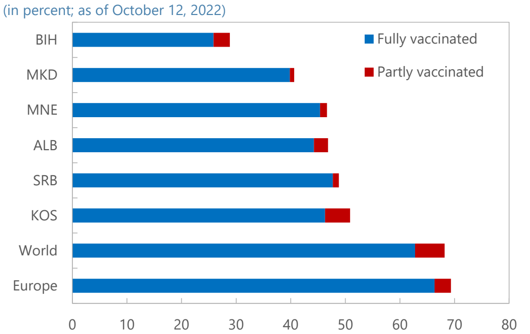
CONTEXT

1. The Albanian economy has shown considerable resilience in the face of consecutive shocks since 2019 but is facing new challenges. Past efforts to build policy buffers and a broadly appropriate macroeconomic policy mix during 2020–21 have helped Albania withstand the earthquake and pandemic shocks. Albania's direct exposures to Russia and Ukraine are limited (Box 1), and growth momentum has remained positive this year despite the shock to the global economy from Russia's war against Ukraine. With twin deficits and high government debt, Albania now faces challenges from soaring international food and energy prices, tighter global financial conditions which are likely to persist, and the economic slowdown in Europe. The opening of the EU accession talks in July marks an important milestone for Albania. Implementation of past Fund advice remains uneven (Annex I). Local elections are set for May 2023.

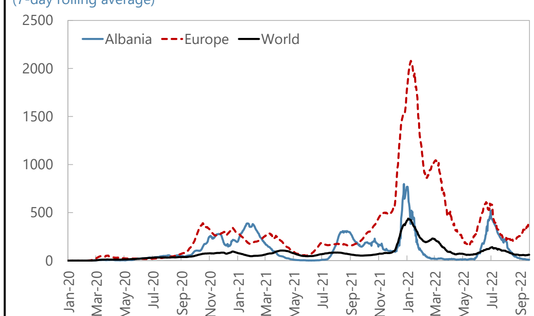
2. The pandemic has largely receded into the background. Despite a relatively low vaccination rate, hospitalization remains contained, and all pandemic restrictions have been lifted and related support measures have lapsed.

Share of People Vaccinated against COVID-19
(in percent; as of October 12, 2022)



Source: Our World in Data

Daily New Confirmed COVID-19 Cases per Million People
(7-day rolling average)

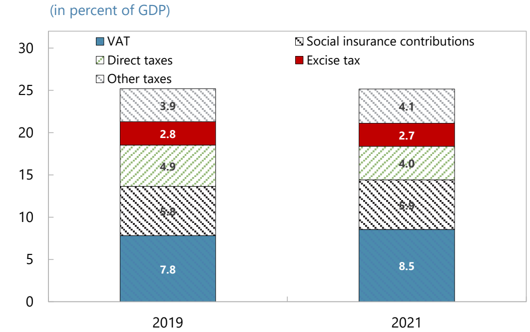


Source: Johns Hopkins University CSSE COVID-19 Data

RECENT DEVELOPMENTS

3. The economy rebounded strongly in 2021, driven by a strong recovery in tourism, a construction boom partly supported by post-earthquake reconstruction, and a record year for electricity production. Real GDP grew by 8.5 percent (Figure 1). Both employment and labor force participation recovered to pre-pandemic levels (Figure 2). The fiscal position saw significant consolidation, with the deficit considerably smaller than that projected in the 2021 Article IV staff report, on account of revenue overperformance and under-execution of overly ambitious capital spending (Figure 3). Public debt declined to 74 percent of GDP. Thanks to the €650 million

Albania: Tax Structure in 2019 versus 2021
(in percent of GDP)

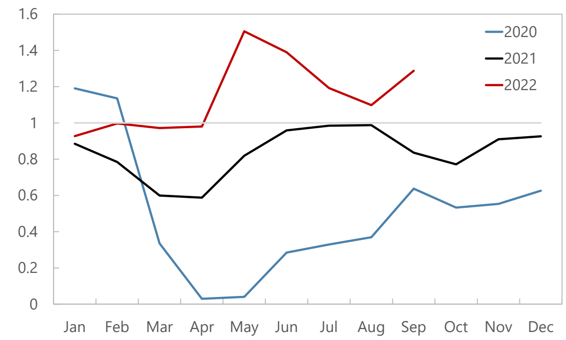


Sources: MoFE and IMF staff calculations

Eurobond (4 percent of GDP), the government accumulated a liquidity buffer of almost 5 percent of GDP at end-2021.

4. The economy has sustained the positive growth momentum in 2022, but signs of a slowdown are emerging. Activity in H1 grew by more than 4 percent y-o-y, supported by services, manufacturing, and construction. January-September tourist arrivals were 9 percent above the historical peak of 2019. However, the rising cost of living has started to adversely affect sentiment and domestic demand. Electricity production has also been below the historical average due to unfavorable weather conditions—Albania was a net importer of electricity in 2022H1 (Annex VI).

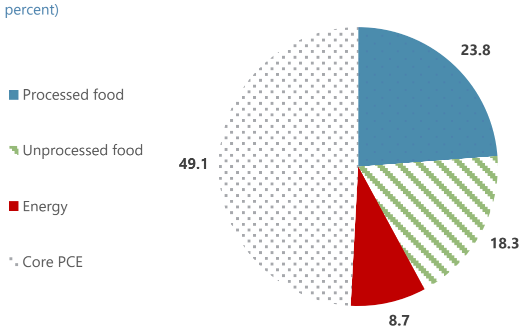
Albania: Foreign Tourist Arrivals
(Ratio to 2019)



Sources: Instat and IMF staff caclucations

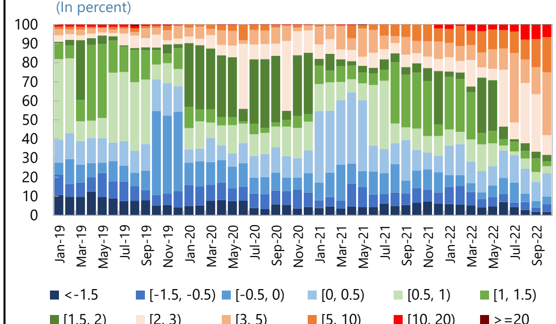
5. Inflation has risen and has become increasingly broad-based. Headline inflation reached 8.3 percent in October, the highest in over two decades, driven by food and energy prices. With food and energy accounting for half of the consumption basket, domestic inflationary pressures have started to build (Figure 4). Core inflation has accelerated rapidly in recent months from a low base. Private sector wages rose faster than CPI in 2022H1 as the labor market continues to tighten, partly reflecting skill mismatches and a dearth of qualified workers. Two-year ahead inflation expectations have risen to considerably above the central bank's 3 percent target.

Albania: CPI Basket Composition
(In percent)



Note: Data above shows the average level between 2008M1 and 2022M9.
Sources: INSTAT and IMF staff calculations.

Albania: Inflation Dispersion of Core Items 1/
(In percent)

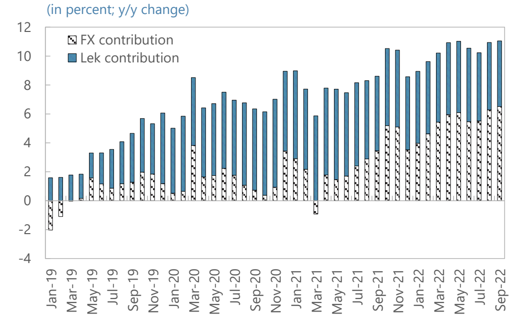


1/ Share of consumption basket within each inflation band. Exclude food and energy items.
Sources: BoA, Instat, and IMF staff calculations.

6. The Bank of Albania (BoA) has rightly started monetary policy normalization. It stopped the provision of unlimited liquidity to banks in February and raised the policy rate in five steps from a historical low of 0.5 percent to 2.75 percent in November (Figure 5). Private credit growth remains strong, driven by an acceleration in FX credit growth, a phenomenon further accentuated by an increasing amount of FX deposits spurred by large FX inflows, mainly driven

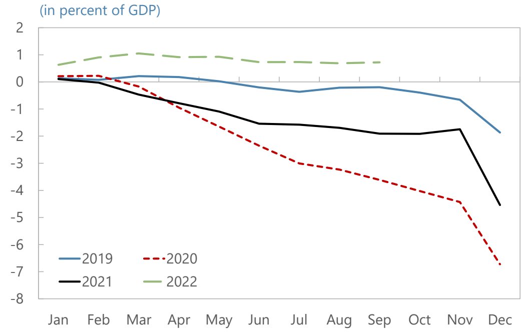
by tourism receipts buoyed by a robust recovery in tourist arrivals, strong FDI inflows, as well as the continued strength of remittance flows.

Albania: Credit Growth
(in percent; y/y change)



Sources: Bank of Albania and IMF staff calculations

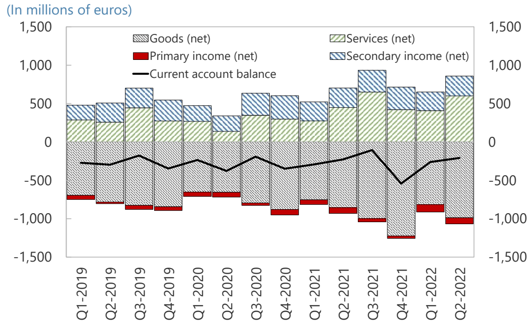
Albania: General Government Fiscal Balance
(in percent of GDP)



Sources: MoFE, IMF WEO, and IMF staff calculations

7. The budget deficit in 2022 is expected to narrow considerably on account of robust revenue and spending under-execution. The government posted an overall surplus in the first three quarters of the year as tax revenue outperformed expectations on the back of higher prices and continued economic growth, capital spending was under-executed, and interest payment was lower than projected. The 2022 Budget was revised in March and July through normative acts to include targeted support to the most vulnerable (0.6 percent of GDP cumulatively)[2] and additional broad subsidies for electricity SOEs (1 percent of GDP). These "Social Resistance Packages" were largely financed by higher tax revenue and reallocation from capital expenditure. Despite an expected acceleration in spending in Q4, the primary deficit is projected to halve to 1.3 percent of GDP. Financing has become more challenging as yields on domestic government bonds have continued to rise and many local bond auctions were undersubscribed amid heightened uncertainty, rising inflation, and further expected monetary tightening. Sitting on large liquidity, the government has also been unwilling to accept higher interest rates requested by banks, contributing to the under-subscription. Public debt is projected to decline further to just under 70 percent of GDP.

Albania: Current Account Balance
(In millions of euros)



Source: Bank of Albania

8. Despite a negative terms of trade shock, the current account balance is expected to remain broadly stable in 2022, supported by a robust rebound in tourism inflows. Higher prices pushed the value of goods imports higher in 2022H1 despite a decrease in volumes, especially for fuels and minerals, construction materials, and machinery (Figure 6). The negative impact of higher imports was offset by strong tourism inflows which saw net travel receipts surpassing the same period before the pandemic, notwithstanding a jump in outbound tourism amid easing travel restrictions. The external position in 2021 is assessed to be

[2] In addition to one-off transfers, the authorities opted for increases in pensions, social assistance, and disability benefits. About 20 percent of public sector employees, who have not received any nominal wage increases in recent years, will receive a salary increase of 7 percent.

moderately weaker relative to fundamentals and desirable policies (Annex IV). The lek saw a brief spate of increased volatility and downward pressure in March but a modest FX intervention by the BoA succeeded in calming the market. The lek/euro exchange rate has been on a slight appreciation path since then. Reserves have remained adequate at about €5 billion at end-October (around 200 percent ARA metric).

OUTLOOK AND RISKS

9. **Growth is expected to remain solid in 2022 before decelerating in 2023.** Real GDP is projected to grow by 3.7 percent, with strong activity through Q3 more than compensating for the expected deceleration in Q4. Growth is forecast to slow to 2.2 percent in 2023, reflecting tighter financial conditions, the slowdown in Europe, and the withdrawal of policy support. Headline inflation is expected to peak in the coming months and should start receding in 2023 before returning to the BoA's target of 3 percent by mid-2024, as international commodity prices stabilize, fiscal and monetary policies tighten—staff assumes the policy rate will reach 3–3.5 percent in 2022 and 4–4.5 percent in 2023—and growth slows. Core inflation is expected to peak in 2023, given second-round effects. Growth is expected to converge to its potential of 3.4 percent over the medium-term, tempered by emigration but supported by expected large investment projects.

10. **There is considerable uncertainty and risks to the growth outlook are tilted to the downside** (Annex II)**.** Further increases in food and energy prices are a key risk, especially if they trigger larger second-round effects and social unrest. Higher and more persistent inflation could further weigh on real income and weaken growth prospects. A more significant tightening in global financial conditions could hamper Albania's access to external market financing. Risks are mitigated to some degree by the high level of FX reserves. The economy is also vulnerable to unfavorable weather conditions and a reversal in the rise of real estate prices given the sector's growing contribution to the economy and banks' rising exposure to the sector.

Box 1. Russia's War Against Ukraine: Albania's Exposure and Responses

Albania has limited direct exposures to Russia and Ukraine, with most of the war's economic impact being manifested through higher food and energy prices, tighter financing conditions, and the prospects of lower demand from main EU trading partners (Figure 7). Albania does not rely on natural gas and its financial sector has no direct links to Russia. However, with policy buffers largely eroded after successive adverse shocks in recent years, the authorities' ability to mitigate the pressures from soaring commodity prices and higher borrowing costs may become more constrained.

Trade. Compared to other Western Balkan countries, Albania has low trade exposures to Russia and Ukraine. While Ukraine and Russia are important sources of seed oil, and cereal and fertilizers, respectively, Albania has successfully secured uninterrupted supplies—albeit at higher prices—partly thanks to its small domestic market and diversified trade linkages.

Tourism. The Albanian economy is highly dependent on tourism but the share of tourists from Russia and Ukraine is small. In 2022, Albania saw its best tourism season on record, beating the pre-pandemic peak in 2019.

Box 1. Russia's War Against Ukraine: Albania's Exposure and Responses (concluded)

Energy. Albania does not use natural gas either for heating or industrial processes. Domestically, it generates electricity entirely from hydropower, but unfavorable weather conditions can create significant energy shortfalls. In the event of a total Russian gas shut off, Albania could be affected through sharply higher prices for imported electricity.

Financial sector. In line with EU-wide agreements, Albania has imposed sanctions on Russia and Belarus, including on the Central Bank of Russia and several Russian banks. No Russian bank is currently operating in Albania. Some foreign-owned banks in the banking sector have exposures to Russia but they are standalone subsidiaries and have remained stable and liquid.

Investment. There is no reported inward and outward direct investment from Russia and Ukraine in Albania. Portfolio investments in Russian and Ukrainian financial assets are also negligible.

Policy responses. The impact of the war has mainly been reflected through higher prices and borrowing costs. The government amended the 2022 Budget twice (in March and July) to provide targeted support (0.6 percent of GDP) for vulnerable groups, combining temporary and permanent measures. The government also increased the minimum wage from ALL 30,000 to ALL 34,000. It has kept electricity tariffs unchanged for households and most small businesses so far, by providing a record amount of untargeted subsidies to electricity SOEs in 2022 (totaling 1.3 percent of GDP). Going forward, the government is considering complementing broad subsidies to the electricity sector with a temporary higher block tariff for high-consumption households.

Authorities' Views

11. **The authorities broadly share the staff's assessment on the outlook and risks**. They highlighted the unusually large uncertainty associated with the projections and the importance of preparing alternative scenarios, which they have been doing. On top of the uncertainty related to Russia's war against Ukraine, weather conditions have considerable impact on Albania's growth, fiscal deficit, and energy security given the country's reliance on hydropower. The BoA sees high inflation as a main threat to macroeconomic stability and long-term growth prospects.

POLICY DISCUSSIONS

Staff advocated faster rebuilding of fiscal buffers underpinned by revenue mobilization. This would reduce the pressure on monetary policy to tighten to bring down inflation. Such a policy mix would also facilitate external adjustment and help preserve market confidence. Supervision will need to follow rising bank lending, notably FX lending, and real estate-related activities, and take actions as needed to rein in any excessive risk taking. Efforts should continue to raise bank capital buffers. Accelerating progress on structural reforms is required to lift potential for sustainable, inclusive, and green growth.

A. Rebuilding Fiscal Policy Buffers Faster and Reducing Demand Pressure

12. **The draft 2023 Budget rightly aims for further consolidation, but optimistic revenue projections suggest lower spending will be required to meet the authorities'**

budget target. The budget targets a small primary surplus, thus adhering to the fiscal rule one year ahead of the deadline stipulated by the Organic Budget Law. The government plans to introduce a number of tax policy measures to boost revenue, including amendments to reduce the loophole for free professionals in the Income Tax Law and a one-off windfall tax imposed on independent power producers. Nevertheless, staff expects limited permanent gains from these measures and considers the budget revenue projections optimistic. Spending plans include further transfers to the electricity sector SOEs to keep tariffs unchanged for households and most businesses (0.6 percent of GDP), and sizable capital spending (5.5 percent of GDP). Staff projects a zero primary balance in 2023 under the baseline, reflecting more modest revenue gains and spending under-execution, especially with capex, as is consistent with the past. The government's plan to issue a Eurobond in 2023 is subject to considerable uncertainty. But even with reduced access to international markets, the government could finance the budget fully with official external loans and grants, domestic borrowing, and the use of the SDR allocation as needed.

13. In the medium term, the fiscal position is expected to stabilize as spending reverts to pre-pandemic norms and the fiscal rule is upheld. A small primary surplus is projected from 2024 and beyond as crisis-related spending is phased out. The public debt ratio is expected to be on a downward trajectory, declining to under 64 percent of GDP by 2027. However, gross financing needs (GFNs, Annex III) will remain sizeable and with higher borrowing costs, interest payment will consume an increasing share of tax revenue.

14. Staff recommended a more ambitious revenue-based consolidation path to rebuild room for policy maneuver faster, reduce demand pressure, and mitigate the effects of rising borrowing costs. Given Albania's high government debt, large gross financing needs, and tighter financial conditions, the authorities should take advantage of the still positive growth momentum for faster debt reduction. This would also reduce the pressure on monetary policy to raise interest rates even more to bring down inflation and facilitate external adjustment.

- The budget deficit target in 2023 is in line with staff's recommendation. However, given the prospect of elevated inflation in 2023, the government should raise more tax revenue through coherent measures (¶15) and reprioritize spending to create room for higher targeted and temporary support to the vulnerable without increasing the deficit target.

- Beyond 2023, the government should aim for a primary surplus of 1.5 percent of GDP in 2024 (Text Table 1), mainly through tax policy measures based on a sound Medium-Term Revenue Strategy (MTRS) (¶15 and Text Table 2). The size of fiscal adjustment needed to achieve this goal would be comparable to that already envisaged for 2023 under the baseline. If downside risks were to materialize, automatic stabilizers should be allowed to operate and further temporary, targeted support to the vulnerable should be deployed.

- After the efficiency and transparency of public spending improve, a lower primary surplus of about 1 percent of GDP could be considered starting in 2026, provided that fiscal risks are in check. This should serve, first and foremost, to support spending on human development needs and a green transition, and second, to address large infrastructure needs.

Text Table 1. Albania: Medium-Term Fiscal Paths, 2019–27

(Percent of GDP)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
						Proj.			
Tax revenues									
IMF staff baseline 1/	25.2	24.2	25.2	26.0	25.9	25.8	25.8	25.8	25.8
IMF recommended path	25.2	24.2	25.2	26.0	26.3	27.0	27.3	27.3	27.3
Medium-Term Budget Framework (MTBF) 2/	25.2	24.2	25.2	26.0	27.0	26.7	26.7	26.8	26.9
Primary expenditure (excluding interest)									
IMF staff baseline	27.1	30.5	29.7	28.9	27.6	27.2	27.2	27.2	27.2
IMF recommended path	27.1	30.5	29.7	28.9	28.0	27.1	27.3	27.8	27.9
MTBF	27.1	30.5	29.7	28.9	28.8	27.4	27.1	26.5	26.2
Overall balance									
IMF staff baseline	-1.9	-6.7	-4.5	-3.3	-2.7	-2.5	-2.7	-2.8	-2.8
IMF recommended path	-1.9	-6.7	-4.5	-3.3	-2.6	-1.2	-1.3	-1.8	-1.8
MTBF	-1.9	-6.7	-4.5	-3.3	-2.6	-2.2	-2.2	-1.7	-1.5
Primary balance									
IMF staff baseline	0.1	-4.6	-2.6	-1.3	0.0	0.3	0.3	0.3	0.3
IMF recommended path	0.1	-4.6	-2.6	-1.3	0.0	1.5	1.5	1.0	1.0
MTBF	0.1	-4.6	-2.6	-1.3	0.3	0.9	1.1	1.8	2.1
Cyclically adjusted primary balance									
IMF staff baseline	0.4	-3.9	-2.9	-1.6	0.0	0.3	0.3	0.3	0.3
IMF recommended path	0.4	-3.9	-2.9	-1.6	0.0	1.5	1.5	1.0	1.0
Structural primary balance (excl. earthquake reconstruction)									
IMF staff baseline	0.7	-2.8	-0.9	-0.6	0.2	0.3	0.3	0.3	0.3
IMF recommended path	0.7	-2.8	-0.9	-0.6	0.2	1.5	1.5	1.0	1.0
Structural primary balance (incl. earthquake reconstruction)									
IMF staff baseline	0.7	-3.8	-2.4	-1.6	0.0	0.3	0.3	0.3	0.3
IMF recommended path	0.7	-3.8	-2.4	-1.6	0.0	1.5	1.5	1.0	1.0
Public debt									
IMF staff baseline	67.4	75.9	73.9	68.5	67.9	66.4	64.7	64.5	63.6
IMF recommended path	67.4	75.9	73.9	68.5	67.9	65.3	62.3	60.6	58.9
MTBF	67.4	75.9	73.9	68.5	67.5	66.4	65.4	64.4	63.3
Memorandum items									
Revenue gains under IMF staff preferred path 1/				0.0	0.4	1.2	1.5	1.5	1.5
Expenditure changes under IMF staff preferred path				0.0	0.4	0.0	0.3	0.8	0.8
Real GDP growth, baseline (percent)	2.1	-3.5	8.5	3.7	2.2	3.3	3.4	3.4	3.4
Real GDP growth, reform path (percent)	2.1	-3.5	8.5	3.7	2.2	2.7	3.6	4.6	4.6

Sources: IMF Staff estimates and projections.

1/The baseline projections for tax revenue of 2023-27 incorporate 0.3 percent of GDP gains from tax policy and revenue administration measures in the fiscal package of 2023.

2/As of October 2022.

15. **The MTRS remains the cornerstone of a credible fiscal consolidation and should be finalized and implemented as a cohesive strategy without further delay.** As a share of GDP, Albania's tax revenue is still among the lowest in the region, and the country needs higher revenue to reduce debt while supporting its development needs. The MTRS should be designed and seen as a cohesive blueprint for Albania's tax reforms, replacing the hitherto piecemeal approach to tax policy changes. Beyond the revenue gains, the stability and predictability of the tax system will also make revenue administration easier and help improve the business environment. To this end, work to finalize and implement the MTRS should proceed without further delay. Within the MTRS, while the introduction of outstanding indirect tax measures could be postponed until inflationary pressures subside, direct taxation and revenue administration measures aiming to broaden the tax base and reduce distortions should not be deferred, as

these are likely to have minimal impact on growth and inflation while helping to reduce informality. In this context, the ongoing work on improving revenue administration represents a step in the right direction, although it is not sufficient. Efforts should be made to reduce the gaps between the authorities' proposed piecemeal reforms and Fund advice to maximize potential revenue gains (Text Table 2). Staff reiterated concerns on the proposed tax amnesty law, given money laundering and governance risks as well as the adverse impact on tax compliance.

Text Table 2. Menu of Revenue Measures During 2023–27 and Expected Yields

(Percent of GDP)

Tax policy	**1.4–1.7***
Indirect Taxes	**0.80**
VAT (starting in 2024, including measures to end exemptions for health, education and financial services; extend coverage to first sale of new residential apartments; review VAT registration threshold)	**0.65**
Excise (starting in 2024, including measures to unify tariffs on beer and wine products and remove some key excise exemptions)	**0.15**
Direct Taxes	**0.6–0.9***
Income taxes (starting in 2023, including measures to bring self-employed professionals under the PIT, remove zero tax bracket for PIT and CIT, make PIT tax brackets and rates more progressive,and introduce simplified turnover-based regime for SMEs)	**0.3–0.6***
National and Local Taxes and Tariffs (starting in 2023, property tax and gambling reforms)	**0.3**
Revenue administration	**0.7**
Tax Administration (starting immediately, to increase VAT compliance in construction, and address "high-risk" non-compliant sectors and high informality)	**0.45**
Customs Administration (starting immediately to increase compliance on excise duty on fuels, modernize business processes, and improve risk-based enforcement)	**0.25**
TOTAL**	**2.1–2.4***

Sources: IMF staff estimates based on MTRS TA reports

*Higher end of the range reflects potential additional gains from removing the zero tax bracket for CIT and PIT for those with an annual turnover above ALL 14 million

**Estimated revenue gains from the 2023 Budget measures that have been incorporated into the baseline (0.3 percent of GDP) reflect the implementation of a few elements related to the MTRS.

16. **Strengthening social protection can help enhance the country's crisis management toolkit by enabling more effective and targeted fiscal support**. The experience in recent years has underlined the important role of social protection in shielding the vulnerable from shocks. In the short term, there is room to further leverage the existing structures and programs to better target and improve the coverage of support beyond the current beneficiaries to ensure adequate access for those who need it the most. In the medium term, updating and scaling up the existing cash transfer framework and regularly reviewing the adequacy and delivery of benefits can help further improve targeting, effectiveness, and reach of social support during future shocks.[3]

17. **The volatility in the global energy market has underlined the urgency of decisive reforms to bring the electricity sector to financial viability and reduce fiscal risks**. Broad-based subsidies should be removed as they benefit disproportionately those who are better off and distort price signals. Gradual tariff adjustments to cost recovery levels are critical for

[3] See the World Bank's Social Protection Situational Analysis for Albania.

reducing fiscal cost and promoting conservation and must be complemented with measures to support the vulnerable. It is also critical to enhance the electricity sector's transparency and strengthen corporate governance in the sector's SOEs.

18. Public investment management (PIM) needs strengthening. A number of major recommendations from the 2016 Public Investment Management Assessment (PIMA) are still outstanding. No meaningful changes have been made to the legal framework, and decisions on public-private partnerships (PPPs), estimated at about 40 percent of 2022 GDP (reflecting the contract value of existing projects and those in the pipeline), continue to be made outside the budgetary process. The framework for coordinating and managing PPPs continues to suffer from important weaknesses and the extent of related fiscal risks remains unclear. The authorities need to redouble efforts to strengthen the Ministry of Finance and Economy's (MOFE) capacity to play an effective gatekeeper role in project selection and to engage actively in evaluation and monitoring. Aligning the PPP and PIM processes, with full integration into the normal budget cycle, remains an urgent priority.

19. Staff called for strengthening fiscal transparency and credibility. All public investment projects need to be subject to the public investment and procurement frameworks. The authorities are urged to publish public procurement contracts pertaining to pandemic and earthquake recovery spending, the names of awarded companies, and their beneficial owners. In keeping with the spirit of maintaining fiscal credibility, the use of normative acts to alter the budget should be minimized.[4]

20. Much remains to be done to improve the coverage, quality, and capacity for monitoring, assessing, and managing fiscal risks. Reporting and analysis of fiscal risks, including those pertaining to SOEs' liabilities, can be further enriched and made more forward-looking. A mechanism is needed to ensure systematic monitoring and follow-through with respect to the repayment of the government's on-lending to SOEs. Going forward, conditions for granting on-lending and guarantees to SOEs and municipalities need to be made more stringent to better manage related risks. Despite reductions in the overall stock, arrears persist, particularly related to investment projects and court cases. Work to improve data on arrears should continue, specifically with respect to data traceability and automation. After a stocktaking exercise, the authorities are currently identifying key priority areas for their third PFM Strategy, which is expected to be finalized in 2023. The strategy should address incomplete reforms and setbacks in commitment controls and arrears prevention, as well as paving the way for incorporating green PFM practices. Over the medium term, to ensure that the Fiscal Risk Unit remains fit for purpose, its mandate and staffing should be progressively strengthened.

21. Effective cash and debt management has gained added significance amid tougher financing conditions and recent improvements are welcome. Persistent challenges posed by

[4] Normative acts are government decisions with the power of the law that can be issued under extraordinary circumstances and require only ex-post parliamentary approval. In the last decade, in-year budget revisions have been conducted through normative acts, thus circumventing the normal parliamentary review processes.

Albania's large gross financing needs and a sizable share of external debt with large bullet repayments underline the importance of an effective implementation of the latest debt management strategy. Coordination between the MOFE and the BoA on cash and debt management has been improved, with the BoA now regularly attending the meetings of the Committee on the Management of Debt and Liquidity and a revised agreement with the BoA to expand the MOFE's cash management toolbox for dealing with foreign currencies.

Authorities' Views

22. The authorities reaffirmed their strong commitment to fiscal consolidation, while pointing to challenges in implementing major reforms in the context of consecutive large shocks. They stressed that fiscal and monetary policy should continue to be closely coordinated and work harmoniously to provide the most adequate policy mix for every macroeconomic challenge. They also acknowledged the downside risks to the 2023 budget revenue projections and emphasized that they would prioritize spending to ensure the achievement of the budget target in case of revenue shortfalls. The authorities stressed their commitment to the MTRS and noted that they have implemented some elements of it, pointing to the ongoing efforts to improve revenue administration. But they took the view that the benefits of the strategy would likely be limited in the currently difficult economic environment. Work is underway on a Social Assistance Modernization Project with the support of the IBRD to improve the social protection system. On PPPs, the authorities indicated that there is increasing reliance on cost-benefit analysis to determine whether the choice of PPPs is appropriate. The MOFE also highlighted that the more difficult financing environment has given it more leeway to play the role of gatekeeper for public investment projects. On the third PFM Strategy, the authorities underscored the need for more realistic objectives and express strong interest in receiving assistance from the Fund for the drafting and costing stage. Overall, they very much appreciate the Fund's technical assistance on fiscal structural reforms and point to high staff turnover as a key obstacle for absorption.

B. Reducing Inflation

23. Monetary policy should continue to normalize. Monetary conditions are still accommodative despite five consecutive policy rate increases, as real policy rates remain negative reflecting rising underlying inflation and inflation expectations. With risks to the inflation outlook on the upside and strong inflation persistence, further policy rate increases are warranted. Acting firmly now will help prevent a wage-price spiral and contain the risk of inflation expectations becoming unanchored, thereby reducing the risk that much higher policy rate increases may be needed in the future. The BoA also needs to be prepared to raise the policy rate to above its estimated neutral rate of 4.5–5 percent if inflationary pressure does not abate. Despite the predominance of loans with variable interest rates, the credit channel of monetary policy transmission is limited by the euroization of the economy and the relatively low level of bank credit penetration.

24. Given high uncertainty, the pace and timing of the tightening cycle need to consider evolving economic conditions. Further increases in international commodity prices

would require stronger tightening to limit second-round effects and keep inflation expectations anchored. Slower growth, faster fiscal consolidation (as recommended in ¶14), or a stronger reaction of core inflation to policy rate increases would instead support a more gradual tightening or an earlier pause in the tightening cycle. Sizable exchange rate depreciations (appreciations), which could be affected by the size and pace of tightening of major central banks, would require larger (smaller) tightening. The BoA has rightly stepped up efforts to clearly communicate its strategy governing monetary policy tightening decisions, which will help preserve its credibility and prevent de-anchoring of inflation expectations.

25. **The exchange rate should remain flexible and continue to perform its role as a shock absorber.** FX interventions should be reserved for disorderly market conditions and mitigating the adverse effects of large depreciations on balance sheets, as well as for modest pre-announced FX purchases. In case of heightened BoP pressures and financial stability concerns—including in the context of drastic tightening of global financial conditions—the authorities should take further measures as needed to preserve macroeconomic and financial stability.

Authorities' Views

26. **The BoA agrees that monetary policy needs to continue raising interest rates decisively while being data driven.** Reflecting Albania's positive cyclical position, sharp increases in the global food and energy prices have fed into domestic inflationary pressures and raised inflation expectations. The BoA expects more rate hikes in the near term under its current baseline projections. Given large uncertainty, it will carefully analyze incoming data to adjust the pace and timing of tightening to evolving situations. The BoA is committed to clearly communicating its monetary policy decisions and strategy. Despite high euroization, the BoA assesses the monetary policy transmission mechanism to be sufficiently effective to allow for the convergence of inflation to the target in 2024, which will be aided by the ongoing tightening of the ECB.

C. Preserving Financial Stability

27. **The banking system has weathered the successive shocks relatively well, supported by the BoA's ongoing efforts to strengthen regulation and supervision, but pockets of vulnerabilities exist.** Partly reflecting the sizable credit growth since 2019, the NPL ratio reached its lowest level of 5.1 percent in September. Capitalization of the banking system is above regulatory requirements (Figure 8), but one large bank has yet to meet the increased macroprudential capital

Albania: Selected Financial Stability Indicators

(Percent)

	Dec-18	Dec-19	Dec-20	Dec-21	Sep-22
Capital Ratios					
Regulatory capital to risk-weighted assets	18.7	18.7	18.7	18.5	19.3
Tier 1 capital to risk-weighted assets	17.4	17.5	17.6	17.4	18.1
Shareholders' equity as a percent of total assets	10.1	10.5	10.4	9.9	10.2
Assets Quality					
Net NPLs to regulatory capital	15.5	13.6	11.3	7.1	6.7
Gross NPLs to total loans	11.1	8.4	8.1	5.6	5.1
Profitability					
ROE (annual basis)	13.0	13.5	10.7	12.9	9.4
ROA (annual basis)	1.3	1.4	1.1	1.3	1.0
Net open FX positions to capital					
Net open FX position to regulatory capital	7.8	7.4	8.4	9.2	8.9
Net open FX position to Tier 1 capital	8.4	8.0	9.0	9.8	9.5
Asset ratios					
Liquid assets to total assets	34.2	35.7	34.8	33.3	28.9
Liquid assets to short-term liabilities (<1Y)	46.2	49.4	47.4	45.4	40.0
Loans and Deposits					
Private sector credit growth	-0.9	6.1	8.9	8.6	11.1
Bank deposits growth	-1.3	3.9	8.3	9.3	6.7

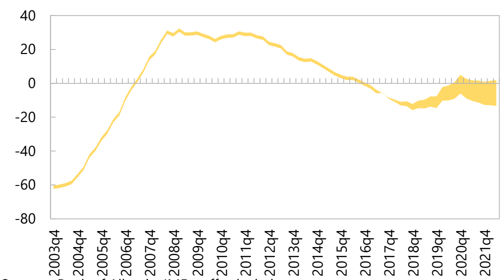
Sources: Bank of Albania and IMF staff calculations

buffer requirements. The banking system is susceptible to credit, exchange rate and interest rate risks, reflecting large unhedged FX loans (a quarter of total loans), prevalence of banks loans with variable interest rates, and large holdings of government bonds.

28. Enhanced vigilance will be key to identify and deal with financial stability risks preemptively, particularly as monetary conditions tighten. The full impact of the consecutive shocks that have hit the economy since 2019 may only become visible on bank balance sheets over time. Staff analysis shows that the credit-to-GDP gap is still negative, but this mechanical measure should not be overemphasized. Close monitoring and management of potential risks from the sizable credit growth since 2019, including rising FX lending, is warranted. The BoA needs to continue to enhance risk-based on-site and off-site inspections and complete focused asset quality reviews (AQRs). Staff support the BoA's ongoing efforts to strengthen bank capital buffers, including through further phase-in of macroprudential and MREL (Minimum Requirement for Own Funds and Eligible Liabilities) capital requirements, and to enhance its capacity to challenge banks' capital projections, given the expected adoption of IFRS 9 standards by end-2023.

Albania: Credit Gap[1/], 2003q4-2022q2

(Percent of GDP)



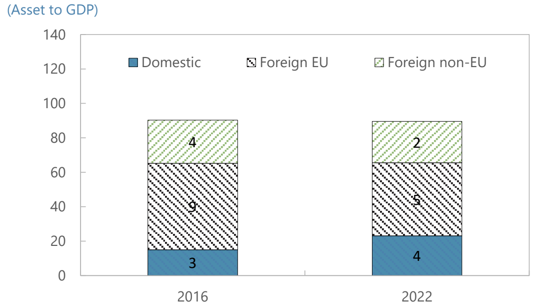
Sources: Bank of Albania, IMF staff calculations.

1/ The credit-to-GDP gap fan chart is based on a one-sided HP filter, with multiple smoothing parameters to account for uncertainty regarding the length of financial cycle.

29. The banking system has undergone notable changes in recent years that call for heightened vigilance in supervision. The number of banks has fallen to 11 from 16 in 2016, reflecting consolidation of Albania's banking system and retrenchment of EU banks from the region. The presence of banks with significant shareholding by individuals and non-financial groups raises the risk of capital shortfalls, related-party transactions, and large exposures. Ensuring that market entrants have strong banking experience and meet fit and proper criteria on an ongoing basis (including their significant shareholders and controllers, beneficial owners, and senior managers) to operate in the Albanian financial system will be critical. In this context, it is important for the BoA to implement enhanced bank licensing and supervisory framework and for authorities to apply pertinent competition rules.

Albania: Banking System Ownership Structure, 2016-2022

(Asset to GDP)



Note: Number of banks is shown on top of each stack column. OTP and Alpha Bank are counted as one EU bank given the approved sale of Alpha Bank to OTP in 2022.

Sources: Bank of Albania and IMF staff calculations

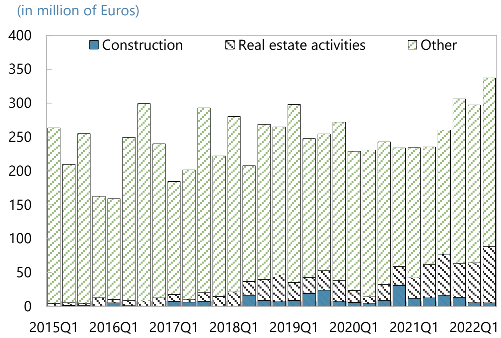
30. Improving supervisory and regulatory frameworks, aligned with EU standards, would provide the authorities with tools to better monitor and manage financial stability risks. The BoA has made commendable progress towards achieving equivalence of supervisory and regulatory frameworks with EU standards and expects to open the discussion of equivalence with the European Banking Authority in 2023. To prepare for any large increases in NPLs, necessary actions that are beyond the BoA's remit should be stepped up to implement swiftly the

insolvency and resolution frameworks already in force, including out-of-court loan restructuring, to prepare for any large increases in NPLs. The long-standing impasse in bailiff reform should also be resolved.

31. The non-bank financial sector requires enhanced monitoring and supervision. Non-bank assets are equivalent to 10 percent of GDP, one-tenth of the banking sector. Reflecting the small size of investment funds and their limited interlinkages with the rest of the financial sector, large redemptions from investors this year, triggered by the rise of government bond yields, have not led to large downward pressure on Albania's sovereign bond market. The Albanian Financial Supervisory Authority (AFSA) should continue to enhance data collection, risk monitoring, and expand its liquidity management toolkit for investment funds. Following the adoption of a virtual asset regulation in 2021, AFSA has strengthened its cooperation with international peers, including participating in IOSCO's Fintech Taskforce. But to date no entity has applied for a license to carry out virtual asset activities under AFSA's supervision.

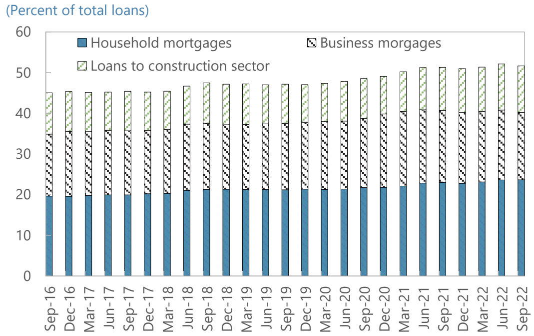
32. Significant data gaps on real estate and construction need to be addressed and enhanced surveillance of this sector's impact on financial stability is warranted. The sector is becoming an important conduit for macro-financial linkages, given its rising contribution to economic activities and increasing financing from banks and foreign flows. The BoA's surveys also point to rapid growth of real estate prices (Figure 9). Despite the BoA's recent efforts, significant data gaps still prevent timely monitoring and identification of potential risks.

Albania: FDI to Construction and Real Estate Sector
(in million of Euros)



Sources: BoA and IMF staff calculations.

Albania: Loans to Construction Sector and Mortgage
(Percent of total loans)



Note: Construction sector includes loans to real estate sector.
Sources: Bank of Albania and IMF staff caculations

Authorities' Views

33. The BoA sees the banking sector as sound, liquid, and well-capitalized and notes that reforms undertaken in recent years have contributed to notable improvements in the stability and efficiency of the banking sector. It interprets the sizable credit growth and the increase in portfolio quality as indications of the contribution of the banking sector to the economic recovery of Albania. Following years of declining and low interest rates, banks now are facing the opposite conditions. The BoA is committed to continuing its efforts to enhance the regulation and supervision of the banking sector and to promote financial stability. It has

updated the stress testing methodology in line with best practices and has completed focused AQR for 6 banks. Regarding the real estate sector, the BoA has collected yearly data to compute loan-to-value, loan-service-to-income, and loan-to-income indicators from an ad hoc report from banks. Based on the European Systemic Risk Board's recommendations, it is also working on a document to provide a legal basis for unified definitions on lending and mortgages indicators.

D. Enhancing Growth Potential

34. Further progress has been made with the EU-supported judicial reform and sustained efforts are needed to preserve the momentum. The vetting of judges is advancing steadily with around 70 percent vetted as of September 2022, and no effort should be spared to meet the December 2024 constitutional deadline. Among the vetted judges, more than two-thirds have resulted in dismissals, resignations, or termination of mandates. Additional appointments to the Constitutional Court and High Court and the new judicial map should improve the judiciary's capacity and efficiency, but implementation should be closely monitored to guarantee access to justice. Guidelines to optimize litigation efforts by the government are being prepared and case backlogs are expected to decline. The authorities have also been making efforts to address the shortage of judges and prosecutors, including by rationalizing the educational and training pipeline. Work to establish a modern and integrated case management system is still at the initial stages and should be a priority.

35. The 2023–2030 National Anticorruption Strategy and Action Plan have been prepared, considering a sector-based approach and the need to strengthen education programs. The strategy and the plan will be submitted for public consultations and should be adopted by end-2022 as planned**.** The Specialized Structure for Anti-Corruption and Organized Crime (SPAK) has initiated investigations and prosecutions in high-profile cases and its staffing and resources should be further bolstered to enhance enforcement.

36. Albania should expedite efforts to exit FATF's grey list and continue to reaffirm its commitment to a robust AML/CFT framework. The authorities have been making progress in implementing FATF's action plan and should swiftly address any remaining issues. Effective implementation of laws ensuring designated non-financial businesses and professionals (DNFBPs) meet fit and proper requirements should continue. Ongoing efforts to conduct risk-based inspections of DNFBPs—including construction companies and real estate agents—are welcome. The authorities are implementing enforcement measures to increase beneficial ownership registration, and if needed, should consider additional enabling measures, including verification procedures by financial institutions. Existing and new policies with potential AML/CFT implications should include adequate safeguards and be aligned with FATF and MONEYVAL requirements, also in light of concerns expressed by FATF that plans for a possible tax amnesty law do not comply with FATF principles.

37. Climate change risks are macro-critical to Albania.[5] Although Albania contributes very little to global emissions, it is disproportionately affected by the impact of climate change and the status quo. Albania's large share of agriculture, the concentration of its vital infrastructure, population, and economic activity (notably tourism) along the coastal plain, and the high reliance on rainfall to generate electricity make it vulnerable to climate change risks. The number and frequency of climate change-induced natural disasters have increased in the last two decades and the impact is being increasingly felt, with each disaster causing damages on the order of 1.3 percent of GDP and affecting a considerable share of the population.

38. Adaptation policies should be integrated into national decision processes and costed properly in medium-term planning and annual budget allocation decisions. Integrating climate considerations into all aspects of PFM (so-called "green PFM") will help given the high cost of climate-resistant infrastructure. Adapting the existing PFM framework to incorporate a climate-sensitive approach could help promote fiscal policies that are responsive to environmental and climate concerns. A key challenge for Albania will be to enhance its PIM frameworks and to include climate-related considerations in project evaluation and selection criteria.

39. Albania needs to generate additional revenue to meet the investment needs of climate adaptation, on top of other development needs. Albania has very limited fiscal room to accommodate additional sizable investments while also keeping to its debt consolidation path. Strong PFM institutions and strengthened PIM frameworks would attract more financing from IFIs and various climate funds. The implementation of a sound MTRS and better utilization of environmental taxes would also help. Over the medium to long term, the authorities can consider raising carbon taxes for heavy polluters (pre-announced and rising to reach internationally suggested carbon price floors) and introduce strong regulations and feebates.

40. An anemic birth rate and steady emigration have left Albania with an aging and declining population. Since the pandemic, Albania has lost an estimated average of 20,000 inhabitants per year and the trend is likely to continue (Figure 2). The drop in productivity due to an aging and shrinking workforce is expected to weigh on potential growth, with implications for tax revenue and the cost of public services. Enhancing governance and institutions, curbing corruption, and addressing human development needs could help reduce emigration. Albania's high level of informality also undermines the incentive structures in the domestic labor market. Given the pervasiveness of informality, tackling it will require a multifaceted and multilayered approach (Annex VII).

Authorities' Views

41. The authorities acknowledged the importance of structural reforms to achieve Albania's development goals and viewed the start of negotiations to join the European Union as the anchor for reforms. They affirmed their commitment to completing the vetting of

[5] See the accompanying selected issues paper.

judges by the constitutional deadline and pointed out that delays in establishing a modern and integrated case management system are mainly due to lack of funding. On AML/CFT, the authorities indicated most of the items on FATF's action plan have been addressed or largely addressed and expressed their commitment to completing all necessary actions to expedite Albania's exit from FATF's grey list. They acknowledged the macro-criticality of climate change in Albania and stressed their commitment to the Paris Climate Agreement, as laid out in the updated National Determined Contributions in 2021 to reduce emissions by 20.9 percent by 2030 and reach carbon neutrality by 2050. However, they emphasized that limited capacity and funds to deal with the complexity of climate adaptation are expected to be the major obstacle to progress. The authorities recognized the role that the MTRS can play in reducing informality and stress that they have been implementing measures to improve revenue administration. The authorities considered emigration as a key concern for long-term growth. To this end, Albania has introduced measures to encourage the free movement of labor in the region, which is aimed at attracting more workers into the domestic labor market. Active labor market policies, such as the Youth Guarantee Program, are also geared towards boosting the formal labor force.

POST FINANCING ASSESSMENT[6]

42. Albania's capacity to repay the Fund remains adequate. Fund credit outstanding was 247.3 percent of quota (8.6 percent of gross international reserves) at end-2021 and will decline to 211.9 percent of quota at end-2022. Debt service to the Fund is projected to peak in 2024 at 3 percent of gross international reserves, well within Albania's capacity to repay. Albania's international reserves are projected to remain adequate in the medium term at around 170 percent of the ARA metric by 2027. The net international investment position is expected to remain stable at around -50 percent of GDP in 2022.

43. Public finances remain the main source of vulnerabilities. Albania's public debt is sustainable, but the level is high and GFNs remain large (Annex III). The public debt ratio is expected to be on a downward path from 2022 onwards but the debt path under the baseline is subject to significant risks. GFNs are projected to average 17 percent of GDP in the medium term, reflecting sizable rollover needs, including maturing Eurobonds in 2025 and 2027 and the short maturity of domestic public debt (one-third of total public debt). Key vulnerabilities stem from: (i) rollover risks; (ii) higher borrowing costs and reduced access to external market financing amid tighter global financial conditions; and (iii) exchange rate risks, given the sizeable share of foreign currency-denominated debt. Risks from the banking system remain contained but warrant close monitoring given pockets of vulnerabilities (Section C).

44. Risks to Albania's capacity to repay the Fund remain manageable. Albania's sizeable reserve coverage and flexible exchange rate remain important shock absorbers. Rollover risks are mitigated by Albania's access to development partners' longer-term financing and a captive domestic financial market. In March 2022, the BoA's repo line of €400 million with the ECB was

[6] See footnote 1. This section reports on discussions under the Post Financing Assessment policy. For a description of the PFA policy see IMF Policy Paper No. 2021/026.

extended to January 2023. With a strong repayment track record, relative macroeconomic stability, high international reserves, relatively long external debt maturity, and access to liquidity, Albania should be able to manage a range of risks to its capacity to repay. If downside risks were to materialize, Albania's twin deficits are expected to rise, implying larger financing needs and further policy adjustment. Additional official support, including from the Fund, could be needed (Annex V).

45. A 2022 update safeguards assessment found that the Bank of Albania has a relatively robust safeguards framework. Progress has been made in addressing the safeguards recommendations, which focus on further enhancing internal audit independence and strengthening legal framework. To this end, drafting amendments have been made to the central bank law with the view to aligning it with leading practices.

46. With tighter financing conditions and heightened uncertainty, reducing fiscal vulnerabilities and rebuilding fiscal room fast are even more critical to risk mitigation. A clear commitment to fiscal prudence, credibility, and transparency is of the utmost importance. In this context, implementing an ambitious fiscal consolidation, underpinned by a sound MTRS, remains the main way forward to rebuild policy buffers, preserve market confidence, and reduce external vulnerabilities. This will also help preserve financial stability, given a quarter of banks' assets are held in government bonds.

47. Staff does not recommend an extension of the PFA after Albania's fund credit outstanding falls below the threshold of 200 percent of quota in February 2023.

Authorities' Views

48. The authorities agree with the assessment and welcome the staff's decision not to recommend an extension of the PFA, seeing it as a tribute to Albania's macro-financial stability and strong repayment track record. They reiterate their confidence in Albania's ability to repay the Fund despite a more challenging external environment and rising uncertainty. They recognize the urgency of rebuilding fiscal policy buffers and reaffirm their commitment to addressing fiscal vulnerabilities.

STAFF APPRAISAL

49. The Albanian economy has weathered multiple shocks since 2019 relatively well, but downside risks are rising. Staff projects the economy to grow by 3.7 percent in 2022 on the back of robust activity in tourism, real estate, and services before slowing down to 2.2 percent in 2023, reflecting tighter financial conditions, the slowdown in Europe, and the necessary withdrawal of policy support. Inflation has risen sharply and has become increasingly broad-based. The outlook is subject to considerable uncertainty and risks to growth are tilted to the downside, including volatile commodity prices, a more significant tightening of financial conditions, and unfavorable weather conditions.

50. Albania needs to pursue a more ambitious revenue-based fiscal consolidation. The authorities should act fast to replenish largely eroded policy buffers given the vulnerabilities associated with its high government debt, large gross financing needs, and rising borrowing costs. Doing so would also reduce the pressure on monetary policy to bring down inflation and facilitate external adjustment, as Albania's external position in 2021 is moderately weaker than the level implied by fundamentals. We welcome the government's plan to reach a primary balance in 2023 and call for a primary surplus of 1.5 percent of GDP in 2024, mainly through revenue measures based on a sound MTRS. For 2023, the government needs to raise more tax revenue through coherent measures and reprioritize spending to create room for higher targeted support while staying within the budget target. Broad-based subsidies should be avoided, and fiscal support needs to be temporary and targeted to the vulnerable, fully leveraging the existing social protection framework.

51. Fiscal structural reforms remain crucial for ensuring fiscal sustainability, credibility, and transparency. The MTRS, serving as a cohesive strategy for tax reforms, should be finalized and implemented without further delay. Aligning the PPP and PIM frameworks, with full integration into the normal budget cycle, remains another key reform priority. All public investment projects need to be subject to the public investment and procurement frameworks. In addition, efforts need to be stepped up to ensure sustained progress in improving the PFM and strengthening fiscal risk monitoring, assessment, and management. The volatility in the global energy market has underlined the urgency of decisive reforms to bring the electricity sector to financial viability and reduce fiscal risks.

52. Monetary policy should continue to normalize while being nimble and data driven. Staff supports the increase in policy interest rates undertaken by the BoA. With still accommodative monetary conditions and risks to the inflation outlook on the upside, further interest rate increases are warranted in the short-term to prevent a wage-price spiral and reduce the risk of inflation expectations becoming unanchored thereby mitigating the risk of much higher policy rate increases in the future. The BoA also needs to be prepared to raise the policy rate to above its estimated neutral rate if inflationary pressures do not abate. Given the high uncertainty, the pace and timing of the tightening cycle need to consider evolving economic conditions.

53. Enhanced vigilance is vital to safeguard financial stability, as monetary conditions continue to tighten and the financial landscape has changed. The banking system has weathered the shocks relatively well, supported by the BoA's ongoing efforts to enhance regulation and supervision. But the full impact of the shocks may only become visible after some time and banks are susceptible to credit, interest rate, and exchange rate risks. Close monitoring and management of potential risks from the sizable credit growth, including rising FX lending, and enhanced surveillance of the real estate and construction sector's impact on financial stability are essential. The BoA's ongoing efforts to enhance bank capital buffers are welcome. Improving regulatory and supervisory frameworks, aligned with EU standards, would provide the authorities with tools to better monitor and manage financial stability risks. The presence of banks with significant shareholding by individuals and non-financial groups raises the risk of

capital shortfalls, related-party transactions, and large exposures. Ensuring the fit and proper status of market participants on an ongoing basis to operate in the Albanian financial system will be critical.

54. Achieving Albania's long-term goals and aspirations require steadfast progress to address long-standing structural issues, supported by revenue mobilization efforts. Progress in judicial reforms and combating corruption are welcome and further efforts are warranted. Albania should expedite efforts to exit FATF's grey list and continue to reaffirm its commitment to a robust AML/CFT framework. A declining and aging labor force is weighing down Albania's growth potential. Strengthening the rule of law and institutions and fighting informality will also go a long way towards stemming the tide of emigration. The macrocriticality of climate change calls for concerted adaptation efforts. Revenue mobilization, underpinned by a sound MTRS, will be needed to support Albania's structural reform agenda.

55. Albania's capacity to repay the Fund is adequate and risks to it remain contained and manageable. Staff does not recommend an extension of the PFA after Albania's Fund credit outstanding falls below the threshold of 200 percent of quota in February 2023.

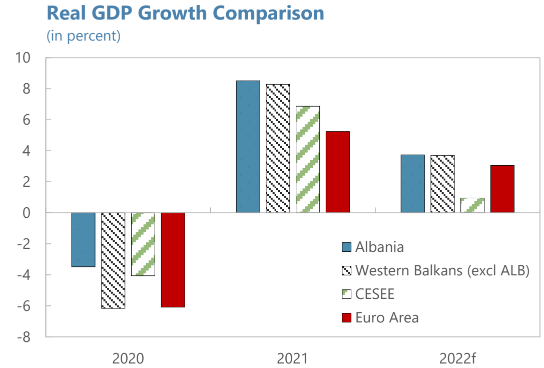
56. It is recommended that the next Article IV consultation be held on the standard 12-months consultation cycle.

Figure 1. Albania: Real Sector Developments

Real GDP growth rebounded strongly in 2021…

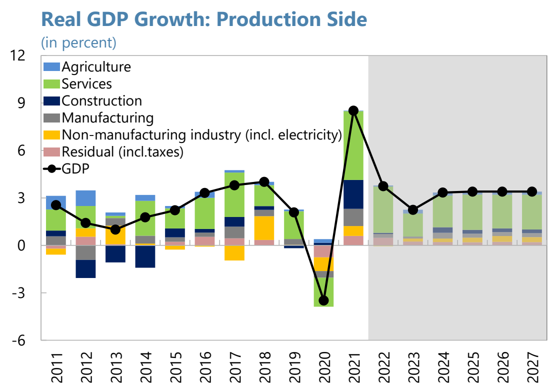
Sources: Instat

… performing better than peers.



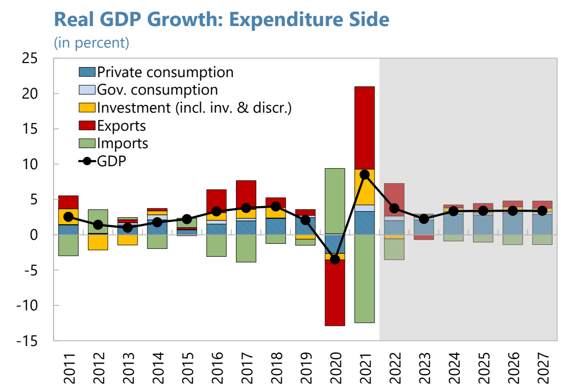
Sources: IMF WEO and IMF staff calculations

The recovery was supported by tourism and construction…



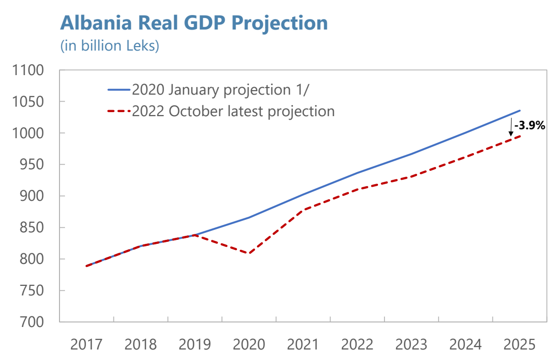
Source: IMF staff calculations

… as well as buoyant domestic demand.



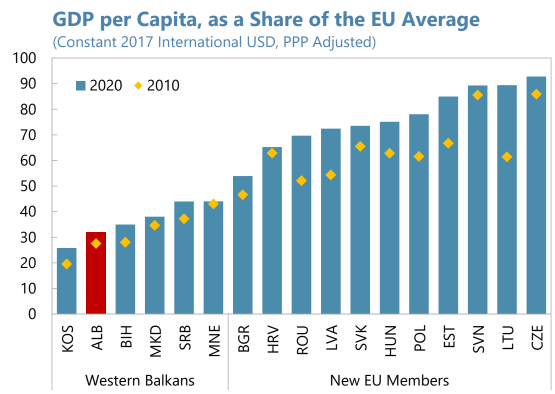
Source: IMF staff estimates

However, real GDP is projected to remain 3.9 percent below the pre-pandemic forecast by 2025.



Sources: IMF WEO and IMF staff estimates.
1/ 2020 January projection was revised with 2018 and 2019 GDP outturn.

Albania continues to lag EU countries in living standards.

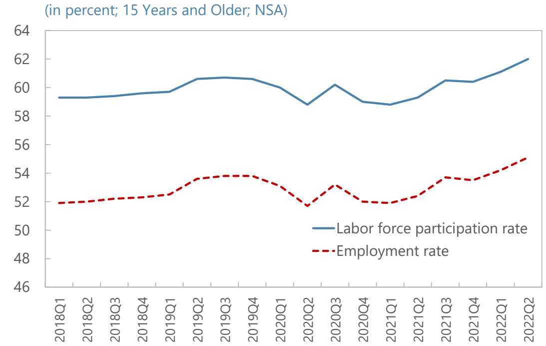


Sources: World Bank World Development Indicators and IMF staff calculations

Figure 2. Albania: Labor Market Developments

Employment and labor force participation have recovered to above pre-pandemic levels…

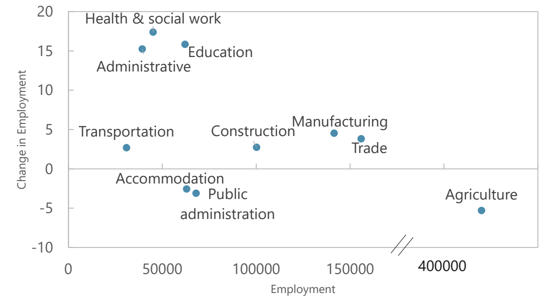
Labor Force, 2018Q1-2022Q2
(in percent; 15 Years and Older; NSA)



Source: Haver Analytics

…driven by a strong pickup in demand in trade, manufacturing, construction, education, and health…

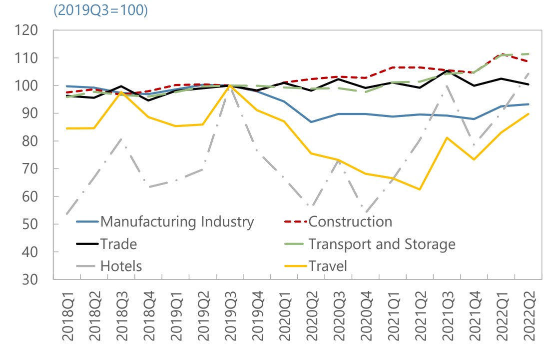
Employment Growth by Sector 1/
(x-axis is in 2021Q4; y-axis is in percent, 2019Q3 vs. 2021Q4)



Sources: Instat and IMF staff calculations.
1/ Only sectors with more than 30 thousands employees are shown on the chart.

… and despite a slower recovery of formal employment in the tourism industry.

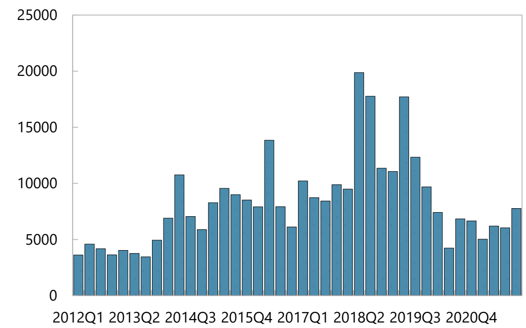
Employment Indexes by Economic Activity
(2019Q3=100)



Source: Haver Analytics

Job vacancies have started to rise …

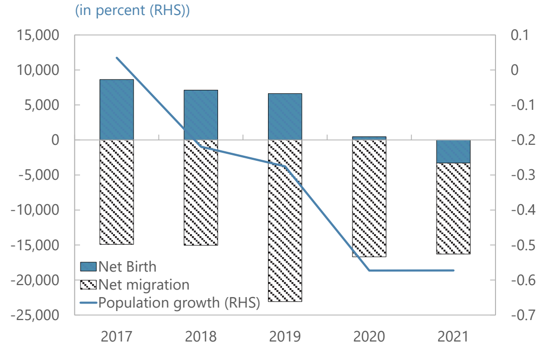
Job vacancies, 2012Q1-2021Q4
(in total)



Source: AKPA

…partly reflecting the decline of the population, driven by emigration and population aging.

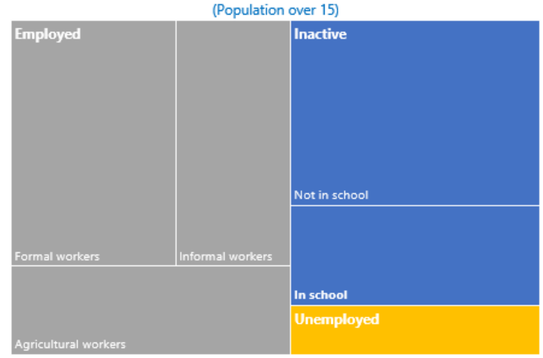
Population, Birth, and Migration
(in percent (RHS))



Sources: Instat and Haver Analytics

Informality remains a key feature of the Albanian economy.

Albania: Employment Composition, 2021
(Population over 15)

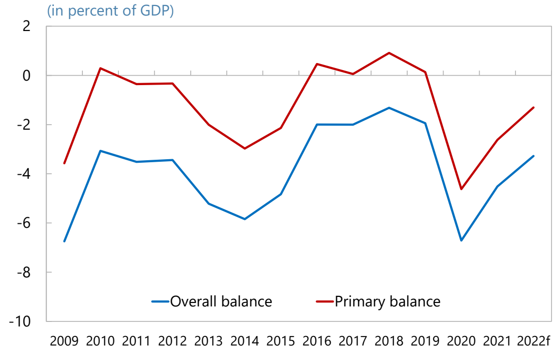


Sources: Instat, ILO, World Bank, Have, and IMF staff calculations.

Figure 3. Albania: Fiscal Sector Developments

Fiscal consolidation started in 2021 with the economic rebound...

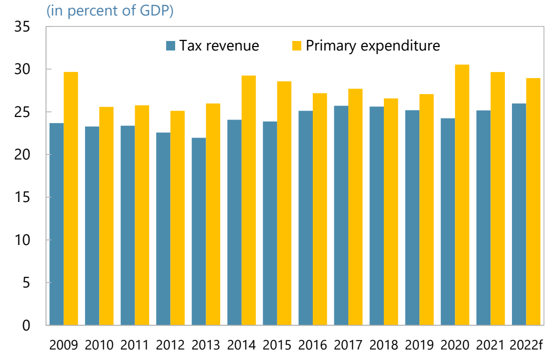
Overall Fiscal and Primary Balance
(in percent of GDP)



Sources: INSTAT, Ministry of Finance and Economy and IMF staff calculations

...driven by rising revenue and spending under-execution.

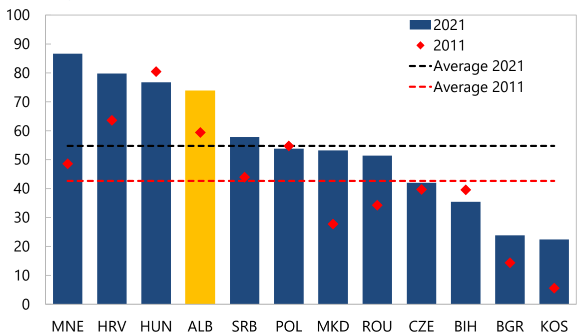
Tax Revenue and Primary Expenditure
(in percent of GDP)



Sources: INSTAT, Ministry of Finance and Economy, and IMF staff calculations

The stock of public debt remains high...

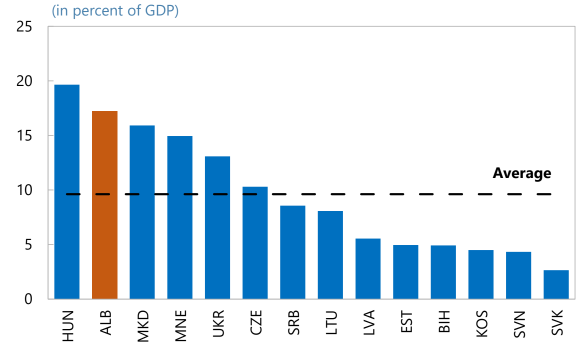
CESEE: Public Debt
(in percent of GDP)



Source: IMF WEO database

...and gross financing needs are large.

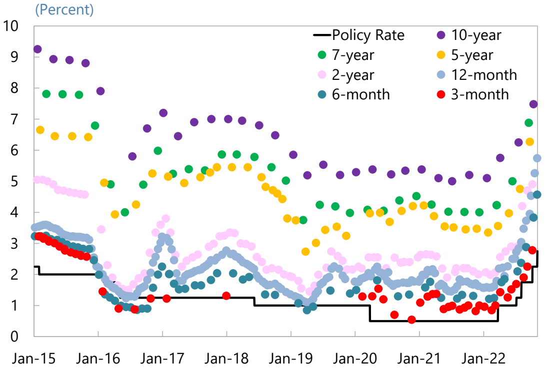
Gross Financing Needs, 2021
(in percent of GDP)



Sources: IMF Vulnerability Exercise database, IMF WEO databse and IMF staff calculations

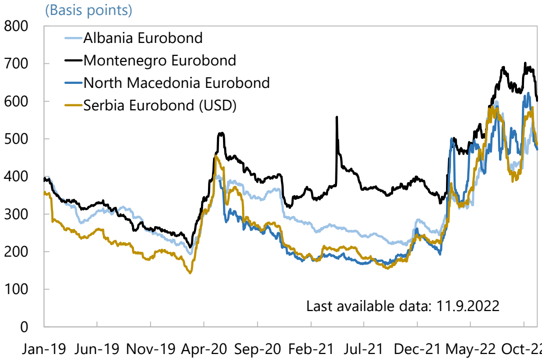
The recent increases in the monetary policy rate have been reflected in higher government bond yields of different maturities ...

Policy Rate and T-Bills Yields
(Percent)



...and sovereign spreads are higher than before the start of the war in Ukraine.

Selected Western Balkans: Sovereign Spreads
(Basis points)



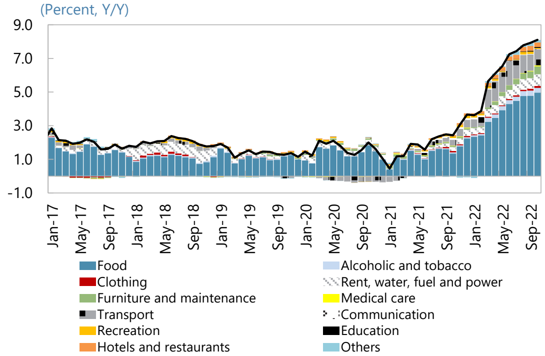
Source: Bloomberg Finance L.P.

Figure 4. Albania: Inflation Developments

Headline inflation has reached its highest level in 24 years, driven by food and energy prices.

Inflation

(Percent, Y/Y)

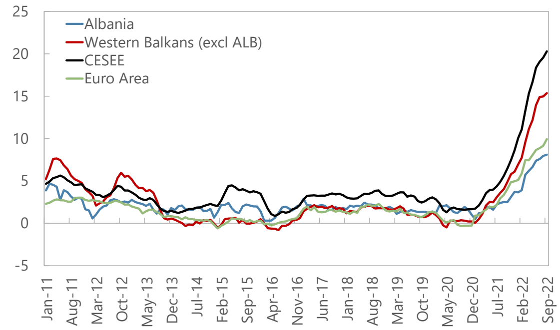


Sources: INSTAT and IMF staff calculations

Albania's inflation has so far remained lower than that in other European countries….

Headline inflation: Albania and other European countries

(Percent; y/y change)

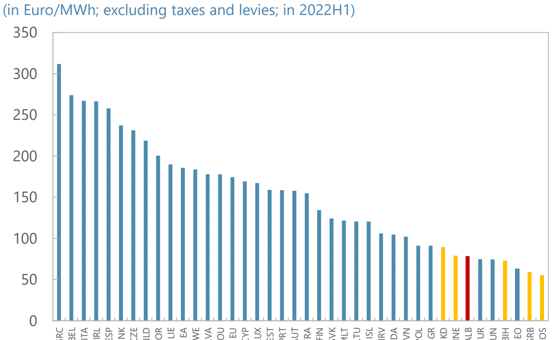


Sources: Haver Analytics, IMF WEO, and IMF staff calculations

… partly reflecting regulated electricity tariffs.

Electricity Prices for Household Consumers

(in Euro/MWh; excluding taxes and levies; in 2022H1)



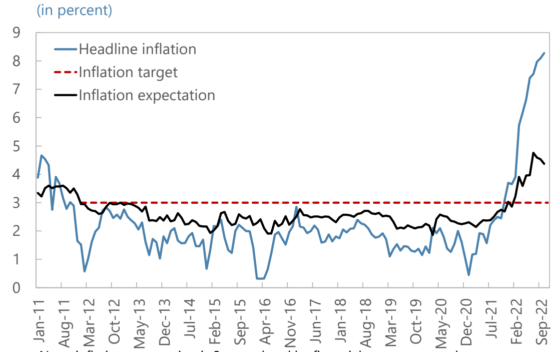
Note: EU except DEU. EA except DEU.

Source: Eurostat

Two-year ahead inflation expectations have risen to above the central bank's target…

Albania: Headline, Inflation Target, and Expectation

(in percent)



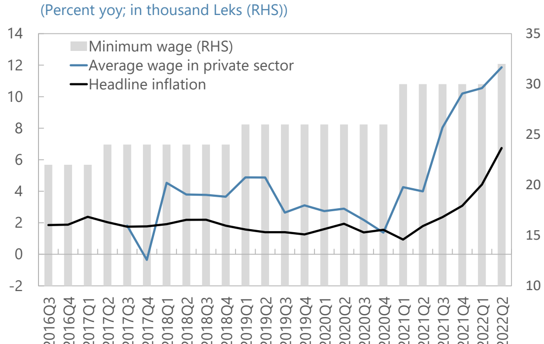
Note: inflation expectation is 2-year ahead by financial sector surveyed.

Sources: Bank of Albania and IMF staff calculations

… while wages are picking up…

Average Wage, Minimum Wage, and Inflation

(Percent yoy; in thousand Leks (RHS))

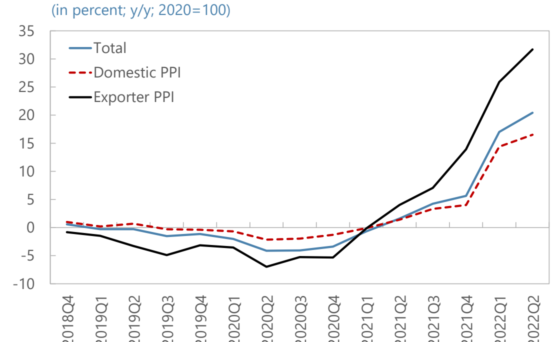


Sources: Bank of Albania, Haver Analytics, and IMF staff calculations

… and producer price indexes are rising.

Producer Price Index

(in percent; y/y; 2020=100)

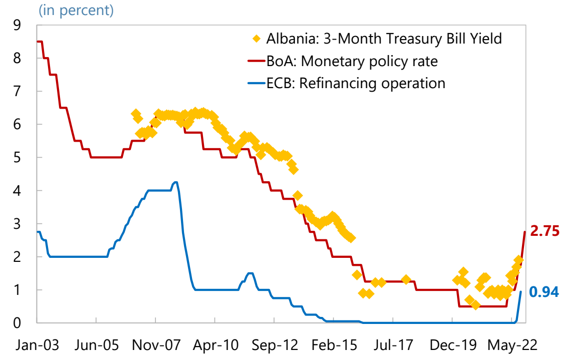


Sources: Instat and IMF staff calculations

Figure 5. Albania: Monetary Developments

The BoA has started to raise the policy rate from a historically low level...

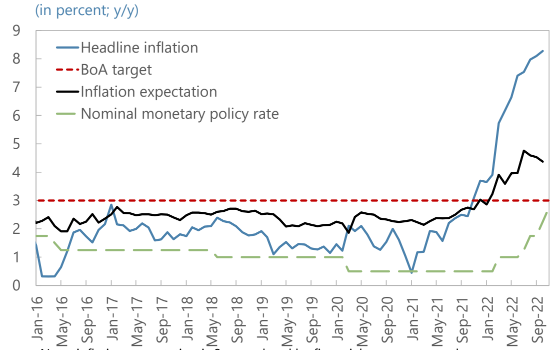
Monetary Policy Rates
(in percent)



Sources: Haver Analytics and IMF staff estimates

...but the real policy rates remain low and negative.

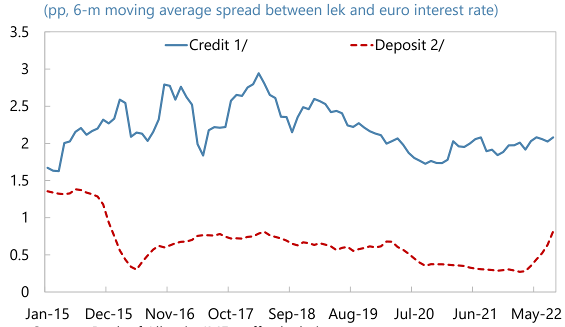
Monetary Policy Rate, BoA Target, and Inflation
(in percent; y/y)



Note: inflation expectation is 2-year ahead by financial sector surveyed.
Sources: Bank of Albania and IMF staff calculations

The recent rise in the spread between lek and euro bank lending rates ...

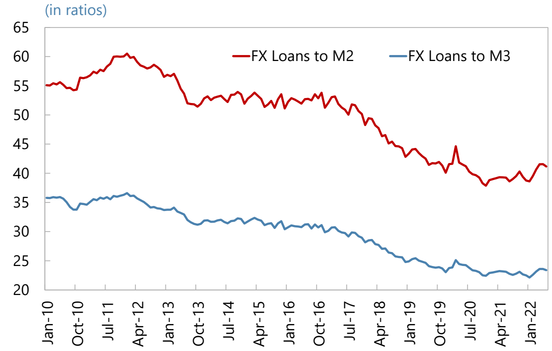
Lending and deposit interest rate spread
(pp, 6-m moving average spread between lek and euro interest rate)



Sources: Bank of Albania, IMF staff calculations.
1/ Spread based on all maturities.
2/ Spread based on 1-month interest rate.

...has accelerated a shift toward more FX loans.

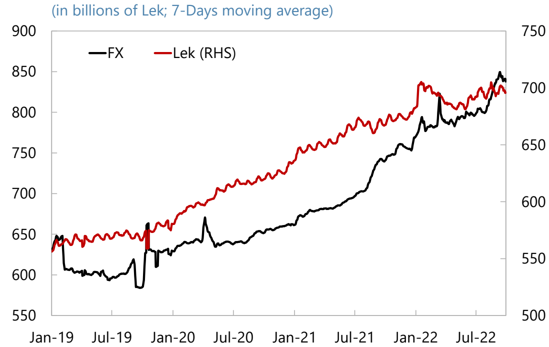
Loans and Deposits to Money Supply
(in ratios)



Sources: IMF MFS database and IMF staff calculations

Deposits in FX surpassed those in lek starting from August 2022...

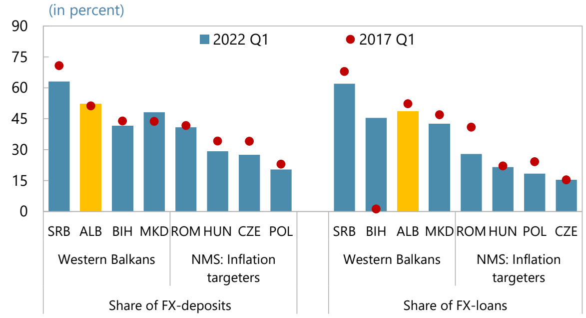
Total Deposits, by Currency
(in billions of Lek; 7-Days moving average)



Source: Bank of Albania

... reinforcing Albania's status as one of the highly euroized countries in the region.

Euroization
(in percent)

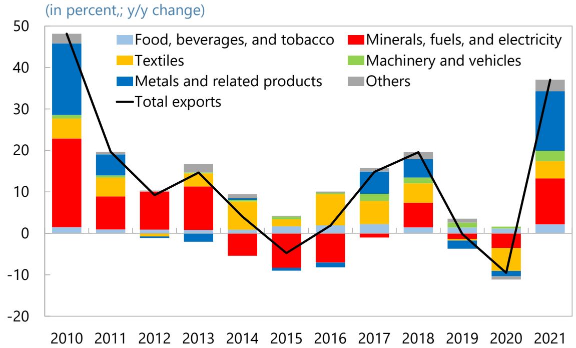


Note: Non-residence FX deposits and FX loans are excluded.
Sources: IMF MFS database and IMF staff calculations

Figure 6. Albania: External Sector Developments

Higher commodity prices since the last quarter of 2021 saw a jump in the value of exports…

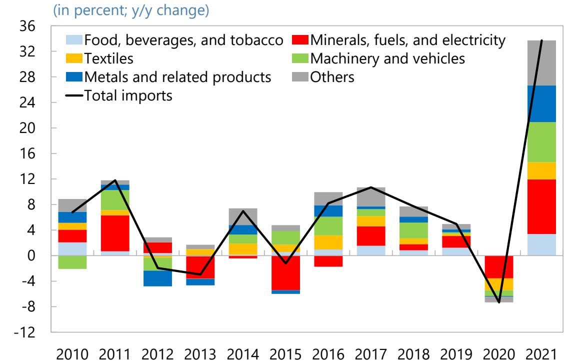
Contribution to Export Goods Growth
(in percent,; y/y change)



Sources: Haver Analytics and IMF staff calculations

…and imports…

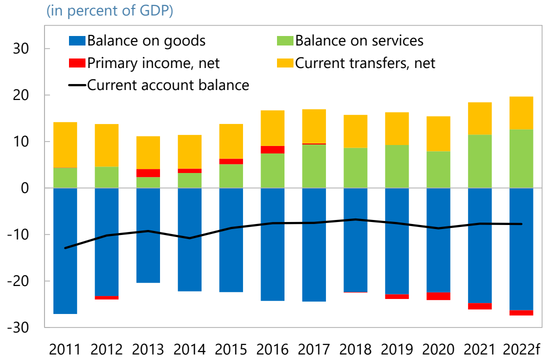
Contribution to Import Goods Growth
(in percent; y/y change)



Sources: Haver Analytics and IMF staff calculations

… but the current account deficit is expected to be broadly stable in 2022…

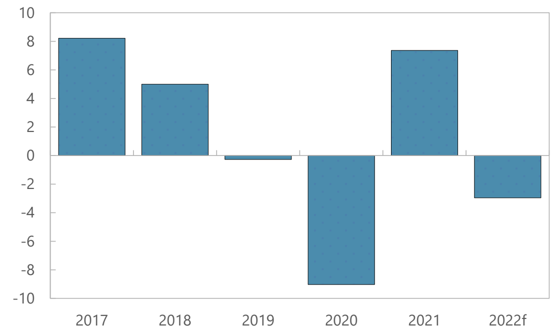
Current Account Balance
(in percent of GDP)



Sources: Bank of Albania and IMF staff calculations

…despite a negative terms-of-trade shock from higher commodity prices.

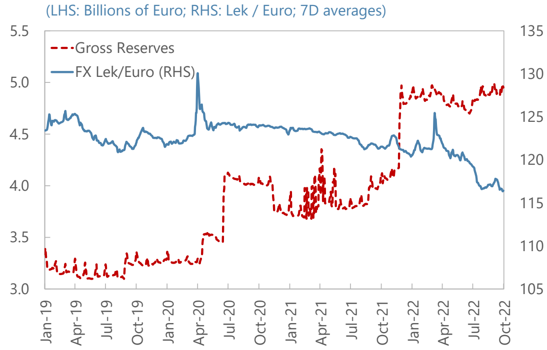
Change in Terms of Trade
(in percent)



Source: IMF staff calculations

FX reserves remain at historical highs and while the lek has appreciated this year…

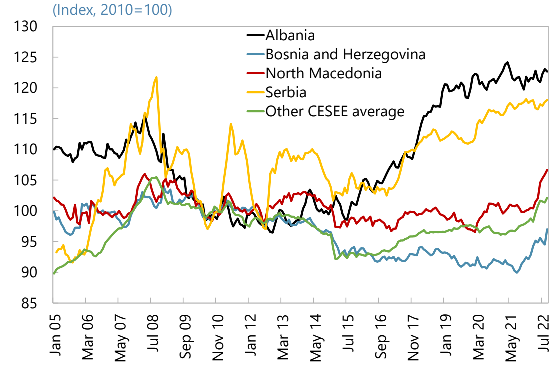
Gross Reserves and Foreign Exchange Rate
(LHS: Billions of Euro; RHS: Lek / Euro; 7D averages)



Sources: Bank of Albania and Haver Analytics

…the real effective exchange rate has remained broadly stable.

CESEE: Real Effective Exchange Rate
(Index, 2010=100)



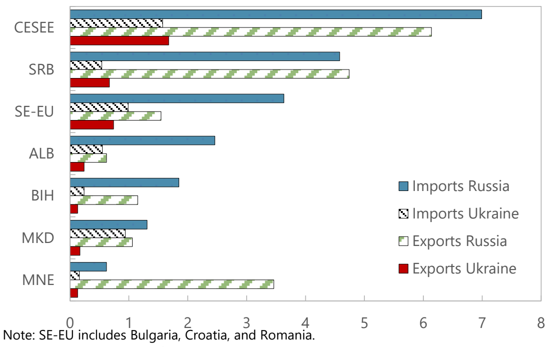
Sources: IMF INS database and IMF staff calculations

Figure 7. Albania: Direct Exposures to the War in Ukraine

Albania has limited direct exposure to Russia's war in Ukraine…

Shares of Trade with Russia and Ukraine

(in percent; in 2020)



Note: SE-EU includes Bulgaria, Croatia, and Romania.
Source: The Observatory of Economic Complexity (OEC)

… with relatively small shares of total trade with both Russia and Ukraine.

Albania: Bilateral Trade Exposure to Russia and Ukraine (Percent of Total, 2020)

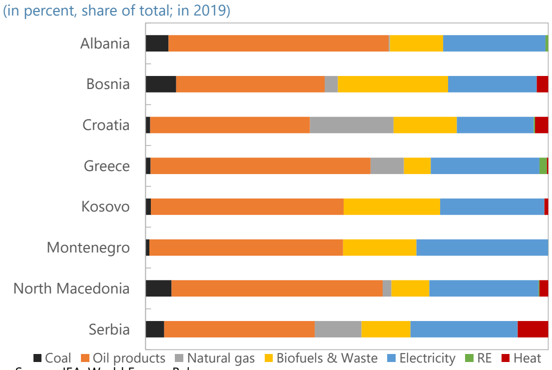
Export of Goods to Russia	0.6
Imports of Goods to Russia	2.5
Exports of Goods to Ukraine	0.2
Imports of Goods to Ukraine	0.5
Tourist Arrivals from Russia	0.2
Tourist Arrivals from Ukraine	0.7

Main Goods Exports to Russia: Textile & Footwear
Main Goods Exports to Ukraine: Mineral Fuels, Fruit & Vegetables and other Foodstuff
Main Goods Imports from Russia: Mineral Fuels, Cereals, Iron and Sunflower oil
Main Goods Imports from Ukraine: Sunflower seeds & Oil, Iron & steal, and Cereals
Source: Instat

Albania's use of natural gas is also very limited.

Energy Final Consumption by Source

(in percent, share of total; in 2019)

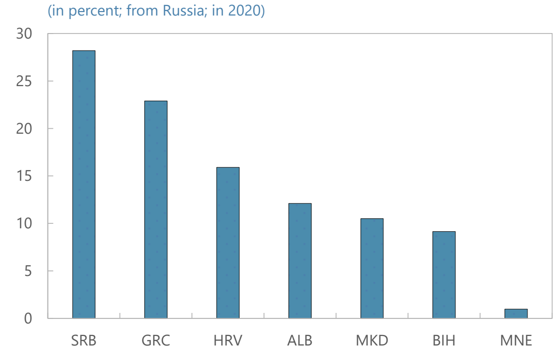


Source: IEA, World Energy Balances

Albania imports some key products from Russia and Ukraine, including fuel…

Imports of Fuel Products

(in percent; from Russia; in 2020)

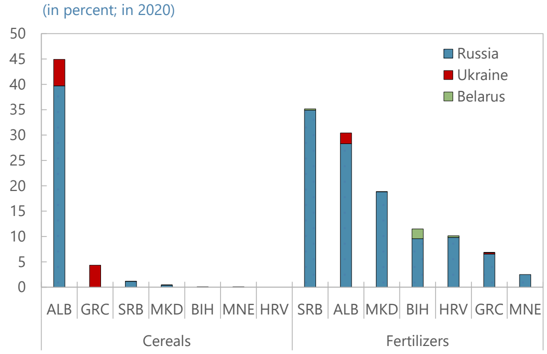


Source: The Observatory of Economic Complexity (OEC)

…cereals, fertilizers…

Imports of Cereals and Fertilizers

(in percent; in 2020)

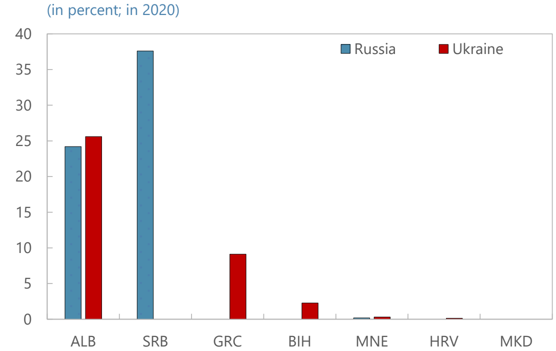


Source: The Observatory of Economic Complexity (OEC)

…and seed oil.

Imports of Seed Oil

(in percent; in 2020)

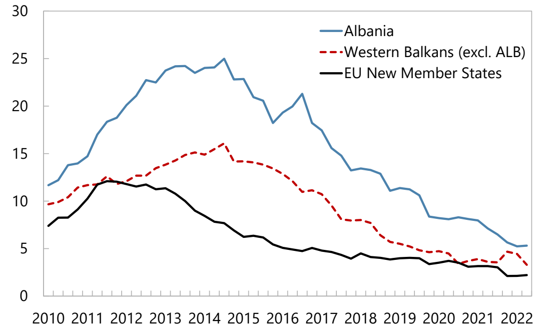


Source: The Observatory of Economic Complexity (OEC)

Figure 8. Albania: Banking Sector Developments

NPLs have reached a historically low level in September and are converging to regional averages.

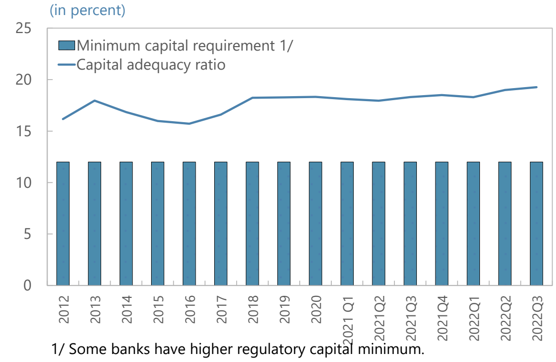
Non-Performing Loans
(in percent of total loans; medians)



Sources: National authorities, IMF Financial Soundness Indicators, and IMF Staff calculations

Capital ratios of the banking system are above regulatory requirements.

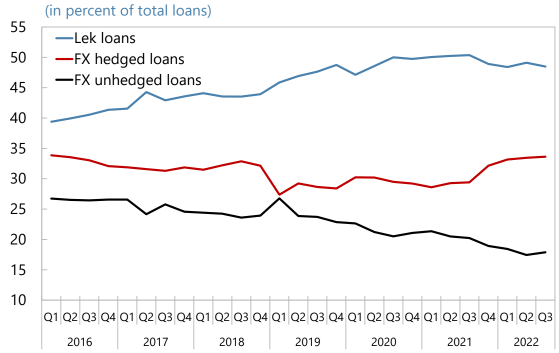
Capital Adequacy Ratio
(in percent)



1/ Some banks have higher regulatory capital minimum.
Source: IMF FSI database

A large share of the FX loans remains unhedged.

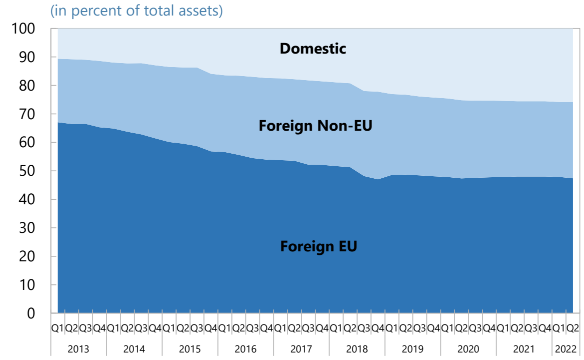
Unhedged FX Borrowing
(in percent of total loans)



Sources: Bank of Albania and IMF staff calculations

The ownership structure has changed in recent years, reflecting the retrenchment of EU banks from the region.

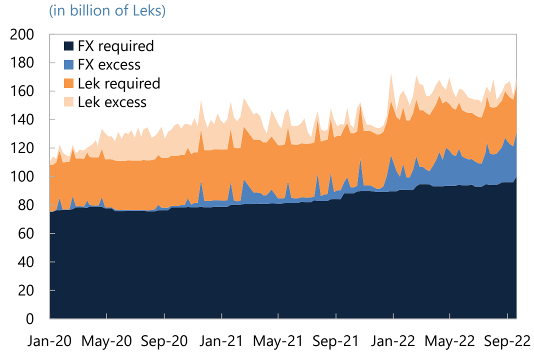
Banking System Ownership Structure
(in percent of total assets)



Sources: Bank of Albania and IMF staff calculations

The banking system has remained liquid.

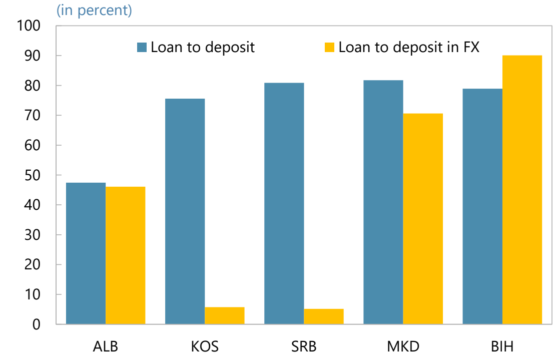
Commercial Banks: Reserves at the Central Bank
(in billion of Leks)



Sources: BoA and IMF staff calculations

Financial intermediation remains low in Albania

Loan to Deposits Ratio, 2021
(in percent)

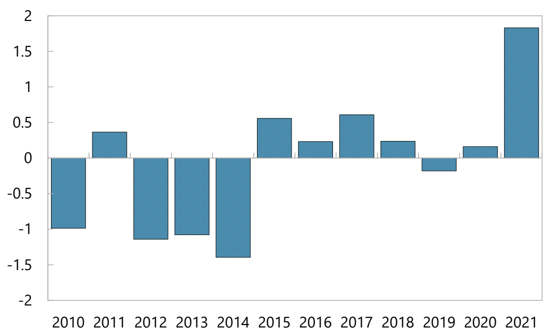


Sources: IMF MFS database and IMF staff calculations

Figure 9. Albania: Construction and Real Estate Developments

Construction was a large contributor to GDP growth in 2021.

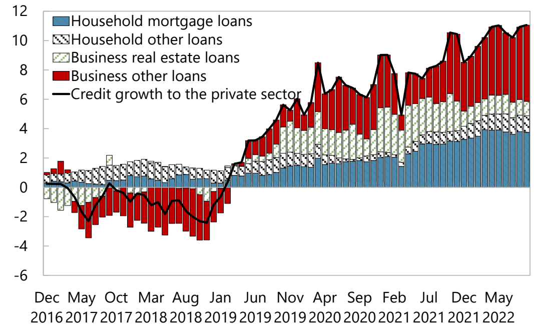
Construction Sector Contribution to Real GDP Growth
(in pp)



Sources: Instat and IMF staff calculations

Household mortgages and business real estate loans have been increasing significantly since 2019…

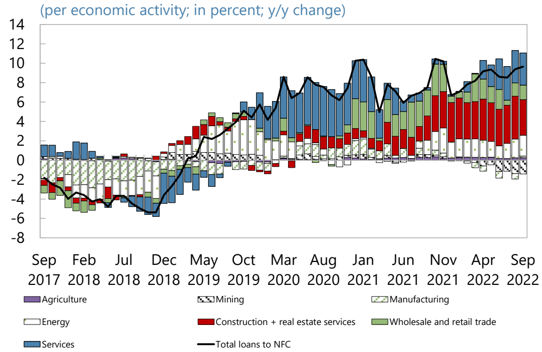
Contribution to Private Sector Credit Growth
(per purpose; in percent; y/y change)



Sources: Bank of Albania, IMF staff calculations.

… and so have loans to nonfinancial corporations in construction and real estate services…

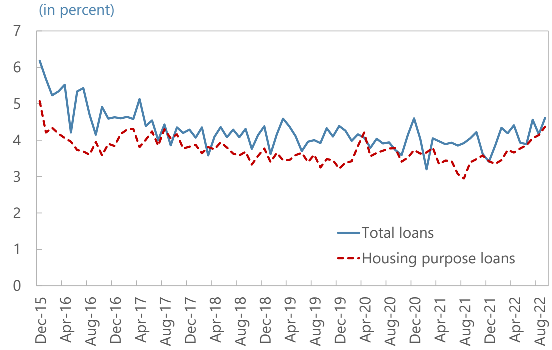
Contribution to Private NFC Credit Growth
(per economic activity; in percent; y/y change)



Sources: Bank of Albania; IMF staff calculations

… although mortgage rates are rising.

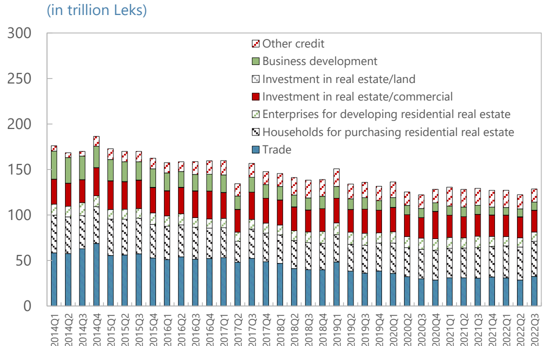
Average Mortgage Rate vs. Total Loans Rate
(in percent)



Source: Bank of Albania

A large share of unhedged FX loans is linked to real estate.

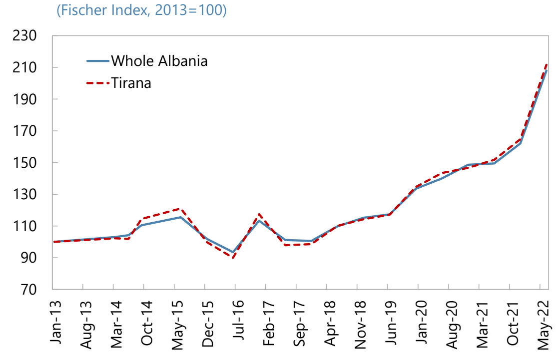
Albania: FX Unhedged Credit
(in trillion Leks)



Source: Bank of Albania

House prices index survey indicates continuous acceleration in prices.

House Prices Index
(Fischer Index, 2013=100)



Source: Bank of Albania

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2018–27

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
							Proj.			
					(Percent change)					
Real sector										
Real GDP	4.0	2.1	-3.5	8.5	3.7	2.2	3.3	3.4	3.4	3.4
Domestic demand contribution	3.9	2.1	-3.4	9.3	2.1	2.8	3.6	3.9	4.0	3.8
Consumption	2.4	2.8	-2.5	4.2	2.6	2.5	3.1	3.3	3.5	3.2
Investment (Incl. inventories and stat. disc)	1.5	-0.6	-0.9	5.1	-0.6	0.3	0.5	0.6	0.5	0.5
External demand contribution	0.2	-0.1	-0.1	-0.8	1.7	-0.5	-0.3	-0.5	-0.6	-0.4
Consumer Price Index (eop)	1.8	1.1	1.1	3.7	9.0	3.9	3.0	3.0	3.0	3.0
Consumer Price Index (avg.)	2.0	1.4	1.6	2.0	7.0	5.4	3.4	3.0	3.0	3.0
GDP deflator	1.5	1.3	0.7	5.9	6.0	3.4	2.2	1.9	1.8	1.8
					(Percent of GDP)					
Saving-investment balance										
Foreign savings	6.8	7.6	8.7	7.7	7.8	7.7	7.6	7.6	7.5	7.4
National savings	17.1	14.7	14.1	16.5	16.1	16.4	16.5	16.3	16.2	16.1
Public	2.7	2.0	-1.0	1.7	1.3	1.6	1.7	1.4	1.2	1.2
Private	14.4	12.8	15.1	14.8	14.8	14.8	14.8	15.0	15.0	15.0
Investment (incl. Inventories and stat. disc.)	23.9	22.3	22.8	24.2	23.9	24.2	24.0	23.9	23.7	23.6
Public	5.6	5.3	6.8	7.5	5.6	5.5	5.4	5.2	5.1	5.0
Private	18.3	17.0	16.0	16.7	18.3	18.7	18.6	18.7	18.6	18.6
Fiscal sector										
Total revenue and grants	27.5	27.2	25.9	27.0	27.6	27.6	27.4	27.4	27.4	27.5
Tax revenue	25.6	25.2	24.2	25.2	26.0	25.9	25.8	25.8	25.8	25.8
Total expenditure	29.1	29.2	32.6	31.6	30.9	30.3	30.0	30.2	30.2	30.2
Primary	26.8	27.1	30.5	29.7	28.9	27.6	27.2	27.2	27.2	27.2
Interest	2.2	2.1	2.1	1.9	2.0	2.7	2.8	3.0	3.0	3.0
Overall balance 1/	-1.6	-1.9	-6.7	-4.5	-3.3	-2.7	-2.5	-2.7	-2.8	-2.8
Primary balance	0.6	0.1	-4.6	-2.6	-1.3	0.0	0.3	0.3	0.3	0.3
Financing	1.6	1.9	6.7	4.5	3.3	2.7	2.5	2.7	2.8	2.8
Of which: Domestic	-1.3	2.4	3.0	-1.0	3.5	1.1	4.1	2.4	1.1	2.8
Of which: Foreign	2.9	-0.5	3.7	5.5	-0.3	1.6	-1.5	0.3	1.6	0.0
General Government Debt 2/3/	69.5	67.4	75.9	73.9	68.5	67.9	66.4	64.7	64.5	63.6
Domestic	37.3	36.9	40.7	37.9	35.3	34.3	35.0	35.3	34.9	35.4
External	32.2	30.4	35.3	36.0	33.3	33.6	31.4	29.4	29.6	28.2
					(Percent change)					
Monetary indicators										
Broad money growth	-0.2	4.3	10.5	8.6	6.4	5.6	5.6	5.3	5.4	5.3
Private credit growth	-0.9	6.1	8.9	8.6	9.9	5.7	5.6	5.3	5.3	5.2
					(Percent of GDP, unless indicated otherwise)					
External sector										
Trade balance (goods and services)	-13.7	-13.6	-14.5	-13.3	-13.8	-14.1	-13.9	-13.8	-13.7	-13.7
Current account balance	-6.8	-7.6	-8.7	-7.7	-7.8	-7.7	-7.6	-7.6	-7.5	-7.4
Gross international reserves (billions of Euros)	3.4	3.4	3.9	5.0	5.1	5.4	5.2	5.2	5.6	5.6
(In months of imports of goods and services)	6.6	8.1	7.0	7.2	7.0	7.1	6.6	6.4	6.5	6.8
(In percent of ARA metric)	182	174	188	201	193	192	182	176	175	167
Gross reserves excl. banks' FX reserves (billions of Euros)	2.9	2.8	3.3	4.3	4.3	4.5	4.3	4.3	4.5	4.3
Memorandum items										
Output gap	-0.1	-1.1	-2.9	0.7	1.1	0.0	0.0	0.0	0.0	0.0
Real GDP (growth per capita)	4.1	2.2	-3.4	8.7	4.0	2.5	3.7	3.7	3.8	3.8
Exchange rate Lek/Euro (avg.)	128	123	124	122	..	..	..	..	..	..
Exchange rate Lek/Euro (eop, annual growth)	-7.2	-1.3	1.6	-2.4	..	..	..	..	..	..

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

1/ The fiscal balance includes guarantees for new loans to the energy sector through 2019 and from 2021, and potential calls of COVID-19 related guarantees from 2022.

2/ Public debt refers to the general government and includes all public domestic and external guarantees for energy and non-energy sector debt as well as arrears from central and local government and VAT refund arrears.

3/ The 2021 SDR allocation equivalent at present to $170 million is recorded with the Bank of Albania and is used as a credit line until 2023 and for budget financing afterwards. Accordingly, public debt and the TSA account only include the SDR allocation starting 2024.

Table 2a. Albania: General Government Operations, 2018–27
(Percent of GDP)

	2018	2019	2020	2021	2022	2023		2024	2025	2026	2027
							Budget				
								Proj.			
Total revenue and grants	27.5	27.2	25.9	27.0	27.6	27.6	29.0	27.4	27.4	27.4	27.5
Tax revenue	25.6	25.2	24.2	25.2	26.0	25.9	27.0	25.8	25.8	25.8	25.8
VAT	8.8	7.8	7.9	8.5	9.2	9.2	9.7	9.2	9.2	9.2	9.2
Profit tax	2.1	2.2	1.7	1.9	2.2	2.3	2.3	2.2	2.2	2.2	2.2
Excise tax	2.7	2.8	2.7	2.7	2.6	2.6	2.7	2.6	2.6	2.6	2.6
Customs duties	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Personal income tax	2.2	2.7	2.0	2.1	2.2	2.2	2.3	2.2	2.2	2.2	2.2
National taxes	2.4	2.2	2.2	2.2	2.1	2.1	2.5	2.1	2.1	2.1	2.1
Local government revenue 1/	1.3	1.4	1.3	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Social insurance contributions	5.7	5.8	5.9	5.9	5.8	5.8	5.9	5.8	5.8	5.8	5.8
Non-tax revenue	1.3	1.5	1.2	1.2	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Grants	0.5	0.5	0.5	0.7	0.6	0.6	1.0	0.6	0.6	0.6	0.6
Total expenditure	29.1	29.2	32.6	31.6	30.9	30.3	31.6	30.0	30.2	30.2	30.2
Current expenditure	24.3	24.7	25.7	24.6	25.1	25.3	25.7	25.1	25.3	25.4	25.5
Personnel cost 2/	4.5	4.5	4.7	4.4	4.3	4.4	4.5	4.5	4.5	4.5	4.5
Interest	2.2	2.1	2.1	1.9	2.0	2.7	2.8	2.8	3.0	3.0	3.0
Operations & maintenance	2.8	2.8	3.0	3.1	3.0	3.0	3.0	3.0	3.0	3.1	3.1
Subsidies	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social insurance outlays	10.3	10.4	10.9	10.6	10.2	10.3	10.4	10.3	10.4	10.5	10.5
Local government expenditure 2/	3.0	3.3	3.1	2.8	2.9	3.0	3.0	3.0	3.0	3.0	2.9
Social protection transfers	1.3	1.4	1.7	1.5	1.3	1.4	1.4	1.4	1.4	1.4	1.4
Other current transfers			0.1	0.2	1.3	0.5	0.6				
Capital expenditure 3/	4.8	4.4	6.2	6.9	5.1	4.9	5.5	4.8	4.7	4.6	4.5
Domestically financed	2.4	2.4	2.4	4.0	2.8	3.2	3.6	3.4	3.2	3.1	3.0
Foreign financed	1.6	1.4	1.5	1.4	1.3	1.4	2.1	1.5	1.5	1.5	1.5
Earthquake spending	0.0	0.0	1.0	1.6	1.0	0.2	0.2	0.0	0.0	0.0	0.0
Lending minus repayment	0.0	0.08	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds	0.0	0.0	0.7	0.0	0.7	0.1	0.4	0.1	0.2	0.2	0.2
Overall balance 3/	-1.6	-1.9	-6.7	-4.5	-3.3	-2.7	-2.6	-2.5	-2.7	-2.8	-2.8
Financing	1.6	1.9	6.7	4.5	3.3	2.7	2.6	2.5	2.7	2.8	2.8
Domestic	-1.3	2.4	3.0	-1.0	3.5	1.1	1.4	4.1	2.4	1.1	2.8
Privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	1.1	1.0	2.9	2.6	0.7	1.1	1.1	2.6	2.2	1.4	2.2
Change in general gov. deposits	-2.1	1.4	0.0	-3.6	2.8	-0.1	0.2	1.5	0.3	-0.2	0.6
Other	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	2.9	-0.5	3.7	5.5	-0.3	1.6	1.2	-1.5	0.3	1.6	0.0
Gross borrowing	6.0	1.4	7.4	7.3	1.7	5.3	4.9	1.0	4.7	3.4	4.4
Amortization	3.2	1.9	3.7	1.8	2.0	3.7	3.7	2.5	4.4	1.7	4.4
Memorandum Items:											
Primary balance	0.6	0.1	-4.6	-2.6	-1.3	0.0	0.3	0.3	0.3	0.3	0.3
Government TSA 4/	3.0	1.9	1.1	4.8	1.6	1.5	1.1	0.9	0.6	0.8	0.2
General government debt 4/	69.5	67.4	75.9	73.9	68.5	67.9	67.5	66.4	64.7	64.5	63.6
Direct general government external debt	30.4	28.8	33.1	34.3	31.1	31.5	31.1	28.9	28.2	28.8	27.6
Government guaranteed external debt	1.8	1.6	2.2	1.7	2.2	2.1	2.3	1.6	1.2	0.8	0.6
Nominal GDP (billions of leks)	1637	1692	1644	1890	2078	2197	2176	2320	2444	2573	2709

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

1/ Includes the property tax, the simplified profit tax for small businesses, and other local taxes.
2/ The fiscal balance includes guarantees for new loans to the energy sector through 2019 and from 2021, and potential calls of COVID-19 related guarantees
3/ The stock of general government debt includes public guarantees (domestic and external) and arrears from central and local government and VAT refund
4/ The 2021 SDR allocation equivalent at present to $170 million is recorded with the Bank of Albania and is used as a credit line until 2023 and for budget financing afterwards. Accordingly, public debt and the TSA account only include the SDR allocation starting 2024.

Table 2b. Albania: General Government Operations, 2018–27
(Billions of Leks)

	2018	2019	2020	2021	2022	2023		2024	2025	2026	2027
							Budget				
					Proj.						
Total revenue and grants	449.4	460.3	425.9	511.0	574.5	607.2	631.7	636.8	670.7	705.9	743.6
Tax revenue	419.3	426.3	398.7	475.6	540.0	570.0	587.9	598.3	631.0	663.8	698.4
VAT	143.5	132.4	130.4	161.5	192.0	202.5	210.9	213.3	224.7	236.1	248.6
Profit tax	34.5	36.6	28.4	35.6	46.4	50.4	49.5	52.0	54.7	57.6	60.2
Excise tax	45.0	46.7	44.5	51.6	54.7	56.7	59.0	59.8	63.3	67.0	70.3
Customs duties	6.2	6.5	6.2	7.5	8.2	8.7	8.5	9.2	9.6	10.2	10.7
Personal income tax	36.5	46.1	33.7	39.3	46.5	49.1	49.0	51.8	55.0	57.9	60.9
National taxes	38.6	36.4	35.8	42.5	43.2	45.9	54.3	47.9	50.6	52.9	55.6
Local government revenue 1/	21.9	23.1	22.0	26.7	27.6	29.1	29.2	30.7	32.3	34.0	35.9
Social insurance contributions	93.2	98.4	97.7	110.9	121.4	127.6	127.5	133.5	140.7	148.2	156.2
Non-tax revenue	22.0	25.3	19.0	22.3	22.8	23.5	22.9	24.5	25.8	27.4	29.8
Grants	8.1	8.8	8.3	13.0	11.6	13.7	21.0	14.0	13.9	14.6	15.4
Total expenditure	475.9	493.2	536.3	596.3	642.6	665.6	687.2	695.9	737.7	776.8	818.1
Current expenditure	397.1	418.2	422.4	464.8	520.7	555.0	558.6	581.4	619.2	654.4	690.3
Personnel cost 2/	73.6	77.0	76.9	83.3	89.0	96.8	96.9	103.3	108.9	115.4	121.9
Interest	36.5	35.1	34.4	35.8	41.0	58.4	60.9	65.4	73.2	77.4	81.6
Operations & maintenance	45.3	47.2	48.9	59.4	62.9	65.2	65.2	70.6	74.4	78.6	84.0
Subsidies	1.9	2.8	1.5	1.4	1.7	1.6	1.6	1.7	1.7	1.6	1.6
Social insurance outlays	168.3	175.6	179.4	199.5	211.3	225.9	226.4	239.9	254.5	269.2	284.2
Local government expenditure 2/	49.6	56.2	51.6	52.6	59.2	65.1	65.6	68.6	72.1	76.2	79.1
Social protection transfers	22.0	24.3	28.7	29.1	27.7	30.1	30.1	31.9	34.3	36.2	37.9
Other current transfers			1.0	3.7	28.0	12.0	12.0				
Capital expenditure 3/	78.8	75.0	101.9	131.0	106.4	107.8	119.0	112.5	114.4	117.5	121.6
Domestically financed	52.6	51.5	60.6	75.8	59.1	71.3	68.4	78.7	78.8	80.0	82.2
Foreign financed	26.2	23.5	24.7	25.7	27.3	31.5	45.7	33.8	35.6	37.5	39.5
Earthquake spending	0.0	0.0	16.6	29.5	20.0	5.0	5.0	0.0	0.0	0.0	0.0
Lending minus repayment	0.0	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds	0.0	0.1	12.1	0.5	15.5	2.8	9.6	2.0	4.0	4.8	6.2
Overall balance 3/	-26.5	-32.9	-110.4	-85.3	-68.1	-58.4	-55.5	-59.1	-67.0	-70.9	-74.5
Financing	26.5	32.6	110.4	85.3	68.1	58.4	55.5	59.1	67.0	70.9	74.5
Domestic	-21.0	40.4	48.8	-18.7	73.4	23.8	30.1	94.3	59.1	29.2	75.1
Privatization receipts	0.1	0.2	0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	17.5	17.5	47.8	48.7	15.0	25.0	25.0	59.8	52.9	35.5	59.7
Change in general gov. deposits	-33.6	22.8	0.8	-67.7	58.4	-1.3	5.1	34.5	6.1	-6.2	15.4
Other	-5.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	47.6	-7.7	61.5	104.0	-5.4	34.6	25.4	-35.2	7.9	41.7	-0.6
Gross borrowing	98.8	23.7	121.4	137.2	35.9	116.9	105.7	23.2	115.6	86.7	118.9
Amortization	51.7	31.4	61.3	33.2	41.2	82.3	80.3	58.4	107.7	45.0	119.4
Memorandum Items:											
Primary balance	10.0	2.3	-76.0	-49.5	-27.1	0.0	5.4	6.3	6.3	6.5	7.1
Government TSA balance 4/	49.7	32.9	18.2	91.1	32.7	34.0	23.5	20.2	14.0	20.3	4.9
General government debt 4/	1,137	1,140	1,248	1,396	1,424	1,493	1469.9	1,540	1,580	1,660	1,722
Direct general government external debt	496.8	488.1	544.4	648.8	646.3	692.7	677.3	670.0	688.2	740.1	748.6
Government guaranteed external debt	29.5	26.7	35.5	31.5	45.1	46.0	51.0	37.9	29.2	21.7	15.5

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

1/ Includes the property tax, the simplified profit tax for small businesses, and other local taxes.

2/ The fiscal balance includes guarantees for new loans to the energy sector through 2019 and from 2021, and potential calls of COVID-19 related guarantees from 2022.

3/ The stock of general government debt includes public guarantees (domestic and external) and arrears from central and local government and VAT refund arrears.

4/ The 2021 SDR allocation equivalent at present to $170 million is recorded with the Bank of Albania and is used as a credit line until 2023 and for budget financing afterwards. Accordingly, public debt and the TSA account only include the SDR allocation starting 2024.

Table 3a. Albania: Balance of Payments, 2018–27
(Percent of GDP)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Proj.					
Current account	-6.8	-7.6	-8.7	-7.7	-7.8	-7.7	-7.6	-7.6	-7.5	-7.4
Goods and services (fob)	-13.7	-13.6	-14.5	-13.3	-13.8	-14.1	-13.9	-13.8	-13.7	-13.7
Goods (fob)	-22.4	-22.9	-22.5	-24.8	-26.5	-26.8	-26.1	-25.1	-24.4	-23.6
Exports	7.7	6.6	6.0	8.2	8.8	8.1	8.0	8.0	8.0	8.0
Imports	30.1	29.4	28.4	33.0	35.2	34.9	34.1	33.1	32.4	31.7
Services	8.7	9.3	7.9	11.5	12.7	12.7	12.2	11.3	10.7	10.0
Exports	24.0	24.7	16.8	22.5	25.5	25.5	25.3	25.0	25.0	25.0
Imports	15.3	15.4	8.8	10.9	12.8	12.8	13.1	13.7	14.3	15.0
Primary Income	-0.1	-1.0	-1.7	-1.4	-1.1	-0.7	-0.7	-0.8	-0.8	-0.8
Compensation of employees (net)	2.2	2.2	1.7	1.9	2.0	2.1	2.3	2.3	2.3	2.3
Investment income (net)	-2.3	-3.2	-3.3	-3.3	-3.1	-2.8	-3.0	-3.1	-3.1	-3.1
Other (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Secondary Income	7.1	7.0	7.5	7.0	7.1	7.1	7.0	7.0	7.0	7.0
General Government (net)	0.5	0.5	0.4	0.3	0.2	0.2	0.1	0.1	0.1	0.1
Workers' Remittances (net)	5.2	5.1	5.1	4.9	5.2	5.2	5.2	5.2	5.2	5.2
Other private transfers (net)	1.3	1.4	2.0	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Capital account	0.8	0.5	1.1	2.3	0.5	0.5	0.6	0.6	0.6	0.6
Financial account	-8.9	-6.0	-11.3	-10.1	-7.8	-8.8	-6.0	-7.3	-8.5	-6.8
Direct investment, net	-8.0	-7.5	-6.7	-6.4	-6.5	-6.5	-6.5	-6.5	-6.5	-6.5
Portfolio investment	-0.6	1.0	-0.5	-0.5	1.2	-0.3	0.9	-0.6	-1.5	0.3
Other investment	-0.3	0.5	-4.1	-3.1	-2.4	-2.0	-0.4	-0.2	-0.5	-0.7
Errors and omissions	-0.1	0.4	1.2	1.4	0.0	0.0	0.0	0.0	0.0	0.0
Net balance	3.0	-1.0	3.7	4.7	0.6	1.6	-1.0	0.3	1.6	0.0
Reserve assets (reserve loss = +)	-2.9	0.6	-4.9	-6.1	-0.6	-1.6	1.0	-0.3	-1.6	0.0
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(Percent change, unless otherwise noted)									
Memorandum items:										
Goods and Services										
Export value (fob)	11.1	6.1	-29.8	56.7	24.9	3.7	4.1	4.2	4.9	4.8
Import value (fob)	7.8	6.1	-19.8	37.0	22.0	5.1	3.9	4.1	4.7	4.8
Export volume	3.8	1.4	-27.5	44.5	14.3	-1.2	1.8	2.3	3.1	3.0
Import volume	6.0	4.5	-19.5	23.7	7.5	-0.2	1.9	2.7	3.3	3.4
Terms of trade	5.0	-0.3	-9.0	7.4	-3.0	0.4	-0.5	-0.4	0.6	-0.3
Gross reserves (millions of euros)	3,399	3,360	3,942	4,972	5,061	5,351	5,163	5,228	5,570	5,566
(in months of imports of goods and services)	6.6	8.1	7.0	7.2	7.0	7.1	6.6	6.4	6.5	6.8
(in percent of ARA metric)	182	174	188	201	193	192	182	176	175	167
Gross reserves excl. banks' FX reserves (millions of euros)	2,887	2,817	3,350	4,267	4,279	4,531	4,308	4,338	4,644	4,603
(in months of imports of goods and services)	5.6	6.8	5.9	6.2	5.9	6.0	5.5	5.3	5.7	5.3
(in percent of ARA metric)	155	146	160	173	163	163	151	146	146	138
Gross external debt (millions of euros)	8,353	8,246	8,548	9,740	9,980	10,550	10,658	11,166	12,098	12,645
Gross external debt (percent of GDP)	65.1	60.0	64.3	63.1	57.9	57.9	55.6	55.5	57.3	57.1

Sources: Albanian authorities; and IMF staff estimates.

Table 3b. Albania: Balance of Payments, 2018–27
(Millions of Euros)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
							Proj.			
Current account	-866	-1,041	-1,153	-1,186	-1,342	-1,407	-1,449	-1,521	-1,575	-1,644
Goods and services (fob)	-1,760	-1,870	-1,931	-2,053	-2,371	-2,576	-2,661	-2,770	-2,890	-3,026
Goods (fob)	-2,871	-3,144	-2,983	-3,829	-4,561	-4,886	-5,002	-5,045	-5,149	-5,233
Exports	986	907	794	1,265	1,510	1,482	1,529	1,614	1,695	1,776
Imports	3,857	4,050	3,776	5,094	6,071	6,368	6,531	6,659	6,844	7,009
Services	1,111	1,274	1,052	1,776	2,190	2,310	2,341	2,275	2,260	2,207
Exports	3,073	3,398	2,226	3,466	4,398	4,644	4,848	5,029	5,273	5,528
Imports	1,962	2,124	1,174	1,690	2,208	2,334	2,507	2,754	3,013	3,321
Primary Income	-14	-140	-219	-211	-194	-123	-137	-160	-165	-168
Compensation of employees (net)	285	299	221	296	339	383	434	460	488	511
Investment income (net)	-300	-439	-443	-508	-533	-508	-572	-621	-654	-681
Other (net)	1	0	2	1	1	1	1	1	1	1
Secondary Income	908	968	997	1,078	1,223	1,292	1,350	1,410	1,480	1,551
General Government (net)	67	67	58	49	27	35	28	22	23	25
Workers' Remittances (net)	670	702	673	761	896	948	996	1,046	1,097	1,151
Other private transfers (net)	171	199	266	268	300	310	326	342	359	375
Capital account	104	76	143	356	86	97	107	112	118	123
Financial account	-1,143	-827	-1,504	-1,555	-1,345	-1,600	-1,154	-1,474	-1,799	-1,516
Direct investment, net	-1,022	-1,036	-894	-990	-1,123	-1,190	-1,251	-1,309	-1,377	-1,443
Portfolio investment	-76	141	-66	-84	198	-48	180	-124	-323	77
Other investment	-44	69	-545	-481	-420	-362	-83	-41	-100	-150
Errors and omissions	-9	60	160	212	0.0	0.0	0.0	0.0	0.0	0.0
Net balance	380	-138	495	724	89	290	-188	65	342	-5
Reserve assets (reserve loss = +)	-371	78	-655	-936	-89	-290	188	-65	-342	5
Financing Gap	0	0	0	0	0	0	0	0	0	0
					(Percent change, unless otherwise noted)					
Memorandum items:										
Goods and Services										
Export value (fob)	11.1	6.1	-29.8	56.7	24.9	3.7	4.1	4.2	4.9	4.8
Import value (fob)	7.8	6.1	-19.8	37.0	22.0	5.1	3.9	4.1	4.7	4.8
Export volume	3.8	1.4	-27.5	44.5	14.3	-1.2	1.8	2.3	3.1	3.0
Import volume	6.0	4.5	-19.5	23.7	7.5	-0.2	1.9	2.7	3.3	3.4
Terms of trade	5.0	-0.3	-9.0	7.4	-3.0	0.4	-0.5	-0.4	0.6	-0.3
Gross reserves (millions of euros)	3,399	3,360	3,942	4,972	5,061	5,351	5,163	5,228	5,570	5,566
(in months of imports of goods and services)	6.6	8.1	7.0	7.2	7.0	7.1	6.6	6.4	6.5	6.8
(in percent of ARA metric)	182	174	188	201	193	192	182	176	175	167
Gross reserves excl. banks' FX reserves (millions of euros)	2,887	2,817	3,350	4,267	4,279	4,531	4,308	4,338	4,644	4,603
(in months of imports of goods and services)	5.6	6.8	5.9	6.2	5.9	6.0	5.5	5.3	5.7	5.3
(in percent of ARA metric)	155	146	160	173	163	163	151	146	146	138
Gross external debt (millions of euros)	8,353	8,246	8,548	9,740	9,980	10,550	10,658	11,166	12,098	12,645
Gross external debt (percent of GDP)	65.1	60.0	64.3	63.1	57.9	57.9	55.6	55.5	57.3	57.1

Sources: Albanian authorities; and IMF staff estimates.

Table 4a. Albania: Monetary Survey, 2018–27
(Billions of leks, unless otherwise indicated; end-period)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Proj.					
Net foreign assets	724.4	729.0	808.2	854.4	858.7	905.4	886.3	883.6	945.1	967.6
Bank of Albania	412.5	402.0	480.4	556.0	551.5	589.1	569.3	578.4	622.4	624.2
Commercial banks	311.9	327.0	327.8	298.4	307.2	316.2	317.0	305.1	322.7	343.4
Net domestic assets	539.7	589.6	648.7	727.9	824.9	871.8	990.4	1,093.4	1,138.0	1,225.4
Claims on central government, net	340.7	378.5	435.4	412.2	481.9	499.4	578.8	620.9	641.3	701.5
Claims on public enterprises	20.3	24.2	15.2	22.5	18.8	20.7	19.8	20.2	20.0	20.1
Claims on the private sector	501.9	532.5	579.9	629.5	692.0	731.5	772.4	813.5	856.4	901.3
In leks	247.0	271.7	300.8	330.1	314.1	350.1	397.5	422.8	448.4	475.3
In foreign currency	254.9	260.8	279.1	299.4	377.9	381.4	374.9	390.7	407.9	426.0
Other items, net	-323.2	-345.5	-381.7	-336.4	-367.8	-379.8	-380.5	-361.2	-379.6	-397.5
Broad money	1,264.1	1,318.7	1,456.9	1,582.3	1,683.6	1,777.2	1,876.7	1,977.0	2,083.1	2,192.9
Currency outside banks	275.3	291.4	344.6	366.3	390.1	408.6	429.3	452.2	476.5	501.6
Deposits	988.8	1,027.3	1,112.3	1,216.1	1,293.5	1,368.5	1,447.4	1,524.8	1,606.6	1,691.3
Domestic currency	456.2	466.6	517.7	552.2	568.0	607.8	650.1	692.4	737.6	784.9
Foreign currency	532.6	560.6	594.7	663.8	725.5	760.8	797.4	832.4	869.0	906.3
Memorandum items:										
Broad money growth (% change)	-0.2	4.3	10.5	8.6	6.4	5.6	5.6	5.3	5.4	5.3
Reserve money growth (% change)	-0.4	2.5	23.1	5.8	1.3	3.2	5.2	4.7	5.4	5.4
Private sector credit growth (% change)	-0.9	6.1	8.9	8.6	9.9	5.7	5.6	5.3	5.3	5.2
Broad money (as percent of GDP)	77.2	77.9	88.6	-1.2	81.0	80.9	80.9	80.9	80.9	81.0
Private sector credit (as percent of GDP)	30.7	31.5	35.3	33.3	33.3	33.3	33.3	33.3	33.3	33.3
Velocity (nominal GDP/broad money)	1.3	1.3	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Money multiplier (absolute values)	3.0	3.0	2.7	2.8	2.9	3.0	3.0	3.0	3.0	3.0
Currency (as share of broad money)	21.8	22.1	23.6	23.1	23.2	23.0	22.9	22.9	22.9	22.9
Foreign currency deposits/total deposits	53.9	54.6	53.5	54.6	56.1	55.6	55.1	54.6	54.1	53.6
Gross reserves (millions of euros)	3,399.0	3,359.6	3,942.4	4,972.2	5,061.5	5,351.4	5,163.4	5,228.5	5,570.2	5,565.6

Sources: Bank of Albania; and IMF staff estimates.

Note: Foreign exchange denominated items are converted at exchange rates for that period.

Table 4b. Albania: Summary of Accounts of the Central Bank, 2018–27
(Billions of leks, unless otherwise indicated; end-period)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
							Proj.			
Net foreign assets	412.5	402.0	480.4	556.0	551.5	589.1	569.3	578.4	622.4	624.2
Assets	436.5	427.0	504.2	600.4	595.7	633.6	613.9	623.2	667.3	669.3
Liabilities	24.0	25.0	23.8	44.4	44.2	44.4	44.7	44.8	44.9	45.1
Net domestic assets	11.0	31.9	54.0	-8.3	21.1	2.1	52.4	72.8	63.9	99.2
Domestic credit	21.7	44.5	66.5	0.0	31.6	11.4	62.3	82.5	73.6	108.9
Net claims on central government	-12.4	8.4	31.8	-43.8	14.6	13.4	47.9	54.1	47.8	63.2
Other credit	34.1	36.1	34.7	43.8	16.9	-2.0	14.4	28.4	25.8	45.6
Private sector	1.8	2.1	2.0	2.2	2.1	2.2	2.1	2.1	2.1	2.1
Commercial banks	32.3	34.0	32.7	41.6	14.8	-4.1	12.3	26.2	23.6	43.5
Other items, net (assets = +)	-10.8	-12.6	-12.5	-8.3	-10.4	-9.4	-9.9	-9.6	-9.8	-9.7
Reserve money	423.4	434.0	534.3	565.2	572.6	591.2	621.7	651.3	686.2	723.3
Currency in circulation	275.3	291.4	344.6	366.3	390.1	408.6	429.3	452.2	476.5	501.6
Bank reserves	148.1	142.4	189.7	198.9	182.5	182.5	192.4	199.0	209.7	221.7
Other nonbank deposits	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Bank of Albania; and IMF staff estimates.
Note: Foreign exchange denominated items are converted at exchange rates for that period.

Table 5. Albania: IMF Core Indicators of Financial Soundness, 2014–22

		Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Sep-22
I	Capital-based									
(i)	Regulatory capital as a percent of risk-weighted assets	16.8	15.8	16.0	17.0	18.7	18.7	18.7	18.5	19.3
(ii)	Regulatory Tier 1 capital as a percent of risk-weighted assets	13.8	13.7	14.1	15.5	17.4	17.5	17.6	17.4	18.1
(iii)	Capital as a percent of total assets									
	Regulatory Tier 1 capital as a percent of total assets	7.4	8.3	8.7	9.0	9.2	9.1	9.1	8.8	9.4
	Regulatory capital as a percent of total assets	9.0	9.7	10.0	9.9	9.8	9.7	9.6	9.4	10.0
	Shareholders' equity as a percent of total assets	8.6	9.5	9.7	10.2	10.1	10.5	10.4	9.9	10.2
(iv)	Nonperforming loans net of provisions as a percent of capital									
	As a percent of regulatory Tier 1 capital	46.7	28.4	26.3	17.3	16.6	14.6	12.0	7.6	7.2
	As a percent of regulatory capital	38.3	24.3	23.1	15.7	15.5	13.6	11.3	7.1	6.7
	As a percent of shareholders' equity	40.2	24.8	23.6	15.3	15.0	12.7	10.5	6.8	6.6
(v)	Return on equity (ROE) (annual basis)	14.2	13.2	7.5	15.7	13.0	13.5	10.7	12.9	9.4
(vi)	Net open position in foreign exchange as a percent of capital									
	As a percent of regulatory Tier 1 capital	10.4	9.0	8.0	7.3	8.4	8.0	9.0	9.8	9.5
	As a percent of regulatory capital	8.5	7.7	7.0	6.7	7.8	7.4	8.4	9.2	8.9
	As a percent of shareholders' equity	8.9	7.8	7.2	6.5	7.5	6.9	7.8	8.7	8.8
II	Asset-based									
(vii)	Liquid assets as a percent of total assets (Liquid-asset ratio)	31.9	32.3	31.3	30.2	34.2	35.7	34.8	33.3	28.9
(viii)	Liquid assets as a percent of short-term liabilities	40.4	41.4	40.6	40.8	46.2	49.4	47.4	45.4	40.0
(ix)	Return on assets (ROA) (net income to average total assets, annual)	0.9	1.2	0.7	1.5	1.3	1.4	1.1	1.3	1.0
(x)	Nonperforming loans (gross) as a percent of total loans	22.8	18.2	18.2	13.2	11.1	8.4	8.1	5.6	5.1
III	Income and expense-based									
(xii)	Interest margin to gross income	84.5	82.7	81.6	95.6	100.8	75.7	74.1	74.0	84.9
(xiii)	Noninterest expenses to gross income	51.1	48.1	50.4	71.9	77.6	61.2	58.7	60.3	65.4
IV	Memorandum items									
	Other (noncore) indicators:									
	Customer deposits as a percent of total (non-interbank) loans	180.2	187.8	192.8	194.0	203.2	207.2	211.3	213.6	209.1
	Foreign currency-denominated loans to total loans	62.4	60.8	58.6	56.4	56.1	51.2	50.3	51.1	51.5
	Foreign currency-denominated liabilities as a percent of total liabilities	58.7	60.7	54.6	60.4	59.1	56.8	55.7	51.0	53.1
	Other indicators:									
	Risk weighted assets as a percent of total assets	53.6	62.0	63.4	59.7	53.9	53.2	52.6	52.4	52.1
	Total loans as a percent of total assets	46.0	44.5	42.7	41.6	40.0	39.0	38.5	37.8	38.6
	Total loans as a percent of shareholders' equity	536.3	466.8	438.6	408.9	393.8	373.3	370.5	381.7	379.1

Sources: Bank of Albania; and IMF staff estimates.

Table 6. Albania: Indicators of Capacity to Repay the Fund, 2021–27
(Under Obligated Repurchase Schedule)
(Millions of SDRs, as of October 31, 2022)

	2021	2022	2023	2024	2025	2026	2027
Fund repurchases and charges based on the existing and prospective drawings							
In millions of SDRs	8.4	9.3	94.0	120.7	71.9	22.1	4.8
In millions of euro	10.4	12.1	122.2	157.1	93.5	28.7	6.3
In percent of gross international reserves	0.2	0.2	2.3	3.0	1.8	0.5	0.1
In percent of exports of goods and services	0.2	0.2	2.0	2.5	1.4	0.4	0.1
In percent of GDP	0.1	0.1	0.7	0.8	0.5	0.1	0.0
In percent of external public debt	0.2	0.2	1.9	2.5	1.4	0.4	0.1
In percent of quota	6.0	6.7	67.5	86.6	51.6	15.9	3.5
Fund credit outstanding (end of period)							
In millions of SDRs	344.4	295.2	211.1	96.2	26.3	4.8	0.0
In millions of euro	426.1	382.6	274.4	125.2	34.2	6.2	0.0
In percent of gross international reserves	8.6	7.6	5.1	2.4	0.7	0.1	0.0
In percent of exports of goods and services	9.0	6.5	4.5	2.0	0.5	0.1	0.0
In percent of GDP	2.8	2.2	1.5	0.7	0.2	0.0	0.0
In percent of external public debt	7.3	6.2	4.2	2.0	0.5	0.1	0.0
In percent of quota	247.3	211.9	151.6	69.0	18.9	3.4	0.0
Memorandum items:							
Gross international reserves	4,020	3,906	4,117	3,967	4,020	4,285	4,286
Exports of goods and services	3,825	4,559	4,713	4,900	5,107	5,360	5,625
External public debt	4,693	4,743	5,009	4,896	5,239	5,650	4,961
Quota	139.3	139.3	139.3	139.3	139.3	139.3	139.3

Source: IMF staff estimates.

Table 7. Albania: External Financing Requirement and Sources, 2018–27
(Millions of Euros)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Total financing requirement	1,546	1,123	2,156	2,181	1,686	2,280	1,633	2,360	2,169	2,492
Current account (incl. official transfers)	762	965	1,009	827	1,256	1,310	1,342	1,408	1,458	1,520
Amortization	412	236	493	325	341	680	480	886	369	976
Of which: IMF	5	17	34	54	61	110	150	91	28	6
Change in gross reserves (increase = +)	371	-78	655	1030	89	290	-188	65	342	-5
Total financing sources	1,555	1,054	1,996	1,973	1,686	2,280	1,633	2,360	2,169	2,492
Foreign direct investment, net	1022	1036	894	990	1123	1190	1251	1309	1377	1443
Official medium- and long-term project loans	154	159	144	195	190	182	192	201	211	221
Official guaranteed loans	118	11	75	31	160	77	38	40	42	40
Official budget support loans	0	14	192	134	141	287	49	48	99	98
SDR Allocation	0	0	0	161	0	0	0	0	0	0
Commercial borrowing (Eurobond and PBG)	498	0	650	653	0	500	0	750	500	750
Commercial Banks, net	7	70	-328	-225	-91	-133	-96	-104	-110	-101
Of which:										
Portfolio investment, net	-176	-77	-256	-303	-149	-150	-150	-150	-150	-150
Other investment, net	183	147	-72	78	58	17	54	46	40	49
Other	-245	-236	370	34	163	176	199	115	50	40
Errors and omissions	-9	68	159	208	0	0	0	0	0	0
Remaining financing gap	0	0	0	0	0	0	0	0	0	0

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

Annex I. Implementation of Past Article IV Recommendations

Key Recommendations (2021 Article IV)	Policy Actions
Fiscal Policy	
Undertake a credible revenue-based fiscal consolidation to rebuild eroded policy buffers.	With growth and revenues overperforming expectations in 2021, the overall deficit was reduced by 2.2 pp of GDP year on year (to 4.5 percent of GDP).
Ensure fiscal support is targeted and refrain from broad subsidies.	Following the war in Ukraine, the government adopted two packages totaling 2/3 percent of GDP targeting low-income pensioners and other vulnerable groups. However, a much larger subsidy of 1.3 percent of GDP under the 2022 Budget for the electricity sector SOEs to prevent the pass-through of higher imported electricity costs to households and SMEs is broad-based.
Structural Fiscal Reforms	
Finalize and adopt a Medium-Term Revenue Strategy to underpin a revenue-based consolidation, with the aim to broaden the tax base, remove loopholes and raise revenue.	An updated draft of the MTRS was completed in 2022 but public consultations have been suspended following the war in Ukraine. Some MTRS recommendations related to amendments to the Income Tax law and revenue administration are going ahead.
Bolster the credibility of the budget and fiscal framework by limiting the use of normative acts to amend the budget outside the regular budgetary cycle and return to the adherence to the fiscal rule.	Due to the emergency created by the war in Ukraine, the use of normative acts to amend the budget continued in 2022. However, the government remains committed to the fiscal rule and plans to achieve a small primary surplus in 2023, thus adhering to the fiscal rule one year ahead of the requirement stipulated by the Organic Budget Law.
Strengthen the Public Investment Management and Public Private Partnership framework, including by addressing outstanding recommendations from the 2016 PIMA and aligning the processes for PPP and budget-funded projects.	Despite the rising stock of PPPs and increasing domestically financed investment, there is no unified process aligned with the budget cycle that aims to maximize value for money. Shortcomings to monitoring fiscal risks related with PPPs, guarantees, and other contingent liabilities persist.
Improve budget transparency by integrating earthquake reconstruction funds into the budget process.	Nearly 3 years after the earthquake, reconstruction spending continues to be treated in an ad hoc manner but new spending will be included in the regular budget process starting with the 2023 Budget.
Monetary Policy and Financial Sector	
Base monetary policy tightening on clear indications of broadening and persistent inflationary pressures.	As inflation has become increasingly broad based, the BoA has started monetary policy normalization.
Preserve exchange rate flexibility.	The exchange rate continues to act as a shock absorber, with the BoA intervening only once during a DMC episode in March 2022.
Closely monitor banks' loan portfolio quality and preserve capital buffers.	The BoA continues to conduct enhanced on- and off-site supervision of banks. The BoA suspended the distribution of dividends for 2021 and 2022, rolling over a measure initially taken at the height of the Covid 19 pandemic.
Enhance surveillance of the fast-growing real estate market, including through data improvement.	Lack of reliable data prevents the BoA from properly monitoring the fast-paced growth in the real estate market and to develop related macroprudential tools.
Strengthen the monitoring of virtual assets and the communication with investors; enforce the framework within AFSA's purview.	Some bylaws have been drafted with Fund TA, but more needs to be done to enhance supervision capacity. So far no entity has applied for a license to carry out virtual asset activities under AFSA's supervision.
Governance Reforms	
Continue with the progress on judicial reform and efforts to combat anticorruption.	Ongoing progress in completing the vetting of judges and prosecutors. The new justice institutions have been set up and there have been prosecutions of high-profile corruption cases. Review of the anticorruption strategy has been completed and a new strategy and an action plan are expected by end-2022.
Strengthen AML/CFT framework, by implementing FATF recommendations to exit from the "grey list".	Progress has been made towards implementing FATF recommendations, but Albania remains on the grey list due to deficiencies in strategic areas. The proposed tax amnesty initiative goes against the spirit of FAFT's and MONEYVAL's recommendations.

Annex II. Risk Assessment Matrix[1]

Risks	Likelihood	Impact	Policy Responses
Conjunctural risks			
Commodity price shocks. A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	High	**High.** Further increase in food and energy prices would hit the most vulnerable households and hurt economic growth, worsen the current account, de-anchor inflation expectations, and increase the budget deficit and fiscal risks from the energy sector.	• Adjust the pace of monetary policy tightening to anchor inflation expectations and clearly communicate the BoA's strategy. • Adopt additional but temporary and targeted income support to the poor and vulnerable. • Gradually adjust electricity tariffs to cost-recovery levels and preserve price mechanism. • Reinvigorate energy sector reforms to restore the financial viability of energy sector SOEs. • Prepare a backup power supply plan.
Intensifying spillovers from Russia's war in Ukraine. Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility, with Europe and commodity-importing EMs among the worst hit.	High	**High.** Due to the limited direct linkages with Russia and Ukraine, the war in Ukraine would affect the Albanian economy indirectly, through higher commodity prices, lower trading partner growth, tighter financial conditions, and weaker confidence.	• Implement policies to cope with commodity price shocks (see above).
Abrupt global slowdown or recession in Europe. The fallout from the war in Ukraine is exacerbated by a gas shutoff by Russia, resulting in acute gas shortages and further supply disruptions, which triggers an EU recession.	High	**High.** A recession in Albania's main export destinations and sources of remittances might spill over to Albania through lower external demand and a decline in remittances, leading to slower growth in Albania.	• Adjust the pace of fiscal consolidation within a credible revenue-based medium-term consolidation plan and seek additional official financing. Better target fiscal support. • Closely monitor and manage fiscal and financial sector risks. • Adjust the pace of monetary tightening and clearly communicate the BoA's strategy. • Improve the business environment to support growth and investment.
De-anchoring of inflation expectations and stagflation. Supply shocks to food and energy prices sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand, currency depreciations in EMDEs, and sovereign defaults. Together, this could lead to the onset of stagflation.	Medium	**High.** Tighter global financial conditions would reduce capital inflows, create depreciation pressures, and worsen debt dynamics. Negative impact in the near term will partly be mitigated by Albania's high level of foreign reserves.	• Adjust fiscal spending to better target support and strengthen debt and liquidity management. • Implement a credible revenue-based fiscal consolidation for faster debt reduction and seek additional official financing. • Closely monitor and manage fiscal and financial sector risks. • Adjust the pace of monetary tightening and clearly communicate the BoA's strategy. • Use FXIs for disorderly market conditions and stand ready to take further measures to preserve stability.

[1] As of August 2022. The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Risks	Likelihood	Impact	Policy Responses
Local Covid-19 outbreaks. Outbreaks in slow-to-vaccinate countries or emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce. This results in extended supply chain disruptions, slower growth, capital outflows, and debt distress in some EMDEs.	Medium	Medium. Reinstatement of containment measures and new disruptions in the tourism sector would stall the recovery. Prolonged fiscal support and lower revenues would put pressure on fiscal.	• Further promote vaccination and strengthen healthcare capacities. • Adjust composition of fiscal spending to scale up pandemic support measures, targeted at those most in need, anchored by credible revenue-based fiscal consolidation • Seek additional official financing.
Structural risks			
Natural disasters related to climate change. More frequent natural disasters deal severe damage to infrastructure (especially in smaller vulnerable economies) and amplify supply chain disruptions and inflationary pressures, causing water and food shortages and reducing medium-term growth.	Medium	High. Under status quo, the intensity, frequency, and economic costs of extreme weather events and natural disasters are expected to increase. These would impact the population, raise fiscal deficits, lower growth, and reduce productivity.	• Assess vulnerability to natural disasters and adopt preventive mitigation measures. • Support affected sectors and rebuild damaged infrastructure. • Gradually adjust electricity tariffs to cost-recovery levels and preserve price mechanisms. • Reinvigorate electricity sector reform to restore the financial viability of public electricity companies. • Prepare a backup power supply plan.
Domestic risks			
Rollover of public debt	High	High. Elevated levels of net domestic borrowing and tightening in the financial markets could lower appetite for Albanian sovereign bonds.	• Diversify the debt holder base and lengthen maturity. • Improve market communication and coordination with the central bank. • Accelerate revenue-based fiscal adjustment and debt reduction. • Seek additional official financing.
Poorly designed PIM projects and PPPs and materialized contingent liabilities	High	Medium. Engaging in poorly designed PIM and PPP contracts for infrastructure investment could impede the efficiency of public investment, and create large contingent liabilities, the realization of which could undermine fiscal and debt sustainability.	• Strengthen public investment management and governance and transparency of PPPs. • Upgrade the capacity of the Ministry of Finance to undertake financial analysis of new PPP contracts and their direct or contingent impact on fiscal for the lifetime of the project.
Materialization of financial vulnerabilities	Medium	Medium. A surge in non-performing loans could lower capital adequacy levels, affecting banking sector stability and the ability to extend credit to the private sector. A collapse in property prices could create significant stress for households and developers, dampen growth, and weaken bank balance sheets.	• Closely monitor the financial sector and continue to improve NPL resolution frameworks. • Continue to strengthen and implement the capital and liquidity regulatory framework and remain vigilant through onsite and off-site supervision. • Enhance bank capital buffers. • Address data gaps on real estate to monitor and manage risks to the financial sector and strengthen macroprudential toolkit.
Rising social discontent and political instability.	Medium	High. Social tensions could resurface due to the increase of food and energy prices. Inadequate policy responses could cause persistent economic hardship and exacerbate preexisting socioeconomic inequities.	• Ensure that reforms are grounded in careful policy analysis and a consultative process. • Enhance communication with the public and provide temporary, targeted support to those most in need. • Reforms, including those to strengthen the rule of law, are key for medium-term growth and prospects for EU accession.
Adverse weather conditions	Medium	High. Drought could affect electricity generation. Power shortages could damage growth. Electricity imports could pose quasi-fiscal risks for the budget. Adverse weather conditions could cause a large toll on population and widespread damage to the infrastructure, resulting in higher fiscal deficits.	• Implement policies to cope with climate change and commodity price shocks (see above).

Annex III. Debt Sustainability Analysis

The strong economic rebound and better-than-expected fiscal outturn for 2021 led to a decline of the debt to GDP ratio to 73.9 percent from almost 76 percent in 2020. Helped by the continued economic growth in 2022 and an expected smaller primary deficit relative to last year, debt is expected to continue to decline this year and remain on a downward path, reaching 63.6 percent by 2027. The debt path under the baseline is subject to significant risks. Gross financing requirements also remain large at an annual average of about 17 percent of GDP, reflecting sizable rollover needs including maturing Eurobonds in 2025 and 2027 and other large commercial loan repayments. Amid tightening global financial conditions, sustaining efforts in revenue-based consolidation to achieve primary surpluses in the medium term is needed to rebuild fiscal buffers and reduce financing needs.

Domestic Debt Sustainability

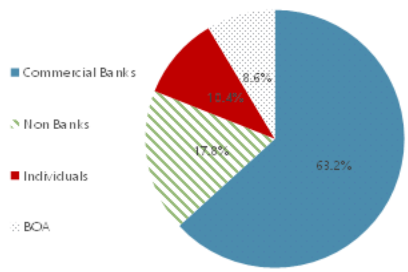
1. **Debt Profile.**[1] Albania's debt profile has gone through several changes over the past decade. First, the share of external debt in total public debt went up from about 33 percent in 2008 to about a half in December 2021 and remained stable through September 2022. Second, this trend reflects a rising share of private debt from 14.6 percent of total external debt to 35 percent over the same period following several issuances of Eurobonds including a €650 million issuance in November 2021. Third, the maturity profile of domestic debt has also changed with the share of long-term papers increasing from about half of the total domestic debt in 2013 to under 70 percent in September 2022. The average weighted maturity of domestic public debt lengthened from less than one year in 2011 to about 2.3 years as of September 2022. The lengthening of maturity, together with the ample liquidity in the banking system, had contributed, to some degree, to the reduction of domestic rollover risks, though they still remain sizeable. With the onset of the war in Ukraine and monetary policy tightening, the government has started to issue debt at shorter maturities in order to mitigate the increase in borrowing costs.

2. **Going forward, further lengthening of maturities would still be needed** to help reduce the very high annual financing requirements, especially as financial conditions are expected to tighten further. The ongoing development of the market maker program for longer-term benchmark bond issuances and seeking foreign official financing should help in this regard. At the same time, the MOFE is encouraged to continue the issuance of short-term debt (specifically for 3–6 months maturity), to support liquidity management and market development. More than 97 percent of domestic debt was denominated in domestic currency, whereas 71 percent of external debt was denominated in euro.

[1] Public debt refers to the general government and includes all public domestic and external guarantees for energy and non-energy sector debt, as well as arrears from central and local government and VAT refund arrears. It does not include contingent liabilities from PPPs. The SDR allocation is used as a credit line until 2023 and for budget financing afterwards. Accordingly, public debt in the DSA only includes the SDR allocation starting 2024.

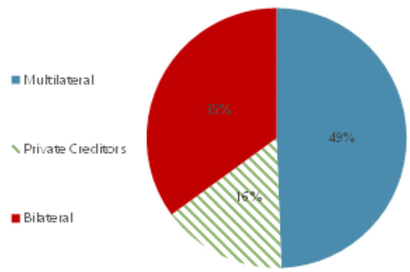
3. The authorities updated their medium-term debt management strategy with World Bank technical assistance. The Medium-Term Debt Management Strategy 2022–2026 plans to lengthen debt maturities and to cap foreign currency-denominated debt at 55 percent of total debt (currently at 49 percent). It indicates continued reliance on domestic financing of the deficit (mostly from banks) to be complemented by foreign borrowing. In addition, the authorities are considering alternative sources of financing including Green, Social, and Sustainability bonds. Staff views a need for deepening the domestic markets for government securities to increase their liquidity and financing capacity.

Albania: Domestic Debt Holders, 2022 Q3
(Percentage share of total debt; excl. arrears and guarantees)



Sources: MoFE and IMF staff calculations

Albania: Public External Debt Holders, 2022 Q3
(Percentage share of total external debt; excl. guarantees)



Sources: MoFE and IMF staff calculations

4. Fiscal risks from energy SOEs have also risen with rising energy prices. Contingent liabilities from utility SOEs (energy and water) constitute sizeable risks. Public guarantees to SOEs are accounted for in the stock of debt at the date of issuance. However, energy SOEs have been dependent on budgetary support with this support increasing to 1.3 percent of GDP so far in 2022. Meanwhile, contingent liabilities related to PPPs seem large, but they are not measured in a comprehensive manner and as such are neither properly assessed nor adequately monitored. Under the Organic Budget Law, direct payments to PPPs and concessions from the budget should not exceed 5 percent of tax revenue of the preceding year but this ceiling could be breached if revenues underperform.

Baseline Scenario

5. Macroeconomic assumptions. Under the baseline, despite headwinds stemming from the war in Ukraine, GDP growth is expected at 3.7 percent in 2022, supported by tourism, real estate, and services. Medium-term growth is forecasted to average about 3 percent during 2023–27. The authorities intend to achieve at least a zero primary balance in 2023, a year before the timeline required by the Organic Budget Law. The baseline also assumes rising interest payments to about 3 percent of GDP in 2027 (compared with 2.2 percent in the 2021 AIV SR) to reflect recent rising interest rates and sovereign spreads for Albania and generally higher borrowing costs over the projection period. The authorities plan to issue a Eurobond in 2023 though these plans are subject to uncertainty stemming from rising sovereign yields and tightening in global financial markets. The baseline assumes further tapping of international capital markets in 2025–27, to finance large Eurobond and other external loan repayments.

6. **Debt level under the baseline and alternative scenarios.** Under the baseline scenario, gross debt is projected to decline gradually from a peak of 75.9 percent in 2020 to 63.6 percent of GDP in 2027. Gross financing needs are projected to remain elevated, averaging about 17 percent of GDP annually between 2023 and 2027, reflecting interest payments (accounting for 15-20 percent of GFNs and about two-thirds of which are due on domestic debt) and large external repayments including amortization of Eurobonds and other commercial loans in 2025 and 2027 as well as repayments of new domestic borrowing starting 2024. To assess the realism of the planned fiscal adjustment under the baseline, two standardized alternative scenarios are presented. On the one hand, the historical scenario (assuming real GDP growth, the primary balance and real interest rates at the historical average of the past ten years) projects debt to remain at about 74 percent of GDP by 2027. On the other, the constant-primary-balance scenario (assuming the primary deficit remains at the 2022 level of 1.3 percent of GDP and therefore not converge to zero by 2024 as required by the Organic Budget Law) shows a debt ratio that would continue to increase to about 71 percent of GDP.

7. **Risks related to debt levels and large gross financing requirements remain elevated.** Gross financing needs slightly breach the 15 percent threshold over the projection period. However, the debt level and gross financing needs remain vulnerable to all risks in the analysis, including shocks to growth, primary balance, real interest rates, exchange rate, and contingent liabilities. Interest rate risks reflect the projected large gross financing needs amid tighter financial conditions. Exchange rate risks reflect the projected increase in foreign currency debt as a share of total debt. The debt profile shows moderate risks related to the declining share of short-term debt (green in the heatmap) but is vulnerable to shocks coming from public debt holdings by non-residents.

Stress Test and Stochastic Simulations

8. **The debt ratio is particularly sensitive to shocks to GDP growth and combined shocks.** Under a real GDP shock, debt peaks at about 75 percent GDP in 2024 and stabilizes at about 72 percent of GDP afterwards. Under the combined shock, debt would rise and broadly stabilize at 82 percent of GDP by 2027. Albania's large debt stock means high rollover requirements, which increases its vulnerability to market risk and magnifies the impact of an interest rate shock on the debt-to-GDP ratio. It also increases vulnerability to growth shocks and reduces the scope for countercyclical policy. Against this background and given tighter global financial conditions, a stress test showing dual shocks to real GDP growth and interest rate is carried out.[2] Under this scenario, debt increases to about 81 percent of GDP by 2027. Sensitivity to both fiscal stance and exchange rate shocks is less significant, with public debt never exceeding 70 percent of GDP. The fan charts illustrate the uncertainty about the evolution of public debt under the baseline over the medium term in response to shocks to relevant macroeconomic variables. They are based on both symmetric and asymmetric distributions of

[2] Assumptions underpinning this test over the period 2023–2027 include: (i) a decline in growth by 2 percentage points every year relative to the baseline, (ii) a decline in the revenue-to-GDP ratio by 2 ppts of GDP relative to the baseline, and (iii) an increase in interest rate by 25 basis points on average relative to the baseline.

risks. Under an asymmetric distribution of risks and in the case of adverse shocks, there is a probability for debt to reach about 87 percent of GDP by 2027.

External Debt Sustainability

9. The external debt-to-GDP ratio remains elevated. Most external debt continues to be held by multilateral creditors and bilateral development agencies, though the share of commercial debt is expected to increase over the medium-term. Most foreign public debt is denominated in euros (inter-government loans and Eurobonds), followed by SDRs (IMF loans).

10. The external debt ratio is expected to decline gradually over the medium-term supported by GDP growth and declining multilateral borrowing.

- **External debt** rose to 63 percent of GDP in 2021 and is projected to decline gradually to around 57 percent of GDP by 2027. Over the same period, the external private debt stock is expected to remain broadly stable at about 30 percent of GDP. FDI-related debt liabilities are expected to continue to be the largest component of the private external debt stock, with deposits held by Albanians living abroad being the second largest component of private external debt.

- Regarding **public external debt,** a €500 million Eurobond issue is assumed in 2023 (the last Eurobond was issued in November 2021 to the amount of €650 million). A €250 million Eurobond buyback is expected in 2023 followed by a repayment of a similar amount at maturity in 2025. Total public and private external debt service is expected to be around 14 percent in 2022 and to be around 23 percent in 2027 following a large amortization payment in 2027. In line with the expected succession of new Eurobond issuances, external commercial debt as a percentage of total public sector debt is expected to be broadly stable at ⅓ over the medium term, reflecting large Eurobond repayments in 2025 and 2027.

11. Stress test results. Under a 30 percent exchange rate depreciation shock, external debt would peak at 84 percent of GDP in 2023 before declining to 82 percent by 2027. Depreciation shocks are likely to have added significance for debt dynamics in view of increased external commercial borrowing. Following a shock to the current account of half a standard deviation (around 1 percent of GDP), external debt would peak at 60 percent of GDP in 2026 before starting to decelerate in 2027.

Annex III. Figure 1. Albania: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

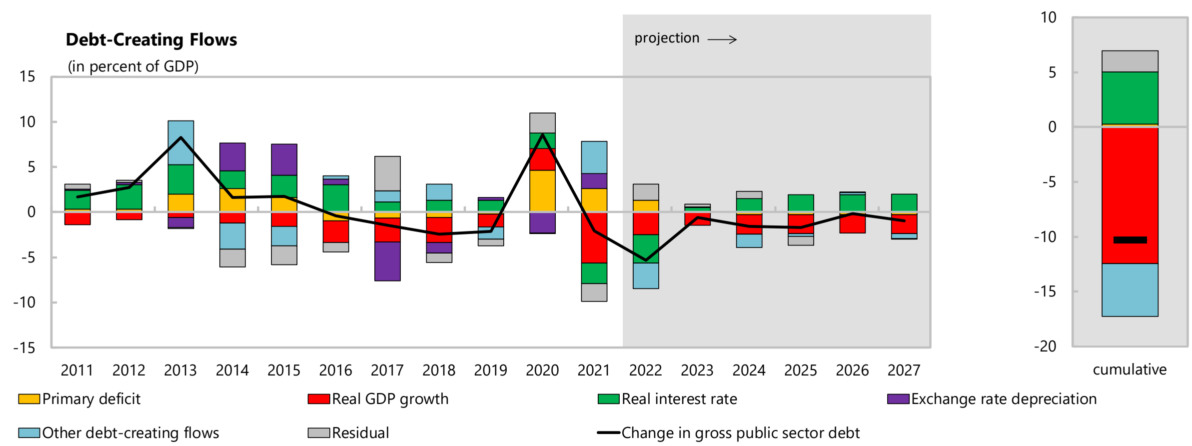
(In percent of GDP, unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of October 17, 2022		
	2011-2019 [2/]	2020	2021	2022	2023	2024	2025	2026	2027			
Nominal gross public debt	68.9	75.9	73.9	68.5	67.9	66.4	64.7	64.5	63.6	Sovereign Spreads		
Of which: guarantees	3.5	3.0	2.9	2.7	2.5	2.4	2.3	2.1	2.0	EMBIG (bp) 3/		547
Public gross financing needs	30.6	28.8	21.9	12.5	20.5	15.6	17.1	14.3	16.7	5Y CDS (bp)		n.a.
Real GDP growth (in percent)	2.5	-3.5	8.5	3.7	2.2	3.3	3.4	3.4	3.4	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	1.0	0.7	5.9	6.0	3.4	2.2	1.9	1.8	1.8	Moody's	B1	B1
Nominal GDP growth (in percent)	3.5	-2.8	14.9	10.0	5.7	5.6	5.3	5.3	5.3	S&Ps	B+	B+
Effective interest rate (in percent) [4/]	4.4	3.1	3.0	1.6	4.3	4.6	5.0	5.0	5.1	Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.1	8.6	-2.0	-5.4	-0.6	-1.6	-1.7	-0.1	-0.9	-10.3	
Identified debt-creating flows	1.3	6.4	-0.1	-7.1	-0.9	-2.4	-0.7	-0.2	-0.9	-12.2	
Primary deficit	0.5	4.6	2.6	1.3	0.0	-0.3	-0.3	-0.3	-0.3	0.3	-0.7
Primary (noninterest) revenue and grants	26.3	25.9	27.0	27.6	27.6	27.4	27.4	27.4	27.5	165.0	
Primary (noninterest) expenditure	26.8	30.5	29.7	28.9	27.6	27.2	27.2	27.2	27.2	165.3	
Automatic debt dynamics [5/]	0.6	1.8	-6.3	-5.6	-0.9	-0.6	-0.2	-0.2	-0.1	-7.7	
Interest rate/growth differential [6/]	0.5	4.1	-7.9	-5.6	-0.9	-0.6	-0.2	-0.2	-0.1	-7.7	
Of which: real interest rate	2.1	1.7	-2.3	-3.1	0.5	1.5	1.9	1.9	2.0	4.8	
Of which: real GDP growth	-1.6	2.4	-5.6	-2.5	-1.5	-2.1	-2.1	-2.1	-2.1	-12.4	
Exchange rate depreciation [7/]	0.1	-2.3	1.6	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.2	0.0	3.6	-2.8	0.1	-1.5	-0.3	0.2	-0.6	-4.8	
Memo: Change in GG depostits (BoA+outside) (negative)	0.1	0.0	3.6	-2.8	0.1	-1.5	-0.3	0.2	-0.6	-4.8	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Creation/clearance of end-2013 stock of arrears	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.3	2.2	-2.0	1.8	0.3	0.8	-1.0	0.0	0.0	1.9	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as .

2/ Based on available data.

3/ EMBIG.

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

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

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

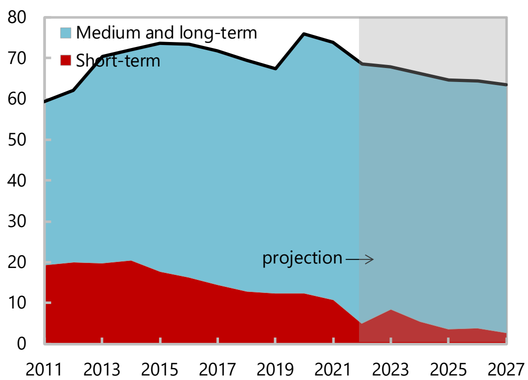
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

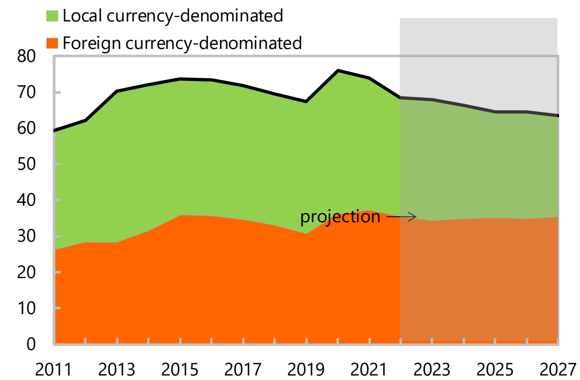
Annex III. Figure 2. Albania: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



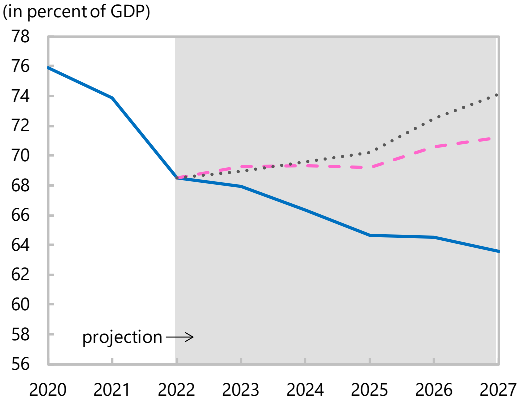
By Currency
(in percent of GDP)



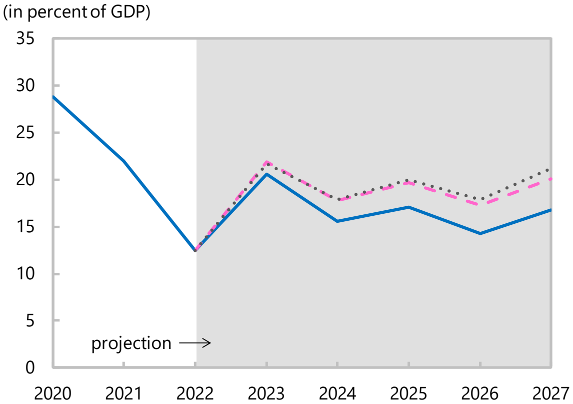
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	3.7	2.2	3.3	3.4	3.4	3.4
Inflation	6.0	3.4	2.2	1.9	1.8	1.8
Primary Balance	-1.3	0.0	0.3	0.3	0.3	0.3
Effective interest rate	1.6	4.3	4.6	5.0	5.0	5.1
Constant Primary Balance Scenario						
Real GDP growth	3.7	2.2	3.3	3.4	3.4	3.4
Inflation	6.0	3.4	2.2	1.9	1.8	1.8
Primary Balance	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Effective interest rate	1.6	4.3	4.7	5.0	5.1	5.1

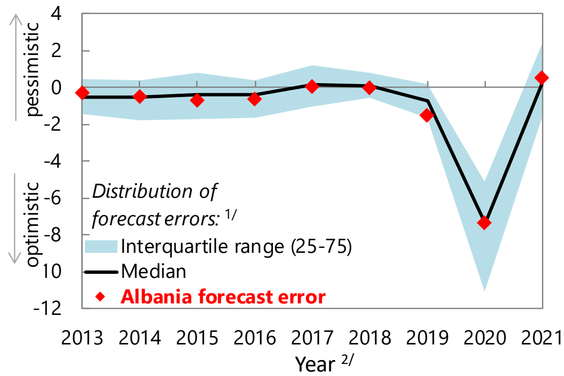
Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	3.7	2.5	2.5	2.5	2.5	2.5
Inflation	6.0	3.4	2.2	1.9	1.8	1.8
Primary Balance	-1.3	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	1.6	4.3	5.0	5.5	5.7	5.9

Source: IMF staff.

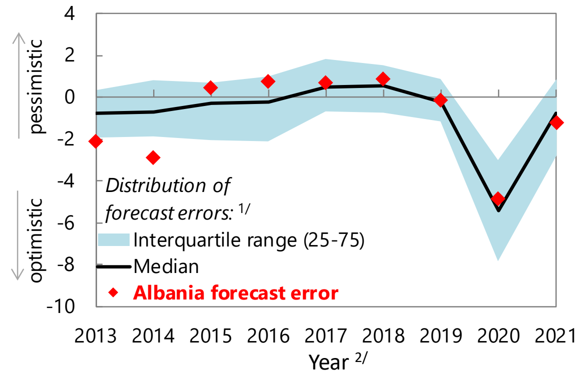
Annex III. Figure 3. Albania: Public DSA - Realism of Baseline Assumptions

Forecast Track Record, versus all countries

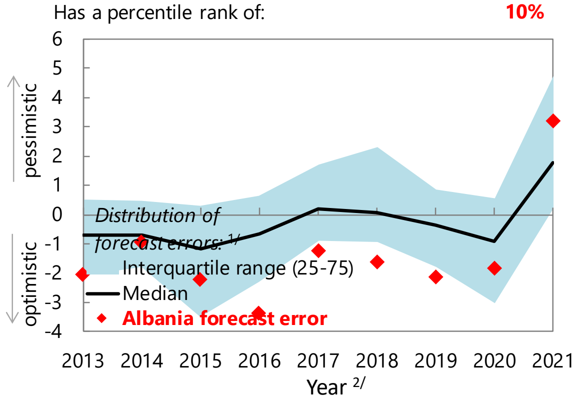
Real GDP Growth
(in percent, actual-projection)
Albania median forecast error, 2013-2021: **-0.48**
Has a percentile rank of: **44%**



Primary Balance
(in percent of GDP, actual-projection)
Albania median forecast error, 2013-2021: **-0.13**
Has a percentile rank of: **61%**

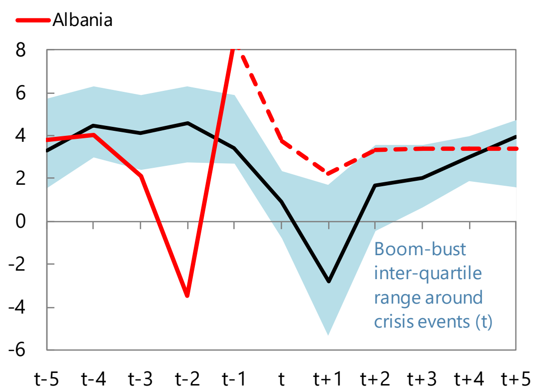


Inflation (Deflator)
(in percent, actual-projection)
Albania median forecast error, 2013-2021: **-1.82**
Has a percentile rank of: **10%**



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



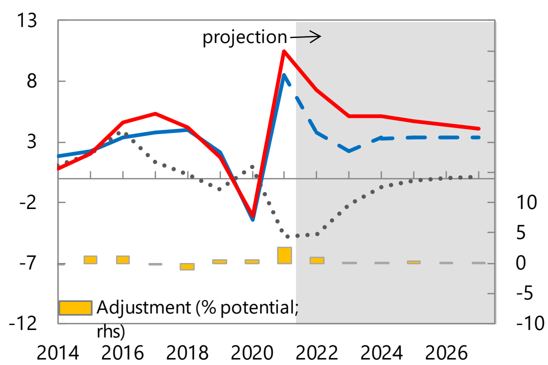
Source : IMF staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries
2/ Projections made in the spring WEO vintage of the preceding year
3/ Albania has had a positive output gap for 3 consecutive years, 2019-2021. For Albania, t corresponds to 2022; for the distribution, t corresponds to the first year of the crisis.

Annex III. Figure 4. Albania: Public DSA - Realism of Baseline Assumptions (concluded)

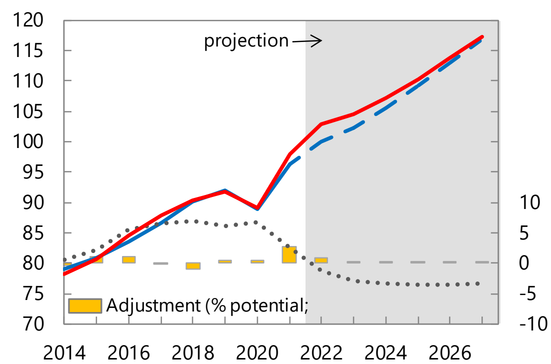
Growth and Level of Output in Absence of Fiscal Adjustment

Assumed multiplier of 1, persistence of 0.6

Real GDP Growth
(in percent)

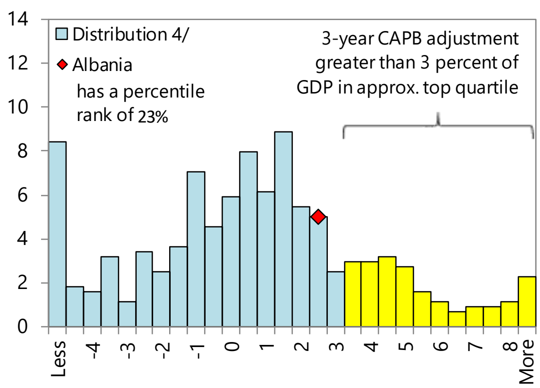


Real Output Level
(Baseline real output in 2022=100)

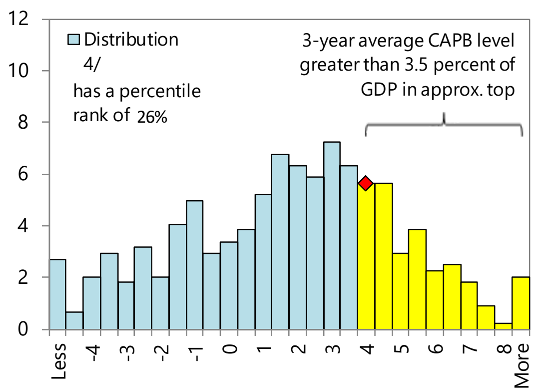


Assessing the Realism of Projected Fiscal Adjustment

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



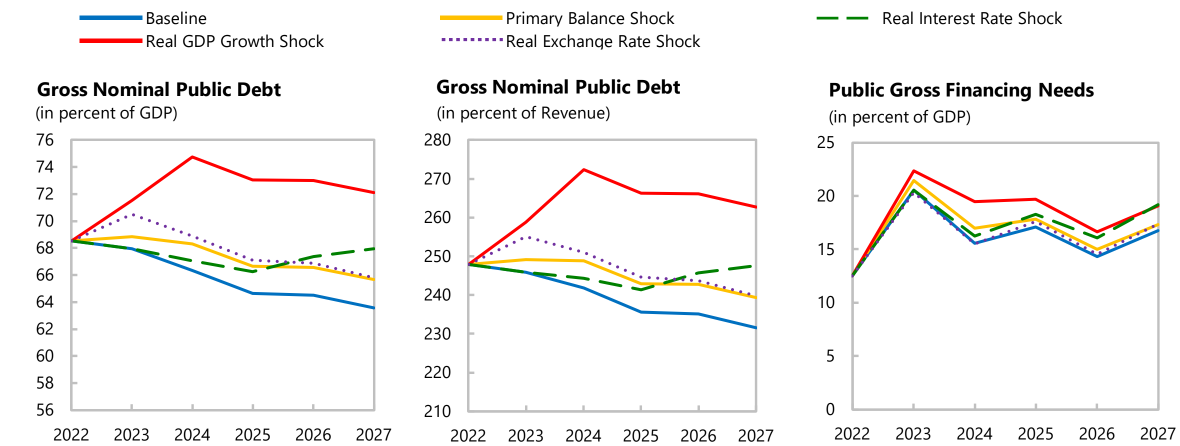
3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



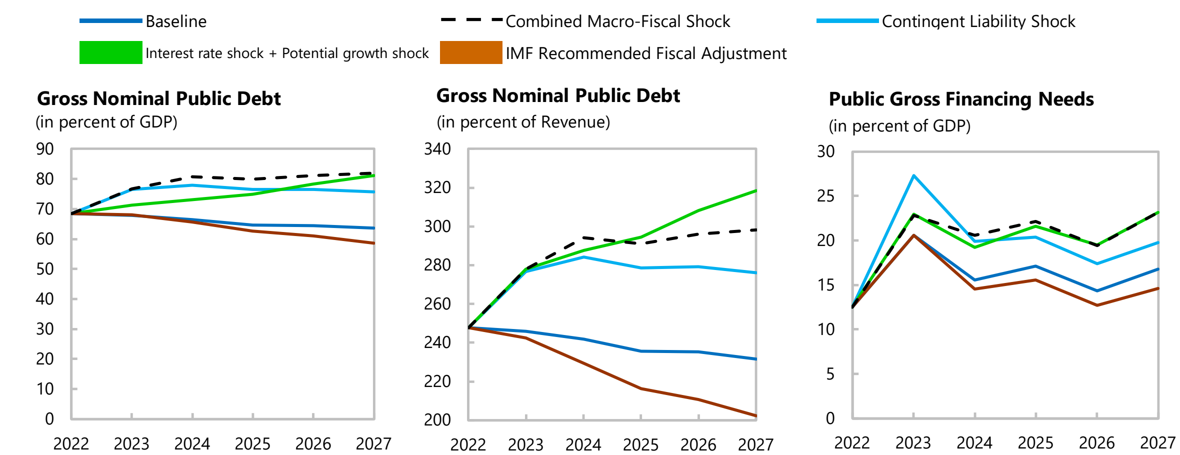
Source : IMF staff.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex III. Figure 5. Albania: Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	3.7	2.2	3.3	3.4	3.4	3.4
Inflation	6.0	3.4	2.2	1.9	1.8	1.8
Primary balance	-1.3	-0.9	-0.7	0.3	0.3	0.3
Effective interest rate	1.6	4.3	4.8	5.1	5.1	5.2
Real Interest Rate Shock						
Real GDP growth	3.7	2.2	3.3	3.4	3.4	3.4
Inflation	6.0	3.4	2.2	1.9	1.8	1.8
Primary balance	-1.3	0.0	0.3	0.3	0.3	0.3
Effective interest rate	1.6	4.3	5.7	6.5	7.2	7.5
Combined Shock						
Real GDP growth	3.7	-0.7	0.3	3.4	3.4	3.4
Inflation	6.0	2.7	1.4	1.9	1.8	1.8
Primary balance	-1.3	-1.0	-1.8	0.3	0.3	0.3
Effective interest rate	1.6	4.5	5.6	6.4	7.0	7.4

Real GDP Growth Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	3.7	-0.7	0.3	3.4	3.4	3.4
Inflation	6.0	2.7	1.4	1.9	1.8	1.8
Primary balance	-1.3	-1.0	-1.8	0.3	0.3	0.3
Effective interest rate	1.6	4.3	4.8	5.2	5.2	5.2
Real Exchange Rate Shock						
Real GDP growth	3.7	2.2	3.3	3.4	3.4	3.4
Inflation	6.0	7.1	2.2	1.9	1.8	1.8
Primary balance	-1.3	0.0	0.3	0.3	0.3	0.3
Effective interest rate	1.6	4.5	4.6	4.9	4.9	5.0
Contingent Liability Shock						
Real GDP growth	3.7	-0.7	0.3	3.4	3.4	3.4
Inflation	6.0	2.7	1.4	1.9	1.8	1.8
Primary balance	-1.3	-5.7	0.3	0.3	0.3	0.3
Effective interest rate	1.6	4.6	5.2	5.4	5.4	5.4
IMF Recommended Fiscal Adjustment						
Real GDP growth	3.7	2.2	2.7	3.6	4.6	4.6
Inflation	6.0	3.4	2.2	1.9	1.8	1.8
Primary balance	-1.3	0.0	1.5	1.5	1.0	1.0
Effective interest rate	1.6	4.3	4.7	5.0	4.9	5.0

Source: IMF staff.

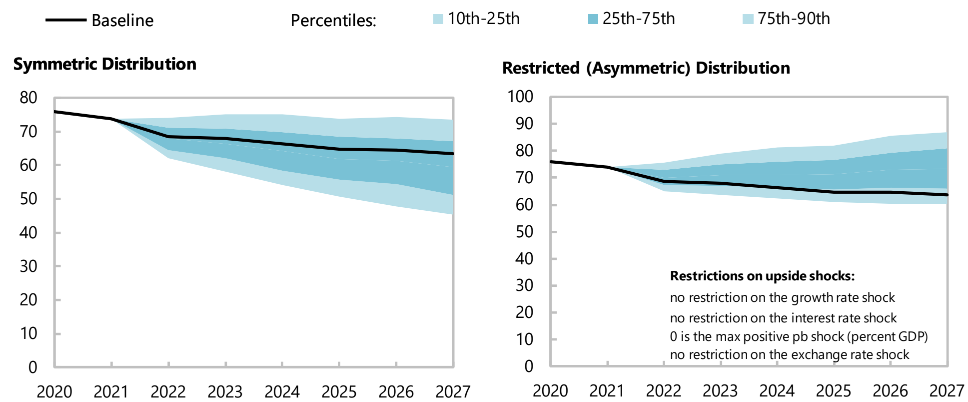
Annex III. Figure 6. Albania: Public DSA Risk Assessment

Heat Map

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

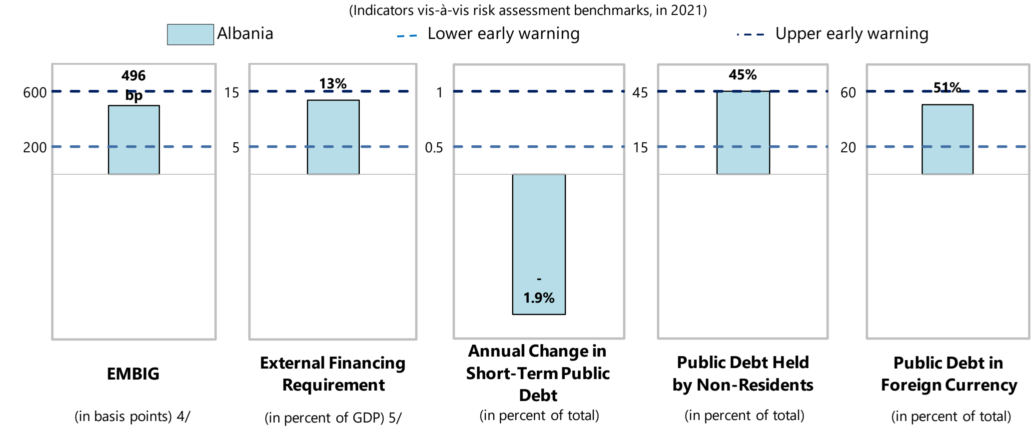
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2021)



Source: IMF staff.

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

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

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

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

4/ EMBIG, an average over the last 3 months, 19-Jul-22 through 17-Oct-22.

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

Annex III. Table 1. Albania: External Debt Sustainability Framework, 2017–2027

(Percent of GDP, unless stated otherwise)

	Actual							Projections						
	2017	2018	2019	2020	2021			2022	2023	2024	2025	2026	2027	
Baseline: External debt	68.8	65.1	60.0	64.3	63.1			**57.9**	**57.9**	**55.6**	**55.5**	**57.3**	**57.1**	
Change in external debt	-4.8	-3.7	-5.2	4.4	-1.3			-5.2	0.0	-2.2	-0.1	1.8	-0.2	
Identified external debt-creating flows (4+8+9)	-8.7	-11.4	0.0	2.4	-10.3			0.1	-0.4	0.1	-1.4	-2.4	-0.6	
Current account deficit, excluding interest payments	6.7	5.9	6.8	7.8	6.9			7.1	7.1	7.0	7.0	7.1	7.1	
Deficit in balance of goods and services	15.1	13.7	13.6	14.5	13.3			13.7	14.1	13.9	13.8	13.7	13.7	
Exports	31.6	31.6	31.3	22.7	30.6			34.1	33.6	33.3	33.0	33.0	33.0	
Imports	46.7	45.4	44.9	37.3	43.9			47.7	47.8	47.2	46.8	46.7	46.7	
Net non-debt creating capital inflows (negative)	-9.5	-8.6	-6.5	-7.2	-6.9			-5.3	-6.8	-5.6	-7.1	-8.1	-6.2	
Automatic debt dynamics 1/	-6.0	-8.7	-0.2	1.8	-10.3			-1.7	-0.6	-1.2	-1.3	-1.4	-1.5	
Contribution from nominal interest rate	0.7	0.9	0.8	0.9	0.8			0.7	0.6	0.6	0.5	0.4	0.4	
Contribution from real GDP growth	-2.5	-2.4	-1.3	2.1	-4.5			-2.4	-1.3	-1.8	-1.8	-1.8	-1.8	
Contribution from price and exchange rate changes 2/	-4.2	-7.2	0.3	-1.2	-6.5			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.9	7.7	-5.2	2.0	9.1			-5.2	0.3	-2.4	1.2	4.2	0.4	
External debt-to-exports ratio (in percent)	217.6	205.8	191.6	283.1	206.3			170.0	172.2	167.1	168.0	173.6	173.1	
Gross external financing need (in billions of US dollars) 4/	3.0	3.6	2.3	2.7	2.7			2.9	3.3	3.2	3.9	3.6	4.5	
in percent of GDP	23.0	23.8	14.9	17.7	14.6	10-Year	10-Year	16.0	17.5	16.4	18.8	16.3	19.2	
Scenario with key variables at their historical averages 5/								**57.9**	**56.5**	**53.7**	**54.7**	**58.7**	**58.8**	
						Historical	Standard							For debt
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							stabilization
Real GDP growth (in percent)	3.8	4.0	2.1	-3.5	8.5	2.5	3.0	3.7	2.2	3.3	3.4	3.4	3.4	
GDP deflator in US dollars (change in percent)	6.0	11.6	-0.5	2.0	11.3	1.4	8.0	-3.5	-0.4	2.0	2.1	2.2	2.1	
Nominal external interest rate (in percent)	1.1	1.5	1.3	1.5	1.5	1.6	0.7	1.1	1.1	1.1	1.0	0.8	0.7	
Growth of exports (US dollar terms, in percent)	19.9	16.2	0.5	-28.5	62.5	6.4	24.5	11.5	0.5	4.4	4.8	5.6	5.5	
Growth of imports (US dollar terms, in percent)	12.0	12.8	0.5	-18.3	42.1	3.2	18.0	9.0	1.9	4.1	4.8	5.4	5.5	
Current account balance, excluding interest payments	-6.7	-5.9	-6.8	-7.8	-6.9	-7.5	1.2	-7.1	-7.1	-7.0	-7.0	-7.1	-7.1	
Net non-debt creating capital inflows	9.5	8.6	6.5	7.2	6.9	7.7	1.3	5.3	6.8	5.6	7.1	8.1	6.2	

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

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

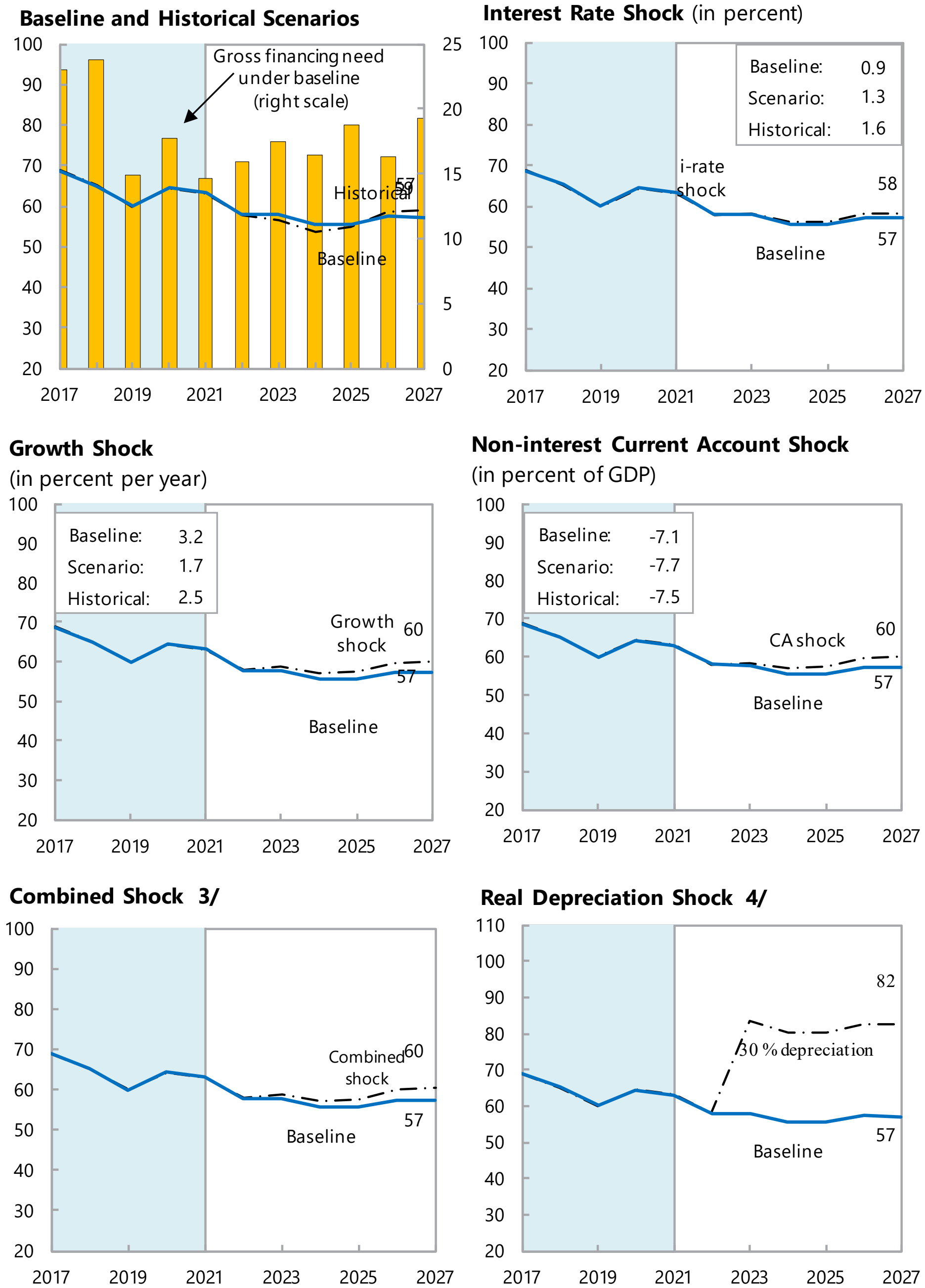
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

Annex III. Figure 7. Albania: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



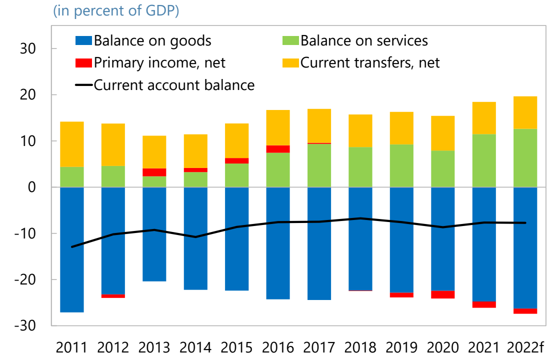
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2020.

Annex IV. External Sector Assessment

The external position of Albania in 2021 was moderately weaker than the level implied by medium-term fundamentals and desirable policies. The EBA-Lite CA-model results indicate a current account gap of -1.8 percent of GDP, implying a REER overvaluation of 7.3 percent. The current account deficit narrowed in 2021 compared to 2020, mainly due to a strong rebound in the services balance. Significant external financing needs, increasing share of commercial financing in the overall external debt, a large negative NIIP, and tighter global financial conditions pose risks. These risks are mitigated by the predominance of FDI flows, an adequate foreign reserve coverage, and a still large share of official financing. The reduction of external imbalances will hinge on efforts to increase domestic saving, particularly fiscal consolidation. Furthermore, Albania's investment climate remains burdened by structural weaknesses, including governance concerns, infrastructure gaps, and skill shortages that hamper a transition to export-led growth.

1. **Albania's current account position improved in 2021.** The current account deficit decreased to 7.7 percent of GDP, driven by a significantly improved services balance, which in turn was lifted by a strong rebound in tourism inflows as Albania removed most of its pandemic-related restrictions while outbound tourism continued to be limited by other countries' restrictions. The improvement in the services account more than offset a significant deterioration in the trade balance as increased construction activity—including earthquake reconstruction—and stronger private demand buoyed by a strong economic rebound and increased goods imports. Despite a negative terms of trade shock, the current account balance is expected to remain broadly stable in 2022, supported by a robust rebound in tourism inflows.

Albania: Current Account Balance
(in percent of GDP)

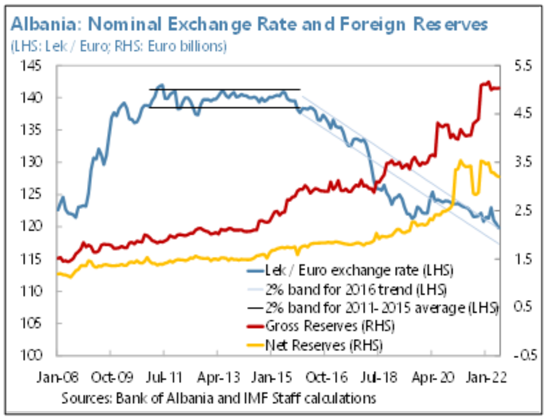


Sources: Bank of Albania and IMF staff calculations

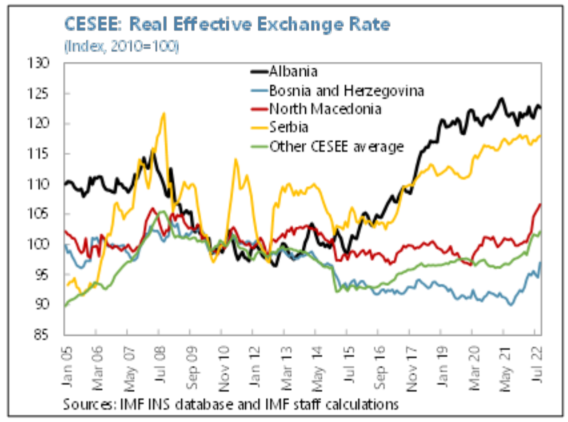
2. **Over the medium term, the current account balance is expected to improve gradually** as: (i) imports generated by spending on earthquake reconstruction and public investment decline as projects are completed; and (ii) in the medium term, net tourism inflows and an expansion of domestic energy production are expected to lead to increased exports. However, Albania's reliance on hydropower and dependence on tourism, remittances, and Italy and Greece as export destinations make the current account vulnerable to external shocks, including weather-related shocks.

3. **The REER remained broadly stable in 2021.** Since the end of 2017, the CPI-based REER had appreciated by about 12 percent, reflecting price differentials vis-à-vis trading partners and a pronounced appreciation of the nominal exchange rate. The latter has been supported by long-term factors, such as robust FDI flows. In the first quarter of 2021, the REER started to appreciate as the effects of the pandemic subsided and tourism inflows recovered, and by the end of the year had

stabilized around the level recorded just before the outbreak of the pandemic. The outbreak of the war in Ukraine saw a temporary downward pressure on the lek in March 2022 amid a sharp rise in international commodity prices but a modest FX intervention by the Bank of Albania managed to calm market sentiment.



Albania: Nominal Exchange Rate and Foreign Reserves
(LHS: Lek / Euro; RHS: Euro billions)
Sources: Bank of Albania and IMF Staff calculations



CESEE: Real Effective Exchange Rate
(Index, 2010=100)
Sources: IMF INS database and IMF staff calculations

4. The deterioration in the net international investment position (NIIP) in 2020 in the wake of the outbreak of the pandemic was largely reversed in 2021. The NIIP has strengthened to about -50 percent of GDP at end-2021 from -54 percent of GDP at end-2020, driven by higher external lending by commercial banks and a larger nominal GDP buoyed by higher prices. Foreign liabilities stood at about 112 percent of GDP, with around half of this stock consisting of stable direct investment liabilities and over 60 percent of the other liabilities comprising long-term public debt. The end-2021 NIIP marked a slight deterioration since 2017, and the profile of liabilities is subject to interest rate and exchange rate risks over the medium term as the authorities plan to regularly tap external commercial borrowings.

5. The external position in 2021 is assessed to be moderately weaker than the level implied by medium-term fundamentals and desirable policy settings. Under the EBA-Lite Current Account approach, the multilaterally consistent cyclically adjusted CA norm in 2021 is estimated at -5.9 percent of GDP and the cyclically adjusted CA balance is -7.7 percent. The estimated CA gap of -1.8 percent of GDP suggests a REER that is overvalued by 7.3 percent. The results of the REER model suggest a REER overvaluation of 16.7 percent.

Albania: EBA-lite Model Results, 2021 (in percent of GDP)

	CA model 1/	REER model
	(in percent of GDP)	
CA-Actual	**-7.7**	
Cyclical contributions (from model) (-)	-0.2	
COVID-19 adjustor (-)	0.5	
Natural disasters and conflicts (-)	-0.2	
Adjusted CA	**-7.7**	
CA Norm (from model) 2/	**-5.9**	
Adjustments to the norm (-)	0.0	
Adjusted CA Norm	**-5.9**	
CA Gap	**-1.8**	**-4.2**
o/w Relative policy gap	3.9	
Elasticity	-0.25	
REER Gap (in percent)	**7.3**	**16.7**

1/ Based on the EBA-lite 3.0 methodology
2/ Cyclically adjusted, including multilateral consistency adjustments.

6. Albania's relatively robust foreign reserve coverage can help mitigate risks as global financial conditions tighten. Albania's external financing needs are large at 22 percent of GDP in 2021 of which almost 75 percent are banks' currency and deposits liabilities. Gross FX reserves were 32 percent of GDP and 201 percent of the ARA metric at end-2021. However, gross FX reserves include large FX deposits held at the BoA by commercial banks, which cannot be used for other

balance of payments purposes. Excluding commercial banks' FX reserves, gross reserves stood at 28 percent of GDP and 173 percent of the ARA metric at end-2021. While this level is above the 150 percent upper threshold for floating regimes, the higher level is appropriate, given Albania's vulnerability to shocks, the sensitivity of public debt and private balance sheets (with sizable unhedged FX loans) to depreciations, risks associated with euroization, and the structurally high fiscal financing needs. Albania's ability to continue to attract new FDI flows and roll over commercial external debt will be increasingly important for external sustainability and growth. The three successive shocks in recent years—the 2019 earthquake, COVID-19 pandemic, and Russia's war in Ukraine—have further underlined the urgency of rebuilding eroded fiscal policy buffers and progressing steadfastly with reforms to improve Albania's competitiveness and economic resilience during the recovery phase.

7. Authorities' views: The authorities broadly agreed with the staff's assessment of the external position of Albania in 2021 as well as the assessment of the exchange rate. However, they also argued that confidence in Albania's long-term potential has been gradually improving over time and this is likely reflected, at least in part, in the exchange rate. They agree that foreign reserves provide adequate buffers while acknowledging Albania's vulnerability to shocks, and the need for fiscal consolidation and structural reforms to increase competitiveness.

Annex V. An Illustrative Adverse Scenario

1. Given the significant outlook uncertainty, this illustrative adverse scenario considers the impact of downside risks, should they materialize. The baseline scenario assumes economic growth to continue in 2022 with growth slowing in 2023 before trending towards long-term potential growth from 2024 onwards. The adverse scenario considers disorderly or larger-than-expected tightening in global financial conditions, which cut off access to international capital markets by emerging markets, and Russia's protracted war in Ukraine and complete gas shut-off with worse-than-expected implications for commodity prices, inflation, and growth in Europe.

2. Under the adverse scenario, public debt is expected to increase in 2023–24, reserves would decline sharply, pressures for exchange rate depreciation would mount, and Albania would be faced with fiscal and external financing gaps from 2023 onwards.

Albania: Adverse Scenario, 2022-2024

(Percent of GDP, unless otherwise specified)

	Baseline			Adverse scenario		
	2022	2023	2024	2022	2023	2024
Real Sector						
GDP growth (percent)	3.7	2.2	3.3	3.7	0.0	0.5
Consumer Price Index (avg.)	7.0	5.4	3.4	7.0	6.5	5.0
Balance of Payments						
Current Account Balance	-7.8	-7.7	-7.6	-7.8	-8.8	-8.2
Capital Account Balance	0.5	0.5	0.6	0.5	0.5	0.6
Financial Account Balance (- = inflow)	-7.8	-8.8	-6.0	-7.8	-4.1	-5.9
BOP Financing Gap (+ = gap)	0.0	0.0	0.0	0.0	0.7	1.3
Reserves (million Euro)	5,061	5,351	5,163	5,061	3,881	3,356
In months of imports	7.0	7.1	6.6	7.0	5.3	4.3
In percent of ARA EM Metric	193	192	182	193	144	123
Reserves excluding banks' FX reserves (million Euro)	4,279	4,531	4,308	4,279	3,297	2,581
In months of imports	6.2	6.2	5.7	6.2	4.6	3.5
In percent of ARA EM Metric	163	163	151	163	122	95
Fiscal Sector						
Tax Revenue	26.0	25.9	25.8	26.0	25.0	25.0
Expenditure	30.9	30.3	30.0	30.9	31.6	31.8
Fiscal balance	-3.3	-2.7	-2.5	-3.3	-4.9	-5.2
Primary balance	-1.3	0.0	0.3	-1.3	-1.8	-1.7
Fiscal Financing Gap	0.0	0.0	0.0	0.0	1.4	2.6
Public debt	68.5	67.9	66.4	68.5	75.5	78.8
Eurobond	0.0	2.7	0.0	0.0	0.0	0.0

Source: IMF Staff calculations.

- **Growth**. Higher commodity prices and sustained inflationary pressures as well as tighter global financial conditions weigh down on growth. Real GDP growth in 2023–24 will be considerably weaker. Pressures generated by drastically tighter global financial conditions and increased risk

aversion vis-à-vis emerging market countries could be expected to result in a considerable nominal exchange rate depreciation.

- **External.** The current account would deteriorate amid lower exports of goods and tourism receipts. The adverse scenario assumes significant pressures on the financial account, with Albania being cut off from market access and experiencing capital outflows. Reserves are expected to decline substantially to finance deteriorating balance of payments. External financing gaps are expected to emerge unless additional IMF or other external financing is mobilized.

- **Fiscal.** With weaker growth and persistently higher inflation, the overall fiscal balance would worsen significantly as revenues decline and spending increases. With Albania being cut off from international capital markets, the adverse scenario assumes no Eurobond issuance during 2023–24 as well as a larger drawdown of liquidity buffers. Consequently, in the absence of additional IMF or other external financing, Albania could face a fiscal financing gap for 2023–24 even if the government were able to obtain higher domestic financing relative to the baseline. Lower growth, higher deficits, and larger nominal exchange rate depreciation would raise the public debt to close to 80 percent of GDP in 2024.

3. Policy options. With the expected deterioration of Albania's twin deficits in the event of a worsened war in Ukraine, a complete Russian gas shut-off, and drastically tighter global financial conditions, contingent policy options could include:

- Further monetary tightening to rein in inflation and anchor inflationary expectations; Keeping domestic financial system functional and liquid.

- Letting automatic stabilizers operate and targeting additional fiscal support to protect the vulnerable. Where needed, budgetary resources should be reallocated. Additional official financing should be considered.

- Retaining a flexible exchange rate as a shock absorber. Foreign exchange interventions should be used only in the face of disorderly market conditions and to mitigate the impact of large depreciations on balance sheets; and

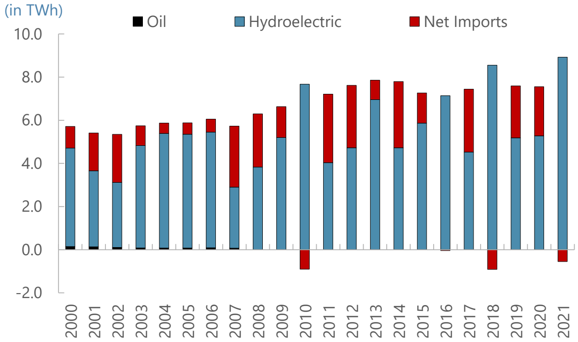
- Strengthening the monitoring and management of financial risks to ensure early detection of vulnerabilities. In case of heightened balance of payments pressures and financial stability concerns, the authorities need to stand ready to take further actions to avoid excessive monetary tightening that will stifle growth and to preserve macroeconomic and financial stability.

Annex VI. Albania's Electricity Sector[1]

Albania's electricity production relies almost entirely on rainfall patterns, threatening energy security and affecting growth and fiscal sustainability. Significant reforms in the electricity sector and investments in other renewable energies are needed to bring the sector into a sustainable footing, reduce fiscal risks, and adapt to climate change.

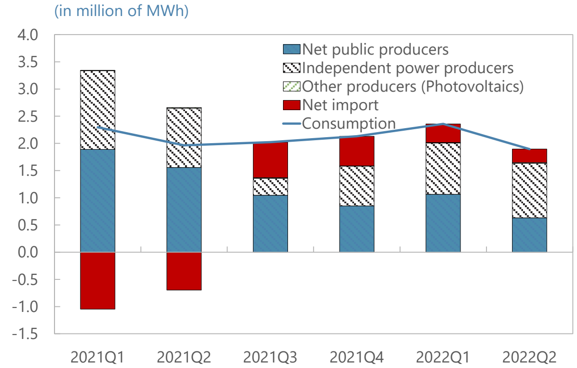
1. **Domestic electricity generation is almost entirely based on hydropower, which makes Albania one of the countries with the lowest carbon intensity in the world,[2] but also highly vulnerable to rainfall patterns.** More than 99 percent of electricity in Albania is produced by hydropower stations (of which 60 percent by state-owned hydropower plants). However, due to limited storage capacity,[3] Albania's electricity trade balance is affected by the pattern of rainfall. In good years, Albania is able to export electricity and the sector contributes up to 1 pp to GDP growth; in adverse years, when electricity imports are necessary, the sector can reduce GDP growth by 1 pp. The increased intensity in precipitation in wet months and prolonged dry periods create mismatches in hydropower generation (given the lack of storage capacity), which are expected to be aggravated with climate change (see the accompanying Selected Issues Paper). On average, Albania imports 20 percent of its electricity needs, with large variability within and across the years. During winter 2021, the authorities had to call for emergency energy-saving measures due to low reservoir levels. While large blackouts were avoided, Albania had to import almost half of its electricity consumption at a very high cost.

Albania : Electricity Consumption by origin
(in TWh)



Note: A negative value of net imports corresponds to net exports.
Source: Instat, Ministry of Finance, Staff calculations.

Albania: Balance of Electric Power
(in million of MWh)



Source: Instat

[1] Prepared by Linda Spahia with inputs from Magali Pinat.

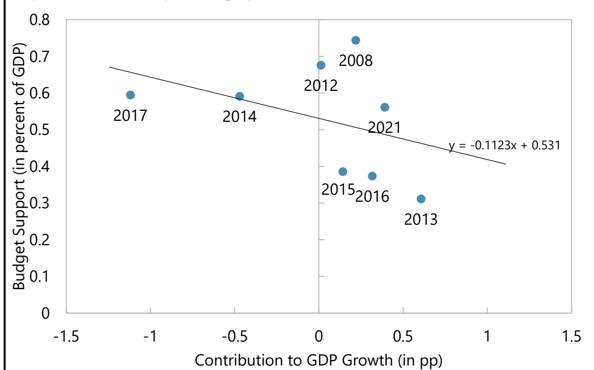
[2] Carbon intensity measures the amount of greenhouse gases emitted per unit of electricity produced.

[3] Large hydropower plants have reservoirs that have maximum security levels beyond which they cannot store water, while many of the small hydropower plants operate downstream and cannot store electricity.

Albania: Fiscal Support to the Energy Sector (Mn LEK)					
	2018	2019	2020	2021	2022*
Transfer					20,000
On lending	4,698.0	4,142.0	3,172.0	3,903.0	1,907
Loans					8,000
Other forms (servicing guaranteed debt)	2,624.0	2,011.0	2,069.0	1,504.0	1,978
Total budgetary support	**7,322.0**	**6,153.0**	**5,241.0**	**5,407.0**	**31,885**
Energy sector guarantees (debt stock)	22,321	19,663	28,609	25,336	29,893
Tax arrears	2,036.3	670.9	0.1	97.3	5.8
	Percent of GDP				
Transfer	-	-	-	-	1.0
On lending	0.3	0.2	0.2	0.2	0.1
Loans	-	-	-	-	0.4
Other forms (servicing guaranteed debt)	0.2	0.1	0.1	0.1	0.1
Total budgetary support	**0.4**	**0.4**	**0.3**	**0.3**	**1.5**
Energy sector guarantees (debt stock)	1.4	1.2	1.7	1.3	1.4
Tax arrears	0.1	0.0	0.0	0.0	0.0

* 2022 figures refer to the first 6 months of the year, apart from transfers and loans which are budgeted amounts

Albania: Fiscal Support and Contribution to Growth in Electricity Sector
(in percent of GDP; in percentage point)



Sources: Instat, Ministry of Finance, and IMF staff calculations

2. Delays in raising tariffs to cost-recovery levels for non-households consumers, insufficient investment, and inefficient management have made the sector financially vulnerable and dependent on fiscal support. On average, direct transfers and indirect budget support for electricity sector SOEs (through loans or sovereign guarantees) was 0.4 percent of GDP per year during the last decade. In 2022, the sharp rise in energy prices led the government to provide a record-high budget support of 1.3 percent of GDP for the electricity sector. The support aimed to prevent the pass-through of higher import prices to the regulated market covering households and most small businesses that are supplied by low-voltage electricity. However, the government acknowledged that if prices remain elevated or rise further in 2023, some tariff adjustments will have to take place.

3. Despite some progress made in recent years, the authorities need to reinvigorate reforms to bring the electricity sector to financial viability. Key reforms include:

- *Strengthening hydro reservoir management as well as hydrological risk management.* The increase in the intensity of rainfalls in wet season and the prolongation of the dry season poses challenges in storing water reserves beyond the dams' safety levels, underlining the need for improved hydro reservoir management. High rainfall also increases generation and export at a time of low demand and prices in foreign markets, while increasing import needs in dry months, when the whole region needs more electricity. Establishing a hydrological risk management financing facility could mitigate the risk from high electricity import prices. The concept of the facility was developed by the World Bank in 2019.

- *Operationalize the power exchange.* The power exchange which is expected to start in 2023 will provide a competitive and transparent indicator for market prices and access for all market players (including small independent power producers and liberalized consumers) and enable the generation company to use the contract for difference mechanism.

- *Gradually adjust tariffs to cover costs, accompanied by targeted support to the poor and vulnerable*. Regulated tariffs have not been changed since 2015. The tariff methodology could be improved to allow for temporary surcharges when the energy mix (import and domestic generation) is unfavorable, while providing targeted support for the vulnerable. The government is considering charging market tariffs for consumption beyond a certain level that would ensure basic energy needs are covered within the band of the regulated tariff. However, this option, also used in the past, carries risks of abuse, especially in the absence of smart metering. Long-standing plans to install smart metering should be implemented.

- *Strengthening corporate governance of the electricity SOEs and reduce distribution losses.* A financial recovery plan for the electricity sector utilities was developed in 2015 with assistance from the World Bank. It aimed at reducing the level of losses in the grid (electricity supplied and not paid for), improving bill collection rates, and capital investments aimed at improving the system's efficiency and turning companies into a positive operating cash-flow. Despite improvements in loss and collection rates, recent shocks have imposed a heavy financial burden on SOEs, making direct budget support necessary for operations. The authorities could prepare a new financial recovery plan, which will inform the key parameters for electricity SOEs.

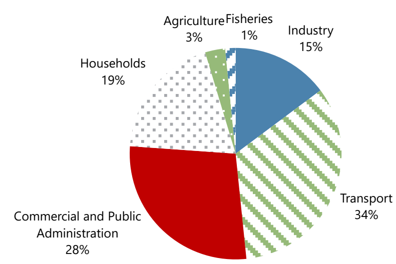
- *Bringing medium-voltage consumers to the liberalized market*. High voltage electricity consumers already buy electricity in the liberalized market, but medium-voltage consumers—typically businesses with intensive electricity use accounting for around 12 percent of total consumption—continue to be serviced by the universal public supplier (with at cost-tariffs). Only households should remain in the regulated market, for which there is sufficient domestic generation to meet their consumption needs.

- *In the long-term more investment in other green energy sources to diversify generation sources are needed.*[4] Albania has already started investing in solar energy, but to date its share in domestic generation is negligible. Gasification plans could also help diversify the domestic generation sources, complementing hydro-reliant generation (*see Box A1*).

Annex VI. Box A1. Albania's Energy Consumption

Reflecting a low level of industrialization, energy use per capita in Albania is among the lowest in Europe. In 2019, energy consumption per capita was at 0.8 ton of oil equivalent, only one fifth of the EU average and 50 percent of the world average. The economy is dominated by consumption and services, and most of the energy consumption is concentrated in transport and residential uses. The collapse of heavy industries in the 90s has reduced the energy intensity of the industry sector. Despite contributing to one-fifth of GDP, the agriculture sector has a very limited share in energy consumption due to its low level of mechanization.

Albania: Energy consumption by sectors, 2019
(Share of total consumption)



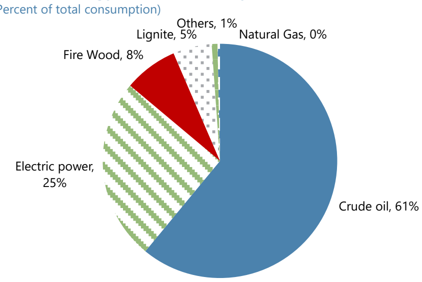
Sources: Instat

[4] Albania produces heavy crude oil, which is almost wholly exported due to lack of capacity to refine, while domestic demand for oil is met mostly by imports.

Annex VI. Box A1. Albania's Energy Consumption (concluded)

Oil and electricity are the main source of energy, while the consumption of natural gas is almost null. Albania does not use natural gas either for industrial processes or for central heating. A major gas pipeline project completed in 2020, the Trans-Adriatic Pipeline (TAP) that will bring gas from Azerbaijan to Italy, transits through Albania, but the country's lack of a gas network limits immediate benefits and opportunities from a diversified source of energy. However, in 2021, the government retroactively negotiated an exit point in Albania, which could help with energy diversification sources in the future.

Albania: Energy Consumption by Product, 2019
(Percent of total consumption)



Sources: Instat

Annex VII. Informality in Albania and Policy Responses[1]

1. **The estimated size of the informal sector in Albania is well above the EU average and at the upper end of the Western Balkan countries (WBCs) in terms of employment.** Informal employment includes undeclared work and income that would add to GDP and tax revenues if they were reported. Envelope wages make up a significant share of informal employment, whereby a lower wage is officially reported to minimize tax and social security payments while the remaining wage is informally paid, usually in cash, hidden from the state. The European Commission estimates the size of the informal sector including agriculture in Albania at 30–35 percent of GDP and employment,[2] while the ILO estimates that as much as 56.7 percent of total employment (including in the agricultural sector) may be informal in Albania.[3] Based on the Labor Force Survey of 2020–2021, INSTAT, the Albanian State Statistics Institute, estimates that there is 29.4 percent of informal employment in non-agricultural sectors.[4] The government's draft Medium-Term Revenue Strategy (MTRS) for 2022-2026 assumes 39 percent of informal employees and 29 percent of employees who under-declare salary as a baseline for 2019.[5] In terms of GDP, the IMF estimates that the informal economy amounted to 27.2 percent of GDP in 2019.[6]

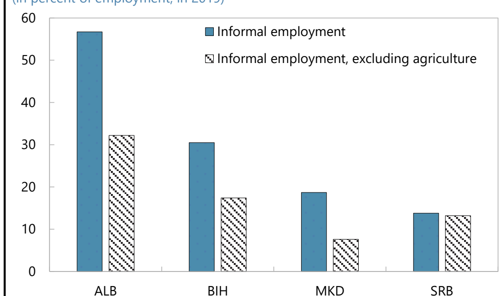
Western Balkans: Informality, 2019

Country	Informal employment in percent of total employment	Informal sector in percent of GDP
Kosovo	>35	30-35
Albania	30-35	30-35
Bosnia and Herzegovina	30-35	30-35
Montenegro	30-35	30-35
Serbia	20	23-30
North Macedonia	<20	20-40
EU average	**17**	**23**

Sources: European Commission, World Bank, ILO, and IMF staff calculations.

Informal Employment Estimates

(in percent of employment; in 2019)



Source: Overview of the informal economy in Albania, Bosnia and Herzegovina, North Macedonia, Serbia, Labor force surveys 2019, ILO.

[1] Prepared by Amanda Edwards.

[2] Western Balkans Regular Economic Report No. 19; 2021, World Bank. Economic Reform Programs of Albania, Montenegro, North Macedonia, Serbia, Turkey, Bosnia and Herzegovina, and Kosovo; Institutional Paper 107; 2019, European Commission.

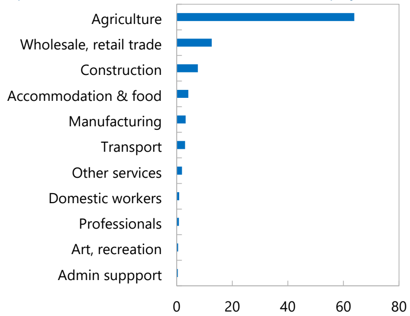
[3] Overview of the informal economy in Albania; 2020, ILO.

[4] Labor Market 2021; 2022, INSTAT, Albania Institute of Statistics.

[5] MediumTerm Revenue Strategy 2022–2026, Draft for Consultation; 2022, Republic of Albania, Ministry of Finance and Economy. Assessment of Corruption and Hidden Economy in Southeast Europe; 2016, Southeast European Leadership for Development and Integrity.

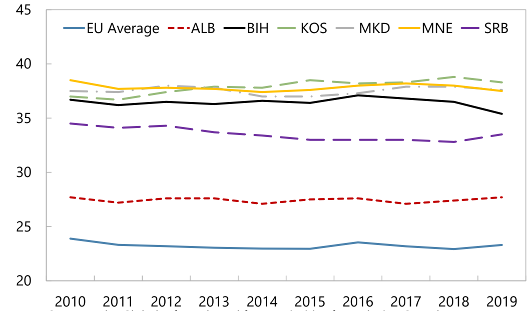
[6] The Global Informal Workforce: Priorities for Inclusive Growth; 2021, International Monetary Fund.

Albania: Sectors with Highest Informality, 2019
(in percent; share of each sector in total informal employment)



Source: Overview of the informal economy in Albania, ILO.

Informal Economy Estimates, 2010-2019
(in percent of GDP)



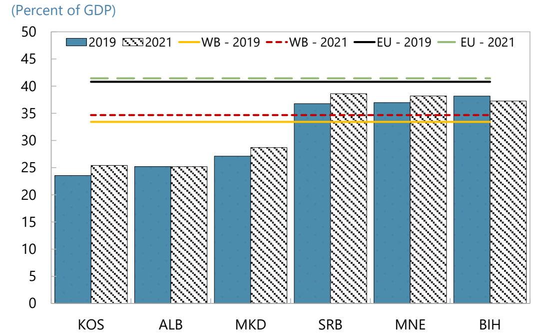
Sources: The Global Informal Workforce, Priorities for Inclusive Growth, and IMF staff calculations.

2. The drivers of high informality in Albania and the other WBCs include perceived corruption and a lack of trust in official institutions, society's acceptance of informality, weak enforcement, burdensome tax administration, and the prevalence of cash-based transactions. According to a survey from 2016, 72.9 percent of businesses in Albania saw corruption as the most important factor in the existence of the hidden economy, while the equivalent figures for North Macedonia and Kosovo were 45.7 percent and 48.6 percent, respectively.[7] The tax administration was also cited as a major burden by 29 percent of respondents that were surveyed in Albania by the World Bank for the 2019 Enterprise Survey, compared to, for instance, 4.6 percent in Serbia, suggesting burdensome tax administration processes in Albania.[8] In addition, cash-based payments, which are more difficult to track than electronic ones and are therefore associated with higher levels of informality, are still very common in Albania.

3. Formalization is a policy priority in Albania and the Western Balkans with three key motivating factors:

- **To create more fiscal room.** Informality reduces the tax base. Albania has been lagging behind regional peers in tax-to-GDP ratios over the last two decades. Low revenues constrain the provision of public goods (such as education, health, and infrastructure) and policies to promote economic growth and development.

Government Revenue: Taxes incl. Social Contributions
(Percent of GDP)



Note: KOS figures don't include mandatory pillar 2 contributions of around 2.7 percent of GDP. EU weighted average doesn't include Latvia, Lithuania, Malta due to data availability.
Sources: IMF WEO July 2022 and IMF staff calculations.

- **To promote fair market competition and higher growth.** Other things being equal, informality puts tax-compliant businesses at a disadvantage. Formalization tends to be associated with greater productivity, as it enables greater economies of scale, due to better access to financing and capital accumulation.

[7] Monitoring the Hidden Economy in Macedonia, Albania and Kosovo; 2018, CRP, IDM and D4D.

[8] Enterprise Surveys; 2019, World Bank.

- **To improve labor conditions, access to the social safety net, and consumer protection.** Informal workers often lack a safe work environment and access to social protection including pensions. During the pandemic, informal workers had less access to government lifelines. Formalization is also associated with greater consumer protection.

4. **The government's draft MTRS for 2022–2026 covers the objective of formalization**. The proposed measures cover a variety of actions, including (i) strengthening the identification of undeclared and under-declared work, including, for example, through the establishment of a taxpayer asset register; (ii) improving the cooperation between the General Directorate of Taxes (GDT), the Social Insurance Institute, and the State Labor Inspectorate; (iii) toughened sanctioning of non-declaration and under-declaration; (iv) delivering public awareness campaigns; and (v) developing partnerships with business representatives. These activities are broadly in line with international good practice. The MTRS also aims to achieve a reduction of cash in circulation and greater use of electronic payments.

5. **The authorities have recently introduced a number of measures to promote formalization.** Recent activities have included increasing access by the tax authority to third-party data. Started in September 2021, the GDT receives reciprocal information about offshore accounts held by Albanian tax residents from 72 foreign jurisdictions. Further, a specialized GDT department with a focus on compliance of high-wealth individuals was recently established, and a successful letter campaign was implemented to address under-declaration of wages by employers. In addition, a fiscalization initiative to provide the GDT with (mandatory) real-time data through an IT system that captures cash register and e-invoice data, is being implemented in phases since 2021 (postponed from 2020).[9] The deadline for small businesses to fiscalize without penalties passed on June 30, 2022. According to the MOFE, large businesses are 100 percent fiscalized, while there are 8,900 small businesses that have not been fiscalized and will be classified as passive as they have no reported turnover.

6. **The Fund's technical assistance on the MTRS has provided recommendations to further improve revenue administration and increase formalization:**

- **In the presence of high informality, the tax system should be based on a relatively small number of taxes with a single or very few tax rates on broad bases.** In this context, it is also important to increase the stability of the tax system by minimizing frequent changes. This facilitates assessment and administration, especially when capacities are limited. While sophisticated tax rules may help to improve efficiency and equity, they are costly to assess and audit for the administration, and to comply with for the taxpayers.

- **Access is needed to a wider range of third-party data, particularly automatic reporting of bank information.** Good progress has been made in increasing the inflow and range of third-party data, such as concerning offshore bank account data for Albanian residents. The GDT needs to continue pressing for a law change to require automatic reporting of key financial

[9] Law No. 87/2019, On Invoice and Circulation Monitoring System.

account information of Albanian residents. Further, automated collection and cross checking of data from financial institutions, shareholders, and real property registers are not in place yet. The recently introduced fiscalization system will be a valuable source of business taxpayers' sales and purchases information for automated cross checking and prefilling when it is fully implemented.

7. **While progress has been made on audit case selection based on risk, too many low-risk cases are audited.** The selection of cases is largely risk-based, but a significant number of cases are still selected due to mandatory audit obligations. However, many of these cases do not necessarily present substantial tax risk. The GDT should review mandatory audit obligations to ensure that there is no obligation to undertake audits unless there is significant tax risk.

8. **An enhanced compliance focus on the large taxpayer segment is essential to ensure that the bulk of the tax revenue is protected and increased.** The amount of tax revenues paid by this taxpayer segment is significant—over 40 percent of total GDT collection. Their business arrangements tend to be more complex than that of smaller businesses and there are increased compliance risks in areas such as international taxation, related party transactions, and tax avoidance. Currently, 50 percent of cases identified for audit are selected by the Large Taxpayer Office (LTO) risk assessment unit with the remainder selected by the HQ risk directorate. However, the LTO risk profiling is not fully tailored to the large taxpayer segment.

- **The level of technical skills and competencies across the GDT workforce must be significantly improved.** This particularly relates to audit, data analytics, debt collection, legislation interpretation, and LTO functions. The GDT also needs greater autonomy to enable it to adjust its organization structure as required to respond to risk and operational needs.

- **Improvements in taxpayer service, simplification of compliance obligations, and GDT communications and guidance on tax legislation and tax procedures to support compliance and build public trust need to be continued.** Progress was made despite the pandemic, including additional online services through the e-Albania portal, but businesses continue to have concerns about the clarity of legislative and procedural guidance. Communication of the increasing capability to detect and deal with non-compliance with fiscalization represents an important deterrent. Awareness campaigns to encourage taxpayers to avoid cash operators and to report non-compliance can also help to support fiscalization.

9. **Furthermore, IMF research suggests the following policy actions to achieve formalization gains, including**:[10] increasing the efficiency and fairness of the justice system; simplifying tax procedures and enhancing monitoring and enforcement; encouraging the completion of secondary, technical, and vocational education; linking taxes to services in order to raise transparency, awareness, and trust; and promoting financial inclusion and electronic payments.

[10] The Global Informal Workforce: Priorities for Inclusive Growth; 2021, International Monetary Fund.