

2. THE ACTIVITY OF THE BANK OF ALBANIA

2.1. MONETARY POLICY

According to the Law "On the Bank of Albania", our monetary policy is formulated and implemented for the purpose of achieving and maintaining price stability. The Monetary Policy Document, which details the objectives, explains the principles and lays out monetary policy strategy, defines price stability as keeping the consumer price inflation rate at 3%, in the medium term.

Through fulfilment of this objective, the Bank of Albania contributes to the stable development of the economy and improvement in the welfare of Albanian citizens.

The Supervisory Council of the Bank of Albania makes monetary policy decisions. These decisions are based on the contemporary framework of analysis and forecast. This framework makes use of all available information, and is based on tested econometric models and the best practices of central banking.

The Covid-19 pandemic dominated economic developments in 2020. The measures put in place to contain its spread coupled with the heightened uncertainty led to a fall in demand, output and employment; an increase in unemployment; and financial difficulties for Albanian enterprises and households. In this economic context, inflationary pressures remained low and inflation undershot the 3% target.

Economic policies - fiscal, monetary and financial - were coordinated for stimulation, to mitigate the impact of the pandemic on the economy. Monetary policy became more stimulatory. The increase of monetary stimulus underpinned better functioning of markets, a reduction in interest rates and risk premia, and bank credit support for Albanian households and enterprises during the time of uncertainty.

The measures which were put in place contributed to preserving financial and monetary stability, by creating the premises for faster economy recovery. This is a necessary precondition for inflation to return to our target, 3%. Against this backdrop, monetary policy should maintain an accommodative stance, keeping inflation on a stable upward trajectory.



2.1.1 MONETARY POLICY IN 2020

2020 was a hard year for both Albanian and global economies. More than 90% of global economies experienced an economic downturn, an increase in unemployment rates and weak inflationary pressures. Indicators of main economic balances deteriorated, while fiscal deficits and public debts increased sharply. Unprecedented fiscal and monetary measures have alleviated the impact of the pandemic, by increasing the chances for rapid rebound in economic activities once the pandemic ends.

According to the Institute of Statistics, the economic activity in Albania contracted by 5.5%, employment dropped by 1.2%, and the unemployment rate jumped to 11.6%, during the first three quarters of 2020. The economic fall reflected the simultaneous contraction in almost all components of the aggregate demand and in all sectors of the economy. The crisis particularly hit the trade flows and services sector, as these activities were the most exposed to the implemented restrictions. The increase of fiscal stimulus only partially compensated for the fall in consumption and private investments. The economic fall contracted fiscal revenue. Coupled with an increase in expenditures, this contributed to a rapid increase in fiscal deficit and public debt. At the end of 2020, public debt to GDP reached 77.8%, from 66.2% at the end of 2019.

The largest impact of the pandemic materialised in the second quarter. Relaxation of restrictive measures opened the way for economic activity and the labour market to gradually and temporarily recover. Nevertheless, both production and employment remain at lower levels than at the end of 2019 and spare capacities have been rising. Hence, inflationary pressures continue to trend downwards.

In 2020, annual inflation averaged 1.6%, remaining below the target of the central bank. Its volatile performance was mostly affected by the prices of

Chart 1. Inflation and policy rate (in %)



Source: INSTAT, Bank of Albania.



foods, which accounted for around 42% of the consumption basket. On the other hand, core inflation¹ was 1.4% and provided a stable contribution to headline inflation. Expectations of households and enterprises for inflation after one year fluctuate close to our 3% target.

Intervention with stimulating economic policies was indispensable for mitigating the impact of the pandemic on the economy and preserving monetary and financial stability. Fiscal policy played the main role in supporting aggregate demand by providing income to households, with wage compensation packages, increasing transfers and access to employment programmes; supporting enterprises with liquidity, by removing tax obligations, and initiating a sovereign guarantee scheme for loans; and increasing spending on the health system to address the pandemic.

The Bank of Albania increased the monetary stimulus and undertook other regulatory measures aimed at maintaining both lending flow and uninterrupted financial services, preserving monetary and financial stability. The eased monetary policy package included:

- Cutting the key interest rate to 0.5% and narrowing channels for standing facilities, by reducing the overnight lending facility interest rate to 0.9%. This measure aims at reducing the cost of debt financing and servicing in the economy.
- Increasing liquidity injections into the banking system, through the adoption of an operational strategy which enables the unlimited injection of liquidity. This measure aims at guaranteeing smooth functioning of the financial market and the monetary policy transmission mechanism.
- Using forward guidance to inform the market on the stimulating monetary policy stance in the future. This measure aimed at controlling the interest rates curve and the extension of its effect in time.

The increase of monetary stimulus helped to control debt financing and servicing costs and bolstered financing to the private sector with bank loans.

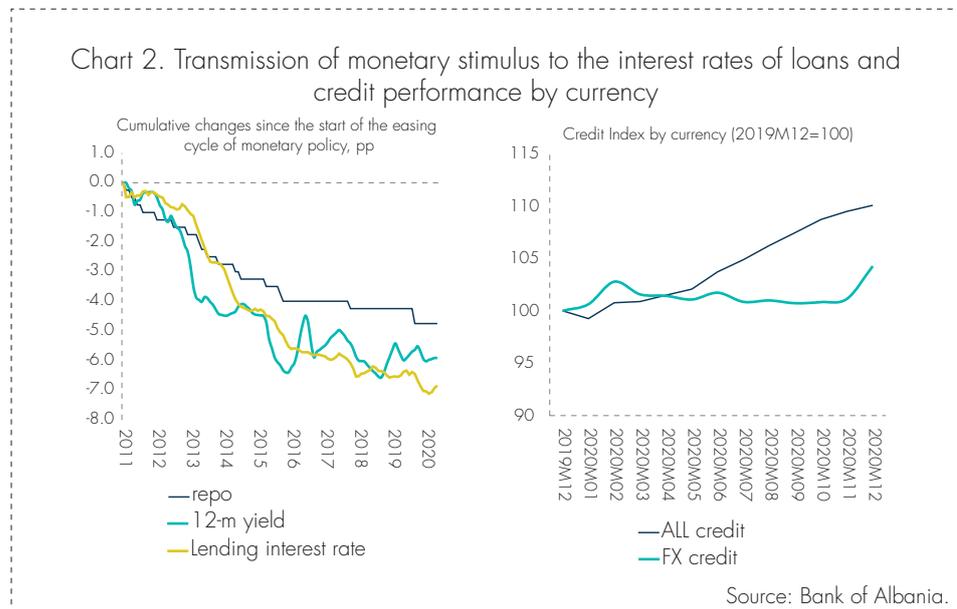
The central bank's provision of ample and sufficient liquidity and the restoring of calm to the uncertainty-related financial market allowed financial markets to continue their normal activity and enabled a better pass through of monetary stimulus to the economy. Financing costs to both private and public sectors remain at low historical levels and the exchange rate has been stable.

Low interest rate levels the ample liquidity in the market led to a 6.8% average growth in the credit portfolio in 2020, by meeting the increasing needs for liquidity to the economy, and supporting investments once the emergency situation was overcome. Lending to enterprises and credit in lek were the main contributors to growth of credit. The latter was sustained by state

¹ Core inflation is defined as an inflation estimate which omits the short-term fluctuations and one-time supply-side shocks. It represents the most stable part of inflation that is affected by the demand-side factors and consequently of monetary policy.



guarantee schemes. The ongoing growth of credit in lek led also to an increase of this portfolio's share to total loans, up to 50% at the end of 2020. This positive development establishes the premises for enhancing monetary policy effectiveness and strengthening the financial stability of Albania.



The coordinated easing of economic policies was adequate and avoided the materialisation of adverse scenarios. Economic fall was not as deep as expected earlier, increase of unemployment was contained and fluctuations in financial indicators, including the exchange rate, were low. Box 1 shows an empirical assessment of the positive contribution of monetary policy to economic activity and inflation.

The banking sector made a rather positive and useful contribution throughout the crisis. This sector continued lending and undertook the payment of a part of the financial bill through the extension of credit payments and credit restructuring. Maintaining a pro-active approach to lending is a crucial precondition to ensure necessary financial support for the economy to rebound.

Premises for the recovery of the economy are positive, but uncertainties remain high. Economic developments in the future depend considerably on how the epidemiological situation will evolve. Economic activity is expected to rebound once the pandemic is over, underpinned by a considerable monetary and fiscal stimulus, and the recovery of global economic activity. The start of the vaccination process provides hope in this regard.

Until a stable economic recovery materializes, the monetary policy will continue to provide stimulating monetary conditions for Albanian households and enterprises. Economic recovery is a precondition for inflation to increase towards our target of 3%.



BOX 1:**MONETARY POLICY IN ALBANIA AND ITS CONTRIBUTION TO ECONOMIC ACTIVITY AND INFLATION**

This box aims to provide an assessment of the impact of monetary policy on both economic activity and inflation in Albania.

The assessment of the undertaken measures over a continuous period of time is particularly important for 2020, when macro-economic policies were all on the stimulating side. The impact of monetary policy in the period 2017-2020 shows a positive effect of 0.83 p.p on economic activity and 0.7 p.p on inflation.

The box is divided into three sections: the first section addresses the impact of monetary policy transmission channels on the economy. The second section addresses the methodologies applied; and in the last section outcomes are presented. This exercise updates the previous assessments, a broader description on the impact and the methodology is found in the previous Annual Reports¹.

Monetary Policy Transmission Channels

The monetary policy is pro-active and forward looking. The monetary policy is an effective instrument aimed at smoothing fluctuations in the economy and controlling the formation of inflationary pressures. This function is achieved through the impact of monetary policy on interest rates in the market; the expectations of economic agents, and performance of the exchange rate.

- *The monetary policy stance impacts the decision of consumers and enterprises on spending and savings, by affecting economic activity and domestic inflationary pressures.*
- *Forward guidance on the monetary policy stance reduces uncertainty for economic agents.*
- *The policy rate is indirectly tied to exchange rate performance. The latter affects the competitiveness of exports, transmission of foreign prices to consumption prices in Albania and the interest rates on loans in foreign currency. In euroized economies, like Albania, the exchange rate also affects the purchasing power of borrowers in foreign currency, unhedged against exchange rate changes.*

The monetary policy is accommodative when the policy rate remains below its equilibrium level. Such policy is undertaken when the economic activity is assessed as below its equilibrium level for a long period and when inflation is below its target. Given that the monetary policy has an accommodative stance, its effect on economic growth and inflation is a positive one. A tight monetary policy operates in an opposite manner.

Assessment methodology of the monetary policy impact

Three exercises were conducted to ascertain the effect of the monetary policy on economic growth:

- *In the first exercise, the effect of monetary policy on interest rates in domestic currency, and further, the latter's impact on economic activity, are assessed.*
- *In the second exercise, the impact of monetary policy on the nominal*



- exchange rate is obtained.
- Finally, looking at the impact of monetary policy on economic activity and on the exchange rate, the impact of monetary policy on inflation rates is assessed.

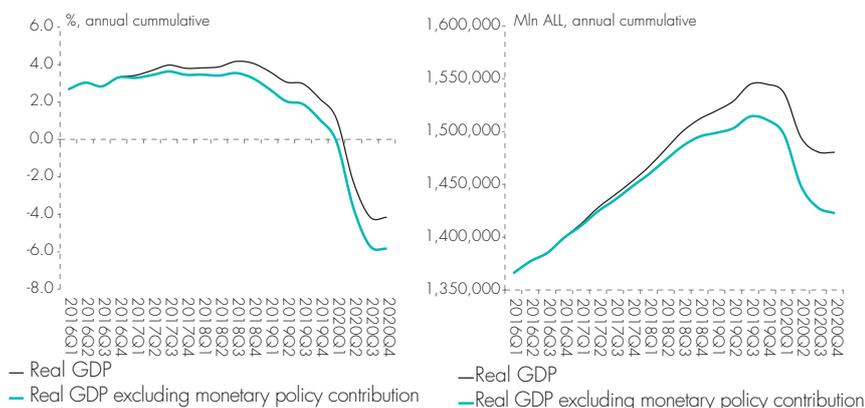
These assessments were carried out through the monetary policy model used by the Bank of Albania for medium-term projections.

Results

The presented findings on the monetary policy's impact have been conducted since 2017. In summary, our conclusions are as follows:

- The accommodative monetary policy stance has made a positive contribution of 0.83 p.p to the average economic growth in the period 2017-2020. This positive effect is being transmitted through the reduction of interest rates and of existing debt servicing costs and through uninterrupted lending to economy.
- Although the real economy indicators deteriorated during 2020, the positive effect of monetary policy on the economy has been strengthened.
- The monetary policy has a cumulative impact on the level of economic activity, measured by the real GDP. Real economic activity was around 3.7 p.p. higher than an alternative GDP without the contribution of the monetary policy, up to 2020 Q3, due to the positive effect of the accommodative monetary policy.

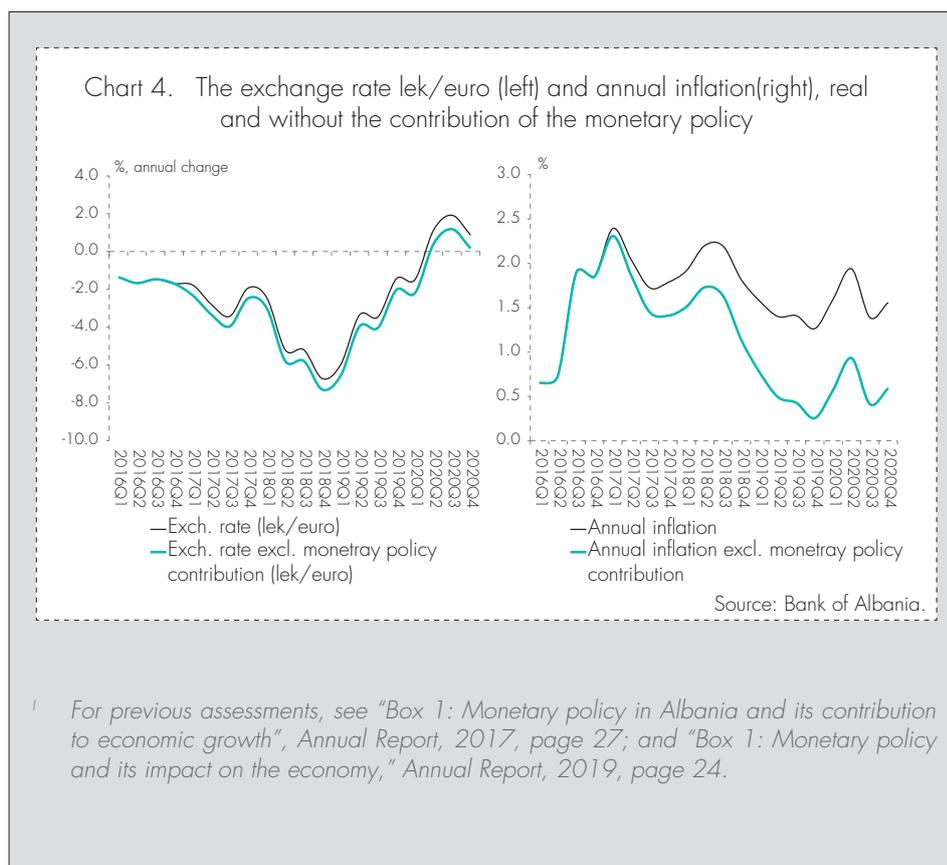
Chart 3. Cumulative economic growth, real and excluding monetary policy contribution (left); cumulative annual GDP, real and excluding monetary policy contribution (right)



Source: Bank of Albania.

- The accommodative monetary policy stance has exerted depreciating pressures on the exchange rate, with an average contribution around 0.6 p.p per year, throughout the period.
- The impact of the accommodative monetary policy on both economic growth and the exchange rate has affected higher inflationary pressures. Annual inflation for 2017-2020 was assessed to be higher, by 0.7 p.p., on average, due to the impact of the monetary policy. During 2019-2020, the intensity of this impact has strengthened, to 0.1 p.p, on average, compared with 0.2 p.p. in 2017.





Despite the challenges and difficulties posed by the pandemic, the Bank of Albania has continued to work towards its strategic priorities in the field of monetary policy. In 2020, BoA has further developed its analysis and forecasting framework, which has enabled the formulation of a monetary policy consistent with economic conditions. Analyses and forecasts were conducted at a higher frequency than normal and we paid special attention to the compilation of contingency plans, as an indispensable approach given the unknown conditions and uncertainties we still are tackling. Collaboration in the form of technical assistance continued, mainly virtually, with SECO and EBRD. This year, special attention was paid to further improving the communication process of monetary policy, with help and assistance provided by Banca d’Italia, Deutsche Bundesbank, and Banque de France, in the framework of the Twinning Project “Enhancing Bank of Albania’s alignment with EU Acquis”.

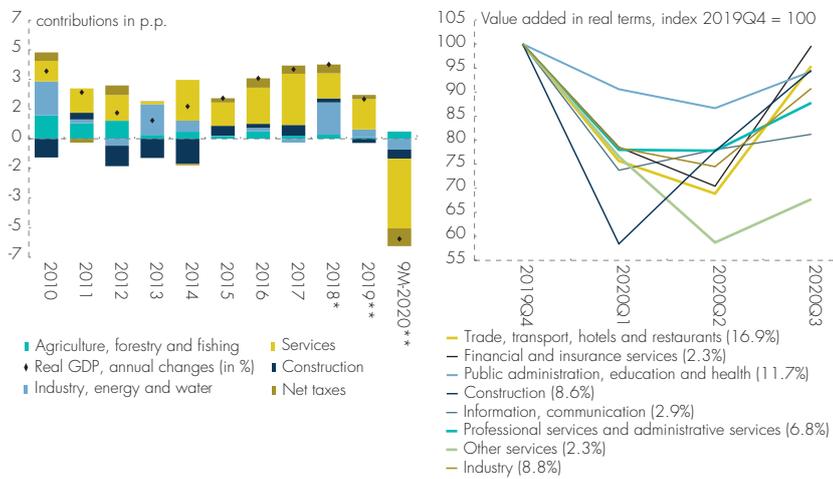
2.1.2 ECONOMIC ACTIVITY

Economic activity in Albania fell over the course of 2020. This downturn reflected the negative contribution of almost all sectors of the economy and of the aggregate demand components. The increase of fiscal stimulus only partially compensated for the fall in both domestic and foreign demand. Economic activity is expected to return to positive growth rates, as health crises end, in 2021 and following.



Economic Activity in Albania continued the contraction which started in the fourth quarter of 2019. After the shock of the earthquake on 26 November 2019, the economy faced the negative effects arising from the restrictive measures undertaken to control the epidemic situation in Albania. GDP shrank by 5.5% during the first nine months of 2020, after the 2.9% growth recorded in the same period a year earlier.² Alleviation of restrictive measures has been driving the economy to reaction since the third quarter. This performance is expected to have continued during the fourth quarter as well. Nevertheless economic recovery remains slow and below pre-pandemic levels.

Chart 5. Economic activity by sectors (left) and real value added (right)



Source: INSTAT and Bank of Albania.

The contraction of economic activity was mainly attributable to developments in the services sector³, whose contribution to the annual contraction of GDP was -3.8 percentage points. The negative shock was particularly strong on the branch of "Trade, transport, accommodation and food service", which includes activities that have been more affected by the restrictive measures, contributing -2.5 percentage points to GDP contraction. Also, construction⁴, manufacturing and mining, and quarrying contributed to the economic fall, although at a relatively lesser extent (each by 0.5 percentage point). Meanwhile, the increase of value added in agriculture, forestry and fishing, and electricity provided a positive contribution to economic performance (0.4 percentage point, respectively). In reflection of a contracting economy, net taxes also dropped

² The information published by INSTAT on gross domestic product by the method of production and expenditures cover developments to the third quarter 2020, published on 24 December 2020.

³ The main branches of services are: "Trade, transport, accommodation and food service", "Information and communication", "Financial and insurance activities", "Real estate activities", "Professional activities and administrative services", "Public administration, education and health", "Art, entertainment, recreation and other service activities".

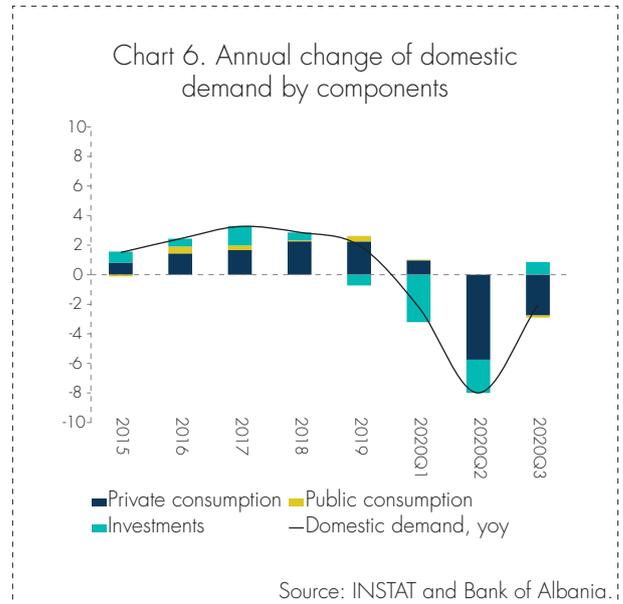
⁴ Negative developments in construction were attributable to a certain degree to the pre-final phase of the TAP project, contraction in construction materials and metals, a relatively low number of granted construction permits compared to a year earlier, and the worsening of business confidence in construction.



during the first nine months of 2020, with a -1.0 percentage point contribution to the annual pace of GDP.

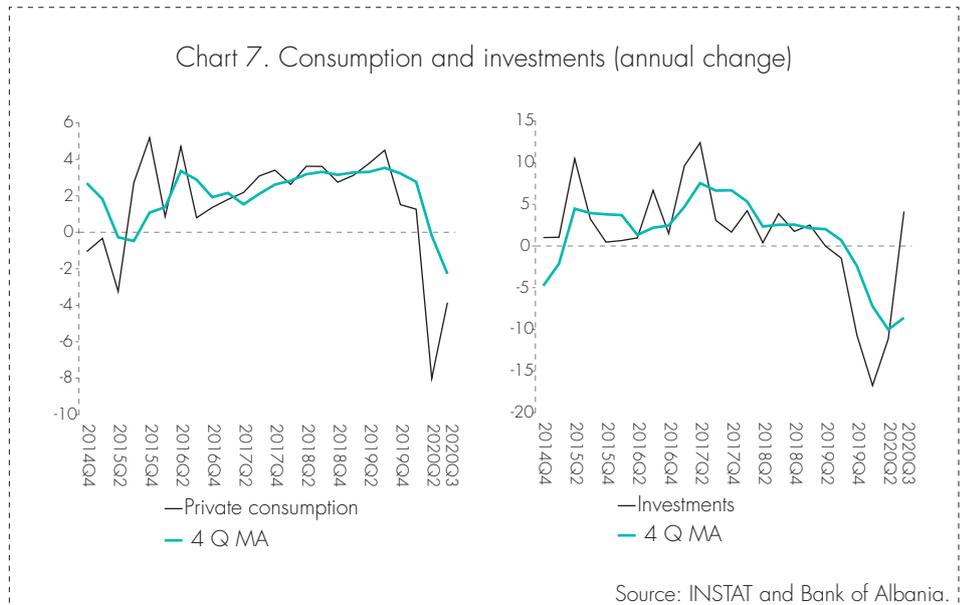
Consumption and investments led to the contraction of aggregate demand

Domestic demand contracted by 4.2% in the first nine months of 2020, reflecting a fall in consumption and private investments. Social distancing and health care measures, a fall in income and an increase of uncertainty resulted in a contraction of both consumer and investment spending. On the other side, favourable financing conditions, growth of credit and fiscal measures have somewhat amortised the drop in consumption and investments.



Private consumption dropped by 3.8% during the first three quarters of 2020.

It recorded the sharpest contraction in the second quarter, when restrictions were heavier. Further, their relaxation opened the path for a gradual recovery and in the third quarter, consumption jumped 6.1% compared to the previous quarter. Various indirect indicators suggest that the recovery of private consumption has continued in 2020 Q4, but remains below the pre-pandemic level.



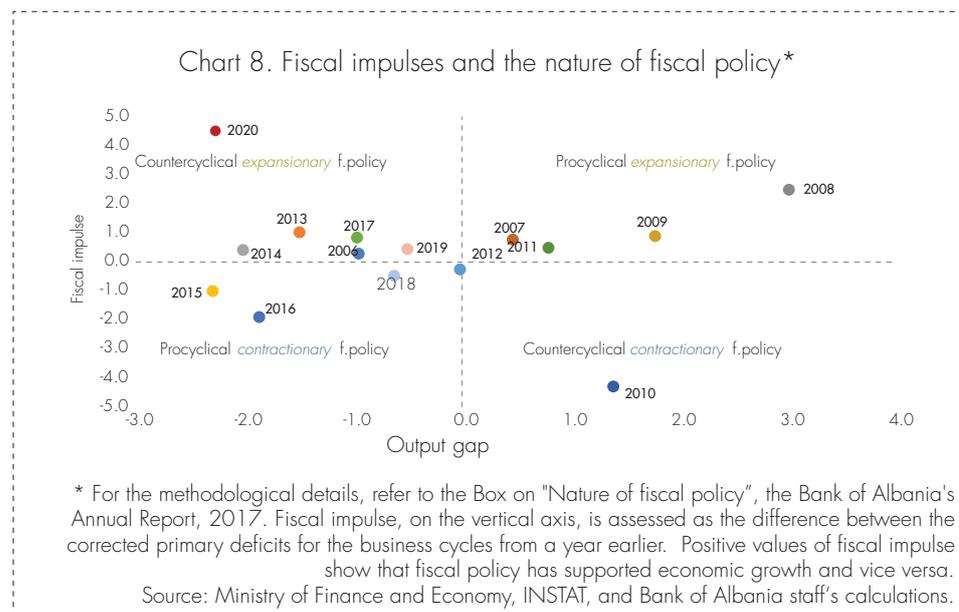
Investments dropped by 7.5% during the first three quarters of 2020.

The fall in this component of private demand is assessed to have reflected the contraction of private investments while public investments have been rising. The

negative performance of investments started in 2019 Q4, and was intensified during the first half of 2020, in line with the placement of restrictions, a fall in consumer demand and an increase of uncertainty. On the other side, activation of the re-construction programme for buildings damaged by the earthquake resulted in the growth of public investments. Preliminary quantitative indicators and results from surveys suggest that investments will continue to contribute positively to the economic growth of 2020 Q4. Low interest rates and credit growth for investment purposes are favourable factors.

The budget deficit increased to 6.9% of GDP⁵ in 2020.

The fiscal policy primarily aimed at mitigating the negative effects stemming from the COVID-19 pandemic and the earthquake of November 2019 on the economy, over 2020. The fiscal authority, to achieve this objective, reacted through the establishment of temporary fiscal facilities, in the form of granting and extending certain tax payments, and through the increase of spending in the form of direct transfers to households who lost their jobs and to vulnerable social groups. These measures were translated into a 4.5% fiscal impulse of GDP, the highest values recorded in years.



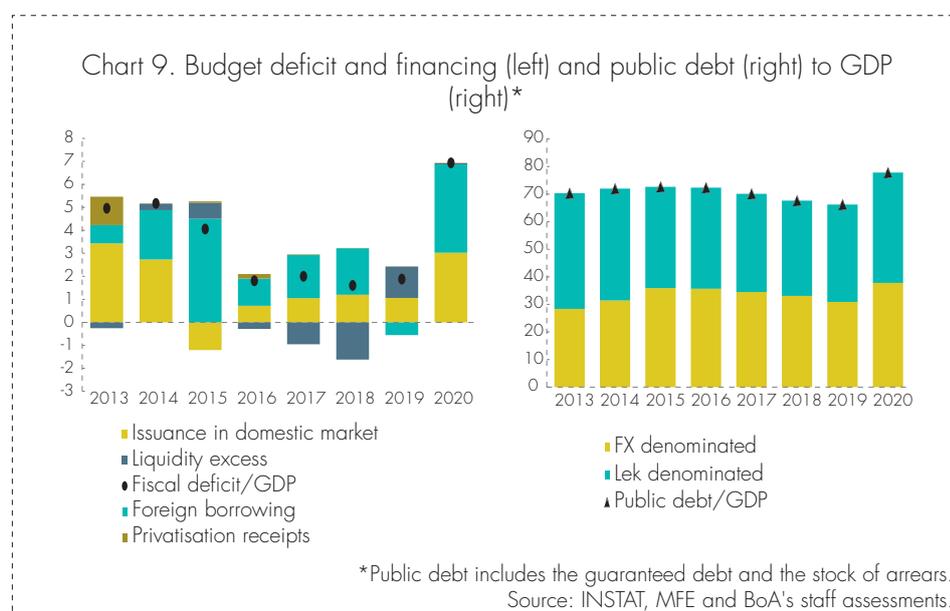
The budget deficit increased considerably in 2020, as a result of countercyclical features of fiscal policy instated to partially mitigate the economic fall. The deficit was around ALL 110.7 billion, or 6.9% of GDP, the highest level in the last decade. The increase in deficit was two-fold, including a fall in tax revenues as well as an increase in spending aimed at alleviating the negative shock on the economy, and reconstruction of infrastructure and buildings damaged by the earthquake.

⁵ Nominal GDP used for the calculation of ratios is an assessment of the Bank of Albania, while fiscal statistics are published by the Ministry of Finance and Economy.



In addition to conventional instruments, for financing the budget deficit, non-conventional instruments were employed, such as the Rapid Finance Instrument (RFI), issued by the IMF, which covered around 21% of the fiscal deficit. Also, the high needs for financing were tackled through the issue of a Eurobond, in the amount of EUR 650 million. A part of this amount was used to pay the remaining portion of the EUR 250 million Eurobond issued in 2015. In the domestic market, borrowing increased through the issue of both short and long-term securities in the primary market. T-bills and bonds issued in the primary market in lek and foreign currency financed around 44% of the budget deficit.

Public deficit ratio to GDP reached 77.8% as of end of 2020, up by 11.6 p.p. from the end of 2019, driven by the expansion of the budget deficit, issue of state guarantees and the contraction effect of GDP. Debt stock denominated in foreign currency accounted for around 49% of total debt.

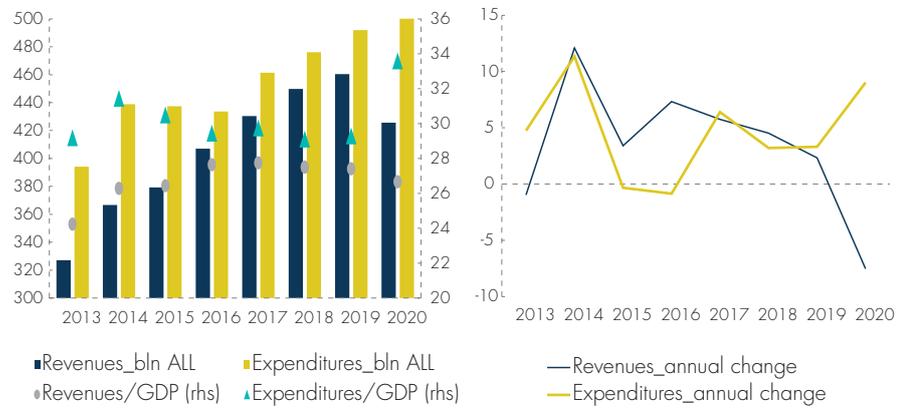


Budget expenditure for 2020 amounted to around ALL 536.3 billion, or around 9% higher than in the previous year. The majority of expenditures growth came from the expansion of public investments, in the form of both capital expenditures, and those designated for the reconstruction of private buildings and public infrastructure damaged by the earthquake. Direct fiscal transfers contributed by around 2.5 percentage points to the expansion of total expenditure for the year.

Budget revenues were around ALL 425.6 billion, and recorded a deep annual contraction of 7.5%. Performance of revenues, during 2020, suffered the simultaneous impact of many factors, including cyclical weakness of the economy, implementation of fiscal facilities, and a drop in fuel prices in the international markets.



Chart 10. Revenues and expenditures

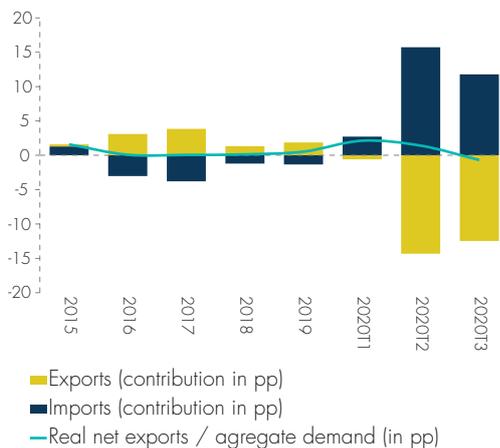


Source: INSTAT, MFE and BoA's staff assessments.

Trade deficit narrowed by 6.6% in real terms during the first three quarters of 2020

Net exports provided a positive impact on economic performance during the first nine months of 2020. This contribution was determined by a fall in imports of goods and services, which have a higher share than exports in our balance of trade. Imports dropped by around 23.1% during the first three quarters of 2020, reflecting a fall in domestic demand. Also, exports of goods and services dropped by 29.6%, reflecting a fall in both foreign demand and commodity prices in international markets. The fall in exports was mainly driven by the export of services (-34.1%), which suffered from the restrictions applied to the movement of citizens.

Chart 11. Net exports



Source: INSTAT and Bank of Albania.

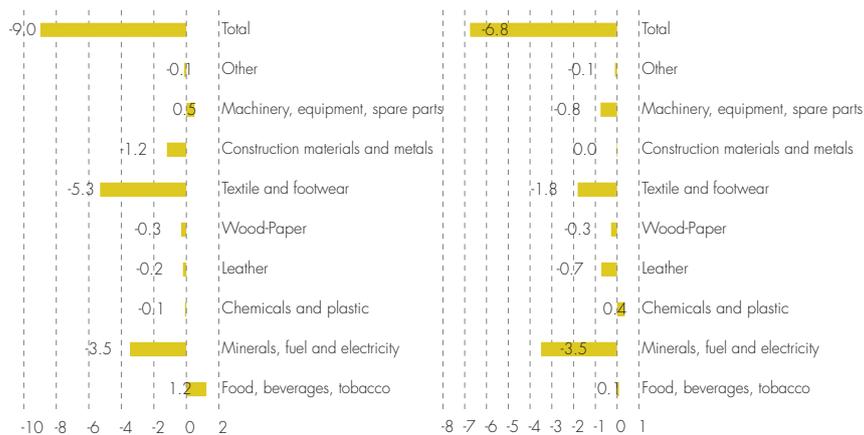
The positive contribution of net exports was concentrated in the first half of the year. The faster recovery of imports against exports was reflected in expansion of trade deficits and led to a negative impact of net exports on economic growth in the third quarter.

The availability of data on the trade in goods enables their analyses for the entire year. The annual drop of exports was 9.0% in 2020. The categories of: "Textile and footwear", "Minerals, fuel, electricity", and "Construction materials and metals", made the main contributions in this regard. A fall in foreign demand, particularly from our main partner (Italy), and the unfavourable conjunctures of oil and metal prices were the main determinants in the performance of exports.



The same view is noted for imports as well. Their annual fall was 6.8%, mainly impacted by the categories: "Minerals, fuel and electricity" and "textile and footwear". The category "Machinery, equipment, spare parts" - whose performance closely relates to the recovery of investments during this period - mainly, affected the slight recovery of imports during the second half of year. The higher importing contribution led to a contraction of trade deficit in annual terms by 4.9%.

Chart 12. Annual growth of exports (left) and imports (right) of goods with contribution of categories



Source: INSTAT.

A map of geographical distribution of trade balance shows that trade with Italy has declined, while exports with neighbouring countries, such as Greece, Kosovo and North Macedonia, have been more stable, even with slightly positive contributions. This phenomenon was in line with global trends during 2020, in relation to affirmation or recovery of short trade relations between neighbouring countries.

2.1.3 LABOUR MARKET

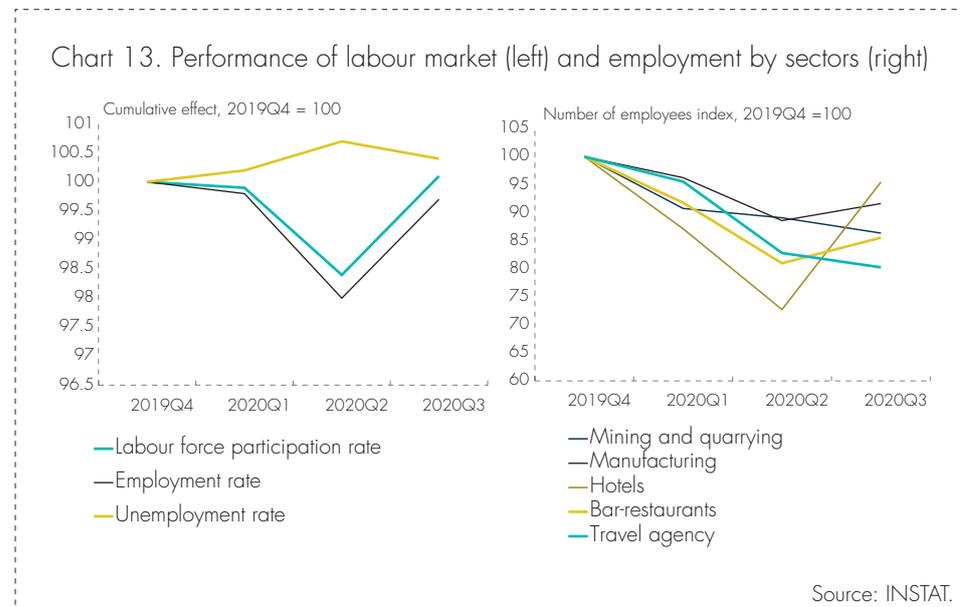
Employment was down; the unemployment rate was up, while pressures on wages increase were low during the first nine months of 2020.

According to the Labour Force Survey, employment contracted by 1.2% and the unemployment rate jumped to 11.6% during the first three quarters of 2020. The fall of employment was sharper in the second quarter, when the number of employed persons was reduced by 33,235 individuals, driving the number of lost jobs to 50,035, during the first half of 2020. Economic activities mostly affected by the fall in employment were those of hotels; bar-restaurants, travel agencies and tour operators, manufacturing, mining and quarrying⁶. The alleviation of restrictive measures in the third quarter coupled

⁶ Referring to the index data of employed persons from Short-term Statistics.



with more dynamic activity of services during the summer season bolstered the return of in-active persons to the labour market, which led to an increase in employment of 34,224 individuals. Nevertheless, the number of employed persons in the economy remains lower than a year earlier, and the recovery of jobs were not complete.⁷



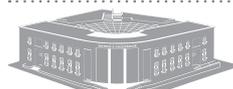
Contraction in employment was accompanied by an increase in the unemployment rate, from 11.2% in 2019 Q4, to 11.4% and 11.9%, respectively, in 2020 Q1 and Q2. The unemployment rate dropped to 11.6%, in 2020 Q3. Although, it remains at its highest rate since the beginning of the pandemic.

The increase in the unemployment rate was contained for two reasons: first, the fall of employment was mostly channelled to an increase in in-active persons, which drove to a decrease of participation in the labour force⁸; and second, the measures implemented by the Government⁹ to support the labour market

⁷ Also, the administrative data show developments in the labour market are in line with the data from the survey. Also, administrative data show that the quarterly performance of employment in the economy improved during 2020 Q3, mainly driven by an increase of employment in the private agricultural sector, although remaining below the levels recorded in the previous year.

⁸ The labour force is the number of people who are employed plus the unemployed in an economy and the participation in it, differently known as the rate of activity in the labour market. It is calculated as the ratio of labour force to the working-age population. As long as the decrease of employment, is not accompanied with an increase in the number of employed at the same degree, the labour force falls. It should be taken into account that the collection of statistical information was affected also by the measures taken to contain pandemic spread in Albania, reflected in a lower degree of responses in the Labour Force Survey or delays in reporting regarding the registered data, also the needed time to receive the unemployment status or restrictions to search actively a job.

⁹ Referring to financial packages and programs on employment bolstering, cited also in Box 1 "Impact of measures taken for supporting lending during the Covid-19 pandemic" in the Quarterly Monetary Report 2020/III.



and protect employment have helped in mitigating the negative impact on this market.

In the presence of a higher unemployment rate, pressures on the increase of wages were low. The gross average monthly wage for an employee was higher than in 2019, but the pace of increase slowed down. The indicator slowed the annual growth pace to 2.7%, from 4.3% recorded in the first nine months of 2019. This growth rate in real terms was around 1.0%, down from the real growth of 2.9% recorded in the same period of the previous year.

BOX 2: SOME ASSESSMENTS ON THE IMPACT OF THE PANDEMIC ON ECONOMIC ACTIVITY AND EMPLOYMENT

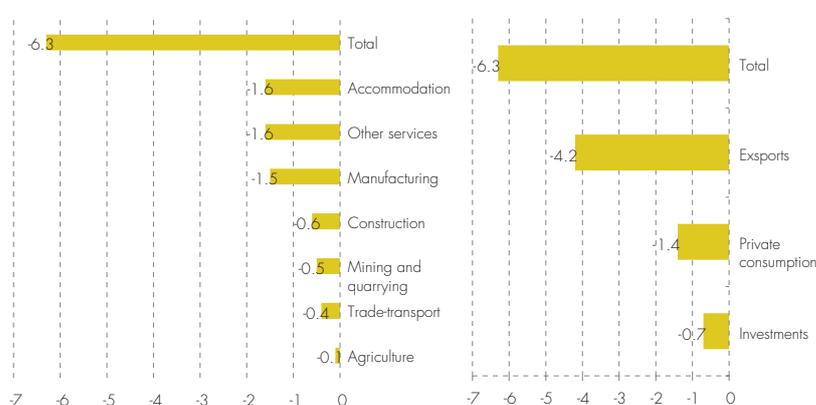
This Box assesses the negative effects of the pandemic and the restrictive measures taken to safeguard public health in 2020, as well as the contribution of these effects to the contraction of GDP and the labour market. In parallel, the indicators of confidence and uncertainty are briefly analysed.

Assessments of the pandemic effect on the real growth of GDP.

Assessments of shocks from the pandemic are calculated for private consumption, as well as investments and exports. These have taken into account the impact of restrictive measures on each component of aggregate demand. Further, through the application of Input-Output tables the impact of these measures on GDP is filtered¹. In more concrete terms, for private consumption, the assessment is based on the sectoral sub-components of consumer demand, which were affected by the lockdown and restrictions on the activities of bars and restaurants, public and private transport; the international transport of travellers, etc.. For investments, assessment is based on the performance of the construction sector and the import of capital goods. For the export of goods and services, assessments are based on real indicators of the trade in goods and services.

Based on this methodology it comes out that the pandemic had a direct negative effect of 6.3% in annual terms, in the first three quarters of 2020 (Chart 14, left). This assessment does not consider the other connections among components of aggregate demand that cannot be obtained from Input-Output tables.

Chart 14. Assessments of restrictive measures by sector and components of aggregate demand



Source: INSTAT and Bank of Albania.

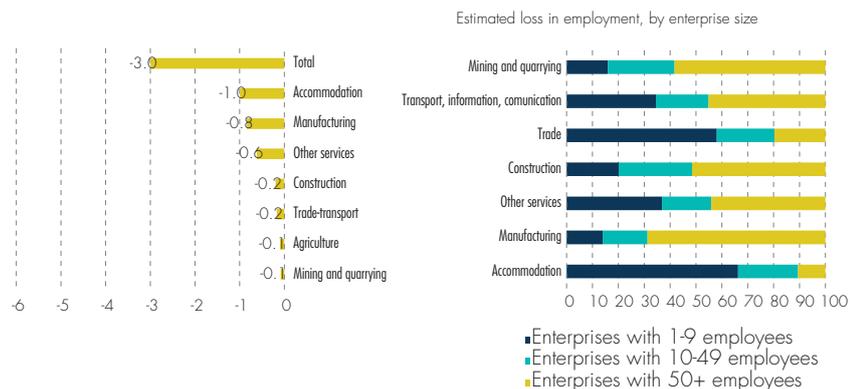


Disaggregated by components, it is clear that exports experienced the sharpest shock, dropping by 40.6%. Meanwhile, components of domestic demand, private consumption and investments (mainly private ones) have fallen by 4.5% and 5.8%, respectively, in annual terms. In sectoral terms, "Accommodation and manufacturing" have suffered the strongest shock.

Assessment of negative effect in the labour market

By using, as a basis, the impact being assessed above and in compliance with the approach of social accounting matrices, the effect of the shock on employment is assessed at around -3.0% in annual average terms (Chart 14, right). This shock is assessed to have mainly affected employment in the activities of "Accommodation", "Manufacturing" and "Other services" (Chart 15, right). By the size of enterprises, the fall of employment is assessed respectively: 39.6% in enterprises with more than 50 employed persons, 39.5% in enterprises with 1-9 employed persons and 21.0% in small enterprises (Chart 15, right)¹¹.

Chart 15. Assessment of the negative impact on employment and by size of enterprises*



*In the assessment, it is employed the information on the number of employed persons by the Structural Questionnaire of Economic Enterprises, 2019. Source: INSTAT and estimations of the Bank of Albania.

The aid packages of the Government and programs undertaken in relation to employment¹¹ have mitigated negative shock on the labour market. They have aimed at supporting, with income, employees mostly affected by the restrictions in place and at the preservation of their jobs.

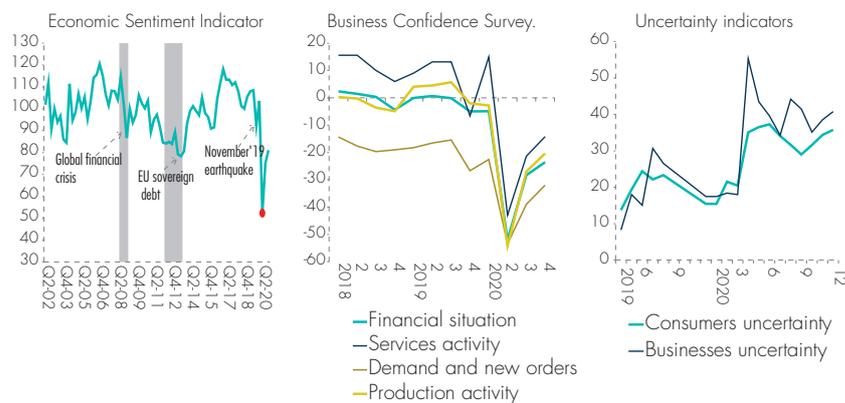
Effect of restrictions on the confidence and uncertainty indicators

The speed and severity of the impact of the containment measures affected negatively the confidence of consumers and enterprises and increased their uncertainty for the future. The Economic Sentiment Indicator (ESI) recorded its lowest historical level in the second quarter of 2020. Enterprises reported the imposed closure of activity, the fall in both domestic and foreign demands, as well as problems in the supply chain and in the circulation of employees as responsible for the drop in activity in productions and services, in the reduction of employment and in the worsening of the financial situation. On their side, consumers were more pessimistic about the future, mainly affected by negative expectations for employment, while increased prudence in spending was reflected in a decreased onward assessment for major purchases.



The gradual alleviation of measures led to improvement in economic agents' confidence, as shown by an increase in the Economic Sentiment Indicator which recuperated almost 85% of the fall recorded in the second quarter. Confidence indicators evidenced improvements in all aspects of activity: demand, employment and the financial situation. In parallel, the indicators of uncertainty, after the notable increase in the second quarter, recorded lower values in the next quarter.

Chart 16. Indicators of confidence and uncertainty to consumers and enterprises*



*Aggregated balances and simple arithmetic average of balances for each sector.
Source: Business Confidence Survey, Bank of Albania.

ⁱ For methodological details see the research paper "Analyses and structural developments of the Albanian economy: an approach by Social Accounting Matrices and Box 3 "A methodology for assessing the impact of shocks in economy" in the Quarterly Monetary Policy Report 2020/II.

ⁱⁱ Based on the information from the Structural Questionnaire of Economic Enterprises, 2019.

ⁱⁱⁱ In concrete terms: the first financial package "Support to small enterprises and citizens"; second package "Support to entrepreneurship and employees"; sovereign guarantee instruments; work programmes of the Government to support the employment of persons who lost their jobs from the pandemic situation, in 4-, 8- and 12-month periods (DCS No. 144, Council of Ministers' Decision No. 608, dated 29.7.2020 and Decision No. 164, Council of Ministers' Decision No. 699, dated 10.9.2020).

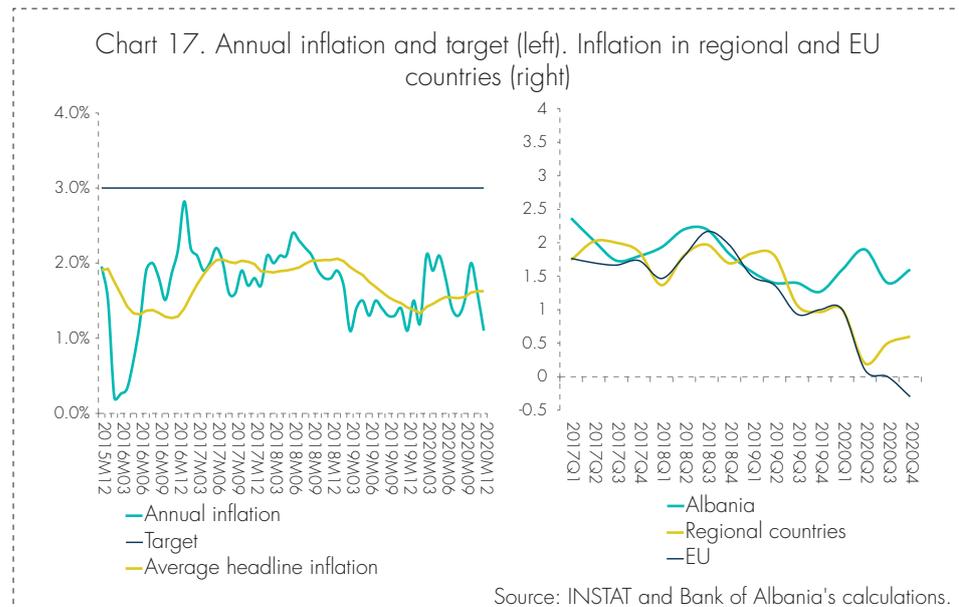
2.1.4 INFLATION AND ITS DETERMINING FACTORS

Annual inflation stood at low levels and below the 3% target in 2020. Inflationary pressures were low in view of a weak demand, spare capacities in the economy, and the low inflation rates in partner economies. Inflation was volatile, mainly driven by food prices. On the other side, measurements of inflation which exclude prices with high fluctuations, maintained stable levels.

Annual inflation in 2020 averaged 1.6%, in parallel being affected by both short-term supply-side shocks, with a raising impact, and by the contraction



of demand, which had a negative effect on inflation. A slight increase of inflation from 2019 reflected a more complete transmission of import prices into final prices due to a more depreciated exchange rate. Nevertheless, the fast worsening of the cyclical position of the economy is assessed to have had an impact, in the short run, on weak inflationary pressures from the domestic economy. The gradual recovery of the economy and the increase of external inflationary pressures are expected to drive inflation to return to a rising trajectory, up to the target in the medium term.

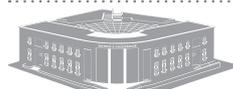


Both domestic and external inflationary pressures were weak in 2020. The most volatile components of inflation were seen in large swings in the prices of oil and food commodities in international markets. Meanwhile, long-term and domestic components of inflation were stable, providing an important contribution of 60% to the formation of headline inflation.

Depreciation of the nominal effective exchange rate, in 2020, provided a more complete transmission of external pressures to inflation. Nevertheless, the latter was quite low this year. Domestic demand factors, in the form of increased spare capacities in the economy and a slowdown in private consumption, have dictated low domestic inflationary pressures. Inflationary expectations recorded a slight increase in 2020, at around 2.5%, remaining close to the historical average value.

Inflation was volatile, mainly affected by food prices.

Categories of foods formed around 90 % of headline inflation. The category “**Unprocessed foods**” had the main role in this regard. Their prices fluctuated considerably during the year. In the lockdown period, prices in this category increased rapidly, affected by demand-supply imbalances and heightened difficulties in trade and supply. In relation to the latter, replacement of containment



measures, at the end of year, affected a fall in demand for unprocessed foods against the unchanged supply, which was reflected in the low inflation of December (1.1%). The category **“Processed foods”**, overall, was characterised by a stable positive contribution during the year.

The other categories made a low contribution to headline inflation. The category **“Non-food consumer goods”** provided a contribution of negative values to inflation in the year. This performance reflected a considerable fall in oil prices in international markets. The prices of other more stable components of inflation, which include housing, services and long-term consumer goods prices, increased their contribution to headline inflation. The category **“Housing-rent”** provided the main contribution in this increase. The other categories maintained their low contribution, almost equal to the one in the previous year.

Table 1 Contribution of key categories to annual inflation (p.p.)*

	Avg. 2016	Avg. 2017	Avg. 2018	Avg. 2019	Q.1'20	Q.2'20	Q.3'20	Q.4'20	Inf. 2020 (%)
Processed food	0.2	0.3	0.2	0.2	0.4	0.5	0.5	0.5	1.9
Bread and grains	-0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1	1.8
Unprocessed foods	1.1	1.2	1.0	0.9	0.8	1.2	0.8	1.0	5.5
Fruits	0.5	0.4	0.2	0.1	0.7	0.7	0.5	0.2	15.2
Vegetables	0.6	0.7	0.7	0.8	0.2	0.4	0.2	0.6	5.2
Services	0.1	0.2	0.1	0.1	0.1	0.1	0.0	0.1	0.3
Goods with regulated prices	0.1	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.1
Housing lease	0.1	0.0	0.4	0.1	0.2	0.3	0.3	0.3	1.6
Non-food consumer goods	-0.1	0.1	0.3	0.1	0.0	-0.2	-0.2	-0.4	-2.7
Fuel	-0.2	0.2	0.2	0.0	0.0	-0.3	-0.3	-0.4	-6.3
Durable consumer goods	0.1	-0.1	0.0	0.1	0.1	0.1	0.1	0.1	1.5
Inflation (%)	1.3	2.0	2.0	1.4	1.6	1.9	1.4	1.6	1.6

Source: INSTAT and Bank of Albania.

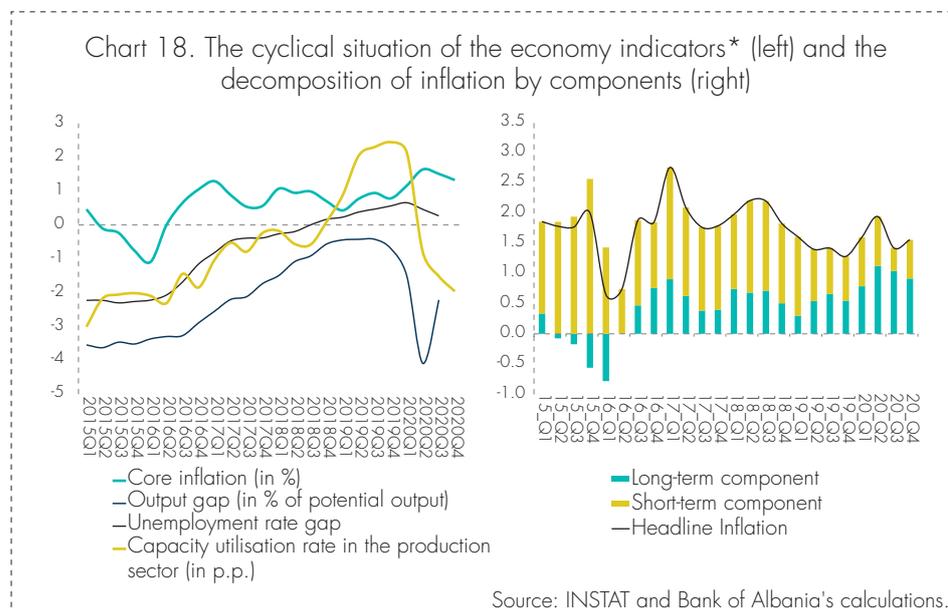
*The table shows some of the main groups of items.

The cyclical position of the economy worsened by generating weak inflationary pressures

The negative shock is assessed to have shifted the economy from its long-term potential, by considerably expanding the negative output gap. This gap reached the lowest point in 2020 Q2, and has been improving in the following quarters, in line with the start of economic activity recovery. Indirect indicators for the assessment of cyclical position, the unemployment rate and the capacity utilisation rate, also show that the economy is operating with spare capacities. Thus, the unemployment rate continues to be above the level recorded in the previous year, and utilisation of production capacities below the average level.



Inflationary pressures remain insufficient for the return of inflation to target, notwithstanding the increase in contribution of the long-term component in the formation of inflation rate.

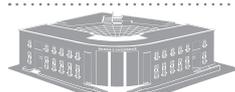


2.1.5 BALANCE OF PAYMENTS AND EXTERNAL POSITION OF THE ECONOMY

The external position of the country worsened in 2020 and current deficit expanded, in reflection of a fall in export and income flows. The fall of foreign direct investments and the expansion of borrowing in foreign currency have made an increased contribution to debt-creating flows in current deficit funding. Given the growth of borrowing in foreign currency and a fall in exports and tax revenues, indicators of long-term repayment ability in relation to foreign debt showed deterioration.

The current deficit to GDP ratio expanded to 8.5% during the first three quarters of 2020, from 8.0% in 2019.

The expansion of current deficit mainly reflected an annual fall in the export of services. The latter was considerably affected by a drop in the exports of tourism given the restrictions in place on the movement of citizens. On the other hand, the deficit of goods account fell by 8.6%, in annual terms, reflecting the stronger contribution of imports contraction. Inflows of “Compensation to employees”, which are closely related to the seasonal employment of Albanian citizens abroad, were reduced over the year as whole. As with the performance of services export, restrictions on the free cross-border mobility made the main negative impact. Remittances were around 9.6% lower than the first nine months of 2019. Nevertheless, their fall was concentrated in the first half of the year. In



the third quarter of 2020, remittances grew by 6.9% in annual terms. Difficulties in the labour markets in countries where Albanian emigrants mainly live seem to not have considerably impacted negatively the flow of remittances to Albania.

Debt-creating flows increased their contribution to funding the current account deficit.

The impact of the pandemic coincided with the entry into the final stage of major projects in the field of energy, as it established non-favourable premises to the performance of Foreign Direct Investments (FDIs). The annual fall in inflows was 16.8% in the first nine months of the year. Given the expansion of current deficit coupled with the reduction of funding flows of foreign direct investments, the debt-creating flows have expanded their funding contribution. Also, it reflects the issue of Eurobond in the second quarter of year, which expanded the foreign debt liabilities of Albania.

Foreign debt stability indicators have temporary worsened, but the high levels of international reserve provide assurance for dealing with the possible contingencies.

Foreign debt stock is estimated at EUR 8.829 billion at the end of 2020 Q3, with an annual growth 6.1%. Its ratio to nominal GDP stands at 68.5%, from 60.4% at the end of 2019. "General Government" continues to be the main holder of foreign debt, having a share of 49.7% to total. Term structure of debt continues to be oriented towards long-term debt, accounting for around 94.0% of total.

The expansion of foreign debt stock coupled with the reduction of exports and fiscal revenues caused a worsening in long-term repayment ability indicators. The ratio of debt stock to the exports of goods and services expanded to 212.2% at the end of 2020 Q3, from 153.7% at the end of the first quarter. The ratio of debt stock to fiscal revenues expanded to 251.1%, from 220.2% at the end of 2020 Q1.

On the other hand, the stock of foreign currency reserve was sufficient to counter the short-term pressures. In December, the stock was sufficient to cover 9.2 months of imports of goods and services or 3.5 times higher than the short-term gross external debt.

2.1.6 FINANCIAL MARKETS AND MONETARY INDICATORS

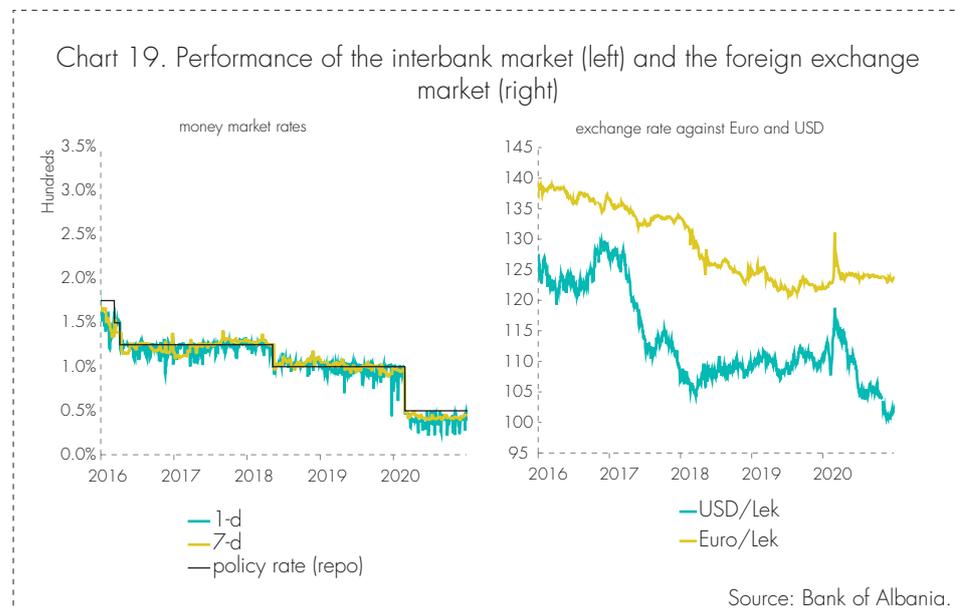
Financial markets have functioned normally by enabling a good transmission of monetary stimulus into the economy. The timely reaction of the Bank of Albania helped to reduce uncertainties, contain liquidity premia and maintain low interest rates. The eased financial conditions, in addition to the supporting lending policies of the Bank of Albania and Government, contributed to the growth of funding to the private sector. The expansion of credit is also supported



by the good performance of funds collected by banks. Lending activity has mainly supported the enterprises in their investment purposes.

The interbank rates ranged close to the policy rate and showed low volatility in accordance with the operational target of the monetary policy.

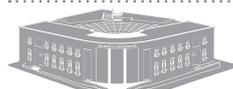
Interbank interests showed immediate transmission of the reduction of the policy rate in March. Liquidity premia were contained, attributable to the sound balance sheets of banks and the policy on liquidity injection of the Bank of Albania. Auctions of 7-day Repo, since the end of March 2020, are held at an unlimited amount and fixed rate. Also, liquidity deficit, although rising from the previous year¹⁰, has not threatened the transmission of monetary policy stimulus to the market. Its growth has reflected an increase in the share of injecting operations with 1-3 months maturity.



The foreign exchange market was characterised by a stability of lek against the euro, its appreciation against the US dollar, and foreign currencies were traded within normal market parameters.

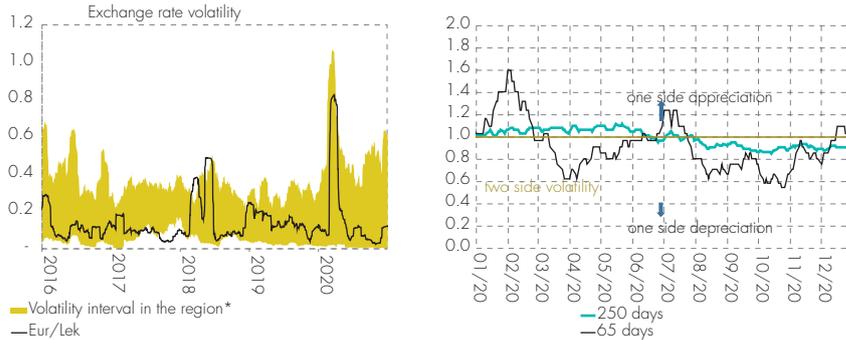
In 2020, the euro was averagely quoted at 123.8 lek/eur, with a lek depreciation of 0.6% from 2019. Trading parameters of the European currency in the domestic market appear stable; volatility indicator and quotation spreads have resulted close to their normal values. At the same time, daily volatilities of the exchange rate were almost two-sided, showing a balancing of agents' positions for purchase and sale in the market. The usd/lek exchange rate fell to 101.6 lek/usd in December, from the average 109.9 lek/usd in 2019, in reflection of the weaknesses of the US dollar in the international market.

¹⁰ In 2019, liquidity deficit reflected a decrease in financing needs as a result of lower Government demand driven by the issue of Eurobond and the effect of the regulation on holding the required foreign exchange reserve in the original currency.



The stability of the eur/lek exchange rate reflected a balanced demand/supply ratio in this market. The considerable fall in trade that followed the closure of domestic economies and of partner countries led to the contraction of trade deficit in the first half of the year. On the other hand, foreign exchange inflows from tourism showed low levels. Capital and financial accounts flows enabled the meeting of the economy's needs for foreign financing.

Chart 20. Indicators of pressures in the foreign exchange market*



* measured using the exchange rates of CZK, HUF, RON, PLN and RSD against Euro.
 *The indicator of appreciation/depreciation bias is calculated as the ratio of the number of days when the exchange rate is appreciated against the number of days when the exchange rate is depreciated, over a moving time horizon, varying, for example from 22 days (calendar month) to 250 days (one calendar year). The value of this indicator represents the equilibrium value, where the number of days when the exchange rate is appreciated is equal to the number of days when the exchange rate is depreciated and shows that there were no appreciation/depreciation biases in the market. If this indicator is above 1, then there are signals for one-sided pressures for appreciation in the market and vice versa.
 Source: Bank of Albania, respective central banks.

In 2020, yields on government securities fluctuated at slightly higher levels than in the previous year.

This increase was mainly notable in the first half of year. In average terms, premia mainly increased for short- and long-term maturities. The 12-month yield was 1.9%, up from an average of 1.6% in 2019. The increase in 2- to 7-year maturities was around 0.4 percentage points on average. The 10-year yield

Chart 21. Performance of yields in the primary market and interest rates in lek



Source: Bank of Albania.



has remained stable for almost two years. This performance of yields has shifted in a slightly upward curve, with a pronounced convex shape on medium-term maturities compared with the previous year.

Interest rates on loans in lek declined during the year, supporting financing to the private sector.

The increase of monetary stimulus and optimum liquidity conditions in the banking system have provided for low interest rates on loans. Sovereign guarantee schemes have contributed to the decrease of funding costs with bank loans to enterprises. Average interest rates on loans to this segment were 5.4%, from 6.0% in the previous year. Interest rates on loans to households recorded a marginal decrease to 6.4%, on average. The lack of liquidity pressures and the further growth of deposits have also enabled decreasing costs for the latter to the banking system, at 0.6% in 2020.

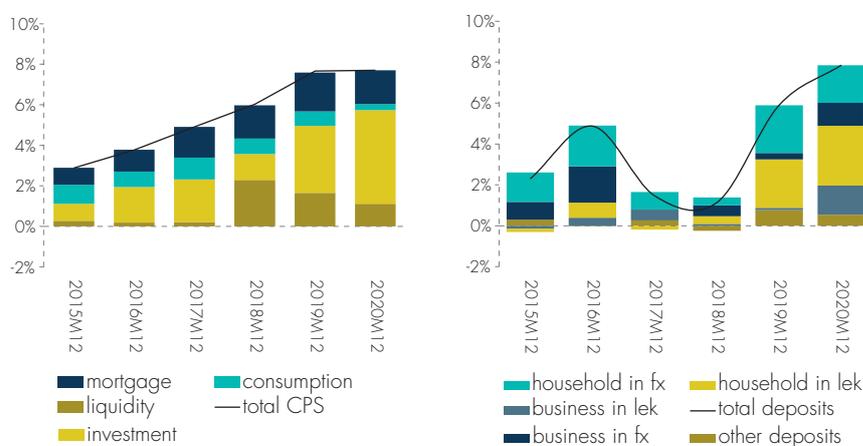
Credit to the private sector recorded a stable annual growth rate, of around 6.8%, on average, in 2020.

The sovereign guarantee schemes and the eased measures implemented by the Bank of Albania have broadly supported the expansion of credit to enterprises and households facing difficulties. Credit to enterprises provided the main contribution to the growth of loans to enterprises, by around 4.6 percentage points (62%). This segment was the focus of the measures undertaken, and a considerable part of this credit was channelled to investment financing. Credit for liquidity purposes has slowed down the growth rate, by providing a low contribution to the expansion of loan portfolio to enterprises. Loans to households contributed by 2.2 percentage points (38%) to the growth of credit to the private sector. This performance shows the high contribution of mortgage loans, supported by a favourable supply from banks for this product and an improved loans demand for house purchase from households. On the other hand, the performance of consumer loans was sluggish, affected by both a fall in consumption and heightened uncertainties.

Loans by currency show a rapid growth of loans to the segment of domestic currency. The credit portfolio denominated in lek recorded an annual growth rate of around 10.5%, on average, over the year, contributing by 5 percentage points to the expansion of credit to the private sector. The implemented accommodative policies have impacted the orientation of lending in the domestic currency. The performance of credit in foreign currency was sluggish. This portfolio recorded an average annual growth of around 3.4% over the year, providing a contribution of 1.8 percentage points to the expansion of credit to the private sector.



Chart 22. Credit to the private sector and deposits of banks



Source: Bank of Albania.

Deposits in the banking system recorded an annual growth rate of around 6.7%, on average, over the year.

Deposits in lek led this expansion, contributing around 3.7 percentage points to the annual growth of total stock. Deposits in lek have mainly been in the form of households' deposits. Meanwhile, an increase in the deposits in lek of enterprises is noted at the end of year. Deposits in foreign currency recorded an average annual growth of 6.1% over the year. In line with seasonal behaviour, their higher expansion was more notable in August and December. This expansion reflects both the increased activity of enterprises and seasonal flows in the form of remittances.

The term structure of deposits reflects further shift towards liquid components. The fast growth of demand deposits further increased their ratio to total deposits, at around 51.8%, as at the end of the year. This behaviour is in line with the low interest rates and the increased uncertainty¹. These factors have also affected the slowdown of the growth rates of deposits with maturity term over two years. The latter, unlike the previous year, have reduced their share to total deposits, to 13.1%, as at the end of the year.



BOX 3: THE FINANCIAL SYSTEM IN THE FACE OF SHOCK FROM THE PANDEMIC

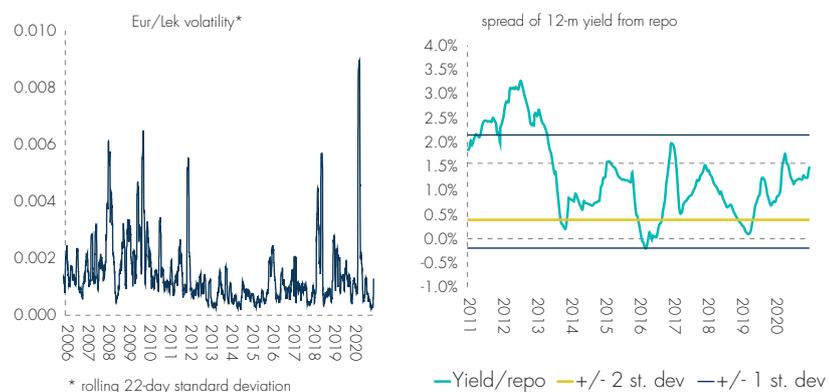
This box is dedicated to the reaction of the financial system against the shock from the pandemic, following Box 2. The financial system proved able to counter the strong negative shocks by simultaneously serving as a powerful support to the economy. This was a different experience from previous shocks following which the system strengthened the negative effects to the economy, by turning making the recovery stage more difficult.

The ability of the financial system to successfully withstand this shock and play an intermediating role, is a result of its enhanced stability, its maturity in years and the strengthened confidence of the economic agents within it. At the same time, the well-coordinated (monetary, macro-prudential/supervisory and fiscal) policies undertaken in a timely manner to mitigate potential risks provided a significant contribution in this regard. Hence, (i) the foreign exchange market appeared stable; (ii) risk premia were contained; (iii) the financial system had ample liquidity and did not suffer any deposit withdrawals; and it supplied the needed financing to the private sector. Each of these dimensions is briefly addressed following:

(i) The foreign exchange market was stable.

The implementation of containment measures in March was immediately reflected in the foreign exchange market. In a short time, lek depreciated considerably and exchange rate volatility increased. The effective and timely intervention of the Bank of Albania was successful for the cessation of uncertainties. The contained psychological reaction of market agents and the broader public also provided an impact in this regard, by reflecting their enhanced confidence in the domestic currency. The eur/lek exchange rate was stabilised within the next month, in line with the new macroeconomic landscape. The stability of the foreign exchange market in the face of this shock is particularly evident when compared to previous episodes of crises. For example the crisis of 2008-2009, in addition to the considerable depreciation of lek due to the worsening of the foreign position of economy, was accompanied by an increased volatility of the exchange rate for a two-year period.

Chart 23. Volatility in foreign exchange market (left) and 12-month prim yield against the policy rate (right)



Source: Bank of Albania.



(ii) Risk premia were contained

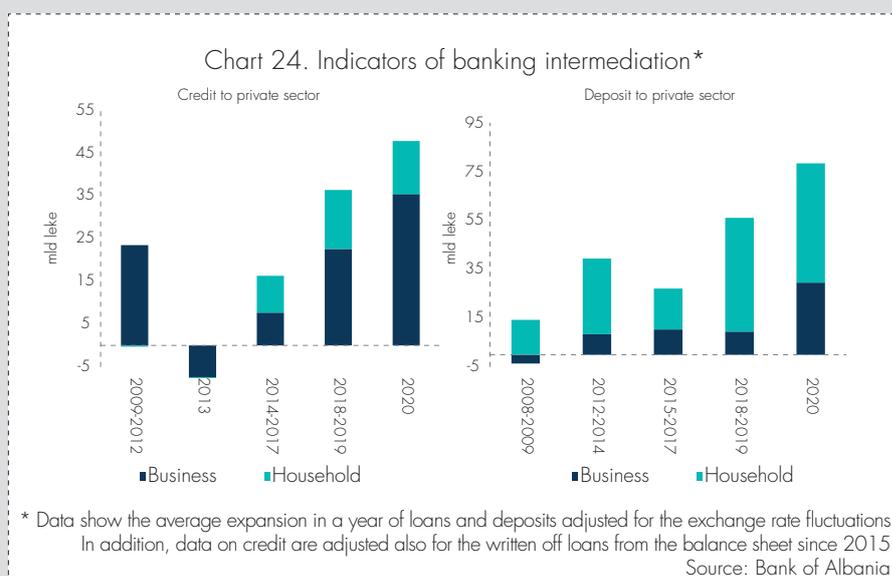
Risk premia in the banking system were contained although uncertainties increased. The supply with unlimited liquidity through one-week repo avoided a possible increase in liquidity risk. Meanwhile, the augmented pressures on risk premia of credit were mitigated through macro-prudential, supervisory and fiscal measures. Clear and continuous communication with the market through forward guidance helped flatten uncertainties about interest rates. All these factors, in addition to the cut of the policy rate, contributed to a fall in interest rates applied on loans to the private sector this year. Ample injection of liquidity and the prudential approach of banks enabled the market to absorb the domestic debt of Government, with no considerable increase of cost and with no impact on financing costs to the private sector.

(i) The financial system was liquid

Previous experiences have shown that shocks to the financial sector may be accompanied by massive withdrawals of deposits and liquidity problems to banks. Our banking sector experienced such events at the beginning of its establishment and during the global financial crisis. During 2008-2009, within a six-month period, around 10% of total deposits were withdrawn due to the public perception of an increased risk from the global financial crisis. Meanwhile, in 2020, at no moment was there noted either withdrawal of deposits or any problem with the liquidity of banks. On the contrary, deposits have continued to grow, reflecting the orientation of households' behaviour towards savings and the strengthening of confidence in banks.

(i) Credit to the private sector increased

Shocks to the financial sector are frequently reflected in a hesitation from banks to finance the economy. Banks showed such a reaction against the sovereign crisis in the euro area in 2011-2012. That crisis, firstly drove the credit portfolio to shrink by 5%, and then to its weaker performance for some years. Developments in 2020 show a different view of lending activity. The measures undertaken by the Bank of Albania and the fiscal authority provided for lending channel to function smoothly. Credit to the private sector grew in spite of an increase in uncertainty and a worsening of economic conditions.



Bank of Albania. Data show the average expansion in a year of loans and deposits adjusted for the exchange rate fluctuations. In addition, data on credit are adjusted also for the written off loans from the balance sheet since 2015.

The financial system appeared able to withstand the negative shock of 2020 and showed sufficient elasticity to support the economy with financing, showing a difference from previous episodes of large negative shocks. Also, the coordinated and timely policies which were undertaken helped to anticipate potential risks that may weigh on the financial system. While the economy will recover, the Bank of Albania will continue to monitor its activity and indicators, aiming to address in a timely manner any potential problems.

Table 2 The main macroeconomic and financial indicators

	2016	2017	2018	2019	2020*
Annual average inflation					
Headline inflation (in %)	1.3	2.0	2.0	1.4	1.6
Core inflation (in %)	0.2	0.8	0.9	0.7	1.4
Economic growth					
Real GDP growth (annual, in %)	3.3	3.8	4.1	2.2	-5.5
Labour Market¹					
Participation rate in the labour force (15-64 years of age)	66.2	66.8	68.3	69.6	69.2
Unemployment rate (15-64 years of age)	15.2	13.7	12.3	11.5	11.6
Fiscal sector					
Budget balance (including grants, % of GDP)	-1.8	-2.0	-1.6	-1.9	-6.9
Budget revenues (as a percentage of GDP)	27.6	27.7	27.4	27.3	26.7
Budget expenditure (as a percentage of GDP)	29.4	29.7	29.0	29.2	0.50
Public debt (as a percentage of GDP) **	72.3	70.1	67.8	66.5	77.8
External sector					
Current account (official transfers exempted in % of GDP)	-8.0	-8.1	-7.3	-8.5	-8.9
Imports of goods (fob, as a percentage of GDP)	30.9	31.3	30.0	29.7	28.2
Exports of goods (fob, as a percentage of GDP)	6.7	6.9	7.7	6.6	5.9
FDIs (as a percentage of GDP)	8.8	7.8	7.9	7.9	7.3
Monetary and financial sector					
Repo rate (end of period)	1.25	1.25	1.00	1.00	0.5
M3 aggregate (annual growth, end of period)	3.9	0.3	-0.2	4.3	10.5
Credit to the private sector (annual growth, end of period) ²	3.1	3.3	1.9	6.9	8.2
Deposit/GDP ³	74.2	71.4	68.7	70.4	80.2
Credit/GDP ³	37.1	36.4	35.3	36.5	41.7
12-month average yield	1.8	2.4	2.0	1.6	1.9
ALL/USD average exchange rate	126.0	119.1	108.0	109.9	108.7
ALL/EUR average exchange rate	136.1	134.2	127.6	123.0	123.8
NEER	110.2	105.2	96.8	92.0	89.9
Banking Sector					
Non-performing loans ratio/total loans (%)	18.2	13.2	11.1	8.4	8.1

Source: INSTAT, Bank of Albania, Ministry of Finance and Economy.

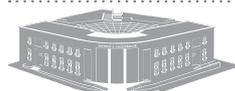
* Data on economic growth for labour market and the external sector are from the first 9 months of 2020.

** Statistical Debt Bulletin, MFE 2020 Q4.

¹ "Labour force survey results", published by INSTAT.

² The data are adjusted for written off loans.

³ GDP assessment for 2020. Data as a ratio to GDO are calculated on this assessment, except for differently specified.



2.2. MONETARY OPERATIONS

The Bank of Albania implements its monetary policy by using indirect market instruments. These include open market operations, standing facilities and a required reserve. The main market operations are the repurchase and the reverse repurchase agreement of seven-day maturity, whose interest rate represents the policy rate.

OPEN MARKET OPERATIONS

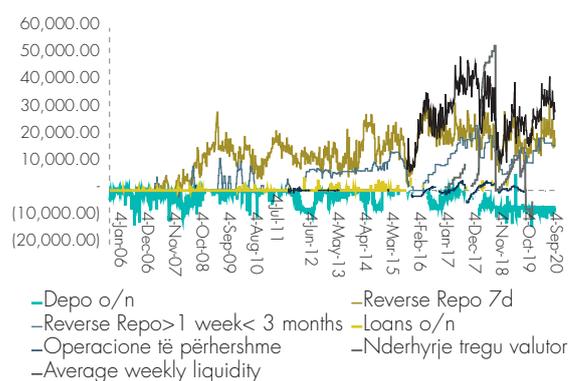
Open market operations are made up of three sub-items: main operations; fine-tuning operations; and structural operations. These are used for short-term management of liquidity in the money market, aimed at accomplishing the Bank of Albania's operational objective - orienting short-term interbank interest rates close to Bank of Albania's policy rate and limiting their fluctuations.

In its response to the coronavirus (COVID-19) pandemic the Bank of Albania has changed the form of the auction of one-week injection from "variable price" to "fixed price auction", on 11 March 2020. This type of auction affected the reduction of liquidity risk to commercial banks, being reflected in an increase of the average number of participating banks in auctions to seven, from two, in the previous year, and in the decrease of interest rates in the interbank market as a ratio to policy rate at lower levels.

In 2020, the average tradable interest rate in the overnight interbank market was 0.11 percentage point **under** the policy rate, in contrast to an average of 0.02 percentage point **under** the policy rate in 2019, 0.02 percentage point **above** the policy rate in 2018, and 0.03-0.07 percentage point under the policy rate in 2014-2017. The interest rate in the one-week interbank market was 0.06 percentage point **under the policy rate**, against the average 0.01-0.02 percentage point above the policy rate in the two previous years, and 0.02-0.06 percentage point under the policy rate in the period of 2014-2017. Trade in longer maturities than one week continued to be quite rare.

The average liquidity shortfall, during 2020, increased by around ALL 35.0 billion, after falling ALL 28.5 billion, on average in 2019. The growth of currency in circulation was the main factor urging the increase of liquidity shortfall in the banking system.

Chart 25. Banking system liquidity*



*One-week average liquidity (left-hand axis) is the average of one-week injections (BoA's injections through one-day + one-week + 1-three-months + intraday loans reverse REPO agreements) minus (liquidity withdrawals from BoA through one-day + one-week + 1-3-month REPO agreements + deposits).

Source: Bank of Albania.



Reflecting the upward tendency of liquidity shortfall, the share of injections from the Bank of Albania with longer than seven-day maturity, increased to 44% in 2020 from 44% in 2019.

Table 3 Structure of liquidity injection operations by the Bank of Albania

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Main instrument	74%	55%	60%	64%	55%	80.7%	61.6%	54%	61.1%	55.9%
Long-term liquidity	26%	45%	40%	36%	45%	19.3%	39.4%	46%	39%	44.1%

Source: Bank of Albania.

Since the end of 2019, the Bank of Albania has permanently injected liquidity amounting around ALL 12 billion, through the increase of T-bills portfolio, by decreasing the pressures for liquidity shortfall in the banking system. At the same time, the Bank of Albania has almost doubled the SWAP agreements in foreign currency/national currency with the Ministry of Finance.

STANDING FACILITIES

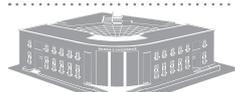
Standing facilities - overnight deposits and overnight loans at the Bank of Albania - are instruments available to commercial banks to manage liquidity on a daily basis and define a corridor in which interest rates fluctuate in the interbank market. After reducing the base interest rate to 0.50%, the Bank of Albania has maintained the interest rate for the overnight deposit facility unchanged at 0.10%, and has reduced the interest rate for the overnight lending facility to 0.90%, by creating a quite narrow corridor of the interest rates.

The instrument of overnight deposits has been used daily, over 2020, with an average of ALL 6.58 billion compared to an average of ALL 6.74 billion in 2019, and ALL 4.55 billion in 2018. In 2020, the use of overnight loans decreased to only one case, compared to 16 cases in 2019 and 42 cases in 2018. The increase in forecast quality and the decrease in the cost of excess liquidity affected the maintaining of the downward trend in using this instrument.

REQUIRED RESERVE

The required reserve is an instrument through which the Bank of Albania aims to adjust money supply, liquidity situation in the system and manage the interest rates in the interbank market. It implies the placement of a certain amount of reserve in Lek and in foreign currency of commercial banks with the Bank of Albania.

No amendments took place in the Regulation on the required reserve during 2020. We recall here, that the 1-year temporary period, when the regulatory amendments of 2018, aimed at increasing the use of national currency were implemented, ended in 2019. The Bank of Albania decreased the mobilisation rate for the required reserve in lek to 5.00% and 7.50%, from 10% in the previous year, and increased the mobilisation rate for the required reserve in foreign currency to 12.5% and 20.0%, by applying a higher rate for



banks which have a higher exposure from liabilities in foreign currency. The remuneration of required reserves in lek accounts was decided to be equal to the policy rate from 70% of it was previously.

No regulatory changes have taken place in the remuneration of required reserve in foreign currency accounts and of banks' surpluses at the Bank of Albania. Starting from September 2016, the remuneration interest rate for the required reserve in euro is equal to the overnight deposit of the European Central Bank, which in 2020 remained unchanged, at -0.50%. The remuneration rate on the required reserves in US dollars has been 0% since 2011. The remuneration rate on the surplus reserves in lek and US dollars remained at 0% in 2020, as in the previous three years. On the other hand, the remuneration interest rate of the surplus reserve in euro remained 0.25 percentage points lower than the interest rate of the deposit of the European Central Bank set in 2016.

2.3 FINANCIAL STABILITY AND MACRO-PRUDENTIAL POLICY

As the responsible authority for the supervision and regulation of the banking sector and consequently the major part of the financial system, the Bank of Albania plays a primary role in drafting and implementing the macro-prudential policy. Macro-prudential policy consists of all the measures, mainly prudential, that aim to prevent and mitigate systemic risks to the financial system, safeguarding in this way the financial stability of the country. The purpose of a considerable part of the macro-prudential measures is to strengthen the resilience of the financial institutions, so they can face situations of stress and economic, financial crises, and continue to carry out their role as financial intermediaries fully and in the most qualitative manner.

The work of the Bank of Albania towards preserving financial stability and implementing macro-prudential policy is concentrated in the meticulous analysis and monitoring of the developments of the financial system and the identification and assessment of systemic risks; pursuing medium-term and long-term objectives of the institutions on completing the regulatory and methodological macro-prudential framework; and, in particular, taking measures to ease the financial system and borrowing entities from the negative effects of the pandemic, restrictions and economic slowdown that characterised the major part of 2020.

During the second half of 2020, specific surveys were conducted regarding the expectations of banks in relation to the performance of assets quality. Also, there were timely observations carried out in relation to the financial situation and borrowing of households and enterprises, real-estate market performance and the perception of systemic risks by the banking sector. The package of stress-test exercises was enriched by a special module on the scale of interconnectivity between banks and exposure between banks and the largest borrowers of the sector.¹¹

¹¹ The results of this exercise together with some specific recommendations related to stress-test exercises carried out by banks are published in the Financial Stability Report 2020 H1.



A significant commitment to enrich and develop the methodological and regulatory framework in the area of financial stability and macro-prudential policy was the successful implementation and completion of the activities laid down in the Twinning Project “Enhancing Bank of Albania’s alignment with EU Acquis”. The activities of the financial stability module handled important aspects such as the methodology of determining the capital buffers for systemic risk, indicators and methodology for assessing the risks from real-estate market, improvement of de-euroisation policies, drafting of risk indicators from the interconnection between the banking sector and investment funds, as well as drafting a comprehensive document on macro-prudential policies and guidelines on the approximation with the European Board of Systemic Risk recommendations.

2.3.1 FINANCIAL STABILITY AND BANKING ACTIVITY

Despite the difficulties of 2020, the domestic financial system and banking sector have continued to operate in stable conditions, maintaining not just the quantity and quality of the financial intermediary services, but also expanding the range of other activities related primarily to payment services and electronic transfers. The size of the financial system as a ratio to GDP increased above 110%, due to the notable difference in the growth rates of the financial system’s balance sheet and the economic activity. The main indicators of the banking system activity, with the exception of the profitability indicator, have remained stable or have recorded slight but clear improvements during the year. The assets of the financial system expanded and within them the balance sheet of the banking sector grew by around 7%. The increase on the side of the banks’ assets was determined by the expansion of investments in securities, while credit stock of banks expanded by 6%. As for the liabilities, the growth was determined by the considerable increase of customer deposits in the banking sector.

The financial result of the banking sector for 2020 was positive (ALL 17 billion), 15% lower compared with the previous year. The level of capitalisation of the banking sector remains good, over 18%. The quality of credit improved slightly over the year, where the non-performing loans ratio (NPLR) declined to 8.1%, as at the end of the year, from 8.4% in the previous year. The fall of NPLR reflected the higher increase in outstanding loans (5.7%) in comparison with the increase in outstanding NPLs (2.5%). Over 2020, the measures taken to assist banks in dealing with loans of borrowers in temporary financial difficulties and to restructure loans, created the space for stabilising the overall level of non-performing loans. However, the effects of the shock in the economy within non-performing loans appeared in the increase of share of loss loans portfolio.

The direct exposure of the banking sector activity to market risks remains under control, but some of these risks indicators have shown upward trends. The



exposure of banking sector against the risk of strong exchange rate volatility is limited since opened positions, for total currency and special currencies, obviously remain under the upper regulatory threshold. Indirect exposure against the exchange rate risk recorded a decrease, since the volumes as well as the unhedged credit share in foreign currency have continued to decrease. Overall the share of transactions of the banking sector in foreign currency recorded a stronger decrease in 2020, in comparison with credit and deposits in foreign currency. At the same time, the share of the banking sector asset of non-resident claims, kept in foreign currency, has fallen significantly. The interest rate risk continues to remain present and has further increased during the entire year, primarily due to the gap expansion between assets and liabilities with fixed interest rate.

2.3.2 SYSTEMIC RISKS

The periodic assessments of the Bank of Albania based on the performance of Macro-prudential Map¹² indicators show that the exposure of the banking sector and other segments of the financial system, which these indicators are able to cover, remain contained. In 2020, and especially during the first half of the year, the interbank market and foreign exchange market showed temporary volatilities related with the short-term demand - and/or supply-side shocks. The corrective actions of the Bank of Albania have avoided disorders in the foreign exchange market and have supported the situation for necessary liquidity in the interbank market.

The indicators used to monitor the risks related to credit and debt expansion, signal that in 2020 these risks were mitigated and far from levels which require intervention with macro-prudential measures. The increase of outstanding credit given the contraction of economic activity during the major part of the year, has driven the main indicator measuring this risk – ‘lending/GDP’ ratio gap - to increase at -6.3% in the third quarter of the year from the average level of -7% in the last decade. Despite the gap tightening, determined primarily by GDP performance, the complementary indicators of this risk suggest that, overall, credit performance is still far from the levels that show overheat and the comparative threshold that would require the increase of counter-cyclical capital buffer over the current 0% level. A development that holds the attention of the Bank of Albania in this regard is the price and real-estate rent performance, and the credit granted to enterprises and households to finance real-estate purchase and investment. This type of credit registered a positive and relatively high increase, but which was comparable to other types of loans and credit in overall. On the other hand, the annual change in

¹² This analysis is currently prepared only for internal use. Based on the analysis of systemic risk performance classified according to intermediary objectives of macro-prudential policy, this analyses orients the decision-making of the Supervisory Council of the Bank of Albania on the need to implement new measures or modify/remove the existing measures of a macro-prudential nature.



prices and real-estate rent during 2020 was somewhat higher compared with previous periods. The performance of this market, exposure of banking sector to it and the performance of debt burden on economic agents continue to be monitored and analysed by the Bank of Albania.

The second intermediary objective of the macro-prudential policy is the mitigation of the excessive mismatch maturity and lack of liquidity in the market. Despite a downward trend, the main liquidity indicators of the banking sector continue to notably remain above the minimum level provided for in the Regulations of the Bank of Albania. The indicator of mismatch maturity and the situation of liquidity in the market continue to signal increase of risk, particularly to assets and liabilities in the short run. A security lever for facing this risk is the high level of liquid assets in banks' balance sheets, although the feature of their liquidity is determined, in the last stage, by the depth of the market where they may be exchanged if need arises. The lowering of base interest rate and the support to the interbank market with unlimited liquidity from the Bank of Albania, have contributed to maintain the interest rates in low levels in the money market and the stability of spreads. The concentrations according to the dimensions covered by the Macro-prudential Map remain in limited levels and have decreased during the second half of 2020, signalling a low concentration risk in both activity and exposure of the banking sector. The concentration of banking activity by currency has decreased, but it remains at high levels and requires continuous monitoring. The indicators of concentration related to systemic banks show a lower and downward risk.

2.3.3 MACRO-PRUDENTIAL MEASURES

Macro-prudential measures implemented by the Bank of Albania up to the end of 2020 aim at establishing favourable conditions for:

- a) *the increase of domestic currency use in the Albanian financial system activity; and*
- b) *the strengthening of the resilience of banking system against systemic risks of cyclical and structural nature.*

- a) The measures for increasing the scale of use of domestic currency are taken in the framework of the de-euroisation package and entered into force in a gradual manner during March-July 2018 period. The package of measures consists of three main elements: i) differentiation of the required reserve for liabilities denominated in foreign currency; ii) higher requirements for indicators of liquidity in foreign currency exchange; iii) increase of awareness of borrowers by banks on the risk of credit denominated in foreign currency. To assess the impact of these measures and the general performance of the indicators of the euroisation level in the economy and the activity of the banking sector,



the Bank of Albania prepares and publishes a six-month report¹³. The report published in February 2021, reflects the positive signals provided by the banking activity indicators toward the superiority shown by the use of financial instruments in lek during this year. At the same time, it must be emphasised that as a result of the pandemic impact during 2020, it is difficult to distinguish the effect of various factors on the movements of indicators selected for this period, to assess whether this movement will establish a trend for their long-term performance and determine the efficiency of these measures.

- b) The measures taken to date on strengthening the banking sector's resilience to systemic risks consist in the implementation of measures set forth in the Regulation "On macro-prudential capital buffers"¹⁴. This Regulation lays down the framework for the implementation on banks of the conservative capital buffer, countercyclical capital buffer, capital buffer for systemically important banks and capital buffer for structural systemic risk. The Regulation stipulates that the performance toward the maximum levels of these buffers extends across a multiannual period. The report on the fulfilment of macro-prudential capital buffers, pursuant to the threshold levels determined in the Regulation, was conducted for the first time by banks in March 2020 and has continued on quarterly basis.

The simultaneous implementation of two or more above-mentioned buffers represents the combined micro-prudential capital buffer. Their implementation is realised through the decisions of the Governor of the Bank of Albania, which are published in the website of the institution. The assessment conducted on the data reported at the end of 2020, show that, overall, banks have fulfilled the requirements for a combined macro-prudential capital buffer, which are applied on the mandatory requirements of micro-prudential supervision. The forecasted increase in the Regulation regarding the level of these buffers during 2021 and beyond requires additional attention of banks to strengthen their capital position.

2.3.4 PACKAGE OF MEASURES UNDER PANDEMIC CONDITIONS

Since the first week of dealing with the situation caused by the pandemic in the country, the Bank of Albania was committed actively to use all the operational instruments and regulatory spaces in order the banking sector continue uninterruptedly the activity and to mitigate in advance the impacts of the pandemic on the economy and financial system. In the press releases to public at large it was emphasized that the decision-making objective was to:

¹³ The Report is called "Report on the performance of indicators to be monitored by the Bank of Albania in the framework of the de-euroisation process" and is published every six months on "De-euroisation Package" in the Financial Stability area in Bank of Albania's website.

¹⁴ The Regulation was approved with Decision No 41 of the Supervisory Council of the Bank of Albania, dated 05.06.2019.



preserve the monetary and financial stability in the country; facilitate the costs of shock to Albanian enterprises and households; and overcome the situation with the least negative effects on the long-term development of the country.

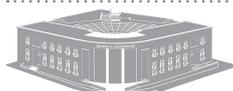
The measures undertaken to contain the spread of the pandemic, being materialised in the complete or partial shutdown of many activities of production and services, for several weeks in March-April 2020, were expected to yield a considerable negative effect in the incomes of enterprises and households, and, consequently, in the borrower's credit worthiness ability of credit borrowers.

In order to ease borrowers faced with temporary insolvency during this period, the Bank of Albania approved the addition of a temporary provision in the Regulations on credit risk management in banking activity, non-bank financial institutions and savings and loan associations and their unions. This regulatory amendment created facilities to lending entities in relation to the implementation of regulatory requirements on credit classification and setting funds for credit provisioning. This provision valid from March-May 2020 in the beginning was extended to cover the period of June-August 2020. As regards restructured credit, it was extended until the end of 2020. Another measure that aimed at facilitating the costs of payments to bank customers and encourage the use of Home Banking services, was the suspension of commissions applied by banks on electronic transfers of credit in lek and the fees for participants in the payment systems operated by the Bank of Albania.

To strengthen the capital position of banks against eventual shocks in the credit quality and to support lending, the Supervisory Council of the Bank of Albania suspended the distribution by banks of allocated and realised profits, first up to June 2020 and later until the end of the year. Another measure applied on the banking sector was the facilitation of the weighing share with risk coefficient to exposure of domestic banks against debt securities of the Albanian government denominated in foreign currency, for issuances during 2020 until their maturity, and the exclusion of this exposure from the calculation of maximum allowed exposure, according to the regulation on large exposures.

2.4 SUPERVISION

The supervisory function of the Bank of Albania has as its main objective the early identification and control of major risks (lending risk, liquidity risk, operational risk, interest rate risk, capital and profitability risk, reputational risk and money laundering etc.), as well as the assessment of internal audit and the effectiveness of corporative governance, as significant factors in mitigating risk in the entire sphere of banks' activity, but also of other non-bank entities which are licensed by the Bank of Albania.



Timely action and effective regulatory measures through ongoing supervision and their implementation remain one of the most important steps to successfully finalize the ultimate goal - to preserve the soundness of financial entities.

2.4.1 MAIN DEVELOPMENTS

STRUCTURAL DEVELOPMENTS

As at end 2020, the banking system remains consolidated to 12 banks, 4 of which with Albanian capital and 8 with foreign capital. Of the latter, 6 originate from European Union countries. In terms of total assets, year 2020 recorded an increase in the share of banks with Albanian capital, by around 1.3 percentage points, and a decrease in the share of banks with European capital, by 0.6 percentage points. The growth in the share of banks with Albanian capital was noticed in the credit portfolio, with 1.5% increase, as well as in deposits, whose share grew by 0.8%. In December 2020, these banks accounted for 30.6% of total assets in the banking system and 35.4% of total credit portfolio.

COVID-19 PANDEMIC

The financial activity in 2020 was carried out under the strong impact of the pandemic effects. Financial institutions readopted their activity to the imposed restrictions, health protocols and market demands. The Bank of Albania undertook significant regulatory changes to alleviate the possible effects to financial institutions, as well as to create facilities to borrowers for the payment of loans. These changes were initiated since March, when the natural disaster situation was declared, and they were reviewed several times during the year in line with the evolution of the pandemic.¹⁵

Pursuant to the regulatory changes undertaken in the Covid-19 context, the Bank of Albania conducted communication in written form with banks in order to determine certain prudential measures to be taken into consideration for managing the created situation, possible risks and transmitting the right message to the market. Thus, banks were required to create adequate structures and internal, transparent and clear procedures to implement the changes, document the entire process, assess and select the appropriate borrowers according to the set criteria, channel the restructuring following the legal path and reduce internal expenditures. The Bank of Albania monitored and controlled the situation by establishing a close communication and sharing the information with banks, by means of intensified reporting requirements.

¹⁵ For a summary of regulatory changes, please refer to Part 2.3.4 "Measure package in pandemic situation," and the list of amended regulations in Part 2.4.3 "Review of regulatory framework."



*IMPLEMENTATION OF RECOMMENDATIONS OF ASSESSMENT REPORT
BY MONEYVAL COMMITTEE AND ICRG/FATF ACTION-PLAN:*

In the framework of implementing the recommendations from the Committee of Experts of CoE on the Evaluation of Anti-Money Laundering Measures and counter Terrorist Financing (MONEYVAL), the Bank of Albania is included in the implementation of the national plan of measures, in the direction of improving the regulatory framework and strengthening the effectiveness of the supervisory process, in order to address the primary issues identified in the report, which will continue to be fulfilled during 2021.

In this framework, the number of on-site examinations has been increased, focusing particularly on terrorism financing issues and implementation of the international sanctions, especially on more vulnerable entities such as non-bank financial institutions and Foreign Exchange Bureaus. Related to the identified violations, in addition to the recommendations for specific entities, also supervisory measures, such as “warnings” and “fines” are implemented.

In 2020, 89 examinations were carried out in 8 banks, 7 non-banks financial institutions and 74 FEB. Four of these examinations were carried out in the framework of collaboration with the General Directorate for the Prevention of Money Laundering (GDPML), respectively in 2 banks, 1 non-bank financial institution and 1 Foreign Exchange Bureau. Also, 3 joint examinations were performed in collaboration with the Financial Supervision Authority, in order to achieve the objective of the measures undertaken to prevent terrorist financing (TF) and implement international sanctions (TFS).

In order to increase the awareness of entities (NBFIs and FEBs), which show deficiencies in implementing both measures to counter Terrorist Financing and the international sanctions, in October 2020, the Bank of Albania in collaboration with the GDPML organised a two-day training on: “Measures to counter Terrorist Financing (TF) and implementation of international sanctions (TFS),” in the framework of implementing the recommendations of Moneyval experts, provided during Round V of the evaluation for Albania. According to this report, financial entities were assessed with a “substantial / significant” level of effectiveness, in particular when banks present a good understanding of the risks of money laundering and terrorist financing and of legal obligations, and have generally taken appropriate measures. The training was targeted to: (i) non-bank financial institutions; (ii) savings and loan associations; (iii) Foreign Exchange Bureaus. Representatives of 33 non-bank financial institutions (NBFIs) and savings and loan associations (SLAs) and of 28 Foreign Exchange Bureaus participated in the training.



LEGAL AND METHODOLOGICAL ESTIMATIONS AND ENHANCEMENT OF SUPERVISORY CAPACITIES

A great deal of work was dedicated to the development and finalisation of twinning project with the Bank of Italy and Bank of Germany, a project which started in November 2019. The project aimed to approximate the supervisory legal and methodological framework with the European Union members, by enhancing capacities in supervising licensed entities. The objectives realised in this project are listed following:

- Several important amendments applied to the Regulation "On Capital Adequacy," which consist in reviewing the calculation method of capital requirements of exposures related to credit risk, market risk, operational risk and securitisation;
- Review of the Guideline "On the internal capital adequacy assessment process" (ICAAP);
- Drafting of a new regulation in compliance with the Directive of Payment Accounts;
- Training on the actual method of control implementation of the Guideline ICAAP as well as improvement of the Assessment Process and Supervisory Review;
- Building an internal methodology for evaluating the borrowing capacity of enterprises pursuant to the international accounting standard IFRS 9.

2.4.2 ON-SITE EXAMINATIONS

The examinations schedule deviated considerably from the plan due to the pandemic situation. Thus, during the first half of 2020, only two full-scope examinations were performed on banks. While, on the second half of the year, 5 examinations were carried out on the largest banks, focusing on the management of the pandemic situation and its impacts, especially concerning credit portfolio. During the year, partial examinations were carried out in banks for assessing the implementation of Regulation "On liquidity coverage ratio."

In total, 27 full-scope and partial examinations were performed on banks and non-bank financial institutions, with a higher trend toward partial examinations due to the health guidelines on reduced staff number. Foreign Exchange Bureaus received higher attention, with 74 examinations carried out on them.



Table 4 Number of examinations by entities and theme

Examinations carried out on entities	Strategic Risk	Organisational Risk	Credit Risk	Liquidity Risk	Interest Rate Risk	Market Risk	Information and Communication Technology	Operational Risk	Reputational Risk	Profitability	Capital
2017	9	12	13	10	10	9	11	8	11	10	11
2018	8	10	9	8	8	8	9	8	28*	9	8
2019	13	13	16	13	13	14	13	13	14	13	15
2020**	2	8	15	11	2	5	5	5	88**	2	6

* In 2018, 28 examinations were carried out at Foreign Exchange Bureaus on Operational Risk. While the other 10 examinations regarding this risk were carried out with the General Directorate for the Prevention of Money Laundering.

** In 2020, 74 examinations were carried out at Foreign Exchange Bureaus on Reputational Risk and 14 other examinations regarding this risk were carried out in banks and non-bank financial institutions. Among these, examinations on 2 banks, 1 non-bank financial institutions and 1 Foreign Exchange Bureau, regarding this risk, was carried out in collaboration with the General Directorate for the Prevention of Money Laundering and examinations on 3 banks were carried out in collaboration with the Financial Supervision Authority.

All the examinations performed in 2020 have as an objective the credit risk – in line and compliant with European Supervision Authorities – dictated by the nature of the undertaken regulatory amendments (freezing the loan payment instalments, encouraging restructuring etc.). The goal was to identify potential worsening of credit portfolios, which may be “hidden” temporarily due to regulatory accommodation, and the immediate measures that must be taken beforehand to create the necessary reserves.

The main recommendations of the examinations relate to carrying out stress-tests by also accounting for additional elements in response to the pandemic situation; careful review of business plans, without neglecting credit support to the economy; preliminary and gradual increase of provisioning, as well as a prudential approach against forecasted developments, and the necessity to review the credit portfolio in order to identify potential changes to clients’ solvency, even in cases when they have benefitted from payment “freeze” or restructuring.

Regarding non-bank financial institutions, attention in 2020 was focused on entities that carry out the activity of lending, leasing and microcredit. Examinations to a large extent aimed to address signals of fraud, non-realisation of supervisory recommendations and signals of market distortions.

A significant part of these examinations - an attentively considered issue regarding non-bank financial institutions - is the assessment of the level of transparency with customers. The examinations have identified several issues



in this regard, which were addressed through recommendations to entities, but also through initiatives for amendments and improvements to the supervisory regulatory framework, which covers transparency and consumer protection issues. Based on the examination conclusions, supervisory measures were initiated in two cases for the suspension of the activity or revocation of license for non-bank entities.

2.4.3 REVIEW OF THE LEGAL AND METHODOLOGY FRAMEWORK

In 2020, the Bank of Albania continued enhancing the supervisory regulatory framework, through approving several new regulatory acts and reviewing some current acts in force, furthering the approximation with the European Union (EU) acquis, the principles of the Basel Committee and the best practices in banking supervision. The reviewing process of the regulatory framework in force took into consideration the situation created in the country due to the Covid-19.

The following are the main regulatory changes approved in 2020:

I. In the framework of the measures taken due to the Covid-19, the Supervisory Council approved in 2020:

- Amendments to the: i) Regulation "On credit risk management from banks and branches of foreign banks"; ii) Regulation "On risk management in the activity of non-bank financial institutions"; and iii) Regulation "On risk management in the activity of savings and loan associations and their Unions."

These amendments consist in an additional temporary provision in the above Regulations, which stipulate a facility for entities in case of identifying insolvency of borrowers during the specific period, to not be subject mainly to the requirements provided for in these Regulations on the classification and establishment of provisioning funds.

- Amendment to the Regulation "On capital adequacy ratio", which consists in handling a preferential risk weight of 0% for banks' exposure to Albanian government debt securities in foreign currency, for securities issued in 2020 until their maturity, as well as an amendment to Regulation "On the risk management from large exposures of banks", through which banks may exclude from the calculations of maximum permitted exposure these type of exposures.
- Two Decisions "On the Suspension of the Profit Distribution from Banks", which stipulates, first up to June 2020 and then up to 31 December 2020, the suspension of the distribution by banks of the allocated profit from the previous periods and the profit realised during the 2020.
- Amendments to the Regulation "On credit risk management from banks and branches of foreign banks", in relation to non-compliance with the provisions on the classification and provisioning of loans up to the end of August 2020, as well as the handling of restructured loans during 2020; extending the entry into force of regulatory amendments



in relation to more restrictive requirements on loan restructuring for the date 1.1.2022 (forecasted to enter into force on 1.1.2021).

- Extending the effects of the Regulation “On out-of-court treatment of distressed borrowers by banks,” on 1 January 2022.

II. With a view to the approximation of regulatory requirements of the Bank of Albania with Basel III requirements and European regulations¹⁶, the following were approved:

- Amendments to the Regulation “On capital adequacy ratio,” which aim to primarily present the method of risk weighting of exposures, based on the credit quality assessment of the counterparty, when this assessment exists, in particular for classes of exposures to supervised institutions, to public sector units, and in the form of guaranteed obligations.
- Amendments to the Regulation “On the risk management from large exposures of banks”, accompanied also by several new reporting and monitoring requirements on banks.
- Amendments to the Regulation “On the consolidated supervision”, in accordance with the latest amendments in Regulation “On the risk management from large exposures of banks”, and Regulation “On the bank’s regulatory capital”.
- The new Regulation “On the financial lever ratio of banks”, which determines the criteria and rules to calculate the ratio of banks’ financial lever, which is calculated as the ratio of first level capital to the total of bank’s exposures (which includes balance sheet items, derivatives, financial transactions of securities and items outside balance sheet), and determines the minimal level of this ratio.
- The new Regulation “On the net ratio of sustainable financing of banks”, which determines the rules to calculate the net ratio of sustainable financing of banks and the minimal level of this ratio. This new regulatory act aims to complete the regulatory framework in force on the liquidity risk administration and complements Regulation “On liquidity coverage ratio.”

III. Pursuant to the Law “On the recovery and resolution of banks”, part of the early resolution framework, the following were approved:

- Regulation “On determining the conditions for granting the prior approval to the intra-banking group financial support agreement,” which lays down the conditions for granting the prior approval to the financial support agreement, that may be granted only by banks that are part of a banking group that falls under the consolidated supervision of Bank of Albania, and the requirements for documentation and its content for acquiring this approval from the Bank of Albania.
- Regulation “On determining the conditions for applying early intervention measures and on the conditions and manner of carrying out the temporary administration”, which lays down the conditions for applying early intervention measures and considers situations when applying early administration measures is probably sufficient to correct

¹⁶ Regulation (EU) No 575/2013 (Capital Requirements Regulation – CCR) and Regulation (EU) 2019/876 (CRR2).



the worsened situation of the bank.

- Regulation "On the establishment, licensing, supervision, functioning, and termination of the operation of the bridge bank," which is an overall review of the Regulation in force. This Regulation lays down the conditions for the establishment, licensing, supervision, functioning and termination of operation of the bridge bank, as a resolution tool.
- IV. In the framework of reviewing and improving the regulatory requirements, to adopt to market developments as well, the following were approved:**
- Amendments to the Regulation "On risk management in the activity of savings and loan associations and their Unions," based also on the requirements/propositions for regulatory amendments brought by savings and loan associations (SLA), to adopt to their developments during the latest years, and amendments to the Regulation "On the reports at the Bank of Albania accordingly to the Unified Reporting System," in accordance with the requirements provided for in Regulation "On risk management in the activity of savings and loan associations and their Unions."
 - Regulation "On the functioning of the Credit Registry of the Bank of Albania, and the conditions and procedures for recognizing, using and reviewing the data administered therein," which aims to regulate the functioning of the new system of the Credit Registry, the necessary conditions and procedures for recognizing, using and reviewing the data, as well as the fee on the use of data that are reported in this system.

2.4.4 LICENSING FRAMEWORK AND APPROVALS

The number of banks operating in Albania at the end of 2020 remains the same compared with the end of 2019. The Albanian banking sector continues to be dominated by foreign banking group subsidiaries, with capital mainly originating from the EU.

Table 5 Banks' ownership structure (number of banks at period-end)

	2014	2015	2016	2017	2018	2019	2020
Banks in Albania	16	16	16	16	14	12	12
Banks' ownership structure, by capital origin, of which:							
I. Majority foreign owned ¹	14	13	13	13	11	8	8
• EU-based banks	10	9	9	9	7	6	6
• Turkish based	1	1	1	1	1	1	1
• Majority owned by an international financial institution (Saudi Arabia)	1	1	1	1	1	1	1
II. Majority Albanian owned	2	3	3	3	3	4	4

¹ "The majority" is in any case a simple majority of 50 per cent of votes plus 1 vote.

² Banks with capital origin from EU countries at the end of 2020 are from: Italy (Intesa Sanpaolo Albania), Austria (Raiffeisen), Germany (Procredit), Hungary (OTP Bank, Albania), Greece (Alpha Bank Albania), and Bulgaria (First Investments Bank Albania).

³ National Commercial Bank.

⁴ United Bank of Albania.

⁵ Majority Albanian owned banks at the end of 2020 are: Union Bank, Credins Bank, American Bank of Investments and Tirana Bank.



In 2020, the Bank of Albania issued preliminary approval for:

- i. ownership of the qualifying holding of shares of one bank;
- ii. exercising additional financial activities in the role of insurance intermediary (1 bank), exercising additional financial activities of commerce, on behalf of clients, transferable government securities (1 bank) and exercising the additional financial activities of signing government securities etc. (2 banks);
- iii. amendments to the statutes of banks, appointments of legal auditors of all banks, the issuance and settlement of subordinate debt from banks, etc.

The Bank of Albania approved 46 bank administrators, specifically by position classification, 16 members of the steering council, 6 members of audit committees, 3 general executive directors and 21 executive directors and managers of the bank's internal audit.

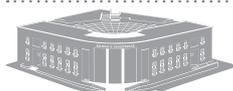
In 2020, the network of banks within the territory of the Republic of Albania was expanded with 3 new branches, while banks have reported reduction of the number of 8 branches and agencies within the country. As of the end of the year, banks operated through 425 branches and agencies.

Based on submission of applications, the Bank of Albania licensed one electronic financial institution (Albanian Post Office sh.a.), while suspending the financial activity of Platinum Investment l.t.d., a non-bank financial institution. In 2020, the activity licenses of three non-bank financial institutions were suspended, specifically:

- i. the license of the non-bank financial institution "Albanian Office Post" sh.a. as a result of transforming (licensing) into an electronic financial institution;
- ii. the license of the non-bank financial institution "Albanian Factoring Services" sh.p.k. by request of the entity;
- iii. the license of the non-bank financial institution "Pay and Go" sh.p.k as a supervisory measure.

Therefore, the number of licensed non-bank financial institutions was 30 at the end of 2020. Non-bank financial institutions received also preliminary approvals for 18 administrators, Chairmen of Steering Council and Chairmen of Control Council; approvals for the transfer of qualifying holding of capital quotes to three entities; approvals of two additional financial entities.

In 2020, no new savings and loan association was licensed (SLA), while an approval was issued for additional payment services for one SLA, as well as preliminary approvals for the re-appointment of the chairman of the Steering Council, the chairman of the Control Council and the administrator of one SLA.



In 2020, 43 new foreign exchange bureaus were licensed, while licences were revoked for 8 existing foreign exchange bureaus. As of the end of 2020, 538 foreign exchange bureaus were operating in the foreign exchange market.

Table 6 Number of banks, non-bank financial institutions, savings and loan associations and foreign exchange bureaus licensed by the Bank of Albania (end-period)

	2014	2015	2016	2017	2018	2019	2020
Banks and branches of foreign banks	16	16	16	16	14	12	12
Non-bank financial institutions	22	27	28	31	30	32	30
Foreign exchange bureaus	356	397	428	426	463	503	538
Unions of Savings and Loan Associations	2	2	2	1	1	1	1
Savings and Loan Associations	113	111	13	13	13	14	14

Source: Bank of Albania.

2.5 RESOLUTION

In accordance with the Law No. 133/2016 "On the recovery and resolution of banks in the Republic of Albania", the Bank of Albania is the Resolution Authority for banks and branches of foreign banks operating in Albania

The Resolution has oriented its activity toward fulfilling the targets envisaged in the medium-term strategy, such as:

- a) *Strengthening resolution in banks;*
- b) *Completion of the regulatory and methodological framework for resolution;*
- c) *Monitoring the Resolution Fund;*
- d) *Enhancing human and logistical capacities.*

The Bank of Albania has strengthened the resolution capacity in banks, through drafting resolution plans for the banking sector, intensifying the communication with banks regarding resolution reporting, continuously meeting the regulatory framework, as well as drafting new methodologies in accordance with the legal provisions. Furthermore, in 2020, the Bank of Albania carefully monitored the administration process of the Resolution Fund by increasing the level of automatization.

2.5.1 STRENGTHENING RESOLUTION IN BANKS AND RESOLUTION PLANS

In 2020, the Bank of Albania drafted the resolution plans for systemic banks, focusing particularly on selecting the preferred strategy for resolution. This strategy is based on the bank's business model, the financial capacity for loss absorption, the interconnectivity between financial entities of the banking group, as well as the operational capacities of the bank to implement resolution.



In accordance with this strategy, the Bank of Albania has identified potential obstacles to the implementation of resolution for each bank, by drafting an individual working plan to remove these obstacles. In conclusion, in accordance with the preferred resolution strategy, the Bank of Albania estimated the individual level of “minimum requirement of capital and eligible liabilities” that must be met by 2027. This minimum requirement enables the identification and allocation of the financial resources in the bank’s balance sheet that may be used by the Bank of Albania to implement the preferred resolution strategy.

In 2020, the Bank of Albania completed the first cycle of drafting the resolution plans regarding the non-systemic banks, by identifying the preferred strategy forecasted in the plan and the information necessary that a bank shall yield to operationally support the implementation of this strategy.

BOX 4 THE MINIMUM REQUIREMENT FOR REGULATORY CAPITAL INSTRUMENTS AND ELIGIBLE LIABILITIES

In compliance with the principles of the Law No. 133/2016, if a bank is insolvent, the shareholders and creditors of the bank shall absorb its losses by bearing the relevant financial burden and avoiding the utilization of public funds as much as possible. In order to allow the effective implementation of resolution instruments, these legal provisions stipulate that banks, at all times, must meet “the minimum requirement for regulatory capital instruments and eligible liabilities,” which is communicated by the Bank of Albania. The purpose of this requirement is for banks to have the necessary financial capacity to absorb losses in case of resolution, as well as to ensure the continuity of critical functions that it provides to the economy, without utilizing public funds.

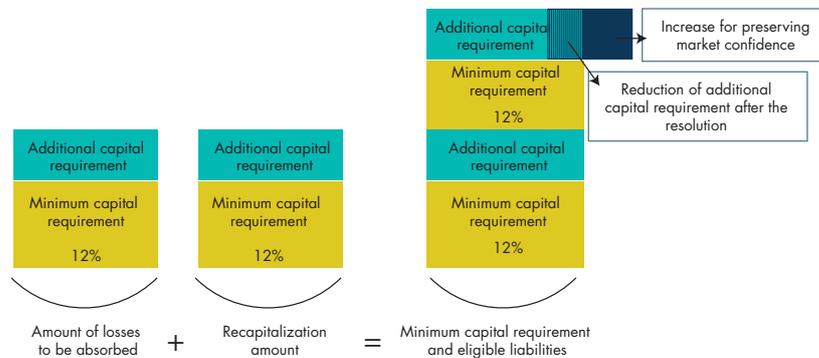
“The minimum requirement for capital and eligible liabilities” is a new regulatory requirement that must be met by banks, which strengthens their financial position and enhances the stability of capital position against possible financial shocks. In contrary to current regulatory requirements, which must be met by banks only through regulatory capital instruments, the minimum requirement for resolution purposes may be met by regulatory capital instruments (the surplus of regulatory capital resulting after banks have firstly met the minimum capital requirement) as well as other financial instruments that meet the conditions provided for by the Bank of Albania pursuant to the Law no. 133/2016, which are known with the term “eligible liabilities.” The banks must save and identify “eligible liabilities” instruments in their balance sheet, in order to allow for the conversion of these instruments into capital, in case regulatory capital instruments are not sufficient for the absorption of financial losses or the necessary recapitalisation of the bank.

“The minimum requirement for regulatory capital instruments and eligible liabilities” is a preliminary condition to be met by all banks, which is necessary for the implementation of resolution plans drafted by the Bank of Albania. With the purpose of determining the methodology of calculating the minimum requirement, as well as the conditions to be met by the financial instruments that may be known as “eligible liabilities”, during 2020, the Bank of Albania approved the Regulation “On the minimum requirement for capital and eligible liabilities.” According to this Regulation “the minimum requirement for capital and eligible liabilities” is calculated as the sum of two indicators, the necessary amount of



the losses to be absorbed and the necessary amount for recapitalisation. Chart 26 shows the scheme for calculating the minimum requirement.

Chart 26. Calculation of minimum requirement for capital and eligible liabilities



Source: Bank of Albania.

More specifically:

- a. "The amount necessary for loss absorption" ensures the bank to absorb its financial losses through regulatory capital. This fulfilment of this requirement is guaranteed at all times by the bank's fulfilment of the total regulatory capital requirement (minimum requirement for regulatory capital of 12% of weighted risk exposures and the requirement for additional capital determined by the Bank of Albania for specific banks).
- b. "The amount necessary for re-capitalisation" ensures, if necessary, the bank to re-capitalise through internal financial resources, which it will identify for this purpose, that are known as "eligible liabilities." Following the implementation of resolution, for the bank to continue to fulfil capital requirements, which guarantee its license preservation, it must recapitalise up to the level of the total regulatory capital requirement communicated by the Bank of Albania (which again consists of the minimum requirement of 12% of the weighted risk exposure and the requirement for additional capital applied to specific banks). In the conditions following resolution, it is supposed that the bank's balance sheet and the specific risk profile may change. After resolution the additional requirement for capital that the bank must fulfil, may be lower if the specific risk is assessed to be falling, or higher, if it is deemed necessary to protect market credibility in the bank's financial position.

In 2020, the Bank of Albania calculated the "minimum requirement for capital and eligible liabilities" based on the provisions laid down in the regulation approved by the Supervisory Council during December. The final deadline for fulfilling the minimum requirement for each bank is December 2027. During the transitory period up to the fulfilment of the requirement, the Bank of Albania will communicate every year the minimum intermediary requirement that banks must fulfil to ensure the gradual fulfilment of the final requirement, within 2027.



2.5.2 COMPLETION OF THE REGULATORY AND METHODOLOGICAL FRAMEWORK FOR RESOLUTION

In 2020, the Bank of Albania has approved several sub-legal acts and decisions in the field of resolution, as below:

- a. By means of Decision No. 2/2020, dated 17.1.2020, the Supervisory Council of the Bank of Albania approved the amendments to Regulation "On the Resolution Fund and its administration procedures," with a view to determine the deadlines and the automatization of the reporting process for banks and the Deposit Insurance Agency in relation to the Resolution Fund.
- b. By means of Decision No. 56/2020, dated 7.10.2020, the Supervisory Council of the Bank of Albania approved Regulation "On the organisation and functioning of the Committee for the Resolution Fund," which aims to establish a special committee in the Bank of Albania for the Fund's administration procedures.
- c. By means of Decision No. 57/2020, dated 7.10.2020, the Supervisory Council of the Bank of Albania approved Regulation "On the operationalisation of the bail-in tool and exceptional cases," which aims to determine the conditions that the Bank of Albania should take into consideration when exercising the power of write-down and conversion of liabilities and bail-in tool, as well as exceptional cases from exercising this power.
- d. By means of Decision No. 58/2020, dated 7.10.2020, the Supervisory Council of the Bank of Albania approved "The exemption from all commissions applied to all accounts with the payment system of the Bank of Albania, for the administration of the Resolution Fund," a Decision which aims at increasing the efficiency of financial assets of the Resolution Fund by decreasing the expenditures of the administration of the Resolution Fund.
- e. By means of Decision No. 62/2020, dated 4.11.2020, the Supervisory Council of the Bank of Albania approved Regulation "On the establishment, licensing, supervision, functioning, and termination of the operation of the bridge bank," which aims at the operationalisation of the bridge bank instrument when it is expected to be applied.
- f. By means of Decision No. 68/2020, dated 25.11.2020, the Supervisory Council of the Bank of Albania approved the amendments to Regulation "On Resolution Plans," which lays down the objectives that the bank must fulfil to be considered capable for implementing resolution.

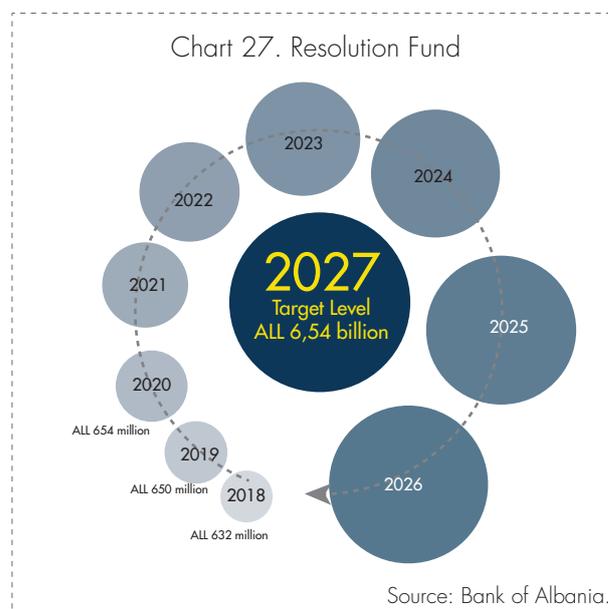


- g. By means of Decision No. 78/2020, dated 16.12.2020, the Supervisory Council of the Bank of Albania approved Regulation "On the minimum requirement of regulatory capital instruments and accepted liabilities," which determines the minimum requirement of capital and accepted liabilities, as the main resource for financing and recapitalising the bank in resolution, when implementing the recapitalisation instrument from within.

And lastly, during this year, the methodology "On assessing the public interest on resolution in banks" was drafted, which determines the factors that the Bank of Albania takes into consideration for determining the presence of public interest during the drafting stage of the resolution plans and during the implementation stage.

2.5.3 RESOLUTION FUND AND MONITORING OF ITS FINANCIAL ASSETS

Pursuant to Law No. 133/2016, the target level of the Resolution Fund is 0.5% of the total liabilities of the banking sector and it is calculated as the difference between the assets and capital of banks operating in Albania, which must be built up by 2027. The target level, estimated in 2020, was ALL 6.54 billion. In April 2020, banks completed the payment of the second year of annual contributions to the Resolution Fund in the amount of ALL 654 billion. These contributions, which constitute the financial assets of the Resolution Fund, are managed by the Deposit Insurance Agency in accordance with the criteria established in the investment policy of the Fund's financial assets. At the end of 2020, the Resolution Fund reached the level of about ALL 1.98 billion.



2.6 CURRENCY ISSUE

The Bank of Albania has the exclusive right for the issue and circulation of the national currency- the Albanian lek. The Bank of Albania determines the form, measure, weight, model and other features of Albanian banknotes and coins of legal tender in Albania, as well as of coins and banknotes for numismatic purposes.

Bank of Albania objectives in the field of currency issue include improving the quality of banknotes in circulation, increasing the engagement for protection against counterfeiting and review of themes, design and security features in the Albanian banknotes series of legal tender.



One of the main responsibilities of the Bank of Albania is to ensure public confidence in the national currency. The central bank fulfils this responsibility by issuing a banknote that communicates security and stability to the Albanian public. This is because banknotes represent the most tangible form of money and are at the service of all citizens.

To fulfil its constitutional and legal mission of putting into circulation the national currency and safeguarding its credibility, the Bank of Albania has continued to print the new and improved series of Albanian banknotes of legal tender.

After putting into circulation the 200 Lekë and 5000 Lekë banknotes on September 2019, the work to complete the new series of 1000 Lekë and 10000 Lekë denomination banknotes has continued. Both these banknotes will be put into circulation in 2021. Meanwhile, work has also continued for the 500 Lekë and 2000 Lekë denominations, which will complete the entire new series of banknotes.

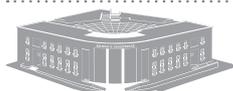
Completing the new series of banknotes with contemporary and sophisticated security features have given the Albanian banknote a modern, yet durable appearance, a quality banknote with high integrity and reliability.



The number and value of banknotes and coins in circulation increased in 2020

At the end of 2020, there were about 156 million notes in circulation worth about ALL 349.7 billion¹⁷. Compared to 2019, the number of banknotes in

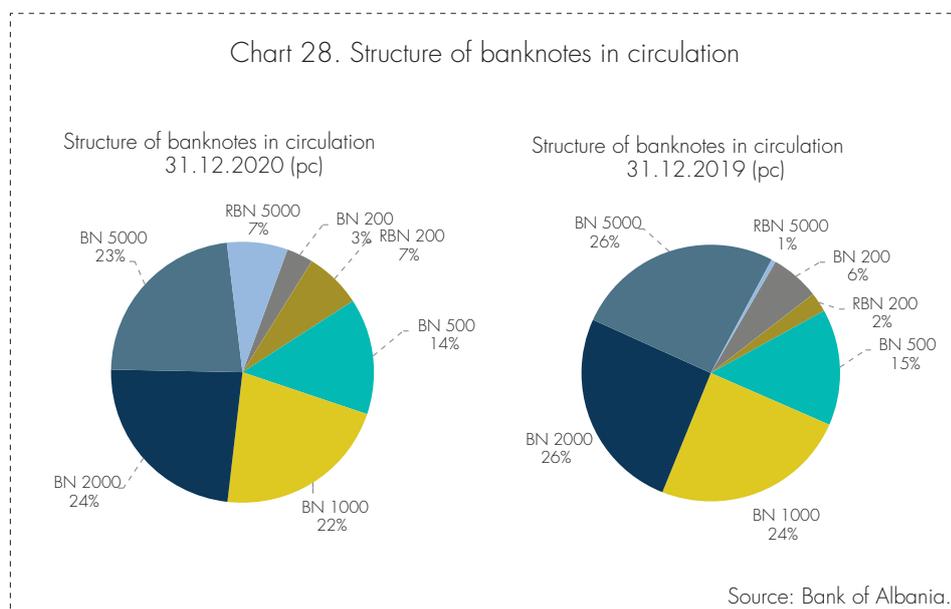
¹⁷ It is the number and value of banknotes put into circulation by the Bank of Albania.



circulation increased by about 16 million notes (10.3%), while in value there was an increase of 52.2 billion (14.93%). The increase in value and number of banknotes in circulation was higher than the annual average increase and was mainly due to the special circumstances caused by the pandemic. The increase of the national currency in circulation beyond the average values has been observed in other countries as well.

The structure of the currency in circulation has changed in favour of banknotes with a nominal value of 5000 Lekë and 2000 Lekë. The average value of a banknote in circulation at the end of 2020 reached 2,242 Lekë, from 2,126 Lekë at the end of 2019.

Chart 28. Structure of banknotes in circulation



At the end of 2020, there were 226 million coins, from 217 million at the end of 2019. The value of coins at the end of the year reached ALL 5.6 billion, from 5.4 billion at the end of 2019.

The speed of cash recirculation decreased and the quality of banknotes in circulation is kept under control

In 2020, around 82 million banknotes were processed, and were checked for authenticity and fitness for circulation. The sorting rate¹⁸ was 19.6% compared to 20% in 2019. Unfit banknotes were replaced with new banknotes fit for circulation.

The banknote circulation coefficient¹⁹ for 2020 was 0.56, implying that a banknote is returned to the cash desks of the Bank of Albania, on average

¹⁸ Ratio of unfit banknotes and coins to the total number of banknotes and coins sorted during one year.

¹⁹ Ratio of the number of banknotes returned to the Bank of Albania cash desks to the average annual number of banknotes in circulation.

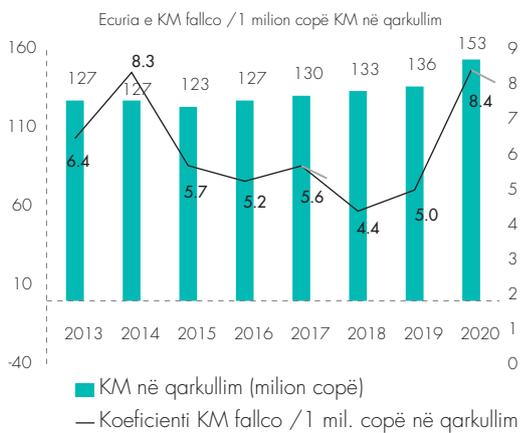


less than once a year. This coefficient is higher for 500 Lekë and 1000 Lekë banknotes (about 1.2 and about 0.78 respectively) and lower for 5000 Lekë banknote about 0.13, showing that the latter are returned more rarely to the cash desks of the Bank of Albania.

Bank of Albania aims to increase and strengthen technological and administrative capacities dedicated to protecting banknotes from counterfeiting

During 2020, despite the pandemic conditions, the Bank of Albania has carried out actions in view of safeguarding the currency from counterfeiting. These actions are preventative in nature, mainly focusing on testing and monitoring the processes of authenticating and sorting machines/equipment used by the professional staff. It is encouraged to identify and withdraw from circulation suspected banknotes and use authenticating and sorting machines/equipment successfully tested by the Bank of Albania. The public is recommended to verify the authenticity of the banknotes when accepting them based on the method “Feel, Look; and Tilt” published in the website of the Bank of Albania.

Chart 29. Counterfeited banknotes statistics



Source: Bank of Albania.

The quantity of counterfeited banknotes discovered in circulation has increased during 2020, meanwhile coins continue on the same trend compared with previous years. However, the coefficient of counterfeited banknotes per 1 million banknotes in circulation remains low.

By structure the 2000 Lekë and the 1000 Lekë denominations have the main share in the total counterfeit banknotes, followed by the 5000 Lekë and the 500 Lekë denominations. From the technical and/or technological aspect of counterfeiting Albanian banknotes, colour digital printings dominate, mainly ink-jet, accompanied by the use of additive artisanal and technological methods to imitate security elements.

2.7 PAYMENT SYSTEMS

Operation, oversight and reform of payment systems are some of the main functions of the Bank of Albania. Their implementation guarantees the security, sustainability and efficiency of the basic infrastructure of payments in lek. This is a crucial precondition for transmitting the monetary policy, safeguarding financial stability and the overall economic growth.

In fulfilment of these responsibilities, the Bank of Albania, beyond the stable operation of payment systems, has paid particular attention to the oversight and catalysing role in the fulfilment of the National Retail Payments Strategy.



2.7.1 PAYMENT SYSTEM OVERSIGHT

Throughout 2020, the Bank of Albania, in order to fulfil the oversight function of payment systems, finalised the overall evaluation of AIPS system according to the oversight principles of the European Central Bank. The evaluation process analyses and provides recommendations where necessary for all types of risks borne by the operation of the system, starting from the legal and governing risk, financial and operational risks, to including the transparency and objectivity of the system participation rules.

The evaluation of AIPS system was conducted with the support of the Central Bank of Italy in the framework of Twinning Project "Enhancing Bank of Albania's alignment with EU Acquis." The rules, procedures, and infrastructure of AIPS system is fully aligned with the standards of the Central European Bank and the provided recommendations are deemed to be easy to address. The positive results of this evaluation guarantee the stability of the core infrastructure of financial markets and are significant to the continued efforts on capital market developments.

The oversight of AECH system has also derived attention during the year, as an analysis was conducted on the fulfilment of recommendations given for the system evolution in 2018. The safety and efficiency guarantee of this system is quite important for the development and modernization of the small-value payments market, which is among the priorities of the Bank of Albania, in the framework of the National Retail Payments Strategy 2018-2023.

In the framework of regulating payment services, the Bank of Albania increased the efforts for the approval of the Law No. 55/2020 "On Payment Services," by the Parliament of the Republic of Albania²⁰, and intensified the work on drafting the bylaws for its implementation. The Bank of Albania has collaborated with the World Bank for drafting the regulatory framework. There has been collaboration with the Bank of Italy regarding specific components, such as Deep Customer Authentication and cybernetic security.

Measures have been taken in relation to drafting the legal act for the transposition of the European Union Directive "On payment accounts". This Directive, besides further encouraging transparency and competition through creating standardized procedures for transferring/switching the customer's account from one bank to the other, is expected to bolster the financial inclusion of people by presenting an account with basic characteristics. This type of account does not have a minimum cost for persons who currently do not have any access to banks.

Prior measures have been taken for the conduction of a survey, which has been sent to banks in relation to the financial inclusion and banking products

²⁰ Law "On Payment Services" approved on 30.04.2020.



offered by them. The information presented from this survey may help the Bank of Albania to draft the legal framework on the transposition of the Directive regarding the determination of fees for instruments and services relevant to these “accounts with basic features.” The results of the survey have identified the fields where more detailed investigation may continue as regards the connection between opening a “payment account with basic features” and its impact to the financial inclusion.

The Bank of Albania has also initiated a series of projects for building and improving the infrastructure of the payment system such as: building the system for settlements in euro, where, during the year, the terms of references were finalised and the procurement of the system development has started; instant payment development which is drafting the project completion report in collaboration with the World Bank a Project; direct debiting function, while working for drafting a regulatory framework.

2.7.2 THE REFORMATORY ROLE OF THE BANK OF ALBANIA IN PAYMENT SYSTEMS

The Bank of Albania has continued its work for the implementation of the National Retail Payment Strategy in Albania (2018-2023). In 2020, a set of measures have been undertaken for implementing a considerable degree of the action plan of this strategy.

BOX 5 APPLICATION OF THE ACTION PLAN OF THE NATIONAL RETAIL PAYMENTS STRATEGY UP TO 2020

In the framework of monitoring developments in relation to National Retail Payment Strategy (2018-2023), the 6th meeting of the National Payment System Committee (NPSC), on 17 December 2020, presented the measures provided for in the action plan, short-term priorities, as well as a review of some deadlines on measures which are in process. This analysis, besides the support to NPSC for monitoring the fulfilment of objectives, aims to encourage transparency and accountability of the Committee. It must be emphasized that the fulfilment of strategy is ever more important due to the interconnection it has to both the national and cross border plan. More concretely, a series of measures forecasted in the strategy support the fulfilment of objectives of the Cross-institutional Working Group on Development and Electronic Commerce in Albania, National Strategy for Diaspora and Emigration, and it is part of the 10th reform of the Economic Reform Programme 2021-2023.

In this framework the conducted analysis identified that, up to now, over 50% of the forecasted measures in the action plan strategy were realised. The following analyses the measures achieved primarily in 2020.

- ***The approval of the Law “On the Payment Services”(PSD2) which transposes the reviewed EU Directive 2015/2366***



This Law, through re-dimensioning the non-bank financial activities which currently offer payment services and transfers (but including those that will potentially enter the market) and allowing the opening of bank accounts by them (currently forbidden by the legal framework in force "On Banks in the Republic of Albania" which classifies every credit surplus as deposit) and issuing of electronic payment instruments, will impact the increase in population that has an account to carry out payments. More specifically, if citizens currently use the Albanian Post Office, Western Union, Money Gram to conduct and receive payments, but cannot have an account in these institutions, the Law No 55/2020 "On the Payment Services" enables and encourages the use of electronic payments through these accounts. By taking into consideration the fact that these institutions have a geographical presence even in rural areas, the impact on financial inclusion will be high. The Law also creates possibility of collaboration between banks and non-bank financial institutions, which helps a larger presence of banks across the territory. The prudential framework for consumer protection provided by this Law will have an impact on financial inclusion. Also the spaces created by the innovative services will allow the larger public to use electronic payments daily.

The objectives achieved by the approval of the Law and the implementing bylaws fulfil the action plan measures as below:

1. Comprehensive regulation of agents and sub-agents for offering payment service and related services.
 2. Sustainable regulation of subcontracted services used by third parties in the entire payments sector, focusing specifically on using the technical service providers.
 3. Including regulation and supervision related to payment services in the legal framework.
 4. Creating a Consumer Protection Unit for payment services and more broadly.
 5. Creating a specific structure at the Payment Service Providers for addressing disagreements.
 6. Creating the banking concept that functions with an agent network.
 7. Encouraging competition and innovation in immigrants' remittances.
 8. Guaranteeing contracts that determine clear and applicable rights and obligations for service providers and users.
 9. Keeping an agent register used by banks and payment service providers. This register will be public and available to consumers.
- **Review the Regulation on the functioning of AIPS and AECH systems and the assessment of systems according to the supervisory principles of the Bank for International Settlements (BIS) and the European Central Bank (ECB), supported by the Bank of Italy.**

By reviewing the regulatory framework for the functioning of AIPS and AECH systems, where a series of findings and evaluations of the systems are reflected according to supervisory principles of BIS and ECB, a set of measures were fulfilled, as evidenced below:

1. Regulations and other rules on the entire infrastructure of the payment system in the Albania will guarantee direct and open access. Where necessary, legal reform will apply.
2. The operationalisation of the "indirect-participants" category of AECH.
3. Analysis of the ability to collateralise ex-ante / net debit positions caused



by participants of AECH. To also analyse the limits set for net debit positions of AECH participants.

4. Detailed assessment of AIPS and AECH based on CPMI-IOSCO of PFMI and the specific regulation of ECB: prepare a detailed self-assessment, conduct an external assessment. The payment systems operated by the private sector apply strict measures on risk management.
5. Assurance that payment service providers and payment service operators regularly review their cost and price structure (Home Banking).

- **Infrastructure developments**

1. Finalisation of the terms of reference for euro settlements and initiation of the procurement of system developments.
2. Draft of a regulatory framework on the functioning of Direct Debiting scheme.
3. In the framework of Instant Payment development an analysis/observation was carried out by banks in order to draft the report on project viability and the "ALBANIA: A Review of Implementation Options for Fast Payment System" report in collaboration with the World Bank.

In the framework of fulfilling its catalyst role, the Bank of Albania organised the VI²¹ meeting of the National Payment Systems Committee on December 2020. In this meeting, besides the presentations on fulfilling the National Retail Payment Strategy, as well as short-term priorities and the necessary measures for their realisation, a series of issues were addressed to support market developments. In relation to the creation of Open banking and Application Programming Interface (API) and the implementation of obligations of banks in compliance with the Law on Payment Systems, the experience of markets, which aim to maximise the effects against the reduction of investment needs, was presented. The membership of non-bank institutions in AECH system also derived attention. To address these topics, besides the members of the Committee, international institutions and companies were invited to attend the meeting, such as the World Bank, SWIFT, TIETO and CBI S.c.p.a.

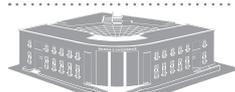
2.7.3 THE OPERATOR ROLE OF THE BANK OF ALBANIA OF AIPS AND AECH SYSTEMS

The Bank of Albania has continued to play its crucial role in enhancing the normal functioning of payment systems, where the main infrastructure consists of AIPS²² and AECH²³ systems. This role has been important in promoting safety

²¹ https://www.bankofalbania.org/Pagesat/Komiteti_Kombetar_i_Sistemit_te_Pagesave/Mbledhja_e_Gjashte_Vjetore_e_Komitetit_Kombetar_te_Sistemit_te_Pagesave_17_dhjetor_2020.html

²² AIPS system is considered the core infrastructure for the settlement of payments in the national currency and of financial markets https://www.bankofalbania.org/Pagesat/Sistemi_nderbankar_i_pagesave_me_vlere_te_madhe_AIPS/

²³ AECH system which accommodates the clearing of interbank transactions by banks' clients (households and enterprises). https://www.bankofalbania.org/Pagesat/Sistemi_i_klerimit_te_pagesave_me_vlere_te_vogel_AECH/

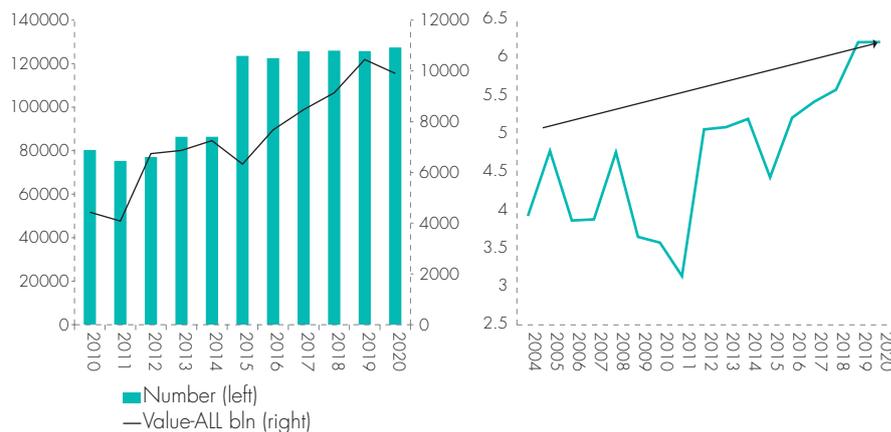


and efficiency, particularly in the first half of the year, taking into account the effect of "natural disasters" declared by the Albanian government. These two systems, administered and operated by the Bank of Albania, have continued to operate safely and efficiently. Both systems have offered maximum availability (99.66% for AIPS and 99.99% for AECH), and have always accommodated the needs of the market.

ALBANIAN INTERBANK PAYMENT SYSTEM FOR LARGE-VALUE PAYMENTS (AIPS)

A volume of 127,500 transactions was settled in AIPS, with a total liquidity circulating in the system of ALL 9,905 billion. Compared to the previous year, the volume and the value of settled transactions reflected an increase by 1.38% and a decrease by 5.24%, respectively. The value of transactions processed in AIPS in relation to the GDP is assessed at almost the same levels compared to 2019.

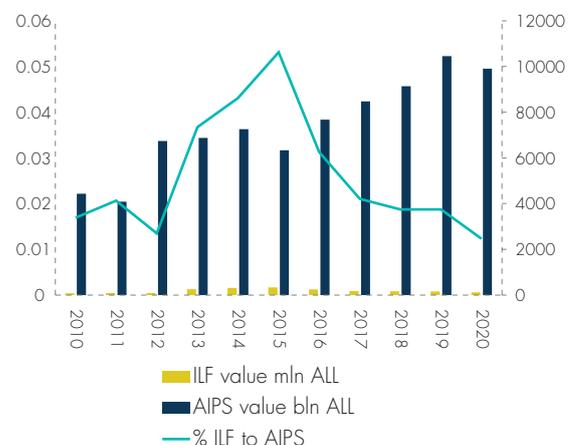
Chart 30. Number and value of transactions processed in AIPS (left) and the ratio of activities against GDP (right)



Source: Bank of Albania.

Referring to the use of this system by different transaction typologies, the item "Payments for Clients" (with main share of payments in terms of figures, 62.5%) continues to register increasing rates in both figures and value. On the other side, "Settlements in the AFISaR system" accounting for 25.6% of the total value of transactions processed in AIPS, registered a decrease of almost 3.4% in the number of transactions, and an increase in volume of 6.2% compared with the previous year.

Chart 31. Intraday Loan Facility (ILF) ratio to total value settled in AIPS



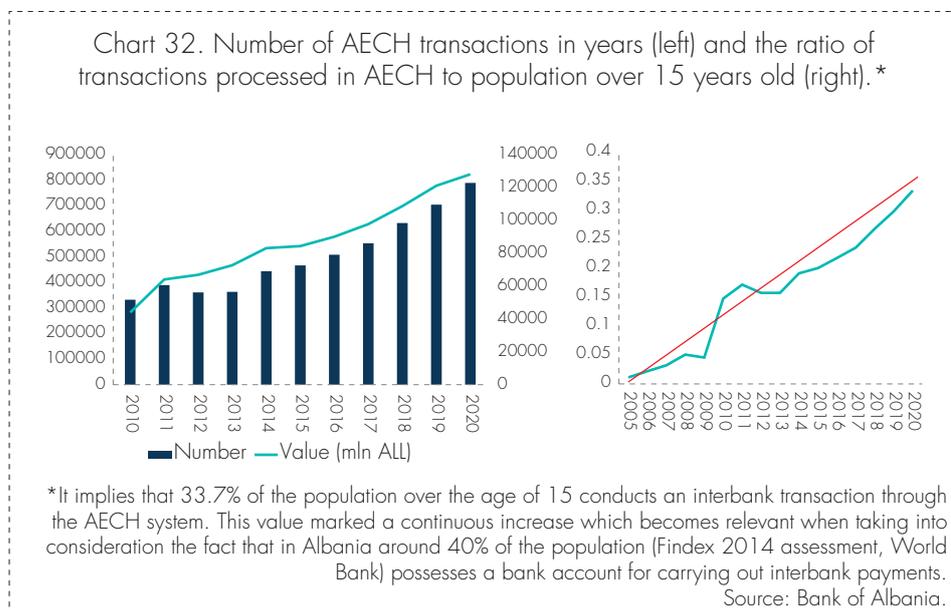
Source: Bank of Albania.



The Interday Loan Facility (ILF) registered a fall by 28.93% in terms of the number, and a rise by 26.1% in terms of value, driving to an increase of the average value per transaction. It must be noted that the decrease in the use of ILF through the years indicates a decline of the exposure of the system to liquidity risk.

ALBANIAN ELECTRONIC CLEARING HOUSE FOR RETAIL PAYMENTS (AECH)

The activity of the AECH reflected an increase, despite the situation created by the pandemic. In annual terms, the number and value of AECH payments have increased by 12.0% and 5.8%, respectively.



The ratio of AECH transactions in relation to population has continued to increase, reflecting a greater usage of this system by the general public. The continuous increase of the use of AECH transactions, mainly payments for bank clients²⁴, indicates the efficiency of the measures taken by the Bank of Albania (in 2011 and also in 2020) on commissions applied by banks on the final user in order to expand the use of this system.

²⁴ The analysis of the payment distribution indicator according to the participants is evidence that customer payments initiated by banks continue to hold the main share of transactions processed in the in AECH system, dominating the transactions initiated by other participants (Ministry of Finance and Economy, the Bank of Albania).



BOX 6 REVIEW OF THE REGULATORY FRAMEWORK OF AIPS AND AECH SYSTEMS AND MARKET IMPACT

In June 2020, the Bank of Albania approved the new regulations of AIPS and AECH systems. These reviews, among others, aim to address a series of market observations and further promote the measures foreseen in the National Retail Payment Strategy.

The main innovations of these reviews relate to the expansion of participations in the AECH system with non-bank financial institutions and the creation of well-defined requirements for cross-participating in both these systems, by aiming to address the risks carried on from these interconnections.

More specifically, the expansion of the participation of non-bank financial institutions, which offer payment services and electronic money, aims to encourage the interactivity among these institutions and banks. This enables these institutions to offer the most efficient services, which are provided mainly to the population category that does not have a banking approach. However, accommodating the participation of these institutions also creates added risks to the system, be it operational and financial, which was addressed through the clear determination of technical, operational and settlement conditions for the participants.

The review of the regulatory framework for the AIPS system aimed at creating the necessary conditions for the membership of private operators of licensed systems by the Bank of Albania. This enables various infrastructures to settle in the AIPS system including the ALREG operator, which functions as a Central Private Securities Depository and it is an important component to the functioning of the stock and capital markets.

The above-mentioned developments directly impact the increase in the activity of both systems as well as the risks carried on. In this framework, the regulatory reviews, besides the conditions determined to minimise risks, have consolidated the collaboration with a series of functions of the Bank of Albania, which relate to the stability and sustainability of these systems and the participants therein.

Lastly, the regulatory framework reviews addressed the need for a differentiation in commission between the system's payments initiated electronically and those in paper form. These reviews were based on the cost evaluation carried on by banks for their offer and reflected the objectives of the National Retail Payment Strategy on encouraging the use of electronic payments.

More specifically, the provisions of the regulatory framework provide the elimination of commissions for retail payments initiated electronically through home banking services for up to 20,000 Lekë and the differentiation of commission for the other payment part initiated through home banking for up to 50% of commissions applied for paper format payments. In this line, the Bank of Albania has determined the ceiling value for commissions applied by banks for payments processed in the AIPS and AECH systems, 1,500 and 500 Lekë respectively, since 2011. These ceilings will actually apply only for payments initiated in paper format.

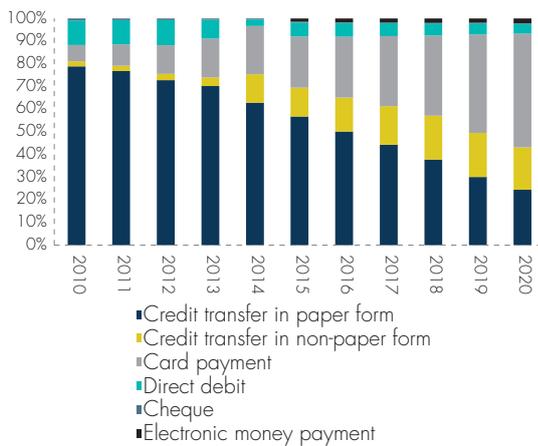
Encouraging the use of home banking services is necessary in the framework of promoting the innovation resulting from the implementation of the Law "On the payment services" and the Instant Payment project.



2.7.4 PAYMENT INSTRUMENTS

In 2020, the use of electronic payment instruments recorded an upward trend compared with the previous year. The reports of banks on payment instruments demonstrate that, up to year-end, there has been a continuous expansion of electronic payments such as bank cards and electronic money payments (pre-paid cards), as well as home banking.

Chart 33. Volume of payment instruments in years.



Source: Reports submitted by banks according to the "Methodology for reporting payment instruments"

The volume of payment instruments has increased by 18.5%, reaching a total level of around 22.06 million payments, while the total value of payments has slightly decreased by 2.9%.

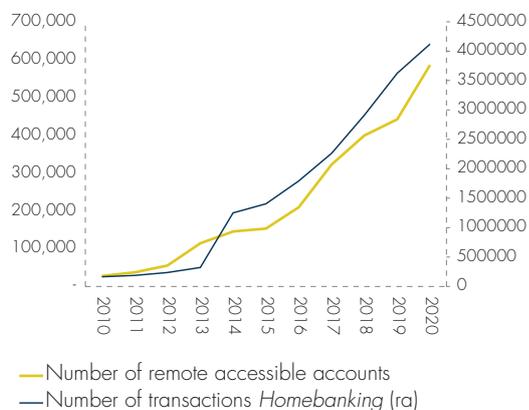
In terms of instruments used, the payment analysis indicates a continuous expansion of electronic payments. Card payments are the main payment instruments accounting for 50.1% of the volume, surpassing for the first time credit transfers in paper form. This increase is also due to movement restrictions during the pandemic.

E-money payments, a relatively new payment instrument, are being used exclusively by individuals, than businesses. Meanwhile, the same trend is noted in card payments, which continue to be used more

by individuals than businesses (with a usage ratio of 97.2% for individuals and 2.8% for businesses). On the other hand, businesses continue to reflect a more traditional use of banking (credit transfer in paper form, non-paper, cheques etc.) compared with individuals.

HOME BANKING

Chart 34. Volume of home banking transactions and account numbers offering these services



Source: Reports submitted by banks according to the "Methodology for reporting payment instruments"

The initiation of credit transfers in electronic form is realised through "home banking" services, which are provided by 11 of the 12 banks that operate in Albania. These services are both increasingly widespread in the Albanian market, and used to carry out payments, not only for basic information services for the account, but also for on-line payments.

In 2020, there was a significant increase in the volume of home banking payments, by 13.7%, and of the value of these transactions by 8.8%, compared to the previous year. Contributions to the upward trend of home banking were assessed to be the measures undertaken by the Bank of Albania and the policies



of banks, in the framework of promoting these alternative payment means. These measures were reflected in an increase in remote accessible accounts by 32.6% and an increase, against the total account, of 19.8%.

From the point of view of the use of internet accessible accounts, until the end of 2020, there were 7.03 transactions in non-cash payments per account, further approaching the level aimed by the National Strategy for Retail Payments (of 10 non-cash payments per capita by the end of 2022).

BANK CARDS

At the end of 2020, all the banks that operate in the Republic of Albania were licensed as card issuers, of which seven were licensed also as card accepters. The infrastructure provided by these banks has trended upward in terms of the number of POS terminals (increasing by 8.5% compared with 2019). Despite the positive trend of the increase of the number of POS terminals, reflected in the POS report per 1.000.000 citizens (4268 in 2020), their concentration continues to remain high in the region of Tirana²⁵, at 88.5%

A considerable increase was experienced by the virtual POS terminals, by means of which card payments could be done online for the purpose of electronic commerce. The banking system has offered such services since 2013, but the pace of use expansion by traders who want to conduct electronic trading, has been quite moderate. Meanwhile in 2020 the virtual POS terminals increased by 44. The development of this infrastructure is quite welcome in the framework of promoting the use of electronic payments. The implementation of the Law No 55/2020 "On Payment Services" will also have a positive impact in this regard.

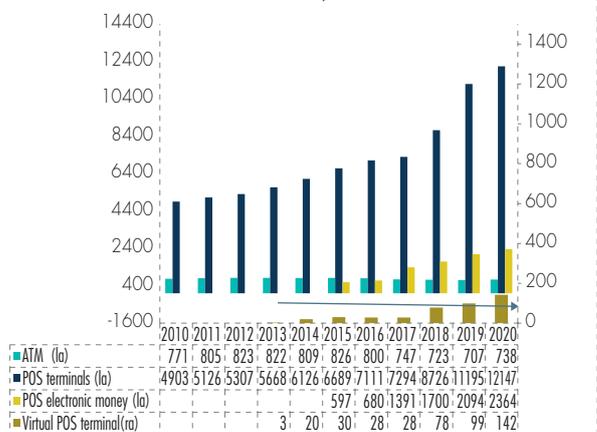
At the end of 2020, the number of ATMs has increased at 738, compared with 707 terminals in 2019²⁶. Although ATMs are used mainly for cash withdrawal, in 2020 there was an expansion of ATM functions for carrying out deposits and transfers.

Positive developments were shown for ATMs, the use of which increased, to 12.9%, compared to the end

²⁵ Division of districts by branches of the Bank of Albania.

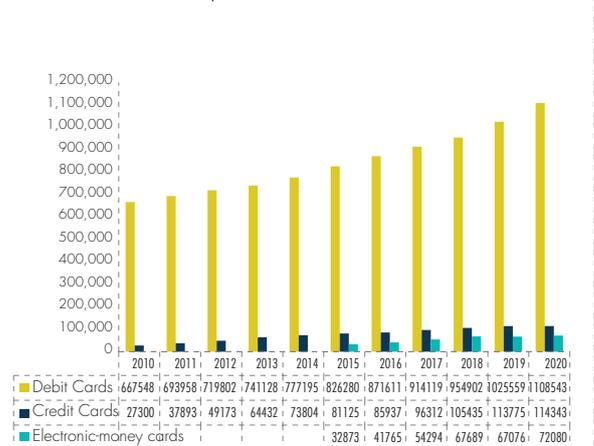
²⁶ At the same time, the number of banks fell from 14 at end-2018, to 12 at end-2019.

Chart 35. Performance of ATM and POS terminals across the years.



Source: Reports submitted by banks according to the "Methodology for reporting payment instruments"

Chart 36. Developments in debit and credit cards



Source: Reports submitted by banks according to the "Methodology for reporting payment instruments"



of 2019. Bolstering the use of electronic money instruments is estimated to have an impact on the financial inclusion of the population by enabling access to banking services from categories of the population that are not able access other services.

In 2020, the issue of debit cards increased by 5.6% and the issue of credit cards decreased by 4.3%. Also, the functioning of electronic-money cards in the market increased by 7.5% compared with the previous year.

Electronic money products, based on the legal and regulatory framework of the Bank of Albania, are also provided by non-bank financial institutions licensed as Electronic Money Institutions. Currently, in the Albanian market, three electronic money institutions are operating. In 2020, these institutions together have conducted a volume of around 3.8 million electronic money payments, with a value of ALL 10.8 billion.

The electronic money, although trending upwards, remains at low levels, but it creates a value added to that part of population that does not access bank accounts. The licensing of the Albanian Post is a very positive development in the electronic money market of non-banking financial institutions. This institution has expanded its presence in the territory of the Republic of Albania.

2.8 INTERNATIONAL RESERVE MANAGEMENT

The Bank of Albania is the authority responsible for maintaining and managing the international reserve of the Republic of Albania. It uses its best opportunities to achieve and maintain a certain level of international reserve, conducive to Albania's financial stability, and in accordance with monetary policy

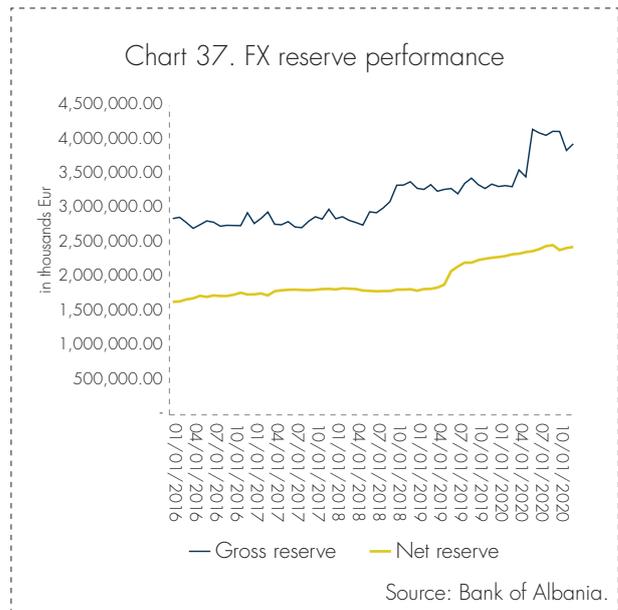
The Regulation "On the policy and management of the international reserve", approved by the Supervisory Council, lays down the purposes of maintaining the international reserve. In compliance with the best international practices, the purpose of maintaining the international reserve is implementation and support of monetary policy and exchange rate policy, as well as safeguarding of financial stability. The primary objectives of international reserve management are liquidity and security. Ensuring returns from reserve funds management represents a third objective, as long as it does not infringe the objective for liquidity and security. The Supervisory Council also approves the qualitative principles and criteria for the development of international reserve management. In order to implement these criteria, the Investment Committee approves the quantitative indicators and follows the application of the investment policy through the periodical publications.

During 2020, several amendments were endorsed in the Regulation "On the policy and management of the international reserve". The main purpose of



these amendments is to include the new class of instruments to the accepted instruments for investment – Mortgage Backed Securities (MBS). Investment to the new class of financial investments will be realised through the World Bank in the role of the external administrator and will extend across a one-year investment time length, becoming part of the investment range of the foreign exchange reserve. Furthermore, the decrease of the minimum accepted level for bank ranking and other financial institutions from AA- to A-, was approved.

At the end of December 2020, the stock of gross foreign currency reserve was EUR 3,945.29 million, including monetary gold, at EUR 137.06 million, or 3.5% of the total.



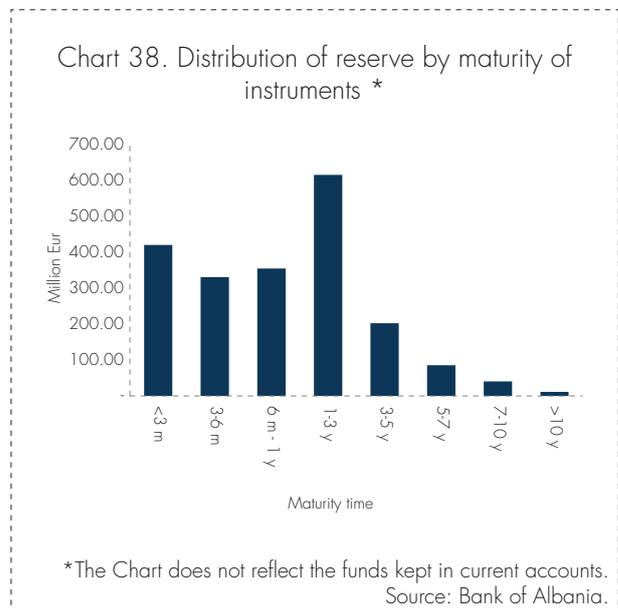
COMPOSITION OF THE RESERVE PORTFOLIO BY CURRENCY

At the end of 2020, the composition of the gross international reserve was: USD 19.0%; EUR 64.9%; GBP 2.1%; JPY 2.0%; AUD 1.2%; SDR 5.8%; Gold 3.5%; RMB 1.5%.

The exposure in AUD (Australian dollar) and RMB (Chinese Renminbi) reflects the decision of the Supervisory Council for investing part of the reserve according to the SDR basket. The share of renminbi (RMB) is distributed onto two currencies, RMB and AUD, according to a ratio that is subject to the Investment Committee’s approval.

COMPOSITION OF RESERVE PORTFOLIO BY MATURITY

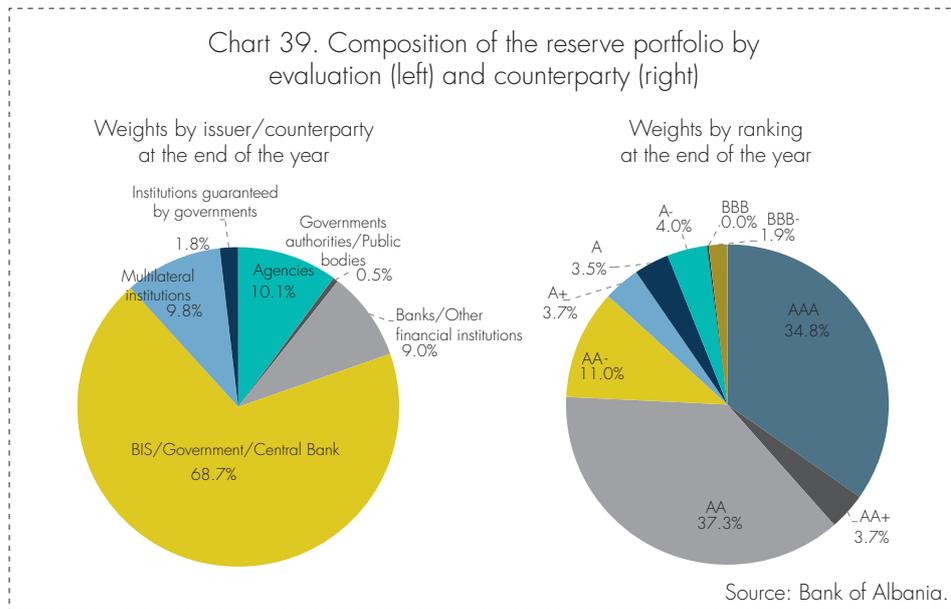
At the end-2020, the international reserve was invested into liquid assets, mainly with maturities of 0-3 years. The share of debt instrument with maturity over 5 years, which are primarily exposures to the investment margin, has increased compared to previous year, representing 7% of the international reserve portfolio at the conclusion of the year (from around 1% in 2019). The portfolio managed by the external manager (World Bank) is invested against a reference portfolio of 1-3 years, mainly in debt instruments issued by governments and government agencies.



COMPOSITION OF THE RESERVE PORTFOLIO BY RATING AND TYPE OF ISSUER/COUNTERPARTY

The Investment Committee approves the names of entities where the international reserve may be invested. These names include the governments of the USA, Japan, United Kingdom, Canada, Australia and those in the euro area, which overall are rated at least A- (for the euro area governments the accepted minimum rate is BBB²⁷). The names of entities allowed for investment also include agencies or institutions related to governments, multilateral institutions or other institutions rated at least AA- (for banks/other financial institutions the minimum accepted rating is A-).

Around 86% of the international reserve portfolio has been invested in institutions with high quality rating (class AAA and AA including exposures in current accounts). By type, exposures of issuers/counterparties are represented by governments/central banks (68.7%), followed by agencies (10.1%), multi-party institutions (9.8%), banks/other financial institutions (9.0%), government-guaranteed institutions (1.8%) and government authorities/public bodies (0.5%).



RETURN ON THE INVESTMENT OF RESERVE PORTFOLIO

The absolute return of reserve in total (excluding the fund managed by the World Bank as external administrator), was around 0.69% in 2020, compared with 0.71% in the previous year²⁸. The return created by the active management of the reserve portfolio is positive. The low rates of absolute return of reserve reflect

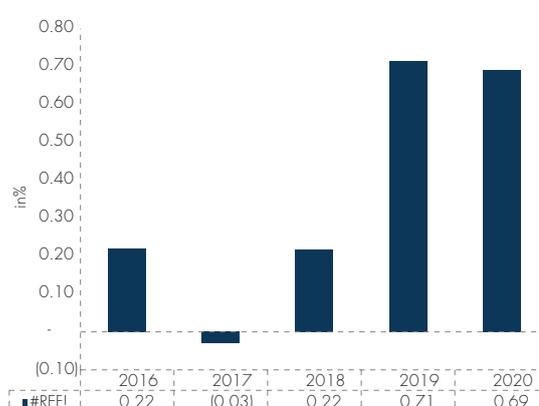
²⁷ Entities/instruments listed up to BBB – are included in “Investment” category (investment grade).
²⁸ Including the fund administered by the World Bank, the absolute return for 2020 is estimated at 0.79%.



the continuity of an environment with low interest rates on main currencies/markets, in which the foreign reserve portfolio is invested, where, in particular, the interest rates on treasury bills in euro continue to remain in a further negative territory compared to previous year. Hence, investment possibilities with a positive return rate for the part of portfolio in euro, while maintaining accepted levels of credit risk, still continue to be impossible.

At the end of 2020, the situation in the current account exceeded 35% of the total reserve portfolio, reflecting the efforts to minimise investment costs. Investments in securities in the euro denominated portfolio resulted with a negative interest rate that varies from -4 basis points to -76 basis points.

Chart 40. Return on the international reserve*



*The return estimation does not account for the exchange rate effect.
Source: Bank of Albania.

OTHER DEVELOPMENTS RELATED TO THE INTERNATIONAL RESERVE MANAGEMENT FUNCTION

Cooperation with the World Bank in the framework of Reserves Advisory Management Program (RAMP) continued in 2020. The World Bank continued to provide specialized training and educational programs. These qualifications aimed at consolidating and increasing the expertise level of the employees engaged in the process of international reserve management and the staff that supports or monitors the performance of this process. Based on the information and technical assistance provided by the World Bank, the analysis process, presentation of proposals and approval of necessary amendments to the regulatory basis was finalized in order to include the class of Mortgage Backed Securities (MBS) to allowed investment instruments. The decision on the MBS portfolio management was also finalised, where the World Bank is assigned the role of external manager. The international reserve portion of the Bank of Albania that will be turned to management is USD 300 million (including the portfolio currently managed by the World Bank).

BOX 7 FLOWS AFFECTING INTERNATIONAL RESERVE IN 2020

Gross international reserve, estimated and reported in euro, increased by around EUR 585.59 million, in 2020, standing at EUR 3,945.29 million as of the end of December. The main factors that have affected the gross reserve are grouped below:

- ⊙ Transactions with the Ministry of Finance and Economy provided a positive impact, estimated at EUR 392.1 million, according to the following items:
 - net inflows from extension of various loans from the IMF and the World Bank at EUR 319.69 million;



- *inflows from the issue of foreign currency debt in the foreign market, at EUR 644.21 million*
- *inflows from the issue of foreign currency debt in the domestic market, at EUR 100.00 million;*
- *transfers of debt service and others, at EUR 671.8 million.*

- ⊙ *Commercial banks and other entities' transactions provided a positive impact, estimated at EUR 173.69 million, according to the following items:*
 - *deposits by commercial banks in their account at the Bank of Albania, for the minimum required reserve, etc., EUR 1,243.31 million;*
 - *transfers by commercial banks at EUR 1,057.78 million;*
 - *net outflows for the account of other entities (DIA, etc.) at EUR 11.84 million.*

- ⊙ *Bank of Albania's transactions provided a positive impact, estimated at EUR 85.21 million, according to the following items 1:*
 - *Purchasing foreign currency from commercial banks and other institutions, EUR 91.53 million;*
 - *from commercial banks EUR 13.70 million;*
 - *from other institutions EUR 77.83 million.*
 - *Selling foreign currency to commercial banks and other institutions, EUR 33.83 million:*
 - *commercial banks EUR 20.40 million;*
 - *other EUR 13.43 million.*
 - *Receipts from interest and coupons etc. (calculated on a cash basis) generated from international reserve investments, at around EUR 33.15 million;*
 - *Transfers at EUR 5.64 million.*

- ⊙ *Market factors provided a positive impact, estimated at EUR 65.41 million, according to the following items:*
 - *foreign-exchange rate volatility of currencies composing the international reserve contributed negatively to the gross reserve reported in EUR, at EUR 59.70 million;*
 - *the portfolio revaluation effect, as a result of interest rate volatility, is estimated at a negative value of around EUR 5.71 million².*

- 1. *The net effect of SWAP transactions carried out with the Ministry of Finance and Economy for 2020 is EUR 378.51 million, while the total volume of SWAP transactions (considered as purchase-sale) is EUR 1,056.65 million. During 2020, with the Ministry of Finance and Economy, a sale and a purchase were realized, with full rights in the amounts of EUR 56 million and EUR 60 million, respectively.*
- 2. *This value also contains the effect created by the issuance of securities coupons and is corrected for the actions of purchasing/selling/maturing of securities on a cash basis.*



2.9 STATISTICS

In accordance with the provisions of the Law “On the Bank of Albania”, the Official Statistics Program and the Law on Official Statistics, the statistics of the Bank of Albania aim aims at compiling impartial, objective and reliable statistics in compliance with the legal objectives of the Bank of Albania as the central bank of the Republic of Albania and as a statistical agency within the National Statistical System.

The Bank of Albania compiles and publishes statistics necessary for monetary policy, supervision of the financial market, financial stability and other tasks of the Bank of Albania. These statistics are available to the public in the Statistics section at the official website of the Bank of Albania.

The pandemic affected the activity of the Bank in the field of statistics as well. The Bank of Albania focused on ensuring the continuity of statistics production and undertaking concrete measures to reduce the risk of statistical activity, by intensifying the use of new analytical and modelling methods in the assessment of statistics. During 2020, the work consisted in several directions.

First, building qualitative, more comprehensive, flexible and integrated statistics²⁹. The challenge of this year highlighted once again the importance of the interconnection of these granular data systems. At the time of the outbreak of the pandemic, the Bank had built a series of statistics available for decision-making (such as detailed reports of credits harmonised with AnaCredit and those of securities), which enabled an important platform for the assessment of the needs for liquidity of banks, and a more complete assessment of the potential impact of the undertaken easing measures in this period³⁰. Specifically:

- The Bank of Albania entered “live” with banks, branches of foreign banks, non-bank financial institutions, savings and loan associations and Unions of saving and loans associations licensed by the Bank of Albania with the reporting in the Credit Registry of the harmonised data³¹ with the regulatory and methodologic framework of the European Union for collecting detailed data related with credit and credit risk. This harmonised database supports the decision-making of the monetary policy, micro and macro-prudential supervision as well as economic research at the Bank.
- The work for building the securities registry and the database with information for each security held/issued by the banking system was finalised. Through this database, were implemented the regulatory requirements of ECB 2015/730 related with the statistics on holdings

²⁹ In the framework of approximation with international practices and the programmes initiated after the Global Financial Crisis 2007-09 (GFC) for addressing the data gap through the Data Gap Initiative (DGI) approved from the G20.

³⁰ For the list of easing regulatory changes in the context of the pandemic refer to section 2.4.3.

³¹ In approximation of the regulatory requirements of the European Central Bank on credit reporting at the European Central Bank (ECB no. 2016/867).



of securities by credit institutions and their subsidiaries in Albania.

- The project “Automation of the compiling and reporting system of external sector statistics” was implemented, which builds up an important foundation for entire block of statistics. This system was installed in December 2019 and throughout 2020 there has been intensively worked on its calibration in compliance with the requirements of EUROSTAT. The system ensures:
 - o The draft of the monthly balance of payments;
 - o The reduction of the processing time from the collection phase to the publication;
 - o The use of modern methods in the production phase of statistical data;
 - o The modernisation of the production process for ensuring statistical confidentiality;
 - o The improvement of statistical quality.

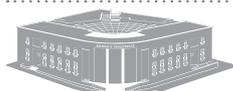
Second, the drafting of quarterly financial accounts, which constitute an important priority in order to better frequently know and the financial interactions in the economy, as well as the distribution of income and possession of financial assets among economic agents.

- In 2020, the drafting process of financial accounts received the expertise and assessment of experts from the Bank of Italy and Bank of France towards consolidating sources, methodology and assessment methods used in drafting financial accounts.

Third, the use of new analytic and modelling methods in assessing statistics, going beyond the “standard” method of assessment of official statistics. In the presence of high uncertainty, the need to have during 2020 fast (almost in real time), frequent (weekly or even daily) and credible indicators in terms of decision-making emerged. Their addressing led to the intensification of data exchange between official producers of statistics in Albania, as well as considering alternative sources, as a complement to official statistics.

The Bank of Albania was also helped by the international community of statistics producers in this process. EUROSTAT and the IMF opened specific sections at their official websites, where they continuously update the methodological announcements. Also, as a member of IFC, the Bank of Albania has been part of the discussions over the implications and alternatives of managing the impact of the pandemic situation on central banks’ statistics. These commitments ensured the qualitative production and in a timely manner of statistics conform to the statistical release calendar of the Bank of Albania, as well as the realisation of the objectives set forth in the Medium-term Development Strategy of the Bank of Albania, the National Plan for European Integration (NPEI) and the Official Statistics Programme 2017-2021.

In 2020, attention was paid to the alignment of practices for the compilation and dissemination of monetary and financial accounts statistics with the



standards of European central banks, as well as finding a long-term solution for the integration of statistical information systems according to the best standards of information management in a central bank.

In the context of the consistency of statistics as well as the completion of the regulatory framework for EU membership, the Bank of Albania is part of joint national and international projects.

- The government finance statistics project - Excess Deficit Procedure (EDP) - and the government's financial accounts, in collaboration with INSTAT and MFE and the expertise of the IMF.

EDP - Excessive Deficit Procedure represents an important statistical block for monitoring the soundness of public finances in member and candidate countries. Starting from November 2014, Albania reports regularly the EPD (Excessive Deficit Procedure) tables to Eurostat. The inter-institutional working group on EDP consisting of BoA, INSTAT and MFE, supported by IMF assistance, has provided a positive impact on the reconsideration of government data compiled by the three institutions:

- The processing and evaluation of extra-budgetary units was finalized. The data of extra-budgetary units missing so far in GFS statistics are evaluated as complete and of good quality, and their publication/reporting within 2021 is recommended.
- The new Maastricht debt data compilation document was finalized. This document automatically compiles detailed data of debt, according to each financial instrument.
- Work was done on building an IT module/system for automated compilation of government financial statistics and development of quarterly statistics. Completion of the system is scheduled for 2021. Completion and implementation for all three institutions is a major project achievement.
- The Bank of Albania has successfully coordinated the work on the development of macroeconomic imbalance indicators (MIP indicators) for Albania, in cooperation with INSTAT and with the expertise from the European Union.

MIP- the Procedure for Identifying Macroeconomic Imbalances is part of the regulatory package aimed at improving the EU economic governance. It is an instrument for assessing and preventing macroeconomic imbalances of member states and the EU as a whole. The development of MIP is an obligation within the EU membership process. From a technical point of view, the most important component to guarantee the accuracy and usefulness of MIP is related to the fact that the data should be: obtained from widely accepted official statistical sources for their high quality; with time coverage over 10 years; and with a high level of harmonization with ESA2010 and BPM6 standards. The project



for drafting the MIP is expected to be completed in June 2021, and will be accompanied by the drafting of quality reports for the component indicators as well as the first transmission (test) of data to Eurostat.

2.10 RESEARCH

The Bank of Albania aims to base its decision-making process on the solid foundation of a body of knowledge tested on the Albanian economy. Investment in creating solid research capacities contributes to improving the Bank of Albania's qualitative work, reputation and credibility as an institution with the methodologies and required knowledge to guarantee the macroeconomic equilibriums of Albania. Therefore, active development of scientific research assumes a primary role in the Bank of Albania's development strategy.

The focus of scientific research at the Bank of Albania in 2020 was on the analysis and exploration of economic and financial phenomena in view of monetary policy and banking stability in the unprecedented conditions dictated by the Covid-19 pandemic. Other research papers addressed issues on banking supervision, monetary operations, development economics, enhancement of financial literacy, and banking challenges in the future. In accordance with its medium-term strategy, scientific research continued to support the decision-making process for drafting and implementing the policies of the Bank of Albania, testing new empirical methodologies and enriching the portfolio of econometric models on which decision-making is based.

The negative impact on the economy of the measures taken in the framework of the Covid-19 pandemic was the most discussed and researched topic during 2020. Based on the intensity of the containment measures imposed during the first wave, an increase in the level of economy lockdown is estimated to cause a fall in industrial production for each month of closure. The impact of 'closing' the economy on the unemployment rate is estimated to be low. However, the pandemic is expected to have a non-symmetric impact on the labour markets where the more affected group ages from the economic shocks are assessed to have been impacted more negatively.

The study on the soundness of financial stability of Albanian households in terms of income, the level of debt and its burden against the shock caused by Covid-19 reached the conclusion that the decline of income may lead to the increase of the debt burden to households, but without damaging their resilience and financial stability overall in the conditions where the vast majority of banking credit is owned by high-income households.

Monetary transmission is discussed through the study of the bank lending channel taking into account a panel of Central Europe and South-Eastern Europe countries (CESEE) during 2010-2018. Preliminary results suggest that



an easing monetary policy stimulates lending in all CSEE countries. However, the efficiency of the transmission varies based on group-countries and individual countries. The size of banks results to be a significant defining factor in the efficiency of the monetary policy of CESEE countries. Meanwhile in new members of the European Union is the level of capitalisation that affects the lending behaviour of banks, and due to the banking credit channel also the transmission of monetary policy.

Remaining in the field of monetary policy, the conclusions of studies that analyse the behaviour of prices and detailed (micro-economic) data by components groups of the consumption basket show, there is heterogeneity of price-setting behaviour. The results suggest that goods and services prices change their behaviour every 4 or 5 months on average, where services prices are more rigid than goods ones overall. Empirical results also suggest that the rigidity in the case of price decrease appears weak during 2007-2019, particularly after 2012.

Research work with forecast models indicates that the inclusion of non-linear assessment methods bring a further improvement of the statistical precision of the existing models. Studies applied for this purpose highlight the advantages of forecast models based on these methods. This is true both in the case of artificial intelligence models and in the case of model with many variables based on Bayesian assessment models. The application of these non-linear assessment techniques is realised in the medium-term period, bringing a positive impact in the decision-making processes of the Bank of Albania.

The results of the research studies in 2020 indicate that empirical modelling is a valuable tool to assist the implementation of operational policies for good liquidity management. The empirical models studied during 2020 have helped in obtaining credible and accurate results for short-term periods up to 5 weeks and have sufficiently explained the characteristics of the market related with time expectations, seasonality and market fluctuation on specific days of a month. This empirical knowledge helps in a more precise translation and filtration of all the data available regarding liquidity management.

These and other studies have become the subject of discussion in the activities and conferences organized by the Bank of Albania or other institutions, where comments and observations have been provided for their further improvement. In this framework, BoA organised the "14th South-Eastern European Economic Research Workshop". This annual international event was organized in the form of a virtual conference. The event is considered to have fulfilled its purpose as a platform for discussing scientific research in economics and for increasing cooperation with central banks and universities in South-Eastern Europe and beyond.

More complete and detailed information on the research papers of the Bank of Albania is found on the official website of the Bank of Albania in the subcategory



“Publications/Researches and Working papers”. Other research works are published as articles in the “Economic Review” of the Bank of Albania. The semi-annual magazine “Scientific novelties at the Bank of Albania” informs about the newly completed research materials or those in process, materials presented in the “Friday Seminars”, and in other scientific activities organized by the Bank of Albania.

2.11 EUROPEAN INTEGRATION

The Bank of Albania has continued to contribute to the fulfilment of the obligations stemming from the Stabilization and Association Agreement, the Progress Reports of the European Commission, joint EU-Albania subcommittees and the National Plan for European Integration. It chairs two Inter-institutional Work Groups for 2 chapters of the acquis.

Albania has continued to implement obligations stemming from the Stabilization and Association Agreement (SAA) as well as from bilateral EU-Albania meetings. On 25 March 2020, the Council of the European Union approved the proposition of the European Commission on opening Albania’s membership negotiations and invited the Commission to present the framework of membership negotiations for Albania. In the Decision of the European Council, Albania is required to continue the reforms undertaken as a condition for holding the first intergovernmental conference.

The Bank of Albania has continued to lead Two Inter-institutional Work Group related to chapters of the European Union acquis: Chapter 17 -“Economic and Monetary Policy” and Chapter 4 -“Free Movement of Capital”. At the same time, the Bank of Albania has continued to actively contribute to Chapter 9 - Financial Services; Chapter – Economic Criterion; Chapter 18 – Statistics; and Chapter 32 - Financial Control. The Bank of Albania prepares regular reports on the performance in the field covered by the above stated chapters, and plans in NPEI, the legal and regulatory measures which contribute to approximating with EU acquis. The Bank of Albania has approved 100% of the regulatory measures projected in NPEI for 2020 and identified the measures foreseen for further alignment with the EU acquis.

The Bank of Albania has participated in the annual high-level meeting of the Stabilization and Association Committee and in the meetings of two subcommittees: 1) Domestic Market and Competition; and 2) Economic, financial and statistical issues, as well as in the Economic and Financial Dialogue between the EU and Western Balkans and Turkey. In the above mentioned meetings, issues such as: drafting and implementation of monetary policy, financial stability, indicators and developments of the banking sector, financial inclusion of the population, etc. were discussed at the political and technical level.



On October 2020, the European Commission published the Progress Report 2020 for Albania. This document assesses the progress made by Albania during March 2019 - October 2020.

In the area of monetary policy the report emphasises again that the Bank of Albania fulfilled its main objective, to achieve and maintain price stability. The BoA is financially independent and has sufficient instruments, competence and administrative capacity to function effectively and to conduct an efficient monetary policy. Further approximation of the Law of the Bank of Albania is needed.

In the area of free movement of capital, according to the Progress Report, Albania is moderately prepared, particularly in the area of payment systems, through the adoption of the Law 55/2020 "On payment services". Its adoption and implementation is considered a significant step to the integration in the Single European Payment Area (SEPA) and the requirements of Chapter 4 regarding payment services. It also enables the alignment with an important European Directive in the field of payment systems in the domestic market. The report also shows progress in the field of anti-money laundering, in fulfilling some of Moneyval's recommendations, mainly through the establishment of the inter-institutional working group, in which the Bank of Albania is part of. More specifically, the Bank of Albania has made progress in terms of the effectiveness of the process of supervision of licensed and supervised institutions in the field of anti-money laundering and combating the financing of terrorism, by ensuring enhanced monitoring and control in these entities through on-site examinations and off-site supervision analysis.

Regarding the developments in the banking sector, the Progress Report states that the Bank of Albania has continued **the approximation of the banking sector regulations with the Basel III framework**, especially in the liquidity ratio and the macro-prudential policy framework. Progress has also been made on alignment with the EU acquis in the area of resolution.

2.12 INTERNATIONAL COOPERATION

RELATIONS WITH THE INTERNATIONAL MONETARY FUND

The Republic of Albania continues to have SDR 139.3 million quotas and owns 2,858 votes or 0.06% of the total amount of the votes of all members of the IMF. It is in the same constituency with Italy, Greece, Portugal, Malta, and San Marino. This constituency has a total of 207,948 votes or about 4.13% of the total amount of votes of all members of the IMF. The total amount allocated and disbursed up to 31 December 2020 is SDR 388.9 million.

Albania's relations with the IMF continue to focus on the Article IV consultations. The Executive Board of the International Monetary Fund concluded the First Post-Program Monitoring review with Albania on 23 November.



In April 2020, the IMF's Executive Board approved USD 190.5 million as emergency financial assistance for Albania to combat the COVID-19 Pandemic disbursed under the Rapid Financing Instrument. The immediate challenge is to respond effectively by strengthening health care and mitigating the effects in the sectors and households most affected by the crisis.

Executive Directors commended the Albanian authorities for maintaining macroeconomic and financial stability thus far, and welcomed their responses to support lives and livelihoods in response to the November 2019 earthquake and the COVID-19 pandemic.

RELATIONS WITH THE WORLD BANK GROUP

The World Bank Group started its work in Albania in 1991 and has supported a number of projects aiming at immediate mitigation of poverty and the provision of sustainable and long-term development tools to drive further growth. In the two decades of involvement in Albania, the World Bank Group has provided over USD 2.2 billion in assistance through commitments from the International Development Association (IDA), the International Bank for Reconstruction and Development (IBRD), the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). Currently, there are 12 projects amounting to a total of USD 738 million, under IDA (USD 35 million) and IBRD (USD 703 million) loans, as well as USD 24 million in grant form.

TECHNICAL COOPERATION

During 2020, the Bank of Albania has implemented the twinning project with IPA funds "Enhancing Bank of Albania's alignment with Acquis" in the framework of approximation with the legislation of the European Union", with Banca d' Italia and Deutsche Bundesbank and the support of the National Bank of Romania and Banque de France. The main implementation areas of the project were: i) Strengthening institutional capacities of the Bank of Albania through the alignment with the model of the European System of Central Banks regarding: independence; accountability, transparency and internal audit; ii) Strengthening the supervision role and financial stability in compliance with the European framework and best international practices, and the further deepening of anti-money laundering and combating terrorism financing ; iii) Harmonising the decision-making process of the Bank of Albania's monetary policy with that implemented at the European Central Bank and the European System of Central Banks, including the guaranteeing of the stability of both financial market and external position of the country; iv) strengthening management capacities of the Bank of Albania.

Due to the Covid-19 pandemic the project was suspended for 3 months, to continue following under online platform. As at end 2020 were realised: 59 activities (group events, study visits etc.) or otherwise 98% of the starting plan.



105 events (missions, webinars, etc.): 99% of the starting plan. 72 experts took part in this project who offered their expertise to around 78 employees of the Bank of Albania.

Also, the two-year project “Programme for Strengthening the Central Bank Capacities in the Western Balkans with a view to the Integration to the European System of Central Banks” has continued. The project consists of two pillars. The first component includes a series of trainings by experts of central banks from the ESCB and the ECB, while the second component consists of bilateral cooperation. The areas covered by this project are those of banking supervision, financial stability, recovery and resolution, monetary policy, payment systems, statistics, compliance and EU integration, governance, accountability and internal auditing policies.

This project as well, due to the situation created by the Covid-19 pandemic, was initially suspended only to continue online. Regarding the first component, thus far, 13 of 3-day trainings have been conducted out of 20. A high level seminar was also held (out of 2 seminars in total). Regarding the second component, the bilateral measures have been rescheduled online as well as the internship with the Bank of Austria.

Over the past year, cooperation with the London School of Economics and Political Science has continued. The Annual Conference on: “COVID-19: The Impact on the Economy and Central Bank Policies” was organised in October 2020. The purpose of this regular conference was to provide a discussing platform of COVID-19 impact on the real economy both in advanced economies and in Europe’s emerging markets; how central banks have adapted their policy toolkits to respond to the challenges arisen in the situation created by the pandemic, with special focus on the South-Eastern European countries, and in Albania.

In the framework of the cooperation with LSE, on 26 February 2020, Governor Sejko delivered a lecture at the premises of the London School of Economics and Political Science (LSE) on “Financial Challenges in Small Open Economies - Central Bank Perspective”. This lecture was organized in the framework of the Bank of Albania’s ongoing cooperation with the London School of Economics and Political Science (LSE) and was attended by international experts in economy, academic body of the University, and foreign and Albanian students of this University.

PARTICIPATION IN INTERNATIONAL CONFERENCES, FORUMS AND SEMINARS

The following is a summary of international activities, attended by the Administrators of the Bank of Albania:



- On 14-15 January 2020, the Governor of the Bank of Albania, Mr Gent Sejko, attended the annual Central and Eastern European Forum organised by Euromoney, in Vienna, Austria. This Forum brings together prominent international personalities in the fields of politics, economy and finance from the CEE countries.
- On 26 February 2020, Governor Sejko delivered a lecture on “Financial Challenges in Small Open Economies – A Central Bank Perspective”, hosted by London School of Economics and Political Sciences (LSE).
- On 28 February 2020, the Governor of the Bank of Albania, Mr Gent Sejko, attended the meeting of the constituency in the International Monetary Fund (IMF)/World Bank Group (WB), in Athens, Greece. Central bank governors and ministers of finance from the constituency member countries met to discuss recent developments in the global economy and in the respective countries.
- On 1 June 2020, the Governor of the Bank of Albania, Mr Gent Sejko, attended the 43rd Meeting of the Central Bank Governors’ Club of the Central Asia, Black Sea Region and Balkan Countries. The meeting held online was attended by Governors of Club member countries: such as: The Central Bank of the Republic of Turkey, the Bank of Slovenia, the National Bank of Romania, the Bulgarian National Bank, the Czech National Bank, the Bank of Greece, the Central Bank of Montenegro, the National Bank of Serbia, the Bank of Israel, the National Bank of Poland, the People’s Bank of China, etc.
- On 9 October 2020, the Governor of the Bank of Albania, Mr Gent Sejko, in the capacity of the Governor of the Republic of Albania at the IMF, attended the Annual Meetings of the International Monetary Fund (IMF) and the World Bank Group (WB), virtually.
- On 19 October 2020, the Governor of the Bank of Albania, Mr Gent Sejko, and the Minister of Finance and Economy, Ms Anila Denqj, had virtual meetings with Ms Anna Bjerde, the World Bank Vice President for Europe and Central Asia, and with Mr Alfred Kammer, Director of the European Department at the International Monetary Fund, in the framework of the Virtual Annual Meetings of the International Monetary Fund (IMF) and the World Bank Group (WBG).
- On 22 October 2020, the Governor of the Bank of Albania, Mr Gent Sejko, in the capacity of the Governor of the Republic of Albania in the International Monetary Fund (IMF), attended the virtual meeting of the Ministers of Finance and Governors of the Central Banks of the Central, Eastern and South-eastern European (CESEE) countries with the Managing Director of IMF, Ms Kristalina Georgieva, in the framework of the Annual Meetings of (IMF) and the World Bank Group (WB).



2.13 ADVISOR'S ROLE AND COORDINATION WITH OTHER PUBLIC INSTITUTIONS

The Bank of Albania is independent in formulating and implementing its monetary policy. In addition to its primary objective, the Bank of Albania is committed to supporting the sound and stable development of the economy country of Albania. To accomplish these objectives, the Bank of Albania accords its work with various public institutions, international institutions and other interested parties. With the purpose of harmonising its decision-making with other economic and financial policies, the Bank of Albania has exercised its role as advisor by providing opinions and suggestions on the policies of partner institutions.

In 2020, the Bank of Albania provided its opinion on the Medium-Term Public Debt Management Strategy, 2021-2023. The Bank of Albania highlighted the importance of continuing with the consolidation of public debt and the direction of policies for its reduction in the medium-term to safeguard macroeconomic stability in Albania, as a necessary precondition in achieving public debt sustainability. Also, in its opinion, the Bank suggested maintaining the foreign debt ratio to total debt, while being attentive that this ratio does not increase. In this way, the country's exposure to shocks in foreign markets is reduced.

In the framework of the implementation of the project by the Ministry of Finance and Economy for the issuance of benchmark securities of public debt through selected financial intermediaries, the Bank of Albania has continued its commitment for the full and successful implementation of this project. This project aims at developing the primary and secondary markets of government debt securities, contributing to the transmission of the monetary policy of the Bank of Albania.

The development of securities markets through the completion of the regulatory framework has been the main object of cooperation between the Bank of Albania and the Financial Supervisory Authority.

The Bank of Albania is represented on the Domestic Debt Committee, which aims at making decisions on liquidity management in the domestic market, at a lower cost and with effective allocation. Coordination of work in this Committee serves to avoid tense situations in the domestic markets, minimise the volatility of interest rates and improve the forecast of liquidity needs from the banking system.

The Bank of Albania is a member of the Financial Stability Advisory Group (FSAG). In 2020 as well, the Bank of Albania has shared information and has coordinated its actions with other public authorities, which are members of FSAG. In addition to assessments on the situation of the financial system and how they are impacted by the effects of the pandemic, it has cooperated



with relevant agencies in the framework of the Twinning project, and certain processes such as those of stress tests and resolution.

The Bank of Albania chairs the National Payment System Committee (NPSC), an inter-institutional body of strategic, consultative and communicative nature, whose decisions aim to contribute to increasing the security, stability and efficiency of the national payment system in Albania. The Committee, since 2018 has undertaken a key role in promoting financial inclusion and literacy, and promoting the use of electronic instruments. In this context, the objective of the Committee and the measures taken in this regard are intertwined with a number of national and regional initiatives where we can mention the Inter-Institutional Working Group for the Development of Electronic Trade in Albania, the National Diaspora and Emigration Strategy, and the action plan for the Common Regional Market in the framework with CEFTA.

2.14 TRANSPARENCY AND PUBLIC COMMUNICATION

Public communication constitutes an important link in the Bank of Albania's activity, in fulfilling the obligation to provide maximum transparency of its decision-making and effectiveness, as well as to achieve the permanent objective of increasing the confidence of this central institution. In this framework, to the Bank of Albania the interacting communication with the public is a primary issue of strategic importance, to transmit its monetary policy directly and comprehensively to the public.

AN OPEN AND TRANSPARENT CENTRAL BANK

Year 2020 was a difficult and challenging year to the Albanian economy due to the situation created by the pandemic and communication with the public has responded to the challenges created by this situation. In this context, the communication with the public aimed to inform it with the immediate and continuous measures taken by the Bank of Albania to minimize the consequences of the pandemic on the Albanian economy and financial system in particular and to support citizens and businesses affected by the aggravated financial situation created by pandemic.

A special section was created on our website where all citizens could receive a variety of information from the decision-making of the Supervisory Council to the daily operational activity of the Bank of Albania, to mitigate the negative effects caused by the pandemic on the well-being of households and enterprises. This transparent communication helped increasing the effectiveness of policies pursued by the Bank of Albania, prompting the public to understand the decisions taken by it in a timely and clear manner, and also to be able to fairly evaluate them.



During 2020 Q2, which was also the period with the greatest restriction of distancing measures, 27 interviews of Administrators and representatives of the Bank of Albania were conducted in order to inform the public on the measures taken by the Bank of Albania to cope with the situation. Also, during this quarter there was an increased flow of public requests for information, regarding the modalities of deferring loan instalments for borrowers of banks and non-bank institutions, requests that have received a full response in a very efficient time.

Starting from March 2020, all public activities of the Bank of Albania were conducted in the online format in compliance with the measures to minimize the spread of the pandemic.

Bank of Albania's communication is further complemented continuously and in real time with a number of periodic reports, observations, analyses, data, evaluations and opinions of the Bank of Albania on the macroeconomic situation of Albania and the role of the Bank in supporting its financial stability.

An important place in communication with the public is occupied by communication with the media. In 2020, media communication continued through press conferences, speeches, presentations and press releases held in activities organized by the Bank of Albania or other domestic and foreign institutions, interviews or participation in dedicated TV programmes, and expression of views on specific issues of interest to the Bank of Albania or other public activities of the Governor and other BoA's representatives. Seven online presentations of its periodic reports were held "off the record" for the media during this year. These meetings aim to guide the media to a correct understanding of the decision-making of the Bank of Albania and are seen as effective means of communication with the public.

To enhancing interaction with the public, in 2020, we continued digital communication through social networks such as Twitter (information), Facebook (financial literacy), YouTube (video) and Flickr (photo) to present the general activities of the Bank of Albania to the public, in a timely and comprehensive manner.

ACTIVITIES WITHIN THE COUNTRY

- *On 13 May 2020, the Bank of Albania organised a discussion forum with the banking system and business community on: "Bank - Business relationships: Common economic challenges in face of the global pandemic Covid-19. The meeting initiated and organized under the auspices of Governor Sejko at the premises of the Bank of Albania, aimed at encouraging the collaboration between these two groups of interest to counter the common economic challenges caused by the Covid-19 pandemic and the providing of platform to share views and needs on the instruments to be employed and the further measures to be taken.*



- On 29 October 2020, the Bank of Albania co-organised with the London School of Economics and Political Science (LSE) the Virtual Conference: "COVID-19: The Impact on the Economy and Central Bank Policies". The conference brought together senior central bankers from the region, policy makers in the fields of economy and finances, representatives from international financial institutions, market participants and leading academics. The purpose of this regular conference was to provide a discussing platform of COVID-19 impact on the real economy both in advanced economies and in Europe's emerging markets; how central banks have adapted their policy toolkits to respond to the challenges arisen in the situation created by pandemic, with special focus in South-Eastern European countries, and in Albania.

The closing panel, the Governors' panel, chaired by Ms Danae Kyriakopoulou, Chief Economist, OMFIF, brought together central bankers and international experts, namely: First Deputy Governor of the Bank of Albania, Ms Luljeta Minxhozi, Governor of the National Bank of the Republic of North Macedonia, Ms Anita Angelovska Bezhoska; Governor of the National Bank of Croatia, Mr Boris Vujčić; Deputy Governor, National Bank of Romania, Mr Leonardo Badea; Chief Economics Commentator, Financial Times, Mr Martin Wolf; Director, Economic Analysis and Research Department, Oesterreichische Nationalbank, Ms Doris Ritzberger-Grünwald; and the former Governor of Central Bank of Argentina and former Executive Director of the Bank of England, Mr Mario Blejer.

- On 10-11 December 2020, the Bank of Albania organized the 14th SEE Economic Research Workshop. This workshop serves as a discussion forum on the researchers conducted by the Bank of Albania throughout 2020, and promotes the exchange of views among researchers from the Bank of Albania, other central bankers, academia, scholars and policy-makers in the region and beyond, on the results of scientific research on issues related to the activity of central banks.
- On 21 December 2020, under the auspices of the Governor of the Bank of Albania, Mr Gent Sejko, the ceremony for the "Governor's Award for the Best Diploma Thesis - 2020", took place virtually. This first prize was awarded to Ms Megi Jaupi, a student at the ETH Zurich University, Switzerland, on the topic "Generative Adversarial Networks for Multivariate Return Simulation and Robust Portfolio Optimization"; the second prize was awarded to Mr Argi Hanku, a student at the Vienna University, Austria, on the topic "Evaluating Low Frequency Liquidity Proxies"; and third prize was awarded to Ms Eda Meta, a student at the Berlin University, "Berlin School of Economics and Law", Germany on the topic "Assessment of the impact of CoCo bonds on banks".

A RESPONSIBLE AND ACCOUNTABLE CENTRAL BANK

As an independent institution, the Bank of Albania aims to inform citizens, and in particular the Parliament, on all its activities.

Institutional relations with the Parliament are held in several directions. The hearing sessions of the Governor in the Parliamentary Commission of Economy



and Finance (CEF) and plenary sessions of the Parliament are the most significant ones. In June 2020, the governor presented the Annual Report of the Bank of Albania to CEF and in August to the Parliament of Albania, responding to MP's interest in issues related to it.

Citizens can find comprehensive and up-to-date information on the national financial and economic situation and the country's key macroeconomic developments, as well as the role and the contribution of the Bank of Albania in this regard, on the official website www.bankofalbania.org.

Throughout 2020, the Bank of Albania continued to regularly update its website, which had about 1.3 million visitors, who checked our page around 3.7 million times and browsed in total about 6.4 million sections.

Periodic and non-periodic publications, in 2020, consisted of about 4500 pages of analyses, statistics and researches in both Albanian and English, and represent the highest number of pages published by the Bank of Albania on the last decade. The set of periodic reports has maintained the same structure as in the previous year: Annual Report, Quarterly Monetary Policy Report, Financial Stability Report (semi-annual) and Annual Supervision Report. In addition to periodic reports, the following were published with the Official Bulletin (depending on the Supervisory Council meetings), the Economic Review (half-yearly); the "Research newsletter" at the Bank of Albania (half-yearly), the Annual Conference Book 2019 "A Brave New World? The Future of Banking in Emerging Europe", as well as various research papers and educational publications.

In 2020, the Bank of Albania continued the free distribution all its publications, taking into account the social responsibility to reduce paper publications.

In order to inform the public, the Bank of Albania responds to the many requests of the citizens in writing or in electronic form, depending on how they want to receive this information. In 2020, replies were provided to 80 official requests sent to the coordinator for the right of information, about 1200 e-mails to the general electronic address of the Bank of Albania, and about 630 messages with requests for information delivered at our Facebook account.

2.15 FINANCIAL EDUCATION

Financial education for the public is a significant part of the Bank of Albania's activity. This is realised through educational activities and programmes, visits to the Museum, exhibitions, as well as through periodic and special publications. The focus of the Bank of Albania in this regard has been on two main objectives: presentation of the role and functions of the Bank of Albania to the public; and cultivation and strengthening of financial literacy in the Albanian society.



Educational publications. In 2020, the distribution of the teaching text "Personal finances in your hands" for 4 high schools, which have chosen to deliver this subject (a total of 560 textbooks), has continued, in addition to the distribution of brochures and educational materials prepared in previous years mainly for Museum visitors.

The Museum of the Bank of Albania. Since October 2015, the Museum of the Bank of Albania has served as a promoter of the communication between the Bank and the public. Tour guides, exhibits, interactive games, as well as the information published at the Museum acquaint the visitor with the history of monetary circulation over the centuries, as well as with concepts of financial literacy. In this Museum, those who are passionate about the field of numismatics and financial and economic history also find themselves. During 2020, due to the COVID-19 pandemic, the Museum of the Bank of Albania was visited by a small number of visitors, around 700. However, all measures have been taken to keep the Museum open, by implementing the anti-COVID measures.

Promotion of the numismatic collection of the Bank of Albania: At the Museum of the Bank of Albania, visitors and the general public can buy the numismatic collection of Albanian coins and banknotes. During 2020, there were a high number of people interested in purchasing this collection, which is collected or can be used as a gift. The prices of the numismatic collection for sale are published on the official website of the Bank of Albania. The numismatic collection for sale is enriched with new issues of the Bank of Albania. During 2020, the collection for sale was enriched with 3 commemorative coins and a medallion, in addition to the new denominations of banknotes and their specimen, put into circulation in 2019.

