

2. THE ACTIVITY OF THE BANK OF ALBANIA

2.1. MONETARY POLICY

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

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

The Supervisory Council of the Bank of Albania makes monetary policy decisions. These decisions are based on the contemporary framework of analysis and forecast, which enables the formulation of a monetary policy consistent with the accomplishment of the inflation target. This framework makes use of all available information, and is based on tested econometric models and the best practices of central banking.

The Bank of Albania maintained an accommodative monetary policy stance throughout 2019. This position was underpinned by inflation values continuing below target. It aims at decreasing financial costs and establishing the premises for a calmer exchange rate, to support the growth of economy, employment and rise in wages, by helping the return of the economy to equilibrium and the convergence of inflation to target.

In compliance with this objective, the Bank of Albania kept the policy rate unchanged, at 1.00%, and continued to orient the market on maintaining the accommodative monetary policy pace in the medium-term horizon, and supplied banks and the financial sector with the necessary liquidity.

The accommodative monetary policy pace provided improvement in financing conditions, expansion of lending, improvement of the financial position of both enterprises and households, and the restriction of strengthening pressures on the exchange rate, by promoting an increase in demand for goods and services. This increase in demand drove to expansion of employment, wages and production costs, which helped maintain inflation close to the Bank of Albania’s target.



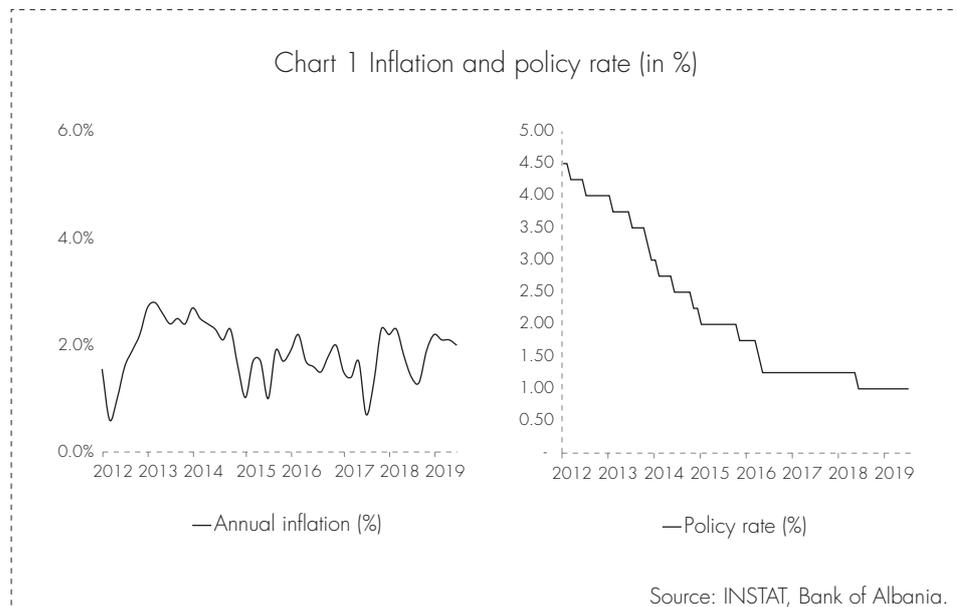
Nevertheless, both domestic and external inflationary pressures still appear insufficient for the return of inflation to target. This dictates maintaining an accommodative monetary policy stance in the medium term as well.

2.1.1 MONETARY POLICY THROUGHOUT 2019

The Albanian economy continued to grow over the course of 2019, but at a slowing pace, compared with the previous year. This performance was dictated by a set of factors, mainly transitional, such as a strong reduction in production of electrical energy, the gradual final stage of work on large energy projects, and the consequences of the earthquake that hit the country at the end of the year.

Although these shocks reduced the growth pace, they did not affect the medium-term trends of the country’s development and have not impacted the main indicators of its economic and financial stability.

According to INSTAT data, in the first three quarters of 2019, the economy grew 2.9%, from 4.1% growth recorded in the same period in 2018. The expansion of consumption and an increase in the export of services, due to a continuing positive trend in tourism, were the main sources of economic growth. The increase of aggregate demand leads to better utilisation of production capacities. Employment increased, on average, 2.8% during 2019. The unemployment rate fell to 11.2% in 2019 Q4, recording an historical minimum level, while the average wage indicator increased by 3.8%. Also, enterprises reported a higher utilization rate of their production capacities, while their ability to service debt improved. These indicators suggest that the Albanian economy is moving towards its potential, and this is expected to be reflected in a gradual return of inflation to target within the next two years.

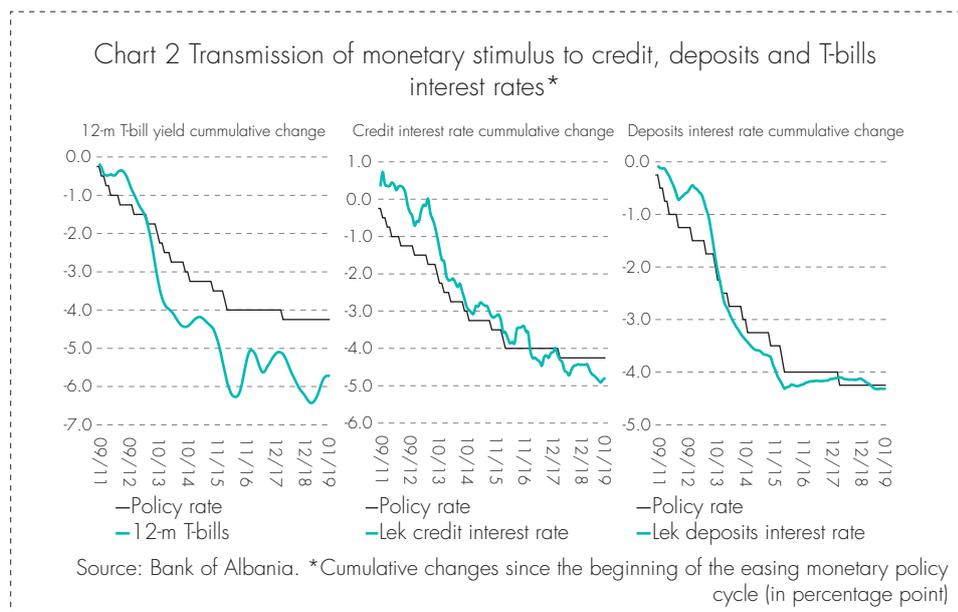


In 2019, annual inflation averaged 1.4%, down from the previous year. The reduction of inflation reflected a more complete transmission of the exchange rate appreciation and a fall in the inflation of goods in international markets. On the other hand, domestic inflationary pressures trended upwards, as shown by an increase in wages and production costs. Nevertheless, increase in costs remains slow and their transmission to consumer prices is still weak.

The still undershooting inflation values dictated maintaining an accommodative monetary policy over 2019. The monetary stimulus has been transmitted by keeping the policy rate at its historic minimum level, liquidity of supply in the banking sector, and forward guidance on the monetary policy stance.

Monetary stimulus of the Bank of Albania is transmitted through various channels.

First, the monetary stimulus drove to a decrease in credit price in lek and a reduction in financing costs to the private sector, which already appears at its historic minimum levels.



The reduction of financing costs has encouraged the growth of lending, by supporting the expansion of consumption and investments. Adjusted for written off loans, the exchange rate, credit to the private sector, and grew by around 8% during 2019. Lending to the private sector had a better sectoral composition, by showing an upward orientation towards the financing of business' needs for investment. Also, the foreign exchange structure of credit continued to improve. Credit in lek ratio to total loans grew 48.7%, from 47.2% in 2018, and 44.7% in 2017.

Second, in parallel with credit boosting, our accommodative monetary policy lead to the reduction of debt servicing costs to enterprises and households. Taking into account index prices and short -term average maturity of credit in



lek, the monetary stimulus is assessed to have reduced their debt servicing costs to the range of ALL 14-15 billion in 2019.

Third, the accommodative monetary policy has provided the premises for a more stable exchange rate in 2019. Although the Bank of Albania was not present in the domestic foreign exchange market, creation of a calm monetary environment provided for stabilisation. The positive effects of this stabilisation on the economy and inflation will be felt more completely in 2020 and beyond.

Fourth, the use of forward guidance on the monetary policy stance helped calm financial markets down, reflecting higher clarity on the trajectory of inflation and interest rates.

Through this transmission channel, our accommodative monetary policy stance has encouraged economic growth and has strengthened domestic inflationary pressures.

BOX 1 MONETARY POLICY IN ALBANIA AND ITS IMPACT ON THE ECONOMY

This box aims to provide an assessment on the impact of monetary policy on economic growth in Albania. The box is divided into three sections: the first section briefly addresses the impact of monetary policy transmission channels on the economy. The second section addresses the methodologies applied; and in the last section outcomes are presented.*

Monetary Policy Transmission Channels

Monetary policy serves as a tool of aggregate demand management, aimed at smoothing cyclical fluctuations in the economy, controlling inflationary expectations and reducing undesirable fluctuations in the financial balance sheets of enterprises, households and the financial sector. Neither the economy's potential nor its long-term growth, which is subject to various structural changes, is affected by the monetary policy.

In a small, open economy, like Albania, monetary policy affects economic activity through three main channels:

First, through its impact on liquidity supply and interest rate levels, the monetary policy impacts new borrowing costs, credit availability and existing debt servicing costs to enterprises and households. In this way, the monetary policy serves as an instrument to boost aggregate demand and economic growth (in case of an accommodative monetary policy), and vice versa.

Second, though its impact on the relative preferences of the economic agents towards owning financial instruments, in either lek or foreign currency, the monetary policy impacts the exchange rate in the economy. In the case of an accommodative monetary policy, the exchange rate tends to decrease, by promoting the growth of exports.

Third, though its impact on the economic operators' expectations about the economic and monetary indicators, the monetary policy also impacts their decisions on consumption and investments. In case of an accommodative



monetary policy, expectations for low financing costs in the future encourage enterprises and households to apply for more bank loans and to undertake more consumption and investments.

Assessment methodology of the monetary policy impact on economic growth

Assessment of the contribution of the monetary policy to economic growth implies measurement of the impact of interest rates on the market and the real exchange rate on economic growth, which derive only as a result of the monetary policy stance.

Three exercises were conducted to obtain this assessment:

- In the first exercise, an individual assessment is made of the impact of all components which define the cyclical position of the economy, singling out the impact of real interest rates in the financial market on economic growth.
- In the second exercise, the impact of monetary policy on the nominal exchange rate is obtained. The assessed impact is used to generate an alternative exchange rate without the impact of the monetary policy. Through this alternative exchange rate effects on economic growth, apart from the impact of monetary policy on the exchange rate, are assessed.
- Finally, looking at the impact of monetary policy on economic growth and on the exchange rate, the aggregated impact on inflation rates is assessed, including future expectations for channels of economic agency.

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

Results

In summary, our conclusions are as follows:

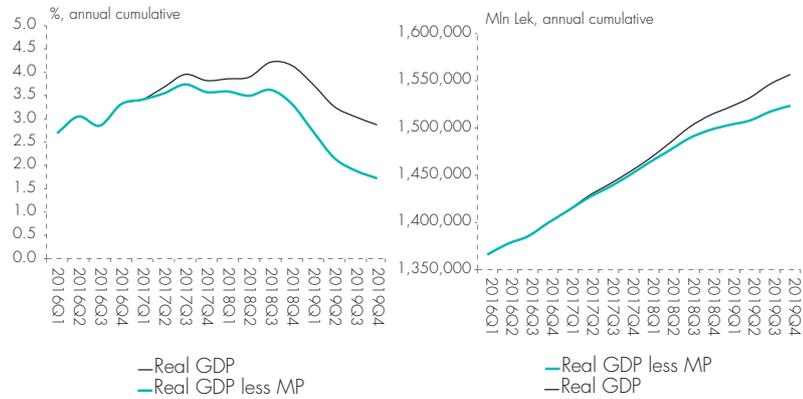
- The positive impact of monetary policy on the improvement of the cyclical position of the economy and on the acceleration of its growth pace has picked up, gradually, from 2017-2019. This performance reflects low interest rates in the financial market, reduction of risk premia and acceleration of lending to the economy. For the entire period, the positive effect on the average economic growth due to the accommodative monetary policy stance is assessed at 0.6 p.p.
- The monetary policy has an accumulative impact on the economic activity level, measured by the real GDP. The real economic activity is around 1.9 p.p. higher from an alternative GDP without the contribution of the monetary policy, up to 2019 Q3, due to the positive effect of the accommodative monetary policy implemented by the Bank of Albania.

Chart 3 shows the results of this exercise.

- The accommodative monetary policy stance has affected the generation of depreciating pressures on the nominal exchange rate. During the period of 2017-2019, the nominal exchange rate pursued an appreciating trajectory mainly in line with its long-term trend, also affected by a strong shock of appreciation during 2018. Nevertheless, without the contribution of the monetary policy, this appreciation would have been, on average, 0.5 p.p. stronger.



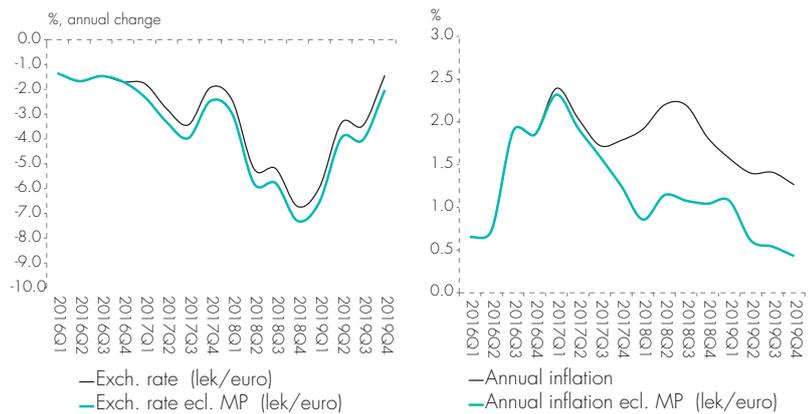
Chart 3 Cumulative economic growth, real and excluding monetary policy contribution (left); cumulative annual GDP, real and excluding monetary policy contribution (right)



Source: Bank of Albania.

- *The impact of the accommodative monetary policy on both economic growth and the exchange rate has affected higher inflationary pressures. The latter have been intensified during 2018-2019 in line with the action time of the monetary policy transmission channel. Annual inflation for 2017-2019 is assessed to be higher, by 0.2 p.p., 1 p.p. and 0.75 p.p., respectively, due to the impact of the monetary policy. The assessments show that the positive impact of monetary policy on economic growth is the dominant channel relating to the impact on inflation.*

Chart 4 The exchange rate lek/euro (left) and annual inflation(right), real and without the contribution of the monetary policy



Source: Bank of Albania.

* A similar assessment is also published in the Annual Report 2017 of the Bank of Albania. For more information see "Box 1": "Monetary policy in Albania and its contribution to economic growth", Annual Report 2017, page 27.



The Bank of Albania deems that maintaining an accommodative monetary policy stance will be necessary, even in the future, for the return of the economy to equilibrium and of the inflation to target. The economy is expected to continue its cyclical improvement, underpinned by the financial environment with low interest rates, an increase in employment and wages and the improvement of the financial balance sheets of the private sector. The improvement of the cyclical position of the economy is expected to lead to a better utilisation of production capacities, and to the strengthening of domestic inflationary pressures. Based on these exceptions, inflation is projected to return to target within the next two years.

The Bank of Albania has fulfilled its medium-term monetary policy priorities

The monetary policy priorities, as set forth in the Medium-term Strategy of the Bank of Albania, 2019-2021, aim at enhancing its effectiveness, flexibility and transparency, by contributing to its adequacy in a dynamic and complex economic and financial environment.

The following table summarises the progress marked in some directions, throughout 2019:

Strategic priority	Highlights in 2019
1. Developing the analysis and forecasting framework, aimed at further qualitative improvement of monetary policy formulation and implementation.	<ul style="list-style-type: none"> – Enhancement of research work, which is transmitted to the public through informative boxes in periodic reports, and working papers published on the website of the Bank of Albania; – Development and enhancement of forecasting apparatus is realised through an increase in the analysis and forecasting capacities of the available models, and an increase in the range of their output; – Improvement of the forecasting process is realised through deeper analysis of the initial conditions and more complete identification of long term behaviour trends in the economy.
2. Maintaining and developing the framework of monetary policy instruments, aiming to increase its effectiveness and flexibility.	<ul style="list-style-type: none"> – An increase in liquidity management effectiveness in the banking system, through implementation of the forecast framework of banking system needs for liquidity and publication of the short-term forecast of liquidity; – Enhancement of the effectiveness of operational decisions, through implementation of the assessment framework for adequacy of foreign reserve levels; – Involvement in initiatives for the development of financial markets.
3. Further improving communication with the public in order to enhance understanding, predictability and the effectiveness of monetary policy.	<ul style="list-style-type: none"> – Increase of published information, with a series of core inflation and inflationary expectations; – Regular meetings with interest groups, including media and banks; – Improving, enhancing and increasing the clarity and understanding of regular reports and materials. – Use of forward guidance, as a monetary policy instrument for communication.
4. Developing further communication and cooperation with domestic and foreign partners, to enhance the synergy of domestic economic policies and bolster the European integration process.	<ul style="list-style-type: none"> – Strengthening of dialogue with the Ministry of Finance and Economy with the purpose of harmonising macro-economic policies; – Fulfilling obligations for reporting to the EU, in compliance with the requirements provided by national coordinators; – Knowing and implementing obligations arising from the European integration process; – Sharing information with other central banks and international institutions, including the International Monetary Fund and the World Bank Group.



2.1.2 ECONOMIC ACTIVITY

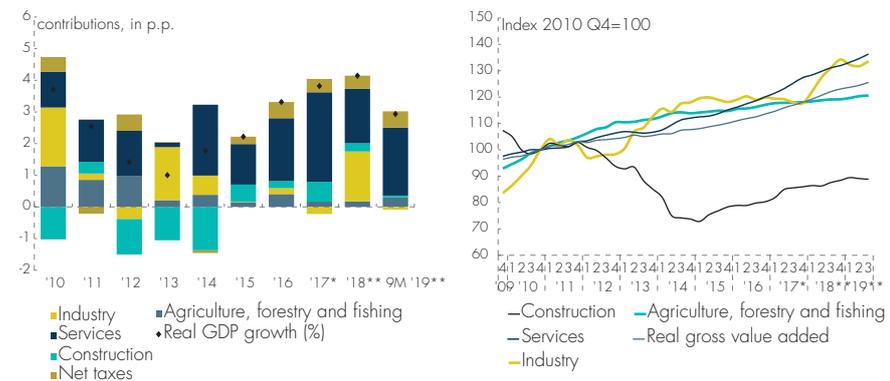
The Albanian economy continued to grow in 2019, mainly underpinned by an increase in private consumption and services exports. Nevertheless, a slowdown of investments and a reduction of goods export resulted in an overall slowdown in the pace of growth. This slowdown mainly reflected supply-side shocks, related to lower electricity production and a reduction on the pace of works in major electrical projects with foreign financing. The growth of aggregate demand led to an increase in employment, a fall of the unemployment rate to minimum historical levels and an increase in wages.

On the other hand, the unfavourable production and export situation of electricity urged the expansion of both trade and current deficit in 2019. Nevertheless, the stability indicators of the external position of Albania recorded an improvement. Last, fiscal policy continued to maintain its consolidating direction; primary deficit continued to remain in positive territory and public debt decreased, but the intensity of fiscal consolidation slowed down.

Economic growth in the first nine months of 2019 was 2.9%, lower than the growth in the same period a year earlier.¹ The information from indirect qualitative and quantitative indicators, given the materialisation of the negative impacts from the earthquake of 26 November 2019, suggests more moderate economic growth in 2019 Q4.

The slowdown of economic pace of growth in the first nine months of 2019 is closely related to the performance of the production sector. The reduction of the sector's contribution to 0.3 percentage point, from 2.2 percentage point

Chart 5 Real GDP growth (in %) and contributions of components (in percentage points); Trend of real gross value added in the economy and sectors*



Source: INSTAT and Bank of Albania. * Semi-final data. ** A preliminary assessment. Note: Indices of the real gross value added for the economy and its sectors are calculated as the moving sum of quarterly values for four quarters.

¹ The information published by INSTAT on gross domestic product by the method of production and expenditures cover developments to the third quarter 2019, published on 24 December 2019.

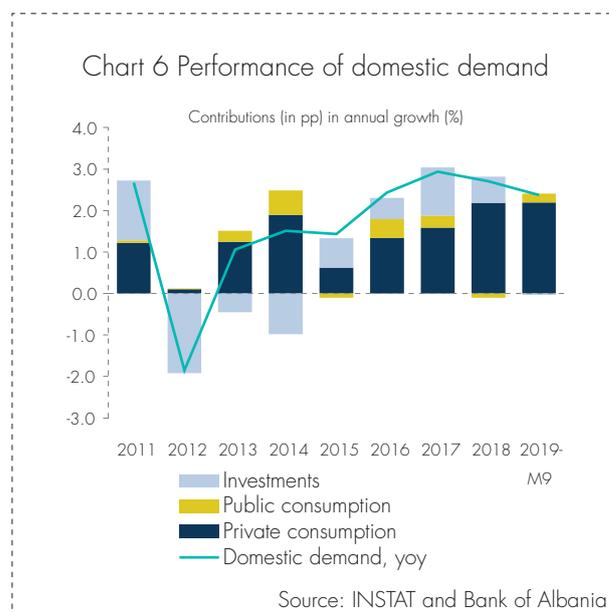


in the previous year, mainly reflected lower production of electrical energy, and to a lesser extent, the slower growth of construction activity. Electricity production affected the falling trend of annual GDP by around 0.8 percentage point, from +1.2 percentage points in the same period in 2018. Regarding construction activity, developments mainly reflected the TAP project's entry into the finalisation phase. Consequently, the positive contribution of construction to annual GDP growth was reduced to 0.1 percentage point. Meanwhile the improvement of agricultural and industrial activities was translated into a larger effect than in the same period in the previous year.

GDP growth is mainly attributed to the services sector², whose contribution is calculated at 2.1 percentage points. The value added by services, which expanded with a higher rate than the historical average, was mainly supported by the activity of the "Trade, transport, accommodation and food service" branch. The contribution of "Trade, transport, accommodation and food service", of 0.9 percentage point to economic growth, was driven by trade activity. Also, other branches of services increased their impact on GDP. Meanwhile, among a few branches having a slowdown effect on GDP is "Art, entertainment, recreation and other activities of service" which in reflection of the closure of betting ventures, experienced a contraction in value added.

Domestic demand provided the main impact on the economic growth in 2019.

Domestic demand expanded by 2.4% in the first nine months of 2019.³ Population consumption, which increased by 3.1% in annual terms, and public consumption provided the main impact. On the other hand, investments decreased by around 0.4% in annual terms.



Private consumption continued its upward trend in 2019

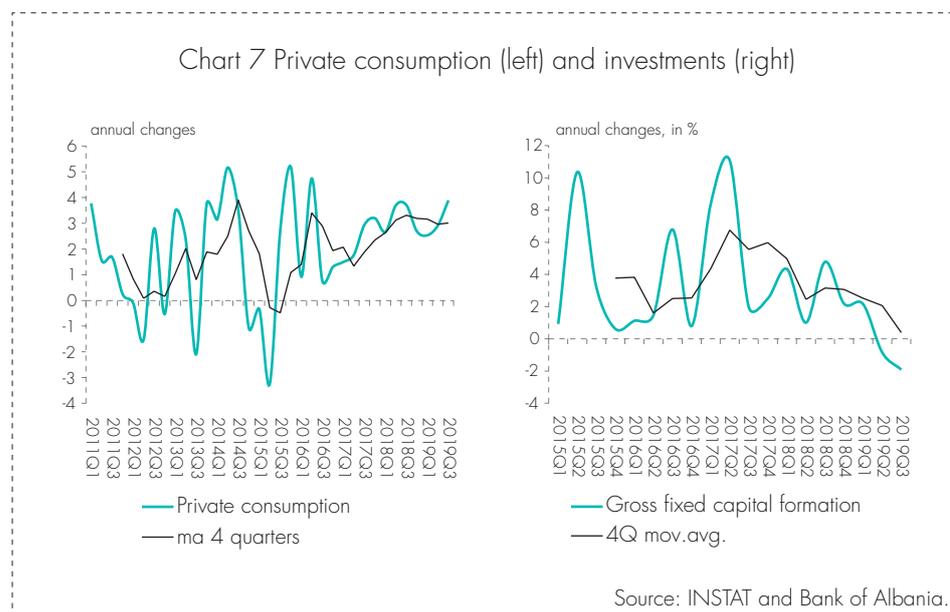
Private consumption recorded stable growth in 2019, comparable to the one in the previous year. In average terms, private consumption grew by 3.1% during the first nine months of the year, being the main contributor to the expansion of the aggregate demand. The growth of private consumption reflected a continuing increase in wages and employment, and the performance of consumer confidence, whose level, notwithstanding the short-term fluctuations,

² The main branches of services are: "Trade, transport, accommodation and food service", "Information and communication", "Financial and insurance activities", "Real estate activities", "Professional activities and administrative services", "Public administration, education and health", "Art, entertainment, recreation and other service activities".

³ Domestic demand components are final consumption (including final consumption of the population, of the public administration and of non-profit institutions) and gross fixed capital formation. In terms of national accounts, private consumption in this report refers to final consumption of the population, whereas investments are equivalent to gross fixed capital formation.



remained above the historical average. In parallel, the expansion of consumer spending was supported by low interest rates and eased financing conditions.



Investments fell slightly in 2019

The volume of investments fell by 0.4% during the first three quarters of 2019, reflecting the contraction of the private sector's investments, while public investments made a low contribution, but an increasingly positive one. The slowdown in investments reflects the Trans Adriatic Pipeline (TAP) project's entry into the completion phase of investments. Excluding this development, the volume of private and total investments appears upwards, reflecting also their supporting factors. The growth of investments continued to be positively affected by a better utilization of production capacities, stable consumer demand and eased financing conditions.

Fiscal consolidation was also present in 2019, but consolidation intensity was lower.

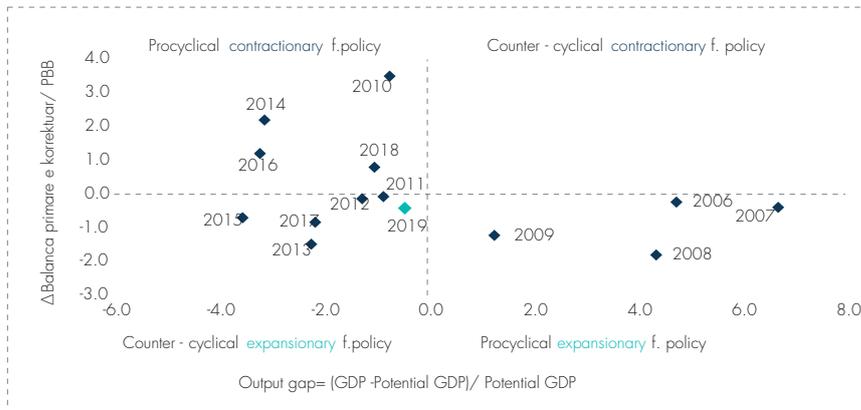
The fiscal policy continued a consolidating cycle in 2019. Nevertheless, the pace of fiscal consolidation was lower from the previous year. Thus, the primary surplus was about 0.2% of GDP, 0.4 percentage point lower than in the previous year. Hence, the activity of the public sector provided a positive effect on both aggregate demand and economic growth in 2019.

The budget deficit stood at ALL 31.5 billion or around 1.9% of GDP in 2019. Unlike in previous years, the deficit was entirely financed from domestic sources, by reducing foreign debt by around ALL 9.4 billion. A transfer of excess liquidity created in 2018⁴ to be used in 2019, financed the deficit by around ALL 22.8 billion. On the other hand, borrowing in the domestic market of securities increased by around ALL 17.8 billion. In 2019, new borrowing in the form

⁴ This surplus was mainly created by the issuance of Eurobond in international markets amounting around EUR 500 million.



Chart 8 The nature of fiscal policy in Albania*

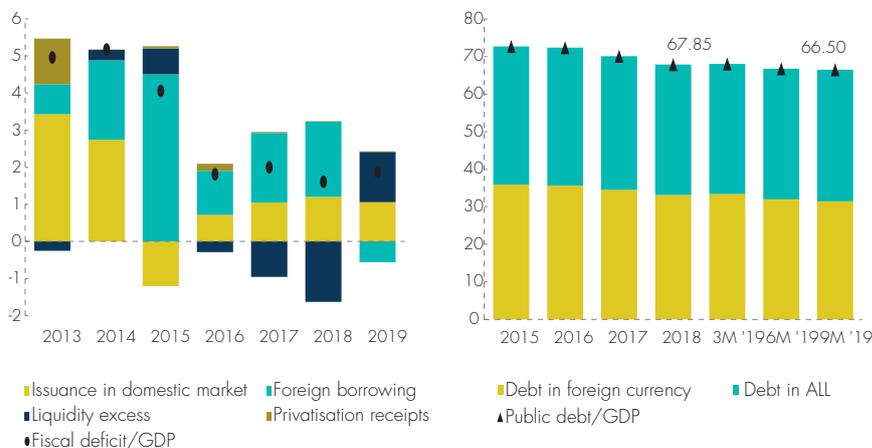


Source: Ministry of Finance and Economy, INSTAT, and Bank of Albania staff's calculations.
 *For the methodological details, refer to the "Fiscal policy and business cycles" box in the Bank of Albania's Annual Report for 2017.

of government securities denominated in the domestic currency was around ALL 27.5 billion, while the Government matured both recent bonds issued in Euro in the domestic market. The new borrowing in securities denominated in the domestic currency mainly consisted in the issuance of 3-, 5-, and 10-year benchmark bonds.

According to data from the Ministry of Finance and Economy, the public debt stock is assessed at 66.5% of GDP in 2019, down from 67.8% in 2018.⁵ The fall of public debt is at its highest extent, attributable to the positive gap between economic growth and interests paid on debt. Also, the consolidating nature of fiscal policy was reflected in the reduction of debt, albeit lower than a year earlier.

Chart 9 Budget deficit and financing (left) and public debt (right) to GDP



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

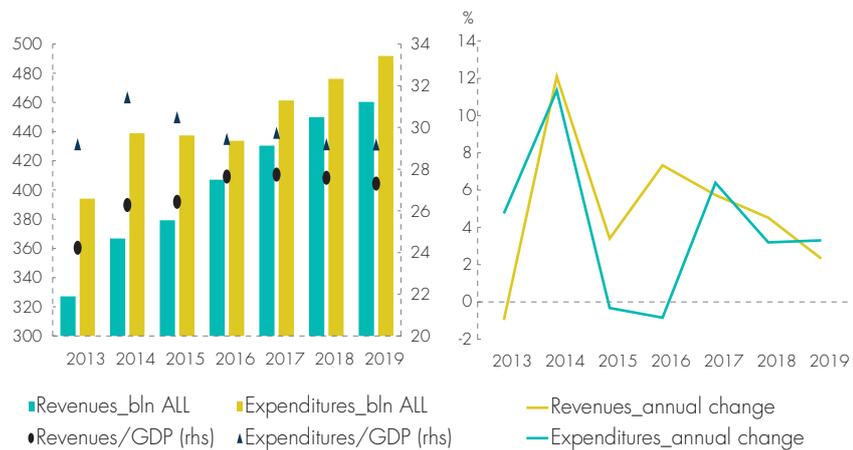
⁵ The data of public debt stock is referred to the publication of MFE for 2019 Q3.



Budget expenditures in 2019 resulted in ALL 491.9 billion, or around 3.3% higher than a year earlier. Expenditures for pensions, personnel and local government mainly affected the growth of expenditures. The performance of interest expenses and capital expenditures provided an opposite effect. The size of the public sector, as a ratio of total expenditure to GDP, was estimated at around 29.2%, similar to the previous year.

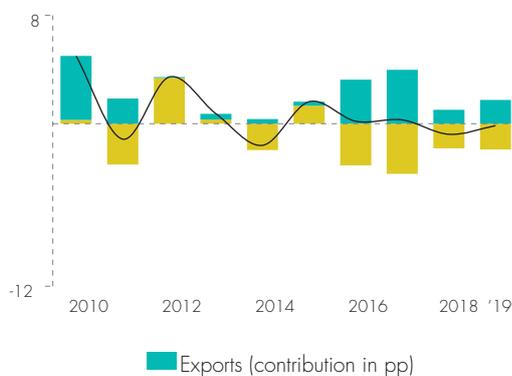
Budget revenues for 2019 amounted to around ALL 460.3 billion, or around 2.3% higher in annual terms. Tax revenues were estimated at around 27.3% of GDP, or around 0.4 percentage point lower than in the previous year. VAT revenues affected negatively the profile of tax revenues in 2019. Their contraction reflected the fiscal facilities used to support specific sectors of the economy, and higher reimbursements than a year earlier. On the other hand, tax revenues on personal income provided the highest impact, mainly affected by higher dividends paid by private companies.

Chart 10 Revenues and expenditures



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

Chart 11 Contribution of net real exports in economic growth (in percentage points to GDP)



Source: INSTAT and Bank of Albania.

The balance of trade exchange with abroad worsened slightly, by providing a negative contribution in the economic growth for the first nine months of 2019.

Trade deficit expanded by around 0.2% in real terms during the first nine months of 2019. Its performance was mainly determined by an increase of imports by around 4.1%, reflecting a 3.6% increase in the import of goods and 4.9% increase in services imports. On the other hand, exports grew by 5.1% in real terms; export of services recorded a growth of 9.2%, while export of goods fell by 8.2%. The fall in the latter is mainly related to the export of electricity.



2.1.3 LABOUR MARKET

The labour market continued to show improving trends during the first nine months of 2019. The unemployment rate followed a downward trend shown since 2016, standing at its lowest historical level, around 11.4%, in 2019 Q3.⁶ This rate was 0.8 percentage point below the level recorded in the same quarter a year earlier. Unemployment fell not only by gender, but also by age group, albeit it remained higher for young people. Regarding employment in the economy, this indicator increased by 2.7% during the first nine months of 2019, from 3.5% in the same period a year earlier. The increase of employment was mainly supported by the services sector, which recorded a slightly faster growth rate, and to a lesser degree by industry.

Table 1 Quantitative labour market figures (%)

	2016	2017	2018	2019		
				Q1	Q2	Q3
Employment (15 years and older, annual changes)	6.5	3.3	3.0	1.4	3.4	3.3
- In agriculture	3.9	-2.0	0.7	-1.8	0.3	0.2
- In industry (including construction)	11.0	3.4	5.1	3.0	4.4	6.0
- In services	7.8	8.4	4.2	3.6	5.7	4.8
Employment rate (15 - 64 years old)	55.9	57.4	59.5	60.3	61.4	61.5
Labour Force Participation Rate (15-64 years old)	66.2	66.8	68.3	69.0	69.8	69.8
Unemployment rate (15 years and older)	15.2	13.7	12.3	12.1	11.5	11.4
The average monthly wage for an employee (nominal annual changes)	-0.8	3.0	3.3	4.9	4.5	3.7
The average monthly wage for an employee (Real annual changes)	-2.1	1.1	1.3	3.3	3.1	2.3

Source: INSTAT and Bank of Albania calculations. Note: The values presented are the average of the annual changes or the values of the indicators for the four quarters of the respective years. Annual changes of wages in real terms are calculated taking into account annual inflation.

The growth of employment coupled with decisions to increase the minimum wage in Albania and of wages in certain segments of the public sector, affected the rise of wages in the economy during the first nine months of 2019. During this period, the annual increase of gross monthly wage for an employed person averaged 4.3%, from 3.0% in the first months of 2018. In real terms, this growth was around 2.9%, from around the 0.9% increase recorded in the same period a year earlier.

2.1.4 BALANCE OF PAYMENTS AND EXTERNAL POSITION OF THE ECONOMY

Current account deficit continued to show a downward trend

The current deficit to GDP ratio declined to 6.8% for the first 9 months of 2019, from 7.3% in 2018 and 10.8% in 2014. A significant contribution in this direction has been made by the decrease of the trade deficit to GDP ratio, from 19.0% in 2014, to 13.7% in 2018 and 12.8% in the first 9 months of 2019.

⁶ Analysis of employment and unemployment is based on the data of the Quarterly Labour Force Survey, and refers to the indicators for those 15 years and older.



The performance of the trade deficit in 2019 reflected two different dynamics - an increase in trade deficit in goods and an increase in trade surplus in services. Trade deficit of goods increased by 12.8% for the first 9 months 2019, reflecting, mainly, a decrease of exports and an increase in electricity imports. As a consequence, exports of goods declined by around 7.3%, whereas imports expanded by 7.5%. On the other hand, services account surplus expanded by 11.9% in annual terms. Exports of services increased by around 9.9%, where the main impact stemmed from travel services (tourism) while imports of services increased by 8.7%.

Despite the fluctuation which characterised the period of 2018-2019, the performance of exports has followed a continuous upward trend in recent years, driven mostly by the positive performance of exports of services and travel. On the other hand, export of goods has been the main factor behind the continuous shocks presented by the overall exports structure. Regarding imports, the performance of goods has been overall stable and in line with overall economic performance and aggregate demand. A new phenomenon has been the rapid increase of imports of services, mostly related to travel services.

Primary income deficit expanded by around EUR 62.5 million in annual terms, affected by the rapid increase of outgoing income related to direct investments. On the other hand, the positive surplus of secondary income increased by 3.6%, mainly due to an annual increase of remittances by around 3.9%. Regarding remittances, over the years, a gradual decline of the importance of these flows as ratio to GDP has been observed. This ratio decreased from around 9.0% in 2009, to 5.2% in 2018 and 5.1% for the first 9 months of 2019.

Financing of the current account deficit is based on non-debt creating flows.

The flow of foreign direct investments played a key role in current deficit funding. For the first 9 months of 2019, inflows expanded by around 7.4% and are estimated at around 8.0% of GDP. In 2019 a decline of flows, related to the energy sector as result of the entry of major projects in the final stages of construction, was observed. Compensatory flows have been recorded in the extracting industry as well as information and communication sectors. Nevertheless, the energy sector ranks first in terms of sectoral structure of FDIs stock. Inflows in this sector have generated the main contributions to the significant growth of FDIs in recent years. On the other hand, projects are entering into the final stages of construction and this is expected to affect future flows of FDIs.

Regarding the origin of FDIs, in 2019, an increase of the relative share of Bulgaria at the expense of Greece was observed. This phenomenon is related to the sale of a company in the communication sector to an operator of Bulgarian origin.

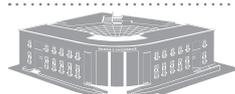
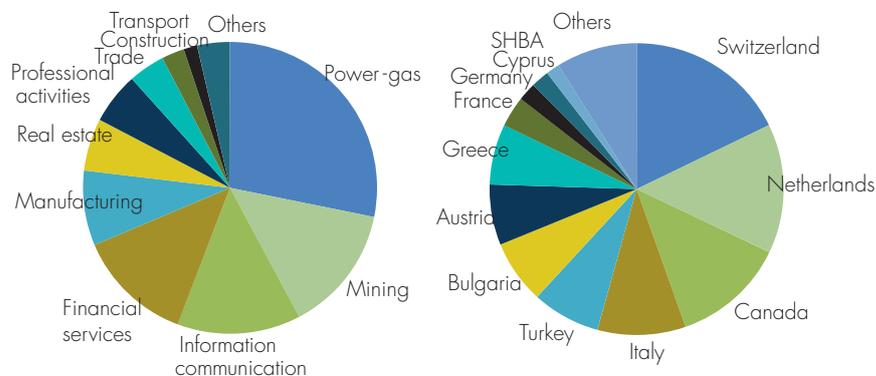


Chart 12 Sectoral structure (left) and by origin of FDIs stock at end-2019 Q3 (% to total)



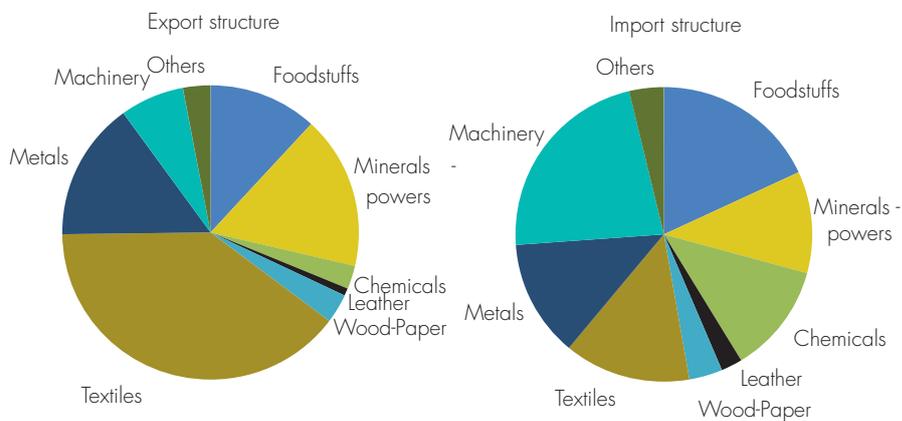
Source: Bank of Albania.

The performance of exports and imports reflected unfavourable conditions in the foreign environment as well as a downward impact on electricity output

The performance of exports reflected weak international demand, low commodity prices and appreciation of the exchange rate. Exports of goods remain relatively focused in a few categories, where in 2019 the group "Textile and footwear" continues to have the main share at around 39.6% of total exports. Overall, the exports structure has not registered fundamental changes in recent years. An increase in the relative share of foods can be observed, due to the increase of exports in neighbouring countries. However, it has not been such as to overturn the existing ratios between categories.

The imports structure is more diverse, where the categories "Machinery, equipment, spare parts", "and Food, beverages, tobacco" and "Chemical and

Chart 13 Exports (left) and imports (right) structure for goods in 2019 (% to total)

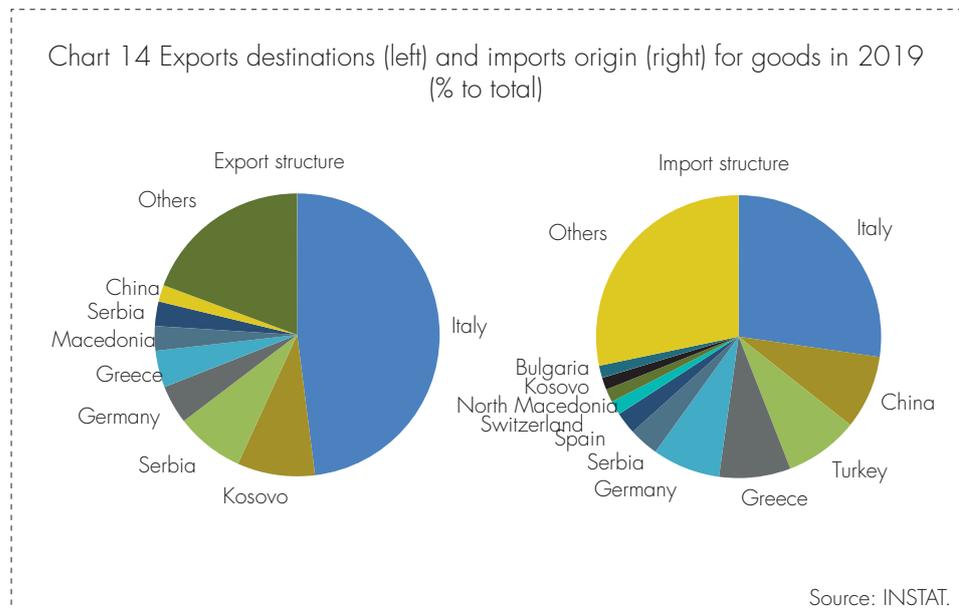


Source: INSTAT.



plastic products” have the main share. The share of the category “Minerals, fuel, electricity” increased in 2019, reflecting the upward imports of electricity. As for exports, overall the imports structure remained solid between years with very few changes in the relative ratios between the categories.

European Union countries, particularly Italy, remain our main trade partners. In 2019, there is a relative decrease in Italy’s share due to the poor performance of exports in the category “Textile and footwear”. The same is true for countries where the main export is electricity, like Switzerland. In recent years, there was a slight increase in the relative share of several neighbouring countries like, Kosovo, Serbia, North Macedonia and Montenegro. In particular, Kosovo has gradually climbed the ladder in the overall structure to become the second trade partner. The factor behind these developments has been the improved performance in exports of foods, fuel, metals and, finally, electricity to these countries.



Foreign debt stability indicators continued to improve in 2019

Foreign debt stock registered EUR 8,328 billion in 2019 Q3, expanding by 3.4% compared to the previous year. It is estimated at 61.6% of annualised nominal GDP from 65.2% at the end of 2018. In structural terms, government debt dominates with around 45.7% of the total, followed by the debt of deposit-taking corporations (17.1%) and debt related to Direct Investments (20.4%). In maturity terms, long-term debt dominates at around 80.6%. Regarding instruments, loans and currency and deposits investments constitute around 70.0%. The share of investments portfolio remains quite low. Overall, no significant changes have been observed in the debt structure over the years. On the other hand, there is a significant decline in the ratio of debt to nominal GDP from 74.4% at the end of 2015, to around 61.6% at the end of 2019 Q3.



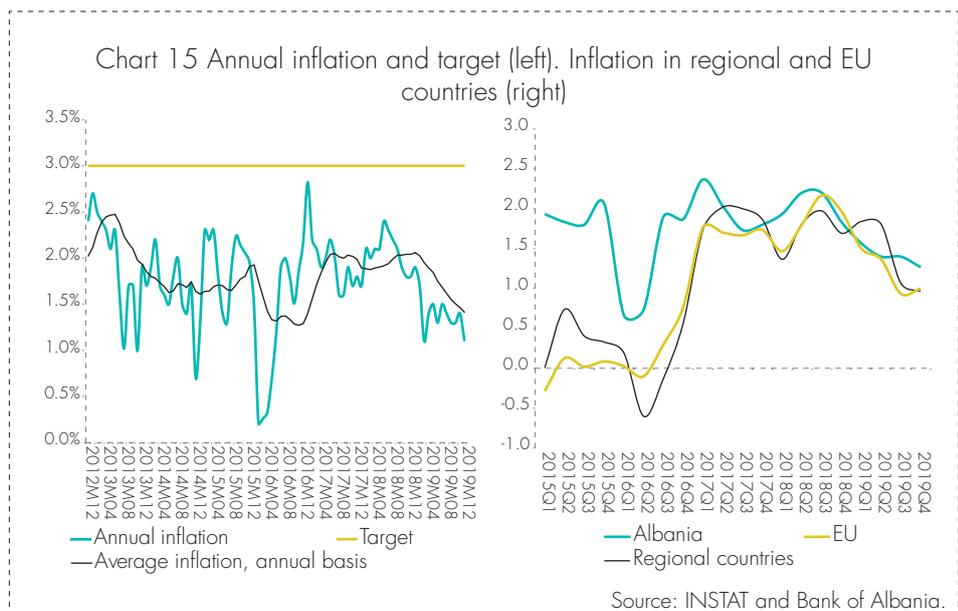
In terms of stability, there was an improvement in long-term repayment ability indicators in 2019. The ratio of debt stock to the exports of goods and services was around 156.2% at the end of 2019 Q3. Meanwhile in the previous year, this ratio stood at 161.5%. At the same time, the ratio of debt stock to fiscal revenue marked 221.5%, compared with 237.8% registered the previous year. Both stability and liquidity indicators have registered clear improving tendencies since 2015.

2.1.5 INFLATION AND ITS DEFINING FACTORS

The performance of inflation in 2019 reflected the global impact of the decline in the prices of broad commodities and a price conjecture affected by supply shocks on the downward side. Positive rates of economic growth and stabilisation of employment market indicators have mitigated the gap between current and potential output, but have not eliminated it, thus supporting the assessment that demand-side inflationary pressures still remain insufficient.

Average inflation for 2019 was 1.4%, down from 2.0% in the previous year. Inflation slowed down from 1.9% in 2019 Q1 to 1.4% in Q2 and Q3, whereas in the last quarter it registered its lowest level of 1.3%.

From a macroeconomic perspective, although the negative output gap continued to narrow, the weak performance of import prices, the prolonged appreciating performance of the exchange rate and the presence of base effects have kept inflation values below those of the previous year.



Low inflation values during the year reflected low pressures from food, fuel and housing prices.

Inflation fluctuations over the past year were largely determined by the food group. Both foods' categories formed around 80% of headline inflation. Short-term events of a seasonal nature that affect the price of the category "Unprocessed foods" have also determined fluctuations in the value of inflation. The lower seasonal intensity of prices in this category in some periods of the year caused a decline of its inflation. In the category "Processed foods" the result of slight fluctuations in the prices of the groups composing it was almost the same as in the previous year. As a consequence, the category provided the same contribution as in the previous year.

*Table 2 Contribution of key categories to annual inflation (p.p.)**

	Q1 '17	Q2 '17	Q3 '17	Q4 '17	Q1 '18	Q2 '18	Q3 '18	Q4 '18	Q1 '19	Q2 '19	Q3 '19	Q4 '19
Processed food	0.6	0.5	0.2	0.0	0.1	0.2	0.2	0.1	0.1	0.2	0.3	0.3
Bread and cereals	0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	0.1
Milk, cheese and eggs	0.4	0.3	0.2	0.1	0.1	0.0	0.1	0.1	0.1	0.2	0.2	0.2
Unprocessed foods	1.3	1.1	1.2	1.3	0.9	1.1	1.0	0.9	1.3	0.8	0.7	0.8
Fruits	0.3	0.3	0.5	0.6	0.6	0.1	0.0	-0.1	-0.3	0.0	0.1	0.4
Vegetables	0.9	0.7	0.7	0.6	0.2	0.9	0.9	0.9	1.5	0.8	0.6	0.4
Services	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.1
Goods with regulated prices	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.2	0.0	0.0	0.0	0.0
Water supply	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.2	0.0	0.0	0.0	0.0
Housing lease	0.0	0.1	0.1	0.2	0.3	0.4	0.4	0.3	0.1	0.2	0.1	0.0
Non-food consumer goods	0.3	0.2	0.2	0.2	0.3	0.3	0.3	0.2	0.1	0.2	0.1	0.0
Fuel	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.2	0.1	0.1	0.0	-0.1
Durable consumer goods	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Headline inflation (%)	2.4	2.0	1.7	1.8	1.9	2.2	2.2	1.8	1.6	1.4	1.4	1.3

Source: INSTAT and Bank of Albania.

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

The other categories have decreased their contribution to headline inflation compared with the previous year. They formed around 15% of headline inflation, compared with 40% in the previous year. The category of "Non-food consumer goods" contributed to low positive values in inflation in 2019. Its contribution finished around -0.2 percentage point lower than in the previous year. This performance has reflected inflation and the negative contribution of fuel due to a downward trend in oil prices by the end of the year; appreciation of the domestic currency; and the impact of the high comparative base of the previous year.

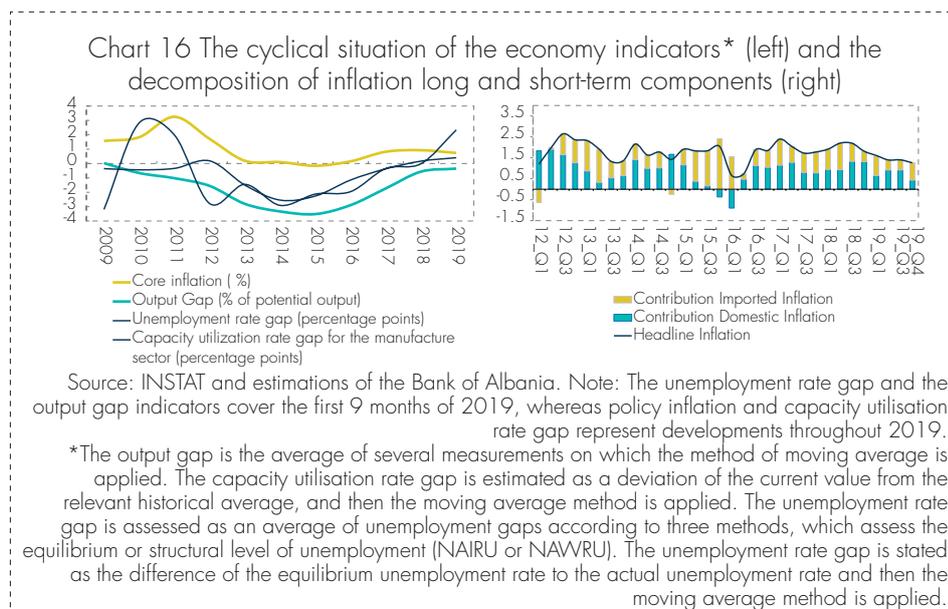
The prices of other more stable components of inflation, which include housing, services and long-term consumer goods prices, also contributed less to the formation of headline inflation compared to the previous year. The contribution of the category "Housing-rent" finished 0.3 percentage point lower, reflecting the higher comparative base impact of the previous year and the almost constant stance of the index in 2019. The category "Services" contributed slightly to headline inflation, maintaining the behaviour of the previous two years. The



contribution of the category “Long-term consumer goods” was positive, but with an almost negligible impact on headline inflation. The category “Goods and services with regulated prices” contributed 0.2 percentage point less to inflation in 2019, due to cessation of the impact of the price increase in the previous year.

The gradual improvement of the cyclical position of the economy was reflected in low domestic inflationary pressures in 2019

The improvement of the cyclical position of the economy continued during the first 9 months of 2019. The increase of employment, salaries and the capacity utilisation rate, continued to contribute into the strengthening of inflationary pressures originated by developments in the domestic economy. However, the slower reaction of policy inflation has been affected by the economy’s continuing below its potential and the appreciating behaviour of the exchange rate. Transmission of the increase of salaries into output costs continues to be insufficient as well.



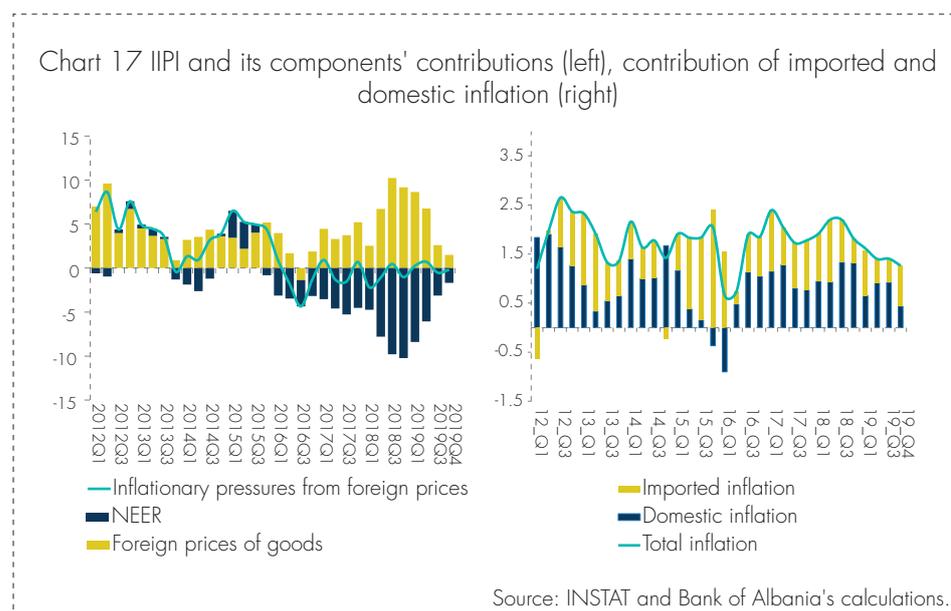
Long-term inflationary pressures have trended upward in 2019. They were stable from April-December 2019, although with a lower contribution than in the previous year, by 0.5 to 0.7 percentage point, respectively. This curtailment reflected, mainly, the impact of the high comparative base from housing prices (rents), whereas the curbing impact from the exchange rate is assessed as more moderate. The decline of headline inflation in 2019 was mainly affected by the slowdown of contributions from short-term components, to 0.9, from 1.4 percentage point in 2018.

Foreign inflationary pressures showed lower volatility in 2019

The indicator “Foreign prices” expanded by 4.9% in annual terms in 2019, a slower rate compared to 2018. Meanwhile, the nominal effective exchange



rate appreciated by 4.8%. As a consequence, the imported inflation pressure index (IIPPI)⁷ expanded by just 0.1% in average annual terms.



In relation to previous developments in foreign prices and the exchange rate, the contribution of imported inflation in 2019 was relatively lower than that of domestic inflation, which remained at 48% and 52%, respectively, in average terms.

2.1.6 FINANCIAL MARKETS AND MONETARY INDICATORS

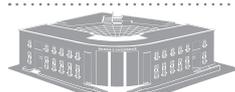
Financial markets had low risk premiums, adequate liquidity and downward trending interest rates. Historically low policy rate levels, constant communication with the market on the future orientation of monetary policy, as well as adequate levels of liquidity deficit, have all supported a decline in credit interest rates. Developments in the foreign exchange market have also been calm, characterized by mitigated appreciation of lek and low volatility.

Credit to the private sector improved, reflecting better credit conditions and structural changes in the banking sector. In particular, lending in lek made the main contribution to this improvement, supported by eased monetary conditions. The latter has contributed positively to monetary expansion throughout 2019.

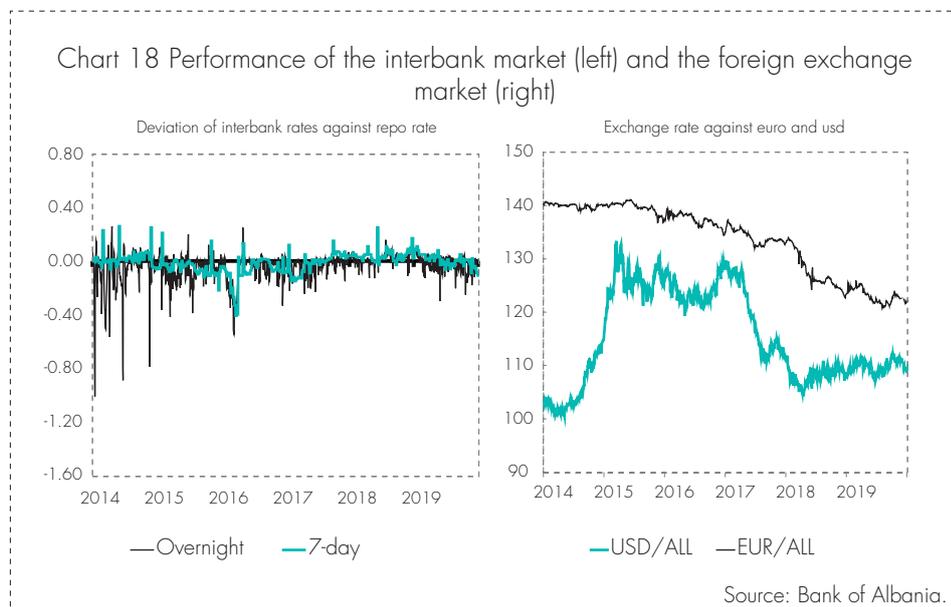
The liquidity deficit in the banking system has been at adequate levels and interest rates in the interbank market have fluctuated near the policy rate, in line with the operational objective of monetary policy.

The Bank of Albania continued to supply banks with liquidity throughout 2019, in line with their financing needs. Liquidity deficit in the system, albeit lower than in

⁷ IIPPI is calculated as the sum of the annual increase in import price indices and the NEER index value for the relevant periods.



the previous year⁸, was within adequate levels to ensure consistent monitoring of monetary stimulus in the interbank market and beyond. Short-term interest rates in this market marked a slight decrease compared to the previous year, maintaining the minimum difference against the policy rate and low volatility.



Appreciation pressures on lek were mitigated and trading of foreign currency was calm

The strengthening of the domestic currency waned significantly in 2019. Appreciation pressures on the lek continued to be present, but were more contained than in the previous year. They were focused mainly in the second and third quarter of the year, characterized by a better season of tourism compared to the previous year. The annual appreciation of lek against the euro, which is also the main currency for the exchange of goods and services abroad, reached 1.0% in December, from the maximum level of 7.4% recorded in December of the previous year.

The performance of the US dollar in the domestic market reflected its strengthening in the international market; lek depreciated against it by an average of 1.7% during this year.

Developments in the foreign exchange market were calm in 2019 and foreign currencies were traded within normal market parameters. Risk and volatility indicators⁹ returned to their normal values, after the shock they received in 2018. Also, no slanted expectations for appreciation or depreciation of exchange rate

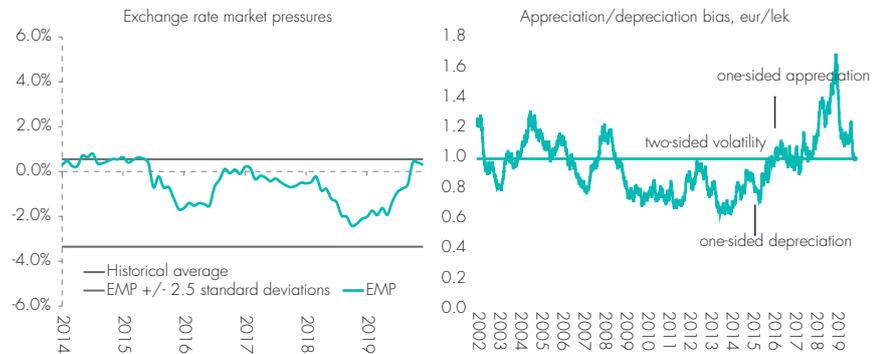
⁸ Two factors contributed to the decrease of liquidity deficit during 2019. First, the financing needs of the system were lower as a result of lower government demand in the first half of the year, dictated by the issuance of the Eurobond at the end of 2018. Second, the entry into force of the regulation on the maintenance of the required reserve in foreign currency in the original currency led to liquidity release in lek at the end of August.

⁹ Bid-ask spreads in the euro / lek exchange rate and volatility indicators have been low.



were present in the market¹⁰. The performance of these indicators shows the normalization of agents' expectations in the market and the lack of speculative positions on their part about the future performance of the exchange rate.

Chart 19 Indicators of pressures and risk in the foreign exchange market*

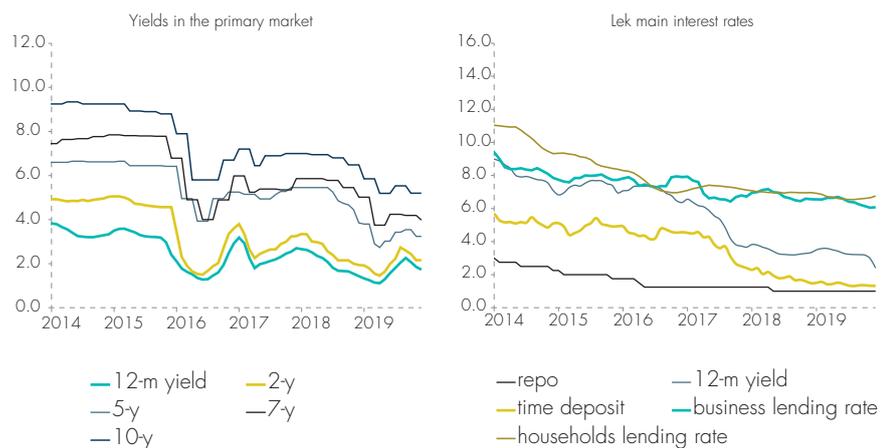


Source: Bank of Albania. *The pressure index in the foreign exchange market measures the amount of change in the exchange rate needed to amortize the imbalance between supply and demand in the foreign exchange market. Its calculation consists of stripping the change of exchange rate due to domestic and foreign monetary policy factors (the difference between the lek interest rates against the US dollar and the euro, as well as the change in the foreign exchange reserve of the Bank of Albania). Values below 0 show appreciation pressures and vice versa.

Yields on government securities were downward and yield curve flattened

Yields on government securities fluctuated at lower levels during 2019 compared to the previous year. The 12-month yield was 1.6%, up from an average of 2.0% in 2018. A shift in the government's supply on long-term

Chart 20 Performance of yields in the primary market and interest rates in lek



Source: Bank of Albania.

¹⁰ The exchange rate appreciation/depreciation ratio is calculated as the ratio of the number of days when the lek is appreciated against the number of days when the lek is depreciated, over a moving time horizon of 250 days. The value of this indicator near 1 indicates an equal number of appreciation and depreciation cases. If this indicator is significantly and persistently above 1, there are one-sided pressures for appreciation in the market and vice versa.



securities during the year was accommodated by a higher demand in the system to invest in these securities. This development is reflected in stronger downward pressures on yields on long-term bonds and a smoothing of the yield curve slope. Reduction in yields on securities with maturity up to two years averaged 0.5 percentage point this year, compared to an average decline of 1.3 percentage point for those with maturity over two years.

Interest rates on loans and deposits in lek declined.

Continuation of monetary stimulus and a lack of liquidity pressures in the system created conditions for further decline in interest rates on deposits and loans in 2019. The average interest rate on time deposits in lek was 0.8%, with a marginal decrease compared to the previous year. Also, enterprises and households benefited from cheaper bank funding this year. The average interest rates for these two segments were 6.3% and 6.6%, respectively, each being 0.4 percentage point lower compared to the previous year. Short-term volatility in yields has not been transmitted to credit interest rates. The latter have maintained an average spread against the same 12-month yield in the previous year.

Growth rates of lending activity improved, supported by better conditions for credit supply and structural changes in the banking sector.

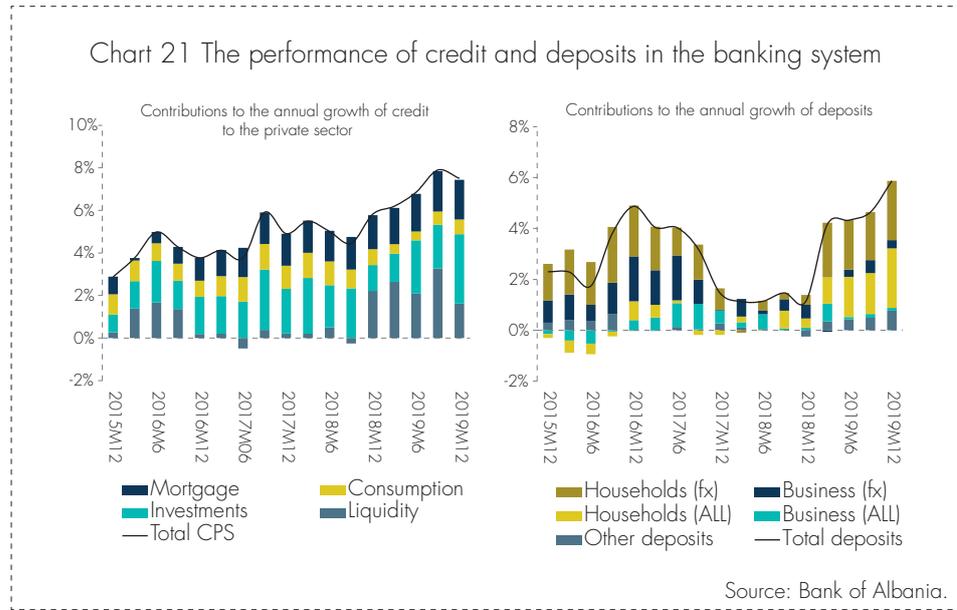
Annual growth rates of credit to the private sector¹¹ accelerated in 2019. Adjusted for the exchange rate appreciation effect, this portfolio expanded by about 7% in average annual terms. At the end of the year, credit stock to the private sector was estimated at about 36.5% of GDP, or 1.2 percentage point higher than the previous year. Lending dynamics was supported by the continuous easing of lending standards, while credit demand was volatile throughout the year. Improvement of banks' supply for loans reflected positive changes in the banking sector in 2019 - in terms of consolidating and write off of balance sheets from bad performing loans - which have dictated a more favourable approach for banks toward funding the private sector. Moreover, accommodative monetary policy supported the orientation of banks' supply to lend in domestic currency. Increased lending activity in lek has been the main contributor to expansion of the loan portfolio to the private sector, with an average annual rate of 8.7%. Credit in foreign currency also increased, increasing on average by 5.4% during the year, adjusted for exchange rate fluctuations.

Performance by market segments shows an increase in credit to both enterprises and households. The annual growth rate of loans to enterprises improved on average by 7.2%. This portfolio made the biggest contribution to credit growth during the year, in contrast to its performance in recent years. The biggest share of growth was channelled to investment financing (about 66%), while a

¹¹ Credit data are adjusted for the effect of loan write offs from the banks' balance sheet and the exchange rate fluctuations.



smaller share to meeting the liquidity needs of enterprises. Credit to households continued to grow steadily, with an average annual rate of 6.9% over the year. The highest contribution to the growth of this portfolio - over 70% - was provided by mortgage loans, with an annual increase of the surplus by 7.4%. The consumer loan portfolio expanded on average by 5.6%, slower, compared to the previous year.



Broad money in the economy expanded in 2019, in contrast to its contraction in the previous year. The broad money indicator, M3 aggregate, registered an annual growth of 3.4%. The expansion of money is supported by the increase of credit to the economy and financing of the public sector through monetary tools employed by the banking system. On the liabilities side, this indicator continued to be affected by structural changes. Given low interest rates, economic agents continued to shift their savings in banks to longer-term instruments, thus benefiting more favourable interest rates. These shifts are mainly to deposits with maturity of over two years, which are not included in the calculation of broad money¹². Meanwhile, the structure of the M3 aggregate reflects a shift towards the liquid component, where there is a further increase in short-term instruments - such as demand deposits as well as holding of money in the form of cash. The ratio of demand deposits and time deposits with maturities of over two years to total deposits stands at 47% and 13.5% respectively at the end of the period. The total stock of deposits in the banking system expanded by 4.5% in average annual terms. At the end of the year, they are estimated at about 70.4% of GDP, or 1.7 percentage points higher than in 2018. The performance of deposits is mainly supported by the good performance of deposits in foreign currency. Their stock increased by 5.4% on average during the year, mainly reflecting high foreign exchange inflows. The stock of deposits in lek increased by 3.7% in average annual terms. The expansion of lek deposits has been

¹² Based on the Methodology of Drafting Monetary Statistics, the broad money indicator consists of money outside banks and deposits with maturity of up to two years (in all currencies).



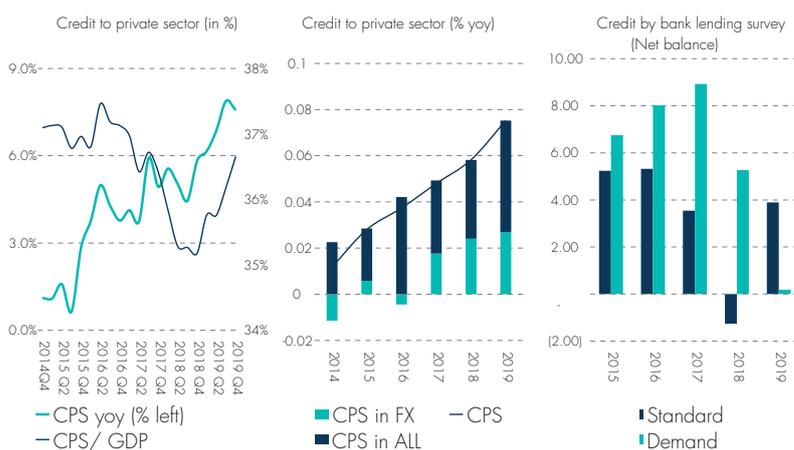
widely supported by deposits of households. The performance of deposits to enterprises was volatile, depending on their economic activity and short-term needs for liquidity.

BOX 2 FACTORS THAT SUPPORTED CREDIT RECOVERY

Credit activity of banks plays an important role in economic growth and inflation performance in the country. For these reasons, its performance has been a constant focus of the analysis and work of the Bank of Albania. These analyses address the factors that first contributed to the decline of lending in the country and the following slow recovery.

Empirical analysis shows that the low growth of lending activity in recent years has been dictated, mostly, by supply factors.¹³ In this context, analysis suggests that improvement of the growth rates of the loan portfolio in 2019 reflects both an increase in credit demand and the easing of supply conditions.

Chart 22 Bank lending to the private sector over the years



Source: Bank of Albania.

On the demand side, the revival of banks' lending activity was supported by the improvement of consumption and the labour market, economic growth and accommodative financial conditions. In terms of supply, the recovery of credit growth rates reflected the following improvements in the loan supply:¹⁴

- *Changes of ownership; the entry of new actors and consolidation in the banking sector have helped bring a more positive approach to banks for financing the economy, as seen in easing of credit standards and an increase of competition between banks. Concentration indicators of bank loans portfolio¹⁵ are lower compared to 2018, thus confirming increased competition between banks.*

¹³ Box 6: Performance of supply and demand factors for loans- Annual Report 2018, Bank of Albania.

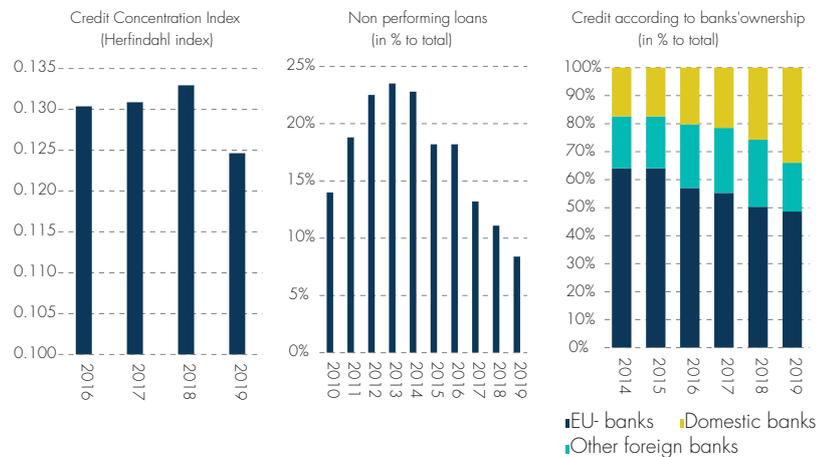
¹⁴ Box 5: Impact of demand and supply on credit performance - Annual Report 2017, Bank of Albania.

¹⁵ In the literature the two main indicators used to assess the concentration of banking activity are the Herfindahl-Hirschman indicator and the concentration indicator of the 4 largest banks in the system. Both of these indicators, calculated according to the respective methodologies for the total credit, are declining towards the optimal levels in 2019.



- Credit risk has been declining, as shown by the ratio of non-performing loans to the total, which was 8.4% at the end of 2019, the lowest level of the last decade. The decline of this indicator signals the perceived probability of default as well as that of the potential loss of the bank, affecting the willingness of banks to take risks. Reduction of credit risk is a result of the Action plan for reducing non-performing loans, adopted in late 2015. The measures outlined in this inter-institutional strategy include legal amendments regarding bankruptcy cases, changes in enforcement procedures and fiscal treatment of non-performing loans, measures taken by the Bank of Albania to restructure them, and the implementation of the scheme "Tirana Approach" for handling non-performing loans of big clients. At the same time, improvement of economic activity and business' balance sheets aided increased lending and reduction of the ratio. Write off of non-performing loans from the banks' balance sheet has also enabled banks to be more committed regarding lending.
- Reduction of the impact of tight policies dictated by "parent banks" for European banks has been another important factor in increasing credit supply. Changes in the ownership of banks that have occurred in the last two years show an increase of banks with domestic capital, and consequently, a decrease in the lending of banks with foreign capital. The change in the ownership structure of our banking sector has stimulated banks to undertake risk and consequently increase the supply of credit.

Chart 23 Supply factors for loan



Source: Bank of Albania.

The lending dynamics in the country were similar to that of the CESEE region. Credit to the private sector in the region recorded an annual growth rate of about 4.4% in 2019¹⁶. Loan portfolios to households dominate the loans of the private sector, excluding Albania, Bulgaria and Serbia. For these countries, the low ratio of loans to enterprises against GDP, among other things, is an indicator of more developed financial markets. Enterprises in these countries have access to alternative financing instruments for their activity, in addition to the banking sector. Unlike other countries in the region, bank credit is the main source of business growth in the country. Restoring banks' focus on financing the needs of enterprises is a positive and welcomed development.

¹⁶ Credit to the private sector in the region is adjusted for fluctuations in inflation and the exchange rate.



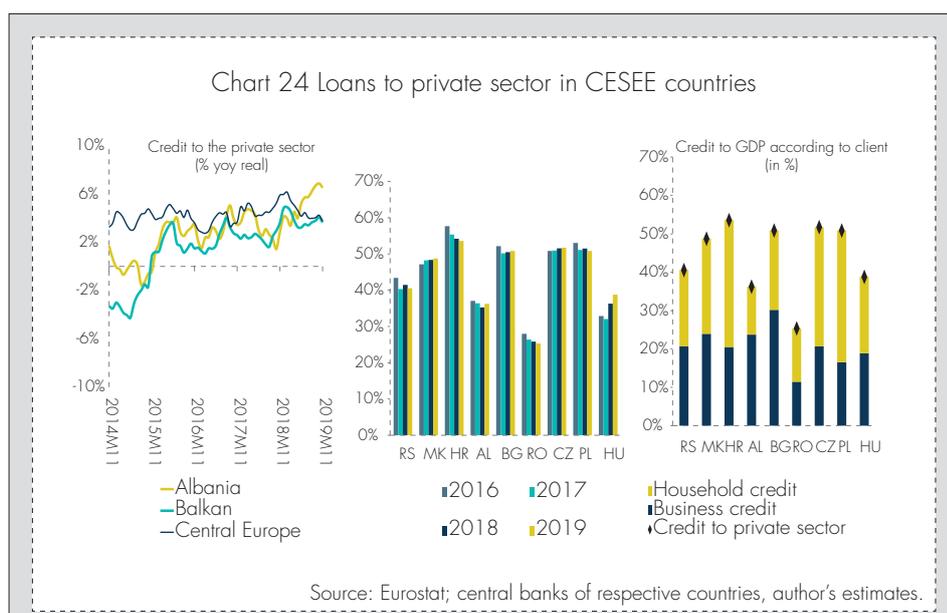


Table 3 The main macroeconomic and financial indicators

	2015	2016	2017	2018	2019*
Annual average inflation					
Headline inflation (in %)	1.9	1.3	2.0	2.0	1.4
Core inflation (in %)	-0.2	0.2	0.8	0.9	0.7
Economic growth					
Real GDP growth (annual, in %)	2.2	3.3	3.8	4.1	2.9
GDP pro capita (EUR)	3,556	4,043			
Labour Market ¹					
Participation rate in the labour force (15-64 years of age)	64.2	66.2	66.8	68.3	69.5
Unemployment rate (15-64 years of age)	17.1	15.2	13.7	12.3	11.7
Fiscal sector					
Budget balance (including grants, as a percentage of GDP)	-4.1	-1.8	-2.0	-1.6	-1.9
Budget revenues (as a percentage of GDP)	26.4	27.6	27.7	27.4	27.3
Budget expenditure (as a percentage of GDP)	30.5	29.4	29.7	29.0	29.2
Public debt (as a percentage of GDP)**	72.7	72.3	70.1	67.8	66.5
External sector					
Current account (official transfers exempted in % of GDP)	-8.7	-8.0	-8.1	-7.3	-7.1
Imports of goods (fob, as a percentage of GDP)	29.9	30.9	31.3	30.1	29.3
Exports of goods (fob, as a percentage of GDP)	7.5	6.7	6.9	7.7	6.7
FDIs (as a percentage of GDP)	8.7	8.6	7.7	7.9	8.0
Monetary and financial sector					
Repo rate (end of period)	1.75	1.25	1.25	1.00	1.00
M3 aggregate (annual growth, end of period)	1.8	3.9	0.3	-0.2	4.3
Credit to the private sector (annual growth, end of period)	2.4	3.1	3.3	1.9	6.9
Deposit/GDP	72.6	74.2	71.4	68.7	70.4
Credit/GDP	37.0	37.1	36.4	35.3	36.5
12-month average yield	3.3	1.8	2.4	2.0	1.6
ALL/USD average exchange rate	126	126.0	119.1	108.0	109.9
ALL/EUR average exchange rate	139.7	136.1	134.2	127.6	123.0
NEER	113.8	110.2	105.2	96.8	92.0
Banking Sector					
Non-performing loans ratio/total loans (%)	18.2	18.2	13.2	11.1	8.4

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

* Data on economic growth for labour market and the external sector are from the first 9 months of 2019.

** MFE Bulletin, 2018 Q4. 1/ "Labour force survey results", published by INSTAT. 2/ The data are adjusted for written off loans. 3/ GDP assessment for 2019.



2.2. MONETARY OPERATIONS

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

OPEN MARKET OPERATIONS

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

In 2019, the average tradable interest rate in the overnight interbank market was 0.02 percentage point under the policy rate, in contrast to an average of 0.02 percentage point above the policy rate in 2018. In both of the last two years trade was much nearer the policy rate than in the period of 2014-2017, where the average rate fluctuated, on average, between 0.03 and 0.07 percentage point under the policy rate. The interest rate in the seven-day interbank market was 0.01 above the policy rate against the average of 0.02 percentage point above the policy rate seen in 2018. This behaviour is different from that of the previous four years where the seven-day rate fluctuated below the policy rate. In 2019, liquidity shortfall returned to the average levels of the 5 previous years, at ALL 28.50 billion after being, on average, above ALL 30 billion in 2017 and 2018.

The Bank of Albania has injected permanent liquidity of around ALL 15 billion from the end of August, period when it ended the 12-month term during which part of the required foreign currency reserve was kept in lek. Also, foreign currency purchase operations by commercial banks have contributed to the increase of permanent liquidity by around ALL 19.0 billion. At the same time, the Bank of Albania has supplied foreign currency to the Ministry of Finance and Economy for the counter-value of ALL 8.20 billion, affecting the reduction of liquidity in lek in the account of the Ministry of Finance. The change in the portfolio of securities issued in Albanian lek by the Albanian government has been negligible, down by ALL 463 million.

The impact of liquidity surplus concentrated in one bank has continued to be present in the market, but at a lower share of traded volumes than before, decreasing the pressure for trading under the key interest rate.



In 2019, as well, an upward tendency of the share of collateralized lending in the trading volume of the interbank market has been maintained. Trading at longer terms than seven-day has been rare. Reflecting the downward tendency of liquidity shortfall, the share of injections from the Bank of Albania with longer than seven-day maturity, has declined to 39% in 2019 from 46% in 2018.

Table 4 Structure of liquidity injection operations by the Bank of Albania

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Main instrument	58%	74%	55%	60%	64%	55%	80.7%	61.6%	54%	61 %
Long-term liquidity	42%	26%	45%	40%	36%	45%	19.3%	39.4%	46%	39%

Source: Bank of Albania.

The Bank of Albania has carried out structural operations, aimed at increasing the share of performing operations in the secondary market. In 2019, ALL 7.8 billion of T-bills were purchased in the secondary market compared to ALL 11.50 billion in 2018 and ALL 9.30 billion in 2017. The participation of banks in these auctions has been high in first 9 months of the year, but quite low in its last quarter.

STANDING FACILITIES

Standing facilities - overnight deposits and overnight loans at the Bank of Albania - are instruments available to commercial banks to manage liquidity on a daily basis and define a corridor in which interest rates fluctuate in the interbank market. After the narrowing of the corridor in 2018 to 1.80 percentage points, there have been no changes in the policy rate or well as in the rates of overnight deposits and loans, keeping the corridor unchanged.

The instrument of overnight deposits has been used daily with an average of ALL 6.74 billion compared to an average of ALL 4.55 billion in 2018. The use of overnight loans decreased to only 16 cases compared to 42 cases in 2018 and 20 cases in 2017. An increase in forecast quality and an increase in the limitations of banks' participation in the Bank of Albania injecting auctions have had a positive impact on reducing the use of credit.

REQUIRED RESERVE

The required reserve in lek is a monetary policy instrument that aims to adjust liquidity in the banking system and enables the stabilisation of interest rates around the key interest rate of the Bank of Albania.

In 2018, within the framework of measures taken to increase the use of the domestic currency in the financial market, mobilisation rates for holding required reserves in lek, US dollar and euro changed. The mobilisation rate for the domestic currency decreased from 10% to 5.0% and 7.5%, depending on the type of liability. For foreign currencies the rate increased to 12.5% and 20%, depending on banks' level of exposure to liabilities in foreign currency, where



to banks with higher exposure a higher rate is applied. In August 2019 the 1-year period, when part of liabilities for the foreign currency reserve could be held as counter-value in lek, ended.

In order to increase the rate of monetary policy transmission, and in line with the European Central Bank standard, the remuneration rate of the required reserve in lek increased to 100% of the policy rate, from 70% in 2018. This decision has increased the volume of liquidity that has, as a reference to cost, the policy interest rate. The remuneration of required reserves in foreign currency accounts and of bank surpluses at the Bank of Albania has not changed. Starting from September 2016, the remuneration interest rate for the required reserve in euro is equal to the overnight deposit of the European Central Bank, which in 2019 decreased to -0.50%. The remuneration rate on the required reserves in US dollars has been 0% since 2011. The remuneration rate on the surplus reserves in lek and US dollars remained at 0% in 2019, as in the previous two years. On the other hand, the remuneration interest rate of the surplus reserve in euro remained 0.25 percentage point lower than the interest rate of the deposit of the European Central Bank.



2.3. FINANCIAL STABILITY AND MACRO-PRUDENTIAL POLICY

In accordance with the legal framework on which its activity is based, the Bank of Albania has a primary role in drafting and implementing macro-prudential policy, which has as a final objective safeguarding financial stability. Macro-prudential policy includes the analysis and assessment of systemic risk and the implementation of measures, mainly prudential, for its mitigation. According to the "Macro-prudential Policy Strategy"¹⁷, macro-prudential policy safeguards financial stability by: a) acting to prevent the accumulation of risks in the financial system; and b) strengthening the resilience of the financial system.

The framework of macro-prudential policy, which includes definitions for financial stability and systemic risk, the macro-prudential policy cycle and the decision-making process, ultimate and intermediate objectives, indicators used to monitor systemic risk and instruments that may be used to fulfil each of the intermediate objectives, as well as the principles of inter-institutional cooperation and communication and transparency, are defined and explained in the Macro-prudential Policy Strategy.

2.3.1. MACRO-PRUDENTIAL POLICY

In 2019, the Bank of Albania achieved a considerable and significant part of the objectives defined in the Medium-term Strategy for 2019-2021¹⁸ towards supporting and safeguarding financial stability. All strategic objectives of the period are oriented towards developing the instruments, indicators and analytical methods that enable monitoring of systemic risks and fulfilling the intermediate objectives of macro-prudential policy. They are:

1. Mitigation and prevention of excessive credit growth and borrowing;
2. Mitigation and prevention of excessive maturity mismatch and market illiquidity;
3. Limitation of direct and indirect exposure concentrations;
4. Limitation of excessive risk-taking by systemically important financial institutions;
5. Safeguarding the stability of the financial infrastructure.

In terms of implementing the macro-prudential policy, the Bank of Albania's work focused on building and implementing capital buffers as macro-prudential instruments, and in developing a complete package of analytical indicators for monitoring systemic risks and warning on their performance.

¹⁷ The "Macro-prudential Policy Strategy" was adopted by the Decision of the Supervisory Council No 38, on 02.08.2017 and can be found at: Financial Stability/Macro-prudential Policies/ Macro-prudential Strategies.

¹⁸ "Medium-term Development Strategy of the Bank of Albania for 2019-2021".



THE REGULATION ON MACRO-PRUDENTIAL CAPITAL BUFFERS

One of the objectives set forth in the Medium-term Strategy of the framework for promoting the stability of the financial system was the implementation of macro-prudential capital buffers for the banking sector, which improve the resilience of the banking sector towards systemic risks of a cyclical and structural nature. After several months of consultation with the banking industry and relevant structures within the Bank of Albania, in June 2019, the Supervisory Council of the Bank of Albania adopted the Regulation "On macro-prudential capital buffers". The Regulation provides for the use of reserved capital buffers, countercyclical capital buffers, capital buffers for systemic banks and capital buffers for systemic risk, as macro-prudential policy instruments, and fully approximates the relevant definitions of the legislation of the European Union¹⁹. The Regulation and the accompanying methodological materials to calculate the countercyclical buffer rate for Albania, calculate the systemic importance ranking and the capital buffer for systemic banks are published²⁰.

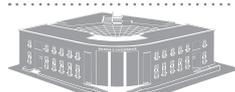
In accordance with the provisions of this Regulation, at the end of each quarter starting from the second quarter of the year, the Bank of Albania has published three decisions from the Governor²¹, which announce the requirement for capital conservation buffer, countercyclical capital buffer, as well as the list of systemically important banks and the required capital buffers for each of them. For the first time, banks must report on fulfilment of the relevant requirements for macro-prudential capital buffers starting from the end of March 2020. During 2019 H2, the Bank of Albania and the banking sector committed to build and test the reporting system by which banks will report fulfilment of macro-prudential capital buffers.

The establishment of macro-prudential capital buffers represents an important achievement towards approximation with the relevant standard of the European Union defined in the legislation of the European Parliament and the Council of Europe and with the relevant technical standards published by the European Banking Authority and the European Systemic Risk Board.

¹⁹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of Europe "On prudential requirements for credit institutions and investment firms" known as the Regulation of Capital Requirements and the Directive 2013/36/EU "On access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms".

²⁰ The Regulation approved by the Supervisory Council Decision No 41 of 05.06.2019, together with the accompanying methodology, can be found at the website of the Bank of Albania at: Financial Stability/Macro-prudential Policies/ Instruments of Macro-prudential Policy/Approved Acts.

²¹ Decision of 28.06.2019 "On the determination of the macroprudential capital buffers" and decisions of 30.09.2019 and 24.12.2019 "On the assignment of countercyclical capital buffer". The decisions are published in the website of the Bank of Albania at: Financial Stability/Macro-prudential Policies/ Instruments of Macro-prudential Policy/Instruments and Decisions.



BOX 3 MACRO-PRUDENTIAL CAPITAL BUFFERS

The objective of a capital conservation buffer is to conserve the capital of a bank. In European Union countries, this buffer has a maximum value of 2.5%. In Albania, the Regulation provides that this buffer have the value 0.5% for 2020 and will increase gradually to 2.5% starting from 1 January 2024. This buffer shall be implemented at the same value for each bank.

The purpose of a countercyclical capital buffer is to counteract the pro-cyclicality of the financial system. Implementation of the requirement for this capital buffer enables banks to collect capital during the periods when cyclical systemic risk is increasing. Capital reserve collected in this way increases the resilience of banks and creates conditions for absorbing losses in the case of future materialisation of risk. This way, volatility in the cycle of lending and the contribution of the bank to financial intermediation is more stable. In the European Union, this rate has started to be announced since 2015 and reflects developments in the financial cycle of each country. The majority of European countries currently apply a countercyclical capital buffer between 0% and 1% and a smaller number of countries apply buffers that reach up to 2.5%. In Albania, the Bank of Albania announces this rate every three months, for the relevant exposures of banks within the country.

Capital buffers that apply to systemically important institutions reflect the importance of these banks for the stability of the financial system. For systemically important financial institutions the application of requirements for capital buffers at the global level¹ is performed in accordance with a methodology drafted by the "Basel Committee on Bank Supervision" and their identification of the level of the particular jurisdiction² is realised according to a methodology developed by the European Banking Authority. The list of systemically important banks at the global level up to the end of 2019 contained 30 banks and the buffer range was 1.0% - 2.5%. The methodology used by the Bank of Albania reflects the international standard as well. Banks are ranked according to the grade of systemic importance, which reflects a combination of size, interconnection, degree of substitutability and local sensitivity. Based on the ranking, and the inclusion in relevant baskets, the capital buffer is also defined for systemically important banks.

The capital buffer for systemic risk aims to address long-term and non-cyclical systemic risks. This buffer, which as a rule may range from 1% to 3%, has a relatively broad spectrum of utilisation and is aimed at those risks which are not addressed sufficiently by other macro-prudential capital buffers. The Regulation of the Bank of Albania also gives broad flexibility to this measure, but currently it is not used.

¹ Other Systemically Important Institutions – O-SIIs.

² Other Systemically Important Institutions – O-SIIs.

MACRO-PRUDENTIAL MAP OF SYSTEMIC RISKS

In 2019, the Supervisory Council of the Bank of Albania took into consideration, for the first time, the six-month analysis²²: "Developments in the macro-prudential

²² This report is prepared in the first and third quarter of the year.



map indicators". The map includes and monitors the performance of selected indicators of systemic risk, grouped by the intermediate objectives of macro-prudential policy.

For each objective, indicators are selected which better signal the systemic risk around which the objective has been built²³. Monitoring of the risk signals registered by each indicator is done by comparing the current value and performance in time of the indicator against a critical value or a comparative threshold. If a certain indicator exceeds the comparative threshold, presented in the map with a particular system of intervals, this is a signal of the accumulation of systemic risk.

Table 5 Main indicators of the macro-prudential map by intermediate objectives and relevant comparative thresholds

Intermediate objective	Name of base indicator	Comparative threshold
Mitigation and prevention of excessive credit growth and borrowing;	"Lending to the economy/GDP" ratio gap	2 pp
	Annual change of outstanding lending	9%
	Annual change of foreign currency lending unhedged from the exchange rate	0%
	Annual change in Consumer Price Index	4%
	Early complementary Warning Indicator (ECWI)	0.5%
	Bank Stress Materialisation Indicator (BSMI)	0.5%
Mitigation and prevention of excessive maturity mismatch and market illiquidity	Liquid assets to total assets	20%
	Cumulative gap up to 7 days	0%
	Interbank ALL/EUR exchange rate spread	HA/1
	Quarterly average of the interbank overnight interest rate	HA/1
Limitation of direct and indirect exposure concentrations	Excessive exposures to Tier 1 capital	200%
	Exposure to 5 main countries to bank assets	HA/1
	Liabilities of SCAs and NBFIs to banks/SCAs and NBFIs assets	20%
	Foreign currency assets to total assets	40%
Limitation of excessive risk-taking by systemically important financial institutions	Interbank exposure to total bank assets	HA/1
	Non-resident claims to total bank liabilities	8%
	Herfindahl index for substitutability (banking sector)	2200
	Herfindahl index for systemic importance grade (systemic banks)	3000

1/Historic average

In addition to the analysis of indicators and risks for each objective, the report includes a particular section with recommendations on macro-prudential measures that may be taken, modified or deactivated during the following period. Over 2019, based on analysis of the indicators of the macro-prudential map, no measure of a macro-prudential nature has been recommended except for the macro-prudential capital buffers defined in the relevant Regulation.

2.3.2. FINANCIAL STABILITY AND RISK ASSESSMENT

The financial situation of the banking sector and the financial system up to the end of 2019 remain stable with good levels of profit. Macroeconomic conditions

²³ E.g. for the first objective, which aims to mitigate and prevent the excessive increase of lending, two base indicators are "Lending to the economy/GDP" ratio gap and "Annual change of outstanding lending".



have been favourable and monetary policy has maintained an accommodative pace. The financial intermediation degree has not changed compared with the previous year, remaining at 107% of GDP, whereas a slight contraction in the share of the banking sector has been compensated by an increase in the share of non-bank financial intermediation, savings and loan associations and insurance companies. The banking sector, which has around 90% of share in financial intermediation, ended 2019 with a positive financial result, a good capitalization level, abundant liquidity at significantly higher levels than the minimum regulatory requirements, and a significant improvement of assets quality compared to the previous year. Overall, the activity of the banking sector expanded by 2% during 2019, where the main contribution came from the expansion of operations with securities. The Return on Assets (RoA) and the Return on Equity (RoE) indicators registered 1.4% and 13.5%, respectively, with a slight increase from the previous year. The Capital Adequacy Ratio registered a decline of 0.4 percentage point, to 18.3%, remaining significantly higher compared with regulatory requirements.

ASSESSMENT OF SYSTEMIC RISKS

The Bank of Albania assesses that the exposure of the banking sector to systemic risks remains contained. However, continuation for an extended period of time of an environment with low interest rates has exerted pressure on the performance of net income from interests and the structure of maturity of banking deposits. On the other hand, the use of foreign currency in the banking sector and real economy remains high, and this phenomenon exposes banking activity to foreign currency liquidity risk and to indirect exchange rate risk.

Focusing on the signals that come from the indicators of the macro-prudential map, we notice low levels of risk related to expansion of lending and increase of debt levels. For risk related to mismatch maturity and the situation of liquidity in the market the relevant indicators signal an increase of risk, but the abundant presence of liquid assets serves as a mechanism to mitigate the risk that may derive from liquidity volatility. Regarding risks related to banking activity levels of concentration, overall indicators show that the concentration of activity in the banking sector toward large borrowers, other non-bank entities and sectors of the economy is at acceptable levels. At the same time, levels of concentration by currency remain over the comparative threshold and need to continue to be monitored. Systemic risk arising from systemically important financial institutions is assessed to have declined, but the share of systemically important banks in the banking sector remains significant.

Overall, developments in the indicators of the real estate market, in the differences of medium-term maturities between assets and liabilities of the banking sector, the concentration of the exposure of the banking sector to foreign currency and the share of systemically important banks, need to be carefully and continuously monitored.



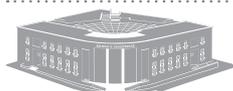
RISKS TO ACTIVITY

Credit risk is assessed to have registered a significant mitigation. The non-performing loan ratio declined to 8.4%, from 11.1% at the end of 2018, and the non-performing loan stock contracted by around 25% reflecting mainly the decline of the non-performing loan stock for enterprises, long-term and foreign currency. The hedging of outstanding loans with provisions and collateral remain at adequate levels. The improvement of lending portfolio quality has come as a result of settlements, write-offs and partial restructuring of losses and non-performing loans. The lending activity of banks is supported by the expansion of lending in the domestic currency mainly to enterprises, whereas lending in foreign currency had registered a decline in annual terms. The Bank of Albania assesses that the requirement to banks for the obligatory write-off of loans classified as lost for more than 2 years, will continue to help the decline of non-performing loan stock and the clean-up of banks' balance sheets from non-performing assets in subsequent years. At the same time, the Bank of Albania constantly instructs banks to be careful of new loans' quality and the continuous monitoring of new non-performing loans.

The interest rate risk and the direct and indirect exchange rate risk to the activity of the financial system and the banking sector remain present and have not registered significant changes compared to the previous year. The current value and performance of the gap between assets and liabilities and particularly the assessed gap for assets and liabilities with variable interest rates, suggest that the banking sector remains exposed to interest rate risk. However, a rapid and near increase of interest rates, particularly in the conditions created after the earthquake of 26 November 2019, is assessed as an event with low probability of occurrence in the short-term future. The direct exchange rate risk continues to remain limited since open foreign currency positions of the banking sector and of particular banks account for a very small share of regulatory capital and is significantly lower than the upper regulatory limits. The exposure to indirect exchange rate risk continues to be significant since foreign currency loans unhedged to the fluctuation of the exchange rate remain high (45%), despite contraction of the share of foreign currency loans against outstanding lending.

In the framework of engagement in the inter-institutional strategy to strengthen the use of the domestic currency (and decrease the use of foreign currency), the Bank of Albania has taken several measures and has continued to publish twice a year the reports provided in the Memorandum of Cooperation²⁴ on the assessment of their effectiveness. The analysis shows that the changes, although positive, have been small and may take longer to fully reveal the impact of the measures. The Bank of Albania assesses that the successful fulfilment of the objective of the inter-institutional strategy towards increasing the use of the domestic currency requires the full and continuous engagement of the responsible institutions.

²⁴ *The Memorandum signed by the Ministry of Finance, the Bank of Albania and the Albanian Financial Supervision Authority No 1069 of 18.04.2017 "On the expansion of the use of domestic currency in the Albanian financial system and economy".*



2.4. SUPERVISION

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

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

2.4.1. MAIN DEVELOPMENTS

In 2019, the bank consolidation process, started years ago, was concluded, bringing the number of banks to 12. This process reformed the domestic banking market, which is now experiencing an increase in the presence of domestic capital, where 4 banks with a share of 29.3% in the market, are owned by this capital. In 2019, the process of ownership transfer for two banks was concluded, as well as the absorption of one bank as well and the self-liquidation of another. Specifically:

- The majority of the shares of Tirana Bank were transferred from Piraeus Bank to new shareholders, Balfin Group. This transfer was approved by the Supervisory Council of the Bank of Albania. With this transfer, the transfer of the management of the bank to the new shareholder was also concluded.
- The qualifying holding of the shares of the Societe Generale Bank Albania was transferred to the ownership of the shareholder of OTP Bank Nyrt, Hungary. After this approval the bank changed its name to OTP Bank.
- The process of full absorption of the International Commercial Bank by Union Bank was completed during the year after the transfer of 100% of the shares was previously approved.
- The licence of Credit Bank Albania was revoked, after the decision of shareholders on its voluntary liquidation.

The map of the representation of banks with branches in various regions of the country also underwent downward changes. This trend was due mainly to the consolidation of the banking system and the reduction of the number of banks.



During the year, approval of the regulatory framework for the implementation of the Tirana Approach²⁵ project was finalised, having gone through a phase of intensive discussions with stakeholders, including representatives of the FinSAC project. This project aims to establish a common inter-bank platform for finding an adequate solution (out of court) for large past-due borrowers.

For the first time in 10 years the non-performing loans indicator fell to a single digit level. The value of non-performing loans reached ALL 48.2 billion, with an annual decline of 25%. The developments of the lending portfolio quality continue to remain under supervisory attention, through on-site inspections or promotion of non-judicial solutions according to the new platform, particularly in the condition of potential negative impacts from the earthquake of 26 November 2019. Meanwhile, the factor of non-performing loans write-off, particularly after the regulatory change through which banks are obliged to write-off loans classified as loss for more than 2 years (from 3 years according to the previous regulation) is expected to contribute to the decline of non-performing loans indicators.

In the framework of implementing the recommendations from the Committee of Experts of CoE on the Evaluation of Anti-Money Laundering Measures and counter Terrorist Financing (MONEYVAL), the Bank of Albania is included in the implementation of the national plan of measures, in order to improve the regulatory framework and strengthen the effectiveness of the supervisory process. Consequently, assessment of the risk exposure of entities to the prevention of money laundering and combating the financing of terrorism has been the focus of the review of the banking regulatory framework and examinations. The findings and recommendations from this process were factored in the drafting of supervisory plans for the more exposed entities, such as the Foreign Exchange Bureaus. According to these plans 97 FEBs were examined for MLP/TFP, for 31 of which supervisory and administrative measures for identified deficiencies were taken, and the licenses of 7 were revoked.

The supervisory process this year was also characterised by a series of collaborations with national and international institutions in order to achieve the objectives of the Bank of Albania and approximating with the best international standards. Among local institutions, the Bank cooperated particularly with the General Directorate for the Prevention of Money Laundering (GDPML) toward implementation of the recommendations of Moneyval and providing relevant reports to the experts of Moneyval and FAG (Financial action group), conducting joint examinations and review of the legal and regulatory framework. Also, BoA assisted the Albanian Financial Supervision Authority in various examinations in the banking sector, in order to fulfil the legal and regulatory obligations of this authority.

²⁵ Since the moment of drafting and presenting it up to its approval and implementation, this Regulation is called as "Tirana Approach", in the view of a parallelism with similar initiatives undertaken in other countries, but with specifics related to its objective and the economic and legal context to be implemented.



Cooperation with international financial institutions extended to several dimensions. During this year, participation in the supervision colleges organised by the European Central Bank was realised, in order to exchange information with some of the banks with EU origins that operate in the Albanian market.

This year communication with the National Bank of Hungary started, with a focus on signing a cooperation agreement, mainly for information exchange. The preliminary agreement is expected to be ratified in 2020.

Cooperation with the IMF has continued in the framework of the multi-year project for the development of supervisory and institutional capacities according to a risk-based approach, part of the strategy of the Bank of Albania. In this context, we particularly highlight the drafting of the internal methodology on the Supervision Review and Evaluation Process (known as SREP) as well as other regulations finalized and approved in 2019. The project will continue during the first part of 2020, which provides for the calibration of requirements for capital buffers of banks according to the second pillar of the Basel framework for capital adequacy, as well as the presentation in the banking industry of some revised, or new, regulations, according to best market practices. Also, cooperation with EBRD for the improvement project of the regulatory framework towards the sound governance of banks has continued, through the technical assistance and expertise of Deloitte London and Albania.

2.4.2. ON-SITE EXAMINATIONS

In 2019, 17 full-scope and partial examinations were performed, covering almost all banks, three non-bank financial institutions, one SLA and 97 Foreign Exchange Bureaus. The examinations programme also took into account the development in the structure of the banking system as well as the commitments of the Bank of Albania in the framework of fulfilling the recommendations of the experts of Moneyval.

Table 6 Number of examinations by entities and theme

Examinations carried out on entities	Strategic risk	Organisational risk	Credit risk	Liquidity risk	Interest rate risk	Market risk	Information and Communication Technology	Operational risk	Reputational risk	Profitability	Capital
2017	9	12	13	10	10	9	11	8	11	10	11
2018	8	10	9	8	8	8	9	8	48	9	8
2019	13	13	16	13	13	14	13	13	113	13	15

The examinations on banks have as an objective the on-site assessment of all risks, theme examination on the assessment of specific identified risks,



and examinations on the follow-up of the recommendations left by previous examinations.

Theme examinations were mainly focused on the management process of non-performing loan portfolios, to continuously decrease them. They were also used to assess the internal methodologies of banks on the calculation of capital requirements for internally identified risks, in accordance with the guideline "On the internal assessment process of capital adequacy".

The recommendations left have identified the main risks to which banks are exposed. Their nature is related to improvement of the risk management quality through methodological improvements, the internal analyses quality of information systems, and changes in the internal regulatory and procedural framework. The objective of the recommendations has also been the improvement of bank governance, an increase in the role of the Board of Directors in bank management, as well as an increase in requirements for information and monitoring of executive structures. Meanwhile, from the other internal structures of banks, the strengthening of audit lines and the qualitative increase of the risk function were required.

Overall, banks have reacted positively to the recommendations, fulfilling a good part of them within the forecasted deadlines. At the same time, for those recommendations related to such aspects as quality of governance, adequate allocation of responsibilities, effectiveness of internal audit systems, and strengthening of risk and compliance units, the process of improvement is ongoing and continues in parallel with the increase of business volumes.

Regarding non-bank financial entities and savings and loan associations, attention in 2019 was focused on entities that carry out lending activity, leasing and microcredit. Examinations have evidenced the rapid development of these entities. Relevant recommendations highlight that the increase of the activity volume of these entities must also be accompanied by an increase of governance quality, information systems infrastructure and internal audit.

Other identified issues are related to the need for a more conservative classification of part of the lending portfolio, also creating relevant reserve funds, and ensuring complete transparency in the relations with the customers.

Part of the supervisory process is also rapid reaction in cases of potential risk identification or breaches of indicators reported by bank and non-bank entities. In 2019 as well, in addition to on-site examinations, there has been frequent correspondence and contact with all entities in response to events or developments with the potential to affect their financial situation, accompanied by specific supervisory measures and requirements. The Bank of Albania has suspended, in two cases, the activity license for entities that have not maintained the minimum required capital level. As well, in one case, an order has been issued to increase capital.



2.4.3. REVIEW OF THE LEGAL AND METHODOLOGY FRAMEWORK

In 2019, the Bank of Albania drafted several new regulatory acts, as well as a review of some current acts of banking supervision, aimed at further approximation with the latest changes in the European Union (EU) acquis (directives and regulations) and in the documents of the Basel Committee. The following are the main regulatory changes approved in 2019.

I. In relation to approximation of regulatory requirements with Basel III requirements, the following were approved, respectively:

- Amendments to the Regulation "On the regulatory capital of the banks", which approximate the requirements of the Bank of Albania on capital ratios with the requirements of Basel III.
- The new Regulation "On liquidity coverage ratio", which aims to complete the regulatory framework on liquidity risk management, through the presentation of a new indicator (liquidity coverage ratio), as well as the definition of banks' requirements on the creation of a liquidity reserve that in conditions of liquidity stress hedges net outflows, within a time horizon of 30 calendar days.
- The new guideline "On banks' stress tests" which defines the requirements and methodologies on banks carrying out stress tests, as part of their risk management process, particularly in the framework internal assessment process of capital adequacy.

II. Pursuant to implementation of the recommendations of Moneyval experts, provided during Round V of the evaluation for Albania, eight regulations on licensing and supervision regarding the prevention of money laundering and combating the financing of terrorism were reviewed. Specifically, the following regulatory amendments were adopted:

- Regulation "On licensing and carrying out the activity of banks and branches of foreign banks in the Republic of Albania";
- Regulation "On licensing and activity of non-bank financial entities";
- Regulation "On licensing and activity of savings and loan associations and their unions";
- Regulation "On licensing, organisation, activity and supervision of foreign exchange bureaus";
- Regulation "On managing risk in the activity of non-bank financial entities";
- Regulation "On the prevention of money laundering and combat the financing of terrorism";
- Regulation "On consolidated supervision";
- Regulation "On supervision of e-banking transactions".

Amendments to the licensing regulations primarily define additional requirements of the Bank of Albania for applying entities, during the licensing process related



to the integrity of shareholders/partners (including indirect shareholders/partners and final beneficiaries). Focus is also expanded to persons related to shareholders/partners, if they have criminal records, and to requirements for entities in relation to continuous reassessment of the integrity of shareholders/partners when reporting results to the Bank of Albania at least once a year. Amendments to the Regulation "On risk management and activity of non-bank financial institutions" define the requirement of an internal audit function/unit and the compliance function, as independent units and an important part of the audit system, as well as the responsibilities and obligations of these functions. The amendments in the three other acts aim to further strengthen the requirements of the supervisory authority on entities, for a better risk management of money laundering and combating the financing of terrorism, at both the individual and group level.

III. In order to fulfil the commitments undertaken by the Bank of Albania in the framework of the National Plan on Addressing Non-performing Loans (Tirana Approach) the following were adopted:

- The requirements of the Regulation "On out-of-court treatment of distressed borrowers by banks", which aims to improve the treatment of distressed borrowers, through structured and efficient cooperation between banks. This Regulation is expected to serve as a cooperation platform, where banks coordinate their attempts and find solutions that reflect the nature of the borrower's difficulties by creating facilities for generation of liquidity, to continue and to recover activity and to settle liabilities with banks.
- Amendments to the Regulation "On credit risk management by banks and branches of foreign banks", which are in line with the new above-mentioned Regulation and that aim to strengthen the classification criteria and provision of restructured loans, after 1 January 2021, when these amendments enter into force, as well as define the reduction of the write-off limit of loss loans by banks from 3 years to 2 years.

IV. In 2019, several new project-acts or draft-amendments of regulatory acts in force were also prepared, which are expected to be adopted in 2020. Specifically:

- Pursuant to the continuous approximation with the requirements of the European Regulation (CRR) 575/2013/EU "On prudential requirements for credit institutions and investment firms". Several project-amendments of the Regulation "On the Capital Adequacy Ratio" were drafted, which aim mainly at presenting the method based on the assessment of credit quality by the counterparty itself, on the definition of the risk share for several particular exposures.
- Several project-amendments to the Regulation "On risk management from large exposures of banks" were drafted, based on the 2019 amendments of the relevant EU Regulation, and on the Basel documents



on the large exposure regime.

- Work on a draft of the Regulation "On defining the conditions for granting preliminary approval on financial supporting agreements within the banking group" was finalised. This was drafted pursuant to the Law on resolution.

2.4.4. LICENSING FRAMEWORK AND APPROVALS

The Albanian banking sector continues to be dominated by EU-based banking group subsidiaries. The number of banks declined to 12 from 14 banks that were operating at the end of 2018.

The decrease of the number of banks at the end of 2019 was due to the revocation of the license of two banks, after the end of the merger by absorption of the International Commercial Bank sh.a. by the Union Bank sh.a, and completion of the voluntary liquidation process of the Credit Bank of Albania sh.a.

In 2019, the Bank of Albania issued preliminary approval for the transfer of 100% of the ownership of the shares of the International Commercial Bank sh.a. to the Union Bank sh.a. and the legal reorganisation of the Union Bank sh.a. through merger by absorption with the International Commercial Bank sh.a.; ownership of the qualifying holding of shares of three banks; increasing the financial activity in the role of insurance agent of one bank; amendments to the statutes of banks; appointments of legal auditors of all banks, the issuance or settlement of subordinate debt from banks; on signing an outsourcing agreement with third parties; on offering e-banking services.

The Bank of Albania approved 64 bank administrators, specifically by position classification, 31 members of the steering council, 13 members of audit committees and 20 executive directors and managers of the bank's internal audit.

Table 7 Banks' ownership structure (number of banks at period-end)

	2015	2016	2017	2018	2019
Banks in Albania, of which:	16	16	16	14	12
Branches of foreign banks	-	-	-	-	-
Banks' ownership structure, by capital origin, of which:					
Majority foreign owned ¹	13	13	13	11	8
- EU-based banks	9	9	9	7	6 ²
- Turkish based	1	1	1	1	1 ³
- Majority owned by an international financial institution (Saudi Arabia)	1	1	1	1	1 ⁴
Majority Albanian owned	3	3	3	3	4 ⁵

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

² Banks with capital origin from EU countries at the end of 2019 are from: Italy (Intesa Sanpaolo Albania), Austria (Raiffeisen), Germany (Procredit), Hungary (OTP Bank, Albania), Greece (Alpha Bank Albania), and Bulgaria (First Investments Bank Albania).

³ National Commercial Bank.

⁴ United Bank of Albania.

⁵ Majority Albanian owned banks at the end of 2019 are: Union Bank, Credins Bank, American Bank of Investments and Tirana Bank.



The network of banks within the territory of the Republic of Albania was expanded with 5 new branches, while banks have reported reduction of the number of branches/agencies (through closure, merger) for 23 branches/agencies within the country. As of the end of 2019, banks operated through 429 branches/agencies.

Based on submission of application, the Bank of Albania licensed one non-bank financial institution for the exercise of the financial activity of factoring (Tirana Capital Trade sh.p.k.) and a microcredit financial institution (Micro Credit Risk sh.p.k.). Meanwhile, the activity licenses of two non-bank financial institutions were suspended. The number of licensed non-bank financial institutions was 32 at the end of 2019. Meanwhile, part of approvals for non-bank financial institutions were preliminary approvals for 9 administrators, and approvals for the transfer of qualifying holding of capital quotes to three entities.

In 2019, a new savings and loan association was licensed (Tirana Invest Kredit 2000), and at the end of year there were 14 savings and loan associations and one union of savings and loan associations.

In 2019, 51 new foreign exchange bureaus were licensed, while licences were revoked for 11 existing foreign exchange bureaus. As of the end of 2019, 503 foreign exchange bureaus were operating in the foreign exchange market.

Table 8 Number of banks, non-bank financial institutions, savings and loan associations and foreign exchange bureaus licensed by the Bank of Albania (end-period)

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

Source: Bank of Albania.



2.5. RESOLUTION

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

In 2019, Resolution at the Bank of Albania has oriented its activity toward fulfilling the targets envisaged in the medium-term strategy such as:

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

In order to strengthen resolution capacity, the Bank of Albania is committed to drafting specific plans for each systemic bank and continuously improving the banks' reporting in this regard.

Also, an important part of the activity of this function has been the identification and evaluation of critical functions of banks and the evaluation of recovery plans drafted by banks in terms of the impact that these plans have on resolution in banks.

In order to regulate the process of resolution and in compliance with legal obligations, the Bank of Albania has drafted and approved several by-laws. The process of administration and monitoring of the Resolution Fund has been continuously improved in the framework of achieving the target level of this fund on time.

The year 2019 marks the first participation of the Resolution Authority of Albania in the Resolution Colleges at European level, which are organized by the Single Resolution Board (SRB) for European banks or banking groups which are in the jurisdiction of the SRB. This participation is important in terms of harmonizing the practices of resolution for the branches of European banks operating in Albania.

2.5.1. STRENGTHENING RESOLUTION IN BANKS AND RESOLUTION PLANS

In order to fulfil the objective of strengthening resolution in banks, in 2019, the Bank of Albania completed the first cycle of drafting resolution plans for systemic banks, according to the regulation "On the content of the resolution plans" and the information reported by the banking sector for this purpose. An important part of these plans consists in drafting a strategic analysis of the business model for each bank; identifying the functions of critical importance



that should continue to be offered even in resolution; assessing the internal and external critical interdependencies of the bank; identifying the infrastructure of financial services and critical systems that support them.

The resolution plan envisages the preferred strategy for resolution and the instrument that will carry out this strategy. It also envisages several measures to ensure financial and operational continuity that will ensure business continuity after the resolution. The plan also envisages communication with interested parties as an important element of transparency in the framework of respecting the principles of resolution. Also, an important element of the plan is the evaluation analysis of resolution, as a tool to identify possible obstacles to the implementation of resolution and pursuing measures to minimize them.

BOX 4 RESOLUTION PLAN

The Bank of Albania is responsible for drafting a resolution plan for each bank. This plan contains in detail all the necessary steps to be taken in case a bank is in a situation of insolvency.

The resolution plan aims mainly to explain how banks operate and their critical functions, important for the economy; it aims to identify possible obstacles to the implementation of the resolution plan and to prepare the entire necessary infrastructure (legal, financial, operational) for the implementation of resolution in case banks face difficulty.

The drafting of a resolution plan follows several steps which are briefly explained below.

***The first step** of the plan is to **prepare a strategic analysis** where the Bank of Albania analyses the structure of the bank, its ownership and legal framework, financial position, business model, the critical functions it offers, internal dependencies that the bank has towards the banking group that it is part of as well as external dependencies to third parties, as well as operational systems and bank infrastructure.*

***The second step** is to choose **the preferred resolution strategy**. This step is important to determine what will happen to the bank if it is unable to pay: will it be liquidated under compulsory liquidation procedures or will it be placed in resolution, where the Bank of Albania will implement one or more of the instruments defined by law for this purpose? If it is considered that the bank should be placed in resolution in fulfilment of the objectives of the law, then the Bank of Albania determines the specific strategy and instruments that it intends to use for the resolution in banks.*

***The third step** of the plan is **to ensure operational and financial continuity** in the bank, even if the bank is in difficulty. In this step, the resolution plan evaluates all the procedures that the bank must draft in order to ensure continuity of financial and operational resources, during the implementation of resolution, but also after implementing it.*

***The fourth step** is related **to access to information and communication plan**. This*



part of the resolution plan explains all the rules and procedures to ensure that the Bank of Albania has all the necessary information it will need to implement the resolution in a timely manner. The plan also includes how the plan will be communicated internally and externally, before, during and after resolution.

The fifth step consists of **summarizing the plan and assessment for resolution possibility**. In this step, all potential impediments to the implementation of the plan should be identified, notifying the bank on the entirety of the steps it must take to remove these potential impediments.

Resolution plans are drafted in cooperation with the banking sector, which is involved in providing the necessary information for the drafting of these plans and is engaged in removing potential impediments to the implementation of the relevant plan. The plan is reviewed annually by updating the relevant information in line with developments in the bank and further deepening of the operational steps for its efficient implementation.

Based on experience gained, for the second cycle of information on resolution planning, the necessary information reporting forms for drafting plans was reviewed, reflecting improvements in the information structure. Along with the forms, the guideline²⁶ for completing the resolution plan forms was reviewed as well.

In the framework of resolution planning, in September 2019, bilateral meetings with representatives of systemic banks were organized, in order for them to get acquainted with the content of the plan during which the selected strategy and instrument, the regulatory capital requirement for instruments, eligible liabilities and identified impediments for the implementation of and efficient resolution planning, were discussed.

In conclusion, since the continuity of critical functions is one of the objectives of resolution and an important part of the resolution planning process, in 2019, a detailed analysis was carried out to identify these functions based on the methodology drafted for this purpose. This methodology takes into account the impact that would have the termination of the critical function offered by a bank to third parties and the market's ability to replace it.

2.5.2. COMPLETION OF THE REGULATORY AND METHODOLOGICAL FRAMEWORK FOR RESOLUTION

In 2019, two sub-legal acts drafted pursuant to the Law no. 133/2016 "On recovery and resolution in banks in the Republic of Albania" were finalized and approved by the Supervisory Council of the Bank of Albania.

²⁶ Guidelines for completing the forms of resolution plans and the forms for gathering information needed to draft the resolution plans are available at the website of the Bank of Albania: https://www.bankofalbania.org/Resolution/Planning_the_Resolution/



Thus, the Supervisory Council approved the Regulation “On determining the level of competencies exercised by the Bank of Albania on recovery and resolution in banks”, which defines the internal units of the Bank of Albania and the heads of its organizational units, who issue individual administrative acts in compliance with the competencies of the Bank of Albania on recovery and resolution.

Also, the Supervisory Council approved the Regulation on “Valuation for the purposes of resolution” which defines the terms and conditions for selecting the independent valuer, the criteria and methodology for valuation before and after resolution and the valuation of obligations deriving from derivative products. This regulation is in line with the Regulatory Technical Standards of the European Banking Authority - EBA and the European Union Directive “On recovery resolution in credit institutions and investment firms”.

In 2019, the Bank of Albania drafted the first version of the regulation “On the minimum level requirements for capital instruments and eligible liabilities - MREL”, which is partly in accordance with the Directive “On Recovery and Resolution in Banks II”, known as BRRD II, related to the loss absorption capacity and the recapitalization of credit institutions and investment firms, as well as Regulation 2019/876 of the European Council and Parliament.

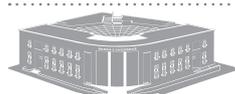
In terms of drafting a complete regulatory framework in line with the European standards recently drafted in the field of resolution, the Bank of Albania has been continuously supported by the World Bank through FINSAC²⁷.

2.5.3. RESOLUTION FUND AND MONITORING OF ITS FINANCIAL ASSETS

Law No. 133/2016 “On the recovery and resolution of banks in the Republic of Albania”, mandates the Bank of Albania to calculate the target level of the Resolution Fund and the annual contribution of each bank.

Pursuant to the Law, the target level of the Resolution Fund is 0.5% of the total liabilities of the banking sector and it is calculated as the difference between the assets and capital of banks operating in Albania, which must be built up by 2027. The target level, estimated in 2019, was ALL 6.49 billion. In April 2019, banks completed the payment of the second year of annual contributions to the Resolution Fund in the amount of ALL 650 million. These contributions, which constitute the financial assets of the Resolution Fund, are managed by the Deposit Insurance Agency in accordance with the criteria established in the investment policy of the Fund’s financial assets. At the end of 2019, the Resolution Fund reached the level of about ALL 1.3 billion.

²⁷ The Financial Sector Advisory Center (FinSAC) based in Vienna.



For the purpose of the Resolution Fund management, the Bank of Albania has continuously cooperated with the Deposit Insurance Agency, to monitor the administration of the fund's financial assets, improve and adapt the regulatory framework in accordance with the structural changes that have occurred in the banking sector, as well as the automation of banking sector reporting in the framework of calculating the target level and the annual contribution of the fund.

2.5.4. STRENGTHENING HUMAN AND LOGISTICAL CAPACITIES

An important objective of the Resolution in the Bank of Albania has been the strengthening of human and logistical capacities, which has to do with increasing the qualitative professionalism of the BoA's staff in the field of resolution, a field which is in development at the European level as well.

In this regard, in 2019 the function of resolution was represented in international conferences, workshops and meetings, organized by the Single Resolution Board.

Also, during this year there has been fruitful cooperation with various units of the Bank of Albania, to achieve institutional objectives, both with the supervisory function for evaluating the recovery plans of banks, in order to evaluate the recovery options that may affect resolution in the bank, as well as with the finalization of some draft regulations with the aim of fulfilling the regulatory framework in function of the obligations of Law No. 133/2016 "On the recovery and resolution of banks in the Republic of Albania".



2.6. CURRENCY ISSUE

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

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

After a period of more than 23 years and 4 years of work, the Bank of Albania enabled the production of a new series of banknotes of legal tender

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

After a period of more than 23 years and 4 years of work, the Bank of Albania enabled the production of a new series of banknotes of legal tender. The new Albanian banknote series consists of six denominations: 200 Lekë, 500 Lekë, 1000 Lekë, 2000 Lekë, 5000 Lekë and 10000 Lekë. On 30 September 2019, the first denominations of the new series, 200 Lekë and 5000 Lekë were issued and put into circulation. The printing materials for other banknotes of the series were also produced. These banknotes are expected to be put into circulation in the coming years. The 10 000 Lekë denomination banknote is expected to be put into circulation by 2020.



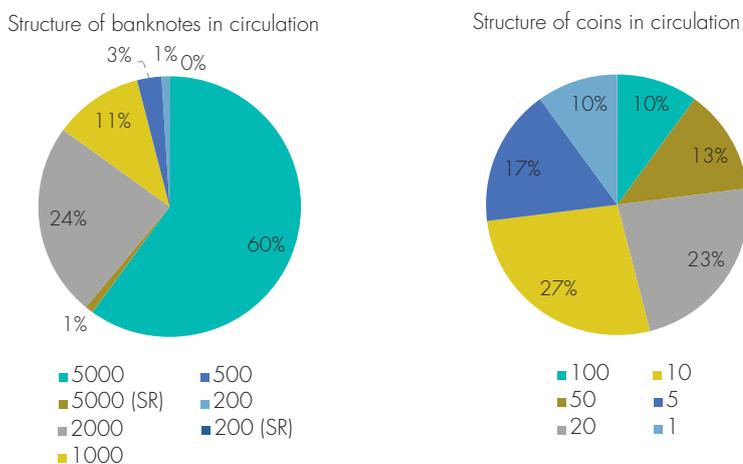
The primary impetus for improving the series of banknotes has been constant changes over time, related to advancements in design techniques, technology for the production of base materials and increasingly sophisticated security features. Changes have given the Albanian banknote a modern, yet durable appearance, a quality banknote with high integrity and reliability, comparable to modern standards.

The Bank of Albania also sees the banknote as a means of communication, transmitting messages of our national identity, by taking the opportunity to evoke the most significant moments of history and honouring distinguished personalities. The theme of the existing banknotes has been retained, which follows the concept of reflecting milestones in the history of the nation, through the presentation of prominent personalities that have left a legacy in our national memory. The design of the new banknote, in addition to the portrait, includes other stylistic elements, which are related to special achievements of the portrayed historical personality.

The number and value of banknotes and coins in circulation increased in 2019

At the end of 2019, there were about 140 million notes in circulation worth about ALL 297.5 billion²⁸. Compared to 2018, the number of banknotes in circulation increased by about 3.6 million notes (2.6%), while in value there was an increase of 16.3 billion (5.8%). Change in these indicators comes as a result of the trend that the structure of money in circulation continues to favour banknotes with a nominal value of 5000 Lekë and 2000 Lekë. The average value of a banknote in circulation at the end of 2019 reached 2126 Lekë, from 2062 Lekë at the end of 2018.

Chart 25 Structure of banknotes and coins in circulation, 31 December 2019



Source: Bank of Albania.

²⁸ It is the number and value of banknotes put into circulation by the Bank of Albania.



At the end of 2019, there were 217 million coins, from 199 million at the end of 2018. The value of coins at the end of the year reached ALL 5.4 billion, from 4.8 billion at the end of 2018.

The speed of cash recirculation decreased and the quality of banknotes in circulation increased

In 2019, around 93 million banknotes were processed, and were checked for authenticity and fitness for circulation. The sorting rate²⁹ was 20% compared to 24.3% in 2018. Unfit banknotes were replaced with new banknotes fit for circulation.

The banknote circulation coefficient³⁰ for 2019 was 0.67, implying that a banknote is returned to the cash desks of the Bank of Albania, on average less than once a year³¹. This coefficient is higher for 500 Lekë and 1000 Lekë banknotes (about 1.4 and about 0.98 respectively) and lower for 5000 Lekë and 200 Lekë banknotes (old series) (about 0.14 and 0.41 respectively).

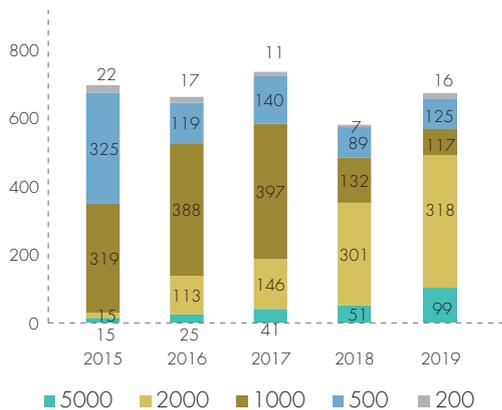
Bank of Albania aims to increase and strengthen technological and administrative capacities dedicated to protecting banknotes from counterfeiting

In view of safeguarding the currency from counterfeiting, a variety of preventative actions were continuously developed and organized, focused mainly on the continuous training of professional staff who handles cash, inspections, testing and monitoring the process of authenticating and sorting machines/equipment used by staff.

The quantity counterfeited banknotes and coins discovered in circulation during 2019, increased by 16% compared with 2018. The counterfeited amount remains insignificant compared with the amount of genuine banknotes and coins in circulation.

Unlike in previous years, the 2000 Lekë denomination has represented the largest share of total counterfeit banknotes, followed by the 500 Lekë and the 1000 Lekë denominations, differently from other years. This year the number of counterfeit 5000 Lekë banknotes increased, with a total of 99 of such banknotes identified.

Chart 26 Counterfeited banknotes trend in years (per piece)

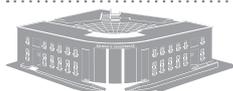


Source: Bank of Albania.

²⁹ Ratio of unfit banknotes and coins to the total number of banknotes and coins sorted during 2019

³⁰ Ratio of the number of banknotes returned to the Bank of Albania cash desks to the average annual number of banknotes in circulation.

³¹ This rate was 0.79 in 2018.



Amongst counterfeit coins, the 50 Lekë denomination (139 coins) continues to be the most counterfeited.

From the technical and/or technological aspect of counterfeiting Albanian banknotes, colour digital printings dominate, mainly ink-jet, accompanied by the use of additive artisanal methods to imitate security elements and/or features mainly of visual and tactile nature. The index of the similarity assessment with real legal tender banknotes is low, which means that counterfeit banknotes have a low risk of being accepted as real. Only a few cases of security feature imitations in counterfeit banknotes, readable by authenticating/ sorting equipment, have been encountered.



2.7. PAYMENT SYSTEMS

The safe and effective operation of payment systems is a crucial precondition for the functioning of the economic system. Operation, oversight and reform payment systems play an essential role in ensuring security, sustainability, and efficiency of financial market infrastructure and enable exchanges between economic actors. Transmission of monetary policy and financial stability is based on the existence of reliable and efficient payment system infrastructure.

In fulfilment of these responsibilities, the Bank of Albania, beyond the stable operation of payment systems, has paid particular attention to further consolidation of the oversight role in the field of securities' settlement systems, as well as to payment systems as an integral part of these systems.

2.7.1. PAYMENT SYSTEM OVERSIGHT

An important step towards payment system oversight is regulation of the activity of the securities' settlement systems by private operators. In this framework, in 2019, the Bank of Albania approved Regulation No. 26/2019, dated 28.03.2019 "On licensing, regulation and oversight of securities' settlement operators", which sets out the terms and conditions of licensing and oversight of securities' settlement systems. Its approval created the necessary preconditions for the Bank of Albania, in November, to license the private operator which will repay and register the securities issued by private companies.

The operation of this system by ALREG sh.a completes the necessary infrastructure for the operation of the stock exchange and capital markets in Albania.

From the point of view of legal and regulatory improvements, during this year the Bank of Albania has intensified its efforts for the approval of the draft law "On payment services", which transposes in the Albanian legislation the European Union directive 2015/2366 "On payment services in the internal market". These efforts were materialized in the adoption of the draft law by the Council of Ministers in December and its submission to the Albanian Parliament for approval.

The implementation of this draft law in the internal market will reform and modernize payment services by digitalizing them as well as by introducing innovative services in this market. These developments will encourage remote interaction of the various actors involved in the payment cycle. In this context, it is necessary to establish technical rules and standards to guarantee the security of authentication in initiating and processing electronic payments remotely.



BOX 5 NEW SERVICES PROMOTED BY THE DRAFT LAW

The new services that the draft law aims to promote, aim to facilitate the public's access to electronic payment services, both in terms of costs and ease of use, thus promoting e-commerce. These services consist of the following:

Payment initiation services which are provided mainly by Fintech companies and play the role of an intermediary between customers and businesses for the purchase of goods and services remotely. The main novelty of this service lies in the fact that consumers can make purchases remotely even though they do not own a debit or credit card, but they do have a bank account which can be accessed via the internet. On the other hand, these institutions facilitate the necessary investments undertaken by businesses to trade electronically.

Also, account information services provide consumers and businesses with an overview of their financial situation, for example, enabling consumers to consolidate various current accounts they may have with one or more banks and categorize their expenditures according to different typologies (food, energy, rent, leisure, etc.) thus selecting the most efficient services in terms of costs for each category, helping them in budgeting and financial planning. In many cases, these types of services also help identify a less costly alternative for payments.

Payment initiation and account information services will be provided by entities licensed by the Bank of Albania. These institutions will have the right to request information from the consumer bank regarding the balance of the account. This right is guaranteed to the institutions only after obtaining an approval from the consumer, an approval which will be realized by means of remote communication, and as a result requires the development of all technical conditions for guaranteeing security and proof that consent is really given by the consumer-account-holder. It is worth emphasizing that communication between the bank and these institutions will not necessarily be based on a bilateral agreement between the two parties, implying the need for banks to take the necessary measures for an in-depth customer authentication as the bank bears the brunt of responsibility to compensate the client in case of fraud.

The Bank of Albania has started to work on implementation of the technical standards created by the European Banking Authority. The implementation of these standards is necessary to promote the interaction of institutions that provide payment services in the European market.

In 2019, the Bank of Albania worked to improve the regulatory framework related to the operation of the AIPS payment system (for large-value payments) and AECH (for small-value payments). These reviews aim to accommodate the innovations of the draft law "On payment services" by enabling access for non-bank financial institutions in the AECH system and creation of conditions for the promotion of electronic payments.



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

In the framework of promoting reforms in the payments market, the Bank of Albania has played an active role in the implementation of the National Retail Payment Strategy (2018-2023). More specifically, during this period a series of meetings and consultations were organized with various actors in order to implement the action plan of this strategy. Also, in October 2019 the fifth meeting of the National Payment System Committee (NPSC) was organized, in order to further promote the projects. The main results of these measures were related to the following:

- Analysis of payments of public institutions where the main needs and opportunities for intervention were identified in the framework of the use of electronic instruments for these services. In this regard, special attention was paid to the possibility of operating a centralized payroll for public administration, as well as the use of banking services for payments related to social insurance. Also, there was cooperation in the framework of formalizing the economy in relation to the implementation of the law "On invoice and turnover monitoring system", otherwise known as the "Draft Law on Fiscalization".
- Measures have also been taken in the framework of projects related to the development of infrastructures and measures to reduce the commissions of payment services such as the euro settlements' system in the country, the project for national SWITCH and instant payments, and the possibility of analysing and reduce commissions paid by merchants for card payments.
- Last, but not least, attention was paid to financial education through continuation of Project Greenback (2.0)³². Moreover, at the NPSC meeting, the need to develop a national strategy for financial education in support of the undertaken reforms was clearly evidenced.

2.7.3. PERFORMANCE OF AIPS AND AECH SYSTEMS

The main infrastructure for processing interbank payments in Albania consists of two payment systems that are operated by the Bank of Albania: AIPS (considered the core infrastructure for the settlement of payments in the national currency and of financial markets) and AECH (which accommodates the clearing of interbank transactions by banks' clients (households and enterprises)).

³² Project Greenback (2.0) is one of the main components of the SECO-funded Remittances and Payments Program (RPP) in Albania managed by the World Bank Group. The project aims at enhancing financial literacy and improving financial services for both senders and recipients; and increasing the efficiency of remittances in the market to reduce costs of these transfers.

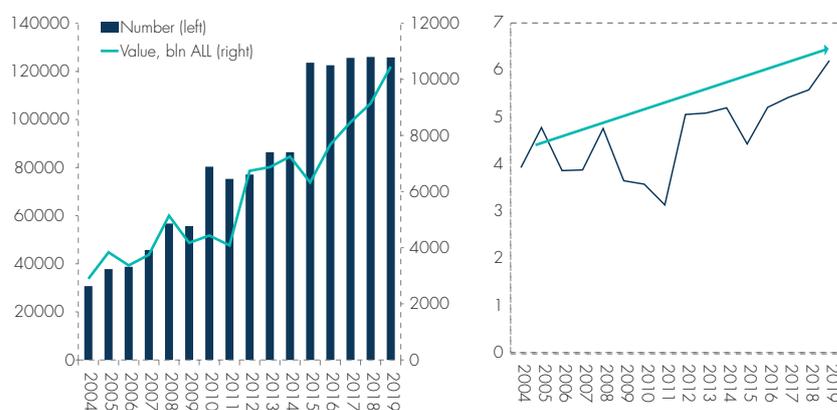


In 2019 these two systems operated safely and efficiently, offering maximum availability for AIPS and AECH, 99.46% and 99.9 % respectively.

Albanian Interbank Payment System for large-value payments (AIPS)

A volume of 125,766 transactions was settled in AIPS, with a total liquidity circulating in the system of ALL 10,453 billion. Compared to the previous year, the volume of settled transactions decreased by about 0.2% while the value of settled transactions reflected an increase of 14%. The value of transactions processed in AIPS in relation to the GDP³³ also shows an upward trend, implying an ever-increasing use of the system and the importance of this system for the Albanian economy.

Chart 27 Performance by number and value of transactions processed in AIPS (left) and AECH (right)



Source: Bank of Albania.

Analysis of the use of this system by different transaction typologies indicates that the item "Payments for Clients" (with share of payments in terms of figures, 59%) continued to register increasing rates³⁴, compared to the previous year. The intraday loan facility (ILF), decreased in both figures and value, by 40% and 44%, respectively). This trend indicates that the exposure of the system to liquidity risk has declined.

Albanian Electronic Clearing House for retail payments (AECH)

The activity of the AECH reflected an increase compared to the previous year, in absolute terms, of the number and value of cleared payments (increased by 11.4% and 11.5%, respectively).

The chart above shows an upward trend of transactions processed in AECH, since the start of its operational activity (2005-2019).

³³ GDP in 2019 is ALL 1,685,604.16 million, source: Bank of Albania and INSTAT

³⁴ In 2018, by 5% in number and 4% in value, respectively.



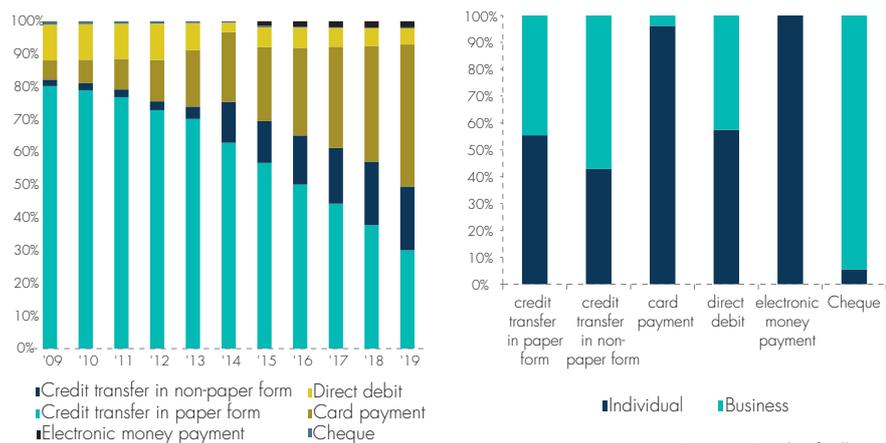
Analysis and distribution of payments according to the participants shows that the main share of transactions processed in AECH consists of payments to customers, initiated by banks. In 2019 there was an increase in the number of transactions processed by commercial banks by 16% and an increase in their value by about 15% compared to 2018, reaching a level of use of the system for this purpose of 64% of the total activity. The growing trend of the number of transactions by banks shows familiarization of the public with payment instruments and their use at the interbank level.

2.7.4. PAYMENT INSTRUMENTS

An increase in the use of payment instruments in the Albanian economy continued throughout 2019. This trend was reflected in an annual increase in the number of payments of 23.8%, reaching about 18.6 million payments in total, as well as a slight increase of their value by 3.15%.

In terms of instruments used, the payment analysis indicates a continuous expansion of electronic payments such as, bank cards, credit transfers in electronic form (home banking), as well electronic money (pre-paid cards). The increase of the share of electronic payments is reflected in a continuous contraction of credit transfers in paper form, which in 2019 accounted for around 30% of the total volume of payments.

Chart 28 Volume of payment instruments in years (left) and the use volume of payment instruments by household and enterprises (right), during 2019



Source: Bank of Albania.

Home Banking

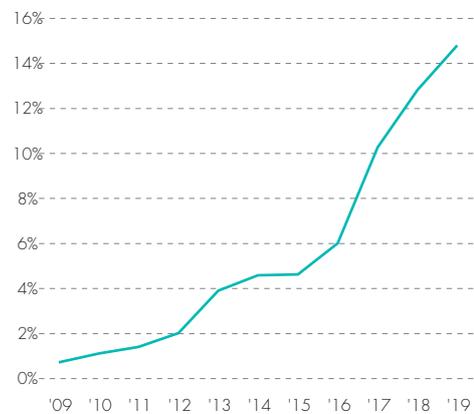
The initiation of credit transfers in electronic form is realised through “home banking”³⁵ services, which are provided by 11 of the 12 banks that operate

³⁵ These products provide remote access to the bank account, via on-line, telephone or software that the bank makes available to its clients.



in Albania. These services are both increasingly widespread in the Albanian market, and used to carry out payments, not only for basic information services for the account, but also for on-line payments. More concretely, in 2019, there was a significant increase in the volume of home banking payments, by 24.45%, and of the value of these transactions by 8.39%, compared to the previous year. Contributions to the upward trend of home banking were assessed to be the development of infrastructure and expansion of possibilities to access internet through smartphones. Also, the policies of banks, in the framework of promoting these alternative payment means, were assessed to have played a positive role, being reflected in an increase in remote accessible accounts, by 10.64% compared with the same period in 2018 and in an increase, against the total account, of 14.79% compared to the same period of the previous year.

Chart 29 Online accessible account to total accounts (right)



Source: Bank of Albania.

Bank Cards

At the end of 2019, all the banks³⁶ that operate in the Republic of Albania were licensed as card issuers, of which seven were licensed also as card accepters. The infrastructure provided by these banks has trended significantly upward in terms of the number of POS terminals, increasing by 28.29% compared with 2018. Despite the positive trend of the increase of the number of POS terminals, reflected in the POS report per 1.000.000 citizens (3.911 in 2019), their concentration continues to remain high in the region of Tirana³⁷, at 84.40%.

Positive developments were shown for ATMs, the use of which increased, to 23.18%, compared to the end of 2018. Encouraging the use of electronic money instruments is estimated to have an impact on the financial inclusion of the population by enabling access to banking services (having an electronic money account and owning a prepaid card) from categories of the population that are not able access other services, such as those who do not own a bank account.

In 2019, the issue of debit and credit cards increased significantly by 7.4% and 7.9% respectively. Also, the functioning of electronic-money cards in the market remained at the same pace as in the previous year. A significant increase in the number and value of card payments in physical and virtual POS continues in 2019, by 37.6% and 23.3%, respectively. In relative terms, the number of payments carried out with prepaid cards has totalled 7.1% of the payments with debit and credit card.

³⁶ At end-2019 there were overall 12 banks in the banking system (from 14 at end-2018).

³⁷ Regions are divided according to the branches of the Bank of Albania.



Electronic money products, based on the legal and regulatory framework of the Bank of Albania, are also provided by non-bank financial institutions licensed as Electronic Money Institutions. Currently, in the Albanian market, two electronic money institutions are operating. In 2019, these institutions together have conducted a volume of around 2.78 million electronic money payments, with a value of ALL 7.734 million. In spite of the upward trend that Electronic money shows, it still remains low, creating an added value for those who do not own a bank account.



2.8. INTERNATIONAL RESERVE MANAGEMENT

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

The Regulation "On the policy and management of the international reserve", approved by the Supervisory Council, lays down the purposes of maintaining the international reserve. In compliance with the best international practices, the purpose of maintaining the international reserve is implementation and support of monetary policy and exchange rate policy, as well as safeguarding of financial stability. The primary objectives of international reserve management are liquidity and security. Ensuring returns from reserve funds management represents a third objective, as long as it does not infringe the objective for liquidity and security.

The Investment Committee approves the names of entities where foreign reserves may be invested. These names include the governments of the USA, Japan, United Kingdom, and those in the euro area, which overall are rated at least A- (for euro area governments the accepted minimum rate is BBB³⁸). The names of entities allowed for investment also include agencies or institutions related to governments, multilateral institutions or other institutions rated at least AA-.

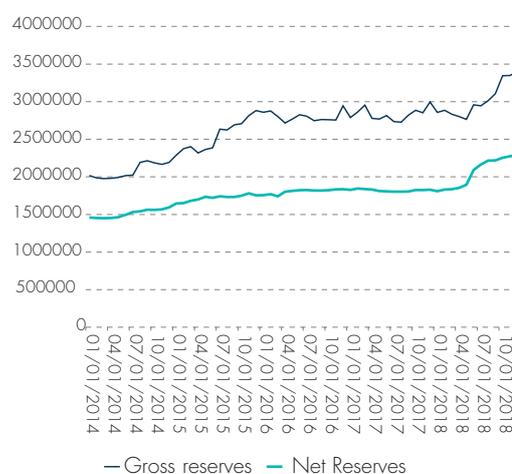
At the end of December 2019, the stock of foreign currency reserve was EUR 3,359.70 million, including monetary gold, at EUR 119.34 million, or 3.6% of the total.

The composition by currency of the gross international reserve at the end of 2019 was USD 20.0%; EUR 65.1%; GBP 2.6%; JPY 2.4%; AUD 1.4%; SDR 3.3%; AR 3.6%; RMB 1.8%.

Composition of reserve portfolio by maturity

At the end of 2019, the international reserve was invested into liquid assets, mainly with maturities of 0-3 years. The share of debt instrument with maturity over 5 years does not exceed 1.1% of the reserve portfolio. The portfolio managed by the external manager (World Bank) is invested against a reference

Chart 30 FX reserve performance



Source: Bank of Albania.

³⁸ Entities/ instruments listed up to BBB- are included in "Investment" category (investment grade).

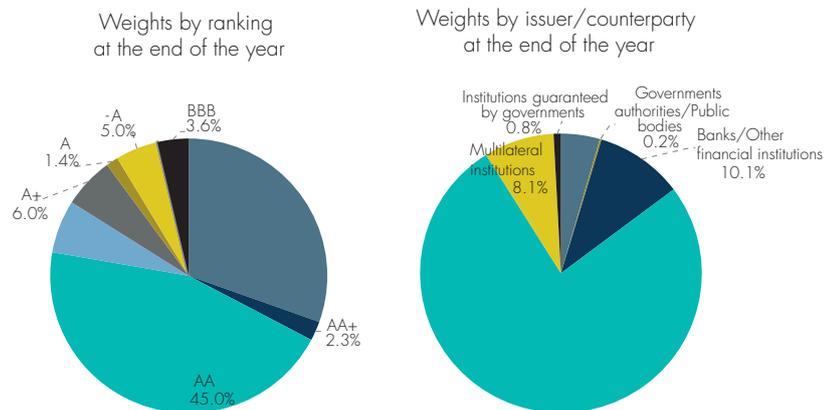


portfolio of 1-3 years, mainly in debt instruments issued by governments or government agencies.

Composition of the reserve portfolio by rating and type of issuer/counterparty

Around 84% of the international reserve portfolio has been invested in institutions with high quality rating (class AAA and AA including exposures in current accounts). By type, exposures of issuers/counter-parties are represented by governments/central banks (69.6%), followed by banks/other financial institutions (13.7%), multi-party institutions (8.8%), agencies (5.4%), government-guaranteed institutions (1.5%) and government authorities/public bodies (1.0%).

Chart 31 Shares by type of issuer/counterparty and rating classes at end-year

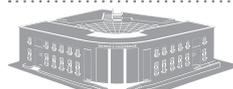


Source: Bank of Albania.

Return on the investment of reserve portfolio

The absolute return of reserve in total (excluding the fund managed by the World Bank as external administrator), was around 0.71% in 2019, compared with 0.22% in the previous year. The low return rate reflects the continuity of an environment with low interest rates on main currencies/markets, in which the foreign reserve portfolio is invested, where, in particular, the interest rates on treasury bills in euro continue to remain in negative territory. Hence, investment possibilities with a positive return rate for the part of portfolio in euro, while maintaining accepted levels of credit risk, still continue to be low.

The contribution to return of the euro, which accounts for more than 60% of the reserve portfolio, was negative reflecting the negative interest rates in the Euro area. Meanwhile, the contribution to return of the US dollar and of the other currencies was positive, as a result of the higher interest rates base in these currencies on average during the year.



Other developments related to the international reserve management function

In 2019, an assessment was made from a strategic perspective on the share of monetary gold in the foreign reserve portfolio. At the end of this assessment, in May, the Supervisory Council decided to purchase the amount of 94 gold ingot (37,600 onz or about 1,05 tons of gold). Purchases for the approved amount of monetary gold were made gradually during the period June-December.

Regarding the main developments in the framework of the relationship of the enterprises with counterparties, in 2019 the Memorandum of Understanding with the Bank for International Settlements (BIS) was renewed, for the continuity of the foreign currency credit line in the amount of Eur 500 million with this institution. The full package of documentation regarding this agreement was signed for the first time in 2018, where the Memorandum of Understanding had a 1-year term with the possibility of renewal. In the next renewal of the Memorandum of Understanding, the eligible collateral for the credit line was expanded, in the form of investment securities from the foreign reserve portfolio.

BOX 6 FLOWS AFFECTING INTERNATIONAL RESERVE IN 2019

Gross international reserve, estimated and reported in euro, decreased by around EUR 36.21 million, in 2019, standing at EUR 3,359.70 million as of the end of December. 2019 was characterised again by a high fluctuation of excess reserves in commercial banks at the Bank of Albania. The main factors that have affected the gross reserve are grouped below:

- *Transactions with the Ministry of Finance and Economy provided a negative impact, estimated at EUR 324.23 million, according to the following items:*
 - *net inflows from extension of various loans at EUR 176.60 million*
 - *transfers, including debt service, at EUR 500.83 million*
- *Commercial banks and other entities' transactions provided a positive impact, estimated at EUR 65.48 million, according to the following items:*
 - *deposits by commercial banks in their account at the Bank of Albania, for the minimum required reserve, for transactions related to the capital. EUR 1,944.16 million;*
 - *transfers at EUR 1,883.34 million;*
 - *net inflows for the account of other entities (DIA, etc.) at EUR 4.66 million.*
- *Bank of Albania transactions provided a positive impact, estimated at EUR 184.77 according to the following items:*
 - *purchasing foreign currency from commercial banks and other institutions, EUR 157.08 million:*
 - o *from commercial banks EUR 154.60 million;*
 - o *from institutions (net) EUR 2.48 million.*
 - *Receipts from interest and coupons. (calculated on a cash basis) generated from international reserve investments, at around EUR 32.51 million;*
 - *settlement of the Bank of Albania's dues to the IMF at EUR 0.27 million;*
 - *transfers at EUR 4.55 million.*
- *Market factors provided a positive impact, estimated at EUR 37.77 million, according to the following items:*



- *foreign-exchange rate volatility of currencies composing the international reserve contributed positively to the gross reserve reported in EUR, at EUR 37.46 million.*
- *the portfolio revaluation effect, as a result of interest rate volatility, is estimated at a slight positive value of around EUR 0.31 million².*

The net effect of SWAP transactions carried out with the Ministry of Finance and Economy for 2019 is EUR 36.98 million, while the total volume of SWAP transactions (considered as purchase-sale) is EUR 196.98 million. In October 2019, with the Ministry of Finance and Economy, a sale was realized, with full rights in the amount of EUR 66 million.

² This value also contains the effect created by the issuance of securities coupons and is corrected for the actions of purchasing/selling/maturing of securities on a cash basis.

In complete accordance with the purpose of keeping the international reserve, the agreement is an important mechanism available to the Bank of Albania, in addition to the Swap agreement signed with the People's Bank of China, to respond to emergency needs for foreign currency liquidity.



2.9. STATISTICS

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

The Bank of Albania is a producer of statistics mainly related to financial markets, financial institutions and financial infrastructure. It produces statistics for the decision-making process and bodies. It also carries out statistical functions to serve the public, as one of the national statistics agencies in Albania.

To meet the need for an increase in the volume and quality of statistical data, the focus of BoA is on the creation of a national statistical framework, which will be integrated into the European Statistical Framework, based on modern information technology infrastructure and standardized methodology.

The activities that took place in 2019, aimed at increasing the quality, reliability and consistency of the data, produced in full compliance with national legislation, as well as with the quantitative standards of international methodologies and of the European Union, were assessed positively in IMF and Eurostat reports.

The important developments in financial accounting statistics, government finance statistics and external sector statistics made 2019 a remarkable year in statistics. For the very first time, an official data transfer to the Eurostat financial account was carried out. This transmission is a step towards approximation to the European requirements, as one of the strategic commitments of the Bank of Albania.

In 2019, the focus of statistical activities was on improvement of the quality and detail of statistics in the external sector and increased transparency of communication with the public through the dissemination of statistical data and press releases.

- In September 2019, in accordance with the timeframe envisaged in the Transmission Program of data at Eurostat, reporting of the International Trade Services (2017-2018) was realised for the first time, along with indicators such as employment income and remittances, with geographical division as envisaged in Eurostat regulation, through the SDMX platform, fulfilling obligations arising from the “Action Plan on Economic, Monetary and Financial Statistics for candidate and potential candidate countries in the EU”. Also, for the first time, detailed data by



country and by service type (export and import) were published on the Bank of Albania website.

- In accordance with the time-frame envisaged in the ESA 2010 Transmission Program³⁹, the Bank for the first time carried out data transmission on Albania's Financial Accounts in Eurostat through the SDMX platform, thus fulfilling the country's obligation in the framework of European integration. Financial account statistics are evaluated by several missions led by IMF and Eurostat experts.
- In 2019, the regular reporting deadlines for EDP⁴⁰ tables (Excessive Deficit Procedure) at Eurostat have improved, reported in April and October 2019 (thus meeting Eurostat deadlines). Under the support of the regional project "Government Finance Statistics" coordinated by the IMF, the design quality of government data improved, as a basis for compiling government debt and EDP tables. The project is expected to be finalized in April 2020, with a very important product, the building of an IT system for the automated design of government finance statistics and the development of statistics.

In the framework of consistency of statistics, the Bank of Albania is part of joint projects with national and international institutions

- The Bank of Albania is part of the IMF-EUROSTAT joint project for the Western Balkans, on foreign sector statistics.

The project aims to improve data obtained at the source, the internal and inter sectoral consistency of external sector statistics with other statistics, and promotion of cooperation between producers of statistics in the country. The project will last 30 months and will end in June 2021.

- The Bank of Albania has successfully coordinated and finalized work for the development of Macroeconomic Imbalance Procedure indicators (MIP indicators) for Albania, in cooperation with INSTAT and expertise support from the European Union.

Macroeconomic Imbalance Procedure (MIP) is a system for monitoring economic policies and timely detection of potential risks to the proper functioning of the economy of the Member States and of the European Union as a whole. The MIP is part of six legislative proposals on economic governance adopted by the European Parliament and Council in November 2011, and as such it is part of the EU acquis to be adopted by candidate countries by the date of accession. In August 2019, Eurostat reported the sources of data needed to compile the main and auxiliary indicators of economic imbalances. Currently, data is available for 12 of the 14 MIP indicators. There has also been progress

³⁹ European System of Accounts - ESA 2010.

⁴⁰ EDP-Extension Deficit Procedure is an important statistical block for monitoring the soundness of public finances in member countries and candidate countries for the observation of two Maastricht criteria.



in compiling data on auxiliary indicators of the MIP platform. The expansion of time series of financial accounts remains an objective of the bank, since 2007.

- The Bank of Albania completed the range of financial stability indicators with new indicators for IMF transmission. It also continued to participate in the "Access to and Use of IMF Financial Services Survey".

The IMF's questionnaire "Access to and Use of Financial Services", FAS, gathers, annually, information on the evaluation of access and use of financial services by consumers of the economy. FAS provides geographic and demographic data on financial services provided to individuals and businesses by financial corporations. Since 2014, the questionnaire also included data on the latest developments in mobile money services. Taking into account the growing interest regarding gender statistics in financial inclusion, the latest FAS report also included data on gender statistics in financial inclusion in Albania. The data is published by the IMF (<http://data.imf.org/FAS>).

Development of new statistical fields - focus on micro data

Statistics regulations and guidelines of the European Central Bank were the basis for the development of statistics in the financial sector in Albania, with important resources and international cooperation oriented toward their development.

The focus regarding the statistics in the financial sector, in recent years, has focused mainly on harmonization with ESA 2010. This does not only include the reporting of monetary and financial institutions, but also harmonization with the guidelines at non-bank institutions in terms of an increase in the detail of data. Focusing on the development of insurance and pension fund statistics in 2019 was no exception to this trend.

The project "Improvement of the Credit Register in order to increase its use and harmonize it with the methodological standards of the ECB", identified the need for evaluation and expansion of areas and functions owned by the current credit register, in order to harmonize it with the methodological standards of the ECB⁴¹ and deepen the analysis of the Bank of Albania by increasing the use of the credit register beyond supervisory needs.

On a more statistical level, development of the current system aims to group the analytical data on each credit line, in a harmonized database that will support some core functions of the Bank of Albania, such as the monetary policy decision-making process, micro-and-macroprudential supervision as well as economic research at the Bank. The use of this detailed data set will enable realization of analyses and comparisons, which cannot be provided on the basis of aggregated data.

⁴¹ Aiming the approximation with AnaCredit (Analytical Credit Report) - the newest platform created by the ECB, where all member states have the obligation to report under the same standard harmonized in methodology and definitions.



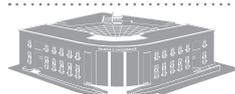
The drafting of securities statistics has significantly developed in recent years due to structural developments in the international financial markets. Detailing of the available information on securities is necessary to identify risks from cross-border and internal financial interconnection, as well as to measure the degree of risks. For this reason, in 2019, work has been done to determine the methodological framework and information sources as well as to build software for collecting and compiling fragmented data regarding securities held by credit institutions and their subsidiaries in accordance with the requirements of the ECB Regulation 2015/730.

The Bank of Albania, in cooperation with Instat, conducted for the first time in 2019, the survey on "Household Budget Survey". The main purpose of this survey is to collect detailed data at the micro level on the real and financial wealth of Albanian households, as well as on the structure of their liabilities, and income and expenses, based on a standardized methodology developed by HFCN (Household Finance and Consumption Network), led by the European Central Bank in cooperation with other central banks of EU member states.

The survey on the finances and consumption of Albanian households included a total of 2261 households in Albania, randomly selected by Instat, based on the principle of proportionality.

Modern statistics cannot be conceived without the strong support of information technology

In 2019, the "Automation of the compilation and reporting system of statistics of the External Sector" project successfully ended. The software of the system was installed in December and it is being put to the test before fully utilizing it.



2.10. RESEARCH

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

Research at the Bank of Albania has aimed at investigating hypotheses and deep economic and financial analyses; establishing and improving new models for the Albanian economy, advising and endorsing decision-making, in view of objectives related to monetary policy, financial stability, banking supervision, financial inclusion and financial education.

Scientific research activity is documented in a total of 31 research papers, scientific articles, and the drafting of two statistical survey analyses which focus on the study and empirical analysis of monetary and financial developments in the Albanian economy. Research is mainly focused on issues related to the analysis of developments in the exchange rate, monetary policy, financial stability and banking supervision, as well as their interaction.

Researches carried out in 2019, aimed at providing an assessment on spill overs of macro financial factors in the euro area and fluctuations in global liquidity to the exchange rate in the Albanian economy; measurement and assessment of effects that competitiveness, concentration and behaviour of banks have on financial system stability; investigation of the relationship between banking stability and real estate markets; the effects that micro frequency of changes in prices have on the formation of inflationary expectations and price rigidities in the economy and investigation of the mutual impact between labour market and economic growth at home.

In terms of methodology, research focused on enriching the methodologies of empirical analysis to assess shocks on the economy and the forecast of economic and financial indicators. The studies aimed at including contemporary techniques in the field of modelling with the aim to improve the portfolio of econometric models, constructed through the application of Bayesian Evaluation and Assessment methodology, and methods for the identification of structural equilibriums to enrich the autoregressive models of analysis and prediction.

Also, research in 2019 scrutinised technological developments, such as blockchain and crypto-activity and the effects they may have on the currency and financial system. The study describes the nature of these risks and addresses the disadvantages and risks that their adoption may pose to the banking system, businesses, and consumers, as well as to the functioning of the central bank.



The need to regulate these activities relates not only to the challenges the may pose to the effectiveness of monetary policies and supervision of banking system, but above all, to the sustainability of the financial system.

Research has contributed to enriched statistical information for analysis and decision-making at the Bank of Albania, through two statistical surveys at the national level. The surveys aimed to look at and identify the behaviours of Albanian households in relation to investments, wealth, consumption, financial inclusion and education.

In 2019, the “Survey on the Finances and Consumption of Albanian Households” was realised for the first time, based on a questionnaire developed by the European Central Bank. The information in the survey was gathered from households and enriches the statistical information regarding various aspects of the level and structure of wealth and debt, sources and their use, employment and income, behaviour of households regarding consumption and savings. These data were not, so far, available at other official sources, Bank of Albania, INSTAT or other statistical agencies.

Also, in the framework of assessing the financial literacy of the public, a third survey, “Financial Literacy in Albania”, was conducted. Like the two previous surveys, it was based on OECD/INFE methodology. Both surveys provide important statistical information to construct a national strategy for financial education and inclusion.

More complete and detailed information on the research papers of the Bank of Albania is found on the official website of the Bank of Albania in the sub-category “Publications/Research and Working papers” . Other research works are published as articles in the “Economic Review” of the Bank of Albania. The semi-annual magazine “Scientific novelties at the Bank of Albania” provides information about newly completed research materials and about those in process, materials presented in the “Friday Seminars”, and on other activities organized by the Bank of Albania throughout the year.



2.11. EUROPEAN INTEGRATION

Albania has continued to implement obligations stemming from the Stabilization and Association Agreement (SAA) as well as from bilateral EU-Albania meetings. Following the positive recommendation of the European Commission to open negotiations with Albania, the European Council, met in October 2019, and decided to postpone the decision on opening negotiations before the Zagreb Summit on EU-Western Balkans, to be held in May 2020.

The Bank of Albania has continued to contribute to the fulfilment of obligations stemming from the Stabilization and Association Agreement, the Progress Reports of the European Commission, joint EU-Albania subcommittees and the National Plan for European Integration.

The Bank of Albania has continued to lead Two Inter-institutional Work Groups related to chapters of the European Union acquis: Chapter 17 - "Economic and Monetary Policy" and Chapter 4 - "Free movement of Capital". In addition, the Bank of Albania has actively contributed to Chapter 9 - Financial Services; Chapter - "Economic Criterion"; Chapter 18 - Statistics; and Chapter 32 - Financial Control. The Bank of Albania prepares regular reports on the performance in the field covered by the above stated chapters, and plans in the NPEI the legal and regulatory measures which contribute to approximating with EU acquis.

The Bank of Albania has participated in the annual high-level meeting of the Stabilization and Association Committee and in the meetings of two subcommittees: 1) Domestic market and competition; and 2) Economic, financial and statistical issues.

On 29 May 2019, the European Commission published the Progress Report for Albania. This document assesses the progress made by Albania from March 2018 - March 2019. In the area of monetary policy the report emphasises that the central bank fulfilled its main objective, to achieve and maintain price stability. The BoA is financially independent and has sufficient instruments, competence and administrative capacity to function effectively and to conduct an efficient monetary policy. The report underlines that progress was made in the area of payment systems, through the adoption of the policy document "payment and settlement systems" and preparation of the Strategy on Retail Payment System. With regard to banks and financial conglomerates, the Bank of Albania has continued to further align the banking regulation and supervisory manual with Basel II and Basel III. Albania has a system in place for the identification of systemically important banks that is similar to EU practice.

With regard to addressing the recommendations stemming from the EC Progress Report 2019, the Bank of Albania was focused, throughout the year,



on aligning the regulatory framework with Basel III. In more concrete terms, there the following were approved: the Regulation "On macro-prudential capital buffers"⁴² with the purpose of determining a way to implement each macro-prudential capital buffer, and their combination; the Regulation "On regulatory capital of banks"; the Regulation "On liquidity coverage ratio"⁴³, which approximates the regulatory framework of the Bank of Albania to the requirements of Basel III and European regulations 575/2013/EC and 2015/61/EU; the Guideline "On stress testing of banks"⁴⁴; Regulation "On capital adequacy ratio".

To strengthen anti-money laundering and counter-terrorist financing (AML/CFT) measures, in compliance with Moneyval recommendations for Albania, the Bank of Albania has approved a set of amendments⁴⁵ in the regulations on the banking system. These amendments aim at further strengthening the criteria that entities must meet to better manage risks related to money laundering and financing of terrorism.

Another issue which has been revealed is the need to increase financial inclusion. For this purpose, the Bank of Albania has drafted a strategic document which aims at promoting payment instruments and systems to enable broader financial inclusion. In this framework, the Bank of Albania has undertaken two important steps: 1) compilation and submission of the Draft-Law "On Payment services (PSD2)", which transposes the revised European Union Directive 2015/2366; and 2) compilation of a draft-law which will transpose the European Union Directive on "Payment Accounts" in 2020. Another important issue concerns the performance of non-performing loans. This year, the Bank of Albania implemented the action plan called "Tirana Approach". The purpose of this plan is to deal with all large creditors with problems that are exposed to more than one bank.

⁴² Decision No.41, dated 5.6.2019 of the Supervisory Council of the Bank of Albania.

⁴³ Decision No. 27, dated 28.3.2019 of the Supervisory Council of the Bank of Albania.

⁴⁴ Decision No. 60, dated 4.9.2019 of the Supervisory Council of the Bank of Albania.

⁴⁵ Decision No. 46, No. 47, No. 48, No. 49, and 50, dated 3.7.2019 and Decision No. 78, 79, and 80, dated 18.12.2019 of the Supervisory Council of the Bank of Albania.



2.12. INTERNATIONAL COOPERATION

Relations with the International Monetary Fund

The Republic of Albania continues to have SDR 139.3 million in quotas and owns 2,858 votes or 0.06% of the total sum of the votes of all members of the IMF. It is in the same constituency with Italy, Greece, Portugal, Malta, and San Marino. This constituency has a total of 207,948 votes or about 4.13% of the total amount of votes of all members of the IMF. The total amount allocated and disbursed to date is SDR 277.31 million.

Albania's relations with the International Monetary Fund continue to focus on the Article IV consultations, which were concluded on 26 November by the IMF Executive Board. In 2019, the Bank of Albania was visited by several IMF missions to provide technical assistance and expertise in various fields such as the payment system, financial stability, statistics, monetary policy, supervision and accounting.

Relations with the World Bank Group

The World Bank Group (WBG) supports Albania through the Partnership Framework covering the period 2015-2019, which aims to support Albania's aspirations for equal growth and integration into the European Union. Over the years, the World Bank Group has provided over USD 2.2 billion in assistance to the country. Currently there are 11 projects amounting to a total of USD 718 million, under IDA (USD 35 million) and IBRD (USD 683 million) loans.

Albania is part of the constituency composed by Greece, Italy, Portugal, Malta and Timor-Leste.

In the framework of the "Reserve Advisory and Management Program" (RAMP), cooperation with the World Bank Group has continued toward providing technical assistance for the implementation of an integrated credit risk and interest rate model.

Throughout 2019, the World Bank continued to provide assistance to the Bank of Albania in relation to payment systems, analysis of the remittances market, and banking resolution. Regarding recovery and resolution, the Bank of Albania has continued to benefit from World Bank assistance in drafting regulatory acts as well as in identifying and evaluating critical functions.

Technical cooperation

On October 2019, the Bank of Albania started implementation of the Twinning Project "Enhancing Bank of Albania's alignment with EU Acquis", in the framework of IPA 2015 EU funding. This project is being implemented by Banka d' Italia and Deutsche Bundesbank. The main implementation areas of

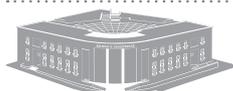


the project are: i) strengthening institutional capacities of the Bank of Albania through alignment with the model of the European System of Central banks regarding independence, accountability, transparency and internal audit; ii) Strengthening the role of supervision and financial stability in compliance with the European framework and best international practices, and the further deepening of anti-money laundering and combating the financing of terrorism; iii) Harmonising the decision-making process of the Bank of Albania's monetary policy with that implemented at the European Central Bank and the European System of Central banks, including guaranteeing the stability of the financial market and the external position of the country; and iv) Strengthening management capacities of the Bank of Albania.

The Bank of Albania, in carrying out its activity, paid special attention to cooperation with the central banks of the European Union, throughout 2019. In more concrete terms, the Bank of Albania, in collaboration with regional central banks, has started implementation of the two-year project "Programme for Strengthening the Central Bank Capacities in the Western Balkans with a view to the Integration to the European System of Central Banks". The project consists of two pillars. The first component includes a series of trainings by experts of central banks from the ESCB and the ECB, while the second component consists of bilateral cooperation. The areas covered by this project are those of banking supervision, financial stability, recovery and resolution, monetary policy, payment systems, statistics, compliance and EU integration, governance, accountability and internal auditing policies.

Over the past year, cooperation with the London School of Economics and Political Science has continued. The Annual Conference on "A Brave New World? The Future of Banking in Emerging Europe. Rethinking Size, Structure, Ownership, Policies and Incentives", was organised in October 2019. The purpose of the conference was to assess ongoing shifts in banking systems and more broadly in financial sectors in terms of size, origin, ownership and incentives globally and regionally, and the implications for the Albanian banking sector and the Southern-Eastern Europe (SEE) region. Among other topics, the conference investigated how banks in the SEE and in particular in Albania deal with new challenges that arise both from regulators and non-bank financial entities; how banks alter their business model; how they engage with innovative financial products; and ultimately whether they can continue operate as traditional financial intermediaries or not.

The Bank of Albania continued to cooperate with the FSVC, among others, notably, emphasising support for building the capacities of the Supervision Department to conduct necessary and adequate tests for banks and non-bank financial institutions' shareholders; and sharing the experience of FSVC experts with the Supervision department staff on best practices for licensing regulations. Also, FSVC provided its support in such areas as statistics, payment systems, and banking resolution.



Also, in 2019, cooperation in the framework of the support of the Swiss State Secretariat for Economic Affairs (SECO) continued. This cooperation focused on research activity at the Bank of Albania for strengthening the research capacities of the Bank of Albania and in the field of monetary policy.

In the framework of technical assistance provided by the European Bank for Reconstruction and Development (EBRD), for enriching economic forecasting and modelling and enhancing the analytical capabilities of existing models, the Bank of Albania has continued to benefit from assistance provided by EBRD experts.

Participation in international conferences, forums and seminars

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

- On 15-16 January 2019, the Governor of the Bank of Albania, Mr. Gent Sejko, attended the annual Central and Eastern European Forum organised by Euromoney, in Vienna, Austria. This annual Forum brings together prominent international personalities in the fields of politics and economy from the CEE countries
- On 28-29 January 2019, the Second Deputy Governor of the Bank of Albania, Ms. Natasha Ahmetaj, attended the conference on "Balancing Fintech Opportunities and Risks - Implementing the Bali Fintech Agenda", in Vienna Austria.
- On 15 February 2019, the Governor of the Bank of Albania, Mr. Gent Sejko, attended the meeting of the constituency in the International Monetary Fund/World Bank Group, in Valletta, Malta. Central bank governors and ministers of finance from the constituency member countries met to discuss recent developments in the global economy and in the respective countries.
- On 25-26 March 2019, the Governor of the Bank of Albania, Mr. Gent Sejko, attended the 41st Meeting of the Central Bank Governors' Club of the Central Asia, Black Sea Region and Balkan Countries, held in Istanbul, Turkey.
- On 4 April 2019, the Governor of the Bank of Albania, Mr. Gent Sejko attended the meeting of the Europe Regional Committee (ERC). This meeting was jointly organised by the Albanian Deposit Insurance Agency (ADIA) and the International Association of Deposit Insurers (IADI), at the premises of the Bank of Albania.
- On 12-14 April 2019, the Governor of the Bank of Albania, Mr. Gent Sejko, attended the Spring Meetings of the International Monetary Fund (IMF) and the World Bank Group (WBG) in Washington D.C., USA.
- On 13-15 June 2019, the Governor of the Bank of Albania, Mr. Gent Sejko attended the annual regional summit in Bečići, Montenegro, together with governors of the central banks of Bosnia & Herzegovina, Montenegro, North Macedonia, Croatia, Kosovo and Albania, as well



- as ministers of finance and tax directors from the region.
- On 15 July 2019, the Governor of the Bank of Albania, Mr. Gent Sejko, attended the second high-level conference on “Demographics, Jobs and Growth: Navigating the Future in Central, Eastern and South-eastern Europe”, organized by the Croatian National Bank and the International Monetary Fund (IMF) in Dubrovnik, Croatia.
- On 18-20 October 2019, Mr. Gent Sejko, Governor of the Bank of Albania, attended the Annual Meetings of the International Monetary Fund (IMF) and the World Bank Group (WB), in Washington. In these meetings organised in round tables, senior decision makers of the IMF, WBG, governors and ministers of finance from member countries, as well as representatives from academia, the business community and civil society discussed the latest developments and the outlook for the global economy.
- On 19 November 2019, the Governor of the Bank of Albania, Mr. Gent Sejko, attended the high-level conference on “The risks and opportunities in a continuous evolving financial landscape - The way forward”, organised by the Central Bank of the Republic of Kosovo (CBRK) on the occasion of its 20th anniversary in Pristina.
- On 20-22 November 2019, the Governor of the Bank of Albania, Mr. Gent Sejko, attended the 42nd Meeting of the Central Bank Governors’ Club of the Central Asia, Black Sea Region and Balkan Countries. The meeting was held in Prague, attended by Governors of the central banks of the Club’s members.

Memorandums of cooperation

- On 1 March 2019, the Governor of the Bank of Albania, Mr. Gent Sejko, signed a Memorandum of Understanding, between the Swiss Secretariat for Economic Affairs (SECO) and the Bank of Albania, on implementation of the second phase of the Bilateral Assistance and Capacity Building Program for central banks for 2018-2022.
- On 19 November 2019, the Governor of the Bank of Albania, Mr. Gent Sejko, signed a “Memorandum of Cooperation” in the field of corporate governance among five banking supervisory authorities of the region: the Central Bank of the Republic of Kosovo, the Bank of Albania, the National Bank of North Macedonia, the Central Bank of Montenegro and the Banking Agency of the Federation of Bosnia & Herzegovina. The objective of this Memorandum is to set out collaboration in the fields of supervision, research, and decision making, related to corporate governance of banks in the region.



2.13. ADVISOR'S ROLE

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

In 2019, the Bank of Albania provided its opinion on the Medium Term Debt Management Strategy (MTDS), 2020-2022. The Bank of Albania highlighted the importance of continuing with the consolidation of public debt to safeguard macro-economic stability in Albania and to reduce risk premia. Also, in its opinion, the Bank of Albania suggested maintaining the foreign debt ratio to total debt, while being attentive that this ratio does not increase. In this way the exposure of the country to shocks in foreign markets will be reduced.

At the end of year, the Bank of Albania provided its opinion on the Draft-budget 2020. In the relevant opinion, the Bank of Albania emphasised the need for coordination of fiscal and monetary policies for the purpose of macroeconomic sustainability, and observation of the budget indicator limits which are set forth in the Organic Law of the Budget.

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

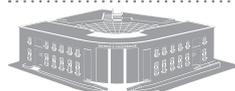
In the framework of its role as a member of the Financial Stability Advisory Group (FSAG), the Bank of Albania has shared information and has coordinated its actions with other authorities, which are members of FSAG. Throughout 2019, the Bank of Albania shared opinions with the Ministry of Finance and Economy and the Albania Financial Supervisory Agency on the financial situation and supervision of the financial institutions and regulated markets, as well as on the compiled draft laws. With the Deposit Insurance Agency, an institution which regularly attends the meetings of FSAG, there has been continuous collaboration in the framework of assessing the financial situation of banks and the fulfilment of legal requirements which interconnect the activities of both institutions.

The Bank of Albania chairs the National Payment System Committee (NPSC). The purpose of the Committee is to support and contribute to increasing the security, stability and efficiency of the national payment system in Albania. It gathers every year, and its recommendations serve to undertake initiatives



on regulatory changes for promoting payment systems and coordinating the activities of participant institutions in the field of payments.

In 2019, the Bank of Albania actively contributed in joint meetings and initiatives with other public institutions, with analyses and discussions, and has provided its opinion on important draft laws, which affect the activity of the Bank.



2.14. TRANSPARENCY AND PUBLIC COMMUNICATION

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

An open and transparent central bank

Beyond its legal obligations, the Bank of Albania communicates a variety of information to the public regarding its role and activity, from the decision-making of the Supervisory Council to its daily operational activity. This transparent communication helps increase the effectiveness of the policies pursued by the Bank of Albania, enabling the public to properly understand the decisions taken by the Bank, in a timely manner, in order to evaluate them fairly.

The Bank of Albania uses a variety of communication channels, in order to more clearly explain its role, its main objective of maintaining price stability, and the means by which it seeks to realize this objective.

The monetary policy strategy is based on a defined decision-making cycle in an annual calendar of 8 meetings of the Supervisory Council. A press conference with the Governor is held after each meeting. Its aim is to explain the decision taken by the Supervisory Council and the analysis used to corroborate this decision, to the public. Relevant press conferences were organized in response to this cycle, in 2019, during which the Governor responded to media interest on various issues related to the Bank of Albania. Press conferences were followed by publication of the Governor's speeches, and related Q&A in Albanian and in English.

Also during 2019, after each meeting, a brief summary of key decisions taken by the Supervisory Council of the Bank of Albania was published. All public decisions of the Supervisory Council, as well as orders or acts of the administrators, applicable by entities licensed by the Bank of Albania, were fully published in the Official Bulletin of the Bank of Albania, in 8 editions of this publication.

The Bank of Albania's communication is further complemented continuously and in real time with a series of periodic reports, surveys, analyses, data, assessments and opinions of the Bank of Albania on the macroeconomic situation of Albania and the role of the Bank in supporting financial stability.

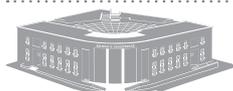
Communication with the public is tailored according to interest group, academic level and professional level of targeted groups by the Bank of Albania, among which, the media has an important role. In this framework, the media is continuously informed and sensitized on issues related to BoA and on the economic and financial performance of Albania. In 2019, media communication continued through press conferences, speeches, presentations and lectures on activities organized by the Bank of Albania or other domestic and foreign institutions, dedicated interviews or participation in TV shows, and expression of views on specific issues of interest to the Bank of Albania or other public activities of the Governor and other representatives of the Bank. In 2019, the activity of the Bank of Albania was communicated to the public mainly through public announcements, press releases, speeches, interviews and participation in TV shows. During the year, seven of its periodic reports were presented "off-the-record" to the media. These meetings aim to guide the media to a correct understanding of the decision-making of the Bank of Albania and are seen as effective means of communication with the public.

In order to enhance interaction with the public, in 2019, we continued digital communication through social networks such as Twitter (information), Facebook (financial education), YouTube (video) and Flickr (photo), transmitting the general activities of the Bank of Albania to the public, in a timely and comprehensive manner.

In 2019, a broad campaign was organised to familiarize the public with the banknotes of the new series, two of which, the denominations 200 Lekë and 5000 Lekë, were put into circulation on 30 September 2019. The launching and the issue of the new series of banknotes was a strategic objective of the Bank of Albania, both in the field of currency issue and public communication and education.

The campaign was informative and educational, taking place throughout the Republic of Albania. Traditional and contemporary means of banknote promoting and launching were also employed, by consulting the experience of other central banks in this field.

This campaign involved various communication channels, amongst which we can mention leaflets and posters available at branches of the Bank of Albania, branches of commercial banks, the Albanian Post, Offices of Civil Status, Offices of OSHEE (Electric Energy Distribution Operator; and exchange bureaus; launching of the new series and two banknotes, denominations, 200 Lekë and 5000 Lekë, on the website; creation of an application related to the security features of banknotes, presenting the security features visually and dynamically; TV and radio spots; city lights at bus stations, billboards, in buses, and at the airport., in Tirana, and in 10 other districts; posts in social networks; and presentation of a movie on the production of the Albanian banknotes.



In the framework of this campaign, the Bank of Albania organised a Moving Exhibition in Tirana and in five other districts (Kukës, Korça, Gjirokastra, Shkodra and Vlora), with the aim of informing the public on the new image and security features of the new banknotes.

Thanks to the communication campaign, the public had the opportunity to know all the necessary information related to the new series, in order for the new banknotes to be easily accepted by the public and be used along with the current banknotes in circulation.

BOX 7 ACTIVITIES WITHIN THE COUNTRY

- On 22 February 2019, a ceremony to promote “Money, banks and society a historic journey, from genesis to modern days”, a book co-authored by Prof Dr. Aristotel Pano and Accad.Prof. Dr. Anastas Angjeli, was organized on the premises of the Bank of Albania. Members of Parliament, representatives from academia, directors of the banking system, economists, and representatives from the Bank of Albania attended.
- On 1 March 2019, the Swiss Secretariat for Economic Affairs (SECO) and the Bank of Albania signed a Memorandum of Understanding on the implementation of the second phase of the Bilateral Assistance and Capacity Building Program for central banks for 2018-2022, at the premises of the Bank of Albania. International Monetary Fund and World Bank Group. The Memorandum was signed by the Governor of the Bank of Albania, Mr. Gent Sejko and H.E. Swiss Ambassador in Albania, Mr Adrian Maître. The Bank of Albania will be part of the bilateral assistance in the field of central banking, in the framework of the new agreement.
- On 29 May 2019, the Bank of Albania met with the banking sector to discuss the “Role of the banking industry in the future development of Albania”. This meeting, which has become somewhat of a tradition, aims at further strengthening the collaboration of the Bank of Albania with the banking system. The meeting organised upon the initiative and chaired by the Governor of the Bank of Albania, Mr. Gent Sejko, was attended by senior officials from the Bank of Albania, executives of commercial banks, and representatives from the International Monetary Fund and World Bank Group.

Following the orientations from this meeting, a joint effort with the Association of Albanian Banks was made to draft an action plan on concrete objectives to boost lending in the Albanian economy in the medium term. The outcome of this work is the Platform for revitalisation of credit. This platform contains a joint plan of action where Bank of Albania and banking systems engage to undertake regulatory improvements and concrete initiatives, which aim to boost lending as the main source for economic growth and financial intermediation. The Platform for revitalisation of credit will address the lending policies implemented by banks, payment systems and financial education.

- On 15-19 July 2019, the Bank of Albania co-organised with the World Bank Treasury the Workshop on Legal Aspects of Governance and



Asset Management. This event brought together representatives from the World Bank Group, the Bank of Albania, central banks from 28 countries and representatives from financial institutions. This workshop focused on dealing with legal issues related to foreign exchange reserve management.

- *On 12 September 2019, the Bank of Albania launched a new series of banknotes, in a ceremony organised for this occasion. The launching of this series is a very significant event, a special moment, not only for the Bank of Albania, also for the entire country. More than 20 years after the launching of the current series of lek banknotes, the new series comes with a refreshed design, giving the Albanian banknote a modern look. The new banknotes are more durable, are made with high-quality material, project integrity and reliability, and follow standards similar to those applied in advanced countries. They are produced with cutting-edge technologies for banknote printing, with new security features, making them safer against counterfeiting.*
- *On 1 October 2019, the National Payment Systems Committee (NPSC) held its fifth meeting, chaired by Ms. Luljeta Minxhozi, First Deputy Governor of the Bank of Albania. A set of studies and initiatives undertaken by participating institutions, were introduced in this meeting, such as: the analysis of government payments and the needs for intervention in the context of automation and digitalization, carried out by the World Bank Group; the need for intervention by the Bank of Albania to identify distant clients and the best practices in this field; a study on the informal economy and the possibilities for intervention, promotion of electronic payments in the Albanian economy, aiming to reduce informality².*
- *On 10 October 2019, under the auspices of the Governor, Mr. Gent Sejko, the Bank of Albania, co-organised with the London School of Economics and Political Science (LSE), the Annual Conference on "A Brave New World? The Future of Banking in Emerging Europe. Rethinking Size, Structure, Ownership, Policies and Incentives". The Conference proceedings were opened by the Governor of the Bank of Albania, Mr. Gent Sejko; the Director of LSE's Institute of Global Affairs (IGA), Mr. Erik Berglof; the President of the Republic of Albania, H.E. Mr. Ilir Meta; the Minister of Finance and Economy, Ms. Anila Denaj; and the Chair of the Parliamentary Committee on Economy and Finance, Mr. Arben Ahmetaj.*

The Closing Panel with the Governors' Roundtable brought together in a discussion panel the Governor of the Bank of Albania, Mr. Gent Sejko; the Vice Governor of the Central Bank of Bosnia and Herzegovina, Ms. Želimira Raspudić; the Deputy Governor of the National Bank of Ukraine, Mr. Dmytro Sologub; the Former Governor of Bank of Estonia, Mr. Ardo Hansson; the former Governor of the Central Bank of Argentina, LSE and IDB, Mr. Mario Blejer; and the Director of the Institute of Global Affairs in the London School of Economics and Political Science (LSE), Mr. Erik Berglof. The panel was moderated by the Programme Director at the LSE Institute of Global Affairs, Ms. Piroska Nagy-Mohacsi.

- *On 5-6 December 2019, the Bank of Albania organized the 13th SEE Economic Research Workshop. For the past 13 years, this workshop has served as a discussion forum on the latest research on economic and financial issues and has promoted the exchange of views among*



researchers from the Bank of Albania, other central bankers, academia, and scholars and policy-makers in the region and beyond. This year's workshop focused on the developments of the external sector and financial stability, as well as on their implications for central banks and the economy.

- On 13 December 2019, the Governor of the Bank of Albania, Mr. Gent Sejko, met with renowned publicists, experts of politics and economy, journalists and representatives of the print and electronic media on the occasion of the traditional end-of-year event. By the end of this activity, the three winners of the "Governor's Award for the Best Diploma Thesis 2019" were announced. The first prize was awarded to Mr. Olsi Pajo, a student at the University of Bonn, Germany; the second prize was awarded to Ms. Meril Canameri, student at the University of Tirana; and the third prize was awarded to Mr. Isli Kola, student at Bilkent University, Ankara, Turkey. This annual event was dedicated to Albanian students graduated this year in Albania and abroad, for scientific research on issues related to topics such as international monetary economics, price and financial stability, and economic integration.

A responsible and accountable central bank

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

Institutional relations with the Parliament are held in several directions. The hearing sessions of the Governor in the Parliamentary Commission of Economy and Finance (CEF) are the most significant ones. In April 2019, the Governor presented the Annual Report of the Bank of Albania to CEF and later to the Parliament of Albania, responding to the MP's interest in specific issues related to it.

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

Throughout 2019, the Bank of Albania continued to regularly update its website, which had about 1.2 million visitors who checked our page around 3.7 million times and browsed in total about 6.4 million sections.

Our website is constantly enriched with a broad statistics system for many sector of the Albanian economy, such as the banking sector, the fiscal sector, the real sector and the external sector, which are published according to a defined schedule that is updated semi-annually. The Bank of Albania's statistics are also found in the monthly statistical reports and in quarterly monetary policy reports.



This site also offers all publications of the Bank of Albania, which summarize updated information on the Albanian and world's economy; developments in the banking and financial system; financial stability and money; amendments and enrichments to banking legislation and its regulatory framework; as well as on other issues, thus consolidating as a source of accurate and reliable information to the public.

Periodic and non-periodic publications, in 2019, consisted of about 5200 pages of analyses, statistics and research in both Albanian and English. The set of periodic reports has maintained the same structure: Annual Report, Quarterly Monetary Policy Report, Financial Stability Report (semi-annual) and Annual Supervision Report. In addition to the periodical reports, this range is further enriched with the Official Bulletin (depending on the Supervisory Council meetings), the Economic Review (half-yearly), the "Research Newsletter" at the Bank of Albania" (half-yearly), the Annual Conference Book 2018: "Monetary Policy, Economic Integration and the" New Normal"; the Second Conference Book of the Museum of the Bank of Albania on "The Role of Money in Wartime"; and various research papers and educational publications.

In 2019, the Bank of Albania continued the free distribution of all its publications, taking into account the social responsibility to reduce paper publications.

In order to inform the public, the Bank of Albania informs its citizens in writing or in electronic form, depending on how they want to receive this information. In 2019, replies were provided to 80 official requests sent to the coordinator for the right of information and about 250 e-mails to the general electronic address of the Bank of Albania, and about 350 messages with requests for information delivered at our Facebook account.



2.15. FINANCIAL EDUCATION

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

To implement the Parliamentary resolution, the objective of the educational campaign, throughout 2019, was to help the public not use the terminology "new lek– old lek", but simply "lek". The educational publications and temporary exhibitions in the Museum were also aimed at educating the public on this important issue.

Educational publications

In 2019, the Bank of Albania put into circulation two new banknotes, for the 200 Lekë and 5000 Lekë denominations. On this occasion, educational materials on the new banknotes, in the form of brochures, leaflets and informative posters were prepared and distributed throughout the country.

Also, the teaching text "Personal finances in your hands" continued to be distributed for 5 high schools which have chosen to deliver this subject (a total of 740 books).

Money week

On 25 March 2019, Money Week 2019 was launched at the Museum of the Bank of Albania, under the motto "Too young to speak in old lek!" The Bank of Albania participated for the sixth time in this celebration, in cooperation with the Albanian Association of Banks, and with the support of the Ministry of Education, Sport and Youth, and the Deposit Insurance Agency (ASD). Throughout the week, numerous educational and awareness activities were organized, including, directly, around 4000 children and young people, representing about 90 middle schools, in 5 cities. Educational activities included school competitions, lectures at university auditoriums and youth centres, visits to the Museum of the Bank of Albania and to commercial banks.

World Savings Day

On the occasion of World Savings Day, on 31 October 2019, the Bank of Albania in collaboration with the Albanian Association of Banks organised some educational activities. In compliance with the best principles of this area, savings should start at a young age. For this reason, under the slogan "The earlier or longer you save, the more savings you will have", activities were



organised and educational publications were provided to pupils of 9-year schools of Tirana, which aimed at educating and making them aware of principles of good management for saving money.

Second Summit of the Albanian Diaspora

The Second Summit of the Albanian Diaspora was held from 28 February– 2 March 2019. The Summit was organized by the Albanian Government and was attended by prominent Albanian personalities from business, science, art and culture communities abroad. The Bank of Albania was an integral part of the fair, opened at the premises where the Summit took place on the 1st of March 2019, in Tirana. At the fair the Bank of Albania had a dedicated booth and presented periodic and non-periodic publications of the Bank, numismatic materials, as well as educational documentaries. On 2 March 2019, the Bank of Albania's dedicated booth was opened to public at the library of Lezha, on the occasion of the activities commemorating the 575th anniversary of the League of Lezha.

The Bank of Albania on Facebook

The Facebook page of the Bank of Albania was created in 2014 to promote and cultivate financial literacy. The Bank of Albania's Facebook page has served as another channel to reach out to the public, mainly the younger generation. In 2019, about 110 posts were published to inform and provide the public with educational materials, numismatic curiosities, activities and publications of the Bank.

The Museum of the Bank of Albania

Since October 2015, the Museum of the Bank of Albania has served as a communication promotor between the Bank and the public. Museum guides, interactive games and information published at the Museum provide the public with the monetary circulation history over the centuries and financial education concepts. Those who are fond of numismatic and financial and economic history also find themselves in this Museum. In 2019, the Museum of the Bank of Albania was visited by 3107 visitors, of which, 1600 were children and students and 1507 adults older than 18. Educational films dedicated to pupils of elementary schools are shown at the premises of the Museum, presentations on personal finances take place, while through electronic quizzes, and knowledge attained during visits to the Museum is tested. The teaching set includes "Çufo piglet learns to save" as well as educational brochures and materials. Already, visiting the Museum of the Bank of Albania is included in schools' programmes, turning it into one of the most required and preferred destinations.

Experts of the Bank of Albania deliver lectures to students of high schools and universities on themes chosen by them.



Each year, the Museum of the Bank of Albania organizes activities to attract new visitors and increase cooperation with scholars, academics, museums and other institutions, as well as specialized institutions in economic, historical and cultural heritage research. For 2019, the Museum organised a series of activities of historical and educational character, listed below:

Temporary exhibition “New series of Lek banknotes”

In the framework of the informative campaign on the new series of Lek banknotes, two of which were put into circulation during 2019, the Museum of the Bank of Albania opened a temporary exhibition, to inform the public on the production, security features, personalities and symbols of the new Lek banknotes. In this exhibition, attention was dedicated to the education of children through interactive materials provided to the little visitors once they had visited the exhibition.

Third Conference of the Museum of the Bank of Albania on “Museums and education in the future”

This Conference, organised on 15 November 2019, at the premises of the Bank of Albania, brought together museum staff, experts, researchers in the field of museology and education, to present and discuss their research findings or experiences in this field, focusing on the role that museums and education may have in the future on the culture and progress of Albania.

The proceedings of the Third Conference of the Museum of the Bank of Albania were opened by the First Deputy Governor of the Bank of Albania, Ms. Luljeta Minxhozi, the Minister of Culture, Ms. Elva Margariti, and the Director of the National Museum of History, Ph.D. Dorian Koçi.

International Museum Day

On the occasion of International Museum Day, the Museum of the Bank of Albania stayed open on 18 May, from 9:00 a.m. to 8:00 p.m. A lot of visitors were informed on the numismatic collections, the history of the bank and finances and on the role and value of money.

Promoting the numismatic collection of the Bank of Albania

At the Museum of the Bank of Albania, visitors and the public at large may buy the numismatic collection of the Albanian banknotes and coins. In 2019, there was a high interest in purchasing this collection, which is collected or used as a present. The prices on the sales of numismatic collection are published on the official web page of the Bank of Albania. The numismatic collection available for sale is enriched with new issuances of the Bank of Albania. In 2019, commemorative coins were approved with the themes 110th anniversary of Normalja e Elbasanit (the first high school in the Albanian language), 1909



- 2019" and "Apollonia". The collection available for sale will be enriched with exemplars of the new denominations of banknotes, issued in circulation in 2019.

