INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/29

ALBANIA

January 2019

2018 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 2018 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 January 23, 2019 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 January 23, 2019, following discussions that ended on November 20, 2018, 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 January 2, 2019
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Albania.

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 19/19
FOR IMMEDIATE RELEASE
January 28, 2019

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

IMF Executive Board Concludes 2018 Article IV Consultation with Albania

On January 23, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the 2018 Article IV Consultation with Albania.[1]

Albania's economic growth has trended upward in recent years as the country has benefitted from the implementation of reforms and from the economic expansion of its European trade partners. Growth is estimated at 4.2 percent in 2018 and is projected to stay close to this level over the medium term, supported by stronger exports, including tourism, and investments in infrastructure. The exchange rate has appreciated sharply since March 2018, putting downward pressure on inflation, which is expected to rise gradually to reach its 3 percent target by 2021. The fiscal stance was broadly neutral in 2018, and in the absence of additional measures the fiscal deficit is expected to hover around 2 percent of GDP in the medium term. In October, the authorities successfully issued a €500 million Eurobond with a seven-year maturity, at a favorable rate of 3.50 percent. As large energy projects with import-intensive components are tapering off, the current account deficit is expected to narrow to around 6 percent of GDP over the medium term. Although the banking system is well-capitalized and liquid, the provision of credit to support business investments has remained weak. The non-performing loan (NPL) ratio has been lowered to about 13 percent, but pockets of vulnerability remain.

Over the medium-term, risks are tilted towards the downside. Albania is strongly exposed to the increasing risks to growth in Europe, notably in its main trading partners. A downturn in these countries could spill over through lower exports, remittances, and foreign direct investment. Moreover, the expected tightening in global financial conditions would raise Albania's cost of financing. On the domestic side, public debt is high, while low domestic savings and the absence of large institutional investors amplify dependence on foreign sources of financing. The increasing reliance on PPPs for infrastructure projects has resulted in rising contingent liabilities. Domestic risks also include the impact of drought on electricity generation, creating risks to the budget.

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

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They welcomed Albania's continued economic growth. Directors encouraged the authorities to use the current favorable economic environment to further advance policies and structural reforms to entrench macroeconomic stability, build buffers, and foster sustainable and inclusive growth.

Directors encouraged additional fiscal consolidation to build stronger buffers. Accordingly, they recommended lowering the fiscal deficit further and accelerating the reduction in public debt, including through stronger revenue measures. Directors welcomed the authorities' aim to achieve a simple, predictable tax system and encouraged them to focus on broadening the tax base and to avoid ad-hoc tax measures that create distortions in the tax system.

Directors recommended containing fiscal risks, including those stemming from public-private partnerships (PPPs). They highlighted the need to consolidate and strengthen the decision-making processes in public investment management and underscored the importance of ensuring value for money for PPP projects through competitive bidding. Directors also called for determined measures to halt the persistent build-up of government arrears, as these hurt private economic activity and undermine trust in the public sector.

Directors agreed that the accommodative monetary policy stance remains appropriate. They considered that the normalization of monetary policy should remain data dependent, aimed at reaching the inflation target over the medium term. Directors welcomed the authorities' commitment to maintain exchange rate flexibility and agreed that interventions should be temporary and limited to preventing disorderly market conditions and a destabilization of inflation.

Directors called for strong measures to address the bottlenecks to credit growth and to improve the effectiveness of monetary transmission. They encouraged the authorities to expedite the implementation of de-euroization measures, and to address structural weaknesses in the provision of credit, including continued high NPLs. Strengthening property rights and insolvency regimes will be helpful in this regard.

Directors emphasized that the authorities should continue to strengthen financial supervision to safeguard financial stability within the changing architecture of the banking sector. They also encouraged the authorities to continue to enhance the AML/CFT framework.

Directors called for resolute structural reforms to improve the business climate, with emphasis on

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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.

strengthening the rule of law. Welcoming the progress thus far, they underscored that it is important to complete the ongoing judicial reform and strengthen anti-corruption efforts. Directors emphasized the need to reduce the pervasive informality, by maintaining a simple and fair tax system, sustaining improvements in tax collection, and by increasing the quality of public services.

It is expected that the next Article IV Consultation with Albania will be held on the standard 12-month cycle.

Albania: Selected Economic Indicators, 2014-2020 1/

	2014	2015	2016	2017	2018	2019	2020
						Proj.	
Real sector			(Growth rate in percent)				
Real GDP	1.8	2.2	3.3	3.8	4.2	3.7	3.9
Domestic demand contribution	3.4	0.7	3.3	4.8	3.2	4.2	4.4
Consumption	3.0	0.8	2.5	2.4	2.3	2.7	2.9
Investment (Incl. inventories and stat. disc)	0.5	-1.0	-0.1	0.8	0.1	0.3	0.0
External demand contribution	-1.7	1.5	0.0	-1.0	0.9	-0.5	-0.5
Consumer Price Index (avg.)	1.6	1.9	1.3	2.0	2.0	2.0	2.4
Consumer Price Index (eop)	0.7	2.0	2.2	1.8	1.8	2.2	2.6
GDP deflator	1.5	0.6	-0.4	1.4	2.1	2.2	2.5
Saving-investment balance			(Percent of GDP)				
Foreign savings	10.8	8.6	7.6	7.5	6.3	6.0	5.8
National savings	15.9	15.8	17.0	17.4	17.9	17.9	18.1
Public	0.6	0.7	1.2	2.4	2.6	1.9	2.0
Private	15.4	15.0	15.8	15.1	15.3	16.0	16.1
Investment (incl. Inventories and stat. disc.)	26.7	24.4	24.5	24.9	24.2	23.9	23.9
Public	5.0	5.3	5.1	5.5	5.5	5.5	5.6
Private	21.7	19.1	19.4	19.4	18.6	18.4	18.3
Fiscal sector							
Total Revenues and grants	26.3	26.4	27.4	27.7	27.2	27.4	27.2
Tax revenue	24.1	23.8	24.8	25.7	25.4	25.2	25.1
Total Expenditure	32.2	31.0	29.6	29.7	29.0	29.3	29.1
Primary	29.3	28.3	27.2	27.7	26.8	27.1	27.0
Interest	2.9	2.7	2.5	2.1	2.2	2.2	2.1
Overall balance	-5.9	-4.6	-2.3	-2.0	-1.7	-2.0	-1.9
Primary balance	-3.0	-1.9	0.2	0.1	0.5	0.2	0.3
Financing	5.9	4.6	2.3	2.0	1.7	2.0	1.9
of which: Domestic	3.4	-1.3	0.9	-0.8	-1.3	1.0	0.0
of which: Foreign	2.5	5.0	1.3	1.9	3.1	1.0	1.9
General Government Debt 2/	72.0	73.9	73.3	71.9	68.6	65.1	63.3
Domestic	42.4	39.6	39.0	39.0	36.7	33.7	32.1
External	29.6	34.3	34.3	32.9	31.9	31.4	31.2
Monetary indicators			(Growth rate in percent, unless otherwise indicated)				
Broad money growth	4.0	1.8	3.9	0.3	2.2	2.0	4.9
Private credit growth	2.0	-2.8	0.4	0.2	0.8	2.6	3.6
Velocity (nominal GDP/broad money)	1.2	1.2	1.2	1.2	1.3	1.3	1.3
External sector			(Percent of GDP, unless otherwise indicated)				
Trade balance (goods and services)	-19.0	-17.3	-16.8	-15.1	-13.1	-12.5	-12.0
Current account balance	-10.8	-8.6	-7.6	-7.5	-6.3	-6.0	-5.8
Gross international reserves (in billions of Euros)	2.2	2.9	2.9	3.0	3.3	3.2	3.4
(In months of imports of goods and services)	5.8	7.0	6.5	6.3	6.7	6.0	5.9
(Relative to external debt service)	2.9	2.6	3.6	3.5	2.9	3.1	2.6
(In percent of broad money)	25.7	32.5	31.5	31.4	32.3	30.3	30.4
Memorandum items							
Nominal GDP (in billions of lek)	1395	1431	1473	1551	1649	1748	1860
Output Gap (percent)	-1.5	-1.8	-1.4	-0.7	-0.7	-0.5	-0.2

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

1/ The numbers have been updated since the Staff Report was issued on January 2, 2019 in line with the Staff Statement issued to the Board on January 23, 2019.

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

INTERNATIONAL MONETARY FUND

ALBANIA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

January 2, 2019

KEY ISSUES

Despite robust GDP growth, projected at 4 percent in 2018, inflation remains below its 3 percent target. The fiscal deficit has stabilized around 2 percent of GDP, implying a modest gradual reduction in public debt, which remains high at close to 70 percent of GDP. Monetary policy was relaxed further in June 2018 following a rapid appreciation of the exchange rate. The current account deficit has moderated over recent years, to about 6.5 percent of GDP. The outlook is mostly positive, with GDP growth projected to converge to 4 percent over the medium term, with inflation stabilizing around its target by 2021.

Further fiscal consolidation and an accommodative monetary policy, combined with growth-promoting structural reforms represent the right policy mix.

- **Fiscal policy**: Utilize the current upswing to build fiscal buffers. Putting public debt on a firmly downward path requires further fiscal consolidation, based on higher tax revenues. An operational fiscal anchor would help achieve these objectives. Structural reforms should aim at enhancing investment management and ringfencing risks from contingent liabilities.

- **Monetary policy:** The current accommodative monetary policy stance remains appropriate until inflation is on track to become entrenched around its target. The transmission of monetary policy to the real economy is delayed due to structural bottlenecks, which need to be remedied by the government and the central bank.

- **Financial Sector:** Financial sector reforms should help restore private credit growth and accelerate intermediation, including through further improvements in NPL resolution. Emerging risks, including from EU bank deleveraging, call for targeted enhancements of the supervisory framework.

- **Structural reforms:** Priority reforms should aim at restructuring the power sector, advancing governance and judicial reforms, reducing corruption, and closing infrastructure and labor skill gaps so Albania can benefit from regional integration.

Past IMF advice: Previous advice on continuing fiscal consolidation remains valid. Thus far, measures to strengthen public finance and investment management (e.g., PPPs) fall short of what was recommended. Progress has been made in aligning banking supervision and regulation with Basel standards, but the NPL overhang continues. Progress in implementing recommended structural reforms has been limited, specifically in SOE restructuring, property rights, and tax reform.

Approved By
Jörg Decressin (EUR) and Nathan Porter (SPR)

Discussions were held in Tirana during November 6–20, 2018. The team comprised J.K. Martijn (head), A. Khachatryan, R. Lafarguette (all EUR), A. Weller (SPR), S. Cerovic (FAD). L. Spahia (local economist) and R. Kadeli (local office manager) assisted the mission team. B. Stewart and P. Kopyrski assisted in the preparation of the report at headquarters. Mr. Di Lorenzo (OED) attended part of the meetings. The mission met with Prime Minister Rama, Minister of Finance and Economy Ahmetaj, Minister of Energy and Infrastructure Gjiknuri, Bank of Albania Governor Sejko, senior officials, parliamentarians and other representatives of political parties, donors, and representatives of business, academia, financial institutions, diplomatic envoys, and civil society. The mission team held an outreach event at the University of Tirana.

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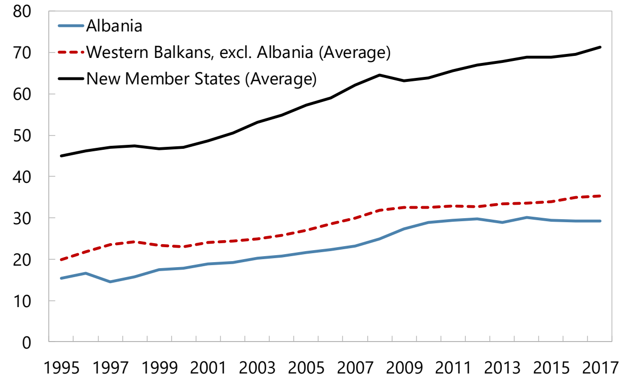
CONTEXT

1. Albania has enjoyed strong economic growth over the past two decades and has mitigated the immediate macroeconomic vulnerabilities that emerged after the Euro-area crisis. At the same time, per capita income remains at only a quarter of the EU average, and about half of new member states (NMS). Challenges in shifting from consumption-led growth to an investment and export-led expansion are compounded by outward migration, with about one third of Albanians living outside of the country. In addition, policy efforts—including under the program supported by a three-year Extended Arrangement that was successfully concluded in early 2017—to resolve imbalances in the fiscal and financial sectors still need to be brought to completion.



Sources: WDI World Bank database; and IMF staff calculations.

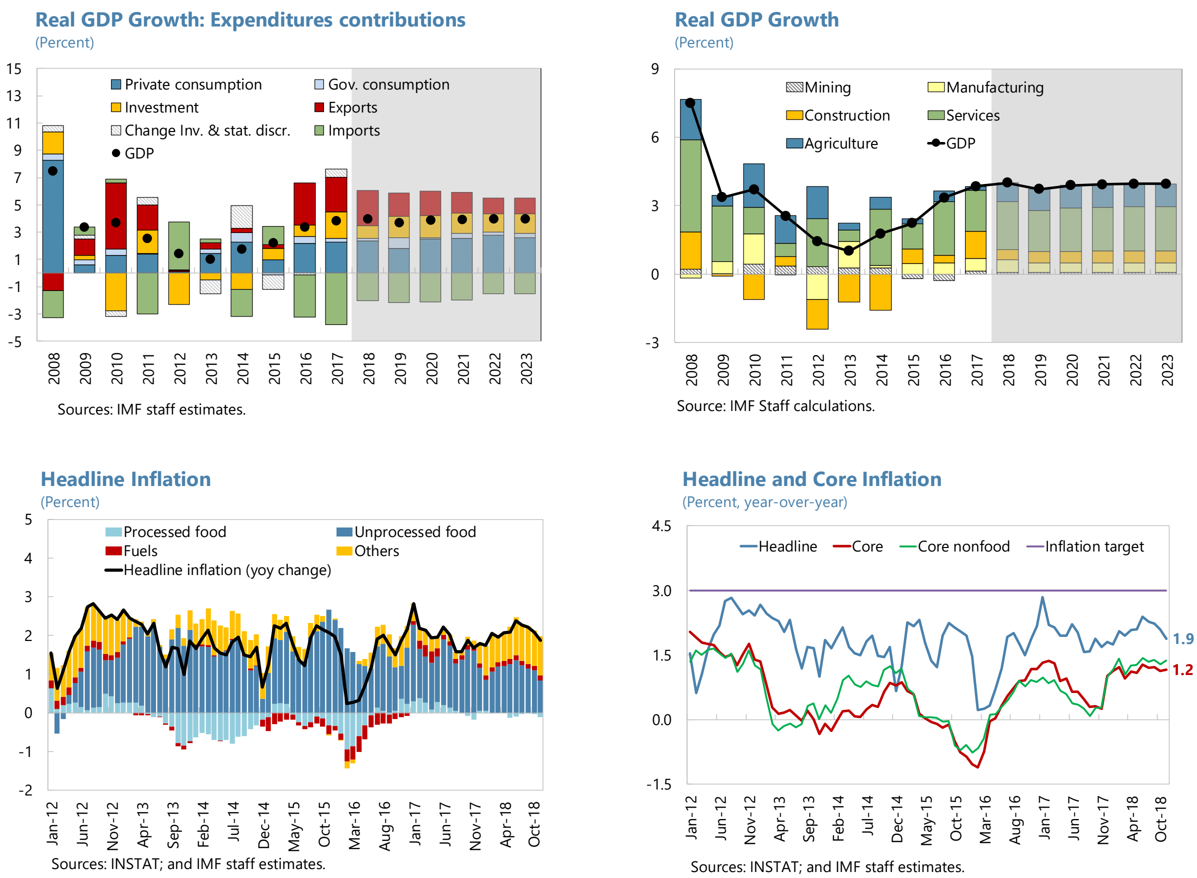
2. With the prospect of EU accession as a strong anchor, the Socialist Party government is well positioned to push ahead with reforms. Negotiations on EU accession are scheduled to commence by June 2019, subject to adequate progress in priority reforms. The challenge is to use the government's majority in Parliament and the benign external environment to accelerate growth-enhancing structural reforms that would enable faster convergence with EU member states and reduce the appeal of emigration. Key reforms include strengthening the rule of law and economic institutions, removing obstacles to higher private savings and investment, and reducing public debt at a faster pace by enhancing the management of public investments and broadening the revenue base. In addition, enhancing regional connectivity should help Albania in its pursuit of further cross-border integration.

3. In this context, the focus of the 2018 Article IV consultation is on macroeconomic and structural policies that should help Albania to safeguard growth and macro-fiscal sustainability and build stronger buffers to handle potential shocks. Albania is currently under Post-Program Monitoring.

RECENT ECONOMIC DEVELOPMENTS

4. Albania's growth remains strong. Real GDP growth has been on an upward trend for five consecutive years, reaching 4.3 percent over the first half of 2018. While growth was broad-based, the largest driver was electricity generation, owing to favorable climatic conditions, with an all-time high contribution of 1.8 percentage points. For the year as a whole, growth is expected to settle at 4 percent, supporting a sustained decline in unemployment. Large idiosyncratic capital inflows (e.g., the conversion of commercial bank capital into lek) spurred an appreciation of the exchange rate against the euro by more than 6 percent during March-June 2018.[1] Headline inflation remains below its 3 percent target, reaching 1.8 percent in November 2018—the same level as a year before; and 0.6 percentage points lower than in June 2018, in part reflecting the pass-through effect of the appreciation.

Figure 1. Albania: GDP Growth and Inflation



5. The fiscal stance is expected to be broadly neutral in 2018, with the overall deficit edging up to 2.2 percent of GDP.[2] In the first nine months, the overall and primary balances improved as revenue underperformance was more than offset by lower current spending. The revenue underperformance was partly driven by the clearance of VAT refund arrears. The total stock of government arrears has oscillated through the year; and stood at 1.5 percent of GDP at

[1] In RER terms the appreciation was 8 percent (yoy) as of the beginning of October.

[2] This corresponds with a 2.0 percent of GDP deficit based on the authorities' definition, as staff includes the on-lending of government-guaranteed loans to the energy sector as part of government spending.

end-September. The authorities issued a seven-year €500 million Eurobond at favorable rates in October 2018, and used €200 million to buyback a portion of the €450 million 2015 Eurobond falling due in 2020. The stock of public debt is expected to decline to 70.5 percent of GDP in 2018, mainly thanks to exchange-rate appreciation.[3]

Fiscal Performance

	Jan-Sept 2018 (Lek billions)	Budget (Lek billions)	Y/Y change (Percent)
Nongrant revenues	**326.50**	**333.76**	**3.8**
Tax	309.29	313.89	3.8
Nontax	17.21	19.87	4.8
Expenditure (ex.guarante	326.59	346.90	1.1
Current	281.47	294.86	-7.0
Capital	45.12	52.03	8.1
Primary balance	**25.97**	**19.16**	
in % of GDP	1.6	1.2	
Overall balance	**2.6**	**-6.4**	
in % of GDP	0.2	-0.4	

Sources: Ministry of Finance and Economy; and IMF staff calculations.

6. Despite an accommodative monetary policy stance, private credit remains weak. In June 2018 the Bank of Albania (BOA) cut its policy rate by 25 bps to a historical low of 1 percent and initiated ad-hoc purchases in the foreign exchange market. The BOA's decision aimed to address disorderly market conditions and deflationary pressures following the sharp appreciation, against the background of a negative output gap. Despite low interest rates and ample liquidity in the system, private sector credit contracted by 5.4 percent (y-o-y) at end-September 2018.[4] Although this decline was mostly driven by credit in foreign currency, credit in local currency to corporates also fell, with only a minor increase in credit to households and SMEs. Credit is mostly driven by domestic banks, while EU-owned banks are deleveraging. On the demand side, recent BOA surveys indicate that the appetite of firms and households for new loans remains weak.

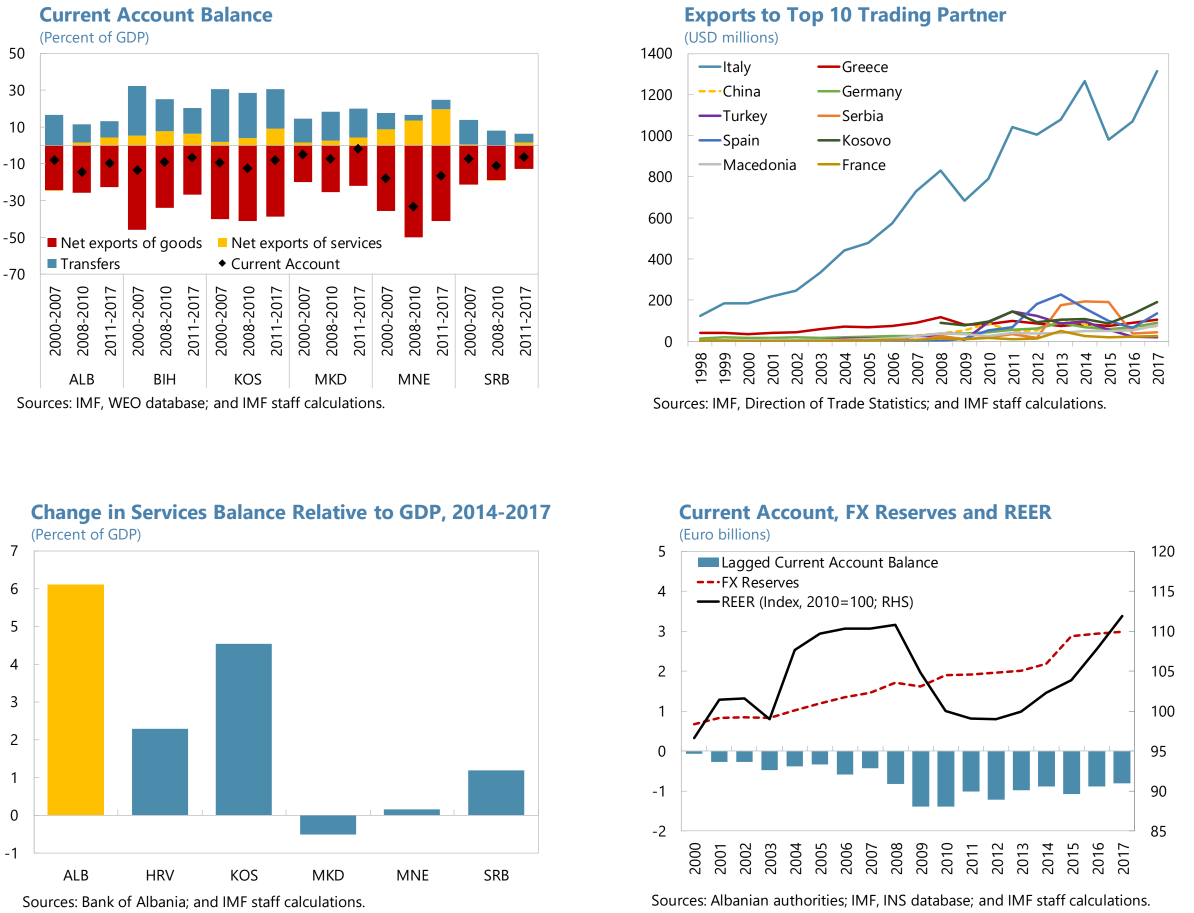
7. The current-account deficit remains large but has narrowed and ample reserves provide a buffer against external shocks. The current-account deficit is expected to decline to 6.2 percent of GDP in 2018 from 7.5 percent in 2017, driven by an increase in electricity exports, and the continued strong growth of services exports, especially tourism.[5] While external debt remains high (63 percent of GDP in 2017), it is expected to decline in 2018 consistent with the buyback (see DSA, Annex III). Robust reserve coverage equivalent to 6½ months of imports, or 189 percent of the ARA metric at end-2018, mitigates risks posed by high FX debt and partial euroization.

[3] Including projected general government arrears, which are not included in the authorities' debt numbers.

[4] Private credit to the economy comprises claims on private non-financial corporations of depository corporations, using monetary survey data.

[5] The 2017 current-account balance was revised from -6.9 percent to -7.5 percent due to one-off revisions to dividends payments of Tirana International Airport and a gaming company.

Figure 2. Albania: Trade and the Current Account

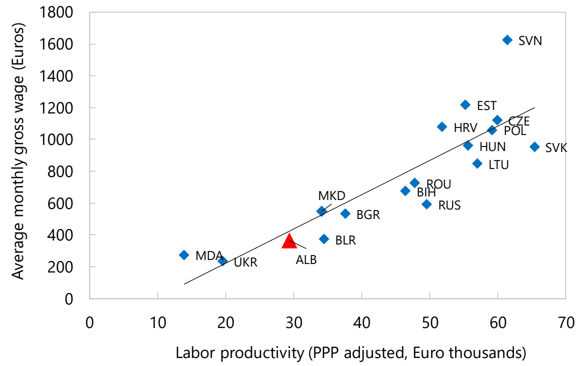


OUTLOOK AND RISKS

8. The outlook is mostly positive, with GDP growth projected to converge to 4 percent over the medium term. In 2019—when growth is projected to moderate to 3.7 percent—and over the medium-term, growth is projected to be driven by a gradual strengthening of the export sectors, including industry and tourism, and by investments needed to close the large infrastructure gap. Visible progress toward EU accession would offer some upward risk. Inflation is expected to edge up gradually as the output gap closes. The current account deficit is expected to narrow in the medium term to slightly less than 6 percent of GDP as a result of the completion of import-intensive large energy projects and related pick up in electricity exports, and the continued strong growth of tourism exports.

9. Albania's external position is assessed to be moderately weaker than implied by fundamentals and desirable policy settings (see Annex I). The EBA-Lite approaches indicate a current-account gap of -1.3 percent and real effective exchange rate overvaluation of about 5 percent. The overvaluation is expected to resolve over time, with fiscal adjustment and productivity growth supported by structural reform. While Albania's wages are low, so is productivity, reflecting a mediocre business climate on various fronts, including governance, labor skills, and infrastructure.

Labor Productivity and Wages, 2017



Sources: National authorities, The Conference Board Total Economy Database™ (Adjusted version), May 2017; and IMF staff calculations.

10. Over the medium term, the balance of risks is tilted to the downside. (Annex II).

- **Rising external risks.** Albania is strongly exposed to the increasing downward risks to growth in Europe, notably in Albania's main trading partners.[6] Furthermore, the expected tightening in global financial conditions would raise Albania's cost of financing, especially as the government is increasing its reliance on external commercial borrowing. Such shocks could also lead to a quick reversal of the recent appreciation pressures, that could entail balance sheet risks (given extensive unhedged FX loans). Nevertheless, Albania's robust reserve coverage and flexible exchange rate provide significant shock-absorbers. A potential upside risk is a greater than expected increase in domestic energy production if large oil reserves prove economical to extract.

- **Limited fiscal buffers and significant domestic vulnerabilities.** The fiscal buffers for mitigating shocks remain insufficient. Public debt is still high, while low domestic savings and the absence of institutional investors amplify dependence on foreign sources of financing. The underdeveloped secondary market increases refinancing risks. Furthermore, the increasing reliance on PPPs for infrastructure projects has resulted in rising contingent liabilities.

Authorities' Views

11. The authorities broadly agreed with the staff's assessment, noting that the projections were not far apart, but put emphasis on the upside potential. The Ministry of Finance projected growth of 4.3 percent in 2019. They pointed to the ongoing investments in infrastructure, the benefits from past FDI in energy, and favorable labor market dynamics, which they expected to boost growth in 2019 and beyond. The authorities broadly agreed with the vulnerabilities shown in the risk assessment matrix, emphasizing vulnerabilities to weather-related shocks and Albania's main Euro-Area trading partners.

[6] An analysis of spillovers to growth in Albania is presented in Annex IV.

POLICY DISCUSSIONS

Further fiscal consolidation and an accommodative monetary policy, combined with growth-promoting structural reforms, represent the right policy mix. Capitalizing on favorable economic conditions and the accommodative monetary policy stance, this is the right time to make progress in building larger fiscal buffers to withstand shocks. Safeguarding financial stability within the changing architecture of the banking sector and continuing financial sector reform should help restore private credit growth and accelerate financial intermediation.

A. Prudent Fiscal Policy—Creating Fiscal Buffers in Good Times

12. Deficit reduction is needed to create larger fiscal buffers. If adverse risks to growth were to materialize in the near term, there would be very limited space for fiscal stimulus. A front-loaded adjustment would help lower debt in the next few years and avoid a potential forced pro-cyclical adjustment later on, under less favorable economic circumstances. In addition, upfront consolidation would bolster the credibility of fiscal policy and could thereby moderate the expected increase in financing costs and rollover risks as financial conditions tighten. A remarkable fiscal adjustment was achieved from 2015 to 2017, through a combination of spending restraint and tax policy measures. However, after the overall deficit declined from 5.9 percent of GDP in 2014 to 2 percent in 2017, further consolidation has stalled.

13. Staff projects that in the absence of additional measures the deficit will hover around 2 percent of GDP in the medium-term. The budget for 2019, is expected to result in a deficit of 2.1 percent of GDP (or 1.9 percent on the authorities' definition). The authorities' updated medium-term budget framework shows some fiscal consolidation after 2019, albeit more slowly than previously envisaged, with the deficit falling to -1.2 percent of GDP in 2021. Based on this path, the authorities expect to reduce debt to just below 60 percent of GDP in 2021. In the staff projection of the fiscal path, although debt will continue to be on a declining path, it will remain high at 62.3 percent of GDP in 2021 and 58.4 percent in 2023.[7] The differences between the authorities' and the staff's baseline projections reflects several elements:

- **Staff considers the authorities revenue projections to be overly optimistic.** Notwithstanding recently introduced tax breaks (see Box 1), and large pending VAT refunds, the budget for 2019 envisages to maintain the tax-to-GDP ratio at the level of 2018. The medium-term budget framework relies on additional improvements in revenue administration as a source of higher revenue.

[7] The projection for 2021 includes projected general government arrears of 0.6 percent of GDP, which are not included in the authorities' numbers.

- **As for spending, the medium-term budget envisages to contain spending on wages, health care and education, while maintaining capital spending at around 5 percent of GDP.**

- The authorities' debt projection for end-2021 assumes a heavy withdrawal at that time from the single treasury account to well below historical levels.[8]

Box 1. Tax Measures in the 2019 Budget

Tax policy measures in the 2019 budget include:

1. **VAT.** A reduced 6 percent (rather than 20 percent) rate will apply to certain services provided by classified agro-tourism companies, five-star hotels; and certain advertising services. Imports of agricultural machinery, raw materials for pharmaceuticals and the processing of foreign goods for re-exports will be exempted from VAT.

2. **Income tax.**
   a) A reduction from 15 to 8 percent in the withholding rate on dividends, including from previous years if declared in 2019.
   b) CIT: the threshold will increase from ALL 8 to 14 million. A reduced rate of 5 percent will apply to agricultural cooperatives and certified agro-tourism entities.
   c) PIT: the highest income tax bracket (taxed at 23 percent) will increase.

3. **Excises**. Duties on cigars and cigarillos will be increased.

4. **Environmental tax.** The tax on plastic packaging will be cut drastically, but extended to a wider range of plastic products, and differentiated between imported and domestically produced plastics.

The authorities project a net gain of 0.3 percent of GDP from the new tax measures.

[8] Staff assumes that a prudent buffer will be maintained in this account equal to 1 percent of GDP, in line with historical levels, and offering a first-line buffer against rollover risks.

14. In this context, staff advised that fiscal consolidation should be accelerated, to create adequate room for fiscal policy maneuver and to achieve the authorities' objective of reducing public debt to 60 percent of GDP by 2021 in a sustainable manner. Absent significant progress, confidence of financial markets will be fragile. For 2019, fiscal policy should seek an additional reduction in the deficit by more than ½ percent of GDP.

Medium-Term Fiscal Paths
(Percent of GDP)

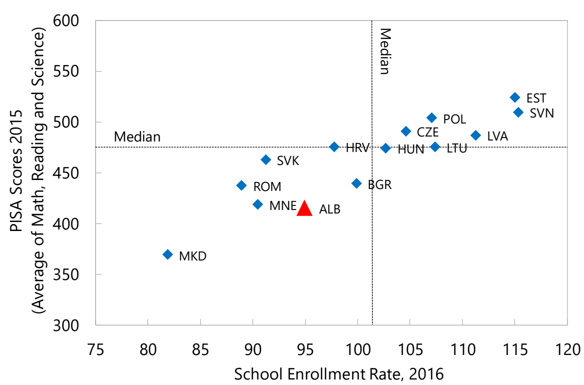
	2016	2017	2018	2019	2020	2021
Overall balance						
IMF baseline	-2.3	-2.0	-2.2	-2.1	-2.1	-2.1
IMF recommended path	-2.3	-2.0	-2.2	-1.5	-0.8	-0.6
Authorities MTBF*				-1.9	-1.6	-1.2
Primary balance						
IMF baseline	0.2	0.1	0.0	0.1	0.1	0.0
IMF recommended path	0.2	0.1	0.0	0.7	1.4	1.5
Authorities MTBF*				0.5	0.9	1.5
Structural primary balance						
IMF baseline	0.4	0.2	0.2	0.2	0.1	0.0
IMF recommended path	0.4	0.2	0.2	0.8	1.4	1.5
Authorities MTBF*				0.5	1.0	1.5
Public debt						
IMF baseline	73.2	71.8	70.5	66.9	65.2	62.3
IMF recommended path	73.2	71.8	70.5	66.3	63.4	59.1
Authorities MTBF*				65.5	63.7	59.9

* MTBF as of November 2018. Based on the authorities' own definitions of debt and deficit (i.e., excluding some energy sector support from the deficit, and omitting arrears in the debt statistics).

Sources: Ministry of Finance and Economy; and IMF staff calculations.

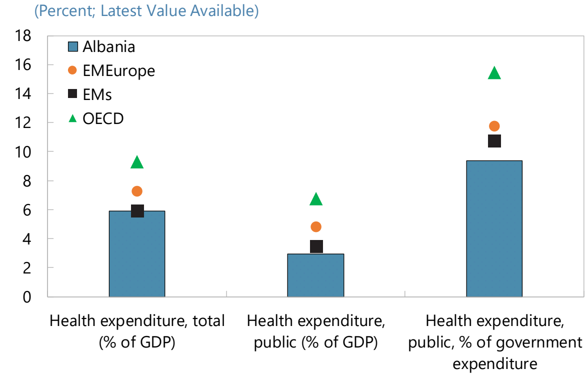
- **On the expenditure side, efforts to strengthen efficiency should not erode the level of spending in priority areas.** The need for upgrading education, health care, and infrastructure towards European standards requires raising both the quality and the level of spending. In particular, spending on education remains low while skills shortages are a serious constraint to productivity and growth.

School Enrollment Rate and PISA Scores



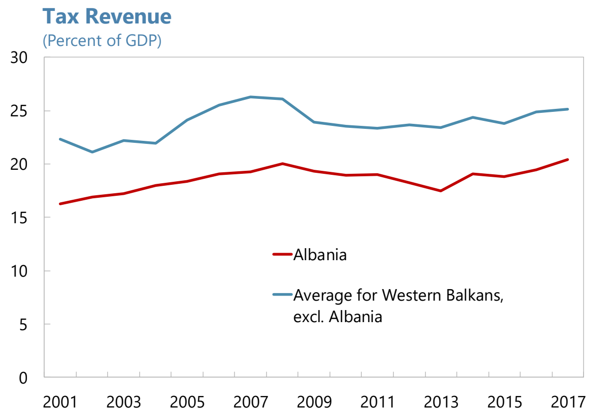
Sources: OECD; UNESCO and IMF staff calculations.

Health Expenditure
(Percent; Latest Value Available)



Sources: WHO; and IMF staff calculations.

- **Revenue performance is lagging behind regional peers**. Staff advised that further consolidation should be achieved through revenue measures, including a mix of excise-rate indexation, environmental taxation, and further broadening of the tax base.



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

Tax Policy Options*

	2019	2020	2021
Recommended permanent tax measures	**0.83**	**0.14**	**0.13**
Index specific excises/national taxes on observed inflation (e.g., fuel excise, carbon tax, circulation tax, car registration, etc.)	0.11	0.11	0.10
Broaden the VAT base (drugs, machineries, new residential property sales, education, advertisement, tourism)	0.16	0.03	0.03
Reintroduce small business income tax	0.15	-	-
Environment and health-related excises	0.42	-	-

* The total effect of the measures is the sum of the supplementary amounts shown in the table.

Sources: Ministry of Finance and Economy; and IMF staff calculations.

15. To lock in the path for further consolidation and support the credibility of the fiscal framework, staff recommended strengthening the fiscal rule. The current Organic Budget Law requires debt to be on a declining path until it reaches 45 percent of GDP, which offers little or no operational guidance for near-term budget targets. Staff recommended setting targets for the annual primary or overall balance, to reduce debt below 60 percent of GDP by 2021 (in line with the EU Stability and Growth Pact) and to underpin the legislated target of reducing debt to no more than 45 percent by 2026.

16. Recurrent tax policy amendments overshadow the ongoing progress in revenue administration. Improvements have been made in compliance-risk management, and information technology systems, with Fund assistance. Progress has also been made in property tax reform and the launch of a supporting fiscal cadaster is expected in January 2019. However, since 2017 the tax system has been undercut by frequent ad-hoc policy changes, often focused on sectoral objectives. Such policies, including those contained in the 2019 budget, can distort resource allocation, undermine the integrity of the tax system, weaken the tax base, and complicate revenue collection. For example, lowering the VAT threshold in 2018 increased the number of taxpayers by around 30 percent, significantly increasing the burden on tax administration and small businesses, while the revenue gains were minor. Similarly, the introduction of multiple tax thresholds for the CIT may fragment the system and lead to tax arbitrage (splitting businesses, outsourcing certain activities).

17. **Staff urged authorities to refrain from introducing tax cuts, exemptions or preferential treatments and consider rolling back those already implemented.** Changes in tax policy should be infrequent and well-prepared, given the importance of stability and predictability for the investment climate. Before announcing tax changes, the authorities should conduct robust policy analysis, to assess their revenue, economic, and distributional impact. Moreover, the authorities are advised to consider preparing a comprehensive medium-term revenue strategy.

18. **Staff urged the authorities to address the increase in government arrears since 2016 without delay.** Budgetary arrears—mostly related to VAT refunds, central government payments for road construction, and local governments—have posed a perennial problem in Albania, undermining trust in the tax administration and the government more broadly. The prevention and control of arrears requires strengthening revenue forecasting (including of VAT refunds) and cash management, and improving commitment controls, particularly by the Road Authority (Annex V).

Stock of Arrears

	2016		2017		End Sept 2018	
	Lek million	% of GDP	Lek million	% of GDP	Lek million	% of GDP
Total	**13,121**	0.9	**26,662**	1.7	**24,578.3**	1.5
Central Government	3,680	0.2	**17,405**	1.1	**17,476.3**	1.1
VAT refund arrears	1,908	0.1	11,705	0.7	11,340.88	0.7
Other	1,772	0.1	5,700	0.4	6,135.4	0.4
Local Government	**9,441**	**0.6**	**9,257**	**0.6**	**7,102.0**	0.4

Sources: Ministry of Finance and Economy; and IMF staff calculations.

19. **More generally, building fiscal buffers require significant improvements in cash and debt management.** There is a need to improve cash forecasting and manage government resources in more integrated and cost-efficient manner. While the authorities have made progress in lengthening the maturity of public debt, staff strongly advised them to maintain the issuance of three-months T-bills. The last issuance occurred in December 2017, limiting the development of money market, complicating BOA liquidity management, and depriving the budget authorities of a potentially important financing tool.

Authorities' Views

20. **The authorities reiterated their commitment to keep public debt on a declining path.** They considered that meeting their debt target of 60 percent of GDP by 2021 would be challenging but achievable. They noted that revenue administration reforms, including new systems for data integration and tackling informality, will help increase revenues and meet debt objectives. They also

noted that the budget for 2019 included sufficient buffers to respond to possible adverse shocks without expanding the deficit. The authorities recognized the case for maintaining a stable and predictable tax system.

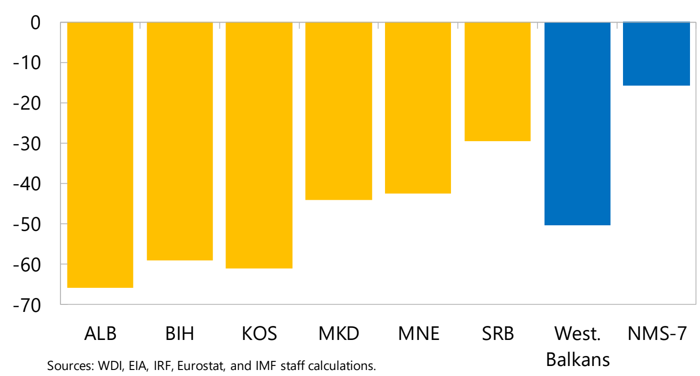
21. The authorities reiterated the political consensus on maintaining a small government, with a low tax burden. They concurred with the need to enhance the quality of education and health care and were of the view that this could be achieved within the envisaged budget envelope through optimization and greater efficiency.

22. The authorities argued that budgetary arrears were under control and on track to being cleared expeditiously. They explained that the VAT arrears were related to three large investment projects and would be phased out as these projects were about to come to an end. To prevent the accumulation of new arrears arising from large projects, they have introduced a reverse charge mechanism for contractors and sub-contractors. The fiscal authorities planned to continue the issuance of short-term T-bills, in coordination with the BOA.

B. Improving Infrastructure and Containing Fiscal Risks

23. Albania has a serious public infrastructure gap.[9] To address this, the authorities have prioritized capital spending, which is maintained at 5 percent of GDP, and accelerated the use of PPPs. However, despite some progress, the appraisal and selection of investment projects continues to be fragmented depending on the source of project funding. Staff recommended consolidating the decision-making processes and strengthening the public investment management unit in the Ministry of Finance and Economy (and including PPP management under the same umbrella). The government is also considering to establish a development bank that would support public investments using physical public assets and prospective IFI financing. In moving this forward, the authorities are advised to take into account international experience with risks associated with such entities, including fiscal, financial and governance risks.

Infrastructure Gap Index, 2015



Sources: WDI, EIA, IRF, Eurostat, and IMF staff calculations.
1/ Infrastructure Gap Index is the weighted sum of railway density, motorway density, installed capacity for power generation, phone lines and cellular subscriptions, air transport passengers, and internet subscriptions. Installed capacity for power generation data are available for 2014 only.
From: Public Infrastructure in Western Balkans, IMF, European Department, 2018. The methodology and assessment are further discussed in the paper.
NMS-7 comprises: Estonia, Latvia, Lithuania, Slovak Republic, Slovenia, Croatia and Bulgaria.

24. The rapid increase in Public-Private Partnerships (PPPs) has raised fiscal risks, and staff proposed further steps to control these. In addition to the existing stock of PPPs of 31 percent of GDP (covering more than 220 projects, including concessions in energy of more than 23 percentage

[9] See 'Public Infrastructure in the Western Balkans,' IMF, European Department, 2018.

points), the 2019 budget documents foresee a pipeline of potential new PPPs capped at 15 percentage points of GDP. Staff welcomed planned amendments to the PPP legislation to enhance the role of the Ministry of Finance and Economy as a gatekeeper in containing the potential fiscal cost of PPPs, as a useful first step. It will also be critical to ensure value for money through a competitive bidding process for all projects by halting the acceptance of unsolicited PPP proposals. While annual PPP-related government spending is projected to remain below the legal limit of 5 percent of tax revenues, this ceiling leaves little room left for additional government-funded PPPs, especially given the need to incorporate risks from contingent liabilities.

25. Containing fiscal risks also requires improving the performance of the energy sector. Staff advised that planned reforms to make the electricity sector financially sustainable should be implemented in a steadfast manner. The reforms are guided by a five-year financial recovery plan, prepared with World Bank support. Completing the reform process also requires timely decisions on the governance structure of the public energy-sector companies, pricing (throughout the production chain) that ensures cost recovery, and contingency planning to deal with droughts.

26. Staff welcomed the inclusion of a fiscal risk assessment in recent budgets, but advised enhancing the depth and coverage of the published document. This should involve extending the analysis to a wider range of risks to the public-sector balance sheet, and a more granular analysis of large contingent liabilities, including those of state-owned utility companies, local governments and those embedded in PPP contracts. To bolster the credibility of budget estimates, the report should also outline the government's policies for mitigating these risks.

Authorities' Views

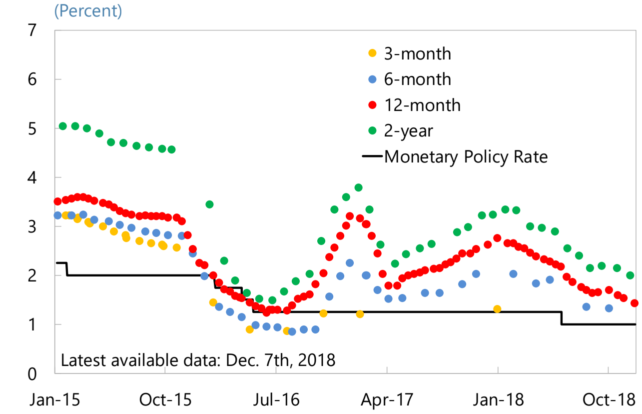
27. The authorities recognized the need to improve public investment management and contain the rapid buildup of PPPs. They were improving the public investment management guidelines and regulations, as well as the PPP legislation, including by halting the acceptance of unsolicited bids in most sectors. The authorities considered that the ongoing improvements would adequately control the various risks.

28. Regarding the power sector, the authorities committed to the swift implementation of their five-year financial recovery plan. A mapping of intracompany arrears had been produced and was discussed by the responsible parties. They also emphasized the importance of controlling investment spending and of further loss reduction and were preparing plans for sector liberalization.

C. Strengthening Inflation Targeting and the Transmission of Monetary Policy

29. The current accommodative monetary policy stance remains appropriate until inflation converges towards the BoA target. Inflation targeting has served Albania well, yielding low and stable inflation and anchoring macroeconomic stability. At the same time, the 3 percent target has been undershot since 2011, posing a challenge to policy makers (as in many other countries). In the wake of the sharp appreciation since March this year, the further relaxation of monetary policy was an appropriate response. Staff projects that inflation will converge towards its target by late 2021, as the output gap closes.

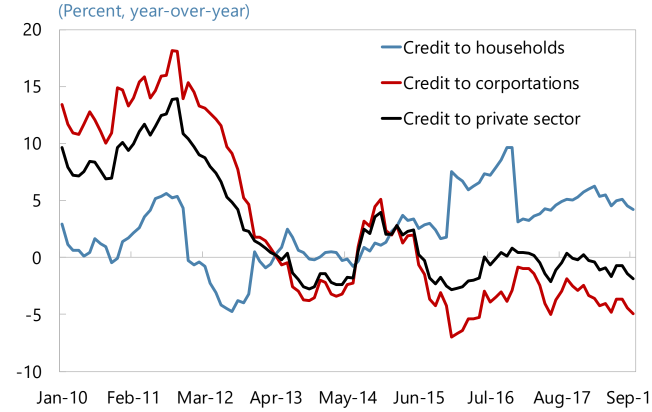
Policy Rate and T-Bills Yields
(Percent)



Sources: Ministry of Finance and Economy; Bank of Albania; Haver Analytics.

30. However, the transmission of monetary policy to the real economy is delayed. Since late 2011, the policy rate has been revised down progressively from 5 to 1 percent, while inflation remained below target. The most recent policy rate cut has been well transmitted to the short-end of the sovereign yield curve and, to a lesser extent, to the deposit and lending rates. However, the level of credit is held down by structural bottlenecks and has not rebounded. In this context, the high degree of euroization is also a major impediment. Moreover, sluggish credit in lek limits money creation (M2) which could perpetuate the euroization trend, under the flexible exchange rate regime.

Private Sector Credit Growth
(Percent, year-over-year)

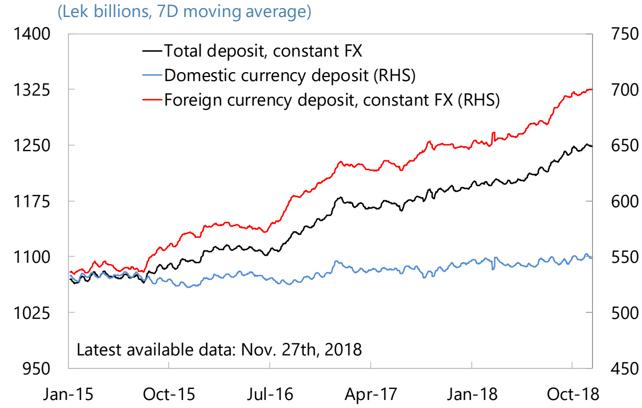


Sources: Bank of Albania; and IMF staff calculations.

31. Alleviating obstacles to monetary transmission calls for measures by both the government and the central bank.

- **Tackling the high degree of euroization.** Based on a joint plan of the fiscal and monetary authorities, the latter introduced differentiated reserve requirements for local and FX deposits in July 2018, and also imposed transparency obligations to banks to communicate currency risks to unhedged borrowers.[10] Staff underscored the importance of continued macroeconomic stability for de-euroization, and considered that possible further prudential measures could be assessed following an evaluation of the recent steps. Staff suggested that, in the meantime, effective de-euroization could also be supported by administrative government action to promote the use of local currency for the pricing and payment of non-tradable goods.

Deposit by Currency
(Lek billions, 7D moving average)



Sources: Ministry of Finance and Economy; Bank of Albania; Haver Analytics.

- **Resolving structural obstacles to credit growth:**

  i. The provision of credit continues to be affected by impaired bank balance sheets. More efforts are needed to unlock the provision of credit (see paragraph 35).

  ii. The general deleveraging of EU-owned banks from the Balkans and CESEE countries has limited credit supply in Albania (see paragraph 36).

  iii. The high level of informality impedes credit growth, as banks can only extend credit based on formal financial statements.

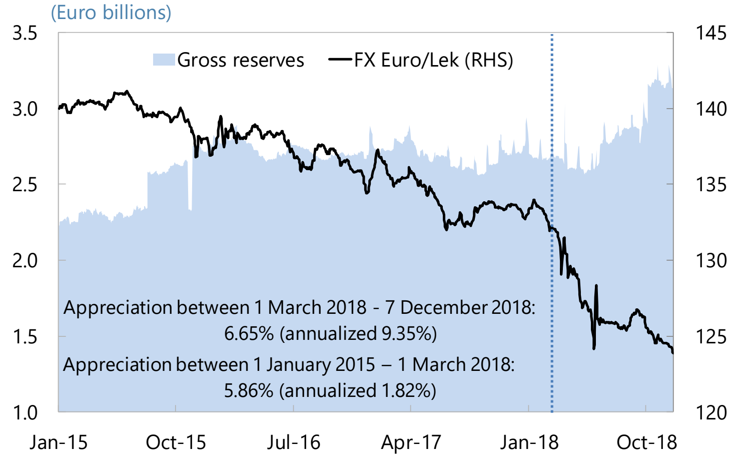
  iv. The low level of financial inclusion further restricts access to bank services, including credit (see paragraph 39).

[10] The latter measure is part of a broader framework to mitigate risks related to unhedged FX lending (around 26 percent of total lending mostly to corporates), which also includes higher capital requirements.

32. Within Albania's flexible exchange rate regime, the authorities have intervened to mitigate the impact of the local currency's recent strong appreciation. While the Albanian lek had been on a gradual appreciating trend since 2016, the movement that started in March was far sharper. The foreign exchange market remained under pressure into June, with a significant widening in bid-ask spreads and resulting in dried-up liquidity. To alleviate disorderly market conditions, and also to dampen the disinflation pressures from the exchange rate pass-through, the BoA conducted unscheduled purchases of foreign currency starting in early June. The purchase program was well communicated to market participants, and has been anchored on the inflation mandate of the BoA and guided by data-dependent triggers. The BoA's timely intervention quickly curbed the sharp appreciation, and since September 2018, the exchange market pressures have abated. While the exchange rate has continued to strengthen, the pace of the appreciation has moderated, and orderly market conditions (with two-sided volatility) has been restored. Staff encouraged the authorities to phase-out these operations as disinflation risks recede; overall, exchange rate flexibility has served Albania well by mitigating the impact of shocks on the economy.

Reserves and Foreign Exchange Rate

(Euro billions)



Sources: Bank of Albania; and Haver Analytics.
Rates annualized using 365 days/year.

33. The BoA's Supervisory Council-–its highest decision-making body—was not operational from November through late December. The appointment by the government and parliament of six new members was delayed, leaving the council with only three active members, whereas at least five are needed for decision making.

Authorities' Views

34. The authorities were in broad agreement with staff's assessment of monetary policy. They noted that early signs of the transmission of the recent policy rate cut could be seen in market prices and lending rates. The authorities also pointed out that wages as well as core inflation have been increasing over the last year. Furthermore, the authorities assessed that the inflation drivers had been shifting from imported inflation to domestic inflation. These considerations supported the BOA's projections which foresee headline inflation reaching the inflation target by mid-2020. Regarding the foreign exchange interventions, the authorities confirmed that they remained fully committed to the flexible exchange rate regime and that such interventions were expected to remain limited and temporary.

D. Developing a Resilient Financial Sector in Support of Economic Growth

35. Albania's banking sector is well capitalized, liquid and profitable; however, efforts are needed to further strengthen its resilience. Financial stability indicators have improved, with average capital-asset ratios exceeding the bank-specific regulatory minimums. Banks are also very liquid, but this reflects sluggish credit. Banks are taking large positions in securities, BoA deposits, and placements—both domestic and foreign. Despite a decline in the return on equity, the sector remains very profitable.

Selected Financial Stability Indicators

(Percent)

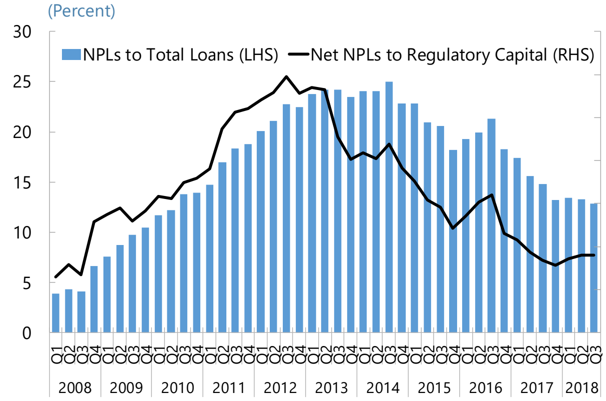
	2014	2015	2016	2017	H1 2018
Capital Ratios					
Regulatory capital th risk-weighted assets	16.8	15.9	16.0	16.6	17.9
Tier 1 capital to risk-weighted assets	13.8	13.5	14.1	15.1	16.6
Shareholders' equity as a percent of total assets	8.6	9.5	9.7	10.2	10.5
Assets Quality					
Net NPLs to regulatory capital	38.3	24.3	23.1	15.7	18.0
Gross NPLs to total loans	22.8	18.2	18.2	13.2	13.3
Profitability					
ROE (annual basis)	10.5	13.2	7.5	15.7	15.0
ROA (annual basis)	0.9	1.2	0.7	1.5	1.5
Net open FX positions to capital					
Net open FX position to regulatory capital	8.5	7.7	7.0	6.7	7.6
Net open FX position to Tier 1 capital	10.4	9.0	8.0	7.3	8.2
Asset ratios					
Liquid assets to total assets	31.9	32.3	31.3	30.2	32.2
Liquid assets to short-term liabilities (<1Y)	40.4	41.4	40.6	40.8	43.2
Loans to (non-interbank) deposits ratio	55.5	53.3	51.9	51.5	50.8

Sources: Bank of Albania; and IMF staff calculations.

36. While the BOA has made significant efforts to clean banks' balance sheets, pockets of vulnerability remain, and further reduction in NPLs is needed. Since 2016, the BOA actions and banks' cooperation have resulted in large NPL write-offs. lowering the NPL ratio to 13.0 percent in October 2018. However, NPLs remain high compared to regional peers. A further reduction will require combined efforts from the BOA, the government and judicial institutions and calls for: (i) strong enforcement of the new bankruptcy law, (ii) enactment of the regulatory framework for out-of-court settlement agreements to resolve NPLs, (iii) resolving the deadlock around more efficient operations of private bailiffs and (iv) rules to accelerate loan write-offs further.

NPLs

(Percent)



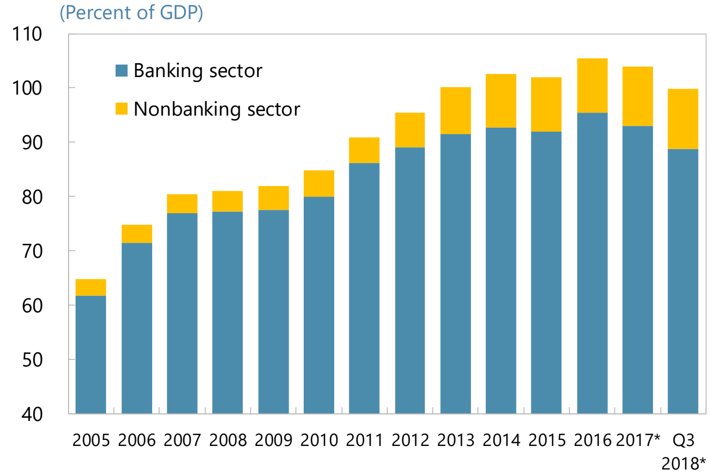
Sources: Bank of Albania; and IMF staff estimates.

37. The departure of several EU-owned banks amplifies the supervisory and regulatory challenges. Subsidiaries of EU banks have played an important role in setting the standard for banking in Albania. Over the last two years, three EU-owned banks have left or are planning to leave Albania, following a more general strategy to retrench from the CESEE countries and the Balkans. As bank ownership is shifting to domestic and non-EU conglomerates, bank supervision has a critical role in containing risks stemming from related-party lending, cross-border lending, and large exposures.

38. High quality supervision and regulation will be key to preserving the stability of Albania's financial sector. BoA supervisors have been proactive in mitigating cross-border lending risks, including through the exchange of information and joint inspections with host regulators. Accounting standards for both the BoA and domestic banks have been aligned with the IFRS9 framework and the authorities are introducing regulatory instruments in line with Basel III.[11] However, more rapid progress regarding Pillar 2 implementation would be welcome.[12] To face the changing banking sector landscape and new regulatory requirements, it is crucial that the supervision department of the BoA is adequately staffed to conduct more frequent on-site inspections, or targeted reviews of credit portfolios, of banks that pose elevated risks. Furthermore, Albania should swiftly implement its action plan aimed at addressing AML/CFT deficiencies identified in its 2018 AML/CFT assessment to address vulnerabilities and avoid being publicly listed by the FATF.

39. The development of capital markets would deepen financial intermediation and support the funding of economic growth. Although marginal, capital markets are expanding in Albania. However, only sovereign instruments are available for domestic trading, with very limited secondary market liquidity. A market-maker program pilot for sovereign bonds was initiated this year, so far limited to 5-year bonds. The non-bank supervisors have been expanding the regulatory framework for capital markets and implementing a new liquidity regulation. However, these efforts should be supported through a rationalization of sovereign debt issuances (and improved capacity for managing sovereign debt). Staff also supported the development of a second pillar of the pension system, to strengthen the social safety net and deepen capital markets through new savings instruments. As the market evolves, financial literacy should be enhanced to mitigate risks and stimulate financial inclusion.

Financial System Assets
(Percent of GDP)



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

Authorities' Views

40. The authorities broadly concurred with staff's assessment of the financial system and they considered that with a recent increase in supervisory capacity, and the ongoing improvements in regulations, they were well positioned to oversee the evolving banking sector and enforce new regulatory requirements under Basel III. The BoA noted its determination to bring the average NPL

[11] The BoA plans to introduce a liquidity coverage ratio and specific capital buffers, including D-SIB buffers

[12] In particular with regards to the Supervisory Review and Evaluation Process

ratio below 10 percent by 2020. The authorities also highlighted their important ongoing work to modernize the payment system.

E. Structural Agenda-Enhancing the Business Climate and the Rule of Law

41. Stronger economic governance and transparency is critical for sustaining high economic growth. Determined efforts are needed to improve the business climate and foster regional integration.

- **A sound judiciary a critical public good.** A sound judiciary is associated with a better macroeconomic performance.[13] Large-scale judicial reforms, implemented with EU support, are underway. The program aims at improvement of the independence, accountability, transparency, professionalism, and efficiency of the Albanian justice system. Independent Qualification Commissions are vetting all judges and prosecutors.
- An anti-corruption strategy, supported by multiple donors, is also being implemented, and the authorities are developing measurable indicators to help track the progress made. Continuing to strengthen the AML/CFT and asset declaration regimes will also help support anti-corruption efforts.
- **Strengthening property registration and property rights will yield benefits on multiple fronts**, including, better tax administration, financial market development, higher private sector credit, and less informality. Measures are underway to improve property registration. There has also been progress in property restitution, as the authorities seek to streamline the fragmented decision making and compensation processes.
- **Lifting export growth requires improvements in economic governance, labor skills, and infrastructure**. Staff analysis suggests that exports growth could benefit from expansion of trade related to Global Value Chains (GVCs), which requires improvements in education, institutions, the quality of infrastructure, and the depth of trade agreements. Albania's links with GVCs are mostly in the lower part of the supply chain and among the weakest in the Western Balkans, primarily due to the high concentration of exports in low-value manufacturing products, unprocessed goods, and tourism.[14]

Authorities' Views

42. The authorities emphasized their commitment to tackling structural obstacles to growth. They recognized the importance of judicial sector reform and anti-corruption measures,

[13] See IMF Country Report No. 17/374; and EUR Regional Economic Outlook, 'Europe Hitting Its Stride', IMF November 2017

[14] See Ilahi, Khachatryan, Lindquist, Rahman, Raei, Nguyen 'Lifting growth in Western Balkans: the role of global value chains and service exports' (forthcoming IMF EUR departmental paper).

that will also be key to unlocking the country's talks on EU accession**.** The authorities confirmed that implementation of judicial reform remains among their top priorities. The planned restructuring of district courts, the reform of court fees, and changing the evaluation criteria for judges was well underway with some positive results. The authorities highlighted good progress in implementing their anti-corruption strategy and action plan, in enhancing property rights, and in dealing with property restitution cases. They also indicated progress on several competitiveness indicators, while acknowledging the need for further reforms.

STAFF APPRAISAL

43. **Albania's economic growth has trended upward in recent years, as the country has benefitted from the implementation of reforms and from the economic expansion of its European trade partners.** At the same time, much remains to be done to make this growth more sustainable and inclusive, and to reduce the appeal of emigration. Accomplishing these objectives hinges on the achievement of sustained high productivity growth, including by exploiting Albania's potential for tourism.

44. **Determined reform efforts are needed to improve the business climate, with emphasis on strengthening the rule of law.** The authorities should complete the ongoing judicial reform expeditiously, and implement strong anti-corruption efforts. A further priority is to reduce the pervasive informality, by maintaining a simple and fair tax system, continuing improvements in tax collection, and by increasing the quality of public services. Tangible progress in these areas should also improve the public perception of Albania's prospects and the career opportunities it can offer—both directly and by helping the country in its pursuit of further integration with the European Union.

45. **A stronger public-sector balance sheet is essential for underpinning confidence in the Albanian economy.** A key requirement is to build stronger buffers, by lowering the fiscal deficit and accelerating the reduction in public debt, especially now that Albania's near-term growth prospects remain favorable but risks to Europe's economic outlook have increased. Additional revenue measures should be considered to support the necessary fiscal improvement.

46. **Fiscal risks should be contained more effectively.** The Ministry of Finance and Economy should play a strong role as a gatekeeper to contain the costs of PPP projects, including the associated contingent liabilities. Such liabilities should be assessed thoroughly and presented in the annual risk statement, together with specific mitigation plans. To stem the fiscal risks posed by the electricity sector, given its vulnerability to drought, the government should play a strong leading role in implementing the power sector rehabilitation plan. Finally, the persistent build-up of government arrears undermines trust in the public sector and should be brought to an end as soon as possible.

47. **Given the absence of fiscal space, the authorities should refrain from introducing ad-hoc tax measures** that offer relief to specific sectors and to consider rolling back those already

implemented. These measures make the tax system more complicated and less predictable, thereby undermining both the investment climate and tax collection.

48. The accommodative stance of monetary policy remains appropriate. Inflation continues to be low, and the normalization of monetary policy should be data dependent, aimed to reaching the inflation target over the medium term. The recent use of temporary unscheduled interventions in the foreign exchange market was a justified response to sharp exchange rate appreciation pressures that was focused on preventing both disorderly market conditions and a destabilization of inflation.

49. It will be critical to address the structural bottlenecks to credit growth and the effective transmission of monetary policy. Monetary transmission is constrained by the extensive use of euros and structural weaknesses in the provision of credit, including continued high NPLs, weaknesses in the property rights and insolvency regimes, high informality, banks' deleveraging and risk aversion.

50. Strong financial supervision will be essential for safeguarding financial stability within the changing architecture of the banking sector. The decline in NPLs should set the scene for increased lending, while non-EU banks are playing an increasing role. These changes are increasing the complexity of financial supervision. To stay ahead, the BOA should continue to improve its supervisory and regulatory framework.

51. It is recommended that the next Article IV consultation be held on the standard 12-months consultation cycle. Meanwhile, Albania remains under Post-Program Monitoring.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2014–23

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Proj.					
Real sector	(Growth rate in percent)									
Real GDP	1.8	2.2	3.4	3.8	4.0	3.7	3.9	3.9	4.0	4.0
Domestic demand contribution	3.4	0.6	3.4	5.0	3.8	4.2	4.3	4.2	4.3	4.2
Consumption	3.0	0.8	2.7	2.6	3.1	3.1	3.1	3.0	3.0	3.0
Investment (Incl. inventories and stat. disc)	0.5	-0.2	0.7	2.5	0.6	1.2	1.2	1.2	1.2	1.3
External demand contribution	-1.7	1.6	0.0	-1.2	0.2	-0.5	-0.4	-0.2	-0.3	-0.3
Consumer Price Index (avg.)	1.6	1.9	1.3	2.0	1.9	2.1	2.4	2.8	3.0	3.0
Consumer Price Index (eop)	0.7	1.9	2.2	1.8	2.0	2.2	2.6	3.0	3.0	3.0
GDP deflator	1.5	0.6	-0.5	1.4	1.9	2.1	2.4	2.8	2.9	2.9
Saving-investment balance	(Percent of GDP)									
Foreign savings	10.8	8.6	7.6	7.5	6.2	6.2	5.9	5.8	5.7	5.8
National savings	15.9	16.9	16.7	15.3	17.1	17.2	17.5	17.5	17.6	17.6
Public	0.6	0.7	1.2	1.7	1.4	1.3	1.5	1.6	1.5	1.6
Private	15.4	16.1	15.5	13.7	15.7	15.9	16.0	15.9	16.1	16.0
Investment (incl. Inventories and stat. disc.)	26.7	25.5	24.3	22.8	23.3	23.3	23.3	23.3	23.4	23.5
Public	5.0	4.7	4.6	4.8	5.1	4.9	5.0	5.0	4.9	4.9
Private	21.7	20.7	19.7	18.0	18.2	18.4	18.3	18.3	18.4	18.5
Fiscal sector										
Total revenue and grants	26.3	26.3	27.3	27.7	27.5	27.3	27.1	26.9	26.6	26.4
Tax revenue	24.1	23.7	24.8	25.7	25.4	25.1	25.0	24.8	24.6	24.4
Total expenditure	32.2	30.9	29.6	29.7	29.7	29.4	29.2	28.9	28.7	28.5
Of which: Repayment of end-2013 stock of unpaid bills and arrears	2.4	1.2	0.0							
Primary	29.3	28.2	27.1	27.6	27.5	27.2	27.0	26.8	26.6	26.2
Interest	2.9	2.7	2.5	2.1	2.2	2.2	2.2	2.1	2.2	2.3
Overall balance	-5.9	-4.6	-2.3	-2.0	-2.2	-2.1	-2.1	-2.1	-2.1	-2.1
Primary balance	-3.0	-1.9	0.2	0.1	0.0	0.1	0.1	0.0	0.1	0.2
Financing	5.9	4.6	2.3	2.0	2.2	2.1	2.1	2.1	2.1	2.1
Of which: Domestic	3.4	-1.3	0.9	-0.8	-1.3	1.1	0.2	2.0	-0.7	2.2
Of which: Foreign	2.5	5.0	1.3	1.9	3.5	1.0	1.9	0.1	2.8	-0.1
General Government Debt 1/	72.0	73.7	73.2	71.8	70.5	66.9	65.2	62.3	60.7	58.4
Domestic	42.4	39.5	39.0	38.9	36.9	34.0	32.6	32.0	29.6	29.5
External	29.6	34.2	34.2	32.9	33.6	32.8	32.6	30.4	31.1	28.9
Monetary indicators	(Growth rate in percent, unless otherwise indicated)									
Broad money growth	4.0	1.8	3.9	0.3	1.8	1.9	4.8	6.0	4.7	5.5
Private credit growth	2.0	-2.8	0.4	0.2	0.5	2.5	3.5	5.3	6.2	6.6
Velocity (nominal GDP/broad money)	1.2	1.2	1.2	1.2	1.3	1.3	1.3	1.4	1.4	1.4
Interest rate (3-mth T-bills, end-period)	3.1	1.5	0.0	0.0	…	…	…	…	…	…
External sector	(Percent of GDP, unless otherwise indicated)									
Trade balance (goods and services)	-19.0	-17.3	-16.8	-15.1	-13.1	-12.6	-12.1	-11.8	-11.6	-11.3
Current account balance	-10.8	-8.6	-7.6	-7.5	-6.2	-6.2	-5.8	-5.8	-5.8	-5.9
Gross international reserves (in billions of Euros)	2.2	2.9	2.9	3.0	3.3	3.2	3.4	3.4	3.7	3.5
(In months of imports of goods and services)	5.8	7.0	6.5	6.3	6.6	6.0	5.9	5.6	5.7	5.2
(Relative to external debt service)	2.9	2.6	3.6	3.5	2.9	3.1	2.6	3.1	3.2	3.0
(In percent of broad money)	25.7	32.5	31.5	31.4	32.5	30.5	30.6	28.9	29.9	27.1
Change in REER (eop, in percent; +=appreciation)	2.4	1.5	3.9	3.8	…	…	…	…	…	…
Memorandum items										
Output gap (percent)	-1.5	-1.8	-1.4	-0.7	-0.7	-0.5	-0.2	0.0	0.0	0.0

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

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

Table 2a. Albania: General Government Operations, 2014–23
(Percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
								Proj.		
Total revenue and grants	26.3	26.3	27.3	27.7	27.5	27.3	27.1	26.9	26.6	26.4
Tax revenue	24.1	23.7	24.8	25.7	25.4	25.1	25.0	24.8	24.6	24.4
VAT	8.9	8.7	8.7	9.0	8.8	8.7	8.7	8.7	8.7	8.7
Profit tax	1.5	1.7	1.9	2.0	2.0	1.9	1.9	1.9	1.9	2.0
Excise tax	2.9	2.7	2.8	2.9	2.8	2.7	2.7	2.6	2.5	2.4
Personal income tax	2.1	2.1	2.1	2.1	2.2	2.3	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	2.3	2.3	2.4	2.5	2.3	2.0	2.0	1.9	1.9	1.8
Local government revenue 1/	0.9	0.8	1.0	1.2	1.2	1.3	1.5	1.5	1.5	1.5
Social insurance contributions	5.0	5.0	5.4	5.6	5.7	5.7	5.6	5.5	5.5	5.4
Non-tax revenue	1.5	1.8	1.5	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Grants	0.7	0.8	1.0	0.7	0.8	0.9	0.9	0.8	0.8	0.8
Total expenditure	32.2	30.9	29.6	29.7	29.7	29.4	29.2	28.9	28.7	28.5
Current expenditure	25.0	24.8	25.1	24.6	24.5	24.5	24.2	23.9	23.8	23.6
Personnel cost 2/	5.1	5.1	4.6	4.7	4.6	4.6	4.4	4.3	4.2	4.1
Interest	2.9	2.7	2.5	2.1	2.2	2.2	2.2	2.1	2.2	2.3
Operations & maintenance	2.2	3.0	3.0	2.8	2.8	2.8	2.7	2.7	2.6	2.6
Subsidies	0.6	0.5	0.3	0.2	0.3	0.3	0.1	0.2	0.2	0.1
Energy guarantees 3/	0.5	0.3	0.0	0.0	0.1	0.2	0.0	0.1	0.1	0.0
Nonenergy guarantees	0.0	0.0	0.1	0.0	0.1	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	0.1
Social insurance outlays	9.9	9.8	10.3	10.4	10.4	10.5	10.4	10.4	10.4	10.2
Local government expenditure 2/ 4/	2.4	2.4	2.8	3.0	2.8	2.8	3.0	3.0	3.0	3.0
Social protection transfers	1.8	1.4	1.7	1.5	1.4	1.4	1.3	1.3	1.3	1.3
Capital expenditure 4/	4.3	4.4	3.9	4.4	5.0	4.8	4.8	4.8	4.8	4.8
Domestically financed	2.4	2.6	2.6	3.0	2.7	2.5	2.5	2.4	2.5	2.6
Foreign financed	1.9	1.7	1.4	1.4	2.3	2.3	2.3	2.4	2.3	2.1
Lending minus repayment	0.4	0.5	0.5	0.6	0.0	-0.1	-0.1	-0.1	0.0	0.0
Reserve and contingency funds 5/				0.0	0.2	0.2	0.2	0.3	0.2	0.2
Overall balance	-5.9	-4.6	-2.3	-2.0	-2.2	-2.1	-2.1	-2.1	-2.1	-2.1
Financing	5.9	4.6	2.3	2.0	2.2	2.1	2.1	2.1	2.1	2.1
Domestic	3.4	-1.3	0.9	-0.8	-1.3	1.1	0.2	2.0	-0.7	2.2
Privatization receipts	0.0	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	3.2	-0.9	0.7	1.0	1.4	0.2	0.8	1.6	-0.2	1.8
Gross borrowing	33.2	31.1	25.2	22.4	18.4	12.9	13.9	14.7	13.5	15.3
Amortization	29.9	31.9	24.5	21.3	17.0	12.7	13.1	13.1	13.6	13.5
Change in general gov. deposits	0.1	0.5	-0.3	-0.9	-1.7	1.7	-0.6	0.4	-0.6	0.3
Other	0.1	-0.9	0.3	-0.9	-0.9	-0.7	0.0	0.0	0.0	0.0
Foreign	2.5	5.0	1.3	1.9	3.5	1.0	1.9	0.1	2.8	-0.1
Gross borrowing	3.9	9.5	2.8	3.5	6.7	3.0	5.5	2.1	4.8	1.7
Amortization	1.3	4.3	1.5	1.7	3.3	2.0	3.6	2.0	2.0	1.9
Memorandum Items:										
Primary balance	-3.0	-1.9	0.2	0.1	0.0	0.1	0.1	0.0	0.1	0.2
Structural primary balance	-0.2	-0.6	0.4	0.2	0.2	0.2	0.1	0.1	0.1	0.2
General government debt 6/	72.0	73.7	73.2	71.8	70.5	66.9	65.2	62.3	60.7	58.4
Direct general government external debt	27.5	32.4	32.6	31.6	31.5	30.3	30.4	28.5	29.4	27.5
Government guaranteed external debt	2.0	1.8	1.6	1.3	2.1	2.6	2.2	1.9	1.6	1.4
GDP (in billions of leks)	1395	1434	1475	1553	1646	1742	1853	1980	2118	2266

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

Table 2b. Albania: General Government Operations, 2014–23
(Lek billions)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
								Proj.		
Total revenue and grants	366.6	377.5	403.1	430.4	452.4	475.1	503.0	531.8	564.3	599.1
Tax revenue	335.8	340.6	366.0	398.6	417.3	437.5	463.0	490.8	520.4	552.3
VAT	123.7	124.8	128.1	139.5	145.0	151.9	161.6	172.6	184.5	197.3
Profit tax	21.5	24.2	28.5	31.6	32.7	32.9	35.2	38.0	41.0	44.3
Excise tax	40.9	39.0	41.9	45.1	46.0	47.9	49.9	52.0	53.8	55.0
Personal income tax	28.9	29.7	31.4	32.1	36.0	40.8	41.3	44.0	47.1	50.4
Customs duties	5.9	5.8	6.1	6.5	6.2	6.6	7.1	7.6	8.1	8.6
Other taxes	32.6	33.7	35.8	38.5	38.4	35.7	36.8	38.0	39.3	40.6
Local government revenue 1/	12.4	11.7	15.0	18.4	19.7	22.5	27.3	29.2	31.2	33.5
Social insurance contributions	69.9	71.7	79.2	86.8	93.3	99.2	104.0	109.5	115.4	122.6
Non-tax revenue	20.7	25.7	22.5	20.7	21.4	22.6	24.0	25.7	27.5	29.4
Grants	10.1	11.2	14.6	11.1	13.8	15.0	15.9	15.3	16.3	17.5
Total expenditure	448.6	443.0	436.5	461.2	488.8	512.1	541.2	572.7	608.8	645.6
Current expenditure	348.1	355.9	370.6	382.6	403.9	427.2	448.7	473.8	504.1	533.8
Personnel cost 2/	71.4	72.5	67.5	72.6	75.5	80.0	82.2	85.1	88.8	93.0
Interest	40.1	38.6	36.3	31.9	36.8	38.2	40.1	41.9	45.6	51.0
Operations & maintenance	31.3	42.4	44.3	43.4	45.3	48.4	50.2	52.5	56.1	60.0
Subsidies	8.4	6.8	3.8	2.6	5.5	4.8	2.3	3.4	3.5	2.9
Energy guarantees 3/	6.7	4.6	0.0	0.1	1.6	3.1	0.3	1.4	1.4	0.7
Nonenergy guarantees	0.1	0.5	2.0	0.2	1.9	0.3	0.5	0.5	0.5	0.5
Other	1.6	1.7	1.7	2.3	2.1	1.5	1.5	1.5	1.6	1.7
Social insurance outlays	138.5	141.2	152.6	162.1	171.8	182.1	193.6	206.4	219.9	230.5
Local government expenditure 2/ 4/	32.9	34.1	41.7	46.5	45.8	49.6	55.6	59.0	63.1	67.6
Social protection transfers	25.5	20.2	24.5	23.4	23.3	24.0	24.5	25.6	27.1	28.7
Capital expenditure 4/	60.5	62.6	58.2	68.8	82.1	82.9	89.6	94.8	100.6	107.8
Domestically financed	33.8	37.7	37.9	46.6	43.9	42.7	47.0	46.8	52.5	59.9
Foreign financed	26.8	24.9	20.4	22.3	38.2	40.2	42.6	48.0	48.2	47.8
Lending minus repayment	5.9	7.3	7.4	9.2	0.0	-1.0	-1.0	-1.0	-1.0	-1.0
Reserve and contingency funds 5/			0.0	0.0	2.7	3.0	4.0	5.1	5.1	5.1
Overall balance	-82.1	-65.5	-33.3	-30.8	-36.3	-37.1	-38.3	-41.0	-44.5	-46.5
Financing	82.1	65.5	33.3	30.8	36.3	37.1	38.3	41.0	44.5	46.5
Domestic	47.5	-18.0	13.9	-12.1	-20.6	19.4	3.7	39.6	-15.7	49.2
Privatization receipts	0.0	0.9	2.8	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	45.0	-12.6	10.6	16.3	23.0	2.6	15.4	31.5	-3.6	41.5
Gross borrowing	462.6	445.5	372.1	347.4	303.1	223.9	258.3	291.5	285.4	346.9
Amortization	417.7	458.2	361.5	331.1	280.1	221.3	242.9	260.0	289.0	305.5
Change in general gov. deposits	1.5	6.9	-4.3	-14.2	-28.5	29.3	-11.6	8.1	-12.1	7.8
Other	1.0	-13.1	4.8	-14.6	-15.1	-12.6	0.0	0.0	0.0	0.0
Foreign	34.3	71.0	19.5	29.4	57.0	17.7	34.5	1.4	60.2	-2.7
Gross borrowing	53.9	135.7	41.9	55.0	111.0	51.8	101.2	40.8	102.5	39.3
Amortization	17.8	61.7	22.0	25.8	54.1	34.2	66.7	39.4	42.2	42.0
Memorandum Items:										
Primary balance	-42.0	-26.9	2.9	1.1	0.5	1.2	1.9	1.0	1.1	4.5
Structural primary balance	-2.6	-8.3	6.4	2.3	3.7	3.6	2.6	1.0	1.1	4.5
General government debt 6/	1004.5	1057.3	1079.7	1114.8	1159.9	1165.0	1208.1	1233.7	1285.5	1323.6
Direct general government external debt	383.9	465.3	481.4	490.5	519.0	527.2	562.5	563.6	623.3	622.6
Government guaranteed external debt	28.5	25.6	23.2	19.8	34.2	44.7	40.9	37.6	34.6	32.0

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

Table 3a. Albania: Balance of Payments, 2014–23
(Percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
								Proj.		
Current account	-10.8	-8.6	-7.6	-7.5	-6.2	-6.2	-5.8	-5.8	-5.8	-5.9
Balance of goods and services	-19.0	-17.3	-16.8	-15.1	-13.1	-12.6	-12.1	-11.8	-11.6	-11.3
Trade Balance (goods)	-22.2	-22.4	-24.2	-24.4	-22.2	-21.9	-21.3	-21.1	-20.9	-20.8
Exports	9.3	7.5	6.6	6.9	7.4	6.9	7.1	7.2	7.1	7.1
Of which: Energy	4.6	3.1	1.8	1.5	2.3	1.7	1.8	1.7	1.6	1.5
Imports	31.6	29.9	30.9	31.3	29.6	28.8	28.5	28.3	28.1	27.9
Of which: Energy	5.8	3.7	3.0	3.7	3.4	2.8	2.8	2.7	2.6	2.5
Services (net)	3.2	5.1	7.4	9.3	9.1	9.3	9.3	9.3	9.4	9.5
Income balance	0.9	1.2	1.6	0.2	-0.1	-0.2	-0.2	-0.2	-0.1	-0.3
Of which: Interest due	1.8	1.8	1.8	1.3	1.5	1.5	1.5	1.5	1.5	1.6
Current transfers	7.3	7.5	7.6	7.3	7.0	6.7	6.4	6.2	5.9	5.7
Capital and Financial account	9.0	5.3	5.4	8.1	7.6	3.8	5.7	4.9	6.5	3.9
Capital transfers	0.9	1.2	0.6	1.1	0.8	0.7	0.7	0.6	0.6	0.6
Direct investment, net	8.1	8.0	8.7	8.6	7.7	6.5	6.0	6.4	6.8	7.1
Government Medium- and long-term loans, net	0.6	-2.5	-0.1	0.3	2.6	0.0	1.7	0.1	2.9	-0.1
Project loans	1.7	1.7	1.3	1.8	1.7	1.6	1.6	1.9	1.7	1.5
Other loans	0.0	0.0	0.0	0.0	3.9	0.0	3.4	0.0	2.9	0.0
Amortization (includes Eurobond bullet payment)	-1.1	-4.2	-1.3	-1.5	-3.0	-1.7	-3.3	-1.7	-1.8	-1.6
Government Guaranteed Borrowing, net	-0.2	-0.2	-0.2	-0.2	0.9	0.6	-0.2	-0.1	-0.1	-0.1
Disbursement	0.0	0.0	0.1	0.0	1.1	0.9	0.1	0.1	0.1	0.1
Other flows	-1.0	-1.9	-4.6	-2.5	-5.3	-5.1	-3.6	-3.3	-4.9	-4.8
Errors and omissions [1/]	0.6	1.4	1.2	-1.6	1.0	1.0	1.0	1.0	1.0	1.0
Net balance	-1.2	-1.9	-1.0	-1.0	2.4	-1.4	0.9	0.1	1.8	-1.0
Available financing	1.2	1.8	1.0	1.0	-2.4	1.4	-0.9	-0.1	-1.8	1.0
Change in net reserves (increase = -) [2/]	-1.0	-5.9	-0.4	-1.3	-2.4	1.0	-1.3	-0.2	-1.9	0.8
IMF (budget support)	0.5	0.9	1.3	0.6	0.0	0.0	0.0	0.0	0.0	0.0
World Bank (DPL)	1.7	0.0	0.1	1.4	0.0	0.4	0.4	0.1	0.1	0.1
Other budget loans	…	…	0.0	0.2	0.0	0.0				
Commercial borrowing	0.0	6.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Exports of Goods and Services (percent of GDP)	28.2	27.3	28.9	31.5	31.3	31.0	31.3	31.3	31.2	31.2
Imports of Goods and Services (percent of GDP)	47.2	44.5	45.8	46.6	44.4	43.6	43.4	43.1	42.8	42.5

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

1/ 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.

2/ Net of valuation changes in 2013–17. In projections for 2018–22, valuation effects are assumed to be zero.

Table 3b. Albania: Balance of Payments, 2014–23
(Euro millions, unless stated otherwise)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Proj.			Proj.		
Current account	-1,076	-882	-812	-867	-801	-855	-861	-924	-984	-1,084
Balance of goods and services	-1,892	-1,772	-1,807	-1,744	-1,686	-1,750	-1,783	-1,871	-1,975	-2,077
Trade Balance (goods)	-2,215	-2,297	-2,603	-2,825	-2,854	-3,033	-3,150	-3,349	-3,575	-3,817
Exports	932	771	712	796	945	958	1,054	1,136	1,218	1,308
Of which: Energy	461	321	197	174	295	234	259	264	269	274
Imports	3,147	3,068	3,315	3,621	3,799	3,992	4,205	4,486	4,794	5,125
Of which: Energy	576	380	318	428	435	393	407	423	441	463
Services (net)	323	525	797	1,082	1,168	1,283	1,367	1,478	1,601	1,740
Income balance	91	122	174	29	-11	-27	-29	-33	-21	-50
Of which: Interest due	176	182	191	148	190	201	219	243	255	296
Current transfers	725	768	821	848	895	923	951	981	1,011	1,043
Capital and Financial account	899	545	578	943	976	522	844	779	1,116	725
Capital transfers	87	126	66	122	102	102	102	102	102	102
Direct investment, net	812	818	936	994	989	901	892	1,014	1,156	1,306
Government Medium- and long-term loans, net	56	-256	-6	31	332	-2	247	19	489	-19
Project loans	165	171	138	203	221	227	241	293	291	284
Amortization (includes Eurobond bullet payment)	-108	-426	-144	-172	-389	-229	-494	-274	-301	-302
Government Guaranteed Borrowing, net	-22	-19	-17	-21	110	82	-28	-23	-21	-19
Disbursement	0	3	16	2	143	125	10	18	18	18
Amortization	-22	-23	-32	-23	-33	-43	37	41	39	37
Other flows	-103	-197	-489	-287	-686	-711	-538	-524	-828	-890
Errors and omissions [1/]	55	142	129	-186	128	139	148	159	171	184
Net balance	-122	-195	-106	-110	303	-195	131	14	302	-175
Available financing	122	186	106	110	-303	195	-131	-14	-302	175
Change in net reserves (increase = -) [2/]	-97	-610	-48	-147	-303	136	-189	-32	-322	155
IMF (budget support)	54	96	145	70	0	0	0	0	0	0
World Bank (DPL)	166	0	9	161	0	59	59	18	20	20
Other budget loans	…	…	0	26	0	0	0	0	0	0
Commercial borrowing	0	700	0	0	0	0	0	0	0	0
Memorandum items:										
Nominal GDP	9,968	10,264	10,740	11,576	12,839	13,856	14,762	15,860	17,069	18,372
Gross international reserves	2,192	2,880	2,945	2,996	3,336	3,186	3,367	3,392	3,692	3,548
(months of imports of goods and services)	5.8	7.0	6.5	6.3	6.6	6.0	5.9	5.6	5.7	5.2
Net international reserves (IMF-Program defintion)	1,623	1,728	1,837	1,908	1,983	2,063	2,143	2,223	2,303	2,383
(months of imports of goods and services)	4.3	4.2	4.1	4.0	3.9	3.9	3.8	3.7	3.5	3.5
Balance of goods and services (percent of GDP)	-19.0	-17.3	-16.8	-15.1	-13.1	-12.6	-12.1	-11.8	-11.6	-11.3
Current account (percent of GDP)	-10.8	-8.6	-7.6	-7.5	-6.2	-6.2	-5.8	-5.8	-5.8	-5.9
Debt service (percent of exports of goods and services) [3/]	2.3	14.3	4.1	3.8	9.8	5.6	10.9	6.0	6.0	6.0
Debt service (percent of central government revenues) [3/]	2.7	15.6	4.7	4.9	12.3	7.1	13.9	7.7	7.6	7.6
Total external debt stock (percent of GDP) [4/]	60.5	63.2	64.0	59.7	56.6	54.3	52.6	49.0	48.4	44.9
Exports of Goods and Services (millions of Euros)	2,813	2,799	3,107	3,652	4,018	4,291	4,622	4,966	5,331	5,734
Imports of Goods and Services (millions of Euros)	4,705	4,571	4,914	5,396	5,705	6,041	6,405	6,837	7,306	7,811
Volume of Exports of Goods and Services (percent change)	3.3	5.3	10.4	10.1	2.8	4.6	5.9	4.8	4.6	4.7
Volume of Imports of Goods and Services (percent change)	5.4	0.2	8.5	5.9	3.1	5.2	4.7	5.3	5.3	5.2
Terms of trade (percent change)	-5.0	-16.9	-6.0	8.3	5.6	-4.6	-1.4	-1.1	-1.0	-0.8

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

1/ 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.
2/ Net of valuation changes in 2013–17. In projections for 2018–22, valuation effects are assumed to be zero.
3/ Public and publicly guaranteed debt only.
4/ 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 Requirement and Sources, 2014–23
(Euro millions)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
							Proj.			
Total financing requirement	1,218	1,815	970	1,088	1,424	888	1,479	1,169	1,544	1,166
Current account (incl. official transfers)	989	756	746	745	699	753	759	822	882	981
Amortization	131	450	176	195	422	272	531	316	340	339
Of which: IMF	0	0	0	0	5	17	33	54	59	59
Change in gross reserves (increase = +) 1/	97	610	48	147	303	-136	189	32	322	-155
Total financing sources	1,218	1,815	970	1,088	1,424	888	1,479	1,169	1,544	1,166
Foreign direct investment, net	812	818	936	994	989	901	892	1,014	1,156	1,306
Official medium- and long-term project loans	165	171	138	203	221	227	241	293	291	284
Multilateral	95	68	57	151	125	100	88	114	119	119
Bilateral	70	103	81	53	96	127	153	180	172	165
Official guaranteed loans	0	3	16	2	143	125	10	18	18	18
Official budget support loans	220	105	153	258	0	59	59	18	20	20
Of which: IMF	54	96	145	70	0	0	0	0	0	0
Commercial borrowing (Eurobond and PBG)	0	700	0	0	500	0	500	0	500	0
Other	21	18	-273	-369	-429	-423	-222	-174	-441	-462
Portfolio investment, net	28	8	-17	-16	-16	-16	-16	-16	-16	-16
Commercial bank flows, net	-202	-77	-330	-24	-228	-28	-78	-78	-40	-66
Errors and omissions	55	142	129	-186	128	139	148	159	171	184
Other	140	-56	-56	-142	-313	-518	-275	-238	-555	-564
Total financing needs	0	0	0	0	0	0	0	0	0	0

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

1/ The change in gross reserves is net of valuation changes for 2014-17. In projections for 2018-22, valuation effects are assumed to be zero.

Table 5. Albania: Monetary Survey, 2014–23

(Lek billions, unless stated otherwise; end-period)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
								Proj.		
Net foreign assets	525	615	697	700	733	719	748	756	796	780
Bank of Albania	292	363	390	391	412	394	414	415	452	429
Commercial banks	233	251	307	310	321	326	334	341	344	350
Net domestic assets	670	602	567	566	557	595	629	704	732	833
Claims on central government, net	378	332	357	351	386	390	412	460	454	517
Bank of Albania	47	27	34	18	-10	19	7	16	4	11
Commercial banks	331	305	322	333	396	370	405	444	451	505
Claims on public enterprises	27	28	27	30	28	38	30	30	30	30
Claims on the private sector	524	509	511	512	515	528	546	575	610	651
In leks	207	212	231	244	246	252	261	274	291	310
In foreign currency	317	296	280	268	269	276	285	300	319	340
Other items, net	-259	-267	-328	-326	-321	-310	-309	-311	-312	-316
Broad money	1,195	1,216	1,263	1,267	1,290	1,314	1,377	1,460	1,528	1,612
Currency outside banks	218	231	249	265	279	284	302	316	330	348
Deposits	977	986	1,014	1,002	1,011	1,030	1,075	1,145	1,198	1,264
Domestic currency	505	493	488	474	461	457	464	508	558	606
Foreign currency	473	493	527	528	550	573	611	636	640	657
Memorandum items:										
Broad money growth (% change)	4.0	1.8	3.9	0.3	1.8	1.9	4.8	6.0	4.7	5.5
Reserve money growth (% change)	8.1	15.3	7.9	2.6	1.0	2.5	2.4	4.1	3.9	4.7
Private sector credit growth (% change)	2.0	-2.8	0.4	0.2	0.5	2.5	3.5	5.3	6.2	6.6
Broad money (as percent of GDP)	85.7	84.8	85.6	81.6	78.4	75.4	74.3	73.8	72.2	71.1
Private sector credit (as percent of GDP)	37.5	35.5	34.6	33.0	31.3	30.3	29.5	29.0	28.8	28.7
Velocity (nominal GDP/broad money)	1.2	1.2	1.2	1.2	1.3	1.3	1.3	1.4	1.4	1.4
Money multiplier (absolute values)	3.6	3.2	3.0	3.0	3.0	3.0	3.1	3.1	3.1	3.2
Currency (as share of broad money)	18.2	19.0	19.7	20.9	21.6	21.6	21.9	21.6	21.6	21.6
Foreign currency deposits/total deposits	48.4	50.0	51.9	52.7	54.4	55.6	56.8	55.6	53.4	52.0
Gross reserves (millions of euros)	2,192	2,880	2,945	2,996	3,336	3,186	3,367	3,392	3,692	3,548

Sources: Bank of Albania; and IMF staff estimates.

Table 6. Albania: Summary of Accounts of the Central Bank, 2014–23

(Lek billions, unless stated otherwise; end-period)

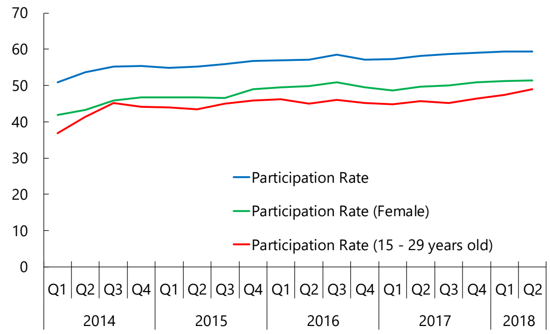
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
							Proj.			
Net foreign assets	292	363	390	391	412	394	414	415	452	429
Assets	319	405	419	418	437	419	440	440	477	454
Liabilities	27	42	29	27	25	25	25	25	25	25
Net domestic assets	41	21	25	35	17	46	37	54	36	81
Domestic credit	75	41	66	60	39	66	54	72	55	100
Net claims on central government	47	27	34	18	-10	19	7	16	4	11
Other credit	27	15	32	42	49	47	47	57	52	89
Private sector	2	2	2	2	2	2	2	2	2	2
Commercial banks	26	13	30	40	47	45	45	55	50	87
Other items, net (assets = +)	-34	-21	-41	-25	-21	-19	-18	-18	-19	-19
Reserve money	333	384	414	425	429	440	451	469	488	511
Currency in circulation	218	231	249	265	279	284	302	316	330	348
Bank reserves	115	152	162	156	150	156	149	154	157	162
Other nonbank deposits	0	2	3	4	0	0	0	0	0	0

Sources: Bank of Albania; and IMF staff estimates.

Figure 3. Albania: Real Sector Developments

Participation rates remain high

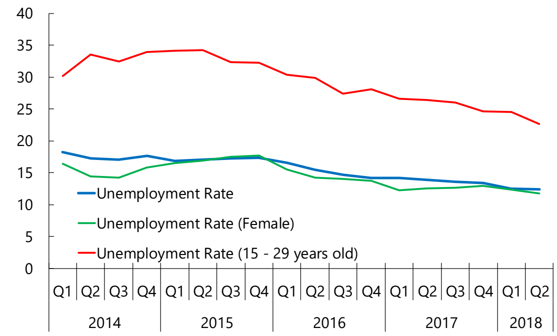
Participation Rates
(Percent, 15 and over, NSA)



Sources: Haver Analytics; and IMF staff calculations.

Robust growth has contributed to a steady decline in unemployment rates

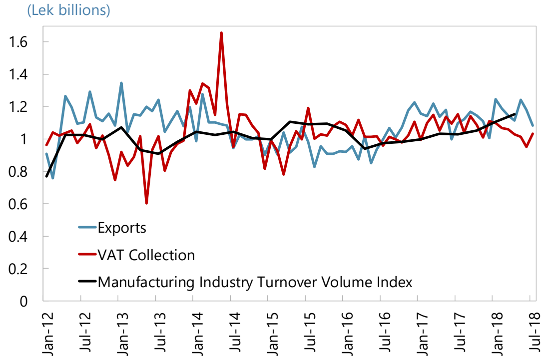
Unemployment Rates
(Percent, 15 and over, NSA)



Sources: Haver Analytics; and IMF staff calculations.

High-frequency indicators are pointing towards strong economic performance in 2018 Q3

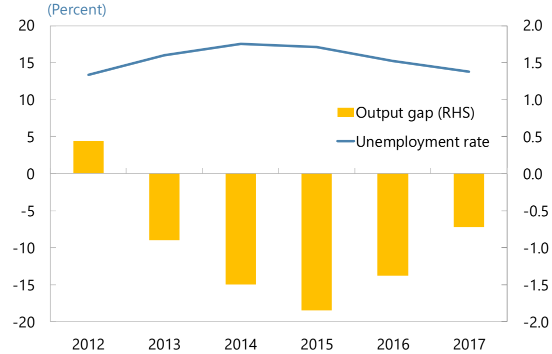
Export, VAT, and Manufacturing Turnover Volume Index
(Lek billions)



Sources: INSTAT; Ministry of Finance and Economy; and IMF staff calculations.

Unemployment has moved in line with the the output gap

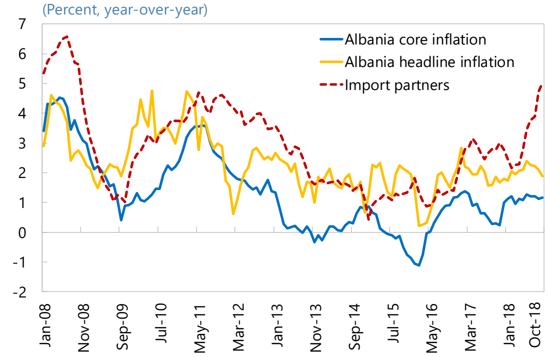
Unemployment Rate and Output Gap
(Percent)



Sources: Haver Analytics; and IMF staff calculations.

Despite higher growth, inflation dynamics are subdued

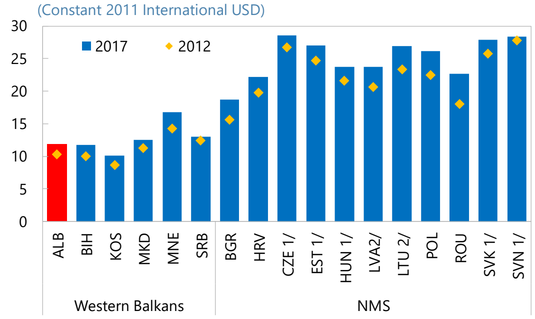
Consumer Price Index
(Percent, year-over-year)



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

Albania's GNI remains among the lowest in the region

GNI per Capita, PPP Adjusted
(Constant 2011 International USD)

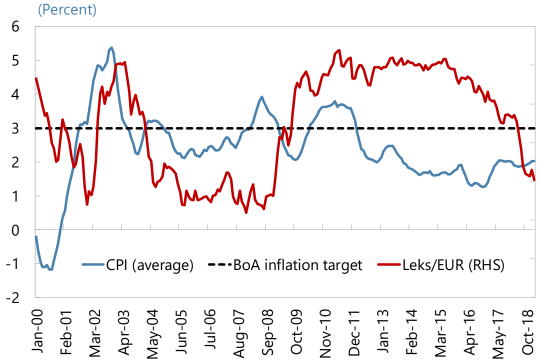


Source: World Bank, World Development Indicators.
1/ 2015 data.
2/ 2016 data.

Figure 4. Albania: Monetary Sector Developments

Inflation has been below target for more than 6 years…

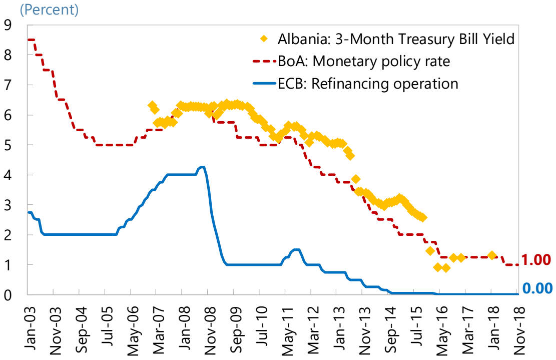
Average Inflation and Exchange Rate
(Percent)



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

… despite a historically loose monetary stance

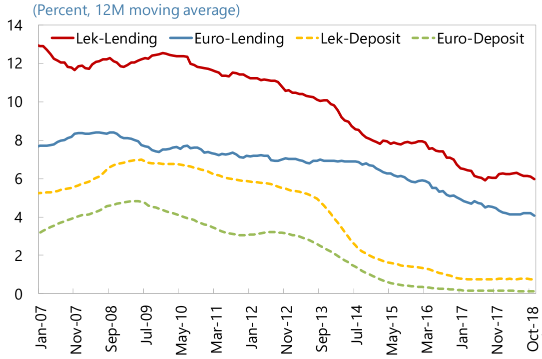
Monetary Policy Rates
(Percent)



Sources: Haver Analytics; and IMF staff estimates.

Lending rates have declined less than deposit remuneration, widening banking spreads

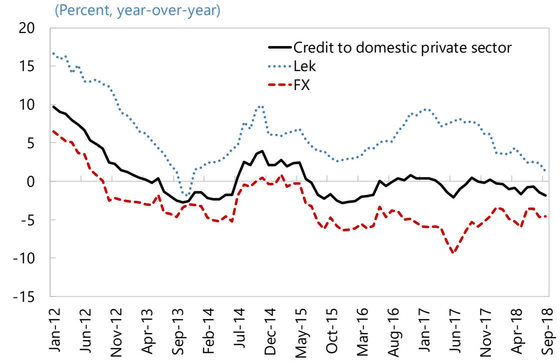
Lending and Deposit Interest Rates, 12-Month
(Percent, 12M moving average)



Sources: Haver Analytics; and IMF staff calculations.

However, despite low funding costs and liquid financial system, credit remains sluggish…

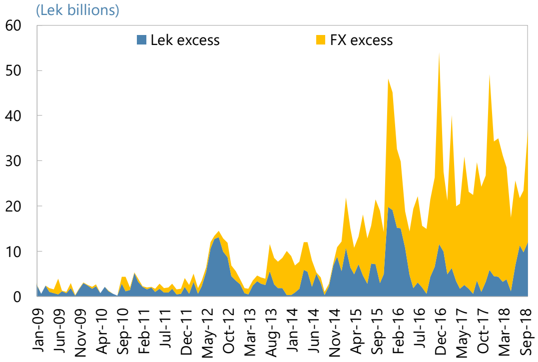
Credit to Domestic Private Sector
(Percent, year-over-year)



Source: Bank of Albania.

… as banks are hoarding more cash at the central bank

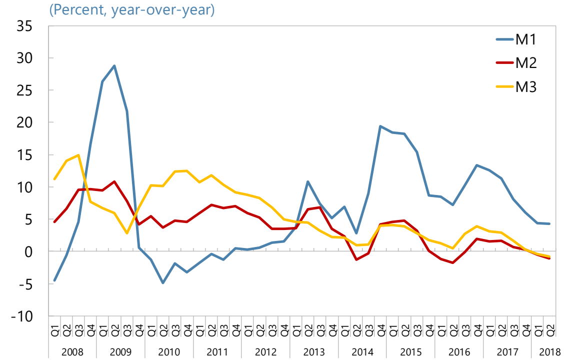
Commercial Banks: Reserves at the Central Bank
(Lek billions)



Source: Bank of Albania.

Consequently, the monetary aggregates in Albania remain stagnant

Money Supply
(Percent, year-over-year)

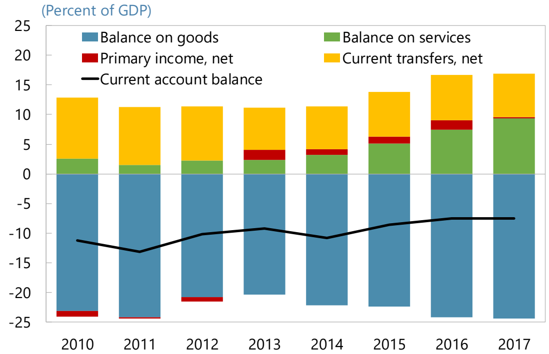


Sources: Bank of Albania; INSTAT; and IMF staff calculations.

Figure 5. Albania: External Sector Developments

The current account has narrowed owing to strong growth of services exports…

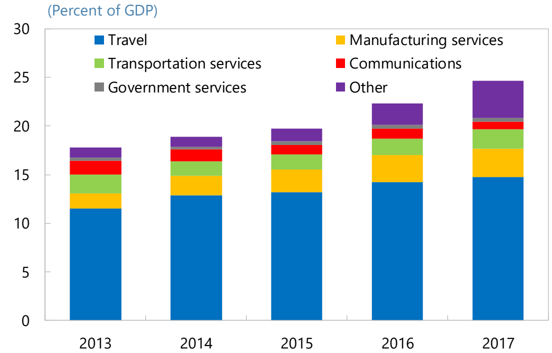
Current Account Balance
(Percent of GDP)



Sources: Bank of Albania; and IMF staff calculations.

…with improvement of the services balance driven primarily by tourism exports.

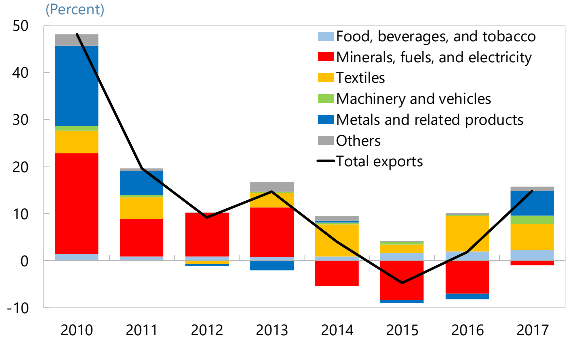
Services Exports
(Percent of GDP)



Sources: Bank of Albania; and IMF staff calculations.

Goods exports have picked up due to strong external demand and favorable terms of trade.

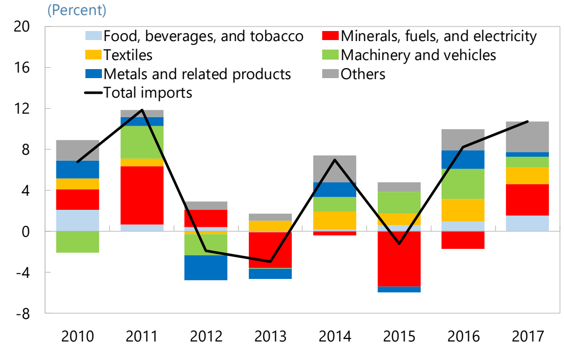
Contribution to Export Goods Growth
(Percent)



Sources: Haver Analytics; and IMF staff calculations.

FDI in large energy projects has helped to sustain high imports.

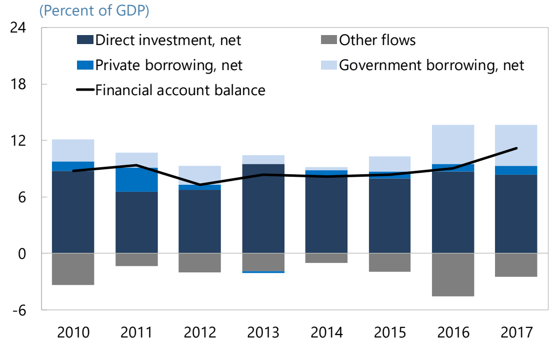
Contribution to Import Goods Growth
(Percent)



Sources: Haver Analytics; and IMF staff calculations.

Capital inflows were driven by large FDI and donor flows…

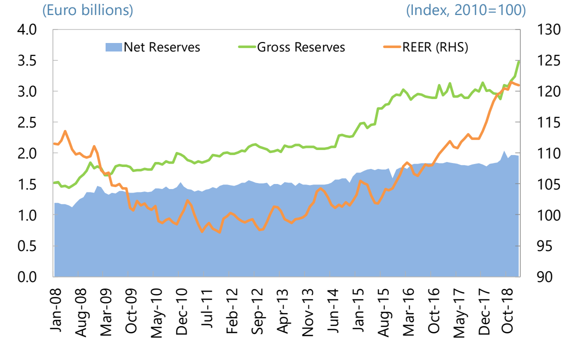
Financial Account Balance
(Percent of GDP)



Sources: IMF staff estimates.

…which supported REER appreciation and increased FX reserves.

Real Exchange Rate and Foreign Reserves
(Euro billions) (Index, 2010=100)

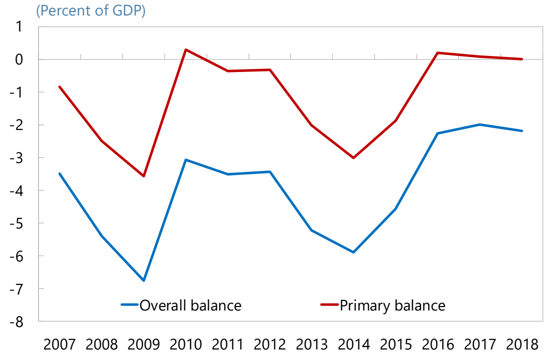


Sources: Bank of Albania; Haver Analytics; IMF, INS database; and IMF staff calculations.

Figure 6. Albania: Fiscal Sector Developments

Albania undertook a large fiscal adjustment in 2014-2016, but its pace has slowed down…

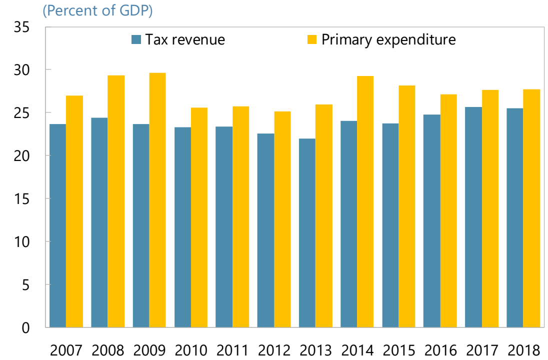
Overall and Primary Balance
(Percent of GDP)



Sources: INSTAT; Ministry of Finance and Economy; and IMF staff calculations.

…as tax revenues are no longer increasing

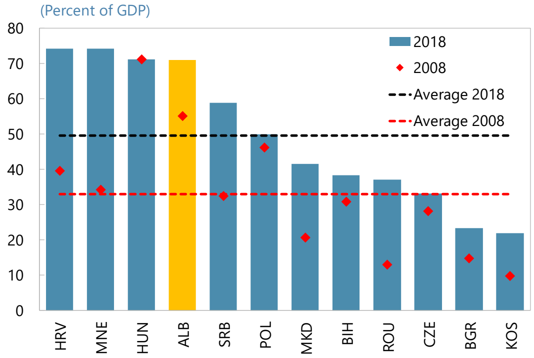
Tax Revenue and Primary Expenditure
(Percent of GDP)



Sources: INSTAT; Ministry of Finance and Economy; and IMF staff calculations.

Public debt has declined from its peak but remains high.

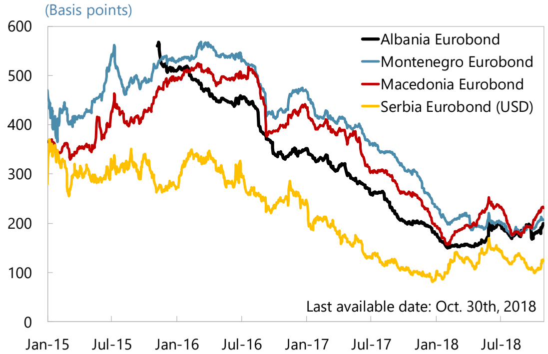
CESEE: Public Debt
(Percent of GDP)



Source: IMF, WEO database.

Sovereign spreads have been declining, in line with regional peers.

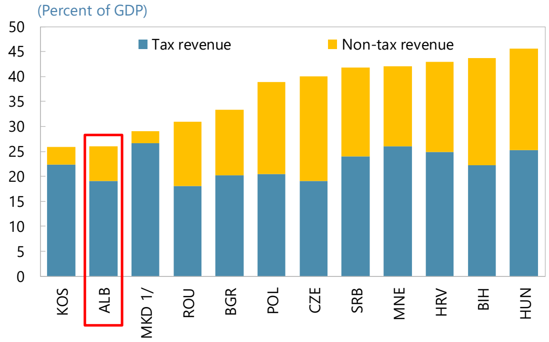
Selected Western Balkans: Sovereign Spreads
(Basis points)



Sources: Bloomberg Finance L.P.

Higher revenues can support fiscal consolidation…

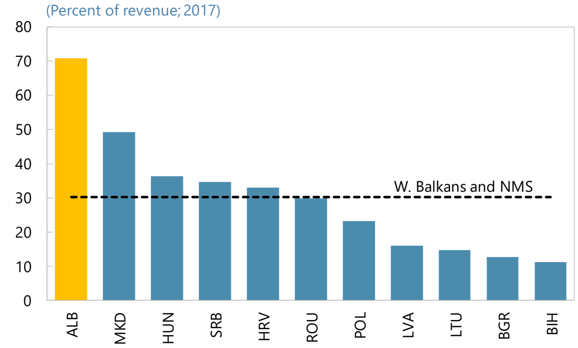
CESEE: Total Revenue, 2008-2017 Average
(Percent of GDP)



Sources: IMF, WEO database; and IMF staff calculations.
1/ 2009-2017 average used.

…and improve debt affordability given the high level of gross financing needs.

Gross Financing Needs, 2017
(Percent of revenue; 2017)

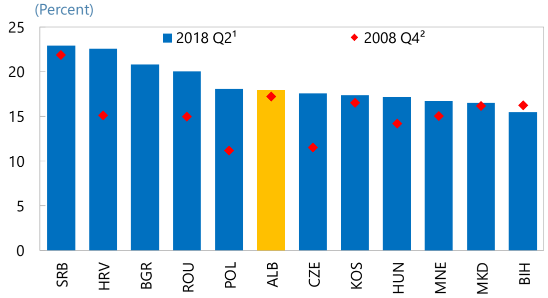


Sources: IMF; Vulnerability Exercise database; IMF, WEO databse; and IMF staff calculations.

Figure 7. Albania: Banking Sector Developments

Albanian bank capital is still below pre-crisis levels and is lagging behind regional peers

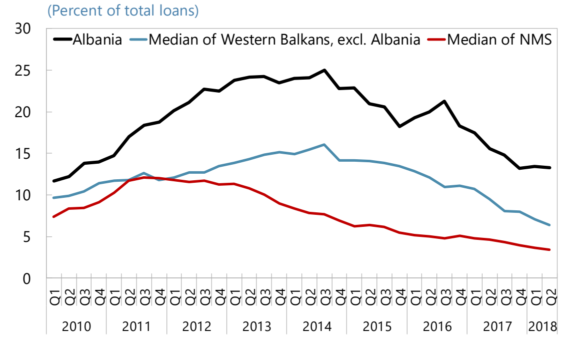
Regulatory Capital to Risk Weighted Assets
(Percent)



Sources: National authorities; IMF Financial Soundness Indicators; and IMF staff estimates.
1/ Except for Montenegro (2017 Q3).
2/ Except for Bulgaria, Hungary, and Romania (2010 Q1).

Notwithstanding the recent decline of NPLs, Albania's NPL ratio remain elevated by regional standards

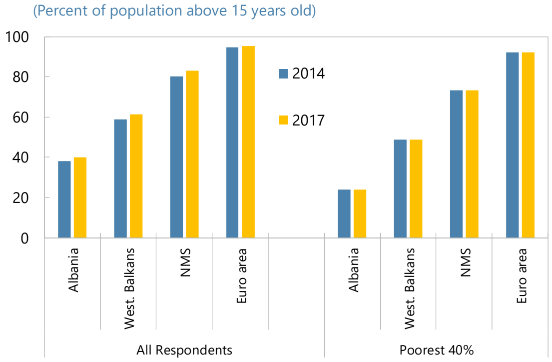
Non-Performing Loans
(Percent of total loans)



Sources: National authorities; IMF Financial Soundness Indicators; and IMF staff estimates.

Financial inclusion in Albania is limited and well below regional averages

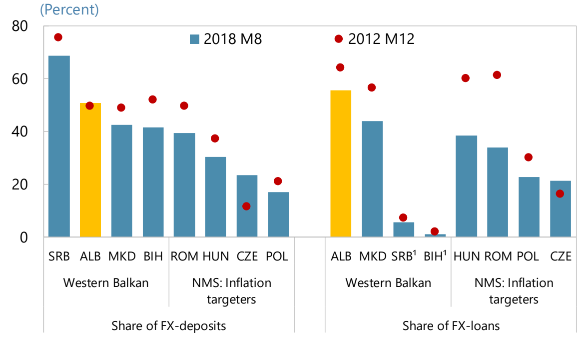
Adults with an Account or Using Mobile Money Services
(Percent of population above 15 years old)



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

Albania remains among the most euroized countries in the region

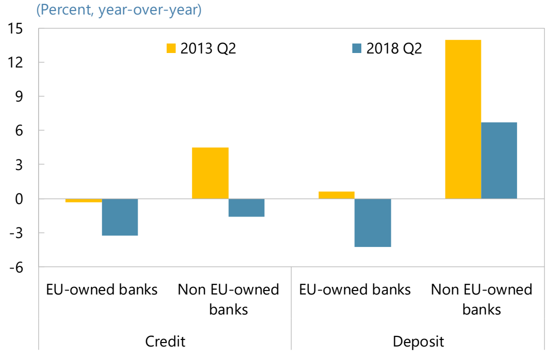
Euroization
(Percent)



Source: IMF, IFS database; IMF staff reports; and IMF staff calculations.
1./ Doesn't include FX-indexed loans.

Credit from both EU-owned and non-EU owned banks is shrinking, although the deleveraging by EU-owned banks is more pronounced.

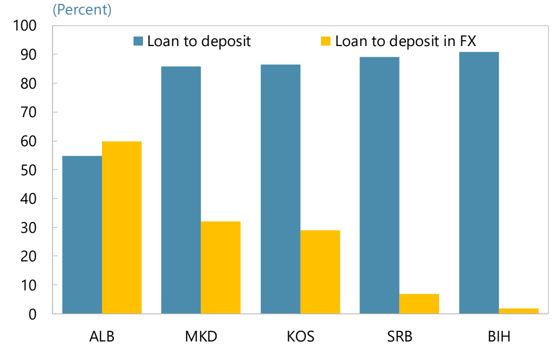
Credit and Deposit Growth
(Percent, year-over-year)



Sources: Bank of Albania; and IMF staff calculations.

Albanian banks have a low deposit-base for local currency loans but a high one by regional standards for FX loans

Loan to Deposits Ratio, 2017
(Percent)

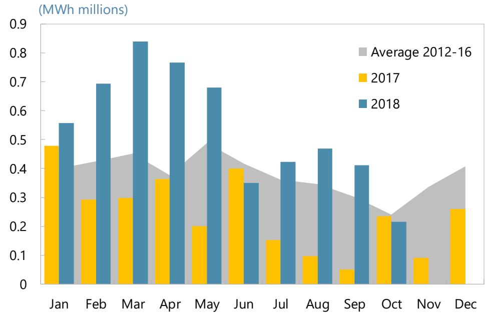


Sources: IFS, MFS database; and IMF staff calculations.

Figure 8. Albania: Electricity Sector—Selected Indicators

Electricity generation was strong in 2018…

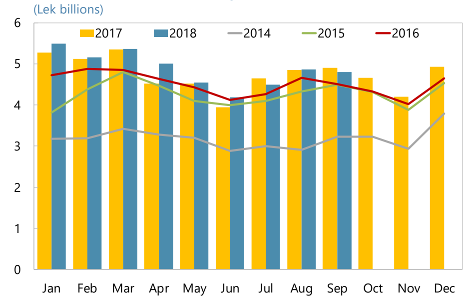
Net Electricity Generation by KESH
(MWh millions)



Sources: KESH; and IMF staff calculations.

…while the collection of bills declined marginally.

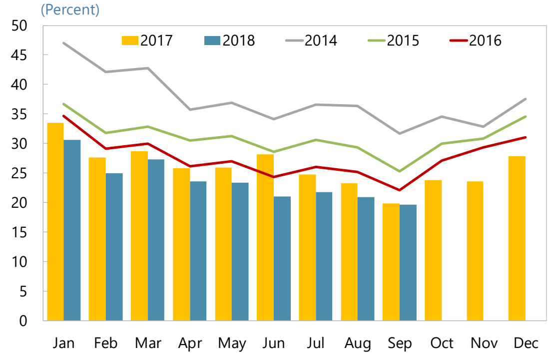
Current Bill Collections by OSHEE
(Lek billions)



Source: OSHEE.

Distribution losses declined, but remain high….

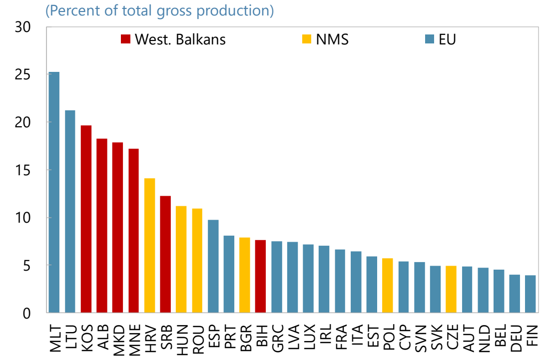
Electricity Distribution Losses
(Percent)



Sources: OSHEE; and IMF staff calculations.

…including compared to regional peers and New Member States (NMS).

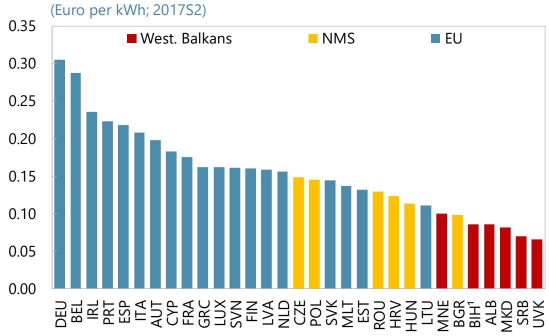
Distribution Losses, 2016
(Percent of total gross production)



Sources: Eurostat; and IMF staff calculations.

Owing to reliance on low-cost hydropower and despite the sector's persistent financial problems, tariffs for household are among the lowest in the region….

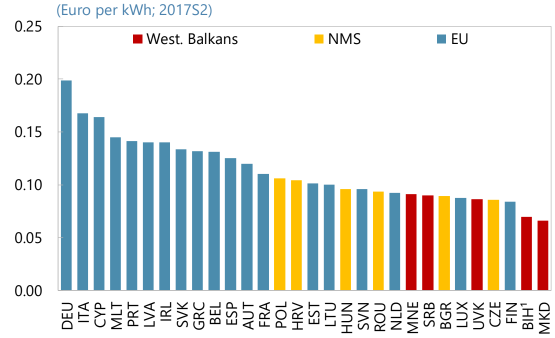
Electricity Prices for Household Consumers
(Euro per kWh; 2017S2)



Source: Eurostat.
1/ 2017S1 data used.

…so are the tariffs for non-household customers.

Electricity Prices for Non-Household Consumers
(Euro per kWh; 2017S2)



Source: Eurostat.
1/ 2017S1 data used.

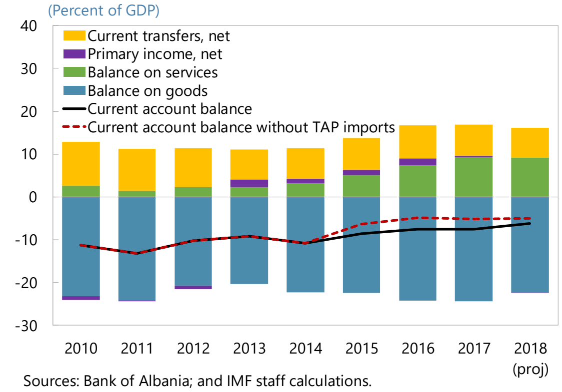
Annex I. External Sector Assessment

The external position is assessed as moderately weaker than implied by fundamentals and desirable policy settings, with EBA-Lite results indicating a current account gap of -1.3 percent and real effective exchange rate overvaluation of about 5 percent. Significant external financing needs and a large negative NIIP pose risks but are mitigated in part by the predominance of FDI flows and official financing. The reduction of external imbalances will hinge on efforts to increase domestic saving. Furthermore, Albania's investment climate remains burdened by structural weaknesses, including governance concerns, infrastructure gaps, and skills shortages that hamper a transition to export-led growth.

1. **Albania's current account deficit improved in 2017 but remains large.** The current account deficit declined slightly to 7.5 percent of GDP at end-2017, the lowest level over the past decade. This improvement was led by the strong growth of tourism, back office services and remittances, offsetting a slight deterioration of the trade deficit due to an increase in electricity imports caused by prolonged drought. Significant rains returned in early 2018 supporting a surge of electricity exports and a projected narrowing of the current account deficit to 6.2 percent in 2018. Over the medium-term, the deficit is expected to fall further as imports generated from FDI in large energy projects, especially the Trans-Adriatic Pipeline (TAP), decline as the projects come to an end, and an expansion of domestic energy production leads to increased exports. However, Albania's reliance on hydropower, and dependence on Italy and Greece as export destinations, makes the current account vulnerable to exogenous shocks.

Current Account Balance

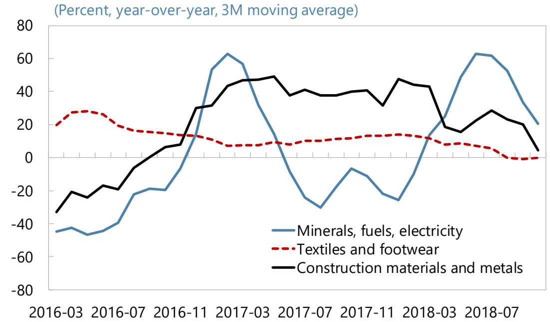
(Percent of GDP)



Sources: Bank of Albania; and IMF staff calculations.

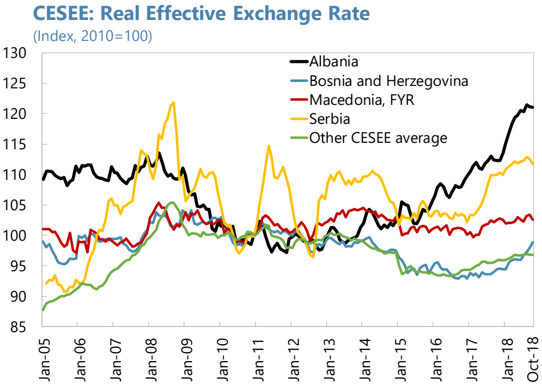
Growth of 3 Largest Export Goods

(Percent, year-over-year, 3M moving average)

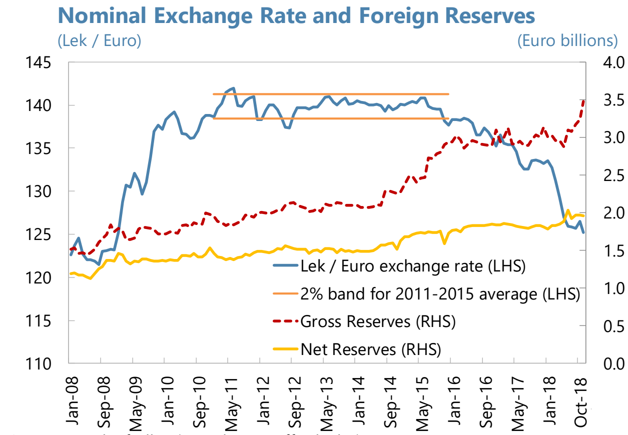


Source: INSTAT; and IMF staff calculations.
Note that in the IMF tables and consistent with BPM6, most textiles exports are classified as manufacturing services on physical inputs owned by foreigners rather than goods exports.

2. **The real exchange rate has appreciated significantly, in part due to one off factors.** Since the beginning of 2017, the CPI-based REER has appreciated by about 9 percent, reflecting price differentials vis-à-vis trading partners and a pronounced appreciation of the nominal exchange rate. The latter has been supported by long-term trends, such as robust flows of FDI and, since the beginning of 2018, by idiosyncratic factors such as lumpy donor disbursements and the conversion of commercial bank capital from euro to lek. As a result, the lek-euro exchange has decisively shifted out of the 2 percent band in which it had moved between 2011–15.



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



Sources: Bank of Albania; and IMF staff calculations.

3. **The net international investment position has been increasingly negative, but the large stock of FDI and official lending mitigates sustainability concerns**. The NIIP increased to -48 percent of GDP in mid-2018 from -42 percent of GDP in 2014, driven by FDI inflows and external borrowing. Foreign liabilities reached 102 percent of GDP, although slightly more than half of this stock comprised stable FDI liabilities, while other liabilities were mostly long-term concessional public debt. The profile of liabilities may become less favorable over the medium-term, however, as FDI inflows related to large energy projects taper off and the authorities increase commercial borrowing.

4. **EBA-Lite results indicate an external position that is moderately weaker than implied by fundamentals and desirable policy settings.** Under the Current Account approach the CA norm, estimated at -5.2 percent, is smaller than the underlying CA balance of -6.4 percent of GDP, reflecting Albania's low national savings and a high dependency ratio due to an aging population. The underlying current account excludes a portion of imports financed by FDI inflows over and above the EBA-lite sample average.[1] The gap of -1.3 percent of GDP suggests a REER that is overvalued by about 5 percent and thus moderately weaker than implied by fundamentals and desirable policy settings. The ES approach shows a comparable result. The REER model indicates an external position that is broadly consistent with fundamentals, but this approach has weak predictive power for Albania. The overvaluation is expected to resolve over time, with fiscal adjustment and productivity growth supported by structural reform.

[1] Albania's FDI inflows have been in range of 7–10 percent of GDP, notably higher than the EBA-Lite sample average of 4½ percent. Staff excludes approximately one-third of excess FDI associated primarily with large energy projects to achieve an adjusted underlying current account deficit of -6.4 percent.

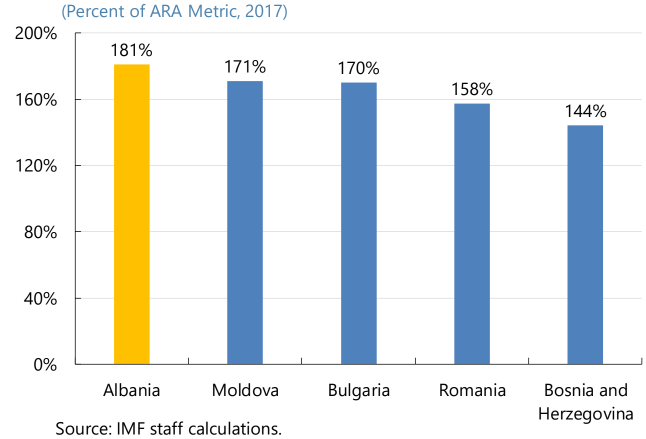
Albania: External Sector Assessment Summary Table
(Percent of GDP)

	Current account-Norm	Adjusted actual current account	Current account gap	REER gap
EBA-Lite (Current account approach)	-5.2	-6.4	-1.3	4.6
External sustainability approach	-4.8	-6.4	-1.6	5.9
REER approach	n.a.	n.a.	n.a.	0.0
REER elasticity	-0.27			

Source: IMF staff calculations.

5. **Albania has large external financing needs, though robust FX coverage and access to concessional financing help to mitigate risk.** At 13 percent of GDP in 2017, Albania's external financing needs are fairly large. However, gross FX reserves, at 26 percent of GDP and 181 percent of the ARA metric at end-2017, have continued to increase, reflecting the BOA's strategy of building reserves based on a pre-announced schedule of purchases, facilitated by inflows of FDI and donor-funded longer-term external borrowing. While this level is above the 150 percent upper threshold for floating regimes, the higher level is appropriate given Albania's substantial euroization and large FX deposits held by domestic banks. Such reserve coverage is also broadly consistent with levels in other Central and Eastern European countries. Albania's reserve coverage increased in 2018 with the issuance of a €500 million Eurobond and is expected to decline gradually through the medium-term as the authorities' de-euroization plans gain momentum and as FX debt is repaid. As the large import-intensive energy projects are completed and the 2015 and 2018 Eurobonds are amortized, Albania's ability to attract new FDI flows and rollover debt will be increasingly important for external sustainability and growth. In 2017, net FDI stood at about 8 percent of GDP, covering more than 100 percent of the current account deficit.

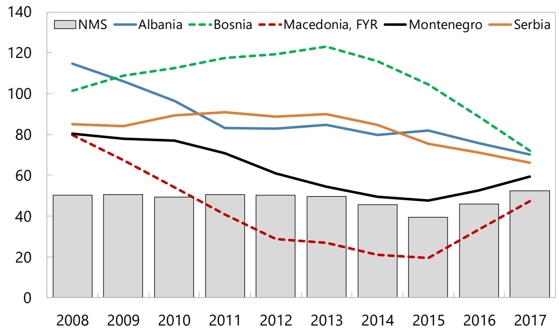
Gross Reserves
(Percent of ARA Metric, 2017)



Source: IMF staff calculations.

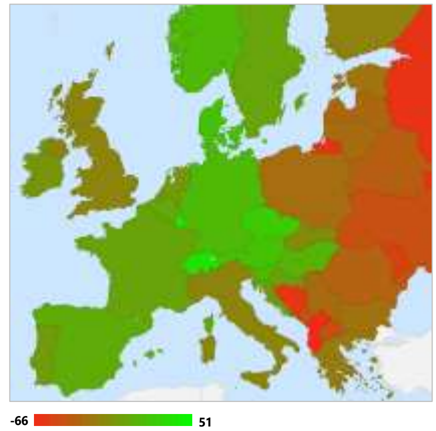
6. **Albania's investment climate has improved, but it continues to trail regional peers, highlighting structural deficiencies.** Weak institutions (especially in the judiciary), infrastructure deficiencies, an excessively complex tax system, limited access to finance, and a shortage of skilled labor hold back Albania's attractiveness for investors, in particular in export-oriented sectors. Low wages are an advantage, but low productivity—due in part to skills shortages—impedes the country's transition to higher value-added production.

Doing Business Indicators
(Ranking; 4Y moving average)



Source: World Bank, Doing Business Reports.

Infrastructure Gap Index 1/



Sources: WDI database; EIA; IRF; Eurostat; and IMF staff calculations.
1/ Infrastructure Gap Index is the weighted sum of railway density, motorway density, installed capacity for power generation, phone lines and cellular subscriptions, air transport passengers, and internet subscriptions.

Annex II. Risk Assessment Matrix[1]

Source of Risk	Relative Likelihood	Impact if Realized	Policy Advice
International Macroeconomic Environment			
Weaker than expected growth in main trading partners	Medium	**High** Weaker than anticipated growth (particularly in 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 business environment to support growth in exports and investment.
International Financial Conditions			
Sharp tightening of financial conditions in the Euro Area	**High**	**Medium** Tapering by the ECB could raise interest rates in Albania and reduce international investor appetite for Albanian securities.	Persist with fiscal consolidation and further lengthen the maturity of public debt. Optimize the foreign debt portfolio based on risk-return tradeoff analysis.
Financial disintermediation	**Medium**	**Medium** Financial turmoil in key partner countries could weigh on investor confidence. An abrupt and disorderly exit of a large foreign bank could stress the domestic banking system and create pressures on the market for domestic public debt. However, the new bank resolution framework adopted by the BOA should mitigate this risk.	Continue sharing information with parent banks and their regulators, strengthen contingency plans, and closely monitor capital and liquidity positions. Conduct strict fit and proper assessment of new entrants, especially those with limited banking experience. Continue to align bank regulations with European standards.
Domestic risks			
Poorly designed PPPs & increased contingent liabilities	**High**	**Medium** Engaging in poorly designed PPP contracts for infrastructure investment could impede the efficiency of public investment, and create large contingent liabilities, the realization of which could undermine fiscal and debt sustainability	Strengthen governance and transparency in PPP implementation. Upgrade the capacity of the Ministry of Finance to undertake financial analysis of new PPP contracts.

[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.

Adverse weather conditions	Medium	Medium Drought conditions could affect electricity generation. Power shortages could damage growth. Electricity imports could pose quasi-fiscal risks for the budget.	Reinvigorate the implementation of the electricity sector reform. Finalize financial restructuring plans to restore the financial viability of public electricity companies. Prepare a backup power supply plan.
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.	Diversify the debt holders base. Improve market communication and coordination with the central bank. Continue fiscal adjustment and debt reduction.
Domestic political instability	Low	High Volatile domestic politics and social tensions could hinder the implementation of the structural reforms and fiscal consolidation agenda. Reforms, including those to strengthen the rule of law are key for medium-term growth and prospects for EU accession talks.	Ensure that reforms are grounded in careful policy analysis and a consultative preparation process.

Annex III. Debt Sustainability Analysis

Public debt in Albania is expected to gradually decline over the medium term but remain high, posing significant risks. Under the baseline scenario, the public debt-to-GDP ratio is projected to reach 58.4 percent by 2023, from the 2017 level of 71.8 percent. Gross financing needs are expected to remain high. Rollover needs are gradually declining but remain sizable. The debt-to-GDP ratio is sensitive to real GDP growth, fiscal performance and borrowing costs.

A. Background

1. Albania's public debt has been on a declining path since 2015 but remains high. After a rapid increase of public debt between 2010–2013, the debt trajectory reversed in 2016. Supported by a sizable fiscal adjustment in last three years, total public debt declined from its peak of 73.7 percent of GDP in 2015, to 71.8 percent in 2017. Despite the decline, debt however remains high.

2. Debt Profile[1]. Domestic debt represents 55 percent of total public debt, of which more than 97 percent is denominated in domestic currency. The maturity of public debt has been gradually improving, with the authorities' effort to shift from short-term domestic financing to long-term external financing. Moreover, the average weighted maturity of domestic public debt has increased from less than 1 year in 2011 to 2.2 years as of June 2018.

B. Public DSA Results

Baseline Scenario

3. Macroeconomic assumptions. After the envisaged increase in 2018, real growth is projected to stabilize at 4 percent over the medium term, reflecting an expansion of investments in line with the authorities plans, and a further strengthening of the export-oriented sectors, including industry and tourism. Inflation is projected to edge up gradually and reach the central bank target of 3 percent by 2021. Absent of new tax policy measures, fiscal consolidation will slow down, with the overall deficit hovering around 2 percent of GDP, and the primary surplus averaging 0.1 percent of GDP.

4. Debt level under the baseline. Under the baseline scenario, gross debt is projected to gradually decline over the medium-term, reaching 58.4 percent of GDP in 2023. Gross financing needs over the same period are projected to average around 22 percent of GDP, well above the 15 percent threshold.

5. Alternative scenario. Under the constant-primary-balance scenario (assuming the primary balance remains at the level of 2018), the debt ratio would reach 59 percent by 2023. The scenario

[1] Public debt refers to the general government and includes all public guarantees for energy and non-energy sector debt. It does not include PPPs.

based on historical performance (assuming real GDP growth, the primary balance and real interest rates at the historical average of the past ten years) projects debt at 70 percent of GDP, however. This scenario highlights the risks to the baseline from slow growth, a sharp increase in interest rate, and a deterioration of the fiscal accounts.

6. Heat map and debt profile vulnerabilities. Debt and gross financing needs are above the relevant thresholds (red in the heatmap). Risks from the debt level are deemed high as the debt-to-GDP ratio is above the 70 percent benchmark for the first year of the projections under several shock scenarios. Gross financing needs breach the 15 percent threshold associated with past crises through all of the projection period. The debt profile shows moderate risks as the share of short-term debt declined, and market perception improved (green in the heatmap) as reflected in average sovereign spread in last three months below the threshold. Despite the improvement in the maturity profile, ***rollover risks*** remain high, as 35 percent of total debt is short-term. Notwithstanding a notable decline from 2017, public gross financing needs are projected to remain above the early warning levels associated with past debt crises. ***Interest rate risk*** is expected to increase with the lengthening of maturity, but the impact on valuations is limited due to underdeveloped secondary market and banks' preference to hold government securities till maturity. ***Exchange rate risks*** will rise with the expansion of foreign currency debt, but Albania's comfortable level of international reserves should limit the negative impact (see paragraph 11).

7. Realism of projections. The baseline scenario remains realistic. Medium-term growth projections take into account Albania's relatively low per capita income by regional standards and its potential for convergence, high inflows of FDI throughout the period, and the expected launch of EU accession negotiations. The median forecast errors for real GDP growth (actual minus projection) in 2008–2016 are broadly within the inter-quartile range of the forecast errors of other countries, and do not suffer from large systemic bias. Forecast errors for the primary balance however suggest that staff projections have been too pessimistic, with a percentile rank of 89 percent. Inflation forecasts, on the other hand, have been too optimistic.

Stress Test

8. Stress test results. The debt ratio remains above 60 percent of GDP under all scenarios, however it is most sensitive to the real GDP growth shock, under which debt reaches about 63 percent in 2023. Sensitivity to interest rate and exchange rate shocks is also notable, as under those scenarios public debt reaches 61 percent of GDP. A combined shock incorporates the largest effect of individual shocks on all relevant variables (real GDP growth, inflation, primary balance, exchange rate and interest rate). Under this scenario the debt-to-GDP ratio will increase to 74 percent of GDP.

9. Stochastic simulations. The fan charts illustrate the possible evolution of the debt over the medium term and are based on both symmetric and asymmetric distributions of risks. Under asymmetric distribution of risks, there is a high level of certainty that debt stock will be in the range of 53 to 68 percent of GDP. However, if restrictions are imposed on the primary balance, debt could be above 65 percent of GDP by 2023 relative to the baseline scenario of 58.2 percent of GDP with a probability of 25 percent.

C. External Debt Sustainability

10. The external debt-to-GDP ratio remains high though its medium-term trajectory has improved modestly relative to the last DSA (April 2018). This is largely due to a more appreciated path for the exchange rate over the medium-term and an upward revision in the 2018 GDP growth forecast. Most external debt continues to be held by multilateral creditors and bilateral development agencies, though the share of commercial debt is expected to increase over the medium-term. Most foreign public debt is denominated in euros (inter-government loans and Eurobonds), followed by SDRs (IMF loans).

11. The external debt ratio peaked in 2017 and is expected to decline gradually over the medium-term as growth picks up and multilateral borrowing declines. External debt is estimated to have peaked at around 63 percent of GDP in 2017, driven by high external public borrowing, and is expected to decline to 45 percent by 2023. Over the same period, external private borrowing is expected to fall from about 23 to 15 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. The authorities issued a seven-year, €500 Eurobond at favorable rates in October 2018, and used €200 million to retire a portion of the €450 2015 Eurobond. The authorities are planning to issue a €500 Eurobond in 2020 to rollover the remaining maturity of the 2015 bond, and another €500 Eurobond in 2022. Public and private external debt service is expected to increase from 7 percent to 9 percent of GDP in 2018, consistent with the partial buyback of the 2015 Eurobond, and then rise to 9 percent again in 2020 as the remaining 2015 Eurobond is amortized. In line with the succession of new Eurobond issuances, commercial debt as a percentage of total PPG debt is expected to increase from 28 percent in 2018 to 36 percent in 2022, before declining gradually thereafter as outstanding commercial debt is repaid.

12. Stress test results. Under a 30 percent exchange rate depreciation shock, external debt would peak at 79 percent of GDP in 2019 before declining to 66 percent by 2023. Depreciation shocks are likely to have added significance for debt dynamics in view of increased external 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 2 percent of GDP), external debt would peak at 56 percent of GDP in 2019 and gradually decline to 53 percent by 2023.

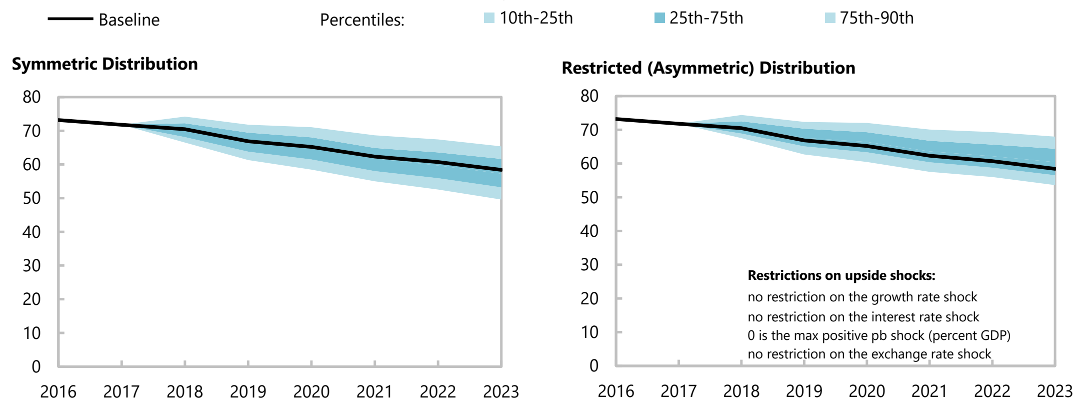
Albania: Public DSA Risk Assessment

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

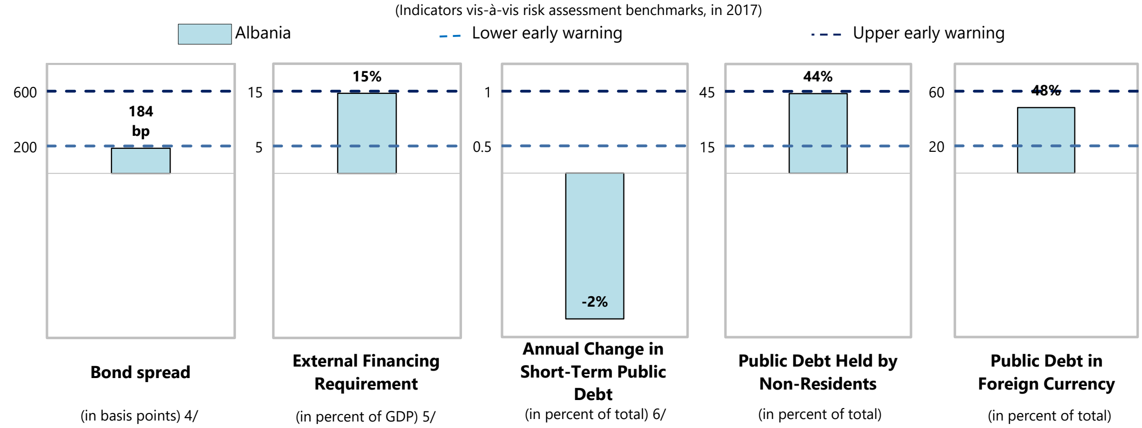
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



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, 13-Jun-18 through 11-Sep-18.

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.

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

(In percent of GDP unless otherwise indicated)

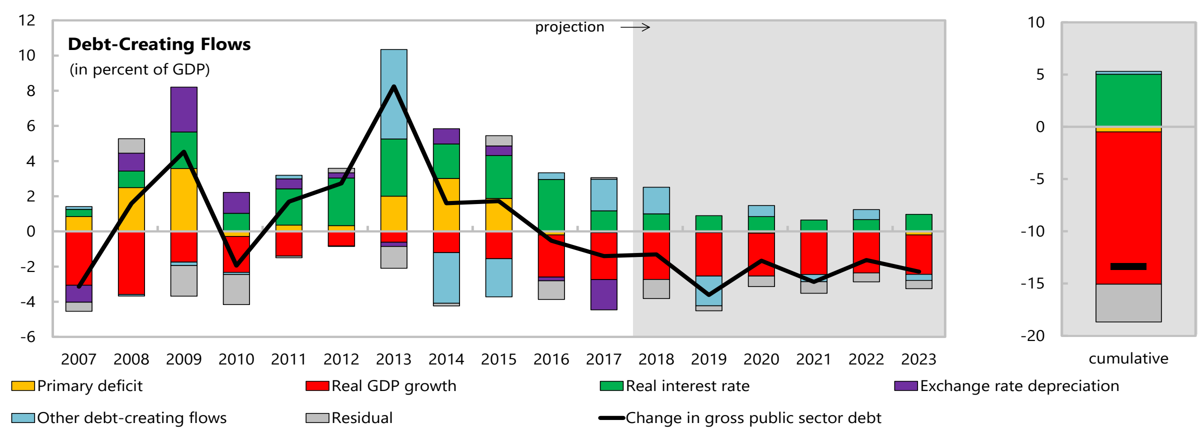
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	62.6	73.2	71.8	70.5	66.9	65.2	62.3	60.7	58.4
Of which: guarantees	3.7	3.6	3.2	3.0	2.8	2.7	2.5	2.3	2.2
Public gross financing needs	39.1	28.3	25.0	22.5	21.0	23.6	21.5	22.5	21.4
Real GDP growth (in percent)	3.3	3.4	3.8	4.0	3.7	3.9	3.9	4.0	4.0
Inflation (GDP deflator, in percent)	2.4	-0.5	1.4	1.9	2.1	2.4	2.8	2.9	2.9
Nominal GDP growth (in percent)	5.7	2.9	5.3	6.0	5.9	6.3	6.8	7.0	7.0
Effective interest rate (in percent) [4/]	5.6	3.6	3.1	3.5	3.5	3.8	4.0	4.2	4.8

As of Sep 24, 2018		
Sovereign Spreads		
Spread (bp) 3/		195
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	B1	B1
S&Ps [11/]	B+	B+
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [10/]
Change in gross public sector debt	1.9	-0.5	-1.4	-1.3	-3.6	-1.7	-2.9	-1.6	-2.3	-13.4	
Identified debt-creating flows	2.3	0.5	-1.5	-0.2	-3.3	-1.1	-2.2	-1.1	-1.8	-9.8	
Primary deficit [5/]	1.6	-0.2	-0.1	0.0	-0.1	-0.1	0.0	-0.1	-0.2	-0.5	-1.6
Primary revenue and grants [5/]	25.7	27.3	27.7	27.5	27.3	27.1	26.9	26.6	26.4	161.8	
Primary expenditure [5/]	27.3	27.1	27.6	27.5	27.2	27.0	26.8	26.6	26.2	161.3	
Automatic debt dynamics [6/]	0.7	0.3	-3.2	-1.7	-1.6	-1.6	-1.8	-1.6	-1.3	-9.5	
Interest rate/growth differential [7/]	0.1	0.5	-1.5	-1.7	-1.6	-1.6	-1.8	-1.6	-1.3	-9.5	
Of which: real interest rate	1.9	3.0	1.2	1.0	0.9	0.8	0.6	0.7	1.0	5.0	
Of which: real GDP growth	-1.8	-2.4	-2.7	-2.7	-2.5	-2.4	-2.4	-2.3	-2.2	-14.6	
Exchange rate depreciation [8/]	0.6	-0.2	-1.7	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.4	1.8	1.5	-1.7	0.6	-0.4	0.6	-0.3	0.3	
Accumulation of general govt. deposits	0.0	0.3	0.9	1.7	-1.7	0.6	-0.4	0.6	-0.3	0.5	
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	0.0	0.1	0.9	-0.2	0.0	0.0	0.0	0.0	0.0	-0.2	
Residual [9/]	-0.4	-1.1	0.1	-1.1	-0.3	-0.6	-0.7	-0.5	-0.5	-3.6	



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

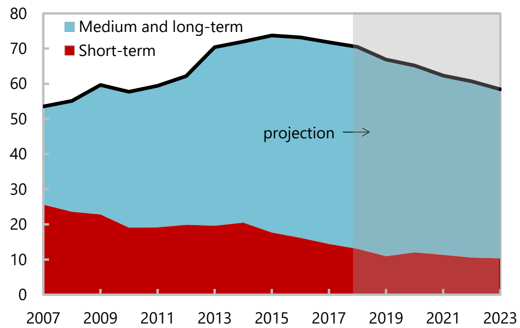
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

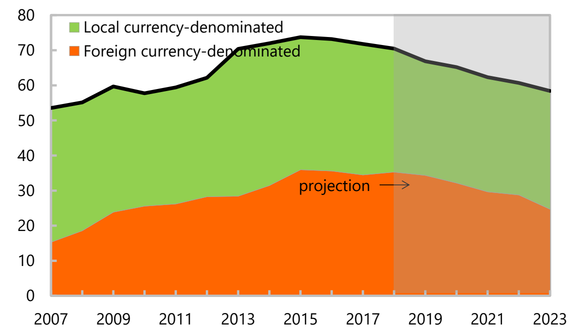
Albania: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



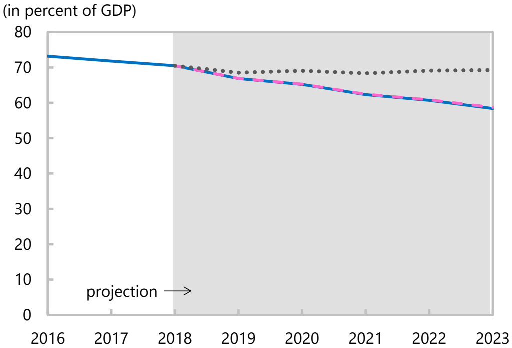
By Currency
(in percent of GDP)



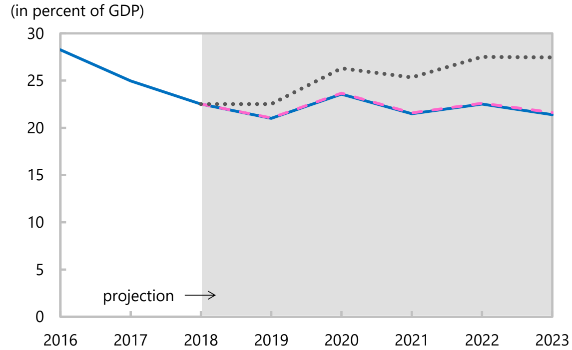
Alternative Scenarios

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)

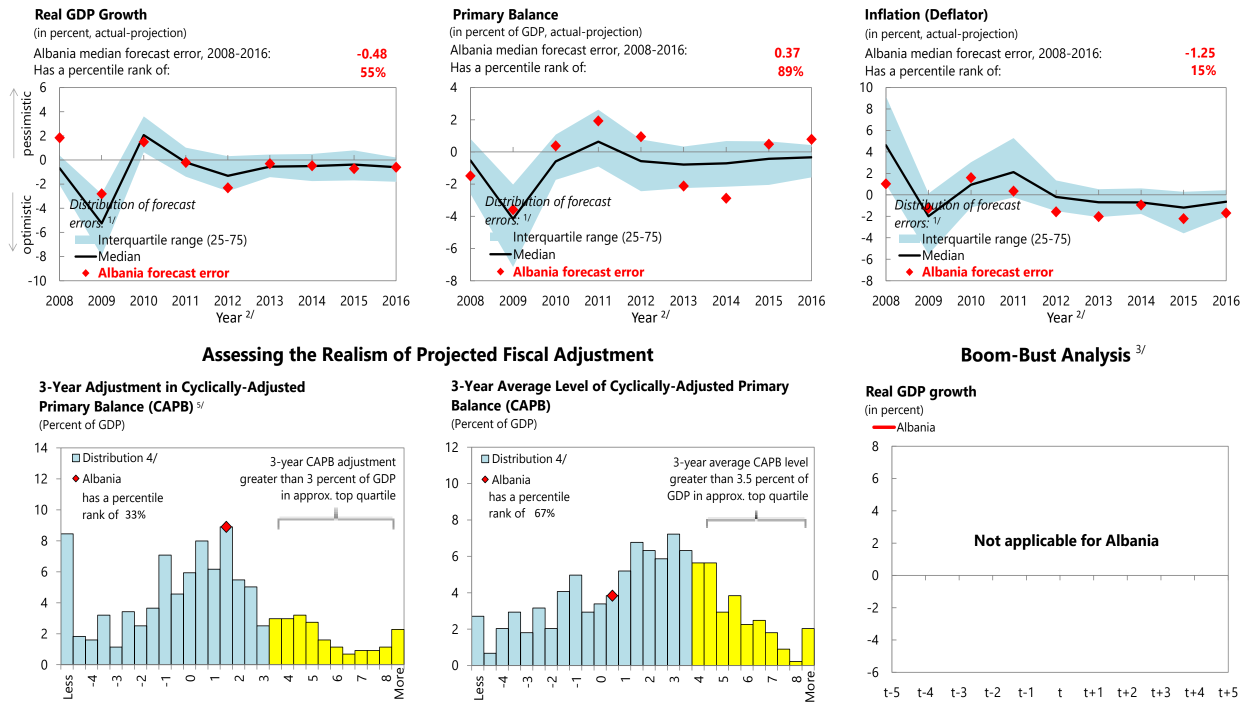
Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	4.0	3.7	3.9	3.9	4.0	4.0
Inflation	1.9	2.1	2.4	2.8	2.9	2.9
Primary Balance	0.0	0.1	0.1	0.0	0.1	0.2
Effective interest rate	3.5	3.5	3.8	4.0	4.2	4.8
Constant Primary Balance Scenario						
Real GDP growth	4.0	3.7	3.9	3.9	4.0	4.0
Inflation	1.9	2.1	2.4	2.8	2.9	2.9
Primary Balance	0.0	0.0	0.0	0.0	0.0	0.0
Effective interest rate	3.5	3.5	3.8	4.0	4.2	4.7

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	4.0	3.1	3.1	3.1	3.1	3.1
Inflation	1.9	2.1	2.4	2.8	2.9	2.9
Primary Balance	0.0	-1.3	-1.3	-1.3	-1.3	-1.3
Effective interest rate	3.5	3.5	4.2	4.7	5.1	5.9

Source: IMF staff.

Albania: Public DSA – Realism of Baseline Assumptions

Forecast Track Record, versus all countries



Source : IMF Staff.

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

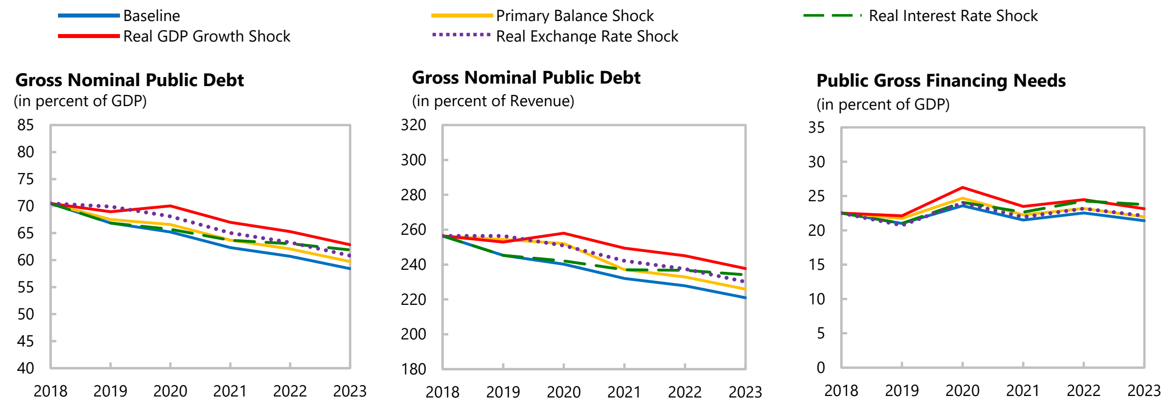
2/ Projections made in the spring WEO vintage of the preceding year.

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

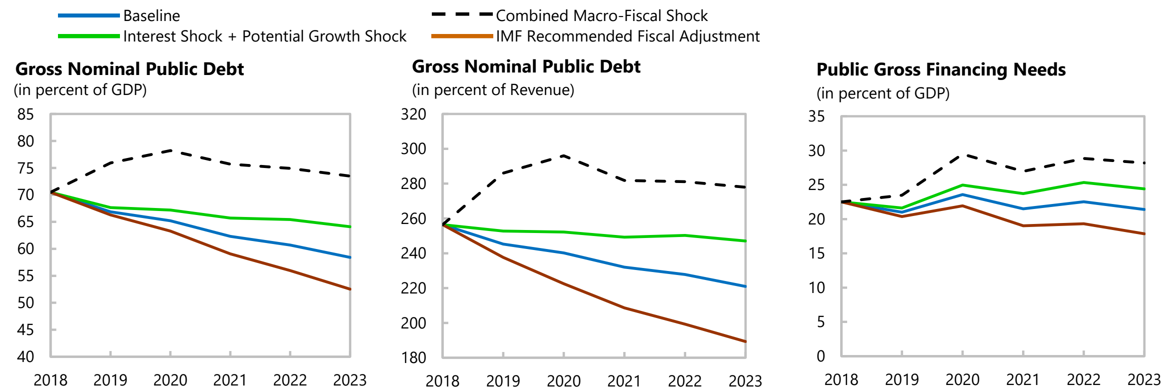
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Albania: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2018	2019	2020	2021	2022	2023
Primary Balance Shock						
Real GDP growth	4.0	3.7	3.9	3.9	4.0	4.0
Inflation	1.9	2.1	2.4	2.8	2.9	2.9
Primary balance	0.0	-0.7	-0.6	0.0	0.1	0.2
Effective interest rate	3.5	3.5	3.8	4.0	4.2	4.8
Real Interest Rate Shock						
Real GDP growth	4.0	3.7	3.9	3.9	4.0	4.0
Inflation	1.9	2.1	2.4	2.8	2.9	2.9
Primary balance	0.0	0.1	0.1	0.0	0.1	0.2
Effective interest rate	3.5	3.5	4.6	5.5	6.0	6.9
Combined Shock						
Real GDP growth	4.0	1.9	2.0	3.9	4.0	4.0
Inflation	1.9	1.6	1.9	2.8	2.9	2.9
Primary balance	0.0	-1.3	-1.9	0.0	0.1	0.2
Effective interest rate	3.5	3.7	4.5	5.3	5.8	6.8

	2018	2019	2020	2021	2022	2023
Real GDP Growth Shock						
Real GDP growth	4.0	1.9	2.0	3.9	4.0	4.0
Inflation	1.9	1.6	1.9	2.8	2.9	2.9
Primary balance	0.0	-0.6	-1.1	0.0	0.1	0.2
Effective interest rate	3.5	3.5	3.8	4.0	4.2	4.8
Real Exchange Rate Shock						
Real GDP growth	4.0	3.7	3.9	3.9	4.0	4.0
Inflation	1.9	6.6	2.4	2.8	2.9	2.9
Primary balance	0.0	0.1	0.1	0.0	0.1	0.2
Effective interest rate	3.5	3.7	3.7	3.9	4.1	4.6
IMF Recommended Fiscal Adjustment						
Real GDP growth	4.0	3.7	3.9	3.9	4.0	4.0
Inflation	1.9	2.1	2.4	2.8	2.9	2.9
Primary balance	-0.1	0.7	1.4	1.5	1.5	1.5
Effective interest rate	3.5	3.5	3.8	3.9	4.1	4.6

Source: IMF staff.

Table 1. Albania: External Debt Sustainability Framework, 2013–2023

(Percent of GDP, unless stated otherwise)

	Actual							Projections					
	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023
Baseline: External debt	60.5	56.1	63.0	61.9	63.2			**55.5**	**54.6**	**52.9**	**49.3**	**48.7**	**45.4**
Change in external debt	8.8	-4.4	7.0	-1.2	1.3			-7.6	-0.9	-1.8	-3.6	-0.6	-3.2
Identified external debt-creating flows (4+8+9)	-2.1	0.5	9.8	-3.8	-6.7			-3.6	-2.3	-2.2	-2.5	-2.8	-3.1
Current account deficit, excluding interest payments	8.9	9.5	7.0	6.0	6.4			5.0	5.0	4.7	4.6	4.6	4.7
Deficit in balance of goods and services	18.0	19.0	17.3	16.8	15.1			13.1	12.6	12.1	11.8	11.6	11.3
Exports	28.9	28.2	27.3	28.9	31.5			31.3	31.0	31.3	31.3	31.2	31.4
Imports	47.0	47.2	44.5	45.8	46.6			44.4	43.6	43.4	43.1	42.8	42.7
Net non-debt creating capital inflows (negative)	-9.5	-8.1	-8.0	-8.7	-8.6			-7.7	-6.6	-6.2	-6.5	-6.9	-7.3
Automatic debt dynamics 1/	-1.5	-0.8	10.7	-1.0	-4.5			-0.9	-0.7	-0.7	-0.6	-0.5	-0.4
Contribution from nominal interest rate	0.4	1.3	1.6	1.6	1.1			1.3	1.3	1.3	1.3	1.3	1.4
Contribution from real GDP growth	-0.5	-1.0	-1.4	-2.0	-2.2			-2.2	-2.0	-2.0	-1.9	-1.8	-1.8
Contribution from price and exchange rate changes 2/	-1.4	-1.1	10.6	-0.6	-3.5			...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	11.0	-4.9	-2.8	2.6	8.0			-4.0	1.4	0.4	-1.1	2.2	-0.2
External debt-to-exports ratio (in percent)	209.1	198.7	231.2	213.9	200.3			177.5	176.5	168.9	157.5	155.8	144.7
Gross external financing need (in billions of US dollars) 4/	1.7	2.2	2.0	1.6	1.8			2.1	1.9	2.3	2.1	2.2	2.3
in percent of GDP	13.0	16.7	17.9	13.4	13.4	10-Year	10-Year	13.8	12.2	13.2	11.4	11.1	10.9
Scenario with key variables at their historical averages 5/								**55.5**	**59.4**	**64.0**	**66.9**	**73.9**	**77.6**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation						
Real GDP growth (in percent)	1.0	1.8	2.2	3.4	3.8	3.1	1.8	4.0	3.7	3.9	3.9	4.0	4.0
GDP deflator in US dollars (change in percent)	2.7	1.8	-15.9	1.0	5.9	-0.7	8.3	11.6	0.9	3.9	4.0	4.2	3.5
Nominal external interest rate (in percent)	0.8	2.3	2.5	2.7	2.0	2.1	0.7	2.3	2.4	2.5	2.7	2.8	3.0
Growth of exports (US dollar terms, in percent)	-10.3	1.1	-16.9	10.7	19.9	4.1	14.7	15.1	3.5	9.1	8.1	8.1	8.1
Growth of imports (US dollar terms, in percent)	-6.3	4.2	-18.9	7.2	12.0	1.2	13.8	10.6	2.6	7.4	7.4	7.6	7.4
Current account balance, excluding interest payments	-8.9	-9.5	-7.0	-6.0	-6.4	-10.1	3.4	-5.0	-5.0	-4.7	-4.6	-4.6	-4.7
Net non-debt creating capital inflows	9.5	8.1	8.0	8.7	8.6	8.0	1.0	7.7	6.6	6.2	6.5	6.9	7.3

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

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

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

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

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

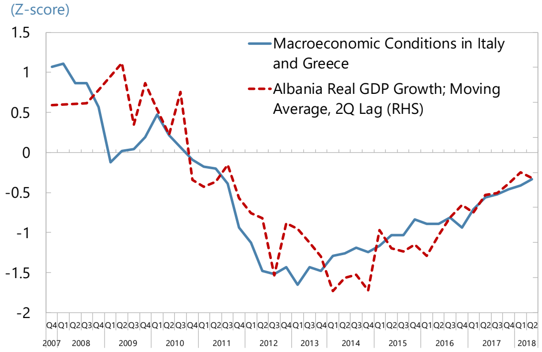
Annex IV. Growth at Risk and Spillovers

Domestic and foreign risks to Albania's growth can be quantified using the Growth-at-Risk (GaR) framework developed at the Fund.[1] GaR results show that the country is mostly exposed to macroeconomic developments in its main trading partners, as well as a deterioration in the level and quality of domestic leverage.

1. Albania is a small open economy, strongly exposed to macroeconomic and financial shocks from its main trading partners. Albania has a flexible exchange rate regime and an open capital account. It depends substantially on remittances—around 10 percent of GDP—to finance its large current account deficit. Trade is concentrated, with few partners (Italy, Greece, Macedonia) and limited diversification across products. On the financial side, the high-degree of euroization and the dependence to euro-denominated foreign funding amplifies the transmission of shocks and limits the strength of countercyclical policies.

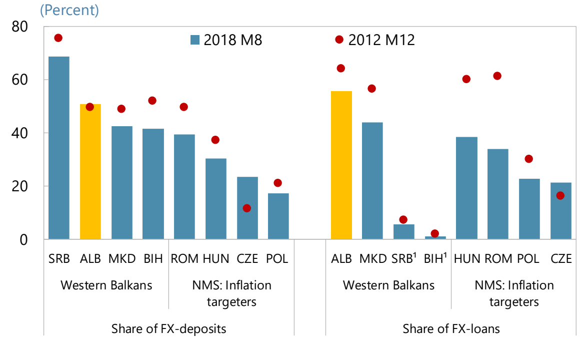
Figure 1. Albania: Correlation Between Macroeconomic Conditions in Trade Partners and Albania's 2-quarters ahead Growth (left) and Euroization Metrics (right)

Albania Growth and Regional Macroeconomic Environment
(Z-score)



Sources: Haver Analytics; and IMF staff estimations.

Euroization
(Percent)



Source: IMF, IFS database; IMF staff reports; and IMF staff calculations.
1./ Doesn't include FX-indexed loans.

2. To reflect the multifaceted risks to growth, a large set of variables is aggregated into five main regressors—also called partitions, using principal component analysis (PCA). Data coverage starts in 2003, at quarterly frequency.[2] The partitions are (see Table 1):

[1] See Prasad et al. (2019) "Growth at Risk: Concept and Application in the IMF's Surveillance", *IMF working paper WP/19/XX, pp. 1–38.* The model has been fitted using the Growth-at-Risk excel toolkit, developed by R. Lafarguette and C. Wang (2018) at the IMF and available upon request.

[2] Some variables are available only on a shorter times-span. In this case, chain-indexed data are used to reconstitute a time consistent PCA (for more information, about the approach, please refer to Lafarguette 2018, "Technical appendix on the Growth at Risk model", *IMF technical note*).

(i) ***Domestic financial conditions*** capture spreads and volatility of local financial instruments. As financial markets are under-developed, only the most liquid instruments are included. Variables denominated in euro have been excluded, apart from exchange rate volatility, which is supposed to be Albania-driven most of the time.[3]

(ii) ***Domestic leverage*** encompasses variables related with the size and quality of balance sheets. Recent research[4] suggests that aggregate leverage and balance sheet quality are important driver of vulnerabilities, both for advanced economies and emerging markets.

(iii) ***Macroeconomic conditions in main trading partners*** aggregates GDP growth and unemployment in Italy and Greece, which can affect Albania not only through trade, but also through remittances and investor' confidence.

(iv) ***Euro area financial conditions***. The choice of the Italian rate rather than German Bunds is motivated by the fact that the Bund is often perceived as a safe haven for investors in period of crisis, hence delivering a counter-cyclical signal when the situation deteriorates.

(v) ***World financial conditions*** is intended to capture other foreign financial developments not specific to the euro area.

Overall, the partitions match quite accurately the large movements they are expected to cover. For instance, the euro area partition captures correctly the global financial crisis in 2008 and the European crisis of 2011, and domestic leverage correctly measures the large spur in Albania leverage before the crisis, the crisis shock and the deleveraging since then (see the time series of the partitions and their loadings (the weights of each variable in the PCA) are presented in Figure 1.

3. The Growth-at-Risk model fits Albania's growth one-year ahead on these five regressors and an autoregressive term. For a given quantile q in {5%, 10%, 25%, 50%, 75%, 90%, 95%}, the model estimates the following quantile regressions:

$$y_{t+4} = \beta_y^q y_t + \beta_f^q\, fci_t + \beta_l^q\, Lev_t + \beta_{TP}^q\, TP_t + \beta_{EA}^q EA_t^* + \beta_w^q w_t^* + \varepsilon_{t+4}^q$$

With y_t the current annual GDP growth rate, y_{t+4} the growth rate 4-quarter in the future, fci_t current domestic financial conditions, Lev_t current leverage, TP_t current trade partners macroeconomic conditions, EA_t^* current financial conditions in the euro area and w_t^* current world financial conditions. Finally, ε_{t+4}^q is the residual term, quantile dependent, of each quantile regression.

---

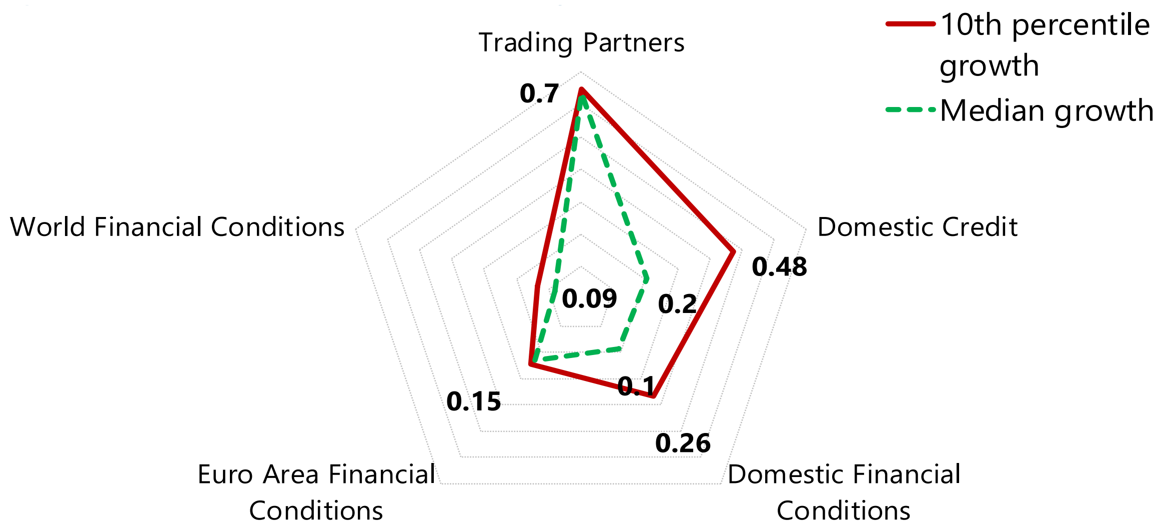
[3] Although the model has a separate partition for euro area financial conditions, this is difficult to distinguish from movements in the domestic price of risk, driven by foreign and "pure" domestic shocks.

[4] See IMF GFSR October 2017 chapter 3.

The results of the quantile regressions are presented in Figure 3, including the confidence interval of each of the coefficients at the 10% significance threshold.[5] The chart below summarizes the coefficients for the 10th and the median quantile regression. Regressors and the dependent variable are normalized in standard deviation terms, ensuring that the coefficients are comparable among each other ("beta-coefficients").

Figure 2. Albania: Spillovers to Albania in Low and Median Growth Environment

(Impact in standard deviation terms, one year ahead)



Sources: Haver Analytics; and IMF staff estimations.
The chart should be read as follows: a one standard deviation shock on current trading partners macroeconomic conditions is correlated with a 0.7 standard deviation lower future growth for Albania, one-year ahead, everything else being equal.

4. The results show that macroeconomic conditions in trading partners have the largest impact on Albania's growth, one-year ahead, both in normal and in bad times. The coefficient related with trading partners' conditions is the same for the median and the 10th percentile of the distribution (linear effect); it should be interpreted as follows: a 1 standard deviation deterioration in main trading partners today lowers median and 10th percentile GDP growth in Albania by 0.7 standard deviation, one-year ahead. In normal times, this coefficient is 6 times larger than the one for euro area financial conditions and 7 times larger than the one for domestic financial conditions.

5. High and poor-quality leverage delivers an amplified shock to growth in bad times. The coefficient associated with the domestic leverage in the 10th percentile quantile regression is large at 0.48 (i.e., a 1-standard deviation increase in leverage lowers the 10th percentile growth one-year

[5] The x-axis stands for each quantile. The label "mean" indicates the coefficients of an OLS regression.

ahead by 0.48 standard deviation). This result is in line with the literature about the amplification mechanism of leverage on output and financial stability.[6]

6. **Based on the quantile fits, the growth at risk model can be used to project the future growth density and also to assess the impact of hypothetical shocks.[7]** The quantile regressions presented above form a non-linear mapping between the regressors at time *t* and the distribution of future growth at time *t+4*.[8] Hence, using the observed values of the regressors for the current year the model estimates the "**no-shock" density forecast** for growth in 2019.[9] Moreover, the model can also provide comparative static analysis by estimating **counterfactual densities** based on shocks affecting the regressors. The exercise presented in the table below shocks individually certain regressors by 2 standard deviations while keeping the other regressors constant (a "ceteris paribus" analysis).[10] It is important to note that although the shock is unique (a 2-standard deviation on one observation for the year 2018), the shock propagates to the forecasted distribution in a non-linear way, as the beta coefficients differ by quantile. To simplify the presentation of the results, the table below presents the impact of these shocks on specific points of the distribution, for instance for the median.[11] **Complementary probabilistic metric assessments** can be obtained in a straightforward way; for instance measuring the impact of the shock on the probability of growth being below 2 percent under the baseline and under the shocked scenario; this can be done by comparing the two relevant cumulative distribution functions.[12]

7. **The results below show the impact of certain shocks (inspired by the Risk Assessment Matrix, Annex III) on future growth, both in normal times (median growth) and in bad times (10th percentile growth).** The largest impacts are related to shocks in the main trading partners, in both good and bad times (see Figure 4), and in leverage, only in bad times. The magnitude of the worst shocks could cost on average 1.8–2 p.p. GDP growth to Albania should they materialize.[13]

---

[6] Cf. GFSR October 2017 Chapter 3.

[7] The methodology to generate counterfactual scenarios is detailed in Prasad et al. (2018), op. cit.

[8] The formal parametric derivation of the density, using a Tskew distribution, is explained in Lafarguette (2018), op. cit.

[9] In the forecasting literature, such forecasts are called conditional density forecasts because the density is conditional to the value of the set of regressors in 2018.

[10] For instance, the model can simulate what would happen to growth if Italian GDP is negatively shocked by 2 standard deviations.

[11] Entire density comparisons are presented in Figure 4.

[12] Choosing 2 percent for Albania is a reasonable threshold as it represents a bad performance for the economy.

[13] Note that the reduced-form model is fitted on past data, without structural identification. Hence, it naturally encompasses an "average" policy reaction function but does not capture responses beyond past practice that could mitigate these very large exogeneous shocks.

Table 1. Albania: Density Quantification of Selected Shocks to Albania GDP Growth

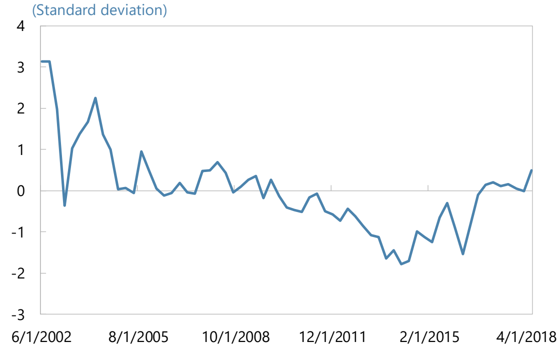
Source of risk	**Relative likelihood compared with the no-shock scenario**	**Simulated shock *(in standard deviations)***	**Estimated impact on the median vs. 10th percentile *(in p.p. real growth)***	**No-shock and counterfactual probability of growth <2%**
Weaker than expected growth in main trading partners	Medium	- 2 stand. dev. in macroeconomic conditions of main trading partners	-1.6 p.p.; -1.7 p.p.	3%; 43%
Sharp tightening of financial conditions in the Euro Area	High	+ 2 stand. dev. in EA FCI composite	-0.9 p.p.; -1 p.p.	3%; 20%
Financial turmoil in key partners country	Medium	+ 2 stand. dev. in key partners bond rates	-1.1 p.p.; -1.8 p.p.	3%; 25%
Increase in leverage	Low	+ 2 stand. dev. in leverage index	-0.4 p.p.; -2 p.p.	3%; 16%

Table 2. Albania: List of Variables Entering each Partition

Domestic Financial Conditions	Domestic Leverage	Main Trading Partners Macro Conditions	Euro Area Financial Conditions	World Financial Conditions
One week repo rate	Credit to GDP	Italy growth rate	Euro Area VIX	VIX
One week repo rate, first difference	Loans to deposits ratio	Italy unemployment rate	10 year Italian sovereign rate	Oil prices
Volatility of the repo rate	NPLs to total loans ratio	Greece growth rate	Euro Area headline inflation	Oil prices, implied volatility
Inflation rate, yearly	Tier 1 capital as percent of risk-weighted assets	Greece unemployment rate	One week Euribor	US Treasuries yield, implied volatility
Deviation from the interest rate corridor	Share of non-resident liabilities			Bonds flows to Central Europe
Volatility of the 2 year sovereign bond				
Exchange rate volatility				

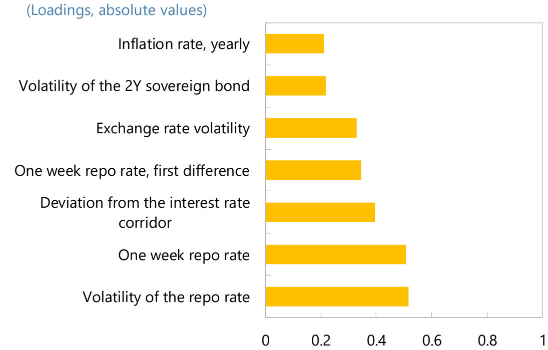
Figure 3. Albania: Partitions and Loadings Using the PCA Approach

Domestic Financial Conditions
(Standard deviation)



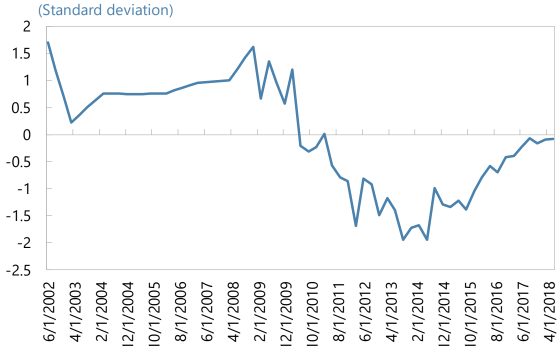
Sources: Haver Analytics; and IMF staff estimations.

Domestic Financial Conditions
(Loadings, absolute values)



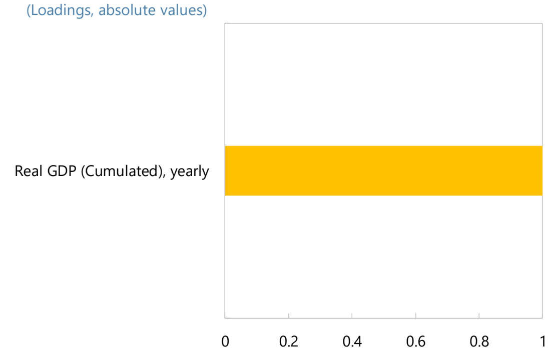
Sources: IMF staff calculations.

Domestic Macro Conditions
(Standard deviation)



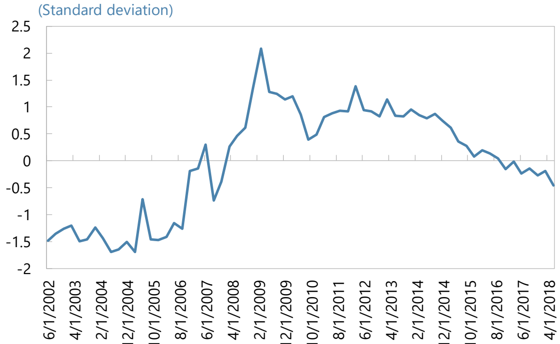
Sources: Haver Analytics; and IMF staff estimations.

Domestic Macro Conditions
(Loadings, absolute values)



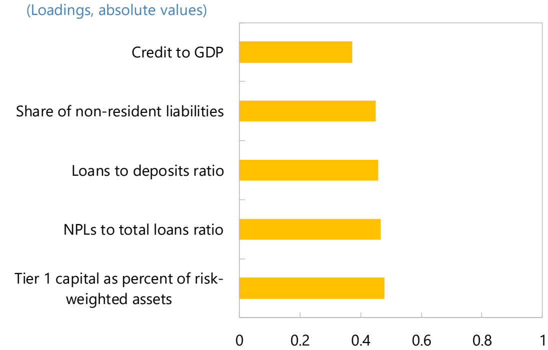
Sources: IMF staff calculations.

Domestic Leverage
(Standard deviation)



Sources: Haver Analytics; and IMF staff estimations.

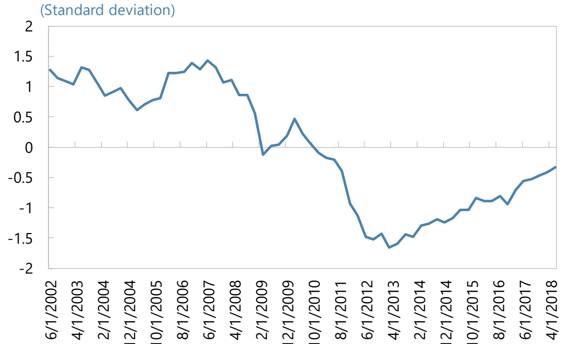
Domestic Leverage
(Loadings, absolute values)



Sources: IMF staff calculations.

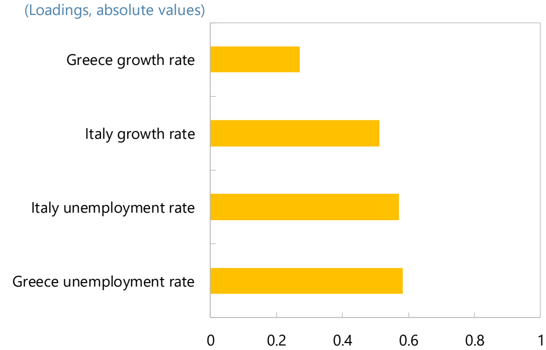
Figure 3. Albania: Partitions and Loadings Using the PCA Approach (concluded)

Main Trading Partners Macro Conditions
(Standard deviation)



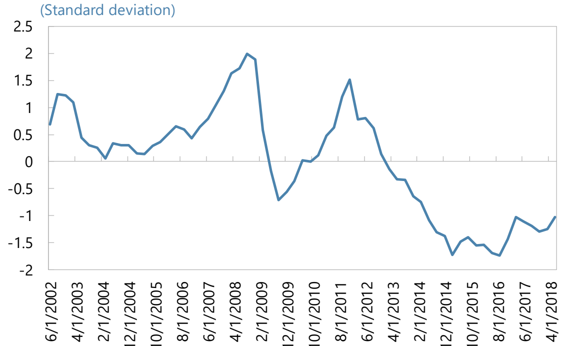
Sources: Haver Analytics; and IMF staff estimations.

Main Trading Partners Macro Conditions
(Loadings, absolute values)



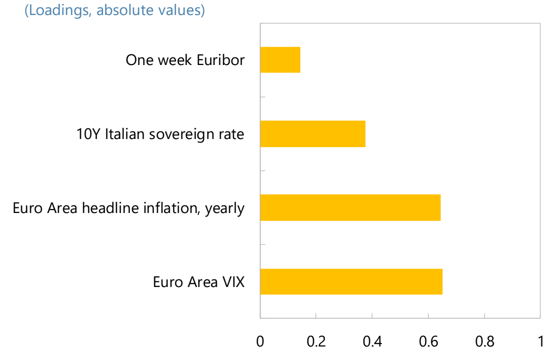
Sources: IMF staff calculations.

Euro Area Financial Conditions
(Standard deviation)



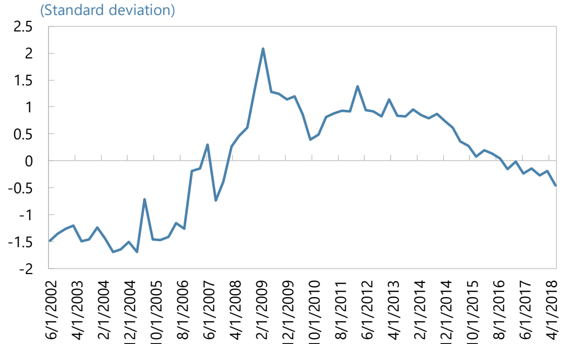
Sources: Haver Analytics; and IMF staff estimations.

Euro Area Financial Conditions
(Loadings, absolute values)



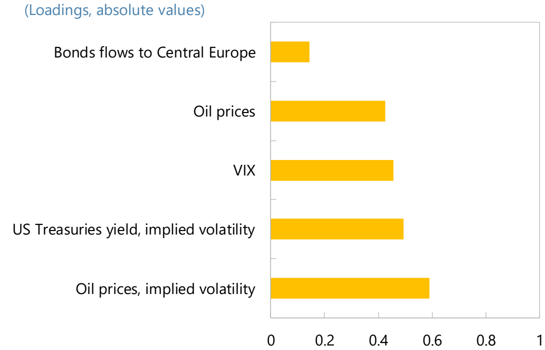
Sources: IMF staff calculations.

World Financial Conditions
(Standard deviation)



Sources: Haver Analytics; and IMF staff estimations.

World Financial Conditions
(Loadings, absolute values)

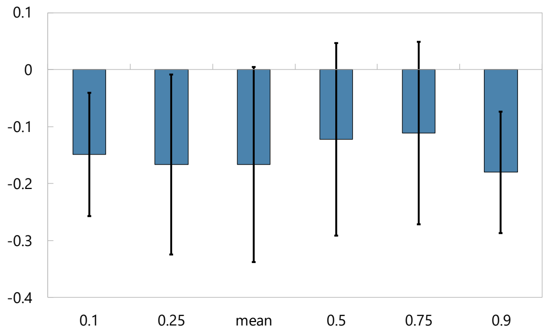


Sources: IMF staff calculations.

Figure 4. Albania: Quantile Regressions Coefficients with Confidence Interval

Domestic Financial Conditions

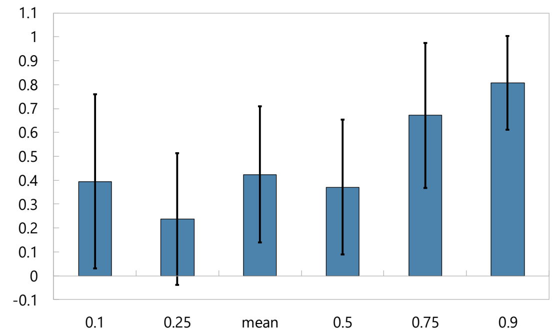
(Quantile regression coefficients; confidence intervals)



Sources: IMF staff calculations.

Domestic Macro Conditions

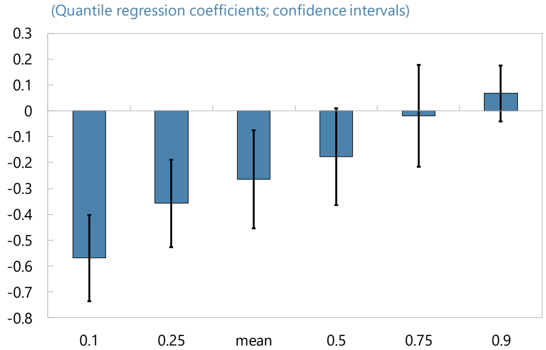
(Quantile regression coefficients; confidence intervals)



Sources: IMF staff calculations.

Domestic Leverage

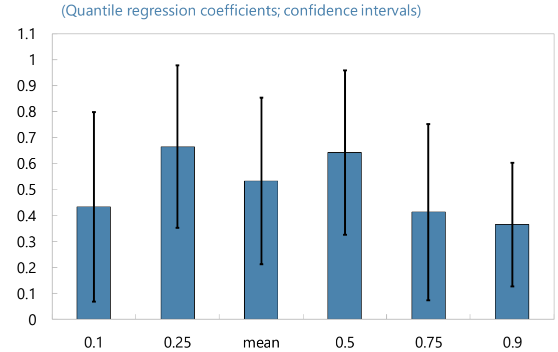
(Quantile regression coefficients; confidence intervals)



Sources: IMF staff calculations.

Main Trading Partners Macro Conditions

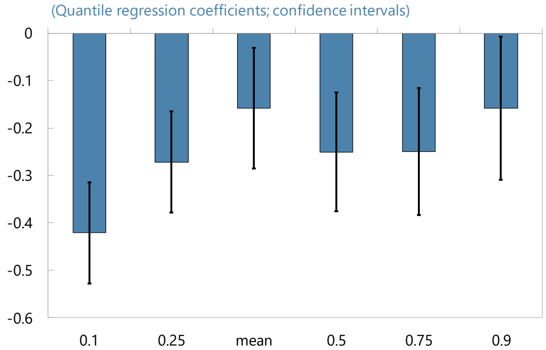
(Quantile regression coefficients; confidence intervals)



Sources: IMF staff calculations.

Euro Area Financial Conditions

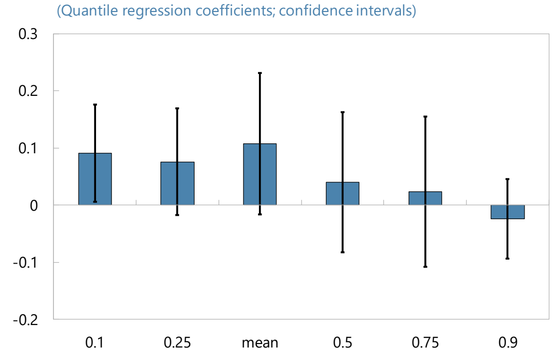
(Quantile regression coefficients; confidence intervals)



Sources: IMF staff calculations.

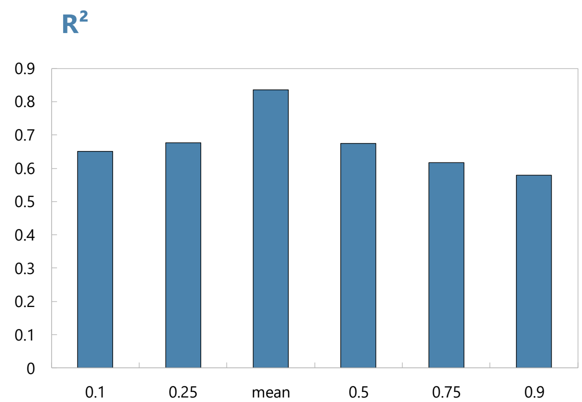
World Financial Conditions

(Quantile regression coefficients; confidence intervals)



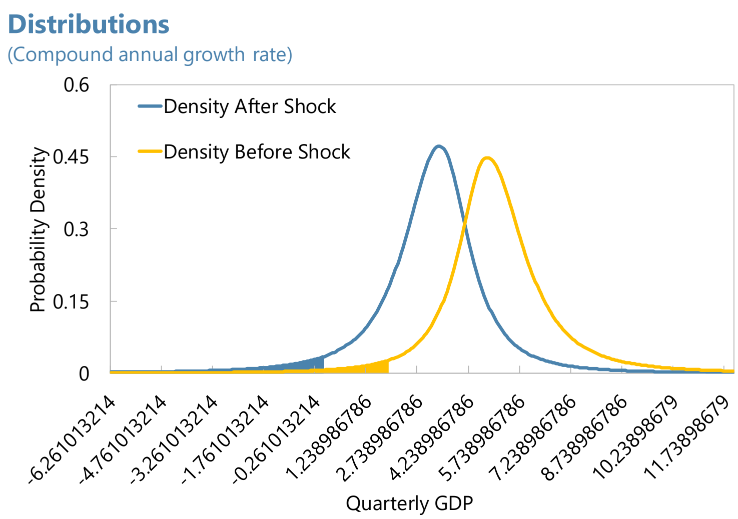
Sources: IMF staff calculations.

Figure 4. Albania: Quantile Regressions Coefficients with Confidence Interval (concluded)



Sources: IMF staff calculations.

Figure 5. Albania: Counterfactual Distribution Under a 2 Standard Deviation Shock on Main Trading Partners Macroeconomic Conditions



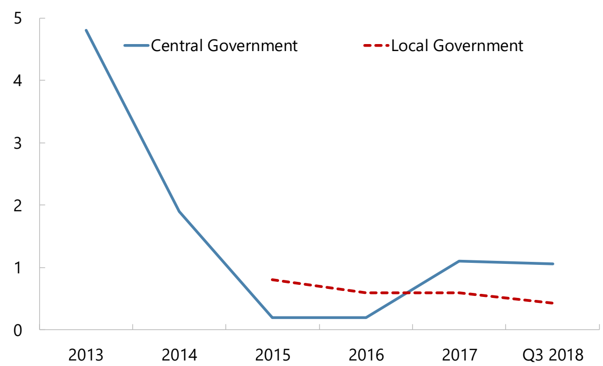
Sources: IMF staff calculations.

Annex V. Arrears—Why They Persist and How to Eliminate Them

1. **Government payment arrears have been a recurring issue in Albania and have not yet been fully addressed.** The stock of arrears was reduced considerably after the early 2000s as Albania's economic growth accelerated. However, in 2013 new arrears at the central government level were uncovered, totaling 4.8 percent of GDP. These arrears aggravated the slowdown of the economy, as a chain of payment delays adversely affected corporate and bank balance sheets. In addition, the authorities' first stocktaking of local government arrears in 2015 revealed an end-2015 stock at of around 0.8 percent of GDP of mostly legacy arrears. Under the Fund-supported program, a 2014 arrears clearance strategy reduced the stock of central government arrears to 0.2 percent of GDP in 2015. After an external auditor conducted a risk-based audit of arrears payments, their clearance started in March 2014, with quarterly publication of the payments made and the stock of outstanding debt by ministry lines. Also, a multi-year commitment control system was rolled out across many, but not all central government entities, as well as funds availability checks prior to procurement. Moreover, the GDT introduced a risk-based approach to VAT refunds and improved its capacity to approve VAT refund claims. However, new government arrears emerged in 2017, and the stock is estimated at 1.5 percent of GDP at end-September 2018.

2. **The composition of arrears has shifted from investment projects to VAT refunds.** About 60 percent of central government arrears at end-2014 had accumulated in the infrastructure and energy sector and close to 70 percent of local government arears in 2015 were also related to investment projects. In 2017, VAT refund arrears represented 67 percent of central government past due financial obligations (compared with 17 percent in 2014). Around 70 percent of total VAT arrears are related to three large taxpayers involved in big investment projects.

Stock of arrears
(Percent of GDP)



Source: Ministry of Finance and Economy.

3. **The recurrence of expenditure arrears underscores the weakness in public financial management.**

- Revenue forecasting. Revenue projections have been persistently overly optimistic. On average, in last 10 years, tax revenues underperformed relative to plan by close to 1.5 percent of GDP. As much of the investment budget for the year is already committed before in-year budget revision are made, arrears may be generated. This was the key reason pre-2014, and despite some improvement, revenues continue to underperform. Furthermore, VAT revenue projections are overly optimistic as they do not take fully into account VAT refunds, contributing to VAT refund arrears—even when VAT refund claims have already been approved.

- Cash forecasting and management. The current treasury plans stipulate monthly expenditure limits and targets, rather than proper cash forecasts. This hinders realistic planning of future inflows and outflows.

- Weaknesses in commitment control, in particular for public investment projects. Despite some progress, multiyear contracts are entered into with inadequate provision in outer years of the medium-term budget. This is particularly the case with the Albanian Road Authority (ARA), the main contributor to expenditure arrears, for which multiyear commitment control has not yet been rolled out.

- Lack of transparency and commitment to address the above problems.

4. Prevention and control of budgetary arrears requires tangible steps:

- Ensuring realistic revenue projections.

- Improving the effectiveness of cash management to ensure that cash is available to meet government's payment obligations. This would imply improving cash forecasting for both revenue and expenditure. Improving coordination between cash and debt management is also needed.

- Paying legitimate tax refunds promptly is important in creating trust in the tax administration and the functioning of the VAT system. It is imperative to recognize that refunds are an integral part of the operation of the VAT system, and not an extraordinary item.

- Further improving transparency in procurement and introducing binding annual and multiyear commitment limits, including in the ARA.

- Strengthening financial oversight of the fiscal risks at central and local government levels. Improve transparency and ensure that stock of arrears is published on a regular basis.

INTERNATIONAL MONETARY FUND

ALBANIA

January 2, 2019

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | European Department

CONTENTS

FUND RELATIONS

(As of November 30, 2018)

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	406.86	292.07
Reserve Tranche Position	26.00	18.67

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	46.45	100.00
Holdings	86.02	185.19

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
Extended Arrangement	293.56	210.74
ECF Arrangements	0.12	0.09

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				
	2018	2019	2020	2021	2022
Principal	1.96	14.40	27.71	44.46	49.24
Charges/Interest		6.59	5.84	4.91	3.91
Total	1.96	20.99	33.55	49.37	53.15

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

[1] Formerly PRGF.

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 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).

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 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 109.69 per U.S. dollar on November 30, 2018.

Article IV Consultation: The 2017 Article IV consultation was concluded on December 4, 2017 (IMF Country Report No. 17/373).

FSAP Participation, 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.

AML/CFT assessment:

Albania has been assessed against the 2012 Financial Action Task Force (FATF) standards during an onsite visit carried out in October 2017 by the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval). The assessment report was adopted by the Moneyval plenary in July 2018 and has been published in December 2018.

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.

Resident Representative: the resident representative position was closed in July 2018, while maintaining the local Fund office in Tirana.

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 December 2018
	Tax Policy	November 2013, March 2014, September 2014, June 2015, September 2016, September 2017; October 2017, June 2018, September 2018,
	Fiscal Transparency Evaluation	June 2015
LEG	Deposit Insurance Law	February 2014
	Tax Law	March 2015, May 2015, June 2018, November-December 2018
	NPL Resolution	April 2015
MCM	IFRS 9 Implementation and capital structure review	May 2013, February 2017 January 2018, November 2018
	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, October 2018
	Banking Supervision and Regulation	July 2015.May 2018
	Long-Term Resident Advisor on Monetary Policy	September 2015-August 2018
	Financial Stability, systemic risk analysis	April 2018, November 2018
	Financial management and accounting policy framework	September 2018

Table 1. Albania—Technical Assistance Since FY2013 (concluded)		
	Monetary Policy Design and Implementation	January 2016, September 2016, December 2016, February 2017, September 2017, September 2018
	Long-Term Resident Advisor on Banking Supervision and Financial Stability	since July 2017
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, April 2018, May 2018, November 2018
	National Accounts Statistics	November 2014, May 2015, April 2017, September 2017, March 2018
	Enhanced General Data Dissemination System	April 2017
	Monetary and Financial Statistics	July 2017

STATISTICAL ISSUES

(As of September 30, 2018)

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 been improving in the last few years and is now generally compliant with the System of National Accounts 2008 and the European System of Accounts 2010. However, there is still room for further improving methodologies and compilation techniques, especially regarding GDP estimates by 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. Data are subject to large revisions and there are significant discrepancies between the aggregated quarterly estimates and the annual national accounts results, due to differences in compilation methods, and between the GDP compilation by the expenditure and by the production approach. In May 2018, INSTAT published the first two non-financial institutional sector accounts for the years 2013–2015. **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. Since December 2015, INSTAT updates annually the CPI weights using the results of a new national Household Budget Survey. The PPI and construction cost 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 fiscal operations in line with the Government Finance Statistics Manual (GFSM)2014, but still does not cover the entire general government (some extrabudgetary units are not covered). Despite recent and ongoing efforts, accounts payable data continue to have some issues, with amounts included in the IMF program not being reconciled to values in the financial accounting records or in the STA GFS database. There has been good progress over the last 3 years, including a 6-year time series of comprehensive GFS data and a full balance sheet. Consistency across fiscal surveillance, GFS Yearbook, and other macroeconomic reporting is being improved.
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 and International Investment Position (IIP) data are compiled by the BoA with a time lag of less than 90 days and are methodologically sound. The adoption of recommendations from IMF technical assistance missions has improved the measurement of compensation of employees and remittances, facilitated compilation of quarterly IIP, currency composition data on debt assets and liabilities, and the Reserves Data Template. Albania also participates in the IMF's Coordinated Portfolio Investment Survey (CPIS) and Coordinated Direct Investment Survey (CDIS). Challenges remain in the measurement of remittances, some financial account transactions outside the banking system, and foreign assistance (data on grants from abroad not channeled through the central government are fragmented and require consolidation). 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 external debt database ensures timely and accurate reporting of external public debt (including commitments of state-owned enterprises).

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

Table 1. Albania: Table of Common Indicators Required for Surveillance
(As of November 30, 2018)

	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	12/19/18	12/19/18	D	D	D		
International Reserve Assets and Liabilities of the Monetary Authorities[1]	12/14/18	12/17/18	D	W	M		
Reserve/Base Money	12/14/18	12/17/18	D	D	D		
Broad Money	12/14/18	12/17/18	D	D	D	O, O, O, LO	O, LO, LO, O, O
Central Bank Balance Sheet	11/30/18	12/14/18	M	M	M		
Consolidated Balance Sheet of the Banking System	11/30/18	12/14/18	M	M	M		
Interest Rates[2]	12/14/18	12/17/18	D	D	D		
Consumer Price Index	11/18	12/8/18	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3] – General Government[4]	9/2018	10/30/18	M	M	M	LO, O, O, O	LO, O, O, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3] – Central Government	9/2018	10/30/18	M	M	M		

Table 1. Albania: Table of Common Indicators Required for Surveillance (concluded)
(As of November 30, 2018)

	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]	9/2018	10/31/18	Q	Q	Q		
External Current Account Balance	2018:Q3	12/12/18	Q	Q	Q	O, O, O, LO	LNO, O, LO, LO, O
Exports and Imports of Goods and Services	11/18	12/10/18	M	M	M		
GDP/GNP	2018:Q2	9/29/18	Q	Q	Q	O, LNO, O, LO	LNO, O, LNO, LO, LO
Gross External Debt	2018:Q3	12/10/18	Q	Q	Q		
International Investment position[6]	Q2 2018	9/10/18	Q	Q	Q		

[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.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL ORGANIZATIONS

As of November 30, 2018, Albania collaborates with the World Bank Group, the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the Council of Europe Development Bank. Further information can be obtained from the following hyperlinks.

https://www.worldbank.org/en/country/albania

https://www.ebrd.com/cs/Satellite?c=Page&cid=1395236446640&d=Mobile&pagename=EBRD%2FPage%2FCountry

http://www.eib.org/en/projects/regions/enlargement/the-western-balkans/albania/index.htm

https://coebank.org/en/about/member-countries/albania/

Statement by the Staff Representative on Albania
January 23, 2019

This statement provides information that has become available since the issuance of the staff report. The information does not alter the thrust of the staff appraisal.

National accounts data for the third quarter of 2018 show real (yoy) GDP growth of 4.5 percent, somewhat higher than was embedded in the 4 percent growth estimate for 2018 in the staff report. This mostly reflected strong electricity production. Staff has revised its growth estimate for 2018 to 4.2 percent, while the projections for 2019 and beyond remain broadly unchanged. CPI inflation amounted to 1.8 percent (yoy) in December 2018, 0.2 percentage points lower than expected. The staff's medium-term inflation projections remain similar to those presented in the staff report.

The authorities have communicated preliminary data indicating that the fiscal deficit in 2018 was smaller than reported in the staff report by 0.4 percentage points of GDP. The lower deficit reflects lower-than-expected spending in December, in particular on investment. Staff's preliminary assessment is that, guided by the approved budget for 2019, the fiscal path will remain broadly in line with the staff report. Preliminary debt data show end-2018 public debt (excluding arrears) at 67.2 percent of GDP, 1.7 percentage points lower than expected in the staff report, owing to the lower deficit as well a more appreciated exchange rate. These one-off effects are expected to be permanent, thus lowering the projected debt levels over the medium term.

On January 16, parliament confirmed the replacement of seven ministers in Prime Minister Rama's cabinet, including the Minister of Finance and Economy. On December 28, the Prime Minister announced the replacement of eight ministers, one of which remains to be finalized.

Statement by Domenico Fanizza, Executive Director for Albania
and Paolo DiLorenzo, Advisor to the Executive Director
January 23, 2019

On behalf of our Albanian authorities, we thank staff for the constructive engagement in the context of the Article IV mission and for the excellent paper. The authorities welcome staff's acknowledgement of Albania's strong economic performance and agree on the need to combine fiscal consolidation with monetary accommodation, while strengthening the economic fundamentals and updating the policy frameworks. The uncertain external environment poses downside risks that leave little scope for complacency. This calls for cementing fiscal and financial stability and stepping up efforts to make growth more inclusive and enhance productivity.

Recent Economic Developments and Outlook

The Albanian economy is reaping the benefits from past and ongoing economic reforms. A sound macro-policy mix and continued structural reforms have sustained a steady growth performance, in the context of a, so far, favorable external environment. Official data show that the pace of economic growth accelerated to 4.5 percent in the third quarter of 2018, led by growth in industry, energy, construction, and services. This broad-based performance is underpinned by a favorable financial environment, robust business confidence, strong FDI inflows, and continued export growth. The economic expansion has made a dent on unemployment rate, now at a historical low. The external position has strengthened, with a narrowing current account deficit, rising external reserves and a declining external debt in percentage of GDP. The appreciation of the exchange rate experienced during the summer, on account of continued structural improvement and temporary foreign exchange inflows, does not seem to have hurt exports, but fueled additional headwinds against the BoA inflation target of 3 percent. In response, the BoA decided to further cut its policy rate as well as to intervene temporarily and transparently in the FX market, in order to avoid disorderly market conditions and to re-establish two-sided movements in the exchange rate. Such interventions have been consistent with its inflation targeting framework and, of course, with its commitment to a fully floating exchange rate.

A Fiscal Strategy Based on Gradual, but Steady, Fiscal Consolidation.

The fiscal position has strengthened. Fiscal operations have delivered a primary surplus for the third year in a row in 2018. Despite excises and customs-revenue losses from the exchange rate appreciation, the overall deficit as a ratio of GDP is set to record the lowest level ever, with an expected over performance of 0.4 percent of GDP (comparing with the target), placing the public debt-to-GDP ratio on a firm downward path. Financial markets have fully appreciated the progress in fiscal consolidation. The risk premia have dropped: Albania recently issued a 500 million EUR 7-year Eurobond at 3.5 percent interest rate, 2.2 points below the 5-year issuance in 2015. A partial buyback of the 2015 Eurobond has improved the debt profile. The authorities' debt strategy will aim at diversifying the investors' base, limiting the foreign-denominated borrowing, and further extending the average maturity.

The 2019 budget continues the path of fiscal consolidation, but also aims at improving the quality of spending. The budget prudently targets a deficit of 1.9 percent of GDP, the lowest targeted level in the last two decades, mainly through new taxes measures, further improvements in tax-administration and contained total expenditures, while accommodating a relatively high level of capital expenditures. The risk-based approach to tax controls is producing results, for instance, in raising collection from the buoyant tourism sector. E-invoicing and the new system for data integration are bound to further enhance tax compliance. Our authorities agree with staff that designing a simple, efficient and fair tax system is paramount. They intend to prepare a medium-term revenue strategy with the technical assistance from the Fund. The budget keeps capital spending at 5 percent of GDP, implying a significant increase in real terms, in order to narrow the infrastructure gap and facilitate interconnectivity. Moreover, the budget allocates more resources to education as requested by the students.

The authorities are taking steps to safeguard the integrity of the PPP process and to increase the efficiency of investment spending. To contain risks from PPP projects, the payments for PPP-related projects will be maintained well below the limit of 5 percent of tax revenues. The Parliament is examining a new law reforming all the aspects for the governance of PPP. A recently launched centralized database enables the Ministry of Finance to improve its decision-making process and all the steps of the public investment management.

The authorities acknowledge that government arrears hurt economic activity and need to be quickly addressed. The central government has already started to clear the arrears on the projects and remain committed to avoid new arrear accumulation. The largest chunk of arrears reflects delayed VAT refunds to three large energy projects. The tax administration has announced that these refunds will be paid by the first quarter of 2020, while the already operational reverse-charge mechanism will help to prevent their reoccurrence. Moreover, the ongoing review of the PFM, aligned with PEFA recommendations, should help in this direction. To raise awareness of possible fiscal risks, the budget for 2019 has introduced, for the first time, a statement on their extent. As recognized in the PEFA, extensive efforts to implement PFM reforms have been done, but capacity constraints remain a challenge.

Monetary and Financial Policies Focus on Achieving the Inflation Target and Preserving Macro-Financial Stability.

Our authorities intend to maintain an accommodative monetary policy stance, in line with staff advice. The BoA lowered the policy rate to 1 percent in June 2018, through a 25 basis points cut. The central bank is providing adequate guidance to markets about the expected path of normalization of its monetary stance, which should remain data-dependent and ready to respond to shocks flexibly. The BoA believes its expansionary monetary stance is affecting the economy. Low interest rates are supporting the expansion of credit. Net of the effects of exchange rate and the loans write-off, the private credit sector grew by 4.9 percent in the third quarter. However, the level of the credit of the economy is still below its potential. The central bank acknowledges impediments to the transmission mechanism coming from high financial and real sector euroization as well as low risk appetite among commercial banks, especially the EU ones. The new higher reserve requirements for foreign currency deposits together with the new strict requirements for transparency on unhedged foreign currency lending should help strengthen the monetary-policy transmission.

The authorities also agree with staff that the overall financial system remains sound, but that ongoing changes require a careful monitoring. Over the last years, banks' balance sheets have strengthened. The NPLs decreased to 12.7 percent of the total loans in November 2018, from a peak level of close to 25 percent in 2014. NPL ratios below 10 percent are already recorded in most of the banks. The BoA has carefully monitored the process of restructuring and consolidation in the banking sector, while devoting large resources to supervision to keep the financial sector safe and stable. The harmonization of regulation with best international practices has progressed, with the establishment of a fund for bank resolution. Moreover, the BoA signed two Memoranda of Cooperation on banking supervision and resolution with the European Central Bank and the Single Resolution Board, to facilitate the exchange of information and coordinate actions. As regard the AML/CFT deficiencies recently identified by Moneyval evaluation report, all the relevant stakeholders are implementing an action plan that follows up on the recommended priority actions; furthermore, implementation of the EU framework is ongoing.

Maintaining Momentum in Structural Reforms.

The expected opening of EU membership negotiations provides a focal point to continue with the implementation of the structural reforms agenda. The ongoing efforts to address governance weaknesses should pave the way for the opening of the negotiations for the EU accession. The comprehensive judicial system reform is in full swing with more than 100 judges already vetted. At the same time, the new institutions that will guarantee the independent self-governing of the judiciary have been established. These achievements follow months of hard work and challenges to implement a unique reform aimed at overhauling the previous system, guaranteeing full independence to judges and prosecutors, consolidating the rule of law, and improving access to justice. The fight against corruption is also being strengthened by the establishment of a special structure in charge of investigating and fighting organized crime and acts of corruption.

Significant strides have been made in reforming and modernizing the energy sector, a government's top priority. The five-year financial recovery plan prepared with the World Bank envisions the clearance of inter-enterprise arrears, a further reduction of distribution losses, and a better targeting of investments, while the authorities are working on measures to diversify energy sources toward gas and renewable resources. To make growth more inclusive, the government intends to reform health care and social programs. The aim is to better target the beneficiaries, and to balance social and financial sustainability. Finally, it is worth noting that Albania has been ramping up in the Doing Business ranking, moving from the position no. 120 in 2007 to no. 63 in 2018, narrowing the gap with the average of the region.