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The governor of the Bank of Albania  
Dr. Shkëlqim Cani



The Annual Report for 2000, as tradition goes, presents the most important developments taking place in the Bank of Albania or in the environment it operates. These developments are dealt in detail to present to the public an as much clearer view of events, as possible.

From the throng of events of I would like to separate three main aspects: the macroeconomic situation, Bank of Albania's monetary policy and its institutional development.

It is for the third year in succession that Albania encounters poised **macroeconomic developments** and within established frames by the mid-term development program. On the whole, the Albanian economy is mostly assessed as further invigorated by the increase in the private sector of economy. As the public sector continues to shrink mainly as a result of its privatisation, an important development of 2000 was the privatisation of some public entities from the strategic sector of economy, which was accompanied with more foreign investments, improvement of investment climate in Albanian economy and with more budget income of state. Above all, of importance will be the long-term proceeds that the Albanian economy will ensure from this process. However, it is assessed that due to the power crisis our country underwent in the third quarter of the year, the growth rate of the economy was not to the expected effect envisaged at year onset.

Inflation arrived in 4.2 percent at year-end. It's three years by now that Albania is observed on low inflation rates something that has made the consumer price stability be met. But, yet, we can not stipulate that the consumer price stability is maintained. Although the consumer price tendency has been falling since 1998, their month over month movements have been rather considerable, to not indicate a situation of maintaining the consumer price stability. The most direct indicator is picking up inflation by 4.6 percent, in December 2000.

Year 2000 marked other positive developments in fiscal aspect. The level of fiscal income especially from tax and customs institutions raised and this confirms the added efforts for the reduction of fiscal evasion and illegal traffic. Reverse from previous years, we note a higher effect of budget expenditures, retaining as necessary, the improvement of work in accomplishing capital expenditures and ensuring a more rhythmical distribution of expenditures throughout the year.

According to the Bank of Albania's latest estimates on the balance of payments developments, it might be generally said that core indicators at year-end corresponded with envisaged developments in the monetary program. Constituting an exception from the current year developments, exports not only did not increase, but presented 7 per cent lower than the previous year.

However, either the current or the capital account corresponded with early year forecasts. The favourable climate, created in the macroeconomic environment, enabled the achievement of satisfactory results in the area of implementing monetary policy through indirect instruments. Thus, the most important development in **implementing monetary policy** was the total replacement of direct instruments (credit ceiling, interest rates on time deposits in domestic currency for state-owned banks) with indirect ones. Through Repo auctions and, more concretely, through the maximum interest rates, Bank of Albania offers in the market and the amount of excessive reserves that it announces for purchase, it transmits the central bank policy relative to interest rates. In year 2000, Bank of Albania has constantly addressed at cutting interest rates in economy. Central bank policy and macroeconomic situation direct results have been the rising credit stock by about 3 times compared to 1999 and the increase of banks' profit by about 4.5 times more than in 1999. Quantitative targets of monetary policy were within fixed limits. Bank of Albania's prepared and applied monetary policy has generally contributed in maintaining low and stable consumer price levels.

Finally, **the institution of Bank of Albania, itself**, has improved the quality of its operation. The reorganised bank structure was to better adjust to the completion of strategic targets as well as to ensure a more effective and functional connection between departments and their component units; a special attention was also devoted to the advances in information technology, improvement of statistics, enhancement of transparency and the central bank credibility, a more intensive commitment in the issues of economic legislation and integration. All these activities help in achieving the Bank of Albania's strategic target, its approach to the European Central Bank.

**Shkëlqim Cani**

**Governor**



### **The Supervisory Council of the Bank of Albania**

**From the left to the right seated:**

<b>Fatos Ibrahimi</b>	<b>member and First Deputy Governor</b>
<b>Shkëlqim Cani</b>	<b>Chairman and Governor</b>
<b>Dhame Pite</b>	<b>member and Second Deputy Governor</b>

**From the left to the right standing up :**

<b>Drini Salko</b>	<b>member</b>
<b>Llazi Balliu</b>	<b>member</b>
<b>Sabah Hilmia</b>	<b>member</b>
<b>Bajram Muça</b>	<b>member</b>
<b>Sulo Hadëri</b>	<b>member</b>



## Chapter I. Economy

### 1.1. WORLD ECONOMY

#### 1.1.1. WORLD ECONOMY DURING 2000.

The end-fall 2000 corresponds with a change in the global growth forecasts made at early year. The “new” forecasts provided a more pessimistic situation mainly based on: a remarkable slow-down of American economy, a distrust in the recovery of the Japanese economy, a more moderate growth of American continent and a large number of developing economies.

In the first half of 2000, **the American economy** continued to have strong growth results (of 5.25 per cent rate on annual basis), exceeding the most optimistic forecasts envisaged to that moment. This growth was more as a result of the strengthening demand than as of net exports. Nevertheless, the second half marked suspension of economic activity (especially in the last quarter, marking 1 per cent growth on annual basis). This slow-down mainly reflects the increase of power prices and the deterioration of financial terms, including NASDAQ decline and the appreciation of USD.

Meantime, signals from Japanese **economy** continued to be ambiguous, reflecting an overall slow-down of world economy, a still weak confidence of consumers as well as the acknowledged problems, characterising the financial system of Japan.

**Euro zone growth** is expected to be a contribution of the growing demand, as the overall slow-down has started to have its own impact on exports.

The economic growth is gaining a strong ground in the **Eastern and Central European** economies mainly due to the growing exports to EU. Poland, Slovenia and Hungary are expected to keep an annual growing rate of over 4 per cent either for 2000 or the next two years.

On the other hand, Rumanian and Czech Republic economies are also stabilising, after the previous year decline. The deteriorating effects of external environment (as to the economic crisis in Russia and the Kosova crisis) are eliminating, providing more favourable conditions to other economies of this group.

On ECB initiative and participation, on September 22, monetary authorities of USA, Japan, Great Britain and Canada undertook co-ordinated intervention in international markets of foreign exchange in reaction to a common worry, attached to the recent movements' impact of Euro rate in the world economy. The reason for that was that on September 20, Euro fell in its lowest historic ratio against USD, since its first issuing, precisely at USD 0.848 per EURO. This exchange rate is considered as inconsistent with core economic principles and, as such, its implications might have been important to the world economy. Blocking the further Euro decline and stabilising its exchange rate by 0.87 USD, during October, were tangible results of this intervention.

In reaction to the positive growth forecasts in Euro zone and the economic decline in other countries, Euro began to take ground, especially, against USD and Japanese Yen. However, at the end of December, it paused by nearly 5.5 per cent under the early year level, whereas in ratio to Yen it stood 6 per cent over the early year record.

**Table 1. GDP real growth in per cent.**

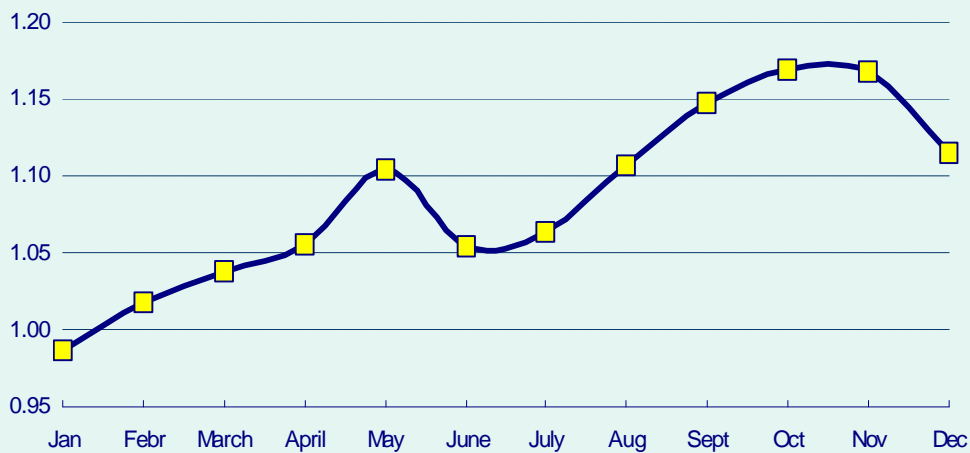
Countries	1995	1996	1997	1998	1999	2000*
USA	2.7	3.6	4.5	4.4	4.3	5.0
Japan	1.5	5.0	1.6	-2.5	0.2	1.5
EU	2.4	1.7	2.5	2.7	2.5	3.3
Euro zone	2.3	1.5	2.3	2.8	2.5	3.4
Countries under European Agreement	5.7	3.6	3.2	2.5	1.8	4.6
Bulgaria	2.9	-10.1	-6.9	3.4	2.4	5.0
Czech Republic	6.4	3.9	1.0	-2.3	-0.2	2.8
Estonia	4.3	3.9	10.6	4.0	-1.1	6.3
Hungary	1.5	1.3	4.6	5.1	4.5	5.3
Latonia	-0.8	3.3	8.6	3.6	-1.4	5.5
Lithuania	3.3	4.7	7.3	5.1	-4.1	2.7
Poland	7.0	6.0	6.8	4.8	4.1	4.1
Romania	7.1	3.9	-6.1	-5.4	-3.2	2.0
Slovakia	6.9	6.6	6.5	4.4	1.9	2.2
Slovenia	4.1	3.5	4.6	4	4.9	4.7

\*IMF assessment, March 2001.

Source: World Economic Outlook, IMF.

**Box 1. Euro – two years from its delivery.**

From its first delivery, Euro has lost nearly 25 per cent of its value in ratio with USD. The main argument mostly used to explain this decline is the moment of its first market delivery which by some analysts is considered as unfit. Although, the European economy has been growing by 2 per cent rate, annually since 1998, the American economy had the highest growth record of nearly 4 per cent, recognising no inflationary pressures, (reaching the climax of 6.1 per cent in June 2000). This American wonder is dedicated to the development of new economy, the significant investments in ICT (information and telecommunication technology) and the rising productivity, consequently. Lacking results, structural reforms in the labour market of Euro zone stay in the bulk of the scepticism of the negative market attitude against the new currency.



**Chart 1.** Euro/ USD exchange rate (January - December 2000).

The impressive achievements of American economy created a very attractive market to other country investments (Europe and Japan). For the first time in history, direct investments (reaching the climax of USD 198 in the third quarter 1999 further declined in USD 76 million) became the main financing resource of the current account deficit. High capital entries were recorded under portfolio investments of debt and equity securities. Portfolio investment reached their climax by USD 270 million in June 2000.

The economists believe that this contrast in the statement of capital account stands in the basis of exchange rate equation, Euro/USD.

The current prospects seem to be in favour of Euro. By USD 400 million, deficit financing of the current account, in view of IHD- ratios and portfolio investments is believed to furnish a loosing ground for USD value. This is also in the context of the expected decline of American economy in the current year and in the narrowing spread between interest rates in economy.

In January 2002, the European currency becomes a tangible reality for consumers. From this date onward, Euro will be issued as circulating currency. At the time of the happening transition to the new currency, the people to be affected will feel these costs directly and this is the phases towards this process is moving on.

**Source :** Rabobank, Forecast 2001, the new euro-economy.

### 1.1.2. FOREIGN TRADE DEVELOPMENTS AND CONSUMER PRICES.

The volume of foreign trade transactions world-wide<sup>1</sup> (in goods and services) is expected to mark a 10 per cent growth or two times higher than in 1999. Imports are expected to record the highest growth by 10.3 per cent whereas exports by 9.9 per cent. Either in import or export transactions, countries in transition are expected to mark the highest growth by 12.4 and 10.1 per cent, respectively.

Meantime, commodity prices internationally, excluding foodstuffs have registered significant growth results. The most conspicuous growth, in overall value, corresponds to power products (by 54.1 per cent against 1999) and oil price, particularly, by 62.7 per cent. Oil price reached the climax of USD 37 per barrel in October. This is the highest record, since early 90's whereas, in December, it had its most significant decline reaching the monthly average of Euro 29.4 per barrel.

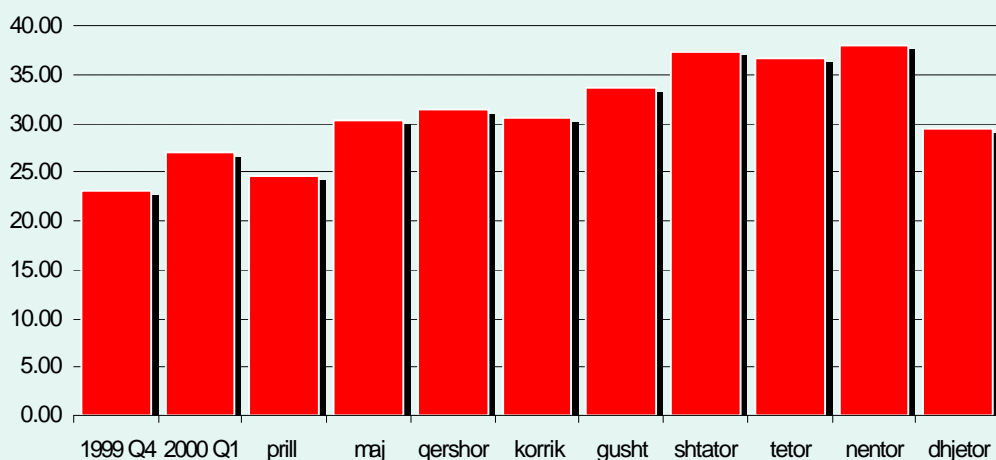
**Table 2. Primary prices.**  
(in USD in % of the change against previous year).

	1994	1995	1996	1997	1998	1999	2000
Foodstuffs	14.0	7.2	7.4	-5.6	-14.5	-11.7	-7.2
Basic materials	11.4	9.7	-4.8	-2.1	-14.8	-4.0	7.3
From wich							
Non-agricultural products	9.6	4.4	-1.2	-5.9	-14.3	-6.3	4.1
Minerals and metals	14.5	18.0	-10.0	3.7	-15.4	-0.8	11.5
Power products	-5.1	8.6	16.4	-6.7	-28.4	25.0	54.1
From wich							
Crude oil	-7.1	7.8	21.1	-7.5	-33.4	40.0	62.7
Primary stuffs							
The total excluding fuels	12.3	8.9	-0.8	-3.4	-14.7	-6.7	3.7
Oil price in USD per barrel	15.8	17.1	20.7	19.1	12.7	17.8	29.0

<sup>1</sup> International Monetary Fund "World Economic Outlook", October 2000.

### Box 2. Why does oil price increase presents an international worry ?

First, many developing economies will be seriously affected. Second, this increase might be ongoing either because of the rising demand or supply. Third, a combination of a high price with a weakening market of equity securities might force private investors of developing countries reduce investments and increase savings, bringing in an economic breakdown. According to a recent study, should the average crude prices remain US\$ 32 per barrel till next year spring or reduce by US\$ 27 per barrel in 2001 (as already foreseen), its resultant effects would be:



**Chart 2.** Euro price per barrel at end-period.

The income loss will reach in 0.7 per cent of GDP for OECD countries, 0.6 per cent of GDP for the American economy, 1 per cent for Japan and 0.8 per cent for Euro zone. Great Britain and Canada advantages will be 0.4 and 1.5 per cent respectively (as they are net suppliers of electricity);

Most of the developing countries that are net purchasers of electricity would be suffering larger losses (these losses would be by over 1 per cent of GDP for some Central European countries).

Whereas, the beneficiary countries would involve crude oil producers and suppliers, such as Russia, Venezuela, Mexico, Nigeria etc. What must be evidenced from these oil price developments is that industrialised economies during the four recent decades have become less tangible against power price oscillations than in the power crises of 70's. This is may be attributed to the fact that oil imports per item of GDP have been half cleft and inflation has been under the control of authorities. In the same light, the structural changes occurring in industrialised countries have reduced the dependence from power resources.

(Source : Taken on abbreviation from Martin Wolf, "The new economy gets a shock", Financial Times, October 18, 2000).

Observed developments in the world economy and in partner countries, especially, have been of effect in some directions in spite of the fact the Albanian economy does not dispose a high rate of integration. As assessed, balanced and stabilised prices in EU countries, the Euro performance against USD as well as the power prices have affected the import of a low inflation rate, on one side, and the power price increase domestically which have led to a rising cost of production.

## 1.2. NATIONAL ECONOMY

Year 2000 corresponds with a further invigoration of economic activity on its entirety. Although the country copped with a power crisis in the production and supply with electricity mainly in the last months of 2000, still it was assessed that the increase in output was considerable and beyond its early year forecast of 7 per cent. According to the recent assessments, this growth was, particularly, strong in the construction and transport sector meantime that higher investments in mechanical machinery and equipment as well as the rising imports of chemical fertilisers and pesticides made agricultural output record a quicker growth than in the previous year. Even the private sector of industry has been assessed on further enlivening term, reflected in the relatively high growth of credit extension during 2000 as well as in the rising imports under the item of machinery and equipment. Although the total industrial output continues to reflect the ambiguity characterising the public sector of industry, especially, in the mineral industry.

**Table 3. Overall macroeconomic indicators.**

	1993	1994	1995	1996	1997	1998	1999	2000
Population (000)	3202.0	3248.8	3283.0	3324.3	3354.3	3373.4	3401.1	3428.3
Population growing rate	1.1	1.5	1.1	1.3	0.9	0.6	0.8	0.8
No. of employees (000)	1046.0	1161.0	1138.0	1116.0	1107.0	1103.0	1081.0	1064.0
GDP (by 1990 prices in millions of Lek)	12309.0	13331.0	15107.0	16478.0	15325.0	16556.0	17764.6	19150.2
Growth of GDP in % (by 1990 prices)	9.6	8.3	13.3	9.1	-7.0	8.0	7.3	7.8
GDP (current prices, in millions of Lek)	125340.0	187891.0	224745.0	280998.0	341716.0	460631.0	506205.0	539210.0
GDP (current prices, in millions of USD)	1221.6	1984.5	2422.1	2689.0	2294.5	3057.8	3676.4	3752.1
GDP (per capita in USD)	381.5	610.8	737.8	808.9	684.0	906.5	1080.9	1094.4
Unemployment rate	22.3	18.4	13.1	12.4	14.9	17.8	18.0	16.9
Inflation rate (y/y)	30.9	15.8	6.0	17.4	42.1	8.7	-1.0	4.2
Internal debt (in % of GDP)			25.1	30.7	35.8	32.9	36.4	41.5
Current account (in % of GDP) 1/	-28.8	-14.3	-9.7	-11.5	-14.4	-8.2	-7.2	-7.0
External debt (in % of GDP)		52.5	30.4	29.2	35.6	26.5	25.8	29.2
Average exchange rate	102.6	94.7	92.8	104.5	148.9	150.6	137.7	143.7

1/ Current accounts excluding net income from service and official transfer factors.

Source : INSTAT, Ministry of Finance, Bank of Albania, and IMF staff assessments.

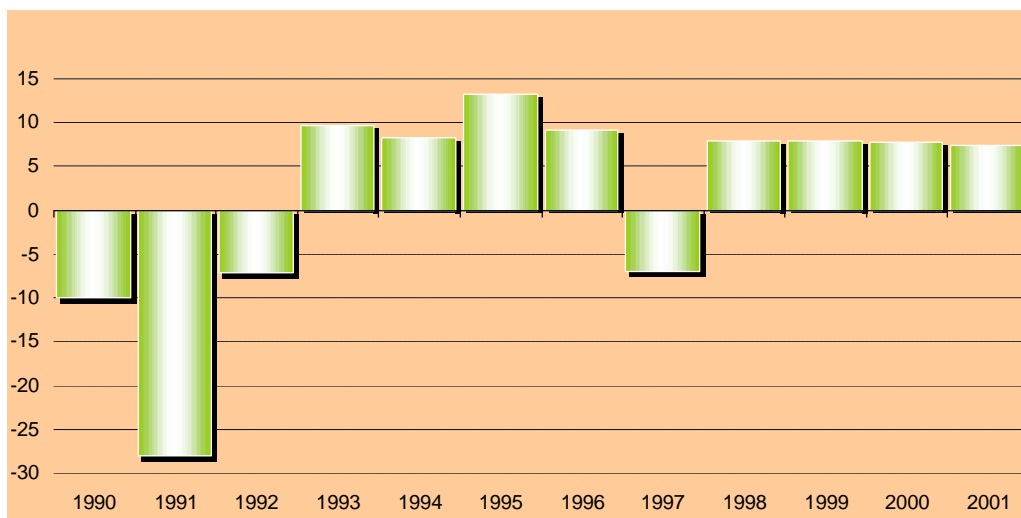
Typical problems, characterising the mineral sector of our country have also affected reducing exports during 2000, which together with the 14 per cent growth in imports have led to a further deterioration of foreign trade deficit<sup>2</sup> by about 3. 7 percentage points of GDP. Nevertheless, an appropriated level due to the higher privatisation receipts and tourism incomes assesses the BOP position. It shouldn't be neglected the fact that private transfers during 2000 continued to be high, by already crystallising as one of the largest share balancing items of foreign trade deficit.

<sup>2</sup> Expressed in USD terms, this is available only for import and export transactions.



### 1.2.1. GROSS DOMESTIC PRODUCTION (GDP).

From the recent assessments performed together with IMF, the real economic growth is assessed at 7.8 per cent rate in 2000. As in the previous years, the main branches to contribute in the increase of domestic production, remain construction, transport and agriculture. It should be noted that year 2000 was also copious even for the private sector of economy especially in industry, including metal and food processing industry ect.



**Chart 3.** The real growth of GDP in %.

**Agricultural product** during 2000<sup>3</sup> had a higher growing rate than in the previous year. Notwithstanding the difficulties caused by the vast and prolonged dryness, year 2000 might be labelled as the year of the positive achievements in agricultural area. This way rural product amounted to Lek 109 billion (assessed by 1994 prices). By 6.8 per cent higher than in 1999, this growth result shared more than 55 per cent of GDP growth. In the total of agricultural product, animal husbandry continues to render the main contribution by about 58.5 per cent followed by field crops and fruit growing by 44.5 and 7 per cent respectively. This structural change in the value of agricultural product has started since 1994 and has always kept the same ratios.

The better circumstance of Albanian agriculture is reflected in the market attendance of domestic products by higher quality and amount and by lower prices something mirrored in the significant reduction of CPI of agricultural products, particularly, interim may - June 2000. Notwithstanding the above-mentioned achievements, the existence of slightly developed markets, the lack of market information as well as the fact that Albanian farmers, generally, produce for individual consumption and not for market consume continue to remain the main concern of Albanian agriculture.

<sup>3</sup> The data on 2000 have been taken from the Ministry of Agriculture reports.

The initial market supply with domestic products is mostly noted in animal products and this was due to the rising flock of live animals. In the conditions of a rising agricultural product and consumer demand in the market the development of food processing industry assumes a very high importance.

The recent data on ***sold out product*** confirm a decline of industrial activity in the public sector<sup>4</sup> of industry. The total of sold out product for 2000 indicates 10 per cent lower than in the previous year. Sustained by consumer price developments the product of oil industry presented 11.2 per cent higher than in 1999 while the mineral and processing industry showed lower levels especially in processing industry where output indicator presented almost the half of previous year record. In the mineral sector of industry it is has been included only the output from chromium, coal and other mineral industry, which production almost halved towards the past year.

However, this analysis must be considered in the context of structural changes that have been going on under the year under analysis. Important public enterprises have been privatised and, as such, they are not included in the system of statistical reporting of the ministry. Such important enterprises were the cement industry and many light industry activities (beer and wine canteen etc) telecommunications industry (with privatisation of AMC) etc.

Based on these arguments, the productive activity of the private sector of economy is totally expected to have had a growing tendency. However, we still continue to base our assessment on some indirect indicators reported by INSTAT such as the increase of domestic consumption, investments (imports of machinery and equipment) cement consumption etc. Amongst the factors to exert negative impacts on industrial sector<sup>5</sup> developments could be mentioned the hard power crisis, accompanied by frequent and long cuts of power supply addressed to economic entities in the country. This one coupled with the fuel price increase internationally had its negative impact in the rising cost of products. However to furnish a precise assessment of such crises effects in production and costs is actually impossible due to the incomplete data from the private sector.

The investment activity of private companies in technology and fixed assets seems to have had a significant increase. Imported machinery and equipment occupied 13.8 per cent of the total imports during 2000, reaching the figure of about USD 149 million. The above mentioned figure embodies a level of nearly 37 per cent higher than the imported machinery and equipment in the previous year, in real terms. In the same line, other import items seem to have been swayed by investment products such as mineral products, textiles and articles used for active processing by domestic industry of our country. Even this fact is evidenced by the increase of re-exports activity in comparison with the previous year.

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<sup>4</sup> The data source is from the Ministry of Agriculture statistical reports.

<sup>5</sup> According to a Bank of Albania assessment on the power crises impact on domestic economy of November 2000, it is assessed that that income loss of domestic economy due to the growing price of power products amounts to 0.3 per cent of GDP.

Thus, the typical products of this category, textiles and articles indicate growing exports by more than 30 per cent against 1999. This data might be considered as evidence of the fact that the economic activity from the private sector of economy has been enlivening against the previous year tendency.

### **1.2.2. SAVINGS AND INVESTMENTS.**

Compared to the previous year when domestic savings were as much as nearly 9.6 per cent of GDP, this year, they are estimated to have been raised to 12 per cent of GDP. The main contributor in the increase of savings belongs to the reduction of budget deficit reflected by public savings' recovery by nearly 3 percentage points. However, the overall balance of public savings still remained negative per 2.6 per cent of GDP.

The few news on market developments and financial intermediation have made bank deposits remain a ruling alternative for individual investments (mostly in the type of foreign exchange deposits). According to the data preliminaries at 2000-end, the total resident deposits amounted to Lek 228.8 billion or experienced an annual growing rate of 8.2 per cent. So, the total deposit statement was nearly 42.6 per cent of GDP from 40.4 per cent in the previous year.

Compared to the previous year, total investments had a growing rate of 2.2 percentage points, amounting to 19 per cent of GDP. It must be noted that private and public investments increased by nearly 1 percentage point each during 2000.

### **1.2.3. LABOUR MARKET AND INCOMES.**

#### **1.2.3.1. LABOUR MARKET.**

Even this year, the labour market continued to be characterised by the formal and informal market coexistence, which is still assessed to be considerable in size. As in the previous years, the structural changes<sup>6</sup> in the labour market continue to be an aftermath of the privatisation highlights, the consolidation of the private sector, emigration etc.

Notwithstanding the recent decade developments, Albania is still classified as one of the countries with a young population. More detailed assessments on the age structure indicate that nearly 40 per cent of the population, both males and females, correspond to 0-19 years old group, 50 per cent of it falls under 20 - 64 years old and only 10 per cent of the population is over 65 years old. A similar dissemination by age groups of the population sounds in tune with a regular form of the population pyramid, indicating no significant change during the recent two years. It presents its most noticeable disfigurement between 1993-95 mainly by males falling under 20-30 years old, which is also explained by the high emigration rates in this period<sup>7</sup>.

Year 1997 was somewhat tangible in the regular shape of the population pyramid as the unusual phenomenon that accompanied the befalling crisis in spring of the same year deteriorated the age structure of the population, mainly in reducing its share by young age groups. The emigration phenomenon as well as the 1997 crisis' effects are also sensed, though not to the same extent, even nowadays. So, if we refer to 2000 projections on the population, 15-19 years old group marked a considerable growth record compared to 1998. This age group comprises the most vital part of the population, assessed as the most real and potential for upcoming trends and valuations of labour market.

#### **1.2.3.2. LABOUR FORCE.**

The labour market supplies or otherwise termed the total labour force, marked year-end decline compared to the same period, previous year. In absolute value, this decline marked 40 thousand persons meaning that the labour supply fell by nearly 3.03 per cent compared to 1999-end. Notwithstanding the positive considerations on a labour force increase, judging from the optimistic forecasts on the age structure of the population, 2000 facts confirm the reverse: to be evidenced is not only a labour force decline, but, moreover, it makes up 2000 tendency throughout its entirety.

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<sup>6</sup> The data source is INSTAT.

<sup>7</sup> Male and female structure in Albania page 4, 1998, Social indicators Year book, an INSTAT publication, page 6, table 2.

### **1.2.3.3. EMPLOYMENT.**

The total number of employees at 2000-end was nearly 1.1 million. The almost constant performance during 2000 was on slight growing and declining vacillations on total indicators, reaching the lowest level in the fourth quarter. Compared to the same term, previous year, this figure fell by nearly 17 thousand persons or was 1.5 per cent less. 15 thousand persons evidenced the highest decline in the number of employees in the public sector of economy. Meanwhile, employment in the private sector of non-agriculture had a quarterly growing tendency, however, it was reduced 2 thousand persons compared to the previous year. Meantime, the private sector of agriculture presents a constant growing statement either on the whole of 2000 or compared to 1999.

Actually, the considerable decrease of employees in the public sector of economy was expected to have a fairer compensation or dissemination to lead increase to both to the private sector of agriculture or the private sector of non-agriculture employees. Facts demonstrate the reverse. On the whole, it has been assessed that the total number of employees has been reduced as a result of the continued reforms in the public administrate, privatisation and, perhaps as to the shrinkage in the private activity in the forth quarter mainly due to the power crises befalling in the country.

### **1.2.3.4. UNEMPLOYMENT.**

Unemployment rate<sup>8</sup> reached at 16.9 per cent at year-end or only 1.1 percentage points lower, than in the previous year. Of interest herewith is the fact that the number of jobless persons was higher by males than females, a mostly evidenced phenomenon in the second half of the year (52-54 per cent pertain to males whereas the rest corresponds to unemployed females). Unemployment rate, as a synthesis of the Albanian labour market situation, recognised a constant falling trend on the whole of 2000.

As already noted, the situation of employment and unemployment indicators, frequently, allows the performing of suppositions or hypothesis by not enabling the facility to make a clear study or analysis through figures. The positive demographic trends towards the increase of the labour market supply and the decrease of labour force have been two reverse tendencies of 2000 that require an as more explicit explanation as possible by respective institutions to produce and publish these figures.

Perhaps, the assessment of informal labour market and emigration should remain priorities in the daily operation of these institutions. This would serve directly the real labour market assessment in Albania, as it would help with data supply the indirect assessments in the social economic studies.

<sup>8</sup> Compared to the same period previous year, unemployment records about 23 thousand less at 2000 end. Based on the same reference terms, unemployment beneficiaries are about 2000 less.

**Table 4. Employment and unemployment indicators.**

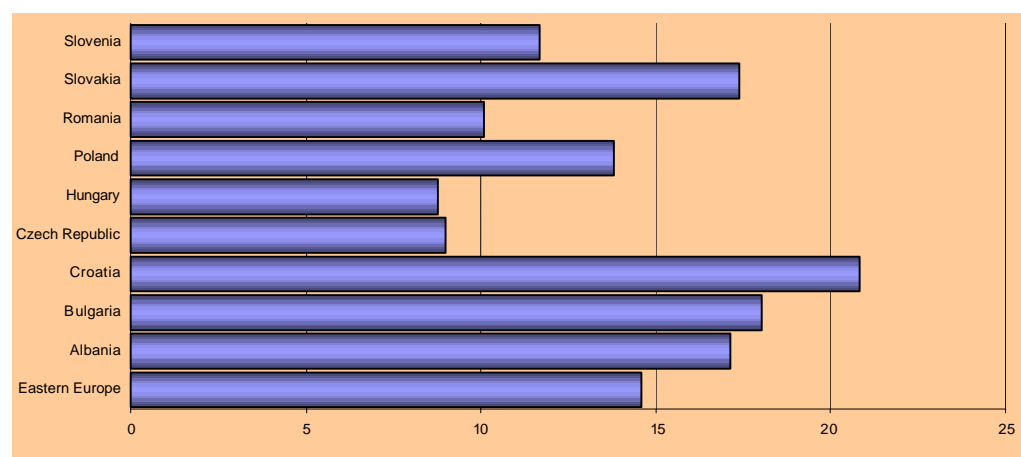
	Year 1999	Q.I Year 2000	Q.II Year 2000	Q.III Year 2000	Q.IV Year 2000
Total labour force	1321	1306	1293	1289	1281
A) Total of employees	1081	1065	1065	1066	1064
a) in the public sector	209	201	201	198	194
b) in the private sector of non-agriculture	111	103	103	107	109
c) in the private sector of agriculture	761	761	761	761	761
B) Unemployment					
The total of unemployed persons	240	241	228	219.2	217.2
Unemployment beneficiaries	23	21	22	21.9	21.3
Unemployment rate in (%)	18.0	18.4	17.6	17.01	16.95

**Box 3. The labour market situations in some Eastern European countries.**

Notwithstanding the remarkable recovery of transition economies, employment continued its falling tendency in many countries, especially, in Eastern Europe in the first half of 2000. The main reason for the subsistence of such unemployment figures must have been the extension of restructuring process for enterprises, which in most of the cases, is accompanied with a shortening of work positions.

At the end of August 2000, the overall number of unemployed persons, registered in transition economies by the Economic Commission of Europe, was 17 million (this was 7,6 million in Eastern Europe, 350,000 in Baltic States and 9,1 million in Independent States of Commonwealth). The reduction of the total unemployed, since August 1999 (by nearly 5 per cent) reflects mainly recovery in Russia, as the number of jobless persons increased by 7 per cent in Eastern Europe and by more than 14 per cent in Baltic States.

In the majority of the Eastern European countries, unemployment continued to increase during the first eight-month term of 2000 and in winter, five countries (Bulgaria, Croatia, Czech Republic, Romania and Slovakia) reported the highest unemployment rates since the early transition in 1989. In spring and summer time, there were noted slight improvements in some countries, while in some others, the situation continued to deteriorate.

**Chart 4. Unemployment rate (August 2000).**

**1.2.3.5. INCOMES.**

The most significant indicator of the living standard of the population is the incomes. Compared to 1999, year 2000 noted a slight growth of this indicator. Thus, in the fourth quarter 2000, the monthly average wage in the public sector of economy was nearly Lek 14,891. It had an average growth in absolute value by Lek 2348 or it was about 19.06 per cent higher. Meantime, the minima admitted wage at the end of 2000 was Lek 7000. Compared to the previous year, it improved by nearly Lek 1200 or it was nearly 20.7 per cent higher. These indicators had slight increase throughout 2000 quarters; meanwhile they did not recognise changes by specific terms.

Although insignificant, the observed changes took into account the previous inflation developments, its 2000 forecasts as well as the previous year policy on budget incomes and expenditures.

It may be assessed that changes in wages per sector of economy indicate that the private sector competes vitally with the public sector of economy. This makes public sector employees be frequently employed by the private sector of economy, in most of the cases, increasing the number of informal market employees. On the other hand, this group makes up a contingent of work unmotivated persons from the financial point of view.

In the same light, the observed differences are also by the economic activities exercised. By highly important and difficult sectors of economy, the wages are significantly higher than in other sectors. The geographical position is another factor to affect the assignment of wage differences.

**Box 4. Assessment of poverty in Albania.**

Poverty in Albania is a many-dimensional phenomenon, expressed by the low level of incomes and consumption, the low educational level of the population, the high unemployment rates etc.

There are various indicators to weight the gravity of poverty such as: the low level of GDP per capita, the average life-time, the quality of health service and the opportunity to use the service, the low educational level, the high unemployment rate etc.

The assessment of poverty requires a considerable number of data accessibility, which lack stiffens excessively, the provision of an exact answer related to the assessment of poverty in Albania.

The relative concept of poverty used by INSTAT provides more data attached to the unequally in the distribution of incomes than related to poverty<sup>9</sup>. European countries frequently use as relative measure of poverty 50 per cent of income median per capita or consumer unit or the amount that corresponds to the first quarter of that income. Up to now, this concept has been used to perform poverty attached assessments by INSTAT.

For 1999, GDP per capita in Albania was nearly USD 1129, while for countries in the region it varied from USD 1540 (Bulgaria) to 19710 (Italy).

Poverty in Albania is, moreover, a rural phenomenon by more than 80 per cent of the poor situated in countryside. The poor of the rural area are frequently acquainted five times more in the northern area of the country where most of the families own less than 0,5 acres of land. By 1998 data, 27 per cent of rural families do not market products and only 50 per cent use mechanical machinery and equipment of agriculture.

In INSTAT social yearbook, there are reported indicators of subjective poverty:

- \* Nearly 27.3 per cent of Albanian families can not afford the power and water supply bills in country level;
- \* Albanian families indicate a low rate of equipment with household appliances, so: nearly 45 per cent of families in areas with less than 10000 inhabitants are not disposed of a colour TV-set, whereas in towns with more than 10000 inhabitants, this indicator is nearly 13 per cent; 40 per cent of rural families are not equipped with refrigerators and 87 per cent of them do not have washing machines.

The above indicators demonstrate as somewhat higher by urban areas, however in country basis, the equipment with long term using appliances is low.

- \* Poverty is more tangible by 5 or more children families. Poverty indicators are also correlated with the gender of the family head. So, from the families that can not afford to pay the water and power supply bills nearly 28,4 per cent of them are governed by females and about 27,2 per cent by males.
- \* Poverty in Albania is a more frequently acquainted phenomenon in the families where the family head is unemployed. About 32 per cent of these cases can not afford to pay water and power supply bills.

<sup>9</sup> Income median per consumer unit have been used by INSTAT to calculate the population or the families that live on a certain income verge that might be considered poor. To calculate the consumer unit, there have been utilised the OCDE rates: the first family head, a senior citizen, is considered one consumer unit, the second family member, elder aged, is considered as much as 0,7 percent of consumer unit, children under 14 years of age are considered as much as 0,5 per cent of consumer unit.

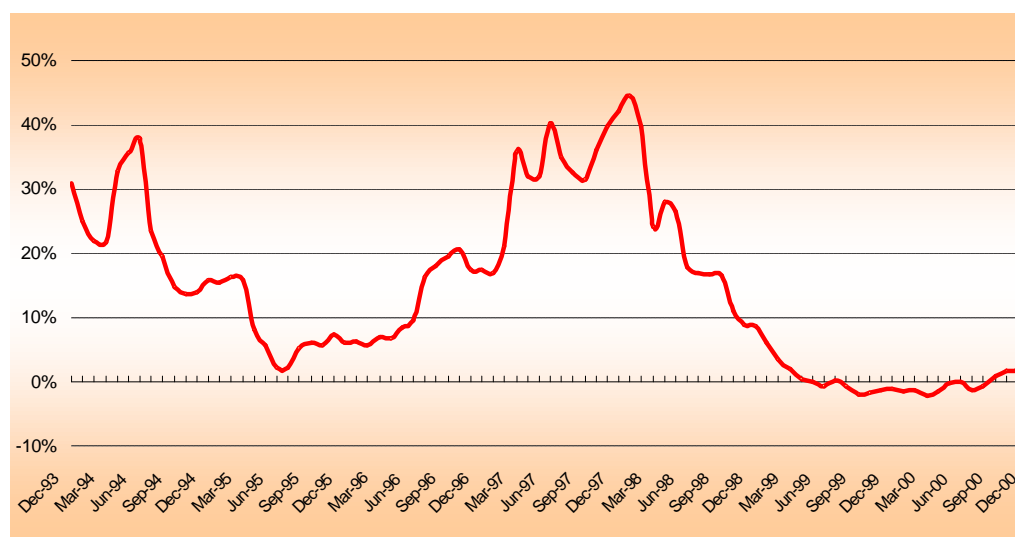


- \* The potentiality to benefit from these health care services is restricted and, when managed to acquire, this service is of a low quality above all. Budget expenditures on health care for 2000 amounted to only 2,2 per cent of GDP. A similar figure is from the lowest in the region. Infant mortality is very high in Albania, nearly 40 per 10000 newborn babies.
- \* The standard of school registering interim 1999-2000 is reduced by secondary schools, especially. The share of budget expenditure for education has fallen from 3,8 per cent in 1995 in 2,86 per cent of GDP for 2000. These are much lower figures than those of the neighbouring countries are. Nearly 3 per cent of school children, during the recent 10 years, quit school, annually.
- \* Though the standard of electrification in country level is very high there are noted continued interruptions of power supply, especially, in winter time;
- \* As to the possibility to benefit from life services (as water supply, waste pipe lines), the actual problems remain very high. Only 15 per cent of rural areas are water supplied by regular pipelines.

The strategy for the reduction of poverty in Albania must concentrate on a relatively equal dissemination of benefits to the entire population, the better opportunity anyone should be disposed of in order to benefit from public services offered by medical and educational institutions. Albania has still much more to do under the framework of the Program for the Reduction of Poverty and Growth Facility (PRGF), the important thing is that its commitment to practise the program be as more efficient as possible.

### 1.2.4. THE CONSUMER PRICE INDEX AND INFLATION.

Year 2000 outset in the conditions of a negative inflation rate to reach the level of 4.2 per cent rate at year-end. Although 1999 developments were exceptional in view of inflation decline beyond any forecast; they had no special effect in fixing inflation target to 2000-end. More concretely, as final target of monetary policy, the inflation rate (measured as 12-month change) was determined to not fall out the 2-4 per cent interval at 2000-end. In assigning this target (some times higher than the confirmed rate at 1999-end), Bank of Albania based on the supposition that 1999 inflation, was mostly a product<sup>10</sup> of shock phenomenon, emerging more precisely in the form of the regional crisis (the Kosova conflict).



**Chart 5.** The consumer price index (its 12-month change in per cent).

For not fully<sup>11</sup> studied reasons, inflation rate continued to be negative throughout the whole of 2000, making us believe that achieving the target would be difficult target to acquire and that reaching the floor value of the targeted interval was also questionable. In fact, this expectancy proved a wrong one, as the last two months of the current year were sufficient to capsize the previous developments. So the annual inflation rate did not only increase significantly but exceeded the upper target by 2 percentage points.

Although evasion from the target was of an insignificant extent, year-end developments revealed some previously evidenced problems by the Bank of Albania. Before ceasing, concretely, by each of them, it would be worth to underline that the Albanian economy did not manage to escape the shock factor effect. From summer time, it was noted a strong upsurge in the market price of fuels, which level remained high till year-end.

<sup>10</sup> Such crises effects have been broadly explained in all Bank of Albania's and international institutions' papers proposed on this matter.

<sup>11</sup> Here we would like to specify similar elements related to the seasons and the retarded effect of the above crises etc.

Furthermore in advance, in the last two months (November- December), the economy faced another crisis, that of power (which continued to be present even at 2001-onset). Meantime that the first shock effect was somewhat straight and measurable (luckily or strangely enough, the fuel price did not cause troubles to the economy), the second shock effect was hard to accurately define; however it might be fairly considered as a shock effect of the aggregate supply.

2000-end developments repeated although not on a higher intensity, this time, the effective developments at any year-end; the speculative increase of consumer prices before year-end festivities Year-end shocks are almost becoming a tradition, transforming into a constant risk development to the monetary policy efficiency and the achievement of inflation target. In fact, we refer to a strange phenomenon, which is ever more assuming the aspect of a seasonal effect. Year-end festivities might be a factor to justify the extension of the aggregate demand in December. Given the consumer price change by CPI classes, as an indicator of the rising demand, we note a strong growth of foodstuff prices 95 per cent caused by the growing price of fruits and vegetables. Whether neglected, the consumer prices of this inflation category result only per 0,63 per cent which in real term's means only 0,2 from 4,2 per cent actually.

**Table 6. The consumer price growth during December (in %).**

Indicators	1998	1999	2000
Inflation	2,05	2,25	4,6
Inflation by "foodstuffs, beverages and tobacco"	2,54	2,99	6,6
Inflation by "fruit and vegetables"	9,13	9,98	24,8
Inflation (omitted "fruit and vegetables")	0,74	0,53	0,63

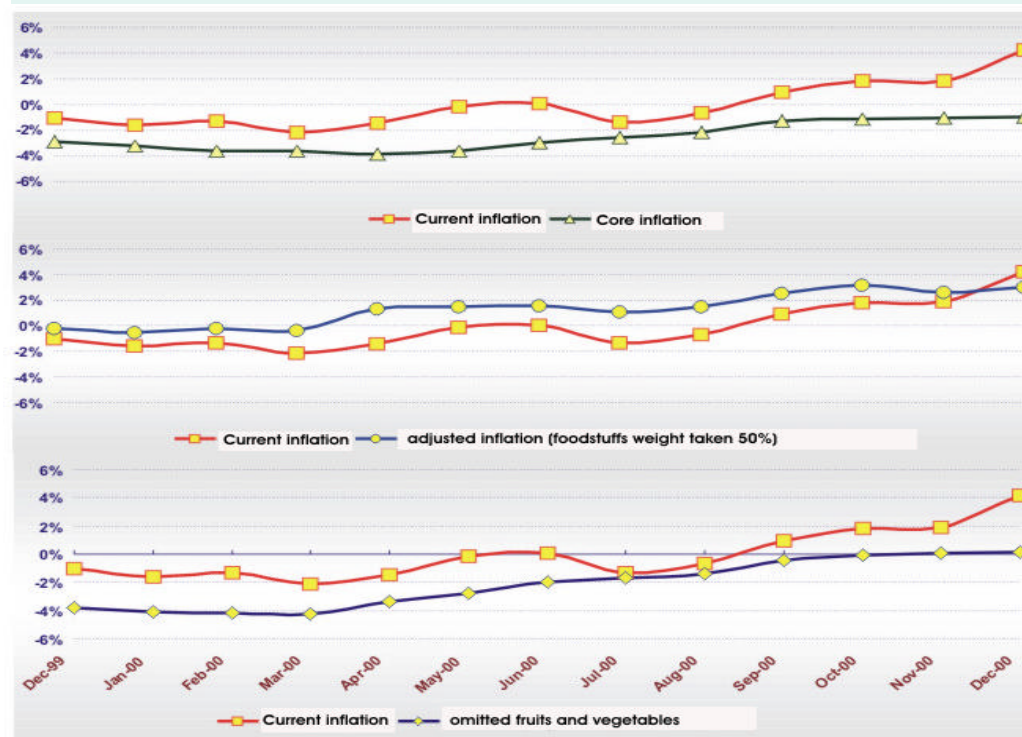
**In conclusion, we can assert that available weights indicate a high growth of CPI, which, at 87 per cent rate is a contribution of the growing demand on foodstuff items, fruit and vegetables.**

There is no doubt that two problems exist actually; the relatively old composure of the CPI basket and the speculative phenomenon with foodstuff prices evidenced on a growing intensity for fruit and vegetables. Though at first glance it may seem a paradox, what happens in fact is that the strong speculative growth of fruit and vegetable prices in the last 10 days of the year capsize everything in the achievement of inflation target. To avoid practises of this nature, especially, in the countries where the applicable monetary regime is called inflating targeting, inflation is accounted as a 'stripped off' indicator from the above nature effects and is mostly called core inflation.

### Box 5. Core inflation.

Central banks and inflation are ever more viewed as one-another derivatives. A successful central bank that succeeds in maintaining low and stable prices and the reverse, a stable inflation on a long term, makes up an adequate motive to enhance central bank credibility and independence. As already mentioned, inflation is not in all the cases an attribute of the monetary policy applied.

Ceasing by the inflation rate, the performance of the commonly observed or permanent phenomenon is constantly guided by the demand, while temporally exceeds consist in relative prices. Similar developments mostly happen as a result of the interaction of the supply. The permanent element, commonly termed **basic or core inflation**, is assessed as a direct result of monetary policy. Generally considered as a temporarily "upset", the effect of relative price developments, viewed from the monetary viewpoint, must be ignored either from the decision-making or the analysis of previously taken decisions.



**Chart 6.** Inflation - various measurements in Albania.  
(December 1999 - December 2000; 12 - months change).

In the case of Albania, the endeavours to set up a similar indicator have been insignificant as long as the Albanian authorities did not feel the necessity to measure the inflation rate caused by the growth of money or the aggregate demand. Amongst the scholars to have dealt with this item is Doris Schiesser<sup>12</sup> (1995) who has concluded that the best approach to core inflation in Albania' case is the one based on the trimmed average (systematic) where x percent of each momentum of spread is eliminated by leaving in effect only the average weighted of the kernel (1-2x). At the end, she has concluded that the best measurement of inflation is that variant that avoids 25 per cent of the trimmed average (12,5 percent of goods for each momentum of spread) and is focused only on the core average of spread by 75 per cent.

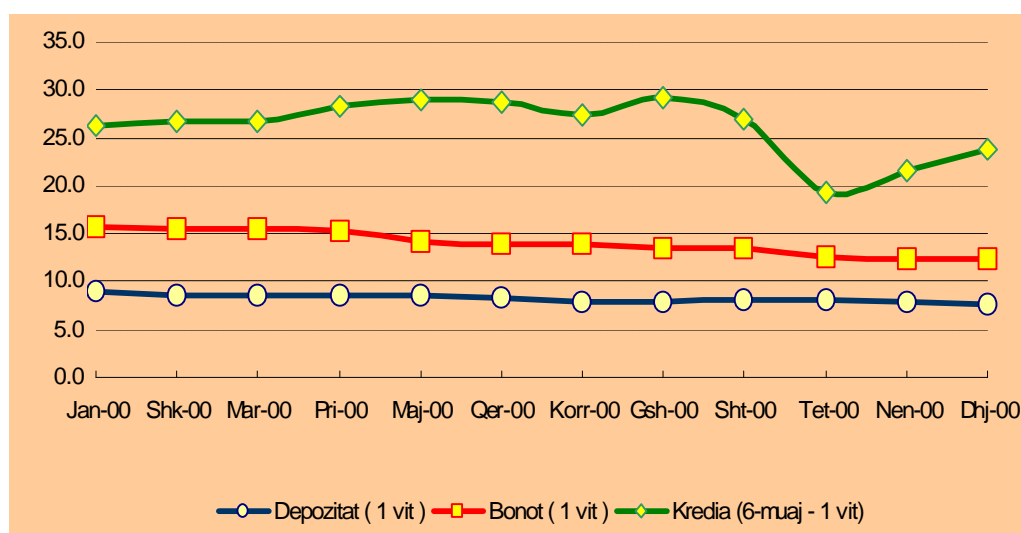
<sup>12</sup> The study covers 1993-1995 term.

With the passing of years and the stabilisation of inflation by single-digit rates and very close by zero in the recent two years, the calculation of a similar indicator becomes difficult task to acquire given the 1997<sup>13</sup> presence. In the performed computations, it is given the 1993-1997 presence (in some cases, it has been avoided a single month, a certain term or the entire of 1997). Meantime to the attempts to measure core inflation there have been attached some other measurements where the first takes into consideration the diminishing share<sup>14</sup> of inconsistent items of the basket and the second transforms in zero the share of the most vacillating items. Based on the criterion of assessing results, the magnitude of the ratio of standard evasion to the average, and the degree of correlation amongst all measurements to the current inflation remains the best measurement focused on 75 of the core spread (where 25 per cent is trimmed average).

#### 1.2.4.1. INFLATION AND BANK OF ALBANIA'S MONETARY POLICY.

Inflation in Albania has followed an unexpected spiral in the five years at late. After reaching a single-digit level at 1995-end it tripled in the successive year-end to reach a new peak of 42 per cent at 1997. Its placing under control in 1998 was reflected in achieving a low figure of only 8.6 per cent tracked by another exceptional figure of -1.3 per cent in the next year. This inflation performance was more than sufficient to urge Bank of Albania to undertake a loosening of its monetary policy reflected in a successive reduction of interest rates throughout 1999 and 2000.

The monetary policy in 2000 had the same target that of maintaining the consumer price stability, which in quantitative terms meant in interval target of 2-4 per cent rate. Monetary policy decisions at early year were merely a continuation of previous year policy with constant cuts on time deposit rates in Lek established with state-owned banks. The reaction was a negative inflation rate disclosing this way a lack of interest rate flexibility, which by mid-1997 played really the role of a core rate in economy.



**Chart 7.** Market rates (12 - month maturity, annual rate).

<sup>13</sup> Year 1997 marks an overthrow of any achieved balance interim the 3-4 pervious years. In general year 1999 should be side stepped as evidenced evasions in this year affect the statistical series behaviour during the whole of 1993-2000 period.

<sup>14</sup> The diminution of weights is made through the multiplication of the current share of the commodity with the historical deviation rate of the consumer price changes relative to that commodity.

That is understandable for the fact that we did not recognise any credit expansion to the economy (credit extensions have been mainly in foreign exchange). Although the lending rate was somewhat cheaper, the budget of state profiting from the favourable circumstance of privatisation during 2000 did not contain a high pressure for liquidity. In this way, the treasury bill-yield diminished continuously for the three terms of maturity on the entire year. It must be asserted that in the conditions of a living reality of a not so efficient monetary market and an interbank market ruled by the Savings Bank, the latter price is not so strange to gain the attributes of a basic rate in economy.

Albeit the spread between the quarterly deposit rates and treasury bills yield on the same maturity diminished significantly, it might be said that the latter significance bleached so profoundly as to not comprise a motive for investors and second-tier banks any more. Chart 5 illustrates the spread between T-bill yield and the lending rate on one hand and the time deposit rates on the other. As inflation continued to be negative, Bank of Albania assessed that the administrative interest rate was not the appropriate instrument to affect the economy any more. As a result it was deemed rational to resign it. This step marked the final separation from the application of direct instruments of monetary control.

In this way it was decided that the monetary policy effect would be totally confided to Repo rates that Bank of Albania would be carrying with second-tier banks. It is still early to give an accurate opinion on the efficiency of this instrument. The short time of using it (only six-month) does not allow a similar possibility. Nevertheless, the overall table at the end of 2000 registered lower interest rates than at previous-year end per all types of maturity.

Bank of Albania has practically understood that its challenge remains the improving application of this instrument, which before all implies an improvement of all transmission conduits, where, undoubtedly, the most conspicuous are: the money market, credit conduits and the assignment of expectancies in economy. Among others, this means a higher interest of private banks against Lek, a reduction of the ruling position of the Savings Bank, the incitement of private banks to credit in Lek and to increase their participation in the primary and the secondary market of T-bills.

Bank of Albania believes that there have been created the first premises to substitute the current regime of monetary policy with inflation targeting, a very preferable monetary policy, that albeit its restrictions, especially, for country in transition, is currently applied by an ever larger number of countries.

### Box 6. Is it really the time to adopt inflating targeting in Albania ?

To adopt the inflation-targeting regime, any country is necessary to comply with some terms in the macroeconomic and institutional aspect. How many does Albania comply with these terms? The answer to this question would provide a clear idea on the appropriate time to adopt this regime.

#### I. Macroeconomic Aspect

##### Inflation

Literature, on the whole, recommends that a low inflation stretch of 2-3 years should commonly precede the adoption of *inflation targeting* regime. On the whole, the recent years' tendency has been the reduction of inflation rate. However, in different years we note the presence of the shock factor either for high or low inflation rates. Based on the current inflation performance although it has only two years that wanders by very low levels, it can be said that there are premises to apply an inflation targeting regime.

##### Exchange rate

The exchange rate regime is one of the strongest points to the adoption of *inflation targeting*. Bank of Albania has the exclusive authority to take decisions to select and manage the type of foreign exchange policy within the Republic of Albania's territory. From 1992, the applicable regime has been a free-float regime of foreign exchange that comprises one of the most important criterions for the initial application of *inflation targeting*.

##### Fiscal consolidation

The recent years have priced important steps ahead to fiscal consolidation. However, it is still premature to talk about fiscal consolidation and stability. From this viewpoint, and knowing the difficulties in selecting that part of inflation caused by the fiscal policy, it might be said that as long as the T-bill market will be the only securities market in Albania, as long as Government borrowing would not be legally restrained from Bank of Albania and as long as political forces will miss a total and a reliable engagement for a transparent and rigorous management of fiscal incomes etc, the successful application of inflation targeting will be difficult to achieve.

##### Financial stability

Albania's immune system against financial crisis has many problems, which although recognisable in time are not yet managed to eliminate. Such a weak immunity makes the Albanian economy have a high rate of exposure and a very important condition of *inflation targeting* remains discontented consequently.

#### II. Institutional aspect

##### Central bank independence

Although the central bank is legally provided with an independent position, however, bank independence remains far off this legal standard.

##### Central bank transparency

Bank of Albania is not fully transparent to the core: in the explication of the decision-making process especially monetary policy issues.

##### Central bank credibility

It can not be affirmed that Bank of Albania has finally won the public confidence. As highly affected by shock and speculative factors, inflation divergence from the target remains of high potentially in Albania.



Legally, Bank of Albania also has a high level of responsibility measured by reporting duties. However, actually, its accountability must be growing.

#### Relations with the fiscal authority

The level of co-ordination between the fiscal and monetary authority does not reflect the required rate by *inflation targeting*. Whether in the macroeconomic aspect exist factors that urge selection of inflation targeting as a monetary policy regime, in the institutional aspect; its weak points are assessed to have more weight.

### 1.2.4.2. OTHER FACTORS TO AFFECT THE INFLATION PERFORMANCE.

At the entry of this item, we mentioned that inflation in Albania is a product of other factors not directly related to monetary policy and indicators. The ***fiscal policy*** applied by the government during the past year was sustained by the budget income effect and the privatisation of large public enterprises, which aftermath was the observance of the programmed effects, notwithstanding the local election held.

Another factor, already traditional that affects the consumer price level is the ***exchange rate of Lek to USD and Euro***. The previous year, still, in fact, recorded the highest level of imported goods and services where consumer goods together with their price which, in many cases, make up a determining factor for inflation, occupied the most part. Partner countries to Albania, generally, indicate low inflation rates and it is but understandable that it is the exchange rate, the factor that usually affects the import and consumer prices aftermath. In the same light, the European currency depreciated significantly (naturally, by all component currencies) against the US dollar. Lek also followed the same tendency, albeit it is worth to underline that it was stable against Euro. This fact points out that Euro, as the ruling currency in Albania's foreign trade, was a key factor to decide the consumer price behaviour.

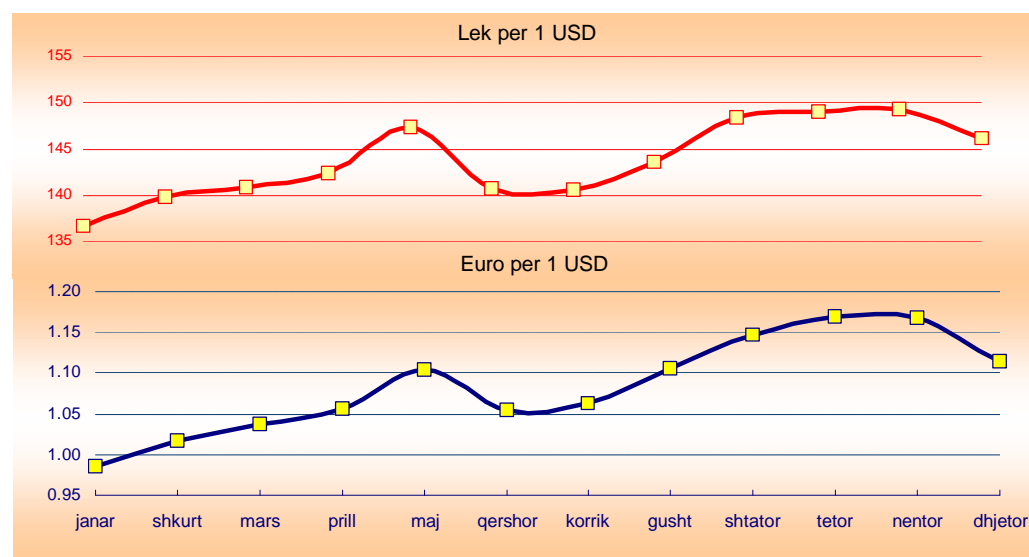


Chart 8. Exchange rate (January - December 2000).



***Expectations in economy.*** Although yet it has not been undertaken a genuine study to define the role of expectations in economy, it must be stressed that, the last years especially, they have began to be present and conduct their lore in Albanian economy. Although all understand that the increase of prices at year-end is a speculative phenomenon, still people are prepared for this growth simply judging from the past, unless this year growth exceeded their expectations.

**Factors related to the rising cost of products** during 2000 were attendant in the form of the increase of nominal wage at 8 per cent and the increase of oil prices and the power crises.

Unless, the rising wages were officially announced only for the public sector of economy, it must have issued its own effect to the private sector of economy, which is hard to measure due to the data, deficiency.

As above mentioned, the effect of rising fuel prices in economy was relatively insignificant to bring to the conclusion that fuels, generally, do not compose an important element in the cost of output. Not omitting potential implications in the future, even in the case of the power crises, its effect in the rising cost of products remained low thanks to the administrative control on the electric power price, by not rhyming a factor for the rising cost of production.

In the same way, the missing rhythm in performing budget expenditures brings difficulty in the management of liquidity, the considerable flow of circulating currency per certain periods of time and the commotion of the consumer price level, consequently.

### 1.2.5. FISCAL STATISTICS OF GOVERNMENT.

Year 2000, was characterised by government endeavours to reach a more efficient fiscal consolidation as possible with respect to a more systematic cropping of income in total and controlling the performance of budget expenditures.

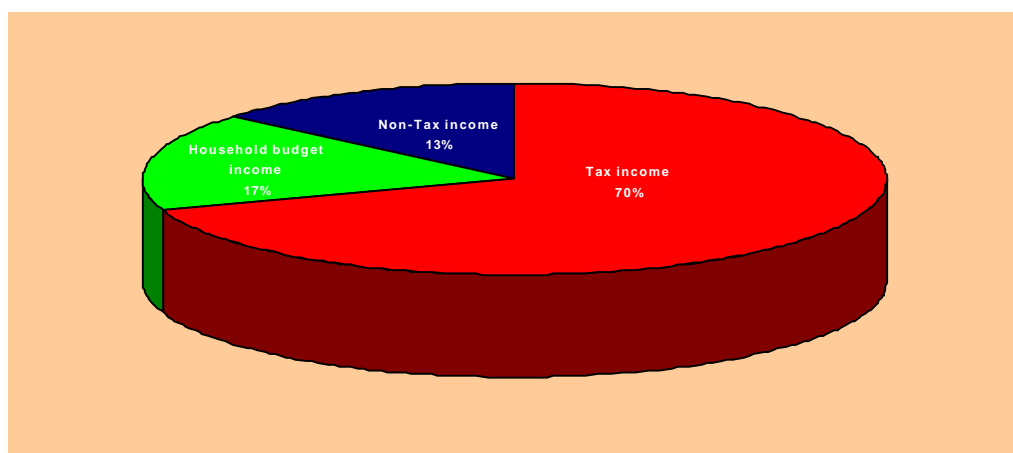
#### 1.2.5.1. BUDGET INCOME.

According to the preliminary data<sup>15</sup>, it is confirmed that total income cropped to 2000-end were at Lek 120,3 billion or nearly 97. 2 per cent compared to their annual forecast on 2000. If we refer to the previous year data of the same term, they have had a nearly 12 per cent growth.

3 percentage points below the annual forecast have positively affected the level of accomplishing annual incomes affected by:

- \* Slight exceeds in the item of tax income (by 2 percentage points) where custom and duty tax income occupy the bulk of it. It is worth mentioning that the most noticeable exceeds for this group income are represented by those deriving from the application of profit tax (+30 per cent) as well as those deriving from the application of private income tax (+ 12 per cent);
- \* Slight exceeds are also with the item of income from the local tax (5.2 per cent).

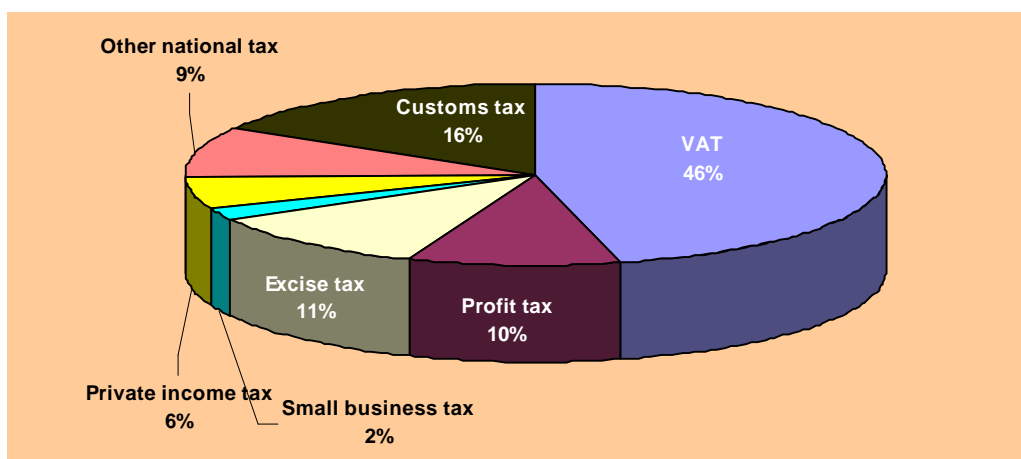
Meantime of negative impact in meeting the income fact, have been the low levels of non-income tax by 17. 1 percentage points under the annual forecast (income deriving from budgetary institutions). Income structure at the end of 2000 points out tax income as their main effect. They comprised nearly 70 per cent of the total income (See: chart 16).



**Chart 9.** Income structure.

<sup>15</sup> The analysis is based on the preliminary data ensured from the Ministry of Finance, March 2001.

In view of the fact that tax income occupy a considerable weight in the total income and moreover, it is them to have affected a positive effect in the value of the total income, it would be of interest to study the structure of the most important and the largest part of these income. Nearly 98. 4 per cent of tax income derive from customs and tax organs of state.



**Chart 10.** The structure of tax income.

Income, deriving from the application of VAT, occupies nearly 46 per cent. Whereas customs income discloses a 16 per cent weight (See: chart 22).

If analysed the performance of accomplishing total income, implicitly, and those deriving from the application duty tax, explicitly, they would indicate following rates.

**Table 7 : Quarterly income – performing rates.**

Fact (in %)	Q. I	Q. II	Q. III	Q. IV	Year 2000
Total income	23.2	22.9	24.3	26.9	97.0
Tax income	22.9	22.9	26.6	28.0	100.3

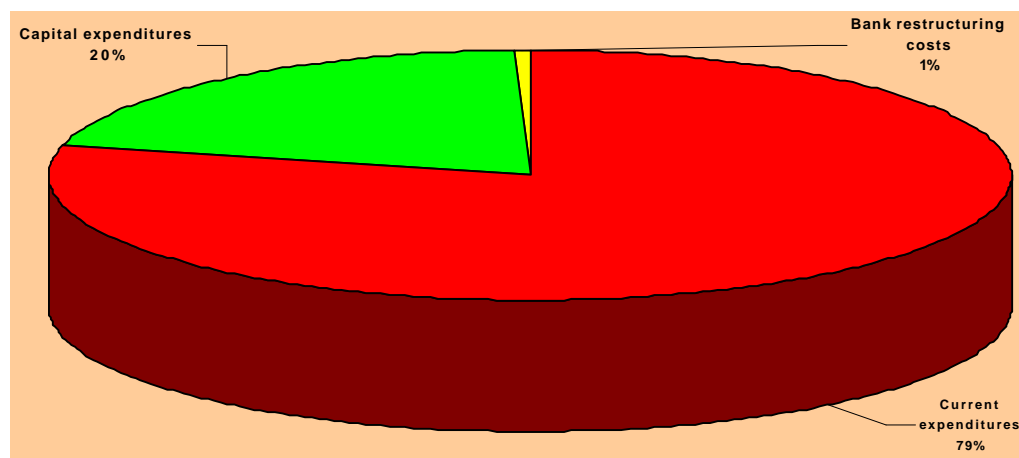
Generally noted is that the performing rates are systematic either for total or tax income where the most conspicuous is a slight growing trend evidenced in the last months of the year. On the whole, there is a positive tendency expressed in the increase of accomplishing budget incomes, particularly, in the group of tax income from customs.

### **1.2.5.2. BUDGET EXPENDITURES.**

Considerations on the macroeconomic situation of the country can not be complete without analysing the statement and the performance of budget expenditures. One of the resources of macroeconomics stability and maintain inflation control is the manner of performing separate expenditure items.

If we refer to the preliminary data of fiscal statistics of Government, it is evidenced that budget expenditures at the end of 2000 marked a non-fulfilling result per about 4 percentage points. Compared to the previous year, they increased by nearly 1.9 per cent.

Stopping by the two largest groups of expenditures, we would be evidencing a slight exceed in current expenditures (See; chart 23). That exceed has been offset by the non-fulfilment in capital expenditures by 7 per cent.



**Chart 11.** The structure of expenditures.

Staff expenditures for wages comprise the largest item of current expenditures, by nearly 25 per cent. (Or 19.6 per cent of the total expenditures) leaving in second place interest expenditures by 21.4 per cent of the total of current expenditures at 200-end.

A special attention must be attached to the rate of performing expenditures. The experience has demonstrated that they are mostly concentrated and performed on no criteria at year-end. Moreover, they become inflationary pressure carriers reflecting the expected inflation by the highest rates. In the same light, year-end needs for liquidity also become more evident to the point that they may set in difficulty the application of monetary policy aspects. So, nearly 32 per cent of expenditures remained to be performed in the fourth quarter of the year.

Capital expenditures manifested the most disorderly view in this aspect. They were complied at 55 per cent rate to the end of the third quarter 2000. Only in the fourth quarter of the year they were contented at 38 per cent.

### 1.2.5.3. BUDGETARY DEFICIT.

Deficit performance and its year-end value provided resultant data on the macroeconomic situation of the country, which to some extent was assessed as steady. The country closed the budgetary deficit by Lek 48, 6 billion at year-end. July marked its highest value by nearly Lek 5,8 billion. On the other hand, compared to its 2000 forecast, it valued a 93 per cent fact. Nearly 54.0 per cent of it was financed by domestic resources and the rest of it (nearly 16 per cent) by foreign resources. Amongst the domestic resources, privatisation receipts to year -end reached the highest figure of Lek 9 billion or 28 per cent higher than the forecast. In this figure it is sensed the instant effect of privatising important state-owned enterprises. Therefore, August marked the source of this effect.

Meantime, privatisation receipts to the end of December 2000 occupied 30 per cent of domestic financing.

The higher than expected increase of privatisation receipts did not enable significant growth of government needs for bank financing.

**Table 8. Fiscal budgetary indicators against GDP<sup>16</sup>.**

	1994	1995	1996	1997	1998	1999	2000
<b>Total income</b>	<b>24.1</b>	<b>23.4</b>	<b>18.3</b>	<b>16.5</b>	<b>16.9</b>	<b>21.1</b>	<b>22.4</b>
From wich : tax income	16	13.2	10.7	9.8	12.3	12.7	15.6
<b>Total expenditures</b>	<b>33.1</b>	<b>33.6</b>	<b>31.3</b>	<b>29.5</b>	<b>27.3</b>	<b>32.7</b>	<b>31.4</b>
From wich : capital expenditures	3.4	8.3	6.3	4.4	5.3	5.8	6.5
<b>Deficit financing</b>	<b>-9</b>	<b>-10.2</b>	<b>-13</b>	<b>-13</b>	<b>-10.4</b>	<b>-11.6</b>	<b>-9.1</b>
Foreign	0.4	3.7	2.8	1.9	3.8	6.1	4.2
Domestic	8.6	6.5	10.2	11.2	6.6	5.5	4.9

<sup>16</sup> The Ministry of Finance & IMF.

## 1.3. EXTERNAL SECTOR DEVELOPMENTS

### 1.3.1. BALANCE OF PAYMENTS.

Balance of payments developments for 2000 evidence a high growth of current transactions mainly caused by the rising value of service transactions. On annual basis, the total of current transactions for 2000 valued about USD 3 billion (80 per cent of GDP) or nearly 24 per cent higher than in 1999. Additionally to services, current transactions and the foreign trade in goods have also contributed in this growth. At year-end, current account recorded a higher deficit of 14.3 per cent than at 1999-end. However, it is necessary to be evidenced that current balances, excluding official transfers valued 17 per cent lower than in the previous year. High inflows in capital account not only enabled a full coverage of the current deficit but also affected increase of the monetary authority reserves.

#### 1.3.1.1. FOREIGN TRADE.

Foreign trade developments in goods for 2000 were characterised by a further import growth and a turbulent circumstance in goods exports. (Chart 7, 9). The total of foreign trade transactions in goods increased by more than 9 per cent and this was totally as a result of the growing imports. For the first time, total transactions in goods exceeded the figure of USD 1 billion, increasing by about 14.1 per cent higher against the previous year. Reverse from imports, exports fell by nearly 7 per cent compared to the previous year. Consequently, compared to the previous year, the foreign trade deficit in goods was further extended by 23 per cent, meaning USD 814 million in absolute figures on entire 2000. Foreign trade transactions were mainly concentrated in traditional neighbouring partners such as Italy, Greece, and FYROM ECT (see: chart 8). Meantime, trade with Euro countries represents about 75 per cent of the total of foreign trade transactions.

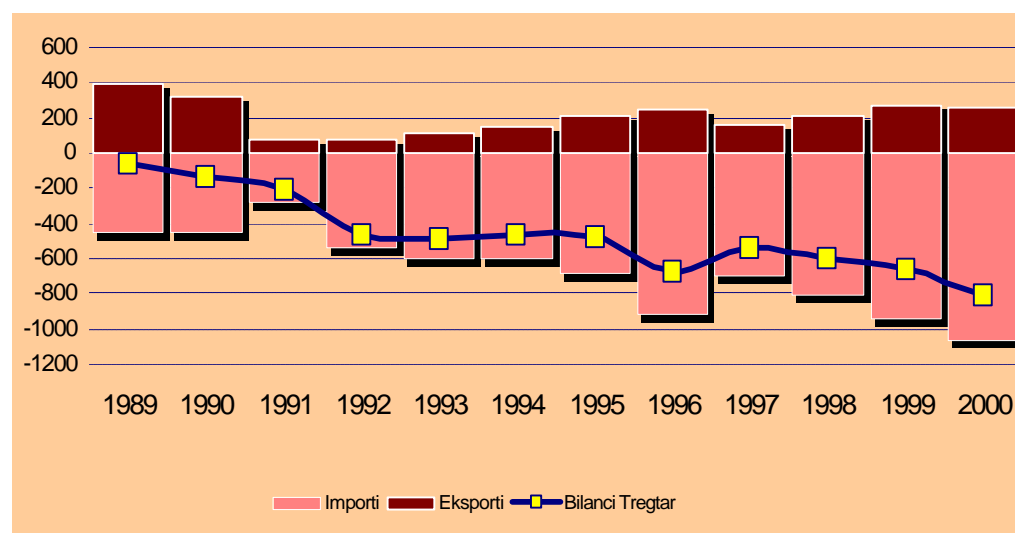
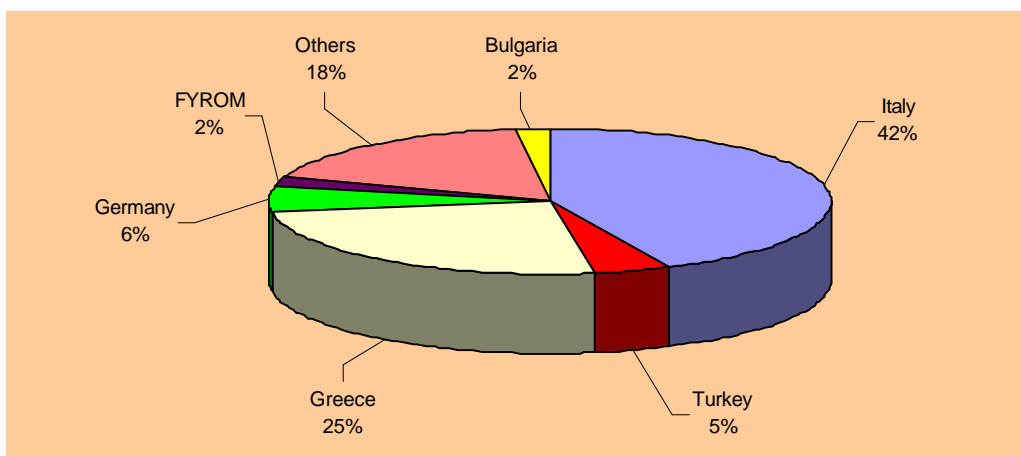


Chart 12. Trade balance (in millions of USD).

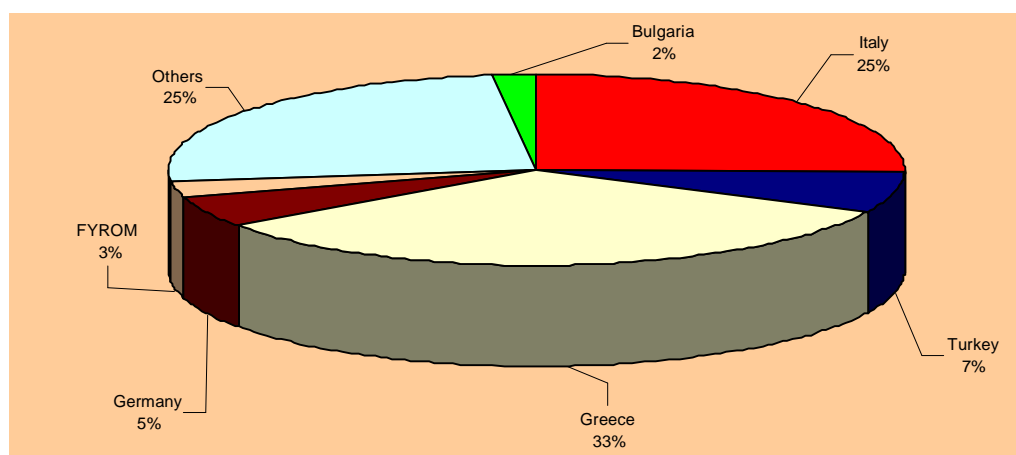
Pricing a record value of USD 1.7 billion, imports disclosed growing tendencies since at the beginning of the year, but they indicated a particularly high growth in the last quarter of the year mainly as a result of pressing need for imports of electricity. The power crisis effect that seized the country with the beginning of 2000 was reflected in high imports of “mineral products”, including imports of electricity and fuel and those of “machinery & mechanical and electrical appliances”. Compared to the previous year, these merchandise imports increased by 37 and 74 per cent respectively. Reverse from other years, foodstuff imports valued 5.6 per cent lower, than in the previous year.

However, in view of the fact that high imports of 1999 represent a rising consumption as to the Kosova crisis effect, that raised the population by 15 per cent and the domestic demand aftermath, it is not hard to draw the conclusion that foodstuff imports did not fall under 1999 level. “Vehicles of transport” and “base metals and articles” are amongst the merchandise groups that indicate import growth by 13.5 per cent and 10.5 per cent. Chemical industry and plastic products are other merchandise groups to also indicate import growth by 17.5 and 20.1 per cent. “Textile and articles” and “footwear and head dressing” are worth of mentioning amongst merchandise groups that indicate falling imports against 1999, by about 3 and 21 per cent, respectively.

Both groups mainly represent imports for active processing. Other declining groups did not play a determining role in the import performance and as such they do not deserve to be evidence consequently (see chart 10).



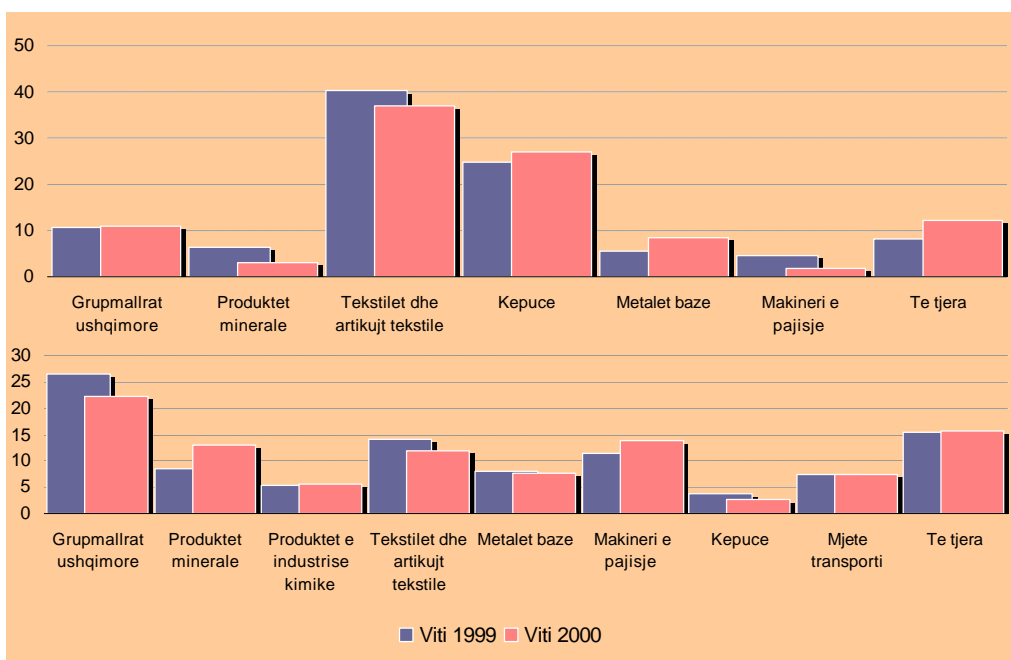
**Chart 13.** Trading partners (in % of the total).



**Chart 14.** Trade balance (in % of the total).

Reverse from the optimistic forecasts at year-onset, exports could neither succeed in meeting the expected forecast nor reach the previous year result, registering a 7 per cent decline. Such decline was, totally, affected by falling re-exports from active processing mainly concentrated by textiles and footwear. Exports from domestic production maintained the previous year level. In this group, the observed decline is by traditional groups of merchandise. Therefore, "mineral products" registered a significant decline of 44 per cent followed a 4 per cent decline by "foodstuffs, beverages and tobacco" Exports in machinery and equipment also valued a 36 per cent decline against 1999. In the group of rising exports against 1999, base metals and articles comprise the highest growth of 47.7 per cent.





**Chart 15.** Trade structure by groups of merchandise (in millions of USD).

### 1.3.1.2. INCOME SERVICES AND TRANSFERS.

Balance of Payment statistics on 2000 indicate that foreign trade services (mainly in tourism) are evidenced as a vital activity of the Albanian economy. Referring to Bank of Albania's assessments, income deriving from this activity are 1.5 times higher from exports meantime that Albanians have spent USD 272 million or over 51 per cent of the total emigrant remittances for 2000 in their travels abroad the country. As of this, the year-end balance of these services estimated positive per USD 117 million. With a similar activity, tourism dominated all trade developments in services, which closed on slight surplus of USD 22.3 million.

**Box 7. Tourism services.**

The current methodology accounts the number of foreign tourists leaving Albania and the number of Albanian tourists entering in Albania; their average stay and average expenditures per day. Statistics for these two groups are based on statistical survey results on income and expenditures from tourist services. Actually, the term of “changing methodology” fits more to the previously used methodology to estimate Albanians’ expenditures abroad which before the presentation of this survey based on the total of travelling expenditures of government and other public agencies. While to appraise the income deriving from tourism services, the term “change” refers to the adoption of the survey results on the average stay and daily expenditures of foreign tourists during their visit in Albania.

This survey on tourism incomes and expenditures was carried on five stages that stretched out during the entire 2000, intending coverage of all seasons with different tourism features. The purpose of this survey was to estimate the average duration and daily expenditures per tourist.

Results indicated a significant increase of average duration and daily expenditures per foreign persons visiting Albania compared to previously used estimates. To illustrate this, enough to mention that the average duration in days according to the survey oscillates between 6-9 days, whereas average daily expenditures vary from USD 112 to 73 per day. From the previous years’ estimates, it was believed that indicators of average stay and expenditures were respectively 5 days and USD 35 per day.

Referring to the survey, the average duration per Albanian tourists travelling abroad oscillates interim 8-9 days and the average expenditures vary from USD 32 to 52 per day. The instant growth of reported statistics under the Balance of payments’ travels additionally to the number of tourists was for the first time presented in 2000. Correspondingly, Bank of Albania reserves the right to review these statistics in case of revaluation or revision of core statistical indicators.

The very high estimates on tourism services are affected by the presentation of the new methodology on the appraisal of incomes and expenditure deriving from this activity<sup>17</sup>. This methodology bases on the estimation of average expenditures and stay per tourist which by Bank of Albania’s undertaking surveys made these indicators have a significant increase against previously used estimates either per foreign or Albanian tourists travelling abroad. This stiffens the comparison of statistics on income and expenditures deriving from different terms of tourism activity.

However, it must be affirmed that during 2000 we have a considerable growth in the number of travellers visiting Albania and those travelling abroad by 52 and 58 per cent respectively (as of the statistical data from the Ministry of Public Order). This might be considered as an adequate indicator to confirm increase by these services’ activity.

As it was expected, the increase of import volume brought about import growth by transport and insurance services. Such service categories have dominated other service transactions by respective categories of transport and insurance services (the deficit of transport services was 2.5 per cent higher than the previous year whereas the deficit of insurance services valued about 13 per cent higher than in 1999).

<sup>17</sup> See: Box 1-7.

“Other services” recorded a surplus value of USD 15.2 million or 2.2 times higher than in 1999. Such growth was mainly enabled after the shrinkage in expenditures of communication services and the increase of other income deriving from government services. However, their role in the development of trade services remained modest and of no noticeable effect. The above comments on the developments in trade of services indicate that, perhaps, the authorities’ attention to improve the current deficits, additionally to, the intentions to stimulate increase in goods exports and to narrow the trade deficit in goods must be also more concentrated in the trade of services.

The positive balance of “income” transactions at year-end is estimated about USD 107 million or 42 per cent higher than in the previous year. The entire growth is due to the higher income from the compensation of seasonal and borders employees and cumulative interests from the investment of the foreign exchange reserves of banks and other non-resident financial institutions.

Emigrant remittances for 2000 valued about 46 per cent higher than in 1999. The instant growth of these transfers was mainly as a result of their low level in 1999<sup>18</sup>. The rising flow of these entering transfers has been more than sufficient to cover the decline in items of official transfers which this year estimated only 58 per cent of those in the previous year. Of course even this decline reflects mainly the Kosova crisis effect during 1999.

Reverse from the previous year, when official transfers were governed by aids in goods, foreign exchange transfers were dominant in the structure of government transfers during 2000, representing 59 per cent of the total transfers. At year-end, the positive balance of current transfers valued USD 535 million or 51 per cent higher than in 1999. Additionally to emigrant remittances and the inflow of official transfers the rising surplus by this category is due to the falling outflow of other transfers. The growth in current transfers is also accompanied with an increase in capital transfers.

Notwithstanding the high positive balances of transfer categories, income deriving from trading services was not sufficient to cover the rapid growth of trade deficit in goods. Accordingly, the current account deficit extended by USD 19 million. Year -end estimate of current deficit was USD 152 million. (Chart 11).

<sup>18</sup> During 1990, the high surge of foreign exchange assets injected in economy by Kosova people during their stay in Albania, reduced the needs for emigrant remittances playing at the same time the role of substitute to these transfers that were also accompanied by high transfers for the Albanian Government. The Kosova crisis effects were only stretched out during 199 and as a result the 2000 statistics albeit the relatively high changes against 1999 did not reflect any peculiar phenomenon. They oscillate by average levels of anterior crisis term. Therefore, although pricing a record of USD 531 million, emigrant remittances for 2000 are comparable to emigrant remittances in 1998 whereas the level of official transfer inflows is appraised by the average of official transfer's interim 1994-1998 term.

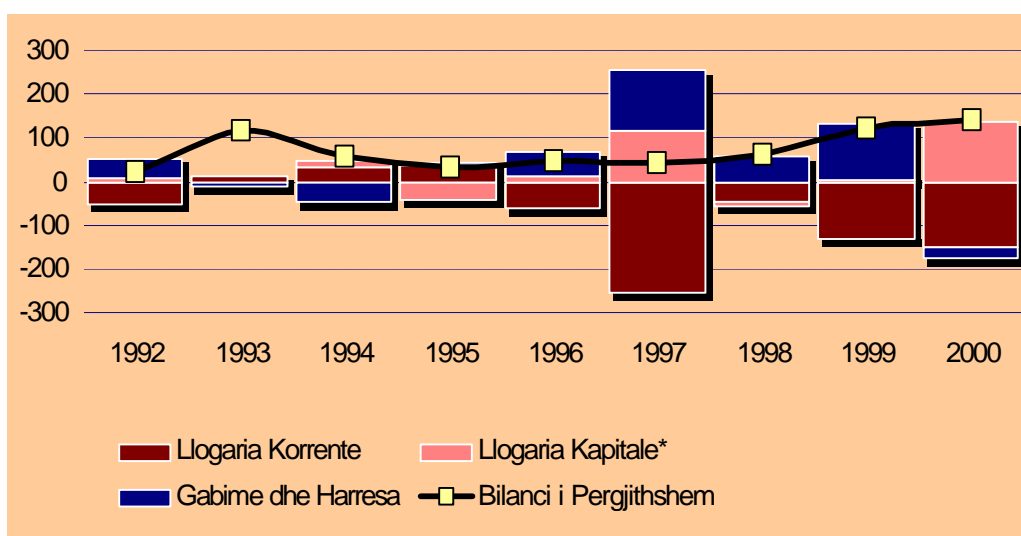
**1.3.1.3. CAPITAL ACCOUNT.**

Coverage (financing) current deficit was enabled by capital entries, which led increase to financial liabilities and decrease of foreign exchange deposits with second tier banks and other non-resident financial institutions. The financial account registered a positive balance of USD 240, 7 million at year-end. Such capital imports were mainly as a result of absorbing direct investments and foreign credit disbursements from abroad, which led an increase of financial liabilities to 44.5 per cent higher than in the previous year.

Direct investments, valued at USD 143 million, for the first time since 1999 (a year they were allowed for the first time), changed into a governing phenomenon to increase the financial liabilities and develop the capital and financial transactions in the current year. The highest capital inflows to 1999 were those registered in 1996, by about USD 90 million. In the years to come, direct investments under the effect of agitated situations in the country and broader in the region had declining inflows by USD 45 million. The increase of these capital entries by 3.3 times or USD 100 million against 1999 reflects mainly the effect of privatising large public enterprises.

Capitals invested in the form of direct investments have been added to the disbursement of foreign credit from abroad. These credit disbursements, at nearly USD 100 million (or 20 per cent lower than in the previous year) went, almost totally, in favour of "General Government", representing increase of this sector's liabilities. The World Bank remained the main government financing, as previously.

Year-end claims have only increased by USD 31.1 million. Comprising only 24 per cent of the total assets' growth for 1999, such a low growth mainly represents the extension of foreign exchange asset by public. In reverse case, after the USD 89 million growth in the previous year, bank deposits reflected only a USD 19 million increase in the current year.



**Chart 16.** Balance of Payments (in millions of USD).

The inflow of foreign exchange assets mainly in the form of financial capitals (mainly in the type of foreign credit disbursements and the use of fund credit and loans from IMF) and current transfers in cash were mainly reflected in the increase of the international reserve of monetary authority by USD 141.5 million for 2000 (about USD 18 million more than in 1999). This growth is mainly recorded in the foreign exchange asset. The level of foreign exchange reserves at year-end was sufficient to cover 6.8 months of imports (goods imports) against 6.1 at 1999-end.

### 1.3.2. FOREIGN EXCHANGE RESERVES.

At the end of December 2000, the value of the gross international reserves amounted to USD 607 million, while the net value of foreign exchange reserve priced USD 455.2 million (the foreign exchange reserve is estimated on the current exchange rate). From early year, the growing value of gross international reserves figured USD 126.24 million or 26.2 per cent. Foreign exchange inflows of this period amounted to USD 301.3 million where to specify is: the USD 57.3 million in the form of grants (from EU and others); USD 91.4 million in the form credit disbursements (IMF, IAS, EU); USD 113, 3 million in the form of bank purchasing (from other banks, the Republic of Albania's Government and others); USD 24.9 million in the form of income from investments.

This year outflow reach the figure of USD 159.6 million where to specify are: the USD 20.2 million in the form external debt payments (of Bank of Albania's and the Republic of Albania's Government); the USD 123.4 million in the form of transfers (the Republic of Albania's Government, banks and others); USD 15.8 million in the form of sales (for banks and the Republic of Albania's Government) etc,

As concerns the management of the foreign exchange reserve, the Bank of Albania's Supervisory Council has approved by decision no. 70, dated 02.08. 2000 "The policy and the management of the foreign exchange reserve", which paper specifies objectives on the investment of the foreign exchange reserve, investment limits by currency, special instruments etc,

The new document envisages the addition of investment instruments of foreign exchange reserves, preserving high quality of safety and liquidity. To precede the need for a better knowledge on risks the new documents anticipates the establishment of Investment Committee and the Risk Assessment Sector (middle office). The first will raise the analysing and the decision-making capacity within core indicators, as specified in this document. The second will be organised in the form of an internal unit within the responsible department for the management of foreign exchange reserve, specialised on the identification and appraisal of financial risks as that of market, credit operating etc.

## *Chapter 2 Monetary policy and instruments*

### **2.1. MONETARY POLICY DEVELOPMENTS**

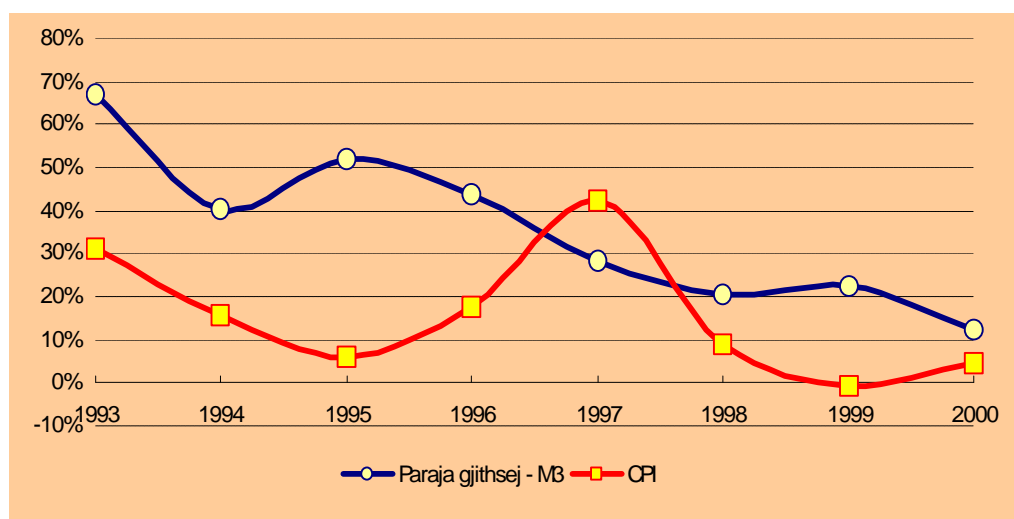
Referring to the Republic of Albania's Constitution, Bank of Albania is the responsible authority for the application of monetary policy. The law on Bank of Albania clearly defines the playing field of monetary policy; that is achieving and maintaining the consumer price stability. Other monetary policy targets are conditioned by the completion of this principal target or serve the accomplishment of the main target.

The consumer price stability is considered amongst the core features of a sound macroeconomic situation, capable to guarantee a stable economic growth on long term. Bank of Albania's monetary policy can not be discerned as detached from current conditions and the macroeconomic measures related to fiscal policy and the structural reforms to economy. As an integral part of a broad mid-term program, it envisages to be supported by international organisations of finance.

Inflation target on 2000 has been the restriction of the consumer price increase by 2-4 percent rate of CPI. Fixing the consumer price stability, as a target of monetary policy, in the type of a narrow band and by low levels, reflected not only Bank of Albania's intention for a low inflation rate, but also took into consideration the macroeconomic situation either at year-onset or during 1998-1999, a two-year term of economic growth and a low inflation rate.

Bank of Albania has constantly aimed the rising control of money supply at a commanded rate by economic growth claims and inflation target. The rate of monetary supply also comprises an intermediate target of monetary policy. Inflation is, generally, considered a monetary phenomenon, which long-term subsistence is enabled only in the circumstance of higher than public required balances of real money.

Monetary supply and core macroeconomic indicators were generally by program rates during 2000. In the same line, the consumer price index was under the expected rates on the whole of 2000, except for December.



**Chart 17.** Money supply (12-month change in %).

Marking 1.8 percent growth on annual basis in November, this index jumped to 4.2 percent in December. Under these conditions, such growth reasons must be also sought by the speculative motives of consumer price growth at the eve of end-year festivities and not only by the extension of monetary supply.

Although it is true that the monetary supply did not reflect a linear growth, still its vacillating character can not be fully explained with the instant growth of CPI in December. The increase of the monetary supply generally corresponded with expected rates.

### 2.1.1. MONETARY PROGRAM AND QUANTITATIVE TARGETS.

The Albanian economy is moving according to the directives of the three-year mid-term program for the macroeconomic development of the country. This program enjoys the support of international institutions of finance, which formality is achieved by the underwriting convention between the monetary authority and representatives of international institutions of finance as IMF and WB in December 1999.

The new program is a continuation of ESAF-2 arrangement, functioning during 1998-1999 term and is labelled the Program for the Reduction of Poverty and Growth Facility (PRGF). Year 2000 represents the last year of the subscribed arrangement.

As an active measure and decision-making plan operating on a three-year term for the Albanian economy, this program has envisaged a comprehensive framework of deep structural reforms, including the main directions of fiscal consolidation and the improvement of the external position of the country.



Monetary policy also has its own role in this program, however its materialisation will be achieved, if the following quantitative targets are satisfied:

- The floor limit on Bank of Albania's net international reserve;
- The upper limit on Bank of Albania's net domestic asset;
- The upper limit on Net banking credit to government.

#### **2.1.1.1. BANK OF ALBANIA'S NET INTERNATIONAL RESERVE.**

Amongst the main targets in drafting and applying the monetary policy and Bank of Albania's monetary program is maintaining a balanced foreign exchange position of the country. To guarantee the maintenance of a rational foreign exchange position, Bank of Albania establishes a floor target on its net international reserve.

To have a stable basis to assess Bank of Albania's achievements with this respect, the exchange rate of USD to Lek is held constant and as by record value of December 1999.

Net international reserves were over their fixed rate during 2000. These reserves indicated a significant growth on annual basis by about USD 174 million while their established target was USD 9 million. In December, international reserves amounted to USD 445, 9 million or USD 94,3 million over the target.

These reserves had their highest growth in the second half of the year. They grew by USD 138.7 million in the second term of the year while they had a more "modest" growth of USD 35,4 million in the first six-month term.

The main cause for the growing reserve may be identified with considerable foreign exchange inflows of the period in the type of grants and foreign loans as well as in foreign exchange purchasing by Bank of Albania during the second six-month term.

Applying a flexible and free- floating regime of exchange rate, Bank of Albania still reserves the right of transaction (to buy and sell) in the domestic market of foreign exchange, especially, in its reaction to the speculative movements of short term or to affect the range or composition of foreign asset.

As the Ministry of Finance was the main partner in performing foreign exchange transactions during 2000, Bank of Albania did not lack foreign exchange transactions with second-tier banks. As second tier bank transactions posed a lower weight, it may be stressed that in the first six-month term they were oriented by the sale of foreign exchange.

**2.1.1.2. BANK OF ALBANIA'S NET DOMESTIC ASSET.**

Bank of Albania's net domestic asset express the amount of (net) claims against the government and the second-tier banks. They, together with the net international reserves make up the monetary base. Bank of Albania's net domestic assets, at 2000-end, resulted Lek 68 billion or somewhat lower than Lek 13 billion under their upper rate.

A similar limit subsistence is directly connected with maintaining the consumer price stability as long as its principal aim is to control the banks' supply with excessive liquidity.

Indicating low rates during the first six-month term, banks' excessive reserves had and a high growth in the second half of the year. To support its monetary policy and hold optimum liquidity<sup>19</sup> in the system, Bank of Albania attracted a part of this liquidity through Repo auctions. This was the reason why Bank of Albania's Repo portfolio recorded the average of Lek 5,2 billion at the end of 2000.

Deficit financing by Bank of Albania has been in conformity with forecast. However, its smooth dissemination on a yearly frame still remained a concern.

**2.1.1.3. NET BANKING CREDIT TO THE GOVERNMENT.**

Net banking loans to the government express net banking claims against government. Their enforced target in the type of an upper rate is in accordance with government budget plan in the effective year.

The condition of net banking claims against the government at the end of 2000 resulted below their upper rate by about Lek 3 billion.

Deficit financing through Treasury bill issuing in primary auctions was Lek 14 billion. The rest of it was covered by Bank of Albania's direct loans and the privatisation receipts from various sectors of economy.

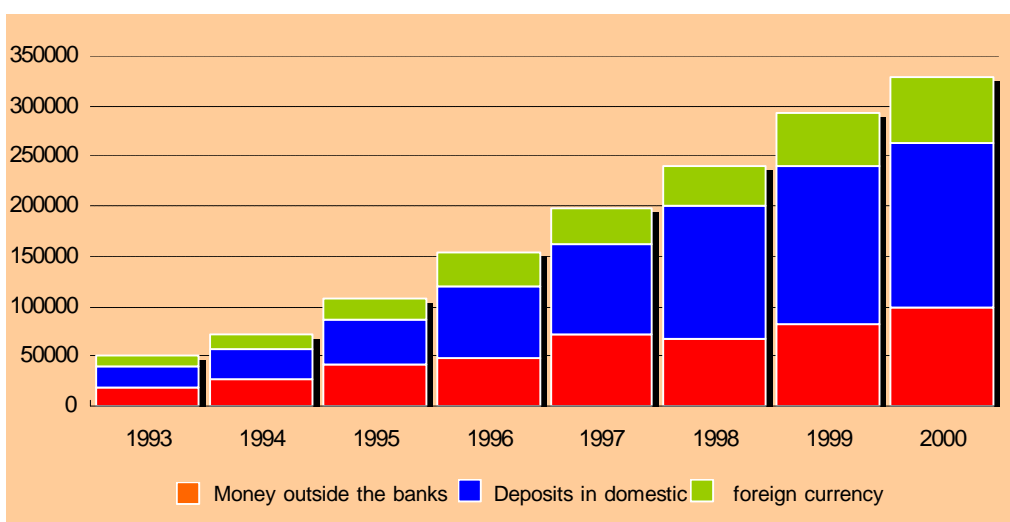
**2.1.2. MONEY.**

Based on early year forecasts for (i) an 8 percent growth of real economy and, (ii) inflation target by 2-4 percent interval, Bank of Albania programmed growth of monetary supply by 12 percent rate.

Monetary supply during 2000 increased by 12 percent (see chart 13) or Lek 35,2 billion in absolute terms. Confirming an observed trend during these years, monetary supply growth has not been evenly on the whole year.

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<sup>19</sup> Bank of Albania together with the Ministry of Finance have raised the Committee for the Management of Domestic Loans, which operating function is to envisage the rate of the excessive reserves in the system and plan measures to is optimum.



**Chart 18.** The structure of monetary supply (in millions of Lek).

It was brittle during the first six-month term as it started to gain a new growing rate in the second six-month term (only 2.4 percentage points of the annual growth of M3 matches to the first six month term). Similar data clearly reflect the fact that monetary supply did not indicate a symmetrical growth throughout all quarters in the year. This was highly affected by concentration of deficit financing in the last months of the year was significant with this respect. Deficit financing only in December was of nearly 22 percent or Lek 4,4 billion effect. This also conducts year end-escapes in the ratios of monetary aggregates from their annual performance.

#### 2.1.2.1. MONETARY SUPPLY ELEMENTS.

As decisive elements, foreign exchange deposits and the currency outside the banks gave the main contribution in the growth of monetary supply, M3 during the year (see chart 12).

**Table 9. Changes in M3 structure (in %).**

Indicators	december 1999	june 2000	Change in M3	december 2000	Change in M3
PJB/M3	27.8	28.54	+0.74	30.30	+2.5
DL/M3	54.1	52.42	-1.68	50.30	- 3.8
DV/M3	18.1	19.04	+0.94	19.40	+1.3

The above-indicated trend has been ruling on the entire year and had a stronger effect on the second half of the year. Currency outside the banks had the highest growth in absolute and relative terms amongst other monetary aggregates by nearly 22 percent or Lek 18 billion, displacing its ratio to the total monetary supply from 27.8 percent at year- onset to 30.3 percent at December-end. As in the previous years, December remains the month with the highest growth of the currency outside the banks to mostly reflect the high level of deficit financing.

As a result, in the first months of 2001, a part of the currency outside the banks is expected to be turned back by banks in the type of required deposits.

Lek deposits on annual basis have a growing rate of 4.4 percent or nearly Lek 6,9 billion in absolute terms. Meantime, foreign currency deposits<sup>20</sup> indicate a growing rate of 19.5 percent or Lek 10,4 billion in absolute terms. It is worthy to stress that Lek deposits during the first six-month term had a declining trend whereas deposits in foreign currency had a significant growing trend. The second six-month term registered a more moderate growth of foreign currency deposits and an initial increase of Lek deposits.

### **2.1.2.2. THE EFFECT OF SECTORIAL ECONOMY IN MONETARY SUPPLY DYNAMICS.**

During 2000, various sectors of economy have issued different contributions in the provision of monetary supply

Statistical data on the Sectoral structure of deposits indicate that customer deposits indicate had a significant increase compared to other deposit sectors of economy, issuing the main contribution in the rising of currency by Lek 15.9 billion. The contribution of the private sector of economy had a growing tendency by Lek 1,4 billion as the public sector had a declining trend by Lek 0,9 billion.

**Table 10. Deposit dissemination by sectors of economy.**

Years	Required deposits in Lek			Time deposits in Lek			Foreign exchange deposits		
	Public	Private	Individual	Public	Private	Individual	Public	Private	Individual
1999	7,706	12,335	1,627	425	3,458	132,775	10,049	11,447	31,715
2000	7,184	15,161	2,460	839	720	138,897	10,025	12,823	40,756
Change	- 522	+2,826	+ 833	-414	-2,738	+6,122	- 24	+1,376	+9,041

These developments indicate that personal deposits bearing an important effect in shaping the tendency of monetary supply M3 and estimated as a stable group, continue to be determining in the provision of M3. Whereas other sectors of economy to mainly affect deposit oscillations with high liquidity indicate a lower contribution.

The individual motives to increase savings seems to bear the trend either in Lek or foreign currency savings (by LEK 6,1 billion and 9 billion increase respectively) with a supremacy of the latter. Reverse from individuals, businesses use the financial asset for transaction purposes and, at the same time, seek that their claims be partly covered with credit. Developments<sup>1</sup> in deposit placements from this sector<sup>2,2</sup> reveal banks' role as financial intermediaries in the dynamic development of economy. What is the deposit statement in view of this fact?

<sup>20</sup> the narrowing interval between deposit rates in domestic and foreign currency have been the main reason to justify the growing ratio of foreign currency deposits against the total deposits. This ratio changed from 25.2 percent at year-onset to 27.8 percent at year-end.

<sup>21</sup> Time deposits have historically composed a highly unstable group and as such the comparison between their stock by two different terms may not accurately reflect the performance of these deposit' stocks. Their growing of declining volume within the year is affected by the seasonal effects the trade circle, transferring year -end operations from budget etc.

<sup>22</sup> Generally, the business sector is further divided in private and public sector (state-owned).

At first glance, it looks like a deposit displacement from business to individuals, from time to current and required ones. Moreover, it seems that businesses have preferred saving in foreign currency, as manifested by the rising stock of foreign currency deposits placed by this sector, by LEK 1,4 billion.

Having a totally different view in the total deposit structure, public sector possessions marked approximately a Lek 1 billion decline, attendant by all deposit types. The high rate of money outside the banks and the not so high growth of required deposit stock in domestic currency make us believe that real sector relationships with the banking sector are not so significant. As a result, business needs for Lek transactions continue to be partly contented outside the banking system, in cash.

### **2.1.3. DEPOSITS.**

#### **2.1.3.1. HOUSEHOLD DEPOSITS IN LEK.**

Required deposits in domestic currency still remained as the largest share item in the total money supply by 49.4 percent at 2000-end. Most of them were placed with the Savings Bank, which at December-end reached in 37.3 percent of the money supply, or 4 percentage points lower than the previous year.

Reverse from the previous years, 2000, on the whole, marked the lowest average rate of monthly growth of required deposits in Lek. Therefore the monthly average for 2000 was Lek 0,3 billion from Lek 1.7 billion in 1999. The total outstanding of required deposits in domestic currency increased from Lek 136,6 billion in December 1999 to Lek 140,4 billion in December 2000. The deposit behaviour in the system interim the period reflects the several factors effect. A part of them is hard to be identified or measured in effect as we lack or possess very indigent statistics on real indicators of economy. Notwithstanding these difficulties, Bank of Albania has managed to identify some of the factors to affect decline in the growing pace of household deposits in Lek.

#### **1. The constant and the gradual reduction of required deposit rates in Lek from 1998 ahead.**

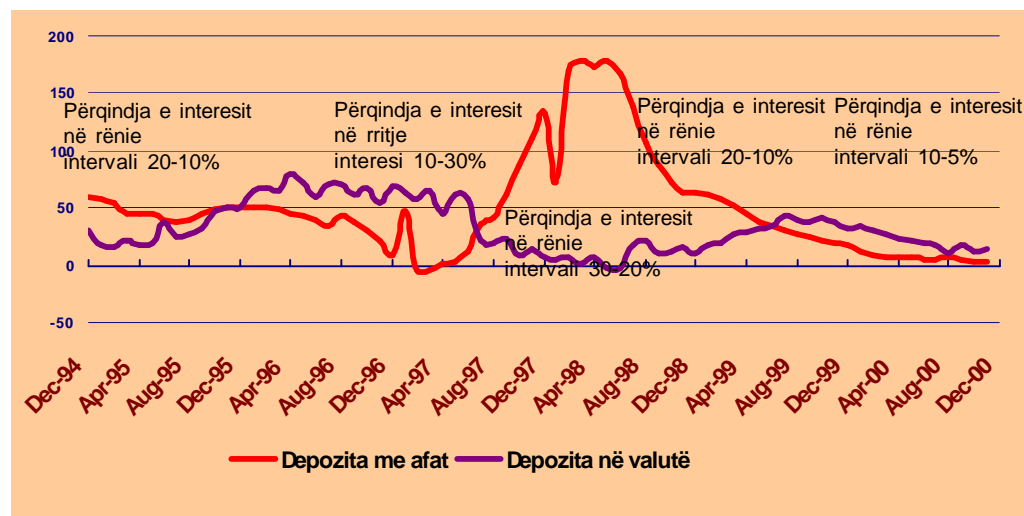
For the first time in the tradition of placing household savings with banks, individuals met the lowest range of deposit rates in Lek. In this way, Bank of Albania's signals directed to the alleviation of the monetary policy seem to have found their reflection in the investors' behaviour<sup>23</sup> and in small savers, particularly. However, it must be accepted that investment alternatives of free funds are few and informal alternatives remain with a high level of risk.

<sup>23</sup> As noted from chart 3 the individual behaviour in Albania is as similar as that, foreign currency deposits are a powerful alternative for holding household saving by those terms when we have reduction of interest rates and political ambiguity.

As assessed free funds are partly addressed to the capitalisation of private business, and partly exist in the type of debt by the private business without neglecting the fact that we have a growing number and sums invested by individuals in Treasury bills etc. On the other side, the investment climate would be more improved if the reduction of the fund costs for banks were accompanied by the expected decline in credit rates.

## 2. Deposit growing has been by very high rates in the past.

We can not be accurately say, which the optimal growing rate of Lek deposits in the system. During the previous 8-year term, the interest offered has been of very high rates and surges in the form of deposits were very high. Given the circumstances when inflation remains by low rates for a long period of time, it is understandable that nobody can expect similar growth rates as those evidenced in years, 1995, 1996, 1998 etc.



**Chart 19.** The annual deposit growth (December 1994-November 2000; 12-month change in %).

## 3. Policy implications and the psychological effect in public.

As the current case is totally immeasurable, still, the first months propaganda on the so-called deposit unfasten in the Savings Bank had a negative impact in the motivation of individuals to place Lek savings with the largest bank. Albeit this factor gave its highest effect in the first six-month term, its effect per inertia was also sensed in the third quarter of the year.

## 4. Not capitalising the interest income deriving from deposit rates.

The reduction of deposit rates has made the income deriving from interest rates be capitalised on a reducing trend and as a result this they have lowered the pace of deposit increment.

### 2.1.3.2. DEPOSIT STRUCTURE IN DOMESTIC CURRENCY.

The deposit structure in domestic currency continues to be under the sway of three- month deposits. This deposit supremacy reduces the stability of outstanding deposits.

**Table 11. Time deposit weights in domestic currency.**

Indicators	1999	2000
1-month	0.5	1.3
3-month	53.9	52.0
6-month	7.0	8.4
12-month	38.6	38.0

These deposits structure by term of maturity is, moreover, inherited. As to 1997 events and to attract customer deposits by the banks in the system, Bank of Albania applied an interest rate structure to favour fund placing with 3-month deposits. The newly posted deposits on 2000 indicate a change in the depositor preference concerning the term of maturity. However, it can be yet confirmed whether this depositor inclination falls on long or short-term deposits.

Bank of Albania's policy on time deposit rates in Lek during 2000 has been the **orientation of interest rates structure on time deposits in Lek to long term maturates**, in favour of 12 month-deposits. This policy related to the timely structure of interest rates will affect the supply of a deposit structure governed by times deposits on longer maturity than 3- month term. Accordingly, it will be also raised the stability of this section of money supply.<sup>24</sup>

### 2.1.3.3. COMMERCIAL BANK CONTRIBUTION IN THE RISING SHARE OF BANK DEPOSITS IN THE SYSTEM.

Although on low figures, the commercial bank contribution in the rising share of bank deposits in the system recognised changes during 2000. Private and joint venture commercial banks have enhanced their total deposit share against the total banking deposits. So the total share of commercial bank deposits (private and joint venture) against the total banking deposits at 2000-end reached in 19.26 percent from 13 percent at 1999-end.

The same tendency is preserved between domestic or foreign currency deposits. So the total of commercial bank deposits in Lek (private and state-owned) against the total banking deposits increased from 3.75 percent at 1999-end to 8.59 percent in December 2000. The share of foreign currency deposits placed with these banks against the total banking deposits in foreign currency priced nearly 45 percent against 39.6 percent at 1999-end.

<sup>24</sup> To comparison effect, the already privatised National Commercial Bank is considered as public bank.

**Table 12. Each bank share against the total deposits for 2000 (in %).**

Banks	Total deposits		Lek deposits		Foreign exchange deposits	
	June	December	June	December	June	December
Savings Bank	73.0	71.0	85.2	83.0	40.7	41.3
National Commercial Bank	9.8	9.7	8.5	8.4	13.8	13.6
Albanian-Italian Bank	3.6	3.5	0.8	1.0	11.5	10.2
Dardania Bank	0.2	0.1	0.0	0.0	0.6	0.4
Arab Islamic Bank	0.4	0.2	0.0	0.0	1.4	0.5
National Bank of Greece	2.3	2.3	1.0	1.0	2.7	2.7
Tirana Bank	4.0	4.3	2.1	2.4	9.5	9.5
International Commercial Bank	0.3	0.4	0.1	0.2	0.9	1.0
Alpha Credit Bank	1.7	2.1	0.8	1.2	4.2	4.8
American Bank of Albania	3.6	4.6	0.8	1.6	11.6	12.6
FEFAD Bank	1.2	1.4	0.6	1.0	2.9	2.3
First Investment Bank	0.0	0.1	0.0	0.0	0.0	0.2
Intercommercial Bank	0.1	0.3	0.1	0.2	0.1	0.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

As rule, public preference against all operating banks in Albania should be the same. In the situation when we miss the approval of deposit insurance scheme, putting money in such investment type is risk-inclined. In the same light, the supervisory rates are also uniformly applied to all banks, denying the possibility to provide costs or additional proceeds per neither of them. Given the interest rates, then it could be affirmed whether the public should be more inclined to deposit by private or joint venture banks, where deposit rates are somewhat higher than by public banks. However, the public is still hooked by the Savings Bank deposits. It is hard to believe that this behaviour is commanded by the principle that "it is too big to bankrupt". We believe that the domestic public behaviour is still governed by the fact that the Savings Bank is a state- owned bank and is widely spread on the entire territory.

#### **2.1.4. THE PERFORMANCE OF MONEY DEMAND.**

The extension of monetary supply during 2000 was mostly in the type of the growing net foreign assets by banks reflecting the considerable growth either in the net foreign asset of banks or Bank of Albania's. By nearly Lek 25 billion growth, Bank of Albania's net foreign assets represented 82 percent of the total growth of the net foreign asset.

***Foreign exchange inflows during the period exceeded the forecasts. This was as a result of foreign aids and loan disbursements as well as Bank of Albania's net purchasing of foreign exchange by other banks.***

Another fact to affect increase of monetary supply appears in the form of the growing net foreign asset by banks, which in 2000 had a growing rate of Lek 26,1 billion.



Reverse from the previous year performance, we note an improvement the ratio of credit use by sectors of economy. However, in view of the growing needs of economy, a specific weight of 76.7 percent of credit to the public sector against the total domestic credit can not be considered as satisfactory. In this sense, there is still more ground to work under a mid-term plan, either to promote credit extension to economy or reduce budgetary deficit.

Deficit financing through domestic resources during 2000 amounted to Lek 26,4 billion (or as much as 4.9 percent of GDP) compared to the Lek 27,8 billion (or 5,5 percent of GDP) at 1999-end. Such figure comprises an abatement of 22.3 percent compared to the previous year.

Deficit financing by the banking system was nearly Lek 20 billion or as much as 3.7 percent of GDP compared to 4.9 percent in the previous year. This slackening of budgetary deficit during 2000 was as a result of the improvement of fiscal administration and the privatisation receipts earned by the privatising process.

Lending performance to economy marked a significant progress compared to the previous year, however it did not reach expected forecast on 2000. The credit stock increased by Lek 6,1 billion from Lek 7,5 billion expected. Reverse from the previous years, credit extension did not recognise a significant growth in the last quarter of the year. One of the facts appraised on effect was the power crisis, which commanded suspension of bank expansion decisions or screwed the current bank activity in the period. Another feature of the lending process consisted in the fact that the ratio of Lek credits against the total outstanding credits tended a constant decline, from 53.4 percent at year-onset to 39.8 percent at year-end.

### **2.1.5. LENDING PERFORMANCE.**

Credit extensions promote investments and production, improve employment, and budget incomes by all resources, by so ensuring economic growth which also provides the consumer price stability in a society where all are consumers.

This major reason makes the lending activity of banks be on the focus of Bank of Albania's concern.

**Box 8. Bank businesss and all other business types.**

This heading fascinated Bank of Albania to initiate an important activity during 2000, termed "credit campaign".

Intending to find the reasons for such uncomfortable rates of bank credit to economy, Bank of Albania gathered around free table discussions second-tier bank representatives, business, various credit project authorities as well as representatives from executive and legislative organs and media.

An important point made clear, right from the start, was that - bank activity is an organised business on market principles that seeks to expand its credit activity so as to gain as higher profits as it can. The "commodity" it sells is under its use and comes out from the mobilisation of individual, family or society money and as such it is a risk-endeavoured liability. To this, the compliance with bank requirements is a required indispensability resulting from fund resources.

The other business part applying for bank loans must follow the elementary requirements beginning with the most important- to form a conviction on the profitability of this activity realising this way the debt payment. Credit means trust and, such a confident relationship arranged between the parties may be realised in the framework of a complete transparency.

Commercial banks in the daily contacts with their credit-applying employees note deficiencies in their core documentation starting from the balance.

Since early activity, banks on other than state-owed equity indicated a slow performance of lending process. This was totally due to the deficiency of relationship between banks and customers and their establishing history. Transparency must be first offered than required. It is up to commercial banks to write as much as they can on their products, to clearly explain all component parts of the credit demand (why not even the required form of their business plan) and offer data on their financial accounts.

Any customer knows how to make simple calculations on the advantage of activity and in a way bank clients can also "calculate" bank profits by simply discounting deposit rates form credit ones.

To the problems of the lacking transparency in bank business relationships - to another business part are also added legal problems related not only with the deficiency of elements to modify the constrictive relations of credit but also with the guarantee of their settlement, certification, the execution of the changing ownership in case of impossibility to repay the debt etc.

This is a summary of discussions and drawn conclusions from the meetings held in the framework of credit campaign.

The selections of issues, labelled problems, can not be instantaneous, but the enhancement of transparency on these relationships is up to the goodwill of parties entering in credit business. Meantime 2000 facts indicate that a similar collaboration as basis for the enhancement of activity on both parties reflects a constant growing tendency.

For the first time in 2000, the level of the newly accorded credit from banks is of a two-digit figure of Lek 24 billion. From Lek 19,9 billion, at initial year, credit stock disclosed an average growing rate of Lek 0,5 billion monthly while the newly accorded credit had an average growing by Lek 2 billion. In relative terms, banks' credit stock had an average growing by nearly 31 percent compared to 1999.

As similar increase in credit extension to economy makes it hoist to 9.9 percent of the total domestic credit from 8 percent at 1999-end.

**Table 13. The performance of credit indicators (in billions of Lek).**

Indicators	December 1999	Year 2000			
		Q. I	Q. II	Q. III	Q. IV
Outstanding credit by banking sector	19.9	21.4	22.7	25.2	26.1
From these :					
Public sector	1.7	1.6	1.6	1.6	1.5
Private sector	18.2	19.8	21.1	23.5	24.6
- In Lek	10.6	10.6	10.6	10.6	9.5
- In foreign exchange	9.3	10.8	12.1	14.5	15.1
New banking credits	8.0	3.4	6.9	6.8	6.9
New banking credit in Lek		0.6	1.1	1.0	1.7
New banking credits in fore		2.8	5.9	5.8	5.2
Share (in %) of credit extensions in foreign exchange.		82.0	85.5	85.0	75.0

During 2000, it was still more credited in foreign exchange and is explained by the lower lending rates in foreign exchange.

**Table 14. Average weighted rates in Lek (in %).**

	december'99	march'00	june'00	september'00	december'00
Newly posted deposits	9.44	8.32	7.98	7.56	7.09
Newly accorded credits	25.46	25.48	19.78	26.13	23.56

Whereas credits in foreign exchange are extended on the interest rates as:

- Per US dollar from 6.5 to 12 per cent.
- Per Italian Lire and Greek drachma from 9 to 12 percent.

Any simple calculation would confirm the noticeable fact of smaller business expenditures to receive credits in foreign exchange meantime banks are allowed to extend credits, being disposed of a larger liability base in foreign exchange and the Lek liabilities, they have, are invested in credit extensions for financing budgetary deficit, guaranteed by T-bills.

From the above table of lending indicators, it is observed that identically as in 1999, the first quarter is characterised by a smaller lending activity of banks compared to reaming quarters of the year.

**Table 15. Bank specific weights by newly accorded credit (in %).**

Indicators	Year '99	March '00	June '00	September '00	December '00	Total '00
<b>As banking system</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Albanian – Italian Bank	28.5	23.2	44.9	34.8	33.9	36.0
Tirana Bank	32.4	29.4	12.3	14.5	19.5	17.5
FEFAD Bank	11.9	14.7	19.7	16.8	16.9	17.5
Alpha Credit Bank	7.0	23.5	11.6	8.7	10.3	12.0
American Bank of Albania	5.0	2.9	8.7	18.8	11.1	11.4
International Commercial Bank	11.3	5.9	1.4	2.9	3.2	2.9
National Bank of Greece	0.5	0.3	0.6	1.4	0.7	0.8
Intercommercial Bank	-	-	0.4	0.3	1.3	0.6
Arab Islamic Bank	-	-	-	0.3	0.6	0.2
Dardania Bank	-	-	0.3	1.3	-	0.5
Savings Bank	1.0	-	-	0.1	2.4	0.7
National Commercial Bank	2.5	-	-	-	-	-

This year, three other banks have started to extend credits, prohibited in the exercise of this activity in 1999. The lending activity during 2000 has been somewhat more oriented to mid- or long-term loans, reaching the year-end statement as below:

✍ short-term loans	Lek 11,7 billion
✍ mid-term loans	Lek 8,1 billion
✍ long-term loans	Lek 6,4 billion

The newly extended credit during 2000, almost totally sustained the private sector of economy, evidencing few cases to the public sector of economy. The most credited activities are reflected in commercial bank balances at the end of 2000, as below:

✍ trade, car repairing and household articles	26,71 per cent;
✍ construction (auxiliary first stuff activities)	25,05 per cent;
✍ processing industry	16,87 per cent;
✍ production, electric power, gas and water supply	9,00 per cent;
✍ other...	22,37 per cent.

**Box 9. A credit survey of December 2000.**

Following the lending activity as well as the level of credit extension and the significance it discloses to the development of economy, generally, Bank of Albania<sup>25</sup> undertook a survey with second-tier bank specialists. Through this, it was availed of the opportunity to crop qualitative opinions on lending activity by credit specialists.

Professional opinions of second-tier bank specialists were consolidated on the level of credit risk, which oscillated from average to high limits as assessed by these bank specialists.

As such it was identified amongst the main factors that affects:

- Lending rate;
- Lending structure by term of maturity, business sizes; type of currency and economic activities.

Nearly 70 percent of specialists expressed that the highest lending risks lie with:

- The fragile social political situation of our country;
- The legal framework deficiencies, the non-execution of collateral sanctions;
- Existence of dishonest competition, smuggling and corruption.

Specialist opinions indicate clearly their preferences for:

- Short or mid-term loans from 82 and 72 percent of the interviewees, respectively. Meantime bank result on higher accorded credits than they would have wanted to as to the impressed pressure by such credit demand. Preferences toward short-term credits are justified with the highest opportunity to constantly follow them;
- Foreign currency credits (100 percent of the interviewees). They state that 71 percent of banks accord credits in US dollars and 53 percent of them in DEM. Foreign exchange credits are mostly preferred for their high stability compared to domestic currency. And customer preferences and the existence of foreign exchange liabilities (in deposits and capital) condition the underlying tendency against lending in foreign currency;
- Lending by sectors of economy: trade (100 percent of the interviewees) industry (61 percent of interviewees), construction (30 percent of interviewees). These are preferred sectors as to the intensity and the satisfactory profitability they show. It is worthy to underline that agriculture in most cases (7 cases) is no more credited, albeit its large share in GDP.

Credit specialists express that banks have accomplished their credit plans.

- In 2000 compared to 1999, bank weight to accord no credit is reduced by 7 percent (from 33 to 26 percent).
- On the same period, banks' share to accomplish and exceed their credit plan is evidenced to increase by 19 percent.
- The non-fulfilment of credit plans is frequently justified with the noticeable lack of electric power especially by localities. On the other hand, exceeds would have been more obvious if the power supply were more normal.
- Credit rate is market representative by 63.2 percent of the interviewees, however, it tends lower rates.

<sup>25</sup> Bank of Albania performed the survey with credit specialists of second-tier banks during December 2000. For comprehensive results of this survey see: Economic Bulletin, vol. 4, and no. 1, March 2001.

Businesses during their credit requesting process by banks reflect a chain of problems and deficiencies, which directly or indirectly affect the reduction of credit rate.

So specialists are crystallised in their opinion that:

- The lacking tradition in bank relations;
- Unreal balances;
- The insufficient argumentation of business plans
- The incomplete cognisance of bank requirements;
- The unfamiliarity with legislation;
- The lack of managing skills by businesses;

Are the weakest business points? Amongst them they appraise as the most important the poor tradition in bank- business relationship and the unreal balances they show.

As of specialists' viewpoint, the near future of lending process will to be more optimistic. They express that the most credited activities will be industry and construction whereas the less credited activity will be trade (compared to the first two). Two very important sectors of economy, agriculture and transport will continue to stay under the shadow of this process.

## **2.2. MONETARY POLICY INSTRUMENTS**

### **2.2.1. INTEREST RATES.**

Year 2000 is considered as transition year as far as the use of instruments for the application of monetary policy is concerned. During this year, Bank of Albania gradually realised the complete transition from the application of indirect monetary policy instruments to the market instruments. Practically, the central bank after the four times cutting of floor deposit rates placed with genuine state-owned banks resigned the further fixing of these rates, realising a complete liberalisation of them.

The first rate to liberalise (in May 2000) was that of 6-month deposits. The decision for the liberalisation of 6-month deposit rates was undertaken before the 12-month rate as to the insignificant share they had in the market. The inconsiderable share of these deposits was assessed as of no help in the diffusion of negative effects resulted from the application of this strategy. After the applicable market test, Bank of Albania, analysing the performance of the most important macroeconomic and financial indicators in the country continued to reduce the minimum rates on rest deposit types (the other two). In June, this level resulted 6.5 percent on 3-month deposits and 7.5 percent on 12-month deposits. On the Bank of Albania's Supervisory Council decision, in June and September it was removed the minimum rate on 3- and 12-month deposits.

The liberalisation of time deposit rates in Lek for state owned banks was assessed to cause no market upset as to the acceleration of the financial reform, especially, with the following measure respect:

- ✍ The rapid restructuring of Albanian banking system aiming strengthening and enhancement of the managing capacity of banks and an as fair market Compton as possible. Here is also included the prudential job performed of Bank of Albania to create sound system through the licensing of new banks, on one hand, and their expansion through privatising state owned banks on the next;
- ✍ Strengthening bank supervision capacities and completing the regulatory framework comprise a strong support to the use of indirect instruments and with low costs. So the requirement on required minimum, standards on the provisions for doubtful loans, limits on the concentration of loans and other obligatory mechanisms are considered as elements to support the liberalisation process;
- ✍ The further improvement of payment and settlement system, the legal and regulatory market framework, the access of market instruments and techniques as well as Repo and reverse Repo agreements and lastly the Repo auctions; all of them as part of the market infrastructure;

- ✍ Performing Repo auctions for the transaction of government securities constitutes the initial development of financial markets. This activity gives Bank of Albania more flexibility in the management of monetary operations;
- ✍ The enhancement of transparency and public familiarity of banks and market through the rising communication of Bank of Albania with them.

Performed analysis and surveys during 2000, indicated that the frequent cuts on time deposit rates in Lek made by Bank of Albania did not find the respective reflection by other market rates. This fact confirmed the level of time deposit rates in Lek was no more effective in moving other bank market rates. As a result albeit from the prudent acts and care exhibited by Bank of Albania to change time deposit rates in Lek, passing to another market rate that would serve as basis for the adjustment of other market rates became necessity.

Open market operations in the form of government securities auction endeavour to increase the flexibility of interest rates. In the first step, Repo auctions tend to ensure an effective form to inject or attract the desired amount of funds through market access elevating the efficiency of financial intermediary.

Bank of Albania intervention through a fixed market rate since July 2000 has aimed cutting the interest rates in compliance with inflation and other monetary and economic developments. For this reason, the following analysis compares the deposit, T-bill and lending rate performance with weekly Repo rates during September - December 2000.

From an overview on the interest rate performance in economy, it is concluded that 2000 tendency has been their reduction. Bank of Albania managed to transmit signals of interest rate policy and apply them in market economy.

Whether analysed in detail, it is observed that the declining tendency of interest rates month over month is not clear. It has a stronger appearance by some interest types and a weaker one in some other types and the interest rate declines in economy have followed Bank of Albania's reactions and decisions in different periods of time.

It must be stressed that when talk of interest rates in economy, as a matter of fact, the attention is eventually concentrated by a small group of interest rates comprised by time deposit rates, T-bill yields, Repo and credit rates.

These rates mainly refer to short terms up to one year. Interest rates over one year are advertised only for lending activity. As several times underlined, market deficiency in Albania makes us lack an efficient mechanism for the transmission of monetary policy decisions.

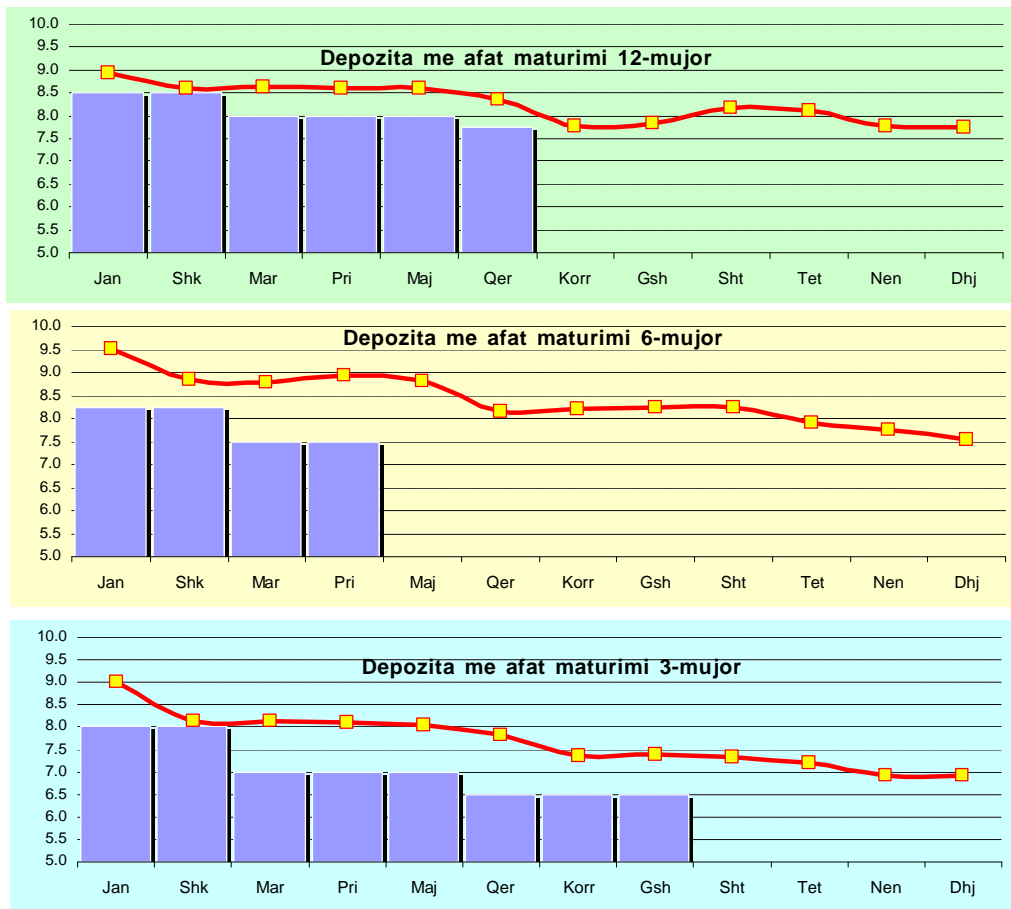
However this market deficiency restrains the "the first stuff " that is the variety of interest rates in economy necessary to analyse the latter reaction by short or long term periods, its expectancy or the level of risk by economic businesses.



Another deficiency created in performing a real analysis of interest rates' behaviour in economy is also the contingency of a bank market governed by a state-owned bank. Such a thing disfigures this behaviour and does not allow the discovery of a real market rate.

### 2.2.1.1. TIME DEPOSIT RATES IN DOMESTIC CURRENCY (LEK).

The level of deposit rates defines one bank or the entire systems expense (liabilities). In 2000, that expense has generally tended decrease as the respective rates had a declining trend on the three maturates.



**Chart 20.** Time deposit rates in Lek (annual rates).

From the comparison of average interest rates at beginning with year-end, the reduction is slight per 1.2, 2 and 2.1 percentage points respectively for 12- 6- and 3- month deposits. The highest reduction by short-term rates has also enforced interest rates change on the deposit structure offered by banks. Whether at year-onset the highest interest rates were by 6 -moth deposits and the lowest by 12-month deposits, at year-end, it were 12-month deposits to reflect the highest interest rate and the 3-month deposits, the lowest.

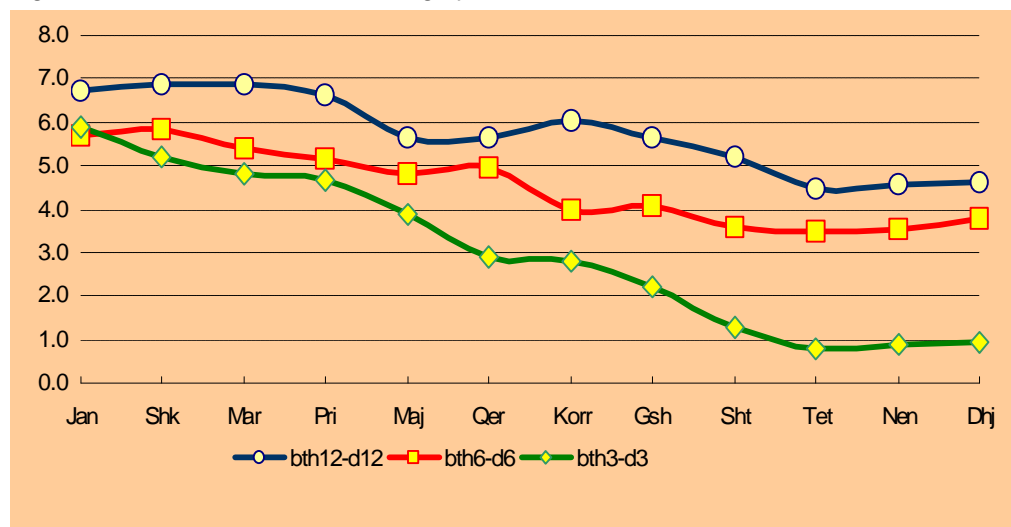
This indicates that deposit rates have been better oriented to more accurately reflect and compensate the risk added by any investment and even by deposit placing with the bank, with the increase of maturity term.

**Table 16. Time deposit rates on newly posted deposits in domestic currency during 2000 (av. in %)**

Months	12-month	6-month	3-month
January	8.9	9.5	9.0
February	8.6	8.9	8.2
March	8.6	8.8	8.1
April	8.6	8.9	8.1
May	8.6	8.8	8.1
June	8.3	8.2	7.8
July	7.8	8.2	7.4
August	7.8	8.2	7.4
September	8.2	8.2	7.3
October	8.1	7.9	7.2
November	7.8	7.8	6.9
December	7.7	7.5	6.9

### 2.2.1.2. TREASURY BILL - YIELDS.

The performance of T-bills yields reveals some similar features with the performance of time deposit rates in Lek. Notwithstanding that when we talk about the yield, we are displaced on the asset side of the balance, thus into an indicator of bank income, its analysis in comparison with deposit rates assumes a special significance for Albanian banking system because:



**Chart 21.** The spread between T-bill yields and time deposit rates (january - december 2000).

- T-bill yields represent the only type of security, where banks may invest, especially, their Lek liabilities in Albania.
- T-bills actually represent the main group of banking assets of the system.

In this way, they comprise the main resource to ensure the adequate Lek income to cover deposit costs. Deposit rates likewise T-bill yields have revealed the same declining tendency on the three maturates. The tendency has been more underlying on three-month bills. Other than deposit rates, the declining tendency has been more strong by T-bill yield of 3-6-and 12 month maturity by 3.4, 3.9 and 7.1 percentage points, respectively.

**Table 17. Average T-bill yields during 2000 (in %).**

<i>Months</i>	<b>12-month</b>	<b>6-month</b>	<b>3-month</b>
January	15.7	15.2	14.9
February	15.5	14.7	13.4
March	15.5	14.2	13.0
April	15.2	14.1	12.8
May	14.2	13.6	12.0
June	14.0	13.1	10.7
July	13.8	12.2	10.2
August	13.5	12.3	9.6
September	13.4	11.8	8.6
October	12.6	11.4	8.0
November	12.3	11.3	7.8
December	12.3	11.3	7.8

This brought in to the reduction of spread between both respective rates. Year-end spread between 3-month rates is only 0.9 percentage points. These data suggest that banking system is coping with a narrowing space to get easy profits and it must find other alternatives to invest its Lek liabilities.

This peculiarity of T-bill yields, compared with deposit rates, is justified by the higher competition in T-bill market. Whether commercial banks hold the exclusivity in deposit market, financial institutions or individuals join the Treasury bill market. Bank of Albania is also present in this market (see: chart 14).

**Table 18. The spread between T-bill yields and deposit rates (in percentage points).**

<i>Months</i>	<b>12-month</b>	<b>6-month</b>	<b>3-month</b>
January 2000	6.8	5.7	5.9
December 2000	4.6	3.8	0.9

### **2.2.1.3. AVERAGE ADMITTED RATES IN REPO AUCTIONS.**

Emerging in the second six month term of 2000, this rate will be ever more attracting the attention for analysis because of its reference role. Its tendency has been variable in reflection of the level of excessive reserves in the banking system.

**Table 19. Auction yields for 2000 (in %).**

<i>Months</i>	<i>Yield</i>
August	6.7
September	5.3
October	4.6
November	6.2
December	6.5

Bank of Albania has given market signals through maximum interest rate offered by the auctions. This rate has disclosed a clear declining trend to reach at 6.5 percent at year-end or 2.5 percentage points less than the auction rate of June 27.

**Table 20. Bank of Albania's maximum auction rate bid on 2000 (in %).**

<i>Auction date</i>	<i>Bid rate</i>
July 27	9.0
August 3	7.5
August 10	7.45
August 17	7.3
August 31	7.0
September 7	6.9
September 14	6.9
September 28	6.9
October 5	6.5
October 12	6.5
October 19	6.5
October 26	6.5
November 2	6.5
November 9	6.5
November 16	6.5
November 23	6.5
November 30	6.5
December 7	6.5
December 14	6.5
December 21	6.5
December 28	6.5

As noted the maximum auction rate has been constant from early October and is significantly reduced during the monthly term of July 27-August 31. Practically 80 percent of this reduction pertains to this month. This not an indicator of a drastic change in the situation of Albanian bank market. It reflects the fact that this instrument was for the first time used in 2000, and the first month over all other months was the testing interval of the market reaction by Bank of Albania.

#### **2.2.1.4. LENDING RATES.**

Lending rates are normally higher than the above-described rates due to the risk added by this activity. This rate has been very high during 2000. This way Lek credits offered by banks had considerable expense.

This rate performance does not follow any regularity. Whether compared year initial with year-end rates they reduced by 2.5 and 2.8 percentage points per respective maturity from 6-12 month term and up to 3-year term.

Whereas for shorter-term loans of 6-month term and longer-term loans up to 3-year term, the interest rate increased by 1 and 5.3 percentage points each.

**Table 21. Average rates for newly accorded credits during 2000 (in %).**

<b>Months</b>	<b>Over 3 years</b>	<b>1-3 year</b>	<b>6-12 month</b>	<b>until 6 month</b>
January	21.69	26.60	26.20	20.16
February	20.64	26.80	26.70	18.57
March	20.00	26.46	26.78	19.44
April	24.74	27.64	28.30	19.21
May	26.90	23.27	29.00	22.58
June	27.00	27.90	28.70	16.07
July		28.30	27.30	27.80
August	13.20	23.31	29.10	27.95
September	16.15	27.10	27.00	27.00
October	28.70	25.89	19.27	26.56
November	25.76	23.83	21.46	19.38
December	27.00	23.76	23.74	21.17

More than a reflection of an added credit demand or risk accretion for certain maturity terms, the lending rate indicates the missing competition of lending market and its low rate. The low credit supply makes this rate oscillate under a single bank effect, which has decided to “to punish”, or “content” its customer with the interest offered or a single lending contract. Meantime, the lacking competition affects holding high lending rates whether compared to other interest rates in economy. Thus, it is very clear that lending market has feeble relationship with other markets in effect switching off the normal functioning of transmission mechanism.

**Table 22. Deposit rate survey.**

<b>Months</b>	<b>12-month rates</b>		<b>6-month rates</b>	
	<b>January 2000</b>	<b>December 2000</b>	<b>January 2000</b>	<b>December 2000</b>
Credit-T-bill	10.5	11.4	5.0	9.9
Credit-Deposit	17.3	16.0	10.7	13.7

**Box 10. Deposit rate survey.**

Realising that its monetary policy effect, concerning the reduction of deposit rates was not at expected level; Bank of Albania organised two surveys on second-tier banks.

The first survey aimed to accentuate the central bank policy effects as well as to collect central bank opinions related to its further policy with this respect. From the survey, all second-tier banks resulted on the same reaction with central bank decisions on the reduction of interest rates. With the reduction of deposit rates by bank of Albania, even the second-tier banks reduced the respective rates but the time of reaction varied from 1 to 44 days. The performance of the average deposit rates indicates a declining tendency throughout 1999-2000. The market rate on domestic currency deposits (excluding state-owned banks) has been constantly higher than the admitted minimum by Bank of Albania. In the first survey, nearly 58 percent of banks responded that there is no more space for a further reduction of interest rates. On September 6, 2000, Bank of Albania took the decision on complete liberalisation of time deposit rates in Lek. The second survey was undertaken at the beginning of November 2000 and aimed to indicate Bank of Albania's monetary policy effects in connection with Repo rates. From the survey, the resulted growth of 4 percentage points corresponded to those banks that were of the opinion that there was no more space for a further reduction of interest rates. From 58 percent in the first survey, nearly 62 of the second survey expressed this opinion.

**2.2.2. REPO, REFINANCING, LOMBARD CREDIT, REQUIRED RESERVE.****2.2.2.1. OPENED MARKET OPERATIONS.**

In the first half of 2000, repurchase agreements between the central bank and second-tier banks were executed on bilateral procedures. To be mentioned is that second-tier banks mainly initiated them in order to settle their liquidity rate.

Considering that the banking system mainly had excessive liquidity they aimed the investment of free reserves for short terms up to 7 days or otherwise said to the nearest sequence auction of primary market. The Repo yield has reflected the yield performance in the primary auction of T-bills giving almost an insignificant effect by other money market rates.

In May 2000, Bank of Albania's Supervisory Council approved the decision on Repo auctions. With the end of July onward in the second half of 2000, Bank of Albania has been operating in the money market through repurchase agreements (it did not practise bilateral repurchase agreements any more). The scope of this technical change to the current practise was fixing a flexible market rate and the efficient transmission of monetary policy decisions.

By means of Repo auctions, it aimed that by managing the excessive reserves of the system intervenes money market rates and bank participation in this market.

This instrument preceded the removing restriction on deposit rates, announced by Bank of Albania. The maturity by repurchase auctions is seven days. The developed auctions have been of a various price type. Bank of Albania's bid rate and amount has been weekly defined depending on banking system's solvency and budget needs for liquidity.

To the end of December, the performed auctions were 22 and the bid amount was LEK 77,6 billion, totally. The performed auctions targeted the attraction of liquidity from the system, aiming "to pilot" the short term rates of money market. Notifying maximum auction rates, Bank of Albania has transmitted clear market signals in connection with its interest rate policy, its rising pressure toward the reduction of money market rates.

It is worth to mention the fact that during 2000, primary market rates of T-bills have been significantly reduced. So at 2000-end these interest rates were by 7.83, 1.34 and 12.32 percent respectively for three- six- and 12-month terms compared to the respective rates of 14.86, 15.39 and 15.73 at year-onset.

#### **2.2.2.2. REFINANCING AND LOMBARD CREDIT.**

Refinancing and Lombard credit imply Bank of Albania's lending for second-tier banks guaranteed on collateral asset. They recognised no Bank of Albania's application during 2000.

#### **2.2.3. THE IMPROVEMENT OF MONETARY POLICY INSTRUMENTS DURING 2000.**

Based on the accumulated experience during 2000 with regard to monetary policy instruments and to improve their use in 2001, in december, the Bank of Albania's Supervisory Council approved a packet of regulations to the framework of these instruments.

The application of the new regulations is estimated to increase the efficiency and the flexibility in the application of monetary policy in the future.

## **2.3. MARKETS**

### **2.3.1. FOREIGN EXCHANGE MARKET.**

During 2000, most of the movements in the exchange rate performance of Lek have been affected by foreign exchange developments by international markets as a sign of interaction of domestic market developments of foreign exchange with foreign market developments. Generally, this may be interpreted as an indicator of the growing sensibility of banks against international market developments and as of a rising velocity of bank reactions for closing differences that may happen in exchange rates.

Lek was appreciated against Euro. The normal value of Euro/Lek at year-onset opened at 137.3 (DEM/Lek = 70.2) and closed at 131.2 at end-December (DEM/Lek = 67.1). Expressed in relative terms, Lek appreciation was 4.6 percent. As it may be understood Lek appreciation was to the same rate against all other component currencies of Euro. Lek appreciation against GDR, which became an Euro component from January 1, 2001, after Greece association in the European Monetary Union, was 7.1 percent. But it was depreciated against USD. At year onset the nominal value of the ratio USD/Lek was 135.2 whereas at the end of December this ratio changed to 13.5 rate. In relative terms Lek depreciation against USD was 6.1 percent rate.

Lek appreciation against Euro and its same time depreciation against USD reflected both currencies' performance by international markets of foreign exchange during 2000. To the end of December, Euro was appraised to have lost 10.6 percent of its value in its exchange with USD. Exchange rate oscillations of Lek during 2000 have been gradual and offset. To ensure a similar thing, Bank of Albania has undertaken market interventions particularly in July- October, when seasonal effects were expected to have a positive effect in the appreciation of exchange rate of Lek. Bank purchases during the term were about USD 35.36 million or nearly 97 percent of the total purchase of USD 36,48 million during 2000. For 2001, the exchange rate of Lek against other currencies is expected to remain stable and with balanced movements with an easily absorbing prospect from economy. Bank of Albania will be ready to ensure this performance.

### **2.3.2. MONETARY MARKET.**

Through these operations Bank of Albania is disposed of an instrument that allows a central bank to affect the liquidity situation in the market, subordinate to its quantitative targets. These operations are applied as standard instruments by all central banks in developed country economies. Bank of Albania's open market operations during 2000 was concentrated in the use of Repo and reverse Repo instruments (in the first half of the year) and in auction type (in the second half of it).



The approving Regulation of Repo auctions in April 2000 and their final arrangement for the first time at the end of June 2000, anticipated the complete liberalisation of deposit rates with state-owned banks and the preparing transition from direct into indirect instruments of monetary policy.

Repo auction transition purposes:

1. The same smooth, simultaneous and the full transmission of Bank of Albania's decisions in the monetary and political sphere by all interbank market operators and broader;
2. The effect in the interest rate of the primary auction of Government Securities and through it to affect deposit rates on the entire system.
3. Development of interbank market of money.

Considering the above targets Bank of Albania has used Repo auctions to affect the rate of liquidity by interbank market.

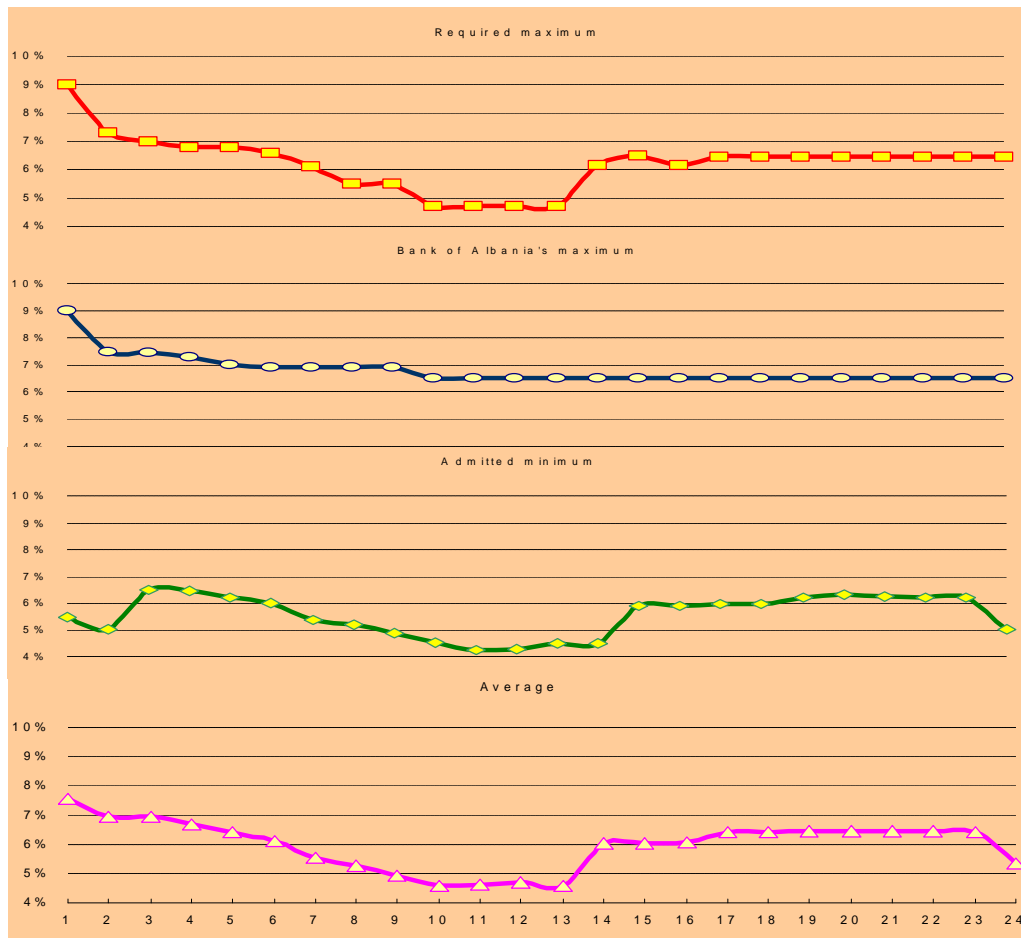


Chart 22. Repo auction rates (the number of auction is by X axis).

Although until presently, auctions have disclosed a commercial bank potentiality to invest their liquid reserves, Bank of Albania has altered the accepted amount for participating banks making auctions' net effect be an addition or reduction of the interbank liquidity according to the established situation.

In general, the performed transactions by Repo auctions during 2000 (where Bank of Albania has issued T- bills against Lek funds) amounted to Lek 117,958 million where Lek 40, 658 represent Repo auctions developed with second-tier banks (in the second half of the year). Nearly all commercial banks, operating in our country, have been participants of these Repo agreements in both types. The Savings Bank had the highest weight in all performed transactions. Below it has been indicated the monthly amount of Repo transactions and the Savings Bank share per each month.

**Table 23. Repo transactions for 2000 (in billions of Lek).**

Month	January	February	March	April	May	June	Total
Amount	9.94	4.81	8.60	7.03	5.57	4.71	40.66

*\*- by auction.*

Months	January	February	March	April	May	June	Total
Amount	1.00	4.30	7.00	5.00	36.50	23.50	77.3

*\*- by bilateral contract.*

**Table 24. The Savings Bank shares in Repo transactions by months (in billions of Lek).**

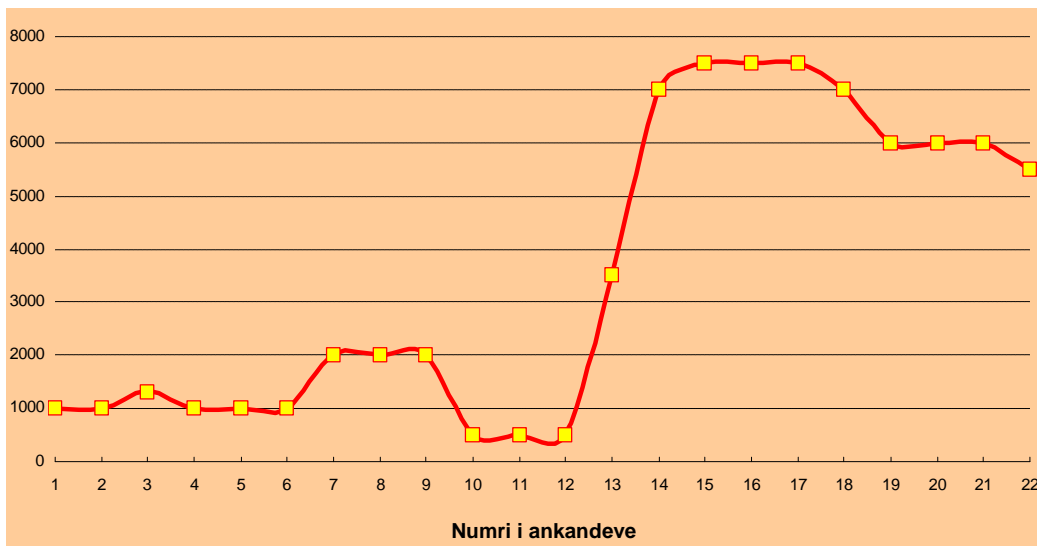
Month	January	February	March	April	May	June	Total
SB	7.15	3.8	7.00	3.50	0.60	2.50	24.55
In %	71.92	79.00	81.40	49.80	10.77	53.10	60.38

*\*- by auction.*

Month	January	February	March	April	May	June	Total
SB	0.65	2.53	5.16	3.58	34.06	22.78	68.77
In %	65.00	58.84	73.73	71.65	93.32	96.96	88.97

*\*- by bilateral contract.*

***For 2000, the average participation of the Savings Bank is 79.11 per cent.***



**Chart 23.** Bank of Albania's auctioned amount (in billions of Lek).

For a detailed view on the Repo auction performance we note that the average participation by any performed auction is 5 commercial banks. The auction rate per accepted amount by Bank of Albania indicates a declining trend. Originally, it was 9 percent and it stabilised by 6.5 percent in the last quarter of the year. The performance of the interest rate offered by Bank of Albania and the average rate per developed auction has been graphically indicated as in chart 18. It has been made care that amount of liquidity by interbank market be sufficient to cover any developing auction in order to maintain the rivalry of participating auctions through commercial banks. At the same time, Bank of Albania's auction amount had a growing tendency as graphically expressed in chart 17.

### 2.3.3. INTERBANK MARKET.

In this market, banks realise borrowing contracts or lending funds on short term. During 2000, it was noted banks' tendency to be more addressed to one-another in accomplishing their liquidity needs. Indirectly, this indicates a growing volume of activity and a more active attitude in the management of their asset portfolio. The data refer to October-December 2000, when commercial banks were requested to report the performed operations by Bank of Albania. As of these reports, there were carried 34 transactions of interbank market in the type of short term borrowing.

In the 17 cases, the Savings Bank has been a lending bank and in no cases a borrowing bank. In the 28 cases, Tirana bank has been borrowing banks and in cases a lending bank. Other banks positioned as borrowing banks were the International Commercial Bank, the Albanian-Italian Bank, and the American Bank.

Nearly all banks were at least once posted in the role of a lending bank. The average duration of these transactions has been 12 days; the minimum duration has been 1 day and the maximum 35 days. The average rate of interbank lending has been 6.3 percent. This value is over the average rate of Repo auctions by 5.72 percent. (The difference represents the Savings Bank's requested rate of return to invest its excessive funds in the interbank market.). The minimum interest rates have been five percent, whereas the maximum rate is 9 percent. The transacted funds record the value of Lek 4,655 million. The biggest amount for a single transaction is Lek 900 million, whereas the smallest is Lek 5 million. The average value per performed transaction is Lek 136.9 million.

#### **2.3.4. SECONDARY MARKET.**

In the secondary market of T-bills where banks realise their selling or purchasing transactions, operations have been very limited in number and participants. Whether excluded from our computations where Bank of Albania has been pair (3 cases), the performed transactions in the secondary market during 2000 have been six similar. The Saving Banks has been a participating party in all these transactions, positioned in T- bill purchasing. An ample rate of liquidity as a result of the structural developments that restrict its investment mode has urged the Savings Bank to seek investment mainly in T-bills.

Meantime, smaller commercial banks, with a more flexible structure and functioning and with the will to be more active in the domestic market of money have sensed the need for liquid funds at a certain moment of time. At the same time, such a low number of transactions reflect banks' appraisal of T-bill transactions, as final investments (preferred to be held to maturity) refinancing and Lombard credit have marked no use during 2000. In general, the situation of market liquidity has been sufficient and the unexpected needs for liquidity arousing at a certain moment of time have been satisfied through bank agreements in the form of collateralized lending.

For the next year, the focus of activity will remain with the expansion of indirect instruments of monetary policy and the completion of their regulatory framework. We assess that only in this way, it will be improved the transmission mechanism of monetary policy decisions with respect of market rate developments and it will be increased the activity of interbank market.

### 2.3.5. CAPITAL MARKET.

#### 2.3.5.1 TIRANA STOCK EXCHANGE FUNCTIONING.

For Tirana Stock Exchange sessions, year 2000 marks the first year no transaction, since its early establishment. A similar fact gives way to the potentiality to draw indicators and assess trends of future development in secondary market of T-bills. Albeit the new regulation on the new dealing procedure in Tirana Stock Exchange is comfortable for banks and, practically, facilitates and simplifies the current procedure for them, the primary market still competes vitally in Tirana Stock Exchange and banks have a high preference for it. Practically, the computed transactions for 14.06.2000- 07.11.2000 2000 valued Lek 1,153,374,000 from which two of them are Bank of Albania's transactions with the National Commercial Bank per the amount of Lek 103,374,000. However, additionally to the secondary market alternative for the direct transaction of T-bills between the banks, we may mention as other reasons for the non-functioning of the secondary market of T-bills in Tirana Stock Exchange:

- i. The monopoly of T-bill ownership from a single entity. The Savings Bank today owns 75 percent of the total T-bill issues, immature;
- ii. The high level of liquidity in the market. This has enforced all banks be almost ever placed in a single buyer position without a selling party;
- iii. Non-performing transactions by non-bank persons. Despite from a Securities Commission licensing of a private company to operate as dealer, this company has executed no transaction in Tirana Stock Exchange during 2000.

During 200 for the third year in sequence, it was carried no transaction with government bonds. The causes for a similar dealing deficiency continue to remain the unfavourable terms of these bonds (mainly their coupon bond).

On the other hand no equity security of a share-holding company has been listed in Tirana Stock Exchange, until recently. This was mainly as a result of the non-fulfilling of qualitative criteria for a stock exchange listing such as: conspicuous skills in the management and yield of qualitative and transparent financial ratios; in many cases, the non-existence of a sound financial position of enterprises or the non-interest of the these latter to list their equity securities in the official list of Tirana Stock Exchange and their deriving unwillingness to become public share holding company or be raised on capital through Tirana Stock Exchange.

### 2.3.5.2. MEETING FIXED TARGETS.

Notwithstanding the current situation in Tirana Stock Exchange and the level of non- performing transactions, it must be stressed that current year movements with this respect consist in;

- ✍ The accomplishment of the core regulatory framework to manage Tirana Stock Exchange operation through the approval of some other regulations from the Supervisory Board of Tirana Stock Exchange (see box 2-5) such as:
  1. The rule of the Disciplinary Committee of Participation;
  2. The rule on the Listing Committee; and
  3. The rule on the dealing procedure in Tirana Stock Exchange.
- ✍ The initiation of the marketing campaign of Tirana Stock Exchange intending promotion of Tirana stock Exchange and introduction of financial instruments. More precisely, there were organised seminars with Bank of Albania's staff, economic journalists and business representatives.
- ✍ The organisation of a conference meeting on "Tirana Stock Exchange Reawakening" undertaken on Bank of Albania's initiative, undoubtedly, comprises the most important movement with Tirana Stock Exchange activity and its final separation from Bank of Albania's body. The end of this conference meeting concluded with some important conclusions<sup>26</sup>.
- ✍ The organisation of the conference meeting "Share holding companies toward Tirana Stock Exchange", a collaboration of Bank of Albania and the Institute for Co-operation and Development. The end of this conference meeting concluded with some important conclusions<sup>27</sup>.
- ✍ The Council of Ministers' approval of a draft law "On some changes and amendments of law no. 8080, dated 01.03.1996" On securities", paving the way for its further approval by Parliament. The final consent of this draft-law will lead to the fact separation of Tirana stock Exchange from Bank of Albania's body<sup>28</sup>.
- ✍ The preparing questionnaire "Albanian business against Tirana stock Exchange" cropping respective data from Albanian businesses. The purpose of this questionnaire was performing a survey on the Albanian business statement intending to find ways and alternatives to attract Albanian business companies in the capital market as one of the unexplored alternatives for the growth and expansion of this activity and their economic efficiency.
- ✍ The publication of :
  1. Some booklets as "Tirana Stock Exchange and Securities";
  2. The summary on "Rregulloret e Bursës së Tiranës" an Albanian edition;
  3. A bilingual summary (in Albanian and English) of "Rregulloret e Bursës së Tiranës - Rules of Tirana Stock Exchange".

<sup>26</sup> The complete paper of these conference meeting conclusions is presented in annex 1 of Annual Report of Tirana Stock Exchange, year 2000, published in Bank of Albania's Quarterly Economic Bulletin, March 2001.

<sup>27</sup> The complete paper of these conference meeting conclusions is presented in annex 2 of Annual Report of Tirana Stock Exchange, year 2000, published in Bank of Albania's Quarterly Economic Bulletin, March 2001.

<sup>28</sup> At the beginning of 2001, this draft law was approved by the Republic of Albania's Parliament.

All steps, undertaken during 200 as well as those expected to be undertaken in the future will aim the achievement of these major targets that are Tirana Stock Exchange vitality on the basic crop: shares and its separation from Bank of Albania and its functioning as an independent institution, finally.



**The meeting hall of the Bank of Albania's Supervisory Council.**



## *Chapter 3. Banking Supervision*

### **3.1. LICENSING AND PRUDENTIAL RULES**

#### **3.1.1. LICENSING.**

In year 2000, Bank of Albania has granted no new bank licences. The number of banks operating in Albania remained 13, but the number of their branch offices within the country is higher. During the year 2000, the only bank licensing application submitted, which is under the process of scrutiny.

On the basis of regulative framework adopted for granting a licence to non-bank financial institutions in the Republic of Albania, the Diners Club Albania association is licensed as a non-bank financial entity in order to perform mediation for monetary transactions (including even foreign currencies).

Subject to Bank of Albania's supervision are even the foreign exchange bureaus, which, just like banks, receive permanent licence and act pursuant to the Regulation: "On foreign exchange activity" and the guidelines provided by it. During the year 2000, ten new foreign exchange bureaus are licensed.

During 2000, the following entities had operating licence in Albania:

- \* Commercial Banks - 13;
- \* Foreign exchange bureaus - 20;
- \* Non-bank financial institutions - 2.

**Box 11. Savings and Loan Associations (SLAS).**

Currently, 36 Savings and Loan Associations exercise their activity in the whole country. The extension of their activity as well as the consistent concern of the Bank of Albania for not allowing the appearance of phenomena of 1997, made possible a common commitment with the World Bank experts for revising the existing law in order to determine clearly the Bank of Albania position. Pursuant to existing law, the Bank of Albania is entitled to receive information and reports by these institutions, but may not supervise them.

To avoid this deficiency, the new draft law provides that the Bank of Albania must supervise the SLAs and their unions in all aspects such as licensing, regulating, reporting, and on-site inspections.

**3.1.2. PRUDENTIAL RULES.**

The regulatory framework of the bank supervision is generally complete and during 2000, it was intended to improve it through adjustments and corrections with the primary purpose to approach the international standards on bank supervision.

Guideline “*On the Banks’ Liquidity*” substituted the respective regulation, which was deemed as very tightening. This Guideline provides more space to bank assessment concerning their liquidity management.

Guideline “*On Interest Rate Risk Management*” was drafted in order to supplement the administrative and regulatory framework, providing even some elements on supervising interest rate risk.

Regulation “*On Prudential Rules of Non-bank entities that Perform Financial Activity*”. It defines some prudential rules concerning capital adequacy, assets quality, the concentration and quality of credit portfolio and liquidity.

Regulation “*On Co-operative Banks*” details legal requirements provided by the Law “On Banking System in the Republic of Albania”, article no. 45 and deals with the regulatory and licensing procedures of co-operative banks.

Revisions in the Regulation: “*On Requirements to Be Met by Administrators of Banks and Foreign Bank Branches*”, which have to do with application of receiving work and residence permit procedures by foreign administrators.

This change was enabled by delays in submitting the relevant documentation by respective institutions. To side skip these obstacles, the Bank of Albania has the right to provide temporary consent, up to submission of the document certifying work and residence permit. Otherwise, it revokes the preliminary consent.

Decision No. 26, dated 29.03.2000 “On excluding some entities from implementing provisions of Law “On Banking System in the Republic of Albania”. According to the Law “On Banking System in the Republic of Albania”, not all entities that perform financial activity as provided under Article 26 of the Law are under the rule of Bank of Albania supervision. Financial entities that perform lending activity which financial assets originate from international organisations or governments of other countries in the form of free funds aimed at developing small and medium businesses in Albania, and which do not perform the collecting deposits activity, are not licensed and supervised by the Bank of Albania, but they only report on the performance of their activity. The same way is acted with Rural Financing Fund, which helps the establishment and functioning of SLAs for supporting the rural sector by extending credit to it.

An amendment in the Regulation “On Bank Licensing in the Republic of Albania” with decision No.43, dated 17/05/2000, concerning the criteria to be met for allowing the establishment of a branch office or a subsidiary of a bank offshore. The existing Regulation did not provide the criteria for the Bank of Albania to provide such consent. The interest of operating some banks in Albania to establish branch offices abroad, enforced relevant amendments to the Regulation.

The amendments made to regulatory framework targeted implementing Basle Committee's core principles for an effective supervision. The rate of implementing these principles has been some times assessed on technical assistance by International Monetary Fund and by Bank of Albania, on its own. As results from these assessments, 20 principles are fully implemented practically and theoretically, whereas 5 of them are either partially implemented or not applicable as far as technical viewpoint is concerned. This situation is a result of current state of bank development in Albania and is mainly related to:

- ° Lending activity. Banks performing lending activity in Albania may extend credits to Albanian citizens and investments are limited to government's treasury bills, only. Hence, so far it is not deemed as necessary to issue a regulation on controlling and supervising the risk of the country;
- ° Unconsolidated activity. Our banking system consists of banks and banks' branch-offices, which so far have not established any subsidiaries. Their balance sheet is set up on individual bases and, therefore, no consolidated supervision principle can be applied.

### **3.2. BANKING SYSTEM PERFORMANCE**

In overall view, the banking system throughout 2000 is assessed as relatively sound. The indicators of the entire banking system of the year-end have been improved. Synthetically, this advancement is indicated by the realised profit of Lek 5.4 billion from Lek 1.2 billion it was at 1999-end. It is the second year in succession that the banking system results with a profit, after a four-year period of losses (see graph 19).

The group of net incomes on interests provides the most considerable impact on the financial result of 2000. These incomes reached Lek 8.7 billion in 2000 (from Lek 5.1 billion resulted at '99-end or Lek 39.3 million loss at '98-end). The significant increase of net incomes on interests is due to some factors, among which we mention:

- \* Reduction of interest rates in economy, incurred due to the policy applied by the Bank of Albania, is reflected with a higher reduction of balance sheet liability interest rates rather than its asset interest rates.
- \* Albanian banking system is presented with a relatively low competitiveness, which creates possibility for holding high margins between the interest rates level.

However, the following factors have also affected the financial result:

- (Net) Income on commissions reached to Lek 1.5 billion, occupying 5 per cent of the total incomes in 2000;
- Operating expenditures that comprise 15.8 per cent of the banking system financial expenses. These operating expenditures are increased by Lek 778,8 million (24.6 per cent) compared to 1999. The banks' operating expenditures comprised around Lek 1.5 billion or about 39,8 per cent of the staff operating expenditures. Staff operating expenditures in 2000 increased by Lek 217.4 million (16,1 per cent) compared to the same period of the previous year.

In the second six-month period of 2000, the bank structure underwent changes.

Thus, the National Commercial Bank was added to private banks due to its privatisation. At 2000-end, the Ministry of Finance, within the framework of preparatory measures for Savings Bank's privatisation, closed the losses this bank inherited from the past years, enabling both its capitalisation and improvement of capital adequacy on the whole system. This factor effect and the increase of paid-up capital for the existing banks to Lek 700 million within March 2001 improved the capital position of banking system.

The ratio of capital adequacy results to 41,8 per cent from 8,2 per cent at 1999-end. Capitalisation is high by specific bank groups and concretely: 43,4 per cent for state-owned banks, 39,5 per cent for joint ventures and 41,8 per cent for other banks.

Additionally to the capital growth, the ratio of capital adequacy was also affected by the structure of risk-classified assets. Even this year, the banks introduced with investments focussed mainly on non-risk assets or low risk assets.

**Table 25. The structure of classified assets by risk rate (in percentage to total assets and off balance sheet items corrected according to risk).**

Indicators in % to	Banking system	G1	G2	G3
Non-risk assets	66.3	82.9	15.1	39.5
Low-risk assets	23.1	13.4	34.6	42.5
Mid-risk assets	1.3	0.1	14.1	1.0
High-risk assets	9.4	3.5	36.2	17.0

The relatively high rate of capital adequacy (by 12 per cent rate) as well as the concentration of investments in non-risk or low-risk assets enabled banks of the possibility to further extend their activity, especially lending.

Positive phenomenon was noticed in lending activity, especially under private or joint venture banks' effect. The credit balance (its net value) by joint-venture and private banks recorded growth per about Lek 6,4 billion (as 1999-end), and this was especially in the private sector, including individuals, as well. Also, at this year-end, while credit balance raised about 56 per cent, (as compared to the year-end 1999), customers' deposits and accounts increased by only 9.7 per cent. Credit extensions raised the level of classified assets as standard loans to 56.2 per cent from 42.4 per cent in 1999 or 44,5 per cent in 1998.

**Table 26. Credit Portfolio indicators (in percentage to classified loans).**

Indicators	G1	G2	G3	Banking system
1. Classified loans*	100.0	100.0	100.0	100.0
- standard	12.6	69.3	90.1	58.9
- Special mention	1.5	16.0	5.3	7.4
- Sub-standard	4.8	4.0	1.4	3.3
- Doubtful	2.7	9.1	1.2	4.1
- Lost	78.4	1.6	2.0	26.2
2. Provisioned	80.9	8.5	5.1	30.3

? Standard and special mention loans are classified as standard loans, while the other three groups are considered as bad loans.

During the year, the banking system structure underwent changes in the favour of banks having private capital (resulting from the privatisation of National Commercial Bank), affecting to a certain degree the mitigation of the banking system domination by banks with an entire state capital. Though the activity segmentation phenomenon continuous, they appear somewhat softened as a result of "aggression" that the private banks are showing towards their activity extension.

**Table 27. Bank group weighted by some indicators to the total banking system (in percentage)..**

Indicators	Group 1	Group 2	Group 3
1. Current accounts and deposits	69,1	4,6	26,3
2. Shareholding capital	17,9	13,0	69,1
3. Net credit	8,7	40,5	50,7
4. Treasury bills	84,2	1,0	14,8
5. Placements with the banks	37,9	9,9	52,2

**Table 28. Profitability indicators in percentage (year 2000).**

Indicators	Group 1	Group 2	Group 3	Banking system
ROA*	2,9	0,7	0,8	2,1
ROE**	93,7***	3,1	3,6	21,1***
Net incomes on interest / total average assets	3,6	4,5	2,8	3,4
Activity / total average assets	1,0	2,7	2,4	1,5
Provisions expenses / total average assets	-1,7	2,8	0,9	- 0,6

\* Return on total assets

\*\* Return on Equity

\*\*\* To avoid its negative value, this indicator is not calculated on average basis of shareholding capital only for the Savings Bank. This has also affected the banking system indicator. (The Savings Bank losses in the previous years have been covered and the shareholding equity marks positive values, consequently).

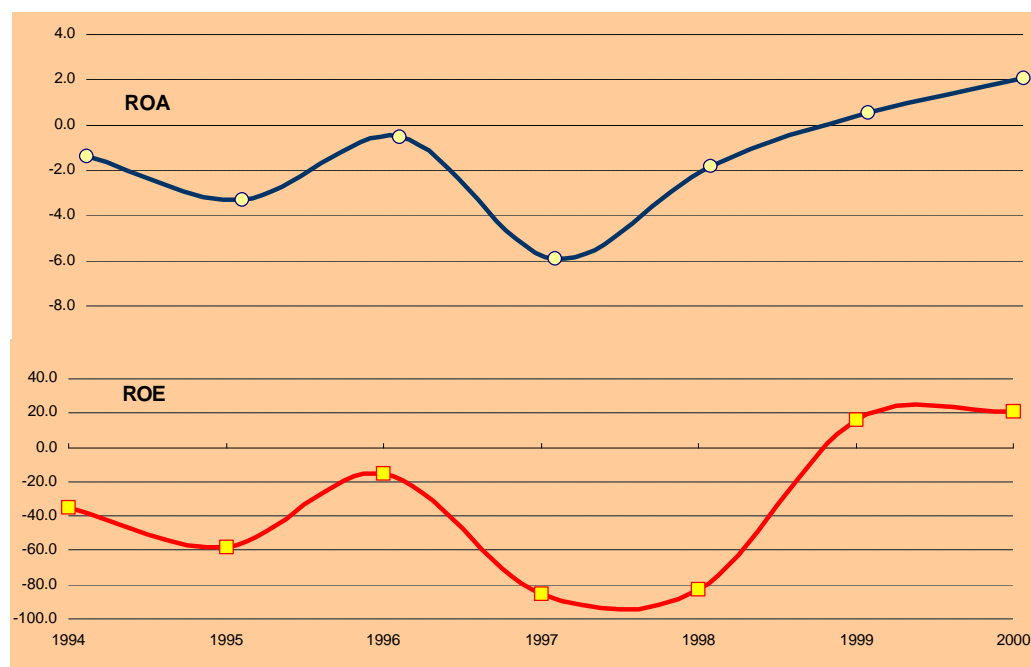
**Chart 24. Profitability indicators (in percentage).**

Table 29. Banking system indicators.

Banks <sup>29</sup>	No. of branches	Paid capital/ Total balance sheet (%)	Total deposits/ Total balance sheet (%)	(Net) Total loans/Total balance sheet (%)	Bad loans/ Total loans (%)	Treasury Bills in per cent in the banking system
<b>First Group</b>						
1. Savings Bank	26	2,8	69,3	27,1	87,7	84,2
<b>Second Group</b>						
2. Italian-Albanian Group	Agency 1	11,3	4,2	18,3	8,9	1,0
3. Arab-Albanian Islamic Bank		9,3	0,3	1,9	0,0	0,0
<b>Third Group</b>						
4. National Commercial Bank	10	27,1	9,7	10,3	0,0	7,3
5. Dardania Bank		3,3	0,6	2,1	1,3	0,0
6. Tirana Bank	3	6,9	4,1	9,7	1,7	3,3
7. National Bank of Greece	Agency 2	5,5	2,5	4,8	0,0	0,8
8. International Comm.Bank		3,8	0,4	1,7	0,0	0,1
9. Alpha Credit Bank	2	9,4	2,4	6,9	0,0	1,2
10. American Bank		4,2	4,6	9,6	0,2	1,1
11. FEFAD Bank	4	4,6	1,5	3,9	0,2	0,7
	Agency 1					
12. First Investment Bank		4,6	0,04	1,9	0,0	0,0
13. International Bank		7,2	0,3	1,7	0,0	0,1

<sup>29</sup> The classification of bank groups is made after equity criterion the first group includes banks of utterly state owned equity, the second group involves joint venture banks, of domestic and foreign capital and the third group includes other banks.

### **3.3. ON - SITE INSPECTIONS.**

One of the strategic objectives of the banking supervision is “strengthening on-site inspections’ capacity and reducing the time interval between two commercial bank inspections from 18 to 12 months. If the strengthening of inspection capacity is a consistent process that claims plenty of time, reducing the gap between two inspections represents a more straightforward objective. Though this objective was set to realise fully in 2001, it was made possible to be achieved within the year 2000. In this way, more scope was created so as to pay more attention for increasing inspection quality.

During 2000, 11 full inspections for 11 second-tier banks, which represent 84 per cent of the banking market and 5 partial inspections, were performed. 14 auditors of Supervision Department participated in them.

These inspections have aimed to:

- i. highlight how much safe and consistent the second tier banks’ activity has been;
- ii. identify certain banks or banking activities that require the attention of supervisory authorities;
- iii. check the implementation, observance and supervision by these banks’ governing councils, of internal acts that regulate each bank’s activity, concerning:
  - \* banking activity procedures and policies that have to do with crediting activity, bank’s asset and liability management, liquidity, risk management, internal audit, etc.;
  - \* bank’s structures with a personnel that responds to bank’s activity development, especially in lending field;
  - \* establishment of a committee for bank’s asset and liability management;
  - \* treatment, by the governing councils, of managers’ and control committee’s interim reports;
  - \* functioning of certified public accountants;
  - \* implementation of banking accounting manual;
  - \* compliance of the Bank of Albania law with the by-laws;
  - \* direct communication with the banks’ governing councils;
  - \* Familiarisation of high administrators with the system used by supervision for assessing the overall financial statement of financial institution (“CAMELS” system).



Partial inspections were particularly aimed at evidencing to what way and size the following were applied:

- (i) The Bank of Albania Regulation "On the requirements to be met by the managers of the banks and branches of foreign banks;
- (ii) The program submitted and approved by the Bank of Albania for issues that are incurred during full scope inspections.

### **3.3.1. MATTERS COMMING OUT OF INSPECTIONS.**

The most striking problems coming out of examinations are :

- \* Lack of lending policies in some banks and inefficiency of reserve funds for covering loan losses.
- \* Violation, in any case, of prudential rules for a loan receiver or a group of loan receivers.
- \* Violation of the Bank of Albania Regulation on the requirements that the second-tier bank managers should meet. Managers are appointed without receiving the Bank of Albania prior consent.
- \* Non-functioning of the asset and liability management committee in some banks, and lack of written foreign exchange policies.
- \* Avoidance from banks' business plans.

Depending on the problems resulted from second-tier banks, the Bank of Albania has announced and requested commitment of banks managing boards and monitoring committees to duly provide relevant solutions.

The direct communication with banks' managing boards was noted to have positive effect in the enhancement managers' responsibility for implementing acts and recommendations left by it.

### **3.3.2. CORRECTIVE MEASURES.**

Pursuant to the Law no. 8365 "On the Banking System in the Republic of Albania", dated 02.07.1998, Article 44, the Bank of Albania has ordered the inspected banks to submit acceptable programs for correcting the violations observed. The bank of Albania has considered these programs as appropriate and attends their application constantly.

### 3.4. SAVINGS BANK PRIVATIZATION

The year 2000 is considered as a relatively vintage year concerning the advancement in privatising state-owned banks. Hence, the privatisation of National Commercial Bank is over, where the new shareholders paid the capital of US\$ 10 million and important steps are made towards the preparations for privatising the Savings Bank, the biggest bank of the Albanian banking system.

#### 3.4.1. LEGAL FRAMEWORK AMENDMENTS.

The Savings Bank's privatisation is a process that needs even many legal amendments.

On 27 March 2000, the decision No. 407 of the Council of Ministers "On adopting the strategy of restructuring the Savings Bank, joint-stock company." was approved. This strategy provides the steps for a technical-administrative and economic- financial restructuring of the bank.

On 26/12/ 2000 the Law No 8726 was approved "On covering with treasury bills the state liabilities to the Savings Bank and its re-capitalisation with treasury bills".

The Council of Ministers adopted the decision No. 737 "On determining T-bills terms and conditions for state liabilities and re-capitalisation of Savings Bank, joint-stock company" on 28/12/2000. It has to do with the factual covering of state liabilities and re-capitalisation of the bank with treasury bills, to the amount of Lek 17.2 billion. This amount ensures the observance of **capital adequacy rate**.

***As it can be noticed, both these acts have a great deal of importance in further advancing the privatisation process. The Savings Bank improves its capital position by increasing its value in the market and by becoming more attractive to foreign investors.***

#### 3.4.2. ROLE OF THE BANK OF ALBANIA.

The Savings Bank is a state-owned bank. The presentation of the state is realised through the Ministry of Finances. Thus, the Ministry of Finances and the Government are directly committed to the Savings Bank's privatisation process. The Bank of Albania has attended closely and with great interest the performance of Savings Bank's privatisation process, since, pursuant to the central bank's Law:

- \* The Bank of Albania has the duty to encourage and support the establishment of a sound and steady banking system.
- \* The Bank of Albania is an adviser of the Albanian Government for economic and financial issues.

Furthermore, the Savings Bank occupies an important weight in Albanian banking system. The dominating position of this bank makes the privatisation process more delicate. The development of Albanian banking system depends on the success of this process and on the bank's post-privatisation performance.

**Box 12. Savings Bank dominates the Albanian banking system.**

The Savings Bank, joint-stock company, has the largest extended network in the country with 223 offices and it is present in 37 districts as follows:

✍	Branch offices.....	26
✍	Agencies.....	87
✍	Banking offices.....	110

The Savings bank's total assets, a joint-stock company, occupy 62.6 per cent of the banking system, whereas concerning total accepted deposits and individuals' deposits it occupies respectively 69.3 and 62.8 per cent of the total banking system. The Savings Bank owns about 84.2 per cent of deposits in Lek and about 43.4 per cent of total credit stock. The dominating position of this bank is noticed even in the treasury bills with 84.2 per cent of the total banking system. The Savings Bank's total asset for one hundred thousand citizens was Lek 5.18 billion for December 2000.

Concerning the payment volume, the Savings Bank's position is also presented as dominating, with 39 per cent of clearing activity, 38 per cent in pay-orders and 39 per cent of the total system for banking checks.



**A view from the Bank of Albania's mosaic.**

## Chapter 4. Balance Sheet of Bank of Albania

### 4.1. BALANCE SHEET

	Notes	2000 Lek (mln)	1999 Lek (mln)
<b>ASSETS</b>			
<b>Foreign assets</b>			
Gold	3	970	954
Deposits with the International Monetary Fund	4	21,808	21,559
Deposits with foreign banks	5	57,094	41,382
Securities	6	19,712	13,791
Other foreign assets	7	196	431
<b>Total foreign assets</b>		<b>99,780</b>	<b>78,117</b>
<b>Domestic assets</b>			
Other gold and precious metals	3	69	61
Transit credits	8	6,549	6,686
Loans to the Government	9	9,429	32,258
Investments in securities	10	72,117	40,938
Other domestic assets	11	2,408	2,277
<b>Total domestic assets</b>		<b>90,572</b>	<b>82,220</b>
<b>Total Assets</b>		<b>190,352</b>	<b>160,337</b>
<b>LIABILITIES</b>			
<b>Foreign liabilities</b>			
Due to the International Monetary Fund	12	22,883	21,434
Due to non-resident financial institutions	13	7,894	8,118
Other foreign liabilities		31	19
<b>Total foreign liabilities</b>		<b>30,808</b>	<b>29,571</b>
<b>Domestic liabilities</b>			
Currency in circulation	14	101,409	82,946
Due to domestic banks	15	32,571	27,137
Due to the Government	16	3,935	3,559
Other domestic liabilities	17	110	67
<b>Total domestic liabilities</b>		<b>138,025</b>	<b>113,709</b>
<b>CAPITAL AND RESERVES</b>			
Capital		750	750
Legal reserve		3,750	3,750
Revaluation reserve		5,281	2,917
Other reserves		7,426	7,407
Retained earnings		4,312	2,233
<b>Total capital and reserves</b>		<b>21,519</b>	<b>17,057</b>
<b>Total liabilities and capital and reserves</b>		<b>190,352</b>	<b>160,337</b>

The accompanying notes are an integral part of these financial statements.

## 4.2. STATEMENT OF PROFIT AND LOSS

	Notes	2000 Lek (mln)	1999 Lek (mln)
<b>Operations with non-residents</b>			
Interest and commission income		3,699	2,584
Interest and commission expense		196	197
<b>Interest and commission from operations with non-residents, net</b>		<b>3,503</b>	<b>2,387</b>
<b>Operations with residents</b>			
Interest and commission income	18	7,570	14,902
Interest and commission expense		305	162
<b>Interest and commission from operations with residents, net</b>		<b>7,265</b>	<b>14,740</b>
Other operating income, net	19	77	18
<b>Net operating income</b>		<b>10,845</b>	<b>17,145</b>
<b>Other non-operating expenses</b>			
Staff costs	20	180	142
Depreciation		90	66
Amortisation of printing and minting costs		59	244
General and administrative expenses		59	48
Other expense		62	50
<b>Total other non-operating expenses</b>		<b>450</b>	<b>550</b>
<b>NET PROFIT</b>		<b>10,395</b>	<b>16,595</b>

The accompanying notes are an integral part of these financial statements.

### 4.3. STATEMENT OF CAPITAL AND RESERVES

In Lek (mln)	Capital	Legal reserve	Revaluation reserve	Other reserves	Retained earnings	Total
As at december 31, 1998 (Unaudited)	750	3,750	6,906	7,223	2,233	20,862
Net profit	-	-	-	-	16,595	16,595
Foreign currency and gold revaluation	-	-	(3,989)	-	-	(3,989)
Profit distribution	-	-	-	184	(16,595)	(16,411)
<b>As at december 31, 1999</b>	<b>750</b>	<b>3,750</b>	<b>2,917</b>	<b>7,407</b>	<b>2,233</b>	<b>17,057</b>
Net profit	-	-	-	-	10,395	10,395
Foreign currency and gold revaluation	-	-	1,036	-	-	1,036
Domestic treasury bills revaluation	-	-	191	-	-	191
US treasury bills revaluation	-	-	17	-	-	17
Tangible fixed asset revaluation	-	-	1,143	-	-	1,143
Release of tangible fixed asset revaluation surplus	-	-	(23)	-	23	-
Profit distribution	-	-	-	19	(8,339)	(8,320)
<b>As at December 31, 2000</b>	<b>750</b>	<b>3,750</b>	<b>5,281</b>	<b>7,426</b>	<b>4,312</b>	<b>21,519</b>

The accompanying notes are an integral part of these financial statements.

## **4.4. NOTES TO THE FINANCIAL STATEMENTS**

### **4.4.1. GENERAL INFORMATION.**

The Bank of Albania (the “Bank”) is the central bank of the Republic of Albania and was established according to the “Law on the Bank of Albania” in 1992. Under the terms of its charter the Bank’s main responsibilities are:

- \* establish and maintain price stability;
- \* supporting the development of a foreign exchange regime;
- \* management of money in circulation;
- \* management of interest rates;
- \* prognosis and analysis of economic and social development indicators within the Republic of Albania;
- \* supervision of commercial bank activities including issue of licenses to all banks;
- \* operating within the Republic of Albania and issuing of permissions for undertaking international banking activities.

The Bank is subject to the regulatory requirements of the Parliament of the Republic of Albania and the “Law on the Bank of Albania”.

### **4.4.2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES.**

The financial statements have been prepared in accordance with the Law “On Accounting”. International Accounting Standards (“IAS”) have been used only where they are appropriate and applicable to the activities of a national central bank. Consequently, a cash flow statement as required under IAS 1 has not been prepared as the liquidity and cash position of the Bank are not of primary concern to the users of these financial statements. Also the revaluation methodology adopted for the revaluation of the head office building as detailed in Note 11 was not according to the revaluation requirements set out in IAS 16 on property, plant and equipment to the extent that the revaluation was not conducted by independent professional qualified appraisers, the future cash flows were not discounted and the entire category of buildings were not revalued.

The significant accounting policies used by the Bank in these financial statements are set out below:

### **4.4.3. BASIS OF PREPARATION.**

The financial statements presented include the accounts of the Bank prepared on the historical cost basis of accounting modified to include the revaluation of foreign currency, gold and the head office building.

The accompanying financial statements are presented in the national currency of the Republic of Albania, the Albanian Leke (“LEK”).



The Bank controls the operations of the Printing House, a business entity engaged in the printing of Government high security material and the minting of five and ten LEK coins. The financial operations of the Printing House have not been consolidated with those of the Bank as the ability of the Printing House to distribute its earnings to the Bank has yet to be determined. The financial position of the Printing House as at December 31, 2000 is set out in Note 21 to these financial statements.

### Interest and commissions

In these financial statements, interest income and expense is recognized on the accrual basis.

Commission income is credited to income when received.

Commission expense is debited to expense when paid.

### Foreign currency translation

Transactions denominated in foreign currency are translated into LEK at the Bank's official exchange rate on the date of the transaction.

Foreign currency assets and liabilities are translated into LEK at the Bank's official exchange rate valid on the balance sheet date. Unrealized foreign exchange gains and losses are credited or charged to the revaluation reserve.

The applicable official Bank rates (LEK to the foreign currency unit) for the principal currencies as at December 31 were as follows:

	2000	1999
United States dollar ("USD")	142.64	135.12
German mark ("DEM")	67.78	69.43
Italian lira ("ITL")	0.07	0.07
European currency unit ("Euro")	132.57	135.80
British pound ("GBP")	212.23	218.22
Swiss franc ("SFR")	87.15	84.66
Greek drachma ("GRD")	0.3895	0.498
Special drawing rights ("SDR")	185.76	185.25

### Investments

Domestic treasury bills to cover the State budget are stated at cost plus amortised discount. United States treasury bills and domestic short-term treasury bills are stated at market value.

### **Repurchase agreements**

Securities purchased under repurchase agreements are accounted for as collateralised loans.

### **Fixed assets**

The fixed assets are stated at historical cost less accumulated depreciation except the head office building which was revalued as at March 29, 2000 (see Note 11 to these financial statements).

If the fair value of a fixed asset is lower than its carrying amount, due to circumstances not considered to be temporary, the fixed asset is written down to its fair value.

Gains and losses on disposal of fixed assets are recognized in the profit and loss account in the year of disposal..

Depreciation is provided on all fixed assets based on the historic cost. The annual charge for depreciation is computed using the straight-line method using rates specified for each depreciable asset based on estimated useful lives. The estimated useful lives applied are:

building - head office	50 years
buildings - at branches	33 years
vehicles	5 years
furniture, fixtures and equipment	10 years
computer hardware	3 years

During 1999 the estimated useful life of all buildings was 33 years. After revaluation of the head office building (see Note 11), the remaining useful life of this building was evaluated at 50 years. The effect on the profit and loss account for the year ended December 31, 2000 of this change in accounting estimate was a reduction in the depreciation expense for the year ended December 31, 2000 of LEK 11 million.

### **Printing and minting costs**

The costs of printing banknotes and minting coins are capitalised as intangible fixed assets and amortised over two years and ten years, respectively.

### **Taxation and profit allocation**

The Bank is exempt from income tax according to the "Law on the Bank of Albania" and is required by law to pay 100% of its statutory profit directly to the State budget after allocations to replenish the levels of reserve funds directed by the Supervisory Council.

## **Legal reserve**

In accordance with Albanian banking legislation, the Bank has established a legal reserve into which 25% of the net profit for the year is transferred until the reserve amounts to 500% of the capital.

## **Use of estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

## **Managed assets**

At as December 31, 2000, the Bank held as custodian short-term treasury bills issued by the Ministry of Finance and gold and other precious metals on behalf of the Government. As the Bank acts as custodian for these assets it does not bear any credit risk related to them.

These assets are excluded from the Bank's balance sheet.

## **1. GOLD AND PRECIOUS METALS**

As at December 31, 2000, the value of gold reserves of international standard owned by the Bank was LEK 970 million (1999 – LEK 954 million), being 16,923.778 troy ounces of gold valued at LEK 658 million (1999 - 16,302.056 troy ounces valued at LEK 640 million) placed in gold time deposits abroad, and 8,007.88 troy ounces of gold valued at LEK 312 million (1999 – 8,007.88 troy ounces valued at LEK 314 million) in a domestic vault.

Gold is valued at the London fixing rate on the balance sheet date. Differences resulting from the revaluation of gold are recorded in the revaluation reserve. As at December 31, 2000, the price for one troy ounce of gold was USD 272.65 (1999 - USD 290.85).

Gold and other precious metals also includes platinum and silver in a domestic vault, valued at the London fixing rate on the balance sheet date, totaling LEK 35 million as at December 31, 2000 (1999 – LEK 24 million) and LEK 34 million of non-international standard gold (1999 – LEK 37 million).

## **2. DEPOSITS WITH THE INTERNATIONAL MONETARY FUND**

Deposits with the International Monetary Fund (“IMF”) are comprised of :

	2000 Lek (mln)	1999 Lek (mln)
International Monetary Fund	10,972	11,173
Special Drawing Rights ("SDR")	10,836	10,386
<b>Total</b>	<b>21,808</b>	<b>21,559</b>

Deposits with the IMF resulted from the membership of the Republic of Albania in the IMF, which is secured by a promissory note issued by the Government. SDR within the reserve tranche approximate the Republic of Albania's membership quota paid to the IMF in SDR and LEK which represent the counterpart of loans which were granted to the Republic of Albania as disclosed in Note 12.

### 3. DEPOSITS WITH FOREIGN BANKS

Deposits with foreign banks are comprised of :

	2000 Lek (mln)	1999 Lek (mln)
Current accounts	10,776	9,688
Short-term deposits	46,318	31,694
<b>Total</b>	<b>57,094</b>	<b>41,382</b>

Deposits with foreign banks are denominated mainly in EURO, USD and DEM which equate to the following foreign currency balances:

	2000 (in million)	1999 (in million)
EURO	183	103
USD	137	112
DEM	118	113

### 4. SECURITIES

Securities are comprised of:

	2000 Lek (mln)	1999 Lek (mln)
United States treasury bills	19,064	13,158
Other investments	648	633
<b>Total</b>	<b>19,712</b>	<b>13,791</b>

The United States treasury bills mature on various dates between March and December 2001 and the income earned is derived from the difference between the nominal value on maturity and the discounted purchase value, which is amortised to income over the life of the treasury bill.

Other investments include participation in the European Bank for Reconstruction and Development, the World Bank and its associated organisations and the Arab Development Bank.

## 5. OTHER FOREIGN ASSETS

As at December 31, 2000, other foreign assets are comprised of cash on hand in foreign currency of LEK 14 million (1999 - LEK 206 million) and accrued interest on deposits with foreign banks of LEK 182 million (1999 - LEK 225 million).

## 6. TRANSIT CREDITS

Transit credits, by industrial sector, are comprised of:

	2000 Lek (mln)	1999 Lek (mln)
Agriculture	1,405	1,437
Industry	4,144	4,245
Services and other	1,000	1,004
<b>Total</b>	<b>6,549</b>	<b>6,686</b>

Transit credits represent interest-free credit facilities, which were provided to credit institutions for further distribution to ultimate borrowers to support state development programmes (See Note 13). All loans are guaranteed by the Government.

## 7. LOANS TO THE GOVERNMENT

Of the total loans to the Government as at December 31, 1999, LEK 22,829 million bore interest at an average rate of 5.5% and LEK 9,429 million was interest free. During 2000, the interest bearing loans were converted into treasury bills owned by the Bank. The balance as at December 31, 2000 of LEK 9,429 million remain interest free.

## 8. INVESTMENTS IN DOMESTIC SECURITIES

Investments in domestic securities are comprised of:

	2000 Lek (mln)	1999 Lek (mln)
Treasury bills to cover the State budget	6,006	24,592
Short-term treasury bills	62,782	13,240
Securities for cooperatives	1,958	1,958
Security for the capitalisation of the National Commercial Bank ("NCB")	1,290	1,148
Treasury bills under repurchase agreements	81	-
<b>Total</b>	<b>72,117</b>	<b>40,938</b>

Treasury bills to cover the State budget as at December 31, 2000 relate to a short-term treasury bill maturing on January 11, 2001 at an interest rate of 11.28%. Those treasury bills to cover the State Budget as at December 31, 1999 related to loans given to the Government from 1994 to 1999 which were converted into short-term treasury bills. The interest rate is set for 6 months based on the discount rate for short-term treasury bills which as at December 31, 1999 varied from 15.4% to 19.5 %. The maturity for these bills was 6 months which is normally renewed.

Short-term treasury bills as at December 31, 2000 relate mainly to treasury bills, with maturities ranging between January and June 2001, bearing interest at rates ranging from 7.8% to 12.5%.

Securities for cooperatives relate to a loan to State agriculture cooperatives prior to 1992. The Government has issued securities in the amount of the loan. These securities bear interest at a rate of 1.5%.

Security for the capitalisation of the NCB relates to a zero coupon bond which was issued by the Government to replace the Bank's participation in the capital of the NCB. The security bears interest of 6% per annum and matures in 2006.

## 9. OTHER DOMESTIC ASSETS

Other domestic assets are comprised of :

	2000 Lek (mln)	1999 Lek (mln)
Accrued interest	-	1,027
Other debtors	46	352
Loans to employees	392	350
Tangible fixed assets, net (see below)	1,399	292
Inventory	16	13
Intangible assets, net (see below)	550	235
Other	5	8
<b>Total</b>	<b>2,408</b>	<b>2,277</b>

The net book values of tangible fixed assets by category are comprised of:

	Land, buildings and general constructions	Technical equipment	Transport vehicles	Office equipment & computers	Total property, plant and equipment
<b><u>Cost/Valuation</u></b>					
Balance at January 1, 1999	131	179	94	99	503
Revaluation	1,143	-	-	-	1,143
Additions	17	14	9	14	54
Disposals	(7)	-	-	-	(7)
Balance at December 31, '00	1,284	193	103	113	1,693
<b><u>Accumulated Depreciation</u></b>					
Balance at January 1, 1999	30	77	62	42	211
Charge for the year	34	29	12	15	90
Disposals	(7)	-	-	-	(7)
Balance at December 31, '00	57	106	74	57	294
<b><u>Net Book Value</u></b>					
Balance at December 31, '00	1,227	87	29	56	1,399
Balance at December 31, '99	101	102	32	57	292

According to Albanian law, the legal title on the Bank's buildings is unclear. The management are of the opinion that this issue will be resolved with the Ministry of Finance in the near future in favour of the Bank.

The head office building of the Bank, included within the category "Land, buildings and general constructions, was revalued during 2000 to LEK 1,413 million from a fully depreciated historic cost amount of LEK 7 million. The revaluation took place on March 29, 2000, effective January 1, 2000, and was conducted by an internal valuation committee. The basis of the valuation was non-discounted future cash flows based on the potential market rental value of the property over its estimated useful life of 50 years. No other buildings owned by the Bank were revalued. The revaluation surplus of LEK 1,143 million was credited to the revaluation reserve.

Net intangible assets is comprised as below:

	2000 Lek (mln)	1999 Lek (mln)
Computer programs and others	10	8
Banknotes printed and coins minted	1,874	1,501
Accumulated amortisation	(1,334)	(1,274)
<b>Total</b>	<b>550</b>	<b>235</b>

## 10. DUE TO THE INTERNATIONAL MONETARY FUND

Due to the International Monetary Fund is comprised of:

	2000 Lek (mln)	1999 Lek (mln)
Enhanced Structural Adjustment Facility ("ESAF")	12,533	10,882
IMF securities account	8,525	8,727
IMF account in LEK	1,825	1,825
<b>Total</b>	<b>22,883</b>	<b>21,434</b>

ESAF borrowings related to the Republic of Albania's IMF quota and were drawn down on behalf of the Government for macroeconomic reforms. There are 3 component facilities:

- \* The initial ESAF facility was drawn down in 1993 and is repayable over 10 years which commenced in 1999. The outstanding balance as at December 31, 2000 is SDR 23,013,000 (1999 – SDR 28,519,000) and the facility bears interest at 0.5%, payable semi-annually.
- \* An additional loan under this facility (Known as Poverty Reduction and Growth Facility) was drawn down in 1999 and 2000. The outstanding balance as at December 31, 2000 was SDR 35,630,000 (1999 – 21,348,000). This is also a ten year facility repayable by 2009 in 10 semi-annual installments commencing in 2004. Interest is payable, after the grace period, at 0.5% semi-annually.
- \* The Emergency Post Conflict Assistance for Albania loan: An SDR 8,825,000 loan granted in 1997 repayable in 8 installments over 5 years after a 3 year grace period. The interest payable is at market rates which as at December 31, 2000 were 5.6%.

## 11. DUE TO NON-RESIDENT FINANCIAL INSTITUTIONS

Due to non-resident financial institutions is comprised of :

	2000 Lek (mln)	1999 Lek (mln)
Transit credits (Note 8)	6,552	6,689
Loan from the Bank of Greece	1,169	1,237
Due to the World Bank	173	192
<b>Total</b>	<b>7,894</b>	<b>8,118</b>



Transit credits were provided by Kreditanstalt für Wiederaufbau totaling LEK 5,891 million (1999 - LEK 6,032 million) and the European Investment Bank totaling LEK 661 million (1999 - LEK 657 million). Interest is paid by the recipients of these transit credits (domestic banks and companies) directly to the providers of the finance. The loan from the Bank of Greece (Hellenic Republic borrowing) was granted for the purpose of funding the balance of payments of the Republic of Albania. The interest rate is set as 4% per annum, payable semi-annually. The loan matures in 2018.

## 12. CURRENCY IN CIRCULATION

The exclusive rights of national currency issue are vested with the Bank. This item comprises valid domestic banknotes and coins in circulation issued by the Bank.

The following bank notes and coins were in circulation:

Nominal value LEK	December 31, 2000		December 31, 1999	
	Number in thousand	Value LEK (mln)	Number in thousand	Value LEK (mln)
1	20,999	21	21,016	21
3	6,479	19	6,489	20
5	6,323	32	6,373	32
10	7,615	76	7,684	77
50	-	-	749	38
100	19,495	1,949	17,831	1,783
200	26,924	5,385	27,706	5,541
500	68,713	34,356	64,048	32,024
1,000	48,181	48,181	40,298	40,298
5,000	2,023	10,113	476	2,380
Coins		1,277		732
<b>Total</b>		<b>101,409</b>		<b>82,946</b>

## 13. DUE TO DOMESTIC BANKS

Due to domestic banks is comprised of:

	2000 Lek ( mln)	1999 Lek (mln)
<b>Foreign currency</b>		
Correspondent accounts of commercial banks	71	84
Compulsory reserves of commercial banks	6,609	5,684
	<b>6,680</b>	<b>5,768</b>
<b>Domestic currency (LEK)</b>		
Demand deposits	20,656	20,584
Treasury bills under repurchase agreements	5,235	785
	<b>25,891</b>	<b>21,369</b>
<b>Total</b>	<b>32,571</b>	<b>27,137</b>

The Bank commenced paying interest on the compulsory reserves of commercial banks in September 2000. The interest is calculated as follows:

- ✍ LEK balances: one third of the yield on 3 month domestic treasury bills (2.6% at December 31, 2000);
- ✍ USD balances: one third of the one month USD LIBOR rate (2.2% at December 31, 2000);
- ✍ EURO balances: one third of the one month EURO LIBOR rate (1.6% at December 31, 2000);
- ✍ GRD balances: one third of the one month ATHIBOR rate (1.6% at December 31, 2000).

The Bank does not pay interest on correspondent accounts and demand deposits.

Treasury bills under repurchase agreements matured on January 4, 2001 at interest rates ranging from 6.2% to 6.45%.

#### 14. DUE TO THE GOVERNMENT

Due to the Government is comprised of:

	2000 Lek (mln)	1999 Lek (mln)
Deposits received on behalf of the Government	3,850	1,562
Undistributed profit appropriation	-	1,903
Other	85	94
<b>Total</b>	<b>3,935</b>	<b>3,559</b>

Deposits received on behalf of the Government represent funds received by the Bank from a loan granted to the Government by the International Organisation for Economic Development.

#### 15. OTHER DOMESTIC LIABILITIES

Of the other domestic liabilities total of LEK 110 million, LEK 84 million relates to amounts due to the Printing House controlled by the Bank (see note 21).

#### 16. INTEREST AND COMMISSION INCOME (RESIDENTS)

Interest and commission income is comprised of:

	2000 Lek (mln)	1999 Lek (mln)
Interest income from government loans	1,378	4,330
Interest income from securities	6,006	10,565
Other	186	7
<b>Total</b>	<b>7,570</b>	<b>14,902</b>

## 17. OTHER OPERATING INCOME, NET

Other operating income is comprised of:

	2000 Lek (mln)	1999 Lek (mln)
Net loss from sales of investments	(2)	(1)
Net profit from foreign currency and precious metals trading	1	3
Other	78	16
<b>Total</b>	<b>77</b>	<b>18</b>

## 18. STAFF COSTS

Staff costs consist of employees' salaries, social and other costs. Social costs represent mainly compulsory contributions to the Social Security Fund, State Employment Fund and others.

As at December 31, 2000, the Bank had 334 employees (1999 - 272 employees).

## 19. PRINTING HOUSE

As detailed in Note 2, the Bank controls the operations of the Printing House. The financial position of the Printing House as at December 31, 2000 is as follows:

	2000 Lek (mln)
<b>ASSETS</b>	
Tangible fixed assets	41
Inventory	62
Trade accounts receivable	1
Amount due from the Bank (see note 17)	84
<b>Total assets</b>	<b>188</b>
<b>LIABILITIES</b>	
Capital	52
Legal reserve	19
Investment reserves	24
Other reserves	6
Retained earnings	87
<b>Total statutory funds and reserves</b>	<b>188</b>

## **20. CONTINGENCIES AND COMMITMENTS**

The Bank is involved in a number of lawsuits and legal proceedings arising in the ordinary course of business. Management is of the view that these proceedings will not have a material effect on the financial position or operating results of the Bank.

There were no significant other significant commitments or contingencies.

## **21. COMPARATIVE FIGURES**

Certain comparative figures have been restated to conform with current year presentation.

#### **4.5. INDEPENDENT AUDITOR'S REPORT**

To the Supervisory Board of the Bank of Albania:

We have audited the accompanying balance sheets of the Bank of Albania (the "Bank") as of December 31, 2000 and 1999, and the related statements of profit and loss and capital and reserves for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

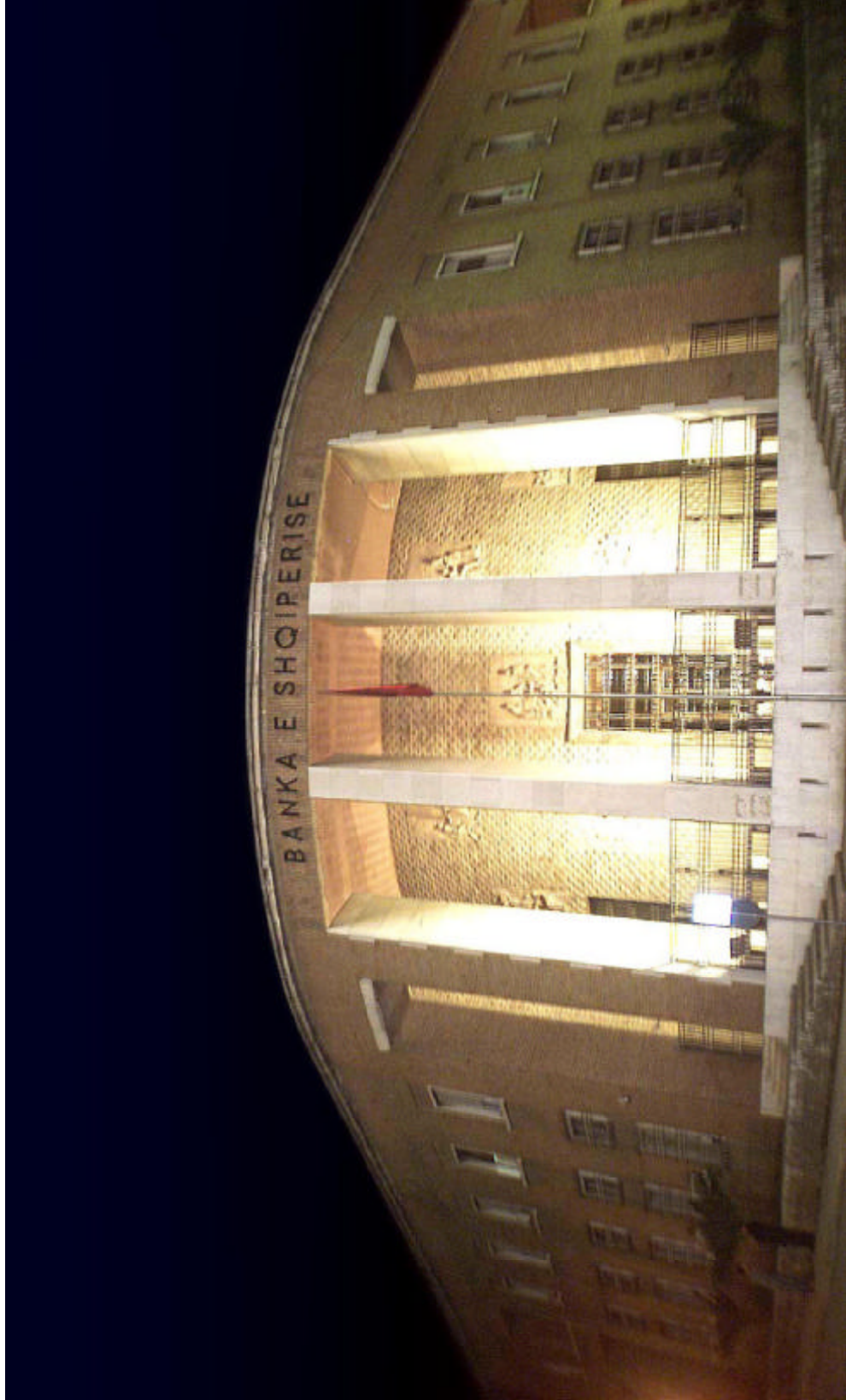
We did not audit the balance sheet as of December 31, 1998, since that date was prior to our appointment as auditors, adjustments to which could materially affect the determination of the statement of profit and loss for the year ended December 31, 1999; accordingly, we were unable to express, and did not express, an opinion on the statement of profit and loss and capital and reserves for the year ended December 31, 1999.

In our opinion, except for the effect on the financial statements of the matter referred to in the preceding paragraph, the financial statements present fairly, in all material respects, the financial position of the Bank as of December 31, 2000 and 1999 and the results of its operations and capital and reserves for the years then ended in accordance with International Accounting Standards modified for generally accepted accounting policies applicable to national central banks.

**Deloitte & Touche, Sh.p.k**

**Tirana, Albania**

**March 5, 2001**



Bank of Albania' s front view.

## *Chapter 5. Other Bank of Albania activities*

### **5.1. PAYMENT SYSTEM DEVELOPMENTS**

The main strategic mid-term target of the Bank of Albania on payment system is the increase of currency in circulation through all operating banks in the system and the reduction of cash quantity in economy, consequently.

Achieving this target is closely connected with the rate of the customer relationship with banks, culture and tradition as well as with development of the necessary infrastructure. For these reasons, as well as for achieving it, the Bank of Albania will concentrate the work on some main bearings: **first**, access in the use of new instruments; **second**, the improvement of the payment system; **third**, the enhancement of inter-bank payments, dealing with small value payments.

#### **5.1.1. OVERVIEW.**

Year 2000 was characterised by the efforts to :

- A. Present *new payment instruments*, through concluding agreements for acknowledgement and uses the “*order for direct debiting*” and “*order for periodic payment*”.
- B. *Reduce time for processing banking documentation*. For this, it was signed an arrangement for unifying terms of processing banking instruments, payment orders and checks, between the second-tier banks and the Bank of Albania.
- C. Standardise payment instruments in use. The year 2000 marked the initial functioning of the agreement “On unifying payment orders and checks” as a step ahead to international standards.
- D. Compile the regulatory basis for the new instruments and improve the current regulatory framework. More concretely:
  - \* It was prepared the regulation “On electronic payments” where were specified the required criteria that must be met, so that the new electronic instruments conduct certainty and efficiency to use for customers, higher productivity and security for their issuers;

- \* It was revised the regulation "On managing reserve accounts of second-tier banks". This Regulation provides a new facility to second tier banks with respect of managing their liquidity availing them up to 5 per cent usage of required reserve held with the Bank of Albania.

In 2000, it was realised the study on automation of clearing as core element of payment system, directly related to the bank's customers, individuals and Albanian businesses. Its organising in Tirana was considered as most appropriate for the current operating conditions of banking system and the concentration of business companies. Concentrated clearing is a continuity of the current clearing which also bears even the following advantages, it:

- \* Enables the enhancement of automation by minimum expenses and raises the security of enhancement clearing operations, without bringing big changes in the current practice used by participating banks on this end.
- \* Does not conduct changes in organising courier services, which will be functioning for the collection and transport of paper instruments;
- \* Affects the velocity of performing payments and payment orders, although it does not convey any positive effect in the velocity of processing checks.
- \* The electronic transmission of clearing results would help automated banks to reconcile easily their internal accounting system.

### 5.1.2. PAYMENT INSTRUMENTS

In 2000, the most frequently used instruments by bank customers were payment orders and checks, by 7 per cent increase compared to the previous year. Thus, the value of transactions cleared through clearing sessions during 2000 was Lek 54.4 billion (about US\$ 381 million<sup>30</sup>), representing 5.9 per cent of the total value circulated in bank accounts. Interbank transactions carried with second-tier banks also occupy the same weight and value. All banks circulated value for 2000 is Lek 913 or US\$ 6.4 billion. The volume of clearing transactions for year 2000 was 8.7 per cent higher compared to 1999. The largest growth was by payments performed through payment-orders, reaching the value of Lek 28.04 billion (\$196 million) or representing 9.3 per cent higher compared to 1999.

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<sup>30</sup> Lek exchange rate to USD is that of 2000-end, 1 USD = 142,64 Lek.



**Table 48. The volume of transactions cleared in clearing sessions during 2000.**

<b>Instrument</b>	<b>Number (in physical units)</b>		<b>Value (in billion Lek)</b>	
<b>Year</b>	<b>1999</b>	<b>2000</b>	<b>1999</b>	<b>2000</b>
Pay orders	53 357	57 500	25.6	28.0
Cheques <sup>31</sup>	6 000	6 500	24.4	26.3
Total	59 357	64 000	50.0	54.4

**Table 49. The average value of payment instruments (in million Lek)**

<b>Instrument</b>	<b>Average value per instrument</b>		<b>Average monthly value</b>	
<b>Year</b>	<b>1999</b>	<b>2000</b>	<b>1999</b>	<b>2000</b>
Pay orders	0.5	0.5	2 136.8	2 336.7
Cheques	4.1	4.1	2 031.0	2 195.3
Total			4 167.9	4 531.9

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<sup>31</sup> Banking checks and personal checks are included in "Checks" group.

## 5.2. CURRENCY ISSUE

On 1 September 2000, it was launched in circulation the biggest coin denomination, that of 100 Lek. This coin denomination issued for the first time is duplicated in type (coin and banknote). Its issuing in circulation was motivated by economic indicators and shall continue to be duplicated denomination until 2004.

On 31 December 2000, there were retracted from circulation banknote denominations of Lek 10, 5,3 and 1, all 1964 and 1976 issues, and coin denominations of Lek 2, 1; Qindarka, 20, 10, 5, 50 (Qindarka = hundredth part of one lek), all 1964, 1969, 1988 and 1989 issues.

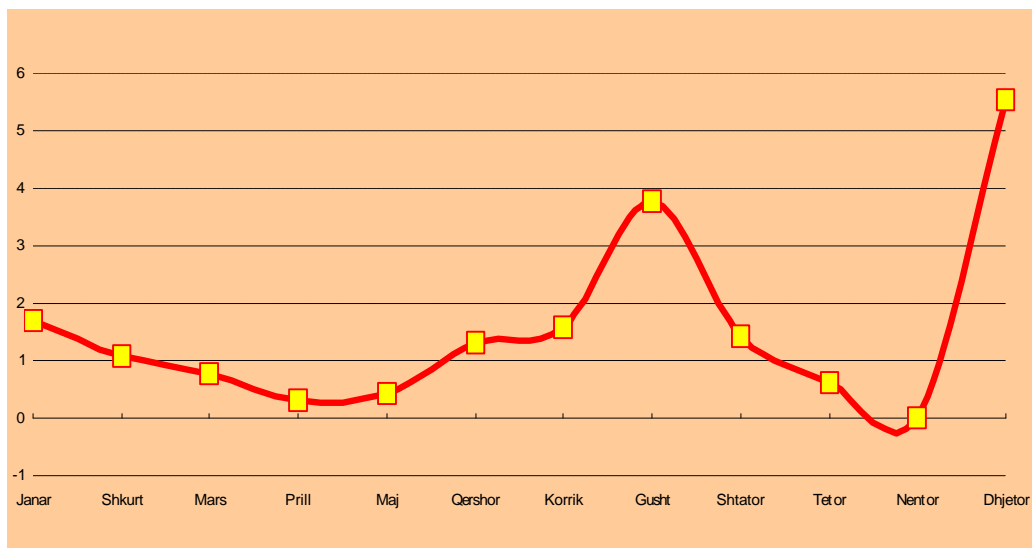
The statement of currency indicators on 31/12/2000 is as below:

* Currency Issues	106.000.000.000,00 Lek
* Currency in circulation	101.408.538.645,55 Lek.

**Currency issues** were added by Lek 21 billion for 2000, considering meeting domestic needs of economy currency and an optimal structure.

**Currency in circulation** resulted at the amount of Lek 101.408.538.645,55. Compared to 1999-end, it improved by Lek 18,5 billion or 22,3 per cent. It indicates its largest growth in December, by Lek 5,53 billion or 29.9 per cent of the whole annual expansion (see graph 24).

The addition of currency in circulation		
Months	Monthly	Progressive
January	+ 1,68	+ 1,68
February	+ 1,08	+ 2,76
March	+ 0,78	+ 3,54
April	+ 0,32	+ 3,86
May	+ 0,41	+ 4,27
June	+ 1,30	+ 5,50
July	+ 1,59	+ 7,16
August	+ 3,77	+10,93
September	+ 1,42	+ 12,35
October	+ 0,60	+12,95
November	- 0,02	+12,97
December	+ 5,53	+18,50



**Chart 25.** The changing statement of currency in circulation.

(monthly change in percentage).

Some of the factors assessed to have affected the addition of the currency in circulation are the following:

- \* The total customer deposits in domestic and foreign currency as of December 2000 were added by 9.6 per cent compared to 1999 from 22.3 per cent increment of circulating currency;
- \* The decrease of time deposit rates;
- \* The stabilisation of exchange rate and the low inflation rate have generally added the public confidence by the domestic currency;
- \* Notwithstanding the recent development so far, covering customer needs for payment and trading purposes, mainly those within the country, still continue to be largely performed in cash.

**Table 51. The structure of currency in circulation (in %).**

Denominations	Year 1999	Year 2000
5000	0.25	0.98
1000	21.00	23.30
500	33.37	33.23
200	14.44	13.02
100	9.29	9.43
10	4.00	3.68
5	3.32	3.06
3	3.38	3.13
1	10.95	10.16
<b>Tot K/m</b>	<b>100.00</b>	<b>100.00</b>
100	0.00	1.98
50	7.23	4.04
20	10.11	5.92
10	10.82	6.57
5	7.68	4.51
2	0.26	0.12
1	10.27	5.00
0.5	8.71	4.21
0.2	18.84	9.11
0.1	22.01	10.65
0.05	4.08	1.97
<b>Tot M/m</b>	<b>100.00</b>	<b>100.00</b>

Attached to the counterfeiting of the currency, it was also attendant even in 2000. Compared to 1999, the total counterfeiting (and for each denomination) increased by 2.2 times.

**Table 52. Counterfeiting resulted in a number of transactions.**

No.	Denominations	Year 2000	Progressive (from the year 1992)
1.	Lek 1000	747	10796
2.	Lek 500	1487	4750
3.	Lek 200	834	944
4.	Lek 100	6	6

More "exposed" to counterfeiting have been the Lek 1000 denominations, especially those of 1992 and 1994 issuing and Lek 500 denomination, of 1996 issuing, a production of Bank of Albania Printing House and a 1994 issuing.

During 2000, there is an obvious growth in counterfeiting Lek 1000 denomination of 1996 issuing, and Lek 200 denomination of 1994 issuing. Only to the latter, from 944 pieces counterfeited altogether, 834 pieces correspond to the year 2000. Counterfeiting is mainly realised through photocopying and offset printing. As concerns, counterfeiting in foreign currency, their amount is inconsiderable.

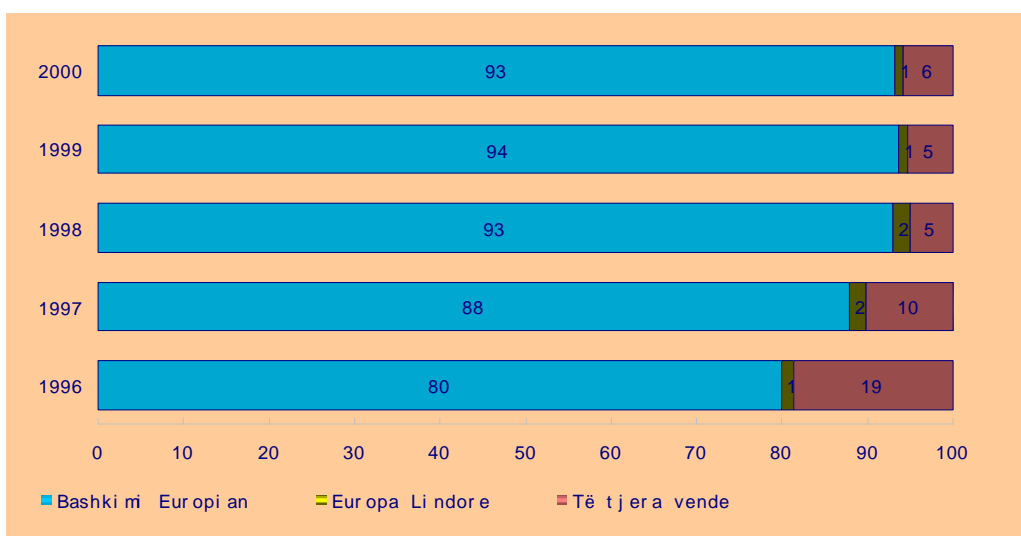
## 5.3. INTERNATIONAL COOPERATION AND INTEGRATION

### 5.3.1. INTEGRATION PROCESSES

The first decade of Albanian transition was that of an important economic and institutional reorientation towards European Union. It is expected that the second decade mark significant developments towards the process of more formal membership in the structures of European Economic and Monetary Union. The target for membership in EU has been the driving force of economic and institutional reforms that are performed and that are under process. In this sense, the economic and monetary policies of EU are gradually becoming an anchor even for the economic and monetary policies of our country.

For the first time in December 1992, Albania signed the Trade and Co-operation agreement with EU, which provided an incentive to the reorientation of economic and trading activity of our country. Since the transition start, the EU has become the most important economic and trading partner of our country. Albania undertakes more than 80 per cent of trading and investment activity with this group. European Union is also the main donator and supporter of economic reforms undertaken. The aid granted by the European Union from 1991 to 2000 is calculated to about EURO<sup>32</sup> 633.4 million.

Albanian exports towards EU, during the period of 1996-2000, were increased by 22.6 per cent by comprising on average, 90 per cent of the overall volume (see graph 25).



**Chart 26.** Geographical distribution of exports.

<sup>32</sup> (MBET) material on the preparation of the Second Table of the Work for the Stability Pact, 2001.

In May 1999, the European Commission approved the document termed "Association and Stability Process for South-eastern Europe" a document that establishes integration basis even of our country to EU.

The Association and Stabilisation Agreement includes elements such as:

- \* Institutionalisation of political dialogue between Albania and Association Council and European Parliament;
- \* Regional co-operation strengthening, including the perspectives of establishing free trade areas with countries of the region;
- \* Perspectives of establishing a free trade area with EU after signing the contract;
- \* Measures towards free movement of people, services and capital;
- \* Commitment in resemblance of legislation and institutions etc.

The CARDS program (Community Assistance for Reconstruction, Democratisation and Stabilisation) was initiated in Zagreb summit (in November 2000) between European Union<sup>1</sup> and countries of South-eastern Europe, which includes a financing of Euro 4.6 billion for the year 2000-2006 for all the countries of the region. This assistance will aim at supporting the democratic, economic and institutional reforms of respective countries.

The Bank of Albania has been part of this process by participating actively in the discussions held at the economic tables in the framework of Stability Pact and Investment Compact, as its composing element, as well as in discussions held for starting the procedures for membership in EU. Besides the support that the Bank of Albania has offered through pursuing the appropriate monetary policies, it has also taken concrete responsibilities, which are being developed, according to the matrices of commitments taken by the country's authorities.

Among the responsibilities that the BoA has in this process, it is worth mentioning:

- \* the necessary legal perfection either for the Savings and Credit Associations or for the new legislation on deposit insurance;
- \* other important initiatives in financial trade development field such as the extension of individual's participation in T-bill market, the further strengthening and development of banking supervision standards aiming at maintaining and developing a sound banking system, etc;
- \* important projects such as the establishment of Information Office on Credit and the development of real time gross payment system (RTGS).

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<sup>33</sup> The program is approved with the Decision of the Council (EC) No. 2666/2000, on 5 December 2000 "On the assistance for Albania, Bosnia-Herzegovina, Federal Republic of Yugoslavia and ex-Yugoslav Republic of Macedonia".

### **5.3.2. INTERNATIONAL COOPERATION.**

The Bank of Albania has had a level of relations that may be considered as satisfactory with international financial institutions and other central banks.

Re-enlivening of relationships remained to a certain degree without new developments due to Kosova crisis, is also worth mentioning. The general normalisation of country's economy and finances was reflected even in the BoA's relationships with its region's homologues and especially with the neighbour countries.

The exchanging of experience in the field of monetary operations, payment system, information technology, etc with international financial institutions such as IMF and World Bank has continued to be at the attention of the BoA.

The relationships initiated some years ago with the Federal Reserve of New York, Bis Basel, Austria Central Bank, Central Bank of England, etc., may be considered as very appropriate and valid concerning technical assistance.

A concrete example of the successful co-operation of the BoA with international financial institutions is the Conference "On Statistical Information in Albania". Representatives of these institutions who were invited in the Conference showed their appreciation for the organisers of this conference, its co-reporters and other persons invited in it by means of their participation and presentations.

## **5.4. LEGAL INITIATIVES**

During the year 2000, the Bank of Albania has made efforts to enhance the quality of its contribution into legal and regulatory field.

The Bank of Albania has intended to consolidate the effective legislation in preparing the laws and by-laws at its own incentive or in co-operation with third parties' lawmaking initiatives in economic and financial field.

The active participation of the Bank of Albania in the lawmaking process is based on the law No. 8417, dated 21.10.98 "On the Constitution of the Republic of Albania", Articles 81-85, on the Law No. 8269, dated 23.12.1997 "On the Bank of Albania" Articles 3,24 and on the Law No. 8365, dated 2.7.98 "On the Banking System in the Republic of Albania" Article 6.

The Bank of Albania, in accordance with its primary objective, supports the economic stability and development of the country. To this end, the Bank of Albania co-operates with legislative and executive bodies of the Republic of Albania. Also, the Bank of Albania, if necessary, undertakes operations for encouraging this co-operation in carrying out its functions especially if the legislation in force is not sufficient for avoiding the financial system threatening as well as for preventing the extraordinary financial circumstances. Every legal act, having economic character and consequences in the field of financial and monetary policy, credit, and foreign exchange, which is sent to the Parliament and the Council of Ministers, is given to the Bank of Albania for opinion.

During the year 2000, the Bank of Albania, at its own incentive, or with the assistance of third parties, has rendered its contribution as follows:

1. Through the approval of the Law "On preventing money laundering" the Bank of Albania, co-operating with IMF and other qualified international institutions, completed successfully its some-year initiative for preventing one of the most modern forms of criminal activity. The Bank of Albania, use its professional sources and institutional flexibility for responding to the world-wide developments in this sensitive field, managed to impose its own initiative to the executive and lawmaking bodies, though it is not the institution that generally treats directly the issues of financial crime and especially the money laundering penal offence.
2. The draft-law "On the insurance of deposits" is included in the structural policies of the year 2001 as a result of the recent developments taking place to Albanian banking system. The draft-law is an important part of structural policies of the banking system because it regulates certain relationships among depositors, second tier banks and lawmaking and executive state bodies. These relationships play a very important role in the framework of finalising the process of state-owned banks' privatisation, in enhancing the competitiveness of banking products market, as well as in softening the consequences of expected financial crises.



3. The Bank of Albania was committed to revising the Law "On Savings and Credit Association". Pursuant to Law, the Bank of Albania re-assessed its position concerning the savings and credit associations whether they should be excluded or included as entities in the provisions of the Law No. 8365, dated 02.07.98 "On the Banking System in the Republic of Albania", totally or partially, because of the nature, volume of activity and origin of their financial assets. Also, the revising of the Law treated even aspects of the purpose of establishing the savings and credit associations. The purposes of revising the law have to do with:

- The defining of savings and credit associations and their unions, which are created from their uniting, as entities of the provisions of the Law "On the Banking System in the Republic of Albania" and
- The revising of the process and manner of granting the licensing and performing the supervision and regulation of their activity.

4. During the year 2000, the process of ownership conveyance of the shares of National Commercial Bank capital was finalised to entities: Kent Bank, International Financial Corporation, and European Bank for Reconstruction and Development. The Bank of Albania contributed to the revising and precision of the legal framework "On determining the form and structure of National Commercial Bank's privatisation formulae". Also, the Bank of Albania, pursuant to Law N0.8365, dated 02.07.98 "On Banking System in the Republic of Albania" approves in advance: (a) every shareholder that is proposed to own an influential share (participation) in more than 10 per cent of share capital of the association; (b) managers of the association proposed by the customers; (c) reduction of share capital of the association; (d) transferring, to a considerable degree, of the bank's shares, etc.

The co-operation in preparing the amendments of the law of securities, the law on investment funds, the draft-law on bankruptcy, the law of the agency treating bad loans, is also worth mentioning etc.



**View from the main hall of the Bank of Albania.**

## **Chapter 6.**

### **Bank of Albania Institutional Development**

The strategy for institutional development of the Bank of Albania<sup>34</sup> determined a set of objectives necessary to be fulfilled within the short-term and mid-term period in order to encourage the central bank's development. In this framework, during the year 2000, special attention was paid to the objectives that had priority, where we can mention the increase of transparency, adjustment of the bank's organisational structure with new tasks to be performed or the development of information technology and the statistical improvement.

#### **6.1. BANK OF ALBANIA'S ORGANIZING STRUCTURE**

In October 2000, the Supervisory Council approved the change of the Bank of Albania organisational structure. This change<sup>35</sup> performed within the time framework of two years and a half, was deemed as necessary so that the structure of the bank be better adjusted to the strategic targets as well as for ensuring a more effective functional relationship between departments and their divisions.

In the reorganised structure, there were reduced or absorbed some of the units which did not justify the independence or created duplication of the activity.

The changes have to do with:

##### **1. Uniting divisions**

- \* In the function of supporting the strategy for perfecting the payment and accounting system, the new structure determined the uniting of Accounting Department with Payment Department as well. This organisation is expected to affect the development, conception and establishment of a payment system of RTGS type, but even the accuracy of accounting system, as a means of serving the administration and internal management needs. Also, the transferring of Finance Sector from Administration Department to Accounting and Payment Department ensured the gathering of the units having similar functions into a single department. It also ensured the task division between the "recorder" of expenses and their "executor" by ensuring the control increase over the expenditures performed by the central bank.

<sup>34</sup> The Bank of Albania Supervisory Council approved the strategy with decision no. 111, dated 17.11.1999.

<sup>35</sup> Recent changes in the organizational structure of the Bank of Albania belong to March 1998.

- \* The uniting of Technology and Information Department with the Information Centre was laid down by the need to inform on and centralise the process of collecting, processing and distributing the Bank of Albania statistical information. Establishing the division of statistical observations in this department is thought to serve the process of improving the statistical information, which will ensure the conducting of more professional observations by the Bank of Albania.
- \* Given the priorities of managing and qualifying human capital, the legal law and by-law improvements in the Bank of Albania, as well as the relations between the Bank of Albania employers and employees, the uniting of Human Resources Department and Juridical Department to one single department was considered as necessary. It is aimed through this operation to support and perfect a more qualified juridical and human resource service, a service that will reflect its impact on other departments and divisions of the institution.

## **2. New divisions**

- \* New divisions, which shall perform new functions, were created within the existing departments. The most important one is the establishment within the Monetary Operations Department of a respective structure, which shall handle the measurement of the risk of the Bank of Albania investments, the investment estimation and the real control of implementing the foreign currency reserve management. These are functions that fulfil better the activity framework of this department.
- \* The intention of the Bank of Albania to be more open and to further develop relations with the public, should be supported by a good-organised department, that of the Public Relations.

According to the reorganised structure :

- The total number of employees is added from 314 to 334. The increase in the number of employees is noticed in the main departments such as: The Department of Technology and Information. In this way, a better ratio is put between the employees that handle the implementation of the central bank functions as compared to the employees that perform supporting activity. At year-end 2000, there were 294 employees working at the Bank of Albania. Thus, the scale of employing staff according to the structure was 88 per cent;
- There is made a division of departments' dependence among the three bank's managers. The Departments that perform the basic functions of the central bank have passed into the dependence of the Governor.

The two deputy governors are also Directors of Departments. This reorganisation aims to increase managers' responsibility, and simultaneously it offers a more effective and functional scheme in sorting out different problems. By means of this division, a larger control is made possible in pursuing and reaching the goals.

- A new position is created in different departments. Besides the director of the department, vice directors are foreseen in the new structure. This was made possible as a consequence of uniting different divisions for their better management. At the same time, the presence of vice-directors shall eliminate one of the deficiencies in organising the work of the Bank of Albania, that is, the concentration of the problems in few hands. Also, the vice-directors should be informed on department's problems. This ensures a normal sequence of the work in any situation;
- The nomination of chief-specialists is also foreseen. The chief specialist does not represent a promotion in the Bank's hierarchy, but an appreciation for a good job of its specialists, by serving even as a pupil at work.<sup>36</sup>

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<sup>36</sup> See the attached organizational chart for any details.



## 6.2. BANK OF ALBANIA - A MORE TRANSPARENT BANK

The Bank of Albania operates in accordance with its legal duties and is responsible to the public for implementing monetary policy, banking supervision management, as well as for carrying out other legal duties. It is the duty of the Bank of Albania to disclose its activity to the public. Therefore, the increase of transparency became a priority to the Bank of Albania during the year 2000. The operations undertaken in 1999 and with more intensity in 2000 served as measures used for establishing transparency foundations so as to adopt the philosophy of being an open institution. This could not be easily realised to an institution that had been relatively unknown and hidden to the public eyes and to an environment lacking well-disposed traditions towards transparency.

### 6.2.1. COMPARABILITY TO INTERNATIONAL STANDARDS.

The Bank of Albania determined firmly its target to observe international standards processed in transparency field such as the code of best practices for transparency into monetary and financial policies (Code) and the general data dissemination standards (GDDS). The Bank of Albania requested from IMF to assess the scale of meeting the requirements of the Code and to participate in GDDS.

The success to the observance of these two standards is different. Albania was decided to be the pilot country in implementing GDDS and managed to successfully finalise its first phase, that is, the publication of metadata in April 2000. Concerning the Code observance, the IMF assessment was disappointing: "The implementation scale of the desirable practices set in the Code, by the Bank of Albania, is mixed. On the one hand, the Bank of Albania has achieved a huge **implementation** of desirable practices regarding the **roles' clarification, responsibilities and targets**, for all practical purposes... On the other hand, the Bank of Albania implements **only partially**, or **even not at all**, the good practices of the Code concerning **the open process for formulating and reporting the monetary policy**."

... The implementation of desirable practices of the Code in this area, when it takes place, is often in relation to the Code **text** and not to its context (spirit). This situation effects concern because it affects significantly the transparency and the responsibility at long last. Besides this, it damages the efficiency of the monetary policy transmission mechanism by making it more difficult to the markets to form expectations effectively. The obvious deficiencies in this field should be treated as a priority issue".

### 6.2.2. REGULATION "ON THE BANK OF ALBANIA TRANSPARENCY AND CONFIDENTIALITY"

The Regulation "On Transparency and Confidentiality" was approved in June 2000 in order to ensure standards' observance and maximum commitment of the Bank of Albania managers and employees for enhancing the institution's transparency.



The Regulation's primary goal is **“the transparency enhancement of the Bank of Albania activity as well as the Bank of Albania non-public information management”**.

The adoption of the Regulation was aimed at realising a change of the Bank's philosophy: from a confidential institution to an institution open to the public. The implementation of the requirements of this regulation aimed at:

- Adopting a more transparent activity within the Bank of Albania;
- Informing the central state bodies, judicial authorities and the public on economic issues.

In this way, the process of enhancing the transparency is thought to help increase the credibility, responsibility and independence of the Bank of Albania. On the other hand, this will ensure public education with economic problems, by orientating economic players and by contributing to the efficiency increase of the transmission mechanism of the Bank of Albania decisions on economy. Time obligations set for realising a number of steps that will lead to transparency enhancement are the most important elements of the Regulation.

### **6.2.3. CONFERENCES AND PUBLICATIONS.**

The transparency enhancement is thought to achieve through increasing press releases, appearing to the People's Assembly, organising seminars and holding discussions or conferences.

In 2000, the Governor of the Bank of Albania was presented three times to Parliamentary Commission of Economy, Finances and Budget; twice to press releases; to the Economics Faculty and Magistracy Higher School for holding lectures on the central bank's independence and on inflation; once to the discussion meeting held on the functioning of Tirana Stock-exchange.

In 2000, the Bank of Albania organised the national conference for the first time on “Statistical Information in Albania” in Co-operation with the Institute of Statistics. The purpose of organising the conference was to attract the attention for the low development level of statistics in Albania and for the low attention showed to this problem. On the other hand, the organisers intended to convey the idea of profitability of having good statistics to the highest authorities of the country and to the business environment. Through this conference, it was aimed to educate the public on the importance the statistics have for the decision-taking process.

On the other hand, the increased number of the titles of publications and their subscribers would help the increase of the recognition size of the Bank of Albania activity.



Currently, the publications comprise the most important tool with which the Bank of Albania discloses its activity to the public. The Bank of Albania publications now comprises a diversity of titles. They are periodically offered to the public, or, in any case, there are also special publications.

The year 1998 marked an important development towards the increased number of published titles. The year 2000 marked an important development concerning the publications' quality, by offering sufficient material that treats issues of a number of economy sectors, aspects of financial, banking, monetary and foreign exchange policies, written not only in technical language (terms), but also in a simpler version.

The increased number of publications, having explanatory character and simple language, has been an important development during the year 2000. These are publications realised in the form of a leaflet, which undertake to transmit to the public the knowledge on different economic issues. For the first time, such a leaflet was published in July 1999 and it explained the central bank. During the year 2000, it was passed into monthly leaflet publication.

Non-periodic publications were also increased especially in the title of discussion materials. For the first time, the Bank of Albania has published surveys by reflecting a new activity that it started to improve the information scale. Surveys contain analyses, conclusions and recommendations reached after conducting surveys on different aspects.

The number of pages published is increased from 90 it was in 1998 to 200 in 1999 and 2000 respectively. During the year 2000, the number of pages published as research materials and promotional materials is increased precisely 70 per cent and six times as compared to 1999. However, these publications still occupy a small weight in the total number of publications, respectively 9.8 and 5 per cent. In this way, the Bank of Albania has identified the increase of promotional materials and discussion materials as its target for the year 2001.

In order to be closer to the public, the Bank of Albania published its Internet page in 2000, which contains sufficient and detailed information. This year, for the first time, it discloses preliminarily the issues to be discussed by the Supervisory Council and immediately after its meetings, it discloses and explains the decisions taken. Month by month the number of messages received by persons interested in its web site is getting increased. In 2000 the number of informing replies by the Bank of Albania is made double (about 250 per month).

The Bank of Albania is guided by the principle of offering a considerable financial support for the process of enhancing the transparency:

- The publications of the Bank of Albania may be requested by anyone and they are offered free of charge. Concretely, the Bank of Albania subscribers' list is on average three times higher in 2000 against 1998, while the list of subscribers for promotional leaflets is 5 times higher in 2000 against 1999.<sup>37</sup> The expenditures performed for publications of 1999 are three times higher than the ones of 1998. In 2000 they were 3 and 18 times higher than 1999 and 1998 respectively;
- It organises seminars, discussion meetings and conferences for which a fund of Lek 3.1 million is expended;
- It has conducted statistical surveys, as part of improving the statistics and transparency, for which Lek 460 thousand are expended.

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<sup>37</sup> The comparisons are made respectively with the years 1998 and 1999 as they represent the period when publications are prepared for the first time.

### **6.3. DEVELOPMENTS IN INFORMATION TECHNOLOGY**

Information Technology Development is more than indispensability. It constitutes a priority of institution's development. Taking into consideration the current scale of implementing the information systems, current tendencies and inclinations, and everyday needs, the Bank of Albania thinks that the implementation on a large scale of these systems will help to increase the efficiency and its general institutional development.

In this view, during 2000, the Bank of Albania reorganised the responsible units for implementing information systems, aiming at supporting the projects with structures and specialists, and the communication quality between other units of the Bank of Albania and that of Information Technology. On the other hand, it has focused its attention on accomplishing two primary and very important projects: implementation of accounting system within the central bank and an RTGS.

#### **6.3.1. ORGANIZATIONAL DEVELOPMENTS.**

Organisational changes conducted in 2000, as well as the re-division of units' tasks and functions and those of each individual within Information Technology Unit are thought to be supporting factors in:

1) Successfully accomplishing the projects currently undertaken, 2) increasing the supporting degree that Information Technology provides to other units of the Bank of Albania, 3) ensuring continuity of fulfilling the objectives in the future, 4) providing close training of the staff and their appropriate positioning.

In no case can it be thought that the developments within the department are sufficient for the accomplishment of its duties. In order to reach the targets in the field of information technology, other units of the Bank of Albania, which get the benefit of using these systems, should contribute as well.

Assessing the co-operation within the institution as of great importance, during the year 2000, good work has been done concerning real inclusion of other Bank of Albania units either in compiling the strategy of information technology or in accomplishing the projects of this area. More concretely, good work has been done for setting up a Committee of Information Technology Strategy Development. Its primary task is to determine a development strategy in line with the institution development.

#### **6.3.2. MAIN PROJECTS IN THE FIELD OF INFORMATION TECHNOLOGY.**

*Projects on Implementing Accounting System and an RTGS to the Central Bank*

The Bank of Albania has its primary short-term target to establish a payment system in high value (an RTGS system) as well as an accounting system and management of foreign currency reserve and its financial activity.

In order to realise these two projects, following a number of IMF recommendations, as well as the technical assistance of foreign experts in these fields, the Bank of Albania has prepared a detailed document on “business requirements” for both information systems. The above documents have received the relevant approval by IMF and later on they have been subject to further technical –financial assistance for improvement by World Bank.

The system of payments in high value (RTGS) will consist in:

1. Adjusting in real time between the participants of this system through their bank accounts;
2. Offering instruments and means for enhancing management efficiency of participants' liquidity;
3. Improving tools in administration and monetary policy supervision;
4. Implementing a high degree of accountability, safety and integration, able to cope with the increasing needs of Albanian economy;
5. Developing the communicating infrastructure of Albanian banking system;
6. Realising supporting infrastructure for further advancements in this field.

This project's implementation is required to be conducted in accordance with the best international practices and should be based on the following principles:

1. Flexibility and modularity, for making possible the following development and maximum integrity with other sub-systems;
2. High degree of security and integrity;
3. High consistency and accountability;
4. Complete tracing on all transactions and their consequence.

The application of these business requirements is performed also by co-operating with and involving banks, which shall participate and profit from its services.

The implementation of accounting system, foreign reserve management and other financial functions of the BoA consist in:

1. Automation of the process;
2. Implementation of international accounting standards pursuing the best international practices in compiling the accounting policies and procedures for central banks;
3. Improvement and development of tools and procedures for foreign reserve management and market interventions;
4. Constant and real time relationship with the Bank of Albania branches in the districts;
5. Establishment of an automatic inter-page with an RTGS system;
6. Accounting information quality and availability enhancement.

Given the importance of the two above projects and its impact not only on the bank's activity, but also on the entire banking system and on overall Albanian economy, their implementation shall be carried out with the financial –technical assistance of the World Bank. The funding of the projects takes part in the new project of "Technical assistance on financial sector institutional building" approved in June 2000.

During the year 2000, the further steps to be followed towards finalising the projects were also set forth. In order to realise a better asset management as well as considering the scale of systems' dependence, their implementation is thought as separate, where the priority will be shown to the accounting one.

### **IDCN system**

During the year 2000, good work is also done for realising inter-bank communication network. The purpose of this project is to realise system communication based on "Internet technology". Banks and other participants of the system will be able to exchange information rapidly and safely with the Bank of Albania and among them, through this standard communication tool which is based on a high security level.

The realisation will be modular and will initially offer the on-line and real-time communication service, publication possibility by the participants, their quotations for different financial instruments, the sending of the requests for participation to Repo auctions –reverse Repo organised by the Bank of Albania, etc. Application in a modular form and with maximum independence between the services would make possible the further extension of this system's services. Particularly, it is thought that a new electronic system of the banks' reporting to the Bank of Albania be realised in a second phase.

The establishment of the link of the first customers to the system is considered to start in the first half of 2001 and the link of all participants is thought to finalise in the following quarter.