



ALBANIA

November 2020

FIRST POST-PROGRAM MONITORING—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ALBANIA

In the context of the First Post-Program Monitoring, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 23, 2020, following discussions that ended on September 28, 2020, with the officials of Albania on economic developments and policies underpinning the IMF arrangement under the Post-Program Monitoring. Based on information available at the time of these discussions, the staff report was completed on November 6, 2020.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Albania.

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IMF Executive Board Concludes 2020 First Post-Program Monitoring with Albania

FOR IMMEDIATE RELEASE

WASHINGTON, DC – November 30, 2020: The Executive Board of the International Monetary Fund (IMF) concluded the First Post-Program Monitoring review¹ with Albania on November 23. Albania has benefited from the IMF emergency financial assistance (around US\$190.5 million) disbursed under the Rapid Financing Instrument in April 2020, which allowed Albania to meet urgent balance of payments needs stemming from the aftermath of the November 2019 earthquake and the outbreak of the COVID-19 pandemic. Albania's capacity to repay the Fund is adequate, but risks have risen in light of the shocks.

Albania continues to be severely affected by the aftermath of the earthquake and the pandemic. The authorities responded promptly to the shocks, and macroeconomic and financial stability have so far been maintained. The economy is expected to contract by 7½ percent in 2020 and rebound gradually in 2021-22 as the shocks subside and reconstruction spending picks up. Inflation is expected to remain subdued before converging to the 3 percent target over the medium term. The current account deficit is projected to widen to more than 10 percent of GDP in 2020, but international reserves are likely to increase slightly, remaining at a comfortable level.

The outlook is subject to major uncertainty with risks to the downside. Downside risks are increasing as new infections have been rising considerably in Albania and many other European countries in the fall. A more severe pandemic would further dampen Albania's economic outlook, through weaker tourism, remittances, external demand, and FDI, as well as tighter financial conditions. Large depreciation pressures could entail balance sheet risks given unhedged foreign currency loans, although the sizeable reserve coverage would be a mitigating factor. Albania's elevated public debt, large rollover needs, growing fiscal risks, and a relatively high level of non-performing loans (NPLs) also present challenges.

¹ Post-Program Monitoring (PPM) is a regular surveillance tool for countries with IMF credit outstanding above 200 percent of quota. A staff team collects economic and financial information and discusses with officials the country's vulnerabilities and risks to the repayment capacity to the IMF. Then, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment²

Executive Directors commended the Albanian authorities for maintaining macroeconomic and financial stability thus far, and welcomed their responses to support lives and livelihoods in response to the November 2019 earthquake and the COVID-19 pandemic. Albania's capacity to repay the Fund is adequate, with a sizeable reserve cover and flexible exchange rate as important shock absorbers. However, risks have risen stemming from the pandemic, elevated fiscal deficits and public debt, weaknesses in management of public finances, and a relatively high level of non-performing loans (NPLs) and euroization. Moreover, considerable uncertainty and downside risks surround the projected recovery for 2021-22. In this context, Directors emphasized the importance of contingency planning and recommended that the authorities stand ready to take further measures to preserve macroeconomic and financial stability.

Directors stressed that support for the economy needs to continue in 2021, but should be temporary and targeted, subject to transparency and accountability. They urged the authorities to regularize as soon as possible extraordinary measures in public financial management (PFM) taken during the emergency and to subject reconstruction funds to adequate PFM controls. Directors recommended that the cyclical boost to revenues be used to achieve a larger deficit reduction in 2021 than is consistent with the budget and to build a buffer for contingencies. Directors welcomed recent amendment to the fiscal rules.

Addressing structural weaknesses in public finances can better support investment in human and physical capital. A sound medium-term revenue strategy should be adopted and implemented without further delay. Frequent, ad hoc changes to tax policy and tax amnesty schemes should be avoided. Directors also stressed the need to strengthen PFM, and manage increasing fiscal risks, including from public-private partnerships and recent government guarantees. They underlined the need to prevent new arrears and continued efforts to strengthen the AML/CFT framework.

Directors underscored the need to safeguard financial stability while supporting borrowers hit by the shocks. They recommended that supervisors closely monitor and carefully manage risks, including by guiding banks' restructuring of credit portfolios. Directors supported retaining restrictions on dividend distributions to safeguard banks' capital positions. They encouraged the authorities to further improve the NPL resolution framework and align the regulatory framework with international standards.

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>.

Albania: Selected Economic Indicators, 2016–21

	2016	2017	2018	2019	2020	2020 RFI	2021 Proj.	2021 RFI
	(Percent change)							
Real sector								
Real GDP	3.3	3.8	4.1	2.2	-7.5	-5.0	5.4	8.0
Domestic demand contribution	3.1	3.6	3.9	1.6	-5.8	-0.9	4.0	5.2
Consumption	2.0	2.3	2.4	2.8	-5.0	0.0	2.3	1.2
Investment (Incl. inventories and stat. disc)	1.1	1.3	1.4	-1.2	-0.9	-0.9	1.8	4.0
External demand contribution	0.2	0.2	0.2	0.7	-1.6	-4.1	1.3	2.8
Consumer Price Index (eop)	2.2	1.8	1.8	1.1	1.0	2.6	2.2	2.9
Consumer Price Index (avg.)	1.3	2.0	2.0	1.4	1.4	2.4	1.6	2.8
GDP deflator	-0.6	1.5	1.4	0.4	1.2	2.6	1.5	2.7
	(Percent of GDP)							
Saving-investment balance								
Foreign savings	7.6	7.5	6.8	8.0	10.6	11.2	8.3	8.1
National savings	16.8	17.1	17.1	14.5	12.1	10.6	14.8	15.4
Public	1.5	2.4	3.0	2.0	-3.6	-3.1	-2.1	-0.1
Private	15.3	14.7	14.2	12.6	15.7	13.8	17.0	15.5
Investment (incl. Inventories and stat. disc.)	24.4	24.6	23.9	22.5	22.7	21.9	23.1	23.5
Public	5.1	5.5	5.6	5.3	6.3	5.6	7.6	5.9
Private	19.3	19.1	18.3	17.2	16.4	16.2	15.5	17.5
Fiscal sector								
Total revenue and grants	27.6	27.8	27.5	27.4	25.3	26.3	26.9	26.9
Tax revenue	25.1	25.7	25.6	25.4	23.2	23.2	24.7	23.9
Total expenditure	29.6	29.7	28.8	29.4	32.1	31.7	33.0	29.9
Primary	27.2	27.7	26.6	27.3	30.0	29.6	30.8	28.3
Interest	2.5	2.1	2.2	2.1	2.1	2.1	2.1	1.6
Overall balance 1/	-2.0	-2.0	-1.3	-2.0	-6.8	-5.4	-6.1	-3.1
Primary balance	0.5	0.1	0.9	0.1	-4.7	-3.3	-4.0	-1.4
Financing	2.0	2.0	1.3	2.0	6.8	-0.4	6.1	3.1
Of which: Domestic	0.7	-0.5	-1.5	2.5	1.5	2.1	5.3	0.4
Of which: Foreign	1.3	1.9	2.9	-0.5	5.3	-2.5	0.8	2.7
General Government Debt 2/	73.3	71.9	69.5	67.8	81.9	75.6	81.5	70.7
Domestic	39.1	39.0	37.3	37.2	42.2	43.0	41.7	40.5
External	34.3	32.9	32.2	30.7	39.8	32.6	39.8	30.2
	(Percent change)							
Monetary indicators								
Broad money growth	3.9	0.3	-0.2	4.3	6.2	-2.6	3.8	10.9
Private credit growth	0.4	-0.8	-0.9	6.1	4.9	-2.5	1.8	11.4
Velocity (nominal GDP/ broad money)	1.2	1.2	1.3	1.3	1.1	1.3	1.2	1.3
	(Percent of GDP, unless indicated otherwise)							
External sector								
Trade balance (goods and services)	-16.8	-15.1	-13.7	-13.8	-15.5	-17.2	-14.1	-14.0
Current account balance	-7.6	-7.5	-6.8	-8.0	-10.6	-11.2	-8.3	-8.1
Gross international reserves (billions of Euros)	2.9	3.0	3.4	3.4	3.5	2.9	3.2	3.3
(In months of imports of goods and services)	6.5	6.2	6.6	8.8	7.8	5.3	6.4	5.5
(Relative to external debt service)	1.6	1.5	1.5	1.5	1.4	1.2	1.4	1.5
(In percent of broad money)	31.5	31.4	33.2	31.0	31.7	30.1	29.6	29.0
Memorandum items								
Real GDP (growth per capita)	3.5	3.9	4.3	2.1	-7.3	-4.9	5.6	8.2

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

1/ The fiscal balance includes guarantees for new loans to the energy sector through 2019, and potential calls of COVID-19 related guarantees from 2021. The 2021 budget was adopted by the parliament after finalization of the staff report and is expected to result in a slightly lower fiscal balance of -6.3 percent of GDP.

2/ The stock of general government debt includes arrears from central and local government.



ALBANIA

FIRST POST-PROGRAM MONITORING DISCUSSIONS

EXECUTIVE SUMMARY

Albania continues to be severely affected by the aftermath of the November 2019 earthquake and the COVID-19 pandemic. The authorities responded promptly to the shocks, and macroeconomic and financial stability have so far been maintained. The economy is expected to contract sharply in 2020, followed by a gradual recovery in 2021-22. The outlook is subject to major uncertainty and rising downside risks as a second wave is gripping many countries in Europe. Albania's capacity to repay the Fund is adequate, but risks have risen in light of the shocks. Aside from a more severe pandemic, key risks stem from elevated public deficits and debt, weaknesses in public finances, and a relatively high level of non-performing loans (NPLs) and euroization.

Policies. Managing risks amid large uncertainty will require continued support for the economy, gradually rebuilding room for policy maneuver as the recovery becomes entrenched, and close supervision of the financial sector.

- Support for people and firms hurt by the shocks is warranted, but should be temporary and targeted, subject to transparency and accountability. With the projected recovery in 2021, the authorities should aim to achieve a larger deficit reduction than is consistent with their budget and, given growing downside risks, maintain a sizeable liquidity buffer for contingencies. They need to make room for supporting essential activities and protecting the most vulnerable, including by containing non-priority spending and improving spending efficiency. There is also an urgent need to strengthen public investment management and contain and manage increasing fiscal risks.
- The preparation of a Medium-Term Revenue Strategy (MTRS) offers a welcome opportunity to comprehensively review and redesign the tax system and should proceed without further delays. Frequent and ad hoc changes to the tax policy should be avoided. As the effects of the shocks subside, it will be critical to take some modest revenue measures in 2021 and build on them substantially over time to recreate room for fiscal policy maneuver.
- Strong efforts are warranted to safeguard financial stability while supporting borrowers hit by the shocks.
- The authorities should prepare contingency measures in case of a more severe pandemic.

Approved By
**Jörg Decressin and
 Martin Sommer (SPR)**

Discussions were held remotely from Washington DC during September 17-28, 2020. The team comprised Y. Sun (head), A. Khachatryan, M. Pinat, P. Kopyrski (all EUR), D. Milkov (SPR), B. Zhao (SEC), L. Spahia and A. Edwards (both local economists), and S. Eble (regional resident representative). R. Kadeli (local office manager) assisted the mission. A. Madaraszova assisted in the preparation of the report at Headquarters. Mr. Fanizza and Mr. Persico (OED) attended part of the meetings. The mission met remotely with Prime Minister Rama, Minister of Finance and Economy Denaj, Bank of Albania Governor Sejko, senior officials, parliamentarians and other representatives of political parties, development partners, and representatives of businesses and financial institutions.

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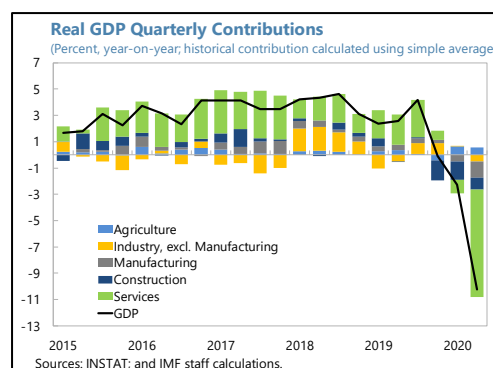
CONTEXT

1. **Before the November 2019 earthquake and the COVID-19 pandemic, Albania's macroeconomic performance was broadly positive although structural and institutional weaknesses persist.** Growth averaged 3.7 percent during 2016-18, and public debt came down to 67.8 percent of GDP in 2019. However, weaknesses in economic governance and institutions have amplified vulnerabilities and impeded broad and sustained improvements in living standards. The recent shocks have put a strain on public finances and balance of payments. The Fund's RFI disbursement in April provided timely relief to Albania and helped mobilize assistance from other IFIs. Progress towards EU integration requires completion of important reforms, including electoral, judicial, and rule of law reforms. Reform momentum has slowed as the country prepares for general elections slated for April 2021.

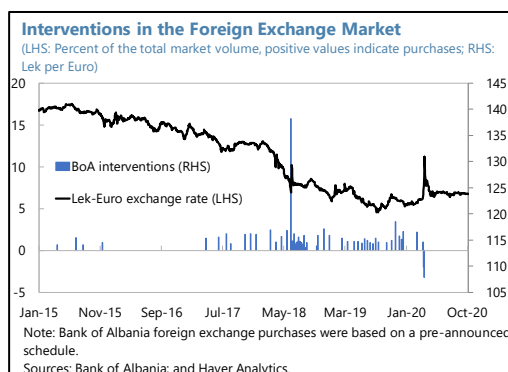
RECENT DEVELOPMENTS AND OUTLOOK

2. **Albania has been hit hard by the earthquake and the pandemic.**

- The economic contraction started in 2019Q4 and reached 10.2 percent (y-o-y) in 2020Q2, first reflecting the impact of the earthquake and then the lockdown during March-May. Arrivals from EU countries dropped sharply, although domestic and regional tourists from non-EU countries have helped cushion somewhat the impact on the tourism sector. Inflation picked up in March reflecting a spike in food prices but has declined to 1.5 percent in September.



- The current account deficit widened in the first half of 2020, reflecting lower tourism receipts, exports of goods, and remittances. But foreign reserves have increased so far thanks to the RFI disbursement and a Eurobond issuance of €650 million. The exchange rate has remained broadly stable, except for an episode of depreciation in late March that was quickly reversed following intervention by the Bank of Albania (BOA).

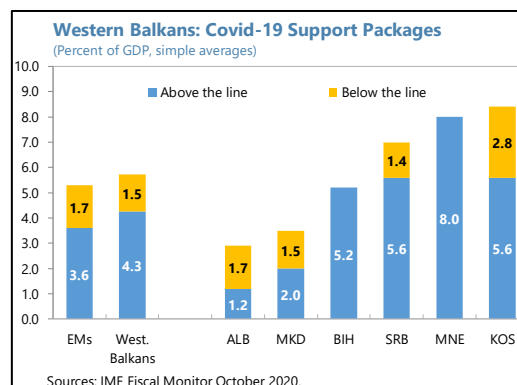


- Fiscal revenue has come under pressure, reflecting the impact of the economic contraction and measures to reduce and defer taxes. Tax revenue during January-September is down by 10.6 percent (y-o-y), with profit and income taxes being severely affected (29 percent decline

y-o-y). Total expenditures are up by 5.5 percent (y-o-y) but are under-executed compared to the budget. The under-execution is particularly notable for earthquake reconstruction, with spending as of September reaching only about 8 percent of the budgeted annual amount.

3. The authorities responded promptly to the shocks (Annex I). The original 2020 budget included earthquake reconstruction of 1.2 percent of GDP, which was later increased.

Strict lockdown measures were imposed in early March as soon as the first two COVID-19 cases were identified and were largely removed in June. With new cases rising considerably in the fall (Box 1), the authorities tightened restrictions, including mandatory use of masks outdoors. The authorities have made three budget revisions so far. The first two focused on increasing health spending and supporting businesses and households, while the third one on scaling up reconstruction and investment. Given the high public debt, Albania's COVID-19 support packages are smaller than the average of those in emerging markets and the Western Balkans. The BOA appropriately relaxed its policy stance, increased liquidity provision, and introduced relief measures to support banks and their borrowers.



4. Staff's baseline projects the economy to recover slowly from the second half of 2020 and strengthen gradually over 2021-22. The economy is expected to contract by 7½ percent in 2020 and rebound gradually in 2021-22 as the shocks subside and reconstruction spending picks up. Inflation is expected to remain subdued before converging to the 3 percent target over the medium term. The current account deficit is projected to widen to 10.6 percent of GDP in 2020, but international reserves are likely to increase slightly, reaching €3.5 billion or 165 percent of ARA metric at end-2020.

5. The outlook is subject to major uncertainty with risks to the downside (Annex II). Downside risks are increasing as new infections have been rising considerably in Albania and many other European countries in the fall. A more severe pandemic would further dampen Albania's economic outlook, through weaker tourism, remittances, external demand, and FDI, as well as tighter financial conditions. Higher financing needs are expected in such a scenario (Annex III). Large depreciation pressures could entail balance sheet risks given unhedged FX loans, although the sizeable reserve coverage would be a mitigating factor. Albania's elevated public debt, large gross financing needs (GFNs), growing fiscal risks, and relatively high NPLs also present challenges.

Authorities' Views

6. The authorities broadly share staff's views on the outlook and risks. The Ministry of Finance and Economy (MOFE) expects a smaller GDP contraction of 6.1 percent in 2020. The BOA projects inflation to return to its 3 percent target in 2022. The authorities reaffirmed their

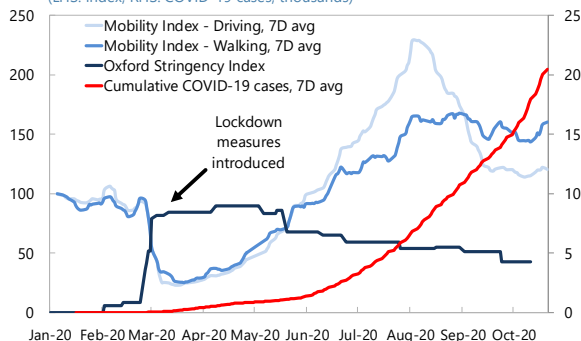
commitment to maintaining macroeconomic and financial stability despite the challenges presented by the two large shocks.

Box 1. COVID-19 Pandemic

Quick introduction of lockdown measures in March were effective in limiting the number of COVID-19 cases.

Lockdown Stringency & Mobility

(LHS: Index; RHS: COVID-19 cases, thousands)

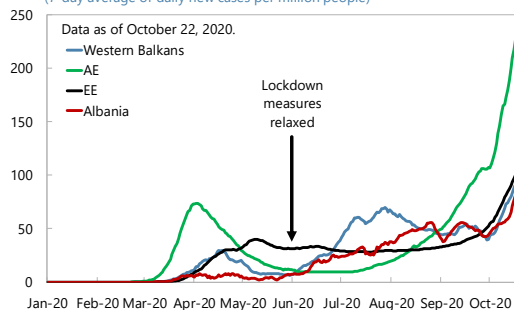


Sources: Blavatnik School of Government, University of Oxford; and Haver Analytics.

New cases have been on the rise since lockdown measures were lifted in June and accelerating since October.

COVID-19 Infection Rates

(7-day average of daily new cases per million people)

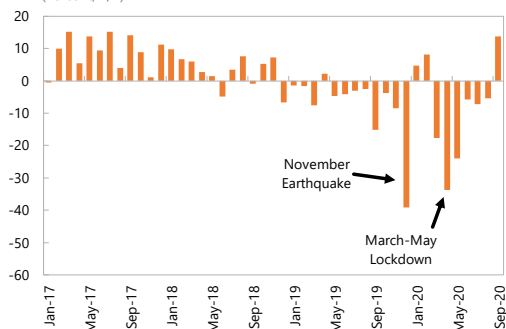


Source: World Health Organization.

Decline in consumption has reduced VAT revenues.

VAT Revenues, Net

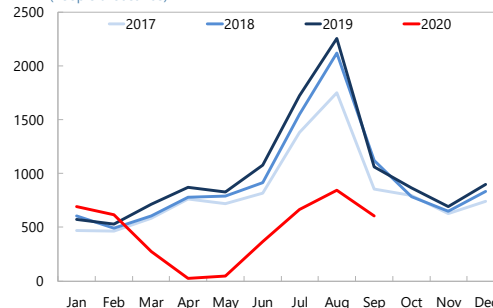
(Percent, Y/Y)



Number of arrivals dropped by 57 percent (y-o-y) during January-September.

Total Arrivals

(People thousands)

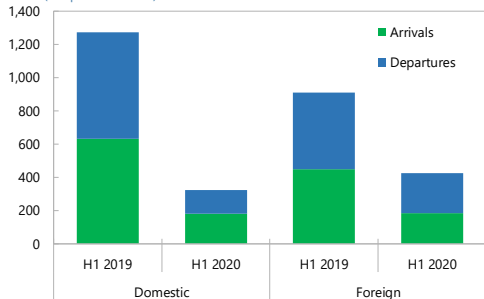


Source: INSTAT.

Traveling restrictions limited drastically movements of residents and non-residents in 2020H1...

Movement of Residents and Non-residents in Albania

(People thousands)

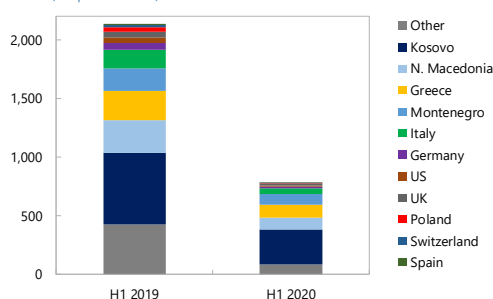


Source: INSTAT.

... and changed the composition of foreign travelers to Albania.

Tourist Arrivals, by Origin

(People thousand)

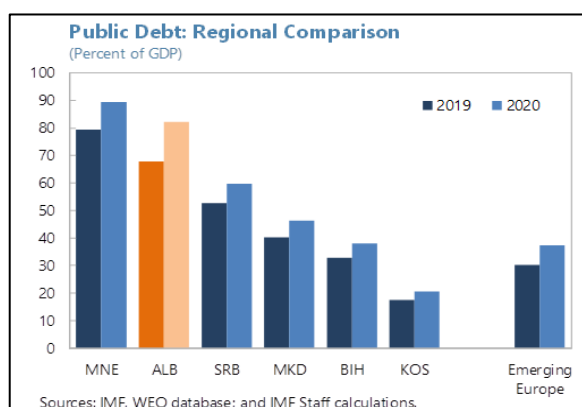


Sources: INSTAT; and IMF Staff calculations.

CAPACITY TO REPAY

7. Albania's capacity to repay is adequate under the baseline. Following the RFI, Fund credit outstanding is estimated at 279.2 percent of quota at end-2020, equivalent to 3.6 percent of GDP or 13.2 percent of gross international reserves. Debt service to the Fund is projected to peak in 2024 at 0.9 percent of GDP and 3.3 percent of reserves, well within Albania's capacity to repay.

8. The main vulnerabilities are in public finances. Albania's public debt is sustainable, but the debt level is high and GFNs are large (Annex IV). The large economic contraction and increased fiscal deficit are projected to raise public debt to 81.9 percent of GDP in 2020 before it declines to just below 70 percent in 2025. At around 3 percent, the effective interest rate, however, is far below nominal GDP growth during 2021-25. The GFNs are expected to rise to 24.1 percent of GDP in 2020 and average 20.4 percent of GDP in the medium-term. The large GFNs reflect the short maturity of domestic public debt (half of the total debt). The main vulnerabilities arise from (i) rollover risk, (ii) exchange rate risk as reliance on FX commercial debt has increased, although external borrowing is mainly from development partners on more concessional terms; and relatedly (iii) euroization of deposits and unhedged FX borrowing.



9. Risks from the banking system to Albania's capacity to repay appear limited at this stage but will need to be monitored closely since the shocks are exceptionally large. The improved asset quality and capital buffers in recent years have reinforced banks' loss absorption capacity. The predominance of foreign ownership of the systemic banks further helps to contain the risks. The BOA has also made progress in aligning the regulatory framework with international standards and adopted more intensive supervision (Annex V). However, given that the full impact of the shocks may only be visible on banks' balance sheets after some time, the buildup of vulnerabilities in banks may not be detected soon enough, unless risks are closely monitored and managed.

10. Albania's external position in 2019 is moderately weaker than implied by fundamentals and desirable policy settings (Annex VI). The net international investment position was -52 percent of GDP in 2019. Foreign liabilities amounted to 110 percent of GDP. But over half of the liabilities comprised less volatile FDI liabilities and a quarter comprised long-term public debt, which help to mitigate balance of payments risks. Albania's foreign reserves are also projected to remain adequate in the medium term. Fiscal consolidation would help limit the

external vulnerabilities and reduce financial sector risks as a quarter of bank assets are held in government securities.

11. While risks to Albania's capacity to repay have risen in light of the shocks, they are still contained and manageable. Albania's sizeable reserve coverage and flexible exchange rate remain important shock absorbers. Rollover risks are mitigated by Albania's access to development partners' financing and captive domestic financial market. The Eurobond issuance at favorable rates during the pandemic also confirms Albania's continued access to international financial markets. Moreover, the BOA recently established a repo line of €400 million with the ECB, which should further enhance market confidence. These factors combined with Albania's strong record of repaying the Fund and relative macroeconomic stability indicate that the repayment risks to the Fund are contained and manageable. That said, new infections have been rising considerably in Albania and many other European countries in the fall and downside risks are increasing. In case of a more severe outbreak, financing needs would likely increase and additional official support, including from the Fund, could be needed (¶131 and Annex III).

RISKS AND POLICY DISCUSSIONS

A. Risks from Public Finances

12. The projected sizeable increase of the 2020 fiscal deficit to cushion the impact of the shocks is warranted. Staff estimates the deficit to rise from 2 percent of GDP in 2019 to 6.8 percent in 2020, reflecting lower revenue and increased spending for the shocks. The projected deficit is below the 8.4 percent of GDP in the revised budget because the pandemic and capacity constraint have slowed budget execution. However, the support targeted at businesses and employees affected by the lockdown (0.8 percent of GDP) has been disbursed swiftly and transparently. Implementation of capital expenditure and reconstruction is expected to pick up in the last quarter.

13. The 2021 budget envisages a deficit of 6.5 percent of GDP.¹ It includes sizeable increases in capital expenditure (on top of the budgeted 1.7 percent of GDP earthquake reconstruction) and public wages.² Financing the budget will require drawdown of the government's deposits to a low level and tapping into excess reserves of the public health and pension funds, leaving very limited liquidity buffers. Assuming some under-execution of spending based on past experience and adjusting the optimistic revenue forecast in the budget, staff's baseline projects the deficit to reach 6.1 percent of GDP.

¹ This is equivalent to 6.8 percent of GDP by staff's definition, which incorporates potential calls on the pandemic-related government guarantees in the overall deficit from 2021 onward.

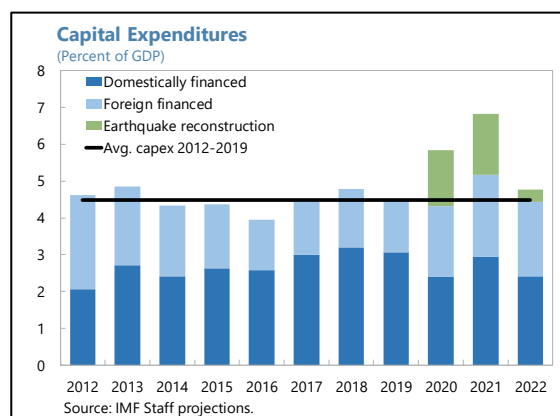
² Public sector wages are expected to grow by 14 percent, reflecting a 40 percent wage increase for health sector workers and 15 percent for teachers.

14. Fiscal policy should balance supporting the economy and addressing Albania’s development gaps with the need to rebuild room for fiscal policy maneuver and limit external pressures.

- **Support for the economy needs to continue in 2021, but with projected growth recovering the authorities should aim to achieve a larger deficit reduction than is consistent with their budget.** Staff recommended a budget deficit of about 5.2 percent of GDP in 2021 or 1.6 percent of GDP lower than the deficit of 2020 reflecting mostly cyclical improvement. The capital expenditure

related to the earthquake should be accommodated. However, given weaknesses in public investment management and financing constraint, staff does not see scope for additional large increases in capital expenditure (on top of earthquake reconstruction) without compromising the quality of spending. The authorities should also contain non-priority spending to make room for adequate health care provision and social

protection for the most vulnerable, and maintain a sizable liquidity buffer for contingencies, as the risks to activity are to the downside and rising. Staff assumes a small revenue gain (0.2 percent of GDP) from starting to implement a sound MTRS in 2021 (¶16). Fiscal upsides need to be saved or used to reduce debt. Automatic stabilizers should be allowed to operate if downside risks materialize and provided financing is available.



- **Staff recommended reaching a primary surplus of 1½ percent of GDP by 2023, building on the revenue gains from the MTRS.** The recent amendment to the fiscal rules stipulating a primary balance of at least zero from 2023 onward is welcome and this requirement should be seen as a floor rather than a target. A lower primary surplus of 1 percent of GDP could be considered for 2025, provided that management of public investment and fiscal risks is strengthened by then, and the additional room is used to address Albania’s large infrastructure and human development needs rather than to accommodate lower revenue. Under the reform path, growth is projected to be lower than under the baseline during 2021-23 reflecting larger deficit reduction. But the medium-term prospects would improve as Albania strengthens the tax system and boosts spending on infrastructure and human development. Public debt is projected to decline to below 65 percent of GDP in 2025.

15. Fiscal support should be temporary and targeted, subject to transparency, accountability, and adequate PFM controls. The pandemic support measures are mostly temporary and targeted. But the permanent profit tax removal for businesses with annual turnovers up to Lek14 million undermines tax compliance given the high threshold. Several other ad hoc tax exemptions that were introduced recently would weaken the tax base. Staff stressed that PFM short-cuts necessary during the emergency should be regularized as soon as possible

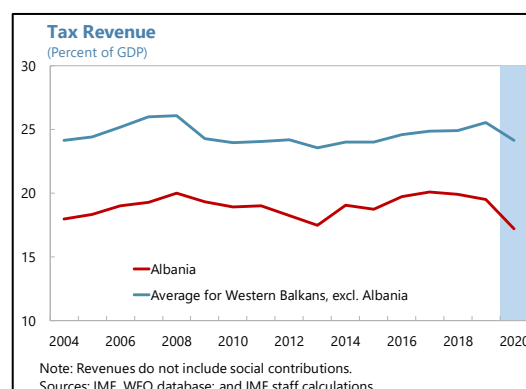
and earthquake reconstruction funds subject to adequate PFM controls, including planning through the budget process. It is important to ensure proper procurement, strong oversight, adequate monitoring and timely reporting (including publication of beneficial owners of procurement contracts), and independent ex-post audits.

Medium-Term Fiscal Paths (Percent of GDP)									
	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Proj.								
Tax revenues									
IMF baseline	25.7	25.6	25.4	23.2	24.7	25.2	25.4	25.3	25.2
IMF reform path				23.2	24.9	26.4	27.0	27.3	27.5
Authorities MTBF ¹	25.7	25.6	25.4	25.1	26.0	26.7	26.9	27.2	27.4
Capital expenditures (incl. reconstruction)									
IMF baseline	4.4	4.8	4.5	5.8	6.8	4.8	4.3	4.3	4.3
IMF reform path				5.8	6.1	4.8	4.4	5.0	5.6
Authorities MTBF ¹				6.5	7.2	4.7	4.7	4.8	4.9
Overall balance									
IMF baseline	-2.0	-1.3	-2.0	-6.8	-6.1	-3.0	-2.0	-2.0	-1.9
IMF reform path				-6.8	-5.2	-1.8	-0.4	-0.6	-0.8
Authorities MTBF ¹	-2.0	-1.3	-2.0	-6.8	-6.5	-2.9	-2.3	-2.0	-1.6
Primary balance									
IMF baseline	0.1	0.9	0.1	-4.7	-4.0	-0.9	0.0	0.0	0.0
IMF reform path				-4.7	-3.1	0.3	1.5	1.3	1.0
Authorities MTBF ¹	0.1	0.9	0.1	-4.6	-3.9	-0.1	0.6	1.1	1.6
Public debt									
IMF baseline	71.9	69.5	67.8	81.9	81.5	79.6	75.3	73.5	69.1
IMF reform path				81.9	81.0	78.3	71.8	68.8	63.5
Authorities MTBF ¹	71.9	69.5	67.8	80.9	78.6	77.9	76.3	74.5	68.5
Memorandum items									
Revenue gains under reform path					0.2	1.0	0.4	0.4	0.3
Capital expenditure increases under reform path					-0.7	0.0	0.1	0.6	0.6
Real GDP growth, baseline (percent)				-7.5	5.4	5.0	4.4	3.5	3.4
Real GDP growth, reform path (percent)				-7.5	5.0	4.7	4.3	4.2	4.3

1/ MTBF as of October 2020. The authorities used the same nominal GDP projections as in staff's baseline
 Note: For the authorities' MTBF, potential calls on the COVID-related government guarantees are excluded from the deficits but included in the public debt.
 Source: IMF Staff estimates and projections.

16. Staff stressed the importance to complete, adopt, and start implementing a sound MTRS in 2021, following public consultation.

Greater tax revenue is essential to support much needed investment in physical and human capital while reducing public debt. Albania's tax system is complex and fragmented, and frequent ad hoc changes have undermined the stability and transparency of the system. A fairer, simpler, more efficient, and more transparent tax system can boost revenue while improving the investment climate and reducing informality. The ongoing



preparation of a MTRS offers a welcome opportunity to review and redesign the tax system and should proceed without further delays.

17. There is an urgent need to strengthen public investment management. Projects should be taken from a pipeline that has gone through a rigorous preparation, assessment, and prioritization process and will contribute sufficiently to an inclusive recovery. A unified process should be established for preparing, prioritizing, and evaluating all public investment projects, including Public-Private Partnerships (PPPs). The use of unsolicited PPPs should continue to be prevented.

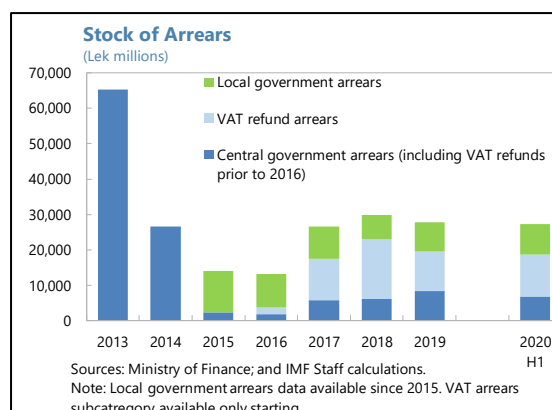
18. Fiscal risks are increasing and need to be carefully monitored and managed.

Notably,

- **PPPs.** The contract value of PPPs is expected to increase to almost 50 percent of GDP in 2021, with payments from the budget doubling to 3.7 percent of tax revenue. Strong efforts are needed to rigorously assess and manage not only direct budgetary impact but also contingent liabilities stemming from PPPs. Their impact should be captured in the fiscal accounts in line with best practices. The PPP law rightly strengthened the gatekeeping role of the MOFE, which needs to build the capacity to perform this important task.
- **Government guarantees.** Some safeguards to limit fiscal risks have been built into the two recent schemes. For these to be effective, the MOFE needs to closely monitor the schemes. Expected costs related to the call on these guarantees should be explicitly incorporated into the budget and detailed information be transparently reported.
- **SOEs.** Efforts should continue to improve the performance of the state-owned electricity sector and other SOEs and address any negative impact that the shocks might have had on their finances. Staff remains concerned that the Albania Investment Corporation (AIC), once operational, will bring new fiscal risks.

19. The authorities should avoid creating new arrears and stick to the plan to clear the existing stock. These arrears not only undermine the business climate and trust in the

government but also hurt businesses' cash flows. Total government arrears in June 2020 have declined slightly from the level at end-2019. A permanent solution to the VAT arrears problem calls for realistic revenue forecasts, disentangling VAT repayments from collection, and strengthening budgetary controls and cash management. The practice of using past years' refunds as a guide for future VAT refunds should be discontinued and VAT collection targets set on a net basis.



20. Efforts should continue to strengthen cash and debt management. There is a need to (i) consolidate cash and government banking arrangements; (ii) improve cash forecasting; (iii) strengthen cash management instruments; and (iv) improve the coordination in cash management. The authorities should continue lengthening the maturity of public debt.

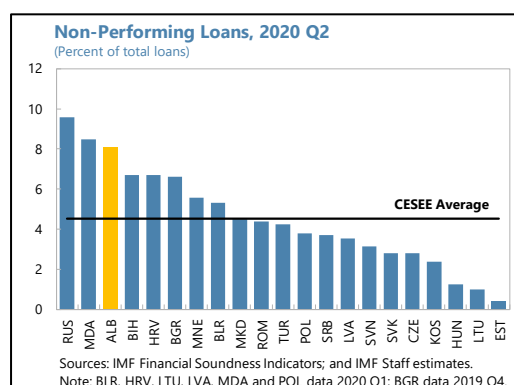
21. It is important to strengthen the AML/CFT framework. Albania was listed by the FATF in February 2020 as a country with strategic AML/CFT deficiencies. It is important to continue to effectively address the shortcomings identified by FATF and MONEYVAL without delay, including by establishing a beneficial ownership register, along with measures to mitigate any new or emerging ML/TF risks arising from the shocks. Staff reiterated advice against a proposed tax amnesty law, given concerns about its impact on tax compliance as well as money laundering and governance risks.

Authorities' Views

22. The authorities reaffirmed their commitment to fiscal prudence, transparency, and accountability. They noted that MTRS adoption was delayed due to the adverse situation caused by the two consecutive shocks, particularly the pandemic. Given the need for public consultation, they expect to complete and adopt a MTRS after the elections. They indicated a revenue objective of 2.3-3 percent of GDP for the MTRS and were confident that their ongoing efforts to strengthen revenue administration would bring sizeable revenue gains in 2021, despite the delays with the MTRS. They expect the 2021 budget to result in a deficit of 5½-6 percent of GDP, lower than the legal limit of 6½ percent due to initially incorporated buffers and possible under-executed spending. Their priority in the medium term remains a clear return to reduction of public debt and containment of fiscal risks. The authorities indicated that they will not pass the tax amnesty law until concerns by domestic stakeholders and international community are addressed. The Supreme Audit Institution plans to conduct and publish an audit of earthquake- and pandemic-related spending in 2021, including auditing relevant procurement procedures and ex-post validation of delivery. A new law for the Register of Beneficiary Owners entered into force in September and a public register of beneficial owners will be established within the first half of 2021.

B. Risks from the Financial Sector

23. The banking system has remained liquid and stable, but pockets of vulnerabilities remain and its resilience will be tested by the shocks. Historically low interest rates, continued deposits growth, and measures to alleviate the impact of the shocks on banks and borrowers have supported credit growth, which reached 6.3 percent (y-o-y) in September. NPLs, at 8.3 percent of total loans in September, remain high compared



to regional peers and vary across banks. Although the average capital adequacy ratio (18.6 percent in September) is well above the regulatory requirements (12 percent plus add-on for some banks), a few banks' capital ratios are only marginally above the requirements. Net profit of the banking system has declined considerably in 2020.

24. A near-term priority is to closely monitor and guide banks' restructuring of credit portfolios. Staff supports prudent bank loan restructuring where necessary to support borrowers hit by the shocks. To ensure consistency and prudence of restructuring practices across the banks, the BOA should closely guide and monitor the quality of restructurings. Staff stressed the importance of maintaining loan classification and provisioning rules to appraise banks' potential losses as accurately as possible. The BOA's decision to temporarily relax such rules may delay the timing when the impact of the shocks on banks' asset quality and capital position can be accurately assessed.

25. The restriction on dividend distributions through end-2020 should be retained until the full impact of the shocks is known and banks' capital position is assessed to be sufficient to absorb the losses from the shocks. The assessment should be made under both the local regulations and IFRS-9 standards. In line with risk-based supervision, the BOA should closely monitor the capital position of vulnerable banks. Where shortfalls arise, a credible capital restoration plan should be adopted, while capital could be allowed to temporarily fall below prudential limits.

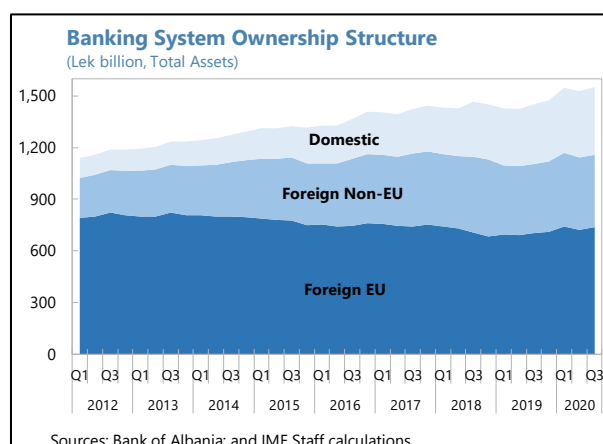
26. The authorities should prepare for a likely surge in NPLs and continue to improve the resolution framework. Efforts should be stepped up to (i) swiftly and credibly operationalize and enforce the insolvency and resolution framework; (ii) implement the regulatory framework for out-of-court restructuring of loans; and (iii) make progress in bailiff reform. Improvements in the judicial process would also be important, to ensure speedy recovery of loans and an effective execution of collateral after court decisions.

27. Continued vigilance is warranted through onsite and offsite supervision. It is important to conduct more frequent on-site inspections on selected banks based on their risk classification or targeted reviews of credit portfolios of banks that pose elevated risks. The off-site monitoring framework of banks' delinquent loans and recovery rates needs to be timely and fully implemented.

28. The BOA has continued its efforts to align the regulatory framework with international standards. Implementation of upgraded regulatory measures will enhance the banking system's resilience to shocks. The implementation process should start, though a sufficiently long phase-in period may be provided to banks so as to avoid procyclicality and disruptions during the pandemic.

29. The authorities should enhance the regulatory and legal frameworks on licensing, transfer of significant ownership, and related-party lending.

With more domestically owned banks and banking sector consolidation over past years, significant bank ownership has shifted toward individuals and non-financial corporates, with implications for related party transactions, large exposures, and corporate governance. Legislative improvement should be implemented to address the resultant risks.



Authorities' Views

30. The BOA broadly concurred with staff's assessment and considers that support measures for banks and their borrowers are timely and effective, pointing to continued credit and deposits growth. It has been closely monitoring and guiding banks' restructuring of credit portfolios through issuing guidance and enhanced communication with banks. The BOA clarified that its intention to temporarily relax loan classification and provisioning rules in 2020 is to provide banks with a necessary but limited time to assess asset quality and strengthen resilience. It expects a rise in NPLs but considers this to be manageable, noting that NPLs have been successfully brought down from a peak of 25 percent of total loans in 2014. The BOA conducted stress tests and sensitivity analysis for the banking system in Q2, which indicated that a few banks would become under-capitalized in the most severe scenario,³ with an estimated recapitalization need of around Lek 36 billion or 2.3 percent of 2020 GDP.

C. Risks from a More Severe Pandemic

31. The nature of the pandemic highlights the importance of contingency planning.

Risks from a return of large infections are rising, as a second wave is gripping many countries in Europe. In case of a more severe pandemic, Albania's twin deficits are expected to increase, implying larger financing needs and further policy adjustment (Annex III).

- Staff supports the accommodative monetary policy stance and flexible exchange rate policy. The BOA should maintain monetary accommodation and keep the domestic financial market liquid in case of a more severe outbreak. Staff noted that the scope of further loosening is quite limited, as the policy rate is close to the zero bound. The benefits and costs of unconventional policy instruments should be carefully weighed, taking account of implications on the exchange rate, euroization, and bank balance sheets.

³ Notably, the economy is assumed to contract by 8.6 percent and 3.1 percent in 2020 and 2021, respectively, and the exchange rate to depreciate by 10 percent in each year.

- Given the elevated public debt, the authorities will need to target new measures to ensure adequate health care provision, protect the most vulnerable, and identify options for budget reallocations and additional official financing.
- The exchange rate should remain a shock absorber. Foreign exchange interventions should continue to be limited to alleviate disorderly market conditions and dampen the balance sheet impact of large depreciations. NPLs could rise further in a more severe pandemic and the BOA should intensify its efforts to monitor and manage financial sector risks. In case of heightened balance of payments pressures and financial stability concerns, the authorities should stand ready to take further measures as needed to preserve macroeconomic and financial stability.

Authorities' Views

32. The authorities stressed that they stand ready to take further measures as needed to preserve stability. They noted that the situation will be more challenging if a recovery does not materialize in 2021 as expected. The MOFE pointed out that budget revisions have provided flexibility to address uncertainties. The BOA assesses that materialization of downside risks would require further monetary stimulus and quantitative easing could be used to reduce credit risk premium. It agreed that benefits and costs of unconventional tools need to be carefully weighed, in line with the developments of financial markets and the applicable legal framework.

STAFF APPRAISAL

33. Albania has maintained macroeconomic and financial stability so far despite two large shocks. The authorities responded promptly to the shocks with mostly targeted measures. The accommodative monetary policy stance and flexible exchange rate policy are appropriate. Reflecting its dependence on tourism, remittances, and FDI, the economy is expected to contract sharply in 2020, followed by a gradual recovery in 2021-22. The outlook is subject to major uncertainty and rising downside risks as a second wave is gripping many countries in Europe.

34. Albania's capacity to repay the Fund is adequate, but risks have risen in light of the shocks. Its sizeable reserve coverage and flexible exchange rate remain important shock absorbers. Aside from a more severe pandemic, key risks stem from elevated fiscal deficits and public debt, weaknesses in management of public finances, and a relatively high level of NPLs and euroization. Managing these risks amid large uncertainty will require continued support for the economy, gradually rebuilding room for policy maneuver as the recovery becomes entrenched, and close supervision of the financial sector.

35. Support for people and firms hurt by the shocks is warranted, but should be temporary and targeted, subject to transparency and accountability. The projected sizable increase of the fiscal deficit in 2020 is warranted. PFM short-cuts during the emergency should be regularized as soon as possible and reconstruction funds should be subject to adequate PFM controls. Support for the economy, including earthquake reconstruction, needs to continue in

2021, but with the projected recovery of activity the authorities should aim to achieve a larger deficit reduction than is consistent with their budget and, given growing downside risks, maintain a sizeable liquidity buffer for contingencies. They need to make room for supporting essential activities and protecting the most vulnerable, including by containing non-priority spending and improving spending efficiency. The recent amendment to the fiscal rules is welcome.

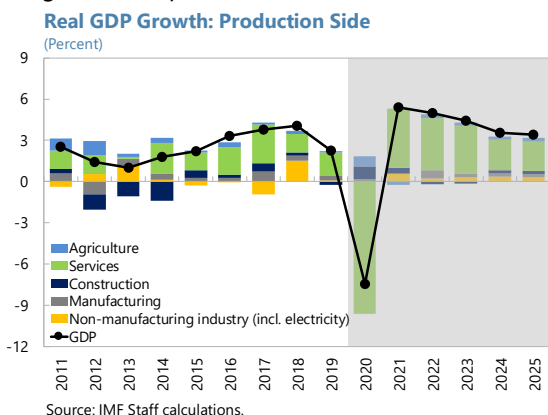
36. The authorities should redouble their efforts to address structural weaknesses in public finances. Higher revenue is critical to sustain the higher spending needs of the people and the economy. A sound MTRS should be adopted and implemented without further delays, and frequent and ad hoc changes to the tax policy avoided. Given the expected recovery and to recreate room for fiscal policy maneuver, it will be critical to take some modest revenue measures in 2021 and build on them substantially over time. There is also an urgent need to strengthen public investment management and the quality of public spending. The authorities should contain and manage increasing fiscal risks, including from PPPs and the recent government guarantees, and avoid new arrears. Efforts to strengthen the AML/CFT framework must continue and tax amnesty schemes should be avoided.

37. Strong efforts are warranted to safeguard financial stability while supporting borrowers hit by the shocks. Prudent loan restructurings by banks are necessary to support the economy. Given the exceptionally large size of the shocks and that their full impact may only be visible on banks' balance sheets after some time, supervisors must monitor banks closely and manage the risks carefully. A near-term priority for the BOA is to monitor and guide banks' restructuring of credit portfolios. Restrictions on bank dividend distributions should be retained until banks' capital position is assessed to be sufficient to absorb the losses from the shocks. The authorities should continue to improve the NPL resolution framework, align the regulatory framework with international standards, and manage risks from related-party lending and large exposures.

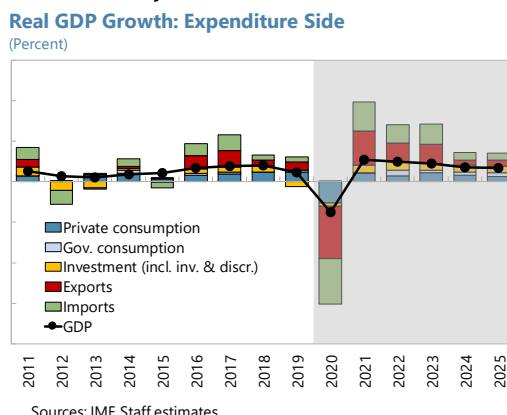
38. The nature of the pandemic highlights the importance of contingency planning. In case of a more severe pandemic, the authorities will need to target new measures to ensure adequate health care provision and protect the most vulnerable, identify options for budget reallocations and additional official financing, and keep the domestic financial market liquid. They should stand ready to take these and any further measures that may be warranted to preserve macroeconomic and financial stability.

Figure 1. Albania: Real Sector Developments

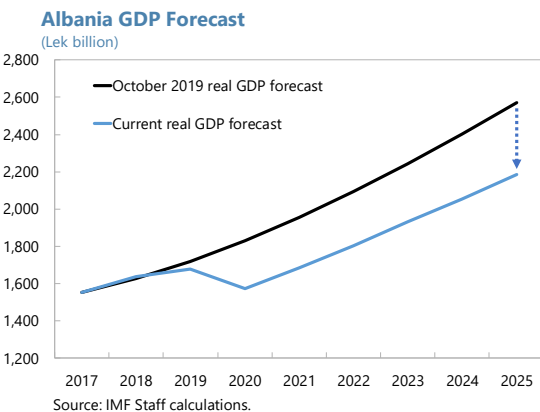
The earthquake in Q4 2019 and the pandemic in 2020 have severely affected the growth, especially through their impact on services.



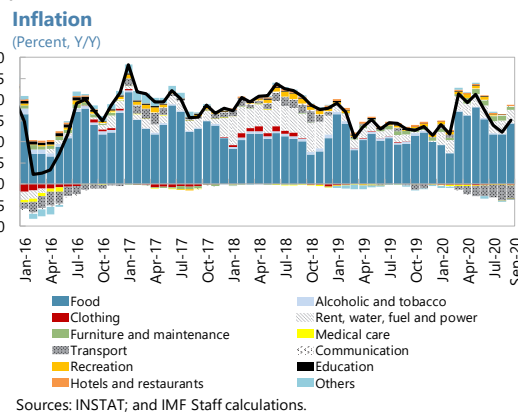
The two shocks have negatively affected domestic demand, which has been the main driver of growth in recent years.



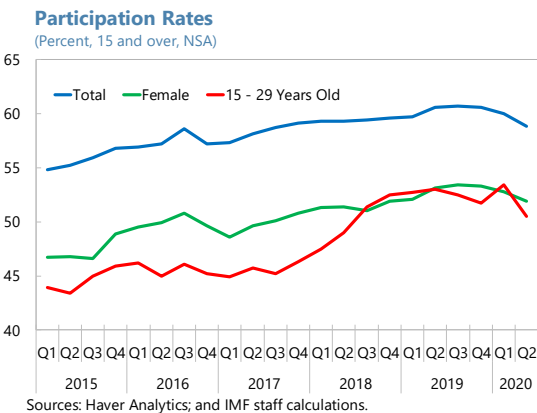
The two shocks are estimated to result in a 7 percent permanent output loss in 2025.



Headline inflation picked up on food prices during the lockdown but is now negatively impacted by fuel prices.



The upward trend in participation rates has reversed due to the shocks.



Similarly, unemployment indicators have started to move against the trends in recent years.

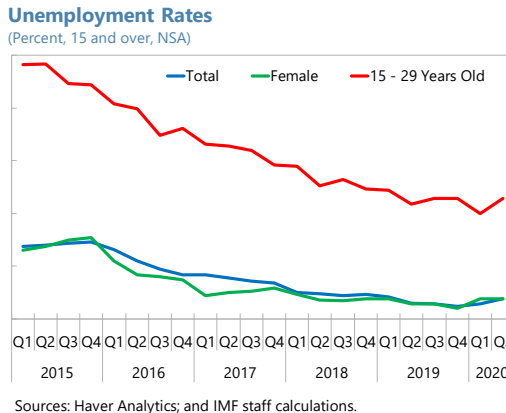
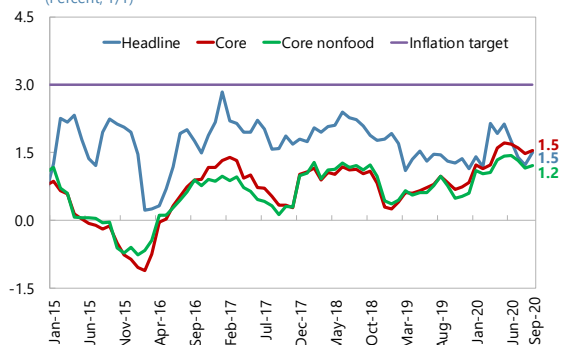


Figure 2. Albania: Monetary Sector Developments

Inflation has been below the target for more than 8 years...

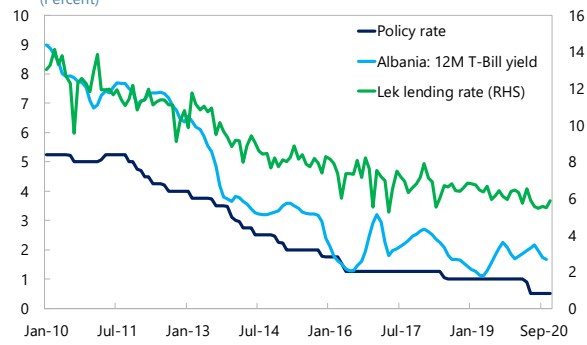
Headline and Core Inflation
(Percent, Y/Y)



Sources: INSTAT; and IMF Staff calculations.

...despite a historically accommodative monetary stance.

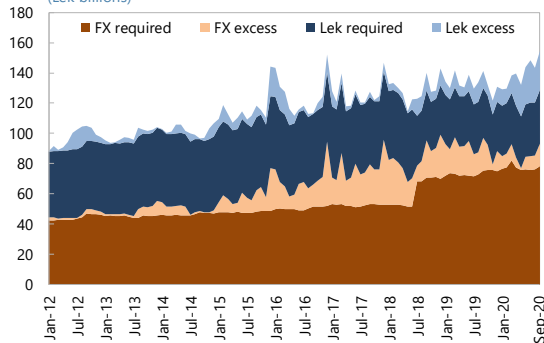
Interest Rates
(Percent)



Source: Haver Analytics.

Banks continue to hoard Lek liquidity at the central bank...

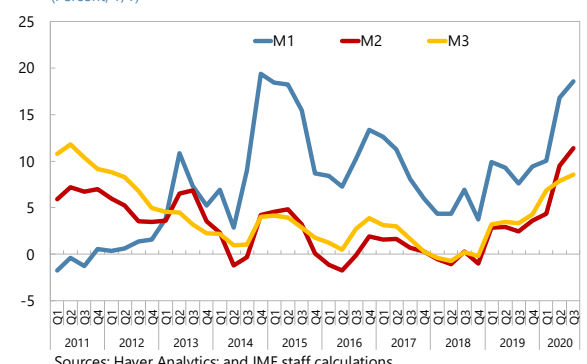
Commercial Banks: Reserves at the Central Bank
(Lek billions)



Source: Bank of Albania.

...while currency in circulation, deposits, and broad money keeps growing.

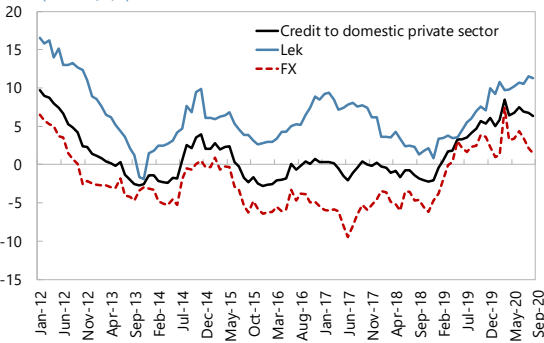
Money Supply
(Percent, Y/Y)



Sources: Haver Analytics; and IMF staff calculations.

Low funding costs, liquid financial system, and measures to alleviate the impact of the two shocks on borrowers have supported private sector credit growth...

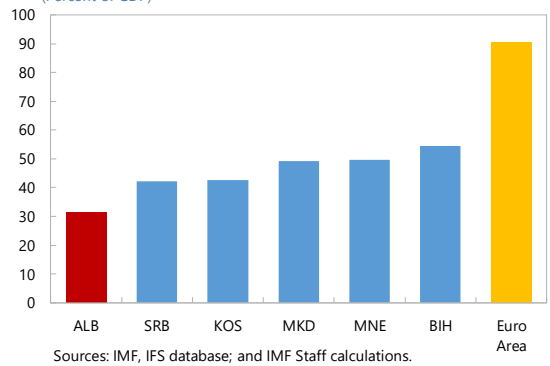
Credit to Domestic Private Sector
(Percent, Y/Y)



Source: Bank of Albania.

...though private sector credit to GDP ratio remains low.

Private Credit to GDP, 2019
(Percent of GDP)

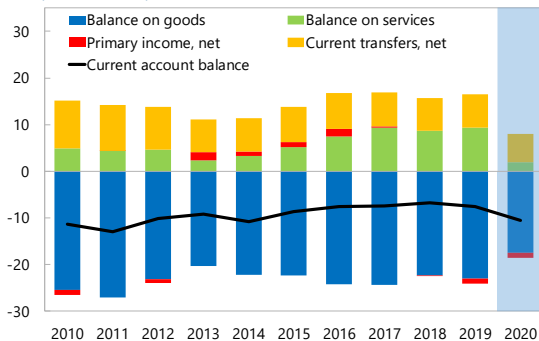


Sources: IMF, IFS database; and IMF Staff calculations.

Figure 3. Albania: External Sector Developments

The current account deficit is expected to widen considerably in 2020 due to lower tourism receipts, remittances, and exports...

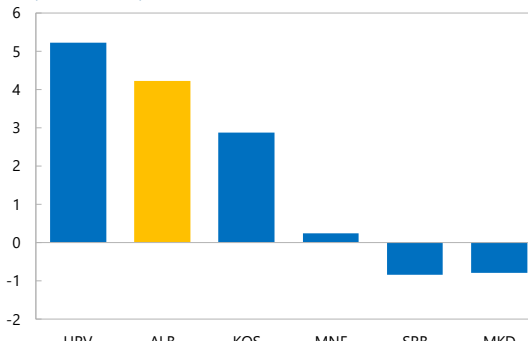
Current Account Balance
(Percent of GDP)



Sources: Bank of Albania; and IMF staff calculations.

...reversing several years of improvement in the services balance driven primarily by the growth in the tourism sector.

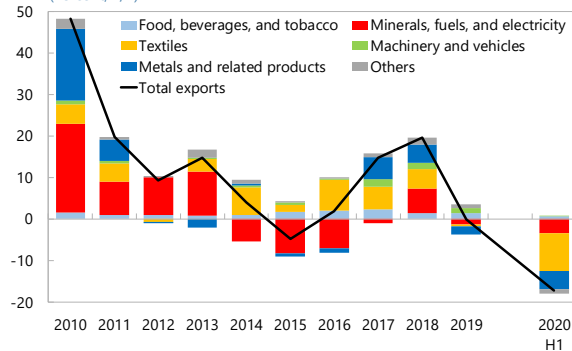
Change in Services Balance Relative to GDP, 2015-2019
(Percent of GDP)



Sources: Bank of Albania; and IMF staff calculations.

Growth of goods exports in 2019 came to a halt and turned negative in the first half of 2020 due to lower textile and energy exports...

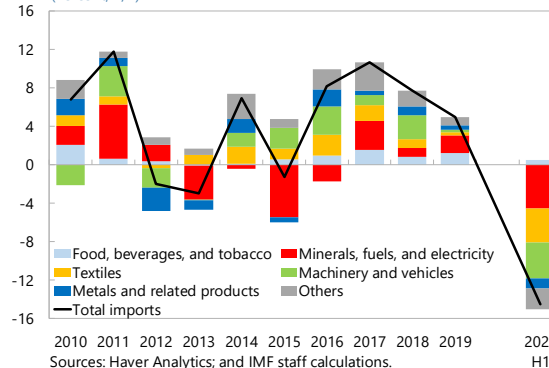
Contribution to Export Goods Growth
(Percent, Y/Y)



Sources: Haver Analytics; and IMF staff calculations.

...while import growth has also turned negative in 2020 reflecting the economic downturn.

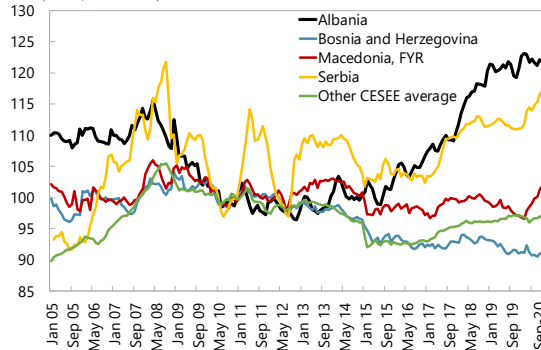
Contribution to Import Goods Growth
(Percent, Y/Y)



Sources: Haver Analytics; and IMF staff calculations.

Albania's real effective exchange rate appreciation has leveled off in 2020...

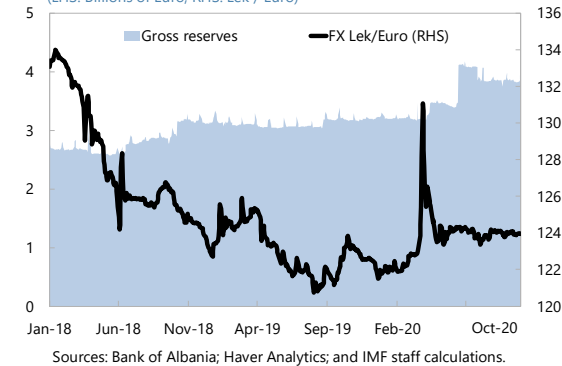
CESEE: Real Effective Exchange Rate
(Index, 2010=100)



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

...while the country has continued to accumulate FX reserves.

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

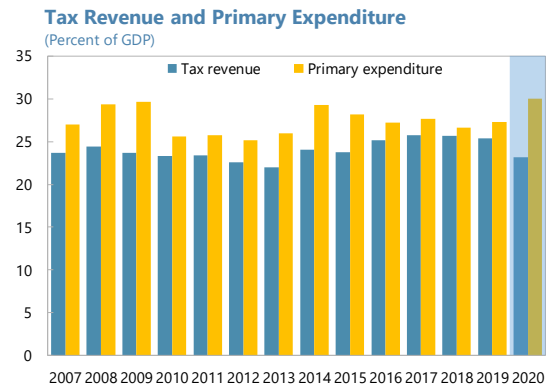
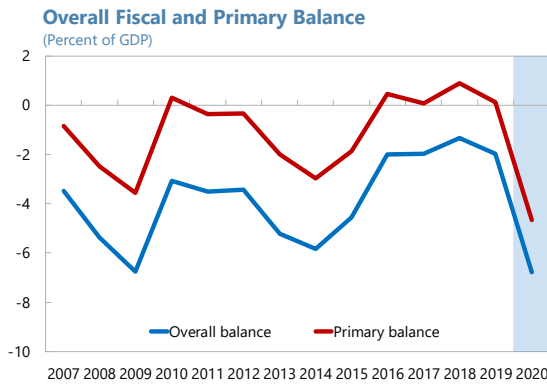


Sources: Bank of Albania; Haver Analytics; and IMF staff calculations.

Figure 4. Albania: Fiscal Sector Developments

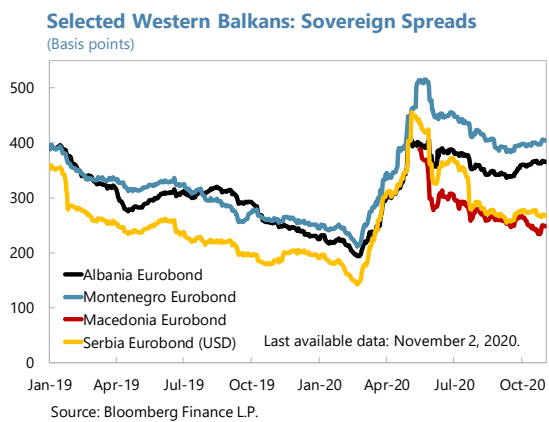
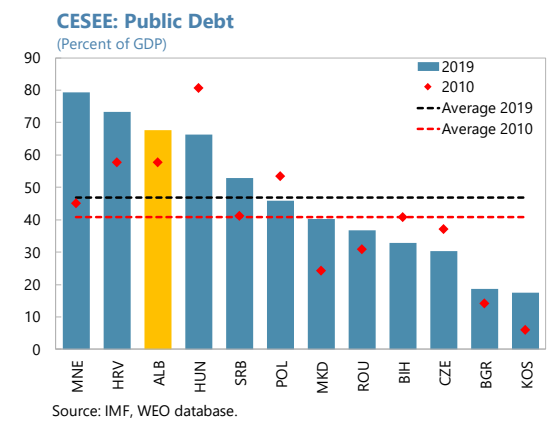
Fiscal balances have improved in recent years till 2019 but a significant worsening is expected in 2020...

...driven by lower revenue and spending increases.



Albania's public debt remains high.

Sovereign spreads jumped after the outbreak but have come down somewhat.



Higher revenues are needed to support fiscal consolidation...

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

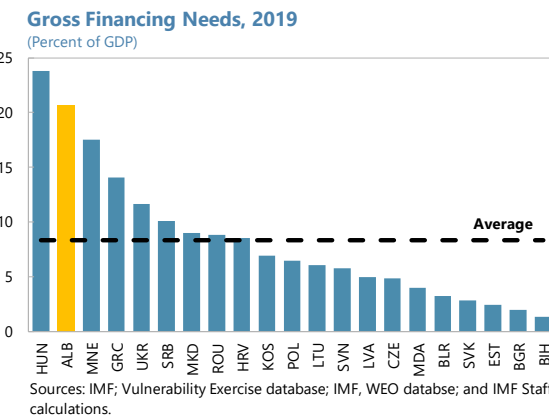
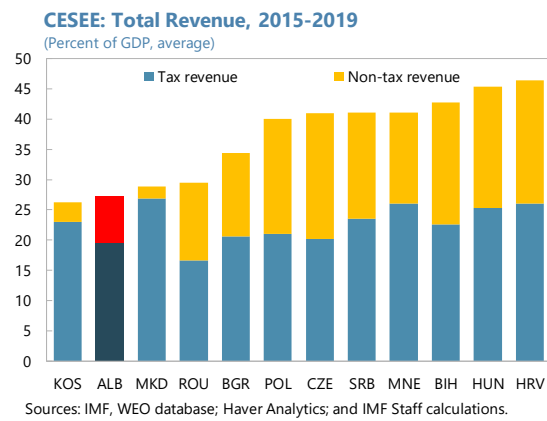
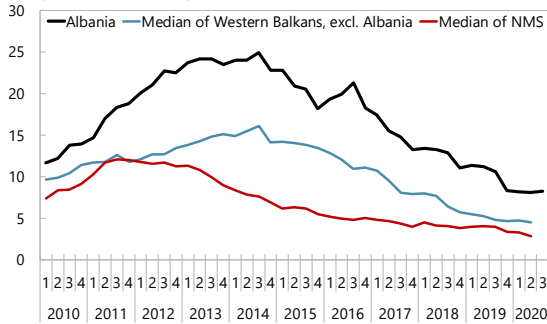


Figure 5. Albania: Banking Sector Developments

Notwithstanding a significant decline over time, Albania's NPL ratio remains relatively high.

Non-Performing Loans

(Percent of total loans)

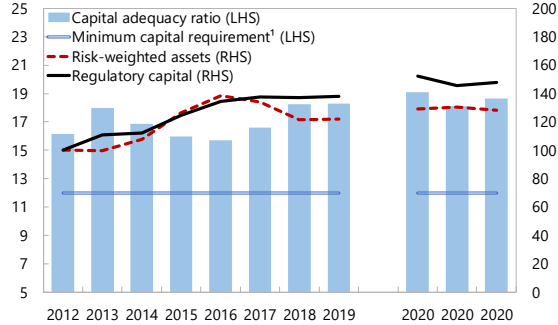


Sources: National authorities; IMF Financial Soundness Indicators; and IMF staff estimates.

Capital of all banks are above regulatory ratio, although buffers are declining slightly.

Capital Adequacy Ratio

(LHS: Percent; RHS: Index, 2012=100)



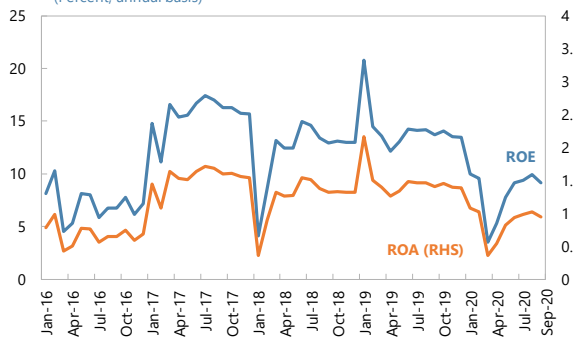
Source: IMF FSI database.

1/ Some banks have higher regulatory capital minima.

The two shocks have weighed on bank profitability.

Profitability

(Percent, annual basis)

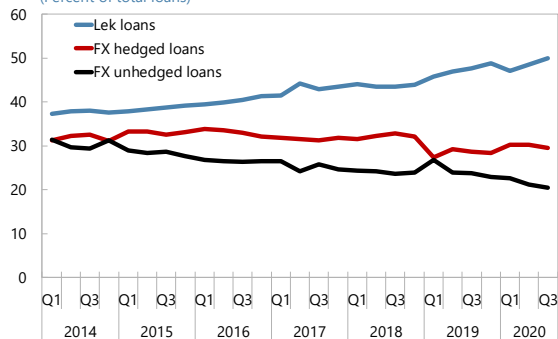


Source: Bank of Albania.

A large share of the FX loans is unhedged.

Unhedged FX Borrowing

(Percent of total loans)

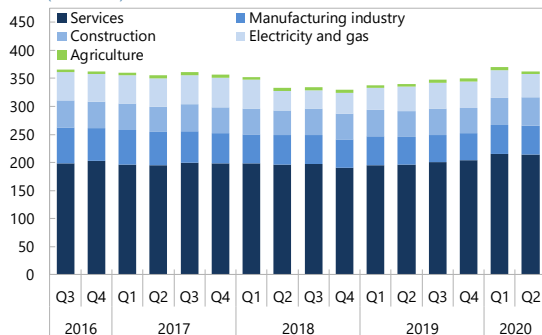


Sources: Bank of Albania; and IMF Staff calculations.

Banks are exposed to the sectors most impacted by the earthquake and pandemic.

Total NFCs Loans

(Lek billion)

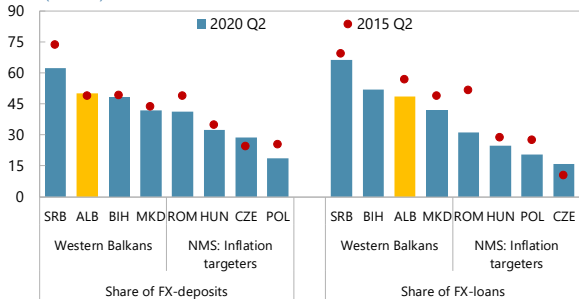


Source: Bank of Albania.

Albania remains one of the most euroized economies in the region.

Euroization

(Percent)



Sources: IMF, MFS database; and IMF Staff calculations.

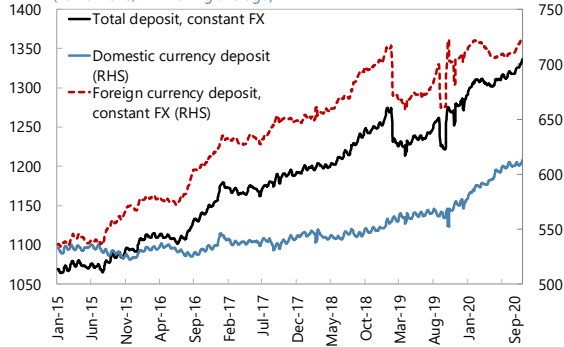
Note: BIH data as of May 2020. SRB FX-loans data as of April 2020.

Non-residence FX deposits and FX loans are excluded.

Figure 5. Albania: Banking Sector Developments (concluded)

However, the banking system has remained liquid.

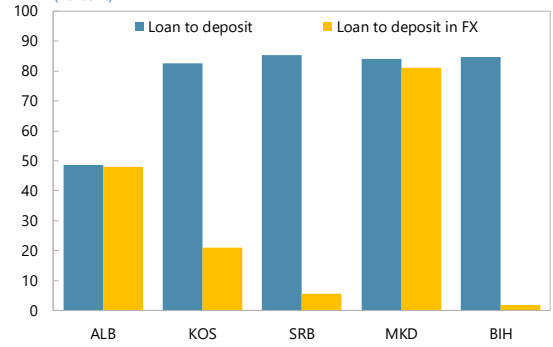
Deposit by Currency
(Lek billions, 7D moving average)



Sources: Bank of Albania; and IMF Staff calculations.

Financial intermediation is low in Albania...

Loan to Deposits Ratio, 2019
(Percent)

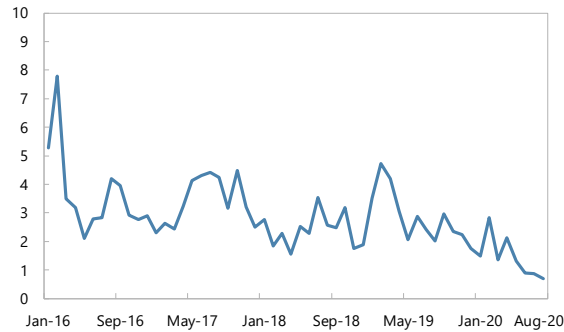


Sources: IFS, MFS database; and IMF staff calculations.

...and activity in the interbank market is limited.

Interbank Market Linkages, Monthly

(Percent, monthly overnight transactions volume as a share of total banking assets)

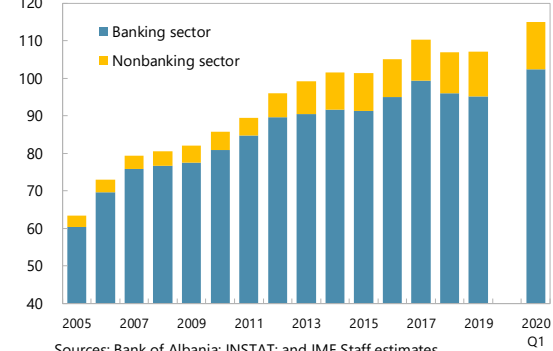


Sources: Bank of Albania; and IMF Staff calculations.

Non-bank financial sector is relatively small.

Financial System Assets

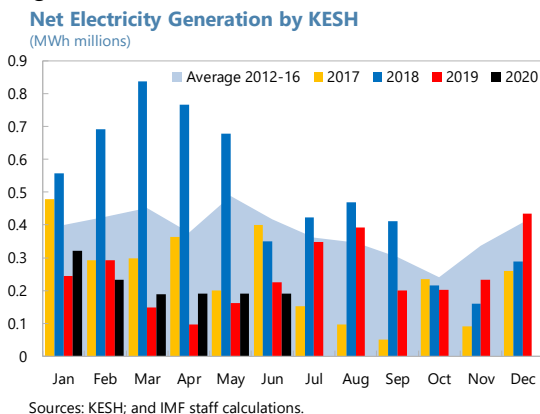
(Percent of GDP)



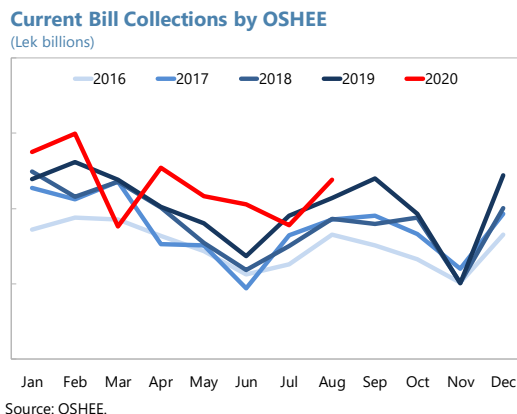
Sources: Bank of Albania; INSTAT; and IMF Staff estimates.

Figure 6. Albania: Electricity Sector

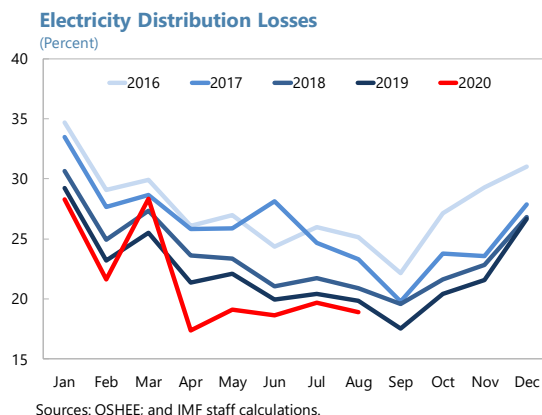
After a strong year in 2018, electricity generation has been negatively affected by the drought in 2019 and the twin shocks in 2020.



The collection of bills in 2020 was adversely affected during the lockdown but has recovered.



Despite a spike in March, distribution losses in 2020 have declined from highs in 2014-2016.



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

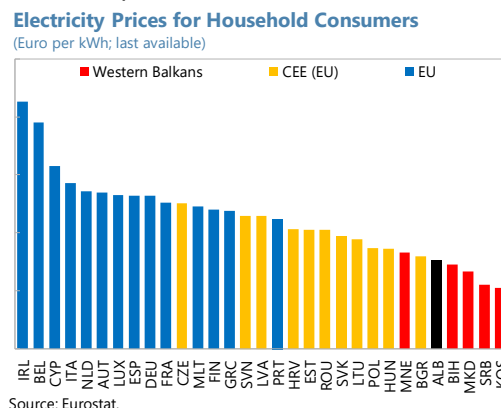


Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2016–25

	2016	2017	2018	2019	2020	2020 RFI	2021	2021 RFI	2022	2023	2024	2025
	Proj.											
	(Percent change)											
Real sector												
Real GDP	3.3	3.8	4.1	2.2	-7.5	-5.0	5.4	8.0	5.0	4.4	3.5	3.4
Domestic demand contribution	3.1	3.6	3.9	1.6	-5.8	-0.9	4.0	5.2	4.8	4.6	4.1	3.8
Consumption	2.0	2.3	2.4	2.8	-5.0	0.0	2.3	1.2	2.8	2.8	2.4	2.2
Investment (incl. inventories and stat. disc.)	1.1	1.3	1.4	-1.2	-0.9	-0.9	1.8	4.0	2.0	1.8	1.7	1.6
External demand contribution	0.2	0.2	0.2	0.7	-1.6	-4.1	1.3	2.8	0.2	-0.2	-0.5	-0.3
Consumer Price Index (eop)	2.2	1.8	1.8	1.1	1.0	2.6	2.2	2.9	2.5	2.9	3.0	3.0
Consumer Price Index (avg.)	1.3	2.0	2.0	1.4	1.4	2.4	1.6	2.8	2.4	2.7	2.9	3.0
GDP deflator	-0.6	1.5	1.4	0.4	1.2	2.6	1.5	2.7	2.1	2.5	2.7	3.0
	(Percent of GDP)											
Saving-investment balance												
Foreign savings	7.6	7.5	6.8	8.0	10.6	11.2	8.3	8.1	7.9	7.8	7.7	7.4
National savings	16.8	17.1	17.1	14.5	12.1	10.6	14.8	15.4	15.7	15.9	16.2	16.8
Public	1.5	2.4	3.0	2.0	-3.6	-3.1	-2.1	-0.1	0.7	1.6	1.8	1.8
Private	15.3	14.7	14.2	12.6	15.7	13.8	17.0	15.5	15.0	14.3	14.4	14.9
Investment (incl. Inventories and stat. disc.)	24.4	24.6	23.9	22.5	22.7	21.9	23.1	23.5	23.6	23.7	23.8	24.2
Public	5.1	5.5	5.6	5.3	6.3	5.6	7.6	5.9	5.7	5.0	5.1	5.1
Private	19.3	19.1	18.3	17.2	16.4	16.2	15.5	17.5	17.9	18.7	18.7	19.1
Fiscal sector												
Total revenue and grants	27.6	27.8	27.5	27.4	25.3	26.3	26.9	26.9	26.9	26.9	26.7	26.7
Tax revenue	25.1	25.7	25.6	25.4	23.2	23.2	24.7	23.9	25.2	25.4	25.3	25.2
Total expenditure	29.6	29.7	28.8	29.4	32.1	31.7	33.0	29.9	29.8	28.9	28.7	28.6
Primary	27.2	27.7	26.6	27.3	30.0	29.6	30.8	28.3	27.8	26.9	26.7	26.7
Interest	2.5	2.1	2.2	2.1	2.1	2.1	2.1	1.6	2.1	2.0	2.0	1.9
Overall balance 1/	-2.0	-2.0	-1.3	-2.0	-6.8	-5.4	-6.1	-3.1	-3.0	-2.0	-2.0	-1.9
Primary balance	0.5	0.1	0.9	0.1	-4.7	-3.3	-4.0	-1.4	-0.9	0.0	0.0	0.0
Financing	2.0	2.0	1.3	2.0	6.8	-0.4	6.1	3.1	3.0	2.0	2.0	1.9
Of which: Domestic	0.7	-0.5	-1.5	2.5	1.5	2.1	5.3	0.4	-0.4	3.3	0.0	4.1
Of which: Foreign	1.3	1.9	2.9	-0.5	5.3	-2.5	0.8	2.7	3.4	-1.3	2.0	-2.2
General Government Debt 2/	73.3	71.9	69.5	67.8	81.9	75.6	81.5	70.7	79.6	75.3	73.5	69.1
Domestic	39.1	39.0	37.3	37.2	42.2	43.0	41.7	40.5	39.9	39.8	38.5	38.3
External	34.3	32.9	32.2	30.7	39.8	32.6	39.8	30.2	39.7	35.5	35.1	30.7
	(Percent change)											
Monetary indicators												
Broad money growth	3.9	0.3	-0.2	4.3	6.2	-2.6	3.8	10.9	5.4	7.0	6.3	6.5
Private credit growth	0.4	-0.8	-0.9	6.1	4.9	-2.5	1.8	11.4	6.4	8.7	6.2	6.6
Velocity (nominal GDP/ broad money)	1.2	1.2	1.3	1.3	1.1	1.3	1.2	1.3	1.2	1.2	1.2	1.2
	(Percent of GDP, unless indicated otherwise)											
External sector												
Trade balance (goods and services)	-16.8	-15.1	-13.7	-13.8	-15.5	-17.2	-14.1	-14.0	-13.7	-13.4	-13.2	-13.1
Current account balance	-7.6	-7.5	-6.8	-8.0	-10.6	-11.2	-8.3	-8.1	-7.9	-7.8	-7.7	-7.4
Gross international reserves (billions of Euros)	2.9	3.0	3.4	3.4	3.5	2.9	3.2	3.3	3.6	3.6	4.2	4.2
(In months of imports of goods and services)	6.5	6.2	6.6	8.8	7.8	5.3	6.4	5.5	6.4	6.0	6.5	6.3
(Relative to external debt service)	1.6	1.5	1.5	1.5	1.4	1.2	1.4	1.5	1.6	1.6	1.8	1.4
(In percent of broad money)	31.5	31.4	33.2	31.0	31.7	30.1	29.6	29.0	31.0	28.7	31.1	29.8
Memorandum items												
Real GDP (growth per capita)	3.5	3.9	4.3	2.1	-7.3	-4.9	5.6	8.2	5.2	4.6	3.7	3.6

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

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

2/ The stock of general government debt includes arrears from central and local government.

Table 2a. Albania: General Government Operations, 2016–25
(Percent of GDP)

	2016	2017	2018	2019	2020	2020	2021	2021	2021	2022	2023	2024	2025
						RFI		Budget	RFI				
	Proj.												
Total revenue and grants	27.6	27.8	27.5	27.4	25.3	26.3	26.9	28.5	26.9	26.9	26.9	26.7	26.7
Tax revenue	25.1	25.7	25.6	25.4	23.2	23.2	24.7	26.0	23.9	25.2	25.4	25.3	25.2
VAT	8.9	9.0	8.8	7.9	7.5	7.6	7.8	8.5	7.9	8.1	8.1	8.1	8.1
Profit tax	2.0	2.0	2.1	2.2	1.5	1.8	1.7	2.0	1.8	1.8	1.9	1.9	1.9
Excise tax	2.8	2.9	2.8	2.8	2.7	2.4	2.8	2.9	2.4	2.8	2.9	2.9	2.9
Customs duties	0.4	0.4	0.4	0.4	0.3	0.3	0.6	0.4	0.4	0.6	0.6	0.6	0.6
Personal income tax	2.1	2.1	2.2	2.7	2.2	2.5	2.2	2.4	2.5	2.3	2.3	2.2	2.2
National taxes	2.4	2.5	2.4	2.2	1.9	1.7	2.3	2.3	2.1	2.2	2.2	2.2	2.2
Local government revenue 1/	1.0	1.2	1.3	1.4	1.2	1.2	1.3	1.5	1.2	1.5	1.5	1.5	1.5
Social insurance contributions	5.4	5.6	5.7	5.9	5.9	5.7	6.0	6.0	5.6	5.9	6.0	6.0	5.9
Non-tax revenue	1.5	1.3	1.3	1.5	1.0	1.4	1.0	1.3	1.4	0.9	0.9	0.9	0.9
Grants	1.0	0.7	0.5	0.5	1.1	1.7	1.2	1.2	1.5	0.8	0.6	0.6	0.6
Total expenditure	29.6	29.7	28.8	29.4	32.1	31.7	33.0	34.9	29.9	29.8	28.9	28.7	28.6
Current expenditure	25.2	24.7	24.0	24.9	25.4	25.5	25.6	27.5	24.3	24.9	24.4	24.2	24.1
Personnel cost 2/	4.6	4.7	4.5	4.6	4.9	4.9	5.2	5.5	4.7	4.9	4.7	4.6	4.4
Interest	2.5	2.1	2.2	2.1	2.1	2.1	2.1	2.6	1.6	2.1	2.0	2.0	1.9
Operations & maintenance	3.0	2.8	2.8	2.8	2.9	2.9	2.8	2.9	2.9	2.8	2.7	2.7	2.9
Subsidies	0.3	0.2	0.1	0.2	0.1	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Social insurance outlays	10.4	10.5	10.3	10.5	10.8	10.6	10.9	11.5	10.7	10.5	10.4	10.3	10.4
Local government expenditure 2/ 3/	2.8	3.0	3.0	3.3	3.0	3.3	3.0	3.3	2.8	3.1	3.0	3.0	3.1
Social protection transfers	1.7	1.5	1.1	1.3	1.6	1.5	1.6	1.6	1.5	1.5	1.5	1.6	1.5
Capital expenditure 4/	4.0	4.4	4.8	4.5	5.8	3.9	6.8	7.2	4.4	4.8	4.3	4.3	4.3
Domestically financed	2.6	3.0	3.2	3.1	2.4	1.6	2.9	3.5	2.2	2.4	2.6	2.5	2.4
Foreign financed	1.4	1.4	1.6	1.4	1.9	2.3	2.2	2.0	2.2	2.0	1.6	1.8	1.9
Earthquake spending	0.0	0.0	0.0	0.0	1.5	0.0	1.7	1.7	0.0	0.3	0.0	0.0	0.0
Lending minus repayment	0.5	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds	0.0	0.0	0.0	0.0	0.9	2.3	0.5	0.2	1.2	0.2	0.2	0.2	0.1
Overall balance 4/	-2.0	-2.0	-1.3	-2.0	-6.8	-5.4	-6.1	-6.5	-3.1	-3.0	-2.0	-2.0	-1.9
Financing	2.0	2.0	1.3	2.0	6.8	-0.4	6.1	6.5	3.1	3.0	2.0	2.0	1.9
Domestic	0.7	-0.5	-1.5	2.5	1.5	2.1	5.3	5.7	0.4	-0.4	3.3	0.0	4.1
Privatization receipts	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	0.7	0.5	0.8	1.5	2.6	0.3	3.0	3.0	2.1	1.2	2.6	1.1	2.3
Change in general gov. deposits	-0.3	-0.3	-2.1	1.0	-1.0	1.8	2.3	2.7	-1.7	-1.7	0.7	-1.1	1.8
Other	0.1	-0.7	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	1.3	1.9	2.9	-0.5	5.3	-2.5	0.8	0.8	2.7	3.4	-1.3	2.0	-2.2
Gross borrowing	2.8	3.5	6.0	1.4	9.4	1.8	3.4	3.2	5.2	5.8	1.3	4.7	4.5
Amortization	1.5	1.7	3.2	1.9	4.1	4.3	2.7	2.4	2.5	2.4	2.6	2.7	6.7
Financing gap (+ =gap) 5/					0.0	5.8	0.0						
<i>Memorandum Items:</i>													
Primary balance	0.5	0.1	0.9	0.1	-4.7	-3.3	-4.0	-3.9	-1.4	-0.9	0.0	0.0	0.0
General government debt 5/	73.3	71.9	69.5	67.8	81.9	75.6	81.5	78.5	70.7	79.6	75.3	73.5	69.1
Direct general government external debt	32.7	31.6	30.4	29.1	37.5	30.4	37.8	37.1	28.3	37.9	33.9	33.6	29.3
Government guaranteed external debt	1.6	1.3	1.8	1.6	2.3	2.2	2.0	2.1	1.9	1.8	1.6	1.5	1.4
Nominal GDP (billions of leks)	1472	1551	1636	1678	1572	1635	1682	1683	1814	1803	1929	2051	2186

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

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

2/ There is a structural break in 2016, reflecting the transfer of central government employees to local governments, as part of fiscal decentralization.

3/ There is a structural break in 2017, reflecting the transfer of the Regional Development Fund to the Ministry of Urban Development.

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

5/ The stock of general government debt includes arrears from central and local government.

Table 2b. Albania: General Government Operations, 2016–25

(Billions of Leks)

	2016	2017	2018	2019	2020	2020 RFI	2021	2021 Budget	2021 RFI	2022	2023	2024	2025
	Proj.												
Total revenue and grants	407.0	430.4	449.4	460.3	398.3	430.4	451.9	479.0	487.1	484.2	518.3	548.5	582.7
Tax revenue	369.9	398.6	419.3	426.3	364.5	379.9	414.7	437.0	434.1	453.5	489.3	518.7	550.9
VAT	131.4	139.5	143.5	132.4	118.6	125.0	131.9	143.5	144.2	145.4	155.6	165.4	176.3
Profit tax	29.2	31.6	34.5	36.6	23.8	29.7	28.8	33.0	32.4	33.1	35.7	38.3	41.2
Excise tax	41.9	45.1	45.0	46.7	41.9	39.1	46.5	49.0	43.7	50.5	55.6	58.8	62.7
Customs duties	6.1	6.5	6.2	6.5	4.8	4.7	9.6	6.5	7.2	10.3	11.0	11.7	12.5
Personal income tax	31.4	32.1	36.5	46.1	34.7	40.8	37.1	41.0	45.2	42.2	45.2	46.0	49.0
National taxes	35.8	38.5	38.6	36.4	29.9	28.4	37.9	38.0	38.5	39.2	42.7	45.1	47.6
Local government revenue 1/	15.0	18.4	21.9	23.1	18.4	19.5	22.2	25.4	21.7	26.3	28.1	29.9	32.9
Social insurance contributions	79.2	86.8	93.2	98.4	92.4	92.7	100.7	100.6	101.3	106.4	115.3	123.3	128.7
Non-tax revenue	22.5	20.7	22.0	25.3	15.8	23.3	16.9	21.6	25.9	16.7	16.5	17.5	18.7
Grants	14.6	11.1	8.1	8.8	18.0	27.2	20.4	20.4	27.1	14.0	12.5	12.3	13.1
Total expenditure	436.5	461.2	471.4	493.3	505.1	518.6	554.6	587.7	542.7	538.2	557.0	588.8	624.2
Current expenditure	370.6	382.6	392.6	418.2	398.7	417.0	430.8	463.0	440.3	449.2	470.7	496.4	526.5
Personnel cost 2/	67.5	72.6	73.6	77.0	77.3	79.8	87.8	91.9	84.4	88.7	89.9	93.5	96.0
Interest	36.3	31.9	36.5	35.1	33.6	34.0	35.7	43.8	29.5	37.7	38.7	40.3	41.0
Operations & maintenance	44.3	43.4	45.3	47.2	44.8	47.1	47.9	49.2	51.9	51.3	52.9	56.3	62.5
Subsidies	3.8	2.6	1.9	2.8	1.3	1.3	-0.4	1.6	1.4	-0.5	-0.5	-0.5	-0.5
Social insurance outlays	152.6	162.1	168.3	175.6	169.6	173.2	182.6	194.0	194.1	189.3	201.5	211.2	227.9
Local government expenditure 2/ 3/	41.7	46.5	49.6	56.2	47.5	54.7	50.9	56.3	50.0	55.8	58.7	61.9	67.0
Social protection transfers	24.5	23.4	17.5	21.9	24.6	24.6	26.2	26.2	26.4	26.8	29.5	33.7	32.6
Capital expenditure 4/	58.2	68.8	78.8	75.0	91.8	63.8	114.9	120.7	80.6	86.0	82.1	88.8	94.6
Domestically financed	37.9	46.6	52.2	51.5	37.7	26.1	49.5	58.3	40.2	43.6	50.7	50.9	53.0
Foreign financed	20.4	22.3	26.2	23.5	30.2	37.7	37.4	34.4	40.4	36.4	31.4	37.9	41.7
Earthquake spending	0.0	0.0	0.4	0.0	24.0	0.0	28.0	28.0	0.0	6.0	0.0	0.0	0.0
Lending minus repayment	7.4	9.2	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds	0.0	0.0	0.0	0.0	14.5	37.7	8.9	4.0	21.8	3.0	4.1	3.6	3.0
Overall balance 4/	-29.4	-30.8	-22.0	-33.0	-106.8	-88.2	-102.6	-108.7	-55.6	-53.9	-38.7	-40.3	-41.5
Financing	29.4	30.9	22.0	33.0	106.8	-6.8	102.6	108.7	55.6	53.9	38.7	40.3	41.5
Domestic	9.9	-8.4	-25.0	41.7	24.1	34.7	89.9	95.6	7.4	-7.6	63.6	-0.1	89.8
Privatization receipts	2.8	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	10.6	7.3	13.5	24.8	40.1	4.7	50.4	49.9	37.4	22.4	50.6	22.9	50.8
Change in general gov. deposits	-4.3	-5.2	-33.6	16.9	-16.0	30.0	39.5	45.7	-30.0	-30.0	13.0	-23.0	39.0
Other	0.8	-10.9	-5.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	19.5	29.4	47.0	-8.7	82.7	-41.5	12.7	13.1	48.3	61.5	-24.9	40.3	-48.2
Gross borrowing	41.9	55.0	98.8	22.8	147.6	29.3	57.5	53.9	93.5	104.3	24.8	95.5	98.6
Amortization	22.0	25.8	51.7	31.4	64.9	70.8	44.8	40.8	45.2	42.8	49.7	55.2	146.8
Financing gap (+ =gap) 5/					0.0	95.0	0.0						
<i>Memorandum Items:</i>													
Primary balance	6.8	1.1	14.5	2.1	-73.2	-54.1	-66.9	-64.9	-26.1	-16.3	0.0	0.0	-0.5
General government debt 5/	1,080	1,115	1,137	1,139	1,288	1,235	1,371	1,322	1,283	1,436	1,452	1,508	1,509
Direct general government external debt	481.4	490.5	496.8	488.1	588.9	496.3	635.2	625.0	512.7	684.1	653.6	688.8	641.3
Government guaranteed external debt	23.2	19.8	29.5	26.7	36.4	36.6	34.2	34.7	34.7	32.5	31.4	30.5	29.8

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

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

2/ There is a structural break in 2016, reflecting the transfer of central government employees to local governments, as part of fiscal decentralization.

3/ There is a structural break in 2017, reflecting the transfer of the Regional Development Fund to the Ministry of Urban Development.

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

5/ The stock of general government debt includes arrears from central and local government.

Table 3a. Albania: Balance of Payments, 2016–25
(Percent of GDP)

	2016	2017	2018	2019	2020	2020 RFI	2021	2021 RFI	2022	2023	2024	2025
	Proj.											
Current account	-7.6	-7.5	-6.8	-8.0	-10.6	-11.2	-8.3	-8.1	-7.9	-7.8	-7.7	-7.4
Goods and services (fob)	-16.8	-15.1	-13.7	-13.8	-15.5	-17.2	-14.1	-14.0	-13.7	-13.4	-13.2	-13.1
Goods (fob)	-24.3	-24.4	-22.4	-23.0	-17.5	-17.5	-19.4	-23.5	-20.5	-21.9	-21.7	-21.7
Exports	6.7	6.9	7.7	6.6	6.0	6.0	6.7	6.5	7.3	7.8	7.7	7.6
Imports	30.9	31.3	30.1	29.7	23.5	23.4	26.1	29.9	27.8	29.7	29.4	29.3
Services	7.4	9.4	8.7	9.3	1.9	0.3	5.3	9.4	6.8	8.6	8.5	8.7
Exports	22.3	24.7	24.0	25.0	15.0	15.0	20.8	26.3	22.9	24.9	24.8	25.0
Imports	14.9	15.4	15.3	15.7	13.1	14.7	15.5	16.9	16.1	16.3	16.4	16.4
Primary Income	1.6	0.2	-0.1	-1.3	-1.1	-0.7	-1.0	-0.9	-1.0	-1.0	-1.0	-0.9
Compensation of employees (net)	2.4	2.3	2.2	2.2	2.0	2.4	2.1	2.2	2.2	2.2	2.2	2.2
Investment income (net)	-0.8	-2.0	-2.3	-3.5	-3.0	-3.1	-3.1	-3.1	-3.2	-3.2	-3.2	-3.1
Other (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Secondary Income	7.7	7.3	7.1	7.1	6.0	6.7	6.9	6.8	6.7	6.6	6.5	6.5
General Government (net)	0.4	0.6	0.5	0.5	0.3	0.5	0.6	0.4	0.2	0.0	0.0	0.0
Workers' Remittances (net)	5.7	5.5	5.2	5.1	4.5	5.0	5.1	5.1	5.3	5.3	5.3	5.3
Other private transfers (net)	1.5	1.2	1.3	1.5	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.3
Capital account	0.6	1.1	0.8	0.6	1.2	1.1	1.1	1.5	1.0	1.0	1.0	1.0
Financial account	-6.2	-9.6	-8.9	-6.1	-10.2	-1.7	-5.1	-9.5	-9.9	-6.7	-10.1	-6.9
Direct investment, net	-8.7	-8.6	-8.0	-7.6	-5.7	-5.8	-6.2	-7.4	-7.1	-7.5	-7.6	-7.6
Portfolio investment	2.1	-0.9	-0.6	1.0	-1.9	3.2	1.0	-2.6	-2.6	1.1	-2.3	0.9
Other investment	0.4	-0.2	-0.3	0.5	-2.5	0.9	0.1	0.5	-0.3	-0.3	-0.3	-0.2
Errors and omissions	1.2	-1.6	-0.1	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net balance	-0.8	3.2	3.0	-1.4	0.8	-8.0	-2.1	2.9	3.0	0.0	3.5	0.5
Reserve assets (reserve loss = +)	-0.4	-1.6	-2.9	0.6	-0.8	3.9	2.1	-2.9	-3.0	0.0	-3.5	-0.5
Financing Gap					0.0	2.7	0.0	0.0	0.0	0.0	0.0	0.0
	(Percent change, unless otherwise noted)											
Memorandum items:												
Goods and Services												
Export value (fob)	11.1	17.5	11.1	6.2	-38.6	-38.0	33.1	70.2	16.3	17.6	6.2	6.7
Import value (fob)	7.5	9.8	7.8	6.4	-25.6	-21.4	15.9	33.5	11.6	14.0	6.1	6.3
Export volume	10.4	10.1	3.5	1.8	-35.6	-33.7	34.7	65.6	15.2	13.7	3.4	4.1
Import volume	8.3	6.0	5.8	5.0	-24.2	-19.6	15.7	32.4	10.5	12.6	4.6	4.8
Terms of trade	-6.0	8.5	6.1	-1.0	-8.7	-9.5	0.7	-0.1	0.1	-0.1	-0.1	-0.1
Gross reserves (millions of euros)	2,945	2,996	3,399	3,360	3,465	2,860	3,200	3,262	3,612	3,611	4,158	4,239
(in months of imports of goods and services)	6.5	6.2	6.6	8.8	7.8	5.3	6.4	5.5	6.4	6.0	6.5	6.3
(in percent of ARA metric)	161	156	167	160	165	152	148	151	156	150	158	160
Gross external debt (millions of euros)	7,882	7,949	8,353	8,258	9,108	7,890	9,170	8,580	9,858	9,803	10,329	10,013
Gross external debt (percent of GDP)	73.5	68.8	65.2	60.5	72.3	62.0	71.5	62.0	72.6	66.5	65.6	59.7
Nominal GDP (millions of euros)	10,720	11,559	12,820	13,644	12,592	12,717	12,833	13,835	13,573	14,749	15,749	16,764

Sources: Albanian authorities; and IMF staff estimates.

Table 3b. Albania: Balance of Payments, 2016–25

(Millions of Euros)

	2016	2017	2018	2019	2020	2020 RFI	2021	2021 RFI	2022	2023	2024	2025
									Proj.			
Current account	-812	-866	-866	-1,089	-1,332	-1428	-1,060	-1122	-1,077	-1,147	-1,206	-1,245
Goods and services (fob)	-1,806	-1,742	-1,760	-1,880	-1,957	-2186	-1,813	-1940	-1,858	-1,969	-2,080	-2,190
Goods (fob)	-2,603	-2,824	-2,871	-3,144	-2,198	-2219	-2,493	-3245	-2,777	-3,235	-3,416	-3,641
Exports	714	797	986	907	759	761	855	895	992	1,145	1,212	1,277
Imports	3,317	3,621	3,857	4,050	2,956	2980	3,349	4140	3,769	4,381	4,628	4,918
Services	797	1,082	1,111	1,264	241	34	681	1305	919	1,266	1,336	1,452
Exports	2,396	2,856	3,073	3,405	1,890	1907	2,671	3645	3,108	3,677	3,912	4,193
Imports	1,599	1,774	1,962	2,141	1,649	1874	1,990	2340	2,189	2,411	2,575	2,741
Primary Income	174	29	-14	-180	-136	-90	-132	-123	-131	-151	-157	-153
Compensation of employees (net)	260	263	285	299	247	303	270	305	297	320	346	373
Investment income (net)	-86	-234	-300	-479	-384	-393	-402	-428	-429	-471	-503	-527
Other (net)	0	0	1	0	0	0	0	0	0	0	0	0
Secondary Income	821	848	908	971	761	848	884	941	913	973	1,031	1,098
General Government (net)	48	70	67	67	44	69	71	60	23	5	-2	-2
Workers' Remittances (net)	615	636	670	702	571	632	651	707	719	782	835	888
Other private transfers (net)	158	142	171	202	146	147	162	174	171	186	198	211
Capital account	66	122	104	76	154	197	139	206	141	153	164	174
Financial account	-664	-1,115	-1,143	-827	-1,283	-214	-655	-1317	-1,348	-993	-1,589	-1,152
Direct investment, net	-936	-994	-1,022	-1,036	-723	-741	-795	-1028	-964	-1,111	-1,193	-1,274
Portfolio investment	225	-100	-76	141	-244	407	131	-362	-348	156	-355	149
Other investment	47	-22	-44	69	-316	120	9	72	-37	-38	-41	-26
Errors and omissions	129	-186	-9	108	0	0	0	0	0	0	0	0
Net balance	-81	372	380	-186	106	-1017	-266	402	412	-1	547	81
Reserve assets (reserve loss = +)	-48	-185	-371	78	-106	500	266	-402	-412	1	-547	-81
Financing Gap					0	345	0	0	0	0	0	0
									(Percent change, unless otherwise noted)			
Memorandum items:												
Goods and Services												
Export value (fob)	11.1	17.5	11.1	6.2	-38.6	-38.0	33.1	70.2	16.3	17.6	6.2	6.7
Import value (fob)	7.5	9.8	7.8	6.4	-25.6	-21.4	15.9	33.5	11.6	14.0	6.1	6.3
Export volume	10.4	10.1	3.5	1.8	-35.6	-33.7	34.7	65.6	15.2	13.7	3.4	4.1
Import volume	8.3	6.0	5.8	5.0	-24.2	-19.6	15.7	32.4	10.5	12.6	4.6	4.8
Terms of trade	-6.0	8.5	6.1	-1.0	-8.7	-9.5	0.7	-0.7	0.1	-0.1	-0.1	-0.1
Gross reserves (millions of euros)	2,945	2,996	3,399	3,360	3,465	2,860	3,200	3,262	3,612	3,611	4,158	4,239
(in months of imports of goods and services)	6.5	6.2	6.6	8.8	7.8	5.3	6.4	5.5	6.4	6.0	6.5	6.3
(in percent of ARA metric)	161	156	167	160	165	152	148	151	156	150	158	160
Gross external debt (millions of euros)	7,882	7,949	8,353	8,258	9,108	7,890	9,170	8,580	9,858	9,803	10,329	10,013
Gross external debt (percent of GDP)	73.5	68.8	65.2	60.5	72.3	62.0	71.5	62.0	72.6	66.5	65.6	59.7
Nominal GDP (millions of euros)	10,720	11,559	12,820	13,644	12,592	12,717	12,833	13,835	13,573	14,749	15,749	16,764

Sources: Albanian authorities; and IMF staff estimates.

Table 4a. Albania: Monetary Survey, 2016–25

(Billions of Leks, unless otherwise indicated; end-period)

	2016	2017	2018	2019	2020	2020 RFI	2021	2021 RFI	2022	2023	2024	2025
							Proj.					
Net foreign assets	697	700	724	729	759	771	756	792	805	806	882	902
Bank of Albania	390	391	412	402	436	379	422	406	467	463	534	545
Commercial banks	307	310	312	327	323	391	334	386	338	343	348	356
Net domestic assets	567	567	540	590	641	514	697	633	726	832	859	954
Claims on central government, net	357	351	341	378	393	413	470	421	456	508	502	579
Claims on public enterprises	27	35	20	24	22	22	23	23	23	23	23	23
Claims on the private sector	511	507	502	533	559	519	569	579	605	657	699	744
In leks	231	239	247	272	286	236	292	283	317	348	369	393
In foreign currency	280	268	255	261	272	283	276	295	288	310	330	352
Other items, net	-328	-326	-323	-346	-332	-441	-365	-390	-358	-356	-364	-392
Broad money	1,263	1,267	1,264	1,319	1,400	1,285	1,453	1,425	1,531	1,638	1,742	1,856
Currency outside banks	249	265	275	291	309	292	303	324	319	342	363	387
Deposits	1,014	1,002	989	1,027	1,091	993	1,150	1,102	1,211	1,296	1,378	1,468
Domestic currency	488	474	456	467	506	431	533	492	558	594	630	673
Foreign currency	527	528	533	561	584	562	617	610	654	702	748	796
Memorandum items:												
Broad money growth (% change)	3.9	0.3	-0.2	4.3	6.2	-2.6	3.8	10.9	5.4	7.0	6.3	6.5
Reserve money growth (% change)	7.9	2.6	-0.4	2.5	4.6	-5.7	3.2	9.0	4.1	6.3	5.4	5.8
Private sector credit growth (% change)	0.4	-0.8	-0.9	6.1	4.9	-2.5	1.8	11.4	6.4	8.7	6.2	6.6
Broad money (as percent of GDP)	85.8	81.7	77.3	78.6	89.1	78.6	86.4	78.6	84.9	84.9	84.9	84.9
Private sector credit (as percent of GDP)	34.7	32.7	30.7	31.7	35.5	31.8	33.8	31.9	33.6	34.1	34.1	34.1
Velocity (nominal GDP/broad money)	1.2	1.2	1.3	1.3	1.1	1.3	1.2	1.3	1.2	1.2	1.2	1.2
Money multiplier (absolute values)	3.0	3.0	3.0	3.0	3.1	3.1	3.1	3.2	3.1	3.2	3.2	3.2
Currency (as share of broad money)	19.7	20.9	21.8	22.1	22.1	22.7	20.9	22.7	20.9	20.9	20.9	20.9
Foreign currency deposits/total deposits	51.9	52.7	53.9	54.6	53.6	56.6	53.7	55.4	54.0	54.2	54.3	54.2
Gross reserves (millions of euros)	2,945	2,996	3,399	3,360	3,465	2,860	3,200	3,262	3,612	3,611	4,158	4,239

Sources: Bank of Albania; and IMF staff estimates.

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

Table 5. Albania: IMF Core Indicators of Financial Soundness, 2012–2020

	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Sep-20
I Capital-based									
(i) Regulatory capital as a percent of risk-weighted assets	16.2	18.0	16.8	15.7	15.7	16.6	18.3	18.3	18.6
(ii) Regulatory Tier 1 capital as a percent of risk-weighted assets	14.6	14.9	13.8	13.5	13.8	15.1	17.0	17.1	17.5
(iii) Capital as a percent of total assets									
Regulatory Tier 1 capital as a percent of total assets	7.9	7.7	7.4	8.3	8.7	9.0	9.2	9.1	9.3
Regulatory capital as a percent of total assets	8.8	9.3	9.0	9.7	10.0	9.9	9.8	9.7	9.9
Shareholders' equity as a percent of total assets	8.6	8.4	8.6	9.5	9.7	10.2	10.1	10.5	10.3
(iv) Nonperforming loans net of provisions as a percent of capital									
As a percent of regulatory Tier 1 capital	61.8	48.5	46.7	28.4	26.3	17.3	16.6	14.6	11.8
As a percent of regulatory capital	55.6	40.2	38.3	24.3	23.1	15.7	15.5	13.6	11.1
As a percent of shareholders' equity	56.9	44.8	40.2	24.8	23.6	15.3	15.0	12.7	10.7
(v) Return on equity (ROE) (annual basis)	3.8	6.4	10.5	13.2	7.2	15.7	13.0	13.5	9.1
(vi) Net open position in foreign exchange as a percent of capital									
As a percent of regulatory Tier 1 capital	4.1	4.9	10.4	9.0	8.0	7.3	8.4	8.0	7.8
As a percent of regulatory capital	3.7	4.1	8.5	7.7	7.0	6.7	7.8	7.4	7.3
As a percent of shareholders' equity	3.8	4.5	8.9	7.8	7.2	6.5	7.5	6.9	7.0
II Asset-based									
(vii) Liquid assets as a percent of total assets (Liquid-asset ratio)	29.4	27.6	31.9	32.3	31.3	30.2	34.2	35.7	34.0
(viii) Liquid assets as a percent of short-term liabilities	34.9	34.7	40.4	41.4	40.6	40.8	46.2	49.4	46.7
(ix) Return on assets (ROA) (net income to average total assets, annual)	0.3	0.5	0.9	1.2	0.7	1.5	1.3	1.4	1.0
(x) Nonperforming loans (gross) as a percent of total loans	22.5	23.5	22.8	18.2	18.3	13.2	11.1	8.4	8.3
III Income and expense-based									
(xii) Interest margin to gross income	101.1	87.9	102.2	98.0	81.6	95.6	100.8	75.7	76.5
(xiii) Noninterest expenses to gross income	65.9	58.3	61.8	57.0	50.4	71.9	77.6	61.2	60.5
IV Memorandum items									
Other (noncore) indicators:									
Customer deposits as a percent of total (non-interbank) loans	171.6	180.8	180.2	187.8	192.8	194.0	203.2	207.2	210.2
Foreign currency-denominated loans to total loans	64.5	63.0	62.4	60.8	58.6	56.4	56.1	51.2	50.0
Foreign currency-denominated liabilities as a percent of total liabilities	52.6	52.8	52.4	53.5	54.6	60.4	59.1	56.8	50.1
Other indicators:									
Risk weighted assets as a percent of total assets	54.2	52.1	53.6	62.0	63.4	59.7	53.9	53.2	53.2
Total loans as a percent of total assets	48.6	45.9	46.0	44.5	42.7	41.6	40.0	39.0	38.3
Total loans as a percent of shareholders' equity	567.4	548.8	536.3	466.8	438.6	408.9	393.8	373.3	373.4

Sources: Bank of Albania; and IMF staff estimates.

Table 6. Albania: Indicators of Capacity to Repay the Fund, 2017–25
(Under Obligated Repurchase Schedule)

(Millions of SDRs)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
Fund repurchases and charges based on the existing and prospective drawings									
In millions of SDRs	6.8	5.7	17.8	29.5	51.4	54.6	87.4	116.7	70.5
In millions of euro	8.1	7.0	22.1	34.8	59.6	63.3	101.3	135.5	81.9
In percent of gross international reserves	0.3	0.2	0.7	1.0	1.9	1.8	2.8	3.3	1.9
In percent of exports of goods and services	0.2	0.2	0.5	1.3	1.7	1.5	2.1	2.6	1.5
In percent of GDP	0.1	0.1	0.2	0.3	0.5	0.5	0.7	0.9	0.5
In percent of external public debt	0.2	0.2	0.5	0.7	1.2	1.2	1.9	2.3	1.4
In percent of quota	4.9	4.1	12.8	21.2	36.9	39.2	62.7	83.8	50.6
Fund credit outstanding (end of period)									
In millions of SDRs	296.8	291.7	277.3	388.9	344.4	295.2	211.1	96.2	26.3
In millions of euro	354.8	355.0	344.1	457.7	399.4	341.8	244.7	111.7	30.6
In percent of gross international reserves	11.8	10.4	10.2	13.2	12.5	9.5	6.8	2.7	0.7
In percent of exports of goods and services	9.7	8.7	8.0	17.3	11.3	8.3	5.1	2.2	0.6
In percent of GDP	3.1	2.8	2.5	3.6	3.1	2.5	1.7	0.7	0.2
In percent of external public debt	9.2	8.3	8.1	9.2	7.9	6.3	4.6	1.9	0.5
In percent of quota	213.0	209.4	199.1	279.2	247.3	211.9	151.6	69.0	18.9
Memorandum items:									
Gross international reserves	2506	2794	2707	2944	2759	3120	3116	3582	3647
Exports of goods and services	3056	3336	3474	2251	3041	3541	4161	4414	4705
GDP	9668	10537	10995	10699	11066	11722	12726	13567	14421
External public debt	3230	3517	3415	4246	4353	4717	4630	4981	4944
Quota	139.3	139.3	139.3	139.3	139.3	139.3	139.3	139.3	139.3

Source: IMF staff estimates.

Table 7. Albania: External Financing Requirement and Sources, 2016–2025

(Millions of Euros)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Total financing requirement	969	1,124	1,546	1,171	1,767	942	1,611	1,313	1,958	2,237
Current account (incl. official transfers)	745	744	762	1,013	1,177	921	936	994	1,042	1,071
Amortization	176	195	412	236	484	287	262	320	369	1,085
<i>Of which: IMF</i>	0	0	5	17	34	52	57	57	53	41
Change in gross reserves (increase = +)	48	185	371	-78	106	-266	412	-1	547	81
Total financing sources	840	1,311	1,555	1,063	1,767	942	1,611	1,313	1,958	2,237
Foreign direct investment, net	936	994	1022	1036	723	795	964	1111	1193	1274
Official medium- and long-term project loans	137	203	154	158	134	131	161	210	165	217
Official guaranteed loans	16	2	118	11	155	26	27	29	31	31
Official budget support loans	153	255	0	14	394	235	95	40	40	40
<i>Of which: IMF</i>	145	70	0	0	169					
Commercial borrowing (Eurobond and PBG)	0	0	498	1	650	3	500	0	500	500
Commercial Banks, net	-387	160	7	70	5	53	30	40	43	45
<i>Of which:</i>										
Portfolio investment, net	-207	104	-176	-77	-122	-99	-118	-121	-133	-140
Other investment, net	-180	56	183	147	127	152	148	161	177	184
Other	-16	-303	-245	-229	-293	-301	-167	-118	-15	129
Errors and omissions	129	-186	-9	108	0	0	0	0	0	0
Total financing needs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

Annex I. Policy Responses to the Earthquake and Covid-19 Pandemic¹

1. The support packages to deal with the immediate impact of the Covid-19 pandemic totaled 2.9 percent of the GDD (1.2 percent of GDP on the budget and 1.7 percent off the budget, respectively) in the first two budget revisions.² The earthquake reconstruction efforts were ramped up in the third budget revision in July to 2.2 percent of GDP.

Earthquake Reconstruction Fund (Lek34 billion or 2.2 percent of GDP)

2. Albania was hit by an earthquake of magnitude 6.4 in November 2019, the strongest in decades. The earthquake caused 51 victims and damages to the tune of 7 percent of GDP. An international donor conference hosted by the EU in February secured pledges of €1 billion in loans and grants. Many pledges are in kind or related to projects. The authorities had budgeted initially Lek20 billion (1.2 percent of GDP) for reconstruction in 2020, to be financed by Lek7 billion in grants and the rest from the budget. In the third budget review, the authorities lowered the expectations for grant disbursements to Lek3 billion received so far and increased the overall spending to Lek34 billion (2.2 percent of GDP).

Covid-19 Support Measures:

I. Fiscal

On-budget measures (Lek19 billion or 1.2 percent of GDP).

- **Additional spending for the health sector** of Lek2.5 billion to support purchase of new equipment and the repurposing of hospitals, bonuses for front line health workers. As of September, some 35% of this amount has been spent.
- A package of Lek6.5 billion for **wage and social support** that included support of small businesses/self-employed that were forced to close activities due to the COVID-19 pandemic by paying them minimum salaries (up to two in the case of family businesses with unpaid family members) for 3 months; the doubling of the unemployment benefits and social assistance layouts for 3 months. As of September, about 95% of these funds were disbursed.
- Lek2 billion of defense spending reallocated toward **humanitarian relief** for the most vulnerable. This reallocation was later cancelled.

¹ Information is as of October 2020.

² In September, an Employment Promotion Program was announced to cover part of re-employment costs of those who lost their jobs during the lockdown, and financing of the program (Lek200 million) is accommodated through reallocations.

- A Lek7 billion **one-off transfer** of Lek40,000 to employees of small businesses affected by the pandemic not covered in the first package, to employees of large businesses laid off due to the pandemic, and employees in the tourism sector. An additional support of one-month minimum wage was offered in August to workers of public transport, whose opening was delayed by a month. The cost of Lk0.1bn was financed by reallocations. As of September, 97% of these funds were disbursed.
- Increase of Lek1 billion in the reserve and contingency fund for Covid-19 related expenses.
- **Deferred taxes**—All large companies (except banks, telecommunication, public enterprises and other essential businesses) can defer payment of profit tax for the second and third quarter of 2020 in 2021. Tourism, active processing and call centers can defer payments for the rest of 2020 to 2021.
- **Foregone revenue**—Small businesses with annual turnovers below Lek14 million will not pay profit tax for the remainder of 2020 (Lek80 million).

Off-budget measures (Lek26 billion—1.7 percent of GDP). The government established two unfunded standardized guarantee schemes to support businesses.

- A sovereign guarantee fund of Lek 11 billion (0.6 percent of GDP) for large companies to access overdrafts in the banking system to pay wages for their employees for up to 3 months, with an interest rate capped at 2.85 percent and a maturity of up to 2 years. The government will bear the interest costs.³ The take up of the scheme is 59 percent.
- A recovery fund guarantee scheme of Lek15 billion (1 percent of GDP) to provide loans for working capital and investments for all private companies that were tax-compliant and solvent before the pandemic. The government will guarantee 60 percent of the loans, and interest is capped at 5 percent for a maturity of up to 5 years. The take up of the scheme is 42 percent.

II. Monetary and Financial Measures

- **Monetary policy:** On March 25th, the Bank of Albania cut its key policy rate—the weekly repo rate—by 50 basis points to a new historic low of 0.5 percent. It also reduced the interest rate for the overnight lending facility from 1.9 percent to 0.9 percent.
- The central bank switched its open market operations from fixed amount of liquidity to unlimited amounts with a fixed price for as long as necessary to ensure liquidity to the banking system.
- **Moratoriums and regulatory forbearance measures:** To address the liquidity bottlenecks of companies and individuals, the Bank of Albania introduced a loan repayment moratorium

³ This payment is on the budget, estimated at maximum of Lek92 million for 2020.

through end-August, enabling borrowers to ask banks and other financial institutions⁴ to defer loan installments without penalties. Almost 40% of the loan portfolio of banks benefited from the opt-in moratorium. The BOA also adopted regulations to allow banks to restructure loans within 2020 without additional provisioning or downgrades for borrowers' status. Entry in force of more stringent classification and provisioning measures for reclassified loans was postponed by one year to January 1, 2022. Out of court restructuring for distressed borrowers under a special regulation will be possible for an additional year until January 1, 2022.

- The Bank of Albania suspended banks' dividend payments through end-2020.
- **FX interventions:** Albania has a floating exchange rate and the Bank of Albania intervenes only in pre-announced purchases to boost reserves or to smooth excessive and disruptive exchange rate volatility. In end-March the BOA intervened by selling €20.4m to smooth temporary excessive volatility caused by initial disruptions due to the lockdown measures (including lack of physical cash as a result of halted flights).
- On April 1st, the BOA amended the capital adequacy regulation, lowering the risk-rating of euro-denominated securities issued in 2020 from 50 percent to zero. This was done prior to the April 6th government auction, in which 100 million euro-denominated government securities were issued in the domestic market.
- On April 8, the BOA decided to temporarily remove any commissions applied by banks on the non-paper based credit transfers in Lek from their clients and the fees charged to participants in the BOA payment systems. The purpose was to further promote home banking services, especially during the lockdown.

⁴ The moratorium for non-bank financial institutions lasted only till May 31st.

Annex II. Risk Assessment Matrix¹

Source of Risk	Relative Likelihood	Impact if Realized	Policy Advice
<i>External risks</i>			
Unexpected shift in the Covid-19 pandemic.			
<ul style="list-style-type: none"> Downside 	High	<p>High</p> <p>The disease proves harder to eradicate causing more containment measures and worse external environment. This could further lower tourism receipts, remittances, and exports and lead to tighter global financial conditions, weighing on Albania's economic activity, fiscal performance and debt, and financial stability.</p>	<p>Prepare for adverse scenarios. Flexibly adjust mitigation measures and budget support. Better target policies to support health care, the most vulnerable, and the economy. Seek external financing. Closely monitor and manage financial sector vulnerabilities.</p>
<ul style="list-style-type: none"> Upside 	Low	<p>High</p> <p>Recovery from the pandemic is faster than expected due to the discovery of an effective and widely available vaccine and/or a faster-than-expected behavioral adjustment to the virus that boosts external demand and economic activity in Albania.</p>	<p>Embark on more front-loaded and faster fiscal consolidation. Use upsides to reduce public debt faster.</p>
Weaker than expected growth in main trading partners	High	<p>High</p> <p>Growth deterioration in Albania's main export destinations and sources of remittances might spill over to Albania through lower demand for exports and a decline in remittances.</p>	<p>Continue to diversify export markets. Improve the business environment to support growth in exports and investment. If a significant external shock were to materialize, allow automatic stabilizers to operate, while strengthening the debt anchor.</p>
Accelerating de-globalization	High	<p>Medium</p> <p>Geopolitical competition and fraying consensus about the benefits of globalization lead to further fragmentation. Pandemic-prompted protectionist actions (e.g., export controls) could re-ignite broader protectionist measures and affect Albania's exports and imports.</p>	<p>Continue with export product and trading partner diversification. Advance structural reforms to support economic diversification and private sector development.</p>
<i>Domestic risks</i>			
Lack of fiscal buffers	High	<p>High</p> <p>The financing gaps continue to increase and no fiscal buffers for mitigating shocks are available.</p>	<p>Contain non-priority spending to free resources for emergency responses and ensure appropriate uses and monitoring. Once the pandemic recedes, resume revenue-based fiscal consolidation and put public debt on a clear downward path.</p>

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.

Source of Risk	Relative Likelihood	Impact if Realized	Policy Advice
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 public investment management and governance and transparency of PPPs. Upgrade the capacity of the Ministry of Finance to undertake financial analysis of new PPP contracts and their direct or contingent impact on fiscal for the lifetime of the project.
Intensification of financial sector vulnerabilities	Medium	Medium A surge in non-performing loans could lower capital adequacy levels, affecting banking sector stability and the ability to extend credit to the private sector.	Closely monitor the financial sector and continue to improve NPL resolution. Restrict dividend distributions. Continue to strengthen and implement the capital and liquidity regulatory framework, with longer phase-in periods. Remain vigilant through onsite and off-site supervision.
Rollover of public debt	Medium	Medium Elevated levels of net domestic borrowing could raise concerns about the ability of foreign-owned banks with limits on exposure to the sovereign to absorb additional borrowing and/or crowding out credit to private sector.	Diversify the debt holders base and lengthen debt maturity. Improve market communication and coordination with the central bank. Resume revenue-based fiscal adjustment and debt reduction once the pandemic recedes.
Social discontent and political instability	Medium	High Social tensions erupt as the pandemic and inadequate policy response cause economic hardship and exacerbate preexisting socioeconomic inequities. 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.
Adverse weather conditions	Medium	Medium Drought 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.

Annex III. An Illustrative Adverse Scenario

1. Given the large uncertainty associated with the pandemic and growing downside risks, staff developed an illustrative adverse scenario. The baseline scenario assumes the economy to recover slowly from the second half of 2020 and strengthen gradually over 2021-22. The adverse scenario assumes that in 2021-22 progress in the fight against the virus proves to be slower than assumed in the baseline. Global financial conditions are also assumed to tighten, cutting off European emerging markets' access to capital markets.

2. Under the adverse scenario, Albania's public debt is expected to increase in 2021 and 2022, reserves would decline, and fiscal and external financing gaps are likely to emerge.

Albania: Adverse Scenario, 2020-2022						
(Percent of GDP, unless otherwise specified)						
	Baseline			Adverse scenario		
	2020	2021	2022	2020	2021	2022
Real Sector						
GDP growth (percent)	-7.5	5.4	5.0	-7.5	2.0	2.5
Balance of Payments						
Current Account Balance	-10.6	-8.3	-7.9	-10.6	-10.4	-9.8
Financial Account Balance (- = inflow)	-10.2	-5.1	-9.9	-10.2	-4.0	-5.2
BOP Financing Gap	0.0	0.0	0.0	0.0	1.2	1.4
Reserves (million Euro)	3465	3200	3612	3465	2965	2715
In months of imports	7.8	6.4	6.4	7.8	6.4	5.2
In percent of ARA EM Metric	165	148	156	165	141	126
Reserves excluding banks' FX reserves (million Euro)	2871	2602	2965	2871	2368	2068
In months of imports	6.5	5.2	5.2	6.5	5.1	4.0
In percent of ARA EM Metric	136	121	128	136	113	96
Fiscal Sector						
Tax Revenue	23.2	24.7	25.2	23.2	24.0	24.6
Expenditure	32.1	33.0	29.8	32.4	33.5	30.7
Fiscal balance	-6.8	-6.1	-3.0	-6.8	-7.3	-4.3
Primary fiscal balance	-4.7	-4.0	-0.9	-5.0	-5.1	-2.1
Fiscal Financing Gap	0.0	0.0	0.0	0.0	1.2	1.4
Public debt	81.9	81.5	79.6	82.2	87.1	88.1
Eurobond issuance (million Euro)	650	0	500	650	0	0

Source: IMF Staff projections.

- Growth.** Continued containment efforts and persistent behavioral changes will negatively impact tourism. Weaker-than-expected growth of trading partners, particularly in advanced Europe, is expected to lower exports and remittances. Real GDP growth in 2021 declines to about 2 percent, with a weaker recovery also in 2022 relative to the baseline. Inflation would also be slightly lower relative to the baseline, with both demand and supply being constrained. Lower exports of goods and services and tightening of global financial conditions would lead to an additional nominal exchange rate depreciation relative to the baseline.

- **External.** Due to lower tourism receipts, remittances, and exports, the current account would worsen in 2021-22 relative to the baseline. Reflecting the weaker external and domestic environment, the adverse scenario assumes some pressures on the financial account, including notably lack of access to international financial markets. It also assumes some additional drawdown of reserves to finance the current account. External financing gaps are expected to emerge unless additional IMF or other external financing is mobilized
- **Fiscal.** Reflecting lower revenues stemming from a weaker economy, the overall fiscal deficit in 2021-22 would deteriorate relative to the baseline. The adverse scenario assumes no Eurobond issuance and that additional domestic financing by banks would be limited. As a result, Albania could face a fiscal financing gap for 2021–22, unless additional IMF or other external financing is mobilized. Lower growth, higher deficits, and larger nominal exchange rate depreciation would raise the public debt to about 88 percent of GDP in 2022.

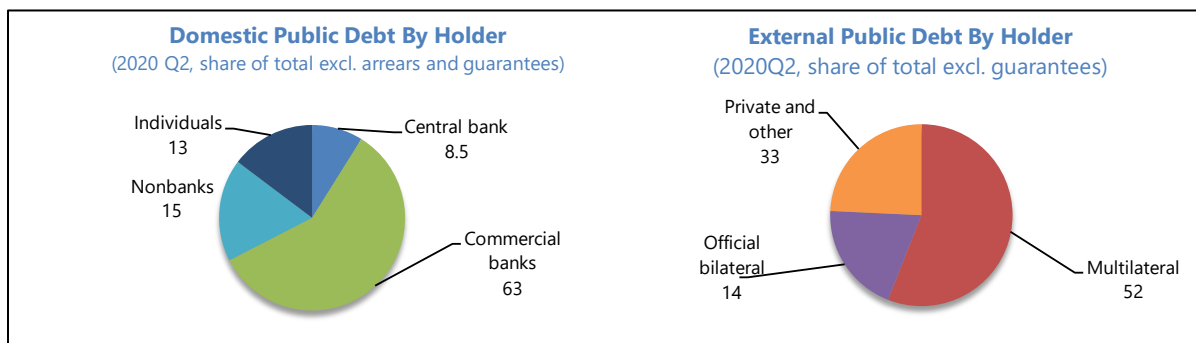
Annex IV. Debt Sustainability Analysis

Public Debt Sustainability

The COVID-19 pandemic, combined with the strong earthquake that struck Albania in November 2019, has resulted in additional expenditure pressures and a large economic contraction, which are expected to reverse the declining trend of debt in recent years and raise Albania's public debt to about 82 percent of GDP in 2020. As the pandemic is expected to subside after 2020 and growth is boosted by reconstruction, Albania's public debt is projected to return to its downward path from 2021 and decline to just below 70 percent by 2025. The debt path is high and subject to significant risks. Gross financing requirements also remain large, reflecting sizable rollover needs including maturing Eurobonds in 2020 and 2025. Stepped up efforts will be important to alleviate these risks. Once the effects of the shocks subside, it would be critical to resume revenue-based consolidation to rebuild space for fiscal policy maneuver and put debt on a solid downward path.

A. Background

1. Debt Profile¹. Albania's debt profile has gone through several changes. Over a decade, the share of external debt in total public debt went up from about 30 percent in 2008 to about 50 percent in June 2020. Domestic debt represents about 50 percent of total public debt. The maturity profile of domestic debt has gone through a transformation: the share of long-term paper went up from about half of the total domestic debt in 2011 to more than 65 percent in June 2020. The average weighted maturity of domestic public debt increased from less than one year in 2011 to about 2.2 years as of June 2020. The lengthening of maturity has reduced rollover risks and improved cost efficiency. Rollover risks have also been lessened by the ample liquidity of the banking system. Nonetheless, further lengthening of maturities is needed to help reduce the still very high annual financing requirements, combined with the preparation of mitigation strategies to address possible tightening of domestic financing conditions. In this context, the ongoing development of the market maker program for longer-term benchmark bond issuances and seeking of foreign official financing should be helpful. At the same time, the MOFE is encouraged to resume the issuance of short-term debt (specifically for 3–6 months maturity), to support liquidity



¹ Public debt refers to the general government and includes all public guarantees for energy and non-energy sector debt and stock of central and local government arrears. It does not include PPPs.

management and market development. About 90 percent of domestic debt was denominated in domestic currency, whereas 60 percent of external debt was denominated in Euro.

B. Public DSA Results

Baseline Scenario

2. **Macroeconomic assumptions.** GDP growth in 2020 has been revised down by about 11 percentage points relative to the pre-earthquake baseline scenario to -7.5 percent. A partial rebound is projected in 2021. With the issuance of a Eurobond of €650 million in June 2020, the baseline assumes further tapping the international capital markets in 2022 and 2025.
3. **Debt level under the baseline and alternative scenarios.** Under the baseline scenario, gross debt is projected to decline gradually from a peak of 81.9 percent in 2020 to 69.1 percent of GDP in 2025. Gross financing needs over the same period are projected to remain elevated, averaging 20.4 percent. Under the constant-primary-balance scenario (assuming the primary deficit remains at the level of 2020 at 4.7 percent of GDP), the debt ratio would continue to increase over the projection horizon, reaching about 89 percent in 2025. The historical scenario (assuming real GDP growth, the primary balance and real interest rates at the historical average of the past ten years) projects debt at about 77 percent of GDP by 2025.
4. **Heat map and debt profile vulnerabilities.** Risks related to the level of debt remain elevated. Gross financing needs breach the 15 percent threshold over the projection period. The debt profile shows moderate risks related to the declining share of short-term debt (green in the heatmap). However, the debt profile remains vulnerable to high external financing needs, interest rates risks, the sizeable share of foreign currency debt, and debt held by non-residents. Exchange rate risks will remain important given the projected increase in foreign currency debt (as a share of total debt).

Stress Test and Stochastic Simulations

5. **The debt ratio remains above 70 percent of GDP under all stress scenarios, and it is particularly sensitive to the fiscal stance, interest rate and real GDP growth shocks.** Under those stress scenarios, debt peaks at about 84 percent GDP in 2021 before declining to between 72 to 75 percent of GDP in 2025. Sensitivity to exchange rate shocks is also notable, as under this scenario public debt reaches about 72 percent of GDP in 2025. 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 stagnate at about 88 percent of GDP during 2021-22 before declining to about 83 in 2025. The fan charts illustrate the possible evolution of public debt over the medium term and are based on both symmetric and asymmetric distributions of risks. Under an asymmetric distribution of risks, there is a high level of certainty that the debt stock will be in the range of 71 to 88 percent of GDP.

External Debt Sustainability

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

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

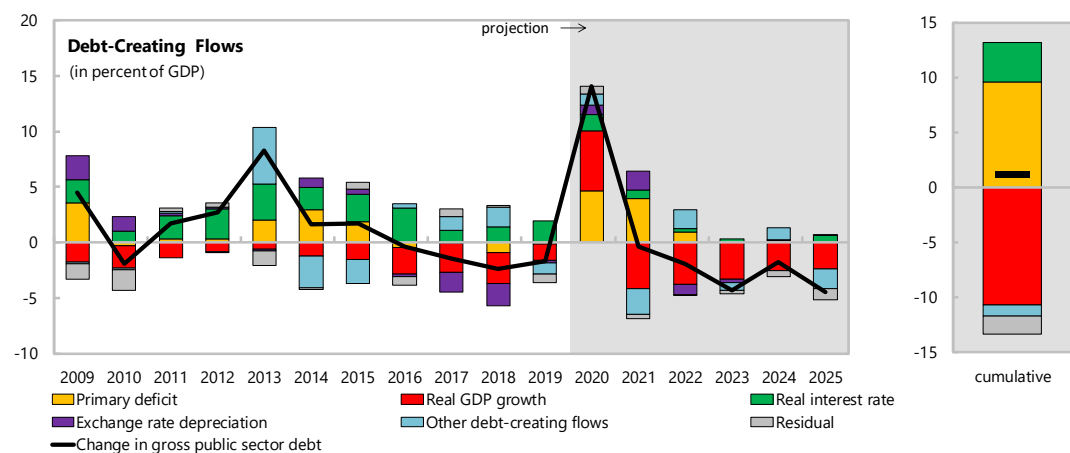
- **External debt** is projected to rise to about 72 percent of GDP in 2020 before declining gradually to just below 60 percent by 2025. Over the same period, the external private debt stock is expected to fall from about 36 to 28 percent of GDP. Although the accumulation of FDI-related debt liabilities 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.
- Regarding **public external debt**, the remaining maturity of €250 million of a €450 million Eurobond issued in 2015 (after having retired €200 million in October 2018) came due in 2020. In line with this, total public and private external debt service is expected to increase to 18 percent of GDP in 2020 but to fall to 14 percent by 2024 before increasing again to 17 percent with large amortization payments in 2025. The recent issuance of €650 million Eurobond helps meet the gross financing needs in 2020. In line with the expected succession of new Eurobond issuances, commercial debt as a percentage of total public sector debt is expected to increase from 13 percent at end-2019 to 19 percent by end-2020, 25 percent in 2022, and 34 percent in 2025.

8. Stress test results. Under a 30 percent exchange rate depreciation shock, external debt would peak at 106 percent of GDP in 2021 before declining to 89 percent by 2025. Depreciation shocks are likely to have added significance for debt dynamics in view of increased external commercial borrowing. Following a shock to the current account of half a standard deviation (around 1 percent of GDP), external debt would peak at 73 percent of GDP in 2021 and gradually decline to 64 percent by 2025.

Figure 1. Albania: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario
(In percent of GDP, unless otherwise indicated)

	Debt, Economic and Market Indicators ^{1/}										As of Nov 02, 2020		
	Actual			Projections									
	2009-2017 ^{2/}	2018	2019	2020	2021	2022	2023	2024	2025				
Nominal gross public debt	66.7	69.5	67.8	81.9	81.5	79.6	75.3	73.5	69.1	Sovereign Spreads			
Of which: guarantees	3.8	2.7	2.5	3.5	3.3	3.1	2.9	2.7	2.5	Spread (bp) ^{3/}	365		
Public gross financing needs	34.7	21.6	20.7	24.1	20.1	20.2	18.9	20.9	22.0	5Y CDS (bp)	n.a.		
Real GDP growth (in percent)	2.6	4.1	2.2	-7.5	5.4	5.0	4.4	3.5	3.4	Ratings	Foreign	Local	
Inflation (GDP deflator, in percent)	1.5	1.4	0.4	1.2	1.5	2.1	2.5	2.7	3.0	Moody's	B1	B1	
Nominal GDP growth (in percent)	4.1	5.5	2.6	-6.3	7.0	7.2	7.0	6.3	6.5	S&P's	B+	B+	
Effective interest rate (in percent) ^{4/}	5.1	3.4	3.2	3.1	2.6	2.7	2.9	3.1	3.3	Fitch	n.a.	n.a.	

	Contribution to Changes in Public Debt											
	Actual			Projections							cumulative	debt-stabilizing primary balance ^{10/}
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025			
Change in gross public sector debt	1.9	-2.4	-1.7	14.1	-0.4	-1.9	-4.3	-1.8	-4.5	1.2		
Identified debt-creating flows	2.2	-2.5	-0.9	13.4	0.0	-1.8	-4.0	-1.2	-3.5	2.9		
Primary deficit ^{5/}	1.1	-0.9	-0.1	4.7	4.0	0.9	0.0	0.0	0.0	9.6		-3.5
Primary revenue and grants ^{5/}	26.0	27.5	27.4	25.3	26.9	26.9	26.9	26.7	26.7	159.3		
Primary expenditure ^{5/}	27.2	26.6	27.3	30.0	30.8	27.8	26.9	26.7	26.7	168.9		
Automatic debt dynamics ^{6/}	0.9	-3.5	0.2	7.7	-1.6	-4.4	-3.4	-2.3	-1.7	-5.7		
Interest rate/growth differential ^{7/}	0.6	-1.4	0.4	6.8	-3.4	-3.4	-3.0	-2.3	-1.8	-7.1		
Of which: real interest rate	2.2	1.4	1.9	1.4	0.8	0.4	0.3	0.2	0.6	3.6		
Of which: real GDP growth	-1.6	-2.8	-1.5	5.4	-4.1	-3.8	-3.3	-2.5	-2.4	-10.7		
Exchange rate depreciation ^{8/}	0.3	-2.1	-0.2	...	...	...	...	...	...	...
Other identified debt-creating flows	0.2	1.8	-1.0	1.0	-2.3	1.7	-0.7	1.1	-1.8	-1.0		
Accumulation of general govt. deposits	0.0	2.1	-1.0	1.0	-2.3	1.7	-0.7	1.1	-1.8	-1.0		
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Creation/clearance of end-2013 stock of arrears	0.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual ^{9/}	-0.4	0.2	-0.7	0.7	-0.4	-0.1	-0.3	-0.6	-1.0	-1.7		



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 7-year eurobond issued in October 2018.

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

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

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

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

The large residual in 2019 is due to a combination of a large accumulation of deposits in BoA and large repayment of arrears

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.

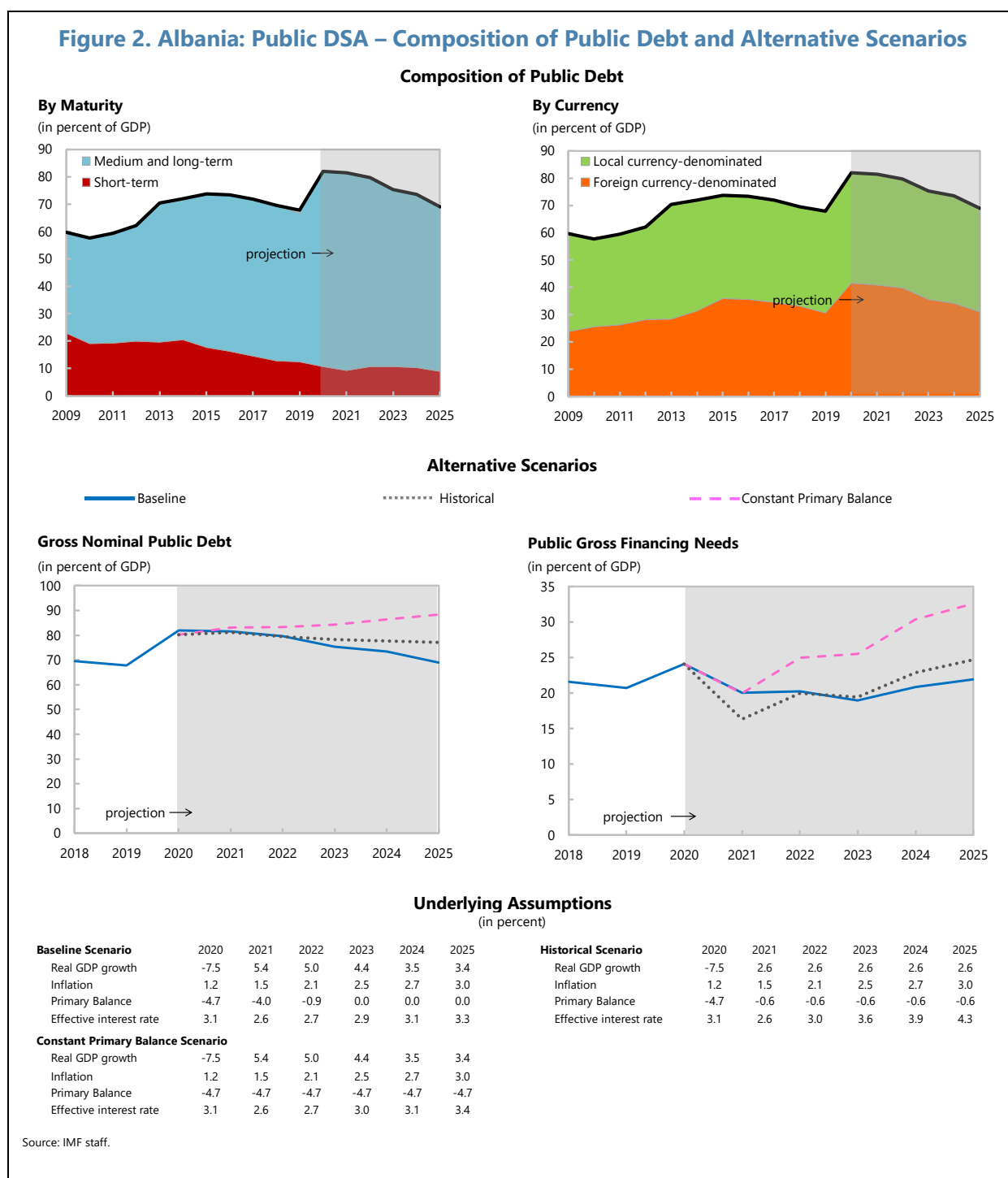
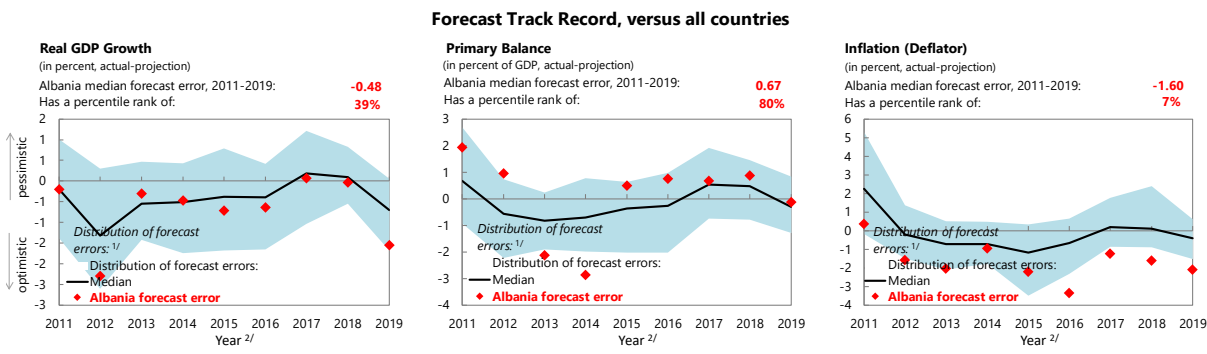
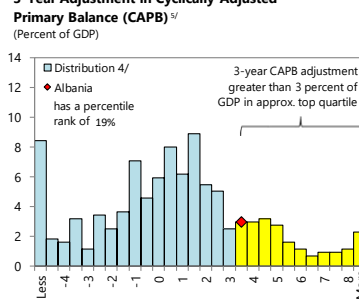
Figure 2. Albania: Public DSA – Composition of Public Debt and Alternative Scenarios


Figure 3. Albania: Public DSA – Realism of Baseline Assumptions

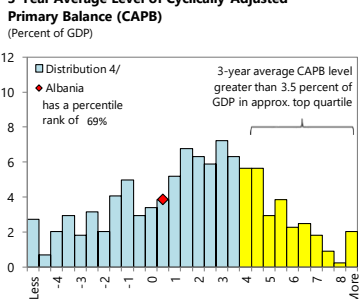


Assessing the Realism of Projected Fiscal Adjustment

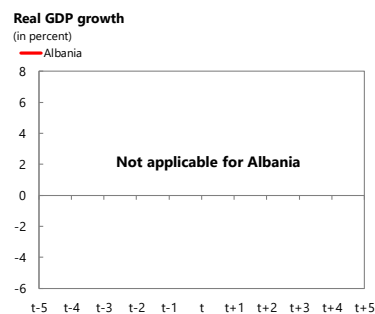
3-Year Adjustment in Cyclically-Adjusted



3-Year Average Level of Cyclically-Adjusted



Boom-Bust Analysis ^{3/}



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 observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.
 5/ The large 3-year improvement in Albania's CAPB is due to substantial arrears clearance in 2015-2017.

Figure 4. Albania: Public DSA – Stress Tests

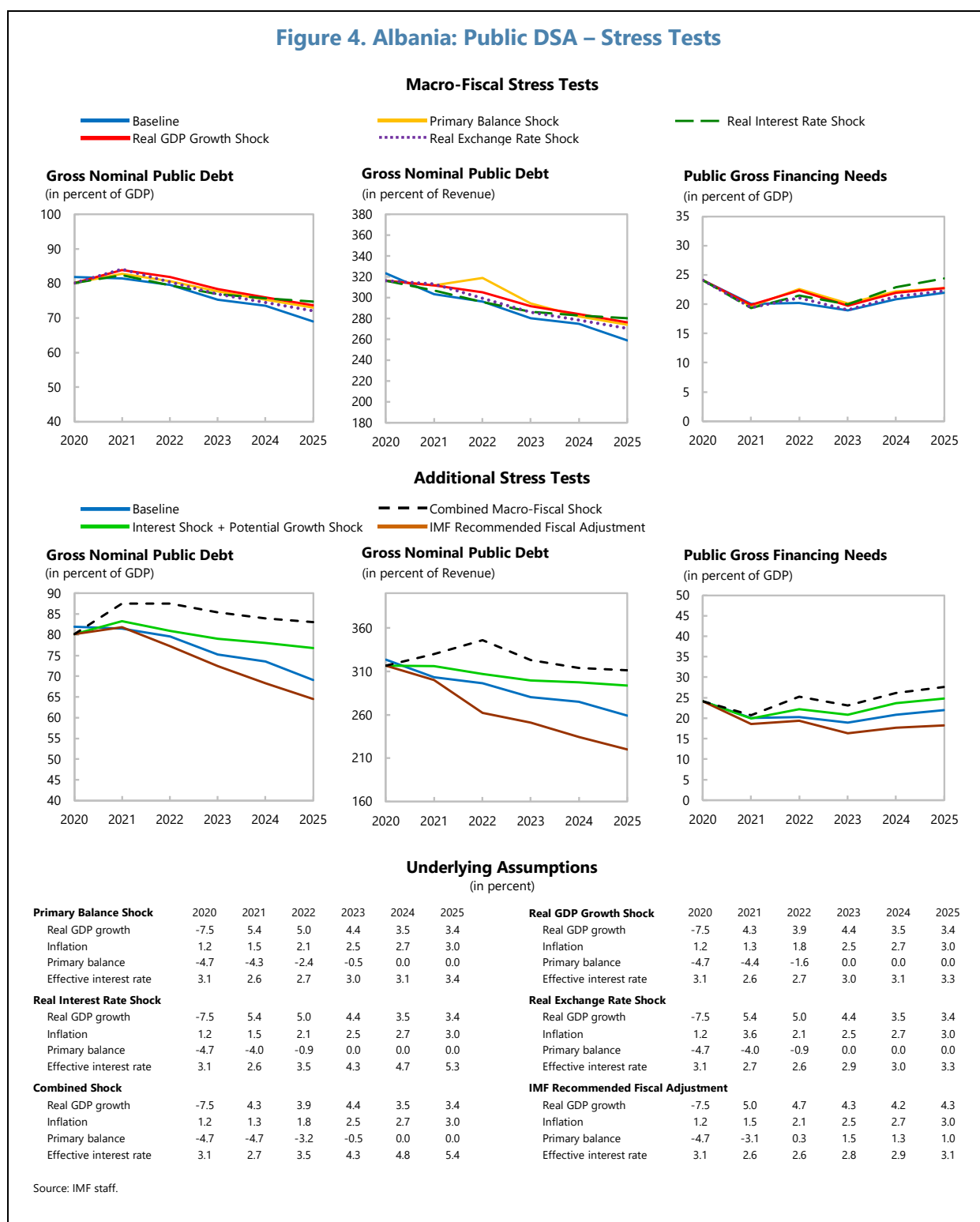
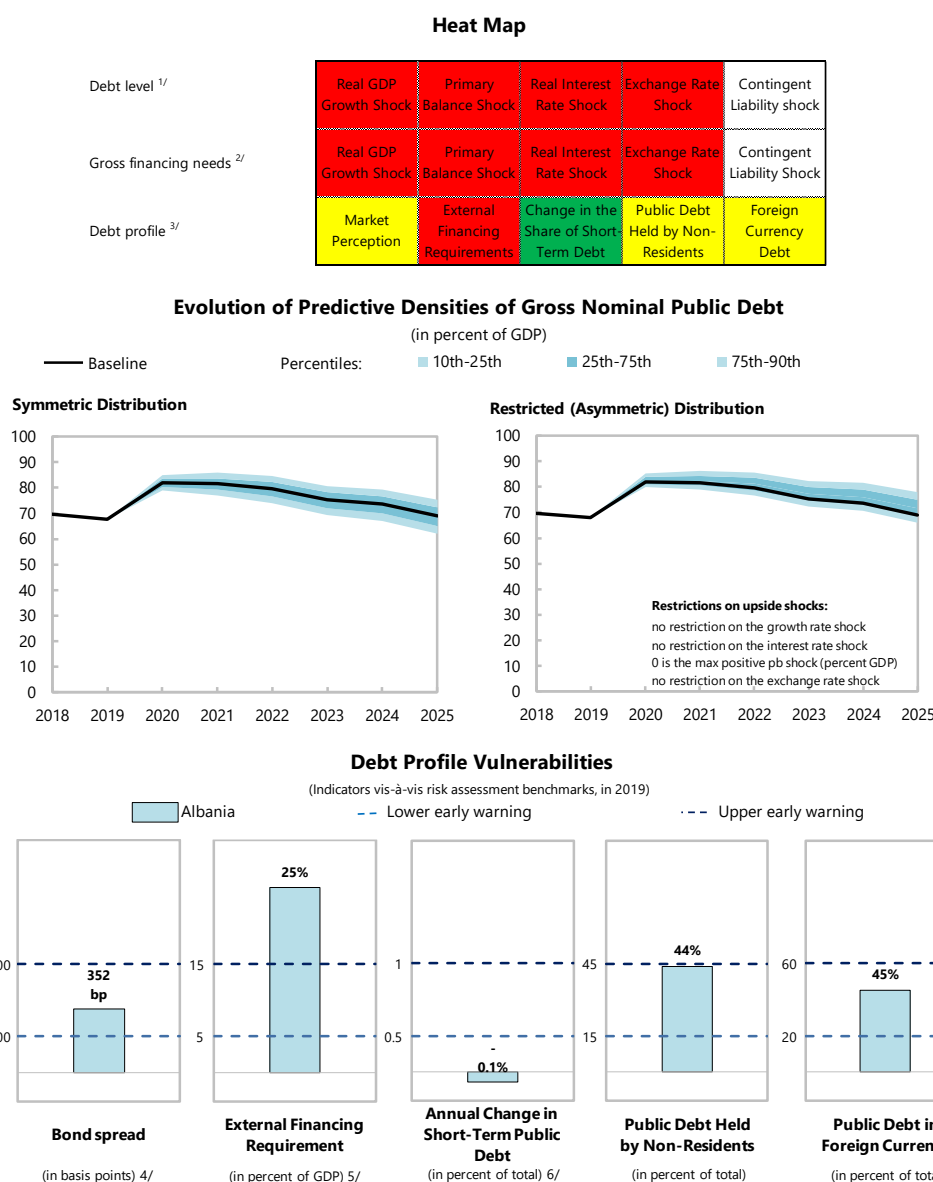


Figure 5. Albania: Public DSA Risk Assessment



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, last available observation as of November 2, 2020.

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.

Table 1. Albania: External Debt Sustainability Framework, 2015–2025
(Percent of GDP, unless stated otherwise)

	Actual					Projections						
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	
Baseline: External debt	72.9	70.0	72.1	62.8	60.1	72.4	71.2	71.7	66.1	65.2	59.5	
Change in external debt	8.4	-2.9	2.0	-9.3	-2.7	12.3	-1.2	0.5	-5.7	-0.8	-5.7	
Identified external debt-creating flows (4+8+9)	11.2	-4.1	-7.5	-11.2	-0.5	10.5	-2.3	-3.2	-2.7	-2.3	-2.5	
Current account deficit, excluding interest payments	7.7	6.8	6.7	5.9	6.8	10.5	7.2	7.0	7.0	6.9	6.7	
Deficit in balance of goods and services	17.3	16.8	15.1	13.7	13.8	16.0	15.3	14.9	14.8	14.7	14.7	
Exports	27.3	29.0	31.6	31.7	31.6	20.6	26.1	28.4	30.9	30.8	30.9	
Imports	44.6	45.9	46.7	45.4	45.4	36.6	41.4	43.3	45.8	45.5	45.5	
Net non-debt creating capital inflows (negative)	-8.0	-8.7	-8.6	-8.0	-7.6	-5.7	-6.2	-7.0	-7.5	-7.5	-7.6	
Automatic debt dynamics 1/	11.4	-2.1	-5.6	-9.1	0.3	5.7	-3.3	-3.2	-2.3	-1.6	-1.7	
Contribution from nominal interest rate	0.9	0.8	0.7	0.9	0.8	0.9	0.7	0.7	0.6	0.5	0.5	
Contribution from real GDP growth	-1.7	-2.3	-2.4	-2.5	-1.4	4.8	-4.0	-3.8	-2.8	-2.1	-2.1	
Contribution from price and exchange rate changes 2/	12.2	-0.6	-4.0	-7.4	0.9	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	-2.7	1.2	9.5	1.9	-2.2	1.9	1.0	3.8	-2.9	1.4	-3.2	
External debt-to-exports ratio (in percent)	267.4	241.5	228.1	198.3	190.4	351.0	272.6	252.1	213.4	211.9	192.8	
Gross external financing need (in billions of US dollars) 4/	3.4	2.8	3.0	3.6	3.5		4.2	3.7	3.8	4.2	4.1	
in percent of GDP	30.2	23.8	23.0	23.8	23.2	10-Year	29.4	23.5	22.2	22.7	20.6	
						10-Year	29.4	23.5	22.2	22.7	20.6	
Scenario with key variables at their historical averages 5/							72.4	76.0	81.2	80.6	84.5	
											82.3	
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation				For debt stabilization	
Real GDP growth (in percent)	2.2	3.3	3.8	4.1	2.2	2.6	1.1	-7.5	6.1	5.8	4.3	
GDP deflator in US dollars (change in percent)	-15.9	0.8	6.0	11.5	-1.4	0.1	7.6	1.8	3.9	1.8	4.0	
Nominal external interest rate (in percent)	1.2	1.1	1.2	1.4	1.3	2.0	1.1	1.5	1.1	1.0	0.9	
Growth of exports (US dollar terms, in percent)	-16.9	10.8	19.9	16.2	0.5	5.2	11.0	-38.4	39.4	17.4	18.0	
Growth of imports (US dollar terms, in percent)	-18.8	7.2	12.0	12.8	0.8	2.0	11.1	-24.0	24.7	12.7	14.5	
Current account balance, excluding interest payments	-7.7	-6.8	-6.7	-5.9	-6.8	-8.2	1.8	-10.5	-7.2	-7.0	-7.0	
Net non-debt creating capital inflows	8.0	8.7	8.6	8.0	7.6	8.1	0.9	5.7	6.2	7.0	7.5	

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.

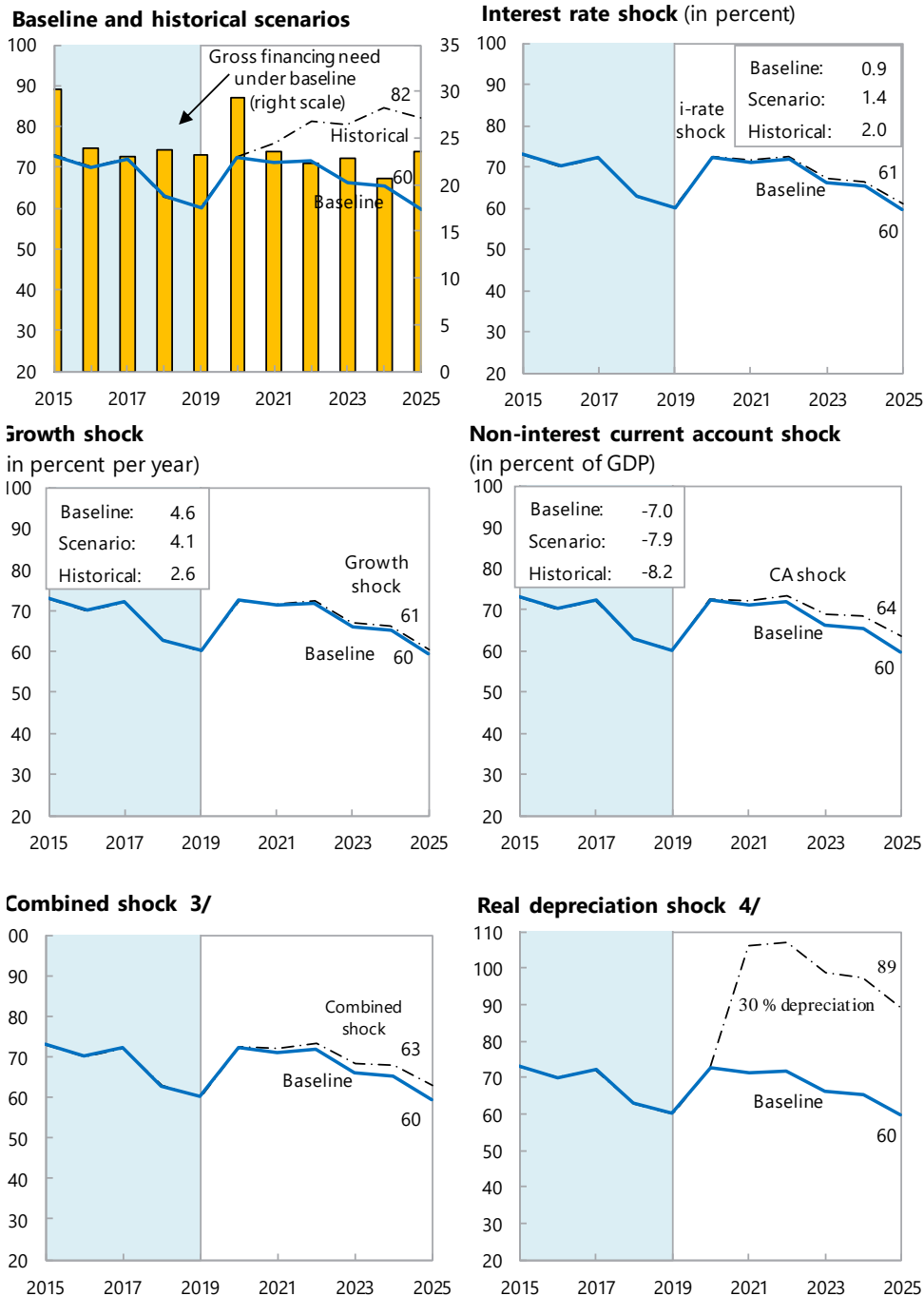
2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

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.

Figure 6. Albania: External Debt Sustainability: Bound Tests ^{1/ 2/}
 (External debt in percent of GDP)



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

Annex V. Recent Developments in Financial Regulations¹

Bank Capital Standards

- Increase of Tier 1 capital requirement [2019]
- Further alignment with Capital Requirement Regulation (CRR) requirements [2020]
- Basel III Leverage Ratio [Planned, 2020]

Notes:

- Minimum capital adequacy ratio in Albania is set at 12% (vs. 8% in Basel standards) and can be higher for specific banks with known issues.
- FX unhedged loans are subject to an additional risk weight of 50%, subject to total risk weight not exceeding 200%.
- The required ratio between Tier 1 capital and risk weighted assets increases from 4.5% to 6.75%, and the ratio between tier 1 capital and risky exposures increases from 6% to 9%.

Bank Liquidity Standards

- Basel III Liquidity Coverage Ratio [2019]
- Basel III Net Stable Funding Ratio [Planned, 2020]
- Internal Liquidity Adequacy Assessment Process [Planned, 2021]

Note:

- LAR is set at a minimum level of 15% for local currency and 20% for foreign currency, while it is set at 20% for the aggregate position, in line with Albania's de-euroization package.

Bank Supervision

- Increase in the frequency of on-site and off-site supervision and tighter reporting requirements for banks with recent change in shareholder structure [2019]
- Pillar 2 Supervisory Review and Evaluation Process (SREP) [Planned, 2020]
- Further enhancements to off-site monitoring of banks' delinquent loans and recovery rates [Planned, 2020]

Macro-Prudential Frameworks

- Methodology on enhanced monitoring of systemic risks through a Systemic Risk Heat Map [2019]
- Countercyclical capital buffer framework [2019]
- Capital conservation buffer framework [2019]
- Framework for identification of domestic systemically important banks (D-SIBs) and higher loss absorbency requirement for them [2019]

Other Bank Regulations and Guidelines

- Amendments to the regulation on the prevention of money laundering and terrorist financing [2019]

¹ For laws and regulatory acts/decisions/guidelines, [year] means "approval year", [Planned, Year] means "expected to be approved year".

- Enhancements to the regulation on licensing and transfer of significant ownership [2019]
- Guidelines on stress testing [2019]
- Regulation on the out-of-court treatment of distressed borrowers by banks [2019]
- Amendments to the regulation on credit risk management from banks and branches of foreign banks [2019]
- Regulation on the conditions for granting prior approval for the financial support agreement within the banking group [2020]
- Alignment of Albanian large exposures regulations with the Basel supervisory framework for measuring and controlling large exposures [2020]
- Guidelines on market risk management and regulation on interest rate risk in banking book [Planned, 2020]

Note:

- Amendments to the regulation on credit risk management from banks and branches of foreign banks adjust the restructured loans provision requirement (delayed entrance into force by January 1, 2022) and reduce the period for loss loans obligatory write-off from three years to two years.

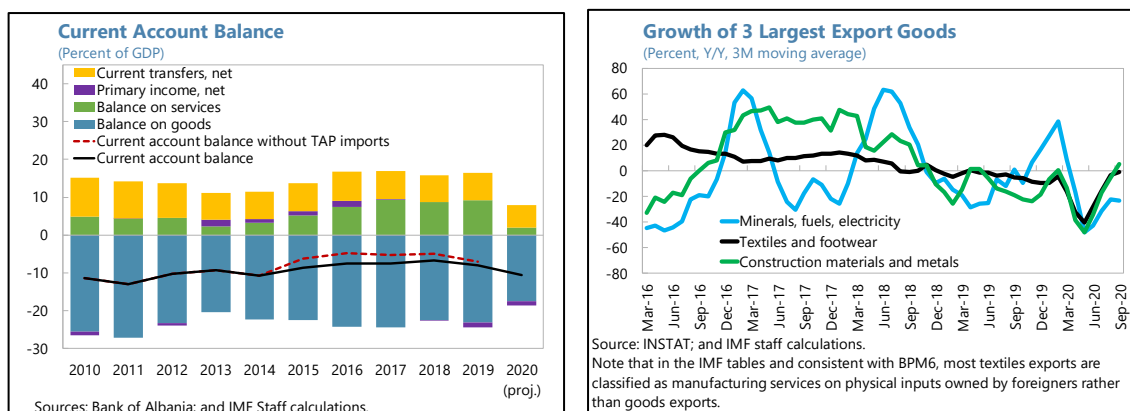
Regulatory Framework for Capital Market and Investment Funds

- New capital market law, aligning with EU regulations [2020]
- New law for collective investment undertakings [2020]
- New investment funds law, converging with EU regulations and clarifying licensing, supervision, and investors and consumer protection [2020]

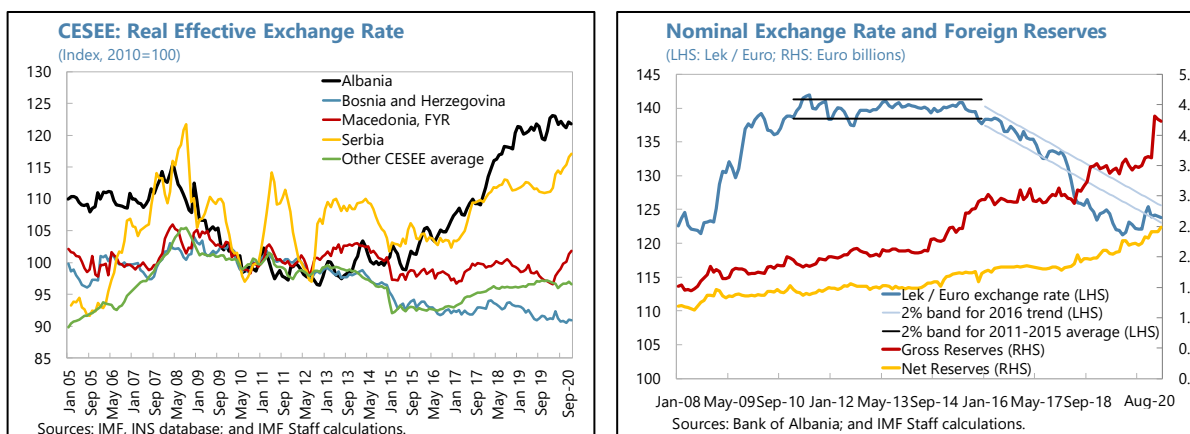
Annex VI. External Sector Assessment

The external position in 2019 is assessed as moderately weaker than implied by fundamentals and desirable policy settings. The EBA-Lite CA-model results indicate a current account gap of -1.5 percent, implying a REER overvaluation of 5.4 percent. The EBA-lite REER model estimates a REER overvaluation at 16½ percent. Significant external financing needs and a large negative NIIP pose risks, which 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, particularly fiscal consolidation. 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 worsened in 2019. The current account deficit increased to 8 percent of GDP, as subpar rainfall in 2019 caused a slowdown in electricity exports (and corresponding need for more electricity imports), together with a significant drop in base metal prices. It is projected to widen to 10.6 percent of GDP in 2020 reflecting the impacts of the twin shocks. The current account deficit is expected to improve gradually over the medium-term, as (i) the impact of the pandemic subsides; (ii) earthquake-related effects dissipate; (iii) imports generated from FDI in large energy projects, especially the Trans-Adriatic Pipeline (TAP), decline as the projects come to an end; and (iv) an expansion of domestic energy production leads to increased exports. However, Albania's reliance on hydropower and dependence on tourism, remittances, Italy and Greece as export destinations make the current account vulnerable to external shocks, including weather-related shocks.



2. The REER's appreciation during 2017–19 has leveled off, with some depreciation taking place at end-2019 and early 2020. Since the beginning of 2017, the CPI-based REER had appreciated by about 15 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. Towards the end of 2019 and into the first half of 2020, this appreciation has levelled off, with the lek subsequently depreciating reflecting the impact of the two successive shocks.



3. The net international investment position (NIIP) has deteriorated somewhat, but the large stock of FDI and official lending mitigate sustainability concerns. The NIIP has decreased slightly to about -52 percent of GDP at end-2019 from -49 percent of GDP at the end 2018, driven by FDI inflows and external borrowing. Foreign liabilities were about 110 percent of GDP, although over half of this stock comprised stable direct investment liabilities, and a large part of the other liabilities were long-term 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. The external position is assessed to be moderately weaker than implied by fundamentals and desirable policy settings. Under the EBA-Lite Current Account approach, the multilaterally consistent cyclically adjusted CA norm, estimated at -6.7 percent, is higher than the actual cyclically adjusted CA balance of -8.1 percent of GDP. The CA gap of -1.5 percent of GDP suggests a REER that is overvalued by 5.4 percent. The results of the ES approach yield an overvaluation of 5.7 percent, while the REER model suggests a REER overvaluation of 16½ percent. The overvaluation is expected to resolve over time, with fiscal adjustment and productivity growth supported by structural reform.

Table 1. Albania: Results from EBA-Lite Models, 2019
(In percent of GDP, unless otherwise indicated)

	CA model	REER model	ES model
CA-Actual	-8.0		
Cyclical Contributions (from model)	0.2		
Additional temporary/statistical factors	0.0		
Adjusted CA	-8.1		
CA Norm (from model) 1/	-6.7		
Adjustments to the norm	0.0		
Adjusted CA Norm	-6.7		
CA Gap	-1.5	-4.4	-1.5
o/w Policy gap	0.8		
Elasticity	-0.27		
REER Gap (in percent)	5.4	16.5	5.7

1/ Cyclically adjusted, including multilateral consistency adjustments.

5. Albania has large external financing needs, though robust FX coverage and access to long-term financing help to mitigate risks. Albania's external financing needs are large at 22½ percent of GDP in 2019, of which almost 75 percent are banks' currency and deposits liabilities. Gross FX reserves were 25 percent of GDP and 160 percent of the ARA metric at end-2019. While

this level is above the 150 percent upper threshold for floating regimes, the higher level is appropriate, given Albania's vulnerability to shocks, the sensitivity of public debt and private balance sheets (with sizable unhedged FX loans) to depreciations, risks of euroization, and the structurally high fiscal financing needs. In addition, the gross FX reserves include large FX deposits held at the BOA by domestic banks, which cannot be used for other balance of payments purposes. 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 roll over debt will be increasingly important for external sustainability and growth. In 2019, net FDI stood at about 7.6 percent of GDP, slightly lower than the current account deficit.

6. The COVID-19 pandemic negatively affects Albania's external position and complicates a forward-looking assessment of external competitiveness. The current account deficit in 2020 is expected to widen considerably, due to lower tourism receipts, remittances, and exports of goods. Reserves are expected to increase slightly, thanks to the issuance of €650 million Eurobond and assistance from IFIs. However, a more severe pandemic is expected to put pressure on the external position (Annex III). Steadfast reforms to improve the competitiveness and resilience of the economy have become even more important in light of the pandemic.

Statement by the Staff Representative on Albania
November 23, 2020

This statement provides information that became available after the staff report was issued on November 6, 2020. The thrust of the staff appraisal remains unchanged.

1. **The authorities have recently tightened restrictions in the face of a surge of infections.** The 7-day average of daily new cases per million people rose to 184 as of November 17th. But a low test rate and a high test positivity rate (around 25 percent) mean that the true spread cannot be gauged with good confidence. Several nationwide restrictions went into effect on November 11th and will last for at least three weeks, including a night curfew (10pm-6am) allowing only movements for health emergency and essential needs. Additional measures were announced on November 17th to limit social and political gatherings. The scale of the restrictions announced so far is much milder than the spring lockdown. But given the fluid situation, the authorities are reviewing measures on an ongoing basis.

2. **On November 16th the Parliament approved the 2021 budget with a headline deficit of 6.5 percent of GDP, as in the staff report.** Major changes to the draft submitted to the Parliament include an additional allocation to the COVID health spending (Lek1.2 billion or 0.07 percent of GDP) and a temporary increase of unemployment and social assistance payments (Lek2.5 billion or 0.15 percent of GDP). Financing of the additional spending is provided by increasing the already optimistic tax revenue projection in the budget. Staff now expects the 2021 deficit to reach 6.3 percent of GDP, slightly higher than the 6.1 percent of GDP in the staff report.

**Statement by Mr. Domenico Fanizza, Executive Director for Albania
and Mr. Tony Persico, Advisor to the Executive Director
November 23, 2020**

I. Introduction

On behalf of our Albanian authorities, we would like to thank very much both staff and management for the constructive policy dialogue following the request for a purchase under the RFI. Fund's support greatly facilitated their response to both the November 2019 earthquake, and the COVID-19 pandemic.

When impacted by these two shocks, the Albanian economy had set on a stable growth path, with growth projected at the time to continue at 3 percent in 2020. The devastating earthquake and the ongoing COVID-19 pandemic radically changed the outlook. The earthquake caused damage estimated close to 7 percent of GDP. The authorities had to pause their reconstruction efforts to contain the COVID-19 outbreak, and they quickly acted to support the affected households and businesses with good results that suggest a recovery will start to materialize in 2021.

The authorities have followed a flexible approach in response to emergency needs but have paid attention to keep a sound macroeconomic framework as a basis for an economic rebound once the emergency is over. Despite the challenging conditions, the authorities aim at lowering the fiscal deficit in 2021 and bringing the debt-to-GDP ratio soon on a downward path. The country's financing needs are fully met and the country's capacity to repay the Fund is adequate. The monetary policy accommodative stance remains appropriate and is complemented by targeted macro-prudential stimulus. Furthermore, Bank of Albania (BoA) expects a gradual increase towards its 3 percent target by end 2022. Financial markets are calm, and the banking sector is liquid and sound. BoA is looking forward for a gradual normalization and stand ready to respond, even considering unconventional measures, in case downside risks materialize.

II. The Outlook

The measures adopted to limit the spread of the COVID-19 pandemic have affected both aggregate production and demand starting from Q1-2020. From the production side, construction, manufacturing, mining and quarrying, as well as services, accounted for the largest negative contributions. From the demand side, the fall in GDP is mostly attributed to the decrease in private investment and private consumption. The Albanian authorities project growth to rebound in 2021 (5 percent) from the expected fall in 2020, broadly in line with the staff's projections, as a result in part of a run-up of reconstruction efforts.

There have been encouraging signs from in-land tourism inflows, which may partially offset the drop of in-flight arrivals in 2021 and help to bring the deficit of the external current accounts to 7 percent of GDP in 2021, down from 9 percent in 2020. The external reserve position is expected to remain comfortable, partially reflecting the successful placement of the Eurobond in June 2020. Inflation is likely to continue to stay low and below the BoA 3 percent target until the end of 2022.

III. Policy Response and Reforms

Fiscal Policy

The 2020 Budget Law has been revised on three occasions to respond to evolving emergency needs. The reviews (approved in March, April and July) provided increased resources for the anti-COVID social and economic packages, in part, through reprioritization of spending that reflected substantially lower than originally budgeted outlays for the reconstruction because of COVID slowdown. To date, out of the originally ALL 34 billion allocated for the reconstruction only ALL 2.6 billion have been spent by beneficiaries.

The Budget Law for 2021 envisages a deficit of 6.5 percent of GDP, down from 8.4 in 2020. However, the Ministry of Finance and Economy (MOFE) is confident that prudent budgetary implementation will keep the actual deficit well below the budgetary target, close to the staff's recommended level of 5.2 percent of GDP. Moreover, the authorities believe that, if needed, they will be able to identify policy actions to contain the deficit, following the 2021 parliamentary elections.

The authorities intend to resume their fiscal consolidation efforts, once the COVID emergency is over and the reconstruction needs are addressed. The main objective of fiscal policy will be to bring back the debt-to-GDP ratio to a downward path, all in compliance with the fiscal rules set by the Organic Budget Law enacted in July 2020. The main operational anchor will be the primary balance that should shift into a balance by 2023. The overall objective is to bring the debt to about 68.5 percent of GDP by 2025.

On financing needs, the recent RFI, coupled to the June 2020 Eurobond issuance, secured satisfactory levels of liquidity. Moreover, Albania is benefitting from Macro-Financial Assistance from the EU (Euro 180 million), a first tranche will be disbursed by end 2020. The 2020 budgetary deficit (8.4 percent of GDP) is fully financed. Despite a likely drop in revenue collections this year, the authorities are confident they will keep domestic financing comfortably below 3 percent of GDP over the next 5 years. Moreover, a new Eurobond issue is planned for 2022.

The authorities are keen to implement the Fund's TA recommendations on liquidity management and have already implemented the earlier recommendation on how to better manage the Treasury Single Account (TSA). In fact, TSA balances account were only slightly above the envisaged 1 percent of GDP upper bound of the recommended range ceiling (ALL 15-20 billion range); going forward the level should be comfortably within the foresaw range.

The stock of VAT arrears to small taxpayers has been almost totally repaid (with the exception of ALL 79 million) and will not weight on the business climate. The remaining stock of ALL 12 billion is due to just three large taxpayers and are in the process to be cleared by mid-2021. Therefore, the authorities believe that the potential adverse effects of arrears, described by staff, on market perception and business climate will not materialize.

The authorities have started an in-depth reorganization of the tax system. In this regard, they will consider staff's advice on rationalization. Furthermore, the tax amnesty law is being reviewed by a parliamentary commission, and will take into account comments from Money Val, the European Commission, as well as other stakeholders (involved in parliamentary audits). The authorities have stepped up their efforts to address the remaining deficiencies highlighted by the Money Val assessment. The MOFE is moving ahead with the related action plan; the main actions regard: land registry, beneficiary owner register, data sharing, licensing process supervision, sanctions enforcement, and the management of seized/confiscated assets.

Monetary Policy and Financial Sector

In response to the adverse shocks, the BoA has further eased its monetary policy stance and applied judicious and targeted macro-prudential stimulus. The monetary stimulus was delivered by cutting the policy rate to a new historical low of 0.5% and by switching to fixed-price full-allotment liquidity injection operations. On the other hand, regulatory accommodation was delivered through a temporary relaxation of credit provisioning rules, aimed at encouraging credit restructuring and a time-limited deferral of loan installment payments. These measures were aimed at reducing debt-servicing costs, encouraging new lending, and improving the cash-flow of crisis-hit businesses.

Pursuant to these actions, both volatility and risk premia in domestic financial markets stabilized quickly. In addition, credit to the private sector continued to grow, greatly facilitating the liquidity situation of businesses and households.

BOA expects a subdued inflation profile in the coming year, followed by a gradual increase towards its 3 percent target by end 2022. This projection reflects its baseline scenario of a gradual improvement in the cyclical position of the economy, aided by several factors: favorable domestic financial conditions, improving external demand, and growing confidence.

The banking sector remains sound, liquid and well-capitalized. While the crisis impact on the bank balance sheets is yet to be fully materialized, the BoA stress-tests indicate the banking sector is robust enough to withstand its impact. The BoA will step up its on- and off-site supervision of the banking sector in compliance with its risk-based approach. Furthermore, the BoA will normalize its macroprudential policy stance within 2020: BoA aims to promote the transparency of the balance sheets of the banking sector in order to identify any potential sign of weakness and undertake timely remedial action.

While the baseline scenario remains positive, the accommodative monetary policy stance remains appropriate and any policy normalization will be only gradual and data driven. The prolonged monetary accommodation will account for the expected gradual withdrawal of fiscal stimulus over the next couple of years and will deliver an appropriate policy mix. The BoA will continue to give to the markets proper guidance on the expected likely path of the policy interest rate and the rationale behind its decision-making.

However, the balance of risks remains on the downside. While additional conventional monetary policy space remains, the BoA assesses it is both limited and likely to run into diminishing returns. Depending on the incidence and magnitude of the shocks, the BoA would consider using unconventional instruments as a last resort of policy accommodation. Being mindful of their potential pitfalls, their deployment will only be considered under extreme circumstances, pursuant a careful cost-benefit analysis of alternative policy instruments, and a diligent consultation with the IMF staff. Under current analysis, a potential quantitative easing program offers the best cost-benefit profile. Such a tool would help to raise liquidity, to lower risk premia in the domestic financial markets, and to promote bank lending. The BoA concurs with staff that the QE adoption should not be seen and neither constitute an unlimited financing of deficit and that clear communication would be key. At the same time, the actual employment of any unconventional instruments will account for the nature of the shock and the relative effectiveness of any policy instrument.

The impact of the twin shocks on institutional investors has been very limited. Stress test to assess the COVID impact showed a good performance and stable prospects. Health related insurances have not been subject to additional pressures, because COVID cases are treated only in public hospital, i.e. free of charge. On the earthquake impact, there are some administrative delays (on demolition's decisions by the local authorities), but there are no liquidity issues on the insurance market as only 2.5 percent of impacted building was insured – usually because of existing bank's loans. Although, investment funds were required to update their key risk assessment as they will not be protected by (COVID-related) public guarantee scheme.

Energy Sector

The authorities are pushing forward with the reform of the energy sector, also with the support from the World Bank-backed consolidation plan. In particular, the road map toward liberalization and the instalment of the free market and power exchange (APEX) is progressing according with the timeline (should be in place in Q2 2021). The new framework would meet the requirements of the EU regulation on independent compliance, while would maintain a universal supplier – with de-regulated prices – to compensate eventual temporary lower supply. The envisaged division of the current public sectorial companies is progressing and should be completed at the end of the year.