IMF Country Reports 17/64

Albania: Ninth and Tenth Reviews Under the Extended Arrangement, and Proposal for Post-Programmonitoring-Press Release; Staff Report; and Statement by the Excutive Director for Albania

INTERNATIONAL MONETARY FUND

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IMF Country Report No. 17/64

ALBANIA

February 2017

NINTH AND TENTH REVIEWS UNDER THE EXTENDED ARRANGEMENT, AND PROPOSAL FOR POST-PROGRAM MONITORING—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ALBANIA

In the context of the Ninth and Tenth Reviews Under the Extended Arrangement, and Proposal for Post-Program Monitoring, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 24, 2017, following discussions that ended on November 2, 2016, with the officials of Albania on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on February 8, 2017.
- A **Statement by the Executive Director** for Albania.

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

Letter of Intent sent to the IMF by the authorities of Albania*
*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 17/61
FOR IMMEDIATE RELEASE
February 24, 2017

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Final Reviews of the Extended Arrangement Under the Extended Fund Facility for Albania

On February 24, 2017, the Executive Board of the International Monetary Fund (IMF) completed the two final reviews (ninth and tenth) of Albania's economic program supported by an arrangement under the Extended Fund Facility (EFF). The completion of the reviews allows the authorities to draw the equivalent of an additional SDR 57.28 million (about €73.2 million), bringing total disbursements to the equivalent of SDR 295.42 million (about €377.3 million at current exchange rates, or 212.1 percent of the country's current quota in the Fund).

The Executive Board approved a 36-month extended arrangement under the EFF for Albania on February 28, 2014 (see Press Release No. 14/81). The arrangement aimed to restore economic growth and control the rapidly rising public debt that had threatened economic stability, by strengthening public finances, maintaining financial stability, and implementing structural reforms focused on improving the energy sector and the business climate.

Following the Executive Board's decision, Mr. Tao Zhang, Deputy Managing Director and Acting Chair, issued the following statement:

"Strong policy implementation under the Fund-supported Extended Arrangement has helped Albania achieve the objectives of correcting large macroeconomic imbalances and boosting economic growth, while maintaining stability in the face of external challenges. The authorities implemented key structural reforms, demonstrating strong ownership of the program. Continued steadfast commitment to the economic reform agenda is crucial to safeguard these economic gains, reduce vulnerabilities, and enhance growth.

"The authorities' main priorities in the post-program period are appropriate. They should continue to pursue fiscal consolidation in 2017 and beyond in order to lower public debt to around 60 percent of GDP by end-2019. The consolidation strategy should focus on

broadening the tax base and improving tax compliance and administration. The strategy is ambitious and will require unwavering political commitment.

“The authorities undertook a sizable fiscal adjustment and made substantial progress in strengthening fiscal institutions. Further reforms in tax administration and public financial management would help reduce fiscal risks and create fiscal space for more high-quality spending. In addition, improving public investment management, and tackling arrears of unbudgeted investment projects should further enhance the credibility of the government’s medium-term budgetary framework.

“The Bank of Albania’s (BoA) accommodative monetary policy stance is appropriate in light of subdued inflationary pressures and expectations. The authorities should pursue gradual de-euroization, with due consideration of disintermediation risks.

“The banking system remains liquid and well-capitalized and recent efforts to strengthen the BoA’s supervisory capacity and to address non-performing loans (NPLs) are encouraging. Further action is needed to tackle high NPLs by ensuring implementation of the new bankruptcy legislation. Priority should also be given to augmenting the supervision of nonbank financial institutions and ensuring that high transparency and governance standards are maintained in developing capital market institutions.”

INTERNATIONAL MONETARY FUND

ALBANIA

February 8, 2017

NINTH AND TENTH REVIEWS UNDER THE EXTENDED ARRANGEMENT, AND PROPOSAL FOR POST-PROGRAM MONITORING

EXECUTIVE SUMMARY

Background: In February 2014, the Executive Board approved a three-year Extended Arrangement with access equivalent to SDR 295.42 million (212.1 percent of current quota). Total disbursements of SDR 238.14 million have been made so far, and a final disbursement equivalent to SDR 57.28 million will be made available upon completion of the combined ninth and tenth reviews. Fund engagement with Albania will continue through a Post-Program Monitoring.

Recent Economic Developments: The economic recovery is strengthening, supported by energy-related investments and a gradual recovery in domestic demand. The current account deficit is widening due to increased import-intensive foreign direct investments (FDI). Inflation is picking up from a very low level. The exchange rate has been broadly stable vis-à-vis the euro and FX reserves are comfortable. With substantial monetary easing, lek-denominated household credit growth has picked up. However, overall credit remains stagnant, given the still sizable overhang of nonperforming loans (NPLs) on bank balance sheets.

Program Performance: All performance criteria were met, although two out of the three indicative targets were missed by a narrow margin. Eleven structural benchmarks were also implemented, albeit seven with delays, while three were missed. Over the past three years, the authorities have met most quantitative targets and have made good progress in implementing the structural reform agenda under the program, albeit with some delays.

Key Issues: The authorities expressed their commitment to continue lowering fiscal vulnerabilities, reviving overall credit growth, and implementing growth-enhancing structural reforms. Fiscal policies will be geared towards (i) consolidating public finances based on a strategy of broadening the tax base and improving tax compliance and administration; (ii) advancing fiscal structural reforms to tackle fiscal risks and strengthen public financial management; and (iii) sustaining the reform momentum in the power sector. The central bank's accommodative monetary policy stance should continue given low underlying inflationary pressure and still nascent demand recovery. Addressing the high stock of NPLs remains key for reviving credit and supporting growth.

Approved By
Jörg Decressin and Zeine Zeidane

Discussions were held in Tirana during October 20–November 2, 2016 and January 17–24, 2017. Staff team: Ms. Tuladhar (head), Messrs. Cabezon and Slavov (all EUR), Mr. End (FAD), and Messrs. Ismail and Weller (both SPR). Mr. Reinke (Resident Representative) and Ms. Spahia (local economist) assisted the missions. Mr. Di Lorenzo (OED) joined some of the meetings. The missions met with Prime Minister Rama, Minister of Finance Ahmetaj, Minister of Transport Dervishaj, Bank of Albania Governor Sejko, other senior officials, parliamentarians, and representatives of banks, the private sector, and the donor community. Support was provided by Mr. Song, Ms. Mendoza (both EUR), and Ms. Kadeli (Tirana office).

CONTENTS

TABLES

ANNEX

APPENDIX

BACKGROUND

1. **Albania's Extended Arrangement aimed to correct large macroeconomic imbalances and increase economic growth (Annex I).** In 2013, Albania's GDP growth decelerated to its lowest level in decades following the economic crisis in key European trading partners (Greece and Italy). Public debt rose rapidly due to pre-electoral fiscal slippages, as well as an unsustainable pension system and electricity sector. Rollover risks escalated as the banking system, heavily exposed to the government and facing rising nonperforming loans (NPLs), continued to deleverage.

2. **Albania has been successful in achieving the program objectives despite external headwinds.** GDP growth has recovered, albeit by less than initially projected. Inflation remains low, helped by lower commodity prices and external disinflationary pressures. Public finances have been strengthened through a sizable fiscal adjustment, and fiscal vulnerabilities reduced. Spillovers from the Greek banking crisis have been contained. Key structural reforms were implemented, including comprehensive pension and electricity sector reforms, and an overhaul of bankruptcy legislation.

Key Economic Indicators

	GDP Growth	Average Inflation	Current Account Deficit	Gross Reserves	Tax Revenues	Overall Balance	Primary Balance	Public Debt 1/	Non-Performing Loans	Private Credit Growth
	(percent)		(percent of GDP)	(months of imports)	(percent of GDP)				(percent)	
2013	1.0	1.9	10.8	4.5	22.0	-5.2	-2.0	70.4	23.5	-1.4
2016	3.4	1.3	12.1	5.7	24.3	-2.2	0.2	72.1	20.4	0.7

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

1/ 2016 general government debt includes arrears owed by local governments.

3. **Nevertheless, significant medium-term challenges remain.** Public debt remains high. Tax administration is inefficient and property taxation reform has lagged. Structural weaknesses in the overall business climate have limited competitiveness gains. In the banking sector, the NPL overhang continues to deter overall credit growth. While legislative and institutional frameworks have been strengthened, implementation risks remain.

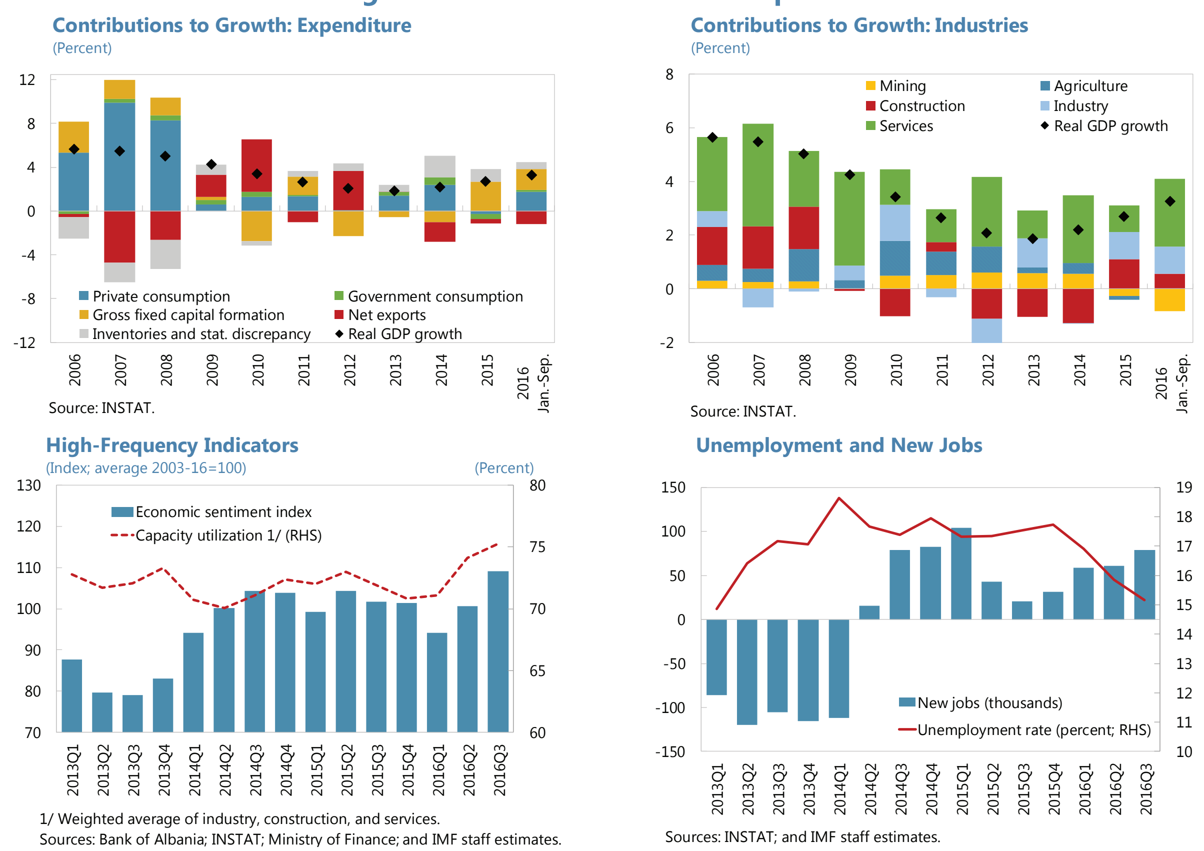
4. **Post-program policies will therefore need to continue focusing on strengthening public finances and the financial sector, and on implementing structural reforms to boost competitiveness.** The main priority going forward is to seek revenue-based fiscal consolidation, reduce NPLs, and advance reforms to improve the business climate. These measures are crucial to boost confidence, spur investment, and achieve higher and sustainable growth.

RECENT DEVELOPMENTS

5. **In early November, the European Commission recommended the launch of EU accession negotiations with Albania.** This followed concerted efforts by the authorities to initiate governance reforms and improve public financial management. However, the recommendation is conditional on further tangible progress with the implementation of judicial reform, in particular with regard to the vetting of judges and prosecutors. Accession negotiations are not expected to start until after the next Parliamentary election in June 2017.

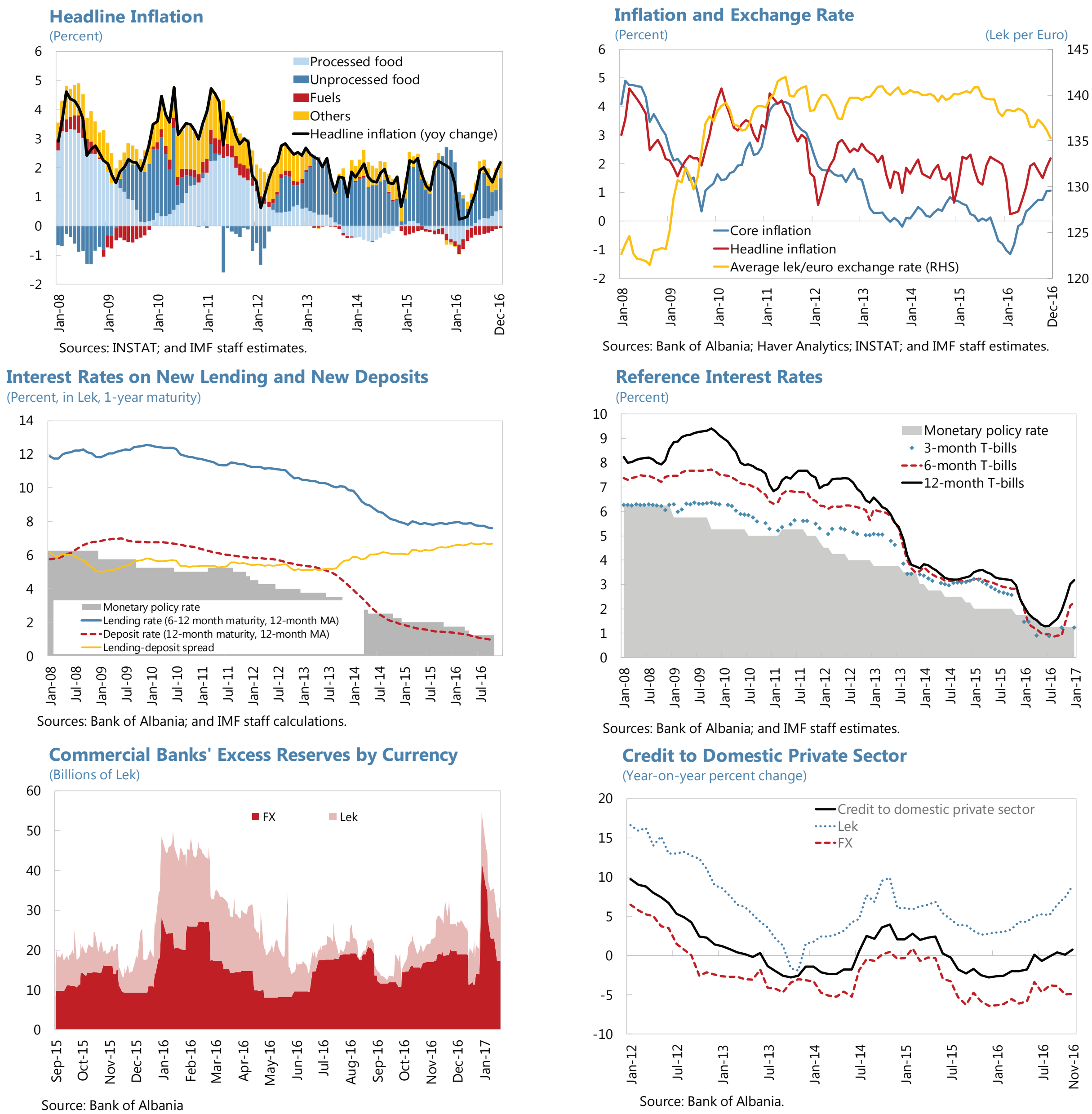
6. **The economic recovery is strengthening (Figure 1 and LOI ¶3).** GDP grew by over 3 percent in the first 9 months of 2016 (yoy), driven by consumption and large energy-related FDI projects. Net exports declined reflecting lower oil exports as well as higher FDI-related imports. The pickup in domestic demand has been supported by improving confidence and an accommodative monetary policy stance. The unemployment rate declined from 17.7 to 15.2 percent between 2015:Q4 and 2016:Q3, while the labor participation rate has continued to rise.

Figure 1. Albania: Growth Developments



7. Inflation rebounded in the second half of 2016 (Figure 2), following monetary easing in early 2016. Headline inflation accelerated to 2.2 percent (yoy) in December from 0.2 percent in February, led mainly by a recovery in food prices. Core inflation also rose to 1 percent in December from -1.2 percent in February, reflecting an increase in prices of processed food and services. The nominal exchange rate appreciated slightly by around 1.7 percent in December (yoy, average).

Figure 2. Albania: Price Developments



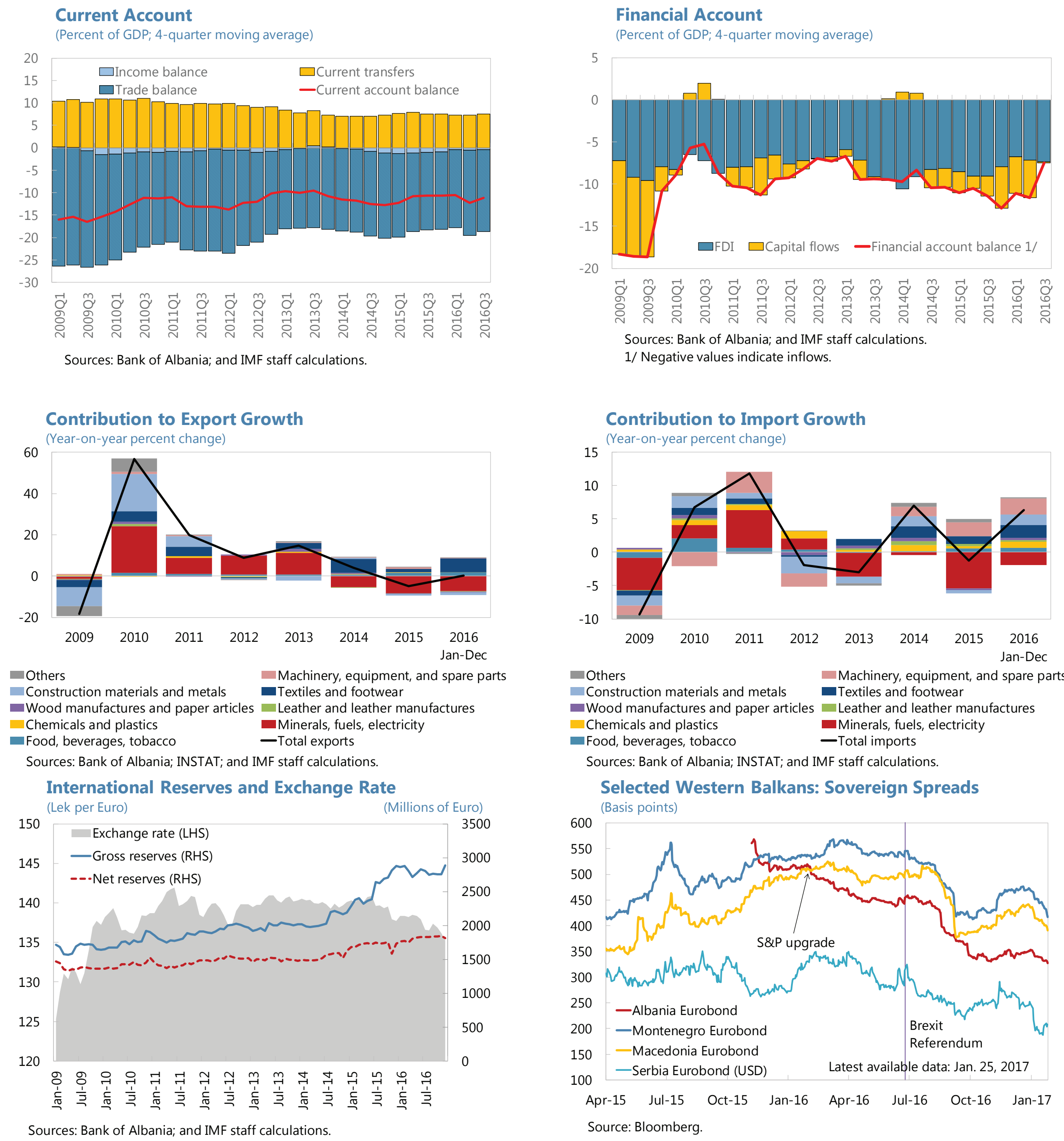
8. The monetary policy stance remains accommodative. Amid signs of a pickup in underlying inflation, the BoA paused its policy rate cuts and has maintained a wait-and-see approach, holding its policy rate at a historical low of 1.25 percent since May. The ample liquidity lowered deposit and T-bill rates during the first half of the year, and helped to gradually accelerate growth in private credit in domestic currency (to 9 percent, yoy, in November). But high bank risk aversion (due to NPLs) and ongoing deleveraging pressures among foreign-owned banks continue to hamper overall credit growth, particularly to corporates (-3 percent, yoy, in November).

9. The current account deficit widened in 2016:H1 (Figure 3 and LOI ¶3).[1] Low commodity prices continued to weigh down on exports, while imports were boosted by the economic recovery and one-off factors related to FDI-funded large energy projects. Tourism receipts, however, remained robust. Remittances have also been broadly stable despite weak growth in the main source countries (Greece and Italy).

10. Financing risk from the large external deficit remains limited. At 7 percent of GDP, FDI remains the single largest source of financing, covering nearly two-thirds of the current account deficit in 2016, with the remainder primarily financed by official flows. Although FDI in oil-drilling has slowed, it has been offset by FDI into other large energy projects (the Trans Adriatic Pipeline and the Statkraft/Devoll hydropower project). Gross FX reserves have been stable and remain at a comfortable level of around 5¾ months of projected imports. Sovereign spreads have been on a declining trend since the ratings upgrade in early 2016.

[1] The recorded current account deficit overstates external imbalances because of sizable errors and omissions (around 2–3 percent of GDP). Most of these are probably unrecorded private remittances.

Figure 3. Albania: External Developments



Triannual General Government Operations, 2016

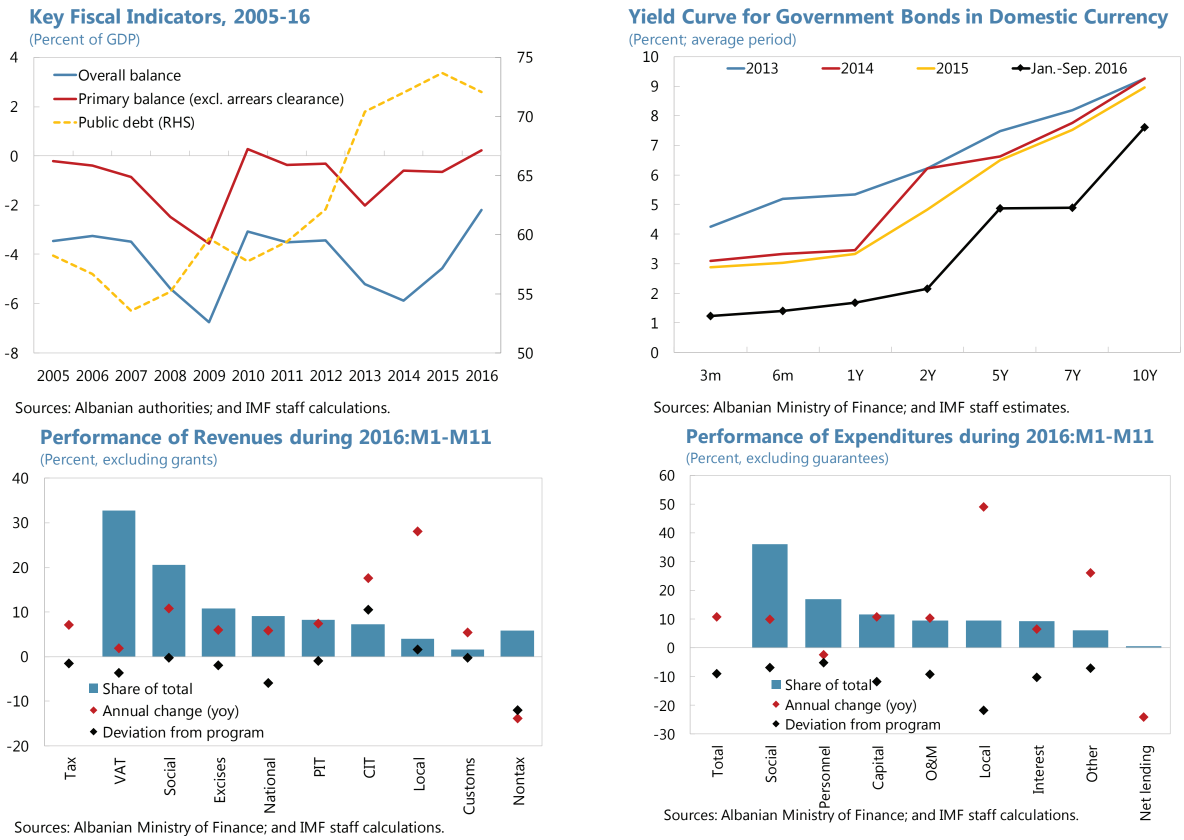
	2016					
	Program					
	T1 EBS/16/6	T2 EBS/16/39	Nov. EBS/16/78	T1 Act.	T2 Act.	Nov. Act.
(Billions of leks)						
Total revenue and grants	129.8	265.0	372.8	129.4	262.6	364.4
Tax revenue	118.7	241.7	338.2	117.6	240.6	333.1
Non-tax revenue	8.0	17.1	23.6	8.4	15.9	20.7
Grants	3.1	6.2	11.0	3.3	6.0	10.6
Total expenditure	132.5	277.8	402.7	117.8	256.1	363.8
o/w Primary expenditure	120.9	252.0	364.8	105.6	232.6	329.7
Current expenditure	115.1	242.8	352.7	105.3	226.0	319.7
o/w Energy guarantees	1.6	2.4	3.2	0.0	0.0	0.0
Capital expenditure	15.3	31.8	47.4	11.4	28.2	42.0
Policy net lending	1.0	1.2	0.9	1.1	1.8	2.1
Overall balance	-2.7	-12.8	-29.9	11.6	6.5	0.6
Primary balance excl. arrears clearance	9.0	13.0	8.0	23.8	30.0	34.7
(Percent of GDP)						
Total revenue and grants	8.5	17.3	24.8	8.6	17.4	24.2
Tax revenue	7.8	15.8	22.5	7.8	16.0	22.1
Non-tax revenue	0.5	1.1	1.6	0.6	1.1	1.4
Grants	0.2	0.4	0.7	0.2	0.4	0.7
Total expenditure	8.7	18.1	26.8	7.8	17.0	24.2
o/w Primary expenditure	7.9	16.4	24.2	7.0	15.5	21.9
Current expenditure	7.5	15.8	23.4	7.0	15.0	21.2
o/w Energy guarantees	0.1	0.2	0.2	0.0	0.0	0.0
Capital expenditure	1.0	2.1	3.2	0.8	1.9	2.8
Policy net lending	0.1	0.1	0.1	0.1	0.1	0.1
Overall balance	-0.2	-0.8	-2.0	0.8	0.4	0.0
Primary balance excl. arrears clearance	0.6	0.8	0.5	1.6	2.0	2.3

Source: IMF staff estimates and projections.

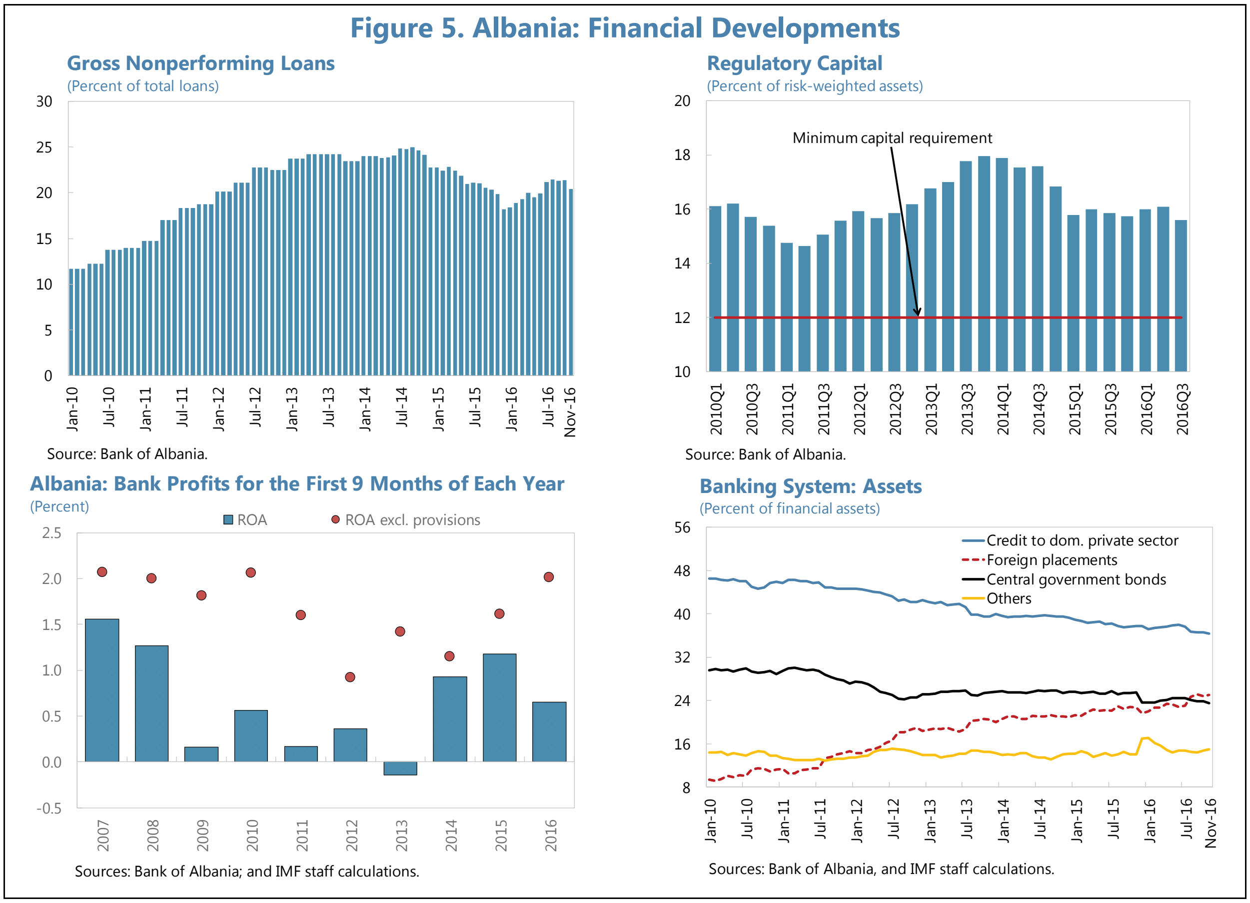
11. The November fiscal targets were met with comfortable margins, due to an across-the-board expenditure underexecution (Figure 4 and text table). The primary balance reached 2.3 percent of GDP, 1.8 percent of GDP above target, despite a sizable revenue shortfall.[2] Tax underperformance—in VAT in particular—stems from lower-than-expected oil prices and inflation, as well as a growth mix that was less consumption- and more investment-driven than anticipated. On the expenditure side, the wage bill benefited from ongoing vacancies in the public administration. Local spending was also behind schedule, following the recent reorganization of local government units. According to preliminary fiscal data for December, continued revenue shortfalls as well as a large pickup in capital spending shrank the primary surplus to 0.2 percent for 2016, broadly in line with the program. Financing pressures remained low. At end-December 2016, general government debt is estimated at 72.1 percent of GDP, compared with 73.7 percent of GDP at end-2015.

[2] The revenue numbers exclude disputed tax payments from a large foreign company. The tax dispute is expected to go into arbitration shortly. These payments will only be recorded as revenue at the time of the conclusion of the dispute resolution process.

Figure 4. Albania: Fiscal Developments



12. The banking system remains liquid and well capitalized, but is constrained by sizable NPLs (Figure 5 and Table 5). NPLs declined significantly in 2015 due to mandatory write-offs of loss loans. The NPL ratio subsequently increased to 20.4 percent in November 2016 as a result of two large corporate bankruptcies (by an oil refinery and a commodity exporter) as well as improved supervision actions leading to NPL reclassifications. Consequently, profitability and capital adequacy ratios fell in 2016 due to higher provisioning requirements. Nevertheless, system-wide capitalization stood at 15.6 percent of risk-weighted assets in 2016:Q3, well above the regulatory minimum of 12 percent. Liquidity buffers remain comfortable. Private sector credit is slowly recovering, gradually shifting from euros to lek and from large corporates to SMEs and households.



PROGRAM PERFORMANCE

13. The program is on track (LOI ¶5–6 and LOI Tables 1 and 3):

- **All performance criteria were met with comfortable margins while two out of three indicative targets were missed**. The indicative target on distribution losses in the electricity sector was missed due to delays in infrastructure investment needed to reduce technical losses. The end-October indicative target on the accumulation of central government domestic arrears was also missed by a small margin (0.2 percent of GDP), with most due to road construction and water infrastructure projects, as well as court decisions regarding layoffs and expropriations. As a prior action to address central government arrears, the authorities have repaid almost all accumulated arrears, in order to bring the stock of outstanding arrears below 1 billion lek (LOI Table 2). In addition, all prioritized contracts from the Ministry of Transport (MoT) have been uploaded into the multi-year commitment registry and a multi-year breakdown has been provided for each contract. Finally, initial steps have been taken toward the establishment of an internal audit unit at the Albanian Road Authority (ARA). Further measures to prevent recurrence of central government arrears are described in ¶21 below.

- **The lower inner band under the Inflation Consultation Clause was missed.** Staff and the authorities concurred that the inflation shortfall did not warrant further policy action at this stage, as upward pressures are building.

- **Most structural benchmarks were implemented, albeit with delays.** Of the fourteen SBs, four SBs were met on time, seven were implemented with delays, and three were missed. The delays in implementation were largely due to capacity constraints and recruitment challenges at the implementing agencies. The need to build consensus within the government postponed the design of a valuation methodology and the drafting of legislation for a valuation-based property tax to October. Therefore, approval by Parliament of the property tax legislation has been delayed to 2017. However, other measures were implemented as prior actions (LOI Table 2) in order to accelerate work on the valuation-based property tax.

MACROECONOMIC OUTLOOK AND RISKS

14. The near-term growth outlook remains broadly unchanged from the Eighth Review under the Extended Arrangement. **GDP growth** is estimated at 3.4 percent in 2016 and projected to reach 3.7 percent in 2017, sustained by large energy-related FDI projects and a gradual recovery of domestic demand. This would raise **inflation** from 2.2 to 2.6 percent. The **current account deficit** is expected to be somewhat narrower in 2016 at 12.1 percent, (compared to 13 percent in the last review) due to weaker-than-expected non-FDI related imports and stronger-than-anticipated tourism exports but to widen somewhat in 2017–18 as demand strengthens and imports of investment goods related to large energy projects pick up.

15. The medium-term outlook remains favorable under the baseline (LOI ¶4). Growth is expected to rise to just over 4 percent over the medium term, underpinned by a flexible labor market, a pickup in investment, and a boost to investor confidence as Albania advances through the EU accession process and implements reforms to improve the business climate. Underlying inflation will then gradually rise to BoA's target of 3 percent in 2018–19. The current account deficit will narrow over the medium term, as large energy-related project imports tail off, and energy and tourism exports pick up and offset gradually declining remittances. External financing will continue to be dominated by FDI and official financing.

16. Risks to the outlook are somewhat on the downside. Political tensions ahead of the 2017 general election could hinder the implementation of structural reforms. A weakening of growth in the EU could spill over to Albania, creating downside risks for public debt reduction. Erratic rainfall could affect electricity generation as in the past, with expensive electricity imports posing quasi-fiscal risks. Slippages in implementing reforms to strengthen the business environment and in tackling corruption and organized crime could erode confidence and investment prospects, undermining medium-term growth potential. On the upside, improved confidence following the passage of the judicial reform package, accelerated donor support as

part of EU accession, and greater spillover effects of the FDI-financed projects could lead to higher investment and a stronger recovery in credit flows.

POLICY DISCUSSIONS

17. Policy discussions for the final review aimed to lock in the main achievements of the program and establish priorities for continued Fund engagement through a Post-Program Monitoring. Specifically, discussions focused on:

(i) a macroeconomic policy mix combining fiscal consolidation with an accommodative monetary policy stance, given the limited fiscal space, the negative output gap, low underlying inflation, and the need to support competitiveness;

(ii) measures needed for the timely implementation of the fiscal structural reform agenda which is key for reducing fiscal risks while achieving growth-friendly consolidation; and

(iii) follow-up actions needed to address NPLs and strengthen supervision to ensure financial stability.

A. Ensuring Fiscal Sustainability and Implementing Structural Fiscal Reforms

18. The authorities remain committed to reducing public debt in order to mitigate risks and support sustainable growth to around 60 percent of GDP by 2019 (LOI ¶13 and text table) from 72.1 percent of GDP in 2016. Under the baseline scenario, this requires measures of around 1 percent of GDP annually and a decline in the overall general government deficit to 0.1 percent of GDP in 2019, from 2.2 percent in 2016. Measures focus primarily on broadening the tax base (for example, by tightening various exemptions), improving tax compliance, and introducing a valuation-based property tax. The authorities are also committed to improving debt management, in order to lower refinancing risks which remain significant given rollover needs of around 25 percent of GDP.

19. Consistent with their medium-term objectives, the authorities target a primary surplus of 1.2 percent of GDP for 2017 (LOI ¶8-10 and text table). The authorities have approved a budget targeting a primary surplus of 0.7 percent of GDP and committed to save additional one-off unbudgeted revenues of around 0.5 percent of GDP. The target implies a structural (excluding one-off factors) improvement of 0.2 percent of GDP but requires the adoption of gross savings measures to the tune of 1.6 percent of GDP in 2017 (text table).[3] The

[3] This difference is broadly accounted for by one-off revenues (0.8 percent of GDP), increased local government spending (0.3 percent of GDP), and a declining revenue baseline due to a low revenue elasticity (0.3 percent of GDP).

fiscal stance seeks to balance the pace of adjustment with its quality and the need to support growth (as the space for monetary easing is limited), and to also accommodate the cost of structural reforms (such as judicial, water sector, and local government reform).

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

	2013	2014	2015	2016		2017		2018		2019	
	Act.	Act.	Act.	EBS/ 16/78	Prel.	EBS/ 16/78	Proj.	EBS/ 16/78	Proj.	EBS/ 16/78	Proj.
Revenues	24.0	26.3	26.3	27.2	26.7	26.6	27.7	26.5	26.8	26.3	26.7
Tax revenue	22.0	24.1	23.7	24.6	24.3	24.3	25.5	24.1	24.6	24.0	24.5
Non-tax revenue	1.6	1.5	1.8	1.7	1.5	1.5	1.4	1.5	1.4	1.5	1.4
Grants	0.4	0.7	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Expenditures	29.2	32.2	30.9	29.7	28.9	29.3	28.8	29.4	28.9	29.6	29.1
Current expenditure (incl. net lending)	24.3	25.4	25.3	25.8	24.9	25.3	24.3	25.2	24.1	25.2	24.2
of which : Energy sector spending 1/		0.9	0.8	0.3	0.2	0.3	0.1	0.3	0.1	0.2	0.1
Capital expenditure 2/	4.8	4.3	4.4	3.8	3.9	3.8	4.5	4.0	4.6	4.2	4.8
Other spending	0.0	2.4	1.2	0.2	0.0	0.2	0.1	0.2	0.1	0.2	0.1
Unidentified measures (cumulative)				0.0		1.1	0.0	2.1	1.3	3.1	2.3
Overall balance	-5.2	-5.9	-4.6	-2.5	-2.2	-1.6	-1.1	-0.8	-0.7	-0.2	-0.1
Overall balance excl. arrears clearance		-3.5	-3.3	-2.5	-2.2	-1.6	-1.1	-0.8	-0.7	-0.2	-0.1
Primary balance	-2.0	-3.0	-1.9	0.2	0.2	0.9	1.2	1.6	1.4	2.1	2.0
Primary balance excl. arrears clearance	-2.0	-0.6	-0.6	0.2	0.2	0.9	1.2	1.6	1.4	2.1	2.0
Structural primary balance	-1.7	-0.2	-0.6	0.5	0.4	1.2	0.6	1.7	1.5	2.2	2.0
Change in the structural primary balance	-1.4	1.6	-0.4	1.1	1.1	0.7	0.2	0.5	0.9	0.5	0.5
Public debt	70.4	72.0	73.7	71.9	72.1	68.7	68.6	65.0	64.8	60.7	60.4
Domestic debt	43.4	42.5	39.5	35.8	38.3	32.7	33.8	30.0	30.5	27.3	27.7
Foreign debt	27.0	29.6	34.2	36.1	33.8	36.1	34.8	35.0	34.2	33.4	32.7
Memo items:											
Nominal GDP (in billions of leks)	1,350	1,394	1,435	1,510	1,505	1,606	1,600	1,718	1,715	1,845	1,842
Public debt (in billions of leks)	950	1,005	1,057	1,086	1,085	1,104	1,098	1,117	1,111	1,120	1,113

Sources: Albanian authorities; IMF staff estimates and projections.

1/ Energy spending includes energy sector subsidies, compensation for the poor, and policy net lending. Prior to 2014, energy subsidies were not recorded in the fiscal accounts, but handled through extra-budgetary guarantees and debt-financed policy net lending.
2/ Starting in 2017, grants to the Regional Development Fund are reclassified from local government spending to capital expenditure.

20. Measures to achieve the target are focused on growth-friendly fiscal adjustment. They aim for a more efficient tax system that broadens the tax base over the medium term while reallocating resources towards capital spending. Specifically, the measures include:

- **Revenue measures:** The 2017 budget seeks to raise oil-related revenues, broaden the base for the circulation tax on luxury cars, reduce exemptions and commence pilot projects to expand the coverage and improve collections from the current area-based property tax. It legislates increases in cigarette excises, starting in 2018, to gradually converge to EU standards. The authorities will also address the increasing stock of VAT credits.

- **Expenditure measures:** The budget will lock in permanent savings under recurrent expenditures, such as from ongoing vacancies in the public administration. The electricity sector is expected to start repaying the public support it received in recent years. The budget allows for moderate public wage and pension increases, while containing the

wage bill as a percent of GDP to 2016 levels and maintaining the current minimum wage in the civil service. The budget also provisions for property compensation claims related to the communist era and provides more resources to local governments, conditioned on enhanced reporting and monitoring of local spending and on clearing the legacy stock of arrears. Finally, the authorities also seek to restore ministerial oversight of the Regional Development Fund and constrain the ability of local governments to carry over their grants.

Policy Measures under the 2017 Budget

Description	2017 Yield (Billions of Leks)	2017 Yield (% of GDP)
Total Measures	**26.2**	**1.6**
Oil-Related Revenues		
Introduce an excise tax on LPG for cars at ALL 8 per liter	0.4	0.0
Repeal the tax incentive to import biofuel	1.1	0.1
Other Tax Measures		
Lower price threshold for luxury cars from 7 to 5 mln.	0.1	0.0
Implement pilot projects on value- or area-based property taxation	2.0	0.1
Reduce customs duty on pet coke and raw materials for the textile industry	-0.1	0.0
Streamline Tax Exemptions	1.0	0.1
Administrative Measures	2.1	0.1
One-off Revenues		
Write off old tax credits and debts and incentivize compliance	4.0	0.2
Rebate capital gains tax for voluntarily declared property values, from Sep. 2016 to Feb. 2017	0.9	0.1
Collect excise debt on diluent for oil extraction	3.7	0.2
Agree to delay TAP VAT reimbursements	4.6	0.3
Expenditure Measures		
Freeze in vacancies offset by an increase in public wages	-1.0	-0.1
Pension reforms partially offset by increase in pensions (3% on average, starting in March 2017)	2.3	0.1
Energy sector reform	1.8	0.1
Rationalization of current primary expenditure (including net lending)	3.3	0.2

21. The authorities are addressing potential risks to their fiscal baseline and further strengthening structural fiscal reforms (LOI ¶9 and 11–12):

- **Tax administration:** Key reforms in tax administration have advanced, including the implementation of a new IT system and comprehensive organizational restructuring, with a focus on compliance-based risk management. However, capacity issues remain a challenge. Audits of VAT refunds are being refocused on high-risk cases and the large stock of tax arrears is being addressed through the use of debt installment and write-off arrangements.

- **Property tax:** The authorities aim to introduce a valuation-based property tax by end-2017, as property tax collections remains very low by regional standards. As a prior action, the Prime Minister has adopted an action plan and appointed a high-level working group to steer the process. A fiscal cadastre is being developed in cooperation with the electricity distribution company. MoF is conducting pilots with four large municipalities in order to strengthen collections by sharing the national property database, integrating property tax bills into electricity/water bills, and collecting property tax based on area, in accordance with current law. Legislative amendments are also under preparation.

- **Public investment management:** Improving public investment management efficiency remains a key challenge given the high degree of project fragmentation in the budget and the large stock of unbudgeted contracted investment projects. The latter have been a source of small but recurring arrears due to weak budget controls. The authorities are implementing the recommendations from the recent Public Investment Management Assessment (PIMA) to address these challenges.

- **Arrears Prevention:** The recurrence of arrears underscores implementation weaknesses in budget execution and commitment control. The authorities have taken initial steps toward the establishment of an internal audit unit (prior action) and have undertaken a financial inspection and revised the framework agreement for road project supervisors to ensure that they do not clear invoices for works exceeding budget allocations. The authorities have prepared a 5-year financing plan for all prioritized unbudgeted investment projects.

- **Public Private Partnerships (PPPs):** To mitigate the risks from PPPs, Parliament amended the Organic Budget Law in June 2016 to limit the total stock of PPPs, integrate PPPs into the budgetary process, and strengthen MoF's role in the assessment and monitoring of PPP proposals. The authorities have clarified the institutional arrangements for monitoring PPPs and have launched a public register of all active PPP projects, in order to ensure transparency for the commitments undertaken by the government.

- **Local government reform**: The authorities are strengthening public financial management as well as new financing sources. They are currently preparing a new law on local finances, to address fiscal risks and improve transparency, monitoring, and accountability. The new local governments have also developed action plans to gradually clear arrears MoF estimates at 0.7 percent of GDP.

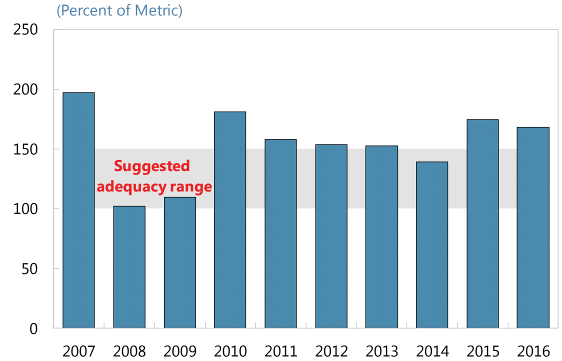
B. Maintaining Accommodative Monetary Policy and Strengthening Central Bank Credibility

22. With inflation below the BoA's target of 3 percent, accommodative monetary policy is expected to continue (LOI ¶14). The BoA is aware that euroization reduces monetary

policy effectiveness, constrains policy space, and heightens financial vulnerabilities, as about half of foreign currency denominated loans (around 1/3 of total loans) are unhedged. The BoA is gradually implementing a de-euroization strategy with a focus on reducing unhedged borrowing and ensuring that banks internalize more fully the risks of FX lending and FX deposits.

23. The BoA is committed to maintaining adequate FX reserve buffers.[4] FX reserves are adequate by standard metrics (text chart). Nevertheless, the authorities considered that additional reserve buffers would provide further insurance in view of the increasing stock of euro-denominated deposits and the large quantity of unhedged FX-denominated loans in the banking system, as well as the moderate overvaluation of the lek (see ¶30).[5] In this context, staff emphasized that any FX intervention should be undertaken gradually, in a transparent manner, and through pre-announced auctions, in order to prevent disorderly market conditions.

Reserves - Floating Regime
(Percent of Metric)



Source: IMF staff calculations.

24. The authorities have made substantial progress in rebuilding the credibility of the central bank and strengthening its governance (LOI ¶20). The BoA has strengthened its internal audit, set up an external audit committee, and adopted IFRS. The authorities are now working on amending the BoA Law to align it with the European System of Central Banks Statute.

C. Safeguarding Financial Stability and Unlocking Credit

25. The BoA continues to strengthen risk-based supervision and its crisis management framework in order to protect financial stability (LOI ¶15 and 17). The banking system is concentrated and dominated by foreign subsidiaries.[6] The BoA is monitoring closely the fastest-growing and systemic banks, as well as banks expanding into non-banking activities. An early warning system has been recently implemented. BoA has entered the European Banking Authority's College of Supervisors. With Fund TA, further efforts are underway to develop a macro-prudential policy toolkit. In addition, the BoA is phasing in an expansion of deposit insurance and has aligned the Bank Resolution Law with the EU's Bank Recovery and Resolution Directive.

26. The authorities have made substantial progress in implementing their comprehensive action plan to reduce NPLs (LOI ¶16 and 18). The new Bankruptcy Law was

[4] BoA has not intervened since August 2015 but has engaged in swap operations with the government.

[5] At end-September 2016, euro-denominated deposits account for 52 percent of total deposits.

[6] The largest four banks account for 70 percent of bank assets, while foreign subsidiaries comprise 86 percent of bank assets.

approved by Parliament in November 2016, together with amendments to the Private Bailiffs Law and the Civil Procedure Code aimed at simplifying the NPL resolution process. The authorities are also seeking to adopt measures to facilitate out-of-court debt restructuring. In addition, efforts are underway to integrate the tax authority into the collateral execution process and to streamline the tax treatment of NPLs. The BoA has also intensified its monitoring of banks' action plans to resolve the NPLs of large borrowers.

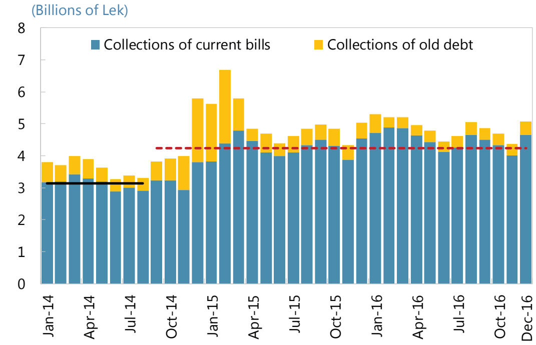
27. Although steps have been taken to strengthen nonbank supervision, weak institutional capacity remains a key challenge (LOI ¶19). New regulations on liquidity requirements and asset valuation for investment funds are expected to be fully phased in by mid-2017. With the investment funds growing and with their portfolios heavily concentrated in illiquid government securities, there is an increasing urgency to strengthen AFSA's supervisory capacity and crisis preparedness. In addition, the increasing role of a single investment fund custodian, a small bank, is raising concerns about systemic vulnerabilities. The authorities are also considering the establishment of a privately-owned stock exchange to develop capital markets.

D. Advancing Structural Reforms

28. The authorities have recently taken important steps in advancing structural reforms that strengthen the investment climate. In July 2016, parliament passed a judicial reform package which seeks to reduce endemic corruption and inefficiency in Albanian courts. The Tax Procedure Code was recently amended to simplify the tax regime. These steps seek to address weaknesses in the business environment, an area where Albania has persistently ranked very low due to critical infrastructure gaps, widespread informality, difficulties with tax administration and access to credit, a shortage of skilled labor, and an inefficient judiciary.

29. Strong implementation of the electricity sector reform is gradually weaning the sector off public support (LOI ¶22). Stronger enforcement has helped reduce distribution losses and raise bill collections (text chart). Fiscal support to the power sector has been reduced from 0.9 percent of GDP in 2014 to a projected 0.1 percent in 2017. A financial restructuring of the state-owned electricity companies is underway while arrears to private power producers have been cleared. Future reforms will focus on further liberalizing the electricity market, upgrading infrastructure, and strengthening corporate governance.

Bill Collections by Electricity Distribution Company
(Billions of Lek)

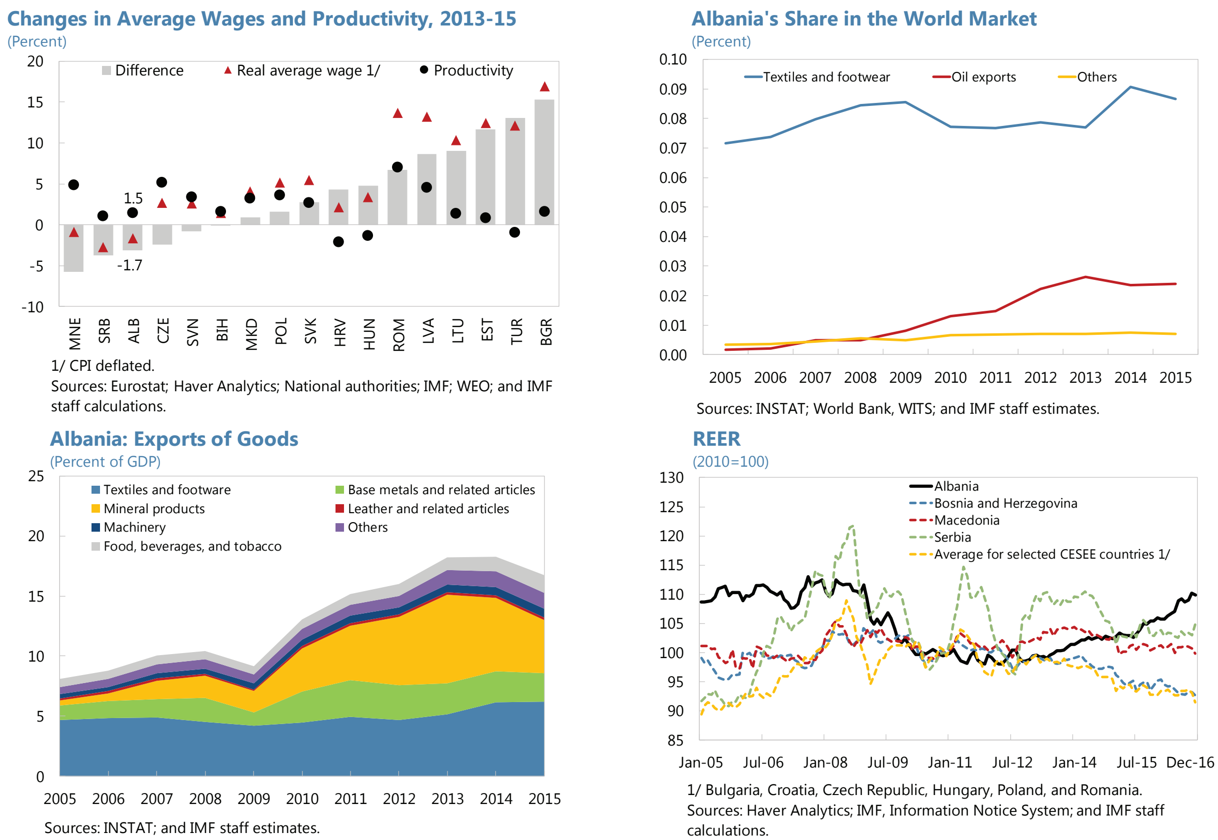


Sources: INSTAT; and IMF staff estimates.

30. Sustaining growth will require further structural reforms to improve productivity and overall competitiveness (Figure 6). The last Article IV staff report (May 2016) reported an exchange rate overvaluation of around 10 percent at end-2015, and the REER has appreciated by

around 4 percent since then. Albania has maintained its cost competitiveness through a tight wage policy, and has made moderate gains in market share in textiles and footwear, its key export sector, since 2013. Nevertheless, Albania's overall competitiveness is lagging due to structural weaknesses which have deterred private investment and hindered productivity growth. Recent commodity price declines have weighed on export growth, particularly as exports remain highly concentrated in a few low value-added sectors (oil, metals, textiles and footwear). Hence, in order to maintain competitiveness and encourage investment in higher value-added products, structural reforms to enhance the business environment, address infrastructure gaps, and improve labor skills would be crucial. The current macroeconomic policy mix combining fiscal consolidation with monetary accommodation should help improve competitiveness by fostering expenditure switching.

Figure 6. Albania: External Competitiveness



PROGRAM DESIGN AND RISKS

31. Given the compressed schedule for the ninth and tenth program reviews, the authorities have requested that they be combined. Although the authorities have met all performance criteria for both test dates, the controlling test date is end-November 2016.

32. Financing remains adequate through 2017. The authorities have built up sizable reserve buffers through market access as well as official financing. In early 2017, the EBRD is expected to complete a €118 million debt restructuring operation with the state-owned electricity generation company and the World Bank is expected to disburse $150 million in development policy loans. EU budget support grants related to the accession process are expected to continue over the next few years at around €15 million annually.

33. Albania's repayment capacity on obligations to the Fund remains strong (Table 7). Fund credit outstanding is estimated to be 3.2 percent of GDP or 13.5 percent of gross reserves in 2017. Debt service to the Fund is expected to peak in 2022 at around 0.4 percent of GDP and 2.7 percent of international reserves. After peaking at around 50 percent of GDP in 2015, external debt will decline to 45 percent of GDP by 2019. External public debt is projected to peak at around 35 percent of GDP in 2017 before falling marginally to around 33 percent of GDP in 2019. Risks to repayment capacity are thus limited and mitigated by Albania's strong record of repaying the Fund and by the authorities' robust performance over the program, including their willingness to move ahead with difficult reforms.

34. Policy risks in the post-program period remain high. The authorities remain firmly committed to an ambitious agenda of fiscal consolidation and structural reform. Nevertheless, with the next general election due by mid-2017, political pressures could test the authorities' perseverance, creating risks for public debt reduction. Revenue mobilization requires sustained political will and is vulnerable to constraints on administrative and technical capacity. Finally, despite good progress so far, electricity sector reforms are subject to implementation and weather-related risks. These risks are mitigated by the prospect of EU accession negotiations, which provides a catalyst for reform. Extensive TA by the Fund and other donors will continue to build up capacity to manage macroeconomic risks.

STAFF APPRAISAL

35. The three-year Extended Arrangement has been successful in achieving its objectives. Growth has recovered while inflation has been persistently low. A sizable revenue-based fiscal adjustment has reduced the fiscal deficit. Public debt has started to decline and refinancing risks have been lowered. Key structural reforms were implemented, including comprehensive pension and electricity sector reforms. A substantial stock of domestic central government arrears was cleared. The recent conditional recommendation to start EU accession negotiations marks an important milestone, recognizing the authorities' commitment in this reform process.

36. Nevertheless, key policy and implementation challenges remain and efforts to address them should continue. Public debt is still high and the efficiency of tax collection remains low. In the banking sector, the NPL overhang continues to deter overall credit growth, particularly among corporates. In this context, the main priorities in the post-program period should be to continue lowering fiscal vulnerabilities, addressing the NPL overhang, and

implementing growth-enhancing structural reforms. Implementation risks remain, given capacity constraints and political uncertainty in the run-up to the elections.

37. Addressing fiscal vulnerabilities posed by the high level of public debt and the related financing needs remains a priority. Steadfast fiscal consolidation in 2017 and beyond is needed to lower public debt to around 60 percent of GDP by end-2019. Under the baseline scenario, this would require measures of around 1 percent of GDP annually. The authorities should seek to strengthen public debt management, in order to lower the high rollover needs and the significant exposure to the domestic banking system.

38. The authorities' consolidation strategy, based on broadening the tax base and improving tax compliance and administration, is appropriate but also challenging. The strategy will thus require strong political commitment. The authorities should refrain from granting new tax incentives. The action plan to introduce a valuation-based property tax should be urgently implemented. Reforms to modernize tax administration and improve compliance are key to ensure fiscal consolidation in an efficient and growth-friendly manner.

39. Sustained effort in tackling fiscal risks is essential. The authorities have made important gains in strengthening fiscal institutions. A strong commitment to implementation will be key as underscored by the small but recurring arrears at the central government level. Further efforts are needed to enhance the credibility of the medium-term budgetary framework, improve public investment management, and tackle arrears on unbudgeted investment projects. The authorities' commitment to strengthen their PPP framework is welcome. The stock of arrears at the local level should be promptly resolved, without introducing moral hazard.

40. The BoA's accommodative monetary policy stance is appropriate. The central bank should maintain its policy stance as long as inflation expectations remain well-anchored and financial stability concerns are contained. Measures to encourage de-euroization should be implemented in a gradual manner with due consideration of disintermediation risks.

41. Recent efforts to strengthen the BoA's supervisory capacity and address NPLs are welcome. Work on amending the central bank law should be accelerated to safeguard its independence. Tackling high NPLs is essential for easing bank risk aversion which continues to hinder a revival in the flow of credit. Implementing regulations for the Bankruptcy and Private Bailiffs laws should be approved rapidly and out-of-court resolution with a focus on large borrowers should be undertaken expeditiously. The BoA's microprudential focus on the fastest-growing and systemically important segments of the banking system should be strengthened further.

42. The supervision of nonbank financial institutions needs to be strengthened. Efforts are needed to build up capacity and improve crisis preparedness. In developing capital market institutions, the authorities should ensure that high transparency and governance standards are maintained.

43. In light of the progress so far and the authorities' policy commitments going forward, staff supports the completion of the Ninth and Tenth Reviews under the Extended Arrangement. Since Albania's outstanding credit to the Fund exceeds 145 percent of quota, staff recommends that Albania return to the standard 12-month cycle for Article IV consultations. Given that outstanding credit to the Fund will exceed quota-based thresholds following drawings on the ninth and tenth review disbursements, it is recommended that Albania engage in Post-Program Monitoring discussions with the Fund after completion of the Extended Arrangement and while outstanding obligations to the Fund exceed 200 percent of quota.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2013–19

	2013	2014	2015	2016		2017		2018	2019
			Prel.	Prog.	Proj.	Prog.	Proj.	Projections	
Real sector				(Growth rate in percent)					
Real GDP	1.0	1.8	2.6	3.4	3.4	3.8	3.7	4.1	4.1
Consumer Price Index (avg.)	1.9	1.6	1.9	1.0	1.3	2.2	2.3	2.9	3.0
Consumer Price Index (eop)	1.9	0.7	2.0	1.8	2.2	2.3	2.6	3.0	3.0
GDP deflator	0.3	1.4	0.3	1.2	1.4	2.4	2.5	3.0	3.1
Saving-investment balance				(Percent of GDP)					
Foreign savings	10.8	12.9	10.8	13.0	12.1	13.4	13.7	13.0	11.8
National savings	16.4	13.0	13.8	15.6	14.8	16.3	15.0	14.5	14.9
Public	-0.8	0.6	0.7	0.6	1.1	1.3	1.6	2.0	2.7
Private	17.2	12.4	13.1	15.0	13.6	14.9	13.4	12.5	12.2
Investment	27.2	26.0	24.6	28.6	26.9	29.6	28.7	27.5	26.6
Public	5.1	4.9	4.9	4.4	4.5	4.2	4.6	4.6	4.6
Private 1/	22.1	21.1	19.7	24.3	22.4	25.4	24.1	22.9	22.0
Fiscal sector									
Total revenue and grants	24.0	26.3	26.3	27.2	26.7	26.6	27.7	26.8	26.7
Tax revenue	22.0	24.1	23.7	24.6	24.3	24.3	25.5	24.6	24.5
Total expenditure	29.2	32.2	30.9	29.7	28.9	29.3	28.8	28.9	29.1
Of which: Repayment of end-2013 stock of unpaid bills and arrears		2.4	1.2	0.0	0.0				
Primary	26.0	29.3	28.2	26.9	26.5	26.8	26.6	26.8	27.0
Interest	3.2	2.9	2.7	2.8	2.4	2.5	2.3	2.1	2.1
Unidentified measures (cumulative)		0.0	0.0	0.0	0.0	1.1	0.0	1.3	2.3
Overall balance	-5.2	-5.9	-4.6	-2.5	-2.2	-1.6	-1.1	-0.7	-0.1
Primary balance	-2.0	-3.0	-1.9	0.2	0.2	0.9	1.2	1.4	2.0
Financing	5.2	5.9	4.6	2.5	2.2	1.6	1.1	0.7	0.1
Of which: Domestic	4.4	3.4	-1.3	0.0	1.1	-0.5	-2.0	-1.0	-0.7
Of which: Foreign	0.8	2.5	4.9	2.5	1.1	2.1	3.1	1.7	0.8
General Government Debt 2/	70.4	72.0	73.7	71.9	72.1	68.7	68.6	64.8	60.4
Domestic	43.4	42.5	39.5	35.8	38.3	32.7	33.8	30.5	27.7
Of which: Unpaid bills and arrears	4.8	1.9	1.0	0.5	0.7				
External	27.0	29.6	34.2	36.1	33.8	36.1	34.8	34.2	32.7
Monetary indicators				(Growth rate in percent, unless otherwise indicated)					
Broad money growth	2.3	4.0	1.8	2.6	3.3	5.4	5.5	5.2	6.5
Private credit growth	-1.4	2.0	-2.8	2.3	0.7	7.0	5.1	8.6	11.0
Velocity (nominal GDP/broad money)	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Interest rate (3-mth T-bills, end-period)	3.4	3.1	1.5	…	1.2	…	…	…	…
BoA repo rate (in percent)	3.0	2.3	1.8	…	1.3	…	…	…	…
External sector				(Percent of GDP, unless otherwise indicated)					
Trade balance (goods and services)	-18.0	-19.0	-17.3	-18.8	-18.2	-18.8	-19.4	-18.5	-17.1
Current account balance	-10.8	-12.9	-10.8	-13.0	-12.1	-13.4	-13.7	-13.0	-11.8
Gross international reserves (in billions of Euros)	2.0	2.2	2.9	2.7	2.9	2.7	2.8	2.7	2.6
(In months of imports of goods and services)	4.5	5.0	6.2	5.4	5.7	5.3	5.3	4.9	4.5
(Relative to external debt service)	6.8	2.9	2.6	6.5	3.6	5.8	3.2	2.9	2.6
(In percent of broad money)	24.6	25.7	32.5	29.7	31.2	29.1	29.4	27.2	24.3
Change in REER (eop, in percent; +=appreciation)	1.0	2.3	1.5	…	3.9	…	…	…	…
Memorandum items									
Nominal GDP (in billions of lek)	1350	1394	1435	1510	1505	1606	1600	1715	1842
Output gap (percent)	-0.7	-1.1	-1.2	-1.0	-1.0	-0.7	-0.7	-0.3	0.0

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

1/ INSTAT revised 2015 national account data in December 2016.

2/ Starting with 2015, the stock of general government debt includes fully documented unpaid bills owed by local governments, most of which were inherited by the new municipalities after the June 2015 territorial reform.

Table 2a. Albania: General Government Operations, 2013–19
(Percent of GDP)

	2013	2014	2015	2016	2016	2017	2017	2018	2019
			Prel.	Prog.	Proj.	Prog.	Proj.	Projections	
Total revenue and grants	24.0	26.3	26.3	27.2	26.7	26.6	27.7	26.8	26.7
Tax revenue	22.0	24.1	23.7	24.6	24.3	24.3	25.5	24.6	24.5
VAT	8.0	8.9	8.7	8.8	8.5	8.7	8.9	8.6	8.6
Profit tax	1.1	1.5	1.7	1.7	1.9	1.7	2.0	1.9	1.9
Excise tax	2.8	2.9	2.7	2.9	2.8	2.8	3.0	2.7	2.7
Personal income tax	2.2	2.1	2.1	2.1	2.1	2.1	2.2	2.2	2.2
Customs duties	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other taxes	2.1	2.3	2.3	2.5	2.4	2.5	2.4	2.4	2.4
Local government revenue 1/	0.8	0.9	0.8	1.0	1.0	1.0	1.1	1.1	1.1
Social insurance contributions	4.4	5.0	5.0	5.3	5.3	5.2	5.3	5.3	5.2
Non-tax revenue	1.6	1.5	1.8	1.7	1.5	1.5	1.4	1.4	1.4
Grants	0.4	0.7	0.8	0.9	0.9	0.9	0.9	0.9	0.9
Total expenditure	29.2	32.2	30.9	29.7	28.9	29.3	28.8	28.9	29.1
Current expenditure	24.3	25.0	24.8	25.7	24.7	25.1	24.2	24.2	24.3
Personnel cost 2/	5.2	5.1	5.1	4.7	4.5	4.7	4.6	4.6	4.6
Interest	3.2	2.9	2.7	2.8	2.4	2.5	2.3	2.1	2.1
Operations & maintenance	2.4	2.2	3.0	2.9	2.9	2.9	2.8	2.8	2.8
Subsidies	0.1	0.6	0.5	0.4	0.2	0.3	0.2	0.4	0.5
Energy guarantees 3/		0.5	0.3	0.2	0.0	0.1	0.0	0.2	0.1
Nonenergy guarantees		0.0	0.0	0.1	0.1	0.1	0.0	0.1	0.2
Other		0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social insurance outlays	9.5	9.9	9.8	10.1	10.1	10.0	10.1	10.0	10.0
Local government expenditure 2/ 4/	2.2	2.4	2.4	3.3	2.9	3.2	2.7	2.7	2.7
Social protection transfers	1.7	1.8	1.4	1.5	1.6	1.5	1.5	1.5	1.5
Capital expenditure 4/	4.8	4.3	4.4	3.8	3.9	3.8	4.5	4.6	4.8
Domestically financed	2.7	2.4	2.6	1.8	2.5	1.4	2.1	2.0	2.5
Foreign financed	2.1	1.9	1.7	2.0	1.4	2.3	2.3	2.6	2.3
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lending minus repayment	0.0	0.4	0.5	0.1	0.2	0.2	0.1	-0.1	-0.1
Reserve and contingency funds 5/	0.0	0.0	0.0	0.2	0.0	0.2	0.1	0.1	0.1
Repayment of end-2013 stock of unpaid bills and arrears		2.4	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified measures (cumulative)		0.0	0.0	0.0	0.0	1.1	0.0	1.3	2.3
Overall balance	-5.2	-5.9	-4.6	-2.5	-2.2	-1.6	-1.1	-0.7	-0.1
Financing	5.2	5.9	4.6	2.5	2.2	1.6	1.1	0.7	0.1
Domestic	4.4	3.4	-1.3	0.0	1.1	-0.5	-2.0	-1.0	-0.7
Privatization receipts	1.2	0.0	0.1	0.2	0.2	0.0	0.0	0.0	0.0
Net borrowing	3.4	3.2	-0.9	-0.2	0.9	-0.5	-2.0	-1.0	-0.7
Change in general gov. deposits		0.1	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Other	-0.3	0.3	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.8	2.5	4.9	2.5	1.1	2.1	3.1	1.7	0.8
Accumulation of arrears 6/	0.0	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:									
Primary balance	-2.0	-3.0	-1.9	0.2	0.2	0.9	1.2	1.4	2.0
Primary balance (excl. repayment of end-2013 stock of unpaid bills and arrears)	-2.0	-0.6	-0.6	0.2	0.2	0.9	1.2	1.4	2.0
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears		-3.5	-3.3	-2.5	-2.2	-1.6	-1.1	-0.7	-0.1
General Government Debt 7/	70.4	72.0	73.7	71.9	72.1	68.7	68.6	64.8	60.4
Of which: Short-term general government debt	19.7	20.6	17.7	12.7	13.5	9.5	8.6	8.6	7.8
Domestic	43.4	42.5	39.5	35.8	38.3	32.7	33.8	30.5	27.7
Of which: Unpaid bills and arrears	4.8	1.9	1.0	0.5	0.7				
External	27.0	29.6	34.2	36.1	33.8	36.1	34.8	34.2	32.7
Direct general government external debt	24.6	27.5	32.4	34.3	32.2	34.4	32.6	32.1	30.3
Government guaranteed external debt	2.3	2.0	1.8	1.8	1.6	1.7	2.2	2.2	2.4
GDP (in billions of leks)	1350	1394	1435	1510	1505	1606	1600	1715	1842

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

1/ Includes the property tax, the simplified profit tax for small businesses, and other local taxes.
2/ There is a structural break in 2016, reflecting the transfer of central government employees to local governments, as part of fiscal decentralization.
3/ Starting in 2017, guarantees are recorded on a net basis, including amortization.
4/ There is a structural break in 2017, reflecting the transfer of the Regional Development Fund to the Ministry of Urban Development.
5/ Spending contingencies are reported according to their economic classification at outturn.
6/ As reflected in official data and not accounting for arrears accumulated outside of the budget prior to 2014.
7/ Starting with 2015, the stock of general government debt includes fully documented unpaid bills owed by local governments, most of which were inherited by the new municipalities after the June 2015 territorial reform.

Table 2b. Albania: General Government Operations, 2013–19

(Billions of leks)

	2013	2014	2015	2016		2017		2018	2019
				Prog.	Proj.	Prog.	Proj.	Projections	
Total revenue and grants	323.7	366.6	377.5	410.1	401.3	427.4	444.0	460.4	492.3
Tax revenue	296.4	335.8	340.6	371.4	366.0	389.6	407.4	421.7	450.7
VAT	108.5	123.7	124.8	132.7	128.1	139.2	143.2	146.9	157.9
Profit tax	15.1	21.5	24.2	25.3	28.5	26.9	32.2	33.0	35.4
Excise tax	38.2	40.9	39.0	43.2	41.9	44.3	48.8	47.2	49.2
Personal income tax	29.6	28.9	29.7	32.1	31.4	34.1	35.5	37.2	39.9
Customs duties	5.8	5.9	5.8	6.1	6.1	6.4	6.7	6.9	7.5
Other taxes	28.5	32.6	33.7	37.9	35.8	39.9	38.8	41.0	43.8
Local government revenue 1/	10.8	12.4	11.7	14.8	15.0	15.7	17.6	19.4	20.8
Social insurance contributions	60.0	69.9	71.7	79.3	79.2	83.0	84.8	90.3	96.3
Non-tax revenue	21.6	20.7	25.7	25.7	22.4	24.0	22.8	23.9	25.7
Grants	5.7	10.1	11.2	13.0	12.9	13.8	13.8	14.8	15.9
Total expenditure	394.1	448.6	443.0	448.1	434.5	470.1	461.3	495.5	536.1
Current expenditure	328.6	348.1	355.9	388.2	372.3	402.6	387.3	415.3	447.1
Personnel cost 2/	70.7	71.4	72.5	70.2	67.5	74.7	74.0	79.4	85.2
Interest	43.3	40.1	38.6	41.8	36.3	39.6	36.1	36.4	38.7
Operations & maintenance	32.4	31.3	42.4	43.6	44.3	46.4	45.1	48.3	51.9
Subsidies	1.6	8.4	6.8	6.7	3.8	5.5	3.1	6.8	9.3
Energy guarantees 3/		6.7	4.6	3.2	0.0	1.3	0.4	2.6	2.6
Nonenergy guarantees		0.1	0.5	1.7	2.0	2.4	0.3	1.7	4.1
Other		1.6	1.7	1.8	1.7	1.9	2.3	2.5	2.7
Social insurance outlays	127.6	138.5	141.2	152.1	152.6	160.5	162.1	172.4	184.6
Local government expenditure 2/ 4/	29.8	32.9	34.1	50.4	43.5	51.0	43.5	47.1	50.6
Social protection transfers	23.2	25.5	20.2	23.4	24.3	24.9	23.3	25.0	26.8
Capital expenditure 4/	65.5	60.5	62.6	56.8	59.1	60.3	71.4	79.3	88.1
Domestically financed	36.7	33.8	37.7	27.0	38.2	22.8	34.1	34.5	45.5
Foreign financed	28.8	26.8	24.9	29.7	20.9	37.6	37.3	44.8	42.7
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lending minus repayment	0.0	5.9	7.3	0.8	3.1	3.2	1.1	-1.1	-1.1
Reserve and contingency funds 5/	0.0	0.0	0.0	2.4	0.0	4.0	1.5	2.0	2.0
Repayment of end-2013 stock of unpaid bills and arrears		33.8	17.6	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified measures (cumulative)		0.0	0.0	0.0	0.0	17.7	0.0	22.3	41.8
Overall balance	-70.4	-82.1	-65.5	-38.0	-33.2	-25.0	-17.3	-12.8	-2.0
Financing	70.4	82.1	65.5	38.0	33.2	25.0	17.3	12.8	2.0
Domestic	59.6	47.5	-18.5	0.1	16.6	-8.7	-32.3	-16.8	-13.4
Privatization receipts	16.7	0.0	0.9	2.6	2.8	0.0	0.0	0.0	0.0
Net borrowing	46.3	45.0	-12.6	-2.5	13.9	-8.7	-32.3	-16.8	-13.4
Of which: banks	…	…	0.0	-1.3	6.9	-4.3	-16.1	-8.4	-6.7
Change in general gov. deposits	…	1.5	6.9	0.0	0.0	0.0	0.0	0.0	0.0
Other	-3.4	4.0	-13.6	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	10.8	34.3	71.0	38.0	17.3	33.7	49.5	29.5	15.4
Accumulation of arrears 6/	0.0	0.3	13.0	0.0	-0.7	0.0	0.0	0.0	0.0
Memorandum Items:									
Primary balance	-27.1	-42.0	-26.9	3.7	3.0	14.5	18.9	23.6	36.6
Primary balance (excl. repayment of end-2013 stock of unpaid bills and arrears)	-27.1	-8.2	-9.3	3.7	3.0	14.5	18.9	23.6	36.6
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears		-48.3	-47.9	-38.0	-33.2	-25.0	-17.3	-12.8	-2.0
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears, and new guarantees		-41.5	-42.8	-33.1	-31.2	-21.4	-16.5	-8.5	4.6
General Government Debt 7/	950.3	1004.5	1057.1	1085.8	1085.3	1103.7	1098.5	1111.3	1113.3
Of which: Short-term general government debt	265.7	286.6	254.3	191.8	202.4	152.3	137.7	146.9	143.8
Domestic	586.4	592.1	566.2	540.5	577.1	524.6	540.8	524.0	510.6
Of which: Unpaid bills and arrears	65.2	26.6	13.9	7.2	10.9				
External	363.9	412.4	490.9	545.4	508.2	579.1	557.7	587.3	602.7
Direct general government external debt	332.5	383.9	465.3	518.2	484.8	551.8	521.8	550.2	557.8
Government guaranteed external debt	31.4	28.5	25.6	27.2	23.3	27.3	35.9	37.0	44.9

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

1/ Includes the property tax, the simplified profit tax for small businesses, and other local taxes.
2/ There is a structural break in 2016, reflecting the transfer of central government employees to local governments, as part of fiscal decentralization.
3/ Starting in 2017, guarantees are recorded on a net basis, including amortization.
4/ There is a structural break in 2017, reflecting the transfer of the Regional Development Fund to the Ministry of Urban Development.
5/ Spending contingencies are reported according to their economic classification at outturn.
6/ As reflected in official data and not accounting for arrears accumulated outside of the budget prior to 2014.
7/ Starting with 2015, the stock of general government debt includes fully documented unpaid bills owed by local governments, most of which were inherited by the new municipalities after the June 2015 territorial reform.

Table 3a. Albania: Balance of Payments, 2013–19[1]

(Percent of GDP)

	2013	2014	2015	2016		2017		2018	2019
			Prel.	Prog.	Proj.	Prog.	Proj.	Projections	
Current account	-10.8	-12.9	-10.8	-13.0	-12.1	-13.4	-13.7	-13.0	-11.8
Balance of goods and services	-18.0	-19.0	-17.3	-18.8	-18.2	-18.8	-19.4	-18.5	-17.1
Trade Balance (goods)	-17.9	-22.2	-22.4	-22.5	-22.2	-22.4	-23.0	-22.1	-20.8
Exports	18.3	9.4	7.5	6.3	6.4	6.1	7.0	7.0	6.8
Of which: Energy	5.7	4.6	3.2	2.2	2.2	2.1	2.3	2.4	2.3
Imports	36.1	31.6	29.9	28.8	28.5	28.4	30.0	29.1	27.7
Of which: Energy	6.6	6.1	3.9	3.9	3.9	4.7	4.6	5.1	5.0
Services (net)	-0.2	3.2	5.1	3.7	3.9	3.6	3.6	3.6	3.8
Income balance	0.2	-1.2	-1.0	-1.6	-1.1	-1.6	-1.1	-1.2	-1.2
Of which: Interest due	0.5	1.8	1.8	1.2	1.8	1.1	1.8	1.9	1.9
Current transfers	7.1	7.3	7.5	7.3	7.2	7.0	6.9	6.7	6.5
Capital and Financial account	8.7	9.0	6.2	6.3	8.0	9.7	7.1	8.2	7.6
Capital transfers	0.5	0.9	1.2	0.8	0.8	0.7	0.7	0.7	0.6
Direct investment, net	9.6	8.1	8.0	8.2	7.4	8.0	8.3	7.2	5.6
Government Medium- and long-term loans, net	1.1	0.6	-2.5	0.0	0.0	0.3	0.3	0.3	-0.1
Project loans	1.9	1.7	1.7	1.5	1.2	2.0	1.7	1.9	1.6
Other loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization (includes Eurobond bullet payment)	-0.8	-1.1	-4.2	-1.5	-1.2	-1.7	-1.4	-1.6	-1.7
Government Guaranteed Borrowing, net	-0.2	-0.2	-0.2	0.0	-0.1	0.0	-0.2	0.1	0.4
Disbursement	0.1	0.0	0.0	0.2	0.1	0.2	0.0	0.4	0.7
Amortization	-0.2	-0.2	-0.2	-0.2	-0.3	-0.2	-0.3	-0.4	-0.3
Other flows	-2.1	-1.0	-1.0	-3.5	-0.9	-0.2	-2.8	-1.0	0.1
Errors and omissions [2/]	3.1	2.7	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Net balance	1.1	-1.2	-1.9	-4.2	-1.5	-1.1	-3.9	-2.2	-1.6
Available financing	-1.1	1.2	1.8	4.2	1.5	1.1	3.9	2.2	1.6
Change in net reserves (increase = -) [3/]	-1.1	-1.0	-5.9	1.8	0.1	-0.7	0.8	0.8	1.0
IMF (budget support)	…	0.5	0.9	1.3	1.3	0.6	0.6	0.0	0.0
World Bank (DPL)	…	1.7	0.0	0.0	0.1	0.8	1.2	0.6	0.5
Other budget loans	…	…	…	1.1	0.0	0.4	1.2	0.8	0.0
Commercial borrowing	0.0	0.0	6.8	0.0	0.0	0.0	0.0	0.0	0.0
o/w WB PBG			2.4						
o/w Eurobond			4.4						
Memorandum items:									
Exports of Goods and Services (percent of GDP)	35.4	35.2	34.3	32.8	33.0	32.6	33.3	33.5	33.2
Imports of Goods and Services (percent of GDP)	53.5	54.2	51.6	51.6	51.2	51.4	52.7	51.9	50.3
Current Account (percent of GDP)									
excluding imports related to large energy projects	-10.8	-12.9	-8.9	-8.8	-9.2	-10.8	-10.8	-11.2	-11.2
Balance of goods and services									
excluding imports related to large energy projects	-18.0	-19.0	-15.4	-14.5	-15.3	-16.2	-16.5	-16.7	-16.5

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

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

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

3/ Net of valuation changes in 2013–14. In projections for 2015–19, valuation effects are assumed to be zero.

Table 3b. Albania: Balance of Payments, 2013–19[1]
(Millions of euros, unless otherwise indicated)

	2013	2014	2015	2016		2017		2018	2019
				Prog.	Proj.	Prog.	Proj.	Projections	
Current account	-1,036	-1,287	-1,105	-1,416	-1,324	-1,533	-1,596	-1,597	-1,551
Balance of goods and services	-1,737	-1,892	-1,774	-2,038	-1,996	-2,151	-2,267	-2,273	-2,245
Trade Balance (goods)	-1,719	-2,216	-2,299	-2,443	-2,428	-2,561	-2,686	-2,720	-2,742
Exports	1,757	932	771	680	699	696	816	861	897
Of which: Energy	545	463	323	239	237	235	269	289	297
Imports	3,476	3,147	3,070	3,123	3,128	3,257	3,502	3,581	3,639
Of which: Energy	631	611	405	428	424	534	533	626	657
Services (net)	-18	323	525	405	432	410	419	447	497
Income balance	21	-119	-99	-169	-120	-184	-133	-153	-161
Of which: Interest due	51	176	182	126	194	129	211	238	256
Current transfers	680	725	768	792	792	802	804	829	855
Capital and Financial account	840	899	641	681	877	1,111	833	1,009	1,002
Capital transfers	48	87	126	85	85	85	85	85	85
Direct investment, net	923	812	818	895	816	915	967	883	735
Government Medium- and long-term loans, net	105	56	-256	-1	-1	31	33	33	-17
Project loans	180	165	171	162	130	231	201	230	208
Other loans	0	0	0	0	0	0	0	0	0
Amortization (includes Eurobond bullet payment)	-74	-108	-426	-163	-131	-200	-168	-197	-225
Government Guaranteed Borrowing, net	-15	-22	-19	-4	-16	1	-28	8	56
Disbursement	5	0	3	20	14	26	5	55	98
Amortization	-21	-22	-23	-24	-30	-25	-33	-47	-42
Other flows	-206	-102	-100	-382	-95	-21	-326	-118	7
Errors and omissions 2/	301	266	268	278	286	293	305	321	344
Net balance	105	-122	-195	-457	-161	-129	-458	-267	-205
Available financing	-104	122	186	457	161	129	458	267	205
Change in net reserves (increase = -) 3/	-104	-97	-610	195	8	-80	98	96	133
IMF (budget support)	…	54	96	144	144	71	73	0	0
World Bank (DPL)	…	166	0	0	9	88	142	71	71
Other budget loans	…	…	…	118	0	50	144	100	0
Commercial borrowing	0	0	700	0	0	0	0	0	0
o/w WB PBG			250						
o/w Eurobond			450						
Memorandum items:									
Nominal GDP	9,625	9,962	10,267	10,862	10,956	11,457	11,666	12,292	13,154
Gross international reserves	2,015	2,192	2,880	2,652	2,900	2,730	2,803	2,708	2,573
(months of imports of goods and services)	4.5	5.0	6.2	5.4	5.7	5.3	5.3	4.9	4.5
Balance of goods and services (percent of GDP)	-18.0	-19.0	-17.3	-18.8	-18.2	-18.8	-19.4	-18.5	-17.1
Current account (percent of GDP)	-10.8	-12.9	-10.8	-13.0	-12.1	-13.4	-13.7	-13.0	-11.8
Debt service (percent of exports of goods and services) 4/	0.0	1.9	11.4	5.4	3.0	5.5	3.8	4.9	5.2
Debt service (percent of central government revenues) 4/	0.0	2.7	15.6	7.3	4.0	7.4	5.3	6.8	7.1
Total external debt stock (percent of GDP) 5/	44.8	47.6	49.6	42.1	49.1	42.4	49.2	47.0	44.7
Exports of Goods and Services (millions of Euros)	3,412	3,507	3,524	3,566	3,615	3,733	3,886	4,113	4,368
Imports of Goods and Services (millions of Euros)	5,149	5,400	5,299	5,604	5,611	5,885	6,152	6,385	6,613
Volume of Exports of Goods and Services (percent change)	5.6	10.1	1.8	1.1	1.0	3.1	3.2	4.9	4.0
Volume of Imports of Goods and Services (percent change)	4.2	7.6	0.6	7.1	6.7	3.8	4.5	2.9	2.5
Terms of trade (percent change)	-1.0	-1.8	-5.6	…	-2.2	…	3.3	-0.6	-0.9

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

1/ Historical data for 2013 reflect old BPM5 estimates which record insourcing services as goods. The data from 2014 onwards reflect BPM6 treatment of textile insourced manufacturing, which is recorded as services.
2/ Includes unidentified flows of private transfers, which are projected to decline gradually over the medium term with the decline in remittances as a share of GDP.
3/ Net of valuation changes in 2013–14. In projections for 2015–19, valuation effects are assumed to be zero.
4/ Public and publicly guaranteed debt only.
5/ Public and private external debt, including arrears. Debt stock converted into Lek at the e-o-p exchange rate. Data revised to reflect higher private external debt as captured under BPM6. These figures exclude the stock of intercompany liabilities.

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

	2013	2014	2015	2016		2017	
				Prog.	Proj.	Prog.	Proj.
Net foreign assets	479	525	615	659	673	701	748
Bank of Albania	274	292	363	344	365	341	345
Commercial banks	205	233	251	315	309	360	403
Net domestic assets	670	670	602	590	583	617	576
Claims on central government, net	363	378	332	331	346	328	336
Bank of Albania	43	47	27	24	34	27	30
Commercial banks	320	331	305	306	312	300	307
Claims on public enterprises	25	27	28	11	26	2	10
Claims on the private sector	513	524	509	521	513	557	539
In leks	195	207	212	217	214	232	225
In foreign currency	318	317	296	303	299	324	314
Other items, net	-231	-259	-267	-272	-302	-270	-308
Broad money	1,149	1,195	1,216	1,250	1,256	1,317	1,324
Currency outside banks	199	218	231	237	244	248	256
Deposits	950	977	986	1,013	1,012	1,069	1,069
Domestic currency	494	505	493	506	485	534	513
Foreign currency	456	473	493	507	526	535	556
Memorandum items:							
Broad money growth (% change)	2.3	4.0	1.8	2.6	3.3	5.4	5.5
Reserve money growth (% change)	3.5	8.1	15.3	-2.2	3.3	3.8	0.2
Private sector credit growth (% change)	-1.4	2.0	-2.8	2.3	0.7	7.0	5.1
Broad money (as percent of GDP)	85.1	85.7	84.8	82.7	83.5	82.0	82.8
Private sector credit (as percent of GDP)	38.0	37.6	35.5	34.5	34.1	34.7	33.7
Velocity (nominal GDP/broad money)	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Money multiplier (absolute values)	3.7	3.6	3.2	3.3	3.2	3.4	3.3
Currency (as share of broad money)	17.3	18.2	19.0	18.9	19.5	18.8	19.3
Foreign currency deposits/total deposits	48.0	48.4	50.0	50.0	52.0	50.0	52.0
Gross reserves (millions of euros)	2,015	2,192	2,880	2,652	2,900	2,730	2,803

Sources: Bank of Albania; and IMF staff estimates.

Table 4b. Albania: Summary of Accounts of the Central Bank, 2013–17
(Billions of leks, unless otherwise indicated; end-period)

	2013	2014	2015	2016		2017	
				Prog.	Proj.	Prog.	Proj.
Net foreign assets	274	292	363	344	365	341	345
Assets	294	319	405	389	410	402	408
Liabilities	20	27	42	44	45	61	63
Net domestic assets	34	41	21	31	32	49	53
Domestic credit	66	75	41	53	65	66	84
Net claims on central government	43	47	27	24	34	27	30
Assets	65	64	53	51	53	51	53
Liabilities	22	17	26	27	19	24	24
Other credit	23	27	15	28	30	38	55
Private sector	2	2	2	2	2	2	2
Commercial banks	22	26	13	27	29	37	53
Other items, net (assets = +)	-32	-34	-21	-22	-33	-17	-32
Reserve money	308	333	384	375	397	390	398
Currency in circulation	199	218	231	237	244	248	256
Bank reserves	109	115	152	139	152	142	142
Other nonbank deposits	0	0	2	0	0	0	0

Sources: Bank of Albania; and IMF staff estimates.

Table 5. Albania: IMF Core Indicators of Financial Soundness, 2007–16

		Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
I	Capital-based															
(i)	Regulatory capital as a percent of risk-weighted assets	17.1	17.2	16.2	15.4	15.6	16.2	18.0	16.8	15.8	16.0	15.8	15.7	16.0	16.1	15.6
(ii)	Regulatory Tier 1 capital as a percent of risk-weighted assets	16.0	16.3	15.3	14.5	14.3	14.6	14.9	13.8	13.1	13.6	13.2	13.5	13.8	14.0	13.6
(iii)	Capital as a percent of total assets															
	Regulatory Tier 1 capital as a percent of total assets	5.8	6.7	8.7	8.6	8.1	7.9	7.7	7.4	8.0	8.3	8.4	8.3	8.5	8.8	8.9
	Regulatory capital as a percent of total assets	6.2	7.0	9.2	9.1	8.8	8.8	9.3	9.0	9.7	9.7	9.7	9.7	9.9	10.1	10.2
	Shareholders' equity as a percent of total assets	7.6	8.6	9.6	9.4	8.7	8.6	8.4	8.6	9.0	9.1	9.2	9.5	9.4	9.6	9.7
(iv)	Nonperforming loans net of provisions as a percent of capital															
	As a percent of regulatory Tier 1 capital	12.0	27.2	29.9	38.1	56.6	61.8	48.5	46.7	42.3	36.1	33.9	28.4	31.5	35.0	36.6
	As a percent of regulatory capital	11.2	25.7	28.2	35.9	52.0	55.6	40.2	38.3	35.2	30.8	29.2	24.3	27.1	30.4	32.0
	As a percent of shareholders' equity	9.1	21.1	27.1	34.8	52.6	56.9	44.8	40.2	37.6	32.8	30.8	24.8	28.7	32.0	33.6
(v)	Return on equity (ROE) (annual basis)	20.7	11.4	4.6	7.6	0.8	3.8	6.4	10.5	20.3	14.2	13.1	13.2	4.5	8.0	6.8
(vi)	Net open position in foreign exchange as a percent of capital															
	As a percent of regulatory Tier 1 capital	1.8	4.5	4.1	5.3	4.3	4.1	4.9	10.4	5.1	8.5	9.3	9.0	7.1	9.7	9.4
	As a percent of regulatory capital	1.7	4.3	3.9	5.0	3.9	3.7	4.1	8.5	4.2	7.2	8.0	7.7	6.1	8.4	8.2
	As a percent of shareholders' equity	1.4	3.5	3.7	4.9	4.0	3.8	4.5	8.9	4.5	7.7	8.4	7.8	6.4	8.9	8.6
II	Asset-based															
(vii)	Liquid assets as a percent of total assets (Liquid-asset ratio) 1/	49.8	42.8	27.6	25.9	26.5	29.4	27.6	31.9	33.2	32.6	33.2	32.3	31.8	31.0	29.9
(viii)	Liquid assets as a percent of short-term liabilities 1/	55.6	104.7	32.6	30.6	33.1	34.9	34.7	40.4	42.3	42.0	43.3	41.4	40.6	40.0	38.6
(ix)	Return on assets (ROA) (net income to average total assets, annual)	1.6	0.9	0.4	0.7	0.1	0.3	0.5	0.9	1.8	1.3	1.2	1.2	0.4	0.8	0.7
(x)	Nonperforming loans (gross) as a percent of total loans	3.4	6.6	10.5	14.0	18.8	22.5	23.5	22.8	22.8	20.9	20.6	18.2	19.3	20.0	21.3
III	Income and expense-based															
(xii)	Interest margin to gross income	92.7	106.5	119.6	118.9	147.7	130.4	112.6	113.1	127.1	108.9	109.8	109.0	101.1	119.1	122.3
(xiii)	Noninterest expenses to gross income	58.5	69.6	83.0	75.5	91.3	85.0	74.7	68.4	81.4	61.2	62.6	63.4	65.7	70.6	74.2
IV	Memorandum items															
	Other (noncore) indicators:															
	Customer deposits as a percent of total (non-interbank) loans	215.5	162.6	154.3	166.4	163.2	171.6	180.8	180.2	180.7	180.5	184.2	187.8	188.3	184.1	187.7
	Foreign currency-denominated loans to total loans	72.5	72.6	70.2	69.8	67.9	64.5	63.0	62.4	62.2	61.7	61.2	60.8	60.6	60.1	59.5
	Foreign currency-denominated liabilities as a percent of total liabilities	46.9	48.5	48.9	51.0	51.9	52.6	52.8	52.4	52.5	52.8	53.0	53.5	54.5	54.1	54.8
	Other indicators:															
	Risk weighted assets as a percent of total assets	36.4	40.8	56.7	59.2	56.5	54.2	52.1	53.6	61.3	60.5	61.3	62.0	62.0	62.6	65.2
	Total loans as a percent of total assets	39.4	47.6	50.8	49.6	50.5	48.6	45.9	46.0	45.6	45.5	44.7	44.5	44.4	44.9	43.9
	Total loans as a percent of shareholders' equity	516.4	555.1	530.2	527.0	581.9	567.4	548.8	536.3	504.1	501.2	485.8	466.8	473.6	469.2	453.1

Source: Bank of Albania.

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

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

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

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

Table 7. Albania: Indicators of Capacity to Repay the Fund, 2013–22[1,2]
(Under Obligated Repurchase Schedule; in millions of SDRs)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Fund repurchases and charges										
In millions of SDRs	6.9	6.1	5.3	5.4	6.2	9.6	18.8	31.5	47.6	51.7
In millions of euro	7.7	7.2	6.8	6.9	7.9	12.3	24.0	40.2	60.9	66.3
In percent of gross international reserves	0.4	0.3	0.2	0.2	0.3	0.5	0.9	1.6	2.5	2.7
In percent of exports of goods and services	0.2	0.2	0.2	0.2	0.2	0.3	0.5	0.9	1.2	1.2
In percent of GDP	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.3	0.4	0.4
In percent of external public debt	0.3	0.2	0.2	0.2	0.2	0.3	0.6	1.0	1.4	1.5
In percent of quota	11.5	10.1	8.9	3.9	4.4	6.9	13.5	22.6	34.1	36.9
Fund credit outstanding (end of period)										
In millions of SDRs	16.4	57.7	129.3	241.5	296.8	291.7	277.3	249.6	205.1	155.9
In millions of euro	18.4	68.1	164.8	308.7	378.6	372.5	353.9	318.7	262.5	199.8
In percent of gross international reserves	0.9	3.1	5.7	10.6	13.5	13.8	13.8	12.9	10.9	8.0
In percent of exports of goods and services	0.5	1.9	4.7	8.5	9.7	9.1	8.1	6.9	5.3	3.7
In percent of GDP	0.2	0.7	1.6	2.8	3.2	3.0	2.7	2.3	1.7	1.2
In percent of external public debt	0.7	2.3	4.8	8.3	9.6	9.2	8.5	7.7	6.2	4.6
In percent of quota	27.3	96.1	215.6	173.4	213.0	209.4	199.1	179.2	147.3	111.1
Memorandum items:										
Gross international reserves	1795	1855	2261	2269	2197	2121	2016	1937	1879	1948
Exports of goods and services	3039	2969	2767	2827	3046	3221	3423	3643	3884	4166
GDP	8575	8432	8060	8571	9144	9626	10308	11055	11832	12709
External public debt	2351	2458	2692	2911	3087	3171	3259	3229	3303	3363
Quota	60.0	60.0	60.0	139.3	139.3	139.3	139.3	139.3	139.3	140.3

Source: Fund staff estimates.

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

Table 8. Albania: External Financing Requirement and Sources, 2014–2019
(Millions of Euros)

	2014	2015	2016	2017	2018	2019
	Act.		Est.		Proj.	
Total financing requirement	1,429	2,038	1,393	1,614	1,661	1,600
Current account (incl. official transfers)	1,200	979	1,239	1,511	1,512	1,466
Amortization	131	450	161	202	244	268
Of which: IMF	0	0	0	0	6	18
Change in gross reserves (increase = +)1/	97	610	-8	-98	-96	-133
Total financing sources	1,429	2,038	1,393	1,614	1,661	1,600
Foreign direct investment, net	812	818	816	967	883	735
Official medium- and long-term project loans	165	171	130	201	230	208
Multilateral	95	68	57	119	127	106
Bilateral	70	103	73	82	103	102
Official guaranteed loans	0	3	14	5	55	98
Official budget support loans	220	105	153	359	171	71
Of which: IMF	54	96	144	73	0	0
Commercial borrowing (Eurobond and PBG)	0	700	0	0	0	0
Other 2/	233	241	280	82	321	488

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

1/ The change in gross reserves is net of valuation changes for 2014-15. In projections for 2016-19, valuation effects are assumed to be zero.

2/ Includes errors and omissions.

Annex. Main Achievements under the Extended Arrangement

1. **The three-year Extended Arrangement has sought to correct large macroeconomic imbalances and increase economic growth, against the backdrop of a weak economic recovery in Europe.** In 2013, Albania's GDP growth decelerated to its lowest level in decades. Public debt increased by 11 percent of GDP between 2011 and 2013, including a large stock of central government domestic arrears (4.8 percent of GDP at end-2013). The government was heavily dependent on the domestic banking sector for financing and facing significant rollover risks, with the bulk of domestic public debt at very short maturities and with a foreign-dominated banking system in the midst of deleveraging from high exposure to the government. In addition, an unsustainable pension system and electricity sector both posed heavy burdens on public finances. Given these challenges, the Extended Arrangement was approved with the objectives of strengthening public finances, maintaining financial stability, and implementing structural reforms focused on reforming the energy sector and improving the business climate.

Albania: Comparison of Projections between Program Proposal and Current Macro Framework
(Percent of GDP, unless otherwise indicated)

program proposal (EBS/14/19)	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	current macro framework	2013 Act.	2014 Act.	2015 Prel.	2016 Proj.
Real					***Real***				
Nominal GDP (billions of lek)	1,358	1,418	1,502	1,607	Nominal GDP (billions of lek)	1,350	1,394	1,435	1,505
Real GDP growth (%)	0.7	2.1	3.3	4.2	Real GDP growth (%)	1.0	1.8	2.6	3.4
GDP deflator (%)	1.7	2.3	2.5	2.7	GDP deflator (%)	0.3	1.4	0.3	1.4
Average CPI inflation (%)	1.9	2.7	2.8	3.0	Average CPI inflation (%)	1.9	1.6	1.9	1.3
External					**External**				
Current account	-9.0	-10.3	-12.4	-14.8	Current account	-10.8	-12.9	-10.8	-12.1
Gross international reserves					Gross international reserves				
(months of imports of goods and services)	4.8	4.5	4.1	4.0	(months of imports of goods and services)	4.5	5.0	6.2	5.7
Fiscal					***Fiscal***				
Total revenue and grants 1/	24.0	25.4	26.4	27.7	Total revenue and grants 1/	24.0	26.3	26.3	26.7
Tax revenue 1/	21.6	23.3	24.5	25.8	Tax revenue 1/	22.0	24.1	23.7	24.3
Total expenditure	30.1	32.1	31.3	31.1	Total expenditure	29.2	32.2	30.9	28.9
Primary expenditure	26.9	28.9	27.1	26.9	Primary expenditure	26.0	29.3	28.2	26.5
Overall balance	-6.2	-6.7	-4.8	-3.4	Overall balance	-5.2	-5.9	-4.6	-2.2
Primary balance	-2.9	-3.4	-0.7	0.8	Primary balance	-2.0	-3.0	-1.9	0.2
Public debt (billions of lek) 2/	957	1,016	1,069	1,106	General government debt (billions of lek) 2/	950	1,005	1,057	1,085
Public debt 2/	70.5	71.7	71.2	68.8	General government debt 2/	70.4	72.0	73.7	72.1
Monetary					***Monetary***				
Private sector credit growth (%)	-3.0	-2.6	4.9	6.2	Private sector credit growth (%)	-1.4	2.0	-2.8	0.7

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

1/ Numbers for the program proposal include unidentified measures.
2/ Starting with 2015, general government debt in the current macro framework includes arrears owed by local governments. These were not included in the program proposal.

2. **Under the Extended Arrangement, the government has made significant progress in addressing these challenges.** GDP growth has recovered, although less strongly than originally projected. Nominal GDP in 2016 is now projected to be about 6 percent lower than in the program proposal, with most of the forecast error due to downside inflation surprises, mainly because of lower commodity prices and external disinflationary pressures. On the external side, gross

international reserves are ample and exceed the original program projections, reflecting stronger than expected financing from multilaterals.

3. **The authorities have implemented sizable fiscal adjustment.** Compared to 2013, fiscal revenues have increased by around 2.7 percent of GDP. While substantial, this increase falls short of the original program projections, as the introduction of sizable new tax expenditures has eroded the tax system's efficiency and the rollout of a valuation-based property tax has been delayed. Nevertheless, the overall fiscal balance is estimated to have improved by 2.9 percent of GDP between 2013 and 2016, in line with the 2.8 percent projected in the program proposal, in part due to a lower-than-anticipated interest bill. The primary balance is now projected to improve by 2.1 percent of GDP between 2013 and 2016, rather than the 3.7 originally projected.

4. **Public debt is estimated to have declined in 2016, after peaking at around 74 percent of GDP in 2015.** The debt-to-GDP ratio has been higher than expected due to revisions to nominal GDP and the stock of arrears, as well as the depreciation of the lek and the euro vis-à-vis the U.S. dollar. These shocks together with the slower-than-anticipated growth in nominal GDP (due to weak inflation) have led to a debt-to-GDP ratio substantially higher than originally projected. In nominal terms, however, end-2016 general government debt is projected to be about 2 percent lower than in the program proposal (even though its current definition is broader).[1] Furthermore, to address rollover risks, the authorities have reduced domestic public debt and lengthened its average maturity from 17 months in 2013 to 25 months in 2016. They also successfully rolled over a maturing Eurobond in November 2015.

5. **Despite sizable monetary easing, inflation has undershot the 3 percent inflation target for an extended period of time.** The BoA lowered its main policy rate by 175 basis points over 2014–16, to a historical low of 1.25 percent. However, high bank risk aversion, weak credit demand, and pervasive euroization have limited the transmission to lending rates. The exchange rate with the euro has remained very stable.

6. **The authorities have implemented a broad array of reforms aimed at restoring fiscal sustainability, with support from the Fund and other IFIs (Annex Table 1):**

- **Public financial management** reforms, such as the commitment control system, have been rolled out across most central government entities. The substantial stock of domestic **central government arrears** was mostly cleared within two years, faster than anticipated. However, small amounts of new arrears have recurred, mostly related to the large old stock of unbudgeted investment projects which remains largely unaddressed due to legal constraints.
- A comprehensive **pension reform** was passed in mid-2014. It gradually raises the retirement age, separates social assistance from social insurance, aligns benefit and contribution ceilings, and indexes pensions to inflation.

[1] At the time of the First Review under the program, the definition of public debt was extended to include all government guaranteed debt. At the time of the Eighth Review, local government arrears were also included.

- The authorities have implemented a sweeping reform of the **electricity sector**. They have substantially lowered distribution losses (from 45 percent in 2013 to 28 percent in 2016), increased bill collections, repaid arrears to the private sector, and strengthened the finances of the state-owned electricity companies. A new power sector law passed in May 2015 has reformed market structure and will gradually remove commercial users from the regulated tariff system. The authorities are restructuring the balance sheets of the SOEs in the sector and investing in improving the grid infrastructure.
- The authorities are strengthening **tax administration**. The GDT has adopted a new IT system, developed a corporate strategy to guide medium- and long-term reforms, and created a Risk Management Unit. GDT headquarters are in the midst of a comprehensive restructuring. However, staffing and capacity issues persist, and the tax administration is burdened with multiple reform initiatives.
- The authorities are implementing an extensive **local government reform**. Following local elections in mid-2015, a large number of communes and municipalities have been consolidated into 61 units. In the process, a stock of local government arrears worth at least 0.5 percent of GDP was uncovered. The reform includes a fiscal decentralization that involves devolution of certain functions, transfer of related personnel, and new financing sources for local governments. The authorities have drafted a new law on local finances, with help from USAID and the World Bank, to address fiscal risks and improve transparency and accountability.

7. The BoA has implemented key structural changes to strengthen the supervision framework. Basel II and a new risk manual were implemented in 2015. In 2016, banking supervision was reorganized and an early warning system was implemented to promote risk-based supervision. Coordination with parent bank supervisors was reinforced as Albania became a member of the European Banking Authority College of Supervisors.

8. Additional reforms in the financial sector supported by the program include:

- In the wake of the vault theft at the Bank of Albania in 2014, the Extended Arrangement has assisted the authorities in rebuilding the credibility of the central bank and strengthening its **governance and internal safeguards**.
- The authorities are tackling the **large stock of NPLs**. They adopted a comprehensive strategy laying out reforms in the areas of supervision, enforcement, debt restructuring, and insolvency. They have made substantial progress to date with its implementation, including by approving a new Bankruptcy Law and amendments to the Private Bailiffs Law. The NPL ratio has declined from a peak of 25 percent in September 2014 to around 20 percent in November 2016, mostly due to a new regulation requiring write-offs of loans that have spent more than three years in the “loss” category. However, banks remain risk-averse given difficulties in collateral execution. Private sector credit growth has disappointed, relative to projections in the program proposal (text table).
- The authorities have taken steps to strengthen **nonbank supervision**. They have introduced new regulations on liquidity requirements and asset valuation for investment funds. Several laws have been amended to strengthen AFSA’s financial and operational independence. However, the agency is still short of capacity and struggling to attract and retain skilled staff.

Annex Table 1. Albania: Structural Benchmarks under the Extended Arrangement,
March 2014–July 2016

	Structural Benchmark	Status
	I. Arrears Clearance and Prevention, Public Financial Management	
1.	MoF to publish regular reports on arrears paid.	Met at each relevant test date.
2.	MoF to publish regular surveys of new arrears accumulation in central government, and gradually expand their coverage.	Implemented at each relevant test date, although twice with a delay.
3.	MoF to publish regular surveys of local government arrears.	Implemented partially and with a delay.
4.	Contract an external auditor to conduct risk-based audits of non-tax arrears payments.	Implemented with a delay.
5.	External auditor to complete first audit of non-tax arrears payments.	Implemented with a delay.
6.	External auditor to complete audit of 20 percent of outstanding non-tax claims paid during January-June 2014.	Implemented with a delay.
7.	External auditor to complete audit of 75 percent of outstanding non-tax claims paid through January 2015.	Met.
8.	MoF to prepare and publish an action plan with measures to address weaknesses identified in the auditor's report on non-tax claims payments.	Implemented with a delay.
9.	Contract an external auditor to conduct verification of arrears payments on tax refunds.	Implemented with a delay.
10.	External auditor to complete verification of arrears payments on tax refunds.	Met.
11.	MoF to issue instructions to all local governments to report all new procurement orders.	Met.
12.	MoF to purchase a new IT server for the treasury system.	Implemented with a delay.
13.	Roll out the new treasury IT server to 15 budget institutions.	Implemented with a delay.
14.	Introduce multi-year commitment limits in the 2015 budget, and change the Procurement Law, the Financial Management and Control Law, and the Organic Budget Law accordingly.	Implemented with a delay.
15.	Publish a report on the prioritization of all outstanding infrastructure projects.	Implemented with a delay.
	II. Tax Administration	
16.	Install the new IT software at the central server site and commence testing.	Met.
17.	The GDT to develop a corporate strategy for medium- to long-term capacity building.	Implemented with a delay.
18.	Adopt an implementation plan for a function-based headquarters restructuring of the GDT.	Implemented with a delay.
19.	Restructure GDT's Large Taxpayer Office with specialization according to business sectors.	Implemented with a delay.
20.	Establish and commence operations of a permanent Risk Management Unit in GDT.	Met.
21.	Commence auditing tax refunds on a risk basis.	Implemented with a delay.

Annex Table 1. Albania: Structural Benchmarks under the Extended Arrangement,
March 2014–July 2016 (Concluded)

Structural Benchmark	Status
III. Pension Reform	
22. Establish a commission to devise a pension reform strategy.	Met.
23. Council of Ministers to approve a pension reform strategy.	Met.
IV. Monetary and Financial Sector	
24. BoA to amend regulations in order to apply the same collateral standards to all of BoA's monetary operations (including repos and reverse repos) and expand collateral eligibility to all negotiable securities issued by the government of Albania.	Met.
25. Hire an external expert to assist the Audit Committee of the Bank of Albania.	Implemented with a delay.
26. BoA to submit to the IMF the audits for the end-September and end-December 2014 program data.	Met.
27. Amend the MoU covering the operations of the inter-agency Financial Sector Advisory Group (FSAG) to: (i) require technical-level meetings every month (in addition to the existing quarterly high-level meetings); and (ii) exclude financial development from FSAG's mandate.	Met.
28. Submit to Parliament an amended AFSA Law, a new Insurance Law, and amendments to the Civil Servant Law and the Law on Salaries of Independent Institutions, in order to strengthen AFSA's independence in line with FSAP recommendations.	Met.
29. Amend the regulatory framework for investment funds on asset valuation, capital adequacy, and liquidity requirements.	Implemented with a delay.
30. Submit to Parliament a new Bankruptcy Law, incorporating best international practices and simplifying existing procedures.	Met.
V. Electricity Sector	
31. Prepare a quarterly survey of the gross consolidated arrears of the electricity sector (KESh, OST, OShEE) to the private sector.	Met at each relevant test date.
32. Publish quarterly financial statements for KESh, OST, and OShEE.	Implemented at each relevant test date, although once with a delay.

Appendix. Letter of Intent

February 8, 2017

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

Dear Ms. Lagarde:

1. **Our economic program has achieved its objectives of correcting large macroeconomic imbalances and boosting economic growth, while maintaining stability against strong external headwinds.** In 2013, fiscal slippages had led to large increases in public debt and financing needs, while heightened uncertainty, tight lending conditions, and spillovers from the weak economic recovery in Europe had slowed Albania's GDP growth rate to its lowest level in decades. To address these challenges, we have undertaken significant reforms:

(i) *Fiscal consolidation:* A sizable fiscal adjustment, mainly revenue-based, has led to a structural primary surplus. Debt-related vulnerabilities have been reduced and gross financing requirements have been lowered. Fiscal risks have been mitigated through improved public financial management. A comprehensive reform of tax administration, alongside stronger enforcement to stem the informal economy, is underway.

(ii) *Financial stability and credit growth:* A comprehensive plan for resolving the still high level of NPLs is being implemented, including through a new Bankruptcy Law. We have maintained financial stability through a period of turmoil in Greece and a governance crisis at the central bank. The banking supervision and crisis management frameworks have been strengthened.

(iii) *Structural reforms and reinvigorating growth:* We have implemented a comprehensive pension reform and are undertaking a sweeping reform of the electricity sector, both of which have significantly reduced long-term fiscal imbalances. Key legislation for judicial reform has been adopted and its implementation is underway. We are also continuing to implement measures to improve the business climate. Economic growth is rising, driven by a pick-up in domestic demand and foreign direct investment.

2. **Important challenges remain and we will continue implementing an ambitious reform program to reduce fiscal vulnerabilities, strengthen financial stability, and enhance medium-term growth.** Further fiscal consolidation to ensure debt sustainability remains one of our core commitments. To this end, we will advance tax administration reforms in order to broaden the tax

base and continue working towards the introduction of a value-based property tax. We will further strengthen public financial management to contain fiscal risks and increase efficiency. Tackling the large stock of NPLs remains an important priority to strengthen bank balance sheets and enhance credit growth. Furthermore, we will seek to advance structural reforms aimed at enhancing economic competitiveness, improving the business climate, and increasing Albania's potential growth rate.

Macroeconomic Outlook

3. **The economic recovery is strengthening.** Real GDP is expected to have grown by 3.4 percent in 2016, compared with 1.0 percent in 2013, reflecting a recovery in domestic demand and a pickup in energy-related FDI. Headline inflation averaged 1.3 percent in 2016 and is expected to continue to recover gradually in line with rising domestic demand, reaching the target rate of 3 percent by 2018. The current account deficit is projected to have widened to around 12 percent of GDP in 2016, mainly due to stronger import-intensive FDI while low commodity prices continued weighing down on exports. Nevertheless, external financing risks remain limited, with the current account deficit expected to be financed primarily by foreign direct investment. The strong foreign currency inflows have led the real effective exchange rate to appreciate by about 4 percent over the last year while FX reserves are ample at over 5 months of import cover.

4. **We expect growth to gradually pick up to around 4 percent over the medium term.** The growth momentum is expected to be driven by continued FDI, recovery in major trading partners, and structural reforms as Albania advances through the EU accession process. The current account deficit is expected to gradually decline, due to expanded export capacity and lower import needs of the major ongoing FDI projects.

Program Implementation

5. **Program performance remains on track.** All November and continuous PCs were met (Table 1). However, two November ITs (out of three) were missed. The indicative target on distribution losses in the electricity sector was missed by 2.5 percent because of delays in infrastructure investments (such as metering and cabling) needed to reduce technical losses. The zero ceiling on the accumulation of central government domestic arrears was also not met. Results from the regular survey show a stock of 3.3 billion lek of arrears at end-October 2016 (0.2 percent of GDP). The bulk of new arrears was due to unbudgeted commitments for road construction and water infrastructure projects, as well as court cases. As a prior action, we have paid down most of these arrears, in order to bring their stock below 1 billion lek, and undertaken remedial actions to prevent future recurrence (Table 2).

6. **We have implemented most of the structural benchmarks established for the 9th and 10th reviews, albeit some with delays (Table 3).** The publication of the Q2 quarterly survey of local government arrears and the formulation of comprehensive action plans to deal with local government arrears were delayed to October 2016, due to capacity constraints at the newly formed local government units. However, the Q3 survey of local government arrears was published on time.

Recruitment challenges delayed the full staffing of the fiscal risks unit at MoF to October 2016. Staff shortages at the GDT's Risk Management Unit postponed work on two pilots for modern compliance risk management to January 2017. The need to build consensus within the government postponed the design of a valuation formula and methodology and the drafting of legislation for a valuation-based property tax to October 2016. Consequently, the benchmark on the approval by Parliament of the legislation for a valuation-based property tax was not met. However, other preparatory measures were implemented as a prior action (Table 2) in order to accelerate work on the valuation-based property tax. In the electricity sector, the Q3 quarterly survey of the gross consolidated arrears of the electricity sector to the private sector was delayed to December, as was the publication of their quarterly financial statements. However, the Q4 survey of electricity sector arrears was compiled on time. The need to pass regulations as well as delays in procuring metering equipment slowed down the process of removing medium-voltage consumers from the regulated tariff system, with both 35 kV and 20 kV customers postponed till later in 2017.

Fiscal Policy and Structural Fiscal Reforms

7. To reduce public debt-related vulnerabilities, we have undertaken a sizeable fiscal adjustment over the past few years. The overall fiscal balance has improved by around 3 percent of GDP from 2013 to 2016, supported by revenue mobilization, expenditure restraint, and administrative reforms. In 2016, we achieved a primary balance surplus of around 0.2 percent of GDP, compared to a deficit of 3.0 percent in 2014. Tax revenue has risen during the program from 22.0 percent of GDP in 2013 to 24.3 in 2016, driven by tax policy measures and improved tax administration. Our campaign against informality also helped increase revenue collections. On the expenditure side, substantial savings were realized from reforms in the pension and energy sectors, as well as from efficiency gains in public administration. We successfully launched a Eurobond issue, and reduced rollover risks by diversifying and lengthening the maturity of our debt. Consequently, the annual rollover requirement declined from 31 percent of GDP in 2013 to 25 percent in 2016.

8. The 2017 budget seeks to lock in these gains. The budget targets a general government primary surplus of 0.7 percent of GDP, bringing the public debt-to-GDP ratio below 70 percent of GDP. Achieving this target will require both revenue and expenditure measures. Key measures include:

- On the revenue side, the measures seek to (i) raise oil-related revenues; (ii) broaden the base for the circulation tax on luxury cars; (iii) introduce pilot projects to increase coverage and improve collections from the property tax; and (iv) legislate increases in excise on cigarettes in order to gradually converge to EU standards. We will implement measures to address the increasing stock of VAT credits, streamline VAT exemptions for imports of machinery and equipment, and refrain from announcing any tax amnesties or new tax exemptions or preferences without prior consultation with the Fund.

- On the expenditure side, we commit to permanent savings for recurrent expenditures such as from ongoing vacancies in the public administration. The budget allows for modest public wage and pension increases of 7 percent and 3 percent on average, respectively, while containing the

wage bill, as a percent of GDP, to 2016 levels and maintaining the current statutory public sector minimum wage. The budget also accommodates the costs of structural reforms, such as strengthening the water utilities sector and implementing judiciary reform, while provisioning for property compensation related to the communist era.

9. The 2017 budget also provides more resources to local governments, to support fiscal decentralization accompanied by improved public financial management. Proceeds from outright transfers, revenue-sharing, and property taxation will be partly used to clear the legacy stock of arrears that emerged after the territorial reorganization in June 2015 while enhancing the monitoring and reporting of local spending. Outright transfers from the budget will be conditioned on the successful clearance of arrears. At the same time, the government will impose limits on the ability of local governments to carry over their grants, restore ministerial oversight of the Regional Development Fund (RDF), and stop new commitment allocations to the RDF in order to improve budgetary control. All these measures will help the transition to the new decentralization framework that should be fully implemented in 2018. The budget also identifies investment projects which will be financed contingent on the realization of one-off revenues or the under-execution of local investment plans. With help from USAID and the World Bank, we have prepared and will pass a new law on local finances that will improve reporting requirements, tighten monitoring, and provide mechanisms for dealing with local governments that fall into financial trouble.

10. We further commit to use large one-off revenue windfalls for debt reduction in 2017. Specifically, we will target to save the proceeds from any one-off revenues not factored in the 2017 budget and currently expected to be worth at least ½ percent of GDP. Towards this end, we commit to stay within the primary expenditure limit envisaged in the initial 2017 budget, and we will respect quarterly spending ceilings consistent with this annual target (Table 4).

11. We have made significant progress on structural fiscal reforms to reduce fiscal risks. Arrears accumulated before the end of 2013 were cleared and a new commitment control system is being rolled out to prevent the recurrence of arrears. We have adopted a new organic budget law and established a fiscal risks unit in the Ministry of Finance. Public access to fiscal information has been improved with the publication of the investment projects list and the inclusion of tax expenditures in budget documentation. The GDT has installed a new IT system, adopted a new risk-based compliance management approach, and is implementing an updated organizational structure.

12. We are committed to further advance structural fiscal reforms, as follows:

- *Public Investment Management:* Unbudgeted public investment projects continue to pose significant fiscal risks. As part of the 2017 budget documentation submitted to Parliament, the MoF has published a list of all projects that the 2017 budget will support, consistent with the Medium Term Budget Framework (MTBF). Our multi-year commitment registry is now operational, after all prioritized old contracts were uploaded into it and a multi-year breakdown was provided for each contract, as a prior action. The framework agreement for the supervision of road project contracts at the Albanian Road Authority (ARA) has been revised to make it

mandatory for the supervisor to match the annual schedule of physical works with the appropriation of funds for each contract in the Treasury system. This revision seeks to ensure that supervisors do not clear invoices for works exceeding budget allocations. The Ministry of Transport (MoT) has submitted to the Strategic Planning Committee a five-year financing plan for all prioritized unbudgeted investment projects. Finally, an internal audit unit will be established at ARA in 2017. In line with the recommendations from the recent Public Investment Management Assessment, we will fully staff the public investment management unit in MoF by end-March 2017. Beginning with the 2017 budget, we have started integrating RDF projects into our MTBF, the budget cycle, and the public investment monitoring framework. A financial inspection report on the recent arrears at MoT will be prepared in early 2017. We will review and streamline project classification to reduce fragmentation, with the objective of using the new classification system for all projects to be included in the 2018 budget.

- *Public Private Partnerships (PPPs):* We will clarify the PPP Law by amending the implementing Council of Ministers Decision in order to strengthen MoF oversight, integrate PPPs into the broader public investment monitoring framework, and ensure consistency with the amendments to the Budget Law. We have clarified the institutional arrangements for monitoring PPPs at the Ministries of Finance and the Economy. Finally, in January 2017 we launched a public register of all active PPP projects which will publish summaries of all PPP contracts as well as the contracts themselves (excluding confidential or protected information), to ensure transparency for the commitments made by the government.

- *Tax administration:* The Risk Management Unit at GDT is now fully staffed in order to enable it to identify major compliance risks and develop mitigating strategies. The taxpayer service function has been upgraded to deliver easy-to-understand and accessible guidance to taxpayers based on their needs and compliance risks, using a variety of communication channels. To improve revenue management, the Risk Management Unit at GDT has changed the risk parameters for vetting VAT refund requests to focus resources on high-risk cases and by mid-2017 GDT will start paying interest to taxpayers for refund payments delayed by circumstances not caused by the taxpayer. We have updated the GDT corporate strategy and amended the Tax Procedure Code in order to address the findings of the June 2016 Tax Administration Diagnostic Assessment. To strengthen tax debt collection, the GDT has developed and started implementing a comprehensive plan for revamping collection processes, in order to take full advantage of the new IT system, consolidate debt collection operations in fewer locations, and make extensive use of debt installment and write-off arrangements. By mid-2017, the NRC will update the taxpayer database based on GDT input, and will update industry codes for all taxpayers in cooperation with GDT and INSTAT.

- *Property tax:* We commit to developing a fiscal cadastre that will enable the introduction of a valuation-based property tax. As a first step, the Prime Minister has adopted an action plan and appointed a high-level working group involving all relevant stakeholders. Furthermore, we have signed a MoU between MoF and OShEE for the sharing of OShEE's national database of property data. We have also signed MoUs with the cities of Tirana, Durres, Korca, and Fier to

integrate property tax bills into electricity/water bills and to collect property tax based on area, in accordance with current law. Finally, we have signed an MoU with Kosovo's MoF on sharing the software for their fiscal cadastre. The new property tax law will be submitted to Parliament in September 2017, and the valuation methodology will be adopted by the Council of Ministers shortly after the law's passage.

13. **We are committed to further fiscal consolidation in order to reduce debt-related vulnerabilities which hamper growth and cause macroeconomic instability.** To this end, we aim to reduce public debt to around 60 percent of GDP by end-2019. We intend to pursue a steady pace of fiscal consolidation involving 1 percentage point of GDP in effort per year, based on a strategy of broadening the tax base and strengthening tax administration and compliance. We will continue to improve debt management to reduce the high level of gross financing needs and the systemic risk from a sovereign-banking feedback loop. To improve debt management, we will also increase staffing levels and strengthen capacity at MoF's debt management unit. We remain committed to augmenting the public financial management framework by strengthening the MTBF, improving public investment management, and implementing the commitment control system.

Monetary and Exchange Rate Policy

14. **The BoA's monetary policy will continue to be anchored by an inflation-targeting framework and a fully flexible exchange rate regime.** With headline inflation below target and core inflation weak, the BoA has maintained an accommodative stance, lowering the policy rate to a historical low of 1.25 percent. The BoA remains committed to achieving an average annual CPI inflation of 3 percent over the medium term. While inflation is expected to gradually pick up in 2017, we stand ready to adjust our monetary policy stance to account for any unforeseen shocks to inflation. To strengthen monetary policy transmission, we will also undertake efforts to reduce euroization in the Albanian banking sector. Exchange rate flexibility complements our price stability objective and supports our operational framework for monetary policy. The exchange rate is determined by market forces, and the BoA undertakes only small pre-announced interventions in the foreign exchange market in order to achieve its FX reserve adequacy target. We are committed to maintaining adequate FX buffers.

Safeguarding Financial Sector Stability and Unlocking Credit Growth

15. **The financial sector has been strengthened significantly during the program.** We preserved the stability of the banking sector, including through a period of stress in Greek-owned banks during 2015. The crisis management framework was updated and the deposit insurance scheme was enhanced. Banking system supervision was improved by adopting the Basel II framework and a new risk manual. The BoA has improved its corporate governance by strengthening internal audit, setting up an external audit committee, and adopting IFRS. Overall, the banking system remains well-capitalized, liquid, and profitable.

16. **Nevertheless, the persistently high level of NPLs remains a key challenge.** Following a decline to 18 percent at end-December 2015 from a peak of 25 percent in September 2014, the level

of NPLs has risen again to around 20 percent in November 2016, mainly due to the insolvency of two large companies. To address the NPL overhang, we have implemented regulatory and legal reforms as part of a comprehensive strategy for NPL resolution. We have adopted a new Bankruptcy Law and amended the Law on the Registration of Immovable Properties, the Law on Securing Charges, and the Private Bailiffs Law, with the aim of protecting the rights of lenders and strengthening collateral enforcement. We have also adopted measures to accelerate the reduction of NPLs through the use of out-of-court debt restructuring.

17. We will continue to strengthen the regulatory framework and increase supervisory vigilance, particularly among systemic banks. A new Bank Resolution Law has been approved to align our legal framework with the EU's Bank Recovery and Resolution Directive and clarify supervision and resolution responsibilities. The BoA will raise prudential requirements on systemic banks that expand into nonbanking activities, as necessary. The central bank will also seek to strengthen its monitoring of loans to unhedged borrowers and will gradually implement macro-prudential measures with the aim of reducing euroization in the financial system.

18. Further measures are being undertaken to implement the NPL resolution action plan. Specifically, we will set up a working group between MoF and the Ministry of Justice to draft the bylaws to implement the new Bankruptcy Law and the amendments to the Private Bailiffs Law. We have already set up a coordination mechanism among BoA, MoF, and the GDT to integrate the tax authority into the collateral execution process and to streamline the tax treatment of NPLs, NPL sales, and collateral recovered in judicial procedures. MoF, MoJ, and BoA will work on strengthening the framework for out-of-court NPL resolution and issue a joint annual report detailing progress with the NPL resolution action plan.

19. Development of the non-bank financial sector will be crucial to deepen financial markets and diversify investment opportunities. To achieve this goal, strengthening the Albanian Financial Supervisory Authority (AFSA) is a key priority. AFSA's toolbox to monitor non-bank financial institutions and its enforcement powers have been enhanced. In accordance with the recently approved regulations to strengthen risk management, AFSA will monitor the results from stress tests to be conducted by investment funds. In addition, AFSA will encourage competition among investment fund custodians. Furthermore, AFSA will set up a crisis management framework for investment funds which will specify procedures and mechanisms for coordination among funds, custodians, AFSA, and the BoA. AFSA will also ensure that a privately-owned stock exchange will be established by reputable and experienced stakeholders with the highest transparency and governance standards, as well as strong risk management and capitalization levels.

20. We will continue our efforts to strengthen the central bank's governance. Substantial improvements took place during 2015-16. A new Inspector General was appointed; internal audit was strengthened; and the Audit Committee is now fully operational. In addition, the BoA adopted IFRS in 2016. We will amend the central bank law in 2017, in order to align it with the European System of Central Banks Statute and take into account IMF staff's recommendations to strengthen the central bank's institutional and operational independence and improve its governance and operations.

Structural Reforms

21. We implemented a comprehensive pension reform with the aim of restoring fiscal sustainability. A new pension law, adopted in 2014, raised the retirement age, indexed pensions to inflation, and strengthened the alignment of individual benefits with reported incomes, thereby improving the incentives of high-income earners to report their full income. The reform therefore reversed the corrosive effect of contribution rate cuts and unfunded benefit increases in previous years. As a result, pension fund deficits have declined from 2.1 percent of GDP in 2013 to 1.8 percent of GDP in 2016.

22. Reforms in the electricity sector have helped place it on a more sustainable path. The reforms have strengthened the finances of electricity SOEs by adjusting tariffs, improving bill collections, and reducing distribution losses, while repaying arrears to private power producers. Distribution losses—unbilled power as a share of total power entering the distribution system—fell from 45 percent in 2013 to 28 percent in 2016. We are committed to reducing distribution losses to 14 percent by 2019 and are stepping up our investments in infrastructure to achieve this goal. Budget allocations to the energy sector have fallen from 0.9 percent of GDP in 2014 to 0.1 percent in 2017. To improve transparency, we have started publishing quarterly financial statements for KESh, OST and OShEE, the generation, transmission, and distribution companies. A new power law passed in May 2015 has reformed the market structure and will gradually move commercial users from the regulated tariff system to a liberalized market. Further reforms to better integrate Albania into regional power markets and improve corporate governance are underway.

23. The investment climate remains a constraint on Albania's competitiveness and growth performance. We are committed to implementing policies that enhance the rule of law, property rights, and private sector confidence. In July 2016, parliament passed a judicial reform package which includes constitutional amendments and marks the start of a process to reduce endemic corruption and inefficiency in Albanian courts. In December 2016, Parliament approved amendments to the Tax Procedure Code to simplify the tax regime. We are further committed to securing property rights, including by advancing the land restitution process, and to continued investment in infrastructure to improve Albania's regional connectivity. Removing these structural bottlenecks will be critical to achieving a higher growth potential for Albania.

Concluding Request

24. Over the next twelve months, we will continue to pursue fiscal consolidation, safeguard financial sector stability, revive credit growth, and implement growth-enhancing reforms. In particular, we will persist with ambitious reforms in revenue administration, public financial management, and the electricity and water sectors. We will also continue our policy consultation and dialogue with the Fund.

25. In view of the strong program performance to date and the strength of policy commitments for the period ahead, we request that the Executive Board of the IMF complete the ninth and tenth reviews under the Extended Arrangement. We further request the purchase of SDR 57.28 million.

26. We wish to make this letter, as well as the related IMF staff report, available to the public. We therefore authorize their publication and posting on the IMF's website, subject to Executive Board approval. These documents will also be posted on the official websites of the Albanian government.

Sincerely,

/s/	/s/
Arben Ahmetaj	Gent Sejko
Minister of Finance	Governor, Bank of Albania

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

(In billions of leks, unless otherwise indicated)

	2014				2015			2016								
	Mar	Jun	Sep	Dec	Apr	Aug	Dec	Apr			Aug			Nov		
	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.
I. Quantitative Performance Criteria																
1. Floor on net international reserves of the BoA (EUR million)	1463	1495	1525	1539	1587	1624	1601	1535		1677	1402		1690	1441		1694
2a. Ceiling on general government overall cash deficit (cumulative) 2/	1.2	6.0	8.0	41.5	1.5	9.0	47.9									
2b. Floor on general government primary modified cash balance (cumulative) /3								9.0	10.5	23.8	13.0	14.0	30.0	9.3	11.1	34.7
3a. Ceiling on general government expenditure (cumulative) 2/		181.2	274.7	408.0	123.2	257.5	425.4									
3b. Ceiling on general government primary expenditure (cumulative) /3								120.9	119.5	105.6	252.0	251.0	232.6	363.5	362.6	329.7
4. Ceiling on the increase of Bank of Albania credit to the general government (cumulative from December 2013) 2/ 4/	-0.1	-0.2	0.0	0.0	-0.8	-0.2	-10.7	0.0		-12.8	0.0		-11.2	0.0		-10.7
II. Continuous Performance Criteria																
5. Accumulation of new external payment arrears by the general government (EUR million)	0.0	0.04	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0		0.0	0.0		0.0
III. Inflation Consultation																
6. 12-month percent change in consumer prices																
Upper outer band								5.0			5.0			5.0		
Upper inner band								4.0			4.0			4.0		
Center point	1.9	1.6	1.7	1.3	2.0	1.6	2.1	3.0		0.6	3.0		1.5	3.0		1.7
Lower inner band								2.0			2.0			2.0		
Lower outer band								1.0			1.0			1.0		
IV. Indicative Targets																
7. Ceiling on subsidies to the energy sector (cumulative)					4.6	4.6	4.6	1.7		0.0	2.4		0.0	3.2		0.0
8. Ceiling on average distribution losses by energy distribution company (OSHEE) (percent, cumulative)					33.2	31.7	31.3	28.6		30.3	25.3		28.1	25.2		27.7
9. Ceiling on contracting nonenergy guarantees (cumulative)					0.0	2.8	2.8	0.6		0.0						
10. Ceiling on accumulation of central government domestic arrears (as reported by MoF's survey on arrears accumulation, cumulative from December 2013)	0.4	1.1	0.4	0.3	1.1	1.1	1.3	0.0		2.3	0.0		2.5	0.0 [5]		3.3
11. Floor on clearance of central government domestic arrears (cumulative) 6/	1.0	19.1	25.9	33.8	7.6	14.5	17.6									
Memorandum Items																
New energy guarantees (excluding rollover, cumulative)					4.6	4.6	4.6	1.7		0.0	2.4		0.0	3.2		0.0
Privatization receipts (cumulative)	0.001	0.010	0.026	0.035	0.1	0.6	0.9	0.0		0.4	0.0		2.6	0.0		2.7
One-off revenues (cumulative)					4.3	6.1	6.1									
Total non-grant revenues (cumulative)								126.8		126.1	258.8		256.6	361.8		353.8
Project grants (cumulative)					2.6	5.5	11.2	3.2		3.3	6.2		6.0	7.8		8.8

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

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

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

3/ Data revisions have led to a minor adjustment of the outturn for April 2016.

4/ Indicative target through December 2014.

5/ The test date for this indicative target is October 2016.

6/ General government for March 2014.

Table 2. Albania: Prior Actions for Completing the Combined Ninth and Tenth Reviews under the Extended Arrangement

Prior Actions	Status
I. Tax Policy	
1. Initiate actions towards introducing a valuation-based property tax by end-2017: (i) issue an order by the Prime Minister adopting an action plan and establishing an intergovernmental working group; (ii) sign a MoU between MoF and OShEE for the sharing of OShEE's national database of property data; and (iii) sign MoUs between the MoF and the cities of Tirana, Durres, Korca, and Fier to collect property tax based on area (in accordance with current law) and integrate valuation data into the fiscal cadastre.	Met.
II. Arrears Clearance	
2. Repay central government arrears in order to bring the stock of outstanding arrears below 1 billion lek.	Met.
3. MoF and MoT to confirm that all prioritized MoT contracts have been uploaded into the multi-year commitment registry and a multi-year breakdown has been provided for each contract.	Met.
4. ARA Board to approve the establishment of an internal audit unit and announcement of vacancies for the unit to be posted on DoPA's website.	Met.

Table 3. Albania: Structural Benchmarks for the Combined Ninth and Tenth Reviews under the Extended Arrangement

	Structural Benchmarks	Test Date	Status	Remarks
	I. Public Financial Management			
1.	Publish a report on new arrears accumulation through end-August 2016 in fourteen key ministries, the Regional Development Fund, and the GDT on MoF's website.	November 15, 2016	Met.	
2.	Publish a report on new arrears accumulation through end-October 2016 in fifteen key ministries, the Regional Development Fund, and the GDT on MoF's website.	January 15, 2017	Met.	
3.	Publish a quarterly survey of local government arrears on MoF's website.	Continuous	Implemented with a delay for Q2. Met on time for Q3.	
4.	Formulate comprehensive action plans to deal with local government arrears.	End-Sep. 2016	Implemented with a delay.	
5.	Fully staff the fiscal risks unit at MoF.	End-Sep. 2016	Implemented with a delay.	
	II. Tax Policy and Administration			
6.	List and quantify tax expenditures in the annual budget documentation submitted to Parliament.	Continuous	Met.	
7.	Commence phasing in a modern compliance risk management approach at GDT, starting with two major risk clusters.	End-Sep. 2016	Implemented with a delay.	
8.	Design a valuation formula and methodology, and draft the legislation for a valuation-based property tax.	End-Sep. 2016	Implemented with a delay.	
9.	Approval by Parliament of the legislation for a valuation-based property tax.	End-Dec. 2016	Not met.	Other measures taken, as a prior action.
	III. Financial Sector			
10.	Submit to Parliament amendments to the Civil Procedure Code and Private Bailiffs Law to increase the efficiency of litigation, foreclosure procedures, and debt collection.	End-Sep. 2016	Met.	
	IV. Electricity Sector			
11.	Prepare a quarterly survey of the gross consolidated arrears of the electricity sector (KESh, OST, OShEE) to the private sector.	Continuous	Implemented with a delay for Q3. Met on time for Q4.	
12.	Publish quarterly financial statements (balance sheet and income statement) for KESh, OST, and OShEE.	Continuous	Implemented with a delay.	
13.	Start the removal of 35 kV medium-voltage consumers from the regulated tariff system.	End-Sep. 2016	Not met.	
14.	Start the removal of 20 kV medium-voltage consumers from the regulated tariff system.	End-Dec. 2016	Not met.	

Table 4. Albania: Fiscal Targets for 2017[1]
(Billions of leks, unless otherwise indicated)

	2017			
	Mar	Jun	Sep	Dec
1. General government primary modified cash balance (cumulative) 2/	12.0	19.9	28.5	18.9
2. Ceiling on general government primary expenditure (cumulative)	90.7	195.1	297.7	425.1
3. Ceiling on gross disbursements of energy guarantees (cumulative, excluding rollover)	0.4	0.4	0.4	0.4
4. Ceiling on contracting of non-energy guarantees (cumulative)	0.1	0.2	0.3	0.3
5. Ceiling on the stock of central government domestic arrears	0.0	0.0	0.0	0.0
Memorandum Items				
Large uncertain one-off revenues (cumulative) 3/	3.3	7.4	8.0	8.3
Privatization receipts (cumulative)	0.0	0.0	0.0	0.0
Project grants (cumulative)	0.0	0.5	1.0	3.0

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

1/ Unless otherwise indicated, all definitions and adjustors are described in the Technical Memorandum of Understanding (TMU) dated August 15, 2016.

2/ Including one-off revenues (that is, revenues expected to accrue only in 2017) whose timing remains uncertain and which were not included in the 2017 budget.

3/ Namely, payments from Bankers Petroleum Ltd. on the lost tax dispute regarding diluent excise and the revenue effects from the agreement with TAP to extend the period of VAT refunds.

Statement by Carlo Cottarelli, Executive Director for Albania and Paolo Di Lorenzo, Advisor to the Executive Director
February 24, 2017

On behalf of our Albanian authorities we would like to express our appreciation to management and staff for the focused and valuable policy dialogue and for the technical assistance provided over the three years of the program. We welcome also the candid assessment of the main achievements realized under the EFF and of the key challenges ahead provided in the staff report.

General remarks on the performance under the program

A steadfast program implementation has been instrumental to rebuilding growth momentum. The fiscal position and the public finance management framework have been substantially strengthened, and ambitious reforms have finally addressed many of the structural constraints that have been piling up over the years. In particular, public debt has now been placed on a downward path after having reached an all-time high in 2016, while a bold pension reform will ensure its long-term sustainability; international reserves are sizable; inflation is on a converging path towards the central bank's target; the financial system has proven its resilience and banks' confidence in lending has been gradually restored. Acting as an anchor of stability, the EFF has contributed to catalyze international financing from private and official sectors partners.

Recent macroeconomic developments and outlook

Hard indicators point to a sustained economic recovery in 2016. A real growth of 3.1 percent y-o-y has been recorded in third quarter of 2016. Growth is gaining further traction with the quarter-on-quarter rate rising to 0.9 percent in Q3 from 0.3 in Q2, pointing at a likely increase of 3.4 percent for the whole year, which would represent the best performance since 2010. Employment is also rising: during the program period employment rate rose by 10 percent points and, while still high at 15.2 percent, the unemployment rate dropped by 3.4 percentage points. The growth cycle is being led by a pickup in domestic demand and by high tourism revenues. On the production side, a drop in the contribution from the mining industry has been more than offset by the increase in the contribution from information and communication services and from construction. On the other hand, trade continues to suffer from the impact of low oil and other commodity prices on the terms of trade. Net FDI are once again performing strongly also due to some large energy-related projects.

For 2017, the approved budget assumes a further acceleration of growth to 3.8 percent,

on the back of the peak in the execution of two large projects in the energy sector and sustained private consumption. Nevertheless, the economy will still perform below potential. The current account deficit is projected to further widen to around 12.6 percent of GDP, then to gradually narrow to below 10 percent in 2020 as oil prices recover. FDI will continue to represent the most important source of finance.

The authorities agree on the medium-term outlook put forward by staff, although they consider that risks are broadly symmetrical. Downside risks stemming from a weakening of activity in major trade partners or from adverse trends in oil and financial markets appear now to be less pronounced than in the past. On the other hand, improvements in the labor market conditions, higher tourism inflows, and the implementation of the structural reforms might contribute to higher external and domestic demand.

Fiscal policy

Sizeable fiscal consolidation has been accomplished under the program. An inherited stock of commercial arrears amounting to 3.7 percent of GDP was repaid in just 2 years. Net of this effort, the average improvement in the primary balance-to-GDP ratio during the program period has been of 0.7 percentage points. Public debt has started to decreased in 2016 (-1.6 percent of GDP over the previous year) and is projected to approach 60 percent of GDP in 2019, while the primary balance is set to continue to improve over the projection period. It is remarkable that the decline in the public debt-to-GDP ratio has occurred in spite of a nominal GDP growth rate that fell short of initial expectations, with a negative impact on both the numerator and denominator of the ratio.

The strong commitment to fiscal consolidation has continued to pay off in 2016. The improvement in tax administration, the higher tax compliance and the non-distortionary basebroadening fiscal measures introduced in 2016 have led to a growth in tax revenues higher than that of nominal GDP. Coupled with a tight expenditure control, especially for current outlays, this has allowed the highest primary surplus recorded in Albania. Under the 2017 budget, priority is being given to: (i) continuing fiscal adjustment and ensuring the reduction of public debt through a further broadening of indirect taxes base; (ii) accommodating the cost of reforms in the justice and public utilities sectors, as well as of fiscal decentralization, reforms that are all critical for improving the business environment; (iii) ensuring adequate financing for much-needed infrastructure projects. The budget approved for 2017 aims to achieve a primary balance of 0.7 percent of GDP, while debt reduction will further benefit from one-off revenues measures generating savings not factored in the budget. Besides, in an effort to avoid any political budget cycle, the authorities and staff agreed to introduce quarterly ceilings on budget execution.

The authorities recognize that a reduction of contingent fiscal risks is key to ensuring long-term fiscal sustainability. The PPPs framework has been strengthened through the

creation of a new unit in the Ministry of Finance dealing with PPPs' financial aspects. This enables the Ministry of Finance (MoF) to comprehensively review the value for money of the PPPs and the related possible fiscal risks, as well as to exercise its veto power right. Moreover, the decision to launch PPPs will be taken under the framework valid for public investment management, and only if it is proven that they represent the most suited instrument to implement specific priorities. The MoF has legally gained a complete and direct oversight on the Regional Development Fund eliminating a primary source of new arrears and unbudgeted projects. Other administrative measures, some of them implemented as prior actions, aim to ensure that only prioritized and fully funded projects will advance, and to avoid the recurrence of arrears.

The implementation of all the EFF's conditionality has enabled an effective modernization of the tax administration. A new organizational structure and a strategic plan, incorporating Fund's TA recommendations, are now operational with the double goal of boosting tax compliance while providing more efficient services to taxpayers. A fully staffed risk management unit has developed a new methodology for compliance risk-based audits. Compliance costs will be lowered through an improved communication and by increasingly automatized procedures, including for processing of VAT refunds (indeed, tax refunds paid in 2016 already over-performed the targets).

Further structural fiscal reforms will strengthen the budget framework. The fiscal decentralization law will provide municipalities with resources needed to perform their new functions. Municipalities' arrears clearing is ongoing as it constitutes a prerequisite for transfers. First steps towards the introduction of a value based property tax have been taken as prior action. After some delays, the implementation of a new fiscal cadaster is ongoing. Moreover, according to the action plan approved by the Prime Minister the new property tax law, including a new valuation methodology replacing the current flat rate system, is expected to be enacted in the second half of 2017.

Monetary policy and financial stability

The acceleration of growth reflects also the transmission of the accommodative monetary policy stance. In the absence of fiscal space, the reduction of financing costs and the supply of liquidity to the financial markets have played a primary role in sustaining domestic activity. As a result, inflation is recovering towards the target, reaching 2.8 percent in January. This pick-up reflects the recovery in the domestic environment and the reduction of external disinflationary pressures, as well as base effects from last year dips and the higher unprocessed food prices due to severe weather conditions (core inflation was almost unchanged). However, inflation is expected to remain below target during 2017, with a durable convergence towards the 3 percent target achieved only in 2018.

The central bank concurs with staff on the importance to stick with this accommodative

stance. The authorities remain committed to maintaining the current stance at least until the end of the third quarter of 2017. The expected baseline scenario of a continued economic recovery and a gradual convergence of inflation to the target will require a gradual normalization of monetary policy. However, in undertaking this path, the Bank of Albania (BoA) will exert due caution, so as to avoid disrupting the recovery or destabilizing inflation expectations. As this policy has been effectively and extensively communicated, at the moment there are no market expectations of an increase in the policy rate and inflation expectations remain well-anchored. The same forward guidance will be provided well ahead any decision of policy normalization takes place. For 2017, the authorities' more recent forecast of average inflation is of 2.3 percent, up from 1.3 percent in 2016.

The credit cycle is starting to react to this stimulus. Excluding the effect of loan writeoffs, the credit to the private sector in December stood 3.2 percent higher than in the previous year, led by lending to households. Credit in domestic currency increased in the same period by 10.2 percent. The BoA expects a further improvement as credit demand recovers in line with the economic activity, while the supply side will benefit from the implementation of the legislative reforms aiming at reducing the non-performing loans (see below). Final data for 2016 show that, after a spike due to two large borrowers' insolvency, the ratio of nonperforming loans to total loans fell from above 25 percent at end-2015 to 18.2 percent. 70.5 per cent of NPLs are fully provisioned, with net NPLs at 5.4 percent. This reduction reflects the combined effects of the improvement of the economic situation, credit restructuring and non-performing loans write-off from balance sheets.

The reduction of the euroization of the economy ranks among the very top priorities of the BoA. The BoA is envisaging a set of measures on the banks' liabilities side, including the establishment of different reserve remunerations for euro and lek deposits and higher requirements for highly liquid assets to be held against FX deposits. Foreign exchange reserves at the end of January stood at around 3 bn euros, covering slightly below 6 months of imports. Still, the monetary authorities consider that additional buffers may be appropriate. Therefore, a schedule of foreign exchange auction purchases for 2017 has been duly and transparently communicated to the market. This operation may also contribute to counteract any possible upward pressure on exchange rate coming from the success of the deeuroization strategy, while maintaining a fully market determined exchange rate.

During 2016, banking sector liquidity and capitalization indicators remained at high levels and the financial results are positives. The BoA has recently amended the regulatory framework for consolidated supervision of banking and financial groups in order to aligning it with the European regulations and directives and the core principles of the Basel Committee. Moreover, the regulatory and supervisory frameworks have been strengthened by the approval of a new bank resolution law that, in line with the European Bank Recovery and Resolution Directive, foresees the creation of a fund with mandatory contributions from financial institutions for the purpose of covering funding needs in the event of a crisis.

A coordinated approach among several Albanian institutions has allowed to successfully implement a fully-fledged strategy for a smooth further reduction of the NPL overhang. A very comprehensive legal package has been approved in the second half of 2016. It includes, among other legal instruments, a new bankruptcy law and amendments to the Private Bailiff law and civil procedural code in order to increase the efficiency of the execution process. Encouraging advancements in collateral execution have already been observed in recent months, especially for what concerns the transfer of land ownership. Finally, credit institutions are asked to elaborate detailed recovery plans for riskier clients.

Structural reforms

The reform of the energy sector could be judged as a leading example of successful macro critical reform. As a result, a source of fiscal risks has been considerably reduced and the sector's performance has clearly improved. At the onset of the program, sizeable unbudgeted support to the energy sector was not sufficient to prevent a considerable risk of bankruptcy for the SOEs of electricity sector. Nowadays, the country's energy balance is positive as a result of the increase of energy production from private hydropower plants and the sensible reduction of distribution losses. Collection rates and revenues have significantly increased, budget allocations in 2017 amount to just 0.1 percent of the GDP, medium term sustainability has been restored, no new intercompany arrears have emerged while increased liquidity has allowed to repay the arrears to independent producers, reducing the existing debt in the sector and contributing to investments needed to further reduce distribution losses. The Power Sector Law has transposed the provisions of the EU Third Energy Package, containing the principles for the liberalization of the electricity market. In July 2016 the Council of Ministers has adopted an action plan for the progressive phasing out of price regulation.

The adoption of the judiciary reform has represented a cornerstone of a strengthened institutional framework. This reform has been long awaited by international partners, as deemed necessary to improve the business climate. Seeking to overcome inherited problems of inefficiency and corruption, it substantially improves independence and accountability of justice institutions. The business climate will benefit also from the simplification of procedures introduced by the reform of the Tax Procedures Code and from the recently approved DPL from the WB focused on establishing a friendlier environment for attracting and retaining investors. To improve medium term growth perspectives, the government has launched a reform of the education system, with a focus on vocational training. An ongoing project financed by the EBRD aims to improve railway interconnectivity in the region.

Final remarks

Building on these important achievements, our Albanian authorities remain committed to a comprehensive strategy aiming to promote growth and job creation in a context of fiscal and financial stability. The engagement with the Fund has provided valuable support to the formulation and implementation of the authorities' economic policy, thus contributing to the country's strong performance in recent years. Our authorities look forward to continuing their engagement with the Fund in the same constructive spirit of close cooperation that has inspired their relationships so far.