INTERNATIONAL MONETARY FUND

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ALBANIA

December 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ALBANIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with Albania, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its December 4, 2017 consideration of the staff report that concluded the Article IV consultation with Albania.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 4, 2017, following discussions that ended on October 3, 2017, with the officials of Albania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 14, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Albania.

The documents listed below have been or will be separately released.

Selected Issues

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

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December 14, 2017

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IMF Executive Board Concludes 2017 Article IV Consultation with Albania

On December 4th, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the 2017 Article IV Consultation with Albania.[1]

Albania's economy grew by 3.4 percent in 2016 and continues to strengthen, benefitting from rising domestic demand, large energy-related foreign direct investment (FDI), and a recovery in key EU trading partners. The declining output gap and pass-through of higher external inflation have pushed up inflation to just under 2 percent. Overall credit growth remains stagnant as banks continue to clean up their balance sheets. Short-term external vulnerabilities are limited, as the current account deficit is predominantly funded by concessional borrowing and large FDI inflows, while official foreign reserves are ample.

Fiscal and financial vulnerabilities have been lowered over the past four years. However, challenges remain from the high level of public debt and financing needs, non-performing loans, and pervasive institutional weaknesses that hinder investment. The new government's clear mandate following election victory in June, the favorable economic outlook, and the prospects for opening EU accession negotiations provide a window of opportunity to resume implementing the reform agenda. The main policy objectives at the current juncture are to maintain macroeconomic and financial stability, and to deepen structural and institutional reforms to accelerate the pace of convergence.

The medium-term outlook remains favorable. GDP growth is projected to accelerate to around 4 percent, driven by continued strong domestic demand, reforms that improve the business climate, and a strengthening EU recovery. Inflation is expected to edge up toward the 3 percent target as the output gap closes. The current account deficit is expected to narrow, as import-intensive energy projects wind down, the Euro Area continues to recover, and higher non-energy FDI propels export diversification. Risks to the outlook are balanced. On the upside, accelerated

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

donor support as part of the EU accession process could lead to higher investment and a stronger credit recovery. On the downside, volatile domestic politics or shocks to global growth could pose risks to reform implementation and fiscal consolidation.

Executive Board Assessment[2]

The Executive Directors emphasized that the growing economy and the new government's clear electoral mandate provide a good opportunity to continue reform efforts to increase Albania's growth potential, enhance the resilience and competitiveness of the economy, and strengthen the financial system while maintaining fiscal discipline.

Directors supported the need to reduce public debt to build fiscal space and ensure debt sustainability. They recommended that the authorities consider a more ambitious and front-loaded consolidation path. They also emphasized that strengthening fiscal institutions remains key for mitigating fiscal risks and enhancing efficiency. They noted that public debt management should focus on lengthening the maturity of public debt and diversifying the investor base.

Directors underscored the need for higher revenues while refraining from lowering tax rates or granting any new exemptions or preferential tax policies. They supported the tax administration's efforts to improve compliance and welcomed the plan to introduce a value-based property tax.

Directors agreed that it is critical to strengthen public investment management, given the planned scaling-up of investment spending. They urged the authorities to ensure proper implementation of the framework for public-private partnerships in line with international best practices. They also emphasized the need to minimize the recurrence of arrears, including by improving the VAT refund process.

Directors noted that after impressive early gains, reforms in the state-owned electricity sector have been delayed and need to resume. They recommended improving operational efficiency, speeding up financial restructuring, and advancing institutional and market design reforms in the sector.

Directors agreed that the Bank of Albania's accommodative monetary policy stance remains appropriate, and any unwinding of monetary easing should await evidence of a sustained rise in inflation. Directors supported the authorities' de-euroization strategy and stressed the importance of aligning the central bank law with modern central banking legislation.

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

Directors supported the authorities' continued efforts to strengthen financial supervision with a focus on the fastest-growing and systemically important banks. They highlighted the need for continued vigilance and improved crisis preparedness, particularly in light of the increased interconnectedness in the sector. To mitigate risks to banking stability, candidates for new banking licenses should possess adequate banking experience and avoid conflicts of interest. They commended the progress in restructuring the NPLs of large borrowers, including by revising bailiff regulation, implementing the new Bankruptcy Law, and facilitating out-of-court debt restructuring.

Directors agreed that addressing structural impediments to competitiveness remains key for achieving faster growth. They welcomed the progress achieved in structural reform implementation, and stressed the need to further advance institutional reforms in areas such as the judiciary, property rights, and anti-corruption. Directors recommended investing further in vocational training to encourage labor participation, especially among women and youth.

Albania: Basic Indicators and Macroeconomic Framework, 2013–17

	2013	2014	2015	2016	2017 (est.)
Real sector			(Growth rate in percent)		
Real GDP	1.0	1.8	2.2	3.4	3.9
Consumer Price Index (avg.)	1.9	1.6	1.9	1.3	2.1
Consumer Price Index (eop)	1.8	0.7	1.9	2.2	2.3
GDP deflator	0.3	1.5	0.1	-0.2	2.1
Saving-investment balance			(Percent of GDP)		
Foreign savings	9.3	10.8	8.6	7.6	8.0
National savings	17.9	15.9	16.3	15.9	16.2
Public	-0.8	0.6	0.7	1.2	1.2
Private	18.7	15.4	15.6	14.7	15.0
Investment	27.2	26.7	25.0	23.5	24.2
Public	5.1	5.0	4.7	4.6	4.6
Private	22.1	21.7	20.2	18.9	19.6
Fiscal sector			(Percent of GDP)		
Revenues and grants	24.0	26.3	26.4	27.4	28.2
Tax revenue	22.0	24.1	23.9	24.9	25.9
Expenditures	29.2	32.2	31.0	29.6	30.2
Primary	26.0	29.3	28.3	27.2	28.1
Interest	3.2	2.9	2.7	2.5	2.1
Overall balance (excluding arrears payment)	-5.2	-5.9	-4.6	-2.3	-2.0
Primary balance (excluding arrears payment)	-2.0	-3.0	-1.9	0.2	0.1
Net domestic financing	4.4	3.4	-1.3	0.9	-1.7
of which: Privatization receipts	1.2	0.0	0.1	0.2	0.0
Foreign financing	0.8	2.5	5.0	1.3	3.7
Public Debt	70.4	72.0	74.1	73.3	71.5
Domestic	43.4	42.4	39.7	39.0	35.3
of which: Unpaid bills and arrears	4.8	1.9	1.0	0.9	…
External (including publicly guaranteed)	27.0	29.6	34.4	34.3	36.2
Monetary Indicators			(Growth rate in percent)		
Broad money growth	2.3	4.0	1.8	3.9	4.3
Private credit growth	-1.4	2.0	-2.8	0.4	0.9
Velocity	1.2	1.2	1.2	1.2	1.2
Interest rate (3-mth T-bills, end-period)	3.4	3.1	1.5	1.2	…
BoA repo rate (in percent)	3.0	2.3	1.8	1.3	…
External sector			(Percent of GDP, unless otherwise indicated)		
Trade balance (goods and services)	-18.0	-19.0	-17.3	-16.9	-16.5
Current account balance	-9.3	-10.8	-8.6	-7.6	-8.0
Gross international reserves (in billions of Euros)	2.0	2.2	2.9	2.9	2.9
(In months of imports of goods and services)	5.4	5.6	7.6	7.2	6.4
(Relative to external debt service)	4.9	2.9	2.6	3.6	3.1
(In percent of broad money)	24.6	25.7	32.5	31.5	29.5
Change in real exchange rate (eop, in percent)	1.0	2.3	1.5	3.9	…
Memorandum items					
Nominal GDP (in billions of lek)	1350	1395	1428	1473	1562
Output gap (percent, - = gap)	-0.7	-1.2	-1.6	-1.2	-0.6

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

INTERNATIONAL MONETARY FUND

ALBANIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

November 14, 2017

KEY ISSUES

Albania's economy continues to strengthen, benefitting from rising domestic demand, large energy-related FDI, and a recovery in key EU trading partners. Fiscal and financial vulnerabilities have been lowered; however, challenges remain from the high level of public debt and financing needs, non-performing loans (NPLs), and institutional weaknesses that hinder investment. The clear government mandate following election victory in June, the favorable economic outlook, and the prospects for opening negotiation for EU accession provide a window of opportunity to resume implementing the reform agenda. Albania remains under Post-Program Monitoring.

The main policy objectives at the current juncture are to: (i) maintain macroeconomic and financial stability; and (ii) deepen structural reforms to accelerate the pace of convergence. Specifically, the key priorities are to:

- ***Fiscal policy*:** Maintain fiscal discipline and continue revenue-based fiscal adjustment to rebuild room for policy maneuver and reduce public debt levels to below 60 percent of GDP by 2021. Further fiscal structural reforms, namely improved tax administration, public investment and debt management, are crucial to control arrears, reduce fiscal risks, enhance efficiency, and improve the investment climate.

- ***Monetary policy*:** Maintain the current accommodative monetary policy stance given still weak inflationary pressures and implement the de-euroization strategy. Amend the Central Bank Law to strengthen its independence.

- ***Financial sector policy*:** Implement the NPL strategy, maintain enhanced supervision of systemic and rapidly expanding banks, and cooperate with EU parent banks and their regulators to minimize risks from a sudden exit. Strengthening crisis management preparedness in the non-banking financial sector is also a key priority.

- ***Structural reforms*:** Implement institutional reforms to improve the business climate, reduce informality, and deepen financial markets, in order to encourage higher investment in more diversified, higher value-added activity. In the face of rising demographic pressures, policies are needed to raise youth and female labor participation and improve human capital.

Approved By
Jörg Decressin (EUR) and Zeine Zeidane (SPR)

Discussions took place in Tirana during September 20–October 3, 2017. The staff team comprised Ms. Tuladhar (head), Messrs. Cabezon and Slavov (EUR), Mr. End (FAD), and Mr. Weller (SPR). Mr. Reinke (Resident Representative) and Ms. Spahia (local economist) assisted the missions. Mr. Di Lorenzo (OED) attended some meetings. Mr. Song, Ms. Akil, and Mr. Stewart (all EUR) assisted in the preparation of the staff report. The staff team met with Prime Minister Rama, Minister of Finance and Economy Ahmetaj, Minister of Energy and Infrastructure Gjiknuri, Minister of Justice Gjoni, Bank of Albania Governor Sejko, Parliamentarians, other senior officials, donors and representatives from banks and the private sector. Albania is an Article VIII country (Informational Annex: Fund Relations). Data provision is adequate for surveillance (Informational Annex: Statistical Issues).

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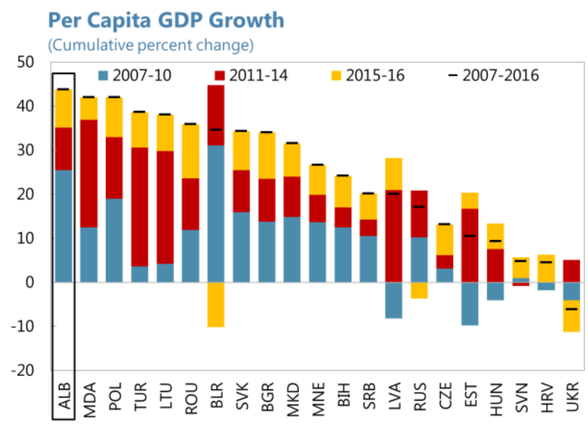
CONTEXT

1. **Albania is making good progress in raising living standards.** The economy successfully weathered the global financial crisis with one of the highest growth rates in the region. However, economic growth slowed down significantly in the wake of the Euro Area crisis and policy slippages ahead of elections, leading to a large buildup of macroeconomic vulnerabilities in the fiscal and financial sectors. Albania has since been gradually recovering and is implementing several key reforms that have reduced its macroeconomic imbalances and are laying the foundation for a more rapid economic growth as it pursues the opening of EU accession negotiations.



Sources: WEO database; and IMF staff calculations.

2. **The ruling Socialist Party has emerged from the latest Parliamentary elections with a strong mandate for continued reforms.** After winning a clear majority, the new government has reiterated its intention to focus the economic agenda on improving the business climate, property rights, and the public administration, while continuing fiscal consolidation efforts to reduce macroeconomic vulnerabilities. Albania is currently under Fund Post-Program monitoring.

RECENT DEVELOPMENTS

3. **Albania's economic recovery continues.** Real GDP growth reached 3.4 percent in 2016, accelerating to 4 percent (yoy) in 2017:Q2 (Figure 1). Investment gained momentum due to large energy-related FDI projects and a revival of construction and tourism services. A recovery in the labor market and household credit, supported by an accommodative monetary policy, boosted private consumption. The declining slack and pass-through of higher external inflation pushed inflation to around 1¾ percent (yoy) in 2017:Q3. However, core inflation remains low at ½ percent amidst a negative output gap.

4. **Overall credit growth remains stagnant as banks continue to clean up their balance sheets.** Credit to the private sector declined, largely due to writeoffs of NPLs (Figure 2). Adjusted for these write-offs, credit grew by around 3 percent (yoy) in 2017:Q2, led by lek credit to households. Despite the monetary policy easing and excess liquidity—especially in euros—banks remain reluctant to lend to corporates and are increasing foreign placements.

5. **The current account deficit narrowed to 7.6 percent of GDP in 2016, supported by strong services exports** (Figure 3)**.** Remittances also rose, reflecting a recovery in Italy and Greece, the two largest sources of inward remittances.

6. Short-term external vulnerabilities are limited, as the deficit is predominantly funded by concessional borrowing and large FDI inflows. The euro-lek exchange rate appreciated by 3½ percent in nominal terms and 4 percent in REER terms (yoy), while reserve accumulation reached six months of imports coverage at end-September 2017.

7. Despite these recent improvements, Albania's external competitiveness is lagging regional peers (External Sector Assessment, Annex I). The results from the EBA-Lite model indicate an external position that is moderately weaker than implied by fundamentals and desirable policy settings, reflecting mainly the structural impediments to improved export competitiveness. While its ranking in the World Bank's *Doing Business* indicators has improved, Albania continues to trail regional peers (¶40).

External Sector Assessment Summary Table

(Percent of GDP)

	Current account norm	Adjusted actual current account	Current account gap	REER gap
EBA-Lite (Current account approach)	-4.9	-6.0	-1.0	6.1
External sustainability approach	-4.4	-6.4	-2.0	9.5
REER approach	n.a.	n.a.	n.a.	-1.0
REER elasticity	-0.17			

Source: IMF staff calculations.

8. Fiscal performance is weaker than expected. Revenues were bolstered by economic and commodity price recovery, although some one-off revenues have not materialized.[1] Primary balance at end-September stood at 1.1 percent of GDP. Based on the revised 2017 budget, staff projects the general government primary surplus of 0.1 percent of GDP in 2017 (compared to initial budget of 0.7 percent of GDP), reflecting large pending VAT refunds, drought-related emergency support to the electricity sector and larger-than-anticipated local governments spending. Net new arrears of around 0.3 percent of GDP have accumulated in 2017:H1 (¶24). However, the overall general government deficit is expected to narrow, from 2.3 percent of GDP in 2016 to 2.0 percent in 2017, due to large interest savings. Public debt, including arrears, is also projected to decline moderately to 71.5 percent of GDP at end-2017 compared to 73.3 percent of GDP at end-2016.

OUTLOOK AND RISKS

9. Economic growth is expected to strengthen further in 2017–18. *GDP growth* is projected to reach 3.9 percent in 2017, supported by rising domestic demand and FDI in large energy projects. Despite the slowdown of these FDI projects in 2018, GDP is expected to grow 3.7 percent due to a recovery in private credit, an expansion in public investment, and a boost in

[1] Bankers Petroleum Ltd. has appealed the tax dispute regarding diluent excise and the tax amnesty has not yet recorded any principal payments on tax liabilities. However, the tax rebate on self-declared real-estate capital gains has yielded slightly more than expected.

confidence from increased political stability. While exports are expected to rise, the ***current account deficit*** is projected to widen temporarily in 2017, reaching 8.0 percent of GDP, as energy investment and drought-related electricity imports pick up. Headline (core) ***inflation*** would rise to 2.1 (0.8) percent in 2017 (average) due to stronger domestic demand and drought-induced food price hikes.

Selected Macroeconomic Indicators, 2012-22

	2012-15	2016	2017	2018	2019-22
		Prel.		Proj.	
			(Percent)		
Real GDP growth	1.6	3.4	3.9	3.7	3.9
Capital contribution	0.9	0.9	1.1	1.1	1.3
Labor contribution	-0.3	1.8	1.2	0.8	0.3
TFP contribution	1.1	0.7	1.6	1.8	2.3
Inflation average	1.9	1.3	2.1	2.8	3.0
			(Percent of GDP)		
Current account	-9.7	-7.6	-8.0	-7.1	-6.6
Primary balance	-1.8	0.2	0.1	0.4	0.8
Gross government debt	69.6	73.3	71.5	71.2	65.0

Source: IMF staff estimates.

10. The medium-term outlook remains favorable.

a. **Growth** is projected to increase to 4 percent, in line with regional peers, driven by continued strong domestic demand, reforms towards EU accession that improve the business climate and a strengthening EU recovery, offsetting the negative effects from the phase-out of large FDI projects (Annex V).

b. **Inflation** is expected to edge up gradually as the output gap closes, stabilizing around the 3 percent target by end-2018.

c. **The current account deficit** is expected to narrow to 6–7 percent of GDP, as import-intensive energy projects wind down, the Euro Area continues to recover, and higher FDI in the non-energy sector (such as tourism) drives export diversification. Gross reserves are projected to increase in line with the government's plan to increase external borrowing, and decline thereafter as the authorities' de-euroization strategy gains momentum and FX debt is repaid. Reserve coverage will continue to exceed the upper range of the ARA metric (External Sector Assessment, Annex I).

11. Risks to the outlook are balanced (Risk Assessment Matrix, Annex II). On the upside, improved confidence following the resolution of political uncertainty, accelerated donor support as part of EU accession process, and greater-than-anticipated spillover effects of the large FDI-financed projects could lead to higher investment and a stronger credit recovery. On the downside, spillovers from new shocks on the global economy could drag down growth and test perseverance with reforms. Continued drought conditions could affect electricity generation beyond 2017, with expensive electricity imports posing quasi-fiscal risks. An abrupt and disorderly exit of a large foreign bank from the Albanian market could lead to stress in the domestic banking system and pressures on the market for domestic public debt. Finally, volatile domestic politics pose risks to the implementation of structural reforms while a weaker fiscal consolidation effort could threaten sovereign bonds yields and banks' balance sheets.

12. Albania's repayment capacity on obligations to the Fund remains strong. Fund credit outstanding is estimated to be 3.1 percent of GDP or 12.5 percent of gross reserves in 2017. Debt service to the Fund is expected to peak in 2022 at around 0.4 percent of GDP and 1.9 percent of international reserves. External public debt is projected to peak at around 40 percent of GDP in 2018 before falling to 34 percent of GDP in 2022. Risks to repayment capacity are mitigated by Albania's robust reserve coverage, strong record of repaying the Fund, and the authorities' stated commitment to continue implementation of reforms.

Authorities' views

13. There was broad agreement on the economic outlook and the balance of risks. While acknowledging the negative growth effect of winding down large energy projects, they believe that increased confidence and improved prospects for investment will offset the negative impacts. The authorities view the drought and large energy projects as having a somewhat smaller impact on imports this year, but agreed that the current account deficit will decline over the medium term in line with increasing export diversification and a stronger EU economy. The authorities agreed that there may be some overvaluation in the exchange rate. They stressed that banks are insulated from shocks by their substantial capital and liquidity buffers.

POLICY DISCUSSIONS

14. Having reduced large macroeconomic vulnerabilities in recent years, Albania should aim its policies towards maintaining macroeconomic stability and deepening structural reforms to accelerate growth. Specifically, policies should focus on:

- ***Fiscal policy***: ensuring fiscal sustainability, reducing risks, and achieving a more efficient and growth-friendly budget;

- ***Monetary and financial sector policy***: strengthening inflation targeting and financial stability;

- ***Structural reforms***: strengthening institutions to improve the investment climate and labor force participation.

Policies should build on the advice under the last Article IV consultation and the EFF program (text table, Annex III).

Implementation of Recommendations from the 2016 Article IV Consultation	
Fiscal Policy	***Progress***
Continue fiscal consolidation, strengthen fiscal framework and improve debt management	Good
Broaden tax base, including fiscal cadastre for property tax	Insufficient
Implement tax administration strategy	Good
Strengthen public investment management and PPP oversight	Insufficient
Strengthen public financial management, including of local governments	Moderate
Monetary Policy	
Continue monetary easing, strengthen inflation targeting	Good
Financial Sector Policy	
Implement the NPL Strategy	Good
Strengthen financial supervision of systemic banks and reduce euroization	Moderate
Strengthen non-bank financial supervision	Insufficient
Structural Reforms	
Improve business environment, with a focus on property rights and judiciary, tax collection, and reducing skills mismatches	Good
Further reforms in the electricity sector	Insufficient

A. Fiscal Policy: Ensuring Fiscal Sustainability and Growth-Friendly Consolidation

15. Albania needs to continue its fiscal consolidation. The overall fiscal balance has improved by 2.1 percentage points of GDP between 2013 and 2017, mostly through higher revenues (Figure 4). However, Albania's public debt and gross financing needs remain high (Annex IV) and room for policy maneuver is limited. The authorities reiterated their commitment to lower the debt ratio below 60 percent of GDP by 2021, consistent with the 45 percent of GDP debt objective under the Organic Budget Law. Staff agreed that these objectives strike an appropriate balance between reducing debt sustainability risks and maintaining the quality of adjustment, on the one hand, with the need for a growth-friendly adjustment that accommodates the cost of structural reforms, on the other. Given the difficulties in operationalizing this debt target and the lack of a quantitative target under the existing fiscal rule, staff recommended adopting the primary balance (excluding one-offs) as a fiscal anchor, supported by an independent fiscal council to strengthen the fiscal framework (Annex VI).

Albania Fiscal Consolidation, 2013-2021

(Percent of GDP, unless otherwise specified)

	2013	2014	2015	2016	2017		2018		2019	2020	2021
	Act.	Act.	Act.	Prel.	Rev. Budg.	Proj.	Draft Budg.	Proj.	Proj.	Proj.	Proj.
Revenues	24.0	26.3	26.4	27.4	28.2	28.2	28.1	28.1	27.9	27.8	27.5
Tax revenue	22.0	24.1	23.9	24.9	25.7	25.9	25.7	25.6	25.5	25.4	25.2
Non-tax revenue	1.6	1.5	1.8	1.5	1.6	1.5	1.6	1.4	1.4	1.4	1.4
Grants	0.4	0.7	0.8	1.0	0.9	0.9	0.9	1.0	1.0	1.0	0.9
Expenditures	29.2	32.2	31.0	29.6	30.4	30.2	30.4	29.9	29.7	29.4	29.3
Current expenditure (incl. net lending)	24.3	25.4	25.4	25.7	25.2	25.5	25.0	24.6	24.6	24.4	24.4
of which : Energy sector spending 1/		0.9	0.8	0.5	0.5	0.5	0.2	0.2	0.2	0.1	0.0
Capital expenditure 2/	4.8	4.3	4.4	4.0	4.8	4.6	5.2	5.2	5.0	4.9	4.7
Other spending	0.0	2.4	1.2	0.0	0.5	0.2	0.2	0.2	0.2	0.2	0.1
Overall balance	-5.2	-5.9	-4.6	-2.3	-2.2	-2.0	-2.2	-1.9	-1.8	-1.6	-1.8
Primary balance	-2.0	-3.0	-1.9	0.2	0.2	0.1	0.3	0.4	0.6	0.9	0.9
Structural primary balance	-1.7	-0.1	-0.4	0.5	0.6	0.5	0.4	0.5	0.7	0.9	0.9
Change in the structural primary balance	-1.2	1.6	-0.3	1.0	0.0	0.0	-0.1	0.0	0.2	0.2	-0.1
Public debt	70.4	72.0	74.1	73.3	71.9	71.5	70.1	71.3	68.7	66.7	64.0
Domestic debt	43.4	42.4	39.7	39.0	37.3	35.3	37.8	31.5	30.0	28.3	27.7
Foreign debt	27.0	29.6	34.4	34.3	34.7	36.2	32.3	39.8	38.7	38.3	36.3
Memo items:											
Primary balance (authorities' presentation) 3/	-2.0	-2.5	-1.9	0.3	0.4	0.4	0.6	0.7	0.9	1.0	1.0
Nominal GDP (in billions of leks)	1,350	1,395	1,428	1,473	1,555	1,562	1,650	1,658	1,764	1,884	2,013
Public debt (in billions of leks)	950	1,005	1,057	1,080	1,119	1,117	1,157	1,182	1,211	1,255	1,288

Sources: Albanian authorities; IMF staff estimates and projections.

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

2/ Starting in 2017, grants to the Regional Development Fund are reclassified from local government spending to capital expenditure.

3/ The budget records as expenditure some financial operations but omits some energy sector support.

16. The authorities' fiscal strategy relies on a gradual, backloaded adjustment to achieve this debt objective.

- **The 2018 budget seeks to maintain the same overall deficit target of 2 percent of GDP (per authorities' definition) as this year**. The general government primary surplus is expected to increase to 0.6 percent of GDP (using the authorities' definition), compared to the 2017 target of 0.4 percent of GDP, which implies a slight relaxation of around 0.2 percent of GDP.[2] The draft budget envisages a large scale-up of public investment in 2018, to finance infrastructure, reforms in the water sector and the judiciary, and higher defense spending. It also includes new tax breaks, particularly for the tourism sector. On the other hand, the budget relies on containing public wages (except for the health and education sectors) and reducing energy support, as well as increasing revenues from the value-based property tax and compliance gains from the anti-informality campaign (Text table).[3]

[2] Based on the change in the structural primary balance using staff estimates of the output gap.

[3] Specific criteria for eligibility for the tourism tax breaks and VAT thresholds for different sectors are yet to be determined, at the discretion of the Council of Ministers. See Annex VII.

- **The 2019-2021 budgetary framework assumes an annual improvement in the primary surplus by around ½ percent of GDP** to reach a primary surplus of 2.2 percent of GDP by 2021. The strategy relies mainly on tax efficiency gains.

17. The mission recommended a more front-loaded consolidation to create room for fiscal policy maneuver and improve the credibility of the medium-term budgetary framework. Such room is critical in case downside risks to activity materialize. The adjustment path relies unrealistically on a sizable adjustment towards the end of the electoral cycle. In the absence of tax policy measures, staff projects public debt to reach around 64 percent of GDP by 2021. This excludes any debt or contingent liabilities arising from PPP-financed investments, but includes some buildup of fiscal buffers which are currently very low.[4] The mission estimates that additional permanent measures to the tune of 1 percent of GDP over 2018 – 19 would be needed to achieve the 60 percent debt target. Safeguarding the original primary balance target in 2017, by locking in existing savings and avoiding inefficient year-end spending, would also help.

Medium-term Fiscal Paths

(in percent of GDP)

	2016	2017	2018	2019	2020	2021
Public debt						
IMF baseline	73.3	71.5	71.3	68.7	66.7	64.0
IMF recommended path		71.0	69.8	66.1	63.4	60.0
Authorities MTBF*		70.8	68.8	66.4	63.5	59.9
Overall balance						
IMF baseline	-2.3	-2.0	-1.9	-1.8	-1.6	-1.8
IMF recommended path		-1.4	-0.9	-0.7	-0.7	-0.8
Authorities MTBF*		-2.0	-2.0	-1.7	-1.2	-0.4
Primary balance						
IMF baseline	0.2	0.1	0.4	0.6	0.9	0.9
IMF recommended path		0.6	1.2	1.5	1.5	1.5
Authorities MTBF*		0.4	0.6	1.0	1.5	2.2
Structural primary balance						
IMF baseline	0.5	0.5	0.5	0.7	0.9	0.9
IMF recommended path		1.0	1.4	1.6	1.5	1.5
Authorities MTBF*		0.6	0.4	0.9	1.4	2.1

* Based on the authorities' own definitions of debt and deficit (i.e., excluding some energy sector support from the deficit, and omitting PPPs and arrears in the debt statistics).

18. Staff recommended that the fiscal adjustment should mainly stem from revenue measures. Tax efficiency is low in Albania reflecting higher tax thresholds and weak tax compliance (Annex VII). Heavy reliance on specific taxes has also led to low tax elasticity to GDP. Staff recommended additional measures such as indexation of excises and broadening the tax base (text table). Staff supported administration reforms focused on modern compliance risk management. However, planned tax and customs merger risks derailing this effort.

[4] Debt projections include a buildup of a precautionary fiscal buffer of 1 percent of GDP over four years. Currently, the size of the fiscal buffer is limited due to legal constraints.

19. Staff discussed the need to rebalance the budget towards more growth-friendly spending. Given the low level of spending and key expenditure reforms (such as pensions and social assistance) already underway, there is limited room for expenditure rationalization (Figure 5).[5] Rather, there is a need to increase the quality and quantity of public spending in areas such as infrastructure and education. At the same time, fiscal buffers are needed to insure against contingent liabilities from SOEs, PPPs, and arrears.

Tax Policy Measures
(in percent of GDP)

	2018	2019	2020	2021
Measures already/being taken by the government*				
Harmonize cigarette excise towards EU standards	0.12	0.06	0.05	0.05
Increase the base for social security contributions	0.09	-	-	-
Lower VAT rate for tourism-related activities	0.00	-	-	-
Other exemptions (IT, high-tech)	-0.01	-	-	-
Permanent tax measures assumed in the baseline				
Ad valorem transfer duty and pilot property tax	0.12	0.10	-0.10	-
Value-based property tax	-	-	0.28	0.01
Recommended permanent tax measures				
Index specific excises/national taxes on observed inflation (e.g., fuel excise, carbon tax, circulation tax, car registration, etc.)	0.12	0.12	0.11	0.10
Broaden the VAT base (drugs, machineries, new residential property sales, education, advertisement, tourism)	0.05	0.16	0.03	0.03
Reintroduce small business income tax	0.15	-	-	-
Reduce the zero-tax threshold to the minimum wage level	0.19	-	-	-
Environment and health-related excises	0.27	-	-	-

* Other measures in the draft budget, such as the property tax reform, the blanket exemption on luxury hotels, and the reduction in VAT thresholds, could not be quanitifed as their implementation require secondary legislation.

Authorities' views

20. The authorities emphasized their strong commitment to persevere with fiscal consolidation. They recognized that meeting their medium-term debt target of 60 percent of GDP by 2021 will be challenging. For 2017, they plan to monitor budget execution closely and take compensatory measures as needed to reach the target. Going forward, they stated their intention to be cautious about contracting new PPPs and to keep PPP-related budgetary payments under their legal ceiling. They also argued that the 60 percent public debt target should exclude the buildup in government deposits.

21. The authorities support a consolidation strategy based on broadening the tax base and improving revenue compliance and administration. There is a strong political consensus on maintaining a small government with a low tax burden. The authorities are thus wary of raising tax rates, which they believe would further undermine compliance. They argued that the

[5] The new government has announced an administrative restructuring to consolidate a number of ministries and agencies. However, details on the operational and financial impact are still pending.

planned lowering of the VAT registration threshold and additional tax preferences for the tourism sector would help in their push against informality. They are cautious about adopting a stringent fiscal rule that limits the flexibility to respond to shocks and are also skeptical about the value added of a fiscal council given a limited pool of available expertise.

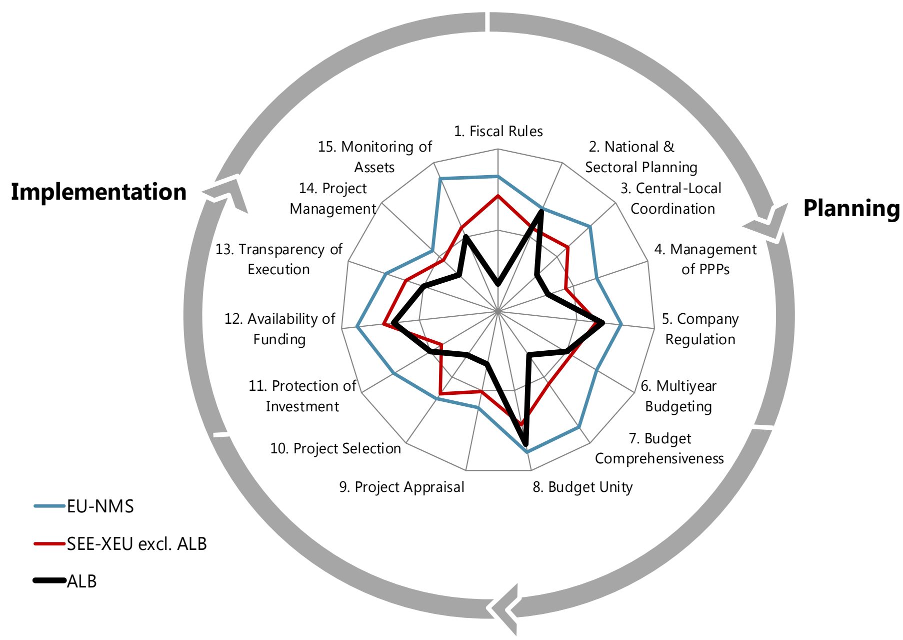
B. Strengthening Fiscal Institutions: Reducing Fiscal Risks and Improving Efficiency

22. Inefficiencies in Albania's public investment management (PIM) undermine growth. A key shortcoming is the fragmentation of investment projects which, as the recent Public Investment Management Assessment (PIMA) showed, has contributed to poor appraisal, selection, management, and evaluation of public investment projects. With the planned scaling-up of public investment, staff stressed the need to strengthen the PIM framework, in order to reduce inefficiencies. Key priorities are to operationalize the PIM unit at MoF and improve budgetary processes, such as project classification, coverage of SOEs and local government in the database, and costing of new policies, to ensure adequate resources for core projects within the medium-term budgetary (MTB) envelope. Adhering to the MTBF would reduce the risks of unfunded commitments and arrears.

23. Implementation of the new PPP framework is a challenge. Albania's regulatory framework compares well in the World Bank's survey on Benchmarking PPP Procurement. Given the fiscal risks posed by the authorities' ambitious PPP agenda, staff stressed the importance of strengthening the implementation of the PPP framework and making use of MoF's recently expanded legal powers to assess, veto, and monitor all PPP projects.[6] Staff recommended introducing an aggregate quantitative limit on the total value of all PPP contracts, in addition to the current limit on annual PPP-related budget payments, to help contain risks. Staff also underscored the need to upgrade the capacity of the Fiscal Risks Unit to undertake financial analysis of new PPP contracts and to empower INSTAT to record PPPs in the fiscal and debt statistics in accordance with ESA.

[6] The new government has announced an ambitious PPP program of €1 billion (around 7 percent of GDP), mainly covering the transport and health sectors. However, the MoF noted that the fiscal burden is likely to be lower and some road projects would be financed through tolls.

Strength of Public Investment Management by Institution



Source: FAD PIMA database; IMF staff calculations.

24. Staff discussed the need to strengthen budgetary controls in order to contain arrears. These arrears arise from court decisions, weak budgetary controls in public investment projects, and more recently, cash management of VAT refunds. The mission encouraged MoF to continue publishing its quarterly surveys of arrears, which indicated stocks of 0.5 and 0.6 percent of GDP at the central and local government levels, respectively, at end-June 2017. Staff advised expediting the clearance of VAT refund arrears (0.4 percent of GDP at end-August) by dedicating adequate cash resources. To prevent other arrears, it will be crucial to strengthen commitment controls, expand the coverage of Treasury's new IT system (AGFIS), and expedite the implementing regulations for the new law on local finances to strengthen reporting and monitoring.

25. The authorities are undertaking efforts to tackle fiscal risks. With Fund TA, the newly-established Fiscal Risks Unit at MoF is preparing a statement of fiscal risks to accompany the budget. The unit should start assessing the fiscal risks of PPPs and SOEs, including their investment budgets and financial performance.

26. Further improvements in debt management are needed to address risks from Albania's public debt and large rollover needs (Annex IV). The high reliance on domestic banks poses a systemic risk of a sovereign-banking feedback loop. While significant progress has been made, efforts to extend the average debt maturity need to continue. The illiquid secondary market has led investors to seek short-term instruments that are held to maturity. Staff advised the authorities to focus on improving the functioning of the primary market for domestic government debt and developing a liquid secondary market, following the plan outlined with the support of the World Bank. Staff suggested the authorities to tap into Eurobond markets to amortize FX debt while being vigilant of risks posed by excessive reliance on FX and nonconcessional borrowing. These efforts will help attract new investors, extend maturity, and lower liquidity premia. Strengthening communication and coordination among the BoA, MoF, AFSA, and other stakeholders on liquidity and debt management is also crucial to avoid excess volatility of T-bill rates.

Authorities' views

- ***Public financial management:*** The authorities acknowledged difficulties in implementation of PIM, including for foreign-financed projects. They are seeking to focus domestic resources on a few key priority projects. They are close to adopting the PIM guidelines and regulations, while the project classification review should be completed in time for the 2019 budget. They are also working on strengthening the MTBF, in cooperation with the EU.

- ***Public Private Partnerships (PPPs)***: The authorities are planning greater MoF involvement in the final approval, monitoring, and *ex post* assessment of PPPs, but noted capacity constraints. They are considering an external review of the existing stock of PPPs. The authorities are reluctant to make further legal changes to their PPP framework at this point and view the current annual limits to be sufficient to contain risks.

- ***Arrears clearance and prevention:*** The authorities are committed to clearing all central government arrears (other than those on court orders) by end-2017 and extending their Treasury IT system to 100 budget institutions by 2020.

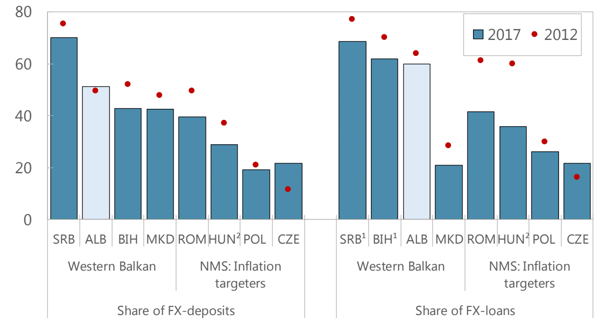
- ***Debt management:*** The government indicated that increased reliance on external commercial borrowing was needed to overcome domestic financing constraints and meet public investment goals. Nevertheless, they agreed that the size and timing of the issuance would duly consider the risks to external debt sustainability.

C. Monetary Policy: Strengthening Inflation Targeting and Mitigating Risks

27. The current accommodative monetary policy stance remains appropriate. The policy rate has been at a historical minimum of 1¼ percent since May 2016. The BoA has maintained its forward guidance that monetary tightening will not take place until the second half of 2018 given the still negative output gap, subdued core inflation, and an appreciating exchange rate. Staff advised that the unwinding of monetary easing should be data-dependent, confirming that underlying inflationary pressures are in line with reaching the inflation target of 3 percent over the medium term. BoA should also consider any financial stability risks due to unhedged FX exposures of borrowers from an abrupt exchange rate depreciation following a tightening in the ECB's monetary stance.

28. BoA is seeking to reduce financial euroization. FX deposits account for half of all deposits, and FX loans account for 60 percent of total loans. Banks' net open FX position is small. However, financial stability risks arise from unhedged FX borrowers (25 percent of the total loans) and a limited capacity as lender of last resort in FX. Following earlier efforts to reduce FX lending, BoA has announced a comprehensive strategy to reduce the use of foreign currency, starting in 2018.[7] Staff advised the authorities to implement their de-euroization strategy gradually, while monitoring the impact on FX markets. In line with this strategy, the BoA should also roll back the reduction in the risk weight on domestic FX government bonds.

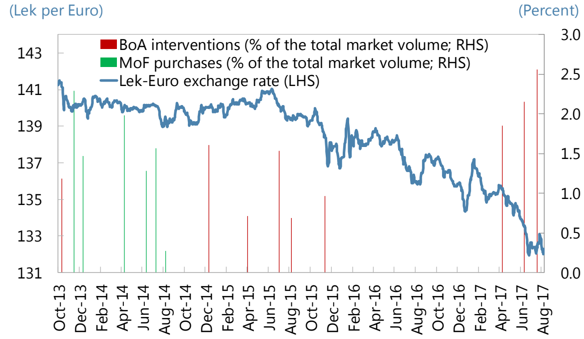
Euroization
(Percent)



1/ SRB and BIH includes FX-indexed loans. 2/ 2016.
Source: IMF, IFS; IMF staff reports; and IMF staff calculations.

29. The authorities have been executing limited and pre-announced interventions to build up FX reserve buffers. In line with Albania's flexible exchange rate regime, staff advised that the authorities' planned interventions should remain fully transparent, consistent with achieving the inflation target and any deviations should be limited to preventing disorderly market conditions. The government's planned issuance of external commercial debt, which will partly roll over the €450 million Eurobond maturing in 2020, is expected to further boost reserves. When considering additional external borrowing, staff advised the authorities to also consider its impact on their de-euroization strategy.

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



Note: BoA auctions for foreign exchange are based on a pre-announced schedule.
Source: Bank of Albania.

30. Staff recommended the authorities to continue strengthening governance and safeguards at the central bank. A key priority is to amend the central bank law in order to align it with best international practices on central bank independence.

[7] The strategy aims to increase awareness of the risks of FX borrowing and reduce incentives for FX deposits. The measures include raising the ratio of FX liquid assets to FX short-term liabilities from 15 to 20 percent, increasing the required reserve ratio for FX deposits from 10 to 12.5 percent, and reducing it for lek deposits from 10 to 7.5 percent. Overall required reserves are projected to increase slightly, in a context where banks have sizable excess reserves.

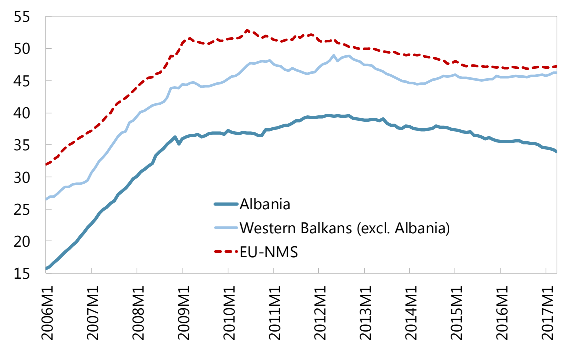
Authorities' views

31. With inflation expected to remain below the BoA's target in the near-term, the authorities agreed that the current accommodative monetary stance remains appropriate. They are implementing the de-euroization strategy transparently and gradually while monitoring risks. The BoA will continue to assess the adequacy of reserve buffers, consistent with its reserve optimization strategy. In the short run, the impact of any changes in ECB's policy should be limited given Albania's small stock of portfolio investment. The authorities agreed on the importance of amending the central bank law, but cautioned that more time might be needed to consult stakeholders and build support.

D. Financial Sector: Ensuring Financial Stability

32. The banking system remains stable, liquid, and well capitalized (Figure 6). The NPL ratio, while still high, has been declining (Box 1) and profits are recovering given lower provisioning needs. Bank lending is financed predominantly with deposits. Despite ample funding, credit deepening remains low by regional standards reflecting structural challenges such as low incomes, large informality, lack of credit scoring, and a weak collateral execution framework (Annex VIII).

Credit to the Dometic Private Sector
(Percent of GDP)



Sources: HAVER; IMF, IFS; and IMF staff estimates.

33. Weak credit growth also reflects the ongoing deleveraging and consolidation in the banking system. The market share of EU-owned banks has declined from 67 percent in 2013 to 54 percent in mid-2017 as deleveraging continues owing to tightening EU regulations and the restructuring of parent (mainly Greek and Italian) banks. An abrupt exit or a portfolio shift by a large bank poses risks for FX and T-bill markets. At the same time, several non-EU banks are expanding rapidly, including via non-resident lending to Kosovo and Turkey, which requires increased vigilance toward the buildup of credit risks. A stock-exchange license was recently granted to a group of banks, raising interconnectedness in the financial sector.

34. The authorities continue efforts to strengthen financial supervision and regulation. A new macroprudential strategy outlining the key objectives, instruments and operational framework has been approved with the objective of safeguarding financial stability.[8] Staff supported the focus on risk-based supervision and recommended higher financial buffers for

[8] The main objectives are to i) mitigate excessive credit growth and borrowing, ii) contain systemic risks, excessive maturity mismatches and market liquidity issues, iii) limit concentration and excessive risk taking. It involves a phase-wise strategy for risk identification, instrument selection and calibration, implementation and communication, and finally an impact evaluation, A financial stability advisory committee is in charge of assessing the risks and formulating the policy proposals.

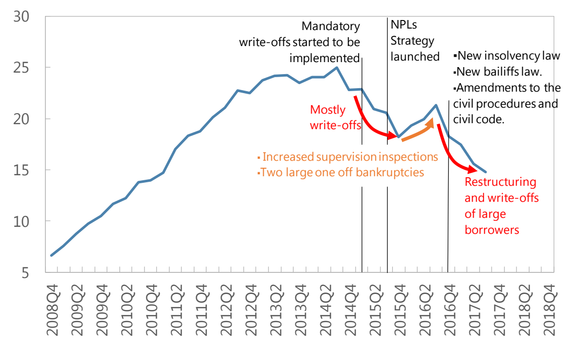
banks expanding to nonbanking activities and close cooperation between supervisors to address the risks from interconnectedness. Staff suggested to consider a special external diagnostic review, possibly with a peer supervisor, to assess high-risk portfolios and identify potential gaps in risk management practices, with a focus on banks with high credit growth. To tackle vulnerabilities from cross-border lending, enhanced screening of these portfolios and increased system-wide risk-based weights and provisioning will be needed to account for underlying risks.

35. Staff underscored the need for close communication with EU-owned banks, their parents, and peer supervisors to ensure a smooth bank consolidation. Staff stressed the need for the regulator to avoid awarding new licensing to inexperienced investors. Aligning supervision with ECB standards could discourage deleveraging by EU banks.[9]

Box 1. NPL Resolution in Albania

The NPL ratio is declining. However, at 15 percent of loans at end-August, it remains among the highest in the region. The decline is attributed largely to mandatory write-offs and BoA's proactive approach in facilitating the resolution of large borrowers' NPLs. Banks also restructured loans after sizable haircuts. In contrast, NPL sales have been limited due to low expected recovery rates and tax impediments.

Albania: NPLs
(Percent of total loans)



Sources: Bank of Albania; and IMF staff estimates.

Reform of the resolution framework has slowed down recently. The work of the NPL working group work has paused and a bylaw to the Private Bailiff's Law was introduced that increased fixed fees paid in advance, thereby disincentivizing the collateral execution process.

The key to reduce banks' risk aversion is to improve the NPL resolution framework. Revising the bylaws regulating bailiffs fees and issuing the pending bylaws for out-of-court agreements and the new Bankruptcy Law remain key priorities. In addition, introducing a rating methodology for the credit registry and developing a credit bureau can improve the risk assessment of borrowers. Strict monitoring of asset quality and restructured loans will help to prevent new NPLs. The authorities are analyzing tax impediments that prevent NPL sales. Finally, publishing a mid-term progress report on the implementation of the NPL strategy will identify pending issues. Reactivating the NPL working group can help advance this process.

[9] EU banks face a high capital requirement for their holdings of Albanian government bonds. EU regulations require higher risk weights as Albania's banking supervision is not considered fully consistent with EU standards. If Albanian supervision is deemed EU-equivalent, risk weights for Albanian government bonds in local currency could be reduced.

36. Strengthening the capacity of the nonbank financial regulator (AFSA) is crucial. The new AFSA management is committed to strengthen its capacity. Investment funds account for 5 percent of GDP and lack an adequate crisis management framework. In the absence of a liquid secondary market, the T-bill market has faced substantial price volatility over the past year.[10] With the support of the World Bank, the authorites and market players are working to improve primary and secondary markets, by piloting longer-dated bonds.

37. Albania has strengthened its AML/CFT framework, but continued efforts to ensure effective implementation are needed. Since its 2011 AML/CFT mutual evaluation against the 2003 FATF standard, the authorities have taken steps to address some of the identified gaps and improve the AML/CFT regime. Albania is currently undergoing an evaluation against the revised 2012 FATF standard which now includes an important focus on effectiveness of the regime in place.[11] Further progress is hence required to comply with the recommendations of the revised standard and ensure that the regime is effectively contributing to mitigating and tackling money laundering and predicate offences such as corruption.

Authorities' views

38. The BoA is fully committed to maintain its supervisory vigilance to preserve financial stability. The central bank will continue to closely monitor fast-growing or systemically important banks, but see limited gains from external diagnostics on high risk portfolio at this stage as NPLs are declining. The authorities are actively communicating with peer supervisors and parent banks to smooth the deleveraging process by EU-owned banks, but noted that interest from the banking sector in the region remains limited, posing challenges for financial deepening. They also noted the planned conversion of large branches of Albanian banks overseas to subsidiaries. Finally, BoA has started implementing the new bank resolution framework which is aligned with the BRRD requirements.

39. The authorities are also fully committed to strengthening AFSA's capacity, through new hiring and continuous training. AFSA will also conduct stress tests and a crisis preparedness exercise for investment funds. They are also preparing regulations on conflicts of interest and related parties, liquidity requirements, and equity and bond trading.

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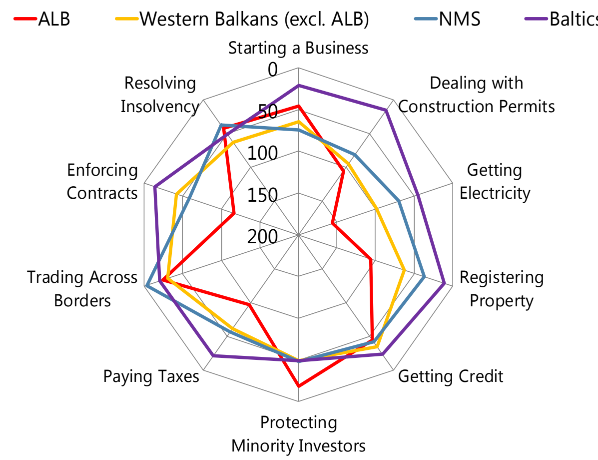
[10] Pre-election uncertainty and miscommunication among market players, MoF, BoA, and AFSA resulted in a surge in interest rates on domestic T-bills of about 200 basis points in late 2016 that was later reversed.

[11] This mutual evaluation is being carried out in the context of MONEYVAL's 5th Round of AML/CFT evaluations. The onsite visit took place in October 2017 and the evaluation report, expected to be adopted in April 2018, will provide further guidance on how to improve the AML/CFT framework.

E. Structural Reform: Improving the Investment Climate and Boosting Labor Force Participation

40. Despite recent improvements, Albania's external and structural competitiveness gaps with regional peers persist. While Albania's wages are competitive, its investment climate suffers from weak institutions, shortages of skilled labor, poor infrastructure connectivity, an inefficient tax system, and difficulties in access to finance. Albania's power supply is notably unreliable, with relatively long electricity blackouts. Albania struggles with a judiciary that lacks integrity, independence, and efficiency in enforcing contracts (Annex VII) as well as with weak property rights (Figure 7). These institutional obstacles also hinder financial deepening, which is crucial for improving resource allocation and reducing the cost of capital (Annex VIII).

Business Environment, Ranking



Sources: Doing Business (2017); and IMF staff calculations.

41. Institutional reforms to address these challenges remain a key priority.

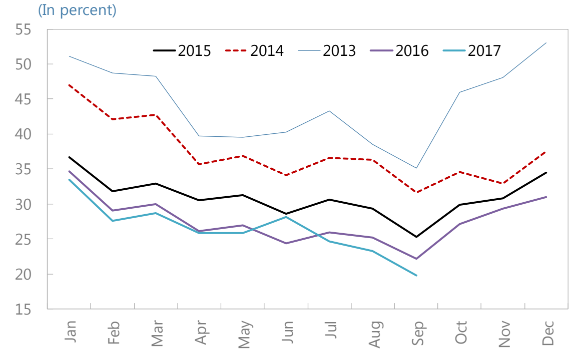
- ***Judicial reform:*** The sweeping judicial reform was adopted in mid-2016, and its implementation is a key precondition for opening EU accession negotiations. The Cross Sector Justice Strategy seeks to improve judicial efficiency by reducing case backlogs, reforming court fees, and introducing an electronic system for operational case management.

- ***Anti-corruption:*** The 2015 review of Albania's implementation of the UN Convention Against Corruption (UNCAC) has revealed several gaps in the legal framework. Reviewers have recommended criminalizing all acts of corruption and ensuring effective international cooperation. In addition, the effectiveness and comprehensiveness of the asset declaration regime should be strengthened further.

- ***Property rights:*** The authorities are seeking to prepare a new strategy to advance property registration and digitization, and coordinate the restitution, compensation, and legalization processes to address the current fragmented process. Staff noted the need to coordinate work on the legal and fiscal cadasters in order to ensure compatibility of the two electronic platforms.

42. Reforms in the state-owned electricity sector need to be reinvigorated. The recent droughts have increased the need for budgetary support even as the energy SOEs accumulated arrears and ramped up investment spending, which was not necessarily well-targeted. Reduction of distribution losses is lagging behind plan while further market liberalization and restructuring have been delayed. Staff recommended accelerating reforms to advance financial restructuring and improve operational efficiency, including through strengthened corporate governance. Staff also highlighted the need for SOEs to resume the regular publication of financial statements. In addition, institutional and market reforms should be accelerated, including establishing a power exchange, unbundling the electricity distribution company, and moving medium-voltage customers to the free market. Tariff adjustments should be made more frequent and automatic. The drought-induced fall in hydropower generation this year underscores the importance of diversifying Albania's sources of electricity.

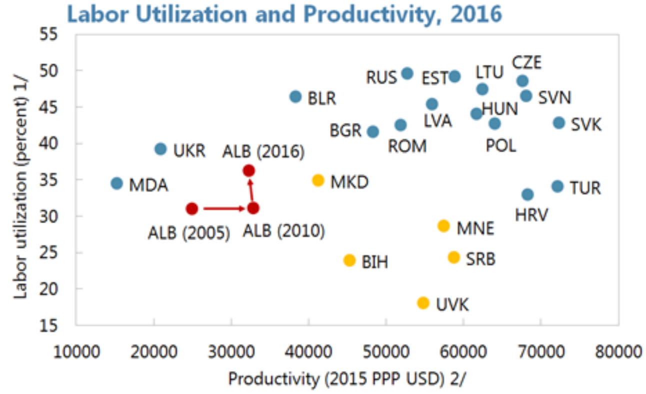
Electricity Distribution Losses
(In percent)



Source: Oshee; and IMF staff estimates.

43. Growth is constrained by demographic pressures and low labor force participation. Labor utilization has been recovering recently, in keeping with Albania's flexible labor market. However, the projected decline in working age population due to emigration[12] and aging will increasingly weigh on growth potential (Annex V, Figure 8). Mismatches between available skills and employers' needs constrain labor absorption. Staff advised the authorities to strengthen the capacity of public employment agencies and raise educational investment to upgrade skills and lower youth unemployment. The mission also proposed better access to parental leave policies to ease labor market entry for women, given the widening gender gap in labor participation.[13] Revisiting minimum wage policies for young, low-skilled, and part-time workers could help reduce informality, which remains high in Albania (Figure 9).

Labor Utilization and Productivity, 2016



1/ Labor utilization = employed population over population.
2/ Productivity = Real GDP per worker.
Sources: Haver Analytics; World Bank, WDI; IMF, WEO database; and IMF staff calculations.

[12] See IMF/SDN/16/07, "*Emigration and its Economic Impact on Eastern Europe*."

[13] See Atoyan and Rahman, "*Western Balkans: Increasing Women's Role in the Economy*", forthcoming IMF Working Paper.

Authorities' views

44. The authorities confirmed that implementation of judicial reform remains their top priority. The planned restructuring of district courts, reform of court fees, and changing the evaluation criteria for judges will improve judicial efficiency. The authorities are also working on a plan to strengthen asset declarations, as part of a twinning project with the EU on anti-corruption. In this context, the authorities also noted efforts to reduce the regulatory burden.

45. The ongoing large energy projects will help improve infrastructure connectivity and energy supply. The authorities noted that the implementation of the TAP project, combined with the recommissioning of the Vlora Thermal Power Plant, will link Albania to regional energy markets, lower the cost of energy, encourage further investment, and diversify energy sources. They agreed that reforms in the electricity sector have slowed given the elections but the process towards market reforms and unbundling the distribution company will resume soon. The power exchange is expected to launch in 2018.

46. The authorities recognize the role of skills mismatches and demographic pressures in constraining growth. They are upgrading the quality and reach of vocational training to better match the skills with the needs of the market, and are specifically targeting under-represented groups, including women, returning emigrants, and young people. Projects to allow part-time work are also being piloted to help facilitate labor market entry and reduce informality, while the new labor code has allowed for parental leave policies to encourage women's labor participation.

STAFF APPRAISAL

47. Albania's economy continues to strengthen but the reform momentum has slowed given the elections and the extended government transition. The growing economy and the clear electoral mandate provide a good opportunity to redouble reform efforts to maintain macroeconomic stability, reduce fiscal risks, revive credit to the private sector, and deepen structural reforms.

48. Fiscal consolidation should continue to rebuild room for fiscal policy maneuver and ensure debt sustainability. While the authorities announced their commitment to reducing public debt below 60 percent of GDP by 2021, they should consider a more ambitious and front-loaded consolidation path than the one currently envisioned.

49. Additional measures are needed to mobilize revenues to support the consolidation effort and priority spending. The planned introduction of a value-based property tax and strengthening of tax compliance are welcome, but both should be carefully planned and sequenced. The authorities should consider additional revenue measures, including broadening the tax base. The authorities should refrain from lowering tax rates or granting any new tax exemptions or preferential tax treatments. The discretionary tax breaks and VAT thresholds could complicate the tax system and undermine revenues significantly.

50. Strengthening fiscal institutions remains crucial to mitigate fiscal risks and enhance efficiency. The tax administration's focus on improving debt collection processes and compliance risk management is appropriate. The announced merger of the tax and customs administrations should be revisited, given the high risks of undermining revenue collection and the ongoing tax administration reforms. Public debt management should focus on lengthening the maturity of public debt and diversifying the investor base, while avoiding risks posed by excessive non-concessional FX borrowing.

51. With the planned scaling up of public investments, it has become crucial to strengthen public investment management. Project appraisal and monitoring are key to reduce inefficiencies. Given the fiscal risks posed by the new PPP agenda, the MoF should ensure proper implementation of the PPP framework by using its recently expanded legal powers to assess and monitor PPP projects. Contrary to current practice, the impact of PPPs on the fiscal accounts should be assessed and reflected transparently and in line with international norms. To minimize the recurrence of arrears, the authorities should improve the VAT refund process, strengthen commitment controls, and extend the coverage of the Treasury's IT system.

52. Reforms in the state-owned electricity sector need to resume. After impressive early gains, the reform process has stalled. The authorities should improve operational efficiency and speed up financial restructuring in the sector. In addition, institutional and market design reforms should be accelerated.

53. The BoA's accommodative monetary policy stance remains appropriate. Any unwinding of monetary easing should await clear evidence of a sustained rise in inflation. The de-euroization strategy should be implemented gradually. The central bank law needs to be amended to align it with modern central banking legislation.

54. The weak NPL resolution framework continues to hamper credit recovery, particularly for corporates. The authorities' progress in restructuring the NPLs of large borrowers is welcome. However, the recent regulation on private bailiff fees is likely to hinder the collateral execution process and should be reversed. The authorities should urgently adopt the bylaws to implement the new Bankruptcy Law and facilitate out-of-court restructuring.

55. The authorities' continued efforts to shore up financial supervision are welcome. They should continue to strengthen their microprudential focus on the fastest-growing and systemically important segments of the banking system. The authorities should remain vigilant of risks from growing interconnectedness with the non-banking financial sector. Strengthening crisis-preparedness is a priority.

56. Recent structural changes in the financial sector call for enhanced supervisory vigilance. The consolidation in the banking sector is welcome. To mitigate risks to banking stability, BoA should ensure that candidates for new bank licenses possess adequate banking experience and avoid conflicts of interest. Developing capital market institutions requires high transparency and governance standards.

57. Addressing structural impediments to competitiveness remains key for achieving faster growth. The authorities should encourage labor participation, especially among women and youth, by investing further in skills and vocational training. Advancing institutional reforms such as the ongoing judicial reform and property rights reform as well as anti-corruption efforts is crucial to improve the business climate, reduce informality, and deepen financial markets. These efforts would pave the way for increased investments and more rapid convergence.

58. It is recommended that the next Article IV consultation be held on the standard 12-month cycle. Meanwhile, Albania will remain under Post-Program monitoring.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2013–22

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
				Prel.	Proj.	Proj.				
Real sector	(Growth rate in percent)									
Real GDP	1.0	1.8	2.2	3.4	3.9	3.7	3.8	3.9	3.9	4.0
Domestic demand contribution	0.4	3.3	0.6	3.1	4.0	3.0	3.6	4.0	4.2	4.3
Consumption	1.7	3.0	0.8	2.7	2.2	2.0	2.3	2.3	2.4	2.5
Investment (incl. Inventories+stat. disc.)	-1.3	0.3	-0.2	0.4	1.8	1.1	1.4	1.8	1.8	1.8
External demand contribution	0.6	-1.5	1.6	0.3	-0.1	0.7	0.1	-0.1	-0.3	-0.3
Consumer Price Index (avg.)	1.9	1.6	1.9	1.3	2.1	2.8	3.0	3.0	3.0	3.0
Consumer Price Index (eop)	1.8	0.7	1.9	2.2	2.3	3.0	3.0	3.0	3.0	3.0
GDP deflator	0.3	1.5	0.1	-0.2	2.1	2.3	2.5	2.8	2.8	2.8
Saving-investment balance	(Percent of GDP)									
Foreign savings	9.3	10.8	8.6	7.6	8.0	7.1	6.9	6.7	6.5	6.3
National savings	17.9	15.9	16.3	15.9	16.2	17.1	17.6	18.3	18.9	19.6
Public	-0.8	0.6	0.7	1.2	1.2	1.6	1.5	1.7	1.7	1.5
Private	18.7	15.4	15.6	14.7	15.0	15.5	16.0	16.5	17.3	18.1
Investment (incl. Inventories+stat. disc.)	27.2	26.7	25.0	23.5	24.2	24.2	24.5	24.9	25.4	25.9
Public	5.1	5.0	4.7	4.6	4.6	5.2	5.1	5.1	5.0	5.0
Private 1/	22.1	21.7	20.2	18.9	19.6	19.1	19.3	19.8	20.5	20.9
Fiscal sector										
Total revenue and grants	24.0	26.3	26.4	27.4	28.2	28.1	27.9	27.8	27.5	27.2
Tax revenue	22.0	24.1	23.9	24.9	25.9	25.6	25.5	25.4	25.2	24.9
Total expenditure	29.2	32.2	31.0	29.6	30.2	29.9	29.7	29.4	29.3	29.2
Of which: Repayment of end-2013 stock of unpaid bills and arrears		2.4	1.2	0.0						
Primary	26.0	29.3	28.3	27.2	28.1	27.7	27.3	26.9	26.6	26.4
Interest	3.2	2.9	2.7	2.5	2.1	2.2	2.4	2.5	2.7	2.8
Unidentified measures (cumulative)		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-5.2	-5.9	-4.6	-2.3	-2.0	-1.9	-1.8	-1.6	-1.8	-2.0
Primary balance	-2.0	-3.0	-1.9	0.2	0.1	0.4	0.6	0.9	0.9	0.8
Financing	5.2	5.9	4.6	2.3	2.0	1.9	1.8	1.6	1.8	2.0
Of which: Domestic	4.4	3.4	-1.3	0.9	-1.7	-3.6	0.8	-0.4	1.5	1.9
Of which: Foreign	0.8	2.5	5.0	1.3	3.7	5.5	1.0	2.0	0.2	0.1
General Government Debt 2/	70.4	72.0	74.1	73.3	71.5	71.3	68.7	66.7	64.0	62.2
Domestic	43.4	42.4	39.7	39.0	35.3	31.5	30.0	28.3	27.7	28.0
Of which: Unpaid bills and arrears	4.8	1.9	1.0	0.9	0.9	0.8	0.6	0.4	0.3	0.3
External	27.0	29.6	34.4	34.3	36.2	39.8	38.7	38.3	36.3	34.2
Monetary indicators	(Growth rate in percent, unless otherwise indicated)									
Broad money growth	2.3	4.0	1.8	3.9	4.3	5.9	6.1	6.5	6.6	6.6
Private credit growth	-1.4	2.0	-2.8	0.4	0.9	4.2	5.6	6.2	6.3	6.3
Velocity (nominal GDP/broad money)	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Interest rate (3-mth T-bills, end-period)	3.4	3.1	1.5	1.2	...	...	...	...	...	...
External sector	(Percent of GDP, unless otherwise indicated)									
Trade balance (goods and services)	-18.0	-19.0	-17.3	-16.9	-16.5	-15.4	-14.8	-14.2	-13.8	-13.4
Current account balance 3/	-9.3	-10.8	-8.6	-7.6	-8.0	-7.1	-6.9	-6.7	-6.5	-6.3
Gross international reserves (in billions of Euros)	2.0	2.2	2.9	2.9	2.9	3.2	3.0	3.2	3.2	3.3
(In months of imports of goods and services)	5.1	5.8	7.0	6.6	6.2	6.5	5.9	5.9	5.6	5.5
(Relative to external debt service)	4.9	2.9	2.6	3.6	3.1	3.2	2.9	2.1	2.8	2.7
(In percent of broad money)	24.6	25.7	32.5	31.5	29.5	31.4	28.6	28.5	27.0	25.9
Change in REER (eop, in percent; +=appreciation)	1.0	2.3	1.5	3.9	...	...	...	...	...	...
Memorandum items										
Nominal GDP (in billions of lek)	1350	1395	1428	1473	1562	1658	1764	1884	2013	2150
Output gap (percent)	-0.7	-1.2	-1.6	-1.2	-0.6	-0.4	-0.2	0.0	0.1	0.1

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

1/ INSTAT revised 2015 national account data in May 2017.

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

3/ Current account had a sizable revision as BoA revised the historical data in September 2017.

Table 2a. Albania: General Government Operations, 2013–22
(Percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
				Prel.	Proj.			Proj.		
Total revenue and grants	24.0	26.3	26.4	27.4	28.2	28.1	27.9	27.8	27.5	27.2
Tax revenue	22.0	24.1	23.9	24.9	25.9	25.6	25.5	25.4	25.2	24.9
VAT	8.0	8.9	8.7	8.7	9.0	8.8	8.7	8.7	8.6	8.6
Profit tax	1.1	1.5	1.7	1.9	2.0	2.0	2.0	2.0	2.0	2.0
Excise tax	2.8	2.9	2.7	2.8	3.0	3.0	2.9	2.9	2.8	2.7
Personal income tax	2.2	2.1	2.1	2.1	2.3	2.2	2.2	2.2	2.2	2.2
Customs duties	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other taxes	2.1	2.3	2.4	2.4	2.4	2.4	2.3	2.2	2.2	2.1
Local government revenue 1/	0.8	0.9	0.8	1.0	1.1	1.2	1.3	1.5	1.5	1.5
Social insurance contributions	4.4	5.0	5.0	5.4	5.6	5.6	5.6	5.5	5.4	5.3
Non-tax revenue	1.6	1.5	1.8	1.5	1.5	1.4	1.4	1.4	1.4	1.4
Grants	0.4	0.7	0.8	1.0	0.9	1.0	1.0	1.0	0.9	0.9
Total expenditure	29.2	32.2	31.0	29.6	30.2	29.9	29.7	29.4	29.3	29.2
Current expenditure	24.3	25.0	24.9	25.2	25.2	24.6	24.6	24.4	24.4	24.4
Personnel cost 2/	5.2	5.1	5.1	4.6	4.8	4.7	4.6	4.4	4.4	4.3
Interest	3.2	2.9	2.7	2.5	2.1	2.2	2.4	2.5	2.7	2.8
Operations & maintenance	2.4	2.2	3.0	3.0	2.8	2.7	2.7	2.5	2.6	2.6
Subsidies	0.1	0.6	0.5	0.3	0.4	0.4	0.4	0.3	0.2	0.2
Energy guarantees 3/		0.5	0.3	0.0	0.3	0.3	0.2	0.1	0.1	0.1
Nonenergy guarantees		0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other		0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social insurance outlays	9.5	9.9	9.9	10.4	10.3	10.3	10.3	10.3	10.2	10.2
Local government expenditure 2/ 4/	2.2	2.4	2.4	2.8	3.3	2.9	2.9	3.1	3.1	3.1
Social protection transfers	1.7	1.8	1.4	1.7	1.5	1.4	1.3	1.3	1.3	1.3
Other current expenditure 8/				0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure 4/	4.8	4.3	4.4	4.0	4.6	5.2	5.0	4.9	4.7	4.7
Domestically financed	2.7	2.4	2.6	2.6	2.2	1.8	1.4	2.0	1.7	1.9
Foreign financed	2.1	1.9	1.7	1.4	2.4	3.4	3.6	2.9	3.0	2.8
Lending minus repayment	0.0	0.4	0.5	0.5	0.3	-0.1	-0.1	-0.1	0.0	0.0
Reserve and contingency funds 5/					0.2	0.2	0.2	0.2	0.2	0.2
Repayment of end-2013 stock of unpaid bills and arrears		2.4	1.2	0.0						
Overall balance	-5.2	-5.9	-4.6	-2.3	-2.0	-1.9	-1.8	-1.6	-1.8	-2.0
Financing	5.2	5.9	4.6	2.3	2.0	1.9	1.8	1.6	1.8	2.0
Domestic	4.4	3.4	-1.3	0.9	-1.7	-3.6	0.8	-0.4	1.5	1.9
Privatization receipts	1.2	0.0	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	3.4	3.2	-0.9	0.7	-0.6	-0.8	0.5	0.3	1.3	2.1
Gross borrowing	33.6	33.2	31.2	25.3	21.3	20.0	20.5	16.1	18.3	19.9
Amortization	30.2	29.9	32.1	24.5	21.8	20.8	19.9	15.7	17.0	17.8
Change in general gov. deposits	...	0.1	0.5	-0.3	-0.1	-1.9	0.3	-0.8	0.2	-0.2
Other	-0.3	0.3	-0.9	0.0	-1.2	-2.8	0.3	-0.8	0.2	-0.2
Foreign	0.8	2.5	5.0	1.3	3.7	5.5	1.0	2.0	0.2	0.1
Gross borrowing	1.7	3.9	9.5	2.8	5.5	7.5	3.1	7.4	2.4	2.3
Amortization	0.9	1.3	4.3	1.5	1.8	2.0	2.1	5.4	2.2	2.2
Accumulation of arrears 6/	0.0	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:										
Primary balance	-2.0	-3.0	-1.9	0.2	0.1	0.4	0.6	0.9	0.9	0.8
Structural primary balance	-1.7	-0.1	-0.4	0.5	0.5	0.5	0.7	0.9	0.9	0.8
General government debt 7/	70.4	72.0	74.1	73.3	71.5	71.3	68.7	66.7	64.0	62.2
Of which: Short-term general government debt	19.7	20.5	17.8	16.3	14.9	13.4	13.1	9.8	10.6	11.0
Domestic	43.4	42.4	39.7	39.0	35.3	31.5	30.0	28.3	27.7	28.0
Of which: Unpaid bills and arrears	4.8	1.9	1.0	0.9	0.9	0.8	0.6	0.4	0.3	0.3
External	27.0	29.6	34.4	34.3	36.2	39.8	38.7	38.3	36.3	34.2
Direct general government external debt	24.6	27.5	32.6	32.7	33.7	36.7	35.8	35.8	34.1	32.4
Government guaranteed external debt	2.3	2.0	1.8	1.6	2.5	3.1	2.8	2.5	2.2	1.9
General government debt (incl. announced PPP projects) 9/	70.4	72.0	74.1	73.3	71.5	73.4	72.6	72.2	70.9	68.8
GDP (in billions of leks)	1350	1395	1428	1473	1562	1658	1764	1884	2013	2150

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

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

Table 2b. Albania: General Government Operations, 2013–22
(Billion Lek)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
				Prel.	Proj.			Proj.		
Total revenue and grants	323.7	366.6	377.5	403.1	440.8	465.3	492.5	524.1	553.7	585.0
Tax revenue	296.4	335.8	340.6	366.0	404.2	425.0	449.5	478.3	506.7	534.7
VAT	108.5	123.7	124.8	128.1	140.3	145.5	154.1	163.7	174.1	184.9
Profit tax	15.1	21.5	24.2	28.5	30.5	32.5	34.9	37.5	40.5	43.6
Excise tax	38.2	40.9	39.0	41.9	47.0	49.9	51.9	54.0	56.2	57.6
Personal income tax	29.6	28.9	29.7	31.4	36.3	36.8	39.1	41.6	44.3	47.2
Customs duties	5.8	5.9	5.8	6.1	6.5	6.8	7.2	7.7	8.2	8.8
Other taxes	28.5	32.6	33.7	35.8	38.2	39.3	40.6	42.0	43.6	45.2
Local government revenue 1/	10.8	12.4	11.7	15.0	17.7	20.6	23.7	28.6	30.6	32.7
Social insurance contributions	60.0	69.9	71.7	79.2	87.7	93.6	98.1	103.1	109.2	114.7
Non-tax revenue	21.6	20.7	25.7	22.5	22.9	23.8	25.3	27.0	28.9	30.8
Grants	5.7	10.1	11.2	14.6	13.8	16.6	17.6	18.8	18.2	19.4
Total expenditure	394.1	448.6	443.0	436.5	471.6	496.5	524.5	554.6	589.3	627.5
Current expenditure	328.6	348.1	355.9	370.6	393.8	408.7	434.4	460.1	492.1	523.8
Personnel cost 2/	70.7	71.4	72.5	67.5	74.3	77.8	80.6	83.4	89.0	91.7
Interest	43.3	40.1	38.6	36.3	32.5	37.1	43.0	47.6	53.5	59.9
Operations & maintenance	32.4	31.3	42.4	44.3	44.3	45.2	47.1	47.5	51.7	55.2
Subsidies	1.6	8.4	6.8	3.8	6.9	7.3	6.6	4.8	4.5	4.7
Energy guarantees 3/		6.7	4.6	0.0	4.0	4.6	4.0	2.2	1.5	1.5
Nonenergy guarantees		0.1	0.5	2.0	0.6	0.5	0.6	0.6	0.6	0.6
Other		1.6	1.7	1.7	2.3	2.1	2.1	2.1	2.4	2.6
Social insurance outlays	127.6	138.5	141.2	152.6	161.5	170.4	181.4	193.5	206.0	219.2
Local government expenditure 2/ 4/	29.8	32.9	34.1	41.7	51.1	47.7	51.8	58.2	61.7	65.9
Social protection transfers	23.2	25.5	20.2	24.5	23.1	23.3	23.8	25.2	25.7	27.2
Other current expenditure 8/				0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure 4/	65.5	60.5	62.6	58.2	71.1	86.1	87.8	92.2	94.9	101.4
Domestically financed	36.7	33.8	37.7	37.9	34.3	30.5	23.9	36.9	35.0	40.5
Foreign financed	28.8	26.8	24.9	20.4	36.9	55.6	64.0	55.4	59.9	60.9
Lending minus repayment	0.0	5.9	7.3	7.4	4.0	-1.0	-1.0	-1.0	-1.0	-1.0
Reserve and contingency funds 5/				0.0	2.7	2.7	3.3	3.3	3.3	3.3
Repayment of end-2013 stock of unpaid bills and arrears		33.8	17.6	0.0						
Overall balance	-70.4	-82.1	-65.5	-33.3	-30.8	-31.2	-32.1	-30.5	-35.6	-42.5
Financing	70.4	82.1	65.5	33.3	30.8	31.2	32.1	30.5	35.6	42.5
Domestic	59.6	47.5	-18.0	13.9	-26.4	-60.0	14.6	-7.9	30.9	39.9
Privatization receipts	16.7	0.0	0.9	2.8	0.4	0.0	0.0	0.0	0.0	0.0
Net borrowing	46.3	45.0	-12.6	10.6	-8.8	-14.0	9.0	6.4	26.2	44.8
Gross borrowing	454.0	462.6	445.5	372.1	332.1	331.0	360.9	302.8	369.0	428.6
Amortization	407.7	417.7	458.2	361.5	340.9	345.1	351.9	296.4	342.8	383.8
Change in general gov. deposits	...	1.5	6.9	-4.3	-2.1	-32.2	5.6	-14.3	4.7	-5.0
Other	-3.4	4.0	-13.1	0.5	-18.0	-45.9	5.6	-14.3	4.7	-5.0
Foreign	10.8	34.3	71.0	19.5	57.2	91.2	17.4	38.4	4.7	2.6
Gross borrowing	22.4	53.9	135.7	41.9	85.2	124.0	54.0	139.9	48.8	50.2
Amortization	12.8	17.8	61.7	22.0	28.0	32.8	36.5	101.5	44.1	47.6
Accumulation of arrears 6/	0.0	0.3	12.5	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:										
Primary balance	-27.1	-42.0	-26.9	2.9	1.7	5.9	11.0	17.1	17.9	17.4
Structural primary balance	-23.6	-1.6	-6.2	8.0	7.8	8.3	12.3	17.3	17.4	16.2
General government debt 7/	950.3	1004.5	1057.3	1079.7	1117.0	1182.0	1211.3	1255.4	1287.7	1338.0
Of which: Short-term general government debt	265.7	286.6	254.3	239.7	232.5	221.8	231.0	184.7	214.0	235.7
Domestic	586.4	592.1	566.4	575.1	551.7	522.0	529.0	533.4	557.5	601.9
Of which: Unpaid bills and arrears	65.2	26.6	14.1	13.1	14.4	12.4	10.4	8.4	6.4	6.0
External	363.9	412.4	490.9	504.6	565.3	660.1	682.3	722.0	730.2	736.1
Direct general government external debt	332.5	383.9	465.3	481.4	525.9	608.2	632.1	674.9	686.5	695.7
Government guaranteed external debt	31.4	28.5	25.6	23.2	39.4	51.8	50.2	47.2	43.6	40.4
General government debt (incl. announced PPP projects) 9/	950.3	1004.5	1057.3	1079.7	1117.0	1216.5	1280.7	1359.8	1427.5	1478.5

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

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

Table 3a. Albania: Balance of Payments, 2013–22[1]

(Percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
				Prel.	Proj.			Proj.		
Current account	-9.3	-10.8	-8.6	-7.6	-8.0	-7.1	-6.9	-6.7	-6.5	-6.3
Balance of goods and services	-18.0	-19.0	-17.3	-16.9	-16.5	-15.4	-14.8	-14.2	-13.8	-13.4
Trade Balance (goods)	-20.4	-22.2	-22.5	-24.3	-24.1	-23.3	-23.1	-22.9	-22.7	-22.7
Exports	11.1	9.3	7.5	6.6	7.0	7.3	7.4	7.5	7.5	7.6
Of which: Energy	5.7	4.6	3.1	1.8	1.9	1.8	1.9	1.8	1.8	1.8
Imports	31.5	31.6	30.0	30.9	31.1	30.7	30.5	30.3	30.3	30.4
Of which: Energy	6.2	5.8	3.7	3.0	3.7	3.5	3.1	3.1	3.1	3.1
Services (net)	2.4	3.2	5.1	7.4	7.6	7.9	8.3	8.6	9.0	9.3
Income balance	1.7	0.9	1.2	1.6	1.1	1.0	0.8	0.7	0.6	0.7
Of which: Interest due	0.5	1.8	1.8	1.8	1.8	1.9	2.1	2.3	2.3	2.3
Current transfers	7.1	7.3	7.5	7.7	7.4	7.2	7.1	6.9	6.7	6.5
Capital and Financial account	8.9	9.0	5.3	5.4	4.6	8.0	4.7	6.8	5.3	5.2
Capital transfers	0.5	0.9	1.2	0.6	0.6	0.5	0.5	0.5	0.5	0.4
Direct investment, net	9.5	8.1	8.0	8.7	9.4	8.5	7.0	6.5	6.4	6.5
Government Medium- and long-term loans, net	1.1	0.6	-2.5	-0.1	0.4	4.2	1.0	2.2	0.3	0.1
Project loans	1.9	1.7	1.7	1.3	1.9	2.5	2.8	2.1	2.2	2.1
Other loans	0.0	0.0	0.0	0.0	0.0	3.3	0.0	5.2	0.0	0.0
Amortization (includes Eurobond bullet payment)	-0.8	-1.1	-4.2	-1.3	-1.5	-1.6	-1.7	-5.1	-1.9	-2.0
Government Guaranteed Borrowing, net	-0.2	-0.2	-0.2	-0.2	1.0	0.7	-0.1	-0.1	-0.2	-0.1
Disbursement	0.1	0.0	0.0	0.1	1.3	1.1	0.2	0.2	0.1	0.1
Amortization	-0.2	-0.2	-0.2	-0.3	-0.3	-0.4	-0.4	0.3	0.3	0.2
Other flows	-1.9	-1.0	-1.9	-4.6	-7.7	-6.9	-4.8	-3.3	-2.9	-3.0
Errors and omissions 2/	3.1	0.6	1.4	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Net balance	2.7	-1.2	-1.9	-1.0	-2.2	2.1	-1.0	1.3	0.0	0.1
Available financing	-1.1	1.2	1.8	1.0	2.2	-2.1	1.0	-1.3	0.0	-0.1
Change in net reserves (increase = -) 3/	-1.1	-1.0	-6.0	-0.4	0.0	-2.7	1.0	-1.3	-0.1	-0.2
IMF (budget support)	…	0.5	0.9	1.3	0.6	0.0	0.0	0.0	0.0	0.0
World Bank (DPL)	…	1.7	0.0	0.1	1.4	0.5	0.0	0.0	0.1	0.2
Other budget loans	…	…	…	0.0	0.2	0.0	0.0			
Commercial borrowing	0.0	0.0	6.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
o/w WB PBG			2.4							
o/w Eurobond			4.4							
Memorandum items:										
Exports of Goods and Services (percent of GDP)	28.9	28.2	27.4	29.0	29.8	30.5	30.9	31.2	31.4	31.8
Imports of Goods and Services (percent of GDP)	47.0	47.2	44.7	45.8	46.3	45.9	45.7	45.4	45.2	45.2
Current Account (percent of GDP)										
excluding imports related to large energy projects	-9.3	-10.8	-6.7	-4.9	-5.0	-5.4	-6.4	-6.7	-6.5	-6.3
Balance of goods and services										
excluding imports related to large energy projects	-18.0	-19.0	-15.4	-14.2	-13.5	-13.7	-14.3	-14.2	-13.8	-13.4

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

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

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

3/ Net of valuation changes in 2013–16. In projections for 2017–22, valuation effects are assumed to be zero.

Table 3b. Albania: Balance of Payments, 2013–22[1]

(Million Euros, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
				Prel.	Proj.			Proj.		
Current account	-890	-1,076	-882	-812	-928	-860	-882	-903	-933	-966
Balance of goods and services	-1,736	-1,892	-1,772	-1,807	-1,908	-1,862	-1,891	-1,926	-1,984	-2,062
Trade Balance (goods)	-1,962	-2,215	-2,297	-2,603	-2,787	-2,824	-2,944	-3,097	-3,282	-3,488
Exports	1,068	932	771	712	815	888	949	1,012	1,089	1,171
Of which: Energy	545	461	321	197	220	220	236	247	262	273
Imports	3,030	3,147	3,068	3,315	3,602	3,712	3,892	4,108	4,370	4,659
Of which: Energy	594	576	380	318	427	422	393	414	441	471
Services (net)	226	323	525	797	879	962	1,053	1,171	1,298	1,425
Income balance	166	91	122	174	129	125	105	91	90	105
Of which: Interest due	51	176	182	191	207	228	267	306	337	353
Current transfers	680	725	768	821	851	877	904	932	961	991
Capital and Financial account	853	899	545	578	532	971	598	915	766	791
Capital transfers	48	87	126	66	66	66	66	66	66	66
Direct investment, net	914	812	818	936	1,084	1,029	893	876	925	1,003
Government Medium- and long-term loans, net	105	56	-256	-6	47	509	133	293	44	17
Project loans	180	165	171	138	223	301	352	282	320	318
Other loans	0	0	0	0	0	400	0	700	0	0
Amortization (includes Eurobond bullet payment)	-74	-108	-426	-144	-176	-193	-219	-689	-276	-302
Government Guaranteed Borrowing, net	-15	-22	-19	-17	120	89	-14	-18	-22	-20
Disbursement	5	0	3	16	152	136	31	23	18	18
Amortization	-21	-22	-23	-32	-32	-47	-45	41	40	38
Other flows	-184	-103	-197	-489	-889	-839	-613	-453	-417	-466
Errors and omissions 2/	301	55	142	129	139	145	153	163	173	184
Net balance	263	-122	-195	-106	-257	256	-130	175	6	10
Available financing	-104	122	186	106	257	-256	130	-175	-6	-10
Change in net reserves (increase = -) 3/	-104	-97	-610	-48	0	-322	126	-180	-21	-35
IMF (budget support)	…	54	96	144	70	0	0	0	0	0
World Bank (DPL)	…	166	0	9	160	66	5	5	15	25
Other budget loans	…	…	…	0	26	0	0	0	0	0
Commercial borrowing	0	0	700	0	0	0	0	0	0	0
o/w WB PBG			250							
o/w Eurobond			450							
Memorandum items:										
Nominal GDP	9,625	9,968	10,217	10,722	11,582	12,102	12,749	13,547	14,427	15,343
Gross international reserves	2,015	2,192	2,880	2,945	2,853	3,173	3,044	3,225	3,250	3,300
(months of imports of goods and services)	5.1	5.8	7.0	6.6	6.2	6.5	5.9	5.9	5.6	5.5
Net international reserves (IMF-Program defintion)	1,477	1,623	1,728	1,837	1,897	1,972	2,052	2,132	2,212	2,292
(months of imports of goods and services)	3.8	4.3	4.2	4.1	4.1	4.1	4.0	3.9	3.8	3.8
Balance of goods and services (percent of GDP)	-18.0	-19.0	-17.3	-16.9	-16.5	-15.4	-14.8	-14.2	-13.8	-13.4
Current account (percent of GDP)	-9.3	-10.8	-8.6	-7.6	-8.0	-7.1	-6.9	-6.7	-6.5	-6.3
Debt service (percent of exports of goods and services) 4/	0.0	2.3	14.3	4.1	4.4	5.2	6.0	17.2	7.2	7.1
Debt service (percent of central government revenues) 4/	0.0	2.7	15.7	4.7	5.5	6.5	7.6	21.9	9.2	9.2
Total external debt stock (percent of GDP) 5/	58.6	60.5	63.5	64.1	63.9	66.5	63.9	62.2	58.8	55.7
Exports of Goods and Services (millions of Euros)	2,783	2,813	2,799	3,107	3,452	3,692	3,938	4,221	4,535	4,878
Imports of Goods and Services (millions of Euros)	4,519	4,705	4,571	4,914	5,360	5,553	5,829	6,147	6,520	6,940
Volume of Exports of Goods and Services (percent change)	-9.9	3.2	5.0	10.3	5.1	6.8	5.2	5.2	5.1	5.1
Volume of Imports of Goods and Services (percent change)	-8.7	5.6	-0.1	8.2	5.2	3.3	3.8	4.3	4.4	4.6
Terms of trade (percent change)	-3.0	-4.6	-16.5	-6.0	5.9	-2.3	-0.9	-0.6	-0.2	0.0

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

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

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

3/ Net of valuation changes in 2013–16. In projections for 2017–22, valuation effects are assumed to be zero.

4/ Public and publicly guaranteed debt only.

5/ Public and private external debt, including arrears. Debt stock converted into Lek at the e-o-p exchange rate. Data revised to reflect the stock of intercompany liabilities and higher private external debt as captured under BPM6.

Table 4. Albania: External Financing Requirements and Sources, 2014–22[1]

(Million Euros)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Act.		Prel.	Proj.			Proj.		
Total financing requirement	1,218	1,815	970	1,069	1,356	954	1,746	1,204	1,274
Current account (incl. official transfers)	989	756	746	862	794	816	837	867	899
Amortization	131	450	176	208	239	264	730	316	340
Of which: IMF	0	0	0	0	5	17	33	53	59
Change in gross reserves (increase = +) 1/	97	610	48	0	322	-126	180	21	35
Total financing sources	1,218	1,815	970	1,069	1,356	954	1,746	1,204	1,274
Foreign direct investment, net	812	818	936	1,084	1,029	893	876	925	1,003
Official medium- and long-term project loans	165	171	138	223	301	352	282	320	318
Multilateral	95	68	57	156	171	203	136	152	154
Bilateral	70	103	81	67	131	150	146	168	164
Official guaranteed loans	0	3	16	152	136	31	23	18	18
Official budget support loans	220	105	153	257	66	5	5	15	25
Of which: IMF	54	96	144	70	0	0	0	0	0
Commercial borrowing (Eurobond and PBG)	0	700	0	0	400	0	700	0	0
Other	21	18	-273	-646	-577	-327	-139	-74	-91
Portfolio investment, net	28	8	-17	-4	-10	-7	-9	-8	-9
Commercial bank flows, net	-202	-77	-330	-468	-410	-425	-195	-310	-210
Errors and omissions	55	142	129	139	145	153	163	173	184
Other	140	-56	-56	-313	-302	-48	-98	71	-57
Total financing needs	0	0	0	0	0	0	0	0	0

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

1/ The change in gross reserves is net of valuation changes for 2014-16. In projections for 2017-22, valuation effects are assumed to be zero.

Table 5. Albania: Indicators of Capacity to Repay to the Fund, 2013–22
(Million SDRs, Under obligated repurchase schedule)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Fund repurchases and charges										
In millions of SDRs	6.9	6.1	5.3	5.4	1.7	11.2	20.2	32.5	48.3	52.3
In millions of euro	7.7	7.2	6.8	6.9	2.0	13.4	24.1	38.8	57.8	62.8
In percent of gross international reserves	0.4	0.3	0.2	0.2	0.1	0.4	0.8	1.2	1.8	1.9
In percent of exports of goods and services	0.3	0.3	0.2	0.2	0.1	0.4	0.6	0.9	1.3	1.3
In percent of GDP	0.1	0.1	0.1	0.1	0.0	0.1	0.2	0.3	0.4	0.4
In percent of external public debt	0.3	0.2	0.2	0.2	0.0	0.3	0.5	0.7	1.1	1.2
In percent of quota	11.5	10.1	8.9	3.9	1.2	8.0	14.5	23.3	34.7	37.3
Fund credit outstanding (end of period)										
In millions of SDRs	16.4	57.7	129.3	241.5	296.8	291.7	277.3	249.6	205.1	155.9
In millions of euro	18.4	68.1	164.8	308.7	355.4	348.8	330.8	298.0	245.6	187.2
In percent of gross international reserves	0.9	3.1	5.7	10.5	12.5	11.0	10.9	9.2	7.6	5.7
In percent of exports of goods and services	0.7	2.4	5.9	9.9	10.3	9.4	8.4	7.1	5.4	3.8
In percent of GDP	0.2	0.7	1.6	2.9	3.1	2.9	2.6	2.2	1.7	1.2
In percent of external public debt	0.7	2.3	4.8	8.3	8.6	7.3	6.8	5.8	4.7	3.6
In percent of quota	27.3	96.1	215.6	173.4	213.0	209.4	199.1	179.2	147.3	111.1
Memorandum items:										
Gross international reserves	1795	1855	2261	2304	2382	2654	2552	2701	2714	2756
Exports of goods and services	2479	2381	2197	2431	2882	3088	3301	3536	3788	4062
GDP	8575	8437	8021	8387	9670	10122	10688	11347	12049	12776
External public debt	2351	2458	2692	2925	3434	3994	4106	4336	4354	4359
Quota	60.0	60.0	60.0	139.3	139.3	139.3	139.3	139.3	139.3	140.3

Source: Fund staff estimates.

Table 6. Albania: Monetary Survey, 2013–22
(Billion Lek, unless otherwise indicated, end-period)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
				Prel.	Proj.			Proj.		
Net foreign assets	479	525	615	697	753	863	911	965	1,016	1,056
Bank of Albania	274	292	363	390	380	429	414	440	446	453
Commercial banks	205	233	251	307	373	434	497	525	571	603
Net domestic assets	670	670	602	567	565	532	570	612	664	735
Claims on central government, net	363	378	332	357	357	310	317	322	337	368
Bank of Albania	43	47	27	34	32	0	6	-9	-4	-9
Commercial banks	320	331	305	322	325	310	311	330	341	377
Claims on public enterprises	25	27	28	27	11	2	2	2	2	2
Claims on the private sector	513	524	509	511	516	537	568	603	641	681
In leks	195	207	212	231	233	242	256	272	289	307
In foreign currency	318	317	296	280	283	295	311	331	352	374
Other items, net	-231	-259	-267	-328	-318	-317	-316	-314	-315	-316
Broad money	1,149	1,195	1,216	1,263	1,318	1,395	1,481	1,577	1,680	1,791
Currency outside banks	199	218	231	249	260	273	287	303	321	339
Deposits	950	977	986	1,014	1,058	1,122	1,193	1,273	1,360	1,452
Domestic currency	494	505	493	488	509	542	580	622	667	716
Foreign currency	456	473	493	527	549	580	614	652	692	736
Memorandum items:										
Broad money growth (% change)	2.3	4.0	1.8	3.9	4.3	5.9	6.1	6.5	6.6	6.6
Reserve money growth (% change)	3.5	8.1	15.3	7.9	0.5	2.8	3.2	3.2	4.0	4.3
Private sector credit growth (% change)	-1.4	2.0	-2.8	0.4	0.9	4.2	5.6	6.2	6.3	6.3
Broad money (as percent of GDP)	85.1	85.7	85.2	85.8	84.3	84.1	83.9	83.7	83.5	83.3
Private sector credit (as percent of GDP)	38.0	37.5	35.6	34.7	33.0	32.4	32.2	32.0	31.8	31.7
Velocity (nominal GDP/broad money)	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Money multiplier (absolute values)	3.7	3.6	3.2	3.0	3.2	3.3	3.4	3.5	3.5	3.6
Currency (as share of broad money)	17.3	18.2	19.0	19.7	19.7	19.6	19.4	19.2	19.1	18.9
Foreign currency deposits/total deposits	48.0	48.4	50.0	51.9	51.9	51.7	51.4	51.2	50.9	50.7
Gross reserves (millions of euros)	2,015	2,192	2,880	2,945	2,853	3,173	3,044	3,225	3,250	3,300

Sources: Bank of Albania; and IMF staff estimates.

Table 7. Albania: Summary Accounts of the Central Bank, 2013–22
(Billion Lek, unless otherwise indicated, end-period)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
				Prel.	Proj.			Proj.		
Net foreign assets	274	292	363	390	380	429	414	440	446	453
Assets	294	319	405	419	409	458	444	470	475	483
Liabilities	20	27	42	29	29	30	30	30	30	30
Net domestic assets	34	41	21	25	37	-1	28	16	28	41
Domestic credit	66	75	41	66	71	33	60	47	59	72
Net claims on central government	43	47	27	34	32	0	6	-9	-4	-9
Assets	65	64	53	53	53	53	53	53	53	53
Liabilities	22	17	26	19	21	53	48	62	57	62
Other credit	23	27	15	32	39	33	55	56	63	81
Private sector	2	2	2	2	2	2	2	2	2	2
Commercial banks	22	26	13	30	38	31	53	54	62	79
Other items, net (assets = +)	-32	-34	-21	-41	-35	-34	-33	-32	-31	-31
Reserve money	308	333	384	414	417	428	442	455	474	494
Currency in circulation	199	218	231	249	260	273	287	303	321	339
Bank reserves	109	115	152	162	157	155	154	152	153	155
Other nonbank deposits	0	0	2	3	0	0	0	0	0	0

Sources: Bank of Albania; and IMF staff estimates.

Table 8. Albania: IMF Core Indicators of Financial Soundness, 2007-17

		Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
I	Capital-based																
(i)	Regulatory capital as a percent of risk-weighted assets	17.1	17.2	16.2	15.4	15.6	16.2	18.0	16.8	15.7	16.0	16.1	15.6	15.7	15.8	16.3	16.4
(ii)	Regulatory Tier 1 capital as a percent of risk-weighted assets	16.0	16.3	15.3	14.5	14.3	14.6	14.9	13.8	13.5	13.8	14.0	13.6	13.8	14.1	14.6	14.8
(iii)	Capital as a percent of total assets																
	Regulatory Tier 1 capital as a percent of total assets	5.8	6.7	8.7	8.6	8.1	7.9	7.7	7.4	8.3	8.5	8.8	8.9	8.7	8.7	8.8	9.0
	Regulatory capital as a percent of total assets	6.2	7.0	9.2	9.1	8.8	8.8	9.3	9.0	9.7	9.9	10.1	10.2	10.0	9.7	9.9	10.0
	Shareholders' equity as a percent of total assets	7.6	8.6	9.6	9.4	8.7	8.6	8.4	8.6	9.5	9.4	9.6	9.7	9.7	10.0	9.9	10.0
(iv)	Nonperforming loans net of provisions as a percent of capital																
	As a percent of regulatory Tier 1 capital	12.0	27.2	29.9	38.1	56.6	61.8	48.5	46.7	28.4	31.5	35.0	36.6	26.3	24.1	20.8	18.7
	As a percent of regulatory capital	11.2	25.7	28.2	35.9	52.0	55.6	40.2	38.3	24.3	27.1	30.4	32.0	23.1	21.6	18.6	16.9
	As a percent of shareholders' equity	9.1	21.1	27.1	34.8	52.6	56.9	44.8	40.2	24.8	28.7	32.0	33.6	23.6	21.1	18.6	16.8
(v)	Return on equity (ROE) (annual basis)	20.7	11.4	4.6	7.6	0.8	3.8	6.4	10.5	13.2	4.5	8.0	6.8	7.2	16.6	16.7	16.3
(vi)	Net open position in foreign exchange as a percent of capital																
	As a percent of regulatory Tier 1 capital	1.8	4.5	4.1	5.3	4.3	4.1	4.9	10.4	9.0	7.1	9.7	9.4	8.0	5.7	6.2	5.4
	As a percent of regulatory capital	1.7	4.3	3.9	5.0	3.9	3.7	4.1	8.5	7.7	6.1	8.4	8.2	7.0	5.1	5.6	4.9
	As a percent of shareholders' equity	1.4	3.5	3.7	4.9	4.0	3.8	4.5	8.9	7.8	6.4	8.9	8.6	7.2	5.0	5.5	4.9
II	Asset-based																
(vii)	Liquid assets as a percent of total assets (Liquid-asset ratio) 1/	49.8	42.8	27.6	25.9	26.5	29.4	27.6	31.9	32.3	31.8	31.0	29.9	31.3	31.1	31.1	29.1
(viii)	Liquid assets as a percent of short-term liabilities 1/	55.6	104.7	32.6	30.6	33.1	34.9	34.7	40.4	41.4	40.6	40.0	38.6	40.6	40.5	41.1	38.9
(ix)	Return on assets (ROA) (net income to average total assets, annual)	1.6	0.9	0.4	0.7	0.1	0.3	0.5	0.9	1.2	0.4	0.8	0.7	0.7	1.6	1.6	1.6
(x)	Nonperforming loans (gross) as a percent of total loans	3.4	6.6	10.5	14.0	18.8	22.5	23.5	22.8	18.2	19.3	20.0	21.3	18.3	17.4	15.6	14.8
III	Income and expense-based																
(xii)	Interest margin to gross income	92.7	106.5	119.6	118.9	147.7	101.1	87.9	102.2	98.0	100.5	95.0	82.7	81.6	82.7	84.8	83.9
(xiii)	Noninterest expenses to gross income	58.5	69.6	83.0	75.5	91.3	65.9	58.3	61.8	57.0	58.7	56.3	50.2	50.4	50.3	52.9	53.7
IV	Memorandum items																
	Other (noncore) indicators:																
	Customer deposits as a percent of total (non-interbank) loans	215.5	162.6	154.3	166.4	163.2	171.6	180.8	180.2	187.8	188.3	184.1	187.7	192.8	191.0	190.6	191.0
	Foreign currency-denominated loans to total loans	72.5	72.6	70.2	69.8	67.9	64.5	63.0	62.4	60.8	60.6	60.1	59.5	58.6	58.5	57.1	57.1
	Foreign currency-denominated liabilities as a percent of total liabilities	46.9	48.5	48.9	51.0	51.9	52.6	52.8	52.4	53.5	54.5	54.1	54.8	54.6	55.1	54.5	54.7
	Other indicators:																
	Risk weighted assets as a percent of total assets	36.4	40.8	56.7	59.2	56.5	54.2	52.1	53.6	62.0	62.0	62.6	65.2	63.4	61.7	60.4	61.0
	Total loans as a percent of total assets	39.4	47.6	50.8	49.6	50.5	48.6	45.9	46.0	44.5	44.4	44.9	43.9	42.7	42.8	42.9	42.7
	Total loans as a percent of shareholders' equity	516.4	555.1	530.2	527.0	581.9	567.4	548.8	536.3	466.8	473.6	469.2	453.1	438.6	429.8	433.3	424.8

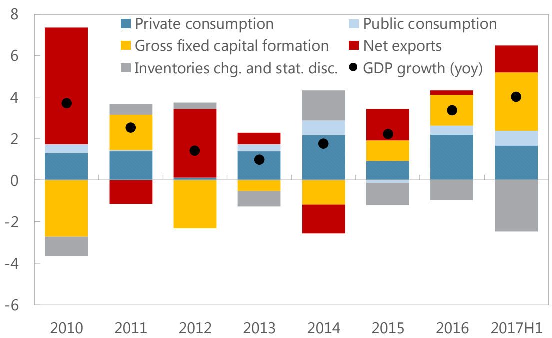
Source: Bank of Albania.

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

Figure 1. Albania: Real GDP Growth and Inflation

Economic recovery continues, driven by rising domestic demand.

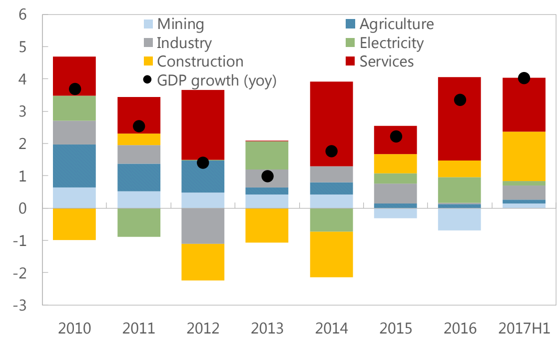
Real GDP Expenditure Contributions to Growth
(Percent)



Sources: INSTAT; and IMF staff estimates.

Services and construction have been key contributors.

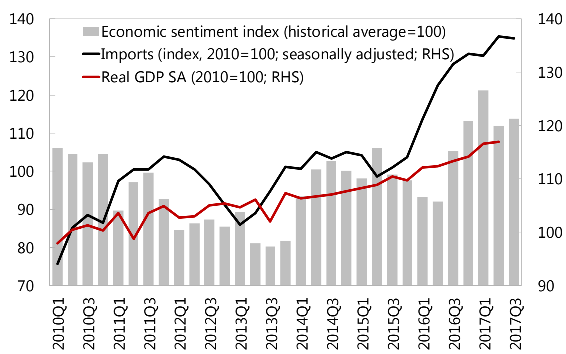
Real GDP Industry Contributions to Growth
(Percent)



Sources: INSTAT; and IMF Staff estimates.

High frequency indicators suggest continued growth momentum...

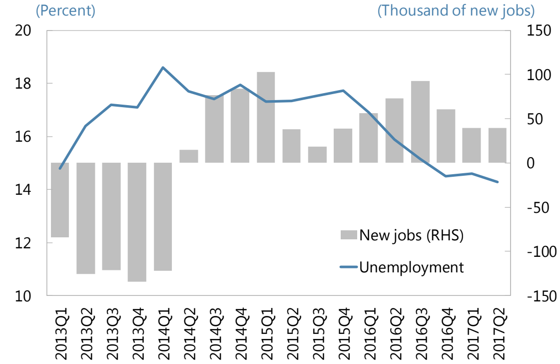
Real GDP, Economic Sentiment, and Imports



Sources: INSTAT; Haver Analytics; and IMF staff calculations.

...while job creation remains robust.

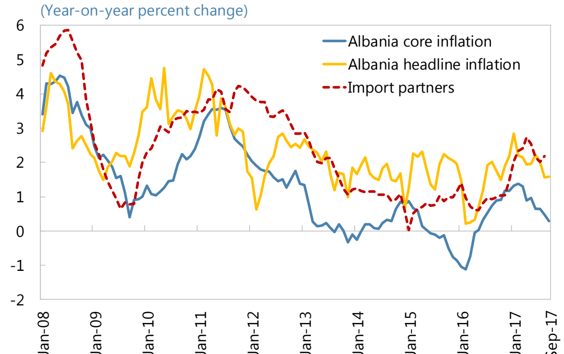
Unemployment and New Jobs
(Percent) (Thousand of new jobs)



Sources: INSTAT, and IMF staff estimates.

Inflation is picking up in line with trading partners, although core inflation remains low...

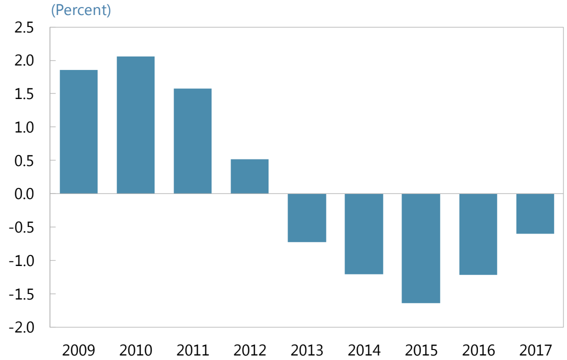
Consumer Price Index
(Year-on-year percent change)



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

...reflecting continued, albeit narrowing, domestic slack.

Output Gap
(Percent)

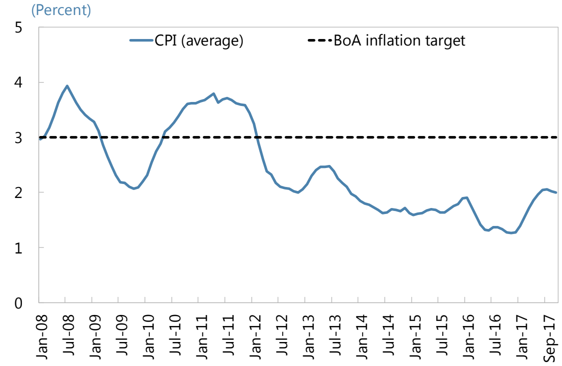


Sources: INSTAT; and IMF staff estimates.

Figure 2. Albania: Monetary Sector Developments

With headline inflation below target of 3 percent…

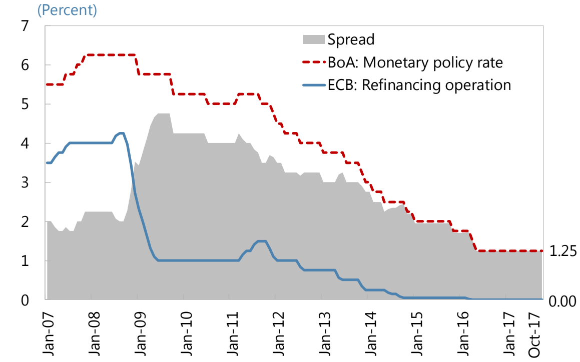
Average Inflation
(Percent)



Sources: INSTAT; and IMF staff calculations.

…monetary policy remains accommodative…

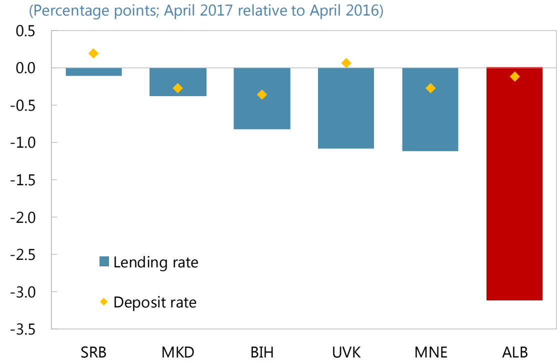
Monetary Policy Rates
(Percent)



Sources: Bank of Albania; and IMF staff estimates.

…helping to push lending rates down…

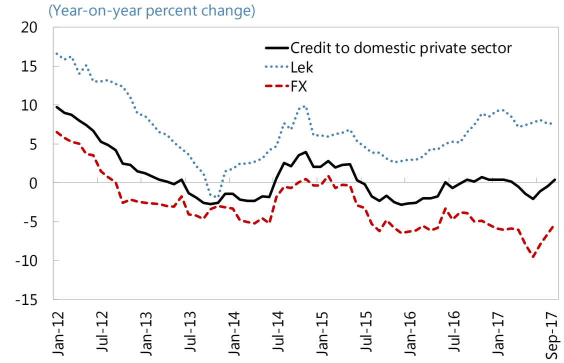
Western Balkans: Changes in Lending and Deposit Rates
(Percentage points; April 2017 relative to April 2016)



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

….and increase lek-denominated lending. Euro-denominated lending remains weak, however …

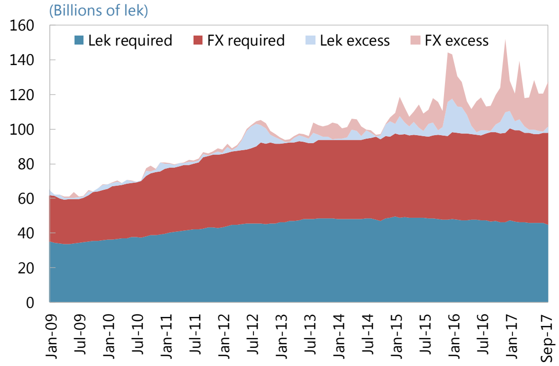
Credit to Domestic Private Sector
(Year-on-year percent change)



Source: Bank of Albania.

…despite excess euro liquidity in the banking system.

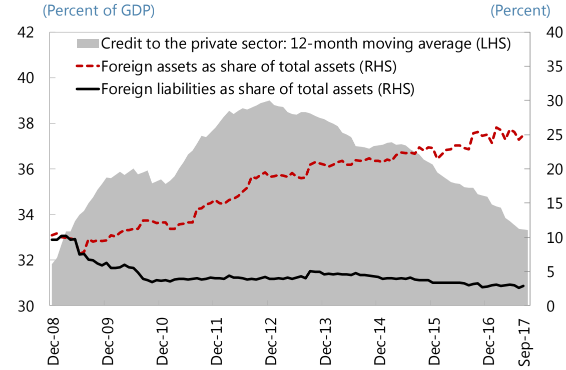
Commercial Banks: Reserves at the Central Bank
(Billions of lek)



Source: Bank of Albania.

Consequently, banks continue to invest abroad to meet net FX exposure limits.

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

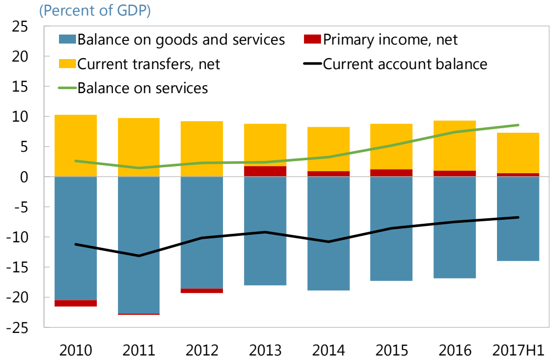


Sources: IMF International Financial Statistics; and IMF staff calculations.

Figure 3. Albania: External Sector Developments

The current account deficit has declined owing to rising remittances and lower trade deficits …

Current Account Balance
(Percent of GDP)



Sources: Bank of Albania; and IMF staff calculations.

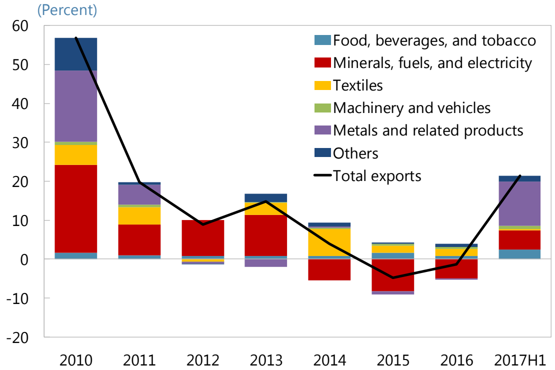
…following a surge in exports of services.

Exports Growth
(Percent)

Sources: Haver Analytics; and IMF staff calculations.

Exports of goods have started to pick up due to favorable terms of trade.

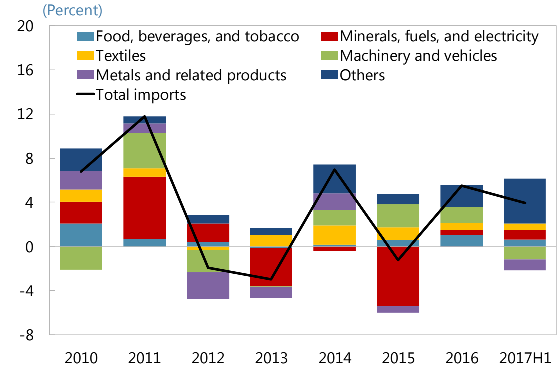
Contribution to Export Growth
(Percent)



Sources: Bank of Albania; INSTAT; and IMF staff calculations.

FDI in large energy projects have helped sustain high imports.

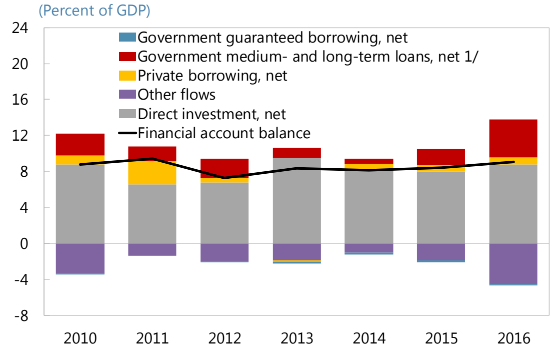
Contribution to Import Growth
(Percent)



Sources: Bank of Albania; INSTAT; and IMF staff calculations.

FDI and donor flows comprise the bulk of external financing…

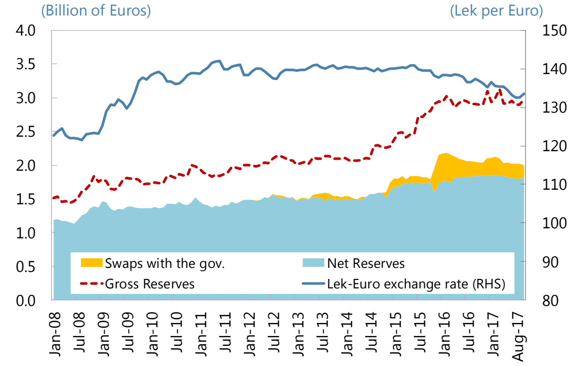
Financial Account Balance
(Percent of GDP)



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

…which have helped increase FX reserves.

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

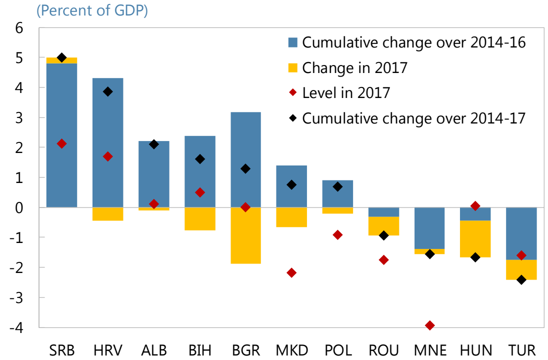


Sources: Bank of Albania; and IMF staff calculations.

Figure 4. Albania: Fiscal Sector Developments

Albania has undertaken a large fiscal adjustment since 2014.

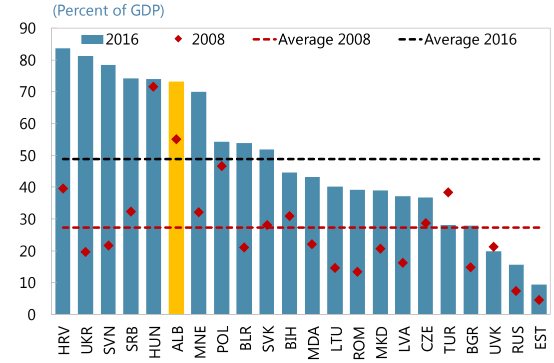
Change in Primary Balance
(Percent of GDP)



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

Public debt has declined from its peak but remains large.

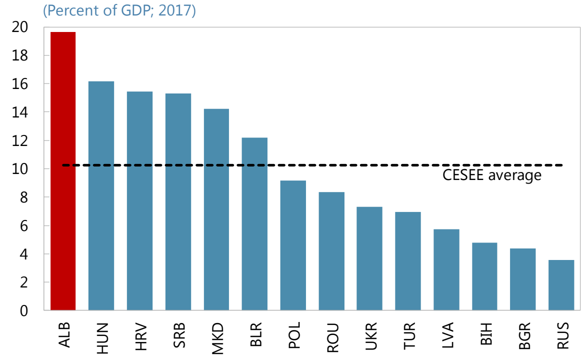
CESEE Public Debt
(Percent of GDP)



Source: IMF, WEO database.

Gross financing needs have also declined but remain sizable.

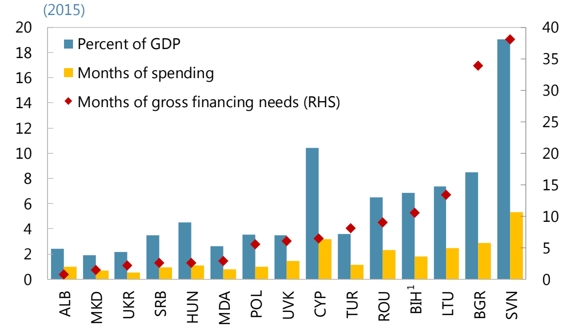
Gross Financing Needs
(Percent of GDP; 2017)



Source: IMF staff estimates.

Government cash buffers are relatively low.

Government Cash and Deposit Assets
(2015)

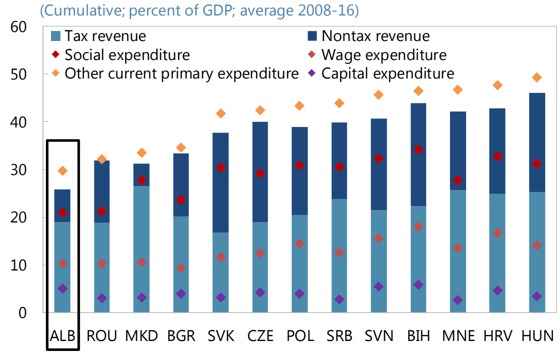


1/ 2014 data used.

Sources: IMF, Debt Sustainability Analyses; IMF, GFS Yearbooks; and IMF staff calculations.

Given the small size of government…

CESEE: Total Revenue and Primary Spending
(Cumulative; percent of GDP; average 2008-16)

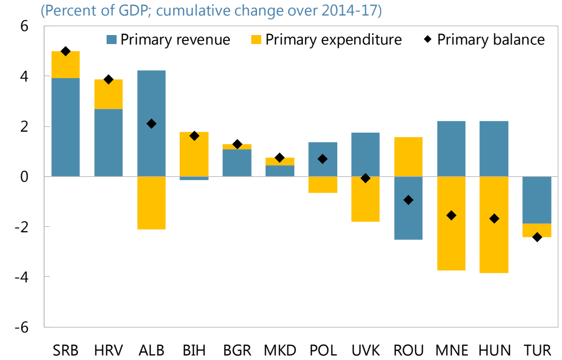


Note: MKD and NME: average 2009-16; ROU: 2012-16.

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

…the adjustment has been mainly driven by revenues.

Contribution to Change in Primary Balance
(Percent of GDP; cumulative change over 2014-17)



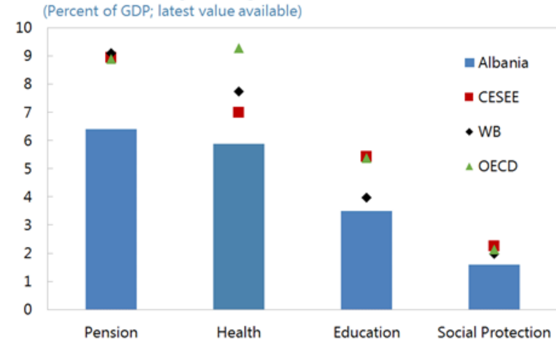
Sources: IMF, WEO database; and IMF staff estimates.

Figure 5. Albania: Social Spending Indicators

Social spending is low.

Government Spending

(Percent of GDP; latest value available)

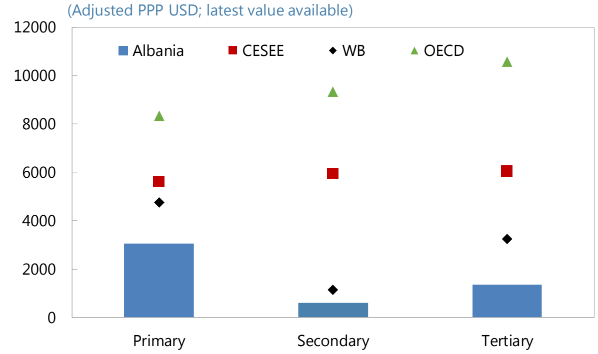


Sources: ASPIRE; EPD; IMF FAD Expenditure Assessment Tool (EAT); World Bank database; and IMF staff calculations.

Spending on higher education is particularly limited…

Government Education Expenditure per Student

(Adjusted PPP USD; latest value available)

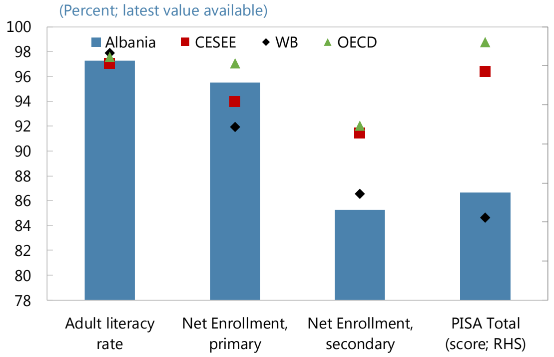


Sources: IMF FAD Expenditure Assessment Tool (EAT); World Bank database; and IMF staff calculations.

…contributing to weaker educational outcomes.

Education Indicators

(Percent; latest value available)

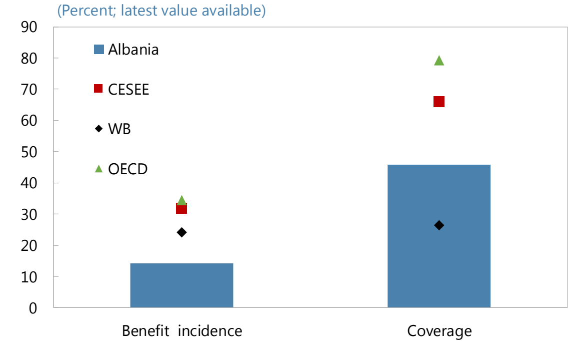


Sources: ASPIRE; IMF FAD Expenditure Assessment Tool (EAT); World Bank database; and IMF staff calculations.

There is scope to improve targeting of social benefits.

Social Assistance Share of Poorest 20 Percent

(Percent; latest value available)

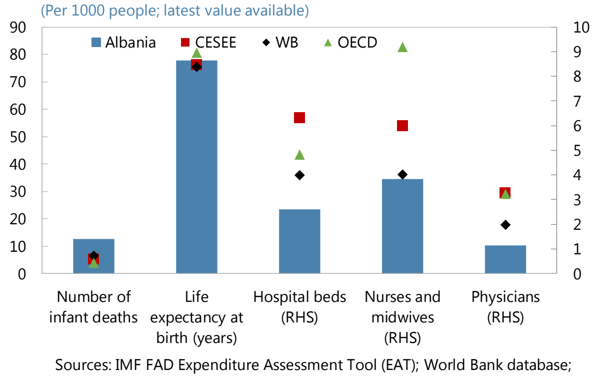


Sources: ASPIRE; IMF FAD Expenditure Assessment Tool (EAT); and IMF staff calculations.

Access to healthcare, a large share of which is financed privately, remains a challenge.

Health and Health System Characteristics Indicators

(Per 1000 people; latest value available)

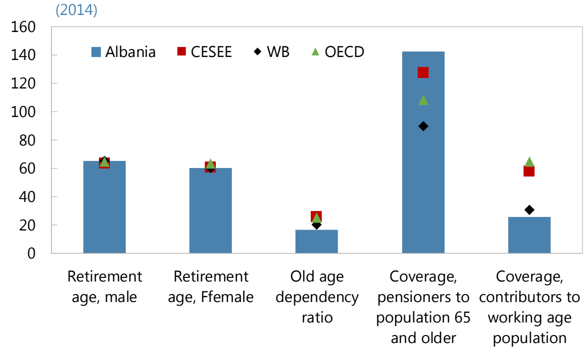


Sources: IMF FAD Expenditure Assessment Tool (EAT); World Bank database; and IMF staff calculations.

The pension system faces challenges from low coverage of contributors and a large number of disability pensioners.

Pension Indicators

(2014)

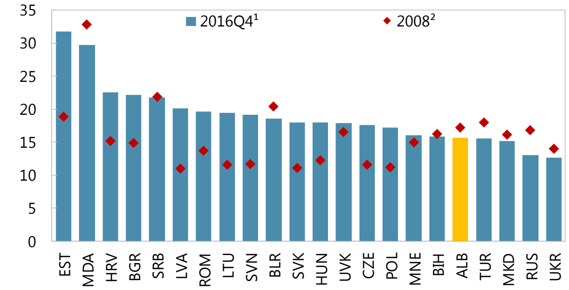


Sources: EPD; IMF FAD Expenditure Assessment Tool (EAT); and IMF staff calculations.

Figure 6. Albania: Banking Sector Indicators

Bank capitalization is adequate and above regulatory thresholds.

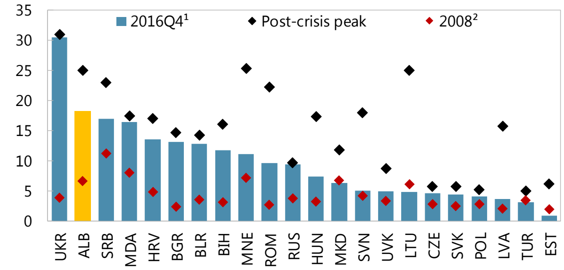
CESEE: Regulatory Capital to Risk Weighted Assets
(Percent)



1/ Except for Lithuania (2016Q3).
2/ Except for Belarus (2010Q4) and Moldova (2009Q1).
Sources: National authorities; IMF Financial Soundness Indicators; and IMF staff estimates.

NPLs remain high…

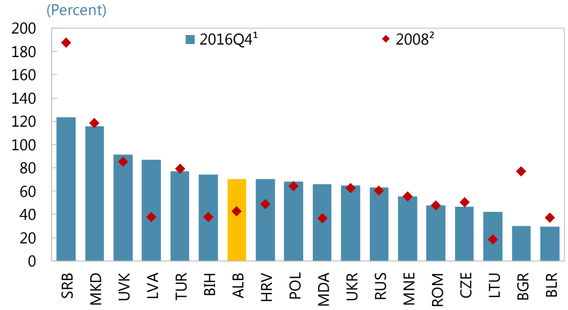
CESEE: Non-Performing Loans
(Percent of total loans)



1/ Except for Lithuania (2016Q3).
2/ Except for Belarus (2010Q4) and Moldova (2009Q1).
Sources: National authorities; IMF Financial Soundness Indicators; and IMF staff estimates.

…but are adequately provisioned.

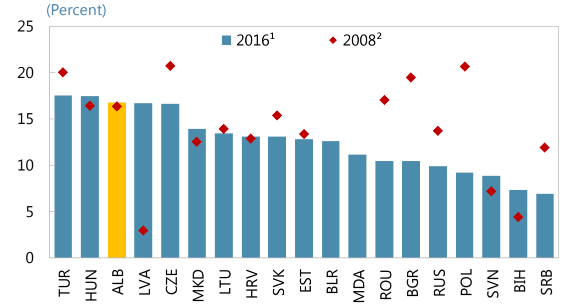
CESEE: Provisions to Gross NPLs
(Percent)



1/ Except for Lithuania (2016Q3).
2/ Except for Belarus (2014Q4), Bosnia and Herzegovina, and Moldova (2009Q1).
Sources: National authorities; IMF Financial Soundness Indicators; and IMF staff estimates.

Banks remain profitable.

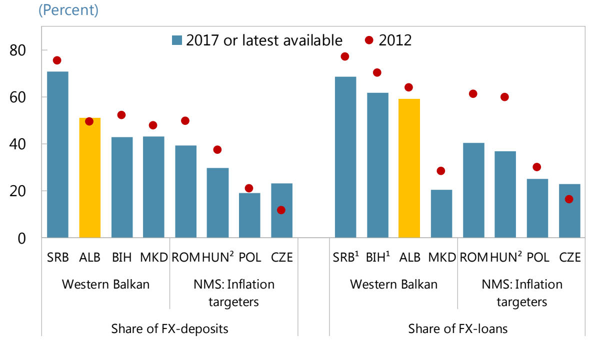
Return on Equity
(Percent)



1/ Except for Albania (2017Q2); Lithuania, Macedonia, Serbia, and Turkey (2016Q3).
2/ Except for Albania and Serbia (2018Q3).
Sources: National authorities; IMF Financial Soundness Indicators; and IMF staff estimates.

High euroization creates risks from significant unhedged exposures.

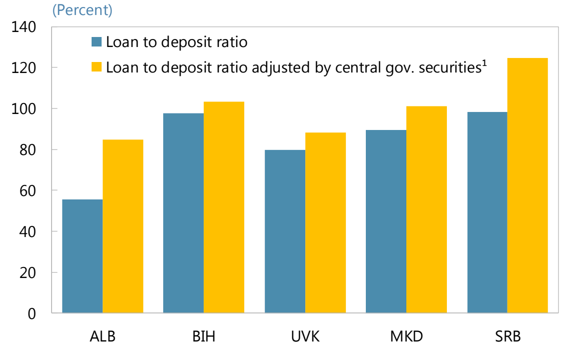
Euroization
(Percent)



1/ SRB and BIH includes FX-indexed loans. 2/ 2016.
Source: IMF, IFS database; IMF staff reports; and IMF staff calculations.

Funding risks are low, while high exposure to sovereign bonds increase systemic risk.

Loan to Deposits Ratio, 2016
(Percent)



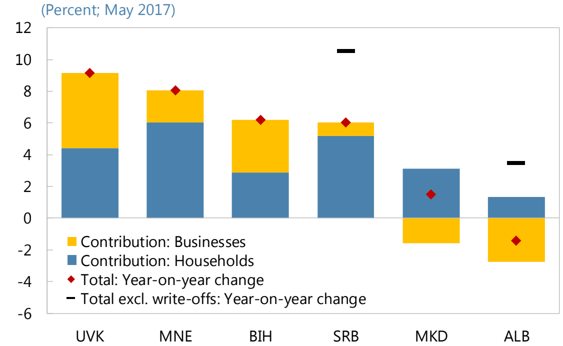
1/ Adds government securities to loans to consider limited liquidity of the system.
Source: IMF staff estimates.

Figure 6. Albania: Banking Sector Indicators (concluded)

Credit growth has been stagnant, especially to the corporate sector.

Western Balkans: Credit to Domestic Private Sector

(Percent; May 2017)

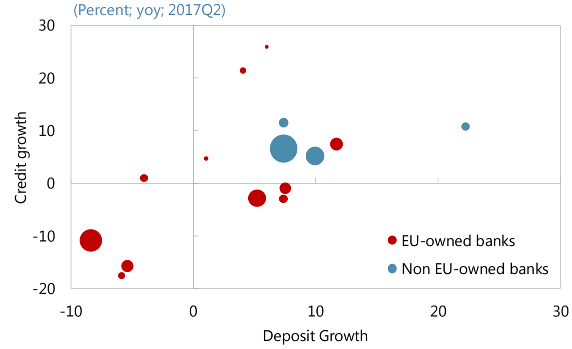


Sources: Haver Analytics; IMF, International Financial Statistics; and IMF staff estimates.

EU-owned banks continue deleveraging while non-EU owned banks are expanding rapidly.

Credit and Deposit Growth at Each Bank

(Percent; yoy; 2017Q2)

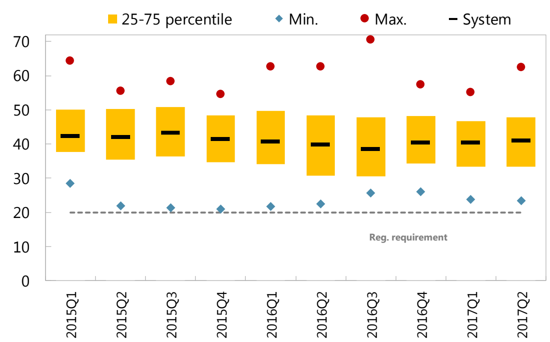


Note: Bubble size indicates market share based on total assets.
Sources: Bank of Albania; and IMF staff estimates.

All banks have sizable liquidity buffers…

Liquid Assets to Short Term Liabilities

(Percent)

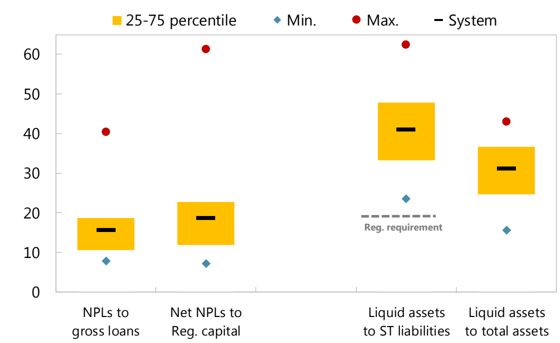


Sources: IMF staff estimates.

However, NPLs are still high in a few banks.

NPLs and Liquid Assets, 2017Q2

(Percent)

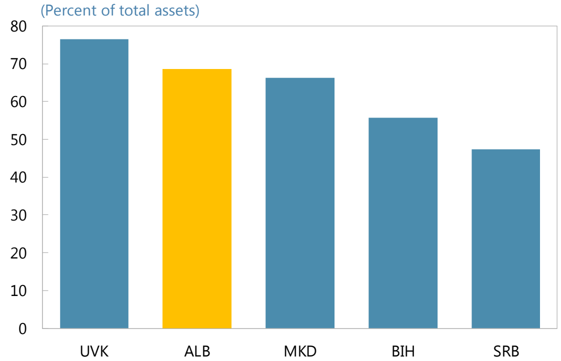


Sources: IMF staff estimates.

The banking system is relatively concentrated.

Bank Concentration: Top 4 Banks, 2016

(Percent of total assets)

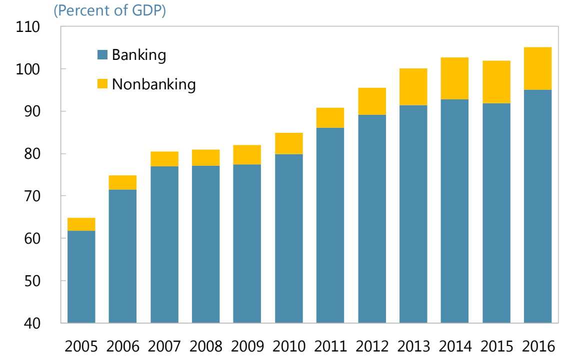


Sources: Country authorities; and IMF staff calculations.

Non-banking sector remains small but is growing rapidly as banks expand into this sector.

Albania: Financial System Assets

(Percent of GDP)

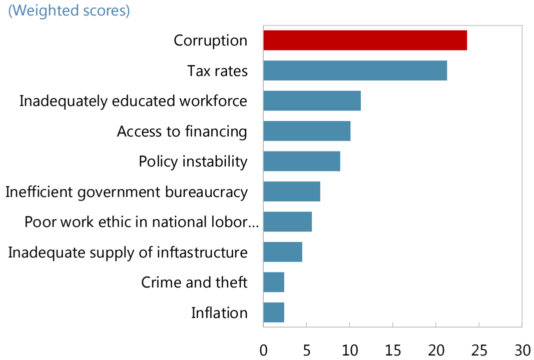


Sources: Bank of Albania; and IMF staff estimates.

Figure 7. Albania: Structural Indicators

A key barrier to investment is corruption, where Albania ranks low.

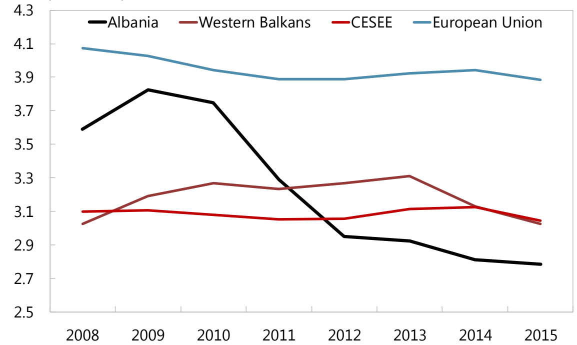
Top Ten Problematic Factors for Business in 2016
(Weighted scores)



Source: Global Competitiveness Report, 2016-2017.

Indicators for settling disputes and contract enforcement have been worsening, which partly reflect…

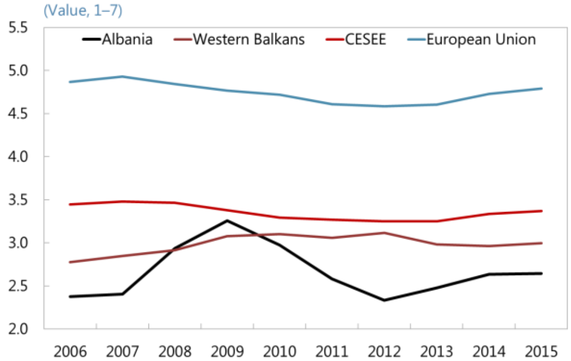
Efficiency of Legal Framework in Settling Disputes
(Value, 1–7)



Source: Global Competitiveness Report, 2016-17.

…lack of judicial independence and impartiality of courts.

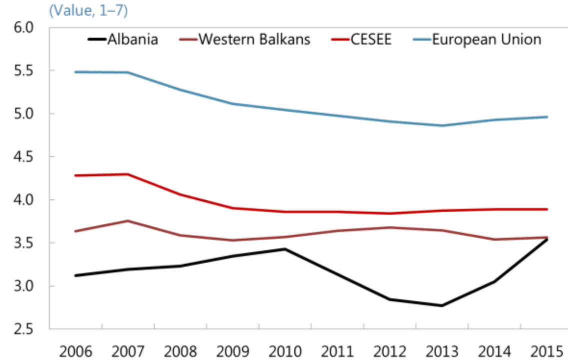
Judicial Independence
(Value, 1–7)



Source: Global Competitiveness Report, 2016-17.

Weakness in property rights is another key barrier to investment.

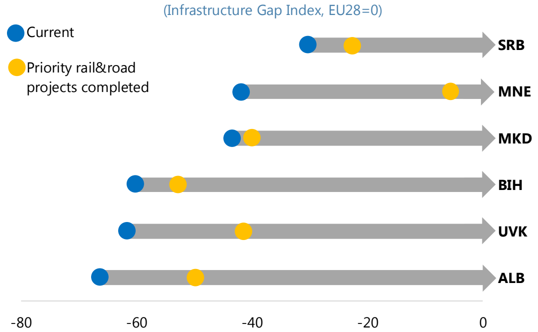
Property Rights
(Value, 1–7)



Source: Global Competitiveness Report, 2016-17.

Albania's infrastructure gap is large.

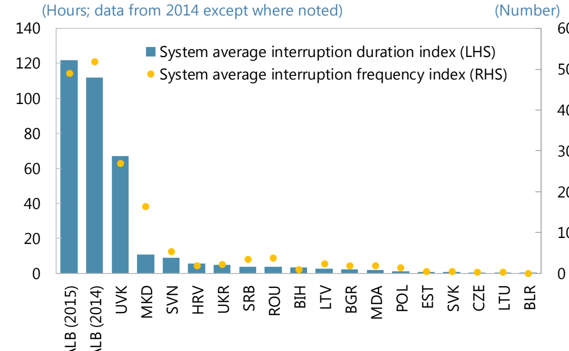
Impact of Priority Projects 1/
(Infrastructure Gap Index, EU28=0)



Sources: Sources: WDI, EIA, IRF, Eurostat, and IMF staff calculations.
1/ Assumes BIH average costs of building one kilometer of rail and road infrastructure for all countries.

Lack of reliable electricity supply remains a key constraint.

Electricty Blackouts
(Hours; data from 2014 except where noted) (Number)

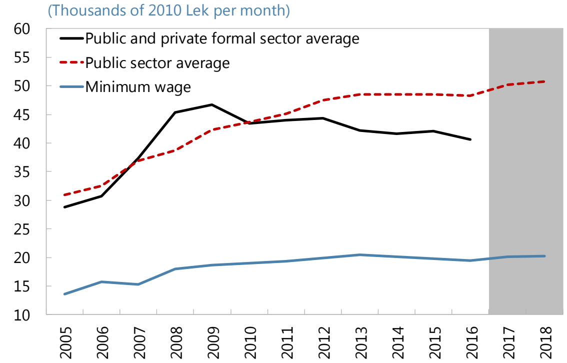


Sources: OShEE; and World Bank, Doing Business Indicators.

Figure 8. Albania: Labor Market and Demographic Developments

Real wage growth has been contained…

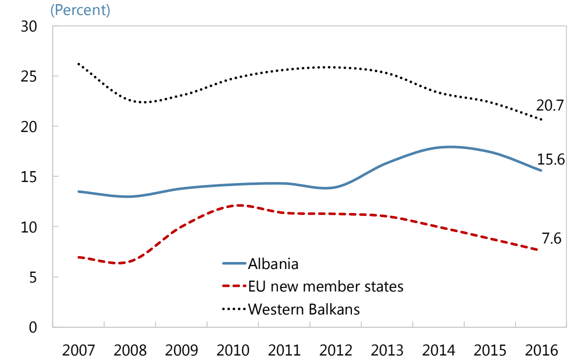
Real Wages
(Thousands of 2010 Lek per month)



Sources: INSTAT; and IMF staff estimates.

…and unemployment rate has started to decline.

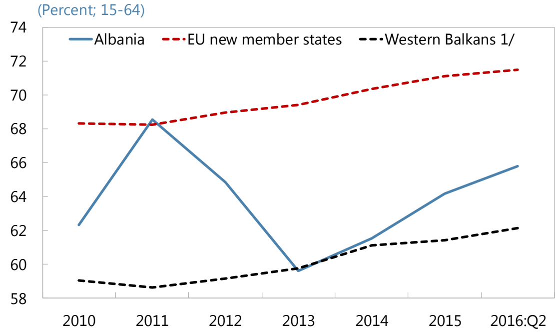
Unemployment Rate
(Percent)



Sources: Country authorities; Eurostat; and IMF staff estimates.

Labor force participation rate has improved recently.

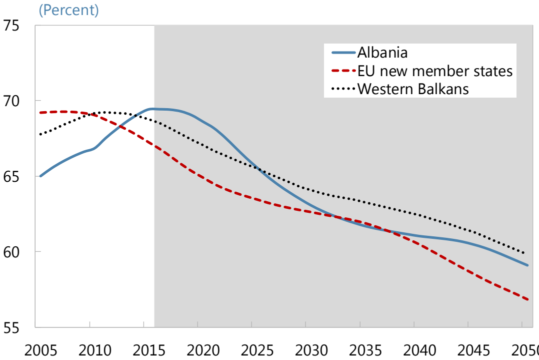
Labor Force Participation Rate
(Percent; 15-64)



Sources: Eurostat; SEE Jobs Gateway database; and IMF staff calculations.
1/ Excludes Kosovo.

However, demographic pressures are rising with the share of working age population set to decline…

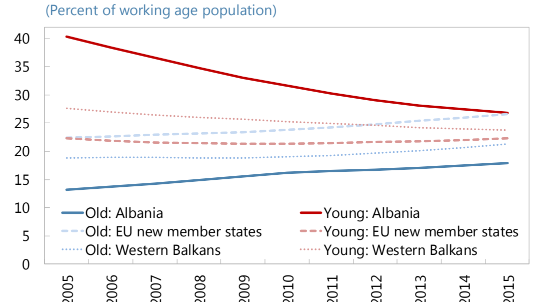
Population 15-64 Years old
(Percent)



Source: UN, Population Prospoects, Revision 2017.

…as the Albanian population ages rapidly…

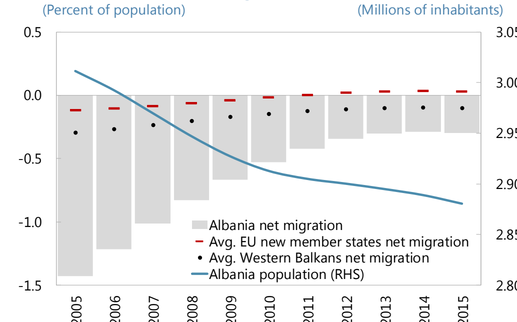
Dependency Ratios
(Percent of working age population)



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

..and high emigration continues.

Population and Net Migration
(Percent of population) (Millions of inhabitants)

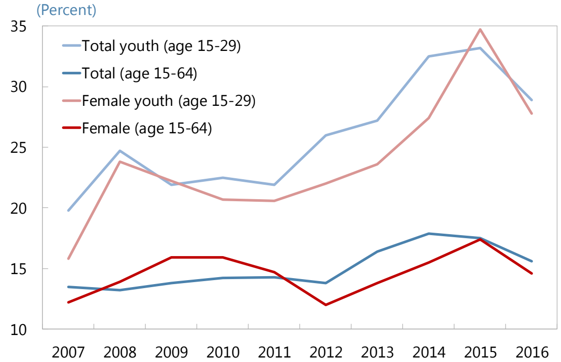


Sources: World Bank, WDI database; and IMF staff estimates.

Figure 9. Albania: Inclusiveness Indicators

Youth unemployment rate is very high…

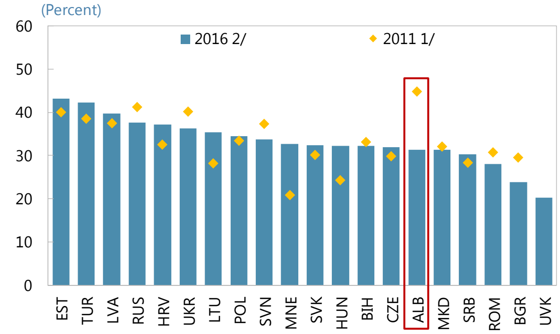
Unemployment Rate
(Percent)



Source: INSTAT.

…and activity rate among the youth has declined significantly.

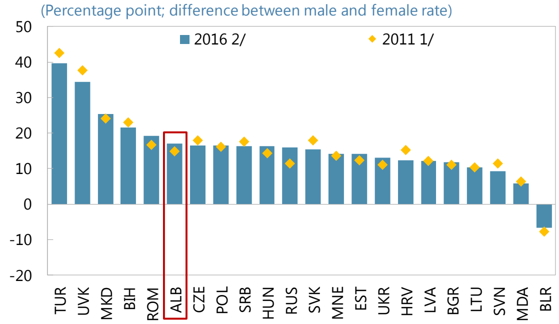
Youth Labor Participation Rate
(Percent)



Source: International Labour Organization.
1/ Except for Bosnia and Herzegovina (2008) and Ukraine (2005).
2/ Except for Albania, Bosnia and Herzegovina, Kosovo, and Ukraine (2015).

Gender gap in activity rate remains sizable and has increased.

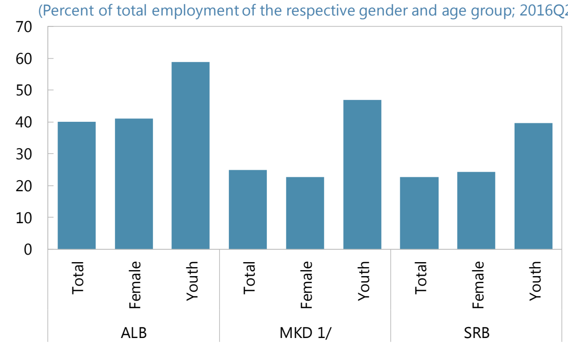
Gender Gap in the Labor Participation Rate
(Percentage point; difference between male and female rate)



1/ Except for Kosovo (2012) and Ukraine (2009).
2/ Except for Albania, Belarus, Bosnia and Herzegovina, Kosovo, and Ukraine (2015).
Source: International Labour Organization.

The young workers are disproportionately in the informal sector…

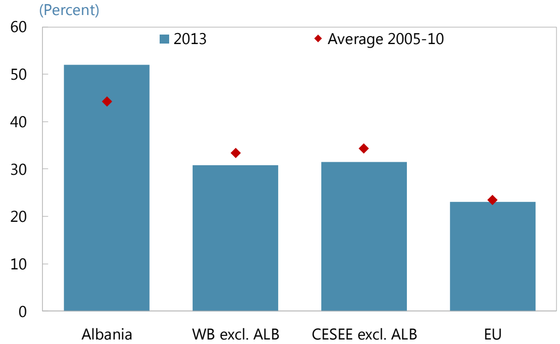
Informal Employment Share
(Percent of total employment of the respective gender and age group; 2016Q2)



1/ 2015.
Source: World Bank, Western Balkans Labor Market Trends 2017.

…which is relatively large and increasing.

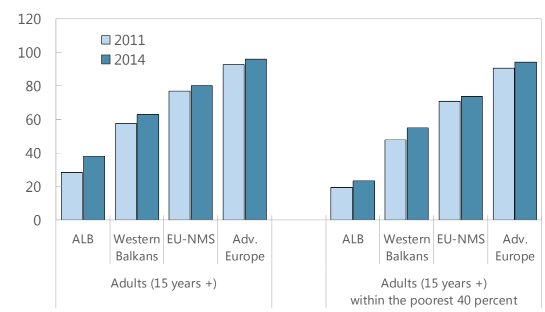
Size of Shadow Economy
(Percent)



Source: Size and Development of the Shadow Economies of 157 Worldwide Countries: Updated and New Measures from 1999 to 2013 (2016).

Financial inclusion is also lagging regional peers.

Share of Adults with an Account at Financial Institutions
(Percent of adults, 15+)



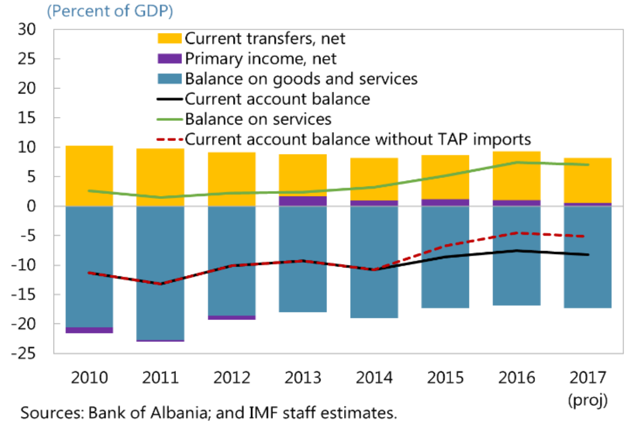
Sources: World Bank, Global Financial Inclusion database; and IMF staff estimates.

Annex I. Albania: External Sector Assessment

The external position is moderately weaker than implied by fundamentals and desirable policy settings, with EBA-Lite results indicating a current account gap of -1 percent and real effective exchange rate overvaluation of about 6 percent. Despite Albania's cost competitiveness, exports are narrowly concentrated in a few low-value added sectors while new investments in the non-energy tradable sector are limited. To strengthen Albania's external position and close its competitiveness gap, the authorities should complete key infrastructure projects to reduce transportation costs and address energy sector reliability; increase domestic savings; improve governance and the rule of law; and raise labor market efficiency by reducing skills shortages.

1. Albania's current account deficit improved in 2016, but remains sizable. The current account deficit declined to 7.6 percent of GDP at end-2016, the lowest level over the past decade. The trade deficit also declined, as a result of a surge in tourism exports, but remains large at 16.9 percent of GDP. The deficit is partially offset by large remittances. In recent years, the trade deficit has been driven by the imports generated from FDI in large energy projects, especially the Trans-Adriatic Pipeline (TAP), contributing around 2.5 percent of GDP in 2016. As the FDI declines over time, the CA deficit is projected to narrow correspondingly. Since the beginning of 2016, the CPI and PPI-based REERs have both appreciated by about 7 percent, reflecting an appreciation of the NEER and price differentials vis-à-vis trading partners.

Current Account Balance
(Percent of GDP)



Sources: Bank of Albania; and IMF staff estimates.

2. The net international investment position has been increasingly negative, but external sustainability risks are mitigated by the large FDI stock. The NIIP increased to -45 percent of GDP in 2016 from -36 percent of GDP in 2013, driven by FDI inflows and external borrowing. Foreign liabilities reached 110 percent of GDP, although nearly half of this stock comprised non-debt creating FDI liabilities, while other liabilities mainly comprise long term concessional public debt. The rate of growth of the NIIP deficit is expected to slow as FDI in large energy projects tapers off.

3. EBA-Lite results suggest an external position that is moderately weaker than implied by fundamentals and desirable policy settings.[1] The Current Account approach points to an external position that is moderately weaker than implied by fundamentals. The CA norm, estimated at -4.9 percent, is smaller than the underlying CA balance of -6.0 percent of GDP,

[1]The EBA-Lite model is used for Albania in view of the country's large aid and remittance flows.

which reflects Albania's low national saving and large FDI inflows. The gap of -1.0 percent of GDP suggests a REER that is overvalued by about 6 percent and thus moderately weaker than implied by fundamentals and desirable policy settings. The results of the ES approach also indicate an external position that is moderately weaker than implied by fundamentals.

External Sector Assessment Summary Table

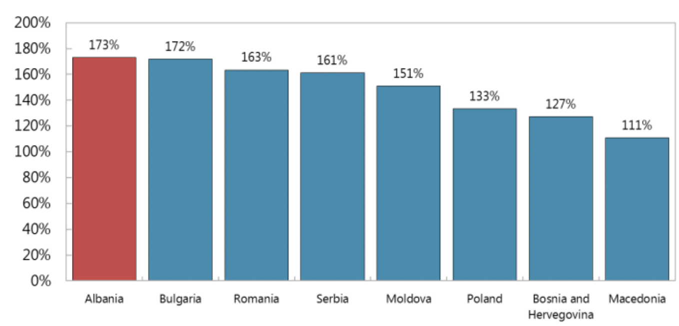
(Percent of GDP)

	Current account norm	Adjusted actual current account	Current account gap	REER gap
EBA-Lite (Current account approach)	-4.9	-6.0	-1.0	6.1
External sustainability approach	-4.4	-6.4	-2.0	9.5
REER approach	n.a.	n.a.	n.a.	-1.0
REER elasticity	-0.17			

Source: IMF staff calculations.

4. Despite large external financing needs, risks are limited and FX reserves coverage remains adequate. At 13.4 percent of GDP in 2016, Albania's external financing needs are substantial. However, gross FX reserves, at 27 percent of GDP at end-2016, have continued to increase, reflecting substantial inflows of FDI and donor-funded longer-term borrowing. In 2016, net FDI stood at 8.7 percent of GDP, covering over 100 percent of CA deficit while FX reserves reached 173 percent of the ARA metric. While this level is above the 150 percent upper threshold for floating regimes, the higher level is appropriate given Albania's large FX deposits held by domestic banks. Reserves coverage is projected to increase in the medium-term in line with the government's desire to boost external commercial borrowing, and decline thereafter as the authorities' de-euroization plans gain momentum and as FX debt is repaid. Reserve coverage is expected to remain above the upper boundary of the ARA over the medium-term, consistent with that of other partially euroized non-Euro Area economies in the region.

Gross Reserves as a Percentage of ARA Metric (2016)



Sources: IMF staff calculations

5. Albania's export shares and competitiveness rankings trail regional peers and show that further policy efforts are needed to create an enabling environment for investment in export sectors (SIP). The country's greatest structural impediments to export competitiveness are weak institutions, deficiencies in infrastructure, an excessively complex tax system, access to finance, and a shortage of skilled labor. Wages are low, but so is productivity. As a consequence, Albania's exports are mostly concentrated in commodities and other low value-added sectors, which may pose an impediment to future growth. To address these gaps and strengthen its external position, the authorities must complete key infrastructure projects to reduce transportation costs and address energy sector reliability; increase domestic savings; improve governance; and raise labor market efficiency by reducing skills shortages.

Annex II. Risk Assessment Matrix[1]

Source of Risk	Relative Likelihood	Impact if Realized	Policy Advice
Weaker-than-expected global growth:			
Structurally weak growth in key advanced economies	High	High Weaker than anticipated growth (particularly in Greece and Italy, the main export destinations and sources of remittances) might spill over to Albania and test the authorities' perseverance with reforms.	Continue to diversify export markets. Improve the domestic policy environment to support growth in domestic consumption and investment.
Financial conditions:			
Tighter global financial conditions	High	Medium Tapering by the ECB could raise interest rates in Albania and stress-test public debt service. Faster-than-expected Fed normalization could lead to dollar appreciation against the euro, pushing up Albania's public-debt-to-GDP ratio. Higher interest rates arising from weaker growth in the euro area would also impact Albanian exports and remittances inflows.	Persist with fiscal consolidation and further lengthen the maturity of public debt. Target improvements in public debt management which would make the debt stock less sensitive to fluctuations in the euro-dollar exchange rate.
European bank distress	Medium	Low Financial turmoil in Greece or Italy could weigh on investor confidence. An abrupt and disorderly exit of a large foreign bank could stress the domestic banking system and also create pressures on the market for domestic public debt.	Continue sharing information with parent banks and their regulators, strengthen contingency plans and closely monitor capital and liquidity positions. In the event of a change of ownership, ensure that fit-and-proper rules are enforced. Fully align Albanian bank regulation with EBA.
Adverse weather conditions	Medium	Medium Continued drought conditions could affect electricity generation beyond 2017. Power shortages could damage growth. Expensive electricity imports could pose quasi-fiscal risks for the budget.	Reinvigorate the implementation of the electricity sector reform. Diversify domestic sources of electricity.
Domestic political instability	Low	High Volatile domestic politics and social tensions could hinder the implementation of the authorities' structural reform and fiscal consolidation agenda.	Reforms improving the business environment are key for medium-term growth prospects. Failure to advance in these areas would undermine medium-term debt sustainability.
Lower energy prices	Low	Medium A drop in oil prices could hurt fiscal revenues and growth, by forcing a scale-back in investment and domestic production. On the upside, since Albania is a net oil importer, low prices could boost domestic demand.	Implement additional fiscal measures, as needed, to meet fiscal targets.
Rollover of public debt	Low	Medium Concerns about debt sustainability may make banks reluctant to roll over government debt, a significant part of which is short-term.	Further lengthen the maturity of public debt and diversify the holder base. Improve market communication. Persist with fiscal adjustment and debt reduction.

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

Annex III. Implementation of the Recommendations from the 2016 Article IV Consultation

FISCAL POLICY	
Recommendation 1: *Continue with revenue-based fiscal consolidation. Adopt a quantitative fiscal rule. Establish a fiscal council to provide independent macro forecasts. Further lengthen the maturity of public debt.*	**Progress: Good.** The authorities achieved their 2016 fiscal target of a small primary surplus. Public debt declined in 2016 for the first time since 2010. For 2017, the authorities are targeting a primary surplus of 0.1 percent of GDP, based mostly on revenue measures. The Organic Budget Law (OBL) was amended in mid-2016 to introduce a requirement to target a lower public debt every year. However, this needs to be supplemented with more operational quantitative targets. Although a fiscal council has not been established, the OBL amendments provided for independent GDP estimates to be used in budget preparation. The average maturity of domestic public debt increased from 706 days at end-2015 to 753 days at end-2016.
Recommendation 2: *Broaden the tax base. Accelerate work on a fiscal cadaster and introduce a valuation-based property tax by end-2017.*	**Progress: Insufficient.** The 2017 Budget included some modest base-broadening measures. However, the authorities recently lowered the VAT on tourist accommodations, and the 2018 draft budget proposes further tax exemptions for the tourism and IT industries. After a protracted delay, the authorities are executing an action plan to build the fiscal cadaster and introduce a value-based property tax.
Recommendation 3: *Implement the tax administration's corporate strategy.*	**Progress: Good.** The authorities are making good progress in implementing the corporate strategy for tax administration reform. Staffing and capacity issues persist at the Risk Management Unit.
Recommendation 4: *Integrate various public investment projects into the budget cycle. Reduce project fragmentation. Review all outstanding unbudgeted investment projects and identify low-priority projects to be cancelled. Boost the credibility of the Medium-Term Budget Framework (MTBF).*	**Progress: Moderate.** Starting with the 2017 Budget, the Regional Development Fund has been brought back into the budget cycle. The authorities are working on reducing fragmentation in project classification, with the objective of using the new classification system for the 2019 budget. Although no unbudgeted investment projects have been canceled, the Minister of Finance has signed an order that makes it more difficult to fund projects not included in the MTBF. Making the MTBF more credible and binding continues to be a challenge.
Recommendation 5: *Strengthen MoF's role in the assessment, approval, and monitoring of PPPs. Record the impact of PPPs on the fiscal accounts in line with international norms.*	**Progress: Insufficient.** The OBL was amended in mid-2016 to strengthen MoF's role, but implementation is weak. A fiscal risks unit has been set up at MoF to vet PPP projects and quantify contingent risks. Capacity constraints and lack of ownership have delayed the recording of PPPs in the fiscal accounts.
Recommendation 6: *Expedite the review of the local public finance law. Verify and resolve local government arrears. Roll out the new treasury IT system to 15 budget institutions initially, and to additional ones over the medium term. Implement multi-year commitment limits.*	**Progress: Moderate.** Parliament passed a new law on local finances in April. While a substantial stock of old local government arrears has been cleared, new ones have accumulated as well. The new Treasury IT system covers 15 budget institutions for now, and there are plans to extend it to 100 by 2020. Multi-year commitment limits have been implemented.

MONETARY POLICY	
Recommendation 7: *Continue with monetary easing, given persistent disinflationary pressures. Allow for greater exchange rate flexibility, but be cognizant of financial stability risks from unhedged exposures. Strengthen the BoA's independence and improve its operations and governance.*	**Progress: Good.** The BoA cut its policy rate by another 50 basis points in the first half of 2016. Inflation has recovered since then but remains below the BoA's 3 percent target. While the BoA is maintaining an accommodative stance for now, it has signaled the gradual withdrawal of monetary stimulus starting in 2018 if growth and inflation continue to recover. The exchange rate has become somewhat more flexible in recent months. Work on the new BoA Law needs to be expedited.
FINANCIAL SECTOR POLICY	
Recommendation 8: *Implement the comprehensive NPL strategy. Simplify the legal framework for insolvency and facilitate collateral execution and out-of-court restructuring. Improve the credit registry.*	**Progress: Good.** The authorities have made substantial progress with the implementation of the NPL resolution strategy and lowered the NPL ratio. However, work on the implementing regulations for the new Bankruptcy Law has been delayed, while the regulations for the amended Private Bailiffs Law have back-tracked. The authorities are revising the guidelines for out-of-court debt restructuring. The credit registry was upgraded in 2016 to incorporate ongoing legal cases and restructured loans.
Recommendation 9: *Further strengthen financial supervision, with a focus on the fastest-growing and systemically important segments of the banking system. Reduce euroization and the share of unhedged FX borrowers. Unwind reduced risk weights designed to encourage moderate credit growth and the lower risk weights on Albanian government securities issued in FX.*	**Progress: Moderate.** Banking supervision inspections have become stricter and are making greater use of risk analysis. The focus on the fastest-growing and systemically important segments of the banking system needs to be strengthened further. The central bank has adopted and started implementing a comprehensive strategy to reduce euroization in the banking system. The measures to encourage moderate credit growth have been repealed. However, the lower risk weights on FX-denominated Albanian government securities are still in place.
Recommendation 10: *Strengthen AFSA's capacity and its ability to attract and retain skilled staff. Assess carefully all license applications. Encourage more competition among investment fund custodians.*	**Progress: Insufficient.** AFSA faces challenges from capacity constraints and staff turnover. Regulatory enforcement needs to be strengthened. Recently granted licenses for nonbanking activities are increasing financial stability and interconnectedness risks and will test AFSA's capacity. AFSA recently licensed a second commercial bank to serve as an investment fund custodian.
STRUCTURAL REFORMS	
Recommendation 11: *Improve the business environment, with a focus on property rights and the judiciary. Expedite efforts to establish the legal cadaster for property registration. Simplify tax collection procedures. Diversify exports beyond commodities and low value-added textiles.*	**Progress: Good.** A sweeping judiciary reform package was approved unanimously by Parliament in July 2016. Its implementation is advancing, but remains politically difficult. Work on the legal cadaster has lagged behind. In December 2016, Parliament approved amendments to the Tax Procedure Code to simplify the tax regime. There is greater emphasis on vocational training to address skill shortages.
Recommendation 12: *Gradually unwind public support for the electricity sector. Liberalize further the electricity market. Strengthen the corporate governance of electricity SOEs and increase their financial transparency. Invest prudently in meters and grid infrastructure.*	**Progress: Insufficient.** Budget support to the electricity sector has fallen from 0.9 percent of GDP in 2014 to 0.5 percent in 2016. Further market liberalization has been delayed. Financial transparency was strengthened in 2016 by the quarterly publication of financial statements for the three electricity SOEs. However, the authorities have stopped publishing those in 2017. The SOEs have ramped up their investment spending. However, the MoF needs to strengthen its monitoring of such spending.

Annex IV. Debt Sustainability Analysis (DSA)

Despite the substantial fiscal adjustment since 2014, Albania's debt remains high and poses significant risks. Rollover needs remain sizable, even following the issuance of a five-year Eurobond in 2015 and the increase in donor financing, both of which have somewhat mitigated rollover risks in the near term. Over the medium term, continued fiscal consolidation and steadfast implementation of structural reforms will be crucial for reducing the risks to debt sustainability. The authorities broadly agreed with this assessment.

A. Background

1. Following a period of rapid growth, public debt declined in 2016, for the first time in six years. High primary deficits and slowing macroeconomic growth led to a rapid increase in public debt by around 13 percent of GDP between 2010 and 2013. In 2014, a new government embarked on a fiscal adjustment strategy. As a result, the pace of debt accumulation slowed down in 2014–15 and was reversed in 2016. However, at 73.3 percent of GDP at end-2016, public debt remains high.

2. The macroeconomic assumptions underpinning the DSA are in line with the authorities' updated macroeconomic adjustment program. The medium term will see a gradual recovery of real growth to around 4 percent, supported by a rebound in confidence and solid implementation of structural reforms following the expected launch of EU accession negotiations. Inflation expectations will remain anchored by the central bank's 3 percent target. After a consolidation of over 2 percent of GDP in 2014–16,[1] fiscal adjustment is expected to continue. The authorities are targeting a gradual improvement of the primary balance in 2018 and beyond, in order to reach a primary surplus of just under one percent of GDP by 2020.

3. The average maturity of the debt stock has been steadily increasing. This reflects efforts to shift from short-term domestic to long-term external financing, including from donors. In addition, the average weighted maturity of domestic public debt has more than doubled since 2011 and now exceeds two years.

B. Public DSA Results

Baseline

4. Under the baseline scenario, Albania's public debt will decline gradually over the medium term, albeit remaining at elevated levels of about 64 percent of GDP by 2021. At this level, debt would continue to pose significant risks because of high rollover needs and a vulnerability to macroeconomic shocks arising from slow growth, low inflation, and volatility in interest rates and the terms of trade. In addition, the heavy reliance on the banking sector (which

[1] As measured by the structural primary balance.

held 60 percent of domestic public debt at end-2016) poses risks given the systemic link between commercial banks and the sovereign.

5. **Public debt under the baseline scenario is susceptible to a range of risks arising from the composition of the financing profile.** Although the authorities have started lengthening the maturity profile, ***rollover risks*** remain high as about two-fifths of central government domestic direct debt was short-term at the end of 2016, and this ratio is expected to decline only gradually over time. Despite a projected substantial decline, public gross financing needs are projected to remain well above the 15 percent of GDP early warning threshold associated with past debt crises. ***Interest rate risk*** is expected to increase with the lengthening of maturities. However, the current lack of a liquid secondary market and commercial banks' preference to hold government securities till maturity both limit somewhat the impact on valuations. Another mitigating factor is the increasing share of external donor financing. Finally, ***exchange rate risk*** will rise with the expansion of foreign currency debt, but Albania's comfortable level of international reserves should alleviate the risk of a large disorderly devaluation.

6. **The alternative scenarios underscore the risks to the baseline if reforms falter.** Key risks arise from a slower-than-projected fiscal adjustment and growth recovery. Indeed, by 2022, public debt would be around 77 percent of GDP under the scenario based on historical performance.[2] Under the same scenario, gross financing needs would be just over 30 percent of GDP in 2022.

7. **The baseline scenario nevertheless remains realistic.** It represents a central forecast reflecting recent policy performance, the new government's policy commitments, and realistic assumptions about the medium-term. In particular, note the following considerations:

- *Limited validity of the historical scenario.* The historical performance of the past 10 years is not representative of the current policy environment. The current government, which took office in 2013 and was re-elected in 2017, has engineered a clear break with past policies. Since 2014, the government has successfully embarked on fiscal consolidation and accompanying reforms, including of fiscal institutions. Given significant risks for macroeconomic stability and uncertain market access, the authorities remain committed to gradually reducing the public debt (by improving the primary balance over the medium term) and accelerating growth (by implementing further structural reforms).

- *Reasonably good forecast record.* Forecasts for growth do not suffer from a large systematic bias, with forecast errors close to the panel average. However, forecasts for the primary balance have been too pessimistic, with a percentile rank of 85 percent, while inflation forecasts have been too optimistic, with a percentile rank of 16 percent. The planned fiscal effort is somewhat larger than what is typical of other countries' adjustment experiences, but this also reflects substantial arrears clearance, which worsened the fiscal balance in 2014–2015.

[2] Under the historical scenario, real GDP growth, the primary balance, and real interest rates are set at their historical average of the past 10 years, while other variables are the same as in the baseline. Under the constant primary balance scenario, the primary balance remains at the 2017 projected level (in percent of GDP), while all other variables are the same as in the baseline.

- *GDP forecasts in line with fundamentals*. Medium-term growth projections seem realistic, given (i) Albania's relatively low per capita income by regional standards and its potential for convergence; (ii) high inflows of FDI throughout the period; (iii) the imminent launch of EU accession negotiations, which should foster further growth-friendly structural reforms; and (iv) the authorities' strong record of implementing difficult reforms.

Stress tests

8. Macroeconomic and fiscal shocks can significantly increase public debt and gross financing needs relative to the baseline throughout the projection period. Among all stress test scenarios, Albania shows the highest vulnerability to a combined macro-fiscal shock.[3] Under this scenario, the debt-to-GDP ratio increases to 81 percent in 2019, before gradually declining to around 78 percent by 2022. Gross financing needs would stabilize around 27–29 percent of GDP by the end of the forecast horizon. The second worst-case scenario would be a growth shock. Following a negative shock in real GDP growth by one standard deviation in 2018–2019, public debt would still be just under 68 percent of GDP in 2022.

9. Fan charts further illustrate the possible evolution of debt over the medium term, through simulating a large number of shocks to macroeconomic variables.[4] These simulations suggest that under a symmetric distribution, an 80 percent confidence interval for the debt stock in 2022 ranges between 54 and 70 percent of GDP. However, under a restricted distribution (which precludes positive shocks to the primary balance), debt could be above 70 percent of GDP by 2022 with a probability of almost 25 percent, relative to the baseline scenario of 62 percent of GDP.

C. External Debt Sustainability

10. The external debt-to-GDP ratio and nominal interest rates on external debt have been revised upwards compared to the last DSA (May 2016). The revisions are the product of a downward adjustment to nominal GDP in U.S. dollars and the conversion to BPM6. Most external debt continues to be held by multilateral creditors and bilateral development agencies. Most foreign public debt is denominated in euros (inter-government loans and the Eurobond), followed by SDRs (IMF loans).

11. The external debt ratio is expected to peak next year and then decline gradually over the medium-term, as growth increases and multilateral borrowing declines. External public borrowing will drive total external debt to peak around 66 percent of GDP in 2018 before declining to 55 percent by 2022. External private borrowing is expected to decline from about 28 to 22

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

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

percent of GDP. Although the accumulation of FDI-related debt liabilities will slow as investment in large energy projects (such as the Trans Adriatic Pipeline) tapers off, such liabilities will likely remain the largest component of the private external debt stock. Public and private external debt service is expected to rise gradually through the medium-term, increasing to 11 percent of GDP in 2020 as the €450 million 2015 Eurobond issuance is amortized. The authorities expect to roll over this debt and accrue new debt via increased commercial borrowing in the medium-term.

12. Stress test results. Under a 30 percent exchange rate depreciation shock, external debt would peak at 100 percent of GDP in 2018 before declining to 84 percent by 2022. Depreciation shocks are likely to have added significance for debt dynamics in view of increased commercial borrowing, although Albania's ample reserve buffers should help mitigate disorderly foreign exchange market conditions. Following a shock to the current account of half a standard deviation (around 2½ percent of GDP), external debt would peak at 68 percent of GDP in 2018 and gradually decline to 63 percent by 2022.

D. Conclusion

13. Despite the significant fiscal adjustment since 2014, Albania's debt remains high and poses significant risks. As highlighted in red in the standardized heat map, Albania's debt and gross financing needs are above relevant thresholds under the baseline. While the share of short-term debt has been declining (green in the heat map), the debt profile shows moderate risks with key indicators above the lower risk-assessment benchmark (yellow in the heat map). The risks are mitigated somewhat by the fact that external donors hold a significant share of the public debt portfolio.

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

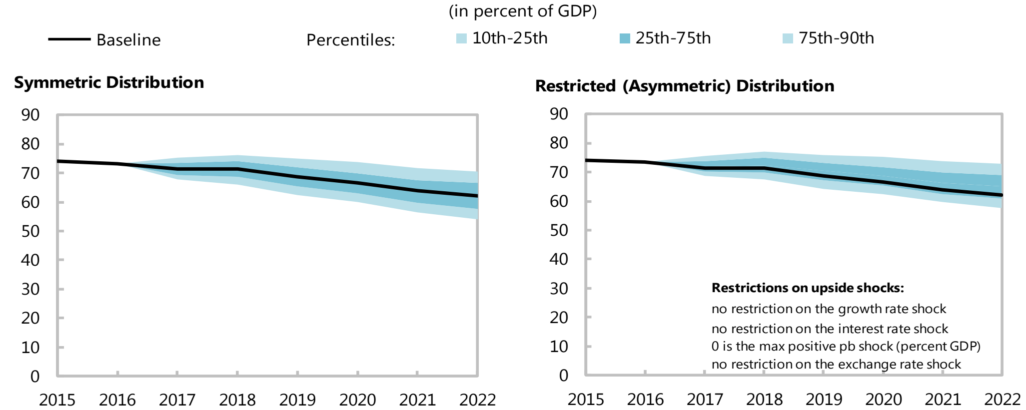
Figure 1. Albania: Public DSA Risk Assessment

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

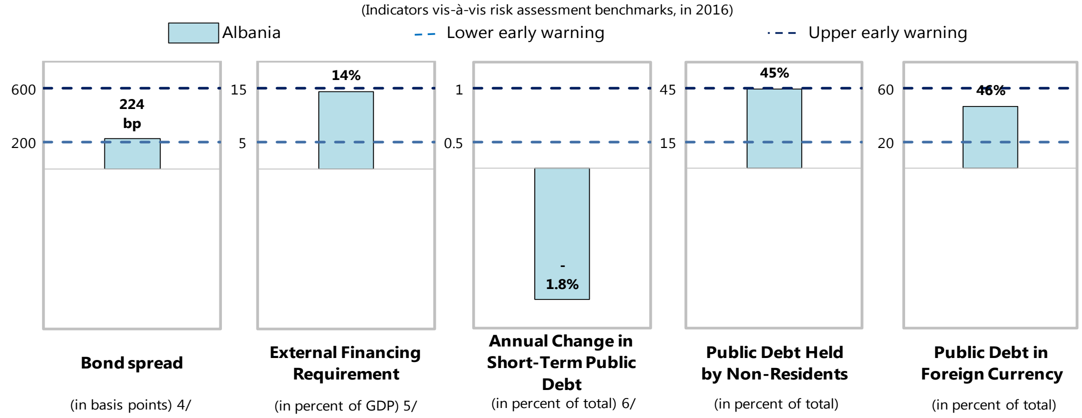
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Source: IMF staff.

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

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

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

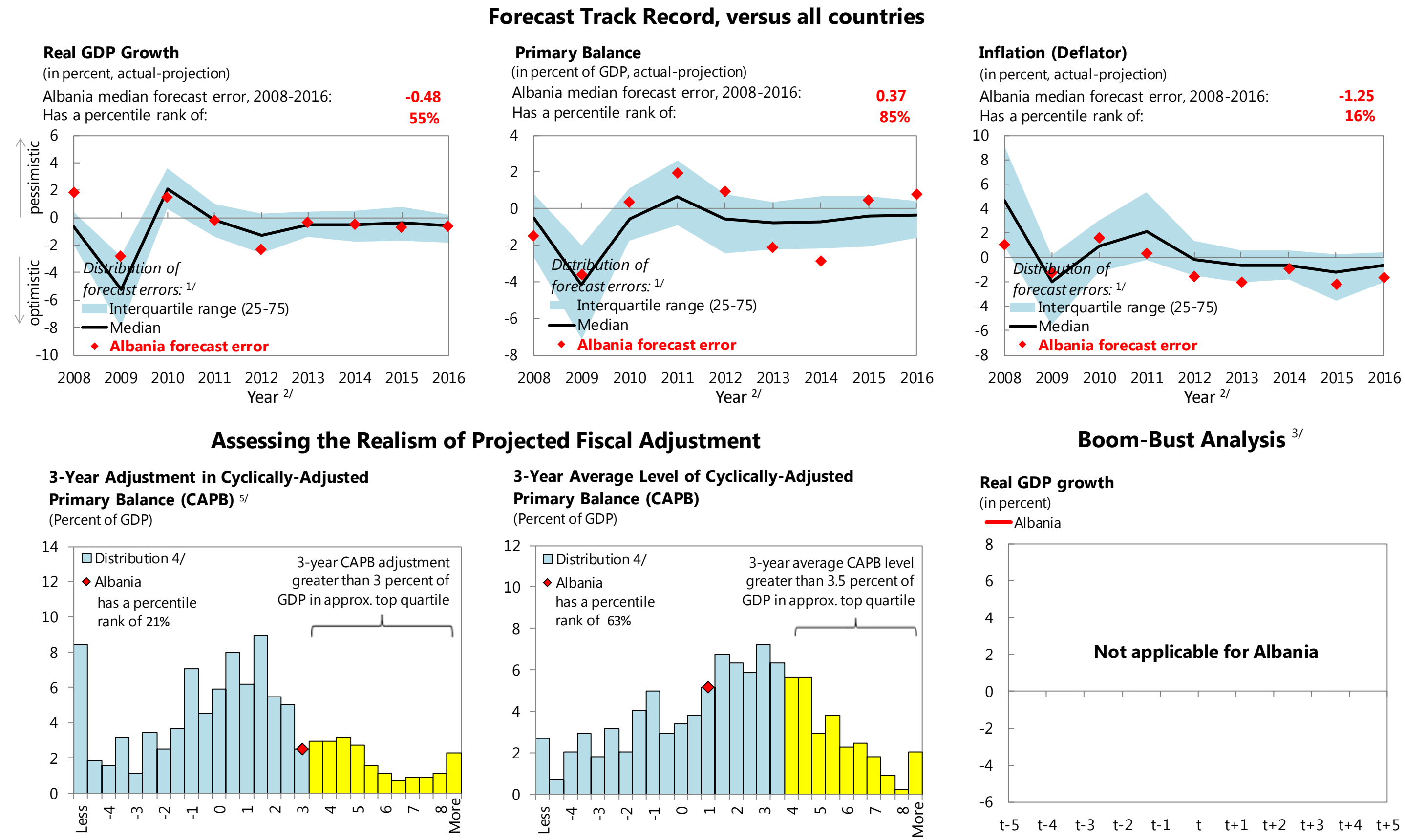
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Bond Spread over German Bonds, an average over the last 3 months, 27-Jul-17 through 25-Oct-17.

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

6/ Following the Eurobond issuance in November, 2015, the government reduced issuance of short-term debt by both reducing rollovers and buying back bonds maturing in early 2016.

Figure 2. Albania: Public DSA – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Albania, as it meets neither the positive output gap criterion nor the private credit growth criterion.

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

5/ The large 3-year improvement in Albania's CAPB is due to substantial arrear clearance in 2014-2015.

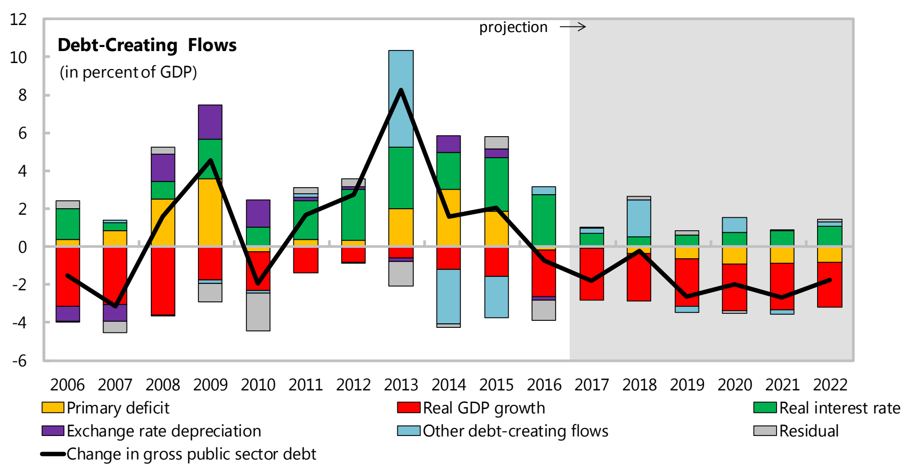
Figure 3. Albania: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario
(in percent of GDP unless otherwise indicated)

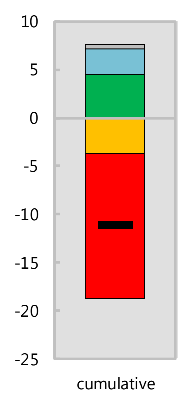
Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of Oct 24, 2017		
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022			
Nominal gross public debt	60.7	74.1	73.3	71.5	71.3	68.7	66.7	64.0	62.2	Sovereign Spreads		
Of which: guarantees	3.6	3.9	3.6	3.4	3.2	3.0	2.9	2.7	2.5	Spread (bp) 3/		197
Public gross financing needs	40.7	41.0	28.3	25.7	25.6	23.7	22.8	21.0	22.0	5Y CDS (bp)		n.a.
Real GDP growth (in percent)	3.7	2.2	3.4	3.9	3.7	3.8	3.9	3.9	4.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	2.6	0.1	-0.2	2.1	2.3	2.5	2.8	2.8	2.8	Moody's	B1	B1
Nominal GDP growth (in percent)	6.4	2.3	3.2	6.1	6.1	6.4	6.8	6.9	6.8	S&Ps [11/]	B+	B+
Effective interest rate (in percent) [4/]	5.8	4.1	3.6	3.2	3.2	3.5	4.1	4.3	4.7	Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [10/]
Change in gross public sector debt	1.5	2.1	-0.7	-1.8	-0.2	-2.6	-2.0	-2.7	-1.8	-11.1	
Identified debt-creating flows	1.9	1.4	0.3	-1.8	-0.4	-2.9	-1.9	-2.7	-1.9	-11.6	
Primary deficit [5/]	1.4	1.9	-0.2	-0.1	-0.4	-0.6	-0.9	-0.9	-0.8	-3.7	-1.0
Primary revenue and grants [5/]	25.7	26.4	27.4	28.2	28.1	27.9	27.8	27.5	27.2	166.7	
Primary expenditure [5/]	27.1	28.3	27.2	28.1	27.7	27.3	26.9	26.6	26.4	163.0	
Automatic debt dynamics [6/]	0.3	1.7	0.1	-2.0	-2.0	-1.9	-1.7	-1.6	-1.3	-10.5	
Interest rate/growth differential [7/]	-0.2	1.2	0.3	-2.0	-2.0	-1.9	-1.7	-1.6	-1.3	-10.5	
Of which: real interest rate	1.8	2.8	2.8	0.7	0.5	0.6	0.8	0.9	1.1	4.5	
Of which: real GDP growth	-2.0	-1.6	-2.4	-2.7	-2.5	-2.5	-2.5	-2.4	-2.4	-15.0	
Exchange rate depreciation [8/]	0.5	0.5	-0.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.2	-2.2	0.4	0.3	1.9	-0.3	0.8	-0.2	0.2	2.7	
Accumulation of general govt. deposits	0.0	-0.5	0.3	0.1	1.9	-0.3	0.8	-0.2	0.2	2.5	
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	0.2	-1.7	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	
Residual [9/]	-0.4	0.7	-1.1	0.0	0.2	0.2	-0.1	0.0	0.1	0.5	





Source: IMF staff.

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

2/ Based on available data.

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

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

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

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

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

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

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

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

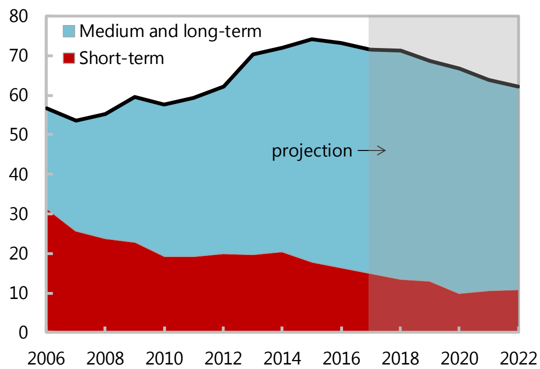
11/ Credit rating for short-term foreign and local currency sovereign debt is maintained at "B."

Figure 4. Albania: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

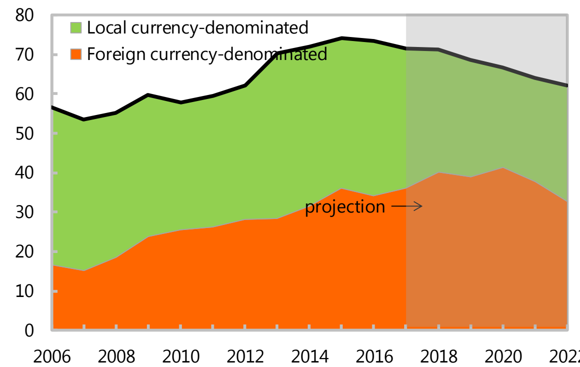
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

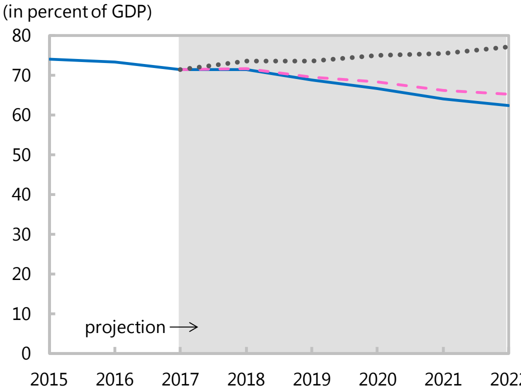


Alternative Scenarios

Baseline — Historical — Constant Primary Balance

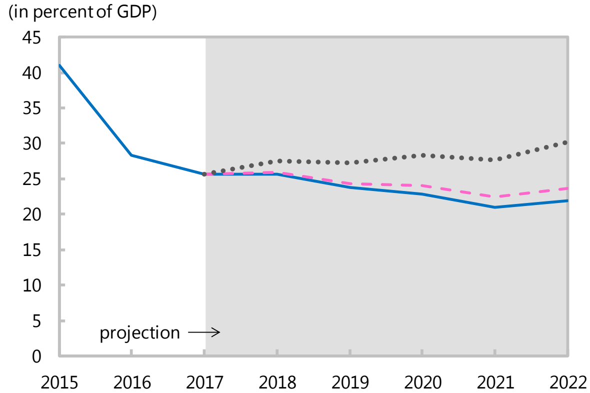
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

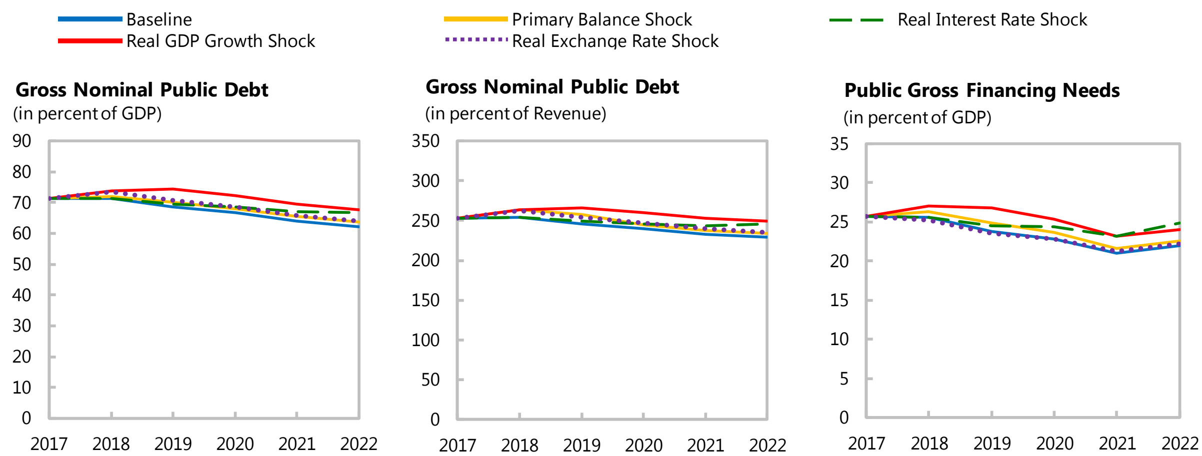
Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	3.9	3.7	3.8	3.9	3.9	4.0
Inflation	2.1	2.3	2.5	2.8	2.8	2.8
Primary Balance	0.1	0.4	0.6	0.9	0.9	0.8
Effective interest rate	3.2	3.2	3.5	4.1	4.3	4.7
Constant Primary Balance Scenario						
Real GDP growth	3.9	3.7	3.8	3.9	3.9	4.0
Inflation	2.1	2.3	2.5	2.8	2.8	2.8
Primary Balance	0.1	0.1	0.1	0.1	0.1	0.1
Effective interest rate	3.2	3.2	3.5	4.1	4.3	4.7

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	3.9	3.3	3.3	3.3	3.3	3.3
Inflation	2.1	2.3	2.5	2.8	2.8	2.8
Primary Balance	0.1	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	3.2	3.2	4.2	4.9	5.4	5.9

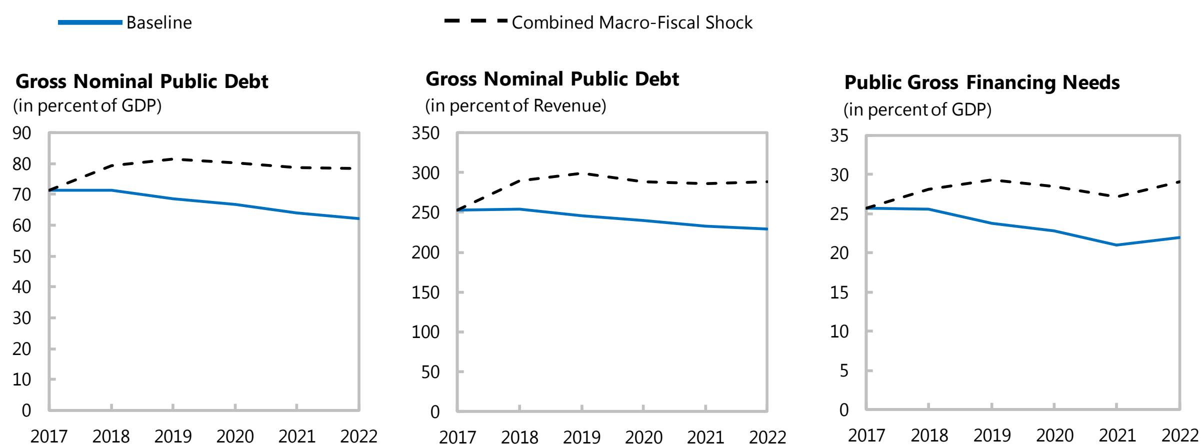
Source: IMF staff.

Figure 5. Albania: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	3.9	3.7	3.8	3.9	3.9	4.0
Inflation	2.1	2.3	2.5	2.8	2.8	2.8
Primary balance	0.1	-0.3	-0.1	0.9	0.9	0.8
Effective interest rate	3.2	3.2	3.6	4.1	4.3	4.7
Real Interest Rate Shock						
Real GDP growth	3.9	3.7	3.8	3.9	3.9	4.0
Inflation	2.1	2.3	2.5	2.8	2.8	2.8
Primary balance	0.1	0.4	0.6	0.9	0.9	0.8
Effective interest rate	3.2	3.2	4.8	5.8	6.4	7.1
Combined Shock						
Real GDP growth	3.9	1.7	1.7	3.9	3.9	4.0
Inflation	2.1	1.8	2.0	2.8	2.8	2.8
Primary balance	0.1	-1.0	-1.5	0.9	0.9	0.8
Effective interest rate	3.2	3.3	4.6	5.6	6.3	6.9

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	3.9	1.7	1.7	3.9	3.9	4.0
Inflation	2.1	1.8	2.0	2.8	2.8	2.8
Primary balance	0.1	-0.3	-0.8	0.9	0.9	0.8
Effective interest rate	3.2	3.2	3.6	4.1	4.4	4.7
Real Exchange Rate Shock						
Real GDP growth	3.9	3.7	3.8	3.9	3.9	4.0
Inflation	2.1	5.7	2.5	2.8	2.8	2.8
Primary balance	0.1	0.4	0.6	0.9	0.9	0.8
Effective interest rate	3.2	3.3	3.4	4.0	4.2	4.6

Source: IMF staff.

Table 1. Albania: External Debt Sustainability Framework, 2012-2022

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
Baseline: External debt	51.6	60.5	56.1	63.3	62.0			**66.0**	**66.2**	**63.8**	**62.0**	**58.6**	**55.4**	**-7.1**
Change in external debt	18.3	8.8	-4.4	7.3	-1.4			4.0	0.2	-2.4	-1.8	-3.4	-3.1	
Identified external debt-creating flows (4+8+9)	4.9	-2.1	0.5	10.1	-4.0			-3.5	-3.5	-2.4	-2.2	-2.2	-2.4	
Current account deficit, excluding interest payments	9.4	8.9	9.5	7.0	6.0			6.0	4.8	4.4	4.1	3.8	3.7	
Deficit in balance of goods and services	18.6	18.0	19.0	17.3	16.9			16.5	15.4	14.8	14.2	13.8	13.4	
Exports	33.4	28.9	28.2	27.4	29.0			29.8	30.5	30.9	31.2	31.4	31.8	
Imports	52.0	47.0	47.2	44.7	45.8			46.3	45.9	45.7	45.4	45.2	45.2	
Net non-debt creating capital inflows (negative)	-6.8	-9.5	-8.1	-8.0	-8.7			-8.8	-7.7	-6.3	-5.8	-5.7	-5.9	
Automatic debt dynamics 1/	2.3	-1.5	-0.8	11.0	-1.2			-0.6	-0.6	-0.6	-0.4	-0.3	-0.2	
Contribution from nominal interest rate	0.8	0.4	1.3	1.6	1.6			1.6	1.6	1.8	1.9	2.0	2.0	
Contribution from real GDP growth	-0.5	-0.5	-1.0	-1.5	-2.0			-2.2	-2.2	-2.4	-2.3	-2.3	-2.2	
Contribution from price and exchange rate changes 2/	2.0	-1.4	-1.1	10.9	-0.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	13.4	11.0	-4.9	-2.8	2.6			7.5	3.7	0.0	0.4	-1.2	-0.7	
External debt-to-exports ratio (in percent)	154.4	209.1	198.7	231.2	213.9			221.5	217.1	206.5	199.0	186.4	174.4	
Gross external financing need (in billions of US dollars) 4/	1.5	1.7	2.2	2.0	1.6			1.8	1.8	1.9	2.4	2.0	2.0	
in percent of GDP	12.3	13.0	16.7	18.0	13.4	10-Year	10-Year	13.6	12.6	12.3	15.1	11.6	11.2	
Scenario with key variables at their historical averages 5/								**66.0**	**75.3**	**78.5**	**82.5**	**84.4**	**86.5**	**-8.7**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	1.4	1.0	1.8	2.2	3.4	3.3	2.1	3.9	3.7	3.8	3.9	3.9	4.0	
GDP deflator in US dollars (change in percent)	-5.8	2.7	1.8	-16.3	1.3	0.0	9.3	5.9	5.1	2.0	2.5	2.2	1.9	
Nominal external interest rate (in percent)	2.2	0.8	2.3	2.5	2.7	2.2	0.7	2.8	2.6	2.8	3.2	3.4	3.5	
Growth of exports (US dollar terms, in percent)	-6.1	-10.3	1.1	-16.9	10.7	5.3	16.5	13.2	11.5	7.2	7.4	7.1	7.1	
Growth of imports (US dollar terms, in percent)	-12.4	-6.3	4.2	-18.9	7.2	3.5	17.2	11.2	8.1	5.4	5.6	5.7	6.0	
Current account balance, excluding interest payments	-9.4	-8.9	-9.5	-7.0	-6.0	-10.5	3.2	-6.0	-4.8	-4.4	-4.1	-3.8	-3.7	
Net non-debt creating capital inflows	6.8	9.5	8.1	8.0	8.7	7.7	1.1	8.8	7.7	6.3	5.8	5.7	5.9	

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 defla

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

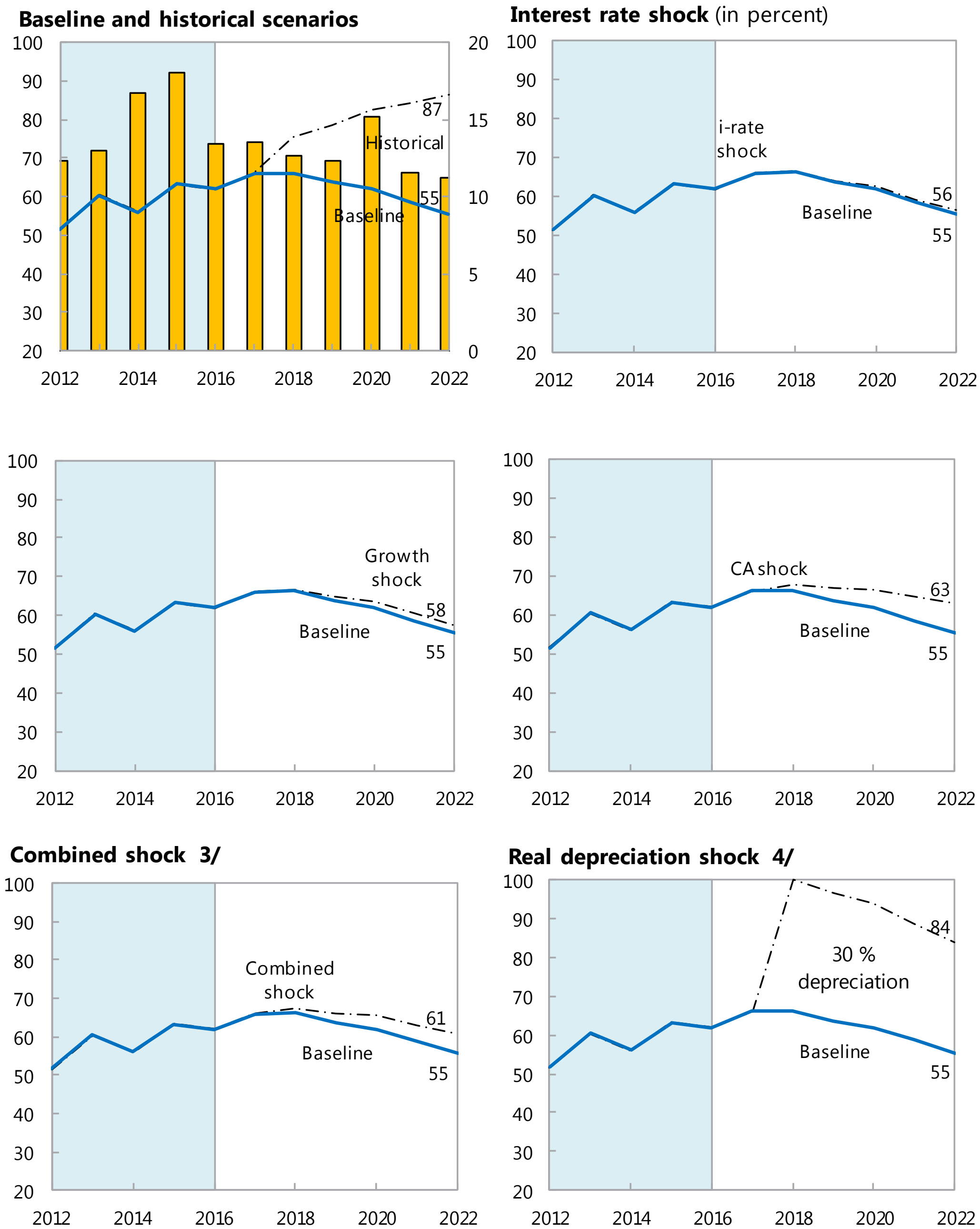
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure 6. Albania: External Debt Sustainability: Bound tests 1/ 2/

(External debt in percent of GDP)



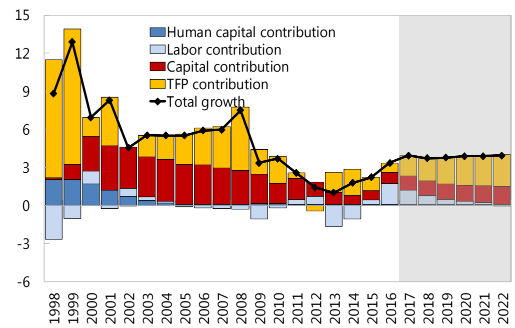
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. 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 2010.

Annex V. Medium-term Growth in Albania

While Albania's external conditions are favorable, the end of large FDI projects, low savings and demographic pressures are expected to weigh on medium-term growth. Institutional reforms catalyzed by the EU accession process can improve productivity and potential growth in Albania.

1. Economic growth has accelerated in Albania over the past three years, owing to higher FDI, the regional recovery, and rising consumer confidence. Growth accounting shows increasing capital contribution, reflecting spillovers of FDI projects and a revival of construction, while labor contribution has also risen due to a pick-up in labor intensive sectors such as textiles, construction, and tourism. Potential growth is estimated to have increased from 2.3 percent in 2013 to 3.2 percent in 2016.

Growth Accounting
(In percent)



Source: IMF Staff estimates.

2. Real GDP is expected to continue growing rapidly over the medium term, but below the historical pace. The FDI projects involving the construction of two hydropower plants and a natural gas pipeline (14 percent of GDP) are having significant effects on economic activity (text table). As these projects end in 2018-20, their contribution to growth is expected to turn negative. Furthermore, with investments largely foreign-financed and national private savings low, concerns about the sustainability of investment remain. Labor contribution is forecasted to decline gradually as Albania faces demographic challenges from continued migration and population aging.

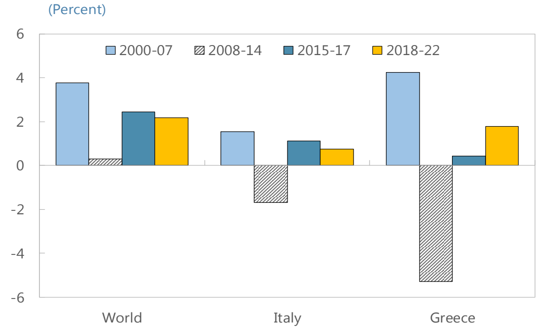
Impact of Trans Adriatic Pipeline and Statkraft on Economic Growth

	2014	2015	2016	2017	2018	2019	2020
	Percent of GDP						
FDI related to TAP/Statkraft	0.8	2.7	3.8	3.8	2.3	0.8	0.0
of which imports	*0.5*	*1.9*	*2.7*	*2.6*	*1.5*	*0.4*	*0.0*
of which domestic expenditure	*0.3*	*0.8*	*1.2*	*1.2*	*0.7*	*0.3*	*0.0*
	Percent						
Effect on GDP growth	0.3	0.5	0.3	0.1	-0.5	-0.4	-0.3

Source: IMF staff estimates.

3. Despite these constraints, economic growth is expected to improve, driven by favorable external conditions and structural reforms spurred by the EU-accession process. Albania has entered a growth acceleration period since 2015 supported by a recovery in key trading partners and positive terms of trade growth. Given Albania's low income level, convergence dynamics imply that adoption of new technologies and institutional improvements offers an opportunity for higher productivity and faster growth. Empirical estimates of convergence suggest that Albania's growth should be around 4 percent. An event study analysis also suggests that Albania's expected productivity growth is in line with the experience of previous EU candidate countries, which benefitted significantly from improved institutions and the access to EU markets.

Albania's Trading Partners: Domestic Demand Growth
(Percent)



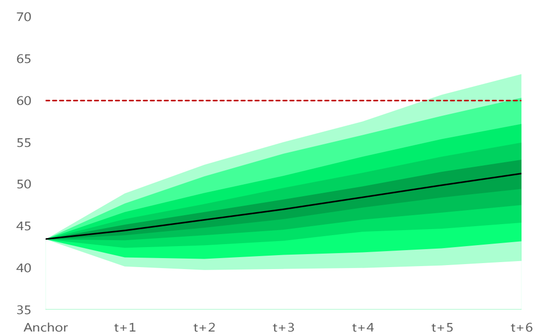
Source: IMF staff estimates.

Annex VI. Fiscal Anchor for Albania

Albania's current fiscal framework comes short of establishing a full-fledged, binding fiscal anchor. Anchoring fiscal policy with the primary balance (excluding one-offs) target and as an instrument for a fiscal rule would help reach the medium-term debt objective.

1. The fiscal framework in Albania, which is based on a medium-term debt objective of 45 percent of GDP, comes short of establishing an operational guidepost. This debt target is adequate for Albania given past macroeconomic volatility and the need to maintain sufficient safety margins below a stress level threshold of 60 percent of GDP (see text box). Even considering the positive growth impact of debt-financed infrastructure, health, and education spending, the literature finds that for countries like Albania the optimal level of debt lies around 40–50 percent of GDP. However, to converge to the debt objective, the Organic Budget Law (OBL) merely requires budgets to target a lowering in the debt ratio, which is operationally insufficient and procyclical.

Safe Debt Level
(in percent of GDP)



Source: IMF staff calculations
Note: This chart plots debt dynamics under stochastic simulations for macro and fiscal shocks and a fiscal reaction function that responds to the cycle and tries to bring debt back to 45 percent. The safe level of debt-to-GDP ratio that would provide enough buffers for Albania to face 95 percent of shocks without breaching a debt ceiling of 60 percent is around 45 percent. Color bands represent deciles, except for the lightest green ones, which are the 5^{th} and 95^{th} percentiles.

2. Albania should focus on the primary balance (excluding large one-offs) as an anchor. Primary balance target excluding one-offs, with a medium-term debt objective[1] is more operational as it is less susceptible to macroeconomic revisions and can be monitored during both budget preparation and execution phases. More specifically, a primary surplus target (excluding one-offs) of 1.5 percent of GDP would bring the debt ratio to below 60 percent of GDP by 2021—the end of the current government's mandate—and 45 percent of GDP by 2026. Given Albania's goal towards EU accession, structural balance should also be monitored.

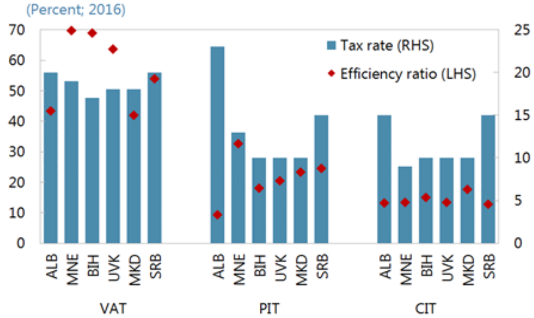
3. Stronger fiscal institutions are also needed to ensure enforcement of the primary balance anchor. Since the anchor does not address the significant revenue forecasting bias (1.8 percent of GDP on average), nor potential reallocation of public spending towards less efficient spending, improvements in public financial management and forecasting are necessary. Furthermore, a simple primary balance rule would help correct time inconsistencies, particularly in good times. Strengthened fiscal reporting and possibly an authority in charge of enforcement—a fiscal council—would support the implementation of such a rule.

[1] One-offs are measures having a transitory budgetary effect that does not affect the intertemporal position (e.g., sales of nonfinancial assets or publicly owned licenses, natural disasters costs, and tax amnesties).

Annex VII. Revenue Mobilization in Albania

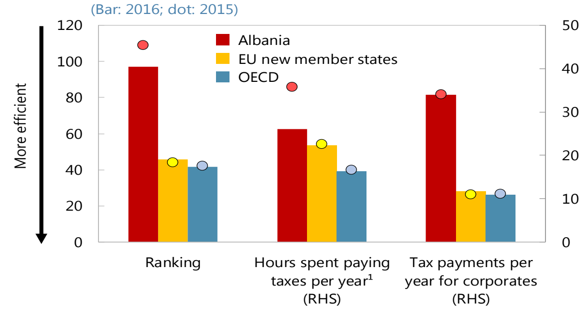
1. The efficiency of Albania's tax system is relatively low, compared to regional peers.[1] VAT efficiency, in particular, has declined. A revenue administration gap analysis model estimates that the total VAT gap has increased from 6.1 percent of GDP in 2009 to 8.1 percent of GDP in 2015. A significant share of this gap represents a compliance gap, reflecting weaknesses in assessments given high informality in the economy. An analysis of tax expenditures estimated a total cost of 1.4 percent of GDP in 2015, largely provided through VAT exemptions and preferential treatment of small businesses and capital income.

Western Balkans: Tax Rate and Efficiency Ratios[1]
(Percent; 2016)



[1] Tax efficiency is the ratio of tax revenue (in percent of GDP) over the tax rate. For PIT, the top tax rate of 23 percent is used for Albania, while other countries have a flat PIT.
Source: IMF staff estimates.

Administrative Efficiency in Paying Taxes
(Bar: 2016; dot: 2015)



1/ Each unit in the chart corresponds to 10 hours.
Sources: Doing Business (2017); and IMF staff calculations.

2. Given the challenge of tax compliance, advancing tax administration reforms has been a key priority. Following the ***adoption of a new IT system***, the General Directorate of Taxes (GDT) is making good progress in implementing its strategic plan. The plan includes introduction of a ***modern compliance risk management system***, based on which the authorities are implementing a campaign against informality. The announced ***merger of the tax and customs agencies and a centralized risk function***, however, risks derailing the reform process. Based on the 2016 Tax Administration Diagnostic Assessment, the main priorities are to (i) revamp ***collection processes*** taking advantage of the new IT system, including by making extensive use of debt installment and write-off arrangements, (ii) ***streamline GDT's regional and local office structure***, to match business needs; and (iii) upgrade to ***risk-based auditing***. Also, the National Registration Center should update its ***taxpayer database*** with input from GDT and INSTAT.

3. Tax policy should aim to improve efficiency and maximize revenues. Several recent and planned policy changes, although aimed at tackling informality, weaken the VAT architecture. The ***reduced VAT rate on hotel accommodation*** creates tax planning opportunities and should be reviewed. The planned ***reduction of the VAT registration threshold that vary by sectors*** would absorb scarce administrative resources while producing almost no collections. A comprehensive presumptive regime with a simple lumpsum tax for microbusinesses and a single turnover-based tax for SMEs, without sectoral differentiation, should be considered. ***VAT refunds*** are a serious and growing problem and should be urgently studied to identify causes. ***VAT and***

[1] 2016 Article IV, Selected Issues Paper, "*Tax Policy, Evasion, and Informality in Albania*". Tax efficiency is defined as the ratio between revenues for each tax and the statutory tax rate.

excise exemptions, while not necessarily costly if they can otherwise be claimed as an input tax credit, raise compliance and administrative costs, and should be eliminated to broaden the tax base. Tax rates and thresholds should be designed consistently between different ***income taxes*** to reduce arbitrage opportunities that lead to domestic transfer pricing and bunching of taxpayers under the various tax thresholds.

Annex VIII. Judicial Reform and Anti-Corruption Efforts in Albania

1. **Implementing judicial reform and strengthening the fight against corruption are key prerequisites for advancing Albania's EU accession process.** Third-party indicators show that the country lags behind its regional peers in areas such as corruption perceptions, control of corruption, bribery incidence, the rule of law, protection of property rights, judicial independence, court impartiality, and efficiency of the legal framework in enforcing contracts and resolving disputes.

2. **Assessments of the *status quo* by external observers confirm the findings from third-party indicators**. The latest review of Albania's implementation of the UN Convention against Corruption found deficiencies pertaining to the criminalization of all acts of corruption as well as weak spots in Albania's legal framework regulating international cooperation. In its 2016 report on Albania, the European Commission (EC) found that anti-corruption institutions have limited independence and effectiveness due to political pressures and weak capacity.

3. **Inefficiency and corruption within the judiciary have been a core component of Albania's corruption problem.** The 2016 EC report criticized the high degree of political interference in Albania's judiciary, the excessive discretion in managing the careers of judges and prosecutors, the overall inefficiency of the judicial system, inadequate working and security conditions, and poor enforcement of judicial decisions.

4. **There is a strong cross-country correlation between average incomes and institutional quality, with Albania's institutions consistently lagging those of other countries at similar levels of economic development.** A large existing literature shows that corruption and inefficient judicial institutions hurt economic efficiency, macroeconomic and financial stability, public and private investment, human capital accumulation, and total factor productivity.

5. **The Albanian authorities have recently taken some bold and comprehensive steps to address the judicial corruption and inefficiency.** After months of contentious negotiations, in mid-2016 Albania's parliament passed a package of constitutional and legal amendments which fundamentally restructures the country's judiciary. The reform package provides for the regular re-evaluation ("vetting") of all judges and prosecutors. It establishes specialized institutions to fight corruption and organized crime. The reform also aims to overhaul the governing bodies of Albania's judiciary.

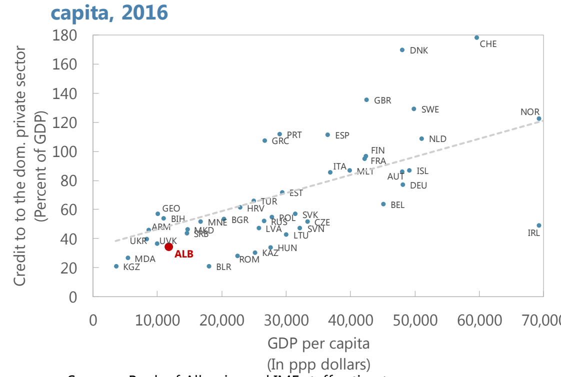
6. **Implementation of the reform is in its early stages and should be pursued with speed and determination**. Next steps include introducing an electronic case management system, strengthening online access to judicial decisions, amending the Codes of Civil and Criminal Procedure, reforming court fees, and operationalizing the new anti-corruption investigation structure.

Annex IX. Financial Deepening

Albania's financial depth is lower than regional peers, but is largely aligned with the institutional and macro fundamentals. An analysis of credit gaps points out that the room for credit recovery is limited if there are no institutional improvements. Development of a private capital market requires addressing weak corporate governance standards in private sector. Addressing these institutional bottlenecks would help support Albania's growth potential.

1. Despite a large banking sector, private sector credit depth is low. Credit to the domestic private sector represented 35 percent of bank assets compared to above 50 percent in regional peers in 2016. Low credit to the private sector primarily reflect low credit to households and a bank portfolio heavily allocated to the public sector —about 25 percent comparted to the 10-15 percent in the regional peers.

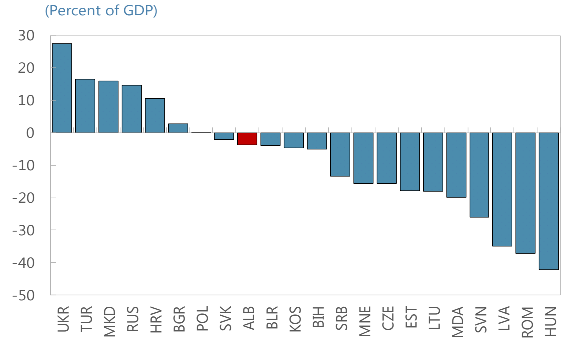
Credit to the Domestic Private Sector and GDP per capita, 2016



Sources: Bank of Albania; and IMF staff estimates.

2. An analysis of Albania's credit gap suggests that the credit level is broadly aligned with institutional and income levels. Low credit to the private sector is explained by low income, high informality, and institutional obstacles such as difficulties in enforcing contracts and recovering collateral. Also, low coverage of credit registry and narrow information about borrowers have also contributed to weak credit penetration. Deepening credit to the private sector will thus require further institutional strengthening.

Private Credit Gaps, 2016
(Percent of GDP)



Sources: IMF staff estimates.

3. Credit deepening can have a positive impact on medium-term growth for Albania given the limited financial development. Studies show that initial financial development has a positive impact on economic growth but that excessive financial development can have negative implications on financial stability. Financial deepening can boost economic growth by incentivizing savings, improving resource allocation, and facilitating trade. Improved financial institutions also enhance intermediation, and consequently strengthen capital accumulation and productivity.

4. The development of private capital markets would also support growth, provided adequate macroeconomic and institutional frameworks are in place. Deep private capital markets are associated with increasing efficiency by enhancing competition between corporate issuance and banks, and reducing cost of financing as foreign investors' access is eased. However, an adequate legal and regulatory framework to protect investors and enforce contracts are critical. In addition, if listing and disclosure standards are limited and corporate governance is weak then financial stability risks increase

INTERNATIONAL MONETARY FUND

ALBANIA

November 14, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of September 30, 2017)

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

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	139.30	100.00
IMF's Holdings of Currency	409.33	293.85
Reserve Tranche Position	26.00	18.67

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	46.45	100.00
Holdings	130.96	281.93

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
Extended Arrangement	296.03	212.51
ECF Arrangements	0.85	0.61

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	Feb. 28, 2014	Feb. 24, 2017	295.42	295.42
ECF[1]	Feb. 1, 2006	Jan. 31, 2009	8.52	8.52
EFF	Feb. 1, 2006	Jan. 31, 2009	8.52	8.52

Projected Payments to Fund:

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

	Forthcoming				
	2017	2018	2019	2020	2021
Principal	0.12	5.04	14.40	27.71	44.46
Charges/Interest	1.34	5.27	5.04	4.38	3.64
Total	1.46	10.31	19.45	32.10	48.11

[1] Formerly PRGF.

Safeguards Assessments. A safeguards assessment update of the Bank of Albania (BoA) was completed in June 2014 and a monitoring report was completed in August 2015. The assessments found that since 2006 the Bank of Albania has strengthened its safeguards framework in a number of areas, including in its external and internal audit and financial reporting functions, all of which are being aligned with international standards. However, the governance structure at the BoA lacked effective oversight of audit, financial reporting, and control matters, and the assessment recommended the establishment of an audit committee. The assessment also recommended that the bank's compilation procedures for the reporting of net international reserves and credit to government be reviewed by its internal audit department at each test date. After a new Governor and a new Inspector General were appointed in mid-2015, there have been improvements in the BoA's safeguards framework, through the implementation of safeguards recommendations, including establishing an Audit Committee governed by a charter aligned with international best practice, as well as engaging an external expert to assist it. In addition, the internal audit function resumed operations following the appointment of a new Inspector General, and financial statements are now prepared in accordance with International Financial Reporting Standards (IFRS). The authorities are also taking preliminary steps to align the BoA Law with modern central banking legislation.

Exchange Rate Arrangement: On July 1, 1992 the Albanian authorities adopted a floating exchange rate system. The *de jure* exchange rate system is classified as free floating, while the *de facto* exchange rate arrangement is floating, with the monetary authorities occasionally intervening in the foreign exchange market in order to accumulate reserves and avoid excessive disruptions in the functioning of the market. On February 21, 2015, Albania accepted the obligations under Article VIII, Sections 2(a), 3, and 4, but continues to maintain an exchange restriction in the form of outstanding debit balances on inoperative bilateral payment agreements. These were in place before Albania became a Fund member in 1991, and relate primarily to debt in nonconvertible and formerly nonconvertible currencies. The exchange rate stood at lek 113.88 per U.S. dollar on October 2, 2017.

Article IV Consultation: The 2016 Article IV consultation was concluded on May 27, 2016 (IMF Country Report No. 16/142).

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

Technical Assistance: The Fund, other multilateral organizations, and donors have provided extensive technical assistance for institutional development in Albania. The Fund has sent multiple technical assistance missions to Albania every year since 1991. The extent and focus of Fund TA since FY 2013 is briefly summarized below.

Table 1. Albania—Technical Assistance Since FY2013		
Department	**Purpose**	**Date**
FAD	Tax Administration	Multiple (nearly monthly) visits.
	Public Financial Management	October 2012, November 2013, April 2014, July 2014, September 2014, November 2014, March 2015, March-April 2016, July 2016, September 2016, October 2016, March 2017, September 2017, October-November 2017
	Tax Policy	November 2013, March 2014, September 2014, June 2015, September 2016, September-October 2017
	Fiscal Transparency Evaluation	June 2015
LEG	Deposit Insurance Law	February 2014
	Tax Law	March 2015, May 2015
	NPL Resolution	April 2015
MCM	IFRS Implementation	May 2013, February 2017
	Basel II Implementation	June 2013
	Stress Testing	September 2013
	Regulatory Framework for Investment Funds	March 2014, October 2014
	NPL Resolution	September 2014, November 2015
	Central Bank Accounting and Official Foreign Exchange Transactions	January 2015
	Banking Supervision and Regulation	July 2015
	Long-Term Resident Advisor on Monetary Policy	since September 2015
	Monetary Policy Design and Implementation	January 2016, September 2016, December 2016, February 2017, September 2017
	Long-Term Resident Advisor on Financial Stability	since July 2017

Table 1. Albania—Technical Assistance Since FY2013 (concluded)		
Department	**Purpose**	**Date**
STA	Price Statistics	September 2013
	External Sector Statistics	April 2014, January 2016, April-May 2017
	Government Finance Statistics	October 2014, May 2015, May-June 2016, November 2016, May 2017, June 2017, September 2017
	National Accounts Statistics	November 2014, May 2015, April 2017, September 2017
	Enhanced General Data Dissemination System	April 2017
	Monetary and Financial Statistics	July 2017

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

WORLD BANK GROUP RELATIONS

1. **The Republic of Albania has been a member of the World Bank Group (WBG) since 1991.** Since then, the WBG has provided strong support to Albania, including 88 IDA, IBRD, and GEF projects in different sectors totaling US$2.07 billion, IFC investments totaling US$490 million, and MIGA guarantees totaling US$8.6 million. The quality of the active portfolio has continued to improve, with an increasing focus on long-term capacity development and implementation through government structures.

2. **A new National Strategy for Development and Integration (NSDI) for 2015–2020 was approved in 2016.** The document highlights six priorities for the country: (i) achieving European Union (EU) membership; (ii) consolidating good governance, democracy, and the rule of law; (iii) ensuring growth through macroeconomic and fiscal stability; (iv) ensuring growth through increased competitiveness and innovation; (v) investing in people and social cohesion; and (vi) ensuring growth through connectivity, the sustainable use of resources, and territorial development. EU integration is the overarching goal of the strategy, while consolidating good governance, democracy, and the rule of law provide the foundation for all other areas and measures. The other four priorities represent pillars under which reforms are to be implemented.

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

4. **The current portfolio of US$615 million includes 10 projects.** Implementation has been affected by chronic public sector weaknesses, including procurement issues. This has led to a slowdown in project implementation, with a very low disbursement ratio of 11 percent in FY2016 and about 7 percent in FY2017. There have been high-level portfolio reviews during FY2017: the last one took place at the end of February 2017 and was chaired by the Minister of Finance. An acceleration in project implementation is anticipated given recent progress in completing procurement actions for large projects. In fact, at the end of Q1 of FY18, the disbursement ratio was approximately 4.5 percent, signaling a high disbursement ratio this FY (15 percent or more), compared to previous years.

Table 2. Albania: Bank-Fund Joint Management Action Plan Matrix
(As of October 2017)

Title	Product	Provisional Timing of Missions	Expected Delivery Date
A. Mutual information on relevant work programs			
The World Bank's work program in the next 12 months	Strengthening AFSA's Supervisory Capacities	October 2017	March 2019
	Strengthening Institutions for Municipal Service Delivery	October 2017	September 2018
	Policy Support for the Water Supply and Sanitation Sector	December 2017	August 2018
	Fiscal DPL	December 2017	June 2018
	Remittances and Payments	n.a.	June 2018
	Promoting Fiscal Transparency and Enhancing Fiscal Surveillance of Subnational Spending	November 2017	June 2018
	Integrated Land Management and Geospatial Infrastructure	December 2017	May 2018
	Additional Financing for Social Assistance Modernization Project	November 2017	March 2018
	Connectivity of Regional and Local Roads	October 2017	March 2018
	Implementation Support for the Power Exchange	October 2017	January 2018
	Water and Irrigation Project	November 2017 (tentative)	January 2018
	PEFA Assessment for 2016	n.a.	December 2017
	Public Debt Management and Government Bonds	n.a.	October 2017

Table 2. Albania: Bank-Fund Joint Management Action Plan Matrix (concluded)
(As of October 2017)

The Fund's work program in the next 12 months	2017 Article IV Consultation First Post Program Monitoring Discussions 2018 Article IV Consultation	September – October 2017 March 2018 October 2018	Board Meeting in December 2017 Board Meeting in May 2018 (LOT) Board Meeting in January 2019
B. Requests for work program inputs			
Fund request to Bank	Growth diagnostics. Assessment of competitiveness and related structural reforms (e.g., electricity sector). Fiscal governance and PFM. Public expenditure reform needs (in particular, civil service, pensions, disability, social assistance). Nonbank financial sector development.		
Bank request to Fund	Periodic macro updates. Joint approach to advisory work on institutional reform at the MoF on PFM and fiscal issues such as debt management, cash management, fiscal risks, and local government finances.		

STATISTICAL ISSUES

(As of September 30, 2017)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. The main obstacles are in real sector statistics and weak inter-institutional cooperation between government agencies.
National accounts: National accounts compilation has improved in the last few years and is now generally compliant with ESA 2010. However, there is still room for further improving methodologies and compilation techniques, especially regarding GDP estimates using the expenditure approach. Better source data would significantly enhance national accounts estimates. Although formal agreements for sharing data among government agencies have been signed, in some cases the cooperation needs to be more effective. Very ambitious objectives combined with severe resource constraints at INSTAT complicate improvements in basic indicators. Currently, quarterly GDP estimates are released with a lag of 90 days and the first annual estimates are published around 15 months after year-end. The lags in handling certain source data hamper the timely dissemination of GDP estimates. Data are subject to large revisions and there are significant discrepancies between the aggregated quarterly estimates and the annual results, due to differences in compilation methods. **Labor statistics:** The Labor Force Survey (LFS) is of insufficient quality. The treatment of agricultural employment needs to improve, as currently all individuals that own agricultural land are considered self-employed by the survey. Various shortcomings in the LFS lead to lack of reliable income and wage indicators. Poverty data are available with a substantial lag, compared to other CESEE countries. **Price statistics:** Compilation generally follows international standards, and the estimation of imputed rent within the CPI was improved in 2003. Since December 2015, INSTAT updates annually the CPI weights using the results of a new national Household Budget Survey. The PPI and construction price indexes are published on a quarterly basis, due to resource constraints.
Government finance statistics: Fiscal source data are adequate to allow a broad presentation of the Albanian general government's fiscal operations in line with the Government Finance Statistics Manual (GFSM) 2001. Transitioning to the GFSM 2001 fiscal presentation does not appear to substantially change the overall picture (Table 1). However, the transition also requires further improvements in fiscal statistics. In particular, Albania would need to: (i) provide greater details on some items (such as National Taxes, Income of Budgetary Institutions, Property Compensation, and Compensation for Electricity); (ii) report transactions of Albania's local governments in a separate statement; (iii) break down Net Acquisition of Nonfinancial Assets (labeled as Capital Expenditure in the local presentation) into the GFSM 2001 subcategories (i.e., fixed assets, inventories, valuables, and non-produced assets); (iv) split the financing section into net acquisition of financial assets and net acquisition of liabilities (and their respective instruments), and (v) keep financial operations, such as issuances of letters of credit, on-lending, or transfers to off-budget funds outside of the spending perimeter. In addition, the wage bill should be recorded on an accrual basis, in order to maintain a consistent standard across expenditure items. Finally, the debt statistics reported in the quarterly Debt Bulletin should be based on a broader definition and also include accounts payable (arrears), in line with GFSM.

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

II. Data Standards and Quality	
Albania participates in the General Data Dissemination System (GDDS). The country implemented e-GDDS in June 2017 at http://instat.gov.al:8080/NSDPAlbania/.	Data ROSC published in October 2006.

Table 3. Albania: Statement of Operations—General Government, 2012–22
(Billions of leks)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Est.			Projection			
Revenue	330.4	323.7	366.6	377.5	403.1	440.8	465.3	492.5	524.1	553.7	585.0
Taxes	243.5	236.4	265.9	268.9	286.8	316.5	331.4	351.4	375.2	397.4	420.0
Social contributions	57.4	60.0	69.9	71.7	79.2	87.7	93.6	98.1	103.1	109.2	114.7
Grants	5.6	5.7	10.1	11.2	14.6	13.8	16.6	17.6	18.8	18.2	19.4
Other revenue	24.0	21.6	20.7	25.7	22.5	22.9	23.8	25.3	27.0	28.9	30.8
Expenditure	376.2	394.1	408.7	418.5	428.9	467.6	497.5	525.5	555.6	590.3	628.5
Expense	314.6	328.6	348.1	355.9	370.6	396.5	411.4	437.7	463.4	495.4	527.1
Compensation of employees	69.4	70.7	71.4	72.5	67.5	74.3	77.8	80.6	83.4	89.0	91.7
Use of goods and services	33.5	32.4	31.3	42.4	44.3	44.3	45.2	47.1	47.5	51.7	55.2
Interest	41.5	43.3	40.1	38.6	36.3	32.5	37.1	43.0	47.6	53.5	59.9
Subsidies	1.9	1.6	8.4	6.8	3.8	6.9	7.3	6.6	4.8	4.5	4.7
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	141.0	150.8	164.1	161.4	177.1	184.6	193.7	205.2	218.7	231.7	246.4
Other expense	27.3	29.8	32.9	34.1	41.7	53.8	50.4	55.1	61.5	65.0	69.2
Net acquisition of nonfinancial assets	61.7	65.5	60.5	62.6	58.2	71.1	86.1	87.8	92.2	94.9	101.4
Domestically financed	27.4	36.7	33.8	37.7	37.9	34.3	30.5	23.9	36.9	35.0	40.5
Foreign financed	34.3	28.8	26.8	24.9	20.4	36.9	55.6	64.0	55.4	59.9	60.9
Gross Operating Balance	15.8	-4.9									
Net lending/borrowing	-45.9	-70.4	-42.1	-40.9	-25.7	-26.8	-32.2	-33.1	-31.5	-36.6	-43.5
Transaction in financial assets and liabilities	-45.9	-70.4	-42.3	-40.1	-23.9	-20.1	5.2	-34.1	-14.5	-39.2	-36.5
Net acquisition of financial assets	-1.2	-16.7	5.9	6.5	4.6	3.6	-1.0	-1.0	-1.0	-1.0	-1.0
Domestic	-1.2	-16.7	5.9	6.5	4.6	3.6	-1.0	-1.0	-1.0	-1.0	-1.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	44.6	53.7	48.2	46.5	28.5	23.7	-6.2	33.1	13.5	38.2	35.5
Domestic	25.3	42.9	14.0	-24.0	11.0	-13.0	-78.5	20.2	-22.1	35.6	34.9
Foreign	19.4	10.8	34.2	70.5	17.5	36.7	72.3	12.9	35.7	2.6	0.5

Sources: Albanian authorities; IMF staff estimates and projections.

Table 4. Albania: Table of Common Indicators Required for Surveillance
As of October 2, 2017

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological Soundness[8]	Memo Items: Data Quality – Accuracy and Reliability[9]
Exchange Rates	10/2/17	10/2/17	D	D	D		
International Reserve Assets and Liabilities of the Monetary Authorities[1]	9/29/17	10/2/17	D	W	M		
Reserve/Base Money	8/17	9/15/17	M	M	M		
Broad Money	8/17	9/15/17	M	M	M	O, O, O, LO	O, LO, LO, O, O
Central Bank Balance Sheet	8/17	9/15/17	M	M	M		
Consolidated Balance Sheet of the Banking System	8/17	10/2/17	M	M	M		
Interest Rates[2]	8/17	10/2/17	D	D	D		
Consumer Price Index	8/17	9/8/17	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3] – General Government[4]	8/2017	9/30/17	M	M	M	LO, O, O, O	LO, O, O, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3] – Central Government	8/2017	9/30/17	M	M	M		

Table 4. Albania: Table of Common Indicators Required for Surveillance (concluded)
As of October 2, 2017

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological Soundness[8]	Memo Items: Data Quality – Accuracy and Reliability[9]
Stocks of Central Government and Central Government-Guaranteed Debt[5]	6/2017	8/31/17	Q	Q	Q		
External Current Account Balance	2017:Q2	9/10/17	Q	Q	Q	O, O, O, LO	LNO, O, LO, LO, O
Exports and Imports of Goods and Services	8/17	9/20/17	M	M	M		
GDP/GNP	2017:Q2	9/29/17	Q	Q	Q	O, LNO, O, LO	LNO, O, LNO, LO, LO
Gross External Debt	2017:Q2	9/10/17	Q	Q	Q		
International Investment position[6]	2016	9/10/17	A	A	A		

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

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

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

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

[5] Includes currency and maturity composition.

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

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

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

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

INTERNATIONAL MONETARY FUND

ALBANIA

November 29, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared By	European Department

This supplement provides information that has become available since the Staff Report was circulated to the Executive Board on November 16, 2017 (SM/17/303). The two attached text tables, based on the authorities' updated draft 2018 Budget and Medium-Term Budget Framework, reflect minor changes in the 2017-18 public debt levels due to one-off below-the-line operations and a slightly revised medium-term deficit target. The information does not alter the thrust of the staff appraisal.

Albania: Fiscal Consolidation 2013-2021

(Percent of GDP, unless otherwise specified)

	2013	2014	2015	2016	2017		2018		2019	2020	2021
	Act.	Act.	Act.	Prel.	Authorities	Proj.	Draft Budg.	Proj.	Proj.	Proj.	Proj.
Revenues	24.0	26.3	26.4	27.4	28.2	28.2	28.1	28.1	27.9	27.8	27.5
Tax revenue	22.0	24.1	23.9	24.9	25.7	25.9	25.7	25.6	25.5	25.4	25.2
Non-tax revenue	1.6	1.5	1.8	1.5	1.6	1.5	1.6	1.4	1.4	1.4	1.4
Grants	0.4	0.7	0.8	1.0	0.9	0.9	0.9	1.0	1.0	1.0	0.9
Expenditures	29.2	32.2	31.0	29.6	30.4	30.2	30.4	29.9	29.7	29.4	29.3
Current expenditure (incl. net lending)	24.3	25.4	25.4	25.7	25.2	25.5	25.0	24.6	24.6	24.4	24.4
of which : Energy sector spending 1/		0.9	0.8	0.5	0.5	0.5	0.2	0.2	0.2	0.1	0.0
Capital expenditure 2/	4.8	4.3	4.4	4.0	4.8	4.6	5.2	5.2	5.0	4.9	4.7
Other spending	0.0	2.4	1.2	0.0	0.5	0.2	0.2	0.2	0.2	0.2	0.1
Overall balance	-5.2	-5.9	-4.6	-2.3	-2.2	-2.0	-2.2	-1.9	-1.8	-1.6	-1.8
Primary balance	-2.0	-3.0	-1.9	0.2	0.2	0.1	0.3	0.4	0.6	0.9	0.9
Structural primary balance	-1.7	-0.1	-0.4	0.5	0.6	0.5	0.4	0.5	0.7	0.9	0.9
Change in the structural primary balance	-1.2	1.6	-0.3	1.0	0.0	0.0	-0.1	0.0	0.2	0.2	0.0
Public debt	70.4	72.0	74.1	73.3	72.7	71.5	70.1	71.3	68.7	66.7	64.0
Domestic debt	43.4	42.4	39.7	39.0	37.3	35.3	37.1	31.5	30.0	28.3	27.7
Foreign debt	27.0	29.6	34.4	34.3	35.4	36.2	33.0	39.8	38.7	38.3	36.3
Memo items:											
Primary balance (authorities' presentation) 3/	-2.0	-2.5	-1.9	0.3	0.4	0.4	0.6	0.7	0.9	1.0	1.0
Nominal GDP (in billions of leks)	1,350	1,395	1,428	1,473	1,555	1,562	1,650	1,658	1,764	1,884	2,013
Public debt (in billions of leks)	950	1,005	1,057	1,080	1,131	1,117	1,157	1,182	1,211	1,255	1,288

Sources: Albanian authorities; IMF staff estimates and projections.

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

2/ Starting in 2017, grants to the Regional Development Fund are reclassified from local government spending to capital expenditure.

3/ The budget records as expenditure some financial operations but omits some energy sector support.

Medium-Term Fiscal Paths

(In percent of GDP)

	2016	2017	2018	2019	2020	2021
Public debt						
IMF baseline	73.3	71.5	71.3	68.7	66.7	64.0
IMF recommended path		71.0	69.8	66.1	63.4	60.0
Authorities MTBF*		71.5	68.7	66.4	63.5	59.9
Overall balance						
IMF baseline	-2.3	-2.0	-1.9	-1.8	-1.6	-1.8
IMF recommended path		-1.4	-0.9	-0.7	-0.7	-0.8
Authorities MTBF*		-2.0	-2.0	-1.7	-1.2	-0.5
Primary balance						
IMF baseline	0.2	0.1	0.4	0.6	0.9	0.9
IMF recommended path		0.6	1.2	1.5	1.5	1.5
Authorities MTBF*		0.4	0.6	1.0	1.5	2.2
Structural primary balance						
IMF baseline	0.5	0.5	0.5	0.7	0.9	0.9
IMF recommended path		1.0	1.4	1.6	1.5	1.5
Authorities MTBF*		0.6	0.4	0.9	1.4	2.1

* Based on the authorities' own definitions of debt and deficit (i.e., excluding some energy sector support from the deficit, and omitting PPPs and arrears in the debt statistics).

Statement by Alessandro Leipold, Executive Director for Albania and Paolo Di Lorenzo, Advisor to the Executive Director December 4, 2017

On behalf of our Albanian authorities we would like to thank staff for the constructive engagement during the Article IV mission and for the candid and focused set of papers. Our authorities note that the electoral year and the related political events have not significantly affected the process of macroeconomic and fiscal stabilization started with the three-year arrangement with the Fund. Indeed, the recovery of the Albanian economy appears to have strengthened further, supported by a balanced policy mix and progress in structural reforms. Taking advantage of the window of opportunity opened by the clear electoral mandate, the authorities intend to continue to work to enhance Albania's growth potential, strengthen the resilience and the competitiveness of the economy and of the financial system while maintaining fiscal discipline.

Recent Macroeconomic Developments and Outlook

With real growth of 4.1 percent (y-on-y), the economy continued its upward trend in the second quarter of 2017. Both domestic and external components have contributed to growth. In particular, investment has surged by 14.3 percent, supported by foreign direct investments in the energy sector. Very strong tourist inflows have been the main driver of export performance, but encouraging signals are coming also from goods exports, with three consecutive quarters of expansion. The current account deficit trended down to an historical low of 6.3 percent of GDP on a twelve-month basis, and it remains comfortably covered by FDI flows. At the same time, overall inflationary pressures remain contained even in the face of economic expansion, with annual inflation rising only moderately, to 1.9 percent in October. High frequency indicators suggest that economic activity continued to grow at a similar pace in the third quarter.

The authorities anticipate a favorable medium-term outlook, in line with staff projections. Growth is expected to remain solid benefiting from strengthened fundamentals, a steady recovery of internal demand driven by improved sentiment, a pickup in wages, still accommodative monetary conditions, improved external conditions in Europe and continued FDI inflows. The economy is nonetheless still operating below capacity. Notwithstanding a continued decline over three years, the official unemployment rate remains relatively high (13.9 percent), thus containing inflationary pressures and indicating the need for continued monetary accommodation over the medium term.

The authorities share the staff's assessment of the external position. The trend exchange rate appreciation, observed in both nominal and real terms in the first half of 2017, has slowed down considerably in the third quarter, and has not affected external competitiveness. A progressive improvement in export performance is expected to reduce the current account deficit to around 6 percent of GDP in the medium term, supported also by the introduction of streamlined import and export procedures aimed at bolstering trade under the new customs code in force since June 2017.

Fiscal Policy

Budget execution for 2017 remains on track, with prospects for an overperformance. The expected primary surplus of 0.4 percent of GDP represents a consolidation of 2.7 percentage points of GDP since 2014. In the first ten months of the year, both tax revenues and primary current expenditures have overperformed the targets. As a result, provisional cash figures show an overall position close to balance, providing adequate buffers for the attainment of the annual targets, while allowing the clearance of all contracts-related arrears and an acceleration in VAT credit refunds. The public-debt-to-GDP ratio is thus set to decline substantially for the second year in a row.

The 2018 budget aims to strike an appropriate balance between ensuring fiscal sustainability and enhancing Albania's growth potential. Sustaining the fiscal adjustment started under the EFF is a key commitment. The authorities remain steadfast in their resolve to reduce the economy's vulnerability via a continued reduction in the public debt and associated gross financing needs. They are accordingly targeting a further improvement of the primary balance in 2018, by 0.2 percentage points of GDP. Primary current expenditure is set to be reduced by 0.3 percentage points of GDP by the avoidance of any new discretionary spending (except for targeted wage increases in health care and education). At the same time, the government is confident that the ratio of tax revenues to GDP will stabilize at last year's historical peak, thanks to measures to broaden the tax base included in the budget, notably the launch of a reformed value-based property tax and the informality campaign. New PPPs included in the draft budget are limited to only a few strategic infrastructure projects designed to improve the connectivity of the country. To avoid an unwarranted expansion of public liabilities, the draft budget also places a limit on the total value of projects contracted under the PPP program, and project-related payments would be reflected in a transparent way in each year's budget.

The authorities intend to move in the direction of a further strengthening of the fiscal and public financial management frameworks. In addition to extending the coverage of the Treasury IT system, to avoid any re-incurrence of arrears, the Procurement Law, the Financial Management Control Law, and the Organic Budget Law have been modified to allow the introduction of binding multi-year commitment limits. Furthermore, the introduction of adequate fiscal rules obliges the government (i) to continuously target annual reductions in the debt-to-GDP ratio until it reaches 45 percent; (ii) to budget annual buffers to absorb potential negative shocks; (iii) to anchor nominal GDP projections with those of the IMF; (iv) to apply a "golden rule" regarding public investment vs. borrowing; and (v) to restrain deficit slippages during electoral years. The new law on local finances, prepared with help from USAID and the World Bank, improves reporting requirements, tightens monitoring, and provides mechanisms for dealing with local governments that face financial difficulties.

Key priorities of the medium-term debt strategy are the progressive lengthening of maturities and the development of a liquid secondary market for government securities. The authorities are mindful of the benefits that progress on these fronts, as well as on the functioning of the primary market for domestic bonds, could deliver in terms of better debt management, enhanced risk reduction, and improvements in the monetary policy transmission mechanism. The budget includes - for the first time – legal provisions for the transfer of foreign-sourced funds from a fiscal year to the next. By making for a better allocation of funds, this provision should help reduce refinancing risk and, potentially, lower financing costs.

Monetary Policy and Financial Stability

The Bank of Albania (BoA) is maintaining an accommodative policy stance, in line with its inflation targeting framework. This stance, communicated to the markets via appropriate forward guidance, has been conducive to improved lending conditions, supporting a sustained flow of Lek-denominated credit and (in conjunction with fiscal consolidation) a reduction in risk premia. Credit in domestic currency is expanding at a steady pace of close to 10 percent, while the share of FX loans in total credit is declining. Based on current trends, the BoA considers that continued monetary stimulus will be required for some time in the future, with the need unlikely to diminish before the fourth quarter of 2018. Any normalization of monetary policy will be weighed against a sustained convergence of inflation to the Bank of Albania's 3 percent target, which the updated forecasts envisage to occur within the first half of 2019.

A continuous decline in the non-performing loan (NPL) ratio bodes well for lending activity. September data put NPLs at 14.8 percent of loans, a markedly better performance than that targeted under the World Bank's Development Policy Loan (DPL), resulting in an improvement in banks' balance sheets and a reduction in the sector's credit risk. The continuous decline of the NPL ratio in the last year is the result of a combination of measures included in the action plan closely monitored by the BoA. While in early 2017 write-offs were the main driver, banks are now increasingly engaged in credit restructuring operations under a new BoA regulation. NPLs remain adequately provisioned and banks dispose of abundant liquid assets. Further improvements are expected as the new legislation on bankruptcy, bailiff procedures, and out-of-court agreement is progressively implemented. In this context, the Bank of Albania judges that a key element for the reduction of the NPL ratio could also result from a steady growth lending going forward.

The banking system remains well-capitalized, liquid and profitable. The process to strengthen the BoA's supervisory and regulatory capacity, and to align it to EU standards, is underway. Priority is also being given to enhancing the supervision of nonbank financial institutions and to ensuring that high transparency and governance standards are maintained in developing capital market institutions. The BoA is committed to pursue a gradual de-euroization, with due consideration to disintermediation risks and the impact on FX markets. Gross foreign reserves continue to increase and are well above the ARA metric, providing an adequate buffer to external shocks.

Structural Reforms

Our Albanian authorities agree with staff on the need to continue to work resolutely to enhance competitiveness and medium-term growth. Efforts will build on the significant advancements recorded in recent years, namely in strengthening the rule of law, improving energy sector efficiency, and addressing the shortage of skilled labor.

Judicial reform stands as one of the most significant achievements in Albania's recent history. The main purpose of the reform, requiring the rewriting of nearly one-third of the Constitution, is to improve the efficiency and independence of the judicial system. The three institutions in charge of the vetting process have recently started working on a number of cases. The new vetting process will ensure that prosecutors and judges with unexplained wealth, insufficient training, or who have issued questionable decisions are removed from the system. The reform will also establish an independent prosecutor and a specialized unit to investigate and prosecute corruption and organized crime. The authorities are confident that the judiciary reform will deter corruption and, by addressing many of the weaknesses in the judiciary system experienced by Albanian citizens and stakeholders, help to promote foreign and domestic investment. Other initiatives are moving in parallel to improve the courts' efficiency and reduce backlogs.

The authorities intend to sustain the reform momentum in the power sector. Building on the steps already taken on bill collections, lowering distribution losses, and repaying arrears to the private sector, the government is targeting a further improvement of the governance and operational practices of the state-owned enterprises. The aim is to place their improved financial position on a sustainable footing, as also recommended by the EBRD. In the meantime, Albania has progressed significantly in the gas market by unbundling the state- owned oil and gas company, and establishing a transmission system operator with the task of developing and managing gas infrastructure. Meanwhile, the government has also been studying the feasibility of a secondary gas infrastructure in the country and identifying priority gasification projects as part of the Gas Master Plan for Albania, for possible implementation in the 2018-20 period. Progress is underway also in the renewable energy sector, with the adoption of a law promoting the use of energy from renewable sources.

With the support of the EU, Albania has made steady progress in recent years in improving labor market policies. With a view to fostering social inclusion, several reforms have strengthened the labor market's legal framework, diversified job opportunities, and raised the quality of vocational training services. Furthermore, a law approved in February 2017 creates a new cooperation model between the public employment service and the private sector, including the joint identification of labor market needs and private-sector participation in curricula development. The positive trend in youth and female employment indicators is encouraging, with reductions in the employment gender gap and in the female and south unemployment rates.

Conclusions

The Albanian authorities remain fully committed to their reform agenda in the pursuit of high, sustainable and job-creating growth in line with the economic and institutional EU convergence process. They are cognizant that a well-calibrated combination of fiscal, monetary, financial, and structural policies is essential for continuing steadfastly on this path.