INTERNATIONAL MONETARY FUND

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ALBANIA

February 2016

FIFTH AND SIXTH REVIEWS UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR MODIFICATION AND WAIVER OF APPLICABILITY OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ALBANIA

In the context of the Fifth and Sixth Reviews under the Extended Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 17, 2016, following discussions that ended on November 10, 2015, with the officials of Albania on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on January 27, 2016.
- A **Statement by the Executive Director** for Albania.

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

Letter of Intent sent to the IMF by the authorities of Albania*
Memorandum of Economic and Financial Policies by the authorities of Albania*
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 16/62
FOR IMMEDIATE RELEASE
February 17, 2016

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth and Sixth Reviews of the Extended Fund Facility Arrangement for Albania

On February 17, 2016, the Executive Board of the International Monetary Fund (IMF) completed the fifth and sixth reviews of Albania's economic performance under a program supported by the Extended Fund Facility (EFF). The completion of the review enables the authorities to draw an additional amount equivalent to SDR 57.76 million (about €72.4 million), bringing total disbursements to SDR 180.84 million (about €226.8 million).

The Executive Board approved a 36-month extended arrangement under the EFF for Albania on February 28, 2014 (see Press Release No. 14/81) in an amount equivalent to SDR 295.42 million (about €330.9 million at the time of approval), or 492.4 percent of the country's quota in the Fund.

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

"Albania's economic recovery is on track but downside risks persist. The authorities' performance under the Extended Arrangement has been strong, including implementation of ambitious and difficult structural reforms. The authorities should persevere with their reform program and build on the substantial progress to date to boost the country's growth potential while maintaining macroeconomic stability.

"The authorities' goal of continued fiscal consolidation, with an adjustment strategy based on broadening the tax base and improving tax compliance and administration, is appropriate. To this end, they should reduce reliance on one-off measures and avoid granting any further tax exemptions or preferential tax rates. In addition, the authorities' drive to improve tax compliance should be better aligned with international best practices and should focus on increasing voluntary compliance.

"The authorities are taking determined steps to tackle fiscal risks, including by strengthening public financial management. Going forward, it will be important to strengthen the capacity to execute public investment projects and to ensure that the impact of any new PPP projects on the fiscal accounts is being assessed transparently and in line with international norms.

"The current accommodative monetary policy stance is appropriate to counter disinflation pressures but should be pursued gradually to avoid risks to financial stability. Strengthening the central bank's credibility and safeguarding its independence remain critical for fulfilling its mandate.

"Tackling the large stock of nonperforming loans is essential for reviving the flow of credit. Timely and forceful implementation of the planned comprehensive strategy will be key to addressing this issue. The central bank's microprudential focus on the fastest-growing and systemically important segments of the banking system is appropriate.

"Significant reforms have been implemented in the electricity sector. Steadfast implementation of these reforms and additional measures aimed at improving corporate governance and the business environment will be necessary to promote strong and broad-based growth."

INTERNATIONAL MONETARY FUND

ALBANIA

January 27, 2016

FIFTH AND SIXTH REVIEWS UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR MODIFICATION AND WAIVER OF APPLICABILITY OF PERFORMANCE CRITERIA

KEY ISSUES

Background: In February 2014, the Executive Board approved a three-year Extended Arrangement with access equivalent to SDR 295.42 million (492.4 percent of quota). So far, four purchases totaling the equivalent of SDR 123.1 million have been made, and another one equivalent to SDR 57.76 million will be made available upon completion of the fifth and sixth reviews.

Recent Economic Developments: Economic recovery is underway, but growth remains below potential and inflationary pressures are limited. Nonperforming loans (NPLs) have started declining but are still high, and credit growth remains sluggish despite substantial monetary easing.

Program Performance and Risks: The program is on track. Staff discussions for the Fifth Review under the Extended Arrangement, held in June, did not conclude due to disagreements over fiscal measures needed in 2015 to offset the revenue shortfall. Nevertheless, the authorities have maintained strict spending discipline. All performance criteria (PCs) were met, as were most indicative targets. Most structural benchmarks were also met, albeit some with delays (including one set as a prior action). Program risks emanate from the challenges of revenue mobilization efforts and the need for sustained political commitment to fiscal adjustment and structural reforms. The authorities request, and staff supports, a waiver of applicability for two end-December 2015 PCs and a modification of PCs for April 2016.

Policy Recommendations: Macroeconomic and structural policies will need to support domestic demand while ensuring sustainable public finances. Reducing public debt from high levels over the medium term will require political commitment to sustain fiscal consolidation. A strategy based on broadening the tax base, improving tax compliance and administration, and implementing structural reforms to reduce subsidies to the electricity sector will help ensure sustainable debt levels while allowing space for more productive public spending. While the early results from the authorities' ambitious power sector reform have been impressive, sustaining the effort is critical. Fiscal structural reforms to strengthen tax administration, the fiscal cadastre, and public financial management are also crucial for entrenching the consolidation gains. The central bank's continued monetary easing is appropriate, given that underlying demand is weak and inflation is below target. Addressing the high stock of NPLs through enhanced supervision, debt restructuring, and insolvency reform is key for reviving credit.

Approved By
Masato Miyazaki and James Gordon

Discussions were held in Tirana during October 28–November 10, 2015. Staff team: Ms. Tuladhar (head), Messrs. Cabezon and Slavov (all EUR), Mr. End (FAD), and Mr. Ismail (SPR). Mr. Reinke (Resident Representative) and Ms. Spahia (local economist) assisted the mission. Messrs. Cottarelli and Di Lorenzo (OED) joined some of the meetings. The mission met with the Prime Minister; the Deputy Prime Minister; the Ministers of Finance, Economy, Energy, and Transport; the Bank of Albania Governor; other senior officials; and representatives of banks and the private sector. Support was provided by Mr. Song, Ms. Mendoza (both EUR), and Ms. Kadeli (Tirana office).

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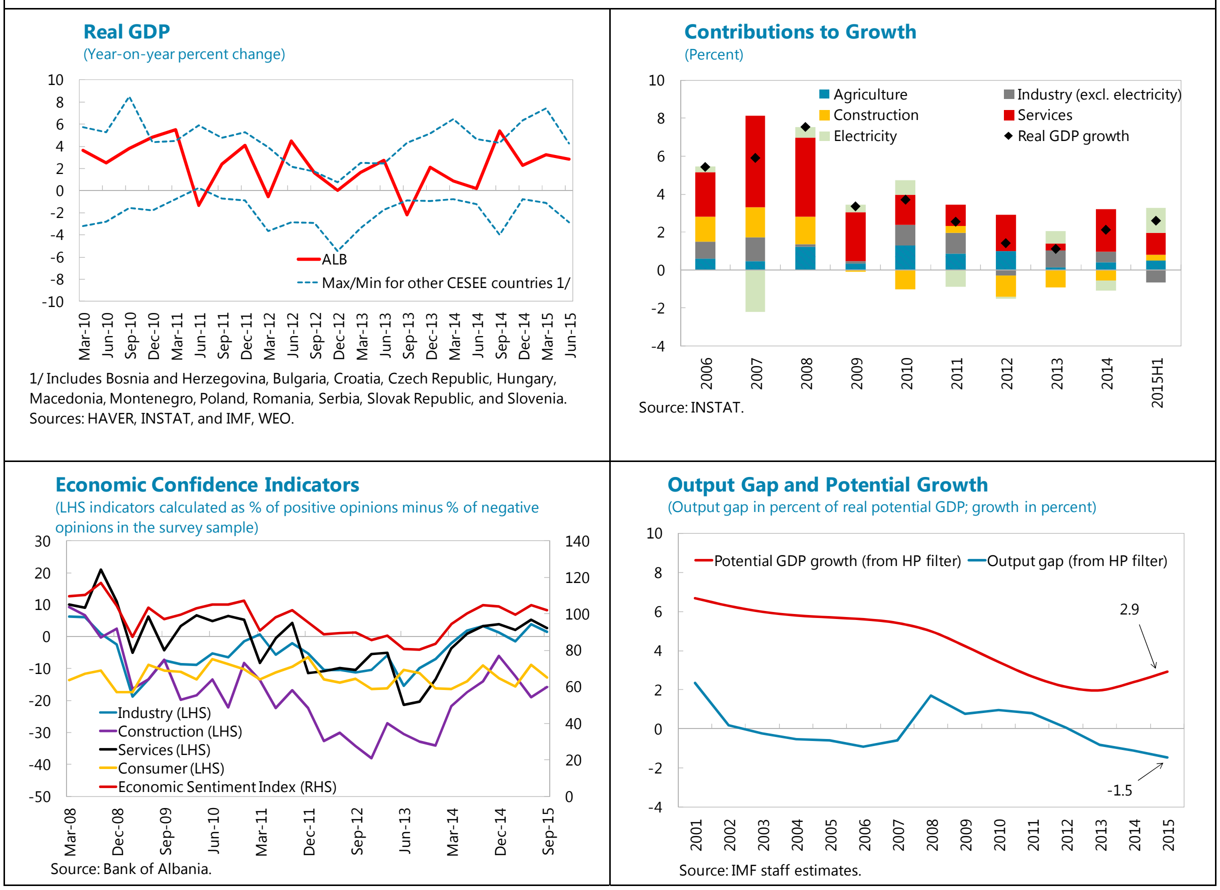
APPENDIX

CONTEXT AND RECENT DEVELOPMENTS

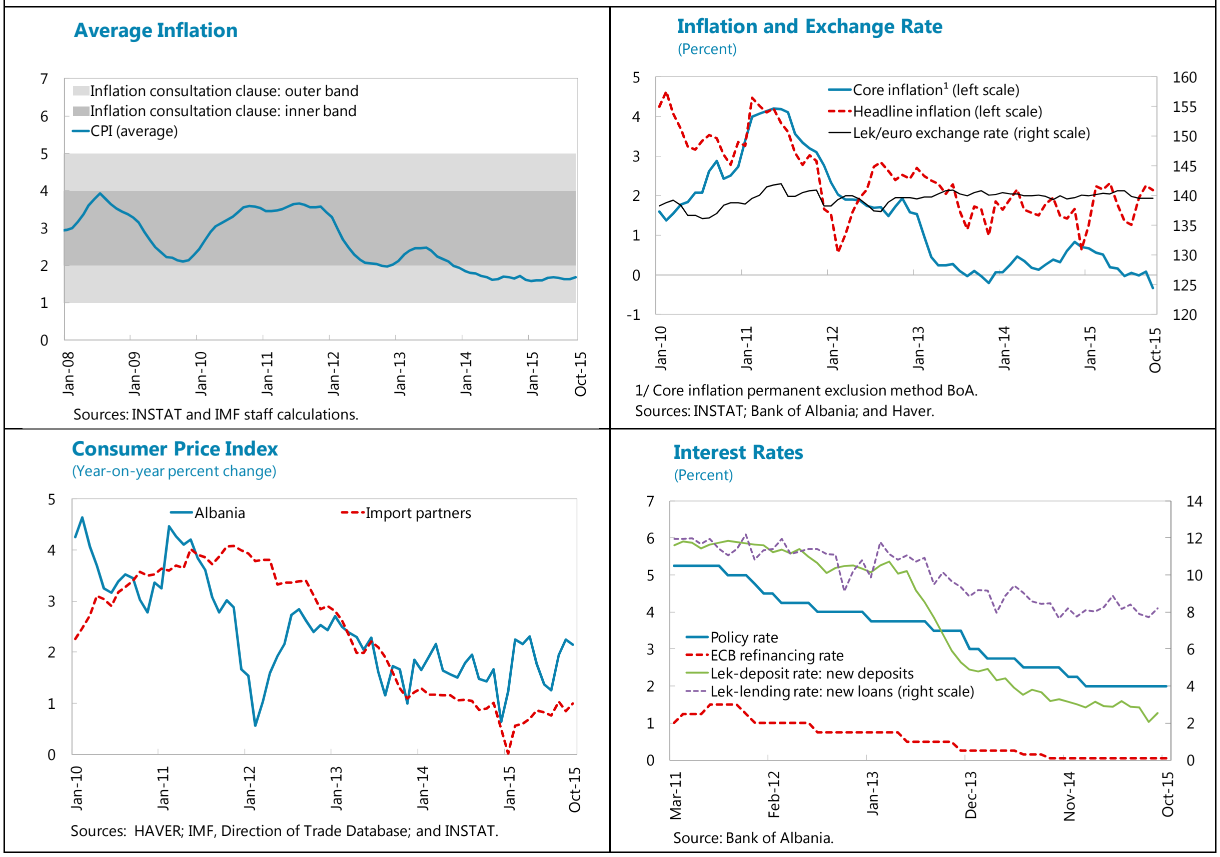
1. The economic recovery continues, despite some headwinds in the first half of 2015 (Figure 1 and MEFP ¶2). Real GDP is estimated to have grown by 2.6 percent in 2015, compared to a projected 3 percent in the 4th review under the Extended Arrangement. The revision reflects the impact of floods earlier in the year which dented agricultural production, falling domestic oil production due to lower international prices, and delays in consumption and investment decisions resulting from financial turmoil in Greece. These factors were partly offset by a stronger than expected pickup in tourism and electricity production (due to exceptional rainfall). There are tentative signs of recovery in construction, supported by low interest rates. Although the economy is expanding and employment is rising, growth remains below potential.

Figure 1. Albania: Output and Growth Developments



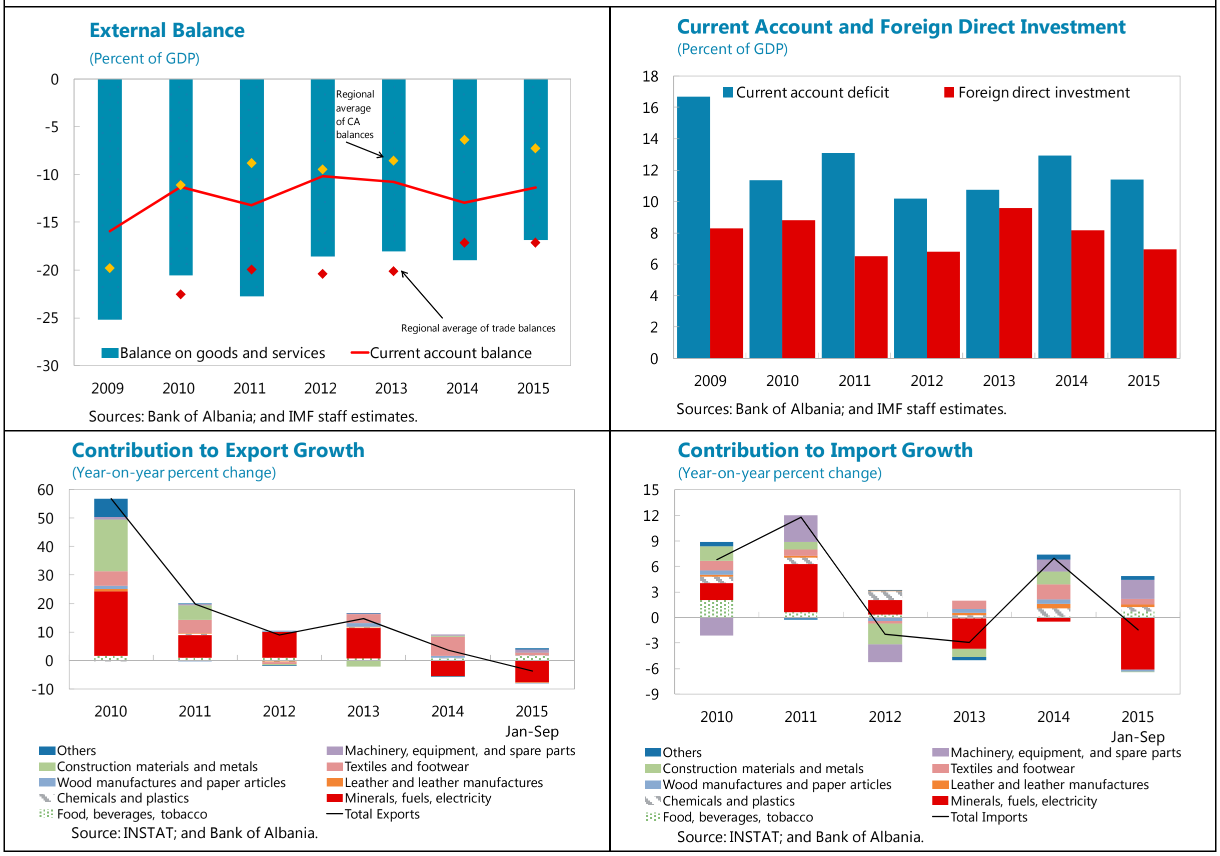
2. **Inflation remains below target (Figure 2 and MEFP ¶3).** Driven by higher food prices, average year-on-year inflation reached 1.9 percent in October 2015. Nevertheless, low external inflation and the negative output gap continue to exert a downward pressure on prices. Core inflation has been falling in 2015 and has hovered around zero in recent months. The BoA lowered its main policy rate to 1¾ percent in November 2015, a historic low. While T-bill yields and deposit rates continue to decline steadily, lending rates are falling at a slower pace, reflecting continued risk-aversion by banks still plagued by high NPLs.

Figure 2. Albania: Price Developments



3. The current account deficit is projected to have narrowed in 2015, and was financed primarily by FDI inflows and external public borrowing (Figure 3 and MEFP ¶5). A one-off reduction in net imports of electricity, due to improved hydropower conditions, and a stronger than expected performance in tourism helped narrow the trade deficit. Remittances have remained broadly stable despite the weak growth outlook in the main source countries (Greece and Italy). FDI, primarily concentrated in the oil sector, has slowed down with falling crude prices. Nevertheless, it remains the primary source of financing at around 7 percent of GDP. With the Eurobond issuance in early November—the first since 2010—net external borrowing by the government has also contributed significantly while FX reserves increased, exceeding five months of imports at end-2015.

Figure 3. Albania: External Developments



4. Overall budget performance was on track at end-August 2015, despite sizable tax shortfalls (text table, Figure 4, and MEFP ¶9). Tax revenues underperformed by around 1.1 percent of GDP in the first eight months of 2015, primarily in excises, PIT, and oil-related taxes. However, a spike in non-tax revenues (due to one-off sales of mobile telecom licenses worth 0.4 percent of GDP), interest savings, and an across-the-board underexecution of expenditure (1.2 percent of GDP) kept the overall budget on track. The tax shortfalls reflected several factors, including problems in revenue administration and coordination among the responsible institutions. Forecasting issues in the 2015 budget also played a role, with the stock of tax credits in the system underestimated, and with lower than expected GDP growth, interest rates, and oil prices. The problem was also likely exacerbated by behavioral responses to tax increases that took effect in January 2015, including front-loading of activity in late 2014, as well as increased tax evasion and informal domestic production.

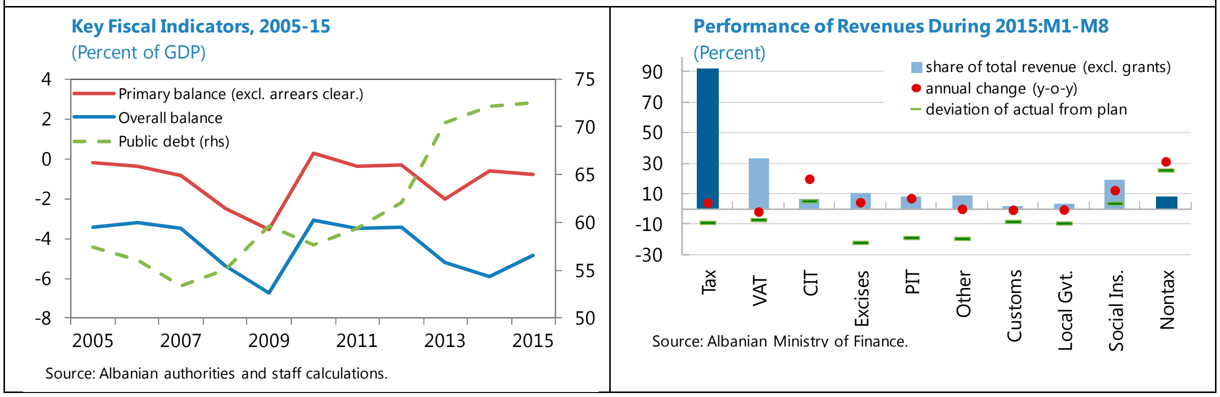
Triannual General Government Operations, 2013-15
(Billions of leks)

	2013			2014			2015					
							EBS/15/43			Proj.		
	T1 Act.	T2 Act.	T3 Act.	T1 Act.	T2 Act.	T3 Act.	T1 Proj.	T2 Proj.	T3 Proj.	T1 Act.	T2 Act.	T3 Proj.
	(Billions of leks)											
Total revenue and grants	106.5	206.7	323.7	116.1	236.4	366.6	123.0	257.7	405.3	121.8	248.5	385.3
Tax revenue	94.3	187.9	296.4	103.7	214.7	335.8	114.6	241.5	370.9	106.2	223.6	346.3
Non-tax revenue	10.5	16.1	21.6	9.0	14.8	20.7	6.0	10.3	22.4	13.0	19.4	29.0
Grants	1.7	2.7	5.7	3.5	6.9	10.1	2.4	5.9	12.0	2.6	5.5	10.0
Total expenditure	130.1	265.2	394.1	126.6	273.0	448.6	142.3	295.0	477.5	130.4	270.5	450.3
Current expenditure	103.6	216.9	328.6	105.9	216.5	348.1	112.7	236.4	378.2	107.5	226.4	365.6
o/w Energy guarantees				1.8	1.8	6.7	5.1	6.8	10.2	4.6	4.6	6.0
Capital expenditure	26.5	48.2	65.5	11.5	26.9	60.5	14.7	35.5	67.9	14.2	28.6	59.2
Policy net lending	0.0	0.0	0.0	1.1	2.6	5.9	3.0	4.4	5.9	1.8	3.3	5.9
Repayment of end-2013 stock of unpaid bills and arrears				7.8	25.9	33.8	10.0	15.0	20.0	7.6	14.5	18.4
Additional unidentified measures (cumulative)										0.0	0.0	0.0
Overall balance	-23.6	-58.4	-70.4	-10.5	-36.6	-82.1	-19.2	-37.2	-72.1	-8.6	-22.0	-65.0
excl. repayment of end-2013 stock of unpaid bills and arrears				-2.8	-10.7	-48.3	-9.2	-22.2	-52.1	-1.0	-7.5	-46.7
Financing	23.6	58.4	70.4	10.5	36.6	82.1	19.2	37.2	72.1	8.6	22.0	65.0
Domestic	19.5	46.9	59.6	8.4	3.7	47.5	5.3	-1.5	1.8	3.4	-22.3	-6.8
Foreign	4.1	11.5	10.8	1.7	31.8	34.3	13.9	38.7	70.3	4.1	43.2	71.8
Accumulation of arrears												
	(Percent of GDP)											
Total revenue and grants	7.9	15.3	24.0	8.3	17.0	26.3	8.4	17.6	27.7	8.4	17.2	26.7
Tax revenue	7.0	13.9	21.9	7.4	15.4	24.1	7.8	16.5	25.4	7.4	15.5	24.0
Non-tax revenue	0.8	1.2	1.6	0.6	1.1	1.5	0.4	0.7	1.5	0.9	1.3	2.0
Grants	0.1	0.2	0.4	0.3	0.5	0.7	0.2	0.4	0.8	0.2	0.4	0.7
Total expenditure	9.6	19.6	29.2	9.1	19.6	32.2	9.7	20.2	32.7	9.0	18.7	31.2
Current expenditure	7.7	16.1	24.3	7.6	15.5	25.0	7.7	16.2	25.9	7.4	15.7	25.3
o/w Energy guarantees				0.1	0.1	0.5	0.3	0.5	0.7	0.3	0.3	0.4
Capital expenditure	2.0	3.6	4.8	0.8	1.9	4.3	1.0	2.4	4.6	1.0	2.0	4.1
Policy net lending	0.0	0.0	0.0	0.1	0.2	0.4	0.2	0.3	0.4	0.1	0.2	0.4
Repayment of end-2013 stock of unpaid bills and arrears				0.6	1.9	2.4	0.7	1.0	1.4	0.5	1.0	1.3
Additional unidentified measures (cumulative)										0.0	0.0	0.0
Overall balance	-1.8	-4.3	-5.2	-0.8	-2.6	-5.9	-1.3	-2.5	-4.9	-0.6	-1.5	-4.5
excl. repayment of end-2013 stock of unpaid bills and arrears				-0.2	-0.8	-3.5	-0.6	-1.5	-3.6	-0.1	-0.5	-3.2
Financing	1.8	4.3	5.2	0.8	2.6	5.9	1.3	2.5	4.9	0.6	1.5	4.5
Domestic	1.4	3.5	4.4	0.6	0.3	3.4	0.4	-0.1	0.1	0.2	-1.5	-0.5
Foreign	0.3	0.9	0.8	0.1	2.3	2.5	1.0	2.6	4.8	0.3	3.0	5.0

Sources: IMF staff estimates and projections.

5. In response to the significant revenue shortfall, the government revised its 2015 budget and launched a large-scale effort to reduce tax evasion. The revised budget targeted expenditure savings across the board. On the revenue side, a public campaign against tax evasion, non-compliance, and informality started in early September focusing on companies that are unregistered, understate their payrolls, and do not use cash registers or issue receipts. The multipronged effort is monitored by a steering committee chaired by the Prime Minister. It includes a public awareness campaign, tougher penalties in the Tax Procedures Code, and an increased number of tax inspectors. The new campaign has already yielded substantial increases in the number of registered employees and small businesses. However, significant revenue dividends have yet to materialize (Box 1).

Figure 4. Albania: Fiscal Developments



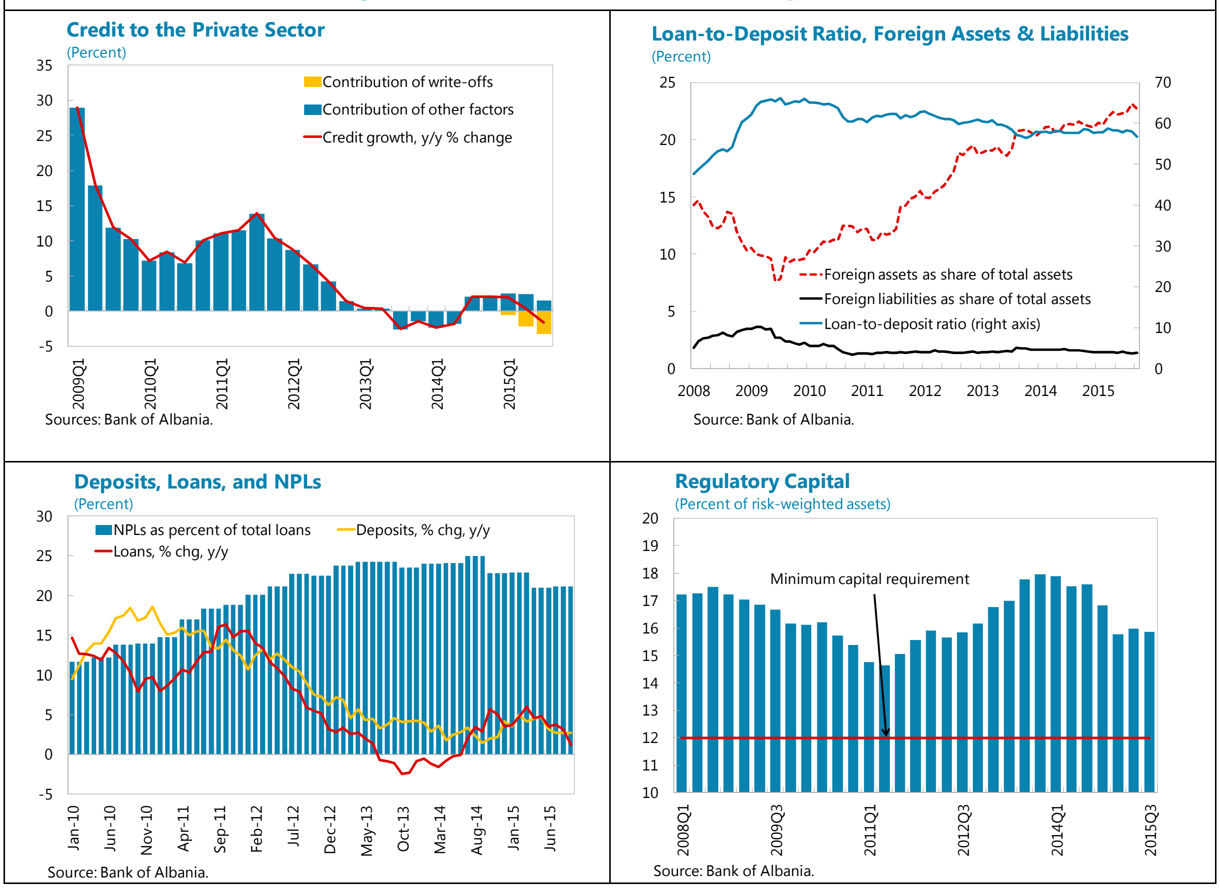
Source: Albanian authorities and staff calculations.

Source: Albanian Ministry of Finance.

6. Credit growth to the private sector remains subdued, as banks remain risk-averse given the significant NPL overhang (Figure 5). Measured credit growth is lowered by a new regulation mandating write-offs of loans that have spent three years in the "loss" category. However, after removing the effects of NPL write-offs, credit to the private sector grew in September 2015 by only 1 percent, year-on-year, despite sustained monetary easing and ample liquidity in the system. Difficulties with contract enforcement and collateral execution in the court system deter new lending, while NPLs, at 21 percent of all loans in September 2015, remain high. Nevertheless, NPLs have declined from their peak of 25 percent in September 2014, due to arrears clearance by the government and various policy initiatives to tackle high NPLs. Provisions cover 69 percent of gross NPLs.

7. Spillovers from the summer financial turmoil in Greece have been limited, mitigating risks to financial stability. While their liquidity buffers were tested in July, the three Greek bank subsidiaries weathered the episode well. System-wide deposits were not affected and the withdrawals subsided by early August. Greek bank subsidiaries remain liquid and well capitalized. Overall, while capital adequacy ratios have been falling in the last year due to the new regulations related to Basel II implementation, system-wide capitalization still exceeds regulatory minima, as do liquidity buffers.

Figure 5. Albania: Financial Developments



PROGRAM PERFORMANCE

8. **The program is on track (MEFP ¶6-7 and MEFP Tables 1 and 3a):**

- **Most performance criteria through December were met with comfortable margins.** The authorities are seeking a waiver of applicability for the end-December ceilings on the general government's deficit and expenditure, for which data are not yet available. Staff expects these PCs to have been met. The April ceiling on energy subsidies was missed by a very small margin (0.02 percent of GDP). However, the August ceiling was met and the end-2015 target is expected to have been met as well. The IT on the accumulation of new central government domestic arrears was missed by a small margin (0.08 percent of GDP) in both April and August. However, the authorities will repay all accumulated arrears by early 2016, except for those on court decisions regarding layoffs and expropriations which will be settled in accordance with a special Council of Ministers (CoM) decision. As a remedial measure, the authorities are improving public investment management and introducing multi-year commitment limits to prevent the recurrence of new arrears. Reforming the VAT refund process by moving to automatic refunds and risk-based auditing of refund claims will also help in this regard.

- **The lower inner inflation band under the Inflation Consultation Clause was missed.** In response, the authorities, after consulting with staff, are continuing with monetary easing—they lowered their policy rate by 25 basis points, to 1.75 percent, on November 4.

- **Most SBs were implemented, albeit some with delays.** Of the ten SBs, five SBs were met on time, one was partially implemented, two were implemented with delays, and two more were delayed. The re-prioritization of all outstanding infrastructure projects was completed in January as a prior action. The need to amend the VAT Law and related regulations delayed the launch of risk-based audits of tax refunds till September. Staff proposes rescheduling the roll-out of the treasury IT system (AGFIS) to 15 budget institutions to March 2016, due to procurement delays with the server upgrade, which have now been resolved. Staff also proposes rescheduling amendments to one law to incorporate multi-year commitment limits to early 2016. Finally, staff proposes rescheduling the removal of 35KV electricity consumers from the regulated tariff system to mid-2016, due to delays in related legislation.

- **Remedial actions are being taken to address concerns over tax revenues that held up the 5th review.** During the policy discussions in June, the authorities opposed mid-year tax increases to offset revenue shortfalls, preferring instead to meet revenue targets solely through improved compliance. However, permanent tax measures focused on base broadening and tax increases with limited distortionary effects have now been adopted in the 2016 budget. Together with the planned expenditure measures, they will account for most of the fiscal adjustment in 2016 (¶13). To cover the remainder, the authorities have stepped up efforts to improve tax compliance, revenue administration, and coordination among the responsible institutions (¶14–15 and Box 1).

POLICY DISCUSSIONS

A. Outlook and Risks

9. The near-term outlook has been marked down since the 4th review under the Extended Arrangement:

- **2016 GDP growth has been revised to 3.4 percent, down from 4 percent in March, due to lower oil prices and weaker domestic demand.** Nevertheless, growth is expected to accelerate relative to 2015, reflecting a pickup in investment in large FDI-financed infrastructure projects and a gradual recovery of consumption. Low interest rates and less front-loaded fiscal consolidation will also help unlock domestic demand.

- **Inflation will remain subdued with a negative output gap persisting in 2016.** Headline inflation is projected to rise above 2 percent based on increased domestic demand, a modest pickup in euro area inflation, and reduced disinflationary pressures from commodity prices.

- **The current account deficit is projected to increase to around 13 percent of GDP in 2016-17 and then moderate over the medium term.** Imports are expected to pick up with increased foreign direct investment in large energy-related projects, such as the Trans Adriatic Pipeline and the Statkraft/Devoll hydropower projects. Subsequently, the current account deficit is projected to gradually narrow as investments into these projects decline. External financing is expected to be predominantly driven by FDI. Reserve cover is expected to stabilize at just over 4½ months of imports.

10. The medium-term outlook is favorable, but has been revised downwards since the 4th review under the Extended Arrangement. The revisions are in response to lower growth in Albania's neighbors and trading partners, as well as slower-than-expected implementation of some growth-enhancing reforms, including those related to governance, property rights, and the judiciary. Growth is expected to rise to about 4¼ percent over the medium term, underpinned by a flexible labor market, a pick-up in investment, and a boost to investor confidence as Albania advances through the EU accession process.

11. The balance of risks is on the downside. Albania's public debt remains high and is subject to significant rollover risks.[1] Stagnant growth could test the authorities' perseverance

[1] These are mitigated somewhat by the fact that most external public debt is held by IFIs and also by the gradual extension of average maturities in recent years. The duration of the domestic direct debt portfolio is close to two years, and the newly issued Eurobond has a maturity of 5 years.

with reforms and commitment to fiscal adjustment. Renewed financial turmoil in Greece would weigh on investor confidence. Further terms of trade deterioration from lower commodity prices and worsening quality of bank credit pose additional risks.

B. Improving Debt Dynamics and Implementing Structural Fiscal Reforms

12. The authorities reaffirmed their commitment to gradually reduce the public debt burden, in order to support sustainable growth and strengthen the economy's resilience to shocks (text table and MEFP ¶8). While cognizant of the risks that excessive consolidation may have on the nascent recovery, the authorities remain committed to lowering the public debt-to-GDP ratio below 60 percent by 2019, in line with their original program request. They have adopted a consolidation strategy based on improving revenue compliance and administration, and implementing structural reforms that yield fiscal savings over time. This implies a smoother, less front-loaded path for fiscal adjustment compared to the 4th review under the Extended Arrangement, involving at least one percent of GDP in adjustment each year until 2019. The adjustment under the program would still remain ambitious by international standards. A less frontloaded adjustment path would also limit fiscal drag at a time of a large negative output gap when the room for further monetary easing is limited. Furthermore, financing pressures appear limited and the ample liquidity in the financial system minimizes the risk of crowding out of private credit.

Fiscal Consolidation, 2012-2019

(Percent of GDP, unless otherwise specified)

	2012	2013	2014	2015		2016		2017		2018		2019	
	Act.	Act.	Act.	EBS/ 15/43	Proj.	EBS/ 15/43	Proj.	EBS/ 15/43	Proj.	EBS/ 15/43	Proj.	EBS/ 15/43	Proj.
Revenues	24.8	24.0	26.3	27.7	26.7	28.1	27.1	28.1	27.3	28.1	27.3	28.1	27.3
Tax revenue	22.6	21.9	24.1	25.4	24.0	25.5	24.6	25.5	24.8	25.5	24.8	25.5	24.9
Non-tax revenue	1.8	1.6	1.5	1.5	2.0	1.7	1.6	1.7	1.6	1.7	1.6	1.7	1.6
Grants	0.4	0.4	0.7	0.8	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Expenditures	28.2	29.2	32.2	32.7	31.2	31.7	29.6	30.4	29.5	31.0	29.6	30.9	29.5
Current expenditure (incl. net lending)	23.6	24.3	25.0	25.9	25.3	25.5	25.7	25.3	25.6	26.0	25.5	26.1	25.2
of which: Energy sector spending 1/			0.9	1.2	1.2	0.9	0.5	0.6	0.4	0.6	0.3	0.2	0.0
Capital expenditure	4.6	4.8	4.3	4.6	4.1	4.6	3.7	4.6	3.7	4.6	3.9	4.6	4.1
Other spending	0.0	0.0	2.9	2.1	1.8	1.7	0.2	0.5	0.2	0.5	0.2	0.2	0.2
Unidentified measures				0.0	0.0	1.5	0.0	0.7	1.1	0.7	1.0	0.4	1.0
Unidentified measures (cumulative)				0.0	0.0	1.5	0.0	2.2	1.1	3.0	2.1	3.4	3.1
Overall balance	-3.4	-5.2	-5.9	-4.9	-4.5	-2.1	-2.5	0.0	-1.1	0.0	-0.2	0.5	0.9
Overall balance excl. arrears clearance			-3.5	-3.6	-3.2	-1.0	-2.5	0.0	-1.1	0.0	-0.2	0.5	0.9
Primary balance	-0.3	-2.0	-3.0	-2.0	-1.8	0.7	0.3	2.7	1.6	2.6	2.4	2.9	3.4
Primary balance excl. arrears clearance	-0.3	-2.0	-0.6	-0.6	-0.5	1.8	0.3	2.7	1.6	2.6	2.4	2.9	3.4
Change in structural primary balance	0.3	-1.4	1.6	0.0	0.2	2.4	0.9	0.8	1.2	-0.2	0.6	0.1	0.8
Public debt	62.1	70.4	72.1	73.0	72.2	69.1	70.6	64.1	67.1	59.4	62.6	54.5	57.3
Domestic debt	35.3	43.4	42.5	40.0	38.7	35.6	36.0	32.7	33.4	29.7	30.6	26.8	26.9
Foreign debt	26.8	26.9	29.6	33.0	33.5	33.5	34.6	31.4	33.7	29.6	32.1	27.8	30.4
Memo items:													
Nominal GDP (in bn leks)	1,333	1,351	1,394	1,462	1,445	1,568	1,530	1,692	1,637	1,825	1,760	1,967	1,891
Public debt (in bn leks)	828	951	1,005	1,068	1,043	1,083	1,080	1,084	1,098	1,083	1,102	1,072	1,084

Sources: Albanian authorities; IMF staff estimates and projections.

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

13. Consistent with their medium-term objectives, the authorities will target a primary surplus of 0.3 percent of GDP, an improvement over the projected outturn for 2015 of 0.8 percent of GDP (text table and MEFP ¶9–10).[2] To achieve the target, the 2016 budget is based on a strategy of broadening the tax base, improving tax compliance, and increased expenditure savings through structural reforms. Tax increases focus on indirect taxes while granting greater revenue autonomy to local authorities in line with fiscal decentralization goals.

- **Revenue measures:** Base-broadening measures include extending the current property tax to urban land and a higher tax base for social contributions by the self-employed (text table). The authorities will increase local tax rates on property and raise the insurance premium tax. Other key measures include higher taxes on luxury cars, and a restructuring of the royalties on non-metallic minerals. These measures will more than offset a reduction in the tax burden on small businesses (including its possible behavioral effects). Tax procedures are also being changed to close regulatory loopholes in VAT and excises. In order to maintain a prudent revenue envelope, the dividends from the ongoing enforcement push against tax evasion are estimated conservatively. Specifically, potential gains from newly registered businesses (Box 1) are excluded while only the social contributions by newly registered workers are included in the revenue projections.

- **Expenditure measures:** On the expenditure side, the authorities will benefit from continued restraint on the public sector wage bill. They will reap dividends from the electricity sector reform, which is reducing the sector's need for public support faster than expected. Finally, the authorities decided to freeze ¼ percent of GDP in capital expenditures and make it contingent on additional revenues from SOE dividends and from their push against tax evasion, non-compliance, and informality.

[2] These targets exclude arrears clearance. In 2016, however, the primary balance does not need to be adjusted for arrears clearance since that process is assumed to have been completed by the end of 2015—see ¶14 below.

Key Measures in 2016 Budget

Measure	Description	Yield (Billions of Leks)	Yield (% of GDP)
Revenue			
Tax exemptions	- Increase in the taxable base for social contributions by the self-employed	1.1	0.07
	- Exemption from simplified profit tax for businesses with turnover below ALL 5 mln. and reduced rate for businesses in the ALL 5-8 mln. bracket	-2.3	-0.15
	- Extension of property tax to urban land	2.2	0.14
New taxes/rates	- Increase in local taxes on infrastructure and public space usage, and change in the assessment base for the infrastructure tax	1.8	0.12
	- Increase in the insurance premium tax from 3% to 10%	0.7	0.04
	- Replacing the *ad valorem* hotel surcharge with a specific tax	0.5	0.03
	- Replacing the *ad valorem* royalty on non-metallic minerals with specific rates	0.4	0.03
	- Introduction of a registration fee and an annual circulation tax on luxury cars	0.3	0.02
	- Cancellation of the 2016 increase in cigarette excises	-1.0	-0.07
Tax administration/tax procedures	- Increase in social contributions from newly registered employees (informality campaign)	4.0	0.26
	- Rescinding of VAT procedural loopholes for the active processing regime at customs	1.5	0.10
	- Registration of IMEI numbers of cell phones	0.5	0.03
	- Tightening of controls over bio-fuel excise refunds	0.5	0.03
Expenditure	- Reduced public support to the electricity sector	4.5	0.29
	- Freeze in public sector salaries and restricted hiring	2.9	0.19
	- Increase in local government spending, to be financed by higher local revenues	-2.1	-0.14
Total		**15.3**	**1.00**

14. The authorities are addressing potential risks to their baseline fiscal framework (MEFP ¶11-13 and MEFP Table 3b):

- **Revenue underperformance.** A dedicated revenue unit has been established at the Ministry of Finance (MoF) and a steering committee led by the Office of the Prime Minister has been meeting regularly to enhance coordination among MOF and the tax and customs administrations. The authorities have committed to taking additional measures, if needed, to meet the end-year primary balance target for 2016.

- **Local government reform:** The authorities are pursuing a fiscal decentralization strategy which involves a devolution of certain functions in the areas of health and education, transfer of related personnel, and new financing sources for local governments. Following local elections in mid-2015, a large number of communes and municipalities have been consolidated into 61 local government units. The authorities are currently auditing the new units and will start preparing annual surveys of local government arrears. They are also reviewing the legal framework on local public finance, with help from USAID and the World Bank.

- **Property compensation claims:** Parliament passed a law in December 2015, endorsed by the Council of Europe, which provides for compensation to all property owners expropriated under the communist regime over a period of 10 years.

- **Capital expenditure.** Commitments on existing infrastructure projects continue to exceed the envelope of the authorities' medium-term budget framework (MTBF). To minimize risks from such unbudgeted commitments, the authorities have, as a prior action, reassessed and prioritized all outstanding projects. Furthermore, the authorities commit to treat public-private partnerships for infrastructure projects with full transparency in the fiscal accounts, in line with international standards (such as GFSM, ESA 2010, or IPSAS).

- **Arrears clearance.** The process of clearing the pre-2014 stock of arrears is projected to have been completed at end-2015, one year ahead of schedule. The authorities will continue to publish the regular survey of new arrears (SB), and will expand its coverage. They will amend the Budget Law to incorporate multi-year commitment limits by end-March 2016, in order to further strengthen the MTBF (SB). After resolving the persistent procurement delays, they will also extend the Albanian Government Financial Information System (AGFIS) to 15 budgetary institutions by end-March 2016 (SB).

15. Further ambitious structural fiscal reforms are planned (MEFP ¶14–18 and MEFP Table 3b):

- **Tax policy.** The authorities are committed to introducing a valuation-based property tax by end-2017 and, towards this end, they will put in place a fiscal cadastre by end-2016 (SB).

- **Revenue administration.** The reform plan includes a function-based restructuring of the tax authority's headquarters, restructuring the Large Taxpayer Office, and phasing in a modern compliance risk management approach for a couple of major risk clusters (SBs). The customs authority is also working on a restructuring proposal and will implement measures to strengthen compliance.

- **Public financial management**. The authorities will take steps to shore up the credibility of their MTBF, as a prerequisite for eventually re-introducing a fiscal rule. They will also strengthen further the process for evaluating, selecting, executing, and monitoring public investment projects.

C. Safeguarding Financial Stability and Unlocking Credit

16. With inflation significantly below the BoA's target rate of 3 percent, monetary easing is expected to continue in the near term (MEFP ¶19-21). Despite the reduction of the policy rate to an all-time low of 1.75 percent, the impact of monetary easing on credit has been modest thus far reflecting high bank risk aversion, weak private sector balance sheets, and extensive euroization, all of which thwart the monetary transmission mechanism. The BoA plans to maintain its easing bias, and at some stage could consider the use of unconventional policy tools for monetary easing. However, it remains concerned that lowering the lek-euro interest rate differential below a certain level could lead to heightened exchange rate volatility, thereby aggravating financial stability risks, as about half of foreign currency denominated loans are unhedged.

17. The BoA continues to improve its supervisory vigilance to preserve financial stability (MEFP ¶22–25). With the adoption of a new risk-based assessment manual in early 2015, the BoA continues to monitor closely individual banks' resilience to risks, as well as capital and liquidity positions, with a micro-prudential focus on the fastest-growing and systemically important segments of the banking system. To strengthen capital positions in the banking system, the authorities are planning to repeal by end-2016 temporary changes to capital requirements designed to encourage moderate credit growth.[3] To contain euroization risks and align their framework with Basel II, they will also explore options for capping and eventually unwinding recently introduced lower risks weights on Albanian government securities issued in a foreign currency. The BoA also signed a MoU with the European Banking Authority in November which will help improve cross-border information exchange.

18. The authorities have formulated and are beginning to implement a comprehensive action plan to reduce NPLs (MEFP ¶27). The plan integrates and sequences reforms in the areas of supervision, regulatory enforcement, debt restructuring, and insolvency. It includes drafting a simpler and clearer bankruptcy law, as well as amending several other pieces of legislation such as the Civil Procedure Code and the Private Bailiff's Law in order to increase the efficiency of the NPL resolution process (SBs).

19. Nonbank supervision has been substantially strengthened (MEFP ¶28). In June 2015, the authorities approved new regulations on liquidity requirements and asset valuation for investment funds. One vacancy on AFSA's executive board, however, remains to be filled by Parliament. New investment fund license applications will be considered only after the full board is operational.

20. There has been progress in implementing safeguards recommendations and rebuilding BoA's credibility, following the events of 2014 (MEFP ¶29). Parliament appointed a new Inspector General in early April and the internal audit function has resumed normal operations. In addition, De Nederlandsche Bank completed an assessment of BoA's internal audit function in September 2015. The BoA's Supervisory Council appointed an external technical expert in June to assist its Audit Committee (AC), and approved a strengthened AC charter in August 2015, thus making the committee fully operational. The BoA will prepare its 2015 financial statements in accordance with IFRS by end-March 2016. The authorities will soon launch the process for amending the BoA Law in order to strengthen the central bank's independence, with the objective of submitting a draft to Parliament by end-2016.

[3] Risk weights were reduced to zero for growth in annual credit to the domestic private sector falling within the range of 4-10 percent. Outside of this range, weights are typically 100 percent, but vary according to risk.

D. Advancing Structural Reforms

21. Continued strong implementation of the electricity reform would gradually ease risks to public finances (MEFP ¶12 and 30-31). Fiscal support to the power sector (in the form of public guarantees, policy net lending, and targeted transfers to the poor) continues to place a substantial burden on public finances. Persistence with reform has started to yield impressive results with distribution losses (defined as the share of total power entering the distribution system that is unbilled) declining from 45 percent in 2013 to 31 percent at end-October. The authorities will continue to prepare a quarterly survey of the arrears of the electricity sector to the private sector (SB). They will target improvements in corporate governance in the sector, including by publishing quarterly financial statements for the generation and distribution companies (SB). The new power sector law was approved in May 2015 and it sets in place a schedule for moving all medium-voltage customers out of the regulated tariff structure by end-2017, beginning with 35kV customers by June-2016 and 20 kV customers by end-2016 (SBs).

PROGRAM DESIGN AND RISKS

22. Given delays associated with the completion of the fifth review, the authorities have requested that the fifth and sixth reviews be combined. The controlling test date is end-December 2015. The authorities request, and staff supports, a waiver of applicability for the end-December ceilings on the general government's deficit and expenditure, as data are unavailable and there is no indication that these PCs will not be met. All PCs for end-August 2015 were met.

23. The authorities propose, and staff supports, the following modifications to program conditionality (MEFP Tables 1 and 3b):

- Replace the PCs on the general government's overall cash deficit and expenditure with a floor on the primary cash balance and a ceiling on primary expenditure.
- Remove the indicative target on the clearance of central government domestic arrears, as the stock of pre-2014 arrears is projected to have been repaid by end-2015.
- Replace the adjustor that allowed the authorities to spend up to 3 billion lek in one-off revenues in 2015 with an adjustor that allows them to spend up to 4 billion lek in 2016, if non-grant fiscal revenues (both tax and non-tax) over-perform. This will create space for additional capital spending, to be financed from any additional dividends from the authorities' compliance campaign (beyond the ¼ percent of GDP in social contributions expected from newly registered workers – see ¶13 above).
- Because of procurement delays, reschedule the deadline for the SB related to rolling out the AGFIS to 15 budget institutions from December 2015 to March 2016. Due to legislative delays, reschedule the deadlines to amend the Budget Law and remove 35KV

electricity consumers from the regulated tariff system from December 2015 to March 2016.

- Introduce new structural benchmarks aimed at improving tax administration, accelerating NPL resolution, and supporting the electricity sector reform.

24. The program remains fully financed. In addition to Fund-provided budget support, the authorities were able to tap international markets twice in 2015. They used a World Bank Policy Based Guarantee to contract a commercial loan of €250 million, which was fully disbursed in Q3. In early November, they placed a Eurobond for €450 million at a yield below 6 percent. In 2016, the World Bank is providing a development policy loan of $100 million, and the EBRD is expected to provide a loan of €218 million to finance a restructuring of electricity sector debt. In addition, the EU is providing €10 million annually over 2016-18, in the form of a grant for balance of payments support linked to the implementation of Albania's PFM reform strategy.

25. Albania is expected to meet repayment obligations to the Fund (Table 7). By the end of the extended arrangement, Fund credit outstanding is projected to be 3.2 percent of GDP, or 14.6 percent of gross reserves. After peaking at 42.9 percent of GDP in 2016, external debt will decline to 38.7 percent of GDP by 2019, with external public debt falling from 34.6 to 30.4 percent of GDP. Risks to repayment capacity are mitigated by Albania's strong record of repaying the Fund and by the authorities' robust performance during the first two years of the program, including their willingness to move ahead with difficult structural reforms.

26. Risks to the program remain high. The revenue gains from the tax compliance efforts are uncertain in the near term. Revenue mobilization requires sustained political will and is vulnerable to constraints on administrative and technical capacity. Despite an impressive start, electricity sector reforms are subject to implementation and weather-related risks, and will require unbending political commitment over the medium term. These risks are mitigated by the prospect for EU accession, which provides a catalyst for reform. Extensive TA by the Fund and other donors will continue to build up capacity to manage macroeconomic risks.

STAFF APPRAISAL

27. The economic recovery is on track but downside risks persist and activity remains below potential. To boost Albania's growth potential and maintain macroeconomic stability, the authorities should persevere with their reform program and build on the substantial progress to date. The recent successful Eurobond issuance is a testament to this progress.

28. Program implementation has been generally robust in the first two years, although sustaining the efforts has become more challenging recently. Program ownership has been strong, with the authorities implementing ambitious and difficult reforms, including in pensions and the electricity sector. Clearance of arrears is projected to have been completed ahead of schedule. Program targets were broadly met, with comfortable margins. Nevertheless, the recent fiscal over-performance had much to do with one-off measures, including significant under-execution in capital expenditure.

29. The commitment to achieving fiscal targets is welcome and should be supported by efficient and sustainable tax base-broadening measures that allow fiscal space for productive spending. The authorities' determination to achieve their 2015 budget deficit target, despite substantial tax revenue shortfalls, is an important signal of their continuing commitment to shore up debt sustainability. Steadfast fiscal consolidation in 2016 and beyond would help lower public debt to below 60 percent of GDP by end-2019.

30. The authorities' gradual consolidation strategy based on broadening the tax base and improving tax compliance and administration is appropriate. In this regard, the recent announcement granting broad exemptions from small business tax undermines the strategy and should be reversed. The authorities' commitment not to grant any further tax exemptions or preferential tax rates is welcome. In addition, the drive to improve compliance should be better aligned with international best practices and should focus on increasing voluntary compliance, to ensure its sustainability. The authorities should also strengthen their capacity to execute high-quality public investment projects. Finally, to achieve the medium-term debt objectives, consolidation efforts will need to continue beyond the current program period. It is therefore critical that the authorities support the adjustment with credible and permanent measures, combined with sufficient buffers should the consolidation effort fall short of the target.

31. Sustained effort would be essential in tackling fiscal risks. Staff supports the authorities' determination to tackle fiscal risks and to implement ambitious reforms to improve revenue administration and public financial management. The authorities' commitment to take additional measures, if needed, to meet the end-year primary balance target for 2016 is encouraging. The authorities should strengthen the credibility of their medium term budgetary framework, in order to reduce the risk of unfunded commitments. The authorities' commitment to ensure that the impact of any new PPP projects on the fiscal accounts will be transparently assessed in line with international norms is welcome. Finally, to mitigate the risks from fiscal decentralization, the ongoing review of the local public finance law should be expedited.

32. Continued progress on power sector reform would also mitigate fiscal risks. The early results from these reforms are impressive. To ensure that these gains are cemented, steadfast implementation of the reform agenda will be critical, especially given the history of failed past attempts. In this regard, the focus on strengthening corporate governance in the sector is welcome.

33. The BoA's continued monetary easing is appropriate, while recent efforts to strengthen its supervisory capacity are welcome. The central bank should maintain an accommodative policy stance as long as inflation expectations remain well-anchored and financial stability concerns are contained. Rebuilding BoA's credibility and safeguarding its independence are both critical for fulfilling its mandate. In this regard, the recent effort to strengthen its internal audit function is welcome. The BoA should also continue enhancing its supervisory capacity and seek to maintain consistency with international standards in order to ensure healthy capitalization in the banking system.

34. Tackling high NPLs is essential for easing bank risk aversion which continues to thwart a revival in the flow of credit and the broader recovery. The speedy formulation by the authorities of a comprehensive strategy to address the NPL issue is welcome. Forceful and timely implementation would be critical to clarify and simplify the legal framework for insolvency and facilitate out-of-court restructuring in order to reduce the NPL overhang and jump-start credit growth in the economy. BoA's microprudential focus on the fastest-growing and systemically important segments of the banking system is appropriate.

35. In light of the progress so far and the authorities' policy commitments going forward, staff supports the completion of the Fifth and Sixth Reviews under the Extended Arrangement, as well as the authorities' request for waiver of applicability and modification of performance criteria.

Box 1. Albania's Campaign Against Tax Evasion, Non-Compliance, and Informality[1]

To address a broad-based revenue shortfall in the first half of 2015, in early September the Albanian authorities embarked on a reform effort to improve tax compliance, fight evasion, and minimize informality. The effort is multifaceted. The government launched a public awareness campaign, waived penalties for businesses that become fully compliant before end-2015, and set up a lottery to incentivize customers to claim their tax receipts. The Tax Procedures Code was amended in November to provide tougher penalties for non-compliance.[2] To enhance enforcement, 500 new tax inspectors have been hired. A steering committee chaired by the Prime Minister monitors the effort and its results on a weekly basis, and promotes closer collaboration between tax and customs administrations.

Early results show impressive increases in the number of registered employees and small businesses (text table). Between August and October 2015, the number of registered employees and self-employed people increased by more than 70,000, an increase of 14 percent compared to end-2014. The number of registered businesses increased by over 33,000 during the same period, representing a 35 percent increase over end-2014. The use of cash registers has also increased markedly. Due to better turnover monitoring, the tax administration has reclassified about 3,600 businesses to higher turnover brackets.

Despite these impressive registration data, the revenue gains are difficult to estimate and will be limited. Receipts from social contributions from newly registered employees are estimated to increase by as much as ¼ percent of GDP in 2016. Additional revenue gains are less certain at this stage. Most newly registered businesses fall under the micro or small business turnover brackets with limited revenue impact. There has been virtually no increase in the declared turnover of businesses under the VAT regime. Behavioral responses, such as bunching just below tax thresholds or breaking up businesses might further dilute the impact of the campaign on fiscal revenues. Finally, revenue gains risk being only temporary if efforts to tackle evasion cannot be sustained over an extended period. For all these reasons staff are being conservative in estimating the additional revenue yield from the efforts to improve compliance, although there is a potential upside to the estimates if the authorities' efforts prove successful.

For significant revenue gains, the authorities need to pursue more vigorously a modern compliance risk management framework as part of a broader strategy to improve compliance. This is a medium-term effort that requires identifying compliance risks and undertaking risk-based audits. Initial data analysis has already begun. While the revenue yields from this effort would take longer to materialize, implementation of this broader strategy is crucial to achieve a sustained increase in revenues.

New Taxpayer Registrations over 2015M8-M10

(net flows)	In Thousands of Taxpayers	In Percent of end-2014 Stock
New businesses	33.3	34.5
New individuals	70.1	14.3
Businesses reclassified into upper turnover brackets	3.6	17.7
into ALL 2-5 mln. bracket (from micro to small business)	*1.2*	*15.4*
into ALL 5-8 mln. bracket (entering VAT regime)	*1.5*	*60.4*
into ALL 8+ mln. bracket (entering CIT regime)	*0.9*	*8.7*

[1] Contributed by Linda Spahia and Nicolas End.

[2] The amendments have been suspended until a constitutional court challenge is resolved.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2012–19

	2012	2013	2014	2015		2016		2017	2018	2019
			Prel.	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Projections		
Real sector				(Growth rate in percent)						
Real GDP 1/	1.4	1.1	2.1	3.0	2.6	4.0	3.4	3.9	4.2	4.2
Consumer Price Index (avg.)	2.0	1.9	1.6	2.0	1.8	2.5	2.3	2.7	3.0	3.0
Consumer Price Index (eop)	2.4	1.9	0.7	2.2	1.9	2.8	2.5	3.0	3.0	3.0
GDP deflator	1.0	0.2	1.0	1.4	1.0	3.1	2.5	3.0	3.1	3.1
Saving-investment balance				(Percent of GDP)						
Foreign savings	10.1	10.8	12.9	13.2	11.4	13.8	13.1	13.0	12.0	10.0
National savings	20.0	18.3	15.2	16.7	15.2	17.4	16.6	18.3	18.1	18.5
Public	0.8	-0.8	0.6	0.7	0.7	2.5	0.5	1.6	2.6	3.4
Private	19.2	19.1	14.6	16.1	14.5	14.9	16.1	16.7	15.5	15.1
Investment	30.2	29.1	28.1	29.9	26.6	31.2	29.7	31.3	30.1	28.5
Public	5.2	4.8	4.3	4.6	4.1	4.6	3.7	3.7	3.9	4.1
Private	25.0	24.2	23.8	25.2	22.5	26.6	26.1	27.6	26.2	24.4
Fiscal sector										
Total revenue and grants	24.8	24.0	26.3	27.7	26.7	28.1	27.1	27.3	27.3	27.3
Tax revenue	22.6	21.9	24.1	25.4	24.0	25.5	24.6	24.8	24.8	24.9
Total expenditure	28.2	29.2	32.2	32.7	31.2	31.7	29.6	29.5	29.6	29.5
Of which: Repayment of end-2013 stock of unpaid bills and arrears			2.4	1.4	1.3	1.1	0.0			
Primary	25.1	26.0	29.3	29.7	28.4	28.9	26.8	26.8	27.0	27.0
Interest	3.1	3.2	2.9	3.0	2.7	2.8	2.8	2.7	2.6	2.5
Unidentified measures (cumulative)			0.0	0.0	0.0	1.5	0.0	1.1	2.1	3.1
Overall balance	-3.4	-5.2	-5.9	-4.9	-4.5	-2.1	-2.5	-1.1	-0.2	0.9
Primary balance	-0.3	-2.0	-3.0	-2.0	-1.8	0.7	0.3	1.6	2.4	3.4
Financing	3.4	5.2	5.9	4.9	4.5	1.2	2.5	1.1	0.2	-0.9
Of which: Domestic	2.0	4.4	3.4	0.1	-0.5	-0.6	-0.5	-0.3	-0.5	-1.6
Of which: Foreign	1.5	0.8	2.5	4.8	5.0	1.8	2.9	1.4	0.7	0.6
Public Debt	62.1	70.4	72.1	73.0	72.2	69.1	70.6	67.1	62.6	57.3
Domestic	35.3	43.4	42.5	40.0	38.7	35.6	36.0	33.4	30.6	26.9
Of which: Unpaid bills and arrears		4.8	2.0	1.2	0.1	0.0	0.0			
External	26.8	26.9	29.6	33.0	33.5	33.5	34.6	33.7	32.1	30.4
Monetary indicators				(Growth rate in percent, unless otherwise indicated)						
Broad money growth	5.0	2.3	4.0	4.9	4.3	7.0	4.1	5.9	6.1	5.9
Private credit growth	1.4	-1.4	2.0	5.3	-0.8	6.8	4.2	7.5	9.9	12.2
Velocity (nominal GDP/broad money)	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Interest rate (3-mth T-bills, end-period)	5.0	3.4	3.1	…	…	…	…	…	…	…
BoA repo rate (in percent)	4.0	3.0	2.3	…	…	…	…	…	…	…
External sector				(Percent of GDP, unless otherwise indicated)						
Trade balance (goods and services)	-18.6	-18.0	-19.0	-19.0	-16.9	-19.4	-18.2	-17.7	-16.5	-14.4
Current account balance	-10.1	-10.8	-12.9	-13.1	-11.4	-13.8	-13.1	-13.0	-12.0	-10.0
Gross international reserves (in billions of Euros)	2.0	2.0	2.2	2.4	2.5	2.5	2.5	2.5	2.6	2.6
(In months of imports of goods and services)	4.6	4.5	5.0	4.6	5.2	4.4	5.0	4.8	4.7	4.7
(Relative to external debt service)	6.6	6.7	6.8	3.5	3.8	5.8	6.1	5.3	5.0	4.6
(In percent of broad money)	24.5	24.6	25.7	26.6	27.8	26.0	27.3	26.2	25.0	23.9
Change in REER (eop, in percent; +=appreciation)	-0.2	1.0	2.4	…	…	…	…	…	…	…
Memorandum items										
Nominal GDP (in billions of lek) 1/	1333	1351	1394	1462	1445	1568	1530	1637	1760	1891
Output gap (percent) 2/	0.1	-0.8	-1.1	-1.1	-1.5	-0.9	-1.6	-1.5	-1.0	-0.5

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

1/ In July 2015, INSTAT revised real GDP for 2012-2013 and quarterly GDP for 2014. The revisions reflect improvements in data sources and compilation methods, and closer aligni with ESA2010/SNA2008 standards.

2/ The output gap closes in 2020.

Table 2a. Albania: General Government Operations, 2012–19
(Percent of GDP)

	2012	2013	2014	2015		2016		2017	2018	2019
				Prog.	Rev. Prog.	Prog.	Rev. Prog.	Projections		
Total revenue and grants	24.8	24.0	26.3	27.7	26.7	28.1	27.1	27.3	27.3	27.3
Tax revenue	22.6	21.9	24.1	25.4	24.0	25.5	24.6	24.8	24.8	24.9
VAT	8.7	8.0	8.9	9.1	8.8	9.1	8.8	8.8	8.8	8.8
Profit tax	1.3	1.1	1.5	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Excise tax	2.7	2.8	2.9	3.4	3.0	3.5	2.9	3.0	3.0	3.0
Personal income tax	2.1	2.2	2.1	2.6	2.1	2.6	2.1	2.1	2.1	2.1
Customs duties	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other taxes	2.2	2.1	2.3	2.6	2.4	2.7	2.5	2.5	2.5	2.6
Local government revenue 1/	0.8	0.8	0.9	0.9	0.8	0.9	1.0	1.0	1.0	1.0
Social insurance contributions	4.3	4.4	5.0	4.7	5.0	4.7	5.3	5.4	5.4	5.4
Non-tax revenue	1.8	1.6	1.5	1.5	2.0	1.7	1.6	1.6	1.6	1.6
Grants	0.4	0.4	0.7	0.8	0.7	0.8	0.8	0.8	0.8	0.8
Total expenditure	28.2	29.2	32.2	32.7	31.2	31.7	29.6	29.5	29.6	29.5
Current expenditure	23.6	24.3	25.0	25.9	25.3	25.5	25.5	25.4	25.2	25.2
Personnel cost 2/	5.2	5.2	5.1	5.2	5.1	5.2	4.7	4.7	4.7	4.7
Interest	3.1	3.2	2.9	3.0	2.7	2.8	2.8	2.7	2.6	2.5
Operations & maintenance	2.5	2.4	2.2	2.7	2.7	2.7	2.9	2.9	2.9	2.9
Subsidies	0.1	0.1	0.6	0.9	0.6	0.7	0.5	0.4	0.4	0.5
Energy guarantees			0.5	0.7	0.4	0.6	0.3	0.2	0.0	0.0
Nonenergy guarantees			0.0	0.1	0.1	0.0	0.1	0.1	0.2	0.3
Other			0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social insurance outlays	9.0	9.5	9.9	9.8	9.8	9.8	10.0	10.0	10.0	10.0
Local government expenditure 2/	2.1	2.2	2.4	2.5	2.5	2.5	3.2	3.2	3.2	3.2
Social protection transfers	1.6	1.7	1.8	1.7	1.9	1.7	1.5	1.5	1.5	1.5
Capital expenditure	4.6	4.8	4.3	4.6	4.1	4.6	3.7	3.7	3.9	4.1
Domestically financed	2.1	2.7	2.4	2.1	2.4	1.7	1.4	1.4	1.9	2.2
Foreign financed	2.6	2.1	1.9	2.6	1.7	2.9	2.2	2.3	2.0	1.9
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lending minus repayment	0.0	0.0	0.4	0.4	0.4	0.3	0.2	0.2	0.3	0.0
Reserve and contingency funds 3/	0.0	0.0	0.0	0.4	0.1	0.3	0.2	0.2	0.2	0.2
Repayment of end-2013 stock of unpaid bills and arrears			2.4	1.4	1.3	1.1	0.0	0.0	0.0	0.0
Unidentified measures (cumulative)			0.0	0.0	0.0	1.5	0.0	1.1	2.1	3.1
Overall balance	-3.4	-5.2	-5.9	-4.9	-4.5	-2.1	-2.5	-1.1	-0.2	0.9
Financing	3.4	5.2	5.9	4.9	4.5	1.2	2.5	1.1	0.2	-0.9
Domestic	2.0	4.4	3.4	0.1	-0.5	-0.6	-0.5	-0.3	-0.5	-1.6
Privatization receipts	0.1	1.2	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Net borrowing	1.9	3.4	3.2	0.1	-0.5	-0.6	-0.5	-0.3	-0.5	-1.6
Other	0.0	-0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	1.5	0.8	2.5	4.8	5.0	1.8	2.9	1.4	0.7	0.6
Accumulation of arrears 4/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (+=gap) 5/				0.0	0.0	0.9	0.0	0.0	0.0	0.0
World Bank				0.0	0.0	0.7	0.0			
Residual financing (e.g., EU)				0.0	0.0	0.2	0.0			
IMF				0.0	0.0	0.0	0.0			
Memorandum Items:										
Primary balance	-0.3	-2.0	-3.0	-2.0	-1.8	0.7	0.3	1.6	2.4	3.4
Primary balance (excl. repayment of end-2013 stock of unpaid bills and arrears)	-0.3	-2.0	-0.6	-0.6	-0.5	1.8	0.3	1.6	2.4	3.4
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears			-3.5	-3.6	-3.2	-1.0	-2.5	-1.1	-0.2	0.9
Public Debt	62.1	70.4	72.1	73.0	72.2	69.1	70.6	67.1	62.6	57.3
Of which: Short-term public debt	20.0	19.7	20.6		15.4		10.1	9.7	8.7	7.6
Domestic	35.3	43.4	42.5	40.0	38.7	35.6	36.0	33.4	30.6	26.9
Of which: Unpaid bills and arrears		4.8	2.0	1.2	0.1	0.0	0.0			
External	26.8	26.9	29.6	33.0	33.5	33.5	34.6	33.7	32.1	30.4
Direct government external debt	24.0	24.6	27.6	31.2	31.6	32.0	32.8	32.0	30.4	28.3
Government guaranteed external debt	2.8	2.3	2.0	1.8	1.9	1.5	1.8	1.7	1.7	2.1
GDP (in billions of leks)	1333	1351	1394	1462	1445	1568	1530	1637	1760	1891

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

1/ Includes the property tax, the simplified profit tax for small businesses, and other local taxes.
2/ There is a structural break in 2016, reflecting the transfer of central government employees to local governments, as part of fiscal decentralization.
3/ Spending contingencies are reported according to their economic classification at outturn.
4/ As reflected in official data and not accounting for arrears accumulated outside of the budget prior to 2014.
5/ Following the approval of the program, Fund purchases are reported under foreign financing. Similarly, secured funding by the World Bank is reported under foreign financing.

Table 2b. Albania: General Government Operations, 2012–19

(Billions of leks)

	2012	2013	2014	2015		2016		2017	2018	2019
				Prog.	Rev. Prog.	Prog.	Rev. Prog.	Projections		
Total revenue and grants	330.4	323.7	366.6	405.3	385.3	440.0	414.4	446.8	480.6	516.7
Tax revenue	300.9	296.4	335.8	370.9	346.3	400.2	376.8	406.5	437.2	470.1
VAT	116.5	108.5	123.7	133.1	126.7	143.0	134.6	144.0	154.8	166.3
Profit tax	16.9	15.1	21.5	23.1	23.0	24.8	24.4	26.1	28.0	30.1
Excise tax	36.4	38.2	40.9	49.9	42.9	55.2	45.1	49.3	53.0	56.9
Personal income tax	28.0	29.6	28.9	38.1	30.0	40.9	31.7	33.9	36.4	39.2
Customs duties	6.1	5.8	5.9	6.1	5.7	6.5	6.0	6.4	6.9	7.4
Other taxes	28.7	28.5	32.6	38.7	34.1	42.0	38.5	41.4	44.8	48.4
Local government revenue 1/	10.9	10.8	12.4	13.1	12.1	14.1	16.0	17.1	18.4	19.8
Social insurance contributions	57.4	60.0	69.9	68.8	71.7	73.8	80.4	88.3	94.9	102.0
Non-tax revenue	24.0	21.6	20.7	22.4	29.0	27.0	24.7	26.4	28.4	30.5
Grants	5.6	5.7	10.1	12.0	10.0	12.9	13.0	13.9	14.9	16.1
Total expenditure	376.2	394.1	448.6	477.5	450.3	497.1	452.4	483.1	520.9	557.0
Current expenditure	314.6	328.6	348.1	378.2	365.6	399.4	390.8	415.5	443.7	476.3
Personnel cost 2/	69.4	70.7	71.4	76.3	73.2	81.8	71.3	76.3	82.0	88.1
Interest	41.5	43.3	40.1	43.4	39.6	44.0	43.0	44.5	46.2	46.8
Operations & maintenance	33.5	32.4	31.3	39.7	39.2	42.5	43.6	46.7	50.2	53.9
Subsidies	1.9	1.6	8.4	13.4	8.7	11.2	7.7	7.0	6.3	8.8
Energy guarantees			6.7	10.2	6.0	8.8	4.4	2.8	0.7	0.7
Nonenergy guarantees			0.1	1.5	0.9	0.6	1.6	2.4	3.6	6.0
Other			1.6	1.8	1.8	1.9	1.8	1.9	2.0	2.2
Social insurance outlays	120.3	127.6	138.5	143.7	141.0	154.0	152.6	163.3	175.7	189.0
Local government expenditure 2/	27.3	29.8	32.9	37.2	36.1	39.4	49.1	52.5	56.4	60.6
Social protection transfers	20.7	23.2	25.5	24.5	27.9	26.3	23.5	25.1	27.0	29.0
Capital expenditure	61.7	65.5	60.5	67.9	59.2	71.6	56.0	59.9	67.9	76.8
Domestically financed	27.4	36.7	33.8	30.1	34.0	26.0	21.9	22.6	32.8	41.7
Foreign financed	34.3	28.8	26.8	37.8	25.2	45.6	34.0	37.3	35.0	35.1
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lending minus repayment	0.0	0.0	5.9	5.9	5.9	4.0	2.6	3.7	5.3	0.0
Reserve and contingency funds 3/	0.0	0.0	0.0	5.5	1.2	4.5	3.0	4.0	4.0	4.0
Repayment of end-2013 stock of unpaid bills and arrears			33.8	20.0	18.4	17.7	0.0	0.0	0.0	0.0
Unidentified measures (cumulative)			0.0	0.0	0.0	23.8	0.0	18.0	37.0	58.1
Overall balance	-45.9	-70.4	-82.1	-72.1	-65.0	-33.2	-38.0	-18.2	-3.4	17.8
Financing	45.9	70.4	82.1	72.1	65.0	18.5	38.0	18.2	3.4	-17.8
Domestic	26.5	59.6	47.5	1.8	-6.8	-9.3	-7.2	-4.4	-8.6	-29.3
Privatization receipts	1.2	16.7	0.0	0.0	0.8	0.0	0.0	0.0	0.0	0.0
Net borrowing	24.8	46.3	45.0	1.8	-7.6	-9.3	-7.2	-4.4	-8.6	-29.3
Other	0.5	-3.4	2.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	19.4	10.8	34.3	70.3	71.8	27.8	45.1	22.6	12.0	11.5
Accumulation of arrears 4/	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (+=gap) 5/				0.0	0.0	14.8	0.0	0.0	0.0	0.0
World Bank				0.0	0.0	11.2	0.0			
Residual financing (e.g., EU)				0.0	0.0	3.5	0.0			
IMF				0.0	0.0	0.0	0.0			
Memorandum Items:										
Primary balance	-4.4	-27.1	-42.0	-28.7	-25.4	10.8	5.0	26.3	42.8	64.6
Primary balance (excl. repayment of end-2013 stock of unpaid bills and arrears)	-4.4	-27.1	-8.2	-8.7	-7.1	28.4	5.0	26.3	42.8	64.6
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears			-48.3	-52.1	-46.7	-15.6	-38.0	-18.2	-3.4	17.8
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears, and new guarantees			-41.5	-40.4	-39.7	-6.2	-32.0	-13.1	0.9	24.4
Public Debt	828.3	950.5	1005.2	1067.6	1043.1	1083.1	1080.2	1098.4	1101.8	1084.0
Of which: Short-term public debt	266.0	265.7	286.6		222.4		154.1	158.6	153.3	144.5
Domestic	470.6	586.6	592.7	585.0	558.9	558.0	550.9	546.4	537.8	508.5
Of which: Unpaid bills and arrears		65.5	27.2	17.7	0.9	0.0	0.0			
External	357.6	363.9	412.4	482.5	484.2	525.1	529.4	552.0	564.0	575.5
Direct government external debt	319.8	332.5	383.9	455.6	456.9	500.9	502.3	524.6	534.4	535.7
Government guaranteed external debt	37.8	31.4	28.5	26.9	27.3	24.2	27.0	27.4	29.6	39.8

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

1/ Includes the property tax, the simplified profit tax for small businesses, and other local taxes.
2/ There is a structural break in 2016, reflecting the transfer of central government employees to local governments, as part of fiscal decentralization.
3/ Spending contingencies are reported according to their economic classification at outturn.
4/ As reflected in official data and not accounting for arrears accumulated outside of the budget prior to 2014.
5/ Following the approval of the program, Fund purchases are reported under foreign financing. Similarly, secured funding by the World Bank is reported under foreign financing.

Table 3a. Albania: Balance of Payments, 2012–19[1]
(Percent of GDP)

	2012	2013	2014	2015	2016	2017	2018	2019
				Projections				
Current account	-10.1	-10.8	-12.9	-11.4	-13.1	-13.0	-12.0	-10.0
Balance of goods and services	-18.6	-18.0	-19.0	-16.9	-18.2	-17.7	-16.5	-14.4
Trade Balance (goods)	-20.8	-17.9	-22.3	-20.7	-21.6	-21.1	-20.0	-18.0
Exports	16.0	18.2	9.4	8.0	7.5	7.9	8.5	8.8
Of which: Energy	4.3	5.7	4.7	3.4	2.9	3.2	3.6	3.7
Imports	36.8	36.1	31.6	28.7	29.1	29.0	28.5	26.8
Of which: Energy	7.9	6.6	6.1	3.9	3.7	3.9	4.0	4.0
Services (net)	2.2	-0.2	3.2	3.8	3.5	3.4	3.4	3.6
Income balance	-0.7	0.2	-1.2	-1.4	-1.6	-1.6	-1.6	-1.5
Of which: Interest due	1.0	0.5	0.9	1.1	1.2	1.2	1.2	1.2
Current transfers	9.2	7.1	7.3	6.9	6.7	6.4	6.1	5.9
Capital and Financial account	8.1	8.7	9.0	3.0	8.4	9.8	9.5	7.6
Capital transfers	0.8	0.5	0.9	0.9	0.8	0.7	0.7	0.6
Direct investment, net	6.8	9.6	8.2	7.0	7.9	7.7	7.1	5.3
Government Medium- and long-term loans, net	2.1	1.1	0.5	-2.7	0.4	0.3	0.2	-0.3
Project loans	2.8	1.9	1.7	1.5	1.9	2.0	1.8	1.3
Amortization (includes Eurobond bullet payment)	-0.6	-0.8	-1.1	-4.2	-1.5	-1.7	-1.6	-1.6
Government Guaranteed Borrowing, net	-0.1	-0.2	-0.2	-0.1	0.0	0.0	0.1	0.5
Disbursement	0.1	0.1	0.0	0.1	0.2	0.2	0.4	0.7
Amortization	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.2
Other flows	-2.0	-2.1	-1.0	-2.8	-1.3	0.1	0.5	0.4
Errors and omissions 2/	2.9	3.1	2.7	2.7	2.6	2.5	2.4	2.3
Net balance	0.9	1.1	-1.2	-5.7	-2.1	-0.7	-0.1	-0.1
Available financing	-0.8	-1.1	1.2	5.7	2.1	0.7	0.1	0.1
Change in net reserves (increase = -) 3/	-0.8	-1.1	-1.0	-2.0	-0.5	-0.3	-0.3	-0.3
IMF (budget support)	…	…	0.5	0.9	1.3	0.6	0.0	0.0
World Bank (DPL)	…	…	1.7	0.0	0.8	0.0	0.0	0.0
World Bank (PBG)	…	…	0.0	2.4	0.0	0.0	0.0	0.0
Other budget loans (EBRD)	…	…	…	…	0.5	0.4	0.4	0.4
Commercial loans (eurobond)	0.0	0.0	0.0	4.4	0.0	0.0	0.0	0.0
Memorandum items:								
Exports of Goods and Services (percent of GDP)	33.4	35.4	35.2	34.2	33.7	34.1	34.5	34.6
Imports of Goods and Services (percent of GDP)	52.0	53.5	54.2	51.1	51.8	51.8	51.0	49.0
Current Account (percent of GDP)								
excluding TAP, Statkraft related imports	-10.1	-10.8	-12.9	-10.5	-10.6	-10.5	-10.0	-9.4
Balance of goods and services								
excluding TAP, Statkraft related imports	-18.6	-18.0	-19.0	-16.0	-15.7	-15.2	-14.5	-13.8

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

1/ Historical data for 2012-13 reflect old BPM5 estimates which record insourcing services as goods. The data from 2014 onwards reflect BPM6 treatment of textile insourced manufacturing, which is recorded as services.

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

3/ Net of valuation changes in 2012–14. In projections for 2015–19, valuation effects are assumed to be zero.

Table 3b. Albania: Balance of Payments, 2012–19[1]

(Millions of euros)

	2012	2013	2014	2015	2016	2017	2018	2019
				Projections				
Current account	-973	-1,036	-1,287	-1,173	-1,431	-1,508	-1,495	-1,333
Balance of goods and services	-1,781	-1,737	-1,892	-1,742	-1,983	-2,056	-2,057	-1,918
Trade Balance (goods)	-1,994	-1,719	-2,216	-2,132	-2,361	-2,449	-2,483	-2,394
Exports	1,531	1,757	932	829	814	922	1,058	1,180
Of which: Energy	408	545	463	346	318	376	447	494
Imports	3,525	3,476	3,147	2,961	3,175	3,371	3,541	3,574
Of which: Energy	757	631	611	399	408	451	496	533
Services (net)	213	-18	323	390	378	393	427	476
Income balance	-72	21	-119	-146	-175	-192	-202	-205
Of which: Interest due	94	51	90	113	128	142	153	158
Current transfers	880	680	725	715	727	739	764	789
Capital and Financial account	779	838	899	310	918	1,138	1,186	1,019
Capital transfers	81	48	87	90	85	85	85	85
Direct investment, net	648	923	812	720	857	896	881	712
Government Medium- and long-term loans, net	205	105	51	-275	40	36	19	-41
Project loans	268	180	165	157	204	231	220	178
Amortization (includes Eurobond bullet payment)	-62	-74	-114	-432	-165	-194	-201	-218
Government Guaranteed Borrowing, net	-12	-17	-22	-8	-2	2	16	72
Disbursement	10	5	0	14	21	26	55	98
Amortization	22	22	23	23	24	24	39	26
Other flows	-191	-206	-97	-289	-147	17	68	55
Errors and omissions [2/]	276	301	266	276	280	287	295	303
Net balance	82	103	-122	-587	-232	-84	-14	-11
Available financing	-77	-104	122	587	232	84	14	11
Change in net reserves (increase = -) [3/]	-77	-104	-97	-209	-52	-38	-36	-39
IMF (budget support)	…	…	54	96	145	72	0	0
World Bank (DPL)	…	…	166	0	89	0	0	0
World Bank (PBG)	…	…	…	250	…	…	…	…
Other budget loans (EBRD)	…	…	…	…	50	50	50	50
Commercial loans (eurobond)	0	0	0	450	0	0	0	0
Memorandum items:								
Nominal GDP	9,586	9,629	9,956	10,315	10,910	11,621	12,437	13,334
Gross international reserves	1,972	2,015	2,192	2,472	2,517	2,547	2,577	2,607
(months of imports of goods and services)	4.6	4.5	5.0	5.2	5.0	4.8	4.7	4.7
Balance of goods and services (percent of GDP)	-18.6	-18.0	-19.0	-16.9	-18.2	-17.7	-16.5	-14.4
Current account (percent of GDP)	-10.1	-10.8	-12.9	-11.4	-13.1	-13.0	-12.0	-10.0
Debt service (percent of exports of goods and services) [4/]	0.5	-0.1	3.0	13.1	5.4	5.4	5.4	4.3
Debt service (percent of central government revenues) [4/]	0.7	-0.1	4.3	18.3	7.4	7.5	7.6	6.1
Total external debt stock (percent of GDP) [5/]	35.7	34.7	37.1	41.6	42.9	42.2	40.5	38.7
Exports of Goods and Services (millions of Euros)	3,204	3,412	3,507	3,532	3,673	3,958	4,287	4,617
Imports of Goods and Services (millions of Euros)	4,985	5,149	5,400	5,274	5,655	6,014	6,344	6,535
Volume of Exports of Goods and Services (percent change)	-2.3	5.6	10.1	2.2	2.9	5.2	5.7	5.2
Volume of Imports of Goods and Services (percent change)	-7.7	4.1	7.6	-0.3	7.8	5.0	4.1	1.7
Terms of trade (percent change)	-0.6	-0.2	-2.0	-6.9	-0.5	1.4	1.1	0.2

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

1/ Historical data for 2012-13 reflect old BPM5 estimates which record insourcing services as goods. The data from 2014 onwards reflect BPM6 treatment of textile insourced manufacturing, which is recorded as services.

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

3/ Net of valuation changes in 2012–14. In projections for 2015–19, valuation effects are assumed to be zero.

4/ Public and publicly guaranteed debt only.

5/ Public and private external debt, including arrears. Debt stock converted into Lek at the e-o-p exchange rate.

Table 4a. Albania: Monetary Survey, 2012–16

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

	2012	2013	2014	2015	2016
Net foreign assets	451	479	525	612	662
Bank of Albania	267	274	292	331	339
Commercial banks	185	205	233	281	324
Net domestic assets	672	670	670	634	635
Claims on central government, net	351	363	378	371	367
Bank of Albania	52	43	47	11	33
Commercial banks	299	320	331	359	334
Claims on public enterprises	24	25	27	27	5
Claims on the private sector	521	513	524	520	542
In leks	192	195	207	205	214
In foreign currency	328	318	317	314	328
Other items, net	-223	-231	-259	-283	-278
Broad money	1,123	1,149	1,195	1,246	1,298
Currency outside banks	193	199	218	227	235
Deposits	931	950	977	1,019	1,062
Domestic currency	477	494	505	522	544
Foreign currency	454	456	473	497	518
Memorandum items:					
Broad money growth (% change)	5.0	2.3	4.0	4.3	4.1
Reserve money growth (% change)	2.7	3.5	8.1	8.4	4.7
Private sector credit growth (% change)	1.4	-1.4	2.0	-0.8	4.2
Broad money (as percent of GDP)	84.3	85.1	85.8	86.2	84.8
Private sector credit (as percent of GDP)	39.1	38.0	37.6	36.0	35.4
Velocity (nominal GDP/broad money)	1.2	1.2	1.2	1.2	1.2
Money multiplier (absolute values)	3.8	3.7	3.6	3.5	3.4
Currency (as share of broad money)	17.2	17.3	18.2	18.2	18.1
Foreign currency deposits/total deposits	48.8	48.0	48.4	48.8	48.8
Gross reserves (millions of euros)	1,972	2,015	2,192	2,472	2,517

Sources: Bank of Albania; and IMF staff estimates.

Table 4b. Albania: Summary of Accounts of the Central Bank, 2012–16
(Billions of leks, unless otherwise indicated; end-period)

	2012	2013	2014	2015	2016
Net foreign assets	267	274	292	331	339
Assets	288	294	319	358	365
Liabilities	22	20	27	27	27
Net domestic assets	31	34	41	30	39
Domestic credit	75	66	75	53	54
Net claims on central government	52	43	47	11	33
Assets	65	65	64	24	64
Liabilities	13	22	17	13	31
Other credit	24	23	27	41	21
Private sector	2	2	2	2	2
Commercial banks	22	22	26	40	19
Other items, net (assets = +)	-44	-32	-34	-23	-15
Reserve money	298	308	333	361	378
Currency in circulation	193	199	218	227	235
Bank reserves	105	109	115	134	142
Other nonbank deposits	0	0	0	0	0

Sources: Bank of Albania; and IMF staff estimates.

Table 5. Albania: IMF Core Indicators of Financial Soundness, 2007–15

	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
I Capital-based														
(i) Regulatory capital as a percent of risk-weighted assets	17.1	17.2	16.17	15.4	15.6	16.2	18.0	17.9	17.5	17.6	16.8	15.8	16.0	15.8
(ii) Regulatory Tier 1 capital as a percent of risk-weighted assets	16.0	16.3	15.3	14.5	14.3	14.6	14.9	14.8	14.5	14.5	13.8	13.1	13.6	13.2
(iii) Capital as a percent of total assets														
Regulatory Tier 1 capital as a percent of total assets	5.8	6.7	8.7	8.6	8.1	7.9	7.7	7.6	7.5	7.6	7.4	8.0	8.3	8.4
Regulatory capital as a percent of total assets	6.2	7.0	9.2	9.1	8.8	8.8	9.3	9.2	9.0	9.2	9.0	9.7	9.7	9.7
Shareholders' equity as a percent of total assets	7.6	8.6	9.6	9.4	8.7	8.6	8.4	8.4	8.3	8.5	8.6	9.0	9.1	9.2
(iv) Nonperforming loans net of provisions as a percent of capital														
As a percent of regulatory Tier 1 capital	12.0	27.2	29.9	38.1	56.6	61.8	48.5	50.7	49.0	53.0	46.7	42.3	36.1	33.9
As a percent of regulatory capital	11.2	25.7	28.2	35.9	52.0	55.6	40.2	41.8	40.5	43.8	38.3	35.2	30.8	29.2
As a percent of shareholders' equity	9.1	21.1	27.1	34.8	52.6	56.9	44.8	45.8	44.2	47.3	40.2	37.6	32.8	30.8
(v) Return on equity (ROE) (annual basis)	20.7	11.4	4.6	7.6	0.8	3.8	6.4	17.2	10.4	11.0	10.5	20.3	14.2	13.1
(vi) Net open position in foreign exchange as a percent of capital														
As a percent of regulatory Tier 1 capital	1.8	4.5	4.1	5.3	4.3	4.1	4.9	7.8	5.9	8.3	10.4	5.1	8.5	9.3
As a percent of regulatory capital	1.7	4.3	3.9	5.0	3.9	3.7	4.1	6.5	4.9	6.8	8.5	4.2	7.2	8.0
As a percent of shareholders' equity	1.4	3.5	3.7	4.9	4.0	3.8	4.5	7.1	5.3	7.4	8.9	4.5	7.7	8.4
II Asset-based														
(vii) Liquid assets as a percent of total assets (Liquid-asset ratio) 1/	49.8	42.8	27.6	25.9	26.5	29.4	27.6	30.9	32.7	32.4	31.9	33.2	32.6	33.2
(viii) Liquid assets as a percent of short-term liabilities 1/	55.6	104.7	32.6	30.6	33.1	34.9	34.7	39.1	41.4	41.2	40.4	42.3	42.0	43.3
(ix) Return on assets (ROA) (net income to average total assets, annual)	1.6	0.9	0.4	0.7	0.1	0.3	0.5	1.5	0.9	0.9	0.9	1.8	1.3	1.2
(x) Nonperforming loans (gross) as a percent of total loans	3.4	6.6	10.5	14.0	18.8	22.5	23.5	24.0	24.1	25.0	22.8	22.8	20.9	20.6
III Income and expense-based														
(xii) Interest margin to gross income	92.7	106.5	119.6	118.9	147.7	130.4	112.6	95.4	106.0	109.6	113.1	127.1	108.9	109.8
(xiii) Noninterest expenses to gross income	58.5	69.6	83.0	75.5	91.3	85.0	74.7	54.7	66.0	95.7	68.4	81.4	61.2	62.6
IV Memorandum items														
Other (noncore) indicators:														
Customer deposits as a percent of total (non-interbank) loans	215.5	162.6	154.3	166.4	163.2	171.6	180.8	183.0	183.3	181.9	180.2	180.7	180.5	184.2
Foreign currency-denominated loans to total loans	72.5	72.6	70.2	69.8	67.9	64.5	63.0	62.6	62.1	62.1	62.4	62.2	61.7	61.2
Foreign currency-denominated liabilities as a percent of total liabilities	46.9	48.5	48.9	51.0	51.9	52.6	52.8	52.5	52.4	52.7	52.4	52.5	52.8	53.0
Other indicators:														
Risk weighted assets as a percent of total assets	36.4	40.8	56.7	59.2	56.5	54.2	52.1	51.5	51.6	52.5	53.6	61.3	60.5	61.3
Total loans as a percent of total assets	39.4	47.6	50.8	49.6	50.5	48.6	45.9	45.2	45.2	45.4	46.0	45.6	45.5	44.7
Total loans as a percent of shareholders' equity	516.4	555.1	530.2	527.0	581.9	567.4	548.8	536.2	544.9	531.1	536.3	504.1	501.2	485.8

Source: Bank of Albania.

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

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

Availability Date	Millions of SDR	In Percent of Quota	Conditions
February 28, 2014	23.55	39.3	Board approval of arrangement
June 28, 2014	23.55	39.3	Observance of end-March 2014 and continuous performance criteria and completion of first review
September 15, 2014	23.55	39.3	Observance of end-June 2014 and continuous performance criteria and completion of second review
December 15, 2014	23.55	39.3	Observance of end-September 2014 and continuous performance criteria and completion of third review
April 15, 2015	28.88	48.1	Observance of end-December 2014 and continuous performance criteria and completion of fourth review
July 15, 2015	28.88	48.1	Observance of end-April 2015 and continuous performance criteria and completion of fifth review
November 15, 2015	28.88	48.1	Observance of end-August 2015 and continuous performance criteria and completion of sixth review
March 15, 2016	28.65	47.8	Observance of end-December 2015 and continuous performance criteria and completion of seventh review
July 15, 2016	28.65	47.8	Observance of end-April 2016 and continuous performance criteria and completion of eighth review
November 15, 2016	28.65	47.8	Observance of end-August 2016 and continuous performance criteria and completion of ninth review
February 15, 2017	28.63	47.7	Observance of end-November 2016 and continuous performance criteria and completion of tenth review
Total	**295.42**	**492.4**	

[1] Albania's IMF quota is SDR 60 million.

Table 7. Albania: Indicators of Capacity to Repay the Fund, 2012–19[1,2]

(Under Obligated Repurchase Schedule; in millions of SDRs)

	2012	2013	2014	2015	2016	2017	2018	2019
				Projections				
Fund repurchases and charges								
In millions of SDRs	6.8	6.9	6.1	5.7	6.3	9.3	12.8	23.7
In millions of euro	8.0	7.7	7.2	7.2	7.9	11.7	16.0	29.5
In percent of gross international reserves	0.4	0.4	0.3	0.3	0.3	0.5	0.6	1.1
In percent of exports of goods and services	0.2	0.2	0.2	0.2	0.2	0.3	0.4	0.6
In percent of GDP	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2
In percent of external public debt	0.3	0.3	0.2	0.2	0.2	0.3	0.4	0.8
In percent of quota	11.3	11.5	10.1	9.5	10.5	15.5	21.3	39.4
Fund credit outstanding (end of period)								
In millions of SDRs	23.2	16.4	57.7	187.1	241.5	296.8	291.7	277.3
In millions of euro	27.2	18.4	68.1	236.1	303.8	371.9	364.7	345.2
In percent of gross international reserves	1.4	0.9	3.1	9.6	12.1	14.6	14.2	13.2
In percent of exports of goods and services	0.8	0.5	1.9	6.7	8.3	9.4	8.5	7.5
In percent of GDP	0.3	0.2	0.7	2.3	2.8	3.2	2.9	2.6
In percent of external public debt	1.0	0.7	2.4	6.9	8.3	9.8	9.5	8.9
In percent of quota	38.7	27.3	96.1	311.8	402.5	494.6	486.2	462.2
Memorandum items:								
Gross international reserves	1682	1795	1855	1959	2001	2032	2061	2094
Exports of goods and services	2732	3039	2969	2800	2920	3158	3429	3709
GDP	8173	8578	8427	8176	8673	9273	9948	10711
External public debt	2233	2351	2445	2699	2924	3025	3063	3104
Quota	60.0	60.0	60.0	60.0	60.0	60.0	60.0	60.0

Source: Fund staff estimates.

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

Appendix I. Letter of Intent

January 22, 2016

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

Dear Ms. Lagarde:

1. The Extended Arrangement approved by the Executive Board of the International Monetary Fund (IMF) in February 2014 remains the anchor of our economic policies. The attached Memorandum of Economic and Financial policies (MEFP) reviews progress in implementing the program and outlines the policies that the government and the Bank of Albania (BoA) will pursue over the next twelve months.

2. Performance under the program has been strong. All end-April, end-August, available end-December, and continuous performance criteria were met, as were most indicative targets. The indicative targets on subsidies to the energy sector (for the end-April test date) and the accumulation of new arrears (for the end-April and end-August test dates) were missed by small margins. The government is implementing remedial measures and most of the newly accumulated arrears will be settled by early 2016. The inflation rate for the end-August test date was slightly below the inner band prescribed under the Inflation Consultation Clause. The BoA and Fund staff expect inflation to converge to the medium-term target and agree that the policy of gradual monetary easing and forward guidance is appropriate. We are currently awaiting data to assess two end-December performance criteria (a waiver of applicability is being requested for the ceilings on general government overall cash deficit and expenditure, and we expect them to be met, based on available data).

3. Most structural benchmarks were implemented, though one was implemented partially, two were implemented with delays, and two more were delayed. The re-prioritization of all outstanding infrastructure projects was delayed in order to align it to the 2016 budget. This has been now implemented as a prior action. The need to amend a law and related regulations delayed the launch of risk-based audits of tax refunds to September. We propose rescheduling the roll-out of AGFIS to 15 budget institutions to March 2016, due to procurement delays with the server upgrade, which have now been resolved. We also propose rescheduling the amendments to the Budget Law to incorporate multi-year commitment limits to early 2016. Finally, we propose rescheduling the removal of 35kV medium-voltage consumers from the regulated tariff system to mid-2016, due to delays in related legislation.

4. Our policy priorities over the next twelve months will focus on pursuing fiscal consolidation, safeguarding financial sector stability, reviving credit growth, and implementing growth-enhancing reforms. In particular, we will persist with ambitious reforms in the electricity sector and in public financial management.

5. Implementation of our program will be monitored by the Fund through reviews, quantitative performance criteria, indicative targets, and structural benchmarks, as described in the attached MEFP and Technical Memorandum of Understanding (TMU). While we are confident that the policies described in the MEFP are adequate to achieve program objectives, we stand ready to take additional measures that may be required for this purpose. We will consult with the Fund on the adoption of such measures, as well as in advance of any revisions to the policies contained in this letter and the MEFP. The government of Albania will provide the IMF with such information as it may request to monitor progress in economic and financial policy implementation.

6. In view of the strong program performance to date and the strength of policy commitments for the period ahead, we request that the Executive Board of the IMF complete the fifth and sixth reviews under the Extended Arrangement. We further request the purchase of SDR 57.76 million. We request a waiver of applicability for the two end-December performance criteria on general government overall cash deficit and expenditure, given the unavailability of data for assessing these. Finally, we request the modification of performance criteria, as described in Table 1 of the MEFP and in the TMU.

7. We wish to make this letter available to the public, along with the attached MEFP and TMU, as well as the IMF staff report on the fifth and sixth reviews under the Extended Fund Facility. We therefore authorize their publication and posting on the IMF website, subject to Executive Board approval. These documents will also be posted on the official websites of the Albanian government.

Sincerely,

/s/	/s/	/s/
Shkelqim Cani	Gent Sejko	Arben Ahmetaj
Minister of Finance	Governor, Bank of Albania	Minister of Economic Development

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

1. This Memorandum lays out the Government of Albania's policy priorities for the period ahead, supported by the IMF's Extended Fund Facility. Our policies seek to generate higher living standards and better employment opportunities for Albanians. Achieving these goals will require sustained efforts to reduce debt-related vulnerabilities, revive credit growth, and unlock structural constraints to medium-term growth.

Recent Economic Developments

2. Economic growth is projected to have picked up in 2015, despite significant headwinds earlier in the year. Weak demand in the Eurozone as well as low international commodity prices reduced export growth, while economic uncertainties arising from the Greek crisis also weighed on domestic demand. The resulting broad-based weakness in manufacturing and services was, however, offset by strong hydropower generation. Real GDP is expected to have grown at the same pace in the second half of the year, reaching 2½–2¾ percent in 2015, supported by continued arrears clearance, higher tourism receipts, and stronger private investment. The current account deficit is expected to have narrowed to around 11½ percent of GDP, given improvements in tourism receipts and higher net electricity exports.

3. Domestic slack and declining international commodity prices have resulted in low headline inflation. CPI inflation accelerated to 2.2 percent in September 2015, up from 1.5 percent a year ago, due mostly to one-off supply shocks, such as increases in food prices. Nevertheless, core inflation continues to hover around zero. Given the disinflationary pressures from imported inflation and the weak domestic demand, inflation is projected to have reached 1.9 percent at end-2015.

Outlook

4. Economic recovery is expected to strengthen next year driven by rising domestic demand. GDP growth is projected to increase to 3.4 percent in 2016, benefiting from improved confidence, continued low interest rates, higher FDI inflows, and a gradual recovery in bank lending. These effects are expected to offset the fiscal drag from the reduction in arrears clearance. Average inflation is projected to rise gradually to 2.3 percent in 2016 on the strength of rising domestic demand, an accommodative monetary policy stance, and a pickup in euro area inflation, but is nevertheless likely to remain below the BoA's target of 3 percent for some time.

5. External imbalances are likely to remain elevated throughout 2016–17. The current account deficit is projected to widen to around 13 percent of GDP next year. Imports are projected to remain high on the back of large infrastructure projects (such as the Trans Adriatic Pipeline and the Statkraft/Devoll hydropower plant), while low commodity prices are expected to continue weighing down on exports. After several years of decline, remittances have picked up, but are expected to remain below their pre-crisis peak, given economic uncertainties in the main source countries. The current account will continue to be financed largely by FDI. Over the medium term, the current account deficit is expected to narrow somewhat because of improvements in export capacity (particularly in agriculture), expenditure switching from imports to domestically produced goods, and falling import needs of the major FDI projects. Gross official reserves are expected to cover above 4½ months of imports of goods and services in 2016-17.

Program Implementation

6. **All April, August, available end-December, and continuous performance criteria were met, as were most indicative targets (Table 1).** The ceilings on the government's cash deficit and expenditure were met due to expenditure under-execution as well as one-off non-tax revenues, both of which offset broad-based weakness in tax revenues. The April ceiling on energy subsidies was missed by a very small margin (0.02 percent of GDP). However, the August ceiling was met and the end-2015 target is expected to have been met as well. The zero ceiling on the accumulation of central government domestic arrears was also not met. Results from the triannual survey of ten key ministries and the General Directorate of Taxation (GDT) show an accumulation of 1.1 billion lek of new arrears at both end-April and end-August 2015 (0.08 percent of GDP). The bulk of new arrears was due to road construction projects, court decisions, and VAT refunds. All accumulated arrears will be repaid by early 2016, except for those on court decisions, which will be settled in accordance with a special Council of Ministers decision. As a remedial measure, we are working on streamlining public investment management and introducing commitment limits to prevent the recurrence of new arrears. The recent implementation of risk-based auditing of tax refunds by the GDT will also help. Finally, the lower inner inflation band under the Inflation Consultation Clause was missed because of external disinflationary pressures and the persisting output gap. After consulting with Fund staff, we have maintained our easing bias and lowered our policy rate by 25 basis points on November 4.

7. **Most structural benchmarks were implemented, although one was implemented partially, two were implemented with delays, and two more were delayed (Table 3a):**

- In the area of public financial management, the regular reports on arrears paid and on the accumulation of new arrears were published on time. The re-prioritization of all outstanding infrastructure projects was delayed in order to align it to the 2016 budget. We propose rescheduling the roll-out of AGFIS to 15 budget institutions to March 2016, due to procurement delays with the server upgrade, which have now been resolved. The Financial Management and Control Law has been amended to incorporate multi-year commitment limits. No changes were deemed necessary for the Procurement Law; instead MoF issued an instruction. We propose rescheduling the amendments to the Budget Law to early 2016.

- In the area of tax administration, risk-based auditing of tax refunds was delayed to September by the need to amend the VAT Law and related regulations.

- In the area of financial sector and central bank governance, the BoA submitted the audits of the end-September and end-December 2014 program data, while the Albanian Financial Supervisory Authority (AFSA) amended its regulatory framework on asset valuation and liquidity requirements for investment funds.

- Finally, we prepared the regular quarterly survey of the consolidated arrears of state-owned enterprises in the electricity sector to the private sector. We propose rescheduling the removal of 35kV electricity consumers from the regulated tariff system to mid-2016, due to delays in related legislation.

Economic Policies for 2015–16

A. Fiscal Policy

8. We commit to continuing with fiscal consolidation in order to reduce debt-related vulnerabilities which hamper growth and cause macroeconomic instability. We intend to pursue a steady pace of fiscal consolidation based on a sound strategy of broadening the tax base and strengthening tax administration and compliance, with the goal of lowering the public debt-to-GDP ratio to below 60 percent by 2019, from around 72 percent at end-2014. This path will be consistent with undertaking measures of at least 1 percent of GDP annually. As a measure of fiscal effort, we will begin using the primary fiscal balance and primary expenditure as our operational targets.

9. In 2015, despite significant underperformance in revenues, we remain committed to achieving our fiscal deficit target of 4.9 percent of GDP. The shortfalls in revenues reflected forecasting issues in the 2015 budget; macroeconomic factors such as lower than expected GDP growth, interest rates, and oil prices; and behavioral responses to tax increases that took effect in January 2015. We have addressed the resulting financing gap by using the savings from our over-performance on the electricity sector reform, as well as savings in personnel costs, social insurance outlays, and the interest bill.

10. We are committed to undertaking further fiscal adjustment in 2016. We will target a primary surplus of 0.3 percent of GDP, a 0.8 percent improvement over the 2015 primary deficit (excluding arrears clearance). On the expenditure side, we will generate savings on the public sector wage bill and budget support to the electricity sector. On the revenue side, specific measures include:

- tightening the tax regime for processing industries and bio-fuels;
- broadening the tax base for the existing property tax and for social contributions by the self-employed, while reducing the tax burden for small businesses;
- introducing a registration fee and an annual circulation tax on luxury cars;
- improving the design of current taxes (for example, specific taxes will replace *ad valorem* ones on non-metallic minerals and hotel stays); and
- as part of our fiscal decentralization strategy, increasing local taxes and giving more rate-setting discretion to local governments.

11. To address the problems of revenue underperformance, we have undertaken several additional reform measures:

- **In early September 2015, we launched a large-scale reform effort against tax evasion, non-compliance, and informality**. It focuses on companies that are unregistered, understate their payrolls, do not use cash registers, or do not issue receipts. Our reform effort has already yielded a large increase in the number of registered small businesses and employees. We have been prudent in projecting the revenue gains from our reform effort in the 2016 budget— although we expect them to be higher, they are limited to 4 billion lek (0.3 percent of GDP), from social contributions by newly registered workers. We have decided to freeze 4 billion lek in capital expenditure and make it contingent on additional revenues from our reform effort. In addition, we will tackle informal markets for cell phones and cigarettes.

- **We are urgently addressing recently identified weaknesses in revenue forecasting and monitoring.** A steering committee led by the Office of the Prime Minister and involving representatives from the IMF and the World Bank has started meeting weekly to address the causes of recent revenue underperformance. It is also enhancing the coordination among the Ministry of Finance (MoF) and the General Directorates of Taxes and Customs (GDT and GDC). In September, a dedicated revenue unit was established and commenced operations at MoF. The unit prepared its first survey of tax expenditures for the 2016 budget and will update this survey annually, with help from IMF TA.

- **We commit not to grant any further tax exemptions or preferential tax rates, without consulting with the IMF.** This complements the administrative efforts aimed towards broadening the tax base by closing tax loopholes, simplifying tax administration, and creating a more level playing field.

- **We have planned sufficient buffers in the budget to cope with the outcome of pending tax disputes, in order to protect the end-year primary balance target for 2016.** To mitigate risks, we commit to taking additional measures, if needed, to meet that target.

12. We are making good progress in reducing the heavy burden the electricity sector places on public finances, while addressing the infrastructure gap. The financial gap in the sector reflected mostly low collection levels and large network losses. We have implemented an ambitious set of reforms in the sector (see ¶30) that have started to reduce the structural imbalances. Therefore, we aim to limit public guarantees and policy net lending to the sector to 7 billion lek in 2016 and 6.5 billion lek in 2017, with the aim of completely eliminating power sector subsidies by 2020. In addition, we have introduced targeted transfers (amounting to 1.1 billion lek in 2016) to compensate the most vulnerable social groups for electricity tariff adjustments. Subsidies to the electricity sector are transparently reflected in the fiscal accounts under the program and in our budget. If government support to the electricity sector exceeds the annual programmed amount, we commit to taking offsetting fiscal measures to meet the program's fiscal targets.

13. We are addressing other emerging and potential risks to the baseline fiscal framework:

- **Local government reform:** Following local elections in June 2015, 61 local government units replaced the previous 373 communes and municipalities. We are pursuing an ambitious fiscal decentralization strategy, including devolving certain functions, transferring personnel, and providing new financing sources for local governments. Audits are currently taking stock of the finances of the new consolidated units. We plan to expand the dedicated unit at MoF to continuously monitor the finances of local governments. The unit will start preparing annual surveys of local government arrears, starting with 2016. With help from USAID and the World Bank, we plan to review the legal framework on local public finance.

- **Property compensation claims:** The European Court of Human Rights (ECHR) in Strasbourg is processing cases brought against the Albanian government by property owners expropriated under the communist regime. An interagency working group headed by the Deputy Prime Minister has prepared a draft law that provides for compensating all property owners at current market values (based on historical land classification) over a period of 10 years with resources from the budget and state-owned land. The law was passed by Parliament and endorsed by the Council of Europe's Committee of Ministers in December 2015.

- **Capital expenditure:** Outstanding unbudgeted investment projects continue to exceed the government's ability to absorb them in its Medium-Term Budget Framework (MTBF). We have now re-assessed and prioritized all these projects. The Ministry of Economy (MoE) has published a list of all projects that the 2016 budget will support, including an indicative budget for each project for all three years of the MTBF, in order to signal our intention to implement only projects included in the list.

- **Arrears clearance:** The process of clearing the pre-2014 stock of arrears is now essentially complete, and we are reinforcing public financial management to prevent the accumulation of new arrears. The small amounts of outstanding pre-2014 arrears are on pending court cases, and will be paid directly by budgetary institutions out of their allocations. Now that procurement delays for the server upgrade have finally been resolved, we plan to extend our treasury IT system (AGFIS) to 15 budget institutions (accounting for 60 percent of the budget) and one local government by end-March 2016. We are also expanding our triannual survey of new arrears to include the ministries of urban development, culture, and the environment, as well as the Office of the Prime Minister (including the Regional Development Fund).

- **Public Private Partnerships (PPPs):** To limit fiscal risks from PPPs, we will ensure that PPPs follow international best practice and that their related fiscal costs and contingent liabilities are transparently accounted for in the fiscal accounts and debt statistics. We will adopt one of the leading international accounting standards (GFSM, ESA 2010, or IPSAS). In 2016, we will launch a public register of all active PPP projects and will also publish summaries of all PPP contracts as well as the contracts themselves, excluding confidential or protected information, to ensure transparency for the commitments made by the government. We will also accelerate the establishment of a MoF unit that will evaluate fiscal risks, propose measures to mitigate them, and provide risks assessments to be included in budget document submissions to Parliament. By end-2016, this unit will assess the risk stemming from all active PPP and concession contracts and from local government arrears, and will consider whether to quantify these risks in our fiscal accounts. Technical assistance from the Fund and other international partners will continue to help assess our current legal and regulatory framework and suggest recommendations for improvement. Regarding a PPP for the VAT Collection Enhancement System, we will undertake a value-for-money analysis before entering into a tender, and any related decisions will be taken in consultation with IMF staff.

B. Medium-term Fiscal Structural Reforms

14. Advancing tax administration reforms is a key policy priority that underpins our fiscal consolidation strategy. By end-March 2016, the GDT will adopt an implementation plan for a function-based restructuring of GDT's headquarters. It will also fully staff the Risk Management Unit to enable it to identify major compliance risks and develop mitigating strategies. By end-June 2016, the Large Taxpayer Office will be restructured, with specialization according to business sectors. The GDT has started phasing in a modern compliance risk management approach for one major risk cluster, and will commence another one by end-September 2016, with help from Fund TA. By end-2016, the GDT will streamline its regional and local office structure, in order to match business needs. A taxpayer service function will also be established that designs and delivers easy-to-understand and accessible guidance to taxpayers based on their needs and compliance risks, using a variety of communication channels. Finally, by end-2017, the GDT will conduct a comprehensive review of its audit function.

15. We are moving forward with reforms in customs administration. The GDC is working on a restructuring proposal, which benefited from the recommendations provided by the external consultant on customs administration. The GDC will accelerate discussions with customs authorities in neighboring countries to develop real-time intelligence sharing on smuggling risks. It will upgrade the fiscal stamps system to conform to international "track and trace" standards set out in the Framework Convention for Tobacco Control. The GDC will put in place more effective measures to supervise and monitor fuel movements, including through the use of remote GPS-based surveillance in high-risk areas. Closer cooperation and information sharing between the GDT and GDC will enhance revenue administration reform efforts. We will establish a joint GDT-GDC project team to tackle abuses in the domestic tobacco supply chain. Nevertheless, the merger of the two departments remains a medium-term objective, and any related decisions will be taken in consultation with IMF staff.

16. We commit to accelerating the work on fiscal cadastre with the goal of introducing a valuation-based property tax by end-2017. The reform will be undertaken in consultation with Fund TA. As a first step, we plan to introduce a fiscal cadastre to assess tax for each property by end-2016. In parallel, we will work on a valuation formula and methodology, and on drafting the related legislation.

17. In consultation with IMF TA, we are taking steps to shore up the credibility of our medium term budgetary framework (MTBF). MoF will continue to align its budget projections and macro framework with independent external forecasts, such as those produced by the BoA and international financial institutions. In 2016, MoF and MoE will develop a methodology for distinguishing core allocations from new policy initiatives in the MTBF, in order to focus attention on the costing of new policies and prevent them from squeezing core allocations for resources. Starting with the 2017 budget, the MTBF will begin to make that distinction at the sectoral and program level. In addition, starting with the 2017 budget, the MTBF will contain the total approved cost, the sunk cost so far, and remaining cost beyond the three-year window of the MTBF for all projects.

18. We are seeking to improve the process for evaluating, selecting, executing, and monitoring public investment projects:

- To strengthen coordination, MoE has been training experts in line ministries on the public investment cycle. By end-March 2016, the MoF and MoE will compile and publish a short manual that spells out the public investment process, in order to provide a handy reference to the laws and regulations guiding the process.

- In the first half of 2016, we will undergo a Public Investment Management Assessment (PIMA), which will provide recommendations on how to strengthen our management of public investment. The diagnostic assessment will also focus on improving the coordination between projects administered by line ministries and those administered by local government and financed by the Regional Development Fund.

C. Monetary and Exchange Rate Policy

19. The BoA remains committed to achieving an average annual CPI inflation of 3 percent over the medium term. The BoA will continue to run an inflation-targeting framework, under which monetary policy decisions are guided by the deviation of forecasted inflation from its targeted value. Monetary policy will also strive to smooth out the macroeconomic cycle and to avoid excessive volatility in the financial sector. Inflation performance will continue to be monitored under the program through an Inflation Consultation Clause.

20. Monetary policy is likely to remain accommodative for the foreseeable future. At the current juncture, underlying inflationary pressures are weak and the economic recovery remains fragile. Furthermore, the overall balance of risks is skewed to the downside owing to continued domestic slack and external disinflationary pressures, while the monetary policy transmission mechanism is hampered by high risk aversion in the banking system. Under these circumstances, the BoA aims to maintain an accommodative monetary policy stance. We expect inflation to gradually converge to 3 percent over the medium term, as improved balance sheets in the banking system strengthen credit flows and enhance policy transmission channels. To strengthen liquidity management, the MoF will continue to coordinate with BoA on public debt and cash management.

21. Exchange rate flexibility complements our price stability objective and supports our operational framework for monetary policy. The exchange rate is determined entirely by market forces. The BoA undertakes only small pre-announced interventions in the foreign exchange market. The BoA will aim to maintain adequate reserve coverage over the medium term. For the duration of the program, we will not introduce or intensify restrictions on the making of payments and transfers for current international transactions, nor introduce or modify any multiple currency practices, nor conclude any bilateral payments agreements that would violate our obligations under Article VIII of the IMF's Articles of Agreement. Also, we will not introduce or intensify import restrictions for balance of payments reasons.

D. Safeguarding Financial Sector Stability

22. The BoA is maintaining its supervisory vigilance. A risk-based supervision manual introducing a new risk assessment system was adopted in early 2015. The new supervisory process has prioritized enhancing the quality of governance and risk management, with a focus on the fastest-growing and systemically important segments of the banking system.

23. The BoA has upgraded its supervisory framework by adopting CRD IV and the Basel II framework on capital adequacy. The new rules on the risk management of large exposures, which entered into force at the beginning of 2015, require boards of directors of commercial banks to be directly involved in the risk management of large borrowers. Furthermore, systemically important banks are required to develop recovery and resolution plans, which are currently being assessed by the BoA with the assistance of the World Bank. Finally, measures adopted earlier to counteract the slowdown in credit growth, including changes to capital requirements designed to encourage moderate credit growth and discourage outflows to non-resident entities, have been extended temporarily. To maintain consistency with international standards and ensure healthy capitalization in the banking system, we will seek to unwind these measures by the end of 2016, while retaining measures discouraging bank outflows to non-resident entities. We will work with banks to ensure a smooth transition during this process.

24. Given delays in external debt issuance caused by financial turmoil in Greece, the BoA has taken temporary measures to avoid disruptions in the government debt market. In particular, the central bank reduced the risk weights on Albanian government securities issued in foreign currency from 100 to 50 percent. The BoA will assess options for unwinding this measure, in consultation with the Fund.

25. BoA became a European Banking Authority (EBA) college member in November 2015. We have signed a Memorandum of Understanding with EBA, which will improve the coordinated supervision of foreign-owned banks. This represents an important mechanism for exchanging information between home and host regulators, performing key supervisory tasks in a coordinated manner, and handling emergency situations.

26. We are undertaking measures to facilitate problem loan restructuring. The BoA is developing recovery and resolution plans for large problem borrowers. A new regulation requiring mandatory write-offs of loans that have spent three years in the "loss" category came into force at the beginning of 2015. As a result, at end-September 2015, approximately 16.8 billion lek of "loss" loans have been written off from banks' balance sheets. The NPL ratio fell to 21 percent at end-September 2015 from 25 percent a year ago. To further facilitate this process, the BoA will coordinate with the MoF to streamline the tax treatment of collateral recovered in judicial procedures after it has been written off from bank balance sheets.

27. We are committed to implement further regulatory and legal reforms to reduce NPLs and promote sound credit growth. We have constituted a high-level working group, with a mandate to develop a comprehensive strategy to address the NPL issue. The strategy was approved by the Prime Minister and BoA Governor in August and published in November 2015 on MoE's website. It integrates and sequences reforms in the areas of supervision, enforcement, debt restructuring, and insolvency:

- By end-March 2016, the BoA will undertake regulatory changes in order to revise the terminology on write-offs, change the time limit for holding repossessed collateral on banks' books, and improve the regulatory framework for NPL sales.
- Also by end-March 2016, we will draft a detailed action plan for handling the 35 largest holders of NPLs and we will change regulations to require banks to grant loans based on companies' fiscal declarations, starting in January 2018. In addition, we will submit to Parliament amendments to Law on Securing Charges and Law on the Registration of Immovable Properties to better protect financial collateral and to increase the legal certainty of security rights over real estate.
- By end-April 2016, the BoA will adopt measures to accelerate the reduction of NPLs through the use of out-of-court debt restructuring.
- With technical assistance from the World Bank and the IMF, the Ministry of Justice will submit a new bankruptcy law to Parliament by end-June 2016. It will incorporate best international practices, simplify the existing framework, allow for expedited approval of reorganization plans, and protect the economic and governance rights of secured and unsecured creditors.
- By end-September 2016, we will submit to Parliament amendments to the Civil Procedure Code and the Private Bailiffs Law to increase the efficiency of litigation, foreclosure procedures, and debt collection.
- Finally, by end-December 2016, we will upgrade the Credit Register (for example, by adding ongoing legal cases).

28. AFSA is strengthening its toolbox and capacity to monitor non-bank financial institutions. New regulations on asset valuation and liquidity requirements for investment funds were adopted at end-June 2015. Following these changes, AFSA will monitor closely the transition of existing funds to the new regulatory framework. It will also assess carefully all license applications to protect financial stability, in line with the new framework. In particular, new investment fund licenses will be considered only after the final member of AFSA's executive board is appointed and the full board is operational. Finally, AFSA will encourage competition among investment fund custodians.

29. The BoA is taking measures to implement the recommendations of the 2015 safeguards monitoring report. In June 2015, the BoA's Supervisory Council appointed an external technical expert to assist the Audit Committee (AC). The Supervisory Council approved the draft AC charter in August 2015. Parliament appointed a new Inspector General in early April and the internal audit function has resumed normal operations. Specifically, the 2014 internal audits were finalized and a risk-based internal audit plan for 2015 has been developed and approved. The Internal Audit Department (IAD) has submitted to the IMF its audits of program monetary data for end-September and December 2014, and for end-April and August 2015. The IAD will update the AC on a semi-annual basis on the implementation status of external and internal auditors' recommendations, including those related to improving controls over currency operations. The central bank of The Netherlands completed an assessment of the internal audit function in September 2015. The BoA will prepare its 2015 financial statements in accordance with the IFRS by end-March 2016. We will launch the process of amending the BoA Law in order to strengthen the central bank's institutional and operational independence, with the objective of submitting a draft to Parliament by end-2016.

E. Structural Reforms

30. We are encouraged by the early results from our efforts to reduce losses and improve collections in the electricity sector. Distribution losses—unbilled power as a share of total power entering the distribution system—fell from 45 percent in 2013 to 31 percent in the first ten months of 2015. We are committed to reducing distribution losses to 14 percent by 2019. We will ensure that budgetary, non-budgetary, and local government institutions make timely and full payments on their electricity bills, including by setting up escrow accounts for their budget allocations for electricity bills. Further reforms will need to focus on improving corporate governance, which is key for the sustainability of the electricity sector. We are moving forward with a performance management contract for the distribution company, and expect the new team of consultants to be in place by mid-2016. Finally, we will begin publishing quarterly financial statements for the generation and distribution companies, KESh and OShEE.

31. The new power sector law was approved by Parliament in May 2015. It restructures the relationship among the three public power companies responsible for generation, transmission, and distribution (KESH, OST, and OSHEE) and moves toward further market liberalization, in line with the EU's 2009 Electricity Directive. The law sets in place a schedule for moving all medium-voltage customers out of the regulated tariff structure by end-2017, beginning with 35kV customers by mid-2016 and 20kV customers by end-2016. On completion, the share of deregulated consumption would increase from 13 to 33 percent of the total energy consumed.

F. Statistics

32. INSTAT will continue with its efforts to improve the quality of macroeconomic statistics. By end-June 2016, we will submit a revised Law on Statistics to Parliament, in order to strengthen INSTAT's institutional independence and provide adequate legal support for more effective cooperation and coordination among INSTAT, MoF, and BoA. By end-2016, the three institutions will establish a Memorandum of Understanding detailing processes and responsibilities for data sharing, source data collection, and statistical compilation.

Program Monitoring

33. We anticipate that the seventh program review will take place on or after March 15, 2016, and require observance of the conditionality for end-December 2015. Thereafter, reviews will occur every four months starting on or after July 15, 2016, and require observance of the conditionality for the most recent test date. The final review will take place on or after February 15, 2017 and require observance of the conditionality for end-November 2016.

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

(In billions of leks, unless otherwise indicated)

	2014				2015								2016			
	Mar	Jun	Sep	Dec	Apr			Aug			Dec		Apr		Aug	Nov
	Act.	Act.	Act.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Est.	Prog.	Rev. Prog.	Prog.	Prog.
I. Quantitative Performance Criteria and Indicative Targets																
1. Floor on net international reserves of the BoA (EUR million)	1463	1495	1525	1539	1507	1389	1587	1509		1624	1510	1601	1535	1535	1454	1476
2a. Ceiling on general government overall cash deficit (cumulative) 2/ 3/	1.2	6.0	8.0	41.5	16.9	17.2	1.0	22.2	20.4	7.5	52.1		-8.4			
2b. Floor on general government primary modified cash balance (cumulative)														9.0	13.1	6.3
3a. Ceiling on general government expenditure (cumulative) 2/ 3/		181.2	274.7	408.0	141.6	144.9	122.8	280.0	281.2	256.1	457.5		132.2			
3b. Ceiling on general government primary expenditure (cumulative)														120.9	253.7	370.2
4. Ceiling on the increase of Bank of Albania credit to the general government (cumulative) 4/	-0.1	0.0	0.0	0.0	0.0		0.0	0.0		0.0	0.0	-10.4	0.0	0.0	0.0	0.0
II. Continuous Performance Criteria																
5. Accumulation of new external payment arrears by the general government (EUR million)	0.0	0.04	0.0	0.0	0.0		0.0	0.0		0.0	0.0		0.0	0.0	0.0	0.0
III. Inflation Consultation																
6. 12-month percent change in consumer prices																
Upper outer band					5.0			5.0			5.0		5.0	5.0	5.0	5.0
Upper inner band					4.0			4.0			4.0		4.0	4.0	4.0	4.0
Actual/center point	1.9	1.6	1.7	1.3	3.0		2.0	3.0		1.6	3.0		3.0	3.0	3.0	3.0
Lower inner band					2.0			2.0			2.0		2.0	2.0	2.0	2.0
Lower outer band					1.0			1.0			1.0		1.0	1.0	1.0	1.0
IV. Indicative Targets																
7. Ceiling on subsidies to the energy sector					4.4		4.6	8.7		4.6	13.1		4.4	1.7	3.1	4.2
8. Average distribution losses by energy distribution company (OSHEE) (percent, cumulative from beginning of year)					37.0		33.2	34.5		31.7	34.0		28.6	28.6	25.3	25.2
9. Ceiling on contracting nonenergy guarantees					0.0		0.0	0.0		0.0	0.0		0.0	0.6	1.1	1.5
10. Ceiling on accumulation of central government domestic arrears (as reported by MoF's survey on arrears accumulation)	0.4	1.1	0.4	0.3	0.0		1.1	0.0		1.1	0.0		0.0	0.0	0.0	0.0
11. Floor on clearance of central government domestic arrears 5/	1.0	19.1	25.9	33.8	5.0		7.6	10.0		14.5	15.0		5.0			
Memorandum Items																
New energy guarantees (excluding rollover)					4.4		4.6	6.7		4.6	10.1		4.4	1.7	3.1	4.2
Privatization receipts	0.001	0.010	0.026	0.035	0.0		0.1	0.0		0.6	0.0		0.0	0.0	0.0	0.0
One-off revenues					0.0		4.3	0.0		6.1	0.0		0.0			
Total non-grant revenues														126.8	260.5	365.4
Project grants					4.7		2.6	5.9		5.5	10.0		2.6	3.2	6.5	7.8

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

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

2/ Data revisions have led to minor adjustments for the outturn of the cash deficit for March, June, September, and December 2014, and for government expenditure for June, September, and December 2014.

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

4/ Indicative target through December 2014.

5/ General government for March 2014.

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

Prior Actions	Status
I. Public Financial Management	
1. Publish on the websites of MoF and MoE a report on the prioritization of all outstanding infrastructure projects. The report should be approved by the Council of Ministers and include: • for each active project: total cost, sunk cost so far, allocations for 2016-18, remaining cost beyond 2016–18; • for each inactive project: total cost and sunk cost so far.	Met.

Table 3a. Albania: Structural Benchmarks with 2015 Test Dates under the Extended Arrangement

	Structural Benchmarks	Test Date	Status	Remarks
	I. Public Financial Management			
1.	Publish a quarterly report on arrears paid on MoF's website.	Continuous	Met.	
2.	Publish a triannual report on new arrears accumulation in ten key ministries and the GDT on MoF's website.	Continuous	Met.	
3.	Publish, on MoF's and MoE's websites, a report on the prioritization of all outstanding infrastructure projects, including a ranking approved by the CoM using transparent criteria.	End-June 2015	Implemented with a delay.	
4.	Roll out the AGFIS to 15 budget institutions (see TMU).	End-Dec. 2015	Not met.	Delayed to end-March 2016.
5.	Change the Procurement Law (PL), the Financial Management and Control Law (FMCL), and the Budget Law (BL) to incorporate multi-year commitment limits.	End-Dec. 2015	Partially implemented.	FMCL amended. No need to amend PL. BL amendments delayed to early 2016.
	II. Tax Administration			
6.	Commence auditing tax refunds on a risk basis.	End-June 2015	Implemented with a delay.	Started on September 28.
	III. Financial Sector and Central Banking			
7.	BoA to submit to the IMF the audits for the end-September and end-December 2014 program data.	End-July 2015	Met.	
8.	Albanian Financial Supervisory Authority (AFSA) to amend the regulatory framework for investment funds on asset valuation and liquidity requirements.	End-June 2015	Met.	
	IV. Electricity Sector			
9.	Prepare a quarterly survey of the gross consolidated arrears of the electricity sector (KESH, OST, OSHEE) to the private sector.	Continuous	Met.	
10.	Remove 35kV medium-voltage consumers from the regulated tariff system.	End-Dec. 2015	Not met.	Delayed to end-June 2016.

Table 3b. Albania: Proposed Structural Benchmarks for 2016 under the Extended Arrangement

	Structural Benchmarks	Test Date	Status	Remarks
	I. Public Financial Management			
1.	Publish a triannual report on new arrears accumulation in thirteen key ministries, OPM, and GDT on MoF's website.	Continuous		
2.	Roll out the AGFIS to 15 budget institutions (see TMU).	End-Mar. 2016		
3.	Amend the Budget Law to incorporate multi-year commitment limits.	End-Mar. 2016		
	II. Tax Policy and Administration			
4.	List and quantify tax expenditures in the annual budget documentation submitted to Parliament.	Continuous		
5.	Adopt an implementation plan for a function-based headquarters structure for GDT.	End-Mar. 2016		
6.	Restructure GDT's Large Taxpayer Office with specialization according to business sectors.	End-Jun. 2016		
7.	Commence phasing in a modern compliance risk management approach at GDT, starting with two major risk clusters.	End-Sep. 2016		
8.	Create a fiscal cadastre to assess tax for each property.	End-Dec. 2016		
	III. Financial Sector			
9.	Submit to Parliament a new Bankruptcy Law, incorporating best international practices and simplifying existing procedures.	End-Jun. 2016		
10.	Submit to Parliament amendments to Civil Procedure Code and Private Bailiffs Law to increase the efficiency of litigation, foreclosure procedures, and debt collection.	End-Sep. 2016		
	IV. Electricity Sector			
11.	Prepare a quarterly survey of the gross consolidated arrears of the electricity sector (KESH, OST, OSHEE) to the private sector.	Continuous		
12.	Publish quarterly financial statements for KESh and OShEE.	Continuous		
13.	Remove 35kV medium-voltage consumers from the regulated tariff system.	End-June. 2016		
14.	Remove 20kV medium-voltage consumers from the regulated tariff system.	End-Dec. 2016		

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) defines the indicators used to monitor the program, and reflects the understandings between the Albanian authorities and the IMF. The TMU also defines the associated reporting requirements.

2. The exchange rates for the purposes of the program are set at lek 140.25 = €1, lek 103.17 = $1, and lek 158.05 = SDR 1. The gold price is set at €920.18 = 1 oz. These were the rates shown on the Bank of Albania's website as of November 30, 2013.[1]

3. For the purpose of the program, the central government includes extra-budgetary funds. The general government includes the central government, local governments, the Social Security Institute (SSI), and the Health Insurance Institute (HII).

4. The fiscal year starts on January 1 and ends on December 31.

Quantitative Performance Criteria

A. Floor on Net International Reserves of the BoA

Definition

5. **Net international reserves** (NIR) are defined as reserve assets minus reserve liabilities of the Bank of Albania (BoA). **Reserve assets** are readily available claims of the BoA on nonresidents denominated in foreign convertible currencies, and held for the purpose of meeting balance of payments financing needs, intervening in exchange markets, and other purposes. They include BoA holdings of monetary gold, SDRs, Albania's reserve position with the IMF, foreign currency cash, securities, and deposits abroad. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

6. **Reserve liabilities** are defined as foreign exchange liabilities to residents and nonresidents of the BoA, irrespective of their maturity. They include: foreign currency reserves of commercial banks held at the BoA; foreign currency deposits of the government held at the BoA; all credit outstanding from the IMF that is a liability of the BoA; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies. Reserve assets and reserve liabilities will both be expressed in euros, at the program exchange rate.

[1] http://www.bankofalbania.org/web/Time_series_22_2.php?evn=agregate_detaje&evb=agregate&cregtab_id=644&periudha_id=1

Reporting

7. Data will be provided by the BoA to the Fund with a lag of no more than five days past the test date.

B. Cumulative Floor on General Government Primary Modified Cash Balance

Definition

8. The **primary modified cash balance of the general government** will be measured from the financing side (below the line) at current exchange rates, based on the template below:

MODIFIED CASH BALANCE
Financing
Domestic
Privatization receipts (gross)
Domestic net borrowing (using residency criterion)
Central government net direct debt
Central government guarantees (drawings minus repayments)
Local government net direct debt
Other
Change in the balance of government accounts at BoA
Change in the balance of TSA bank account
Change in the balance of SSI & HII's bank accounts
Change in the balance of trust accounts
On-loan principal
Change in the balance of government accounts outside BoA
Government accounts outside TSA (in commercial banks)
Transitory accounts – guarantees on custom duties
Cash in transit
Accounting items
Variance accrual-cash
Float
Liability to SSI (receipts minus payments)
Others
Foreign
Drawings
Long-term loans (all direct debt drawings included in Albania's official debt statistics, including loans for the energy sector, even if on-lent)
Budget support loans (drawings)
Guarantees (drawings)
Change of statistical account
Repayments (of direct and guaranteed debt)

9. In determining the primary modified cash balance, the following considerations will apply:[2]

- Domestic borrowing is reported on a net basis and using the residency criterion. It covers bank loans, securities issued, overdraft accounts, and other debt instruments, less government deposits.
- Principal repayments include only principal paid by the government and not that by the actual borrower. In case a borrower repays the Ministry of Finance (MoF) at a later point in time, principal is recorded under "on-loan principal."
- Foreign borrowing is reported on a gross basis and using the residency criterion. It covers disbursements by international financial institutions, bank loans, securities issued, overdraft accounts, and other debt instruments.
- "Change of statistical account" covers funds disbursed but not yet withdrawn and held by nonresidents in financial institutions for project-related spending.
- "Repayments" refers to all payments to nonresidents related to disbursements or guarantees by international financial institutions, bank loans, securities, overdraft accounts, and other debt instruments.

10. The primary modified cash balance will also include all new issuances of general government guarantees (excluding rollover) for the energy and non-energy sectors, as well as net policy lending. It will exclude interest payments.

Reporting

11. Data will be provided to the Fund, using current exchange rates, with a lag of no more than 30 days after the test date for April and August test dates. For December test dates, data should be provided no more than 60 days after the test date.

Adjustors

12. The **floor on the primary modified cash balance** of the general government will be adjusted upward (downward):

- the shortfall (excess) of new energy guarantees, excluding rollover, issued during the course of the year up to a maximum of the annual budgeted allocation. The adjustor will not apply to December targets. Energy guarantees are defined as guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE.

13. The **floor on the primary modified cash balance** of the general government will be adjusted downward by:

- 50 percent of privatization receipts, up to total privatization receipts of lek 15 billion in a given year.

[2] Cash balance data come from the Treasury, the Debt Office, and the BoA.

C. Cumulative Ceiling on General Government Primary Expenditure

Definition

14. **General government primary expenditure** covers spending on personnel, operations and maintenance, subsidies, social insurance outlays, local government expenditures, other current expenditures (social protection transfers), capital expenditure, reserve and contingency funds, and net lending, as reported in the government's monthly fiscal indicators table. It excludes interest payments.

Reporting

15. Data will be provided to the Fund, using current exchange rates, with a lag of no more than 30 days after the test date for April and August test dates. For December test dates, data should be provided no more than 60 days after the test date.

Adjustors

16. The **ceiling on primary expenditure** of the general government will be adjusted upward (downward) by:

- the excess (shortfall) of new energy guarantees, excluding rollover, issued during the course of the year up to a maximum of the annual budgeted allocation. The adjustor will not apply to December targets. Energy guarantees are defined as guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE.

17. The **ceiling on primary expenditure** of the general government will be adjusted upward by:

- 50 percent of privatization receipts, up to total privatization receipts of lek 15 billion in a given year.
- the excess of total non-grant revenues (both tax and non-tax) over programmed amounts, up to a maximum of lek 4 billion in 2016.
- the excess of project grants over the programmed amount, up to a maximum of lek 15 billion in a given year.

D. Cumulative Ceiling on the Increase of Bank of Albania Credit to the General Government

Definition

18. **Credit of the central bank to the general government** is defined as outstanding claims of the BoA on the general government, including overdrafts, direct credit, and holdings of government securities (excluding repo operations), advance distribution of profits, other technical receivables, and holdings of the BoA pension fund. For the purpose of this target, government securities will be valued at their original purchase price. The stock of central bank credit to the government amounted to lek 63.965 billion at the end of December 2013. The cumulative ceiling will be computed relative to that amount.

Reporting

19. Data will be provided by the BoA to the Fund on a monthly basis with a lag of no more than fifteen days.

Continuous Performance Criteria

A. Accumulation of New External Payment Arrears by the General Government

Definition

20. **External debt** is determined according to the residency criterion. The term "debt"[3] will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time. These payments will discharge the principal and/or interest liabilities incurred under the contract. Debt can take a number of forms, the primary ones being as follows:

- **loans**, defined as advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);
- **suppliers' credits**, defined as contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and
- **leases**, defined as arrangements under which property is provided which the lessee has the right to use for one or more specified periods of time that are usually shorter than the total expected service life of the property. For the purpose of the program, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

21. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

22. Under the definition of debt set out above, external payments arrears consist of arrears of external debt obligations (principal and interest) falling due after the due date and grace period, as

[3] As defined in Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, Decision No. 6230-(79/140), as amended.

specified in the contract, has passed. Arrears resulting from nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is being sought are excluded from this definition.

23. The external arrears of the general government will be calculated based on the schedule of external payments obligations reported by the MoF. Data on external arrears will be reconciled with the relevant creditors, and any necessary adjustments will be incorporated in these targets as they occur.

24. The performance criterion on the accumulation of new external payment arrears by the general government will exclude any arrears relating to obligations prior to 2014 which existed prior to the program but are now recognized.

25. This performance criterion does not cover arrears on trade credits and will apply on a continuous basis.

Reporting

26. The MoF will provide the final data on the external arrears of the general government to the Fund, with a lag of no more than two weeks after the end of each month.

Inflation Consultation

27. **The triannual consultation bands apply to the 12-month rate of inflation** in consumer prices as measured by the headline consumer price index (CPI) published by the INSTAT. Should the observed year-on-year rate of CPI inflation (4-month average) fall outside the outer bands, the authorities will complete a consultation with the IMF on their proposed policy response before requesting further purchases under the program. In addition, the BoA will conduct discussions with IMF staff should the observed year-on-year rate of CPI inflation (4-month average) fall outside the inner bands specified for each trimester.

Indicative Targets

A. Ceiling on Subsidies to the Energy Sector

Definition

28. **Subsidies to the energy sector** are defined as new guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE, excluding rollover.

Reporting

29. Data will be provided to the Fund by the MoF on a monthly basis with a lag of no more than thirty days.

B. Ceiling on Average Distribution Losses by OSHEE

Definition

30. **Average distribution losses** are defined as the difference between total electricity entering the distribution system and the amount of electricity billed to consumers by OSHEE, the energy distribution company, as a share of the total amount of electricity entering the distribution system. These are measured on a cumulative basis for each calendar year.

Reporting

31. Data will be provided to the Fund by the Ministry of Energy on a monthly basis with a lag of no more than thirty days.

C. Ceiling on Contracting Nonenergy Guarantees

Definition

32. **Nonenergy guarantees** are defined as new guarantees issued by the general government, excluding those issued for the benefit of the electricity operators KESH, OST, and OSHEE.

Reporting

33. Data will be provided to the Fund by the MoF on a monthly basis with a lag of no more than thirty days.

D. Ceiling on Accumulation of Central Government Domestic Arrears

Definition

34. **Central government domestic arrears** consist of domestic expenditure arrears of the central government and domestic tax refund arrears. **Domestic expenditure arrears** are defined as payments to residents determined by contractual agreements that remain unpaid 30 days after the due date specified by the contract, or, in the absence of a contractual definition, as determined by law.

35. **Domestic tax refund arrears** are defined as obligations on any valid tax refund claims, in accordance with tax legislation, that remain unpaid 60 days after the claim is submitted.

36. For the purpose of this target, the accumulation of domestic arrears will be monitored through MoF's triannual survey on arrears accumulation. The recording of invoices and tax refund claims should be cumulative, that is, the recording in each trimester should include all invoices/refund claims that have not been paid from the previous trimesters, starting from the beginning of 2014. MoF should verify that the invoices/refunded claims reported in the survey are not already included in the arrears clearance database.

Reporting

37. MoF should send to the Fund the consolidated data from the survey with a lag of no more than 75 days after each trimester.

Structural Benchmarks

38. **MoF to publish a triannual survey on new arrears accumulation in thirteen key ministries, OPM, and GDT.** The ministries covered are Transportation, Health, Education, Defense, Justice, Interior, Agriculture, Finance, Economy, Social Welfare, Urban Development, Culture, and the Environment. The Office of the Prime Minister includes the Regional Development Fund. The survey should be published within 75 days from the end of each trimester.

39. Roll out the AGFIS to 15 budget institutions (60 percent of budget). The 15 budget institutions are as follows: Council of Ministers, Ministry of Transport and Infrastructure, Road Authority, Ministry of Finance, National Agency of Information Society, Municipality of Tirana, Ministry of Welfare, Ministry of Education, Ministry of Agriculture, Agricultural and Rural Development Agency, Ministry of Health, Ministry of Interior, Ministry of Justice, Ministry of Defense, and Ministry of Energy.

40. List and quantify tax expenditures in the annual budget documentation submitted to Parliament. The survey of tax expenditures should be submitted to Parliament by end-November of each year.

41. Adopt an implementation plan for a function-based headquarters structure for GDT. This benchmark is met when the Prime Minister approves the implementation plan.

42. Restructure GDT's Large Taxpayer Office with specialization according to business sectors. This benchmark is met when a chart of the current organization of the LTO shows that it is organized according to business sectors.

43. Commence phasing in a modern compliance risk management approach at GDT, starting with two major risk clusters. This benchmark is met when: (1) strategies have been adopted for the mitigation of two major identified compliance risk clusters; (2) operational plans reflecting the strategies are in place; and (3) substantial operational implementation activities have commenced.

44. Prepare a quarterly survey of the gross consolidated arrears of the electricity sector to the private sector. The survey should be prepared within 15 days from the end of each quarter.

45. Publish quarterly financial statements for KESh and OShEE. The statements will be published within 30 days from the end of March, June, and September, and within 120 days from the end of December.

Monitoring and Reporting Requirements

46. To facilitate the monitoring of program performance, the authorities will provide the following information on a monthly basis (except where noted).

The Bank of Albania will supply to the Fund:

i) the balance sheets of the BoA;

ii) the separate consolidated accounts of commercial banks and Savings and Loan Institutions;

(iii) the monetary survey;

(iv) banking sector prudential indicators;

(v) the net foreign assets of the BoA and their components;

(vi) comprehensive information on reserve assets that are pledged, collateralized, or otherwise encumbered;
(vii) the foreign exchange cash flow of the BoA, including the level of NIR;
(viii) daily average exchange rates;
(ix) quarterly balance of payments data and updates of balance of payments estimates;
(x) inflation forecasts on a monthly basis; and
(xi) data on government deposits and net domestic financing.

The Ministry of Finance will supply to the Fund:

(i) the summary monthly fiscal table, including the overall budget deficit, on a modified cash basis;
(ii) issuance of treasury bills and bonds by the MoF, including gross value and cash received;
(iii) privatization receipts;
(iv) information on the contracting and guaranteeing of new debt;
(v) information on the stock of short-, medium-, and long-term debt;
(vi) information on official grants for projects or budget support purposes;
(vii) information on the stock of expenditure arrears identified in the APCS, and progress in arrears repayment;
(viii) information on the accumulation of new arrears in central government ministries;
(ix) information on the implementation of stronger procurement and commitment controls;
(x) information on energy and non-energy guarantees issued by the general government, including on new issuance, drawings, repayments (called and non-called), interest (called and non-called), late returned principal and interest, separately for domestic versus external as well as energy versus non-energy guarantees; and
(xi) monthly local government spending (including conditional and unconditional grants).

The General Directorate of Customs will supply to the Fund:

(i) detailed monthly data on customs revenues collected.

The General Directorate of Taxation will supply to the Fund:

(i) detailed monthly data on tax revenues collected;
(ii) information on progress in implementing business restructuring and IT reforms; and
(iii) information on the stock of VAT refunds claimed, refund arrears, and refunds paid out.

The Albanian Statistical Agency (INSTAT) will supply to the Fund:

(i) the consumer price index (CPI index) at the aggregated level and at the level of each individual item making up the basket;
(ii) the producer price index;
(iii) the construction cost index;
(iv) all short term indicators as they become available, as defined in INSTAT's quarterly publication "Conjuncture"; and

(v) preliminary estimates for quarterly GDP and preliminary estimates for annual GDP disaggregated by 35 sectors and distinguishing between the observed and unobserved economy.

Statement by Carlo Cottarelli, Executive Director for Albania and Paolo Di Lorenzo, Advisor to Executive Director
February 17, 2016

Our Albanian authorities would like to thank staff for comprehensive and candid discussions during the mission to Tirana and for the in-depth analysis of the state of economy, reform programs and the policy framework provided in the informative staff report.

The Albanian authorities broadly concur with staff's appraisal and the overall policy recommendations. The positive performance under the Extended Arrangement reflects their full commitment to reforming the economy while putting public finance on a sound footing, with the goal of improving competitiveness and making Albania an increasingly attractive destination for foreign investors. Robust market confidence, underpinned by Fund's engagement as well by the financial support from IFIs and from the EU, has permitted the successful issuance last November of a five-year Eurobond worth €450mn.

Real growth is accelerating but output gap still remains negative.

The economy has been growing at increasingly high rates since the inception of the program. Real GDP growth in 2015 is estimated to have accelerated from 2 percent in 2014 to 2.7 percent, whereas it was just 1.1 percent in 2013. Against the backdrop of unfavorable external conditions, in the third quarter of 2015 the economy has grown at the sustained pace of 3 percent on a yearly base. Investment growth (12.6 percent) is the largest source of growth while households' consumption is recovering. Growth is expected to gain further traction during the current year. The effects on the value of exports of the drop in oil prices should be offset by good performance of services (mainly tourism) and manufacture, in the context of a recovering external demand.

Domestic demand will further strengthen with the decrease in economic uncertainty, as reforms' effects gradually materialize. The accommodative monetary policy and the completion of the arrears clearance program will create favorable conditions to keep investments on a sustained pace of growth. The continued strength of foreign direct investment will also reflect the launch of some major projects in the energy sector (like the Albanian section of the Trans-Adriatic Pipeline), with positive spillovers on export capacity. Low inflation is offering a reduced contribution to nominal GDP growth. Despite a recent hike, driven principally by food prices, CPI has been below the 3 percent target for the fourth consecutive year, reflecting the negative output gap as well the low imported inflation.

Public finances are constantly improving.

Sound fiscal policy has always constituted a fundamental pillar of the authorities' reform strategy. Consequently, after the sizable adjustment in the primary balance achieved in 2014 (1.6 percentage points net of the effects of an increasingly negative output gap), a further improvement has been recorded in 2015 despite a widening output gap. The overall deficit was considerably lower than planned. This has to be ascribed to the authorities' strong commitment to efficiently keeping expenditure under control while at the same time allocating available resources to the clearance of the large stock of arrears accumulated until 2013 – amounting to around 4 percent of GDP. This process has almost been fully completed one year ahead of the schedule.

Looking ahead, the structural adjustment of almost 1 percent envisaged for 2016 will permit to achieve a primary surplus for the first time since 2010. The recently approved budget includes permanent new measures amounting for 0.6/0.7 percent of the GDP and focusing primarily on streamlining the tax system and making it more equitable. Such measures are designed with the aim of reducing tax avoidance, while supporting the recovery. Our authorities are confident that their strategy to promote tax compliance will increasingly bear fruits during the year, raising tax revenue (especially from VAT) above what included in staff's budget scenario. Tax collection will further improve as a result of the ongoing modernization and reorganization of the tax administrations bodies. A modern risk and tax credit audit system is in course of implementation, with more resources devoted to audits on large taxpayers and on tax refunds. A technological platform in course of realization will permit to introduce electronic invoices and to track business transactions in real time. Appropriate fiscal space for growth-enhancing public investment has been preserved and might further augment (by 0.3 percentage point of GDP) contingently on additional revenues coming from higher tax compliance.

Compared to the last review, strong budget execution has led the debt-to-GDP ratio for 2015 to be well below the target; the target for 2016 has remained broadly unchanged in nominal value despite the fiscal impact of less-than-expected growth, and is only somewhat higher than originally target due to cyclically lower GDP level. As in the program original request, the authorities remain committed to bring the debt-to-GDP ratio below 60 percent by 2019.

The reform of local governments has reduced their number and increased their responsibilities. Resources will be no longer provided by central government transfers, as a new tax on urban land has been adopted while preparatory work is undergoing (with the assistance of WB and IMF staffs) in order to launch a valuation based property tax in the

2018. The Ministry of Finance will continue to monitor closely the finances of local governments.

The authorities acknowledge that there is room for improving the management of public investment projects. In order to avoid the formation of new arrears, priority will be accorded to the conclusion of ongoing projects while multi-year commitments limits have been introduced in the budget. Public investment management will benefit from the forthcoming FAD technical assistance mission.

The monetary stance will remain accommodative while financial stability will be further strengthened.

Monetary conditions were eased last November, when the policy rate was set at an historical low of 1.75 per cent. The monetary authorities believe that the medium term scenario warrants the prosecution of a low rates policy. At the moment, average annual inflation is forecast at around 2 percent in 2016 and is expected to reach the 3 percent target during the 2018. Financial markets are liquid, the banking system is healthy and lending rates are slowly declining. Credit in national currency is increasing, offsetting the continuous fall of the credit portfolio in foreign currency.

The authorities are firmly committed to tackle obstacles to a smooth monetary policy transmission mechanism. Non-performing loans, as a ratio to total loans, have declined by almost five percentage points in one year and the authorities are working to create the conditions for bringing them further down. Financial support from the World Bank will permit to further improve financial sector performance, but capitalization and liquidity ratio are already strong, respectively at 16 percent and 41 percent. After the adoption of the CRD IV and Basel II frameworks, a very important new step will be the adoption of a new resolution Law in line with the EU directive.

On the external side, over the past years exchange rate volatility has been very low. The authorities reiterate their intention to intervene only for small pre-announced amounts which are not intended to alter the market forces. Sizable reserve coverage provides an adequate safeguard against adverse shocks. The Bank of Albania has also undertaken concrete steps towards a further development of the payment system. The National Committee on Payment Systems was established in October 2015. This inter-institutional committee will contribute to enhancing the security, stability and efficiency of the national payment systems in Albania. The strengthening of the internal audit and risk management will be one of the main priorities of the Bank of Albania.

Finally, the Bank of Albania is actively implementing the recommendations of the 2015 safeguards assessment report.

Since the inception of the program, structural reforms have been successfully tackling long lasting weakness.

Albania will benefit fully from a global recovery only if it will be able to make further progress on structural reforms and advance towards the EU accession. The reduction in NPLs will be facilitate by the implementation of the recently approved strategy which includes, among other things: a reform of the bankruptcy law addressing impediments to judicial enforcement, in line with best international practices; the introduction of out-of-court procedures of debt restructuring, with the aim of improving collateral execution; and amendments to the Civil Procedure Code to speed foreclosure procedures and debt collection.

Progress on energy sector reform has been remarkable, as recognized in the report. Distribution losses have sharply declined, together with the amount of guarantees provided by the public sector. Collection rates have moved to 100 percent. Based on the achievements so far, the power sector could become self-sustaining by 2018 and it is even possible that part of the resources included in the 2016 budget will be saved. A new electricity Law, compliant with the Third EU Energy Package, was adopted in April 2015 and represents a decisive step forward on the long path towards full energy sustainability. A working group has been set up to identify the best option for restructuring and privatizing the profitable oil company Albpetrol. In order to diversify energy sources, a natural gas master plan scheduled for completion in November 2016 will examine all aspects related to the introduction of a gas market.

In addition, a decision was made to privatize through an open tender the state insurance company INSIG, which is valuated at around $16 million.

Concluding remarks.

Under the first two years of the program, the Albanian authorities have implemented a broad range of bold and politically challenging policies aimed at (i) reducing current expenditures, (ii) actively improving tax compliance and reducing informal economy, in order to increase tax revenues in a growth friendly and socially acceptable manner, (iii) minimizing contingent fiscal risks stemming from the energy sector and from the accumulation of arrears, (iv) strengthening financial sector stability and intermediation, and (v) improving the business environment. Our authorities reiterate their strong commitment to the program as one of their major policy anchor along with EU accession.