuracy and Reliability ⁸
Exchange Rates	05/29/07	05/29/07	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	04/30/07	03/22/07	M	M	M		
Reserve/Base Money	05/22/07	05/25/07	D and M	D and M	M and M	O, O, O, LO	O, LO, LO, O, O
Broad Money	04/30/07	03/22/07	M	M	M		
Central Bank Balance Sheet	05/22/07	05/25/07	D and M	D and M	M and M		
Consolidated Balance Sheet of the Banking System	04/30/07	03/22/07	M	M	M		
Interest Rates ²	02/22/07	02/22/07	D	D	D		
Consumer Price Index	04/2007	05/17/07	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	04/2007	05/2007	M	M	M	LO, O, O, O	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	04/2007	05/2007	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	03//31/07	04/25/07	Q	Q	A		
External Current Account Balance	12/31/06	2/16/07	Q	I	I	O, O, O, LO	LNO, O, LO, LO, O
Exports and Imports of Goods and Services	12/31/06	2/16/07	M	Q	Q		
GDP/GNP	2005	01/2007	A	A	A	O, LNO, O, LNO	LNO, O, LNO, LO, LO
Gross External Debt	12/2006	04/2007	Q	I	NA		

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

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

³ Foreign, domestic bank, and domestic nonbank financing.

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

⁵ Including currency and maturity composition.

⁶ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

⁷ 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).

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

ATTACHMENT I

Tirana, June 19, 2007

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

For over 10 years, IMF assistance has been instrumental in promoting macroeconomic stability and economic growth, as well as improving governance in Albania.

The current Fund-supported program, approved in January 2006, is on track. All quantitative and structural performance criteria have been observed and economic prospects remain favorable, both from the near- and medium-term perspectives. We consequently maintain our expectation that our need for the Fund's resources will end with the expiration of this program in 2009.

On this basis, we request completion of the third review under the three-year Poverty Reduction and Growth Facility arrangement together with concurrent approval of the third review under the three-year Extended Fund Facility arrangement; and also request the fourth disbursement under both these arrangements in a total amount of SDR 2.435 million.

We believe that the policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP) are adequate to achieve the objectives of the program, but will take any further measures that may become appropriate for this purpose. Albania will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

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

to the publication of this letter, the attached MEFP, and the accompanying Executive Board documents on the IMF's website.

Sincerely yours,

/s/

Sali Berisha
Prime Minister

/s/

Ridvan Bode
Minister of Finance

/s/

Ardian Fullani
Governor, Bank of Albania

Memorandum on Economic and Financial Policies (MEFP) for Albania

I. BACKGROUND

1. This memorandum lays out the broad thrust of our policies over the second half of the 2006-2009 program period, and provides a detailed description of our policy intentions up to the middle of 2008. It is fully consistent with our new National Strategy for Development and Integration (NSDI) for 2007-13—currently in draft form with finalization expected by end-October 2007. The new NSDI is being formulated within the comprehensive Integrated Planning System introduced in 2005 and is benefiting from the ongoing intensive consultation with stakeholders that began in March of this year.

II. ECONOMIC DEVELOPMENTS

2. **Macroeconomic developments are unfolding favorably, and broadly as envisioned at the time of the last review.** Growth is accelerating and inflation remains low. The energy shortages that became apparent at end-2006 have for now eased, and a broad-based and rapid export recovery and vibrant construction and service sectors are poised to raise growth to 6 percent in 2007. The current account deficit is likely to widen reflecting strong import demand, but inflation is still expected to remain within the Bank of Albania's (BoA) 3 ± 1 percent target range.

3. **However, downside risks—primarily to price stability but also to growth—have increased.** Our baseline projections have not changed, but ensuring that macroeconomic objectives remain on track now requires an increasingly cautious and prudent approach to policy formulation.

- The main risk comes from the weakened financial position of our public electricity utility, KESH, where poor collection performance and a sharp increase in the import price of electricity have reduced cash flow and net worth.
- Additional risk may arise from a slight slowdown of domestic revenue collection in early 2007.
- Strong credit growth has the potential to accelerate inflationary pressures, especially if positive expectations of the fiscal outturn are not maintained.

4. **We have made considerable progress in structural reform since the time of the last review.**

- **Tax administration**—We prepared and approved an action plan to review the role of the Tax Police, including a description of the measures that will be taken to implement IMF technical assistance recommendations in this area (PC; end-March 2007). We continued to prepare and issue quarterly reports on progress made in the actual use of the risk

assessment model of the ASYCUDA system to perform inspections in the customs; and on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected (both SB; ongoing). We have already made some progress in reallocating part of the Tax Police Staff (which was reduced from 350 to 262 in 2006) to more productive tax administration activities such as audit and enforcement.

- **We made significant advances in debt management since the time of the last review.** We continued the process of lengthening domestic debt maturity, raising average maturity of government securities held outside the BoA from 284 days at end-2006 to 327 days at end May 2007. To better coordinate cash and debt management functions, we developed weekly cash forecasts on the basis of cash needs of line ministries; and the Ministry of Finance and the Bank of Albania are now holding regular meetings twice a month to coordinate debt management and monetary policy. An independent review of staffing requirements was conducted by the World Bank in the debt management unit (DMU) of the Treasury and Public Debt Management General Directorate (TPDMD), including a review of the conditions necessary to recruit people with the appropriate skills (SB; end-June 2007); and we completed a functional review of public debt management. In accordance with our existing program commitments, we continued to: safeguard the use of nonconcessional project loans by conducting independent feasibility studies for all large projects financed in this manner; provide the Fund with a semestrial listing and status report of all projects being considered for nonconcessional foreign financing; and prepare timely semi-annual reports on the stock of external arrears; (all SB; ongoing).
- **We also made progress in improving our public financial management.** A new organic budget law has been prepared and will be submitted to Parliament soon. This proposed legislation aims to establish a comprehensive budget process, covering both regular budget organizations and special (extrabudgetary) funds, at both the central and local government level, and to strengthen the role of the Medium Term Budget Program (MTBP) in the annual budget preparation process. We also significantly strengthened the capacity of the new public investment unit of the Ministry of Finance to select public investment projects, including by approving procedures for public investment management; and began training line ministries on how to use such procedures, which will include the obligation for line ministries to submit a cost-benefit analysis for their investment projects. Our capacity to execute capital spending is improving—we have introduced and are currently carrying out a mid-year budgetary review of investment projects aimed at redirecting investment allocations to sectors that show higher implementation capacity. We also strengthened coordination between the selection of public investment projects and the Medium Term Budget Program (MTBP), and between the MTBP and the annual budget process by using annual expenditure ceilings for line ministries established under the MTBP as basis for annual budget allocations.

- **In the financial sector** we passed amendments to the civil code to improve the legal framework and process for banks to execute collateral; and made further progress towards the goal of establishing a credit registry in the BoA by end-December 2007 (SB). The development of an electronic delivery-versus-payment (DVP) system for government securities is also proceeding and could also be completed by end-year, resources permitting. We also eliminated the two-day lag previously needed to publish the treasury bill auction results on the Ministry of Finance web site.
- **With respect to financial sector supervision**—Implementation of new BoA prudential regulations to safeguard lending became effecting in December 2006. As at the first test date of March 31, 2007, seven banks were directly impacted by the measures governing credit growth and experienced lower capital adequacy indicators. Should such banks maintain similar credit growth rates, they will have to raise capital shortly in order to comply with minimum level of Capital Adequacy ratio, required by BoA. We continued to improve both our on-site and off-site supervisory capacity, and to improve communications with commercial banks, including through arranging continuous meetings with their management structures, sharing information regarding stress-test analysis, and by maintaining an open dialogue for the discussion and full understanding of changing prudential regulation. Cross-border cooperation in supervision has improved significantly. We have finalized memorandums of understanding (MoUs) with the supervisory authorities in Greece, Bulgaria, FYR of Macedonia, Montenegro, Turkey, and Kosovo. We are exchanging information with these authorities and with some have also organized joint on-site examination and ad-hoc meetings. Although we do not have formal MoUs with Financial Market Authorities in Austria and Banca d'Italia, we are nonetheless cooperating with them through exchanges of information on cross-border banking investments and through joint on-site examinations and ad-hoc meetings. In the nonbank area, our supervisory capacity has increased, but from a low base, while developments in market structure have been rapid. We expect a substantial portion of the insurance industry to soon be under the control of reputable foreign companies—two local companies have already been sold, while finalization of the sale of another two is expected soon.
- **We took steps to improve our business environment.** We reformed the business registration process, set up the National Registration Center which—with assistance from the US Millennium Challenge account—will establish a one-stop shop for business registration by the end of September 2007. We are also intensifying work to reduce barriers in the licensing system and have reduced the legal timeline for business registration from 30 to 8 days—and will reduce it further to one day by September 2007. We moved ahead with our Regulatory Reform Task Force. The institutional framework to monitor these reforms has been set up; and we are moving ahead on steps to develop the regulatory management system, improve the existing legal and regulatory frameworks, and introduce systematic monitoring and evaluation of reforms. Our legal

environment has improved. Parliamentary passage in late 2006 of a new procurement law and a new concessions law will both serve to improve the transparency and competitiveness of the bidding process; while we expect the passage in late 2006 of the law on the business advisory council and the law on chambers of commerce and industry to significantly improve the dialogue between government and the business community. To promote SMEs, we secured additional donor funds for the financing of micro credits and small loans; and we established a small fund to promote further SME development—the Competitiveness Fund is capitalized with about US\$250,000 and has a mandate to promote the increased competitiveness of SMEs. We also created the AlbInvest agency to assume responsibility for the implementation of government policies with respect to SMEs, exports, and foreign direct investment.

- **We have taken significant steps to further liberalize trade.** On December 1 2006, Albania implemented the Interim Agreement for Free Trade with the EU. Under this agreement, customs duties for a large range of industrial and consumer products have been eliminated on imports from the EU. Duties on remaining products imported from the EU were reduced by 20 percent on December 2006 and by another 20 percent in January 2007. Duties on agricultural products imported from the EU have also been reduced or eliminated in accordance with the Annexes of the Agreement. As a result, the overall weighted effective tariff rate, based on trade flows, is expected to decline to less than 4 percent in 2007 from above 7 percent in 2005. We expect further reduction in the overall weighted effective tariff rate once a total of four signatories to the Central Europe Free Trade Agreement join us in ratification—which will allow the agreement to enter into force—and from the upcoming free trade agreement with Turkey, which we are in the process of finalizing
- **Our negotiations for the sale of Albtelecom are expected to be finalized within June 2007.** The winner of the original tender is expected to agree to address all the concerns raised in the independent review of the process and the sale is expected to be concluded within this year. The renegotiation is expected to lead to a number of improvements in the contract, including the buyer meeting the strategic investor criterion.

III. STRATEGY, OBJECTIVES, AND POLICIES

5. **We remain committed to the medium-term strategy outlined in our previous LOI/MEFP of January 11, 2007.** This strategy is designed to maintain macroeconomic and financial sector stability. At the same time, it addresses the institutional and infrastructure deficiencies—and the resulting lack of nonprice competitiveness—that may hinder the continuation of rapid private sector-led growth.

- **Given the flexibility present in our economy, particularly in the labor market, the proper management of expectations is key to macroeconomic stability.** We will therefore continue our existing policy of limiting unexpected fiscal variability, through

strict adherence to our medium-term fiscal framework. We expect in this way to maintain market confidence, imbue development spending with greater stability and predictability, and further consolidate our fiscal and debt positions. With the fiscal stance largely predetermined, monetary policy will remain our main instrument for dealing with short-term threats to price stability. Our reluctance to employ fiscal policy for countercyclical operations is also related to the lack of timely savings and investment data.

- **This policy framework reflects our belief that a small, but increasingly efficient, government is the most effective means of promoting our economic development.** Reform efforts will therefore be concentrated in reducing key vulnerabilities; improving efficiency of core activities; and, wherever possible, offloading noncore functions to the private sector. We anticipate that a successful implementation of our reform program will substantially improve the attractiveness of Albania as a destination for foreign investment.
- **Financial sector stability will be promoted through a continued refinement of our regulatory and supervisory reforms.** So far in 2007, the tightened supervisory and regulatory regime put in place in January appears to have resulted in higher capitalization of banks and heightened provisioning against risk. However, credit growth remains rapid, as the majority of banks, when faced with a choice of raising provisions or slowing lending, managed to secured additional capital. Further regulatory and supervisory tightening is therefore in order. Strengthening nonbank financial sector supervision is also an important goal which we will pursue vigorously over the program period, with support from the World Bank.
- **Over a longer time horizon, our program will strengthen our institutions, infrastructure, and degree of nonprice competitiveness.** It is designed to encourage a broadening of the export base through wide-ranging reforms to improve the business environment, strengthen governance, and improve the financial sector. We are also pursuing institutional change outside the program in areas impacting the investment climate, including measures to improve the commercial court system and the process of land title registration—with the aim of creating conditions capable of attracting enough foreign and domestic investment to effect a rapid increase of our productive capacity. Consistent with this, we intend to significantly downsize government involvement in non-core areas, primarily by stepping up the pace of privatization, including in the electricity sector. We are also taking decisive action to improve our infrastructure, particularly in the transportation sector.

A. Macroeconomic Framework

6. **The medium-term macroeconomic framework outlined in our LOI/MEFP of January 11, 2007 remains a realistic goal.**

- Economic growth is expected to return to its trend rate of 6 percent in 2007 and beyond, supported by continued strong performance of exports, an acceleration in the growth of services, and by a rise in public investment, including in the road sector.
- We expect inflation to remain within the BoA's target range. Credit growth is now projected to be more rapid than envisaged at the time of the second review. However, when combined with an appropriate monetary policy stance, and supported by a flexible exchange rate regime, we expect it to remain consistent with our price objectives. Ongoing fiscal consolidation—in line with our medium-term framework—will allow a steady improvement in government solvency.
- Public savings will increase over the program period as we improve our revenue administration and reduce the share of current expenditure in total spending—including through lower interest costs resulting from better debt management. We also anticipate a rise in private—mainly corporate—savings beginning in 2008 in response to ongoing structural reform and rapidly rising income levels. With capital goods imports for public investment rising rapidly in the near term, there will be an increase in the current account deficit this year. However, we expect this to be temporary and the deficit will begin to narrow again from 2008.

In recognition of rising risk levels, we are taking additional measures—outlined below—to increase the already-significant degree of protection built into this framework.

B. Fiscal Policy

7. **We remain committed to the 2007 fiscal targets—including program targets—and priorities outlined at the time of the last review.**¹ The 2007 budget, as originally formulated, appropriately and safely balanced the need for ongoing fiscal and debt consolidation with development objectives. With revenues projected to rise as a result of already-observed improvements in tax administration, domestic borrowing of 2½ percent of GDP, and a further decline in debt as a percent of GDP, would both be consistent with increased expenditure on education, health care, and roads. At the same time, the budget was appropriately protected through the use of large budgetary contingencies; by prudent estimates of tax revenue and privatization receipts; and by a policy of not expending the gains from tax administration reforms before their realization. With proven revenue gains allocated almost exclusively to investment and capital maintenance expenditures, full execution would imply that investment spending increases, and that the current surplus remains at a relatively high level.

¹ See MEFP ¶7 in IMF Country Report No. 07/75

8. **We also remain committed to keeping external debt at sustainable levels and to keep the program limit on nonconcessional borrowing unchanged at €680 million.** This is fully consistent with maintaining our transportation strategy unchanged. In this latter regard, we are securing €200-€230mn of external financing for the Rreshen-Kalimash road. However, consistent with our long-standing program agreement, we will reduce our recourse to such borrowing by using half the receipts of any large privatization to reduce our domestic debt stock and the remainder for this road project.

9. **The immediate goal of our policies in the fiscal area is to ensure that the fiscal targets embedded in our 2007 budget and medium-term fiscal framework are preserved in the face of previously-unforeseen risk.** The protections and contingencies built into the budget were adequate for the environment prevalent at the time of approval of the 2007 budget. However, they were calibrated to the risks embodied in the large road investments currently underway, and were not sufficient to cover previously unprogrammed fiscal costs that arose from the deterioration of KESH.

10. **Stabilizing the financial position of KESH is key to containing risks to the budget and maintaining macroeconomic stability.** Poor hydrological conditions are expected to reduce domestic power generation by about 30 percent this year compared to 2006, while import prices for electricity have increased sharply. Despite allowing for limited and well-planned load shedding of power to partly offset the shortfall in production, the cost of necessary electricity imports, which will not exceed 1800 GWhs in 2007, is likely to increase by about 1¼ percentage points of GDP. We are taking actions to reverse the recent deterioration in financial performance of KESH. We have already appointed a new CEO and brought in an Italian management consultancy firm. In consultation with the World Bank, the government has finalized the seventh power sector action plan that includes strong measures to improve efficiency, reduce waste and theft, and raise collection rates through better financial management and technical improvements. Such actions are key to recovery—while collections were effected on only 82.7 percent of the electricity billed to the consumer in 2006, theft and technical loss resulted in this being equivalent to less than 50 percent of the value of the total power supplied to the grid. We will ensure that the past arrears of budgetary and non-budgetary institutions to KESH are fully paid this year and that these institutions henceforth pay power bills in a timely manner. We will also implement an incentives package for key employees in sales and collection to achieve performance targets identified in the action plan. With these and other measures, including taking a stricter position with respect to cutting off service to nonpaying customers, we anticipate that the annual loss rate can be reduced to 35 percent in 2007 (compared to 39.4 percent in 2006). We also expect that the overall collection rate can be raised to 86.8 percent (including collection of arrears from business and household consumers). These improvements are expected to increase revenue collection by about 0.6 percent of GDP. Thus, with strong political support and determined efforts, KESH's financial performance could be improved relatively quickly. However, despite full implementation of the proposed measures, KESH would nonetheless still

require budgetary support of Lek 5 billion (0.5 percent of GDP) including the above mentioned payments for past arrears in 2007.

11. Our aim is to make the power utility self-reliant and to ensure a stable supply of electricity in Albania. In this context, we are committed to the privatization of the distribution arm of KESH as soon as possible, and have already selected IFC as an advisor. We are also committed to eliminating the financial gaps of the power utility in 2008 and beyond, including through higher tariffs, if necessary. We are seeking financing from the World Bank for the technical improvements needed to reduce losses and theft. To ensure a stable supply of electricity we are undertaking a number of initiatives. Construction of a thermal power plant, financed jointly by the World Bank, EIB and EBRD, will start soon and is expected to be completed in 2009.

12. We consider the enactment of additional revenue measures to be necessary in the latter half of 2007. Although revenue for 2007 is expected to be in line with budget targets—even at current policies—we believe additional tax policy measures are needed to cover a significant portion of the necessary fiscal support to KESH, while preserving the capacity of the budget to absorb future unforeseen risks. We expect to raise revenue relative to our original budget by an additional 0.3 percentage points of GDP—of which about two thirds from increasing excise tax rates on fuel and alcohol, and the remainder by increasing the rate of the environment tax on cars. We plan to introduce a 10 percent single personal income tax rate from July 1, 2007. We will take appropriate action to ensure that low income taxpayers are protected against reduction of their available income. At the same time, we will compensate local governments for losses incurred due to this policy change.

13. We are confident that the fiscal measures outlined in this memorandum will be sufficient to fully protect our budget. We intend to enact them in a supplementary budget before the end of July. However, should additional fiscal risks emerge, we stand ready to take appropriate actions needed, in consultation with the Fund, to fully safeguard the budget outcome and medium-term fiscal framework. In particular, performance against the energy sector action plan, aimed at eliminating the need for budget support for KESH in 2008 and setting it on a more sustainable path, will be essential to safeguard the budget.

14. Our tax strategy for 2008 will include further changes in income taxes, but we will maintain a single-rate VAT system and will refrain from reducing the existing VAT rate. In the next budget year, we will align the corporate and personal income tax rates. However, we will design—in consultation with the Fund—and implement compensatory measures to ensure that the change in the corporate income tax rate will not reduce total revenues compared to our medium-term budget framework.

15. Maintaining momentum on revenue administration reform and consolidating gains made to date constitute a cornerstone of our structural agenda. Also as a consequence of

improved tax administration, tax revenues have increased from 22 percent of GDP in 2005 to almost 23 percent of GDP in 2006. In the year ahead, we will continue to concentrate our efforts to direct revenue administration resources towards activities with the highest revenue potential. For this purpose, we will remove all inactive taxpayers from the register of active taxpayers maintained by the General Directorate of Taxation (PC; December 15, 2007). This will help collection efficiency and will avoid resource misallocation by ensuring that the tax administration only concentrates its efforts on active businesses. We will also seek to improve administration of social security contributions. For this purpose, we will develop a comprehensive cross agency campaign aimed at improving compliance in relation to social security contributions, including the appointment of a high level and sufficiently-mandated person to co-ordinate and lead the efforts (SB; end-December 2007); this strategy will be instrumental in increasing the number of taxpayers paying social contributions (excluding contributions paid by agricultural workers and voluntary contributors) to 440,000 by end July 2008 (SB). We will also continue our efforts to further strengthen the Large Taxpayer Office by making it a full service office for all large taxpayers in Albania (SB; end-October 2007). Conditional on technical assistance from the Millennium Challenge Account, we will implement a pilot project on electronic filing aimed at reducing face-to-face interactions between taxpayers and tax administration officers, thus reducing opportunities for corruption. We will introduce strong measures to ensure that the practice of VAT refunds is in line with the law; and will continue to improve VAT administration by preparing and providing to the Fund quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected (within one month of the end of each quarter) (SB; ongoing); and prepare and issue quarterly reports on progress made in the actual use of the risk assessment module of the ASYCUDA system to perform inspections in the customs (SB; ongoing).

16. In debt management, we intend to continue to improve capacity as a matter of priority. Over the remainder of the year, we will expand and restructure the DMU, including by increasing personnel and elevating the unit into a separate General Directorate for Debt Management. We will also begin to revise the debt management strategy annually, starting from September 2007. We will improve further our IT capacity by establishing an integrated management system for external and domestic debt; and will migrate domestic debt into the computerized system. To safeguard existing gains, we will continue to conduct independent feasibility studies for any large project (as defined in the TMU) financed through non-concessional commercial borrowing; provide a semestrial listing and status report on all projects being considered for nonconcessional foreign financing; and prepare semi-annual reports (within one month of the end of each semester) on the stock of external arrears (all SB; ongoing).

17. To further reduce debt-related vulnerabilities, we are developing new forms of government securities. Following the issue of our first foreign currency-denominated treasury bills in December 2006, we are investigating ways and means of tapping the large foreign currency-denominated savings of nonresident Albanians. We anticipate that the improved

maturity structure would reduce rollover risk sufficiently to compensate for the possibility of adverse exchange rate movements.

C. Monetary, Exchange Rate, and Financial Sector Policies

18. **Skillful execution of monetary policy combined with strict adherence to fiscal targets have anchored inflationary expectations at low levels.** Over the last year, the BoA has successfully steered headline inflation back to the midpoint of the target range without causing undue real appreciation or preventing growth from recovering to its potential rate. This significant achievement resulted partly from two policy rate increases—in July and November 2006. However, it was also in large part predicated on the BoA's past policy success which—along with continued adherence to the medium-term fiscal framework—has anchored inflationary expectations at low levels. Combined with the relatively-mild degree of structural—including wage—rigidity in our economy, this now affords us considerable resilience to unexpected shocks.

19. **This resilience notwithstanding, both our vulnerability to price shocks and risks to the inflation outturn are now on the increase.** These stem not only from the difficult financial situation in KESH, but also from a resurgence in credit growth. Our existing monetary framework is experiencing stress as the asset structure of our financial system tilts increasingly towards private credit. This framework—a reserve money program with quantitative targets set in consultation with the Fund and with changes to the repurchase rate as the main policy instrument—has served us well and will be retained along with the flexible exchange rate. However, we recognize that the underlying transmission mechanism operates primarily by controlling the pass through effect on the lek price of traded goods. Changes in the policy rate appear less effective in mitigating the demand effects of rapid credit creation, and as a result we are increasingly vulnerable to demand shocks emanating from this source.

20. **We will consequently remain vigilant and react quickly to any deterioration in inflationary expectations or excessive increase in the rate of credit growth.** Given the level of risk, and for reasons of caution, we have adopted an upward bias with respect to decisions on moving the policy rate. In these circumstances, we believe full transparency to be the best guarantor of inflationary expectations, and so have clearly communicated to the public our readiness to quickly raise the rate in the event price stability is threatened. Consequently, if risks materialize, additional policy action may be required.

21. **Given limitations in the monetary framework, demand shocks due to credit growth may also require measures aimed at reducing the supply of credit.** The strengthening of banking supervision regulations in January of this year have added to the safety of the loan portfolio and prudential indicators remain highly positive. However, they do not appear to have had the hoped-for dampening effect on credit growth—which remains high. If this growth trend does not soon show signs of reversing itself, and we judge that price and financial sector stability objectives are being compromised, we again stand ready to supplement policy rate increases with additional supply-restricting measures. These could include the imposition of higher

provisioning requirements for foreign currency lending to customers that cannot cover their FC exposure with foreign currency income; and higher reserve requirements for foreign currency deposits. While we would prefer the new measures to be limited to additional strengthening of the prudential and regulatory frameworks, we cannot exclude at this point—as a last resort—the imposition of more direct administrative measures. Regardless of the measures chosen, we will continue to consult closely with members of the banking community to ensure that they fully understand the actions taken to safeguard the banking system.

22. We will continue to develop and refine our capacity to oversee the banking system.

The banking system remains solvent liquid and profitable, due in large part to the oversight exercised by our banking supervision department, which now operates at a high level of proficiency. We will maintain such capacity by providing regular training opportunities to our staff, continuously assessing the needs for hiring additional qualified staff, and adjusting the department structure should it be necessary.

23. We will continue to pursue an ambitious structural reform agenda aimed at refining and improving financial sector infrastructure. We will complete the establishment of a credit bureau within the BoA as planned (SB; end 2007); and a delivery versus payment system (DVP) for government securities shortly thereafter. We expect the DVP system will raise volumes in the secondary market for government debt and foster the development of the interbank market—both of which will improve the efficiency of monetary policy and of the overall intermediation process. The treasury bill window at BoA will be maintained until alternate means of ensuring nonbank access to government securities are in place and the necessary steps have been taken to ensure non-bank participants have access to the government debt market on an equitable basis. In a near-term measure to foster additional competition and efficiency in this market, we will allow nonbank foreign and domestic institutional investors full access to primary auctions—on a competitive basis—for all types of government securities beginning on September 30, 2007 (SB).

24. We will protect the existing high level of institutional quality in the financial sector.

To preserve the benefits of a completely privately-owned banking system, we will refrain from creating any public financial institution or from taking an equity stake or from issuing any explicit or implicit government guarantee to any financial institution. We will take no legislative or regulatory action that weakens the independence of the BoA, including the Supervisory Board of the BoA's control over the Bank's budget and its authority to decide on compensation levels. We are also considering how best to develop and set in place the legal and institutional structures necessary to guarantee the BoA an adequate and prudentially- and operationally-sound level of capital on a sustainable basis; and also how to deal with the other important issues raised by IMF technical assistance. We expect these solutions to build on IMF technical advice and to be completed by end-September 2007.

25. In contrast to the situation in the banking sector, nonbank financial sector supervision remains underdeveloped and in need of considerable improvement. While the

unification of the nonbank supervisory agencies under the Financial Supervisory Authority (FSA) provides a sound framework for moving forward, significant work will be needed to effect needed institutional changes and to raise the quality of supervision to acceptable standards. At a basic level, the institutional and legal framework underpinning the FSA does not yet provide the agency with sufficient independence of activity or administrative autonomy—including with respect to salary and staffing levels—needed for it to fully carry out its mandate. In conjunction with the World Bank, we intend to correct this situation as a matter of priority and have already begun upgrading our capacity. Our immediate priorities are to develop a new supervisory strategy and operating procedures (including operations manuals and basic staffing structures); and to carry out an urgent assessment of the health of insurance sector that will identify the necessary corrective actions. Over the longer term we will review all laws and regulations to bring them up to date with international standards, conduct ongoing staff training, and develop appropriate information technology systems. Until an appropriate legal framework is developed in the private pension industry, and until supervisory capacity improves, we will continue to restrict participation in the pension industry to the three companies already licensed. With respect to leasing companies, those incorporated as subsidiaries of resident commercial banks are currently supervised by BoA. For efficiency reasons, we intend to transfer supervisory authority over the remaining leasing companies—as well as over factoring activity—to the BoA, and will submit the necessary legislative to Parliament by end-October 2007 (SB).

D. Other Structural Reforms

26. **In addition to Albtelecom, we are expecting good progress in privatization of other strategic public enterprises in the remainder of 2007.** The significant interest shown by foreign insurance companies in the Albanian insurance sector makes us fairly certain we will be able to sell INSIG this year or next. In the oil sector, we are in the process of selecting a privatization advisor for ARMO and will prepare a privatization plan once this is done. In line with the decision of the Council of Ministers, ARMO's refinery unit will be separated from 36 retail trading posts, and the sale of these retail posts will conform with SME privatization procedures. We will also intensify our efforts to divest the assets of the new company Albpetrol-One, which we recently formed by merging Albpetrol and Servcom. We also intend to offload our remaining minority stake in the mobile telephone company AMC in a timely manner.

27. **We are also taking significant actions to improve our business and investment climate in areas outside the IMF-supported program.** We will continue our efforts under the Regulatory Reform Task Force to ease market entry barriers, to make the regulatory environment, more transparent, predictable, and simple; and to ensure a level playing field for local and foreign business. To support the development of SMEs, we will continue to encourage donor support for micro credits, finalize a SME Medium-Term Strategic Program for 2007–09, and carry out the actions necessary to make our new Competitiveness Fund, Export Guarantee Fund, and AlbInvest Agency fully operational and effective.

E. External Arrears

28. **We are continuing to make good faith efforts to conclude the rescheduling of our arrears on inoperative payment agreements.** We have now cleared all official arrears with Poland and Bulgaria; reconciled the amounts owed to Russia, Serbia and Montenegro and Greece and begun negotiating on terms; and are reconciling remaining arrears with Algeria, Cuba, and Vietnam to conclude the clearance process with official creditors. We have cleared arrears with private creditors in Germany, Italy, Kosovo and Turkey and continue to expect that we will eliminate all remaining external arrears with private and official creditors by end-2007. Once all arrears are cleared, we intend to begin discussions with the Fund with a view to accepting Article VIII.

F. Data Issues

29. **We are undertaking a number of surveys to improve the basis for national accounts and other important data.** The household budget survey—covering about 5,600 households at the national level—is currently underway and we expect the field work to be completed by September 2007. The fieldwork for a labor force survey was carried out in May and June, and preliminary results are expected by December 2007. To strengthen short-term economic indicators, we are improving the coverage, timing and quality of our STS business survey.

G. Program Monitoring

30. The fifth disbursement under the PRGF/EFF-supported program will be based on the end-September 2007 quantitative performance criteria (Table 1 and the TMU); the mid-December 2007 structural performance criteria (Table 2 and the TMU); and completion of the fourth review and financing assurances review. The fourth review under the PRGF and EFF arrangements is expected to be completed no later than February 1, 2008. During the program period, Albania will not impose or intensify restrictions on the making of payments and transfers for current international transactions; or introduce multiple currency practices, or conclude bilateral payments agreements inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments reasons.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets, December 2006-December 2007 1/

	End-December			End-March			End-June	End-September	End-December
	Est.	2006	Prog. (Adj.)	Actual	2007	Prog. (Adj.)	2007	2007	2007
					Prog.		Prog.	Prog.	Prog.
(In billions of lek)									
Ceiling on net domestic credit to the government 2/	13	24	26	2	8	8	16	22.0	25.1
Ceiling on accumulation of net domestic assets of the BOA 3/	-4	10	11	-6	12	12	12	16.6	23.5
Indicative total tax revenue target 4/	197	188	188	48	45	45	97	155.0	221.0
(In millions of US dollars)									
Floor on accumulation of net international reserves of the BOA 3/	223	96	84	200	71	71	91	-24.9	28.6
(In millions of Euros)									
Ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt with original maturities of more than one year	45	70	70	68	180	180	380	380.0	380.0
Ceiling on public and publicly-guaranteed external debt with original maturities up to and including 1 year 5/	0	0	0	0	0	0	0	0.0	0.0
Ceiling on accumulation of new external payments arrears, excluding interest on pre-existing arrears 5/	0	0	0	0	0	0	0	0.0	0.0

1/ The performance criteria and indicative targets outlined in this table, and their adjusters, are defined in the Technical Memorandum of Understanding (TMU). Targets are defined as cumulative changes from end-2005 except where marked. Data for end-March 2007 are performance criteria, except where marked. Data for end-September 2007 are proposed performance criteria, except where marked. Data for end-December 2006, end-June 2007 and end-December 2007 are indicative targets.

2/ Cumulative change within the calendar year.

3/ For end-December 2006, end-March 2007, and end-June 2007, cumulative change from end-December 2005. For end-September 2007 and end-December 2007, cumulative change from end-December 2006.

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

5/ Applies on a continuous basis.

Table 2. Proposed Structural Performance Criteria and Structural Benchmarks for Third Review of PRGF and EFF Arrangements

	Proposed Test Date
I. Performance Criteria	
1. <i>Remove all inactive taxpayers from the register of active taxpayers maintained by the General Directorate of Taxation</i>	Mid-December, 2007
II. Structural Benchmarks	
A. Improve public expenditure management	
2. Safeguard the efficient use of nonconcessional foreign project loans:	
(i) Conduct an independent feasibility study for any large project (as defined in the TMU) financed through non-concessional commercial borrowing;	Ongoing
(ii) Provide a semestrial listing and status report on all projects being considered for nonconcessional foreign financing.	Ongoing
B. Reduce fiscal vulnerabilities	
Strengthen tax administration	
3. Improve VAT administration by preparing and providing to the Fund quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected (within one month of the end of each quarter).	Ongoing
4. Prepare and issue quarterly reports on progress made in the actual use of the risk assessment module of the ASYCUDA system to perform inspections in the customs.	Ongoing
5. <i>Make the Large Taxpayer Office (LTO) a full service office for all large taxpayers in Albania.</i>	End-October 2007
6. <i>Develop a comprehensive cross agency campaign aimed at improving compliance in relation to social security contributions, including appointing a sufficiently-mandated person to coordinate the efforts.</i>	End-December 2007
7. <i>Increase the number of taxpayers paying social security contributions (excluding agricultural workers and voluntary contributors) to 440 thousands.</i>	End-July 2008
Improve debt management capacity	
8. Prepare semi-annual reports (within one month of the end of each semester) on the stock of external arrears.	Ongoing
C. Strengthen the financial system and improve economic monitoring capability	
9. <i>Allow nonbank foreign and domestic institutional investors full access to primary auctions — on a competitive basis — for all government securities.</i>	End-September 2007
10. <i>Submit the necessary legislation to Parliament for transferring supervisory authority over the remaining leasing companies to the Bank of Albania.</i>	End-October 2007
11. Complete the establishment of a credit bureau within the Bank of Albania.	End-December 2007

1/ Text in italics refers to new conditionality not carried over from the second review under the program (IMF Country Report No. 07/75).

ATTACHMENT II

ALBANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the quantitative performance criteria, benchmarks and indicative targets established in the Memorandum of Economic and Financial Policies (MEFP) up until end-December 2007; and associated reporting requirements.

A. Net Domestic Credit to the Government

1. For the purposes of the program, the **government** includes the State Budget, the Social Security Institute (SSI), the Health Insurance Institute (HII), and the accounts of all entities (including special purpose vehicles) that are used to operate or manage public-private partnership (PPP) projects.

2. **Net domestic credit to the government** (NCG) is defined as gross domestic credit in lek and in foreign currency extended to the government (as defined above) by the banking system, savings and loan institutions (SLIs), and other domestic lenders;¹ less the sum of government financial assets held in the banking system and in the SLIs.

3. The following definitions apply to **gross domestic credit to the government**:

- (i) Gross domestic credit in lek and in foreign currency extended to the government includes: (a) securities (including treasury bills and bonds) issued by the government and held by the Bank of Albania (BoA), deposit money banks (DMBs), SLIs, and other domestic lenders; (b) loans and advances extended to the government by BoA, DMBs, SLIs, and other domestic lenders; (c) negative balances in government deposits with BoA, DMBs and SLIs; (d) any securities or debt instrument of any kind issued by government (as defined above) to the Bank of Albania to compensate the Bank of Albania for its net valuation losses on its assets and liabilities in, or denominated in, gold, special drawing rights or foreign currencies, and which the Bank of Albania keeps in its (off-balance sheet) Valuation Reserve Securities Account of the Bank of Albania, as required in Article 64 of the Law on the Bank of Albania (No. 8269, dated December 12, 1997)²; and (e) any other form of financial obligation of the government the

¹ Other domestic lenders comprise firms, nonbank institutions, and households, or any other resident legal or natural person, or institution.

² This was equivalent to Lek 12.164 billion at end-December 2006.

issuance of which resulted in borrowing funds by the government or a payment for an existing payment obligation of the government.

- (ii) Gross domestic credit in lek and in foreign currency extended to the government excludes (a) the onlending of foreign project loans to all parts of government; and (b) advances on profit transfers by the BoA. The value of the stock of gross domestic credit to government will also exclude the claims held by the units of government as defined above (in particular, the SSI and the HII).
- (iii) The stock of gross domestic credit extended to the government and held by the BoA and DMBs in the form of treasury bills will be valued at issue price. The stock of gross domestic credit extended to the government and held by the BoA in the form of other securities and direct loans to government will be valued excluding accrued interest. The stock of gross domestic credit extended to the government and held by the DMBs in the form of variable and fixed income securities (excluding treasury bills) will be valued at face value. The stock of all gross domestic credit extended to the government and held by SLIs and other domestic lenders will be valued at face value³.
- (iv) For the purposes of program monitoring, gross domestic credit to the government in foreign currency will be converted from Lek to SDRs at the end-of period Lek/SDR exchange rate prevailing on the test date; and then converted to Lek at the program Lek/SDR exchange rate of Lek 141.5/SDR.

4. The following definitions apply to **government financial assets held in the banking system and in the SLIs**:

- (i) Government financial assets held at the Bank of Albania include: (a) transferable deposits in domestic and foreign currency; (b) lek deposits held in BoA for projects; and (c) standard gold deposits of the government. For the purposes of program monitoring, standard gold deposits will be valued at the program price of gold (SDR 421.7 per ounce)⁴.

³ Under current reporting standards, the following data is only available at face value: (i) the stock of gross domestic credit extended to the government and held by the DMBs in the form of fixed and variable income securities; and (ii) the stock of all gross domestic credit extended to the government and held by the SLIs and other domestic lenders.

⁴ The lek value of standard gold deposits will be (a) converted to US dollars using the current end-of-period lek/US dollar exchange rate; (b) then converted to ounces of gold using the current US dollar market price of gold; (c) then converted to SDRs at the program price of gold (SDR

(continued)

- (ii) Government financial assets held at the Bank of Albania exclude: (a) foreign currency deposits related to foreign financed projects; and (b) deposits serving as the counterpart for non-standard gold and other precious metals owned by the government.
- (iii) Government financial assets held at the DMBs include: (a) all deposits of government in domestic and foreign currency; and (b) payable amounts owed by the DMB to government.
- (iv) Government financial assets held at the SLIs include all deposits of government held at the SLIs.

5. For the purposes of program monitoring, government financial assets in foreign currency will be converted from Lek to SDRs at the end-of period Lek/SDR exchange rate prevailing on the test date; and then converted to Lek at the program Lek/SDR exchange rate of Lek 141.5/SDR.

6. Under these definitions, the stock of net domestic credit to the government was Lek 329.5 billion at end-December 2006. The breakdown of the categories of net domestic credit to the government as defined above is given in Attachment Table 1.

7. The limits on the change in net domestic credit to the government will be cumulative within each calendar year.

B. Net Domestic Assets

8. The stock of **net domestic assets (NDA) of the Bank of Albania** is defined as reserve money—defined as the sum of currency issue (less lek notes and coins held by the Bank of Albania) and commercial bank reserves held at the BoA—less the net international reserves of the Bank of Albania (Section C). For program monitoring purposes, all foreign currency assets and liabilities making up NIR will be valued in local currency at the exchange rates of end-December 2006. Under this definition, the level of NDA was Lek 77.1 billion as of end-December 2006. The NDA limits will be cumulative changes from end-December 2006 and will be monitored from the accounts of the Bank of Albania.

421.7 per ounce); and (d) then converted to Lek at the program Lek/SDR exchange rate of Lek 141.5/SDR.

C. Net International Reserves

9. **Net international reserves (NIR)** are defined as reserve assets minus reserve liabilities of the Bank of Albania. **Reserve assets** are readily available claims of the Bank of Albania on nonresidents denominated in foreign convertible currencies, and held for the purpose of meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include Bank of Albania holdings of monetary gold, SDRs, Albania's reserve position in the IMF, foreign currency cash, securities, and deposits abroad. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options). **Reserve liabilities** shall be defined as foreign exchange liabilities to residents and nonresidents of the Bank of Albania, irrespective of their maturity. They include: foreign currency reserves of commercial banks held at the Bank of Albania; all credit outstanding from the IMF; 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. Excluded from reserve liabilities are the government's foreign currency deposits at the Bank of Albania.⁵ Reserve assets and reserve liabilities will both be expressed in U.S. dollars. The NIR limits will be cumulative changes from end-December 2006, and will be monitored from data supplied by the Bank of Albania.

10. During this program, for monitoring purposes, the exchange rates of the SDR and non-dollar currencies will be kept at their end-December 2006 levels and holdings of monetary gold will be valued at SDR 421.7 per ounce. Excluded from net international reserves are holdings of nonconvertible currencies, claims on nonresident financial institutions denominated in nonconvertible currencies, and other claims which are not readily available. Under this definition, the level of NIR was US\$1,493.9 million at end-December 2006.

D. Adjusters for NCG, NDA, and NIR

11. The NCG and NDA ceilings and the NIR floor are defined on the assumption that cumulative privatization proceeds from January 1, 2007 will be as follows:

End-September 2007	Lek 750 mn.	(Of which US\$0 mn. in foreign currency);
End-December 2007	Lek 1,000 mn.	(Of which US\$0 mn. in foreign currency).

⁵ This exclusion is justified by current procedures in Albania, whereby the government's foreign currency receipts are deposited in a blocked account at the Bank of Albania and the funds are transferred to the government's lek account before being spent. A change in this procedure, would require revisiting the NIR definition.

The NIR floor will be adjusted upward (downward) and the NDA ceiling adjusted downward (upward) by half of any excess (shortfall) in the receipt of privatization proceeds in foreign currency from these assumed values. The NCG ceiling will be adjusted downward (upward) by half the amount of any excess (shortfall) in the receipt of total privatization proceeds from these assumed values⁶.

12. The ceiling on NCG:

- will be adjusted upward (downward) by the increase (decrease) in debt instruments of any kind (valued at issue price if possible) that the government (as defined above) transfers to the Bank of Albania to compensate the Bank of Albania for its net valuation losses on its assets and liabilities in, or denominated in, gold, special drawing rights or foreign currencies, and which the Bank of Albania keeps in its (off-balance sheet) Valuation Reserve Securities Account of the Bank of Albania, as required in Article 64 of the Law on the Bank of Albania (No. 8269, dated December 12, 1997).
- will be adjusted downward by the amount of fiscal expenditure that was authorized by the 2007 budget, but legally expended in the first 14 days of 2008 and legally credited to the 2007 fiscal year.
- will be adjusted upward by the amount of fiscal expenditure that was authorized by the 2006 budget, but legally expended in the first 14 days of 2007 and legally credited to the 2006 fiscal year.

13. The ceilings on NCG and NDA, and the floor on NIR are defined based on the assumption that foreign budgetary and/or balance of payments loan financing (excluding IMF financing, project and commodity loans, loans from the International Development Association of the World Bank Group, and macro-financial assistance from the EU) will amount, on a cumulative basis, from January 1, 2007, to:

End-September 2007	US\$10 mn.
End-December 2007	US\$10 mn.

The ceilings on NDA of the Bank of Albania will be adjusted downward, and the floor on NIR will be adjusted upward by the amount total foreign loan financing (excluding IMF financing, project and commodity loans, loans from the International Development Association of the World Bank Group, and macro-financial assistance from the EU) exceeds these projections. The

⁶ For the NCG adjuster, the lek equivalent of deviations from the programmed amounts received in foreign currency will be converted to lek at the exchange rates prevailing on the value date of the transaction.

NCG ceiling will be adjusted downward by the amount total foreign loan financing (excluding IMF financing, project and commodity loans, loans from the International Development Association of the World Bank Group, and macro-financial assistance from the EU) exceeds these projections.⁷

14. The NDA ceilings will be also adjusted to reflect the impact of any change in the required reserve ratio of commercial banks with the Bank of Albania.

E. External Debt and Arrears

15. As set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274–00/85) August 24, 2000), the term “debt” will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to 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); (ii) suppliers’ credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, 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. 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.

16. The limit on medium- and long-term external debt applies to the contracting or guaranteeing by the government or the Bank of Albania, of new nonconcessional external debt

⁷ For the NCG adjuster, the lek equivalent of deviations from the programmed amounts received in foreign currency will be converted to lek at the exchange rates prevailing on the value date of the transaction.

with an original maturity of more than one year. It applies not only to debt as defined in paragraph 15 of this memorandum, but also to commitments contracted or guaranteed for which value has not been received. External debt will be considered to have been contracted at the point the loan agreement or guarantee is ratified by the Albanian parliament. Excluded from the limits are refinancing credits and rescheduling operations (including the deferral of interest on commercial debt), credits extended by the IMF, and credits on concessional terms defined as those with a grant element of at least 35 percent. The grant element is to be calculated using the OECD Commercial Interest Reference Rates (CIRRs): for maturities of less than 15 years, the grant element will be calculated based on six-month averages of CIRRs; and for maturities longer than 15 years, the grant element will be calculated based on ten-year averages. Debt falling within the limit shall be valued in euros at the exchange rate prevailing at the time the contract or guarantee becomes effective.

17. The limit on short-term external debt applies on a continuous basis to the stock of short-term external debt owed or guaranteed by the government or the Bank of Albania, with an original maturity of up to and including one year. It applies to debt as defined in paragraph 15 of this memorandum. Excluded from the limit are rescheduling operations (including the deferral of interest on commercial debt) and normal import-related credits. Debt falling within the limit shall be valued in Euros at the exchange rate prevailing at the time the contract or guarantee becomes effective.

18. A continuous performance criterion applies on the accumulation of new **external payments arrears** on external debt contracted or guaranteed by the government or the Bank of Albania. External payment arrears consist of external debt service obligations (principal and interest) falling due after December 31, 2006 and that have not been paid at the time they are due, taking into account the grace periods specified in the contractual agreements. Excluded from the prohibition on the accumulation of new arrears are: (i) arrears arising from interest on the stock of arrears outstanding as of December 31, 2006; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

19. **Large projects** (as referred to in MEFP paragraphs 4 and 16 and MEFP Table 2) financed by nonconcessional foreign borrowing are defined as those projects involving total nonconcessional foreign borrowing in excess of Euro 20 million.

20. For the purpose of verifying the observance of the performance criteria "Remove all inactive taxpayers from the register of active taxpayers maintained by the General Directorate of Taxation." (MEFP Table 2), a taxpayer shall be considered inactive when business operations have ceased, except for the following situations:

- When there are outstanding tax liabilities (including penalties) that are considered collectible by the GDT₂

- When there are outstanding returns (in situations where it is expected by the GDT that the submission of the returns will produce additional revenue claims);
- When there are unsettled objections or appeals in respect of tax assessments;
- When the GDT has reasonable evidence that the taxpayer is planning to resume business activities in the near future (e.g. within one year).

F. Tax Revenues

21. Collection of total tax revenue by the Tax and Customs Departments and social insurance contributions will be monitored on the basis of quarterly indicative floors. These indicative floors will include all revenues collected by the GDT, GDC, and SSI (including revenues collected on behalf of local governments), but exclude revenues collected by local governments directly.

G. Monitoring and Reporting Requirements

22. Performance under the program will be monitored from information supplied to the Fund by the Bank of Albania, the Ministry of Finance, the General Directorate of Taxation (GTD), the General Directorate of Customs (GDC), the Ministry of Economy and INSTAT. This information will include the following, which will be supplied monthly (except where noted) and on a timely basis:

The Bank of Albania will supply to the Fund:

- (i) The balance sheets of the Bank of Albania;
- (ii) The consolidated accounts of the commercial banks and (separately) the SLIs;
- (iii) The monetary survey;
- (iv) Banking sector prudential indicators;
- (v) Net domestic credit to the government (in the form outlined in Appendix Table 1);
- (vi) The net foreign assets of the Bank of Albania and their components;
- (vii) Comprehensive information on reserve assets that are pledged, collateralized, or otherwise encumbered.
- (viii) The foreign exchange cashflow of the Bank of Albania, including the level of NIR; (ix) Daily average exchange rates;
- (x) Trade flows;
- (xi) Periodic updates of balance of payments estimates;
- (xii) Detailed information on the stock and flow of any securities or debt instrument of any kind issued by government (as defined above) to the Bank of Albania to compensate the Bank of Albania for its net valuation losses on its assets and liabilities in, or denominated in, gold, special drawing rights or foreign currencies, and which the Bank of Albania keeps in its (off-balance sheet) Valuation Reserve Securities Account of the

Bank of Albania, as required in Article 64 of the Law on the Bank of Albania (No. 8269, dated December 12, 1997).

The Ministry of Finance will supply to the Fund:

- (i) The summary fiscal table, including the overall budget deficit, on a cash basis;
- (ii) Issuance of treasury bills by the MOF, including gross value and cash received;
- (iii) Privatization receipts;
- (iv) Information on the contracting and guaranteeing of new debt;
- (v) Information on the stock of short-, medium- and long-term debt;
- (vi) Information on all overdue payments on short-, medium- and long-term debt (with assistance from the Bank of Albania).
- (vii) Information on the stock of VAT refunds claimed and refunds paid out every quarter will be supplied within one month of the end of the quarter.
- (viii) Information on official grants for projects or budget support purposes.
- (ix) Biannual reports on the stock and clearance of outstanding debit balances of inoperative bilateral payment agreements will be supplied within one month of the end of the semester.
- (x) Information on expenditure arrears;
- (xi) A biannual listing and status report of all projects being considered for nonconcessional foreign financing.

The General Directorate of Customs will supply to the Fund:

- (i) Detailed monthly data on customs revenues collected; and
- (ii) Quarterly reports on corrective measures taken to deal with problems identified by the internal audit function.
- (iii) Quarterly reports on the progress made in the actual use of the ASYCUDA risk-assessment module to perform custom inspections;

The General Directorate of Taxation will supply to the Fund:

- (i) Detailed monthly data on tax revenues collected.
- (ii) Detailed monthly data on the share of taxes collected by the Large Taxpayer Office (LTO).

The Ministry of Economy will either report quarterly to the Fund or publish quarterly:

- (i) All instances of nonpayment on the agreed memorandums of understanding for the repayment of the stock of end-December 2001 inter-enterprise government arrears. It will communicate to the Fund progress in clearing the inter-enterprise government arrears accumulated in the years 2002 to 2005.

- (ii) A description of remedial actions undertaken by the ministry in the event of non-payment on the agreed MOUs for the repayment of the stock of end-December 2001 inter-enterprise arrears.

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

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

Table 1. Albania: Calculation of Net Domestic Credit to Central Government for Program Monitoring Purposes, 2007
(In millions of lek)

		Dec-06	Mar-07	Jun-07	Sep-07	Dec-07
1.	Treasury bills held outside central government	261,390				
Of which:						
1. (i)	Held by Bank of Albania 1/	67,025				
1. (ii)	Held by deposit money banks 1/	160,083				
	In domestic currency	154,740				
	In foreign currency	5,342				
1. (iii)	Held by savings and loan institutions 2/	0				
1. (iv)	Held by other domestic lenders (excluding holdings of HHI and SSI) 2/	34,282				
	Of which:					
1. (iv) (i)	INSIG	2,096				
1. (iv) (ii)	Individuals and firms	32,186				
1. (iv) (ii) (i)	Of which: BoA window	20,229				
Plus:						
2.	Other central government debt held outside central government (millions of lek)	87,697				
Of which:						
2. (i)	Held by Bank of Albania 3/	12,164				
2. (i) (i)	Other securities 3/	12,164				
2. (i) (i) (i)	Of which: for BoA valuation losses 3/	12,164				
2. (i) (ii)	Short-term direct loans to government 3/	0				
2. (ii)	Held by deposit money banks 4/	75,533				
2. (ii) (i)	Fixed income securities 4/	75,343				
2. (ii) (ii)	Variable income securities 4/	189				
2. (iii)	Held by savings and loan institutions 5/	0				
2. (iv)	Held by other domestic lenders 5/	0				
Equals gross domestic credit to government:		349,086				
Less:						
3.	Assets of central government (excluding HHI and SSI)	17,153				
3. (i)	Deposits held at Bank of Albania 6/	16,438				
3. (i) (i)	In domestic currency	7,613				
3. (i) (i) (i)	Transferable deposits in lek	7,189				
3. (i) (i) (ii)	Deposits in lek for projects	424				
3. (i) (ii)	In foreign currency at program exchange rates and program price of gold 7/ 8/	8,825				
3. (i) (ii) (i)	In foreign currency evaluated at current exchange rates	7,699				
3. (i) (ii) (i) (i)	Transferable deposits in foreign currency evaluated at program exchange rate 7/ 9/	5,470				
3. (i) (ii) (i) (i) (i)	Transferable deposits in foreign currency evaluated at current exchange rate 9/	5,469				
3. (i) (ii) (i) (ii)	Standard gold deposits of government evaluated at program exchange rate and gold price (Lek mns.) 8/	3,355				
3. (i) (ii) (i) (ii) (i)	Standard gold deposits of government at current exchange rate and gold price (Lek mns.) 8/	2,230				
3. (i) (ii) (i) (ii) (i) (i)	Number of ounces of gold equivalent	37,376				
3. (ii)	Assets held at deposit money banks	715				
3. (ii) (i)	Deposits 10/	1,163				
3. (ii) (i) (i)	Deposits in domestic currency	218				
3. (ii) (i) (i) (i)	Transferable deposits in domestic currency	218				
3. (ii) (i) (i) (ii)	Other deposits in domestic currency	0				
3. (ii) (i) (ii)	Deposits in foreign currency evaluated at program exchange rates	945				
3. (ii) (i) (ii) (i)	In foreign currency evaluated at current exchange rates 7/	945				
3. (ii) (i) (ii) (i) (i)	Transferable deposits in foreign currency evaluated at current exchange rates	945				
3. (ii) (i) (ii) (i) (ii)	Other deposits in foreign currency evaluated at current exchange rates	0				
3. (ii) (ii)	DMB payables to government	-651				
3. (ii) (iii)	Ministry of finance short-term lending to commercial banks	203				
3. (iii)	Held at savings and loan institutions 10/	0				
Less:						
4.	Deposits of HHI and SSI	2,475				
Equals:						
5.	Stock of Net domestic credit to central government (1+2-3-4)	329,458				
	Change since December 2006	...				
6.	Memorandum items:					
6. (i)	Current exchange rate (Lek/SDR, eop)	141.5	143.3	...	...	...
6. (ii)	Current exchange rate (Lek/US dollar, eop)	94.0	94.9	...	...	...
6. (iii)	Program exchange rate (Lek/SDR, eop)	141.5	141.5	141.5	141.5	141.5
6. (iv) (i)	Program price of gold (SDR per ounce)	421.7	421.7	421.7	421.7	421.7
6. (iv) (ii)	Program price of gold (US\$ per ounce)	634.4	634.4	634.4	634.4	634.4
6. (v)	Market price of gold (price in US dollars per ounce)	634.4	663.0	...	...	...
6. (vi)	Current exchange rate (US dollar per SDR, eop)	1.504	1.510	...	...	...

1/ Evaluated at issue price.

2/ Evaluated at face value (data on treasury bill holdings of SLAs and other domestic lenders are currently available only at face value).

3/ Excludes accrued interest.

4/ Valued at face value (data on fixed and variable income securities held by DMBs are currently available only at face value).

5/ Includes accrued interest.

6/ Includes transferable deposits of government in domestic and foreign currency, lek deposits of central government for projects; and standard gold deposits of government (footnote # 8). Excludes all non-standard gold deposits; and excludes all nongold precious metal deposits of government; and excludes government deposits in foreign currency for projects.

7/ The reported lek value of foreign currency denominated assets of government will be converted to SDRs using the current end-of-period lek/SDR exchange rate; and then converted back to lek using the program Lek/SDR exchange rate of Lek 141.5/SDR.

8/ Standard gold deposits are usable by government and therefore included in the definition of government assets. The lek value of standard gold deposits will be (a) converted to US dollars using the current end-of-period lek/US dollar exchange rate; (b) then converted to ounces of gold using the current market price of gold; then (c) converted to SDRs at the program price of gold of SDR 421.7 per ounce; and then (d) converted to lek at the program Lek/SDR exchange rate of Lek 141.5/SDR.

9/ Including account set up to hold the Savings Bank privatization revenue (Account No: 11.2.2.1.4).

10/ Includes all deposits of central government.

Statement by the IMF Staff Representative
July 9, 2007

1. This statement updates on developments in Albania since the preparation of the staff report (www.imf.org). The additional information does not change the thrust of the staff appraisal.

2. **The authorities have continued to implement their reform agenda.**

- Parliament has passed a package of tax reforms in its first reading. The package is fully in line with the authorities' intentions expressed in the Memorandum on Economic and Financial Policies. The package—to become effective in July 2007, will introduce a single personal income tax (PIT) rate of 10 percent combined with a zero bracket; as well as increase some indirect taxes. The PIT changes will be budget neutral, while the half year effect of the higher indirect taxes is estimated at about 0.3 percent of GDP.
- To avoid tax arbitrage, the corporate income tax rate will be reduced from 20 to 10 percent in 2008, at an estimated budget cost of 1 percent of GDP. However, this loss will be offset in part by the full-year effect of the increase in indirect taxes. The remaining loss will be covered by additional tax measures which the authorities have committed to design in consultation with Fund staff and introduce in the 2008 budget.
- An agreement has been reached with a Turkish consortium on the privatization of Albtelecom. The purchase price—€120 million for 76 percent of the company's shares—remained as agreed in the original privatization tender. Albtelecom will pay the budget a dividend of 0.4 percent of GDP (accumulated from profits since 2005) before the privatization takes place.

3. **To allocate the additional revenue and cover the cost of stabilizing the financial position of the state-owned electricity company (KESH), the government is preparing a supplementary budget for 2007.** The overall deficit will remain broadly unchanged at 3.9 percent of GDP, as the additional revenue from the tax measures and Albtelecom dividend (some $\frac{3}{4}$ percent of GDP) will be offset by a $\frac{1}{2}$ percent of GDP capital transfer to KESH and additional spending in priority areas (education, health, and roads) amounting to $\frac{1}{4}$ percent of GDP.

4. **Recent results indicate that KESH's new management has been successful in improving the company's financial performance.** In April–May 2007, KESH's effective collection rates increased significantly, and the company met the targets set in the revised power sector action plan supported by the World Bank.

5. **To anchor inflation expectations in the face of rapid credit growth, the Bank of Albania raised the policy rate by 25 basis points on June 27, 2007.** The policy rate now stands at 5¾ percent.

6. **Albania obtained its first ever credit ratings from Moody's.** The rating for government debt obligations was B1, which is four steps below investment grade rating, reflecting the economy's continued transition.

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FOR IMMEDIATE RELEASE
July 9, 2007

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Executive Board Completes the Third Review Under the PRGF and EFF
Arrangements with Albania and Approves US\$3.7 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Albania's economic performance and financing assurances under the three-year Poverty Reduction and Growth Facility (PRGF) arrangement and the Extended Fund Facility (EFF) arrangement. The completion of the reviews enables the release of an amount equivalent to SDR 2.4 million (about US\$3.7 million), which will bring the total disbursements to Albania under both arrangements to SDR 9.7 million (about US\$14.8 million).

The concurrent three-year arrangements under the PRGF and EFF, amounting to the equivalent of SDR 17.0 million (about US\$25.9 million) were approved effective from February 1, 2006 (see [Press Release No. 06/17](#)).

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

“Albania’s macroeconomic performance has remained strong. Economic growth is returning to its potential level, supported by robust exports, while inflation is low. These favorable developments reflect the authorities’ strong commitment to sound macroeconomic policies. Looking forward, maintaining these gains and achieving faster convergence toward emerging market income levels will require lasting solutions to the problems in the energy sector and additional growth-enhancing structural reforms.

“The authorities are committed to fiscal discipline, and are implementing a fiscal program that aims to provide sufficient funds for development projects while also reducing public debt. They are adopting a supplementary budget for 2007 that maintains the deficit target while providing temporary budget support to the state-owned electricity company (KESH) through new revenue measures. They are also committed to using half of the receipts from large privatization for public debt reduction.

“It will be crucial to correct on a sustained basis the deterioration of KESH’s financial position. Full implementation of the donor-supported power sector action plan will help stabilize the company’s financial position and contain the budgetary impact in 2007. Looking forward, a lasting solution would be expedited by the privatization of the distribution arm of KESH in accordance with a firm implementation plan gradually raising domestic electricity prices to cost-recovery levels will also be important to eliminate reliance on budget support in the future.

“The existing monetary policy framework remains appropriate. As the recent hike in the policy rate indicates, the Bank of Albania stands ready to take measures to maintain low inflation and to mitigate the risks of rapid credit expansion. Allocating supervision of the financial leasing sector to the Bank of Albania will eliminate a gap in the supervisory framework. The authorities have taken welcome steps to enhance the supervisory capacity of the Financial Supervisory Authority.

“Significant structural reforms, particularly for promoting private sector involvement in key sectors, are progressing, and sustained efforts are being made to improve public institutions. A general directorate for debt management has been created in the Ministry of Finance to ensure effective implementation of the new debt strategy, and a credit information bureau will become operational later this year. The national telecommunication company Altelecom has been privatized, and the authorities are committed to privatization in other strategic sectors. The strong interest from foreign investors in Albania is welcome. Large Public-Private Partnership projects with sophisticated financing structures should, however, be treated carefully and the capacity to assess and manage the risks involved in such projects needs to be built,” Mr. Portugal said.

**Statement by Arrigo Sadun, Executive Director for Albania
and Carlo Gola, Senior Advisor to Executive Director
July 9, 2007**

On behalf of the Albanian authorities, we wish to express our appreciation to the staff for a well-written report, which reflects the remarkable cooperation and very constructive dialogue with the authorities.

1. Introduction

The Albanian economy continues its strong performance, supported by sound policies and structural reforms. Economic growth is expected to return to its trend rate of 6 percent in 2007, thanks to positive results in the export sector, acceleration in the growth of services, and by a rise in public investment, including the road sector. Average inflation was held to 2.5 percent in 2006, in part due to two 25-basis point hikes in the policy interest rate. On the fiscal side, relevant administrative efforts aimed at increasing the tax base yielded tangible results: in 2007 tax revenues should be at about 23.7 percent of GDP from 22.9 in 2006. A responsible fiscal stance has contributed to maintaining the primary deficit, including grants, at only 0.4 percent of GDP in 2006 and should only slightly increase it at about 1 percent of GDP in 2007, mainly due to a slight slowdown of domestic revenue collection in early 2007. However, the total public debt should decline from 55.7 percent of GDP (2006) to 54.2 percent of GDP this year, also thanks to privatization receipts estimated at about 1.1 percent of GDP, half of which will be used for debt reduction. The ongoing fiscal policy will allow a steady improvement in government solvency. In the mid-year fiscal package, the authorities have decided to reduce the marginal personal income tax rate, to further broaden the tax base and improve compliance. The supplementary budget also includes a transfer of about 0.5 percent of GDP to the electricity company KESH, to be mostly absorbed by increases in indirect taxes.

Notwithstanding this favorable macroeconomic framework, the authorities are aware that downside risks have increased.

- Additional risks may arise from the strong credit growth. The Bank of Albania stands ready to take further restrictive measures to address this concern, as confirmed by the recent latest 25 basis points increase in the policy rate on June 27.
- Another potential risk is related to the still weak position of the public electricity utility, KESH, where poor collection performance, despite the last improvement, and a sharp increase in the import price of electricity have reduced cash flow and net worth.

We elaborate further on these two issues below.

2. Monetary and financial sector policies

The BoA has successfully maintained inflation within the midpoint of the target range without causing undue real appreciation or preventing growth from recovering to its potential rate. This achievement resulted partly from two policy rate increases—in July and November 2006.

However the authorities are aware that the underlying transmission mechanism operates primarily by controlling the pass-through effect on the lek price of traded goods. Changes in the policy rate appear less effective in mitigating the demand effects of rapid credit creation, and as a result the economy is potentially vulnerable to demand shocks. Recognizing this, the authorities are committed to remaining vigilant and reacting quickly to any deterioration in inflationary expectations or any excessive increase in the rate of credit growth. Consequently, they have adopted a precautionary approach. They believe that full transparency is critical in order to curb inflationary expectations, and have therefore clearly communicated to the public their firm intention to raise the policy rate again if this is necessary to maintain price stability.

Moreover, given limitations in the transmission mechanism, they have implemented innovative, but market friendly, improvements in the regulatory framework aimed at maintaining the quality of the loan portfolio and possibly reducing the supply of credit.

In particular, stricter requirements will be applied to those banks where the growth of credit and/or non-performing loans exceed specific thresholds. Should credit growth remain excessive, based on prudential considerations, the authorities are ready to supplement policy rate increases with additional prudential and regulatory measures. These could include the imposition of higher provisioning requirements on foreign currency loans to customers lacking foreign currency income, as well as higher reserve requirements on foreign currency deposits. The authorities are also refining and enhancing banking supervision, and developing a credit bureau within BoA, which will be operational by the end of this year.

The reform of the market infrastructure (in particular the implementation of the delivery versus payment system) will reduce risks and increase volumes in the secondary market for government debt and will foster the development of the interbank market, with positive effects both for monetary policy implementation and for the overall intermediation process. The authorities intend to protect the existing high level of institutional quality in the financial sector and are committed to avoiding legislative or regulatory action that weakens the independence of the BoA. This includes the Supervisory Board of the BoA's control over the Bank's budget and its authority to decide on compensation levels.

With respect to the nonbank financial sector, the unification of the non-bank supervisory agencies under the Financial Supervisory Authority provides a sound framework for moving forward. However, the authorities are cognizant that significant effort will need to be devoted to this sector to effect needed institutional changes and to raise the quality of supervision to acceptable standards.

Finally, for the first time this spring Albania was rated B1 by Moody's and the rating was accepted by Government. This is a huge step toward entering financial markets and Eurobond perspective for Albania, at the same time it shows that the macroeconomic picture and debt sustainability are in favorable conditions.

3. Macroeconomic implications of the difficulties in the electricity sector

The electricity sector is posing some non-trivial problems to the economy for its implications on the budget, (both in terms of uncollected bills and financial losses) as well as for its potential effects on inflation and growth. Recent data on the distribution losses, which declined from 41 to 34 percent average, are encouraging but such a level is still above the 10-15 percent that is considered "normal" for a country with a similar stage of development. For this reason, the authorities are taking several initiatives. In particular they have appointed a new CEO of the electricity company, they have implemented an incentives package for key employees in sales and collection to achieve performance targets, and they have adopted a stricter position with respect to cutting off service to nonpaying customers. Moreover, in consultation with the World Bank, they have finalized strong measures to improve efficiency, reduce waste and theft, and raise collection rates through better financial management and technical improvements. The authorities believe that, with strong political support, KESH's financial performance could be improved relatively quickly. Finally they are committed to the privatization of the distribution arm of KESH as soon as possible, and have already selected IFC as an advisor.

4. Other issues

On structural reforms, significant and tangible results have been achieved also thanks to the valuable support of the Fund and donors. In particular:

- Significant progress has been done in the area of debt management: the average domestic debt maturity has increased from 284 days at end-2006 to 327 days at end May 2007. To better coordinate cash and debt management functions, the authorities have developed weekly cash forecasts on the basis of cash needs of line ministries; and the Ministry of Finance and the Bank of Albania are now holding regular meetings twice a month to coordinate debt management and liquidity operations.
- Public financial management is improving: a new organic budget law will establish a comprehensive budget process, covering both regular budget organizations and special (extra-budgetary) funds, at both the central and local government level; it will also strengthen the link between the Medium Term Budget Program and the annual budget preparation process.
- The new public investment unit of the Ministry of Finance will select public investment projects and approve procedures for public investment management, including the obligation for submitting a cost-benefit analysis for investment projects.
- Finally, in order to enhance the business environment, the authorities have reformed the business registration process and set up the National Registration Center that will

establish a one-stop shop for business registration by the end of September 2007. They are working to reduce barriers in the licensing system and have reduced the legal timeline for business registration from 30 to 8 days. Other initiatives, such as the new procurement law and a new concessions law will both serve to improve the transparency and competitiveness of the bidding process; the law on the business advisory council and the law on chambers of commerce and industry will further promote a better business environment.