

CHAPTER I. INTERNATIONAL ENVIRONMENT

I.1 WORLD ECONOMY

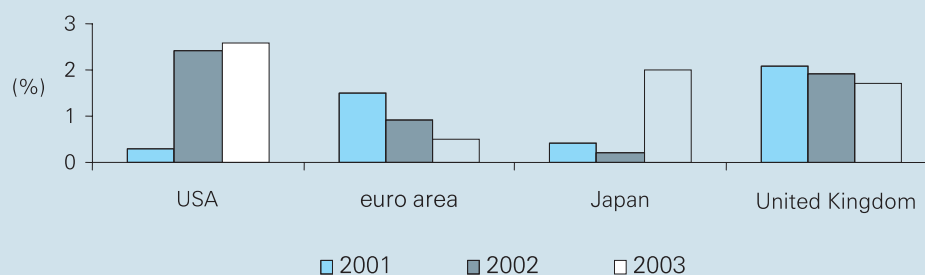
In 2003 world economy experienced a moderate growth. The increased uncertainty following Iraq war, negative effect of artificial increase of equity prices in the United States and the effect of SARS epidemic in countries of East Asia led to a weakening of international trade and production during April – June. Meanwhile, since the third quarter of the year, the economy started showing signs of improvement, especially in countries such as the United States, Japan and some countries of Asia.

Large economies have implemented easing macroeconomic policies in 2003, reflecting low inflationary pressures. Led by ECB and FOMC, monetary authorities of leading economies in the world have continued to lower key interest rates. At the same time, these economies have followed an expansionary fiscal policy, especially in the United States. European economies were not left behind as traces of fiscal expansion were reflected in breaching the criterion of Maastricht Treaty which limits budget deficit to 3 per cent of GDP.

Yet, it seems that stimulating macroeconomic policies have been more efficient in the United States and Great Britain.

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Chart I.1 Economic growth of leading countries



Source: IMF, World Economic Outlook, September 2003.

Table I.1 Inflation (12-month change in percent) and unemployment rate (percent of labor force) in the euro area and the United States

	CPI*		Unemployment	
	euro area	USA	euro area	USA
2000	2.1	3.4	8.5	4.0
2001	2.3	2.8	8.0	4.8
2002	2.3	1.6	8.4	5.8
2003-1 st Q	2.3	2.9	8.7	5.8
2003-2 nd Q	1.9	2.1	8.8	6.1
2003-3 rd Q	2.0	2.2	8.8	6.1
2003-4 th Q	2.0	1.9	8.8	5.9

Source: ECB statistics (January 2004.)

* euro area measured by Harmonized Consumer Price Index (HICPI).

Excess liquidity in financial markets, easing monetary policies and expectations that interest rates would remain low for a period longer than it was thought of in the beginning, led to the decline of interest rates of financial instruments of long maturity. In June these rates reached the lowest point in the last forty years. The following months marked a slight increase of financial instruments rates, which was more evident in the United States. This move followed the positive signals underlining the improvements of economic environment and low inflationary pressures. However, they were considered still low as a result of large demand for long term maturity American bonds from the Asian countries.

In exchange markets, the US currency has continued to depreciate against euro and other currencies of industrialized countries. Relatively lower interest rates, rising concerns about the current account deficit and the increasing fear of terrorist attacks in the United States are believed to have contributed to US dollar depreciation.

I.1.1 EUROPEAN ECONOMY.

During 2003 the economy in the euro area countries developed at a slower pace than expectations. The Gross Domestic Product in the second quarter recorded its lowest growth rate, consequent on the low demand for consumption and private investments in tangible assets, as well as increase of imports by higher rates than extra-euro area exports. Improvements in the global economic environment during the third quarter have ameliorated the performance of European exports. This fact is believed to have been a decisive factor in the GDP growth of euro area countries, especially in that of Germany and France.

Despite the positive signs showed in the euro area during the second half of the year, business and consumer confidence remained low, unemployment rate stood at a high 9 per cent until December, and the industrial production growth rate was not stable. Furthermore, consumer price index has recorded a relatively low and stable increasing rate for the euro area over the whole year. Inflation rate reached 2 per cent at the end of the year, being driven mainly from the price of energy and raw food. Low domestic demand and euro appreciation against American dollar have been the key factors influencing the sluggish development of the euro area during 2003.

I.1.2 AMERICAN ECONOMY

Economic activity of the United States expanded during 2003. The adjusting macroeconomic policies and continuous productivity growth have served to sustain domestic demand. GDP rate increased rapidly from one quarter to the other. Private consumption expenditures, government expenditures and fixed investments have been the main contributors to GDP.

The beginning of 2003 marked the culmination of Iraq war. Consequently, forecasts for the first quarter were conditioned by the uncertainties following conflicts in Iraq. The rise of oil price and the worsening of budget deficit due to increasing defense expenditures led to economic decline in general. Consumer confidence index was shaken, adding to business reluctance to invest in projects and hire new employees.

The fast termination of military interventions in Iraq played a decisive role in the American economy, which reacted immediately to the event. GDP grew by 4.3 per cent in the last quarter compared to the corresponding period of the last year. Meanwhile, inflation rate

kept dropping from 3 per cent in the first quarter to 1.9 per cent in December. Unemployment rate declined gradually to 5.9 per cent compared to its 6.1 per cent high in mid year. US dollar depreciation was in line with the aims of American policy-makers, although the trade deficit indicator showed slight improvements.

I.1.3 EXCHANGE RATES

International foreign exchange markets were characterized by a continued appreciation of euro against US dollar. At the beginning of the year, one euro was buying US\$1.0392, while by the end of the year the exchange rate stood at 1.259, a change of 21 per cent. US dollar depreciation during the whole year was conditioned to a certain extent by the Iraq war, as well as by the economic agents and the decision-making of the countries.

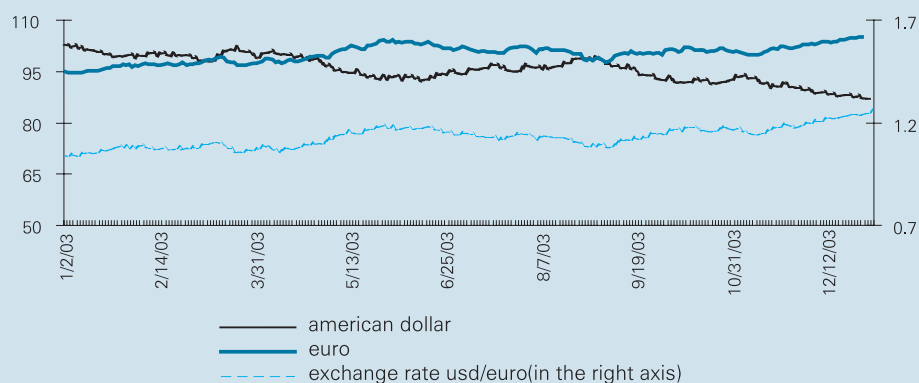
The first quarter of the year was surrounded by geo-political uncertainties associated with Iraq war. Consequently, US dollar fluctuations have been shaped by confusion about the performance of American economy and its indicators threatened by high fiscal deficit, high capital account deficit, low industrial production and weak labor markets. Therefore, the international investors' confidence in US dollar declined, reducing their share of portfolio in this currency and leading the dollar to a further drop.

Yet, the performance of US currency remained the same even during the second part of the year, when the American economy started to show signs of recovery.

Despite economic factors, US dollar drop has found support from the American authorities that have given up expressing themselves in favor of strong dollar policies. A weaker dollar would help to recover exports and correct current account deficit, hence making the revitalization of the American economy more sustainable. Also, the lowering of Fed interest rate and public statements on reviewing Japanese and Chinese monetary and foreign exchange regimes have come to encourage this attitude.

Meanwhile, a strong euro has not aided the economy of the euro area. Euro's strength has often been blamed for the poor performance of the economy. However, euro's nominal appreciation against dollar does not fully reflect the relative competitive edge of the two economies. Compared to selected currency baskets, US dollar nominal effective rate has been depreciated by 15 per cent, while that of euro has been appreciated by 10.76 per cent.

Chart I.2 Movements of nominal effective exchange rate of euro and US dollar and usd/euro spot exchange rate during 2003



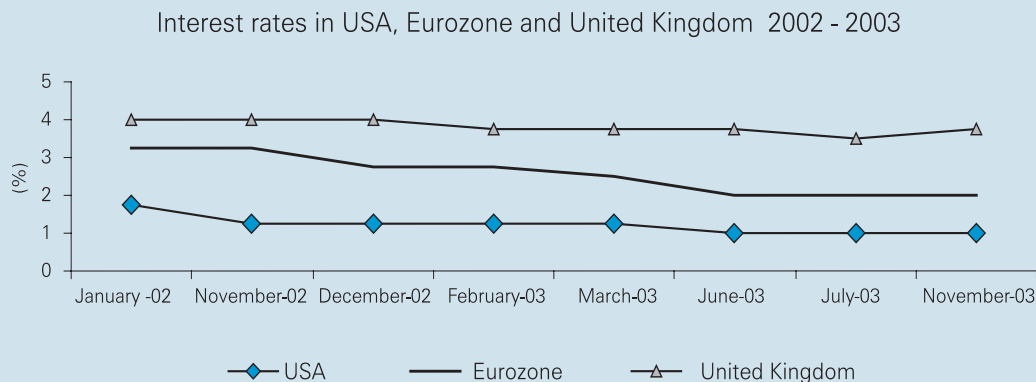
I.1.4 CENTRAL BANKS' INTEREST RATES

Monetary policy of central banks in the most industrialized countries has been characterized by easing trends. Given a low inflation rate and even the existing concerns on possible deflation, an easing monetary policy has aimed at fostering economic growth.

European Central Bank has cut interest rates twice, once in March and the other time in June. These moves sent interest rate from 2.75 per cent to 2.00 per cent. During 2003, the Council of European Central Bank affirmed that decisions on monetary policy would fully uphold the maintenance of price stability over the medium term. Euro's appreciation caused the price of oil to be cheaper, thus lowering inflationary pressures and allowing enough room for ECB to cut interest rates. Although money supply and liquidity stood at high levels during this period, ECB analysts believed that inflationary pressures would not strengthen due to weak economic development and uncertain future.

Fed Open Market Committee reacted using interest rates only after the ECB Council made its second move. The Committee decided to reduce interest rate from 1.25 per cent to 1.00 per cent. The decision was made to support economic growth in view of weak inflationary pressures.

Chart I.3 Monetary policy of leading economies



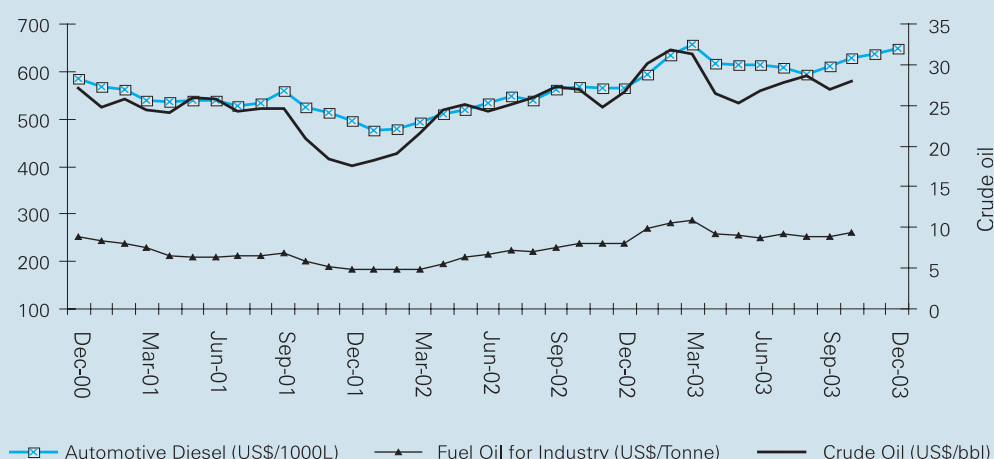
I.1.5 OIL PRICE

Oil prices have fluctuated largely during 2003 mainly because of political events in the world. In the first two weeks of March, the price of a barrel dropped from US\$34 to US\$25. During the fights in Iraq, the supply of oil did not change much as the quota provided by this country was replaced by the supply coming from other OPEC members, mostly from Saudi Arabia.

Other countries like Venezuela and Nigeria have also triggered variations in the price of oil. A two-month strike of the state-owned oil company in Venezuela contributed to shortages of oil output in this country. The situation however improved sooner than it was expected and the number of oil barrels produced per day reached to 3.3 million compared to 3.2 million before the strike. In Nigeria, the oil supply remained unstable due to internal conflicts.

In September OPEC reduced its supply of oil by 900,000 barrels a day. Consequently the price per barrel varied around US\$35, while the target price for OPEC lies from 22 to 28 US dollar per barrel. At present, OPEC (excluding Iraq) supplies 24.5 million barrels of oil daily, contributing to 40 per cent of the overall oil output in the world.

Chart I.4 Oil price during 2003



I.2 ECONOMIES OF THE REGION

In general, economies of the regional countries have marked high growth rates during 2003, combined with low inflation and interest rates. Implementation of reforms has been an additional factor supporting the achievement of optimistic results.

Table 2: Regional Countries Economic Indicators in 2003.

	Real GDP (% change) 1/	Inflation (% change) 1/	Fiscal Balance	Real GDP (% change) 1/	Inflation (% change) 1/
Turkey	5.4	25.4	-8.0	-3.0	10.2
Macedonia	3.0	2.5	-1.5	-8.6	31.6
Serbia & Montenegro	4.0	12.2	-2.5	-10.3	34.7
Croatia	5.0	1.5	-5.0	-17.2	14.1

1/ Consensus Economics; OECD Economic Outlook; Economic Commission for Europe.

2/ Official estimates. European Commission; FMN; UN Economic Commission for Europe; EBRD.

3/ FMN, International Financial Statistics; UN Economic Commission for Europe; Economic Survey of Europe, 2003, No 2.

4/ EBRD Transition Report 2003; Economic Commission for Europe; OECD Economic Outlook .

TURKEY

In 2003 Turkish economy grew by 5.4 per cent. Industrial production increased by 12.6 per cent compared to the previous year. The rate of capital mobilization increased to 80.9 in July, the highest since October 2002. Unemployment rate stood at 10.2 per cent, being at almost the same level as a year ago.

The actual rate and expectations for inflation have marked a downward trend following the tight monetary policy implemented by Central Bank of Turkey. Annual inflation rate for 2003 dropped to 25.4 per cent compared to 45 per cent in 2002.

MACEDONIA

In general, positive developments have been noted also in the Former Yugoslavian Republic of Macedonia, although the economic growth rate of 3 per cent was lower than that of a year ago.

Annual inflation change stood at 2.5 per cent while the average inflation rate scored 1.1 per cent. Budget deficit reached to 1.5 per cent of GDP, being at the lowest level over the last three years. Imports have increased at a greater extent than exports and current account deficit was calculated at 1.5 per cent of GDP, being slightly lower than in the previous year.

SERBIA & MONTENEGRO

Political crises in the country have slowed down the institutional reforms related to banking sector and other sectors of economy. Nevertheless, the country's economy grew by 4 per cent in real terms, same as last year growth.

Progress has been made in terms of consolidating fiscal position. Budget deficit accounted for 2.5 per cent of GDP compared to 5.7 per cent in 2002. The greatest challenge seems to be the reduction of unemployment rate, which keeps increasing due to structural reforms in the economy. According to data from Ministry of Labor and Social Affairs, unemployment rate reached to 34.7 per cent.

CROATIA

In 2003 Croatian economy grew slower than it did last year. During the first ten months, industrial production increased by 2.4 per cent compared to 4.6 per cent during the same period of the last year. Real GDP growth still marks a relatively high value, 5.0 per cent.

Annual inflation rate stood at 1.5 per cent, while unemployment rate was 14.1 per cent, dropping by 2 percentage points from the previous year rate.

However, it seems that fiscal consolidation remains one of the major concerns for the country. In 2003 budget deficit rested at a constant level of 5 per cent of GDP.

CHAPTER II. ALBANIAN ECONOMY

The compliance with the main macroeconomic objectives settled by the mid-term poverty reduction and economic growth program enabled the sustenance of the domestic macroeconomic equilibrium during 2003.

The year 2003 left the impression that the Albanian economy experienced a recovered pulse of economic growth. Preliminary economic evaluations revealed a 6 per cent growth of Gross Domestic Product during 2003, compared to 4.7 per cent marked in 2002. The pick up in the economic activity was proved by all sectors of economy, but it was particularly evidenced in the construction, transport and service sector. The economic progress was additionally amplified by the investment growth, which amounted to 22.3 per cent of GDP, reflecting a 0.3 per cent growth compared to 2002. Investments in the private sector, which counted for 75 per cent of total investments, were highly backed up financially by the banking system. The outstanding credit extended during 2003 grew by ALL* 11.9 billions, equivalently to 30.7 per cent.

The labor market activity evidenced a slight upturn, highlighting an increase in the number of employed persons. Nevertheless, the transition phenomena: emigration and informal economy contracted the employment potential as well as shadowed the effect of employment and economic development strategies. The unemployment rate registered in 2003 was 15 per cent, 0.8 per cent lower than in 2002.

The inflation rate remained within the monetary policy objective, marking 3.3 per cent in December 2003, while the consumer price experienced a 2.37 per cent growth on average. The general control of demand pressures through effective monetary and fiscal policies contributed to maintain a low inflation rate throughout the year.

Developments in public finances during 2003 were characterized by a rational distribution of fiscal expenditures. The government demand to raise funds was dispersed more uniformly throughout the year, condensing the concentration of deficit financing at year-end. Moreover, the local elections of October and the irritated political climate during the second half of the year were not accompanied by any expenditure concentration or any other infringement of the fiscal discipline. These specifics, along with the limitation of government domestic borrowing to 2.7 per cent of GDP, enhanced the fiscal policy contribution to macroeconomic stability and particularly to price stability. Nevertheless, the Achilles' heel remained the revenue collection, which reckoned 93 per cent of the forecasted incomes, and especially the capital expenditures which resulted only in 62 per cent of the projected amount.

Year 2003 saw favorable developments in the foreign sector of economy, underscoring the substantial increase in the current incomes and expenditures. The current account deficit was evaluated to count 6.7 per cent of GDP, revealing a decrease of 2 per cent vis-à-vis the deficit in 2002. Yet to be mentioned, the trade deficit keeps increasing in absolute terms. It reflects the augmented domestic consumption, which urges the need to expand the production capacity and competition of the Albanian economy. Nevertheless, the positive developments in the balance of payments brought about a continuous increase of foreign exchange reserves. The level of foreign exchange reserves recorded USD1 billion for the first time in December 2003, ending up to USD 1.026 billion at the end of December 2003.

*ALL: Albanian Lek

Table II.1 Main economic indicators

	1996	1997	1998	1999	2000	2001	2002	2003
Growth of real GDP (%)	9.1	-10.3	12.7	8.9	7.7	6.5	4.7	6.0
GDP(in current prices, millions of ALL)	315,835	333,071	425,356	488,611	551,282	590,237	658,062	744,974
GDP (in current prices, millions of USD)	3022.3	2236.9	2824.4	3548.4	3836.3	4113.7	4695.4	6,027.3
GDP per Capita (USD)	920.6	672.9	842.1	1052.0	1128.0	1332.6	1521.0	1934.9
Number of employees (in thousands)	1116.0	1107.0	1103.0	1081.0	1068.0	1065.0	921.0	928.0
Unemployment rate	12.4	14.9	17.8	18.0	16.9	14.6	15.8	15.0
Inflation rate (v/v)	17.4	42.1	8.7	-1.0	4.2	3.5	2.1	3.3
Budget deficit (free of grants, as % of GDP)	-11.4	-13.2	-11.4	-12.1	-9.2	-8.2	-6.9	-5.6
Public debt (% of GDP)	30.7	36.2	36.2	37.4	42.6	39.5	38.8	38.0
Current account (free of official transfers, as % of GDP)	-3.6	-12.2	-7.1	-7.9	-7.4	-6.2	-9.0	-6.7
Foreign debt (as % of GDP)	29.2	35.6	36.9	32.3	31.8	28.2	24.4	23.3
Foreign exchange rate, ALL/USD	104.5	148.9	150.6	137.7	143.7	143.5	140.1	121.9
Average exchange rate, ALL/USD	-	-	-	146.96	132.58	128.47	132.36	137.51

Source: Institution of Statistic, Ministry of Finance, IMF estimates and Bank of Albania.

II.1 SECTORAL ANALYSIS

A general view on the performance of different sectors of economy clearly highlights the impact of service sector, whose contribution to total domestic production has been growing. Whereas, the agriculture, which historically has been one of the most potential economic sectors was positioned just in the opposite side by revealing a clear downsizing contribution. The main reasons behind this remain the land reform, land division, ownership and demographic movements.

¹ The data on the real growth of GDP for 1996-2000 are taken from the Institution of Statistics. For the rest of the years, the respective data are evaluations of Ministry of Finance, IMF, and Bank of Albania.

² Nominal GDP is adapted by using the average exchange rate. During 2003, USD has been appreciated on average 13 per cent against ALL.

³ The employment data correspond to the nine-month period of 2003.

Table II.2 Domestic Production Decomposed by Economic Sectors

Sectors	2001	2002	2003
Agriculture	26.0	25.4	24.7
Industry	10.8	10.5	10.2
Construction	8.3	8.6	9.1
Services	45.7	45.9	46.1
Transport	9.1	9.6	10.0

Source: Ministry of Finance.

II.1.1 INDUSTRY

The industrial production saw a significant growth during 2003, appending the economic development of the country. The sales of manufactured products amounted to ALL 20.5 billions, divulging an increase of 18 per cent compared to last year. The mining, oil and gas extracting industry, particularly the hydrocarbon and energy sub-sectors experienced a 77.5 per cent growth (respectively 12 and 90 per cent). Metal processing industry, machinery and textile industrial sectors were the only non-performing segments.

Table II.3 Sales Growth of Selected Economic Sectors (%)⁴

Activity	Q1-03/Q1-02	Q2-03/Q2-02	Q3-03/Q3-02	2003/2002
Total industrial change	25.48	15.87	13.84	17.92
Mining and oil industry	54.77	77.04	101.83	77.50
Metal processing industry	20.55	24.50	7.57	16.76
Energy, gas and water industry	28.76	-11.42	14.09	9.94
Construction	2.96	3.89	22.90	10.69
Trade, hotels, restaurants	18.32	17.2	3.7	12.27
Transport and telecommunication	-16.60	5.43	5.25	-1.18
Other services	28.08	-4.13	-8.30	3.90
Total economy sales growth	14.38	12.59	8.40	11.51

Source: Institute of Statistics.

As it has already been mentioned, during 2003, the electrical energy situation of the country was more favorable compared to the previous periods. This can be attributed to better atmospheric conditions, along with a more effective administration of the Albanian Power Corporation. As it is noticed in Table⁵ II.4, the imported energy diminished by 46.5 per cent with respect to the previous year. At the same time, the internal production capacity met 80 per cent of the domestic demand, compared to 57 per cent of the last year. Regrettably, 37 per cent of the total energy production was lost during distribution. Households' energy consumption inflated this year by 9.4 percent, counting for 63.3 per cent of the total energy utilization.

⁴ Table II.3 shows the sales volume change in percentage for the country's economic activity. As such, it may be used as a reference even for the other sectors analyzed below.

⁵ It is difficult to understand the real change of the indicators, since the only available data are in current prices.

Table II.4 Electric Energy Main Indicators (in millions of ALL)

	2002	2003	2003/2002
Total energy sources	5,535,832	6,145,611	11.0%
Production	3,179,488	4,903,668	54.2%
- Thermal-power plants	106,712	81,275	-23.8%
- Hydro-power plants	3,072,776	4,824,060	57.0%
Energy imports (including energy exchange)	2,321,595	1,241,943	-46.5%
Consumption	5,470,145	6,145,611	12.3%

Source: Institute of Statistics.

II.1.2 AGRICULTURE

Although the agricultural sector has lately experienced a loss of importance, it still remains one of the main sectors of economy reckoning for 24.7 percent of the Gross Domestic Product. Ministry of Food and Agriculture releases speak of a 3 per cent increase of agricultural product during 2003 compared to the preceding year.

Specific 2003 performance of the main components of the agricultural product estimated from the Ministry of Food and Agriculture would be briefly described as follows:

- Production of field crops, in general, kept the same pace as in the last year. The low temperatures of April and the prolonged summer drought resulted in low wheat and vegetable harvest. In contrast, the corn and industrial plant yield a beyond forecasted production.
- Fruit farming production boosted by 9.6 per cent during 2003.
- Animal farming yielded a 4.6 per cent increased production.

Moreover, the agro-industrial and fishing sectors have been developed according to expectations, marking respectively 10 per cent and 15 per cent.

Table II.1 Forecasted Performance of Agricultural Sector over 2003

Sectors	Estimates of October (billions of ALL)	Growth (%)
Agriculture	189.8	2.9
Agro-industry	37.3	10.0
Fishing	2.4	15.1
Total	229.6	4.1

Source: Ministry of Food and Agriculture

The new credit extended to agricultural sector amounted to ALL 712 millions during 2003, revealing a 25 percent increase compared to the respective figure of 2002. Nevertheless, the support of banking system towards this economic subdivision remains at pretty trifling levels, counting for only 1 per cent of the total credit portfolio.

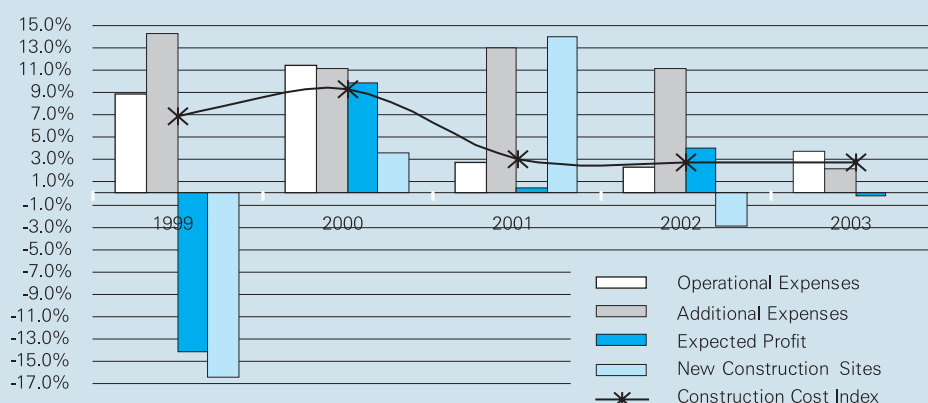
The low organizational level, land partitioning, underdeveloped infrastructure in rural areas, lack of financing resulting in failure to use the advanced technology or other efficient processing and preservation methods, as well as the continuous immigration towards urban zones continue to be the main obstacles inhibiting the progress of agricultural sector.

Overcoming these difficulties will undoubtedly speed the future development of this economic sector.

II.1.3 CONSTRUCTION

Construction is one of the most dynamic sectors of the Albanian economy. During the nine months to September 2003, revenues in the construction industry rose by 22 per cents compared to the same period of a year earlier, which is considered as a high growth in real terms. Whilst, the annual raise in the construction cost index registered only 2.7 per cent.

Chart II.1 Construction Cost Index Movements.



Source: Institute of Statistics.

One of the main factors that drove up the construction cost was the direct expenditure, which climbed by 3.8 per cent. In addition, the cost of building materials rose by 4 per cent, accompanied by an increase of respectively 2.4 and 3.8 per cent of the electrical inputs and sanitary supplies. The salary expenditures ascended by 3.5 per cent. The only expenditure category that dwindled by 2.3 per cent was the transport operating cost.

Nevertheless, the projected turnover and the number of the built construction-yards did not face any remarkable change during this year compared to one year earlier. These factors, along with the improved regulative framework of this sector are expected to bring a new developing rhythm.

II.1.4 SERVICES

During 2003 the service sector experienced another upward year, yielding 46.1 per cent of the gross domestic product. The sales volume of the sub-categories "trade, hotels, restaurants" and "other services" mounted by 11.5 per cent compared to the preceding year. According to the estimates released by the experts of balance of payments, the incomes from tourism activity grew by 7.2 per cent, which still remains lower than the expenditures rate of Albanians for the out-of-country tourism. This resulted in a net fall of incomes from tourism activity, amounting at USD 33 millions vis-à-vis USD 121 millions that

was the respective figure last year. The new extended credit to the service sector⁶ totaled ALL 55.9 billions, while the outstanding credit summed ALL 24.9 billions by the end of the year, sharing 49 per cent of the total crediting activity of the banking sector.

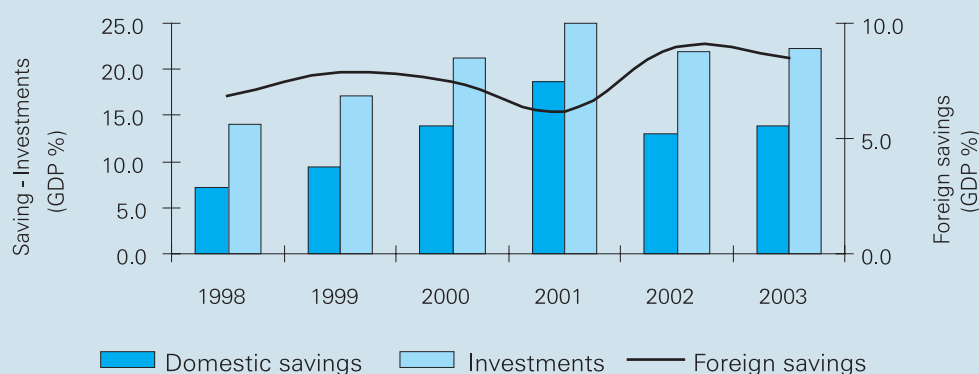
II.1.5 TRANSPORT

During 2003 investments in transport sector experienced a 3 per cent moderate growth. In plain number these investments were ALL 9.7 billions. This acceleration was primarily fuelled by the enclosure of a 7 per cent higher governmental budget, aiming at improving the domestic infrastructure. Whereas, the financial investments through credit extensions and grants remained at the same level as in the last year, plainly ALL 5.3 billions. The construction and assembling activities received 80 per cent of these investments, while the rest were distributed between other transport categories and structural design activities, respectively 15 and 5 per cent of the budget.

II.2 SAVINGS AND INVESTMENTS

The 2003-estimated ratio of the domestic savings⁷ against GDP was 14.0 per cent. In this year, they slightly mounted by 0.8 per cent, being impacted by the increase of public savings⁸, which had a positive value for the first time during the transition period. The positive value of the public savings can be attributed to the consolidated financial discipline, along with the well-managed budget deficit. Nonetheless, the domestic private savings remained the main source of the savings in the Albanian economy. The estimated weight of the private savings to Gross Domestic Product was 13.3 per cent during 2003. The level of the real interest rates encouraged the investment of a part of these savings as bank deposits.

Chart II.2 Savings and Investments as a percentage of GDP



Source: IMF, Country Report, January 2004.

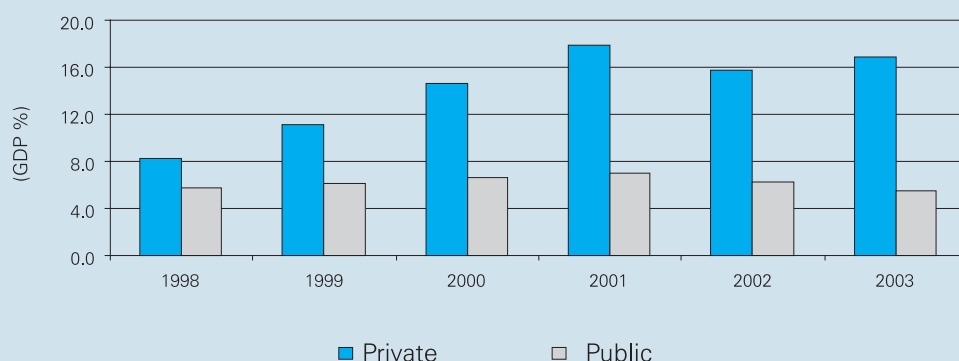
⁶ Credit extended to trade, vehicles repairing, hotels, restaurants, services and social activity, collective and personal services, are included here.

⁷ The data on savings and investments are cited from the IMF paper: Country report 04/22 'Albania: Review under the three year arrangement under poverty reduction and growth facility - staff report', January 2004.

⁸ Public savings are estimated as the difference between the incomes and current expenditures.

Total investments of economy weighted 22.3 per cent of GDP. The growth of investments is fully attributed to the expansion of private investments, since the public ones were cut down by 11.7 per cent due to the partial completion of the projected capital expenditures.

Chart II.3 Public and Private Investments as a percentage of GDP



Source: IMF, Country Report, January 2004.

The balance of savings and investments remained pretty much equilibrated during 2003. Actually, the faster growth rate of domestic savings resulted in a reduction of the current account deficit. Nevertheless, channeling the saving to actual investments must remain one of the main governmental priorities.

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II.3 LABOR MARKET⁹

Labor market experienced several structural transformations during 2003. The main variations were noticed in the total labor supply, total number and structure of the employed persons, as well as in the unemployment rate.

Table II.6 Labor Market: Main Indicators (in thousands of persons)

	2002				2003			
	Q.I	Q.II	Q.III	Q.IV	Q.I	Q.II	Q.III	Q.IV
Labor supply	1096	1093	1094	1094	1096	1093	1092	1091
A. Employed persons	918	917	919	921	926	927	928	927
i) public sector	189	188	187	187	185	185	184	182
ii) private non-agricultural sector	203	203	206	208	207	208	210	211
iii) private agricultural sector	526	526	526	526	534	534	534	534
B. Unemployed persons								
i) total unemployed persons	178	176	175	173	170	166	164	164
ii) receipt unemployment benefits	13	13	12	11	11	11	11	11
C. Unemployment rate (%)	16.2	16.1	16.0	15.8	15.5	15.2	15.0	15.0

Source: Institute of Statistic

⁹ Despite the progress made in the statistical method, the resulted labour market indicators should be considered with precaution, due to high deformation caused by the uncontrolled migration. This migration brings continuous changes in the concentration of the population in rural and urban areas, and the existence of a relatively large black employment market

II.3.1 LABOUR SUPPLY

The labor supply suffered a slight decrease, quantifying at 1.091 million persons by the end of 2003. The continuous decrease of labor force during the four quarters of this year confirmed that the emigration phenomenon and the informal market employment are still strong in Albania.

II.3.2 EMPLOYMENT

The end of the year 2003 marked a 6 thousand increase in the number of employed persons. This increase was mainly ascribed to the expansion of employment in the private non-agricultural sector, particularly on the retail trade and services. The number of persons employed in the private non-agricultural sector totaled 4 thousand at the end of 2003, while the concentrated growth of employment in the retail trade was 12.8 per cent compared to the end of 2002. On the other hand, the continuous reforms in the public sector, driven by the obligation to meet the European Union requirements, reduced the employment in this sector by 5 thousand persons.

The increase in the number of persons employed in the private agricultural sector seemed to bear the most remarkable growth. Nevertheless, the figure of 8 thousand increase was a result of a more exact counting of natural labor supply in the last population registration. In fact, the period of economic transition in Albania was accompanied with population movements from rural areas towards urban centers. No movements are noticed in the opposite direction. This actuality makes doubtful the real employment growth in this sector.

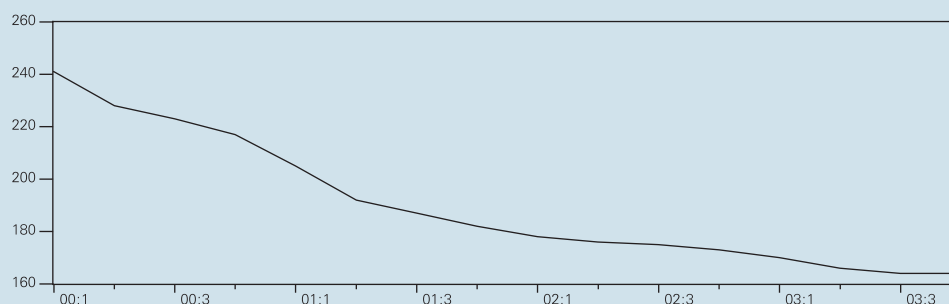
II.3.3 UNEMPLOYMENT

The number of unemployed persons fell by 9 thousands during 2003, totaling 164 thousand persons by the end of the year, equal to 15 per cent unemployment rate. The drop in the unemployment rate was a quarter to quarter event, revealing the highest zenith in the beginning of the year, when the number of unemployed persons fell by 6 thousands.

The number of persons that received unemployed benefits remained at the same level as in the last year, summing at 11 thousand. The only noticed improvement is unveiled if the comparison is done with respect to the year 2001, when this category numbered 21 thousand persons.

Nevertheless, the entire analysis performed on the employment figures is subject to data limitation. The only clear conclusion that can be drawn is that besides the visible improvement, unemployment remains one of the greatest problems that needs particular attention in the years to come.

Chart II.4 Unemployment during the last three years (in thousand of persons)



II.4 FISCAL SECTOR

According to the principles enclosed by the Mid-term Budget Program 2002-2005, the main objective of the budget of 2003 was the intensification of the fiscal discipline, which in general terms means the continuous provision of fiscal and macroeconomic stability, along with increased efficiency of utilization of public funds, aiming at improving the quality of the public services.

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The 2003 fiscal budget projected a 20 per cent growth of revenues and the maintaining of the budget deficit below 6 per cent of Gross Domestic Product. The performance of fiscal indicators was evaluated as sufficiently positive to maintain macroeconomic stability, but it revealed a lower than projected contribution to the economic activity. While the budget deficit was kept within the limit, resulting in the sustentation of the general macroeconomic equilibrium and particularly contributing to the control of inflation rate, the fiscal policy failed to meet the revenue objective. The collected revenues were only 93 per cent of the projected ones, consequently shrinking the expenditures to 90 per cent of the projected level.

Table II.7 Fiscal indicators as a percentage of GDP

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total revenues	24.1	23.4	16.3	17.0	22.0	22.0	21.9	23.0	22.9	22.4
- Tax revenues	16.0	13.2	10.7	9.8	12.3	12.9	15.6	15.6	15.7	19.6
Total expenditures	33.1	33.6	31.3	27.7	30.2	33.3	30.9	31.5	29.1	26.9
- capital expenditures	3.4	8.3	4.9	4.2	5.7	5.8	6.6	7.4	5.6	4.1
Budget deficit	-9.0	-10.2	-11.4	-13.2	-11.3	-11.3	-9.1	-8.6	-6.2	-4.4
- Domestic finances ¹⁰	8.6	6.5	9.0	11.3	6.5	5.0	5.4	4.8	3.2	3.2
- Foreign finances	0.4	3.7	2.4	1.9	4.8	6.3	3.7	3.8	3.0	1.2

Source: Ministry of Finance

¹⁰ The figure includes even the proceeds from privatization.

In nominal terms, the revenues and the expenditures grew individually by 11 and 4 per cent compared to the respective figures in 2002, counting respectively for 22.4 and 26.9 per cent of nominal GDP. The budget deficit was 19 per cent lower than in the previous year, being 4.4 per cent of GDP.

II.4.1 REVENUES

The strategic objective of the fiscal policy of 2003 on revenue collection was the consolidation of tax base, accompanied by the creation of a favorable environment for economic development. The budget revenues trajectory revealed continuous positive growth, even though they failed achieving the 20 per cent projected increase. The revenues marked an 11 per cent increase compared to 2002. The tax and customs revenues keep having the largest contribution in the gross state earnings. On the other hand, the general failure to meet the revenue objective was explicitly due to lower than projected value-added tax proceeds, which were collected at 93 per cent of the intended amount.

Table II.8 Historical structure of the budget revenues (%)

	1998	1999	2000	2001	2002	2003	Realization 2003
Total revenues	100	100	100	100	100	100	93
- Tax revenues	59.9	60.0	68.6	66.2	66.7	65.0	94
- VAT	30.8	27.7	31.6	30.4	30.6	30.3	93
- Income tax	4.6	5.6	6.7	7.6	8.1	7.9	101
- Excise tax	5.3	6.5	7.6	7.0	6.2	7.3	106
- Small business tax	1.0	1.1	1.4	1.5	1.7	1.8	96
- Personal income tax	1.2	2.9	3.8	4.6	4.1	3.8	86
- National tax	3.3	3.7	4.8	5.1	6.7	7.3	87
- Customs tax	13.5	10.7	11.2	9.4	8.9	8.3	94
- Revenues from local governments	0.8	0.8	1.1	1.5	1.8	5.0	103
- Social contribution	16.9	16.9	16.6	16.6	17.0	17.2	94
- Non-tax revenues	22.2	22.1	13.7	15.6	14.6	11.3	86

Source: Ministry of Finance

The excise tax revenues, revenues from the local government and income tax revenues were the only earnings categories that exceeded the projected level.

II.4.2 BUDGET EXPENDITURES

The budget expenditure objective was attained at 89.6 per cent level, marking a 4 per cent growth compared to one year earlier. The main category that failed reaching the projected level was the capital expenditures. The incurred monthly capital expenditures were far from the planned amount, thus limiting their contribution to the country's economic growth. These expenses were only 62 per cent of the intended amount, mainly attributed to lack of foreign funding. Domestic funding counted for 86 per cent of financing the capital expenditure, almost double of the foreign financing which was limited to 43 per cent. Conversely, the current expenditures were within the planned quantity, although they were particularly accelerated by the end of the year, especially in the salary expenditures.

Table II.9 Attained level of the projected expenditures for 2003 (%)

	1998	1999	2000	2001	2002	2003	Plan 2003
Total expenses	100	100	100	100	100	100	89.6
- Current expenses	82.9	79.1	78.1	76.0	80.6	84.8	100.7
- Personnel	20.0	18.8	19.5	22.2	21.9	22.4	96.6
- Interest	25.3	21.1	17.3	13.0	12.9	14.9	110.3
- Social Insurance	17.2	20.5	21.9	23.6	24.2	22.4	99.5
- Capital expenses	17.1	20.6	21.3	23.2	19.4	15.2	61.8

Source: Ministry of Finance

II.4.3 BUDGET DEFICIT

The lower governmental spending condensed the budget deficit to 76 per cent of the forecasted level. The end of the year figure was ALL 32.8 billion or 19 per cent less than in the previous year. The 2003 budget deficit was projected to be covered 51 per cent from domestic financing and 43 per cent from foreign funding. Nonetheless, the domestic financing reckoned 73 per cent of total finances and the rest of 27 per cent was provided by foreign institutions.

The increase of domestic financing was realized via expanding the portfolio of government securities, whose main investors remained the commercial banks.

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II.5 INFLATION DEVELOPMENTS AND MONETARY POLICY

Inflation rate of 2003 fell within the Bank of Albania targeted band. At year-end, 12-month inflation rate stood at 3.3 per cent, while the average annual rate during the year was measured at 2.37 per cent.

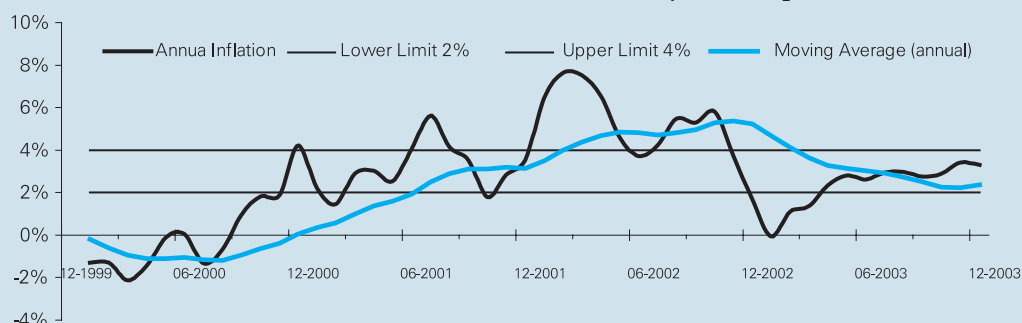
Table II.10 Annual inflation rate (in percentage)

	1999	2000	2001	2002	2003
January	6.0	-1.3	2.2	6.5	0.0
February	3.5	-1.3	1.5	7.6	1.1
March	2.0	-2.1	2.9	7.5	1.3
April	0.4	-1.4	3.0	6.5	2.3
May	-0.1	-0.1	2.5	4.6	2.8
June	-0.6	0.1	4.0	3.7	2.6
July	0.1	-1.3	5.6	4.2	3.0
August	-0.6	-0.7	4.1	5.5	3.0
September	-1.9	0.9	3.5	5.3	2.8
October	-1.8	1.8	1.8	5.8	2.9
November	-1.2	1.9	2.8	3.7	3.4
December	-1.0	4.2	3.5	1.7	3.3

Source: INSTAT.

In 2003 price changes have been more stable than in the previous year. Except for the first quarter, annual inflation rate has ranged within the 2-4 per cent band. Also, on average terms, the annual rate has declined, approaching to the lower limit of this band.

Chart II.5 Annual inflation rate (in percentage)



Meeting the Bank of Albania inflation target by holding it within 2-4 per cent has led to positive developments in all sectors of economy. It helped sustaining macroeconomic equilibrium and financial system stability. Following low inflation rate, the real interest rate has remained positive, enabling the banking system to attract savings and channel them into financing the needs of economy.

II.5.1 PRICE CHANGES OF THE BASKET

Inflation performance has been shaped by the price changes in “Food and non-alcoholic beverages” item. This item¹¹ has contributed the most to annual inflation rate, especially during May – September period. In this year, the introduction of domestic products in the market did not generate the same effect on overall inflation as the last year. Demand for consumer goods increased due to large tourism activity, and the seasonal effect on inflation weakened. The contribution of “Rent, water, fuel and energy” item has been at moderate levels during the first months of 2003. However, increasing energy price in May and the rent price rise in August and October added the contribution of this item to overall inflation rate. As the price of rent rose, so did that of imputed rent, which was recalculated in October by Institute of Statistics (see Box 1.)

Table II.10 Contribution of basket items (in percentage points)

	1999	2000	2001	2002	2003
January	6.0	-1.3	2.2	6.5	0.0
February	3.5	-1.3	1.5	7.6	1.1
March	2.0	-2.1	2.9	7.5	1.3
April	0.4	-1.4	3.0	6.5	2.3
May	-0.1	-0.1	2.5	4.6	2.8
June	-0.6	0.1	4.0	3.7	2.6
July	0.1	-1.3	5.6	4.2	3.0
August	-0.6	-0.7	4.1	5.5	3.0
September	-1.9	0.9	3.5	5.3	2.8
October	-1.8	1.8	1.8	5.8	2.9
November	-1.2	1.9	2.8	3.7	3.4
December	-1.0	4.2	3.5	1.7	3.3

Source: INSTAT.

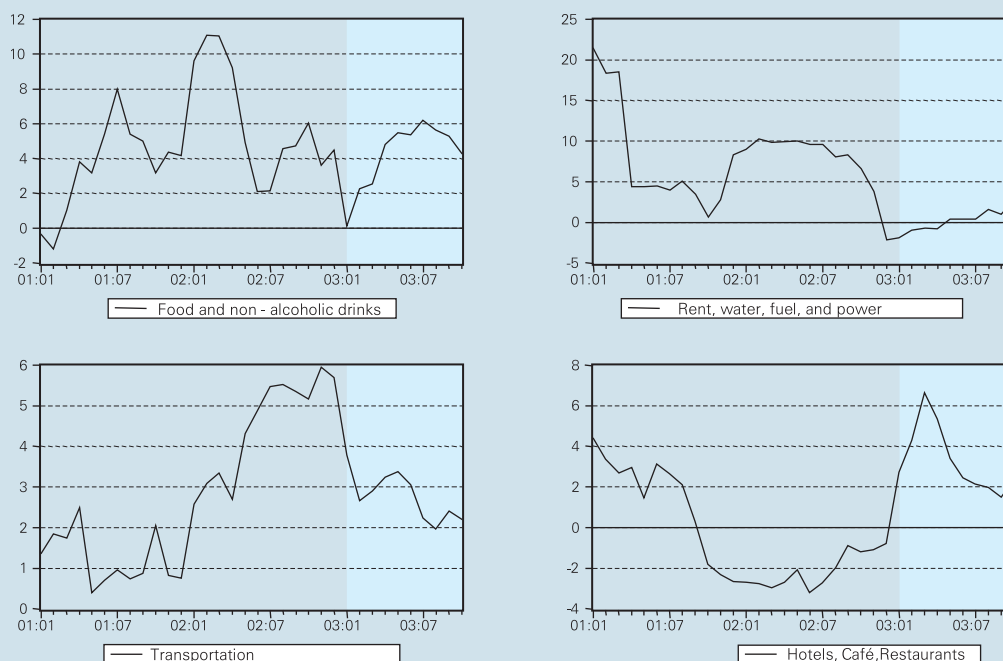
¹¹ The “Food and non-alcoholic beverages” item occupies 42.6 per cent in the CPI basket.

The contribution of other items of the basket has been moderate during 2003.

Increasing the price of fixed phone tariffs in December influenced the inflation rate of this item and its contribution to overall inflation. Annual inflation rate increased by 0.67 pp., as a result of a 67 per cent increase of phone tariffs.

Oil price fluctuation in the international market affected the price of oil in the domestic market and consequently, transportation prices moved up during the first quarter. In the following months, this outcome smoothed out.

Chart II.6 Annual inflation of four main items of CPI basket (in percentage)



In the second half of the year, the wages in education and payments for health service changed upwards, causing slightly the rise of annual inflation rate.

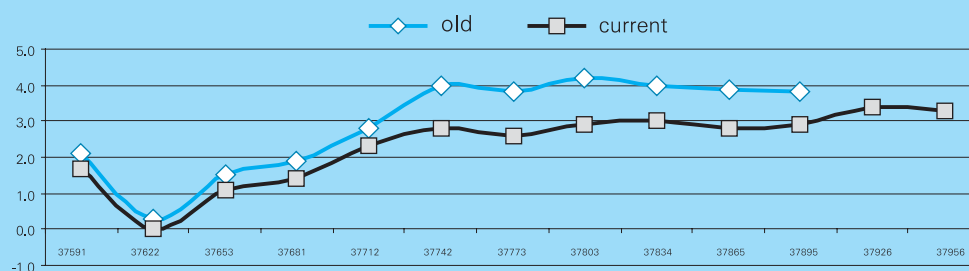
Box 1 Recalculating the index of “Rent, water, fuel & energy” item

In December 2001, the basket used to calculate consumer price index changed. Changes consisted in adding new consumer items and recalculating the weight of each item in the total basket in order to represent better the real situation of Albanian households.

One of the added items was the imputed rent, which accounts for a considerable share in the basket (17 per cent.) Imputed rent is the potential rent (potential consumption) that an Albanian pays. It can be understood as the rent that could be paid if one had to live in a dwelling that is not his/hers. The method of calculating the imputed rent had a couple of problems. Before October 2003, imputed rent was calculated as weighted average of all items included in “Rent, water, fuel & energy” group. Consequently, a rise in the price of the items in the group was counted twice with regards to total inflation. As soon as this inaccuracy was recognized, the method for calculating the index of this group was revised. The new changes made in October 2003 base the calculation of imputed rent on the normal rent price.

Revising the index for imputed rent changed also the total price index, making it drop by 0.6-1 pp for 2003. The following chart displays annual inflation rate during 2003 based on both methods.

Chart 1 Annual inflation rate based on the old and current method



Based on the new method, inflation rate has moved within the Bank of Albania targeted band.

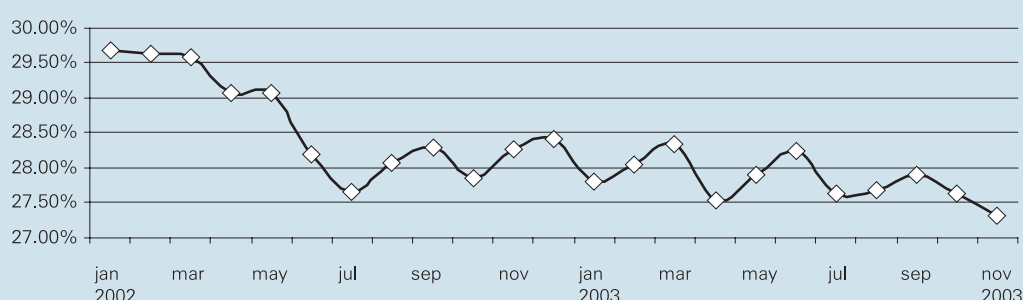
II.5.2 FACTORS THAT HAVE INFLUENCED PRICE INFLATION

As the objectives of the country's economic development program were observed, favorable conditions to control inflation were in place. Domestic demand was kept under control and monetary indicators were stable.

BUDGET EXPENDITURES AND BUDGET DEFICIT

Budget expenditures were measured at a lower level than the annual projection. This has pushed down inflationary pressures, since budget expenditures are part of domestic demand. Moreover, expenditures spread more evenly over the year compared to the previous years. The tense political situation and local elections of October have not been followed by shaking of fiscal policy, i.e. increasing expenditures and aggravating budget deficit. As expenditures have not been concentrated at specific points in time, large price fluctuations have been avoided, facilitating the control of budget financing and movement of liquidity in the economy.

Chart II.7 Monthly budget expenditures (as a percentage of GDP)



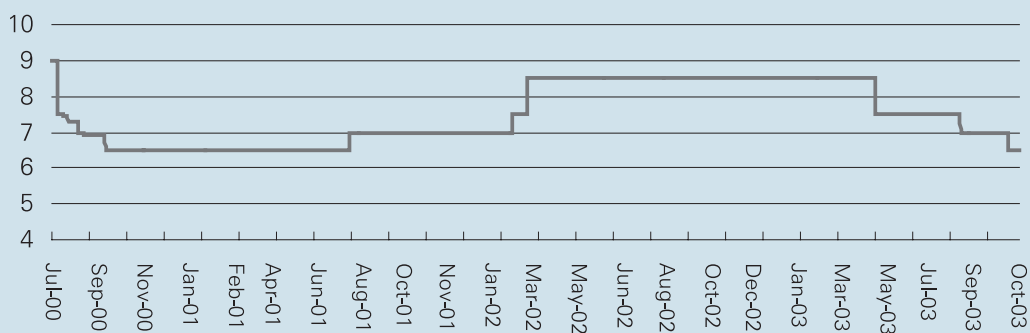
The government has met the projection of domestic financing for 2003. Financing from domestic sources fell to 2.7 per cent of GDP, compared to 3.2 per cent of GDP in the last year. Keeping budget deficit under control has brought down pressures on monetary indicators and has released funds to credit the economy. Budget deficit was financed from savings of economy and the Bank of Albania did not contribute to this.

MONETARY POLICY AND INDICATORS

Monetary policy of the Bank of Albania has followed an easing trend during 2003. It has aimed at lowering the cost of borrowing in economy under the conditions of an acceptable inflation and stable financial system. Furthermore, it was necessary to take steps to ease monetary policy in order to make up for the raise of interest rate in 2002.

During the first half of 2003 the Bank of Albania took only one move to loosen its monetary policy. It lowered reference interest rate by 0.5 pp in April. In view of increasing inflation and stability of monetary indicators, which was still fragile, the Bank of Albania tried to take a cautious stance. Later, as inflation remained stable within the target band of 2-4 per cent, the Bank of Albania cut interest rates three times by 0.5 pp each in July, October and December. At the end of the year, reference interest rate stood at 6.5 per cent, being the lowest in the last four years.

Chart II.8 Reference interest rate

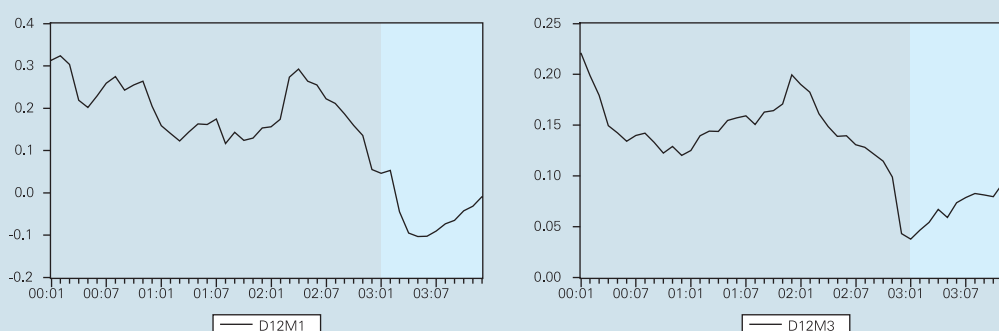


Interest rates difference has favored the further appreciation of ALL, adding to a large demand for financial assets denominated in ALL. In line with its monetary policy, the Bank of Albania has been present in the foreign exchange market buying foreign currency. As a result of such interventions, a total of ALL 6.2 billion was injected in the market.

Cuts of reference interest rate did not have a negative effect on inflation and monetary indicators. Monetary policy stance has tried to carefully foster the achievement of performance criteria and projections set in the monetary program. The Bank of Albania has been prudent, trying to keep real interest rates at positive levels, drawing public interest in deposits and keeping an eye on banking system liquidity.

Monetary indicators have developed in accordance with expectations. Monetary aggregates showed stable growth and within projected values; ALL deposits and currency outside banks showed a stable trend, providing a steady level of liquidity.

Chart II.9 Annual growth rate of M1 and M3 (in percentage)



Foreign exchange rate has been characterized by appreciation of ALL against two main currencies, euro and USD. ALL appreciation has smoothed down the effect of imported inflation on total inflation and has kept population expectations for inflation low. In particular, appreciation trend has been more obvious during the second half of the year, when ALL appreciated by 3.8 per cent against euro and by 7.8 per cent against USD.

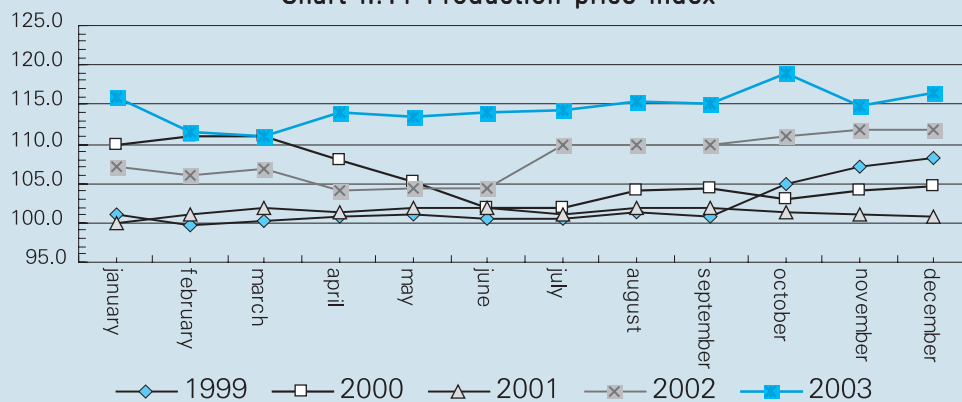
Chart II.10 Nominal effective rate of ALL in 2003



Inflation developments have been affected also by the increase of administrative prices and supply shocks.

- **Oil price** increased from US\$26 per barrel in December 2002 to US\$32 in March 2003 due to Iraq war. Contribution of "Transportation" item to total annual inflation increased considerably up to 0.31 pp in March. In May this effect extenuated (this item's contribution to inflation dropped to 0.16 pp) as a result of OPEC's decision to place a higher limit for their maximum oil production and to reduce reference oil price.
- **Agriculture sector** produced less than it was previously expected from the Ministry of Agriculture. Low temperatures of April, long droughts in summer and increasing exports of agricultural and stock products during January – August have been factors, which have reduced domestic supply in the market¹². In addition, tourism expanded largely. Therefore, the seasonal effect in summer, which contributes to reduce prices in this period, had a smaller effect in 2003.
- **Increased cost of raw materials** affected the price rise. Production price index¹³ marked high figures during 2003. High input prices at first steps of production were carried forward into high prices of final production.

Chart II.11 Production price index



¹² Source: Ministry of Food and Agriculture. The projection on the growth of agricultural production in July was reduced by 0.2 pp. The drought reduced the wheat and vegetable harvest by respectively about 20 thousand tons and 10 thousand tons less than the projection of 2003. Also, for the period of January – August 2003, export of agricultural and farming products was 12 per cent higher than in the previous year.

¹³ This index calculated by Institute of Statistics measures the raw material price and intermediate ones, based on the surveys to 600 productive enterprises.

- **Imported inflation** from partner countries has pushed up prices of consumption products in the Albanian market. This factor takes a special significance, given that domestic demand is mostly met by imported products. Our economy, being a developing one and with a narrow production base, remains oriented to imports¹⁴. Our main trading partners are Italy and Greece. Imports from these countries account respectively for 34 and 21 per cent of total imports. On the other hand, both these countries have registered high inflation rates¹⁵.

Table II.11 Annual inflation rate of main trading partners (in percentage).

	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
Greece	1.2	1.2	1.0	3.5	3.6	3.5	3.3	3.4	3.2	3.1	2.9
Italy	4.2	3.9	3.3	2.9	2.9	2.9	2.7	3.0	2.8	2.8	2.5

Another particular factor that needs to be mentioned is the resultant campaign to prevent the speculative price rise during the end year holidays. The outcome of this campaign is reflected not only in the fact that prices in December were increased by a small rate, but also in inducing public awareness about the positive effect that a normal consumer and business behavior has on price changes (see Box 2.)

Box 2 Campaign to prevent speculative price changes

Maintaining price stability is the main objective of Bank of Albania. In order to follow this objective, apart from implementing an appropriate and cautious monetary policy, the Bank of Albania uses also other means to increase the efficiency of its decisions. One of the means is also the communication with public via the campaign to reduce speculations with price peaks during end year holidays. For the second consecutive year, the Bank of Albania organized such a campaign. Speculations resulting from lack of competition, appropriate fiscal control, and a model of buying behavior, which makes demand inelastic, bring prices up even in a sufficient supply. The Bank of Albania, being sensitive to the harmful outcome of such happening on overall economy, household's economy and the fulfillment of Bank's objective, started a cooperation with government authorities, business community, civil society and media, in order to educate the public and increase the transparency and effectiveness of its own decisions.

The main focus of the campaign and its success as well was to increase public awareness. Higher prices during end year holidays have become part of the mentality and have gained general acceptance. From a survey conducted by the Bank of Albania, it turned out that 92 per cent of the population expected prices to rise during December. A consumer with such expectations can be a drive for prices to actually go up. Advising the consumers not to buy in excess, was coupled with advising businesses to increase their profits by increasing the volume of sales as well as urging tax officers to be firm on tax collections.

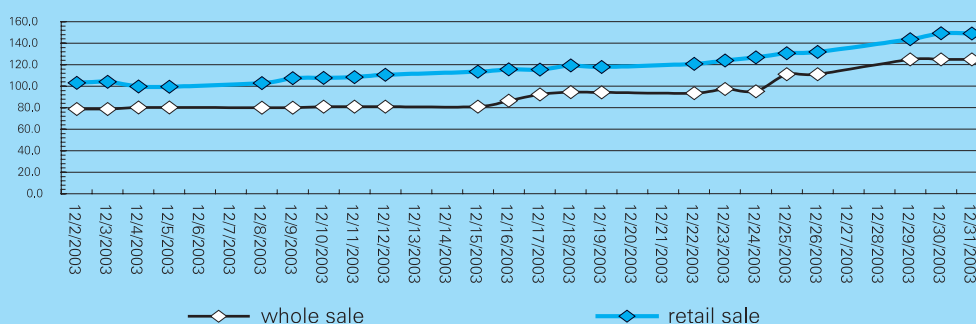
¹⁴ During the first nine-month period, import was about 4 times higher than export.

¹⁵ In 2003 the average HCPI inflation rate of Italy and Greece was respectively 2.8 per cent and 3.5 per cent. These rates are higher than the average inflation rate of euro area, by 2.1 per cent. Source: Eurostat.

¹⁶ Source: Ministry of Industry and Energy.

As part of this campaign, the Bank of Albania was monitoring prices of food products on daily bases. Various analyses and surveys indicate that prices of these products, which count for a large part of CPI, reflect the effect of speculative price increases. Price of fruits and vegetables were increased considerably during season's holidays. Wholesale market was the main contributor, driving prices up in the whole process of selling these products.

Chart 1 Price developments in different markets



The campaign for prevention of speculative increase of prices showed its results in December. Monthly inflation for food products stood lower than in the previous years.

Table 1 Monthly inflation rate (December) of "fruits" and "vegetables"

	2000	2001	2002	2003
Fruits	24.8	16.3	16.5	1.5
Vegetables	25.6	41.2	42.9	33.7

However, the outcome of such campaigns is carried forward over long periods of time. In the short term, the campaign had an impact on smoothing down the negative effects of speculation on monthly inflation rate of December 2003. Compared to four previous years, monthly inflation for "Fruits" and "Vegetables" in December 2003 recorded lower values.

In the long term, the outcome of this campaign relates to the raising of public awareness and education. The results of the campaign were a reward for the good will, time, energy and commitment of the Bank of Albania.

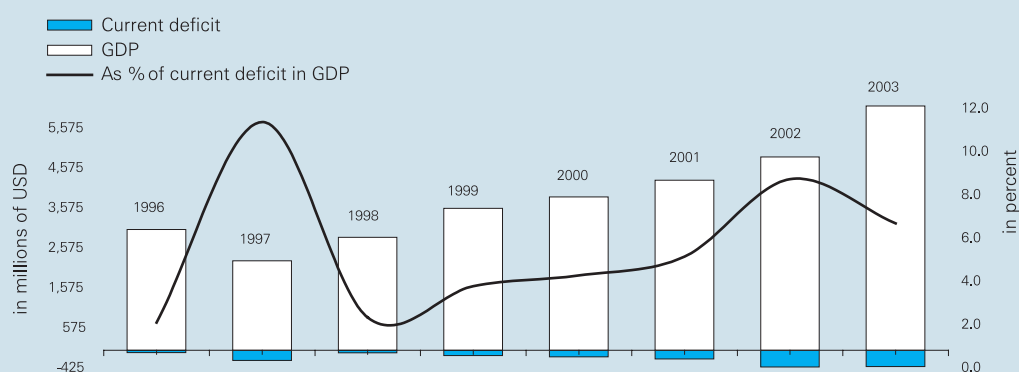
II.6 BALANCE OF PAYMENTS

II.6.1 MAIN DEVELOPMENTS IN THE BALANCE OF PAYMENTS

At the end of 2003 current account deficit was estimated at USD 407 million or 6.7 per cent of GDP. The share of current account to GDP has narrowed considerably compared to previous year when the ratio stood at 8.7 per cent. The gap narrowed by USD 13 million, due to positive balance of income and current transfers.

Net capital flows account for around 90 per cent of current deficit. Albania's financial liabilities to nonresidents have increased by USD 328 million. They stand almost entirely for foreign direct investments and official and private borrowings. Residents' assets abroad namely deposits, portfolio investments and foreign currency marked a positive change compared to last year.

Chart II.12 Current deficit as percentage of GDP



In 2003 USD depreciated considerably against euro and ALL. Given that most of transactions between residents and not-residents are made in euro and not in USD – the currency which denominates balance of payment accounts, analyses of balance of payments should provide for exchange rate effect. Consequently, trade deficit estimated in euro has decreased by 3.4 per cent in 2003, while if estimated in USD, trade deficit has increased by 15.7 per cent. The same holds true for other items of current account or capital and financial account.

II.6.2 CURRENT ACCOUNT

Current transactions amounted to USD 5 billion during 2003. Around 2.7 billion are expenditures on purchase of goods and services by non-residents. Income item in current account has been mostly supplied by current transfers (40 per cent), services to non-residents (32 per cent) and exports (20 per cent.) Current account deficit registered a value of USD 407 million during 2003. This figure is lower than that of 2002 even if we do not provide for the exchange rate effect.

Table II.13 Current account items during 2002 and 2003 (USD millions)

	2001	2002	2003	Change 2003/2002
CURRENT ACCOUNT (1 + 6)	-217.9	-420.8	-406.7	96.6
1. Goods, services and income (2 + 5)	-788.7	-1,034.0	-1,248.6	120.8
1.1 Credit	1000.6	1,062.2	1,361.6	128.2
1.2 Debit	-1789.2	-2,096.2	-2,610.3	124.5
2. Goods and services (3+4)	-937.7	-1,160.4	-1,419.0	122.3
2.1 Credit	838.1	915.3	1,166.9	127.5
2.2 Debit	-1,775.8	-2,075.6	-2,585.8	124.6
3. Goods	-1,027.0	-1,155.1	-1,336.3	115.7
3.1 Credit	304.6	330.2	447.2	135.4
3.2 Debit	-1331.6	-1,485.4	-1,783.5	120.1
4. Services	89.3	-5.2	-82.7	1578.8
4.1 Credit	533.5	585.0	719.7	123.0
4.2 Debit	-444.2	-590.3	-802.4	135.9
5. Income	149.0	126.4	170.3	134.8
5.1 Credit	162.5	146.9	194.8	132.6
5.2 Debit	-13.4	-20.6	-24.4	118.7
6. Current transfers	570.8	613.2	841.9	137.3
6.1 Credit	647.5	671.7	924.2	137.6
6.2 Debit	-76.7	-58.5	-82.3	140.5

The deep trade deficit was partly covered from surplus of income and current transfers accounts. Though in relative terms imports calculated in USD increased at a smaller rate than exports, trade deficit in 2003 stood at USD 180 million higher than that in 2002. Annual change by 16 percent has been caused mainly from the exchange rate effects.

In 2003 both income and expenditures in the balance of services have increased. It is worth noting that expenditures have marked a higher growth rate than income. The balance of this account was rounded with a deficit of USD 83 million, while during the previous years it was in surplus.

Due to having similar sources, income account displays the same trend as that of current transfers account. A positive aspect of this account is the increase of interest income from investments of residents abroad.

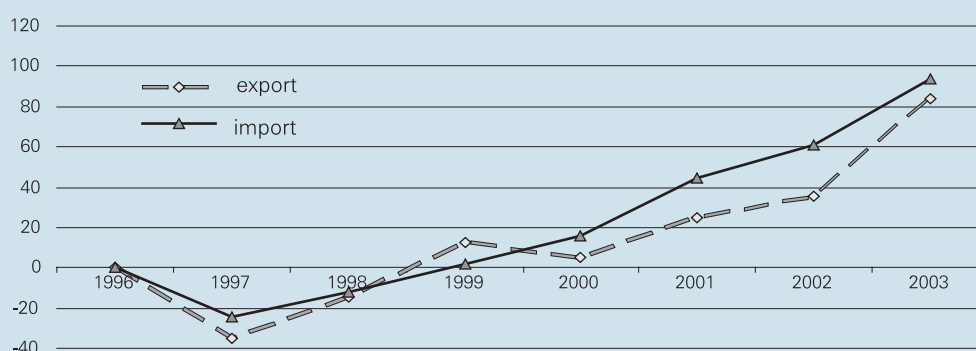
Current transfers account shows the same sign and composition as in previous years, being dominated by remittances. These make for 84 per cent of inflows in this account, a share a bit lower than that of 2002, when flows from remittances made 94 per cent of total current transfers.

MERCHANDISE TRADE

Trade of goods marked a volume worth USD 2.2 billion, equal to 22.8 per cent higher than in 2002. Trade transactions represent 54 per cent of all transactions of Albania with the rest of the world. Expenditures on imports reached USD 1.8 billion, being USD 289 million (or 20 per cent) higher than those in the previous year. Income from exports recorded a figure of USD 447 million and an annual growth rate of 35 per cent. Albanian economy remains oriented towards imports, which account for 80 per cent of overall foreign trade volume. In 2003 trade deficit reached USD 1.3 billion, being 16 per cent higher than that of the last year. Even though exports increased by a higher yearly rate than previously (USD 117 million)

total exports volume covers only 25 per cent of all imports. The main reasons for the unsatisfactory developments in exports can be found in the low competitiveness of Albanian products in the international markets. Therefore, Albanian exporters cannot fully benefit from the advantages of Free Trade Agreements. Foreign demand for Albanian products, specially that from EU countries, has remained at the same level during the last two-three years, thanks to the slow world economic development.

Chart II.13 Imports and Exports Growth (Index. 1996=100)



Despite their small volume, exports have signaled the improvement of processing industry in the country. The main contribution has come from re-exporting (exports of ordered products) which account for 77 per cent of total volume of Albanian exports. Exports of domestic products increased by 16 per cent in 2003. They account for 22.5 per cent of total exports. Despite this positive evidence, the structure of exports suffers from low diversification.

After six years, in 2003 the price of chrome in international market increased, giving an opportunity to develop to the mining industry of chrome in Albania. The price of ferrochrome in the international market (around US\$600 per ton) led to increasing Albanian chrome exports. Income from export of metals in 2003 stood 61 per cent higher than in 2002. Currently, there are 109 private entities operating in this activity¹⁶.

Table II.13 Imports by groups of merchandise

Code	DESCRIPTION	Imports	Exports	Trade balance
0	Live animals, animals products	268.1	18.9	-249.2
1	Prepared foodstuffs, beverages, tobacco etc.	68.8	5.8	-63.0
2	Raw material	63.7	19.4	-44.3
3	Fuel	158.9	4.9	-154.0
4	Vegetable and animal fat and oil	29.0	0.5	-28.5
5	Chemical products	159.7	2.9	-156.8
6	Manufactured articles	441.0	77.5	-363.4
7	Machinery and equipment	403.4	15.8	-387.5
8	Miscellaneous manufactured articles	264.7	301.5	36.8
9		0.0	0.0	0.0
	TOTAL	1,857.2	447.2	-1,410.0

¹⁶ Source: Ministry of Industry and Energy.

Trade imports have recorded considerable growth in all group items. An encouraging development relates to higher imports of capital goods that are employed in different production processes. The greatest contribution has come from imports of machinery and equipment, which marked a yearly growth of 18 per cent and make a considerable share in total imports. The performance of imports of this group is an indicator of investments in the country. The largest volume of imports has been recorded in the group of IT and communication equipment (electronic media, communication waves) and equipment needed for reconstruction of power transmission network in the country.

Despite the continuous rise of oil price in international markets, domestic demand remained high. Imported oil in 2003 was 19 per cent higher than that in 2002. As domestic production of energy improved, import of this item decreased compared to that in the previous year. Imports of energy in 2003 amounted to 561 kWh less than the previous year, thus decreasing expenditures by 17 per cent.

Unfavorable climatic conditions for agricultural products led to higher imports of these products (by 18 per cent), especially of cereal, fruits and vegetables. Imports of food, alcohol and tobacco remained high, marking an increase of 21 per cent compared to last year. Here, it should be noted that imported tobacco has increased by 29 per cent, apparently as a result of attempts to prevent fiscal evasion. Continuing these attempts in the future will have an impact on the registered imports of items subject to excise.

Imports of raw material for active processing (textile, footwear and metals) increased by 34 per cent. The trend of this group reflects the developments noticed in the re-export sector. Geographically, Albanian trade activity stayed oriented towards countries of the European Union. Trade exchanges with this group account for 68 per cent of total imports and 93 per cent of total exports. Italy and Greece represent the main partners in this group. Imports and exports with this group have expanded further. Meanwhile, trade with Southeastern European countries, which are included in the process of establishing free trade zones seems to be limited. Trade with these countries displays a random behavior rather than a genuine trading model.

Table II.14 Imports by trading partners

Imports	Share on total imports			Annual change	
	2001	2002	2003		%
Total	100.0	100.0	100.0		24.9
EU countries – 15	74.2	71.1	68.3		14.5
Italy	31.9	34.7	34.1		17.6
Greece	25.8	21.9	19.8		1.7
Germany	5.8	5.6	5.7		42.8
Southeastern European countries	5.8	7.1	6.1		2.9
Bulgaria	2.0	1.9	2.2		40.8
Bosnia & Herzegovina	0.0	0.0	0.1		83.6
Croatia	1.3	2.2	1.5		-12.2
Former Yugoslavia	0.5	0.8	0.6		-23.8
FYROM	1.1	1.1	0.9		-4.8
Romania	0.9	1.1	0.9		-6.1
Turkey	6.2	6.1	6.5		31.4
Russia	1.4	2.6	2.9		46.8
Ukraine	1.1	1.2	2.3		205.0
Other	11.4	11.8	13.9		22.6

Expected outcome from liberalization of trade among countries of Southeastern Europe can be viewed in different ways. Trade liberalization implies not only changes in business environment, which promotes the expansion of possibilities to export and increase competitiveness, but also changes in the social and cultural behavior of the countries involved.

Table II.15 Exports by trading partners

Exports	Share on total exports			Change (2003/2002)	
	2001	2002	2003		%
Total	100.0	100.0	100.0		35.4
Countries of EU – 15	91.6	92.1	93.3		37.1
Italy	71.2	71.7	74.9		41.4
Greece	13.1	12.8	12.9		35.7
Germany	5.5	5.5	3.4		-16.8
Southeastern European countries	4.7	3.8	4.3		20.8
Of which:					
Former Yugoslavia	3.1	2.2	2.6		41.7
FYROM	1.5	1.5	0.7		-37.1
Other	3.7	4.1	2.4		45.2

BALANCE OF SERVICES

Year 2003 was characterized by a high deficit in service account. Net exports of services for 2003 was reckoned at USD -82.7 million, being much higher than that of USD -5.2 million recorded in 2002. The deficit of 2003 marks a turn in this account, which has registered continuous surplus during 1999-2001. Also, this year's deficit has been the highest since 1993. Inflows from services increased by 23 per cent while expenditures increased by 36 per cent. Main items included in the services between Albania and rest of the world are: travel service, transportation service, insurance service, etc. The main share of total services, either debit or credit is carried by travel services. This item is characterized by a rapid increase of expenditures compared to income. Transportation and insurance services related to goods show the same pattern of development as that of trade of goods.

"Other services" has recorded a deficit of USD 10 million, being remotely far from the USD 30 million surplus at the end of 2002. The deficit of this year has been caused by increasing expenditures on technical assistance that our country receives from abroad. During 2003, these expenditures have amounted to USD 44 million. A positive development in the group of "other services" relates to communication services. Like in the previous year, this item has generated more revenue than occurred expenditures, bringing a net of 27 million USD in the current account. Lately, telecommunication services have taken a bursting development, fueling contacts with non-residents. These trends bring up the need for a larger base of telecommunication entities to obtain information on balance of payments.

Concluding the analysis of merchandise trade and services, it should be emphasized that the degree of economic opening of Albania is estimated to be 61 per cent, or 1 pp smaller than in 2002, leaving enough room for improvement compared to other regional countries.

INCOME AND CURRENT TRANSFERS

Income account has ended the year with a positive balance of 170 million USD. Inflows in this account have been clearly higher than in the last year, while the difference of outflows

has been small. It has been noted that income from employee compensations and investments has increased. Income from employee compensations is affected by evaluation of remittances, given that part of the latter is classified as income from seasonal and border workers. Consequently, inflows from current private transfers have been also reflected in inflows from work or employee compensations. The latter has totaled to USD 110 million in 2003, being USD 22 million higher than in 2002. Residents' investments abroad – being portfolio investments, reserve investments and others, have generated interest income of USD 84 million.

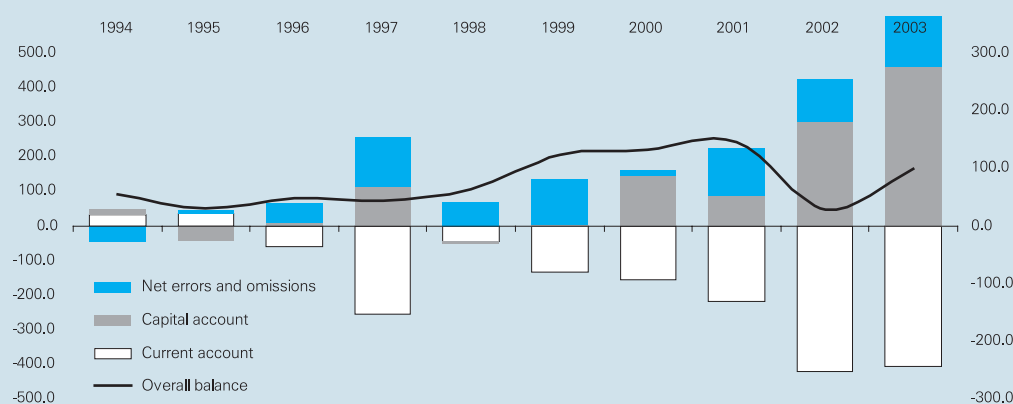
Current transfers have been shaped from remittances, showing similarity with the development in the previous years. These represent the main source for financing goods and services deficit and have been estimated at a total of USD 778 million for 2003 (23 per cent higher than in 2002.) However, bearing in mind the currencies in which these transfers occur, it could be argued that exchange rate effect has had a considerable impact on this item.

II.6.3 CAPITAL AND FINANCIAL ACCOUNT

Around 88 per cent of current deficit was financed by net capital inflows, which recorded a value of USD 360 million at the end of the year. This positive figure has been fed by capital transfers of USD 157 million – 29 per cent higher than a year ago – as well as positive balance of USD 202 million of financial account. Capital imports, being an outcome of attracting foreign direct investments and extension of long-term loans, have added USD 328 million to financial liabilities of Albania to the rest of the world. This amount is 22 per cent higher than a year ago.

In 2003 expansion of financial liabilities is presented in the form of foreign direct investments, credit lines, deposits of banking system in nonresident banks and institutions, as well as commercial loans.

Chart II.14 Balance of payments structure



In 2003 foreign direct investments are reckoned at USD 178 million or 32 per cent higher than in 2002. These capital flows have turned into a dominant factor in building up financial liabilities and in the performance of capital and financial transactions. They account for 54 per cent of positive balance of financial account.

Another important factor in adding up financial liabilities in 2003 relates to the extension of long term credits and soft credits from abroad, which have contributed to the foreign debt of Albania by USD 155.5 million. This debt included also the use of loans and credits of USD 11 million from IMF. The Albanian Government has already used a major part of these loans. The World Bank still appears to be the main financer of government through the International Development Agency (IDA). Foreign debt service in the form of payments of principal totaled to USD 43.6 million.

Liabilities as deposits of non-residents in our banking system have increased by 19 million USD in 2003 (2.2 times more than in 2002.) This outcome was the result of the exchange rate effect (12 million USD), given that 80 per cent of the deposits is in euro, 15 per cent in USD and 5 per cent in other currencies. Liabilities as commercial credit increased by USD 11 million or 64 per cent more than in the last year. The change was reflected also in the rise of imports during 2003.

Albania's financial claims to the rest of the world increased by 126 million USD or twice as much as in 2002. The major contribution has come from cash in foreign currency. Unlike the previous year when foreign currency held by the public decreased, this year it increased by USD 35 million.

At this point, the effect of foreign exchange rate needs to be mentioned. Of all foreign assets of the banking system in the country, only 28 per cent are in US currency, the rest are in euro (66 per cent), British pound (4 per cent) and Swiss franc (2 per cent).

Domestic deposits in the foreign banking system increased by the same extent as foreign assets in cash. In its composition as of end 2003, deposits in US dollar accounted for 52 per cent and those in euro for 46 per cent. The stock of financial assets classified as portfolio investments amounted to USD 142 million and it recorded an annual increase of USD 26 million.

II.6.4 FOREIGN RESERVES

The foreign assets proceeds, mainly the financial proceeds from foreign credit disbursements and credit utilization, influenced the foreign reserve growth by USD 99 million. By the end of 2003, the gross foreign reserves of the monetary authority amounted to USD 1025.6 million. This level of reserves is considered sufficient to cover 4.7 months of imports of goods and services.

¹⁷ E llogaritur si raport i vëllimit tregtar në mallra dhe shërbime ndaj PBB-së.

Chart II.15 Movements of Foreign Reserves in Months of Imports

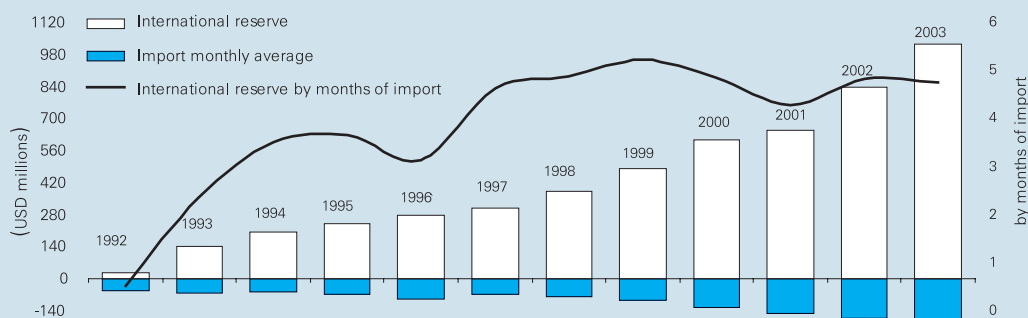


Table II.16 Balance of Payments (USD millions)

	1998	1999	2000	2001	2002	2003
Current account	-65.0	-132.9	-163.1	-217.9	-420.8	-406.7
Export of goods	208.0	275.1	255.4	304.6	330.2	447.2
Import of goods	-811.7	-937.9	-1,076.4	-1,331.6	-1,485.4	-1,783.5
Trade balance	-603.6	-662.8	-821.0	-1,027.0	-1,155.1	-1,336.3
Services: Credits	86.6	266.7	448.1	533.5	585.0	719.7
Services: Debits	-129.3	-165.4	-430.0	-444.2	-590.3	-802.4
Revenues: Credits	86.1	85.6	115.9	162.5	146.9	194.8
Revenues: Debits	-8.7	-10.3	-9.1	-13.4	-20.6	-24.4
Private transfers free of compensation	421.3	188.4	438.6	542.6	575.0	781.7
Public transfers free of compensation	82.6	165.0	94.4	28.1	38.2	60.3
Capital account	31.1	67.5	78.2	117.8	121.2	157.0
Financial account	16.0	36.8	182.5	109.0	206.9	202.0
Direct investments	45.0	41.2	143.0	207.3	135.0	178.0
Portfolio Investments	0.0	0.0	-25.0	-23.4	-36.8	-22.5
Other capitals*	-29.0	-4.4	64.5	-86.9	103.4	35.3
Net errors and omissions	69.4	131.3	15.0	136.1	121.3	147.4
General Balance	59.4	123.5	131.9	145.0	28.6	99.6
Reserves						
Foreign assets	-59.9	-123.6	-131.9	-145.0	-28.6	-99.6
Use of IMF credit and loans	7.9	20.9	19.3	12.0	5.3	11.1
To receive attention:						
Net reserves change	-75.9	-97.4	-130.5	-116.2	-109.9	-175.6
Change due to exchange rate movement	12.6	-26.2	-3.5	1.5	65.0	87.0

* The use of IMF credits and loans is not included

Source: Bank of Albania

II.7 FOREIGN RESERVE AND ITS ADMINISTRATION

The gross amount of the foreign exchange reserves met the USD 1.03 billion level in December 2003. During 2003 the foreign reserves grew by USD 186.62 million, or equal to 22 per cent. The factors that can be mentioned as the main contributor to the reserve growth are presented below:

- Disbursement of the loans extended by the International Monetary Fund, International Development Agency and other international institutions summing at USD 68.05 million;
- Purchase of foreign currency from commercial banks and Ministry of Finance amounting at USD 87.80 million;
- Required reserves sediment from commercial banks to Bank of Albania totaling USD 28.08 million dollars;
- Income from the investment of foreign reserves recorded USD 1.04 million higher than the respective figure last year.

The purchases of foreign currency from commercial banks were conducted in accordance with the general monetary policy framework. Alongside the foreign currency purchases from Ministry of Finance, they are considered as the main contributors to the growth of foreign exchange reserves. In addition, the 20 per cent Euro appreciation against the USA dollar, affected the gross reserve amount by USD 87 million.

On the other hand, the debits of foreign reserves marked USD 127.23 million, consisting of USD 83.65 million transfers ordered by Ministry of Finance and commercial banks and USD 43.57 million instalments of government foreign debt.

As concerns the regulatory framework of reserve administration, the Supervisory Council approval of the yearly amendments of the regulation on "Foreign Reserves Administration Policy and Methodology" must be mentioned. The periodical revision of this regulation aims at designing a more flexible administration of international reserves through introducing alternative investment ways. This year amendments, which were formulated referencing the best practices of international central banks, presented a new strategy of foreign reserve investments as well as a reorganization of the existing investment portfolios. Along with the active control structures and risk management procedures, the amended regulation is expected to improve the administration of foreign reserves through satisfying the predetermined objectives, increasing safety liquidity and investments performance.

CHAPTER III. MONETARY DEVELOPMENTS AND MONEY MARKETS

III.1 MONETARY PROGRAM AND THE QUANTITATIVE OBJECTIVES

The Bank of Albania monetary policy has been oriented towards inflation objective. In line with this policy, the Bank of Albania aims at overseeing the monetary conditions of economy, so that it can accomplish the medium term inflation objective. The projections of monetary developments are summarized in the annual monetary program framework. In this light, the monetary program defines the direction towards which the monetary indicators should move, in order to accomplish the primary objective of Bank of Albania. The monetary program is also a means that can control and evaluate the progress of monetary indicators and accordingly program necessary interventions.

In drafting the monetary program for 2003, the Bank of Albania have mainly consisted in the decreasing of the currency outside banks to money supply ratio and the reallocation of deposits towards longer maturities. Year 2003 was also characterized by a substantial difference between the Albanian ALL interest rate and those of foreign currencies, which contributed to domestic currency appreciation.

The Bank of Albania revised its monetary program in October 2003, in order to adjust it better to the country's macroeconomic developments. The increase of economy demand for assets brought about a change in the projections for money supply growth at the end of 2003, from 8.4 percent to 9.5 percent. At the same time, the forecast of the ratio of currency outside banks to M3 was decreased to 28.3 percent. The Bank of Albania also revised its projections of the banking system credit to the government as well as the composition of the growth of outstanding credit in foreign and domestic currency.

Table III.1 Aggregates vis-à-vis the program (ALL billion)

	Program	Current
Currency outside banks	126.5	125.2
ALL deposits	223.5	226.0
Foreign currency deposits	97.0	92.2
M1	144.5	142.0
M2	349.9	351.2
M3	446.9	443.4

The monetary indicators developments during 2003 have followed the monetary program's projections. The differences between the current values and those forecasted are minuscule. Some of the most important differences are:

- *Annual growth of money supply at the end of 2003 was 8.7 percent compared to 9.5 percent forecasted in the program.*

The annual growth of money supply under the monetary projections was caused by Albanian Lek appreciation during 2003. This appreciation has resulted in a lower value of foreign currency deposits when converted into domestic currency. The annual growth rate of foreign currency deposits was 6.6 percent compared to the forecasted 12.1 percent. The exchange rate effect has decreased the value of foreign currency deposits by 13.4 billion ALL.

- *Currency outside banks at the end of December was slightly below expectations, while the ALL deposits exceeded the monetary program forecast.*

Liquidity developments closely followed expectations, mainly due to the reduction of currency outside banks, while the monetary base and M1 aggregate stood below the monetary program projections.

The quantitative objectives of the Bank of Albania have been satisfied all along 2003.

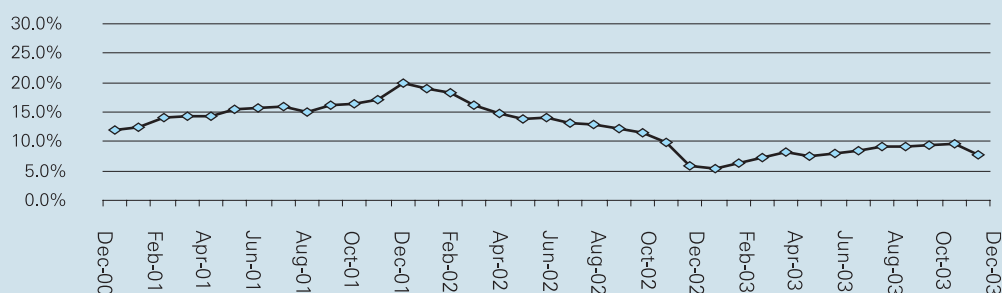
Table III.2 Quantitative objectives of the Bank of Albania

	Mar'03	Jun '03	Sep '03	Dec '03
Net foreign reserve objective (USD millions)				
Objective	560.6	582.2	576.2	583.2
Actual	596.2	607.3	614.3	673.9
Difference	35.6	25.2	38.2	90.7
Net domestic assets objective (ALL billions)				
Objective	97.1	98.1	89.1	93.1
Actual	76.5	68.8	73.3	68.5
Difference	-20.7	-29.4	-15.9	-24.6
Net credit to government objective (ALL billions)				
Objective	266.8	267.7	277.8	282.8
Actual	266.3	268.9	276.9	282.8
Difference	-0.5	1.2	-0.9	0.0

III.1 MONEY SUPPLY AND ITS COMPONENTS

In the course of 2003 the annual pace of money supply growth increased constantly, only to stabilize towards the end of the year. Due to the Bank of Albania's easing monetary policy, the money supply growth revisited its historical growth rate and stood at levels that assure a normal supply of money to economy.

Chart III.1 Annual growth rate performance of money supply

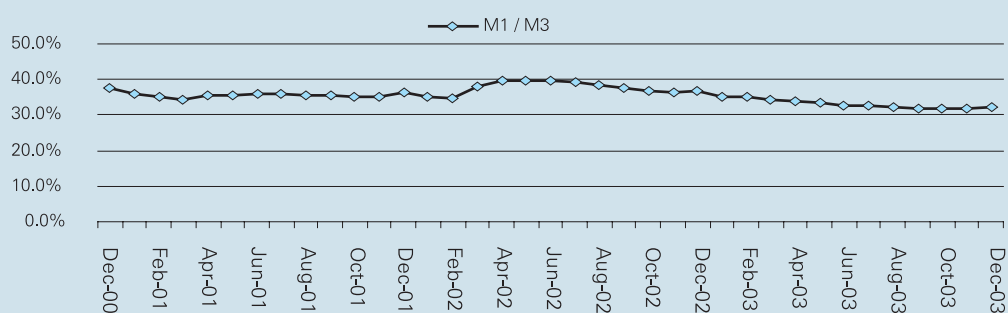


III.2.1 DEVELOPMENTS OF MONEY SUPPLY STRUCTURE

From the liquidity viewpoint, the money supply components have revealed changes that have mainly reflected a coming back to equilibrium from the structure distortion caused by deposit withdrawal of 2002.

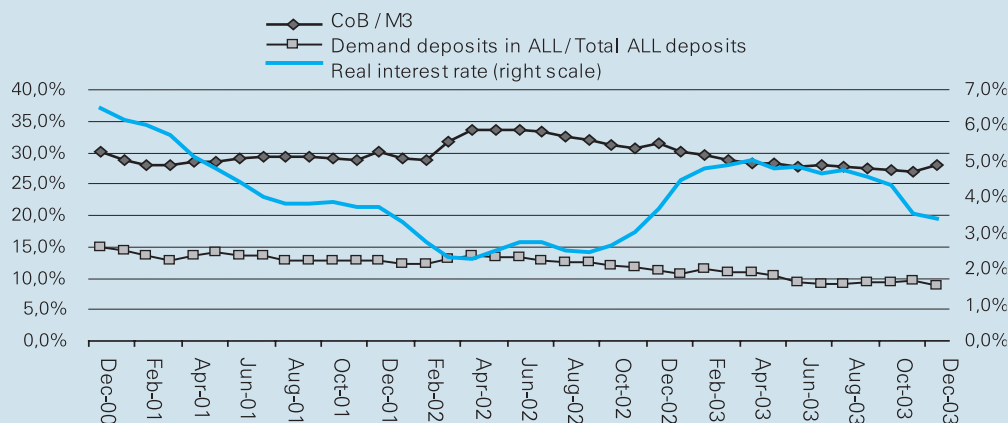
The most liquid monetary aggregate, M1, has shown negative growth throughout 2003. By year-end its annual growth rate reached -5.2 percent. Such developments have been determined by the progress of currency outside banks, which is its main component. During 2003 there was a substantial decrease of 3.5 percentage points of currency outside banks to money supply and this marked the lowest level of this indicator for the past four years.

Chart III.2 Time structure of money supply (M1/M3 rate)



The currency that returned to the system has favored ALL time deposits. By year-end the latter reached an annual growth of 19.1 per cent, a substantial rise compared to the past years. Due to this significant increase, the ALL time deposit was the component that contributed most to money supply growth.

Graph III.3 Time structure of money supply performance and real interest rates



The rather high real interest rates of ALL deposits have had a positive impact in shifting the money supply towards less liquid instruments. The annual average inflation rate falling trend has played an important role in the real interest rate trajectory throughout 2003.

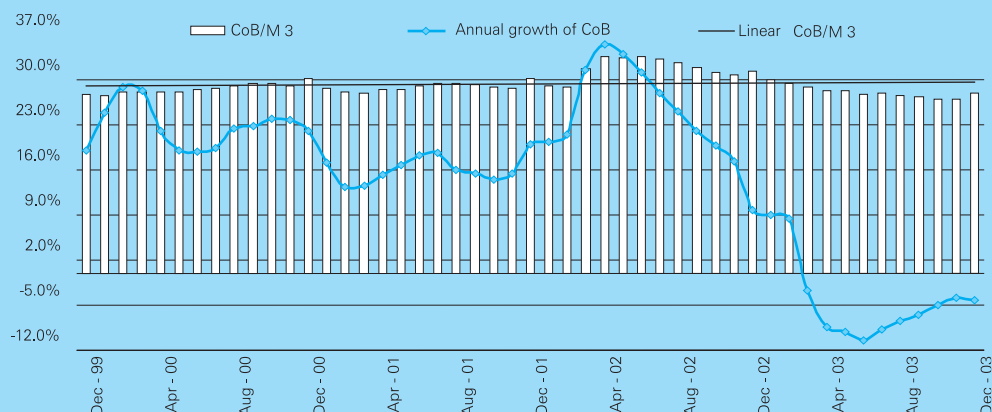
Box III.1 Main factors that influenced the unusual behavior of currency outside banks during 2003

During 2003 the currency outside banks has behaved differently compared to the previous years. At year-end it had decreased by approximately 5.6 billion ALL, which is equivalent to a decline of 4.3 per cent. This unusual behavior is explained by the re-establishment of equilibrium of the monetary aggregates following the massive withdrawal of deposits in March-April 2002.

The deposit withdrawal triggered a substantial increase of currency outside banks vis-à-vis money supply. The aforementioned ratio reflects a very important monetary condition: the structure of the portfolio of Albanian economy financial assets. The changes in this portfolio need to be gradual. They should reflect a new reality that takes the form of financial innovations or an increase of public confidence in the banking system. The growth of this ratio below historical growth levels was a consequence of a decrease of public confidence in the banking system due to speculative reasons. Accordingly, the second half of 2002 and 2003 saw a return of the currency outside banks to the system, which was associated with the decrease of the absolute amount of currency outside banks, as well as the decrease of the ratio of currency outside banks to money supply.

Once this was over, at the end of 2003 the ratio of currency outside banks to money supply was 27.9 per cent, close to the historical average level of the last four years (29.4 per cent). This ratio is 2.3 percentage points lower than the same period before the crisis.

Chart 1 Ratio of currency outside banks to M3 and its annual growth



Expectations for 2004 speak for an increase of currency outside banks. This is a normal phenomenon for a stabilized economy. The increase of money supply is spread among all of its components, nevertheless the focus of a central bank lies on preserving the liquidity structure, as well as the foreign currency structure of money supply. In this light, the 2004 projections argue for a relatively stable ratio of currency outside banks to M3, thus playing an important role in controlling inflationary pressures.

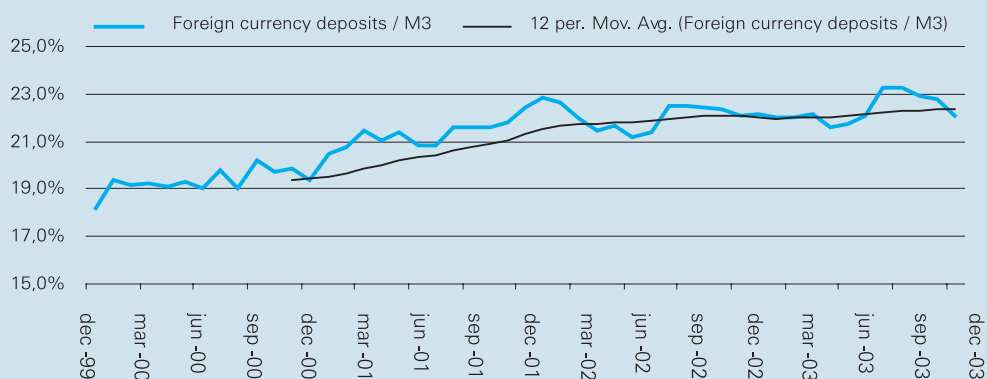
Nonetheless, in the future, a more active participation of commercial banks, which is expected to introduce new services (such as a widespread use of ATMs), an overall improvement of macroeconomic environment, a strengthening of fiscal discipline and the introduction of effective ways to fight fiscal evasion, will encourage a falling trend of this ratio.

III.2.2 DEVELOPMENTS IN FOREIGN CURRENCY STRUCTURE

Compared to the previous years, the contribution of foreign currency component to money supply growth has been smaller. In 2003 the annual growth of foreign currency deposits stood at about 12 per cent, as opposed to the last five years average of 18 per cent. The appreciation of ALL against foreign currencies has brought about a decrease of foreign currency deposits growth. Once the foreign exchange effect is removed, the annual growth of foreign currency deposits becomes 21.9 per cent.

The money supply structure has continued to shift towards the foreign currencies. However, the interest rate difference between ALL instruments and foreign currency ones has brought forward a public preference for ALL time deposits. Portfolio restructuring has contributed in the appreciation of ALL vis-à-vis foreign currencies during 2003. These factors have also smoothed the shifting of monetary assets towards foreign currencies in the second half of 2003 (see chart III.4).

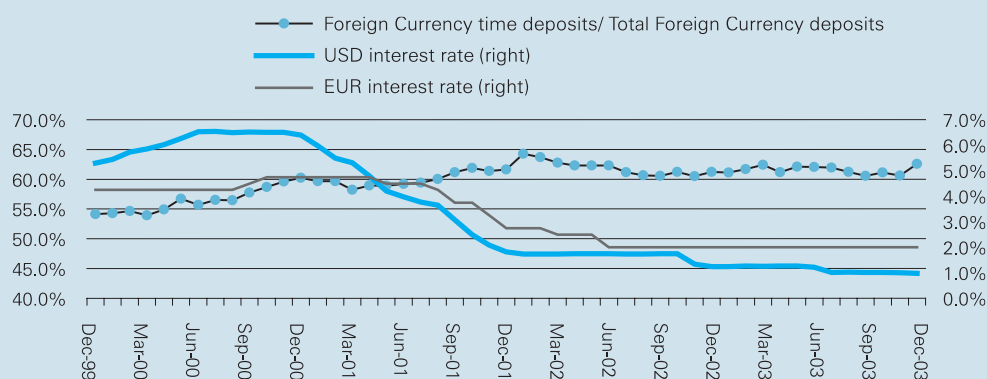
Graph III.4 Performance of foreign currency deposits to broad money ratio



In the future, the expectations speak for more balanced developments of the foreign currency structure of money supply. The expected crediting in domestic currency as a result of the involvement of the Savings Bank in this process will contribute to an increased weight of the domestic currency in the money supply.

The low levels of interest rates of USD and EUR deposits have not sufficed to prompt the public to deposit its savings in time deposits. This conclusion can be drawn from the chart below, where there is a clear break of the growing trend of the ratio of foreign currency time deposits to total foreign currency deposits.

Graph III.5 The ratio of foreign currency time deposits to total foreign currency deposits and to the EUR and USD interest rates



Box III.2 Survey on depositing and lending activity of commercial banks in 2003

Last year, the Bank of Albania organized two surveys as part of the efforts of being closer to the opinions of the commercial banks' experts on the main developments of the depositing and lending activities. Approximately 100 experts of all commercial banks from all cities where these banks exercise their activities were part of this survey. The response level was 95 per cent.

Deposit-collecting activity:

The surveys carried out in 2003 revealed that commercial banks believe there is an improvement in this activity compared to the previous six months. The main factors that positively impact on deposit-collecting activity are as follows: a growing public confidence in the banking system, high-quality service, as well as the high level of interest rates.

The interest rate difference between ALL deposits and foreign currency deposits has supported an increase of ALL deposits and has slowed down the growth of foreign currency deposits. The easing monetary policy of the Bank of Albania has lowered the ALL deposit interest rates. Commercial banks' experts think that the Bank of Albania policy has been effective in dealing with distortions and in increasing banking system efficiency.

Overall, the bankers were optimistic that deposit collecting would maintain this growing pace in the first half of 2004. The Savings Bank privatization will further increase the competition in the banking system.

Lending activity:

The survey on the lending activity of commercial banks during 2003 revealed that banks continue to prefer medium-size enterprises. However, the second half of the year showed a growing interest on crediting big enterprises. Banks stated that compared to their forecasts, lending stood at 92 per cent. The experts judge that a growing business demand for loans and a greater-than-forecasted level of deposit-collecting lay ground for a growing crediting activity that can exceed the initial forecasts. On the other hand, there are several obstacles to lending activity such as the legal restrictions that businesses face, their difficulties in attaining the needed collateral, as well as the malfunctioning of the mortgage offices.

The lending activity is expected to continue growing in the future, especially the lending to big businesses, where the trading sector businesses are preferred to the rest of the economy sectors. The high interest rate of domestic currency and the absence of valid crediting projects in ALL are the main reasons that will continue to favor lending in foreign currency. In a medium-term horizon it is believed that the privatization of the Savings Bank will change this preference.

In any case, expectations speak for an interest rate cut on both, the domestic and the foreign currency loans. Such a move will be based on central banks' decision for lower key interest rates, a growing confidence in the financial institutions, and an increasing competition among the commercial banks.

III.3 MONEY DEMAND

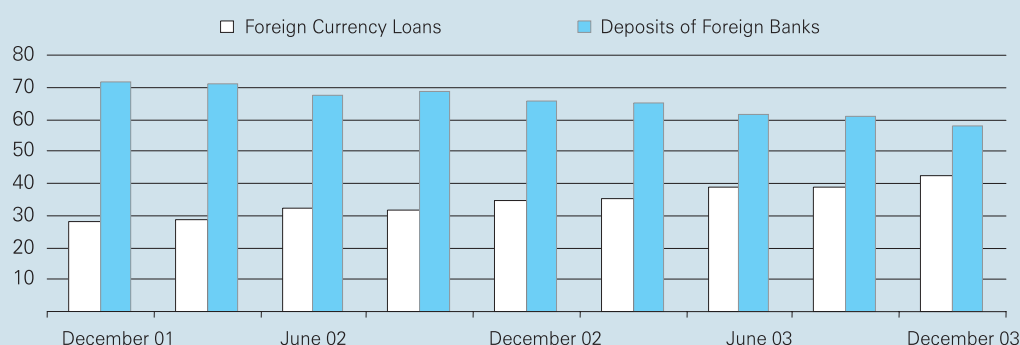
III.3.1 BANKING SYSTEM NET FOREIGN ASSETS

During 2003 the banking systems' foreign assets position has improved significantly, as the net foreign assets of the system grew by approximately USD 314 million. If stated in percentage, last year increase of net foreign assets was 26 per cent vis-à-vis an increase of 3.2 per cent in the previous year.

The Bank of Albania's USD 211.7 million increase of foreign reserve was the most important factor in the banking system's increase of net foreign reserves. It was the appreciation of the euro vis-à-vis the US dollar that contributed to the increase of the value of that part of foreign reserve that is invested in euro-denominated instruments. Thus the appreciation of euro played a very important role in the increase of banking system net foreign assets. Once the exchange rate effect is excluded, the foreign reserve of the Bank of Albania increase is USD 123 million. Another important factor that contributed to foreign reserve increase were the Bank of Albania interventions that in 2003 consisted of purchases of foreign currency that amounted to USD 87.8 million. The interventions, of which 56 per cent were purchases from commercial banks, while the rest were purchases from the Ministry of Finance and others, were concentrated in the three first quarters of the last year.

Commercial banks have demonstrated a slower growth rate of net foreign assets. In 2003 their net foreign assets increased by USD 102.7 million, which is equivalent to a growth rate of 20.9 per cent. The foreign currency deposits are the main source of commercial banks' net foreign assets. However, year 2003 has marked an increased efficiency of commercial banks in channeling their foreign currency funds towards lending to economy.

Chart III.6 Foreign currency loans and deposits of foreign banks as a percentage of banking system deposits



Box III.3 Bank of Albania foreign reserve

There are several reasons why central banks hold and use foreign reserves. Usually, foreign reserves are held to service foreign trade needs and to maintain the stability of the domestic currency. In the case of free-floating exchange rate regimes, which is the case of Albania, guarding the level of foreign reserves is not one of the central bank's primary objectives. Thus, foreign reserves are held and administrated in order to help in smoothing out short-term foreign exchange excess volatility.

Table 1 Bank of Albania gross foreign reserve (in million USD)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Foreign reserve	490.3	547.6	566.7	642.8	520.8	642.5	763.5	852.1	1025.6
-in months of imports	7.5	6.2	8.5	8.2	5.6	5.1	5.1	4.9	4.7

Overall, the foreign reserve of the Bank of Albania displays a growing trend. Once 1999 is excluded, the growth rate of 1995-2003 is 13.7 per cent. The foreign reserve reached USD 1.025 billion at the end of 2003. The foreign reserve increase is mainly the outcome of the increasing returns of its investment, the Bank of Albania interventions in the domestic foreign exchange market, international institution inflows of foreign currency that are used for financing Albanian government projects, as well as from the increase of the value of euro investments when converted into US dollars as a consequence of euro appreciation.

Measuring the foreign reserve in months of imports yields an indicator of the ability to meet the demand for imports (goods and services) in the event of unexpected financial crisis. This indicator has been in satisfactory levels.

III.3.2 NET CREDIT TO GOVERNMENT

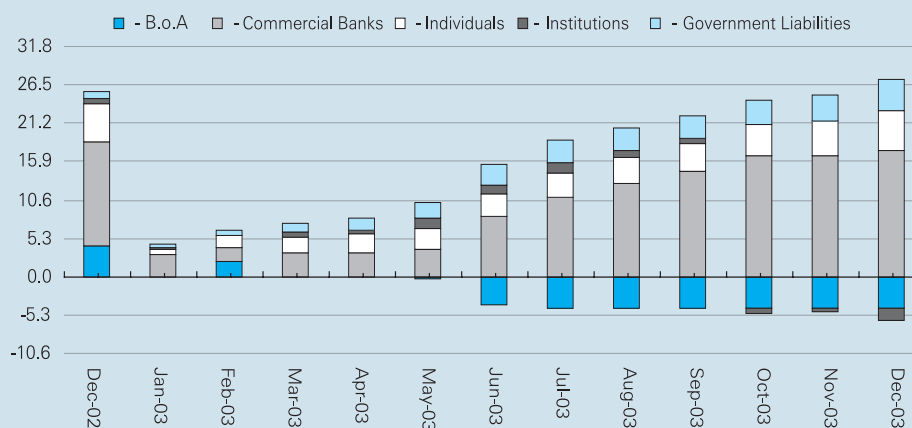
The internal financing of the budget deficit stood at 2.7 per cent of GDP, a level that marks the lowest in the past six years. The banking system was the main internal source of domestic financing with over 90 per cent. Banks have financed the budget deficit through purchases of one-year treasury bills and two-year treasury notes.

Table III.3 Budget deficit domestic financing as a percentage of GDP

	1998	1999	2000	2001	2002	2003
Domestic financing/GDP	7.2	5.6	3.2	3.0	3.2	2.7

In the course of last year the commercial banks increased their treasury bill portfolios by 17.5 billion ALL, while the Bank of Albania t-bills portfolio decreased by 4 billion ALL. The public has displayed an increasing interest in investing in t-bills and has increased its portfolio holdings by 5.4 billion ALL, while institutions' portfolio holdings decreased by 1.7 billion ALL.

Chart III.7 Gross internal financing of the budget deficit (2003, ALL billions)



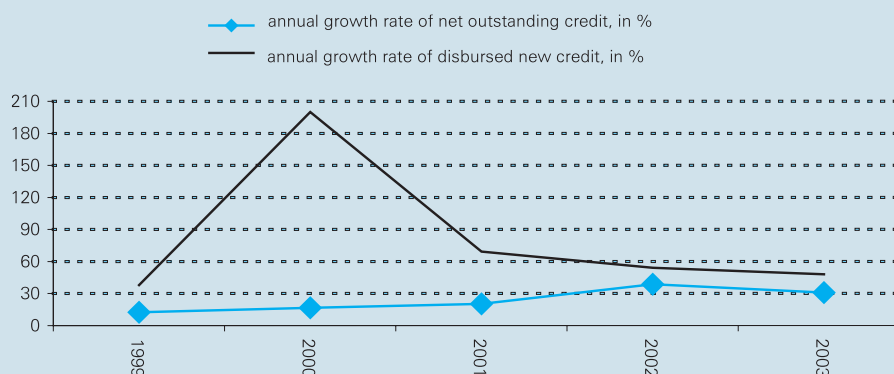
Commercial banks have purchased two-year treasury notes. The Albanian government issued two-year treasury notes worth 4.2 billion ALL during 2003. Two-year treasury notes were first introduced in October 2002.

III.3.3 CLAIMS ON PRIVATE SECTOR

Last year saw remarkable improvements with regard to banking financing of economy through loans. The outstanding credit increased by 11.9 billion ALL, thus standing at 92 percent of the amount forecasted in the monetary program. The aforementioned crediting of the private sector makes up 37.5 percent of the total increase of broad money. New credit increased by 48 percent (equivalent to an increase of 92.6 billion ALL) compared to the previous year. Had the ALL not appreciated last year, new credit would have increased by 100.1 billion ALL.

A greater crediting of economy in foreign currency makes the growth of outstanding credit vulnerable to exchange rate movements. The appreciation of ALL against foreign currencies during 2003 has brought about a decrease of 5.3 billion ALL of outstanding credit. Excluding the exchange rate effect, the outstanding credit grew 17.2 billion ALL, thus exceeding the monetary program projections by 33 per cent.

Chart III.8 Outstanding credit and new credit annual growth rate



The monetary policy of the Bank of Albania has contributed to building a favorable climate towards businesses' crediting via keeping the inflation within acceptable limits. The Bank of Albania easing monetary policy was followed by lower interest rates for loans denominated in ALL. Furthermore, the improvement of the banks' liquidity helped in lowering their mediation costs by lowering the loan-deposit spread.

Table III.4 Main indicators of claims on private sector

	2001	2002	Q-1 '03	Q-2 '03	Q-3 '03	Q-4 '03
Domestic credit (as % of M3)	67.5	70.8	71.2	71.4	70.9	71.5
-Loans to government (as % of M3)	60.4	61.5	61.6	61.0	60.1	60.2
-Loans to private sector (as % of M3)	7.1	9.3	9.6	10.4	10.8	11.3
Credit to economy (as % of GDP)	4.7	5.9	5.6	6.0	6.4	6.8
Credit to economy (as % of assets)	8.9	11.5	11.6	12.5	12.9	13.7
Ratio of loans/deposits (in %)	10.2	13.5	13.5	14.5	14.9	15.6

The outstanding credit of the private sector reached 50.6 billion ALL by the end of 2003. Its portfolio structure revealed a shifting towards medium and long-term loans. The medium and long-term loans stood at 54 percent of total loans, thus increasing 8.5 percentage points compared to the previous year. This shows that commercial banks are becoming more inclined towards financing longer-term projects, which ultimately has positive effects on the economy.

At the end of 2003 the loan currency portfolio structure shows that 20 percent of the given loans are denominated in ALL, thus leaving an 80 percent denominated in foreign currency, as opposed to the previous year, where the respective percentages were 21 and 79.

Table III.5 Outstanding credit indicators (in percentage)

	Year 2001	Year 2002	Q-1	Q-2	Q-3	Q-4
Short-term loans	61.3	53.8	53.2	53.4	51.4	45.5
Medium-term loans	26.5	30.1	30.4	30.7	30.5	37.0
Long-term loans	12.2	16.1	16.4	15.9	18.1	17.5
Private sector	98.0	99.8	99.8	100.0	100.0	100.0
Public sector	2.0	0.2	0.2	0.0	0.00	0.0
Lek	18.3	21.3	21.5	21.2	19.3	19.6
Foreign currency	81.7	73.7	78.5	78.8	80.7	80.4
Outstanding credit (in billion lek)	27.9	38.7	40.4	44.5	48.0	50.6

OUTSTANDING CREDIT STRUCTURE ACCORDING TO ECONOMY SECTORS

Trade sector remains the favorite crediting sector by commercial banks. At the end of 2003 this sector continues to have the greatest weight of the banking system loan portfolio. Agricultural sector is still the least preferred as far as crediting is concerned. However, last year saw some improvements towards the crediting of this sector, as well as of the refining industry sector. There is also an increase in crediting of public purchases of real estate properties.

Table III.6 Outstanding credit according to economy sectors (in percentage)

Economy sectors	Year	Year	Year 2003			
	2001	2002	Q I	Q II	Q III	Q IV
1 Agriculture, hunting and agro-forestry	1.0	0.8	1.1	1.2	1.3	1
2 Fishing	0.1	0.2	0.2	0.2	0.2	0
3 Mining and quarrying	1.6	0.2	0.2	0.2	0.2	1
4 Manufacturing industry	19.5	17.0	14.9	16.0	17.1	17
5 Electricity, gas and water production and distribution	3.0	3.3	3.1	2.8	3.1	3
6 Construction	12.5	8.6	8.1	8.4	9.1	10
7 Trade, automobile and home appliances repairing	41.3	40.4	40.5	38.4	35.9	34
8 Hotels and restaurants	4.3	6.0	6.3	6.2	6.2	6
9 Transport and telecommunication	4.6	2.4	2.1	1.8	1.8	1
10 Financial activities	0.1	-	0.0	0.0	0.0	0
11 Real estate	6.3	9.1	5.6	10.2	12.5	13
12 Health and social activities	1.2	0.5	0.5	0.5	0.5	0
13 Social, personal and collective services	3.3	4.2	7.8	7.0	8.1	8
14 Other	1.2	7.3	9.5	7.1	6.1	4
Total	100	100	100	100	100	100

NEW LOANS (2003)

During 2003 the monthly average level of commercial banks' new extended loans was 7.7 billion ALL, while December was the month that registered the highest level with 14.4 billion ALL. The new loan maturity structure reveals that short-term loans make up 68 per cent of the total, while with regard to currency composition 67 per cent of the new loans are denominated in foreign currency. Loans denominated in foreign currency dominate the credit portfolio, as well as the total of new loans due to the differences between the interest rates of ALL and foreign currency loans. This difference still favors foreign currency denominated loans. However, it is following a declining trend, thus boosting the appeal of ALL-denominated loans.

The credit extended last year was heavily oriented towards the trade sector (56 per cent), manufacturing industry (11 per cent) and for household purchases of real estate (8 per cent)

Table III.7 New credit (in billion ALL)

	Year 2001	Year 2002	Year 2003	Year 2003			
				Q I	Q II	Q III	Q IV
Short-term loans	27.6	44.7	63.1	11.6	17.5	15.6	18.3
Medium-term loans	10.4	13.0	22.2	4.3	5.6	4.2	8.0
Long-term loan	2.6	4.8	7.4	1.5	1.5	1.8	2.6
Public sector	0.5	0.06	0.04	0.05	0.0	0.0	0.0
Private sector	40.1	62.5	92.6	17.4	24.6	21.6	28.9
ALL	10.0	20.8	30.8	7.1	8.0	7.4	8.3
Foreign currency	30.6	41.8	61.8	10.4	16.6	14.2	20.6
New loans (ALL billions)	40.6	62.6	92.6	17.5	24.6	21.6	28.9

Box III.4 Concentration of bank lending market (2003)

In the last few years, the competition in the Albanian banking system has been increasing. The presence and growing number of private banks has been associated with the diminishing of monopolies in the Albanian banking system.

During 2003 the concentration of lending market has been dissipating as the number of banks has been increasing. In the past year, the Herfindahl index, which measures the concentration of several indicators of the bank lending market has been pursuing a falling trend. The areas that show more of a fall of concentration in the market are lek denominated loans and long-term loans, as longer-term maturity loans and a greater number of banks have been involved.

Table 1 Herfindahl index for some outstanding credit indicators

	Total credit	Short-term credit	Medium-term credit	Long-term credit	ALL credit	Foreign currency credit	Perfect competition (1/ no. of banks)
December '00	0.23	0.28	0.18	0.44	0.72	0.28	0.08
December '01	0.21	0.31	0.18	0.21	0.22	0.22	0.08
December '02	0.17	0.32	0.17	0.15	0.34	0.17	0.08
March '03	0.17	0.32	0.17	0.13	0.33	0.16	0.08
June '03	0.17	0.29	0.19	0.14	0.30	0.16	0.07
September '03	0.15	0.26	0.19	0.13	0.24	0.14	0.07
December 2003	0.15	0.25	0.17	0.13	0.21	0.14	0.07

The new extended credit of the past three years has been accompanied with a high growth rate. However, even though the number of banks has been increasing and there have been improvements in the bank lending market, four banks still dominate the market. If compared to the previous year (2002), these four banks, the most active in this market, show a 2-percentage point decrease of their activity in the lending market. Additionally, compared to 2002 there has been a decrease of the indicators of concentration of new short-term loans, as well as of lek denominated loans.

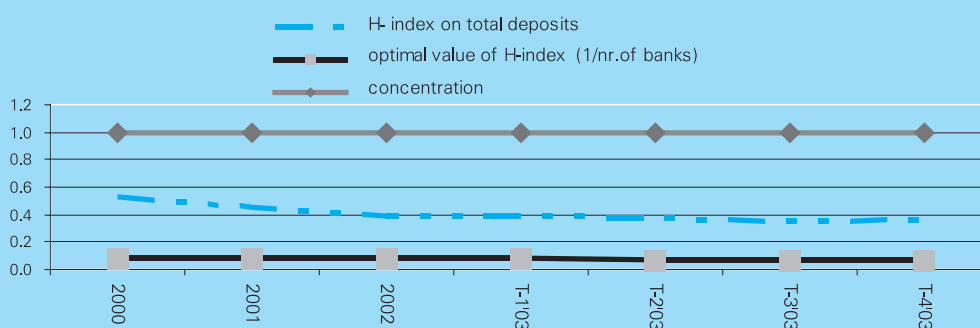
Table 2 The N index, in percentage (the weight of four most active banks in the bank lending market)

Period	Total credit	Short-term credit	Medium-term credit	Long-term credit	Private sector credit	Lek-denominated credit	Foreign currency credit
December'00	83	81	90	51	83	90	81
December '01	83	83	87	72	84	92	81
December '02	82	85	75	54	82	94	74
March '03	81	84	85	60	81	94	72
June'03	79	83	75	47	79	94	71
September'03	80	84	77	54	80	93	73
December '03	80	83	79	57	80	93	74

Box. III.5 Deposit concentration (2003)

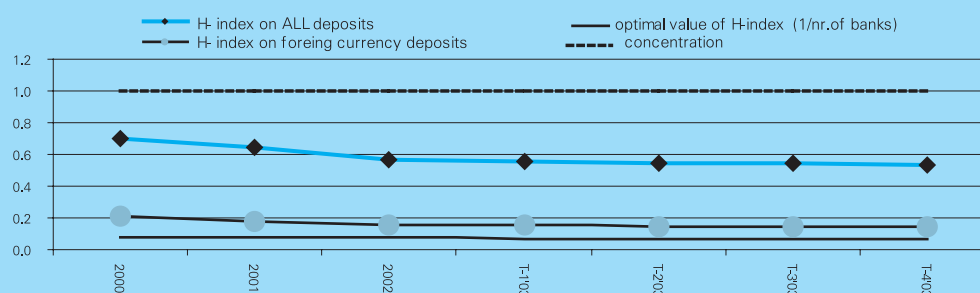
The falling trend of the concentration in the deposit-collecting market continued during 2003. This can be explained by the growing number of banks, as well as by the growing number of branches of the existing banks.

Chart 1 Herfindahl index of the banking system deposits



The indicators of the lek deposits paint a different picture, revealing high concentration, with the Savings Bank maintaining its dominating position in the deposit-collecting activity in 2003. On the other hand, the foreign currency does not show symptoms of concentration and is gradually transforming to a quasi-perfect competition market.

Chart 2 Herfindahl index of the ALL and foreign currency deposits



III.4 FOREIGN EXCHANGE MARKET (2003)

Last year saw an appreciation of ALL, which compared to the end of 2002 strengthened 20.85 per cent against the US dollar and 3.60 per cent against the euro.

The main reason behind the ALL appreciation is the substantial difference between ALL and foreign currency instruments' interest rate in an environment of low inflation within the BoA targeted band. The increase of imports positively influenced the demand for foreign currency, while its supply sufficed to satisfy the demand and bring about the appreciation of the domestic currency.

From the very beginning of last year, a strengthening trend of ALL was in place in a period that traditionally has favored the depreciation of domestic currency. At the same time, the significant depreciation of US dollar in the international market was having a positive effect on the exchange rate volatility in the domestic market. Being that the US dollar is a psychologically important currency, the Bank of Albania decided to intervene in the domestic foreign exchange market. Its interventions were in line with its easing monetary policy. The Bank of Albania interventions were concentrated mainly in the first half of the year. All of the BoA interventions in 2003 consisted in purchases of foreign currency, thus decreasing its supply and increasing the supply of ALL, which ultimately resulted in lower depreciating pressures on the foreign currencies.

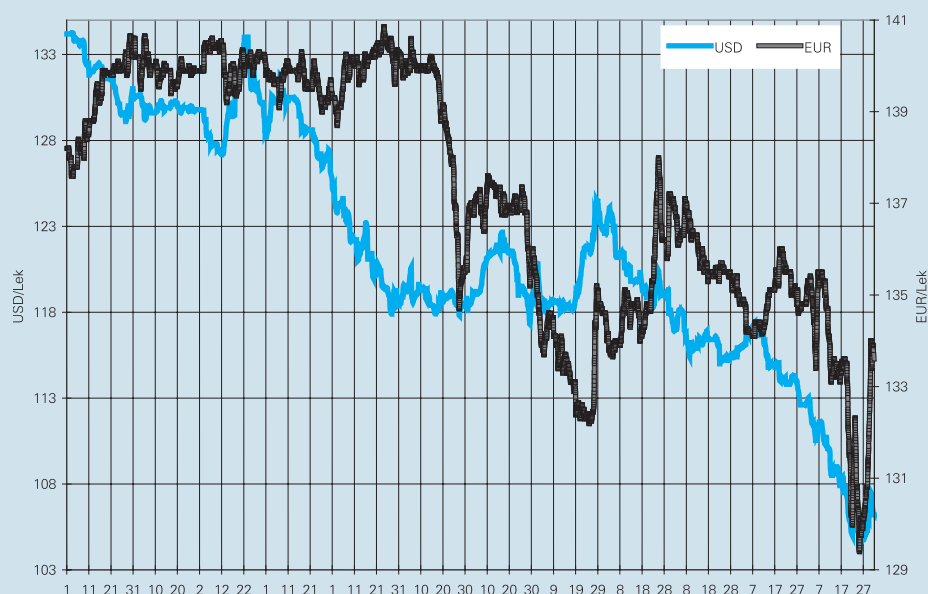
The second half of the year witnessed a lower presence of the Bank of Albania in the domestic foreign exchange market. This period saw a higher appreciation of ALL against euro and also a higher volatility of euro/ALL. The European currency tends to be less volatile than the US dollar, due to growing importance of euro in the domestic currency. The euro is growing to have a wider use, since it is the main currency of immigrant remittances, which are the main source of the foreign currency inflow, and also of import payments, as long as Albanian imports originate mostly from euro area countries.

In the second half of the year the interventions of the Bank of Albania were concentrated mostly in the periods that the ALL traditionally appreciates, such as the months of August and December. The purchases of foreign currency in August amounted to USD 3.0 million, while the less aggressive intervention in December (where the BoA purchased USD 3.3 million) brought the main currencies to new lows for 2003. The closing rates of the euro and US dollar for 2003 were respectively 133.6 ALL and 106.2 ALL.

Table III.8 Intervention of the Bank of Albania in the domestic foreign currency market (2003, by quarters)

	Total (USD thousands)	%USD	Average exchange rate	% EUR	Average exchange rate
Q1	28,338	100	129.89	0	-
Q2	11,326	49.27	124.17	50.73	140.52
Q3	6,596	3.24	121.45	96.76	134.90
Q4	3,346	0	-	100	132.45

Chart III.9 EUR/ALL and USD/ALL (2003)



III.5 MONETARY POLICY INSTRUMENTS

During 2003 the Bank of Albania has followed an easing monetary policy. The decreasing trend of key interest rate has been in the same direction with the monetary policy of the majority of the countries of the Balkan region and of the euro area countries.

Most of last year witnessed an application of the monetary policy in a banking environment of excess liquidity. Consequently, the Bank of Albania operations aimed at withdrawing liquidity from the market. Indirect instruments were used to fulfill the monetary policy objective. The main instruments used were one-week, one-month and three-month repurchase agreements, as well as outright transactions.

These instruments were employed based on the specific conditions in the money market. Meanwhile, there have been regulation-related improvements of various instruments, such as on the calculation and remuneration of the required reserve and on the interest rate of overnight deposit placed with the Bank of Albania.

Table III.9 Type of one-week repurchase agreement auction used in 2003

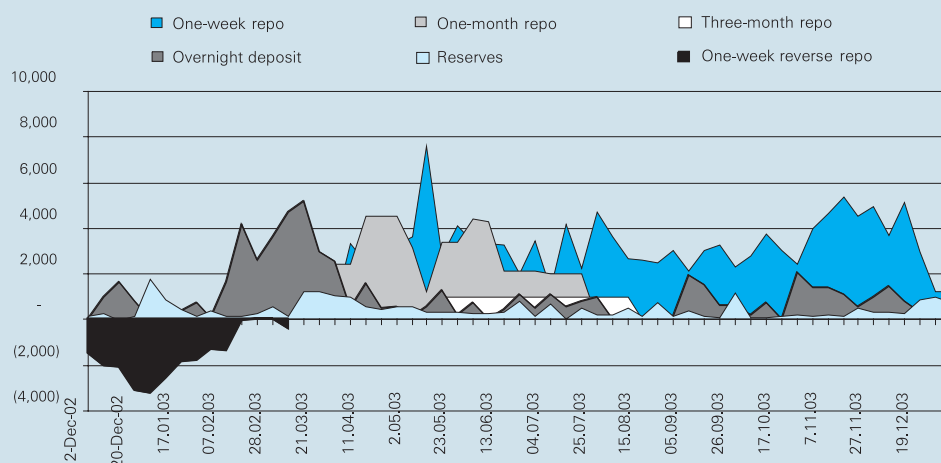
	Fixed-price r/repo	Fixed-price repo	Fixed-price repo	Fixed-price repo	Fixed- price repo	Variable- price repo
Period	1 Jan – 9 Mar	20 mar -1 may	2 May – 16 July	17 July – 5 Nov	6 Nov –17 Dec	18 Dec -30 Dec
Key interest rate	8.5%	8.5%	8%	7.5%	7.0%	7.0%

III.5.1 REPURCHASE AGREEMENT AUCTIONS

In the first quarter of 2003 the Bank of Albania continued to inject liquidity in the market through reverse repo auctions. The deposits had started to return in the system towards the end of 2002, thus triggering an improvement of liquidity in the system. In order for this process to continue, the Bank of Albania operated with one-week fixed price reverse repurchase agreement auction. The same auction type was used until March 2003, injecting an average of ALL 1.6 billion on a weekly basis.

The Bank of Albania changed the instruments used, once there was a stable improvement of the banking system liquidity and a curbing of the increasing trend of the t-bills yield. The interventions until the end of the last year constituted in withdrawing of liquidity through repo auctions.

Chart III.10 Banking system liquidity during 2003



The weekly repo auctions consisted mainly of fixed price auctions. They withdrew an average of ALL 3.2 billion per week, as opposed to an average of ALL 2.3 billion that were injected through reverse repo auctions the previous year.

In the last weeks of December the Bank of Albania changed the type of the auction employed, intervening through variable price and fixed amount auctions, thus giving the banks the possibility to decide the interest rate.

III.5.2 STRUCTURAL INSTRUMENTS

During the liquidity management process in 2003, the Bank of Albania has employed structural operations, such as one-month, three-month repo auctions and outright sales.

In 2003 there were 11 one-month repo auctions, two of which did not draw the attention of any of the banks. These interventions were carried out in the period of March-July and later

on in November with amounts that varied from 1 - 3 billion ALL. In the meantime, banks offered amounts that varied in much narrower ranges from 0.1 to 2.4 billion ALL.

The three-month repo auctions were limited to one occasion, in May of last year, and amounted to approximately ALL 1 billion.

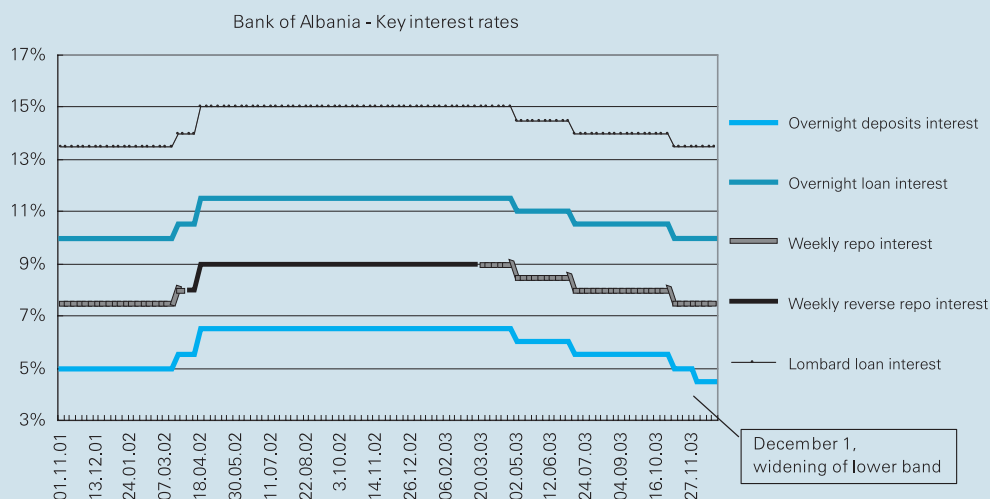
The Bank of Albania organized 4 structural (irreversible liquidity withdrawal) auctions that consisted of outright sales of t-bills in the months of June, July and September of 2003. The amount that the BoA withdrew adds up to approximately ALL 4 billion.

III.5.3 STANDING FACILITIES

The banks have been more active in employing the *overnight deposit* instrument due to the improvement of their liquidity situation. They placed overnight deposits that amount to an average of ALL 1.1 billion as opposed to an average of ALL 0.5 billion in 2002.

In December 2003 the Bank of Albania increased by 0.5 percentage points the difference between the overnight deposit interest rate and the repo rate. This change aimed at drawing the banks' interest towards managing their liquidity in the market. On the other hand, the upper limit – the difference between the overnight loan rate and the repo rate- is unchanged.

Chart III 1.1 Interest rate of instruments employed by the Bank of Albania



The *overnight loan* was rarely used during 2003, while in the previous year it was widely employed as a standing facility in order to deal with the liquidity shortage. In 2003 its average use amounted to ALL 0.03 billion as opposed to an average of ALL 2.1 billion in 2002. The Lombard loan was never employed in 2003.

III.5.4 IMPROVEMENTS OF THE BANK OF ALBANIA OPERATIONAL FRAMEWORK IN 2003

Last year marked significant improvements of the *required reserve* instrument. The improvements of its regulation in March 2003 have drawn this instrument's structure and functioning closer to that of the European Central Bank. These changes consisted in:

- Determining the required reserve base based on the data of the commercial banks' monthly balance sheet;
- Applying the monthly averaging system and placing the mobilization of the required reserve on a monthly basis;
- Changing the period of the reserve holding, thus bringing it closer to the standards of the European Central Bank;
- Calculating the remuneration of the required reserve in lek based on the key interest rate;
- Bringing closer the measures to be taken in the event of non-compliance with those employed by the European Central Bank;
- Increasing the remuneration of the required reserve from 50 per cent to 70 per cent of the key interest rate for the lek required reserve and euribor and libor for the foreign currency one;
- Increasing the limit of its employment from 5 per cent to 20 per cent.

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These percentages and the rate of the required reserve will continue to draw the attention of the Bank of Albania, which will assess the need to change them. They remain the main challenge that Bank of Albania faces in its process of bringing the required reserve instrument closer to the model provided by the European Central Bank.

Additionally, the Bank of Albania has made improvements on the regulation of the collateral that it uses in its operations. These improvements largely consist in the method used for assessing the collateral and aim at increasing the efficiency of the Bank of Albania operational framework. The measures taken aim at reducing the market and credit risk that is involved in the crediting operations and also sanction the administrative measures to be taken in the event the collateral requirements are not fully met.

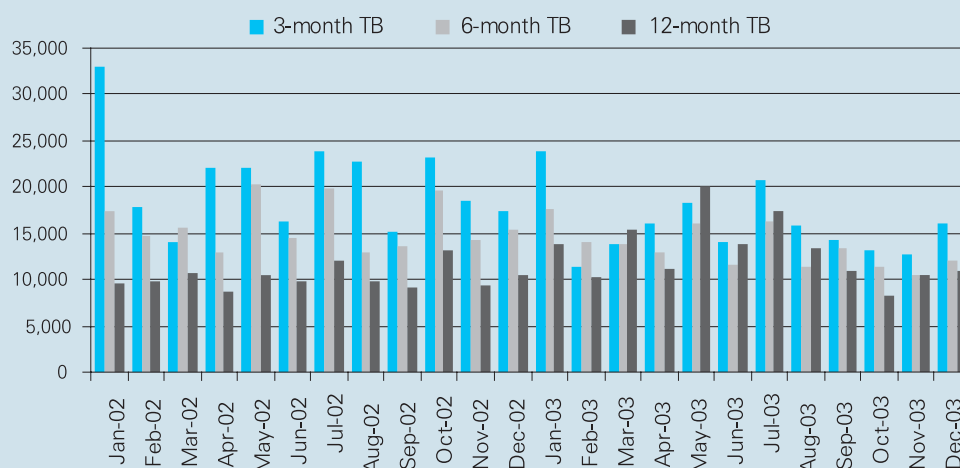
III.6 FINANCIAL MARKETS

Owing to the systems' liquidity excess, borrowing in the *inter-bank market* even though frequent, has been employed to meet short-term (mostly daily) needs. Daily transaction have averaged a total of ALL 0.5 billion compared to an approximate average of ALL 1 billion in 2002.

In the *primary market*, the government demand for monetary assets has been met mainly by commercial banks and households. The participants' supply in the primary market has been often higher than the amount issued by the Ministry of Finance, especially in the second half of 2003. This has positively influenced the constant decline of the t-bills yield.

Banks demanded mostly 12-month t-bills. In 2003 the weight of the 12-month t-bills issued by the government increased to 31 per cent of the total from 22 per cent in 2002.

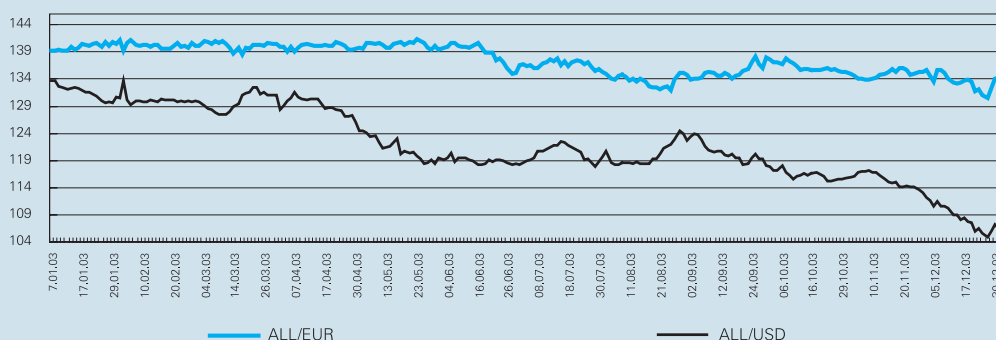
Chart III.12 Amount of Treasury bills issued by the government.



The government also issued two-year Treasury notes on a monthly basis with amounts varying from 300 to 500 million ALL. The interest rate for this notes has declined gradually along 2003 and by the end of December it reached 10.2 per cent compared to 14.1 per cent in December 2002.

In the domestic foreign exchange market the lek has appreciated substantially against the US dollar, especially during the second half of the year. The appreciation trend has been positively influenced by the weakening of the US dollar in the international market. Bank of Albania intervened in the domestic *foreign exchange market*, aiming at stabilizing the exchange rate of lek to other currencies. In the first quarter of 2003 the interventions aimed at reducing the supply of the US dollar, while in the period of May-August and in December they sought to reduce the supply of euro. In these events the fluctuations of domestic currency vis-à-vis foreign currencies (euro and US dollar) have been the outcome of immigrant remittances during vacations.

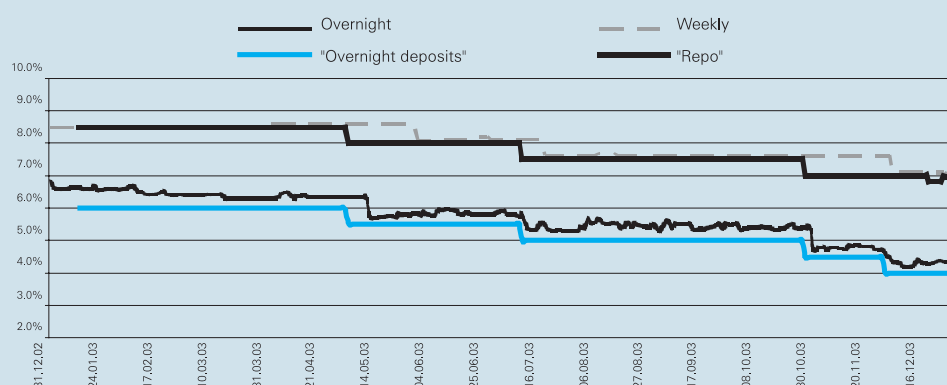
Chart III.13 ALL exchange rate against EUR and USD



III.7 INTEREST RATES

Interest rates have displayed a falling trend across all markets, thus reflecting the easing monetary policy of the Bank of Albania. By the end of 2003 the interest rate of overnight transactions in the inter-bank market reached 3.92 per cent, almost half of the level it stood at the same period last year. The interest rate in the inter-bank market was influenced not only by the key interest rate cut, but also the cut of the interest rate of the overnight deposit in the beginning of December.

Chart III.14 Inter-bank interest rates



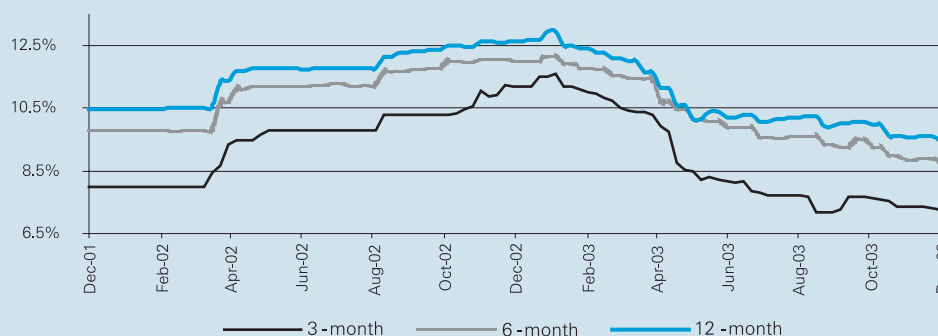
The treasury bill yield almost reached the same level it stood at prior to the liquidity crisis. The three-month t-bills yield has decreased by 3.85 percentage points, thus revealing the highest decline of all maturities. The yield for t-bills of this maturity fell significantly after the very first easing signal that the central bank sent to the markets, while the yield of the other maturities displayed more uniform changes. The growing demand of commercial banks for treasury bills has been another factor behind the decreasing yield of the t-bills.

Table III.10 Changes in T-bills yield

Treasury Bills	December 2002	Percentage point changes compared to December 2002			
	Dhjetor 2002	May 2003 ¹			May 2003 ²
3-month	11%	-2.45	-3.4	-3.57	-3.87
6-month	12%	-1.52	-2.1	-2.78	-3.25
12-month	13%	-2.02	-2.4	-2.62	-3.13

¹ The Bank of Albania signal is given at the end of April 2003.

Chart III.16 Primary market interest rates according to maturities



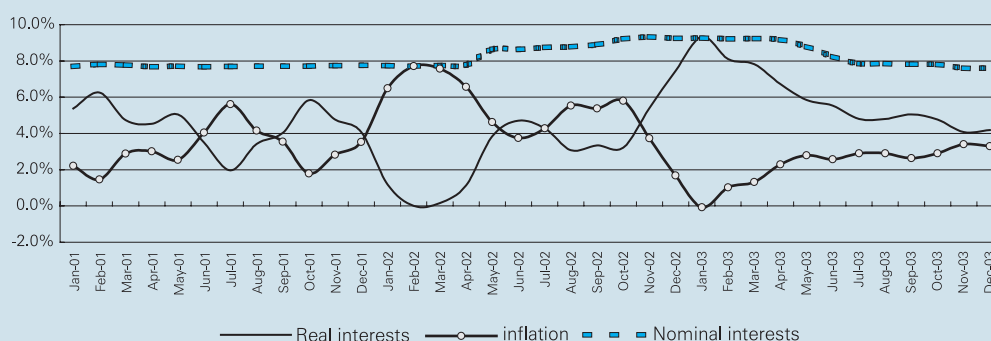
The interest rate of the deposits and loans have been falling all along 2003, while this decrease has been reflected in the decrease of the banking system mediation cost² from 7.9 percent in the end of 2002 to 5.05 percentage points at the end of 2003. This is the lowest historical value of this indicator.

Table III.11 Changes of the interest rate of deposits and loans

Deposits	December 2002 (in %)	Change to December 2002 in pp			
		May 2003	July 2003	Nov 2003	Dec 2003
3-month	9.25	-0.45	-1.4	-1.64	-1.63
6-month	8.89	-0.59	-1.28	-1.79	-1.82
12-month	7.98	-0.97	-1.74	-2.47	-2.49
Loans					
0- 6 month	14.63	-0.89	-1.03	-0.83	-2.82
6 month-1 year	15.98	-3.82	-4.82	-4.93	-5.46
1- 3 years	17.88	2.20	1.16	0.96	2.45
> 3 years	17.71	-5.12	-3.05	-3.88	-2.01

The falling trend of the nominal interest rate has positively affected the decrease of the real interest rate. However, the real interest rate is still in positive levels.

Chart III.16 Real and nominal interest rates of one-year ALL deposits

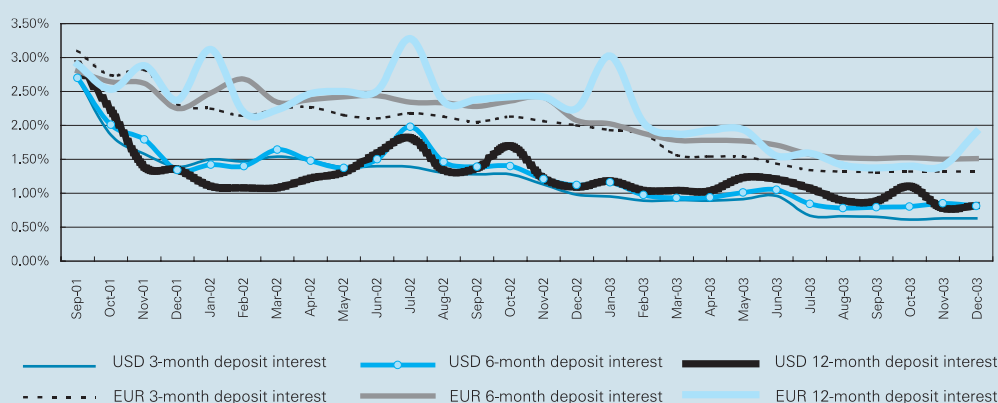


² The difference between the loan and deposit interest rate.

Despite the fluctuation of real interest rates, in the second half of 2003 this indicator was stable at an average rate of 4 per cent.

The foreign currency deposit interest rates have revealed a falling trend due to the interest rate cuts of international central banks.

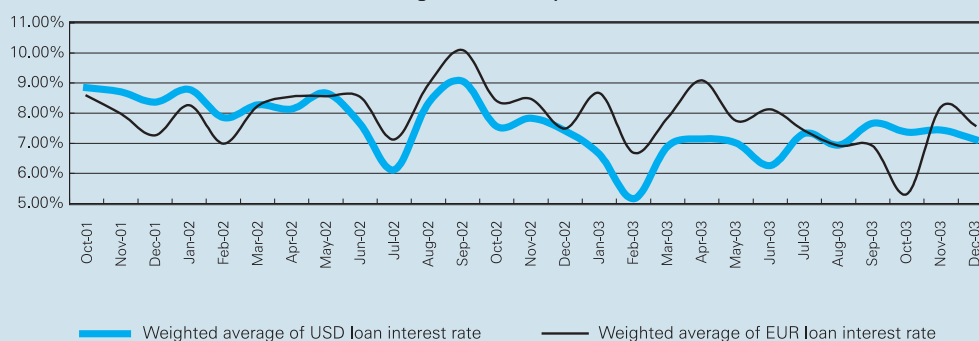
Chart III.17 Interest rates of new foreign currency deposits inflow



The mid-year interest rate cuts of the European Central Bank and the Federal Reserve triggered a substantial fall of foreign currency deposit interest rates. The rest of the year saw fairly stable interest rates.

The foreign currency loan market has been rather stable, with average credit interest rates of 7 per cent in the second half of the year.

Chart III. 18 Foreign currency credit interest rates



This market displays a wider range of interest rates than the deposits one, mainly due to monthly changes of credit extending structure.

Table III.8. Weighted average credit interest rate

	Dec-01	Dec-02	Dec -03
Weighted average of USD loans int. rate	8.36%	7.41%	7.12%
Weighted average of EUR loans int. rate	7.26%	7.49%	7.59%

CHAPTER IV BANKING SUPERVISION

IV.1 BANKING SYSTEM PERFORMANCE

IV.1.1 BANKING SYSTEM PERFORMANCE

During 2003 the banking system experienced important developments such as the entrance of a new nationally-owned bank, preliminary licensing of another bank of the same kind as well as successful conclusion of the Savings Bank privatization process. Eventually, after being faced with some unsuccessful privatization attempts, last December Savings Bank was sold at one hundred percent share to the strategic investor, Raifeissen Bank. These changes raised up to fifteen the number of the Albanian banks. The detailed data on these banks are presented in the following table:

Table IV.1 Banking system indicators

Banks	Number of branches	Number of agencies	Owner's equity/ Total assets (%)	Total deposit / Total assets (%)	Total loans / Total assets (%)	TB investments as a % of total TB investments of the banking system
1. Albanian Italian Bank		3	10.0	84.6	37.7	1.6
2. Savings Bank	14	83	0.0	94.9	0.3	76.1
3. United Bank of Albania	2		50.0	51.8	15.5	0.0
4. Dardania Bank			91.6	17.9	0.0	0.0
5. National Commercial Bank	15	1	5.6	91.8	8.5	10.4
6. Tirana Bank	12	2	5.9	86.3	27.1	4.7
7. International Commercial Bank	1		40.0	63.0	44.7	0.2
8. American Bank of Albania	4		6.3	87.3	22.3	2.8
9. Procredit Bank	12		5.0	86.8	44.9	1.6
10. Commercial Bank of Greece-Albania			38.6	56.6	57.4	0.3
11. National Bank of Greece – Tirana Branch		4	15.5	86.6	22.6	0.8
12. Alpha Bank – Tirana Branch	7		5.2	54.7	47.2	1.6
13. First Investment Bank – Tirana Branch			36.8	16.1	1.2	0.0
14. Credit Bank of Albania			81.1	37.9	0.0	0.0
15. Credins Bank		1	19.5	77.3	31.3	0.0

Based on the respective figures, the banking system financial state is deemed to be satisfactory. The net income of the banking system was nearly ALL 4.45 billion or 0.6 per cent of GDP. In comparative terms, the net income of 2003 was ALL 0.6 billion (or 14.4 per cent) higher than respective figure in 2002.

Table IV.2 Revenues, expenses and the net income (ALL billions)

	Dec'99	Dec '00	Dec '01	Dec '02	Dec '03
Total revenues	39.1	31.0	29.2	28.0	32.0
Total expenses	37.9	25.7	24.9	24.1	27.6
Net income	1.2	5.3	4.3	3.9	4.4

The net revenues¹ from the main activity of the banking system rose to ALL 13.3 billion. These net revenues increased by ALL 2.1 billion or 18.8 per cent compared to the respective figure at the end of 2002. Net revenues from interest, which are the main revenue contributors, made up 84 per cent of total net revenues while the rest came from commissions and foreign exchange activity.

The good financial state of the banking system was also reflected by the profitability ratios, which have improved considerably, compared to the previous years.

Table IV.3 Profitability ratios (in percentage)

	Dec'99	Dec '00	Dec '01	Dec '02	Dec '03
ROA ²	0.5	2.1	1.5	1.2	1.24
ROE ³	15.7	20.6	21.6	19.2	19.5

Total assets of the banking system increased by ALL 34.3 billion or 10.1 per cent compared to end of the year 2002. This growth is attributed not only to the treasury and inter-bank transactions but also to the crediting activity as well as investments in Treasury Bills. Nonetheless, there is evidence of a slight decrease in the ratio of total assets against the GDP that has been attributed to the restricted activity of Savings Bank on the eve of its privatization.

Table IV.4 Total assets (ALL billions)

	Dec'99	Dec '00	Dec '01	Dec '02	Dec '03
Total assets	249.5	270.8	318.5	339.3	373.6
As % of the GDP	49.2	50.2	53.5	51.6	50.2

The figures of the Herfindahl index of the banking system asset concentration revealed a downsizing trend evidencing a well-diversified asset structure.

Table IV.5 Herfindahl index of banking system asset concentration

	Dec 2000	Dec 2001	Dec 2002	Dec 2003
Index H	0.44	0.37	0.32	0.30

¹ Detailed information on the performance and financial state of the banking system is provided on the Annual Report of the Supervision Department, published separately by the Bank of Albania.

² Return on Assets

³ Return on Owner's Equity

Bank crediting activity increased by 30.5 per cent during 2003, compared to 2002. The crediting activity counts for 13.5 per cent of the total assets of the banking system. Nevertheless, the calculations demonstrate that credit activity tot up for 27.9 per cent of the total assets of banking system excluding Savings Bank. This can be considered a good base line for further development of the crediting activity during 2004, which will be further enhanced by the capacity and the ability of the Savings Bank to extend credits after its successful privatization.

The ratio of non-performing loans to credit stock is subject to continual shrinking indicating improved lending quality. The correspondent figure of this indicator in 2003 was 4.6 per cent compared to 5.6 per cent in 2002.

Table IV.6 Credit portfolio indicators expressed as a percentage of classified credits

Indicator	2000 ⁴	2001	2002	2003
1. Classified Credits	100.0	100.0	100.0	100.0
Standard Credits	59.1	88.3	89.8	92.3
Special mention credits	7.4	4.6	4.7	3.1
Substandard credits	3.3	4.0	3.0	1.9
Doubtful credits	4.1	1.7	0.7	0.5
Loss credits	26.0	1.3	1.9	2.1
2. Provisions	29.7	3.1	2.9	2.9

Capital adequacy ratio stood at a satisfactory level of 28.5 per cent by the end of 2003, even though it decreased compared to 2002⁶ figure. The main reason behind this decrease was the upsurge by 12.3 per cent (or ALL 7 billions) of the *risk weighted assets* component as opposed to the moderate increase of *regulatory capital* by 1.3 per cent or ALL 222 millions.

Table IV.7 Capital adequacy ratio (ALL billions)

	Dec 2001	Dec 2002	Dec 2003
Regulatory capital	16 392	17 525	17 747
Risk weighted assets	46 424	55 422	62 238
Capital adequacy ratio (in %)	35,3	31,6	28,5

The ratio of quick assets to total assets remained at satisfactory level during 2003 (exceeding 32 per cent), corresponding to the excess liquidity situation that characterized the banking sector during 2003 as revealed from the data on inter-banking activity and the utilization of Bank of Albania standing facilities. These satisfactory levels of liquidity indicators signaled a reduction of the liquidity risk exposure of the banking system.

⁴ The respective figures for 1999 and 2000 include the non-performing loans of Savings Bank transferred to the Bank Asset Resolution Trust (BART) by the end of 2001.

⁵ Standard and special mention credits are classified as regular credits. The remaining groups are treated as non-performing loans.

⁶ The respective figure by the end of 2002 was 31.6 per cent.

IV.2 LICENSING AND BANKING REGULATION

The approval of the document "Principles of Bank Licensing" was a successful accomplishment of the efforts to create a comprehensive regulatory framework for banks and other financial intermediaries, a framework that will steer them towards prudent business without stifling healthy competition. This document clearly sets out the main principles of bank licensing and Supervisory Council decision-making process, which could be shortly summarized as: equal rights in applying for a bank license, equal consideration of applications, safeguard public confidence and fair competition and transparency of the licensing and decision-making process.

The continuous amendments of the banking supervision regulative system aimed at its harmonization with the European Union regulative system and international standards of effective supervision as well as its adaptation to banking system developments, legislation and to the overall economic development in Albania.

IV.2.1 LICENSING

The 2003 developments in the licensing activity of Bank of Albania can be summarized as:

- The Supervisory Council of the Bank of Albania decided to accord the license to Credins Bank for the conduct of banking activities in the Republic of Albania. In addition, the Council granted the preliminary license to Popular Bank.
- The Bank of Albania gave the permission to the American Bank of Albania to open a new branch abroad. This stands as a preliminary permission to operate until this bank receives the final license for a new branch opening in Athens, Greece. Additionally, the Bank of Albania granted the license to Popular Bank of Puglia to open a representing office in Albania. This is the first time a foreign bank opens a representative offices here.
- Two new non-banking agencies were licensed this year, "Albacredit Ltd" and "AK-Invest SA". These subjects were licensed to conduct cash collecting and cash payment services and other financial intermediation functions in domestic and foreign currencies.
- The number of the building societies increased by 20 new institutions, all of which members of two long-established credit unions. At the same time, the Bank of Albania revoked the license to two building societies, for reasons provided for in the law.
- The Bank of Albania approved the structural change of the Tirana Bank shareholders. Three more practices are being followed to change the shareholder structure of Dardania Bank, National Commercial Bank and Savings Bank.
- Additionally, the Bank of Albania approved the revision in names of the following banks: Arabian-Albanian Islamic Bank to United Bank of Albania, FEFAD Bank to ProCredit Bank as well as Commercial Bank of Greece to EMPORIKI Bank. While the first two are already legally approved, the last one is still in process.

The table below gives a view of all subjects licensed by Bank of Albania in the respective years:

Table IV.8 List of Subjects Licensed by Bank of Albania

nr.	Subjects	2000	2001	2002	2003
1	Banks and branches of foreign banks	13	13	14	15
2	Non-banking Financial agencies	2	4	5	7
3	Foreign exchange bureaus	19	38	58	58
4	Building societies			113	131
5	Credit unions			2	2

IV.2.2 REGULATIONS

The regulative framework of bank supervision knew further changes during 2003. A brief summary of the amendments are presented below:

- The regulation on **"Authorized chartered auditors of banks"** has been amended following the recommendations provided by Development Plan of Supervision. This new version gives a more important role to the control committee in evaluating the authorized accounting experts.
- The modification of the guideline on **"Liquidity of a bank"** aims at giving more flexibility to banks in applying additional ratios for bank liquidity management.
- The perceived tendency of microfinance institutions to consolidate or to form alliances made necessary the revision of the regulation on **"Licensing the Building Societies"**. The changes that were made intended to adapt this regulation to this new tendency.
- The Bank of Albania issued a new regulation on **"Granting the license to non-banking financial subjects"**, which is expected to improve the way in which the required documentation is completed and to elucidate the paid-capital requirements necessary when the subject demands the expansion of its allowed activity. This regulation complements to the regulation on **"Licensing Financial Institutions to Conduct Banking Activities in Republic of Albania"**.
- The new amended regulation on **"Foreign Exchange Activity"** is well harmonized to the European Union recommendations and to the obligations that follow international agreements on capital account liberalization. This regulation is also expected to solve some problems that arose from practical application of its old version. The most significant change was lifting the restriction on the approval of banks' current and capital accounts activities by the Bank of Albania, delegating banks the right to self-verify the documentation, as well as the simplification (minding the content) of the documentation required to conduct these activities.
- The new issued regulation on **"Bank Related Persons"** defines persons who are considered related to one bank, and it sets the guidelines necessary to supervise the conducted activity of the bank with its related persons.

- The new regulation on “**Administrators of banks and branches of foreign banks**” specifies the concept of a bank administrator, the requirements they must meet as well as defines a set of guidelines fundamental for coordinating the relationships between the main managerial levels.

IV.3 ON-SITE EXAMINATIONS

The on-site examination was guided by the approved annual examination plan aiming at exercising comprehensive examinations in all banks throughout the year, associated with partial examination in problematic areas. During 2003 twenty-two inspections were carried out in the banks; fifteen of which were comprehensive and the rest were partial.

Generally speaking, these on-site examinations demonstrated a healthy financial state of the banking system. The main conclusions drawn from the inspection process are reviewed in the subsequent paragraphs:

- The remarked growth of the assets in a number of banks evidenced the aggressive policy followed by these banks and responsiveness of the clients towards these policies.
- The structural changes of the assets in some banks, explicitly the upsurge of the “credit to clients” category, revealed a change in the banks attitude towards conducting a more keen banking activity, and therefore unequivocally influencing the economic growth of the country. As it may be expected, the expansion of the crediting activity has been occasionally accompanied with increase in the absolute value of bad loans.
- The banking system has been characterized by ample liquidity, mainly due to investment in liquid assets as: interbank loans, Treasury Bills issued by the Albanian Government or other securities issued by the governments of countries in the A area.
- Overall, the net profit figure has improved compared to last year respective figure. This increase has been attributed to the expansion of banking activity, the coverage of the first-establishing expenses and enhancement of the balance sheet assets brought about by investments in profiting activities. The positive trend in the net profit is considered stable for most of the banks.
- Banks continue to penetrate the market by opening new branches and agencies throughout the country. Product diversification is one of the most followed strategies by some of the banks that have started to offer credit cards, insert Automatic Teller Machines, etc.
- The commercial bank managers have been showing a satisfactory commitment to resolve the problems evidenced during the on-site examinations. Nevertheless, delays have been noticed in:

- Proper and in-time implementation of the Bank of Albania's recommendations;
 - Improvement of policies and procedures concerning banking activity;
 - Completion of the banking activity regulative framework;
 - Implementation of the bank business plan.
- In addition, the on-site examination did find track of legal misconduct. Explicitly, the Law on "Accounting", "Banks in the Republic of Albania" and the "Prevention of Money Laundering" (as well as the respective guidelines of Bank of Albania and Ministry of Finance) have been violated.
 - There has been evidence of failure to accurately implement Bank of Albania's regulative framework. Occasionally it was noticed:
 - Failure to classify credits in accordance with the respective regulation of the Bank of Albania on "Credit Risk Management";
 - Appointment of managers without the preliminary approval of the central bank;
 - Lack in the documentation of the foreign exchange transfers;
 - Deficiency of the internal control system, etc

The commercial banks paid the necessary attention to the recommendations of the on-site inspection reports as far as the enhancement of the banking process and the improvement of internal banking regulations in all areas is concerned particularly in security investments, crediting activity, risk management, etc.

CHAPTER V. OTHER ACTIVITIES

V.1 THE PAYMENT SYSTEM

The stimulation and the support of payment system are considered as legal obligations of the Bank of Albania. As the very institution that performs account settlements, the Bank of Albania is fully committed to expanding the operational area as well as promoting technological innovations in the payment system.

V.1.1 DEVELOPMENT OF THE PAYMENT SYSTEM

The new Accounting and Treasury Management (ATM) system – implemented in the last quarter of 2002 to automate operations conducted by the Bank of Albania – eased the finalization of the last project phase, the implementation of **Albanian Inter-bank Payment System (AIPS)**. This project, which is expected to upgrade the financial infrastructure of the country, was backed up by the counseling and assistance of the World Bank. It took seven months to be fully implemented requiring intensive involvement not only of the Bank of Albania staff, but full participation of commercial banks, which are the eventual beneficiaries of this project.

The new AIPS system holds the entire standard functions to process Real Time Gross Settlements (RTGS). This system irreversibly processes all inter-bank transfers in domestic currency checking in real time whether the banks have sufficient coverage for them or not. It offers to participants the possibility to manage the preferred queue of their transfers and their own liquidity.

The Bank of Albania is the owner, the main operator and at the same time one of the participants of this system. The system numbers twelve participant banks from a total number of fifteen licensed banks. All the licensed banks have the right to partake in AIPS system once they receive the membership certificate from the Bank of Albania. The participating and service fees and charges are set to cover operational expenses, as a contribution fund to the general reform of the national payment system, although investment costs are fully covered by the Bank of Albania.

The AIPS system is fully compatible with other payment systems such as the cheque and payment-order clearing system, a system implemented the by Bank of Albania to clear and settle cheques and small payment transfers. This is the system that processes interbank transfers ordered by banks' clients. The clearing process is carried out on a daily session organized by the Bank of Albania. The net result of this clearing procedure is then processed with high priority in the AIPS system.

One of the future projects designed by the Bank of Albania is the complete automation of the cheque clearing process to be introduced by a new system, the **Automated Clearing House (ACH)**. This new system, which will process cheques and the small transfers clearing and settlement, is going to be fully integrated into the AIPS system.

V.1.2 INSTRUMENTS OF PAYMENT

2003 was another year that evidenced the payment order as the most used payment instrument. It counted for 77 per cent of the total payment volume and 53 per cent of the total payments ordered by clients.

Using cheques as a means of payment remains limited stressing thus the fact that cheque is still considered an uncomfortable means of payment in Albania. Hence, the most preferred type continues to be the bank cheque.

Year 2003 evidenced a general tendency to improve the payment infrastructure by increasing investments in the field. The highest funds were concentrated in introducing electronic means of payment. The number of Automatic Teller Machines installed during 2003 amounted to twelve, partly in Tirana and the rest in other Albanian cities.

The number of debit and credit cards in domestic currency issued in 2003 summed to 4,300. Nevertheless, the practice of electronic payment means count for only three per cent of the total payment volume ordered by clients.

V.2 EU INTEGRATION AND RELATIONS WITH INTERNATIONAL FINANCIAL INSTITUTIONS

V.2.1 EU INTEGRATION

Year 2003 is regarded as a remarkable year in the European integration process since January 2003 marked the start of the official negotiations to sign the Stabilization and Association Agreement between the European Union and Albania. The Bank of Albania has played an active role in this process as a member of the Albanian Government negotiation team. The main task assigned to the central bank was the coordination of respective roles played by the country institutions in the negotiation process.

In this respect, the Bank of Albania has been active in discussing some of the articles of this agreement, which deal with:

- establishment of banking institutions and the activities allowed to be conducted by these institutions,
- capital account liberalization as the main provision for economic integration in the common European market,
- prevention of money laundering.

Furthermore, the Bank of Albania offered its contribution to the process by providing information to the European Commission concerning: the economic developments of the country, the design and implementation of monetary policy tailored to achieve the main objective – price stability, the stance of monetary policy and the conducted operations, banking system and banking supervision, etc.

The Bank of Albania has clearly presented its strategic approach to the European Union representatives towards reaching the convergence with European Central Bank. This important objective found reflection in one of the articles of the bilateral agreement between the Republic of Germany and the Republic of Albania, according to which German experts will assist the Bank of Albania in the convergence process.

V.2.2 RELATIONS WITH INTERNATIONAL FINANCIAL INSTITUTIONS

THE INTERNATIONAL MONETARY FUND

Article IV of the Articles of Agreement of the IMF was adequately implemented during 2003. Three IMF examining missions visited Albania during April, July and October to evaluate the progress done in accordance to this article. The missions' discussions were focused on tracing monetary developments; the progress in the real sector of the economy and forecasts on its future performance; the pace of the inflation rate and economic growth along with the explicit factors that affect them, the financial situation of the banking system analyzed with respect to the liquidity situation, risk management, quality of the credit portfolio, crediting activity, etc.

After a detailed examination of the consulting reports and objectives enclosed by the Albanian Government in the Memorandum of Economic and Financial Policies, the IMF Executive Board considered *that Albania's performance during the first year of the three-year PRGF-supported program on balance has been satisfactory, with low inflation, a stable effective exchange rate, and gradual consolidation*¹. This evaluation confirmed the first along with the second review, and brought the extension of two new loan-instalments amounting to SDR 4 million each, respectively in March and July. These instalments are part of the three-year "Poverty Reduction and Growth Facility" arrangement, which was signed last year.

The Technical Assistance Program is another important aspect of the bilateral relations between the Bank of Albania and the IMF. Two technical assistance missions at expert level visited Bank of Albania during July and November 2003. The technical assistance provided by the International Monetary Fund has been quite effective and helpful in resolving different issues of central banking, problems in designing monetary policy and in modeling and forecasting inflation regime.

WORLD BANK GROUP

Year 2003 saw favorable developments in the cooperation between the Bank of Albania and the World Bank Group. The assistance of the World Bank was considered very constructive in the implementation of the new payment system, the Albanian Interbank Payment System. Additionally, this institution continued to advice the Bank of Albania concerning the Supervision Development Plan.

Bank of Albania welcomes and appreciates the growing trend in the commitment of the World Bank to giving financial support to the projects implemented by the central bank. After the successful implementation of the AIPS project, the World Bank has expressed its keenness to contribute financially to other projects such as the Automated Clearing House (ACH) project, the Credit Information Bureau project, etc.

¹ Press Release No.03/102, IMF External Relations Department.

THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

The Bank of Albania as a supervisor of the banking system and as an independent observer of the economic developments in Albania has been a decent partner of the European Bank for Reconstruction and Development. This collaboration was not limited only in the exchange of information aspect but it was also extended in conducting official meetings with high-level representatives of the EBRD. These meetings provided the necessary acquaintance with the evaluation criteria as well as deepened the bilateral relationship. The successful privatization of the Savings Bank is expected to upgrade the international evaluation for our banking system.

CENTRAL BANKS AND OTHER INSTITUTIONS

The relations of Bank of Albania with other central banks have kept the same pace as last year, particularly in information and experience exchange areas as well as the organization of training activities mostly with the European Central Bank, and central banks of Germany, France and Czech Republic. The relevant relations have been focused mainly in technical assistance, short-term training courses and support provided through document exchanges. Remarkable growth has been noticed in the cooperation in the aforementioned areas with the Czech National Bank and Bank of Italy.

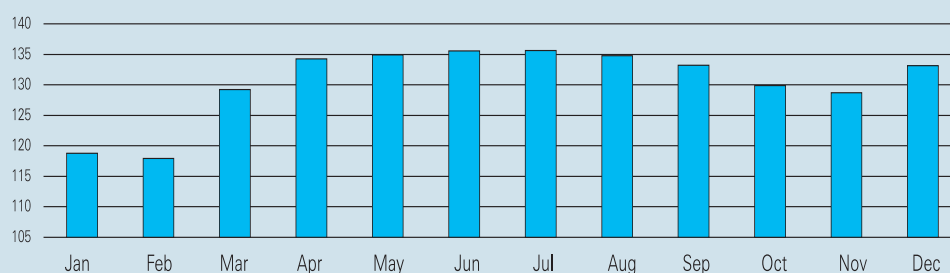
During 2003 the Bank of Albania made significant progress in its relations with the Banking and Payment Authority of Kosovo (BPA). Apart from the official visits and meetings, experts from Bank of Albania paid a few days visit to the BPA to offer, for the first time, their own experience in Archive and Protocol matters. The conclusion of the meeting organized with the Executive Director of the BPA was the expansion of the cooperation between the two institutions to share the best experiences. Furthermore, an assisting program is going to be prepared and completed during the next upcoming year.

V.3 BANKNOTES AND COINS

V.3.1 CURRENCY IN CIRCULATION

Currency issuing and management were characterized by positive developments during 2003. These positive developments were reflected by the downsizing trend of currency in circulation. The particular figure by the end of the year was ALL 127.7 billion, otherwise ALL 5.34 billion less than the respective figure in 2002.

Chart V.1 Currency in Circulation (ALL millions)



Cash placements during the first half of the year were higher than cash withdrawals; nevertheless they exhibited a diminishing growth rate. The highest level of the cash placements was noted in January followed up by gradual reduction until June. The quantity of the cash placements remained high even in the second half of the year but it was accompanied with growth in cash withdrawals attributed to the increase in the government public spending moderately in July and August and particularly high in December.

Chart V.2 Cash Placements and Withdrawals of Banking System during 2003 (in billions)



The structure of banknotes and coins in circulation has been generally kept within the forecasted structural boundaries. The central bank provided funds to commercial banks in complete accordance to both the structure of currency in circulation and banks' own demand. An issue of particular importance was the increased circulation of 100 ALL coin during December, which brought the structure of currency circulation very close to the projected one.

Chart V.3 Coins in Circulation (in millions of pieces)

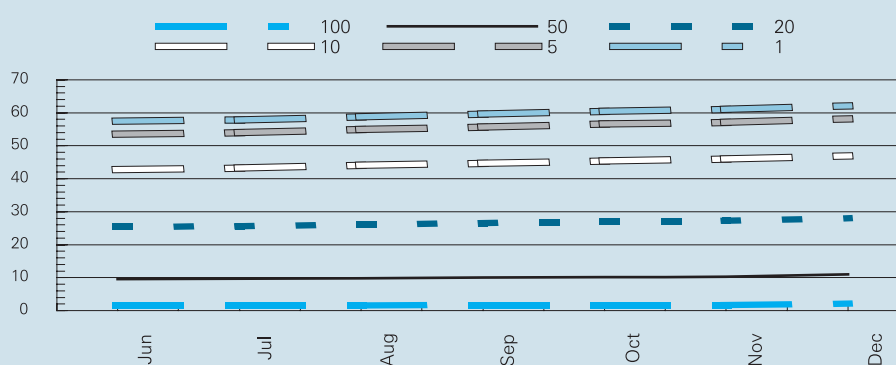
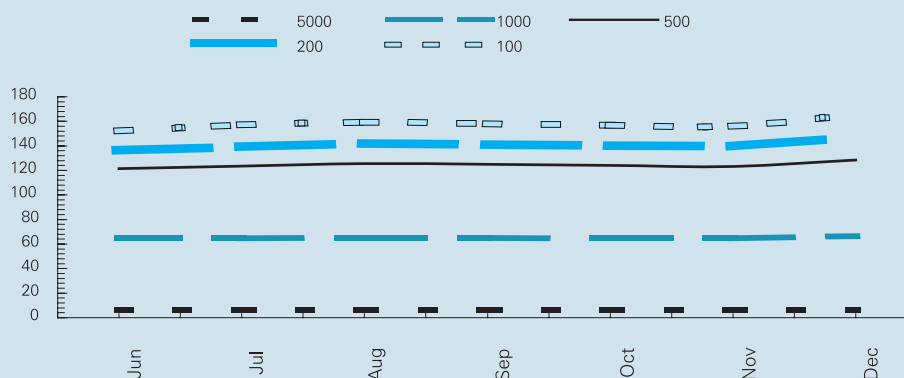


Chart V. 4 Banknotes in Circulation (in millions of pieces)



Bank of Albania processed the currency guided by the principle of protecting the authenticity of the Albanian issued currency. The banknotes were selected according to their physical quality. The banknotes unfit for further circulation were destroyed. Additional attention was paid to hold an adequate level of the monetary reserve in order to satisfy in time the demand of the economy for domestic currency.

Particular interest has been assigned to the prevention of the production and distribution of counterfeit banknotes. Nevertheless, historically the counterfeits have had an inconsiderable number in the totality of banknotes in circulation.

V.3.2 NUMISMATICS

The numismatic activity was further developed during 2003. During this year, there were created some new metallic coins mainly for numismatic purposes but even for issuing purposes. One of these metallic coins created for numismatic purposes, was '50 lekë' coin. This coin, which marked the 90th Anniversary of the Independence Proclamation, remained without legal tender. Two other coins were also minted during

**100 Lekë coin, without legal tender
"90th Anniversary of the Independence
Proclamation"**



**50 Lekë coin, without legal tender
"90th Anniversary of the
Independence Proclamation"**



**100 Lekë coin, without legal tender
"Albanian Antiquity"**



2003, marking the "Albanian Antiquity". The '20 lekë' coin remained without legal tender, while the '50 lekë' coin received a legal tender. Aiming at achieving a complete convergence with the respective international practices, for the first time in 2003, the Bank of Albania intended to give a legal tender to the coins created for numismatic purposes. This process is going to be fully accomplished during 2004.

**50 Lekë legally tendered coin
"Albanian Antiquity"**



Another commemorative coin created for numismatic purposes (without legal tender) was the '50 lekë' coin, which marked the "100th Anniversary of Jeronim De Rada's Death, 1903-2003", famous Albanian writer and patriot.

**50 Lekë coin, without legal tender
"100th Anniversary of Jeronim De
Rada's Death"**



During 2003 there was a boosting interest of foreign numismatists in buying and collecting the Albanian banknotes in circulation.

The Bank of Albania published for the first time a catalogue entitled "The Albanian Banknotes and Coins", which can be regarded as the encyclopedia of Albanian banknotes and coins.

V.4 INTERNAL AUDITING

The Bank of Albania internal auditing was exercised respecting the legal provisions of Article 54 of the Law "On the Bank of Albania". The internal auditing assessed the performance of all departments in the Bank of Albania based on methods widely applied in other central banks. The harmonization of auditing methods was further intensified by the experience received as a member of the Institution of Internal Auditing, USA. The membership in this institution was one of the events of 2003.

A total number of 43 audits, or otherwise 3.6 audits on monthly average, were exercised during 2003. Out of them, 40 audits were planned in the annual program and only 3 of them were realized upon the recommendation of the bank administrators covering specific subject matters. Additionally, the audits exercised on the information technology issues were further intensified this year. Particularly following the suggestions of the international organizations, the Audit Department performed internal audits in the statistical sector intended to provide references on the data quality in the balance of payments.

All recommendations driven by the exercised audits targeted the amplification of the internal auditing function of the central bank, bringing about the intensification of preventative measures implemented by the internal auditing department. The audits throughout 2003 evidenced three cases of incurred economic damage that were compensated by the persons held accountable for.

CHAPTER VI. FINANCIAL STATEMENTS AND BANK OF ALBANIA BUDGET

INDEPENDENT AUDITORS' 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 at December 31, 2003 and 2002, and the related statements of profit and loss, changes in capital and reserves and cash flows 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 audits 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.

In our opinion the financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2003 and 2002 and the results of its operations, changes in capital and reserves and cash flows for the years then ended in accordance with accounting policy adopted by the Supervisory Board of Bank of Albania as disclosed in note 2 to the financial statements.

Deloitte & Touche, Sh.p.k.
Tirana, Albania
March 25, 2004

BANK OF ALBANIA
BALANCE SHEET
AS AT DECEMBER 31, 2003 AND 2002
(ALL AMOUNTS ARE EXPRESSED IN MILLIONS OF LEK)

		As at December 31, 2003	As at December 31, 2002
ASSETS			
Assets denominated in foreign currency	Notes		
Gold and precious metals	3	593	1,182
Deposits with the International Monetary Fund	4	18,056	19,861
Deposits with foreign banks	5	10,553	5,450
Securities available for sale	6	86,875	95,184
Other foreign assets	7	588	652
Total assets denominated in foreign currency		116,665	122,329
Assets denominated in local currency			
Gold and precious metals	3	43	40
Transit credits	8	384	7,323
Loans to domestic banks		-	3,405
Loan to the Government		-	1,150
Securities available for sale	9.1	71,687	74,436
Investments held to maturity	9.2	1,573	1,449
Other domestic assets	10	2,635	2,900
Total assets denominated in local currency		76,322	90,703
Total assets		192,987	213,032
LIABILITIES			
Liabilities denominated in foreign currency			
Due to the International Monetary Fund	11	17,478	19,147
Due to non-resident financial institutions	12	1,747	8,775
Total liabilities denominated in foreign currency		19,225	27,922
Liabilities denominated in local currency			
Currency in circulation	13	127,774	133,115
Due to domestic banks	14	33,970	30,697
Due to the Government	15	5,464	3,024
Deferred income	16	117	151
Other domestic liabilities	17	389	328
Total liabilities denominated in local currency		167,714	167,315
CAPITAL AND RESERVES			
Capital		750	750
Legal reserve		3,750	3,750
Revaluation reserve	18	(6,330)	5,468
Other reserves	19	7,878	7,827
Total capital and reserves		6,048	17,795
Total liabilities, capital and reserves		192,987	213,032

The accompanying notes on pages 95 to 116 are an integral part of these financial statements.

BANK OF ALBANIA
STATEMENT OF PROFIT AND LOSS
FOR YEARS ENDED DECEMBER 31, 2003 AND 2002
(ALL AMOUNTS ARE EXPRESSED IN MILLIONS OF LEK)

		Year ended December 31, 2003	Year ended December 31, 2002
	Notes		
Operations with non-residents			
Interest and commission income		3,515	4,076
Interest and commission expense		(1,033)	(814)
Gains arising from foreign securities		963	758
Losses arising from foreign securities		(1,139)	(435)
Operations with non-residents, net		2,306	3,585
Operations with residents			
Interest and commission income	20	7,567	7,819
Interest and commission expense		(1,353)	(1,015)
Gains arising from domestic securities		796	205
Losses arising from domestic securities		(765)	(215)
Operations with residents, net		6,245	6,794
Other operating income, net	21	322	146
Net operating income		8,873	10,525
Other operating expenses			
Personnel expenses	22	(377)	(304)
Depreciation		(186)	(120)
Amortisation		(253)	(202)
General and administrative expenses		(204)	(169)
Total other operating expenses		(1,020)	(795)
NET PROFIT FOR THE YEAR		7,853	9,730

The accompanying notes on pages 95 to 116 are an integral part of these financial statements.

BANK OF ALBANIA
STATEMENT OF CHANGES IN CAPITAL AND RESERVES
FOR YEARS ENDED DECEMBER 31, 2003 AND 2002
(ALL AMOUNTS ARE EXPRESSED IN MILLIONS OF LEK)

	Capital	Legal reserve	Revaluation reserve	Other reserves	Retained earnings	Total
As at December 31, 2001	750	3,750	57	7,588	-	12,145
Net profit for the year	-	-	-	-	9,730	9,730
Foreign currency and gold revaluation	-	-	5,526	-	-	5,526
Domestic treasury bills revaluation	-	-	(119)	-	-	(119)
Release of tangible fixed assets revaluation surplus	-	-	(28)	-	28	-
Increase of pension fund	-	-	-	22	-	22
Historic notes and coins revaluation	-	-	32	-	-	32
Profit distribution	-	-	-	217	(9,758)	(9,541)
As at December 31, 2002	750	3,750	5,468	7,827	-	17,795
Net profit for the year	-	-	-	-	7,853	7,853
Net of pension fund	-	-	-	(128)	-	(128)
Foreign currency and gold revaluation	-	-	(12,040)	-	-	(12,040)
Securities revaluation	-	-	270	-	-	270
Release of tangible fixed assets revaluation surplus	-	-	(28)	-	28	0
Increase of pension plan	-	-	-	20	-	20
Profit distribution	-	-	-	179	(7,881)	(7,702)
As at December 31, 2003	750	3,750	(6,330)	7,878	-	6,048

The accompanying notes on pages 95 to 116 are an integral part of these financial statements.

BANK OF ALBANIA
STATEMENT OF CASH FLOWS
FOR YEARS ENDED DECEMBER 31, 2003 AND 2002
(ALL AMOUNTS ARE EXPRESSED IN MILLIONS OF LEK)

	Notes	Year ended December 31, 2003	Year ended December 31, 2002
Cash flows from operating activities			
Net profit for the year (no extraordinary expenses)		7,853	9,730
Non-cash items in the statement of operation			
Depreciation and amortisation		439	322
Amortisation of securities		955	725
Income from interests and commissions		(11,067)	(11,895)
Expenses for interests and commissions		3,356	1,104
Profit/loss from sales of securities available for sale		(59)	507
Cash flow before the movement of working capital		1,477	493
Changes in operating assets			
Decrease in deposits with the IMF		1,794	1,006
Decrease in deposits with foreign banks		-	18,805
Decrease in other foreign assets		55	350
Decrease/(increase) in transit credits		6,939	(1,069)
Decrease/(increase) in loans to domestic banks		3,405	(2,929)
Decrease in loans to the Government		1,150	1,562
(Increase)/decrease in other domestic assets		(25)	821
Decrease in due to the IMF		(1,669)	(1,347)
Increase/(decrease) in due to financial institutions		(7,028)	1,233
Decrease in other foreign liabilities		-	(3)
Increase/(decrease) in due to domestic banks		2,093	(571)
Increase in due to the Government		2,440	290
Increase in other domestic liabilities		60	221
Decrease in deferred income		(33)	-
		9,181	18,369
Cash Flow generated from operations			
Interest received		9,692	2,120
Interest paid		(1,094)	(2,056)
Foreign exchange revaluation effect on operating assets and liabilities		(11,798)	(11,554)
Net cash used in operating activities		7,458	7,372
Cash flows from investing activities			
Purchases of fixed assets		(114)	(138)
Purchases of intangible assets		(35)	(617)
Purchases of foreign securities		(85,507)	(123,780)
Purchases of domestic securities		(195,468)	(210,181)
Sale and maturity of foreign securities		81,843	99,692
Sale and maturity of domestic securities		209,641	211,043
Increase of repurchase agreement		1,204	-
Net cash from investing activities		11,564	(23,981)

The accompanying notes on pages 95 to 116 are an integral part of these financial statements.

BANK OF ALBANIA
STATEMENT OF CASH FLOWS (CONTINUED)
FOR YEARS ENDED DECEMBER 31, 2003 AND 2002
(ALL AMOUNTS ARE EXPRESSED IN MILLIONS OF LEK)

Cash flows from financing activities	Notes	Year ended December 31, 2003	Year ended December 31, 2002
Increase in other reserves		51	190
(Decrease)/increase in money in circulation emissions		(5,341)	14,500
Profit distribution to the Government		(7,881)	(7,924)
Net cash from (used in) financing activities		(13,171)	6,766
Increase (decrease) in cash during the year		5,851	(9,843)
Cash and cash equivalents at the beginning of the year	23	16,075	25,918
Cash and cash equivalents at the end of the year	23	21,926	16,075

The accompanying notes on pages 95 to 116 are an integral part of these financial statements.

BANK OF ALBANIA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002

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 No. 8269, dated December 23, 1997 "On the Bank of Albania". 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;
- compilation, approbation and application of monetary policy of Republic of Albania;
- supervision of commercial bank activities including issuance of licenses to all banks; and
- issuing of licenses for international banking institutions operating within the Republic of Albania.

The Bank is subject to the regulatory requirements of the Parliament of the Republic of Albania and the Law "On the Bank of Albania".

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(A) BASIS OF PREPARATION OF FINANCIAL STATEMENTS

The financial statements have been prepared in accordance with the Albanian Law "On Accounting" and in accordance with accounting policy adopted by the Supervisory Council of the Bank of Albania. This accounting policy is broadly in line with International Financial Reporting Standards (IFRS) approved by the International Accounting Standards Board (IASB) with the exceptions related to IAS 16, IAS 21, IAS 19, IAS 26 and IAS 27. These standards and interpretations were previously called International Accounting Standards (IAS).

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

The financial statements presented include the accounts of the Bank prepared on the historical cost basis of accounting modified to include the revaluation of securities portfolio, foreign currency, gold, the head office building, and other financial assets and liabilities (available for sale).

The accompanying financial statements are presented in the national currency of the Republic of Albania, the Albanian Lek ("LEK").

The Bank controls the operations of the Printing House, a business entity engaged in the printing of Government high security material and publications of Bank of Albania. The financial operations of the Printing House have not been consolidated with those of the

Bank, because of the inability of the Printing House to perform the revaluation of its assets and its buildings in accordance with IAS 16. Supervisory Council of the Bank of Albania at the meeting dated on April 1, 2003, decided that the Printing House should be under the supervision of Bank of Albania as a separated part of the organizational structure of Bank of Albania meanwhile is aimed its separation within year 2005.

The financial position of the Printing House as at December 31, 2003 is set out in Note 24 to these financial statements.

(B) DEVIATION FROM INTERNATIONAL FINANCIAL REPORTING STANDARDS

- IAS 16 "Property, Plant and Equipment"

The revaluation methodology adopted for the revaluation of the head office building as detailed in Note 10 was not in accordance with the revaluation requirements set out in IAS 16 on property, plant and equipment to the extent that the revaluation was not conducted by independent, professionally qualified appraisers, the future cash flows were not discounted and the entire category of buildings were not revalued.

- IAS 21 "The Effects of Changes in Foreign Exchange Rates"

The Law "On the Bank of Albania" requires the recognition of all the realized gain/loss from exchange rate revaluation in the balance sheet under the "Capital and Reserves" account and not as an income/expense for the period when revaluation occurred.

- IAS 19 "Employee Benefits" and IAS 26 "Accounting and Reporting by Retirement Benefit Plans"

Reporting and accounting of Pension Fund is not prepared in accordance with IAS 19 and IAS 26. Obligation due to Pension Fund is expressed as net value, but the calculation of this obligation is not in compliance with specifics of accounting standards to the extent that no actuarial estimation is performed.

- IAS 27 "Consolidated Financial Statement and Accounting for Investments in Subsidiaries"

The financial operations of the Printing House under the administration of the Bank have not been consolidated with those of the Bank, as it is explained below.

(C) CHANGES IN ACCOUNTING POLICIES

Income from interest on administrative operations

During the period 1992 - 2002, the Bank has recognised interest income from all the gold deposits accounts including also the gold deposits that represents managed assets on behalf of the government (see Note 2(m)).

During year 2003 a recalculation of interests from gold deposits that belongs to managed assets was performed for the period in question. The liability was estimated around 843 gold ounces (LEK 37 million), due to Government, having decreased the gold reserves of the Bank and also the revaluation reserve.

Reclassification of Pension Plan

During year 2003, the Bank compiled its accounting policy in compliance with IAS 26

"Accounting and Reporting by Retirement Benefit Plans". As a result, a net pension plan was prepared, reclassifying investments in Treasury bills (12 months maturity) from "Domestic Securities available for sale", and " Other reserve" to "Net obligation/ Pension Fund".

Pension Plan was recognised as "Net obligation/ Pension Plan" totaling of LEK 1 million for year 2003 (2002: LEK 6 million).

Revaluation of Securities

During year 2003 the Bank has implemented IAS 39 "Financial Instruments: Recognition and Measurement". Unrealized gains or losses from the revaluation of securities available for sale are recognized in the balance sheet in the "Reserves from revaluation of securities" account until the date of disposal. The implementation of this treatment has increased the revaluation reserves of LEK 270 million for the year and the respective securities portfolio.

(D) INTEREST AND COMMISSIONS

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

Commission income is credited to income when received.

Commission expense is debited to expense when paid.

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(E) 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 monetary assets and liabilities are retranslated into LEK at the Bank's official exchange rate valid on the balance sheet date. Unrealised foreign exchange gains and losses are credited or charged to the revaluation reserve.

The applicable official Bank rate (LEK to the foreign currency unit) for the principal currencies as at December 31, 2003 and 2002 were as below:

	December 31, 2003	December 31, 2002
United States dollar (USD)	106.58	133.74
European Union currency unit (EUR)	134.32	140.18
British pound (GBP)	189.92	215.31
Special Drawing Right (SDR)	157.81	181.16

Revenues and expenses in foreing currency for the year are translated with the annual average exchange rate of the Bank as follows:

	2003	2002
United States dollar (USD)	108.69	134.97
European Union currency unit (EUR)	133.65	137.90
British pound (GBP)	190.25	214.38
Special Drawing Right (SDR)	159.37	180.80

(F) INVESTMENTS

Securities held by the Bank are categorised into portfolios in accordance with the Bank's intent on the acquisition of the securities and pursuant to the Bank's security investment strategy. These are classified as follows:

- Held-to-maturity and
- Available for sale.

All investments are initially recognised at cost, being the fair value of the consideration given including acquisition costs associated with the investment.

Held-to-maturity

Investments held to maturity are financial assets with fixed or determinable payments and fixed maturities that the Bank has the positive intent and ability to hold to maturity. This portfolio comprises obligations issued by the Government for recapitalization of the National Commercial Bank.

Held to maturity investments are recognized on a trade-date basis and are initially measured at cost. At subsequent reporting dates they are carried at amortized cost, less any impairment loss recognized to reflect irrecoverable amounts. The annual amortization of any discount or premium on the acquisition of held to maturity securities is aggregated with other investment income receivable over the term of the instrument so that the revenue recognized in each period represents a constant yield on the investment.

Available for sale

After initial recognition, investments which are classified as "available for sale" are remeasured at fair value. Such fair value adjustments are reported as a separate component of equity until the investment is sold, collected or otherwise disposed of.

Fair values

For investments traded in organised financial markets, fair value is determined by reference to stock exchange quoted market bid prices at the close of business on the balance sheet date.

For investments where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument which is substantially the same.

Impairment and uncollectability of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a financial asset or group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount and any impairment loss of that asset is determined, based on the net present value of future anticipated cash flows, and is recognized for the difference between the recoverable amount and the carrying amount as follows:

- For financial assets at amortised cost - the carrying amount of the asset is reduced to its estimated recoverable amount either directly or through the use of an allowance account and the amount of the loss is included in the statement of profit and loss; and
- For financial assets at fair value - where a loss has been recognised directly in equity as a result of the write-down of the asset to recoverable amount, the cumulative net loss recognized in equity is transferred to the statement of profit and loss.

(G) REPURCHASE AGREEMENTS AND REVERSE REPURCHASE AGREEMENTS

Securities purchased under agreements to resell (reverse repurchase agreements) and securities sold under agreements to repurchase (repurchase agreements) are generally treated as collateralized financing transactions and are carried at the amounts of cash advances or received, plus accrued interest.

Repurchase agreement are recorded in the balance sheet item "Due to domestic banks". Based on the Bank's regulation on repurchase agreements, the Bank is not required to put any collateral for these liabilities.

Interest earned on reverse repurchase agreements and interest incurred on repurchase agreements is recognized as interest income or interest expense, over the life of each agreement using the interest rate approved by the Supervisory Council.

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(H) 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 10).

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(sell or out of use) of fixed assets are recognised 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 during 2003 are the same as year 2002:

	2003
Building – Head office	40 years
Buildings – At branches	25 years
Vehicles	5-10 years
Furniture, fixtures and equipment	3-20 years
Computer hardware	2 years

(I) PRINTING AND MINTING COSTS

The costs of printing banknotes and minting coins are capitalised as intangible fixed assets and amortised over 2.5 years and 10 years, respectively.

(J) 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 as directed by the Supervisory Council of the Bank of Albania.

(K) LEGAL RESERVE

In accordance with the Law "On the Bank of Albania", 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.

(L) 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 periods. Actual results could differ from those estimates.

(M) MANAGED ASSETS

At as December 31, 2003, 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 at December 31, 2003, the value of gold held on behalf of the Government placed in gold deposits abroad was LEK 2,484 million (2002 - LEK 2,523 million), being 55,876.42 troy ounces of gold (2002 - 55,036.5 troy ounces of gold). At the same date, the value of gold and other precious metals was LEK 1,430 million (2002 - LEK 1,467 million) including platinum, silver and other precious metals in a domestic vault of LEK 119 million and LEK 1,309 million of non-international standard gold. As the Bank acts as custodian for these assets it does not bear any credit risk related to them.

Interest received from the deposit of government gold reserves are recognized as income from interest due to Government, increasing the liability due to Government.

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

(N) GRANTS

Grants are initially recorded in the balance sheet at the amount received. Grants related to expenditure items are released to income during the period of the related expenditure. Grants related to the purchase of property, equipment and software are released to income over the life of the relevant assets at an amount corresponding to the associated depreciation/ amortisation charge on that asset.

(O) COMPARISON

Certain comparative figures have been reclassified to conform to current year presentation.

3. GOLD AND PRECIOUS METALS

As at December 31, 2003, the value of gold owned by the Bank placed in gold time deposits abroad was LEK 593 million (2002 - LEK 1,182 million), being 13,322 troy ounces of gold (2002 - 25,782 troy ounces).

On January 2003 have been sold for needs of foreign exchange reserves management totaling 11,608 ounces gold.

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, 2003, the price for one troy ounce of gold was USD 417.25 (2002 - USD 342.75).

Other gold and precious metals included within domestic assets include platinum and silver in a domestic vault, valued at the London fixing rate on the balance sheet date, amounting to LEK 39 million as at December 31, 2003 (2002 - LEK 36 million) and LEK 4 million of non-international standard gold (2002 - LEK 4 million).

4. DEPOSITS WITH THE INTERNATIONAL MONETARY FUND

	As at December 31, 2003	As at December 31, 2002
International Monetary Fund	8,407	8,951
Special Drawing Rights (SDR)	9,623	10,873
Accrued interest	26	37
Total	18,056	19,861

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 of Albania. The SDR holdings approximate the Republic of Albania's membership quota paid to the IMF in SDR and LEK. This represents the counterpart of loans, which were granted to the Republic of

Albania as disclosed in Note 11. The SDR holdings bear interest, which is determined on weekly basis. The interest rate prevailing as at December 31, 2003 was 1.57% (2002 - 1.91%).

5. DEPOSITS WITH FOREIGN BANKS

	As at December 31, 2003	As at December 31, 2002
Current accounts	8,753	2,537
Short-term deposits	1,797	2,909
Accrued interest	3	4
Total	10,553	5,450

Short-term deposits mature in January 2004 and earn interest in the range of 0.93% to 3.63% (2002 - 1.2% to 3.76%). Deposits and current accounts with foreign banks are denominated in EUR, USD and GBP which equate to the following foreign currency balances:

	As at December 31, 2003	As at December 31, 2002
EUR	41	17
USD	44	19
GBP	2	2

6. FOREIGN SECURITIES AVAILABLE FOR SALE

	As at December 31, 2003	As at December 31, 2002
United States Government discounted notes	33,587	23,905
French Government Treasury bonds	32,612	22,021
Bank for International Settlements: medium-term investments	4,046	17,849
United States agencies discounted notes	7,567	12,436
French Government Treasury bills	2,662	8,773
Fixed rate investments (FIX BIS)	6,401	5,530
United States agencies Treasury notes	-	2,669
United States Government Treasury bills	-	2,001
Total	86,875	95,184

Foreign securities portfolio disclosed in nominal value and by currency as follows:

	As at December 31, 2003	As at December 31, 2003
USD		
United States Government discounted notes	315	180
United States agencies discounted notes	71	93
Bank for International Settlements: medium-term investments	5	42
Fixed rate investments (FIX BIS)	5	5
United States Government Treasury bills	-	15
United States agencies Treasury notes	-	20
Total	396	355
EURO		
French Government Treasury bonds	243	158
Bank for International Settlements: medium-term investments	26	89
Fixed rate investments (FIX BIS)	20	11
French Government Treasury bills	20	63
Total	309	321
GBP		
Fixed rate investments (FIX BIS)	16	15
Total	16	15

United States Government discounted notes are denominated in USD and have coupon rates varying between 1.125% and 5.75%. Interest is paid semi-annually and maturities vary between February 2004 and November 2008. The yields vary between 0.95% and 4.65% (2002 - 0.97% and 4.75%).

The French Government Treasury bonds are denominated in EUR with coupon rates varying between 3% and 8.25%. Interest is paid annually and maturities range between January 2004 and July 2008. The yields vary between 2.06% and 4.53% (2002 - 2.60% and 4.53%).

Bank for International Settlements - medium term investments comprise of fixed coupon securities denominated in USD and EUR with coupon rates varying between 5% and 5.5%. Interest is payable annually for investments in EUR and semi-annually for investments in USD, and maturities range between June 2004 and December 2005. The yields vary between 3.11% and 4.72% (2002 - 2.34% and 4.72%).

United States agencies discounted notes are denominated in USD with coupon rates varying between 1.875% and 5.25%. Interest is paid semi-annually and maturities range between January 2004 and May 2006. The yields vary between 1.14% and 4.71% (2002 - 1.59% and 4.71%).

The French Government Treasury bills are denominated in EUR and mature on various dates between March 2004 and August 2004 with yields varying between 1.86% and 2.18% (2002 - 3.04% and 3.82%).

The Fixed rate investments (FIX BIS) issued by the Bank for International Settlements are denominated in USD, EUR and GBP with yields varying between 1.02% and 4.16% (2002 - 1.21% and 4.53%) and maturities ranging between January 2004 and December 2004.

7. OTHER FOREIGN ASSETS

As at December 31, 2003, other foreign assets are comprised of cash on hand in foreign currency of LEK 13 million (2002 - LEK 22 million) and of quotas for participation in the European Bank for Reconstruction and Development, the World Bank and the Islamic Development Bank.

	As at December 31, 2003	As at December 31, 2002
Cash on hand in foreign currency	13	22
Other		
World Bank Quota	362	372
IDA Quota	36	37
MIGA Quota	13	14
IFC Quota	78	98
EBRD Quota	62	78
IDB Quota	24	31
Total Other	575	630
Total	588	652

8. TRANSIT CREDITS

Transit credits, by industrial sector, are comprised of:

	As at December 31, 2003	As at December 31, 2002
Agriculture	-	1,475
Industry	-	4,966
Services and other	384	882
Total	384	7,323

Transit credits for agriculture and industry represent interest-free credit facilities, which were provided to credit institutions for further distribution to ultimate borrowers to support state development programmes (See Note 12). All loans are guaranteed by the Government of Albania.

With the decision of the Ministry of Finance No. 6779, dated December 19, 2003, the Bank has transferred to the Ministry of Finance the loan principals from Kreditanstalt für Wiederaufbau (KfW) amounting EUR 48 million. The Bank will continue to intermediate for the payments transfer and loan repayments until to full reimbursements of the loans.

9. DOMESTIC SECURITIES

9.1 SECURITIES AVAILABLE FOR SALE

	As at December 31, 2003	As at December 31, 2002
Short-term Treasury bills	71,687	74,436
Total	71,687	74,436

Short-term Treasury bills as at December 31, 2003 relate to Government of Albania zero-coupon Treasury bills, with maturities ranging between January 2004 and December 2004, with yields varying between 7.25% and 12.95% (2002 - 10.30% and 12.51%).

9.2 SECURITIES HELD TO MATURITY

	As at December 31, 2003	As at December 31, 2002
Zero-coupon bond for capitalization of National Commercial Bank (NCB)	1,573	1,449
Total	1,573	1,449

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

10. OTHER DOMESTIC ASSETS

	As at December 31, 2003	As at December 31, 2002
Other debtors	84	112
Loans to employees	491	435
Tangible fixed assets, net	1,449	1,455
Inventory	22	18
Intangible assets, net	549	834
Other	40	46
Total	2,635	2,900

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

In millions of LEK	Land, buildings and general constructions	General equipment	Transport vehicles	Total property, plant and equipment
Cost/Valuation				
Balance at January 1, 2003	1,337	454	160	1,951
Additions	84	28	1	114
Disposals	-	-	-	-
Balance at December 31, 2003	1,421	482	161	2,065
Accumulated depreciation				
Balance at January 1, 2003	113	280	103	496
Charge for the year	34	71	14	119
Disposals	-	-	-	-
Balance at December 31, 2003	147	351	117	615
Net book value				
Balance at December 31, 2003	1,274	131	44	1,449
Balance at December 31, 2002	1,224	174	57	1,455

The head office building of the Bank, included within the category "Land, buildings and general constructions", was revalued during the year 2000 to LEK 1,143 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 not based on discounted future cash flows, but based on the potential market rental value of the property over an 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 and is amortised monthly in accordance with the respective amortization rate.

According to Albanian law, the legal title of the building where the Bank is located is unclear. Bank of Albania is in process with Ministry of Finance to determine the status of the ownership for the fixed assets managed by the Bank.

Net intangible assets are comprised of:

	As at December 31, 2003	As at December 31, 2002
Computer software	166	145
Banknotes printed and coins minted	2,397	2,383
Accumulated amortisation	(2,014)	(1,694)
Total	549	834

11. DUE TO THE INTERNATIONAL MONETARY FUND

	As at December 31, 2003	As at December 31, 2002
Enhanced Structural Adjustment Facility (ESAF)	9,599	10,803
IMF securities account	6,032	6,497
IMF accounts in LEK	1,847	1,847
Total	17,478	19,147

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 4 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, 2003 was SDR 4,377,000 (2002 - SDR 10,589,000) 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 during the period 1999 to 2001. The outstanding balance as at December 31, 2003 was SDR 44,451,500 (2002: SDR 45,040,000). This facility is repayable by 2009 in 10 semi-annual installments commencing in 2004. Interest is payable, after the grace period, at 0.5% semi-annually.

The Poverty Reduction and Growth Facility 3 for Albania loan: This is a SDR 28,000,000 loan facility approved by the IMF Executive Board on June 21, 2002. As a result of loan repayments during 2003 the balance as of December 31, 2003 is SDR 12,000,000 (2002: SDR 4,000,000) with an interest rate of 0.5% payable semi-annually. This facility is repayable after a grace period of five and a half years in 10 semi-annual equal installments.

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12. DUE TO NON-RESIDENT FINANCIAL INSTITUTIONS

	As at December 31, 2003	As at December 31, 2002
Transit credits (Note 8)	384	7,326
Loan from the Bank of Greece	1,183	1,234
Due to the World Bank	175	210
Accrued interest	5	5
Total	1,747	8,775

The loan for development of LEK 384 million consists of USD 1.7 million and of EUR 1.7 million (see Note 8) by European Investment Bank. Interest is paid by the recipients of these transit credits (banks and domestic companies) directly to the providers of the funds.

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 1.17% per annum, payable semi-annually. The loan matures in 2018.

13. 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 as at December 31, 2003:

Nominal value LEK	December 31, 2003		December 31, 2002	
	Number in thousand	Total LEK (mln)	Number in thousand	Total LEK (mln)
100	18,441	1,844	19,724	1,972
200	18,596	3,719	19,407	3,881
500	62,049	31,025	67,382	33,691
1,000	60,563	60,563	62,067	62,067
5,000	5,875	29,375	6,080	30,400
Coins		1,248		1,104
Total		127,774		133,115

14. DUE TO DOMESTIC BANKS

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	As at December 31, 2003	As at December 31, 2002
Foreign currency		
Accounts of second level banks	9,191	9,208
License application deposit	-	669
	9,191	9,877
Domestic currency (LEK)		
Accounts of second level banks	22,899	20,764
Repurchase agreements	1,204	-
Overnight deposits	652	8
	24,755	20,772
Accrued interest	24	48
Total	33,970	30,697

Interest on compulsory reserves is calculated as follows:

LEK balances: 70% of the yield on the repurchase agreements: 4.9% as at December 31, 2003 (50% of the yield on 3-month domestic Treasury bills: 5.6 % as at December 31, 2002);

USD balances: 70% of the one-month USD LIBOR rate: 0.8% as at December 31, 2003 (50% of the one-month USD LIBOR rate: 0.69% as at December 31, 2002);

EUR balances: 70% of the one-month EUR LIBOR rate: 1.49% as at December 31, 2003 (50% of the one-month EUR LIBOR rate: 1.45% as at December 31, 2002);

The Bank does not pay interest on correspondent accounts, demand deposits and the license application deposit.

Overnight deposits from domestic banks attract interest of 3.5% (6% at December 31, 2002).

15. DUE TO THE GOVERNMENT

	As at December 31, 2003	As at December 31, 2002
Profit distributable to the Government	200	1,350
Deposits received on behalf of the Government	5,230	1,543
Other	34	131
Total	5,464	3,024

"The profit distributable to the Government" relates to the remaining part of the profit not yet distributed to the Government at the year-end based on the decision of the Supervisory Council No.12, dated February 25, 2004.

"Deposits received on behalf of the Government" relate mainly to international donor funds deposited at the Bank for subsequent transfer to aid projects in Albania, of LEK 1,678 million, and the main account of LEK 3,552 million.

"Other" includes funds received by the Bank of LEK 24 million from a loan granted to the Government by the Islamic Development Bank (IDB), and LEK 10 million relating to a loan for courier system.

16. DEFERRED INCOME

	As at December 31, 2003	As at December 31, 2002
World Bank grant	157	157
World Bank grant amortisation	(76)	(6)
Other	36	-
Total	117	151

"The World Bank grant" relates to a grant received by the Bank during the year 2002 for the purchase of computer software and equipment for the implementation of the ATM project (Accounting and Treasury Management).

17. OTHER DOMESTIC LIABILITIES

	As at December 31, 2003	As at December 31, 2002
Due to Printing House	176	104
Deposits of individuals from the participation in Treasury bills	177	129
Net obligation/ Pension fund	1	6
Other	35	89
Total	389	328

Net obligation/pension plan as at December 31, 2003 and 2002 are as follow:

	As at December 31, 2003	As at December 31, 2002
Net obligation/ Pension plan of 2% contribution	1	1
Net obligation/ Pension plan of 15% contribution	-	5
Net obligation/ Pension plan	1	6

Pension plan scheme consists of employee contribution of 2% of gross salary and pension fund of employer of 15% on the general fund of employees salaries.

	As at December 31, 2003	As at December 31, 2002
Obligation value of 2% of contribution	12	9
Results of 2% contribution invested	1	-
Real value of the Treasury bill portfolio	(12)	(8)
Net obligation of 2% contribution	1	1

	As at December 31, 2003	As at December 31, 2002
Obligation value of 15% of contribution	137	107
Results of 15% contribution invested	28	12
Real value of the Treasury bill portfolio	(165)	(114)
Net obligation of 15% contribution	-	5

18. REVALUATION RESERVE

The components of the revaluation reserve are as follows:

	As at December 31, 2003	As at December 31, 2002
Revaluation of foreign currency and gold balances	(7,672)	4,367
Reserve of securities revaluation	270	-
Revaluation of historic notes and coins	32	32
Revaluation of Head Office building (Note 10)	1,040	1,069
Total	(6,330)	5,468

"The revaluation reserve component for foreign currency and gold balances" has changed due to the revaluation of currencies during the year with LEK 12,003 million, and due to the decrease of bank position in gold for the amount of LEK 37 million related to deposit interests transferred to the Government (See Note 2(b) and 2(m)).

19. OTHER RESERVES

The components of the other reserves are as follows:

	As at December 31, 2003	As at December 31, 2002
Special reserve for Balance of Payments	7,209	7,209
Investment fund	301	301
Pension fund	-	127
Other	368	190
Total	7,878	7,827

"The special reserve" relates to funds provided by the European Community for the Balance of Payments and no movement has been incurred in this reserve since 1995.

"Investment fund" consists of a fund created with decision of Supervisory Council with aim purchase of a new building for the Bank of Albania.

"Other " includes a total of LEK 378 million created by the transfer of LEK 193 million from the profit of year 2003, based on the Decision of Supervisory Council No.12, dated February 25, 2004.

20. INTEREST AND COMMISSION INCOME (RESIDENTS)

	Year ended December 31, 2003	Year ended December 31, 2002
Interest income from Government loans	54	186
Interest income from securities	7,484	7,263
Other	29	370
Total	7,567	7,819

21. OTHER OPERATING INCOME, NET

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	Year ended December 31, 2003	Year ended December 31, 2002
Net profit from the sale of investments	246	115
Income from social aid	70	6
Other	6	25
Total	322	146

22. PERSONNEL EXPENSES

"Personnel expenses" consist of employees' salaries, social insurance, pension plan contribution and other costs.

"Social costs" represent mainly compulsory contributions to the Social Security Fund. As at December 31, 2003, the Bank had 304 employees (2002 - 245 employees).

23. CASH AND CASH EQUIVALENTS

	As at 31 December 2003	As at 31 December 2002
Deposits with foreign banks (Note 5)	10,551	5,446
Domestic currency on hand	10,726	9,385
Foreign currency on hand (Note 10)	13	22
Gold held abroad (Note 3)	593	1,182
Gold and other precious metals held domestically (Note 3)	43	40
Total	21,926	16,075

24. PRINTING HOUSE

As detailed in Note 2(c), the Bank controls the operations of the Printing House. The financial position of the Printing House as at December 31, 2003 and 2002 is as follows:

	As at 31 December 2003	As at 31 December 2002
ASSETS		
Tangible fixed assets	30	38
Inventory	41	48
Trade accounts receivable	10	49
Amount due from the Bank (see Note 17)	176	104
Total assets	257	239
EQUITY AND LIABILITIES		
Capital	52	52
Legal reserve	19	19
Investment reserves	24	24
Other reserves	6	6
Retained earnings	156	134
Total capital and reserves	257	235
Other liabilities	-	4
Total equity and liabilities	257	239

25. 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 opinion that these proceedings will not have a material effect on the financial position or operating results of the Bank.

As at 31 December 2003 the Bank has recorded as an off balance item only the value of the long-term loans given to employees totaling of LEK 537 million.

26. RELATED PARTIES

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the party in making financial and other decisions.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

As at 31 December 2003 and 31 December 2002, transactions made with related parties comprised:

	As at 31 December 2003	As at 31 December 2002
Other domestic loans		
Loans to employees		
- Directors	40	40
Total assets	40	40

	As at 31 December 2003	As at 31 December 2002
Income from interest		
Income from loan interest		
- Directors	-	-
Total from income	-	-

	As at 31 December 2003	As at 31 December 2003
Administration expenses		
Mobile expenses		
- Directors	2	1
Salaries and Bonuses		
- Directors	40	28
Total of administrative expenses	42	29

27. RISK MANAGEMENT

Liquidity risk

Policies to monitor and address liquidity risk are set by the Supervisory Council of the Bank. The Monetary Operations Department of the Bank monitors the liquidity risk on a continual basis by analysing liquidity ratios, gaps and economic scenarios.

Liquidity management policies are set to ensure that, even under adverse conditions, the Bank is in a position to meet its obligations.

Credit risk

The Monetary Operations Department of the Bank, under the control of the Supervisory Council, is responsible for assessing the credit risk associated with the Bank's operations. The credit risk is mitigated by the Bank transacting largely with international and governmental institutions. Loans to domestic banks are secured by Government of Albania Treasury bills.

Price risk

The key elements of price risk affecting the Bank are:

- currency risk associated with fluctuations in the value of financial instruments due to changes in foreign exchange rates, and
- interest rate risk associated with fluctuations in the value of financial instruments due to changes in market interest rates.

The Bank's exposure to currency risk is monitored on a continual basis by the Monetary Operations Department. Financial assets denominated in foreign currency are disclosed in each relevant note to the financial statements.

Interest rate risk is monitored by the Monetary Operations Department of the Bank. The Bank mitigates such risks by maintaining a significant excess of interest bearing assets over liabilities (as detailed in Note 28 below). The Bank maintains a portfolio of interest

bearing financial assets and liabilities such that the generated net interest income is significantly in excess of operating requirements which minimizes the potential adverse effects of interest rate fluctuations. Interest rates applicable to financial assets and liabilities are disclosed in each relevant note to the financial statements.

28. INTEREST RATE SENSITIVITY

	Up to one month	One to three months	Three to six months	Six to twelve months	One to five years	Over five years	Non- interest sensitive	Total
Assets								
Gold	593	-	-	-	-	-	-	593
Deposits with the IMF	-	-	-	-	9,649	-	8,407	18,056
Deposits with foreign banks	10,553	-	-	-	-	-	-	10,553
Foreign securities	5,351	6,920	7,655	17,593	49,356	-	-	86,875
Other foreign assets	-	-	-	-	-	-	588	588
Other gold & precious metals	-	-	-	-	-	-	43	43
Transit credits	-	-	-	-	-	-	384	384
Securities available for sale	22,078	30,820	18,789	-	-	-	-	71,687
Held to maturity securities	-	-	-	-	1,573	-	-	1,573
Other domestic assets	-	-	-	84	-	491	2,060	2,635
	38,575	37,740	26,444	17,677	60,578	491	11,482	192,987
Liabilities and equity								
Due to the IMF	-	-	-	-	9,599	-	7,879	17,478
Due to non-resident financial institutions	-	-	-	5	-	1,183	559	1,747
Currency in circulation	-	-	-	-	-	-	127,774	127,774
Due to domestic banks	33,970	-	-	-	-	-	-	33,970
Due to the Government	-	-	-	-	-	-	5,464	5,464
Deferred income	-	-	-	-	-	-	117	117
Other domestic liabilities	-	-	-	-	-	-	389	389
Capital and Reserves	-	-	-	-	-	-	6,048	6,048
	33,970	-	-	5	9,599	1,183	148,230	192,987
Balance sheet gap as at 31 December 2003	4,605	37,740	26,444	17,672	50,979	(692)	(136,748)	-
Cummulative interest rate sensitivity gap - 2003	4,605	42,345	68,789	86,461	137,440	136,748	-	-

	Up to one month	One to three months	Three to six months	Six to twelve months	One to five years	Over five years	Non- interest sensitive	Total
Assets								
Gold	1,182	-	-	-	-	-	-	1,182
Deposits with the IMF	-	-	-	-	10,873	-	8,951	19,824
Deposits with foreign banks	5,446	-	-	-	-	-	-	5,446
Foreign securities	3,438	11,555	13,017	32,286	34,887	-	631	95,814
Other foreign assets	26	-	-	37	-	-	-	63
Other gold & precious metals	-	-	-	-	-	-	40	40
Transit credits	-	-	-	-	-	-	7,323	7,323
Loans to domestic banks	3,402	-	-	-	-	-	-	3,402
Loans to the Government	1,148	-	-	-	-	-	-	1,148
Domestic securities	22,170	31,527	20,783	38	1,367	-	-	75,885
Other domestic assets	5	-	-	112	-	435	2,353	2,905
	36,817	43,082	33,800	32,473	47,127	435	19,298	213,032
Liabilities and equity								
Due to the IMF	-	-	-	-	10,803	-	8,344	19,147
Due to non-resident financial institutions	-	-	-	-	1,234	-	7,536	8,770
Other foreign liabilities	-	-	-	5	-	-	-	5
Currency in circulation	-	-	-	-	-	-	133,115	133,115
Due to domestic banks	30,649	-	-	-	-	-	-	30,649
Due to the Government	-	-	-	-	-	-	3,024	3,024
Deferred income	-	-	-	-	-	-	151	151
Other domestic liabilities	376	-	-	-	-	-	-	376
Capital and Reserves	-	-	-	-	-	-	17,795	17,795
	31,025	-	-	5	12,037	-	169,965	213,032
Balance sheet gap as at December 31, 2002	5,792	43,082	33,800	32,468	35,090	435	(150,667)	-
Cumulative interest rate sensitivity gap - 2002	5,792	48,874	82,674	115,142	150,232	150,667	-	-

29. CURRENCY NET POSITION

	LEK	USD	EUR	GBP	Other	Total
Assets						
Foreign Assets						
Gold	-	-	-	-	593	593
Deposits to IMF	7,879	-	-	-	10,177	18,056
Deposits with foreign banks	-	4,667	5,458	428	-	10,553
Securities available for sale	-	42,233	41,468	3,174	-	86,875
Other foreign assets	360	221	7	-	-	588
Domestic assets						
Gold and other precious metals	43	-	-	-	-	43
Transit credits	-	160	224	-	-	384
Securities available for sale	71,687	-	-	-	-	71,687
Investments held to maturity	1,573	-	-	-	-	1,573
Other domestic assets	2,560	56	18	1	-	2,635
Total assets	84,102	47,337	47,175	3,603	10,770	192,987
Liabilities						
Foreign Liabilities						
Due to IMF	7,879	-	-	-	9,599	17,478
Due to foreign financial institutions	176	160	1,411	-	-	1,747
Domestic liabilities						
Cash in circulation	127,774	-	-	-	-	127,774
Due to local banks	24,777	5,086	4,107	-	-	33,970
Due to Government	4,144	194	1,125	1	-	5,464
Profit to be allocated	117	-	-	-	-	117
Other domestic liabilities	379	6	4	-	-	389
Capital and reserves	3,552	874	1,391	118	113	6,048
Total liabilities, capital and reserves	168,798	6,320	8,038	119	9,712	192,987
Net currency position as at December 31, 2003	(84,696)	41,017	39,137	3,484	1,058	-
Net currency position as at December 31, 2002	(88,841)	43,060	40,286	3,710	1,785	-

BUDGET INDICATORS

The Bank of Albania drafts and implements its budget plan to attain the completion of functions assigned to it as provided by law.

The Bank of Albania's financial activity relies on the management of foreign currency reserves, credit to government and its relations with commercial banks, according to its monetary policy. The Bank of Albania's targets are reflected in the budget indicators approved by the Supervisory Council.

The main budget indicators for 2003 are fulfilled as follows:

Indicators	Planned	Fact	Change in value	In %
1 Income from interests	12,517,455	10,206,825	-2,310,630	82%
Foreign currency income	3,450,745	2,615,667	-835,078	76%
Income from Government operations	9,053,180	7,566,997	-1,486,183	84%
Income from loans to financial institutions	13,530	24,161	10,631	179%
2 Interest expenditures	1,204,146	1,416,336	212,190	118%
Foreign currency expenditures	191,531	138,097	-53,434	72%
Lek expenditures	1,012,615	1,278,239	265,624	126%
3 Net income from interests	11,313,309	8,790,489	-2,522,820	78%
4 Other income (net)	10,900	81,844	70,944	~ 8 times
5 Total income (net)	11,324,209	8,872,333	-2,451,876	78%
6 Operating cost	694,230	566,382	-127,848	77%
Personnel	382,967	388,280	5,313	94%
Management	228,760	145,460	-83,300	64%
Expenditures for asset management	82,503	32,642	-49,861	40%
7 Amortization expenditures	497,700	438,934	-58,766	88%
8 Profit prior to discounts	10,132,279	7,867,017	-2,265,262	78%

Main budget indicators for 2003, in billions of Lek.

Foreign currency incomes converted into US dollar exceeded the plan by USD 267 thousand, while foreign currency incomes expressed in Lek did not meet the expectations. Some factors led to this situation, and particularly the exchange rate produced a dominant negative effect of about Lek 873 million, thus absorbing the positive effect of exceeding the volume of foreign currency reserves. The foreign currency reserve was planned at USD 812 million, while converted into US dollar reached about 1 billion.

Net incomes from government operations result unfulfilled due to the interaction of two factors: the reduction of financing stock of the State budget deficit for less than 1 billion and 152 million Lek and the decrease of the Treasury bills yield for 334 million Lek. Both of them are estimated as positive factors since they suggest the liquidity's improving in the system and the decrease of currency cost, though the Bank of Albania's incomes were not fulfilled.

Foreign currency expenditures were not fulfilled according to the expectations, mainly due to the decline of foreign currency exchange rate compared to the projections. Another reason is the cut of interest rates on accounts (liabilities) held with the IMF and the commercial banks' required reserves held with the Bank of Albania compared to the plan.

Expenditures to liabilities in Lek exceeded the plan compared to the projections. A significant improvement of liquidity in the banking system brought about positive effects in exceeding the expenditures for Repo interests and other deposits of commercial banks.

Expenditures for required reserves in Lek resulted to be within the targeted expectations. Effects of the growing average state of deposits and the increase of the base interest rate in Lek, the EURIBOR and LIBOR in the remuneration of the required reserve are neutralized by the falling of the average interest rate level.

Management expenditures have been fulfilled less than expectations, almost at all components, due to the non-completion of some expenditures in due time and to the concept of the plan as an upper limit. However, non-fulfillment of some indicators did not hamper the normal progress of business in the Bank.

